

FISCAL POLICY STRATEGY STATEMENT

A. Fiscal Policy Review:

1. Fiscal policy in 2016-17 was guided by the macroeconomic imperative of increasing investments for promoting growth. The expenditure focus of the Government was primarily on infrastructure sectors. Impetus was given to agricultural and rural sectors as well. Higher budgetary provision was made for these 3 broad sectors and with the core developmental schemes of the Government. In a time when demand was depressed it was felt that the Government should step-in to bridge the gap. The need to focus on improving the productive capacity of the economy meant that the government's expenditure focus was on infrastructure sectors. Simultaneously it was felt that the social sectors should not be ignored as a majority of our population still live in rural areas. On a broader basis, the fiscal policy strategy of the Government was aimed at ensuring that the growth momentum of the economy in the first half is not lost. This push towards higher growth could not be jeopardised by falling off the fiscal cliff. In other words, the fiscal policy strategy of the Government was to momentum of aiding the growth revival of the economy, while at the same time staying firm on the path of fiscal consolidation.

2. The Advance Estimates of GDP growth released by the Central Statistics Office (CSO), indicates a slowdown in the growth momentum in 2016-17. Based on data available till October 2016, the CSO estimates that the economy will grow in real terms by 7.1 per cent. Fall in rate of real GDP growth by 50 basis points from 2015-16, reflects the impact of a sluggish investment recovery and private consumption. The data however, does not take into account the temporary (not likely to last beyond current fiscal year) impact of the withdrawal of specified bank notes declared on November 8. The prime demonetization goal was to eradicate black money, counter tax evasion and destroy counterfeit currency. Further, incentivizing businesses to use banks and digital payments will help to bring them inside the tax net. Together, the factors mentioned above have resulted in a minor setback to the estimated real GDP growth. However, it is expected that the setback to growth is temporary, with a rebound expected in the first quarter of 2017-18 once consumption activity picks-up. The enhanced capacity generated by Government investment in the infrastructure sectors is expected to increase the potential output in the economy, thereby expanding the opportunities for higher growth.

3. Despite challenging circumstances, the broader macroeconomic conditions continue to show positive signs with lower inflation, lower current account deficit,

robust foreign exchange reserves and continued fiscal consolidation. On the fiscal front, the government is persistently in pursuit of promoting growth and stability even within reduced fiscal space. Indian economy is expected to remain as one of the fastest growing large economies of the world. The continued spotlight on strong fiscal discipline over the medium term will reduce the Government's share in the economy and free resources for private investment. A dynamic private sector and a responsive Government are expected to partner in the process to promote growth and employment in the economy.

4. The expenditure policy of the Government is driven by the needs of promoting investments in core infrastructure and developmental schemes. The total expenditure of the Government estimated at ₹19,78,060 crore (13.1 per cent of GDP) in BE 2016-17 was given further boost through mid-year additional allocations during the course of the year. The total expenditure is now estimated at ₹20,14,407 crore (13.4 per cent of GDP) in the revised estimates of 2016-17. The revenue-capital ratio has also shown substantial improvement from the projections made at the BE stage. In RE 2016-17, the Capital expenditure of the government is estimated at 13.9 per cent as compared to 12.5 per cent estimated at the time of the presentation of previous budget.

5. The additional fiscal space permitting enhanced expenditure allocations in the revised estimates of 2016-17, materialised broadly on account of buoyant tax revenues, particularly in the Indirect tax side and specifically on account of Excise duty collections. The additional tax revenues and achievement of estimated non-tax revenues despite shortfall through spectrum auction receipts has enabled the Government to stick to the fiscal deficit target of 3.5 per cent of GDP in 2016-17, while providing substantial increase in allocations for expenditure.

6. The gross tax to GDP ratio is estimated at 11.3 per cent in the revised estimates of current year as compared to 10.8 per cent estimated in BE 2016-17. For the first time since 2007-08, the gross tax to GDP ratio is estimated to cross the 11 per cent mark. Consequently, along with the Centre, even the State Governments' finances are slated to receive a big boost, as they are entitled to 42 per cent of the divisible pool of taxes. This is a big boost to the economy, considering that the tax to GDP ratio had been stagnating in the range of 10 per cent since 2008-09. This is despite an estimated slowdown in the growth of the economy, the lower anticipated collections from the Customs duty. The other major components of both direct and indirect taxes have more than made

up for lower collections in these two major taxes, and the gross tax collection is estimated to increase by ₹ 72,355 crore over the budgeted estimates of 2016-17 to ₹17,03,243 crore in the revised estimates.

7. On the other hand, important sources of receipt for the government viz. non-tax revenues and the non-debt capital receipts, the position is quite satisfactory. Despite shortfall of approximately ₹ 20,280 crore from telecom receipts the overall non tax revenues is estimated to increase by ₹11,849 crore in the revised estimates for 2016-17. This is on account of the revised guidelines for dividend payment by the public sector enterprises and the efforts of the government to mop up additional dividend out of the excess cash reserves carried by some of these government companies. Similarly, non-debt capital receipts even though lower by ₹ 10,563 crore against the budgeted estimates, shows a higher achievement in comparison to the previous years.

8. To conclude, the fiscal policy of the Government in 2016-17, despite difficult conditions have shown several positives. The government interventions received a boost through enhanced mid-year budgetary allocations despite shortfalls in some major components of tax and non-tax receipts; the share of capital expenditure improved from 12.5 per cent estimated in budget estimates to 13.9 per cent of total expenditure in the revised estimates and; the government was able to create additional fiscal space to remain within the budgeted fiscal deficit target of 3.5 per cent of GDP despite an anticipated slowdown in the pace of economic growth. Overall, the fiscal policy of the Government continues to hold up the macroeconomic objectives of promoting growth and stability, at a time when the private investments are still sluggish.

B. Fiscal Policy for 2017-18

9. Fiscal policy of the Government in Budget 2017-18 is guided by the larger macroeconomic needs of reviving the growth momentum while being committed to fiscal consolidation. This will be achieved broadly through creating additional fiscal space to promote higher public expenditure by raising the level of tax collections as a ratio of GDP as well as pacing the fiscal consolidation process through gradual reduction of fiscal deficit. The Government's fiscal strategy in 2017-18, is aimed at guiding the budget to a sustainable level of deficit with fiscal consolidation undertaken at a responsible pace.

