Indian Journal of Economics and Finance (IJEF)
ISSN: 2582-9378 (Online), Volume-2 Issue-1, May 2022

Fiscal Consolidation: The Indian Experience

Swati Yadav

Abstract: ***Fiscal consolidation methods have always been under lens since their origin with newer and more stringent way of monitoring them. Still the elected policymakers tend to find a way to manage them so as to not to lose the externality benefits of higher fiscal deficits in term of electoral gains. This paper analyses the fiscal adjustment programme adopted by the central government of India since the inception of FRBM act 2003. A comparison of the consequences of fiscal adjustment on public finance under discretionary phase of economic reforms with the initial rule phase has also been discussed in this paper. Analysis indicates that fiscal reforms has led to consolidation of public finances in India but some crucial challenges remain i) setting up of Fiscal Council ii) not to use creative accounting to maneuver accounts to meet the fiscal targets iii) implementing countercyclical fiscal policy in totality and iv) starting a countercyclical fund. JEL Classification: E 62, E 60***

Key Words: Fiscal Consolidation, Fiscal Rules, FRBM, India

I. INTRODUCTION

Fiscal consolidation was major focus of the reforms initiated in the aftermath of the macroeconomic and balance of payments crisis of 1991. The 80s saw significant increase in total fiscal deficit and its financing through domestic and external borrowing led to the macroeconomic crisis of 1991. The political instability in 1990 and steep rise in oil prices during gulf crisis of 1990 further added to the woes of Indian economy. The government initiated a setof economic reforms in 1991 at the behest of International Monetary Fund (IMF) (for three years 1991-93 on IMF condition and thereafter as part of GOI strategic decision), covering all aspects of macro economy (financial, fiscal and external sector reforms). Initially the fiscal reforms were at the discretion of the ruling party but after the enactment of FRBM act there are fixed rules which technically limit the ability of politicians to maneuver public finances. But it has been observed that the use of creative accounting has made it possible for the government to on one hand meet FRBM targets and on the other to fulfill their political agendas by reducing the capital expenditure. This article presents a detailed analysis of the Indian experience under fiscal adjustment programme and it also looks at the impact of fiscal policy on public capital formation during the discretionary phase and rule phase of Indian public finance. India adopted FRBM and FRL legislation at the central and state level respectively in the year 2003. The objective was to ensure fiscal sustainability by putting a limit on central government debt and fiscal deficit levels.

Manuscript received on 15 April 2022 | Revised Manuscript received on 26 April 2022 | Manuscript Accepted on 15 May 2022 | Manuscript published on 30 May 2022.

* Correspondence Author
Dr Swati Yadav*, Associate Professor, Bhagini Nivedita College, University of Delhi, India. E-mail: swatiyaadav@gmail.com

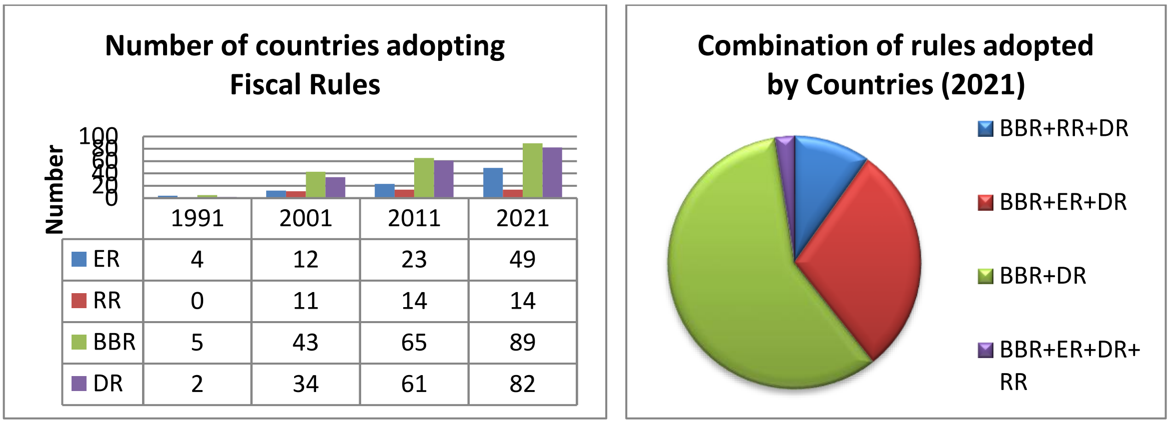
The fiscal deficit was to be reduced to 3 percentages of Gross Domestic Product (GDP) and Revenue deficit (RD) to be eliminated by Fiscal Year (FY) 2009. Karnataka was the first state to adopt Fiscal Responsibility Legislation (FRL) in 2002 even before central government adopted FRBM . Subsequently other states also enacted similar legislations with adopting and implementing FRLs being incentivized as per the finance commissions' revenue sharing formulae. Since then rules have been amended. In May 2016 a committee was set up to review the FRBM act and suggest a roadmap for fiscal consolidation. After suspending the fiscal rules in FY 2020-21 to deal with economic crisis government also announced revision of fiscal roadmap for Indian Economy. The rest of the paper is structured as follows: The next section provides a brief analysis of background of fiscal rules. Section III discusses and compares the fiscal adjustment under discretion and under rules for the Indian economy covering the period (FY 1990-91 to FY 2020-21). Section IV reports the difference and similarity in the fiscal policy response Global Financial Crisis and the recent pandemic led recession. The last section provides concluding remarks listing out the key challenges before Indian Government in balancing the public finances at the central level.

