Chapter 4

Debt Management Strategy

4.1 Introduction

A debt management strategy is a plan that operationalizes the debt management objectives. It lays down the desired composition of the public debt portfolio, which captures the government's preferences with regard to a cost-risk trade-off. A debt management strategy has a longer focus than a borrowing plan, and is essentially an iterative process to define the government's optimal funding sources, based on its risk tolerance, the stage of development of domestic financial markets, the ability of the government and the private sector to obtain external funding, and the country's stage of economic development.

A public debt management strategy document contains description of the market risks being managed, the future environment for debt management, including fiscal and debt projections. It should also describe the analysis undertaken to support the recommended debt management strategy and indicate the adopted strategy and its rationale, with specific targets and ranges for key portfolio risk indicators and the financing programme over the projected horizon.

A risk management framework is developed to enable debt managers to identify and manage the trade-offs between expected cost and risk in the government debt portfolio. To assess risk, debt managers should regularly conduct stress tests of the debt portfolio on the basis of the economic and financial shocks to which the government - and the country more generally - are potentially exposed. The stress testing framework should consider the interrelations among the variables that affect public debt dynamics and cover extreme scenarios to better assess the costs and risks associated with the debt portfolio.

A debt management strategy is generally for a medium term, i.e., three to five years. Further, it is seen that a medium term debt management strategy formulated for achieving the longer term debt management objectives, should be reviewed periodically to assess the validity of the assumptions in the light of changed circumstances. This is all the more important where the debt is predominantly long term. It can be seen that nearly 70 *per cent* of the outstanding public debt of India as on 31 March 2015 had residual maturity period of more than five years extending upto 30 years as shown in **Table 4.1** below pointing towards the criticality of formulation of debt management strategy in India**.**

Table 4.1: Maturity Profile of Outstanding Dated Securities-Union Government

Residual Maturity	Percentage of dated securities
Less than 1 year	**3.5**
1-5 Years	**21.4**
5-10 Years	**31.4**
10-20 Years	**30.6**
20 years and above	**13.1**

(*Source: Quarterly Report on PDM, MO, DEA*))

4.2 Formulation of Medium Term Debt Management Strategy and Risk Management Framework

Audit observed that although some of the elements of a debt management strategy such as roll over risk, projected cash flows and government market borrowing for six months, elongation of maturity, issuance of debt instruments with variable coupons, revision in the upper limit of maturity buckets and individual securities and usage of cash balances, were discussed in the six monthly meetings of the Monitoring Group on Cash and Debt Management (MGCDM)[2], medium term debt strategy (MTDS) was not formulated till December 2015. Audit further observed that some of the elements of debt management strategy, namely, description of the future environment for debt management; specific targets and ranges for key risk indicators; assessment and management of risks associated with foreign currency and policies related to management of external debt vulnerabilities, were not discussed/analyzed in the meetings of the MGCDM.

Audit observed that although refinance risk (roll over risk) and interest rate risk were discussed in MGCDM meetings, Risk Management Framework was not formulated. Audit further observed that the expected cost of debt was not being projected forward over the medium to long term, exchange rate risk was not considered and stress tests were not being conducted.

It was stated in the Status Paper[3] (December 2014) that 'there is little consensus with regard to a level of debt that may be considered unsustainable'. While it may be true that there is little consensus even among international organizations on the acceptable levels of debt in the country, it is felt that every country, including India, should work out the level and type of debt

[2] MGCDM consisted of Secretary (DEA), Deputy Governor (RBI) and other Officers from DEA and RBI.
[3] Status Paper presents an analysis of the Government's debt position and is brought out by the DEA annually.

that is acceptable to them on the basis of analysis of the fiscal, economic, financial and other parameters applicable to them and also work out indicative levels of debt and debt indicators, so that the conclusion on the sustainability of the government debt may be verifiable.

In December 2015, DEA brought out a Debt Management Strategy for India for a period of three years (2015-18). In the Debt Management Strategy document, issues related to raising debt at low cost, risk mitigation and market development had been delved upon. The document contained strategic benchmarks for certain items like share of short term debt, average maturity of debt, issuance limits, indexed and floating debt and share of domestic to external debt. The Debt Management Strategy also contained a Risk Management Framework presenting risk analysis and stress testing. While this is a welcome step, the scope of the Debt Management Strategy was restricted only to the marketable debt of Union Government.

In the Exit Conference, DEA stated that most of the external debt were concessional and were backed by other considerations of bi/multi-lateral co-operation, agreements etc; it did not seem appropriate to bracket them under the category of 'borrowing' and include them into debt management strategy.

The reply of DEA needs to be seen in light of the fact that the borrowings from IBRD and ADB which accounted for nearly 31 *per cent* of the total external borrowing as on 31 March 2015 were not on concessional terms. Further, external borrowing, whether concessional or not, is subject to exchange rate risk which needs to be managed through a well-thought out strategy.