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A Separate Debt Management Office

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Abstract

In the aftermath of recent global crisis, the issue of separation of monetary policy, fiscal policy and debt management has re-emerged. In many countries, during the period of crisis, scope of fiscal policy was expanded and debt to GDP ratios increased significantly. Consequently, debt management, in general, became difficult and coordination between monetary and debt management assumed significance.

Historically, a number of countries with liberalized financial markets and high levels of government debt sought to adopt professional debt management techniques to save cost and to provide policy signals to the market.

In India, traditionally, management of debt is diffused in different layers of different governments. The setting up of separate debt management office (DMO) will help to establish transparency, and assign specific responsibility and accountability on the debt manager. This could lead to an integrated and more professional management of all government liabilities, with a focussed mandate to operate on sound economic and commercial principles. The strategy could ensure that resources are available to the government at competitive market rates of interest prompting expenditure prioritization and fiscal discipline in budget making.

Keywords: Debt management, Fiscal domination, Fiscal policy, Monetary policy, Coordination, DMO.

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Introduction

In recent years, after the global crisis, the issue of separation of monetary policy, fiscal policy and debt management has re-emerged. In many countries, during the period of crisis, scope of fiscal policy was expanded and debt to GDP ratios increased significantly. Consequently, debt management, in general, became difficult and coordination between monetary and debt management assumed significance.

Historically, the debt crises of 1982 and the Asian Crisis of 1997 had led many countries to assign priority to public debt management and then, a number of countries chose to separate debt from monetary management. As developments in the Government securities market became more sophisticated, a different institutional structure was considered to be better suited to achieve different monetary policy and debt management objectives. In normal economic circumstances the central bank operates at the short-end of the market and debt management on the long end to minimize cost of raising resources but in times of crisis, the operations can become blurred. A separation in responsibilities was considered a better solution that reduces the risk of policy conflicts in the central bank actions. Once the financial markets had developed, the role of the central bank in sustaining the markets was considered minimal. Therefore, in many of the OECD countries, separation of debt and monetary management had been undertaken in the 1990's.

This paper discusses the basics of debt management and its separation in Section II. Traditional viewpoints about separation of debt management, central banks' independence, coordination between debt management, monetary and fiscal policy, and present global debt management practices are presented in Section III. Section IV presents the debate on separating debt from monetary policies, in the aftermath of recent crisis. Indian debt management practices, role of Reserve Bank of India and the debate about separation of debt management in India are discussed in Section V. Finally conclusions are presented in Section VI. The discussion on separation of debt management should cover the scope and structure of a separate debt office which is presented in the forthcoming paper by Kanagasabapathy and Singh (2013).[2]

[2] This aspect was partially covered by Singh (2005).

Section II: Some Basics of Debt Management

The main objective of debt management is to minimize the cost of borrowings over the medium to long run, consistent with a prudent degree of risk. To achieve this minimization of cost, promotion and development of efficient primary and secondary market for government securities are also important complementary objectives for debt management. Hence, Public debt management can be explained as the process of executing a strategy for managing the government's debt - to raise the required amount of borrowings, pursue cost/risk objectives, and also meet any other goal that the government might have set (IMF, 2003). This may be expressed as a numerical target for the stock composition of the debt referred to as the strategic benchmark. The policy instrument is medium to long-term debt, and the composition is managed through new debt issuance, as well as changing the composition of existing debt through swaps, debt buybacks and exchange offers (Togo, 2007).

The debt management strategy in a number of countries is formulated in the framework of asset-liability management, implying the application of a portfolio approach to government debt management. In the portfolio approach, the importance of debt management in stabilization policy will depend on how substitutable different types of bonds are, and how the return on bonds varies with changes in other asset prices. If different types of bonds are not perfect substitutes, then changing the mix of bonds in the private sector's portfolio could affect relative asset yields, investment and economic activity (Bernanke and Gertler, 1999; Vickers, 1999). Empirical results are mixed on this relationship. For the US, Agell and Persson (1992) find a small effect while Hess (1998) finds a significant effect on asset yields from changes in the maturity mix of government securities for the UK.

Debt management has an impact on monetary policy through asset prices and on fiscal policy through interest payments. The important issue in this context is the relationship between debt and monetary management. Historically, in the UK, concerns over the interaction of debt and monetary policy were closely linked to the level of public debt (Goodhart, 1999). The two functions were separated mainly to grant enhanced autonomy to the central bank and to focus on debt policy, and the two agencies continued to coordinate at the operational level as both operate

in the government securities market. This coordination helped to ensure that fiscal and monetary policies do not operate at cross-purposes in the financial markets.

Section III: Separate Debt Management Office – A Traditional View

There was a growing consensus among practitioners to treat debt management as a separate policy instrument from monetary policy until 2008. A number of countries with liberalized financial markets and high levels of government debt sought to adopt professional debt management techniques to save cost and to provide policy signals to the market (Giovannini, 1997).The benefits of separation of the two functions were basically conditional upon the level of financial development as argued by Blommestein and Turner (2012). The trend started with New Zealand in the 1980s, with the government recognising the need for proper policy assignment and accountability framework for debt management to meet the fiscal targets set in the then adopted Fiscal Responsibility Act. In Europe, several countries that were heavily indebted in the late 1980s and early 1990s like Belgium, France, Ireland and Portugal, decentralised debt management to varying extent, in order to reduce the variability of debt service cost that could jeopardize the targets set by the Growth and Stabilisation Pact. In the UK, debt management responsibilities were taken out of the Bank of England in order to remove the perception of conflict of interest in conducting debt management and monetary operations (Togo, 2007).

A number of countries have chosen to open a separate debt management office to have a more focused debt management policy (Table – 1). The location of the debt management office is also important and will depend on a number of considerations. The dispersal of debt management functions within different layers of government can lead to lack of coherent debt management policy and overall risk assessment, and therefore higher operational risk. Some OECD countries have opted for an autonomous debt management office to improve operational efficiency (Austria, Finland, Ireland, Portugal, Sweden, Germany, Hungary, and UK) while others, seeking a balance between public policy and financial management, have a separate office but operating under the Ministry of Finance (Australia, Belgium, Canada, France, Netherlands, New Zealand, Poland and USA). In Denmark, debt management is undertaken by a privately owned central bank (OECD, 2002). In the case of developing countries, Currie, Dethier and Togo (2003) argue

that the separate office can be initially placed under the Ministry of Finance while Kalderen (1997) suggests that in countries where fiscal deficits were high and financial markets were underdeveloped, a separate debt management office may be unsuitable for overall policy effectiveness of debt management.

On the basis of the experience of OECD countries, Cassard and Folkerts-Landau (1997) conclude that several reasons emerge that justify the separation of debt management – to preserve the integrity and independence of the central bank, to shield debt management from political interference, to ensure transparency and accountability, and to improve debt management by entrusting it to portfolio managers with expertise in modern risk management techniques. The separation of debt and monetary management positively affects expectations as it explicitly indicates to the market and credit rating agencies that monetary policy is independent of debt management.[3]

Table 1: Location of Debt Management Office in Select Countries

Country	Location of Debt Management Office	Scope of Debt Management			Advisory Board
		Cash	Debt	Contingent	
1.Australia	Separate agency under Treasury since 1999	Yes	Yes	No	Yes
2.Brazil	Debt office under Treasury since 1988	Yes	Yes	No	No
3.Colombia	Debt office under Treasury since 1991	No	Yes	Yes	Yes
4.Denmark	Debt office in Central bank	Yes	Yes	Yes	No
5.France	Separate agency under Treasury since 2001	Yes	Yes	No	Yes
6.Germany	Separate agency under Treasury since 2001	Yes	Yes	No	No
7.Ireland	Separate agency under Treasury since 1991	Yes	Yes	No	Yes
8.Italy	Debt agency under Treasury – 1997	Yes	Yes	No	No
9.Mexico	Separate office in Treasury	No	Yes	Yes	No
10.New Zealand	Separate office under Treasury since 1988	Yes	Yes	Yes	Yes
11.Poland	Debt office within Treasury since 1994	No	Yes	Yes	No
12.Portugal	Separate debt office under Treasury since 1996	Yes	Yes	Yes	Yes
13.Sweden	Separate debt office under Treasury since 1789	No	Yes	Yes	Yes
14.UK	Separate debt office under Treasury since 1997	Yes	Yes	No	Yes
15.USA	Debt office within Treasury	Yes	Yes	No	No
16.South Africa	Debt Management Office within Treasury	Yes	Yes	Yes	No

Source: Singh (2005).

[3]In case the two are not separated, then debt management policy eventually becomes subservient to the monetary policy as the monetary authorities attempt to use debt instruments to strengthen monetary policy signals and to enhance the credibility of the central bank.

There is a conflict between different economic policies of the government. The classic conflict between monetary and debt management policy relates to the fixation of interest rates. The conflict between fiscal policy and debt management relates to the choice of keeping debt servicing costs low over the short term or over the medium-long term. A separate debt management authority is a step removed from the political process of budget making and generally would not succumb to the political pressure to trade-off long term debt management goals with short-run budget goals (Alesina, Prati and Tabellini, 1990). A separation of these policies was expected to avoid such conflicts and improve policy credibility.

In case the central bank conducts debt management policy, conflicting objectives may emerge. Should liquidity be tightened based on monetary conditions prevailing in the economy or should it be relaxed to ensure success of market borrowing program of the government? Another area of concern could be interest rates which are of prime importance to the central bank. The government will like to borrow at low costs while the central bank will consider monetary and financial stability more important. The central bank may be tempted to manipulate financial markets to reduce the interest rates at which government debt is issued (Cassard and Folkerts-Landau (1997). Taylor (1998) argues that the Accord between the Federal Reserve and the Treasury in 1951, which emancipated the Fed from assisting the Treasury in borrowings at low rates of interest, helped the Fed to focus on interest rates. Even if a separate department within the central bank conducts debt management, the market will still perceive that the debt management decisions are influenced by inside information on interest rates. In contrast, a separate authority on fiscal issues would be required to present a separate debt management report to the Parliament which will prompt better fiscal discipline, appropriate audit, and financial and management controls.

In an autonomous debt office, staffing pattern can be more professionally competent and the operational environment is similar to that of a privately run commercial enterprise that is required to manage a portfolio within the risk parameters. The ongoing developments in the financial markets, illustratively the derivative instruments, require specialized training to monitor mark-to-market positions, over-the-counter dealings and pricing by the debt management authority, which would require competent and qualified professionals.