II. BACKGROUND

The economies all over the world face some common macroeconomic challenges. One of them is prudent management of fiscal finances both at national and supranational level. Managing public finances becomes more difficult where electoral politics are rewarded due to externalities attached with higher deficit. The electoral gain by following popular policies irrespective of the deficit and consequent debt burden makes it very difficult to manage public finances at discretion. This leads to inability to follow countercyclical policies to counter the shocks either due to business cycle or other reasons such as the latest pandemic. The room for maneuvering public finance becomes limited. Thus, various countries started adopting and following fiscal rules in different form and flexibility. In simple terms fiscal rule is a legislated mathematical limit on the budgetary aggregates with twin objectives

a) Sustainability of public finances, and
b) Macroeconomic stabilization

The advantage for government to stick to these rules is enhanced market credibility and rating. As a result the number of countries having adopted fiscal rules in some form has increased from 7 in 1990 to 92 in 2015 to finally 105 by end of 2021(IMF Fiscal Report 2022) [6] [15].Generally four kinds of numerical Fiscal rules are adopted: i)Budget Balance Rules ii)Expenditure Rule iii) Revenue rule and finally iv)Debt rule. As per the IMF dataset on 100 countries the number of rules adopted by the countries varies from all four types to only single fiscal rule (Figure 1).



	1991	2001	2011	2021
ER	4	12	23	49
RR	0	11	14	14
BBR	5	43	65	89
DR	2	34	61	82

Figure 1: Fiscal Rules Adopted By Countries By 2021

Source: IMF Dataset and author's own calculations

Any fiscal rule should be simple but simple rules with a given numerical target are generally rigid. The Global Financial Crisis (GFC) of late 2000's and collapse of commodity prices lead to revision of fiscal rules in a way to make them more flexible. As a result escape clauses were increasingly adopted. Several countries have included these clauses as part of second generation fiscal reforms. Before the pandemic, around two third of countries following fiscal rules also adopted escape clauses. Initially, many countries were following rules out of their choice with no legal basis. The last decade saw increasing legal basis and focus on efficient implementation of fiscal rules. Gradually the demand for setting up independent fiscal councils to reduce election bias in policy making and effective implementation of rules is increasing. Some countries like Brazil, Chile Costa Rica, EU and Australia has this structure in place. As of 2021 there are 51 fiscal councils in place. In India also the thirteenth finance commission had recommended setting up of fiscal councils [13]. On the pro side a non partisan public entity that promotes sustainable public finance by independently assessing fiscal plans, evaluating macroeconomic forecasts and implementing fiscal rules can lead to increase in transparency and improve the country's finances in long run. But that reduced the fiscal power of elected policy makers. The decision about setting up of Fiscal Councils is thus a difficult one for the policy makers.

III. FISCAL ADJUSTMENT: DISCRETION VS RULES

Simulations done by IMF study (2020) has shown that the fiscal deficit (FD), primary deficit (PD), and public debt ratios (PDR) all slowly decline with higher capital expenditure during the interactions of the model for the Indian Economy. This shows that there is scope for India to reorient public expenditures toward growth-enhancing investment along with maintaining overall fiscal discipline. Thus it is important to study what shape public finances have taken under the FRBM regime [12]. A comparison of how the rules have affected public capital formation under the discretionary phase of fiscal policy with the rule phase is essential. The entire post reform sample period can be divided into two phases: i) Phase 1: Discretionary phase (1991-92 to 2002-03) and ii) Phase 2: Rule Phase (2003-04 to 2020-21). The rule phase is divided into three sub phases :

i) FRBM Rule phase (2003-04 to 2007-08)

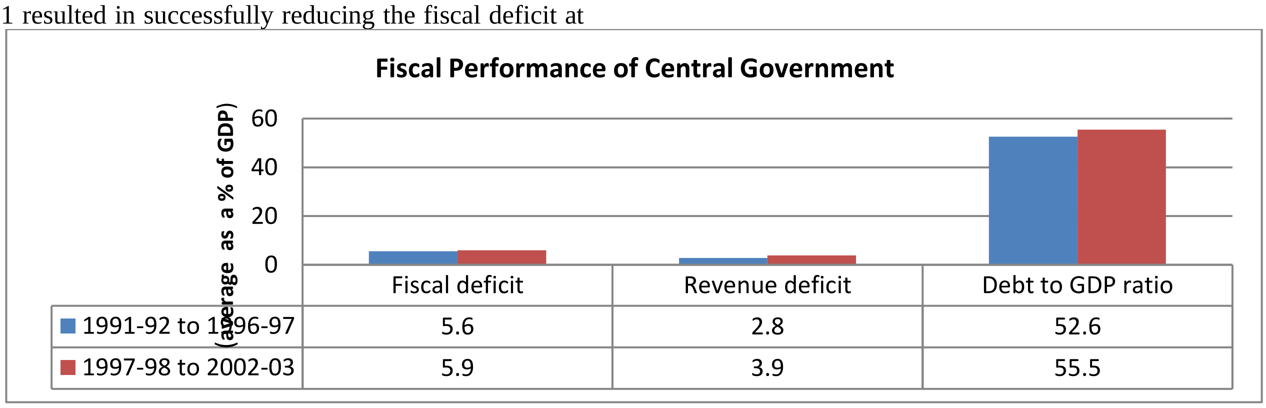
ii) Intermediate phase with Amended FRBM

iii) New FRBM phase (2015 onwards)

