MEDIUM TERM FISCAL POLICY STATEMENT

A. FISCAL INDICATORS – ROLLING TARGETS AS PERCENTAGE OF GDP

(at current market prices)

		Revised Estimates 2013-14	Budget Estimates 2014-15	Targets for	
				2015-16	2016-17
1.	Effective Revenue Deficit	2.0	1.6	0.0	0.0
2.	Revenue Deficit	3.3	2.9	2.2	1.6
3.	Fiscal Deficit	4.6	4.1	3.6	3.0
4.	Gross Tax Revenue	10.2	10.6	10.9	11.2
5.	Total Outstanding Lliabilities[2] at the end of the year	46.0	45.4	43.6	41.5

Notes:—

1. *"GDP" is the Gross Domestic Product at current market prices as per new series from 2004-05.*
2. *"Total outstanding liabilities" include external public debt at current exchange rates. For projections, constant exchange rates have been assumed. Liabilities do not include part of NSSF and total MSS liabilities which are not used for Central Government deficit.*

1. The performance on select fiscal indicators presented above reflects minor deviations from the Interim budget numbers. As explained in this chapter and the next, the changes were necessitated by the sub five per cent growth in last two years as per the latest CSO estimates released in end of May, 2014. Government has re-affirmed its commitment to continue on the path of fiscal consolidation which began two years back. The fiscal deficit target represents an improvement over the target adopted in the roadmap announced in 2012-13.

2. Analysis of the macro-economic conditions prevailing in the previous financial year and fiscal performance as per revised estimates presented above was given in this statement presented in the Interim Budget. Provisional actual estimates released in May, 2014 corroborate the claim of improvement in the fiscal performance. Economy had to face varied challenges in terms of unsupportive external environment, domestic structural constraints and inflationary pressures. However, there was improvement in the major fiscal parameters on deficits from the revised estimates presented above, despite gross tax revenue recording lower growth at 10.0 per cent. Effective revenue deficit, revenue deficit and fiscal deficit as per provisional actuals were 2.0, 3.2 and 4.5 per cent respectively, which are an improvement over estimates.

3. The General Budget 2014-15 is a step further in the direction of fiscal consolidation with government re-affirming its commitment towards the fiscal consolidation. Despite several challenges including falling growth rate, and external uncertainties and the need for pro-active welfare measures to protect vulnerable sections of the society decision on fiscal prudence was challenging. With the GDP growth rate falling below 5 per cent level in the second successive years and pressure on tax revenues, the gross tax revenue estimates had to be revised to 10.6 per cent of GDP which represents increase of 17.7 per cent over RE 2013-14 and 19.8 per cent over provisional actuals for 2013-14. Despite downward revision of tax revenues over estimates of interim budget total expenditure has been revised up wards at 13.9 per cent of GDP which represents a growth of 12.9 per cent over RE 2013-14 and 14.8 per cent growth over actuals 2013-14.

4. The higher growth in expenditure is financed through resources mobilization from the Non-Tax revenues. Non-tax revenues in the General Budget has increased by 10 per cent over RE and is pegged at 1.7 per cent of GDP. This, however, is in keeping with trends in previous years and represents an increase of 6.7 per cent over actuals in 2013-14. This has been planned through unlocking of resources from

out of unspent balances lying in the Public Account such as Guarantee Redemption Fund and Social Infrastructure Development Fund. Similarly accumulations in the Cess backed funds over previous years which could not be utilized are proposed to be drawn and utilized for the purposes delineated in the Cess. For instance, while current spending for National Clean Energy Fund is proposed to be met from Fund after transfer in the fund as per the prescribed procedure, it is proposed to utilize past balances as non-tax revenue again for the purposes under NCEF. An amount of ₹12,252 crores has thus been additionally mobilized. Another contribution under non-tax revenues has come by way of dividend from RBI which has been revised upwards by RBI following its closure of annual accounts on 30th June, 2014. As against ₹33,000 crore proposed in the Interim budget, actual dividend from RBI stands at ₹46,000 crore. Over past years RBI has been setting aside portion of its profits as reserves before declaring dividend to the Central Government. Over the years sufficient balances has been built up in various reserves and as such RBI has decided to pass on higher dividend to the Government. Accordingly, the dividend declared in 2014-15 has been revised upwards.

5. On the expenditure side, government has provided realistic allocations for subsidies based on the assessment of exchange rate and international crude oil prices. With gradual deregulation of diesel prices and rationalization of LPG subsidy, it is expected that the provision for fuel subsidy kept in the Interim budget should suffice. The allocation for fertilizer has been increased from the level proposed in the interim budget based on current assessment. The increase is to meet the requirement on account of indigenous Urea and other fertilizers. Increased allocation for food subsidy has been retained in view of additional requirements to meet the demand from National Food Security Act. While limiting the Non-plan expenditure to 9.5 per cent of the GDP, an increase of 9.9 per cent over the actuals of 2013-14 has been provided to meet the commitments of the government. Importantly, an increase of 3.5 per cent above the interim level has been provided in the Plan expenditure, with a growth of 26.9 per cent over the actuals of 2013-14. The Plan expenditure thus stands at 4.5 per cent of the GDP. Higher allocation has been provided to meet the development programme of the government to meet its social and welfare commitments while providing for development in the key sectors oriented towards job creation and revival of growth in the economy.

