Research Paper
Impact Factor: 6.462
Peer Reviewed & Indexed Journal
www.ijmsrr.com

IJMSRR
E- ISSN - 2349-6746
ISSN -2349-6738

FRBM (Fiscal Responsibility and Budget Management) ACT- EFFECTS ON THE ECONOMY

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Abstract
The Fiscal Responsibility and Budget Management Act,2003 (FRBMA) is an Act of the Parliament of India to institutionalize financial discipline, reduce India's fiscal deficit, improve macroeconomic management and the overall management of the public funds by moving towards a balanced budget. In 1980s, India saw a sharp deterioration of the fiscal situation, which ultimately culminated in the balance of payments crisis of 1991.Within a decade of economic liberalization, the fiscal deficit and debt situation again seemed to head towards unsustainable levels around 2000. At that time, a need to institutionalize a new fiscal discipline frame work. FRBM Bill was introduced to institutionalize the fiscal discipline at both the centre and state level. Under the Fiscal Responsibility and Budget Management Act (FRBMA) 2003, both the Centre and States were supposed to wipe out revenue deficit and cut fiscal deficit to 3% of GDP by 2008-09, thus bringing much needed fiscal discipline.

The difference between total revenue and total expenditure of the government is termed as fiscal deficit. It is an indication of the total borrowings needed by the government. However, uncontrolled Fiscal Deficit is harmful not only for the health of economy but also for the Growth of the economic indicators and finally the development prospects in the road towards Inclusive Growth.

The important objectives of the Act are to reduce Fiscal Deficit and improve macroeconomic management. The law aims at promoting Fiscal Stability for the country on a long-term basis. It emphasizes a Transparent Fiscal Management System and a more equitable distribution of debts over the years. This law also gives flexibility to the Reserve Bank of India to undertake monetary policy to tackle inflation and take corrective measures in order to give an impetus to the economic environment. FRBM Act was notified in response to the need felt to curb broadening Fiscal Deficit. The FRBM rules specify annual reduction targets for fiscal indicators. Following the enactment of FRBM Act, Government constituted a Task Force headed by Dr. Vijay Kelkar for drawing up the medium-term framework for fiscal policies to achieve the FRBM targets.

The task force proposed the following measures: -Widening the tax base through removal of exemptions and An All-India goods and service-tax (GST). Income tax exemption limit to be increased to Rs.1,00,000.A two-tire rate structure of 20 percent tax for income of Rs. 1,00,000 to Rs. 4,00,000 and 30% for income above Rs. 4,00,000 for individuals and elimination of standard deduction available to the salaried tax payer. A reduction in the corporate income tax to 30% for domestic companies and the reduction in depreciation rates from 25 to 15%.

FRBM- The Impacts

Impact on deficits

The Act has helped on the issues relating to fiscal consolidation due to the mandatory medium-term and strategy statements which are required to be presented annually before Parliament.

Impact on development

The Union Government's development expenditure as proportion of GDP declined in the post FRBM era from 7.49% in 2002-03 to 6.42 % in 2005-06. The revenue account of the development expenditure by states shows that in almost all sectors there has been a decline in the post FRBM era. In case of education, it declined from around 2.5 % of GDP in 2002-03 to less than 2.2 % of GDP in 2005-06. In

Health sector, the decline has been from 0.6% to 0.49 % and in agriculture, from 0.67 % to 0.58 %. In overall social sectors, it declined from 4.5 %of GDP to 4.16 % of GDP during the period. Thus the act and its rules are adverse to social sector expenditure necessary to create productive assets and general upliftment of rural poor of India.

Impact on credit growth

There is an inverse link between fiscal deficit (fiscal expansion) and bank credit (monetary expansion). That is, if credit growth falls, fiscal deficit may need to rise and if credit rises, fiscal deficit ought to fall — to ensure adequate money supply to the economy. Data on money supply growth, bank credit and GDP establishes that, in the last six years, both money supply growth and credit expansion have halved absolutely and in relation to GDP growth. Even the combined fiscal deficit (fiscal expansion) and credit growth (monetary expansion) as a percentage of GDP has halved from 17.4 per cent in 2009-10 to 8.8 per cent, which is less than nominal GDP growth. Thus, the FRBM Act has not only reduced fiscal deficit but also starved the growing economy from much needed investment.

Criticisms of FRBM Act 2003

The Bill stipulates that by March 31, 2006, the Gross Fiscal Deficit (GFD) as a proportion of GDP must be 2%. This, of course, means that the government can borrow from the economy only to the extent of 2% of GDP, whatever be the level of savings.

One of the major omissions of amended FRBM Bill 2000 or FRBM Act 2003 was the complete absence of any target for time bound minimum improvement in areas of power generation, transport, etc. which is very important both from the point of equity and higher economic growth.

The provisions of the bill impose restrictions on only the central government but state governments are out of its scope. But, deficits of state governments are as much or even a greater problem.

Today, the levels of capital expenditures by the government are miserably low in India. These capital expenditures increase the efficiency and productivity of private investment and thus contribute to the development process in the country. If Revenue Deficit is to be reduced to zero and GFD to be 2% of GDP as per the requirement of FRBM Bill, it is the capital expenditure which will be sacrificed and thus will hinder further development of the country.

Revenue deficits are determined by the interplay of expenditure and revenues, both tax and non-tax. Too often, attention gets focused only on the expenditure side of the identity to the neglect of the revenue side. Increasing non-tax revenue requires that public sector services be appropriately priced, which may be difficult as the present society has got used to the subsidised education, health, food items, etc.

The FRBM bill does not mention anything relating to social sector development. However, investment in social sector such as health, education, etc is very vital for the economic development of the nation.

The government may be able to reduce revenue deficit by reducing subsidies. However, it is quite likely that the government will be under severe pressure to continue the subsidies. It means the expenditure on the productive areas may be reduced due to subsidies.

Suggestions

The govt shall make endeavour to increase revenues by methods such as recovery of loans, collection of taxes (by advertisement, warnings etc.) to control fiscal deficit rather than just creating burden on side of expenditure especially on capital expenditure.

The govt shall make endeavour to eliminate system of subsidies to control fiscal deficit. As of now, maximum part of subsidies are used by non-users or leaked in corruption and almost 1/4th of it reached to the needed ones.

The famous economist Dr. Raja Chelliah suggests that the ratio of GFD to GDP shall be around 4-5% as public investment on infrastructure is essential to boost economic growth.

The recent step of govt towards effective revenue deficit by eliminating factor of grant for capital assets is also a bright step towards boosting expenditure on infrastructure or basic amenities to create employment for future prospective growth

Above features of Amended FRBM bill 2000 or Fiscal Responsibility and Budget Management Act 2003 clearly points out that the government intends to create a strong institutional mechanism to restore fiscal discipline at the level of the central government. Similarly, the government wants to introduce greater transparency in fiscal operations of the central government.

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