

MAINS iMPACT 202523-08-2025

FRBM ACT

SYLLABUS:

GS 3 > Basic Economics

REFERENCE NEWS:

A recent CAG review of the **FRBM Act** indicates India is progressing towards long-term macroeconomic stability. The Union government's debt has decreased from 61.38% of GDP in 2020-21 to 57% by March 2024.

Objective of FRBM Act (2003): Ensure long-term macroeconomic stability and inter-generational equity through reduction of fiscal deficit and debt.

Key Highlights:

- **Debt-to-GDP Ratio:** Central government debt declined from **61.38% (FY 2020-21)** to **57% (March 2024)**.
- **Debt Accumulation vs. Growth:** Debt grew at a **slower pace than GDP**, showing India's improved debt-servicing capacity.
- **Debt Sustainability:** Public debt repayment-to-receipts ratio improved from **86.66% (2019-20)** to **81.46% (2023-24)**.

FRBM Targets:

- **General Government Debt (Centre + States):** To be **≤ 60% of GDP** by FY 2024-25.
- **Central Government Debt:** To be **≤ 40% of GDP** by FY 2024-25.
- **Fiscal Deficit:** Originally targeted at **3% of GDP by 2021**, but revised—Government now aims for **<4.5% by FY 2025-26**.

Fiscal Prudence

- Government has limited **additional guarantees** on loans from the Consolidated Fund of India to **0.5% of GDP per year**.

Overall Observation by CAG

- India is moving steadily towards **macroeconomic stability** and **inter-generational equity**.
- Fiscal health is improving, but continued reforms are needed to meet FRBM targets.

FRBM ACT:

The **Fiscal Responsibility and Budget Management (FRBM) Act, 2003** was enacted by the Parliament of India to institutionalize financial discipline, reduce fiscal deficit, improve macroeconomic management, and ensure long-term stability of the Indian economy.

Objectives of the FRBM Act, 2003:

- **Ensure Fiscal Discipline:** To check fiscal profligacy by setting targets for reduction of fiscal and revenue deficit. The Act originally mandated eliminating the **revenue deficit** and reducing **fiscal deficit to 3% of GDP** by 2008–09.
- **Promote Macroeconomic Stability:** By reducing government borrowing, it aimed to control inflation and interest rates, ensuring stable growth.
- **Inter-generational Equity:** To avoid burdening future generations with unsustainable levels of debt by reducing the debt-to-GDP ratio.
- **Transparency in Fiscal Operations:** Mandated the government to present **Medium-Term Fiscal Policy (MTFP) statements, Fiscal Policy Strategy Statements, and Macroeconomic Framework Statements** along with the Union Budget.
- **Sustainable Debt Management:** To ensure that the **public debt remains sustainable** and repayment obligations do not crowd out developmental expenditure.
- **Accountability of the Government:** Required the government to place quarterly reviews of fiscal performance before Parliament.

The **FRBM Rules, 2004** operationalized the Act by prescribing annual reduction targets:

- **Fiscal Deficit:** To be reduced by at least 0.3% of GDP every year.
- **Revenue Deficit:** To be reduced by 0.5% of GDP annually.

However, deadlines were repeatedly postponed due to crises like the **2008 Global Financial Crisis** and **COVID-19 pandemic**, requiring amendments.

SIGNIFICANCE OF FRBM ACT:**Fiscal Discipline & Reduction of Deficits**

- The FRBM Act set **numerical targets** for reducing **fiscal deficit** and **revenue deficit**.
- After the Act, India's **fiscal deficit fell from 6.5% of GDP in 2001-02 to 2.5% in 2007-08**, showing its effectiveness in controlling fiscal profligacy. Helped prevent reckless borrowing by both Centre and States.

Macroeconomic Stability

- By curbing excessive borrowing, it reduced inflationary pressures and interest rates.
- The **2003–2008 period** saw a high-growth phase (8–9% GDP growth), partly due to fiscal discipline under FRBM combined with global growth.

Transparency & Accountability

- Made it mandatory for the government to publish **Medium-Term Fiscal Policy (MTFP) Statement, Fiscal Policy Strategy Statement, and Macroeconomic Framework Statement** along with the Budget.
- Citizens and Parliament could assess deviations from targets — enhancing democratic accountability.

Debt Sustainability

- FRBM aimed to limit **public debt to sustainable levels**.
- Central Government debt, which was **61.38% of GDP in 2020-21**, declined to **57% of GDP by March 2024** (CAG Report, 2024). This reflects progress toward inter-generational equity.