Thus, the main advantages of having a separate and autonomous debt office are – a) Signal to the financial markets that the government assigns institutional importance to the function; b) Commitment to the financial markets and the political parties for a transparent and accountable debt management policy; and c) Avoidance, at least, of any political pressures aimed at short-term political gains.

Central Bank Independence

The other factor of separation of debt from monetary management was the argument of independence of a central bank. In the years until 2008, because of the great moderation and Volcker's victory over inflation in the 1980s, [4]substantial evidence had been advanced in theoretical and empirical literature to support the political and economic independence of the central bank (Grilli, Masciandaro and Tabellini, 1991). Bade and Parkins (1980) define political independence as the ability of the central bank to choose its policy without the influence of the fiscal authority while economic independence refers to the freedom to use its monetary policy instruments. In support of central bank independence, Kydland and Prescott (1977), Barro and Gordon (1983a and 1983b), Burdekin and Laney (1988), Eschweiler and Bordo (1993) and Grilli, Masciandaro and Tabellini (1991) argue that more independent central banks reduce the rate of inflation, while Alesina and Summers (1993) conclude that such independence has no impact on real economic performance. Wagner (1998) argues that making a central bank independent lowers the expectations pertaining to inflation of the private sector that determine wage and price contracts, and thereby also the expectations that impact the exchange rates. Blinder (1997), and Bernanke and Mishkin (1997) suggest that policy makers should announce targets and that policy transparency to achieve those specific targets will enhance accountability while providing independence to the central bank.

Goodhart (1994) argues that it is easier for the principal to appoint an agent and prescribe a single, quantified, easily recognized, measured and understood outcome, which would facilitate monitoring and accountability. A number of countries had granted increased independence to the

[4]Fed Reserve's victory (Under Paul Volcker) over inflation in the US was institutionalised in legislation and practices that granted central bank greater autonomy and, in some cases, formal independence from long standing political constraints. Now many central banks could be trusted to do the right thing; and they delivered. (El-Erian, 2013).

central banks to focus on the objective of price stability and inflation targeting (Blinder, 2004; Cukierman, 1992). Unlimited access to central bank credit on easy terms by the government not only restricts the independence of the central bank, but also adversely affects the financial position of the banking sector. Kopits and Symansky (1998) argue that a prohibition on central bank credit to the government removes an important source of inflationary pressure.

In some countries, where financial markets are not developed, the need to finance the deficit of the government restricts the independence of the central bank - automatic and unlimited access to central bank credit is resorted to, supposedly for the purpose of capital expenditure expected to lead to higher economic growth.[5] Independent central banks are able to restrict such accommodation of fiscal deficits depending on the needs of the monetary policy (Demopoulos, Katsimbris and Miller, 1987 and Burdekin and Laney, 1988). Rather, Grilli, Masciandaro and Tabellini (1991) and Carracedo and Dattels (1997) mentioned that in many countries, borrowing from the central bank is prohibited. Sundararajan, Dattels and Blommestein (1997) argued that a ceiling on central bank credit to government promotes monetary restraint and helps to establish central bank credibility and operational autonomy. In the Maastricht Treaty (1992), only indirect credit and that also at the discretion of the central bank is extended to the government. Although OECD countries impose no formal constraints on indirect central bank credit to government, nevertheless there are often informal constraints – open market operations can only be done for monetary policy reasons.

The transfer of profits of the central bank to the government also restricts the independence of the central bank and could also be inflationary, if these lead to higher expenditure (Table-2).[6] Historically, the need to impose limits on the government's ability to finance itself through seigniorage revenue was one of the major reasons to grant independence to the central bank (Swinburne and Castello-Branco, 1991). Therefore, Blommestein and Thunholm, (1997) and Sundararajan and Dattels (1997) argue that such profits should be netted out against treasury debt

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[5]Cukierman (1992) discusses some of the structural reasons that led to flow of credit from the central bank to the government and eventually erosion of its independence - *(i)* underdeveloped financial markets, *(ii)* inelastic supplies of funds with respect to real rate of interest, *(iii)* large outstanding domestic debt, and *(iv)* inelastic revenue and expenditure of the government with respect to income.
[6] If debt management activity is also undertaken by the central bank, then the profits may be substantially large.

to the central bank and the rest of the profits should be transferred to the government.[7] Robinson and Stella (1988) argue that if profits of the central bank go to the government, then conversely transfers from the Government should cover losses. This would imply a combined balance sheet of the central bank and the government resulting in a continuous flow of seigniorage revenue to the government, which, however, would not be acceptable to an independent central bank.

Table 2: Select Country Practices relating to Distribution of Profit

Country	Distribution of Profit
Euro system	Up to 20 per cent of its profit in any year subject to a limit equal to 100 per cent of the ECB's capital.
Germany	Net profit is transferred to the Federal Government after setting aside amount for statutory reserves.
Canada	Net revenue of the Bank is remitted to the Receiver General for Canada.
Portugal	Net profit for the year is distributed equally between allocation to reserves and the State.
UK	Profit of both Issue (entire) and Banking (some amount) departments is payable to the Treasury.
Sweden	Central Bank makes a dividend payment to the Treasury.
Italy	Net profit for the year, after allocations to the Ordinary Reserve and Extraordinary Reserve accounts and distribution of dividend to shareholders, transferred to the State.
South Africa	Nine-tenths of the surplus of the Bank is paid to the Government.
Brazil	Net profit after constitution or reversal of reserves is transferred to the National Treasury.
Norway	A third of the capital in the Transfer after provisions is transferred to the Treasury every year.
Russia	T transfers fund to the federal budget amounting to 80 per cent of its profits.
Japan	5 per cent of net income for the fiscal year is transferred to the legal reserves.
Korea	Voluntary reserves are transferred to the Government's General Revenue Account.
Australia	Net profit including transfers to/from unrealized profits reserve earnings available for distribution, payable to the Government.
Singapore	Yearly Net profit including transfer of reserves from Currency Fund is paid to the Government.
USA	Excess earnings on Federal Reserve notes are transferred to the US treasury.

Source: Report on Currency and Finance, RBI, 2006.

Need for Coordination

In each country, the economic situation, including the state of domestic financial markets and the degree of central bank independence, would play an important role in determining the range of activities to be handled by the debt manager and the level of coordination that is necessary. Monetary policy and debt management clearly have to be complementary to each other but debt management should not be considered a tool of monetary management nor should monetary policy be considered the objective of debt management (Bank of England, 1995). The industrial

[7]Blommestein and Thunholm (1977) suggest that another way to restrict the transfer of seigniorage to the government is to maintain the real value of reserves and capital.

countries have generally separated the objective and accountability of debt and monetary management. In the case of the EMU, monetary policy is operated by the ECB while national authorities conduct debt management. The sharing of adequate information between Treasuries, national central banks and the European Central Bank is a norm, and ensured for the purpose of liquidity management. The industrialized countries also ensure that debt manager and monetary authority coordinate their activities in financial markets to avoid operating at cross-purposes.

In the case of developing countries, coordination between fiscal, monetary and debt management functions is considered even more crucial, where financial markets are under-developed and forecasts of government revenues and expenditure are inaccurate. The financing options of the government are limited and cash requirements are uncertain, and this then limits the independence of the central bank. The issuance of government securities by a separate debt office needs to be closely coordinated with the open market operations undertaken by the central bank to ensure appropriate liquidity conditions in the market.

Therefore, the role of the central bank in public debt management, though separated, would continue to be crucial. As an issuing agency of government securities, the central bank organizes rules and procedures for selling and delivering securities and for collecting payments for the government. As a fiscal agent, the central bank makes and receives payments, including interest payments and servicing of principal. As adviser to the government and to the debt manager, it could provide policy inputs on the design of the debt program, mix of debt instruments and maturity profile of debt stock. These inputs will be useful in providing stability to the overall debt program, facilitating smooth functioning of the market, and providing a stable environment for the conduct of monetary policy.

Section IV: Separate Debt Management Office - Post- Crisis Debate

In view of the financial crisis, in recent years, there has been a rethink on the issue of separation of debt management because of the following factors - a) sharp increase in government deficit and debt, because of the fiscal stimulus in many countries (Table-3); b) The use of unconventional monetary policy in advanced countries involving large scale purchase of government securities of varying maturities; c) Imposition of new liquidity requirements

resulting in higher demand of government securities; and d) Increase in foreign ownership of government debt.

Table 3 General Government Gross Debt

(Percent of GDP)

Country/ Year	2006	2008	2010	2012
France	64.1	68.2	82.3	90.3
Germany	67.9	66.8	82.5	82.0
Greece	107.5	112.5	147.9	158.5
Iceland	30.1	70.4	90.6	99.1
Ireland	24.6	44.5	92.2	117.1
Japan	186.0	191.8	216.0	237.9
Netherlands	47.4	58.5	63.1	71.7
Portugal	63.7	71.6	93.2	123.0
Singapore	86.4	96.3	99.3	111.0
Slovenia	26.4	22.0	38.6	52.6
Spain	39.7	40.2	61.3	84.1
United Kingdom	43.0	52.2	79.4	90.3
United States	66.1	75.5	98.2	106.5

Source: Fiscal Monitor, IMF

According to the conventional mandate, central banks were expected to operate in the bills market or short end of the market while debt managers were expected to operate in the long end of the same government securities market. In the post crisis period, the boundary between debt management and monetary policy became blurred mainly because of fiscal domination and unconventional monetary policy. The floatation of bonds by the debt manager, given the uncertainty, was of shorter maturity and not long-term bonds. This also created confusion in the role of the central bank and debt manager (Bank of England, 2011).

Thus, the thrust of the recent debate is that under difficult macroeconomic situation, the lines between debt and monetary policy become blurred and hence the two functions should be brought under the same agency. In the UK, there is a discussion but not in the US where the two functions had been separated in 1951. Goodhart (2012) argues that under quantitative easing there is a possibility that the policy of the debt management can negate the policy of the central bank. When the debt ratios increase, as in the case of UK or Greece, the short term interest rates also become a matter of concern to the ministry of finance. Obviously, then the monetary policy and debt management has to be closely coordinated. Therefore, according to Goodhart (2012)

separation between debt management and monetary policy is not desired as the existing arrangements are already under stress. Earlier also, Goodhart (2010)[8] argued that the central banks should be encouraged to revert to their role of managing national debt because with rising debt levels, debt management cannot be treated as a routine function which can be delegated to a separate independent institution.

