FISCAL POLICY STRATEGY STATEMENT

A. Fiscal Policy Review

1. The Interim budget 2014-15 was presented against the background of sub five per cent growth rate. The prevailing economic conditions had been enumerated in the Macro-economic Framework Statement and Fiscal Policy Strategy Statement presented along with the Interim Budget 2014-15. The assumptions underlying the Statements have since been confirmed by release of advance estimates on GDP growth by CSO. There was a marginal improvement in 2013-14 with GDP growing at 4.7 per cent, against 4.5 per cent growth in 2012-13. Significantly, provisional accounts show improvement in the fiscal deficit over and above the estimates at 4.5 per cent, against 4.8 per cent in BE and 4.6 per cent in RE.

2. It may be indicated that the improvement in state of public finances for two successive years was achieved despite varied challenges both on the receipt side and expenditure side. Due to negative economic outlook in domestic markets and complex economic situation prevailing in the external market, there was pressure on tax receipts as well as spending on subsidies. However, government adhered to the path of fiscal consolidation steadfastly, resulting in correction of fiscal deficit. The fiscal consolidation achieved in the fiscal 2004-05 to 2007-08, immediately following enactment of the Fiscal Responsibility and Budget Management Act, 2003 was largely due growth in tax revenues in the backdrop of robust economic growth. The tax to GDP ratio which peaked at 11.9 per cent in FY 2007-08, however declined following stimulus package in the aftermath of global financial crisis. The current phase of fiscal consolidation was implemented against the backdrop of slowdown in growth. The tax revenues could not be mopped up to the targeted levels in both the years of consolidation. Fiscal consolidation, therefore, was largely by way of expenditure management. Going forward, consolidation has to be achieved through greater mobilization of resources as well as rationalization of expenditure.

3. One of the concerns of government expenditure has been the capital revenue split. While concerns of equitable growth demand expenditure on social and welfare sector, growth imperatives require higher capital spending by the government. Fiscal consolidation targets limit the fiscal space available, mandating balance between the two demands. Over the medium term, the fiscal constraints imposed by the fiscal roadmap provide the framework for application of resources available. An analysis of government expenditure is provided in the latter section. Another interesting feature on the resource mobilization side has been the growth in non-tax revenue. The increase in non-tax revenue in 2013-14 has been one of the steepest in recent years and it has now grown in volumes to be equivalent to one of the Indirect tax receipts.

4. Resource mobilization in 2014-15 on the non-tax side has been the result of measures taken by the Government of unlocking locked up resources". Government through legislation and executive decisions had created balances under various earmarked funds after seeking Parliamentary appropriation for specific purposes. An analysis of the balances under theses earmarked funds revealed that there are significant balances lying under such funds, which are not being used for financing welfare and development activities of the Government. It was accordingly decided that amounts lying unutilized in the fund shall be used for the purpose for which they were earmarked in the first instance. An amount of ₹12,252 crores lying unused in various funds such as National Clean Energy Fund, Central Road Fund, Prarambhik Shiksha Kosh, Social and Infrastructure Development Fund and Guarantee Redemption Fund etc. has been redeployed in the Budget for financing activities spelt out in the respective legislation or Government decision. For sake of greater legislative accountability and transparency, the transaction is being routed through Consolidated Fund of India .

5. The imperative of fiscal consolidation for providing impetus to growth as well as taming inflation is well appreciated. There is general consensus that sustained high levels of fiscal deficit causes diverse forms of macroeconomic imbalances and calls for immediate corrective action. High fiscal deficit tends to heighten inflation, reduces room for monetary policy actions, and dampens private investment. The moderation in GDP growth to sub 5 per cent level in two successive years has been accompanied with one of the difficult inflationary phases in recent times; especially retail sector inflation has been sticky. This calls for firm and decisive action. Weakening growth along with sticky inflation presented formidable macro-economic situation which calls for coordinated response from fiscal and monetary policy. It was

essential to contain government spending so as to provide necessary space for the easing of monetary policy to revive investment cycle and growth. The correction in fiscal was urgently required to provide the room for monetary policy to provide much needed impetus to growth while balancing the concerns on inflation. The ground has been laid for monetary policy action to follow.

6. In the main budget, government has re-affirmed its commitment to continue the fiscal consolidation path announced in 2012-13. The fiscal deficit has been retained at the interim budget level; while providing additional resources in sync with the objective of the government to meet its social and welfare commitments and remain focussed on development agenda. The effort is to contain regular spending while providing for much needed developmental expenditure to spur growth. It is noteworthy that despite changes in the developmental goals, government has remained undeterred on the path of fiscal consolidation. The commitment to fiscal consolidation also lays down the foundation of fiscal policy over the medium term framework.

