MEDIUM TERM FISCAL POLICY STATEMENT

A. FISCAL INDICATORS – ROLLING TARGETS AS PERCENTAGE OF GDP

(at current market prices)

		Revised Estimates 2010-11	Budget Estimates 2011-12	Targets for 2012-13	Targets for 2013-14
1.	Revenue Deficit	3.4	3.4	2.7	2.1
2.	Fiscal Deficit	5.1	4.6	4.1	3.5
3.	Gross Tax Revenue	10.0	10.4	10.8	11.3
4.	Total outstanding liabilities at the end of the year	45.3	44.2	43.1	41.5

Notes:—

1. *"GDP" is the Gross Domestic Product at current market prices as per new series from 2004-05.*
2. *"Total outstanding liabilities" include external public debt at current exchange rates. For projections, constant exchange rates have been assumed. Liabilities do not include part of NSSF and total MSS liabilities which are not used for financing Central Government deficit.*
3. *Comparison with the Thirteenth Finance Commission roadmap is shown in annexure I.*

1. The performance on select fiscal indicators during the current financial year and the rolling targets for ensuing financial year presented above, show improvement over the commitments made in the Budget 2010-11.

2. During the first half of the current financial year, with higher receipts from auction proceeds of 3-G and BWA spectrum, it was evident that the revenue receipts of the government would exceed significantly over the estimated level in BE 2010-11. At the same time, there were signs of higher than estimated buoyancy in tax collection resulting in higher growth in tax revenue receipts as well. These factors brought in two options before the government –first to over perform on correction in fiscal deficit and; second to utilize additional resources by providing higher outlays for priority sectors but still remain within the mandated deficit level.

3. In a developing country like India, the need for further investment in physical and social infrastructure is immense. However, the provisions in Budget for the same have to factor in the availability of resources. It was in this context that additional allocations for expenditure in 2010-11 were made without exceeding the fiscal deficit target of 5.5 per cent of GDP. With the availability of higher resources during the year (especially from 3G and BWA spectrum auctions), the government opted for the second option and decided to increase allocation for certain sectors which include rural infrastructure (₹10,000 crore for PMGSY); implementation of Right to Education Act (₹4,000 crore); Plan Assistance to States (₹6,379 crore) and Recapitalization of Public Sector Banks (₹3,657 crore). However, even with significant increase in overall expenditure, the government has not deviated from the committed path of fiscal consolidation. Higher revenue receipts coupled with higher nominal growth in GDP have helped the government in reducing the fiscal deficit as percentage of GDP to 5.1 per cent in RE 2010-11.

4. This reduction in fiscal deficit may be seen in the context of change in policy of the government introduced in the current financial year not to issue Government securities in lieu of cash subsidies to oil and fertiliser companies. It may be recalled that effective fiscal deficit (including securities issued in lieu of subsidies to oil and fertiliser companies) had gone up to 7.8 per cent of GDP in the crisis year of 2008-09. Revenue deficit on the same analogy has come down from 6.3 per cent of GDP in 2008-09 to 3.4 per cent in RE 2010-11. From the current financial year, new fiscal indicator, namely, effective revenue deficit has been depicted (details of which are explained in the Fiscal Policy Strategy Statement). This indicator indicates how much of imbalance in revenue account is attributed to grants for creation of capital assets. In the RE 2010-11, effective revenue deficit is estimated at 2.3 per cent of GDP.

5. Gross tax revenue receipts in BE 2010-11 were estimated to grow at 19.6 per cent from actuals of 2009-10 and are now estimated to grow at 26 per cent in RE 2010-11. However, with upward revision of GDP data for 2009-10 and higher than estimated nominal growth in GDP during 2010-11, tax to GDP ratio shows a decline from estimated level of 10.8 per cent in BE 2010-11 (as per earlier GDP number) to 10.0 per cent in RE 2010-11. In the revised series of GDP data with effect from 2004-05, gross tax revenue as percentage of GDP reached peak of 11.9 per cent in 2007-08 and had gradually declined to 9.5 per cent in 2009-10. This reduction in tax to GDP ratio was the outcome of the adverse impact of global economic crisis on the Indian economy and related fiscal measures (reduction in taxes and duties) undertaken during the period 2008-09 and 2009-10. With partial withdrawal of stimulus measures during 2010-11, the increase in tax to GDP ratio from 9.5 per cent in 2009-10 to 10.0 per cent in RE 2010-11 demonstrates that the recovery process has firmly set in and one can look forward for further accelerated improvement in this ratio in coming years in the medium term.

