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## Fiscal Prudence

### Why in news?

A close look at the government's accounts highlights that fiscal deficit is owing to low revenues and not high spending.

#### Key terms

##### Fiscal prudence

- It means managing government finances in a responsible and sensible way to ensure the nation's sustainable growth, stability, and welfare.
- Indicators- Fiscal Deficit, Debt-GDP ratio and quality of expenditure.

##### Fiscal Deficit

- It occurs when a government spends more than it earns in a given fiscal year.
- $\text{Fiscal deficit} = \text{Total Expenditure} - \text{Total Revenue (Excluding the borrowings)}$ .

##### Debt-GDP ratio

- It is the ratio of the government's outstanding debt to its gross domestic product which measures the size of the economy.

##### Tax buoyancy

- It measures the responsiveness of tax mobilisation to economic growth.
- A tax is said to be buoyant if the tax revenues increase more than proportionately in response to a rise in national income or output.

### What is the need for fiscal prudence?

- **Stable fiscal policy**- It helps to maintain fiscal sustainability and macroeconomic stability as well as promotes economic growth and social welfare.
- **Safety net**- It can help avoid fiscal crises, reduce public debt and improve the quality of public spending.
- **Effective resource mobilization**- The government should not spend more than it earns, and should use its resources efficiently and effectively to promote the economic and social well-being of its citizens.
- **Future recovery plan**- The government should also plan for the future and be prepared for any shocks or uncertainties that may affect its fiscal position.

- **Long term goals-** It involves making sound decisions regarding revenue generation, expenditure allocation and debt management.
- **Realistic strategy-** The government should have a clear strategy for raising revenues such as taxes, fees or grants and for allocating expenditures such as public goods, services or transfers according to its priorities and needs.
- **Balanced fiscal deficit-** It will indicate that the government is living within its means and not relying too much on borrowing.
- **Low debt-GDP ratio-** It indicates that the government's debt is manageable and not crowding out private investments or consumption.
- **Quality of expenditure-** A high quality indicates that the government is getting value for money and delivering results for its citizens.

*India achieved fiscal prudence by enacting the Fiscal Responsibility and Budget Management (FRBM) Act in 2003, which set targets for reducing its fiscal deficit and debt-GDP ratio.*

#### FRBM Act, 2003

- **Aim-** To ensure fiscal discipline for the Centre by setting targets including reduction of fiscal deficits and elimination of revenue deficit.
- **Main objectives**
  - To introduce transparent fiscal management systems
  - To introduce a more equitable and manageable distribution of the country's debts over the years
  - To aim for fiscal stability in the long run
- **Key features-** The FRBM Act made it **mandatory** for the government to place the following along with the Union Budget documents in Parliament annually.
  - Medium Term Fiscal Policy Statement
  - Macroeconomic Framework Statement
  - Fiscal Policy Strategy Statement
- **Escape clause-** In grounds of national security, calamity, etc, the set targets of fiscal deficits and revenue could be exceeded.
- **NK Singh Committee-** In the Union Budget 2016-17, it was proposed to constitute a committee to review the implementation of the FRBM Act and give its recommendation.

#### What is the picture of Indian economy with respect to fiscal prudence?

- **Fiscal deficit** - Fiscal deficit target is at **5.9%** for 2024 and aims to reduce it to **4.5% by 2026**.
- This is still higher than the **3% target** specified in the *FRBM Act, 2013*.
- **Debt-GDP ratio-** *NK Singh Committee* recommended a debt-GDP ratio of **60% to be achieved by 2023**, but the current ratio is about **81%**.
- This indicates high level of public debt and low revenues.
- **Cost of debt servicing-** India spends about **5.5% of its GDP** on servicing public debt which is more than the combined spending on health and education.
- **Investment-** Most of the debt is financed by *household savings* which curtails private investment.
- **Expenditure profile-** Majority of the government spending is on *interest payments*.

subsidies and pensions which leaves little room for fiscal policy flexibility.

- The government has increased its capital expenditure from **12% to 22%** of the total expenditure which is considered to be productive and growth-enhancing spending.
- **Revenue**- Tax collection especially GST has been increasing over the years, still tax buoyancy is low.

*India's subsidies as a % of GDP were 1.4% in 2020, which was higher than the global average of 0.9%*

### What lies ahead?

- **Tax reforms**- Utilise technologies like Artificial Intelligence- Machine Learning to widen the tax base and ensure compliance.
- **Rationalise GST slabs**- This can be done to simplify the tax system and reduce tax exemptions and rates to improve the tax efficiency.
- **Revisit expenditure composition**- As per Economic Survey 2020-21, the quality of expenditure can be improved by rationalising subsidies, increasing capital expenditure, and adopting outcome-based budgeting.
- **Sectoral reforms**- The government has to initiate sectoral reforms, especially in the power and informal sectors, to improve the efficiency and performance of these sectors.
- **Formalisation**- As per World Bank, the informal sector reforms include enhancing access to finance, social protection and digital platforms.

### Reference

[Business Line- Fiscal prudence a performance check](#)



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