

FRBM ACT- A STEP TOWARDS FISCAL DISCIPLINE

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ABSTRACT

A developing economy has to spend more to increase the level of disposable income in the hands of its citizens. It has to undertake various projects which can provide long term benefits to the people and can raise their standard of living. Such projects involves huge amount of investment which are met through borrowings. Reckless borrowings results in unproductive interest expenditure, thereby depriving the nation with most of its income. In order to fix the responsibility with the government and to prevent it from unnecessary borrowings for unproductive purposes, the FRBM Act was enacted in 2003. However, due to the international financial crisis from 2007, the implementation of this act was postponed and later on suspended in 2009. The current paper attempts to highlight the features and the recommendations of this Act.

Key Words: FRBM Act, Fiscal deficit, Revenue deficit, GDP

INTRODUCTION

Every country, especially developing countries, needs external financial assistance to meet its developmental and other expenses. These developmental projects help in increasing the country's income in long term and are helpful in uplifting the status of the economy. There are, however, few expenses which are unproductive and do not, in turn, benefit economy in the form of increased income. All the money spent in such expenses is, thus, a burden on the economy. These expenses such as pensions, subsidies, interest on external loans etc needs to be curtailed and to be kept within the reasonable limits. This is because more such expenses, less is the availability of funds for the developmental projects and government will be forced to borrow money from outside which will lead to heavy interest burden. Moreover, reckless borrowings also downgrade the value of the currency and economy as a whole.

In Indian context, high revenue deficit and high unproductive expenses shook the economy during late 80s which was then overcome through

liberalization policy in 1991. During the decade of 90s, the Indian economy was trapped in high revenue deficits due to increased expenditure on subsidies, pensions etc and reduced incomes through taxes and other sources. This situation continued till 2000 when it was first thought to have a law to force government to limit its unproductive expenditures and have a responsibility to curtail its borrowings. The Fiscal Responsibilities and Budget Management Act was passed in 2003 to put check on government's fiscal responsibilities and fixed the target of reducing fiscal deficits to 3% of GDP by 2008-09. Later on, the implementation of FRBM Act was postponed and suspended due to financial crisis of 2007.

OBJECTIVES OF THE STUDY

1. To understand the concept of Fiscal Responsibilities and Budget Management Act
2. To understand the salient features of the Act.
3. To understand the important recommendations under the Act.

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CONCEPT OF FRBM ACT

Fiscal deficit is defined as the difference between the total revenue and total expenditure of the government in a particular year. This difference shows the amount of borrowings needed by the government to meet out its expenditures. The fiscal deficit consists of two components i.e. revenue deficits and capital deficits. Revenue deficits occurs due to over spending of government on recurring expenses like salaries, pensions, subsidies etc while capital deficits occurs due to delay in long term projects. The government, in order to fill these deficits, tend to borrow money either within the country from the Central Bank or from issuing securities or from outside the country from international financial agencies. These loans needed to be served through interest payment which take a heavy toll on government's revenue and create a deficit for another year. This traps the economy in a vicious circle of debt which can only be broken through reducing the spending on revenue items or unproductive expenses like subsidies, pensions etc and also on timely completion of big developmental projects. There need to be a check on the government on the amount borrowed as its interest part will be a burden on future generations and its benefits will be reaped by the current generation specially in case of revenue expenses.

Table 1: Fiscal deficits to percentage of GDP

Year	Percent of GDP
2007	3.5
2008	3.1
2009	7.8
2010	6.9
2011	5.1
2012	5.8
2013	4.9
2014	4.5
2015	3.9
2016	3.5

Source : *Tradingeconomics.com, Ministry of Finance, Government of India*

Table 1 show that Indian economy has been continuously functioning under the deficit status. This implies extended borrowing for which heavy interest payment is to be made.

Table 2: Interest Payment by India (Rs. Billion)

Year	Percent of GDP
2007	1502.72
2008	1710.30
2009	1922.04
2010	2130.93
2011	2340.22
2012	2731.50
2013	3131.70
2014	3742.54
2015	4024.44
2016	4426.20

Source : *Handbook of Statistics on Indian Economy*

Table 3 : Debt to Percent of GDP

Year	Percent of GDP
2007	74
2008	74.5
2009	72.5
2010	67.5
2011	69.6
2012	69.1
2013	68.5
2014	68.6
2015	69.6
2016	69.5

Source: *Tradingeconomics.com, Ministry of Finance, Government of India*

Table 3 shows that a considerable portion of GDP is entrapped under debt and the interest payment on debt has been constantly on rise (table 2).

In order to curb the borrowing and to maintain the fiscal discipline, FRBM Act was proposed in 2000 which was passed in 2003. This Act puts ceiling on the maximum amount of borrowings and put emphasis on the gradual reduction on the borrowings as percentage of GDP and to bring it to 3% of GDP by the end of

March 2018.

OBJECTIVES OF THE ACT

The Act was passed with the following objectives:

- a. To fix the responsibility of government for establishing a better and transparent fiscal management system.
- b. To ensure long term macro economic stability by removing fiscal deficits.
- c. To ensure prudential debt management and limiting the debts and borrowings of government for proper fiscal management.

FEATURES OF THE ACT

The Act was enacted with the basic aim of controlling the fiscal deficit of the government to reduce the interest burden on the coming generations. To achieve this objective, the various provisions focusing over it includes mechanism for increasing surplus and reducing deficits, breach of fiscal targets only in case of national security and prohibition of borrowings by government from RBI.

