भारतीय प्रबंध संस्थान बेंगलूर
INDIAN INSTITUTE OF MANAGEMENT
BANGALORE

WORKING PAPER NO: 431

INDEPENDENT DEBT MANAGEMENT OFFICE: RATIONALE, SCOPE AND STRUCTURE

Kanagasabapathy K
Director
EPW Research Foundation,
Mumbai – 400 101
kanakam@gmail.com

Charan Singh
RBI Chair Professor
Economics & Social Science
Indian Institute of Management Bangalore
Bannerghatta Road, Bangalore – 5600 76
Ph: 080-26993818
charansingh@iimb.ernet.in

Year of Publication -November 2013

INDEPENDENT DEBT MANAGEMENT OFFICE: RATIONALE, SCOPE AND STRUCTURE[1]

Abstract

Ever since the onset of financial sector reforms in India in early nineties, the proposal for separation of debt management from monetary management and setting up of an independent Debt Management Office (DMO) gained prominence. As both debt and monetary management became market oriented, the potential conflict between the two has surfaced. Since RBI is a major investor in government securities, and its market interventions through open market operations in government securities and liquidity management operations through CRR or LAF can be clouded by debt management objectives. The fiscal-monetary nexus in that sense cannot be underestimated. As the role of RBI is restricted to management of market loans, debt management should be viewed in a holistic manner while structuring the new DMO. The interests of all stakeholders, namely, the central government, state governments and the Reserve Bank also need to be kept in view. The Institutional and organisational structure of DMO across the globe can serve as vital leads in crafting the structure of India DMO.

Key Words: Debt Management Office, Fiscal- Monetary Nexus, Transparency, Independency.

[1] The authors wish to thank Debaleena Dutta for research assistance and Lavanya Srinivasan for secretarial assistance.

1. Introduction

The debate about setting up of an independent debt management office (DMO) gained significance in India only since early 1990s with the onset of reforms in the financial sector ushering in a market oriented system. Borrowings by the governments increasingly became market oriented and the central bank's monetary operations also turned from using direct to indirect instruments, mainly relying on interest rate as a policy instrument. During the earlier period of financial repression, when the entire financial system was subject to tight regulation on portfolio choices by institutions, instruments and their pricing, the question of an independent debt management office (IDMO) did not emerge in policy discussions. The primary debt management operations carried out by the Reserve Bank of India (RBI) as an agent remained passive and monotonous with governments' demand for borrowed funds met from a captive group of investors or from the RBI itself. Secondary market was practically absent in government securities.

RBI's monetary management function was also circumscribed by the practice of automatic monetisation of government deficits. In this milieu of fiscal-monetary nexus, and passive operations, the question about independent debt management was mostly irrelevant.

With the removal of portfolio restrictions and introduction of auctions as the primary method of government securities issuance and market based pricing, government had to compete for raising funds with the rest of debt issuers and they could not have a privileged access to the pool of savings. Evolution of term structure of interest rates became mostly market determined and with improvements in settlement and delivery practices, secondary market in government securities became vibrant. In this new environment, monetary management, especially using interest rate instrument, has the potential of coming into conflict with the debt management function which has the objective of minimising cost of government borrowings.

While monetary management became market oriented, there was lack of transparency in some respects and the central bank does not enjoy operational autonomy or functional independence. Since RBI is a major investor in government securities, its market interventions through open market operations in government securities and liquidity management operations through CRR or LAF can be clouded by debt management objectives. Nevertheless, monetary operations of the central bank cannot be oblivious to the impact of debt management operations on the overall liquidity conditions and interest rates in the system. The fiscal-monetary nexus in that sense cannot be underestimated. In structuring the new DMO as an independent agency, therefore, the interests of all stakeholders, namely, the central government, state governments and the RBI need to be kept in view.

Even while debt management turned active with auction based issuances, some new instruments and reforms in market structure such as primary dealers, and clearing and settlement systems, there is no holistic approach to debt management across governments and across different instruments of market borrowing. Functionally also, it remains divided between the governments and the RBI. No serious attention has been paid so far on closely linked issues such as cash and investment management, particularly at the states level.

In the above backdrop, it is argued here that the advantage of an IDMO lies essentially in integrating the debt management function across governments and instruments and also efficiently linking cash and investment management on behalf of governments. IDMO can help to rectify distortions arising out of fragmented approach, and with specialised human resource can contribute to a more effective interface with the market resulting in cost efficient management of government borrowings. The remaining paper is organized in four sections. Section 2 presents the rationale of IDMO and current status of RBI in the context of debt management. Section 3 describes the overarching role and scope of IDMO while section 4 discusses the organisational setup of the separate debt management office. Section 5 provides the concluding observations.

2. Rationale for an Independent Debt Management Office

One basic reason for the creation of an IDMO is separation of debt management from monetary management so that any conflict of interest between the two is avoided (Singh, 2013). The argument presupposes that RBI can focus on monetary policy without any conflicting responsibility. This is prima facie remarkably true since interest rate setting, as also use of other instruments such as Cash Reserve Ratio (CRR) and Open Market Operations (OMO) by the RBI can be clouded by debt management objectives.

One inherent conflict in the RBI's operations is that it is really difficult to distinguish its monetary operations from debt management operations. The liquidity augmenting measures when undertaken are intended apparently to ease monetary conditions to enable the banking system to expand its credit portfolio to productive sectors of the economy. But, at times, it would appear that the measures were intended to ensure that the increasing appetite of the government to borrow from the market sailing through smoothly. Once the IDMO is set up, the RBI is expected to be relieved of this inherent conflict in its operations. While avoiding such conflicts, it also needs to be recognised that the two functions are indeed complementary. Therefore, the broad approach should be independent functioning of debt management consistent with fiscal and monetary policy stances and objectives but with close coordination.

