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Fiscal Monitoring in India

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India adopted FRBM Act 2003

The basic objectives

- ensuring inter-generational equity in fiscal management
- achieving long term macroeconomic stability.

Results so far not clear yet,

- Target dates postponed repeatedly,
- Slippages, rise in the off-budget activities
- Apprehensions about the coercive attitude
- Search on for better version

This study adds to the debate

The theme:

- Fiscal malaise deep-rooted and external caps alone won't do
- Correct the institutional weaknesses first.
- Why earlier attempts failed
- Need to strengthen FRBMA

Fiscal stress, world over

- Post-stress vs preventive fiscal correction
- Many countries resort to FRRs
- CSA in Australia, DRPC Act of Canada, Goria Plan in Italy, MTFS in UK, Gramm Rudman Hollings Act in USA, FR Act of New Zealand, Stability and Growth Pact of EU, FRL of Argentina .....

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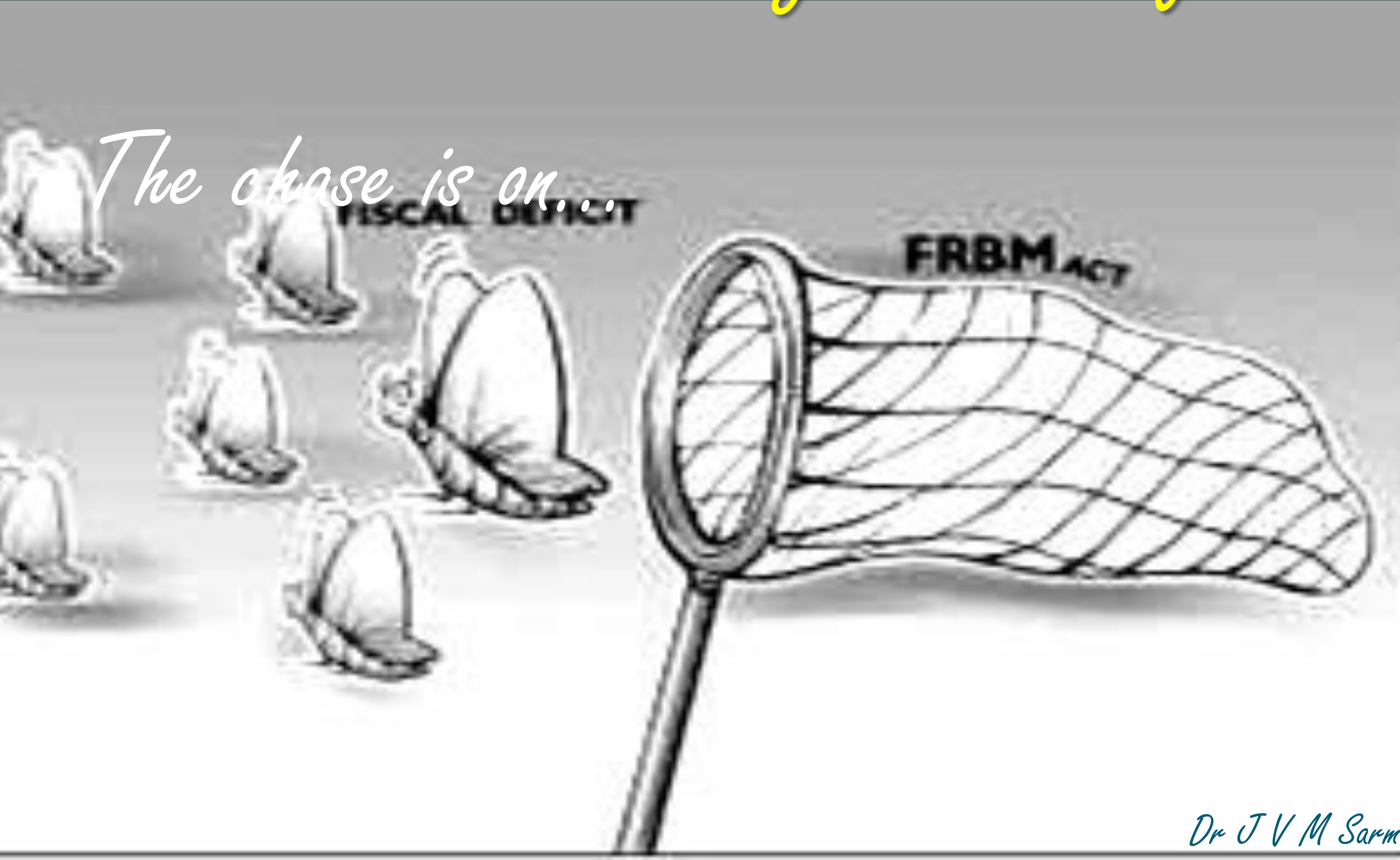
FRBMA 2003 – not yet successful

