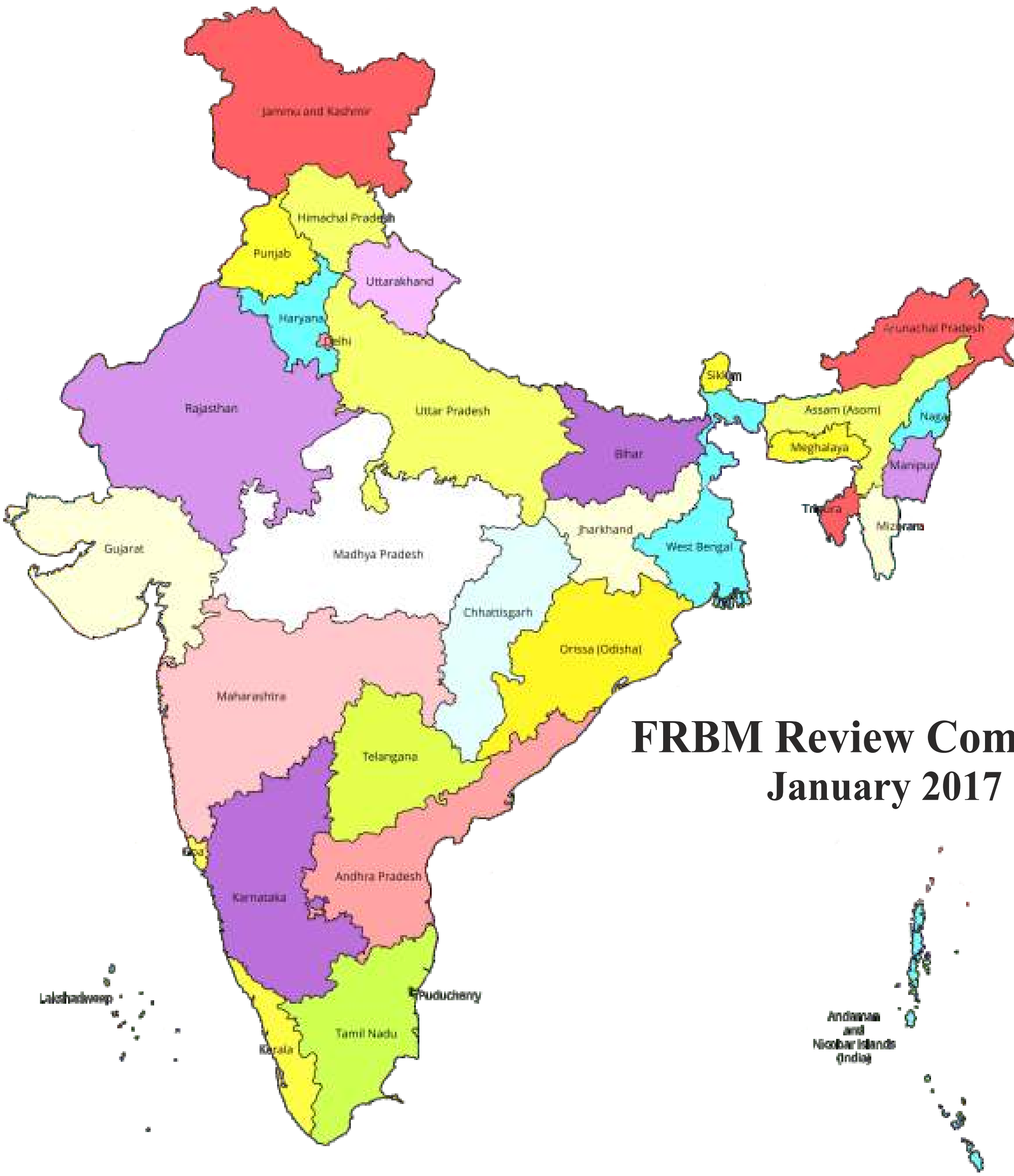
सत्यमेव जयते

Department of Economic Affairs
Ministry of Finance
Government of India

Volume III
Governmental Perspective – Centre & States



FRBM Review Committee
January 2017

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VOLUME-III
Governmental Perspective – Centre & States

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Inputs from Central Ministries / Departments / Institutions

Governmental Perspective: Centre & States

This Volume contains summary of comments and feedback provided by some Central Government Ministries/Departments to customised questionnaires sent to them by the Committee so as to elicit their assessment of the working of the FRBM Act, their financing requirements in the coming years and major institutional reforms undertaken by them (or on anvil) having significant implications for Central Government finances. We approached only some Ministries/Departments considered significant from the viewpoint of management of fiscal stress.

Further, the Volume contains summarised response to a questionaire to the State Governments so as to elicit their assessment of the working of the State FRBM Act, problems faced by them in implementing the Act and their specific suggestions for framing a second generation FRBM law.

The comments received from the following Central Ministries/Departments and State Governments are summarised here.

Department of Agriculture, Cooperation & Farmers Welfare

- The Government aims at doubling the income of the farmers by 2021-22. One of the strategies towards this goal is to increase per ha. yields. When compared to global averages, India's performance is wanting. In order to realise the yield gaps that exist in respect of cereals, including coarse cereals, pulses, oilseeds, fibre crops (cotton and jute) and sugarcane.Priority focus is needed on pulses, oilseeds and coarse cereals grown in rainfed areas. Derisking India agriculture requires expansion of irrigation network (Pradhan Mantri Krish Sinchayee Yojana (PMKSY)), expanding coverage and scope of agricultural insurance (Pradhan Mantri Fasal Bima Yojana (PMFBY)), using water use efficieny (more crop per drop), extensive programme of soil health cards, mKisan mobile based IT enabled extension services (next level of Kisan Call centres), higher income through improved marketing of agricultural produce, Diversification towards high value commodities etc.

- Country achieved continuous increase in food grain production of Rice, Wheat, Coarse Cereals, Pulses (From 146.6 lakh tonnes in 2009-10 to 197.7 lakh tonnes in 2013-14), Oilseeds (From 24.88 million tons in 2009-10 to 32.75 lakh million tons in 2013-14), even though the climatic change, frequent drought or flood in one or more parts of the country and external pressure and contained to manage the food inflation very wel. We have even continuously exported 100 lakh tonnes of rice both Basmati and non Basmati every year after meeting the domestic requirements.

- Implementation of convergence of other programmes in dryland areas like Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), Bharat Nirman etc.

- Steps taken to tackle regulatory and distribution bottlenecks that restrict marketing of agricultural produce while protecting public health and safety. Agriculture marketing- steps taken to eliminate constraints limiting direct procurement from farmer- by retailers, processors, modern whole sellers, fiscal uncertainty and transaction costs, eg., double taxation, inter-state investment of goods and agri-commodities. National Agriculture Market (eNAM) launched on 14th April 2016 to create an integrated National Agriculture Market, covering 23 Markets, 26 commodities across 8 states. The target is to cover 200 markets by Sep 2016 and 585 by March 2018. The three basic reforms to APMC Acts under e NAM are Single Trading License, Single Point Levy of Market Fee and e-auction for price discovery. Efficient markets, transfer remunerative prices to farmers and increase farm incomes.

- **Rashtriya Krishi Vikas Yojana (RKVY):** RKVY was launched during 2007-08 to incentivize states to increase their expenditure on agriculture and allied sectors to achieve & sustain desired annual growth in this sector The inbuilt incentive mechanism of the scheme has resulted significant growth in percentage share of States' allocation to agriculture and allied sectors from 4.88 % in 2006-07 to 8.36% in 2013-14.

- **Information Technology based schemes:** Web Portals, Mobile Apps, SMS Advisories, Kisan Call Centers and Mass Communication are strategies evolved to reach out farmers. As one stop shop for meeting diverse needs of the farmers, the IT oriented programmes need to continue.

- **Pradhan Mantri Fasal Bima Yojana (PMFBY) :** A simplified scheme for easy understanding by Farmers with very low farmers share of premium- (2% for Kharif, 1.5% for Rabi, for all food crops & oil seeds and 5% for commercial and Horticultural Crops) Extensive use of technology for faster, more accurate and transparent assessment of yield loss and claims. There is a provision for payment of full insured amount against losses. Government of India targets to increase coverage of farmers from 20% to 50% in 3 years.

Questions that could be of interest to the Committee and responses thereto by the Office of the CAG

1. Debt/GDP ratio, a stock parameter, could be one anchor that can be used in addition to the Deficit/GDP ratio and other parameters already present in the existing FRBM Act. What are the views of the CAG on this? Some other noted economist have also suggested other parameters like bond yield/loan yield/ Domestic savings as alternatives. Which one of this will emerge as most sound parameters?

Reply:

At the outset we would like to mention that the question of which appropriate indicators, ratios, and other relevant fiscal parameters are to be incorporated in the FRBM Act is largely a domain of Government policy making. As such it is for the sovereign Government to take appropriate decisions as to what are the changes/amendments that are required to be brought in. This of course will require study of the best practices that are under implementation/have been implemented in other countries. The views of the stakeholders and particularly those of the reputed Institutes in the country dealing with the economic and particularly fiscal policies would be relevant. We understand that the Committee had already extensive deliberations with the stakeholders on this.

We also understand that at the time of formulating the current FRBM Act the Government had visited the idea of having debt to GDP ratio as one of the parameters/fiscal indicators. Perhaps given the position that many of the countries in the world are now having such a fiscal indicator in addition to others, the Committee could also look at the past policy, decisions and appropriately see whether the matter needs to be considered afresh in the light of changing national and global economic outlook and circumstances. Finance Commissions have also recommended fiscal consolidation path which also included Debt/GDP ratio as one of the fiscal indicator. Accordingly Committee may also consider this as one of the indicators.

2. The existing FRBM Act mentions grounds of national security or national calamity or such other exceptional grounds, as the Central Government may specify, as escape clause to defer achievement of deficit targets. Would the CAG consider the present specification in the Act as well defined? Given the situation that other countries are having very specific criteria for escape clause, does the CAG feel that there is a need to revisit the this Section of the FRBM Act so that our definition and practices are in line with the best practices followed by other peer countries?

Reply:

The first proviso under Section 4(2) of FRBM Act stipulates that the revenue and fiscal deficits may exceed the prescribed targets due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify. The Act further provides that the ground or grounds specified in the first proviso shall be placed before both Houses of Parliament, as soon as may be, after such deficit amount exceed the aforesaid targets. We however have noticed that the Government has not specified the ‘exceptional grounds’ on which it may deviate from the FRBM targets. The 13th FC in its report (December 2009) had also recommended that the FRBM Act needs to specify the nature of shocks that would require a relaxation of FRBM targets. Considering the deviations that had been made from the targets a number of times in the past year, we feel that the scope of ‘exceptional grounds’ is too wide and needs to be clearly defined in the Act/Rules so as to remain on the path of fiscal consolidation. Here we would like to mention that in the case of several other countries the events which constitute exceptional grounds have been clearly specified, this include economic recession, banking system bail out, events outside the Government control, change in Government, change in budget coverage, in addition to natural disaster and economic recession. Moreover, in number of countries if there is to be deviation from fiscal consolidation path, these has to be first got approved in the respective Parliaments through a well-defined voting mechanism.

In number of other countries also the transition path by which the country will come back to the original fiscal consolidation path is also specifically defined. In the Indian context, we however noticed that a statement is merely placed before the Parliament and that is deemed to have sufficed. We therefore feel that it may be a good practice to further define the exceptional grounds so that while they provide good escape mechanism and flexibility to the Government, the triggers for the exceptional circumstance is clearly laid out in the FRBM Act.

3. The Department of Expenditure during their presentation before the Committee had brought out that the C&AG may be given the task of auditing the performance of FRBM framework in respect of the States also. What is the views of the CAG on this?

Reply:

We would like to mention here that the FRBM Act and the Rules thereof as brought out in August 2003 and July 2004 respectively, did not have specific mention or provisions for the CAG to bring out specific standalone report on the compliance of provisions of the Act by the Government. However, we would like to mention that in CAG's Financial Audit Reports on the accounts of the Union Government did contain analysis of some of the fiscal indicators vis-à-vis the target specified under the Act and the Rules.

However, sometime in November 2011 the Government proposed to introduce amendments in the FRBM Act bringing in a provision thereby entrusting an independent agency (which could be CAG) to review periodically the compliance o the provisions of the Act. After consideration of the matter in the CAG Office, it was informed to the Government that the CAG is in agreement with the request of the Ministry for an independent review annually of the compliance of the FRBM Act. Accordingly an amendment in the Act was notified in May 2012 and connected Rules were notified in October 2015 bringing out the specific areas which were to be covered by the CAG during the annual review.

We have noticed that there exist provision in the Fiscal Legislation Act of some of the States (viz. Haryana, Tamil Nadu, etc.) saying that "State Government may entrust the C&AG or an agency independent of the State Government (which could be C&AG) to review periodically as required, the compliance of the provisions of the Act and such review shall be laid on the table of the State Legislature". Even without specific entrustment, our Principal Accountant General/Accountant General have been bringing out observations on the compliance of the provisions of the Act by the State Government from time to time in the respective State Finances Audit Report.

4. The IMF, the OECD and other stakeholders have mentioned that the key ingredient for success of Fiscal Act/Rules is the presence of independent monitoring bodies. Does the CAG feel that the existing set up in India is sufficient?

Reply:

We would like to mention that as brought out in our Report on Compliance of provisions of the FRBM Act for the Central Government, the Government has been largely gliding towards the path of gradual fiscal consolidation, albeit some misses and deviations from targets from time to time due to factors global recession which were beyond the control of the Government. Similarly the State Governments have also been able to adhere broadly to the fiscal deficit targets except in the case certain outlier States, viz J&K, West Bengal, Himachal Pradesh, Punjab, Kerala, etc. However, we do feel that some of the key elements and provisions in the Acts and Rules may require either more precise definitions; relatedly some of the other elements/stipulations under the Act/Rules may require incorporation of pragmatic provisions so as to leave adequate maneuverable room to the Government to the cyclical impacts on the economy. For example, the IMF, World Bank and other reputed rating agencies have acknowledged that periodically shocks are going to impinge on the sovereign Governments. Some of the shocks like impact of oil prices, bailing out of sick institutions, failure of monsoon/draughts, etc., are predictable to quite some degree and it may be possible to build in the FRBM Act some suitable criteria to leave adequate room to the Government to accommodate such events.

5. Many countries are now having Fiscal Council/Fiscal Institutes who are giving timely ex-ante inputs to the Finance Ministry particularly in respect of analysing the Budget formulations and Estimates. What is the view of the CAG in respect of establishment of such an institution in India?

Reply:

We would like to mention that the 13th as well as the 14th FCs had recommended the formation of Fiscal Council which should act as an autonomous body reporting to the Ministry of Finance, which would, in turn, report to Parliament on matters dealt with by the Council in accordance with current Constitutional provisions. Such a Council is to undertake ex-ante assessment of the impact of fiscal policy and the fiscal implications of budget proposals. We have also noticed that a number of countries have constituted fiscal councils to monitor fiscal policy calibration, particularly since 2005. These include the United States of America, Australia, Canada, the United Kingdom and Brazil. While the common agenda of these institutions is to promote sound fiscal policies as watchdogs, there is considerable diversity in their structure and the functions they are assigned to perform. A common objective of these fiscal councils is to assist the national legislatures to monitor and evaluate the fiscal adjustment process and impart greater transparency to this process by objectively estimating the costs of various policies and programmes.

However, the effectiveness of Fiscal Council may also hinges on several factors including having full autonomy within the scope of their mandates, active and unfettered dissemination of their analysis and their credibility. Also such a body is not defined in the Constitution and the mandate of the CAG in so far as it relates to the independent examination of the accounts of the Union and the States is a distinct and constitutionally defined mandate. Our views on this had earlier been presented to the Government at the time of deliberation prior to the enactment of the FRBM Act 2003. We had brought out that setting up of a Fiscal Council through statute is not consistent with the existing institutional arrangements and it goes against the basic structure of the Constitution. Under the rules of business and scheme of accountability of executive to the Legislature, it is the prerogative of the Finance Minister to inform and explain to the Parliament the conduct of the fiscal policies and budget management. It is inconceivable therefore that a statute should set up a Committee to monitor performance of Finance Ministry and whose Reports Finance Minister should be bound to place before the Parliament. Therefore setting up of a Fiscal Council reporting to Parliament may be an encroachment on the prerogative of the Finance Minister, who has to present Reports/policy statements of the Government to the Parliament for its consideration and debate. In fact such a body may create unanticipated legal and procedural problems. At best such a Fiscal Council may only be limited to the role of aiding the Finance Minister in ex-ante analysis of Budget, etc.

6. What is the views of the CAG with regard to the suggestions received from some of the sources for having a range/band for the deficit target instead of a fixed number? Would not a range/band be able to take care of cyclical ups and downs in the economy and the fiscal shocks which every country is now experiencing due to global turmoil and other factors beyond the sovereign's control?

   If in case we stick to a fixed number then what would the CAG consider as adequate number – 3, 4, 5 … per cent of GDP for fiscal deficit? Similarly many economists and international institutes like the

IMF have suggested that for India Debt/GDP should be within 60% - What is the view/suggestion of the CAG on these numbers?

Reply:

At present our understanding is that in the countries where fiscal rules are in existence, not a single country is having the range/band for the deficit targets. Therefore, what may be pros and cons of adopting such a unique approach may not be discernible at this stage in the absence of adequate empirical evidence on the topic. However, a common sense pointer could be that having a band would give too much leeway to the Union and State Governments to veer towards the end point of the band and result in being an instrument of fiscal indiscipline. From the point of view of auditing, the auditors also traditionally are comfortable with fixed points as a band or range may give too much ambiguity to interpret and report the financial result.

As regards, the adequate of fixed numbers, the original files/papers in the Ministry of Finance prior to the enactment of the FRBM Act 2003 and Rules 2004 may contain the logic behind the choice of arriving at the fixed numbers like 3% for FD/GDP ratio. However, from a thumb rule interpretation it perhaps can be surmised that this 3% figure might have been arrived on a yard stick assumption like this – deficits of Union and States have to be financed out of household financial savings, apart from leaving adequate space for private/public sector borrowing need. Majority of outstanding debt of the Union Government is financed from domestic savings and are termed as 'internal debt', and the percentage of 'external debt' is in single digit in the total composition of outstanding debt. Therefore, the reliance of financing the deficit falls back on household financial savings. Perhaps in the year 2001 or so the national savings was roughly of the order of 9-10% GDP. Distribution of this proportionately over the three constituents – Centre, State and Private/Public Sector borrowers would have yielded the figure of 3% each. However, the Committee may have to recalibrate/revisit such numbers keeping into consideration the borrowing needs of the Union for the emerging priorities (7th Pay Commission, Bank Recapitalisation, Infrastructure development needs of various central Ministries); Borrowing needs of the State Government as a result of implementation of UDAY, etc.

7. Has the CAG come across instances of off-budget borrowings and other creative techniques in States/Centre finances?

Reply:

The economic literature suggests that in many countries, the sovereign Government may resort to creating accounting and off budget financing schemes to mask the real effect of the actual borrowing. While examining the accounts of the States/Union at times there are indicators of such transactions. We have for example highlighted instances of several off-budget transactions in respect of the Government of Punjab in our Audit Report on the State Government Finances for the year 2012-13 to 2014-15. However, it may be mentioned that it is difficult to capture or locate such financing during the course of audit, unless inputs from lending agencies, etc., are received. In some of the Reports of CAG on State Finances, we have defined the term off-budget borrowing as incurring of liabilities by the Government without bringing them into Government accounts. This may also arise when Government does not fully pay monies it owes to Government companies/corporations.

8. The Central Government, State Governments and even some of the PSUs are taking up various projects through PPP mode. Are details of all these coming to the financial statements of the Government and is the CAG able to ascertain the implications of these on the finances of the Union and States?

Reply:

The audit of PPP arrangements is an emerging area of interest for the audit institution. In the recent past we have come out with Audit Reports touching on some of the key PPPs. In such audit reports we do examine and come up with detailed analysis of the entire picture of the PPPs. However, getting comprehensive details of PPP arrangements in the financial statements of the Union and State Governments is a challenge. Our Principal Auditors have been taking up the issues with the counterpart in the Governments but the details furnished are sketchy. We will be continuing to pursue with the Governments on this.

For example FRBM Act 2003 provides for disclosure of liability of the Government on Annuity Projects. These details are furnished in Receipt Budget, even prior to the enactment of the Act. However, examination of the details furnished in Receipt Budget of two successive years revealed that details are furnished only in respect of two Ministries, viz. M/o Road Transport & Highways, and M/o Home Affairs. Further, a reading of the information furnished do not bring out the exact amount of liability outstanding on these annuity projects, because of inadequate correlation of annual payout on account of annuity payment and number of years of payment. It is also inconceivable that out of huge set up of Government of India only two Ministries are implementing projects under annuity payment scheme. Consequently we feel that the Committee may have to come up with good recommendations and solutions regarding the complete and accurate disclosure of the liability befalling from annuity and PPP projects.

9. On the concept of Effective Revenue Deficit (ERD) there has been debates and exchange of views by various stakeholders. The operation of such a concept by the Central Government is also leading to demand from many of the State Governments for similar arrangements. In the past it is understood that the CAG had also given its views on the concept of ERD. Considering the present position of the deficit numbers, what is the view of the CAG on the issue?

Reply:

In November 2011, the Union Government with a view to introduced the concept of ERD (to be worked out by excluding revenue expenditure incurred on ‘grants for creation of capital assets’ from the revenue deficit) initiated discussion process with the CAG. CAG in January 2012 had emphatically responded that the structure of expenditure classification, nature of grants in aid, revenue deficit, etc. are settled issues – settled by internationally accepted accounting standards, principles of classification of expenditure between revenue and capital, national standard/rules as notified and other best practices. Therefore for purposes of financial reporting, a review of benchmark fiscal parameter is infeasible.

While making a presentation before the 14th FC, the office of CAG vide DO letter No.SMU/FFC/22-2013 dated 17 June 2014 had expressed their concerns on the following lines:

a) Creating a category of capital grants would lead to a tendency to put everything into the capital grants category (i) because to project a lower effective revenue deficit, (ii) because of the connotations implied by capital grants and revenue grants. This could also lead to presenting an inflated picture of Government assets holding. Also, if a category of capital grants were to be created the issues of assets ownership and recording of assets would have to be clarified. At present, the practice of maintaining asset records/registers, though mandated, is not very prevalent. The creation of capital grants would not give an assurance of existence and recording of an asset.

b) This is also important because in the case of aggregation of general Government which is inclusive of all tiers, treatment of capital grants as capital is likely to entail a double counting of capital at the level of the Central Government and recipient tier.

An advice to exercise prudence while classifying amounts as grants for creation of capital assets was also prescribed by the Office of C&AG on the logic that (i) a number of works which were categorized as capital creation was abandoned midway, (ii) in a number of cases, the ownership of assets were not with the Government, and (iii) a large number of works were focused on employment generation with minor improvements in the existing assets. These works did not realize in creation of any durable assets.

We may also mention that in this context in similar vein the 14th FC had observed that artificial carving out of revenue account deficit into effective revenue deficit to bring out that portion of grants which is intended to create capital assets at the recipient level leads to an accounting problem and raises the moral hazard issue of creative budgeting. The 14th FC was of the view that the ERD is unique and did not fit within international practices of classification of accounts/expenditure. Even a few State Governments argued that they also be allowed to incorporate the concept of ERD. The 14th FC recommended to omit the definition of ERD from the FRBM Act from April 2015, and to pursue the objective of balancing revenues and expenditure on the revenue account enunciated in the original FRBM Act.

As we brought in our recent Audit Report, absence of defined criteria for classification of expenditure as 'grants for creation of capital assets', as recommended by the High Level Expert Committee on Efficient Management of Public Expenditure (Rangarajan Committee) formulating precise definition and criteria for classifying expenditure as grants for creation of capital assets, and its rigid compliance to prevent misclassification, led to understatement of the effective revenue deficit by ` 711.38 crore.

We also had brought out that in absence of defined criteria for classification of expenditure as 'grants for creation of capital assets', there exists inconsistent and varying practices in the treatment of such expenditures. Expenditure incurred on flagship schemes viz. Indira Awas Yojana, Rajiv Awas Yojana and certain components of expenditure under MPLAD, MNREGA and Multi-Sectoral Development Programme were incorrectly classified as grants for creation of capital assets, resulting in understatement of effective revenue deficit.

The above aberrations already prevalent in the Central Government transactions coupled with the demands from several State Government for similar arrangement in respect of ERD classification would entail the reconsideration of the concept of ERD.

10. There is a talk that the Government intends to bring in the concept of multiyear budgeting. Would the goal of bringing out multiyear Budget statements and Medium Term Expenditure Framework be not in conflict with Parliament prerogative of passing a vote of the Budget? How has it been resolved in other countries? Are there experiences/views which can be shared with the Committee?

Reply:

The concept of multiyear budgeting could work to the advantage of line Ministries of the Union Government who are implementing the major flagship programmes of the Government. With this arrangement, the programme implementing Ministries would be assured of the resources to fund the programme. However, the constrains may come upon the Ministry of Finance as they may lose the flexibility, besides obtaining Parliamentary approval on outlays which may intrude on the prerogative of the Parliament. Therefore, the best arrangements which are in vogue in comparable countries may have to be studied by the Committee and the Government on this.

11. The 7th Pay Commission has already been implemented in respect of the Central Government minus the allowances. There were various views that the budget for 2016-17 had not fully taken care of the outcome of 7th PC. In respect of Railways, the reports in the media already indicated that there is a shortfall of around `30,000 crore for 7th PC provision. Also once the allowances are also finalised for

remaining part of current financial year, it is likely that the Central Government may have to provide additional resources at the RE stage of the current year. Very shortly the States would have also to follow the recommendation of the 7th PC and some of the States like UP, NCT Delhi have already announced the implementation. Keeping in view the impact of 6th PC on the finances of the State Governments, which they have already brought before the 14th Finance Commission, and even before this Committee, what is the views of the CAG on this entire issue?

Reply:

In would be an inevitable fact that the 7th PC implementation would affect the fiscal consolidation path of the Central as well as the State Governments. The respective Governments will have to take appropriate steps to bolster their revenue generation and prudent expenditure management mechanism.

12. The Committee observed that the CAG in his Reports have brought out various observations relating to transparency in the accountal of cess. Apparently such observations indicate that the cess collections are being used to bridge the revenue and fiscal deficits instead of financing the intended schemes for which cess were collected. Relatedly, during the meetings with the Committee, the Department of Revenue and Department of Economic Affairs expressed their concerns regarding the likely sudden loss of resources once the GST is implemented and the proceeds from cess are merged into one single divisible pool of resources. What are the CAG's reactions and further thoughts? Could the CAG also kindly provide the details of the cess being collected for the last five years?

Reply:

Given the situation that the GST implementation is a certainty, the cess pool available with the Central Government will no longer be an exclusive central resources (particularly non-shareable). In 2014-15, the resources available from cess collection stood at around ` one lakh crore (0.8% of GDP). We believe that a major portion of this is exclusive to Centre and therefore the Government will have to contemplate how best the targets can be met minus such helpful instruments. The Committee may also like to appropriately factor the impact of such shocks in their Report. As regards the details of cess collection of last five years, it will be made available subsequently.

13. The Committee has gathered from the interactions with several stakeholders, International Monetary Institutions and the literature on the subject of Fiscal Rules that making timely expenditure on maintenance of assets already created is a sine qua non. In this respect would it be possible for the CAG to glean out from the accounting and financial records the details of impaired/stressed assets and the quantum of expenditure required for bringing such assets into good operational position?

Reply:

At present the accounting system in place in Central and State Governments do not have any mechanism for capturing the details of impaired assets. In respect of Railways and Defence Ordnance Factories, since they have to provide for depreciation fund for renewal and replacement of assets, it can be said that some amount of provision exists for details relating to impaired assets, although the total quantum of impairment is not ascertainable. In respect of Railways we have in our recent Report on Railway Finances brought out that the contribution to the Depreciation Reserve Fund (DRF) is made on need and availability basis, instead of actual requirement as per life and physical condition of the Assets. The backlog in renewal and replacement of overaged assets, which will have to be replaced in due course for safe running of trains, will have implications on finances of Railways having cascading effect on Union Finances as well. More shockingly, in 2009-10 the resources from the DRF, which itself is underfunded, was transferred to the Pension Fund to absorb expenditure on pension payments. The Committee may therefore like to recommend good measures so as to institutionalize the process of furnishing complete details of quantum of impaired assets at the end of a financial year in their accounts by the respective Ministries/Departments.

14. The Committee is already besieged with the reports of the huge quantum of non-performing assets (NPAs) of the banks, several of which are nationalised banks (NBs). There are indications that as of 31 March 2016, the quantum of NPAs have already crossed over `6 lakh crores. The Government may have to therefore infuse much larger resources for re-capitalising the NBs beyond the present allocation of around `25,000 crore. What are the CAG's considered views and whether the CAG is contemplating any detail examination of the subject from the fiscal consolidation point of view and quality of capital expenditure?

Reply:

We are planning to take up an audit which may among other objectives dwell on the issue of whether the money given by the Central Government to the NBs as part of recapitalisation has been utilized efficiently and effectively and whether the objective of restructuring has been achieved. We understand that in the last five years the Finance Ministry has infused over `85,000 crore to improve the performance of the PSBs. Once the audit exercise is over and we come out with the Report we hope to present the Report which will also cover the important aspects relating to the quality of capital expenditure of the Government and other issues.

15. We appreciate the unique position that the CAG is the repository of data relating to State Government Accounts being the compiler, as well as the certifier of State Government Accounts and the Union Government accounts. The Committee has also been given to understand that the CAG brings out a compilation called Combined Finance and Revenue Account of the Union and State Governments, which also brings out interesting trend analysis of few key parameters for some specific years and for specific States. The Committee is looking into the aspects of the key fiscal parameters of Union as well as the State Governments, the Committee will appreciate if the details for the period from 2004-05 to 2014-15 are made available.

Reply:

The data pertaining to Union and States relating to deficit indicators, outstanding debt/guarantees, Resources transferred to States from Centre/Resources received by States from Centre, etc. from 2010-11 to 2014-15 have been compiled and the hard copy and soft copy have been provided alongwith.

16. While reading the recently tabled CAG's Report on FRBM of the Union Government, the Committee noticed that the Report has drawn attention to short assignment of net proceeds to the States, indicating aggregated amount of around `81,000 crore short devolved to States. What exactly is this issue? Would this amount have to be ultimately passed on to the States by the Union Government and if so in what time frame?

Reply:

In terms of Article 279 of the Constitution, the Comptroller and Auditor General of India is required to ascertain and certify the 'net proceeds' (any tax or duty the proceeds thereof reduced by the cost of collection), whose certificate shall be final.

During the certification of 'net proceeds' by the Comptroller and Auditor General of India based on the recommendations of the successive Finance Commissions, it was noticed that during the period 1996-97 to 2014-15, there was difference between the net proceeds of the taxes and duties assignable to the States and actually assigned to the States, as detailed in the table below. Thus during the said period an aggregated amount of ` 81,647.70 crore was short devolved to the States, as detailed below.

(` in crore)

Year	Certified amount of net proceeds	Share (%) to be assigned to States	Amount of net proceeds to be assigned to Stated	Net proceeds already assigned to States as per Finance Accounts	Difference
1996-97	1,22,358.66	29	35,484.01	35,060.67	423.34
1997-98	1,32,824.42	29	38,519.08	35,953.69	2,565.39
1998-99	1,36,847.49	29	39,685.77	39,145.42	540.35
1999-00	1,62,496.54	29	47,124.00	43,480.81	3,643.19
2000-01	1,78,067.52	29.5	52,529.92	51,687.52	842.40
2001-02	1,77,243.16	29.5	52,286.73	52,841.53	-554.80
2002-03	1,98,909.72	29.5	58,678.37	56,122.07	2,556.30
2003-04	2,35,168.54	29.5	69,374.72	65,766.40	3,608.32
2004-05	2,76,449.38	29.5	81,552.57	78,594.59	2,957.98
2005-06	3,30,098.92	30.5	1,00,680.17	94,385.40	6,294.77
2006-07	4,27,387.11	30.5	1,30,353.07	1,20,330.18	10,022.89
2007-08	5,29,635.56	30.5	1,61,538.85	1,51,800.01	9,738.84
2008-09	5,33,188.09	30.5	1,62,622.37	1,60,178.71	2,443.66
2009-10	5,47,345.13	30.5	1,66,940.26	1,64,831.30	2,108.96
2010-11	7,05,444.35	32	2,25,742.19	2,19,302.67	6,439.52
2011-12	7,90,333.84	32	2,52,906.83	2,55,413.62	-2,506.79
2012-13	9,29,677.64	32	2,97,496.84	2,91,546.61	5,950.23
2013-14	10,17,126.85	32	3,25,480.59	3,18,229.58	7,251.01
2014-15	11,09,783.08	32	3,55,130.59	3,37,808.45	17,322.14
Total			**26,54,126.93**	**25,72,479.23**	**81,647.70**

To the extent of short devolution of net proceeds of taxes to the States, the revenue and fiscal deficit of the Union Government was understated in the relevant year. In the FY 2014-15, the understatement of revenue and fiscal deficit was by `17,322.14 crore constituting 0.14 per cent.

Background for certification at one go: Article 270 of the Constitution was amended in June 2000 (8th Amendment) with effect from 1 April 1996. The amendment provided that all taxes and duties included in the Union list levied and collected by the Union Government except the duties and taxes referred to in Articles 268 and 269, respectively, surcharge on taxes and duties referred to in Article 271 and any cess levied for specific purposes under any law made by the Parliament are to be shared with the States. Consequently, corporation tax, customs, service tax and non-shareable segment of the Union excise duties also became sharable with the States.

After the 80th Amendment, the Ministry of Finance in July 2000 requested the CAG to undertake the certification exercise of net proceeds of taxes and duties coming within the purview of amended Article 270 afresh for each effective year from 1996-97.

Some clarification were sought from Ministry of Finance in August 2001, followed by reminders in February 2002, May 2002, March 2005, and August 2005. However no response was received. Pending receipt of clarifications, the draft certificate of net proceeds were issued for 1996-97 to 2014-15 in three batches, viz. 14 December 2015, 31 December 2015 and 6 January 2016 with detailed calculations, requesting for Ministry's observations, if any. The final certificate of net proceeds was issued on 10 February 2016.

17. During the presentation by the OECD they had stressed on the need to reduce inefficient spending particularly those on subsidies. In this context the Committee observes that the CAG has drawn attention to issue of unpaid subsidy claims of a few PSUs amounting to around `45,000 crore. Can further details be shared and elaborated to the Committee on this topic?

Reply:

In the FY 2014-15 it was found that an amount of ` 27,759 crore of unpaid subsidy claims (` 23,699 crore of FCI, and ` 4,060 crore of four CPSUs viz. National Fertilisers Ltd., Fertilisers and Chemicals Travancore Ltd., Madras Fertilisers Ltd., Hindustan Petroleum Corporation Ltd.) were pending during 2014-15, excluding 4th quarter bills submitted by the CPSUs. This amount would further increase to ` 44,941 crore in 2014-15, if outstanding subsidy claims are considered in totality including the past unpaid claims, but excluding 4th quarter claims.

An examination of budgeting on subsidies and actual expenditure incurred there against during the FY 2010-11 to 2014-15 has been made and it was found that the budgeting/expenditure on food subsidy has continuously shown an increasing trend. However, if the budget provision is made on realistic basis taking into account the outstanding unpaid subsidy claims of FCI, the provisioning/ expenditure on subsidies would have been much higher than being budgeted/accounted for in the Union Accounts. Thus there have been under-budgeting by the concerned Ministries in violation of Rule 46 of GFR 2005. In absence of adequate provisioning the actual expenditure on subsidy is not being booked to guard against the excess expenditure in terms of Rule 52 of GFR.

In terms of standards prescribed in IPSAS relating to financial reporting under the cash basis of accounting, a disclosure is required on the face of the statement of cash receipts and payments of certain payments made by third parties on behalf of the reporting entity, for the sake of fair presentation and enhanced accountability. The information relating to receivables, payables, borrowings and other liabilities, non-cash assets, accruing revenues and expenses, etc., which are not recognised under cash accounting needs to be collected and disclosed in the notes to the financial statements where that information is likely to be useful to users. IPSAS also encourages inclusion of information about non-cash assets and liabilities and a comparison thereof with the budget in the general purpose financial statements.

The above shows that the subsidy liabilities are being short budgeted and consequently short accounted having impact on deficit numbers. Moreover our analysis above was on test basis and if the full accounting of the accrued liabilities on subsidy across all Ministries is properly declared by the Government and brought to book, the figure will be much higher. Moreover, the trends of the unpaid bills as brought out in our Report bring out that the unpaid rolled over amount is on increasing trend year on year basis and therefore merely putting forth an argument that this has been a past tradition and practice may not hold good.

18. What is the way out for treating the accumulated loss in the operation of NSSF?

Reply:

National Small Savings Fund (NSSF) was created in Public Account in April 1999 with the Central Government taking on the responsibility of servicing the small savings deposits. The fund receives money from subscribers of various small saving schemes, and invests the balance available with it in Central and State Government Securities. Before the NSSF was constituted, the small savings receipts mobilised by the Union Government and on-lent to the States were treated as capital expenditure of the Union Government and, accordingly, calculated in its gross fiscal deficit. Shortfall in returns from loans given out of small savings proceeds and the interest paid on small savings were accounted for under CFI and hence calculated under its revenue deficit.

After the constitution of the NSSF in 1999, however, the income deficit of NSSF is not being reflected as part of the Union Government's revenue deficit. This is because NSSF operations are being accounted for within the Public Account, and around half of the outstanding balances under NSSF are accounted for as Public Account liabilities, instead of being accounted for as internal debt in the CFI.

On this context the 14th FC had observed that the off-budget nature of NSSF operations renders them outside the regulatory framework of the FRBM Act, raising concerns of fiscal transparency and comprehensiveness.

At the end of FY 2014-15, total accumulated deficit in the operation of NSSF was ` 90,707.56 crore. The operational loss, which was ` 1,681.68 crore at the end of first year of operation, viz 1999-2000, has steady increased year after year to ` 90,707.56 crore. These deficits are in the nature of loss to the Government which will have to be borne on revenue account, whenever the liabilities under NSSF are finally repaid. By keeping the annual loss in the operation of NSSF under Public Account, the deficit figure for the relevant year are not reflected fairly. The entire arrangement requires urgent intervention.

In reply to the observation included in the CAG's Audit Report on compliance of FRBM Act, the Ministry of Finance accepted that administrative intervention is required for making good the accumulated losses in NSSF, adding that if administrative decision is taken to make good the progressive deficit, this needs to be provided in CFI (with due appropriation authorised by Parliament) and this will have an adverse impact on revenue/fiscal deficit of the Government.

The Committee may like to obtain the views of the Ministry of the Finance on this issue.

19. The spirit of the FRBM Act is to ensure inter-generational equity in fiscal management and long term macro-economic stability by achieving sufficient revenue surplus and removing fiscal impediments in the effective conduct of monetary policy; carry out prudential debt management consistent with fiscal sustainability through limits on the Central Government borrowings, debt and deficits; ensure greater transparency in fiscal operations of the Central Government. In this context what are the key suggestions and advice of the CAG to the Committee with regard to measures for increasing the mopping up of revenues and curtailing expenditure. The Committee would be grateful if the CAG can kindly suggest five-six examples which can be recommended by the Committee in its Report and implemented straightaway with regard to bolstering of revenue and curtailment of expenditure. The Committee would also be glad if the CAG can pin-point the key measures and activities which need to be put in place by the Government right away in so far as issues relating to accounting and finance to increase the transparency and disclosure in fiscal operations. The Committee would like to capture all such crucial suggestions in its Report.

Reply:

(a) In CAG's Financial Audit Report on the accounts of the Union Government and in CAG's Report on FRBM, a comment relating to non-inclusion of eight disclosure statements in the Union Accounts recommended by the 12th Finance Commission and also endorsed by the 13th and 14th Finance Commissions are being included every year. These disclosure statements were required to be given in the Union Accounts till the migration from cash basis to accrual accounting is achieved in the Government Accounts. The additional statements recommended by the Commission were:-

(i) *Subsidies given, both explicit and implicit;*

(ii) *Expenditure on salaries by various departments/units;*

(iii) *Detailed information on pensioners and expenditure on Government pensions;*

(iv) *Committed liabilities in the future;*

(v) *Debt and other liabilities as well as repayment schedule;*

(vi) *Accretion to or erosion in financial assets held by the Government including those arising out of changes in the manner of spending by it;*

(vii) *Implications of major policy decisions taken by the Government during the year or new schemes proposed in the Budget for future cash flows; and*

(viii) *Maintenance expenditure with segregation of salary and non-salary portions.*

Many of the State Governments in their accounts are already furnishing such disclosure statements. Therefore the Committee may like to bring out strong recommendation for the Central Government to act on the matter.

(b) As the Committee would be kindly aware a much needed area of action is the adoption of accrual budgeting and accounting that shows the full financial costs and benefits of budget decisions, including the impact upon financial assets and liabilities. It is understood that the Railways have already completed a pilot project on implementation of accrual accounting in some selected zone. The adoption of accrual accounting and its implementation in the Government sector has been deliberated and considered by the highest level of the Government in the recent past. Therefore, to begin with we feel that the Railways, Posts, Units of Defence Ministry which need to operate on commercial lines should immediately take up the task of switching over to accrual based accounting within definite time frames. The Committee may like to dwell over this issue and recommend appropriately.

(c) Government Accounting Standards Advisory Board (GASAB) is tasked with framing Accounting Standards for switching over to the accrual basis of accounting in the Government. The accounting standards for accrual system of accounting in the Government are called Indian Government Financial Reporting Standards (IGFRSs). GASAB has developed various documents to serve the purpose of roadmap and transition path for accrual accounting. Five IGFRSs have been approved by the GASAB but are lying under consideration/pending with the Ministry of Finance, Government of India, for quite some time. An Apex Committee with 11 members and Secretary (Expenditure) as chairperson, as nodal agency for transition to accrual accounting, was constituted in September 2011 based on 2nd ARC's 14th Report. The Apex Committee has met only once in May 2012. In January 2015, GASAB has addressed the last communication to the Secretary, Expenditure, MoF, seeking clarification on transition from cash to accrual basis of accounting. The Apex Committee needs to be re-activated with regular meetings and the Finance Ministry needs to act on all the IGFRs with alacrity. The Committee may like to give strong recommendation in this regard.