RBI de jure is not autonomous or independent

The rationale for supporting DMO on the basis of independent monetary management cannot be taken too far in the Indian case. There is a lack of clarity on the objectives of monetary policy and the autonomy of the RBI vis-à-vis the government. In fact, a legislative review would be called for to enhance central bank independence. The review should cover four dimensions that form the crux of the autonomy and transparency debate: clarity of objectives, overriding powers of the government, appointment and removal of governors and deputy governors, and institutional relationship between monetary and fiscal operations.

The legislation concerning the objectives of monetary policy is the preamble to the Reserve Bank of India Act, 1934 which reads as follows: “...to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage." The preamble lays down the broad objective for the central bank as a whole, but not the specific objectives of monetary policy.

The multiple objectives of maintaining price stability, ensuring credit flow to productive sectors, supporting growth, maintaining orderly conditions in financial markets, and creating an environment of financial stability, have evolved over time, thanks to the erudition of RBI governors, the emphasis on each aspect varying according to the situation and the preference of the governor. However, price objective has generally been accorded priority over others.

While these expanding and varying objectives cannot be considered inconsistent with the preamble, it is doubtful that there is sufficient legal clarity on all of them. For instance, regarding financial stability, there is no accepted definition. It is also unclear as to who should be responsible for financial stability, though there are strong claims from RBI that it alone should be the responsible authority.

The second issue relates to government's ability to issue directions to the central bank. The law is very clear and strong here. The Government can issue directions in the public interest in consultation with the RBI governor. While no such recorded direction is evident, the central bank is vulnerable to being overridden by the government, as is evident from statements on monetary policy and its stance originating from the government on many occasions, in the not so distant past. The override can be prompted by a conflict over objectives, targets or a policy decision. In the case of the targets — if such targets were ever to be introduced — there would need to be a transparent framework. This might well include a situation where the government sets the target itself. If the government overrides actual policy decisions, it would undermine the role of the central bank, and effectively transfer to the government or political arena the setting of policy itself. While this is an unrealistic proposition, the recent tendency of the government to make contradictory announcements on monetary policy matters is a disturbing development. Never in the advanced countries like the US, such contradicting statements have been recorded.

There is no way to discern whether the government issues directions to the central bank. There is constant dialogue on policy matters between the government and the RBI, but the outcomes of such discussions are not in the public domain. The government's behaviour is mostly revealed through its communication channels, which at times send conflicting signals vis-à-vis the central bank communication. That raises serious doubts about the nature of independence of the RBI.

The RBI therefore, is certainly not independent in a *de jure* sense because the government enjoys overriding powers in the statute: It can remove the head of the institution without assigning any reason, it can supersede the governing board, and it can issue directions on policy matters. But, *de facto*, the RBI claims a lot more independence in operating monetary policy and choosing the timing and extent of applying its tools. Since it is legally subordinated to the government, the RBI can obviously enjoy independence only to the extent that Government chooses to allow it, implicitly or explicitly.[2] The central bank, therefore, seems to be independent within a boundary set by the government; but the problem is that there is no defined or recognisable boundary and, whatever little turf that RBI claims to be of its own, even that seems to shift from time to time. The Government appears to allow more operational space to the RBI during the easing phase of monetary policy; conversely, it seems to constrain it from interventions during the tightening phase.

Historically, central bank independence has evolved over time and inflation targeting is one major framework which embodies this principle. After the 1980s, the Fed Reserve gained independence and the Bank of England in 1997. By 1998, independence was seen as such a critical element that it was enshrined in the Maastricht Treaty. Bernanke (2010) argues that the case for independence requires clarity about the range of central bank activities deemed to fall under

[2] Bernanke (2010) argues that independence enjoyed by a central bank cannot be unconditional and that democratic principles demand that it is responsive to the public and its elected representatives.

monetary policy. In a cross country analysis, Diencer and Eichengreen (2013) compare transparency and independence between different central banks. India's track record in these comparisons is not very encouraging.

Table: 1 Central Bank's Transparency Index[3]

	1998	2000	2002	2004	2006	2008	2010
Brazil	3.5	9.0	9.0	9.0	8.0	6.0	8.5
Russia	1.5	1.5	1.5	3.0	3.0	3.0	3.0
India	2.0	2.0	2.0	2.0	3.0	3.0	3.0
China	1.0	1.0	1.5	4.5	4.5	4.0	4.0
South Africa	5.0	6.0	8.5	8.5	8.5	8.5	8.5
USA	8.5	10.0	10.0	10.0	11.0	11.0	11.0
UK	11.0	12.5	12.5	12.5	12.5	12.5	12.0
New Zealand	10.5	13.0	14.0	14.0	14.0	14.0	14.0
Euro Area	8.5	8.5	10.5	11.0	11.0	11.0	11.0

Source: Dincer and Eichengreen (2013).

Table: 2 Central Bank's Independence Index [4]

	1998	2000	2002	2004	2006	2008	2010
Russia	0.6	0.6	0.6	0.6	0.6	0.6	0.6
India	0.1	0.1	0.1	0.1	0.1	0.1	0.1
China	0.5	0.5	0.5	0.5	0.5	0.5	0.5
South Africa	0.2	0.2	0.2	0.2	0.2	0.2	0.2
USA	0.2	0.2	0.2	0.2	0.2	0.2	0.2
UK	0.2	0.2	0.2	0.2	0.2	0.2	0.2
New Zealand	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Euro Area	0.8	0.8	0.8	0.8	0.8	0.8	0.8

Source: Dincer and Eichengreen (2013).