Boosts Investor Confidence

- Fiscal prudence ensures macroeconomic stability, which attracts domestic and foreign investors.
- **Moody's upgraded India's outlook in 2017**, citing fiscal consolidation as a factor. A stable fiscal framework under FRBM improves credit ratings.

Supports Inter-generational Equity

- Prevents passing the burden of today's borrowing onto future generations.
- By aiming for **general government debt ≤60% of GDP**, FRBM tries to ensure that younger generations don't inherit unsustainable liabilities.

Anchors Medium-Term Growth

- Stable fiscal environment encourages long-term infrastructure investments.
- Between 2004–2008, when fiscal deficits were kept under control, India saw high investment rates and an infrastructure boom.

Guides States' Fiscal Responsibility

- States were asked to enact their own FRBM laws (all States did).
- States like **Karnataka (first State to adopt FRBM in 2002)** maintained relatively better fiscal health and higher social sector spending due to controlled borrowing.

CHALLENGES OF FRBM ACT:

Rigid Fiscal Targets

- FRBM mandates specific numerical limits (e.g., fiscal deficit ≤3% of GDP), which sometimes conflict with growth and welfare needs.
 - During the **2008 Global Financial Crisis**, India had to suspend FRBM targets to allow higher public spending, as rigid adherence could have deepened recessionary effects.

Counter-Cyclical Inflexibility

- Economic theory suggests **counter-cyclical fiscal policy** (spending more during recessions, cutting deficits during booms). FRBM's rigid rules restrict this flexibility.

- In **COVID-19 (2020-21)**, fiscal deficit ballooned to **9.2% of GDP**, far beyond FRBM norms, as massive stimulus was required. This exposed FRBM's impracticality during crises.

Frequent Deviations & Dilutions

- Successive governments have missed or revised FRBM targets multiple times.
 - The fiscal deficit target of **3% of GDP (to be achieved by 2008-09)** has been postponed several times; now the government aims for **<4.5% by 2025-26**.

Focus on Fiscal Deficit, Not Quality of Expenditure

- FRBM focuses on the size of deficit, not **how the money is spent**. Productive capital expenditure and wasteful subsidies are treated the same.
 - India spends heavily on **food, fuel, and fertilizer subsidies (~2% of GDP, 2022-23)**, crowding out capital investment in infrastructure and health. FRBM does not distinguish between these.

Off-Budget Borrowings & Creative Accounting

- Governments often bypass FRBM limits by pushing liabilities to PSUs or special purpose vehicles (SPVs).
 - **Food Corporation of India (FCI)** borrows through NSSF to fund food subsidies, keeping them off the budget books (~₹2.5 lakh crore in 2020). This hides true fiscal stress.

Debt Burden Remains High

- Despite FRBM, India's debt levels remain above sustainable limits.
 - CAG Report (2024) – Central govt debt at **57% of GDP**, against FRBM's long-term target of **40%**. General govt debt (Centre + States) is still **~82% of GDP**, above FRBM's **60% target**.

Weak Enforcement Mechanism

- FRBM lacks **strict penalties** for non-compliance. Deviations are justified through "escape clauses" (war, calamity, structural reforms).
 - Fiscal deficit limits have been relaxed repeatedly without consequences, making FRBM more aspirational than binding.

Centre-State Fiscal Imbalances

- While the Centre sets FRBM norms, States' compliance varies.
 - Many States breached their fiscal deficit limit of **3% of GSDP** during COVID, worsening India's consolidated debt. FRBM doesn't provide an effective coordination framework.

Unrealistic Assumptions in Targets

- FRBM targets are often based on optimistic revenue and growth projections.
 - Tax buoyancy assumptions in budgets are frequently missed (tax-to-GDP ratio stagnates around **11-12%**), leading to fiscal slippages.

Adopt a Debt Anchor with Flexibility

- **N.K. Singh Committee (2017):** Recommended a **debt-to-GDP ratio of 60% (40% Centre + 20% States)** as the medium-term anchor. Suggested **fiscal deficit target of 2.5% of GDP** for the Centre.
- Flexibility to deviate by **0.5% of GDP under escape clauses** (natural calamities, structural reforms, security issues).
- **EU's Maastricht Criteria** also sets a debt anchor of 60% of GDP with a 3% fiscal deficit cap, balancing discipline with flexibility.