6. To meet the additional resources, the non-debt capital receipts has been revised marginally by ₹6,500 crores. Debt receipts have been revised marginally while retaining the fiscal deficit target at 4.1 per cent. Additional borrowings of ₹3,176 crores within the deficit limit was available due to minor corrections in the GDP numbers based on revised estimates by CSO and GDP projections.

7. While adhering to the path of fiscal consolidation, the imbalances on revenue account could not corrected to the extent provisioned in the amended FRBM Act. As pointed out above, amended FRBM Act mandates elimination of effective revenue deficit and constriction of revenue deficit to 2 per cent by 31st March, 2015. However, General Budget 2014-15 provides for ERD of 1.6 per cent and RD of 2.9 per cent. Fiscal consolidation efforts of the government in past years have yielded results on the fiscal deficit, thereby implying that government finances have been contained within manageable levels. However, inter alia the revenue spending has increased principally due to increase in interest payments, subsidies and defence outlays. Domestic and external economic conditions have limited the manoeuvrability of the government to correct the imbalance in revenue spending. Inflationary pressures limit the scope of reducing the spending on subsidies which are essential to protect the vulnerable sections from the ill-effect of price rise. Similarly, external exigencies such as Iraq crisis, tapering of quantitative easing by US Fed and sluggish economic growth in Europe have adversely impacted the exchange rate and international prices of crude oil. Further, slowdown in economic growth and consequent employability are the factors that call for positive action in social and welfare sectors. Defence outlays and interest payments require to be sufficiently provided. Therefore, inflexible nature of such expenditure in the larger macro-economic context has been the primary reasons for inability to meet the targets on revenue account. With possible revival of growth and improvement in the macro-economic conditions in the ensuing fiscal will provide ample opportunity to rectify the public finances on this count and meet the targets laid down in the FRBM Act.

Fiscal Outlook for 2014-15 to 2016-17

8. The General Budget 2014-15 re-affirms Government's commitment to carry the process of fiscal consolidation to its logical end. Accordingly, the fiscal deficit target of 4.1 per cent has been retained in this year's fiscal policy. The target is commensurate with the fiscal target laid down in the amended FRBM Rules notified in 2013. Going forward, in the medium term fiscal deficit target will be progressively reduced to 3.6 and 3.0 per cent in FY 2015-16 and 2016-17

respectively to accomplish the target set under fiscal consolidation policy stance. This implies limited fiscal space over the medium term period. The process of fiscal rectitude which has so far been largely on the expenditure side will have to be matched by greater resource mobilization in coming years.

9. Fiscal parameters on the revenue account, revenue deficit and effective revenue deficit, presented in the general budget 2014-15 shows progressive improvement over last year and the estimates presented in the Interim budget. However, they represent an imbalance in the revenue account which is not in conformity with the norms set forth in the amended FRBM Act, which mandates elimination of the effective revenue deficit and containing revenue deficit within 2 per cent. As explained in the next section, this shortfall in the target is due to difficult macro-economic conditions in the international and domestic market. With improvement in these conditions, especially revival of growth and easing of inflationary pressure, it is expected that government will be able to achieve the required correction on revenue parameter as well. Accordingly, the assessment over next two fiscal as presented in the table above will be aligned to the amended FRBM Act and Rules framed therein.

10. As a significant proportion of revenue expenditure is being provided as grants for creation of capital assets, it would be pertinent to look at the effective revenue deficit of the government. The effective revenue deficit, after factoring in the above mentioned grant component in the revenue account, is estimated at 1.6 per cent of GDP in BE 2014-15. It is required to be eliminated in the current financial year. It is this component of imbalance in revenue account which needs to be addressed in right earnest - through expenditure management and revenue augmentation.

11. It is pertinent to note that under the amended FRBM Act, 2012 and the Rules notified therein, government had set a target of reducing the revenue deficit to 2 per cent of GDP and eliminating effective revenue deficit by 31st March, 2015. Elimination of effective deficit implies that grants-in-aid for capital creation must equal the revenue deficit. In other orders, government's revenue expenditure in excess of revenue receipts must be used for creation of capital assets in the field. As per the budget estimates presented in the Interim budget 2014-15, there is need for a correction in the composition of expenditure mix to achieve the set targets. Going forward, necessary changes in the program implementation mode will be made to achieve higher capital formation either directly by government or through implementing agencies. The grant-in-aid for capital creation has been introduced from the financial year 2010-11, has been around one-third of the Plan revenue expenditure. This component has to be increased to the level of two-thirds, i.e. around 67 per cent in order to eliminate the effective revenue deficit as mandated by the amended FRBM Act. In effect, this implies structural change in design of plan schemes such that resources transferred from the Union government is utilized in the field for creation of capital assets rather than funding operational costs. The central government has taken up the matter in earnestness and it is expected that necessary changes will be affected to address this issue.

12. Gross tax revenue is estimated to increase from 10.0 per cent of GDP as per actuals in 2013-14 to 10.6 per cent in BE 2014-15 (reflecting growth of 19.8 per cent over actuals 2013-14), which is however lower than peak of 11.9 per cent of GDP achieved during 2007-08. With economy reverting back to the path of trend growth rate, it would be possible to get back to the achieved level of tax to GDP ratio. In the medium term targets, gross tax collection as percentage of GDP is projected at 10.9 per cent in 2015-16 and 11.2 per cent in 2016-17.

