

## FISCAL POLICY STRATEGY STATEMENT

### A. Fiscal Policy Review

1. After a brief impact of the global economic slowdown in 2008-09, Indian economy recovered quickly recording 8.4 per cent GDP growth in 2009-10 and 9.3 per cent GDP growth in 2010-11. The recovery, however, was short lived as growth rate slowed down substantially in the following year, 2011-12 to 6.2 per cent. Fiscal expansionary response which continued since 2008-09 to arrest the growth decline resulted in high fiscal deficits. The continued Euro Zone crisis and gloomy economic trends in major economies contributed adversely, impacting India's exports negatively. This along with the elevated levels of crude prices and high levels of gold imports led to the widening of trade gap and Current Account Deficit. Macroeconomic analysis of India during the years 2010-11 and 2011-12 therefore showed a trend of rising current account deficit, sticky inflation, falling savings rates, falling investments and even consumption. The uncertainty in global economy along with the monetary policy tightening measures led to a perceptible negative impact on economic growth. As a result of these factors, the growth is estimated to come down to a decade low of 5 per cent of GDP, as per CSO's advance estimates. Last time sub 6 per cent growth was seen in 2002-03, when the growth in GDP was registered at 4 per cent.

2. The widening trade gap, falling investment and difficult economic situation both domestically and abroad have added to negative outlook on the Indian economy. The rigid inflationary conditions and consequent tightening measures on monetary policy along with negative sentiment on investments and savings have had a deep impact on industrial growth. Discouraging trends in economic growth called for immediate corrective measures and appropriate policy response. Public debate centered around the fact that high fiscal deficit tends to heighten inflation, reduces room for monetary policy actions, and dampens private investment. The sustained high levels of fiscal deficit though required as a counter-cyclical measure to spur growth, has also caused diverse forms of macroeconomic imbalances, which could not be overlooked and immediate corrective measures were called for to contain the likely growth in fiscal deficit during 2012-13 and onwards.

3. Mid-year course correction with suitable policy response became imminent in the emerging scenario.

Fiscal consolidation by way of regulating deficits and cutting expenditure to create positive business environment was immediate need of the hour. Government accordingly appointed Kelkar Committee in August, 2012 to suggest 'Roadmap for Fiscal Consolidation' within one month's time period. Kelkar committee held series of meetings with Ministry of Finance, concerned line ministries and Planning Commission to finalize its report within the given timeframe. Deliberating on various issues facing the economy, Kelkar committee suggested a slew of measures to contain the rising trend of fiscal deficit. The committee observed that deficit financing through domestic sources tends to be inflationary. At the same time, twin deficits hypothesis implies that, given a certain level of private savings, an increase in fiscal deficit will have to be balanced by either a reduction in private investment or an increase in the current account deficit. The Indian economy has been witnessing both.

4. The fiscal stress in the 'do-nothing' scenario as per Kelkar committee report was fast approaching unsustainable levels. On revenue side, slower pace of economic growth implied shortfall in both direct taxes - both corporation and income tax - due to lower profits and incomes. Similarly, slower pace of economic growth meant shortfall on custom duty, being directly linked to imports and excise duty due to slower pace growth in production. Another matter of concern related to expected shortfall in Non-tax revenue by at least ₹ 30,000 crore on account of lower realization from 2G spectrum following court litigation and poor response to auctions. It was estimated by the committee that the revenue collections in the current year, Tax and Non-tax put together will take a hit by at least ₹ 60,000 crore from the budgeted targets in BE 2012-13. Similarly, international crude prices remained at high levels in the range of US \$ 110 to 115 per barrel peaking to above US \$ 120 per barrel for some time. As India imports bulk of its crude requirements and the pricing of petroleum products by oil marketing companies for the purpose of calculating under-recoveries are benchmarked to the international prices, there was a significant increase in the estimated under-recovery of OMCs. In tandem with high crude price, prices of most of the petroleum products in the international market went up sharply, and fertilizer bill ballooned due to rising Urea prices.

Therefore, it was estimated that the subsidy expenditure would rise by about ₹ 70,000 crore. Accordingly, it was estimated that unless immediate corrective measures are taken the deficit will be well above 6.1 per cent of GDP.

5. The net effect would be 'crowding-out' of private sector financing for investment due to large gross borrowing requirement. In an extremely fragile world market financing of this magnitude would be creating huge risks for macroeconomic and external stability. Against this scenario and aided by Kelkar committee recommendations, government undertook the task of meeting the challenge. As a first credible step towards fiscal consolidation, the fiscal deficit target was revised from 5.1 per cent to 5.3 per cent for the current year. As per the roadmap of fiscal consolidation laid down by the government the fiscal deficit in 2013-14 has been projected at 4.8 per cent, to be reduced by 0.6 per cent every year to achieve 3.0 per cent target by the end of the plan period, viz. 2016-17. In order to achieve the target for Disinvestment, committee of secretaries was constituted in the Ministry of Finance. Similarly, efforts were made to mop up revenues both tax and non-tax to contain the fiscal deficit within the projected targets. However, shortfall in the customs duty on indirect side and non-realization of targeted revenues from Spectrum sale on the Non-tax side had to be factored in.