RBI's role in debt management is limited

While the Reserve Bank manages public debt of the central government and state governments, it does not perform a holistic integrated function of managing the total liabilities. RBI manages essentially market loans. Perhaps, it decides on maturity, volume, timing and nature of instruments and method of issuance, but in close consultation and with the approval of the

[3] The Central Bank's Transparency index is calculated by summing values across the following five dimensions on transparency: a) Political – openness about policy objectives, b) Economic - data, models, forecasts, c) Procedural - release of minutes and votes , d) Policy- explanation of decisions , e) Operational – implementation of those decisions. The scale ranges from 0-15 (lowest and highest levels of transparency, respectively)

[4] The independence index includes factors like a) CEO – term / appointment / dismissal of CEO; b) policy formulation; c) objectives; d) limitations on lending to the government; and e) . The scale is from 0-1 (lowest and highest levels of independence respectively). Independence affects transparency positively, as do the flexibility of the exchange rate regime and measures of institutional quality.

respective governments. In fact, loan notifications are issued by the governments. While external debt of the central government is outside the purview of RBI, it also does not have any say on matters relating to other liabilities like, special securities, compensation bonds, small savings and provident funds. A holistic approach to debt management should encompass the entire liability structure of governments including external loans and other internal liabilities such as contractual savings in the form of small savings and provident funds though they do not form part of consolidated fund of governments, since such liabilities still finance budgetary operations of respective governments.

When public debt is viewed from the general government level, combining state and central finances, then the borrowing, lending and investment relationships between the centre and states should also receive attention.

3. The Overarching Role and Scope of the IDMO

There are at least four major issues that need to be addressed regarding the scope of IDMO's functions. The first issue is whether the DMO should manage only Central Government debt or State loans also. From the macro perspective, public debt would include the debt of both governments.

State loans

Market borrowings constitute a significant component of financing fiscal deficit at both levels of government and the corresponding share has been increasing over the years. In respect of states, during the 1990s, this component constituted only about 16 per cent of fiscal deficit which increased to around 26 per cent during 2000-2005. After witnessing a decline to around 17 per cent in 2005-06 and 2006-07, it rose to a range of 57.1 per cent to 77.3 per cent during 2007-08 to 2010-11. Correspondingly, loans from the centre remained less than 4 per cent of states' fiscal deficit since 2000-01 compared to an average of 40 per cent to 49 per cent during the 1990s. This is consequent to recommendations of the Finance Commissions making the states to become more market dependent, directly.

The risk free yields of central government securities determine the overall term structure of interest rates in fixed income market. The state government securities are on par with the central government securities for purposes of statutory liquidity ratio (SLR). Technically they should command the same yield in primary and secondary markets. In fact, during the pre-reform period of fixed coupon floatation's, no distinction was made between state and central loans. However, practically, states are in a subordinate position as far as market borrowings are concerned. The states are placed relatively in a disadvantageous position constitutionally compared to the centre. While, the centre can borrow both in domestic and foreign markets, states cannot borrow directly from abroad. Secondly, states cannot borrow effectively even in domestic market without taking permission from the central government and these borrowings are practically allocated by the centre to states. Furthermore, state securities are not held by RBI in its investment account though of late repos are permitted in state securities. Presumably because of all these reasons, state securities in auctions are sold at higher yields and hence have a spread over the auction yields of central government securities ever since the auction system was introduced. This can also be attributed to several other factors: state loans have a fixed maturity of ten years; their market lots are significantly low when considered state wise; and the yields of state loans may depend upon the fiscal position of states, their borrowing size and other economic factors such as the banking spread. Yet another disadvantage with state loans is that they are auctioned on multiple prices and to that extent it discourages secondary market trading soon after primary issues.[5]

The Thirteenth Finance Commission has laid down a roadmap for fiscal consolidation which covers both governments and one important target to be monitored is the individual and combined debt-to-GDP ratio of both governments. The IDMO should, therefore, encompass within its fold State government debt also.

Cash and Investment Management

The second issue relates to whether the DMO should focus upon cash and investment management functions too. The recent experience shows that the government's cash management needs sophistication and refinement. Cash management and debt management are intricately related. Recent experience has brought to light that the Central government could not cope with the huge accumulation of cash surpluses on account of windfall 3G revenues, creating distorted liquidity and interest rate conditions as the government did not create possible avenues for investing such surpluses, as practised in other countries.

The cash balance position of the Central Government is also closely linked to the State Governments' balances since the latter temporarily place surpluses with the Central Government. The cash balance position and dependence of both governments on the RBI for ways and means advances or overdrafts is influenced by the complexity of fiscal transfers and other inter-

[5] Central Government market borrowing is on uniform auction.

governmental transactions. For these reasons, the IDMO should integrate within its scope the cash and investment management functions of the governments at both Centre and State.

The government exerted pressure in the market by pushing ahead with its net borrowing even with huge cash balances. Debt operations should better align with cash flows. Government should coordinate with the central bank very closely for this purpose, even after the proposed separation of the debt management function.

