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Fiscal Prudence

Why in news?

A close look at the government's accounts highlights that fiscal deficit is owing to low revenues and not high spending.

Key terms

Fiscal prudence

- It means managing government finances in a responsible and sensible way to ensure the nation's sustainable growth, stability, and welfare.
- Indicators- Fiscal Deficit, Debt-GDP ratio and qualtiy of expenditure.

Fiscal Deficit

- It occcurs when a government spends more that it earns in a given fiscal year.
- Fiscal deficit= Total Expenditure- Total Revenue (Excluding the borrowings).

Debt-GDP ratio

- It is the ratio of the governmetn's outstanding debe to its gross domextic product which measures the size of the economy.

Tax buoyancy

- It measures the responsiveness of tax mobilisation to economic growth.
- A tax is said to be buoyant if the tax revenues increase more than proportionately in response to a rise in national income or output.

What is the need for fiscal prudence?

- **Stable fiscal policy**- It helps to maintain fiscal sustainability and macroeconomic stability as well as promotes economic growth and social welfare.
- **Safety net**- It can help avoid fiscal crises, reduce public debt and improve the quality of public spending.
- **Effective resource mobilization**- The government should not spend more than it earns, and should use its resources efficiently and effectively to promote the economic and social well-being of its citizens.
- **Future recovery plan**- The government should also plan for the future and be prepared for any shocks or uncertainties that may affect its fiscal position.
- **Long term goals**- It involves making sound decisions regarding revenue generation, expenditure allocation and debt management.
- **Realistic strategy**- The government should have a clear strategy for raising revenues such as taxes, fees or grants and for allocating expenditures such as public goods,

services or transfers according to its priorities and needs.

- **Balanced fiscal deficit-** It will indicate that the government is living within its means and not relying too much on borrowing.
- **Low debt-GDP ratio-** It indicates that the government's debt is manageable and not crowding out private investments or consumption.
- **Quality of expenditure**- A high quality indicates that the government is getting value for money and delivering results for its citizens.

India achieved fiscal prudence by enacting the Fiscal Responsibility and Budget Management (FRBM) Act in 2003, which set targets for reducing its fiscal deficit and debt-GDP ratio.

FRBM Act, 2003
• **Aim-** To ensure fiscal discipline for the Centre 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 - To aim for fiscal stability in the long run • **Key features-** The FRBM Act made it ***mandatory*** for the government to place the following along with the Union Budget documents in Parliament annually. - Medium Term Fiscal Policy Statement - Macroeconomic Framework Statement - Fiscal Policy Strategy Statement • **Escape clause**- In grounds of national security, calamity, etc, the set targets of fiscal deficits and revenue could be exceeded. • **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.

What is the picture of Indian economy with respect to fiscal prudence?

- **Fiscal deficit** - Fiscal deficit target is at ***5.9%*** for 2024 and aims to reduce it to ***4.5% by 2026***.
- This is still higher than the *3% target* specified in the *FRBM Act, 2013*.
- **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%.***
- This indicates high level of public debt and low revenues.
- **Cost of debt servicing**- India spends about ***5.5% of its GDP*** on servicing public debt which is more than the combined spending on health and education.
- **Investment**- Most of the debt is financed by *household savings* which curtails private investment.
- **Expenditure profile**- Majority of the government spending is on *interest payments, subsidies and pensions* which leaves little room for fiscal policy flexibility.
- The government has increased its capital expenditure from ***12% to 22%*** of the total expenditure which is considered to be productive and growth-enhancing spending.
- **Revenue**- Tax collection especially GST has been increasing over the years, still *tax*

buoyancy is low.

India's subsidies as a % of GDP were 1.4% in 2020, which was higher than the global average of 0.9%

What lies ahead?

- **Tax reforms**- Utilise technologies like *Artificial Intelligence- Machine Learning* to widen the tax base and ensure compliance.
- **Rationalise GST slabs**- This can be done to simplify the tax system and reduce tax exemptions and rates to improve the tax efficiency.
- **Revisit expenditure composition**- As per *Economic Survey 2020-21*, the quality of expenditure can be improved by rationalising subsidies, increasing capital expenditure, and adopting outcome-based budgeting.
- **Sectoral reforms-** The government has to initiate sectoral reforms, especially in the power and informal sectors, to improve the efficiency and performance of these sectors.
- **Formalisation-** As per World Bank, the informal sector reforms include enhancing access to finance, social protection and digital platforms.

Reference

Business Line- Fiscal prudence a performance check