UPSC Prelims

Economy Crisp Notes by Ayussh Sanghi

Govrnment Budgeting

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What is Government Budgeting

In essence, government budgeting is a meticulous process encompassing:

- **Estimating Revenue**: This involves calculating the income the government expects to receive during the upcoming fiscal year, primarily through taxes and non-tax sources.

- **Deciding on Expenditures:** This entails determining how much the government will spend on various services and projects throughout the year.

Budget Process in India

Annual Financial Statement: The Constitution refers to the budget document as the "Annual Financial Statement" (***Article 112***).

The Indian government budgeting process unfolds in four distinct stages:

1. **Budget Formulation**: meticulous preparation of expenditure and receipt estimates for the ensuing fiscal year.

2. **Budget Enactment**: approval from the legislature through the enactment of the Finance Bill and Appropriation Bill.

3. **Budget Execution**: This stage focuses on enforcing the provisions outlined in the Finance Act and Appropriation Act by the government. It encompasses collecting receipts and making disbursements for various services as approved by the legislature.

4. **Legislative Review:** This final stage involves audits of the government's financial operations conducted on behalf of the legislature.

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Budget Enactment Procedure

1. President's Recommendation: The President recommends the introduction and consideration of the budget in the Lok Sabha.

2. Presentation of the Budget: The Union Finance Minister presents the Union Budget in the Lok Sabha, accompanied by a comprehensive speech outlining the key points and rationale behind the proposals. The budget is then laid before the Rajya Sabha.

3. General Discussion on the Budget: Following the presentation, both houses of Parliament engage in a general discussion on the budget as a whole or specific policy issues.

4. Scrutiny by Departmental Committees: After the general discussion, the Houses adjourn to allow departmental standing committees to thoroughly scrutinize the budget demands. These committees then submit their reports to Parliament.

5. Voting on Demands for Grants: Based on the reports from departmental standing committees, the Lok Sabha debates and votes on the demands for grants. Once approved, these demands become grants. The Rajya Sabha can discuss the budget but lacks the power to vote on the demands for grants.

- **Cut Motions:** During the voting stage, MPs can move cut motions to reduce any demand for grant. These motions come in three forms:

➢ Policy Cut Motion: Expresses disapproval of the underlying policy.
➢ Economy Cut Motion: Aims to achieve savings in the proposed expenditure.
➢ Token Cut Motion: Aims to draw attention to a specific grievance.

6. Passing of Appropriation Bill: After approving the demands for grants, the Appropriation Bill is introduced, debated, and voted upon. Upon receiving Presidential assent, the Appropriation Bill becomes the Appropriation Act, authorizing withdrawals from the Consolidated Fund of India to meet the government's expenditure.

7. Passing of Finance Bill: The Finance Bill, containing the government's tax proposals, is introduced immediately after the presentation of the Budget. Passing this bill is essential to legalize the income side of the budget. With the passing of the Finance Bills, the budget enactment process is complete.

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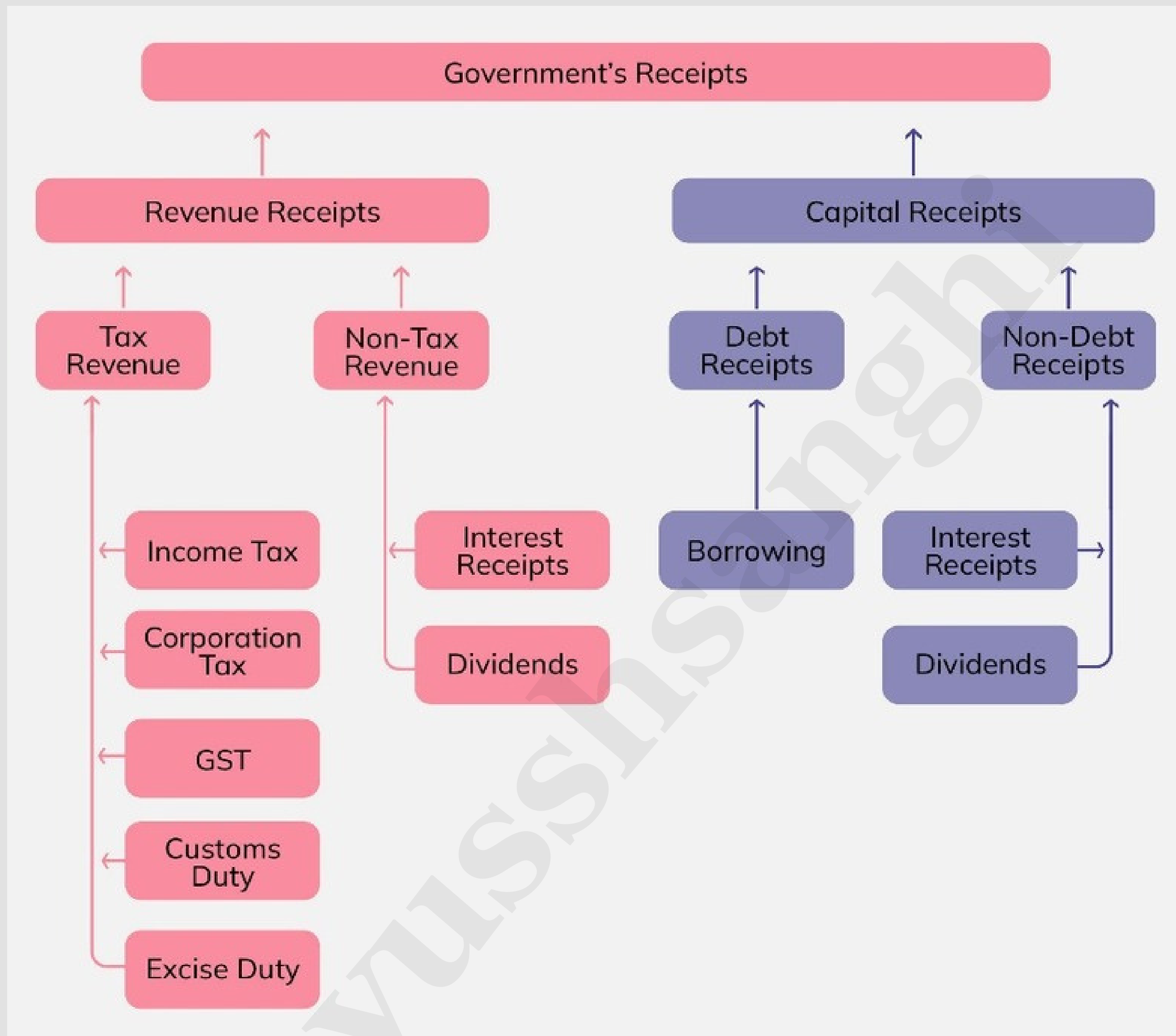
Components of a Government Budget



