Chapter 3: Progress in achievement of FRBM targets

This chapter analyses the extent of achievement of fiscal indicators for financial year 2016-17 in relation to the targets set in the FRBM Act/Rules as amended from time to time and in comparison to estimates and trend of previous years. Annual reduction targets of achievement of fiscal indicators *viz* Revenue Deficit, Fiscal Deficit and Effective Revenue Deficit were revised in June 2015 applicable from financial year 2015-16. Analysis of progress of achievement of these fiscal indicators has been made from financial year 2014-15 as the base year and progress in subsequent years. For analysis, GDP[5] at current prices (new series with 2011-12 as base year) released by Central Statistical Office, Ministry of Statistics and Programme Implementation on 31 January 2017 and 31 May 2017 have been adopted.

3.1 Revenue Deficit

Section 2(e) of FRBM Act, defines revenue deficit as the difference between revenue expenditure and revenue receipts. Revenue deficit signifies that Government's own revenue is insufficient to meet the expenditure on general functioning of Government and provisions for various services. Financing the gap implies deferred taxation as debts raised in current financial year would ultimately be paid by collecting money from taxation in future unless Government augments its non-tax revenue receipts.

Through the amended FRBM Act 2018 and the Rules made thereunder, Government has removed revenue deficit targets which would be applicable for the year 2018-19 and onwards. It has been cited that in a country like India, there is little or no evidence to say that capital expenditure should enjoy pre-eminence over revenue expenditure. However, the Government added that this strategy will not compromise on the capital expenditure since Government is meeting the requirement through off-budget borrowings. Debt raised for the purpose would be repaid through revenue generation from such projects. Thus, both revenue and capital expenditure needs of the economy would be met.

Though Government's strategy to meet capital expenditure through off-budget financing provides flexibility in meeting requirement of capital intensive projects, such financing would be outside budgetary control. Further, mainly backed by the trust in the Government's explicit or implicit guarantee, it would pose fiscal risk in

[5] The GDP figures for 2012-13 and 2013-14 are taken from press note dated 31 January 2017 and for 2014-15 to 2016-17 from press note dated 31 May 2017.

the long term in cases the entity that raises the funds fails to meet debt servicing. Select cases of off-budget financing of Ministries of Government of India were examined to understand methods and extent of such borrowings which remain beyond Parliamentary control. It came to notice that the Government resorts to off-budget methods of financing to meet revenue and capital requirements. The quantum of such borrowings is huge and current policy framework lacks transparent disclosures and management strategy for comprehensively managing such borrowings.

Ministry maintained (July 2018) that off-budget borrowings remain within the scope of Union Budget as provisioning of repayment of principal and of interest of off-budget borrowings is being made through the Budget. Expenditure Budget contains the details of Extra Budgetary Resources (EBRs). Statement for 'Resources of Public Enterprises' contains details of Ministry-wise Internal and Extra Budgetary Resources of the public enterprises.

Ministry also stated that amendments to FRBM Act in 2018 now include a debt target and widens the scope of the Central Government debt which inter-alia includes 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 from the annual financial statement. Thus, it is incorrect to say that there is no direct legislative control over off-budget borrowings.

The fact remains that off-budget financing is a tool of deferring the expenditure for subsequent year(s). As such, the overall quantum of such borrowings remains beyond calculation of fiscal indicators. Despite being solely dependent on Government's implicit/explicit guarantees, such borrowings are not being included in accounts either as debts or guarantees. The Ministry's reply about provisioning of repayment of principal and interest of off-budget borrowings through the Annual Budgets endorses audit view that Government is using off-budget borrowings for financing schemes and subsidy. However, though interest is budgeted for under relevant head, the modality of repayment of debt/borrowing is not spelt out.

3.1.1 Revenue Deficit target

As per the amended FRBM Rules 2015 (June 2015), in order to achieve the target of two *per cent* of Revenue Deficit by the 31 March 2018, the Central Government shall reduce such deficits by an amount equivalent to 0.4 *per cent* or more of the GDP at the end of each financial year beginning with financial year 2015-16. Thus, Revenue Deficit target for 2016-17 works out to 2.1 *per cent* of GDP after factoring in annual reduction of 0.4 *per cent* in 2015-16 and 2016-17 each from 2.9 *per cent* in 2014-15. However, the budgeted target for Revenue Deficit was kept at 2.3 *per cent* of GDP for 2016-17.

The Government was able to maintain it at 2.1 *per cent* primarily due to 2.34 *per cent* reduction in Revenue Expenditure. The details are in following **Table 3.1**.

Table-3.1 : Revenue Deficit - Estimates and Actuals in 2016-17

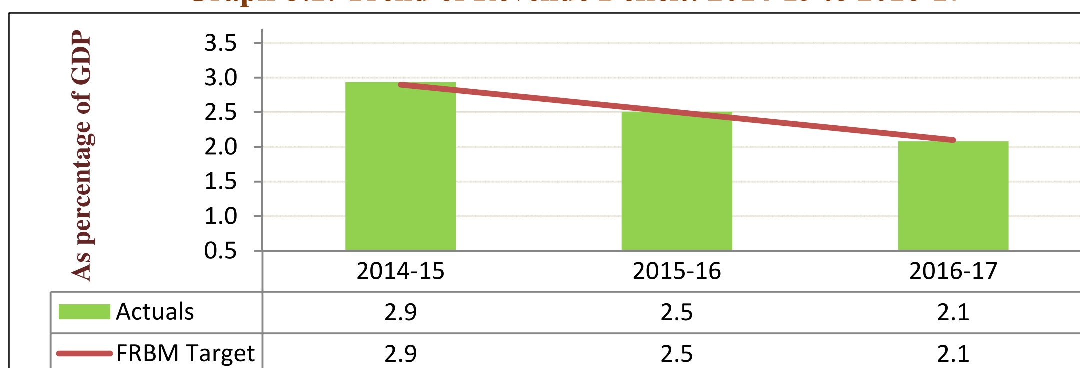
(₹ in crore)

Components	Revenue Expenditure	Revenue Receipts	Revenue Deficit (RD)	RD as % of GDP
	(1)	(2)	(3=1-2)	
Budget Estimates	17,31,037	13,77,022	3,54,015	2.3%
Actuals	16,90,584	13,74,203	3,16,381	2.1%
Variation with reference to Budget Estimates	40,453	2,819	37,634	0.2%
Variation	-2.34%	-0.20%	-10.63 %	

Source: Budget at a Glance for 2016-17 and 2018-19.

Graph-3.1 below shows the downward trend of revenue deficit as a percentage of GDP over the period 2014-15 to 2016-17 and consistent achievement of FRBM targets applicable as per amended FRBM Rules 2015:

Graph-3.1: Trend of Revenue Deficit: 2014-15 to 2016-17



Source: Budget at a Glance for 2016-17, 2017-18 and 2018-19.
Note: Data in absolute terms for deficits is at ***Annexure-3.1****.*

3.1.2 Off-budget financing of Revenue Expenditure

Subsidy expenditure against supplies (e.g., food and fertilizers) during a financial year is Revenue Expenditure and unpaid arrears against those supplies for that financial year is committed expenditure. Following cases of food and fertilizer subsidy depict this carryover subsidy liability. Government has adopted off-budget means of financing the subsidy arrears, thereby deferring the payment in the relevant financial year and in the process also incurring additional cost by way of interest payments.

