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The Indian Fiscal Responsibility Laws

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This article examines India's approach towards fiscal policy and the adoption of fiscal discipline under the framework of the Fiscal Responsibility and Budget Management Act, 2003. It focuses on annual nominal expenditure growth rules, medium-term fiscal policy statements, and sustainable medium term debt targets. The macro-economic prudential approach advocates bringing down the revenue and fiscal deficit. The act aims to achieve a well balanced budget and bring transparency to budget preparation. Every developing country has to foster 'external financial assistance' to meets its expenses and development goals. Unchecked fiscal policy leads to uncertainty in the country's income for the long run. Moreover, mounting debts and reckless borrowing curtails the government's expenses and leads to a heavy interest burden. Therefore, it is important to understand the impact of fiscal discipline on the government's expenditure and revenue.

Keywords: *fiscal deficit, revenue deficit, fiscal responsibility, balanced budget.*

INTRODUCTION

Fiscal Responsibility and Budget Management Act came into force in the year. The act aims to achieve economic stabilization, sustainable growth in fiscal balance and links between the fiscal policies, and non-obstruction of other fiscal instruments. Unpredictable fiscal policy leads to the government taking a loan from the central banks. The borrowed money is then financed and supported by the government to looser fiscal position which causes an increase in the demand for loanable funds and increases the interest rate. Uncontrolled government expenditure and investment cause a mounting rise in debt level, inflation, foreign trade restrictions, large tax imposition currency imposition. If these state affairs are not brought in check and no discipline is being imposed it will cause uncertainty and a volatile environment for the investors due to bursts in fiscal contractions and expansions. In the long run, it weakens the investment system by changing focuses in the short run.[1]The role of the fiscal policy rule is to reinstall confidence by easing financial constraints and support the growth of the economy. Control on government expenditure improves the fiscal position, brings down the excessive deficit and uplifting surpluses. Greater transparency on central government's fiscal operation i.e. debt-borrowing, debt, fiscal deficit, and revenue deficit. It strives for maintaining balance and introduces intergenerational equity, equitable distribution of debt, and creates fiscal stability in the other public sectors in the economy[2].

PRINCIPLE OF BUDGET MANAGEMENT

Financial Responsibility ensures the budget management is done to achieve sustainability and macroeconomic sustainability for the long run. FRBM act adopts a macroprudential approach done under numerical rules as well as with procedural rules. Fiscal indicators for targets and coverages on government's borrowing and revenue, and to eliminate revenue deficit and reduce the fiscal deficit.[3]

FRBM, the act has been authorized through legislation and granted power under the Article 292[4] and 293 of the Indian Constitution[5]. Article 292 states that "*Borrowing by the Government of*

[1] Ratin Roy & Ananya Kotia, 'History And Evolution Of The FRBM Act: Issues And Challenges' (*Economic Advisory Council to The Prime Minister*, 2018) <https://eacpm.gov.in/wp-content/uploads/2018/04/4.History-and-Evolution_FRBM_-4-Domain-Experts-1.pdf> accessed 15 May 2021

[2] Çiğdem Akın & BC, 'Fiscal Responsibility and Budget Management Act In India A Review and Recommendations for Reform' (*Asian Development Bank*, 2017) <https://www.adb.org/sites/default/files/publication/337306/swp-52.pdf> accessed 15 May 2021

[3] Kotia (n 1) 1

[4] Constitution of India, art 292 "*Borrowing by the Government of India: The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed*"

India The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed".[6] Thus putting a limit on borrowing and extending guarantees carried by the government. Moreover, it gives the role of transparency, appoints authority to be more responsible, and has come under the surveillance of the policy rules. Therefore, following the principle that government is responsible towards its people.[7] Parliament can authorize Comptroller and Auditor General, to review reports by exercise its power on its behalf as stated under Article 148 of the Constitution and Section 7A.[8] Suitable measures have been adopted and operated on the account of public interest. Annual financial statements, demand for grants, disclosure of more significant details, and changes in the standard of practices and policies by the central government are informed to both the House of Parliament. Financial statements are laid down before or in presence of the parliament medium-term fiscal policy statement by the central government. Similarly, statements like macro-economic framework statements and fiscal policy strategy statements are conducted in each financial year[9].

