

CHAPTER 6

Impact of FRBM Act

6.1 The fact that the FRBM Act became a reality shows that it had majority support. So it is pointless and rather late in the day to go into the debate about whether the Act was needed or not and what could have been the possible provisions of the Act. The fact is that whether you like it or you hate it, if you are a fiscal policy practitioner in India or analyst, you can ill afford to ignore the FRBM Act 2003 and the related developments. In this chapter, we will take up an evaluation of the impact of FRBM Act on the budgetary process in Government of India and try and assess the extent to which the objectives underlying the Act have been achieved.

6.2 For the last seven years, since the enactment of FRBM Act, every budget has regenerated the debate about efficacy of this Act and every successive Finance Minister has been compelled to spell out the stand of the Government towards achieving the targets mandated under the FRBM Act and the Rules framed thereunder. Let us try and examine some questions relating to implementation of the Act on ground to see how committed the governments of the day have been to the Act and to what extent.

Government's Commitment to FRBM Act

6.3 Let us try and track the journey of implementation of the FRBM Act through the budget speeches of 2004-05 to 2010-11. As stated above, the FRBM Act became a reality in August 2003 after heated debate regarding each and every proposed clause in the FRBM Bill and after amendments being made to many of the provisions included therein. Immediately after the enactment of this law there was a change of Government at the Centre. Serious doubts regarding adherence to FRBM targets arose as the new Government was dependent on support of left parties for its existence, who were opposed to the concept of FRBM. Act. But, in the Common Minimum Programme (CMP), announced on May 22, 2004 the new Government's commitment to eliminate revenue deficit of the centre by 2009 found a categorical mention.

6.4 A reiteration of CMP commitment of the UPA Government towards FRBM was seen in the Finance Minister's Budget Speech 2004-2005. While presenting the Budget, the Finance Minister stated that, "*The Fiscal Responsibility and Budget Management Act (FRBM) 2003 has streamlined the Budget presentation process. The Government has demonstrated its commitment to prudent fiscal and financial policies by notifying the Act and the Rules with effect from July 5, 2004. Along with the Budget, a medium-term fiscal policy statement, a fiscal policy strategy statement and a macroeconomic framework statement are being presented to the House*".

6.5 However, despite the stated commitment of the Government to meet the FRBM targets, the then Union Finance Minister, in the Budget Speech while presenting the Budget for 2005-06, stated that despite being confident of meeting the FRBM targets for the year 2004-05, he was being compelled to put a temporary stop on the FRBM button in his projections for the year 2005-06 because of the additional burden of nearly Rs. 26000 crore arising from implementation of the recommendations of the XII Finance Commission.. He stated:

"What gives me satisfaction is that, while faithfully attempting to implement the mandate of the NCMP, I have been able to remain on the path of fiscal consolidation. According to the revised estimates for 2003-04, the revenue deficit was 3.6 per cent and the fiscal deficit was 4.8 per cent of GDP. The FRBM Act requires a reduction in the two ratios, respectively, of 0.5 per cent and 0.3 per cent every year. I am happy to inform the House that we will achieve this degree of fiscal correction in 2004-05, and the year is expected to end with a revenue deficit of 2.7 per cent and a fiscal deficit of 4.5 per cent of GDP. Consequent to accepting the recommendations of the Twelfth Finance Commission and the drastically changed pattern of devolution and funding, there has been a considerable strain in making the Budget for 2005-06. I was left with no option but to press the 'pause' button vis-a-vis the FRBM Act. I am relieved that we have not been forced to go in the opposite direction. I may add that we are perilously close to the limits of fiscal prudence and there is no more room for spending beyond our means. I am confident that we can resume the process of fiscal correction with effect from 2006-07 and achieve the FRBM goals by 2008-09."

6.6 During 2005-06 more than 9% growth rate of the economy proved to a boon for fiscal consolidation process since the receipts of the Government exceeded the budget estimates and the actual expenditures fell short. According to the revised estimates for 2005-06, the revenue deficit for the year was only 2.6 per cent and the fiscal deficit only 4.1 per cent, a marked improvement over the budget estimates. Announcing the Budget estimates of 2.1% for revenue deficit and 3.8% for fiscal deficit for the year 2006-07, the Finance Minister claimed in his budget speech that he had redeemed his promise that the process of fiscal correction will be resumed in 2006-07.

6.7 The buoyant growth of Government revenues during 2007-08 further facilitated fiscal consolidation. The tax to GDP ratio increased from 9.2 per cent in 2003-04 to 12.5 per cent in 2007-08 bringing the Union Government "*within striking distance*" of the target for fiscal correction. The revised estimates for revenue deficit and fiscal deficit stood at 1.4 per cent (against a BE of 1.5 per cent) and 3.1 per cent (against a BE of 3.3 per cent), respectively. The year 2008-09 was a crucial year from the point of view of fiscal correction at the Centre, as this was the year in which the ultimate targets of elimination of revenue deficit and reduction of fiscal deficit to not more than 3% of GDP were to be attained. But, the then Finance Minister sought, in his budget speech, one more year from the Parliament for elimination of revenue deficit.

