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A Review of the FRBM Act

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Abstract

The Fiscal Responsibility and Budget Management Act (FRBMA), 2003 sets fiscal rules that seek to foster fiscal discipline on the Central Government and achieving a balanced budget with effective revenue management. The Act sets targets and suggests means of reducing fiscal and revenue deficits. It has however, had limited success. The targets that were to be achieved by 2008-09 were relaxed because of financial crisis of 2008. However, strict implementation of FRBMA has been a matter of concern. This paper notes that there is an urgent requirement for greater transparency in budget preparation, making the medium-term framework more binding and greater capacity building on the part of government to promote budgetary and debt management institutions.

Keywords: FRBMA, Medium-Term Framework, Effective Revenue Deficit, Balanced Budget

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I. Introduction[2]

Fiscal Responsibility and Budget Management Act (FRMBA) was introduced in Parliament as the FRBM Bill in December 2000 with the intention of fostering fiscal discipline; efficient management of expenditure, revenue and debt; and achieving a balanced budget.

While the Act was passed on August 26, 2003, FRBMA was brought into effect from July 5, 2004. The objectives of FRBMA were elimination of revenue deficit by 2008-09 and reduction of fiscal deficit to no more than 3 per cent of GDP at the end of 2008-09. However, global financial crisis led the government to infuse resources in economy as fiscal stimulus in 2008 and therefore fiscal targets had to be postponed temporarily in view of the global crisis. Later, the Budget for 2012-13 introduced amendments to FRBM Act.[3] The Central Government introduced a medium-term fiscal adjustment road map on March 16, 2012 to improve fiscal situation at federal level. The concept of effective revenue deficit was introduced, which excluded grants to states for creation of capital assets from conventional revenue deficit.[4] The second important feature was the introduction of provision for 'Medium Term Expenditure Framework Statement' in the FRBMA. This medium-term framework provides for rolling targets for expenditure, imparting greater certainty, and encourages prioritization of expenditure.[5]

The implementation of FRBM Act has been stalled four times since its enactment in 2003. With more than a decade of experience, including regular pauses, there was a critical need to evaluate the implementation of provisions of FRBMA. Since FRBMA enactment in 2003, its role has been discussed continuously in controlling fiscal and revenue deficit. Recently, a special FRBM Committee submitted a report on its findings to the Finance Minister.[6] Finally, the report was made public in April 2017.

The Preamble to the FRBM Act 2003 sheds light on some of its key features. The Act seeks to achieve long-term macroeconomic stability, while generating budget surpluses, prudential debt

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[2] The authors have benefitted from the discussions in the module on 'Fiscal Responsibility and Budget Management Act' of the 11th Annual Conference on Public Policy and Management at IIMB on August 8, 2016 and in the 'National conference on Issues in Public Economics and Policy' at NIPFP on March 24, 2017.

[3] Singh, 2013, p. 23.

[4] This was an important development for the reason that while the revenue deficit of the consolidated general government fully reflected total capital expenditure incurred, in the accounts of Centre; these transfers were shown as revenue expenditure. Therefore, the mandate of eliminating the conventional revenue deficit of centre became problematic. With this amendment, the endeavour of the government under the FRBM Act was to eliminate the effective revenue deficit (GoI, 2013).

[5] Singh, 2013, p. 23.

[6] The Committee (Chairman: N.K. Singh), set up in May 2016, submitted Report in January 2017.

management, limiting borrowings to cut down deficits and debt, greater transparency, removal of fiscal impediments and providing a medium-term framework for budgetary implementation.

The scheme of the paper, after this brief introduction, has six sections. Section II briefly reviews literature on the FRBMA. Section III examines cross-country experiences and Section IV highlights historical developments pertaining to FRBMA. Section V discusses the need for review of the Act, and Section VI presents trend analysis. Finally, Section VII concludes the paper with certain recommendations.

II. Review of Literature: Select Studies

Chelliah (2004) observed that Task Force (TF) Report, 2004[7] attempted to tackle implementation of FRBMA through a revenue-led effort. While the TF report suggested that revenue deficit should be reduced to zero by increasing revenues, it failed to take into account that fiscal deficit could still be high. It was also suggested that debt dynamics should factor in implementation scheme of FRBMA. Finally, base scenario adopted by TF, assumed 'business as usual' as status quo, which, as a critique, cannot be considered.

Lalvani (2009) argued that despite focus on growth preceding any implementation of fiscal rules (given the 2008 financial crisis), structure and direction of expenditures have failed to abide by targets even when growth targets were met. A set of "Second Generation Fiscal Rules" that would take current inadequacies into consideration and consolidate on the experience with fiscal rules since 2004 would be beneficial. A suggestion to give powers to Comptroller and Auditor General to act as a Fiscal Council for better enforcement of rules was also made. In opposition to implementation of fiscal rules, EPW Research Foundation (2009) argued that fiscal constraints have overburdened the monetary policy and banking sector, to encourage create a stimulus package for the economy due to extraordinary circumstances, because of financial crisis of 2008.

The rationale of FRBMA was to serve as a deficit management tool of the government as these deficits were seen as factors that were leading to fiscal indiscipline, higher debt, spillover into monetary policy, and higher inflation. The Government has been making efforts in raising financial resources through disinvestment and reduction in expenditure, mainly in case of capital goods. CBGA (2007) assessed the impact of this deficit management on the public policy paradigm of the country. Fiscal rules had made in-roads into debt management and

[7] Task Force Report on Implementation of FRBM Act, 2004 (Chairman: Dr. Vijay Kelkar).

monetary policy as Khan (2014) explained that FRBMA had prevented conflict of interest in monetary policy and debt management by not allowing RBI to participate in primary auctions of government securities.

Reddy (2008) observed that despite the positive effect of FRBMA, it led to expansion of off-budget liabilities which could be detrimental to debt and monetary management, a thought that was also mirrored in Dholakia, Khundrakpam and Gajbhiye (2009), where the exclusion of off-budget liabilities, market stabilisation scheme, and usage of national small savings fund to finance deficits of states were key reasons for discrepancy in fiscal deficit and debt movement. These discrepancies were also highlighted by GOI (Fourteenth Finance Commission, 2014) where expansionary fiscal policy in 2008-09 had led to subsequent decline in fiscal health of the Union Government. The Fourteenth Finance Commission proposed that FRBMA be replaced by a Debt Ceiling and Fiscal Responsibility Legislation at both Centre and State levels. The Commission also recommended need for an independent fiscal council and governmental fiscal roadmap.

In recent past, according to Dholakia (2014), Central Government appeared to chart a path for fiscal consolidation and achieve revised targets of FRBMA. Mohapatra (2014) makes an interesting suggestion that the targets for reduction of fiscal deficit as a percentage of GDP must not be the only measure, as reduction in absolute figures of fiscal deficit can help arrive at desired results.

Misra and Khundrakpam (2008) find that key deficit indicators improved because of high growth rate which led to improved revenues. Uncertainty in award of sixth pay commission, debt waiver and debt relief schemes, and policy changes with regards to oil and petroleum products had not been factored in the estimation for the medium-term outlook. Authors also noticed that the fiscal consolidation process of both centre and state remained inadequate on several fronts and fiscal outlooks based on potential lower growth rates had been made. Pattnaik (2016) conferred with the view that quality of fiscal adjustments has been poor at both centre and state. However, state governments were found to be more responsible in eliminating Revenue deficit compared to Central Government.

Limitations of FRBMA are due to absence of a mechanism that has incentives in achieving the targets (Buiter and Patel, 2012). New rules of FRBMA type need to bind the government to its medium-term fiscal plan but must also allow for government discretion during difficult times.

