

Time Ripe to Signal Revival of Stalled Fiscal Reforms

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WOULD

Prime Minister Narendra Modi apply his Gujarat Model of commitment to fiscal reforms at the national level? The trigger for this question is the mothballed fiscal law reforms at the Centre and its knock-on, adverse impact on States.

Both International Monetary Fund (IMF) and Comptroller & Auditor General (CAG) have flagged this inertia in their relevant reports released last month. These muted reports, however, don't reveal three disturbing facts.

These are: A) Four-years' holiday in presenting statutory, annual Medium-term Expenditure Framework (MTEF) to Parliament, thereby fuelling economic uncertainties. B) The Finance Ministry's (FM's) blow-hot, blow-cold stance on amending Fiscal Responsibility and Budget Management Act (FRBMA), 2003. 3) Deafening silence on fiscal and debt reforms recommended by 15th Finance Commission. Its final report was made public in February 2021. ([Time to Rescue Fiscal Responsibility from Ritualism](#))

Before detailing these facts, recall what Mr. Modi, as Chief Minister, stated during June 2013. He articulated Gujarat's fiscal reforms at an interaction with Mr. Jim O'Neill, a world-renowned economist who coined the name BRICS. The interaction was aptly captioned '**Achieving India's Full Economic Potential**'.

Mr. Modi recalled how he turned around Gujarat state finances from " **severe fiscal deficits** " into revenue surpluses. He also referred to enactment of the Fiscal Responsibility Act by the State. His government was thus able to allocate more money on the development front, he explained.

Mr. Modi agreed with Mr. Jim's 2008 research paper titled ' **10 Things for India to Achieve its 2050 Potential** '. The fifth item in this agenda was ' **Introduce a Credible Fiscal Policy: A Medium-Term Strategy** '.

At that time, Mr. Jim was top-notch expert at Goldman Sachs and he had co-authored this paper with Tushar Poddar, then Chief Economist at Goldman Sachs' Indian office.

On 23rd May 2019, Mr. Jim wrote a gentle reminder on this invaluable vision at a Bloomberg website. The article was captioned ' **Will Modi Turn To The Ten Things Needed To Deliver India's 2050 Potential ?** '

Pitching for "**A Credible Fiscal Policy** ", he wrote: "

I tried to persuade Modi's advisors, and have publicly stated many times since, that India should consider some 'Golden Rule' for its fiscal policy framework."

He continued:

"If done credibly, it would allow markets to be more relaxed about the overall size of any one year's fiscal deficit (or level of debt) as it would be easy for investors to distinguish between investment by the government for future growth benefits from that being undertaken to maintain more consumption type payments ."

We all know fiscal profligacy has been constant, robust trait of Modi Government. To be fair to the present Government, all preceding regimes have practised fiscal laxity in varying degrees and shades.

UPA regime tinkered with FRBM rules and targets under this law. It could not resist temptation to play to the gallery. UPA lacked the courage to take tough measures. ([Don't degenerate fiscal responsibility into a set of malpractices](#) JANUARY 24, 2014)

FRBMA has thus been reduced to a kids' football game where goal posts (targets for fiscal and revenue deficits & borrowings) are changed at whims and fancies of those who call shots. The breach of rules has become the rule of the law! This is because FRBMA confers 100% immunity to the Government from judicial scrutiny. ([Muster political will for credible fiscal reforms MARCH 8, 2010](#))

Mandarins in Government might clear their doubts, if any, on this count by reading all the six CAG reports on compliance with FRBMA presented so far. The process of CAG scrutiny started after amendment of this law in 2012 & notification of relevant rule in October 2015.

Compare the existing flux with the laudable objectives of FRBMA. As put by FM in a document dated 16th October 2019, FRBMA "**provides a legislative framework to ensure inter-generational equity in fiscal management and impart long-term macro-economic stability of the country**."

It adds: "

The Act envisages limiting Central Government borrowings, debts and deficits and aim at increasing transparency in the conduct of fiscal operations."

The latest case of breach -deviation in official parlance- is the go-by to the MTEF statement for the 4th consecutive year! Under the rules, this Statement should be presented to Parliament under FRBMA in the session beginning immediately after the one in which budget is presented.

MTEF comprises three-year rolling targets for the specified expenditure indicators with the clear signal of underlying assumptions.

As put by FM

"The MTEF Statement as required in terms of Section 3 of the FRBM Act (Fiscal Responsibility and Budget Management) has ensured that the Budget making exercise is made more professional and realistic by giving the Ministry/Department an estimate of the available fiscal envelope for their respective Ministry/Department which also serves as a guideline and facilitates expenditure planning for the EFC/PIB Committee while providing fixed goalposts to the Ministry/Department."

