MEDIUM TERM FISCAL POLICY STATEMENT

A. FISCAL INDICATORS – ROLLING TARGETS AS PERCENTAGE OF GDP

(at current market prices)

		Revised Estimates 2011-12	Budget Estimates 2012-13	Targets for 2013-14	Targets for 2014-15
1.	Effective Revenue Deficit	2.9	1.8	1.0	0.0
2.	Revenue Deficit	4.4	3.4	2.8	2.0
3.	Fiscal Deficit	5.9	5.1	4.5	3.9
4.	Gross Tax Revenue	10.1	10.6	11.1	11.7
5.	Total outstanding liabilities[2] at the end of the year	45.7	45.5	44.0	41.9

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 financing Central Government deficit.*
3. *Comparison with the Thirteenth Finance Commission roadmap is shown in annexure I.*

1. The performance on select fiscal indicators during the current financial year and the rolling targets for ensuing financial years presented above, show slippage over the projection made in the Budget 2011-12. After witnessing financial turmoil in the global economy for two financial years 2008-09 and 2009-10, Budget 2011-12 was presented against the backdrop of robust revival of the growth in Indian economy during 2010-11. It was assumed in the Budget 2011-12 that Indian economy would grow at 9 per cent against the then estimated growth of 8.5 per cent in 2010-11. However, after budget presentation, happenings around the globe including hardening of global crude prices and sticky high inflation scenario in the domestic economy, forced the government to make necessary changes in policy stance during 2011-12 to address the emerging challenges.

2. Before analyzing the fiscal performance during 2011-12 viz-a-viz Budget Estimates, it would be desirable to look into the significant changes in some of the macro-economic parameters in the Indian and world economy, post February 2011. First is the issue of international crude prices; while it was hovering around US $ 85 to 90 per barrel at the time of Budget presentation, it went up sharply and remained sticky at about US $ 110 to 115 per barrel during most part of the calendar year 2011. This coupled with high inflation persisting in domestic economy necessitated reduction in indirect taxes and duties on petroleum products during June 2011. The fiscal impact of this was ₹49,000 crore annually and about ₹36,750 crore during the remaining part of the year 2011-12. After factoring in Share in Central Taxes for States, the give-away on petroleum products for the Central Government was of the order of ₹26,000 crore. However, better than estimated collection in Service tax resulted in no shortfall in the overall indirect tax collection in RE 2011-12. Notwithstanding the relief provided through above duty cuts on petroleum products, subsidy on account of petroleum products still increased by ₹45,000 crore in RE 2011-12 when compared to BE 2011-12. Also, high international prices resulted in additional fertilizer subsidy of ₹17,201 crore in RE 2011-12 over BE 2011-12.

3. Secondly, growth in economy which was robust at 8.4 per cent during 2009-10 as well as 2010-11, started showing signs of moderation as it grew at 7.7 per cent, 6.9 per cent and 6.1 per cent in the first three quarters of 2011-12 respectively. This drop in growth rate impacted the direct tax collection during 2011-12 and there is estimated shortfall of ₹32,000 crore from the BE 2011-12 level in RE 2011-12. This would result in shortfall of about ₹22,800 crore in the net tax revenue for Centre. Gross tax revenue is

therefore estimated to decline from 10.4 per cent of GDP in BE 2011-12 to 10.1 per cent of GDP in RE 2011-12.

4. Thirdly, while Indian economy was showing signs of moderation, the outlook for world economy was also grim and the prevailing uncertainty in world economy brought in volatility to the Indian capital market. Government had to recalibrate its disinvestment programme and accordingly ₹13,895 crore has been realized during 2011-12 as against BE of ₹40,000 crore.

5. The above items itself resulted in overall slippage of about ₹1,37,000 crore amounting to 1.5 per cent of GDP. However, with better control on other expenditure, fiscal deficit is estimated to increase to 5.9 per cent of GDP in RE 2011-12 which is an increase of 1.3 per cent of GDP when compared to BE 2011-12. Due to shortfall in tax revenue receipt and increase in expenditure, mainly in subsidies, the revenue deficit is estimated to increase from 3.4 per cent of GDP in BE 2011-12 to 4.4 per cent in RE 2011-12. Though, fiscal deficit increased by 1.3 per cent of GDP, debt and liabilities of the Central Government reduced marginally to 45.7 per cent in RE 2011-12 from 46.0 per cent in 2010-11. This reduction was largely on account of higher than estimated growth in nominal GDP during 2011-12.

6. The increase in fiscal deficit may also be seen in the context of continuation of the policy of the government, introduced during 2010-11, not to issue Government securities in lieu of cash subsidies to oil and fertiliser companies. Also, government had the benefit of higher than estimated non-tax revenue of about 0.9 per cent of GDP from auction of 3G & BWA spectrum during 2010-11. The fiscal deficit, net of this additional receipt, would have been at 5.8 per cent of GDP in 2010-11. If one sees this deficit in the above context, the slippage is not so pronounced; however, this level of deficit needs to be brought down to a sustainable level in coming years. The fiscal policy of the government for the ensuing year would be guided by the above principle. To reinforce its commitment towards fiscal consolidation, Government is bringing out amendment in the FRBM Act, details of which are spelt out in the Fiscal Policy Strategy Statement.

7. From 2011-12, new fiscal indicator, namely effective revenue deficit had been introduced. This indicator reflects the structural component of imbalance in the revenue account. The emphasis is to eliminate effective revenue deficit by 2014-15, and generate adequate surplus thereafter to augment resources for financing investment and capital expenditure (including grants for creation of capital assets). In the rolling targets for select fiscal indicators, this component has been included in the Medium Term Fiscal Policy Statement.

8. Tax to GDP ratio witnessed sharp decline from a high of 11.9 per cent during 2007-08, to 10.8 per cent in 2008-09 and 9.7 per cent of GDP in 2009-10. With partial withdrawal of stimulus measures during 2010-11, the trend got reversed and tax to GDP ratio increased to 10.3 per cent in 2010-11. However, due to the moderation of growth in economy during 2011-12 and give-aways on petroleum products, Gross tax revenue is estimated to increase at a lower growth rate of 13.7 per cent over the actuals of 2010-11. Accordingly, gross tax to GDP ratio shows a decline from estimated level of 10.4 per cent in BE 2011-12 to 10.1 per cent in RE 2011-12. With further roll back of stimulus measures, gross tax revenue as percentage of GDP is estimated to increase to 10.6 per cent in 2012-13.

