

FISCAL POLICY STRATEGY STATEMENT

A Fiscal Policy Review

1. The moderation in economic growth which started in 2011-12 and continued in 2012-13 impacted the macro-economic situation in the current year. Indian economy did escape the immediate fall-out of global financial crisis in 2008-09 and responded well recording high growth rate of 8.4 percent and 9.3 percent in the immediate years. However, continuing global economic uncertainty and negative outlook at domestic level led to phase of sub optimal economic growth. Sustained inflationary pressure further added to the negative outlook in the macro-economic scenario in the country.

2. Further the current financial year also witnessed pressure on Rupee valuation vis-a-vis Dollars as early warning signal of US tapering of quantitative easing emanated in the second quarter. While RBI intervened to control sliding Rupee value with swift monetary policy actions, Government initiated steps to contain the widening trade gap. Both actions yielded result by end of the calendar year with CAD improving substantially. However, inflationary pressures and RBI's action to contain rupee slide resulted in tightening of interest rates both in the short-term and long-term. Rising cost of funding impacted investments as well as profitability; impacting the investment scenario. Moderation in economic growth also posed fiscal challenges through sluggish tax collections.

Fiscal Consolidation

3. It may be recalled that in the financial year 2012-13, government undertook mid-year course correction following Kelkar committee's recommendation on Roadmap for fiscal consolidation. Rules were framed under the Amended FRBM Act, 2012 adopting revised targets for fiscal consolidation. Government undertook drive to contain fiscal deficit through concerted effort for mobilization of resources on one side and curtailing spending to remain within sustainable levels of deficit. The deficit was controlled by over one trillion, stating Government's intent of controlling twin deficits.

4. Efforts of the government bore fruits. While, revised estimates in 2012-13 pegged fiscal deficit at 5.2 per cent, marginally above the budget estimates of 5.1 per cent. Provisional accounts for 2012-13 established that actual deficit was much lower at 4.8 per cent. Against the backdrop of serious concerns of deficit breaching 6 per cent in September, 2012,

this achievement was indeed noteworthy. It established government's intent and ability in fiscal management.

5. There was general consensus that sustained high levels of fiscal deficit causes diverse forms of macroeconomic imbalances and calls for immediate corrective action. 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 moderation in GDP growth to sub 5 per cent level needs to be seen in the larger macro-economic context. India has also been witnessing one of the difficult inflationary phases in recent times; especially retail sector inflation has been sticky. Growing fiscal deficit in such macro-economic situation would be detrimental to growth in the longer run, as was evidenced in years following stimulus. Hence, paradigm shift towards fiscal consolidation became imperative for providing impetus to growth as well as taming inflation.

6. The fiscal consolidation initiated as part of mid-year course correction in the previous financial year formed the basis of budget presented in the current financial year 2013-14. FY 2013-14 targeted the fiscal deficit at 4.8 percent, having achieved similar level in the previous year itself. Realistic allocation was made for major subsidies, while providing necessary increase in other non-plan expenditure. Similarly, increase was provided in plan expenditure for programme implementation and to protect vulnerable sections of society. Tax revenue was provided reasonable increase, aside of additional resource mobilization through surcharges. However, government remained firmly resolved to carry forward the task of fiscal consolidation as laid down under the Amended FRBM rules. Government also initiated action to reign in the twin deficits posing threat to growth viz. fiscal deficit and current account deficit. While, fiscal deficit was contained in relatively short span in latter half of FY 2012-13, efforts on the trade side started coming in by end of second quarter in the current financial year. However, in the early part of the current year, rupee came under pressure. Following, signs of tapering of US quantitative easing coming in May and June 2013, there was rather sharp depreciation of rupee vis-a-vis US dollars. Depreciation of almost 10 per cent within few days and 31 per cent in the major part of second quarter put strain on the economy.

7. Reserve Bank had to intervene with measures to hike short term interest rates through marginal stand-by facility (MSF) and introduce certain temporary regulations to retain the sliding value to the currency against major currencies of the world. Government responded with key initiatives to attract foreign investments, provide confidence to industry and curb gold imports. Action of the central bank and government taken in tandem led to significant improvement of the macro-economic situation and by end of October, 2013 normalcy was restored. In calibrated manner RBI withdrew restrictions imposed on call money market. MSF was restored to standard levels vis-a-vis repo rate. By this time, it also became apparent that the trade gap will be much less than earlier quarters and that current account deficit will be very much within manageable limits. Trends on gold imports started showing positive signs. It was therefore evident that the position with regard to foreign exchange and adverse trade deficit, which posed major threat in the second quarter, would no longer be an issue. Rupee also stabilized against dollar finding new level of equilibrium. Improving exports with South-East Asian countries and moderating imports via gold added to the feel good factor. Further, highest levels of FII inflows in last months of the calendar year 2013 also added to comfort levels. RBI created separate reserves to meet any exigency arising out of tapering of quantitative easing by the US reinforcing market's confidence in the domestic currency. Inflation moderated in the fourth quarter of the financial year.

