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FRBMA and Central Government Expenditure: A Lesson from Recent Union Budgets: 2005-06 –2012-13

KEYWORDS: FRBMA, Union Budget, Central Government Expenditure, Fiscal Consolidation, Deficit Management

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ABSTRACT *The present Paper takes as reference point the well-timed FRBMA (Fiscal Responsibility and Budgetary Management Act 2003), and examines how far recent Union Budgets, and Central Government Expenditure in particular, have succeeded in adhering to the envisaged "Roadmaps for Fiscal Consolidation", given the various circumstances at home and abroad, particularly the recent global financial crisis and the Euro-zone scenario. The paper critically examines whether budgets in recent years have remained true to the spirit of the FRBMA. It concludes that external factors, being largely beyond the control of the Fiscal Authorities, have frequently led Indian finances astray with the envisaged fiscal management presumably beyond the authority's control in the immediate foreseeable future.*

INTRODUCTION
It was amid remarkable crisis situations, both internal as well as external, that the Union Budget 2013-14 for India was presented in February this year. The context and backdrop were provided first, on the domestic front, by a determined step towards fiscal consolidation, taken with the FRBMA (Fiscal Responsibilities and Budgetary Management Act 2003). Initiated at the Central Government level in 2004-05, this marked, at least on the policy level, a determined recognition for concerted efforts towards fiscal management. However, such possible endeavour were soon to be overtaken by subsequent events with their wide global repercussions, viz., the global financial crisis that reached its nadir in 2008, and the recent crisis in the Euro-zone area, threatening to shake the foundations of fiscal sustainability.

The present paper examines recent budgetary trends at central government level in India against the backdrop outlined above. As the paper finds, on the fiscal front at least, compulsions to meet the challenges have had indelible impact on government finances that will presumably continue to determine fiscal trends for some time to come.

TIME PERIOD
Any policy announcements/ decisions require time to bear appreciable results. There are, also, well-known adjustment lags involved in government budgetary magnitudes. Hence the 2005-06 Budget onwards to 2012-13 is chosen as study period.

HYPOTHESES
Two central hypotheses are examined critically:

1. Union Budgets between 2005-06 and 2012-13 have succeeded in adhering to the FRBMA (2003) and the "Revised Roadmap for Fiscal Consolidation"

2. Overall, budgetary trends have been conducive to economic growth.

DATA & METHODOLOGY
Data are Secondary, culled from well-documented sources, including: Budget Documents of the GOI (various), Indian Public Finance Statistics, Ministry of Finance, GOI (various issues); Economic Survey, MOF, GOI (various issues), RBI Handbook on Indian Economy (2013).

The methodological tools used in the present paper are primarily Ratio Analysis and Trend Projection methods.

ANALYSIS
FRBMA and the Subsequent "Revised Roadmap for Fiscal Adjustment"
To recapitulate briefly, the government's recognition of its worsening fiscal position was embodied in the well-known Fiscal Responsibility and Budgetary Management Act (FRBMA 2003) that came into effect in 2004-05 at the Centre. The key features were:

- Reducing the revenue deficit by 1.5% or more of GDP at the end of each financial year, and reducing it to zero within the next five financial years;
- Reducing the fiscal deficit by 1.5% or more of GDP at the end of each financial year, and reducing it to not more than 2% of GDP within the next five fiscal; and
- Achieving a total debt (+liabilities) share in GDP of not more than 60% within the span of ten years. (Economic Survey, 2004-05)

Accordingly, the recommended Tax Reforms Strategy (Kelkar Committee) suggested a set of reforms estimated to take the Centre's Tax-GDP ratio to 13.2% in 2008-09 from the 2003-04 share of 9.2 % of GDP, with a concomitant fall in total expenditure from 15.4% of GDP in 2003-04 to 14.3% in 2008-09. A revenue surplus was expected to emerge in 2008-09 (0.2% of GDP) with a reduced fiscal deficit of 2.8% in 2008-09 (Economic Survey, 2006-07).

After some initial success, the debt and deficit targets set by the FRBMA 2003 were soon recognized as being too ambitious and unrealistic given the ensuing developments on the domestic as well as external fronts. As the Terms of Reference (ToR) set before the Thirteenth Finance Commission suggested: "... the Commission may review the roadmap for fiscal adjustment and suggest a suitably revised roadmap with a view to maintaining the gains of fiscal consolidation through 2010 to 2015" (Report of the Thirteenth Finance Commission, 2010-2015), emphasis added.