9. In the non-tax revenue estimates for BE 2011-12, ₹13,000 crore and ₹1,600 crore were estimated from auction of telecommunication spectrum and FM phase III respectively. However, these auctions have not materialized during this financial year. Notwithstanding the shortfall of ₹14,600 crore on the above two items, non-tax revenue is estimated to marginally decline from ₹1,25,435 crore in BE 2011-12 to ₹1,24,737 crore in RE 2011-12. This is primarily on account of higher than estimated receipts in the form of dividend from Public Sector Undertakings.

10. Disinvestment proceeds which form a significant part of non-debt capital receipts were estimated at ₹40,000 crore in BE 2011-12. However, the prevailing uncertainty in the world economy affected the performance of Indian capital market. In a flight to safety scenario, rupee depreciated and capital market became volatile during 2011-12. Government had to modify its disinvestment programme during 2011-12 and accordingly estimated receipts from disinvestments in PSUs have been reduced to ₹13,895 crore in RE 2011-12. After factoring in recoveries of loans and advances, the total non-debt capital receipts are estimated to reduce from ₹55,020 crore in BE 2011-12 to ₹29,751 crore in RE 2011-12.

11. Total expenditure which was estimated at ₹12,57,729 crore in BE 2011-12 has increased to ₹13,18,720 crore showing an increase of ₹60,991 crore in absolute terms. This increase is mainly on account of increase in major subsidies on food,

fertiliser and petroleum, which has increased by ₹74,292 crore. After accounting for increase in interest payment by ₹7,632 crore and defence services expenditure by ₹6,522 crore in RE 2011-12 when compared to BE 2011-12, total increase in estimated expenditure for above three items would be ₹88,446 crore. This indicates that there are net savings of ₹27,455 crore in the other items of expenditure after excluding the above three items. The desired action to control expenditure increase would be to reduce the outgo on subsidies and contain the growth in interest payment by lowering the fiscal deficit.

12. On the financing side, 2011-12 witnessed significant shortfall in small savings collection during the year. Though the rates on small saving instruments have been aligned with the prevailing market rates with effect from 1st December, 2011, still there would be shortfall of ₹34,484 crore in financing from National Small Savings Fund (NSSF) in RE 2011-12 when compared to BE 2011-12. Further, due to lower than estimated collection in 2010-11, NSSF had shown negative balance and thereby impacting the closing cash balance of the government. This had resulted in non-availability of ₹20,000 crore which was estimated as cash draw-down in the financing of deficit for 2011-12. Fiscal deficit itself has increased by ₹1,09,163 crore in absolute terms in RE 2011-12 over BE 2011-12. The above factors led to increase in the net market borrowings of the government through dated securities and auction treasury bills by ₹92,872 crore and ₹1.01 lakh crore respectively. The levels of borrowing were increased also to take care of emerging cash requirements during the first quarter of ensuing year (2012-13) when the redemptions of existing debt stock is of higher level.

Fiscal outlook for 2012-13 to 2014-15

13. Government resumed the process of fiscal consolidation in 2010-11, after a pause of two difficult financial years in 2008-09 and 2009-10. However, uncertainty in the global economy impacted the growth trend in India as well and the process had to be paused during 2011-12. With the assumption that declining growth has bottomed out during 2011-12 and economy is likely to be growing at higher than previous year rate, the fiscal policy of 2012-13 has been designed. By bringing back the focus on fiscal consolidation process, government has undertaken measures to reduce the fiscal deficit from 5.9 per cent of GDP in RE 2011-12 to 5.1 per cent of GDP in BE 2012-13. This reduction in fiscal deficit by 0.8 percentage point is largely revenue driven. Increase in tax revenue and non-tax revenue is of the order of 0.5 per cent and 0.2 per cent of GDP respectively. While increase in tax as percentage of GDP is mainly on account of further roll back of stimulus measures in indirect taxes, increase in non-tax revenue is on account of estimated receipts of ₹40,000 crore from auction of telecommunication spectrum.

14. The fiscal deficit target for 2012-13 is higher than 4.2 per cent of GDP recommended by the 13th Finance Commission and 4.1 per cent of GDP targeted in the MTFP Statement of 2011-12. Higher deficit may be seen in the context moderation in growth in economy from the potential growth rate. Also, slippage of 0.9 per cent of GDP in fiscal deficit from the recommended level of the 13th FC may be seen in the context of lower than recommended non-debt capital receipt assumed in the Budget 2012-13. In its recommended fiscal roadmap, while 13th FC had estimated non-debt capital receipt of 0.8 per cent of GDP in 2012-13, it is estimated at 0.4 per cent of GDP including 0.3 per cent of GDP from disinvestment proceeds in BE 2012-13.

15. Impact of higher than recommended level of fiscal deficit on total debt and liabilities of the Central Government during 2011-12 and 2012-13 is partially offset due to better performance in 2010-11 and higher nominal growth in GDP during 2010-11 and 2011-12. It may be recalled that while the 13th FC recommended fiscal deficit target for 2010-11 was 5.7 per cent of GDP, the actual fiscal deficit for this year turned out to be 4.9 per cent of GDP. Coupled with the benefit of high nominal growth of 18.8 per cent in GDP during 2010-11, total debt and liabilities of the Central Government has declined to 46 per cent of GDP as against 13th FC target of 53.9 per cent of GDP. Even with higher level of fiscal deficit in RE 2011-12 and BE 2012-13, it is estimated to decline to 45.7 per cent and 45.5 per cent of GDP in respective years as against recommended target of 52.5 per cent and 50.5 per cent respectively.

