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	Targets for 2016-17
1.	Effective Revenue Deficit	2.2	1.8	0.0	0.0
2.	Revenue Deficit	3.3	3.0	2.0	1.5
3.	Fiscal Deficit	4.6	4.1	3.6	3.0
4.	Gross Tax Revenue	10.2	10.7	11.2	11.5
5.	Total outstanding liabilities[2] at the end of the year	46.0	44.8	43.1	41.0

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 during the current fiscal year and the rolling targets for ensuing financial years presented above. There is improvement in the fiscal deficit at 4.6 per cent against the projection made in budget 2013-14 of 4.8 per cent despite pressure on receipts, particularly tax revenues. Exchange rate pressure following indications of tapering of quantitative easing by US Fed on May 22, 2013 and elevated inflationary trend posed threat to the twin deficit on trade and fiscal front. However, with pro-active policy stance government successfully reigned in both the deficits. Seen against the challenges faced in the current financial year, the above table presents the pattern of fiscal consolidation.

2. It may be recalled that Government undertook mid-year policy review in last financial year and adopted path of fiscal consolidation following recommendations of Kelkar committee. The fiscal performance in FY 2012-13, as borne out by provisional accounts, was better than expected. It is noteworthy that a change in fiscal policy could be implemented so effectively. Having successfully implemented fiscal consolidation measures in latter half of the last fiscal year, current year budget was presented with realistic assessment of expenditure and receipts. Growth of Non-plan expenditure of 11.4 percent over the actuals included sufficient allocation for subsidies. Similarly, on the plan side a growth of 34 per cent was budgeted over the actuals in previous year. However, increase in the expenditure was matched by measures for additional resource mobilization both on the tax and other receipts.

3. However, the challenges faced by the economy,due to both global and domestic factors, put the budget targets under stress since the beginning of the financial year. First, there was pressure on the exchange rate following signals of tapering of quantitative easing by US Fed on 22nd May, 2013. Following two to three months witnessed sharp depreciation in the rupee value against dollars. Though similar problems were being faced by other emerging economies as well; in India growing trade deficit added additional pressure.

4. RBI had to intervene in the financial markets by increasing short-term interest rates. This led to increase in cost of borrowing. However, government continued with pro-active policy reforms for attracting investments and also to curb import of Gold. Effective action by government and the central bank in tandem yielded result and the Balance of Payment position eased substantially by end of the calendar year 2013. The Current Account Deficit (CAD) position improved in response to the policy measures with second quarter deficit at US $ 5.2 billion against US $ 21.8

billion in the first quarter. It is expected that the CAD in the FY 2013-14 will be around US $ 45 billion, much lower than the previous year.

5. Economy had to face varied challenges in terms of unsupportive external environment, domestic structural constraints and inflationary pressures. Declining growth trend had to be reversed against these odds. Government remained steadfast with its policy reforms and fiscal consolidation stance. Despite pressure on the receipts, conscious decision was taken to front load the plan spending. As a result, proportional fiscal deficit for successive months as compared to previous years widened. However, government re-affirmed its commitment to fiscal consolidation. Concerted efforts were made to achieve targeted resources, while rationalization of expenditure was undertaken with a view to remain with budgeted deficit level.

6. Performance on fiscal deficit is more credible against the fact that there was revenue shortfall of ₹ 27,078 crores in total net revenue receipts to centre as per the revised estimates for FY 2013-14. There was marginal increase in the Non-plan expenditure of ₹ 4,927 crores from the budgeted level, despite higher increase in subsidies by an amount of ₹ 24,432 crores largely due to higher fuel subsidy. It is noteworthy that part of the increase was offset by savings within non-plan spending under the austerity drive. The revenue deficit, therefore, remained at the budgeted level of 3.3 percent in FY 2013-14. Better fiscal management and control on expenditure led to a fiscal deficit of 4.6 percent of GDP, improving by order of 0.2 per cent from the budget estimates of 4.8 per cent.