Similarly, rules have been laid down on the subject of '*borrowing principles*' and prohibits government debt-borrowing from the central bank i.e., the Reserve Bank of India. In India, the FRBM act 2003 sets a limit of 50 percent of GDP on total liabilities of the Central government's assets. The FRBM act is operationally effective as it seeks 'the *year to year ceiling*' rather than '*a*

[5] Constitution of India, art 293 Borrowing by States, "*(1) Subject to the provisions of this Article, the executive power of a State extends to borrowing within the territory of India upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be fixed by the Legislature of such State by law and to the giving of guarantees within such limits, if any, as may be so fixed, (2) The Government of India may, subject to such conditions as may be laid down by or under any law made by Parliament, make loans to any State or, so long as any limits fixed under Article 292 are not exceeded, give guarantees in respect of loans raised by any State, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India, (3) A State may not without the consent of the Government of India raise any loan if there is still outstanding any part of a loan which has been made to the State by the Government of India or by its predecessor Government, or in respect of which a guarantee has been given by the Government of India or by its predecessor Government, (4) A consent under clause (3) may be granted subject to such conditions, if any, as the Government of India may think fit to impose CHAPTER III PROPERTY, CONTRACTS, RIGHTS, LIABILITIES, OBLIGATIONS AND SUITS.*"

[6] Constitution of India, art 292

[7] 'Report, Volume III, Centre-State Financial Relations And Planning" (*Commission On Centre-State Relations*, 2010) < http://interstatecouncil.nic.in/wp-content/uploads/2015/06/volume3.pdf> accessed 17 May 2021

[8] Fiscal Responsibility and Budget Management Act 2003, s 7A

[9] *Ibid* s 3(4)(a)

medium-term ceiling'. Any finance covering the subject of expenditure and revenue is under the subject of fiscal deficit as per FRBM act 2003. It ensures that the government fiscal stands are empowered by pre-empting public resources, not at the cost of desirable expenditure such as building infrastructure for rural and Urban Development, 100% electricity supply for the rural area, building roads, healthcare, and education schemes. The capital expenditure should be in a declining ratio to total expenditure and prevents the continued fiscal deficit. Fiscal deficit caused by government's uncontrolled financing which causes more demand for money in terms of high expenditure. Therefore, the FRBM act of 2003 governs how deficits are to be financed in proportion to nations' GDP[10].

FRBMA set out rationales for targeting the revenue deficit, fiscal deficit, revenue receipt, revenue expenditure, and liabilities of the government corresponding to the assets of the government. It depicts, an equal proportion of borrowed funds for the Centre and State which will yield the future revenue not for capital investment but for consumption and payments of subsidies pensions, and salaries. It gives a broad picture towards spending and lays down rules for the elimination of revenue deficits which has been broadly justified under the FRBM act, 2003. In May 2016 the Central government appointed N.K. Singh and set up a committee to review the FRBM, act of 2003. The committee stated that reducing revenue expenditure by eliminating of revenue deficit is not always seen as feasible.[11]

Fiscal Responsibility Laws (FRLs) checks on the expenditure being carried on for the purpose of generating future income stream and aims for a zero revenue deficit. The Reserve Bank of India (RBI) has enforced to set out a balance between government expenditure and revenue which are reflected in account balance. FRBM, the act of 2003 provides an '*escape clause*' for non-performance towards the stipulated act. It acknowledges certain development of

[10] Subramanya A & Nithyananda N, 'Impact of FRBM act 2003 on levels and composition of expenditure of the government of India: an evaluation and policy implication' (2017) 6(11) International Journal of Current Advanced Research

[11] 'Responsible Growth: A Debt And Fiscal Framework For 21st Century India' (*FRBM Review Committee Report*, 12 April 2017) <https://dea.gov.in/sites/default/files/Volume%201%20FRBM%20Review%20Committee%20Report.pdf> accessed 19 May 2021

circumstances that embark upon the internal disturbance or occurrence of any natural or unforeseeable calamities or any happening in the future[12].