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1.Revenue Budget: This component details the revenue receipts and expenditures for the upcoming fiscal year. It comprises two sub-components:

2. Revenue Receipts: This includes income the government expects to receive during the fiscal year that is not to be repaid, categorized as:

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3. Tax Revenue: This consists of proceeds from taxes levied by the Central Government, including direct taxes (personal income tax and corporation tax) and indirect taxes (excise duties, customs duties, and service tax).

3. Non-Tax Revenue: This comprises earnings from sources other than taxes, such as interest receipts on loans by the Central Government, dividends and profits on investments made by the government, fees, and other receipts for services rendered.

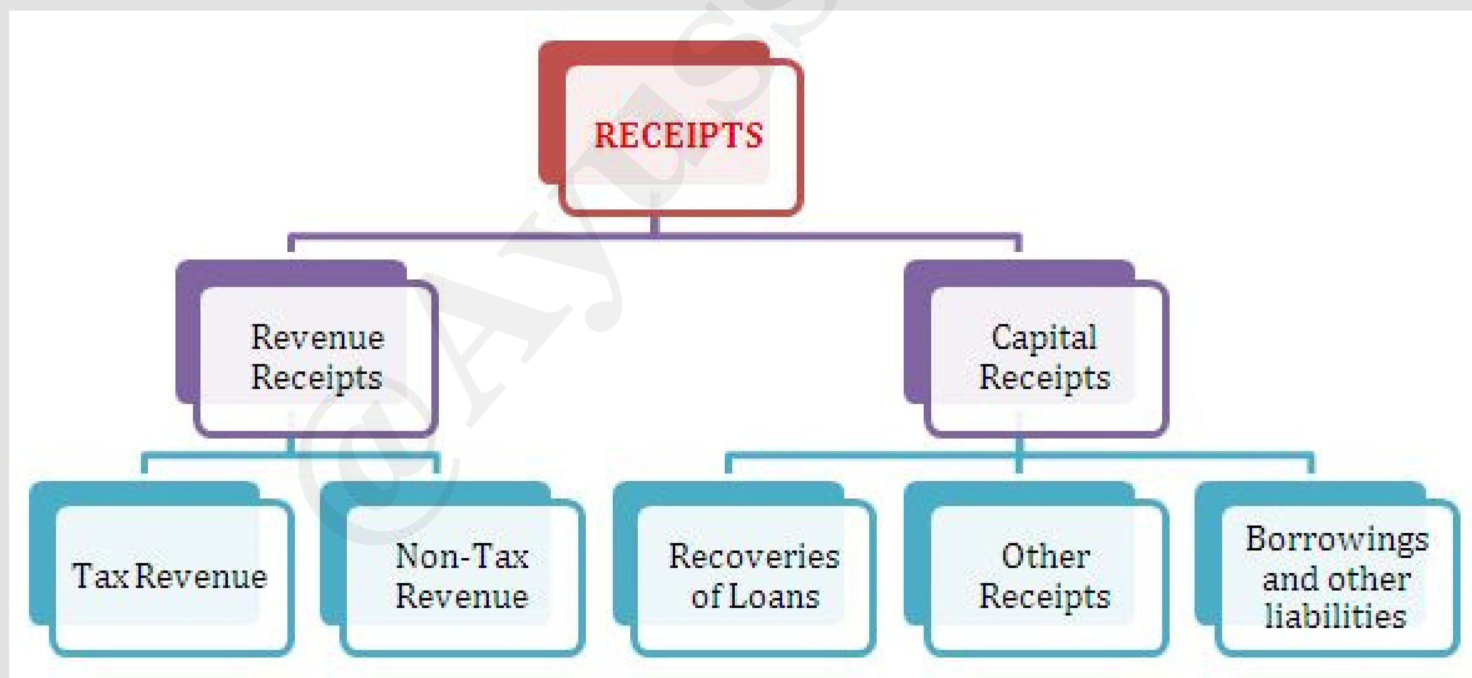
4. Revenue Expenditure: This refers to expenditure incurred for purposes other than creating physical or financial assets, and includes expenses for day-to-day functioning of government departments, salaries, pensions, subsidies, and interest payments on debt incurred by the government.

5. Capital Budget: This component reflects the government's assets and liabilities and showcases its capital requirements for creating long-term infrastructure. It further comprises two subcomponents:

➢ **Capital Receipts**: These are funds received by the governmet that are not part of the regular income sources. They can be categorized as:

➢ **Debt Creating:** These include fresh loans and other liabilities raised by the government.