Case Study - 1
Special Banking Arrangements by Ministry of Chemicals and Fertilizers.

When the budget allocation made to Ministry of Chemicals and Fertilizers in a financial year is not sufficient to clear all the dues of fertilizer subsidies, the dues of fertilizer subsidies are carried over to next financial year. During recent years, these accumulated carryover liabilities of the Ministry have increased, as shown in the following **table**[6]:

(₹in crore)

Year	Subsidy Expenditure	Carryover liability
2012-13	70,592	26,417
2013-14	71,280	40,341
2014-15	75,067	31,831
2015-16	76,538	43,356
2016-17	70,100	39,057

The accumulated subsidies adversely affect cash flow of the companies, which have huge subsidy receivables from Government. To overcome the liquidity problems of the fertilizer companies, Department makes 'Special Banking Arrangement' (SBA) in which loans from PSU banks are arranged to make payments against arrears of subsidies with some selected companies. Government makes payments of interest on these loans at Government Security (G-sec) rate. Interest over and above G-sec rate is borne by the fertilizer companies. Recent instances of SBA by Department of Fertilizers are given in following **table**:

(₹in crore)

Year	Amount of SBA	Interest Paid on SBA
2013-14	13,961.08	169.93
2014-15	6,806.66	64.03
2016-17	9,969.00	80.90

Resorting to SBA in order to improve the liquidity of fertilizer companies is an off-budget arrangement for financing a part of the subsidy payment, which is deferred.

Case Study - 2
Off-budget financing for Food Corporation of India (FCI).

Food Corporation of India (FCI) is a statutory corporation created through Food Corporations Act 1964 by Parliament to implement the objectives of the National Food Policy. FCI procures food grains at minimum support price (MSP) notified by Government of India and provides food grains for public distribution system (PDS). The difference between the cost of procurement and cost of providing it to fair price shops is worked out as subsidy bill and it is raised with Government for payment. When the budget allocation of a financial year to Ministry of Consumer Affairs, Food and Public Distribution is not sufficient to clear all the dues of food subsidies bill raised by FCI, the dues of such subsidies are carried over to next financial year. During recent years, these accumulated carryover liabilities on account of subsidies have increased as follows:

[6] Standing Committee on Chemicals & Fertilizers (2016-17).

(₹ in crore)

Year	Subsidy Expenditure	Carryover liability
2011-12	59,936	23,427
2012-13	71,980	31,753
2013-14	75,530	45,633
2014-15	91,995	58,654
2015-16	1,12,000	50,037
2016-17	78,335	81,303

(Source: Department of Economic Affairs, Ministry of Finance)

In order to cover financial requirements arising out of the subsidy arrears, FCI resorts to a number of methods in different years such as Bonds (₹ 13,000 crore), unsecured short term loans (₹ 40,000 crore), National Small Saving Funds (NSSF) Loans (₹ 70,000 crore) etc.

Besides**,** Cash Credit Facility guaranteed by Government of India with consortium of 68 banks (₹ 54,495 crore) also remains available with FCI. Government regularly extends this guarantee.

It is evident that there was increase of about 350 *per cent* in carried over subsidy arrears in the five years preceding 2016-17 which require financing from a number of methods including very high interest cash credit facility which increases actual cost of this subsidy substantially.

Case Study - 3
Off-budget funding under Accelerated Irrigation Benefits Programme (AIBP)

The Accelerated Irrigation Benefit Programme (AIBP) was launched during 1996-97 to give assistance to States to help them complete some of the incomplete major/medium irrigation projects which were at an advanced stage of completion and to create additional irrigation potential in the country. Like other Central Sector Schemes, several components of the scheme are eligible for grant of assistance from 2004. Actual expenditure by Central Government on this account in 2015-16 and 2016-17 was ₹ 2,549.01 crore and ₹ 999.86 crore respectively. However, a dedicated Long Term Irrigation Fund (LTIF) in National Bank for Agriculture and Rural Development (NABARD) was created in 2016-17 for funding and fast tracking the implementation of incomplete major and medium irrigation projects. This funding mechanism through NABARD was for both States and Central share of financing irrigation projects.

Analysis of financial statements of NABARD revealed that bonds worth ₹ 9,086 crore were issued during 2016-17 to arrange financing for LTIF. NABARD disbursed ₹ 3,336.88 crore towards Central share to National Water Development Agency (NWDA) for LTIF Projects, ₹ 2,414.16 crore towards Central share to NWDA for Polavaram Project and ₹ 3,334.98 crore towards States share for LTIF Projects.

Earlier, expenditure for AIBP schemes were provided through the budget appropriations, but due to off-budget financing it does not appear in the budget of 2016-17 onwards.

It is evident from the instances given above that certain expenditure (grants and subsidies) of the Government in 2016-17 were through off-budget financing route with fiscal implication of understating Government's expenditure in the year as they were deferred. Such off-budget financial arrangement, defers committed liability, being interest bearing, increases cost of subsidy, and understates the annual subsidy expenditure and prevents transparent depiction of fiscal indicators for the relevant year. As such, appropriate disclosure framework may be required for off-budget financing.

Ministry reiterated (July 2018) that off-budget borrowings are not beyond the scope of Union Budget as provisioning of repayment of principal and of interest of off-budget borrowings is being made through the Budget. Ministry also mentioned disclosure of Internal and Extra Budgetary Resources (IEBR) of NABARD and loans to FCI by NSSF in budget documents/finance accounts.

Ministry acknowledged that practice of provisioning 95 per cent of food subsidy in budget for a year and clearing remaining five per cent in subsequent years after finalization of accounts of FCI exists. Due to budgetary constraints, it may not be possible to provide the entire amount of food subsidy in a particular year. The off-budget financial arrangement is to meet the working capital requirement of FCI which was being met from banking sources independently.

The reply of Ministry supports audit view that such borrowings caused by budgetary constraints in financing current subsidy/planned expenditure defer this expenditure to future period. Besides, repayment of principal and interest through the budgets in future years not only prevents transparent depiction of deficit indicators but also adversely affects inter-generational equity.

3.2 Fiscal Deficit

Section 2(a) of FRBM Act, defines fiscal deficit as the excess of total disbursements from the Consolidated Fund of India (CFI) over total receipts into the Fund during a financial year (excluding debt receipts and repayment of debt).

3.2.1 Fiscal Deficit target

As per the amended FRBM Rules 2015 (June 2015), in order to achieve the target of three *per cent* of Fiscal Deficit by the 31 March 2018, the Central Government shall reduce such deficit by an amount equivalent to 0.4 *per cent* or more of the GDP at the end of each financial year beginning with financial year 2015-16. Thus, Fiscal Deficit target for 2016-17 works out to 3.3 *per cent* of GDP after factoring in annual reduction of 0.4 *per cent* in 2015-16 and 2016-17 each from 4.1 *per cent* in 2014-15.