16. As evident from the rolling targets of select fiscal indicators, government is committed to continue the process of fiscal consolidation during 2013-14 and 2014-15. With necessary policy measures, fiscal deficit is projected to decline to 4.5 per cent of GDP in 2013-14 and 3.9 per cent of GDP in 2014-15. At the same time, effective revenue deficit is projected to decline from 1.8 per cent of GDP in BE 2012-13 to 1 per cent of GDP in 2013-14 and get eliminated in 2014-15. The above fiscal roadmap would result in increase in capital expenditure (including grants for creation of capital assets) from 3.1 per cent of GDP

in 2010-11 to 3.6 per cent in BE 2012-13, 3.8 per cent in 2013-14 and 3.9 per cent of GDP in 2014-15. Though the deficit levels projected above are higher than the 13th FC recommended target of 3 per cent of GDP in 2013-14 and 2014-15, it is estimated that debt and liabilities would still be lower as percentage of GDP at 44.0 per cent and 41.9 per cent in the two respective years than the recommended debt target for these two years at 47.5 per cent and 44.8 per cent of GDP respectively. Total outstanding debt and liabilities indicated above include external debt at current exchange rates and do not include National Small Savings Fund (NSSF) and Market Stabilisation Scheme (MSS) liabilities which are not used for financing Central Government deficit.

17. Revenue deficit has been estimated to decline from 4.4 per cent of GDP in RE 2011-12 to 3.4 per cent of GDP in BE 2012-13. This is at the same level as estimated in BE 2011-12. The revenue deficit as percentage of GDP in 2012-13 may be seen in the context of lower growth in direct tax receipts assumed during 2012-13 due to moderated growth in economy and higher subsidy provision in 2012-13 at 1.9 per cent of GDP against 1.6 per cent of GDP in BE 2011-12. With estimated revival in growth rate, tax receipt as percentage of GDP is estimated to improve and with necessary measures in revenue expenditure management, revenue deficit is estimated to decline to 2.8 per cent of GDP in 2013-14 and 2.0 per cent in 2014-15. As significant proportion of revenue deficit is on account of provisions for grants for creation of capital assets, it would be pertinent to look at the effective revenue deficit of the government to analyse structural nature of imbalance in the revenue account.

18. Gross tax revenue is estimated to increase from 10.1 per cent of GDP in RE 2011-12 to 10.6 per cent in BE 2012-13 (reflecting growth of 19.5 per cent over RE 2011-12). This increase is largely on account of additional resource mobilization measures (ARM) in indirect taxes. After taking out the impact of ARM, BE 2012-13 is estimated at growth of 15.1 per cent over RE 2011-12. With economy estimated to grow at higher rate than 2011-12, it would be possible to further improve the tax to GDP ratio. In the medium term targets, gross tax collection as percentage of GDP is projected at 11.1 per cent in 2013-14 and 11.7 per cent in 2014-15.

19. The fiscal consolidation roadmap enumerated in this Statement, is designed with a mix of reduction in total expenditure as percentage of GDP and improvement in tax to GDP ratio. With re-prioritization of expenditure towards developmental side and curtailing the growth in non-developmental expenditure, total expenditure is projected to decline from 14.7 per cent of GDP in 2012-13 to 14.1 per cent in 2013-14 and 13.6 per cent of GDP in 2014-15. Notwithstanding above reduction in expenditure, plan expenditure is projected to be maintained at 5.1 per cent of GDP during those years as in BE 2012-13 and capital expenditure (including grants for creation of capital assets) is projected to increase from 3.6 per cent of GDP in BE 2012-13 to 3.9 per cent of GDP in 2014-15. Efforts are being taken to bring down total expenditure of the government as percentage of GDP to the above projected level.

B. ASSUMPTIONS UNDERLYING THE FISCAL INDICATORS

1. Revenue Receipts

(a) Tax-Revenue

20. Aided with consistent higher growth in economy during 2004-05 to 2007-08, gross tax revenue as percentage of GDP had increased to 11.9 per cent of GDP in 2007-08 before the advent of global economic crisis in 2008. However, due to the moderation in growth in Indian economy during 2008-09 and stimulus measures undertaken in the form of tax/duty concessions, this percentage has declined to 9.7 per cent in 2009-10. With economy growing at 8.4 per cent during 2010-11 and partial restoration of stimulus tax measures, this ratio has improved to 10.3 per cent in 2010-11. The economic revival, however, has not sustained during 2011-12. There is a view that the recovery would be W-shaped instead of V-shaped. With the moderation in growth and measures to insulate consumers from prevailing high global crude prices, tax as percentage of GDP is again estimated to decline to 10.1 per cent of GDP in RE 2011-12. With ARM measures proposed in the form of partial roll back of stimulus measures, coupled with economy estimated to do better than 2011-12, gross tax revenue as percentage of GDP has been estimated to increase to 10.6 per cent of GDP in BE 2012-13. This would result in growth of 19.5 per cent over RE 2011-12. This level of growth may look ambitious, if seen in isolation without factoring in the impact of ARM measures during the year. After netting off the impact of ARM measures in taxation side, the growth required to achieve BE 2012-13 target would be 15.0 per cent over RE 2011-12. With the assumption of economy returning to the path of higher potential growth during 2013-14 and 2014-15, in the medium term outlook, gross tax revenue as percentage of GDP is projected to improve from 10.6 per cent in BE 2012-13 to 11.1

per cent in 2013-14 and further to 11.7 per cent in 2014-15. This would be still lower than 11.9 per cent achieved during 2007-08. Any slippage in the growth forecast would impact these projections.

21. During the high growth period of 2004-05 to 2007-08, direct tax receipts as percentage of GDP has consistently increased from 4.1 per cent in 2004-05 to 5.9 per cent in 2007-08. Even during the period of global economic crisis, it was clinging on 5.9 per cent in 2008-09 and declined marginally to 5.8 per cent in 2009-10. During 2010-11, though direct tax collections grew at healthy rate of 18.1 per cent; however, due to the impact of high inflation which increased the nominal growth in GDP, direct tax collection as percentage of GDP only maintained its level of 5.8 per cent and had not shown any improvement. With economy again estimated to grow at a lower than potential growth rate during 2011-12 and 2012-13, this ratio is estimated to decline to 5.6 per cent in RE 2011-12 and BE 2012-13. This would be even lower than the level prevailing during difficult years of 2008-09 and 2009-10. This trend needs to be reversed with necessary measures. With the assumption that economy will come back nearer to the potential growth rate during 2013-14 and 2014-15, this ratio is projected to improve to 6.1 per cent and 6.5 per cent of GDP respectively. In order to achieve, the above projected direct tax to GDP ratio, direct tax revenue would require to grow at 25.2 per cent and 23.1 per cent on year-on –year basis. The estimated growth rate may be seen in the context of the performance in direct tax collection during the high growth period of 2003-04 to 2007-08. The compounded annual growth rate for major components of direct tax during the above mentioned period was about 29 per cent. While the Direct Tax Code is being in legislative process, it may be recalled that in a prelude to introduction of DTC, during 2010-11, income slabs were increased for the prevailing tax rate structure and rate of surcharge had been reduced on Corporation Tax. This had helped in improving the compliance level. With widening of tax base and improved compliance, the effective rate of taxation could be increased.

