

Role of Supporting PFM Institutional Arrangements for Fiscal Rules: A Perspective from India

ICGFM 2017 Conference

The Macroeconomic Benefits of Strong PFM Practices

May 14 - 19, 2017

Pratap Ranjan Jena

National Institute of Public Finance and Policy

New Delhi

INTRODUCTION

- **The fiscal rules have been the cornerstone of the fiscal management at Central and the State levels for more than a decade**
 - **Reducing deficit and stabilizing debt to achieve long-term macroeconomic stability**
 - **Removing fiscal impediments for conduct of monetary policy**
 - **Improving transparency**
- **The global crisis of 2008-09 posed disruptions**
- **While State Governments succeeded in adhering to targets, Deficit of Central Govt. remained high**
- **The Changes in fiscal institutions became more relevant for fiscal rules and any possible changes**



TRUST AND REVISIONS OF FISCAL RULES

- **Many countries faced severe fiscal stress during the global financial crisis in 2008 and abandoned the fiscal rules**
- **The trust over fiscal rules to help stabilizing public finance and restoring confidence in the market persisted and Governments have overhauled their rules**
- **The 'next generation rules', carried on with the objectives of sustainability, allowed flexibility to provide for the macroeconomic shocks**



RESPONSE TO SHORTCOMINGS IN BUDGETING

- **Fiscal rules aim to counter the expansionary tendency (open ended budget) by compelling budget-makers to tax and spend within fixed constraints**
- **Fiscal rules deal with budgetary decisions for long-run sustainability, in contrast to procedural rules of the budget**
- **Addressing Biases and Rigidities**
 - **Biases embedded in budgeting that spur higher spending in excess of available resources**
 - **The common pattern is for spenders to seek increases**
 - **Budget outcomes also are biased in many countries by the stickiness of public expenditure**
 - **The spread of entitlements weakening fiscal discipline**



FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT (FRBM) ACT OF INDIA

- Appropriate measures to reduce fiscal deficit (to 3%) and balance current account**
- Annual targets for reduction of deficit**
- Govt. not to give guarantees in excess of 0.5 per cent of GDP in any FY**
- Reducing additional liabilities**
- Very general escape clauses and statements of progress in Parliament**
- Ending borrowing from Central Bank**
- Medium Term Fiscal Policy Statement**
- Medium-term Expenditure Framework Statement - MTEF**