The authors concluded that an incentive framework that rewards and punishes Centre and states' fiscal performance may be incorporated in India's macroeconomic management.

III. Cross Country Experience

Advanced countries around the world have begun adopting budgetary management and fiscal responsibility laws since the turn of the century. Illustratively, Australia, Brazil, Canada, Mexico, Republic of Korea, United Kingdom and the United States have all established budget management offices with varying levels of parliamentary oversight.

However, fiscal responsibility legislation and rules adopted by emerging markets are considered to be legally and administratively frail when compared to advanced countries. This has in turn helped emerging economies to raise taxes and reduce spending during recessions and lower taxes and increase spending during booms, which has resulted in procyclical fiscal policy.[8]

It is important to note that emerging market economies have adopted fiscal responsibility and budgetary management for the following two reasons: - a) Rising debt and interest costs; and b) Strengthening liberalization reforms. As Berganza (2012), and Blondal and others (2009) note, Latin American and South Asian emerging economies adopted fiscal rules during debt distress while East European and African nations adopted fiscal rules for strengthening of liberalization reforms.

3.1. Australia

The Fiscal Rules over the Parliament's 3-year term (trilogy) was adopted in 1985-86 with commitments of Not to raise tax revenue as a share of GDP; not to raise government expenditure as a share of GDP; and reduce budget deficit in absolute terms and relative to GDP.

The Charter of Budget Honesty Act (CBH), 1998 explains Government's disclosure requirements and principles of sound fiscal management. Based on these sound fiscal management guidelines, the Government Financial Services (GFS) framework for the conduct of government fiscal policy is explicitly stated. The act also mandates regular fiscal strategy statements that include targets for next 3 years, longer-term fiscal strategy and fiscal objectives. The aim of regular updates was to increase fiscal transparency and accountability, by facilitating public scrutiny of fiscal policy and performance. The Act also requires:

[8] Bova et al, 2014, p. 7

- Prudent Management of financial risks faced by the Commonwealth. Hence, the report on Budget Outlook contains a statement of risks that includes contingent liabilities and publicly announced government commitments;
- Preparation of a 5-yearly inter-generational report which assesses sustainability of current government policies over a 40-year period, taking into account financial implications of demographic change; and
- Half yearly fiscal strategy statements released regularly to the public.

The provisions of CBH are divided into two groups, namely a regime for setting fiscal objectives and an extensive system of fiscal reporting to monitor consistency of the government's fiscal actions. Fiscal objectives are set by a two-step process that includes "Principles of Sound Fiscal Management" and an annual "Fiscal Strategy Statement" prepared by the government.[9] A part of the Act pertains to Parliamentary Budget Office (PBO), the purpose of which is "to inform the Parliament by providing, in accordance with this Division, independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals."[10] The Parliamentary Service Amendment (Parliamentary Budget Office) Bill was passed in March 2013. PBO is now required to produce a post-election report on the cost of parties' election commitments. It was also provided with additional funding to implement this requirement and to enhance fiscal policy analysis and costing capabilities.

PBO provides an independent and non-partisan analysis of the budget cycle, fiscal policy, and the financial implications of policy proposals. PBO also prepares mid-year economic and fiscal outlook reports and comprehensive Consolidated Financial Statements for the central government on accrual and cash basis. More than three-quarters of the Commonwealth budget is subject to a standing appropriation. There are however, no annual ceilings for contingent liabilities and it isn't a part of the medium-term expenditure framework.

3.2. Brazil

In the case of Brazil, a Fiscal Responsibility Law was passed in 2000 with no independent fiscal council. The FRL mandated that the President proposes debt limits for federal, state, and municipal governments, while also presenting an extensive fiscal risk statement to Congress annually. The central bank plays an important role in ensuring fiscal responsibility of the Government. But once the year, a provision in Federal Constitution allowing for correction of

[9] Blondal et al., 2008, p. 13
[10] Parliamentary Service Act, 1999.

"errors and omissions" has been exploited by Congress to inflate revenue forecasts, thereby funding additional expenditure.

3.3. Canada

Government of Canada introduced the Federal Accountability Act (FAA) on April 11, 2006 which received the Royal Assent on December 11, 2006. The Act also established a position known as the Parliamentary Budget Office (PBO) who was given the following responsibilities:

- Objective analysis of the nation's finances; Undertake economic and fiscal research; and Estimate the cost of proposals currently or prospectively under consideration in either House.[11]

In a broad sense, the role of the PBO is to analyse national finances, analyse trend in the Canadian economy, and analyse of cost of government.

PBO provides independent assessment of government proposals and forecasts. The Office also ensures that annual financial statements are externally audited. It also publishes the Economic and Fiscal Outlook semi-annually. Fiscal Monitor provides details on Federal Government budget execution on a monthly basis.

3.4. Mexico

Since the enactment of the 2006 Budget and Fiscal Responsibility Law (BFRL), Mexico has created a balanced budget rule. BFRL has developed a formula for arriving at oil prices, it has upgraded the congressional budget approved procedure and it has established funds to stabilize the surplus oil revenues of the country. The central government was facing difficulty to monitor and enforce the fiscal rules, because Mexico's subnational legislations had too many regulations.

3.5. Republic of Korea

The Republic of Korea established the National Assembly Budget Office (NABO) as an independent fiscal agency in 2003. NABO makes independent macroeconomic forecasts and analyzes executive budget proposals and pending legislation. Financial statements are audited, and published by the Board of Audit and Inspection annually and within six months of the end

[11] Fact Sheet of Treasury Board of Canada Secretariat, Government of Canada.

of fiscal year. A National Assembly reviews and amends the executive's proposed budget but only the executive can introduce budget bills.

3.6. United Kingdom

The Office for Budget Responsibility (OBR) was established as an independent fiscal council for the United Kingdom in May 2010 to provide credible analysis of public finance in the UK. There are clear procedures governing Parliamentary oversight of budget, but in practice expenditure and revenue decisions are largely passed with little amendment. A draft finance bill is published three months before the start of the fiscal year and the Government publishes audited Whole of Government Accounts on an annual basis.

3.7. United States of America

Congressional Budget Office (CBO) provides independent forecasts and analyses of fiscal policies for the United States. CBO also presents fiscal options in the form of limits (caps) on discretionary spending to limit the impact of deficit of the Budget Control Act of 2011. But it does not make recommendations on policy. On other hand, the Office of Management and Budget (OMB) makes medium-term macroeconomic and fiscal projections. About two-thirds of federal government spending is authorized by permanent legislation, and thus is not subject to annual review or appropriation in budget process. The Government Accountability Office (GAO), an independent, nonpartisan agency presents financial statements to the Congress.

Escape Clauses in Select Countries

One of the key clauses in any Fiscal Responsibility Legislation (FRL) is an 'Escape Clause' and the nature of the clause makes it one of the hardest and most important to design. The clause validates any breach in implementation and adherence of FRL, often characterised by severe economic crises or natural catastrophes.[12]

FRLs in some countries have numerous escape clauses that give scope for suspension of the legislation under various conditions. These clauses are often vaguely defined to give authorities the leeway to decide what circumstances may be termed as unforeseen. However, in most cases, these clauses can only be evoked through a legislative action.[13]

For the countries listed in this section of the paper, escape clauses can be found in only some cases. In the case of Australia, Canada, Korea, U.S.A. and U.K., there are no well-specified

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[12] Cangiano et al, 2013, p. 90
[13] Kumar and Ter-Minassian, 2007, p. 65

escape clauses.[14] Brazil, however, can suspend the Fiscal Responsibility Law, 2000 if a natural disaster or recession occurs. Article 17 of Mexico's FRL can suspend achievement of fiscal targets in case of an economic downturn.[15]

IV. Historical Developments

In India, fiscal responsibility as a concept has been in public domain since 1958 when Estimates Committee recommended that "performance budgeting should be the goal which should be reached gradually and by progressive stages without any serious budgetary dislocation". The Twentieth Report of this Committee released in April, 1958 also suggested constituting a Standing Finance Committee which would have the authority to scrutinise new items of expenditure before it was to be added to the budget.

