Consistent policy path needed to achieve $5 trillion economy

With the Budget documents, the FM also presented the much awaited 15th Finance Commission's report for the year 2020-21. While the commission is expected to submit the full five-year report in October 2020, it is interesting to note that the first report has made several recommendations and the Union Budget has indeed used this for preparing the Budget for 2020-21.

One of the major recommendations of the commission is to more or less retain the share of devolution as suggested by the 14th Finance Commission (although at 41% adjusted for J&K and Ladakh that are outside the central devolution). But the commission clearly mentions that these recommendations could change when it submits the final report 'in the light of subsequent data and analysis'. To that extent, the recommendations in the first report

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are mostly to ensure continuity for the year 2020-21 with not much change in the Centre-state financial relation.

On the fiscal road map, it is a departure from the previous commissions when it says 'a credible fiscal and debt trajectory road map remains problematic'. Indeed, it helps the Centre by reminding that it could 'invoke the escape clause in the amended FRBM Act and deviate from the stipulated fiscal target by 0.5% of GDP". It also describes the trigger conditions for invoking such an escape clause when there are 'structural reforms in the economy with unanticipated fiscal implications', although it does not specify how often one could invoke and during what period of 'structural reforms'.

However, what the Centre has done in the Budget is to invoke the escape clause for two consecutive years! And that too for the GST reforms initiated in 2017-18 and with no major structural reforms in the 2020-21 Budget.

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What is more surprising is that the commission's estimate of a fiscal deficit of 3.5% for 2020-21 is the same as that in the Budget. However, the underlying GDP growth differs — the Budget assumes nominal GDP growth of 10% while the commission assumes at 11%! Another departure in the commission's recommendations is the neglect of revenue deficit targets, which are clearly inconsistent with the existing FRBM Act (as amended in 2018).

However, the report talks about the need for supporting public investment without mentioning the targets. Further, it says, 'the country needs an overarching legal fiscal framework that would mirror the revised FRBM Act…". As our analysis shows, such a fiscal consolidation exercise consistent with the revised FRBM Act does not result in higher growth. This is even highlighted in the 2017 FRBM committee report.

Clearly, there is a strong connect between the first report of the 15th FC and the Budget. However, it is only hoped that when the commission submits the final one (for the 5-year period), it would take a long-term and consistent view on the deficits (including revenue deficit), debt as well as economic growth into consideration, even though there are forecast uncertainties.

While structural reforms are as always work in progress, especially in a country like ours, what is needed is the right consistent policy path. Here it is urged to relook and revert back to the original FRBM Act of 2003 and not to the amended one in 2018. Otherwise, achieving the goal of a US$ 5 trillion economy could end up as a dream.