6.8 The year 2008-09 proved to be far more difficult than what the Government had envisaged mainly due to a world-wide economic recession, the impact of which was felt in India as well. The Government was compelled to boost the economy by way of a fiscal stimulus resulting in sharp increase in its total expenditure. As a result, the estimates of revenue deficit and fiscal deficit for the year 2008-09 were revised upwards to 4.4% and 6% of GDP respectively.

6.9 The interim budget for the year 2009-10 was significant in so far as it was the last budget before the general elections, and more importantly, this was the first budget that the Government was presenting post the global meltdown. The reversal of fiscal consolidation process was reflected in the Finance Minister's budget speech as he clarified while presenting the interim budget (2009-10).

“Extraordinary economic circumstances merit extraordinary measures. Now is the time for such measures. Our Government decided to relax the FRBM targets, in order to provide much needed demand boost to counter the situation created by the global financial meltdown. Indeed, depending on the response of the domestic economy and the revival of the global economy, there may be a need to consider additional fiscal measures when the regular budget is presented by the new Government after the elections. However, the medium term objective must be to revert to the path of fiscal consolidation at the earliest.

6.10 This is what the Finance Minister had to say about FRBM while presenting the final budget for the financial year 2009-10:

*“The short term fiscal stimulus has to be balanced against long term prudence and fiscal sustainability objectives. To quote **Kautilya**, “In the interest of the prosperity of the country, a King shall be diligent in foreseeing the possibility of calamities, try to avert them before they arise, overcome those which happen, remove all obstructions to economic activity and prevent loss of revenue to the state”. I intend to take **Kautilya’s** advice and return to the FRBM target for fiscal deficit at the earliest and as soon as the negative effects of the global crisis on the Indian economy have been overcome”.*

6.11 With the budget estimates of fiscal deficit and revenue deficit being placed at 6.8% of GDP and 4.8% respectively in the 2009-10 (final) budget, reversion to the path of fiscal consolidation appeared to be a daunting task. In addition, the path itself was not clear as neither the FRBM Act nor the Rules framed thereunder had laid out a path beyond the target year of 2007-08, which was later extended to 2008-09 through an amendment to the Act. In absence of a well laid out path for fiscal consolidation, the Centre amended the terms of reference of the Vijay Kelkar-led Thirteenth Finance Commission in August 2008, to include a review of ‘the roadmap for fiscal adjustments’ and suggest a ‘suitably revised roadmap to maintain the gains of fiscal consolidation through 2010 to 2015.

6.12 The Report of the Thirteenth Finance Commission (TFC) was placed before Parliament on 25th February, 2010. TFC has recommended that the Government must cut its fiscal deficit to 3% of the GDP by the end of fiscal year 2013-14, eliminate its revenue deficit in 2014-15 and cap its total debt at 68% of the GDP by the end of financial year 2014-15. According to the TFC, The fiscal deficit is estimated at 5.7% in the year ending on March 2011, and will fall further to 4.8% in the year 2011-12. The report said that the fiscal deficit should drop to 4.2% in 2012-13 and to 3% in 2013-14. The Government has accepted all major suggestions of the 13th Finance Commission.

6.13 While presenting the budget for the year 2010-11 on 26th February 2010, the Finance Minister reiterated the need for fiscal policy to be guided by the required framework for fiscal prudence and pegged the Budget Estimate of fiscal deficit for the year at 5.5% of GDP. Regarding revised estimate of fiscal deficit and for the current year (2009-10), he had the following to say,

“While presenting the Budget for 2009-10, I had expressed my concern about the high level of fiscal deficit. I had also stated that the Government will address this issue in right earnest to come back to the path of fiscal consolidation at the earliest. I am happy to report that against a fiscal deficit of 7.8 per cent in 2008-09, inclusive of oil and fertiliser bonds, the comparable fiscal deficit is 6.9 per cent as per the Revised Estimates for 2009-10. Both

these deficit figures are based on the revised GDP numbers published by the Central Statistical Organization and include what were earlier referred to as below the line items. This marks an improvement of about one per cent in fiscal deficit during the current year. I have made a conscious effort to avoid issuing bonds to oil and fertiliser companies. I would like to continue with this practice of extending Government subsidy in cash, thereby bringing all subsidy related liabilities into our fiscal accounting"

6.14 To see how the Government intends to get back to the path of fiscal consolidation and bring down fiscal deficit from 7.9% in 2009-10 to projected level of 5.5 of GDP, one needs to look at the fiscal policy strategy statement placed before Parliament on 26th February 2010. In this statement the Government has clarified that the process of fiscal consolidation is being restarted in 2010-11 after the deviations experienced during 2008-09 and 2009-10. *'Though the revenue base has not yet increased to the level of 2007-08, yet by carrying out expenditure reforms and with the help of disinvestment proceeds, the Government will be able to bring down the fiscal deficit to the estimated level of 5.5 per cent of GDP in 2010-11. With the introduction of the Direct Tax Code in 2011-12 and also the likely introduction of GST in 2011-12, it is expected that the fiscal deficit would be brought down in 2011-12 and 2012-13 in line with the recommendations of the Thirteenth Finance Commission. This level of deficit would reduce the debt to GDP ratio from 51.1 per cent in RE 2009-10 to 48.2 per cent in 2012-13.*

However, the mandated correction under the FRBM Act and Rules can be achieved once the revenue buoyancy is restored to the earlier level of 2007-08'.