10. On the expenditure side, the Government's focus in Budget 2017-18 is on redirecting expenditure allocations towards investments to promote growth, employment and more meaningful interventions. Focus is on lumpy allocations for key sectors and schemes aimed at promoting infrastructure development and improving social development in the

country. The higher allocations for agriculture, rural development and health sectors on the one side and enhanced allocations for railways, highways and rural roads need to be seen in this context. These measures are expected to bring an all round revival of growth momentum in the economy while also leading to a 'crowding-in' effect through higher levels of private investments. The process of rationalization of schemes and programmes aimed at doing away with small and insignificant interventions has also been carried forward from the previous year. The Ministries/ Departments will be encouraged to focus on the main schemes so as to get tangible outputs and outcomes, through proper monitoring.

11. With regard to deficits, the fiscal policy of the Government continues to be guided by the principle of gradual adjustment. The fiscal deficit target of 3 per cent of GDP for 2017-18, as per the amended FRBM Act is estimated to be achieved by 2018-19. The government, on a re-assessment of the macroeconomic needs of higher public expenditure has tilted in favour of a gradual reduction by 0.3 per cent of GDP in 2017-18. The fiscal deficit for 2017-18 has therefore been pegged at 3.2 per cent of GDP, so as to utilize the additional fiscal space for on investment for capital generation and necessary social sector expenditure as growth drivers. The Government needs to take a higher responsibility to promote economic growth, while private consumption and investment expenditures see a gradual revival.

12. In order to achieve the FRBM mandated fiscal consolidation targets the preference of the Government is to follow a strategy of enhancing the capacity to generate more revenues and simultaneously rationalise expenditure wherever feasible. In an economy, like ours there is adequate scope for improving production capacity by focusing on infrastructure investment. A strategy of curtailing expenditure is not the preferred fiscal path for the Government. The efforts to promote higher infrastructure investments have resulted in an increase in the level of capital expenditure, thereby reducing the revenue-capital imbalance. The capital expenditure of the Government is estimated at 14.4 per cent of the total expenditure in BE 2017-18 against 12.5 per cent in BE 2016-17. The details on expenditure policy of the Government have been brought out subsequently, in a separate section.

13. The fiscal data shows that the Government measures to correct the structural imbalance between revenues and expenditures of the Government unlike the earlier years, has shifted in recent times to revenue side corrections. The effort of the Government therefore has shifted from curtailing expenditure to generating higher revenues for reducing the fiscal deficit and to raise additional resources to implement Government policy priorities. To achieve this, the Government policy is oriented broadly in favour of

minimizing exemptions and broadening the tax base to achieve a higher tax to GDP ratio.

14. In Budget 2017-18, the gross tax revenue has been estimated at 11.3 per cent of GDP. The growth in gross tax revenues has been estimated to be moderate considering the high base on account of substantial growth achieved in the current year. In BE 2017-18, the growth in gross tax revenues have been estimated at 12.2 per cent over the revised estimates of 2016-17 as against the growth of 17 per cent growth estimated in the revised estimates of current year.

15. The recent demonetization exercise and the implementation of GST are also expected to contribute to broaden tax base and in the process increase the tax to GDP ratio. Thus, there is expectation that actual tax collections may exceed budgetted estimates.

(1) Tax Policy

A. Indirect Taxes

16. The indirect collection has been very buoyant showing a growth of more than 25 per cent during April-December, 2016 over the corresponding period in previous year. Robust growth in indirect taxes seems to suggest that Budget Estimates would be crossed by a healthy margin.

17. India's indirect tax-GDP ratio at current market prices (based on central taxes) during the financial year 2015-16 was around 5.2 per cent, which is expected to go up to 5.5 per cent. Certain sectors of the economy have been kept out of the service tax net by way of negative list/exemptions. GDP includes the economic activities of unorganized/informal sectors falling under manufacturing and services sectors, which may not be covered under the tax net. Non-taxation of agricultural and allied sectors, relatively higher threshold for small scale industries and fiscal concessions in the form of exemptions for socio-economic reasons are mainly attributable as reasons for the existing indirect tax-GDP ratio in India.

18. A number of steps have been taken to increase the indirect tax to GDP ratio, like, widening the tax base by comprehensive taxation of all services (introduction of Negative List approach to taxation of services with effect from 1st July, 2012) and reduction of exemptions in Central Excise, Customs and Service tax, wherever possible. In addition to the above, several measures have been taken by the government to improve the revenue collections such as, risk management system, use of information technology, special audit, speedier adjudication, liquidation of arrears, speedy disposal of confiscated/seized goods etc.

19. In spite of the introduction of negative list and reducing the number of exemptions, the service sector is still not taxed comprehensively owing to services specified in negative list which are not taxable or

exemptions by way of notifications or due to truncated tax base (service tax on abated value). This is a major obstacle in increasing the indirect tax-GDP ratio. The problem would be partly solved in the GST regime with the entire value chain being subjected to both Central GST and State GST. It is still not clear as to what would be the fate of exemptions. Ideally, most of the exemptions, if not all, ought to be phased out in the GST regime which would increase the indirect tax GDP ratio in a non-distortionary and neutral manner.

20. In the Union budget 2016-17, various proposals have been made to increase the indirect tax-GDP ratio by pruning of the negative list and withdrawal of certain exemptions with regard to service tax.

Broadening the tax base

1. Service tax

21. In Budget 2015-16, provision was made to tax all services provided by the government or local authority to business entities; however, it came into force with effect from 1st April, 2016.