It will be interesting to analyze and compare these two phases to understand the impact of fiscal consolidation process in India.

Phase 1- Discretionary phase (1991-92 to 2002-03)

Fiscal reforms that were started as part of economic reforms of 1991 resulted in successfully reducing the fiscal deficit at both central and consolidated level, but improvement infiscal situation lasted only till the mid 90s (Figure 2).



	Fiscal deficit	Revenue deficit	Debt to GDP ratio
1991-92 to 1996-97	5.6	2.8	52.6
1997-98 to 2002-03	5.9	3.9	55.5

Figure 2: Fiscal Performance of Central Government

Source: Handbook of Statistics (2008), RBI and author's own calculation.

Retrieval Number:100.1/ijef.C2517051322
DOI:10.54105/ijef.C2517.051322
Journal Website: www.ijef.latticescipub.com

Published By:
Lattice Science Publication (LSP)

From 1997 onwards a significant deterioration in public finances was observed (Table 1) that culminated into enactment of Fiscal Responsibility and Budget Management (FRBM) act for ensuring fiscal discipline at the central level and subsequently Fiscal Responsibility Acts (FRAs)for states . Table 1 gives some of the important economic and fiscal indicators after the initiation of economic reforms of 1990's. The tax to GDP ratio in the 90s decreased by 2% in comparison to the improvement in tax collection achieved in the previous decade. During the latter half of the 90s consolidated government's consumption and subsidies on average grew at 9.6% and 12.6% respectively, whereas public capital formation grew only by 1.9%. Investment in agriculture and infrastructure in fact declined by 5.6% and 0.2% respectively (Rakshit; 2002) [9]. The three year since 1996-97 show a sharp rise in deficit of the central and state governments following pay increase recommended by the fifth pay commission: revenue deficit and fiscal deficit of the central government increased from 2.4% and 4.1% in FY1996-97 to 4.1% and 5.7% by 2000-01 respectively. The staff downsizing which was part of the recommended package was not formally accepted (Rajaraman, 2004) [8] The entire improvement in central government finances till 1996-97 was because of reduction in government expenditure from 17.3% (1990-91) to 13.9% (1996-97) as tax revenues showed a decline. Similarly, the worsening of central government finances from 1997 onwards is largely due to rapid rise in government expenditure in 1999-2000 to accommodate increase in revenue expenditure as a result of pay hike. The vigorous increase in oil prices from 1999 had adverse implications for India's import bill. To prevent the pressure to be transmitted into additional fiscal problem the administered prices of petroleum products were revised upwards in three stages between October 1999 and November 2000. The change in fiscal situation gets reflected in saving and investment data. Higher revenue deficit would mean lower public savings. From increase of 2% of GDP in 1995-96 the rate of growth of public savings as a ratio of GDP became negative (-0.9%) by 1999-2000. The investment ratio also fell by four percentage points from 26.9% of GDP in 1995-96 to 22.7% in 1998-99. The three major changes occurred in the decade of ninety with regard to conduct of fiscal policy: firstly, the institutionalization of the concept of fiscal deficit in FY 89; secondly, the shift of central government borrowings to market interest rates and progressive reduction of statutory liquidity requirement (SLR) and finally, the decision taken in 1994 to phase out ad hoc treasury bills over the span of three years and introduce a system of ways and means advances to limit government's automatic access to RBI's financing. The government also introduced in parliament the FRBM bill in December 2000. The sharp worsening of fiscal situation with deficitreaching its highest level in 2001-02 finally lead to the implementation of the bill from 2003-04.

Phase 2- Rule phase (2003-04 to 2007-08)

The FRBMA stated objective is to ensure inter generational equity in fiscal management and fiscal sustainability necessary for long term macroeconomic stability. The act was first implemented at the central level along with the implementation of FRA in four states namely: Karnataka, Punjab, Tamil Nadu and Kerala. As of mid 2008 all Indian states except West Bengal and Sikkim enacted fiscal responsibility legislation. Now India is reviewing its fiscal rules framework to design a successor arrangement to FRBM act. The period from 2003- 04 can be called the rule phase of fiscal adjustment programme of Indian government.