➢ **Non-Debt Creating:** These include amounts received by the government from the disposal of its assets and recovery of loans



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1.Capital Expenditure: This refers to expenses incurred by the government to create longterm assets and investments that yield profits or dividends in the future. Some major components include:

➢Expenditure on developing infrastructure like roads, schools, hospitals, etc.

➢ Investments in shares of government companies and corporations.

➢ Loans and advances made by the Central government to States and Union Territories or foreign agencies

Year 2022

Q. With reference to the expenditure made by an organisation or a company, which of the following statements is/are correct?

1. Acquiring new technology is capital expenditure.
2. Debt financing is considered capital expenditure, while equity financing is considered revenue expenditure.

Select the correct answer using the code given below:

(A) 1 only (B). 2 only

(C). Both 1 and 2 (D). Neither 1 nor 2

Answer: (A)

Explanation:

● Acquiring new technology is indeed a capital expenditure (CapEx). CapEx refers to funds used to buy, upgrade, or maintain long-term assets like property, technology, equipment, or buildings. New technology qualifies because it benefits the company for multiple accounting periods.

● **Debt vs. Equity Financing:**

● **Incorrect: Debt and equity financing aren't CapEx or revenue expenditure.**

● **Explanation:**

➢Debt financing involves borrowing money (used for CapEx or other purposes).

➢Equity financing involves selling company shares (also used for various purposes)

➢Revenue Expenditure: Revenue expenditure refers to ongoing business costs like salaries, rent, and office supplies.

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Year 2016 Q.

Which of the following is/are included in the capital budget of the Government of India?

1. Expenditure on acquisition of assets like roads, buildings, machinery, etc.
2. Loans received from foreign governments
3. Loans and advances granted to the States and Union Territories Select the correct answer using the code given below.

(A) 1 only (B) 2 and 3 only
(C)1 and 3 only (D) 1, 2 and 3

Answer: (D)

Year 2014

Q. With reference to Union Budget, which of the following is/are covered under Non-Plan Expenditure?

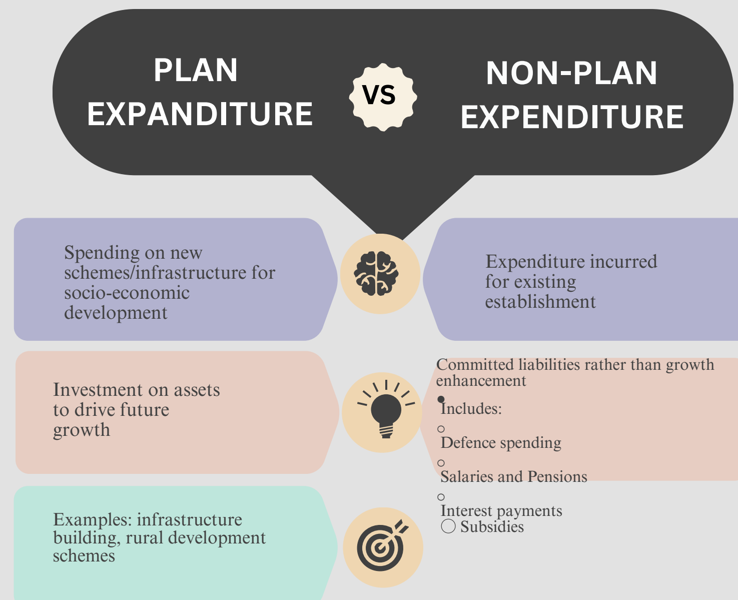
1. Defence expenditure
2. Interest payments
3. Salaries and pensions
4. Subsidies Select the correct answer using the code given below.

(A)1 only (B) 2 and 3 only
(C) 1, 2, 3 and 4 (D) None

Answer: (C)

Explanation: The Union Budget expenditure is categorized into:

1. Plan Expenditure
2. Non-Plan Expenditure



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Year 2013

Q. Which of the following constitute Capital Account?
1. Foreign Loans
2. Foreign Direct Investment
3. Private Remittances
4. Portfolio Investment
Select the correct answer using the codes given below.
(A) 1, 2 and 3 (B) 1, 2 and 4
(C) 2, 3 and 4 (D) 1, 3 and 4

Answer: (B)

Different Types of Budgets

Government budgets can be classified into three main types based on the relationship between receipts and expenditures:
1. Balanced Budget: expected or actual receipts are equal to proposed expenditures, signifying that income equals total spending. A balanced budget is recommended when the economy is close to achieving full employment.

2. Surplus Budget: when receipts exceed expenditures, indicating more money coming in than going out. A surplus budget is recommended during periods of high inflation to reduce aggregate demand.

3. Deficit Budget: when expenditures exceed receipts, meaning the government is spending more than it is earning or receiving. A deficit budget is recommended during economic depressions to increase aggregate demand.

Types of Deficits :

Budget Deficit: This refers to the gap between all receipts and expenses in both revenue and capital accounts of the government. It's not a very significant measure as it usually equals zero.
➢**Budget Deficit** = Total Expenditure - Total Receipts.
➢ **Revenue deficit** - It is excess of total revenue expenditure of the government over its total revenue receipts. A high revenue deficit often results in government borrowing to finance recurring and non-asset-creating expenditures inadequate.