Self Assessment by the Government

6.15 The preceding paragraphs discuss the commitment of the Union Government in meeting the targets laid out in the FRBM Act and Rules. We now move on to the more pertinent question of whether and how the commitment of Government was translated into reality. In other words, we move from the world of budget estimates and revised estimates to the world of actuals.

6.16 The self assessment of the Government in this regard is reflected in the Fiscal Policy Strategy Statements for the last two years placed before Parliament. In these statements the Government has patted its back and claimed that significant improvement in fiscal indicators, during the FRBM Act, 2003 regime definitely put the country on a higher growth trajectory inspiring confidence in the medium to long term prospects of the economy. The Government claims that the process of fiscal consolidation during these years has resulted in improvement in fiscal deficit from 5.9 per cent of GDP in 2002-03 to 2.7 per cent of GDP in 2007-08. During the same period, revenue deficit has declined from 4.4 per cent to 1.1 per cent of GDP. In tune with the philosophy of equitable growth, the process of fiscal consolidation was taken forward without constricting the much-required social sector and

infrastructure related expenditure. This improvement in the state of public finances was achieved through higher revenue buoyancy, driven by efficient tax administration and improved compliance which is evident from increase in the tax to GDP ratio from 8.8 per cent in 2002-03 to 12.5 per cent in 2007-08.

6.17 Further, the Government has explained away the reasons for departure from the FRBM targets by stating that riding on the path of fiscal consolidation, the Union Budget 2008-09 was presented with fiscal deficit estimated at 2.5 per cent of GDP and revenue deficit at 1 per cent of GDP. However after the presentation of the Union Budget in February 2008, the world economy was hit by three unprecedented crises - first, the petroleum price rise; second, rise in prices of other commodities; and third, the near breakdown of the global financial system. The combined effect of these crises of unprecedented magnitude was bound to affect emerging market economies and India was no exception. The first two crises resulted in serious inflationary pressure in the first half of 2008-09. The focus of the monetary as well as fiscal policy shifted from fuelling growth to containing inflation, which had reached 12.9 per cent in August, 2008. Series of fiscal measures both on tax revenue and expenditure side were undertaken with the objective of easing supply side constraints. These measures were supplemented by monetary initiatives through policy rate changes by the Reserve Bank of India, and contributed to the softening of domestic prices. Headline inflation fell to 4.39 per cent in January, 2009. However, the fiscal measures undertaken through tax concessions and increased expenditure

on food, fertiliser and petroleum subsidies along with increased wage bill for implementing the Sixth Central Pay Commission recommendations significantly altered the deficit position of the Government.

6.18 Not everyone, however, is supportive of this assessment of the Government. There are many who were critical of the FRBM Act *ab initio* and continue to be severely critical of the outcome. One such critique Paranjoy Guha Thakurta writes (Deccan Chronicle on the web) that, "*The time has come for the next Parliament to repeal the Fiscal Responsibility and Budget Management (FRBM) Act. Wait! Do we hear howls of protest that this would be a sure-fire recipe for financial profligacy and worse, rampant inflation? Not really. The FRBM Act was a piece of legislation that became an article of faith for neo-liberal economic ideologues – led in India by the triumvirate comprising Prime Minister Manmohan Singh, former finance minister P. Chidambaram and Planning Commission deputy chairman Montek Singh Ahluwalia – but which has today become irrelevant in the context of the ongoing worldwide recession that has resulted in a sharp slowing down of the rate of growth of the Indian economy*".

6.19 Then there are others who support the discipline underlying the FRBM Act but who feel that the adherence to the FRBM targets has been at the cost of development expenditure. One such thinker, Dr. Ameresh Bagchi (late) had commented (The Economic and Political Weekly; September 30, 2006) in his article titled "India's Fiscal Management Post Liberalisation" that,

“An exclusive focus on deficit reduction has had the adverse fallout for public spending on health and education in several states, forcing shrinkage of the public sector’s involvement in the social sector. Policy-makers are now seeking an escape route by getting the fiscal and revenue deficit targets relaxed. While there can be valid arguments against inflexible targets, abandoning the discipline underlying fiscal responsibility legislation, as has been suggested, is questionable. For, at base, the fiscal problems of democracies have their origin in the short time horizon of governments and their penchant for promising the moon to the electorate while showing an extreme reluctance to tax.”

6.20 The assessments of FRBM Act both by the Government as well as the detractors suffer from an inherent bias and at best give only a partial picture. They are primarily concerned with fiscal targets. Unfortunately, the debate on the FRBM Act right since its inception has been mainly confined to discussing the need to attain the fiscal targets and their implications. These fiscal targets, no doubt, form an important component of the legislation in so far as fiscal discipline is concerned, but we can ill afford to ignore the other aspects of the Act. Any serious analysis of impact of FRBM on discharge of fiscal policy by Government and reforms in the budgetary process post FRBM Act will be incomplete without a discussion about attainment of greater fiscal transparency and the need to move into medium-term framework of fiscal policy which are essential objectives of the FRBM Act.