The chase is on….



Fiscal imbalances:

The leads

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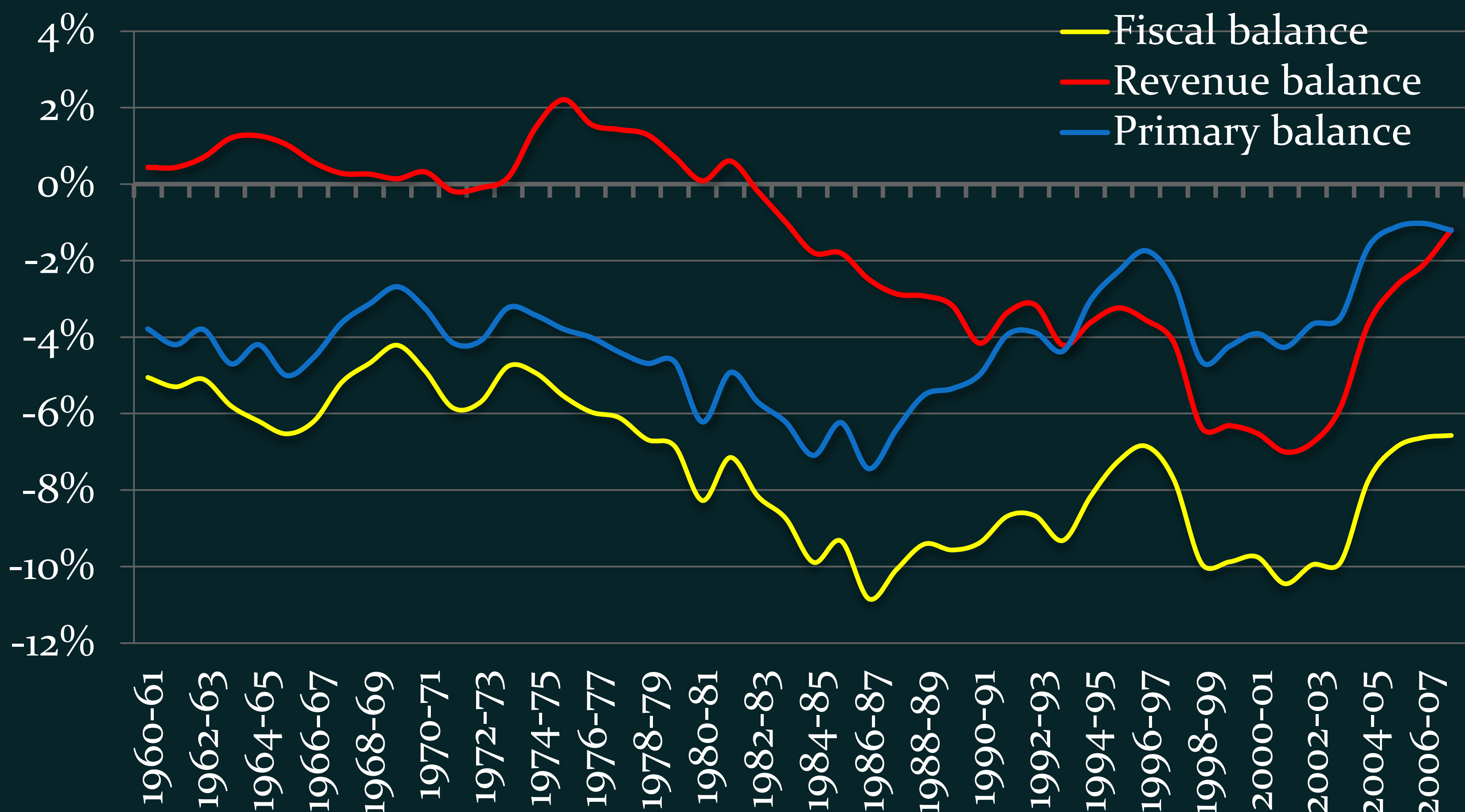
The trends