1. Revenue Deficit : In the initial version of the Act proposed, the target was to reduce the revenue deficit by 0.5% of GDP or more every year from 2004-05. It should have been reduced to zero within five years by the end of 2008-09 and afterwards revenue surplus should have been built up to discharge liabilities before time.

2. Fiscal Deficit: The draft proposal of the Act emphasised that government should reduce the fiscal deficit by 3% per year of GDP from 2004-05 and should bring it to 2% of GDP by the end of 2005-06.

However, it was provided that both the above, revenue and fiscal deficit targets can be breached only on the grounds of national security and any natural calamity faced being declared as "national".

3. National Debt: As per the initial provisions of the Act, the government should ensure that total liabilities of government should not exceed 9% of GDP at the end of financial year 2005 and there should be reduction of 1% in this

limit every subsequent year.

4. Borrowings from RBI: The Act prohibits the government to borrow any money from RBI except in case of meeting excess cash payment in the form of temporary advance from RBI in accordance with the agreement with RBI.

5. Medium Term Fiscal Policy Statement: The Act also directs government to present Medium Term Fiscal Policy Statement in both the houses of Parliament along with the Annual Financial Statements which should indicate (a) Revenue Deficit as percentage of GDP, (b) Fiscal Deficit as percentage of GDP, (c) Tax Revenue as percentage of GDP and (d) Total outstanding liabilities as percentage of GDP.

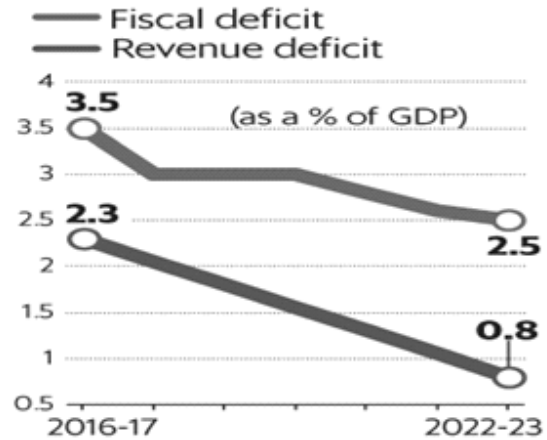
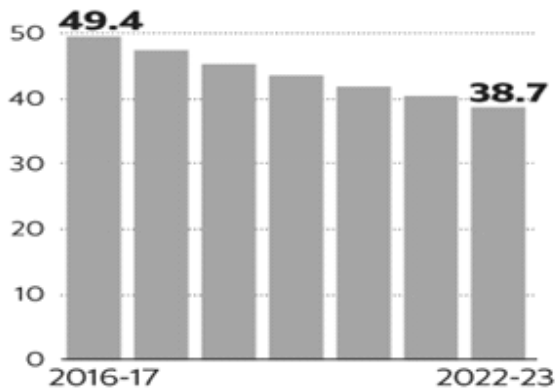
FRBM COMMITTEE

The government, under the chairmanship of N.K. Singh, constituted a five member committee in May 2016 to review FRBM Act according to current situations. The Committee consisted of N. K. Singh – former Revenue & Expenditure Secretary, A. Subramaniam – Chief Economic Advisor to Finance Ministry, Sumit Bose – former Finance Secretary and Dr. Urjit Patel – the then Deputy Governor of RBI. The committee was constituted to provide a rethinking and flexibility over fiscal deficit to cope up with difficult phase of economy. The committee was entrusted with the following responsibilities:

1. To review the current performance of FRBM Act since 2003 and to suggest the way forward for the achievement of targets set under the Act keeping in view the current global economic scenario.
2. To look into the various aspects and the factors affecting the performance of FRBM Act while determining the new fiscal targets.
3. The committee was asked to determine a fiscal target range in place of a static fiscal target of 3% as per the changing economic scenario.
4. The committee was asked to suggest to government on the issue of adjustment on fiscal deficit targets in alignment of the expansion or contraction of credit in the

PROPOSED TARGETS

Debt-to-GDP ratio (%)



Source: N.K. Singh committee report

economy.

FRBM COMMITTEE RECOMMENDATION

The committee under N. K. Singh submitted its report on the future shape of FRBM Act and future fiscal deficit targets on January 23, 2017. This report was made public on April 12, 2017.

The major recommendations of the reports are :

1. Gradual lowering of debt to GDP ratio from presently around 68% to 60% comprising 40% of Centre and 20% of States.
2. Limiting fiscal deficit to 3% of GDP by March end 2020, to 2.8% by March end 2021 and to 2.5% of GDP by March end 2023. However, this limit can be breached in case of war, natural calamity or severe agricultural setback but should not exceed 0.5% of the stipulated limits of fiscal targets for that concerned year.
3. Reduction in the revenue deficit to GDP ratio by 0.25% per year to 1.55% in March 2020 and to 0.8% by March end 2023.

CONCLUSION

High amount of debt may be helpful to government in meeting its present expenditure but put a pressure on the future earnings and resources to be utilised for future generations.

These expenses need to be curtailed so that borrowings could be limited. The FRBM Act has been passed with a view to put a ceiling on the government's limit to borrow. The Act has provided a way to gradual reduction in fiscal and revenue deficit to contain it within a reasonable limit by March end 2023. The Act has, however, exempted the government from following the laid guidelines in case of war or calamity. The FRBM committee has given its recommendations keeping in view the future economic scenario and it is expected that the Act, if followed in its true sense, will help the government in putting a ceiling on the deficits and can be helpful in saving the high amount of money being paid as interest.

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