

Replace FRBMA with debt ceiling law as mooted by Dr. Ambedkar

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"If Parliament does not make a law, it is certainly the fault of Parliament and I should have thought it very difficult to imagine any future Parliament which will not pay sufficient or serious attention to this matter and enact a law. Under the article 268 (renumbered Article 292 in the finalized Constitution), I even concede that there might be an Annual Debt Act made by Parliament prescribing or limiting the power of the executive as to how much they can borrow within that year."

Dr. B. R. Ambedkar's apprehension about Parliament's failure has turned out to be true to the horror of voiceless future generations being burdened by borrowings resorted to be successive short-sighted regimes.

No doubt, Parliament belatedly enacted Fiscal Responsibility and Budget Management Act 2003 (FRBMA). This law is not what is envisaged by Article 292. FRBMA is a toothless wonder that provides no penalty for its violation. The Executive's actions under this law can't be challenged in courts.

FRBMA is thus a far cry from what Dr. Ambedkar desired on 10 th August 1949. It is poles apart from what certain members of Constituent Assembly unsuccessfully demanded for tightening the Article relating to government borrowings.

The Act has been violated and amended by successive regimes without an iota of guilt. And now Modi Government is raring to amend this law, which has turned out to be a football for the Executive & Parliament.

The Finance Ministry recently constituted a committee to review the working of FRBMA and suggest a roadmap for fiscal consolidation. The Committee is also mandated to examine the feasibility of replacing existing fixed number fiscal deficit targets (as percentage of GDP) with **'fiscal deficit range'** as the target.

On 1 st June 2016, the Finance Ministry sought comments from public regarding expansion of terms of reference (TOR) of this committee within one month.

This exercise in transparency, though welcome, is similar to one initiated in 1986 when the Ministry sought suggestions for fiscal policy, offering a prize of Rs 5000 for best idea. The Ministry received overwhelming response and yet the fiscal rot has grown by leaps and bounds.

The country's public debt has shot up from Rs 2100 crore in March 1947 (a few months before the Partition) to provisional Rs 5,573,332 crore in March 2016. The revenue deficit has increased from Rs 1.55 crore (revised estimate) in 1948-49 budget (1st full year budget after Independence) to Rs 341589 crore (revised estimate) in 2015-16.

In the instant case of FRBMA review panel, the Ministry could have dispensed with public consultation. It could have instead opted for retrieval of countless gems of fiscal wisdom buried in reports of committees and commissions.

And the best way to make start is to refer to the recommendations of Fourteenth Finance Commission (FFC), which has sought to address concerns articulated in Constituent Assembly without making reference to it.

In its report tabled in Parliament in February 2015, FFC recommended:

"We, therefore, urge the Union Government to replace the existing FRBM Act with a Debt Ceiling and Fiscal Responsibility Legislation, specifically invoking Article 292 in its preamble. This could be an alternative to amending the existing FRBM Act as proposed by us. We urge the State Governments also to consider similar enactments under Article 293(1)."

FFC noted that Article 292 of the Constitution envisages such fiscal responsibility in the form of enactment of a legislation imposing a ceiling on debt. It also pointed out that Comptroller & Auditor General (CAG) referred to the suggestions made in several reports of the Public Accounts Committee (PAC) and the Estimates Committee of Parliament in this regard, and commented that the Union Government had not acted on their recommendations.

Ironically, the Ministry has not asked the FRBMA committee to study the prospects of implementing FFC's recommendation. While accepting tax devolution recommendations in February 2015, the Ministry had stated that FFC's other recommendations ***"will be examined by the Government in due course in consultation with the concerned stakeholders."***

It is not for the first time that Government has given customary assurance to consider Finance Commission's (FC's) recommendations other than ones relating to taxes devolution to States. It has hardly ever acted on such sage suggestions.

Take the case of ninth FC. In its final report submitted in 1990, FC recommended:

"A convention should be developed limiting the extent of deficit financing by the Central Government, in any given year, to an amount determined in advance in consultation with the Reserve Bank of India. If under certain extraordinary circumstances, the agreed upon limited are to be exceeded, the matter should be discussed in Parliament and its approval obtained."

