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 government
- 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-stabilization policy framework

- Fiscal policy
- Financial sector reform
- Monetary policy framework
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
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 framework?
  - 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?
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 should be this framework? New rules? Building in flexibility? Fiscal council?
Thank you