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Distance Learning Programme

UPPCS Mains

Indian Economy – I

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INDIAN ECONOMY - I

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The Act

- The government has to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 2008-09 and thereafter, sizable revenue surplus has to be created.
- Setting annual targets for reduction of fiscal deficit and revenue deficit, contingent liabilities and total liabilities.
- The government shall end its borrowing from the RBI except for temporary advances.
- The RBI not to subscribe to the primary issues of the central government securities from 2006-07.
- The revenue deficit and fiscal deficit may exceed the targets specified in the rules only on grounds of national security, calamity etc.

Though the Act aims to achieve deficit reductions *prima facie,* an important objective is to achieve *inter-generational equity in fiscal management*. Other objectives include: long run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in fiscal operation of the Government.

In pursuance of the act, the FRBM rules were framed which set a target reduction of fiscal deficit to 3% of the GDP by 2008-09. This will be realized with an annual reduction target of 0.3% of GDP per year by the Central government. Similarly, revenue deficit has to be reduced by 0.5% of the GDP per year with complete elimination by 2008-09. Later, the target dates were reset and budget 2016-17 aims to realize the 3% fiscal deficit target by March 2018.

The Act gives slight flexibility to the government regarding the realization of the target as well. It gives the responsibility to the government to adhere to these targets. The Finance Minister has to explain the reasons and suggest corrective actions to be taken, in case of breach.

Implementation of FRBM

The implementation of the FRBM Act improved the fiscal performance of both centre and states. The States have achieved the targets much ahead the prescribed timeline.

Government of India was on the path of achieving this objective right in time. However, due to the global financial crisis, this was suspended and the fiscal consolidation as mandated in the FRBM Act was put on hold in 2007-08.The crisis period called for an increase in expenditure by the government to boost demand in the economy. As a result of fiscal stimulus, the government has moved away from the path of fiscal consolidation. However, it should be noted that strict adherence to the path of fiscal consolidation during the pre crisis period created enough fiscal space for pursuing counter cyclical fiscal policy.

Amendments to the FRBM Act

Amendments to the Act were made after its initial version in 2003. This includes revision of the target realization year and introduction of the concept of effective revenue deficit. In 2012 and 2015, notable amendments were made. As per one provision of the amendment, a “Medium-term Expenditure Framework” statement should be prepared which will set a *three-year rolling target* for expenditure indicators.

As per the amendments in 2012, the Central Government has to take appropriate measures to reduce the fiscal deficit, revenue deficit and effective revenue deficit to eliminate the effective revenue deficit by the 31st March, 2015 and thereafter build up adequate effective revenue surplus and after that as prescribed by the rules made by the Central Government.

As per the Finance Act 2015, the target dates for achieving the prescribed rates of effective deficit and fiscal deficit (3% fiscal deficit) were further extended by 3 years to March 2018.

As per the 2017-18 budget, the government has extended the timeline for the achievement of the 3% target to 2018-19.

FRBM – A New Framework Proposed by Government

In tune with the requirement of the changing times and the need to re-focus on the issue of fiscal prudence along parameters that are acceptable internationally, the government has decided to amend the existing FRBM act in a suitable manner. In the new framework the following key changes are being instituted:

- To target simultaneously on fiscal deficit and debt.
- To target fiscal deficit as an operational target and to ensure that the fiscal deficit of 3% of GDP is reached by the Government by FY 2020-21.
- The Central Government shall endeavour to follow a declining debt trajectory and the
- Central Government shall reach a debt target of 40 % of GDP as also to keep the general government debt at 60 % of GDP by FY 2024-25.
- Inserting adequately defined escape and buoyancy clauses to determine when the targets defined by the FRBM Act may be relaxed or tightened as the case maybe.

Analysis of the New FRBM Framework

In the new proposed framework, as mentioned earlier, the Revenue Deficit targets shall not enjoy the pre-eminence as it did earlier. This is to remove the anomaly created by a preference for capital expenditure that was inherent in the framework where the revenue deficit was following a declining trend. However, apart from the creation of assets, there is also a need to focus on the maintenance of the assets that have been created. Moreover, in a federal country like India, all the capital-related transfers that the Government passes on to State Government agencies who implement certain schemes are categorised as revenue expenditure. Moreover, education and health as part of human capital, the expenditures on these items are as crucial as the ones on physical capital. For example, the presence of well-trained and adequately paid teachers and doctors are as important as well established infrastructure.

