Chapter 6

Union Finances: Assessment of Revenue and Expenditure

Introduction

6.1 The Central Government shoulders the primary responsibility of discharging the key functions of stabilisation and growth in the arena of public finance. Maintaining a stable macroeconomic and fiscal environment, fostering increased rates of savings and investment, ensuring current account stability and maximising growth are, thus, the main policy objectives. In addition, to ensure inclusive growth, the State must mobilise and allocate resources in a manner that allows the poor, vulnerable and disadvantaged sections of the population access to the benefits of growth. In practice, this enlarges the equity or allocative aspect in the public finances of the Central Government.

6.2 The Government of India has to maintain fiscal prudence and at the same time, make certain that adequate incentives exist for stable, sustainable and inclusive growth. It also has to ensure availability of resources for functions relating to external and internal security, maintenance of law and order; and provision of critical infrastructure in the areas of national transport and communication network. Although the main engine of growth, in an emerging economy such as India, is private sector investment, the government needs to provide for adequate supply of essential public goods and create enabling conditions for an efficient private sector to flourish. The states and the Centre have an important collaborative role to play in this endeavour. These are the general principles that inform the Commission's assessment of Union finances.

6.3 The purpose of undertaking an assessment of Union finances is to see that the Central Government has adequate fiscal space to fund the expenditure needs that stem from the above responsibilities. Since resource availability with the government is limited, this is, necessarily, an exercise in constrained optimisation. The Central Government and the states alike have expenditure responsibilities that need to be met out of a finite resource envelope. In addition, these responsibilities must be discharged in a manner that is consistent with maintaining the efficiency of public expenditure. This is an important consideration for this Commission in assessing the relative apportionment of public expenditure into competing requirements such as expenditure on provision of social and economic services, security expenditure, committed expenditure and transfers and subsidies.

Scope of the Chapter

6.4 The Terms of Reference (ToR) require the Thirteenth Finance Commission (FC-XIII) 'to review the state of the finances of the Union and the states, keeping in view, in particular, the operation of the states' Debt Consolidation and Relief Facility (DCRF) 2005-10 introduced by the Central Government on the basis of the recommendations of the Twelfth Finance Commission'. In doing so the Commission has, among other things, been asked to take account of:

i) 'The resources of the Central Government for five years commencing 1 April 2010, on the basis of the levels of taxation and non-tax revenues likely to be achieved at the end of 2008-09.

ii) The demands on the resources of the Central Government, particularly on account of the projected gross budgetary support to the central and state plan, expenditure on civil administration, defence, internal and border security, debt-servicing and other committed expenditure and liabilities.

iii) The objective of not only balancing the receipts and expenditure on the revenue account of all the states and the Union, but also generating surpluses for capital investment.

iv) The need to improve the quality of expenditure to obtain better outputs and outcomes.

v) The need to ensure the commercial viability of irrigation projects, power projects, departmental undertakings and public sector enterprises through various means, including levy of user charges and adoption of measures to promote efficiency.'

6.5 With reference to the above considerations, this chapter presents our assessment of the revenue prospects and the expenditure needs of the Union Government for the award period. In undertaking this assessment, the views of the central ministries/ departments, Planning Commission, Reserve Bank of India (RBI) and the opinions of the various experts consulted have been duly taken note of.

The Consultative Process

6.6 The Ministry of Finance (MoF) gave its comments on our ToR, vide a memorandum submitted on 13 March 2009, followed by projections (including assumptions made) on revenues and expenditure furnished on 8 September and 16 October 2009, respectively. The response from the Planning Commission on these issues was received on 9 January 2009 and 21 May 2009. The Planning Commission also furnished projections on revenues, expenditure (including gross budgetary support (GBS)) and the underlying assumptions, vide their communication on 16 November 2009. Several other ministries also commented on various aspects of the ToR, either in writing and/or during the discussions held with them.