Both receipts side and expenditure side of budgetary management should be looked at for striking a balance between the two. At present, it is very much cost inefficient. While some regulations and systems have been developed to handle cash deficits, the system of handling cash surpluses of both State and Central governments at present is not only very complex, but also is passive, offering no incentive for governments to introduce efficient cash management practices. Secondly, the system does not allow in any way return flow of such surpluses to the market, except by way of increasing expenditure. As a result, there is a tendency to treat such surpluses exogenous to the system and allow the frictions to be unwound totally in an unplanned manner.

Whenever there is a surplus balance in central government account, up to a certain limit, it is invested in Government of India securities held by the Reserve Bank. Thus, a substantial balance is invested in government’s own securities thereby, any interest accrued is appropriated by the government itself, saving to that extent the net interest outgo on such securities held. Since this transaction is between the government and the Reserve Bank, there is no flow of money back into the market. Furthermore, since the quantum of such investments is not reported or published, one can surmise that the actual reported cash surpluses of the government is mostly understated. If it is assumed that at least half of the surplus is invested in this manner, then the actual cash surplus could be at least double that of the reported figure.

Whenever State governments accumulate surplus balances, such surpluses are invested in 14 day treasury bills (TBs) of the Central government. State governments are also allowed to participate in issues of auction TBs on non-competitive basis. While this practice helps the Central government to meet their need for funds in a deficit situation, when the Central government is already in a surplus situation, it accentuates the problem. In the recent period, at any point of time, a huge amount of 14 day TBs remained outstanding predominantly representing state government’s investments.

The primary issuance of government securities follows mostly its own calendar announced half yearly, except for some occasional changes. As a result, the progressive net borrowing results in further build up of surplus, intensifying the frictional factor. Therefore, frictional factors contributing to the unintended liquidity crunch from time to time are mostly avoidable if better cash management practices are introduced by both Central and State governments attuned in harmony with their debt management practices. Country experiences would show that there are several ways of handling the surplus cash balances, other than locking up of these funds from flowing back into the system. Hajra, Jain and Gajbhiye (2009) have attempted to explore the serious problems posed by cash surpluses and has documented well tested practices followed by many countries.

The preceding analysis also shows the intricate link between cash and debt management of two levels of government. The proposed separation of debt management should address the frictional problem that gets generated in the absence of overall coordination. While it is understandable that government's cash flows are to some extent exogenous, refined cash management practices in coordination with debt management can minimize frictions caused by such movements. At present, the system functions very passively with too much of complexity causing avoidable frictional problems also posing strain on liquidity and interest rate management by the RBI.

External Debt

The third issue is whether the DMO should manage the external debt. State governments cannot directly borrow from abroad and have to go through the Centre as the sovereign risk is essentially borne by the latter. While the Centre is yet to issue a sovereign paper abroad, at some stage, it has to test that source, probably soon, considering the pattern in which markets are getting integrated. Considering all these, and the risk associated with debt, it cannot be viewed in isolation. Thus, both internal and external debt should fall under the purview of the DMO.

Other Liabilities

Last, but not the least is the issue of whether only marketable debt should engage the attention of IDMO or the entire contractual liabilities of governments, including small savings and provident fund receipts. While these liabilities are part of public accounts and not a part of consolidated funds, they influence the cost of raising debt and provide indirect support to governments.

4. The Set-up of the IDMO

It is necessary that the debt management office is generally provided with a sufficient degree of functional autonomy to fulfil its mandate without political pressure. Such autonomy may be permitted along with the requirement that the debt management office be accountable, and transparent in its operations, procedures and results. Two aspects need careful attention. First, the scope and functions of the new agency and, second, the nature of the organisational structure which, in a way, will depend upon the first. Institutionally, it is very important that the relationship between the Central and State Governments, and of both with the RBI, need to be considered in designing the organisational structure of the IDMO. The IDMO needs to function independently, maintaining an arms-length association with all these entities. Considering these two aspects, it would be ideal to set up a statutory corporation with equal participation from the three, with independent goals and objectives. Several countries have already separated DMO to have a more focussed debt management policy and preserve the integrity and independence of central bank.

The location of the debt management office is also important. The dispersal of debt management functions within different layers of government can lead to incoherent debt management policy thus to ensure operational efficiency certain countries opted for separate office while others have separate office but operating under the Ministry of Finance (Table 3).

Table -3: Location of Debt Management Office in Select Countries

Country	Location of Debt Management Office	Scope of Debt Management			Advisory
		Cash	Debt	Contingent	Board
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)

An alternative solution to the separation of debt management would be creation of the proposed DMO as Debt Management Corporation as a subsidiary of the RBI with shareholding of also central and state governments, to handle debt management of both. There could be an arm's length relationship of this Corporation to all the three stake holders. The Corporation can be entrusted with cash and investment management function of both the governments in a seamless and harmonious manner reducing the frictional element and eliminating forces working at cross purposes that may seriously disturb the market conditions.

This structure can also ensure independence, transparency and accountability of the corporation to all stake holders.

Based on the above discussion, the functions of the new IDMO, whatever form it assumes, can encompass the following:

a) To get projections of revenue and expenditure of governments and assess the resources gap in terms of borrowing requirements of both central and state governments.

b) To decide on the mix of short term and medium to long term borrowings consistent with the evolving interest rate structure and liquidity conditions.

c) To decide the maturity, type and mode of issuance of debt in the market duly taking into account investor preferences and risks.

d) To manage cash balances of governments in coordination with debt management in such a manner that situations of unduly large deficit or surplus situations do not occur, and when they occur, plan for borrowings and investments in coordination with respective governments.

e) To decide on policies and operations on external debt and managing sovereign borrowings from abroad.

f) To evolve policies on managing other liabilities of governments such that the interest rate structure of government debt as a whole is consistent with cost of incurring those liabilities.

g) To promote and diversify the primary market in government debt including development of a retail base for government debt.

h) To coordinate and oversee the primary market agents like primary dealers.

i) To conduct research on matters relating to government debt including periodical debt sustainability analysis and disseminate periodic information and data to stake holders and the general public in a transparent manner.

