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FRBM - Part III

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Are the proposed targets reasonable?

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- **Combined Debt Target -** The combined debt of the Centre and the states is targeted to go down from 68% in 2016-17 to 60% by 2022-23.
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- The 60% debt target is an improvement from 68% in 2016-17, but it is still much above the average of about 40% for similarly rated emerging market countries.
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- However, since our growth rate is also much higher, a 60% debt ratio may be accepted as a reasonable target.
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- **Fiscal Deficit -** The committee had recommended a fiscal deficit trajectory which is a step function, with the deficit of coming down from 3.5% in 2016-17 to 3% in 2017-18 and staying at that level for the next two years, and then declining steadily to 2.5% by 2022-23, yielding a debt ratio of 38.7%.
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- The chief economic adviser in his dissent note had favoured a more gradual decline which would take the fiscal deficit down to 2% in 2022-23 and reduce the debt ratio more sharply to 35.7%.
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- **Flexibility -** Fiscal rules that signal that fiscal targets will be modified in the light of actual growth performance will add to credibility.
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- The new Act should explicitly allow adjustment of the medium-term fiscal deficit targets once every two years, to reflect revisions in the expected medium-term growth rate.
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- **Escape Clause -** The committee has therefore recommended an “escape clause” which would enable departure from the fiscal deficit target in specific circumstances like\n

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1. Overriding considerations of national security, acts of war, calamities of national proportions, etc.,
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2. Far-reaching structural reforms, with unanticipated fiscal implications, and
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3. A decline in output growth of at least 3% points below the average of the last four quarters.
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- The proposal clearly improves over past practice because the escape will be possible only on the recommendation of the Fiscal Council. However, a shortfall of 3% points is too large.
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- The extent of the departure from the fiscal target should be appropriately calibrated.
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- **Fiscal Council -** The Fiscal Council could be tasked with recommending it *suo motu*.
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- The council would be responsible for preparing the usual macroeconomic sustainability documents that are presented with the budget, based on transparent guidelines that would avoid the non-transparency that arose in the past.
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- Many countries have established such councils and our doing so will add to the credibility of the new system.
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- **Fiscal targets for the states -** The committee has not spelt out any state-specific fiscal deficit trajectory.
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- The difficult issue here is whether fiscal deficit targets for individual states will be set equal to the average for all states, as has been the case thus far, or whether each state will have its own target.
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- A state-specific target is more rational, and creates incentives for good behaviour.
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- But it does mean that states with relatively high debt/GDP ratios, and those that have lower growth prospects, will have to accept sharper reductions in their fiscal deficit.
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- This will be a politically sensitive issue and the Finance Commission, being a constitutional body, is best equipped to handle it.
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