Chapter 4: Analysis of projections in fiscal policy statements

Section 3 of the FRBM Act envisages laying of three fiscal policy statements (viz. Mid-term Fiscal Policy (MTFP); Fiscal Policy Strategy (FPS); and Macro-economic Framework (MF)) in both Houses of Parliament along with the Annual Financial Statement and the Demands for Grants. Amendment made in the FRBM Act in 2012 prescribed another statement (Medium Term Expenditure Framework (MTEF) Statement) containing a three year rolling target for prescribed expenditure indicators, with specification of underlying assumptions and risks involved. The MTEF is mandated to be laid before both Houses of Parliament immediately following the Session of Parliament in which the MTFP; FPS and MF Statements are laid.

Efficient management of tax administration/other receipts and public expenditure holds the balance for achievement of various fiscal indicators envisaged under the FRBM Act/Rules. This chapter analyses the receipts and expenditure of the Union Government for FY 2014-15 vis-a-vis projections contained in the fiscal policy statements and the Budget at a Glance and Annual Financial Statement.

4.1 Projections in Mid Term Fiscal Policy Statement

MTFP Statement contains three year rolling targets for fiscal indicators viz. revenue deficit, effective revenue deficit, fiscal deficit, Tax Revenue and Total Outstanding Liabilities as a percentage of GDP with specification 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. Analysis of projections of some of the components of fiscal indicators for FY 2014-15 in MTFP Statement are discussed below:

4.1.1 Gross Tax Revenue projection

In the MTFP Statement placed along with Budget 2012-13, the Government had set gross tax revenue target of 11.7 *per cent* of GDP for FY 2014-15. This target was revised to 11.2 and 10.6 *per cent* of GDP in subsequent MTFP Statements placed with Budget 2013-14 and 2014-15 respectively. The target was again revised downward to 9.9 *per cent* (revised estimates) of GDP in MTFP Statement placed with Budget 2015-16.

In Budget 2014-15, several proposals were made to recalibrate the tax effort on Indirect Taxes so that fiscal consolidation may be achieved. However, in its Mid-Year Economic Analysis Report (December 2014), while explaining deviation in meeting the obligations under the FRBM Act, the Government stated that its revenue projections for FY 2014-15 were over-optimistic. In the said Analysis Report it was brought out that there was overestimation of gross tax revenue amounting to ₹ 1,05,084 crore. The Report also stated that an overestimation of revenue can result from an overestimation of nominal GDP growth as well as overestimation of buoyancy.

The Ministry stated (May 2016) that audit observation is factual in nature. It added that the rolling targets in respect of prescribed fiscal indicators including tax-GDP ratio is based on underlying assumptions, and variation in these macro-economic parameters necessitates re-adjustment in prescribed fiscal indicators of the Budget year.

The reply is not tenable as the MTFP Statement containing rolling targets with specifications of underlying assumptions for fiscal indicators should be on a sound basis, which may form the base for preparing the Budget for the relevant year.

4.1.2 Total Outstanding Liability projection

Rule 5 of FRBM Rules 2004 requires that the Central Government shall set forth a three-year rolling target through MTFP Statement in respect of total outstanding liabilities as a percentage of GDP.

In Budget 2012-13, the Government had set the target as 41.9 *per cent* of GDP for FY 2014-15. It was noticed that the projections were revised upwardly for the year 2014-15, to 44.3 *per cent* and 45.4 *per cent* of GDP in next two MTFP Statements placed along with Budgets for the financial years 2013-14 and 2014-15 respectively. Against this, the actual ratio of total liability to GDP for 2014-15 stood at 46.2 *per cent* (Refer Para No.3.4.2 of this Report).

The Ministry stated (May 2016) that while preparing Budget for particular financial year, the Government provides the rolling targets of specified fiscal indicators 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.

The reply is not tenable as the Act/Rules envisaged that the targets of fiscal indicators contained in MTFP Statement should be based on underlying assumptions which could be the base for preparing the Budget for the relevant year. Changing projection of fiscal indicators for a relevant year frequently shows that the underlying assumptions were not on sound basis.

4.1.3 Disinvestment projection

In the MTFP Statement placed with Budget 2013-14, an amount of ₹ 20,000 crore was projected as disinvestment proceeds for FY 2014-15. Further, in MTFP Statement placed along with the Budget of 2014-15, the Government expected to raise ₹ 63,425 crore as total miscellaneous capital receipts. But in RE 2014-15, this projection was scaled down to ₹ 31,350 crore. Against this reduced projection, the actual realization from disinvestment of Public Sector Undertakings in FY 2014-15 was ₹ 37,737 crore, far off from the budgeted projection of ₹ 63,425 crore.

The Ministry stated (May 2016) that the audit observation is factual. It added that with uncertain market conditions prevalent for most part of the year, there was high probability of getting less than optimum returns on disinvestment and the Government decided to take more cautious approach to go slow on disinvestment.

The reply of the Ministry reinforces the audit contention that the projection for various components of fiscal indicators contained in the fiscal policy statements are not based on sound assumptions.

4.1.4 Structural imbalance in the composition of expenditure

MTFP statement measures deployment of capital receipts for generating productive assets through the ratio of Plan Expenditure as a percentage of fiscal deficit and Non-Plan expenditure as a percentage of revenue receipts.