- Imposition of Krishi Kalyan Cess on all taxable services at a rate of 0.5 per cent on the value of such taxable services, with effect from 1st June, 2016.
- Withdrawal of exemption from service tax on transportation of passengers, with or without accompanied belongings, by ropeway, cable car or aerial tramway.
- Withdrawal of exemption from service tax with respect to construction, erection, commissioning or installation of original works pertaining to monorail or metro, in respect of contracts entered into after 1st March, 2016.
- Withdrawal of exemption from service tax on provision of Online Information and Database Access or Retrieval (OIDAR) services, with effect from 1st December 2016, which are received from a provider of services located in non-taxable territory (cross-border supply of services) by government, local authority, government authority, or an individual in relation to any purpose other than commerce, industry or any other business or profession.
- Services provided by person located in non-taxable territory to a person in non-taxable territory are exempt from service tax. However, such exemption to import freight service when provided by a foreign flag ship to a foreign charterer with respect to goods destined for India has been withdrawn with effect from 22nd January, 2017.

2. Customs and Central Excise

- Clean Energy Cess (renamed as Clean Environment Cess) levied on coal, lignite and peat was increased from ₹200 per tonne to ₹400 per tonne.
- Infrastructure cess @1 per cent/2.5 per cent/4 per cent was levied on certain specified motor vehicles.
- Excise duty on Aerated waters, lemonade and other waters, containing added sugar or other sweetening matter or flavoured was increased from 18 per cent to 21 per cent.
- Additional Excise Duty on cigarettes was increased on non-filter and filter cigarettes of various lengths so that the aggregate of duties of excise on cigarettes increases by about 10 per cent.
- The specific rates of excise duty on Cigar and Cheeroots, Cigarillos, Cigarettes of tobacco substitutes, Cigarillos of tobacco substitutes and other forms of tobacco substitutes was increased by about 10 per cent.
- Excise duty on Gutkha, chewing tobacco (including filter khaini) and jarda scented tobacco was increased from 70 per cent to 81 per cent, excise duty on un-manufactured tobacco was increased from 55 per cent to 64 per cent and excise duty on pan masala was increased from 16 per cent to 19 per cent. Accordingly, the duty payable per machine per month for each of these tobacco products was notified.
- Excise duty on Aviation turbine fuel (ATF), other than for supply to aircraft under the Regional Connectivity Scheme, was increased from 8 per cent to 14 per cent.
- Excise duty of 2 per cent (without CENVAT credit) and 12.5 per cent (with CENVAT credit) was imposed on branded readymade garments and made up articles of textiles of retail sale price of ₹ 1000 or more. Also, the tariff value was increased from 30 per cent of the retail sale price to 60 per cent of the retail sale price.
- Excise duty of 1 per cent (without CENVAT credit) and 12.5 per cent (with CENVAT credit) was imposed on Articles of Jewellery (excluding silver jewellery, other than studded with diamonds/other precious stones).
- Customs duties exemption on direct imports of specified goods for defence purposes by

the government of India or state governments was withdrawn with effect from 1st April, 2016.

- Basic Customs Duty on Cashew nuts in shell was increased from Nil to 5 per cent.

22. The government plans to implement GST shortly, which will subsume excise duty, service tax, VAT and several other local levies. The new indirect tax regime is expected to make India a single market, eliminate multiple assessments, check evasion and bring more revenues into the system. For Budget 2017-18, the government has not factored any gains from GST at this stage. However, once the new GST system stabilizes the indirect tax to GDP ratio is expected to go up significantly while also making tax compliance easier.

B. Direct Taxes

23. Collection of tax being product of two factors, viz. tax rates and tax base, the Government's policy on direct taxes has been to achieve consistent growth in direct taxes by broadening the tax base while maintaining a moderate tax rate regime. In the case of individuals, HUFs, association of persons, body of individuals and artificial persons, it is proposed to lower the tax rate from existing ten per cent to five per cent where the total income is between two lakh fifty thousand rupees and five lakh rupees and in the case of resident individual between the age of sixty years and eighty years, where the total income is between three lakh rupees and five lakh rupees. There will be no change in the rate of tax for foreign companies in respect of income earned in the financial year 2017-18. However, it is proposed that in the case of domestic companies having total turnover or gross receipts not exceeding fifty crore rupees in financial year 2015-16, the income-tax shall be charged at the rate of twenty-five per cent. All other domestic companies shall be liable to tax at the rate of thirty per cent in respect of income earned in the financial year 2017-18, assessable in the assessment year 2018-19. Further, the option provided to domestic companies, incorporated on or after 1st March, 2016 and engaged solely in manufacture and production of articles and things, of payment of tax at the rate of twenty-five per cent in respect of its income if they do not claim any accelerated depreciation, investment allowance, profit-linked and investment-linked deductions, shall continue to be available.

24. It is further proposed to introduce fresh levy of surcharge at the rate of ten per cent in the case of individuals, HUFs, association of persons, body of individuals and artificial persons, having total income between fifty lakh and one crore rupees in addition to the surcharge currently being levied at the rate of fifteen per cent if their total income exceeds one crore rupees. In all other cases, the rate of surcharge shall continue to be the same as in the financial year 2016-17.

25. In order to fight the menace of black money in the wake of demonetisation, through the Taxation Laws (Second Amendment) Act, 2016, a surcharge at the higher rate of twenty-five per cent of the income-tax on income levied at the rate of sixty per cent on income from unexplained sources is proposed to be continued in respect of such income in the financial year 2017-18 as well.

26. The widening of tax base to achieve growth in tax collection is a continuous process which involves both legislative as well as administrative measures. The major policy proposals, intended to broaden the tax base and augment revenue, in the Union Budget 2017-18, are as under:

- The scope of section 115BBDA of the Act is proposed to be widened by imposing the levy of income-tax on dividend income exceeding ₹ 10 lakh in case of all resident persons except domestic companies and trust/ institution/ fund registered under section 12AA or referred to in sub-clause (iv) or (v) or (vi) or (via) of 10(23C) of the Act.
- The scope of section 56 of the Act is proposed to be widened by providing that any money, immovable property or specified movable property received without any/for inadequate consideration by all persons, subject to certain exemptions and exceptions, shall be taxable if the value of the same exceeds rupees fifty thousand.
- To prevent misuse of exemptions of long term capital gains on transfer of listed shares, it is proposed to check off-market acquisitions of shares subject to notified exceptions.
- It is also proposed to provide fair market value in case of transfer of unquoted equity shares in order to plug the loophole of transferring property held in the books of the company through transfer of unquoted shares at understated value.
- It is also proposed to restrict the set off of losses under the head "Income from house property" during any assessment year to a maximum amount of ₹ 2 lakh in order to protect the revenue base.
- The scope of tax deduction at source is proposed to be widened by inserting section 194-IB to provide that an individual or a Hindu undivided family, subject to certain conditions, shall deduct tax at source while making payment of rent, if the amount of rent paid exceeds ₹ 50,000 per month.