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➢ **Fiscal deficit -** It is defined as excess of total budget expenditure over total budget receipts excluding borrowings during a fiscal year. This is a crucial measure indicating how much the government needs to borrow from the market to meet its expenditure when its resources are

Fiscal deficit = Total expenditure – Total receipts excluding borrowings
➢**Fiscal deficit** = total expenditure - (revenue receipts + non-debt creating capital receipts).
➢ **Revenue deficit** = Total revenue expenditure – Total revenue receipts
➢ **Primary Deficit** - It is defined as fiscal deficit of current year minus interest payments on previous borrowings.
➢ **Primary deficit** = Fiscal deficit – Interest payments
➢ **Effective Revenue Deficit (ERD):** This represents the actual revenue deficit after grants given for capital expenditure. It was introduced in the Union Budget 2012-13.
➢ **Monetized Deficit:** This refers to the part of the fiscal deficit financed by te government either by borrowing money or drawing down its cash from the RBI. It involves infusion of new money and hence expansion in money supply. Difference between budget deficit and fiscal deficit
➢ **Budget Deficit:** Shows the overall gap between spending and all income sources (including borrowing).
➢**Fiscal Deficit**: Shows the gap between spending and regular income sources (excluding borrowing)

Year 2017 Q.
Consider the following statements :
1. Tax revenue as a percent of GDP of India has steadily increased in the last decade.
2. Fiscal deficit as a percent of GDP of India ha steadily increased in the last decade.
Which of the statements given above is/are correct ?
A 1 only B 2 only
C Both 1 and 2 D Neither 1 nor 2
Answer: D.
Explanation:

Tax revenue as a percent of GDP of India:
➢While there has been an improvement in the tax-to-GDP ratio, it is important to note that the ratio has not been consistently increasing over the last decade. The ratio has fluctuated over the years, with improvements seen in recent years due to factors such as effective data-sharing between tax authorities and tightened compliance monitoring, which have contributed to robust GST collections.

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Fiscal deficit as a percent of GDP of India:

➢ The government is on a path of fiscal consolidation, intending to bring the fiscal deficit below 4.5% of GDP by 2025-26. The fiscal deficit as a percent of GDP has seen significant fluctuations over the last decade, particularly due to the impact of the COVID-19 pandemic and other economic challenges

Year 2016 Q.

There has been a persistent deficit budget year after year.
Which action/actions of the following can be taken by the Government to reduce the deficit?

1. Reducing revenue expenditure
2. Introducing new welfare schemes
3. Rationalizing subsidies
4. Reducing import duty Select the correct answer using the code given below.

(A) 1 only (B) 2 and 3 only
(C) 1 and 3 only (D) 1, 2, 3 and 4

Answer: (C)

Addressing Fiscal Deficits Effective Strategies

● **Reducing Revenue Expenditure**

➢ Focuses on cutting recurring government costs like salaries and maintenance expenses.
➢ Directly lowers overall spending and reduces the fiscal deficit.

● **Rationalizing Subsidies:**

➢ While positive (reduces wasteful spending), it might not be enough on its own.

Less Effective Approaches:

● **Introducing New Welfare Schemes:**

➢ Increases government expenditure and the deficit.

● **Reducing Import Duty:**

➢ Doesn't directly address the fiscal deficit issue.
➢ Might impact trade balance positions.

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Year 2013 Q.

In India, deficit financing is used for raising resources for
(A). economic development
(B). redemption of public debt
(C). adjusting the balance of payments
(D). reducing the foreign debt

Answer: (A)

Explanation:
Deficit Financing in India:
A Tool for Growth
● Definition: Borrowing from the RBI to finance government spending on development projects.
● Purpose: Bridge the gap between government revenue and expenditure for economic development.

Year 1999

Assertion (A): Fiscal deficit is greater than budgetary deficit.
Reason (R): Fiscal deficit is the borrowings from the Reserve Bank of India plus other liabilities of the Government to meet its expenditure.
(A). Both A and R are true, and R is the correct explanation of A
(B). Both A and R are true, but R is not a correct explanation of A
(C). A is true, but R is false
(D). A is false, but R is true

Answer: (B)

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Types of Government Budgeting

Based on the underlying philosophy and process followed, there are different approaches to government budgeting:

1. Line-Item Budgeting: This traditional method lists expenditures for the budgeted period according to objects of expenditure, called "line items." While it facilitates centralized control, it lacks information about program activities and achievements.

2. Performance Budgeting: This approach focuses on allocating funds and managing programs based on performance information. It emphasizes achieving specific goals and measuring outcomes.

3. Zero-Based Budgeting (ZBB): This concept requires all programs to be reviewed and justified annually during the budget development process, ensuring efficient resource allocation.

4. Outcome Budgeting: This method shifts the focus from spending to measurable outcomes. It involves defining desired outcomes, identifying interventions required to achieve them, and estimating the expenditure needed.

5. Gender Budgeting: This approach aims to advance gender equality and women's rights by analyzing government budgets to ensure benefits reach women and men equitably.

Type of Indian government Budgeting:

● India follows a line item budgeting system for its central government. This means the budget allocates funds to specific government departments, programs, and activities. Each line item details the authorized amount that can be spent on a particular purpose.

key characteristics of India's line item budgeting:

● **Focus on Expenditure:** The primary emphasis is on controlling government spending by setting spending limits for each department or program.

● **Detailed Allocations:** The budget specifies the exact amount allocated for salaries, supplies, equipment, and other expenses within each department.

● **Scrutiny by Parliament:** The Indian Parliament plays a crucial role in scrutinizing the budget proposals before they are approved.

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Ways and Means Advances (WMA) in India:

● **Lender and Borrower**: The Reserve Bank of India (RBI) acts as the lender, providing WMAs to
the central and state governments.

● **Purpose**: WMAs are meant to address temporary mismatches between a government's receipts
and payments. This could be due to delays in tax collections, unexpected expenses, or seasonal fluctuations in revenue.

● **Short-Term Loans:** WMAs are intended to be short-term bridges, with a repayment period typically not exceeding three months.

● **Repayment:** The government is obligated to repay the borrowed amount within the stipulated
time frame.

● **Types of WMA:** There are two main types of WMAs:

➢ Normal WMA: These are clean advances without any collateral security.
➢ Special WMA: These are secured advances provided against the pledge of government securities. Special WMAs are offered when the normal WMA limit has been exhausted.