7. Fiscal management has to be analyzed in the context of falling resources of the government. Due to declining exports and lower industrial growth, taxes on both direct and indirect side were showing slippage from the budgeted target. Net shortfall of ₹ 48,052 crore on taxes to centre was result of overall slowdown in economy. Particularly, Indirect taxes and more so central excise witnessed down-ward trend. In fact, for most part of the financial year, excise collections registered negative growth over the collections in corresponding period last year. However, Non-tax revenue increased by ₹ 20,974 crore, following good response to spectrum auctions and higher dividend. Non-debt capital receipts target was revised downwards by an amount of ₹ 29,824 crores from ₹ 66,468 crores in BE 2013-14 to ₹ 36,644 crores in RE. The shortfall was mainly due to lower than expected receipts from disinvestment due to uncertainties in the financial markets.

8. At the same time, government under took the task of limiting the spending, in line with the emerging view of containing government spending and providing enough space for private investment and easing of monetary policy. Total expenditure of the government was reduced to ₹1590435 crore in RE 2013-14 from ₹ 1665297 crore in BE 2013-14. While expenditure on major subsidies increased from ₹ 220972 crore in BE 2013-14 to ₹ 245452 crore in RE 2013-14, overall Non-plan expenditure was revised to ₹ 11,14,902 crores from ₹ 11,09,975 crores in the BE, showing marginal increase. Following RBI's intervention in the financial market to contain the fall in rupee value in the aftermath of announcement on tapering of quantitative easing, the interest rates increased sharply. Inflationary pressure also contributed in rising rates, resulting in revision of interest payments by the government from initial estimates of ₹ 3,70,684 crores to ₹ 3,80,066 crores.

9. On financing side, market borrowing from dated securities was reduced by ₹ 15,098 crore, by cancelling an auction from third week of January, 2014 borrowing calendar. This was a significant step in conveying government intent to manage the fiscal situation and was viewed by the market positively. With prudent fiscal management government bettered on the deficit projections, thereby giving scope for cut in market borrowing. This cut in market borrowing has to be seen in the backdrop of declining external borrowings. Net external borrowing was revised to ₹ 5,440 crore in RE 2013-14 against ₹ 10,560 crore in BE 2013-14. Borrowings from short term Treasury Bills was increased from ₹ 19844 crore in BE to ₹ 22,678 crore in RE 2013-14.

Fiscal Outlook for 2014-15

10. Government continued with fiscal consolidation policy stance, started with the mid-year policy review in FY 2012-13, through FY 2013-14. Fiscal policy 2014-15 has been designed to meet the macro-economic challenges faced by India in an uncertain international economic situation. The economic growth with started sliding from FY 2011-12 has shown signs of turn around with growth rate reversing the trend upward, from 4.5 per cent in FY 2012-13 it is estimated to increase to 4.9 in FY 2013-14. However, international economic situation remains uncertain with stagnant growth in major economies and US Fed starting tapering of quantitative easing. Government remained un-wavered in its commitment to contain the twin deficits.

11. By bringing back the focus on fiscal consolidation process, government has undertaken measures to reduce the fiscal deficit from 4.6 per cent of GDP in RE 2013-14 to 4.1 per cent of GDP in BE 2014-15. This reduction in fiscal deficit by 0.5 percentage point

is largely revenue driven. Total expenditure is reduced by 0.3 per cent of GDP from 14.0 per cent in RE 2013-14 to 13.7 per cent in BE 2014-15. The increase in tax revenue is of the order of 0.5 per cent of GDP from 10.2 percent in RE 2013-14 to 10.7 per cent in BE 2014-15. However, non-tax revenue declined by 0.3 per cent from 1.7 per cent of GDP in RE 2013-14 to 1.4 per cent in BE 2014-15. Revenue deficit has been estimated at 3.0 per cent of GDP in BE 2014-15, declining from 3.3 per cent in FY 2013-14. The budget estimate of 3.3 per cent of GDP for revenue deficit has been retained in the revised estimates for FY 2013-14. The fact that the revenue deficit has been retained in RE and projected to decline in BE bears testimony to government's drive to improve nature of fiscal spending in conformity with roadmap of fiscal consolidation. Slew of policy measures taken to tackle the increasing subsidy bills, especially decision to progressively increase in diesel prices to link it to market prices will be yielding results progressively. It is expected that with better expenditure management the revenue deficit will be reduced to 2.0 per cent and 1.5 per cent in financial year 2015-16 and 2016-17 respectively.

