The Role Of Frbm Act 2003 In Ensuring Transparency And Accountability In Government Finances In India

Abstract

The FRBM Act was enacted in India to inject fiscal discipline in financial governance of india. However, time and again many concerns have been raised regarding its efficacy in promoting transparency. This study aims to find whether FRBM Act has achieved its objectives.

India's fiscal deficit and internal debt have continued to rise despite the introduction of the Fiscal Responsibility and Budget Management (FRBM) Act. To accomplish its objectives, the research contains a comprehensive analysis of CAG compliance reports, which provide insights into the government's financial performance and investigates whether it has adhered to the laws. By examining these reports, the study aims to ascertain whether the government has effectively implemented the provisions of the FRBM Act and the extent of compliance by different states.

Furthermore, the research evaluates the impact of the amendments made to state FRBM Acts. By analyzing the outcomes of these amendments, the study seeks to determine their effectiveness in controlling fiscal deficit and improving fiscal transparency at the state level. The findings of this research will contribute to the existing literature on fiscal governance and transparency in India.

Keywords: FRBM Act, fiscal deficit, internal debt, transparency, compliance, CAG, fiscal discipline, fiscal governance, fiscal transparency, debt management.

Introduction

The Balance of Payments crisis of 1991 was a turning point in the economic history of India. One of the major reasons behind the crisis was the large fiscal deficit of the economy as a result of excessive government borrowings. The exponential increase in the Government expenditure can be attributed to the expenditure on non-developmental activities like salaries, pensions, subsidies throughout the decade of 1980s which resulted in humongous borrowings.

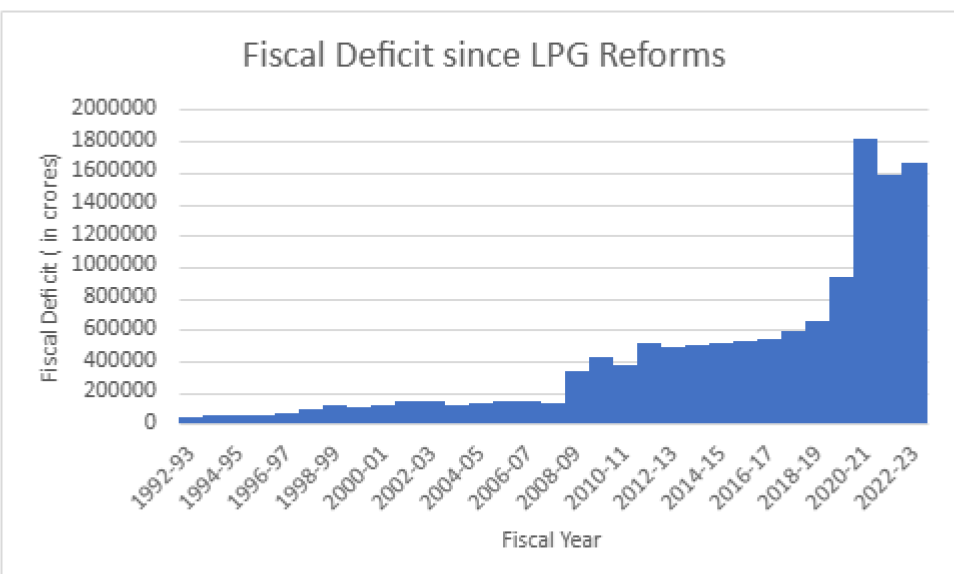
In 1991, the gross fiscal deficit of the union government rose from 6.1 percent of GDP in 1980-81 to 8.4 percent in 1990-91. Since these deficits had to be financed by loans, the debt of the government accumulated rapidly. The internal debt rose from 35 % of GDP in 1980-81 to 53 % of GDP in 1990-91 and the external debt was more than 30% of GDP.

India resorted to The International Monetary Fund (IMF) for a bailout; but IMF laid down the following demands before India- devaluation of Indian currency by 22 %, reduce custom duty on foreign products from 130% to 30%, increase excise duty by 20%, reduce 10 % expenditure on salaries, pensions etc.

