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Debt Management Office: Relevance and Concern

Introduction:

World over, debt management is distinct from monetary management. The establishment of a Debt Management Office (DMO) in the Government has been advocated for quite some time. The DMO's mandate will be to manage debt of the country. It will be an independent agency that will help the government manage borrowings efficiently. By separating debt management from monetary policy functions, policy makers expect the central bank to emerge as an independent central bank which like some of its peers will focus more on inflation control.

RBI had first recommended this when Bimal Jalan was the governor. But subsequently, it dissented when a committee set up the government by the then financial minister, Yashwant Sinha, as the then governor, YV Reddy, thought the move will not help unless the fiscal deficit was reduced.

In most of the countries, central banks are only responsible for monetary management and do not even function as a regulator for banks. In the US, the treasury manages public debt, not the Fed. In addition to these core problems of conflicts of interest, Indian debt management has many other weaknesses. There is no one place in the country where there is a full database of all the liabilities of GoI. This information is, hence, not used for risk management and optimisation of the financial burden of GoI. There is a big gap between the way mature market economies apply sophisticated financial economics for the purpose of devising optimal strategies for debt management, and the state of play in India. As far as the mechanics of implementation are concerned, the Budget speech says: "[I]n the first phase, a Middle Office will be set up." A mid-office would constitute a single comprehensive database about all liabilities and guarantees of GoI, and a risk management overlay, which improves the risk profile of the overall portfolio. It is the logical starting point for the construction of the DMO. If the MoF is able to get key staffpersons with experience in state-of-the-art debt management in public sector settings, it is possible to set up the mid office in nine months, and have the DMO fully running in 18 months.

Establishing a debt management office (DMO) would consolidate all debt management functions in a single agency, and be the catalyst for wider institutional reform and transparency about public debt. It is internationally accepted best practice that debt management should be disaggregated from monetary policy, and taken out of the realm of the central bank. Most advanced economies have dedicated debt management offices. Several emerging economies, including Brazil, Argentina, Colombia, and South Africa, have restructured debt management in recent years and created a DMO.

“In the present situation, it is imperative to seek every institutional innovation which can yield even the slightest improvements in the implementation of public borrowing, or slight improvements in risk management.” - **Kelkar Report**

“Looking ahead, a sound public borrowing strategy for India would incorporate three elements. . . An independent Indian “debt management office” - operating either as an autonomous agency or under the Ministry of Finance - that regularly auctioned a large quantum of INR denominated bonds in an IFC in Mumbai. The size of these auctions would be substantial by world standards and would enhance Mumbai’s stature as an IFC.” - **Percy Mistry Committee Report**

“This is also a good time to carefully think about changing the structure of public debt management, particularly in a way that minimizes financial repression and generates a vibrant government bond market. The Ministry of Finance has announced that an independent Debt Management Office (DMO) will be set up. This provides an opportunity to think about and incorporate best practices in this field.” - **Raghuram Rajan Committee Report**

Need of DMO in India

Three key issues that influence the design of debt management in India are: - consolidation, conflicts of interest and financial repression.

Consolidation-

A well structured debt management office is one where all information about onshore and offshore liabilities, and contingent liabilities, is centralized into a single database and will enable better information transmission to the bond market. Unification of information also makes possible a variety of strategies for reducing the cost of borrowing.

Conflicts of interest-

The debt management office works as the ‘investment banker’ for the government, selling bonds and engaging in other portfolio management tasks in close coordination with its client, the budget division. Each of these agencies then has a clear focus and conflicts of interest are avoided.

Financial repression-

Debt management is relatively simple when financial firms are forced to purchase government bonds through financial repression. In this context, the task of funding public debt will become more complex.

It is hence important to undertake institutional reform that strengthens debt management alongside the process of financial sector reforms that eases financial repression.

Source: Report of the Internal Working Group on Debt Management-October 2008

In India, the debt management function is presently dispersed over several agencies. Broadly, external debt and non marketable debt and other liabilities are largely managed by the Ministry of Finance through various departments and marketable debt is largely managed by the Reserve Bank of India. In course of managing the government debt and financing requirement by the Reserve Bank, however, the fiscal operations have been perceived to be overburdening the monetary policy and even leading to blurring of distinction between fiscal and monetary policy operations. Ways and means agreement of the Reserve Bank with the Government in 1997 and prohibition of direct borrowings by the Central Government from the Reserve Bank under the Fiscal Responsibility and Budget Management Act, 2003 have provided greater transparency and operational autonomy to the monetary policy framework.

International Scenario in Debt Management office

Moving public debt management from the Central Bank to a DMO is internationally accepted best practice (IMF and World Bank, 2002). However, there are certain common features across countries that have restructured and modernized public debt management:

The Central Bank no longer manages public debt; there is a clear separation between monetary policy and public debt management.

Debt management is integrated in one entity rather than dispersed over several departments and authorities.

The split between external and domestic debt management gives way to integrated debt management, with a front-middle-back office structure.

The DMO focuses on making debt management more transparent.

The DMO focuses on communicating regularly and clearly with financial markets

New Zealand

Source: Report of the Internal Working Group on Debt Management-October 2008

Structure of NZDMO (New Zealand Debt Management Office) resembles that of a private-sector financial markets institution, with separate front, middle and back offices. That structure leads to clearly defined responsibilities and accountabilities, procedural controls and the segregation of duties, which is consistent with best practice.

Responsibilities

Financing the Crown's gross borrowing requirement, managing foreign-currency assets required to meet net foreign-currency interest and principal requirements and settling and accounting for all related debt transaction.

