India's fiscal responsibility framework

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Objectives of policy framework

- Growth
- Macroeconomic stability

Business cycles in India

In old India

- Government determined a large share of investment
- Agriculture was a large share of the economy
- Services production was dominated by goverment
- Downturns were due to exogenous shocks such as droughts, oil price shocks and wars.
- The economy did not see investment inventory cycles as seen in market economies.
- The objective of the fiscal responsibility framework to keep deficits in control.

Macro-stablization policy framework

- Fiscal policy
- Financial sector reform
- Monetary policy framework

Financial sector

- Allow financial markets to expand while at the same time reduce the probability of failure of firms by improving regulation.
- Reduce the impact of firm failure on the economy.
- Implementation of many of the recommendations of the Financial Sector Legislative Reforms Commission (FSLRC)

Monetary policy

- Low and stable inflation helps reduce macroeconomic volatility.
- Monetary Policy Framework to achieve an inflation target being put in place

Fiscal policy

- Framework should provide fiscal space at the time of a downturn.
- Review of Fiscal Responsibility Budget Management Act (FRBM) 2003

Fiscal Policy and Budgetary Management Act

- FRBM Act, 2003
  - Bring down revenue deficit to zero and fiscal deficit to 3% of GDP
  - Annual medium-term fiscal policy statements presented to parliament
- Fiscal deficit at 6.46% and revenue deficit at 5.2% of GDP in 2009-10
- 2008: FRBM targets first postponed and subsequently suspended due to the fiscal stimulus following the global financial crisis
- 2013: FRBM reinstated with amended rules
  - Outlined fiscal consolidation starting from 2013-14
  - Numerical targets for March 2015 and March 2017 for effective revenue deficit and fiscal deficit

Questions

- **Rules**
  - Did the FRBM framework give us the fiscal space needed in the downturn?
  - Would a different rule have helped us avoid the perhaps “excessive stimulus” in the crisis?
  - Has the fiscal framework in India been pro/counter cyclical?
  - How can we build flexibility in a rule-based framework to not have to “suspend” the framwork?
  - Do we need to look at a combination of rules as some countries have done after the crisis?
  - Is targeting the “effective revenue deficit” as under the new rules playing a role similar to combining it with an expenditure rule?
  - What has been the impact of fiscal rules for sub-national governments?

Questions

- **Fiscal Councils**
  - As many as 30 countries have instituted independent Fiscal Councils for assessment and monitoring of fiscal policy and budget management
  - Is there a role for a fiscal council in India?
  - If yes, who could play that role?

In summary,

- The question is not merely about meeting targets
- It is about whether we achieve our objectives
- Are rules devised for achieving debt sustainability in old India adequate for an India with business cycles?
- Should the objective of counter-cyclical policy guide reframing of the fiscal responsibility framework?
- What shoud be this framework? New rules? Building in flexibility? Fiscal council?

Thank you