6. Non-tax revenue has significantly exceeded the budget estimates of ₹1,48,117 crore to ₹2,20,148 crore in RE 2010-11. This is primarily due to higher than estimated receipts from auction of 3-G and BWA spectrum. After factoring in lower than estimated transfer of surplus from the Reserve Bank of India, dividend receipts from various Public Sector Undertakings (PSUs) and Financial Institutions (FIs) have increased in RE 2010-11 from the estimated level of BE 2010-11.

7. Disinvestment proceeds which form a significant part of non-debt capital receipts were estimated at ₹40,000 crore in BE 2010-11. However, taking into account the increase in other sources of revenue, the disinvestment programme during the year 2010-11 has been modified and accordingly receipts from disinvestments in PSUs have been reduced to ₹22,144 crore in RE 2010-11. After factoring in recoveries of loans and advances, the total non-debt capital receipts are estimated to reduce from ₹45,129 crore in BE 2010-11 to ₹31,745 crore in RE 2010-11.

8. With higher receipts from other deficit financing sources, the overall net market borrowings of the government have been reduced by ₹10,000 crore in RE 2010-11 from the estimated level of ₹3,45,010 crore in BE 2010-11. The indicated level of borrowing will also aid in better cash management in the first quarter of ensuing year when the redemptions of existing debt stock is of higher level.

Fiscal outlook for 2011-12 to 2013-14

9. Continuing with the process of fiscal consolidation, which resumed in 2010-11 after a pause of two difficult financial years, the fiscal policy of 2011-12 is continued to be steered by the Government's commitment in Medium Term Fiscal Policy Statement (MTFP) statement presented along with Budget 2010-11. Fiscal deficit which was committed to be brought down to 4.8 per cent of GDP, in line with recommendations of the 13th Finance commission (FC), has actually been estimated to further improve to 4.6 per cent in BE 2011-12. This re-emphasizes the Government's commitment to carry on the process of fiscal consolidation more vigorously in the coming years. Fiscal deficit target for 2012-13 has been estimated at 4.1 per cent of GDP and 3.5 per cent in 2013-14. Though the target for 2012-13 is a slight improvement over the recommended roadmap of the 13th FC (4.2 per cent), target for 2013-14 is less ambitious when compared to 3.0 per cent. This is mainly on account of lower disinvestment proceeds assumed in the projection when compared to the 13th FC recommendations wherein non debt capital receipts were assumed at 0.9 per cent of GDP for 2013-14 whereas in this Statement it is assumed at 0.3 per cent of GDP. In the first two years of the 13th FC award period i.e. 2010-11 and 2011-12, government has strived for improving upon the recommended level of fiscal deficit. While the suggested roadmap of the 13th FC puts fiscal deficit at 5.7 per cent and 4.8 per cent of GDP for 2010-11 and 2011-12 respectively, it has now been estimated at 5.1 per cent and 4.6 per cent respectively. This better than recommended performance on fiscal deficit side, coupled with higher GDP, would help the government in reducing the debt as percentage of GDP even faster and well below the target set in the 13th FC.

10. The recommended debt target for terminal year (2014-15) of the 13th FC award period which is 44.8 per cent of GDP is estimated to be achieved in the year 2011-12 itself, wherein it is estimated at 44.2 per cent of GDP. With the above projections of fiscal deficit and assuming that the net increment in liability would not be more than the fiscal deficit of respective years, debt as percentage of GDP is projected to reduce to 43.1 per cent and 41.5 per cent in 2012-13 and 2013-14 respectively. Total outstanding liabilities indicated above include external public debt at current exchange rates and do not include part of National Small Savings Fund (NSSF) and total Market Stabilisation Scheme (MSS) liabilities which are not used for financing Central Government deficit. It however includes

liabilities on account of 14-days treasury bills which would be excluded along with Central Government Loans to States while consolidating the General Government debt and liabilities.