6.7 The MoF has urged the Commission to take note of the fact that due to the global events unfolding over the last two years, it may not be appropriate to treat either 2007-08 or 2008-09 as the base year for the purpose of calibrating the variables that would ultimately influence the award. It has been argued that there is a need to make the necessary adjustments in the adopted base year in order to have a more realistic estimate of the revenue and expenditure during 2010-15. It has also emphasised the need to create fiscal space for inclusive growth as envisaged in the Eleventh Plan. While doing so, the Commission has been urged to keep in mind the constraints on resource mobilisation through borrowings in view of the Fiscal Responsibility Legislation (FRL) in place, both at the Centre and in the states. The likely impact of the proposed implementation of the Goods and Services Tax (GST) has also been highlighted for consideration. Issues concerning emphasis on the quality of public expenditure; management of the ecology, environment and climate change; and shift to an accrual system of accounting, have also been mentioned in the memorandum. A detailed note on the macroeconomic framework, an overview of the central and state finances, including transfer of resources from the Centre to the states, was also presented by the MoF. In conclusion, the memorandum mentions that in view of the Constitutional roles and responsibilities of the Centre and the states remaining unchanged and the fact that the introduction of GST will augment the revenues of the states significantly, there is a scope for substantially reducing the states' share in net central taxes and overall transfers from the Centre to the states. The other submissions in the memorandum include a review of the actual utilisation of grants by the states during the period 2005-09 and the need to ensure that the states provide for adequate maintenance expenditure for assets created under the plan schemes.

6.8 The Planning Commission in its submission on 16 November 2009 has projected an aggregate GBS requirement of Rs. 26,23,701 crore for the period 2010-15. In respect of the Centrally Sponsored Schemes (CSS), it states that according to the expressed views of the Central Government it is not desirable to transfer these funds in the form of 'Normal Central Assistance' as demanded by the states because of the fact that the transfer mechanism via the CSS ensures that central funds actually flow to the critical sectors and that there is also a matching flow of state funds into these sectors. In this context, this Commission has been asked to ensure adequate availability of funds to the states to enable them to make the matching contributions. The Planning Commission has also opined that a larger provision of earmarked grants offset by a lower tax share would have the effect of delineating the states' resources more effectively. Like the MoF, the Planning Commission has also underlined the need to earmark funds for the maintenance of assets created through plan expenditure. It has further expressed the view that given the slowdown of the economy due to global recessionary trends, the fiscal correction strategy may not only have to be state-specific, but may also need to be recalibrated. Comments have also been made on the issue of improving the quality of public expenditure to obtain better outcomes in areas such as the management of ecology, environment and climate change; the commercial viability of state level public sector enterprises and departmental undertakings, including irrigation and power projects; the roadmap for fiscal adjustment; the revenue-capital classification of budgetary expenditure; the relevance of revenue and fiscal deficit targets; cyclically adjusted budget balancing; and disaster management.

6.9 Other central ministries have also commented on the specific issues of the ToR pertaining to them. The RBI has expressed its opinion on the additional ToR about including the off-budget liabilities while setting deficit targets. The joint memorandum of the states has expressed serious concern about the inclusion of the GBS (comprising primarily of CSSs) as committed expenditure of the Central Government in the ToR, which is without precedent in the history of Finance Commissions. They have pointed to a possible pitfall in such an approach, in that the Finance Commission's constitutionally recommended transfers in terms of devolution of the states' share of central taxes and the grants-in-aid, could then become residual. The comments of all the ministries, the Planning Commission, the RBI and the collective views of the states have been dealt with in the relevant chapters of the Report.

6.10 The MoF, on 8 September 2009, submitted statements containing item-wise projections of revenues and expenditures, along with the assumptions made therein. After a meeting with the Commission, some of the figures were revised in the light of their submission on 16 October 2009. Several major revenue earning/spending ministries also gave their assessment of the resources likely to be generated/required during the award period. The Commission considered all these estimates while making its projections of the revenue and expenditures of the Central Government.

Policy Considerations Informing the Assessment

6.11 A major challenge faced by this Commission, as noted in chapters 3 and 4, was the macroeconomic situation extant since late 2007-08. The Indian economy has faced several exogenous shocks in the past years. First, sharp increases in commodity prices have impacted public finances by raising the cost of financing fuel and fertiliser subsidies. Second, the global financial crisis has led to a slowdown in Gross Domestic Product (GDP) growth, impacting the revenue base and necessitating significant incremental counter-recessionary public expenditure. While the situation has improved considerably in the last few months, it may still be some time before the world economy reverts to its pre-recession growth trajectory. The advanced economies are likely to recover rather slowly and investors worldwide are likely to evince greater discretion and caution while making fresh commitments. Added to this would be the threat of inflationary pressures due to the increased pressure on crude oil prices in the wake of economic recovery. This could further aggravate the existing domestic inflationary pressure due to increasing food prices. Several experts in this field are of the view that there is also a risk that arises from the possibility of another setback in the world of finance, where even a small adverse event has an amplified capacity for destabilisation. These risks call for a prudent assessment of the growth prospects of the Indian economy and require the Commission to carefully calibrate its assessment of the future growth of GDP and correspondingly, of the revenue base. The judgement as to when the process of recovery would become sustained may be critical in this regard. Our consultations with leading professional economists have also underscored this point. Accordingly, the Commission has not assumed a constant GDP growth rate over its award period but has employed a calibrated approach. It has also been urged by the experts that the Commission maintain, at least, the level of adjustment envisaged in the Fiscal Responsibility and Budget Management (FRBM) Act 2003, during its award period, given that the Indian economy may quite reasonably be expected to revert to a trend nominal growth rate of at least 13.5 per cent in the medium term.