13. By bringing back the focus on fiscal consolidation process, government has undertaken measures to reduce the fiscal deficit from 4.5 per cent of GDP in actuals 2013-14 to 4.1 per cent of GDP in B.E. 2014-15. This reduction in fiscal deficit is largely revenue driven. Total expenditure as per cent of GDP is reduced from 14.0 per cent in RE 2013-14 to 13.9 per cent in B.E. 2014-15. Going forward, it is estimated that the expenditure of the government will be progressively reduced to 13.1 and 12.5 per cent of the GDP in the financial years 2015-16 and 2016-17 respectively. The increase in tax revenue is of the order of 0.6 per cent of GDP from 10.0 percent achieved in 2013-14 to 10.6 per cent in BE 2014-15. Over the period of next two years it is targeted to be increased to 10.9 and 11.2 per cent of GDP respectively. With improvement in the macro-economic conditions and revival of growth, it is expected that tax reforms including implementation of GST on the indirect taxes side and rationalization of tax structure in the direct taxes will restore the total tax revenues of the government.

14. Non-tax revenue has emerged as one of the important components of government resources, in the present phase of fiscal consolidation. With tax revenues under pressure due to slowdown in the economic growth, the rise in non-tax revenues has

played key role in the fiscal rectitude in recent years. Non-tax revenues grew by 45 per cent in 2013-14 over the previous year, 2012-13. In the general budget 2014-15 it is estimated to grow by 6.7 per cent over the last year's actuals, to reach level of 1.7 per cent of GDP. However, the growth in this component of revenue is limited and it is expected that in next two years it will register modest growth. The fiscal consolidation efforts of the government in this phase will have to be financed through tax revenues. It is estimated that as ratio of GDP, non-tax revenue will be at 1.4 and 1.2 per cent in the financial year 2015-16 and 2016-17 respectively.

15. Total liabilities of the Government, as a percentage of GDP, will also see a decline continuing with the trend in the recent past. At end of 2013-14, a total liability of the Government was estimated at 46 per cent of GDP which will reduce to 45.4 per cent by the end of 2014-15. Continuing the declining trend it is likely to reduce to 43.6 per cent in 2015-16 and 41.5 per cent in 2016-17. A progressive reduction in debt-GDP ratio of the Government will ease the interest burden and allow more space for the government to spend particularly on infrastructure development without taking recourse to additional borrowings.

B. Assumptions underlying the fiscal indictors

1. Revenue receipts.

(a) Tax-Revenue

16. Tax revenues as a percentage of GDP, riding on high economic growth and aided by rich menu of tax reform measures, reached its peak by 2007-08 and touched a level of 11.9%. Average annual tax growth rate during the five year period in 2003-08 was 21.3%, where annual tax growth was highest at 28.9% in 2006-07. These reforms were mainly driven by direct tax whose average annual growth rate during this period was about 28%. The buoyancy of tax revenue with respect to GDP was almost 1.5 during this period.

17. This trend of high tax growth was moderated due to global economic crisis and the tax-GDP ratio slid to 10.8% in 2008-09 and further to 9.6% in 2009-10. With the initial signs of economic recovery and partial roll back of stimulus measures in 2010-11, the tax-GDP ratio increased to 10.2%, with tax revenues witnessing a high growth rate of 27%. Since the stimulus measures were mainly on indirect tax side, the partial roll back caused a high growth of 40.7% in indirect taxes in 2010-11 over 2009-10 actuals. However, with moderation in economic growth at 6.2 per cent in 2011-12, the tax collections recorded growth of 12.1 per cent over the previous year resulting in tax to GDP ratios of 9.9 per cent.

18. The economic growth rate which started to decline in 2011-12 and continued downward trend in 2012-13 showed sign of recovery in 2013-14. However, the path of recovery was slow, punctuated by exchange rate volatility in the initial part of the financial year. Gross tax revenue was short by ₹40,893 crores in actuals when compared to budget estimates in FY 2012-13, due to moderation in economic growth. The tax to GDP ratio in 2012-13 was 10.2 per cent, recording a growth of 16.5 per cent. As per the provisional accounts of FY 2013-14, the gross tax revenue recorded a growth of 9.9 per cent over the previous year and tax to GDP ratio was 10.0 per cent. Central Excise registered a negative growth with ₹6376 crores less collections over the previous year in nominal terms. Customs grew marginally, by 4.7 per cent over last year, resulting in 4.8 per cent growth for Indirect taxes in this period. Direct tax collections were better than Indirect, recording growth of 14.2 per cent over the previous year, marginally higher than the revised estimates.

19. Projections for 2014-15 have been made taking into account a realistic economic recovery and continuation of set of tax measures announced in the budget for 2013-14. It is also expected that reforms in the administrative machinery oriented towards strict implementation will yield result.

Details of Tax Measures

20. With above measures, tax revenues in BE 2014-15 are targeted to grow at 19.8 per cent over the actuals of 2013-14. The tax to GDP ratio estimated in the Budget for 2014-15 is 10.6 per cent. It is expected with the revival of growth in the economy, early signs of which are perceptible; the buoyancy in tax will result in normal tax growth of 17% over FY 2013-14 and remaining tax growth will be emanating from additional resource mobilization measures.