11. Revenue deficit has been estimated at 3.4 per cent of GDP in BE 2011-12. This is at the same level as estimated in RE 2010-11. However, this non-reduction in revenue deficit as percentage of GDP when compared to RE 2010-11 may be seen in the context of windfall gain in revenue receipts through 3-G and BWA spectrum auction during 2010-11. Contribution from this component, which was one off receipt, in correction of revenue deficit during 2010-11 was of the order of 1.3 per cent of GDP. Revenue deficit is further estimated to decline to 2.7 per cent of GDP in 2012-13 and 2.1 per cent in 2013-14. As a significant proportion of revenue expenditure is being provided as grants for creation of capital assets, it would be pertinent to look at the effective revenue deficit of the government. The effective revenue deficit, after factoring in the above mentioned grant component in the revenue account, is estimated at 1.8 per cent of GDP in BE 2011-12. It is further projected to decline to 1.1 per cent in 2012-13 and 0.5 per cent in 2013-14. It is this component of imbalance in revenue account which needs to be addressed in right earnest - through expenditure management and revenue augmentation.

12. Gross tax revenue is estimated to increase from 10.0 per cent of GDP in RE 2010-11 to 10.4 per cent in BE 2011-12 (reflecting growth of 18.5 per cent over RE 2010-11), which is however still lower than 11.9 per cent of GDP achieved during 2007-08. With economy reverting back to the path of trend growth rate, it would be possible to get back to the achieved level of tax to GDP ratio. In the medium term targets, gross tax collection as percentage of GDP is projected at 10.8 per cent in 2012-13 and 11.3 per cent in 2013-14.

13. The fiscal consolidation roadmap enumerated in this Statement, is designed with a conscious effort to bring down total expenditure of the government as percentage of GDP to the pre-crisis level i.e. of 2007-08. Including issuance of securities in lieu of subsidies and securities issued to nationalized banks, total expenditure of the government during 2007-08 was 15.9 per cent of GDP. This went up to 17.3 per cent in 2008-09 (inclusive of securities issued in lieu of subsidies) and has declined to 15.4 per cent in RE 2010-11. With re-prioritization of expenditure towards developmental side and curtailing the growth in non-developmental expenditure, the total expenditure is estimated to be brought down to 14 per cent of GDP in BE 2011-12. In the medium term projection, it is estimated to further decline to 13.5 per cent of GDP in 2012-13 and 13.0 per cent in 2013-14.

B. ASSUMPTIONS UNDERLYING THE FISCAL INDICATORS

1. Revenue Receipts

(a) Tax-Revenue

14. During the period 2004-05 to 2007-08, gross tax revenue increased from 9.4 per cent of GDP to 11.9 per cent. However, due to the global economic crisis and its adverse impact on Indian economy, this percentage has declined to 9.5 per cent in 2009-10. With economy returning back to the path of trend growth rate, it should be the endeavour of the government to restore the tax buoyancy to the pre–crisis year level. Gross Tax revenue is estimated to improve from 10 per cent of GDP in RE 2010-11 to 10.4 per cent in BE 2011-12. This percentage is still lower than 10.8 per cent which was the tax to GDP ratio in the crisis year of 2008-09. With the introduction of Direct Tax Act in 2011-12 and likely introduction of Goods and Services Tax, the endeavour is to set right the reduction in tax to GDP ratio witnessed during the crisis period. In the medium term outlook, it is projected to improve from 10.4 per cent in BE 2011-12 to 10.8 per cent in 2012-13 and further to 11.3 per cent in 2013-14. This, however, is still lower than 11.9 per cent achieved during 2007-08. These improvements are assumed with projected higher growth in the economy for 2011-12, 2012-13 and 2013-14. Any slippage in the growth forecast would impact these projections.

15. Direct tax collections, which reached a peak of 6.3 per cent of GDP in 2007-08, are estimated at 5.9 per cent of GDP in BE 2011-12 up from 5.7 per cent in RE 2010-11. It is estimated to grow at 19.4 per cent in BE 2011-12 over RE 2010-11. The estimated growth rate is in line with the performance in direct tax collection during the trend growth period of 2003-04 to 2007-08. The compounded annual growth rate for major components of direct tax during the above mentioned period was about 29 per cent. With the economy showing swift and broad based recovery and likely continuance of the higher rate of growth in the medium term, direct tax collections should reach the pre crisis year level. With the implementation of Direct Taxes code (DTC) from 2012-13, direct tax collection as percentage of GDP is projected to improve from 5.9 per cent in BE 2011-12 to 6.2 per cent in 2012-13 and further to 6.5 per cent in 2013-14. The year on

year growth rate assumed for the above projections are 19.5 per cent and 19 per cent for 2012-13 and 2013-14 respectively. It may be recalled that in a prelude to introduction of DTC, during 2010-11, income slabs were increased for the prevailing tax rate structure and rate of surcharge had been reduced on Corporation Tax. This had helped in improving the compliance level. With widening of tax base and improved compliance, the tax collections tend to show higher growth. The current year trends point in this direction. Taking forward the process of reduction in surcharges, rate of surcharge on Corporation Tax has been proposed to be further reduced during 2011-12.