8. Fiscal deficit once again came into focus in the third quarter. Inflationary pressure and the rupee depreciation added to rising interest rates. Consequently, growth rate continued to remain under pressure. On the fiscal side, rising interest rates increased the cost of borrowing and also impacted tax revenues. With slowing of major sectors including manufacturing, mining, industrial performing at sub optimal levels, the revenues from Central Excise and Customs grew marginally over last year. In fact, Central Excise recorded negative growth over the previous year and Customs increased by narrow margin. Service Tax showed some growth over last year, but fell short of its budgeted level. Similarly, corporate tax underperformed due to declining profitability. Therefore, by end of the calendar year 2013, there was substantial pressure on resources. In the three quarters, there was a shortfall of about 5 per cent for collections up to the month as percentage of the annual target, when compared with collections up to the period in previous years.

9. In the current financial year there was front loading of plan spending. The expenditure pattern in

FY 2013-14 shows increase in plan spending by about 5 percent in the respective months as compared with five year moving average for corresponding period. Implementing agencies were encouraged to expedite grounding of various schemes as the middle phase of plan period was underway. Non-plan spending as a percentage of budgeted level, on the other hand, maintained same levels as in previous years. As a result, spending increased marginally while resource mobilization lacked pace during first nine months of the financial year.

10. The difference between the pace of expenditure and revenue became apparent by end of first half of the financial year. By end of September, 2013 the fiscal deficit had reached almost 75 per cent of the budgeted level as against 65 per cent in the previous year. By November end 2013, fiscal deficit reached 94 per cent level and there was major concern that year end fiscal deficit may be much above the budgeted level. Lower than expected tax receipts and market sentiments made slippage on resources imminent. Therefore, higher pace of plan spending threatened breach of deficit targets. Under the prevailing macro-economic scenario likelihood of breach of deficit target was taken as negative signal.

11. However, government re-affirmed its commitment to the path of fiscal consolidation and it was clearly stated that fiscal deficit was a *red line* and that under no circumstance would it be allowed to be breached. The tax receipts, especially from direct taxes showed improvement in December, 2013 and the deficit which reached 94.1 per cent in November, 2013 maintained at the same level by the year end. At the same time, government reassessed the plan funding with various ministries as part of pre-budget consultations. It was decided that government spending has to be contained so as to meet any exigency arising out of shortfall in resource mobilization. As a result, austerity measures were reinforced to cut non-plan spending by ten per cent. Plan expenditure was similarly rationalized keeping in view the balances with implementing bodies and overall resource position. Due care was taken to ensure that programmes implementation does not suffer on account of such rationalization.

12. While rationalization of expenditure was being worked out, concerted efforts were also being made to mobilize revenue to the maximum extent. Due to prevailing macro-economic conditions downward revision of tax revenue, especially on the indirect taxation side was imminent efforts were being made to limit the shortfall. Government undertook measures to mobilize resources through direct taxes, non-tax

revenue and disinvestment. As a result of containing expenditure on one side and mobilizing resources on the other the deficit which posed threat of breaching at one point was in fact narrowed to lower than budgeted level in the revised estimates. Favourable trade deficit, easing of inflationary pressure and stable foreign exchange with increase in foreign inflows actually reversed the sentiment prevailing in December, 2013. By January 2014, government efforts to reign in the fiscal had infused much confidence in the market. Government's ability to keep fiscal position under check and avoid any breach of deficit under even severe stress of falling revenues was laudable and appreciated both at the domestic and global level. As in last financial year, government demonstrated its efficacy in controlling the fiscal.

13. Government has re-affirmed its commitment to the path of fiscal consolidation. Both the financial years viz. 2012-13 and 2013-14 were similar in terms of challenges posed on the management of fiscal matters. On both occasions government could instil confidence in the market by demonstrating that it is firmly in control of its finances. Despite several pressures on both domestic and global fronts, Government demonstrated its commitment to the process of fiscal consolidation, having performed consistently better than the estimated level. Proactive policy decisions led to containment of twin deficits, softening of inflation, stable exchange rate and higher investment flows. It is expected that early signs of recovery of growth, if sustained over the next financial year and with stable global economic order should translate in to revival of growth rate. The budget 2014-15 is being presented against backdrop of a decade low growth rate. It is expected that continuing fiscal consolidation forward, with effective policy measures to attract investments in key sectors of infrastructure and manufacturing will be key drivers for revival of growth during 2014-15.