The specific timeline of FRBMA is presented in Table 1.

Table 1: Timeline of FRBMA in India and Relevant Developments

Month and Year	Event
January 17, 2000	Sarma Committee on Fiscal Responsibility Legislation constituted by Finance Minister
December 21, 2000	FRBM Bill tabled in Parliament
August 27, 2002	Karnataka FRBM Act enacted by State Government
August 26, 2003	FRBM Act receives assent of President
July 2, 2004	FRBM Rules notified by government under FRBMA
July 5, 2004	FRBMA and FRBM Rules brought into force
July 16, 2004	Task Force Report on Implementation of FRBM Act
March 31, 2006	Date recommended for revenue deficit elimination and reduction of fiscal deficit to 3 percent by Sarma Committee
March 31, 2008	First target date by which revenue deficit had to be eliminated and fiscal deficit reduced to 2 percent of GDP (set by FRBMA)
September 15, 2008	Lehman Brothers files for bankruptcy
March 31, 2009	First target date by which revenue deficit had to be eliminated and fiscal deficit reduced to 3 percent of GDP (set by FRBM Rules)
July 6, 2009	FRBM targets suspended and Act put on hold till negative effects of Global Financial Crisis are overcome
February 28, 2011	Revised fiscal road map for five succeeding years and amendments to FRBMA

[14] Cangiano et al, 2013, p. 105
[15] IMF, 2013, p. 3

May 7, 2013	Amendments to FRBM Rules
March 31, 2015	Fiscal and revenue deficit target set in Budget Speech of 2011-12; Fiscal target date set for elimination of revenue deficit (set by FRBM Rules 2013)
May 14, 2015	FRBM target of March 31, 2015 revised to March 31, 2018
June 25, 2015	Amendments to FRBM Act
May 17, 2016	FRBM Review Committee headed by N.K. Singh constituted
January 23, 2017	FRBM Review Committee submits its Report
March 31, 2017	Fiscal target date by which gross fiscal deficit to be reduced to 3 percent of GDP (set by FRBM Rules 2013)
April 12, 2017	FRBM Review Committee Report released to public
March 31, 2018	First target date by which revenue deficit has to be reduced to 2 percent and fiscal deficit to 3 percent of GDP (set by FRBMA 2015)

Source: Author's Compilation.

In 1963, when Milton Friedman visited India, he advised sustainable deficit financing as a means of powering economic growth without inflation (Centre for Civil Society, 2000). The fiscal situation started deteriorating from 1979-80 onwards when revenue deficit was recorded for the first time in the Union Budget.

India witnessed a severe fiscal deterioration by 1991 when balance of payments crisis forced India to take a loan from the IMF to finance imports. The reforms led to a review of the monetary-fiscal situation.[16] In light of these developments, India's introduction of a kind of fiscal rule dates back to September 1994 when *ad-hoc* Treasury bills that were automatically monetising budget deficit were phased out by the RBI.

The salient features of FRBMA 2003 are presented in Table 2.

[16] Buiter and Patel, 2010; and Rao, 2016

Table 2: Salient Feature of FRBM Act. 2003

Indicators	**FRBM Act 2003 (August 26, 2003)**	**FRBM Rules 2004 (July 02, 2004)**	**FRBM Rules 2013 (May 07, 2013)**	**FRBM Act Amendment 2015 (June 25, 2015)**
Gross Fiscal Deficit (GFD)	Reduce the GFD by March 31, 2008.	To bring down the GFD to not more than 3 per cent of GDP at end of March 31, 2008. To achieve this target of GFD the Central Government shall reduce the GFD by an amount equivalent to 0.3 percent or more of GDP at end of each financial year beginning with financial year 2004-05.	To bring down the GFD to not more than 3 per cent of GDP at the end of March 31, 2017. To achieve this target of GFD, Central Government shall reduce the GFD by an amount equivalent to 0.5 percent or more of GDP at end of each financial year beginning with financial year 2013-14.	GFD not more than 3 per cent of GDP at end of March 31, 2018 with annual reduction by an amount equivalent to 0.4 per cent or more of GDP at end of each financial year beginning with Financial Year 2015-16.
Revenue Deficit (RD)	Reduce RD and eliminate by March 31, 2008. Thereafter build up adequate revenue surplus.	To achieve target of RD by March 31, 2008, Central government shall reduce RD by an amount equivalent to 0.5 percent or more of GDP at end of each financial year, beginning with 2004-05.	To achieve the target of RD by March 31, 2015 Central government shall reduce RD by an amount equivalent to 0.6 percent or more of GDP at end of each financial year, beginning with 2013-14.	RD of not more than 2 percent of GDP by March 31, 2018 with annual reduction by an amount equivalent to 0.4 per cent or more of GDP at the end of each financial year beginning with Financial Year 2015-16.
Liabilities	The annual targets of assuming total liabilities which is a percentage of GDP.	The Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of 9 per cent of GDP for financial year 2004-05 and in each subsequent financial year, the limit of 9 per cent of GDP shall be progressively reduced by at least one percentage point of GDP.	NC	NC

Indicators	FRBM Act 2003 (August 26, 2003)	FRBM Rules 2004 (July 02, 2004)	FRBM Rules 2013 (May 07, 2013)	FRBM Act Amendment 2015 (June 25, 2015)
Contingent Liabilities (Guarantees)	The annual targets of assuming contingent liabilities as guarantees which is a percentage of GDP.	The Central government shall not give guarantees aggregating to an amount exceeding 0.5 percent of GDP in any financial year beginning with financial year 2004-15.	The Medium-term Expenditure Framework Statement should contain a Statement of explicit contingent liabilities which are in form of stipulated annuity payments over a multi-year time-frame.	NC
Effective Revenue Deficit*	NA	NA	In order to achieve target of effective revenue deficit by March 31, 2015, Central Government shall reduce such deficit by an amount equivalent to 0.8 per cent or more of GDP at end of each financial year, beginning with financial year 2013-2014.	In order to achieve target of effective revenue deficit by March 31, 2018, Central Government shall reduce such deficit by an amount equivalent to 0.5 per cent or more of GDP at end of each financial year, beginning with financial year 2015-2016.

Note: * The Finance Act of 2012 amended section 2 of the FRBM Act and inserted the following statement- “effective revenue deficit” means the difference between revenue deficit, and grants for creation of capital assets.
NC – No Changes; NA – Not Available.
Source: FRBM Act 2003, Amendments, Ministry of Finance, GOI.

The initiative to set up strict fiscal rules legislation was taken in December 2000.[17] Following three years of discussion, FRBMA was enacted by the Parliament in August 2003. The Act had come into effect on July 5, 2004 albeit being watered down significantly during the course of those three years. Interestingly, on a sub-national level, Karnataka was the first major state of India to implement FRBMA. In 2002, Karnataka had enacted a state FRBMA and began adhering to the fiscal limits set under the Act. The Task Force (Chairman: Dr. Vijay Kelkar) was given the task of outlining proposals to achieve "high quality growth".[18] It submitted a report on implementation of FRBMA in July 2004.

