

Chapter 1: Introduction

1.1 Background

The issue of management of fiscal deficit assumed importance in India in the late eighties when the combined deficit of the Union and State Governments rose to levels above *7 per cent* of Gross Domestic Product (GDP). In the year 1999-2000, the combined fiscal deficit of the Union and State Governments stood at about *9.8 per cent* of GDP, while revenue deficit was about *6.8 per cent*.

Fiscal deficit of the Union was over *6 per cent* of GDP in the first half of the eighties which widened further in the second half, reaching almost *9 per cent* at the end of financial year (FY) 1986-87. It was about *8.3 per cent* in FY 1990-91. During the period 1994-99, the average fiscal deficit of the Union was over *6 per cent*. Moreover, the total debt liability of the Union increased from ₹ 6,30,071 crore in 1994-95 to ₹ 10,12,486 crore in 1998-99, showing an increase of *61 per cent*.

In view of the continuing fiscal stress on the economy and the need to contain the fiscal deficit within a reasonable limit, the Union Government, in January 2000, set up a Committee to go into the various aspects of the fiscal system and to recommend a draft legislation on fiscal responsibility. Based on recommendation of the Committee, the Government, in December 2000, introduced Fiscal Responsibility and Budget Management (FRBM) Bill, which became Act in August 2003.

1.2 Fiscal Responsibility and Budget Management Act, 2003 and Rules, 2004

The objective of FRBM Act, 2003 was to institutionalize fiscal discipline, reduce fiscal deficit, improve macro-economic management and the overall management of the public funds by moving towards a balanced budget. FRBM Rules, 2004, framed under Section 8 of the Act came into force in July 2004. FRBM Act was enacted to provide for following responsibilities of the Central Government:

- ✓ to ensure inter-generational equity in fiscal management and long term macro-economic stability by achieving sufficient revenue surplus and removing fiscal impediments in the effective conduct of monetary policy;
- ✓ prudential debt management consistent with fiscal sustainability through limits on the Central Government borrowings, debt and deficits;
- ✓ greater transparency in fiscal operations of the Central Government; and
- ✓ conducting fiscal policy in a medium-term framework and for matters connected therewith or identical thereto.

To achieve the above, the Act and the Rules stipulated following targets to be achieved by the Union Government in respect of major fiscal indicators as indicated in **Box-1**.

Box-1: Targets for various fiscal indicators

Fiscal Indicators	Target
Revenue Deficit (RD)	Elimination of RD by 31 March 2008 and thereafter to build up adequate revenue surplus. To achieve the target of RD the Central Government shall reduce the RD by an amount equivalent to 0.5 <i>per cent</i> or more of the GDP ¹ at the end of each financial year beginning with 2004-05.
Fiscal Deficit (FD)	To bring down the FD to not more than three <i>per cent</i> of GDP at the end of 31 March 2008. To achieve the target of FD the Central Government shall reduce the FD by an amount equivalent to 0.3 <i>per cent</i> or more of the GDP at the end of each financial year beginning with 2004-05.
Guarantees	The Government shall not give guarantee aggregating to an amount exceeding 0.5 <i>per cent</i> of GDP in any financial year beginning with 2004-05.
Liabilities	The Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of 9 <i>per cent</i> of GDP for FY 2004-05 and in each subsequent financial year, the limit of 9 <i>per cent</i> of GDP shall be progressively reduced by at least one percentage point of GDP.
Borrowings from Reserve Bank of India	The Act imposes restrictions on the borrowing by the Central Government from Reserve Bank of India (RBI).

Note: The position of the fiscal indicators from 2004-05 to 2014-15 are given in Annex 3.1. In respect of liabilities the figures are available at Table-7 and Graph-5 and in respect of guarantees position is available in Graph-6.

¹ As per FRBM Rules GDP means Gross Domestic Product at current price.

Besides, the Act and Rules require the Government to lay in both Houses of Parliament three policy statements along with the Annual Financial Statement and the Demands for Grants, as briefly narrated in **Box-2** below.