B. Fiscal Policy for 2014-15

7. The General Budget 2014-15 is being presented against a backdrop of less than 5 per cent growth rate in the last two financial years. However, there are early signs of recovery with the growth rate having bottomed out at 4.5 per cent in 2012-13 has registered marginal improvement at 4.7 per cent in 2013-14. It is expected to recover further in this fiscal, with varied estimates pegging growth between 5.5 to 6 per cent. Government has retained the fiscal deficit target of 4.1 per cent of the interim budget in the General Budget. Higher allocation to meet social and welfare objectives while providing for development has been provisioned. Having tamed the twin deficit, on the fiscal and current account, challenge lies in reviving the growth while keeping inflation under check. The thrust of fiscal policy in the General Budget is thus guided by need to steer the economy on higher growth trajectory with emphasis on equitable sharing of the fruits. Special emphasis is laid on promoting sectors with potential for higher employability and skill upgradation to meet the requirements of emerging job demand. With revival of market sentiment, it is expected that positive and pro-active action on the policy will boost the prospects of growth in the current fiscal.

8. The fiscal policy of 2014-15 has been calibrated with two fold objectives – first, to aid economy in growth revival; and second, to continue on the path of fiscal consolidation by containing fiscal deficit so as to leave space for private sector credit as the investment cycle picks up. Having contained the spending within sustainable limits in the previous financial year, budget 2014-15 provides 3.5 per cent increase in the plan expenditure over the budgeted estimates of FY 2013-14. Against the actual expenditure in 2013-14, this allocation marks an increase of 26.9 per cent and is expected to adequately meet the developmental requirements. A growth of 9.9 per cent has been provided for Non-plan expenditure in BE 2014-15 over 2013-14 keeping in view the requirements for Defence, Subsidies, Interest payments, Finance Commission Grants and increase in salaries and pensionary payments etc. This would result in overall expenditure increase of 14.8 per cent in BE 2014-15 over provisional actuals of 2013-14. As a result of these measures, fiscal deficit is estimated to come down to 4.1 per cent of GDP, improving over the target set in the roadmap for fiscal consolidation announced by the government. As percentage of GDP, total expenditure is estimated to be 13.9 per cent in BE 2014-15 as against 13.8 per cent in 2013-14.

9. Apart from containing growth in expenditure, the reduction in fiscal deficit is planned to be achieved in conjunction with targeted revenue augmentation both through tax and non-tax revenues. Tax to GDP ratio estimated at 10.9 per cent of GDP in BE 2013-14, stood at 10.0 per cent of GDP as per provisional accounts in 2013-14, due to slowdown in economic growth. However, with the recovery in GDP growth expected in FY 2014-15, tax to GDP ratio of 10.6 per cent is targeted in BE 2014-15. This implies a growth of 19.8 per cent over actuals in 2013-14; however it is only 10.4 per cent growth over the budget estimate of FY 2013-14. Moderation of GDP growth in last few years had led to lower than budgeted performance; it is expected that with revival of growth in the economy to above 6 per cent levels, with existing tax provision, this target can be achieved. It is noteworthy that additional measures introduced last year on the service tax, corporation and surcharges will continue in 2014-15 as well. Growth of 6.7 per cent has been provided for non-tax revenue in BE 2014-15 as compared to actuals in 2013-14. However, as compared to BE 2013-14 there is substantial growth of 23.4 per cent. This has been made possible due to unlocking of resources lying in various funds, higher dividend paid by RBI and increase in estimates of Spectrum charges, as explained in the Medium Term Fiscal Policy Statement.

10. On the expenditure front, apart from measures taken to control increase in spending, certain key policy decisions relating to subsidies have been taken by the Government in FY 2013-14. Government has adopted the policy of gradually increasing the diesel prices to

eliminate under recovery and deregulate the diesel prices. Inflationary pressures and other macro-economic factors make it difficult to affect sharp price correction. However, Government will continue with the policy of calibrated correction in the prices. Stabilization of external exchange and stable international crude oil prices are critical in the process of rationalization of diesel prices. It is expected that the gap between administered price and market price of diesel would be eliminated by early FY 2014-15. Thereafter, both petrol and diesel would be deregulated and linked to market prices, leaving PDS Kerosene and LPG subsidy. On the Food subsidy, so far 11 States have started implementing National Food Security Act (NFSA) and gradually other States too would follow. Under NFSA, two-thirds of the population is entitled to receive 5 kg per person, per months at the rate of Rs. 1/2/3 per kg for coarse grains/wheat/ rice. AAY households would continue to receive 35 kg per month. The release of food subsidy during 2011-12 was ₹ 72,822 crore, which increased to ₹ 85,000 crore in 2012-13 and ₹ 92,318 crore in 2013-14.

Tax Policy

11. During the fiscal consolidation period, the tax-GDP ratio improved significantly from 9.2 per cent in 2003-04 to 11.9 per cent in 2007-08. This has been achieved through rationalization of the tax structure (moderate levels and a few rates), widening of the tax base, and reduction in compliance costs through improvement in tax administration. The extensive adoption of information technology solutions and re-engineering of business processes has also fostered a less intrusive tax system and encouraged voluntary compliance. These measures resulted in increased buoyancy in tax revenues till 2007-08 and helped in achieving fiscal consolidation through revenue measures alone. Due to the stimulus measures undertaken largely on the tax side during the global economic crisis in 2008-09 and 2009-10, as a measure to insulate Indian economy from the adverse impacts of global economic crisis and slowdown in domestic growth, the gross tax revenue as percentage of GDP declined sharply to 9.7 per cent in 2009-10.