RBI should be left with the regulatory control over money and government securities markets and would also be expected to continue and retain other agency functions such as maintaining the depository, managing the settlement system and conducting auctions on behalf of the DMO. In a nutshell, the IDMO should evolve into a policy oriented institution leaving the operational part to RBI as a banker and fiscal agent to governments. This is the case with the Fed Reserve.

The IDMO would have the objective of minimizing the cost of rising and servicing public debt over the long period within an acceptable level of risk at all times. There can be a Debt Agency Advisory Council to advise the Debt Agency Management Committee. The Debt Agency Advisory Council (DAAC) will comprise of a Chairperson, a representative from Central Government and the RBI and four other experts. The members of the DAAC may be appointed by the Central Government and would be different from those who are from the Debt Management Agency Committee. The DAAC must meet at least once in a quarter to review the borrowing program of the Government.

The debt agency could manage public debt, cash and contingent liabilities of the Central Government.

The activities of the agency can be supervised by a special advisory board, which would provide guidance on strategic and technical issues to the Chief Executive (CE), and would regularly monitors its activities. The constitution and functioning of the advisory board[6] lends credibility to the operations, which is necessary for robust market expectations (Calvo, 1988; Diamond and Dybvig, 1983). The membership of the advisory board should generally be broad based, with representatives from the government, market, academia, and the central bank, to function in a transparent and effective manner.

The CE would be responsible for the operational aspects and the office would be mainly organized to independently cover operational work, policy and planning, risk assessment, regulations and audit. The front office would be responsible for resource mobilization, executing transactions in financial markets, including the management of auctions and other forms of borrowing, and all other funding operations, including guarantee operations, hedging, and derivative transactions of the government. The middle office would undertake risk analysis, prepare alternate debt scenarios and assesses the performance of the debt managers against any strategic benchmarks. The back office would handle the settlement of transactions and the maintenance of financial records and market information system (debt registry, disbursements, and debt-service payments).

[6] The organisation of Boards within Debt Management Office in United Kingdom and Sweden are presented in Annex-1.

Audit and Reporting

The debt management function of the RBI at present is subjected to internal audit and the statutory external audit. The internal debt management functions of the RBI are reported in the statutory Annual Report of the RBI while external debt management functions are reported in the Annual Status Report on External Debt – both presented to Parliament. The data on contingent liabilities is consolidated by the RBI and placed in its annual statutory publications. On separation of IDMO, the Comptroller General of Accounts would do the accounting of debt management operations; the Comptroller and Auditor General of Accounts, a constitutional body, would do the audit.

Debt and Monetary Management – A conflict

There is an apparent conflict between the two functions of monetary and debt management. The conflict is inherent in its very objectives. The objective of Debt management is minimization of cost of borrowing while the objective of monetary management is price stability operated through the instrument of interest rates. Since late 1990's several committees have proposed separation of debt and monetary management and an independent debt management office (Table 4). A number of measures have been taken in the last two decades illustratively, elimination of *ad hoc* treasury bills in a phased manner, legislation of Fiscal Responsibilities and Budget Management Acts by different governments, discontinuing the participation of RBI in the auctions of primary markets, setting up of primary and satellite dealers and developing the financial markets. These measures have improved the RBI's operating space but have not resulted in removing the fiscal domination over monetary policy which has been increasing with rising gross fiscal deficit. In addition, the RBI has also to do cash management as well as manage the investments of the Central Government. The RBI also continues to manage the rising market borrowing of the State Government. In addition to these liabilities which are apparent there are contingent liabilities which are being incurred by the States and the Centre separately. Further, in a State, contingent liabilities are being incurred in different departments of the Government and a consolidated approval mechanism is absent for a consolidated policy overview on liabilities being incurred by the State. The Government also incurs rupee loans and foreign currency loans which have different implications for both the regulator and the investor. Finally, non-market liabilities are also regularly incurred by the Government. The present managerial structure of public debt management is presented in Table-4.

Table – 4: 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.

In India, the separation of debt would provide the RBI with necessary independence in monetary management and an environment to pursue any particular definitive target, if assigned by the government. The separation of debt management would provide focus to the task of management of government liabilities, undertake risk and sustainability analysis. 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 – 5).

Table 5: 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.
2012	Report of the Working Group on Debt Management Office (Chairman: Govinda 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: Justice 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, an important water-shed in the institutional arrangements of debt management was 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 IDMO in the Ministry of Finance. The IDMO was entrusted with the responsibility of piloting the evolution of legal, governance and comprehensive risk management framework, 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. The Financial Sector Legislative Reforms Commission report has discussed the issue in depth with an aim to understand the structural organisation of IDMO.

Relevant Proposals in the Financial Sector Legislative Reforms Commission[7]

The draft code of the Financial Sector Legislative Reforms Commission (FSLRC) proposes a creation of a specialized statutory public debt management agency that is equipped to manage liabilities of the Government in a holistic manner. It would have an independent goal and objective but would operate as an agent of the Central Government. The principles of governance, including transparency and accountability will apply to all functions of the agency, its committee and the council.