6.12 Accordingly, we have adopted nominal growth rates of 12.50 per cent in 2010-11, 13 per cent in 2011-12 and 13.5 per cent in each of the years from 2012-13 to 2014-15. The MoF projections are broadly similar, while those of the Planning Commission are higher. The inflation scenario adopted by us is in line with the RBI projections of a rate of 4.5 per cent to 5 per cent. MoF, however, has assumed a lower inflation rate of 3 per cent to 4.5 per cent over the period 2010-15.

6.13 In order to project the revenues and expenditures of the Centre for the period 2010-15, we have followed a two-step approach comprising a reassessment of the base year figures and, based on this, their projection for the award period (2010-15). The 2009-10 (BE) figures reflected in the Union Budget presented on 6 July 2009 have, by and large, been taken as the base for projections. However, with regard to some items of revenue and expenditure, suitable adjustments have been made after careful consideration.

Reassessment of Base Year 2009-10

6.14 In the case of tax revenues we have used the 2009-10 (BE) projections made by the Central Government. These reflect a decreasing buoyancy relative to the previous years, which is appropriate, given the severity of the economic downturn in 2008-09 and 2009-10 that has affected the direct as well as the indirect tax base.

6.15 For non-tax revenues we have used the 2009-10 (BE) projections made by the Central Government in all cases except receipts under economic services. In the case of economic services, using the BE figure (Rs. 60,039 crore) as the base seemed inappropriate as this figure included receipts from the auction of 3G–a one-time phenomenon which, if included in any growth projections, would significantly overestimate the future non-tax receipts under this head. In view of this consideration, the receipts under other communication services have been reassessed at Rs. 23,335 crore as against the BE figure of Rs.48,335 crore, thereby reducing the overall receipts under economic services to Rs.35,039 crore.

6.16 On the non-plan side we have reassessed some of the items of expenditure as per the rationale given in paras 6.17 to 6.20.

6.17 The MoF memorandum urged the Commission to take account of the revision of salaries and pensions due to the implementation of the Sixth Central Pay Commission's recommendations. In the 2009-10 (BE) figures, the impact of increased pay and allowances was already subsumed. Moreover, these figures also include the arrears payable. Since the arrears are a one-time payment, for the purposes of projection of the salary component, this amount was deducted from the relevant items of non-plan expenditure (viz. defence; police; other general, social and economic services and non-plan expenditure of UTs with legislature).

6.18 The expenditure estimates for debt waiver to farmers in 2009-10 (BE) are not expected to recur. Hence, these have not been included in the assessment of the base year. However, the Ministry of Finance has provided estimates of expenditure under this head for 2010-11 and 2011-12. These have been incorporated in the expenditure projections for the above years as these are policy commitments pursuant to the original decision on debt relief. No fresh commitments to such expenditure in the future have been allowed.