Receipts: Pattern of Resource Mobilization: General Concerns
Government receipts, categorized into revenue and capital accounts respectively, have the distinction that revenue receipts (comprising tax and non-tax revenues) entail no liability implications on the government's account, while capital receipts, by definition involve changes in the asset/ liability position of the government. Capital receipts that add to the assets includes the item "Recovery of Loans and Advances". However, as we presently see, the lion's share has been increasingly claimed by the component of Borrowings and

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other Liabilities. Hence, from the revenue point of view, the relevant concerns are: i), The respective contributions of Revenue vs. Capital Receipts in government's resource mobilization, ii) Within revenue receipts, the respective contributions of inflationary vs. non-inflationary revenue sources, specifically, the respective weightage of tax and non-tax sources of revenue, as also that of direct vs. indirect taxes within tax revenue

Finally, the crucial question is the weightage of borrowings, that is, receipts entailing liability implications, within capital receipts. We examine these issues using budgetary data for the period 2005-06 to 2012-13.

Expenditure: Pattern of Resource Use by the Government
A similar distinction is made between expenditure components, i.e., between revenue and capital items of expenditure. This apparently balance-sheet approach to categorizing expenditure has the important fallout that they reveal the asset-liability implications of government budgetary operations.

Functionally, government expenditure has always been characterized into Plan vs. Non-Plan expenditure. Although criticized by the High Level Committee on Efficient Management of Public Expenditure (Planning Commission 2011) as having lost relevance, this classification continues to remain up to the latest budget (2013-14).

In assessing expenditure pattern, some of the relevant concerns are:

1. The trend in Revenue vs. Capital Expenditure, indicating the extent of assets creation consequent on government's expenditure.
2. Final outlays as against transfers. The relative trend in Final outlays (i.e., final expenditure on goods and services) vis-à-vis transfers indicates the evolving role of the government in direct participation in the production process, as against intervention through transfers.

Budgetary Receipts:

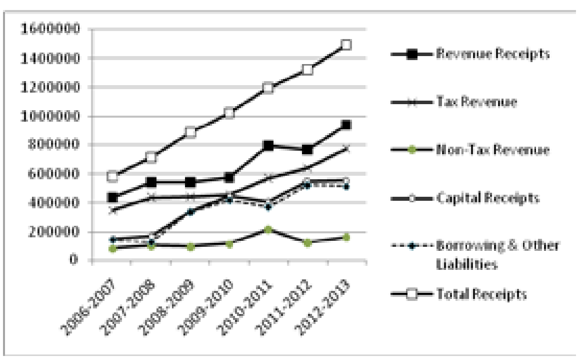

Fig 1: Trend in Receipts 2006 onwards

Source: i) Ministry of Finance, GOI (2013), ii) Economic Survey (various years)

While receipts have continued to accelerate throughout 1990s and 2000s, the period from 2006 shows an interesting trend as figure 1 above shows. Over the period 2005-06 to 2012-13, revenue receipts grew steadily, while the trend in capital receipts showed marked fluctuations.

Within tax revenues, ideally, direct taxes should dominate both on grounds of equity as well as potentially inflationary consequences, although indirect taxes are much easier to administer in practice.

The weightage of direct taxes (net) vis-à-vis indirect taxes had all along been lower, until 2006 when finally direct tax receipts began to outstrip indirect taxes. From 2005-06 onwards the overall gross tax-GDP share has increased from around 9% to a little above 11% with the tax-mix gradually evolving towards growing share of direct taxes vis-à-vis indirect taxes, reflecting broad-basing of tax coverage and better tax administration.

TABLE 2: TAXES (GROSS, DIRECT AND INDIRECT) AS A SHARE OF GDP: INDIA: OVERVIEW 2005-06 TO 2012-13

Year	Gross Direct Tax	Gross Indirect Tax	Total Gross Tax
2005-06	4.47	5.44	9.92
2006-07	5.36	5.67	11.03
2007-08	6.26	5.63	11.90
2008-09	5.98	4.86	10.84
2009-10	5.76	3.77	9.53
2010-11	5.66	4.33	9.99
2011-12	5.93	4.45	10.38
2012-13	5.98	4.55	10.53

Source: RBI Handbook of Statistics on Indian Economy (2012), Ministry of Finance (2013)

Capital receipts subsequent to 2006 (figure 1 above) show a markedly steep rise, with the trend entirely dominated by "borrowings and other liabilities". This indicates a growing reliance on receipts that add to the government's liabilities, entailing serious potential interest and debt implications, issues that clearly merit explicit consideration in future resource mobilization efforts.