The composition of the management committee will be as follows:

a) the chief executive of the public debt management agency as its chairperson;
b) a nominee of the Central Government as member;
c) a nominee of the RBI as member;
d) nominee of the State Governments, only if the agency borrows on behalf of any of them;

The structure of the advisory council is proposed as follows:

a) A chairperson;
b) A nominee of the Central Government higher than the rank of its nominee in the management committee;
c) A nominee of the RBI higher than the rank of its nominee in the management committee;
d) Experts; and
e) The chief executive of the agency. With the exception of the chief executive of the agency, the members of the advisory council cannot be the same as the members of the management committee.

Public Debt Management Agency

FSLRC stipulates that PDMA will always act on instructions from the Central Government. But if the instruction does not enable its objectives to be met, then the PDMA must have the opportunity to place its objections on record. The Central Government should be obliged to consider the views of the PDMA and if there is a disagreement between the two, then PDMA would be statutorily bound to meet the instructions, by very clearly articulating on record its inability to meet the objectives. The accountability mechanism routed through the central government and eventually through the parliament would pay cognizance to the effort made by PDMA in achieving its objectives and the objections raised.

Functions

The public debt management agency (PDMA) would cater to the following functions:

[7] The first author draws upon his presentations in the conferences organized by the Institute of Company secretaries on India at Hyderabad and Mumbai during March/April, 2013.

1. Managing public debt:

a) Prepare and recommend an annual calendar for the Central Government to manage its public debt; the calendar will advise on all aspects of the composition of the borrowing and repayment of public debt.
b) Annual Calendar would be prepared in consultation with Central Government and other key stake-holders;
c) Follow instructions received from the Central Government,
d) Will be empowered to make recommendations, even if on a daily basis,
e) Ensure that there is an integrated approach to debt management, including external debt for the Central Government

2. Cash management:

a) Co-ordinate with the departments, ministries and agencies of the Central Government and RBI to estimate, monitor and manage daily cash balances.
b) Advise Government on measures to promote efficient cash management practices and to deal with surpluses and deficits.

3. Contingent liabilities:

a) Manage and execute implicit and explicit contingent liabilities;
b) Evaluate the potential risk of contingent liabilities and advise the Central Government on charging appropriate fees
c) The Central Government must seek PDMA's advice before issuing any fresh guarantees as it affects the overall stability of the public debt portfolio.

4. Research and information:

a) Must have a complete view of the entire liability structure of the Central Government for maintaining and managing information systems;
b) Disseminate information and data; and conduct and foster research relating to its functions.

5. Foster a liquid and efficient market for Government securities, including advising the regulators and the Central Government on the policy and design of the market to ensure low cost financing. Thus following needs to be considered

a) Growth and diversity in investors and intermediaries;
b) Fairplay;
c) Competition in intermediation;
d) Cost-minimising mechanisms for issuance and trading; and
e) Measurement of liquidity and market efficiency, and presentation of an annual report on the progress of the Government of India sovereign bond market.

Scope of the PDMA

The placing of all contingent liabilities in the single debt office will facilitate the scrutiny of issuances, record keeping, risk assessment, pricing, audit and approval by the Parliament. This will help in better coordination of the debt management function, operational efficiency, risk assessment, accountability and responsibility. There are limitations on the functions of PDMA and these mainly pertain to expanding its role to the state governments as the management of state debt is a state subject. However, PDMA would be obliged to undertake those functions related to state government which has implications for the central government's debt portfolio. This would involve maintaining a database on state government debt and coordinating the central government's borrowing calendar with that of the state government's. The state government may choose to PDMA to manage their debt and the PDMA should be empowered to offer technical assistance to state governments to set up their own PDMAs if required.

Independence and other relevant issues for the PDMA

The discussion in the preceding paragraphs, pertaining to FSLRC, point out to a disconnect between the recommendations in Volume I and the draft code in Volume II of the Report. The draft code clearly indicates that the independence of PDMA would not be ensured. The objective or a preamble that the "Debt Agency has the objective of minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk at all times, under the general superintendence of the Central Government".[8] On the basis of the draft law, it can be concluded that the present arrangement under the RBI, seems to be more independent than the status envisaged for the PDMA.

There are a number of issues which need careful consideration in the proposed arrangement. First relates to the assignment of the contingent liabilities to the PDMA. Though their implications are important, it is really akin to a rating function of the Government. Second, the draft law suggests that PDMA 'must take steps to foster a liquid and efficient market for government securities' but should this responsibility be shifted to PDMA so early in its existence. In addition, given that the RBI which is actively operating at the short end of the market, should that responsibility not be allowed to stay with the RBI. Further, given that the market infrastructure in the government securities market has been established by the RBI and that the RBI is coordinating with other regulators in the financial markets, should the role be assigned to the newly constituted PDMA? Third, the draft code is not clear on many other issues like the state loans and state contingent liabilities. To encourage the State Government's to entrust their debt management activities to a separate debt management agencies there should be some representation in the membership from the State Government's. The members of DAAC should also be appointed from States on a rotational basis to have representation of the views from the State Government. Finally, the other issue is that of

[8] Part XII, Public Debt Management Agency, Volume II: Draft Law, Report of the Financial Sector Legislative Reforms Commission, Government of India.

depository and settlement functions. The settlement is by central bank money as the central bank is an anytime lender to the central government. Therefore, in the new arrangement, book keeping, depository and settlement functions of the RBI should be retained and there is no need for any change

5. Conclusion

There is a need for a holistic approach to debt management of the Centre and States which is absent in the current situation. The RBI has different set of responsibilities as compared with the Governments of the State as well as the Centre.