But there are also problems with recommendations like:

- One major uncertainty is on the front of State Governments. The redemption of UDAY Bonds is on the horizon and these may apply an upward pressure on the state's fiscal calculations. In the era of the amended FRBM Act, where there is a cap on General Government Debt at 60 % of GDP, the implications of these on the fiscal position of the states will be detrimental.
- This framework still talks about a fixed value for fiscal deficit, which is very unrealistic. It also does not explain how this figure of fiscal deficit has been arrived at. Instead, it should have suggested a range of fiscal deficit.
- Focus on fiscal deficit may lead to less investment on creating new assets.

Committee to Review FRBM Targets

As per the Union Budget 2016-17, the government constituted a Committee under Shri N.K. Singh to review the implementation of the FRBM Act. This was after a widely held view among experts that instead of fixed fiscal deficit targets, it may be better to have a fiscal deficit range as the target. This will help the government to meet specific situations like recessions which demand high government expenditure. There is also a suggestion that fiscal expansion or contraction should be aligned with credit contraction or expansion respectively, in the economy. While remaining committed to fiscal prudence and consolidation, Budget stated that a review of the FRBM Act is necessary in the context of uncertainty and volatility in the global economy.

The recommendations of the committee are as follows:

- A total debt to GDP ratio of 60% should be achieved by 2023 with centre, making 40% and state rest 20% of the total debt to GDP ratio.
- Fiscal deficit of 2.5 % should be achieved by 2025.
- Fiscal Council should be constituted with following functions:
  - It will prepare a multi-year fiscal forecast.
  - It will improve collection of better quality fiscal data.
  - It will advise government if there is a need of deviation for FRBM Act.
  - It will help government to take corrective measures for non-compliance to the bill.
- Reasons for deviations must be explicitly described. Right now, the government can deviate from target in case of a national calamity, national security or other exceptional circumstances as notified by it.
- It recommends that 15th Finance Commission should be asked to recommend debt trajectory for states.

Recommendations have been criticized for various reasons like debt to GDP ratio target is arbitrary. The report does not give reason for adopting 2.5 % fiscal deficit as acceptable. Many scholars consider that India should target a range of fiscal deficit rather than a value.

Key Recommendations of 14th Finance Commission

- **Sharing of Union Taxes:** Increase tax devolution from the Centre to states up to 42 % from the central divisible pool (Vertical Transfer).
- **Criteria for Transfers Between States (Horizontal Transfers):** The commission did not recommend for sector specific grants (except few like Local Body Grant) and did not take into account Plan and Non Plan categories of fund transfer.
- **Revenue Deficit Grant:** The commission recommended revenue deficit grant for eleven States (Andhra Pradesh, Himachal Pradesh, J&K, Manipur, Mizoram, Nagaland, Tripura, Assam, Kerala, Meghalaya and W. Bengal) to offset fiscal challenges arising from low revenue raising capacity and higher costs of providing public services.
- **Grants to Local Bodies:** The grants comprised two parts – a basic grant and a performance grant for duly constituted gram panchayats and municipalities.
- **Disaster Management:** It recommended the union government to provide an assured fund for the National Disaster Response Fund.
- **Setting up an Independent Council** to assess fiscal policy implications of budget proposals.
- **Replace Existing FRBM Act** with a debt ceiling and fiscal responsibility law.

- **Conclude the National Investment Fund** and maintain all disinvestment receipts in the Consolidated Fund of India.
- **Steps for States to Augment Revenues,** such as property tax reforms and issuance of municipal bonds suggested.
- The Commission stated that sharing the pattern with respect to various centrally sponsored schemes needs to be changed. It sought to provide greater fiscal responsibility to the states for the implementation of such schemes.

Limitations

- Its doing away with the plan and non-plan revenue expenditure implies that the tax-share devolution to the states now includes grants and other central assistance, etc. Such assistances earlier accounted for 7% of total central transfers to the states. Hence the 10 % point jump in the tax pool share is actually not much in the light of this corresponding reduction.
- The commission discontinued the distinction between special category and other states. This may end up reducing the grant that the special category states received under Normal Central Assistance, Special Central Assistance and Special Plan Assistance.

