On Path to Fiscal Consolidation

What is the issue?

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- The government has been breaching the fiscal deficit targets time and again.
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- Understanding the fiscal status in the light of the recent budget and the recent review committee's recommendations is imperative.
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What is the FRBM Act?

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- The Fiscal Responsibility and Budget Management (FRBM) Act was enacted in 2003.
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- It led to the framing of FRBM Rules in 2004.
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- **Rules** - It essentially sets targets for the Central government to ensure fiscal discipline.
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- The FRBM rules set a target:
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i. for reduction of fiscal deficit to 3% of the GDP by 2008-09 (with annual reduction target of 0.3% of GDP)
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ii. for complete elimination of revenue deficit by 2008-09 (with annual reduction target of 0.5% of the GDP)
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- **Amendments** - The target of 3% was achieved only once, in 2007-08.
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- It was thus first postponed and later suspended in 2009, following the global financial crisis.
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- The FRBM Act was later amended twice, in 2012 and 2015.
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- In May 2016, the government set up the NK Singh committee to review the FRBM Act.
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- In this backdrop, the recent budget has reset the target again.
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What is the present fiscal picture?

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- **FISCAL DEFICIT** - The current Budget has retained the fiscal deficit at **3.5% of GDP**.
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- This is a deviation from the budgeted target of 3.2%.
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- 3.2% itself is a **deviation** from the stipulated target of 3% for 2017-18 in the amended FRBM Act.
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- **DEBT** - The **debt-GDP ratio** has increased to 49.1% in 2017-18 from 48.7% in 2016-17.
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- The **increase** in debt-GDP ratio is against a declining trend observed until recently.
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- **MTFP** - As per the requirement of the FRBM Act, a medium-term fiscal policy (MTFP) statement is presented in each Budget.
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- The statement pertains to fiscal, revenue, and effective revenue deficits, and outstanding debt of the Central government.
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- A review of the statements highlights **missing the targets** for all four variables often by big margins.
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What are the recent changes in targets?

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- **FISCAL DEFICIT** - Budget 2018-19 has proposed amending the FRBM Act again.
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- This will shift the target of **3%** fiscal deficit-GDP ratio to end-**March 2021**.
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- **DEBT** - The **general** debt-GDP ratio is slated to be reduced to **60%** of the GDP by **2024-25**.
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- The **Central** government debt-GDP ratio is to be reduced to **40%** of the GDP by **2024-25.**
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- These targets are based on the recommendations of the FRBM Review Committee.
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- However, the committee's target of 2022-23 is shifted to 2024-25.
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What are the deviations from the recommendations?

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- **FISCAL DEFICIT** - The FRBM review **committee** proposed the fiscal deficit to GDP ratio to be stabilised at **2.5%.**
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- This target is derived in reference to the annual estimate of available investible resources at 10% of GDP.
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- It comprises of surplus savings of the household sector and sustainable net capital inflows.
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- Apparently, the **government** did not accept this and continued with the **3% target.**
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- If 3% target is the case, the government would have continued with the present FRBM Act.
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- **REVENUE DEFICIT** - The **committee** had specified a revenue deficit glide

path, reaching **0.8% by 2022-23.**
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- But, **no target** has been set by the **government** for revenue deficit **in** the present budget.
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- The target of revenue account balance is significant to a country.
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- It is favourable if a country borrows as long as the entire borrowing is spent on capital spending.
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- However, in the Indian context, the revenue deficit with some adjustments reflects **government dis-savings**.
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- Unless government dis-savings are eliminated, it will be difficult to reverse the trend of a falling savings rate.
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- **FISCAL COUNCIL** - The Committee recommended the setting up of a fiscal council.
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- This is to independently examine the economic case and justification for deviating from the specified targets.
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- This is to keep a check on unconstrained fiscal flexibility and to prevent the possibly avoidable fiscal risks.
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- The Central government however did not accept this recommendation as well.
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What are the concerns?

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- **FISCAL DISCIPLINE** - A slippage margin of 50 basis points implies a delay in reaching the fiscal deficit target by two and a half years.
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- The government has been missing the fiscal responsibility targets year after year and changing the statutory framework repeatedly.
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- This questions the credibility of the government's commitment to fiscal discipline.
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- **EXTRA-BUDGETARY RESOURCES** - In the recent budget, government's

total outlay for 3 **focus areas** is **11.6% of GDP**.
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- The focus areas are agriculture and rural livelihoods, infrastructure and education, and health and social sectors.
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- Notably, **budgetary resources** constitute only **16.4%** of the total outlay.
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- The remaining **83.6%** is to be raised as an **extra-budgetary resource.**
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- This will be through the public sector enterprises concerned, special purpose vehicles and other similar institutions.
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- However, a substantial part of this may only be based on **borrowing**.
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- This is because the relevant bodies may have only limited surpluses.
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- This will be an added borrowing dependence for extra-budgetary resources along with **States' borrowing requirements**.
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- Given the already falling **savings rate**, increased borrowing can put considerable pressure on **interest rates**.
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What is the way forward?

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- The fiscal deficit rule in India has been honoured more in breach than in observance.
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- Another year of fiscal slippage can be fatal for the economy.
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- The fiscal deficit target needs continued vigilance to ensure sustainability for larger fiscal benefits.
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Source: The Hindu

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