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

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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 by 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


FRBM Target  Union Fiscal Deficit  State Fiscal Deficit
**How States Succeeded**

- The fiscal stress during the late nineties and early 2000s made it necessary for the States to inculcate discipline.
- Incentives by the Central Government in initial years 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

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<tbody>
<tr>
<td><strong>Revenue Receipts</strong></td>
<td>-4.87</td>
<td>-6.03</td>
<td>-3.94</td>
<td>-7.43</td>
<td>4.68</td>
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<tr>
<td><strong>Tax Revenue</strong></td>
<td>-5.23</td>
<td>-3.79</td>
<td>-7.72</td>
<td>-7.54</td>
<td>2.60</td>
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<tr>
<td><strong>Non-Tax Receipts</strong></td>
<td>-3.00</td>
<td>-16.56</td>
<td>15.45</td>
<td>-6.94</td>
<td>13.32</td>
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<tr>
<td><strong>Revenue Expenditure</strong></td>
<td>4.43</td>
<td>-3.31</td>
<td>-4.48</td>
<td>-6.45</td>
<td>0.11</td>
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<tr>
<td><strong>Capital Expenditure</strong></td>
<td>-1.24</td>
<td>-18.53</td>
<td>-18.09</td>
<td>-13.27</td>
<td>4.80</td>
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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 facilitate 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
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

<table>
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<tr>
<th>Score</th>
<th>Tax Devolution</th>
<th>Grants-in-Aid</th>
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<tr>
<td>A</td>
<td></td>
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</tr>
<tr>
<td>B</td>
<td>HR, JH, MP, OD</td>
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## Expenditure Outturn Scores

<table>
<thead>
<tr>
<th>Score</th>
<th>Revenue Expenditure</th>
<th>Capital Outlay</th>
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<tbody>
<tr>
<td>B</td>
<td>CG, GJ, HR, KR, OD, UP</td>
<td>GJ</td>
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<tr>
<td>C</td>
<td>AP, GA, MP</td>
<td>BH, MP, RJ</td>
</tr>
<tr>
<td>D</td>
<td>BH, JH</td>
<td>AP, CG, GA, HR, JH, KL, MH, OD, PN, TN, WB</td>
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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