B. FISCAL POLICY FOR 2014-15

14. Despite several challenges witnessed in first half of the financial year 2013-14 accompanied by not so encouraging macro-economic trends, government steadfastly adhered to firm and pro-active policy stance, which started yielding results by fourth quarter. Unambiguous, if feeble, signs of economic recovery started emerging by turn of the calendar year. Assisted by encouraging trends on the inflation side and surging foreign inflows, together with better than expected results on the twin deficit – both fiscal and trade, created reversal of macro-economic fundamentals. Exchange rate was robust enough to withstand pressure when US Fed actually started

tapering of quantitative by end of 2013. This demonstrated resilience of the domestic economy as compared to the vulnerability in earlier part of the financial year. Relentless pursuance of policy reforms, along with effective monetary and fiscal policy measures brought about a major change in the macro-economic conditions in relatively short span. The fiscal consolidation by the government in two successive, and difficult, financial years demonstrated its resolve to tackle major challenges. Fall in gold imports, rising exports, stabilizing crude oil prices, high levels of Investment inflows in last quarter of FY 2013-14, point towards unambiguous, though tentative, turnaround in the economy. Growth, which had fallen to sub five per cent level, is poised to recover to above six per cent in FY 2014-15 and resume path of higher levels in successive years.

15. Interim budget 2014-15 is being presented against a lower than expected GDP growth in FY 2013-14. The fiscal policy of 2014-15 has been calibrated with two fold objectives – first, to aid economy in growth revival; and second, to continue on the path of fiscal consolidation by containing fiscal deficit so as to leave space for private sector credit as the investment cycle picks up. Having contained the spending within sustainable limits in current financial year, budget 2014-15 maintains the plan expenditure at the budgeted estimates of FY 2013-14. Against the actual expenditure in 2012-13 and revised estimates in 2013-14, this allocation marks an increase of about 16.7 per cent and is expected to adequately meet the requirements. A growth of 8.3 per cent has been provided for Non-plan expenditure in BE 2014-15 over RE 2013-14 keeping in view the requirements for Defence, Subsidies, Interest payments, Finance Commission Grants and increase in salaries and pensionary payments etc. This would result in overall expenditure increase of 10.9 per cent in BE 2014-15 over RE 2013-14. As a result of these measures, fiscal deficit is estimated to come down to 4.1 per cent of GDP, improving over the target set in the roadmap for fiscal consolidation announced by the government. As percentage of GDP, total expenditure is estimated to be 13.7 per cent in BE 2014-15 as against 14.0 per cent in RE 2013-14.

16. Apart from containing growth in expenditure, the reduction in fiscal deficit is planned to be achieved in conjunction with targeted revenue augmentation both through tax and non-tax revenues. Tax to GDP ratio estimated at 10.9 per cent of GDP in BE 2013-14 is estimated to fall to 10.2 per cent of GDP in RE 2013-14, due to slowdown in economic growth. However, with streamlining of tax administration accomplished in FY 2013-14, and the recovery in GDP growth

expected in FY 2014-15, tax to GDP ratio of 10.7 per cent is targeted in BE 2014-15. This implies a growth of 19.0 per cent over RE 2013-14; however it is only 11.6 per cent growth over the budget estimate of FY 2013-14. Moderation of GDP growth in last few years had led to lower than budgeted performance; it is expected that with revival of growth in the economy to above 6 per cent levels, with existing tax provision, this target can be achieved. It is noteworthy that additional measures introduced last year on the service tax, corporation and surcharges will continue in 2014-15 as well. Growth of 4.9 per cent has been provided for non-tax revenue in BE 2014-15 as compared to BE 2013-14. However, as compared to RE 2013-14 there is marginal decline of 6.5 per cent. This has to be seen against the fact that RE 2013-14 included special dividends in certain cases and also higher dividend pay-outs by Banks etc. Since, the proceeds from dividend from PSUs and Banks are assumed at same levels, the Non-tax revenue is assumed with marginal increase over last year's budget estimates. Moreover, a significant increase was provided in the budget estimate of Non-tax revenue in 2013-14. Having achieved the target then, it is expected that in 2014-15 there will be marginal increase on an elevated base.

17. On the expenditure front, apart from measures taken to control increase in spending, certain key policy decisions relating to subsidies have been taken by the Government in FY 2013-14. Government continued with the policy of gradually increasing the diesel prices to eliminate under recovery. In fact, in the beginning of second quarter of FY 2013-14 the difference between administered prices and market prices narrowed substantially. However, sharp depreciation of rupee in second again widened the gap between the administered prices and market prices. Inflationary pressures and other macro-economic factors made it difficult to affect sharp price correction. However, Government continued with the policy of calibrated correction in the prices. Stabilization of external exchange and stable international crude oil prices helped in the process of rationalization of diesel prices. It is expected that the gap between administered price and market price of diesel would be eliminated by early FY 2014-15. Thereafter, both petrol and diesel would be deregulated and linked to market prices, leaving PDS Kerosene and LPG subsidy. Government also brought cap on subsidized LPG to 9 per connection annually. However, owing to public demand the cap was revised to 12 cylinders towards end of FY 2013-14.

