



IMPACT OF FRBM ACT 2003 ON LEVELS AND COMPOSITION OF EXPENDITURE OF GOVERNMENT OF INDIA: AN EVALUATION AND POLICY IMPLICATION

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ABSTRACT

In recent decades, most of developed and developing countries embarked upon rule based fiscal policy framework to achieve fiscal prudence and India is not exception to it. The fiscal prudence has direct and positive relationship with sustained economic growth and macro economic stability. Hence, the government of India enacted rule based fiscal policy named as Fiscal Responsibility and Budget Management Act in 2003. The main purpose of act is to reduce Gross Fiscal Deficit and Gross Revenue Deficit. Thus, Union government set up expenditure reform commission to reduce public expenditure with out affecting social sector expenditure. However, after global financial crisis, Government introduced various stimulus packages to revive economic from global shock and that cause to further deterioration in the fiscal health of nation. This situation compelled Union and State Government to reduce capital expenditure particularly on social sector development. It is clearly evidenced from various studies, the negligence of social sector expenditure may provide temporary solution to improve fiscal health, but it damages to over all economic growth and ultimately affect fiscal health of nation. In this context, this paper seeks to evaluate expenditure performance of Union Government particularly under FRBM Regime. Also make comparative analysis of expenditure of union government during pre and post FRBM Act by using RBI published time series data covering period from 1975-76 to 2014-15. The study finally pointed out that neither fiscal consolidation nor FRBM Act effective in controlling revenue expenditure of government of India. Thus, the study suggest government of India to set up expenditure management committee for evaluate and restructure composition of public expenditure to reduce negative impact of fiscal consolidation rules on social sector development while adhering fiscal target

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INTRODUCTION

India never experienced with a problem of fiscal deficit in the early stage of planning period. As goals of fiscal policy move towards equity, government launched several welfare programs. Besides, the entry of Congress and Non Congress parties in formation of government by them both at centre and state cause to introduce and implement various populus schemes and flagship programs by centre and state government to reap benefits of short term election gain. Hence, after 1970s, India encountered with a problem of sevier fiscal deficit which cause to macro economic crisis in 1990. Since then, economic stability accorded highest priority among goals of fiscal policy. Thus, India launched comprehensive economic reforms along with fiscal consolidation to achieve macro economic stability through fiscal prudence. The fiscal consolidation was effective till 1996-97 and there after, the fiscal situation again worsen

and made Government of India to embarked upon a self-imposed fiscal rule in terms of Fiscal Responsibility and Budget Management (FRBM) Act 2003 and FRBM rule 2004. The main aim of this act is to bring down the central government fiscal deficit to 3 percent of GDP by 2008-09 with an annual reduction target of 0.3 percent of GDP per year. Further, the FRBM Act targeted a zero revenue deficit and primary surplus by 2008-09. The central government achieved targets lay down in FRBM act in 2007-08 with out compressing essential capital expenditure and after global economic crisis; government introduced various stimulus packages to revive economy from economic crisis causing to deteriorate fiscal health of nation. The worst situation compelled Union Government to deny essential public investment on economic and social service while at hearing fiscal targets set under FRBM act. Therefore, this research paper examines whether fiscal consolidation rules adversely impacted capital expenditure particularly social sector expenditure in India.

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REVIEW OF LITERATURE

There are very few studies dealt with comparative analysis of expenditure performance of Union Government. Maheshwari (2012), Dasgupta (2013) and Soni (2014) were concentrated on impact of fiscal consolidation reforms on public expenditure of union and state government. Among them, Maheshwari (2012) reviewed social sector expenditure of union government after fiscal consolidation reform (1990-91) and Dasgupta (2013) analyzed impact of FRBM act on union government spending. Further, Soni (2014) analyzed trends and composition of public finance during pre and post reform period. However, in my knowledge, no study dealing with comparative analysis of expenditure pattern of central government under FRBM regime.

An Evaluation of Levels and Composition of Expenditure of Central Government During Pre and Post Fiscal Consolidation Rules (FRBM Act 2003) in India

Public Expenditure of Union Government under FRBM Regime

After enactment of self imposed fiscal policy rules, the Government of India made an attempt to reduce public expenditure through public expenditure reforms and efficient public expenditure management. However, the central and state government failed to reduce revenue expenditure and the targets of FRBM were mechanically achieved by compressing capital expenditure without understanding the adverse consequences in the long run. Therefore, this section seeks to make an attempt to analyse expenditure performance of central government particularly under FRBM regime by analysing annual time series data covering the period from 2002-03 to 2014-15. The study reviews ratio of public expenditure as percentage of GDP mainly in two phases: The 1st phases are ranging from 2002-03 to 2007-08 (period of improvement) and the 2nd phase is 2008 onwards (period of deterioration) in quality of government spending.