6.19 Budget 2009-10 has provided for Rs. 3109 crore as petroleum subsidy, even though the actual subsidy on this item is much higher–the balance amount being borne through off-budget mechanisms. In keeping with our additional ToR with regard to bringing all off-budget liabilities on government account, the 2009-10 base year figure for petroleum subsidy has been reassessed. The reassessment is based on the estimates of the High Powered Committee on Financial Health of Oil Companies headed by Shri. B.K. Chaturvedi. As per this report, the estimated annual subsidy on kerosene is Rs. 30,000 crore. This subsidy was based on the international crude price of US $140 per barrel. With mean crude prices assumed to be around US $70 per barrel, the subsidy would come down by at least Rs. 15,000 crore. The report also suggests a number of reform measures which, once implemented, could reduce the subsidy bill to 60 per cent of the estimated level. Accounting for such reform measures, which the Commission feels could be implemented without delay, the kerosene subsidy bill would be around Rs. 9000 crore. On Liquefied Petroleum Gas (LPG) sales, the Ministry of Petroleum has estimated an under-recovery of Rs. 17,600 crore for 2008-09 (at the prevailing crude oil prices). With mean crude prices assumed to be around US $70 per barrel the subsidy amount would come down by at least Rs. 8800 crore. It is assumed that of this, GoI will apportion 20 per cent (i.e. Rs. 1760 crore) for future subsidies on account of LPG so as to protect below poverty line (BPL) families transiting from superior kerosene oil to LPG, as envisaged in the Chaturvedi Committee Report. Thus, the reassessed base year figure for fuel subsidy amounts to Rs.10,760 crore (9000 + 1760). There should be no off-budget financing of such subsidy in future years and this approach would be in line with our ToR.

6.20 The non-plan, non-FC grants for states and UTs have been modified by deducting the non-plan grants given to the states and UTs as compensation for Value Added Tax (VAT)/ Central Sales Tax (CST). The reassessed amount is Rs. 5154 crore as against Rs. 14,176 crore in 2009-10 (BE).

Projections for the Award Period

Tax Revenues

6.21 The Commission considered various scenarios with respect to future tax revenue streams. If all taxes grow at the Trend Growth Rate (TGR) for the period 1999-2000 to 2007-08, the implied buoyancy would be 1.43. TGRs for shorter periods yield even higher buoyancies. It was felt that assuming such a high buoyancy for the projection period would be unrealistic, given that the 2004-08 period witnessed an unprecedented growth in the direct and service tax base. Thus, it was decided to moderate the buoyancy estimate and the tax revenues for the period 2010-15 have been projected by using an overall buoyancy of 1.33. This is derived by calculating the buoyancy of gross tax revenue, excluding service taxes for the period 1999-2008 (service taxes had a high outlier buoyancy of 4.54 during this period). This has been applied on the base year estimates of individual taxes to arrive at year-wise projections for revenue from each tax item. The resultant tax-GDP ratios

Table 6.1: Tax-GDP Ratio

(*per cent*)

Years	2009-10 BE	2010-11	2011-12	2012-13	2013-14	2014-15
Tax-GDP ratio	10.95	11.35	11.78	12.24	12.72	13.22

are reported in Table 6.1. Our projections are somewhat lower than the projections of the MoF.

6.22 As detailed in Chapter 5, the introduction of GST will not affect tax revenues as the rates implemented would be revenue-neutral. On the contrary, as explained, it is likely to improve revenues. This 'upside' potential of GST has not been factored into our projections and, to that extent, they are conservative.

Non-tax Revenues

6.23 Under non-tax revenues, interest receipts from State and UT Governments have been projected to decline by 2 per cent each year from the base year onwards. This is to take account of the fact that the Centre's loan portfolio to states is reducing as past loans are amortised and no new loans are being issued, as per existing policy. Interest receipts from railway capital are projected to remain constant at the base year level of 0.09 per cent of GDP. Profits from RBI/banks have been assumed to grow at the same rate as that of GDP. On the basis of our consultations with the Ministry of Petroleum and Natural Gas and the Department of Telecommunication as well as various sector experts, receipts from economic services have been projected to grow at an annual rate of 18 per cent over the reassessed base year. For all other items, the TGR for the period 1999-2008 has been applied on the base year figures to get the annual projections. As a proportion of GDP, the non-tax revenue is projected to increase from 2.01 per cent in 2010-11 to 2.24 per cent in 2014-15. MoF projected a decline in this ratio from 2.00 per cent to 1.70 per cent during the same period. However, in view of the immense potential of sectors like telecommunication and petroleum, we feel that the MoF projection is an underestimation.

6.24 Our revenue projections for the Union Government for the period 2010 to 2015 have considerable upside potential. This is due to the fact that: (i) the revenue buoyancy that we have assumed is less than the MoF buoyancy estimate; (ii) our growth assumptions are conservative compared to the projections of the Planning Commission, particularly for the latter half of the period; (iii) the game-changing tax reforms that are slated during this period, such as GST and the Direct Tax Code, will have a positive impact on revenues as these reforms will further stimulate growth and improve tax compliance and finally, (iv) our projections for the proceeds from disinvestment are less than the potential that we have identified in Para 6.44. Further, there is a possibility of additional revenues from sale of non-performing land assets. These additional revenues can comfortably finance the new expenditures arising out of implementation of the The Right of Children to Free and Compulsory Education Act (RTE), 2009 or to meet unforeseen external challenges.