However, the budgeted target for Fiscal Deficit was 3.5 *per cent* of GDP for 2016-17, without factoring in non-achievement of annual reduction target in 2015-16, which, in turn, would have resulted in actual target of 3.3 *per cent* (Please see paragraph 2.1). Fiscal deficit in 2016-17 was 3.5 *per cent* as detailed in **Table 3.2** below:

Table-3.2 : Fiscal Deficit-Budget Estimate and Actuals in 2016-17

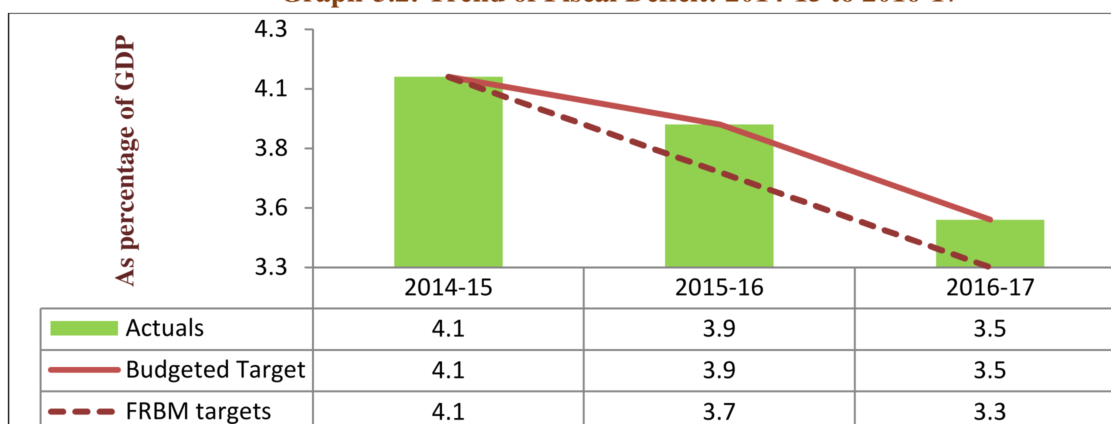
Components	Total Expenditure	Non-debt Receipts	Fiscal Deficit (FD)	FD as % of GDP
	(1)	(2)	(3=1-2)	
			(₹ in crore)	
Budget Estimates	19,78,060	14,44,156	5,33,904	3.5 %
Actuals	19,75,194	14,39,576	5,35,618	3.5 %
Variation with reference to Budget Estimates	2,866	4,580	-1,714	-
Percentage of variation	-0.14%	-0.32%	0.32%	

Source: Budget at a Glance for 2016-17 and 2018-19.

Table above shows that there was an upward variation of 0.32 *per cent* in Fiscal Deficit compared with Budget Estimates. Further, ₹ 40,453 crore reduction in revenue expenditure (shown in **Table 3.1** above) got offset due to ₹ 37,587 crore increase in capital expenditure. Overall variation between budgeted and actual figures of total expenditure stood at ₹ 2,866 crore (₹ 40,453 crore - ₹ 37,587 crore) only.

Graph-3.2 below presents the trend of fiscal deficit as a percentage of GDP over the period from 2014-15 to 2016-17:

Graph-3.2: Trend of Fiscal Deficit: 2014-15 to 2016-17



Source: Budget at a Glance for 2014-15 to 2018-19.
*Note: Data in absolute terms for deficits is at **Annexure-3.1**.*

The fiscal deficit shows a declining trend which converged to its budgeted level during the financial years 2014-17. However, if we factor in annual reduction target of fiscal deficit of 0.4 *per cent* during 2015-17 (after amendment in 2015), the Government deviated by 0.2 *per cent* from planned course of achievement of FRBM targets of fiscal deficit of 3.3 *per cent*.

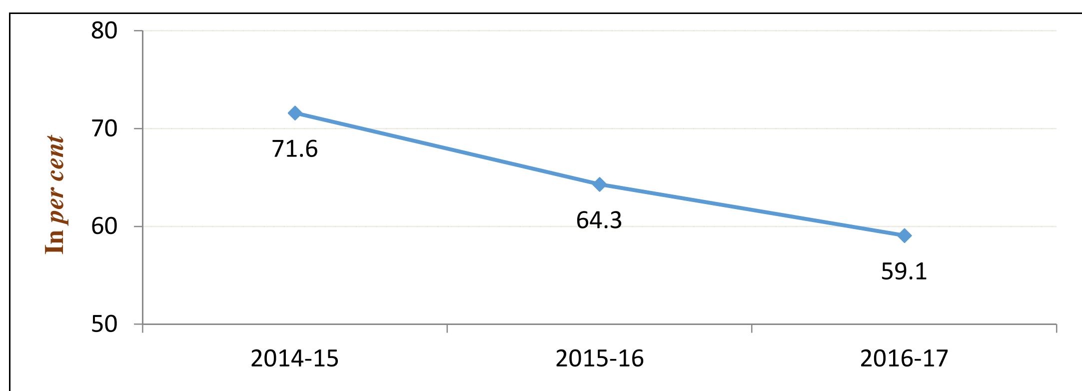
Ministry stated that the annual target for 2016-17 has been reached and reiterated that annual targets are not cumulative. Recalibration of target of fiscal deficit from 2018-19 in the amendments has since been brought out in 2018 in Budget Statements.

The fact remains that achieving annual targets could have helped Government achieve further reduction cumulatively.

3.2.2 Revenue Deficit as a component of Fiscal Deficit

The amended FRBM Act/Rules envisage fiscal deficit of not more than three *per cent* of GDP and revenue deficit of not more than two *per cent* of GDP by 31 March 2018, implying that the revenue deficit accounts for two-thirds (66.6 *per cent*) of fiscal deficit. **Graph-3.3** below presents the trend of revenue deficit as a component of fiscal deficit over the period 2014-15 to 2016-17:

Graph-3.3: Trend of RD as component of FD: 2014-15 to 2016-17



Source: Budget at a Glance for 2016-17 to 2018-19.

Graph-3.3 depicts that during 2015-16, Revenue deficit as a component of Fiscal deficit improved to 64.3 *per cent* from 71.6 *per cent* in 2014-15 and further to 59.1 *per cent* in 2016-17. During 2014-15 to 2016-17, major portion of fiscal deficit was because of revenue deficit, resulting in revenue deficit averaging 65 *per cent* of fiscal deficit.

It is clear that Revenue Deficit, although contained within limit, constitutes a large part of Fiscal Deficit. In the light of the amended FRBM Act 2018, doing away with Revenue Deficit target carries the risk of not addressing the issue of revenue deficit.

Ministry stated (July 2018) that the Revenue Deficit is still being projected as a fiscal indicator in Medium-term Fiscal Policy cum Fiscal Policy Strategy Statement.

However, the fact remains that revenue deficit continues to have significant bearing on targets of fiscal deficit and there is need of addressing revenue deficit in containing fiscal deficit as an indicator.