● **Not a Funding Source:** It's important to understand that WMAs are not a permanent source of government funding. They are meant for temporary relief and should not be used to finance ongoing budgetary deficits.

Related Concepts

1. Off-Budget Financing: This refers to PSUs borrowing from the market with a government repayment guarantee.

2. Monetization of Deficit: This practice involves the central bank creating new money to finance government deficits, now discontinued in India.

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Finance Commission

● **Formation:** The President of India has the responsibility to establish a Finance Commission every five years or earlier if deemed necessary (Article 280(1)).

● **Composition:** The Commission consists of a Chairman and four other members, all appointed
by the President (Article 280(1)).

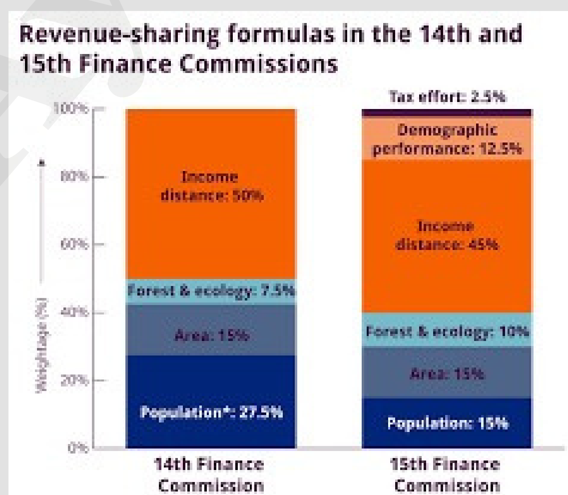
● **Parliamentary Role:** While the President appoints the Commission, Parliament holds the authority to determine the qualifications required for membership and the selection process (Article 280(2)).

Key Functions:

● Recommend fair distribution of tax revenue between central and state governments.
● Recommend principles for grants-in-aid to support finances of individual states.
15th Finance Commission
● The 15th Finance Commission was constituted by the President of India in November 2017, under the chairmanship of NK Singh. Its recommendations will cover a period of five years from
the year 2021-22 to 2025-26.

Recommendations (2021-26):

1. Devolution of Central Taxes:
● States to get 41% share of the divisible pool of central taxes (excluding certain costs).
2. Distribution among States:



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Grants-in-Aid:

● **Revenue Deficit Grants:** To bridge the gap for states facing shortfalls after receiving their 41% share.
○ Number of eligible states expected to decrease over time.

● **Local Body Grants:**
➢ Total allocation of Rs. 4,36,361 crore for five years.
➢ 60% for priorities like water and sanitation.
➢ 40% untied for local discretion.
➢ Increasing share for rural bodies (35% by 2025-26).

● **Disaster Management Grants:**
➢ Centre contributes 75%, states 25% (90:10 for North-Eastern states).
➢ Divided into State Disaster Response Fund (SDRF) and Mitigation Fund (SDMF).

4. Sector-Specific Grants:
● Performance-based incentives for improvements in: Health, School Education, Higher Education,
Agriculture etc

5. State-Specific Grants:
● Additional grants addressing specific needs beyond formula-based allocation.
● Areas include social welfare, governance, water conservation, cultural preservation, infrastructure, and tourism.

6. Additional Central Support:
● Special Assistance Grants ● Additional Central Assistance (grants & loans)
● National Disaster Response Fund (NDRF) aid

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Year 2015

Q. With reference to the Fourteenth Finance Commission, which of the following statements is/are correct?

1. It has increased the share of States in the central divisible pool from 32 percent to 42 percent.
2. It has made recommendations concerning sector-specific grants.

Select the correct answer using the code given below.

(A) 1 only (B) 2 only
(C) Both 1 and 2 (D) Neither 1 nor 2

Answer: (C)

● It has increased the share of States in the central divisible pool from 32 percent to 42 percent. This statement is correct. The 14th Finance Commission did raise the share of states in the central tax pool (central divisible pool) from 32% during previous 13th FC period, to 42%, thereby substantially increasing it.

● It has made recommendations concerning sector-specific grants. This statement is correct. Apart from raising states' share of central taxes, the 14th Finance Commission introduced features like sector-specific grants targeted for development of priority sectors like health, education etc.

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Year 2013

Q. Which of the following is/are among the noticeable features of the recommendations of the Thirteenth Finance Commission?

1. A design for the Goods and Services package linked to adherence to the proposed design.
2. A design for the creation of lakhs of jobs in the next ten years in consonance with India's demographic dividend
3. Devolution of a specific share of central taxes to local bodies as grants

Select the correct answer using the codes given below:

(A) 1 only
(B) 2 and 3 only
(C) 1 and 3 only
(D) 1, 2 and 3

Answer (C)

National Debt:

● **Definition:**
total amount of money that the government of a country owes its lenders at a particular point in time.

● **Composition:**
Includes domestic and external loans, as well as obligations to social security schemes.

● **Component of Debt:**
➢ Market borrowings (most significant): government securities like bonds and bills.
➢ Loans from banks for specific projects or short-term needs.
➢ External debt from foreign governments, institutions, and bond sales.
➢ Small savings schemes like PPF and NSC.
➢ State development loans (SDLs).
➢ Treasury bills (short-term debt).
➢ Special securities issued to the Reserve Bank of India.
➢ Other liabilities like bonds for specific purposes.

