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AN ANALYSIS ON FISCAL DEFICIT IN INDIA AND THE EFFECTIVENESS OF FRBM ACT

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ABSTRACT

Fiscal deficit is the most significant concept in public finance and in recent times it is also a much in discussion among the researchers and academicians. It measures the Government's spending over the revenue it receives from taxes and non-tax revenues. This paper made a modest attempt to study the fiscal deficit in India and the effectiveness of FRBM Act. As the FRBM Act 2003 has been introduced to limit the size of the fiscal deficit. Fiscal deficit is one of the major issue in the economy which arises due to high spending by the government over revenue through the high borrowings from internal and external sources. FRBM act sets the percentage limit in fiscal deficit gap which is 3 percentage. This study is based on secondary data that has been gathered from RBI Database and the period of the study is 2010-11 to 2021-22.

Keywords: Fiscal deficit, Types of deficit and FRBM Act 2003.

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INTRODUCTION

Every economy needs the huge investments to enhance the development of the country. It became a challenge to the developing nations to meet the expenditures according to its demand. Developing countries needs the financial support to carry out the developmental projects which generates the long-term income and it uplifts the status of the economy. To spend on such projects the revenues received from tax and non-tax revenue are not enough and the government tends to borrow from external or internal sources to spend on productive and unproductive expenditures like pensions and subsidies. Government implemented FRBM (Fiscal Responsibilities and Budget Management) act in 2003 to resolve the problems of fiscal deficit and debt management. It fixed the target to reduce fiscal deficit to 3 percent of GDP. But the FRBM act was suspended in 2007 due to the financial crisis of 2008, which affected many nations.

Implications of Fiscal Deficit

In early 20th century, economists and government advisers favoured balanced budgets where there was not much discussion about fiscal deficit. Then the modern economists came in and the macroeconomic policies were changed to meet the demand and fulfill it through more spending by the government for its citizens. Government tends to borrow more for its spending. In our economy there is a limited savings are available for investment, it goes to private businessman through the financial institutions and banks. Higher fiscal deficit leads to the problems like debt trap which causes due to high borrowing by the government for spending. Borrowings are not only the repayment of principal amount but also the interest payments. This increases the burden of government in paying interest payments which is spend through revenue expenditure and it increases the revenue deficit. The inflationary pressure also arises due to borrowings from bank to meet its deficit, and bank prints currency to finance which increase the money supply and leads to inflation. Fiscal deficit also increases the dependent on foreign sources and it affects the growth and development of the economy and fails to attract the foreign investments.

Review of Literature

(Rangarajan and Srivastava, 2004), their study on 'Fiscal deficits and government debt in India. Implications for growth and stabilization' reveals that revenue deficits amount to reduction in government savings, which may not be fully offset by a corresponding rise in private savings, leading to a fall in overall saving rate. The impact of fiscal deficit on investment arises both from its impact on private investment and government investment.

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(Ramu and Gayithri, 2016), their working paper on 'Relationship between fiscal deficit composition and Economic growth in India: A time series econometric analysis' reveals that fiscal deficit adversely affects GDP supporting the mainstream neo-classical theory and also the RBI's view. When fiscal deficit is bifurcated into effective fiscal deficit and revenue deficit, it has been found that the former has a significant positive relation whereas the latter has negative relation with GDP.

(Gupta and Singh, 2016) in their study on 'Fiscal deficit and its trend in India' found that from 1980-81 to 2002-03 the period of crisis led to the burgeoning of the deficit to unsustainable levels and prompted the government to introduce and adopt economic reform to ensure that the deficit stood at more reasonable levels. However since 2003-04 the government has been proactive and has undertaken fiscal policy reforms to ensure a steady reduction in fiscal deficit as a percentage of GDP leading to a more resilient economy.

(Ali, 2019) in his research paper on 'Impact of fiscal deficit on Economic growth: An Empirical Study of Indian Economy' states that after employing the linear regression model and Pearson's correlation model, results establish that fiscal deficit significantly influence GDP in significant way. Besides, linear regression model, Pearson's correlation model revealed the negative relationship between variable and concluded that fiscal deficit is negatively influences gross domestic product.