Box-2: Fiscal Policy Statements

Medium Term Fiscal Policy Statement (MTFP)	MTFP Statement containing three year rolling targets for fiscal indicators viz. RD, FD, Tax Revenue and Total Outstanding Liabilities as a percentage to GDP with specifications of underlying assumptions, including assessment of sustainability relating to balance between revenue receipt and revenue expenditure; use of capital receipts including market borrowings for generating productive assets.
Fiscal Policy Strategy (FPS) Statement	FPS Statement containing policies of the Central Government for the ensuing financial year, relating to taxation, expenditure, market borrowings and other liabilities, lending and investment, pricing of administered goods and services, securities and description of other activities etc., an evaluation of current policies vis-à-vis fiscal management principles, intra-year benchmarks for assessing trends in receipts and expenditure relating to annual targets and Budget Estimates (BE).
Macro-economic Framework (MF) Statement	MF Statement containing an assessment of growth in GDP, fiscal balance of the Union Government and external sector balance of economy as reflected in current account of balance of payment.

In the Budget speech of 8 July 2004, it was brought out that 2008-09 would be a more credible terminal year, which would also coincide with the term of the then Government. Accordingly, through the Finance Act 2004, amendment in Section 4 of the FRBM Act was made, thereby the target dates for revenue deficit and fiscal deficit were shifted to 31 March 2009.

1.3 Temporary hold of FRBM Act

Beginning from FY 2005-06, the fiscal deficit showed signs of improvement and was reduced to a level of 2.7 *per cent* of GDP (as per Budget at a Glance) in FY 2007-08 (refer Graph-2 of Para 3.2.2). In February 2009, the Government put on hold temporarily the fiscal consolidation process citing global economic crisis and adverse circumstances. During the two financial years, i.e. FY 2008-09 and 2009-10, the fiscal deficit again rose to the level of 6.0 and 6.4 *per cent* of GDP (as per Budget at a Glance) respectively. The outstanding liability of the Government during these two years' period also hovered around 49 to 50 *per cent* of GDP (refer Graph-5 of Para 3.4.2).

1.4 Introduction of renewed road-map under amended FRBM Act

The 13th Finance Commission (FC) in its report (December 2009) for the award period 2010-15 had presented renewed fiscal consolidation path for the Centre. 13th FC recommended zero and three *per cent* targets of revenue and fiscal deficit respectively to be achieved by the end of March 2014 followed by revenue surplus of 0.5 *per cent* of GDP by 2014-15.

An amendment in the FRBM Act was passed by the Parliament in May 2012, wherein a new fiscal indicator namely ‘effective revenue deficit’ was introduced, to be worked out by excluding revenue expenditure incurred on ‘grants for creation of capital assets’ from the revenue deficit. In addition, it envisaged elimination of effective revenue deficit by 31 March 2015 and thereafter build up adequate effective revenue surplus and also to reach revenue deficit of not more than two *per cent* of GDP by 31 March 2015, among other measures. Further, in order to eliminate the effective revenue deficit by 31 March 2015, the Central Government shall reduce such deficit by an amount equivalent to 0.8 per cent or more of the GDP at the end of each financial year beginning with FY 2013-14.

Subsequent to the amendment of May 2012 in the Act, the Government set up a committee chaired by Dr. Vijay L. Kelkar, who was charged with the task of introducing mid-term corrections for fiscal year 2012-13 and to chart a medium term framework on this basis, for the remaining time horizon of the 13th FC. The Kelkar Committee in its report (September 2012) had recommended fiscal roadmap of zero effective revenue deficit; two *per cent* revenue deficit and 3.9 *per cent* fiscal deficit by the end of FY 2014-15.