12. Further, due to high international prices and as a measure to insulate consumers and to reduce under recoveries government had to further reduce taxes/ duty on petroleum products in 2011-12. As a result the gross tax receipts as percentage of GDP in 2011-12 declined to 9.9 per cent from 10.2 per cent in 2010-11. With partial roll back of stimulus measures in indirect taxes and additional revenue measures, it was estimated that tax receipt as percentage of GDP would improve to 10.9 per cent in 2013-14. However, global uncertainties and exchange rate volatility and growth rate lower than expectations in 2013-14, the tax-GDP ratio as per provisional actuals was 10.0 per cent. Tax buoyancy has come down to below one, implying thereby that tax collection has failed to keep pace with the growth in GDP. This is more pronounced in case of Indirect taxes than in Direct tax collection. Continuing forward on the path of fiscal consolidation with a view to narrow the gap in government spending and resources, the tax-GDP ratio has been targeted at 10.6 per cent in the BE 2014-15 with a growth rate of 19.8 per cent over provisional actuals of 2013-14.

Indirect Taxes

13. With the turnaround in economic activity expected in FY 2014-15, growth in exports and better industrial and manufacturing and expectation of recovery of growth rate provides scope for achieving the targets. While, the performance in 2013-14 was subdued with marginal growth over the previous year, it is expected that with the revival of growth in 2014-15 the budgeted target of 4.8 per cent of GDP will be achieved.

14. In the medium term, the most significant step from the point of view of broadening the tax base and improving revenue efficiency through better compliance is the introduction of Goods and ServicesTax (GST). As far as Central taxes viz. Central Excise duties and Service Tax are concerned, a fair amount of integration has already been achieved, especially through the cross-flow of credits across the two taxes. It would be possible to realize full integration of the taxation of goods and services only when the State VAT is also subsumed and a full-fledged GST is launched. In recent years, as a preparation for introduction of Goods and Service Tax (GST), Government has been taking consistent policy steps to expand the scope of service tax. To broaden the tax base, negative list approach to taxation of services was introduced with effect from 1st July, 2012.

15. In the same direction, to further broaden the service tax base by bringing stop filers and non-filers within the tax net, a Voluntary Compliance Encouragement Scheme (VCES) was proposed in the Budget exercise, 2013. The Scheme came into effect from 10th May, 2013. Under the scheme, one time amnesty by way of (i) waiver of interest and penalty; and (ii) immunity from prosecution, was extendable to the stop filers, non-filers or non-registrants or service providers who have not disclosed true liability in the returns filed by them during the period from October 2007 to December 2012, provided they declare and pay the tax dues. The VCES scheme was open for the declarants till 31st December, 2013. About 65,000 Declarations involving ₹ 7500 Crore of service

tax approximately had been received by the filed formations of Central Excise and Service tax, till 31st December, 2013. In FY 2013-14 the total amount paid under VCES was around ₹ 4000 Crore.

16. There are several specific proposals in the Budget 2014-15 to recalibrate the tax effort on indirect taxes so that fiscal consolidation may be achieved in the short term. The important and revenue significant proposals include:

- Basic Customs Duty on stainless steel flat products (CTH 7219 and 7220) is being increased from 5% to 7.5%.
- Export duty on bauxite is being increased from 10% to 20%.
- Basic Customs Duty on half-cut or broken diamonds is being increased from NIL to 2.5% and Basic Customs Duty on cut & polished diamonds and colored gemstones is being increased from 2% to 2.5%.
- Basic Customs Duty on specified telecommunication products not covered by the Information Technology Agreement is being increased from NIL to 10%.
- Education cess and Secondary & Higher Education (SHE) cess is being levied on imported electronic products so as to provide parity between domestically produced goods and imported goods.
- The duty structure on coal of various types is being rationalized at 2.5% BCD and 2% CVD. Accordingly, BCD on coking coal is being increased from Nil to 2.5% and on steam coal and bituminous coal from 2% to 2.5%. The CVD on anthracite, coking coal and other coal is being reduced from 6% to 2%.
- Basic Customs Duty on metallurgical coke is being increased from Nil to 2.5%.
- Excise duty on winding wires of copper is being increased from 10% to 12%.
- Excise duty at the rate of 2% (without CENVAT) or 6% (with CENVAT) is being imposed on Polyester Staple Fiber/Polyester Filament Yarn manufactured from plastic waste or scrap or plastic waste including waste polyethylene terephthalate (PET) bottles.
- Excise duty on cigarettes is being increased by 72% on cigarettes of length not exceeding 65 mm and by 11% to 21% on cigarettes of other lengths.
- Excise duty is being increased from 12% to 16% on pan masala, from 50% to 55% on unmanufactured tobacco and from 60% to 70% on jarda scented tobacco, gutkha and chewing tobacco.
- The rate of clean energy cess on coal, lignite and peat is being increased from 50 per tonne to ₹100 per tonne.
- Excise duty on recorded smart cards is being increased from 2% (without cenvat benefit)/ 6% (with cenvat benefit) to a uniform rate of 12%.
- An additional duty of excise is being levied at the rate of 5% on aerated waters containing added sugar.

