Executive Summary

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1. Introduction

Public debt is the total financial obligations incurred by the entire public sector of a nation, including guarantees and implicit debt. Public debt would include obligations evidenced by a legal instrument issued by the Central, State, Municipal, or Local Government or Enterprises owned or controlled by the Government; and other entities considered public or quasi public. Public debt management is the process of establishing and executing a strategy for managing public debt in order to raise the required amount of funding at the desired risk and cost levels.

India, like most of the developing countries, seeks to grow its economy as also to expand social services to its citizens. This raises large financing needs on the country resulting in excess of expenditure over non–debt receipts, termed as fiscal deficit. The fiscal deficit is sought to be plugged by borrowing, which adds to the country's outstanding debt stock. The shortfall is met either by internal or external borrowing contracted on the security of the Consolidated Fund of India or by the use of surplus fund in the Public Account. In the budget documents, internal debt and external debt together are referred to as 'Public Debt'.

Internal debt refers to rupee–denominated debt, consisting of marketable securities (dated securities, treasury bills) and non-marketable securities (14 days Intermediate Treasury bills, compensation and other bonds, securities issued to international financial institution etc.).

External debt refers to the debt raised by the Union Government from non-domestic sources, namely, multilateral institutions like the International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), Asian Development Bank (ADB) etc. In addition, external debt was also contracted from bilateral sources, i.e., directly from the foreign countries.

In India, the function of public debt management in respect of internal debt was performed by Budget Division of the Department of Economic Affairs (DEA) of the Ministry of Finance (MOF) along with the Internal Debt Management Department (IDMD) of Reserve Bank of India (RBI). In respect of external debt (Multilateral and Bilateral), the various divisions of the DEA like the Multilateral Relations (MR), Bilateral Cooperation (BC) and Multilateral Institutions (MI) performed the function of debt management. They were also supported by the Controller of Aid, Accounts and Audit (CAAA). The Chief Controller of Accounts, Ministry of Finance maintained accounts for both internal and external debt.

The performance audit on Public Debt Management was conducted as public debt constituted a significant portion of the receipts of the Union Government. Further, such an audit would help policymakers to understand the risks of public debt, make their operations more effective, increase the efficiency of internal administrative processes and also enhance public debt transparency and accountability. Moreover, the frequency and severity of debt crises across the world and the consequent adverse impact on managing of public finances reinforces the need for promoting responsible lending and borrowing behaviours.

The total outstanding public debt of India as on 31 March 2015 was ₹ 51,04,675 crore of which ₹ 47,38,291 crore (92.82 *per cent*) was internal debt and ₹ 3,66,384 crore (7.18 *per cent*) was external debt. The repayment of principal and the payment of interest of the contracted debt is together termed as debt servicing. In 2014-15, 77 *per cent* of the long term internal borrowings and 73 *per cent* of the external borrowings were utilized for debt servicing implying that a larger percentage of debt was being used for debt servicing which in turn meant lower percentage of debt taken was available for meeting developmental expenditure to promote growth which is one of the reasons for contracting debt.

(*Chapter 1*)

2. Legal Framework

The legal framework provides strategic direction, defines and clarifies powers and supports professionalism and operational focus in public debt management and promotes good governance by establishing accountability for managing the government's debt liabilities. As per international best practices, the legal framework of public debt management should provide for authorization by Parliament to the Executive and the debt management unit to borrow, include the borrowing purposes and the debt management objectives, provide for the formulation of debt management strategy and indicate the reporting requirements to ensure accountability of the executive to the legislature.

The existing legal framework for the management of public debt in India is contained in the Constitution of India and in various primary and secondary legislations like RBI Act, 1934, Public Debt Act, 1944, FRBM Act, 2003, FRBM Rules, 2004, Government Securities Act, 2006 etc. The existing legal framework does not define the term 'Public Debt', does not indicate the objectives of public debt and the borrowing purposes and also does not require the formulation of a debt management strategy.

(*Para 2.3.1& 2.3.2*)

As per Rule 3 (4) of FRBM Rules, 2004, no additional liabilities could have been assumed in 2013-14 or thereafter. This provision was inconsistent with the target of 3 *per cent* of GDP for fiscal deficit provided in Rule 3 (2) of FRBM Rules, 2004.