In the budget of FY 1991-92, the Liberalization, Privatization and Globalization (LPG) reforms were introduced as a solution to the BoP crisis. Even after the introduction of the LPG reforms, the Indian Government could not handle the ballooning fiscal deficit which led to a surge in India's debt. On one hand the debt increased and on the other the Government didn't have enough funds to spend properly on welfare schemes and development. The government had to fill these deficits. Hence it resorted to issuance of exorbitant loans from other nations. These huge loans were to be repaid through huge interest payments which took a heavy toll on the government's revenue. The economy got entangled in a vicious debt trap as a result of debt piling to every year's fiscal deficit.

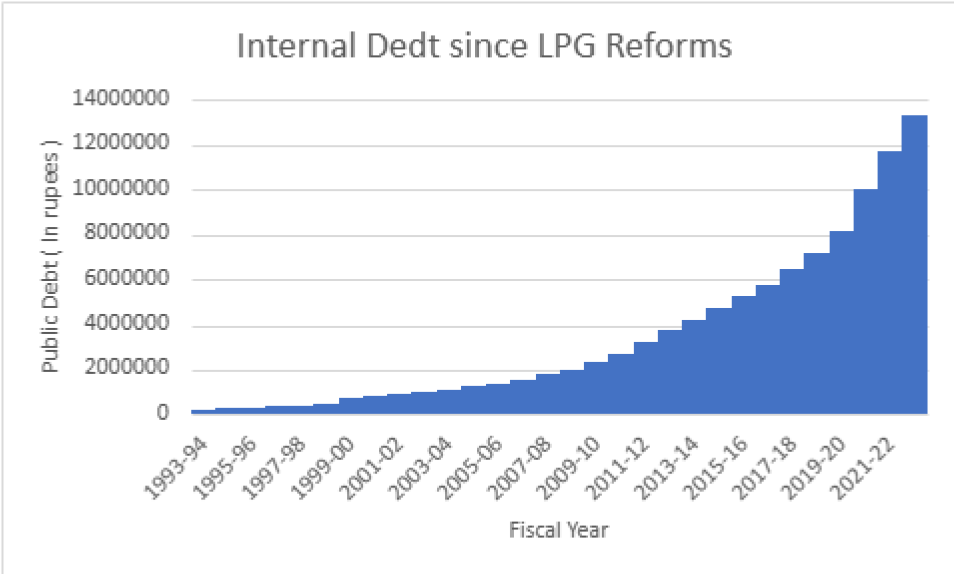
A need to create a check on the amount of borrowings of the government so as to reduce the burden on future governments arose and the 'The Fiscal Responsibility and Budget Management Act of 2003' was tabled in Indian Parliament in the year 2000. The bill explained the need of the Act by giving reference to the terrible state of government finances in India in the states like Andhra Pradesh, Gujrat, Maharashtra, Uttar Pradesh, West Bengal, etc and lack of transparency in the Public Finances[1]. It sought to introduce the fundamentals of fiscal discipline through Fiscal Consolidation.

State of India's Fiscal Deficit and Internal Debt since LPG Reforms



Source- Handbook on Indian Economy, Reserve Bank of India.

[1] RBI Publications



Source- Handbook on Indian Economy, Reserve Bank of India.

The data is sourced from the annual publications of the Reserve Bank of India. It shows that the Internal Debt of the government is rising continuously in spite of the fiscal deficit fluctuating time and again. Soon after the introduction of the FRBM Act the Fiscal deficit reduced but the Internal debt kept on increasing rapidly - because of borrowings of the central government as well as instability in the world economy.

Fiscal Responsibility and Budget Management Act 2003

FRBM Act 2003 was enacted in the view of decreasing Fiscal deficit and thereby debt of the central government.

Objectives - The Act contains the following broad goals to achieve.

1. Hold the central government responsible for ensuring inter-generational equity in fiscal management and long-term macro economic stability.
2. Ensuring greater transparency in fiscal operations of the government.
3. Conduct fiscal policy in a medium term framework.

Provisions for Fiscal Consolidation-

Under the fiscal management principles the Central Government is required to take measures to limit the fiscal deficit to 3 % of GDP by the 31st March, 2021. Mandated to ensure that the general Government debt does not exceed 60 % and the Central Government debt does not exceed 40% of gross domestic product by the end of financial year 2024-2025. The act has also specified grounds on which deviation from the fiscal deficit target is allowed that shall not exceed 0.5 % of the GDP in any financial year. The central government should present the following statements while presenting the budget every year.