#### **Roadmap for Fiscal Consolidation**

6. On the expenditure side, government took major decisions to contain government spending on subsidy. The choice was between the devil and the deep sea. Raising diesel and LPG prices to meet the widening gap would have been inflationary in the short run but not passing on the price escalation and thereby increasing fiscal deficit would have only enhanced the fiscal strains. As a result, Government was forced to take corrective measures for increasing in the price of diesel by 5 per litre, allowing oil marketing companies (OMCs) to raise diesel prices by small amounts regularly, and a cap on the number of subsidized LPG cylinders. The rationale was that the current level of fuel subsidy was unsustainable and a gradual increase in prices over extended period of time would ease the impact on inflation. This also meant that though the decision will ease pressure on subsidies in due course, in the immediate future government will have to meet the rising subsidy bill. It was estimated that on account of revenue shortfall and increased government spending, largely on subsidies, there will be need for curbing other expenditures to remain within the announced fiscal deficit target of 5.3 per cent in 2012-13.

7. Accordingly, government undertook major exercise of rationalizing both Plan and Non-plan spending to match the revenues. Therefore, with a view to rationalize of expenditure and optimize available resources, measures for economy cut, reduction in plan and non-plan expenditure to reprioritize releases based on implementation schedule and actual requirements based on pace of expenditure etc. were taken to contain public spending within the available resource limits and targeted levels of fiscal deficit. While, government took major steps towards containing its spending and mopping up resources in keeping with fiscal discipline, important steps were also taken to infuse confidence in the market for growth revival. Government took important administrative decisions including allowing FDI up to 49 per cent in Insurance sector, permitting FDI in multi brand retailing, carrying out amendment in banking regulation laws to allow foreign banks, deferring General Anti-Avoidance Rule etc. Government's proactive stance in carrying forward reforms along with credible steps to limit spending and contain fiscal deficit has been instrumental in reviving the market sentiments and infusing fresh confidence in the Indian economy, the result of which will be seen to some extent in the next financial year.

8. Increase in tax to GDP ratio coupled with lower than budgeted expenditure has demonstrated government's ability to rein in the escalating fiscal deficit. The step was much needed and removed substantial gloom in the market, as it provided some leg-room for easing of monetary policy measures by the RBI. Firm action to control public spending and easing of inflationary pressure led to downward revision of interest rates by the Reserve Bank in January, 2013. Easing of 25 basis points on the interest rates, first since April 2012, combined with lowering of Cash Reserve Ratio by another 25 bps provided the much needed fillip to the market sentiments. The mid-course correction undertaken during the year and proposed to be sustained during 2013-14 has been a much needed catalyst much needed for revival of the market confidence and economic growth.

9. Reform process under taken in the current year, forms the basis of fiscal policy of the government during 2013-14. Proactive policy decisions, contained government spending to provide space for private investment, along with reforms to attract capital inflows are expected to be key drivers of growth revival during 2013-14. Accordingly, having made the base corrections on expenditure front, fiscal policy of the government in 2013-14 is aimed at continuing with

the trend by providing for an affordable and realistic growth of 6.6 per cent for Plan expenditure. At the same time, revenues are targeted to grow at an improved 10.9 per cent of the GDP, through additional resource mobilization as well as bringing out improvements in overall tax administration, thereby bringing down the fiscal deficit to the projected levels of 4.8 per cent.

#### **FRBM Act - Rules Notified**

10. As part of amendments to the FRBM Act, 2003, carried out as part of the Finance Bill, 2012 one of the key changes related to the laying of a Medium Term Expenditure Framework (MTEF) in the Parliament, in the Session immediately following the Budget session. The objective of the MTEF statement is to have a closer integration between the expenditure and medium term fiscal targets planned by the Government. The MTEF sets forth a three-year rolling target for the expenditure indicators along with specification of underlying risks and assumptions involved. Projections made by the Government over a three year framework are vertically expanded for the expenditure side in the statement for various sectors. The statement gives confidence to administrative Ministries / Department of certainty of allocations over a medium term framework for better planning of activities under various government programmes.

11. In pursuance of the above amendments MTEF statement was laid for the first time in Monsoon session in September, 2012 before the Parliament. The statements contained a three year expenditure framework for various sectors viz. Education, Health, Energy, Rural and Urban development and Transport etc. and were shown separately for revenue and capital expenditure. The fiscal deficit targets adopted in the roadmap formed the basis of the new FRBM Rules notified. Accordingly, government laid down that the fiscal deficit will be contained within 5.3 per cent in 2012-13, with gradual reduction of 0.5 per cent to achieve 4.8 per cent in the year 2013-14 and followed by 0.6 per cent reduction in subsequent years to achieve the target of 3.0 per cent level in 2016-17. Further, the target of Revenue deficit have been reset to bring it down to below 2.0 per cent by 2015-16 and to eliminate Effective Revenue Deficit in the same time period.