An Independent Assessment of the extent to which the objectives of the FRBM Act have been achieved

6.21 Going beyond the claims of the Government on one hand and those of the critiques on the other, I propose to undertake an objective and comprehensive evaluation of the process of implementation of the FRBM Act in the following paragraphs. In this process of evaluation, apart from looking at the trend of fiscal parameters, it is considered critical to find answers to the following questions:

- What has been the impact of reduction in fiscal and revenue deficit on the level of public expenditure?
- Has the envisaged improvement in quality of expenditure taken place?
- Has the process of fiscal policy and budgeting become more transparent?
- Has the practice of keeping some of the Government's liabilities 'off budget' being contained?
- Is the Union Government on course regarding targets relating to total liabilities and contingent liabilities (guarantees etc.)?
- Has the objective of moving into medium-term frame work of budgeting and fiscal policy been attained?

Fiscal targets

6.22 The following table summarizes the position with regard to fiscal and revenue deficits of the Union Government in the last few years:

TABLE 2

Fiscal year	Fiscal deficit as a percentage of GDP	Revenue deficit as a percentage of GDP	Primary deficit as a percentage of GDP
2009-10(BE)	6.8	4.8	3.0
2008-09(RE)	6.0	4.4	2.5
2007-08	2.7	1.1	-0.9
2006-07	3.5	1.9	-0.2
2005-06	4.1	2.6	0.4
2004-05	4.0	2.5	0.0
2003-04	4.5	3.6	0.0
2002-03	5.9	4.4	1.1

(Source: Budget documents of Government of India)

6.23 An analysis of the above table would confirm the Finance Minister's claim that in the year 2007-08, the Union Government was very close to reaching the fiscal targets as given in the legislation. The data relating to 2008-09 and 2009-10 also clearly support Government's claim of Indian economy having been significantly impacted by global financial meltdown. The rate of growth of the economy declined steeply bringing down with it the revenue collections and reversing the fiscal correction process. However, merely based on the above analysis, it would be too simplistic to conclude that the government of India was well on its way to fully achieving all the objectives embedded in the FRBM Act 2003 but the global

meltdown put a halt on the process. To arrive at any meaningful conclusion we also need to look at other parameters like trends in Government expenditure and revenue etc.

Trends in expenditure and revenues

6.24 The most common apprehension that in its quest to attain the FRBM targets, Government will curtail expenditure has not proved to be right. In fact, there has been an upward trend in both Plan and Non-plan expenditure and the total expenditure of the Government has more than doubled between 2004-05 to 2009-10, as would be evident from the following table.

TABLE 3

Trends in Expenditure of Government of India

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Non Plan	365960	365100	413527	507589	617996	695689
Plan	132292	140638	16986	205082	282957	325149
Total Exp	498252	439376	583387	712671	900953	1020838
Revenue	384329	439376	514609	594433	803446	897232
Capital	113923	66362	68778	118238	97507	123606

(Source : Budget documents of Government of India)

6.25 Two other features about composition of expenditure of the Union Government merit mention;

- (i) Total expenditure as a percentage of GDP declined from 14.3% in 2004-05 to 13.95 in 2007-08 and increased thereafter to 15.9% in 2008-09(RE) and 16.2% in 2009-10(BE).
- (ii) Share of capital expenditure in total expenditure post FRBM Act has shown a decline.

Decline in total expenditure as a percentage of GDP should not be seen as a matter of concern as during the first 5 years after the enactment of the FRBM Act, plan expenditure as percentage of GDP has remained more or less stable at around 4% of GDP and reduction in total expenditure was mainly due to decline in Non-Plan expenditure which was attributable to reduction in interest liability to a great extent. Reduction in the share of capital expenditure in total expenditure is, however, a matter of worry. This qualitative change in union expenditure can pose problems for a growing economy like India, facing a major challenge of inadequate infrastructure.

6.26 While looking at the quality of expenditure of the Union Government, Mala Lalvani writes (Economic and Political Weekly , September 12, 2009), *“Clearly, since the passing of the FRBM Act by the centre in 2003, there has been some reduction in the major deficit indicators (barring the worsening of the deficit in 2008-09(RE) and 2009-10(BE)). However, for a complete and correct picture, it is essential to go a step further and look “below the line” at the structure or composition of the fiscal correction that has occurred*

on the expenditure side of the budget. The share of revenue and capital expenditure has worsened in the post-FRBM phase with a rising share of revenue expenditure and a falling share of capital expenditure. A look at the share of revenue and capital expenditure in total expenditure at the central government level indicates that the share of revenue expenditure in total expenditure has increased from 77% in 2004-05 to 89% in 2008-09 (RE), thus implying that the share of capital expenditure has declined from 23% to 11%."