(*Para 2.4)*

3. Organizational Framework

A number of expert committees set up in India over the past two decades had recommended the establishment of a separate Public Debt Management Agency (PDMA). Though a PDMA was not set up, a separate Middle Office (MO) was established in September 2008. No further progress has been made on the setting up of a separate PDMA till date.

The responsibilities of the MO, among other things, included formulation of comprehensive risk management framework, formulation of a long term debt management strategy and developing and maintaining a centralized database on Government liabilities. However, these activities were not performed by the MO. Some of these functions were, however, discharged by other agencies.

(*Paras 3.2 & 3.4)*

In respect of external debt (bilateral and multilateral), the MO functions, namely, undertaking risk analysis and monitoring reports on portfolio-related risks, and assessing the performance of debt managers against any strategic targets/benchmarks, were not being performed by any entity.

(*Para 3.3)*

4. Debt Management Strategy

A debt management strategy is a plan that operationalizes the debt management objectives. It lays out the desired composition of the public debt portfolio, which captures the government's preferences with regard to a cost-risk trade-off.

DEA brought out a Medium Term Debt Strategy (MTDS) for the first time in December 2015 which included risk analysis and stress testing but its scope was restricted to the marketable debt of the Union Government only. Previously, some of the elements of debt management strategy were discussed in the meetings of the Monitoring Group on Cash and Debt Management (MGCDM) but MTDS had not been formulated.

(*Para 4.2)*

5. Borrowing Activities

The borrowing activities envisage all the activities from the estimation of the required borrowing to the actual borrowing of fund either from the domestic markets or from the external markets.

The budget division, DEA, MOF is responsible for preparation of budget estimates (BE) and revised estimates (RE) in respect of internal borrowings, external borrowings and other receipts on the basis of inputs received from RBI, CAAA and other departments.

The borrowing calendar for market borrowings is prepared half–yearly on the basis of the estimates of market borrowing, cash inflows, cash outflows and the likely funding-gap of the Union Government. The borrowing calendar indicated the amount of securities to be issued through weekly primary auctions during the ensuing half year and is issued with the approval of the MGCDM.

During the period from 2009–10 to 2014–15, the variation between the actual external borrowing and the revised estimates of external borrowing as per the budget ranged between (-)33 *per cent* and 225 *per cent.*

(*Para 5.3)*

Primary auctions of government securities were conducted on the E–Kuber platform by RBI. A system of underwriting for market lending operated in the government securities markets in India through the mechanism of Primary Dealers (PDs). The Auction Committee in the RBI decided the cut-off price/yield and the securities, if any, to be devolved upon the underwriters.

There were no criteria for deciding particular issues wherein securities were to be devolved on the underwriters. There were also no criteria for deciding the cut–off rate or the reasons for deciding a particular cut-off rate. Subsequently RBI informed (May 2016) that a policy on devolvement criteria had been prepared which *inter alia* incorporated the factors to be considered for arriving at the devolvement decision.

(*Para 5.2)*

In respect of external borrowing, DEA is the nodal agency for posing projects to WB, ADB and the IFAD. The proposals for external assistance to be posed to WB, ADB and IFAD were decided by the Screening Committee in the DEA constituted in August 2009.

'Finance Plus' criteria were instituted (September 2011) to maximize access and leverage of Multilateral Financial Institutions' (MFIs')/Multilateral Development Banks' (MDBs') knowledge base, international experience and familiarities with best practices making the best use of limited available external resources. Since September 2011, a total of 82 proposals for obtaining external loan assistance were approved by the Screening Committee. But in 60 of the approved proposals, the minutes of the Screening Committee did not indicate whether knowledge transfer, technology transfer and best practices transfer from international experience were considered.

(*Para 5.4)*

RBI is entrusted with the cash management of Government of India which they perform in co-ordination with the Ministry of Finance, Government of India. Cash management mainly entails cash flow forecasting, arranging temporary liquidity, maintaining target balance in the Government account, investment of surplus balance over and above the target balance in the market etc.