12. The concept of effective revenue deficit was introduced in the Budget 2010-11. It effectively brings out structural problems in the revenue expenditure in federal set-up and attempts to resolve these by laying greater emphasis on development related expenditure at field level. Coupled with fiscal deficit target, this

fiscal indicator would ensure allocation of borrowed resources in productive sector through creation of capital assets and at the same time would bring the debt and liabilities as percentage of GDP to a more sustainable level. The emphasis to eliminate effective revenue deficit by 2015-16, and generate adequate surplus thereafter would help in augmenting resources for financing investment and capital expenditure (including grants for creation of capital assets).

13. The Budget 2013-14 is being presented in the backdrop of a decade low GDP growth rate and continuing uncertainties in the global economic scenario. Government is faced with the unenviable task of providing a kick start to the revival of growth process by continuing reforms to attract investments and manufacturing while at the same time vacate space for private investments through adequate fiscal consolidation measures.

#### **B. FISCAL POLICY FOR 2013-14**

14. The fiscal policy of 2013-14 has been calibrated with two fold objectives - first, to aid economy in growth revival; and second, to bring down the deficit from 2012-13 level so as to leave space for private sector credit as the investment cycle picks up. Having undertaken mid-year course correction to contain government spending within sustainable limits during the current financial year, Budget 2013-14 provides for a measured increase in plan expenditure by 6.6 per cent over the budgeted estimates of last year. However, this marks an increase of 29.6 per cent over the revised estimates of 2012-13. A growth of 10.8 per cent has been provided for Non-plan expenditure in BE 2013-14 over RE 2012-13 keeping in view the requirements for Defence, Subsidies, Interest payments, Finance Commission Grants and increase in salaries and pensionary payments etc. This would result in overall expenditure increase of 16.3 per cent in BE 2013-14 over RE 2012-13. As a result of these measures, fiscal deficit is estimated to come down to 4.8 per cent of GDP, in keeping with the revised roadmap for fiscal consolidation announced by the government. As percentage of GDP, total expenditure is estimated to remain at same level in BE 2013-14 as in RE 2012-13 at 14.3 per cent.

15. Apart from containing growth in expenditure, the reduction in fiscal deficit is planned to be achieved in conjunction with targeted revenue augmentation both through tax and non-tax revenues. Tax to GDP ratio estimated at 10.7 per cent of GDP in BE 2012-13 is estimated to fall to 10.4 per cent of GDP in RE 2012-13, due to slowdown in economic growth. Tax to GDP ratio is estimated to increase to 10.9 per cent in BE 2013-14,

with the growth of 19.1 per cent over RE 2012-13. Substantial growth of 32.8 per cent has been provided for non-tax revenue in BE 2013-14 as compared to RE 2012-13. However, this has to be seen against the fact that RE 2012-13 was substantially lower than BE 2012-13 due to shortfall from 2G spectrum sale. Compared to BE 2012-13, an increase of 4.6 per cent has been provided which is as per the trend for Non-tax receipts over last several years.

16. On the expenditure front, apart from measures taken to control increase in spending, certain key policy decisions relating to subsidies have been taken by the Government. Apart from measures taken to reduce fuel subsidy through deregulation of diesel prices in a phased manner and capping of subsidized LPG, there is need to look at revision of Kerosene prices also. These measures are expected to substantially bring down under recoveries and the resultant fuel subsidy requirements to sustainable levels. On the fertilizer side, decision to move towards nutrient based subsidy (NBS) regime along with recent trends of softening in the rates of imported fertilizers is expected to contain the requirements on fertilizer subsidy in 2013-14. Further measures by revision of prices are overdue.

17. As regards Food subsidy, Government stands committed to extending food security to all and take adequate measures to carve out fiscal space for its adequate provisioning. 'National Food Security Bill' was introduced in Parliament in 2011 and was subsequently referred to Standing Committee on Food, Consumer Affairs and Public Distribution in January, 2012. After completing the process of deliberation with various stakeholders viz. State Government / UT administration, Central Ministries/ Departments and other individuals / organization, the Standing Committee presented its report on the Bill in January, 2013. Various recommendations related to coverage, entitlement, improvement in identification process and delivery systems have been made by the Standing Committee. Government after giving due consideration to the recommendation will be making suitable changes to the 'National Food Security Bill'.

18. While there will be additional funding requirements on account of the proposed 'National Food Security Bill' it will be the endeavor of the Government to ensure better coverage through improved operational efficiency. In this regard Government has taken measures to reduce the cost of working capital of Food Corporation of India (FCI) by extending Ways and Means advance at lower cost. Measures will also be taken to reduce the administrative cost of FCI in food grains delivery to

offset the additional food subsidy requirements to the extent feasible. As per the recommendations of the Standing Committee, Government will support non-procuring States to strengthen their procurement machinery by creating suitable institutional mechanism and by adopting Decentralized Procurement Scheme (DPS) and also by leveraging food credit facilities offered by RBI. Government shall be pursuing with the State Governments to adopt DPS system for more efficient food grains management and lower cost of delivery to entitled population. Sufficient provision has been made to accommodate additional food subsidy requirements on account of the National Food Security Bill, planned to be implemented during the financial year 2013-14. It is estimated that the incremental requirement on account of Food Security Bill in the initial year will be limited, but will go up in the subsequent years after full scale implementation.