16. Indian economy has shown its characteristic resilience in the aftermath of global economic crisis. The recovery has become broad based and this is evident from the growth in indirect tax receipts in the current year. After factoring in the effect of partial rollback of stimulus measures, BE 2010-11 was estimated to grow at 27.3 per cent. Latest trends in 2010-11 indicate that the growth in indirect tax receipts will be much higher and RE 2010-11 is estimated to grow at 38.2 per cent. With this accelerated revival in economy, indirect tax receipts as percentage of GDP has gone up from 3.8 per cent in 2009-10 to 4.3 per cent in RE 2010-11. The implementation of GST would help in further improving the compliance and thereby will result in improvement in overall indirect tax collection. With the assumption that the economy would continue to register the higher growth trajectory, it is projected that the indirect tax receipts as percentage of GDP would increase to 4.5 per cent in BE 2011-12 and to 4.7 per cent in 2013-14.

17. Assignment to States and net Tax Revenue of Centre in B.E.2011-12 are placed at ₹2,63,458 crore and ₹6,64,457 crore respectively after factoring in the recommendations of the 13th FC. With gradual reduction in surcharges, the shareable pool as proportion of gross tax revenue has increased in BE 2011-12 when compared to BE 2010-11. Therefore, net tax revenue to Centre is estimated to decline from 71.5 per cent in BE 2010-11 to 71.3 per cent in BE 2011-12.

18. The fiscal indicators shown in Table in paragraph A for BE 2010-11 are based on new Budget proposals.

(b) Non-tax-revenue

19. Non-tax revenue (NTR) which was estimated at ₹1,48,118 crore in the B.E. 2010-11 has gone up significantly due to higher receipts from the auction of 3G and BWA spectrum. It is estimated at ₹2,20,148 crore in RE 2010-11. This one time receipt had helped the government in containing the fiscal deficit within the mandated level even with higher outlays for priority sector expenditure. However, absence of any such receipts in 2011-12, brings the non tax revenue estimates back to the trend level. It is estimated at ₹1,25,435 crore. Major proportion of this receipt is estimated from dividends and profits from PSUs and FIs along with transfer of surplus from the RBI. This component of revenue being highly inelastic, government has to devise mechanisms to increase receipts from non tax revenue. One of the items could be efficient pricing of natural resources which may bring in regular flow of revenue for the government. With the existing policy, it is estimated that non tax revenue as percentage of GDP would decline from 1.4 per cent in BE 2011-12 to 1.2 per cent in 2012-13 and 2013-14. In absolute terms, it is estimated to grow at 10 per cent in 2012-13 and 7 per cent in 2013-14. There may be a spike wherein some of the one off items may bring in more revenue for the government.

(c) Devolution to States

20. 13th FC has recommended for increasing the States' share in net proceeds of Union taxes from 30.5% to 32% during its award period 2010-2015. It has also recommended increase in the indicative ceiling on total transfers from Centre to the States on the revenue account from 38% to 39.5%. This has impacted the availability of resources for the Central Government.

2. Capital receipts

(a) Recovery of loans and advances

21. Net recovery of loans from the States have declined during the 12th FC award period on account of gradual disintermediation by Central Government and the debt consolidation and debt waiver scheme. However, with the passage of 12th FC award period, the debt waiver scheme will not be in operation anymore and therefore the recovery of loans from States have shown an increasing trend.

22. The repayment of loans from Central PSEs is also impacted on account of defaults from PSEs that are either sick or under revival through BIFR. The waiver of interest or write off of loans of sick PSUs has reduced the potential future receipts. Recovery of loans and advances is estimated at ₹15,020 crore in B.E.2011-12. The higher estimated receipt is primarily on account of recovery of short term loans given to the Food Corporation of India (₹ 5,000 crore) for its procurement operation. For 2012-13 and 2013-14, this component of receipt is estimated to be flat at ₹10,000 crore as the government would not

encourage net lending (except for the back to back arrangement made for external loans to States).