The projections for the year 2014-15 in the MTFP Statements for 2012-13 and 2014-15 vis-à-vis actuals are as under:

Table-9: Structural composition of expenditure

(in percentage)

Parameters	Assumptions made for FY 2014-15 in MTFP Statement placed along with		Actual for FY 2014-15 (worked out from Budget at a Glance for 2016-17)
	Budget for 2012-13	Budget for 2014-15	
Plan Expenditure/Fiscal Deficit	131	108.3	90.6
Non-Plan Expenditure/total revenue receipt	88	102.5	109.0

Note: Issue not discussed in MTFP Statement for FY 2013-14.

To assess the quality of government spending, an increasing ratio of plan expenditure to fiscal deficit is a pointer towards the efficient deployment of borrowed resources. On the other hand, non-plan expenditure in excess of revenue receipts indicate use of capital resources for consumptive expenditure, thereby raising issues of structural problem in the composition of expenditure, requiring corrective measures towards development works. However, from **Table-9** above, it would be observed that the projections made in the MTPF Statements to address the issue of structural problems in the composition of expenditure could not be achieved, as plan expenditure to fiscal deficit ratio slipped to 90.6 *per cent* from budgeted level of 108.3 *per cent* and non-plan expenditure to total revenue receipt ratio increased to 109 *per cent* from 102.5 *per cent* for FY 2014-15.

Ministry stated (June 2016) that the projections in the MTFP statement are set on the basis of certain underlying assumptions viz., GDP growth, receipts, expenditure etc. over the projection period and variation in these macro-economic parameters at the time of actual budgeting necessitates re-fixing of fiscal targets in the Budget year. It also added that there has been improvement in deployment of capital receipts for generating productive assets. Between 2012-13 and 2016-17, capital expenditure as percentage of fiscal deficit has increased from 34 per cent to about 46 per cent.

The increasing proportion of capital expenditure as percentage of fiscal deficit is appreciable. However, the fact remains that projections for components of fiscal indicators including receipts, expenditure and liabilities, as contained in fiscal policy statements are not based on sound assumptions leading to frequent and substantial recalibration in later years and also having impact on structural imbalance in composition of expenditure.

4.2 Projections in Medium Term Expenditure Framework Statement

Consequent to amendments made in FRBM Act in 2012, one of the key requirements relate to laying of a Medium Term Expenditure Framework (MTEF) Statement in the Parliament, in the Session immediately following the Budget Session. In terms of sub-section 6A of Section 3 of the Act, the MTEF Statement shall set forth a three year rolling target for prescribed expenditure indicators (in prescribed format notified on 5 September 2012) with specification of underlying assumptions and risks involved.

Comparison of projection of expenditure for FY 2014-15 contained in MTEF Statement of 2013-14 (August 2013) with Budget estimates for FY 2014-15 contained in MTEF Statement of 2014-15 (December 2014) and revised estimates for FY 2014-15 as contained in MTEF Statement of 2015-16 (August 2015) is given in **Annex-4.1**.

From the annexure, it would be seen that underlying assumptions based on which the expenditure projections made for FY 2014-15 in MTEF Statement of 2013-14 were changed in subsequent years. As a result of persistent changes in projections, following points were observed.

- In respect of revenue expenditure and capital expenditure, the projection made in August 2013, as compared to RE 2014-15 (August 2015), were overestimated by 3.93 and 16.89 *per cent* respectively.

- The projection made in respect of grants for creation of capital assets was reduced from ₹ 2,33,345 crore (August 2013) to ₹ 1,68,104 crore (December 2014) and to ₹ 1,31,898 crore (August 2015). The ultimate contraction under this head of expenditure was ₹ 1,01,447 crore, amounting to 43.48 *per cent* of the projected figure.

- Projections of revenue expenditure on Subsidy, Defence, Finance, and Urban Development were augmented substantially in RE 2014-15. While in rest of the heads of expenditure there were over projections, which were curtailed in RE 2014-15.

- With respect to Capital Expenditure in Home Affairs, Finance, Health, Commerce and Industry, Planning and Statistics, IT & Telecom and Scientific Departments the over projections were more than 40 *per cent* in MTEF Statement of August 2013.

- Some of the heads of expenditure have also been compared vis-à-vis actuals as detailed in **Annex-4.2**. The actual revenue expenditure under the heads Pension and Defence for FY 2014-15 outstripped the projection for that year as contained in MTEP Statement of 2013-14 by 20.3 and 9.3 *per cent* respectively. At the same time, actual capital expenditure fell short by 15.0 *per cent* as compared to projections. Comparison of projections with actuals in Annual Financial Statement and Union Government Finance Accounts is also given in **Annex-4.2**

Ministry stated (June 2016) that the projections in the MTFP statement are set on the basis of certain underlying assumptions viz., GDP growth, receipts, expenditure etc. over the projection period and variation in these macro-economic parameters at the time of actual budgeting necessitates re-fixing of fiscal targets in the Budget year.

The reply of the Ministry needs to be seen along with the comments contained in Paras 4.1 and 4.2 which bring out that there were wide variations in the projected receipts and expenditure figure for a particular financial year included in the various fiscal policy statements vis-a-vis budget estimates prepared for that financial year. This indicates deficiencies in the process of making assumptions while preparing these fiscal policy statements.

Recommendation: *The Government may strengthen the process of making underlying assumptions for projection of receipt and expenditure in various fiscal policy statements to insulate them from frequent changes and to seamlessly integrate the projections in the Budget.*

Conclusion

The analysis of the projections of receipts and expenditure included in the fiscal policy statements for multi-year revealed that the projections were at variance vis-a-vis corresponding figures for that year as reflected in subsequent statements and Budget documents.