Borrowing of money should not be constrained as long as it does not deter the sustainability of long-term stabilization of debt-borrowing. FRBM, act focuses on establishing a mid-term limit on debt- GDP ratio. It gives certain authorities control over factors that are usually exposed to evaluation of setting annual operational targets and calculate state's debt burdens which are engaged by the state expenditure[13]. Such adoption of a macroprudential approach aims to safeguard financial stability.

HISTORICAL PERSPECTIVE

Fiscal responsibility was first acknowledged by the Constituent Assembly while drafting the Indian Constitution. Art. 292 & 293 of the Indian Constitution state that, government borrowing and funding programs should be within the explicit targets. Such executive power extended to the borrowing of security of the Consolidated Fund of India. Similarly, Article 293 grants the legislation the power to fix the limit on borrowing by the state government and put a limit on the guarantee given by the states. Dr. Bhimrao Ambedkar was the first to highlight the importance of fiscal discipline and put control on Constituent Assembly's borrowing in the parliamentary legislation. The Finance Commission has laid down the process of restructuring the fiscal transfer carried on by the government in accordance with fiscal responsibility. The Estimate and Public Accounts Committee of the parliament since Independence urged to fix the government's borrowing limit. In the early 1990s, India suffered a balance of payment crisis and it had to take a loan from the Reserve Bank of India (RBI) and the International Monetary Fund (IMF). The RBI repeatedly advocated the government to place a restriction on the ceiling on public debt and central government's deficits. The 11th Finance Commission was the first to introduce the concept of fiscal discipline for the purpose of tax devolution. It paved

[12] Kotia (n 1) 1

[13] Shishir Kumar Gujrati, 'FRBM ACT- A STEP TOWARDS FISCAL DISCIPLINE' <https://www.researchgate.net/publication/318593423_FRBM_ACT-_A_STEP_TOWARDS_FISCAL_DISCIPLINE/fulltext/5a1e1b48aca272cbfbc0264a/FRBM-ACT-A-STEP-TOWARDS-FISCAL-DISCIPLINE.pdf> accessed 20 May 2021

the way for more measures to be employed for the improvement in the index of fiscal discipline. Later on, the 12th Finance Commission employed the concept of creating incentives for enhancement of fiscal management which modified the fiscal index made by the previous Commission. So on 13th Finance Commission also retained these same criteria for creating an index of fiscal discipline which is still being carried down from 2006 till present[14]. Many formulae have been discovered and are being used as a signal for achieving fiscal discipline. The recent recommendation by the NK committee for adoption for a more feasible & simple approach on the role of revenue deficit, fiscal deficit, and debt borrowing by the central and state government[15].

IMPACT ON ECONOMY

FRBMA has laid the framework to achieve prudence management towards fiscal policy. It is a direct positive relationship stimulated towards economic growth and stabilization of the macroeconomy. Prudential management aims to bring down the fiscal deficit, debt-borrowing, and revenue deficit. Although fiscal deficit, revenue deficit, and debt borrowing have not witnessed any changes. With the crash in the world economy in 2008,

the Central government invoked the '*escape clause*' i.e., non-performance towards the act by not following the said rule and provision laid under the act. The provision states that any development of circumstances caused by internal disturbance or caused by unforeseeable circumstances can give the government power of '*non-performance*. This empowers the government to raise the bar of fiscal deficit from 3% of the GDP to 6.85% of GDP[16]. The main purpose of the act was to reduce gross revenue deficit and gross fiscal deficit; however, due to the global financial crisis, the government had to revive the economy. The purpose of the '*escape clause*' was to recover from the global shock but to no avail, as it led to mounting debt-borrowing from the central bank and a rise in the revenue deficit and fiscal deficit.