FM has rationalized its decision to not present MTEF Statement, 2022. In the half-year statement on trends in receipts & expenditure presented to Parliament on 19th December 2022, FM contends:

"Three continuous Covid-19 waves, ongoing Russia Ukraine conflict and global economic uncertainties have affected almost all macroeconomic indicators, making synchronization between the Budget and Medium-Term Goals difficult."

It points out that "

effective management of the exogenous shocks and global uncertainties requires the additional flexibilities in terms of expenditure management and fiscal consolidation keeping the Government's intent to reach the Fiscal Deficit of 4.5 percent of GDP by FY 2025-26 as announced in the Budget 2021-22 through a glide path."

It adds: **"any projections amidst global turbulence, having consequence on all major economies, may bring risk of considerable gap between projected numbers and actuals therein."**

Earlier, in the '**Statements of Fiscal Policy**' presented on 1st February 2022, FM stated: "

it is vital for the Government to retain requisite fiscal flexibility to effectively respond to emerging contingencies till the pandemic-induced uncertainties ease. Hence, amendment to FRBM law is not being proposed and fiscal projections for the year FY 2023-24 and FY 2024-25 are not being placed alongside this Statement."

In 2021-22, FM justified its inability to present MTEF, 2021 by claiming: "

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."

In a statement on 3rd August 2021, FM cited four reasons for not presenting MTEF 2021. One of the reasons reads as: "**Any projections amid Covid-19 pandemic brings risk of huge gap between projected numbers and actuals therein because of its spread and magnitude. The MTEF Statement's numbers act as reference point during pre-budget meeting to decide upon expenditure ceilings.**"

In preceding year 2020-21, FM stated:

"The Fifteenth Finance Commission's report for the 5-year cycle beginning 2021-22 was submitted only in November 2020. 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 added:

"Government targeted a fiscal deficit below 4.5 per cent to be achieved by FY 2025-26 and towards that goal amendment to the FRBM Act are proposed to be introduced."

Earlier on 15th September 2020, FM cited six reasons for not issuing MTEF Statement 2020. These include limited applicability of 15th FC's interim recommendations and arrival of Covid-19 pandemic.

In 2019-20, FM, for the first time, decided to skip presentation of MTEF. In a statement released on 4th February 2020, FM defended this decision by referring to flux resulting from the ongoing work of 15th FC and review of various central & centrally sponsored schemes. MTEF 2019 was required to be presented in August 2019.

In a document explaining the action taken on the final recommendations made by the 15th FC, FM stated on 1st February 2021:

"The Commission has recommended that the FRBM Act needs a major restructuring and recommend that the time-table for defining and achieving debt sustainability may be examined by a High-powered Inter-governmental Group."

It continued: "

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."

FM added:

"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."

Even before Covid-19 & Russia-Ukraine War shook global and national economies, FM found MTEF a hard nut to crack.

In its maiden report on compliance with FRBMA in 2014-15 released during August 2016, CAG found substantial variations in projections for next three years as compared to corresponding figures for relevant year as reflected in subsequent statements and Budget documents.

CAG thus recommended:

"The Government may strengthen the process of making underlying assumptions for projection of receipt and expenditure in various fiscal policy statements to insulate them from frequent changes and to seamlessly integrate the projections in the Budget."

CAG came to similar conclusion and similar recommendation in its 2nd report on compliance with FRBMA. The trend of variations between projects and corresponding estimates in subsequent year's budget documents persisted.

Leave aside MTEF, CAG found significant variations in data presented in different FM documents for any given year.

In its report on compliance with FRBM Act in 2019-20 presented to Parliament in August 2022, CAG recommended that FM

"may institute a better reconciliation mechanism to ensure uniformity of information given in the budget documents, FRBM Act-mandated disclosures and Union Accounts ."

Like CAG, IMF's Staff Report on India dated 23rd December 2022, has flagged the issue of data adequacy and quality, apart from echoing fiscal concerns.

As put by the Report,

"India's fiscal space is at risk and well-communicated consolidation is needed to ensure medium-term fiscal sustainability."

([Debate Impact of Fiscal Responsibility with Opacity & Zero Accountability](#) MARCH 29,2017)

The Government has told IMF staff that "

amendments to the FRBM Act have not been proposed to maintain policy flexibility until uncertainties ease."

In its final report released on 1 st February 2021, 15th FC recognized that "***FRBM Act needs a major restructuring***". It thus suggested setting up of by

"a High-powered Inter-governmental Group , " which should " craft the new FRBM framework and oversee its implementation."

15th FC added:

"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".

It also recommended "

the establishment of an independent Fiscal Council with powers to access records as required from the Union as well as the States."

Setting up of fiscal council has been recommended in the past by IMF and other stakeholders of fiscal transparency and accountability. The Government has repeatedly turned down this proposal as evident from its replies to parliament questions over the years. (

[Make Fiscal Discipline Enforceable & Independently Verifiable](#) JULY 18, 2019)