Traditionally, the government debt managers were guided to pursue a cost minimization policy but these institutional arrangements and principles would not hold in times of macro stress. At a recent OECD global debt forum meeting it was concluded that the global crisis has led to blurring of lines between debt management and monetary policy. It was also noted that different mandates appeared of the two institutions sometimes to be in conflict. The minutes of the US Treasury borrowing advisory committee had also hinted at some tensions according to Blommestein and Turner (2012).

On the other hand, the Study Group (SG) commissioned by the Committee on the Global Financial System (Chairman: Paul Fisher, 2011), after an extensive research, observed that there was little evidence that existing arrangements' for operational independence of sovereign debt management and monetary policy have created material problems. The SG concluded that modifying this independent arrangement would rather be risky, and that the central banks would benefit by keeping abreast of debt management activities. However, as would be expected in a difficult economic situation, SG did not recommend separation of debt management out of those central banks` where the debt management functions were still being conducted.

Recent experience shows that there is a need for close communication and coordination among the relevant agencies managing monetary policy and debt management, as stressed by SG. This conclusion was also consistent with the Stockholm Principles (2011), which stated that "communication among debt managers and monetary, fiscal and financial regulatory authorities

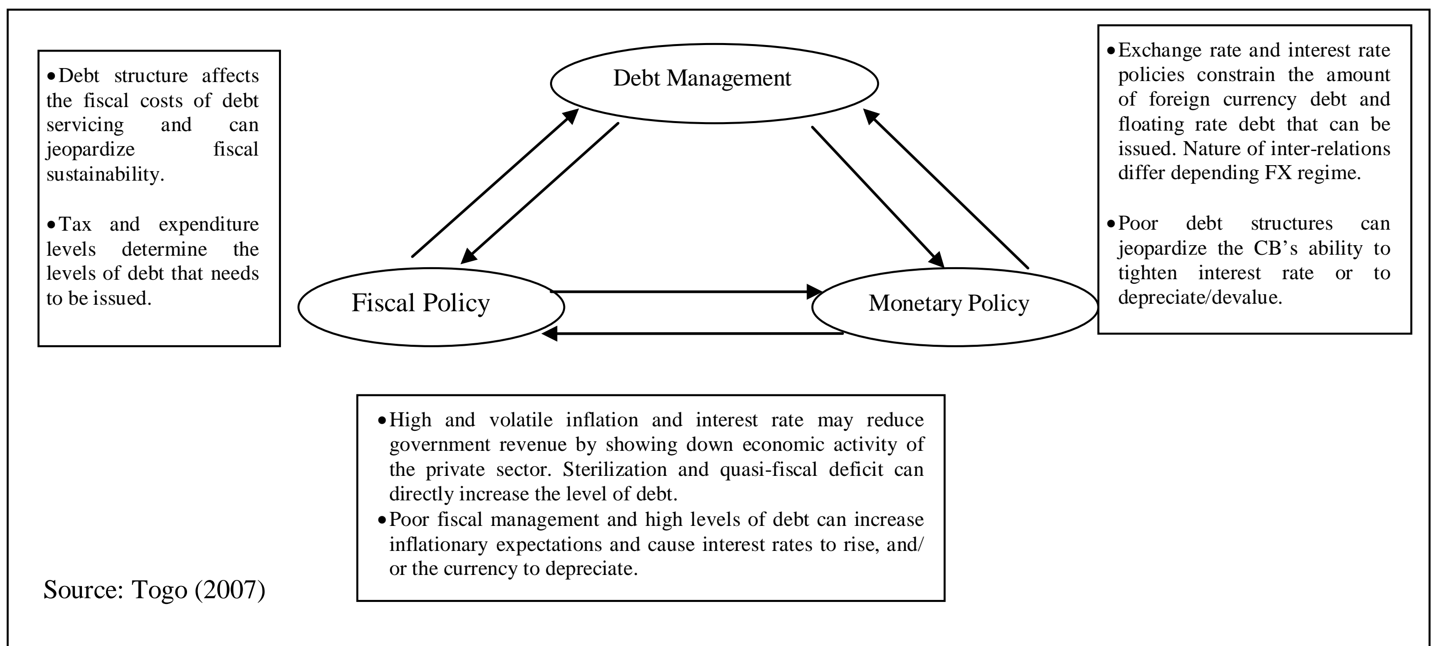
[8]Debt Management is again becoming a critical element in the overall conduct of policy, as events in Greece have evidenced. Debt management can no longer be viewed as a routine function which can be delegated to a separate, independent body. Instead such management lies at the cross-roads between monetary policy and fiscal policy.

should be promoted, given greater inter linkages across objectives, yet with each agency maintaining independence and accountability for its respective role".[9]

According to Togo (2007), policy coordination would imply some form of decision-making process that determines a consistent policy mix that would result in the type of society that citizens want their elected government to implement (Fig 1). Governments would therefore need to figure out the desired economic outcome, and determine the policy mix through policy coordination that most effectively achieves this outcome. However, this choice of policy mix may mean that fiscal space may be reduced in the future if debt servicing costs increase due to the realization of risky events, or monetary policy needs to be tightened to reign in high inflation caused by lax monetary policy in earlier periods.

Policy interdependence and trade-offs between debt management, fiscal policy, and monetary policy is depicted in Figure -1. Another important change is concurrently occurring in the monetary policy objectives, internationally.

Figure 1: Debt management, Fiscal Policy and Monetary Policy



Source: Togo (2007)

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[9] Stockholm Principles (2011) were promulgated by debt managers and central bankers from 33 advanced and emerging market economies.

While theoretical arguments can be made to justify recent departures from policy, the reality is that in the post-crisis world, objectives of the central bank are no longer limited to price stability. In the United States, the Federal Reserve has essentially adopted a quantitative employment target and nominal GDP targets. Financial stability is also a central bank responsibility, according to the new global understanding. The dilution of the central bank independence is because of the multiple objectives like pursuit of GDP growth, job creation, and financial stability.[10] Further, the need to establish priorities when there is trade-offs, clearly requires political decisions, which cannot be made by unelected officials alone. Moreover, by pushing interest rates toward zero, the current policy of quantitative easing has strong, often regressive, income effects which cannot be implemented without political patronage. Hence, the emerging consensus, in the post-crisis period is that central banks' decision-making should be subject to political control and that policymakers must accept that central-bank independence will continue to weaken over the years (Blejer, 2013).

According to Goodhart (2010), the separation of debt and monetary management in England took place when debt operations became simpler and standardized, falling into a routine pattern. But given the crisis, debt management can no longer be considered as routine which can be now delegated to a separate and independent body. In the present situation therefore the need is to combine an overall fiscal strategy with high calibre market tactics. But, the above argument by Goodhart is contrary to following reasons explained by Bank of England (1995) for separating debt management from the monetary policy - a) Monetary policy decisions should be seen as separate from debt management policy; b) To ensure that Debt Management Office (DMO) did not have advance access to other policy decisions; c) To avoid possible conflicts which could undermine the achievement of debt management objective of minimizing the cost of government financing; and d) To create a clearer allocation of the responsibilities for debt management and monetary policy.[11]

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[10] Initially, central-bank independence was based on two main arguments which no longer apply because of multiple objectives being assigned to a central bank – First, politicians can exploit expansionary monetary policy's positive short-run effects at election time, without regard for its long-run inflationary consequences. Second central banks have a clear comparative advantage in dealing with monetary issues, and can therefore be trusted to pursue their targets independently.

[11] In fact this was a key factor in shaping the new arrangement.

There are other important developments which have been largely ignored. First, the government issues government securities which are required as collateral for repo transactions between the central bank and the financial markets as well as during transactions amongst the market players. Therefore, the tenor and coupon rate of these bonds is of interest to the central bank. Second, the fact that debt management was separate from monetary management in the US and OECD, provided transparency to the rescue operations launched by many governments in face of the global crisis. Independence of operations and objectives, and close coordination between different agencies lent credibility to the government policies. Third, in case of conflict of interest, closer coordination between the agencies, and clear explanations of differences helped the financial markets to understand the dilemma facing regulatory and statutory agencies, resulting in more accountability and responsibility. Fourth, if the interest rates are market determined then fiscal discipline is imposed on the government that would restrict fiscal profligacy and populist competitiveness during periods of crisis and elections. This, in a way, creates a level playing field between the public and private sector, and probably restricts crowding out of private sector due to large borrowings by the government.

Section V: Debt Management in India

In India, presently public debt management is divided between the Central and State Governments, and the RBI. The RBI manages the market borrowing programme of Central and state governments. External debt is managed directly by the Central Government. The RBI acts as the debt manager for marketable internal debt, for the Central government as an obligation and for the State Governments by an agreement, under the RBI Act, 1934. RBI decides about the maturity pattern, calendar of borrowings, instrument design and other related issues in consultation with the central government (IMF, 2003)[12].

The public debt of the country, estimated at 66.0percent of GDP at end-March 2013, has been declining since 2000-01 and the trend reveals that domestic debt has been steadily increasing over the years (Table- 4). The outstanding amount of guarantees of both centre and state has

[12]Thorat, Singh and Das (2003).

been declining from 3.9 per cent and 7.7 per cent, respectively, as at end-March 2000 to 1.4 per cent and 0.3 per cent of GDP as at end-March 2011.[13]

Table 4: Public Debt of the Government

	As per cent to the Total			As per cent of GDP		
Year	External Debt	Domestic Debt	Public Debt	External Debt	Domestic Debt	Public Debt
1980-81	18.8	81.2	100.0	9.0	38.9	47.9
1990-91	16.4	83.6	100.0	11.3	57.5	68.9
2000-01	11.8	88.2	100.0	8.7	64.9	73.7
2010-11	5.5	94.5	100.0	3.6	61.9	65.5
2011-12	5.5	94.5	100.0	3.6	61.9	65.5
2012-13	5.0	95.0	100.0	3.3	62.7	66.0

Source: RBI

The major components of domestic debt are internal debt, small savings, provident funds, and reserve funds and deposits (Table 5). The Constitution of India provides for the option of placing a limit on the internal debt, both at the Centre and the States, but no such limit has been imposed so far. Internal debt, the most prominent component of domestic debt, consists of markets loans, Treasury bills and other bonds issued by the Central and State governments.