22. Moderation of growth in economy during 2008-09 along with stimulus measures undertaken in the form of indirect tax concessions, severely impacted indirect tax receipts. During 2007-08, indirect tax collection as percentage of GDP was at 6.0 per cent. This came down sharply to 4.8 per cent in 2008-09 and further to 3.8 in 2009-10. With partial roll back of stimulus measures during 2010-11 and economy rebounding to the level of 8.4 per cent growth, this ratio improved to 4.5 per cent in 2010-11. Notwithstanding concessions given on petroleum products to the extent of 0.4 per cent of GDP during 2011-12, indirect tax receipts as percentage of GDP maintained the level of 4.5 per cent of GDP in RE 2011-12. In order to continue the process of fiscal consolidation, indirect tax revenue has to contribute more and at least reach the level of pre-crisis level. As part of ARM measures in BE 2012-13, partial roll back of stimulus measures have been proposed in indirect taxes. Accordingly, it is estimated to increase from 4.5 per cent of GDP in RE 2011-12 to 5.0 per cent of GDP in BE 2012-13 reflecting a growth of 26.5 per cent. However, the year on year growth would be 14.9 per cent after netting off the impact of ARM measures. This level of growth is in line with the growth seen in 2011-12, which is estimated at 15.5 per cent in RE 2011-12 over the actuals of 2010-11. In the medium term outlook, indirect tax receipts as percentage of GDP is projected at 5.0 per cent in 2013-14 and 5.2 per cent in 2014-15.

23. The fiscal indicators shown in Table in paragraph A for BE 2012-13 are based on new Budget proposals.

24. Assignment to States from Gross tax revenue is undergoing a major reform starting from RE 2011-12. Based on the recommendations of the 13th Finance Commission, assignment to States would be adjusted in succeeding year based on the actuals of previous year. As the shareable pool of gross tax collection during 2010-11 was higher in actuals from the revised estimates level of 2010-11, States are assigned additional tax revenue amounting to ₹2,391 crore as carry over for 2010-11 in RE 2011-12.

25. After adjusting for non-sharable components in the form of cess and surcharge and cost of collection, share of States in Central Taxes has increased from 28.1 per cent in 2010-11 to 28.8 per cent in RE 2011-12. This is estimated to decline to 28.4 per cent in BE 2012-13. Accordingly, net tax revenue of Central Government is estimated at 71.2 per cent of gross tax revenue in RE 2011-12 and 71.6 per cent in BE 2012-13. The increase in Centre's share is on account of increase in cess under indirect taxes as part of ARM measures. In the medium term outlook, it is projected at the same level as in BE 2012-13 for 2013-14 and 2014-15. Any significant change in non-sharable components would impact the projected net tax revenue of the Central Government and in turn would impact deficit projections.

(b) Devolution to States

26. 13th FC has recommended for increasing the States' share in net proceeds of Union taxes from the level of 30.5 per cent in 2009-10 to 32 per cent during its award period 2010-2015. It has also recommended increase in the indicative ceiling on total transfers from Centre to the States on the revenue account from 38 per cent to 39.5 per cent. This has impacted the availability of resources for the Central Government.

(c) Non-tax-revenue

27. Non-tax revenue (NTR) was estimated at ₹1,25,435 crore in the B.E. 2011-12. This included ₹14,600 crore on account of auctions of telecommunication spectrum and phase III FM radio. However, these two auctions were not conducted during the year and the above estimated receipts could not be realized. Notwithstanding the above shortfall, non-tax revenue is estimated at ₹1,24,737 crore in RE 2011-12 showing a marginal decline from BE 2011-12. With regard to comparison with 2010-11 actuals, after netting off the one time receipts from 3G and BWA spectrum auction, RE 2011-12 is showing a growth of 10.8 per cent over actuals of 2010-11. Including an estimated receipt of ₹40,000 crore from auction of telecommunication spectrum, BE 2012-13 for non-tax revenue is estimated at ₹1,64,614 crore. Other major component of this receipt is estimated from dividends and profits from PSUs and FIs along with transfer of surplus from the RBI, profit petroleum and regular telecommunication receipts. This component of revenue being highly inelastic, government has to devise mechanisms to increase receipts from non tax revenue with periodic revision in various user charges. This would ensure recovery of cost of service delivery, particularly in respect of railways and posts and accordingly bring down the reliance on budgetary support for various service providers. With ₹25,000 crore of non-tax revenue estimated from telecommunication spectrum in each year 2013-14 and 2014-15 and 8 per cent growth assumed in other non-tax revenue components, it is estimated that non tax revenue as percentage of GDP would decline from 1.6 per cent in BE 2012-13 to 1.4 per cent in 2013-14 and 1.3 per cent in 2014-15. There may be an upward risk wherein some of the one off items may bring in more revenue for the government or dividend growth from PSUs may be higher as economy is projected to grow at higher rate.

2. Capital receipts

(a) Recovery of loans and advances

28. 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. However, with the passage of 12th FC award period, the debt waiver scheme will not be in operation anymore and therefore the recovery of loans from States has shown an increasing trend.

29. Recovery of loans and advances was estimated at ₹15,020 crore in B.E.2011-12. The higher estimated receipt was primarily on account of recovery of short term loans given to the Food Corporation of India for its procurement operation. It is estimated at ₹14,258 crore and ₹11,650 crore in RE 2011-12 and BE 2012-13. For 2013-14 and 2014-15, 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

30. Disinvestments in Government PSUs are main source of receipts under this head. National Investment Fund (NIF) was created to hold disinvestment proceeds and investment of accumulation under the Fund by the fund managers used to give returns as non tax revenue of the government till 2008-09. During 2009-10, Government had decided to use the disinvestment proceeds received during 2009-10 to 2011-12 for the purpose of financing social sector programmes which create capital assets. Accordingly, disinvestment receipts are being used to partly meet expenditure on select flagship programmes related to Rural Employment, Irrigation infrastructure, Urban and Rural Infrastructure. Also, the returns from the investments made earlier through National Investment Fund would continue to be employed to finance selected social sector schemes which promote education, health and employment and to meet capital investment requirement of profitable and revivable CPSEs.