[14] Kotia (n 1) 1
[15] Sanhita Sucharita & Narayan Sethi, 'Fiscal Discipline in India' (2011) 2(1) Romanian Journal of Fiscal Policy <https://www.econstor.eu/bitstream/10419/59803/1/717976254.pdf> accessed 22 May 2021
[16] Kotia (n 1) 1

After the financial crisis, the government induced many schemes for the revival of the economy. The government started to initiate more expenditure for sectoral development which led to a breach in the limitation laid down under the act for fiscal deficit and revenue deficit. Due to high government expenditure and revenue deficit, it led to a huge imbalance. In the year 2015-16 the Union and State government aimed to reduce capital expenditure and maintain equilibrium between expenditure and revenue deficit. The Indian government has adopted new procedures, on the recommendation of N.K. committee. Due to covid-19 and one of the most stringent lockdowns in the history of India led to the deterioration of the economy thus, hampering the government revenue and creating an imbalance caused by the rise in government expenditure.[17]

Fiscal Responsibility Laws in India, for nearly two decades, have not been able to show any significant success. With the Implementation of FRBMA in 2003, the country's fiscal balance although has improved over the years, but is still under uncontrolled debt-borrowing that has been rapidly increasing. With the adoption of the Fiscal Responsibility Law, the country has postponed meeting the requirement laid under its FRL's numerical targets. Similarly, it has laid down the numerical targets which are only applied to the central government and believe in providing an incentive to engage quasi-fiscal activities for the public enterprises that are not covered under the Fiscal Responsibility and Budget Management act. India has complied with the targets laid down by the Central government which may not bring out an overall fiscal consolidation because the Indian States have major accounts or a large share of fiscal imbalances. The central government has encouraged its states to adopt FRLs or already under the process of adopting fiscal responsibility legislation. The Fiscal Responsibility Law has paved the way for increased transparency that conforms with standards of good practice. The FRBMA, 2003 has yet to cover up several dimensions such as **(1)** transparency which is a supplement to our constitutional framework still has many gaps that need to be filled, **(2)** It lacks a well-defined accounting system for the target fiscal indicator, **(3)** insufficient

[17] C Singh and others, 'A Review of the FRBM Act' (*IIMB*, June 2017) <https://repository.iimb.ac.in/bitstream/123456789/10789/1/WP_IIMB_550.pdf> accessed 24 May 2021

transparency preparation for the budget, **(4)** widely defined escape clause and **(5)** lack of expenditure rule and debt target[18].

INTERNATIONAL EXPERIENCE

The Fiscal Responsibility Law has been broadly defined through empirical studies, thorough use of fiscal performance, and rules to strengthen the fiscal Institution. The United States, during the year 1990s, has shown a positive and significant relationship between the existence of systematically well-balanced-budget provision for the state level and accommodations for the size of the state's budget deficits. The association between the states borrowing costs and the strength of financial institutions has made a significant impact. The Organisation for Economic Cooperation and Development member (OECD) countries have shown different priority in term of '*cross-section regressions*' and has laid there a foundation for the tighter budget rules and aim for lower deficits and borrowing. Hence, focuses on the procedural budget processes than a numerical target. Similarly, the Central and Eastern European countries aim to strengthen budget institutions only in terms of relationship with fiscal performance. European institutions have given absolute powers to the finance ministry and to their senior cabinet committees. Therefore, obstructing the president and parliament's discretion on finance and fiscal policies. Latin America, has given more importance to the notion of fiscal responsibility. Through binding constraints on the permissible size of fiscal deficits and rules, voting procedures from top-bottom during the budget process, and the budget transparency and control are coherent with the fiscal institution. Importance of hierarchical and transparent budget procedures" and "the use of medium-term fiscal frameworks.