21. Tax reforms and tax efforts are the most critical elements for the overall process of fiscal consolidation. Without a robust and ambitious tax growth it is not possible to achieve the fiscal roadmap which the Government has embarked upon. While the tax projections need to be realistic, at the same time they need to be ambitious to enable Government in achieving the fiscal roadmap without resorting to more than required expenditure compression. Overall, while tax should increase as percentage of GDP, expenditure should progressively reduce as percentage of GDP till the fiscal consolidation goals

are fully met. While the ultimate objective should be to bring back the tax to GDP ratio to the pre-crisis levels, it should be calibrated gradually over the period of fiscal consolidation. As the tax to GDP ratio increases, further improvements would be more gradual and difficult to achieve. The outlook for tax revenues for the years 2015-16 and 2016-17 have been designed keeping this in mind. As shown in table above the tax to GDP ratio is projected to reach 10.9 per cent in 2015-16 and 11.2 per cent in 2016-17. This implies an average buoyancy of 1.32 which is realistic but an ambitious target. This will require an average tax growth of 17.7% which would be possible through a combination of better tax effort. It may be contextual that a much higher tax growth has been achieved in the previous decade.

(b) Devolution to States

22. The states' share in the net proceeds of Union Tax is based on the recommendations of 13th Finance Commission which has recommended the 32 per cent of net proceeds be devolved to states as their share. The projections period crosses the time horizon of 13th Finance Commission and spills over to the first year of the award period of the newly constituted 14th Finance Commission. It has been assumed that States' share will remain constant over the projection period despite this change as there is no better basis for assumption available. The fiscal plan outlined in this document will have to be redesigned if the 14th Finance Commission changes the State share.

(c) Non Tax Revenues

23. Non Tax Revenues of the Centre mainly comprise of interest and dividend receipts of the Government, receipts from the services provided by Central Ministries and Departments like supply of central police force to various agencies, issue of passport and visa, registration of companies, patents and license fees, royalty from off-shore oil fields, profit petroleum and various receipts from telecom sector. In FY 2013-14 ₹ 1,99,233 crore was realized, recording a growth of 45 per cent over the previous year, at 1.7 per cent of GDP. In the general budget, non-tax revenue has been estimated at ₹2,12,505 crore marking a growth of 6.7 per cent over provisional accounts of 2013-14. This component of revenue has shown marked increase in last years and has grown to be comparable with one of the Indirect taxes. As discussed in the above section, in FY 2014-15 major components contributing to its growth are spectrum charges, unlocking of funds in the Public Account and increase in dividend paid by RBI.

24. Interest receipts of Government that are mainly from Railways, State Governments and loans extended by central ministries and departments to Central PSUs.Interest receipts from States will be declining overall as net lending from states has considerably reduced after disintermediation as per the recommendations of 12th Finance Commission. Dividends receipts of the Centre may be split into two parts, one from RBI and banks and the other is from various PSUs. While dividends from PSUs should grow as their profit grows, they would be moderate due to disinvestment of Government stake in PSUs. On the contrary, since the Government would be infusing equity into banks to meet the CRAR requirement of BASEL III, the dividend from banks would increase relatively faster due to the coupled effect of increase in profit and increase in GoI stake in public sector banks. With these assumptions in 2014-15 the non-tax revenues of the Centre are estimated at 1.7 per cent of GDP.

25. Mostly following the assumptions above, the outlook for non-tax revenues for 2015-16 and 2016-17 have been put in place. Certain one-time receipts budgeted in 2014-15 will not be available in 2015-16 and 2016-17. With regard to dividends from PSUs, the policy of the Government would be to enable them in investing their retained earnings in their capital projects. However, in the absence of any concrete capital investment plan PSUs should pay their cash surpluses as dividend to Government and other share holders. From telecom sector it has been assumed that renewal of licenses issued for 20 years earlier will come up for renewal during the projection period. The success of Spectrum auctions conducted in February, 2014 will translate into higher revenues on regular basis over the term of allocation. This will entail stable stream of income to the government. Based on the assumptions, the non-tax revenue for 2015-16 and 2016-17 has been projected at 1.4 per cent and 1.2 per cent of GDP respectively.

2. Capital receipts

(a) Recovery of loans and advances

26. Net recovery of loans from the States have declined during the 12th FC award period on account of gradual disintermediation by Central Government and the debt consolidation and debt waiver scheme. Since further loans are not given to State governments, this receipt will decline over years as old loans get liquidated. The repayment of loans from Central PSEs is also impacted on account of defaults from PSEs that are either sick or under revival through BIFR. The waiver of interest or write off of loans of sick PSUs has reduced the potential future receipts. Recovery of loans and advances was estimated at ₹10,654 crore

in B.E.2013-14. However, it was revised to ₹ 10,802 crore in RE 2013-14. In 2013-14, Recovery of loans and advances at ₹ 12,502 crore is 116 per cent of RE but 17 per cent lower compared to previous year figure of ₹ 15,060 crore. In BE 2014-15 it is estimated at ₹ 10,527 crore. For 2015-16 and 2016-17, this component of receipt is estimated to be flat at ₹10,000 crore as the government would not encourage net lending (except for the back to back arrangement made for external loans to States).

(b) Other non-debt capital receipts

27. Disinvestments in Government PSUs are main source of receipts under this head. Earlier, government had created National Investment Fund (NIF) as interim measure to account for the proceeds from disinvestment within Consolidated Fund (CFI) separately and deploy the same towards creation of assets within the plan outlay. However, from FY 2013-14 government decided to create a separate fund, NIF under Public Account, with the intent that proceeds from disinvestment will only be deployed for specific authorized purposes. With this major step forward, the proceeds will not be available to fund regular government spending. As per provisional accounts for FY 2013-14, receipts from disinvestment proceeds accounted at ₹21,992 crore (137% of RE).