12. 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 1.8 per cent of GDP in BE 2014-15. It is proposed to be eliminated over the projection period. It is this component of imbalance in revenue account which needs to be addressed in right earnest - through expenditure management and revenue augmentation. However, 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. 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.

13. 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 44.8 per cent by the end of 2014-15. Continuing the declining trend it is likely to reduce to 43.1 per cent in 2015-16 and 41.0 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.

14. Gross tax revenue is estimated to increase from 10.2 per cent of GDP in RE 2013-14 to 10.7 per cent in BE 2014-15 (reflecting growth of 19.0 per cent over RE 2013-14), which is however still 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 11.2 per cent in 2015-16 and 11.5 per cent in 2016-17.

15. The fiscal consolidation roadmap enumerated in this Statement, is designed with a conscious effort to bring down total expenditure of the government as percentage of GDP to the pre-crisis level i.e. of 2007-08. Including issuance of securities in lieu of subsidies and securities issued to nationalized banks, total expenditure of the government during 2007-08 was 15.9 per cent of GDP. This went up to 17.3 per cent in 2008-09 (inclusive of securities issued in lieu of subsidies) and has declined to 15.4 per cent in RE 2010-11. With re-prioritization of expenditure towards developmental side and curtailing the growth in non-developmental expenditure, the total expenditure is estimated to be brought down to 13.7 per cent of GDP in BE 2014-15. In the medium term projection, it is estimated to further decline to 13.4 per cent of GDP in 2015-16 and 12.8 per cent in 2016-17.

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 11.9per cent. Average annual tax growth rate during the five year period in 2003-08 was 21.3per cent, where annual tax growth was highest at 28.9per cent in 2006-07. These reforms were mainly driven by direct tax whose average annual growth rate during this period was about 28per cent. 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 10.8per cent in 2008-09 and further to 9.7per cent 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 per cent, with tax revenues witnessing a high growth rate of 27 per cent. Since the stimulus measures were mainly on indirect tax side, the partial roll back caused a high growth of 40.7 per cent 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 9.1 per cent.

18. The economic growth rate which started on declining 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 ₹ 41,378 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 16.6 per cent. In FY 2013-14, the gross tax revenue grew by 8 per cent in the first half as against 19.1 per cent budgeted.Central Excise registered a negative growth with ₹ 5496 crores less collections over the corresponding period previous year in nominal terms. Customs grew marginally, by 5.7 per cent over last year in H1, resulting in 3.6 per cent growth for Indirect taxes in this period. Direct tax collections were better than Indirect, recording growth of 11.5 per cent in H1, though short of the growth rate budgeted.

19. Tax collections on the whole were sub-dued in H1 due to external shocks and consequent negative outlook in the economy. However, situation changed in the later part of the financial year with active policy measures leading to boost in foreign inflows, better balance of payment position, easing of inflation. Exports picked up and there was sign of revival with economic activity picking. At the same time, government took measures to mobilize resources and contain expenditure to limit the fiscal deficit within targeted level. While, tax collections picked up especially in the direct taxes and service tax on the In-direct side, the revised estimates had to be reduced. The direct taxes was reduced by 4.8 per cent while Indirect taxes was reduced by 8.1 per cent in RE 2013-14 as compared to BE. Thus, total tax revenues was revised downwards by 6.2 per cent of the initial estimates resulting inshortfall of ₹ 76,964 crore than the Budget Estimates. Most of this shortfall comes from indirect taxes, Union Excise Duties in particular. During the 2013-14, the anticipated tax growth is 11.8 per cent over 2012-13 actuals and the tax to GDP ratio is expected to reach 10.2 per cent, marginally lower than 2012-13 levels.