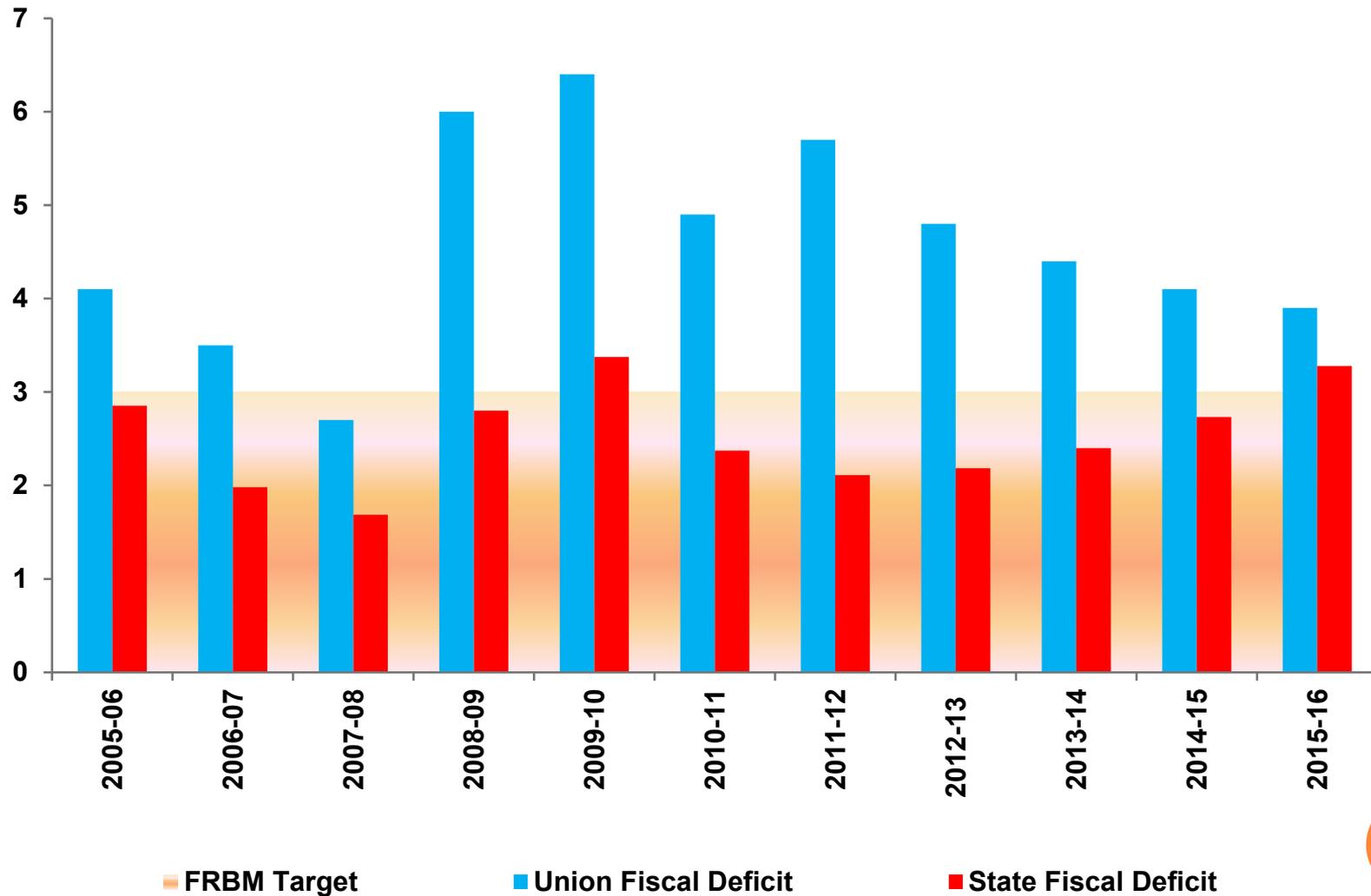


AMENDMENTS, DEFERRALS AND PROSPECTS

- **After global financial crisis the target dates for achieving deficit targets deferred to 2018**
 - **The effective revenue deficit to be eliminated March 2018**
 - **The 3% target of fiscal deficit to be achieved by the end of 2017-18**
 - **Independent review by the SAI (Comptroller and Auditor General – CAG in India)**
 - **Policy of Gradual adjustment from fiscal expansionary measures**
- **Comprehensive review of the FRBM Act**
 - **Feasibility of having a fiscal deficit range instead of a fixed ratio**
 - **Future fiscal framework and roadmap for the country.**



THE FISCAL TREND: UNION AND STATES



HOW STATES SUCCEEDED

- **The fiscal stress during the late nineties and early 2000s made it necessary for the States inculcate discipline**
- **Incentives by the Central Government in initial year since 2005-06**
 - **Debt restructuring facility**
 - **Waving of repayments dues**
- **High growth until 2007-08 and consequent flow of tax devolution**
- **Tax reforms yielded higher revenue**
- **The external control on borrowing of the States exerted by the Centre played a crucial role**
- **States put a control on giving sovereign guarantees**



CENTRE'S CHALLENGES

- **The high growth at about 9% fell to 6% in 2008-09 due to global financial crisis**
 - **Fall in revenue collection**
 - **Growth stimulus packages**
 - **Suspension of fiscal consolidation for temporary period**
 - **FD 6.5% of GDP & RD 5.2% of GDP in 2009-10**
- **Success of fiscal rules closely related with the growth performance**
 - **It is difficult to hold on to fiscal rules during downturns and shocks**
 - **The exuberant expectation regarding economic growth fuels fiscal expansion**
 - **Revenue forgone and spending commitments during the growth phase generate fiscal stress during the downturn**



STRENGTHENING PFM PROCESS FOR EFFECTIVE FISCAL RULES

- **Disciplined budget procedures, and political commitment – Budget Credibility**
- **Medium term fiscal policy framework and debt sustainability**
- **Medium Term Expenditure Framework (MTEF)**
- **A unified top-down budgeting process**
- **Independent Review Process**
- **Transparency in Budgetary Process**
- **A stable macroeconomic environment**



BUDGET CREDIBILITY

	2011-12	2012-13	2013-14	2014-15	2015-16
Revenue Receipts	-4.87	-6.03	-3.94	-7.43	4.68
Tax Revenue	-5.23	-3.79	-7.72	-7.54	2.60
Non-Tax Receipts	-3.00	-16.56	15.45	-6.94	13.32
Revenue Expenditure	4.43	-3.31	-4.48	-6.45	0.11
Capital Expenditure	-1.24	-18.53	-18.09	-13.27	4.80

