



Impact Of Fiscal Consolidation And FRBM Act On India's Fiscal Deficit: A Comparative Analysis From 1986-87 To 2019-20

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ABSTRACT

The idea behind this study is to examine the gradually development /fall in India's Fiscal deficit through average method by taking data into two parts i.e. 1986-87 to 2002-03 and 2003-04 to 2019-20. This study shows how Fiscal Consolidation and FRBM act-2003 have a significant effect on the Gross Fiscal deficit and aim of the study is to examine the impact of Fiscal Consolidation and FRBM act on India's Fiscal deficit.

Keywords: FRBM Act, Fiscal consolidation and Fiscal Deficit.

INTRODUCTION

Fiscal consolidation in simple words is when the government fiscal health improves it is known as fiscal consolidation. One of the indicators used to measure fiscal consolidation is fiscal deficit and when the fiscal deficit of the government or the government's fiscal deficit improves then this concept is fiscal consolidation so when the fiscal deficit reduces it indicates that the government is borrowing less to fund its expenditure so therefore it shows that government is having its own money and it is spending it rather than borrowing so improvement of fiscal condition of a country is termed as fiscal consolidation. To reduce fiscal deficit we have to increase our receipt i.e. earning or we have to reduce our expenditure.

In order to achieve fiscal consolidation we have an act which is known as fiscal responsibility and budgetary management act 2003. Objective of FRBM act is to institutionalize financial discipline, reduce India's fiscal deficit to 3% by March 2008 and further improve macro-economic management, to introduce a more equitable and manageable distribution of the country's debts over the years.

The FRBM act is a law enacted by the Government of India in 2003 to ensure fiscal discipline by setting targets including reduction of fiscal deficits and elimination of revenue deficit. It is considered as one of the major legal steps taken in the direction of fiscal consolidation in India.

By 2003, the continuous government borrowing and the resultant debt had severely impacted the health of the Indian economy. Much of the borrowing was utilized for interest payments of previous borrowings, but not for productive purposes. This resulted in interest payments becoming the largest expenditure item of the

government. Many economists warned the government that this condition is not sustainable. They advised legal steps to prevent India to fall into a debt-trap. Hence in 2000 bill was introduced to bring responsibility and discipline in matters of expenditure and debt. This bill was passed by the Indian Parliament in 2003 and came to be known as the FRBM ACT.

FRBM act is all about maintaining a balance between government revenue and government expenditure. The intention of the fiscal responsibility and Budget management act was to bring-

- Fiscal discipline
- Achieving a balanced budget
- Better coordination between fiscal and monetary policy
- Efficient management of expenditure, revenue and debt.

The fiscal deficit as per the Indian budget 2020-21 was estimated 3.5% of GDP. In India, Fiscal consolidation or fiscal roadmap is expressed and measured in terms of deficit targets (fiscal and revenue deficits). The FRBM act sets the targets for fiscal consolidation in India. FRBM act sets targets for the governments to reduce fiscal deficits. FRBM act provides a legal institutional framework for fiscal consolidation. Further, the act prohibits borrowing by the government from the reserve bank of India, thereby making monetary policy independent of fiscal policy.

Fiscal consolidation and FRBM act-measures required for realizing the fiscal consolidation targets

- Improved tax revenue realization (direct and indirect tax) –eliminating tax evasion, increasing efficiency of tax administration by reducing tax avoidance.
- Enhancing tax –GDP ratio- by widening the tax base and minimizing tax concession.

RECOMMENDATION OF N.K.SINGH COMMITTEE ON FISCAL CONSOLIDATION

In May 2016, the central government had set up a committee under the chairmanship of N.K.SINGH to review the FRBM act. The government believed the targets were too rigid. The committee recommended that the government should target a fiscal deficit of 3% of the GDP in years up to March 2020, cut it to 2.8% in 2020-21 and to 2.5% by 2023.

FRBM became an act in 2003. The objective of the act is to ensure inter-generational equity in fiscal management, long run macroeconomic stability, better coordination between fiscal and monetary policy and transparency in fiscal operation of the government.

The government notified FRBM rules in July 2004 to specify the annual reduction targets for fiscal indicators. The FRBM rule specifies reduction of fiscal deficit to 3% of the GDP by 2008-09 with annual reduction target of 0.3% of GDP per year by the central government.

Similarly, revenue deficit has to be reduced by 0.5% of the GDP per year with complete elimination to be achieved by 2008-09. It is the responsibility of the government to adhere to these targets. The finance minister has to explain the reasons and suggest corrective actions to be taken, in case of breach.

FRBM act provides a legal institutional framework for fiscal consolidation. It is now mandatory for the central government to take measures to reduce fiscal deficit, to eliminate revenue deficit and to generate revenue surplus in the subsequent years. The act binds not only the present government but also the future government to adhere to the path of fiscal consolidation. The government can move away from the path of fiscal consolidation only in case of natural calamity, national security and other exceptional grounds which central government may specify.