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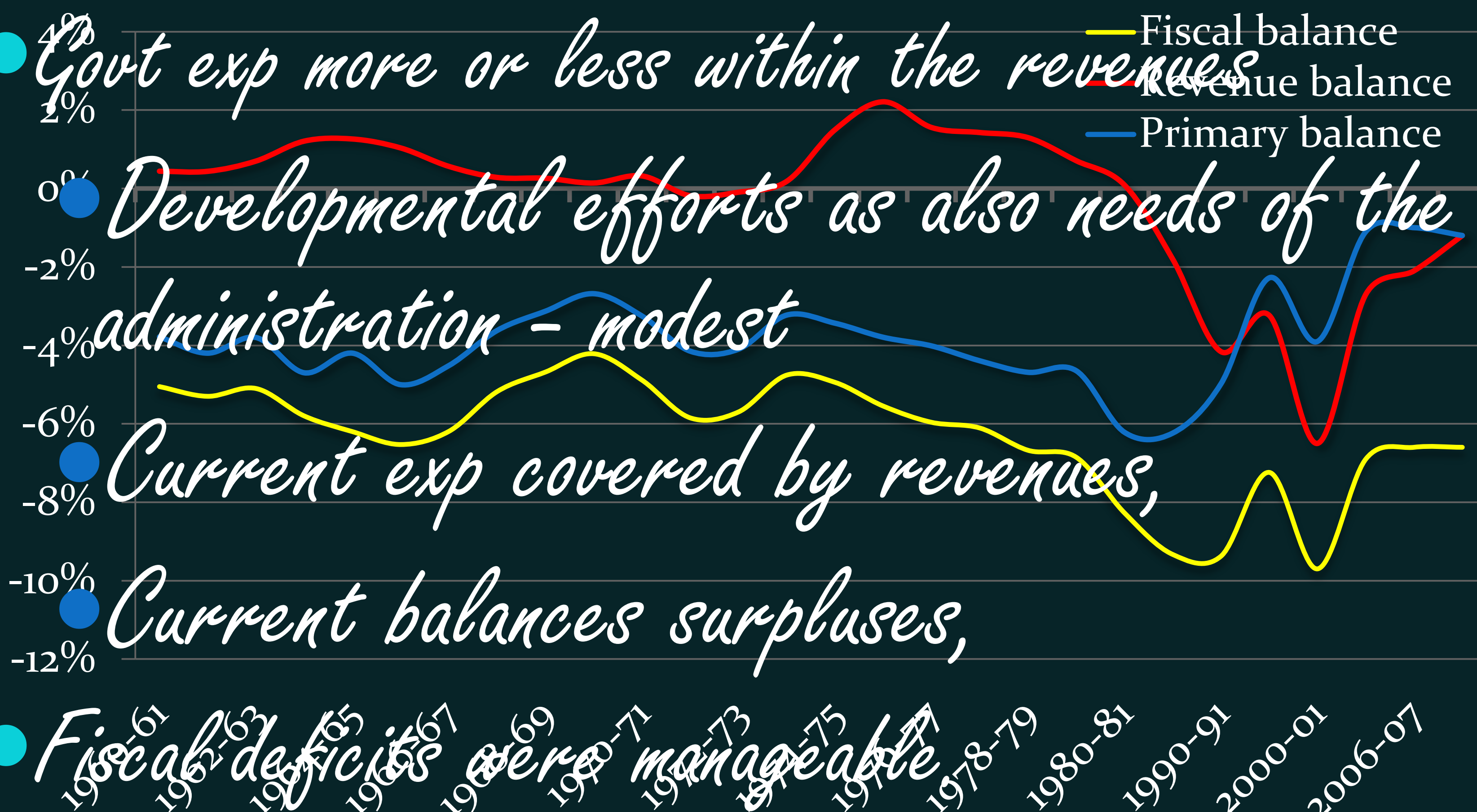
Need for fiscal monitoring not strong till the 80s

