Time to Rescue Fiscal Responsibility from Ritualism

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India is Living dangerously beyond its Means

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Responsibility has proved to be a revolving door for the successive regimes at the Centre. It is a special door from where the economy is unable to either take off to sustainable, double-digit growth or slip into abyss.

Covid-19 pandemic and the resulting lockdowns have thus brought fiscal discipline back to square one. The yet-to-stabilize situation has pushed India to the danger zone with estimated fiscal deficit (FD) touching record 9.5% of gross domestic product (GDP) in 2020-21.

The previous peak FD of 8.16% occurred in 2008-09 post global financial meltdown-led fiscal stimulus. This is actual FD computed by CAG and different from what was reported in the budget documents.

The general government debt (Centre & States' explicit borrowings) has touched 90% of GDP, well above globally acceptable prudent level of 60%. The actual debt might be higher by a few percentage points as India does not have accurate, timely data on all government borrowings raised by different tiers of Government.

The Union Budget for 2021-22, coupled with the report of the 15th Finance Commission (15th FC), offers Modi Government a rare opportunity to start afresh in a challenging milieu. The two documents also serve as trigger for the States to review their fiscal framework. 15th FC has lined up slew of fiscal initiatives for the States.

No doubt, the Finance Minister Nirmala Sitharaman deserves appreciation for improving fiscal transparency. She has cleaned some fiscal cobwebs that her predecessors avoided. She, for instance, has disclosed & cleared annually rolled-over portion of the total food and fertilizer subsidies. The roll-over of unpaid subsidies to corporate entities helped the Government hide true picture of the health of Government finances.

Mrs. Sitharaman has, however, avoided biting the bullet offered by 15th FC and its predecessors. Unfortunately, 15th FC has left wide open the issue of sustainable debt & fiscal discipline by recommending that the issue be resolved by a high-powered committee.

This is like driving a nail in the sage recommendations made by FRBM Review Committee (FRBMRC) that submitted its report in 2017. It is pertinent to remember that this panel as well as 15th FC were chaired by N.K. Singh. 15th FC should have reiterated FRBMRC's core suggestions.

Leaving aside deficit targets trashed by late Arun Jaitley, FRBMRC's recommendations are more valid and relevant today than in 2017 when they were mooted. One recommendation that brooks no delay is enactment of '***The Debt Management and Fiscal Responsibility Bill, 2017***.' FRBMRC drafted this Bill as replacement for much-abused Fiscal Responsibility and Budget Management (FRBM) Act, 2003 (FRBMA) and rules framed under it.

Before elaborating further on fiscal domain, consider why India needs a sustainable budgetary framework that puts it firmly on take-off path. Without this, India would never be a poverty-free nation. Poverty here refers to extreme poverty as defined by the World Bank. And poverty has increased substantially due to Covid-19 phobia-led lockdowns.

The Word Bank believes India has slipped back to 2016 level of poverty due to pandemic. The Bank sees emergence of a new class of poor in Urban India due to lockdowns.

As put by the World Bank in its '***Poverty and Shared Prosperity 2020***' report,
"It is important to reiterate that the absence of recent data on India, one of the economies with the largest population of extreme poor, creates substantial uncertainty around current estimates of global poverty".

No wonder, the Government prefers silence on World Bank's anguish voiced again & again in its recent documents. The word 'Poverty' is thus conspicuous by its absence in the 2021-22 Budget speech. The common name 'poor' or 'Garib' finds mention only five times in the Speech. Both the main political parties - the Congress and BJP - coined their respective slogans against poverty in early seventies. Both failed to eradicate humanity's biggest curse.

In 2004, BJP unveiled its vision. It stated
"Our goal: 8-10% GDP growth rate on a sustained basis over the next five years, with eradication of poverty by 2015" . In 2016, Prime Minister Narendra Modi resolved to make India poverty free by 2022.

In 2016, NITI Aayog had projected that India would eliminate poverty by 2032 if it grew 10% per annum to emerge as $10 trillion economy. The pandemic and the resulting contraction in economy has made this goal appear like moon.

What is worrisome is Global Risk Report's projection that India would house the world's largest population by 2027. The population-poverty growth tango requires no elaboration here.

The hapless poor expected the Finance Minister to roll out working definition of poverty - a task that remains incomplete since its initiation in 2015. The Budget should have laid roadmap for eradication of poverty and the fiscal matrix for it.

Unfortunately, the Finance Ministry is clueless about the fiscal situation for the next two years. The Medium-Term Fiscal Policy cum Fiscal Policy Strategy Statement (MTFP & FPS) points out 15th FC's report for the 5-year cycle beginning 2021-22 that was submitted only in November 2020.

It says:
"In view of the above, Government was unable to place the Medium-term Expenditure Framework Statement for FY 2020-21 on the table of the House as mandated under S.3(1B) of the FRBM Act".