The initial sentence of FRBMA mentions intergenerational equality and that is the fundamental principle of the Act. The concept of intergenerational equity dates back to 1796 BC Sumaria where the failure of repayment of debt resulted into slavery and bondage of children to the creditor. However, in modern context, it is a cornerstone of sustainable development.

The Central government shall lay in each financial year before both houses of Parliament the following statements of fiscal policy along with the annual financial statement and demands for grants-

1. The Medium-term Fiscal Policy Statement
2. The Fiscal Policy Strategy Statement
3. The Macro-Economic Framework Statement

Further, FRBMA 2003 set targets for both fiscal and revenue deficits. The government notified the Rules under the FRBM Act on July 02, 2004 which came into force on July 5, 2004 and prescribed a yearly reduction of 0.3 percent of GDP, fiscal deficit was targeted to reach 3 percent of GDP by 2008-09.[19] Similarly, revenue deficit was fixed to be eliminated by 2008-09 with a 0.5 percent reduction every year. Unfortunately, targets were suspended and the Act was put on hold in 2007-08 due to global financial crisis (GFC). The then Finance Minister, Pranab Mukherjee, announced that GOI would return to the targets "as soon as the negative effects of the global crisis on the Indian economy" had been overcome."[20]

[17] The decision was taken by the then Finance Minister, Yashwant Sinha.
[18] Preface of Task Force Report, 2004.
[19] Notification of Ministry of Finance, GOI, July 02, 2004, p.13.
[20] Budget Speech 2009-10, July 2009

The conditions/targets of FRBMA were resumed in 2011-12 when the Union Government announced that a fiscal road map for next five years would be laid down with other amendments to FRBMA.

Contingent Liabilities in FRBMA

Contingent liabilities refer to any obligations that are based on the occurrence or non-occurrence of a discrete event. Thus, a fixed amount of obligation and date of settlement is also dependent on the occurrence or non-occurrence of the event. Contingent liabilities can either be explicit, as is recognised by law or implicit, as obligations based on public sentiment and expectations. While credit guarantees, insurance schemes for floods, deposits, crops, etc., and exchange rate guarantees are explicit, defaults of state governments, bank failures, default of the central bank and sudden capital outflows leading to collapse of markets are referred to as implicit contingent liabilities.[21]

FRBMA, 2003 directed the Central Government to make rules to set annual targets for the amount of guarantees that it will assume, thus setting a ceiling on the total amount of contingent liabilities on the Government's balance sheet. The FRBM Rules, 2004 validated FRBMA and set a target of 0.5 percent of GDP for a financial year as the maximum amount of guarantees that the Central Government was allowed to give. The Government is also required to present such liabilities in the annual financial statement for greater transparency.

However, GFC forced the suspension of FRBMA in 2009 which correspondingly allowed contingent liabilities to rise. Evidently, in 2009-10 and 2011-12, the additional guarantees of the Central Government rose to 0.6 percent of GDP (Table 9), exceeding the target of 0.5 percent of GDP. However, it must be noted that FRBMA had been suspended during these years.

Research suggests that in times of crisis and systemic risk, countries with larger fiscal deficits and growing contingent liabilities risk the incidence of contagion given that market uncertainties are heightened in international financial markets.[22]

Contingency Fund

The Contingency Fund of India is established under Article 267 (1) of the Constitution. The purpose of this fund is to meet urgent, unforeseen expenditure, however, with the approval of

[21] Report of the Technical Committee on State Government Guarantees (Convenor: Usha Thorat), 1999
[22] Gooptu and Primo Braga, 2010, p. 214

the Parliament. The Constitution also states that any amount withdrawn from this Fund has to be recovered. The corpus of this Fund as on March 31, 2017, was Rs. 500 crore.[23]

Escape Clause in FRBMA

Section 4 of the FRBM Act, 2003 states that "due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify"[24], the set targets for revenue and fiscal deficit can be exceeded.

A popular contention to this clause is the vagueness of 'exceptional circumstances' which could lead to misuse or covering up of failures. There is a need to tighten and meticulously list out specific conditions under which a suspension of the FRBMA would be valid. A penalty should also be charged in case of non-compliance of stated targets.[25]

Also, a contingency fund (as is the case in India) could take care of natural disasters in ways that wouldn't affect the targets, while specifying the degree to which targets can be exceeded in case of such eventuality.[26] Countries of the European Union are mandated to pay a penalty of 0.2 to 0.5 percent of GDP if they fail to meet the fiscal targets, excluding exceptional circumstances. These circumstances are also clearly specified as times when economic activity has declined by more than 2 percent annually and does not include a recession or natural disaster.

Invoking the Escape Clause in 2009

The Global Financial Crisis (GFC) led to an abrupt collapse of domestic and international demand, fall in capital inflows and drop in economic growth in India.[27] The year of 2008-09 saw a dramatic drop in GDP growth which fell further in 2009-10 because of a bad monsoon that compounded the GFC.

As a result, three focused stimulus packages were provided by the Government, in December 2008, January 2009 and March 2009, in the form of tax reliefs (central excise duty reduction by 4 percent), increased expenditure (Rs. 200 billion planned spending) and targeted subsidies (interest subsidies on export finance).[28]

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[23] GoI, 2005, Finance Bill, p. 42
[24] FRBM Act, 2003, p. 3
[25] Lalwani, 2009, p. 63
[26] Howes and Jha, 2001.
[27] Joseph, 2009, p. 1
[28] Joseph, 2009, p. 10

Consequently, gross fiscal deficit (GFD) of the country reached 6 percent of GDP in 2008-09 and rose above the figure for the first time in 2009-10 to 6.4 percent of GDP (Table 7). It is worth noting that the budget estimate of GFD for 2008-09 was 2.5 percent of GDP. Revenue deficit (RD) shot up by 4 times its budget estimate of 1.1 to 4.5 percent of GDP in 2008-09 and further rose to 5.2 percent of GDP in 2009-10 (Table 7). In both circumstances, the targets set by the FRBMA, 2003 had been breached significantly.

In response to these developments, the then Finance Minister, Pranab Mukherjee, announced, in his Union Budget Speech of 2009-10, that the Government would only return to the targets set by the FRBM when negative effects of the global crisis on the Indian economy had been overcome.[29] This resulted in the suspension of FRBMA and deviation from the fiscal consolidation plan, so as to achieve the objective of maintaining a high economic growth trajectory through increased public expenditure which would create demand and minimise impact of global economic slowdown.[30]

The fiscal targets had been scrapped for two years, from 2009 to 2011, and both the fiscal and revenue deficit continued to rise to 4.9 percent and 3.3 percent of GDP, respectively, in 2010-11. However, in 2011-12, GFD was recorded at 5.7 percent of GDP, slightly more than a full percentage point of budget estimate of 4.6 percent of GDP. Similarly, actual RD also rose to 4.4 percent of GDP, as compared to the budget estimate of 3.4 percent of the GDP (Table 7).

While the fiscal targets that were missed in 2008-09 were intentional and aimed at negating the impact of GFC, the targets for GFD and RD in 2011-12 overshot due to various unintended factors. Low direct tax revenue realisations, high inflation, provisioning of subsidies, subdued financial market conditions and a sharp deceleration in real GDP growth, especially in the industrial sector resulted in adverse domestic economic conditions. Amongst international factors, high price of crude oil and fertilisers, that did not pass through to domestic prices, were responsible for increased expenditure which in turn inflated GFD and RD (GOI, 2013).

