

Chapter 2: Deviation in performance from the Act and Rules

The FRBM Act 2003 and FRBM Rules 2004 (as amended from time to time) prescribed targets for fiscal indicators. This chapter discusses deviations from the provisions of the Act and the Rules including shifting of targets in subsequent years.

2.1 Compliance with annual reduction targets specified under the FRBM Act

Rule 3 of FRBM Rules (amended in June 2015) 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 (ERD), Revenue Deficit (RD) and Fiscal Deficit (FD). The reduction in ERD, RD and FD was to be done by an amount equivalent to 0.5, 0.4 and 0.4 *per cent* or more of GDP respectively at the end of each financial year, beginning with financial year 2015-16.

Table-2.1 below analyses compliance of the annual reduction targets for the FY 2016-17 in comparison to 2014-15 and 2015-16.

Table-2.1: Annual Reduction Targets: 2016-17

(As percentage of GDP)

Fiscal Indicators	Annual reduction target	Actuals (As per Budget At Glance)			Annual Reduction against target mentioned at column (1)	
	June 2015	2014-15	2015-16	2016-17	2015-16	2016-17
	1	2	3	4	5 (2-3)	6 (3-4)
Effective Revenue Deficit	0.5	1.9	1.6	1.0	0.3	0.6
Revenue Deficit	0.4	2.9	2.5	2.1	0.4	0.4
Fiscal Deficit	0.4	4.1	3.9	3.5	0.2	0.4

The **table** shows that the Government was not able to achieve annual reduction targets in respect of ERD and FD in 2015-16 *vis-à-vis* 2014-15 as actual reduction was 0.3 and 0.2 *per cent* against targeted reduction of 0.5 and 0.4 *per cent* of GDP respectively. However, the Government achieved the reduction target in case of all the three fiscal indicators in 2016-17.

Although Government was able to achieve annual reduction targets in respect of all the three indicators in 2016-17, it was against the base that prevailed in 2015-16 in respect of ERD and FD. In 2015-16, Government had already deviated from the annual reduction target by 0.2 *per cent* against ERD target of 0.5 *per cent* and by 0.2 *per cent* against the FD target of 0.4 *per cent*. As such, taking into consideration 2015-16 and 2016-17 together, if Government would have met the annual reduction targets as required by 2015 amendment, the actual ERD at the end of March 2017

would have been 0.9 *per cent* and not 1.0 *per cent* and the actual FD would have been 3.3 *per cent* and not 3.5 *per cent*. As such, after the amendment in 2015, Government was not able to achieve the cumulative reduction target for two years together.

Ministry stated (July 2018) that the FRBM Rules provided for reduction in the FD/RD/ERD targets by an amount equivalent to 0.4 per cent/0.4 per cent/0.5 per cent beginning with FY 2015-16; the reference points for comparing the annual reduction target is 2015-16 and not 2014-15. The annual reduction targets are prospective, beginning with end of 2015-16.

The reply of the Ministry is not tenable as the FRBM Rules 2015 amended in June 2015 requires that in order to achieve the FD/RD/ERD deficit target of three *per cent*, two *per cent* and *Nil* of the GDP respectively by the end of FY 2017-18 (target year), Central Government shall reduce such deficit by an amount equivalent to 0.4, 0.4 and 0.5 *per cent* or more of GDP respectively at the end of each financial year beginning with financial years 2015-16.

Audit is also comparing the achievement in annual reduction targets at the end of March 2016-17 with reference to those at the end of March 2015-16, as stated by the Ministry. However, audit is pointing out non-achievement of targets in 2015-16. Though the amended annual reduction targets (amendment in June 2015) of 0.5 *per cent* and 0.4 *per cent* for ERD and FD respectively were applicable for FY 2015-16 also, Government could achieve annual reduction of only 0.3 *per cent* and 0.2 *per cent* of ERD and FD respectively. Hence, in 2015-16, there was less achievement by 0.2 *per cent* of annual reduction for ERD and FD both. Further, if the pre-amended targets (before June 2015 amendment) are taken into account, the target of annual reduction for ERD was 0.8 *per cent* and FD was 0.5 *per cent*. As such, comparing actual annual reduction in 2015-16 of 0.3 *per cent* and 0.2 *per cent* of ERD and FD, there was less achievement by 0.5 *per cent* and 0.3 *per cent* for ERD and FD respectively.

This implies that first annual reduction was to be effected from the end of financial year 2015-16 as compared to actual figures at the end of financial year 2014-15. Hence, Ministry's view about 2015-16 as a reference year for effecting this amendment and reckoning of first annual reduction at the end of 2016-17 rather than 2015-16 is not consistent with the provision of the amended Rules.

2.2 Inconsistency in specifying liability targets between FRBM Act and Rules

As per Section 4 (2) (b) of the FRBM Act, 2003, the Central Government shall, by rules made by it, specify the annual targets of assuming contingent liabilities in the form of guarantees and the total liabilities as a percentage of gross domestic product. Rule 3(4) of the FRBM Rules 2004 provides that the Central Government shall not assume additional liabilities (including external debt at current

exchange rate) in excess of nine *per cent* of GDP for the financial year 2004-05 with one *per cent* reduction in each subsequent year instead of total liability limit as specified in the Act.

While the Act required an annual target of assuming contingent liabilities and total liabilities, the Rules specified a cap on additional liability of nine *per cent* of GDP for the year 2004-05 and required one *per cent* annual reduction thereafter. As such, the Rules envisaged a sunset point at the end of March 2014 after which no additional liability was to be assumed. However, in 2014-15, 2015-16 and 2016-17, additional liability was 4.1, 4.7 and 3.2 *per cent* respectively.