Indian economy faced with the problem of large fiscal deficit and its monetization spilled over to external sector in the late 1980s and early 1990s. The large borrowings of the government led to such a bad situation that government was unable to pay even for two weeks of imports resulting in economic crisis of 1991.

Consequently, economic reforms were introduced in 1991 and fiscal consolidation emerged as one of the key areas of reforms. After a good start in the early nineties, the fiscal consolidation faltered after 1997-98. The fiscal deficit started rising after 1997-98. The government introduced FRBM act, 2003 to check the deteriorating fiscal situation.

The implementation of FRBM act/FRLs improved the fiscal performance of both centre and states. The states have achieved the targets much ahead the prescribed timeline. Government of India was on the path of achieving this objective right in time. However, due to the global financial crisis, this was suspended and the fiscal consolidation as mandated in the FRBM act was put on hold in 2007-08. The crisis period called for increase in expenditure by the government to boost demand in the economy. As a result of fiscal stimulus, the government has moved away from the path of fiscal consolidation. However, it should be noted that strict adherence to the path of fiscal consolidation during pre-crisis period created enough fiscal space for pursuing counter cyclical fiscal policy.

In order to deal with crisis created by COVID-19 pandemic, Kerala government announced a package of 20000 crores and urged the centre to provide flexibility under the FRBM act.

The objective of the FRBM act are-

- To ensure fiscal discipline in government finances.
- Inter-generational equity in fiscal management.
- Long term macro-economic stability.

REVIEW OF LITERATURE

- **Bishnoi M. (2015)** “*FRBM Act 2003 and fiscal consolidation in India a state level study*” - This paper discusses the fiscal consolidation process under the FRBM acts at the state level. It finds that up to 2007-08, under the rule based framework, state government was capable to recover from the severe fiscal stress experienced during mid/late nineties and early phase of present decade. The paper suggests some elements of future design of the fiscal architecture for deliberation and consideration.
- **Ravindra H. Dholakia, Jeevan K. khundrakpam, Dharendra Gajbhiye-** “*An outline of post 2009 FRBM Fiscal architecture of the union Government in the medium term*”-The study emphasizes that in designing a meaningful framework on fiscal consolidation during the post-fiscal responsibility and budget management (FRBM) period in India there is a need for reconciling the discrepancies between the fiscal deficit and movement in debt. In the post 2009 FRBM period, the medium term fiscal architecture implied by the target 20 percent IP/RR ratio, therefore appears to be challenging but achievable under normal expectation about future. The Government can move away from the path of fiscal consolidation only in case of natural calamity, national security and other exceptional grounds which central government may specify.

RESEARCH GAP

Above Literature Review ignored the impact of Fiscal Consolidation on Fiscal Deficit.

AIM

Aim of this research paper is to examine the impact of Fiscal Consolidation –FRBM act-2003 on India's fiscal deficit.

OBJECTIVE

- To examine the impact of fiscal consolidation and the Fiscal Responsibility and Budget Management (FRBM) Act-2003 on India's fiscal deficit, using data from 1986-87 to 2002-03 in the first part and in the second part i.e. 2003-04 to 2019-20. .
- To analyze the trends in fiscal deficit before and after the implementation of the FRBM Act-2003, highlighting the effectiveness of fiscal consolidation measures.

HYPOTHESIS

H₁: The implementation of the Fiscal Responsibility and Budget Management (FRBM) Act-2003 has significantly reduced India's fiscal deficit, indicating the effectiveness of fiscal consolidation measures.

METHODOLOGY

DATA TYPE AND SOURCE- The type of data is quantitative in nature and whole part of the data is collected from secondary source. The main source of the secondary data used in the study are from the estimates by RBI and Budget documents.

SAMPLE SELECTION –included India's Gross fiscal deficit for the period 1986-87 to 2019-2020.

DATA ANALYSIS

INDIA'S GROSS FISCAL DEFICIT AS A % OF GDP: (1986-87 TO 2019-2020)

- **1st part -1986-87 to 2002-03**

S.no	Years	Gross Fiscal Deficit
1.	1986-87	8.13
2	1987-88	7.34
3	1988-89	7.08
4	1989-90	7.1
5	1990-91	7.61
6	1991-92	5.39
7	1992-93	5.19
8	1993-94	6.76
9	1994-95	5.52

10	1995-96	4.91
11	1996-97	4.7
12	1997-98	5.66
13	1998-99	6.29
14	1999-2000	5.18
15	2000-01	5.46
16	2001-02	5.98
17	2002-03_ Enactment of FRBM act.	5.72

Source: RBI and budget documents, handbook of statistics on Indian economy (2014-15) Unit: % of GDP



