



Mains Practice Question

Q. Enactment of Fiscal Responsibility and Budget Management (FRBM) Act has brought the Indian economy on the path of fiscal prudence only in letter but not in spirit. Critically analyse. (250 words)

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Approach

- Briefly discuss the Fiscal Responsibility and Budget Management (FRBM) Act.
- Enumerate the achievements and failures of the FRBM Act.
- Give suggestions for effective implementation of the Act.

Introduction

Fiscal Responsibility and Budget Management (FRBM) Act was enacted in 2003. The objective of the Act is to ensure inter-generational equity in fiscal management, long-run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in the fiscal operations of the Government.

It provides a legal and institutional framework for fiscal consolidation. It is now mandatory for the Central government to take measures to reduce the fiscal deficit, to eliminate revenue deficit and to generate revenue surplus in the subsequent years. The Act binds not only the present government but also the future Government to adhere to the path of fiscal consolidation.

Body

Implementation of the FRBM Act has significantly improved India's quantitative fiscal situation such as:

- The implementation of the FRBM Act has improved the fiscal performance of both the centre and states. The States have achieved the targets much ahead of the prescribed timeline.
- The Act has helped in the issues relating to fiscal consolidation due to the mandatory medium-term and strategy statements which are required to be presented annually before Parliament.
 - The Act has helped in strict adherence to the path of fiscal consolidation during the pre-subprime crisis period created enough fiscal space for pursuing the countercyclical fiscal policy. Implementing the Act, the government had managed to cut the fiscal deficit to 2.7% of GDP and revenue deficit to 1.1% of GDP in 2007-08.
- However, due to the global financial crisis of 2008, the deadline for the implementation of the targets in the Act was suspended. The fiscal deficit rose to 6.2% of GDP in 2008-09 against the target of 3% set by the Act for 2008-09.

However, the qualitative aspects of fiscally consolidating the economy have remained largely elusive:

- While there is a drastic fall in deficits, it has largely been on account of reductions in expenditure in critical sectors of the economy such as education, health etc. The Union government's development expenditure as a proportion of GDP has declined over time.
- An analysis of revenue account of the development expenditure by states shows that in almost all sectors of development, there has been a decline in the FRBM era.

- Also, at times it has been seen that the government has achieved the deficit targets by manipulating the revenue and expenditure accounts such as curtailing the capital expenditure; demanding interim dividend from Public Sector Undertakings (PSUs) in advance etc.
- Further, the FRBM Act ignores the possible inverse link between fiscal deficit (fiscal expansion) and bank credit (monetary expansion). That is, if credit growth falls, fiscal deficit may need to rise and if credit rises, fiscal deficit ought to fall — to ensure adequate money supply to the economy.
- Data on money supply growth, bank credit and GDP establishes that both money supply growth and credit expansion have significantly reduced in relation to GDP growth. Thus, the FRBM Act has not only reduced the fiscal deficit but also starved the growing economy from much-needed investment.

Conclusion

To ensure effective and efficient operation of the FRBM Act, few steps can be followed such as:

- The Government should consider a medium-term framework for fiscal policy and ensure that over the medium-term targets are met.
- On the basis of international developments, there is a need to build capacity in managing the fiscal policy of the government, and effective and efficient debt management of the government.
- 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 the interest expenditure of the Central Government.
- There is a need to be more specific on 'exceptional circumstances' when the 'pause' button can be used to stall the targets provided by the FRBM Act.
- Recommendations of the N.K. Singh Committee should be implemented in a time-bound manner so that the developmental needs of the economy are not unduly compromised while being on the path of fiscal prudence.