18. Government has also reduced the burden of roll-over by providing additional amount to cover part dues of the OMCs pertaining to last quarter, despite the normal practice of carrying fourth quarter payment to

the next financial year. Similarly, additional amount has been provided to meet the requirement for Food Security Bill. Considering the fact that number of State governments has to pass necessary legislation and take administrative measures to implement the Food Security Act passed by the Central government in middle of FY 2013-14, the additional allocation is expected to be more than adequate to meet the requirement in FY 2014-15. Despite additional allocation for subsidy as discussed above, the fiscal policy for financial year 2014-15 has been calibrated to achieve the path of fiscal consolidation.

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 slowdown 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. With partial roll back of stimulus measures in indirect taxes and additional revenue measures in direct taxes, it was estimated that tax receipt as percentage of GDP would improve to 10.9 per cent in 2013-14. However, global uncertainties and exchange rate volatility and growth rate lower than expectations in 2013-14, the tax-GDP ratio has been revised to 10.2 per cent. Tax buoyancy has come down to nearly one, meaning thereby that tax collection has failed to keep pace with the growth in GDP. This is more pronounced in case of Indirect taxes than in Direct tax collection. Continuing forward on the path of fiscal consolidation with a view to narrow the gap in government spending and resources, the tax-GDP ratio has been targeted

at 10.7 per cent in the BE 2014-15 with a growth rate of 19.0 per cent. The Voluntary Compliance Encouragement Scheme for Service Tax has brought in additional amount of ₹ 7,700 crores. While half of the amount has accrued in 2013-14, remaining amount will be realized in FY 2014-15.

Indirect Taxes

21. As part of Interim budget no major changes are proposed in the duty structure or rate. It is proposed to continue with all the measures introduced in the last financial year. However, the turnaround in economic activity evidenced in the first quarter of this calendar year in terms of improving softening inflation, improving exports and better industrial and manufacturing and expectation of recovery of growth rate provides scope for achieving the targets. While, the performance in last three quarters in 2013 witnessed subdued collections, some of the lost ground was covered in the fourth quarter of the financial year 2013-14. Going forward, it is expected that with the revival of growth in 2014-15, the budgeted target of 4.8 per cent of GDP will be achieved.

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 administrative measures initiated to streamline the administrative set-up. Government has approved massive expansion of field staff. Additionally several initiatives have been taken on information technology side. Recognizing the fact that globalization is both a challenge and an opportunity, sustained efforts have been made by the Indirect Tax Administration to introduce trade facilitation measures. This year's new initiative is introduction of Information Technology based Risk Management System (RMS) for exports. Further, e-payment of duty/tax has been made mandatory for all those manufacturers and service providers who paid duty / tax of more than ₹ 1 lakh in the previous financial year. These steps are aimed at reducing human interface and cut down transaction cost, making Indian business internationally competitive. Concurrently, clearance in major Customs Clearance Ports and Air Cargo Complexes in the country has also been made available on 24x7 basis.

24. Several specific proposals in the Budget 2013-14 to recalibrate the tax effort on indirect taxes will be continued in FY 2014-15, so that fiscal consolidation may be achieved in the short term.

Direct Taxes

25. Tax collection is a product of two factors- tax rates and tax base. Government policy on Direct Taxes has been to broaden this base while maintaining moderate tax rates. As part of the Interim budget no change is being proposed 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. Similarly, the surcharge on personal income-tax and corporation tax will continue.

26. Expansion of tax base is a continuous process and involves measures on both legislative and administrative fronts. No legislative measures are proposed at present. However, a number of administrative measures have been taken to improve compliance and augment revenue collections, such as:

- Extensive use of technology is being made for collection of information.
- 360 degree profiling of taxpayers and potential taxpayers is being done for collating and correlating information of the sources of income and spending habits.
- Information technology tools are being developed for monitoring information and maintenance of database.
- Utilization of information collected from returns of income and other sources and specific targeted action is taken against tax evaders.
- The CPC at Bengaluru has become fully functional, thereby efficient processing of returns has been ensured.
- CPC-TDS at Vaishali Ghaziabad has made significant improvement in the compliance by the tax deductors.

27. The above measures shall continue to be effective in the financial year 2014-15. Moreover the Department has also undertaken a restructuring exercise in the current FY. 2013-14. This would result in better resource management and effective use of information technology. This is expected to contribute significantly in augmentation of revenue collection from direct taxes.

28. In 2013-14 direct taxes have shown lower growth as compared to the targeted growth rate of

19 per cent. 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 business 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 contribute to personal income tax collection. Consequently, the estimates are revised down-wards by ₹ 31,791 crores, being 0.3 per cent of GDP.