		2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2012-13
		Actuals	Actuals	Actuals	Actuals	Actuals	Actuals.	B.E.	R.E.
1. Revenue Receipts		434387	541864	540259	572811	788471	766989	935685	871828
	Of which: Tax Revenue (Net to Centre)	351182	439547	443319	456536	569869	642252	771071	742115
2. Capital Receipts, of which		149000	170807	343697	451676	408857	551730	555241	558998
	Borrowing & other Liabilities	142573	126912	336992	418482	373591	521980	513590	520925
3. Total Receipts (1+2)		583387	712671	883956	1024487	1197328	1318720	1490925	1430825
	Borrowing as % Capital Receipts	95.69	74.30	98.05	92.65	91.37	94.61	92.50	93.18
4. Non-Plan Expenditure, Of which		413527	507589	608721	721096	818299	892116	969900	1001638
	6. Interest Payments	150272	171030	192204	213093	234022	275618	319759	316674

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8. Plan Expenditure		169860	205082	275235	303391	379029	426604	521025	429187
11. Total Expenditure (4+8)		583387	712671	883956	1024487	1197328	1318720	1490925	1430825
	12. Revenue Expenditure	514609	594433	793798	911809	1040723	1161940	1286109	1263072
	13. Capital Expenditure (7	68778	118238	90158	112678	156605	156780	204816	167753
14. Revenue Deficit (12-1)		80222 (1.9)	52569 (1.1)	253539 (4.5)	338998 (5.2)	252252 (3.3)	394951 (4.4)	350424 (3.4)	391245 (3.9)
15. Fiscal Deficit {11-(1+Non-Borrowing Capital Receipts)}		142573 (3.5)	126912 (2.7)	336992 (6.0)	418482 (6.4)	373591 (4.9)	521980 (5.9)	513590 (5.1)	520925 (5.2)
16. Primary Deficit (15-6)		7699 (0.2)	44118 (0.9)	144788 (2.6)	205389 (3.1)	139569 (1.8)	246362 (2.8)	193831 (1.9)	204251 (2.0)

Source: Budget Documents, Ministry of Finance, GOI (various years)

Figures in ( ) indicate percentage to GDP

From 2011-12 Budget onwards a figure for the "Effective Revenue Deficit" began to be reported, computed by netting out the component of Grants for capital formation from revenue expenditure, so that this "Effective" revenue deficit figure is somewhat lower than the unadjusted deficit measure (Economic Survey 2011-12, Budget Documents of the GOI recent years). Given the typically rather low value of such grants, however, discussion of this concept is postponed for a later occasion.

Expenditure Pattern

Figure 3 below focuses on the respective growths of Non-Plan and Plan expenditure subsequent to 2006.

Pattern of Resource Usage: Expenditure of the Central Government

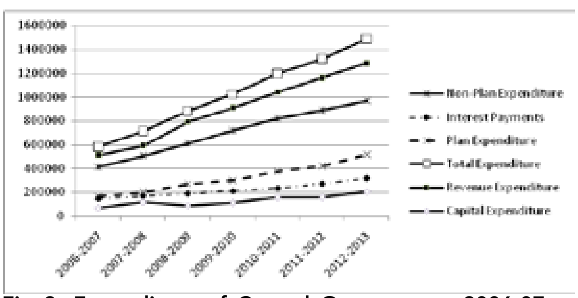

Fig 3: Expenditure of Central Government: 2006-07 to 2012-13

Source: i) Ministry of Finance, GOI (2013), ii) Economic Survey (various years)

Non-Plan expenditure over 2005-06 to 2012-13 has been characteristically much higher than Plan expenditure, spiking sharply since 2006-07. Of special interest is the much higher component of revenue expenditure, which has all along far outstripped capital expenditure. The latter has remained remarkably sluggish, and since it is the capital component that leads to addition of physical / real assets, its deceleration has been viewed with serious concern. The long-term effect of such pattern on public investment and economic growth, and sustainability of the growth process is thrown into serious doubt.