Consequently, the Finance Minister in his 2011-12 Budget Speech announced that amendments would be made to the FRBMA along with "laying down the fiscal map for the next five years."[31] In the succeeding year's Budget Speech, the FM yet again announced that amendments to FRBMA would be introduced through the Finance Bill of 2012. The Finance

[29] Budget Speech 2009-10, July 2009
[30] Bajpai, 2011, p. 12
[31] Budget Speech 2011-12, February 2011

Bill proposed that the new target for the reduction of GFD and RD, and elimination of effective revenue deficit be set as March 31, 2015. These proposals resulted in amendment of FRBMA in May 2013. The term ‘effective revenue deficit’ was also introduced into FRBMA through Finance Bill of 2012. The government then revised the FRBMA further in the Finance Bill of 2015 by amending Section 4 to change deadline of March 31, 2015 to March 31, 2018, to grant the newly formed Government in May 2014, some more fiscal space to achieve deficit targets.

Hence, India’s brief interaction with a fiscal responsibility legislation that was operational from 2003 was paused for two years, then restarted and amended.

V. Need for Review

Fiscal and Monetary Policy are the two pillars of a macroeconomic framework. While the Monetary Policy by virtue of being governed by the RBI, a permanent statutory body, is reviewed constantly, the Fiscal pillar needs some serious consideration. Changing dynamics such as the Goods and Services Tax (GST), recent developments with regard to fighting corruption that includes Central Government’s bold demonetisation move, 7^{th} Pay Commission, higher tax compliance amongst citizens, a growing demographic dividend that is boosted by initiatives such as Stand-up and Start-up India and the latest step taken by RBI to set up the Monetary Policy Committee (MPC) to tackle inflation will greatly influence operations and impact of fiscal policy.

The need for review of FRBMA is in sync with the need for enhancing credibility, discipline, transparency and accountability. Rules that discontinued the use of *ad-hoc* Treasury Bills and the ones that govern monetary policy are illustrative examples of need for strict rule-bound operation of FRBMA.

However, experience with implementation of these rules suggests otherwise. Manipulation of impact of the rules, diversion of attention away from vital issues, continuous pauses in implementation; dissimilar interpretations of “unforeseen circumstances” by the authorities and alternative versions of rules that comply in spirit and not proforma are some of major concerns with rule implementation. The Golden Rule of fiscal discipline states that there should be no deficit on revenue account and borrowing should only be applied towards asset formation. The annual compliance of Golden Rule will be imperative for achieving balanced budgets and fiscal responsibility.

The introduction of concept of effective revenue deficit was also critically discussed in the recent literature (Pattnaik, 2016). The Fourteenth Finance Commission noted that the concept of effective revenue deficit is not recognized in standard government accounting process, globally, and had recommended removing it (GOI, 2014)

The need for review of FRBMA is centred around two fundamental questions: 1) Is it an issue of numbers alone and 2) Is it not concerned with Institutional issues in Budget Management?

In May 2016, the Government of India constituted a five-member committee to review the working and functioning of FRBMA.[32] On January 23, 2017, the committee submitted a report to the Finance Minister.

VI. Trend Analyses

The key fiscal indicator of Central Government Gross Fiscal Deficit (GFD has declined in post-FRBM period (2004-05 to 2017-18) as compared with pre-FRBM period (1992-93 to 2003-04). However, revenue deficit and primary deficit have declined marginally. The interest payments as a ratio of revenue receipts and revenue expenditure have also recorded substantial reduction in post-FRBM era (Table 3). However, RDB as a ratio of GFD has increased which shows that revenue expenditure is rising more rapidly than capital expenditure.

Table 3: Select Fiscal Indicators of the Central Government- Mixed Results

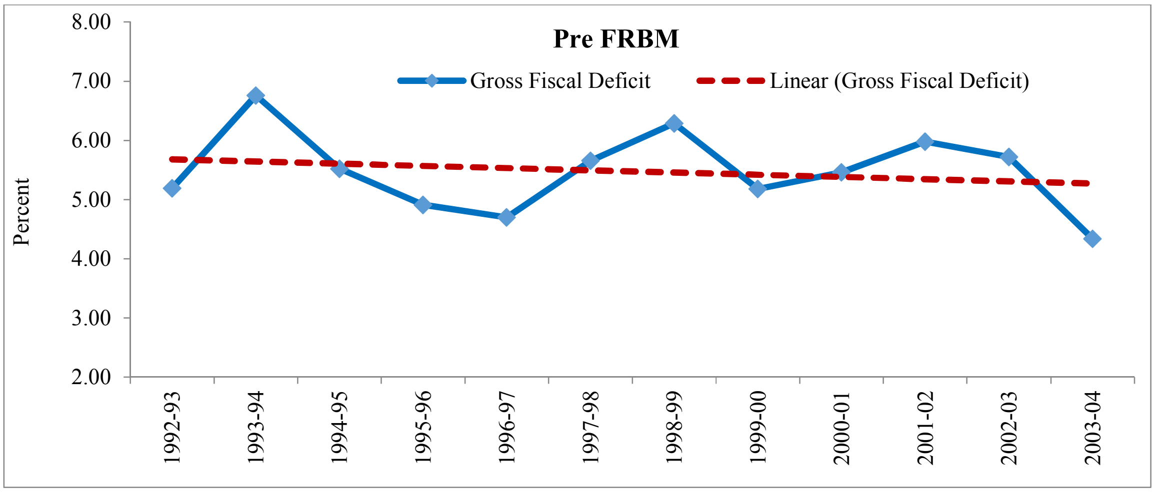
Year	**(As percentage to GDP)**						
	Gross Fiscal Deficit	Primary Deficit	Revenue Deficit	RD as the ratio of GFD (RD/GFD)	PD as the ratio of GFD (PD/GFD)	Interest Payments as the ratio of Revenue Receipts	Interest Payments as the ratio of Revenue Expenditure
Pre-FRBM 1992-93 to 2003-04	5.5	1.2	3.3	0.6	0.2	0.5	0.4
Post-FRBM 2004-05 to 2017-18	4.4	1.0	30	0.7	0.2	0.4	0.3

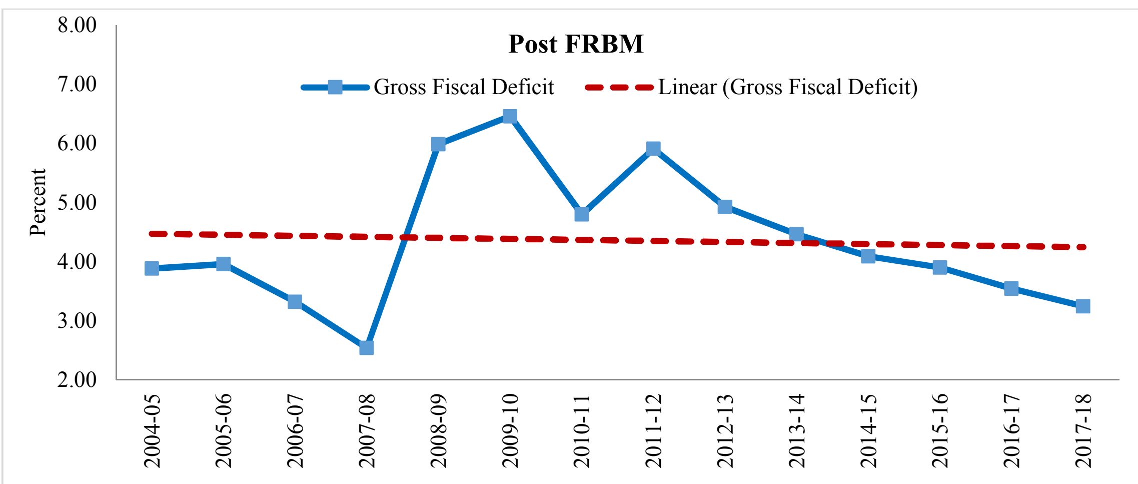
Note: Pre-FRBM = 1992-93 to 2003-04, Post-FRBM = 2004-05 to 2017-18. (2016-17 RE and 2017-18 BE).
Source: RBI and GOI.