20. 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 strictimplementation will yield result.

Details of Tax Measures

21. With these measures, tax revenues in BE 2013-14 are targeted to grow at 19.0 per cent. The tax to GDP ratio estimated in the Budget for 2014-15 is 10.7 per cent. Budget Estimates for 2014-15 assumes a normal tax growth of 17 per cent over RE 2013-14 and remaining tax growth emanating from additional resource mobilization measures.

22. 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 11.2 per cent in 2015-16 and 11.5 per cent in 2016-17. This implies an average buoyancy of 1.22 which is realistic but an ambitious target. This will require an average tax growth of 16.4 per cent which would be possible through a combination of better tax effort and certain ARM measures.

(b) Devolution to States

23. 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

24. 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. During the current year ₹ 40,000 crore was budgeted from auction of broadband wireless access spectrum and other one-time receipts of telecom sector, which are likely to materialize following successful spectrum auctions towards the end of the fiscal year. Moreover, higher receipts from dividends payments by various CPSEs and special dividend payment by Coal India Limited led to higher collections than the budget estimates. Other Non-Tax Revenues also have shown moderate increase as compared to Budget Estimates. Overall the non-tax receipts are projected to be 1.7 per cent of GDP in 2013-14.

25. 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 1.4 per cent of GDP. There is, however, negative growth projections over RE 2013-14 on account of the fact the non-tax revenues were robust in FY 2013-14 due to special dividend payment. Sans the special dividend, non-tax revenue in BE 2014-15 is at par with previous year in nominal terms.

26. 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 in to 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 2016-17have been projected at 1.3 per cent and 1.2 per cent of GDP respectively.

2. Capital receipts

(a) Recovery of loans and advances

27. 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 ₹ 10,803 crore in RE 2013-14. 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

28. 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 Public Account 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 against BE 2013-14 target of ₹ 55,814 crore the RE 2013-14 has been fixed at

₹ 20,841 crore. This shortfall should be seen against adverse market conditions.

29. In BE 2014-15, it is estimated that an amount of ₹ 51,925 crore will accrue under NIF from disinvestment, including proceeds from disinvestment of government stakes in private companies that could not materialize in FY 2013-14. 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 works out as ₹ 36,644 crores and ₹ 67,452 crores in the RE 2013-14 and BE 2014-15 respectively. Over the medium term frame work, an amount of ₹ 55,000 crore each has been taken for the years 2015-16 and 2016-17.

(c) Borrowings – Public Debt and other Liabilities

30. 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 ₹ 4,84,000 crore were budgeted to finance 89.2 per cent of gross fiscal deficit during 2013-14. Other sources of financing such as external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 13.5 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 for the year 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 14.34 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 8.47 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.

31. Pursuing with Government's commitment to carry on with the fiscal consolidation measures, the fiscal deficit for 2014-15 is budgeted to decline to 4.1 per cent of GDP. Total borrowings requirement for 2014-15 has been budgeted at ₹ 5,96,083 crore or 4.6 per cent of GDP. Net market borrowings of ₹ 4,57,322 crore has been budgeted to finance nearly 86.5 per cent of the fiscal deficit. In nominal terms, net borrowing projections show decline by 2.5 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 the revised estimate of FY 2013-14. Borrowings through external debt are budgeted to remain relatively insignificant during 2014-15.

32. Commercial banks are major investor category which currently holds about 48 per cent of outstanding dated securities. The deposits of commercial banks during 2013-14 saw a y-o-y growth of 15.7 per cent (as on 24 January 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 end-September 2013, share of insurance companies in the holding central government dated securities increased to 19.3 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 be 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 44.8 per cent by the end of 2014-15. Continuing the declining trend it is likely to reduce to 43.1 per cent in 2015-16 and 41.0 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.

33. Gross fiscal deficit is projected to decline progressively to 4.2 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 86 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.

34. 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 at 4.6 per cent of GDP.

35. 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 cannot be followed again until the fiscal deficit is brought down to acceptable level. While the effort should be to reduce the unproductive expenditure of the government, the Plan Expenditure has to remain within the affordable levels, at least till the process of fiscal consolidation is over.