The Government could consider making PDMA a statutory corporation independent from both the Government and the RBI. The government could also provide strength to the advisory council by appointing experts for the committee. Debt sustainability analysis should be a regular feature of the PDMA. Management Committee's operations should be free of day to day interference. The roles on contingent liabilities and secondary market development/operations need to be considerably diluted.

The shift to a separate debt office can be strategized to be gradual. All the debt management activities, including short-term cash requirements, domestic and external market borrowings, small savings and eventually, with development of expertise, contingent liabilities should be assigned to a single debt agency. Cash management of important government undertakings of the government like the railways, post (including collections under small savings) and telecommunications, pension and provident funds, and reserve funds and deposits could be transferred to the debt office if considered appropriate or else, these commercial undertakings/funds could benefit from the expert advice available within the government sector. The management of pension and provident funds could also benefit from the advice and experience of the debt management office during the period of transition while pension reforms are being undertaken.

The separation of debt management would provide focus to the task of management of government liabilities, undertake risk and sustainability analysis. The separation of debt and monetary management accompanied with better transparency will enhance credibility of the RBI and the government.

References

Australian Office of Financial Management (1999-2000), Annual Report.

Bernanke, B. S. (2010), Central Bank Independence, Transparency and Accountability, Board of Governors, Federal Reserve System, May.

Calvo, A.G. (1988), Servicing the Public Debt: The Role of Expectations, *The American Economic Review*, Vol.78, No.4, pp.647-661.

CLSA Emerging Markets (2002), Unravelling Public Finances Gordian Debt, Special Report: Global Economics Research

Diamond, D.W. and P.H. Dybvig (1983), Bank Runs, Deposit Insurance, and Liquidity, *The Journal of Political Economy*, Vol.91, No.3, pp. 401-19.

Dincer, N and B. Eichengreen (2013), Central Bank Transparency and Independence: Updates and New Measures, Working Paper No. 2013-21, Bank of Korea.

Government of India (2013), Report of the Financial Sector Legislative Reforms Commission, Vol-I Analysis and Recommendations, Ministry of Finance.

Government of India (2013), Report of the Financial Sector Legislative Reforms Commission, Vol-II Draft Law, Ministry of Finance.

Hajra, K, R.Jain and D. Gajbhiye (2009) Determinants of Surplus Cash Balances of States in India: A Panel Data Analysis, Reserve Bank of India, Staff Report.

Kanagasabapathy, K (2012) Independent Debt Management Office: Rationale, Scope and Structure, A discussion note submitted to Working Group on DMO, FSLRC (mimeo)

Saket, N (2009), Debt Management Office: Relevance and Concerns, indiastat.com

Singh, C (2005), Public debt in India: The Need to Separate Debt from Monetary Management. Working Paper No. 240. Stanford Centre for International Development.

Singh, C (2013), A Separate Debt Management Office, WP No. 425, Indian Institute of Management Bangalore.

United Kingdom Debt Management Office (2000), Secondary Market for Gilts Consultation and Response.

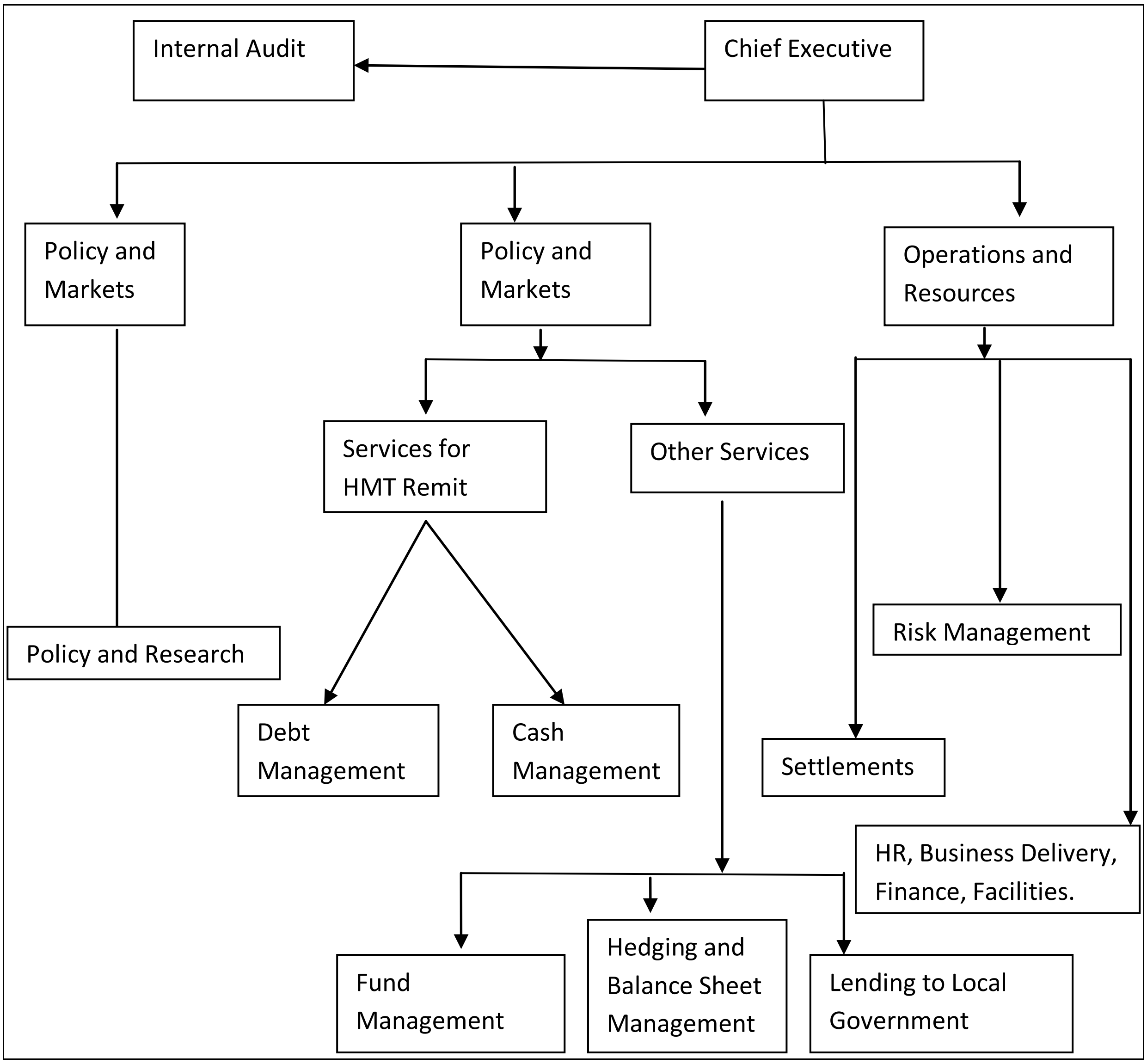
United Kingdom Debt Management Office (2005), Executive Agency Framework Document.

