Flexibility Under the FRBM Act

Why in News

Recently, the State government of **Kerala has sought flexibility under the Fiscal Responsibility and Budget Management (FRBM) Act.**

- This is to ensure that fiscal stimulus in the wake of COVID-19 does not get deterred by FRBM considerations.

Reasons for Seeking Flexibility

- According to Kerala's current fiscal position, Kerala can borrow about ₹25,000 crore during the financial year 2020-21.
- Kerala has announced an **emergency relief package of worth Rs. 20,000 crore** to mitigate the impact on livelihoods and overall economic activity from the sweeping steps taken to battle the COVID-19 pandemic, including the latest 21-day nationwide lockdown.
- The State has proposed to borrow as much as ₹12,500 crore from the market at the start of the financial year (April -March).
- The government is concerned that the stringent **borrowing cap under the fiscal responsibility laws should not constrain its borrowing and spending ability** over the remaining 11 months.
    - During the 11 months, the government will have to take not only COVID-19 mitigation measures but would also have to meet other expenditure for routine affairs related to the running of the State's socio-economic programmes as well as the post pandemic recovery.

FRBM Act

- It was enacted in **August 2003.**
- It aims to make the Central government responsible for ensuring inter-generational equity in fiscal management and long-term macro-economic stability.

- The Act envisages the **setting of limits on the Central government's debt and deficits.**
    - It limited the fiscal deficit to 3% of the GDP.
- To ensure that the States too are financially prudent, the 12th Finance Commission's recommendations in 2004 linked debt relief to States with their enactment of similar laws.
    - The States have since enacted their own respective **Financial Responsibility Legislation**, which sets the same **3% of Gross State Domestic Product (GSDP) cap on their annual budget deficits.**
- It also mandates **greater transparency in fiscal operations** of the Central government and **the conduct of fiscal policy in a medium-term framework.**
    - The Budget of the Union government includes a **Medium Term Fiscal Policy Statement** that specifies the annual revenue and fiscal deficit goals over a three-year horizon.
- The rules for implementing the Act were notified in July 2004. The rules were amended in 2018, and most recently to the setting of **a target of 3.1% for March 2023.**
- **The NK Singh committee** (set up in 2016) recommended that the government should target a fiscal deficit of 3% of the GDP in years up to March 31, 2020 cut it to 2.8% in 2020-21 and to 2.5% by 2023.

Relaxation under the FRBM Act

- **Escape Clause:**
    - Under **Section 4(2) of the Act,** the Centre can exceed the annual fiscal deficit target citing certain grounds.
    - The grounds include
        - National security, war
        - National calamity
        - Collapse of agriculture
        - Structural reforms
        - Decline in real output growth of a quarter by at least three percentage points below the average of the previous four quarters.
- The lockdown could cause severe contraction in economic output and the COVID-19 pandemic could be considered as a national calamity.
- Also, the government has already made the use of escape clause this year.

Instances of the FRBM Norms been Relaxed in the Past

- During the **Budget 2020-21** presentation:
    - The **reductions in corporate tax** were cited as **structural reforms** that triggered **the escape clause.** This implies that this year the government has already made use of the escape clause
    - **This enabled the government to adjust the fiscal deficit target** for 2019-20 to 3.8%, from the budgeted 3.3%.
    - It was also cited that the impact of the reforms would also necessitate a reset for 2020-21: from the earlier deficit target of 3% to 3.5%.
- During the **global financial crisis in 2008-09:**
    - The Centre resorted to a focused fiscal stimulus: tax relief to boost demand and increased expenditure on public projects **to create employment and public assets,** to counter the fallout of the global slowdown.
    - This led to the fiscal deficit climbing to 6.2%, from a budgeted goal of 2.7%.
    - Simultaneously, **the deficit goals for the States too were relaxed** to 3.5% of Gross State Domestic Product(GSDP) for 2008-09 and 4% of GSDP for fiscal 2009-10.

Source: TH