Contingent and other Liabilities

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

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 the Government. The principles enunciated in the policy lay down framework for minimization of risk exposure of sovereign while undertaking these contingent liabilities. The principles include assessment of risk including the probability of a future pay-out, priority of the activity, institutional limits on guarantee for limiting exposure towards select sectors and reviewing the requirement of guarantee for limiting exposure towards

select sectors and reviewing the requirement of guarantee vis-a-vis other forms of budgetary support or comfort. Additional measures to further streamline the process of assuming risk could include charging of risk based premia disincentive for willful default, other part sharing of risk by the Government and insisting on guaranteed debt cost to be near the benchmark 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 ₹ 233769 crore at the end of 2012-13. FRBM ceiling on guarantees which can be assumed by Government during a FY has resulted in reduced contingent liability to GDP ratio. Ratio which stood at 3.3 percent in 2004-05 is now reduced to 2.3 percent in 2012-13. The disclosure statement on outstanding Guarantees as prescribed in FRBM Rules, 2004 is appended in the Receipt Budget at Annex 5(iii). During the year 2012-13, net accretion to the stock of guarantees was ₹ 36938 crore, amounting to 0.37 percent of GDP, which is within the limit of 0.5 percent set under the FRBM Rules.

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 commitment liabilities towards such projects including project costs and annual pay-outs under the annuity projects. These commitments on account of on-going Annuity Projects under Ministries/Departments are disclosed in the prescribed format in Receipts Budget at Annexure-8. The annuity projects contracted by Government have a total committed value of ₹ 101146.69 crore with annual payment of ₹ 6525.65 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 was published in July, 2013. Prudent debt management is corner stone of good economic policy and experience in other part of the world has shown that vulnerability of debt profile to international shocks needs to be closely monitored in emerging global economic order. In India, debt policy is driven by the principle of gradual reduction of public debt to

GDP ratio so as to further reduce debt servicing risk and create fiscal space for developmental expenditure. Indian debt profile is characterized by reliance on domestic market borrowings, with market determined rates rather than administered rates. Development of deep and wide secondary market for Government securities is one of the key reforms in this regard.

34. One of the key features on country's debt profile is diminishing proportion of external debt as percentage of total borrowing. External borrowing is limited to bilateral / multilateral loans from select development partners for financing development projects. It has been decreasing in view of their exposure norms and income norms and the only significant bilateral partner as on date is Japan. The external funding has reduced significantly from ₹ 10,560 crores in BE 2013-14 to ₹ 5,440 crores in RE 2013-14, as many projects are in inception stage and could not come up for payments while repayments were as per schedule, resulting in decline of net financing. The BE 2014-15 for external debt has therefore been kept at ₹ 5,734 crores. With gradual decline in net inflow from Multilateral Institutions in the coming years, government would have the option of exploring other sources of external debt for example in the form of sovereign bond issuance to maintain a reasonable mix of domestic and external debt in its portfolio. However, a low share external debt in the total debt insulates the debt portfolio from external sector shocks and currency risks. Low interest rates in the international financial markets in recent past suggested that it may be beneficial to borrow from international financial market. The decision to issue foreign currency denominated sovereign bonds, however, cannot be based on relative cost alone. The need to access international capital markets should be justified in the context of overall savings and investment requirements of the economy. Therefore, decision to issue sovereign bonds would require establishing a regular and predictable schedule of issuance leading to a build up of interest and redemption payments, keeping in view balance of payments (BoP) implications.

35. Developing a liquid and vibrant secondary market for government securities and broadening the investor base are the key factors to ensure that debt is raised in a cost effective manner. The initiatives to development market are undertaken with close coordination with the Reserve Bank of India. Primary issuance strategy of the Government remains focussed on issuing new securities under benchmark maturities and building volumes under existing securities to improve liquidity in the secondary market. During 2013-14, six new securities were issued

including inflation indexed bonds which constituted 3.9 per cent of total issuance during the year, implying that more than 96 per cent issuances were in terms of re-issues. Broadening of investor base is another key factor in the stability of demand for government securities. The Government introduced inflation indexed bonds based on WPI for institutional category in the starting of FY 2013-14 for market development and price discovery. A separate series of Inflation Indexed National Savings Securities-Cumulative (IINSS-C) linked CPI inflation was introduced exclusively for retail investors in the last week of December, 2013.

36. 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.

37. 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 10.8 per cent of GFD. During 2013-14, 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 4.6 percent, 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.

38. The rollover risk in the Government debt portfolio continues to be low with weighted average maturity of outstanding dated securities close to 10 years. Furthermore, the share of short-term debt in outstanding dated securities at end-January 2014 was just 4.4 per cent and debt maturing in next 5 years was less than 30 per cent of total debt, indicating a low level of rollover risks. Notwithstanding a low rollover risk, the Government is continuing its efforts to elongate the maturity profile of its debt portfolio. During the 2013-14, weighted average maturity of primary issuance of issuance was raised to 14.5 years from 13.5 years in the previous year. Noticeably, the increase in weighted average maturity was achieved without substantial increase borrowings costs. The weighted average yields of primary issuance during 2013-14 saw only moderate increase to 8.47 per cent from 8.36 per cent in the previous year, which may be seen in the backdrop of hardening of interest rates in the economy due to global factors and monetary tightening by Reserve Bank during the year. The increased maturity of primary issuances without a substantial increase in borrowings cost reflects the greater demand for longer tenor securities by insurance companies and provident funds which will continue to support the Government efforts to elongate its maturity profile in medium term.

