- What is the full form of FRBM?

The full form of FRBM is Fiscal Responsibility and Budget Management.

- Why was the FRBM Act enacted? (red marked/lines/paragraphs may be avoided)

The FRBM Act is a law enacted by the Government of India in 2003 to ensure fiscal discipline – by setting targets including reduction of fiscal deficits and elimination of revenue deficit. It is considered as one of the major legal steps taken in the direction of fiscal consolidation in India.

In India, the borrowing levels were very high in the 1990s and 2000s. Indian Economy was weak as it had high Fiscal Deficit, high Revenue Deficit, and high Debt-to-GDP ratio. By 2003, the continuous government borrowing and the resultant debt had severely impacted the health of the Indian economy. Much of the borrowing was utilized for interest payments of previous borrowings, but not for productive-purposes. This resulted in interest payments becoming the largest expenditure item of the government.

Many economists then warned the government that this condition is not sustainable. They advised legal steps to prevent India from falling into a debt-trap. Hence in 2000, a bill was introduced in Parliament to bring responsibility and discipline in matters of expenditure and debt. This bill was passed by the Indian Parliament in 2003 and came to be known as the Fiscal Responsibility and Budget Management Act.

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003

The Fiscal Responsibility and Budget Management Bill (FRBM Bill) was introduced in India by the then Finance Minister of India, Mr.Yashwant Sinha in December 2000. The provisions provided in the initial versions of the bill were too drastic. After much discussions, a watered-down version of the bill was passed in 2003 to become the FRBM Act. The FRBM Rules came into force from July 5, 2004.

What is the FRBM Act all about?

FRBM Act is all about maintaining a balance between Government revenue and government expenditure. The intention of the Fiscal Responsibility and Budget Management Act was to bring –

- fiscal discipline.
- efficient management of expenditure, revenue and debt.
- macroeconomic stability.
- better coordination between fiscal and monetary policy.
- transparency in the fiscal operation of the Government.
- achieving a balanced budget.

Objectives of the FRBM Act

1. to introduce transparent fiscal management systems in the country.
2. to introduce a more equitable and manageable distribution of the country's debts over the years.
3. to aim for fiscal stability for India in the long run

Additionally, the act was expected to give the necessary flexibility to Reserve Bank of India (RBI) for managing inflation in India.

Provisions of the Fiscal Responsibility and Budget Management Act

The FRBM rules mandate four fiscal indicators to be projected in the medium-term fiscal policy statement. These are:

1. revenue deficit as a percentage of GDP
2. fiscal deficit as a percentage of GDP.
3. tax revenue as a percentage of GDP.
4. total outstanding liabilities as a percentage of GDP.

Initial FRBM Targets (to be met by 2008-09)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2009. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2009. The minimum annual reduction target was 0.3% of GDP.
3. Contingent Liabilities – The Central Government shall not give incremental guarantees aggregating an amount exceeding 0.5 per cent of GDP in any financial year beginning 2004-05.
4. Additional Liabilities – Additional liabilities (including external debt at current exchange rate) should be reduced to 9% of the GDP by 2004-05. The minimum annual reduction target in each subsequent year to be 1% of GDP.
5. RBI purchase of government bonds – to cease from 1 April 2006. This indicates the government not to borrow directly from the RBI.

Did the government meet the FRBM targets by March 2009?

No. Implementing the act, the government had managed to cut the fiscal deficit to 2.7% of GDP and revenue deficit to 1.1% of GDP in 2007–08. However, the targets were not met.

The global financial crisis (2007-08) led the government to infuse resources in the economy as the fiscal stimulus in 2008. Therefore, fiscal targets had to be postponed temporarily in view of the global crisis.

Amendments in the FRBM Act

In 2012 and 2015, notable amendments were made, resulting in relaxation of target realisation year.

A new concept called Effective Revenue Deficit (E.R.D) was also introduced.

The requirement of 'Medium Term Expenditure Framework Statement' was also added via amendment in FRBMA.

FRBM Targets after Amendment to FRBM Act in 2012 (to be achieved by 2015)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2015. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2015. The minimum annual reduction target was 0.3% of GDP.

FRBM Targets after Amendment to FRBM Act in 2015 (to be achieved by 2018)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2018. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2018. The minimum annual reduction target was 0.3% of GDP.

