

## Corpsec Hotline

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### IS INDIA READY FOR DEBT MANAGEMENT OFFICE?

Debt management has over the years become a specialist job and administrations the world over have resorted to branching this activity under a separate authority. In the US, debt management falls within the Treasury's domain, while the Federal Reserve, the US government's central bank, deals with monetary policy. Most of the jurisdictions worldwide, like UK, Sweden, Brazil, have a separate entity managing debt and in-charge of raising and managing debt for the respective administrations.

Presently, the Reserve Bank of India carries out both the debt management and the monetary policy implementation functions, for the central government. Therefore, a case for a separate DMO is being made out mainly on the ground that the central bank is conflicted when it acts both as the government's banker trying to borrow as cheap as possible, and also as the prime authority responsible to enforce the monetary policy with the prevalent interest rates.

Contrary to popular belief, a separate DMO is unlikely to increase in forced mopping of government securities (G-Secs) by public sector banks anymore than already be. With ever-decreasing global interest rates, higher yield of Indian public debt anyways remains very alluring.

Importantly, the development of the G-Secs market is essential for any economy to come of age. It requires dedicated professional management and carving out a separate DMO may be the correct approach. Another factor to consider is India's debt rating that is just about investment grade or thereabouts. A dedicated approach towards debt management will help in improving the disappointing debt rating.

With the Indian government taking on its biggest public debt raising exercise till date of approximately close to \$ 90 billion or Rs 4.5 lakh crore, the presence of a vibrant and dynamic debt and G-Secs market involving participation from all class of investors (and not only from a few institutional players, as is the case now) has become paramount. Due to the severe global credit crisis, the Indian government, like most other governments the world over, was pushed to walk the path of an expansionary fiscal policy.

The Fiscal Responsibility and Budget Management Act, 2003, which lay policy targets for both the fiscal deficit and the revenue deficit up to 2008 and aimed at institutionalising fiscal management to bring about greater fiscal discipline, had to be consequently put in suspension. Taxes were lowered and expenditure increased to stimulate (a) the sagging economic sentiment; and (b) increase the money flow to thwart the adverse effects of credit crunch which has resulted in India's present fiscal deficit reaching alarming levels.

Therefore, the need for a sound public debt management strategy has become even more pressing. It is the need of the time to lower the cost of public borrowing, while balancing it with extant monetary policy initiatives and refinancing risks inherent in any government borrowing plan.

Is there a downside? Absolutely, every change has the potential to be catastrophic.

It is contended that there exist three pre-conditions to separation of debt management, namely, (a) reasonable control over fiscal deficit; (b) development of financial market; and (c) legislative changes.

The first two pre-conditions are moot as they pose the chicken and egg problem. The third one is entirely achievable.

There are some issues that must necessarily be addressed during the process of setting-up the DMO.

- The seamless integration for efficient debt management and coordination of the DMO with the other limbs of the Indian government is the pivotal concern.
- Sustainability analysis for public debt should incorporate appropriate mechanism for reporting from on-ground debt managers, thereby drawing upon their market intelligence and understanding.
- The ongoing credit crisis has proven that the once infallible are also fallible. Countries can little afford defaulting on their sovereign debt obligations as there is unquantifiable reputational risk associated with it. Legal enforceability of debt obligations in both, domestic and international markets, and understanding the legal implications of various complex structured transactions becomes essential. Adequate measures are necessary in this regard.
- Creation of DMO has to adhere to a proper constitutional procedure that empowers the DMO to bind and be bound on behalf of the Indian government. Clarity in delegation of this power and function is indispensable.
- It is rather impossible to foresee all future situations for such a wide function. Thus, the regulations must not be too detailed. They should clearly state the main activity of DMO, provide operational guidelines and establish a seamless coordination mechanism.

Indian regulators, RBI and SEBI, have been casted away for towing a conservative approach over the years, but the

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same dogged approach tempered with sensible pro-action, like in the Satyam fiasco, has largely served in shielding India from the Asian financial crisis and the present global credit crisis.

Nevertheless, the creation of DMO will not be frivolous, as it shall result in removing the conflict with monetary policy management and provide the much needed stimulus to debt markets. In any case, divestment of the debt management function from RBI to a separate authority is likely to involve multiple phases, with adequate check-posts at each phase. If worked out with adequate precaution, the DMO can serve as a change agent for the development of the Indian debt markets.

This article first appeared on the Policy Page of The Economic Times, Mumbai edition dated August 11, 2009.

- Nirvaan Gupta, Chittaranjan Datar & Siddharth Shah

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