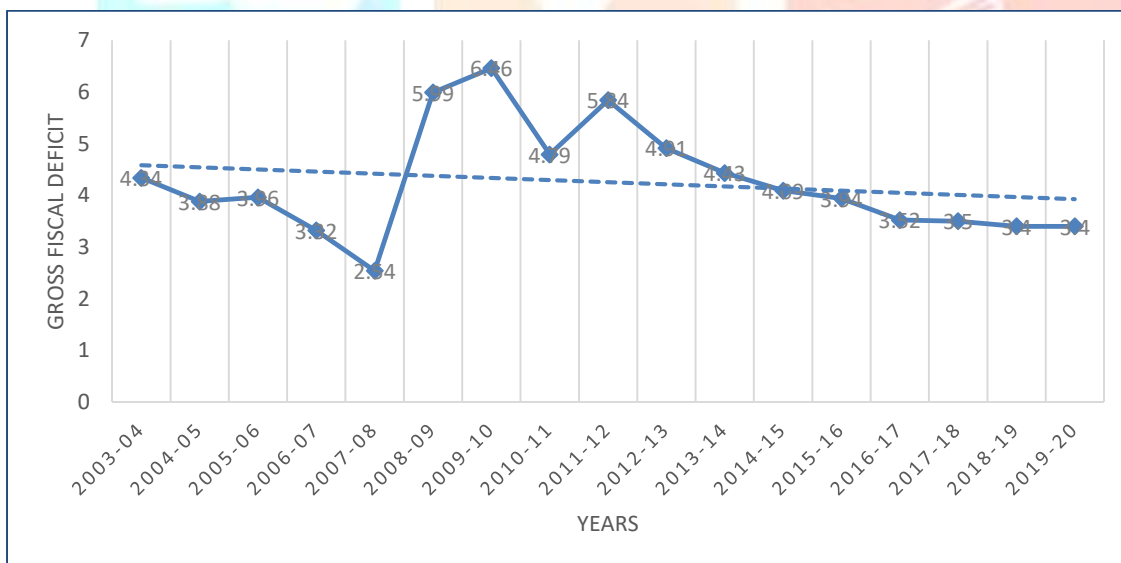
Source –Author's Interpretation

Data Analysis: 1st Part -1986-87 to 2002-03

- 2nd part -2003-04 to 2019-20

S.no	YEARS	Gross Fiscal Deficit
1	2003-04	4.34
2	2004-05	3.88
3	2005-06	3.96
4	2006-07	3.32
5	2007-08	2.54
6	2008-09	5.99
7	2009-10	6.46
8	2010-11	4.79
9	2011-12	5.84
10	2012-13	4.91
11	2013-14	4.43
12	2014-15	4.09
13	2015-16	3.94
14	2016-17	3.52
15	2017-18	3.5
16	2018-19	3.4
17	2019-20	3.4

Source: RBI and budget documents, handbook of statistics on Indian economy (2014-15) Unit: % of GDP

**Source –Author’s Interpretation****Data Analysis: 2nd Part -2003-04 to 2019-20**

- India’s Gross Fiscal deficit in average (mean) for the period 1986-87 to 2002-03(before enactment of FRBM act) is $104.02/17 = 6.11$
- India’s Gross Fiscal deficit in average (mean) for the period 2003-04 to 2019-2020 (after enactment of FRBM act) is $72.31/17 = 4.25$

After analyzing the data by taking India's gross fiscal deficit into two parts i.e. 1986-87 to 2002-03 and 2003-04 to 2019-20. By seeing the average Gross fiscal deficit we can conclude that after enactment of FRBM Act in 2003, gross fiscal deficit as percent of GDP declined.

In 2nd part i.e. 2003-04 to 2019-20, FRBM act has a positive impact on restoring fiscal balance in India then compared to 1st part i.e. 1986 -87 to 2002-03.

DATA TECHNIQUES USED – Average (mean) method is used to find out the average Gross Fiscal Deficit in India.

FINDINGS (RESULTS) - FRBM act has a positive impact on restoring fiscal balance by reducing India's gross fiscal deficit and hence hypothesis is accepted.

CONCLUSION – After the implementation of FRBM act central and government major fiscal deficit indicators showing a declining trend. No doubt FRBM act has been proved as an important development in managing centre and states finances. Our results find out that FRBM act does have significant effects on the gross fiscal deficit.

Overall, during 1986-87 to 2002-03 it was seen that the period of crisis led to the burgeoning of the deficit to unsustainable levels and prompted the government to introduce and adopt economic reforms to ensure that the deficits stood at more reasonable levels. However since 2003-04 the government has been more proactive and has undertaken fiscal policy reforms to ensure a steady reduction in fiscal deficit as a percentage of GDP leading to a more resilient economy.

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