#### **Tax Policy**

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

20. Further, due to high international prices and as a measure to insulate consumers and to reduce under recoveries government had to further reduce taxes/ duty on petroleum products in 2011-12. As a result the gross tax receipts as percentage of GDP in 2011-12 declined to 9.9 per cent from 10.2 per cent in 2010-11. However, with partial roll back of stimulus measures in indirect taxes, it was estimated that tax receipt as percentage of GDP would improve to 10.7 per cent in 2012-13. With moderation of growth rate in 2012-13, the tax-GDP ratio has been revised to 10.4 per cent. Continuing on the path of fiscal consolidation with a view to narrow the gap in government spending and resources, the tax-GDP

ratio has been targeted at 10.9 per cent in the BE 2013-14 with a growth rate of 19.1 per cent. This includes additional resource mobilization, while maintaining pro-growth stance.

### Indirect Taxes

21. In keeping with the overall thrust of fiscal policy, in the realm of indirect taxes also, the stance during 2013-14 would be in favour of further fiscal consolidation, stability in duty rates, rationalization of duty structure by way of withdrawal of certain exemptions without increasing the tax burden on common man. This is in line with the medium term objective of enhancing the tax-GDP ratio both through base expansion as well as administrative improvement.

22. In the medium term, the most significant step from the point of view of broadening the tax base and improving revenue efficiency through better compliance is the introduction of Goods and Services Tax (GST). As far as Central taxes viz. Central Excise duties and Service Tax are concerned, a fair amount of integration has already been achieved, especially through the cross-flow of credits across the two taxes. It would be possible to realize full integration of the taxation of goods and services only when the State VAT is also subsumed and a full-fledged GST is launched.

23. There are several specific proposals in the Budget 2013-14 to recalibrate the tax effort on indirect taxes so that fiscal consolidation may be achieved in the short term. The important and revenue significant proposals include:

- ♦ Increase in excise duty on mobile phones of retail sale price exceeding ₹ 2000 from 1 per cent to 6 per cent.
- ♦ Increase in excise duty on SUVs from 27 per cent to 30 per cent.
- ♦ Increase in basic customs duty on high end motor cars from 75 per cent to 100 per cent.
- ♦ Increase in excise duty on cigarettes.
- ♦ Increase in basic customs duty on Set Top Boxes from 5 per cent to 10 per cent.
- ♦ Imposition of basic customs duty on steam coal at 2 per cent and CVD at 2 per cent. On bituminous coal, basic customs duty is being reduced from 5 per cent to 2 per cent and CVD from 6 per cent to 2 per cent.
- ♦ Increase in basic customs duty on raw silk from 5 per cent to 15 per cent.

- ♦ Levy of export duty on bauxite and unprocessed ilmenite at 10 per cent and on upgraded ilmenite at 5 per cent.
- ♦ Increase in excise duty on marble slabs and tiles from ₹ 30 per square metre to ₹ 60 per square metre.
- ♦ To allow one time voluntary compliance encouragement scheme by way of waiver of interest and penalty, to stop filers, non-filers, non-registrant and service providers who have not disclosed true liability in the returns filed by them during the period from October 2007 to December 2012.
- ♦ Imposition of service tax on all air-conditioned restaurants.

24. Government had earlier revised the customs duty on standard gold bars from 4 per cent to 6 per cent, with a view to contain the impact of gold imports on the Current Account Deficit. It is expected that the decision will also have a favourable impact on revenue collections in the immediate future. It is Government's objective to provide non-adversarial tax administration by simplifying, rationalizing and modernizing customs, central excise and Service tax procedures.

### Direct Taxes

25. Government policy on Direct taxes has been to achieve growth while maintaining a regime of moderate tax rates. Tax collection is the product of two factors - tax rates and tax base. There will be no change in the rate of personal income tax and the rate of tax for the domestic and foreign companies in respect of income earned in the financial year 2013-14. Additionally, surcharge has been proposed under various categories.

26. Expansion of tax base is a continuous process and involves measures on both legislative and administrative fronts. Major policy proposals in the Union Budget 2013-14 intended to broaden tax base are:

- ♦ Tax Deduction at Source at the rate of 1 per cent on immovable property (other than agricultural land) having value exceeding ₹ 50 lakhs.
- ♦ Final withholding tax on unlisted companies at the rate of 20 per cent on the income distributed to shareholders through buy back of shares.
- ♦ Commodities Transaction Tax is proposed to be levied on sale of commodity derivative at the rate of 0.01 per cent.
- ♦ Tax on payments by way of royalty and fees for technical services to non-residents to be raised

from 10 per cent to 25 per cent, however, DTAA rates if lower will apply.