(d) The Government is grappling regularly with the issue of finding adequate sources for funding the requirements of various Ministries – from social sector schemes to infrastructure sector projects. In this context we have noticed that many Regulators in various sectors of economy, viz. SEBI, IRDA, MCI, AICTE, CBSE, UGC, etc., and many Autonomous Bodies have huge corpus of funds as reserves/bank balances, which could be made available to the Government by bringing their funds as part of the Public Account, where the same has not been carried out so far. This is so in view of the position that these Regulators/Autonomous Bodies function as an extension of 'State', and are fed by resources from the Government whenever they require support.

Ministry of Defence

- The Budget for 2016-17 for MoD is Rs 3,40,921.98 crore. This comprises of Defence Service Estimates of Rs 2,22,456 crore (Revenue Rs 1,43,869 crore and Capital Rs 78,587 crore), MoD Civil Estimates amounting to Rs.36,133 crore and Defence Pension amounting to Rs 82,332 crore. While formulating the guidelines for 13th Defence Plan, it has been decided to consider year on growth at the rate of 12% for Revenue and 15% for Capital for budget projection/preparation.
- For crucial border roads, based on Long Tern Roll on Works Plan, requirement of funds upto 2019-20 is Rs.2380 crore. Our aim is to ensure that defence expenditure does not fall below 2% of GDP, given the current hostile geo-political environment in our neighbourhood. Variations in international price of crude oil could cause a change in budget of defence profile as 15-20 % of non-revenue salary goes into the payment of crude oil.

Department of Investment and Public Asset Management

- The effort of the Department is to list all profit making CPSEs on stock exchanges and to achieve 25 % public shareholding as per listing norms. This will raise resources for the Government, improve corporate governance, promote people's ownership and accountability of the stakeholders and unlock the value in the company.
- Current disinvestment policy aims at the following: (i) Disinvestment through minority stake sale in listed CPSEs, Government to retain majority shareholding & management control (ii) Listing of profitable CPSEs (Unlisted CPSEs with no accumulated losses and having earned net profit in three preceding consecutive years to be listed) (iii) Strategic disinvestment -sale of share upto 50 % or more with transfer of management control. Government to exit from non-strategic business, promote efficiency and professional management of the company and unlock optimum economic potential of business enterprises.
- As per the Public Enterprises Survey 2014-15 conducted by Department of Public Enterprises, there are 298 CPSEs under different Ministries/Departments as on 31.03.2015. Out of these, about 50 CPSEs have been listed on the stock exchanges. As on 31 July 2016, about 45 Central Public Sector Enterprises (CPSEs) listed on the stock exchanges contributed to about 11% of the total market capitalization which is Rs. 13,01,260.08 crores on Bombay Stock Exchange and Rs. 12,52,900.11 crores on National Stock Exchange. Two of the top ten companies by market capitalization are CPSEs such as Coal India Ltd.(Rs.2,07, 176.75 crore on BSE) and Oil and Natural Gas Corporation Ltd.(ONGC) (Rs.l ,88,178.01 crore on BSE). Further, there are more than 60% profit making CPSEs among the unlisted CPSEs. Some of these companies are set up under section 8 of Companies Act, 2013 and prohibited from distribution of profits to its members. The remaining CPSEs can be listed on the stock exchanges to enhance the value of Gol investment.
- DIPAM is engaged in comprehensive management of Gol's Investment in CPSEs. In pursuance to the announcement made in the budget 2016-17, guidelines on 'Capital Restructuring of CPSEs' have been issued in May 2016. These guidelines supersede all previously issued guidelines on payment of dividend, buy back of shares, issue of bonus shares and splitting of shares. The focus of these guidelines is on economic activities by CPSEs and optimum return on investment.
- The CCEA has approved the procedure and mechanism for strategic disinvestment of CPSEs. NITI Aayog has been given the mandate to identify CPSEs for strategic disinvestment. NITI Aayog would also advise the government on mode of sale, and the percentage of shares to be sold of the CPSE and suggest methods for valuation of the CPSE.
- Government of India launched the CPSE- Exchange Traded Fund (ETF) scheme comprising of shares of ONGC, CIL, GAIL, PFC, REC, OIL, IOCL, CONCOR, BEL and ElL in March 2014. Government realised an amount of Rs.3000 crore by divestment of its holdings in the above 10 CPSE scrips.
- Buyback of shares has been undertaken in the case of some of the CPSEs who had not deployed substantial cash/bank balances for viable business expansion. Buyback of shares shall transfer excess cash with the CPSEs having high net worth, cash and bank balance, low borrowing and limited CAPEX. In such cases, it aims to improve investors' confidence in the company.

- The disinvestment targets and achievements during the last five years is shown in the table below.

Year	Target		Amount Realized
	BE	RE	
2011-12	40000	15493	13894
2012-13	30000	24000	23956
2013-14	40000	16027	15819
2014-15	43425	26353	24349
2015-16	41,000 (excluding strategic sale)	25313	23997*
An additional amount of approx. Rs. 8152 crore has also been realised through sale of bonus debentures to EPFO (NTPC) respectively.			

- The disinvestment targets are planned annually and are driven by budget projections. The disinvestment exercise is driven based on budgetary projections, market conditions and approvals from the Administrative Ministries. An average realization through disinvestment of Central Public Sector Enterprises (CPSEs) per annum comes is ofRs.21,100 crore (approx) in the past seven years. The disinvestment target for the current financial year (20] 6-17) is Rs.56,500 crore, comprising Rs.36,000 crore from disinvestment of minority stake sale of CPSEs and Rs.20,500 crore from "Strategic Disinvestment".

- CCEA approval has been obtained for disinvestment of 25 CPSEs through Offer For Sale/IPO. In financial years 2015-16 and 2016-17, out of these approvals, disinvestment process has been completed in 9 CPSEs. Transactions of other CPSEs are under process. Buy back of shares is under progress in 4 of CPSEs. Further, NITI Aayog has been mandated to recommend CPSEs for strategic disinvestment. Based on its recommendations, the Core Group of Secretaries on Disinvestment (CGD) will finalize the proposal for approval of CCEA.

- During the current financial year, the ratio between "minority stake sales" and "strategic disinvestment" is 64 and 36 per cent respectively. For achieving annual target of minority stake sale, the Department obtained CCEA approval for disinvestment of 25 CPSEs through Offer for Sale/IPO. Out of these approvals, disinvestment process has been completed in 9 CPSEs in financial years 2015-16 and 2016-17 (uptill now)and the transaction of other CPSEs is in progress. Some CPSEs are also in the process of share buy back.

- Regarding strategic disinvestment, NITI Aayog is in the process of identifying CPSEs for strategic sale, suggest methods of valuation and mode & percentage of shares to be sold. Based on its recommendations, the Core Group of Secretaries on Disinvestment (CGD) will finalize the proposal for approval of the CCEA.

- Public ownership of CPSEs should be promoted. Cross holding of shares by the CPSEs, however, defeats this objectiveCross holding of shares by the CPSEs and hence needs to be discouraged. With cross holding of shares, the basic intent of bring in accountability in the Board of the CPSE is defeated While the funds of the holding CPSE are locked up in the shares of other CPSE, practically the holding CPSE does not take a call on offloading the shares at opportune time.

- CPSEs should leverage their assets for generation of resources and for investment in new initiatives that relate to their core business. To manage the resources and the assets in a prudent manner, it is important that the CPSE undertakes periodic exercise to identify such assets that are either redundant, excessive and are no longer relevant for business operations. The CPSE should thereafter take a business call on dealing with such assets including divesting of such individual assets like land, manufacturing units, etc. This shall help in release of the asset value and provide funds to invest in relevant business initiatives.
- Restricting tendency of CPSE to create subsidiaries outside core business is an area of concern. Constitution of such of these entities/subsidiaries/joint ventures is such that they do not fall with the specified definition of the CPSE (ie. companies in which the direct holding of the Central Government or other CPSEs is 51% or more).As a result, these entities remain outside the purview of monitoring by the Government even though significant public money has been invested in them. It is suggested that a comprehensive exercise should be undertaken to monitor such investments for their performance evaluation.

Department of Economic Affairs

Record Notes of the Meeting of the FRBM Review Committee with Secretary Economic Affairs on 12th August, 2016:

A meeting of the FRBM Committee with Secretary, Economic Affairs was held on the 12th of August, 2016 in Room No.41, at the North Block. Chairman FRBM Committee initiated the meeting by welcoming Secretary (EA) and other members of the Committee. The Chairman at the very onset mentioned that it was Department of Economic Affairs which had constituted the Committee and while the Committee had already been deliberating upon a lot of these issues, they would like to hear the views of the Department of Economic Affairs. He also requested Secretary Economic Affairs to address the issues raised in the questionnaire sent by the Committee during the course of the discussions. He also mentioned that the Committee would expect a written response on those issues and any other that the Department may like to address to the Committee. With these words he requested Secretary (EA) to give his opening remarks/ observations.

2. Secretary (EA) expressed his gratitude to the Committee for giving a chance to interact with the Committee and put forth his views. The Secretary (EA) briefly explained the circumstances relating to the setting up of the Committee. It was stated that in the run up to the 2016-17 Budget there were two streams of views. The first view was in favour of adherence to the FD target of 3.5% as per the revised roadmap of achieving the target of 3% of GDP in two years announced in the 2015-16 Budget speech. This view held that this had clear implications on Government's credibility and that the Government should not be seen to be simply shifting the goal post. This view was of the opinion that overall, FRBM targets have played a positive role and led to significant gains to both Centre and the States. The 2nd opinion was for adopting an expansionist stance for achieving/maintaining the growth momentum. The decision was finally taken to adhere to the FD target. However, taking into account the representations, it was also decided that since it has already been 10 years that the FRBM regime begun, it may be a good time to review the performance of FRBM implementation as well as to have a fresh look on the 'way forward', keeping in view the uncertain global economic situation etc. A budget announcement on these lines was made vide Para 111 of the 2016-17 Budget speech.

3. Secretary (EA) further explained that the Government was expecting the Committee to give their objective views on the various issues raised in the ToR. While doing so, the Committee may keep in view the gains achieved through FRBM implementation, including the positive impact on the economy over the last 10 years, and in the global economic uncertainties, which have become the new norm in the recent times. Secretary (EA) further elaborated on the positive impact of the FRBM on both Central and State finances and the strong impact on the broad macroeconomic parameters, despite 2008 global economic crisis, Eurozone crisis the PIGS problem and the recent Brexit issue.

4. Secretary (EA) while further elaborating on the economic impact of FRBM, mentioned that it had facilitated sufficient borrowing space for the private sector, impact on Ratings (even though still not up to the expectations of the Government as the major reforms/changes undertaken by the Government do not get enough weightage from the Rating Agencies). He further mentioned that the changes

brought out by the Government in the last two years were far reaching. These measures had helped in maintaining the existing rating levels. FRBM regime had aided in sustained growth along with improvements in broad macro-economic parameters. Having said this, Secretary (EA) mentioned that there was a need to have a fresh look particularly in the context of uncertainties over the last 6-7 years. The Government, he stated, is looking forward to benefit from the recommendations of the Committee.

5. Chairman sought the views of the Members of the Committee on the initial remarks by the Secretary (EA). Shri Urjit Patel stated that he agreed with all the points made by Secretary (EA) and that FRBM as per his views also, helped in maintaining macro-economic stability/external credibility. Shri Arvind Subramanian (CEA) stated that while in the case of States there was clear evidence that FRBM had helped, he did not hold the same opinion about the Centre as in his views the Centre breached the FRBM limits, whenever they wanted to. Shri Rathin Roy expressed that the evidence in the last three years showed that the FRBM definitely acted as a restraining factor on the Government. Secretary (EA) at this stage intervened and requested CEA to share the details/list of evidences which showed that FRBM did not work for Centre. Secretary (EA) pointed out that in the post-2008 years, the centre was borrowing higher amounts and passing on bulk of it to the states for various infrastructure and development schemes. This was in line with the 13th Finance Commission recommendations, although the quality of expenditure could have been better. He further added that the FRBM Act itself provides for laying of a Statement by the Finance Minister in case of breach/ failure to adhere to the FRBM limits with reasons for deviations, as happened during the global economic crisis. He added that the very fact that there was a law, acted as a benchmark for the Government. Ms. Prachi Mishra from RBI added that the Fiscal deficit did come down post 2003 with the implementation of the FRBM Act. Shri Sumit Bose mentioned that he witnessed the FRBM implementation both from within the Government as Secretary as well as from outside as a Member of the 13th Finance Commission. He stated that the force of FRBM was clearly seen through the push generated for mobilization of higher disinvestment receipts as well as the cuts in expenditure resorted to at the RE stage to keep within the resource space and FRBM limits. Chairman pointed out that the FD limit was altered/staggered by the Centre.

6. On the issue of response of the rating Agencies to various reform initiatives, Shri Urjit Patel mentioned that Rating agencies are hardly interested in factoring the views of the country. However, he added that FRBM did provide a boundary. He added that with approximately $350 billion worth FII investments, the rating agencies do matter. The Chairman mentioned that a whole lot of structural reforms have also been undertaken and queried whether Rating Agencies were prejudiced. Shri Urjit Patel replied that it was difficult to say so, but what has been witnessed is that good book keeping does not necessarily lead to upgrades, yet we need to do the best we can. Shri Arvind Subramanian stated that keeping in view the action already taken on the monetary side, the right way would now be to move ahead and take care of the fiscal part. He added that what was needed was to differentiate between the 'commitment' and actual FRBM implementation. He also pointed out about the broad opinion of the States that the Centre flouted the FRBM limits. Secretary (EA) responded by stating that the States in saying so, are forgetting the fact that the Centre took the fiscal load which enabled the States to adhere to/achieve their fiscal targets.

7. The Chairman mentioned about the meeting of the FRBM Committee with the Economists held earlier, wherein he mentioned the economists were broadly skeptical about the Government's

performance on FRBM, though they were unanimous that FRBM had helped tremendously. He also mentioned about the views of the economists that whatever be the recommendations, quality of enforcement be given consideration. With these observations, the Chairman requested Secretary (EA) to give his views on the specific issues raised by the Committee in their questionnaire.

8. Point wise response of Secretary (EA) to the specific queries was as follows:

(i) Need for next generation fiscal framework that is able to respond to shocks:

Secretary (EA) stated that it was a good idea and the provision be made for both external/internal shocks. However, he pointed out that the experience in the past shows that while fiscal expansion is easy there are serious difficulties in rolling it back. He was of the view that clear mechanisms/guidelines for fiscal expansion/roll back were necessary. For example, fiscal expansion could be in areas of non-recurring commitments or capital expenditure. Similarly, on the issue of structurally adjusted fiscal deficit, he stated that tight controls were essential. He also emphasized the importance of Effective Revenue Deficit (ERD) especially in the context of guidelines that need to be laid down for fiscal expansion. He explained the origin of the concept of ERD emanating from the recommendations of the 13th Finance Commission and the consequent opening of the new object head 'Grants for creation of capital assets'. He stated that the concept had been very useful in assessing the actual nature and quality of expenditure.

(ii) Views on (a) fiscal range rather than a point target with debt rule; (b) an expenditure rule and a debt rule and (c) a revenue rule and a debt rule:

Secretary (EA) mentioned that in his views, a narrow fiscal deficit range plus a debt rule should be the right approach (as revenue receipts/expenditure are built in into debt). However, he reiterated about the need for a simple fiscal formula for easy understanding by the stakeholders, including Parliamentarians. In case the Committee decides to recommend in favor of a range, he suggested that there should be clear cut guidelines for the range, to avoid any subjectivity and possible attractiveness of the upper limit in the range. He mentioned that on the issue of having a range, while it is easy for any Government to undertake fiscal expansion, roll back turns out to be a huge challenge. He also pointed out about the risks of operating at the top end of a range, which he mentioned should be taken into account while recommending the guidelines. The roll back mechanism therefore was very important and should be done through Rules and within specific timelines.

(iii) Most appropriate framework to introduce 'bounded discretion:

Secretary (EA) stated that considering the difficulties in roll back, it would be better to opt for a very narrow range plus debt target, with clearly laid down principles/guidelines. He further mentioned that in the 'Escape clauses', return path should be clearly laid down in case of fiscal expansion, as any expansion becomes the base for subsequent expansions. The roll back mechanism, therefore, was very important and should be done objectively through Rules.

(iv) How would one ensure that this is compatible with a medium term fiscal anchor?

Secretary (EA) mentioned that to address this issue, the fiscal expansion should be accompanied with simultaneous targets on reducing it and the corresponding timelines. This would ensure that the medium term deficit/debt targets are adhered to.

(v) Is there a constraint imposed by how much borrowing markets can absorb? How could one alleviate that constraint?

Secretary (EA) mentioned that this was an important issue. Domestic financial savings and the private sector requirements can be estimated to arrive at the borrowing limits under FRBM. He further added that whatever formula we agree upon, there will be need to ensure enough space for private sector credit requirements (so as not to crowd out). He briefly mentioned about the principles adopted in determining 3 percent Fiscal deficit target at the time of FRBM enactment which took into account the borrowing needs of the Government as well as the private sector. He felt that in today's context also there was no other way of assessing the same.

However, Secretary (EA) pointed out that with liberalization of FDI/ECBS/FII and NBFC regulations and the new Rupee/Masala bonds, there are lot of avenues/sources for private sector borrowings.

(vi) Prescription of the Department for relationship between fiscal and monetary policy:

Secretary (EA) stated that inflation determined the GDP base/size (on nominal basis) and high inflation leads to larger GDP size, which should not lead to excess expenditure. Similarly, low inflation should not curtail expenditure. He suggested that the fiscal targets may factor in this aspect.

(vii) Experience with the Rating Agencies, what are their principle concerns?

Secretary (EA) stated that the main concerns of the rating agencies related to robustness of the fiscal targets, GoI's ability to finance its expenditure through tax, non-tax and the non-debt capital receipts, quality of government expenditure, the method of calculation of fiscal deficit (i.e. taking into account the 'below the line items' if any). Secretary (EA) mentioned that the concerns of rating agencies can be addressed with adequate assurance on government's commitments towards fiscal consolidation and improving the quality of expenditure. The structural reforms like Bankruptcy law, GST and DBT would have positive impact along with the liberalization of FDI policy and the measures taken for promoting the 'ease of doing business'.

9. Apart from the above pertaining to the questionnaire sent by the FRBM Committee, there were certain other issues raised during the meeting on which the Committee desired the views of Secretary (EA). The important ones were as follows-

(a) The Chairman sought the views on the 'Countercyclical' actions. Shri Rathin Roy expressed that for each level of fiscal expansion some calibrated deviations should be clearly spelt out. The Chairman mentioned about the concept of structurally adjusted deficit, for example, linking petroleum subsidies to prices etc. He, however, stated that the 'escape clause' bore the risks of becoming open to interpretation.

(b) What anchors can be used:

Secretary (EA) observed that FD and debt targets together should be appropriate (twin targets). The Chairman observed that this also raised the issue that if we move to different anchors, what if the States do not want to move and the consequences thereupon.

(c) What could be the possible checks on the Centre:

Secretary (EA) was of the view that any parameter decided upon should be simple and without complexities to implement as well as for the Parliamentarians to understand. It should be clear, transparent and not open to interpretation. He further pointed out that with amendments to the FRBM Act, post facto review of performance on FRBM has been entrusted to the C&AG. Secretary (EA) pointed out that Centre as a sovereign cannot be prevented from dealing with completely unforeseen situations. However, there was a need to draw clear lines/laxman-rekha for the purpose. On the request of the Chair to suggest some credible measures, Secretary (EA) mentioned that he agreed that there has to be accountability but anything outside the Constitutional framework should not be done.

(d) Is it possible to strengthen Parliamentary oversight? What are the choices available, Parliament or Independent Office?

Secretary (EA) responded by saying that while he would need to think through in greater detail, but he was of the clear view that any fiscal council should be within the purview of Finance Ministry and not outside it. He further elaborated that there was a need to trust our systems and therefore any such Council should be within the Finance Ministry, having full autonomy but must be answerable to the Finance Minister. He stated that the commitment of the Government to fiscal/structural reform in the last two years has been tremendous and an autonomous institution within Finance Ministry for concurrent evaluation/advise to the Government, and under the aegis of the Finance Minister could be an option.

(e) How should the Monetary and Fiscal policies interact?

Secretary (EA) mentioned that the targeting of inflation was the real issue. However, 4% target was not the real issue but the anchoring done with CPI was the real issue since 46% of the CPI basket consists of vegetables etc which are not impacted by interest rates. On the Monetary targets, he pointed out that the same had a statutory backing now through the amendment carried out in the RBI Act.

(f) Relationship between Finance Minister and the RBI Governor:

Secretary (EA) pointed out that there has been healthy, free and frank discussions and the relationship between the two Institutions have been cordial, except that there could be honest differences of opinion on certain issues. He was of the view that the relationship between these Institutions cannot and should not be codified.

(g) Views on the issue of credit expansion/contraction:

Secretary (EA) pointed out that there were some suggestions and arguments to the effect that in times of credit contraction, Government needs to step up expenditure. Shri Rathin Roy queried whether Government should interfere if RBI measures lead to contraction due to inflation targeting. Secretary (EA) mentioned that the objective of the monetary policy – as per amendment to RBI Act – is to ensure price stability, keeping in view the objective of growth. He further added that the Committee may examine these aspects and make appropriate recommendations. Secretary EA also mentioned that the Committee may factor in UDAY Bonds etc. in analyzing borrowing space of the States.

(h) Economists have expressed the view that the SLR should be dispensed away with, any views:

Shri Urjit Patel pointed out that the SLR was partly used to hold Government bonds. Secretary (EA) mentioned that as on date most banks have more than the 21% stipulated SLR. However, before taking any call on the issue, the role of SLR as assets in the context of huge NPAs of Banks will need to be kept in view.

10. Secretary (EA) finally touched upon two quick points relating to the need and importance of the concept of Effective Revenue Deficit and the fact that the kind of fiscal stimulus given in the past is not possible in the post GST regime, due to the role of the GST Council. Chairman requested Secretary (EA) for a detailed written Memorandum to the Committee on the issues discussed as well as any other relevant issue that the Department may consider relevant.

11. The meeting ended with the above deliberations.

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FRBM Review Committee
Questionnaire for Department of Expenditure

Question for DoE	Comments of the Department of Expenditure
1. The Medium Term Expenditure Framework statement was introduced in 2013 with the objective of providing closer integration between the Budget and the FRBM of the States. It has been observed that the expenditure projections are presented in a format of the expenditure budget. EMC recommended the format of MTEF statement should be changed to make it consistent with Demand for Grants format and break up in Volume II of the expenditure budget. What are the views of the Department of Expenditure on this suggestion?	The MTEF Statement was introduced in 2013 with the purpose of medium term expenditure planning by the Central Government. If the medium term expenditure statement is made demand-wise it will surely place a hard constraint on the Central Ministries, but that does not necessarily determine the allocation to the States under the Centrally Sponsored Schemes. The devolution of central taxes and duties is governed by the recommendations of the Fourteenth Finance Commission, which has a more powerful impact on the FRBM achievements of the State Governments. It would be unrealistic to expect that medium term framework of the Central Government would, by itself, provide a closer integration with the FRBM of the States.
2. Ministries/ Departments often complain that they do not have an idea how to plan expenditure beyond the annual budgeting cycle. Expenditure rules prescribing boundaries for spending could help in prioritizing an allocation. Certain suggestions were made by the EMC regarding this. What are the views of DoE?	World over, there are two types of medium term expenditure frameworks: *Rolling* and *Sunset*. Rolling frameworks are best used in settings where there is a clarity over flow of resources in the medium to long term. Sunset frameworks are used where institutions like the Finance Commission provide clarity over flow of resources over a fixed time frame. The medium term rolling framework becomes difficult in the twilight zone between the two Finance Commission periods. For Schemes we have already moved to a medium term framework that is coterminous with the Finance Commission Cycle as schemes need medium term outlays over a well-defined time frame for appraisal and approval.

3. Central Ministries/Departments and States often have a complaint about uncertainty of fund flows which affects major Programs. For instance under MANREGA uneven fund flows could result in delay in payment to workers as well as payments to material suppliers and vendors. Through the FRBM structure could an environment be created for more predictable fund flows for programs?	To address the complaint of the Ministries/ Departments about the *schemes outlay,* we have recently issued guidelines that for all central sector and centrally sponsored schemes outlays will be communicated over the FFC period in consultation with the Budget Division. For MGNREGA, the new fund flow mechanism allows States to converge wage payments of all their works with central assistance leading to a huge increase in outflow. Correspondingly, the material components may be left entirely to the States and Local Bodies concerned for convergence with internal and devolved resources.
4. The FFC in its report accepted a target of 1.6 percent of GDP for subsidies in 2016-17 as given in MTFP and has thereafter provided subsidies at the rate of 1.4 percent, 1.2 percent and 1.0 percent of GDP in 2017-18,2018-19 and 2019-20 respectively. What are the views of Department of Expenditure on this projection?	Cooking Gas, Kerosene and NBS fertilizers subsidy has been contained at around Rs 50,000 crore through sustained reforms. To bring subsidy down to 1.0 percent of GDP, issue price of food-grains needs to be linked to MSP. Besides, the Urea regime will need to be comprehensively overhauled, either by moving it to the NBS regime or by replacing it with cash transfers along the lines of cooking gas.
5. While the FFC has incorporated fiscal deficit of 3 percent in 2016-17 in its projection. For the correction of revenue deficit it has suggested a path to which the projected revenue deficit for 2016-17 is given as 2.25 percent to be brought down to 0.93 percent in 2019-20. How does the Department of Expenditure view this path? How does this impact the operation of the "golden rule" ?	Revenue deficit which was estimated at 2.8% of GDP in BE 2015-16 is estimated at 2.5% of GDP in RE 2015-16. The reduction in revenue deficit has been achieved despite of higher allocation for Defence Pensions and Food Subsidy. However, the Effective Revenue Deficit is projected to decrease from 2.0% of GDP in BE 2015-16 to 1.5 per cent of GDP in RE 2015-16. The Medium Term Fiscal Policy as laid in the Budget 2016-17 projects progressive reduction of revenue deficit from 2.3% of GDP in 2016-17 to 1.3% in 2018-19 and elimination of effective revenue deficit by 2018-19. *The Golden Rule should be interpreted as elimination of effective revenue deficit.*
6. State Government PSUs often avail of loans from banks and agencies such as HUDCO/NABARD where the interest and repayment is serviced from the State Budget. Is the DoE able to ensure that States inevitably	States do not seek permission under Article 293(3) of the Constitution for the borrowings made by State Government PSUs. The State Governments can be advised to seek permission in such cases

seek permission under Article 293(3) of the Constitution for such borrowings?	where the interest and repayment is serviced from the State Budget.
7. There have been several recommendations in the past on the need to move to accrual accounting. What is the present Status in this regard?	Financial Rules prescribe accounting on cash basis. Accrual accounting is not advisable for all PAOs and DDOs. However, for subsidies, accrual accounting could help in estimation of carry forward liabilities. For schemes and projects, medium term outlays are more useful.
8. One reason given for build-up of cash reserves of States is that States sometime borrow in excess of their actual requirement since any portion of the borrowing limit not availed within the year cannot be carried over. The 14^{th} FC has allowed States the option of availing any unutilized borrowing amount in the following year. How will this be operationalized? Will this create uncertainty in the General Govt. fiscal deficit?	If a State is not able to fully utilize its sanctioned fiscal deficit of 3% of GSDP in any particular year during the FFC award period, it will have the option of availing the un-utilized fiscal deficit amount (in rupees) *only* in the following year, within FFC award period. Similarly, any additional borrowings availed beyond the State's entitlements shall be adjusted from Net Borrowing Ceiling of the following year. This is unlikely to create uncertainty in the General Govt. fiscal deficit as any over-utilization of the borrowing space by some States shall be counter-balanced with the lessor borrowing by some other States. State of Maharashtra has under-utilized its borrowing space in 2014-15 and 2015-16 to the tune of Rs. 25,000 cr. and Rs. 23,000 cr respectively.
9. Action Plan and roadmap for moving towards a three-year expenditure plan cycle which is credible and can be a basis for Ministries and Departments to plan ahead.	As explained above, it would be simplest to make the medium term expenditure framework coterminous with the Finance Commission Cycles as this is the constitutional framework over which both Central and State Governments have clarity over flow of resources.
10. Multi-year budgeting framework is all over the world regarded as the centre-piece of budgetary reforms and also central to determine fiscal norms. How do we intend to achieve this as well standard OECD guidelines on transparency in budget making which contribute to predicted and greater engagement with	OECD guidelines are not statutory, even for their own members. For Schemes, we have already adopted a multi-year expenditure framework coterminous with the Finance Commission Cycles.
11. The status/proposed action plan on stipulating 'Sunset date for every scheme' as announced in para 110 of the Budget speech;	Sunset and medium term framework for schemes has been introduced in the revised guidelines issued on August 05, 2016.

12. Any action plan on comprehensive review of Central sector scheme for weeding out unproductive schemes/ de-duplication etc on the lines of the lines of Centrally Sponsored Schemes done earlier through Shivraj Committee Report;	Centrally Sponsored Schemes have been rationalized and Chief Ministers recommendations accepted by the Government. Centrally Sector Schemes were rationalized in the run-up to the Union Budget 2016-17 and their number brought down from 1500 to around 300. Guidelines have been issued to Ministries to rationalize sub-schemes to improve outcomes. At the end of 12^{th} Pan, all Schemes will be revisited, and as per the revised guidelines rationalization is now an integral part of the appraisal and approval process.
13. Action plan on DBT for Fertilizer and Food subsidy which can lead to major savings on subsidies and move towards projected FFC target/reduction of subsidy as percentage of GDP;	DBT may not be a substitute for Nutrient Based Fertilizer Subsidy as the latter is a producer side subsidy mechanism, which works by modulating relative prices of nutrients on year to year basis, on the recommendations of an inter-ministerial committee. For Urea, DBT can be done twice a year (kharif and Rabi) on pro-rata cultivable land basis. For food, the Food Security Act permits cash transfers on voluntary basis, and pilot experiments have been launched for the same in the union territories.
14. Additional fiscal impact if any, foreseen on proposed merger of Rail budget with Union budget.	While the Railways' finances are stressed, the endeavor of Ministry of Finance will be to see that the merger does not lead to additional fiscal burden on the Union Budget, and the Railways, as a commercial undertaking, would continue with the existing fiscal discipline of meeting their revenue expenditure requirements from their revenues/earnings. The gross budgetary support as at present will be limited to the capital investment needs.

Record of Discussions with Department of Financial Services

1. The mess of Banks' NPAs is a combination of 3 sets of problems:

- Over-financing and diversion, due to collusion or negligence of Banking personnel. Especially in infrastructure projects, it is alleged and has also been commented in the CAG Review on Highway projects that the project costs are inflated to get higher bank finance and effectively reduce the net risk capital put in by the private entrepreneur. He de-risks himself at the expense of banks and has no incentive to remain committed to the project and abandons it with cash siphoned off and diverted to his other ventures.

- Valuation lapses, due to collusion or negligence of Banking personnel - Lack of due diligence in verifying true value of undervaluing security

- Bonafide lending gone bad due to external, economic developments - adverse business cycle shocks

We understand that public outrage against NPAs of all the above origins does not seem to distinguish between them. This would certainly call for greater transparency in disclosures about NPAs.

2 The overall fund requirements for recapitalization of public sector banks and its impact on fiscal deficit.

When the bank recapitalization securities were first issued in early 90s, these were NON-NEGOTIABLE GOVERNMENT SECURITIES and hence their exclusion from fiscal deficit calculation had a certain economic logic. The issuance of NON-NEGOTIABLE SECURITIES did not in any way affected the supply of funds in the market. Can we reconsider going back to the same mechanism with appropriate changes in the definition of fiscal deficit in the FRBM Act.

3. Economists generally advocate quick SLR phase out as one of the policy instruments to end the lazy/cautious banking syndrome and also make the governments more receptive to discipline of open markets rather than relying on financial repression. Presently - when most banks are holding government securities in excess of minimum SLR – it is the opportune time to wind up SLR.

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Ministry of Health & Family Welfare

- The Draft National Health Policy, 2015 proposes raising public health expenditure to 2.5% of GDP in a time bound manner. It advocates a progressive increase in allocation of public resources upto two-thirds in primary health care. (As per NHAestimates 2013-14, based on international standards, primary health care expenditure in government- both Centre and States, was 51%, for secondary health care- 23% and for tertiary it was around 13%)
- The Centre-States Ratio in the total Government health allocation is 28:72. Given that the public health expenditure is approximately Rs.152567 crore in 2015-16 and GDP is projected at Rs. 15065010 crore, public health expenditure would need to increase by 147 % in 2016-17 over 2015-16, for the public health spending to reach 2.5% of GDP (i.e. Rs. 376625 crores. Accordingly, assuming that the Centre-States ratio continues at present levels (28:72), the public health allocations needs to grow at 147% over 2015-16 levels, for the Centre and the States respectively.
- The public expenditure on health as percentage of GDP stands at 1.3 percent for 2015-16(BE) as per Economic Survey 2015-16. The Twelfth Five Year Plan envisaged increasing total public health funding on core health to 1.87 percent of GDP by the end of the Plan period. The 12th Five Year Plan outlay for Department of Health and Family Welfare and NACOis Rs.2,79,945 crore. The overall Plan expenditure incurred vis-a-vis the Budget Estimates during Twelfth Five Year Plan period of the Department of Health and Family Welfare are as under:

Year	Budget Estimate (Rs. in crore)	Expenditure (Rs. in crore)
2012-13	28827.00	20908.18
2013-14	30950.00	22476.66
2014-15	32430.00	23484.66
2015-16	25946.00*	26610.89
2016-17	31300.00	
Total	**149453.00**	

*RE 2015-16 increased to Rs.27414.00 crore

- Out of total outlay of Rs.2,79,945 crore of 12th Five Year Plan in respect of Department of Health & FW and NACO, only a sum of Rs. 1,49,453 crore has been allocated during the Plan period, which works out to 53.39% of total approved outlay of 12th Plan outlay.
- Lack of front loading of resources of the annual budgetary allocation during the 12thPlan has hindered the achievements of targets envisaged.
- As a result of emphasis placed on settling of pending Utilisation Certificates(UCs), there has been substantial reduction in pendency of UCs. For Health Sector, as on 1st April, 2015, there were 4630 UCs pending amounting to Rs. 17991 crores. Whereas, as on 15th March, 2016 there are 2517 UCs pending amounting to Rs. 6925.29 crores. For NACO, as on 1st April, 2015, there were 187 UCs pending amounting to Rs. 442.74 crores. Whereas as on 15th March, 2016 there are 90 UCs pending amounting to Rs. 144.60 crores.

Ministry of Home Affairs

- The expenditure trend in respect of Grant directly controlled by MHA viz. Ministry of Home Affairs and Police Grant are as under:

Demand No. 46- Ministry of Home Affairs

(Rs in crore)

	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue	4330.54	5196.65 (20%)	5716.31 (10%)	6287.94 (10%)	6916.73 (10%)
Capital	300.36	330.40 (10%)	363.44 (10%)	400.00 (10%)	440.00 (10%)
Total	**4630.90**	**5527.04**	**6079.75**	**6687.94**	**7356.73**

Demand No. 48- Police

(Rs in crore)

	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue	61213.53	73456.24 (20%)	80801.86 (10%)	96974.50 (10%)	106671.90 (10%)
Capital	8971.05	10316.71 (15%)	11348.38 (10%)	12483.21 (10%)	**13731.53** (10%)
Total	**70184.58**	**83772.94**	**92150.24**	**109457.71**	**120403.43**

- Increase in salaries / cost of ration and other related heads on account of recommendation of ih CPC as majority of the Revenue expenditure is on account of Salaries [67.47%]. Other contributory factors of increase include (a) Raising of 24 battalions for the CAPFs (b) Construction of Housing and Office Building for Central Armed Police Forces and Central Police Organsiations (c) Planned increase housing satisfaction level from the existing level of 12.06%, which is far below the prescribed satisfaction level of 25%. (d) Setting up of Central Armed Force Institute of Medial Sciences and (e) Building Programme of Delhi Police.

- Since 2013-14, as far as CAPFs are concerned, Rs.6138 Cr has been the outgo pegging the annual outgo since 2013-14 to Rs.2046 crore. As far as Modernisation of Police Forces Scheme (MPF) is concerned, the total outgo since 2013-14 is Rs.3335 crore (for three years).

The allocation of funds under the scheme modernisation of Police under which assistance is provided to the States is as under:

(Rs in crore)

	2013-14	2014-15	2015-16	2016-17
Budget Estimate	1847.00	1500.00	595.00*	595.00*
Revised Estimates	1342.01	1397.50	662.11	
Actual Expenditure	1338.38	1397.44	662.08	

* The allocation has been reduced as Plan component under Centrally Sponsored Scheme has been discontinued with effect from 2015-16

Ministry of Power

- The projected expenditure in respect of all Schemes of Ministry of Power is given below

Name of the Schemes	Rev/Cap	FY 2016-17 (BE)	FY 2017-18 (Projections)	*Percentage growth in FY 2017-18 over 2016-17*	FY 2018-19 (Projections)	*Percentage growth in FY 2018-19 over 2017-18*	FY 2019-20 (Projections)	*Percentage growth in FY 2019-20 over 2018-19*
Total Revenue (plan+non plan)	R	8862.05	17717.02	99.92%	18760.47	5.89%	21756.70	16%
Total Capital (plan+non plan)	C	3488.94	3207.79	-8.06%	3050.11	-4.92%	2322.25	-24%
Grand Total		12350.99	20924.80	69.42%	21810.58	4.23%	24078.95	10%

- GOI is committed to achieve 100% electrification of villages and try to provide 24X7 power for all through intensive electrification. This would require not only strengthening of Distribution and sub-transmission network but also Inter-State Transmission network.

- The long term relationship between the GDP and the power sector resource requirement has to be worked out on the basis of elasticities. The Integrated Energy Policy had calculated an elasticity figure for electricity consumption for the period 2011-12 to 2021-22 as 0.85. This estimate is very old since the Energy Policy was published in 2006. The demand for electricity is worked out in the CEA on the basis of "partial end use method". It breaks up the economy in to 9 segments and makes a projection based on the past growth figures. This exercise is done every five years and as of now, the 19th Electric Power Survey work is on which is making an assessment of the peak and energy requirements till the year 2021-22 and also 2026-27. Quick estimates indicate that by the year 2021-22, the peak requirement would be 235 GWs whereas the energy requirement would be about 1600 billion units.Jn terms of energy requirement, it projects a CAGR of a little over 6% during the period 2015-16 to 2021-22. The corresponding figures for 2026- 27 are 317 GWs and 2131 BUs, respectively.

- In order to meet the peak energy requirement, as projected above, by 2021-22, we would need to have an additional installed capacity of only about 22,470 MWs. This is on account of the fact that 175 GWs of capacity would come from renewables and also on account of the fact that about 50,000 MWs of coal based capacity is under construction for which main plant orders has already been placed. This additional capacity of 22,470 MWs would consist of only hydro, gas and nuclear plants. The corresponding capacities would be 15330 MWs, 4340 MWs and 2800 MWs, respectively. In terms of ownership, out of 22,470 MWs, only about 11,400 MWs would be under the public sector, be it Central or State.

- Tentative estimates indicate that under the National Electricity Plan that for the period 2017-22 about Rs 20.6 lakh crore would be required for generation, transmission and distribution alone. The requirement for R&D, energy conservation etc. would be over and above this. It may, however, be added that though no new coal based capacity is required during the period 2017-22, the resource requirement would be there for the ongoing projects.

- The need for a robust transmission system to support a capacity of 175 GWs based on renewables cannot be over-emphasied. Prevalent norms require a ratio of 2:1:1 should be maintained between generation, transmission and distribution, respectively. (In case 175 GWs of renewables are actually is installed, there may be a fall in the PLF of coal based power generation.)

- According to the Indian Banks Association, about 39 projects (list not exhaustive) having a total capacity of 43,617 MWs is stressed. The total debt given to these projects is about Rs. 156,800 crore which comprised of 24% of the total exposure. The major issues affecting these projects relate to PPA matters, Fuel issues, land acquisition problems, delay in clearances etc. Most of the stressed projects are in the thermal sector.

- Steps are being taken so far to provide relief to Stranded and stressed Assets in Thermal (Coal &Gas) and Hydro. CEA holds review meetings periodically with the developers and stakeholders and identify issues critical for commissioning of projects and resolve them. Regular reviews were also undertaken by MoP, Ministry of Heavy Industries and the Cabinet Sectt. A Power Project Monitoring Portal has been set up by MoP for monitoring ongoing thermal and hydel generation projects, targeted for commissioning during 12thPlan and beyond along with associated transmission system. The status of such stalled projects were also discussed in the meetings of PRAGATI.

- The cancellation of 204 coal blocks by Hon'ble Supreme Court had resulted in the thermal plants getting stranded. The Government of India promulgated an ordinance "Coal Mines Special Provisions Ordinance 2014 [now replaced by an Act, The Coal Mines (Special Provisions) Act, 2015], thereby ensured re-allocation of 47 blocks to power sector supporting a capacity of about 50,000 MW through auction/allotment till date. Ministry of Coal allowed supply of coal on MOU best effort basis on the same terms and conditions as at present till 30.6.2016 or until a policy is formulated, whichever is earlier, for plans having long term PPAs. Further, on the request of Ministry of Power, the Ministry of Coal has started separate e-auction window for power sector under which CIL is making arrangements for conduct of forward e-auction of coal exclusively for power sector on a sustained basis offering adequate quantities of at regular intervals. Ministry of Coal also notified policy guidelines vide their letter dt. 8.2.2016 for grant of Brings Linkage to specified end-use plants of Central and State PSUs. A comprehensive policy on future coal linkage is also under finalization.

- A total of 18 projects have been stalled/stranded after construction had started. Efforts have been made through constant dialogue with stakeholders to provide relief to these stranded projects.