As a matter of fact, while ascertaining a relationship is straightforward, but it is seen to be difficult in establishing causality. Although adoption for good budget institutions reflects society's prudential fiscal policy. Modification in budget institutions and reform in the fiscal institutional have a huge impact on the fiscal policy, and it leads to discrepancy in the various

[18] Alejandro Sergio Simone & Petia Topalova, 'India's Experience with Fiscal Rules: An Evaluation and The Way Forward' (*IMF Working Paper*, 2009) <https://www.imf.org/external/pubs/ft/wp/2009/wp09175.pdf> accessed 26 May 2021

process. For e.g., United States witnessed that, under the endogeneity the states which have support for the consolidation of fiscal support and likely to enforce and adopt a budget rule. Therefore, the center's control over the estimation of the impact of balanced budget rules on fiscal outcomes turns insignificant due to controlling for the state's endogeneity.

Through categorization of a panel between the both developed and developing countries[19] lay its research that fiscal rules and Fiscal Responsibility Law. It aims to reduce the deficit bias for average, but such frameworks do not exert independence in relation to its effects once the institutions' quality is accounted for. When causality issues are not accounted for, traditional econometric approaches will lead to misleading conclusions in relation to the link between FRLs and fiscal outcomes [20]. Therefore, the challenge is to lay the foundation for the correction in the timing of using the potential effect of FRLs. Hence, it is difficult to demonstrate a strong and clear link between FRLs and improvements in fiscal outcomes.

The Countries like Australia, New Zealand, and the United Kingdom, we're able to achieve fiscal performance, with help of the Fiscal Responsibility Law. It acquired the measurement used by the primary & overall balances and public debt and has shown a positive overall impact. Although, such a turnaround happened a few years before the implementation of the Fiscal Responsibility Laws. Fiscal responsibility law was an end result of society's change of preferences for advanced and tighter fiscal policies. Brazil also adopted a similar step towards fiscal policies which paved a way for major fiscal adjustment before introducing its FRL back in 2000. Therefore, the Fiscal Responsibilities Law in countries all around the world has given strong emphasis on the FRL's on rules and transparency provision. It is equally applied to all the relevant levels of government and supported by a well-developed accounting system and public expenditure management. Although critical reforms were taken in advance before the adoption of the FRL. Spain's FRLs have taken experience aim for providing a full assessment,

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[19] Paolo Manasse, 'Procyclical Fiscal Policy: Shocks, Rules, and Institutions' (*International Monetary Fund*, 2006) <https://www.imf.org/external/pubs/ft/wp/2009/wp09175.pdf> accessed 28 May 2021

[20] Ana Corbacho & Gerd Schwartz, 'Fiscal Responsibility Laws and Fiscal Outcomes: A New Approach to Test for Structural Breaks' (*IMF Working Paper*, 18 October 2007) <https://www.elibrary.imf.org/view/books/071/05461-9781589066090-en/ch05.xml> accessed 28 May 2021

but fiscal indicators have shown significant improvement after the adoption of the FRL came into force in 2003. the FRL was helped in the attainment and promoting fiscal stability.

CONCLUSION

The Fiscal Responsibility and Budget Management act of 2003, under the Indian economic history, is the first legal initiative taken by the parliament to bring the macro-prudential approach and budget management and paving the way towards fiscal policy. It aims to bring down the fiscal deficit, and revenue deficit, and growing debt borrowing by the centre and state government. Yet, for nearly two decades there have not been any major changes in fiscal and revenue deficit. The key features of the Fiscal Responsibility Laws (FRLs) are setting targets for fiscal deficit and preventing the government to fall under the debt trap, yet India still has mounting debts and high expenditure. The FRBM act, 2003 aims to lay down rules, and guidelines for the central and state government. The use of the escape clause gives the government flexibility and recovers the economy but to no avail, as it led to debt-borrowing from the central bank and a rise in the revenue deficit and fiscal deficit. Although the FRBM act, 2003 has introduced a transparent system of fiscal management & provides equal distribution of debt between the Centre and State government. Many reforms have been proposed to attain new concepts and financial indicators such as the *'highest efficiency revenue deficit'*. The government has been able to achieve the balance between expenditure and revenue, not at the cost of public interest. Therefore, fiscal responsibility is a must for any country to attain sustainability and ensure proper stability for the economy as a whole.