28. In BE 2014-15, it is estimated that an amount of ₹ 36,925 crore will accrue under NIF from disinvestment. Additionally, ₹ 15,000 crore is expected from disinvestment of residual government share in non-government companies. Other non-debt capital receipts include loan repayments by State Governments and Central ministries. This amount has remained more or less flat over the years. However, RBI proposed to buy SDRs maintained by GoI as part of its efforts to develop reserves for providing cushion against currency volatility and would buy some SDRs on experimental basis. Amount received in this transaction form part of miscellaneous capital receipts. Accordingly, total receipts were pegged at ₹56,925 crores in the interim BE 2014-15. It is also estimated that an amount of ₹6,500 crore will be realized from the sale of stakes in Specified Undertaking of the Unit Trust of India (SUUTI). Thus the amount estimated under disinvestment works out to be ₹63,425 crore for general budget 2014-15. Over the medium term frame work, an amount of ₹ 55,000 crore has been estimated for the years 2015-16 and 2016-17.

(c) Borrowings – Public Debt and other Liabilities

29. Of the overall Central Government debt, about 92 per cent is domestic debt and only 8 per cent is external debt. 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) together accounted for the remaining 8 per cent of GFD. The realization from external borrowing was substantially lower than budgeted. There was negative outflow from other debts due to higher disbursements. However, there was higher realization from State Provident funds. Treasury bill realization also increased due to higher investment by State governments in the non-competitive auction T-bills. This was mainly on account of comfortable cash position of the State Governments and higher interest rates in auction T-bills as compared to Intermediate T-bills. Better fiscal management resulted in reduction of market borrowings by ₹15,000 crore to ₹4,68,902 crore for fiscal year 2013-14, including ₹6,500 crores from inflation indexed bonds. Borrowings programme for the year was completed smoothly in line with pre-announced calendar for borrowings. The weighted average maturity of primary issuances of dated securities during 2013-14 increased to 14.28 years from 13.50 years in the previous year, reflecting the continued efforts by the Government to elongate the maturity profile of its outstanding debt. The weighted average yields of issuance during the year went marginally to 8.48 per cent from 8.36 per cent in the previous year. Increase in yields was on account elongation of maturity as well as hardening of yields.

30. 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 86.8 per cent of the fiscal deficit. In nominal terms, net borrowing projections show a decline by 1.7 per cent over the previous year. In terms of GDP, net market borrowing is budgeted to decline to 3.6 per cent as compared with 4.1 per cent in FY 2013-14. Borrowings through external debt are budgeted to remain relatively insignificant during 2014-15.

31. Commercial banks are major investor category which currently holds about 46 per cent of outstanding dated securities. The deposits of commercial banks during 2013-14 saw a y-o-y growth of 14.6 per cent (as on 05, June 2014), which is higher than 13.1 per cent growth seen in the same period of previous year. Insurance companies are another major investor category in the government securities, which traditionally has demand from longer tenor securities. As on end of March 2014 the share of insurance

companies holding in the central government dated securities increased to 19.5 per cent from 18.6 per cent at end of previous financial year. Provident funds are another stable source of demand for government securities whose share is stable at around 7.2 per cent. Thus, a significantly higher growth in deposits of commercial banks *vis-a-vis* the budgeted growth in net market borrowings of Government implies that the government borrowings programmes for 2014-15 will completed comfortably without exerting any pressure on availability of financial resources for the private sector. Furthermore, improved share of insurance companies and stability in the share of provident funds in holding of government securities provide space for further increasing the maturity profile of the Government debt without increasing the cost. Total liabilities of the Government, as a percentage of GDP, will also see a decline continuing with the trend in the recent past. At end of 2013-14, a total liability of the Government is estimated at 46.0 per cent of GDP which will reduce to 45.4 per cent by the end of 2014-15. Continuing the declining trend it is likely to reduce to 43.6 per cent in 2015-16 and 41.5 per cent in 2016-17. A progressive reduction in debt-GDP ratio of the Government will ease the interest burden and allow more space for the government to spend particularly on infrastructure development without taking recourse to additional borrowings.

32. Gross fiscal deficit is projected to decline progressively to 4.1 per cent of GDP in 2014-15. The MTFP statement projects a further decline in GFD to 3.6 per cent by 2015-16 and to 3.0 per cent by 2016-17. Assuming market borrowings financing at about 90 per cent of the GFD, the net market borrowings are likely to decline significantly in next three years to 3.6 per cent of GDP in 2014-15, 3.1 per cent in 2015-16 and 2.6 per cent in 2016-17. With contraction of government deficit there will be more room for private investment and capital inflows. This will also ease inflationary pressure providing comfort to RBI for easing monetary policy.

3. Total Expenditure

(I) Revenue account.

(i) Plan Revenue Expenditure.

33. The Plan Revenue Expenditure of the Government remained at an average level of 4.2 per cent of GDP during the 11th Plan Period. However, due to the stimulus measures undertaken to counter global slowdown of Indian economy, the overall Plan Expenditure during the 12th Plan Period was increased at 4.6 per cent of GDP. To meet the twin objective of sustained economic growth and fiscal consolidation, it is very essential to keep the Plan Expenditure at optimal levels. During 2008-09 the Government could resort to fiscal expansion only because it was riding on a lower fiscal deficit base and could afford increase in its deficit. This kind of a policy must not be followed again and the fiscal deficit must be brought down to acceptable level. While the effort should be to reduce the unproductive expenditure of the government, Plan Expenditure has to remain within the affordable levels, at least till the process of fiscal consolidation is over.

