New FRBM Framework

Time to Recast Union Government Expenditure Needs

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The structural inability to control revenue deficits needs different solutions from the usual argument that the utilisation of government expenditure is inefficient and that the government should spend less. It is time to relook at the way the union government spends.

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The Government of India has proposed a very critical amendment to the Fiscal Responsibility and Budget Management (FRBM) Act in Union Budget 2018–19. As mentioned, "in the proposed FRBM architecture, Government will simultaneously target debt and fiscal deficit, with fiscal deficit as an operational target and do away with the deficit targets on revenue account that is revenue deficit (RD) and consequentially, effective revenue deficit (ERD)." In 2003, the union government enacted the FRBM Act. The act required the government to bring down the fiscal deficit to gross domestic product (GDP) ratio to 3% and eliminate revenue deficit by 2008–09.

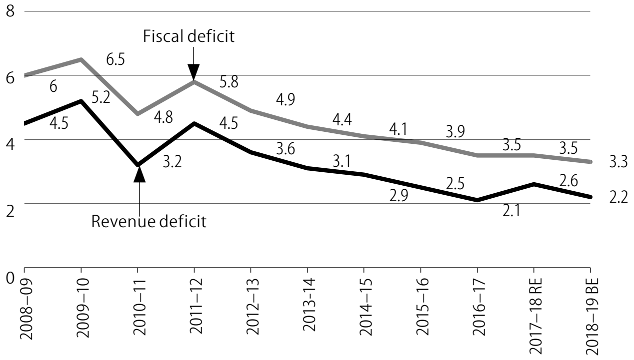
Compliance with the zero revenue deficit target in the FRBM Act implies imposition of hard budget constraint on government to prevent use of borrowed resources for the purpose of consumption expenditure such as wages and salaries, interest payment, pension, payment of subsidies, etc. With discontinuation of the revenue deficit as a target for compliance, in the budget 2018–19, a revised fiscal correction path has also been introduced. As specified in this path, the Government of India (GoI) would only be able to achieve the 3% of GDP fiscal deficit target in 2020–21 instead of 2018–19. Though there is no target, revenue deficit would remain stubbornly high and would be at 1.6% of GDP in 2020–21. The debt–GDP ratio, which is estimated at 48.8% of GDP in 2018–19, is expected to decline to 44.6% of GDP in 2020–21. This article analyses the implications of the changes in the FRBM Act on union finance and on fiscal management of GoI.

Recent Fiscal Policy

In the "Rethinking Macroeconomics" meeting held in Peterson Institute, Auerbach (2017) has highlighted that many countries in recent years amended their existing fiscal rules.[1] Even logical and well-written fiscal rules require justification, given that constraining a government's

Figure 1: Fiscal and Revenue Deficits of Union Government—2008–09 to 2018–19 (BE)

(As % of GDP)



RD has been mentioned only for information.
Source: Government of India, Union Budgets (various years).

ability to practise fiscal policy has obvious disadvantages as well (Auerbach 2017). In India, the Finance Bill 2018 has incorporated a few clauses (clauses 207–10) to amend FRBM Act, 2003, with special reference to eliminate the reference to "revenue balance" and using fiscal deficit as an operational parameter.[2] It is interesting to recall here the recommendation of the Fourteenth Finance Commission (FFC), which suggested an amendment to FRBM Act 2003 to eliminate "effective revenue deficit." The FFC mentioned that the current definition of effective revenue deficit is unique and does not fit within international practices of classification of accounts/expenditure. The FFC has also recommended that the objective of balancing revenues and expenditure on the revenue account enunciated in the FRBM Acts should be pursued (p 198, Chapter 14, FFC).

