NATIONAL INSTITUTE of Public Finance and Policy

NIPFP One pager

No. 24

October, 2016

Legislative strategy for setting up an independent debt management agency

Radhika Pandey, Consultant, National Institute of Public Finance and Policy, New Delhi. Email: radhika.pandey@nipfp.org.in
Ila Patnaik, Professor, National Institute of Public Finance and Policy, New Delhi. Email: ila.patnaik@nipfp.org.in

Every government requires an institutional arrangement for its borrowing and debt management. The borrowing of the government, i.e. the sale of bonds, is enabled by a capable bond market. To the extent that the bond market is liquid and has wide ranging participation, it becomes easier for the government to obtain low cost financing. Just as resource-raising of a private firm has an 'investment banker' for advice and then execution, resource-raising for governments has a 'public debt manager' for advice and issuance.

In India, RBI has traditionally been the public debt manager for the Government. RBI owns or controls bond market infrastructure (exchange, clearing house and depository), and also regulates the bond market. Historically, RBI managed government debt on paper based ledgers. However, following a scam in the government securities market in 1992 and recommendations by an RBI Committee on Repurchase Agreements, RBI set up an electronic ledger for holding government securities. This ledger, the Securities General Ledger, was legally mandated to be the only depository for government securities through the Government Securities Act. The Act gave RBI exclusive powers to oversee, govern and regulate participation in the depository. The RBI also set up a trading platform for government securities that was based on an order matching system known as NDS-OM and helped banks set up CCIL, a bank owned clearing and settlement system on which G-Secs could be settled.

In its role as overseer of the G-Sec market, RBI also acquired powers to regulate the G-Sec spot market through a carve-out created through a government notification under Securities Contracts Regulation Act. In 2006 it was given additional powers to regulate derivatives on government securities, through an amendment to the RBI Act by adding a chapter (Chapter III-D) giving it these powers. The amendment mandated that all derivatives transactions on G-secs will be legal only if they are undertaken by RBI regulated entities. The amendment gave powers to RBI to issue directions to agencies dealing in Government securities. These steps ensured that RBI had full supervisory powers over any entity that participated in either G-sec markets or in their derivatives.

In this period, RBI did not have a clear objective, as was emphasised by the preamble of the RBI Act which described the agency as a 'temporary provision'. This arrangement came under question from two points of view. On one hand, securities markets underwent legal and institutional reform that improved their market infrastructure and regulatory capacity. In parallel, the objective of inflation targeting was gaining currency as the predominant objective of RBI. This repeatedly led to the proposal that the debt management work, which conflicts with monetary policy, be placed in an independent Public Debt Management Agency, and the bond market be merged into securities markets. In this paper we describe the legislative aspects of implementation of the PDMA. We work out the intricacies of a PDMA Act which establishes the PDMA as an agency, and merges the bond market with securities markets.

Existing thinking on the subject, such as the Financial Sector Legislative Reforms Commission, assumes a clean slate in which the PDMA is created as an agency and a unified financial market system is enacted at one go. We work out the complexities of amending existing laws, without the assumption of a clean slate. We also work out the issues of sequencing through which the existing institutional arrangements are transitioned into the new arrangements. In light of some recent developments[1] towards setting up of a PDMA, this paper is useful as laying the groundwork for implementing the PDMA reform.

The establishment of PDMA would yield numerous gains for the Indian macroeconomic and financial system. It would free RBI of the conflict of interest of performing debt management work for the central and state governments. It would yield low cost financing for government debt. It would result in development of the bond market by harnessing the capabilities of the securities market infrastructure. Finally it would yield improvements in government borrowing programme by selling bonds to voluntary buyers in a deep and liquid government bond market.

References

Pandey, Radhika, Ila Patnaik (2016). "Legislative strategy for setting up an independent debt management agency", NIPFP WP No. 178.

[1]See http://finmin.nic.in/the_ministry/dept_eco_affairs/budget/setting_PDMC_Cell_Budget_Division.pdf