(b) Other non-debt capital receipts

23. Disinvestments in Government PSUs are main source of receipts under this head. National Investment Fund was created to hold disinvestment proceeds and investment of accumulation under the Fund by the fund managers used to give returns as non tax revenue of the government till 2008-09. During 2009-10, Government had decided to use the disinvestment proceeds received during 2009-10 to 2011-12 for the purpose of financing social sector programmes which are creating capital assets. Accordingly, disinvestment receipts are being used to partly meet expenditure on select flagship programmes related to Rural Employment, Rural Housing, Rural Electrification, Irrigation, Urban Infrastructure and Reforms in power sector. In the year 2010-11, government set up an ambitious target of ₹40,000 crore receipts from disinvestments. With successful completion of one of the largest IPO related to Coal India, the target was expected to be achieved during the current year. However, on review of latest trends in receipts from other sources of revenue of the government, disinvestment programme during 2010-11 has been moderated and the RE 2010-11 is estimated at ₹22,144 crore. In BE 2011-12, this is estimated at ₹40,000 crore. Also, the returns from the investment made earlier through National Investment Fund would continue to be employed to finance selected social sector schemes which promote education, health and employment and to meet capital investment requirement of profitable and revivable CPSEs.

24. During the year 2012-13, as per the existing decision of the Government, disinvestment proceeds would not be available for financing of programme expenditure and only the returns made from earlier and future investments could be used for financing select social sector programmes. However, as recommended by the 13th FC, the medium term outlook in this Statement assumes that disinvestment proceeds would continue to be used for financing government expenditure in 2012-13 and 2013-14 as well. Receipts under this component have been projected at ₹30,000 crore and ₹25,000 crore in 2012-13 and 2013-14 respectively. This amounts to 0.3 per cent and 0.2 per cent of GDP for respective years much lower than the estimated receipts by the 13th FC. This receipt would help government to finance developmental expenditure within the fiscal deficit levels in the medium term framework. However, discontinuance in use of disinvestment proceeds for financing programme expenditure would lead to higher than projected fiscal deficit in 2012-13 and 2013-14, unless the government is able to achieve higher buoyancy in tax and non tax revenues. Depending on the capital market condition and prevailing macroeconomic parameters in the economy, both upward and downward risks are associated with the successful completion of the projected level of disinvestment programme in respective years.

(c) Borrowings – Public Debt and Other Liabilities

25. In the Budget 2010-11, it was announced that the Government will bring out a status paper giving detailed analysis of the government's debt situation and a roadmap for curtailing the overall public debt. It was also announced that it would be followed by an Annual Report on this subject. As a follow up of the above announcement, a paper "Government Debt – Status and Road Ahead" was brought out in November 2010. Of the overall Central Government debt and liabilities, about 92 per cent is domestic debt and only 8 per cent is external debt. Presently, deficit of the government is financed largely through dated securities at market determined interest rates which are raised through auction. Other sources of financing for the government include Securities issued to National Small Savings Fund (NSSF), external debt from multilateral and bilateral agencies, short term bills, net accretion in public account of the government, etc.

26. During 2010-11, the market borrowing programme has been reduced by ₹10,000 crore from the estimated level in the Budget Estimates. The announced borrowing calendar has been largely completed except the balance ₹ 10,000 crore which may not be raised during the remaining part of the financial year. The change in monetary policy stance and prevailing liquidity condition has resulted in hardening of yield during the current financial year. The weighted average yield in primary auction of dated securities in 2011-12 has gone up from 7.2 per cent in 2009-10 to 7.9 per cent. In the year, 2011-12 the Government would finance about 82 per cent of deficit through dated securities at market determined interest rates. The net borrowings from the open market in 2011-12 have been estimated after factoring in private sector requirements. It has been estimated to be reduced from 5.0 per cent of GDP in BE 2010-11 to 3.8 per cent in BE 2011-12. As a proportion of overall deposits with the banking system also the estimated market borrowing will show a significant decline in BE

2011-12 when compared to BE 2010-11. The details on other sources of financing of deficit are shown in the Receipts Budget.