39. 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 ₹ 5,28,631 crore or 4.1 per cent of GDP. Net market borrowings of ₹ 4,57,322 crore has been budgeted to finance nearly 86.5 per cent of fiscal deficit. In nominal terms, net borrowing is decreased by 2.5 per cent over the previous year. In terms of GDP, however, they are budgeted to decline to 3.6 per cent as compared with 4.1 per cent in the previous year. Borrowings under other sources of financing are budgeted at 13.5 per cent during 2014-15.

40. In terms of debt financing, the borrowings strategy during 2013-14 will continue to rely on domestic sources with external sources financing only 1 per cent of the fiscal deficit. Nearly, 99 per cent of GFD of ₹ 5,42,499 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 ₹ 4,57,322 crore proposed to be raised through dated securities, a provision of ₹ 34,554 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 6.9 percent of the deficit.

41. 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.

42. Cash management framework is an essential ingredient of the overall debt management strategy. Government is moving toward a market based cash framework with reduced dependence on the central bank. With the introduction of Cash Management Bills in 2010-11, cash deficit requirements are now largely managed through the market. It has been decided that cash surplus of the central government will be invested by RBI in the market, beyond the current account necessary to meet day to day requirements. Government is continuously improving and refining its cash flow projections, which is a primary requirement of effective cash management. As part move toward establishment an independent debt management office, Government has adopted a nuanced approach. The Middle Office established in the Ministry of Finance, has evolved and strengthened. Making further progress toward transparency and dissemination of information, Government began publishing a Handbook of Statistics on the Central Government Debt in November 2013, which will be updated on annual basis. Government already brings out a Status Paper on Government Debt, annually.

43. In view of redemption pressures in coming years, particularly during 2015-16 to 2017-18, the Government in coordination with Reserve Bank made progress during 2013-14 in putting in place an active debt management strategy to manage its debt portfolio. In 2013-14, the buyback / switching operations were undertaken whereby the securities worth about ₹ 30,000 crore maturing in 2014-15 and 2015-16 were switched for longer tenor securities and securities worth ₹ 15,000 crore maturing in 2013-14 also scheduled for buy-back towards end of FY 2013-14. Continuing further with active debt management strategy, it is proposed to undertake buyback / switch of another ₹ 50,000 crore securities of shorter tenor during 2014-15. Buyback of the debt serves twin purposes of effective cash management and smoothening of maturity profile. It is expected that Switching / Buy-backs will ease redemption pressure

in the initial part of ensuing financial year. Moreover, with redemption pressure rising over next three financial years, active debt management synchronized with cash management will help in managing redemptions with optimal costs.

44. As per the decision taken by the Government disinvestment proceeds from Central PSUs from the financial year 2013-14 onwards are being used only for select capital investments. Therefore, National Investment Fund (NIF) has been constituted in FY 2013-14, as a fund in Public Account to hold all proceeds from disinvestment. The fund can be utilized for limited purposes of acquiring assets as authorized by the Government. This ensures that only the nature of capital assets owned changes without depleting the asset base, 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. As per the BE 2013-14 ₹ 40,000 crores was proposed to be transferred to NIF for financing Bank recapitalization and Investments in Railways. However, due to lower realization under the disinvestment, RE 2013-14 has now been revised to ₹ 16027 crores, to finance investments in railways, while bank recapitalization financing was taken through GBS. In BE 2014-15, disinvestment target for NIF has been projected at ₹ 36,925 crores.

Initiatives in Public Expenditure Management

Restructuring of Centrally Sponsored Schemes:

45. In a major initiative towards improving the efficacy of plan schemes, Planning Commission implemented the restructuring of centrally sponsored schemes and direct releases through State Treasury. As a part of streamlining, 126 CSS haven restructured into 66 schemes which includes 17 Flagship programmes. The restructuring of schemes, to be affected from next financial year i.e. FY 2014-15 onwards, shall add to more effective application of resources as plan allocations shall be more concentrated. This will also result into more focused monitoring of implementation of schemes by the administrative ministries.

Direct releases to State/UTs with Legislature:

46. All Plan schemes under which central assistance is provided to States/UTs are to be restructured and budgeted as Central assistance to State/UT plans w.e.f 2014-15 BE onwards. For all such schemes funds will be placed with the Administrative Ministries for transfer to the States through the Consolidated Fund of the States/UTs with Legislature concerned. This mode of transfer may be implemented in a phased manner in 2014-15 (BE).The routing of money through

State Treasury will infuse greater ownership of Plan schemes to State/UT governments and greater accountability on them to make timely and need based releases to local Implementing Agencies (IEs) and also to monitor the implementation of schemes more closely.