36. During 2013-14, the Plan Expenditure was rationalised by 0.7 per cent of GDP and the Revised Estimates of 2013-14 for Plan Expenditure stands at 4.2 per cent of GDP. The Plan Expenditure for 2014-15 has been maintained at the level of 2013-14 BE which works out to 16.8 per cent over 2013-14 RE. 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 4.3 per cent and 4.0 per cent of GDP in FY 2015-16 and FY 2016-17 respectively.

(ii) Non Plan Revenue Expenditure

37. 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 8.6 per cent in 2014-15 BE due to various expenditure reform measures undertaken by the Government. Non Plan Revenue Expenditure is estimated to be ₹ 10.28 lakh crore in RE 2013-14 and ₹ 11.08 lakh crore in BE 2014-15. Various components of Non Plan Revenue Expenditure are detailed below.

(a) Interest Payments

38. 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 the current year the interest payment would be at 45.5 per cent 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.

39. In BE 2014-15, interest payment is projected at 43.3 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.

(b) Defence Services

40. Defence Expenditure on the revenue account mainly comprises of salary expenditure of defence forces and their operational expenses. Defence Revenue Expenditure is estimated at ₹ 1.24 lakh crore in RE 2013-14 and ₹ 1.34 lakh crore in BE 2014-15. During the projection period Defence Revenue Expenditure is projected to grow at 7.7 per cent.

(c) Pensions

41. The expenditure on pension payments of the Central Government includes both defence as well as civil pensions. Pension payment, in nominal terms is estimated at ₹ 74,076 crore in RE 2013-14 and ₹ 80,983 crore in BE 2014-15. 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 9.3 per cent.

(d) Non Plan Grants to States

42. 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 ₹ 55,290 crore and in BE 2014-15 at ₹ 64,675 crore. BE 2014-15 also includes the compensation for loss of CST to States which is critical for an agreement between Centre and States towards finalization of GST. 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.

43. 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

44. Major subsidies in the Revised Estimates for 2013-14 have increased to ₹ 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. Major subsidies are budgeted at ₹ 2,46,397 crore in BE 2014-15. Total subsidies are at 2.2 per cent of GDP in RE 2013-14 and are budgeted to be at 1.9 per cent of GDP in 2014-15. Going forward, it is expected that with policy reforms and better targeting the expenditure on major subsidies will be coming down to 1.8 per cent and 1.6 per cent of GDP in FY 2015-16 and 2016-17 respectively.

45. 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 will have to align the pricing policy for subsidized goods to ensure that the total subsidies remain within the affordable levels. Secondly, it is extremely essential to ensure that proper systems are put in place for better targeting of subsidies provided by Government.

46. To improve targeting of subsidies, Government has embarked upon an ambitious programme to directly transfer government benefits into Aadhar linked bank accounts of beneficiaries using the UID platform. Although,currently the scheme is at a pilot stage covering limited schemes in limited districts, once the pilot is found to be satisfactory, the system can be expanded nationwide to various transfersof benefits. Since the system is based on the UID platform to begin with, it will ensure that transfers to duplicate beneficiaries and non-existent beneficiaries will be eliminated from inception. Even the issue of eligibility can be much easily tackled in due course.

47. 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, after affecting a substantial price hike of ₹ 5 per litre,Government has allowed Oil Marketing Companies to apply a ‘small’ price corrections on a frequent basis. 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 or two the Government will be able to decontrol diesel fully.

48. 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. 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. 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.

49. The food subsidy regime, in the coming years, will have to undergo a massive overhaul with introduction of Food Security Act.Alongwith 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.

50. As already explained without focused subsidy reforms, the process of fiscal consolidation will be next

to impossible. The expenditure of Government on major subsidies is expected to come down from 2.2 per cent of GDP in 2013-14 RE to 1.9 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 1.8 per cent and 1.6 per cent of GDP in 2015-16 and 2016-17 respectively.