[32] The five-member committee chaired by former Revenue Secretary and Member of Parliament, Rajya Sabha, N.K. Singh; included former Finance Secretary, Sumit Bose; Chief Economic Advisor, Arvind Subramanian; RBI Governor, Urjit Patel; and NIPFP director, Rathin Roy.

In pre-FRBM period, GFD as a percentage to GDP was showing a declining trend. However, due to global financial crisis of 2008, GFD was higher in some years in Post-FRBM period (Chart 1).

Chart 1: Increasing Gross Fiscal Deficit as Percentage of GDP

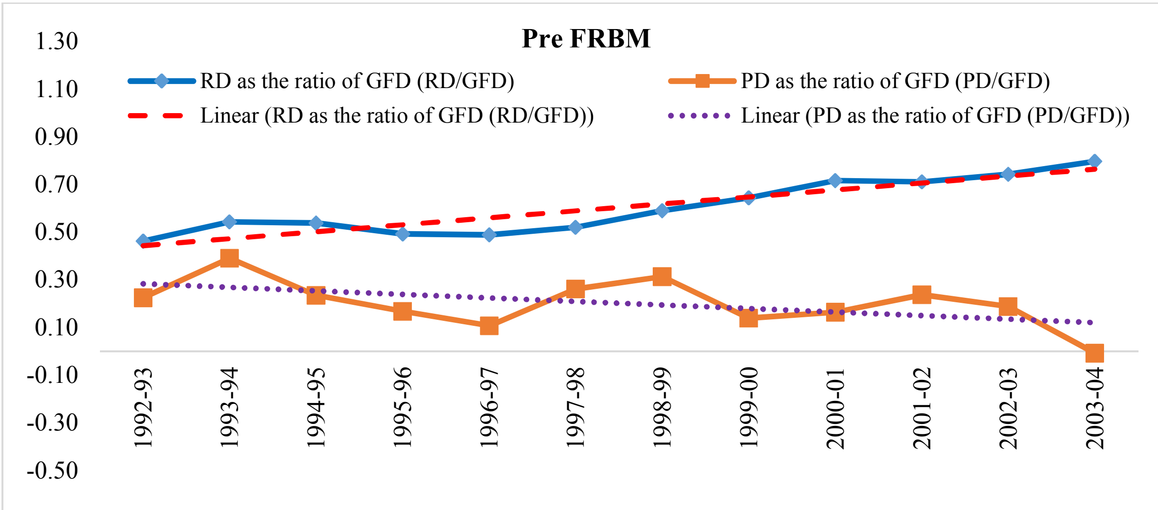


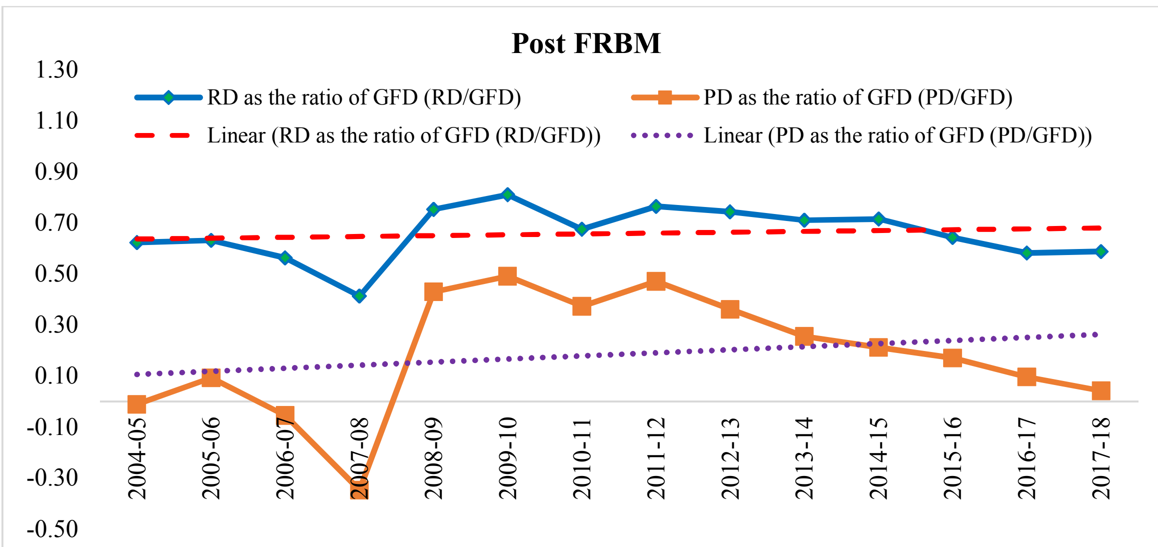


Note: Pre-FRBM = 1992-93 to 2003-04, Post-FRBM = 2004-05 to 2017-18. (2016-17 RE and 2017-18 BE).
Source: RBI and GOI.

In general, in pre-FRBM period RD and PD deteriorated, while in post-FRBM period, both RD and PD revealed a recovery path (Chart 2).

Chart 2: RD and PD - as Percentage to GDP





Note: Pre-FRBM = 1992-93 to 2003-04, Post-FRBM = 2004-05 to 2017-18. (2016-17 RE and 2017-18 BE).
Source: RBI and GOI

The expenditure of Central Government, mainly interest payments and total, as percentage of GDP, declined in post-FRBM period. However, quality of expenditure incurred was not good as capital expenditure declined to 1.9 percent in post-FRBM period from 3.2 percent pre-FRBM period (Table 4).

Table 4: Expenditure Management and FRBM – Declining Capital Expenditure

Year	(As percentage to GDP)					
	Revenue Expenditure	Interest Payments	Subsidies	Defence (Revenue + Capital)	Capital Expenditure	Total Expenditure
Pre-FRBM	12.2	4.3	1.3	2.2	3.2	15.3
Post-FRBM	12.3	3.3	1.9	1.9	1.9	14.2

Note: Pre-FRBM = 1992-93 to 2003-04, Post-FRBM = 2004-05 to 2017-18. (2016-17 RE and 2017-18 BE).
Source: RBI and GOI

In India, tax to GDP ratio of the Central Government, at around 10 percent, is very low in both post and pre-FRBM period. However, non-tax revenue and capital receipts also declined in Post-FRBM period (Table 5).