Table 5: Components of Domestic Debt of the Government

(As per cent to the Total)

Year	**Internal Debt**	**Small Savings Deposits and Provident Funds**	**Reserve Funds and deposits and other accounts**	**Domestic Debt**
1980-81	60.6	22.6	16.8	100.0
1990-91	51.3	23.3	25.4	100.0
2000-01	67.4	13.0	19.6	100.0
2010-11	70.7	16.6	12.7	100.0
2011-12	73.5	15.2	11.2	100.0
2012-13	75.9	14.1	10.0	100.0

Source: RBI

Market loans, also called as Rupee loans, generally comprised of three kinds of obligations: (a) Marketable debt, (b) dated loans issued by the Government to the Reserve Bank in exchange for

[13] Detailed trend data on outstanding guarantees and liabilities of State and Central Governments are in Annex -1 to 8.

ad hoc Treasury bills outstanding, and (c) miscellaneous debts such as, the Hyderabad State Loans, National Defence Bonds, Gold Bonds, etc. Since the start of planning in India in 1951, the amount of market loans mobilized annually has been rising rapidly. The market loans were raised by the Government, both Central and State, from the market on fixed coupons and prices, till 1992. As a part of the financial sector reforms, borrowings for the Central Government have been raised through auctions of government securities of different maturities since June 3, 1992. Since then new instruments have been regularly introduced – e.g. zero coupon bonds, floating rate bonds, capital indexed bonds and inflation indexed bonds. In the case of State Governments, the auction system was initiated in January 1999 and now all States are raising market loans through the auction system.

The amount of market borrowings is decided in consultation with the Planning Commission, State Governments, the Central Government and the Reserve Bank of India (RBI). RBI also advises the central and the state governments on the quantum, timing and terms of issue of new loans. While formulating the borrowing programme for the year, the government and the RBI take into account a number of considerations such as the Central and state loans maturing for redemption during the year, an estimate of available resources (based on the growth in deposits with the banks, premium income of insurance companies and accretion to provident funds) and absorptive capacity of the market.

The amount of outstanding market loans have increased from Rs. 16 billion in 1952 to Rs. 862 billion in 1991 and Rs.39,048 billion in 2013. In general, the share of central government, in total outstanding amount, is significantly large but varies over time, depending on annual market borrowings. Illustratively, net annual borrowings by the Centre were Rs.80 billion in 1990-91 which rose to Rs.4,929 billion in 2012-13 while in comparison that by the States rose from Rs. 26 billion to Rs.1, 130 billion over the same period. In case of ownership of market loans the share of commercial banks, insurance and provident funds has changed significantly over the years (Table- 6).

Table 6: Ownership Pattern of Market loans

(As percentage of total)

Year	RBI (own account)	Commercial Banks	Insurance	UTI / MFs	FIs/ Cooperatives	Provident Funds	Primary Dealers	Others	Total
1991	20.3	59.4	12.3	.	.	1.7	.	6.4	100.0
2001	7.7	61.0	18.3	0.8	0.2	3.3	1.4	7.3	100.0
2008	7.2	56.2	21.8	0.3	1.1	4.4	0.3	8.6	100.0
2009	8.4	60.0	21.0	0.6	1.6	4.8	0.2	3.4	100.0
2010	10.1	59.1	20.8	0.2	2.4	4.9	0.1	2.4	100.0
2011	8.9	53.5	21.4	0.4	2.1	4.8	0.1	8.8	100.0
2012	13.6	46.1	21.1	0.2	3.4	7.5	0.1	5.1	100.0
2013	17.0	43.9	18.6	0.7	3.6	7.4	0.1	6.1	100.0

UTI-Unit Trust of India, MFs-Mutual Funds, FIs- Financial Institutions.
Source: RBI

The Government also offers a variety of small savings schemes to meet the varying needs of different groups of small investors. In respect of each scheme, statutory rules are framed by the Central Government indicating various details including the rate of interest and the maturity period.[14] Small saving instruments can be classified under the following three heads: Postal deposits, Savings Certificates and Public Provident Fund (PPF), with PPF being a small component.[15] Illustratively, of the outstanding Small Savings amount of Rs. 6,066 billion, at end March 2012, PPF through post offices accounted for a small amount of Rs. 360 billion. The trend in share of deposits has been rising over the period in recent years (Table 7).

Table 7: Components of Small Savings

Year	As percentage of Total Small Savings		Total Small Savings (in Billions)
	Deposits	Certificates	
1980-81	80.4	17.1	82
1990-91	32.2	62.9	529
2000-01	35.8	61.3	2348
2010-11	60.4	34.6	6199
2011-12	59.5	34.6	6066

Sources: Hand of Statistics on Indian Economy, Reserve Bank of India

[14]However, there is a unique small saving scheme run by the government of Kerala.

[15]Total Deposits constitutes of Post Office Saving Bank Deposits, MGNREG, National Saving Scheme, 1987, National Saving Scheme, 1992, Monthly Income Scheme, Senior Citizen Scheme, Post Office Time Deposits: 1 year Time Deposits, 2 year Time Deposits, 3 year Time Deposits, 5 year Time Deposits; Post Office Recurring Deposits, Post Office Cumulative Time Deposits, Other Deposits. Saving Certificates constitutes of National Savings Certificate VIII issue, Indira Vikas Patras, Kisan Vikas Patras, National Saving Certificate VI issue, National Saving Certificate VII issue, Other Certificates. Public Provident Fund.

In order to account for all the monetary transactions covering small savings schemes of the Central Government under one umbrella, "National Small Savings Fund" (NSSF) was set up in the Public Account of India from April 1, 1999. The interest rates on small savings are fixed by the Central government. Small saving schemes are regularly examined and revised. With a view to achieving flexibility in interest rates, an Expert Committee was constituted by the Central Government on April 19, 2001 (Chairman: Dr. Y.V. Reddy) to review the system of administered interest rates and other related issues. In pursuance of the Committee's recommendations, the Union Budget, 2002-03 announced that interest rates on small savings would be linked to the average annual yield of government securities in the secondary market for the corresponding maturities.[16] Further in July 2010, in pursuance of the recommendation of Thirteenth Finance Commission, the Government constituted a Committee, for comprehensive review of NSSF (Chairman: Shyamala Gopinath). After detailed examination of the recommendations made in June 2011, the Central government decided to rationalize some of the schemes including the recommendation of linking the interest rates on small saving instruments with G-Sec rates from December 1, 2011. [17]

The ownership pattern of small savings is not available, though some ad hoc surveys have been undertaken.[18] In fact, there is lack of comprehensive analysis of the liabilities of the Central and State Government and their distributional aspects, which impedes informed decision regarding domestic borrowing.

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[16] Though the recommendation was accepted in the Union Budget of 2002-03, but was not implemented then.

[17]The maturity period for Monthly Income Scheme (MIS) and National Savings Certificate (NSC VIII Issue) was reduced from 6 years to 5 years, and one new NSC instrument, with maturity period of 10 years, was introduced. Kisan VikasPatras (KVP) was discontinued from November 2011. The annual ceiling on investment under Public Provident Fund (PPF) Scheme was increased from Rs. 70,000 to 1 Lakh. Interest rate on small savings schemes was aligned with G-Sec rates of similar maturity, annually.

[18]The ownership pattern of small savings is not available but on the basis of a survey undertaken in Uttar Pradesh in 2000-01, it can be concluded that industrial laborers top in terms of aggregate investments in small savings schemes followed by traders and government employees. In terms of invested amount, traders show the maximum investment followed by the government employees. Kisan Vikas Patra and post office time deposits are the most important documents amongst farmers. Amongst the government employees and self-employed persons, National Saving Certificates and Public Provident Fund are the most popular instruments. In 2011 the Report of the Committee to Review National Small Savings Fund observed that there appears to be an urban bias in ownership of social security schemes. Of the outstanding amount in PPF, 87 percent is from urban and metropolitan areas, according to the Report.

Important Role of the RBI

The key role in management of internal debt is played by the RBI which could conflict with its pursuit of the objectives of monetary policy. The monetary policy of the RBI aims to provide adequate liquidity to meet credit growth and support investment demand in the economy, while continuing to maintain a vigil on movements in the price level, and to prefer a soft and flexible interest rate environment within the framework of macroeconomic stability.

The RBI is the regulator and supervisor of the financial system, including banks, and also of the money, government securities and foreign exchange markets. The RBI has to balance the needs of the markets (manage liquidity), government requirements (fiscal requirements), balance sheet of the banks (asset prices and interest rate movements) and general price level (growth of money supply). The RBI is also a significant contributor of profits to the Central Government (Table - 8).[19]

Table 8: Profits of RBI Transferred to Central Government

(Per cent of GDP)

Year	Revenue Receipts	Non-Tax Revenue Receipts	Profits of RBI Transferred to Central Government
2000-01	9.4	2.8	0.4
2005-06	9.7	3.8	0.2
2010-11	10.1	2.8	0.2
2012-13	8.7	1.3	0.3

Source: Annual Reports, Reserve Bank of India.

In the RBI, the Department of Internal Debt Management (DIDM), set up in April 1992, undertakes the work relating to government securities, Treasury bills and cash management. DIDM is organized essentially as a separate debt management office with the essential units- primary market (borrowing and cash management of both Central and State), policy and research, dealing room, MIS and regulation (of primary dealers). The actual receipts of bids and settlement functions are undertaken at various offices of the RBI specially public debt offices

[19]Under Section 47 of the RBI Act-1934, after making provisions for bad and doubtful debts, depreciation in assets, contribution to staff and superannuation fund and for all matters for which provision is made by or under the Act, the balance of the profit of the RBI are paid to the Central Government.

(PDOs) across the country. The public debt offices of RBI, located in various parts of the country also manage registry and depository functions, including the book entry form of ownership. The Department of Government and Bank Accounts (DGBA) maintain the accounts of both the governments – central and state, on a daily basis. On external debt, Department of External Investment and Operations in RBI works as a front office along with MOF. The function of cash management of the Central and State Governments is also performed by DIDM and DGBA in RBI. The managerial structure of public debt management is presented in Table-9.