It adds:
"The Government will amend the FRBM Act. Hence, no fiscal projections for the years 2022-23 and 2023-24 have been presented along with this Statement".

Amendments to Fiscal Responsibility and Budget Management Act (FRBMA), 2003 and its rules is the only rule of the law that works with clinical precision in India. The Government of the day invokes the fiscal law, breaches it, misses the deficit targets, resorts to every trick in the accounting book to hide fiscal rot till the new Finance Commission steps in under the five-year cycle.

The public mandate-empowered Government makes all sort of excuses to justify fiscal indiscipline. Welfare of the public, especially the poor, is the staple logic for Government living beyond its means.

All Governments thus reduced FRBMA into a toothless wonder. It is administered easily by amending the rules almost every year.

The dilution of fiscal responsibility started right from the enactment stage. The original FRBM Bill, 2000 mooted deficit ceiling levels as integral part of the law. The Government shifted deficit ceilings from the law to the rules following recommendations from Parliamentary Standing Committee (PSC) in 2001. This empowered the Government to revise deficit targets without Parliament's approval.

Successive Governments amended this flexi-law or its rules to start on a clean state. It is like a nursery student never been able to move to primary school.

FRBMA provides eternal immunity to the Government from any judicial intervention on its fiscal actions, unlike flu vaccine that provides immunity only for one season.

No regime ever complied with fiscal consolidation road-map laid down by the respective finance commission.

15th FC has recommended that the FRBM Act needs a major restructuring and recommends that the time-table for defining and achieving debt sustainability may be examined by a High-powered Inter-governmental Group.

As put by the Commission,
"This High-powered Group can craft the new FRBM framework and oversee its implementation. It is important that the Union and State Governments amend their FRBM Acts, based on the recommendations of the Group, so as to ensure that their legislations are consistent with the fiscal sustainability framework put in place".

In the action taken statement on 15th FC's final report laid along with Budget documents, FM stated:
"The Government accepts in principle, the recommendations in respect of the quantum (as a per cent of GSDP) of net borrowing ceilings for the States. Other recommendations related to the fiscal road map for the States and amendments to the FRBM Act will be examined separately".

She also stated that the Government would examine in due course other non-binding recommendations of 15th FC. This "due course' mantra is stale response that every Finance Minister gave in the past while releasing action taken report on finance commission's report.

Let Modi Government turn this ***"due course"*** into timely, decisive decision on many valuable reforms initiatives mooted by 15th FC in its report organized into three volumes.

15th FC has estimated combined debt of Centre and States at 89.9% of GDP for 2020-21. This appears to be an underestimate as UB 2021-22 has revised fiscal deficit to 9.5% of GDP (as compared to 7.4% assumed by FC) and has indicated that Govt would borrow Rs. 80,000 crore more from the capital markets to fund this deficit.

In its indicative, deficit and debt path, FC has projected combined fiscal deficit of 6.8% for 2025-26 and 85.7% for combined debt for the same year. These assumptions are hardly comfortable to inspire any hope for sustained, robust growth required to eradicate extreme poverty.

Modi Government should convene a meeting of Inter-State Council (ISC) to prepare a road-map for phased reduction in general government debt to 60% by 2030. ISC should also work-out a formula for dividing the total debt in 60-40 ratio between the Centre and the States.

Such an understanding is required to rein in proliferation of subsidies and competitive populism. Both Centre and the States should focus on quality of expenditure and improve capital use efficiency.

ISC should also reach a consensus on what constitutes off-budget borrowings (OBBs). This is a pre-requisite for Centre-States agreement on strict ban on fresh forays into OBB domain.

OBB should be defined in both in the Central and States' respective Debt Management and Fiscal Responsibility, which must substitute outdated FRBM laws.

It is here pertinent to cite IMF Working Paper captioned 'Enhancing Fiscal Transparency and Reporting in India' released in November 2020. It says:
"Current fiscal transparency and reporting practices in India place it behind most peer G20 economies, implying that policy makers are lacking critical data to ground their fiscal and other economic planning decisions. The increasing use of off-budget financing at the central government level in recent years represents one key example of reduced transparency".

The proposed law or the amended FRMBA should restore revenue deficit (RD) as statutory indicator as was the case up to 2017-18. In April 2018, NDA Government downgraded RD as a mere ***"reference indicator"*** by amending FRBM Rules.

FRBMA should provide for annual disclosure of deficit in NSSF and other major Funds and whether it is reflected in FD. Suffice it to say that fiscal reforms agenda is vast.

It should not be kept on the backburner by short-sighted, populism-driven regimes. It is high time they consider how they are burdening future generations with debt that they never borrowed. No political party should interpret popular mandate to turn fiscal law into game of amendments.