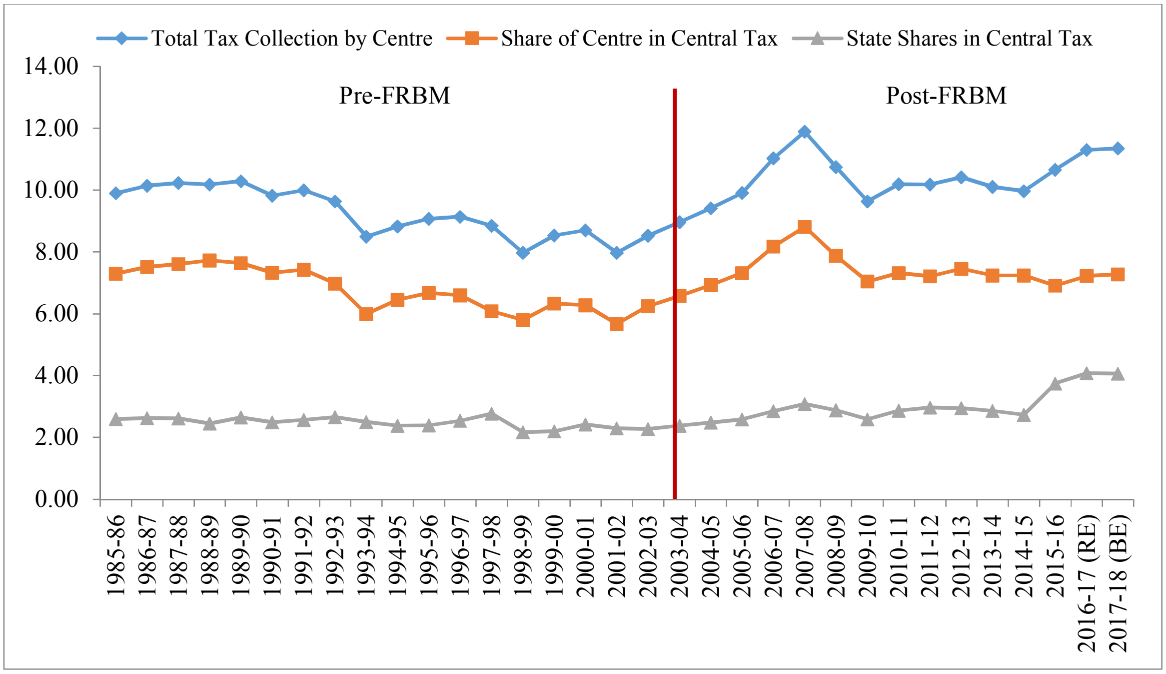
Table 5: Revenue Management and FRBMA – Low Tax Performance

Year	(As percentage to GDP)						
	Gross Tax			Tax Revenue Net	Non Tax Revenue	Revenue Receipts	Capital Receipts
	Direct	Indirect	Total				
Pre-FRBM	2.9	5.8	8.7	6.3	2.5	8.8	6.1
Post-FRBM	5.5	5.0	10.5	7.4	1.9	9.3	4.9

Note: Pre-FRBM = 1992-93 to 2003-04, Post-FRBM = 2004-05 to 2017-18. (2016-17 RE and 2017-18 BE).
Source: RBI and GOI.

However, in recent years, there was improvement in tax collection (Chart 3). However, something more needs to be done in tax administration and management, to achieve higher tax collections compared to advanced countries where tax to GDP ratio is generally above 30 percent.

Chart 3: Tax Revenue as Percentage of GDP



Source: GOI and RBI.

The fiscal projections of tax and non-tax revenues made by the Fourteenth Finance Commission (FFC) are conservative and not too different from earlier trend (Table 6).

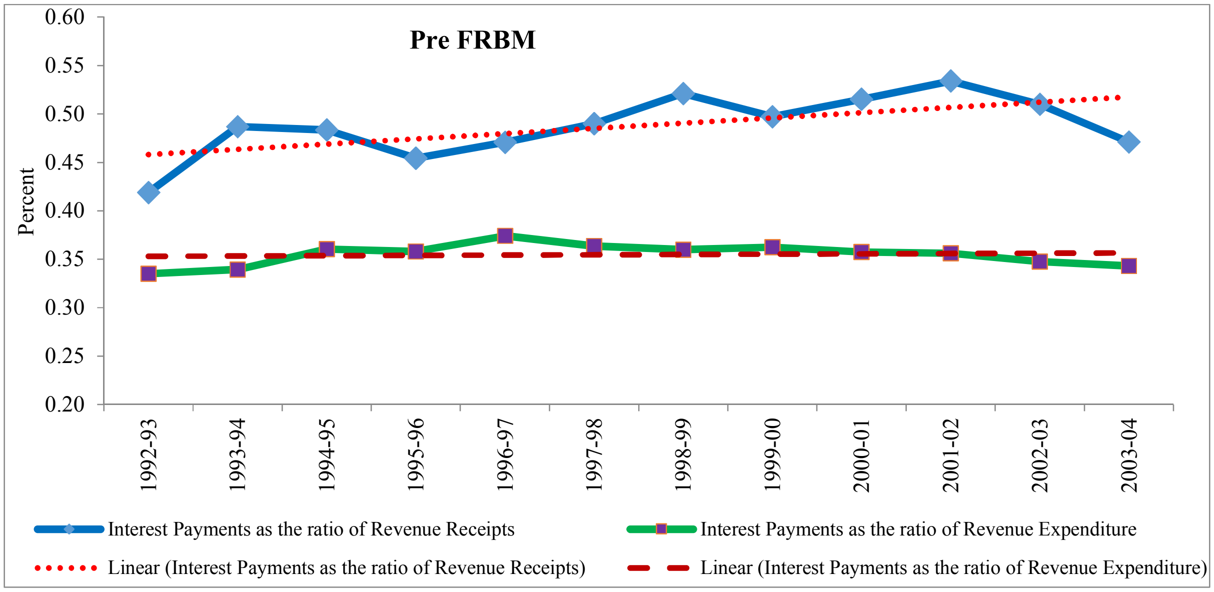
Table 6: Projection of Union Government Finances for the Award Period of the FFC

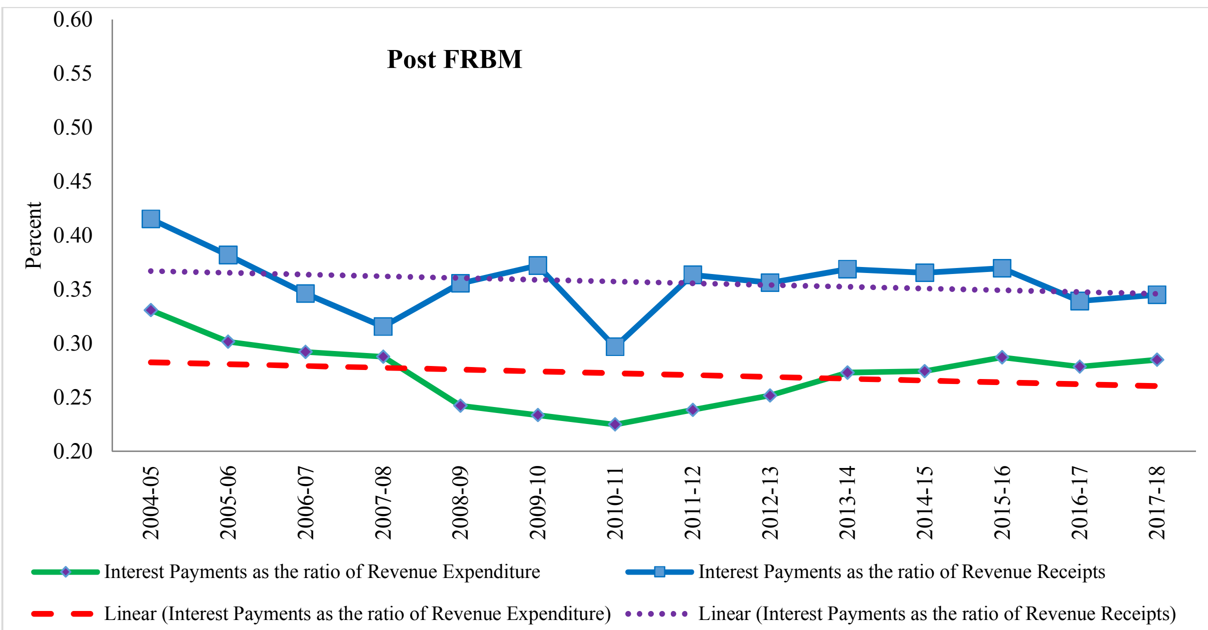
	2014-15	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Gross Revenue Receipts	12.1	12.3	12.4	12.6	12.7	12.9
Gross Tax Revenues	10.6	10.7	10.9	11.0	11.2	11.4
Non-Tax Revenues	1.5	1.5	1.5	1.5	1.5	1.5

Source: RBI and GOI.