- UDAY scheme envisages a complete financial turnaround of DISCOMs by the year 2018-19 with ACS-ARR gaps and DISCOM losses becoming zero by this time through several operational and financial interventions. UDAY was formed on the basis that liabilities of DISCOMs are contingent liabilities of State. Hence UDA Y ensures financial discipline by the State post takeover of debts.The outcome of UDAY scheme is mainly measurable through AT&C losses and ACSARR gap. These parameters have financial implications on the health of DISCOMs. Further to tighten the financial discipline banks/Fls shall not advance short term debt to DISCOMS for financing losses as well as restrict working capital funding to 25% of previous year's annual revenue. The State have also been made a stakeholders in the scheme by the way of taking over of future DISCOM losses in a graded manner as well as loss financing through State Govt. Bonds or State guaranteed DISCOM bonds. Further States not meeting the operational milestones will be liable to forfeit their claim on IPDS & DDUGJY grants. The states of Rajasthan, UP and Haryana are expected to face the largest fiscal impact of UDAY bonds in the coming years.

- Regulatory framework in the electricity sector is envisaged in Part X of the Electricity Act, 2003 (Section 76 to 109). As envisaged in the Act, Regulatory Commissions have been constituted at the Central and State levels. The Central Commission was already in existence at the time of enactment of the Electricity Act, which was deemed to be the Central Commission for the purposes of the Act. As on date, Electricity Regulatory Commissions (ERC) have been constituted in 29 States, including two Joint ERCs, one for Manipur and Mizoram and the other for Goa and UTs (except Delhi). The Central Govt. has notified all Rules, for which power has been conferred under under Section 176 of the Act. Further, the Electricity (Amendment) Bill 2014 introduced in Lok Sabha on 19.12.2014 is also expected to bring further improvement in the regulatory framework with overall objective to sustainable growth of the power sector aimed at consumer benefits.

Ministry of Railways

- There has been under investment in the Railways, as a result its key routes are saturated. Railway traffic is a derived demand which is related to the growth of economy. Therefore, economic activity and growth will definitely affect Railway traffic and Railway revenue in future. Unless the railway system is expanded enough through sufficient investment, the Railways may not cope up with the need of the fast growing economy

- Railway expenditure can be categorised as Works and Revenue. While the works expenditure, which is spent on expansion, modernisation and capital formation, is met from multiple sources like Gross Budgetary Support(Budgetary Support and contribution from Central Road Fund (CRF)) extended by MoF, internal resources generated by Railways and Extra Budgetary Resources like market borrowings, institutional .finance, Public Private Partnership, JVs with state governments etc, the revenue expenditure is entirely met from Railway revenues.

- Works expenditure needs for the next five years amounts to Rs 8.56 lakh crore out of which Rs. 2.561akh crore is sought to be met from Budgetary Support from the Government.

- Railways also receive contributions from CRF for executing its safety works. In 2015-16 and 2016-17 BE, the allocation received from CRF has been Rs. 2,508 cr and Rs. 10,780 cr respectively. Appropriate increase in this allocation is expected in the coming years.

- Rest of the amount of the projected works expenditure of Rs. 8.56 lakh crore will have to met by Railways though internal resources and EBR. Post ih CPC implementation, Railways' internal resource generation capacity would come under huge depression. As a result, the Central Government is expected to extend a helping hand to sustain the Railway operations in the country.

- The progressive higher dependence on EBR would lead to accumulation of debt servicing liability. Railways would thus need to pay mandatory lease/interest charges to IRFC and other institutions (both interest and principal component) against the market borrowings for part financing Railways' works expenditure. Liabilities in this respect in the coming years are as follows:

Year	Amout (Rs. in cr)
2016-17	15,021
2017-18	16,045
2018-19	17,069
2019-20	24,073
2020-21	26,551

- In view of Railways' dwindling internal resource generation, Railways would need a non-lapsable and non-dividend bearing grant from the Government with nomenclature of 'Rastriya Rail Sanraksha Kosh' for making up the safety maintenance arrears for the next five years. The year-wise requirements for this are as follows:

Year	Amount (Rs. in cr)
2016-17	20,000
2017-18	24,750
2018-19	24,750
2019-20	24,750
2020-21	24,750

- Further, to enable the Railways to come out of the financial crisis, Central Government is also expected to exempt the Railways from payment of dividend and reimburse the Public Service Obligation of about Rs.32,000 crore being borne by the Railways in carrying certain services below cost.
- Revenue expenditure on Railways comprise of Ordinary Working Expenses (OWE), Pension payments, Miscellaneous expenditure and payment of dividend. The projected expenditure under Revenue head for the next 3-5 years is as follows:

Year	Projected Revenue Expenditure
2016-17	1,77,591
2017-18	2,01,947
2018-19	2,24,875
2019-20	2,50,229
2020-21	2,78,332

Responses from Central Ministries/Departments
Department of Revenue

Implementation of the FRBM Act calls for fiscal consolidation, which crucially hinges on success of tax reforms. Improving tax yields is also considered important for future enhancement in the government's capacity to borrow. The following inputs from the Department summarise the key issues.

Direct Taxes:

- India cannot be said to be an over-taxed jurisdiction. Direct tax-to-GDP ratio of the country is one of the lowest compared to similar sized economies of the world. Reasons for low tax-to-GDP ratio of the country are as follows:

- The per capita income of India is Rs.93,293. However, the exemption limit for individual tax payers is Rs.2,50,000 and when effect of tax rebate u/s 87A upto rupees five thousand is factored in, the effective exemption limit is Rs 3,00,000. Thus, the basic exemption limit is almost three times the average per capita income of the country. The effective exemption limit is even higher than the basic exemption limit of Rs.2,50,000 in the case of individuals/HUFs on account of various deductions

- Apart from the high basic exemption limit, various deduction and exemptions are claimed by individual tax payers as well as firms and corporates. The charitable and religious trusts also enjoy exemption from taxation. As per the estimates of revenue impact of various direct tax incentives under the central tax system, the projected amount for F.Y 2015-16 is going to be Rs.1,28,639 crore. The effective tax rates are thus moderate.

- The rate of tax for personal income-tax is as under: Taxable income Tax Rate:Up to Rs. 2,50,000 Nil, Rs. 2,50,000 to Rs. 5.00,000 10%, Rs. 5,00,000 to Rs. 10,00,000 20% and above Rs. 10,00,000 30%. In case of resident senior citizen (who is 60 years or more but less than 80 years) the basic exemption limit is Rs 3.00,000 and in case of resident super senior citizens (who is 80 years of age or more),the exemption limit is Rs 5,00,000.Where the taxable income exceeds one crore rupees, an additional surcharge of 15% is levied on the tax. The tax so computed is also subjected to Education Cess and Secondary and Higher Education Cess totalling to 3%. The individuals having total income upto Rs.5,00,000 are allowed tax rebate up to a maximum amount of Rs 5000. The deductions/exemptions available to individual tax payers are as follows: Deduction u/s 80C(Rs.1,50,000); Deduction uls 80CCD (Rs.50,000); Deduction on account of interest Rs.2,00,000 on house property loan for self occupied property; Deduction uls 800 on health insurance premium Rs.25,000; Exemption of transport allowance Rs.19.200 [Total Rs.4,44,200]. Vide Finance Act, 2016 a further deduction of Rs 50,000 was provided for interest paid on loan on first house property and rebate u/s 87A was enhanced from Rs 2000 to Rs 5000 for taxpayers whose taxable income is less than five hundred thousand rupees. As evident from the above, the effective exemption threshold is much above the exemption limit of Rs 2.5 lakh for individuals.

- Similarly, substantial amount of exemptions/deductions/concessions are claimed by the companies. A domestic company is taxable at 30%. Further, the amount of income-tax is subject to a surcharge at the rate of 7% of such tax. where total income exceeds one crore rupees but not exceeding ten crore rupees and at the rate of 12% of such tax, where total income exceeds ten crore rupees. The tax so computed is also subjected to Education Cess and Secondary and Higher Education Cess totalling to 3%. It may be pointed out that in accordance with policy of government to phased reduction of corporate tax rates to 25% in next four years, it has been provided in Finance Act, 2016 that in the case of domestic companies having total turnover or gross receipts not exceeding Rs.5 crore in the financial year 2014-15. the income-tax shall be charged @ 29%. Besides. the domestic companies incorporated on or after l " March, 2016 and engaged solely in manufacture and production of articles and things, may, at their option. pay tax @25% if they do not claim any accelerated depreciation, investment allowance, profit linked deductions and investment linked deductions.

- Thus, the rate of tax for personal income-tax is moderate as compared to rate of corresponding tax in developed countries. In comparison to the personal income-tax rate in India, the tax rate in developed economies such as Germany, Finland, Norway, etc crosses 50%. So far as surcharge and cess are concerned, these are temporary levies, therefore these do not form part of the basic tax rate. Of course, in developed economies, high taxes and payroll levies are also associated with social security benefits for the taxpayers and certain portion of the taxes/leveies flows back to the citizens during unemployment or old age. There is no such matching system in India. Therefore, there are limits to burdening the existing tax base with much higher tax than the prevailing tax rates. Further, in our country, agricultural income is exempt from direct taxes. Agriculture sector alone contributes around 16% of GDP.

The estimate of revenue performance over next five years as shown in table below is based upon the assumption of GDP figures as provided by office of Chief Economic Advisor and applying buoyancy ratio as the average buoyancy of corporate and personal income tax collections for last three years. These estimates are the 'business-as-usual-scenario' projections over the next five years without factoring any major policy decision affecting revenue collection

Year	BE 2016-17	Projections				
		2017-18	2018-19	2019-2020	2020-2021	2021-2022
Corporate Tax (in cr.)	4,93,923.55	5,43,618.86	6,00,760.20	6,64,584.42	7,36,543.74	8,18,201.41
Personal Income Tax (in cr.)	3,53,173.68	4,19,020.34	5,00,607.97	5,99,191.46	7,19,413.39	8,67,206.89
Total Direct taxes (in cr.)	8,47,097.23	9,62,639.20	11,01,368.2	12,63,775.9	14,55,957.1	16,85,408.3

- Above estimate is subject to the stated policy of the Government to reduce corporate tax rates from 30% to 25% over the next four years along with corresponding phasing out of profit linked and area based deductions/exemptions. The phased reduction of corporate tax rates is expected to cause shortfall in revenue collections as it is unlikely to be fully offset by the phased reduction of tax incentives because the effect of phase out of exemptions and deductions shall be dissipated over a longer period of time. The Roadmap plan for phasing out of various tax incentives was provided in Finance Act, 2016.

Indirect Taxes:

- The indirect tax revenue collection in a particular financial year would depend on factor such as growth in nominal GDP, tax policy initiatives in the particular fiscal, dernand for goods (petroleum and non-petroleum) and services in the domestic market, growth in volume of dutiable imports, rate of exchange W.r.t leading international currencies, international prices of imported goods and mix of commodities imported, outgo on account of indirect tax refund/rebate & drawback. al1d additional resource mobilization(if any) through budgetary changes and administrative measures etc.
- India's central indirect tax-GDP ratio for F.Y 2015-16 is estimated at 5.2% as against 4.4% in F.Y 2014-15. Certain sectors of the economy are kept out of tax net by way of exemptions. GDP includes the economic activities of unorganized/informal sectors falling under manufacturing and service categories. on-taxation of agricultural and allied sectors, relatively higher threshold for small scale industries and fiscal concessions in the form of exemptions for socio-economic reasons are mainly attributable as reasons for the existing tax-GDP ratio in India.
- Indirect tax revenue projections for F.Y 2017-18 to F.Y 2021-22 are summarized below. These are based on GDP projections provided by D/o Economic Affairs and indirect tax historical buoyancy based on the previous three financial years, with BE 2016-17 taken as baseline and assuming no major change in tax policy/tax structure during the period of projection.

(Rs in crore)

Financial Year	B.E	Projection				
	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22
Nominal GDP	151,34281	169,98825	191,37277	215,94503	244,23383	276,86347
*Indirect Tax	7,78,000	8,34,158	8,96,257	9,65,108	10,41,763	11,27,233
Indirect Tax Buoyancy	0.8 [with ARM)	0.6 [without ARM]	0.6 [without ARM]	0.6 [without ARM]	0.6 [without ARM]	0.6 [without ARM]

*Exclusive of cesses not collected by CBEC, DoR.

- Presently, only Constitutional Amendment enabling GST has been passed by the Parliament and GST law is yet to be enacted. Therefore, at this juncture, It will not be possible to factor in the impact of GST on tax-base thereby resulting in variation of revenue estimates. Such an impact analysis would be possible only after one year of implementation of GST Act.
- The impact of GST on the indirect tax revenues of the Central Government would depend on the final CGST and IGST rates recommended by. the GST Council. Attempts would be made to ensure that the GST rates are aligned to the revenue neutral rate of GST as far as possible, which will protect the

present revenues of the Central Government. Two exercises for the determination of revenue neutral rates have been conducted - one by the National Institute of Public Finance and Policy, and the other by Chief Economic Advisor to the Government of India. Both these reports are under consideration of the Government. It is expected that GST will broaden the tax base, and result in better tax compliance due to a robust IT infrastructure, which will lead to an increase in indirect tax revenues. Further, the NCAER study on the implementation of GST, commissioned by the Thirteenth Finance Commission, indicated that the implication of GSTwould lead to an increase of about 0.9% to 1.7% in India's GDP. This economic growth is expected to further lead to buoyancy in tax collections.

- Tentative estimates indicate that the compensation likely to be provided to the State Governments for loss of revenue on account of GST needed in the first year would be about Rs. 30,000 crores a 2013-14 figures. Further, a standard combined rate of about 20% would be need to recover the compensation amount by the Centre. As per clause 19 of the Constitution (122nd Amendment) Bill, 2014 it is proposed that Parliament may, by law, on the recommendation of the Goods and Services Tax council, provide for compensation to the States for loss of revenue arising on account of implementation of the Goods and Services Tax for a period of five years. Exact compensation amount would largely depend on the final rates of GST recommended by the GST Council.

Ministry of Road Transport and Highways

- Budget-making in this sector needs special attention. Even if, GBS+ IEBR (1.03 lakh crore) stepped up in line with the nominal GDP growth (@ 12%), we could be looking at a figure close to Rs.2,00,000 crore by 2020. There has to be greater predictability in the demands and allocation process. The only way to do it is to freeze the MT work programme and then assure adequate flows. This should be possible because the roadssector would probably reach a reasonably level of maturity over the next 5 years or so (Ref. Rakesh Mohan Transport Committee Re~ort 2012) in terms of pure length expansion of National Highways and reach 2 lakh kms, around 4% of the total road network in the country - at par with other countries.

- With that in mind, the new MT investment programme could seek to optimise and unfreeze the assets created under NHDP (GQ, E-W/N-S) through a more focussed approach, including congestion removal, expressways and links to Sagarmala.

- The programme could also seek to eliminate the Transport Sector inefficiencies in line with the NH expansion/upgradation programme.

- Unless this is done, it would be difficult to fully achieve the benefits of huge capital investments. It would also be nearly impossible to reap the benefits of the GST,without opening up the transport bottlenecks.

- The NHAl's credit ratings would continue to play a critical role in mobilising borrowings. While recognising that the NHAI is under leveraged, it would also be equally necessary to recognise the importance of continued toll plough back and earmarked cess inflows in NHAl's overall long-term financial health and its ability to raise cheap money. Budgetary dogmas notwithstanding, the role of "islanding" in ensuring a steady predictable stream of resources for the NH sector cannot be over-emphasised.

- Though a lot has been done through a case-by-case approach to unlock frozen/stranded assets, the absence of a statutory framework to deal with dispute resolution in the PPP projects, has become a major impediment. The proposed law on dispute resolution with a possible clause to over-ride the PCAct, would be a major step forward.

- In a manner similar to annuity payouts, we could consider making projected and cumulated O&M expenditures a part of the investment approvals process. After O&M expenditures reach a certain percentage level vis-a-vis the capital outlays, a trigger could mandate re-balancing between O&M and capital within the Ministry.

- The State Governments have to honour the State Support Agreements (SSAs), so crucial to successful PPPs. States have flouted SSAs allover the place, by violating the non-compete provisions, staying toll notifications, providing special dispensations for SRTCs, regulating aggregate availability through quarry permits, not indemnifying cash losses on account of unpaid tolls etc. A special dispensation mandating deductions from the CRF in such events could be considered.

- A 2-lane road (10 m) with paved shoulders could be considered a basic necessity and the States told to prepare action plans to upgrade single and intermediate lane roads (SHs or ODRs) to 2-lane paved shoulder status within a given timeframe. A major portion of it could be NH.

Department of School Education

- The Kothari Commission (1964-66) and Tapas Majumdar Committee (1999) suggested for allocation of 6% of GDP to education sector. But public expenditure on education both by Union and State Governments (School and Higher) as percentage to GDP is as low as 3.5% in 2011-12 and 3.9% in 2014-15. As percentages of total public expenditure, education gets around 11% shares. The 12th Five Year Plan allocation was Rs. 3,43,028 crore but the DoSE&L got only 59% out of that (including BE of 2016-17).
- Funds required for major programmes of DoSE&L for the next five years :
  - RTE - Rs.55,814 crore needed under RTE Act to fulfill the infrastructure requirement in elementary schools.
  - SSA - Rs.160,000 crore needed for teacher salaries [Under SSA, 19.48 lakh teacher posts have been sanctioned out of which 15.74 lakh teachers are in position. Further, States have sanctioned 32.33 lakh teacher posts, of which 26.99 lakh teachers are in position.]
  - RMSA - Rs.34,088 crore needed for meeting Infrastructural gaps of Integrated RMSA and Rs.12,151 crore for ICT in scools
  - MDM: Rs.55,000 crore funding is required at the present rates and components. Additional requirements: Rs.76,005 crore for extension of MDM to Class IX and X, serving Breakfast to elementary class children and revised costing norms.

Ministry of Urban Development

- Urban Development is a State subject. Swachh Bharat Mission(SBM), Atal Mission for Rejuvenation and Urban Transformation(AMRUT) and Smart Cities Mission(SCM) launched to help the States.
- Rapid urbanization has resulted in pressures on urban infrastructure and services. Improvement in urban governance and capacity constraints are also areas of focus.
- In April,2015, the Cabinet had approved the Atal Mission for Rejuvenation and Urban Transformation(AMRUT) and the Smart Cities Mission to drive economic growth and foster inclusive urban development.
- The AMRUT was launched on 25.6.2015 in 500 cities/towns with the objective to improve the basic urban infrastructure such as water supply, sewerage system, drainage, urban transport and green spaces/parks. The Mission gives priority to universal coverage of water supply and sewerage. Under this Mission the MoUD approves the State Annual Action Plans of the States/UTs and releases the Central Assistance(CA). The projects are conceived, DPRs prepared, appraised and sanctioned and executed by the States/UTs. The following Plans have been approved so far:

Year	Total investment	Central Assistance	1st instalment of CA released to States
2015-16	Rs 20774 crore	Rs 9894 crore	Rs 1979 crore
2016-17(upto July)*	Rs 19213 crore	Rs 8654 crore	Rs 1731 crore

*to 20 States

- Besides the core infrastructure, the AMRUT focuses on Reforms. There are 11 mandatory reforms. Financial incentive in the shape of 10% of the annual allocation is set apart to be given to the States/ UTs on achievement of reforms. The Mission period is 2015-16 to 2019-20 and was launched on 25.06.2015. The States/UTs are in the process of tendering/awarding contracts. The Mission is in initial stages of its implementation. It is expected to make a discernable impact in the cities covered by it and give impetus to business.
- The Smart Cities Mission was also launched on 25th June 2015. Stage I of the selection process was completed by States/UTs on 30th June 2016. Based on the same, 98 potential Smart Cities were announced to participate in the All India City Challenge (Stage-2). 20 Smart Cities were selected in Round 1 in January 2016 and thereafter 13 Smart Cities in fast track round in May 2016. Result of Round 2 is expected in August 2016 in which 27 more Smart Cities are likely to be selected. All these cities will have to implement their Smart Cities Proposals (SCPs) at ground level. Development of Smart Cities is itself a step towards improving the quality of life and attracting people and investments to the city, setting in a motion of virtuous cycle of growth and development. Rs 3293 crore has been released to the States under the Mission in 2015-16 and 2016-17.
- One of the major challenges is managing the finances of the Urban Local Bodies(ULB) The Fourteenth Finance Commission has recommended Grant-in-aid of Rs.87,143.80 crore for the period 2015-20 to duly constituted Municipalities (ULBs) for augmentation of basic services. The Grants are in two parts, namely - (i) a Basic Grant of Rs. 69,715.03 crores and (ii) a Performance Grant of Rs. 17, 428.76 crores. The division between Basic and Performance Grant is 80:20 basis.
- MoUD provides only partial financial assistance under its schemes & programs. The balance

funds are contributed by the States/ULBs or met through private investment. At the ULB level the contribution from internal sources (taxes, fees, others) and external sources (e.g.transfers from States, project funds from States/Central Government and others) and possibilities of debt, bonds and others has to be assessed. The citizens have to be motivated to share the additional cost. One way is through the Tax Increment Financing(TIF) - take a loan for project funding for a locality and repay the same through an increase in property taxes over a period of time. 'Value Capture financing' of urban infrastructure is an important tool. States and ULBs are being sensitized towards this. In the case of Smart Cities Mission Implementation has to be done by the city level Special Purpose Vehicle (SPV) created by States/ULBs as a limited company under Companies Act, 2013. The Smart Cities Mission Guidelines require States/ULBs to ensure that a dedicated and substantial revenue stream is made available to the SPV so as to make it self-sustainable and could evolve its own credit worthiness for raising additional resources from the market.

- Dovetailing of funds through convergence with other Central and State Government Programs/ Schemes with the AMRUT is also another source of funding to be considered at planning stage itself. AMRUT has a mandatory reform 'Devolution of funds and functions to ULBs' which inter alia stipulates 'Ensuring transfer of 14th FC devolution to ULBs.
- Municipal bond market has not developed as envisioned.s to augment the finances of ULBs for financing sustainable infrastructural development.
- Different Missions are working, through convergence, to provide safe water and waste management. While construction of toilets and behavioral change is being done through Swachh Bharat Mission, provison of water supply and its disposal and treatment of waste water (sewerage) is being taken up under AMRUT. The smart components like SCADA systems are being taken up under Smart Cities Mission.

Inputs from State Governments

Ajeya Kallam, I.A.S.,
Special Chief Secretary to Government

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D.O. Lr. No. 001/ Budget. I/ 2016

Dt: 06-10-2016

Dear Sir,

Sub: Review of FRBM Legislation - Views of the State of Andhra Pradesh.
Ref: Letter No.3/8/2016-FRBM, dt. 12th July, 2016. & 9.9.2016

*****

I draw your kind attention to the reference cited. I am furnishing herewith the remarks of the State of Andhra Pradesh on the proposed review of FRBM Legislation and the issues raised in the paper.

With regards,

Yours sincerely,

(Ajeya Kallam) 06/10

Sri N.K. Singh,
Chairman, FRBM Review Committee,
Department of Economic Affairs,
Ministry of Finance, Government of India,
North Block,
New Delhi – 110 001.

Dt: 06-10-2016

Note on views of the State on Review of FRBM Legislation

1. Impact on State FRLs on the fiscal outcomes of State.

i. The Fiscal Responsibility Legislations (FRL) imposed obligations on states to reduce fiscal deficit thereby maintain the annual debt ceilings imposed by FRL. The FRL has streamlined the process of estimation of resources for financing the budget thereby brought discipline in the budgetary management. It contributed to slow down the rate of growth of non-priority revenue expenditure.

ii. The FRBM rules were successful when the States were experiencing tax buoyancy which incidentally coincided with the framing of fiscal rules. The country also was in the midst of high growth rates and low interest regime during 2004-05 to 2008-09. However, as a consequence global financial crisis, the pace of growth of the national economy slowed down from 2009-10 to 2013-14. This had affected different sub-national economies in different ways, specially, fall in growth of revenue receipts. The loose fiscal and monetary policies to prop up growth led to high inflation with consequential high subsidies especially for the State Governments. The problem of higher revenue deficit surfaced and the fiscal rules have impacted the fiscal situation of states.

iii. The residuary state of Andhra Pradesh landed in revenue deficit because of large gap between the resources and commitments. The bifurcation of the State has left a higher debt burden (on the basis of population) with lower revenue resources. The structure of economy of residual state of Andhra Pradesh is dominated by agriculture that does not contribute substantially to State Revenues. To push the state's economy to high growth path through rapid industrialisation, revenue sacrifices again have become imperative.

iv. The stipulation of limit for guarantees is essential but the present stipulation is very high and there is a danger of recklessness in extending the guarantees.

2. Transparency

- As per Rule 2(1) of the APFRBM Act, 2005 "total liabilities" means the liabilities under the Consolidated Fund of the State and Public Account of the State and shall also include borrowings by the public sector undertakings and the special purpose vehicles and other equivalent instruments including guarantees where the principal and / or interest rates are to be served out of the State Budget.

- In view of the stringent FRL provisions, States are constrained to resort to, off budget borrowings. States also permit the parastatal / State PSUs to borrow from banks and other financial institutions as their financial position is not strong enough to provide capital / debt to these organisations. Some of the PSUs though loss making shoulder the responsibilities entrusted to them by the State Government. The responsibilities of the State Government have been increasing over the years. Many of the parastatal organisations are created and continued to shoulder the responsibilities which normally should have been the departmental activity. Some of the parastatal bodies are necessitated to provide flexibility in operations. While the State has no objection for disclosures on off-budget borrowings and contingent liabilities, the improvement of State Finances and flexible FRBM rules will reduce the extant of off-budget borrowing.
- Fiscal Policy shall assign a specific target of expenditure for creation of capital assets. Further, fixed portion of capital expenditure shall be assigned to maintain capital assets. However, distinction may be made between expenditure on materials and expenditure on manpower. **In this regard, the expenditure under grants for creation of capital assets to various agencies of the State may also be included in the capital expenditure made by the state.**
- The FRLs already contain a provision for a Medium Term Fiscal Policy which shall set forth the fiscal management objectives of the State Government and 3 year rolling targets for the prescribed fiscal indicators. It shall also include the assessment regarding (a) the balance between revenue receipts and revenue expenditure (b) use of capital receipts for generating productive assets (c) estimation of pension liabilities. However, there is need to expand the scope of medium term fiscal policy by including all aspects of fiscal management, the policy objectives and goal posts.

3. Impact on FRLs on Development expenditure

As explained in the foregoing paras, **States are constrained by the stringent FRBM rules as these are based on the rule "öne size fits all". Different States are at different points of growth trajectory.** The stage of development and growth strategies followed by the states are also different. However, too much flexibility in FRBM rules also lead to fiscal profligacy which is very detrimental to the long term growth. **If any State government is in a position to incur higher capital expenditure and development expenditure that can result in higher revenues in the medium to long term, flexible FRBM rules will be beneficial**. As explained, State Governments are entrusted with large responsibilities that involve huge non-developmental revenue expenditure and are forced to maintain structures in order to implement Union Government economic policies. The revenue resources at the disposal of the State do not allow them to incur higher capital expenditure. The Government strategy to control non-development expenditure specially administrative and debt services is not always successful as it is influenced by market forces and also peer pressure.

4. **Public investment**

FRBM architecture do not provide for sustainable and quality public spending as the quantitative and qualitative aspects of expenditure are not linked in any way. There is inadequate disclosure on the quality of the public spending. **FRBM rules can only address the quantitative aspects of public spending.**

Whenever the public debt reaches unsustainable level, the usual strategy would be to compress the expenditure and enhance revenue. The structure of political economy leaves little room to State Government to reduce the revenue expenditure. The quantity centric fiscal adjustment in the context of fiscal rules invariably leads to compromise on qualitative aspects. Resource constraints force cut backs in capital outlay on physical infrastructure and developmental expenditure. Normally expenditure reforms can improve the efficiency of spending without reducing the level public investment as the process would free the resources.

In this connection it may be mentioned Andhra Pradesh is in the group of those States where committed expenditure such as interest payments, pensions and administrative expenditure is higher than the national average. Further, Social Sector spending at 18.4% is lower than both higher income states and national average. The quality of expenditure on physical infrastructure and social sector is also lower than lower income group states.

The bifurcation of the State imposed a huge burden of investment on physical infrastructure as the State is forced to build a new capital and align infrastructure. In order to achieve rapid industrialisation, the state needs to invest in physical infrastructure as well as social sector on a large scale.

5. **Impact of FRLs on Cash Surpluses of States**

State does not have any surplus cash.

6. Annual CAG audits of State finances

The annual audit reports of the Comptroller and Audit General (CAG) are main source of information for policy decisions. The audited figures furnished by AG are more reliable.

7. The impact of the recommendations of the Fourteenth Finance Commission (FFC) on State Finances.

a. Transfers from Government of India.

Even though, GoI increased share in central taxes from 32% to 42% as per the recommendations of 14th Finance Commission, the actual net increase is not substantive as explained below.

In case of Andhra Pradesh, during the year 2014-15, the State had received Rs.15,299 crores as share in central taxes and Rs.12,281 crores as grants under CSS i.e., a total of Rs. 27,580 crores. Due to increase in share of central taxes, Andhra Pradesh got during 2015-16 an amount of Rs. 21,894 crores as share in Central taxes and Rs. 9,451 crores as grants under CSS i.e., a total of Rs. 31,345 crores. The net increase is only Rs. 3,765 crores over 2014-15 i.e., only 14%. As such, **the figures reflect that the 14th Finance Commission award is not substantial when it is adjusted to inflation**. Moreover, 14th Finance Commission assessed Andhra Pradesh state's financial position during the entire award period (2015-16 to 2019-20) as 'deficit' and recommended deficit grant.

It is stipulated that States have the appropriate fiscal space to provide for additional expenditure needs as per their requirements and this should help them to address the problems and facilitate them to build capacity and bridge the existing gaps in regard to general administration and police. But, **it may be noted that Andhra Pradesh state has been the victim of double jeopardy; (a) the nature of bifurcation of the State has left it with a resource gap, (b) the State is required to build a new capital city, revive the battered economy and launch the State on path of development.**

Therefore, the State of Andhra Pradesh has to rebuild the entire administrative structure that has been impacted negatively following bifurcation of the State. As such, the State is unable to meet the additional expenditure needs according to our requirements and to enhance expenditure on maintenance of capital assets to the appropriate level, as stipulated in the Commission's Report.

In view of the above circumstances, Government of Andhra Pradesh does not agree the proposition of 14th Finance Commission relating to Grants-in-aid. **We strongly demand explicit earmarking of Grants-in-aid to strengthen the delivery of services, especially in the area of health, education, nutrition, social services, women's empowerment and institutional strengthening, including strengthening of Judiciary and Police Administration.**

According to the A.P. Reorganization Act, Government of India have to provide funds for construction of New Capital City of Andhra Pradesh. **Government of India may be requested to exempt the expenditure on Capital City for calculation of Revenue Deficit and also for FRBM indicators.**

b. Conditions prescribed for availing additional borrowing limit of 0.5% over 3% GSDP.

The following are the conditions prescribed for availing additional borrowing space of 0.50% by 14th Finance Commission.

A. For 0.25% over 3% - Debt-GSDP ratio is less or equal to 25% in the preceding year.
A. For additional 0.25% over 3% - interest payments should be less than or equal to 10% of the revenue receipt in the preceding year.
B. The above two options can be availed separately or simultaneously.
C. To avail the above addl. limits, the State should not be in revenue deficit during the immediately preceding year.

If the State is not able to fully utilize its sanction borrowing limit of 3% of GSDP in any particular year during the first four years of award period of 2015-2019, it will have option of availing this un-utilized borrowing amount in the following year.

As explained earlier and as per the recommendations of the 14th Finance Commission, **Andhra Pradesh State is in deficit and will be in deficit till the year 2019-20 FY**. As such it is clear that our State will not be eligible for this additional space. **GoI may relax these conditions, as a special case.**

8. The impact of the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) on State Finances.

A. As per the guidelines of UDAY scheme, debt of DISCOMs will be taken over wherever the cost of debt is higher. Hence, action is being taken by Government of A.P. for taking over 75% of the working capital loans amounting to Rs. 6,346.32 crores and Rs. 2,546.15 crores for outstanding 2012 FRP bonds (Total Rs. 8,892.47 crores). This will result in increase of outstanding debt of the State Government. In addition, interest payments of Rs. 750 crores per year will be the additional burden on the State Exchequer. **This will push the interest to revenue receipts ratio from 10.58% to 11.45%.**

B. The state proposes to stagger the redemption of liabilities being taken over under Uday Scheme. Further, to cushion the impact to higher redemption, the state is attempting to alter the maturity profile of the date by elongation of the maturity. This is being attempted to reduce the burgeoning public debt at the current FRBM limit.

C. The State has entered into an MoU with Ministry of Power, GOI under which State shall-

a) to strive to ensure tariff hikes

b) to improve the efficiency of power generation and reduce the transmission losses.

GOVERNMENT OF ASSAM
FINANCE (ECONOMIC AFFAIRS) DEPARMENT

No.FEA.143/2015/Pt/29 Dated Dispur the December 8, 2016

From : Shri Hemanta Kr Dewri
Director,
Finance (Economic Affairs) Department

To : Shri N.K Singh
Chairman, FRBM Review Committee
Government of India
Ministry of Finance
Department of Economic Affairs
Room.No-435, C Wing,
Shatri Bhawan, New Delhi-110001

Sub: Views of Assam on the consultation Papers (AFRBM Act).

Ref: DO dated 23/11/2016

Sir,

In inviting a reference to the above mentioned subject, I am directed to forward herewith a copy of the letter No FEA.143/2015/pt/22 dated 26/10/2016, communicating views of the Government of Assam for favour of your needful.

Enclo: As stated

Yours faithfully,

Director
Finance (Economic Affairs) Department

GOVERNMENT OF ASSAM
FINANCE (ECONOMIC AFFAIRS) DEPARMENT

No.FEA.143/2015/pt/22 Dated Dispur the October 26, 2016

From : Dr. Ravi Kota, IAS
Commissioner & Secretary
to the Govt. of Assam
Finance Department

To : Shri N.K Singh
Chairman, FRBM Review Committee
Government of India
Ministry of Finance
Department of Economic Affairs
Room.No-435, C Wing,
Shatri Bhawan, New Delhi-110001

Sub: Views of Assam on the consultation Papers(AFRBM Act).

Ref: Do.No.Nil dated 9/09/2016

Sir

1. In inviting a reference to the subject cited above, I am directed state that the State of Assam has been endeavouring for compliance of the fiscal parameter stipulated in the AFRBM Act, 2005 i.e Zero revenue Deficit, Fiscal Deficit : GSDP ratio to 3% and Debt: GSDP to 28.5 % and has been successful in maintaining the trend and parameter as per the stipulation made in the AFRBM Act barring from a year or two.

2. In this context it may be indicated that the 14th Finance Commission has recommended for availing flexibility of additional 0.50% borrowing subject to compliance of the following two conditions.

   (i) Debt / GSDP to be restricted to 25% of GSDP instead of existing 28.5%.
   (ii) Interest payment to the Revenue Receipt should be restricted, within 10% instead of existing 15%.

3. However, it may be pointed out that the 14th Finance Commission in its para 2.29 has also recognised that " the North-Eastern and hill States have several unique features that have a bearing on their fiscal resources and expenditure needs, such as low level of economic activity, remoteness and international border".

4. Moreover in the absence of the NCA, SPA and SCA from Government of India, the State Government has to largely depend on the borrowings and State's own tax revenue for the State planning process. As a result the stipulation recommended by 14th Finance Commission far availing additional borrowing will be very difficult to maintain for the State of Assam.

5. In view of above, I am directed to request the FRBM Review Committee to allow Assam for availing additional flexibility option of 0.50% with the existing parameters of Debt: GSDP (28.5%) and interest payment: Revenue Receipt (15%) instead of the recommended ones. Moreover, the Govt. of India is also urged for raising the Assam borrowing ceiling from existing 3% to 4% of the State GSDP so as to enable the State Government for availing more borrowing for development purposes.

This has the approval of Finance Minister, Government of Assam.

Yours faithfully,

26/x/16

Commissioner & Secretary
to the Govt. of Assam ,
Finance Department

अंजनी कुमार सिंह, भा०प्र०से०
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D.O. Letter No. 8058
Dated 07 October, 2016

Dear Sir,

With reference to your letter 3/8/2016-FRBM, dated 12th July, 2016, the State Government has formulated its response to various issues raised in the consultation paper. Views of the State Government have been enclosed along with this letter.

Regards,

Yours sincerely

7/10/16
(Anjani Kumar Singh)

Shri N.K. Singh,
Chairman,
FRBM Review Committee,
Ministry of Finance,
Govt. of India,
New Delhi

FRBM Review Committee Meeting on 27th July, 2016

Response of the State Government

Background:

The growth performance of the Bihar economy has been steady in the recent decade. During the period 2005-06 to 2014-15, the state economy has grown annually at 10.5 percent, which is one of the highest among all major Indian states. This growth performance is even more appreciable in the background of slower growth rate for the national economy. Through higher development expenditure, the state government was able to insulate Bihar's economy from the macroeconomic constraints that had hampered the growth of national economy. Apart from attaining a high growth rate in economy, Bihar was also able to ensure that its growth process is indeed inclusive. This was possible first because of a high growth rate of the agricultural sector and, secondly, through a number of welfare programmes benefitting the marginalised sections of the population.

To ensure better living conditions and all round development, the State has increased public expenditure manifold. The plan size which was approximately Rs. 4000 crores in 2005-06 has gone upto Rs. **71500 crores in 2016-17.** The budget of the state is estimated for Rs. **1.447 lakh crores for 2016-17.** It became possible because in the past 10 yrs, revenues have increased seven times. State recorded an average increase of 17.99 percent per annum in the Gross Domestic Product (at current prices) during this period.

Comment

The FRBM Act - 2006 provides a limit of 3% fiscal deficit limit for the State. The 14th Finance Commission has recommended an additional limit of 0.25% if debt to GSDP ratio is less than 25% and 0.25% if interest to total receipts is less than 10%.

The provision of a fixed 3% limit for all States whether they are fiscally prudent or not is not correct. Our view is that the fiscal deficit limit should be based on fiscal parameters such as debt to GSDP ratio, interest to total receipts ratio etc. We are also of the view that a band of FD limit say 3.0 to 3.5% may be prescribed instead of prescribing a fixed number say 3.0%.

The detailed comments are given below:—

1. **Impact on State FRLs on the fiscal outcomes of States**

   a) **The enactment of State FRLs have coincided with a process of fiscal consolidation at the subnational level. After a decade of rising fiscal and revenue deficits in the 1990s, the deficit indicators have demonstrated a marked improvement in the past decade (see Figures 2 (a) and Figure 2 (b) in the Annexure). In this context, how have the extant State FRLs been useful in securing the States' macro-fiscal goals?**

The state government had passed the Bihar Fiscal Responsibility and Budget Management (FRBM) Act in February 2006, committing itself to : (a) eliminate the revenue deficit by 2008-09 and build up adequate revenue surpluses thereafter; (b) bring down the Gross Fiscal Deficit (GFD) to a level of less than 3 percent of GSDP by 2008-09; (c) raise non-tax revenue with due regard to cost and equity; and (d) lay down norms for prioritization of capital expenditure and pursue expenditure policies that would provide impetus for economic growth, poverty reduction and human development. These resolutions have largely been adhered to. However, capping the GFD at 3 percent of GSDP, as prescribed in the Act, has in general limited the scope to borrow more and invest in capital assets.

The revenue surplus of Bihar had slumped to its lowest level of Rs 2943 crore in 2009-10, but 2010-11 was a year of recovery, when the revenue surplus climbed to its hitherto highest level of Rs 6316 crore. However, 2011-12 had witnessed the beginning of the slowing down of national economy and, in that year, the revenue surplus again decreased to Rs 4820 crore, leading to a steep rise in the Gross Fiscal Deficit (GFD) by nearly Rs 2000 crore. The revenue surplus had since increased to Rs 6441 crore in 2013-14 before decreasing again to Rs 5848 crore in 2014-15. However, the fiscal deficit has increased continuously from Rs 3970 crore in 2010-11 to Rs. 11,178 crore during this period due to substantial increases (Rs. 8954 crore) in capital investments. In spite of this, the GFD of the state government is still comfortably within the FRBM Act limit of 3 percent. In the budget estimates for 2015-16, it was projected to reach Rs. 13,584 crore, or 2.9 percent of GFD, due to much higher capital investments, estimated to rise to an unprecedented high level of Rs. 24,853 crore. The revenue surplus, estimated at Rs 11,981 crore during the year 2015-16 have substantially financed the higher capital outlay.

b) In recent years, some States have achieved revenue and fiscal deficits that are below their FRL targets. Equally, other States have been unable to comply with their FRL deficit targets. In this context, what is the States' view on the impact of FRLs on the States' ability to efficiently utilise their fiscal space?

The fiscal space provided by the FRL has efficiently been made use of by the Government. This is evident from the consistent growth of GSDP at more than 15% per annum. Robust capital outlay year after year is also an indicator that the State has been able to use the available fiscal space for attaining high growth rate accompanied by substantial infrastructure development.

c) What has been the States' experience with different types of fiscal rules, i.e. deficit and debt rules? What are the States' views on second-generation fiscal rules such as expenditure ceilings?

The Government of Bihar does not have deficit and debt rules. However, it is necessary that there should be a ceiling on the expenditure as explained in 14th Finance Commission Report. As noted in the Commission's Report there is a need to curb the scope for perverse allocation of available funds among competing projects and to ensure that the economy benefits from investments in capital works by putting a statutory ceiling on the sanction of new capital works. This can be done by amending the FRBM Acts. The State Government recommends that the Union and the State Governments provide a statutory ceiling on the sanction of new capital works to an appropriate multiple of the annual budget provision.

d) Specifically, why did some States feel the need to incorporate a debt rule whereas others did not? Moreover, how did States decide the level of their respective debt targets? What the optimum perceived path of debt sustainability?