6.27 This fact was pointed out to Deputy Secretary (FRBM) in the Ministry of Finance, Government of India, in an informal interview. The officer clarified that this trend was inevitable as increasingly the budget allocations of the Union Government are taking the shape of grants to the State governments or direct grants to the organizations implementing social programmes. As per the accepted classification of expenditure, all grants have to be classified in the books of the donor as revenue expenditure, thus the share of revenue expenditure of the Union Government has been increasing. He pointed out that the question of classification of grants was under deliberation of Government Accounting Standard Advisory Board (GASAB). He, however, clarified that under the present dispensation, a combined balance sheet of the centre and state government and the percentage of their combined expenditure on capital account would be a better indicator of quality of expenditure. He also highlighted the fact that the 'Approach Paper to the Eleventh Five Year Plan' has questioned the wisdom of treating all expenditure on health and education as revenue expenditure despite the fact that such expenditure adds substantially to

creation of human capital. In absence of the on-going debate about the classification of expenditure itself, it would be difficult to arrive at any conclusion on quality of expenditure in so far as share of revenue expenditure versus capital expenditure is concerned.

6.28 Economic Survey placed before the Parliament on 25th February 2010 states that “reductions in fiscal deficit in the period 2003-04 to 2007-08 were made possible in equal measure by higher tax revenues and expenditure compression”. Trends in Expenditure read with trends in tax-receipts indicate that the Government has broadly followed the fiscal correction path advocated by Kelkar as the Tax-GDP ratio increased from 8.20% in 2001-02 to more than 12% in 2007-08. Thus, the secular upward trend in Tax-GDP ratio as depicted in the following table would indicate that fiscal correction post FRBM Act has been broadly revenue-led although the increase in tax receipts has not been of the order envisaged in the Report of the task-Force headed by Kelkar.

TABLE 4

Trends in Tax-GDP Ratio (*per cent*)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Gross tax revenue/GDP	8.81	9.23	9.68	10.23	11.42	12.5

(Source: C&AG's Report on accounts of Union Government 2007-08)

6.29 The debate on quality of expenditure will, however, be incomplete without a mention about shift from outlays to outcomes. A renewed emphasis on outcome

budgeting in Government of India since 2005-06 indicates that atleast an attempt was being made to adhere to Kelkar's (Task force Report),' advice that there is a need for a greater focus on public good outcomes'. Presenting the Union Budget 2005-06 in Parliament on February 28, 2005, the finance minister had said:

"I must caution that outlays do not necessarily mean outcomes. The people of the country are concerned with outcomes. The prime minister has repeatedly emphasised the need to improve the quality of implementation and enhance the efficiency and accountability of the delivery mechanism. During the course of the year, together with the Planning Commission, we shall put in place a mechanism to measure the development outcomes of all major programmes. We shall also ensure that programmes and schemes are not allowed to continue indefinitely from one Plan period to the next without an independent and in-depth evaluation,".

6.30 However, my analysis (Chapter 4) shows that in reality, there has been no paradigm shift from outlays to outcomes in Union Government budgeting. The finding is supported by Harnita Chowdhury, who writes (EPW June 24, 2009), *"Though the basic procedure remains the same as in the administrative budget, performance budgeting emphasises the implementation and evaluation stages with a stress on the physical aspects too. It involves a modification of the classification, accounting, workload and organizational aspects. However in India, even till date the performance budgets are merely*

conversions of the administrative budgets into performance type of budgets. While the formal elements are in place, the system suffers from neglect and its penetration of decision-making is patchy and superficial. Thus in the words of Briones it has largely been "a reform of mere form, not substance" [Toye 1981]."

6.31 It seems that the Government has itself realized the futility of continuing with the exercise in its present form as the Deputy Chairman of the Planning Commission has gone on record (October 2009) to say that "The outcome budget is not that useful. We need to have better understanding of both the issues involved and the ground situation," Dr. Ahluwalia said sectors like health and education needed a different approach as it was difficult to gauge the ground situation. The process of evaluation in such areas was more complex and desired results cannot be expected by manipulating existing data. He said the government, accordingly, was not pleased with the outcome budget in the present format.

Fiscal transparency

6.32 Another important objective forming the foundation of the FRBM Act is the need for attaining greater transparency in fiscal operation which *inter-alia* entails:

- Minimization of secrecy in the preparation of Budget
- Disclosure of significant changes in accounting standards, policies and practices
- Disclosure of all contractual and contingent liabilities

6.33 The manner in which the Government's most important fiscal tool i.e the budget is prepared would indicate the fiscal policy dispensation in India continues to be opaque. Budget of the Government of India has been receiving a lot of media attention and a lot of hype is generated about it every year. There are speculations galore about what the budget is likely to contain and what it ought to contain. But, not many people in this country, including the expert budget analysts, know that the budget document is guarded as one of the biggest national secrets. That, nearly 150 people are 'locked' inside the budget press for 9-10 days, totally cut-off from the rest of the world in order to make sure that there are no budget leakages which would tantamount to breach of privilege of the Parliament. There is hardly any rationale or justification for this kind of secrecy surrounding the budget in an environment where more and more countries are opting for participative open budgeting. Our analysis (chapter 4) on budgetary process shows that despite passage of seven years after the enactment of the FRBM Act, there exists opaqueness in the process of budgeting which defies logic.