3.3 Effective Revenue Deficit

Fiscal indicator of effective revenue deficit was introduced in Union Budget of 2011-12 to segregate the grants-in-aid which were used to finance current expenditure and those used to create capital assets. Section 2(aa) of amended FRBM Act (May 2012) defined 'effective revenue deficit' as the difference between the revenue deficit and grants for creation of capital assets.

3.3.1 Effective Revenue Deficit target

As per the amended FRBM Rules 2015 (June 2015), in order to achieve the target of elimination of Effective Revenue Deficit by the 31 March 2018, the Central Government shall reduce such deficits by an amount equivalent to 0.5 *per cent* or more of the GDP at the end of each financial year beginning with financial year 2015-16. Thus, Effective Revenue target for 2016-17 works out to 0.9 *per cent* of GDP after factoring in annual reduction of 0.5 *per cent* in 2015-16 and 2016-17 each from 1.9 *per cent* in 2014-15.

However, the budgeted target for Effective Revenue Deficit was kept at 1.2 *per cent* of GDP for 2016-17 without factoring in non-achievement of annual reduction target in 2015-16 (Please see paragraph 2.1). Government was able to maintain it at 1.0 *per cent* as detailed in **Table 3.3** below:

Table-3.3 : Effective Revenue Deficit-Budget Estimate and Actuals: 2016-17

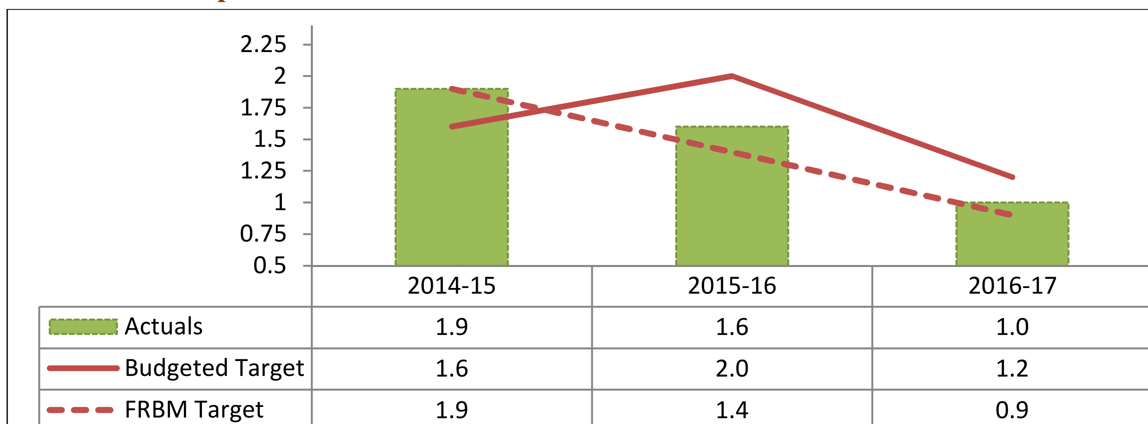
Components	Revenue Deficit	Grant for creation of capital assets	Effective Revenue Deficit (ERD)	ERD as % of GDP
	(1)	(2)	(3=1-2)	
			(₹ in crore)	
Budget Estimates	3,54,015	1,66,840	1,87,175	1.2
Actuals	3,16,381	1,65,733	1,50,648	1.0
Variation with reference to BE	-37,634 (-10.63%)	- 1,107 (-0.66%)	-36,527 (-19.51%)	0.2

Source: Budget at a Glance for 2016-17 and 2018-19.

Table-3.3 above reflects that 10 *per cent* reduction in revenue deficit led to around 20 *per cent* reduction in Effective Revenue Deficit over the Budget Estimates.

The trend of effective revenue deficit as a percentage of GDP over the period 2014-15 to 2016-17 is given in **Graph-3.4** below:

Graph-3.4: Trend of Effective Revenue Deficit: 2014-15 to 2016-17



Source: Budget at a Glance
Note: Data in absolute terms for deficits is at ***Annexure 3.1***

Graph above shows declining trend of effective revenue deficit, which remained below its budgeted target during 2015-17 period. However, if we factor in the annual reduction target of effective revenue deficit of 0.5 *per cent* during 2015-17, the actual effective revenue deficit was 1.0 *per cent* against the planned course of achievement of FRBM targets of 0.9 *per cent* in 2016-17. This was due to deviation of 0.2 *per cent* in 2015-16.

In reply to this observation, Ministry stressed that the annual reduction targets are prospective, beginning with 2015-16 and not cumulative.

The audit observation depicts status of adherence to budgeted and FRBM target after amendment in June 2015 and does not insist on achievement of cumulative targets for two-year period. However, it does show that Government has not been consistent in its annual achievement of targets.

3.3.2 Inconsistency in estimation of effective revenue deficit

In order to correctly estimate the effective revenue deficit, every Ministry prepares information containing revised provision for current year and budget provision for ensuing year under the object head 'grants for creation of capital assets' under various schemes/programmes. The Detailed Demands for Grants (DDG) of the respective Ministries reflects this along with the actuals of previous year, and furnish the same to the Ministry of Finance. On the basis of this information, Ministry-wise statement is appended in the Expenditure Budget Volume-I showing the provision of expenditure on grants for creation of capital assets. A consolidated provision for expenditure on grants for creation of capital assets is given in Budget at a Glance (BAG).

Scrutiny of information contained in Annex-6 of Expenditure Budget Volume-1 showing Ministry-wise details of provision on grants for creation of capital assets in financial year 2016-17 and their cross-verification with Detailed Demands for Grants (DDG) of 28 Ministries/Departments revealed variation in two sets of documents as detailed in **Annexure-3.2**. The errors/omissions resulted in under/over estimation of grants for creation of capital assets with overall impact of underestimation of ₹ 2,692.25 crore. The budgeted figures of grants for creation of capital assets would have been ₹ 1,69,532 crore instead of ₹ 1,66,840 crore which has also impacted the correct estimation of effective revenue deficit.

3.3.3 Re-appropriation from object head 35 – Grants for creation of capital assets

As per amended FRBM Rules, in order to achieve the target of elimination of effective revenue deficit by the end of 31 March 2018, the Central Government shall reduce such deficit by an amount equivalent to 0.5 *per cent* or more of the GDP at the end of each financial year beginning with the financial year 2015-16.

To achieve the elimination of ERD target by 31 March 2018 and considering the wide gap between Revenue deficit and Grants for creation of capital assets, Ministry of Finance issued an Office Memorandum in February 2016 whereby Ministry stated that "*Re-appropriation from the object head Grant-in-aid (GIA) for creation of capital assets to other object heads must be avoided. Re-appropriation would be allowed within the same object head only.*"

Scrutiny of Re-appropriation orders pertaining to Grant No. 95, Ministry of Urban Development for the year 2016-17 revealed that funds aggregating to ₹ 50.46 crore were re-appropriated from the object head 35 to the different object heads as detailed in **Annexure-3.3**.

Keeping in view huge gap of ₹ 1,50, 648 crore between Revenue Deficit and Grants for creation of capital assets in FY 2016-17, re-appropriation from the object head Grant-in-aid (GIA) for creation of capital assets to other object heads is not only violation of above office memorandum but also inconsistent with the final target of eliminating Effective Revenue Deficit by 2017-18.