Non-plan Expenditure

6.25 With regard to non-plan expenditure, the memorandum of the MoF asserts that such expenditure is, to a large extent, highly inflexible in the short run. We recognise this as being true for interest payments, defence revenue expenditure, salaries, pensions and transfers to the states and UTs. As mentioned by the Ministry of Defence, we recognise that modernisation of the defence forces is a high priority. We are also of the view that there exists considerable scope to rationalise expenditures on explicit subsidies. The expenditure projections have been made with these aspects in mind and the reasoning underlying them has been outlined in paras 6.26 to 6.38.

6.26 For interest payments we have used projections consistent with the growth in adjusted debt stock allowed by the FRBM path. The details of adjustments made in the debt stock are explained in Chapter 9. We have projected interest payments using an average interest rate of 7.35 per cent for debt contracted till 2009-10 and 7.5 per cent for the subsequent years on the incremental borrowing required to finance the fiscal deficit of the previous year. This would imply that interest payments as a proportion of non-plan expenditure would range between 35.21 per cent and 39.99 per cent during the award period.

6.27 For defence expenditure, the Ministry of Finance has projected a growth rate of 7 per cent per annum for defence revenue expenditure. Capital expenditure is projected to grow at 10 per cent per annum. The Ministry of Defence has emphasised the need to provide adequately for enhanced force multipliers. We also recognise the need to provide for some real growth in defence revenue expenditure, to allow for adequate depreciation and maintenance. We are of the view that the Finance Ministry's projections address these needs and have, therefore, adopted them. The resultant projection for the overall annual growth rate of defence expenditure works out to 8.33 per cent. Further, we are of the view that there exists considerable scope to improve the quality and efficiency of defence expenditure through increased private sector engagement, import substitution and indigenisation; improvements in procedures and practices and better project management, within the parameters of Government of India's policy. Efforts in this direction will further expand the fiscal space available for defence spending.

6.28 The Commission has taken the view that long term fiscal consolidation and improvement in the quality and effectiveness of government expenditure would require realignment in the expenditure priorities of the Central Government. If the Central Government is to expand its provisioning of the much needed national public goods, it will need to streamline expenditures. This is particularly true in the case of subsidies. Without subsidy reform it will not be possible to improve the supply of national public goods and also maintain fiscal prudence. We are of the view that it is, at the present juncture, feasible to implement reforms in the administration of key subsidies pursuant to the recommendations of the various high-powered committees and other institutions that have provided valuable suggestions in this regard. We have closely consulted with the relevant line ministries on the subject to ensure that such reforms can be implemented without adversely affecting the consumption capabilities of the target groups. This approach is also in continuity with the normative approach of the Eleventh and Twelfth Finance Commissions.

6.29 Against this backdrop, the Commission has made normative projections with regard to future expenditure on subsidies, keeping in mind the need for reform as well as the need to better target subsidies to enhance the access of target sections of the population to key merit goods. Hence, in this respect, we have digressed from the estimates of MoF which has assumed an annual growth of 5 per cent for food, fertiliser and fuel subsidies.

i) Food: The intention behind providing food subsidy is to improve the food security of the vulnerable sections of society. With this in mind, we have allowed for 50 per cent subsidy on the minimum support price (MSP) to BPL families and full subsidy for the beneficiaries under Antyodaya Anna Yojana (AAY). These subsidy figures have been based on the calculations of the Department of Food and Public Distribution which assume MSP to increase 10 per cent annually. On this basis the average annual growth in food subsidies for the projection period is 8.87 per cent.

ii) Fertiliser: The fertiliser subsidy needs to be targeted to ensure food security and self sufficiency while preventing wasteful and suboptimal use of fertilisers. In addition, we are informed that given the oligopolistic nature of the global fertiliser market, with India as a large buyer of key fertilisers, restraining inefficient fertiliser consumption would also result in price benefits in the medium term. The Department of Fertilisers, in their interaction with the Commission, also made the point that a reworking of the subsidy regime would promote optimal use of fertilisers as well as better targeting of the subsidy. With these considerations in view, we have taken as a reference point the recommendation of the PM's Economic Advisory Council (EAC) to restrict this subsidy to 120 kilograms[1] of fertiliser per cultivator household. On