The debt target of the State Government is largely decided by the limitations imposed by the FRBM Act. RBI in its bi-monthly report has lauded the debt sustainability of the State. This has been made possible with the healthy growth in the internal resources of the State, less than 25% debt to GSDP ratio and about 6% interest to revenue receipts. Except for emergency situations like flood, droughts, monsoon failures, etc. State is of the opinion that it should tread within the stipulations of FRBM Act.

e) **Some States have provided for legal limits on guarantees. What has been their experience in this regard?**

The outstanding guarantees of the state government at the end of 2014-15 stood at Rs 2001 crore (2.6 percent of total revenue receipts) compared to Rs 1961 crore at the end of 2013-14. Out of this, Rs 734 crore were against the loans to the Bihar State Electricity Board (BSEB), Rs 193 crore against the Bihar State Road Transport Corporation, and Rs 127 crore against the Bihar State Financial Corporation. Further, Credit Cooperative Societies and Housing Cooperatives accounted for Rs. 349 crore. Due to increase in investment in the electricity sector, the state is yet to establish any Guarantee Redemption Fund, as suggested by the Twelfth Finance Commission, to discharge any possible future liabilities. The outstanding guarantees remained at 42, nearly the same during the last two years. The interest on outstanding guarantees amounted to Rs. 148 crore during the year 2014-15.

The State Government is of the view that Government guarantees should be given in rare cases. In the last one decade owing to greater emphasis on developmental expenditure, Government Guarantee has been given to Government entities and cooperatives. So far, a situation has not arisen where the Government had to repay the interest / principal of the debt. However, under UDAY scheme Government has taken over 75% of the DISCOMS debt which comes to about Rs. 2250 crore.

Government Guarantee is required as the PSEs will be able to raise the debts at lower interest levels against such guarantees. Government of India had stipulated in 2004-05 that the guarantee given by the State Government should not exceed 0.5% of GSDP. Though, the Government of Bihar has not exceeded this limit so far, however, prescribing any legal limit on guarantees is not prudent as it is very difficult to forecast whether any debt taken by the Government entity will be able to repay or not on its own.

2. **Transparency:**

Researchers as well as official appraisers of State compliance with FRLs have observed that there is some opacity in the manner in which States report certain categories of public finance and budget data. In some States it is also the case that a significant proportion of public expenditure is off-budget. In this context, the Committee would like to seek the following information.

a) **How do States define their overall liability? Does their measure include borrowings by State Public Sector Undertakings, Special Purpose Vehicles, and other equivalent**

instruments including guarantees where the liability for repayment of principal and / or interest is on the State Government?

The overall liability of the State is the sum total of the liability on the consolidated fund as well as the public account. However, this does not include borrowings by the Government entities against the Government Guarantee.

b) **What are States' views on voluntary disclosures of off-budget borrowing and contingent liabilities?**

There is need to account for extra-budgetary operations. The non-transparent practice of off-budget borrowings and not recognising it in the revenue and fiscal deficits is a clear violation of transparency and the spirit of the FRBM Act. It destroys the comprehensiveness of the budget and understates the extent of the fiscal problem. There is a need to bring the government's liabilities into fiscal accounting.

c) **More specifically, do States collect and report information on public-private partnerships and other off-budget vehicles in a comprehensive manner?**

The Finance Account prepared by the CAG comprehensively reports the Government Guarantees given against the off budget borrowings of the Government Guarantees. However, there is need to empower CAG to effectively bring in public domain, through Finance Accounts, all kinds of off-budget borrowings and contingent liabilities.

d) **There are concerns expressed that the increasing reliance on PPP (annuity) projects has arisen as a way of circumventing the fiscal deficit targets. In this context, how do States view such commitments and how should the annuity payments be properly reflected in the Budget documents?**

Commitment of State for PPP (Annuity) Projects per se is not an unholy practice. The State resources and the available fiscal space may not be sufficient to take up necessary developmental activities. Annuity payments are part of the committed liability of the State. While sanctioning the new projects the committed liability of various projects of the concerned department is also taken into account. However, it is not separately reflected under any specific head in the Budget. The liabilities on Annuity payment should be reflected in the Budget as Annuities are akin to debt.

e) **There are instances where parastatals / State PSUs borrow funds from banks and development agencies but the repayments and interest payments for these loans are made from the Budget. However, these loans are sometimes outside the State's debt limit. Moreover, the repayment of these amounts by State Governments is reported as "repayment of loans" rather than grants-in-aid to the borrowing entity. In the view of the State, how can FRL provisions ensure that such instances of misrepresentation in the Budget are avoided?**

In the State of Bihar, since the borrowing in the past has been for financing capital expenditure, therefore, the repayments are always classified as capital expenditure and interest payments are classified under revenue expenditure. It is also to be noted that Bihar is a revenue surplus State for the last more than 8 years. The revenue surplus is being used to fund the capital expenditure. We agree that such future repayments should be shown in the budget.

f) **The classification of expenditure as 'capital' and 'revenue' is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as 'bad', has led to the neglect of maintenance of assets, which is revenue expenditure. If so what are the options which could be considered to ensure that adequate funds are earmarked for maintaining capital assets?**

It is desirable that the recurring expenditure on the maintenance of the assets should be classified as capital expenditure. Upto 10% of capital outlay may be earmarked for the maintenance of assets and it should be treated as capital expenditure.

g) **Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the State Legislature a statement on the adherence to the State FRL and also setting forth a 3 year rolling target which outlines for the ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure.**

h) **Will the State Government have any difficulty in complying with the aforesaid stipulations in a modified State FRL.**

The State of Bihar to a very large extent (almost 70%) dependent upon the central transfers. However, under section 5 of FRBM Act 2006, the State Government places a statement before the State Legislature containing 3 year rolling target (including current year) of GSDP, revenue surplus (deficit), fiscal deficit, debt liability, tax revenue etc.

3. **Impact on FRLs on Development Expenditure:**

The working assumption underlining the FRL process has been that the purposes of public expenditure (other than for Consumption and for Investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro-management of development trajectories that are highly state-specific. However, it can also be argued that FRL targets, indicators, and rules should take cognizance of (1) the type and purpose of expenditures undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' views on this important issue.

The high level of development expenditure by the state government has been one of the principal causes behind the appreciable growth performance of the state's economy. The state government was thus able to maintain high level of development expenditure, without compromising on the principles of financial management like generating revenue surplus, keeping Gross Fiscal Deficit within the limits, and containing the level of outstanding debt. During 2016-17, the state government has continued that practice of financial discipline which will facilitate its development agenda in near future.

4. **Public Investment:**

States are the prime movers for public investment (Figure 2). Therefore, it is important to ensure that fiscal space for public investment by States is secured. In this context, the Committee seeks the following information.

a) **Does the FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regard?**

Diverting from the fiscal conservatism towards profligacy leads to wasteful expenditure. Higher fiscal deficits tend to crowd out the private sector and the space for private sector borrowing is severely constrained. Higher fiscal deficits also tend to be inflationary.

Though the present FRBM architecture has sufficient safeguards against wasteful expenditure and ensures inter-generational equity, nevertheless the Act requires some more tweaking to accommodate extraordinary situations.

One such proposal is to transition to a cyclically adjusted fiscal deficit framework. Under this arrangement, government spending would increase during economic downturns to shore up aggregate demand, only to recede when private spending strengthens. The policy stance would thus be counter cyclical- increase government spending during times of distress as opposed to a pro-cyclical policy and increase government spending when the going is good.

The State Government supports the FFC report, which has been adopted by the Central Government, wherein additional fiscal space of 0.25% is provided if the State's debt-GSDP ratio less than or equal to 25% and further additional borrowing limit of 0.25% of GSDP if the interest payment to revenue receipts is less than or equal to 10% in the preceding year.

b) **Going forward, do States think that it will be best to have fiscal constraints that distinguish between borrowing for consumption (revenue expenditure) and borrowing for public investment (capital expenditure)? Are there alternative ways in which fiscal rules can be crafted to maintain fiscal sustainability while also allowing adequate fiscal space for public investment?**

One possible alternative is to link government spending and providing additional fiscal space for public investment is to consider bank credit, data which is both reliable and available timely. The logic for choosing this indicator is pretty straightforward. Sluggish bank credit signals low private sector demand and could be construed as a sign that greater government spending is needed to boost aggregate demand.

The ideal case would be that a reformed FRBM Act sets up an independent Budget scrutiny office that helps, through transparent and predetermined factors, ensure that the Centre and the State is constrained to keep within prudent deficit limits during good times, and is allowed a reasonable amount of leeway during bad times - but not too much, as happened in 2008-09, the year that the enforcement of the existing FRBM Act was paused. This office shall also ensure the 'golden rule' that governments should not borrow for consumption spending.

5. **Medium Term Fiscal Framework (MTFF):**

A medium term fiscal framework (MTFF) presents multi-year budget forecasts. It helps anchor fiscal policy to a medium-term target, around which annual deviations can be planned. An MTFF also induces greater transparency and accountability in the budget making process. In this context, the Committee would like to inquire the following.

a) **What are the States' views on the scope of the implementation of an MTFF?**

The State is in favour of implementing a functional Medium-Term Fiscal Framework (MTFF). This would consist of (a) a multi-year macroeconomic framework that provides GSDP and inflation forecasts (b) a revenue forecasting framework (MTRF) that predicts tax revenue on the basis of the relevant tax base (GSDP, consumption, service sector growth etc.), and the impact of changes in tax rates, and (c) an expenditure framework that specifies the department / sector-wise allocable ceiling each year, which is total expenditure less committed expenditure on ongoing projects, salaries, maintenance, pensions etc.

b) **Examine the various reporting and operational methodologies to set forth implementable fiscal targets.**

Decide fiscal targets: The macroeconomic framework should provide real and nominal GSDP aggregates. The MTRF will fix the revenue-to-GSDP ratio. Decide the allocation of fiscal deficit space between the Centre and the states: This can be the status quo (3.5 per cent of GDP for both) until incorporated into the terms of reference of the Fifteenth Finance Commission.

Specify exit clauses that address volatility. The focus should be on adapting fiscal targets to address known volatilities which impact fiscal policy. Agriculture is the most important internal source of volatility. Monsoon failures, floods, droughts, etc, can require governments to temporarily increase public spending, either nationally, or in specific states. An exit clause allowing increases in public spending on the basis of quantifiable evidence that such volatility has occurred, should be part of the fiscal responsibility framework.

c) **We would also be interested in whether the State FRL could incorporate measures designed to promote the productivity and efficiency of public expenditure.**

The Central FRBM Act and State FRL should mandate medium-term fiscal policy (MTFP) statement. The MTFP lays down three-year rolling targets for revenue and fiscal deficits, tax revenues and total outstanding liabilities of the central government, all expressed as a proportion of GDP and GSDP. What it should contain, is three-year-forward estimates of detailed breakup of major items of revenues and expenditures, together with a narrative explanation of how these have been generated. It should also specify the parameter values underlying expenditure and revenue projections and the band within which these parameters can vary while remaining consistent with FRBMA / FRL targets. The government should be required to make an evidence-based case for relaxation of the MTFP targets, should such circumstances arise.

6. **Impact of FRLs on Cash Surpluses of States:**

Alongside the improvement in fiscal position of States, there has been a build-up of cash balances with them. These have persisted at high levels since 2004-06 (See Figure 3). Such high magnitude of cash balances raises issues regarding the cash management by State Governments. In this context

a) **What is the States' view on the rise in their surplus cash balances in the post-FRL period?**
b) **Are there alternative investment options for surplus cash balances?**
c) **Given that several States have comfortably achieved their FRL targets, why have they preferred to build up cash surpluses rather than spending on productive purposes such as public investment?**

As of March 31, 2015, the state government had a cash balance of Rs 6337 crore, compared to Rs 6156 crore on March 31, 2014. Out of this, Rs 3528 crore were invested in Cash Balance investment account, Rs 211 crore as cash with departmental officers from Public Works and Forest Departments, Rs 344 crore as permanent advances for contingent expenditure with various departments, and Rs 2343 crore were invested in earmarked funds like the Sinking Fund, leaving a net credit cash balance of Rs 89 crore with the RBI. An amount of Rs 312 crore was realised as interest on the state government's investments during the year 2014-15, compared to Rs 233 crore during the last year (2013-14).

One of the major reasons for the accumulation of the cash balances at the end of the financial year is due to last or penultimate day release of State share of Central Taxes by the Union Government. Added to this, several revenue earning departments accelerate the revenue collection; include advance tax collections at the financial year ending resulting in the excess cash balances.

RBI is effectively managing the cash surpluses of the state. All the day to day cash balances in excess of about Rs.1.73 cr are invested in the Treasury Bills of 14 days maturity, yielding 5% rate of interest. In this financial year the state also resorted to Auction Treasury Bills (ATB) keeping in view of the sustained high cash balances.

7. **Annual CAG audits of State Finances:**

The Comptroller and Auditor General (CAG) of India publishes annual audit reports on State Government finances that are important sources of policy information for inter-governmental bodies like the Finance Commissions.

a) **In this context, we would be particularly interested in knowing the States' views on the content and focus, and coverage of such reports. How can the audit reports be better shaped to serve the purposes of fiscal responsibility and budget management of States?**

b) **To what extent can we make better use of the CAG audit reports of state finance and FRBM compliance reports published by orgs like NIPFP to facilitate and ensure FRBM compliance going forwarded?**

CAG, through Finance Accounts analyses the appropriation of the funds against the legislature sanction and the framework of laid down principles of expenditure. CAG through its reports largely concentrates on the Fiscal Deficit, with less emphasis on the equally important parameters such as debt sustainability, off-budget borrowings etc. Many a times CAG completely misses the off-budget borrowings resorted to by the state PSEs. Therefore, there is a need to empower the CAG to alert the State on the Fiscal Prudence and commitment to the cardinals of fiscal discipline.

8. **Impact of the recommendations of the Fourteenth Finance Commission (FFC) on State Finances:**

The FFC has recommended landmark changes in the vertical devolution of States, increasing States' share in the divisible pool to 42 percent, a rise of 10 percent points from the recommendations of the Thirteenth Finance Commission. Equally radical were the FFC's changes to the formula governing the horizontal distribution of the divisible pool of central taxes among the States.

a) **The Committee recognizes that the combined implication of these changes, along with the changes in non-FC central grants to the States would, in combination, have a highly differentiated impact on States. In the context, the Committee would be keen to understand the specific implications of these changes for inter-governmental transfers on State Finances.**

The recommendation of 14th Finance Commission envisaged that the joint share of the State have increased from 32% to 42%. However, the parameter formulated by the commission for the horizontal distribution of fund amongst the state have resulted in a huge difference among different states. The share of State of Bihar has gone down to 9.665% in comparison to 10.917% in 13th Finance Commission. It is needful to mention here that under the parameters adopted for horizontal distributions by the 14th Finance Commission, the area and forest coverage area has been given weightage of 22.5% which has adversely affected the State's Share in the sharable pool of the Central Net Taxes. However, the density of population and specific problem related to landlocked state has been ignored. Besides the flood from the rivers originating from Nepal which adversely affect, the State have not been taken into consideration. The per capita income of the state is about 40% of the national per capita income. Hence, the recommendation of the 14th Finance Commission is regressive and compositional only.

It is pertinent to state that the reduction in share of the State from 10.917 to 9.665 has led to a great loss to the State. Since the total divisible pool of the Central Government is Rs 3948186.00 crore, the share of Bihar at 10.917% would have been Rs. 431023.47 crore. However at 9.665% the State would get only Rs 383853.62 crore over 5 years. Thus the loss to the State would be Rs 431023.47 crore - 383853.62 crore i.e Rs 47169.85 crore over 5 year period.

It is also pertinent to mention here that a massive reduction under the Centrally Sponsored Schemes by the Government of India has been made after the acceptance of the recommendation of the 14th Finance Commission. Under the Centrally Sponsored Schemes, all the states together received Rs. 3.38 lakh crore, by way of central assistance during the financial year 2014-15 which was reduced to Rs. 2.04 lakh crore in financial year 2015-16. Thus, this reduction has been to the tune of Rs. 1.34 lakh crore (39.64%). In the context of Bihar, it was estimated that a total of Rs. 27494.00 crore would accrue to the state in financial year 2015-16 by way of central assistance under the centrally sponsored schemes. This estimation was based on a 10% increase in the receipt by way of central assistance under the centrally sponsored schemes for financial year 2014-15. There has been a substantial reduction in the central budget for financial year 2015-16 and 2016-17 by way of receipts under the State Plan.

In light of the scope of development and available resources of a state in tandem with the recommendations of the 14th Finance Commission and the central assistance to the State Government by the Central Government as illustrated in abovementioned paragraph, the net increase is approximately (Rs. 50748.00 crore- Rs.48118.00) Rs. 2500 crore space for the year 2015-16, whereas, there is a reduction of about Rs. 12300.00 crore by way of plan assistance from the Central Government. As a result, the initial size of the Plan Head for Bihar for financial year 2015-16 which was fixed at Rs. 69250 crore has been reduced to Rs. 57137.62 crore. It is clear that if the sharing pattern of funds between the Central and the State Governments under the centrally sponsored schemes remain the same, a state like Bihar will not be able to provide the central share from its meagre resources.

b) **Subject to certain conditions, the FFC has also provided for some flexibility in the States' fiscal deficit target of 0.5 percentage points, over and above their FRL limits. What are the States' views on this recommendation? If States' plan to avail of this provision, how do they plan to allocate the extra fiscal space of 0.5 percent of GSDP among their different expenditure priorities? Do they plan to use the extra fiscal space to incur revenue expenditure or capital expenditure?**

The Union Cabinet chaired by the Hon'ble Prime Minister on 6 April 2016 gave its approval to Recommendations on Fiscal Deficit Targets and Additional Fiscal Deficit to States during Fourteenth Finance Commission (FFC) award period 2015-20 under the two flexibility options recommended in para 14.64 to 14.67 of its Report (volume – I). FFC has adopted the fiscal deficit threshold limit of 3 per cent of Gross State Domestic Product (GSDP) for the States. Further, FFC has provided a year-to-year flexibility for additional fiscal deficit to States. FFC, taking into account the development needs and the current macro- economic requirement, provided additional headroom to a maximum of 0.5 per cent over and above the normal limit of 3 per cent in any given year to the States that have a favourable debt-GSDP ratio (means if debt-GSDP is not more than 25%, then an additional 0.25% fiscal deficit can be afforded) and interest payments-revenue receipts ratio (means if IP-RR is not more than 10%, then an additional 0.25% fiscal deficit can be afforded) in the previous two years. However, the flexibility in availing the additional fiscal deficit will be available to State if there is no revenue deficit in the year in which borrowing limits are to be fixed and immediately preceding year. If a State is not able to fully utilise its sanctioned fiscal deficit of 3 per cent of GSDP in any particular year during the 2016-17 to 2018-19 of FFC award period, it will have the option of availing this un-utilised fiscal deficit amount (calculated in rupees) only in the following year but within FFC award period.

The State Government, in pursuance to the Government of India decision has already passed a Cabinet Resolution facilitating amendment of FRBM Act to provide additional fiscal space of 0.5% of GSDP. This additional space would be utilised for the capital expenditure. The Government of Bihar has continuously maintained revenue surplus ever since 2008-09.

9. **The impact of the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) on State Finances:**

The Ujwal DISCOM Assurance Yojana (UDAY) was launched by the Government of India on 20th November, 2015. Its primary objective is to revive Power Distribution Companies (DISCOMs) in financial distress and ensure their sustainability. Under the UDAY scheme, a significant portion of the debt of DISCOMs will be taken over by the States in a phased manner. The State government will also assume future losses of the DISCOMs in a phased manner, assuming responsibility for half of the DISCOMs' previous year losses by 2021.

The Scheme incentivizes the States by exempting State takeover of DISCOM debts from Fiscal Responsibility and Budget Management (FRBM) limits for two years; increased supply of domestic coal; coal linkage rationalization; liberally allowing coal swaps, allocation of coal linkages to States at notified prices and additional / priority funding in Schemes of Ministry of Power and Ministry of New & Renewable Energy, if they meet the operational milestones in the Scheme. In this context, the Committee is keen to learn the following.

Bihar has Signed Ujwal DISCOM Assurance Yojana (UDAY) on 22nd Feb'16 along with concerned DISCOMs with Ministry of Power, Govt. of India, New Delhi. As per the scheme both DISCOMs have formulated action plan to achieve financial turnaround by reducing AT&C (Aggregate Transmission & Commercial) loss to 15% and making ACS (Average Cost of Supply) and ARR (Average Revenue Realisation) to Nil by 2019-20. The future losses of the DISCOMs shall also be assumed by the State Govt. as per the commitment already given under UDAY.

The State Govt. has taken liability of Rs. 1554.52 Crore (50% of the total outstanding loan of both DISCOMs as on 30th Sept'15) by issuing non SLR bond and paying the proceeds to both DISCOMs for liquidation of outstanding loan to that extent as per the commitment under UDAY scheme. 25% (i.e. Rs. 777.26 Crore) of the remaining loan will also be taken over by Septemeber,2016 as per UDAY scheme.

a) **Measures that States plan to undertake to ensure transparent fixation of tariff by the State level regulatory authorities.**

The Bihar Electricity Regulatory Commission (BERC) is functioning independently as a quasi-judicial entity and determining the ARR (Average Revenue Realisation) of every year following the judicial process of hearing of different stake holders. The State Govt. communicates its decision to provide subsidy to different categories of consumers in advance and also releases the amount to both DISCOMs as per tariff order in advance every month.

b) **Whether States have an accurate quantification of on and off-budget subsidies to the power sector.**

As already stated, the Hon'ble Regulatory Commission is informed about the Annual Subsidy to be released by the State Govt. in advance. This is quantified on the basis of projected income and expenditure of DISCOMs for the year.

c) **How have States planned for the additional burden that will accrue as result of assuming DISCOM debts?**

d) **If States plan to avail of the above mentioned exemption from FRL limits for two years, how have States planned for a transition back to FRL targets after the end of the exemption period?**

The State has taken the additional burden of DISCOMs debt availing the exemption from Fiscal Responsibility and Budget Management (FRBM) limits as envisaged under UDAY scheme. This additional burden will be compensated from the reduction in Annual subsidy towards excess AT&C loss over the trajectory fixed by BERC for DISCOMs.

छत्तीसगढ़ शासन
वित्त विभाग
महानदी भवन, मंत्रालय, नया रायपुर

क्रमांक/1087/03143/ब–4/चार/ नया रायपुर, दिनांक 17 अक्टूबर, 2016

प्रति,

अध्यक्ष
एफ.आर.बी.एम. समीक्षा समिति
आर्थिक कार्य विभाग
वित्त मंत्रालय
भारत सरकार, नई दिल्ली

विषयः– एफ.आर.बी.एम. के संबंध में टीप
सदंर्भ :– अध्यक्ष, एफ.आर.बी.एम. समीक्षा समिति, भारत सरकार, वित्त मंत्रालय, आर्थिक विभाग का अर्द्धशासकीय पत्र दिनांक 9 सितम्बर, 2016

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उपरोक्त संदर्भित पत्र के अनुक्रम में राजकोषीय उत्तरदायित्व और बजट प्रबंध (एफ.आर.बी.एम.) के संबंध में टीप आवश्यक कार्यवाही हेतु संलग्न प्रेषित है।

संलग्नः – यथोपरि।

(आनंद मिश्रा)
विशेष कर्तव्यस्थ अधिकारी

पृ. क्रमांक/1088/03143/ब–4/चार/ नया रायपुर, दिनांक 17 अक्टूबर, 2016

प्रतिलिपिः–

मुख्य सचिव के संयुक्त सचिव, मुख्य सचिव कार्यालय, छत्तीसगढ़ शासन, मंत्रालय, महानदी भवन, नया रायपुर

विशेष कर्तव्यस्थ अधिकारी

Views/comments of Chhattisgarh State Government regarding FRBM targets

1. The Central Finance Commission prescribes the same fiscal deficit and borrowing limits for all States despite wide variation of Total outstanding liabilities/GSDP percentage ranging from 15.5 to 32.9 among non special category states (The report of RBI on State Finances 2016). States with low levels of indebtedness have the capacity for more resource mobilisation by way of borrowing and should have access to more resources by way of higher borrowing limits of investing in productive capital investments to speed up the pace of development. Hence borrowing limit should be differentially prescribed to different States considering their Total outstanding liabilities/GSDP percentages and resources requirements. For states with Total outstanding liabilities/GSDP percentage upto 20, annual borrowing limit may be revised to 3.5% of GSDP as against existing 3%.

2. The Union Government introduced the concept of effective revenue deficit through an amendment to the FRBM Act in 2012. Within current budgetary classification certain categories of revenue expenditure are actually utilised for creation and maintenance of capital assets which are public in nature. e.g. Grants to Universities and Urban local bodies. Hence Revenue Deficit calculated as per existing classification methodology doesn't actually portray the deficit on revenue account. Therefore a revised methodology to accurately define the Revenue Deficit is necessary by way of using new classification of "Effective Revenue Deficit" to adjust for such revenue expenditure for creation and maintenance of capital assets.

"माननीय मुख्यमंत्रीजी द्वारा वित्त विभाग के भारसाधक मंत्री के रूप में अनुमोदित"

विशेष कर्तव्यस्थ अधिकारी
छत्तीसगढ़ शासन
वित्त विभाग (बजट..5..)
मंत्रालय, नया रायपुर

Gujarat

- Gujarat has been able to maintain the recommended parameters of debt sustainability in the last few years recommended by the respective Finance Commissions and Ministry of Finance. Due to implementation of FRL, the State's ability of efficient utilisation of fiscal space has improved.

- State Government publishes Guarantee disclosures in FRBM and maintains Guarantee Redemption Fund (GRF), aggregated to Rs. 352 crore as at the end of March, 2016. The State Government publishes the information pertaining to various schemes which includes public private partnership (PPP). Moreover, the State permits non budgetary resources to the State Owned PSUs and reflects this information in its budget document in a comprehensive manner. Gujarat State Guarantees Act, 1963 provides the frame work for fixing the limit on the executive power of the State regarding the Government Guarantees. The State Legislature decides such limits from time to time. At present (with effect from March 2001) the limit for the total outstanding guarantees is Rs. 20,000 crore. As against this limit, the outstanding Government Guarantees, as on March 31, 2016 stood at Rs. 5319 crore.

- There are instances where parastatals / State PSUs borrow funds from banks and development agencies but the repayments and interest payments for these loans are made from the Budget but no such incidence has occurred in the State of Gujarat. owever, these loans are sometimes outside the State's debt limit. Moreover, the repayment of these amounts by State Government is reported as "repayment of loans' rather" than grants-in aid to the borrowing entity. In this view of the States, how can FRL provisions ensure that such instances of misrepresentation in the Budget are avoided?

- The expenditure of maintenance is classified under the revenue expenditure. Hence, the sufficient amount for maintenance is not provided in the budget because which increases the revenue expenditure and which is bad as per tendency. As a result the capital structure does not maintained as it requires to be maintained.

- Suggestion: The maintenance may be framed in two parts. Maintenance – General and Maintenance – Assets. The maintenance of General may be classified in revenue expenditure. The maintenance of Assets may be classified in capital expenditure. If, the above suggestion is considered, the assets will be properly maintained and negligence of maintenance of assets may be avoided.

- The Grant in Aid for the purpose of Creation of Capital Assets should be treated as capital expenditure instead of Revenue expenditure.

- With the formation of FRBM, along with the fiscal prudence the State has also managed its quality public spending. Developmental expenditure in last 5 years has been around 70% of the total expenditure. Capital Expenditure on Human/Physical assets creating future income for the State should be encouraged. This will improve the quality of public expenditure.

- State doesn't borrow funds for its revenue expenses. Borrowed funds are mainly used for capital expenditure. The present rules are acceptable.

- State Government has decided that the financial turnaround of Gujarat's discoms has already been achieved therefore, State has participated without the component of financial turnaround and financing of future losses and working capital. Gujarat accepted only the "Improving Operational Efficiency" parameters of the UDAY scheme. No debt has been created under the UDAY Scheme by Government of Gujarat.
- Cash balance on 31st March cannot be predicted accurately in advance. Cash surplus is invested only in Treasury Bills. RBI should allow premature withdrawal of 91 Days T-Bills, which is restricted at present.

CONSULTATION BRIEF FOR STATES ON THE IMPACT OF SUB-NATINAL FISCAL RESPONSIBILITY LEGISLATION ON STATE FINANCES

1. Impact on State FRLs on the fiscal outcomes of States

❖ How have the extant State FRLs been useful in securing the States' macro-fiscal goals?

➢ *The macro-fiscal goals consists of*

I. Maintaining Revenue Surplus

II. Containing Fiscal Deficit to GSDP below 3%

III. Containing Public Debt to GSDP below 27.1%

➢ With *the* formation of FRL, the state has achieved its macro-fiscal goals from last few years. This can be seen in the table below:

FY	Revenue Surplus / Deficit	Fiscal Deficit	Fiscal Deficit to GSDP (%)	Public Debt (A/cs)	GSDP	Target of Debt to GSDP (%)	Public Debt (A/C) as % of GSDP
	Rs. In crore						
1	2	3	4	5	6	7	8= 5/6
2010-11	-5076	15073	2.89%	110874	521519	No Target	21.26%
2011-12	3215	11027	1.82%	123406	605456	27.1	20.38%
2012-13	5570	16492	2.32%	136367	712123	27.1	19.15%
2013-14	4717	18423	2.28%	149506	806745	27.1	18.53%
2014-15	5326	18320	2.05%	163451	895202	27.1	18.26%
2015-16 (BE)	7308	22049	2.24%	184667	982626	27.1	18.79%
2015-16 (RE)	3657	22167	2.25%	182068	984971	27.1	18.48%
2016-17 (BE)	3236	24608	2.25%	202978	1094303	27.1	18.55%

With Total ***Outstanding Liability***

FY	Revenue Surplus / Deficit	Fiscal Deficit	Fiscal Deficit to GSDP (%)	Outstanding Liability (A/cs)	GSDP	Target of Debt to GSDP (%)	Total Debt (A/C) as % of GSDP
	Rs. In crore						
1	2	3	4	5	6	7	8= 5/6
2010-11	-5076	15073	2.89%	135656	521519	No Target	26.01%
2011-12	3215	11027	1.82%	150785	605456	27.1	24.90%
2012-13	5570	16492	2.32%	166667	712123	27.1	23.40%
2013-14	4717	18423	2.28%	183057	806745	27.1	22.69%
2014-15	5326	18320	2.05%	202313	895202	27.1	22.60%
2015-16 (BE)	7308	22049	2.24%	225368	982626	27.1	22.94%
2015-16 (RE)	3657	22167	2.25%	224950	984971	27.1	22.84%
2016-17 (BE)	3236	24608	2.25%	249803	1094303	27.1	22.83%

❖ In recent years, some States have achieved revenue and fiscal deficits that are below their FRL targets. Equally, other States have been unable to comply with their FRL deficit targets. In this context, what is the State's view on the impact of FRLs on the State's ability to efficiently utilise their fiscal space?

- ➢ Optimum *utilisation of fiscal space results into better debt sustainability, creation of revenue surplus due to reduction in interest liability, creation of assets and utilisation of funds for the overall development of the state.*
- ➢ *Due to implementation of FRL, the State's ability of efficient utilisation of fiscal space has improved.*

- What has been the States' experience with different types of fiscal rules i.e. deficit and debt rules? What are the States' views on second generation fiscal rules such as expenditure ceilings?
  - *Fiscal* ***Deficit rule*** *gives an idea of the fiscal space while preparing budget estimates. Accordingly, the estimates of receipts and expenditure are worked out.*
  - ***Debt rules*** *set an explicit limit or target for public debt w.r.t GSDP. The available resources to meet the fiscal space are estimated considering the ratio of outstanding debt to GSDP.*
  - *Deficit rule is related to the inflow and outflow of the resources in a particular year while the debt rule is affected by the debt created in the past as well as the particular year.*
  - *Debt could also be affected to some extent by volatility of foreign exchange rate in the market.*
  - *Expenditure* ***rules*** *set limits on total spending.Such limits are typically set in absolute terms, and occasionally in percent of GSDP with a time horizon.These rules are not linked directly to the debt sustainability objective since they do not constrain the revenue side.*

- Specifically, why did some States feel the need to incorporate a debt rule whereas others did not? Moreover, how did States decide the level of their respective debt targets? What is the optimum perceived path of debt sustainability?

- *Debt Sustainability is defined by the ratio of:*
    - *Debt to GSDP*
    - *Interest payment to Revenue Receipt*
    - *Debt to Revenue Receipt*

FY	Public Debt to GSDP		Interest payment to Revenue Receipt		Public Debt to Revenue Receipt	
	Target	Achievement	Target	Achievement	Target	Achievement
2011-12	27.1% (13th FC)	20.38	20% (12th FC)	15.63	3 Times (MoF)	1.96
2012-13		19.15		14.47		1.81
2013-14		18.53		14.90		1.87
2014-15		18.26		14.42		1.78
2015-16 (RE)		18.49		13.89		1.74
2016-17 (BE)		18.55		13.91		1.61

- *Gujarat has been able to maintain the recommended parameters of debt sustainability in the last few years recommended by the respective Finance Commissions and Ministry of Finance.*

❖ Some States have provided for legal limits on guarantees. What has been their experience in this regard?

- *"Contingent liabilities" means the liabilities to State Government that may arise out of the borrowings by Public Sector Undertakings and other institutions owned or controlled by the State Government for which the State Government has given guarantees, subject to the condition that the liabilities do not exceed the ceiling on total* *government guarantees given under the Gujarat State Guarantees Act, 1963;*

- *Gujarat State Guarantees Act, 1963 provides the frame work for fixing the limit on the executive power of the State regarding the Government Guarantees. The State Legislature decides such limits from time to time. At present (with effect from March 2001) the limit for the total outstanding guarantees is Rs. 20,000 crore. As against this limit, the outstanding Government Guarantees, as on March 31, 2016 stood at Rs. 5319 crore.*
- *A Guarantee Redemption Fund (GRF) has been set up to take care of any contingent liabilities arising out of the State Government guarantees. The GRF has been aggregated to Rs. 352 Crore as at the end of March, 2016, which has attained the level 6.60% of net outstanding guarantees against the minimum level of 5%.*

2. Transparency

- How do States define their overall liability? Does their measure include borrowings by State Public Sector Undertakings, Special purpose Vehicles, and other equivalent instruments including guarantees where the liability for repayment of principal and/or interest is on the State Government?
- It is stated by 14th Finance Commission

- ✓ As per Gujarat FRBM Act and Rule “public debt” means small savings loan (NSSF), market borrowings (OMB) by the Government, loan from the Government of India (EAP) and the Financial Institutions (NABARD, HUDCO) outstanding at the end of the financial year.
- ✓ As per 14th FC Outstanding debt & liabilities include internal debt of State Governments, loans and advances from the Union Government and other liabilities viz., provident funds etc., reserve funds and deposits (Public Account).
- ✓ Gujarat State Guarantees Act, 1963 provides the frame work for fixing the limit on the executive power of the State regarding the Government Guarantees. The State Legislature decides such limits from time to time. At present (with effect from March 2001) the limit for the total outstanding guarantees is Rs. 20,000 crore. As against this limit, the outstanding Government Guarantees, as on March 31, 2016 stood at Rs. 5319 crore.
- ✓ A Guarantee Redemption Fund (GRF) has been set up to take care of any contingent liabilities arising out of the State Government guarantees. The GRF has been aggregated to Rs. 352 crore as at the end of March, 2016, which has attained the level 6.60% of net outstanding guarantees against the minimum level of 5%.

❖ What are States’ views on voluntary disclosures of off-budget borrowing and contingent liabilities?

- ➢ *State Government publishes Guarantee disclosures in FRBM viz. Table 3.12 : Department wise outstanding guarantee as % of Total Guarantee, Form B-4 : Guarantees given by the*

Government and Form B-6 : Guarantee Redemption Fund (GRF).

- More specifically, do State collect and report information on public – private partners and other off budget vehicles in a comprehensive manner?
    - *The State Government publishes the information pertaining to various schemes which includes public private partnership (PPP). Moreover, the State permits non budgetary resources to the State Owned PSUs and reflects this information in its budget document in a comprehensive manner.*

- There are concerns expressed that the increasing reliance on PPP (annuity) projects has arisen as a way of circumventing the fiscal deficit targets. In this context, how do States view such commitments and how should the annuity payments be properly reflected in the Budget documents?

- There are instances where parastatals / State PSUs borrow funds from banks and development agencies but the repayments and interest payments for these loans are made from the Budget. However, these loans are sometimes outside the State's debt limit. Moreover, the repayment of these amounts by State Government is reported as "repayment of loans' rather" than grants-in aid to the borrowing entity. In this view of the States, how can FRL provisions ensure that such instances of misrepresentation in the Budget are avoided?

- *State Government raises funds through open market borrowing, NSSF Loans, GoI loans and loans from NABARD. Accordingly, relevant details of above components are published in FRBM document.*
- *No such incidence has occurred in the State of Gujarat.*

- The classification of expenditure as 'capital' and 'revenue' is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as 'bad', has led to the neglect of maintenance of assets, which is revenue expenditure. If so what are the options which could be considered to ensure that adequate funds are earmarked for maintaining capital assets?
  - *It is stated above that Capital expenditure is desirable and revenue expenditure is bad i.e. Construction of Building of School, Hospital etc. are capital expenditure. This capital expenditure desirable because it is development expenditure. This type of expenditure meant for the development of the State. This type of building requires maintenance regularly. The expenditure of maintenance is classified under the revenue expenditure. The sufficient amount for maintenance is not provided in the budget because which increases the revenue expenditure and which is bad as per tendency. As a*

result the capital structure does not maintained as it requires to be maintained.

Suggestion:

- *The maintenance may be framed in two parts.*
- *Maintenance - General*
- *Maintenance - Assets*
- *The maintenance of General may be classified in revenue expenditure.*
- *The maintenance of Assets may be classified in capital expenditure.*
- *If, the above suggestion is considered, the assets will be properly maintained and negligence of maintenance of assets may be avoided.*

Grant-in Aid

- *Classification of Grant-in Aid is as under:*

  Object head:

  3100-Grant in Aid-General

  3500-Grant in Aid for creation of Capital Assets

  (Will include amounts released as grants for creation of capital assets)
- *As per the Guidelines of the office of the Controller General of Accounts (CGA), the provision for Grant in Aid should be made under The Revenue Budget Head. Hence, the expenditure of which is booked as Revenue Expenditure.*

- *As per list of object head prescribed by office of the Controller General of Accounts, The provision for the Grant in Aid to local bodies i.e. panchayats/Municipalities for the purpose of creation of capital Assets is to be made under the Revenue heads –object head-3500-Grant in Aid for creation of Capital Assets. Though the expenditure is of the capital nature but under the Grant in Aid it is treated as Revenue Expenditure.*
- *Suggestion: The Grant in Aid for the purpose of Creation of Capital Assets may be treated as capital expenditure instead of Revenue expenditure and to permit the state Government to make provision for the purpose of 'Grant in aid - Creation of Capital Assets' under capital budget heads.*

❖ Transparency would be enhanced if in the reporting methodology, the State Government can lay in each financial year before the State Legislature a statement on the adherence to the State FRL and also setting forth a 3 year rolling target which outlines for the ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure.

Will the State Government have any difficulty in complying with the aforesaid stipulations in a modified State FRL.

- *State Government publishes Medium Term Fiscal Policy Statement having rolling fiscal targets for the next three*

Years in FRBM and this Statement is laid down in the State Legislature.

3. Impact on FRLs on Development Expenditure

The working assumptions underlining the FRL process has been that the purpose of public expenditure (other than for Consumption and for Investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro-management of developing trajectories that are highly state-specific. However, it can also be argued that FRL targets, indicators, and rules should take cognizance of (1) the type and purpose of expenditure undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' views on this important issue.

4. Public Investment

❖ Does the FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regard?

➢ *With the formation of FRBM, along with the fiscal prudence the State has also managed its quality public spending.*

➢ *Developmental expenditure in last 5 years has been around 70% of the total expenditure.*

Financial Year	Developmental Expenditure	Total Expenditure	Developmental Expenditure to Total Expenditure (%)
2011-12	52924	79437	67%
2012-13	68100	98304	69%
2013-14	71985	104743	69%
2014-15	81751	116669	70%
2015-16 (RE)	94558	133026	71%
2016-17 (BE)	101486	149892	68%

- Capital Expenditure on Human/Physical assets creating future income for the State should be encouraged. This will improve the quality of public expenditure.

- Going forward, do States think it will be best to have fiscal constraints that distinguish between borrowing for consumption (Revenue expenditure) and borrowing for public investment (Capital Expenditure)? Are there alternatively ways in which fiscal rules can be crafted to maintain fiscal sustainability while also allowing adequate fiscal space for public investment?
  - *State doesn't borrow fundsfor its revenue expenses. Borrowed funds are mainly used for capital expenditure.*
  - *The present rules are acceptable.*

5. Medium Term fiscal framework

A medium term fiscal framework (MTFF) multi-year budget forecasts. It helps to anchor fiscal policy to a stable medium-term targets, around which annual deviations can be planned. An MTFF also induces greater transparency and accountability in the budget making process. In this context, the Committee would like to inquire the following.

- What are the State's views on the scope of the implementation of an MTFF?
- Examine the various reporting and operational methodologies to set forth implementable fiscal targets.

- We would also be interested in whether the State FRL could incorporate measures design to promote the productivity and efficiency of public expenditure.
    - *Every year, State Government presents Statements of FRBM in the legislature. FRBM consists of Medium Term Fiscal Policy Statement having a rolling fiscal targets for the next three years.*
    - *FRBM consists of 'The Fiscal Policy Strategy Statement' where strategy has been outlined for Receipt Side viz. Tax Revenue and Taxation Policy, Non-Tax Revenues and public debt management and Expenditure Side Strategy viz. Expenditure and investment, contingent & other liabilities and strategic priorities.*

6. Impact of FRLs on Cash Surpluses of states

Alongside the improvement in fiscal position of States, there has been a build-up of cash balance with them. These have persisted at high level since 2004-2006.

- What is the State's view on the rise in their surplus cash balance in the post-FRL period?
- Are there alternative investment options for surplus cash balance?
- Given that several states have comfortably achieved their FRL targets, why have they preferred to build up cash surpluses rather than spending on productive purposes such as public investment?