Ministry stated (July 2018) that instructions have been issued to all Ministries/ Departments, for avoiding instances of re-appropriation from the object head Grant-in-aid (GIA) for creation of capital assets to other object heads and the issue is being pursued with the concerned Ministry.

3.3.4 Alteration in previous year's Budget provision

The Parliament had approved a budget provision of ₹ 134.12 crore under the object head 'Grants for Creation of Capital Assets' for Department of Space for the year 2016-17. However, allocation under this object head placed in Parliament in February 2017 along with the budget for the year 2017-18 revealed that the budget estimates for financial year 2016-17 was depicted as ₹ 525.87 crore instead of ₹ 134.12 crore. Similarly, in case of Department of Atomic Energy, Grants for creation of Capital Assets of ₹ 1,080 crore were depicted in Detailed Demands for Grants for 2016-17, whereas the same figures were depicted as ₹ 1,052 crore in Expenditure Budget 2017-18.

Provisions under any head of expenditure in any financial year are approved by the Parliament and revision in the approved figures in subsequent years indicates that transparent and correct estimates of expenditure for previous year were not prepared. As the estimates of expenditure on 'Grants for Creation of Capital Assets' has a bearing on the deficit indicators, changing them frequently defeats the very concept of having any fiscal target in respect of deficit indicators.

The Department of Space, in its reply (December 2017), accepted error on their part and stated that information was inadvertently furnished by the department to the Ministry of Finance and it would take utmost care in future.

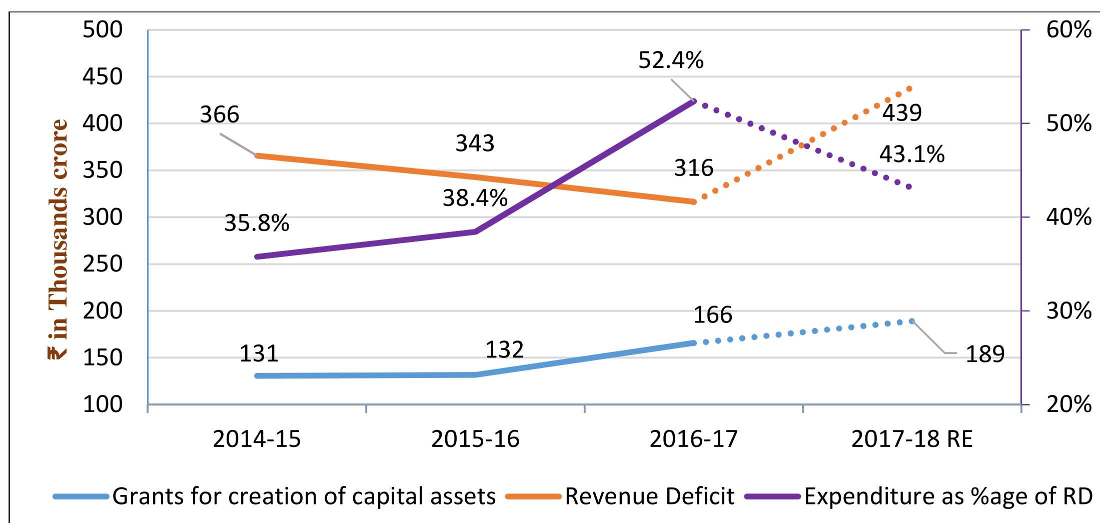
Ministry replied (July 2018) that efforts are being made to rectify errors/ inconsistencies in reporting of information by various Ministries/Departments.

Being the nodal Ministry for the administration of the FRBM Act and preparation of Central Budget, Ministry of Finance should ensure that information obtained from the line Ministries and included in the Budget documents laid before the Parliament is complete, accurate and consistent.

3.3.5 Expenditure on grants for creation of capital assets

Elimination of effective revenue deficit implies that expenditure on grants for creation of capital assets must be equal to revenue deficit. In other words, the Government's revenue expenditure in excess of revenue receipts must be used for creation of capital assets. The trend of expenditure on grants for creation of capital assets as a percentage of revenue deficit over the period from 2014-15 to 2016-17 and projections/revised estimate for 2017-18 are given in **Graph-3.5**.

Graph-3.5: Trend of expenditure on grants for creation of capital assets



Source: Budget at a Glance

Note: Second axis represents expenditure on grants for creation of capital assets as percentage of revenue deficit.

Graph-3.5 depicts that grants (which are part of revenue expenditure) for creation of capital assets increased from 38.4 *per cent* in 2015-16 to 52.4 *per cent* of Revenue deficit in 2016-17, i.e. more than 50 *per cent* of Revenue deficit was due to such grants. The revised projection for 2017-18 shows that Government has planned to bypass the FRBM target of elimination of effective revenue deficit by the end of 2017-18. However, the Government has expressed intention in MTFP statement 2018-19 (Para 5) to finance expenditure of Capital nature through off-budget borrowings.

Ministry stated (July 2018) that the reason for continuous revision in ERD was due to structural issues relating to booking of grant-in-aid for creation of capital assets in the revenue side of the account. Till such time, this structural issue is addressed through a suitable and appropriate accounting mechanism or through a substantial change in the revenue-capital composition of Government expenditure, this imbalance is likely to persist.

3.4 Liability of the Government

The Government resorts to borrowing from internal and external sources to meet its annual fiscal deficit. The internal borrowings mainly comprise market loans and special securities issued to financial institutions. In addition to this, the resources available in the Public Account, in respect of which the Government functions as a trustee, are also liabilities, which in turn are used to finance the deficit. According to Section 2(f) of FRBM Act, total liabilities mean the liabilities under the CFI and the Public Account of India.

3.4.1 Liability target

Rule 3(4) of the FRBM Rules required that the Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of nine *per cent* of GDP for financial year 2004-05 and in each subsequent financial year the limit of nine *per cent* was to be progressively reduced annually by at least one percentage point of GDP.

Table 3.4 shows the liability position of the Government since 2012-13:

Table-3.4: Liability of the Government: 2012-13 to 2016-17

(₹ in crore)

Financial year	Liability at the beginning of the year	Liability at the end of the year	Additional liability during the year	GDP	Liability as %age of GDP	Additional liability as %age of GDP
	1	2	3=(2-1)	4	(2/4)	(3/4)
2012-13	41,51,284	47,06,586	5,55,302	99,46,636	47.3	5.6
2013-14	47,06,586	52,59,310	5,52,724	1,12,36,635	46.8	4.9
2014-15	52,59,310	57,75,685	5,16,375	1,24,45,128	46.4	4.1
2015-16	57,75,685	64,23,032	6,47,347	1,36,82,035	46.9	4.7
2016-17	64,23,032	69,06,265	4,83,233	1,51,83,709	45.5	3.2

Source: Union Government Finance Accounts
Note: liability includes external debt at current rates of exchange

It may be seen from **Table 3.4** that total liability of the Government for 2016-17 was 45.5 *per cent* of GDP down from 47.3 *per cent* of GDP in 2012-13. It also indicates that additional liabilities declined from 5.6 *per cent* in 2012-13 to 3.2 *per cent* of GDP in 2016-17.