27. The administrative and technological initiatives taken to streamline tax payer services, strengthen

internal business processes and to augment revenue are as under:

- Reforms in Tax Payer Services were focused especially on expediting processing of Income Tax Returns and issuing of refunds to tax payers, especially small tax payers and returns filed have been processed and refunds have been issued within 60 days in over 90 per cent of the cases.
- In addition to electronic verification of Income Tax returns through Aadhaar OTP and net banking, tax payers were also given the facility to get EVC through Bank ATMs, Bank Account Validation and Demat Account Validation. This has led to increase in popularity of the e-filing portal, which has received over 3.88 crore e-filed returns till 26.01.2017, a 20 per cent increase over the previous year. Also, nearly 40 per cent of Income Tax returns are now electronically verified including use of digital signature.
- The Department has also digitized many forms such as Form 35 for electronic filing of Appeal, form for filing of grievance applications (E-Nivaran project), filing of TDS statements, Statement of financial transactions (SFT) and Form 60 and 61 for taxpayers who do not have PAN, thus increasing the efficiency of collection and processing of information.
- Internal business processes of the Income Tax Department have also been digitized through the Income Tax Business Application (ITBA) project whereunder departmental processes such as appellate proceedings before the Commissioner (Appeals), issuing of approval/registration under sections 80G and 12AA for religious and charitable trusts and under section 10(23C) for educational institutions, issuing of approval/registrations for superannuation funds, pension funds, provident funds, standing counsels, Income Tax practitioners, hospitals etc. have been digitized. Similarly, grievance redressal by officers of the Department (E-Nivaran project) and the Human Resource Management System for Departmental personnel have also been digitized.
- The e-assessment pilot programme has been extended to Hyderabad and Kolkata. Efforts are also underway to enable tax payers to file responses under the e-assessment project using their tax payer accounts on the e-filing portal for greater veracity of responses.

- Under the Non-filers Monitoring System (NMS), 67.8 lakh potential non-filers have been identified in the current year who have carried out high value transactions in the financial year 2014-15 but did not file income tax return for the relevant assessment year i.e. AY 2015-16. The information relating to the identified non-filers has been made available on the 'Compliance Module' on the e-filing portal of the Income Tax Department. The PAN holder will be able to submit the response electronically and keep a printout of the submitted response for record purposes.
- The "e-Sahyog" initiative is aimed at reducing compliance cost, especially for small taxpayers, by providing an online mechanism to resolve any mismatch or discrepancy in information as per Income-tax return of the taxpayer vis-à-vis third party information collected by the Department. Under this initiative the Department provides an end-to-end e-service using SMS, e-mails to inform the taxpayers of the mismatch. Based on the responses by the taxpayers, the issue is closed or processed for further action. In the current year 57,785 cases have been identified for online resolution under this initiative.
- The scope of Project Insight was conceptualized to enable the achievement of the following three objective, viz.
 - (i) to promote voluntary compliance and deter non compliance;
 - (ii) to impart confidence that all eligible persons pay appropriate tax; and
 - (iii) to promote fair and judicious tax administration.

28. The Project envisages the creation of an Income Tax Transaction Analysis Centre (INTRAC) for data integration, data processing, data quality monitoring, data warehousing, master data management, data analytics, web/text mining, alert generation, compliance management, enterprise reporting and research support.

29. A new Compliance Management Central Processing Centre (CMCPC) will also be set up under this project for adopting non-intrusive information driven approach for compliance management by leveraging campaign management, compliance portal, preliminary verification, generation of bulk letters/notices and follow-up for greater productivity and efficiency. This initiative focuses on use of electronic means of communication and online portal for resolution of issues. The Project is proposed to be rolled out in a phased manner from May 2017.

(2) Expenditure Policy

30. As indicated earlier, in the current scenario where the private consumption and investments expenditure are slack, the Government needs to pitch in through higher investments and expenditures to revive the high growth momentum. To this end, the Government has allowed itself additional fiscal space of 0.2 per cent by pegging the fiscal deficit at 3.2 per cent of GDP in BE 2017-18. Since the government it is assessed needs to take a greater responsibility to promote economic growth, while the private sector sees a gradual revival. However, in the medium term, the Government expenditure as a percentage of GDP will need to be brought down from the existing levels, to ensure that the fiscal consolidation targets are met.

31. The total expenditure of the Government is estimated at ₹ 21,46,735 crore in BE 2017-18 which is estimated at 12.7 per cent of GDP as against 13.4 per cent of GDP in the revised estimates of 2016-17. It may be noted that in 2016-17, an increase of 0.3 per cent of GDP was allowed through mid-year additional fund allocations and despite fiscal deficit estimates of 3.2 per cent of GDP in BE 2017-18, the total expenditure as a percentage of GDP is lower by 0.7 percentage points in BE 2017-18. Nonetheless, the improvement in tax to GDP ratio and higher growth would allow substantial growth in nominal expenditure while retaining fiscal targets. The increase in total expenditure is also muted at 6.6 per cent over the revised estimates of 2016-17. However, the year to year increase in total expenditure is estimated at 8.5 per cent in budget 2017-18 when seen against the budget estimates of 2016-17.

32. The revenue expenditure of the Government is estimated at ₹18,36,934 crore in BE 2017-18 which is 85.6 per cent of the total expenditure, while the Capital expenditure is estimated at ₹3,09,801 crore which is 14.4 per cent of the total expenditure. This is a substantial improvement from the 12.5 per cent provision for capital expenditure made in BE 2016-17, thereby substantially reducing the revenue-capital expenditure imbalance. The effective revenue deficit budgeted at ₹1,25,813 crore in 2017-18 will be 0.7 per cent of GDP as against 1.2 per cent of GDP estimated in BE 2016-17. This is on account of increase of ₹28,510 crore provided towards grants for creation of capital assets, and the increase of ₹ 62,778 crore in Capital expenditure provided in BE 2017-18 over the budget estimates of previous year.

