

Chapter 1: Introduction

1.1 Background

The Fiscal Responsibility and Budget Management (FRBM) Bill was introduced in Parliament by the Government of India (Government) in December 2000 which became an Act in August 2003. The objective of FRBM Act, 2003 was to institutionalize fiscal discipline, reduce fiscal deficit, improve macro-economic management and the overall management of public funds by moving towards a balanced budget. FRBM Rules 2004 framed under Section 8 of the Act came into force in July 2004.

The FRBM Act, 2003 and Rules made thereunder specified targets for eliminating revenue deficit and containing fiscal deficit to not more than three *per cent* of GDP¹ by March 2008. Other stipulations and conditions regarding guarantees to be given, assumption of liabilities and borrowings from Reserve Bank of India by the Government were also included in the Act. Besides, the Act and Rules require the Government to lay in both Houses of the Parliament three policy statements², viz. Medium Term Fiscal Policy (MTFP) Statement, Fiscal Policy Strategy (FPS) Statement and Macro-economic Framework (MF) Statement along with the Annual Financial Statement and the Demands for Grants.

Through the Finance Act 2004 (September 2004), amendment was made in FRBM Act, whereby the date for achievement of revenue and fiscal deficit targets was shifted to 31 March 2009. However, in February 2009, the Government put on hold temporarily the fiscal consolidation process citing global economic crisis and adverse circumstances.

1.2 Amendments in FRBM Act

The 13th Finance Commission (FC) in its report (December 2009) for the award period 2010-15 had outlined a 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, to be followed by revenue surplus of 0.5 *per cent* of GDP by 2014-15. Accordingly, the FRBM Act was amended through the Finance Act 2012 (May 2012). The Rules made thereunder, which were notified in May 2013, contained revised target of two *per cent* of GDP by 31 March 2015 for revenue deficit and for fiscal deficit of not more than three *per cent* of GDP by 31 March 2017.

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

² Refer Annexure I.1.

The amended FRBM Act introduced a new fiscal indicator namely ‘effective revenue deficit’, 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.

Further, the amended FRBM Act and Rules required the Government to lay down another Statement, viz. Medium Term Expenditure Framework (MTEF) Statement before both Houses of the Parliament, immediately following the session of Parliament in which the other three policy statements (as mentioned in Para 1.1) were laid. The FRBM Act and Rules (as amended from time to time) also require laying of quarterly review reports, besides six disclosures in the prescribed forms. A brief on different fiscal policy statements and disclosure forms to be laid before the Parliament under the provisions of FRBM Act is given at **Annexure-1.1**.

In May/June 2015, the FRBM Act/Rules were further amended thereby shifting the target year of the three deficit indicators to 31 March 2018.

In Budget 2016-17 presented in February 2016, the target year of effective revenue deficit was deferred to 31 March 2019 through MTEF Statement on the ground that imbalance within the revenue component of expenditure require deeper correction and concerted efforts of all Ministries/Departments as well as State Governments to enhance the expenditure on the capital component from the revenue grants flowing from the Centre.

Again, in Budget 2017-18 presented in February 2017, through MTEF Statement, the target year of effective revenue deficit was deferred to a period beyond 2019-20 citing structural issues in the revenue expenditure component of the Centre as a reason. The target year of fiscal deficit was deferred to 31 March 2019 citing the macro-economic need of higher public expenditure by the Government in a scenario when private investment was not picking up.

The target dates applicable for various fiscal indicators during the financial year 2015-16 and for subsequent years and other stipulations in respect of guarantees, liabilities and borrowings from RBI are indicated in **Box-1** below:

Box-1: Targets for various fiscal indicators

Indicators	Targets
Effective Revenue Deficit (ERD)	ERD was 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 financial year 2015-16.

	<p>In February 2016, the target for elimination of ERD was deferred to 31 March 2019 through MTFP Statement placed alongwith Budget 2016-17.</p> <p>Further, in MTFP Statement placed alongwith Budget 2017-18 in February 2017, the target of elimination of ERD was pushed beyond 2019-20 as a target of 0.2 <i>per cent</i> of GDP was fixed in respect of ERD to be achieved by 31 March 2020³.</p>
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 financial year 2015-16.
Fiscal Deficit (FD)	<p>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 financial year 2015-16.</p> <p>In February 2017, the target for FD was deferred to 31 March 2019 through MTFP Statement placed alongwith Budget 2017-18.</p>
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 financial year 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 borrowings by the Central Government from Reserve Bank of India.