GoI also constituted the FRBM Review Committee in 2016 to review the FRBM Act. Making fiscal deficit as the operational parameter was based on the recommendations of the FRBM Review Committee.[3] This committee has also proposed to replace the FRBM 2003 Act with a new Debt Management and Fiscal Responsibility Bill, suggesting a debt–GDP ratio of 60% with a 40% threshold limit to centre and 20% limit to states by 2023. The FRBM Committee has also suggested a road map of yearly targets of fiscal deficit and revenue deficit to progressively reduce the debt to GDP ratio by 2023. However, with the announcement in the budget speech 2018–19 for the elimination of the revenue deficit concept, how much of the fresh borrowings would be used to cover the revenue expenses cannot be clearly deciphered from this year onwards. The distinction between how much of the fresh borrowings will be used for revenue expenses and for capital formation is blurred with the phasing out of revenue deficit. The FRBM Committee has also recommended "escape clauses" in the suggested act, on how much the government can deviate from the debt-to-GDP target in case of exceptional macroeconomic circumstances or natural calamities or national security issues.

There was a dissent note in FRBM report by one of its committee members with regard to having multiple deficit targets—debt, fiscal deficit, and revenue deficit—with threshold limits. In the dissent note, the member argued that having multiple debt–deficit targets with precise limits may make it difficult to achieve them all by 2023 (for details, refer to Annexure VI, FRBM report 2017).[4] The dissent note proposed primary deficit to be targeted for fiscal prudence. These debates on "which" deficit to be targeted can be tracked down to the early 1990s, when a plethora of concepts of deficits were introduced in India.[5] Over the years, this is the third time that a particular "purpose-specific" deficit is eliminated in India. One, the concept of budget deficit (the overall deficit of the central government is that part of the deficit that was covered by 91 days Treasury bills) was eliminated in the early 1990s, and replaced with Ways and Means Advances for any temporary mismatch in receipts. Two, monetised deficit (a concept of deficit introduced by Chakraborty Committee [RBI: 1985] to capture the net Reserve Bank of India or RBI credit to the government) was contained in the 1990s by an institutional agreement between RBI and GoI to contain the inflationary pressures of monetisation of deficits. Since then, the emphasis has been on revenue deficit, fiscal deficit, and primary deficit.[6] Three, the clauses for elimination of "revenue balance" (effective revenue deficit and revenue deficit) have been incorporated in the Finance Bill of 2018.

Implications of the Amendment

As mentioned above, the amendment suggests that the government will simultaneously target debt and fiscal deficit and do away with the revenue deficit target. Since the revenue deficit would not be a target to be monitored under FRBM anymore, and with fiscal deficit still fixed at 3% of GDP, can the movement of revenue deficit be ignored for the purpose of policy and prudent management of government finances? Between 2008–09 and 2018–19 budget estimates (BE), both fiscal and revenue deficit declined from 6% of GDP to 3.3% of GDP and 4.5% of GDP to 2.2% of GDP respectively (Figure 1). In 2008–09, revenue deficit was 75% of fiscal deficit and in 2018–19 (BE), it is estimated to be 66.66% of the fiscal deficit. In other words, during the last 10 years, it is the revenue deficit of the union government that has driven the fiscal deficit. The anatomy of revenue deficit is discussed in the next section.

Anatomy of Revenue Deficit

The fiscal profile of the union government is presented in Table 1. As evident, tax revenues net to the union government is expected to increase from 7.31% to 7.83% of GDP between 2016–17 and 2018–19 (BE). The non-tax revenue to GDP ratio is expected to decline from 1.81% of GDP in 2016–17 to 1.3% of GDP in 2018–19 (BE). The slippage in target of

Table 1: Fiscal Profile of Union Government—2016–17 to 2018–19 (BE)

(As % of GDP)

	2016–17 Actuals	2017–18 Budget Estimates	2017–18 Revised Estimates	2018–19 Budget Estimates
Revenue Receipts (Net to the Union Government)	9.12	8.97	8.92	9.13
Tax revenues	7.31	7.26	7.52	7.83
Non-tax revenues	1.81	1.71	1.40	1.30
Total expenditure	13.11	12.70	13.14	12.91
Revenue expenditure	11.22	10.87	11.52	11.33
Interest payment	3.19	3.09	3.14	3.04
Capital expenditure	1.89	1.83	1.62	1.59
Revenue deficit	2.1	1.9	2.6	2.2
Fiscal deficit	3.6	3.2	3.5	3.3

Source: Union Budget Document 2018–19.

non-tax revenues as per the 2017–18 RE is to the extent of 19% of 2017–18 (BE). Between 2016–17 and 2018–19 (BE), the share of dividends and profits in total receipts is expected to decline from 6.2% in 2016–17 to 4.72% in 2018–19 (BE). It is also generally argued that due to higher tax devolution to states, net availability of revenues to the union has declined. But it is evident from Table 2, post devolution of taxes, the net share of centre in total tax collection is expected to increase from 55.51% in 2016–17 to 56.24% in 2018–19 (BE).