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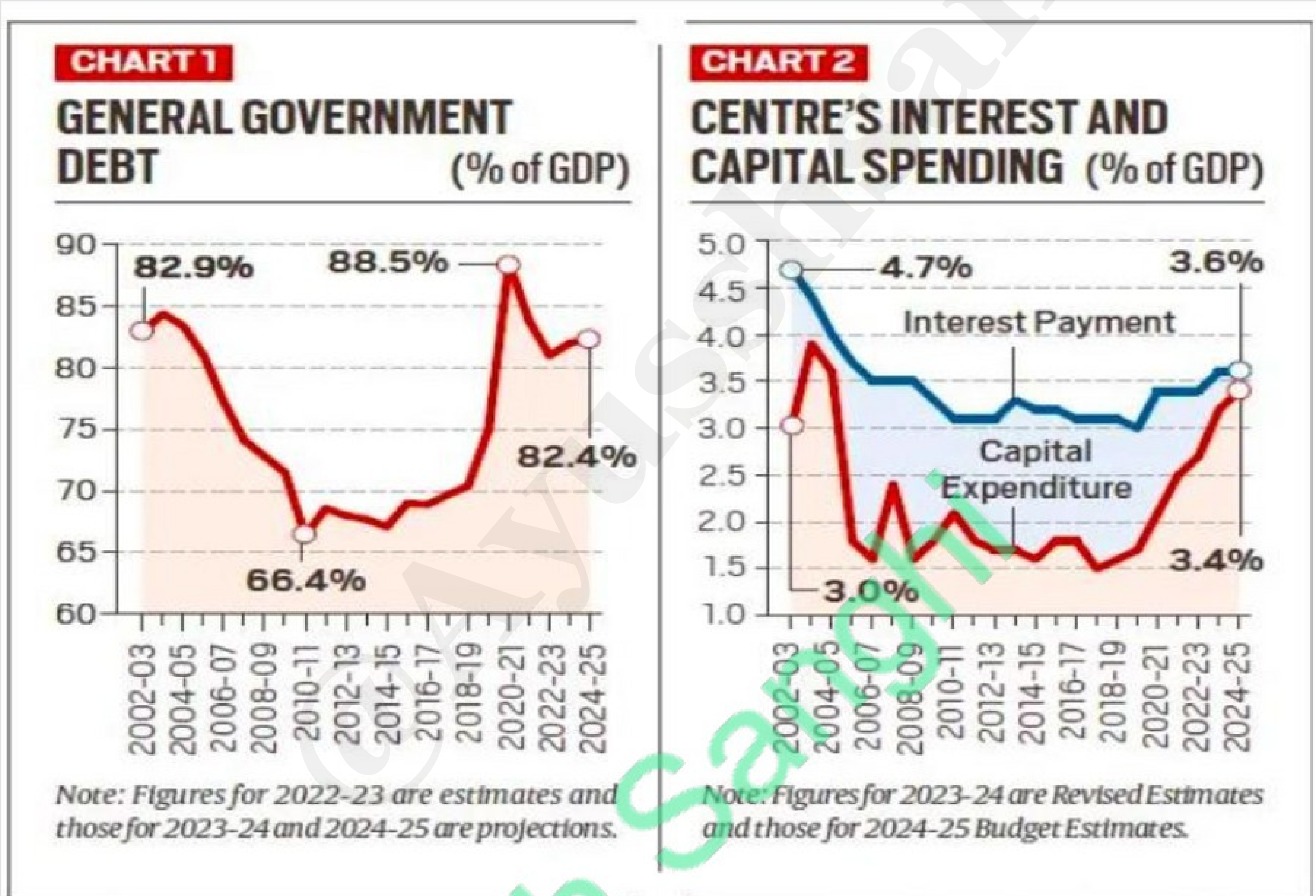
• **Financial Burden:**
Requires interest payments and principal repayment, straining government finances.

• **Fiscal Deficit:**
Higher deficits make debt repayment more difficult.

• **Debt to GDP Ratio:**
It It measures how much a nation owes in relation to its GDP

• **Debt to GDP= Total Debt of Country/Total GDP of Country Trends in National Debt: Debt-to-GDP Ratio**
➢ Fluctuated over time, reaching 84.4% in 2003-04.
➢ Increased post-2014 due to the COVID-19 pandemic, peaking at 88.5% in 2020-21.
➢ Despite slight improvements in subsequent fiscal years, remains high at 82.4% projected for 2024-25, posing challenges for fiscal management.



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State Government Borrowing and Central Consent:

● It's important to note that Article 293(3) of the Indian Constitution already addresses state borrowing:

● A state cannot raise a loan without the central government's consent if it has outstanding loans or loan guarantees from the central government.

Borrowing by household and business

● **Household Debt:**

➢ Housing loans: Mortgages taken from banks or housing finance companies.

➢ Consumer durables loans: Loans for items like vehicles, appliances, etc.

➢ Credit card debt: Outstanding balances on credit cards.

● **Business Debt:**

➢ Commercial loans: Loans taken from banks for business purposes.

➢ Trade credit: Credit extended by suppliers for goods purchased on credit.

➢ Debentures: Long-term debt instruments issued by companies to raise capital.

year 2020

Q. In the context of the Indian economy, non-financial debt includes which of the following?

1. Housing loans owed by households
2. Amounts outstanding on credit cards
3. Treasury bills

Select the correct answer using the code given below:

(A) 1 only (B) 1 and 2 only

(C) 3 only (D) 1, 2 and 3

Answer: (D)

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Year 2019

Q. Consider the following statements :

1. Most of India's external debt is owed by governmental entities.
2. All of India's external debt is denominated in US dollars.

Which of the statements given above is/are correct?

(A) 1 only (B) 2 only

(C)Both 1 and 2 (D) Neither 1 nor 2

Answer: (D)

Explanation:

● While the government is a major borrower, the majority of external debt is significantly contributed by non-government entities.

● India's external debt is not exclusively in US dollars; it is held in a mix of currencies.