FRBM Review Committee headed by NK Singh: Recommendations

In May 2016, the government set up a committee under NK Singh to review the FRBM Act. The committee recommended that the government should target a fiscal deficit of 3 per cent of the GDP in years up to March 31, 2020, cut it to 2.8 per cent in 2020-21 and to 2.5 per cent by 2023. The Committee suggested using debt as the primary target for fiscal policy. This ratio was 70% in 2017.

The important targets set by NK Singh committee include:

1. Debt to GDP ratio: The review committee advocated for a Debt to GDP ratio of 60% to be targeted with a 40% limit for the centre and 20% limit for the states.
2. Revenue Deficit Target – revenue deficit should be reduced to 0.8% of GDP by March 31, 2023. The minimum annual reduction target was 0.5% of GDP.
3. Fiscal Deficit Target – fiscal deficit should be reduced to 2.5% of GDP by March 31, 2023. The minimum annual reduction target was 0.3% of GDP.

Latest FRBM Targets

The latest provisions of the FRBM act requires the government to limit the fiscal deficit to 3% of the GDP by March 31, 2021, and the debt of the central government to 40% of the GDP by 2024-25, among others.

The Act provides room for deviation from the annual fiscal deficit target under certain conditions.

Escape Clause in the FRBM Act

Escape clause refers to the situation under which the central government can flexibly follow fiscal deficit target during special circumstances. This terminology was innovated by the NK Singh Committee on FRBM.

In 2018, the FRBM Act was further amended. Specific details were updated in sub-section (2) of Section 4. The clause allows the govt. to relax the fiscal deficit target for up to 50 basis points or 0.5 per cent. Under FRBM, if the escape clause is triggered to allow for a breach of fiscal deficit target, the RBI is then allowed to participate directly in the primary auction of government bonds, thus formalising deficit financing.

The Act exempts the government from following the FRBM guidelines in case of war or calamity. In 2020, Finance Minister, Nirmala Sitharaman used the escape clause provided under the FRBM Act to allow the relaxation of the target. Finance Minister revised the fiscal deficit for FY20 to 3.8 per cent and pegged the target for FY21 to 3.5 per cent.

What is the current status of Fiscal Deficit and Revenue Deficit?

		Revised Estimates 2019-2020	Budget Estimates 2020-2021	(Projections)	
				2021-2022	2022-2023
1.	Fiscal Deficit	3.8	3.5	3.3	3.1
2.	Revenue Deficit	2.4	2.7	2.3	1.9
3.	Primary Deficit	0.7	0.4	0.2	0.0
4.	Gross Tax Revenue	10.6	10.8	10.7	10.7
5.	Non-tax Revenue	1.7	1.7	1.5	1.5
6.	Central Government debt	50.3	50.1	48.0	45.5
7.	Of which				
	Liabilities on account of EBR[1]	0.7	0.8	0.9	0.9

- Fiscal Deficit (FD)- The Fiscal deficit as per the Indian Budget 2020-21 was estimated 3.5 % of GDP.
- Revenue Deficit (RD)- The Revenue Deficit as per the Indian Budget 2020-21 was estimated 2.7 % of GDP.
- Effective Revenue Deficit (ERD)- The effective revenue deficit as per the Indian Budget 2020-21 was estimated 1.8 % of GDP.
- Tax to GDP ratio: 10.8
- Debt to GDP ratio (Central Government): 50.1

What if there is no Fiscal Discipline? (Conclusion)

If there is no fiscal discipline, the government (executive) may spend as it wishes. A country is just like a house; if the expenditure is too much and if there is no revenue to balance the high expenditure, the country will eventually fall into a debt trap, which may finally result in its collapse.

As seen in the above analysis, different governments have failed to achieve the FRBM targets set to be achieved in 2008 even by 2020.

The FRBM Act seeks to achieve long-term macroeconomic stability, while generating budget surpluses, prudential debt management, limiting borrowings to cut down deficits and debt, greater transparency, removal of fiscal impediments and providing a medium-term framework for budgetary implementation.

Though the Act aims to achieve deficit reductions prima facie, an important objective is to achieve inter-generational equity in fiscal management. This is because when there are high borrowings today, it should be repaid by the future generation. But the benefit from high expenditure and debt today goes to the present generation.

Achieving FRBM targets thus ensures inter-generation equity by reducing the debt burden of the future generation.