6.34 The Twelfth Finance Commission (TFC) in their Report submitted to the Government in November 2004 had recommended inclusion of the following eight additional statements/information in Union Government accounts for greater transparency to enable informed decision making:

- (i) Statement of subsidies given, both explicit and implicit,
- (ii) Statement containing expenditure on salaries by various departments/units,
- (iii) Detailed expenditure on pensioners and expenditure on government pensions,
- (iv) Data on committed liabilities in the future,
- (v) Statement containing information on debt and other liabilities as well as repayment schedule,
- (vi) Accretion to or erosion in financial assets held by the government including those arising out of changes in the manner of spending by the government,
- (vii) Implications of major policy decisions taken by the government during the year or new schemes proposed in the budget for future cash flows and
- (viii) Statement on maintenance expenditure with segregation of salary and non- salary portions.

6.35 These important statements have not been included in the Union Finance Accounts by the Government even after six years of the Commission's Report. It must, however, be mentioned that the statements which are placed before the Parliament in fulfillment of obligations under the FRBM Act have brought in certain amount of transparency in the process. The underlying assumptions relating to GDP

estimates, estimates of tax revenue etc are now clearly stated in these documents. There is also a greater openness about direction in which the tax rates are likely to move and the path of major tax reforms like moving to VAT or GST etc. finds an upfront mention in these documents. This is certainly a very positive development, however, complete transparency is yet to be attained.

6.36 Question of budgetary transparency is also closely related to the issue of treatment of "off budget" items. As an important fallout of the FRBM Act, the Union Government has been increasingly coming under pressure to bring to fore it's 'off budget' transactions. It would not be out of context to quote Govind Rao here, who wrote in his article, 'Fiscal Adjustment: Rhetoric and Reality' (EPW April 2007) that, *"While the fiscal deficit reduction programme is on course, there are concerns both about the magnitude and quality of fiscal adjustment. First, there are hidden deficits and those that are pushed to the public enterprise account. "Creative accounting" to show lower deficits is a practice common to all governments and this is as old as budgeting itself."*

6.37 The Finance Minister, in his budget speech of 2007-08 admitted the existence of such transactions when he said,

"I acknowledge that significant liabilities of the Government on account of oil, food and fertilizer bonds are currently below the line. This accounting arrangement is consistent with past practice. Nevertheless, our fiscal and

revenue deficits are understated to that extent. There is a need to bring these liabilities into our fiscal accounting. As a first step, I have shown these liabilities clearly in 'Budget at a Glance'. After the obligations on account of the Sixth Central Pay Commission become clear, I intend to request the Thirteenth Finance Commission to revisit the roadmap for fiscal adjustment and suggest a suitably revised roadmap".

6.38 As a follow-up of this budget commitment, the terms of reference of the Thirteenth Finance Commission were modified to insert [*Inserted vide Presidential Order dated 25th August, 2008*] the following,

"Having regard to the need to bring the liabilities of the Central Government on account of oil, food and fertilizer bonds into the fiscal accounting, and the impact of various other obligations of the Central Government on the deficit targets, the Commission may review the roadmap for fiscal adjustments and suggest a suitably revised roadmap with a view to maintaining the gains of fiscal consolidation through 2010 to 2015."

6.39 The contents of the report of the Thirteenth Finance Commission on this issue are yet to be made public. Meanwhile, in his Report on Union Government Accounts 2007-08, the Comptroller and Auditor General has been critical of such off budget transactions and has recorded the following:

“The Union Government has been issuing securities as an integral component of restructuring plan of nationalised banks and other domestic financial institutions such as UTI, IDFC, IDBI as well as to IMF thereby creating extra budgetary liabilities. The extra-budgetary items have, however, become a significant component of liabilities in the recent past. The Central Government, besides providing explicit subsidies on petroleum, food and fertiliser, has also been periodically issuing special bonds to the oil marketing companies (since 1997-98), the FCI (in 2006-07) and fertiliser companies (in 2007-08) as compensation towards under-recoveries of their products. The Finance Accounts for 2006-07 placed the issuance of such securities at Rs. 40321 crore of which Rs. 24121 crore were issued to oil marketing companies and Rs. 16200 crore to FCI. The ‘Budget at a Glance 2008-09’ indicates revised estimates for 2007-08 for issuance of such securities at Rs. 18757 crore, of which Rs. 11257 crore were issued to oil marketing companies and Rs. 7500 crore to fertiliser companies in lieu of subsidies. The Finance Accounts for 2007-08, however placed the actual issuance of special securities to oil companies as compensation for under-recoveries and for settlement of contingent liabilities amounting to Rs. 20333 crore and Rs. 221 crore, respectively. The Government’s outstanding liability on account of Petroleum Bonds has been consistently increasing and stood at Rs. 71288 crore as on 31 March, 2008. Special securities issued to fertiliser companies as compensation

for fertiliser subsidy amounted to Rs. 7500 crore as indicated in Budget at a Glance for 2008-09.

Union Government considers the issuance of these bonds/securities per se to be fiscal deficit neutral since they do not involve cash flow and are, therefore, not treated as part of budgetary expenditure/receipts. According to the existing accounting practice, the issuance of oil bonds and other similar bonds is reflected in the Annual Financial Statement (AFS) of the Union Budget under the public account and a matching transaction is shown under revenue expenditure for settlement of claims with oil companies/fertilizer companies. These transactions are then netted out of the revenue account of the expenditure budget and the capital account of the receipts budget through the respective reconciliation statements. However, these bonds have fiscal implications as they add to the liability of the Government. Furthermore, as interest payments on such bonds are treated as part of the revenue expenditure, they affect the revenue deficit and, thereby, the fiscal deficit on a continuing basis. The net accretion to Public Account during the year is, thus, utilised as a resource to meet deficits in Consolidated Fund of the Government.