Table 1: Changes in Fiscal Parameters (average as a % of GDP): Discretionary phase: 1991-92 to2002-03; Rule phase: 2003-04 to 2007-08

	Phase 1 1991-92 to2002-03	Phase 2 2003-04 to 2007-08		Phase 1 1991-92to 2002-03	Phase 2 2003-04 to 2007-08
Tax Revenues 1. Direct tax 2. Indirect tax 3. Non tax revenue	9.2 1.9 4.7 2.6	10.1 3.6 4.2 2.3	Outstanding liabilities(consolidated) External liabilities Domestic liabilities	66.2 4 62.2	79.2 2.2 77.0
Total expenditure (TE) Revenue expenditure (RE) Interest payments (IP) Subsidies Defence Capital expenditure (CE) Capital outlay (CO)	15.8 12.5 4.4 1.4 2.3 3.3 1.3	15.2 12.5 3.9 1.5 2.2 2.7 1.5	Gross domestic savings Household sector Private corporate sector Public sector	23.4 18.8 3.9 0.77	33.2 23.2 7.1 2.9
Gross fiscal deficit (GFD) Gross primary deficit(PD) Revenue deficit(RD)	5.7 1.3 3.3	3.8 -0.1 2.4	GFCF Public investment Private investment	22.9 7.6 15.3	30.3 7.4 22.3
Debt to GDP	50	60.2	Growth rate of GDP at factor cost	5.5	8.9

Source: Handbook of Statistics (2009), RBI

Table 1 gives a comparison of state of public finances at the central level under the discretionary and rules phase of fiscal policy. As a ratio of GDP both revenue and fiscal deficit of central government declined steadily from 2001-02 and much sharply since 2003-04. The central fiscal deficit as a percentage of GDP declined from 6.19% to 2.7% whereas the consolidated fiscal deficit declined from 10.3% to 5.3% respectively. Revenue deficit also decreased from 4.4% to 1.1% for central government and 7.64% to 0.64% for the consolidated figure. As a matter of fact, states revenue account showed a surplus beginning 2006-07.

Retrieval Number:100.1/ijef.C2517051322
DOI:10.54105/ijef.C2517.051322
Journal Website: www.ijef.latticescipub.com

Published By:
Lattice Science Publication (LSP)

The improvement on this front was achieved largely due to very sharp increase in central government revenues especially direct taxes. Implementation of tax information network (TIN; 2003-04) and widening of tax base on one hand and reduction in tax rates resulting in better compliance on the other hand led to significant increase in personal income tax and service tax revenue. The task force on implementation of FRBM act had worked out the targets for both revenue and expenditure components of central government budget. But the government failed to compress expenditure according to plan (Rao, Sen, and Jena, 2008) [10]. Revenue expenditure was expected to be curtailed from 13.2% of GDP in 2003-04 to 11.3% in 2007-08(Figure 3). But it declined only by half a percent, well short of the plan reduction. That too when government was able to take advantage of low interest rates by swapping debt with high interest rate to low interest rate. As can be seen from the Figure 1, the non interest component of revenue expenditure increased during the period 2003-04 and 2007-08.

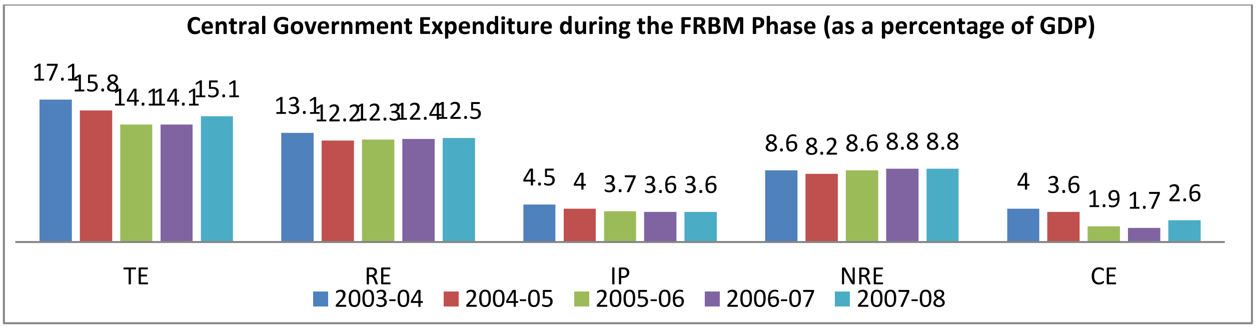


Figure 3: Overview of Central Government Expenditure during the FRBM Phase (as a percentage of GDP)

Source: Basic data from Public Finance Statistics (2009) and author's own calculation

As far as the fiscal deficit is concerned the adjustment figures are broadly as per the FRBM targets. This can only happen if government is trying to achieve fiscal targets by reducing its capital expenditure. Question is at what cost and what will be the implication for future growth. Government has not been able to contain and weed out unproductive expenditure with the result that burden of fiscal consolidation has fallen on capital expenditure with disastrous consequences for future growth. The 13th Finance Commission has laid out a road-map for reducing the Central government's fiscal deficit from 6.8% of GDP in FY10 to 3% in FY14 and eliminating the revenue deficit by FY14. It also recommends a combined debt target of 68% of GDP for the centre and states, to be achieved by FY15; and suggests that "*the Medium Term Fiscal Plan be made a statement of commitment rather than a statement of intent*".

