

## **INDIA DOES NEED A FISCAL COUNCIL**

**Though it is not a silver bullet, it is an important institution needed to complement the rule-based fiscal policy**

The fiscal situation in India has been under severe stress even before COVID-19 and the novel coronavirus pandemic has only worsened it. The fiscal deficit of the Centre in 2019-20 as estimated by the Controller General of Accounts (CGA) was 4.6%, 0.8 percentage point higher than the revised estimate. For the current year, even without any additional fiscal stimulus, the deficit is estimated at about 7% of GDP as against 3.5% estimated in the Budget due to a sharp decline in revenues. The consolidated deficit of the Union and States could be as high as 12% of GDP and the overall debt could go up to 85%. When off Budget liabilities are considered, the situation looks even more alarming.

While the prevailing exceptional circumstance warrants loosening of purse strings, it is necessary that the government must return to a credible fiscal consolidation path once the crisis gets over.

### **Need for transparency**

Besides large deficits and debt, there are questions of comprehensiveness, transparency and accountability in the Budgets. The practice of repeated postponement of targets, timely non-settlement of bill payments and off Budget financing to show lower deficits has been common. The report of the Comptroller and Auditor General (CAG) of India in 2018 on the compliance of the Fiscal Responsibility and Budget Management (FRBM) Act for 2016-17, highlights various obfuscations done to keep the liabilities hidden.

These include special banking arrangements for covering arrears of fertilizer subsidy, issuing short-term bonds, unsecured loans and borrowing from the National Small Savings Fund (NSSF) by the Food Corporation of India towards meeting food subsidy and its arrears, financing irrigation projects from the Long Term Irrigation Fund (LTIF) created by the National Bank for Agriculture and Rural Development (NABARD), and financing of railway projects through borrowings from the Indian Railway Finance Corporation (IRFC) are just some examples. We are familiar also with the cases of the Life Insurance Corporation of India buying out the Industrial Development Bank of India and the Power Finance Corporation buying out the Rural Electrification Corporation (REC) and remitting the money to the government as disinvestment proceeds.

In order to make the Budgets comprehensive, transparent and accountable, the 13th Finance Commission recommended that a committee be appointed by the Ministry of Finance which should eventually transform itself into a Fiscal Council to "..., conduct an annual independent public review of FRBM compliance, including a review of the fiscal impact of policy decisions on the FRBM roadmap" (Paragraph 9.65). The FRBM Review Committee too made a similar recommendation underlining the need for an independent review by the Finance Ministry appointing the Council.

The problem is that a Council created by the Finance Ministry and reporting to it can hardly be expected to be independent. Therefore, the 14th Finance Commission recommended the establishment of an independent Fiscal Council which should be appointed by and reporting to Parliament by inserting a new section in the FRBM Act. Former Deputy Governor of the Reserve Bank of India, Viral Acharya, in his recent book, *Quest for Restoring Financial Stability in India*, also makes out a case for a bipartisan, independent Fiscal Council.

### **The mandate**

A Fiscal Council is an independent fiscal institution (IFI) with a mandate to promote stable and sustainable public finances. Robert Hagemann ("How Can Fiscal Councils Strengthen Fiscal Performance?". OECD Journal: Economic Studies, Vol. 1, 2011; p.76) defines a fiscal council as, "...a publicly funded entity staffed by non-elected professionals mandated to provide nonpartisan oversight of fiscal performance and/or advice and guidance — from either a positive or normative

perspective — on key aspects of fiscal policy”. These institutions assist in calibrating sustainable fiscal policy by making an objective and scientific analysis.

First, an unbiased report to Parliament helps to raise the level of debate and brings in greater transparency and accountability. Second, costing of various policies and programmes can help to promote transparency over the political cycle to discourage populist shifts in fiscal policy and improve accountability. Third, scientific estimates of the cost of programmes and assessment of forecasts could help in raising public awareness about their fiscal implications and make people understand the nature of budgetary constraint. Finally, the Council will work as a conscience keeper in monitoring rule-based policies, and in raising awareness and the level of debate within and outside Parliament.