33. A number of major expenditure related budgetary reforms have been carried out in Budget 2017-18 viz. merger of Plan and Non-plan, merger of Railway budget with the General budget and the Advancement of budget presentation. These are discussed briefly in the following paragraphs.

Major Expenditure Related Budgetary Reforms

34. Fiscal policy of the Government apart from the major macro parameters, is built on a number of landmark budgetary and fiscal reforms undertaken in Budget 2017-18. As announced in the previous budget, the Budget for 2017-18 has removed the plan and non-plan distinction to present the budgetary allocations in the form of constitutionally mandated and standard international norms of revenue and capital expenditure. Budget is a means to implement the broad objectives of the Government through resource allocations which need to be broken down into detailed line entries. These reflect the imperative of the Government for implementing each of the schemes/projects and other Government expenditures including funds needed to be transferred to the State/UT Governments or to meet the running expenses of the Government.

35. The earlier plan and non-plan distinction,, had resulted in a skewed pattern of expenditure allocation. There was an excessive focus on plan expenditure. This also caused substantial distortion in the expenditure profile whereby important manpower related or maintenance needs of assets, particularly in the areas of public delivery of services were neglected. Expenditure commitments for any scheme/programme of the Government were not assessed holistically but in fragmented plan and non-plan parlance. As a result, it became difficult not only to assess the cost of delivery of services but also to link the outlays with the deliverables and outcomes.

36. It is expected that with the presentation of budget in the capital and revenue based classifications, there will be efficient deployment of public resources. Policy formulation and sectoral needs assessment will also become easier along with developing a performance-oriented approach. A new consolidated Outcome Budget document is also being laid with the budget papers, indicating scheme wise outputs and deliverables linked with the outlays along with the anticipated medium term outcomes.

37. Apart from the revenue-capital classification, certain other standardization in expenditure categorization has also been carried out, across all Demands for Grants. The expenditure allocations in the budget have been broadly divided into two main categories of (i) Centre's Expenditure and (ii) Transfers to State and Union Territory Governments. The Centre's expenditure has been further organized into (a) Secretariat Expenditure (b) Central Sector Schemes and (c) Other Central Expenditures. Similarly, the second category of Transfers to State/UTs has been presented into another three distinct sub-categories of (a) Finance Commission Transfers (b) Centrally Sponsored Schemes and (c) Other Transfers.

38. Another major budgetary reform that has taken place in Budget 2017-18 relates to the merger of the Railway budget with the General budget. The Committee constituted by Ministry of Railways under the chairmanship of Shri Bibek Debroy, Member, NITI Aayog on restructuring of Ministry of Railways, had recommended that the present system of a separate Budget for Railways should be phased out and merged with General Budget.

39. The Government considering the various benefits, anticipated in the form of bringing Railways to the centre-stage of Governments' fiscal policy and facilitating multimodal transport planning between highways, Railways and inland waterways etc., decided in favor of implementing this landmark budgetary reform from Budget 2017-18. In financial terms, apart from getting higher allocations, the Railways have also benefitted through wiping off of their liability towards dividend payment, thereby enhancing their fiscal space for developmental activities. However, the Government decision is very candid that the operational and financial autonomy of the Railways will not be impacted and they will remain as they were prior to the merger.

40. The advancement of the budget presentation by about a month to the 1st day of February in place of the last day of the month is another budgetary reform which is expected to garner long term benefits to fiscal performance of the Government through optimization of both expenditure and revenue outcomes. The main benefits of advancement of budget presentation are as follows-

- The earlier system constrained optimization of expenditure allocations as the Budget process (passing of full year Appropriations and the Finance Bill) got completed almost 2 months after the commencement of the new financial year, leading to the loss of valuable working season till the time Ministries/Departments got full budgeted appropriations;
- In fact by the time the full Budget was passed, the onset of the Monsoon would be on the horizon, thereby in reality, restraining the optimum utilization of working seasons for almost half of the financial year;
- Similarly, with the Finance Act coming into effect from around 1st June, the benefit of tax changes involving legislation, especially in service tax and central excise, was available to the Government only after passing of the Finance Bill. With advancement of the budget cycle, the benefit of new taxation measures involving legislative changes will accrue from the commencement of the financial year;

- The Union Budget has an important bearing on the State Governments' Budgets, more specifically in the context of allocations for Centrally Sponsored Schemes, the expected cash flow on account of devolution of States' share of taxes, and other important announcements. Hence from the view point of more effective expenditure planning and overall national perspective, the presentation of the Union Budget in advance would give greater fiscal clarity to State governments in preparing their budgets;
- Advancement of Budget presentation would enable various stakeholders like business and industry to have greater clarity on tax measures from the beginning of the financial year;
- Finally, with the presentation of the budget on 1st February, a single Appropriation Bill will need to be presented to Parliament, providing for the expenditure of the Government for the full year. The need for a separate Bill for Vote on Account and related Parliamentary procedures would not arise. This is also, a major process simplification.

(3) Government Borrowings, Lending and Investments

41. In 2016-17, net market borrowings through dated securities at ₹ 4,25,181 crore were budgeted to finance 79.6 per cent of Gross Fiscal Deficit (GFD). Other sources of financing such as treasury bills, external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 20.4 per cent of GFD. Total borrowings requirement for 2017-18 has been budgeted at ₹ 5,80,000 crore. The net market borrowings are estimated to finance 63.7 per cent of the gross fiscal deficit. During 2016-17, there was higher net inflow in the small savings account vis-a-vis budget estimates, primarily due to exclusion of states from NSSF investments as per the recommendations Fourteenth Finance Commission (FFC). Only the states of Madhya Pradesh, Kerala, Arunachal Pradesh and UT of Delhi have opted for NSSF investments. With revised policy for deployment of NSSF, share of finance from NSSF will be higher at 18.3 per cent of GFD in 2017-18. In addition, State Provident Fund and other receipts from Public Account would finance remaining portion of the deficit.

