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Sovereign Debt Management and Monetary Policy in India: An Empirical Investigation of Conflict of Interest Argument

The Reserve Bank of India today placed on its website a Working Paper titled "[Sovereign Debt Management and Monetary Policy in India: An Empirical Investigation of Conflict of Interest Argument](#)". The paper has been written by Shri Sunil Kumar and Shri N.R.V.V.M.K. Rajendra Kumar.

The separation of sovereign debt management (SDM) from Reserve Bank of India (RBI) has often been suggested based on the conflict of interest argument. The main thrust of this argument is that cost minimisation for government's market borrowing programme might be deterring the Reserve Bank from increasing the interest rates and in the process it might be compromising its core mandate of price stability. Against the above backdrop, this paper attempts to verify empirically the tenability of this argument in the case of India.

This paper estimates the augmented monetary policy reaction function in a VAR framework, taking monthly data from April 2004 to December 2011 and then with quarterly data from 2000:Q1 to 2011:Q4 to corroborate the results of estimation with monthly data. It is found that that level of government market borrowing does not explain the statistically significant portion of forecast error variation of the policy operating target rate. Further, the results of Impulse Response Function (IRF) demonstrate that response of policy operating target rate to one Standard Deviation (SD) innovation in the government market borrowing remains statistically insignificant. Moreover, the VAR Granger Causality results find that government market borrowing does not Granger cause the policy operating rate. Hence, the results of all tests in VAR -show that the response of the policy operating target rate to the Government market borrowing is not statistically significant and hence, it can be inferred that the quantum/ size of the government market borrowing is not influencing the policy rate decisions of the RBI. Therefore, it may be concluded that the aforementioned conflict of interest argument is not tenable in the Indian context. In the above backdrop, the separation of SDM from Reserve Bank to a Public Debt Management Agency, for which the process is already underway, could be justified by other policy imperatives, if any, but not by conflict of interest argument.

The Reserve Bank of India introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of RBI and are disseminated to elicit comments and further debate. The views expressed in these papers are those of authors and not that of the Reserve Bank of India. Comments and observations may kindly be forwarded to authors. Citation and use of such papers should take into account its provisional character.