Maintaining and developing an appropriate framework for efficiently managing the portfolio and the risks associated with it.

Disbursing cash to departments and facilitating departmental cash management.

Advancing funds to government entities in accordance with government policy.

Providing capital markets services and derivative transactions for departments and government entities.

Providing reporting for fiscal forecasting and financial statements.

Maintaining a diversified funding base and, where appropriate, enhancing relationships with investors who hold, or are potential holders of, New Zealand government securities and with financial intermediaries and the international credit rating agencies.

United Kingdom

 Source: Report of the Internal Working Group on Debt Management-October 2008

Practicable structure of the DMO

There are four models for debt management offices:-

A division or unit within the Ministry of Finance.

An executive agency which is not a creature of statute, and operates at arm's length from the Government.

A statutory body which functions at arm's length from the Ministry of Finance.

A state-owned company that manages public debt.

 Source: Report of the Internal Working Group on Debt Management-October 2008

IMF, in its guidelines on Public Debt Management (2001), discussed that operational responsibility for debt management is generally separated into front and back offices with distinct functions and accountabilities, and separate reporting lines. This separation helps to promote the independence of those setting and monitoring the risk management framework and assessing the performance from those responsible for executing market transactions.

Major functions of the Middle Office, inter alia, include preparation of a medium-term debt management strategy, issuance of periodic calendars for borrowings, managing Government cash requirements, managing the risks in Government debt portfolio, developing and maintaining a centralized database on Government liabilities, preparing periodical reports on public debt and disseminating debt-related information. Middle Office has begun work on some of these functions such as preparation of a medi-

um term strategy framework, annual issuance programmes, instrument framework for managing cash surplus/deficit of the Government, developing a comprehensive debt database, etc.

Indian DMO should be a statutory body corporate with considerable operational autonomy, which functions as an agent of the Central and State Governments. DMO is likely to move away from the current division between managing foreign and domestic debt and towards a front, middle and back office structure. However, the draft Bill does not specify operational arrangements, and concentrates instead on defining the DMO's management structure.

Issues in debt management office:

RBI would like to have control over the proposed National Treasury Management Agency; the Finance Ministry wants the agency in its fold.

RBI has built up considerable expertise in market operations. In fact, it is quite likely that the staff of the Bank may continue to be employed in the NTMA for a couple of years, with deputation allowance, till the government officials learn the ropes. Thus the control of NTMA by the government would only result in increased expenditure without any additional tangible benefit to the economy.

RBI has had a policy of grooming the market for new floatation through conversions of the old ones. If government does not take note of the status of the market flowing from RBI actions the loan programme may come a cropper if the subscribers quote high yields and the government is not willing to pay them. Thus there could be a conflict between monetary and debt policies in the new set-up.

Once the DMO is established, it will operationalise the decision to issue government securities for MSS when the central government and the RBI decide on it. The operational part is crucial and has an element of immediacy for the RBI to carry out its monetary function. It cannot lose time by asking the NTMA to act.

There will be no change in Policy and Operations area, irrespective of whether the DMO is in the Government or with the RBI. Only the nitty-gritty of the actual floatation of loans will be handled by the DMO.

Issue of conflict of interest, in the current Indian context where 70 per cent of the banking assets remain in the public sector banks, setting up of a DMO under the Ministry of Finance may, in fact, exacerbate the conflict between government's role as a debt manager and its status as the owner of a substantial portion of the banking sector.

Recent Development:

The Reserve Bank of India (RBI) has advised the government to put the creation of a debt management office (DMO) on the backburner because of the huge borrowing programme this fiscal. The finance ministry is at present working on a Bill to set up a separate DMO, independent of the ministry and the RBI. There is already a middle office housed within the finance ministry that crunches data, but a full-fledged office will have a far larger role. It will operate on an MoU with the finance ministry that will decide the

amount of bonds to be floated each year, the price of the coupons, the tenor of the papers and even their periodicity.

The government plans to legally empower the proposed Debt Management Office (DMO) with the mandate to do debt profiling and debt stock analysis of borrowings of the Centre and states. Though the work profile of DMO was to include these functions, the finance ministry wants to explicitly spell these out as it starts framing the draft legislation.

DMO is to take over the Reserve Bank of India's function of managing government debt. It is likely to be in place by the second half of 2010-11. The finance ministry has also decided that till the DMO is created, the existing office, the middle office, within the ministry will be strengthened. The middle office currently has a three-member structure, with a director-level official as its head. The officials are drawn from RBI and are functioning independent of the ministry, though they are located within the ministry premises. "The middle office is taking care of the government's debt strategy and stock monitoring, though the actual raising of debt is done by RBI. They are free to consult RBI. While welcoming the creation of DMO, state governments have suggested it should aim at bringing down the cost of borrowing. Besides state governments, the ministry of finance has got suggestions from various stakeholders, experts and multilateral lending agencies like the World Bank, International Monetary Fund and the Asian Development Bank on a report of an internal working group set up for suggesting the structure of DMO. Most of these suggestions were on the operational aspect of the terms of reference. DMO's activity should be broad-based. The underlying idea is to separate the functions of government debt management and monetary policy, both currently vested with RBI. It is felt that the present arrangement creates a conflict of interest.

Conclusion

Process of setting up the proposed independent debt office needs to be carried forward. In this regard, the Report of the Internal Working Group on Debt Management (October 2008) has laid down the broad road map - including the required legislation, institutional and governance structure of an independent debt office, its responsibilities and transition issues. The steps involved in evolution of the independent debt office need to be traversed in a manner characterized by urgency and transparency on the one hand and caution and coordination on the other.

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