- ◆ It is proposed to provide that where the stamp duty value on transfer of immovable property held as stock in trade is greater than the sale consideration, the stamp duty value will be considered as full value of consideration.
- ◆ General Anti-Avoidance Rule has been deferred till 31st March, 2016.

27. The administrative and information technology initiatives are:

- ◆ Extensive use of technology is being made for collection of information without intrusive methods. 360 degree profiling of taxpayers and potential taxpayers is being done for gathering information regarding their sources of income and spending habits. Information technology tools are being developed for exhaustive collection of information and maintenance of database. Information collected from returns of income and other sources is collated and specific targeted action can be taken against tax evaders.
- ◆ The large tax payer units are being expanded. The CPC at Bangaluru has become fully functional and CPC-TDS at Vaishali Ghaziabad has also gone live recently.

28. Tax buoyancy has come down to less than one, meaning thereby that tax collection has failed to keep pace with the growth in GDP. This is more pronounced in the corporate tax collection than in Personal Income tax collection. It is mainly due to the fact that net profitability of businesses and trade has been diminishing on account of rising inflation as compared to real GDP growth rate and higher cost of funds borrowed. These factors of inflation do not affect wages which mainly contributes to personal income tax collection.

### **Contingent and other Liabilities**

29. The FRBM Act mandates the Central Government to specify the annual target for assuming contingent liabilities in the form of guarantees. Accordingly, the FRBM Rules prescribe a ceiling of 0.5 per cent of GDP for incremental guarantees that the Government can assume in a particular financial year. The Central Government extends guarantees primarily for the purpose of improving viability of projects or activities undertaken by the Government entities with significant social and economic benefits, to lower the cost of borrowing as well as to fulfill the requirement in cases where sovereign guarantee is a precondition for bilateral / multilateral assistance.

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

31. The Stock of contingent liabilities in the form of guarantees given by government has increased in absolute terms from ₹ 1,07,957 crore at the beginning of the FRBM Act regime in 2004-05 to ₹ 1,90,518.70 crore at the end of 2011-12. FRBM ceiling on guarantees which can be assumed by Government during a FY has resulted in reduced contingent liability to GDP ratio. Ratio which stood at 3.3 per cent in 2004-05 is now reduced to 2.1 per cent in 2011-12. The disclosure statement on outstanding Guarantees as prescribed in FRBM Rules, 2004 is appended in the Receipts Budget at Annex 5(iii). During the year 2011-12, net accretion to the stock of guarantees was ₹ 39, 515.70 crore, amounting to 0.44 per cent of GDP, which is within the limit of 0.5 per cent set under the FRBM Rules.

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

Government have a total committed value of ₹ 1,01,146.69 crore with annual payment of ₹ 6,530.63 crore.

### **Government Borrowings, Lending and Investments**

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

34. One of the key features on country's debt profile is diminishing proportion of external debt as percentage of total borrowing. Proportion of external debt in the Central Government debt has declined consistently in the recent years from 10 per cent in 2005-06 to 7.9 per cent in 2010-11. External borrowing is limited to bilateral / multilateral loans from select development partners for financing development projects. It has been decreasing in view of their exposure norms and income norms and the only significant bilateral partner as on date is Japan. The external funding has reduced significantly in RE 2012-13, as many projects are in inception stage and could not come up for payments while repayments were as per schedule, resulting in decline of net financing. The BE 2013-14 for external debt has been retained at BE 2012-13 level. With gradual decline in net inflow from Multilateral Institutions in the coming years, government would have the option of exploring other sources of external debt for example in the form of sovereign bond issuance to maintain a reasonable mix of domestic and external debt in its portfolio.

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

36. In 2012-13, net market borrowings at ₹ 4,79,000 crore were budgeted to finance 93.3 per cent of gross fiscal deficit during 2012-13. Other sources of financing such as external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 6.7 per cent of GFD. During 2012-13, there was net inflow in the small savings account. However, as the net collection is invested in Central and State Securities as per the committee's recommendation and Thirteenth Finance Commission (FC-XIII) norms, the amount was required to be invested in State securities and net financing for Central government was reduced at the RE stage. As a result of lower realization than budgeted from external debt and small savings, and also to meet revised fiscal deficit target of 5.2 per cent, the net borrowing from Auction Treasury Bills (ATBs) was increased by ₹ 20,000 crore viz. from BE 2012-13 of ₹ 9,000 crore to ₹ 29,000 crore.

37. However, fiscal position during the year remained mostly within the budgeted framework as a result of Government initiatives towards containing expenditure through economy measures and rationalization of plan and non-plan expenditure as well as optimum revenue mobilisation through improved compliance. The finances of State governments also reflect contained fiscal deficit as indicated by build-up of cash balances and increased investments in Central Government treasury bills. In 2012-13 Central Government also had additional cushion of higher opening cash balance at the beginning of the year. These factors enabled the

Central Government to reduce its market borrowing for the year by ₹ 12,000 crore to ₹ 4,67,000 crore for fiscal year 2012-13. Borrowings programme for the year was completed smoothly in line with pre-announced calendar for borrowings. The weighted average yield of primary issuance of dated securities during 2012-13 was lower at 8.36 per cent as compared with 8.52 per cent in the previous year while weighted average maturity increased to 13.50 years as against 12.66 years in the previous year.