[1] The report of the Economic Advisory Council (2007) states that 120 kg of fertiliser (comprising 80 kg of nitrogenous fertiliser, 30 kg of phosphatic fertiliser and 10 kg of potassic fertiliser) provide a well balanced total of 60 kg of nutrients. This will meet the full requirement of small and marginal farmers and will also meet the self-consumption food requirement of medium and large farmers. The balance requirement is to be met from the free market.

this basis, the estimated financing requirement for this subsidy was Rs. 10,980 crore in 2006-07. We consider this to be a reasonable target for 2014-15 if oil prices (which are closely aligned with the freight on board (FOB) unit price of the fertiliser basket) remain around US $70 per barrel. To achieve this in the terminal year, the 2009-10 (BE) figure has been reduced equi-proportionately each year so that the forecasted subsidy provision in 2014-15 is equal to the target figure of Rs. 10,980 crore. We have not allowed for any inflation as we expect trend prices to be lower than those extant in 2006-07, not least due to the expected inhibition of cartel formation in international fertiliser supply during the Finance Commission award period.

iii) Fuel: The reassessed base year figure has been kept constant in nominal terms over the projection period, reflecting the need to control this subsidy if the parameters underlying the calculation (chiefly oil prices) do not change in this duration. Our assumption is that any real growth will be financed through efficiency savings.

iv) Other subsidies: For each of the projection years the number, equivalent to the figure in the base year, has been kept constant in nominal terms, reflecting the need for some real reduction in these subsidies.

6.30 Such reduction in subsidies is important to improve equity as well as growth in the economy. As shown in a study undertaken by National Institute of Public Finance and Policy (NIPFP), these subsidies are regressive, in the sense that in per capita terms, they are relatively higher for the higher income states. Further, large subsidies, such as in fertilisers and LPG, are likely to be regressive on an inter-personal basis also, as fertiliser subsidies are higher in per capita terms in irrigated areas and LPG subsidies are higher in per capita terms in urban areas. The reduction of these subsidies, by freeing up fiscal space, will facilitate increase in the supply of public goods such as schools, village roads and irrigation, which will lead to higher growth by inducing greater private investment.

6.31 For police expenditure, we have projected growth at an annual rate of 7.5 per cent per annum over the reassessed base year figure, given the need to provide adequately for non-wage operational expenditure and taking into account the expected increase in the strength of the central police force.

6.32 Pensions have been projected to grow at an annual rate of 9 per cent during the award period. MoF had projected this to grow at 9 per cent for the first three years and 10 per cent for the two subsequent years. In view of the fact that the effect of increased outgo on pension has already been factored into the 2009-10 (BE) figures, we did not perceive any rationale for providing a differentiated growth rate for this item of expenditure.

6.33 Election expenditure has been assumed to be largely on account of the next general election to the Lok Sabha due in 2014-15. We have provided for 5 per cent of the base year expenditure in each year (except 2014-15) for by-elections. For 2014-15, however, in anticipation of the general election, the amount provided has been calculated by applying a 5 per cent compound growth rate to the election expenditure incurred in 2009-10.

6.34 Expenditure on other general services and economic services is projected to grow at an annual rate of 5 per cent over the reassessed base year, making full provision for inflation. Expenditure on social services is projected to grow at an annual rate of 7.5 per cent over the reassessed base year, reflecting the Central Government's intention to expand spending on human development. MoF had projected an annual growth rate of 7 per cent for other general services (including police), economic services and social services.

6.35 For each of the projection years, the 2009-10 base year figure for the non-plan grants and loans to public enterprises is assumed to remain constant in nominal terms. Non-plan expenditure of the UTs without legislature is projected to grow at the trend growth rate of 12.1 per cent, calculated for the period 2004-05 to 2008-09 (RE), over the reassessed base year.

6.36 As compared to the Centre, the states had to pay a higher effective rate of interest on the National Small Savings Fund (NSSF) loans taken till 2006-07. In order to correct this, the Commission has recommended interest relief on the NSSF loans contracted by the states till 2006-07, with the precondition that the states will have to enact the FRL as outlined in Chapter 9. Total relief on this account amounts to Rs. 13,517 crore. The Centre has to compensate this amount to the NSSF. Accordingly, the non-plan revenue expenditure of the Centre will increase by an equivalent amount. Provision has been made for this.