Table – 9: Management of Public Debt in India

Major Items	**Appropriated By**	**Managed By**	**Fixation Authority for/Determination of**		
			Amount	**Maturity**	**Interest Rate**
1	2	3	4	5	6
Market Loans	Centre	MOF, RBI	MOF	MOF, RBI	Market
	State	DOF, RBI	MOF	DOF, RBI	RBI, Market
Market Bonds	Centre	RM, MOF, RBI	RM, MOF	RM	RM, MOF, RBI
	State	RD, DOF, RBI	RD, DOF	RD	RD
Treasury bills	Centre	MOF, RBI	MOF, RBI	MOF, RBI	Market
WMA	Centre	MOF, RBI	MOF, RBI	MOF, RBI	RBI
	State	DOF, RBI	RBI	RBI	RBI
Loans from Bk & FI	State	DOF	RD	RD	RD, DOF
Small Savings	State	MOF, DOF	MOF, DOF	MOF	MOF
Provident Funds	Centre	MOL, MOF	MOL, MOF	MOL	MOL
	State	MOL, DOF	DOF	MOL	MOL
Reserve Funds/Deposits	Centre	RM, MOF	RM	RM	RM
	State	RD, DOF	RD	RD	RD
External Debt	Centre	MOF, RBI	MOF	MOF	MOF
Contingent Liabilities	Centre	RM, MOF	RM	RM	RM
	State	RD, DOF	RD	RD	RD

MOF – Ministry of Finance; DOF – Department of Finance; MOL – Ministry of Labour; RM – Respective Ministry; RD – Respective Department; Bk – Banks; FI – Financial Institutions
Source: Author's compilation.

Coordination between RBI, Government and Markets

To coordinate the activities of debt management with fiscal authorities, various committees function in RBI. The Cash and Debt management committee, consisting of officials from the MOF and RBI meets regularly to discuss the operational details of market borrowings for the Central Government. The issues pertaining to the State Governments are discussed in a semi-

annual meeting with the officials from MOF, DOF and RBI. The Technical Committee on Money and Government Securities, consisting of representatives from market, academia, government, banks, and RBI, meet regularly and advise the RBI on development and regulation of the government securities market.

Fiscal Responsibility Legislations

Financial Responsibility and Budget Management Act 2003 (FRBMA) was brought into force effective from July 5, 2004. The objectives were elimination of revenue deficit by 2008-09 and reduction of fiscal deficit to no more than 3 per cent of GDP at the end of 2008-09. In the meantime, global financial crisis led the government to infuse resources in the economy as fiscal stimulus since 2008. The fiscal targets had to be postponed temporarily in view of the global crisis. The Budget for 2012-13 introduced amendments to the FRBM Act. The concept of effective revenue deficit was introduced, which excludes from the conventional revenue deficit, grants for the creation of capital assets. [20]The second important feature is the introduction of the provision for 'Medium Term Expenditure Framework Statement’ in the FRBMA. This medium-term framework provides for rolling targets for expenditure, imparting greater certainty, and encourages prioritization of expenditure.

The Twelfth Finance Commission recommended that along with the Central government, all states should also consider enacting fiscal responsibility legislations with specific target to eliminate revenue deficit by 2008-09 based on reduction of borrowings and guarantees; set up sinking funds for amortization of all loans; and impose ceilings on guarantees. The Thirteenth Finance Commission (TFC) had recommended a number of amendments to the fiscal legislation and provided guiding principles for the state’s fiscal policy for the period 2010-15. TFC had

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[20]This is an important development for the reason that while the revenue deficit of the consolidated general government fully reflects total capital expenditure incurred, in the accounts of the centre; these transfers are shown as revenue expenditure. Therefore the mandate of eliminating the conventional revenue deficit of the centre becomes problematic. With this amendment, the endeavour of the government under the FRBM Act would be to eliminate the effective revenue deficit. Similarly, at state level also, some of the capital transfers to local bodies or parastatals could get reflected as revenue expenditure. By understating capital expenditure, this might lead to a divergence between the national accounts data on capital formation on the government accounts and the conventional public finance data that is gleaned from the Budgets. (GoI, 2013)

worked out a fiscal consolidation road map for states requiring them to eliminate revenue deficit and achieve a fiscal deficit of 3 per cent of their respective GSDP latest by 2014-15 (Table-10).

Table 10: Fiscal Responsibility Legislation for States

Year	State	Original Documents			Targets as per 13th Finance commission
		RD by March 31	GFD as percent of GSDP as on March 31	Debt as percent of GSDP as on March 31	Percentage of GSDP by 2015
2002	Karnataka	Nil;2006	3 ; 2006	25; 2015.	25.2
2003	Kerala	Nil; 2009	3 ; 2008	-	29.8
	Tamil Nadu	Nil; 2009	3 ; 2008	-	25.2
	Punjab	Nil; 2009	3 ; 2008		38.7
2004	Uttar Pradesh	Nil;2009	3 ; 2009	25; 2018.	41.9
2005	Andhra Pradesh	Nil; 2009	3	35 ; 2010	27.6
	Assam	Nil; 2010	3 ; 2010	45 ; 2010	28.5
	Chhattisgarh	Nil; 2009	3 ; 2009	-	23.9
	Gujarat	Nil; 2008	3 ; 2009	30 ; 2008	27.1 ; 2012
	Haryana	Nil; 2009	3 ; 2010	28 ; 2010	22.9
	Himachal Pradesh	Nil; 2009		-	40.1
	Madhya Pradesh	Nil; 2009	4 ; 2010	40	35.3
	Maharashtra	Nil; 2009	3 ; 2009		25.3
	Manipur	Nil; 2010	3	-	54.3
	Tripura	-	3 ; 2010	40; 2010.	43.8
	Uttarakhand	Nil; 2009	3 ; 2009	25; 2015.	43.8
	Odisha	Nil; 2009	3 ; 2009	Debt stock limited to 300 percent of total revenue receipt ; 2008	29.5
	Rajasthan	Nil; 2009	3	Debt should not exceed twice consolidated fund receipt.	36.5
2006	Arunachal Pradesh	Nil; 2009	3 ; 2010	-	50.1
	Bihar	Nil; 2008	3 ; 2008	-	41.6
	Goa	Nil; 2009	3 ; 2009	30 ; 2009	-
	Jammu &Kashmir			55 ; 2010	49.3
	Meghalaya	Nil	3	28	31.7
	Mizoram	Nil; 2009	3 ; 2009	Debt should not exceed twice Consolidated Fund receipts.	74.8
	Nagaland	Nil	3 ; 2009	40 ; 2010	52.3
2007	Jharkhand	Nil; 2009	3 ; 2009	Debt stock limited to300 percent of total revenue receipt.	26.9
2010	Sikkim	-	3; 2014.		55.9
	West Bengal	Nil;2015	3 ; 2015	34.3; 2015.	34.3

RD: Revenue Deficit; GFD: Gross Fiscal Deficit; GSDP: Gross State Domestic Product.
Source: Various FRBM Acts of States.

Need for a Separation of Debt and Monetary Management

In India, the separation of debt would provide the RBI with necessary independence in monetary management and an environment to pursue an inflation target, if assigned by the government. The separation of debt management would provide focus to the task of asset-liability management of government liabilities, undertake risk analysis and also help to prioritise government expenditure through higher awareness of interest costs. The need for setting up a specialised framework on public debt management which will take a comprehensive view of the liabilities of Government, and establish the strategy for low-cost financing in the long run has been advocated by various expert committees since late 1990s (Table – 11).

Table 11: Timeline: Separation of Debt Management

Year	Source	Recommendations
1997	Report of the Committee on Capital Account Convertibility (Chairman: S.S. Tarapore)	Setting up of an Office of the Public Debt (OPD)
1997	A working group on Separation of Debt Management from Monetary Management (Chairman: V. Subrahmanyam)	Separate Debt management office as a company under the Indian Companies Act
2000	The Advisory Group on Transparency in Monetary and Financial Policies	Independent Debt Management Office, in a phased manner.
2001	The RBI Annual Report 2000-01	Separate DMO.
2001	The Internal Expert Group on the Need for a Middle Office for Public Debt Management, (Chairman: A. Virmani)	Establishing an autonomous Public Debt Office.
2004	The Report on the Ministry of Finance for 21st Century (Chairman: Vijay Kelkar)	National Treasury Management Agency.
2004	The Fiscal Responsibility and Budget Management (FRBM) Act	Prohibits the Reserve Bank from participating in the primary market for Central Government securities with effect from April 2006.
2006	Fuller Capital Account Convertibility (Chairman: S.S. Tarapore)	Set up of Office of Public Debt outside RBI
2007	The Union Budget 2007-08	Establishment of a DMO in the government.
2008	The High Level Committee on Financial Sector Reforms (Chairman: Raghuram Rajan)	Structural change of public debt management, such that it minimises financial repression and generates a vibrant bond market. Set up independent DMO.
2008	Internal Working Group on Debt Management (Chairman: Jahangir Aziz)	Establishing a DMO.
2009	Committee on Financial Sector Assessment (Chairman: Rakesh Mohan)	Setting up DMO.
2012	Report of the Working Group on Debt Management Office (Chairman:Govind Rao)	Independent DMO.
2012	The Financial Sector Legislative Reforms Commission Approach Paper	Separation of debt management with specialised investment banking capability for public debt management.
2013	The Financial Sector Legislative Reforms Commission (Chairman: B.N. Srikrishna)	Specialised framework to analyse comprehensive structure of liabilities of the Government, and strategizing minimal cost techniques for raising and servicing public debt over the long term within an acceptable level of risk.

Source: Various Reports, GoI and RBI.

In India, important water shed in the institutional arrangements of debt management was the setting up of the middle office in the Ministry of Finance in 2008, to formulate debt management strategy for the central government. Again the Union Budget 2011-12 had stated that the government was in the process of setting up an independent Debt Management Office (DMO) in the Ministry of Finance. The DMO was entrusted with the responsibilities of piloting the evolution of legal, governance and comprehensive risk management framework suitable for independent debt office, formulation of strategies regarding long term debt management and annual debt issuance; and maintaining centralised data base on government liabilities and dissemination of debt related information to public. Similarly, the Union Budget for 2012-13 proposed to move the Public Debt Management Agency Bill in the Parliament.