1.3 FRBM Review Committee

The Government had constituted a committee in May 2016 to comprehensively review the working of the FRBM Act over last 12 years and to suggest the way forward, keeping in view the broad objective of fiscal consolidation and prudence and the changes required in the context of the uncertainty and volatility in the

³ The target for elimination of ERD was to be achieved by March 2019. However, in MTFP Statement submitted along with Budget 2017-18 (February 2017), the projected ERD targets as a percentage of GDP were 0.7 in 2017-18, 0.4 in 2018-19 and 0.2 in 2019-20 i.e. target for elimination of ERD was shifted beyond 2019-20.

global economy. The terms of reference of the Committee also included looking into various aspects, factors, considerations going into determining the FRBM targets; to examine the need and feasibility of having a ‘fiscal deficit range’ as the target in place of the existing fixed numbers (percentage of GDP) as fiscal deficit target and to examine the need and feasibility of aligning the fiscal expansion or contraction with credit contraction or expansion respectively in the economy.

The Committee had submitted its report on 23 January 2017. Some of the major recommendations made by the Committee are as follows:

- Repeal the existing FRBM Act, 2003 and the FRBM Rules, 2004.
- Enact a new Debt and Fiscal Responsibility Act, in pursuance of the new Act, enact, and adopt the Debt and Fiscal Responsibility Rules, as per drafts suggested by the Committee.
- Adopt a prudent medium-term ceiling for general government debt⁴ of 60 *per cent* of GDP to be achieved by no later than financial year 2022-23. Within the overall ceiling of 60 *per cent*, adopt a ceiling of 40 *per cent* for the Centre, and the balance 20 *per cent* for the State.
- Adopt fiscal deficit as the key operational target consistent with achieving the medium term debt ceiling.
- The path of fiscal deficit to GDP ratio of 3.0 *per cent* in financial year 2017-18 to financial year 2019-20, 2.8 *per cent* in financial year 2020-21, 2.6 *per cent* in financial year 2021-22 and 2.5 *per cent* in financial year 2022-23 be adopted.
- Revenue deficit to GDP ratio to decline steadily by 0.25 percentage points each year with the path specified as follows: 2.3 *per cent* in financial year 2016-17, 2.05 *per cent* in financial year 2017-18, 1.8 *per cent* in financial year 2018-19, 1.55 *per cent* in financial year 2019-20, 1.30 *per cent* in financial year 2020-21, 1.05 *per cent* in financial year 2021-22 and 0.8 *per cent* in financial year 2022-23.
- The deviation from the stipulated fiscal deficit target shall not exceed 0.5 percentage points in a year in case of invocation of Escape Clauses.
- Constitute a Fiscal Council with the Terms and Conditions as mentioned in the Report of the Committee.

⁴ As per the report of the Committee, ‘general government debt’ means total liabilities of the Central Government and the State Government excluding inter-governmental liabilities.

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

Section 7A inserted through FRBM Amendment Act (May 2012) provides 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. Rule 8 was framed and notified in October 2015 to carry out the effect of Section 7A of the Act. The notified Rule 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.

The first Report of CAG on compliance of the provisions of FRBM Act in respect of financial year 2014-15 was presented in Parliament in August 2016⁵.

1.5 Structure of the Report

The present report is the review by the CAG as per Rule 8 of FRBM (Amendment) Rules 2015 on compliance to the provisions of the Act by the Government for financial year 2015-16. The findings of Audit are discussed in **Chapters 2 to 6**.

- **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 financial year 2015-16 as compared to the targets set under the Act

⁵ Report of the CAG on Compliance of FRBM Act, 2003 for financial year 2014-15 (Report No. 27 of 2016).

and Rules including trend analysis of fiscal indicators since financial year 2011-12.

- **Chapter-4** provides an analysis of components of receipts and expenditure and macro-economic parameters including comments on classification of revenue and expenditure having a bearing on deficit indicators.
- **Chapter-5** examines the receipts and expenditure of the Union Government for financial year 2015-16 *vis-à-vis* projections contained in various fiscal policy statements, Budget at a Glance, Annual Financial Statement and Union Government Finance Accounts.
- **Chapter-6** contains observations relating to adequacy and accuracy of disclosures mandated under the Act and Rules and also issues of transparency in fiscal operations.