Strengthen Enforcement Mechanism

- Create an **independent Fiscal Council** (as recommended by N.K. Singh Committee) to monitor compliance, provide unbiased fiscal projections, and assess deviations.
- Countries like **UK (Office for Budget Responsibility)** and **USA (Congressional Budget Office)** have such independent bodies.

Enhance Transparency in Public Finances

- Bring **off-budget borrowings** (e.g., FCI/NSSF loans, oil bonds) within the FRBM framework.
- Regularly publish a **comprehensive debt report** (Centre + States + PSUs) for clarity.
- The CAG report (2024) flagged hidden borrowings that distort India's real fiscal position.

Shift Focus from Deficit Numbers to Quality of Expenditure

- Differentiate between **productive capital expenditure** (infrastructure, health, education) and **revenue expenditure** (subsidies, salaries).
- Allow more fiscal space for capex while curbing wasteful subsidies.
- Union Budget 2023-24 raised **capital expenditure to 3.3% of GDP**, boosting growth multipliers while adhering to fiscal discipline.

Better Centre–State Fiscal Coordination

- Harmonise Centre and State fiscal targets to manage **combined general government debt**.
- Incentivise States through GST compensation, interest-free loans for reforms, and fiscal space for infrastructure.
- FRBM Review Committee suggested a **debt management and monitoring cell** to oversee combined liabilities.

Adopt Counter-Cyclical Fiscal Policy

- Introduce **flexible fiscal rules** that allow deficits to widen during crises but mandate correction in high-growth years.
- **Chile's structural balance rule** allows government to spend more during downturns and save during booms, ensuring stability.

Improve Revenue Mobilisation

- Expand tax base via GST reforms, better compliance, and reduction in exemptions.
- Strengthen **disinvestment and asset monetisation** to reduce debt.
- India’s tax-to-GDP ratio remains around **11–12%**, far below OECD average of ~34%.

