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Research Article

Fiscal Responsibility and Budgetary Management Rules, 2004: Have the Fiscal Targets Been Achieved?

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ABSTRACT

The article deals with the Fiscal Responsibility and Badgetary Management Rule 2004. The fiscal deficit in India has been a subject of serious investigation ever since the introduction of New Economic Reforms, 1991. The article gives a brief account of FRBM Rule, 2004. The investigation into the question whether the fiscal deficits managed as expected or not is based on the rule and acceptable fiscal limited prescribed in the FRBM Rule, 2004. The data analyses and findings from it suggest that the gross fiscal deficits could not be manage as expected though the GDP growth rate was much higher during the period taken for consideration. It is concluded that given the state of Indian economy, management of fiscal deficits on account of controlling revenue and capital expenditures is still a matter to be considered.

Keywords: Fiscal Responsibility and Budgetary Management Rules, Fiscal deficit and Indian Economy.

INTRODUCTION:

Public expenditure is expected to remain within acceptable limits required for fiscal sustainability. The size of fiscal deficits shows to what extent the public expenditure goes beyond public revenues. When it is deemed fiscal deficits are excessive various ways and means are conceived and tried to manage and contain them. However, managing fiscal deficits is not an event undertaken at any one point of time and cannot be believed that it is not required any further. A continuous effort is required to keep fiscal deficits within limits. From the economic point of view the allocative, distributive and sustainability aspects of fiscal activity assume crucial importance. Nay, such effort is also required through legislative and executive instruments. Fiscal and monetary policy, respectively, are the two such instruments in consideration. Assuming monetary policy to be responsive in the short run in managing fiscal deficits during short term deviations, nevertheless from legislative side and for long term measures, Fiscal Responsibility and Budgetary Management Act, 2003, was created and in 2004 rules, corresponding to the Act, have also been framed. Clearly, rules with respect to various kinds of deficits to be expressed in budget have been put in place under these rules. The Rules are concerned with various deficit targets to be presented in terms of percentage to gross domestic product (GDP). This paper will discuss these rules and will explore if the targets, mentioned under those rules, have been met with.

A Brief discussion on Fiscal Responsibility and Budgetary Management Rules (FRBM), 2004:

Not going into the descriptive details of the FRBM Rule, 2004, only aspects concerning objectives of the Rule and mechanism in it to control fiscal deficits are discussed here.

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Objectives of FRBM:

1. To pursue intergenerational equity so that there is no undue burden of public debt on generation coming next.
2. To promote fiscal management with revenues and expenses in all their type and aspects.
3. To achieve long-term macro-economic stability
4. To provide a framework for fiscal sustainability
5. To provide an acceptable limit to central government borrowings
6. To manage debt and deficits so that there is no crowding-out.
7. To provide greater fiscal transparency in all aspects of fiscal conduct.

Mechanism in FRBM to control Fiscal Deficits:

A. The mechanism established in FRBM Rules, 2004 can be understood by the assumptions made for fiscal indicators and the relationship conceived between them. In the FRBM Rules, 2004, consideration is given for revenue receipts and expenditure, capital receipts and expenditure and these two divisions of fiscal policy is put in the context of GDP growth. Furthermore, other macro-economic indicators like external sector and money, banking & capital markets have been taken into consideration as parts determining fiscal conduct. The relationship between these fiscal and macro-economic indicators and performance thereof is considered while adjusting fiscal deficits. For example, deficits at various levels and/or kind arise due to imbalance between receipts and expenditure in revenue account and/or capital account. The size of imbalance prompts the government to adjust its fiscal policy. This aspect of mechanism plays the role of diagnostics in identifying exact deviation in fiscal targets. Other macro-economic indicators like external sector, i.e., international trade and money, banking and capital markets play a deterministic role in restructuring whole fiscal policy or conduct of the government and hence avoid slippage in fiscal sustainability.
   The assumption in the FRBM Rule, 2004, made while prescribing fiscal deficit targets is that the indicators, both fiscal and macro-economic, involved in the mechanism will behave in a manner which is normal in the due course of normal economic functioning as a whole.
   Hence, based on this mechanism, the FRBM Rules, 2004 lays down targets of fiscal deficits to be managed.
B. Based on the mechanism given above, the limit to fiscal deficits is drawn as follows:

If (i) the total non-debt receipts are less than 40 per cent of Budget Estimates for that year; or (ii) the fiscal deficit is higher than 8[70] per cent of the Budget Estimates for that year; or (iii) the revenue deficit is higher than 8[70] per cent of the Budget Estimates for that year, ***then***, **-** (a) the Central Government shall take appropriate corrective measures; and (b) the Minister-in-charge of the Ministry of Finance shall make a statement in both Houses of Parliament during the session immediately detailing the corrective measures taken, the manner in which any supplementary demands for grants are proposed to be financed and the prospects for the fiscal deficit of that financial year. (FRBM, 2004).