34. During 2013-14, Plan Expenditure was rationalised by 0.7 per cent of GDP and in the Revised Estimates of 2013-14 for Plan Expenditure was fixed at 4.2 per cent of GDP. However, government efforts for fiscal consolidation resulted in containing total plan expenditure at 4.0 per cent of GDP which was ₹ 22,447 crore less than the RE 2013-14 and most of this reduction (₹ 19,308 crore) was achieved on revenue account. The Plan Expenditure for 2014-15 at ₹ 5,75,000 crore is 3.5 per cent above the interim level and represents growth of 26.9 per cent over the performance in last financial year. Keeping the fiscal targets in view and available resources as per the roadmap of fiscal consolidation adopted in the amended FRBM rules, the Plan Expenditure has been projected during the projections. Accordingly, it is projected that resources for plan expenditure will be at 4.1 per cent and 3.7 per cent of GDP in FY 2015-16 and FY 2016-17 respectively.

(ii) Non Plan Revenue Expenditure

35. Non Plan Revenue Expenditure of government mainly consists of its establishment expenditure, interest payments, defence expenditure, subsidies, statutory grants to States and other residual items. The Non Plan Revenue Expenditure jumped from 8.4 per cent of GDP in 2007-08 to 10.2 per cent of GDP in 2009-10 mainly due to implementation of Sixth Pay Commission's recommendations. Since then it has come down to 8.7 per cent in 2014-15 BE due to various expenditure reform measures undertaken by the Government. It is expected to be further constricted at 8.2 per cent in the financial years 2015-16 and to be reduced to 8.1 per cent in FY 2016-17. Non Plan Revenue Expenditure was ₹ 10.23 lakh crore in FY 2013-14 and is projected ₹ 11.14 lakh crore in BE 2014-15. Various components of Non Plan Revenue Expenditure are detailed below.

(a) Interest Payments

36. Due to fiscal expansion undertaken by the Government, interest payments increased sharply post global economic crisis. As a percentage of net tax revenue of the Centre, interest payments jumped from 38.9 per cent in 2007-08 to 43.4 per cent in 2008-09 and further to 46.7 per cent in 2009-10. In BE 2013-14 expenditure under this component was estimated at 41.9 per cent of net tax to center which

was revised at 45.5 per cent in RE, but as known from provisional accounts, at the end of the year interest payment at ₹ 3,77,502 crore stood at 46.3 per of net tax to centre. The factors that have impacted interest payment during the recent period are the increased debt stock due to stimulus measures alongwith the fiscal slippage during 2011-12 and relatively tougher interest rate regime that has been in existence for quite some time now.

37. In BE 2014-15, interest payment is projected at 43.7 per cent of net tax to Centre, showing a decline following fiscal consolidation. With the government deficit coming down and government's efforts to control inflation, it is expected that interest rates would be falling in the years to come. Deficit reduction and fall in interest rates would create positive space for the private sector to raise resources at lower cost. With policy of fiscal reforms gaining ground, over the medium term it is expected that this ratio will come down to 41.2 per cent in FY 2015-16 and 39.0 per cent in FY 2016-17.

(b) Defence Services

38. Defence Expenditure on the revenue account mainly comprises of salary expenditure of defence forces and their operational expenses. Defence Revenue Expenditure was estimated at ₹1.24 lakh crore in RE 2013-14 and at the end of the year it remained at the same level. In BE 2014-15, Defence Revenue Expenditure is estimated at ₹ 1.34 lakh crore. In FY 2015-16 Defence Revenue Expenditure is projected to grow at 7.2 per cent. However, additional provision has been assumed in the financial year 2016-17 to accomodate the likely impact of VII Pay Commission. Total Defence expenditure as ratio of GDP is projected to remain at 1.7 per cent in FY 2015-16 and 2016-17.

(c) Pensions

39. The expenditure on pension payments of the Central Government includes both defence as well as civil pensions. Pension payment, in nominal terms was estimated at ₹ 74,076 crore in RE 2013-14 and at the year end it was accounted at ₹ 74606 crore, marginally above the RE figure. In BE 2014-15, pension payment in nominal terms estimated at ₹ 81,983 crore. The pension payment of Central Government for the past few years has been growing faster than the salary expenditure. The main reason for this is that there is an increase in number of pensioners due to higher retirements and increased life expectancy. Accordingly, keeping past trend in view the Pension Expenditure of the Government has been projected to grow at 10.4 per cent in FY 2015-16. In view of the likely impact of VII Pay Commission, higher growth is assumed in FY 2016-17.

(d) Non Plan Grants to States

40. Non Plan Grants to States mainly comprises of the grants recommended by the Finance Commission. In RE 2013-14 the Non Plan Grants are estimated at ₹ 60,763 crore and in BE 2014-15 at ₹ 69,084 crore. As per the provisional accounts, in 2013-14, Non-plan Grants to states were ₹ 64,565 crore. The projection for 2015-16 has been done keeping the recommendations of 13th Finance Commission in view and the fact that CST compensation would continue in 2015-16 as well. Non Plan Grants in 2015-16 have been marginally increased over 2014-15 as recommendations of 14th Finance Commission will come into force. Normally most of the grants recommended by Finance Commission are recommended to flow from second year of the award period to ensure a convenient preparatory period for the State Governments. Based on these assumptions Non Plan Grants have been projected at 0.5 per cent of GDP in 2015-16 and 2016-17.