- Govt exp more or less within the revenues
- Developmental efforts as also needs of the administration – modest
- Current exp covered by revenues,
- Current balances surpluses,
- Fiscal deficits were manageable



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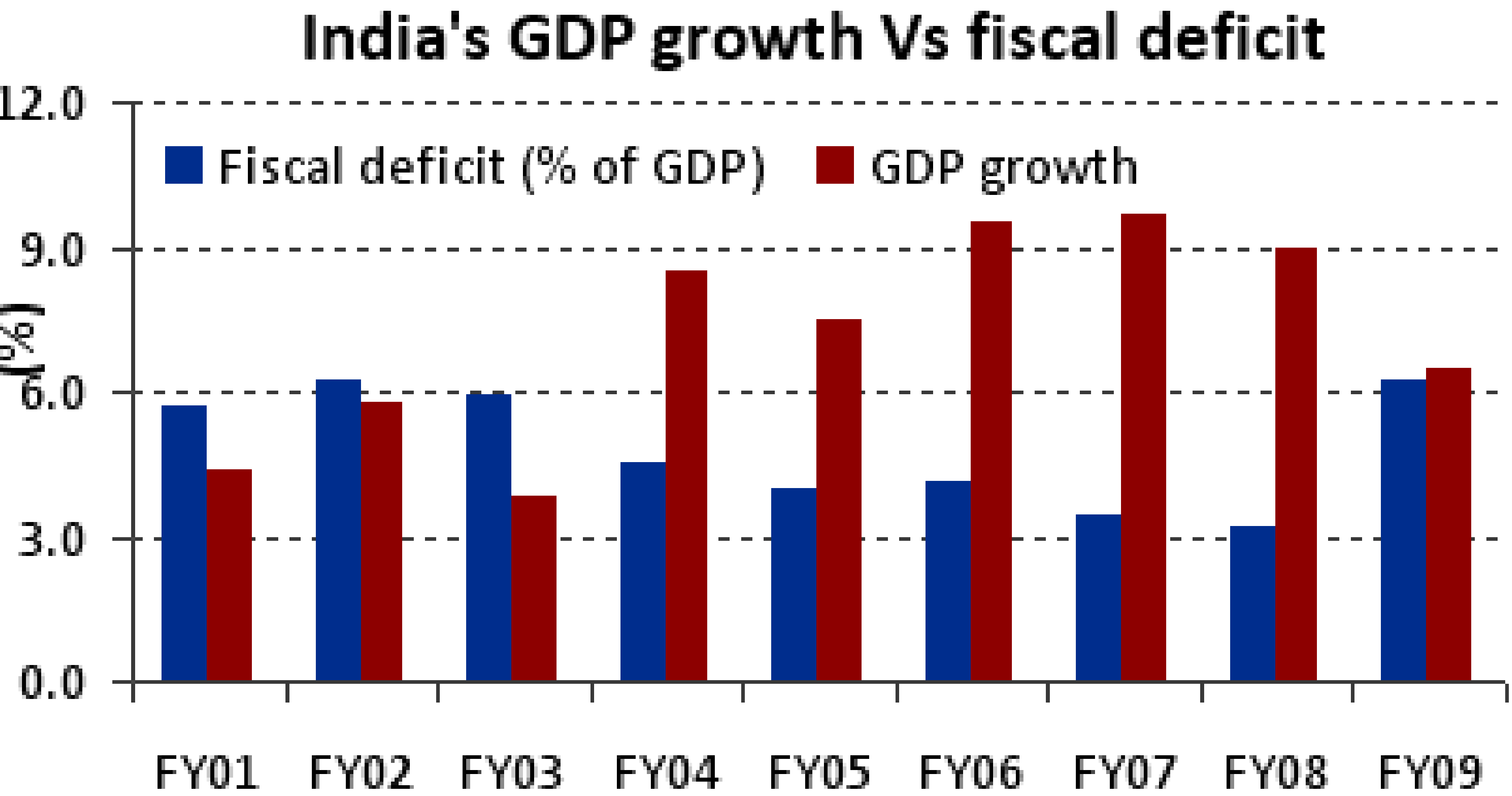
The final impact