Objectives of the Study

- To analyze Fiscal deficit in India and the effectiveness of FRBM Act.
- To give the policy implication.

Methodology

This paper is based on secondary data collected from various articles, journals, books and published and unpublished sources. To analyze the impact of fiscal deficit on GDP the data will be collected form RBI Database from the period of 2010-11 to 2021-22.

Types of Deficits

There are three types of budget deficits. They are as follows:

1. Fiscal Deficit
2. Revenue Deficit
3. Primary Deficit

1. Fiscal Deficit

Fiscal deficit is the difference between the total expenditure of the government and its total

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revenue (excluding borrowings) is known as fiscal deficit. In other words, this can be defined as the amount that government needs to borrow in to meet expenditure.

Formula for calculating fiscal deficit is:

Fiscal Deficit = Total expenditures – Total Receipts (excluding borrowings)

2. Revenue Deficit:

Revenue deficit is the excess of total revenue expenditure over the total revenue receipts. In other words, the shortfall of revenue receipts as compared to the revenue expenditure of the government is called as revenue deficit.

Formula for calculating revenue deficit:

Revenue deficit = Total revenue expenditure – Total revenue receipts

3. Primary Deficit

Primary deficit is the fiscal deficit of the current year subtracted by the interest payments that are pending on previous borrowings. It can also be said that, the primary deficit shows the requirement of borrowings without interest payment.

Formula for calculating Primary deficit:

Primary = Fiscal Deficit – Interest Payments

Table.1 Deficits of the Central Government as Percentage of GDP

Year	Gross Fiscal Deficit	Gross Primary Deficit	Gross Revenue Deficit
2010-11	6.9	2.4	3.2
2011-12	7.8	3.3	4.2
2012-13	6.9	2.3	3.5
2013-14	6.7	1.9	3.3
2014-15	6.7	2.0	3.3
2015-16	6.9	2.2	2.5
2016-17	6.9	2.2	2.3
2017-18	5.8	1.1	2.7
2018-19	5.8	1.1	2.5
2019-20	7.2	2.5	3.9
2020-21	13.3	7.8	9.3
2021-22	10.2	4.6	5.6

Source: RBI Database

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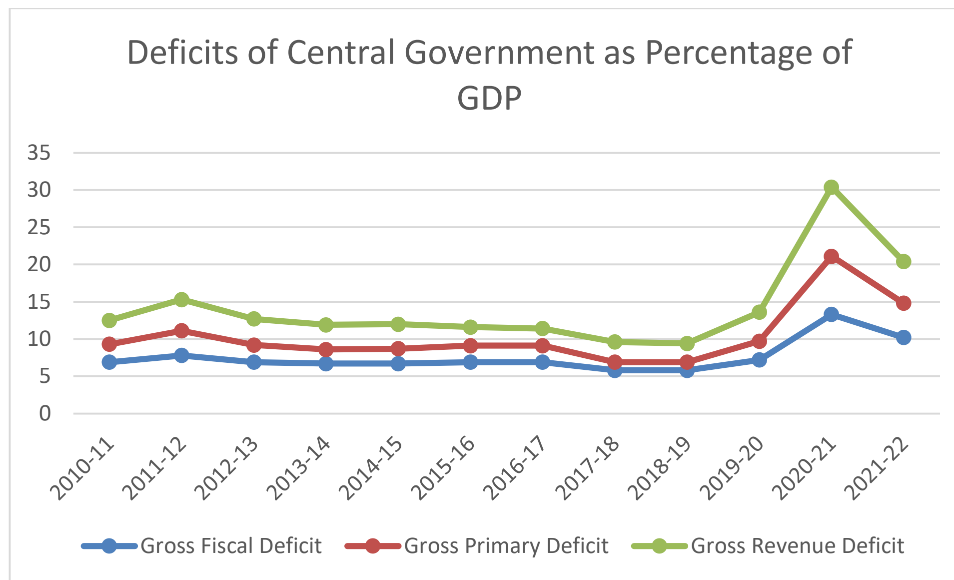
Figure. 1 Deficits of Central Government as Percentage of GDP