The mismatches between inflow and outflow in Government account are managed by cash management instruments, viz. treasury bills and further fine tuned through availing Ways and Means Advances/Overdraft and issuing Cash Management Bills (CMBs). Ways and Means Advances (WMA) are the advances made by the RBI to the Government. Limits on the WMA are fixed on a half yearly basis. Overdraft (OD) is similar to WMA and can be resorted to for maximum 10 days at a stretch, when limit of WMA is crossed.

During the period from 2010 to 2015, in at least 40 weeks in each year, the variations between the weekly projected cash balance and the actual cash balance were more than ₹ 10,000 crore. In many instances, the projection of the weekly cash balance was negative.

(*Para 5.5.1)*

Cash Management Bills were introduced in 2009 to meet temporary cash flow mismatches of the Government. During August and September 2013, Cash Management Bills were issued to the extent of ₹ 96,000 crore for meeting monetary policy objectives.

(*Para 5.5.2.1)*

6. Debt Information System, Debt Servicing and Debt Reporting

Debt management activities should be supported by an accurate and comprehensive information system with proper safeguards. The information system should comprise of components that capture, monitor, analyse and report debt information of a country. A Public Debt Information System should support recording, reporting and analytical functions.

RBI uses E-Kuber for primary auctions of dated securities and treasury bills, debt service payments and generating various reports for internal debt. In respect of external debt, Integrated Computerised System (ICS) is used for maintaining various ledgers and registers relating to each loan/grant, debt servicing and generating various reports. E-Kuber and ICS did not have the provision for analytical functions.

(*Para 6.1.1)*

A centralized database on all internal and external liabilities of the government was not available. The information in respect of internal debt and external debt was, however, available in RBI and in the Office of the Controller of Aid, Audit and Accounts respectively.

(*Para 6.1.3)*

Commitment charges on undrawn balance of external loans are paid on the amount of principal rescheduled for drawal on later dates. During the period from 2009-10 to 2014-15, commitment charges to the extent of ₹ 602.66 crore were paid.

(*Para 6.2.1)*

The figures of internal debt presented in different documents such as Status Paper and Indian Public Finance Statistics published by Government of India did not agree with those in the Finance Accounts of the Government of India.

(*Para 6.3.2)*

7. Government Securities Market

One of the objectives of Public Debt Management is to develop a liquid market. Developing a liquid and vibrant secondary market for government securities and broadening the investor base are the key factors to ensure that debt is raised in a cost effective manner. Further, the government securities market (GSM) provides the benchmark yield and imparts liquidity to other financial markets and is considered an essential precursor, in particular, for development of the corporate debt market. Moreover, government securities market acts as a channel for integration of various segments of the domestic financial market and helps in establishing inter linkages between the domestic and external financial markets.

Trade in dated Government securities in the secondary market was predominantly taking place in a few securities with the top ten securities accounting for more than 90 *per cent* of the trading volume of government securities.

(*Para 7.3)*

A scheme of non-competitive bidding for allocation of upto 5 *per cent* of the notified amount in the specified auctions of dated securities was introduced in January 2002 to encourage small and medium investors to participate in the primary auction. However, the total amount of bids received and accepted during 2009 to 2015 from small and medium investors ranged from 0.30 *per cent* to 0.47 *per cent* of the notified amount.

(*Para 7.4)*

8 Recommendations

- Legal framework, consisting of both the primary as well as secondary legislation, may include the definition of public debt, debt management objectives, borrowing purposes, and requirement of debt management strategy. DEA may consider doing this in a phased manner.
- Conditions of 'Finance Plus' criteria aimed at maximizing access and leverage of Multilateral Financial Institutions'/Multilateral Development Banks' knowledge base, international experience and familiarity with best practices may be applied in deciding on the projects for external assistance and the same should be properly documented.
- A centralized database of internal debt, external debt and other liabilities may be developed.
- Steps may be taken to ensure that the public debt information systems used (E-Kuber and ICS) support analytical functions.
- Mechanism may be developed to ensure consistency in the reporting of public debt by RBI and DEA and amongst the various divisions of DEA.