- *Cash balance on 31st March comprises of all other transactions like central government devolutions in form of share in central sales tax, grants-in-aid and other levies over and above public debt. This amount cannot be predicted accurately in advance.*
- *The state cash balance comprises of its own cash balances and balances in public deposits and personal ledger accounts covered under the public accounts. Moreover,the State government has to maintain certain level of cash balance to meet its expenditure for the month of April and May of the next financial year, and also to cover its liabilities towards the public account, which is variable.*
- *Government cash surplus is invested in T-Bills of 14 and 91 Days. Cash surplus is invested only in Treasury Bills, for limited period as a part of liquidity management.*
- *Reserve bank of India should allow withdrawal (premature) of 91 Days T-Bills, which is restricted at present.*

Table A : Cash Balance of State Government

SR.NO.	FINANCIAL YEAR	OP. BALANCE	CL. BALANCE	ANNUAL INCRESE / DECREASE
1	2010-11	6598	9246	------
2	2011-12	9246	13197	3951
3	2012-13	13197	13357	160
4	2013-14	13357	11923	(-)1434
5	2014-15	11923	12401	478
6	2015-16	12401	7951	(-)4450

7. Annual CAG audits of state finances

The Comptroller and Auditor General (CAG) of India publish annual audit reports on state government finances that are important sources of policy information for inter-governmental bodies like the Finance commissions.

- ❖ In this context, we would be particularly interested in knowing the state's views on the content and focus, and coverage of such reports. How can the audit reports be better shaped to serve the purposes of fiscal responsibility and budget management of states?
- ❖ To what extent can we make better use of CAG audit reports of state finance and FRBM compliance reports published by orgs like NIPFP to facilitate and ensure FRBM compliance going forward?
  - ➢ *CAG report reflects that the State maintains a large amount of Cash Balance in the month of March.*
    - o *The state cash balance comprises of its own cash balances and balances in public deposits and personal ledger accounts covered under the public accounts. Moreover,the State government has to maintain certain level of cash balance to meet its expenditure for the month of April and May of the next financial year, and also to cover its liabilities towards the public account, which is variable.*
  - ➢ *CAG report mentions that the State Government may consider 'need based borrowing' & utilizing the existing cash balance before resorting to fresh borrowing.*
    - o *Estimates of borrowing are on the basis of fiscal space available as compared to the GSDP. But, the actual borrowing has always been less than the estimates. The State always follows the principal of "Need Based Borrowing" along with the maintenance of fiscal parameters.*

8. The impact of the recommendations of the Fourteenth Finance Commission (FFC) on state Finances

The FFC has recommended land mark changed in the vertical devolution of states, increasing states ‘ share in the divisible pool to 42 percent, a rise of 10 percentage points from the recommendations of the Thirteenth Finance commission . Equally radical were the FFC’s changes to the formula governing the horizontal distribution of the divisible pool of central taxes among the states.

- *Considering four important factors (i) States not being entitled to the growing share of cessand surcharges in the revenues of Union Government (ii) the importance of increasing the share of tax devolution in total transfers (iii) an aggregate view of the revenue expenditure needs of States without Plan and Non-Plan distinction and (iv) the space available with the Union Government, FFC recommended increase in the share of tax devolution to 42 per cent of the divisible pool to serve the twin objectives (i) increasing the flow of unconditional transfers to the States and (ii) leave appropriate fiscal space for the union to carry out specific purpose transfers to the States. (para 8.13 of FFC Report)*
- *FFC Considered following major 5 indicators while horizontal distribution of the divisible pool of central taxes among the States. (para 8.22 to 8.30 of FFC Report)*
- *Share in Central Tax: Criteria and weights assigned for inter-se-determination of the shares of taxes to the State.*

  Criteria Weight (per cent)

Population	*17.5*
Demographic Change	*10.0*
Income Distance	*50.0*
Area	*15.0*
Forest Cover	*07.5*

- *As per Inter se Share of States – Gujarat share is 3.084 per cent.*
- *Share of States in Service Tax – Gujarat share is 3.172 per cent.*

The committee recognizes that the combined implication of these changes, along with the changes in non-FC central grants to the state would, in combination, have a highly differentiated impact on states. In the context, the committee would be keen to understand the specific implications of this these changes for inter-governmental transfers on States Finances.

- *As per FFC Report - Chapter 6 Annex 6.3 (para 6.49) divisible amount will be distributed as follow (Statement : 1) :*

  1. *42 % is Tax Devolution to States*
  2. *5.72 % is Grants from FC to States for 1. Post Devolution Revenue SDRF and 3. LBs*
  3. *52.28 % is Fiscal Space with Union*
  4. *Out of 52.28 %, 15.72 % is a provision for other transfers to states*
  5. *So State will receive total 63.44 %*

- *As per FFC recommendations, 42 % of net proceeds of the central tax to Gujarat State is Rs. 121762 Crore which is 3 times more compared to 32 % of net proceeds of the central tax to Gujarat State under 13th FC Rs. 44107.10 Crore. (Statement : 2 and 2A)*

- *In 13th FC, total Rs. 53789.89Crore Grant was allocated and against that released Rs. 51831.76 Crore. Total Rs. 1958.13 Crore less Grant released by GoI. (Statement : 3)*
- *In Share in Central Tax, Rs. 44107.10 Crore allocated and released Rs. 43345.28 Crore. Less Grant receipt was Rs. 761.82 Crore.*
- *In total 17 (13 FC) schemes, grant allocated was Rs. 3814.39 Crore and grant released was Rs. 2875.17 Crore. Less Grant receipt was Rs. 939.22 Crore. These less grant received by the State due to non-submission of UTC, not fulfilling conditionalties, late submission of recommendations by line ministry of GoI for some concerned schemes.*
- *In Local Bodies, against allocation of Rs. 3757.50 Crore, Rs. 2723.05 Crore released by GoI and State received less grant of Rs. 1034.45 Crore. Though number of attempts made by Finance Dept., Panchayat Dept. and Urban DevelopmentDept., only due non fulfilment of Lokayukta appointment conditionality, this less grant was not released by GoI.*
- *Incentive Grant in Infant Mortality Rate and Grid connected renewable Energy, State received Rs. 777.35 Crore. This grant was received only in last year of Commission.*

Impact:

- *In 13th FC, grants were allocated in particular schemes. To get next instalments, we had to submit UTCs, fulfilconditionalties, solve the queries raised by line ministry* *of GoI in some schemes, and prepare Action Plan etc. to GoI. Now 14 FC has not recommended grants for such schemes except SDRF and Local Bodies but increased net proceeds of central tax to 42% among the States. So the State has vide discretionary powers to utilize this amount for the State's very important schemes.*

- *Infrastructure and Man power related to Centrally Sponsored Scheme (CSS) under 13th FC has been continued by the State to achieve the prescribed targets. These schemes have not been recommended by the 14th FC, but in order to continue the ongoing schemes, the fixed as well as recurring expenses of these schemes have increased the financial burden on the State Government.*

Regarding changes in non-FC central grants to the States.

- *Vide Adviser(PCMD & HUA), Planning Commission, New Delhi's Office Memorandum no. M-12043-03-2013-PC dated 11-07-2013, total 137 + 18 = 155 Centrally Sponsored Schemes were merged into 66 schemes.*
- *Vide Director (CSS & CMC), NITI Aayog, New Delhi's letter U.O. No. M-12043-04-2015-NI dated 30-10-2015 funding pattern of Centrally Sponsored Schemes were issued. As per letter, some schemes were unchanged, some schemes Central / State ratio was changed to 60:40.*
- *CSS receipt in 2014-15 was Rs. 10799.02 Crore while in 2015-16 it was Rs. 8949.23 Crore. At present in most of the CSS schemes, grant released in old schemes names.*

Impact:

- *As allocation in the CSS for the previous years and current years not given, impact on CSS cannot be shown though FFC has recommended 15.72 % of divisible pool for other transfers (expected) to States.*

- *Subject to certain conditions, the FFC has also provided for some flexibility in the states' fiscal deficit target of 0.5 percentage points, over and above their FRL limits. What are the state's views on this recommendation? If states' plan to avail this provision, how old they plan to allocate the extra fiscal space of 0.5 percent of GSDP among their different expenditure priorities? Do they plan to use the extra fiscal space to incur revenue expenditure or capital expenditure?*
  - *Para 14.64 The fiscal deficit targets and annual borrowing limits for the States during the award period of 14th FC are enunciated as follows: -*
  - *Fiscal deficit of all States will be anchored to an annual limit of 3 per cent of GSDP. The States will be eligible for flexibility of 0.25% over and above this for any given year for which the borrowing limits are to be fixed if their debt – GSDP ratio is less than or equal to 25 per cent in the preceding year.*
  - *States will be further eligible for an additional borrowing limit of 0.25 per cent of GSDP in a given year for which borrowing limits are to be fixed if the interest payments are less than or equal to 10 per cent of the revenue receipts in the preceding year.*

- *The two options under this flexibility provision can be availed of by a State either separately, if any of the above criteria is fulfilled, or simultaneously if both the above stated criteria are fulfilled. Thus, a State can have a maximum fiscal deficit-GSDP limit of 3.5 percent in any given year.*

- *The flexibility in availing the additional limit under either of the two options or both will be available to a State only if there is no revenue deficit in the year in which borrowing limits are to be fixed and the immediately preceding year.*
- *If a State is not able to fully utilize its sanctioned borrowing limit of 3 per cent of GSDP in any particular year during the first four years of our award period (2015-16 to 2018-19), it will have the option of availing this un-utilized borrowing amount (calculated in rupees) only in the following year but within our award period.*
- *If a State is not able to fully utilize its sanctioned fiscal deficit of 3 per cent of GSDP in any particular year during the 2016-17 to 2018-19 of FFC award period, it will have the option of availing this un-utilized fiscal deficit amount only in the following year but within FFC award period.*

Table B : Statement of Fiscal Parameters

FY	Revenue Surplus / Deficit	Fiscal Deficit	Fiscal Deficit to GSDP (%)	Public Debt (A/cs)	GSDP	Target of Debt to GSDP (%)	Public Debt (A/C) as % of GSDP
	Rs. In crore						
1	2	3	4	5	6	7	8= 5/6
2010-11	-5076	15073	2.89%	110874	521519	No Target	21.26%
2011-12	3215	11027	1.82%	123406	605456	27.1	20.38%
2012-13	5570	16492	2.32%	136367	712123	27.1	19.15%
2013-14	4717	18423	2.28%	149506	806745	27.1	18.53%
2014-15	5326	18320	2.05%	163451	895202	27.1	18.26%
2015-16 (BE)	7308	22049	2.24%	184667	982626	27.1	18.79%
2015-16 (RE)	3657	22167	2.25%	182068	984971	27.1	18.48%
2016-17 (BE)	3236	24608	2.25%	202978	1094303	27.1	18.55%

Table C: Statement of Interest payment to Revenue Receipt

Financial Year	Revenue Receipt	Interest Payment (MH 2049)	Interest payment to Revenue Receipt (%)
	Rs. In crore		
2010-11	52364	9627	18.38%
2011-12	62959	10934	17.37%
2012-13	75229	12161	16.17%
2013-14	79976	13332	16.67%
2014-15	91978	14946	16.25%
2015-16 (BE)	109295	16312	14.92%
2015-16 (RE)	104384	16382	15.69%
2016-17 (BE)	116366	17466	15.01%

- *Availing the option of additional fiscal space of 0.25% in a particular financial year based on debt-GSDP ratio will ultimately increase the outstanding debt. This will increase interest expenditure for the following years upto the tenure of that debt and consecutively affect the ratio of Interest payment to Revenue Receipt which gives additional fiscal space of 0.25%*

9. The impact of the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) on State Finances.

- Measures that States Plan to undertake to ensure transparent fixation of tariff by the State level regulatory authorities.
  - *Hon'ble Gujarat Electricity Regulatory Commission is empowered under Indian Electricity Act 2003 to determine the retail tariff for various categories of consumer after giving opportunity to various stakeholders to submit their written views / comments and representing through personal hearing. The process of determination of tariff is transparent and undertaken with knowledge of public after filing petitions by the concerned Distribution Companies before Hon'ble Commission. Hon'ble Commission decides the tariff after examining the suggestions / objections / views / comments of various stakeholders.*
  - *In view of the above it can be said that the State Electricity Regulatory Commission is already following the transparent procedure in respect of determining of tariff.*

- Whether States have an accurate quantification of on and off-budget subsidies to the power sector.
  - *In pursuance of section of the Electricity Act, 2003, the Hon'ble GERC is determining the Rate of Tariff of all categories of consumers. However, wherever the State Government decides to provide the power to certain class of consumers at a differential rate (less than the rate of tariff determined by Hon'ble GERC), the differential rate is being paid by the State Government to the concernedPower Utilities, by way of payment of subsidy, through providing Budgetary Support in the Budget of the State.*
- How have States planned for the additional burden that will accrue as result of assuming DISCOM debts?
- If States plan to avail of the above mentioned exemption from FRL limits for two years, how have States planned for a transition back to FRL targets after the end of the exemption period?

- *Ujjaval Discom Assurance Yojana (UDAY) is introduced by Ministry of Power, Government of India for operation and financial turnaround of State owned power distribution companies.*
- *State Government has decided that the financial turnaround of Gujarat's discoms has already been achieved therefore, State has participated without the component of financial turnaround and financing of future losses and working capital.*
- *Accordingly, Government of Gujarat accepted only the "Improving Operational Efficiency" parameters of the scheme. Accordingly, Tripartite MoU under UDAY scheme has been signed on 13/02/2016 amongst Ministry of Power, GoI, Energy and Petrochemical Department of Government of Gujarat and Gujarat UrjaVikas Nigam Ltd. (GUVNL) on behalf of all four discoms of Gujarat namely Paschim Gujarat Vij Company Ltd. (PGVCL), Uttar Gujarat Vij Company Ltd (UGVCL), Madhya Gujarat Vij Company Ltd. (MGVCL), Dakshin Gujarat Vij Company Ltd. (DGVCL).*
- *No debt has been created under the UDAY Scheme by Government of Gujarat.*

Fiscal Responsibility Legislation (FRL)	
Issues	**comments**
Impact on State FRLs on the fiscal outcomes of States	
➢ How have the extant State FRLs been useful in securing the State's macro fiscal goals? What is the States view on the impact of FRLs on the State's ability to efficiently utilize their fiscal space?	As per Central Finance Commission (CFC) recommendations, the State Government enacted the FRBM Act 2005. The necessary amendments in the FRBM Act are being made by the State Government as per recommendation of CFC as well as Ministry of Finance Government of India guidelines. The fiscal deficit as percentage of the GSDP of Haryana Government was well within the prescribed limit of 3 per cent during the award period of the 13th FC (2010-2015). The State Government planed its expenditure as per the availability of State's own resources, proceeds from Central Government under Finance Commission grants, grants under plan schemes (CSS) and borrowing within the permissible limit. As per 13th FC there was no provision to carry forward the unutilized borrowing limit to the next year. However, as per recommendation of the 14th FC, unutilized borrowing could be utilized in the next year during the 14th FC award period.
State's view on the second generation fiscal rules such as expenditure ceiling.	As per Union Government decision, expenditure ceiling may be considered on unproductive activity/non-development activities like office expenses overhead expenditure.
Specifically, why did some states fell the need to incorporate Debt rules where as other did not? Moreover, how did State decide the level of their respective debt targets? What the optimum Perceived path of debt sustainability?	As the resources are limited vis-à-vis development needs, States are forced to borrow to finance its development works. Utilisation of debt is important if it is used for creation of productive assests then debt may be self sustainable. The sustainability of the finances of the State can be measured in terms of Interest payment to Revenue

	receipts and Debt to GSDP ratio. The fiscal indicators of Haryana are well within the prescribed limit of CFC except revenue deficit. State has never defaulted in re-payment of loans and interest thereto. During the award period of 13th Finance Commission, debt to GSDP ratio of the State was within the prescribed limit. After taking over the 50 per cent outstanding debt of the DISCOMs in 2015-16 and 25 per cent in 2016-17 under UDAY, the State's debt to GSDP ratio are well within the prescribed limit of 25 per cent (viz, 22.46 per cent in the RE 2015-16 and 23.96 per cent in 2016-17 BE). State was able to reduce its Revenue Deficit from 1.88 per cent in 2014-15 to 1.34 per cent in 2015-16 (RE) and further estimated to reduce to 1.10 per cent in 2016-17(BE). Fiscal deficit has been reduced to 2.58 per cent in 2015-16 (RE) from 2.80 per cent in 2014-15 and further estimated to reduce to 2.47 per cent of GSDP in 2016-17(BE).
Some states have provided for legal limit on Guarantee. What has been their experience in this regard?	In Haryana there is no legal limit on State Government guarantee. As per Haryana Government instruction dated 01.08.2001, 2% guarantee fee is being charged by the State Government from Boards, Corporations and Public Sector Enterprises for raising loans from Financial Institutions with State Government guarantee. In FY 2012-13 as per GoI scheme, for Financial Restructure Plan (FRP) of DISCOMs, State Government Guarantee to the tune of Rs. 19547 crore was given by the State. Further, State has taken over the debts of Rs. 7366 crore under FRP scheme.

	The State has never defaulted in any loan repayment as well as interest payment. As per RBI guidelines, Haryana State has created a Guarantee Redemption Fund (GRF) and the guarantee fee is being deposited in the GRF annually. As on 31.03.2016, balance in GRF is ` 843.42 crore. All repayment of loans and payment of interests are being made by the PSEs and never revoked the State Government guarantee. As the guarantee given by the State is a contingent liability of the State, in case it revoked, the State has to pay the loan amount to the financial institution concerned. Therefore, it is suggested that there may be a ceiling for providing the State Government Guarantee as percentage of revenue receipts or GSDP.
Transparency	
Views on the overall liability of the State. Disclosers of off -budget borrowings and contingent liability	The off budget borrowings may be part of the overall liability of the States. As the borrowings made by the PSEs with State Government guarantee is ultimately liability of the State in case same is revoked. Haryana State is providing the statement of contingent liability (guarantee) in budget document every year while presenting budget before the State Legislature.
The borrowing made by PSUs/SPVs may not include the overall borrowing of the State as the PSUs raise loan from financial institution as per their capacity.	The PSUs take loan as per need and capacity to utilize the funds. The repayment of principal amount and interest is also made by the PSUs. However, State Government charges 2% Guarantee fee from PSUs on giving guarantee for raising loans from financial institutions.

Public Private Partnership (PPP)	A PPP Cell has been created by the State Government to deal with issues of PPP projects.
Repayment of off-budget borrowing from the State Budget	In Haryana no such practice is being exercised.
Classification of Revenue and Capital expenditure	As per decision of Government of India, State Government has decided to adopt the classification of Revenue and Capital from the budget 2017-18.
Option which could be considered to ensure that adequate are earmarked for maintaining Capital assets.	Presently, there is no such norm for earmarking the funds for maintaining the Capital assets. However, it is proposed that a ceiling could be fixed for earmarking the funds for maintaining the Capital assets. Proper/timely utilization of fund for maintaining of Capital assets, certainly will enhance the life of the Capital assets.
Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the State Legislature a statement on the adherence to the State FRL and also setting forth a 3 years rolling target which outlines for the ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure.	As per guidelines of Central Government, FRBM targets are being amended annually and placed before the State Legislature for the approval. The State Government has no objection to fix rolling targets for three years outlining important policies parameters, expenditure, market borrowing, other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure for ensuing three years.

Impact on FRLs on Development Expenditure The working assumption underlining the FRL process has been that the purposes of public expenditure (other than for Consumption and for Investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro-management of development trajectories that are highly state-specific. However, it can also be argued that FRL targets, indicators, and rules should take cognizance of (1) the type and purpose of expenditure undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' views on this import issue.	State welcomes any initiative in this area by the Government of India.
Public Investment	
The FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do states have any alternative proposals in this regard?	As per Government of India guidelines State has enacted the FRBM Act in 2005. As per 13th FC , the fiscal parameters of the Haryana State were well within the prescribed limit except revenue deficit. **Fiscal Deficit** During 13th FC award period 2010-15, the fiscal deficit was 2.79% in 2010-11, 2.38% in 2011-12, 2.96% in 2012-13, 2.10% in 2013-14 and 2.85% in 2014-15 against the limit of 3% of GSDP. The 14th FC has recommended the fiscal deficit limit of 3% for the award period of 2015-20 to Haryana

	State. **As per RE 2015-16 and BE 2016-17 this ratio is 2.58% and 2.47% respectively which does not match with the data of enclosed Appendix Table-I.** State Government has initiated following steps to increase the fiscal space for investment in Capital assets:- **i)** **Personal Deposit Accounts (PDA):** In order to ensure accountability and transparency in utilization of funds and to avoid parking of funds in Bank accounts outside the State Treasury, the Finance Department has issued instructions to all Departments to open the PDA with the approval of Finance Department. It is expected that there will be a saving of funds in hundreds of crore on this account. **ii)** **Loans and advances of Government employees through banks:** The State Government has decided to shift the portfolio of loan advances to Government employees like house building advance, computer loan, marriage advance, etc., though Banks. By implementing this scheme the Government would be able to divert this saving towards development works and employees will get loan from banks in time on the same terms and conditions of the government as per their requirement.
Distinguish between borrowing for consumption (revenue expenditure) and borrowing for public investment (Capital expenditure).	Borrowing limit of the State is fixed as percentage of GSDP by the Ministry of Finance, Government of India. The primary objective of the State borrowing for creation of Capital assets and development activities. In practice, borrowing made by the State is utilized to bridge the gap of resources. However, it is difficult be distinguish between borrowing for consumption

	(revenue expenditure) and borrowing for public investment (Capital expenditure).
Impact of FRLs on Cash Surpluses of States	
What is the States' view on the rise in their surplus cash balances in the post-FRL period?	State Government is in Revenue Deficit from 2008-09 and Fiscal Deficit from Financial Year 2007-08, accordingly State forced to borrow funds for development activities. Hence, there is no surplus cash.
Are there alternative investment options for surplus cash balances?	
Several States have comfortably achieved their FRL targets, why have they preferred to build up cash surplus rather than spending on productive purposes such as public investment?	
The impact of the recommendations of the 14th Finance Commission on State Finances	
The Fourteenth Finance Commission has recommended total devolution of Rs. 50036.80 crore to Haryana for its award period 2015-20 consisting Rs. 42798.00 crore as Share of Central Taxes, Rs. 5963.46 crore as Local Bodies Grant and Rs. 1529.00 crore (90% Centre Share) for State Disaster Response Fund (SDRF) grant.	The Fourteenth Finance Commission has increased the share of States in the divisible pool of central taxes from 32% to 42%, but on the other hand all State Specific grants like improvement in Justice Delivery, State Specific Grants for Mewat and Shivalik region and incentive grants etc. have been discontinued. Apart from this, the funding pattern of many Centrally Sponsored schemes have been changed by the Central Government which leads to a decrease in allocation of funds to State Government. There is overall increment of Rs. 1200 crore approximately in total devolution to the State under 14th FC award period (2015-20). However, the recommendation of 14th Finance Commission gives flexibility to the States in utilization of funds as per its requirement.

The impact of the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) on State Finance	A) The State Government of Haryana had signed a tripartite agreement on 11 March 2016 with the Ministry of Power, Government of India and DISCOMs (UHBVNL & DHBVNL). B) As per Scheme out of total debt of Rs. 34600 crore, the 75% debt i.e. Rs. 25950 crore was to be taken over by the State in two years (50 per cent of Rs. 17300 crore during the FY 2015-16 and 25 per cent of Rs. 8650 crore in 2016-17). C) Accordingly 50 per cent of the outstanding debt of Rs. 17300 crore was taken over on 31st March 2016 at the interest rate of 8.21% p.a. payable semi-annually through RBI. The remaining 25 per cent debt amounting to Rs. 8650 crore was to be taken over till 30 September 2016 through RBI and private placement. However, the State Government took this entire amount by 04 July 2016. D) The weighted average yield of UDAY Bonds of Haryana for all the bonds amounting to Rs. 25950 crore taken over comes to 8.1960%. F) As per UDAY Scheme, the debt taken over by the State Government and borrowings under this scheme would not be counted against the fiscal deficit limit of the State in the financial year 2015-16 and 2016-17. However, there will be long-term impact of UDAY's Scheme on State finances. The Government of India is requested to exclude the UDAY's impact during the award period of 14th Finance Commission (i.e. up to 2019-20).

Measures that States Plan to undertake to ensure transparent fixation of tariff by the State level regulatory authorities.	In Haryana State, Haryana Electricity Regulatory Commission (HERC) was established on 17th August 1998 as an independent statutory body corporate as per the provision of the Haryana Electricity Reform Act, 1997. Haryana was the second State in India to initiate the process of Reform & Restructuring of the Power sector.
Whether States have an accurate quantification of on and off-budget subsidies to the power sector.	In Haryana State, Rural Electrification (RE) subsidy is being provided to the power utilities through State Budget on the recommendation of HERC. As per Revised estimates there is a Budget provision of Rs. 6425.90 crore in 2015-16, and Rs. 6800.00 crore in Budget Estimates 2016-17 under RE subsidy.
If States plan to avail of the above mentioned exemption from FRL limits for two years, how have states planned for a transition back to FRL targets after the end of the exemption period?	As per UDAY Scheme, the debt taken over by the State Government and borrowings under this scheme would not be counted against the fiscal deficit limit of the State in the financial year 2015-16 and 2016-17. However, there will be long-term impact of UDAY Scheme on State finances. The Government of India is requested to exclude the impact of UDAY scheme during the award period of 14th Finance Commission (i.e. up to 2019-20).

V. C. PHARKA
Chief Secretary

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D.O.No:Fin. G-C (2)3/2013
14th December, 2016

Respected Sh NK Singh Ji.

Please refer to your D.O. Letter of 23rd November, 2016. The views of the State Government on consultation paper have now been uploaded on both emails mentioned in your letter.

Besides, I am also attaching a hard copy of the views uploaded for your perusal.

Regards,

Yours sincerely,

(V.C. Pharka)

Sh. N.K. Singh,
Chairman, FRBM Review Committee,
Ministry of Finance,
Department of Economic Affairs,
Room No-435, C Wing,
Shastri Bhawan, New Delhi-110001.

View of the Government of the Himachal Pradesh on Consultation Brief For States on The Impact of Sub-National Fiscal Responsibility Legislation on State Finances.

1. Himachal, over years, has achieved all round equitable growth reflected in HDIs. Himachal stand 3rd after Kerala and small state of Goa in HDIs.
2. Therefore, Himachal has to incur committed expenditure to consolidate and improve upon impressive achievements made in Education, Drinking Water, Heath Care, Roads and Electricity etc.

3. Entire Himachal, including all villages, had been electrified some 30 year ago. And all energy supplies are metered; and the T&C losses are very low.

4. Being a Revenue Deficit State, Himachal has absolutely no fiscal space. Beside, while assessing the taxation potential, the 14th FC, assumed a tax buoyancy of 1.5 on SGDP growth of 13.79 percent which works out to a very steep and unattainable tax growth of 20.69 percent year on year for a hill state with narrow tax base.

5. Mathematically, for all Revenue Deficit States, the enhancement or decrease in share of Central Taxes is totally inconsequential because the share of Central Taxes plus RDG exactly equals the pre devolution deficit. For Revenue Deficit States like Himachal, the rise in share of central taxes reduces RDG by exact amount and vice-versa. Enhancement of share of central taxes from 32% to 42% by 14th FC has been a bonanza only for Revenue Surplus States; and is of no consequence for Revenue Deficit State of Himachal.

6. With the demise of Planning Commission, an important source of revenues has been abolished. It is relevant to place

on record that during 2014-15 Himachal had received R2896.16 Crore as NCA, SCA and SPA.

7. Himachal, which has adopted UDAY, must be incentivized by permitting it to impose a generation tax of 25 paisa per unit like the state with thermal plants are to be incentivized by increased coal Supplies/Coal linkages Rationalization/Coal swap etc. It is felt Hydro Power, a green energy, needs to be incentivized much more.

8. It is therefore obvious that Fiscal Consolidation road map and targets of Revenue and Fiscal Deficits should be fixed for Himachal realizing that, as Revenue Deficit state, Himachal has no fiscal space; and Himachal's Pre Devolution Deficit was assessed by 14thFC that with assumption and calculations based on an unrealistic growth of 22.69% in taxes year on year. Moreover it has inherent cost disabilities being a hill state.

Responses from State Governments
Jharkhand

- With inadequate revenues, Government resorted to high level of borrowing for supporting their Plan Outlay. Resultant Government Debts had seriously eroded the financial health of the Government. High revenue deficit due to higher expenditure on Subsidies, Salaries and Interest payments compelled the state Government to make more borrowing from Government of India, Market Loans etc. Hence, the FRBM Act was enacted on 10 May, 2007. The FRBM rule set a target reduction of fiscal deficit to 3% of the GDP by 2008-09. This was to be realized with an annual reduction target of 0.3% of GSDP per year Similarly, revenue deficit was to be reduced by 0.5% of the GDP per year with complete elimination by 2008-09. Later, the target dates were reset and budget 2016-17 aims to realise the 3% fiscal deficit target by March, 2018.
- Jharkhand Government has achieved the two major fiscal targets of Revenue Deficit and Fiscal Deficit as projected in the fiscal correctional path.
- As Jharkhand Government has almost ensured revenue surplus State for last 7-8 years, Salary, Pension and non-interest committed expenditure are being discharged from revenue receipts of the Government. However, the concept of revenue deficit needs to be revisited particularly in respect of Grants-in-aid given by the Government for creation of Capital Assets and maintenance of Capital assets.
- State Government has hardly given any Guarantees since 15 November, 2000. Hence, no policy on government guarantees has been formed.
- All liabilities includes public debt, small saving, provident fund and balances under deposits are covered by the FRBM Act. Although, loans and advances given by the Jharkhand Government to State PSU etc. are defined as assets of the Government but practically, the loans are the liabilities of the Government. Apart from Loans & Advances to Government Servants as House Building advances, Motor Car Advances etc., almost nil recovery is made.
- PPP annuity projects are very few in Jharkhand. The annuity payments are reflected in the budget and accounts
- There is no instance where parastatals/ State PSUs borrow funds from bank and development agencies but repayments and interest payments for these loans are made from the Budget. The repayment of the liabilities of State PSUs etc. by the State Government in respect of funds borrowed from Bank should be either recorded as grants to PSU or Loans to PSU. Recording such transaction as repayment of loans will be depicted as adverse balance in the State Finance Accounts.
- Maintenance of capital assets is always considered as "Revenue expenditure". But if such expenditure indicated creation of capital assets or upgradation of quality of the assets, the same can be classified under Capital section.
- There is a structured system in State Government to evaluate impact of FRBM Act on Development Expenditure. Source of financing, performance and outcome of the development expenditure are properly monitored by Planning and Development Department. Some provisions of debt sustainability and quality public expenditure have already been included in the FRBM Act. We feel that availability of funds for development expenditure after setting off committed expenditure viz. salary, interest

payment, pension, repayment of borrowing etc. are very less in comparison of our plan outlay. The impact of GST will have an important impact on State Finances.

- State Government believes that more budgetary support is required from the Central Government. After meeting the need of committed expenditure and proving matching grant of central schemes, there are hardly any fiscal space for public investment.
- Jharkhand Government believes that multi-year budget forecasts will have greater transparency and accountability in the budget making process.
- Off-budget subsidies to power sector have not been quantified by the State Government. Grants in aid to meet gap in resources are given by the State Government. Assumption of DISCOM debts under Ujwal DLSCOM Assurance Yojana (UDAY) will have adverse effect on State budget. This will increase debt-revenue ratio of the State Government. State Government will request to exempt DISCOM debts for next plan period. The burden of debt of DISCOMs will certainly state fiscal space and its plan outlay. Financing of plan schemes from debt funds will be very tough after inclusion in FRBM due to debt sustainability policy.
- Increase in share in Central Taxes for the State under the 14th Finance Commission's award will be virtually neutralized through the effect of inflation, delinking of 8 CSS schemes and reduction in the budgeted Central Assistance to State Plans. Schemes such as SSA, Mid-day Meal etc. have been mentioned as "Fully supported by Centre". It may kindly be clarified whether "fully supported" means 100% support from GoI or support as per the existing pattern of funding.

Government of Jharkhand

Planning-cum-Finance Department

Views of the State Government of Jharkhand on FRBM Act and on consultation paper

1. Impact on State Fiscal Responsibility Legislations (FRLs) on the fiscal outcome of States

1.1 How have the extant State Fiscal Responsibility Legislations (FRLs) been useful in securing the States' macro-fiscal goals?

The FRBM Act is a fiscal sector legislation enacted by the Government of Jharkhand on 10 May, 2007, aiming to ensure fiscal discipline by setting targets including reduction of fiscal deficits and elimination of revenue deficit. It is a legal step to ensure fiscal discipline and fiscal consolidation at National and Sub-national level.

The FRBM Act was enacted in 2007 as rising Government borrowing and the resultant Government Debts had seriously eroded the financial health of the Government. High revenue deficit due to higher expenditure on Subsidies, Salaries and Interest payments compelled the state Government to make more borrowing from Government of India, Market Loans etc. With inadequate revenues, Government resorted to high level of borrowing for supporting their plan Outlay.

The borrowing again produced high interest payments. In this way, interest payments became the largest expenditure item of the Government. To arrest this financial weakness in its budget, the Government has taken some serious deficit cut targets by introducing a law in the form of the FRBM.

The FRBM rule set a target reduction of fiscal deficit to 3% of the GDP by 2008-09. This was to be realized with an annual reduction target of 0.3% of GSDP per year by the Jharkhand Government. Similarly, revenue deficit was to be reduced by 0.5% of the GDP per year with complete elimination by 2008-09. Later, the target dates were reset and budget 2016-17 aims to realise the 3% fiscal deficit target by March, 2018.

The Act gives slight flexibility to the government as well. It gives the responsibility to the government to adhere Minister has to explain the reasons and suggest corrective actions. Following are the provisions of the Act in detail.

- The government has to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 2008-09 and thereafter, sizable revenue surplus has to be created.

- Setting annual targets for reduction of fiscal deficit and revenue deficit, contingent liabilities and total liabilities.

- The government shall end its borrowing from the RBI except for temporary advances.

- The RBI is not to subscribe to the primary issues of the Central Government securities after 2006.

- The revenue deficit and fiscal deficit may exceed the targets specified in the rules only on grounds of national security, calamity etc.

Though the Act aims to achieve deficit reductions prima facie, an important objective is to achieve inter-generational equity in fiscal management. This is because when there are high borrowings today, it should be repaid by the future generation. But the benefit from high expenditure and debt today goes to the present generation. Achieving FRBM targets thus ensures inter-generation equity by reducing the debt burden of the future generation.

Other objectives include: long run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in fiscal operation of the Government.

1.2 In recent year some States have achieved revenue and fiscal deficits that are below FRL targets. Equally other States have been unable to comply with their FRL deficit targets. In this context, what is the States' view on the impact of FRLs on the State ability to efficiently utilize their fiscal space?

Jharkhand Government has achieved the two major fiscal targets of Revenue Deficit and Fiscal Deficit as projected in the fiscal correctional path.

1.3 What has the States' experience with different types of fiscal rules, i.e. deficit and debt rules? What are the State views on second generation fiscal rules such as expenditure ceilings?

The concept of revenue deficit needs to be revisited particularly in respect of Grants-in-aid given by the Government for creation of Capital Assets and maintenance of Capital assets.

1.4 Specifically, why did some states feels the need to incorporate and other did not? Moreover, how did states decide the level of their respective debt targets? What the optimum perceived path of debt sustainability?

As Jharkhand Government has almost ensured revenue surplus State for last 7-8 years, Salary, Pension and non-interest committed expenditure are being discharged from revenue receipts of the Government.

1.5 Some States have provided for legal limits on Guarantees. What has been their experience in this regards?

State Government has hardly given any Guarantees since 15 November, 2000. No Guarantee policy has been formed.

2. Transparency

2.1 How do the States define their overall liability? Does their measure include borrowings by State Public Sector undertakings, Special Purpose Vehicles and other equivalent instruments including guarantees where the liability for repayment of principal and / or interest is on State Government?

Jharkhand Government over all liabilities includes public debt, small saving, provident fund and balances under deposits. It also includes guarantees given by the Government. Although, loans and advances given by the Jharkhand Government to State PSU etc. are defined as assets of the Government. But practically, Loans and Guarantees are the liabilities of the Government. Apart from Loans & Advances to Government Servants as House Building advances, Motor Car Advances etc., almost nil recovery is made.

2.2 What are States' views on voluntary disclosures of off -budget borrowing and contingent liabilities?

Off Budget borrowing viz. guarantees should be disclosed to evaluate actual financial health of the Government.

2.3 More specifically. Do States collect and report information on public private partnership and off-budget vehicles in a comprehensive manner?

Not properly or in a structured manner. State Government needs to develop such practice in near future which may be included in modified FRBM.

2.4 There are concerns expressed that the increasing reliance on PPP (annuity) projects has arisen as a way of circumventing the fiscal deficit targets. in this context, how do states view such commitments and how should the annuity payments be properly reflected in the Budget documents?

PPP annuity projects are very few in Jharkhand. Hence, comments on its effects and actual outcome will be premature. But, the annuity payments are reflected in the budget and accounts

2.5 There are instances where parastatals/ State PSUs borrow funds from bank and development agencies but repayments and interest payments for these loans are made from the Budget. However, these loans are sometimes outside the State's debt limit. Moreover, the repayment of these amounts by State Governments is reported as "Repayments of loans" rather than grant-in-aid to the borrowing entity. In the view of the States, how can FRL provisions ensure that such instances of misrepresentation in the Budget are avoided?

There is no such case in Jharkhand. The repayment of the liabilities of State PSUs etc. by the State Government in respect of funds borrowed from Bank should be either recorded as grants to PSU or Loans to PSU. Recording such transaction as repayment of loans will be depicted as adverse balance in the State Finance Accounts.

2.6 The classification of expenditure as "Capital and Revenue" is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as "bad" has led to the neglect of maintenance of assets which is revenue expenditure. If so what are the options which could be considered to ensure that adequate funds are earmarked for maintaining capital assets?

Maintenance of capital assets is always considered as "Revenue expenditure". But if such expenditure indicated creation of capital assets or upgradation of quality of the assets, the same can be classified under Capital section.

2.7 Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the State Legislature a statement on adherence to the State FRL and also setting forth a 3 year rolling target which outlines for the ensuring year important policies pertaining to taxation, expenditure, market borrowings and other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure.

No comment. After FRBM Act is passed by the Legislature, State Government has to place fiscal performance report in the Budget session each year.

2.8 Will the State Government have any difficulty in complying with the aforesaid stipulations in a modified State FRL?

No comment.

3. Impact on FRLs on Development Expenditure

3.1 The working assumption underlining the FRL process has been that the purposes of public expenditure (other than for Consumption and for investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro management of development trajectories that are highly state-specific. However, it can be also be argued that FRL targets, indicators and rules should take cognizance of (1) the type and purpose of expenditures undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' view on this important issue.

There is a structured system in State Government to evaluate FRLs on Development Expenditure. Source of financing, performance and outcome of the development expenditure are properly monitored by Planning and Development Department.

4. Public Investment

4.1 States are the prime movers for Public investment. Therefore, it is important to ensure that fiscal space for public investment by States is secured. Does the FRBM architecture adequately provide for sustainability and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regards?

Some provisions of debt sustainability and quality public expenditure have already been included in the FRBM Act. We feel that availability of funds for development expenditure after setting off committed expenditure viz. salary, interest payment, pension, repayment of borrowing etc. are very less in comparison of our plan outlay. The impact of GST will have an important impact on State Finances.

4.2 Going forward, do States think that it will be best to have fiscal constraints that distinguish between borrowing for consumption (revenue expenditure) and alternative ways in which fiscal rules can be crafted to maintain fiscal sustainability while also following adequate fiscal space for public investment?

No comments. State Government believes that more budgetary support is required from the Central Government. After meeting the need of committed expenditure and proving matching grant of central schemes, there are hardly any fiscal space for public investment.

5. Medium Term Fiscal Framework

5.1 A medium term fiscal framework presents multi-year budget forecasts. It helps fiscal policy to a stable medium term target around which annual deviations can be planned an MTFF also includes greater transparency and accountability in the budget making process. What are States' views on the scope of the implementation of on MTFF?

Jharkhand Government agrees that multi-year budget forecasts will have greater transparency and accountability in the budget making process.

5.2 Examine the various reporting and operational methodologies to set forth implementable fiscal targets.

After implementation of IFMS, the reporting and operational methodologies to set forth implementable fiscal targets will be clear.

5.3 We should also be interested in whether the State FRL could incorporate measures designed to promote the productivity and efficiency of public expenditure.

No comment.

6. Impact of FRLs on Cash Surpluses of States

6.1 Alongside the improvement in fiscal position of States, there has been a build-up of cash balances with them. These have persisted at high levels since 2004-05. What is the States' view on the rise in their surplus cash balances in the post FRL period?

We agree that there are some cash surpluses after enactment of FRBM.

6.2 Are there alternative investments options for surplus cash balances?

No comment.

6.3 Given that several States have comfortably achieved their FRL targets, why have they preferred to build up cash surpluses than spending on productive purposes such as public investment?

No comment.

7. Annual CAG Audit of State finances

7.1 The comptroller and Auditor General of India publishes annual audit reports of State government finances that are important sources of policy information fir inter-governmental bodies like Finance Commissions. In this context, we would be particularly interested in knowing the States' view on the content and focus and coverage of such reports. How can the audit reports be better shaped to serve the purposes of fiscal responsibility and budget management of States?

The input in the audit report is perfect and it covers almost all areas of state fiscal performances. But reporting standard needs to be revisited to be more friendly for public.

7.2 To what extent can we better use of the CAG Audit Reports of state finance and FRBM compliance reports published by organizations e.g. NIPFP to facilitate and ensure FRBM compliance going forward.

No Comment.

8. The impact of the recommendations of the Fourteenth Finance commission (FFC) on State Finances.

8.1 The FFC has recommended landmark changes in the vertical devolution of States increasing States' share in the divisible pool to 42% points, a rise of 10% points from the recommendations of the Thirteen Finance Commission. Equally radical were the FFCs changes were the FFCs change to formula, governing the horizontal distribution of the divisible pool of central taxes among the states. The committee recognizes that combine implications of these changes, along with the changes in non-FC grants to States would, in combination, have a highly differentiated impact on States. In this context, the Committee would be keen to understand the specific implications of these changes for inter-governmental transfers on State Finances.

A note on impact of FFC on Jharkhand is attached.

8.2 Subject to certain conditions, the FFC has also provided for some flexibility in the states, fiscal deficit target of 0.5% points, over and above their FRL limits. What are states, views on this recommendation? If States' plan to avail of this provision, how does they plan to allocate the extra fiscal space of 0.5% of GSDP among their different expenditure priorities? Do they plan to use the extra fiscal space to incur revenue expenditure or capital expenditure?