Interpretation: The above Table 1. Shows the Gross fiscal deficit, gross primary deficit and gross revenue deficit from 2010-11 to 2021-22. It is clear from the Table 1. That all the three deficits are low after the implementation of the FRBM Act 2003. In the year 2020-21 has shown the sharp rise due to the shock of Covid-19 pandemic, where the sources of revenue from various sources has been frozen and the expenditure was incurred through debt. This Covid-19 shock has raised the Gross fiscal deficit. But in 2021-22 it is visible that there is step taken by the government to reduce the fiscal deficit came down from 13.3 percentage in 2020-21 to 10.2 percentage in 2021-22.

Fiscal Responsibility and Budget Management (FRBM) Act 2003

The FRBM Act was introduced by the parliament of India in 2000 by Atal Bihari Vajpayee Government which became effective from July 5, 2004 to eliminate revenue deficit and sets the target for the Government of India to establish financial discipline, improve the management of public revenue, and strengthen fiscal shrewdness.

Effectiveness of FRBM Act 2003

The implementation of FRBM Act implies remarkable reforms to both public revenue and expenditure in India.

i.Changes in Tax System: The FRBM Act was very effective in reforming the world class tax system. The tax system should be equitable and should address the prejudice behavior of tax payers as well as companies. The companies should aim at growth and productivity not on tax planning. So, removal of such behavior will bring improvement in taxation system and increase in GDP growth. The change in tax system will enhance equity. The complexity in paying tax

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will leads to tax avoidance and less revenue to the government. The FRBM Act helped the government to frame such fiscal policies which increased the public revenue.

ii.Impact on Investment:

The FRBM Act 2003 has the positive impact on Investment at many levels. The reform of tax system will enhance the 'investment-led' growth. The public capital expenditure has decreased from 2.5 percent of GDP in 2002-03 to GDP in 2008-09. If the capital expenditure will be conducted through vibrant institutional mechanism it will bring huge private investment.

iii. Impact on Credit ratings and Manufacturing:

A strong fiscal policy will enhance the credit ratings through inflow of foreign capital. There will be high private investment will ease the fiscal burden of the government. Previously CENVAT was not so progressive and doesn't provide credit to the manufacturing firm. But introduction of GST has resulted in positive way and removed the negative rates of protection.

iv. Impact on State Financial Position:

Under the FRBM Act 2003, the state finances would obtain expansive improvement in collecting the revenues. If the Central government revenue goes up to 3 percent of GDP, it will increase the transfer of resources to states by at least 1 percent of GDP. The State VAT will also be very effective in raising the revenues.

v. Effect on Expenditure:

The public expenditure was expected to go down from 15.4 percent of GDP in 2003-04 to 13.7 percent of GDP in 2008-09. This was the sharp fall of 1.7 points. The high debt leads to the high interest payment, it increase the public expenditure. It is important take steps to bring down the interest payment GDP ratio from 4.5 percent in GDP to 3.9 percent of GDP in 2008-09. Further it has come down to 3.5 percent of GDP.

Conclusion:

The fiscal imbalances in India is a prime concern problem discussed by Government officials, researchers and academicians. The fiscal deficit in India was much higher before the FRBM Act was introduced in 2003, but after introduction of this Act fiscal deficit came in control. The Government official and Economists tried to control the fiscal deficit limit of 3 percent. But during the 2008 economic crisis this limit was lifted and during Covid-19 pandemic also the fiscal deficit increased up to 9.3 percent. The fiscal deficit amount should be used for capital formation and for crucial programs, not in the current consumption of the government. It is important to control the fiscal deficit through FRBM Act, otherwise it leads to debt trap and increase in the public expenditure on interest payments rather than on other productive channels.

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The effectiveness of the FRBM Act is successful in controlling the fiscal deficit and on related indicator of fiscal deficit. The FRBM Act 2003 is one of the good initiative taken by the Government to keep a watch on the fiscal deficit in India.

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