● The diversification across different currencies like the US dollar, Indian rupee, Japanese yen, Special Drawing Rights (SDRs), and Euros is a strategic approach to mitigate currency exchange risks

Government Securities (G-Secs)

What are G-Secs?

● G-Secs, or Government Securities, are tradable debt instruments issued by the Indian government (central and state) to borrow money from the public. This money helps finance the government's budget deficit.

Types of G-Secs:

● Treasury Bills (T-Bills): Short-term (less than one year) securities with maturities of 91 days, 182 days, and 364 days. They are zero-coupon, meaning they don't pay regular interest but are issued at a discount and redeemed at face value at maturity.

Cash Management Bills (CMBs):

Very short-term instruments (less than 91 days) used to manage temporary cash flow mismatches of the government.

● Dated G-Secs:

Long-term (1 to 40 years) securities with fixed or floating interest rates (coupons) paid half-yearly.

● State Development Loans (SDLs):

Long-term securities issued by state governments to raise funds

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Benefits of G-Secs:
● **Very Low Risk:** Backed by the government, G-Secs are considered risk-free investments (giltedged instruments).
● **Competitive Returns:** Offer competitive returns compared to other low-risk investment options.
● **High Liquidity:** T-Bills can be easily traded in the secondary market, offering liquidity.

How to Invest in G-Secs:
● **Retail Direct Gilt (RDG) Account:**
Retail investors can open an RDG account with the RBI to directly purchase T-Bills.

● **Authorized Channels:**
Bids can also be placed via authorized banks and agents for T-Bills and dated G-Secs.
● **Secondary Market:**
Investors can participate in the secondary market through demat accounts to buy and sell G-Secs before maturity.

Who Manages G-Secs?

● The Reserve Bank of India (RBI) conducts auctions for issuing G-Secs and manages Open Market Operations (OMOs) to regulate money supply by buying or selling G-Secs.
Indian Treasury Bills
● Indian Treasury Bills (T-Bills) are short-term debt instruments issued by the Government of India to meet its short-term funding needs.

Here's a breakdown of their key characteristics:
● **Issuer**: Exclusively issued by the Government of India.
● **Purpose:** To manage short-term cash flow requirements of the government.
● **Maturity Periods**: Available in three tenors: 91 days, 182 days, 364 days
Investment Features:
● **Zero-Coupon:** T-Bills are zero-coupon securities, meaning they don't pay regular interest.
● **Discounted Purchase:** Issued at a discount to their face value. Investors effectively earn a return
by the difference between the purchase price and the redemption value at maturity.
● **Risk-Free Investment:** Considered a risk-free investment as they are backed by the Government of India. Investor- Individuals, Banks, Financial institution, companies

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Benefits of Investing in T-Bills:

• High Liquidity:
Highly liquid and can be easily traded in the secondary market.

• Safety:
Backed by the government, offering low credit risk.

• Returns:
Provide competitive returns compared to other short-term investment options like savings accounts.

How to Invest in T-Bills?
- T-Bills are primarily auctioned through the Reserve Bank of India (RBI).
- Investors can participate in these auctions directly or through authorized agents.

Year 2018
Q. Consider the following statements :
1. The Reserve Bank of India manages and services Government of India Securities but not any State Government Securities.
2. Treasury bills are issued by the Government of India and there are no treasury bills issued by the State Governments.
3. Treasury bills offer are issued at a discount from the par value.

Which of the statements given above is/are correct ?
(A) 1 and 2 only (B) 3 only
(C) 2 and 3 only (D) 1, 2 and 3

Answer is C.
statement 1 is incorrect.
- The RBI indeed manages and services both Central and State Government securities.
- The RBI, as an agent of the Government, manages and services these securities through its public debt offices located in various places.
- Additionally, it's specified that the RBI undertakes receipts and payments for the Central Government and manages the public debt of the Union, including transactions for State Governments under agreements with them.
- This includes issuing both treasury bills and bonds or dated securities on behalf of the Central Government while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs).

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Statement 2 is correct.

● Treasury bills, as short-term debt instruments, are issued exclusively by the Government of India. They are utilized to meet short-term liquidity needs of the government and are not issued by State Governments.

● Treasury bills are issued in three tenors: 91 days, 182 days, and 364 days, and they are zero coupon securities, meaning they pay no interest but are issued at a discount and redeemed at face value at maturity.

Statement 3 is correct.

● Treasury bills are indeed issued at a discount to their face value and are redeemed at the face value upon maturity. The difference between the issue price and the face value represents the earnings for the investors. This method of issuing at a discount effectively makes treasury bills a zero-coupon security.

FRBM Act:

A Guide to India's Fiscal Responsibility and Budget Management.

What is FRBM?

● FRBM stands for Fiscal Responsibility and Budget Management.

● Fiscal Responsibility and Budget Management (FRBM) Act 2003 implemented in India to bring discipline and transparency to government spending.

Why was FRBM introduced?

● High borrowing levels in the 1990s and 2000s led to a weak Indian economy with high fiscal and revenue deficits, and a rising debt-to-GDP ratio.

● Excessive borrowing for interest payments instead of productive purposes strained the economy. What are the objectives of FRBM?

● Promote fiscal discipline and efficient management of expenditure, revenue, and debt.

● Achieve macroeconomic stabilit and better coordination between fiscal and monetary policies.

● Increase transparency in government budgeting and work towards a balanced budget.

● Ensure a more equitable distribution of debt burden across generations.