MEDIUM TERM FRAMEWORK

- **Fiscal rules could be effective with an MTEF instead of an annual plan**
- **The FRBM Act provided for a medium term fiscal policy (MTFP) along with the budget**
 - **Three year rolling targets for fiscal indicators**
 - **Assessment of sustainability**
 - **Fiscal Policy Strategy Statement**
- **Medium-term Expenditure Framework Statement – MTEF (introduced after amendment in 2012)**
 - **set forth a three-year rolling target for prescribed expenditure aggregates**
 - **provides closer integration between budget and the FRBM Statements**



MTEF: A WORK IN PROGRESS

- **The projections show the features of medium term budget framework (MTBF) with departmental ceilings**
- **The role of spending departments in budget planning and resource allocation has been acknowledged**
- **Effective for expenditure control and fiscal rules**
- **However, it does not sufficiently inform the budgetary implications of policy changes.**
 - **The Government needs to establish a hard budget constraint in the budgeting process**
 - **Improve the predictability in the flow of resources to ministries and departments**
 - **Improve the strategic priorities in resource allocation.**



ABOLITION OF DEVELOPMENT PLAN

- **The abolition of Planning Commission in India has ensured a unified budget decision making process to the Ministry of Finance**
 - **A unified top-down budgeting process will facilitates expenditure discipline**
 - **Removal of plan and non-plan distinction gave a holistic picture of spending requirements**
 - **Expected to limit the tendency of expanding plan size every year**
 - **The change in expenditure classification is stated to facilitate better formulation of MTEF**
 - **The policy decisions, particularly relating to investments, will be based on both capital and operating costs together in a unified manner**



INDEPENDENT REVIEW PROCESS

- **Independent review of the fiscal stance of the Government was advised by the 13th Central Finance Commission**
 - **At Central level the SAI – Comptroller and Auditor General of India (CAG) has undertaken a performance audit of the FRBM Act**
 - **The CAG collaborated with fiscal policy think-tank (NIPFP) for this audit.**
 - **Many State Governments conduct independent review of their compliance with the FRBM Act**
 - **This seems to have a positive impact on the expenditure restructuring**



TRANSPARENCY IN BUDGETARY PROCESS

- **The PEFA report indicates that both the Central and State Government publish relevant fiscal information and public accessibility is high**
- **The MTFP provides fiscal stance of the Government for the ensuing budget year and for the medium term**
- **The MTEF has added another layer of spending requirement data for the spending departments**
- **The Government has started preparing medium term debt strategy document – Central bank undertakes the debt management**



THE SUB-NATIONAL CONTEXT

- **Record of fiscal discipline under the FRBM Act**
- **After the abolition of Planning Commission the focus has shifted to the ability of the States to chart their own development path**
- **States have large functional responsibilities and consequent expenditure requirements**
- **The indicators of sustainable development goals (SDGs) have been emerging as the new focus of Governance**
- **The contemporary PFM challenges faced by States are allocative and operational efficiency**



REVENUE OUTTURN SCORES: 2012-13 TO 2014-15

Score	Tax Devolution	Grants-in-Aid
A		
B	HR, JH, MP, OD	
C	BH, CG, GA, GJ, KR, KL, MH, PN, RJ, TN, UP, WB, AP	
D		AP, BH, CG, GA, GJ, HR, JH, KR, KL, MP, MH, OD, PN, RJ, TN, UP, WB

EXPENDITURE OUTTURN SCORES

Score	Revenue Expenditure	Capital Outlay
A	KL, MH, PN, RJ, TN, WB	KR, UP
B	CG, GJ, HR, KR, OD, UP	GJ
C	AP, GA, MP	BH, MP, RJ
D	BH, JH	AP, CG, GA, HR, JH, KL, MH, OD, PN, TN, WB

PFM ISSUES FOR STATES

- **Improving existing budgetary institutions will be key for States to remain on fiscal consolidation path**
 - **Improving budget forecasting and credibility of budget**
 - **Better coordination with Centre for indications relating to grants**
 - **Utilizing the new devolution process – higher untied funds from the Centre – to restructure spending plans**
 - **Moving towards a structured MTEF from existing fiscal rule bound medium term fiscal plan**
 - **Avoiding the tendency of expanding the budget size, spreading resources thinly, and bias towards short-term goals**
 - **Utilizing the existing planning bodies to coordinate across the spending departments to improve budget planning**