Ministry stated (July 2018) that Section 4 of FRBM Act has since been modified vide Finance Act 2018 and Rule 3(4) of the FRBM Rules, 2004 and assumption of additional liabilities has also been omitted by amending the FRBM Rules, 2004 on 2 April 2018.

The reply of the Ministry recognises this anomaly in principle and states that concept of Central government debt has been introduced in place of additional/total liabilities from financial year 2018-19. However, the audit observation pertains to FY 2016-17 on the provisions of Act that were applicable at that time.

2.3 Continuous deferment of mid-year benchmarks for review to enforce corrective measures

In order to take corrective measures timely to enforce compliance, Section 7 (1) of the Act required quarterly review of the trends of receipts and expenditure in relation to budget estimates and pre-specified levels mentioned in the Fiscal Policy Strategy Statement by the Minister-in-charge of the Ministry of Finance. In order to have controlled achievement of annual targets and have scope for timely corrective measures, the Government fixed mid-year benchmarks (second quarter ending September) in respect of non-debt receipts, fiscal deficit and revenue deficit. Government was required to maintain Fiscal Deficit and Revenue Deficit up to 70 *per cent* of Budget Estimates for the year in 2016-17. In the event of breach of this mid-year targets, the Government was required to take appropriate corrective measures and appraise the Parliament of such corrective measures in the session immediately following the end of second quarter.

Audit noticed that the mid-year benchmarks for review at the end of the second quarter in respect of fiscal deficit and revenue deficit as compared with the figures of budget estimates were revised twice; from 45 *per cent* in 2004 to 60 *per cent* in 2013 and then to 70 *per cent* in 2015 through amendments as detailed in **Table 2.2**.

Table – 2.2: Revisions in benchmarks for mid-year review of trend of fiscal indicators compared with budget estimates

Fiscal indicators	Mid-year benchmark as a per cent of Budget Estimate for that year		
	As per FRBM Rules 2004	As per FRBM Amendment Rules 2013	As per FRBM Amendment Rules 2015.
Fiscal deficit	Higher than 45 per cent	Higher than 60 per cent	Higher than 70 per cent
Revenue deficit	Higher than 45 per cent	Higher than 60 per cent	Higher than 70 per cent

A comparison of the actuals in 2016-17 against mid-year benchmark revealed that the actuals were higher than the benchmarks as follows:

Table – 2.3: Actual versus benchmarks for mid-year review of trend of fiscal indicators compared with budget estimates

Fiscal indicators	Performance benchmarks under FRBM Rules	Actuals
		2016-17
Fiscal deficit	Higher than 70 per cent of BE	83.9 %
Revenue deficit	Higher than 70 per cent of BE	92.1 %

This shows that even after relaxing the target twice, the Government was unable to keep the indicators at the benchmark levels of budget estimates. The Finance Minister informed Parliament about reasons of breach of targets and corrective measures being taken to stick to annual targets. However, specific areas of expenditure and receipt responsible for breach and specific corrective measures were not specified in the statement.

Ministry stated (July 2018) that deviation vis-à-vis mid-year benchmarks in respect of fiscal deficit and revenue deficit may be seen in the context of higher pace of expenditure on one hand and comparatively slow progress in realisation of receipts in general and non-tax receipts and disinvestment receipts in particular on the other side.

It was further stated in the Statement that the Government is continuously monitoring the emerging economic scenario and is taking measures for reviving growth. To mobilize higher amount of resources, administrative, legal and technological measures initiated by Government are underway. Measures initiated by Government for expenditure management, fiscal prudence, subsidy reforms, direct transfer of benefits (DBT) are also in progress and incremental benefits may become visible in later part of the financial year. Government is steadfast on the policy of fiscal rectitude and committed to achieve the fiscal targets as estimated in budget 2016-17.

The reply of the Ministry neither provides specific reasons of continuous deferment of mid-year benchmarks of FD and RD nor highlights specific reasons of breach of mid-year benchmarks in 2016-17. This defeats the purpose of having mid-year

benchmarks and presenting strategy statement before Parliament to correct the course in achieving the targets.

2.4 Audit Summation

Though the Government met the annual reduction targets of Fiscal Deficit (FD), Revenue Deficit (RD) and Effective Revenue Deficit (ERD) in 2016-17, it had deviated in 2015-16 by 0.2 *per cent* against ERD target of 0.5 *per cent* and by 0.2 *per cent* against the FD target of 0.4 *per cent*. As such, together for 2015-16 and 2016-17, the actual ERD at the end of March 2017 would have been 0.9 *per cent* and not 1.0 *per cent*, and the actual FD would have been 3.3 *per cent* and not 3.5 *per cent*. The FRBM Rules specified a cap on additional liability of nine *per cent* of GDP for the year 2004-05 and one *per cent* annual reduction thereafter; meaning after March 2014, no additional liability was to be assumed by the Government. However, assumption of liability, as reflected in borrowings for meeting fiscal deficit continued to exist. With regard to mid-year review of trend of fiscal indicators (FD, RD) compared with budget estimates, even after relaxing the benchmark twice, the Government was unable to keep the indicators within the mid-year target of budget estimates for 2016-17.

2.5 Recommendations

- (i) The Government may ensure adherence to the medium term fiscal path as specified under FRBM Act/Rules and align its annual achievements accordingly.*
- (ii) Mid-year benchmarks for comparison with pro-rata performance against the budget estimates should be realistic and mid-course corrections should enable achievement of year-end targets, which should be disclosed transparently to the Parliament.*