India needs a fiscal council

PUBLIC INTEREST

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The Fiscal Responsibility and Budget Management (FRBM) Review Committee report is being actively discussed in policy circles but its proposal to establish an independent fiscal council has not so far featured in the discussion.

Fiscal councils are now part of the institutional fiscal apparatus of over 80 countries, including several emerging and developing economies. The functions of these councils vary widely in scope, but the *raison d'être* for such councils is clear. Globally, the frequency of unplanned general government deficits has been increasing over time. In India, this is an endemic problem which extant legislation has tempered but not institutionally corrected. While most economies including India do have fiscal rules, experience shows that these tend to be breached on fairly specious grounds when there are political costs to government fiscal discipline. Governments also tend to overestimate their ability to enhance revenues and control expenditure.

Fiscal councils are an attempt to provide an institutional solution to these challenges by providing the necessary analytical and technical inputs to enable government secure better fiscal predictability, to work with government to make fiscal projections more credible and consonant with general economic trends, and to present institutional checks to fiscal profligacy by facilitating the implementation of fiscal rules.

Fiscal councils can be part of the executive or legislature. In the latter case, the council acts as a watchdog enabling the legislature to evaluate the credibility of government fiscal proposals which it is asked to approve. The US Congressional Budget Office (CBO) has been performing this role creditably since 1975. It provides independent budgetary and economic projections and cost estimates of expenditure legislation, and assesses the consistency of the executive's spending plans with what was legislatively approved. The UK Office for Budget Responsibility reports to the exchequer, but is specifically tasked with undertaking independent analysis of the country's public finances. It does all that the CBO does and, in addition, identifies and evaluates emerging fiscal risks. There are also other models of standalone fiscal councils (Ireland) or multiple bodies reporting to different branches of government (South Africa).

The FRBM committee has chosen to recommend a fiscal council that would be an autonomous body under the aegis of the Ministry of Finance. In my view, this choice makes sense in the Indian context for three reasons.

First, the Constitution specifies a number of institutions which have a fiscal role — importantly the Finance Commission and the Comptroller and Auditor General of India. These, respectively, take care of inter-governmental fiscal issues and the *ex post* fiscal accountability of government. The former institution also provides a guideline fiscal road map for five years which is duly placed before Parliament. In addition, relevant parliamentary committees can also call for expert advice and inputs on different fiscal dimensions as required.

However, the finance branch of the executive at both central and state levels do not have the institutional support that would enable them to establish the credibility and strategic validity of their fiscal actions. Our executive departments have been constructed to perform administrative, not analytical functions. Analytical functions are either outsourced to technical experts or obtained by constituting subject-specific committees from time to time. As our economy grows, and the task of policy-making becomes more complex and subject to national and international scrutiny, there is need to institutionalise the analytical function within government on a permanent basis.

Second, the fiscal council is not intended to be a policy-making body (unlike the Monetary Policy Committee). Policy-making authority must vest with the elected government reporting to the legislature, especially when we are speaking of fiscal affairs, a core function of the state involving the use of coercive power.

Third, the fiscal council must complement existing institutions without overlap and not seek to take power from nodes where it is currently vested — if the fiscal council is to endure as a credible institution, it must complement the existing institutional architecture, and its remit must reflect this.

For these reasons, nine of the eleven functions of the proposed fiscal council are to provide inputs to enhance the credibility of government decision-making, and to advise the government on policy options available to it in difficult times. The council will also prepare two analytical reports for the public domain — the macroeconomic framework statement, which will provide an economic assessment of the macro fiscal situation of the Union of India to be presented with the annual Budget by the finance minister, and an annual fiscal strategy report on relevant fiscal issues of the time, as well as a statement on its own activities. These public documents will provide a benchmark for policy debate and dialogue on these important issues.

The need for a fiscal council has been a recurring theme since the first FRBM Act and has been recommended by successive finance commissions. The fiscal council will find consensual acceptance if there is clarity on its technical, advisory and public information role, and it is unambiguously understood that it is not a policy-making body but an unglamorous yet essential institution to assist government draft better fiscal policy and strategy going forward. In my view, this is the most important recommendation of the committee for the medium- and long-term health of fiscal policy making in India, which will endure once the heat and dust of debates on targets, anchors and escape clauses passes into the archives of Indian fiscal history.

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