Recommendations of the Committee with regard to proposed reforms on expenditure and receipts were accepted by the Government (October 2012). However, the Government decided (May 2013) to achieve the fiscal deficit target of not more than 3 *per cent* of GDP by 2016-17. Accordingly, amendments in FRBM Rules indicating new targets for fiscal consolidation were notified in May 2013 whereby the target date for elimination of effective revenue deficit, achieving the target of revenue deficit of not more than two *per cent* of GDP was fixed as 31 March 2015 and for fiscal deficit of not

more than three *per cent* of GDP as 31 March 2017. The annual rates of gradual reduction in the deficit parameters were also revised upwardly (revenue deficit from 0.5 *per cent* or more of GDP to 0.6 *per cent* or more and fiscal deficit from 0.3 *per cent* or more of GDP to 0.5 *per cent* or more). In June 2015, the FRBM Rules were further amended to achieve the targeted levels in respect of the three deficit indicators by 31 March 2018 and also the annual rate of gradual reduction were relaxed in contrast to the upward revision made in the Rules in May 2013 (revenue deficit from 0.6 *per cent* or more of GDP to 0.4 *per cent* or more, fiscal deficit from 0.5 *per cent* or more of GDP to 0.4 *per cent* or more and effective revenue deficit from 0.8 *per cent* or more of GDP to 0.5 *per cent* or more).

1.5 Amended FRBM Act and obligations of the Union Government

Since the enactment of the Act in 2003 and taking into account numerous amendments made in the Act and Rules from time to time, including the latest amendments in the Act (as of May 2015) and the Rules (as of June 2015), the status of the target dates for various fiscal indicators stand as indicated in **Box-3** below:

Box-3: Revised targets for various fiscal indicators

Indicators	Targets
Effective Revenue Deficit (ERD)	ERD is to be eliminated by 31 March 2018 with annual reduction by an amount equivalent to 0.5 <i>per cent</i> or more of GDP at the end of each financial year beginning with FY 2015-16.
Revenue Deficit (RD)	RD of not more than two <i>per cent</i> of GDP by 31 March 2018 with annual reduction by an amount equivalent to 0.4 <i>per cent</i> or more of GDP at the end of each financial year beginning with FY 2015-16.
Fiscal Deficit (FD)	FD of not more than three <i>per cent</i> of GDP at the end of 31 March 2018 with annual reduction by an amount equivalent to 0.4 <i>per cent</i> or more of GDP at the end of each financial year beginning with FY 2015-16.

Since the introduction of the Act, no change has been made in targets related to guarantees, total liabilities and borrowings from RBI (shown in **Box-1**). The amended FRBM Act and Rules² also requires the Government to lay down another Statement, viz. Medium Term Expenditure Framework Statement

² Sections 6 and 7 of the FRBM Act and Rule 6 of FRBM Rules

before both Houses of Parliament, immediately following the Session of Parliament in which the other three policy statements (shown in **Box-2**) were laid, containing the following information:

Medium Term Expenditure Framework (MTEF) Statement	MTEF Statement containing three year rolling target for prescribed expenditure indicators, with specification of underlying assumptions and risks involved.
---	---

Further, the FRBM Act and Rules (as amended from time to time) requires laying of quarterly review reports, in addition to certain disclosures in the prescribed formats, which are indicated in **Annex-1.1**.

1.6 Review of compliance of provisions of FRBM Act by the Comptroller and Auditor General of India (CAG)

13th FC had recommended that the Centre may institute a process of independent review and monitoring of the implementation of FRBM process. Accordingly, a new Section 7A was inserted through FRBM Amendment Act (May 2012) which provides that *the Central Government may entrust the CAG to review periodically as required, the compliance of the provisions of this Act and such reviews shall be laid before both Houses of Parliament*. An amendment in the Rules was further made in October 2015 to carry out the effect of amendment in the Act made in May 2012. The amended Rules provide that, the CAG shall carry out an annual review of the compliance of the provisions of the Act and the Rules made thereunder by the Central Government beginning with the Financial Year 2014-15. The review shall include:

- (i) analysis of achievement and compliance of targets and priorities set out in the Act and the Rules made thereunder, Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement, Macro-economic Framework Statement and Medium Term Expenditure Framework Statement;
- (ii) analysis of trends in receipts, expenditure and macro-economic parameters in relation to the Act and the Rules made thereunder;
- (iii) comments related to classification of revenue, expenditure, assets or liabilities having a bearing on the achievement of targets set out in the Act and the Rules made thereunder; and

- (iv) analysis of disclosures made by the Central Government to ensure greater transparency in its fiscal operations.

