Fiscal Deficit

Why in news?

Recently the Confederation of Indian Industry (CII) has suggested that Union Government should not set aggressive targets for fiscal deficit.

What is fiscal deficit?

- **Fiscal deficit** – Is the difference between total revenue and total expenditure of the government.
  - The ***fiscal deficit for 2023-24 is 5.8% of the GDP***.
  - The average fiscal deficit of Indian States is 3.5% in 2023-24.
- **Target** – Fiscal deficit target is at ***4.9% of GDP for 2024-25*** and aims to reduce it to ***4.5% for 2025-26***.
- **Borrowing limit** – Union government imposed the *net borrowing ceiling of 3.5% of GSDP* on states as recommended by the Fifteenth Finance Commission.
- **Fiscal Responsibility and Budget Management Act, 2003** – To ensure inter-generational equity in fiscal management.
- It sets limit on fiscal deficit and borrowing for both the Central and State governments.

FRBM Act, 2003
• The Fiscal Responsibility and Budget Management (FRBM) Act was enacted in 2003 to implement the mandate in ***Article 292***. • **Aim** – To *ensure fiscal discipline for the Union Government* by setting targets including reduction of fiscal deficits and elimination of revenue deficit. • **Main objectives**: - To introduce transparent fiscal management systems, - To introduce a more equitable and manageable distribution of the country's debts over the years and - To aim for fiscal stability in the long run. • **Key features** – The FRBM Act made it ***mandatory*** for the government to place the following components along with the Union Budget documents in Parliament annually. The components are: - Medium Term Fiscal Policy Statement - Macroeconomic Framework Statement - Fiscal Policy Strategy Statement • **NK Singh Committee** – In the Union Budget 2016-17, it was proposed to constitute a committee to review the implementation of the FRBM Act and give its recommendation. • **Debt-GDP ratio** – NK Singh Committee recommended a *debt-GDP ratio of 60% to be achieved by 2023*, but the current ratio is about 81%.

- **State fiscal responsibility acts** – Each State may have its own Fiscal Responsibility

Act, which further defines the limits and guidelines for borrowing and fiscal management within the State.

- **Role of Union Government** – It plays a significant role in overseeing fiscal matters, including approving borrowing limits for States based on recommendations from bodies like Finance Commission.

Fiscal deficit across states (% of GSDP)

State	FY12-FY19	FY20	FY21	FY22	FY23	FY24RE	FY25BE
Andhra Pradesh	4.3	4.3	5.6	2.2	4.0	4.2	3.5
Assam	1.6	4.3	3.3	4.4	5.9	5.2	3.5
Bihar	2.9	2.1	5.3	3.9	6.0	8.9	3.0
Chhattisgarh	2.1	5.2	4.5	1.5	1.0	7.3	3.8
Gujarat	1.9	1.5	2.5	1.2	0.8	1.7	2.5
Haryana	3.4	4.1	3.9	3.7	3.2	2.8	2.8
Himachal Pradesh	3.2	3.5	3.8	3.0	6.5	5.9	4.7
Jharkhand	3.0	2.6	5.0	0.7	1.1	2.7	2.0
Karnataka	2.2	2.4	4.1	3.3	2.1	2.7	3.0
Kerala	3.6	2.9	5.3	5.0	2.5	3.4	3.4
Madhya Pradesh	2.7	3.6	5.3	3.4	3.3	3.6	4.1
Maharashtra	1.4	2.0	2.7	2.0	1.9	2.8	2.6
Meghalaya	3.1	3.2	7.7	5.4	6.0	3.9	3.8
Punjab	3.0	3.1	4.2	4.4	5.0	4.1	3.8
Odisha	1.5	3.5	1.8	-3.0	2.0	3.0	3.5
Rajasthan	4.3	3.8	5.8	4.0	3.8	4.3	3.9
Tamil Nadu	3.8	3.5	5.3	3.9	3.4	3.5	3.4
Telangana	2.7	3.3	5.2	4.1	2.5	3.4	3.0
Uttar Pradesh	2.1	-0.7	3.3	2.0	2.8	3.5	3.5
West Bengal	3.0	3.1	3.9	3.8	3.3	3.5	3.6
Mizoram	3.2	4.9	7.8	1.4	3.6	4.7	2.8
All States	**2.9**	**2.6**	**4.1**	**2.8**	**2.8**	**3.5**	**3.2**

Source: CMIE States of India, PRS, State budget documents, NSE EPR.