For this purpose, in the FRBM Rule, 2004, the following fiscal indicators are recommended to focus upon. Namely,

(i) fiscal deficit as a percentage of GDP;
(ii) revenue deficit as a percentage of GDP;
(iii) primary deficit as a percentage of GDP;
(iv) tax revenue as a percentage of GDP;
(v) non-tax revenue as a percentage of GDP; and
(vi) Central Government debt as a percentage of GDP.

The FRBM Rules, 2004, The most critical part of the FRBM Rules is the task to successively reduce the fiscal deficit by an amount of per cent or more of the GDP at the end of each financial year so that fiscal deficit is brought down and contained to not more than 3 per cent of GDP by 31st day of March, 2021. Is it possible to achieve this target. What is the probability that this target will be achieved by the end of the financial year 2020-21?

REVIEW OF LITERATURE:

The dominant view of classical economists against public debt and the need for keeping public expenditure within bounds of public revenue has been discussed and evaluated time and again and has been the beginning point to argue against or for the increasing economic role of the State and therefore increasing public expenditure. Economists like Adam Smith, David Recardo and J.S. Mill did not favour public debt (Tsoulfidis, 2007). However, Adolf Wagner, E.D. Domar, Paul A Samuelson, and John Maynard Keynes put the issue of increasing public expenditure and consequential public debt and fiscal deficit on an acceptable economic rationale (Hakhu, 2021). In today's economic scenario especially concerning emerging economies like India, fiscal deficit is inevitable. Hence, in recent times legislative acts were proposed to manage fiscal deficits (Koopit, 2001). Managing fiscal deficit is multidimensional.

In the Indian context Mishra (2001) has analysed in detail the basic structure of the FRBM Act and its prescribed fiscal deficit limits. He focused on the cyclical effects of fiscal deficit and FRBM Act. The structure of public expenditure and consequential fiscal deficit are the variables he suggests need a relook before it is brought into full effect. It is believed that the fiscal deficit targets given in the form of ratios to GDP required degrees of freedom to be achieved. Lahiri (2000) on the other hand anlysed fiscal positions from the point of view federal structure in India and gives an account of fiscal management by both central and state governments. It is argued that the States have been controlling fiscal deficit because of fiscal constrains due to federal structure existing in Indian federal system. However, the Central government must manage its own fiscal deficit. Rakshit (2006) focussed on the definition of various types of deficits simultaneously exploring the possibilities of contrasting objectives of three main bodies concerning economic policy in India viz. planning commission (PC), Reserve Bank of India (RBI), the Finance Commission (FC) and the Finance Ministry (FM). Various dimensions of FRBM like fiscal deficits, public debt, change in taxation due to fiscal deficit and their relationship with business cycles and social cost-benefit have also been explored. Lalvani (2009) has given a detailed description through which fiscal deficit surfaces. For example, points out more than one cause when he says fiscal deficit in India is strongly corelated to increase in capital expenditure more than its revenue counterpart. But he contends that to reduce fiscal deficit, tightening development expenditure is not a solution. He advocates quality in fiscal adjustments. Rastogi (2015) gives several reasons for deviations from achieving fiscal deficit targets. However, he also recognizes why those reasons are economically logical.

An Act to provide for the responsibility of the Central Government to ensure intergenerational equity in fiscal management and long-term macro-economic stability by [omitted]1 removing fiscal impediments in the effective conduct of monetary policy and prudential debt management consistent with fiscal sustainability through limits on the Central Government borrowings, debt and deficits, greater transparency in fiscal operations of the Central Government and conducting fiscal policy in a medium-term framework and for matters connected therewith or incidental thereto.