38. Pursuing with Government's commitment to carry on with the fiscal consolidation measures, the fiscal deficit for 2013-14 is budgeted to decline to 4.8 per cent of GDP. Total borrowing requirement for 2013-14 has been budgeted at ₹ 5,42,499 crore or 4.8 per cent of GDP. Net market borrowings of ₹ 4,84,000 crore has been budgeted to finance nearly 89 per cent of fiscal deficit. In absolute terms, net borrowing is increasing by 3.6 per cent over the previous year. In terms of GDP, however, they are budgeted to decline to 4.3 per cent as compared with 4.7 per cent in the previous year. Borrowings under other sources of financing are budgeted to remain relatively insignificant during 2013-14. A large share of market borrowings is subscribed by the commercial banks, which maintains investment in government securities at around 30 per cent of their aggregate deposits. As year on year growth in aggregate deposits of banks at 13.1 per cent (as on January 25, 2013) much higher than the growth of 3.6 per cent in estimated market borrowings, it is expected that the budgeted market borrowings for 2013-14 will not put any pressure on the markets and ample resources will be available for private investment.

39. In terms of debt financing, the borrowings strategy during 2013-14 will continue to rely on domestic sources with external sources financing only 2.4 per cent of the fiscal deficit. About 97.6 per cent of GFD of ₹ 5,42,499 crore would be financed from the domestic sources. Borrowing strategy will continue its focus on raising resources through on market oriented instruments to meet both the short-term and medium term borrowings requirements of the Government. Apart from ₹ 4,84,000 crore proposed to be raised through dated securities, a provision of ₹ 20,000 crore is also made to be realised through treasury bills. In addition to providing a greater manoeuvrability for cash management, treasury bills also provide benchmark and momentum to trading activity in the money market therefore facilitating the financial and corporate sector in meeting their short-term cash requirements. In addition, Small Savings, State Provident Fund and other receipts from Public

Account would finance remaining portion of the deficit, about 6.3 per cent of the deficit.

40. There is no balance estimated at the end of financial year 2012-13 under Market Stabilization Scheme (MSS). Net accretion in MSS to the tune of ₹ 20,000 crore is however estimated in BE 2013-14.

41. 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 2012-13, a total liability of the Government is estimated at 45.9 per cent of GDP which will reduce to 45.7 per cent by the end of 2013-14. Continuing the declining trend it is likely to reduce to 44.3 per cent in 2014-15 and 42.3 per cent in 2015-16. 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.

42. Gross fiscal deficit is projected to decline progressively to 4.8 per cent of GDP in 2013-14. The MTFP statement projects a further decline in GFD to 4.2 per cent by 2014-15 and to 3.6 per cent by 2015-16. Assuming market borrowings financing at about 90 per cent of the GFD, the net market borrowings are likely to decline significantly in next three years to 4.3 per cent of GDP in 2013-14, 3.8 per cent in 2014-15 and 3.2 per cent in 2015-16. 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.

43. As part of debt management strategy it has been decided to introduce buy-back / switches of government securities in order to reduce the redemption pressure from the maturity buckets 2014-15 to 2018-19. The decision has to be seen in the context that redemption presently in the range of ₹ 90,000 crore will continue at level of ₹ 95,000 crore in 2013-14. However, it will rise to ₹ 1,68,000 crore in 2014-15 and maintain above ₹ 2,00,000 crore thereafter. Buy-back is essentially liability management option which is not only budget neutral but also cash neutral. Only impact that it will have is to the extent of premium / discount on net issuance. Since securities are swapped or re-issued, the transaction will have no net impact on monetary liquidity. Buy back options helps in managing rollover risk and to create space for issuance in corresponding years. Consequently, provision has been made for undertaking buy-back in 2013-14. However, actual operational matters such as amount and timing of buy

back will be by the government at appropriate stage, depending on fiscal and market situation.

44. As per the decision taken by the Government disinvestment proceeds from Central PSUs from the financial year 2013-14 onwards will be used only for select capital investments. Accordingly, specific schemes financed till now from National Investment Fund (NIF) will henceforth be financed from the gross budgetary support. It has now been decided by Government that disinvestment proceeds from FY 2013-14 will get credited to the public account under the head National Investment Fund (NIF), and would remain there until withdrawn/invested only for the approved purposes. During 2013-14, Government proposes to finance "Recapitalization of Public Sector Banks (PSBs)" and investments in Railways for modernization and other capital projects from NIF. By using disinvestment proceeds for above purposes Government will only change the nature of capital assets owned by it as the disinvestment proceeds by reduction in capital assets of Government on one side will be matched by increase in the stock of its capital assets in other approved areas.