1. Macroeconomic Framework Statement
2. Medium Term Fiscal Policy Statement and
3. Fiscal Policy Strategy Statement

Also, the act mandates four fiscal indicators i.e, revenue deficit as a % of GDP, fiscal deficit as a % of GDP, tax revenue as a % of GDP, and total outstanding liabilities as a % of GDP should be mentioned in the medium-term fiscal policy statement.

Provisions for Fiscal Transparency-

The Act obliged the Central Government to take suitable measures for ensuring greater transparency in all the fiscal operations in public interest and to minimize clandestine approach in budget preparation and demands for grants and take time to present the disclosures specified under the Fiscal Responsibility and Budget Management Rules 2004 along with the budget.

The disclosures mandated are-

1. Any significant change in accounting standards, policies and practices affecting or likely to affect the computation of prescribed fiscal indicators.
2. Statements of receivables and guarantees in Forms D-1 to D-3 along with

explanatory notes, if any

3. A statement of assets in Form D-4 along with explanatory notes, if any.
4. A statement of explicit contingent liabilities, which are in the form of stipulated annuity payments over a multi-year time-frame in Form D-5.

FRBM Review Committee of 2016

1. Debt to GDP Ratio- Using debt as a primary target for fiscal policy, the debt to GDP Ratio- of 60% should be targeted by 2023. It has also proposed annual targets to progressively minimize the fiscal and revenue deficits till 2023.
2. Deviations- The committee attempted to clearly specify the circumstances under which deviations from the fiscal targets are allowed. It has also mentioned that the deviations cannot be more than 0.5% of GDP in a year
3. Furthermore, it has asked the 15th Finance Commission to recommend the debt trajectory for individual states.
4. Restrictions are imposed on the government from borrowing from the Reserve Bank of India but are allowed under specified exceptional conditions.
5. The committee proposed an autonomous fiscal council and even detailed its objectives[2].

[2] FRBM Review Committee, PRS Discussion paper

Amendments to the FRBM Act

The Act was amended four times since its commencement.[3]

1. Amendment of 2004 mandates the Union government to eradicate revenue deficit by 2009 and to reduce fiscal deficit to 3 % of GDP by 2008.
2. Amendment of 2012 shifts the target to achieve a fiscal deficit of 3% of GDP by 2015. The minimum annual reduction target was 0.3% of GDP.
3. Amendment of 2015 further shifts the target to achieve a fiscal deficit of 3% of GDP by 2018 The minimum annual reduction target was 0.3% of GDP.
4. Amendment of 2018 is being made on the recommendations of the Fiscal Reform and Budget Management Committee chaired by Mr. N. K. Singh and the deadline for achieving the operational target for fiscal deficit has been extended from 2018 to 2021

The amendments include reducing the central government's debt to GDP ratio to 40% and setting an operational target for fiscal deficit at 3% of GDP. The target for debt to GDP ratio will have to be achieved by 2025.

Report of the 15th Finance Commission

The 15 th Finance Commission for 2021-26 chaired by Mr. N. K. Singh has provided new fiscal deficit targets for both union and state.

1. The Commission suggested that the center should bring down the fiscal deficit to 4 % of GDP by 2025-26 and the states should maintain the fiscal deficit limit as % of Gross State Domestic Product to a) 4% by 2021-22, b) 3.5% in 2022-23, and c) 3% by 2023-26.
2. The Commission endorses that if the recommended path of borrowing ceilings is followed by center and state then the fiscal deficit would reduce the debt of a) the center from 62.9% of GDP in 2020-21 to 56.6% in 2025-26, b) the states on aggregate from 33.1% of GDP in 2020-21 to 32.5% by 2025-26. [4]

Objective of the study -

To analyze the success of FRBM Act in ensuring greater transparency and accountability.