6.37 All other items, viz. non-plan, non-FC grants to states and UTs; grants and loans to foreign governments; non-defence, non-plan capital expenditure; non-plan loans to states and UTs; and other non-plan loans have been assumed to grow at 5 per cent annually over the base year, thus making full provision for inflation. However, postal deficit is assumed to decline at 2.19 per cent per annum, which is also its trend rate of decline for the period 1999-2008.

6.38 In the aggregate, as per our estimates, non-plan expenditure, as a proportion of GDP decreases from 10.06 per cent in 2010-11 to 7.73 per cent in 2014-15. As per the MoF's projections, the percentage comes down from 10.74 to 8.80 during the corresponding period. Our normative projection with respect to subsidies is the major reason for this divergence.

Plan Expenditure

6.39 In making our recommendations we have been asked to consider, among others, the demands on the resources of the Central Government, especially on account of the projected GBS to the central and state plans. In the dispensation of recent Finance Commissions, GBS emerged as a residual after fully providing for the requirements of the Centre on the non-plan revenue account. If the GBS is taken upfront as a demand on the Centre's resources, the Finance Commission transfers will have to be tailored accordingly. This, in a way, reverses the current practice of arriving at the GBS residually and alters the basic character of the Finance Commission transfers.

6.40 We have examined the matter in detail and our approach has been guided by the methodological issues involved in first taking GBS as a demand on the resources of the Central Government and then recommending transfers to the states. Projections of GBS are available only for the Eleventh Five-Year Plan period (2007-12) and do not fully cover our award period. Further, these are not broken down year-wise and the estimates of each year are arrived at during the finalisation of the annual plans. There is a tendency to project GBS at higher than realisable levels in order to have a larger plan size. After fully providing for the projected GBS and other demands on the resources of the Centre, there may not be enough fiscal room to fully meet the requirements of the Centre on non-plan revenue account and maintain the current level of transfers to states, while bridging the gaps in the non-plan revenue accounts of the states. The requirements on the non-plan revenue account, of both the Centre and the states, being mostly committed in nature, have to be provided for in the first instance and cannot be provided for in a residual manner. There are also major problems in assessing the requirements of GBS normatively. After examining all these aspects, we are of the view that there are far too many practical difficulties in taking the GBS for plan as a demand on the resources of the Centre and that the balance of advantage clearly lies in arriving at the GBS residually, as has been the practice in the past.

6.41 The MoF memorandum projects an aggregate GBS of Rs. 23,49,515 crore during the period 2010-15. As per the Planning Commission's submission, the requirement of GBS for the same period is projected at Rs. 26,23,701 crore. Based on our assessment of revenue receipts and non-plan revenue expenditure and the FRBM path with respect to the revenue balance as spelt out in Chapter 9, the plan revenue expenditure is a residual. The capital component of plan expenditure, as explained in the next section, has been arrived at after projecting a total capital expenditure consistent with the FRBM target and adjusting for the non-plan capital expenditure determined normatively. The resultant GBS (or plan expenditure) as projected is consistent with the estimates of the MoF and the Planning Commission. More importantly, the GBS for the last two years of the Eleventh Plan (i.e., the first two years of the FC-XIII award period) is more than the projections of the MoF for the respective years. The total GBS for these two years, taken together, is also higher than that projected by the Planning Commission. Bearing in mind the anticipated increase in the states' contribution to Centrally Sponsored Schemes in the Twelfth Plan period and the need to be prudent in the expansion of these schemes, we are of the view that this adequately provides for the Centre's GBS commitments.

6.42 Annexes 6.1 to 6.4 provide the reassessed base year estimates for 2009-10 and normative estimates for 2010-15, of the Central Government's revenue receipts and revenue expenditure.

Capital Receipts and Expenditure

6.43 The major item of non-debt capital receipts for the Centre has been the recovery of loans and advances from the states. In view of the discontinuation of any further loans extended by the Centre to the states, this source of receipt will decline steadily over the years. However, disinvestment of Central Public Sector Undertakings (PSUs) remains a potent source of non-debt capital receipts and needs to be pursued actively, given the desirability of disinvestment in central PSUs to allow more space to private enterprises for the delivery of goods and services.