Jharkhand Government has already notified some economic measures and restriction of expenditure for extra fiscal space for development expenditure.

9. The impact of the implementation of the Ujwal DLSCOM Assurance Yojana (UDAY) on State Finances.

9.1 Measures that States plan to undertake to ensure transparent fixation of tariff by the State level regulatory authorities.

We may take the opinion of Regulatory commission in this regard.

9.2 Whether States have an accurate quantification of off-budget subsidies to the power sector.

No subsidy has been quantified by the State Government. Rather, Grants in aid to meet gap in resources are given by the State Government.

9.3 How have States planned for the additional burden that will accurate as result of assuming DISCOM debts?

DISCOM debts will have adverse effect on State budget. This will increase debt-revenue ratio of the State Government.

9.4 If States plan to avail of the above mentioned exemption from FRL limits for two years, how have states planned for a transition back to FRL after the end of the exemption period?

State Government will request to exempt DISCOM debts for next plan period. The burden of debt of DISCOMs will certainly state fiscal space and its plan outlay. Financing of plan schemes from debt funds will be very tough after inclusion in FRBM due to debt sustainability policy.

Government of Jharkhand

Planning-cum-Finance Department

Impact of the XIV Finance Commission Recommendations

- Increase in share of Tax Devolution from 32% (FC XIII) to 42%: The State is expected to get a net increase of **Rs. 5620.19 Crore** in 2015-16.
- However, 8 CSS schemes (including BRGF, Rajiv Gandhi Panchayat Shashaktikaran Abhiyaan, 6000 Model Schools etc) are to be delinked from Central support.
- In 24 CSS Schemes, the Centre: State funding pattern will undergo a change with States to contribute higher share.
- There has been a reduction of Rs. 1.34 lakh Crore in the budgeted **Central Assistance to State Plans** in 2015-16. Based on this trend the State is expected to receive Rs. 4705 Crore in 2015-16 against the Rs. 7974.01 BE for 2014-15, a **net deficit of Rs. 3269 Crore.**
- Against the total allocation of Rs. 7238 Crores in the 13th FC award, the State has been allocated a sum of Rs. 10,080 Crore in the 14th FC award period across 4 sectors.

In Crore Rs.

S.No	Particulars	2013-14 (Actual)	2014-15 BE	2015-16 BE
1	Share of Central Taxes	8822.63	10878.61	16498.8
2	Finance Commission-Grants-in-Aid	1232.3	1851.41	1262.57
3	Central Assistance to State Plan	1150.96	7974.01	4705
	TOTAL	**11205.89**	**20704.03**	**22466.37**
Net increase in 2015-16 BE over 2014-15 BE			**1762.34 (8.5%)**	

- Although there is a net increase of 8.5% over BE figures, however, in actual practice BE gets reduced by almost 10-15 % at RE stage. In Union Budget 2014-15, the RE figures for Central Assistance for State Plan has reduced from Rs. 3.38 lakh Crore (BE) to Rs. 2.78 lakh Crore, a drop of around 18%.
- Further, the increase in Share in Central Taxes for the State will be virtually neutralized through the effect of Inflation, Delinking of 8 CSS schemes and reduction in the budgeted Central Assistance to State Plans.
- Schemes such as SSA, Mid-day Meal etc. have been mentioned as "Fully supported by Centre". It may kindly be clarified whether "fully supported" means <u>100% support</u> from GoI or <u>support as per the existing pattern of funding</u>.

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D.O. No. FD 54 DS(B&R)/2016 **Dated: 14th September 2016**

Dear Sir,

With reference to your letter dated 12th July 2016, Chief Secretary to Government has highlighted certain key points that were raised in the meeting held on 27th July 2016, in his letter dated 31st August 2016 (copy enclosed).

State's written response to the issues raised in the Consultation paper on the impact of Sub-National Fiscal Responsibility Legislation on State Finances is enclosed in the form of a detailed Note to this Letter.

With regards,

Yours sincerely,

Shri N.K. Singh
Chairman
FRBM Review Committee
Department of Economic Affairs
Ministry of Finance
New Delhi-110 001

Response of Karnataka to the points raised in Consultation Paper of FRBM Review Committee

1. Impact on State FRLs on the fiscal outcomes of States.
   - The enactment of State FRLs has coincided with a process of fiscal consolidation at the sub national level. After a decade of rising fiscal and revenue deficits in the 1990s, the deficit indicators have demonstrated a marked improvement in the past decade. In this context, how have the extant State FRLs been useful in securing the States' macro-fiscal goals?
   - In recent years, some States have achieved revenue and fiscal deficits that are below their FRL targets. Equally, other States have been unable to comply with their FRL deficit targets. In this context, what is the States' view on the impact of FRLs on the States' ability to efficiently utilise their fiscal space?
   - What has been the States' experience with different types of fiscal rules, i.e. deficit and debt rules? What are the States' views on second-generation fiscal rules such as expenditure ceilings?
   - Specifically, why did some States feel the need to incorporate a debt rule whereas others did not? Moreover, how did States decide the level of their respective debt targets? What the optimum perceived path of debt sustainability?
   - Some States have provided for legal limits on guarantees. What has been their experience in this regard?

Reply:

1. **Karnataka has consistently maintained revenue surplus since 2004-05 and has also maintained fiscal deficit within the statutory ceiling of 3 per cent of GSDP except in 2009-10, when it was permitted to cross that ceiling as a part of fiscal stimulus.**

Statutory binding under the FRL has been effective in ensuring fiscal discipline.

2. **As far as fiscal deficit is concerned, fixing of rigid ceiling on annual borrowing needs to seen in context of natural uncertainties in both revenue mobilization and expenditure. The states typically try to cushion these uncertainties by adopting a conservative fiscal deficit target in the budget. Thereby, they thereby end up foregoing a part of debt resources that would have been otherwise available to them as per the FRL. Therefore, FRL in its present form may not have been that effective when it comes to efficient use of fiscal space by the states. A medium-term target with annual flexibility would be far more efficient.**
3. **Linking of fiscal parameters to GSDP needs to be reviewed. There is uncertainty about the GSDP figure as they are revised many times and we have had a situation where AG even proposed recalculation of fiscal parameters of past years based on subsequently revised GSDP figures. Assumption of GSDP as a proxy for the State's tax generating capacity has its own limitation as it depends on the structure of the state's economy. There is also delay in the indication of the GSDP figure. Last year it was informed only on 29th March by which time budget was already passed by the State Legislature. Though some certainty was brought in by the 14th Finance Commission methodology, Union Government arbitrarily reduced the figure of State's GDP *by adjusting for GDP growth adopted in the Union budget 16-17.* To avoid all these issues, it is better that the Fiscal ceilings are rather linked to the revenue receipt of a state which represents its debt servicing capability far more closely. Both fiscal deficit and debt stock ceilings may be a suitable multiplier of the last available audited revenue receipt figure.**
4. **Though MTFP is prepared along with the budget, the approach to budgeting still remains annual. The optics of announcing new**

projects and schemes in every budget is expanding committed expenditure to unsustainable levels. To adhere to the statutory fiscal targets, there is under-provisioning, resulting in inefficient outcomes like pending bills and slow projects. Second generation fiscal reforms like expenditure ceilings should be actively explored. For example, the total size of capital program including ongoing works could be a multiplier of its annual budget. This multiplier can be based on the average time required for implementation. Similarly, new revenue schemes should be considered only based on resources available after accounting for all ongoing committed expenditure.

5. **The Karnataka ceiling of Government Guarantee Act (KCGGA) 1999 provides for a cap on outstanding guarantees extended by the Government as at the end of any year at 80% of the State's revenue receipts of the second preceding year. This cap has never been breached. Recently, State decided to set up Guarantee Redemption Fund in the Public Account. While further refinements like inter-se sectoral allocation of guarantee cap, risk weighted guarantee commission is not yet done, the Act has helped to contain the exposure to relatively risky guarantees.**

2. Transparency

- How do States define their overall liability? Does their measure include borrowings by State Public Sector Undertakings, Special Purpose Vehicles, and other equivalent instruments including guarantees where the liability for repayment of principal and/or interest is on the State Government?
- What are States, views on voluntary disclosures of off-budget borrowing and contingent liabilities?
- More specifically, do States collect and report information on public-private partnerships and other off-budget vehicles in a comprehensive manner?
- There are concerns expressed that the increasing reliance on PPP (annuity) projects has arisen as a way of circumventing the fiscal deficit targets. In this context, how do States view such commitments and how should the annuity payments be properly reflected in the Budget documents?
- There are instances where parastatals/State PSUs borrow funds from banks and development agencies but the repayments and interest payments for these loans are made from the Budget. However, these loans are sometimes outside the State's debt limit. Moreover, the repayment of these amounts by State Governments is reported as 'repayment of loans' rather than grant-in aid to the borrowing entity. In the view of the States. How can FRL provisions ensure that such instances of misrepresentation in the Budget are avoided?
- The classification of expenditure as 'capital' and 'revenue' is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as bad has let to the neglect of maintenance of assets which is revenue expenditure. If so what are the options which could be considered to ensure that adequate funds are earmarked for maintaining capital assets?

- Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the State Legislature a statement on the adherence to the State FRL and also setting forth a 3 year rolling target which outlines for the ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure.

Reply:

1. **The unique feature of KFRA is that the total liabilities (TL) are inclusive of not only the liabilities of the State but also the borrowings by Public Sector Undertakings and Special Purpose Vehicles (SPV) and other equivalent instruments (Off Budget Borrowings) where the liability for repayment is on the State Government. The State discloses the details of off budget borrowings as part of budget documents. The disclosures mandated under Section 5 (2) (c) of KFRA are made in the MTFP submitted to the Legislature.**
2. **Considering that the whole purpose of fixing debt ceiling is to ensure its sustainability in that the state is in a position to repay it without the risk of default, it becomes imperative that it takes into account those liabilities too which while may not be reflected in its books, nevertheless need to be repaid through the state budget. Hence, disclosure of off-budget liabilities and their inclusion in the total liabilities ceiling is the correct approach.**
3. **The classification of repayment of off-budget borrowings as Repayment of Loans may be misrepresentative but at the same time classifying it as a GIA in general may also not be proper. The accounting classification should correctly identify it as meant for repaying a debt by having a suitable minor head for it like exists**

for GIA-salary, GIA-asset creation and GIA-others. This would fall in the domain of the CA&G rather than FRL.

4. **KFRA mandates the State Government, amongst others, to make specific disclosures on tax expenditure/revenue foregone during the year, compliance costs of major State taxes, revenue consequences of capital expenditure, future expenditure commitments on account of major policy decisions during the year and explicit and implicit liabilities in public private partnership (PPPs) initiatives. Karnataka has also constituted a Fiscal Management Review Committee (FMRC) headed by the Chief Secretary to review the fiscal and debt position of the State, progress on the fiscal correction path and advice on the corrective measures as may be necessary.**
5. **It may be advisable to mandate normative approach towards maintenance budget in the FRL itself to discourage an inherent systemic incentive to substitute maintenance with new capital expenditure. Further, it may be necessary to emphasize the importance of user charges as a means to fund proper upkeep of the assets created. A legal obligation in the FRL for life-cycle cost approach that every capital program will disclose its running and maintenance costs and will be accompanied with a commitment that a certain minimum proportion of that will be met from the user charges.**
6. **Medium term fiscal plan projections incorporating the subjects mentioned above are a part of the medium term fiscal plan (MTFP) document.**

3. Impact of FRLs on Development Expenditure

   The working assumption underlining the FRL process has been that the purposes of public expenditure (other than for Consumption and for Investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro-management of development trajectories that are highly state-specific. However, it can also be argued that FRL targets, indicators, and rules should take cognizance of (1) the type and purpose of expenditure undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' views on this important issue.

Reply:

1. **This would fall in much too a subjective domain. Priorities change with the incumbent Government's development agenda and strategies. Therefore, while the principles of fiscal discipline may be a part of FRL, any attempt to attach value to a particular expenditure (as in development and non-development) is not advisable. In fact, it is such value association with revenue expenditure (not good) which is already creating problems.**

4. Public Investment

- Does the FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regard?
- Going forward, do States think that it will be best to have fiscal constraints that distinguish between borrowing for consumption (revenue expenditure) and borrowing for public investment (capital expenditure)? Are there alternative ways in which fiscal rules can be crafted to maintain fiscal sustainability while also allowing adequate fiscal space for public investment?

Reply:

1. **Present FRBM architecture does not impact quality or sustainability of expenditure. Maintenance of fiscal discipline does not guarantee that the quality of expenditure is necessarily good. Issues like adequate value-for-money, most cost-effective solution, over-commitment in works, duplication of schemes, scientific measurement of outcomes of an intervention etc. are not addressed. Though inclusion of such expenditure rules in a statute is a debatable proposition, states may be encouraged to consider adopting some good principles. One way could be to have a provision in the FRL that each new government will notify the principles that will govern its expenditure during its tenure.**
2. **It has become increasingly necessary that the values associated with revenue and capital expenditure are revisited. These may have been derived from commercial accounting principles and may not be exactly relevant to public expenditure. Investment in public expenditure needs to be look at not just physical assets but also social assets. Both contribute to development equally. Direct financial returns from physical assets are miniscule and they are justified on the grounds of overall economic returns (a**

road connection to a village improves the economic linkages). Such being the case, investment even in the social assets (education, health, skill development) are justifiable on the same ground (more productive labour force, more responsible and aware citizenry).

3. **Therefore, the issue whether revenue surplus is indeed a target to be adhered to becomes relevant. Of course, if an open-ended approach is adopted and all the revenue expenditure is freely allowed to be spent using borrowed resources, then it may turn out to be unsustainable. Therefore, there may be need to further refine the definition of revenue expenditure to separate out certain items in social sector expenditure and allow them to be funded using borrowed resources. For example, items that contribute to creation and up-gradation of social assets, grant-in-aid to local bodies for creation of assets etc. This will require redefining revenue surplus as {Revenue Receipt - (Revenue expenditure less expenditure on allowable items)}, which should be always maintained positive.**

term goals. MTFP remains largely a background paper and is hardly used as a benchmark to evaluate the budget, which continues to remain a standalone document. Till this basic structure is revised and this incentive system is fundamentally challenged, implementation of MTFP will remain a question mark.

6. Impact of FRLs on Cash Surpluses of States

- What is the State's view on the rise in their surplus cash balances in the post-FRL period?
- Are there alternative investment options for surplus cash balances?
- Given that several States have comfortably achieved their FRL targets, why have they preferred to build up cash surpluses rather than spending on productive purposes such as public investment?

Reply:

Cash management is an integral part of the public finance management. The cash balance of the State is maintained by Central Accounts Section (CAS) of RBI in Nagpur. State has not availed of any Special Ways and Means Advances (SWMA) or Normal Ways and Means Advances (NWMA) from RBI since the year 2007-08. Even in the current year, there may not be any necessity to operate SWMA / NWMA due to reasonably comfortable cash position. Presently cash surpluses above the minimum prescribed limit by RBI are automatically invested in Government of India 14-day Treasury Bills. However these have very low yields varying from 5-6 per cent. Hence additional cash balance available over and above anticipated requirement, is not kept idle and is being invested in 91 day Government of India Treasury Bills.

Based on RBI's request, State has been estimating the timing of its Open Market Borrowing by communicating an advance indicative calendar for borrowings. This enables the market to arrange for funds in advance while subscribing to State Development Loans (SDLs). State in turn gets the benefit of favourable interest rates. However, it also meant that the State was availing market borrowings even in the 1st & 2nd quarters more from the point of utilization of the approved limit so that Government of India concurrence for the balance amount could be sought, rather than the actual need.

7. Annual CAG audits of State finances

- In this context, we would be particularly interested in knowing the State's views on the content and focus, and coverage of such reports. How can the audit reports be better shaped to serve the purposes of fiscal responsibility and budget management of States?
- To what extent can we make better use of the CAG audit reports of state finance and FRBM compliance reports published by organizations like NIPFP to facilitate and ensure FRBM compliance going forward?

Reply:

It is important to align the audit system to various modern fiscal concepts including those in the FRL. For example, while AG does not agree with separate investment of balances under various reserve funds, the issue of built up of cash balances is repeatedly brought out in audit reports. The audit paras have even included objection on the use of reserve funds for fiscal management. Focus of audit needs to change its from fault finding approach to systemic improvement. This may require effective involvement of senior officers of C&AG in the audit process.

While academic organizations may be used to support fiscal policy formulation and decision making, there is a need to bridge the gap between their academic knowledge and their understanding of operational aspects. There can be better value addition from their inputs if their association with governments is more regular rather than only for a particular study or generation of a particular report. Hands-on exposure of the researchers to various practical issues should complement their conceptual understanding to generate outputs of credibility.

8. The impact of the recommendations of the Fourteenth Finance Commission (FFC) on State Finances

Subject to certain conditions, the FFC has also provided for some flexibility in the States' fiscal deficit target of 0.5 percentage points, over and above their FRL limits. What are the States' views on this recommendation? If States' plan to avail of this provision, how do they plan to allocate the extra fiscal space of 0.5 percent of GSDP among their different expenditure priorities? Do they plan to use the extra fiscal space to incur revenue expenditure or capital expenditure?

Reply:

We welcome this flexibility as we had ourselves argued for it in our memorandum to the 14th Finance Commission. However, this flexibility is practically not of much use unless initial revenue surplus is sufficiently high or the capital investment to be made by this borrowing quickly translates into a substantial tax revenues for the state. Otherwise, additional borrowing space above 3% may be utilised for a year or two and subsequently, stress on revenue surplus on account of interest payment may actually force the state to borrow much less than 3% itself. It may end up effectively being in the nature of advance borrowing on year-to-year basis rather than being source of net additional resources.

Some of the issues that have had a negative impact on the revenue surplus are as below.

(a) <u>Uncertainty in the quantum of devolution</u>

We had submitted to the 14th Finance Commission that there should be minimum floor of resources to be mandatorily transferred to the states to help improve the state finances. We have received Rs.7843 Crores less than when compared to the projections by the 14th Finance Commission in the first two years of the award period itself.

(b) <u>Indian Government Accounting Standard (IGAS) - 2</u>

As per IGAS-2, grants to the local bodies are to be shown as revenue expenditure even if they are used for capital investment, this creates further stress on the revenue budget. They may either be allowed to be classified as capital expenditure or should be classified as transfer from the state budget, not included in its revenue expenditure for revenue surplus calculation.

(c) <u>Statutorily obligatory expenditure</u>

The subsidies which arise because of specific central legislations should be borne by the Centre and there should not be any sharing of these subsidies with the States. Our experience with MNREGA and RTE Act is not very positive both in terms of quantum and timeliness of release of grants. Since the expenditure is an obligation, the gap is being met by the state government itself further reducing revenue surplus.

Addressing the above issues will help to generate enough revenue surplus to enable it to make effective use of this flexibility.

- **Existing bank/FI loans of ESCOMs will simply be substituted with Government grant. There is no additional resource implication to enable the ESCOMs to clear the dues of the KPCL.**

While it does not solve our real power sector problem, it has other serious implications as below.

Issues with Power Sector Reforms

3. The scheme contradicts certain basic principles of power sector reforms as explained below-

(i) Viability of power utilities

A fundamental measure of viability of power sector is the ability to recover investment through future revenues. Proposing taking over of these loans by the State Government defeats the very purpose of this reform.

(ii) User pays principle

Presently, the regulator takes into account debt servicing cost while determining tariff. If the State Government takes over the loans of ESCOMs, this loan will be repaid by the tax revenues of the Government while the tariff will get reduced to that extent. Thereby, power consumer will in effect get subsidized by general tax payers. This kind of opaque subsidizing does not satisfy any economic or financial rationale.

Issues with Fiscal Framework

4. UDAY has serious repercussions for the fiscal framework of the Government.

(i) Use of borrowing to fund revenue expenditure

Fiscal Responsibility Act prohibits use of borrowing to fund revenue expenditure.

(ii) Impact on Revenue Surplus

Grant to ESCOMs as proposed will be a net additional revenue expenditure not supported by any additional revenue receipts. Therefore, it may result in revenue deficit as present revenue surplus itself is marginal. To avoid this situation, revenue resources for other sectors will need to be curtailed.

(iii) Reducing Fiscal Flexibility

The scheme guideline proposes that "debt taken over by the State under the scheme will not be accounted against fiscal deficit limit of the respective state in the FY 2015-16 and 16-17". But it ignores long term impact of this loan-

- **There will be interest outgo over the tenure of the loan (usually 10 years) which will need to be paid from the State's tax revenues.**
- **This loan will be a perpetual part of State's total outstanding liability which currently stands at 24.57% of the GSDP. 75% of long-term and short-term loans of ESCOMs amounting to Rs.9664 Crores will add another 0.98% to this ratio, which will have following implications-**
    - **TOL: GSDP ratio will exceed legally mandated ceiling of 25%.**
    - **The flexibility provided by the 14th Finance Commission of borrowing up to 0.25% over and above 3% annual fiscal deficit ceiling will not be available to the State.**

(iv) Changing the constraining condition

- **Presently borrowing by the ESCOMs is done as per their financials within the Regulator's oversight. UDAY instead seeks to constraint it within Government's statutory fiscal ceilings.**

- **Moreover, borrowings by power utilities are considered as Extra Budgetary Resources (EBR) of the State's Plan. Bringing that back on the Government books will defeat the very purpose of EBR.**

On both the grounds, the logic of this change is unclear.

ARVIND JADHAV
CHIEF SECRETARY
ಮುಖ್ಯ ಕಾರ್ಯದರ್ಶಿ

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No: FD/3608/PS/2016 31st August 2016

Dear Sir,

With reference to you letter dated 12th July 2016, I wish to highlight a few points that I had raised in the meeting on the 27th July.

1. Karnataka has consistently adhered to the parameters laid down under Fiscal Responsibility Act, (KFRA)
    (a) Maintaining revenue surplus,
    (b) Keeping fiscal deficit within 3% of GSDP
    (c) Keeping the total outstanding liabilities to within 25% of GSDP.
    (d) The off-budget liabilities for which servicing is done from the state budget are included in the figure of total outstanding liabilities to bring complete transparency.

2. One of our major concerns is that a very marginal revenue surplus directly impacts our ability to invest in infrastructure. Some of the issues that have had a negative impact on the revenue surplus are as below.

    (a) <u>Uncertainty in the quantum of devolution</u>

    We had submitted to the 14th Finance Commission that there should be minimum floor of resources to be mandatorily transferred to the states to help improve the state finances. We have received Rs.7843 Crores less than when compared to the projections by the 14th Finance Commission in the first two years of the award period itself.

    (b) <u>Indian Government Accounting Standard (IGAS) - 2</u>

    As per IGAS-2, grants to the local bodies are treated as revenue expenditure even if used for capital investment, this creates further stress on the revenue budget. I suggest that either it may be allowed to be classified as capital expenditure or it should be classified as transfer from the state budget and not included in its revenue expenditure.

(c) Statutorily obligatory expenditure

The subsidies which arise because of specific central legislations should be borne by the Centre and there should not be any sharing of these subsidies with the States. Our experience with MNREGA and RTE Act is not very positive both in terms of quantum and timeliness of release of grants. Since the expenditure is an obligation, the gap is being met by the state government itself further reducing revenue surplus.

3. Linking of fiscal parameters to GSDP needs to be reviewed. There is uncertainty about the GSDP figure as they are revised many times and AG even proposed recalculation of fiscal parameters of past years based on subsequently revised GSDP figures.

   There is also delay in the indication of the GSDP figure. Last year it was informed only on 29th March. Moreover, our GSDP figure for the current financial year was reduced by adjusting for GDP growth adopted in the Union budget 16-17.

   To avoid all these issues, we suggest that the Fiscal Liabilities ceiling may rather be linked to the revenue receipt of a state which correctly represents its debt servicing capability.

4. Debt related issues

   (a) Exchange risk for the Externally Aided Projects should be borne by the Centre since it is in a better position to bear this risk.

   (b) We have already conveyed our position in favour of discontinuing the operation of National Small Savings Fund (NSSF) scheme in line with the recommendations of 14th Finance Commission. It arises both from out of a relatively higher rate of interest compared to other borrowings by the state and also on account of uncertainty in the quantum of its disbursal which has a bearing on our fiscal management.

5. We welcome Fiscal flexibility as recommended by the 14th Finance Commission. However, this flexibility is practically not of much use unless the initial revenue surplus is sufficiently high. Addressing our suggestions at 2 above will help the state to generate enough revenue surplus to enable it to make use of this flexibility.

We are separately preparing a detailed response to the issues raised in the Consultation Paper sent by you and will be sending it shortly.

With warm regards.

Yours sincerely

(ARVIND JADHAV)

Sri N K Singh
Chairman
FRBM Review Committee
Department of Economic Affairs
Ministry of Finance
New Delhi 110001.

Kerala

- The FRBM Acts fix responsibility on the Government to reduce Fiscal Deficit to bring transparency in fiscal operations of the Government. However, the economic situation has changed drastically following the global turmoil and its impact in the economies of the States, particularly Kerala. In this period of turbulence in the global economy when governments ought to adopt a counter- cyclical fiscal policy.
- Many States have reduced their deficit targets by compressing developmental expenditure. This would adversely affect the economic growth.
- State is not able to reduce revenue expenditure beyond a point because of its commitments in the social sectors and increase in salary, pension commitments. This put enormous pressure on the finances of the State and adhering to the FRBM Act leaves little space for raising resources for development expenditure.
- We would, therefore, urge the committee to review the FRBM Act and revise the FRBM targets for the State
- Irrespective of the level of savings in the economy, the Act restrict the State to borrow from the economy only to the extent 3% of the GSDP. This is very low. The increase in public investment helps to increase the level of effective demand and increases private investment in the economy.
- The rising level of debt and commitments on interest payments, reduce the capacity of State to widen the much needed fiscal space for improving the quality of public services and invest in development infrastructure.
- Keeping the debt stock at manageable levels is therefore crucial from the point of view of achieving budgetary control and attracting more private investment to accelerate and sustain economic growth.
- In the current FRL there is a ceiling on debt accumulation, but there is not a specific target on the stock of debt.
- Since public investment on infrastructure sector is essential to boost economic growth the Fiscal Deficit to GSDP should be range bound say 4-6%. If the Government Fiscal Deficit is restricted to 3% it is the capital expenditure which will be sacrificed and thus will hinder further development of the State. Fiscal Deficit range would give necessary policy space to the government to deal with dynamic situations.
- The Kerala ceiling on Government Guarantees Act (Amendment) 2015 stipulate that the total outstanding Government Guarantees shall not exceed Rs.21000 crore. The State Government has been able to contain the total outstanding guarantees which stood at Rs. 11127 crore in 2014-15 within the limit prescribed in the Act.
- Fiscal consolidation measures are mainly focused on the expenditure side neglecting the revenue side. In order not to compromise on various pro-poor measures, ceiling on reveneue deficit should not be zero but of 1.5 %.
- Also, a flexible fiscal deficit targets need be fixed so that States will get additional fiscal space for development expenditure.
- A sizable amount of grant provided to LSGIs and other autonomous institutions is meant to create

capital assets and the present accounting standards deter the Government to classify these grants as capital expenditure. From the Budget 2012-13 Central and State Government had adopted a system to compute and incorporate effective revenue deficit after segregating grants for capital nature and deducting it from revenue expenditure. We may, therefore, urge the committee to give proper recognition to the concept of effective revenue deficit as real revenue deficit after factoring in the capital nature of grants so that the effective revenue deficit as proxy would satisfy the revenue deficit target in the roadmap for the fiscal consolidation recommended by the 14th FC.

- We also suggest the Committee to promote small savings and keep it out of the purview of the FRBM borrowing limits due to following grounds :- a) NSSF loan is not an attractive source of borrowing to State Governments as it demands a higher rate of interest compared to other source of borrowing. b) If small savings are not encouraged, small savers may be lured by unauthorized non – banking financial entities. c) National saving is a self employment scheme for rural unemployed women and it needs to be encouraged. Otherwise, the educated unemployed women will lose their chances of livelihood.
- As per the method adopted by erstwhile planning commission other liabilities arising out of public account (except State Provident Fund) are not reckoned in the net borrowings for financing annual plan but other liabilities are now being reckoned by Ministry of Finance in calculating net borrowings for the State. We urge the committee to review this aspect also.
- The existing FRBM Act ignored the logic of correlation between credit expansion and fiscal expansion (Fiscal Deficit) and fixed 3 % fiscal deficit limit. It is time to align monetary and fiscal economics. If bank credit growth falls, fiscal deficit may need to grow up. If bank credit growth rises, fiscal deficit should reduce. Hence, we urge the committee to fix the Fiscal Deficit target linking with growth of economy.
- A sizable amount provided to Local Self Government Institutions and other autonomous institutions is meant to create capital assets and the present accounting standards deter the Government to classify grants as capital expenditure. If proper recognition was given to the concept of effective revenue deficit as real revenue deficit, most of the fiscal targets in the FRBM Act would have been achieved by the state.
- Similarly, certain part of revenue expenditure, which is spent on health and social sector is also regarded as development expenditure. The concept of effective revenue deficit and developmental expenditure in revenue expenditure should be one of the factors in deciding fiscal FRL targets, indicators and rules.
- Even though 14th FC has recommended an enhanced vertical devolution of 42 % from 32 % and horizontal devolution (Kerala's share) of 2.5 %, Union Government kept the gross transfers to States at 61-62% and made commensurate decrease in plan grants to State which pose tremendous threat to State Finances. Hence, it can be seen that State does not benefit much from the landmark devolution package recommended by the 14th FC.
- If Fiscal Deficit is restricted to 3 %, it is the capital expenditure which will sacrifice heavily. This will hinder further development of the State. 14th FC's recommendation to provide some flexibility in the State's fiscal deficit target of 0.5 % points, over and above their FRL limit is a welcome move. However, FRBM review committee may consider certain relaxation in the condition that the flexibility in availing the additional limit under either of the two options or both will be available to

a Sate only if there is no revenue deficit in the year in which borrowing limits are to be fixed and the immediately preceding year so that state will be eligible for availing additional borrowing limit.

- UDAY scheme will not to be attractive to the State. This would considerably reduce the fiscal space available to the State for its developmental expenditure. More over there will be a substantial rise in interest burden of the State due to the taking over of the existing debt burden.
- The State is not able to reduce revenue expenditure beyond a particular point because of its commitments in its social sector and increase in salary, interest payment and pension. These growing commitments put enormous pressure on the finances of the State and adhering FRBM Act leaves little room for raising resource for development expenditure.
- Setting of numerical targets for States needs a revisit, given the significant disparity of financial conditions across India's States. Fiscal conditions and growth prospects of States vary widely. Thus, some states require more fiscal adjustment and/or debt relief than others to achieve a sustainable debt position.
- In India, we have not yet tested expenditure ceiling, in a State like Kerala, committed more on social sector expenditure and other committed expenditure, limits on nominal growth of spending may not be possible.
- State like Kerala is not able to eliminate the revenue deficit and reduce fiscal deficit to as stipulated in the FRBM Act because of its commitments in social sector and increase in non-plan revenue expenditure. Moreover, more than 60% of State's annual plan expenditure constitutes revenue expenditure. Hence, it is high time to stipulate a second generation fiscal rule like expenditure ceiling. We urge the committee to stipulate a statutory fiscal target on capital expenditure to an appropriate multiple of annual plan size in the FRBM Act so that State can achieve fiscal targets set forth in the FRBM Act by ensuring fiscal discipline.
- State's overall liability includes open market borrowings negotiated loans from Financial institutions, NSS Fund Loans, Central Government Loans including EAPs, any loan from State plan schemes and CSS, other liabilities arising out of public account transfers under small savings, Provident Funds , Reserve Funds, Deposits etc
- Bridging the infrastructure deficit will be one of the foremost critical priorities of Government. Given the limited range of fiscal choices available to the state there is a limit to the quantum of capital expenditure, State can carry within the budget itself. Therefore, State will make use of innovative methods adopted by countries all over the world and by many of our states who are ahead in building their public infrastructure.
- This requires mobilizing off- budgetary resources through the various financial and infrastructure institutions in the State for taking up and completing major capital projects that the State badly needs. This strategy will be disclosed by the State in the annual budget in the coming years.
- Initial steps are being taken to create a database on PPP projects implemented in the State by linking 'Planscape' State plan monitoring interface. Most of the PPP projects implemented in the state are on BOT-Toll/Lease mode. Only few projects are implemented on annuity mode of which annuity/ payments are properly provided in the State budget.
- State Government has constituted a Asset Maintenance Fund to ensure timely renovation and maintenance of assets created by State Government.

Comments and Suggestions on the Terms of Reference (ToR) of the FRBM Committee:

I. ***To 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 of the global economy.***

The suggestion to review the working of the FRBM Act is a most welcome ToR. Of course, the FRBM Acts fix responsibility on the Government to reduce Fiscal Deficit to bring transparency in fiscal operations of the Government. However, the economic situation has changed drastically following the global turmoil and its impact in the economies of the States. Many of the states have reduced their deficit targets, complying with the fiscal responsibility legislations by compressing developmental expenditure. Thus, attempt to reach sustainable deficit levels complying with the fiscal responsibility legislations would adversely affect the economic growth of the State, especially in this period of turbulence in the global economy when governments ought to adopt a counter- cyclical fiscal policy. Therefore, working of existing FRBM Act need to be reviewed from a larger perspective. For the last decade concerted efforts are being made by the State towards fiscal consolidation with specific focus on the elimination of revenue deficit and reduction of fiscal deficit. But State is not able to reduce revenue expenditure beyond a point because of its commitments in the social sectors and increase in salary, pension commitments. This put enormous pressure on the finances of the State and adhering to the FRBM Act leaves little space for raising resources for development expenditure.

We would, therefore, urge the committee to review the FRBM Act and revise the FRBM targets for the State in such a way that:

- Irrespective of the level of savings in the economy, the Act restrict the State to borrow from the economy only to the extent 3% of the GSDP. This is very low. The increase in public investment helps to increase the level of effective demand and increases private investment in the economy.

- Since public investment on infrastructure sector is essential to boost economic growth the Fiscal Deficit to GSDP should be range bound say 4-6%. If the Government Fiscal Deficit is restricted to 3% it is the capital expenditure which will be sacrificed and thus will hinder further development of the State. Fiscal Deficit range would give necessary policy space to the government to deal with dynamic situations.

- Fiscal consolidation measures are mainly focused on the expenditure side neglecting the revenue side. If revenue deficit has to be reduced to zero, it can only by compromising various pro-poor measures. Hence, a ceiling of 1.5 % may be stipulated for the revenue deficit instead of insisting its elimination and fiscal deficit targets can be fixed with a flexible fiscal deficit range instead of fixed numbers as explained in the comments of 3rd ToR.

II. To look into various aspects, factors, considerations going into determining the FRBM targets.

A sizable amount of grant provided to LSGIs and other autonomous institutions is meant to create capital assets and the present accounting standards deter the Government to classify these grants as capital expenditure. From the Budget 2012-13 Central and State Government had adopted a system to compute and incorporate effective revenue deficit after segregating grants for capital nature and deducting it from revenue expenditure. **We may, therefore, urge the committee to give proper recognition to the concept of effective revenue deficit as real revenue deficit after factoring in the capital nature of grants so that the effective revenue deficit as proxy would satisfy the revenue deficit target in the roadmap for the fiscal consolidation recommended by the 14th FC.**

we also suggest the Committee to promote small savings and keep it out of the purview of the FRBM borrowing limits due to following grounds :-

a) NSSF loan is not an attractive source of borrowing to State Governments as it demands a higher rate of interest compared to other source of borrowing.

b) If small savings are not encouraged, small savers may be lured by unauthorized non – banking financial entities.

c) National saving is a self employment scheme for rural unemployed women and it needs to be encouraged. Otherwise, the educated unemployed women will lose their chances of livelihood.

As per the method adopted by erstwhile planning commission other liabilities arising out of public account (except State Provident Fund) are not reckoned in the net borrowings for financing annual plan but other liabilities are now being reckoned by Ministry of Finance in calculating net borrowings for the State. We urge the committee to review this aspect also.

III. 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: if so, the specific recommendations of the committee thereon; and

The enactment of FRBM Act and its adherence has arisen some issues as most of the States are not able to meet the obligations laid down by the Act. The State is of the view that this ToR suggesting the need and feasibility of having a fiscal deficit range is in the right direction. **We would therefore urge the committee to recommend a fiscal deficit range in place of the existing fixed number (% of GSDP) as fiscal deficit target so that States will get additional fiscal space for development expenditure.**

IV. To examine the need and feasibility of aligning the fiscal expansion or contraction with 'credit contraction or expansion' respectively, in the economy.

The suggestion in this ToR will have impact on the economics of Central and State and hence it is a welcome ToR. The existing FRBM Act ignored the logic of correlation between credit expansion and fiscal expansion (Fiscal Deficit) and fixed 3 % fiscal deficit limit. It is time to align monetary and fiscal economics. If bank credit growth falls, fiscal deficit may need to grow up. If bank credit growth rises, fiscal deficit should reduce. **Hence, we urge the committee to fix the Fiscal Deficit target linking with growth of economy.**

Comments/Reviews on issues raised in the consultation paper of FRBM Review Committee

1. Impact on State FRLs on the fiscal outcomes of States

The FRBM Acts served a useful purpose in bringing about some discipline in resource mobilization and spending. The attempt to reach sustainable deficit levels complying with the fiscal responsibility legislations would adversely affect the economic growth of the State, especially in this period of turbulence in the global economy when governments ought to adopt a counter- cyclical fiscal policy. For the last decade concerted efforts are being made by the State towards fiscal consolidation with specific focus on the elimination of revenue deficit and reduction of fiscal deficit. But state has not been able to achieve the target to reduce revenue deficit nil by 2014-15 and to keep the Fiscal Deficit at the prescribed level of 3 % of the GSDP as envisaged in the FRBM Act. This is mainly attributed to the fact that the State is not able to reduce revenue expenditure beyond a particular point because of its commitments in its social sector and increase in salary, interest payment and pension. These growing commitments put enormous pressure on the finances of the State and adhering FRBM Act leaves little room for raising resource for development expenditure.

Setting of numerical targets for States need a revisit, given the significant disparity of financial conditions across India's States. Fiscal conditions and growth prospects of States vary widely. Thus, some states require more fiscal adjustment and/or debt relief than others to achieve a sustainable debt position. Therefore, working of existing FRBM Act need to be reviewed from a larger perspective. Fiscal consolidation measures are mainly focused on the expenditure side neglecting the revenue side, but the present FRL have no nominal expenditure path and implied nominal expenditure growth ceilings. If revenue deficit has to be reduced to zero, it can only by compromising various pro-poor measures. Hence, a ceiling of 1.5 % may be stipulated for the revenue deficit instead of insisting its elimination and fiscal deficit targets can be fixed with a flexible fiscal deficit range of 4-6 % instead of fixed numbers. In India we have not yet tested expenditure ceiling, in a state like Kerala, committed more on social sector expenditure and other committed expenditure, limits on nominal growth of spending may not be possible.

State like Kerala is not able to eliminate the revenue deficit and reduce fiscal deficit to 3 % of GSDP as stipulated in the FRBM Act because of its commitments in social sector and increase in non-plan revenue expenditure. Moreover, more than 60 % of State's annual plan expenditure constitutes revenue expenditure. Hence, it is high time to stipulate a second generation fiscal rule like expenditure ceiling. We urge the committee to stipulate a statutory fiscal target on capital expenditure to an appropriate multiple of annual plan size in the FRBM Act so that State can achieve fiscal targets set forth in the FRBM Act by ensuring fiscal discipline.

The rising level of debt and commitments on interest payments, reduce the capacity of State to widen the much needed fiscal space for improving the quality of public services and invest in development infrastructure. Keeping the debt stock at manageable levels is therefore crucial from the point of view of achieving budgetary control and attracting more private investment to accelerate and sustain economic growth. The State has always been able to achieve the debt targets prescribed by the finance commissions. In the current FRL ***there is a ceiling on debt accumulation, but there is not a specific target on the stock of debt.***

Kerala is one of the first state to enact legislation to cap Government guarantees to contain contingent liabilities. The Kerala ceiling on Government Guarantees Act (Amendment) 2015 stipulate that the total outstanding Government Guarantees shall not exceed Rs.21000 crore. The State Government has been able to contain the total outstanding guarantees which stood at Rs. 11127 crore in 2014-15 within the limit prescribed in the Act. This, in turn, has helped the State to ensure fiscal discipline in issuing guarantees to its PSEs and contain contingent liabilities to a great extent.

2. Transparency

a) State's overall liability includes open market borrowings negotiated loans from Financial institutions, NSS Fund Loans, Central Government Loans including EAPs, any loan from State plan schemes and CSS, other liabilities arising out of public account transfers under small savings, Provident Funds , Reserve Funds, Deposits etc as reflected in the statement 6 of the State's finance accounts.
b) Bridging the infrastructure deficit will be one of the foremost critical priorities of Government. Given the limited range of fiscal choices available to the state there is a limit to the quantum of capital expenditure, State can carry within the budget itself. Therefore, State will make use of innovative methods adopted by countries all over the world and by many of our states who are ahead in building their public infrastructure. This requires mobilizing off- budgetary resources through the various financial and infrastructure institutions in the State for taking up and completing major capital projects that the State badly needs. This strategy will be disclosed by the State in the annual budget in the coming years. Contingent liabilities arising out of guarantees given by the state Government is depicted in the statement No. 9 of State's finance accounts.
c) Initial steps are being taken to create a database on PPP projects implemented in the State by linking 'Planscape' State plan monitoring interface.

d) Most of the PPP projects implemented in the state are on BOT-Toll/Lease mode. Only few projects are implemented on annuity mode of which annuity/payments are properly provided in the State budget.
e) Such practice does not exist in the State.
f) State Government has constituted a Asset Maintenance Fund to ensure timely renovation and maintenance of assets created by State Government.

3. Impact on FRLs on Development Expenditure

A sizable amount provided to Local Self Government Institutions and other autonomous institutions is meant to create capital assets and the present accounting standards deter the Government to classify grants as capital expenditure. Taking a cue from the centre a system has been evolved to compute and incorporate effective revenue deficit after segregating grant's of capital nature and deducting it from the revenue expenditure. If proper recognition was given to the concept of effective revenue deficit as real revenue deficit, most of the fiscal targets in the FRBM Act would have been achieved by the state. Similarly, certain part of revenue expenditure, which is spent on health and social sector is also regarded as development expenditure. The concept of effective revenue deficit and developmental expenditure in revenue expenditure should be one of the factors in deciding fiscal FRL targets, indicators and rules.