(II) Capital Outlay

51. The total capital expenditure of Government is estimated to be ₹ 1,90,894 crore in the Revised Estimates for 2013-14; and projected to go upto ₹ 2,13,160 crore in the Budget Estimates for 2014-15. Out of this, the Plan Expenditure is expected to be at ₹ 1,03,681 crore in the Revised Estimates going upto ₹ 1,13,049 crore in the Budget Estimates. The Non Plan Capital Expenditure is estimated to be at ₹ 87,214 crore in the Revised Estimates and is budgeted to be ₹ 1,00,111 crore in 2014-15.

52. On the non-plan side, the major portion of Capital Expenditure consists of the Defence Capital Expenditure. The Defence Capital Expenditure is estimated to ₹ 78,872 crore in RE 2013-14 and is expected to go up to ₹ 89,588 crore in 2014-15 BE. During the projection period Defence Capital Expenditure has been provided growth of 10 per cent which is consistent with the overall resource availability and other demands on Centre's resources.

53. The Plan Expenditure of GOI mainly consists of gross budgetary support to Railway Capital 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 20 per cent of total Plan Expenditure in 2014-15 and is projected to increase to 25 per cent of total Plan Expenditure in 2015-16 and 2016-17.

C. Fiscal outlook for 2014-15 to 2016-17

54. The budget of 2013-14 was presented with a fiscal deficit estimate of 4.8 per cent of GDP with economy poised to reverse the declining growth rate. Growth rate which recorded sub 5 per cent in FY 2012-13 for the first time in a decade was estimated to recover above 6 per cent levels. While, the growth trends belied the expectations, economy did break-away from declining trend to record growth rate above the previous year. With exchange rate volatility triggered by imminent tapering of quantitative easing in the US and growth being sluggish in other major economies, impacting trade, the macro-economic situation remained uncertain in the first half of the fiscal year. As a result, the tax collections remained sub-dued in 2013 posing a threat of breach of fiscal deficit.

55. However, active policy stance, slew of measures to boost investment, action to contain gold imports and effective monetary and fiscal policy interventions led to reversal of the macro-economic environment. Firm and timely action helped to rein in the twin deficits and improve various macro-economic parameters. In December, 2013 highest foreign investment inflows were recorded, the foreign exchange reserves were comfortable and exchange rate fairly stable. There was minimal impact when actual tapering of quantitative easing was started towards of the calendar year. The trade deficit was much comfortable, beyond the expectation of the market. Similarly, concerted efforts on the fiscal side in terms of expenditure rationalization and mobilization of resources helped to contain the fiscal deficit, sending unambiguous signs of fiscal prudence. As a result, India was reasonably comfortable as compared to other emerging economies.

56. The Budget of 2013-14 was presented with a fiscal deficit estimate of 4.8 per cent of GDP when signs of moderation in economic growth had already become visible. During 2012-13 the tax receipt fell short by almost ₹ 41,378 crore as compared to Budget Estimates.However, with fiscal consolidation the fiscal deficit was much below the revised estimates in FY 2012-13. With prudent fiscal management government effectively tackled the widening deficit, in later part of the year. Similar measures were undertaken in FY 2013-14. Consequently, the fiscal deficit target has been revised downward to 4.6 per cent as compared to budgeted level of 4.8 per cent.

57. The fiscal policy for 2014-15 has been designed on the lines of the roadmap already announced by the Government. However, Government has shown its resolve to improve upon the target given in the road map. Against fiscal deficit of 4.2 per cent provided in the road map for FY 2014-15, it is proposed to achieve fiscal deficit of 4.1 per cent by better mix of tax revenues and expenditure management. With its approach in the Budget, Government establishes its credibility and commitment to the process of fiscal consolidation. The fiscal deficit targets of the government as outlined in the table above are in line with the fiscal consolidation roadmap announced by the Government. The roadmap has been laid out to ensure that it remains achievable and at the same time establishes the credibility of the Government and its commitment towards the fiscal consolidation roadmap. The assumptions of various constituents are the building blocks of the roadmap outlined above are explained in this chapter.