Provision of Flexi funds:

47. In another major initiative, government decided to earmark at least 10 per cent of the outlay of CSS on flexi funds. Central Ministries concerned shall keep at least 10 per cent of their Plan budget for each CSS as flexi-funds, except for schemes which emanate from a legislation (e.g. MGNREGA), or, schemes where the whole or a substantial proportion of the budgetary allocation is flexible (e.g. RKVY).The introduction of a flexi-fund component within the Centrally Sponsored Schemes (CSS) has been made to achieve the following objectives: i) to provide flexibility to States to meet local needs and requirements within the overall objective of each programme or scheme; ii) to pilot innovations and improved efficiency within the overall objective of the scheme and its expected outcomes; and iii) to undertake mitigation/restoration activities in case of natural calamities in the sector covered by the CSS. In order to enforce financial discipline to achieve the stated objectives, it has been decided that the flexi-funds of a CSS in a particular sector; a) shall not be diverted to fund activities/schemes in other sectors, b) shall not be used to substitute State's own non-Plan or Plan schemes/expenditure, and c) shall also not be used for routine operational expenditure of State/UT governments.

Direct Benefit Transfer

48. In a move to ensure accurate targeting of the beneficiaries, cut down wastage, duplication and leakages, enhance efficiency in disbursement of funds, and efficacy of use of government money, it was decided in October, 2012 that individual benefits from the government would be directly transferred into the Aadhar linked bank account of the beneficiaries. Accordingly, the scheme of Direct Benefit Transfer (DBT) was rolled out from 1 January 2013 in 43 identified districts in 26 selected schemes of 8 Ministries. About 97 lakh beneficiaries in 121 districts stand to benefit under DBT till end of the year 2013. The measure is expected to achieve process re-engineering of Government schemes for simpler and faster flow of information and funds. With an aim to improve subsidy administration, DBT in LPG subsidy (DBTL) began in 20 districts on 1-06-2013 and thereafter in 5 phases (up to 01.01.2014). It has covered 291 districts across the country. Districts with

higher Aadhar penetration were given preference in selection. Once DBT-LPG is rolled out completely across the 291 districts, it will cover over 7 crore consumers making it one of the largest cash transfer programme in the world.

49. One of the major initiatives in the area of disbursement of government money is the implementation of an electronic payment system through a Government Electronic Payment Gateway (GePG) by the Pay & Accounts Offices (PAOs) of Central Civil Ministries/Departments. Under this e-Payment System, payments by PAOs are directly credited into beneficiary's account thus reducing the beneficiary's dependency on government offices / officials to receive their dues/payments. The system helps in quick realization of their dues. By eliminating the need for issuance of Demand drafts for outstation payments, this initiative has greatly reduced the quantum of government money floating idly in the system which has a direct positive impact on government cash position. This is one of the first security compliant, digital signature based payment system in Government and covers 363 PAOs in 50 Central Ministries/Departments through 22 banks. It is now being rolled out for CDDOs of CPWD and has been implemented in 5 CDDOS on pilot basis. Apart from being an important tool for good governance and reduction of corruption, this measure will also be a boost to environmental protection by eliminating paper based physical instruments of payments and scrolls.

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 at 5 per cent. There has been no default in the payment of dividend in the last ten years. Railway Revenues are primarily earned through two major traffic streams, passenger and freight. Some earnings are also contributed by parcels, commercial utilization of land, siding charges, advertisement and dividend paid by Railways' PSUs. The earnings are utilized to meet the operating expenses called Ordinary Working Expenses (OWE) and pensionary charges. The remaining surplus is used to pay dividend and balance is ploughed back as plan investment for meeting safety and development needs of the system.

51. Railway Finances improved in the last decade in as much as that it attained the Operating Ratio of

75.9 per cent in 2007-08. This was primarily due to buoyancy in the national economy getting reflected in railway traffic also and the average growth in railway expenditure. However, after 2007-08, the OWE and pension payment soared consequent upon implementation of the 6th Central Pay Commission (CPC), whereas the momentum of growth in earnings witnessed earlier could not be maintained. As a result the Operating Ratio deteriorated to the extent of 95 per cent. The Railway Plan could be sustained by drawing down from the Railway Reserves Funds. In fact, the balances in Railway Reserve Funds become negative to the extent of ₹ 2,100 crore and ₹ 385 crore during 2010-11 and 2011-12 respectively. 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 resources mobilization through rationalizing the fare and freight tariffs, the financial position of the Railways has started showing signs of improvement in the subsequent years. The entire loan of ₹ 3,000 crore has also been returned with interest to general revenues in 2012-13. The revenue earnings of the Railways at ₹ 140450 crore are likely to register a growth of 13.6 per cent in RE 2013-14 over the previous year, whereas the OWE and the pension expenditure at ₹ 120760 crore is estimated to increase by 15.3 per cent. The internal resource generation is likely to be ₹ 14,496 crore in 2013-14 RE against ₹ 15144 crore in RE 2012-13. The Operating Ratio in RE 2013-14 is likely to be at 90.8 per cent. Traditionally the passenger services of railways have been loss making and the under recovery has exceeded ₹ 25,000 crore.