On the expenditure side, revenue expenditure to GDP ratio was 11.22% in 2016–17. However, the revenue expenditure as per the 2017–18 revised estimates (RE) was expected to be 10.87% of GDP. As per the 2017–18 (RE), it is expected to be 11.52% of GDP, an increase of around 6% of 2017–18 (BE). The capital expenditure to GDP ratio is expected to remain at around 1.6% of GDP in 2017–18 (RE) and 2018–19 (BE). The corresponding fiscal outcome is a fiscal deficit of 3.3% of GDP and a revenue deficit to 2.2% of GDP in 2018–19 (BE).

Recasting Expenditure Needs

A detailed expenditure profile of the union government is presented in Table 3. Despite pay revisions, the share of establishment expenditure has not increased. In fact, the share of establishment expenditure in total expenditure is expected to decline from 21.46% to 20.82% between 2016–17 and 2018–19 (BE). Other components of expenditure, namely, central sector schemes and committed expenditure such as interest payment in fact declined marginally during the same period. As mentioned in the Budget Documents, in the case of central sector schemes and other central sector expenditure, the decrease in RE when compared to BE for 2017–18 was for fertiliser subsidy and petroleum subsidy (₹3,094 crore), decreased allocations under food subsidy in the National Food Security Act (by ₹5,057 crore) and reduction in capital outlays for internal security, major and medium irrigation and power projects (by ₹19,274 crore). While the share of centrally sponsored schemes has maintained its share above 12% of total expenditure, the share of finance commission grants has declined. The share of other transfers as a percentage of total expenditure is expected to increase from 2.77% in 2016–17 to 5.4% in 2018–19 (BE). However, when it comes to total transfers, as a percentage of GDP, it is expected to increase marginally from 6.37% in 2016–17 to 6.55% of GDP in 2018–19 (BE) (Table 4).

As mentioned in the *Expenditure Budget Volume I*, the fiscal slippage in expenditure in the budget 2018–19 (BE) has happened due to 11 components, as shown in column v of Table 5 (p 33). The slippage was due to high interest payments under market loans by ₹44,952 crore, increased allocation in defence pensions, civil pensions, and pensions payable to erstwhile employees of Department of Telecommunications, absorbed in Bharat Sanchar Nigam Limited, provisions made for compensation to states for revenue loss on rollout of goods and services tax (GST), increased allocation made for food subsidy under National Food Security Act, increased capital outlays provided for investment in Indian railways, higher education financing agency, atomic energy industries and construction of roads, higher allocation for capital expenditure for defence

Table 2: Receipts of Government of India (%)

	2016–17 Actuals	2017–18 BE	2017–18 RE	2018–19 BE
Revenue receipts				
1 Tax revenue				
Gross tax revenue	86.48	89.58	86.22	86.22
Less-state's share	30.64	31.61	29.82	29.82
1a Centre's net tax revenue	55.51	57.50	56.24	56.24
2 Non-tax revenue of which	13.75	13.53	10.45	10.45
Dividends and profits	6.20	6.67	4.72	4.72
Other non-tax revenue	6.58	5.75	4.89	4.89
Receipts of union territories	0.09	0.07	0.08	0.08
Total revenue receipts (1a + 2)	69.26	71.03	66.70	66.70
3 Capital receipts	3.29	3.96	5.20	5.20
A Non-debt receipts				
(i) Recoveries of loans and advances	0.89	0.56	0.77	0.77
(ii) Disinvestment receipts	2.41	3.40	4.43	4.43
B Debt receipts	27.44	25.01	28.10	28.10
Total capital receipts (A+B)	30.74	28.97	33.30	33.30
4 Draw-down of cash balance	-0.45	0.60	-1.74	1.80
Total receipts (1a+2+3)	100	100	100	100

Source: Government of India, Union Budget Documents 2018–19.