#### **Initiatives in Public Expenditure Management**

45. The most important public expenditure management initiative taken by the Government relates to its reversal of policy from fiscal expansion to fiscal consolidation. The public expenditure management through fiscal consolidation required major initiatives to contain government spending without affecting developmental and welfare programmes. With economic growth rate slowing, it was imperative that government spending particularly for the vulnerable section of the society continues, to provide effective protection against inflation in a difficult year. Thus the rationalization of expenditure had to be carried out judiciously rather than indiscriminately. A number of important initiatives have been taken towards fiscal consolidation largely with the aim of containing fiscal deficit, by taking appropriate measures particularly on the front of expenditure control, as brought out in earlier paras and optimization of revenue collections both on the tax and non-tax side.

46. The quarterly exchequer control based cash and expenditure management system which inter alia involves preparing a Monthly Expenditure Plan (MEP) was extended initially from 23 Demands for Grants during 2011-12 to additional 23 Demands for Grants with effect from 2012-13. However, it was subsequently extended to all Demands for Grants. Further, IT based application with the MIS system from e-lekha/Central Plan Scheme Monitoring System

(CPSMS) of the Controller General of Accounts was effectively used to monitor and evenly pace the plan expenditure during the year and also to avoid rush of expenditure at the year end. The practice of restricting the expenditure in the month of March to 15 per cent of budget allocation within the fourth quarter ceiling of 33 per cent was not only enforced rigorously, but also made applicable to Schemes-wise expenditure rather than limiting it to Demand as a whole. The emphasis was on right pacing plan expenditure by ensuring adequate resources for execution of budgeted schemes. Instructions were issued for strict adherence to rules on Utilization Certifications including linking of releases to the utilization of existing funds. This helped in prioritization of spending and avoiding undue parking of funds during the year. It was ensured that all programmes at implementation stage are provided adequate funds but at the same time avoiding excess releases merely on account of allocations. With modern technology at command, there is no need for withdrawing funds much in advance of actual expenditure requirements. It was impressed upon Ministries/Departments that funds may be released keeping in view the actual requirements. Austerity measures on Non-plan expenditure were also strictly enforced. Surplus funds lying with implementing agencies were also asked to be accounted for mandatorily at the stage of next release. Defence expenditure was also rationalized through reprioritization and keeping in view the actual fund requirements by taking into account the unutilized balances lying with its PSEs from the earlier government advances.

47. Rationalization of expenditure exercise thus undertaken also needs to be seen against the fact that a very ambitious plan outlay was provided in BE 2012-13, which was 22.1 per cent higher than RE 2011-12 and 26.3 per cent above 2011-12 Actuals. However, 2012-13 being the first year of the twelfth five year plan, many of the new schemes were at the preparatory/ take-off stage and it was not possible to incur expenditure of full scale magnitude in the very first year. Further, in many cases the releases were being made in advance of actual expenditure requirements leading to piling of funds in the pipeline. Given the fact that on the amount being kept idle in pipeline, government has to incur additional interest liability, it became imperative to curb such tendencies. With the help of modern technology and the real time availability of information on status of fund utilization and balances available, it became easier to improve the cash/fiscal management through timely release of adequate funds and avoidance of parking of funds without actual requirement. Further, exercise on

prioritization of expenditure was undertaken to implement need based releases without compromising on thrust programmes/ areas. The approach yielded result, and helped in containing government spending within the targeted levels of fiscal deficit. The aforementioned steps not only helped in rationalizing government spending but also enabled base correction essential to contain government spending at sustainable levels. Having achieved the task, it was imperative that the consolidation thus achieved is carried forward in 2013-14. Task of fiscal consolidation has accordingly been carried out yielding good results in terms of containing fiscal deficit as per projections made, providing positive outlook to the economy as a whole.

48. While designing programmes and schemes for the XII Five Year Plan, government would be benefitted from the recommendations of the Expert Committee to streamline various Centrally Sponsored Schemes and reduce their numbers only to the critical areas. Further, the recommendation of the Expert Committee on the issue of plan and non-plan classification is being examined. The recommendation regarding direct releases to State Treasury would be gradually encouraged for various Centrally Sponsored Schemes. The proposal is being implemented by Planning Commission in consultation with line Ministries and is expected to make Central schemes more lean and effective.

49. Government has taken important decisions to streamline petroleum subsidy. However, there is need to target both fuel and fertilizer subsidy to benefit directly to the deserving. The Government of India provides Kerosene at subsidized prices to BPL families under the Public Distribution System (PDS). There is overwhelming evidence that this approach is resulting in waste, leakage, adulteration and inefficiency. Therefore, it is imperative that the system of delivering the subsidized Kerosene be reformed urgently. The system of provision and delivery of subsidized LPG to intended beneficiaries needs to be similarly reformed. Fertilizer subsidy, as it exists today, is available to all farmers. It is not possible to differentiate the segments for which the subsidy should be given in this sector. There is a need to evolve a suitable mechanism for direct subsidies to individuals who are entitled to them. Similarly, delays and leakages in respect of various welfare schemes of the Government have been an area of concern. As a result Government felt urgent need to evolve a suitable mechanism for transferring subsidies and benefits directly to the entitled individuals/families. Based on the decision taken in the meeting of the National

Committee on Direct Cash Transfers held by the Prime Minister, Direct Benefit Transfers has been rolled out from 1st January 2013 in 43 identified districts. The purpose of Direct Benefits Transfer is to ensure that benefits go to individual's bank accounts electronically, cutting down delays, channels and diversions. Further, Pilot projects in respect of direct transfer of subsidy for LPG and Kerosene have been undertaken. Similar projects for Fertilizers are also being considered. Based on the lessons learnt there from, Government shall decide about nationwide rollout of the programme. With direct transfer of benefits to the end users, delivery of subsidies can be streamlined through better targeting and administration.