The significant quasi-fiscal transactions to finance recurrent revenue expenditures through de facto borrowings not only create apprehensions about the quality of the fiscal consolidation process that is underway but raises the

issue of transparency in fiscal operations and inter-generational equity in fiscal management and long term macroeconomic stability. Logically, fiscal deficit calculations presented to the Parliament in 'Budget at a glance' should reckon net effect of all such items taken to the Public Account. However, on being pointed out by CAG that the revenue and gross fiscal deficits were understated to the extent the Government incurred liabilities on account of oil, food and fertiliser bonds, the Union Budget 2008-09 for the first time explicitly reported the off-budget items as below the line items in the 'Budget at a Glance'. It was also recognised that there was need to bring these liabilities into the fiscal accounting and Thirteenth Finance Commission has been requested by the Union Government to suggest the suitable roadmap for accounting these off budget liabilities. However, till such liabilities are fully reckoned in the budgeting process of the Union Government, inconsistency between revenue and fiscal deficits as reported in the Union Budget and as emerged from the audited Finance Accounts need to be appropriately disclosed and correct amount of the revenue and fiscal deficits reckoning all the off-budget liabilities should be reported by the Government in the Union Budget bringing transparency in the operations of these off-budget items".

Medium-term framework of budgeting

6.40 Another important lacuna of the budgeting process in India is that we have annual budgets which often lead to irrational expenditure patterns and create avoidable uncertainty about continuity of funding for projects, especially in the capital sector. An important underlying objective of the FRBM Act was to set right this lacuna by providing for conduct of fiscal policy in a medium-term framework.

6.41 It has been discussed at length (chapter 4) that annual pattern of budgeting where all unspent balances lapse on the last day of the financial year leads to huge savings, rash spending or parking of funds. The Comptroller and Auditor General has repeatedly adversely commented upon this issue in his reports. In his Report on Union Government Accounts 2007-08 the C&AG has pointed out that Unspent provisions in a grant or appropriation indicate either poor budgeting or shortfall in performance or both. Unspent provisions of more than Rs. 100 crore, which need a detailed explanatory note to the Public Accounts Committee (PAC), occurred in 60 cases of 47 grants (including Civil, Posts and Defence) during the year 2007-08.

6.42 The obligation under FRBM Act and criticism by the C&AG notwithstanding, there has been no move on the part of the Government to shift from annual to a medium term framework of budgeting as budgeting in India continues to be

essentially an annual exercise with all unspent balances on 31st March lapsing and going out of the administrative control of the concerned Ministry/Department.

6.43 However, the medium-term fiscal policy statement to be placed before Parliament under the FRBM Act, which requires Government to provide a 3-year rolling target for prescribed fiscal indicators like expenditure, taxation and revenue deficit is certainly a positive movement towards adopting a medium-term framework in fiscal policy decisions.

6.44 Substantive change in this direction will take place only if the budget is presented once in every two or three years, however, a move to permit the Ministries /Departments to retain and carry a part of their savings or atleast a part of their savings on the capital account automatically to the next financial year could be the first constructive step in this direction.

Targets Relating to Contingent Liabilities

6.45 The FRBM Act mandates the Central Government to specify the annual target for assuming contingent liabilities in the form of guarantees. Accordingly the FRBM Rules prescribe a cap of 0.5 per cent of GDP in any financial year on the quantum of guarantees that the Central Government can assume in the particular financial year. The Central Government extends guarantees primarily on loans from

multilateral/bilateral agencies, bond issues and other loans raised by various Public Sector Undertakings/Public Sector Financial Institutions.

6.46 The stock of contingent liabilities in the form of guarantees given by the Government has increased from Rs.1,07,957 crore at the beginning of the FRBM Act regime in 2004-05 to Rs.1,13,335 crore at the end of 2008-09. As a percentage of GDP, it has reduced from 3.3 per cent in 2004-05 to 2.0 per cent in 2008-09.

6.47 The assumption of contingent liability in the form of guarantee for 2009-10 upto January 2010 is Rs.38,778 crore which is 0.6 per cent of GDP during 2009-10, is higher than the target of 0.5 per cent of GDP set under the FRBM Rules. Government claims that this deviation has been necessitated in the larger interest of re-invigorating the economy in the background of the economic slowdown, to stimulate demand and increase investment in infrastructure sector projects with assistance from multilateral agencies.

Restriction on RBI to participate in primary market for Government securities

6.48 Another important provision of the FRBM Act relates to the total restriction on RBI's participation in the primary issues (beyond April 2006) of the Government. Limiting central bank accommodation to the Government is based on two arguments: (i) in the absence of such a limit, there is a risk of Government resorting

to inflation tax i.e, relying upon the central bank's power to create money to finance expenditure instead of resorting to prudent taxation and viable public sector pricing; and (ii) given the trade-off between price stability and output in the short-run, the risk of a Government sacrificing price stability in favour of higher output levels. Both these arguments point to the necessity of imposing some limit on central bank credit to the Government, and the need to break the nexus between debt management and monetary management.