42. The rollover risk in the Government debt portfolio continues to be low with weighted average maturity of outstanding dated securities remaining close to 10.66 years as on January 23, 2017, which is high compared to international standards. Furthermore, securities maturing in next 5 years are around 25.35 per cent of total outstanding dated

securities, which reinforces the low level of rollover risks in the short term. During 2016-17, weighted average maturity of primary issuance continued to be high at 14.75 years vis-a-vis 16.03 years in previous year. The weighted average yield of dated securities issued during the same period of 2016-17 stood at 7.2 per cent as compared to 7.9 per cent during 2015-16 indicating lower yield environment with falling inflation rates. The continued high maturity of primary issuances with a decrease in borrowings cost reflects the greater demand for longer tenor securities by insurance companies and provident funds, which continue to support the Government efforts to elongate its maturity profile in medium term.

43. One of the key features on country's debt profile is diminishing proportion of external debt as percentage of total liabilities, which amounts to 6.2 per cent of Central Government's total liabilities as on March 31, 2016. External borrowing is limited to multilateral/bilateral loans from select development partners for financing development projects and, thus, not exposed to reversal of capital flows. The external funding at ₹ 19,094 crore in 2016-17 has a share of 3.6 per cent in GFD. The BE 2017-18 for external funding is at ₹15,789 crore. Thus, Government will continue to rely on raising debts from domestic market borrowing or market linked domestic sources, with external sources financing only 2.9 per cent of the GFD in 2017-18.

44. Prudent debt management is a corner stone of good economic policy and also a pre-requisite for financial stability. In India, debt policy is driven by the principle of gradual reduction of public debt to GDP ratio so as to reduce debt servicing cost and create fiscal space for other expenditure. The debt policy emphasizes maintaining stable, low cost and prudent debt structure. Further, GoI in consultation with RBI have used market-oriented active debt management strategy since 2013-14 in the form of buyback and switching of shorter tenor G-securities with longer tenors G-securities securities, with an objective to spread the redemption pressure evenly, and reduce rollover risks. In view of redemption pressures in coming years, particularly during 2017-18 and 2018-19, the Government will continue its active debt management strategy.

45. 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 to yields in secondary market for dated securities. The interest rates are also reviewed every quarter.

46. The Government is committed to bring transparency in public debt management operations. The Government of India has been publishing a number of documents on public debt. These publications include an annual Government Debt

Status Paper (since 2010), Debt Management Strategy document (2015) and Handbook of Statistics on Central Government Debt (since 2013). Government has now decided to consolidate all these publications into a single report to bring entire Government Debt related information at one place. The first such report, 'Status Paper on Government Debt', was released in October, 2016 which covers various facets of public debt including overall debt position of the country, assessment on various aspects of debt sustainability, debt management strategy for covering various risks, etc.

Medium Term Debt Management Strategy

47. A Medium-Term Debt Management Strategy (MTDS) has been prepared based on sound international practices and taking into account the domestic economic and financial conditions. The MTDS collates different elements of debt management strategy and is articulated for a period of three years, reviewed annually and rolled over for the next three years. The MTDS is based on three broad pillars, viz., low cost, risk mitigation and market development, the objective of MTDS are three-fold:

- a. To lower Government's cost of market borrowing over the medium/long term through planned issuance and offer of appropriate instruments to lower costs;
- b. Reduction of risk through containment of rollover risk by elongation of maturities and switches/ buy-back of securities, lowering interest rate risks by keeping the floating rate debt low, managing foreign currency risks by issuing debt in domestic currency and limiting external debt;
- c. Aiding market development by introducing new instruments, expanding the investor base, strengthening market infrastructure, etc.

48. In the present MTDS (published in September 2016), strategy and projections have been made for a period of three years i.e. 2016-17 to 2018-19, which would be reviewed next year and rolled over for next three years. The scenario analysis and stress tests of the debt portfolio of the Central Government with regard to cost, maturity and potential risk factors suggest that the GoI's debt is stable and sustainable over the medium to long run. However, to implement MTDS, in line with the above strategy, action will be taken to: carry forward issuance process in transparent way; build benchmark issues by issuing significant volumes; elongate the maturity of the debt portfolio; build a balanced maturity profile and supply along the yield curve; issue varied instruments to help investors manage their portfolio more efficiently; undertake switches/ buybacks for effective management and

consolidation of debt; and diversify investor base by opening Government securities market to foreign and retail investors.

(4) Contingent Liabilities

49. 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 per cent of GDP for assuming incremental guarantees in a financial year. The guarantees are extended primarily for the purpose of improving the 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 fulfil the requirement in cases where sovereign guarantee is a pre-condition for bilateral/multilateral assistance. In the process of guaranteeing their financial obligations the government has the commitment to assess the fulfilment of such obligations, and adequately disclose them under the statutory requirements.

50. The stock of contingent liabilities in the form of guarantees given by government has increased in absolute terms from ₹1,07,957 crore in 2004-05 to ₹3,43,762 crore at the end of 2015-16. FRBM ceiling on government guarantees has led to a reduction in the contingent liability to GDP ratio. This ratio has come down to 2.53 per cent of GDP in 2015-16 as compared to 3.3 per cent of GDP in 2004-05. During the year 2015-16, net accretion to the stock of guarantees was ₹43,185 crore or 0.32 per cent of GDP which was way within the limit of 0.5 per cent set under the FRBM Rules. The disclosure statement on outstanding guarantees is appended to the Receipt Budget.

C. Strategic priorities for the ensuing year

51. The government's fiscal strategy priorities for 2017-18 rests on the principle of continuing on the path of fiscal consolidation while allowing for flexibility in response to the prevailing economic conditions. The 2017-18 fiscal strategy of the government is based on the following broad intents:

- (a) Prioritising and re-directing government spending on core infrastructure and developmental schemes particularly in agriculture, rural development, health, education, drinking water and sanitation and to boost growth and employment along while bringing improvements in human development indices;
- (b) Continue steadily on the path of fiscal consolidation by reducing the public debt/

total liabilities as a percentage of GDP and relying on tax and non-tax revenues to support expenditure growth.