### **Railway Budget**

50. Railway Budget is presented separately however, the earnings and expenditure and all other major financial figures are incorporated in the General Budget. Government support is provided to Railways in the form of Gross Budgetary Support (GBS) and a return on this investment, called Dividend, is paid every year. The rate of Dividend is determined by the Railway Convention Committee and is presently proposed at 4 per cent. There has been no default in the payment of dividend in the last ten years. Railway revenues are primarily earned through two major traffic streams, passenger and freight. Some earnings are also contributed by parcels, commercial utilization of land, siding charges, advertisement and dividend paid by Railways' PSUs. The earnings are utilized to meet the operating expenses called Ordinary Working Expenses (OWE) and pensionary charges. The remaining surplus is used to pay dividend and balance is ploughed back as plan investment for meeting safety and development needs of the system.

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

52. Due to various measures taken including additional resource mobilization through rationalizing the fare and freight tariffs, the financial position of the Railways has started showing signs of improvement in the current year. The revenue earnings of the Railways at ₹ 1,25,680 crore are likely to register a growth of 20.6 per cent in RE 2012-13 over the previous year, whereas the OWE and the pension expenditure at ₹ 1,04,400 crore is estimated to increase by 13.2 per cent. The internal resource generation may improve from ₹ 7,682 crore in 2011-12 to ₹ 17,469 crore in RE 2012-13. The Operating Ratio in RE 2012-13 is likely to improve to 88.7 per cent. The entire loan of ₹ 3,000 crore has also been returned with interest to general revenues. Traditionally the passenger services of railways have been loss making and the under recovery has exceeded ₹ 20,000 crore. However, some correction has been carried out in 2012-13 in the budget and subsequently in January, 2013. It is likely to generate additional revenues of nearly ₹ 7000 crore in 2013-14.

53. The plan investment in railways is funded through GBS, internal resources and extra budgetary resources (EBR). The 12th Five Year Plan for railways has been approved at ₹ 5.19 lakh crore, targeting investment of ₹ 1.94 lakh crore through GBS, ₹ 1.05 lakh crore of internal resources and ₹ 2.20 lakh crore of EBR. An amount of ₹ 63,363 crore has been provided in BE 2013-14, as against investment of ₹ 52,265 crore in RE 2012-13. The plan resources are also targeted to be invested judiciously and operationally important projects will be provided assured funding during the 12th Plan. This will help the railways in not only removing the infrastructure bottlenecks but also augment the revenue earning capacity of the system.

### C. POLICY EVALUATION

54. The mid-year course fiscal correction led to complete policy reversal from fiscal expansionary model to that of fiscal consolidation. While, in the initial year of global financial crisis in 2008-09, fiscal expansionary policies helped in reviving the growth, subsequent developments called for contraction of

government spending. This became especially true with the growing impact of twin deficits, which loomed large on the horizon and there was much debate on government's rising fiscal deficit putting inflationary pressures leading to tightening of monetary policy measures. It was felt that the fiscal expansionary policy will drive economic growth domestically and offset the impact of global crisis was valid in the initial years. However, developments since 2009 have shown that sharp reduction in fiscal deficit coupled with loosening of monetary policy may be the prescription more suitable in present context.

55. Against this backdrop, Government announced roadmap for fiscal consolidation with a view to limit government spending and provide enough room for encouraging private investment along with continuing reforms process to attract capital investment / inflows. The strategy was to provide confidence to market, reduce inflationary pressure and create room for easing of monetary policy. Government worked towards this goalpost in later part of 2012-13 and intends to take forward the process in 2013-14. The expenditure and revenues have been thus targeted at realistic levels to retain net market borrowing of the government within comfortable levels. With net borrowing increasing by 3.6 per cent y-o-y basis, there will be sufficient room for banking sector to provide funds for private investments.

56. Having carried out base correction in 2012-13 to contain public spending and followed with major decisions such as deregulation of diesel prices, capping subsidized LPG etc. the fiscal policy for 2013-14 is aimed at further consolidation of these measures by providing realistic increase in the Plan and Non-plan expenditure. Resource mobilization has also been given due care to narrow the existing gap between potential and actual tax to GDP ratio. The strategy adopted for revival of the economy has the twin objectives of containing government spending to achieve the projected fiscal deficit targets and to carry forward the reforms process to kick start a fresh investment cycle and revive the growth process.