### **Diverse role, more acceptance**

According to the International Monetary Fund (IMF), there were 36 countries with IFIs in 2014 and more have been established since. While most of the IFIs are in advanced countries, emerging economies too have also shown growing interest in them. Although their common agenda has been to function as watchdogs, there is considerable diversity in their structure and functions. The important tasks of these IFIs include: independent analysis, review and monitoring and evaluating of government’s fiscal policies and programmes; developing or reviewing macroeconomic and/or budgetary projections; costing of budget and policy proposals and programmes; and presenting policy makers with alternative policy options. Over the years, monitoring compliance with fiscal rules and costing policies and programmes have become major tasks of these councils.

The OECD (2013) has documented the important principles needed for successful fiscal councils under nine broad heads and these are: local ownership; independence and non-partisanship; mandate; resources; relationship with legislature; access to information; transparency; communication and external evaluation. These principles are important, ensure autonomy, being unbiased, transparency, and effective and accountable Councils.

How effective have these institutions been? A study by the IMF (“The Functions and Impact of Fiscal Councils”, July 2013), documents that the existence of IFIs is associated with stronger primary balances; countries with IFIs tend to have more accurate macroeconomic and budgetary forecasts; IFIs are likely to raise public awareness and raise the level of public debate on fiscal policy. Case studies in Belgium, Chile and the United Kingdom show that IFIs have significantly contributed to improved fiscal performances.

In Belgium, the government is legally required to adopt the macroeconomic forecasts of the Federal Planning Bureau and this has significantly helped to reduce bias in these estimates. In Chile, the existence of two independent bodies on Trend GDP and Reference Copper Price has greatly helped to improve Budget forecasts. In the U.K., the Office for Budget Responsibility has been important in restoring fiscal sustainability. Cross-country evidence shows that fiscal councils exert a strong influence on fiscal performances, particularly when they have formal guarantees of independence.

### **The final word**

When the markets fail, governments have to intervene. What do we do when the governments fail? It is here that we need systems and institutions to ensure checks and balances. In that respect, a Fiscal Council is an important institution needed to complement the rule-based fiscal policy. Of course, it is not a ‘silver bullet’; if there is no political will, the institution would be less effective, and if there is political will, there is no need for such an institution.

That is also true of the FRBM Act. While we cannot state that the FRBM Act has been an unqualified success, it has also not been an abject failure either. The counterfactual will show that things would have been much worse without it, and it has helped to raise the awareness of government, legislators and the public at large. Similarly, the Fiscal Council will help in improving comprehensiveness, transparency and accountability.

**Meanings of Difficult Words:**

- ❖ **fiscal council** (noun) – an independent body set up by a government to evaluate fiscal policy, its expenditure and tax policy.
- ❖ **silver bullet** (noun) – a simple solution to a complex problem.
- ❖ **complement** (verb) – contribute, supplement, augment, enhance (to make something more better).
- ❖ **rules-based** (adjective) – based on a predetermined set of principles.
- ❖ **Fiscal policy** (noun) – in simple terms, it is an estimate of taxation and government spending that impacts the economy.
- ❖ **fiscal** (adjective) – financial.
- ❖ **stress** (noun) – pressure, burden, strain, trouble, difficulty.
- ❖ **fiscal deficit** (noun) – the difference between total expenditure and total income of the government.
- ❖ **Controller General of Accounts (CGA)** (noun) – Controller General of Accounts (CGA) is The Principal Advisor on Accounting matters to the Union Government. It is responsible for establishing and managing a technically sound Management Accounting System. It is responsible for preparation and submission of the accounts of the Union Government. It is responsible for exchequer control and internal audits.
- ❖ **percentage point** (noun) – the difference between two percentages is termed as percentage point. (for example: “Interest Rates Jump From 10% to 12%”. In this case, the interest rate increased by “2 percentage points” or you can say that the interest rate is increased by 20%).
- ❖ **fiscal stimulus** (noun) – Government measures, normally involving increased public spending and lower taxation, aimed at giving a positive jolt to economic activity.
- ❖ **deficit** (noun) – shortfall, deficiency, shortage.
- ❖ **Gross domestic product (GDP)** (noun) – a measure of economic activity in a country. It is the total value of a country’s annual output of goods and service.
- ❖ **due to** (phrase) – because of, owing to, on account of, as a result of.
- ❖ **consolidated** (adjective) – combined, merged, integrated.
- ❖ **debt** (noun) – liability, financial obligation, borrowed capital.
- ❖ **go up** (phrasal verb) – increase, rise.
- ❖ **off budget** (adjective) – not included in the regular government budget.
- ❖ **liabilities** (noun) – (financial) obligation, debt.
- ❖ **alarming** (adjective) – worrying, disturbing, shocking/distressing.
- ❖ **prevailing** (adjective) – existing; current.
- ❖ **exceptional** (adjective) – unusual, uncommon, abnormal, atypical.
- ❖ **circumstance** (noun) – situation, conditions, state of affairs.
- ❖ **warrant** (verb) – justify/necessitate, vindicate/ validate, call for.
- ❖ **loosen the purse strings** (phrase) – to increase the spending of money.
- ❖ **credible** (adjective) – believable, acceptable, reasonable, convincing.
- ❖ **fiscal consolidation** (noun) – it is a reduction in the underlying (basic) fiscal deficit and public debt.
- ❖ **get over** (phrasal verb) – recover, get better; resolve, overcome.
- ❖ **transparency** (noun) – clarity, straightforwardness, openness, honesty, unambiguity.
- ❖ **besides** (preposition) – apart from, in addition to.
- ❖ **comprehensiveness** (noun) – the condition of including all parts of something.
- ❖ **accountability** (noun) – responsibility, liability, answerability.
- ❖ **compliance** (noun) – conformity, observation, adherence.
- ❖ **Fiscal Responsibility and Budget Management (FRBM) Act** (noun) – Fiscal Responsibility and Budget Management (FRBM) Act enacted in 2003 by the parliament, establishes financial discipline to reduce fiscal deficit. The FRBM Act aims to introduce transparency in India’s fiscal management systems. The Act’s long-term objective is for India to achieve fiscal stability and to give the Reserve Bank of India (RBI) flexibility to deal with inflation in India. The FRBM Act was enacted to introduce more equitable distribution of India’s debt over the years.