6.44 For PSUs which are listed, the government equity invested is valued at approximately Rs. 10,00,000 crore as per market capitalisation information for mid-October, 2009. The available estimates of the average Price/Earning (P/E) ratio and Price/Book (P/B) ratio of these enterprises stand at 22.4 and 3.4, respectively. The market value of listed nationalised banks, also in mid-October, 2009 is estimated at about Rs. 1,90,000 crore. The latest available book value and the profit/loss position for the unlisted PSUs is for 31 March 2008. This is of the order of Rs. 82,934 crore. Applying the P/E and P/B ratio of the listed PSUs, respectively to the earnings (i.e., profit/loss) and book value of the unlisted PSUs and taking the average of the two, the market value of the unlisted PSUs is estimated at approximately Rs. 3,50,000 crore.

6.45 Assuming divestment of unlisted PSUs from the present holding of 96.79 per cent to 90 per cent to enable them to be listed, an amount of around Rs. 24,000 crore would be unlocked. Also, listing of these enterprises would enhance their quality of corporate governance. Further, for listed companies, divestment from the present holding of 84.73 per cent to 51 per cent could imply additional resources of approximately Rs. 3,41,000 crore. Similarly, for banks, bringing down the government share from the existing 60 per cent to 51 per cent would entail a resource availability in the vicinity of Rs. 17,000 crore. Thus, in the aggregate, an approximate amount of Rs. 3,81,000 crore (unlisted PSUs – Rs. 24,000 crore, listed PSUs — Rs. 3,41,000 crore, listed banks – Rs. 17,000 crore) could become available to the government. Assuming that this is pursued over five years, i.e., till 2010-15, this would provide resources to the tune of around 0.88 per cent of GDP every year on an average.

6.46 The Government of India has recently decided that disinvestment proceeds accruing to the National Investment Fund between April 2009 and March 2012 will be available for utilisation in full on capital expenditure for social sector programmes. We feel this policy is unduly restrictive and needs to be liberalised. We recommend that the proceeds should also be utilised for augmenting critical infrastructure and the natural or environmental capital of the economy. The increasing investment needs of the social sectors, such as education and health to promote inclusive growth and the infrastructure requirements of a growing economy will require greater capital expenditure. This will also 'crowd in' private investments in the economy. There are also emerging needs such as environmental protection and growing urbanisation. For instance, the new solar energy programme launched under the National Action Plan on Climate Change will require enormous investment to increase the supply of solar energy in India. Equally, there will be a need for a rapid urban transport system in almost all the major cities. These programmes require large investments. Hence, the entire proceeds from disinvestment should be utilised to augment the budget resources of the Centre to finance the changing requirements of the public capital portfolio.

6.47 For the award period, however, we have assumed that non-debt capital receipts, including disinvestment, will increase equi-proportionately from 0.5 per cent of GDP in 2010-11 to 1 per cent of GDP in 2014-15.

6.48 One of the major under-performing assets of the government is institutional land of the central PSUs. The information provided to us on the details of the unutilised lands of central PSUs by the concerned ministries is patchy and incomplete. This highlights the need for a proper inventory of land held by the PSUs. We would strongly urge that the records of landholdings of PSUs be properly maintained so that this scarce resource is put to productive use or made available for other public projects, or else sold. Such a measure will facilitate further development projects without recourse to land acquisition and involuntary displacement.

6.49 Central Government borrowings have been projected keeping in view the FRBM target of achieving a debt-GDP ratio of 45 per cent in 2014-15. The Commission has noted with concern that the debt-GDP ratio of the Centre has been unsustainably high and feels that this should be reined in. The issue has been discussed in detail in Chapter 9.

6.50 Based on the above estimates of capital receipts and accounting for the revenue deficit/surplus on the basis of the norms adopted for revenue receipts and revenue expenditure, total capital expenditure is projected at 3, 3.13, 3.75, 3.88 and 4.50 per cent of GDP, respectively in each of the years 2010-11 to 2014-15. Plan capital expenditure has been arrived at as a residual after providing for the normatively determined non-plan capital expenditure (i.e., the capital component of defence expenditure; non-plan loans to states, UTs, public sector enterprises and foreign governments; and other non-plan loans).

Summary of Recommendations

6.51 To summarise, our recommendations are:

i) The policy regarding use of proceeds from disinvestment should be liberalised to include captial expenditure on critical infrastructure and the environment, in addition to capital expenditure on the social sectors (Para 6.46).

ii) Record of landholdings of the PSUs should be properly maintained to ensure that this scarce resource is put to productive use or made available for other public projects, or else sold (Para 6.48).