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Exigencies of planned devt

- The desire for rapid growth with planning
- Demand for higher resources could be met only with borrowings.
- As long as borrowings financed the cap exp, the situation manageable.
- Difficulty only when the current exp started absorbing the borrowings.

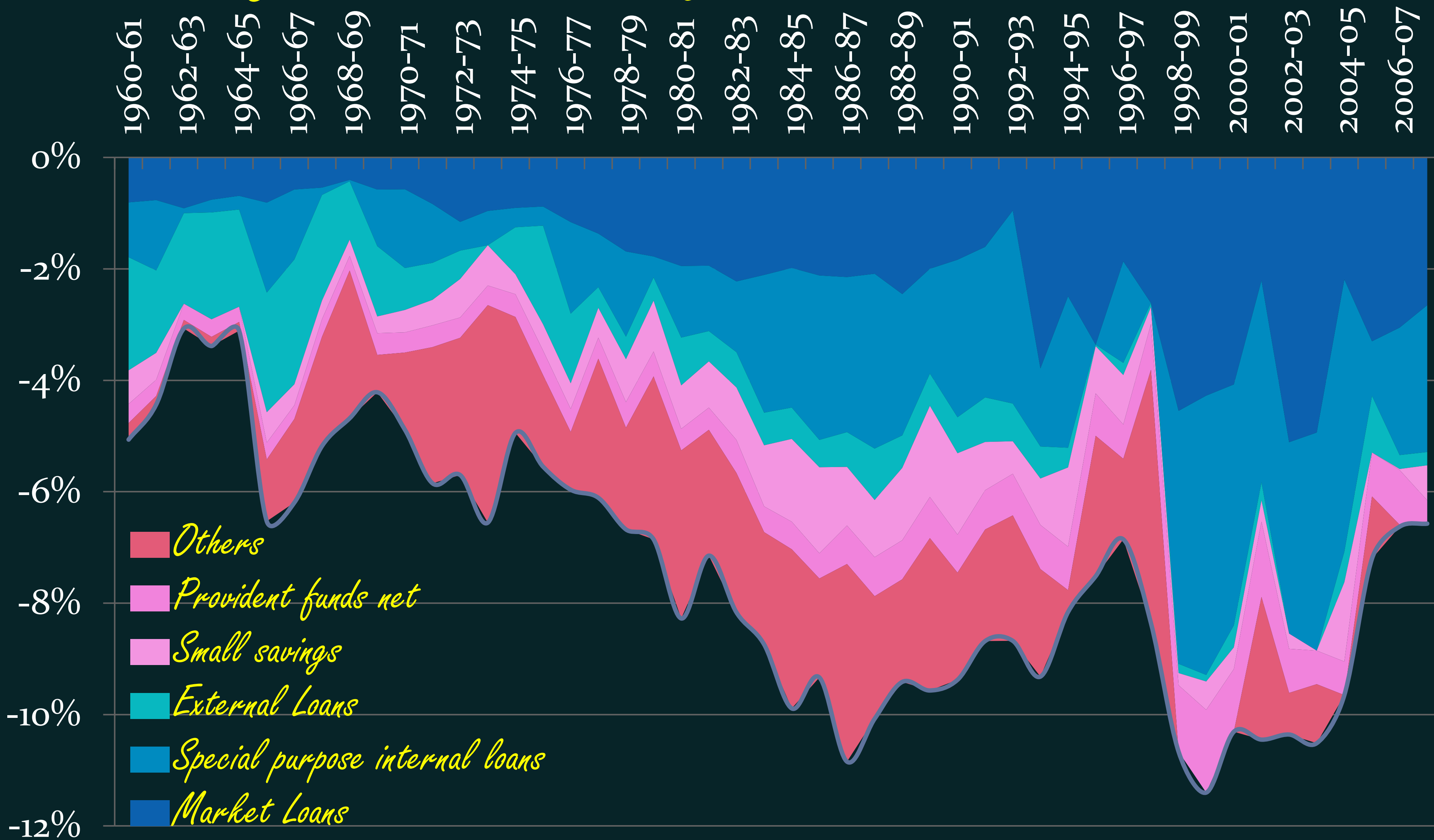
Low productive capital expenditures

- Planned capital investments not always productive, due to
  - Cost over-runs
  - Wrong prioritizations
  - Other bottlenecks.

Wrong mix of public – private sectors

- Capital investments no significant commercial or revenue benefits to the government.
- Not increased the tax bases to ease the need for further borrowings.
  - Controlled license raj hampered private sector
- Debt servicing exp rising and revenue growth fell short resulting in higher current deficit.

Financing Fiscal deficit



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Captive borrowings

- Nationalized banks, financial agencies the easy sources.
- Public accounts and pension funds are under the government control.
- Post office savings - artificially attractive by tax sops.
- IRR on government financial instruments lower thereby crowding out
- Resultant inefficient allocation of resources dampened the economic growth.

Economic liberalization – sea change

- Licence raj eased
- Private sector liberalized
- Reflected in higher growth
- Growth in revenue base due to the TRC

Fiscal Monitoring through Institutions

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Policy designing institutions

- The Constitution
- The Finance Commission
- The Planning Commission
- The Reserve Bank of India

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Monitoring institutions

- Comptroller and Auditor General
- Public Accounts Committee
- Estimates Committee

Constitution

- Division of revenue and exp powers (ch 12)
  - Not so clear
  - Concurrent list – source of vagueness
  - Possibility of infringements