- ❖ **Comptroller and Auditor General (CAG)** (noun) of India (noun) – it is empowered to audit all expenses from the combined fund of the union or state governments, whether incurred within India or outside.
- ❖ **fiscal responsibility** (noun) – the act of creating, optimizing and maintaining a balanced budget.
- ❖ **highlight** (verb) – underline, underscore, emphasize, call attention to.
- ❖ **obfuscation** (noun) – making of something obscure or unclear to understand; evasiveness, confusion.
- ❖ **subsidy** (noun) – also called as subvention; a financial contribution granted to help an industry or business, mostly given by a government, in order to keep the price of service/goods at a low level.
- ❖ **unsecured loans** (noun) – An unsecured loan is one that doesn't need collateral or a security deposit to receive. With an unsecured loan, instead of pledging assets, borrowers qualify based on their credit history and income.
- ❖ **National Small Savings Fund (NSSF)** (noun) – The National Small Savings Fund (NSSF) was established by the Union Government in 1999. All deposits received under small savings schemes (including public provident fund deposits and savings certificates) are credited to the National Small Saving Fund (NSSF). Attractive interest rates and sovereign guarantee make small savings schemes very popular. The net collections are invested in central and state government special securities. Net collections under NSSF are also invested in various public agencies like Food Corporation of India and National Highways Authority of India (NHAI) as well.
- ❖ **irrigation** (noun) – the process of (artificially) supplying water to farm land to grow crops & plants.
- ❖ **Long Term Irrigation Fund (LTIF)** (noun) – a fund under the National Bank for Agriculture and Rural Development (NABARD) for implementation of major and medium irrigation projects in India.
- ❖ **buy out** (phrasal verb) – pay to buy all or part of the shares in a company.
- ❖ **remit** (noun) – send, dispatch, forward, transmit (money).
- ❖ **disinvestment** (noun) – the process of reducing capital investments.
- ❖ **proceeds** (noun) – profits, earnings, returns, income, revenue.
- ❖ **in order to** (phrase) – with the purpose/aim of.
- ❖ **comprehensive** (noun) – all-inclusive, all-encompassing, all-embracing.
- ❖ **transparent** (adjective) – open/candid, forthright, straightforward, honest.
- ❖ **accountable** (adjective) – answerable, responsible, liable.
- ❖ **eventually** (adverb) – in the end, in due course, after some time.
- ❖ **roadmap** (noun) – schedule of a (complex) program.
- ❖ **underline** (verb) – emphasize, underscore, highlight.
- ❖ **hardly** (adverb) – barely, slightly; not.
- ❖ **make out** (phrasal verb) – distinguish, recognize, discern.
- ❖ **bipartisan** (adjective) – involving cooperation between two (opposite & big) political parties.
- ❖ **independent fiscal institution (IFI)** (noun) – Independent fiscal institutions (IFIs) are defined as non-partisan public bodies, other than the central bank, government or parliament aimed at promoting sustainable public finances through various functions, including monitoring compliance with fiscal rules, production or endorsement of macroeconomic forecasts for the budget, and/or advising the government on fiscal policy matters.
- ❖ **sustainable** (adjective) – acceptable, reasonable, sensible, legitimate, well founded.
- ❖ **staff** (verb) – operate, occupy, work.
- ❖ **nonpartisan** (adjective) – fair, unbiased, impartial, neutral.
- ❖ **oversight** (noun) – supervision, surveillance, administration, management.
- ❖ **normative** (adjective) – relating to a standard/norm, particularly of behaviour.
- ❖ **perspective** (noun) – outlook, viewpoint, approach.
- ❖ **calibrate** (verb) – carefully assess, regulate, adjust.
- ❖ **objective** (adjective) – impartial, unbiased, unprejudiced, non-partisan; real/actual.