Annexure-1

United Kingdom

The Managing Board usually consists of a member from HM Treasury, appointed at the discretion of the DMO's Chief Executive, and two other non executive directors. The board considers all strategic operational and management issues.

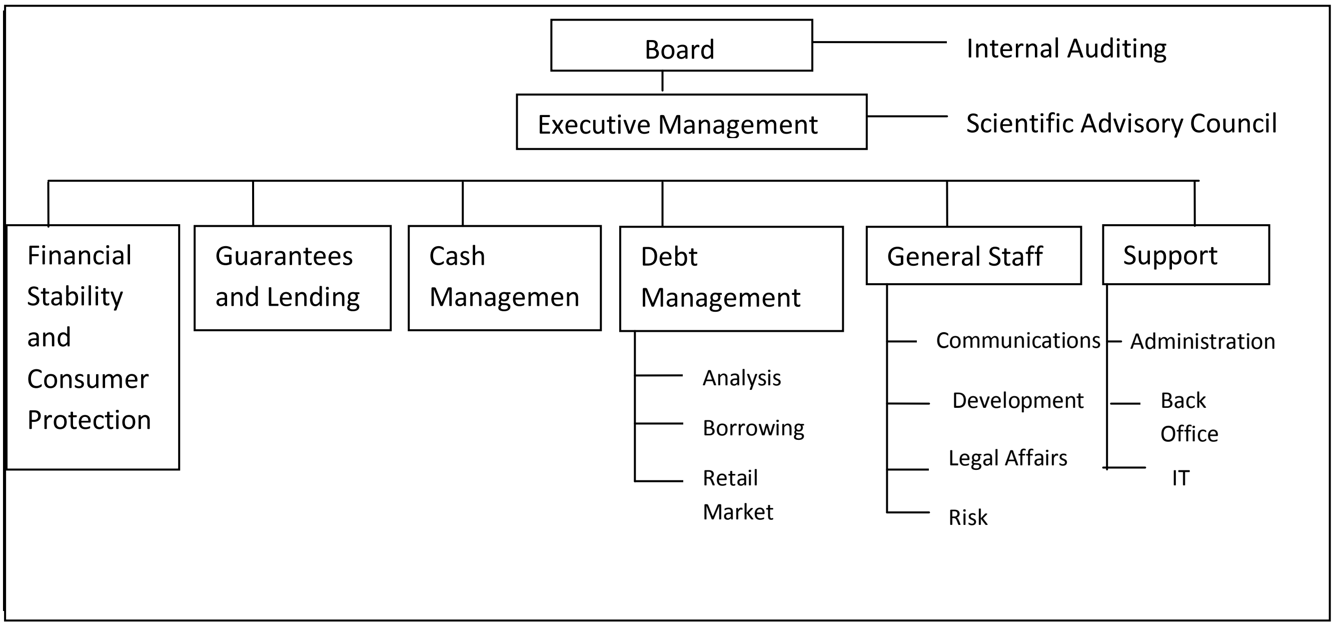
Debt Management Office Structure



Source: United Kingdom Debt Management Office

Sweden

Organisation of Swedish National Public Debt Office



Source: Swedish National Debt Office

The debt office is led by Director General and Deputy Director General along with Management and Policy Group. The Management Group supports the Swedish National Debt Office by discussing and preparing both strategic issues and office overall decisions that are taken by the General Director. The group is led by the General Director and consists of the Executive Management, Chief Economist and the Heads of General Staff, Support and Communication. The Policy Group discusses and prepares policy issues within the Swedish National Debt Office. The group is led by the Director General and consists of the Executive Management, Chief Economist and the Heads of Development, Financial stability and consumer protection, Guarantees and lending and Cash Management.

The internal auditor has authorized the Chairman to review the Debt Office's operations and reports directly to the Board.

The Swedish National Debt Office also has a Scientific Advisory Council, which assists with advice and ideas in the SNDO's different responsibilities and assure the quality of the evaluation and analysis methods that the SNDO prepare and apply. Council meetings are led by the Director General.