Objectives of the study:

1. To identify deviations in fiscal targets laid-down under FRBM Act.
2. To find if fiscal deficits were rationalized according to rules under FRBM Act.
3. To define alternatively the rationalization of fiscal deficit

METHODOLOGY:

The conditions or more specifically terms of references laid down in the FRBM Act to control fiscal deficit are as follows:
The expected limit to fiscal deficit comes with time lags as follows:
Using little notation for the sake of simplification, the FRBM rule with respect to managing fiscal deficit with an increasing GDP can be given as follows:

$$\lim_{n\to\infty} (GDP_{n-1} - GDP_{n-2}) > 0, \quad \text{then} \quad \lim_{n\to\infty} (FD_{n+1} - FD_n) < 0 \ \ldots (1)$$

GDP_{n-1} is the growth rate in previous year; GDP_{n-2} Growth rate in the year before previous; FD_n stands for fiscal deficit projected for the current year; FD_{n-1} fiscal deficit in the previous year.

The equation (1) gives important insights into the working relationship between the two macroeconomic variables, namely, the gross domestic product and fiscal deficits. It is apparent that when the GDP increases, i.e., posts positive rate of growth successively it generates additional revenues to the State. And when this happens so, the direct impact is noticed on the reduction in fiscal deficit because the State then will have higher revenues to meet its expenditures. Hence, there is better management of fiscal transactions of the government, i.e., the state.

We know that within the macro-economic framework, the variables like, rate of investment, interest, money supply, employment generation and per capita income are positively affected by an increase in the growth rate of GDP. This in turn, generates additional revenues to the government because there will be higher distribution of income out of which direct and indirect taxes correspondingly increase. Finally, as a result of this process, fiscal deficit is expected to be reduced.

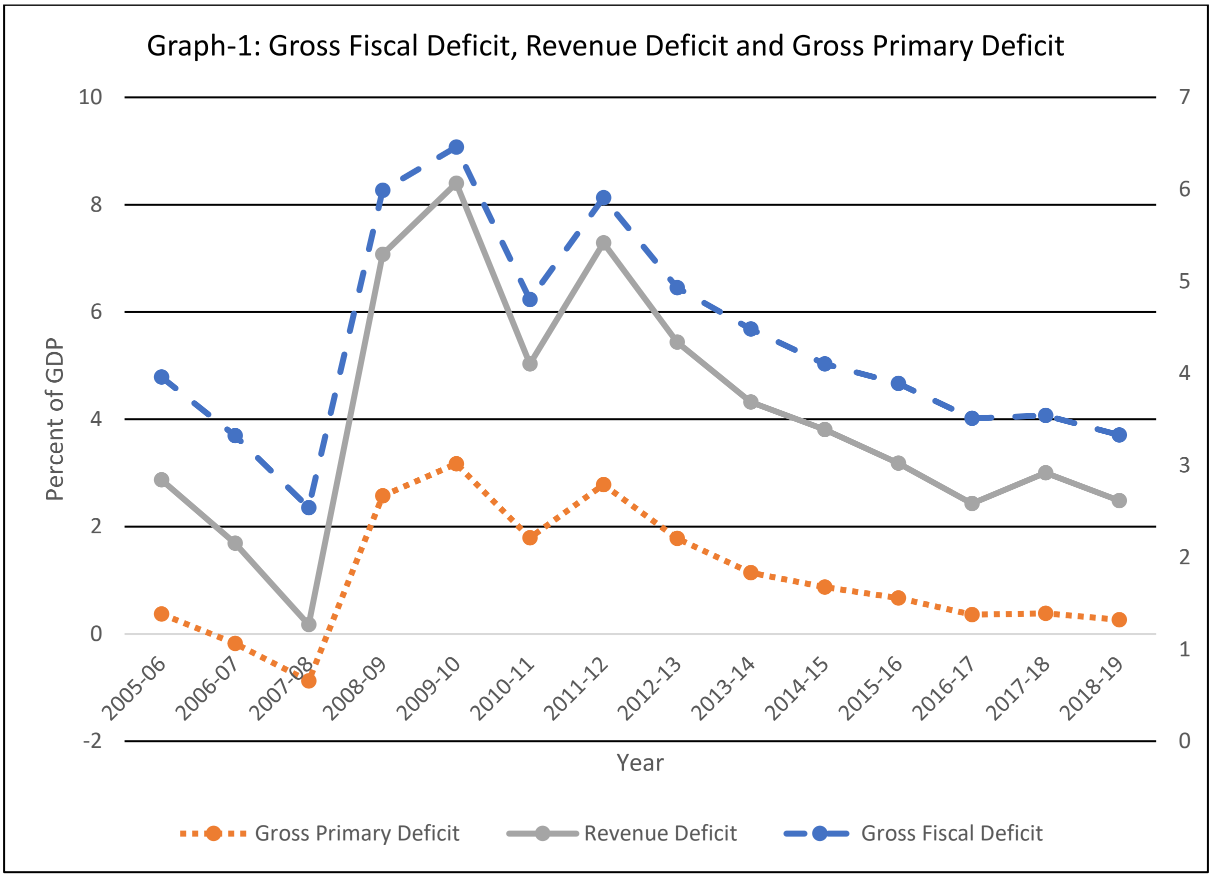
Data Analysis:

