DO YOU KNOW?

PUBLIC DEBT MANAGEMENT

What is Public Debt Management?

Sovereign debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

In a broader macroeconomic context for public policy, governments should seek to ensure that both the level and rate of growth in their public debt is fundamentally sustainable, and can be serviced under a wide range of circumstances while meeting cost and risk objectives

What is the Objective of Debt Management?

The main objective of public debt management is to ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.

What is the importance of Public Debt Management?

Poorly structured debt in terms of maturity, currency, or interest rate composition and large and unfunded contingent liabilities have been important factors in inducing or propagating economic crises in many countries throughout history. For example, irrespective of the exchange rate regime, or whether domestic or foreign currency debt is involved, crises have often arisen because of an excessive focus by governments on possible cost savings associated with large volumes of short-term or floating rate debt. This has left government budgets seriously exposed to changing financial market conditions, including changes in the country's creditworthiness, when this debt has to be rolled over. Foreign currency debt also poses particular risks, and excessive reliance on foreign currency debt can lead to exchange rate and/or monetary pressures if investors become reluctant to refinance the government's foreign-currency debt. By reducing the risk that the government's own portfolio management will become a source of instability for the private sector, prudent government debt management, along with sound policies for managing contingent liabilities, can make countries less susceptible to contagion and financial risk.

What are the different categories of Public Debt Management?

Under current budgetary practice, there are three categories of Union government liability that constitute public debt - internal, external and "other" liabilities.

Internal debt is classified into (1) market loans, (2) other long and medium-term borrowing and (3) short-term borrowing and is shown in the receipt budget of the Union government. It includes market loans, special securities issued to the Reserve Bank of India (RBI), compensation and other bonds, treasury bills (including 14-day treasury bills issued to States only), commercial banks and other parties, as well as non-negotiable and non-interest bearing rupee securities issued to international financial institutions.

External debt represents loans received from foreign governments and multilateral institutions. The Union Government does not borrow directly from international capital markets. Its foreign currency borrowing takes place from multilateral agencies and bilateral sources, and is a part of official development assistance (ODA). At present, the Government of India does not borrow in the international capital markets.

However, as noted by the Report on Ministry of Finance for the 21st Century (Kelkar Report), this is a partial picture and does not account for "proxy" foreign exchange borrowing, in the form of contingent liabilities. Foreign exchange borrowing by para-statal agencies is substantially influenced by the Union Government. For example, the State Bank of India (SBI), which is majority owned by the Union Government and the RBI, borrows in foreign currency through instruments such as Resurgent India Bonds, India Millenium Deposits and Millenium India Bonds (MIB). The Union Government and RBI restrict how SBI can use these funds, and the Union Government provides exchange rate guarantees for this borrowing. Government-owned banks have raised substantial funds through this route for many years now; 1.6 billion USD was raised using the "India Development Bond" in 1991, 4.2 billion USD using the "Resurgent India Bond" in 1998 and 5.3 billion USD using the "Millennium India Deposit" in 2000, (MoF, 2004).

The **"other" liabilities** category, not a part of public debt, includes other interest bearing obligations of the government, such as post office savings deposits, deposits under small savings schemes, loans raised through post office cash certificates, provident funds and certain other deposits

What is the Debt Portfolio of the Government?

A government's debt portfolio is usually the largest financial portfolio in the country. It often contains complex and risky financial structures, and can generate substantial risk to the government's balance sheet and to the country's financial stability. As noted by the Financial Stability Forum's Working Group on Capital Flows, "recent experience has highlighted the need for governments to limit the build-up of liquidity exposures and other risks that make their economies especially vulnerable to external shocks." Therefore, sound risk management by the public sector is also essential for risk management by other sectors of the economy "because individual entities within the private sector typically are faced with enormous problems when inadequate sovereign risk management generates vulnerability to a liquidity crisis." Sound debt structures help governments reduce their exposure to interest rate, currency and other risks. Many governments seek to support these structures by establishing, where feasible, portfolio benchmarks related to the desired currency composition, duration, and maturity structure of the debt to guide the future composition of the portfolio.

What is Cash Management and Annual Financial Statement?

Cash management in India is a collaborative effort of the Reserve Bank of India (RBI) and the Budget Division, Ministry of Finance. The RBI acts as the banker to the Government and in this process maintains the Consolidated Fund of India. It also participates actively in the cash forecasting process, which is carried out via negotiations between the Budget Division and the RBI. The Monitoring Group on Cash and Debt Management coordinates this process in its meetings. The RBI uses the Ways and Means Advances, which are short-term (three month) loans to States to smooth temporary mis-matches in revenues and expenditures.

Under Article 112, the Central Government is required to submit an annual financial statement before both Houses of Parliament each year, showing estimated receipts and expenditures for that year. The estimates of expenditure in the annual financial statement fall into two categories: (1) sums required to meet expenditure that the Constitution provides is to be charged upon the CFI and (2) sums required to meet other expenditure proposed by the Central Government.

Under Article 113(1), estimated expenditure charged on the Consolidated Fund of India under the first category is not submitted to the vote of the Parliament, but nothing in Article 113 prevents either house of Parliament from discussing those estimates.

Under Article 113(2), the Lok Sabha shall have the power to vote on "other expenditure", i.e. the second category of proposed expenditure in the annual financial statement.

Once Parliament sanctions grants based on the annual financial statement, an Appropriations Bill is introduced to provide for the appropriation out of the CFI of all monies required to meet these grants and any expenditure charged on the CFI. ❑

Table 3.1: Debt Management Functions of the Central Government

	Front Office	Middle Office	Back Office
Function	Implementation of debt strategy	Strategy formulation	Record keeping etc.
Domestic debt	PDO, RBI, Banks, Post Offices	IDMD, RBI, Budget Division	DGBA and CAS, RBI, CCA(F), MoF
External debt	BC and FB Division of MoF	External Debt Management Unit	CAAA