4. Public Investment

Many of the states have reduced their deficit targets, complying with the fiscal responsibility legislations by compressing developmental expenditure. Thus, attempt to reach sustainable deficit levels complying with the fiscal responsibility legislations would adversely affect the economic growth of the State, especially in this period of turbulence in the global economy when governments ought to adopt a counter- cyclical fiscal policy. Therefore, working of existing FRBM Act need to be reviewed from a larger perspective. The existing FRBM Act ignored the logic of correlation between credit expansion and fiscal expansion (Fiscal Deficit) and fixed 3 % fiscal deficit limit. It is time to align monetary and fiscal economics. If bank credit growth falls, fiscal deficit may need to grow up. If bank credit growth rises, fiscal deficit should reduce. Hence, we urge the committee to fix the Fiscal Deficit target linking with growth of economy so that States will get additional fiscal space for development expenditure.

5. Medium term fiscal framework

In the medium term fiscal framework multi-year budget forecast is made on the basis of TGR of last three years accounts. Despite consorted efforts, the State is not able to achieve the fiscal targets set forth in the MTFF due to growing commitment on Non plan revenue expenditure and recent declining trend in State's own Tax Revenue.

6. Impact of FRLs on Cash Surpluses of States

Even in the post FRL period the State has not been a State with surplus cash balance due to its peculiar socio-economic nature.

7. Annual CAG audits of State Finances

Despite various observations on State finances in the report, C&AG has not made any creative suggestions for achieving the purposes of fiscal responsibility and budget management of the State.

8. The impact of the recommendations of the Fourteenth Finance Commission (FFC) on State Finances

Even though 14th FC has recommended an enhanced vertical devolution of 42 % from 32 % and horizontal devolution (Kerala's share) of 2.5 %, Union Government kept the gross transfers to States at 61-62% and made commensurate decrease in plan grants to State which pose tremendous threat to State Finances. Hence, it can be seen that State does not benefit much from the landmark devolution package recommended by the 14^{th} FC.

If Fiscal Deficit is restricted to 3 %, it is the capital expenditure which will sacrifice heavily. This will hinder further development of the State. 14^{th} FC's recommendation to provide some flexibility in the State's fiscal deficit target of 0.5 % points, over and above their FRL limit is a welcome move. However, FRBM review committee may consider certain relaxation in the condition that the flexibility in availing the additional limit under either of the two options or both will be available to a Sate only if there is no revenue deficit in the year in which borrowing limits are to be fixed and the immediately preceding year so that state will be eligible for availing additional borrowing limit.

9. The impact of the implementation of the UJWAL DISCOM assurances Yojana (UDAY) on the State Finances.

The state is of the view that, UDAY scheme will not to be attractive to the State, due to the reason that State finances would be stressed on account of the liabilities due to takeover of 75 % of the existing debt of Kerala State Electricity Board Limited. This would considerably reduce the fiscal space available to the State for its developmental expenditure. More over there will be a substantial rise in interest burden of the State due to the taking over of the existing debt burden of the Kerala state Electricity Board. This in turn will unfavourably impact the fiscal balances, thereby destabilizing fiscal outcomes and resulting in a deviation from the fiscal consolidation path as well as the targets set by the 14th Finance Commission.

Nagaland

	Point discussed in the Consultation Brief	Our position
1. **Impact of State FRLs (Fiscal Responsibility Legislations) on the fiscal outcomes of States**		
1.1	The enactment of State FRLs have coincided with a process of fiscal consolidation at sub-national level. After a decade of rising fiscal and revenue deficits in the 1990s, the deficit indicators have demonstrated a marked improvement in the past decade (see Figures 2(a) and Figure 2(b) in Annexure). In this context, how have the extant State FRLs been useful in securing the States' macro-fiscal goals?	We do furnish, every year, an overview of the State economy indicating the GSDP, the State's Receipts & expenditure, the State's Debt position for a number of preceding years. Some analysis as to the growth of the receipt/expenditure and composition of various factors are also provided. However, it must be admitted that we have not been able to really analyse the GSDP and take concrete steps to obtain higher growth etc. Similarly, though efforts have been made to enhance the State's revenue receipts from time to time, no time-bound implementable programme to obtain a sustainable growth either in the medium or in the long term could be framed or pursued. Same is the position in so far as the State's expenditure is concerned. Though efforts have always been made to curtail the expenditure to the barest minimum level, success in this field is elusive. The Target of containing the State Debt Stock within the permissible limit has been fulfilled by and large, mainly because the net borrowing each year has been restricted within the prescribed limit (% of GSDP). Nothing has been done or is likely to be done in the area of analysing the future financial prospect of the State. The prevailing situation does not appear to be conducive to such action.
1.2	In recent years, some States have achieved revenue and fiscal deficits that are below their FRL targets. Equally, other States have been unable to comply with their FRL targets. In this context, what is the States' view on the impact of FRLs on the States' ability to efficiently utilise their fiscal space?	We have been able to achieve the revenue deficit targets mainly because we receive large revenue deficit grants, share in central taxes and also central grant for CSS etc, which are revenue receipts. A large part of these revenue receipts being applied towards capital expenditure, revenue surplus do occur. This has not, however, been the case for Fiscal Deficit targets. Though we restrict the annual borrowing within the prescribed ceiling, the huge budgetary deficit results into financing the State expenditure with the WMA from RBI which adds to the fiscal deficit. However, in some years, the fiscal deficit comes below the target because of non-utilisation of revenue receipts (mainly grants for CSS etc) within the same financial year. The accounts exhibit figures which are not real.
1.3	What has been the States' experience with different types of fiscal rules, i.e. deficit and debt rules? What are the States' views on second-generation fiscal rules such as expenditure ceilings?	We do not have these rules yet.

1.4	Specifically, why did some States feel the need to incorporate a debt rule whereas others did not? Moreover, how did States decide the level of their respective debt targets? What the optimum perceived path of debt sustainability?	We have no comments.
1.5	Some States have provided legal limits on guarantees. What has been their experience in this regard?	We have kept our guarantees within the FRBMA limits, and have not faced any difficulty.
2. Transparency		
2.1	How do the States define their overall liability? Does their measure include borrowings by State PSUs, Special Purpose Vehicle and other equivalent instruments including guarantee where liability for repayment of principal and/or interest is on the State Government?	We include only the borrowings directly made by the State Government. We also include the guarantees. The borrowings of PSUs are not taken into account. We do not have SPV or any other similar instrument of borrowing.
2.2	What are States' views on voluntary disclosures of off-budget borrowing and contingent liabilities?	We do not resort to any off-budget borrowings.
2.3	More specifically, do States collect and report information on public private partnerships and other off-budget vehicles in a comprehensive manner?	We do not have any PPP project yet.
2.4	There are concerns expressed that the increasing reliance on PPP	We do not have any PPP project yet.
2.5	There are instances where parastatals/State PSUs borrow funds from banks and development agencies but the repayment and interest payments for these loans are made from the Budget. However,, these loans are sometimes outside the State's debt limit....	We do not allow such borrowings by State PSUs.
2.6	The classification of expenditure as 'capital' and 'revenue' is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as 'bad', has led to the neglect of maintenance of assets, which is revenue expenditure. If so what are the options which could be considered to ensure that adequate funds are earmarked for maintenance of capital assets?	There is no use creating assets if they are not maintained. Therefore, the resources available to the State must first be applied to the existing assets and only thereafter funds still available should be applied towards creating new assets. Problem of States like Nagaland is the lack of resources even for proper maintenance of existing assets.
2.7	Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the State Legislature a statement on the adherence to the State FRLs and also setting forth a 3 year	The suggestions are sound, but as for Nagaland it may not be feasible at this stage to bring out any document indicating long term action plan on finances. It may be remembered that we have not been able to publish even the Works Programme. Even when these were published in some years, implementation of the laid

<table>
<tr><td></td><td>rolling target with outlines for ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure</td><td>down programme was not satisfactory.</td></tr>
<tr><td colspan="3">Will the State Government have any difficulty in complying with the aforesaid stipulations in a modified State FRL?: Position indicated above against each proposed stipulation.</td></tr>
<tr><td colspan="3">3. Impact of FRLs on Development Expenditure:

The working assumption underlining the FRL process has been that the purposes of public expenditure (other than for Consumption and for Investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro-management of development trajectories that are highly state-specific. However, it can also be argued that FRL targets, indicators, and rules should take cognizance of (1) the type and purpose of expenditures undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' views on this important issue.
We have no comments to offer on this matter.</td></tr>
<tr><td colspan="3">4. Public Investment: States are the prime movers for public investment (Figure 2). Therefore, it is important to ensure that fiscal space for public investment by States is secured. In this context, the Committee seeks the following information.</td></tr>
<tr><td>4.1</td><td>Does the FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regard?</td><td>We do not have any alternative proposal.</td></tr>
<tr><td>4.2</td><td>Going forward, do States think that it will be best to have fiscal constraints that distinguish between borrowing for consumption (revenue expenditure) and borrowing for public investment (capital expenditure)? Are there alternative ways in which fiscal rules can be crafted to maintain fiscal sustainability while also allowing adequate fiscal space for public investment?</td><td>We are not in a position to comment on this matter.</td></tr>
<tr><td colspan="3">5. Medium Term fiscal framework: A medium term fiscal framework (MTFF) presents multi-year budget forecasts. It helps anchor fiscal policy to a stable medium-term target, around which annual deviations can be planned. An MTFF also induces greater transparency and accountability in the budget making process. In this context, the Committee would like to inquire the following.</td></tr>
<tr><td>5.1</td><td>What are the States' views on the scope of the implementation of an MTFF?</td><td rowspan="3">We are not in a position to offer any specific comment.</td></tr>
<tr><td>5.2</td><td>Examine the various reporting and operational methodologies to set forth implementable fiscal targets</td></tr>
<tr><td>5.3</td><td>We would also be interested in whether the State FRL could incorporate measures designed to promote the productivity and efficiency of public expenditure.</td></tr>
</table>

6	**Impact of FRLs on Cash Surpluses of States.**	We do not have any cash surplus at the closing of any financial year.
7	**Annual CAG audits of State finances**	We have no suggestions for any change.
8	**The impact of the recommendations of the Fourteenth Finance Commission (FFC) on State finances. (increasing States' share in the Divisible pool to 42 per cent)**	The increase in the States' share in divisible pool has no impact on the finances of the States which remain revenue deficit even after devolution.
9	The impact of the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) on State finances.	The scheme has not yet been implemented in Nagaland.

GOVERNMENT OF ODISHA
FINANCE DEPARTMENT
***

No.________________________/F., Dated ________________________
FIN-BUD1-FRBM-003/2016

From

Shri D.K. Jena, IAS,
Joint Secretary to Government.

To

Shri S.R. Raja,
Under Secretary,
FRBM Review Committee,
Department of Economic Affairs,
Ministry of Finance,
Government of India,
New Delhi – 110001
e-mail – raja.sr@nic.in

Sub: **Written response of the State Government to the issues raised in the "*Consultation Brief of the States on the impact of Sub-National Fiscal Responsibility Legislation on State Finances*".**

Sir,

I am directed to send herewith the written response of the State Government to the issues raised in the "Consultation Brief of the States on the impact of Sub-National Fiscal Responsibility Legislation on State Finances".

Yours faithfully,

Joint Secretary to Government

Odisha

- Impact on State FRLs on the fiscal outcomes of States has been positive. Revenue Balance has been maintained since 2005-06. Moreover, consistently surplus in the revenue account is being generated. It helps in reducing the dependence on borrowing. As a result fiscal deficit has been kept within 3% of GSDP. The debt stock has come down to 15.65% of GSDP in 2015-16 from the high point of 50.73% in 2002-03. The Interest payment to Revenue Receipt ratio has been brought down from the level of 40% in 2002-03 to 5% in 2015-16.
- The headroom available in the Fiscal Deficit space is being utilised increasingl for capital outlay. The capital outlay in terms of GSDP went up from 1.22% in 2005-06 to 3.57% in 2014-15 and 5.14% in 2015-16. For optimum utilisation of fiscal space, the fiscal deficit target may be prescribed over a medium term/cycle (3-5 years) with provision for adjustment in successive years in case the target is exceeded or fallen short of in a particular year. It may have a built in flexibility to respond to exogenous shocks.
- Odisha support second-generation fiscal rules such as expenditure ceilings. Expenditure ceilings may be introduced to promote productive expenditure. For example there may be a ceiling on salary and administrative expenditure and the States may be mandated under the FRL to increase expenditure to a certain level in health, education, water supply and sanitation etc.
- The government guarantees are now limited to principal only. Though the State Government have prescribed the limit on guarantees through administrative orders, it is being observed strictly and it has been possible to bring down the guaranteed liability considerably. For example as against the mandated level of 80% of revenue receipt minus grant-in-aid in the second preceding year, it is 3.18% as at the end of 31st December, 2016. The guarantees are contingent liabilities and are disclosed in a separate statement.
- The Debt and other liabilities include public debt and other liabilities in the Public Account. But the borrowings of PSUs and SPVs etc. do not form a part of State Government borrowings.
- The State Government have eliminated all off budget borrowings. While the off budget borrowing are disclosed as a separate disclosure, the Viability Gap Fund (VGF) and equity investment for PPPs are provided in the budget upfront. But the annuity based PPP are outside the Budget document at present. Such annuities need be disclosed as future revenue commitments on the State Budget through a separate statement. These are deferred liabilities which should be captured through a disclosure statement in the Budget. This may be prescribed in the FRBM Act.
- FRL should discourage off budget or off balance sheet borrowings which runs counter to the objectives of fiscal sustainability through a cap on borrowing and debt level. The lending organisations should also be prohibited from lending to States outside budget balance sheet. The FRL could prohibit servicing of loans taken by PSUs/ parastatals through State Budget.
- The classification of expenditure as ‘capital’ and ‘revenue’ is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as ‘bad’, has led to the neglect of maintenance of assets, which is revenue expenditure. A thumb rule should be developed for provision of funds for maintenance of capital assets as well as Special Repair and improvements. It should be accompanied by an inventory of assets, asset management plan and an annual maintenance plan for effective and efficient utilisation of maintenance provision. The Medium

Term Fiscal Plan and Fiscal Policy Strategy Statement should contain specific mention about these items stating the measures taken for improving productivity and efficiency of public expenditure and reducing the cost of delivery of services.

- The FRL targets may include an indicator for developmental expenditure i.e. expenditure on the social sector and economic sector. Besides, a specific portion of expenditure may be earmarked for removing regional disparity or development of a backward region or enhanced outlay to meet the cost disability of hilly and sparsely populated areas as is being done for the development of the North Eastern Region.
- The present FRBM architecture does not provide any rule or norm for sustainable and quality public spending. In order to improve the quality of public expenditure it may be desirable to prescribe a certain percentage of public expenditure on capital outlay, health, education, sanitation, water supply, nutrition etc. in terms of GSDP which directly contribute to human development and help improve the quality of life. Where a large portion of the revenues come from natural resources / commodities which are subject to market volatility, in the years of boom, the collection over and above a threshold level should be parked in a stabilisation fund which can be drawn upon in the years in which such revenues decline below the threshold.
- Borrowing for consumption expenditure should be discouraged as it will divert funds borrowed for investment purposes to consumption expenditure. Borrowing for consumption expenditure will lead to a debt trap where borrowing becomes inevitable and unsustainable on the long term. This would go against the spirit of fiscal consolidation. Therefore, the concept of zero revenue deficit or revenue balance acts as a binding constraint on borrowing for revenue expenditure.
- Medium Term Fiscal Plan (MTFP) should be linked to a Medium Term Expenditure Framework (MTEF). The MTEF need be prepared with three year rolling targets of public expenditure with physical outputs and outcome indicators. It will be precursor to multi-year budgeting and provide predictability of fund flow and medium term project implementation plan.
- The fiscal targets under the FRBM Act are both ex ante and ex post. Based on the monthly Civil Accounts, these fiscal parameters need be worked out and reported to the State Government by the Accountant General for intra year monitoring of the fiscal targets. The report on State finances compares the achievements of the State Government against the fiscal targets prescribed in the FRBM Act and the fiscal targets prescribed by the Finance Commission which is ex post evaluation.
- In terms of Section 8 [(2-a) of the FRBM Act, the State Government is required to entrust the task of periodical review of compliance to the provisions of the FRBM Act to an agency independent of the State Government interference. NIPFP etc.are assigned these reviews /evaluation of State's performance under the FRBM Act.
- It may be difficult to measure the productivity and efficiency of public expenditure through quantifiable and measurable indicators and it should not be made a part of the FRL However, like actuarial assessment of pension liability, it may be incorporated in the statute as an advisory for undertaking technical evaluation studies for assessing the productivity and efficiency of public expenditure under different sectors.
- The build-up of surplus cash balance of most of the States in the post-FRL period can be attributed to a combination of factors like revenue surplus, compulsory/passive borrowing from sources like GPF and NSSF and lumpy transfer of funds from the Centre at the year end. It incidentally coincided with

high growth regime resulting in buoyancy in tax and non-tax revenue. In case of mineral rich States like Odisha, there was substantial increase in mining revenue due to boom in mining sector.

- Aggregate central transfers on the recommendations of the 14th Finance Commission has registered a significant rise , it would be largely offset by the increased State share for Centrally Sponsored Schemes and reduction in Central Plan Assistance for development of backward regions, left wing extremist affected areas and KBK region etc. The discontinuance of the State and sector specific grants have also put a stop to targeted flow of funds to correct inter-state disparities
- Odisha is a pioneer in Power Sector Reform through which an independent State Electricity Regulatory Commission has been put in place since the year 1996. The State Government do not provide any subsidy to the Power Sector in the post reform period i.e. after 1996.
- The 2 year exemption from FRBM Act for UDAY bonds is only with respect to the net inflow of debt i.e. fiscal deficit for the two years but not in respect of the total debt level. The interest outgo of the State Government will adversely impact on developmental expenditure.

Government of Rajasthan
Finance Department
(Budget Division)

No. F.10(8)F.1(1)Bud/2015 **Jaipur, Dated: 28th July, 2016**

Sh. N.K. Singh,
Chairman,
FRBM Review Committee,
Department of Economic Affairs,
Ministry of Finance,
Government of India,
North Block, New Delhi-110001.

Sub.:- Written response of Government of Rajasthan on the issues raised in the "Consultation paper on brief for States on the impact of sub-national fiscal responsibility legislation on State Finances".

Sir,

With reference to your letter No.3/8/2016-FRBM dated 12.07.2016, regarding the issues raised in the "Consultation paper on brief for States on the impact of sub-national fiscal responsibility legislation on State Finances", the comments of Government of Rajasthan is enclosed for consideration.

Encl.: As above

Yours Sincerely,

(Naveen Mahajan)
Finance Secretary (Budget)

Comments on "Consultation paper on brief for States on the impact of sub-national fiscal responsibility legislation on State Finances"

Government of Rajasthan
Finance Department

Comments of Government of Rajasthan on "Consultation paper on brief for States on the impact of sub-national Fiscal Responsibility Legislation on State Finances"

<table>
<tr><th>S.No.</th><th>Issues</th><th>Comments</th></tr>
<tr><td>1</td><td>Impact on State FRLs on the fiscal outcomes of States</td><td></td></tr>
<tr><td>1.1</td><td>The enactment of State FRLs have coincided with a process of fiscal consolidation at the subnational level. After a decade of rising fiscal and revenue deficits in the 1990s, the deficit indicators have demonstrated a marked improvement in the past decade (see Figures 2 (a) and Figure 2 (6) in the Annexure). In this context, how have the extant State FRLs been useful in securing the States' macro -fiscal goals?</td><td>
<table>
<tr><th>Year</th><th>Fiscal Deficit as % to GSDP</th><th>Revenue Deficit as % to GSDP</th></tr>
<tr><td>2005-06</td><td>3.62</td><td>-0.47</td></tr>
<tr><td>2006-07</td><td>2.32</td><td>0.37</td></tr>
<tr><td>2007-08</td><td>1.75</td><td>0.85</td></tr>
<tr><td>2008-09</td><td>3.02</td><td>-0.36</td></tr>
<tr><td>2009-10</td><td>3.87</td><td>-1.79</td></tr>
<tr><td>2010-11</td><td>1.22</td><td>0.31</td></tr>
<tr><td>2011-12</td><td>0.83</td><td>0.77</td></tr>
<tr><td>2012-13</td><td>1.73</td><td>0.70</td></tr>
<tr><td>2013-14</td><td>2.76</td><td>-0.19</td></tr>
<tr><td>2014-15</td><td>3.10</td><td>-0.53</td></tr>
<tr><td>2015-16 (RE) (with UDAY)</td><td>9.99</td><td>-0.78</td></tr>
<tr><td>2015-16 (RE) (without UDAY)</td><td>3.62</td><td>-0.78</td></tr>
<tr><td>2016-17 (BE) (with UDAY)</td><td>5.62</td><td>-1.15</td></tr>
<tr><td>2016-17 (BE) (without UDAY)</td><td>3.00</td><td>0.03</td></tr>
</table>
The State Fiscal Responsibility Legislation (FRBM Act) as well as the Medium Term Fiscal Policy Statement are the basic documents which provide Fiscal Management Objectives and Targets to achieve macro fiscal goals. This document is found useful during last 10 years.</td></tr>
<tr><td>1.2</td><td>In recent years, some States have achieved revenue and fiscal deficits that are below their FRL targets. Equally, other States have been unable to comply with their FRL deficit targets. In this context, what is the States' view on the impact of FRLs on the States' ability to efficiently utilise their fiscal space?</td><td>The Fiscal Deficit in a particular year at the rate of 3% is equivalent to the borrowing ceiling allowed under Article 293(3) of Constitution of India. The funds available through such borrowings are used for Capital as well as Developmental Expenditure during past years.

In ten FYs (before UDAY scheme i.e. 2005-06 to 2014-15), Rajasthan Govt. has exceeded the prescribed 3% limit for fiscal deficit only on four occasions (FY 2005-06, 2008-09, 2009-10 and</td></tr>
</table>

S.No.	Issues	Comments
		2014-15). As can be seen, prescribed ceilings have exceeded in or close to Assembly election years (2003 and 2008). It shows that otherwise fiscal space available is sufficient to cater to State's overall requirements. During 2010-11 to 2013-14 the fiscal deficit to GSDP was well below the ceiling of 3% of the GSDP, whereas during those years the borrowing was done upto the fiscal space ceiling. It reflects that the borrowings were made looking to the future year requirements and not on the basis of that particular year requirement. In the years when State has revenue surplus, the fiscal space does not get utilised fully. On the other hand, when there is a revenue deficit, the capital expenditure is compromised as the funds are utilized for revenue expenditure. Therefore, the revenue and fiscal deficit targets as well as borrowing limits should be made flexible for adjustments in five years period.
1.3	What has been the States' experience with different types of fiscal rules, i.e. deficit and debt rules? What are the States' views on second -generation fiscal rules such as expenditure ceilings?	There are budgetary ceiling for expenditure in the annual budget document of the state duly passed by the Legislative Assembly. On the basis of these ceilings, the Fiscal goals and targets are achieved.
1.4	Specifically, why did some States feel the need to incorporate a debt rule whereas others did not? Moreover, how did States decide the level of their respective debt targets? What the optimum perceived path of debt sustainability?	In the Fiscal Responsibility Legislation (FRBM Act) of the State, target of Debt to GSDP ratio has been prescribed. The FRBM Act of Rajasthan restricts the total outstanding debt upto 36.5, 36.5, 35.5 35.0 and 34.0 per cent of Gross State Domestic Product for the financial year 2015-16, 2016-17, 2017-18, 2018-19 and 2019-20 respectively. The debt sustainability is perceived and decided on the basis of the annual borrowing ceiling approved by GoI under Article 293(3) of Constitution of India as well as existing other commitments of the State Government. Fourteenth FC recommended for extra borrowing ceiling of 0.5% for those States who fulfils following criteria - 1. The primary condition to avail this extra borrowing limit is that the State has revenue surplus. 2. The State may be allowed

S.No.	Issues	Comments
		0.25% extra borrowings if the total interest payment of the State is less than 10% of the total revenue receipts of the State. 3. If Debt to GSDP ratio is less than 25% then States may be allowed 0.25% extra borrowings. Government of Rajasthan participated in UDAY Scheme, will not be able to fulfil the above criteria thus it will not be able to avail the additional borrowing limit due to Revenue Deficit as well as Fiscal Deficit on account of heavy interest burden and grants to be given to DISCOMs under UDAY scheme.
1.5	Some States have provided for legal limits on guarantees. What has been their experience in this regard?	According to the Fiscal Responsibility Legislation (FRBM Act), the state has to ensure that total outstanding Government Guarantee on 31-03-2017 shall not exceed 70 per cent of estimated receipts in the Consolidated Fund of State in financial year 2016-17 and thereafter, total outstanding Government Guarantee at the end of each financial year shall not exceed 60 per cent of estimated receipts in the Consolidated Fund of State in that financial year. The ceiling has been decided on the basis of existing guarantees and annual Fiscal sustainability based on perceived guarantees as well as funds available in Guarantee Redemption Fund (GRF) of the State Government. State enacted Govt. Guarantee ceiling from current FY only.
2	**Transparency**	
2.1	How do States define their overall liability? Does their measure include borrowings by State Public Sector Undertakings, Special Purpose Vehicles, and other equivalent instruments including guarantees where the liability for repayment of principal and/or interest is on the State Government?	In the State Budget, the total debt liability of the State Government is shown and the Contingent liability in the form of Government Guarantee is shown separately. Wherever, the Government Guarantee is given, the liability for repayment of principal and interest is not on the State Government but on the borrowing entity namely viz. State PSUs and other autonomous bodies.
2.2	What are States' views on voluntary disclosures of off - budget borrowing and contingent liabilities?	The state voluntarily discloses its Contingent liability in the form of Government Guarantee in the state budget annually. The State Government does not believe in off

S.No.	Issues	Comments
		budget borrowings and therefore the issue of voluntary disclosure does not arise.
2.3	More specifically, do States collect and report information on public- private partnerships and other off -budget vehicles in a comprehensive manner?	Such information is shown in the State Budget document and Planning Department of the State Government monitors these projects. The status of PPP Projects is available on the website of Planning Department, Government of Rajasthan.
2.4	There are concerns expressed that the increasing reliance on PPP (annuity) projects has arisen as a way of circumventing the fiscal deficit targets. In this context, how do States view such commitments and how should the annuity payments be properly reflected in the Budget documents?	Annuity Payment related to PPP projects does not circumvent Fiscal Deficit targets in any way. Commitments in the form of annuity payments are included in the Annual Budget Estimates and thus become a part of State Budget. PPP Projects in Rajasthan covers following sectors:- 1. Road Sector 2. Urban Infrastructure 3. Power Sector 4. Social Sector
2.5	There are instances where parastatals/State PSUs borrow funds from banks and development agencies but the repayments and interest payments for these loans are made from the Budget. However, these loans are sometimes outside the State's debt limit. Moreover, the repayment of these amounts by State Governments is reported as "repayment of loans" rather than grants- in aid to the borrowing entity. In the view of the States, how can FRL provisions ensure that such instances of misrepresentation in the Budget are avoided?	No, the FRLs of the State Government do not allow the parastatals/State PSUs to borrow funds for which the liability of repayment of principal and interest amount is on the State Government.
2.6	The classification of expenditure as 'capital' and 'revenue' is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as 'bad', has led to the neglect of maintenance of assets, which is revenue expenditure. If so	In the Budget Speech of 2016-17 of Union Finance Minister, it was announced "Successive committees have questioned the merit in having Plan and Non-Plan classification of Government expenditure. A broad understanding over the years has been that Plan expenditure are good and Non-Plan expenditures are bad. This results in skewed allocations in the Budget. We need to correct this and give greater focus to Revenue and Capital classification of Government expenditure."

S.No.	Issues	Comments
	what are the options which could be considered to ensure that adequate funds are earmarked for maintaining capital assets?	Government of India has decided to do away with the distinction of non plan and plan expenditure and has proposed that the expenditure should be shown under revenue and capital heads only. If the same argument for revenue and capital has been insisted, then there cannot be any distinction in the nature of expenditure. Under the revenue expenditure, the social and development expenditures are included; therefore, assets which have been created under the capital heads have to be maintained (as it would be the responsibility of State Government). Subsequent to the creation of a Capital Asset, cost accrued for additions, improvements, replacements, rearrangements, re-installations, maintenance and repairs of these Assets needs to be prudently accounted for. Only ordinary repairs and maintenance of the Asset should be classified as revenue expenditure. The cost accrued for additions, improvements, replacements, rearrangements and re-installations that is value addition in the economic life as well as beneficial for more than one year should be classified as Capital expenditure. The accounting principles should be amended by CGA accordingly.
2.7	Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the State Legislature a statement on the adherence to the State FRL and also setting forth a 3 year rolling target which outlines for the ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities, lending and investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure. Will the State Government have any difficulty in complying with the aforesaid stipulations in a modified State FRL.	The State Government already has completed transparency in terms of reporting details adhering to the state FRLs which are duly presented before the State Legislature and also ensures that all such details are available in public domain. The state's Medium Term Fiscal Policy Statement also ensures setting forth 3 years targets related to expenditure and revenue.

S.No.	Issues	Comments
3	**Impact on FRLs on Development Expenditure**	
	The working assumption underlining the FRL process has been that the purposes of public expenditure (other than for Consumption and for Investment) should not be a factor in deciding the fiscal rule framework. Doing so may result in micro -management of development trajectories that are highly state -specific. However, it can also be argued that FRL targets, indicators, and rules should take cognizance of (1) the type and purpose of expenditures undertaken by States and (2) that public expenditure that explicitly impacts the development objectives of States should be treated differently from public expenditure that does not explicitly do so. We seek the States' views on this important issue.	Public Expenditure covered under the existing fiscal rule frame work as well accounting classification is as under: 1. General Services 2. Social Services 3. Economic Services 4. Grant-in-aid The expenditure on all the above is duly represented in the Annual Budget Document of the State. Therefore, no public expenditure is left from the representation in the State Budget.
4	**Public Investment**	
4.1	Does the FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regard?	The existing system adequately addresses sustainable and quality public spending.
4.2	Going forward, do States think that it will be best to have fiscal constraints that distinguish between borrowing for consumption (revenue expenditure) and borrowing for public investment (capital expenditure)? Are there alternative ways in which fiscal	Yes, it will be better to have fiscal constraints that distinguish between borrowing for consumption (to fulfil revenue expenditure) and borrowing for capital expenditure (public investment). Borrowing for Capital expenditure should be looked at differently.

S.No.	Issues	Comments
	rules can be crafted to maintain fiscal sustainability while also allowing adequate fiscal space for public investment?	
5	**Medium term fiscal framework**	
5.1	What are the States' views on the scope of the implementation of an MTFF?	The expected targets shown in medium term fiscal policy statement is generally taken as guiding factor for revenue as well as expenditure targets (sector wise) in the annual budget document.
5.2	Examine the various reporting and operational methodologies to set forth implementable fiscal targets.	Implementable fiscal targets determined every year on the basis of past performances as well as objectives and priorities of the State Government.
5.3	We would also be interested in whether the State FRL could incorporate measures designed to promote the productivity and efficiency of public expenditure.	Yes, the State is interested in incorporating such measures which may promote the productivity and efficiency of public expenditure.
6	**Impact of FRLs on Cash Surpluses of States**	
6.1	What is the States' view on the rise in their surplus cash balances in the post-FRL period?	The State cash balances are on decline due to various factors the major factor in the recent year is due to liability posed on account of takeover of Discoms debt liability amounting to Rs.60,857 crore as well as takeover of bonds issued under FRP 2012.
6.2	Are there alternative investment options for surplus cash balances?	The surplus cash is invested by the State Government according to the guidelines issued by RBI for WMA advances scheme for the State Governments. In case any other investment options are to be included, then it should be included within the purview of RBI Ways Means Advances scheme for State Government.
6.3	Given that several States have comfortably achieved their FRL targets, why have they preferred to build up cash surpluses rather than spending on productive purposes such as public investment?	The State Government is spending on social and developmental priorities and the limited cash surpluses available with the State Government are invested prudently as per the WMA scheme.
7	**Annual CAG audits of State finances**	
7.1	In this context, we would be particularly interested in knowing the States' views on	The report of Comptroller and Auditor General of India on State Finances is quite qualitative and exhaustive and serves the purpose well.

<table>
<tr><th>S.No.</th><th>Issues</th><th>Comments</th></tr>
<tr><td></td><td>the content and focus, and coverage of such reports. How can the audit reports be better shaped to serve the purposes of fiscal responsibility and budget management of States?</td><td></td></tr>
<tr><td>7.2</td><td>To what extent can we make better use of the CAG audit reports of state finance and FRBM compliance reports published by orgs like NIPFP to facilitate and ensure FRBM compliance going forward?</td><td>The CAG audit reports are presented before the State Legislature and compliances on the recommendations on these reports has to be presented before the public accounts committee of the legislative assembly as per the constitutional requirements.
The FRBM compliance is a part of CAG report itself.</td></tr>
<tr><td>8</td><td>The impact of the recommendations of the Fourteenth Finance Commission (FFC) on State Finances</td><td></td></tr>
<tr><td>8.1</td><td>The FFC has recommended landmark changes in the vertical devolution of States, increasing States' share in the divisible pool to 42 percent, a rise of 10 percentage points from the recommendations of the Thirteenth Finance Commission. Equally radical were the FFC's changes to the formula governing the horizontal distribution of the divisible pool of central taxes among the States. The Committee recognizes that the combined implication of these changes, along with the changes in non-FC central grants to the States would, in combination, have a highly differentiated impact on States. In the context, the Committee would be keen to understand the specific implications of this these changes for inter - governmental transfers on State Finances.</td><td>The likely impact on the State Budget during 2015-16 (RE) is as under:-
<table>
<tr><th>S. No.</th><th>Description</th><th>Amount (In crore)</th></tr>
<tr><td>1.</td><td>Increase in Share in Central Taxes (due to increase in State's share from 32% to 42% as per 14th FC recommendations) (Rs.27916 cr. - Rs.21799 cr.)*</td><td>6117</td></tr>
<tr><td>2.</td><td>Reduction in other sectors</td><td></td></tr>
<tr><td>a.</td><td>Sector specific/State specific grants recommended by 13th FC, Normal Central Assistance, One Time ACA and not recommended by 14th FC</td><td>2277</td></tr>
<tr><td>b.</td><td>Estimated reduction in other CSS schemes</td><td>6576</td></tr>
<tr><td></td><td>Total estimated reduction [2(a+b)]</td><td>8853</td></tr>
<tr><td>3.</td><td>Net loss ** (Rs.6117 cr. – Rs.8853 cr.) (2-1)</td><td>-2736</td></tr>
</table></td></tr>
</table>

S.No.	Issues	Comments
		• Share in Central Taxes 2014-15 (BE)- Rs.22432 crore • Share in Central Taxes 2014-15 (RE)- Rs.19817 crore • Share in Central Taxes 2015-16 (BE)- Rs.28925 crore • Share in Central Taxes 2015-16 (RE)- Rs.27916 crore • Projection of 14th FC for 2015-16 - Rs.31997 crore * An annual normal increase of 10% in Share in Central Taxes is considered on the Revised Estimates of 2014-15 (Rs.19817 crore). It comes to Rs.21799 crore as Share in Central Taxes to the State of Rajasthan. Accordingly there is an increase of Rs.6117 crore in RE 2015-16 (Rs.27916 crore). ** The Share in Central Taxes is in the nature of Untied Funds. Due to reduction in Central Assistance in State Plan (CSS Schemes), even the additional share in central taxes cannot be said to be untied as this has to be spent on the schemes in which Union Government has decreased their share. The impact of change in sharing pattern of Central Assistance Schemes, announcement of new schemes by Government of India and upward revision of unit cost in some of the schemes being implemented, have negated the benefit (if any) of the enhanced share in central taxes.
8.2	Subject to certain conditions, the FFC has also provided for some flexibility in the States' fiscal deficit target of 0.5 percentage points, over and above their FRL limits. What are the States' views on this recommendation? If States' plan to avail of this provision, how do they plan to allocate the extra fiscal space of 0.5 percent of GSDP among their different expenditure priorities? Do they plan to use the extra fiscal space to incur revenue expenditure or capital expenditure?	The additional borrowings allowed under the UDAY Scheme lead to fiscal deficit of 9.99% and 5.62% in 2015-16 (RE) and in 2016-17 (BE) respectively. State Government is of the view that additional fiscal deficit of 0.5% may be allowed at least during 2017-18 to 2019-20 so that the State Government having such funds through extra fiscal space of 0.5% of GSDP would be allocated for developmental activities as the interest liability of the borrowings done under UDAY Yojana may not hamper the developmental activities. The State of Rajasthan is not eligible to avail extra Fiscal Space of 0.5% of GSDP. Since, the State of Rajasthan has taken over Discoms debt liability of Rs.60,857 crore which requires sizeable amount for payment of interest. This would also increase

S.No.	Issues	Comments
		the revenue deficit of the State Government. UDAY Scheme does not have any provision for revenue deficit occurring due to payment of interest because of takeover of Discoms debt liability.
9	**The impact of the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) on State Finances**	
9.1	Measures that States plan to undertake to ensure transparent fixation of tariff by the State level regulatory authorities.	MoUs have been executed amongst Ministry of Power, Government of India, State Government and DISCOMs under UDAY Scheme, according to the conditions laid down in UDAY Scheme a mechanism for close monitoring and performance to be devised by MoP and the DISCOMs. The progress of the commitments made by DISCOMs in the MoU is being reviewed by the Chief Secretary of the State on monthly basis. The tariff is decided by the State Regulatory Authority on the basis of a transparent procedure.
9.2	Whether States have an accurate quantification of on and off -budget subsidies to the power sector.	The State provides budgetary support to Power Companies. This is represented in the Annual Budget document of the State.
9.3 9.4	How have States planned for the additional burden that will accrue as result of assuming DISCOM debts? If States plan to avail of the above mentioned exemption from FRL limits for two years, how have States planned for a transition back to FRL targets after the end of the exemption period?	Impact of UDAY on State Finances • Total outstanding debt of the state Discoms as on 30/09/2015 was Rs.80530 cr. • State took over 75% of it i.e. Rs.60857 cr. in 2015-16 and 2016-17. • Interest liability of nearly Rs.5200 cr. annually. • The Debt to GSDP of the state government - from 24.11% in 2014-15 to 31.33% in 2015-16 and 33.16% in 2016-17 • Fiscal deficit of state shoot up to an alarming level of 9.99% of GSDP in 2015-16 (RE) and 5.62% in 2016-17(BE). • Complying with FRBM condition of zero revenue deficit in future years would not be possible. • According to recommendations of 14th Finance Commission State can borrow additional 0.5 % of GSDP during the tenure of 14th Finance Commission if- 1. Debt to GSDP ratio is 25% or below

S.No.	Issues	Comments
		2. Interest to revenue receipt 10% or below State will not be able to get benefit of this as it will take many years to come down to these levels. • Rajasthan is one of the States which participated in the UDAY scheme introduced by Government of India in 2015-16 for increasing the operational efficiency and financial turnaround of Power Distribution Companies. The interest liability of this amount would be around Rs.5200 cr. per annum, which would be borne by the State Government. State Government may be allowed to avail additional borrowing ceiling of 0.5% of GSDP in next 5 years. This will enable the State Government to spend this additional borrowing for infrastructure and developmental projects. A letter to Secretary (Expenditure), Government of India was sent on 24.05.2016 (copy enclosed). • Due to interest liability of UDAY scheme, there would be Revenue Deficit in the State Budget. Revenue Deficit upto the repayment amount of interest liability due to UDAY may also be allowed for next 5 years in the FRBM Act.

Rajasthan FRBM Act, 2005

Objectives of enactment of FRBM Act –

(i) to ensure prudence in fiscal management

(ii) fiscal stability by progressive reduction of revenue deficit

(iii) prudent debt management consistent with fiscal sustainability

(iv) greater transparency in fiscal operations of the Government and

(v) conduct of fiscal policy in a medium term fiscal framework.

State Government has enacted the FRBM Act, 2005 on 3rd May, 2005.

Fiscal Management Objectives laid down in State FRBM Act:

(a) appropriate measures shall be taken to eliminate the revenue deficit and contain the fiscal deficit at sustainable levels,

(b) pursue non tax revenue policies with due regard to cost recovery and equity;

(c) lay down norms for prioritization of capital expenditure, and pursue expenditure policies that would provide impetus for economic growth, poverty reduction and improvement in human welfare.

Fiscal Management Targets- In particular and without prejudice to the generality of the foregoing provisions, the State Government shall-

(a) Achieve zero revenue deficit target from financial year 2011-12 and thereafter maintain it or attain revenue surplus; (amended in 2011)

(b) Achieve fiscal deficit of 3 percent of Gross State Domestic Product by financial year 2011-12 and thereafter maintain the said ratio or reduce it; (amended in 2011)

(c) Restrict its total outstanding debt upto 39.3, 38.3, 37.3 and 36.5 per cent of Gross State Domestic Product for the financial year 2011-12, 2012-13, 2013-14 and 2014-15 respectively; (amended in 2011)

(d) Restrict its total outstanding debt upto 36.5, 36.5, 35.5 35.0 and 34.0 per cent of Gross State Domestic Product for the financial year 2015-16, 2016-17, 2017-18, 2018-19 and 2019-20 respectively;

(further revised in 2016)

(e) Ensure to bring out annual statement giving prospects of the State economy and related fiscal strategy;

(f) Ensure to bring out special statement along with the budget giving in detail number of employees in Government, Public Sector and Aided institution and related salary;

(g) Ensure that total outstanding Government Guarantee on 31-03-2017 shall not exceed 70 per cent of estimated receipts in the Consolidated Fund of State in financial year 2016-17 and thereafter, total outstanding Government Guarantee at the end of each financial year shall not exceed 60 per cent of estimated receipts in the Consolidated Fund of State in that financial year. (added in 2016)

"Provided that revenue deficit and fiscal deficit may exceed the limits specified under this section-

(a) due to ground or grounds of unforeseen demands on the finances of the state government arising out of national security or natural calamity including drought relief or such other exceptional circumstances beyond the control of the state government; or

(b) due to developmental and other unavoidable expenditure; or

(c) upto the limits indicated by the central government from time to time;or (amended in 2009)

(d) due to take-over of loans of the Power Distribution Companies and interest thereon under the Ujwal DISCOM Assurance Yojana promulgated by the Government of India in the Ministry of Power vide Office Memorandum No. 06/02/2015-NEF/FRP dated 20th November, 2015. (added in 2016)

Provided further that the excess beyond limits arising due to the grounds mentioned in the first proviso shall be explained with a detailed statement on the said grounds, as soon as possible, before the House of the State Legislature.