31. In BE 2011-12, disinvestment receipts were estimated at ₹40,000 crore. However, prevailing uncertainty around the globe has impacted the capital market in India. Like other emerging market economies, India also witnessed flight to safety syndrome resulting in currency depreciation and decline in market capitalization. The disinvestment programme was therefore slowed down during 2011-12 to a larger extent and accordingly RE 2011-12 is estimated at ₹13,895 crore.

32. For the year 2012-13, Government has modified its earlier decision and disinvestment proceeds would be available for financing of programme expenditure as done during 2009-10 to 2011-12. The 13th FC recommended that disinvestment proceeds should continue to be used for financing government expenditure. It may be recalled that the MTFP statement for 2011-12 had assumed receipts under this component at ₹30,000 crore and ₹25,000 crore in 2012-13 and 2013-14 respectively. These receipts have been assumed in BE 2012-13 and projection for 2013-14. For 2014-15, no disinvestment proceeds have been assumed for financing programme expenditure. However, in case of discontinuance in use of disinvestment proceeds for financing programme expenditure, the projected fiscal deficit in 2013-14 would be higher to that extent. The above projected receipts for 2012-13 and 2013-14 amount to 0.3 per cent and 0.2 per cent of GDP for respective years much lower than the estimated receipts by the 13th FC at 0.8 per cent and 0.9 per cent of GDP. This receipt would help government in fast tracking the fiscal consolidation process in the medium term framework. Depending on the capital market condition and prevailing macroeconomic parameters in the economy, both upward and downward risks are associated with the successful completion of the projected level of disinvestment programme in respective years.

33. During 2010-11 and 2011-12, when the earlier NIF modality was kept in abeyance, government is estimated to raise disinvestment proceeds of ₹36,039 crore. Incidentally, during the same period, Government is estimated to invest ₹36,316 crore in capitalization of public sector banks, regional rural banks and other financial institutions including NABARD. This information may be factored in while analyzing the uses of disinvestment proceeds by the government. In a way, the above pattern reflects reallocation of government's asset in different portfolios.

(c) Borrowings – Public Debt and Other Liabilities

34. As announced in the Budget 2010-11, the Government has brought out in March 2012 the second edition of the status paper giving detailed analysis of the government's debt situation and likely financing scenario in coming years. Of the overall Central Government debt and liabilities, 92.2 per cent is domestic debt and only 7.8 per cent is external debt. Further, the proportion of external debt in general government debt reduces to 5.9 per cent.

35. As in the recent years, deficit of the government is financed largely through dated securities at market determined interest rates which are raised through auction. Other sources of financing for the government include Securities issued to National Small Savings Fund (NSSF), external debt from multilateral and bilateral agencies, short term bills and net accretion in public account of the government.

36. During 2011-12, the market borrowing programme through dated securities had to be revised twice. Accordingly, an additional amount of ₹92,872 crore amounting to 1 per cent of GDP was raised over and above the estimated net borrowing of ₹3,43,000 crore in BE 2011-12 through this instrument. Further, borrowing through auction treasury bills was also increased by ₹1.01 lakh crore during the year 2011-12. While about ₹1.09 lakh crore of additionality was necessitated due to increase in fiscal deficit, the balance increase was due to shortfall in other financing items when compared to BE 2011-12 coupled with a cash gap in National Small Savings Fund (NSSF) and the need for building cash surplus at the end of year to take care of first quarter cash requirements of the government in 2012-13. Notwithstanding a significant increase in borrowing, government has completed its borrowing programme through dated securities during 2011-12 without disrupting the market. The continuance of tight monetary policy stance, prevailing liquidity condition and higher amount of borrowings has resulted in hardening of yield during the current financial year. The weighted average yield in primary auction of dated securities in 2011-12 has gone up to 8.5 per cent from 7.9 per cent in 2010-11.

37. In BE 2012-13, about 93 per cent of deficit is estimated to be financed through dated securities. The net borrowings from the open market in 2012-13 have been estimated after factoring in private sector requirements. A detailed analysis in this regard was done in the Status Paper for the Government Debt, March 2012. The net borrowing through dated securities is estimated to decline marginally from 4.9 per cent of GDP in RE 2011-12 to 4.8 per cent of GDP in BE 2012-13. In absolute terms, it is estimated to increase to ₹4.79 lakh crore in BE 2012-13 as against ₹4.36 lakh crore in RE 2011-12 reflecting growth of 9.9 per cent. However, with the assumption of trend increase in bank deposits, the estimated market borrowing is expected to show a decline as a proportion of overall deposits with the banking system in BE 2012-13 when compared to RE 2011-12. The details on other sources of financing of deficit are shown in the Receipts Budget.

38. In the Status paper on government debt, it has been explained that while accounting for Central Government debt and liabilities, the amount not used for financing Central Government deficit should be taken out for truly depicting Government's liability. The component of NSSF which are invested in State Governments' securities has been excluded for the purpose of calculating Central Government's liabilities. Similarly, debt raised under Market Stabilisation Scheme (MSS), which are backed with matching sequestered cash not available for financing of government's deficit, has also been adjusted while arriving at the debt and liabilities of the Central Government. With these adjustments from the shown liabilities in the Receipts Budget Annex-5A, along with external debt at current exchange rate, the estimated debt to GDP ratio for Central Government would be 45.7 per cent in RE 2011-12 and 45.5 per cent in BE 2012-13. With the projected level of fiscal deficit of 4.5 per cent of GDP in 2013-14 and 3.9 per cent of GDP in 2014-15, the estimated debt to GDP ratio would be 44.0 per cent and 41.9 per cent respectively. These estimates show that the debt to GDP ratio would come down below the recommended level of 44.8 per cent for 2014-15 by the 13th Finance Commission, one year earlier in 2013-14.