17. The underlying theme of the indirect tax policy during the year was to boost domestic manufacture, to bring about clarity in tax laws, stability in duty rates, rationalization of taxes and minimizing disputes.

Direct Taxes

18. The Government policy on direct taxes has been to achieve growth in direct taxes by broadening the tax base while maintaining a regime of moderate tax base. Tax collection is the product of two factors- tax rates and tax base. There will be no change in the rate of personal income tax the rate of tax for the domestic and foreign companies in respect of income earned during the financial year 2014-15. The rate of surcharge will continue to be the same as in the last year.

19. The widening of tax based to achieve growth in tax collection is a continuous process which involves both legislative as well as administrative measures. The major policy proposals, intended to broaden the tax base and augment revenue, in the Union Budget 2014-15 are as under:-

- It is proposed to include the investment linked deduction within the ambit of alternate minimum tax (AMT) after making adjustment for depreciation.
- It is proposed to tax any advance received by the seller during the course of negotiations for transfer of capital assets if the transfer does not take place and such amount is forfeited.
- It is proposed to levy dividend distribution tax instead of only the actual amount paid to shareholders.
- It is proposed to provide that a unit of mutual fund (other than a unit of equity oriented fund)

or a share of an unlisted company shall be considered as a short term capital asset if it is held for a period not exceeding 36 months instead of 12 months.

- It is proposed to provide that the long term capital gain arising on transfer of a unit of a mutual fund (other than a unit of equity oriented fund) shall be chargeable to tax at the rate of 20 per cent after allowing indexation benefit instead of 10 per cent without indexation.
- Tax deduction at source at the rate of 2 per cent at the time of payment of maturity amount on Life Insurance Policies which are not exempt.

20. The administrative and technological initiatives to augment revenue are as under:-

- Extensive use of technology is being made for collection of information without intrusive methods. Information technology tools are being developed for exhaustive collection of information and maintenance of data base.
- Data ware house and business intelligence project has been undertaken for developing a comprehensive platform for effective utilization of information to enhance voluntary compliance and deter non-compliance.
- Centralize processing centre (Compliance management) is also proposed to be set up for handling resource intensive repeated tasks to increase greater efficiency.

21. There has been significant growth in the direct tax collection during the year 2013-14. Tax buoyancy for direct taxes has increased from 1.07 in financial year 2012-13 to 1.16 in financial year 2013-14. This shows that growth in direct tax collection has exceeded the nominal growth in GDP. The personal income tax has shown a higher growth as compared to the corporate income tax. The personal income tax increased by 20.51 per cent whereas the corporate income tax showed a growth of 10.76 per cent. Though there has been an increase in corporate income tax in terms of percentage in financial year 2013-14, the buoyancy remains less than one. The reason for buoyancy to be less than one in corporate income tax is that the profitability of the business and trade has diminished due to higher component of inflation in nominal GDP growth rate. These factors of inflation do not affect wages which mainly contribute to personal income tax collection.

Contingent and other Liabilities

22. In terms of Article 292 of the Constitution, Central Government gives guarantees for the repayment of borrowings upon the security of the Consolidated Fund of India. The FRBM Act mandates the Central Government to specify the annual target for assuming contingent liabilities in the form of guarantees. Accordingly, FRBM Rules prescribe a ceiling of 0.5 percent of GDP for incremental guarantees that the Government can assume in a particular financial year. The Central Government extends guarantees primarily for the purpose of improving viability of projects or activities undertaken by the Government entities with significant social and economic benefits, to lower the cost of borrowing as well as to fulfill the requirement in cases where sovereign guarantee is a precondition for bilateral/multilateral assistance. As the statutory corporations, government companies, co-operative institutions, financial institutions, autonomous bodies and authorities are distinct legal entities, they are responsible for their debts. In the process of guaranteeing their financial obligations the Government has the commitment to assess the fulfillment of such obligations and adequately disclose them. The disclosure is being made by the Government as per statutory requirements decided on the advice of Comptroller and Auditor General.