Interest payments as a ratio of revenue expenditure and revenue receipts though declined in the Post-FRBM period but still there is need to consider further rationalisation of interest payments (Chart 4; Kanagasabapathy et al, 2016).

Chart 4: Interest Payments as percentage of Receipts and Expenditure





Note: Pre-FRBM = 1992-93 to 2003-04, Post-FRBM = 2004-05 to 2017-18. (2016-17 RE and 2017-18 BE).
Source: RBI and GOI.

The petroleum price rise, rise in prices of other commodities and the breakdown of the financial system in 2008-09 resulted in recessionary trends around the world which also impacted the Indian economy causing the focus of fiscal policy to be shifted towards providing growth stimulus in the Union Budget which was presented in February 2008. Hence the Revised Estimates and Actual figures of GFD, PD and RD in 2008-09 rose by more than 50 percent, mainly on account of revenue deficit (Table 7). In February 2009, the Government temporarily used the pause button on fiscal consolidation due to global uncertainties.

Table 7: Trends in Estimates and Actuals of Deficits

Year	Gross Fiscal Deficit			Primary Deficit			Revenue Deficit		
	BE	RE	Actuals	BE	RE	Actuals	BE	RE	Actuals
2003-04	5.6	4.8	4.5	1.1	0.3	0.0	4.1	3.6	3.6
2004-05	4.4	4.5	4.0	0.3	0.4	-0.1	2.5	2.7	2.5
2005-06	4.3	4.1	4.1	0.5	0.5	0.4	2.7	2.6	2.6
2006-07	3.8	3.7	3.5	0.2	0.1	-0.2	2.1	2.0	1.9
2007-08	3.3	3.1	2.7	-0.2	-0.6	-0.9	1.5	1.4	1.1
2008-09	2.5	6.0	6.0	-1.1	2.5	2.6	1.0	4.4	4.5
2009-10	6.8	6.7	6.4	3.0	3.2	3.1	4.8	5.3	5.2
2010-11	5.5	5.1	4.9	1.9	2.0	1.8	4.0	3.4	3.3
2011-12	4.6	5.9	5.7	1.6	2.8	2.7	3.4	4.4	4.4
2012-13	5.1	5.2	4.9	1.9	2.0	1.8	3.4	3.9	3.6
2013-14	4.8	4.6	4.4	1.5	1.3	1.1	3.3	3.3	3.1
2014-15	4.1	4.1	4.1	0.8	0.8	0.9	2.9	2.9	2.9
2015-16	3.9	3.9	3.9	0.7	0.7	0.7	2.8	2.5	2.5

Note: BE = Budget Estimate, RE = Revised Estimate.
Source: GOI and RBI.

However, in view of the fiscal prudence, and the adoption of fiscal responsibility, outstanding liabilities of the Union Government have generally recorded a declining trend consistently since 2001 (Table 8).

Table 8: Outstanding Liabilities and Guarantees of Central Government

As Percentage to GDP - Market at Current Price						
Year (end-March)	**Internal Debt**	*of which* **Market Loans**	**Small Savings & Provident Funds**	**External Liabilities**	**Total Liabilities**	**Out-standing Guarantees**
1990-91	26.3	12.0	10.5	11.3	59.6	-
2000-01	37.1	19.8	4.4	8.8	59.6	4.1
2010-11	34.3	26.6	8.7	3.6	52.2	1.9
2011-12	37.0	28.8	8.1	3.7	53.5	2.2
2012-13	37.8	30.0	7.4	1.8	51.0	2.4
2013-14	37.7	30.6	6.9	1.6	50.5	2.2
2014-15	38.1	31.3	6.5	1.6	50.2	2.4
2015-16	38.8	31.5	6.4	1.5	50.5	2.5
2016-17	38.0	30.8	6.2	1.5	49.4	-
2017-18	36.7	29.7	5.6	1.4	47.3	-

Source: GOI and RBI.

The Government was successful in containing additional liabilities with targets until 2007-08 but has consistently missed it since then (Table 9). Similarly, in case of Guarantees, the Government was successful in containing guarantees in all years except 2009-10 and 2011-12.

Table 9: Additional Liabilities and Guarantees of Central Government

Year	**Additional Liability as percentage of GDP**	**FRBM target of Additional Liability as percentage of GDP**	**Addition to Guarantees as percentage of GDP**
2004-05	5.0	≤ 9	-
2005-06	3.9	≤ 8	0.2
2006-07	5.0	≤ 7	0.1
2007-08	5.8	≤ 6	0.3
2008-09	6.5	≤ 5	0.2
2009-10	5.0	≤ 4	0.6
2010-11	4.8	≤ 3	0.3
2011-12	6.9	≤ 2	0.6
2012-13	5.5	≤ 1	0.5
2013-14	4.9	0	0.3

Note: 1. Additional liabilities included of borrowings of internal and external (Public Debt), the internal borrowings mainly included of market loans and special securities issued to the RBI, and Public accounts which includes Government function as a trustee.

2. Guarantees are not included in liabilities in the Table above. These are separately computed.

Source: GOI.

VII. Conclusion and Recommendations

India has adopted fiscal rules for more than a decade. The fiscal rules have generally not been followed by the Central Government, especially after 2008 mainly because of the global crisis. In this context, an important question is whether there is need for stiff fiscal rules and should these be adhered strictly or prudently in the welfare of the society. 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 circumstances can change in the economy.

It must be noted that there are a set of pre-conditions that need to be fulfilled before rules come into play. 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 FRBMA.

On the basis of the analysis in the study, it is recommended that –

a) There is need to have transparency in macroeconomic forecasting on the basis of which growth rates are projected as well as different types of deficits are computed in the Union budget. Similarly, there is need for a regular review of the assumptions that are made in computing receipts and expenditure of the Government. Illustratively, IMF clearly mentions in detail all the assumptions that are taken into account while making forecasts of growth in their global publications like World Economic Outlook.
b) In modern fiscal literature, it is discussed that budget deficits should not only be confined to a single year computation but preferably balanced over a medium term. Therefore, the Government should consider a medium-term framework for fiscal policy and ensure that over the medium term, if not annually, targets are met. In the FRBM, the Golden Rule of revenue neutral, preferably surplus, should be strictly followed, if not on annual basis, at least over a stipulated period of medium term or a business cycle.
c) On the basis of international developments, there is a need to build capacity in managing fiscal policy of the government, and effective and efficient debt management of the government. Similarly, there may be need for the Government to consider developing and strengthening institutions that can help in assisting in budget formulations and evaluating budget outcomes.

d) To achieve fiscal discipline and meet targets of GFD, there is need to raise tax to GDP ratio. Therefore, there may be a need to revisit the exemptions given on direct taxes, especially on agriculture income. In the same vein, the use of technology can be considered to ensure effective and efficient tax collection. The current drive of adopting GST and digitalizing India can help in higher tax collections.

e) Interest payments pre-empt a substantial part of revenue receipts. Given the limitations of enhancing tax collection, the Government increasingly resorts to borrowing. Therefore, there is a need to rationalize interest expenditure of the Central Government.

f) There is need to be more specific on 'exceptional circumstances' when 'pause' button can be used to stall the targets provided by FRBMA.

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