27. In the debt paper (November, 2010), it had been explained that while accounting for Central Government debt and liabilities, the amount not used for financing Central Government deficit should be taken out for truly depicting Government's liability. The component of NSSF which are invested as State Governments' securities has been excluded for the purpose of calculating Central Government's liabilities. Debt raised under Market Stabilisation Scheme (MSS) which are sequestered in a separate account in the RBI, are also not availabe for financing of fiscal deficit. Hence MSS balances are adjusted while arriving at the debt and liabilites of the Government. With these adjustments from the shown liabilities in the Receipts Budget Annex-5A, along with external debt at current exchange rate, the estimated debt to GDP ratio for Central Government would be 45.3 per cent in RE 2010-11 and 44.2 per cent in BE 2011-12 respectively. This marked improvement from the earlier reported data on debt has to be seen in the context of revision in GDP data with a new series effective from 2004-05 as well as higher than earlier estimated growth in 2009-10 and 2010-11. With the projected level of fiscal deficit of 4.1 per cent of GDP in 2012-13 and 3.5 per cent of GDP in 2013-14, the estimated debt to GDP ratio would be 43.1 per cent and 41.5 per cent respectively. These estimates show that the debt to GDP ratio in 2011-12 itself will be lower than the 13th FC recommended level of 44.8 per cent for the terminal year 2014-15.

3. Total expenditure

(A) Revenue account

(i) Plan Revenue expenditure

28. Starting with 2008-09 and then in 2009-10, the government had to step up plan expenditure significantly for boosting demand and investment in infrastructure sector. This decision was part of the fiscal stimuli measures provided by the Government to minimise the impact of the global slowdown on the Indian economy. The fact that Indian economy grew at 8 per cent in 2009-10 shows that the policy of increasing government plan expenditure has aided the quick and broad based revival of the economy. Plan revenue expenditure has increased from ₹1,73,572 crore in 2007-08 to ₹ 3,26,928 crore in R.E.2010-11. This shows compounded annual growth of 23.5 per cent during 2008-09 to 2010-11. Plan revenue expenditure is further estimated at ₹3,63,603 crore in BE 2011-12 reflecting growth of 11.2 per cent over RE 2010-11.

29. With these allocations, the overall provision for plan expenditure would exceed the projected expenditure outlay in the Eleventh Plan in nominal terms. This may be seen in the context of earlier performance during Ninth and Tenth Plan, when actual expenditure was only about 84 per cent of the projected outlays. The significant increase in allocations brings in the issue of transforming outlays into outcomes, particularly outcomes which could be monitored from a base scenario in the medium term.

(ii) Non Plan Revenue expenditure

30. Non-plan revenue expenditure which mainly consists of salary, pension, defence services, interest payment and statutory grants to States, has risen sharply during the crisis year period of 2008-09 and 2009-10. From 9.6 per cent of GDP in 2006-07, it has gone up to 11.0 per cent in 2009-10. This level of growth in non-plan expenditure is found to be non sustainable and current sources of government revenues would not be able to fully finance it; thereby necessitating use of borrowed resources for financing this component. With lower estimated growth in salary and pension related expenditure vis a vis GDP and completion of Agricultural Debt Waiver and Debt Relief Scheme for farmers, the growth in non-plan revenue expenditure has been moderated and the overall allocation has been brought down accordingly in BE 2011-12 to 8.2 per cent of GDP. This sharp reduction as percentage of GDP may also be seen in the context of very high rate of nominal growth in GDP witnessed during 2010-11. The challenge however remains to adhere to these allocations and not to resort to substantive augmentation through Supplementary Demands for Grants.

31. In absolute terms non-plan revenue expenditure has been estimated to increase from ₹7,26,749 crore in R.E.2010-11 to ₹ 7,33,559 crores in B.E.2011-12 reflecting growth of 1 per cent. The major items of non-plan revenue expenditure are detailed below.