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 ₹ 64,305 crore has been provided in BE 2014-15 as against investment of ₹ 59,359 crore in RE 2013-14 and ₹ 50,383 are in Actuals 2012-13. The plan resources are also targeted to be invested judiciously and operationally important projects will be provided assured funding during the 12th Plan. This will help the railways in not only removing the infrastructure bottlenecks but also augment the revenue earning capacity of the system. Railways have been provided additional budgetary support of ₹ 1,000 crore in the current fiscal taking GBS from General Revenues from ₹ 26,000 crore to ₹ 27,000 crore. GBS of ₹ 29,000 crore provided to Railways includes ₹ 6,000 crore towards National Projects.

C. POLICY EVALUATION

54. Fiscal consolidation initiated as part of mid-year review in FY 2012-13, was fully implemented in the FY 2013-14. Government notified the new FRBM Rules in July, 2013 following FRBM (Amended) Act, 2012 as passed by the Parliament in the budget session. Accordingly, legal status was provided to the roadmap of fiscal consolidation announced by the government earlier in 2012. Having successfully implemented the policy change in FY 2012-13, and rationalized expenditure in FY2013-14, including realistic assessment of Subsidy requirement, it was expected that fiscal consolidation in FY 2013-14 would be achieved without any major fiscal stress.

55. However, two developments hindered the path of fiscal consolidation in the current fiscal year. One was due to the external shock in the early part of the fiscal year due to likelihood of tapering of quantitative easing indicated by US Fed in third week of May, 2013. As discussed above, the announcement along with growing trade deficit led to a panic reaction in the market. Rupee depreciated steeply, by almost 31 per cent within a month. Monetary policy response from the central bank, RBI, over a period of three months helped in containing the downward trend. At the same time, government persisted with policy reforms for greater investment as well filling the current account deficit by imposing higher import duty on gold. Combined efforts of the central bank and government started bearing results after half year period. By end of the calendar year, the value of rupee had stabilized considerably, RBI had built up foreign exchange reserve to provide adequate buffer for the quantitative easing, portfolio investments were highest in the month of December, 2013 and the trade gap had considerably narrowed following decline in gold import. The effectiveness of government policy measures was clearly discernable in the reversal of trends by the beginning of 2014. Resilience of the measures taken can be gauged by the fact that by the time of actual tapering of quantitative easing was initiated by US; there was little impact on the currency.

56. None-the-less, in the intervening period of four months from July to October, 2013 the adverse impact of the exchange rate on the macro-economic situation was substantial. RBI's intervention led to sharp increase in short-term interest rates eroding private investment and profitability. Along with inflationary pressures, this impacted adversely hitherto sluggish economic growth. In turn, there was pressure on government receipts. Tax receipt, both Direct and Indirect, were lower than the target. At the same, macro-economic scenario was not favourable for disinvestments, while dividend pay-out also was under

duress to lower project of profitability of PSUs. On the expenditure side, plan spending maintained higher level as compared to previous years. Third year of the plan period show grounding of several schemes. Moreover, due to expenditure rationalization in the later part of previous financial year, spending in the current year remained elevated since beginning, as unlike in other years when typically there was drawdown in last quarter in anticipation of next financial year's requirement.

57. As a result, there was higher spending and lower receipts in the period April to December, 2013, leading to higher proportional fiscal deficit as compared to previous years. Therefore, having resorted to fiscal consolidation in the later part of FY 2012-13, government was confronted with similar situation in FY 2013-14 as well. Once again, government demonstrated its firm resolve to tame the deficit. Efforts were intensified to mop up resources, while taming the expenditure to reign in the widening gap. While rationalization of Non-plan expenditure was undertaken with a view to contain additional requirements on subsidies within overall allocation, it was decided to contain plan spending to meet shortfall in total revenues, both on tax and non-tax side. Concerted efforts on these lines undertaken along with pre-budgetary exercise in November – December, 2013 fructified in start of 2014 with fiscal frudence, thus undertaken, it is expected that the fiscal targets will be achieved in the FY 2013-14.

58. The financial year 2013-14 concluded with positive indications on the twin deficit. Trade gap fell beyond expectations of the market with dramatic fall in gold imports. At the same time, position on fiscal deficit was better than budgeted. After providing sufficiently for subsidies, including higher allocation to fuel subsidy towards part of last quarter estimates which are normally paid in the next financial year, government was able to provide funds to meet development programs adequately. RBI continued with its tight monetary policy to tame in further the weakening inflationary trends. However, market was upbeat about positive signals, with many analysts and international agencies reposing confidence in recovery of growth to above 6 per cent levels in FY 2014-15. Interim budget 2014-15 continues path of consolidation by progressively reducing the fiscal deficit to 4.1 per cent, while providing sufficient funds for development programs. The fiscal policy is calibrated with 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.