Table 3: Composition of Central Government Expenditure (%)

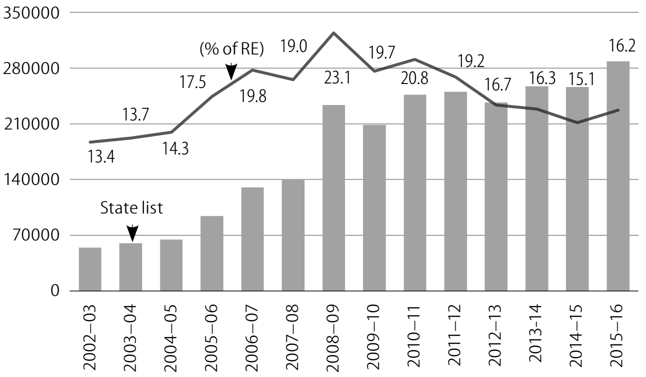
	2016–17 Actual	2017–18 Budget Estimates	2017–18 Revised Budgets	2018–19 Budget Estimates
A Centre's expenditure				
I Establishment expenditure	21.46	20.38	21.14	20.82
II Central sector schemes/projects	29.84	30.91	28.60	29.03
III Other central sector expenditure of which Interest payment	24.34	24.36	23.94	23.58
B Transfers				
IV Centrally sponsored schemes	12.22	12.97	12.88	12.51
V Finance commission grants	4.84	4.80	4.58	4.48
VI Other grants/loans/transfers	2.77	1.95	4.03	5.40
Grand total (in crore)	19,75,194 (100)	21,46,735 (100)	22,17,750 (100)	24,42,213 (100)

Source: Government of India, Union Budget Documents 2018–19.

Table 4: Transfer of Resources to States: 2016–17 to 2018–19 (BE) (₹ crore)

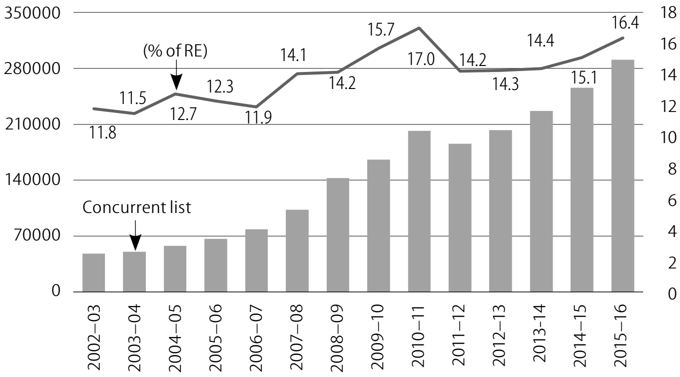
	2016–17 Actuals	2017–18 Revised Estimates	2018–19 Budget Estimates
Tax devolution to states	6,08,000	6,73,005	7,88,093
As a % to GDP	4.04	3.99	4.17
Finance Commission grants	95,550	1,01,490	1,09,373
As a % to GDP	0.63	0.60	0.58
Centrally sponsored schemes	2,25,848	2,63,783	2,77,754
As a % to GDP	1.50	1.56	1.47
Total transfers	9,59,299	10,90,105	12,38,435
As a % to GDP	6.37	6.46	6.55

Figure 2: Share of Union Government's Revenue Expenditure on State List Subjects



Source: Chakraborty et al (2018)

Figure 3: Share of Union Government's Revenue Expenditure on Concurrent List Subjects



Source: Chakraborty et al (2018)

services, higher requirement by Central Armed Police Forces, higher outlays provided to school education and literacy, higher provision made for Pradhan Mantri Swasthya Suraksha Yojana (PMSSY), and the increased allocation for compensation to union territory governments for revenue loss on rollout of GST. For comparative purpose, the variations between RE and BE for 2017–18 are shown in column IV of Table 5. The fiscal marksmanship ratio (RE/BE) for the year 2017–18 is also given in column VI of the table, which refers to the forecast errors in the public expenditure in that year.

