

Chapter 2: Deviation from the Act and Rules

In the FRBM Act 2003 and FRBM Rules 2004 (as amended from time to time) various fiscal targets were set. In this chapter, we have discussed the issues regarding deviations from provisions of the Act and the Rules and inconsistencies between the Act and the Rules, followed by recommendations wherever considered necessary.

2.1 Continuous deferment of targets

Fiscal targets prescribed in the original FRBM Act 2003 were to be achieved by 31 March 2008 which were deferred to 31 March 2009 in 2004. However, in 2009, the Government decided to put on hold temporarily the process of fiscal consolidation citing reason of global meltdown necessitating adjustment of fiscal policy to take care of exceptional circumstances through which the economy was passing and promised to return to the FRBM target for fiscal deficit at the earliest and as soon as the negative effects of the global crisis on the economy have been overcome. Accordingly, the FRBM Act amended through the Finance Act 2012 (May 2012) and rules made thereunder notified in May 2013, contained revised targets for Revenue Deficit and Effective Revenue Deficit, to be achieved by 31 March 2015. Further, in the MTFP Statement placed along with Budget for FY 2014-15, the Government shifted target for achievement of revenue deficit to March 2017 citing the reason ‘below five percent growth in GDP in the last two years’. Through Finance Act 2015, amendment was made in the FRBM Act by which the target dates for achievement of all the three deficit indicators were again extended to March 2018. The reasons given were ‘emerging government priorities and compositional shift in the fiscal relations between the Centre and States’ following the recommendations of the Fourteenth Finance Commission. Thus, the Government has continuously been deferring the targets under the Act immediately after its enactment.

2.2 Non-adherence to annual reduction targets in 2014-15

Rule 3 of amended FRBM Rules notified in May 2013 required that in order to achieve the deficit targets as set out in Section 4 of the Act, the Central

Government shall reduce the effective revenue deficit, revenue deficit and fiscal deficit targets by an amount equivalent to 0.8 *per cent*, 0.6 *per cent* and 0.5 *per cent* or more of the GDP respectively³ at the end of each financial year beginning with FY 2013-14.

It may be mentioned that the Budget for FY 2013-14 was already placed in February 2013, whereas the amended FRBM Rules were notified subsequently in May 2013 setting out the amended annual reduction targets in respect of three deficit indicators beginning with FY 2013-14. Taking into account the amended annual reduction target of three deficit indicators, the **Table-1** below analyses the compliance of annual reduction in FY 2014-15 as set by the Government in MTFP Statement for 2014-15 vis-à-vis RE for FY 2013-14.

Table-1: Annual Reduction Targets

(As percentage of GDP)

Fiscal Indicators	RE 2013-14	Target in BE 2014-15	Annual Reduction
Effective Revenue Deficit	2.0	1.6	0.4
Revenue Deficit	3.3	2.9	0.4
Fiscal Deficit	4.6	4.1	0.5

Source: MTFP Statement for 2014-15

The annual reduction target in respect of two deficit indicators, i.e. effective revenue deficit and revenue deficit were only 0.4 *per cent* of GDP in Budget of 2014-15 with reference to the revised estimates for FY 2013-14 as against required reduction of 0.8 *per cent* and 0.6 *per cent* respectively as specified in FRBM Rules applicable during that period. As such, the annual reduction targets envisaged in the Budget of 2014-15 were not in accordance with provisions contained in the Rules.

The Ministry stated (May 2016) that the MTFP Statement for the year 2014-15 had acknowledged an imbalance on revenue account and it was clarified that the difficult macro-economic conditions in the international and domestic market prevailing over the year resulted into lesser than mandated correction in deficit. It further stated that later in the year 2015, in sync with the existing macro-economic realities and need for creating additional fiscal space to increase public investment, the FRBM Act was amended and new target date was set for achieving deficit targets. It also added that annual reduction targets have been re-calibrated. In Budget 2016-17, annual reduction in

³ These stipulations were further relaxed in June 2015 through amendment in the Act.

estimates of FD is in line with the FRBM Act, whereas, it is more than mandated in respect of RD and ERD.

While taking into consideration the reply of the Ministry in the above para as well as the position brought out in the MTFP Statement for FY 2014-15, which bring out the impediments having a bearing on the achievement of the annual reduction targets, it may be mentioned that the reduction targets as specified in the FRBM Rules applicable during that period could not be achieved. The subsequent recalibration of the reduction targets as mentioned by the Ministry was brought into effect in June 2015 and the annual reduction was to begin from FY 2015-16.

2.3 Inconsistency in fiscal targets between MTFP Statement and FRBM Act/Rules

Section 4 of FRBM Act and Rule 3 of FRBM Rules specifies the targets for the three fiscal indicators along with target date for their achievement. MTFP Statement laid along with the Budget also contains three year rolling targets for these fiscal indicators.

In this regard, following were observed in respect of target dates relating to effective revenue deficit and revenue deficit after introduction of renewed roadmap, which has also been summarized in **Table-2** hereunder.

- FRBM Act as amended in May 2012 (through Finance Act 2012) set the target of eliminating the effective revenue deficit and reach the revenue deficit of not more than two *per cent* of GDP by 31 March 2015.
- MTFP Statement laid in Parliament in February 2013 along with Budget 2013-14 indicated that this target will be achieved at the end of FY 2015-16.
- FRBM Rules as amended and notified in May 2013 again set the said targets of effective revenue deficit and revenue deficit as 31 March 2015.
- MTFP Statement laid in Parliament in July 2014 along with Budget 2014-15 showed that the targets of effective revenue deficit and revenue deficit will be achieved at the end of FY 2016-17.

