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FRBM Act and Indian Fiscal Consolidation

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ABSTRACT

Fiscal consolidation refers to the policies undertaken by the government to reduce all types of budget deficits and reduce debt burden. Fiscal Deficit and Revenue Deficit are the key deficits of the budget. The FRBM act was enacted to enforce fiscal discipline and reduce expansionary fiscal policies. The act sets phased targets for fiscal and revenue deficit reduction. The targets to be achieved in 2008 were relaxed due to global recession. However, there has been increased concern over expanding deficit. It is realized that urgent requirement arises for strict adherence to FRBM norms and improving fiscal health of the country. In this light, this paper seeks to assess the budget deficits in the last two decades.

Keywords
Fiscal Policies, FRBM Act.

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1. Introduction

Fiscal health is one of the most important indicators of how well the economy is doing. The Macroeconomic Vulnerability Index (MVI) consists of Fiscal deficit, Current Account Deficit and Inflation. Twin Deficit includes Current Account Deficit and Fiscal Deficit. A high value of both of these, indicate economic vulnerability and possibility of crisis. Therefore it is utmost important to contain the budgetary deficits.

Revenue deficit (RD) indicates the deficit in the revenue account of the budget. It is the gap between revenue receipt and revenue expenditure of the revenue account. It indicates a regular consumption type of expenditure which does not lead to asset creation. While, revenue receipts are income of the government that do not create any liabilities on the government. That's why a non- asset creating deficit is not desirable. RD leads to an increase in the borrowings and liabilities of the government, that result into interest payment burdens that further leads to increasing revenue expenditure and thereby a higher revenue deficit. Thus, the objective of fiscal consolidation is to reduce and wipe out revenue deficit and thereafter create revenue surplus. A revenue surplus situation, certainly provides the fiscal space to increase productive capitalexpenditure.

Fiscal Deficit (FD) is the most important indicator of fiscal health of the economy. It shows the real gap between the government's total expenditure and total revenue in a fiscal year. It is the total amount of borrowings and liabilities which are needed by the government to meet its total expenditure in a fiscal year. In India, Fiscal Deficit is the largest of all deficits measured in thebudget.

Primary Deficit (PD) was introduced by then FM Dr. Manmohan Singh in 1991. Interest payment is an item of the nature that is being paid in the current financial year. It is the debt service payment of a debt taken prior to the current fiscal year. Therefore, primary deficit is the deficit in the budget for which the current year is primarily responsible. It excludes ineterst payment on loans.

2. FRBMAct

Implementation of Fiscal Responsibility and BudgetManagement (FRBM) legislation at national as well as at sub- national levels in India during the period 2005-10 helped both the Union and the States to achieve considerable correction in their respective fiscal position, which was weak prior to 2005. The global slowdown in 2008-09 and 2009-10 however adversely affected the achievement of targets specified in the legislation. The Thirteenth Finance Commission (FC-XIII) had proposed a roadmap of fiscal consolidation for both centre and states. It aimed at reducing FD to 3% of GDP and eliminate RD completely. The target was revised again and again. The recent N.K. Singh committee has set the target for 2022-23 as Fiscal Deficit 2.5% of GDP and Revenue Deficit to be 0.8% of GDP.

3. Calculation ofDeficits

- FD = Total Expenditure – Total Receipts (excluding borrowings andliabilities)
- RD = Revenue Expenditure – RevenueReceipts
- PD = Fiscal Deficit – interestpayments

4. Deficits in the pastdecades

Table 1: Deficits as percentage of GDP

Year	Revenue Deficit	Fiscal Deficit	Primary Deficit
2000-2001	4.1	5.7	0.9
2001-2002	4.4	6.2	1.5
2002-2003	4.4	5.9	1.1
2003-2004	3.5	4.3	0.0
2004-2005	2.4	3.9	0.0
2005-2006	2.5	4.0	0.4
2006-2007	1.9	3.3	-0.2
2007-2008	1.1	2.5	-0.9
2008-2009	4.5	6.0	2.6
2009-2010	5.2	6.5	3.2
2010-2011	3.2	4.8	1.8
2011-2012	4.4	5.7	2.7

2012-2013	3.6	4.9	1.8
2013-2014	3.1	4.4	1.1
2014-2015	2.9	4.1	0.9
2015-2016	2.5	3.9	0.7
2016-2017	2.1	3.5	0.4
2017-2018	2.6	3.5	0.4
2018-2019 **(B.E)**	2.2	3.3	0.3
2018-2019 **(R.E)**	2.2	3.4	0.2
2019-2020 **(B.E)**	2.2	3.4	0.2

Source: Budget Document, Ministry Of Finance (compiled by author)

A close look at the table reveals that Fiscal Deficit was highest in 2009-10 (6.5%). It is because the government adopted a stimulus package to provide for the losses of global recession and to resist its impact. Subsequently, it has reduced very steadily, not conformimg to FRBM targets. In the latest interim budget (2019-20) the FD is pegged at 3.4% (still higher than the target of 3 %). The Revenue Deficit was 1.1% in 2007-8, just before the crisis. But after that it rose to more than four times. Now it is just double (2.2 %) of what it was before crisis. The FRBM dream of zero RD could not be realized and it is not expected to be eliminated by 2022-23. Primary Deficit has been falling consistently since 2011-12. It was negative during crisis period. A negative PD is a more serious situation because it means that the amount of interest payment is more than total expenditure (excluding borrowings and liabilities). If there were no interest payments there would have been a fiscal Surplus.

5. Conclusion

More than a decade has passed since India adopted fiscal consolidation rules. The Central Government has not adhered to fiscal rules mainly due to the crisis of 2008. In this context, a question as to strict fiscal rules arises. In view of the changing circumstances in the economy, probably, there is a need for a regular and constant review of the fiscal policy and targets contained in FRBM, as the economy has become highly dynamic in face of massive globalisation. It is to be noted that there are strong preconditions needed for strict fiscal compliance. Robust forecasting of fiscal and monetary indicators that will help improve fiscal marksmanship, a strong focus on fiscal prudence, assessment of productivity of government expenditure, avoidance of any form of fiscal engineering, establishment of a long-term fiscal policy with a medium-term intermediate target system, emphasis on government investment rather than spending and separation of debt and monetary management will be instrumental in the effective and efficient operation of FRBM Act.

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