3. Total expenditure

(A) Revenue account

(i) Plan Revenue expenditure

39. Starting with 2008-09 and then in 2009-10, the government had to step up plan expenditure significantly for boosting demand and investment in infrastructure sector. This decision was part of the fiscal stimuli measures provided by the Government to minimise the impact of the global slowdown on the Indian economy. The fact that Indian economy grew at 8.4 per cent in 2009-10 and 2010-11 shows that the policy of increasing government plan expenditure has aided the quick and broad based revival of the economy. Plan revenue expenditure has increased from ₹3,14,232 crore in 2010-11 to ₹ 3,46,201 crore in R.E.2011-12 reflecting growth of 10.2 per cent. This may be seen in the context of compounded annual growth of about 23 per cent during 2008-09 to 2010-11 for this component. Plan revenue expenditure is further estimated at ₹4,20,513 crore in BE 2012-13 reflecting growth of 21.5 per cent over RE 2011-12. The level of growth in revenue expenditure (other than grants for creation of capital assets) has to be moderated in coming years to achieve the desired objective of eliminating the effective revenue deficit.

40. With the above allocation, the provision for plan expenditure would exceed the projected expenditure outlay in the Approach to the Twelfth Five Year Plan. The significant increase in allocations brings in the issue of transforming outlays into outcomes, streamlining schemes and bringing down the number of plan schemes to reflect focussed priorities of the government which could be monitored from a base scenario over the medium term.

(ii) Non Plan Revenue expenditure

41. Non-plan revenue expenditure which mainly consists of salary, pension, defence services, interest payment and statutory grants to States is the component which contributes to the structural imbalance in the revenue account of the government. This component has risen sharply after 2007-08, due to impact of sixth pay commission recommendations and global economic crisis during 2008-09 and 2009-10. While total revenue receipts of the government were 8.9 per cent of GDP during 2009-10, non-plan revenue expenditure has gone up to 10.2 per cent of GDP in 2009-10. This level of non-plan revenue expenditure is not sustainable and current sources of government revenues would not be able to fully finance it; thereby necessitating use of borrowed resources for financing this component. It would be desirable not to use borrowed resources for fulfilling expenditure commitment for these components. With lower estimated growth in salary and pension related expenditure vis a vis GDP growth and measures in subsidy reform, it is estimated that the overall allocation in BE 2012-13 would be 8.5 per cent of GDP compared to 9.2 per cent of GDP in RE 2011-12. The challenge however remains to adhere to these allocations and not to resort to substantive augmentation through Supplementary Demands for Grants during the course of the year. This indeed is an associated risk factor in these projections.

42. In absolute terms non-plan revenue expenditure has been estimated to increase from ₹8,15,740 crore in R.E. 2011-12 to ₹8,65,596 crore in B.E. 2012-13 reflecting growth of 6.1 per cent. The major items of non-plan revenue expenditure are detailed below.

(a) Interest payments

43. Two years of fiscal expansionary policy during 2008-09 and 2009-10, coupled with moderation in growth and in lower tax realization, has resulted in sharp increase in interest payment as percentage of net tax revenue of Central Government. During the fiscal consolidation period i.e. 2004-05 to 2007-08, interest payment as percentage of net tax revenue of

Central Government declined from 56.5 per cent in 2004-05 to 38.9 per cent in 2007-08. This has increased to 46.7 per cent in 2009-10. The slippage would be more pronounced after netting off the impact of MSS related interest payment in 2007-08 and 2009-10.

44. With resumption of fiscal consolidation process in 2010-11, this percentage has improved to 41.1 per cent during 2010-11. However, increase in fiscal deficit and shortfall in targeted tax revenue during 2011-12 has once again led to increase in this percentage to 42.9 per cent in RE 2011-12. This indicates that any slippage on fiscal front even for one or two financial years, has the potential to crowd out resources for developmental expenditure in future as interest payment will elbow out other expenditures from government's net tax revenue.

45. In the coming years government has to guard against any further slippage under this component. With reduction in fiscal deficit estimated in BE 2012-13, interest payment as percentage of net tax revenue to Centre would decline to 41.5 per cent. In the medium term outlook, with the assumed fiscal deficit and with the assumption that incremental debt would be equal to fiscal deficit during the year, this ratio is projected to improve to 39.0 per cent in 2013-14 which would be near to the pre-crisis level and further to 35.9 per cent in 2014-15. Interest payment as percentage of GDP is estimated to remain in the range of 3 per cent of GDP over the medium term. The risk associated with the above projections are significant change in interest rate in the coming years or larger than projected fiscal deficit for the corresponding period.

(b) Defence Services

46. Defence Services expenditure in revenue account is estimated to increase from ₹92,061 crore in 2010-11 to ₹1,04,793 crore in RE 2011-12 reflecting growth of 13.8 per cent. This level of growth in revenue account needs to be moderated. Accordingly, it is estimated to grow at 8.6 per cent in BE 2012-13 to ₹1,13,829 crore vis-à-vis RE 2011-12. For 2013-14 and 2014-15, it is projected to increase by 7 per cent. As percentage of GDP, this component is estimated to reduce from 1.2 per cent in RE 2011-12 to 1.1 per cent in B.E. 2012-13. It is further projected to decline to 1.0 per of GDP in 2013-14 and 2014-15.

(c) Major subsidies

47. In absolute terms provision for major subsides (food, fertiliser and petroleum) has increased significantly from ₹1,64,516 crore in 2010-11 to ₹2,08,503 crore in RE 2011-12 reflecting a growth of 26.7 per cent. Year on year, this level of growth in subsidy related expenditure would not be sustainable. Government is taking necessary policy and administrative measures to arrest the growth in subsidy expenditure. Better targeting of subsidy and direct cash transfer with the help of UIDAI programme would help in going forward on this issue.