Contemporary Committees Related to Public Finance

The Tax Administration Reforms Commission (TARC), chaired by Dr Parthasarathi Shome, submitted its Report on May 30, 2014. The committee made the following observations:

- There exists an artificial separation between direct and indirect tax administration, and a lack of cooperation between CBDT and CBEC.
- One of the highest numbers of disputes between tax administration and taxpayers exists in India with lowest proportion of recovery of tax arrears.
- Research-based policy analysis and impact assessment studies are absent. Neither the benefits of Information and Communication Technology (ICT) systems have been reaped.

Recommendations

- **Consumer Focus**
  - Ombudsman's decision with regard to redressing taxpayer grievances should be binding on tax officers.
  - A minimum of 10% of the tax administration's budget must be spent on taxpayer services.
- **Structure and Governance**
  - Full integration of CBDT and CBEC in 10 years as a unified management structure under the Central Board of Direct and Indirect Taxes.
  - Ending the post of Revenue Secretary and its functions should be assigned to the two Boards.
  - Setting up a Governing Council to oversee the working of boards and a Tax Council to suggest policy and legislation.
- **Human Resource Development**
  - Indian Revenue Service (IRS) officers should be specialised in specific tax administration areas.
  - Central Vigilance Commission should have a member who has been an IRS officer.

- **Dispute Resolution and Management**
  - Retrospective legislation should be avoided.
  - A special drive for review and liquidation of cases presently clogging the system should be run by setting up dedicated task forces.

Moody's Upgrade Sovereign Credit Rating of India

Moody has upgraded credit rating of India from Baa3 to Baa2. It is the acknowledgement of the reforms by the current government, such as direct cash transfer, recapitalization of PSUs, goods and services tax. Credit ratings also depend on various indicators like the high fiscal and current account deficits and high inflation had negatively impacted the rating in the past.

How will India Benefit from the Upgrade?

- The direct and immediate benefit of the rating upgrade is that it will reduce the cost of borrowings for the government and therefore is positive for the macroeconomic balance.
- Rating upgrade will lead to lower credit risk premiums for corporates resulting in the reduction in interest costs for those borrowing abroad.
- Rating upgrade can reduce the cost of funds by 75 to 100 basis points (bps) for Indian corporates.
- Rating upgrade would attract more foreign capital flows into the economy thereby accelerating growth.
- The biggest positive of the rating upgrade is the perceptional change of the Indian economy as an investment destination.

Other Perspective

- A negative fallout of the rating upgrade would be the appreciation of the rupee hurting the nascent recovery in exports.
- Rating upgrade, though highly positive for the economy, will have only marginal morale-boosting impact from the market's perspective.

Concepts of Credit Rating

Sovereign Credit Ratings

Countries are issued sovereign credit ratings, which analyses the general creditworthiness of a country.

It takes into account the overall economic conditions of a country, including the volume of foreign, public and private investment, capital market transparency and foreign currency reserves.

It also assesses political conditions such as overall political stability and the level of economic stability a country will maintain during times of political transition.

Credit Rating Agencies

Credit ratings provide individual and institutional investors with information that assists them in determining whether issuers of debt obligations and fixed-income securities will be able to meet their obligations with respect to those securities.

Credit rating agencies provide investors with objective assessments of companies and countries that issue such securities.

Three Major Rating Agencies: Fitch Ratings, Moody's Investors Service, Standard and Poor's

Uttar Pradesh Budget Analysis 2018-19

Budget Highlights

- **The Gross State Domestic Product** of Uttar Pradesh for 2018-19 (at current prices) was estimated to be ₹14,88,934 This was 8% higher than the revised estimates for 2017-18.
- **Total expenditure** for 2018-19 was estimated to be ₹4,28,385 crore, a 16.3% increase over the revised estimates of 2017-18. In 2017-18, there was a decrease of ₹16,259 crore (4.2%) in the expenditure over the budget estimates.
- **Total receipts (excluding borrowings)** for 2018-19 were estimated to be ₹3,53,784 crore, an increase of 15.9% as compared to the revised estimates of 2017-18. In 2017-18, total receipts (excluding borrowings) fell short of the budgeted estimate by ₹14,369 crore.
- **Revenue surplus** for the next financial year is targeted at ₹27,099 crore, or 1.82% of the Gross State Domestic Product (GSDP). Fiscal deficit is targeted at ₹44,053 crore (2.96% of GSDP).