- (c) Supporting tax revenue growth through policies that result in increasing the tax net and higher tax collections to enhance the tax to GDP ratio; and
- (d) To cover the existing fiscal gap, focus to be maintained on enhancing non-tax revenues and higher non-debt capital receipts through an accelerated pace of disinvestments.

52. The government continues on the path of fiscal consolidation by targeting a fiscal deficit of 3.2 per cent of GDP in 2017-18 against 3.5 per cent estimated in the revised estimates of current financial year. This pace of consolidation even though sizeable, is lower than the FRBM targets, to allow for enhanced fiscal space for meeting government commitments on core public service functions both in the infrastructure areas and major social sector schemes.

53. Substantial increase in allocations over the previous year has been made towards infrastructure projects particularly on highways, railways, metros and power sector development. Similarly the provision for the centrally sponsored schemes which largely cater to social development goals in the State government domains, have been increased from ₹ 2,31,900 crore in BE 2016-17 to ₹ 2,78,433 crore in BE 2017-18. The government is providing record and affordable levels of financial assistance with the outlays linked to physical and financial deliverables along with monitorable medium term outcomes.

54. The government's intent is to continue with strong fiscal discipline to reduce the government's share of the economy over the medium term and free up resources for private investments to promote employment and economic growth. The government's fiscal strategy is aimed at reducing the net public debt and liabilities to the extent feasible considering the existing spending constraints. The public debt and liabilities of the Centre is estimated to decline on account of continued fiscal consolidation. A continued focus on ongoing fiscal consolidation process will also free up resources for the government for developmental activities, through reduced interest liabilities.

55. The need for enhancing tax to GDP ratio and increasing other sources of government receipts cannot be over-emphasized. The enactment of GST and its impending implementation during the course of 2017-18 is set to change the course of indirect tax regime. Similarly, the continued drive on enhancing receipts through non-tax revenues through policy measures initiated by the government and enhanced pace of disinvestments will remain in focus during 2017-18.

Broad principles underlying expenditure management

56. In the previous year's fiscal policy strategy statement, it was mentioned that while the government has managed to control expenditure through rationalization during the fiscal consolidation phase, quality of expenditure remained an area that needs to be addressed. In this direction, the 2016-17 exercise to rationalize the number of schemes to avoid overlap of objectives and thin spread of resources, has been carried forward in 2017-18. The focus, this time has been brought on the central sector schemes. The steps taken for rationalization of schemes it is expected, shall further help in making scheme/programme allocations more focused/outcome-oriented and lead to more effective application of central resources. It is also expected to lead to an improved monitoring and implementation of schemes by the administrative ministries and the State governments. Further, as announced in last Budget, all schemes are now being cleared with a sunset date so as to achieve outcomes within stated timeline and prevent proliferation of schemes.

57. Further, the Medium Term Fiscal Targets and Medium-term Expenditure Framework (MTEF) Statement was earlier prepared with broad aggregates without providing Ministry/Department wise expenditure framework. Starting from 2016-17, a new Statement has been added to the earlier MTEF Statement (laid in the 2016 Monsoon Session of Parliament) indicating Demand wise revenue and capital expenditure targets for the current year as well as the two year rolling period. The detailed scheme/project-wise allocation and the deliverables against each on this basis are now being planned in advance by the Ministries/Departments.

58. As a further expenditure reform, to improve the quality of government expenditure, a new document in the form of a consolidated 'Outcome Budget' of all Ministries/Departments is being laid for the first time in Budget 2017-18. The document contains details of schemes of each Ministry/Department indicating firm outputs and deliverables linked to the budgetary outlays along with the medium term outcomes expected out of these schemes. The Outcome framework was decided by the Ministries/Departments in consultation with NITI and the Department of Expenditure. At the end of the year, the NITIAayog can review the performance of each Ministry/Department on the outputs/deliverables achieved against the budget allocation.

59. Government is also taking steps to expand the coverage of Public Financial Management System (PFMS) to cover the entire profile of government expenditure. It may be noted that in accordance with the recommendations of XIV Finance Commission and in the spirit of "cooperative federalism", Government

is allowing States greater flexibility in schemes implementation and design to meet the State specific requirements. However, this requires a more holistic view to be taken of the total finances available at various tiers of scheme implementation. PFMS aims at achieving these through twin objectives of "tracking of usage of public funds" and "just in time transfer of funds". Achievement of these objectives will yield significant synergy and improved efficiency in the financial administration of Government programmes. As information for scheme administration will be available at greater granularity, monitoring and evaluation of the Government programmes will significantly improve.

60. Government is taking steps towards promotion of payment through digital mode. The e-payment system is an important tool for good governance and anti-corruption measures. Consequent upon the enhanced application of PFMS for all payments, 361 numbers of Pay and Accounts Offices are using PFMS and 433 numbers of PAOs are using GePG (Government e-Payment Gateway) for electronic payments. In order to attain the goal of complete digitization of Government payments, the threshold limit of e-payments to Vendors, Suppliers etc. of ₹ 25,000/- has been reduced to ₹ 10,000/- in August 2016 which has subsequently been further reduced to ₹ 5,000/-.

61. Similarly, on the revenue side tax collections have already reached a high level of digitization. Government has now set up a non-tax revenue portal to facilitate collection of receipts by electronic mode, through accredited banks including POS terminals. The steps taken by the government towards less cash economy are not confined in relation to government receipts and payments alone but also encouraging greater use of digital/online transactions by the private sector and the people in general, through various promotional/incentive schemes. These measures will help in greater formalization of the economy and provide an impetus to the pace of growth and fiscal improvements in the economy.

Railway Budget

62. Till 2016-17, Railway Budget used to be presented separately from the General Budget. However, the earnings and expenditure and all other major financial figures of railways were incorporated in the Annual Financial Statement. Government support was provided to Railways in the form of Gross Budgetary Support (GBS) and a return on this investment, called Dividend, was paid every year. The rate of Dividend was determined by the Railway Convention Committee and was 4 per cent for 2015-16. For 2016-17, the Railway Convention Committee has recommended waiver of dividend payment taking into account the precarious financial position of Railways emerging out of the shortfall in traffic receipts

and rise in Ordinary Working Expenses (OWE) consequent to implementation of the 7th Central Pay Commission recommendations. The Government has accordingly decided that Railways would not pay dividend in 2016-17 and also would not receive subsidy on dividend payment.