3.4.2 Understatement of liability

A comment relating to understatement of Public Account liability was included In Para 1.5 of CAG's Report No. 44 of 2017 on the Union Government Accounts for financial year 2016-17. The understatement of liability works out to ₹ 7,63,280 crore. Taking into account the actual liability in the Public Account, total liability of the Central Government at the end of the financial year 2016-17 would be ₹ 76,69,545 crore[7] which is 50.5 *per cent* of GDP as against 45.5 *per cent* shown in **Table 3.4** above.

Ministry replied (July 2018) that understatement of Central Government Liabilities is due to Post Office Insurance Funds operated through private fund managers and shown as negative credit instead of debit balance and stated that the same needs to be shown in the same manner as NSSF operations. This will be kept in view while

[7] ₹ 76,69,545 crore =₹ 69,06,265 crore + ₹ 7,63,280 crore.

preparing the liabilities and assets statement in the year 2019-20 on the analogy of NSSF.

The Ministry's reply needs to be seen in the context that the total understated liability on account of NSSF is ₹ 7,63,280 crore and relating to investment in the Post Office Insurance Funds is only ₹ 53,634 crore. The rest of ₹ 7,09,646 crore relates to other components of investment from the NSSF.

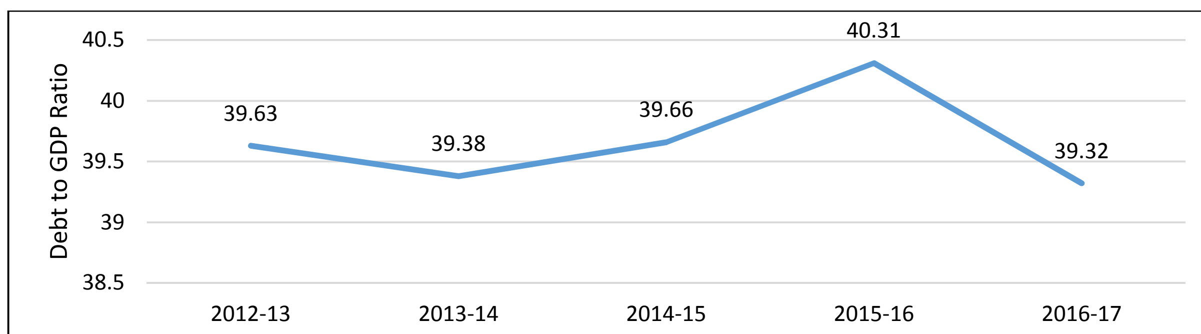
3.4.3 Debt Sustainability

Debt sustainability is generally measured in terms of level of debt, primary deficit and interest cost in relation to nominal GDP growth rate. A falling debt to GDP ratio can be considered as leading towards stability. The ratio of interest payments to revenue receipt is also used to measure debt sustainability. In this section, assessment of the sustainability of debt has been made using trends observed in critical variables.

3.4.3.1 Debt – GDP Ratio

The trend in the Debt-GDP ratio is an important indicator, which signifies sustainability of the debt, which is presented in **Graph 3.6** below:

Graph-3.6: Trends in Debt-GDP ratio

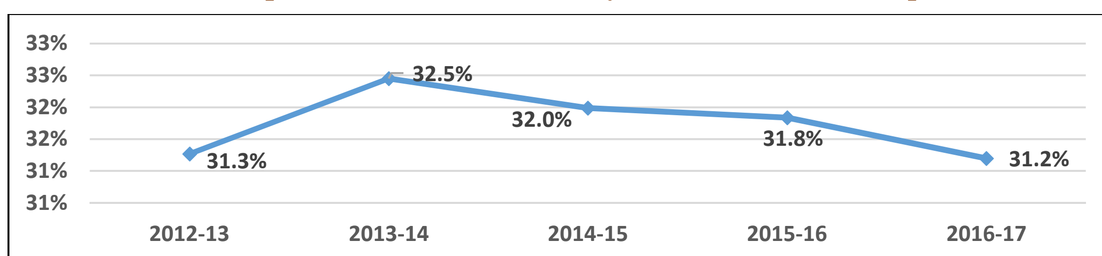


Source: Union Government Finance Accounts

3.4.3.2 Ratio of interest payments to Revenue Receipts

Interest cost of debt is another indicator of measuring sustainability of debt. The ratio of interest payment to revenue receipts (IP/RR) showed a declining trend during previous three years 2014-15, 2015-16 and 2016-17, from a peak of 32.5 *per cent* in 2013-14 as shown in **Graph 3.7** below:

Graph-3.7: Ratio of Interest Payment to Revenue Receipt

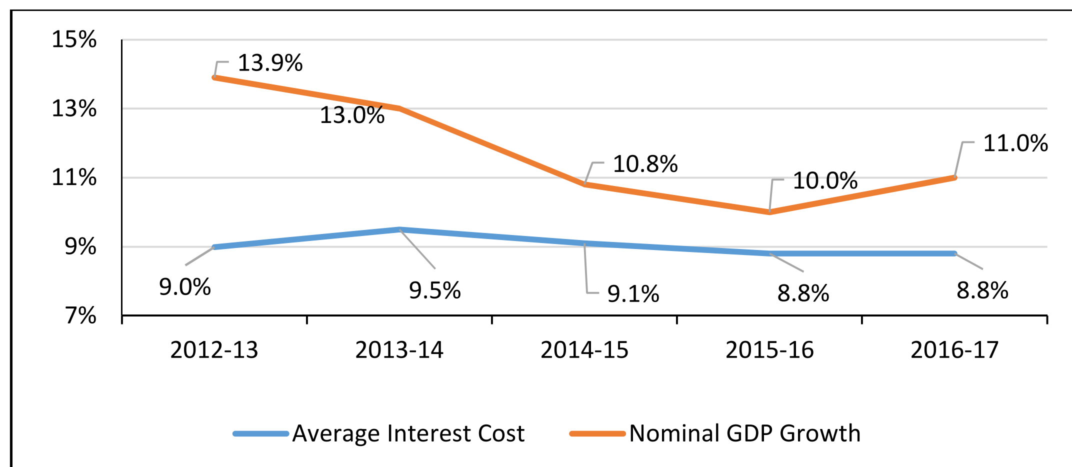


Source: Union Government Finance Accounts

3.4.3.3 Average Interest Cost

Average Interest Cost (AIC) is arrived at by dividing interest payments during the year with average debt stock[8]. A declining average interest cost augurs well for the sustainability of the debt. However, as depicted in **Graph 3.8**, over the period 2012-17, the average interest cost ranged between 8.8 to 9.5 *per cent*.

Graph-3.8: Average Interest Cost and Nominal GDP growth



Source: Union Government Finance Accounts and GDP data published by CSO

In reply (July 2018) Ministry maintained that AIC remained between 6.6 and 6.9 per cent during 2013-17 period.

The source of Ministry's information is Status paper on Government Debt, 2016-17 whereas Audit worked out average interest costs on the basis of figures of debt and interest payments available in certified finance accounts.