An alternative characterization of expenditure in terms of "economic categories" is presented in Fig 4 below (2005-06 to 2011-12 (Actuals)).

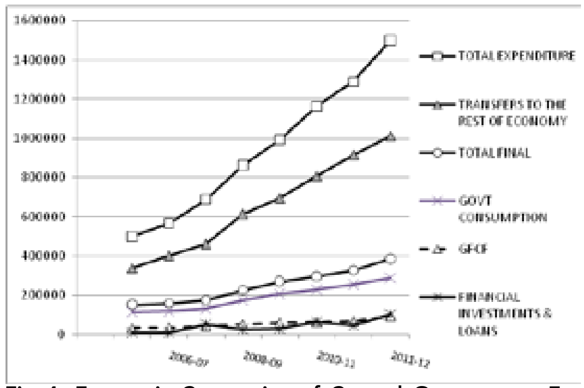

Fig 4: Economic Categories of Central Government Expenditure 2005-06 to 2011-12

Source: Economic Survey (2012-13)

The plot of major economic categories (government consumption, transfers, gross capital formation, and loans to the rest of the economy) above reveals significant patterns as summarized below:

1. Total government expenditure has grown steeply particularly since the year 2006, largely dominated by the growth in transfer payments.
2. Transfers in turn, have been dominated by the component of current transfers including interest payments and subsidies, far outstripping the capital component.
3. Final outlays, comprising government final consumption and capital formation have grown more slowly.
4. Within final outlays, again, government consumption expenditure has dominated the trend while capital formation has remained extremely sluggish.
5. The divergence in respective growth rates has continued to widen and grow dramatically over the entire period.

TABLE 4: Trends in Deficit-GDP Ratios (2005-06 to 2013-14 BE)

	REVENUE DEFICIT	FISCAL DEFICIT
2005-06	2.5	4.0
2006-07	1.9	3.5
2007-08	1.1	2.7
2008-09	4.5	6.0
2009-10	5.2	6.4
2010-11	3.3	4.9
2011-12	4.4	5.7
2012-13 RE	3.9	5.2
2013-14 BE	3.3	4.8

Source: Budget Documents of GOI, various years

Clearly, the initial years i.e., till 2007, show visible success in achieving reductions both in the fiscal and the revenue deficits. However, the success was not permanent as 2008-09 onwards both fiscal and revenue deficits again sharply spiked above 6% of GDP. The more recent trends have partially offset the growing trends, but the RE of 2012-13 already showed signs of some slippage from its .optimistic budgetary estimates.

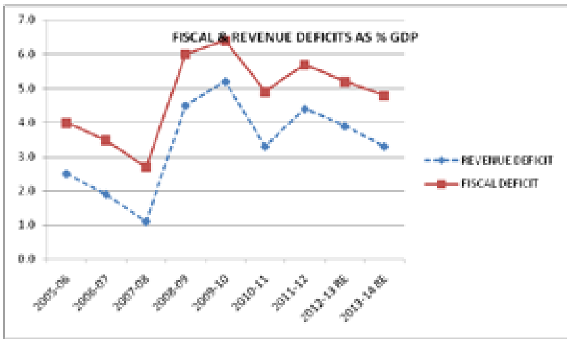

Fig 5: Fiscal and Revenue Deficits as %-age of GDP 2005-2006 to 2013-14 (B.E.)

The trends in deficits discussed above are also brought out clearly in Fig. 5 showing Fiscal and Revenue Deficits, respectively, as percentage shares in GDP.

CONCLUDING REMARKS

This paper attempted to present salient trends in the overall fiscal developments prevailing in the Indian economy in the recent years. It concludes that overall, taking a firm step toward further fiscal consolidation would require massive efforts that seem to have been somewhat postponed, anticipating circumstances that would be hopefully more encouraging. In point of fact, since the annual budget is necessarily a short-term instrument, bringing about effective fiscal change is indeed beyond the purview of a single budget.

Having examined the revenue-expenditure pattern in recent years, we concluded that both resource mobilization and resource usage pattern needed substantial corrective measures. On the deficit front again, the empirical evidence clearly reveals that despite best efforts, deficit-correction courses have been rather short-lived and transitory, and that we have still a long way to go to achieve the fiscal consolidation envisaged.

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