However, an important re-think in the whole process was required because the RBI was not convinced that the separation would be useful for the financial markets. The proposed argument was that in the post crisis period there has been an increased need for close coordination between monetary policy, financial stability and debt management. Debt management, according to Khan (2012), was a difficult exercise in a developing country and was not simply raising resources from the market. The size and dynamics of government borrowing has a wider influence on interest rate movements, and liquidity and credit growth. Therefore, focus only on the cost factors may not be an appropriate way to manage debt. He also argued that policy co-ordination may not be operationally effective especially, if the fiscal deficit was high. According to Subbarao (2011), despite a large borrowing program, the RBI was able to complete successfully market borrowings in a cost efficient manner and with the long average maturity of 10 years, amongst the longest maturity profiles in the world. Merely shifting the debt management to a different agency in an uncertain environment and with large size of deficit would not help as the pressure on the central bank would continue to ensure government borrowing at low cost. The remedy is fiscal consolidation and not separation of debt management, according to him. Also, significant capital flows require close co-ordination between debt management and monetary policy, especially when sterilization through government bonds has to be undertaken by the central bank.

According to Mohan (2003), given the federal structure of India, debt management of the state governments is difficult. In the case of State Governments, a substantial amount of deficit financing is through government borrowings. In view of the size of the borrowings by the state and central government, it is necessary to harmonize the annual borrowing program of the government. A separation from the central bank would make such harmonization difficult.

There are also other views as to why the two functions should not be separated.[21] These can be summarised as follows

a. High level of fiscal deficit and over all government debt to GDP ratio,
b. Conflict of interest between debt manager and the government's role as an owner of public sector banks,
c. Debt and monetary management roles, management of government debt, regulation of banks and monetary policy will be interlinked,
d. Difficulty in harmonizing the operations of debt issue and redemptions, SLR maintenance and Market Stabilisation Scheme,
e. Existing expertise available in the RBI, and
f. Inappropriateness of State debt management by a Central government entity.

A discussion on the Views against Separation

A separate debt management office will help to consolidate all debt related activities of the government in one office. At present, various schemes operate, some under the government of India and few under states, many of which are independently managed by different governments. There are no economies of scale being explored and little interaction or synchronisation of activities occurs between these offices and their practices.

Further, the argument that because the central government has an ownership share in public sector banks, debt management should not be placed under the same government needs further analysis. If the central bank regulates and supervises the government securities market then in a similar vein it can be argued that there is a conflict between regulation / supervision and participation in the market, as the RBI participates in the government securities markets as a dealer/trader too. Similarly, as the central bank is a regulator and supervisor of commercial banks there could emerge a conflict of interest to strengthen the balance sheet of commercial banks,

[21]The reasons offered by the Committee on Financial Sector Assessment (GOI and RBI, 2009).

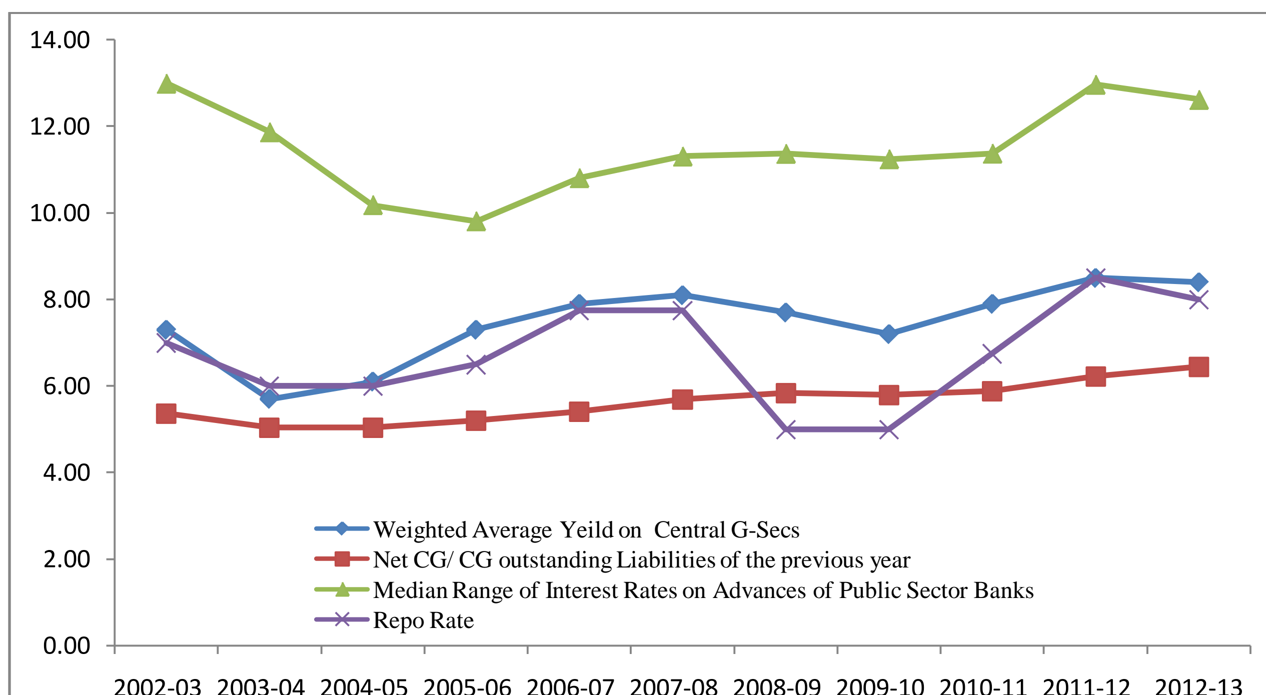
therefore RBI may prescribe higher stipulations of holding government bonds. The central bank could also use its influence over the regulated entities to subscribe to flotations that it manages on behalf of the government. Goodhart (2010) goes further and questions the necessity of entrusting the role of setting interest rate on Central Bank which already manages the essential role of liquidity management and financial stability in the country. The argument is weak on the issue of conflict emerging due to ownership pattern on select institutions in the financial sector, mainly public sector banks because of following reasons – a) RBI had a share in State Bank of India (SBI) for many years, and that never diluted the RBI's supervision or regulation of SBI; b) The share of ownership of the Government in public sector bank, has been declining over the years and is expected to decline even further; c) The government, even if not the owner, is finally responsible for the operations of the commercial banks, as demonstrated by the recent financial crisis in many countries in the US and Europe; d) The share of public sector banks in holding of government securities has been declining in recent years while the share of non-public sector banks has been rising; e) There are different techniques to ensure an arms length's distance between ownership of public sector banks and administration of separate debt management office, most important being public dissemination of information.

Finally, despite the ownership, performance of public sector banks, in terms of NPAs or return on assets are not significantly different when compared with other banks operating in India (Annex 9, 10 and 11). Even if there is a separate department, with the requisite 'firewall' conducting debt management, within the central bank, the markets will still suspect the influence of inside information on interest rates. This 'joint family approach' does not augur well for transparency in management of debt and monetary policy formulation. And when the central bank is balancing different objectives of debt and monetary management, accountability is difficult to fix. In practise and performance, the movement of various interest rates of government securities were substantially lower than the average lending rate of commercial banks[22] which could be interpreted rather negatively by the markets, despite the fact that central government borrowings were being raised in auction (Graph 1). In contrast, market borrowings

[22] Data on lending rates sourced from RBI and relate to five major Public Sector Banks up to 2003-04. For other years, data relates to five major banks.

in a difficult financial market have been raising as also weighted average maturity but not the yield curve (Graph-2)[23].

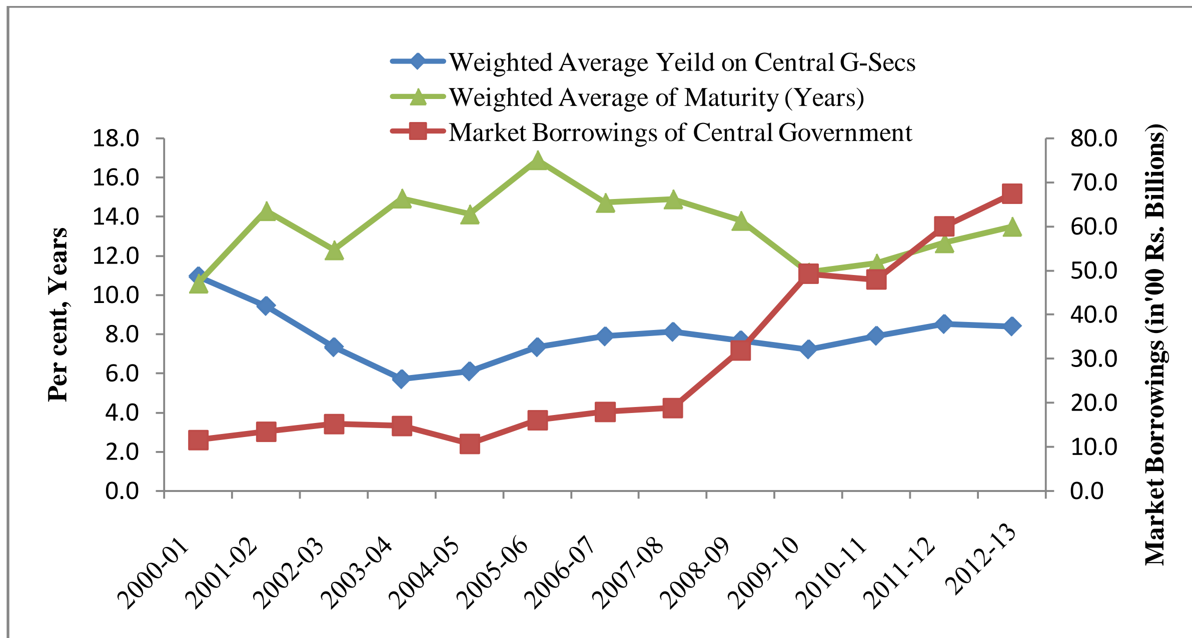
Graph-1: Trend in Select Interest Rates[24]



[23]Kumar and Kumar (2012) attempted to verify the interest rate conflict, underlying the idea of separation of debt management, empirically and conclude that the relationship between policy rates and government market borrowings is statistically insignificant.