48. Provision for major subsidies is estimated to decline from ₹2,08,503 crore in RE 2011-12 to ₹1,79,554 crore in BE 2012-13. Total Subsidies are estimated to decline from ₹2,16,297 crore in RE 2011-12 to ₹1,90,015 crore in BE 2012-13 amounting to 1.9 per cent of GDP. This is with the assumption that necessary policy measures would be undertaken to keep petroleum and fertiliser subsidies at a level below the current year requirement. There is a need to focus on measures and means to ensure the effective utilisation of these provisions and cap this expenditure to create further fiscal space for increased investment in physical and social infrastructure. The present level of subsidy payment is not sustainable and the Government undertook certain measures like introduction of nutrient based subsidy mechanism for certain fertilisers, deregulation of petrol pricing etc. These measures have helped in reducing the expenditure on major subsidies to some extent. The policy on subsidies has to be reworked along with reforms in delivery mechanism in order to adhere to the projected reduction in subsidy expenditure from 1.9 per cent of GDP in 2012-13 to 1.6 per cent of GDP by 2014-15. Any slippage on this account would impact the future fiscal consolidation process and crowd out financial resources for developmental expenditure.

49. Government has firmly established the practice of providing petroleum and fertiliser subsidy in cash instead of securities. The Government has continued the practice of extending government subsidy in cash during 2011-12 also.

50. The practice of providing working capital loan assistance to FCI on market linked rate has helped in reducing their reliance on high cost funds. This in turn has reduced the interest cost for providing food security. This practice is being continued in the coming year FCI may look at the possibility of further rationalizing their administrative cost and States are being requested to join the De-centralised Procurement System in order to bring down the overall cost of delivering food security to the nation.

(d) Non-Plan Grants to States and UTs

51. Under the following categories, grants have been recommended by the 13th FC and the same have been provided in BE 2012-13 and factored in the estimates for 2013-14 and 2014-15:

Post-devolution Non-plan Revenue Deficit (NPRD), Performance Incentive, Elementary Education, Improving Outcomes, Environment related, Road Maintenance, State-specific, Local Bodies, Disaster Relief.

52. The total grants recommended during 13th FC award period is ₹3,18,581 crore and is much higher than the grants recommended by the 12th FC. This, coupled with recommended higher percentage of devolution of Central Taxes to States, would result in lower availability of revenue resources for the Central Government for its expenditure. Accordingly, it would impact the reduction in revenue deficit in the coming years during the 13th FC award period.

53. Total non-plan grants to States and UTs are estimated to increase from ₹49,790 crore in 2010-11 to ₹55,322 crore in RE 2011-12 reflecting an increase of 11.1 per cent. Both as percentage of GDP and net tax revenue to Centre, it is estimated to remain at the same level in RE 2011-12 as in 2010-11. In BE 2012-13 it is estimated at ₹64,211 crore reflecting growth of 16.1 per cent.

54. Based on the recommendations of the 13th FC and likely other non-plan grants, total non-plan grants to States and UTs are estimated at 0.6 per cent of GDP in 2013-14 and 2014-15.

(e) Pensions

55. Subsequent to the implementation of Sixth Pay Commission, expenditure on Pension has gone up significantly from ₹24,261 crore in 2007-08 to ₹57,405 crore in 2010-11 reflecting compounded annual growth of about 33.3 per cent. Pension expenditure, which was 5.5 per cent of net tax revenue to Centre and 0.5 per cent of GDP in 2007-08, has increased to 10.1 per cent and 0.7 per cent respectively in 2010-11. With the payments on arrears being completed, these percentages are estimated to moderate to 8.7 per cent and 0.6 per cent in RE 2011-12 and further to 8.2 per cent of net tax revenue in BE 2012-13.

56. With assumption that pension related expenditure would grow at 8 per cent in the coming years, it is estimated that pension payments would reduce to 0.5 per cent of GDP by 2014-15 and would decline to 6.5 per cent of net tax revenue to Centre in the same year. The assumption made above is associated with risk of large attrition rate in coming years which would result in higher than estimated expenditure.

(B) Capital accounts

(i) Capital outlay

57. The total capital expenditure is estimated at ₹2,04,816 crore in BE 2012-13 reflecting a growth of 30.6 per cent over RE 2011-12. Plan capital expenditure is estimated to increase from ₹64,797 crore in 2010-11 to ₹80,404 crore in RE 2011-12 and ₹1,00,512 crore in BE 2012-13 reflecting compounded growth of 24.5 per cent in the two years period. In the consolidated account of the general government, most of the capital expenditure is reflected as grants for creation of capital assets from the Central Government to States or other implementing agencies.

58. This under depicts the capital investment undertaken at the general government level. Total capital expenditure (including grants for creation of capital assets) is estimated at ₹3,69,488 crore in BE 2012-13 amounting to 3.6 per cent of GDP. It would be the endeavour of the Government to progressively increase this percentage over the medium term. In the medium term fiscal plan, this percentage is projected to increase to 3.7 per cent in 2013-14 and 3.9 per cent in 2014-15. This may be seen in the context of projected reduction in overall expenditure from 14.7 per cent of GDP in BE 2012-13 to 14.1 per cent in 2013-14 and 13.6 per cent of GDP in 2014-15. This would result in increase in percentage share of these components of expenditure in the overall expenditure from 22.3 per cent in RE 2011-12 to 24.4 per cent in BE 2012-13 and further to 26.2 per cent and 28.7 per cent in 2013-14 and 2014-15 respectively. Presently, a lot of capacity addition takes place through Public Private Partnerships. Also, Central Public Sector Undertakings (CPSUs) have been meeting a large part of their capital expenditure through Internal and Extra Budgetary Resources (IEBR). The IEBR of CPSUs (including Railways) is estimated to increase from ₹1,56,893 crore in 2010-11 to ₹2,11,359 crore in R.E. 2011-12 and ₹2,25,485 crore in B.E. 2012-13.

59. Non-plan capital expenditure primarily consists of defence expenditure. Defence capital expenditure is estimated to increase from ₹66,144 crore in RE 2011-12 to ₹79,579 crore in B.E.2012-13 reflecting a growth of 20.3 per cent. Overall non-plan capital expenditure is estimated to increase from ₹76,376 crore in RE 2011-12 to ₹1,04,304 crore reflecting a growth of 36.6 per cent. Apart from the increase in

Defence capital outlay, this increase is primarily on account of government's contribution towards quota increase in the International Monetary Fund (IMF). A sum of ₹14,000 crore has been provided in BE 2012-13 for this purpose.