Similarly, 11 th FC, in its final report submitted in June 2010, recommended:

"A time has come when, as a part of the overall thrust towards fiscal responsibility, concrete steps are taken under the provisions of articles 292 and 293. In particular, Parliament and respective State Legislatures may consider fixing limits on total borrowing as well as on guarantees to be given by them."

This recommendation was preceded with Finance Minister Yashwant Sinha announcing NDA Government's resolve to enact a fiscal responsibility law. In the budget speech for 2000-01 delivered on 29th February, 2000, Mr. Sinha stated that a committee has been set up study this proposal.

This initiative led to introduction of FRBM Bill 2000 in Lok Sabha in December 2000. It proposed phased elimination of revenue deficit within five years ending 31 March 2006. It provided for build-up of revenue surplus for discharge of existing liabilities. The Bill also mooted phased reduction in fiscal deficit to 2% of GDP during the same period. Nobody knows when these targets would ever be achieved & followed by sustained fiscal discipline.

Both these timelines were shifted when FRBM bill was revised and enacted as FRBM Act, 2003. The target for eliminating revenue deficit was shifted by 2 years to year ending 31 March 2008. Similarly, the target for reducing fiscal deficit was relaxed to 3% of GDP for the same period.

Barely six days after FRBM rules were notified on 2 nd July 2004, the newly formed UPA Government announced its intent to amend the Act to further shift these target to 2008-09. UPA Government trashed these goals in zeal to return to power in 2008-09 and to ostensibly provide fiscal stimulus to economy.

Revenue deficit, which should have been eliminated in 2007-08 under amended law, was revised at 4.4% of the gross domestic product (GDP) for 2008-09. It increased further to 5.3% in 2009-10. Similarly, fiscal deficit shot up to 7.8 per cent of GDP in 2008-09. It declined to 6.7 per cent of GDP in 2009-10.

No doubt, both the deficits have been gradually brought down in subsequent years but are still nowhere the targets set in FRBM 2000 bill. Modi Government is aiming for 1.3% revenue deficit and 3% fiscal deficit in 2018-19.

The massive deviation from deficit targets and period revision of timelines makes a mockery of the Act.

FRBMA Committee's first TOR should thus be acting on FFC's recommendation to replace FRBMA with a new law for capping annual debt as envisaged by Article 292.

The second TOR should be suggesting zero-compromise mechanism for eliminating revenue deficit and generating revenue surpluses to pay off old loans and to create assets. The Committee should also specify sustainable level of fiscal deficit, which perhaps can be 1% or 2% of

GDP. The deficit targets should be relaxed only in case of grave natural calamities that require financing over and above provided by existing disaster management funds. The targets would, of course, have to be dispensed with in the case of war.

The Ministry should also enlarge the mandate and composition of the Committee by asking to recommend a combined fiscal deficit target for the Centre and the States.

The rationale for this suggestion is twofold: First, the fiscal indiscipline either by the Centre or the States has multiple adverse effects on the economy. As pithily put by B. J. PANDA in Rajya Sabha on 28th July 2003,

"Fiscal deficit leads to all kinds of ills down the road. If more money is printed, if more loans are taken, it leads to inflation. Or, by way of more money chasing the same goods and services, it leads to inflation. Also, when loans are taken indiscriminately and the country is not able to repay them, when a certain large portion of our revenue itself goes in repaying debts, there is no developmental work which really takes place."

Second, certain decisions of the Centre impacts the fiscal discipline of the States.

An obvious instance in point is the Centre's decision to set up Central Pay Commission (CPC) for revision of salaries structure after every 8-10 years in utter disregard of advice given by successive FCs. The States are forced to either follow the CPC award accepted by the Centre or set up their own pay commissions. This strains fiscal strengths of many States – an issue that was articulated repeatedly before FFC by States.

FRBMC's TOR should thus also provide for study of impact of 7 th CPC award on fiscal discipline of States and the manner in which Centre should compensate them financially for easing the unwarranted burden of restructuring pay scales.