Table-1 shows a time-series data of various fiscal indicators presented in terms of percent of GDP between the time period from2012-13 to 218-19. All the fiscal indicators show a steady secular trend in terms of percent to GDP. Revenues show a trend which is steady without showing any significant deviations, either on higher or lower side. Interestingly, the expenditure both on revenue and capital account show continuous decline. As such deficits on all accounts show a declining trend. Internal and external debts also show a continuous decline. The Grph-1 exhibiting gross primary deficit, revenue deficit and gross fiscal deficit the curves of which show declining trend.

Table-1: Various Fiscal Indicators presented as percent of GDP in corresponding years

Fiscal indicators	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Revenue Receipts	8.69	8.94	8.70	8.80	9.06	8.56	8.17
Gross Tax Revenues	10.22	9.99	9.81	10.68	11.26	11.42	10.93
Goods & Services Tax						2.64	3.06
Non Tax Revenues	1.36	1.75	1.56	1.85	1.81	1.15	1.24
Expenditure	13.95	13.73	13.15	13.19	13.04	12.77	12.18
Revenue Expenditure	12.30	12.08	11.59	11.33	11.15	11.20	10.56
Capital Expenditure	1.65	1.65	1.55	1.86	1.89	1.57	1.62
Fiscal deficit	4.85	4.43	4.04	3.92	3.54	3.52	3.42
Revenue Deficit	3.60	3.14	2.89	2.52	2.09	2.64	2.39
Effective Revenue Deficit	2.46	2.00	1.86	1.56	0.99	1.50	1.38
Public Debt	40.51	40.64	40.34	42.07	40.50	40.82	39.71
Internal Debt	37.22	37.35	37.45	39.08	37.81	38.16	37.22
External Debt	3.28	3.30	2.90	2.99	2.69	2.65	2.50

Source: Various issues of Indian Economic Survey.



Source: Table-2.

It can be noticed that the rate of growth of GDP is higher for most of the years between 2005-06 to 2018-19 (Table-2). Except for few years, the GDP growth rate is more than 7.63% during that period. Because of this and as per the macro-economic framework assumed to manage fiscal deficits, it is not out of place to expect reduction in deficits on various accounts. Revenue, primary and gross fiscal deficits are well over 3% which is prescribed in the FRBM Rule. The gross fiscal deficit on an average during the period has been well over 3%, i.e., 4.34% of GDP. Considering an average GDP growth rate of 7.63%, the fiscal deficits might be expected to be managed at 3% of GDP as per FRBM Rule, 2004. The year-to-year fiscal deficit is more than 3% of GDP except for the year 2007-08 when it was just 2.54% of GDP.

Table-2: GDP growth rate and Various deficits

Year	GDP Growth rate	Gross Fiscal Deficit	Revenue Deficit	Gross Primary Deficit
2005-06	9.28	3.96	2.5	0.37
2006-07	9.26	3.32	1.87	-0.18
2007-08	9.80	2.54	1.05	-0.88
2008-09	3.89	5.99	4.5	2.57
2009-10	8.48	6.46	5.23	3.17
2010-11	10.26	4.8	3.24	1.79
2011-12	6.64	5.91	4.51	2.78
2012-13	5.46	4.93	3.66	1.78
2013-14	6.39	4.48	3.18	1.14
2014-15	7.41	4.1	2.94	0.87
2015-16	8.00	3.89	2.51	0.67
2016-17	8.17	3.51	2.07	0.36
2017-18	7.17	3.54	2.62	0.38
2018-19	6.81	3.33	2.22	0.26

Source: Various issues of Indian Economic Survey.

To get better understanding of the change in fiscal deficit the growth rate of it is calculated with the help of the following formula:

$$\text{Growth ate of Fiscal deficit} = \frac{FD_{t-1} - FD_t}{FD_{t-1}} \text{ X } 100 \ldots (2)$$

Where, FD_{t-1} is fiscal deficit in the previous year, FD_t is fiscal deficit during the current year. It is a simple formula for calculating growth rate about a variable. Using this formula, the growth rates of FD is calculated which are presented in column-4 of the Table-3. The column-4 suggests that for the years, 2007-08, 2010-11, 2012-13, 2014-15, 2016-17 the growth rate of FD was actually negative meaning that the FD is managed to bring under control. For the rest of the years the FD is positive which means the FD actually grew year-on-year basis. Corresponding to the signs of growth rate of FD is the identification of compliance of FRBM Rule which is given in the column-5 of the Table-3. If the growth rate of FD is positive it means that there was no compliance of FRBM Rule and vice versa. For the financial years corresponding to the negative growth rate of FD there was compliance with FRBM Rule and corresponding to positive growth rate of FD there was no compliance with FRBM Rule.