shock cause to increase revenue expenditure under FRBM regime. Hence, off budget liabilities expenditure increased from 0.9% in 2006-07 to 1.8% in 2008-09 (Kumar and Sowmya, 2011). However, after certain amendments made in FRBM act with inclusion of these bonds in budget of 2010-11, the revenue expenditure gradually brought under control in 2014-15. The ratio of revenue defence expenditure to GDP continuously decreased in the beginning years of rule based fiscal policy and it marginally increased after global economic crisis once again. However, after 2012 onwards, the rate of revenue defence expenditure slowly decreasing. The interest payment decreased from 4.64% of GDP in 2002-03 to 3.03% in 2011-12 due to mixed monetary management, softer interest rate and strategy of pre payment of debt by government (Pattanaik, Bose, Bhattacharyya and Chander 2007). And then onwards, it shown increasing trend. The ratio of subsidy to GDP increased only after global economic crisis and on aggregate, it was 2.24% during 2002-07-08 onwards. The percentage of capital expenditure to GDP decreased from 3.84% in 2003-04 to 1.53% in 2014-15 revealing that central government tried to achieve fiscal target by compressing essential capital expenditure. The ratio of capital defence expenditure to GDP decreased from 0.99% in 2004-05 to 0.65% in 2014-15. An increase in transfer payment and public consumption were cause to reduce capital expenditure The (Dasgupta, 2014). rate of loans and advance as percentage to GDP decreased from 1.28% in 2002-03 to 0.17% in 2014-15. The capital out lay during post FRBM period was around 1.50% of GDP suggesting government to reduce expenditure on public consumption (Dasgupta, 2014). The total expenditure as percentage of GDP Hovered around 14%-15% during post FRBM period. The growth in total expenditure is steeper since 2006, dominated by transfer payments such as interest payment and subsidies (Das Gupta 2014).

Table 1 Expenditure Performance of Union Government as Percentage of GDP under FRBM Regime

Year	%Revenue Expenditure/GDP	%Revenue Defence/GDP	%Interest Payment/GDP	%Subsidy/GDP	%Capital Expenditure/GDP	%Capital Defence/GDP	%Loans and Advances	%Capital Outlay/GDP	Total Expenditure/GDP
2002-03	13.35	1.61	4.64	1.72	2.94	0.59	1.25	1.15	16.29
2003-04	12.74	1.52	4.37	1.56	3.84	0.59	1.01	1.20	16.58
2004-05	11.85	1.35	3.92	1.42	3.50	0.99	0.89	1.61	15.37
2005-06	11.90	1.31	3.59	1.29	1.80	0.88	0.31	1.49	13.69
2006-07	11.98	1.20	3.50	1.33	1.60	0.79	0.20	1.40	13.58
2007-08	11.92	1.09	3.43	1.42	2.37	0.75	0.23	2.14	14.29
2002-03 to 2007-08)	12.29	1.35	3.91	1.46	2.67	0.76	0.65	1.50	14.97
2008-09	14.10	1.30	3.41	2.30	1.60	0.73	0.25	1.35	15.70
2009-10	14.08	1.40	3.29	2.18	1.74	0.79	0.24	1.50	15.82
2010-11	13.37	1.18	3.06	2.23	2.01	0.80	0.32	1.69	15.38
2011-12	12.72	1.14	3.03	2.42	1.76	0.75	0.23	1.53	14.48
2012-13	12.30	1.10	3.10	2.54	1.65	0.70	0.21	1.44	13.95
2013-14	12.08	1.10	3.30	2.24	1.65	0.70	0.17	1.48	13.73
2014-15	11.87	1.12	3.28	2.13	1.53	0.65	0.17	1.36	13.41
2008-09 Onwards	12.93	1.19	3.21	2.29	1.71	0.73	0.23	1.48	14.64
Post FRBM (2008 onwards)	12.61	1.27	3.56	1.87	2.19	0.75	0.44	1.49	14.80

Author’s Calculation from RBI hand book of statistics on Indian Economy

The rate of revenue expenditure as percentage of GDP decreased from 13.35% in 2002-03 to 11.92% in 2007-08 and then, it increased to 14.08% in 2009-10 indicating that expansionary fiscal policy to revive economy from global

A Comparative Analysis of Public Expenditure during Pre and Post FRBM period

This section evaluates Levels and composition of government spending during pre and post FRBM period. Hence, the study period is divided into two phases: The first phases is ranging from 1975-76 to 2001-02 considered as period of Pre Fiscal

consolidation Rules and Second Phase is ranging from 2002-03 to 2014-15 considered as Post Fiscal Consolidation Rules.