(e) Major Subsidies

41. Major subsidies in the Revised Estimates for 2013-14 were fixed at ₹ 2,45,452 crore as compared to the Budget Estimates of ₹ 2,20,972 crore. The major part of increase has come from petroleum subsidies that went up from ₹ 65,000 crore in BE 2013-14 to ₹ 85,480 crore in RE 2013-14. In provisional accounts of 2013-14 expenditure on major subsidies was accounted at ₹ 2,47,596 crore. This has been constituted by food, petroleum and fertilizer at ₹ 92,318 crore, ₹ 83,998 crore and ₹ 71280 crore respectively. Major subsidies are budgeted at ₹ 2,51,397 crore in BE 2014-15. Total subsidies were at 2.3 per cent of GDP in 2013-14 and are budgeted to be at 2.0 per cent of GDP in 2014-15. Over the projection period, major subsidies are estimated to reduce to 1.7 and 1.6 per cent of GDP respectively. In order to achieve the fiscal targets of fiscal consolidation it is essential that government follows the policy of progressively reducing the expenditure on subsidy through improved targeting of beneficiary.

42. Major subsidies are extremely critical from the viewpoint of fiscal consolidation and are the most important factor in determining the success of Government in meeting its fiscal targets. The effort of Government would be to address this issue with a two pronged strategy. Firstly, the Government should align the pricing policy for subsidized goods to ensure

that the total subsidies remain within the affordable levels. Secondly, it is very essential to move towards better targeting of subsidies provided by Government. To improve targeting of subsidies, Government has embarked upon an ambitious programme to directly transfer government benefits. Albeit in inception stages, it is likely to streamline the process of identification and targeting of beneficiaries under various subsidy programmes.

43. On the pricing issue, especially on petroleum, side the most important commodity which poses the greatest risk to the fiscal consolidation process is diesel. The basic problem with diesel pricing that the Government has been facing is that any delay in price correction makes further required price corrections steeper and hence even more difficult. This triggers a vicious cycle of high subsidy and rigidity in the administered prices. To resolve this issue, Government has announced the decision to progressively deregulate diesel prices. This approach will ensure that the consumer will not feel the pinch of upward revisions as revisions will be small and at the same time it will help the Government move towards eventual decontrol. It will also ensure that the impact of diesel price increase on inflation is minimised. If there are no international shocks in the oil sector, it is expected that in a year the Government will be able to decontrol diesel fully. With rising fuel subsidy, there is need to cap the subsidized cylinders at a more realistic level.

44. On fertilizers, Nutrient based subsidy regime has been working well in the P&K sector. What is now urgently required are certain pricing reforms in the urea sector with an immediate price correction for urea, new Nutrient based Urea Policy. This is not only essential from viewpoint of the size of the subsidy bill but also from the viewpoint of balanced use of N, P & K nutrients. The Government had notified the New Investment Policy (NIP)-2012 on 2nd January, 2012 to encourage investments in urea sector leading to increase in indigenous capacities and reduction in import dependence. The policy will also lead to savings in subsidy due to import subsittution at prices below IPP. Over long term, Government will be working towards increase in indigenous production of fertilizers which will help reducing dependence on imports and make prices much more stable.

45. The food subsidy regime, in the coming years, will have to undergo a massive overhaul with introduction of Food Security Act. 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 polulation is entitled to receive 5 kg per person, per months at the rate of ₹ 1/2/3 per kg for coarse grains/wheat/ rice. AAY households would continue to receive 35 kg per month. Along with the legislation coming into force, Government will have to focus on strengthening of public distribution systems, better tracking of delivery chain, reduction in administrative costs of FCI and other entities involved and other related reforms. With introduction of National Food Secuirity Act, there is need for rationalization of food subsidy. Restructring of FCI, use of technology for increasing the efficiency in PDS and better targeting of beneficiaries are key areas of reforms to streamline food subsidy.

46. As already explained without focused subsidy reforms, the process of fiscal consolidation will be difficult. The expenditure of Government on major subsidies is expected to come down from 2.2 per cent of GDP in 2013-14 to 2.0 per cent of GDP in 2014-15. It is expected with active policy reforms the incidence will progressively reduce. Over the projection period it has been proposed to contain at 1.7 per cent and 1.6 per cent of GDP in 2015-16 and 2016-17 respectively.

(II) Capital Outlay

47. As per the provisional accounts for 2013-14, total capital expenditure of Government at ₹ 1,87,895 crore as against the RE of ₹ 1,90,894 crore. This has been projected to go up to ₹ 2,26,781 crore in the Budget Estimates for 2014-15. Out of this, the Plan Expenditure of ₹ 1,00,542 crore in FY 2013-14 is going up to ₹ 1,21,497 crore in the Budget Estimates 2014-15. The Non Plan Capital Expenditure at ₹ 87,353 crore in the FY 2013-14 is budgeted at ₹ 1,05,283 crore in 2014-15.

48. On the non-plan side, the major portion of Capital Expenditure consists of the Defence Capital Expenditure. As seen from the provisional accounts, the Defence Capital Expenditure was ₹ 79,222 crore against ₹ 78,872 crore of RE 2013-14 and is expected to go up to ₹ 94,588 crore in 2014-15 BE, growth of 19.4 percent over last year actuals. On an increased based, it has been assumed at nominal growth of 5.7 per cent in FY 2015-16. However, growth of 10 per cent has been projected for FY 2016-17, which is consistent with the overall resource availability and other demands of Centre's resoucres.