6.49 Freeing the RBI from debt management functions and giving it discretion to independently decide the levels of monetization and bringing the RBI's credit to Government under strict prudential norms was viewed by majority as an integral part of fiscal responsibility as it was in tandem with the most prudent and best practices being pursued the world over. But, there were some who felt that this would lead to avoidable increase in cost of borrowing for the Government or to an unnecessary shortage of funds for development purposes. Economist like Mr.C.P.Chandrashekar wrote (EPW, December 24, 2004) :

"Burdened with rising interest payments, the government finds itself increasingly short of funds for investment and development purposes. In the circumstances the Planning Commission's foreign exchange for infrastructure scheme which is an implicit advocacy of a monetized deficit is indeed welcome. But to strengthen its own case, the commission should possibly be more

explicit and advocate both the repeal of the FRBM Act and the restoration of the practice of monetizing a part of the deficit. In the short run, while efforts to raise the tax-GDP ratio are underway, these are the only ways of garnering resources for faster and more egalitarian development.

6.50 To advocate monetization of a part of Government's deficit in 2004 may have worked in 2004, but in 2010 when inflation reached a double digit figure and threatened to stabilize there, monetization does not appear to be a viable solution. Given the present circumstances, the provisions of the FRBM Act with regard to borrowing from RBI seem to be both prudent and practical. The transition to FRBM Act mandated environment with effect from April 1, 2006 wherein recourse to borrowing from RBI under normal circumstances was prohibited has been smooth.

6.51 However, the ultimate objective of breaking the nexus between debt management functions and monetary policy functions of RBI is yet to be fully achieved. Some progress has been made in this direction but the process is yet to be completed. The Government has committed itself to setting up of a 'Debt Management Office' (DMO) in the Ministry of Finance which would eventually take over the functions of debt management from the RBI. It was stated in the Union Budget for 2006-07 that *"World over, debt management is distinct from monetary management. The establishment of a Debt Management Office (DMO) in the Government has been advocated for quite some time. The fiscal consolidation achieved so far has*

encouraged us to take the first step. Accordingly, I propose to set up an autonomous DMO and, in the first phase, a Middle Office will be set up to facilitate the transition to a full-fledged DMO.” Following this announcement, the Middle Office was established in September 2008 in the Ministry of Finance. The Middle Office is to be merged into the Debt Management Office (DMO), when it is established.

Conclusion

6.52 One can conclude by saying that despite change of Government at the Centre twice since the passage of the FRBM Act, the commitment of the Government towards achieving the objectives underlying the Act has been evident in each successive budget. There has been an earnest effort made to achieve the fiscal targets mandated by the Act and the Rules framed thereunder and any deviation from the FRBM mandated path of fiscal consolidation has been explained to the Parliament.

6.53 However, despite Government's stated commitment, the fiscal targets have not been achieved and the post global melt-down scenario suggests that it may be a long-time before the Government gets back on the track on this account. With the budgeted targets of 4.8% and 6.8% of GDP for revenue deficit and fiscal deficit respectively for the year 2009-10, the dream of achieving the fiscal targets mandated by the FRBM Act and Rules seems, once again to be a distant dream. The other two important objectives of the FRBM Act i.e of attaining fiscal transparency and moving

towards a medium term framework of budgeting are also yet to be fully attained. The results on both accounts have been mixed and despite Government's many efforts on these accounts, full attainment of these objectives in the near future does not appear to be an easy task.

6.54 Does that mean that the FRBM Act has had no impact and has not brought about any major reform in the process of budgeting in India? The answer to this question is a resounding 'No'. The FRBM Act has, in fact, revolutionized the manner in which Government of India makes its budgets and the way it discharges its fiscal policy. Budgeting in Government of India has acquired a great deal of discipline since enactment of FRBM Act. This discipline has resulted in the revenue deficit getting almost wiped out and the fiscal deficit figure nearly hitting the 3% target. Yes, it is true that this trend has got derailed because of the worst ever recession that the world and India have faced after the Great depression of 1929-30, but one must ask the question as to what would have happened if the revenue and fiscal deficit figures had been at the pre-FRBM Act levels on the eve of global meltdown. The fiscal discipline that the Government exercised in the years 2004-05 to 2007-08 certainly helped India a great deal in facing the recession of the last two years. The recession is said to be over and India is back on the path of recovery and the dream of reaching double digit growth rate seems once again to be real. If that happens, the discipline that the FRBM Act has built into the system of fiscal policy dispensation will ensure that India is back on the path of fiscal consolidation.

6.55 On the transparency front also the contribution of the FRBM Act cannot and should not be ignored. The three fiscal policy statements that the Government is obliged to present before the Parliament and the statement of quarterly expenditure and receipts that the FRBM Rules mandate have brought greater transparency and openness in which the Government of India prepares and presents its budget. The fiscal policy strategy statement is a very positive and welcome step which can well be used by the Government as a stepping stone to move towards a medium term framework of budgeting in future.