3.5 Guarantees

Central Government extends guarantees primarily for improving viability of projects or activities undertaken by the Government entities with significant social and economic benefits, to lower the cost of borrowings as well as to fulfil the requirement in cases where sovereign guarantee is a precondition for bilateral/multilateral assistance. While guarantees being contingent liabilities do not form part of debt, in the eventuality of default, they have the potential of aggravating the liability position of the Government.

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[8] Average debt stock is a simple average of outstanding debt at the beginning and at the end of the year.

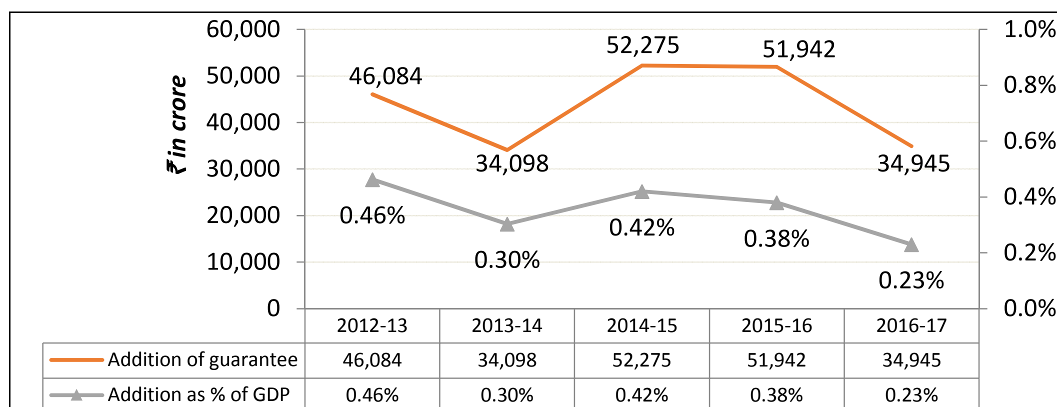
3.5.1 Guarantees target

FRBM Act and the Rules made thereunder stipulate that the Central Government shall not give guarantees aggregating to an amount exceeding 0.5 *per cent* of GDP in any financial year beginning with financial year 2004-05.

3.5.2 Trend of additions in Guarantees

Following **Graph-3.9** shows the trend of additions in guarantees given by the Government in a financial year as a percentage of GDP over the period from 2012-13 to 2016-17:

Graph 3.9: Trends of addition in guarantees: 2012-13 to 2016-17



Source: Union Government Finance Accounts.
Note: Second axis represents addition in guarantees as percentage of GDP.

Graph 3.9 shows that in the last five years, addition of guarantees in a financial year remained within the prescribed target of 0.5 *per cent* of GDP. It was 0.23 *per cent* of GDP in 2016-17.

3.6 Payment of Commitment Charges

Prudential debt management is one of the objectives of Fiscal Responsibility & Budget Management (FRBM) Act, 2003. Effective debt servicing plays a key role in prudential debt management. Debt servicing refers to payment made to creditors towards interest and matured principal amount, which includes service charges, commitment charges, etc.

Commitment charges on undrawn balance of external loans are paid on principal amount rescheduled for drawl on later dates. During the period 2012-13 to 2016-17, commitment charges to the extent of ₹ 553.22 crore were paid. The details are given in **Table 3.5**.

Table-3.5: Payment of Commitment Charges

(₹ in crore)

Year	Unutilized committed external assistance	Commitment Charges
2012-13	1,85,381	92.95
2013-14	2,16,083	117.33
2014-15	2,08,275	110.53
2015-16	2,52,396	110.60
2016-17	2,54,779	121.81
	Total	**553.22**

The need for payment of commitment charges points towards inadequate planning of the loan/credits without proper linkages with the requirement leading to avoidable payment of commitment charges.

Ministry stated (July 2018) that commitment fee/charges are payable by the borrowers on the undisbursed committed loan amount, as per the prevalent terms and conditions of relevant loan/credit agreement with the external agencies from time to time.

The reply of the Ministry does not address the reasons for huge commitment charges nor does suggest methods to reduce this avoidable expenditure.

3.7 Off-budget financing of Capital Expenditure

Fiscal Responsibility & Budget Management (FRBM) Act, 2003 provided debt management framework through containing revenue and fiscal deficits. Prudential borrowing norms suggest that borrowed funds should be deployed in such a manner that return from deployment of borrowed funds is more than borrowing cost of debt to be sustainable. It is therefore essential that there should be a policy framework for deployment of borrowed funds keeping in mind cost of borrowing and potential of increase in income.

The Ministry of Finance stated that borrowed funds are required to meet the mismatches between the Government Receipts and disbursements and that funds are not mobilized for income generation or cost off settings activities. It was also mentioned that it is not possible to account for and earmark the borrowed funds for use in specific sectors on one to one basis.

It appears that there is no policy with respect to either rate of return, creation of assets, potential of increase in income, socio-economic or regional disparities for deployment of borrowed funds. Government has now recognized off-budget borrowings as a prominent method of financing capital expenditure. Financing for large infrastructure projects involving huge investments should be aligned in such a manner that the future rate of return from the investment is able to generate enough revenue to cover debt-servicing costs. However, in the absence of any

policy guidelines in respect of deployment of borrowed funds, there is risk of deployment of these funds in areas which do not generate enough returns to cover future debt servicing needs.

Ministry stated (July 2018) that funds are not raised only for income generation activities and money being fungible, cannot be earmarked for a dedicated purpose. Ministry also mentioned that Government's expenditure on social security, defence, civil facilities, infrastructure, administrative expenses etc. is indispensable in nature and borrowings are required to meet both productive and other establishment related expenses. It has been emphasised that investment in human capital have long gestation period and borrowing only with commercial motive and seeing cost benefit analysis could not be the only criterion.

The reply of the Ministry illustrates expenditure of revenue nature and points out that these expenditures could not be treated with commercial motive or cost-benefit analysis. Audit observation pertains to borrowings for capital expenditure where clear policy of deployment of borrowed funds in investment avenues having capacity to generate financial resources for servicing of debt is required. Such policy becomes all the more important while resorting to off-budget methods of financing capital expenditure as investors judge feasibility of projects solely on financial viability and implicit/explicit guarantees of government.

Cases of Indian Railway Finance Corporation (IRFC) and Power Finance Corporation (PFC) were studied to understand the method and quantum of borrowings.

Case Study – 4

Arrangement of financial resources by Indian Railway Finance Corporation (IRFC)

At the end of 2016-17, long term and short term borrowings of IRFC were ₹ 96,710.26 crore and ₹ 5,769.35 crore respectively.