(a) Interest payments

32. During the period 2004-05 to 2007-08, fiscal consolidation aided with lower interest rate regime had helped the government in bringing down interest payment as percentage of net tax revenue of Central Government to 38.8 per cent in 2007-08 from the high of 56.5 per cent in 2004-05. However, higher fiscal deficit during the crisis period, resulted in higher

interest outgo which coupled with moderation in net tax revenue, has increased the interest payment as proportion of net tax revenue to Centre to 46.7 per cent in 2009-10. With resumption of fiscal consolidation path by the Central Government, this percentage is estimated to improve to 40.3 per cent in BE 2011-12. This indicates that any slippage on fiscal front even for one or two financial years may lead to serious crowding out of resources for developmental expenditure in future as interest payment will elbow out other expenditures from government's net tax revenue. In the medium term outlook, this ratio is projected to further improve to 38.4 per cent and 36.1 per cent in 2012-13 and 2013-14 respectively. Interest payment as percentage of GDP is estimated to decline from 3.3 per cent in 2009-10 to 3.0 per cent in BE 2011-12 and 2.9 per cent by 2013-14. The risk associated with the above projections are significant change in interest rate in the coming years or larger than projected fiscal deficit for the corresponding period.

(b) Defence Services

33. Defence Services expenditure in revenue account is estimated to marginally increase from ₹90,669 crore in 2009-10 to ₹90,748 crore in RE 2010-11. The lower growth in this component is due to the additional requirements on account of implementation of the Sixth Central Pay Commission recommendations during 2009-10. It is estimated to increase to ₹95,217 crore in BE 2011-12 reflecting a growth of 4.9 per cent over RE 2010-11. As percentage of GDP, this component is estimated to reduce from 1.4 per cent in 2009-10 to 1.1 per cent in B.E. 2011-12.

(c) Major subsidies

34. It may be recalled that the expenditure on subsidies for food, fertilisers and petroleum products increased substantially during 2008-09. After including ₹95,942 crore of Special Securities issued to oil and fertiliser companies in lieu of cash subsidies, total expenditure on subsidies on these three items increased to ₹2,19,582 crore amounting to about 40 per cent of revenue receipts of the Government and about 4 per cent of GDP. This level of subsidy payment was certainly not sustainable and the Government undertook certain measures like introduction of nutrient based subsidy mechanism for fertilisers, deregulation of petrol pricing etc. Details of these measures are given in the Fiscal Policy Strategy Statement. These measures have helped in reducing the expenditure on major subsidies as percentage of GDP to 1.5 per cent in BE 2011-12 and it is projected to decline to 1.3 per cent by 2013-14. The medium term projection for subsidies has factored in 5 per cent year on year increase in absolute terms. The policy on subsidies has to be reworked along with reforms in delivery mechanism in order to not exceed the above mentioned projections. Any slippage on this account would impact the future fiscal consolidation process.

35. Government has firmly established the practice of providing petroleum and fertiliser subsidy in cash instead of securities. Government would like to continue with this practice of extending government subsidy in cash. This is a major step towards bringing in all subsidy related liabilities into Government's fiscal accounting and overall correction in subsidy outgo may be seen in this context.

36. The practice of providing working capital loan assistance to FCI on market linked rate has helped in reducing their reliance on high cost funds. This in turn has reduced the interest cost for providing food security. This practice will be continued in the coming years. FCI may look at the possibility of further rationalizing their administrative cost and States are being requested to join the De-centralised Procurement System in order to bring down the overall cost of delivering food security to the nation.

37. On the assumptions that current price level may prevail during 2011-12 in the world commodity markets and factoring in impact of reform measures, provision for fertiliser subsidy has been kept at ₹49,998 crore in B.E.2011-12. Food subsidy is estimated at ₹60,573 crore in B.E.2011-12. In BE 2011-12, petroleum subsidy including that to oil marketing companies to compensate for under recoveries are also provided at ₹23,640 crore.

38. In absolute terms provision for major subsides is estimated to decline from ₹1,53,962 crore in RE 2010-11 to ₹1,34,211 crore in BE 2011-12. Total Subsidies are estimated to decline from ₹1,64,153 crore in RE 2010-11 to ₹1,43,570 crore in BE 2011-12. The present level of subsidy provision is premised on the assumption that there would not be major variations in the international market in fertiliser and petroleum product prices during the entire span of 2011-12. At the same time, it is also assumed that the allotted quantity outgo under TPDS and procurement costs would by and large remain stable during the year. There is a need to focus on further measures and means to ensure the effective utilisation of these provisions and cap this expenditure to create further fiscal space for increased investment in physical and social infrastructure.

