

## Chapter 1: Introduction

### 1.1 Background

The objective of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 was to provide for the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macro-economic stability. The Central Government should achieve the objectives through sufficient revenue surplus and prudential debt management through limits on borrowings, debt and deficits. It also stipulated requirement of greater transparency in fiscal operations of the Central Government and conducting the fiscal policy in a medium-term framework. The FRBM Rules 2004 framed under Section 8 of the Act came into force in July 2004.

The FRBM Act, 2003 (as amended from time to time) and Rules made thereunder specified targets with regard to eliminating/containing three fiscal indicators namely, revenue deficit, effective revenue deficit and fiscal deficit in terms of percentage of Gross Domestic Product (GDP<sup>1</sup>) to be achieved by 31 March 2018 with annual reduction targets for the respective indicators. The Act and the Rules also included requirements of capping of guarantees, additional liabilities with the stipulation of not resorting to borrow from Reserve Bank of India except in special situations<sup>2</sup>. Besides, the Act and the Rules require the Government to lay in both the houses of Parliament three policy statements, *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. Further, it also required laying of Medium-term Expenditure Framework (MTEF) Statement in Parliament immediately following the session of Parliament in which the previously mentioned three policy statements were laid.

The FRBM Act and Rules 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**.

The following **Table 1.1** gives an overview of the sunset targets and applicable targets at the end of 2016-17 after resetting targets based on actual reduction in 2015-16 with regard to the various fiscal indicators.

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<sup>1</sup> Figures of Gross Domestic Product (GDP) as appearing in the report refer to GDP at current price as defined under the FRBM Act.

<sup>2</sup> To meet temporary excess of cash disbursement over cash receipt, subscription of primary issues upto 1 April 2005 and thereafter on grounds of national security, national calamity, etc. and open market operations in the secondary market.

Table -1.1 : Targets of fiscal indicators under the FRBM Act/Rules as amended from time to time

<i>(As percentage of GDP)</i>		
<i>Fiscal Indicators</i>	<i>Sunset/overall targets</i>	<i>Annual target for 2016-17</i>
<b>Fiscal Deficit</b>	Not more than three <i>per cent</i> of GDP by 31 March 2018 with annual reduction of 0.4 <i>per cent</i> or more of GDP beginning with the FY 2015-16	3.5
<b>Revenue Deficit</b>	Not more than two <i>per cent</i> of GDP by 31 March 2018 with annual reduction of 0.4 <i>per cent</i> or more of GDP beginning with the FY 2015-16	2.1
<b>Effective Revenue Deficit</b>	To eliminate by 31 March 2018 with annual reduction of 0.5 <i>per cent</i> or more of GDP beginning with the FY 2015-16.	1.1
<b>Guarantees</b>	Not to give guarantee aggregating to an amount exceeding 0.5 <i>per cent</i> of GDP in any financial year beginning with FY 2004-05	0.5
<b>Liabilities</b>	Not to assume additional liabilities (including external debt at current exchange rate) in excess of 9 <i>per cent</i> of GDP for the financial year 2004-05 and in each subsequent financial year, progressively reduce the limit of 9 <i>per cent</i> of GDP by at least one <i>percentage</i> point of GDP	Nil

## 1.2 FRBM Review Committee

The Government in 2016 felt a need to review the FRBM Act attributing it to substantial changes in global backdrop including slowdown, developments in China and Eurozone, protectionism and low inflation and unconventional monetary policy, etc. It was felt that due to increased financial integration with the world economy, domestic policy changes to cope with challenging, uncertain and volatile exogenous environment were needed.

It was also argued that changes and flexibility in fiscal rules in several countries allow fiscal space to absorb exogenous shocks. Presence of independent fiscal council, escape clauses and automatic correction to impart transparency, flexibility and credibility to the framework in the fiscal rules also necessitated alignment of rules in India in the same parlance.

With these objectives in mind, Government constituted the FRBM review committee in May 2016 under the chairmanship of Shri N.K. Singh to comprehensively review the working of FRBM Act over last 12 years and to suggest way forward. Terms of reference of Committee include particularly in exploring the feasibility of having fiscal deficit range as the target instead of fixed numbers in order to give necessary policy space to the Government to manage dynamic situations and aligning the fiscal expansion or contraction with credit contraction or expansion respectively in the economy.