The level of public investment can influence overall level of capital accumulation and economic growth through its effect on both demand and supply side of the economy. Public investment especially in infrastructure services can stimulate private investment. If the economy is operating close to its full employment level, increase in government investment can have some crowding out effect on private investment due to rise in interest rate. But if there is an output gap or economy is operating below full employment level, government investment can have a multiplier effect on the economy by generating additional demand and inducing private investment. Higher public capital accumulation in areas which do not attract private investors at the desired level and have strong supply side linkages with the rest of the economy can be highly beneficial for the economy (R.Chelliah, 2002) [4]. Agriculture, transportation and communication services providing linkage between rural and urban areas, education and health services specifically in rural areas are some of the areas where public sector investment will have significant positive externalities. Several studies have noted crowding in effects of public sector investment on the level of private sector investment for the Indian economy. RBI study (2002) shows the positive influence of public sector investment in infrastructure on private capital accumulation in manufacturing and services. Chelliah (2002) has noted that between 1992-96 and 1996-99 annual average growth rate of public investment in agriculture deteriorated from 14.8% to -8.2%, the corresponding figures for private (agricultural) investment also saw a decline from 5.7% to 1.3% respectively. Table 2 compares the average share of public and private sector in Gross Fiscal Capital Formation (GFCF). The data shows that since the fiscal reforms initiated in 1990's the capital expenditure by the public sector has gone down irrespective of the nature of fiscal reforms; discretionary or rule based.

Table 2: Average (percentage) Share of GCF in Public and Private sector in Total GCF (at constant prices)

	Average (%) Share of GCF in Agriculture & Allied Sector to Total GCF (at constant prices)			Average (%) Share of GCF in Manufacturing Sector to Total GCF (at constant prices)			Average (%) Share of GCF in Total GCF (at constant prices)	
	Public	Private	Total	Public	Private	Total	Public	Private
1980's	12.1	16.7	14.2	12.0	47.5	28.8	52.8	47.2
1990's	7.0	11.4	9.6	10.6	49.4	34.8	38.9	61.1
2000's	7.2	9.3	8.7	7.9	43.1	34.4	25.0	75.0

Source: Handbook of Statistics,RBI (2009)

Retrieval Number:100.1/ijef.C2517051322
DOI:10.54105/ijef.C2517.051322
Journal Website: www.ijef.latticescipub.com

Published By:
Lattice Science Publication (LSP)

Since the Government has not been able to curtail its unproductive revenue expenditure it has transferred the burden of fiscal consolidation on capital expenditure. To meet FRBM targets the average capital expenditure as a percentage of GDP went down from an average of 6.2% of GDP during the decade of 1980s to 3.3 % in Phase 1 of reforms and to 2.7 % in Phase 2 (Table 2).

Mundle (1999) using a macroeconomic model for Indian economy found that when variations in fiscal deficit are completely absorbed by variations in capital expenditure, the rate of growth of Indian economy for the year 1993-94 will fall by 3% as compared to only 1% decrease when variations are completely absorbed by revenue expenditure. Several other studies have also shown that public capital formation has a positive impact on private sector production (Aschauer: 1988, 1989) [3][5]. Given the positive impact of public investment it is disheartening to observe that rate of public capital accumulation has seen a continuous decline during both the phases of fiscal adjustment (Table 2).

Thus the Indian experience of fiscal adjustment under discretion and rules (1991-92 to 2007-08) show that adjustment is mainly revenue based without meeting the targets of cut in expenditure as targeted in the FRBM act. Most of the reduction in expenditure has come from cut in government capital spending. When fiscal adjustment is based on increasing revenue without a commensurate reduction in expenditure, its sustainability is doubtful.

The international experience has also shown that revenue-based adjustments are likely to be short-lived (Alesina and Perotti, 1996) [1][2]. When revenues are increasing governments tend to relax and do not undertake to reduce unnecessary expenditures rather government spending increases, so the adjustment effort is undermined and the result is a larger government. The increase in revenues for the Indian economy has been based on widening of tax bases and high growth of the economy. Though the revenue potential of Indian economy has still not been exhausted still in future it has to remain prepared for large cyclical fluctuations in total revenues. On the other hand the committed expenditure forms a large part of government spending in India and continues to grow. This can create imbalances.

Thus the important features of fiscal adjustment in India in the initial stage are firstly it is revenue based, secondly capital expenditure is bearing the brunt to meet fiscal targets and thirdly a large part of government spending is rigid.

2008-09 - The Global Slowdown

Between 2001-02 and 2007-08 India's public finances experienced a commendable turnaround in respect to the deficit indicators. The central fiscal deficit as a percentage of GDP declined from 6.19% to 2.7% whereas the consolidated fiscal deficit declined from 10.3% to 5.3% respectively. Revenue deficit also decreased from 4.4% to 1.1% for central government and 7.64% to 0.64% for the consolidated figure. In fact for state revenue account showed a surplus beginning 2006-07 [7]. This trend showed a complete reversal of 180 degree with deficit figures in 2008-09 reaching the level as were observed in 2001-02 (6.02% for central government and 8.09% consolidated deficit).