Status of Fiscal Responsibility Management in Rajasthan

Year	Fiscal Deficit as % to GSDP	Revenue Surplus (+)/ Deficit (-) as % to GSDP
2005-06	3.62	(-) 0.47
2006-07	2.32	(+) 0.37
2007-08	1.75	(+) 0.85
2008-09	3.02	(-) 0.36
2009-10	3.87	(-) 1.79
2010-11	1.22	(+) 0.31
2011-12	0.83	(+) 0.77
2012-13	1.73	(+) 0.70
2013-14	2.76	(-) 0.19
2014-15	3.10	(-) 0.53
2015-16 (RE) (with UDAY)	9.99	(-) 0.78
2015-16 (RE) (without UDAY)	3.62	(-) 0.78
2016-17 (BE) (with UDAY)	5.62	(-) 1.15
2016-17 (BE) (without UDAY)*	3.00	(+) 0.03

- In last ten FYs (before UDAY scheme i.e. 2005-06 to 2014-15), Rajasthan Govt. had exceeded the prescribed 3% limit for fiscal deficit only on three occasions (FY 2005-06, 2009-10 and 2014-15).
- The prescribed ceilings exceeded either in the assembly election year or near to it (i.e. 2003, 2008 and 2013).
- The State of Rajasthan was under revenue deficit in financial years 2005-06, 2008-09, 2009-10, 2013-14 and 2014-15 during last ten years.
- When there is a revenue deficit, the capital expenditure is compromised.
- As can be made out from the above chart, without UDAY, the fiscal deficit stands at 3% of GSDP as per 2016-17 (BE) assuming revenue growth is as targetted and the fiscal health would not have been adversely affected. The UDAY scheme itself is borne out of two **injustices** . In the Year 2008-09 , the total debt of the Electricity Companies was **Rs.14000 Crores** ; in the Year 2013-14 when the Government came back, this had risen to an astonishing

Rs.72,000 Crores . Secondly, the UDAY scheme did not provide that lenders take a small part of the debt burden . Normally , When debt is settled with private companies, (One Time Settlement) , banks too shoulder some part of the hit with the State Governments in fiscal trouble. However , while the UDAY scheme allows the Banks to have their cake and eat it too . It is noteworthy that had UDAY interest burden not come in the Year 2016-17 , Rajasthan would have managed with a fiscal deficit of 3 % and a revenue deficit of only 0.03% which is hardly any deficit at all . The State Government was left with no option but to embrace the UDAY scheme and in the process, the fiscal parameters of State Government have taken a significant hit as can be made out from the chart. With UDAY, fiscal deficit rose to staggering 9.99% of GSDP in 2015-16 (RE).

* As per 2016-17 (BE) Revenue surplus to the GSDP is (+) 0.03%. The trend in State's Own Revenue receipt upto August, 2016 is below targeted estimates. Accordingly, the Revenue surplus is likely to get converted into Revenue deficit at the time of 2016-17 (RE).

The FRBM Review Committee may be requested to consider the following suggestions while framing the model draft for the State Governments:

- The 14th Finance Commission recommended that "if a State is not able to fully utilise its sanctioned borrowing limit of 3% in any particular year during the first four years of our award period (2015-16 to 2018-19), it will have the option of availing of this un-utilised borrowing amount not only in the following year but within our award period". This recommendation needs to be implemented, specially in view of UDAY & liabilities on account of 7th CPC(Central Pay Commission) .
- The Fiscal Deficit targets may be increased from 3% to 5% of GSDP. Consequently, the annual borrowing ceiling would also increase. The additional borrowings of 2% of the GSDP will bridge the Revenue Deficit created by the additional burden of UDAY and implementation of 7th CPC with effect from 01.01.2016.
- *The additional borrowing of 2% will provide additional funds to State Government as follows:*

(Rs. in crores)

Year	*GSDP*	*Borrowing Ceiling with 3%*	*Borrowing ceiling with 5%*	*Increase in Borrowing by 2%*
2016-17	*767142*	*23014*	*38357*	*15343*
2017-18	*858738*	*25762*	*42937*	*17175*
2018-19	*961272*	*28838*	*48064*	*19226*
2019-20	*1076048*	*32281*	*53802*	*21521*
2020-21	*1204528*	*36136*	*60226*	*24090*

Normally market borrowing by the State Government is done for 10 year period. It is suggested that the State Government may opt for a tenure of 15 years in place of 10 years for this additional borrowing of 2% (if allowed by GoI).

- As a natural corollary, the "No Revenue Deficit" target would need to be relaxed for at least 5 years i.e. upto financial year 2020-2021. (Increased expenditure on pay and pensions on account of 7th Pay Commission, payment of interest on debt taken over by the State Government under the

UDAY scheme etc. are all revenue expenditure and there is no commensurate increase in revenue, specially in Rajasthan, where royalty from oil has dropped around 60% as is evident from the table below:

(Rs. in crores)

Year	Royalty from Petroleum
2012-13	5069.93
2013-14	5954.00
2014-15	4850.00
2015-16	2341.00
Upto August, 2016	876.00

Projections for Receipt & Expenditure for the year 2017-18 and 2018-19
(with 7th Pay Commission benefits including allowances)

(Rs. In crores)

S. No.	Particulars	2012-13 Actuals	2013-14 Actuals	2014-15 Actuals	2015-16 (Prov.)	2016-17 (BE)	2016-17 (Est.)	2017-18 (Proj.)	2018-19 (Proj.)
1.	**Revenue Receipt** (4+7)	**66913**	**74470**	**91326**	**100285**	**123251**	**114603**	**128610**	**144393**
2.	State Own Tax Revenue	30503	33478	38672	42712	53300	47410	53574	60538
3.	State Own Non Tax Revenue	12133	13575	13229	10928	14084	11147	11704	12289
4.	**Total Own Revenue** (2+3)	**42636**	**47053**	**51901**	**53640**	**67384**	**58557**	**65278**	**72827**
5.	Share in Central Taxes	17103	18673	19818	27917	31478	31546	35647	40281
6.	Union Grant	7174	8744	19607	18728	24389	24500	27685	31284
7.	**Total Central Transfer** (5+6)	**24277**	**27417**	**39425**	**46645**	**55867**	**56046**	**63332**	**71565**
8.	**Capital Receipts** (9+11 to 14)	**14273**	**19680**	**25004**	**69958**	**48089**	**47224**	**35072**	**41010**
9.	Internal Debt of State (Market Borrowings etc.)	9755	14233	17347	59249	38429	37643	24816	29995
10.	Borrowings under UDAY included in 9.	-	-	-	40049	20133	20807	-	-
11.	Loans from Centre	200	259	794	1749	5582	5724	6010	6311
12.	Recovery of Loans and Advances	1102	315	1004	1447	133	133	150	200
13.	Net of Public Account	3208	4863	5844	7489	3935	3714	4085	4494
14.	Misc. Capital Receipts (Disinvestment + Bonus share)	8	10	15	24	10	10	10	10
15.	**Total Receipt** (1+8)	**81186**	**94150**	**116330**	**170243**	**171340**	**161827**	**163681**	**185402**
16.	**Revenue Expenditure**	**63462**	**75510**	**94542**	**106239**	**132053**	**130174**	**135715**	**152001**
17.	of which Interest Payment	8340	9063	10463	12008	17527	16827	18510	20361
18.	Interest burden due to UDAY included in 17.	0	0	0	0	5200	4500*	5200	5200
19.	**Impact of 7th Pay Commission**	**0**	**0**	**0**	**0**	**0**	**10834$**	**10215**	**11237**
20.	**Revenue Exp. with 7th Pay** (16+19)	**63462**	**75510**	**94542**	**106239**	**132053**	**141008**	**145930**	**163237**
21.	**Capital Expenditure** (22+23+24) (for creation of new assets or increasing the value of existing assets as well as repayment of loans)	**17802**	**18590**	**21763**	**63521**	**39208**	**40024**	**35160**	**39986**
22.	Capital Outlay	10683	13664	16102	21985	23421	23421	22463	24409
23.	Loans and Advances	2412	810	701	36602	11067	11883	3547	3615
24.	Repayment of Debt	4707	4116	4960	4934	4720	4720	9150	11962
25.	**Total Exp. without 7th Pay** (16+21)	**81264**	**94100**	**116305**	**169760**	**171261**	**170198**	**170875**	**191987**
26.	**Total Exp. with 7th Pay** (19+25)	-	-	-	-	-	**181032**	**181090**	**203223**
27.	**Revenue Surplus/Deficit** (1-16)	**3451**	**-1040**	**-3216**	**-5954**	**-8802**	**-15571**	**-7105**	**-7608**
28.	**Revenue Deficit with 7th Pay** (1-20)	-	-	-	-	-	**-26405**	**-17320**	**-18844**
29.	**Fiscal Deficit** (1+12+14-16-22-23)	**-8534**	**-15189**	**-19000**	**-63070**	**-43147**	**-50732**	**-32955**	**-35422**
30.	**Fiscal Deficit with 7th Pay** (29-19)	-	-	-	-	-	**-61566**	**-43170**	**-46658**
31.	**Primary Deficit** (29-17) [Fiscal Deficit excluding interest payments]	**-194**	**-6126**	**-8537**	**-51062**	**-25620**	**-33905**	**-14446**	**-15061**
32.	**Primary Deficit with 7th Pay** (31-19)	-	-	-	-	-	**-44739**	**-24661**	**-26298**
33.	Budgetary Surplus/Deficit without 7th Pay (15-25)	-78	50	25	483	79	-8371	-7194	-6584
34.	Budgetary Deficit with 7th Pay (15-26)	-	-	-	-	-	-19205	-17409	-17821
35.	2% Additional borrowing	-	-	-	-	-	15343	17175	19226
36.	Shortfall (Budgetary Deficit) (34+35)	-	-	-	-	-	-3862	-234	1405

Prov. - Provisional, Est.- Estimated, Proj.- Projections

(i) All Surplus shown as positive and Deficit shown as negative.

(ii) Assuming that 7th Pay Commission benefits (including Salary, Pension & Allowances) be given from 01.01.2016.

(iii) * There will be only one six monthly installment of interest liability of Rs.20807 crore taken over by GoR in current financial year.

(iv) $ The annual burden of 7th Pay Commission is Rs.9286 cr. + Arrear of 2 months (January, February, 2016) Rs.1548 cr. = Rs.10834 cr.

- Revenue Receipts - Comprises Government's Own Tax and Non-Tax Revenues, Central Tax transfers and Union Grants.
- Revenue Expenditure - Expenditure on current consumption on goods and services and establishment expenditure of a department for activities of known capital character.
- Capital Receipts - It comprises proceeds from disinvestments, recoveries of loans and advances, debt receipts (market loans, borrowings from Financial Institutions/Commercial Banks) and loans and advances from Government of India.
- Capital Expenditure - Expenditure incurred with the objective of creating new or increasing value of existing assets (material and permanent character).
- Revenue Deficit - Revenue Expenditure - Revenue Receipts.
- Fiscal Deficit - Revenue Expenditure + Capital Expenditure + Net Loan and Advances - Revenue Receipts - Misc. Capital Receipts
- Misc. Capital Receipts - Receipts from Disinvestments and Bonus Shares
- Primary Deficit - Fiscal Deficit - Interest Payments.
- Budgetary Deficit - Total Expenditure - Total Receipts

GOVERNMENT OF SIKKIM
FINANCE, REVENUE & EXPENDITURE DEPARTMENT
GANGTOK

No. 191/FRBM/Fin

Date 23.7.2016.

To,

The Principal Secretary (Finance),
Ministry of Finance,
Government of India,
New Delhi.

Sub : **FRBM Review Committee- regarding**.

Sir,

I am directed to enclose herewith the view of the State, Government of Sikkim regarding consultation brief for states on the impact of sub-national fiscal responsibility legislation on state finance as desired vide letter No. 03/08/2016/FRBM dated 12th July 2016 resting with the Chief Secretary, Government of Sikkim.

Thanking you,

Yours faithfully,

Principal Director,
Finance Revenue &
Expenditure Department
Gangtok

Enclosed : as above

VIEW OF THE STATE GOVERNMENT – SIKKIM – REAGARDING CONSULTATION BRIEF FOR STATES ON THE IMPACT OF SUB-NATIONAL FISCAL RESPONSIBILITY LEGISLATION ON STATE FINANCES

1. **Impact on State FRLs on the fiscal outcomes of States**

   - What has been the States' experience with different types of fiscal rules, i.e. deficit and debt rules? What are the States' views on second-generation fiscal rules such as expenditure ceilings?

   After the implementation of the FRBM Act 2010, the State has brought down the fiscal deficit and debt ratio to the level as prescribed by the FRBM Act. The present arrangement for management of the State finance seems to be adequate.

   - Specifically, why did some States feel the need to incorporate a debt rule whereas others did not? Moreover, how did States decided the level of their respective debt targets? What is the optimum perceived path of debt sustainability?

The level of debt target is being governed by the FRBM Act 2010, and as amended from time to time. The level to be maintained is prescribed in the Act itself. The State does not feel the need to incorporate debt rule.

2. Transparency

- How do States define their overall liability? Does their measure include borrowings by State Public Sector Undertakings, Special Purpose Vehicles, and other equivalent instruments including guarantees where the liability for repayment of principal and/or interest is on the State Government?

The details of overall liability of the state has been reflected in the Finance Accounts of the State as follows;-

1. ***Public Debt***
2. ***Liability on Public Accounts.***
3. ***Government Guarantees.***

The overall liability of the state does not include the borrowings by Public Sector Undertakings.

- The classification of expenditure as 'capital' and 'revenue' is part of our constitutional structure. However, the tendency to view capital expenditure as desirable and revenue expenditure as 'bad', has led to the neglect of maintenance of assets, which is revenue expenditure. If so what are the options which could be considered to ensure that adequate funds are earmarked for maintaining capital assets?

After creation of the Capital assets it has been found difficult sustain their maintenance expenditure as the same has to be met up from revenue receipts which is very limited in terms of having a very low tax base. In addition to it the Fourteenth Finance Commission has also reduced the grants from which such maintenance expenditures were being met up. The State of Sikkim desires that separate grants –in – aid be provided to meet up such expenses.

- Transparency would be enhanced if in the reporting methodology the State Government can lay in each financial year before the

State Legislature a statement on the adherence to the State FRL and also setting forth a 3 year rolling target which outline for the ensuing year important policies pertaining to taxation, expenditure, market borrowings, other liabilities, lending the investment, pricing of administered goods as well as policies designed to improve productivity and efficiency of public expenditure.

Will the State Government have any difficulty in complying with the aforesaid stipulations in a modified State FRL.

The above mentioned policy matter requires an in depth study by the State. However, we are preparing annually the Medium Term Fiscal Plan (MTFP) for Sikkim covering three years as rolling targets.

4. Public Investment

States are the prime movers for public investment (Figure 2). Therefore, it is important to ensure that fiscal space for public investment by States is secured. In this context, the Committee seeks the following information.

- Does the FRBM architecture adequately provide for sustainable and quality public spending, maintaining the fiscal prudence that has been painstakingly secured over the past decade? Do States have any alternative proposals in this regard?

The FRBM architecture has adequately provided for sustainable and quality public spending, maintaining the fiscal prudence. The state does not have any alternative proposals and has no further comment in this regard.

- Going forward, do States think that it will be best to have fiscal constraints that distinguish between borrowing for consumption (revenue expenditure) and borrowing for public investment (capital expenditure)? Are there alternative ways in which fiscal rules can be crafted to maintain fiscal sustainability while also allowing adequate fiscal space for public investment?

The above policy matter is desirable. However, it adversely impacted the States flexibility in decision making

5. Medium term fiscal framework

A medium term fiscal framework (MTFF) presents multi-year budget forecasts. It helps anchor fiscal policy to a stable medium-term target, around which annual deviations can be planned. An MTFF also induces greater transparency and accountability in the budget making process. In this context, the Committee would like to inquire the following.

- What are the States' views on the scope of the implementation of an MTFF?

Medium Term Fiscal Plan (MTFP) for the State prepared annually and presented to the State Legislative Assembly alongwith Budget Documents. The Fiscal Deficit projected in the MTFP is being maintained at the targeted level with certain modifications within the Sectors as per requirement and availability of fund.

- Examine the various reporting and operational methodologies to set forth implementable fiscal targets.

The reporting and operational methodologies to set forth for implementing the fiscal targets are reported in the following two reports:-

1. ***Half Yearly Review Report.***
2. ***Compliance Report by an independent Agency- The National Institute of Public Finance & Policy, New Delhi.***

- We would also be interested in whether the State FRL could incorporate measures designed to promote the productivity and efficiency of public expenditure.

The issue is addressed by the three year rolling target as encapsulated in the MTFP being prepared annually and presented to the State Legislative Assembly.

6. Impact of FRLs on Cash Surpluses of States

Alongside the improvement in fiscal position of States, there has been a build-up of cash balances with them. These have persisted at high levels since 2004-06 (See Figure 3). Such high magnitude of cash balances raises issues regarding the cash management by State Government. In this context

- What is the State' view on the rise in their surplus cash balances in the post-FRL period?

The cash surplus at the end of the financial year is largely due to :-

a) ***large amount of transfers under central plan scheme and CSS that are received at the last quarter of the financial year and substantial portion of it remains unutilized.***

b) Difference between the cheque issued during the year but not encashed during the year give rise to cash surplus.

The cash surplus arising due to the above fact is not actual cash surplus because it is against the committed liabilities.

- Are there alternative investment options for surplus cash balances?

The cash surplus is being invested at the regular intervals and the interests accrued are being credited to the government accounts.

7. Annual CAG audits of State finances

The Comptroller and Auditor General (CAG) of India publishes annual audit reports on State government finances that are important sources of policy information for inter-governmental bodies like the Finance Commissions.

- In this context, we would be particularly interested in knowing the States' views on the content and focus, and coverage of such reports. How can the audit reports be better shaped to serve the purposes of fiscal responsibility and budget management of States?

The audit report does not contain the detailed analysis as required by the FRBM Act. It will be better if such analysis is incorporated in the CAG's Report. **The State will require** ***to study it further.***

- To what extent can we make better use of the CAG audit reports of state finance and FRBM compliance reports published by orgs like NIPFP to facilitate and ensure FRBM compliance going forward?

Compliance Reports on FRBM Act 2010 are being prepared independently by National Institute of Public Finance & Policy, New Delhi every year for the State. The report has guided the government on efficient management of the State finances within the framework of the FRBM Act 2010.

8. The impact of the recommendations of the Fourteenth Finance Commission (FFC) on State Finances

The FFC has recommended landmark changes in the vertical devolution of States, increasing States' share in the divisible pool to 42 percent, a rise of 10 percentage points from the recommendations of the Thirteenth Finance Commission.

Equally radical were the FFC's changes to the formula governing the horizontal distribution of the divisible pool of central taxes among the State.

The Committee recognizes that the combined implication of these changes, along with the changes in non-FC central grants to the States would, in combination, have a highly differentiated impact on States. In the context, the Committee would be keen to understand the specific implications of this these changes for inter-governmental transfers on State Finances.

Subject to certain conditions, the FFC has also provided for some flexibility in the States' fiscal deficit target of 0.5 percentage points, over and above their FRL limits.

- What are the States' views on this recommendation? If States plan to avail of this provision, how do they plan to allocate the extra fiscal space of 0.5 percent of GSDP among their different expenditure priorities? Do they plan to use the extra fiscal space to incur revenue expenditure or capital expenditure?

Though the State was eligible for the fiscal space of 0.5 percent of GSDP during last financial year 2015-16, the Ministry of Finance, Government of India has not allowed the additional amount being the first year of the FFC award period. If allowed in the current financial year the same will be utilized for Capital Expenditure.

The Fourteenth Finance Commission (FFC) has projected annual growth rate of comparable GSDP for Sikkim at 28.05% from 2014-2015 and at 24.32% for the period of 2015-16 to 2019-20. The higher growth rate assumed by the FFC resulted in higher assessed revenue of the state during the award period of the Commission. The own tax revenue projected for 2015-16 by the Commission is Rs876.00 crores which rises to Rs3039.00 crores in the year 2019-20. Higher tax projection by the Commission reduced the pre-devolution revenue deficit gap for the State during the award period. The projected revenue receipt cannot be achieved as it is based on a very high rate of growth as indicated above which in it self cannot be achieved.

The year 2009-10 makes a clear shift in the growth path of the GSDP as the growth rate this year jumped to a high of 73.6 % (89.9% in Current prices). This was basically due to investment in hydro electricity power projects including higher production in the manufacturing sector due to establishment of new pharmaceutical industries. However, these sectors growing rapidly have contributed to the growth process but have not contributed to the revenue of the State to the same extent. This is not due to any weakness in the tax policy or tax administration of the State.

The investment in hydro electricity power projects while adding to the GSDP now remains outside the State tax system. Similarly the *pharmaceutical industries send their products out of the State through stock transfers which is not captured in the tax network. Thus, it may not be possible for the State to achieve the said receipt projected by 14th FC in their assessment for the period 2015-16 to 2019-20 and also adversely affect the share of Central Taxes.*

Further, the FFC transfers to the State depend upon the resource mobilization of the Central Govt. While the FFC recommended Rs2129 crores as share in the Central taxes for Sikkim, the Union budget for 2015-16 provided Rs1924.69 crores only. The actual flow, however, was much less at Rs1870.28 crores. This implies a gap of Rs258.72 crores during 2015-16 which is expected to grow in the future years.

Consequent upon the enhancement of share of States in Central divisible pool from the current 32% to 42%, central assistance to the State plan has been restructured. Normal Central Assistance, Special Plan Assistance, Special Central Assistance, Additional Central Assistance are subsumed within the increased devolution. The Central Government has discontinued the Normal Central Assistance, Special Plan Assistance, Special Central Assistance, Additional Central Assistance. The Central Government has also de-linked support for eight Central Schemes from funding and brought about substantial changes in the funding pattern of some other schemes resulting in reduction of funds available to the State.

Decline in the Central grants and gap in actual flow of tax devolution to that of the budget projection makes it very difficult to provide funds to the infrastructure projects started earlier and in the future based on the funds flow mechanism existing under the then Planning Commission and the Finance Commission.

The State has been adversely affected and moreover the low population base along with difficult geography of the state makes it difficult for taking up additional resource mobilization. It is therefore, necessary to re-visit the assumptions for the higher rate of growth of GSDP projected by the FFC and the resultant award made to the state in view of the above facts.

23/7/16

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Additional Chief Secretary to Government,

Finance (W&M-I) Department,
Secretariat, Chennai-600 009.

D.O.Letter.No.1275/FS/T/2016- 2, dated. 08.10.2016

Dear Sir,

Sub: FRBM Review Committee - Terms of Reference - Views of Tamil Nadu - Furnished - Reg.

Ref: Your D.O.Letter No.3/8/2016-FRBM, dt.12.07.2016 addressed to the Chief Secretary, Government of Tamil Nadu.

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I take this opportunity to thank FRBM review Committee for the kind intimation to the meeting. However, as the Tamil Nadu Legislative Assembly was in session during that meeting, officials from Tamil Nadu were not able to attend the meeting. Meanwhile, I wish to inform the Committee about the views of Government of Tamil Nadu regarding FRBM norms, which Tamil Nadu has already raised on various platforms from time to time.

The strait-jacketed annual three percent fiscal deficit norm greatly weakens States' ability to pursue counter cyclical policies during times of economic stress. Annual deficit parameters wildly fluctuate year after year based on events like pay revision, natural calamities, general economic situation etc. In an environment of economic downturn, States have an obligation to strengthen their social security net in spite of falling revenues. The present approach does not provide for flexibility to increase expenditure during the times of actual necessity. Further, this approach penalizes States which have bettered the targets during the major portion of a period, by disallowing them to mobilize additional funds on occasional needs.

Hence, we would like to suggest a dynamic and flexible model, which needs to be adopted in order to reward States that have a strong fiscal record and enable them to meet cyclical needs. One way to make the model dynamic is to link the eligible Fiscal Deficit limits for a given year with Fiscal Deficit for the past 2 years and ratio of interest payment to revenue Receipts, as illustrated bellow:

Fiscal Deficit for the past 2 years	Ratio of Interest Payment to Revenue Receipts	
	Less than 15 percent	More than 15 percent
Less than 2.5 percent	4 percent of FD	3.5 percent of FD
Between 2.5 percent and 3 percent	3.5 percent of FD	3 percent of FD

Having successfully implemented the Tamil Nadu Fiscal Regulation Act, 2003 for thirteen years, we are of the firm view that the condition of Revenue surplus create artificial restriction on expenditure needs of the State. The three percent fiscal deficit criterion already ensures that the States' overall expenditure is within sustainable limits. The requirement of nil Revenue Deficit creates a distinction as if revenue deficit is bad and capital expenditure is good, which is a sweeping generalization. Such criterion may force States to push for expenditure which can be described in accounting terms as capital expenditure rather than as revenue expenditure. Such distinction is highly detrimental to overall public service delivery requirements. Hence, we believe that the nil Revenue Deficit requirement should be removed from FRBM legislations.

The Debt-GSDP ratio and a dynamic Fiscal Deficit target are sufficient indicators to assess the fiscal health of the Government finances. Both these parameters are simple and are organically linked with the performance of the economy.

A detailed response of the State Government to our consultation paper has been enclosed as an Annexure to this D.O. Letter.

Yours sincerely,

13/10/16.

To

Thiru N.K.Singh,
Chairman, FRBM Review Committee,
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Uttar Pradesh

- U.P. recorded quantum jump came in 1998-99 with an all time high revenue deficit of Rs. 8696.16 crore, which in relation to GSDP was 5.1 percent.
- Due to FRBM Act, the State has managed to move ahead maintaining a disciplined economy in which the State has maintained its revenue surplus since 2006-07 and has adhered the 3 percent GFD/GSDP in most of the last 12 years.
- UP FRBM Act enacted in February 2004 to reduce revenue deficit to zero by 2008-09, GFD to 3% of GSDP by 2008-09 and (c) debt stock to 25% of GSDP by 2017-18.
- However in the wake of report of 13th FC the targets were again amended for the award period of 13th FC in which revenue surplus to be maintained, GFD/GSDP ratio should be less than 3 percent and Debt/GSDP ratio should gradually come down from 46.9 percent in 2011-12 to 41.9 percent in 2014-15.
- Again after the recommendation of the 14th Finance Commission the State Government amended the FRBM Act in FY 2015-16 in which revenue surplus to be maintained and GFD/GSDP ratio should continue to be less than 3 percent barring 0.25-0.25 flexibility.
- The State however defined its own Debt/GSDP ratio in the FRBM Act visualising the impact of FRP etc under which it should be 31 percent in 2015-16 and brought down to 30 percent by 2019-20.
- Apart from that a ceiling on new capital works has also been fixed i.e at least 70 percent of budget provision for capital works for the ongoing capital works and not more than 30 percent for the new capital works in the annual budget provision of various departments.
- The state's net lending has always been fully ultilised in the creation of capital asset and a substantial portion of revenue surplus has also been used.
- Apart from that Debt/GSDP ratio was always been well below the limits of FRBM act and also less than the ratios recommended by respective Finance Commissions.
- State has managed to increase its capital expenditure from 1.2 percent in 1998-99 to 5.58 percent in 2008-09.
- After that due to the recession in economy and other vital factors, the capital outlay slowed a bit but again been raised to 5.58 percent in 2014-15. .
- The State of Uttar Pradesh was among the first few States which incorporated the FRBM Act in the year 2004 in which Debt/GSDP ratio were defined for the rolling years. The State has initially defined these ratio as per its current volume and its need in future however later 13th Finance Commission recommended the Debt/GSDP cap for all the States from the year 2010-11 onwards and thus State of Uttar Pradesh amended its FRBM act accordingly. Now with 14th FC doing the same, however this time State has amended its FRBM Act as per the current debt situation of the State taking into account the impact of FRP.
- The State of Uttar Pradesh has not provided for legal limits on guarantees.
- primary sources of the debt of the State of Uttar Pradesh have been market loans, loans against Small Savings, loans from Financial Institutions and Loans against General Provident Fund (GPF). Of these

small savings loans prior to formation of NSSF, and subsequently loans from NSSF, have piled up most rapidly, and have also been the costliest loans. Other constituents mentioned such as Special Purpose Vehicles, Public Sector Undertakings are not included in the component of State's liability.

- State supports 14th FC views on voluntary disclosures of off-budget borrowing and contingent liabilities [14th FC has recommended that "Keeping in mind the importance of risks arising from guarantees, off-budget borrowings and accumulated losses of financially weak public sector enterprises when assessing the debt position of States, we recommend that both Union and State Governments adopt a template for collating, analysing and annually reporting the total extended public debt in their respective budgets as a supplement to the budget document".]
- The concerned department related to PPP usually keep the information at departmental level. There is no reporting mechanism by the State Government
- There is a single instance where State Government Agency has borrowed funds indirectly from financial institutions and repayment of such amounts is to be made from the State Budget in the form of grants-in-aid. The State Government doesn't report these borrowed funds under the "repayment of loans". It is to be noted that due to some unforeseen circumstances, State sometimes needs urgent fund but due to the cap of borrowing ceiling of 3 percent, States are left with no choice but to opt for off-budget borrowings. However principally State agrees that there should not be any off-budget borrowings & a provision in this regard should be incorporated in FRL along with more flexibility in GFD/GSDP ratio say 4 percent of GSDP provided they are in revenue surplus. This will restrict States from taking any off-budget borrowings.
- The State agrees with the view that there has been a tendency of seeing revenue expenditure as a bad expenditure. The State suggests that the expenditure on maintenance of capital assets should be incorporated under the capital head which will ensure adequate funds for maintaining of capital assets. Such amendment should be brought into the ambit of FRBM rules.
- The State agrees with view that certain public expenditure that explicitly impacts the development objectives of States should be treated differently. In this view, our suggestion is that in case due to certain factors such as economic slowdown etc such developmental expenditure is adversely affected then in such circumstances the GFD/GSDP ratio should be made flexible for the States and raised to 4 percent provided they are in revenue surplus to ensure that more money can be influx into these public expenditure items of paramount nature.
- Theoretically it is true that State of Uttar Pradesh has managed to keep its macro fiscal indicators within their limits and at the same time State has also managed to provide sufficient funds for quality public spending. However on the other side, it is also true that States have to manage its spending within the FRBM targets which squeezes its fund and thus directly or indirectly it does affect the public spending at times. The States have to keep the state specific needs in their mind for which a large chunk of fund is used. Hence the states suggestion is that State's should be given flexibility in their FRBM targets or borrowing ceiling in order to expend in major public expenditure segment.
- We do not support the view regarding fiscal constraints on borrowing for consumption and borrowing for public investment. State has its own developmental agenda and priorities and thus State borrows as per its needs and requirements.
- If any other measure such as public expenditure is incorporated and designed in FRL then it will only complicate the matter further since on one hand the State Government has to stick to its FRBM targets

and also at the same time forced to expend on the areas incorporated in FRL. It is evident that with the State's limited resource, incorporation of public expenditure in FRL is likely to squeeze the funds for many other developmental and state specific areas and State may not have sufficient fund for this.

- State doesn't have surplus cash balances offlate, however sometimes due to uncontrollable circumstances at the end of the financial year, the State is left with surplus cash balance which is usually invested in treasury bills.
- The State Government does take the views into account of CAG audit reports of State Finances and acts accordingly. The State of Uttar Pradesh welcomes the analysis of organisations like NIPFP on State's issues such as FRBM compliance which will help State in impartial assessment of its policies.
- The Fourteenth Finance Commission has undoubtedly increased vertical transfers to States by increasing their share in tax devolution by 10%. However, side by side there has been a substantial decline in statutory grants and change in funding pattern of CSS.
- As far as horizontal distribution is concerned, the share of Uttar Pradesh has declined from 19.677% under 13th FC to 17.959 % i.e. a loss of 1.718 %. In the first year of the 14th Finance Commission this reduction in U.P.'s interse share has resulted in a loss of about Rs.8630 crores which is likely to increase further with the increase in the central revenues.
- The 14th Finance Commission while increasing the share of States in the divisible pool has done away with State Specific grants assuming that the States will utilize the additional fiscal space to provide for the same. In the last year of the 13th Finance Commission award period the State received a grant of Rs.2595 crores under different schemes/sectors.
- Therefore, the State which has to fund its regular development projects will not be left with much fiscal space even after the 10% increase in devolution for States.
- U.P. Electricity Regulatory Commission has provided under its tariff regulations that Commission will take maximum 120 days in determining the tariff subsequent to ARR filing by the licensee. Accordingly, it has been contemplated that the State Discoms shall ensure ARR filing before Regulatory Commission by 30th November of each year so that tariffs for the prospective year gets determined by the Regulatory Commission by 31st March necessarily. Since last two years State Discoms are filing tariffs on time however there is delay in the part of the Commission in the determination of the tariff leading to a situation of under recovery of revenue gap by way of tariff increase. This matter has been taken up with the Regulatory Commission so that tariff for any particular year gets effective from the beginning of financial year. Transparency is strongly embedded in the Regulatory process of issuance of tariff order, which is followed in letter and spirit by the Commission. There are no off-budget subsidies to the power sector..
- The total outstanding debt of the DISCOMS on Sep 30, 2015 was Rs. 53,935 crore. Against this, The State Government issued bonds of Rs. 39,133.76 at average rate of interest is 8.6% p.a. and repayment of bonds starts from the F.Y. 2019-20. The State Government has already requested the GOI to keep the interest on UDAY bonds outside FRBM limit for the maturity period of the bonds. The repayment burden, although not a part of the fiscal deficit, will eat into cash balance of the State if substitution of the repayment burden is not allowed. The State Government is of the view that interest on UDAY bonds should be kept outside FRBM targets and substitution of repayment burden should be allowed depending on the cash position of the States.

ANNEXURE

Response to the Consultation Paper on FRBM Review

With reference to Terms of Reference of the FRBM Committee

(i) The FRBM legislation and its compliance by States largely depend on the macro economic policy initiatives/ decisions of Government of India/ recommendations of successive Finance Commissions. The role of States in taxation and macro-economic policy decisions are limited, especially the global economic progression, its impact on the national/ State economies, fluctuation in the prices of major commodities like fuel, gas, gold, etc. and the internal factors like natural calamities, pay commission implementation, policy interest rates and so on.

Impact of global economy

- Whenever there happens a global economic slow-down/ saturation, the impact on the revenues of States does have a double whammy effect, one by way of cut in sharable central taxes and the other on the State's own tax collections. Normally the cut in shareable central taxes are made available only during February last every year, by which time, the States could not adjust their committed expenditure for the year.
- A major portion of States' revenue expenditure goes towards committed liabilities such as Salaries and Pensions, Interest Payments and Welfare schemes for the deprived segments of the society. Therefore, the States are, generally, not in a position to curtail their expenditure in tune with the lower revenue collections.

Central Grants to States

- In addition transparency in allocation of funds for centrally assisted schemes and ensuring timely release of approved outlays for the year in full also goes a long way in deciding the fiscal parameters of States. As witnessed in some of the preceding years, the ad-hoc cuts in Central outlays for Non-Plan/ Plan schemes during the third quarter, also burdens the liability of the State, as the funding for the ongoing schemes could not be abruptly withheld for want of central funds. This was felt in some of the vital sectors like health, education, welfare of SCs/STs, etc.
- The accumulation of agreed compensation for Central Sales Tax, and the delay in release of the grant till date also aggravates the fiscal situation of the State. Therefore, in the context of implementation of the Goods and Services Tax, necessary safe-guards shall be provided for release of the compensation within the financial year itself and any delay in the release shall be factored in while calculating the deficits.

Impact of Natural Calamities

- One more neglected area is the cascading effect of natural calamities on the economies of the States. Whenever drought occurs, it has the spiraling effect of negative growth in the agriculture sector and on the manufacturing and services sectors. Similarly, floods also severely affect the manufacturing and

	services sector and it takes time to undertake the restoration / renovation works through incurring additional capital spending. The pecuniary grants from SDRF/ NDRF fully goes towards the immediate relief and response activities only and it is not a substitute to the growth that could have been achieved but for natural calamities. Therefore, the States shall be provided sufficient time and fiscal space to bring back the economy on the sustainable growth path. On the other side, when the economy performed well and is sustained, it had a positive effect on the revenues of the State and help in fiscal consolidation and achieving the fiscal targets set out in the FRBMA. This is manifested in the fiscal performance in the past 12 years, which has witnessed ups and downs in tune with the economic upheavals. This covers the relaxation to FRBMA during the global economic crisis. It is pertinent to mention here that the 13th and 14th Finance Commissions had observed that macro-economic stabilization and counter recessionary actions are the primary responsibility of the Union Government and the core objective of which is the need to allow the fiscal system to adapt to exogenous shocks and/or changes in exogenous parameter values. In particular, the 14th FC had suggested that the Union Government may take a comprehensive view on the above taking into account the global experience of legislation in this regard, Indian experience in the past, and the data and operational requirements for the purpose. Therefore, it is suggested that rather than imposing mid year cuts on the approved outlays for the centrally assisted schemes in order to achieve the fiscal parameters of the Centre and allowing the individual States to amend their FRBMA, the Union Government shall take a pragmatic view of the circumstances and take necessary steps to protect the States from macro-economic changes/ exogenous shocks and recessionary trends. It may also be appreciated that the cost of funding of such additional expenditure, when undertaken by the Centre is less in comparison to mobilization of additional resources by the States.
(ii)	**Incentive for Fiscal Prudence** Till the 13th Finance Commission, though the size of incentive gradually depleted, the States were offered some rewards for showing improvements in their fiscal performance like elimination of revenue deficit, containing fiscal deficit, complying with net borrowing ceilings and Debt-GSDP ratio, etc, The 14th FC had not provided any relief to the States for their adherence to the fiscal prudence. In addition, the weightage given for fiscal performance in determining the horizontal devolution of shareable central taxes was also completely obliterated. So, there is no incentives for the States to adhere to the FRBM norms, anymore. **Additional Borrowing Space** The 14th FC had provided the much needed flexibility in incurring capital expenditure by way of offering an additional 0.5% fiscal deficit and the carry forward/ adjustment of unutilized/ overspent fiscal deficit in the succeeding years during its award period 2015-2020, provided the States are primarily in revenue surplus. For this, the States have to keep their Debt-GSDP ratio within 25% and maintain interest payments to Revenue Receipts within 10%. Though, maintaining Debt-GSDP ratio, the Interest Payments to Total Revenue Receipts norm may be enhanced to atleast 15%, as most of the States may not be in a position to adhere to the 10% ratio. The requirement for additional funding will normally arise in the years of revenue deficit rather than revenue surplus years. It is only during revenue deficit years that the States will face pressure in maintaining the Capital spending and any

	contraction in capital outlay may hamper the much needed impetus to the growth of the economy. As in the case of proposed declassification of Plan and Non-Plan expenditure by the Centre, the expenditure on human / social development indices like payment of salaries to teachers, doctors, cost of providing education kit, drugs, .etc. though form part of revenue expenditure as per extant accounting classification, are basically an investment in human resources for a healthy and able future generation. Hence, irrespective of the revenue account balances, the emphasis shall be on the overall fiscal limits for the purpose of sustainability of debt. Hence, the States expect the much needed fiscal space in the years of economic slowdown so as to revive the growth through additional capital spending. Therefore, the benefit of additional 0.5% of fiscal deficit may be given to the States regardless of revenue deficit during the 14th FC award period. **Exceptions to FRBM norms** It is felt that two main areas of State Governments' expenditure relating to the State's share of contribution made to Defined Pension Contribution Scheme and the Sinking Funds are not at all looked into while assessing the fiscal performance of the States. While the first one is a current consumption against a future saving which may be called as inter-generational equity and the later one is an investment of capital nature against future repayment liabilities. The norms/ expenditure are not uniform among the States and therefore due weightage/ a criterion shall be fixed to exclude these expenditure from the overall revenue/ fiscal deficits.
(iii)	It is understood that the fiscal deficit range contemplated in the terms of reference is for a specific period rather than year on year targets. It is felt that fixing a range for a span of years without any yearly targets for reduction of fiscal deficit may lead to expansion of the deficit in the intervening years. Though, this may prevent the Centre and States from approaching the legislature for annual revision in fiscal targets, the question of accountability to the legislature may get diluted. Further, the very purpose of fiscal consolidation may not be achieved because of the additional space provided in the range for incurring the fiscal deficit and may prove counter-productive to the credit expansion contemplated in ToR (iv). Moreover, the 14th FC itself had recommended that the unutilized fiscal deficit in any of the years during the award period can be carried forward to the succeeding year. Similarly, the excess fiscal deficit can also be adjusted against the subsequent year's spending. Thus it is suggested that instead of maintaining a strict 3% GSDP limit year on year, FD limits may be relaxed, subject to the fiscal performance in the past years. This would help States to meet economically stressful years more positively. A model as detailed below, will provide way for both a strong fiscal consolidation in the long term and a flexible approach in the short term.

Fiscal Deficit for the past 2 years	Ratio of Interest Payment to Revenue Receipts	
	Less than 15 percent	**More than 15 percent**
Less than 2.5 percent	4 percent of FD	3.5 percent of FD
Between 2.5 percent and 3 percent	3.5 percent of FD	3 percent of FD

(iv)	In the years of economic crisis, when the private sector may find it difficult to sustain the demand, naturally, it is the responsibility of the Centre and States to step up their expenditure in order to create/sustain the demand, so as to accelerate the growth cycle. Therefore, the fiscal expansion of States need not be directly linked to credit contraction. At the same time, when the inflation is high and interest rates are hiked to rein the inflation, generally there will be less credit off-take by the private players.

K.SHANMUGAM,
Additional Chief Secretary to Government

/True Copy /

Section Officer

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