23. For better management of contingent liabilities, Government guarantee policy enumerates various principles which need to be followed before new contingent liabilities in the form of Sovereign Guarantees are undertaken. As guarantees extended by Government have the risk of its devolution on Government, the proposals are examined in the manner of a loan being taken directly by the Government. The principles enunciated in the policy lay down framework for minimization of risk exposure of sovereign while undertaking these contingent liabilities. The principles include assessment of risk including the probability of a future pay-out, priority of the activity, institutional limits on guarantee for limiting exposure towards select sectors and reviewing the requirement of guarantee for limiting exposure towards select sectors and reviewing the requirement of guarantee vis-a-vis other forms of budgetary support or comfort. Additional measures to further streamline the process of assuming risk could include charging of risk based premia disincentive for willful default, other part sharing of risk by the Government and insisting on guaranteed debt cost to be near the bench marked Government Securities rate.

24. The Stock of contingent liabilities in the form of guarantees given by government has increased in absolute terms from ₹ 1,07,957 crore at the beginning

of the FRBM Act regime in 2004-05 to ₹ 2,33,769 crore at the end of 2012-13. FRBM ceiling on guarantees which can be assumed by Government during a FY has resulted in reduced contingent liability to GDP ratio. Ratio which stood at 3.3 percent in 2004-05 is now reduced to 2.3 percent in 2012-13. The disclosure statement on outstanding Guarantees as prescribed in FRBM Rules, 2004 is appended in the Receipt Budget at Annex 5(iii). During the year 2012-13, net accretion to the stock of guarantees was ₹ 36938 crore, amounting to 0.37 percent of GDP, which is within the limit of 0.5 percent set under the FRBM Rules.

25. Government is also assuming liabilities for financing its activities by entering into annuity projects in respect to some infrastructure development activities. The commitments so made in these projects will occupy the fiscal space for future Governments and due care needs to be exercised in assuming these liabilities for the sake of intergenerational equity. As part of amended FRBM Rules, Government discloses its commitment liabilities towards such projects including project costs and annual pay-outs under the annuity projects. These commitments on account of on-going Annuity Projects under Ministries / Departments are disclosed in the prescribed format in Receipts Budget at Annexure-8. The annuity projects contracted by Government have a total committed value of ₹ 101146.69 crore with annual payment of ₹ 6,525.65 crore.

Government Borrowings, Lending and Investments

26. Status Paper on Government Debt is published annually to improve transparency in dissemination of information related to public debt. The third edition of the document was published in July, 2013. Prudent debt management is corner stone of good economic policy and experience in other part of the world has shown that vulnerability of debt profile to international shocks needs to be closely monitored in emerging global economic order. In India, debt policy is driven by the principle of gradual reduction of public debt to GDP ratio so as to further reduce debt servicing risk and create fiscal space for developmental expenditure. Indian debt profile is characterized by reliance on domestic market borrowings, with market determined rates rather than administered rates. Development of deep and wide secondary market for Government securities is one of the key reforms in this regard. Another important decision is to establish an independent Debt Management Office (DMO) in Ministry of Finance. While government is in the process of introducing necessary legislation, Middle Office has been established in the interlude. The office is assisting government in issuance of calendar for borrowing and advice on selection of instruments and other related matters.

27. One of the key features on country's debt profile is diminishing proportion of external debt as percentage of total borrowing. External borrowing is limited to bilateral / multilateral loans from select development partners for financing development projects. It has been decreasing in view of their exposure norms and income norms and the only significant bilateral partner as on date is Japan. The external funding has reduced significantly from ₹ 10,560 crores in BE 2013-14 to ₹ 5440 crores in RE 2013-14, as many projects are in inception stage and could not come up for payments while repayments were as per schedule, resulting in decline of net financing. The BE 2014-15 for external debt has therefore been kept at ₹ 5,734 crores. With gradual decline in net inflow from Multilateral Institutions in the coming years, government would have the option of exploring other sources of external debt for example in the form of sovereign bond issuance to maintain a reasonable mix of domestic and external debt in its portfolio. However, a low share external debt in the total debt insulates the debt portfolio from external sector shocks and currency risks. Low interest rates in the international financial markets in recent past suggested that it may be beneficial to borrow from international financial market. The decision to issue foreign currency denominated sovereign bonds, however, cannot be based on relative cost alone. The need to access international capital markets should be justified in the context of overall savings and investment requirements of the economy. Therefore, decision to issue sovereign bonds would require establishing a regular and predictable schedule of issuance leading to a build up of interest and redemption payments, keeping in view balance of payments (BoP) implications.

28. Developing a liquid and vibrant secondary market for government securities and broadening the investor base are the key factors to ensure that debt is raised in a cost effective manner. The initiatives to development market are undertaken with close coordination with the Reserve Bank of India. Primary issuance strategy of the Government remains focussed on issuing new securities under benchmark maturities and building volumes under existing securities to improve liquidity in the secondary market. During 2013-14, six new securities were issued including inflation indexed bonds which constituted 3.9 per cent of total issuance during the year, implying that more than 96 per cent issuances were in terms

of re-issues. Broadening of investor base is another key factor in the stability of demand for government securities. The Government introduced inflation indexed bonds based on WPI for institutional category in the starting of FY 2013-14 for market development and price discovery.