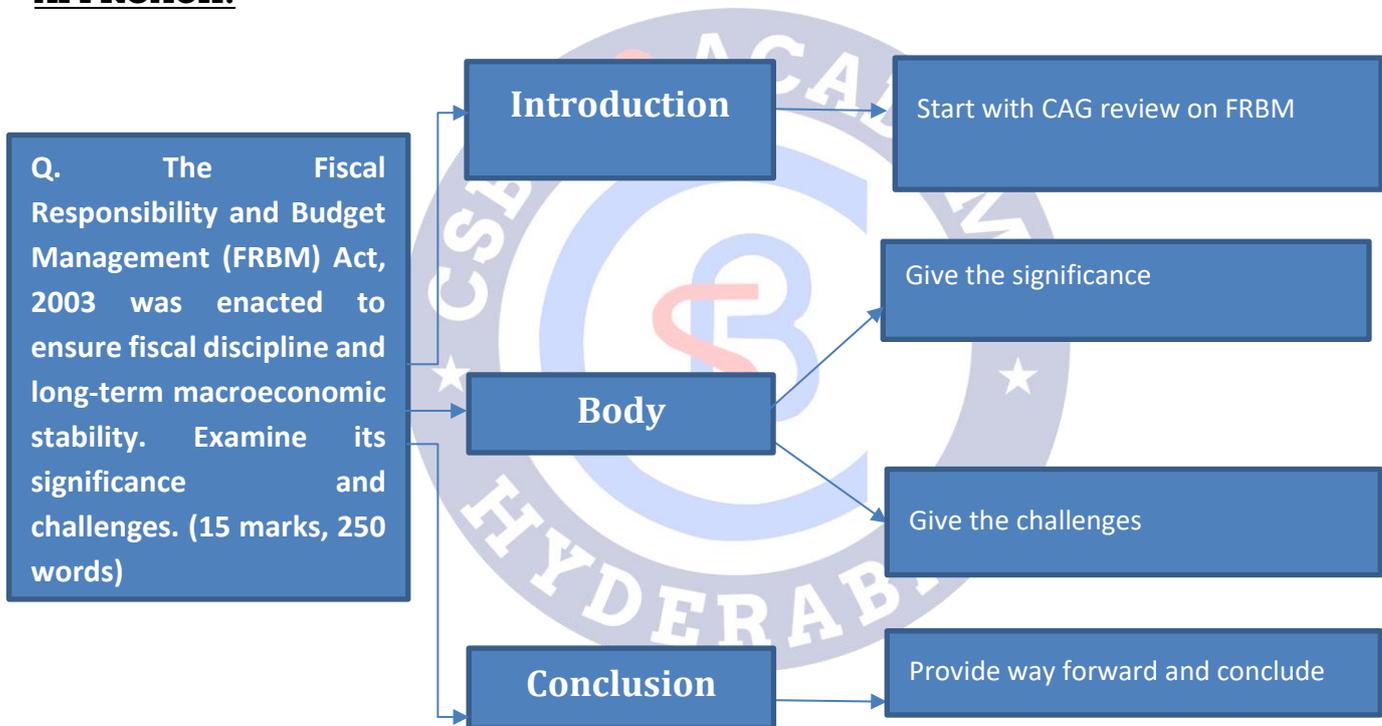
Inter-Generational Equity

- Ensure borrowings fund productive investments, not current consumption, so that future generations are not burdened.
- National Infrastructure Pipeline (NIP) aligns public borrowing with long-term growth.

PRACTICE QUESTION:

Q. The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 was enacted to ensure fiscal discipline and long-term macroeconomic stability. Examine its significance and challenges. (15 marks, 250 words)

APPROACH:



MODEL ANSWER:

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 was enacted to institutionalise fiscal discipline by reducing deficits and debt. A recent CAG review (2024) highlights that Central government debt has declined from **61.38% of GDP (2020-21) to 57% (2023-24)**, showing progress but also underlining persistent challenges.

Significance of FRBM Act

1. **Fiscal Discipline:** Helped reduce fiscal deficit from **6.5% of GDP in 2001-02 to 2.5% in 2007-08**. Prevented reckless borrowing by Centre and States.
2. **Macroeconomic Stability:** Curbed inflationary pressures by limiting borrowings. Growth phase of **8–9% GDP (2003–08)** was supported by fiscal prudence.

3. **Transparency & Accountability:** Made it mandatory to present **Medium-Term Fiscal Policy (MFTP), Fiscal Strategy Statement, and Macroeconomic Framework** with the Budget.
4. **Debt Sustainability:** Central govt debt declined to **57% of GDP (2024)**. Target is **40% of GDP by 2025-26**.
5. **Investor Confidence:** Improved creditworthiness; Moody's upgraded India's outlook (2017) citing fiscal consolidation.
6. **Inter-generational Equity:** Restrained unsustainable borrowing so future generations aren't burdened.

Challenges of FRBM Act

1. **Rigid Fiscal Targets:** Mandated **3% fiscal deficit cap**, which proved impractical during crises (2008 GFC, COVID-19 when FD rose to 9.2%).
2. **Counter-Cyclical Inflexibility:** FRBM lacked flexibility to allow higher spending during downturns.
3. **Frequent Deviations:** Targets repeatedly postponed; <4.5% FD now targeted for **2025-26**, not 2021.
4. **Off-Budget Borrowings:** Hidden liabilities (e.g., **₹2.5 lakh crore FCI borrowings via NSSF, 2020**) escape FRBM limits.
5. **High Debt Levels: General govt debt (Centre + States) ~82% of GDP**, far above FRBM's 60% target.
6. **Weak Enforcement:** No penalties for non-compliance; escape clauses often invoked.
7. **Centre-State Fiscal Imbalance:** Many states breached the **3% GSDP deficit cap** post-COVID. FRBM lacks coordination framework.

Way Forward

1. **Adopt a Debt Anchor:** N.K. Singh Committee (2017): Recommended **60% debt-GDP ratio (40% Centre, 20% States)** as anchor, with flexible fiscal deficit limits.
2. **Independent Fiscal Council:** To provide unbiased fiscal projections and monitor compliance, like the **UK's Office for Budget Responsibility**.
3. **Transparency:** Bring off-budget borrowings (FCI, oil bonds) under FRBM. Publish a **comprehensive debt report**.
4. **Quality of Expenditure:** Distinguish productive **capital expenditure** from subsidies. Union Budget 2023-24 raised **capex to 3.3% of GDP**.
5. **Counter-Cyclical Fiscal Rules:** Adopt Chile's model of structural balance rule — spend more in downturns, save in booms.

6. **Strengthen Centre-State Coordination:** Harmonise fiscal targets, incentivise States via **interest-free loans for reforms**.
7. **Improve Revenue Mobilisation:** Expand GST base, reduce exemptions, and boost disinvestment/asset monetisation.

The FRBM Act has been instrumental in instilling fiscal prudence, but rigid targets, lack of enforcement, and hidden borrowings weaken its impact. A reformed framework with **flexibility, transparency, and strong oversight**—as suggested by the **N.K. Singh Committee**—is essential for ensuring macroeconomic stability and inter-generational equity while enabling India to pursue its growth aspirations.