Table 2A Level and Composition of Public Expenditure (Ratio to Total Expenditure) During Pre and Post FRBM Period

	Pre-FRBM (1975-76 to 2001-02)	Post FRBM (2002-03 to 2014-15)	1976-2015
Revenue Expenditure	67.65%	84%	75.78
Revenue Defence	11.94%	9.2	10.57
Interest Payment	19.5%	25.8	22.65
Subsidies	8.4	14%	11.2
Capital Expenditure	28.4	15.4%	19.75
Capital Outlay	11.5	11.1	11.3
Loans Advances	17.5%	2.8	5.15
Capital Defence	3.4%	5.5	4.45

Source: Author's Calculation from RBI Data

The ratio of revenue expenditure to total expenditure was 67.65% during pre-FRBM period and it rose to 84% during post FRBM period reveals that the FRBM act is not effective. The share of revenue defence expenditure to total expenditure hovered between 9.2%, which is lower as compare to pre-FRBM period (11.94%). The interest payment take away the major part of revenue expenditure and share of interest payment to total expenditure recorded 19.5% of total expenditure before FRBM act and after enactment FRBM act, it rose to 25.8% suggest government to institute stringent rules to reduce leakage of public borrowings and enhance productivity of borrowed resources. The rate of subsidies to total expenditure was 8.4% during pre FRBM period, which is low as compare to post FRBM period (14% of total expenditure revenue) suggesting government to take necessary measures to increase productivity of agriculture and energy subsidies. The share of capital expenditure to total expenditure have been decreasing after post liberalisation and it recorded 15.4% under FRBM regime, which is lower as compare to pre FRBM period (28.4% of total expenditure) revealing that our government denied significance of capital expenditure while achieving fiscal prudence under fiscal consolidation process. The share of capital out lay shown decreasing trend over the year and it is hovered around 11-12% during the study period showing that the efforts of government towards economic and social infrastructure development is not substantial in India. The ratio of loans and advances to total expenditure was 17.5% during pre fiscal policy rules and it decreased to 2.8% after enactment of FPR in India suggesting government to borrow loans only for mobilising productive capital expenditure in country. The rate of capital defence expenditure to total expenditure during pre FRBM period was 3.4% and increased to 5.5% during post FRBM period

Table 2B Expenditure of Union Government as Percentage of GDP during Pre and Post FRBM Act

	Pre-FRBM	Post-FRBM	1975-76 to 2014-15
Revenue Expenditure	11.19	12.61	11.95
Revenue Defence Expenditure	2.01	1.27	1.64
Interest Payment	3.22	3.56	3.39
Subsidy	1.36	1.87	1.61
Capital Expenditure	4.70	2.19	3.13
Capital Defence Expenditure	0.52	0.75	0.86
Loans and Advance	2.86	0.44	1.65
Capital Outlay	1.83	1.49	1.66
Total Public Expenditure	15.89	14.80	15.30

Author Calculation from RBI hand book of Statistic on Indian Economy

The efficient public expenditure policy and public expenditure management play crucial role in achieving goals fiscal policy. Hence, public expenditure has direct link with economic growth. After enactment of discretionary fiscal policy by central government, the union public expenditure has registered 14.80% per annum, which is low as compare to earlier period (15.89% per annum). The revenue expenditure is the main culprit of growing imbalance in public finance of union government, which is increased by 1.5% per annum particularly during post FRBM period revealing that the legalised fiscal policy measure failed to curtail unnecessary expenditure of union government. The percentage of revenue defence expenditure was 1.27% per annum during post FRBM period, which is low as compare to pre FRBM period (2.01% per annum). The percentage of interest payment marginally increased during post FRBM era. The rate of subsidy increased by .50 percentage point under FRBM regime. On the other hand, the ratio of capital expenditure to GDP has recorded very lower growth during post FRBM period (2.19% per annum) as compare to pre FRBM period (4.70% per annum) suggesting government to improve quality of public expenditure while adhering fiscal target under fiscal consolidation rules. The capital defence, loans and advance and capital outlay are the major component of capital expenditure which necessary to improve physical and social infrastructure and there by, achieving economic growth with macro economic stability. However, the rate of capital outlay decreased to 1.49% after enactment of FRBM act by union government. The aggregate capital outlay recorded less than 2% in the study period reveals that the concentration of central government on social and economic infrastructure development is not substantial in India. The capital defence expenditure recorded higher growth during post FRBM period (0.75% per annum) as compare pre FRBM period (0.52% per annum) The percentage of loans and advances was growing at higher rate before enactment of fiscal consolidation rules (2.86% per annum) as compare to post FRBM period (0.44% per annum) suggesting central government to utilise public borrowing only for the purpose of development project without allowing room for corruption and other kind of likeges

CONCLUSION AND POLICY IMPLICATION

From the above observation, it is clearly evidenced that the FRBM act not effective in case of reducing revenue expenditure in India particularly after global economic crisis. Hence, it is inevitable for Government of India compressed capital expenditure to achieve fiscal targets fixed under FRBM regime. Thus, paper suggest government to empirically evaluate which component of public expenditure affect economic growth and then decide how to reduce unnecessary expenditure and invest those revenue resources on social and economic infrastructure development in order to bring India on sustained economic development path with macro economic stability in the long run through efficient expenditure management and expenditure control policies.

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