The allocations for energy, irrigation, and rural development were estimated to witness the highest increase in allocations over the previous year. Allocations for agriculture were expected to witness a 59% decrease.

Policy Highlights

- **Healthcare:** A 500-bed super speciality hospital, and paramedical and nursing college will be constructed at the Dr. Ram Manohar Lohia Institute of Medical Sciences, Lucknow. Further, the emergency medicine department at the Sanjay Gandhi Postgraduate Institute of Medical Sciences will be expanded, and an additional 200 beds will be added.
- **Education:** Uttar Pradesh has allocated 14.5% of its total budget on education in 2018-19. This was lower than the average expenditure allocated to education by 18 other states (using 2017-18 BE).
- **Rural Development:** Uttar Pradesh allocated 5.9% of its expenditure on rural development. This was higher than the average (5.6%) of the 18 other states.
- **Health:** Uttar Pradesh has allocated 5.5% of its total expenditure on health, which was higher than the average expenditure of 18 other states.
- **Agriculture:** The state allocated 3.5% of its total budget towards agriculture and allied activities. This was lower than the allocations of 18 other states (6.4%).
- The government envisaged to launch 'Ek Janpad, Ek Utpaad' ('One District, One Product') scheme to promote artisans at the district-level.
- The state has implemented the 'Uttar Pradesh Khanan Neeti-2017' for the mining. The policy seeks to control illegal mining and bring transparency. The government will implement an evolved mining system in the state, with assistance from the central government, for satellite tracking of mining activities.
- **Solar Energy:** The state has set a target of generating 10,700 MW of power using solar energy by 2022. The budget allocates ₹25 crore for setting up grid-connected rooftop solar power plants. Further, ₹30 crore has been allocated for the Pt. Deen Dayal Upadhyaya Solar Street Light scheme.

- ₹250 crore has been allocated for establishing a start-up fund in the state.

Economy of Uttar Pradesh

- **Economy:** The GSDP of Uttar Pradesh has grown in the range of 4% to 8% between 2012-13 and 2016-17.
- The services sector with a share of 51% in the GSDP grew by 7% in 2016-17 over the previous year. Agriculture, which contributes 25% to the GSDP grew by 6.8%. Manufacturing with a share of 24% grew by 5.1% in 2016-17.
- **Per Capita Income:** The per capita GSDP of Uttar Pradesh in 2016-17 (at current prices) was ₹58,626. This is 12% higher than 2015-16, when the per capita GSDP was ₹52, 320.

Highlights of UP Budget 2019-20

The Uttar Pradesh government has recently presented a ₹4.79 lakh crore state budget for the financial year 2019-20. The key features of the budget are:

- The annual budget presented is 12% higher than the 2018-19 budget of ₹4.28 lakh crore.
- The budget includes new schemes totalling ₹21,212.95 crore.
- New schemes include "Kanya Sumangala Yojana" to raise health and educational standard of girls, brighten their future and bring in a positive change in the thinking towards women. An amount of ₹1,200 crore has been proposed for the Yojana.
- An allocation of ₹612.6 crore has been made for maintenance of stray cattle and constructing 'gaushalas'.
- Allocations have been made for development of Ayodhya, including ₹200 crore for an airport and ₹101 crore for the development of tourist spots in the city.
- ₹207 crore has been pegged for the expansion and beautification of the road from the Ganga bank to the Vishwanath Temple in Varanasi.
- The total receipts would be ₹4,70,684.48 crore, which includes ₹3,91,734.40 crore of revenue receipts and ₹78,950.08 crore of capital receipts.
- The tax revenue is pegged at ₹2,93,039.17 crore, including ₹1,40,176 crore of the State's own tax revenue and ₹1,52,863.17 crore of the State's share in the Central taxes.
- The total State expenditure is estimated at ₹4,79,701.10 crore, which includes ₹3,63,957.04 crore of revenue expenditure and ₹1,15,744.06 crore of capital expenditure.
- A revenue saving of ₹27,777.36 crore is estimated in the year 2019-20.
- The State's fiscal deficit has been pegged at ₹46,910.62 crore, i.e., 2.97% in 2019-20.
- The State's debt liability is estimated at 29.98% of the State's GDP.
- After deducting total expenditure from the receipts of the consolidated fund, a deficit of ₹9,016.62 crore has been projected for next fiscal.