[24] Net CG/CG outstanding previous year refers to net interest payments (interest payments adjusted for interest receipts) of the central government (CG) in a specific year on outstanding liabilities of the previous year. Median range of interest rates on advances of public sector banks as released by the RBI and compiled by EPW Research Foundation.

Graph-2: Interest Rates and Market Borrowings of Central Government



Source: RBI

A separate debt management office also ensures that there are alternative views of the economic situation of the markets and the economy, and not just that special view which has been formed by the central bank through its trading desk and market intelligence. The debt manager has to carefully understand the pulse of the market and the economy through constant interaction, as debt manager has to regularly operate in the financial markets. Through proper coordination between the central bank and debt manager, a better view of the financial markets and the economy can be formed.

The arguments against the separation like difficulty in harmonizing the operations, could basically be resolved by better coordination between various agencies, similar to the type of informal as well as institutionalised coordination between the RBI and the Ministry of Finance. A separated agency has an advantage that it will bring in transparency in the operations of debt management. It will also help in focusing on the communication policy as well as dissemination of debt related information to the market.

On the issue of lack of expertise to manage the DMO, as in other countries, the government could consider hiring experts, temporarily or permanently, that are available in the RBI or from

rest of the world. Incidentally, it may be considered that in the central bank, in absence of any specialised cadre of debt management recruits, staffs is transferrable and generally moved to different desks. In contrast, in a proposed DMO, the staff will be completely dedicated to activities of debt management and gain specialisation and expertise on the job. On a long term basis, certification courses to ensure specialized training to individuals in the DMO could be initiated in leading educational and management institutions in the country.

Finally, the benefits of separating debt from monetary management are significantly large. First, given that fiscal deficits are large and that debts are substantial, a focussed approach will be useful. In the last six years, government borrowings (Centre and States) have increased from Rs. 1,657 billion in 2007-08 to Rs. 6,811 billion in 2012-13. Such a substantial increase of annual borrowings of market loans from 3.6 per cent of GDP to 7.2 per cent, over a six year period would require careful examination and analysis which a specialised institution can provide. Second, given the focussed approach, specifically tailored schemes for different segments of the population can be simulated. Illustratively, the outstanding amount of small savings schemes like Senior Citizen Scheme and Public Provident Fund have increased from Rs. 436 billion in 2007-08 to Rs. 628 billion in 2011-12 but the ownership pattern remains unknown because of which, it becomes difficult to tailor social security schemes for the elderly in terms of interest rates and maturity. This also applies to other social security schemes which result in increasing liabilities of the Government. Third, an autonomous DMO would imply an annual statutory report and consequent public scrutiny, and dissemination of information. This would ensure that the government does not take undue advantage of being the owners of public sector banks and does not practise fiscal profligacy by access to easy borrowing at low rates of interest.

Section VI: Conclusion

The objective of debt management, as generally defined, is raising resources from the market at the minimum cost while containing the risks. In contrast, the objective of monetary policy in India is to maintain a judicious balance between price stability, economic growth and financial stability. Thus, the objective of debt management is subsumed in the overall objectives of monetary policy in India, if the two functions are not separated.

To implement the specifically focussed debt management strategy, and choosing to separate debt from monetary management, governments seek to emphasize the role assigned to debt management, to preserve the integrity and independence of their central banks, to shield debt management from political interference, and to ensure transparency and accountability in public borrowing. Hence, the choice of separating debt from monetary management by many countries while ensuring that their activities are coordinated.

The overall conclusion from recent research is that there is an extensive interaction between debt management, monetary policy and financial policy in mutually reinforcing or conflicting ways. Such interactions become intense during strained macroeconomic policy conditions and therefore there is a need for close coordination between the three organs of economic policy.

Since the budget speech of 2007-08, the Finance Minister had proposed to set up an autonomous Debt Management Office (DMO). Many a developments have occurred since then except the DMO. Earlier, since 1997, various groups of experts set up by the RBI and the GOI had consistently suggested hiving of debt management function from the RBI to an independent entity.

The middle office was has been set up in the Ministry of Finance but the hiving-off has not been undertaken. The reasons advanced for the hesitancy are that the global circumstances are not conducive in terms of volatile capital flows and need for intervention/sterilization; deficits and debt levels are still high; staff of the proposed DMO may not have the requisite skills; and there could be a conflict between the role of government as a debt manager and owner of public sector banks. On the other hand, the paper argues that separation of debt management will help to establish transparency, and assign specific responsibility and accountability on the debt manager. This could lead to an integrated and more professional management of all government liabilities, currently dispersed in different offices, with a focussed mandate to operate on sound economic and commercial principles. The strategy could ensure that resources are available to the government at competitive market rates of interest prompting expenditure prioritization and fiscal discipline in budget making.

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Annexure 1

Outstanding Guarantees and Liabilities of the State Governments

(Rs. Billion)

States	Outstanding Guarantees					Outstanding Liabilities				
	1992	2001	2011	2012	2013	1991	2001	2011	2012	2013
Andhra Pradesh	36	131	116	101	–	82	418	1395	1530	1734
Arunachal Pradesh	–	–	–	–	–	3	7	35	36	38
Assam	10	11	3	–	–	43	102	265	263	292
Bihar	14	12	6	–	–	106	299	636	686	750
Chhattisgarh	–	–	11	22	–	–	70	170	177	220
Goa	–	–	–	–	–	9	28	96	104	115
Gujarat	45	173	88	80	160	81	428	1430	1581	1765
Haryana	13	82	45	–	–	31	147	463	537	621
Himachal Pradesh	4	19	29	–	–	13	87	264	279	299
Jammu and Kashmir	5	11	–	–	–	34	91	322	353	377
Jharkhand	–	–	–	–	–	–	85	283	344	384
Karnataka	31	130	66	–	–	59	253	935	1008	1163
Kerala	17	88	74	–	–	50	263	840	945	1058
Madhya Pradesh	7	105	50	51	50	78	221	755	801	904
Maharashtra	74	450	150	–	–	129	676	2306	2572	2827
Manipur	–	–	–	–	–	4	19	62	64	68
Meghalaya	2	–	11	9	9	2	14	43	48	54
Mizoram	–	–	1	1	1	3	14	47	49	53
Nagaland	–	–	0	–	–	4	16	59	59	63
Odisha	11	38	21	25	–	52	242	470	475	508
Punjab	13	61	–	–	–	71	308	748	833	929
Rajasthan	27	120	560	–	–	66	355	995	1072	1163
Sikkim	–	–	–	–	–	1	9	25	26	28
Tamil Nadu	29	124	–	–	–	70	345	1145	1289	1497
Tripura	–	–	1	–	–	5	24	61	63	67
Uttar Pradesh	43	64	–	–	–	198	831	2299	2469	2712
Uttarakhand	–	–	–	–	–	–	41	213	253	286
West Bengal	25	70	72	–	–	89	549	1929	2123	2304
TOTAL	403	1687	1306	288	220	1282	5942	18290	20038	22277

Source: State Finances: A Study of Budget, Various Issues, RBI.

Annexure 2

Outstanding Liabilities – as percentage of GSDP

(End-March)

State	1991	2001	2011	2012	2013
Andhra Pradesh	24.4	28.9	23.7	22.6	22.4
Arunachal Pradesh	55.0	41.4	42.6	38.3	38.3
Assam	40.9	27.8	25.4	22.7	22.6
Bihar	40.2	33.5	29.8	29.0	28.4
Chhattisgarh	–	27.0	14.5	13.1	13.4
Goa	71.8	41.8	29.4	23.5	21.8
Gujarat	28.8	38.5	27.9	26.7	26.1
Haryana	22.6	25.2	17.5	17.4	16.8
Himachal Pradesh	47.2	55.6	48.3	46.3	44.4
Jammu and Kashmir	92.9	54.5	58.7	56.6	53.7
Jharkhand	–	26.3	25.5	27.7	27.5
Karnataka	25.3	23.3	24.5	23.2	22.3
Kerala	35.3	36.1	30.3	28.9	27.0
Madhya Pradesh	25.5	27.9	27.8	26.6	26.9
Maharashtra	20.0	26.8	21.6	21.5	21.0
Manipur	47.5	60.1	64.7	60.1	60.3
Meghalaya	24.5	35.0	30.8	30.0	29.0
Mizoram	96.7	79.2	77.0	69.5	65.9
Nagaland	62.5	47.2	53.0	48.7	48.2
Odisha	47.3	55.9	24.1	21.0	19.5
Punjab	37.4	41.2	33.2	32.7	32.0
Rajasthan	31.8	43.1	30.7	29.1	28.7
Sikkim	60.5	84.0	43.4	41.0	40.4
Tamil Nadu	22.5	23.5	22.1	22.2	21.7
Tripura	50.1	43.4	35.0	31.9	30.0
Uttarakhand	–	28.3	28.1	29.0	29.0
Uttar Pradesh	35.6	45.8	40.0	38.7	37.2
West Bengal	25.5	38.2	40.7	38.6	36.3
All States (Per cent of GDP)	21.9	27.4	23.8	22.6	21.9

Source: State Finances: A Study of Budget, Various Issues, RBI.

Annexure 3

Outstanding Liabilities of the Central Government

(Rs. Billion)

	1950-51	2000-01	2010-11	2012-13
Public Debt	21	8696	28248	39218
Internal Debt	20	8037	26671	37437
Market Loans	14	4288	20720	29874
Special Securities converted into marketable securities.	4	200	768	768
Other special securities issued to RBI.		21	15	15
Compensation, other bonds and securities.	0	73	310	151
14 days treasury bills	-	40	1031	769
91 days treasury bills	-	19	704	1294
182 days treasury bills	-	28	220	524
364 days treasury bills	-	135	425	1044
Ways and means advances	-	54	0	0
Securities issued to international financial institutions	2	226	293	703
Securities against small savings		1935		
91 days treasury bills funded into special securities	-	1018		
External Debt	0	659	1576	1781
Other Liabilities	8	2989	11140	11036
1. National small savings fund	3	546	5686	5626
2. State Provident Funds	1	417	1119	1339
3. Other accounts	0	1440	3047	2720
4. Reserve funds and deposits	4	585	1288	1351
Bearing interest	3	281	704	828
Not bearing interest	1	304	58	522
Total – Liabilities	29	11685	39388	50254

Source: Receipt Budget, GoI.