29. Apart from greater focus on market borrowings, the Government is also moving toward alignment of administered interest rates with the market rates. Interest rates on small savings are now linked with yields in secondary market for dated securities. The interest rates for every financial year are notified before 1st April. Collections under various small saving schemes, net of withdrawals, during the financial year form the source of funds for National Small Savings Fund (NSSF). The net collection is invested in Central and State Government Securities as per the recommendation of the Committee on Small Savings constituted in July, 2010. Redemption of these securities is reinvested in Central and State Government Securities in 50:50 ratio at prevailing rate of interest. States are provided excess interest relief based on their compliance with fiscal targets in respective FRBM Act. Interest payment to subscribers and cost of management constitute the expenditure under the fund and interest on Central and State Government Securities forms the income of the fund.

30. In 2013-14, net market borrowings at ₹ 4,68,902 crore financed about 92 per cent of gross fiscal deficit. Other sources of financing such as external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 8 per cent of GFD. During 2013-14, there was net inflow in the small savings account. The rollover risk in the Government debt portfolio continues to be low with weighted average maturity of outstanding dated securities close to 10 years. Furthermore, the share of short-term debt in outstanding dated securities in FY 2013-14 was just 4.0 per cent and debt maturing in next 5 years was less than 30 per cent of total debt, indicating a low level of rollover risks. Notwithstanding a low rollover risk, the Government is continuing its efforts to elongate the maturity profile of its debt portfolio. During the 2013-14, weighted average maturity of primary issuance of issuance was raised to 14.28 years from 13.5 years in the previous year. Noticeably, the increase in weighted average maturity was achieved without substantial increase borrowings costs. The weighted average yields of primary issuance during 2013-14 saw only moderate increase to 8.48 per cent from 8.36 per cent in the previous year, which may be seen in the backdrop of hardening of interest rates in the economy due to global factors and monetary tightening by Reserve Bank during the year. The increased maturity of primary issuances without a substantial increase in borrowings cost reflects the greater demand for longer tenor securities by insurance companies and provident funds which will continue to support the Government efforts to elongate its maturity profile in medium term.

31. Pursuing with Government's commitment to carry on with the fiscal consolidation measures, the fiscal deficit for 2014-15 is budgeted to decline to 4.1 per cent of GDP. Total borrowings requirement for 2014-15 has been budgeted at ₹ 6,00,000 crore or 4.7 per cent of GDP. Net market borrowings of ₹ 4,61,205 crore has been budgeted to finance about 86.8 per cent of fiscal deficit. In nominal terms, net borrowing reduced by 1.7 per cent over the previous year. In terms of GDP, however, they are budgeted to decline to 3.6 per cent as compared with 4.1 per cent in the previous year. Borrowings under other sources of financing are budgeted at 13.2 per cent during 2014-15. In terms of debt financing, the borrowings strategy during 2014-15 will continue to rely on domestic sources with external sources financing only 1 per cent of the fiscal deficit. Nearly, 99 per cent of GFD of ₹ 5,31,177 crore would be financed from the domestic sources. Borrowing strategy will continue its focus on raising resources through on market oriented instruments to meet both the short-term and medium term borrowings requirements of the Government.

32. Apart from ₹ 4,61,205 crore proposed to be raised through dated securities, a provision of ₹ 34,553 crore is also made to be realised through treasury bills. In addition to providing a greater manoeuvrability for cash management, treasury bills also provide benchmark and momentum to trading activity in the money market therefore facilitating the financial and corporate sector in meeting their short-term cash requirements. In addition, Small Savings, State Provident Fund and other receipts from Public Account would finance remaining portion of the deficit. There is no balance estimated at the end of financial year 2013-14 under Market Stabilization Scheme (MSS). Net accretion in MSS to the tune of ₹ 20,000 crore is however estimated in BE 2014-15.

33. In view of redemption pressures in coming years, particularly during 2015-16 to 2017-18, the Government in coordination with Reserve Bank made progress during 2013-14 in putting in place an active debt management strategy to manage its debt portfolio. Government adopted the policy of passive consolidation of dated securities during 2013-14. To ease out the short term redemption pressure in 2014-15, switch operation in dated securities (G-Secs)

was carried out with institutional investors. Accordingly, securities from 2014-15 and 2015-16 maturity buckets for face value of about ₹ 31,000 crore were successfully switched to longer tenor securities with institutional investors during January and February 2014. Securities amounting to ₹ 15,590 crore were bought back in March 2014 to smoothen the maturity profile of outstanding dated securities in 2014-15. Continuing further with active debt management strategy, it is proposed to undertake buyback / switch of another ₹ 50,000 crore securities of shorter tenor during 2014-15. Buyback of the debt serves twin purposes of effective cash management and smoothening of maturity profile. It is expected that Switching / Buy-backs will ease redemption pressure in the initial part of ensuing financial year. Moreover, with redemption pressure rising over next three financial years, active debt management synchronized with cash management will help in managing redemptions with optimal costs.