IRFC was created in 1986 exclusively for arranging finances for projects of Indian Railways. IRFC arranges finances for Ministry of Railway in International and Domestic market using various financial instruments. Bonds issued by IRFC are listed based on Issue Specific Rating given by various Credit Rating Agencies (CRAs). Investors draw assurance about safety of their investment based on Rating assigned by CRAs. It is understood that the CRAs consider the ownership of IRFC by Government of India, its functioning under Ministry of Railway, favourable lease agreements with Indian Railways protecting net interest margin, and transfer the interest and foreign exchange risks on its borrowings to Railways. International rating agencies also recognize that IRFC's credit profile is inseparable from the Government's credit profile and bank on "almost certain" likelihood of Government of India extraordinary support to IRFC in events of financial distress. Ministry of Railways provides letters of undertaking (LoU) to foreign lenders stating that in the event of IRFC falling short of funds to redeem the bonds on maturity and/or to repay the term loans owing to inadequate cash flows during the year, Ministry of Railways shall make good such shortfalls.

Case Study - 5
Power Finance Corporation (PFC) Ltd.

PFC's total market borrowings includes ₹ 2,00,187 crore long term loans/bonds and ₹ 2401 crore short term borrowings at the end of 2016-17

Power Finance Corporation (PFC) Ltd was incorporated in 1986 as a dedicated Financial Institution in Power Sector. It was registered as Non-Banking Finance Company (NBFC) in 1998 and was categorized by RBI as Infrastructure Finance Company (IFC) in 2010. PFC is a nodal agency for various Government of India schemes such as Ultra Mega Power Projects (UMPPs) and Integrated Power Development Scheme (IPDS) for the development of the country's power sector. PFC is strategically important for achieving the Government's objective of augmenting power capacity across the country. PFC provides loans for a range of power-sector activities, including generation, distribution, transmission, and plant renovation and maintenance. As of 31 March 2017, Government of India owned 66 *per cent* stake in PFC.

PFC's rating by international rating agency Moody's is in line with the rating for the Government of India due to its linkage with the Government, given the latter's ownership, as well as the strategic role it plays in the Government's plans for the power sector. PFC's role in Ministry of Power's Restructured Accelerated Power Development & Reforms Program and the Ultra Mega Power Projects Program also has bearing on its ratings.

Similarly, while assigning rating to PFC, international rating agency Fitch noted that PFC's ratings reflect its strong operational and strategic ties with the Government of India as the company plays an important role in developing and financing power sector utilities in India. Role of PFC in Ministry of Power's Restructured Accelerated Power Development & Reforms Program and the Ultra Mega Power Projects Program also finds mention by Fitch.

Rating agency CRISIL notes PFC's high strategic importance to Government of India is reflected in the role it plays in implementing Government policies, and its importance in financing India's power sector, particularly state power utilities (SPUs). Additionally, majority ownership by GoI implies a strong moral obligation on the Government to support the company in the event of an exigency.

ICRA notes that PFC's ratings continue to reflect its majority sovereign ownership (66.35 *per cent* equity held by the GoI as on 31 March 2017) and its strategically important role in the implementation of various GoI schemes such as Ultra Mega Power Projects (UMPPs) and Integrated Power Development Scheme (IPDS) for the development of the country's power sector. Further, PFC, as one of the major power sector financiers, remains strategically important for achieving the Government's objective of augmenting power capacities across the country.

PFC finances Private and Public sector units involved in power generation and distribution. About 83 *per cent* of financing provided by PFC is in Public Sector and remaining 17 *per cent* in private sector. In an Audit report (2015-16) related to practices adopted by PFC while providing finances to private sector Independent Power Producers (IPPs), CAG highlighted several weaknesses in its operations related to IPPs.

Being off-budget in nature, these borrowings do not find mention in the Finance Accounts nor are included as part of guarantees given by the Government. This not only reflects lack of disclosure; it also puts major sources of funding of Government's crucial infrastructure projects beyond the control of Parliament. Such substantial borrowings for capital expenditure may require concrete policy for sustainability of debt and adequate disclosure.

Ministry reiterated its stand (para 3.1) (July 2018) that off-budget borrowings remain within the scope of Union Budget as provisioning of repayment of principal and of interest of off-budget borrowings is being made through the Budget.

Ministry further stated that the Central Public Sector Enterprises (CPSEs) have autonomy to leverage on Government backing and due to this fact they are able to borrow at a better rate. If Government borrows the funds on behalf of CPSEs, it will have fiscal deficit implications.

The reply of the Ministry suggests that the CPSEs have autonomy and their borrowings are for independent business ventures where government backing just helps in getting a better interest rate. However, the audit observations are regarding expenditure being incurred by CPSEs on behalf of the Government which otherwise would have been borne on the budget. This fact was also accepted by the Ministry when it stated that planned borrowings of CPSEs are taken as IEBR in budget documents and payment of principal and interest remains within scope of budget. Thus, in the absence of any comprehensive policy regarding debt sustainability and transparent disclosure for such off-budget borrowings, fiscal implications of financial risks of CPSEs could not be ruled out.

3.8 Audit Summation

The Government in 2016-17 met the annual reduction targets of the revenue deficit (by 0.4 *per cent*), effective revenue deficit (by 0.5 *per cent*) and fiscal deficit (by 0.4 *per cent*) over the previous year (2015-16). As at the end of March 2017, it also met the target of revenue deficit of 2.1 *per cent* of GDP, effective revenue deficit of 1.1 *per cent* (actual was 1.0 *per cent*) of GDP and fiscal deficits of 3.5 *per cent* of GDP. Revenue deficit as component of fiscal deficit declined from 71.6 *per cent* in 2014-15 to 59.1 *per cent* in 2016-17, which implies corresponding increase in capital expenditure.

With regard to debt sustainability, Audit noticed that *Debt to GDP ratio* in 2016-17 was 39.32 *per cent*; a decline from 40.31 *per cent* in 2015-16. *Ratio of interest payment to revenue receipts* was 31.2 *per cent*; a decline from 32.5 *per cent* in 2013-14. *Average interest cost* was 8.8 *per cent* in 2016-17; a decline from 9.5 *per cent* in 2013-14.

However, audit noticed that Government has increasingly resorted to off-budget financing for revenue as well as capital spending. In terms of revenue spending, off-budget financing, for instance, was used for covering/deferring fertilizer arrears/bills through special banking arrangements; food subsidy bills/arrears of FCI through borrowings and for implementation of irrigation scheme (AIBP) through borrowings by NABARD under the Long Term Irrigation Fund (LTIF). In terms of capital expenditure, for instance, off-budget financing of railway projects through borrowings of the IRFC and financing of power projects through the PFC are outside the budgetary control.

Off-budget financing route being outside the parliamentary control, has implication for fiscal indicators, as they understate Government's expenditure in the year by keeping them off the budget. Such off-budget financial arrangement, defers committed liability (subsidy arrears/bills) or create future liability and increases cost of subsidy due to interest payment. As such, appropriate disclosure framework may be required for off-budget financing.

3.9 Recommendations

Government may consider putting in place a policy framework for off-budget financing, which amongst others, should include disclosure to Parliament:

(i) ***The rationale and objective of off-budget financing, quantum of off-budget financing and budgetary support under the same project/scheme / programme, instruments and sources of financing, means and strategy for debt servicing of off-budget financing, etc.***

(ii) ***Details of off-budget financing undertaken during a financial year by/ through all the bodies/companies substantially owned by Government; and***

(iii) ***Government may consider disclosing the details of off-budget borrowings through disclosure statements in Budget as well as in Accounts.***