63. With effect from 2017-18, the Railway Budget has been merged with the General Budget and no separate Railway Budget would henceforth be presented to Parliament. Accordingly, a single Appropriation Bill of the Union Government, including estimates of Railways, will be presented to the Parliament by the Ministry of Finance. Ministry of Railways will, however, continue to function as a departmentally run commercial undertaking requiring meeting all its revenue expenditure including Ordinary Working Expenses (OWE), pay and allowances and pension payable to its employees from its revenue receipts. With the capital-at-charge wiped off with effect from 2017-18, the requirement of dividend payment by Railways and the receipt of subsidy from the Government have also been done away with. The Government will however continue to provide Gross Budgetary Support to Railways towards meeting part of its capital expenditure.

64. Railway revenues are primarily earned through two major traffic streams, passenger and freight. Some earnings are also contributed by luggage/ parcels, commercial utilization of land, siding charges, advertisement etc. and dividend paid by Railways' PSUs under two categories called 'other coaching and sundries'. The earnings are utilized to meet the operating expenses called OWE, Depreciation and Pensionary charges. The remaining surplus (partly used to pay dividend earlier) will be entirely ploughed back as plan investment for meeting safety and development needs of the railways.

65. With stabilization of the impact of 6th Central Pay Commission (CPC) and also due to various tariff and non-tariff measures taken, the financial position of the Railways improved in the subsequent years. Gradual improvement was also seen with Railways attaining Operating Ratio of 90.2 per cent and 90.5 per cent in 2012-13 and 2015-16 respectively. In 2016-17 however, while the working expenses of Indian Railways, specifically under pay and pension have gone up with the implementation of 7th Central Pay Commission recommendations, the prime earning segments of Railways i.e. passenger and goods have not performed on expected lines. While the negative growth in originating passengers witnessed since 2013-14 has been contained, Indian Railways has witnessed an unprecedented negative incremental loading over the corresponding period of previous year.

66. In view of above, the revenue earnings of the Railways estimated at ₹ 1,72,155 crore are likely to

register a growth of 4.8 per cent in RE 2016-17 over 2015-16 (actual), whereas the OWE and the pension expenditure at ₹ 1,62,760 crore are estimated to increase by 17.6 per cent. The high growth in OWE and pension expenditure is on account of provision of ₹ 15,000 crore towards meeting the additional burden on salaries and pension on account of implementation of 7th CPC recommendations. The Operating Ratio in RE 2016-17 is estimated at 94.9 per cent. Traditionally the passenger services of railways have been loss making and the under recovery this year is likely to exceed Rs30,000 crore.

67. The Capital expenditure of Railways is funded through Gross Budgetary Support (GBS), Internal Resources and Extra Budgetary Resources (EBR). A capital outlay of ₹1.31 lakh crore has been envisaged in BE 2017-18 (including ₹55,000 crore as GBS support) as against an estimated total outlay of ₹1.21 lakh crore in RE 2016-17.

68. Further, the Railways have proposed a five year (2015-2019) investment plan of ₹8.56 lakh crore with special emphasis on network decongestion, network expansion and safety. The plan resources are targeted to be invested judiciously and operationally important projects are being provided assured funding. This will help the railways in not only in removing the infrastructure bottlenecks but also augment the revenue earning capacity of the system.

Outlook:

69. Government will aggressively focus on the objectives of pushing economic growth, improving human development indices and greater formalization of economy to create meaningful employment. The Government has the prime responsibility of providing a safe and stable environment for the private sector to create wealth. It is within this context that the government will be intensifying efforts toward robust tax reforms, divestment of public assets, containing the cost in government operations and accelerating the economic growth momentum. These efforts will ensure a more stable macroeconomic environment, a sustainable debt and deficit trajectory, and an improved business climate that will attract new investments and result in durable job creation and increased prosperity.

70. The government is however fully cognizant of the country's tight fiscal situation and is committed to remain fiscally responsible by adhering to the principle of gradual reduction in debt and fiscal deficit. However,

the concept of a fiscal straitjacket suggesting strict constraint on government expenditure and borrowing to limit the budget deficit to the FRBM targets is not advisable also in a country such as India with excess and unutilised capacity. In the current context, the need for priming the economy through higher public spending is more vital for providing an impetus to the revival of a high growth trajectory. The government's conscious decision to shift the FRBM target of pegging the fiscal deficit at 3 per cent of GDP, by another year to 2018-19, needs to be seen in this context. In brief, the fiscal strategy of the government while underlining the commitment to budget discipline outlines the government policy to allow flexibility in response to changing economic conditions.

71. On public expenditure management front, changing the classification structure from plan and non plan to revenue/capital has resulted in presenting a clearer picture on the expenditure allocations and their anticipated outputs and outcomes. However, this by itself is not expected to lead to any radical reform. In order to optimize outcomes and prevent assets created out of past government funding from languishing, Ministries/Departments need to do a comprehensive review of allocation needs for maintenance, supplies and staffing needs in public delivery of services. If needed, the design of the schemes and programmes may also be reviewed and re-designed in consultation with the State governments. The change in budgetary classification provides an opportunity to keep up the focus on quality of government expenditure.

72. The fiscal position of the government is expected to maintain an improving trajectory, consistent with the Government's commitment to reduce fiscal deficit and debt over the medium term. On the downside however, the high levels of receipts projected through non-tax revenues and disinvestments in 2017-18 will need to be followed up through supportive policy measures, so as to avoid any slippages against the projected fiscal targets. Moreover, the growth in gross tax revenues in BE 2017-18 at 12.2 per cent over the revised estimates of 2016-17 is subdued compared to the growth of 17 per cent estimated in RE 2016-17. This factors in the possible initial reduction in indirect tax revenues after introduction of GST. However, the real performance will play out only after the initial results of the expected GST implementation are known and the economic benefits of the anticipated less cash economy on real growth become clearer during the course of the next financial year.