- In February 2015 through Finance Bill 2015, the Government proposed changes in the FRBM Act and Rules and targets for achieving the deficit indicators were shifted to 31 March, 2018. The Finance Bill 2015 became the Finance Act in May 2015.

Table-2: Inconsistency in target dates

As set out in						
	%age of GDP	Amendment Act of May 2012	MTFP Statement of February 2013 (in Budget for FY 2013-14)	FRBM Rules notified in May 2013	MTFP Statement of July 2014 (in Budget for FY 2014-15)	Finance Bill 2015 (in Budget for FY 2015-16)
Effective revenue deficit	Nil	<i>To be achieved by</i>				
		31 March 2015	31 March 2016	31 March 2015	31 March 2017	31 March 2018
Revenue deficit	Not more than 2					

Thus, between February 2013 and February 2015, different target dates were set in respect of effective revenue deficit and revenue deficit. It may be seen that MTFP Statements for 2013-14 and 2014-15 were having target dates inconsistent with target dates set out in FRBM Act and Rules applicable during that period.

The Ministry stated (May 2016) that the deferment of targets referred to in audit observation was in respect of rolling targets/projections for next two years (medium-term). It also stated that while preparing Budget for particular financial year, the Government provides the rolling targets of specified fiscal indicators viz., FD, RD, ERD, Tax-GDP ratio etc. in MTFP Statement. It added that rolling targets are set on the basis of certain underlying assumptions viz., GDP growth, receipts, expenditure etc. and variation in these macro-economic parameters necessitates re-fixing of fiscal targets in the budget year. Therefore, an advance amendment to the Act on the basis of rolling targets is unwarranted, since situation may change by the time Budget is presented.

The reply needs to be viewed in the light of the position that the MTFP Statement which provides the underlying assumptions of fiscal indicators along with rolling targets should have been aligned with the corresponding fiscal targets stipulated in the FRBM Act/Rules.

2.4 Inconsistency in FRBM Act and Rules – on assumption of additional liabilities

Rule 3(4) of the FRBM Rules requires that the Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of *9 per cent* of GDP for FY 2004-05 and in each subsequent financial year, the limit of *9 per cent* of GDP shall be progressively reduced by at least one percentage point of GDP. Thus, according to application of this Rule, with gradual reduction of one percentage point of GDP, from the level of *9 per cent*, beginning from financial year 2004-05, the Government should not assume any additional liabilities from the financial year 2013-14 onwards. However, given the prevalence of deficit budgeting in the Union Government, a significant portion of fiscal deficit is to be met from borrowings and hence creation of additional liabilities cannot be ruled out. Thus, Rule 3(4) with regard to assumption of additional liabilities is inconsistent and needs to be aligned with the Rule 3(2) regarding fiscal deficit, which stipulates bringing down fiscal deficit at the level of not more than of *3 per cent* of GDP by 31 March 2018.

The Ministry stated (May 2016) that Rule 3(4) needs to be seen in the context that with a fiscal deficit target of 3 per cent of GDP, creation of additional liability cannot be avoided, but it will decline with reduction in fiscal deficit. It also added that additional liability was to be progressively reduced by at least one percentage point of GDP from the financial year 2005-06 onwards till the ultimate fiscal deficit target of not more than 3 per cent of GDP is achieved, and not that additional liability will be completely eliminated.

The reply of the Ministry does not address the issue. Subsequent amendments in Rule 3(2) shifted the target of bringing down fiscal deficit at the level of not more than of *3 per cent* of GDP to 31 March 2018. Thus, with the shifting of target dates for achieving the fiscal deficit, appropriate amendments could have concurrently been brought in Rule 3(4) also to align the related provisions in the Rules.

Recommendation: *To address the issues of inconsistency in the FRBM Act/Rules, the Government may carry out suitable amendments.*

2.5 Inconsistency in format of disclosure statement (D-6)

Rule 6(1) of amended FRBM Rules requires that in order to ensure greater transparency in its fiscal operation in the public interest, the Central Government shall at the time of presenting the Annual Financial Statement and the Demands for Grants, make disclosures in prescribed Form (D-6) with regard to expenditure incurred on grants for creation of capital assets (refer **Annex 1.1**). This disclosure statement is presented in the Expenditure Budget Volume-I in a different format from FY 2011-12, although the Rule 6(1) was notified in May 2013. This disclosure statement appended in the Expenditure Budget Volume-I from FY 2011-12 onwards has a different format which varies from the prescribed Form (D-6). The disclosure does not provide details of actual expenditure data for previous year (Y-1), as required under the format prescribed by FRBM Rules.

The Ministry accepted (May 2016) the audit observation.

Recommendation: *The Government should follow the format of Form D-6 as prescribed under the FRBM Rules.*

Conclusion

After introduction of FRBM Act, the Government had been continuously deferring the fiscal targets. During 2014-15, in respect of effective revenue deficit and revenue deficit, the annual reduction targets set out by the Government were not in accordance with the provisions of the Act/Rules. Between February 2013 and February 2015, the target dates set out in MTFP Statement for effective revenue deficit and revenue deficit were inconsistent with the FRBM Act and Rules. Further, there is inconsistency between provisions made under the FRBM Act and Rules made thereunder on assumption of additional liabilities.