IIMB Management Review (2015) 27, 56—71

available at www.sciencedirect.com

ScienceDirect

journal homepage: www.elsevier.com/locate/iimb

ROUND TABLE

# Separation of debt and monetary management in India☆

Charan Singh*

*Economics and Social Sciences, Indian Institute of Management Bangalore, Bangalore, Karnataka, India*

Available online 6 March 2015

**KEYWORDS**
Debt management;
Separation of debt and monetary management;
Debt management office (DMO);
Independence of a central bank;
Independent debt management office

**Abstract** The discussion highlights the importance of and the need for a separate debt management office, separate from the monetary authority. The objective of debt management is raising resources from the market at minimum cost while containing the risks, while that of the monetary authority is to achieve price stability. In the years preceding the financial crisis of 2008, separation of debt and monetary management was a settled norm and 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. Separation of debt management is essential to preserve the integrity and independence of the central bank, to ensure transparency and accountability, and to improve debt management by entrusting it to portfolio managers with expertise in modern risk management techniques. In India, debt is managed by the central and state governments, and the RBI. The separation of debt management would provide focus to the task of asset-liability management of government liabilities, undertake risk analysis and also help the government to prioritize public expenditure through higher awareness of interest costs. The separation would also be helpful for the borrowing programme which would have to be completed without the support of the regulatory or supervisory authority. This may lead to widening of investor base and market friendly yield curve.

But after the great financial recession of 2008, the issue has re-emerged as in many countries, especially the advanced economies, the scope of fiscal operations was expanded, and the debt to GDP ratios have increased substantially. Similarly, in view of the sensitiveness of the issue, especially amidst less developed financial markets, there has been some re-thinking on the issue; in India, the Reserve Bank has also been re-thinking the separation issue and seems reluctant given the present context of the economy.


☆ This paper is based on the Module on Debt Management under the aegis of the 9th Annual International Conference on Public Policy and Management held at IIM Bangalore on August 11, 2014. Views are personal.
* Tel.: +91 80 2699 3818.
*E-mail address:* charansingh@iimb.ernet.in
Peer-review under responsibility of Indian Institute of Management Bangalore.

http://dx.doi.org/10.1016/j.iimb.2015.01.007
0970-3896 

## Introduction

In recent years, after the global crisis (2008), the issue of separation of monetary management from fiscal and debt management operations has re-emerged. In many countries, during the period of crisis, the scope of fiscal operations was expanded; the debt to GDP ratios also increased significantly. Consequently debt management encountered difficulties, and coordination between monetary management and debt management assumed greater significance.

Historically, the debt crises of 1982 and the East Asian financial crisis of 1997 led many countries to assign priority to public debt management and several countries chose to separate debt management from monetary management. As government securities markets became mature and more sophisticated, a separate institutional structure was considered to be better suited to achieve an appropriate balance between monetary policy and debt management objectives. In normal economic circumstances the central bank operates at the short end of the market and debt management at 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 would reduce the risk of policy conflicts. Once the financial markets had developed, the role of the central bank in sustaining the stability of markets was considered minimal. Therefore, in many of the Organisation for Economic Co-operation and Development OECD countries, separation of debt management and monetary management was undertaken in the 1990s.

The round table discussion follows a brief contextual introduction to the issue, covering the objectives of debt management; traditional and post-crisis viewpoints about separation of debt management; central banks' independence; coordination between debt management, monetary and fiscal operations; debt management practice in India; and the role of the Reserve Bank of India (RBI).

## Objectives 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, promotion and development of efficient primary and secondary markets for government securities is an important complementary objective. 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 assumes added significance with high fiscal deficits and government debt.

## Separate debt management office — a traditional view

There was a growing consensus among practitioners until 2008 to treat debt management as a separate policy instrument from monetary policy. 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 recognizing the need for proper policy assignment and an accountability framework for debt management to meet the fiscal targets set in the Fiscal Responsibility Act. In Europe, several countries that were heavily indebted in the late 1980s and early 1990s, such as Belgium, France, Ireland and Portugal, decentralized debt management to varying extents, in order to reduce the variability of debt service cost that could jeopardize the targets set by the Growth and Stabilization Pact. In the UK, debt management responsibilities were taken away from 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 focussed debt management policy in terms of cost of borrowings, market determined yield curve, and optimal mix of maturity profile of outstanding loans (Table 1). The location of the debt management office is important and depends 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.[1] Some OECD countries have opted for an autonomous debt management office to improve operational efficiency while others, seeking a balance between public policy and financial management, have a separate office but operating under the Ministry of Finance (MOF). 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 MOF while Kalderen (1997) suggests that a separate 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) concluded 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 management and monetary management positively affects expectations as it explicitly indicates to the market that monetary policy is independent of debt management.[2]

The classic conflict between monetary policy and debt management policy, and operations relates to the fixation of interest rates. The interest rates on government securities are crucial in determining the yield curve and prices

[1] Operational risk, generally neglected in debt management, pertains to internal processes, people and systems.

[2] 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.