Aforementioned analysis shows that this high level of revenue deficit is not either due to major increase in expenditure or due to a huge revenue shortfall. The structural inability to control revenue deficit needs different solutions than the general argument that the utilisation of government expenditure is inefficient and the government should spend less. It is time to have a relook at the way the union government spends. Analyses by P Chakraborty et al (2018) show that a large part of the revenue expenditure of the union government is spent on state and concurrent list subjects with a corresponding decline in expenditure on union list subjects. As evident from Figure 2, the union government used to spend around 13% of its revenue expenditure on state lists in 2002–03, which had increased to 23% in 2008–09. Subsequently though, it declined, it still remains as high as 16% of union government's revenue expenditure (as per 2015–16 estimates). In the concurrent list subjects union government expenditure has increased from 11.8% of total revenue expenditure of the union government in 2002–03 to 16.4% in 2015–16 (Figure 3).

Table 5: Fiscal Slippage: Details of Major Forecast Errors/Variations in the Expenditure (₹ crore)

		I 2017–18 BE	II 2017–18 RE	III 2018–19 BE	IV Variation 2017–18 BE to RE	V Variation 2017–18 RE to 2018–19 BE	VI Fiscal Marksmanship Ratio (RE/BE) 2017–18
1	Grants and loans to states	3,07,553 (14.33)	3,68,585 (16.62)	4,20,133 (17.20)	61,032	51,548	1.20
2	Pensions	1,31,201 (6.11)	1,47,387 (6.65)	1,68,466 (6.90)	16,186	21,079	1.12
3	Interest payments	5,23,078 (24.37)	5,30,843 (23.94)	5,75,795 (23.58)	7,765	44,952	1.01
4	Defence	2,62,390 (12.22)	2,67,108 (12.04)	2,82,733 (11.58)	4,718	15,625	1.02
5	Police	65,576 (3.05)	69,704 (3.14)	74,866 (3.07)	4,128	5,162	1.06
6	Education	36,884 (1.72)	38,649 (1.74)	40,612 (1.66)	1,765	1,963	1.05
7	Grants and loans to UT governments	3,996 (0.19)	5,272 (0.24)	6,500 (0.27)	1,276	1,228	1.32
8	Health and family welfare	16,836 (0.78)	17,312 (0.78)	19,163 (0.78)	476	1,851	1.03
9	Other subsidies	1,26,937 (5.91)	1,23,843 (5.58)	1,23,502 (5.06)	-3,094	-341	0.98
10	Food subsidy	1,45,339 (6.77)	1,40,282 (6.33)	1,69,323 (6.93)	-5,057	29,041	0.97
11	Capital outlay excluding defence	1,83,280 (8.54)	1,64,006 (7.40)	1,84,681 (7.56)	-19,274	20,675	0.89
12	Other expenditure	3,43,665 (16.01)	3,44,760 (15.55)	3,76,439 (15.41)	1,095	31,679	1.00
	Total expenditure	21,46,735 (100)	22,17,750 (100)	24,42,213 (100)			1.03

The figures in bracket refer to percentage in total expenditure (composition).
Source: Government of India, Union Budget documents 2018–19.

Conclusions

Given this decomposition of expenditure, we argue that there is a need to think seriously about reprioritisation of union government expenditure. When most of the current expenditure responsibilities, be it health, education, water supply, and sanitation are with the state governments, should the union government spend such large amounts on the state and concurrent list subjects of the Constitution? Some of the expenditure by the union government may be necessary: what the optimal level of spending is, needs to be determined keeping allocative and technical efficiency of government spending in mind. Since the union government has done away with the revenue deficit target, it should also recast union's expenditure responsibilities for greater efficiency of public spending and prudent fiscal management keeping constitutional responsibilities and available fiscal space of each level of government in mind.