Initiatives in Public Expenditure Management

Direct releases to State/UTs with Legislature:

34. All Plan schemes under which central assistance is provided to States/UTs are to be classified and budgeted as Central assistance to State/UT plans w.e.f 2014-15 BE onwards. For all such schemes funds will be placed with the Administrative Ministries for transfer to the States through the Consolidated Fund of the States/UTs with Legislature concerned. This mode of transfer may be implemented in a phased manner in 2014-15 (BE). The routing of money through State Treasury will infuse greater ownership of Plan schemes to State/UT governments and greater accountability on them to make timely and need based releases to local Implementing Agencies (IEs) and also to monitor the implementation of schemes more closely.

Restructuring of Plan Schemes:

35. In a major initiative towards improving the efficacy of plan schemes, Planning Commission implemented the restructuring of centrally sponsored schemes and direct releases through State Treasury. As a part of streamlining, 126 CSS haven restructured into 66 schemes which includes 17 Flagship programmes. The restructuring of schemes, to be affected from this financial year i.e. FY 2014-15 onwards, shall add to more effective application of resources as plan allocations shall be more concentrated. This will also result into more focused monitoring of implementation of schemes by the administrative ministries. In another major initiative, government decided to earmark at least 10% of the outlay of CSS on flexi funds. Central Ministries concerned shall keep at least 10% of their Plan budget for each CSS as flexi-funds, except for schemes which emanate from a legislation (e.g. MGNREGA), or, schemes where the whole or a substantial proportion of the budgetary allocation is flexible (e.g. RKVY).

Direct Benefit Transfer:

36. In a move to ensure accurate targeting of the beneficiaries, cut down wastage, duplication and leakages, enhance efficiency in disbursal of funds, and efficacy of use of government money, it was decided in October, 2012 that individual benefits from the government would be directly transferred into the Aadhar linked bank account of the beneficiaries. Accordingly, the scheme of Direct Benefit Transfer (DBT) was rolled out from 1 January 2013 in 43 selected districts in 25 identified schemes of 8 Ministries. About 97 lakh beneficiaries in 121 districts stand to benefit under DBT till end of the year 2013. The measure is expected to achieve process re-engineering of Government schemes for simpler and faster flow of information and funds. With an aim to improve subsidy administration, DBT in LPG subsidy (DBTL) began in 20 districts on 1-06-2013 and thereafter in 6 phases (up to 01.01.2014). It has covered 291 districts across the country. Districts with higher Aadhar penetration were given preference in selection. Once DBT-LPG is rolled out completely across the 291 districts, it will cover over 7 crore consumers making it one of the largest cash transfer programme in the world.

Expenditure Management Commission:

37. While Government has managed to control the expenditure through rationalization in the fiscal consolidation phase, quality of expenditure remains an area that needs to be addressed. The ongoing fiscal consolidation has been successful in taming the fiscal deficit; however there is still imbalance in the public finance on the revenue side. As discussed in earlier section, concerted efforts are required to accomplish the target set for the revenue deficit and effective revenue deficit in the new FRBM regime. This entails structural changes in the Plan spending and definitive measures to contain Non-Plan spending within sustainable limits. Moreover, in the medium term, award of VII Pay Commission and XIV Finance Commission pose significant downside risk to Public Finance. Thus, time has come to look into the places where Government spends money and output achieved from it. Government will constitute an Expenditure Management Commission, which will look into various aspects of expenditure reforms to be undertaken by the Government.

Railway Budget

38. Railway Budget is presented separately however, the earnings and expenditure and all other major financial figures are incorporated in the General Budget, Government support is provided to Railways in the form of Gross Budgetary Support (GBS) and a return on this investment, called Dividend, is paid every year. The rate of Dividend is determined by the Railway Convention Committee and is presently at 5 per cent. There has been no default in the payment of dividend in the last ten years. Railway Revenues are primarily earned through two major traffic streams, passenger and freight. Some earnings are also contributed by parcels, commercial utilization of land, siding charges, advertisement and dividend paid by Railways' PSUs. The earnings are utilized to meet the operating expenses called Ordinary Working Expenses (OWE) and pensionary charges. The remaining surplus is used to pay dividend and balance is ploughed back as plan investment for meeting safety and development needs of the system.

39. Railway Finances improved in the last decade in as much as that it attained the Operating Ratio of 75.9 per cent in 2007-08. This was primarily due to buoyancy in the national economy getting reflected in railway traffic also and the average growth in railway expenditure. However, after 2007-08, the OWE and pension payment soared consequent upon implementation of the 6th Central Pay Commission (CPC), whereas the momentum of growth in earnings witnessed earlier could not be maintained. As a result the Operating Ratio deteriorated to the extent of 95 per cent. The Railway Plan could be sustained by drawing down from the Railway Reserves Funds. In fact, the balances in Railway Reserve Funds become negative to the extent of ₹ 2,100 crore and ₹ 385 crore during 2010-11 and 2011-12 respectively. General Reserves provided a loan of ₹ 3,000 crore in 2011-12 to bridge the negative balances in the Railway Funds.