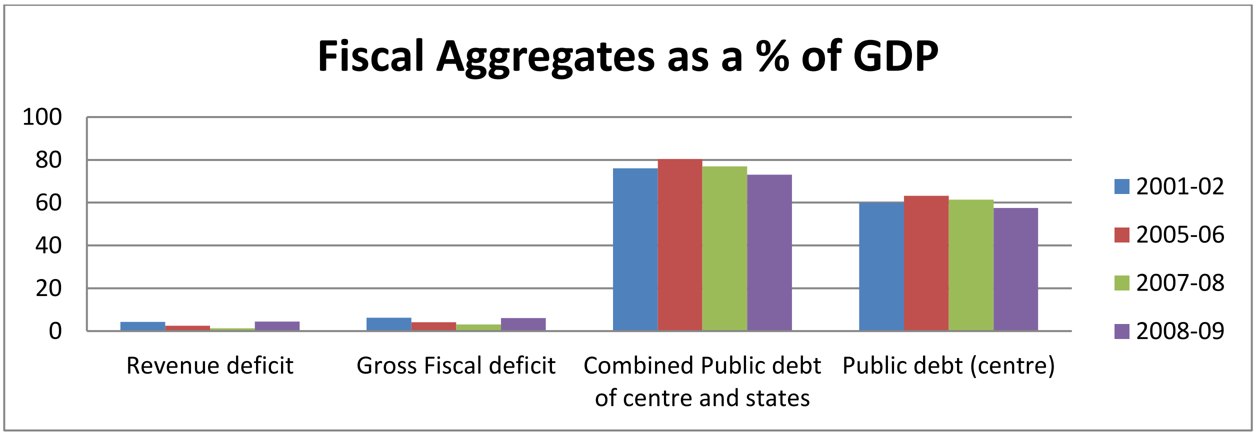


Figure 4: Overview of Fiscal Aggregates in India (as a percentage of GDP)

Source: Handbook of Statistics (2008), RBI

Revenue deficit increased to 4.45% for central government (Figure 2a). The revised estimates put consolidated fiscal deficit at 9% of GDP. Moreover the off budget liabilities amounting to Rs. 96000 Crore by way of bonds issued to oil and fertilizers companies led to fiscal deficit figure to as high as 11% of GDP (2008-09) which is worse than the highest level of deficit India had ever experienced(it was 10.3% in 2001-02). The crisis brought Indian economy's fiscal position back to the same level of deficits that were observed in 2001-02. To accommodate the fiscal stimulus introduced to manage the financial crisis MTFP targets were modified in the FY2009 and FY2010. The government was quick to point out that deterioration in deficit indicators is largely due to global slowdown which may not be completely true just as the improvement in the post FRBM act period is not just because of passing of an act. The improvement in central Government finances in India before the 2008 crisis shows that this consolidation has in effect been achieved through improved revenue collections. The task force on implementation of FRBM act had worked out the targets for both revenue and expenditure components of central government budget.

In FY 2008-09 the two supplementary demands for grant amounting to 2.8% of GDP was made that included – provision for pay revision, additional funds for food and fertilizer subsidies, funding of loan waiver scheme and extra funds for governments flagship program like the NREGA scheme. The creative accounting led to show that the government is trying to adhere to FRBM targets whereasall extra expenditure was being meted out by using the supplementary demand for grants. The adjusted fiscal deficit for the centre government is 8.02% for 2008-09 and consolidated deficit amounts to 11% of GDP (Figure 4).

Sub Phase: 2(2008-09 to 2014-15)

In the FY 2012 amendments were made in the FRBM act 2003 using the Finance Act of 2012 whereby it was decided to table Medium Term Expenditure Framework Statement (MTEF) before both houses of the parliament [14]. This MTEF statement will give three year rolling target for approved expenditure indicators. The amended FRBM Act included

a) The revised fiscal consolidation path recommended by the 13th Finance Commission thereby shifting the targets of the original FRBM Act from 31 March 2009 to 31 March 2015 [11].

b) New concept of Effective Revenue Deficit was introduced.

ERD=RD-Grants for Capital Assets creation

Grants for Capital Assets creation are the grants-in-aid given by the Central Government to state governments, autonomous bodies, local bodies and other scheme implementing agencies for creation of capital assets. ERD shows the amount of capital receipts that are being used for actual consumption expenditure of the Government. The new MTFP targets required only the effective revenue deficit to be eliminated by 31 March 2015.

Sub Phase: 3 (2015 -2019)

In the year 2015 the concept of ERD was abolished and new FRBM act was enacted with escape clause provisions for the central government. The period from 2015-16 to 2019-20 saw a gradual increase in both GFD and RD (Figure5). The combined Public debt of centre and states as a percentage of GDP also increased. The year 2019-20 saw a massive increase in all the figures. India activated the escape clause in February 2020 before the pandemic. The clause allows a temporary deviation of deficit not exceeding ½ percentage points of GDP a year. As a result it raised the FY2019-20 and FY20-21 deficit to ½ percentage points of GDP above the earlier estimate to 3.8 and 3.5 percent of GDP, respectively.