NOTES

1 Auerbach (2017) noted that the most elaborate fiscal rules in existence are those that apply to member countries in the European Union, the culmination of a process dating to the original Stability and Growth Pact in the 1990s and now enshrined in a 224-page volume (European Commission 2017) specifying the rules and the enforcement process in great detail. The fiscal rules framework in European Union has undergone substantial revision over the years. But rule complexity does not guarantee success, as it invites subjective interpretation and reduces transparency (Auerbach 2017). The problems are particularly severe when the underlying objectives are unclear.

2 The Clause 207 of the Finance Bill 2018 seeks to amend the long title of the FRBM Act, 2003. It provides for omission of the words "achieving sufficient revenue surplus and" from the long title. Clause 209 of the bill seeks to amend Section 3 of the act relating to *fiscal* policy statements to be laid before Parliament. It provides for omission of item (i) of subsection (3) and omission of the words "revenue balance and" in clause (b) of subsection (6) and omission of item (iii) of subsection (6A). Clause 210 of the bill seeks to amend Section 4 of the act relating to *fiscal* management principles. It provides for substitution of Section 4 so as to provide that the central government shall take appropriate measures to limit the fiscal deficit up to 3 percentage of GDP by 31 March 2021; endeavour to ensure that general government debt and central government debt do not exceed 60%, and 40% respectively of GDP by the end of financial year 2024–25. It also provides that where *fiscal* deficit amount is varied from targets, a statement explaining the reasons thereof and the path of return to the annual target shall be laid before Parliament.

3 For details, refer paras 141 and 142 of Union Budget Speech 2018 "In order to impart unquestionable credibility to the Government's commitment for the revised *fiscal* glide path, I am proposing to accept key recommendations of the *Fiscal* Reform and Budget Management Committee relating to adoption of the Debt Rule and to bring down Central Government's Debt to GDP ratio to 40%. Government has also accepted the recommendation to use *Fiscal* Deficit target as the key operational parameter. Necessary amendment proposals are included in the Finance Bill."

4 The dissent was with respect to two points: (i) The primary balance is the principal quantifiable objective or goal of *fiscal* policy with zero general government primary balance as the medium-term target. Although the dissent note does not derive the optimal medium-term primary balance for India using any economic theory or empirical analysis, it refers to zero primary balance as the goal in several places in the note, for example, "zero deficit (page 7)," "eliminating the general government primary deficit" (page 10), "as long as primary balance remains in deficit …" (page 11). And (ii) the primary balance is also the operational target secured through a 0.2 percentage point annual reduction in primary deficit for both the center and the states (Annexure VI, FRBM Committee Report).

5 It is always argued that unless a correct indicator of deficit is adopted, there is a possibility of miscalculation of pre-emption of resources by the government and thus the assessment of the fiscal policy and its impact on macroeconomy (Boskin 1988). It is interesting to recall here that the evolution of concepts of deficits, from one specific deficit to purpose-specific plethora of deficits, has happened only in the early 1990s drawing on the four pioneering surveys by Blinder and Solow (1974), Heller et al (1986), Blejer and Chu (1988) and Blejer and Cheasty (1993). For detailed discussion on measurement issues and various concepts of deficit, refer Chakraborty (2016).

6 The fiscal deficit is the net borrowing requirement of the government. Conventional measurement of fiscal deficit is defined as the difference between total government receipts (non-debt creating) and the total government expenditure net of repayment of previously incurred debt. In India, the gross fiscal deficit is defined as the excess of the total of revenue expenditure, capital outlay and net lending over revenue receipts and non-debt-creating capital receipts, including the proceeds from disinvestment. Thus, gross fiscal deficit = revenue expenditure + capital outlay + net lending – revenue receipts + non-debt creating capital receipts). The primary deficit is an indicator to assess the impact of the current year's discretionary fiscal action on the indebtedness of the government. Primary deficit = fiscal deficit – interest payments. Revenue deficit as a concept measures government "dissavings." Revenue deficit is defined as the difference between the revenue earning of the government and revenue/current expenditure government. In the context of the structural adjustment programme, as a policy of demand management, among the economists, there have been arguments for and against the adoption of these deficit indicators to evaluate the budgetary performance of the government (Chakraborty 2016).

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