It is here pertinent to remind the Centre that it had set up a Committee in 2002 to work out mechanism to cushion the fiscal impact of cascading effect of 5 th CPC award on States.

For level playing field in fiscal discipline, the Committee should also recommend changes in States' FRBMAs.

The Committee should also be asked to work out a comprehensive definition of fiscal deficit to kill prospects for exclusion of off-budget borrowings/transactions such as fertilizer bonds, or roll-over of pending subsidy bills to next year/delay clearance of Government payments to contractors/ tax refunds and lack of transparency in accounting of deficit within specific funds such as National Small Savings Fund (NSSF).

According to FFC-sponsored study titled 'Fiscal Transparency and Sustainability of Small Savings Schemes' dated September 2014 , ***"there is also a serious fiscal transparency issue as well since this income deficit is not included in the Centre' Revenue Deficit, NSSF being out of reckoning from the fiscal accounts of government's expenditures and revenues. Had these treasury banking operations been subject to transparent and prudential regulations, such build-up of accumulated operational deficit would have been red-flagged by regulators long back."***

Yet another item in FRBMA Committee's TOR should be to consider and recommend setting up of truly independent fiscal council for the Centre. The Committee should specify proposed council's charter to review fiscal policy at regular intervals.

As put by International Monetary Fund's (IMF's) Working Paper captioned

'Fiscal Councils: Rationale and Effectiveness' released in April 2016,

"a strong majority of fiscal councils exhibit features - political independence and

Functions - that allow them to clarify existing signals about fiscal policy."

It is here pertinent to pinpoint the deficiencies in existing fiscal review mechanism as elucidated by FFC. It stated

: "recent experience invites our attention to the need for a fiscal council at the Union Government level. In an amendment to FRBM Act in 2012, a new Section 7A was inserted which requires the CAG to conduct a periodic review of the compliance of the provisions of the FRBM Act by the Union Government."

The Ministry admitted to FFC that the periodicity and scope of the CAG review needs to be deliberated, keeping in mind the impact of fiscal policy on key macro-economic parameters as well as the efficacy of periodic review in the context of the economic growth cycle.

FFC concluded that the term 'review' appearing in Section 7A has not been defined. In this context, the 'review' that the CAG can be entrusted with would only be an ex-post review.

FFC added:

"it is important to have an ex-ante evaluation of the fiscal implications of the budget proposals and, therefore, (we) believe that it is essential to establish an independent fiscal institution for this purpose. This could be done through the establishment of a fiscal council by an amendment to the FRBM Act, similar to the one that enables the ex-post assessment by the CAG."

FRBMA Committee should also study the prospects and merits of setting up a Joint Fiscal Responsibility and Budget Management Council by the Centre and States. This has been recommended by FFC-sponsored study titled 'Research Report on Queries Raised by the Fourteenth Finance Commission',

The Study, conducted by Vidhi, in its report dated October 2014, says:

"The purpose of such a Council will be to act as an expert, independent body to co-ordinate fiscal strategies between the Centre and States and oversee compliance with FRBM legislations. One of its key functions will be to advise both Central and State Governments on borrowings."

FRBM implies both robust revenue collection policy and efficient expenditure management policy. The Committee should be made to feel free to give its advice on these issues.

And the last but not the least the Committee should advise the Government to commission an exhaustive study on whether deficit financing has contributed to creation of assets which, in turn, are generating interests to repay borrowings. This is putting the fiscal deficit issue head on: Is the objective of Government borrowings growth promotion or sustaining vote-catching populism or a blend of both?

It is here pertinent to quote Constituent Assembly member, H. V. Kamath. He stated

: "Borrowings can easily be one of those rocks upon which the ship of State may founder; and in modern times, and in the modern world, when economics has assumed such tremendous importance, and when loans are floated and subscribed very frequently by every State, by every country in the world, I feel that the executive of the Indian Union-to-be, should not be vested with the power to decide upon borrowing, within the limits, of course, fixed by Parliament, no matter what the purpose of the borrowing may be. I feel that the purpose for which the loan is raised, under this article must be laid before Parliament and the approval of Parliament must be sought and obtained for the purpose of that loan."