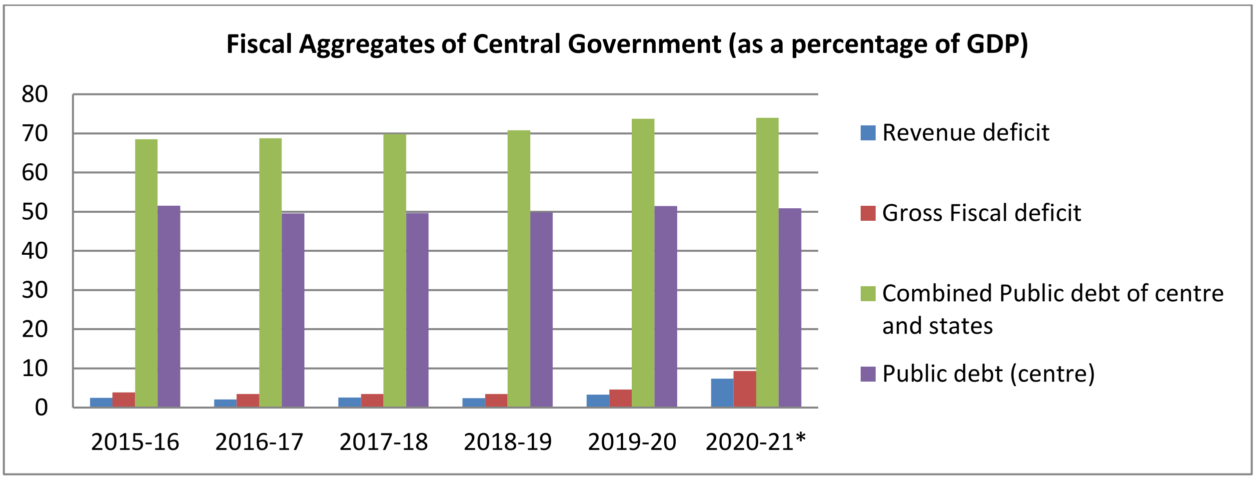


Figure 5: Overview of Fiscal Aggregates of Central Government (as a percentage of GDP)

Source: Handbook of Statistics (2021), RBI *Budget Estimate

To provide fiscal stimulus to support the economy facing significant economic consequences because of pandemic government suspended the fiscal rule in Fiscal Year 2020-21. The government also announced that the FRBM act will be changed to meet the revised fiscal path. Also it is worth deliberating on the fact that government announced some stimulus even before the pandemic as the economy was on the path to slowdown even before pandemic hit Indian economy. That requires structural reforms and the need to go for capital expenditure in a big way to boost the economy.

IV. FISCAL RESPONSE TO PANDEMIC A COMPARISON WITH RESPONSE TO GFC

On May 12,2020 the government of India announced a stimulus package of rupees 20 lakh crore worth around 10% of India's GDP. The package was mix of fiscal and monetary support along with measures to enhance ease of doing business in India. Money was also used to provide food and relief to poorest and vulnerable population through Direct to Beneficiary Transfer (DBT) using Jan Dhan account model. Other sector where stimulus was given was health sector, small and informal businesses, infusing liquidity into the banking system. The government also tried to cut down the current expenditure by reducing the increase in Dearness Allowance (DA) for its employees. The aim of these stimulus measures was to resolve supply side issues. Nothing major was done to augment demand initially. Launching of big infrastructure projects to create productive jobs was required. Such projects can be designed in a way that they can act as automatic fiscal stabilizers for urban poor.

Retrieval Number:100.1/ijef.C2517051322
DOI:10.54105/ijef.C2517.051322
Journal Website: www.ijef.latticescipub.com

Published By:
Lattice Science Publication (LSP)

Big infrastructure boost is the direction taken by countries like USA and China recently.

The response to this crisis is different from that in case of Global Financial Crisis of 2008. The government announced three stimulus packages between December 2008 and February 2009 worth 3.5 % of GDP along with easing of monetary policy by the RBI. As a result of the combined effort of Government and RBI the economy bounced back in 2009-10. Again the government continued with the mistake of not following countercyclical policy in totality and did not withdraw fiscal stimulus after the economy rebounded. The result was increased current account deficit, uncontrolled growth of Non Performing Assets and increasing debt and deficit of the government.

The cause and nature of the GFC crisis of 2008-09 and Pandemic led crisis of 2020 are very different and so is the approach to deal with both crisis needs to be different. But the main similarity and difference lies in whether government is able to maintain the countercyclical stance of fiscal policy in totality or it leads to public finances slip out of its hand. In that scenario it will have adverse consequences for fiscal sustainability in long run. This defeats both objectives of fiscal policy.