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Key Features of FRBM:
● **Fiscal Indicators:**

The act mandates tracking four key fiscal indicators:
➢ Revenue deficit (% of GDP)
➢ Fiscal deficit (% of GDP)
➢ Tax revenue (% of GDP)
➢ Total outstanding liabilities (% of GDP)

● **Target Setting:**
FRBM initially set annual targets for reducing fiscal and revenue deficits. These targets were later revised.
● Establishes a Fiscal Responsibility and Budget Management (FRBM) Committee to monitor progress and recommend policies.
● Mandated Budget Documents.

● **Medium-Term Fiscal Policy Statement (MTFPS):**
➢ Projects three-year rolling targets for fiscal indicators like fiscal deficit and revenue deficit.

● **Fiscal Policy Strategy Statement (FPSS):**
Explains the government's strategic fiscal priorities for the upcoming year.
Justifies any major deviations in fiscal measures or targets and their impact on long-term fiscal health.

● **Macroeconomic Framework Statement (MFS):**
Presents key macroeconomic forecasts and underlying assumptions.

● **Statement of Revenue Foregone (though not mandated by the original Act):**
Details the estimated revenue loss due to tax concessions and incentives offered by the government.

● **Effective Revenue Deficit Statement (introduced by FRBM Act Amendment, 2012):**
Effective Revenue Deficit = revenue deficit - revenue expenditures used for creating capital assets.

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Table 1.1: Details of FRBM amendments made

(As percentage of GDP)

	Fiscal Indicators	Target detail	Principal Act/ Rules	1st Amendment (in 2004)	2nd Amendment (in 2012)	3rd Amendment (in 2015)	4th Amendment (in 2018)
1.	Revenue Deficit	Target	Zero	Zero	2	2	Target for RD has been removed.
		Annual reduction	0.5	0.5	0.6	0.4	
		Beginning with FY	2004-05	2004-05	2013-14	2015-16	
		Sunset Target date	31.03.08	31.03.09	31.03.15	31.03.18	
2.	Fiscal Deficit	Target	3	3	3	3	**3**
		Annual reduction	0.3	0.3	0.5	0.4	**0.1**
		Beginning with FY	2004-05	2004-05	2013-14	2015-16	**2018-19**
		Sunset Target date	31.03.08	31.03.09	31.03.17	31.03.18	**31.03.21**
3.	Effective Revenue Deficit	Target	Introduced in 2012		Zero	Zero	Target for ERD has been removed.
		Annual reduction			0.8	0.5	
		Beginning with FY			2013-14	2015-16	
		Sunset Target date			31.03.15	31.03.18	
4.	Guarantee	Aggregate guarantees in any FY not to exceed 0.5 *per cent* of GDP, beginning with FY 2004-05					No additional guarantee for any loan on security of CFI, in excess of 0.5 *per cent* of GDP, in any financial year
5.	Liability/ Debt	Not to assume additional liabilities (including external debt at current exchange rate) in excess of 9 *per cent* of GDP for the financial year 2004-05 and progressively reduce the limit of 9 *per cent* of GDP by at least one *percentage* point of GDP in each subsequent financial year.					General Govt debt and Central Govt debt not to exceed 60 and 40 *per cent* of GDP respectively by the end of the FY 2024-25.

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FRBM Act's Escape Clause: Key Points

● Purpose: Allows the government to deviate from fiscal deficit targets under special circumstances.

● Introduction:

Introduced by the NK Singh Committee on FRBM.

● Trigger:

Can be invoked during exceptional situations, excluding war or calamity (already exempt from FRBM).

● Process:

Requires consultation and advice from the Fiscal Council.

Government must commit to returning to the original target in the next fiscal year.

Activation Examples:

2017:
Government deferred 3% target to 3.2%, citing NK Singh recommendations (later questioned by CAG).

➢ **2020:**
Finance Minister relaxed target due to economic reasons.

● **Additional Impact:**
➢ If escape clause is used, RBI can participate directly in government bond auctions (formalizing deficit financing).

Recommendations of FRBM committee headed by N K Singh*
● Repeal the existing FRBM Act, 2003 and the FRBM Rules, 2004.
● Enact a new Debt and Fiscal Responsibility Act and enact and adopt the Debt and Fiscal Responsibility Rules, as per drafts suggested by the Committee.
● Adopt a prudent medium-term ceiling for general government debt of 60% of GDP (40% for the Centre, and 20% for the States) to be achieved by no later than FY23.
● An independent Fiscal Council may be constituted.

● **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.

● **Fiscal Deficit Target – F**iscal deficit should be reduced to 2.5% of GDP by March 31, 2023. The minimum annual reduction target was 0.3% of GDP.

Current Status:
● The latest FRBM targets aim for a 3% fiscal deficit by 2024-25 and a 40% central government debt-to-GDP ratio.
● Despite revisions, meeting FRBM targets has proven challenging due to various factors.

Conclusion:
The FRBM Act strives for long-term economic stability by promoting responsible fiscal management and reducing the burden of debt on future generations.

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Year 2018

Q. Consider the following statements :

1. The Fiscal Responsibility and Budget Management (FRBM) Review Committee Report has recommended a debt to GDP ratio of 60% for the general (combined) government by 2023, comprising 40% for the Central Government and 20% for the State Governments.
2. The Central Government has domestic liabilities of 21% of GDP as compared to that of 49% of
GDP of the State Governments.
3. As per the Constitution of India, it is mandatory for a State to take the Central Government's consent for raising any loan if the former owes any outstanding liabilities to the latter

Which of the statements given above is/are correct ?
(A). 1 only (B). 2 and 3 only
(C). 1 and 3 only (D). 1,2 and 3

Answer: (C)

Year 2006

Q. Which one of the following statements is correct?
Fiscal Responsibility and Budget Management Act (FRBMA) concerns
(A). Fiscal deficit only
(B). Revenue deficit only
(C). Both fiscal and revenue deficit
(D). Neither fiscal nor revenue deficit

Answer: (C)

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