- ❖ **unbiased** (adjective) – impartial, unprejudiced, neutral, non-partisan.
- ❖ **bring in** (phrasal verb) – cause, bring about, give rise to, create, produce.
- ❖ **populist** (adjective) – relating to the politicians who claim that they are representing the common/ordinary people.
- ❖ **assessment** (noun) – evaluation, appraisal, analysis.
- ❖ **forecast** (noun) – prediction, indication, projection, speculation, calculation (of future events or trends).
- ❖ **implications** (noun) – consequence/outcome, ramification, repercussion.
- ❖ **constraint** (noun) – restriction, limitation, restraint.
- ❖ **conscience** (noun) – moral sense, inner voice, sense of right and wrong.
- ❖ **keeper** (noun) – guardian, protector, defender.
- ❖ **diverse** (adjective) – very different, varying, mixed, manifold.
- ❖ **growing** (adjective) – increasing, intensifying.
- ❖ **watchdog** (noun) – inspector/supervisor, observer, ombudsman.
- ❖ **diversity** (noun) – the state/condition of having many different types of people.
- ❖ **macroeconomic** (adjective) – relating to the branch of economics concerned with large-scale factors (interest rates/national productivity).
- ❖ **broad** (adjective) – comprehensive, inclusive, extensive, wide-ranging.
- ❖ **non-partisanship** (noun) – fairness, neutrality, impartiality, egalitarianism.
- ❖ **legislature** (noun) – government/authority.
- ❖ **autonomy** (noun) – independence, freedom; self rule, self-determination.
- ❖ **primary balance** (noun) – The primary (budget) balance is the government fiscal balance excluding interest payments. Government net borrowing or net lending excluding interest payments on consolidated government liabilities.
- ❖ **Federal Planning Bureau** (FPB) (noun) – The Federal Planning Bureau (FPB) is a Belgian independent public agency. It draws up studies and projections on economic, social and environmental policy issues and on the integration of these policies within a context of sustainable development.
- ❖ **bias** (noun) – prejudice, partiality; favouritism, unfairness, one-sidedness.
- ❖ **sustainability** (noun) – maintainability of something at a certain rate/level.
- ❖ **fiscal sustainability** (FS) (noun) – the ability of a government to maintain public finances at a credible and serviceable position over the long term. It broadly refers to limits on government debt or debt accumulation. The most commonly used definition is that the government cannot engage in a Ponzi scheme (i.e., borrowing just to meet interest payments, leading to a ballooning of debt).
- ❖ **cross-country** (adjective) – across a country.
- ❖ **exert** (noun) – apply, bring into play, exercise, employ.
- ❖ **checks and balances** (plural noun) – a system in which all departments of a government organization have right to amend/limit the powers of the other departments in order to avoid dominance of one department.
- ❖ **political will** (noun) – political intention/desire (to complete a scheme/project even if it is not admired/welcome in the beginning).
- ❖ **unqualified** (adjective) – unconditional, categorical, unequivocal, unambiguous, unrestricted.
- ❖ **abject** (adverb) – miserable, hopeless, pathetic.
- ❖ **counterfactual** (noun) – a claim, hypothesis, or other belief that is contrary to the facts.
- ❖ **legislator** (noun) – a member of a legislature (parliament); lawmaker, representative.
- ❖ **at large** (phrase) – as a whole, generally, extensively.