49. The Plan Expenditure of GoI mainly consists of gross budgetary support to gross Railway Expenditure, of national highways investments in government companies and banks and loans to State Govt. and PSUs. Since the overall effort has to be to reduce the revenue deficit of the Government, it is essential that within the overall Plan Expenditure, the expenditure on capital components grows faster than the revenue component. Plan Capital Expenditure is budgeted at 21.1 per cent of total Plan Expenditure in 2014-15 and is projected to increase to 23.8 per cent of total Plan Expenditure in 2015-16 and further increase to 25.2 per cent in FY 2016-17

C. Assessment of Sustainability relating to

(i) The balance between Revenue Receipts and Revenue Expenditure

50. With the stimulus package and fiscal profligacy in the years following global financial crisis, the advances attained earlier on the revenue account of public finances were lost. The revenue deficit which had reduced to 1.1 per cent in 2007-08 had reached the high level of 5.2 per cent in 2009-10. Accordingly the FRBM Act was amended in 2012 to re-calibrate fiscal policy stance towards this component of imbalance in Government finance. Since all transfer of funds in federal polity are accounted as revenue, even when the end use may lead to capital formation, it was realized that elimination of revenue deficit will impinge upon central government's efforts in pursuing developmental expenditure. The merit of inter-generational equity principle which requires part of capital creation to be financed by debt is lost in this approach. Therefore, new concept of effective revenue deficit was introduced to account for that portion of revenue deficit which is used for creation of capital. The approach was re-calibrated to eliminate effective revenue deficit and limit revenue deficit to two per cent by 31st March, 2015.

51. The roadmap of fiscal consolidation has been adopted by the government since the new FRBM regime has come in vogue. As discussed in the earlier section, government has been steadfast in adhering to the path of fiscal rectitude and performed better than target in successive years. However, adverse economic scenario has impinged Government's performance on the revenue side. Economic growth has been declining since 2010-11 and remained below 5 per cent for last two years, with marginal improvement in the last year. Tax revenues have been under pressure with tax buoyancy being below one. Moreover, inflationary pressure and external factors have made it necessary to increase public spending on welfare measures to protect vulnerable sections against its adverse impact. As a result, despite remaining firmly within the fiscal limits set under the new FRBM regime, public finances have not been able to attain the inter alia targets on the revenue side. The revenue deficit has progressively declined from high of 4.4 per cent in 2011-12 to 3.2 in 2013-14 and is projected at 2.9 per cent in 2014-15; it is still some distance away from the milestone of 2 per cent set for 31st March, 2015. Further, under prevailing conditions, the fiscal framework assumptions yield a revenue deficit of 2.2 per cent which is above the two per cent limit prescribed by the new FRBM regime. It is noteworthy that the revenue deficit projections work out to 1.6 per cent in FY 2016-17, an improvement over the limit set by the Act. However, it is expected that in the course of current year, if the macro-economic conditions improve the target set on revenue account will be achieved.

52. Similarly, effective revenue deficit has come down from 2.9 per cent in 2011-12 to 2.5 per cent in 2012-13 and stands at 2.0 per cent in 2013-14. It is estimated to reach 1.6 per cent in 2014-15, while it was required to be eliminated by closure of the financial year. In order to eliminate effective revenue deficit, the revenue deficit must equal to grants-in-aid for capital creation, which implies that revenue spending of the government in excess of receipts must be deployed for creation of capex. Along witht the stipulation that revenue deficit must be contained within the 2 per cent limit and given Plan size, this implies that nearly two-thirds of plan reveue expenditure must be used for capital creation. This requirement calls for structural changes in Plan schemes. Central government funds must be utlised for capital creation, while State government must meet the operational cost of running the programme. Government has re-affirmed its commitment for fiscal reforms and acknowledged the need for restructuring the Plan schemes. However, review and restructuring of ongoing schemes will have to be phased out. Committted liabilities have to be met before affecting such changes. Thus any fundamental change in respect of the mix of expenditure may be implemented

over a period of time. With further progress on the fiscal consolidation, it is set to be eliminated by next year, favourable macro-economic developments could provide scope for achieving the target set under new FRBM regime i.e. eliminating this gap by end of current financial year.

(ii) The use of capital receipts including market borrowings for generating Productive Assets

53. Non-Plan expenditure at 109.4 per cent of total revenue receipts during 2013-14 has resulted in use of capital resources for consumptive expenditure. This raises the important issue of structural problem in the composition of expenditure which needs corrective action so as to enable government its efforts towards developmental works. With active reforms in fiscal policy it is expected that the issue will be addressed. In the general budget 2014-15, it is estimated that the ratio of non-plan expenditure to total revenue receipts will come down to 102.5 per cent and will be progressively brought down to 98.1 and 95.9 per cent in next two financial years respectively.

54. Another important parameter to assess the quality of government spending is the ratio of Plan expenditure to fiscal deficit, which a pointer towards deployment of borrowed resources. In B.E. 2014-15, the total Plan expenditure of ₹5,75,000 crore is about 108.3 per cent of the estimated fiscal deficit. With further contraction of borrowing as part of fiscal consolidation, it is expected that this ratio will further improve to 115.5 and 123.8 per cent in next two fiscal respectively, pointing towards marked improvement in deployment of public resources towards development. Part of fiscal reforms is targeted to bring down debt to GDP ratio and interest payment to net tax revenue of Centre gradually to a sustainable level so as to make available precious public resources for developmental purposes. The Interest payment to net tax revenue of the Centre has progressively come down to 46.3 per cent in FY 2013-14. With improvement in public finances further, it is estimated at 43.7 per cent in the current year and projected to reduce to 41.2 and 39.0 per cent in next two years respectively.