For this study of the following is necessary-

1. Whether the disclosures mandated under FRBM Act are presented by the Union government or not.
2. The analysis of the Reports of 'Compliance of the Fiscal Responsibility and Budget Management Act, 2003, Union Government, Department of Economics (Ministry of Finance)'

---

[3] Factly.in

[4] PRS India

3. Analysis of the success of the state FRBMA
4. Study of the impact of the amendments done to the state FRBM Acts.

Analysis of the CAG Reports of Audit of FRBM Act 2003

The office of Comptroller and Auditor General of India has issued only 4 Compliance Audit Reports in Public Domain of the following year-

Sr. No.	Fiscal Year	CAG's Assessment of the Disclosures
1.	2016	1. Variation in deficits figures in Budget at Glance and Annual Financial Statement. 2. Expenditure of the Central Government on grants used for creating capital assets was at variance in Union Government Finance Accounts and Expenditure Budget. 3. Gross Liability of the government depicted in Union Government Finance Accounts and Receipt Budget were different figures. 4. Obscure Direct tax receipt figure government Finance Accounts and other publications 5. Inconsistency was found in disclosure of Non-Tax Revenue and Incorrect information of coal levy in arrears 6. Figures of loans to Foreign Governments and figures of closing and opening balances of assets at variance.
2.	2017	1. Variation in figures of revenue as well as fiscal deficit in the Annual Financial statement and in the Budget at a Glance (BAG). 2. Expenditure of the Central Government on grants used for creating capital assets was at variance in Union Government Finance Accounts and Expenditure Budget. 3. Variation in the amount of liabilities depicted in different government documents. 4. Lack of transparency in Direct tax receipt figure in government finance documents

Sr. No.	Fiscal Year	CAG's Assessment of the Disclosures
		5. In the mandatory disclosures, Inconsistency was observed in disclosure of arrears of Non-Tax Revenue. Also, false information of coal levy in arrears was seen. 6. Variation in guarantee given by the Government. 7. Variation in disclosure of details in asset register. 8. Inconsistency in figures of loans to Foreign Governments. 9. Variation in figures of closing and opening balances of assets.
3.	2020	1. Variation in deficits figures in Budget at Glance and Annual Financial Statement. 2. Variation in the amount of liabilities in different government documents. 3. The National Small Saving Fund (NSSF) showed a deficit in its operation. 4. Lack of transparency in Direct tax receipt figure in government finance documents. 5. In the mandatory disclosures, Inconsistency was observed in disclosure of arrears of Non-Tax Revenue. Also, false information of coal levy in arrears was seen. 6. Variation in disclosure of details in asset register. 7. Inconsistency in figures of loans to Foreign Governments. 8. Variation in figures of closing and opening balances of assets.
4.	2021	1. Inconsistent figures in D-2 as compared with UGFA 2. Variation in number of Guarantee in Form D-3 3. Variation in outstanding amount of guarantees 4. Variations in Form D-4 Asset Register 5. Inconsistency in figures of financial assets loans and advances

All the statements necessary under FRBM Act have been tabled in the parliament along with the Annual Financial Statement since the act was enacted. This suggests that by providing additional information and disclosures, the government is making an effort to enhance accountability and provide a clearer picture of its financial activities. However, the Compliance report of the office of CAG highlighted inconsistencies in the budget documents with the disclosures and the other finance documents. The reports for the FY 2016, 2017, 2020 and 2021 were available in public domain and highlight similar findings year after year. It provides a clear picture that the government practices non-transparency by manipulating revenue and expenditure accounts which allows the deficit to be seriously understated.

State-level fiscal responsibility legislations in India

Individual states are required to reduce their state fiscal deficit at 3% of GSDP in the recent amendment. However, as of December 2022, 13 states of Andhra Pradesh (3.6%), Assam (3.2%), Bihar (3.5%), Chattisgarh (3.3%), Haryana(3.5%), Karnataka (3.3%), Kerala (3.9%), Mizoram (3.1%), Nagaland (3.5%), Punjab (3.8%), Tamil Nadu (3.6%), Uttarakhand (3.1%) and West Bengal (3.6%) has fiscal deficit as % of respective GSDP between the range of 3% -4%. Further, 8 states of Goa (4.7%), J&K (4.7%), Meghalaya (4.5%), Madhya Pradesh (4.6%), Rajasthan (4.4%), Sikkim, Tripura and Uttar Pradesh (4.0%) have in the range of 4%-5%. Lastly, two states of Himachal Pradesh (5.0%) and Manipur (6.5%) have the highest fiscal deficit recorded. Rest of the states has controlled fiscal deficit. As per the report of the 15th Financial Commision, the level of debt of states has shown a steep rise. The outstanding liabbilities of states on aggregate as % of GDP for the year 2021-22 is 31.2% which is far beyond the ceiling of 20% of GDP as mandated by 2018 reform to the FRBM Act. Also, the general government debt is 85% of GDP in 2022-23, much higher than the recommended level of 60 % of Gross Domestic Product[5].