40. Due to various measures taken including additional resources mobilization through rationalizing the fare and freight tariffs, the financial position of the Railways has started showing signs of improvement in the subsequent years. The entire loan of ₹ 3,000 crore has also been returned with interest to general revenues in 2012-13. The revenue earnings of the Railways at ₹ 140450 crore are likely to register a growth of 13.6 per cent in RE 2013-14 over the previous year, whereas the OWE and the pension expenditure at ₹ 120760 crore is estimated to increase by 15.3 per cent. The internal resource generation is likely to be ₹ 14,496 crore in 2013-14 RE against ₹ 15144 crore in 2012-13. The Operating Ratio in RE 2013-14 is likely to be at 90.8 per cent.

41. The plan investment in railways is funded through GBS, internal resources and extra budgetary resources (EBR). While 23 per cent of the Plan requirements are estimated to be met from internal resources of the Railways, it is largely dependent on budget support from Government. The 12th Five Year Plan for railways has been approved at ₹ 5.19 lakh crore, targeting investment of ₹ 1.94 lakh crore through GBS, ₹ 1.05 lakh crore of internal resources and ₹ 2.20 lakh crore of EBR. An amount of ₹ 65,445 crore has been provided in BE 2014-15 as against investment of ₹ 59,359 crore in RE 2013-14 and ₹ 50,383 are in Actuals 2012-13. The plan resources are also targeted to be invested judiciously and operationally important projects will be provided assured funding during the 12th Plan. This will help the railways in not only removing the infrastructure bottlenecks but also augment the revenue earning capacity of the system. There is also a need to rationalize ordinary working expenses and strive towards fiscal consolidation. It is imperative that augmentation of capital expenditure is financed through greater mobilization of resources including investments from Public Private Partnership and Foreign Direct Investments.

C. Policy Evaluation

42. The General Budget 2014-15 re-affirms Government's commitment to continue the process of fiscal consolidation. The fiscal deficit target set out in Interim budget has been adopted in the main budget. Government has re-prioritized expenditure and made additional allocations in consonance with policy for equitable growth, providing fillip to growth while focussing on the social and welfare sector. On the expectation of moderate global recovery, modest recovery in manufacturing, improved sentiments witnessed in recent months and absence of large upshots in international energy prices, the economy can be expected to recover the growth rate, after sub 5 per cent level witnessed in last two years.

43. Adoption of the fiscal consolidation targets also set the guiding principles for fiscal policy from the medium term perspective. It entails constriction of fiscal space over the period 2014-5 to 2016-17. With weakening of growth rate government revenues have been under stress and consequently fiscal consolidation hitherto was essentially by way of expenditure management. However, there is need increase the tax to GDP ratio progressively to garner greater resources. This in turn would require comprehensive review of tax structure including

widening the tax base in the direct taxes and duty structure in the indirect taxes in coming years. At the same time expenditure management has to be fine-tuned further to meet the challenge of inclusive growth which caters to the development of poor while providing impetus to economic growth.

44. Another important aspect of the fiscal consolidation pertains to the capital spending. The ratio of capital expenditure as proportion of total expenditure has come down from a high of 23.2 per cent in 2003-04 to 12 per cent in 2012-13. The imbalance in the revenue expenditure of the government also reflects problem of classification of government spending as explained in earlier statements. In a federal structure, most of the implementation of Central government's spending in infrastructure and other core sectors gets reflected as revenue due to transfer of funds to the State governments. As a result much of the spending which rightfully is in nature of capital is actually classified as revenue. Since this is an accounting problem and any analysis on nature of government spending based on such classification is bound to result in improper understanding, the FRBM Act was amended in 2012 to introduce the concept of Effective Revenue Deficit (ERD) which segregates that component of government spending, in the revenue deficit, which leads to creation of capital assets. The Amended FRBM Act provides elimination of ERD while limiting RD to 2 per cent by 31st March 2015.

45. The roadmap of fiscal consolidation adopted by the government in FY 2012-13 is aligned with the fiscal deficit targets laid down in the amended FRBM Rules, 2012. Government has been steadfast in adhering to these targets. With the General budget 2014-15, the fiscal deficit roadmap is on track and expected to achieve 3 per cent goalpost in next two fiscal. Therefore, the task of fiscal consolidation is half done with respect to fiscal deficit. However, the performance on revenue deficit and effective revenue deficit has not matched the targets laid down in the amended FRBM Act, principally because of vulnerable global economic situation and high inflation in the domestic economy has limited government's manoeuvrability in curbing subsidies and other welfare measures. These are necessary to protect the vulnerable groups from the ill-effect of rising prices, social obligation of a welfare State which cannot be abrogated. This implies that while government has been successful in limiting its overall expenditure and contain borrowings as per laid down targets, the revenue and capital mix of the expenditure needs further correction in sync with the targets prescribed in the FRBM Act. It is expected that the revival of growth and stabilization of external economic conditions will provide necessary space to correct the balance on revenue side in the ensuing years.