Economics Class 23

FRBM ACT (09:02 AM)

- **AMENDMENTS IN FRBM ACT:-**
- In 2012 and 2015 notable amendments were made resulting in the relaxation of the target realization year.
- A new concept called **Effective revenue deficit (ERD)** was also introduced.
- The requirement of a medium-term expenditure framework statement was also added through amendment in FRBM Act.
- **To be achieved by 2015 (Amendment in FRBM act in 2012):-**
- Eliminate RD by March 31st, 2015. The minimum Annual reduction is 0.5% of the GDP.
- Fiscal deficit target- To be reduced to 3% of GDP by March 31st, 2015. Minimum annual reduction of 0.3% of GDP.
- **To be achieved by 2018 (Amendment in FRBM act in 2015):-**
- RD is to be eliminated by March 31st, 2018.
- Fiscal deficit target- it should be reduced to 3% of GDP by March 31st, 2018.
- **DOCUMENTS REQUIRED AS PER THE REQUIREMENT OF THE FRBM ACT:-**
- **Medium Term Fiscal policy statement-**
- It sets out a 3-year rolling target for 4 specific fiscal indicators of GDP:
- 1) Revenue deficit
- 2) Fiscal deficit
- 3) Tax/GDP ratio
- 4) Total outstanding debt at the end of the year
- **Macroeconomic Framework statement-** Assessment of growth prospects of the economy (GDP growth rate) along with the fiscal balance of central government and the external sector balance of the economy.

- **Fiscal policy strategy statement-** It outlines the strategic priorities of the government concerning taxation, expenditure, lending, investments, administered pricing, borrowings, and guarantees. The statement explains how current policies conform to sound fiscal management principles.
- **Medium-term expenditure framework statement (MTEF)-** A 3-year rolling target for the expenditure indicators with a specification of underlying assumptions and risk involved. The objective of MTEF is to provide closer integration between Budget and FRBM statements.

FRBM target is to be achieve by 2015

FRBM REVIEW COMMITTEE- N K SINGH RECOMMENDATIONS (09:37 AM)

- The committee recommended that the government should target the FD of 3% of GDP in the years up to March 31st, 2020, cut it to 2.8% in 2020-21 and further to 2.5% by 2023.
- The committee suggested using Debt as the primary target for Fiscal policy.
- **The target set by the committee:**

This target was kept when debt to GDP ration was around 70 percent on 2017-18.

- **Debt/GDP ratio-** The review committee advocated for a Debt to GDP ratio of 60% to be targeted with a 40% limit for the centre and a 20% limit for the state.
- **RD target-** RD should be reduced to 0.8% of GDP by March 31st, 2023 with a minimum annual reduction target of 0.5% of GDP.
- **FD target-** FD should be reduced to 2.5% of GDP by March 31st, 2023 with a minimum annual reduction target of 0.3% of GDP.
- **Escape clause**
- An escape clause under the FRBM Act details a set of events in which the central government can deviate from FD targets.
- In 2017, the N K Singh committee said that the exceptional circumstances mentioned in the FRBM Act 2003 were defined opaquely and were liable to misuse.

- **In 2018, FRBM Act was amended to specify 3 conditions upon which an escape clause can be invoked-**
- 1) During national security issues, Acts of war, Calamities of national proportion, and collapse of agriculture severely which could affect farm outputs and income.
- 2) Structural reforms in the economy with unanticipated fiscal implications.
- 3) A sharp decline in Real output growth of at least 3 percentage points below the average of the previous 4 quarters.
- The FRBM amendments also mentioned that the deviation from the FD targets must not exceed 0.5 percentage points in a year.
- Do note that the term escape clause is not used in the FRBM Act 2003 but only in the FRBM review committee report.

PUBLIC DEBT (09:54 AM)

- It is the total amount borrowed by govt of a country.
- When govt revenue from taxes and other sources falls short of its spending requirements.
- In India, public debt includes the total liabilities of the govt to be paid from the Consolidated fund of India.
- It is further classified into **internal and external debt.**
- **Internal debt** is categorised into marketable and non-marketable securities.
- **Marketable govt securities** include G-secs and T-bills issued through auction.
- **Non-marketable securities** include intermediate treasury bills issued to state governments and special securities issued to national small savings funds etc.
- The Central govt clearly distinguishes its debt liabilities from those of the states.
- The internal debt comprises loans raised in the open market including treasury bills, non-negotiable non-interest-bearing rupee securities issued to financial institutions etc.
- The part of the nation's debt that is borrowed from foreign lenders such as commercial banks, govt or international financial institutions is referred to as external debt.
- These loans must typically be repaid in the currency used to make the loan plus any applicable interest.

PUBLIC DEBT MANAGEMENT (10:24 AM)

- Sovereign or public debt management is the process of establishing and executing a strategy for managing the government's debt to raise the required amount of funding.
- It aims to achieve risk and cost objectives and to meet any other sovereign debt management goals.
- The govt may have set goals such as-
- developing an efficient market for govt securities. In 2015, the creation of a statutory body called the Public Debt Management Agency was envisaged in India.
- As RBI sets interest rates and conducted the purchase and sale of govt bonds, it raised the issue of conflict of interest.
- Till the time PDMA comes into place, govt created an interim arrangement that deals with the management of public debt called the Public debt management cell.
- Currently Public Debt Management cell in coordination with RBI manages the Public debt system in India.
- **OFF BUDGET BORROWING**
- Off Budget borrowings are loans that are taken not by the centre directly but by another public institution that borrows on the directions of the central govt.
- Such borrowings are used to fulfil the government's expenditure needs.
- But since the liability of the loan is not formally on the central govt, the loan is not included in the national fiscal deficit.

FINANCIAL MARKET (11:28 AM) 1. Money Market:-

- It caters to short-term borrowing requirements such as working capital.
- The money market mainly deals with Financial instruments whose maturity is up to one year.
- Common Money market instruments are Treasury bills, Cash Management bills, Call Money, Certificates of deposit, Commercial paper, Commercial bills etc.
- In the Money market, debt is taken for a short period (<365 days). Example- Treasury bills.
- In the Capital market, the maturity period is long-term (> 365 days).
- **BOND YIELD**
- When the recession is expected bond yield curve graph is inverted.
- People remove money from short-term bonds and invest in long-term bonds.
- Bond price is inversely proportional to Bond yield.

TOPIC OF THE NEXT CLASS- DISCUSSION ON FINANCIAL MARKET (TO CONTINUE)