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

- Repeal the existing FRBM Act, 2003 and the FRBM Rules, 2004 and enact a new Debt and Fiscal Responsibility Act, enact and adopt the Debt and Fiscal Responsibility Rules in pursuance of the new Act, as per drafts suggested by the Committee.
- Adopt a prudent medium-term ceiling for General Government debt 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 States.
- 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 2017-18 to 2019-20, 2.8 *per cent* in financial year 2020-21, 2.6 *per cent* in 2021-22 and 2.5 *per cent* in 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 2016-17, 2.05 *per cent* in 2017-18, 1.8 *per cent* in 2018-19, 1.55 *per cent* in 2019-20, 1.30 *per cent* in 2020-21, 1.05 *per cent* in 2021-22 and 0.8 *per cent* in 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 in conditions such as national security, act of war, national calamity, collapse of agriculture, structural reforms in the economy, decline in real output growth, etc.
- Constitute a Fiscal Council with the terms and conditions as mentioned in the Report of the Committee.

### **1.3 Action taken by the Government on recommendations of the Committee**

The Government has made comprehensive amendments in the FRBM architecture through Finance Act 2018 presented along with Budget 2018-19 in view of the recommendations made by the FRBM Review Committee. In compliance to amendment in FRBM Act through Finance Act 2018, Central Government notified FRBM (Amendment) Rule 2018 on 2 April 2018.

In the revised FRBM architecture, the Government will simultaneously target debt and fiscal deficit and treat fiscal deficit as an operational target. The revised FRBM

framework has done away with the requirements of achievement of targets on revenue account (Revenue Deficit) and consequently Effective Revenue Deficit.

Further, Medium-term Fiscal Policy cum Fiscal Policy Strategy Statement is now required to be prepared in place of earlier Medium-term Fiscal Policy Statement. This includes new indicators such as Primary deficit<sup>3</sup>, non-tax revenue and Central Government debt.

The major amendments made through the Finance Act 2018 in the FRBM framework are;

- Fiscal deficit as the key operational target with focus on achieving three *per cent* of GDP by the end of the FY 2020-21.
- Doing away with the Revenue Deficit target and consequently Effective Revenue Deficit target and inclusion of Primary deficit as a fiscal indicator.
- Achieving the General Government debt<sup>4</sup> target of 60 *per cent* and Central Government debt target of 40 *per cent* by the end of the FY 2024-25. The scope of 'Central Government Debt' has been expanded to include the total outstanding liabilities on the security of the Consolidated Fund of India and Public Account plus such financial liabilities of any body corporate or other entity owned or controlled by the Central Government, which the Government is to repay or service.
- Not to give additional guarantees with respect to any loan on security of the Consolidated Fund of India in excess of one-half *per cent* of GDP in any financial year.
- Widening of grounds (escape clauses) on which Central Government is allowed to breach the deficit targets including national security, act of war, national calamity, collapse of agriculture, structural reforms in the economy, decline in real output growth, etc. However, any deviation from Fiscal Deficit target shall not exceed one-half *per cent* of the GDP.
- In case of increase in real output growth of a quarter by at least three *per cent* points above its average of the previous four quarters, reduce the fiscal deficit by at least one-quarter *per cent* of the GDP in a year.
- Half-yearly review in place of quarterly review and preparation of monthly statement of accounts.

The Government, however, has not included the recommendations of the Committee relating to indicator of Revenue Deficit and establishment of Fiscal

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<sup>3</sup> Fiscal deficit minus interest payments

<sup>4</sup> General Government Debt means total liabilities of the Central Government and the State Governments excluding inter-Governmental liabilities

Council in the amended FRBM Act. With regard to not including the indicator of revenue deficit, the Government argued that there is little or no evidence to say that capital expenditure should enjoy pre-eminence over revenue expenditure in a country like India. Moreover, expenditure of revenue nature such as health and education also enhance human capital formation. The Government did not provide any specific reason in either budget documents and/or MTFP statements for not constituting Fiscal Council as recommended by FRBM review Committee.

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

As per Rule 8 of amended FRBM Rules 2015, 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 two Reports of CAG on compliance of the provisions of FRBM Act for financial year 2014-15 (Report No. 27 of 2016) and 2015-16 (Report No. 32 of 2017) were presented in Parliament in August 2016 and December 2017 respectively.

#### **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 2016-17. 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 2016-17 as compared to the targets set under the Act and Rules including trend analysis of fiscal indicators since financial year 2014-15.
- **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 2016-17 *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 issues of transparency in fiscal operations.