What are the Constitutional provisions related to fiscal management?

- **Article 280** – It mandates to constituted *Finance Commission* every fifth year or earlier constituted to make fiscal matters.
- **Article 293** – It grants *fiscal autonomy to states*, allowing them to borrow only from within the territory of India on guarantee from the Consolidated Fund of the State.
- **7th Schedule** – Fiscal matters are delineated in the 7th Schedule of the Constitution, with *Public Debt of the State* falling under the State List, giving states exclusive jurisdiction over this matter.
- **Distribution of revenues** – ***Articles 268 to 272*** of the Indian Constitution define the distribution of revenues between the Union and the States.
- ***Article 268*** deals with certain *duties are levied by the Centre* but collected and retained by the States.
- ***Article 269*** mentions about those *taxes and duties that are levied and collected by the Centre* but assigned in whole to the States.
- ***Article 270*** deals with *sharing of the proceeds of all Union taxes* between the Centre and the States.
- **Grants-in-Aid** – The Constitution provides for grants-in-aid to the States from the Central resources.
- **Statutory grants** – ***Article 275*** provides for ***compulsory statutory grants-in-aid*** to the revenues of States.
- **Discretionary grants** – ***Article 282*** empowers both the Centre and the States to make any grants for any public purpose, even if it is not within their respective

legislative competence.

- **Other grants** – These grants were to be given for a *period of 10 years* from the commencement of the Constitution.

What are the suggestions by CII to maintain fiscal discipline?

- **Fiscal stability reporting** – To aid longer-term fiscal planning, the government should consider instituting Fiscal Stability Reporting.
- This could include annual reports *on fiscal risks under different stress scenarios* and the outlook for fiscal stability.
- The exercise will help *forecast potential economic headwinds or tailwinds* and assess their impact on the fiscal path.
- **State-level fiscal stability reporting** – To ensure that states regularly assess and report their fiscal health, helping to identify risks and fiscal vulnerabilities at the state level.
- It would also bring more transparency to state finances and improve fiscal discipline.
- **To maintain moderate targets** – CII has suggested sticking to the fiscal deficit target of *4.9% of GDP for FY25* and a target of *4.5% for FY26*.
- CII has also pointed out that *overly aggressive targets* beyond the ones mentioned could adversely affect economic growth.
- **To allow states to borrow directly from the market** – It provides states with *more fiscal flexibility* and states sometimes provide guarantees for borrowings by State Public Sector Enterprises (PSEs).
- These guarantees can have significant implications for the state's fiscal health and should be carefully managed.
- **Credit rating system for States** – CII suggests that the Central Government *create an independent and transparent credit rating system for states*.
- It would incentivize fiscal discipline by linking the cost of borrowing to a state's fiscal performance.
- If states maintain sound fiscal health, they would be rewarded with better credit ratings, reducing their borrowing costs.
- This would provide an additional layer of accountability and encourage states to maintain fiscal prudence.

Quick facts
• **Confederation of Indian Industry (CII)** – It is a *non-governmental*, industry-led and industry-managed organization *headquartered in New Delhi* that was *founded in 1895*. • **Objective** – It works to create and sustain an environment conducive to the development of India, partnering Industry, Government and civil society, through advisory and consultative processes. • CII was appointed as the *B20 India Secretariat* by the Government of India to lead the B20 India process during *India's G20 Presidency in 2023*.

Reference

[The Hindu | CII Urges Centre to Stick To Fiscal Deficit Target]