1.7 Audit Objectives

Audit objectives for the review of the compliance of the provisions of the Act were to examine whether:

- a) the Rules framed under the Act are consistent with the provisions of the Act;
- b) the Government achieved the targets of fiscal indicators set out in the FRBM Act and Rules made thereunder effectively;
- c) the classification of revenue, expenditure, assets and liabilities are in line with established rules and principles;
- d) the projections of components of receipts and expenditure in various fiscal policy statements are based on concrete assumptions; and
- e) the disclosures made by the Central Government to ensure transparency in fiscal operations are adequate.

1.8 Audit Scope and Methodology

In terms of Government of India (Allocation of Business) Rules 1961, the Ministry of Finance, Department of Economic Affairs is responsible for preparation of Central Budget other than Railway Budget including supplementary/excess grants; monitoring of budgetary position of the Central Government; credit, fiscal and monetary policies; and administration of the Fiscal Responsibility and Budget Management Act 2003, among other business of the Government of India.

Accordingly, the field audit was conducted during the period December 2015 to February 2016. During this period, records of the Ministry of Finance, Department of Economic Affairs were examined, including examination of the FRBM Act and Rules made thereunder and various amendments carried out from time to time, disclosures contained in prescribed Forms D-1 to D-6 for the year 2014-15 presented along with the Budgets for the year 2015-16 and 2016-17, as well as other budget and accounts related publications.

Report No. 27 of 2016

As brought out in para 1.6, the CAG is mandated to carry out an annual review of the compliance of the provisions of the Act and the Rules made thereunder by the Central Government beginning with the financial year 2014-15. Accordingly, the focus has been on the targets and transactions relating to this particular financial year. However, matters relating to periods prior to 2014-15 as well as subsequent years were also examined wherever necessary. The draft report was issued to the Ministry of Finance on 29 February 2016. An exit conference with the officers of the Ministry of Finance, Department of Economic Affairs was held on 13 April, 2016, wherein the audit findings and recommendations were discussed. On receipt of replies from the Ministry, the same together with rebuttal were incorporated and the revised draft report was again made available to the Ministry on 23 May 2016. Subsequent replies of the Ministry on the revised draft report received on 24 June 2016 have also been incorporated in this report.

1.9 Audit Criteria

The main sources of audit criteria used for the purpose of review were drawn from documents, such as the following:

- FRBM Act, 2003 as amended from time to time.
- FRBM Rules, 2004 as amended from time to time.
- Budget documents including various statements submitted by Government under FRBM Rules and disclosures made to ensure transparency in fiscal operations.
- Quarterly Review Reports submitted by the Ministry of Finance in Parliament.
- Union Government Finance Accounts compiled by the Controller General of Accounts under Ministry of Finance, Department of Expenditure.

In addition, the reports of the Finance Commissions, High Level Expert Committee on Efficient Management of Public Expenditure, and other Committees on Fiscal Consolidation have also been consulted to determine the audit criteria.

1.10 Structure of the Report

The present report is the first annual review by the CAG as per Rule 8 of FRBM (Amendment) Rules 2015 to examine compliance of provisions of the Act by the Government for FY 2014-15. The findings of Audit are discussed in Chapters 2 to 5.

- Chapter 2 of this Report deals with the issues where deviations from the Act and Rules were noticed.
- Chapter 3 analyses the extent of achievement of various fiscal indicators during FY 2014-15 as compared to the targets set under the Act and Rules.
- Chapter 4 examines the receipts and expenditure of the Union Government for FY 2014-15 vis-à-vis projections contained in various fiscal policy statements, Budget at a Glance, Annual Financial Statement and Union Government Finance Accounts.
- Chapter 5 contains observations relating to adequacy and accuracy of disclosures mandated under the Act and Rules and also issues of transparency in fiscal operations.