Annexure 4

Outstanding Government Guarantees

(Percentage of GDP)

End-March	Centre	State	Total
2000	3.9	7.7	11.6
2001	3.7	7.0	10.7
2002	3.8	7.3	11.1
2003	3.2	7.7	10.9
2004	2.7	6.3	9.0
2005	2.9	5.3	8.2
2006	2.6	3.8	6.4
2007	2.2	3.3	5.5
2008	1.9	2.7	4.6
2009	1.7	2.8	4.6
2010	1.8	1.7	3.4
2011	1.7	0.3	2.0

Source RBI and Economic Survey, GoI.

Annexure 5

Combined Liabilities of the Central and State Governments

Year (end-March)	Domestic Liabilities of the Centre	External Liabilities of the Centre	Total Liabilities of the Centre	Total Liabilities of the States	Combined Domestic Liabilities of the Centre & States	Combined Total Liabilities of the Centre & States
Rs. Billion						
1980-81	485	135	619	268	583	717
1990-91	2830	663	3493	1282	3373	4036
2000-01	11026	1900	12926	5941	14141	16041
2010-11	37811	2789	40600	18290	48292	51081
2011-12	43332	3229	46561	20038	55576	58804
2012-13	48671	3320	51991	22277	62849	66169
As percentage to GDP						
1980-81	32.4	9.0	41.4	17.9	38.9	47.9
1990-91	48.3	11.3	59.6	21.9	57.5	68.9
2000-01	50.6	8.7	59.4	27.3	64.9	73.7
2010-11	48.5	3.6	52.1	23.5	61.9	65.5
2011-12	48.3	3.6	51.9	22.3	61.9	65.5
2012-13	48.6	3.3	51.9	22.2	62.7	66.0

Data related to external liabilities of Centre are at current exchange rates.
Source: Handbook of Statistics on Indian Economy, Reserve Bank of India.

Annexure 6

Composition of Outstanding Liabilities of State Governments

Year	Rs. Billion (End March)				As Proportion to Total (Per cent)			
	1991	2001	2011	2013	1991	2001	2011	2013
Market Loans	157	868	6041	9173	12.2	14.6	33.0	41.2
Power Bonds	–	–	144	87	–	–	0.8	0.4
Compensation and Other Bonds	1	1	1	1	–	–	–	–
NSSF	–	564	4946	4877	–	9.5	27.0	21.9
WMA from RBI	11	66	14	45	0.8	1.1	0.1	0.2
Loans from LIC	7	42	95	94	0.6	0.7	0.5	0.4
Loans from GIC	2	–	8	8	0.2	–	–	–
Loans from NABARD	3	65	408	601	0.2	1.1	2.2	2.7
Loans from SBI and Other banks	3	44	59	9	0.2	0.7	0.3	–
Loans from NCDC	6	14	16	20	0.5	0.2	0.1	0.1
Loans from Other Institutions	3	127	231	90	0.3	2.1	1.3	0.4
Loans from Banks and FIs	25	292	817	821	2.0	4.9	4.5	3.7
Total Internal Debt	193	1790	11964	15004	15.0	30.1	65.4	67.3
Loans and Advances from Centre	735	2387	1442	1631	57.4	40.2	7.9	7.3
State Provident Funds, etc.	169	936	2282	2769	13.2	15.8	12.5	12.4
Reserve Fund	47	229	1032	1150	3.7	3.8	5.6	5.2
Deposit and Advances (Net Balances)	128	593	1537	1688	10.0	10.0	8.4	7.6
Contingency Fund	10	7	34	36	0.8	0.1	0.2	0.2
Total	1282	5942	18291	22278	100	100	100	100

Note:
'–': Not applicable/Not available/negligible.
Source: State Finance Report: A Study on Budget, Various Issues, RBI.

Annexure 7

Outstanding Market Loans of State Governments (As at end-March 2012)

(Rs. Billion)

State	**State Development Loans**	**Power Bonds**	**Total Outstanding Market Loans**
Non-Special Category			
1. Andhra Pradesh	751	10	761
2. Bihar	202	8	210
3. Chhattisgarh	22	2	24
4. Goa	31	–	31
5. Gujarat	608	7	615
6. Haryana	211	8	219
7. Jharkhand	86	9	95
8. Karnataka	308	–	308
9. Kerala	382	5	387
10. Madhya Pradesh	280	11	291
11. Maharashtra	894	4	898
12. Odisha	51	4	56
13. Punjab	345	3	348
14. Rajasthan	386	1	386
15. Tamil Nadu	628	–	628
16. Uttar Pradesh	778	24	802
17. West Bengal	880	8	888
Special Category			
1. Arunachal Pradesh	7	0	7
2. Assam	106	3	109
3. Himachal Pradesh	102	0	102
4. Jammu and Kashmir	140	6	146
5. Manipur	21	1	22
6. Meghalaya	20	0	20
7. Mizoram	15	0	16
8. Nagaland	34	0	34
9. Sikkim	13	0	13
10. Tripura	19	0	19
11. Uttarakhand	84	2	86
All States	7402	115	7518
Memo Item:			
1. Puducherry	23	–	23

Note:
'–': Nil/Negligible
The outstanding market loans for the undivided States of Bihar, Madhya Pradesh and Uttar Pradesh have been apportioned to the respective newly formed States of Jharkhand, Chhattisgarh and Uttarakhand on the basis of their population ratios.
Source: State Finance Report: A Study on Budget, RBI

Annexure 8

Maturity Profile of Government Securities as on End March 2013

(Rs. Billion)

Year of Maturity	State Government			Central Government
	State Development Loans	Power Bonds	Total	
2013-14	321	29	350	950
2014-15	334	29	363	1680
2015-16	352	29	381	1972
2016-17	315	14	329	2311
2017-18	678	0	678	2568
2018-19	1181	0	1181	2345
2019-20	1306	0	1306	1970
2020-21	1045	0	1045	970
2021-22	1586	0	1586	2838
2022-23	1654	0	1654	2575
2023-24				270
2024-25				1020
2025-26				757
2026-27				1324
2027-28				1247
2028-29				110
2029-30				
2030-31				730
2031-32				787
2032-33				759
2033-34				
2034-35				604
2035-36				420
2036-37				860
2037-38				
2038-39				130
2039-40				
2040-41				720
2041-42				600
2042-43				90
Total	8772	101	8873	30,607

Source:
a) State Finance Report: A Study of Budget, RBI and
b) Handbook of Statistics on Indian Economy, RBI.

Annexure 9

Asset Quality Indicators

	End-March	All Banks	Foreign Banks	New Private Sector Banks	Old Private Sector Banks	Public Sector Banks
Gross NPA to Gross Advances (per cent)	2012	2.9	2.7	2.2	1.8	3.2
	2013	3.4	3.0	1.9	1.9	3.8
Net NPA to Net Advances (per cent)	2012	1.2	0.6	0.4	0.6	1.5
	2013	1.7	1.0	0.4	0.7	2.0
Restructured Standard Assets to Gross Advances (per cent)	2012	4.7	0.1	1.1	3.5	5.7
	2013	5.8	0.2	1.2	4.0	7.2
CRAR	2012	14.2	16.8	16.7	14.1	13.2
	2013	13.8	17.5	17.5	13.7	12.4

Source: Annual Report, RBI.

Annexure 10

Classification of Loan Assets

(Rs. Billion)

Bank Group	Year	Standard Assets		Sub- standard Assets		Doubtful Assets		Loss Assets	
		Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent
Public Sector Banks	2011	32,718	97.8	350	1.0	332	1.0	65	0.2
	2012	38,255	97.0	623	1.6	490	1.2	60	0.2
Nationalised Banks	2011	22,900	98.1	218	0.9	193	0.8	32	0.1
	2012	26,910	97.5	402	1.5	268	1.0	21	0.1
SBI Group	2011	9,818	97.0	132	1.3	139	1.4	33	0.3
	2012	11,345	95.9	221	1.9	222	1.9	39	0.3
Private Sector Banks	2011	7,936	97.8	45	0.6	108	1.3	29	0.4
	2012	9,629	98.1	52	0.5	104	1.1	29	0.3
Old Private Sector Banks	2011	1,836	98.0	13	0.7	18	1.0	6	0.3
	2012	2,287	98.2	18	0.8	17	0.7	7	0.3
New Private Sector Banks	2011	6,100	97.7	33	0.5	90	1.4	22	0.4
	2012	7,342	98.1	34	0.4	87	1.2	22	0.3
Foreign Banks	2011	1,943	97.5	19	0.9	21	1.1	11	0.5
	2012	2,284	97.3	21	0.9	22	0.9	20	0.8
All SCBs	2011	42,596	97.8	414	0.9	461	1.1	104	0.2
	2012	50,168	97.2	695	1.3	617	1.2	109	0.2

Source: Report on Trend and Progress of Banking in India, RBI.

Annexure 11

Performance of Scheduled Commercial Banks

(In Per cent)

Bank Group/ Year	Return on Assets		Return on Equity	
	2010-11	**2011-12**	**2010-11**	**2011-12**
Public Sector Banks	0.96	0.88	16.90	15.33
Nationalised Banks	1.03	0.88	18.19	15.05
SBI Group	0.79	0.89	14.11	16.00
Private Sector Banks	1.43	1.53	13.70	15.35
Old Private Sector Banks	1.12	1.20	14.11	15.18
New Private Sector Banks	1.51	1.63	13.62	15.27
Foreign Banks	1.75	1.76	10.28	10.79
All SCBs	1.10	1.08	14.96	14.60

Source: Report on Trend and Progress of Banking in India, RBI.

Annexure 12

Select Small Savings- Outstanding Amount

(Rs. Billion)

Instruments	**2007-08**	**2011-12**
Total	**5094**	**6066**
Total Deposits	3241	3607
Post Office Saving Bank Deposits	198	341
National Saving Scheme, 1987	40	41
National Saving Scheme, 1992	6	4
Monthly Income Scheme	1824	2053
Senior Citizen Scheme	222	268
Post Office Time Deposits	299	274
1 year Time Deposits	146	169
2 year Time Deposits	13	13
3 year Time Deposits	46	42
5 year Time Deposits	94	50
Post Office Recurring Deposits	651	627
Total Certificates	574	2099
National Savings Certificate VIII issue	-	551
Indira VikasPatras	12	9
KisanVikasPatras	1504	1540
Public Provident Fund	214	360

Source: Monthly Bulletin, RBI.