Constitution

- Vertical imbalance – consciously built
  - Not so scientific
- Articles 292, 293 - borrowings
- Provision for Parliamentary control, FC, PC, CAG, RBI
- Parliamentary control
  - PAC, EC, PSU committees

RBI

- Controls the monetary and banking policies
- Provides captive market for govt borrowing,
  - leading to inefficient use of funds
- Crowding out
- Money creation issue

CAG

- Surveillance powers (Article 148)
- Accounting standards and procedures
- Not so clear stipulation
- No compulsion of cash or accrual basis

Finance Commission

- Assessment of Central and State fiscal position
  - Not always unbiased
- Tax devolution on the basis of fiscal efficiency criteria
  - But the weight and importance inadequate
- Tax assignment problem and sharing
- ToR includes macroeconomic stability solutions
  - Recommendations not comprehensive and not long-lasting
  - More concerned about debt-write offs.

Planning Commission

- National comprehensive planning process
  - Somewhat affected due to Gadgil formula
- Project feasibility studies
  - Forecasting errors
- Financial planning essential.
  - No evidence of accuracy.

Externally imposed FPR

not first time

The Evolution: the implicit incentivization

- The FC's horizontal sharing criteria including fiscal efficenciency
  - 10th FC use of tax effort (10%)
  - 11th FC using tax effort (5%) and fiscal self reliance (7.5%)
  - 12th FC use of tax effort (7.5%) and fiscal discipline (7.5%)

Debt-relief scheme

Linked to

- fiscal performance (10, 11FC)
  - r = Rev / Rev exp
  - Relief = $(r - r^*) \times a$
- Disinvestment (10, 11FC)
- RD reduction (12FC)

Debt-Swap scheme

- Central loans (2004-5)
- Consolidating and rescheduling
- Reduced rates of interest

MTFR program (11FC)

- Deficit grants (Art 275)
- 15% withdrawn for deficit States
- Centre contributes +15% to Incentive fund
- Redistributed to all States for fiscal performance
  - Fiscal indicators – deficit, rev, exp, reforms.
- MoF – single indicator, RD.