Similar to the provisions of fiscal discipline mandated for the central government, the 10th planning Commission of India advocated the need for fiscal discipline guidelines at the level of the states too. This was to reduce the debt-to-GDP ratio of India aggregated. States of Tamil Nadu, Maharashtra, Karnataka, Kerala, Punjab and Uttar Pradesh legislated the FRBM Act at the level of their respective states by 2007.

Time and again it has been observed that state governments amend their FRBM Acts and set up new targets. The recent example of this is Himachal Pradesh (HP). Himachal Pradesh has a fiscal deficit of 5 % of GDP. In 2021 an amendment was made to state FRBM Act of HP. The Chief minister gave the following reason to it- "to enable the state government to avail additional borrowing in public interest and to maintain the pace of development, the fiscal deficit could not be maintained at the level of 3 percent of the estimated Gross State Domestic Product in the financial year 2019-20."'

The State Finances Audit Report of Himachal Pradesh by the comptroller and auditor general (CAG) for the FY 2021-22, exposed financial mismanagement by the state government. The report alleges that over the years the government has spent more funds than the budget approved by legislature and huge inconsistencies are observed in financial documents when compared to the state budget. It says that till 2026-27, the government needs to spend around ₹ 6926 every year on repaying loan payments.

---

[5] Discussion Paper on State Finances; PRS India

Conclusion

State needs to spend on developmental projects and hence cannot stop borrowing altogether. If it does then development would come to a halt. FRBM Act stops the government from borrowing to meet its targets but in reality, the implementation of the act is cumbersome. Amending FRBM Act doesn't serve the purpose because it only shifts the targets in future.

Recommendations

1. The government has committed to achieve a fiscal deficit of 4.5 % of GDP by the year 2025-26. Last year it was 6.7 % of GDP and this year the government has targeted to achieve 6.4 % of GDP. This is a very difficult feat to achieve as the union government needs to reduce the fiscal deficit by 2% of GDP in the next 3 years. Government would need to come up with many initiatives for fiscal consolidation. This requires the government to amend the FRBM Act by taking into consideration the recommendations of 15th Finance Commission and present a detailed plan as to how it will head towards achieving its target. However, it has been observed that the government is silent on it. The Economic survey 2022-23 stated that "The gradual decline in the Union government's fiscal deficit as a % of GDP, in line with the fiscal glide path envisioned by the government, is a result of careful fiscal management supported by buoyant revenue collection over the last two years". Similar step is recommended that government table an amendment to the act and provide measures of fiscal consolidation to instill credibility and reinstate
2. For the Ministry of Finance to be able to disclose complete, accurate and consistent data and information written in Annual Financial Statement and with other Government documents, the recommendations are, firstly, to create a mechanism to verify the authenticity of the information provided by the ministries/departments independently. Secondly, suitable depiction of the correct definition of various terminologies related to the audit.
3. The Government should establish a department under the budget division to solve the issue of netting of transactions. {The practice of netting is a method of reducing credit, settlement and other risks of financial contracts by aggregating two or more obligations to achieve a reduced net obligation of any transaction, cash and/or non-cash}
4. The 15th Finance Commission suggests a major restructuring in the FRBM Act. It recommended that the time-table for defining and achieving debt sustainability may be examined and implemented by a High-powered Inter-governmental Group.
5. The 15th Finance Commission also recommends the state governments to form independent public debt management cells for efficient charting of borrowing programmes.

References

1. Government of India (2003) FRBM ACT 2003 and FRBM Act Rules 2004
2. Reserve Bank of India, Handbook on Indian Economy
3. International Monetary Fund, Working Paper
4. Ankit Mital, The long road to the 1991 economic crisis