(ii) Loans and advances

60. With States contracting domestic debt directly from the market, the net loans from centre are likely to decline in medium term. External loans to States however will continue to pass-through the Central Government. In BE 2012-13, Additional Central Assistance for Externally Aided Projects (EAPs) as loan is estimated at ₹11,000 crore. Non-plan loans to Foreign Government are estimated at ₹550 crore in BE 2012-13.

61. Non-Plan loans are also extended to CPSUs for various purposes, including budgetary support for investments, restructuring/revival and Voluntary Retirement Scheme/Voluntary Separation Scheme. However, these loans are not of significant order.

4. GDP Growth

62. In this Statement, GDP data for Quick Estimate 2010-11 and Advance Estimate 2011-12 as released by Central Statistical Organisation (CSO) have been used. According to the above series of data, during the year 2010-11 annual real GDP growth at factor cost (at constant 2004-2005 prices) remains at 8.4 per cent, same as during 2009-10. For 2011-12, the latest release of data from CSO puts the growth rate at 6.9 per cent in real term and after factoring in inflation expectation, the GDP growth (at current market prices) for 2011-12 is estimated at 16.1 per cent. Thus the GDP for the year 2011-12 (at current prices at market price) is now estimated at ₹89,12,179 crore as against ₹89,80,860 crore estimated in BE 2011-12.

63. For the year 2012-13, it is expected that the real GDP growth would be 7.6 per cent (+/-25 bps). After factoring in inflation expectation, the GDP growth (at current market prices) for 2011-12 is estimated at 14.0 per cent resulting in GDP of ₹1,01,59,884 crore. For the period 2012-13 and 2013-14, after factoring in medium term inflation expectation and the endeavour of the government to have 9 per cent average growth over the XIIth five year plan period, the GDP growth at current market prices is projected at 15.0 per cent for 2013-14 and 15.5 per cent for 2014-15.

C. Assessment of sustainability relating to

(i) The balance between Revenue Receipts and Revenue Expenditure

64. The existing revenue classification of government expenditure does not give emphasis on the structural component of imbalance which is consumptive in nature. The objective of prescribing a balance in revenue account was for the purpose of not allowing borrowed resources for meeting consumptive expenditure. The balance in the revenue account has to be seen in the context of consolidated account of three tiers of government i.e. Centre, State and Local Bodies. This is all the more relevant in Indian context as large sum of inter government transfer takes place from Centre to States and States to Local Bodies. This distorts the true depiction of imbalance in revenue account as one looks at the fiscal account of different tiers of the government in isolated manner. The present information system provides collated data at the Centre and State level with a lag. However, it would not be incorrect to analyse how much of imbalance in revenue account of the Central government is arising on account of transfers made in the form of grant for the creation of capital assets to the other tiers of government as well as other grantee bodies.

65. In the Budget 2011-12, the concept of effective revenue deficit had been introduced to truly depict the structural imbalance in the government revenue account. To further strengthen this concept, government is bringing out amendment in the FRBM Act wherein inter alia it has been mandated to eliminate effective revenue deficit by 2014-15. This would ensure that the structural imbalance in revenue account of the government is addressed in right earnest. After taking in to account expenditure in revenue account in the form of grants for creation of capital assets, which is of the order of 1.6 per cent of GDP in BE 2012-13, the effective revenue deficit of the Central Government is estimated to decline from 2.9 per cent of GDP in RE 2011-12 to 1.8 per cent of GDP in BE 2012-13. Through the process of reorientation of expenditure towards productive sector, it will be the endevour of the government to eliminate this deficit by 2014-15.

66. In the projections for 2013-14 and 2014-15, the proportion of capital expenditure and grants for creation of capital assets in the total expenditure has been increased gradually. This requires concious policy and administrative initiatives. This would result

in increase in percentage share of these components of expenditure in the overall expenditure from 22.3 per cent in RE 2011-12 to 24.4 per cent in BE 2012-13 and further to 26.2 per cent and 28.7 per cent in 2013-14 and 2014-15 respectively. With this projected level of expenditure, the effective revenue deficit is estimated to decline to 1.0 per cent of GDP in 2013-14 and get eliminated by 2014-15. Policy initiatives and administrative efficiency would be required to make the target of eliminating effective revenue deficit by 2014-15 achievable.

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

67. With the resumption in fiscal consolidation process during 2010-11, non-plan expenditure as percentage of total revenue receipts had declined to 104 per cent from the high of 126 per cent in 2009-10. In BE 2011-12 it was estimated to decline marginally to 103 per cent. However, due to the increase in subsidy related expenditure and reduction in tax receipts, this percentage is estimated to worsen to 116 per cent in RE 2011-12. At the same time, plan expenditure as percentage of fiscal deficit declined from 101 per cent in 2010-11 to 82 per cent in RE 2011-12. This has resulted in use of borrowed resources for non-plan expenditure.

68. With the proposed resumption of fiscal consolidation process in BE 2012-13, plan expenditure as percentage of fiscal deficit is estimated to improve to 101 per cent. This brings us back to the issue of structural problems in the composition of expenditure and reorientation of expenditure towards productive sectors. This issue has to be addressed on consistent basis. In the medium term outlook, it is projected that plan expenditure as percentage of fiscal deficit would improve to 114 per cent in 2013-14 and 131 per cent in 2014-15. At the same time, non-plan expenditure as percentage of total revenue receipts is projected to decline to 96 per cent and 88 per cent in 2013-14 and 2014-15 respectively. This shows a significant improvement in deployment of borrowed resources. The Government will make further efforts for not using debt receipts for financing non-plan expenditure, particularly non-plan revenue expenditure. The endeavour will be to bring down the ratio of debt to GDP and interest payment to net tax revenue of Centre gradually to sustainable levels and use the borrowed funds judiciously.

Annex - I

COMPARISON OF MTFP WITH 13th FINANCE COMMISSION FISCAL ROADMAP

	2011-12	2012-13	2013-14	2014-15
Fiscal Deficit				
MTFP	5.9	5.1	4.5	3.9
13th FC	4.8	4.2	3.0	3.0
Revenue Deficit				
MTFP	4.4	3.4	2.8	2.0
13th FC	2.3	1.2	0.0	-0.5
Debt*				
MTFP	45.7	45.5	44.0	41.9
13th FC	52.5	50.5	47.5	44.8

* *Excluding NSSF Loans to States, Loans under MSS and accounting for external debt at current exchange rate.*