Table-3: Year-on-year Growth Rate of Fiscal Deficit as percent of GDP.

Year	Growth rate of GDP	FD as percent of GDP	Year on Year growth rate of FD (in %)	Compliance, If Col. 4 <0 when Col.2 >0
1	2	3	4	5
2005-06	9.28	3.96	15.44	No
2006-07	9.26	3.32	3.78	No
2007-08	9.80	2.54	-20.19	Yes
2008-09	3.89	5.99	172.56	No
2009-10	8.48	6.46	25.05	No
2010-11	10.26	4.8	-12.25	Yes
2011-12	6.64	5.91	42.40	No
2012-13	5.46	4.93	-5.77	Yes
2013-14	6.39	4.48	2.42	No
2014-15	7.41	4.1	-0.18	Yes
2015-16	8.00	3.89	6.47	No
2016-17	8.17	3.51	-2.06	Yes
2017-18	7.17	3.54	13.99	No
2018-19	6.81	3.33	8.59	No

Source: Various issues of Indian Economic Survey.

RESULTS AND DISCUSSION:

The results from the data analysis show one important thing quite prominently which is that the management of fiscal deficit is still at its early stage barring successful limitation of deficits to the prescribed levels un FRBM Rule during few years. While interpreting the results it should be borne in mind that during the time for which the data is considered here, has seen few economic phenomena. In the year 2008 and 2009 the economic system all over the world saw financial meltdown. Monetary and banking system in many advanced countries went into recession because of which Indian economy also had to see certain set-back (Claessens, 2010). However, as the data shows in the Table-3 the Indian economy was not affected much. It showed a growth rate of GDP during the world financial crises though less than the previous year but bounced back to register GDP growth at the rate of 8.48%. The data for 2008-09 and 2009-2010 suggests that Indian government had to spend more than what it earned during those couple of years. Hence, the increase in fiscal deficits. The reason for such increase in the deficits may be due to the pro-activeness of the government to revive the economy which took a hit due to world financial crisis. This is understandable because, the modern-day governments are entrusted with the responsibility to steer the economy when deviation from the expected course is detected (Bhattacharya, 2016). One point to note from the Table-2 is that the revenue deficit is steady and maintained a secular trend and for some years it has increased

Findings of the study:

Though the FRBM Rule stipulates and prescribes the deficit limits, it is found that barring couple of years those limits have not been met with. The gross fiscal deficit does not show the quality of fiscal deficit management. For example, the control of fiscal deficit might have occurred on account of controlling revenue deficit and deficit on account of controlling capital expenditure. What is acceptable is that the control of fiscal deficit on account of revenue deficit is reasoned to be acceptable since, by convention, revenue expenditure is regarded as non-development expenditure (Ramakumar, 2008).

On the other hand, the capital expenditure adds to the capital assets of the economy. Hence, the deficits on account of controlling capital expenditure might be counter-productive. However, in case of capital expenditure also there has been control of the amount being spent. Thus, it can be seen that the management of gross fiscal deficit has been around controlling and rationalizing both revenue and capital expenditure. Table-2 helps us also to identify that the debt obligations of the government is continuously increasing. This aspect read with Table-1 tells that the internal debt obligations are more than external debt obligations. This is good for the economy as this means that when the internal debt obligations are met with the national resources remain within the political boundaries of the national economy. The sum of these findings suggest that revenue expenditure becomes the initial target to control gross fiscal deficits of the government.

CONCLUSION:

The FRBM Rule, 2004, lays down various guidelines and limits to manage gross fiscal deficits. The management of gross fiscal deficits is expected to stick to these guidelines. The gross fiscal deficit has always been above the prescribed limits under the Rule even in the event of higher GDP growth rates. The gross fiscal deficit so far controlled appears to be on account of manging revenue deficits and controlling capital expenditure. On both accounts, such management of deficits is not only critically but also difficult to term as rational especially when the Indian economy needs continuous thrust of investments to boost all round development of the economy.

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