V. CONCLUSION

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 was enacted with the aim to provide a legislative framework for reduction of deficit, and thereby debt, of the Government to sustainable levels over a medium term. The act will, thereby, ensure inter-generational equity in fiscal management and long term macro-economic stability. The Indian FRBM act focuses on BBR rules. Initially, it was decided to apply the golden rule of achieving zero current deficit by a stipulated date and borrowing to be done only for capital expenditure. But the golden rule of maintaining zero current deficit was abandoned in case of central government. Creative accounting has been used to manage around the targets. The concept of effective revenue deficit was adopted but later it was dropped. The fiscal rules have the primary objective of debt sustainability followed by the secondary objective of macroeconomic stabilization. Thus apart from debt sustainability, India needs to incorporate countercyclical fiscal policies. Even though the finance commission has recognized the need for countercyclical policies yet India has not adopted the SSBR rules. India's experience with fiscal rules at the central government level shows that although it has adopted a rule that meets the requirement of simplicity a lot needs to be done on the forefront of getting accurate data, abstaining from creative accounting and strict enforcement of rules. Establishment of an independent fiscal council as recommended by the fourteenth finance commission is the need of the hour. This independent body can help in assessing the fiscal compliance without any prejudice. Such councils do exist in countries like USA, Europe and several emerging market economies. The analysis in the paper provide the following findings: Firstly, in the initial stage of fiscal consolidation public capital formation bore the brunt of fiscal adjustment which was primarily revenue based. Secondly, the introduction of FRBM rules has helped overall to consolidate India's public finances. Thirdly, Government has used creative accounting to tweak the rules. Fourthly, India's fiscal rules are mainly in the sphere of traditional budget balance rule with no debt ceiling law

The key challenges are (i) inadequate coverage or assessment of fiscal risks, and (ii) inability to set up an independent fiscal council to ensure transparency and monitoring adherence to fiscal rules while assessing the requirement to use escape clauses (iii) maintaining strong coordination between fiscal and monetary policy as part of its policy regime to meet the goal of economic stability (iv) following countercyclical policies in totality (v) setting up a countercyclical fund to meet future challenges.

REFERENCES

1. Alesina, Alberto and Tamim Bayoumi (1996). "The Costs and Benefits of Fiscal Rules: Evidence from U.S. States". NBER Working Paper No. 5614 [CrossRef]
2. Alesina, Alberto and Roberto Perotti. "Fiscal Adjustments In OECD Countries: Composition And Macroeconomic Effects," International Monetary Fund Staff Papers, 1997, v 44(2,Jun), 210-248. [CrossRef]
3. Aschauer, David Alan, 1989. "Is public expenditure productive?," Journal of Monetary Economics, Elsevier, vol. 23(2), pages 177-200, March. [CrossRef]
4. Chelliah R. (2002), "Some Macroeconomics of India's Reforms Experience", in K. Basu (eds), India's Emerging Economy: Performance and Prospects in the 1990's and Beyond, MIT press, Cambridge, Massachusetts.
5. David Aschauer, 1998. "Public Capital and Economic Growth: Issues of Quantity, Finance, and Efficiency," Macroeconomics 9805016, University Library of Munich, Germany. [CrossRef]
6. Davoodi, Hamid R., Paul Elger, Alexandra Fotiou, Daniel Garcia-Macia, Andresa Lagerborg, W. Raphael Lam and Sharanya Pillai. 2022b. "IMF Fiscal Council Dataset: The 2021 Update", International Monetary Fund, Washington, D.C.
7. Fatás, Antonio, and Ilian Mihov. "The macroeconomic effects of fiscal rules in the US states." Journal of public economics 90, no. 1–2 (2006): 101–117. [CrossRef]
8. Rajaraman, I. (2004), "Fiscal developments and outlook in India", NIPFP Working Paper, National Institute of Public Finance and Policy New Delhi. NIPFP Conference on Fiscal Policy in India. Available from World Wide Web: (http://www.nipfp.org.in/working_paper/wp04_nipfp_015.pdf).
9. Rakshit, M. K. (2002), "Macroeconomic Management in the 1990's", EPW, April 2002.
10. Rao, M. G., Sen, T. K., & Jena, P. R. (2008). Issues before the Thirteenth Finance Commission. *Economic and Political Weekly*, *43*(36), 41–53. http://www.jstor.org/stable/40277926
11. Reuter, Wolf Heinrich. "National numerical fiscal rules: Not complied with, but still effective?" European Journal of Political Economy 39 (2015): 67–81. [CrossRef]
12. Public Finance: Policy Issues For India by Sudipto Mundle (pp. 88-90)
13. Thirteenth Finance commission report retrived on 15th April 2022 from http//www.finmin.nic.in
14. Yadav, S., Upadhyay, V. And Sharma, S. (2012), "Impact of Fiscal Policy Shocks on The Indian Economy", Margin:The Journal of Applied Economic Research, Vol: 6(4), pp. 415-444 Rbi [CrossRef]
15. Yadav, S.(2022), "Revisiting Fiscal Policy And A Case For Automatic Stabilisers In Urban India", Jindal Journal of Public Policy,Vol 6(1), pp 38-44

AUTHOR PROFILE

Dr. Swati Yadav, I completed my graduation from Kirori Mal College Delhi University followed by MA (Economics) from Delhi School of Economics. I completed PhD in Economics from Humanities and Social Science department, IIT DELHI in 2012. I have more than twenty years of experience of teaching undergraduate students in Bhagini Nivedita College, Delhi University. My areas of Interest are Macroeconomics and Public Finance.