Why failed

- Single parameter not acceptable
- Inability to reduce RD
- Incentive fund size small
- Complex procedure
- Definition of RD

FRBMA
Main features

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India adopted FRBMA 2003

- Intergenerational equity in fiscal management
- Fiscal sustainability
- Macroeconomic stability
- Improve transparency

Main features of FRBMA

- Numerical limits
  - Fiscal and revenue deficits
  - Debt to GDP ratio
- Procedural rules
  - Statement of MTFF,
  - Statement of FPS and
  - Macroeconomic framework.

Numerical limits on fiscal balances

- Reduction of current deficit-GDP ratio by 0.5% per annum from 2004-5 to reach zero by 2008-9.
- Reduction of fiscal deficit-GDP ratio by 0.3% to reach a minimum of 3% by 2008.

Limits on govt borrowing

- Initial annual limit of 9% on debt-GDP ratio to be further reduced by 1% in each year.
- No borrowing from RBI.
- Limit of 0.5% on the total govt guarantees.

Procedural rules: MTFP statement

- 3-year rolling target for four fiscal indicators
  - CD /GDP,
  - FD /GDP,
  - Tax revenue /GDP ,
  - Total outstanding liabilities /GDP.

Macroeconomic framework statement

- Assessment of sustainability of the balance between revenue receipt and expenditure.
- assessment of GDP, FD, current account balance of the BoP.

Fiscal policy statement

- Policies on taxation, expenditure, market borrowings and other liabilities, lending and investment, pricing of administered goods and services, securities, underwriting and guarantees which have potential budgetary implications.
- Evaluation how the current policies are in conformity with the fiscal management principles.

Fiscal policy statement

- Intra-year bench-marks for assessing the trends in receipts and expenditure relating annual targets and budget estimates.
- Strategic priorities of the Central Government for ensuring financial year in the fiscal area.

States' level FPRs

- Almost all the States had to adopt FPR following the 12th FC
    - Fiscal deficit of 3% of GSDP
    - zero revenue deficit by 2008-09
    - Yearly issuance of guarantees to ½ per cent of GDP;
    - Reduction of total liabilities to 50 per cent of GDP;
    - No borrowing from the Reserve Bank of India.


Welcome to the Era of
FISCAL IRRESPONSIBILITY
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Strengths of the FRBMA

- Good design in line with international practices
- The strength lies in the procedural rules
- Supplement the existing constitutional procedures governing budget processes.
- Similarities to those of advanced countries, – New Zealand, EU and Canada.

Failure due institutional weaknesses

- Because of certain systemic faults
- Some inherent weaknesses of the existing institutional structures
- Insufficient coordination between different institutions relevant for fiscal management;
- other socio-cultural factors.

Systemic faults

- No time frame for forecast corrections
- Ambiguities in the definition of targets
- Postponement of the original deadlines
- Expenditure projections – no transparency yet
- Insufficient recognition of fiscal risks
- Bias against human development expenditure

Systemic faults

- Mis-classification of current and capital expenditure
- Lack of expenditure rules and debt target
- Absence of well-defined penalties for non-compliance
- Widely defined escape clauses
- No independent assessment of statistical forecasts

The right way

- The problem with most of these fiscal responsibility schemes Ignorance of the institutional set up
- More powerful method would be to remove the institutional impediments first and then resort to external FPRs.

The prudent choice

- Need for strengthening the institutions or looking for alternative
- Combining institutional strengthening
- And Modifying FRBM.


UNEMPLOYMENT
5
YOU WORKED FOR THE GOVERNMENT?
I WAS IN CHARGE OF FISCAL RESPONSIBILITY

Thank you!