(d) Non-Plan Grants to States and UTs

39. In compliance with the recommendations of the 13th FC, non-plan grants have increased significantly from ₹45,947 crore in 2009-10 to ₹66,311 crore in B.E.2011-12. Under the following categories, grants have been recommended by the 13th FC and the same have been provided in BE 2011-12 and factored in the estimates for 2012-13 and 2013-14:

Post-devolution Non-plan Revenue Deficit (NPRD), Performance Incentive, Elementary Education, Improving Outcomes, Environment related, Road Maintenance, State-specific, Local Bodies, Disaster Relief and GST Implementation (not included in BE 2011-12 but factored in for 2012-13 and 2013-14).

40. The total grants recommended during 13th FC award period is ₹3,18,581 crore and is much higher than the grants recommended by the 12th FC. This coupled with recommended higher percentage of devolution of Central Taxes to States, would result in lower availability of revenue resources for the Central Government for its expenditure. Accordingly, it would impact the reduction in revenue deficit in the coming years during the 13th FC award period.

41. In 2010-11, the Central Government continued its commitment to compensate the State/UT Governments for loss of revenue that may arise on account of phasing out of Central Sales Tax (CST). A provision of ₹14,000 crore has been made in R.E. 2010-11 and ₹12,000 crore in B.E.2011-12 for this purpose.

42. Based on the recommendations of the 13th FC and likely other non-plan grants, total non-plan grants to States and UTs are estimated at 0.7 per cent of GDP in 2012-13 and 2013-14. These estimates also show that non-plan grant to States and UTs as percentage of tax revenue (net) to Centre has increased from 9.3 per cent in RE 2010-11 to 10 per cent in BE 2011-12.

(e) Pensions

43. Subsequent to the implementation of Sixth Pay Commission, expenditure on Pension has gone up significantly from ₹24,261 crore in 2007-08 to ₹56,149 crore in 2009-10. This increase was also due to the payments of arrear components arising on account of the pay commission recommendations. Pension expenditure, which was 5.5 per cent of tax revenue (net) to Centre and 0.5 per cent of GDP in 2007-08, has increased to 12.3 per cent and 0.7 per cent respectively in RE 2009-10. With the payments on arrears being completed in 2009-10, these percentages are estimated to come down to 8 per cent and 0.9 per cent in 2009-10. However, with payment of arrears being completed, these ratios are estimated to come down to 8.2 per cent and 0.6 per cent respectively in BE 2011-12.

44. With assumption that pension related expenditure may grow at 5 per cent in the coming years, it is estimated that pension payments would reduce to 0.5 per cent of GDP by 2013-14 and would decline to 6.5 per cent of net tax revenue to Centre in the same year. The assumption made above is associated with risk of large attrition rate in coming years which would result in higher than estimated expenditure in the coming years.

(B) Capital account

(i) Loans and advances

45. With States contracting domestic debt directly from the market, the net loans and advances are likely to decline in medium term. External loans to States however will continue to pass-through the Central Government.

46. Non-Plan loans are also extended to CPSUs for various purposes, including budgetary support for investments, restructuring/revival and Voluntary Retirement Scheme/Voluntary Separation Scheme.

(ii) Capital outlay

47. The total capital expenditure is estimated at ₹1,60,567 crore in BE 2011-12. Of this, Plan capital expenditure is estimated to increase from ₹49,507 crore in 2009-10 to ₹68,096 crore in RE 2010-11 and ₹77,943 crore in BE 2011-12 reflecting average growth of 25.5 per cent in the two years period. Most of the capital expenditure for the overall government system are being accounted in the Central Government accounts as grants for creation of capital assets under the Revenue Account. This under depicts the capital investment undertaken at the general government level. Hence for better and more transparent presentation of data, the entre expenditure under grants for creation of capital assets are shown in a separate Statement in Annex-6 of Expenditure Budget, Volume-1. In the current scenario when capital market has become deep and robust and when many of the capacity addition in the form of capital expenditure is taking place under the Public Private Partnership mode, Central Public Sector Undertakings (CPSUs) have been meeting a large part of their capital expenditure through Internal and Extra Budgetary Resources (IEBR). The IEBR of CPSUs (including Railways) is estimated to increase by 26.2 per cent from ₹2,03,638.08 crore in R.E. 2010-11 to ₹2,56,935.99 crore in B.E. 2011-12.

48. Non-plan capital expenditure primarily consists of defence expenditure. Defence capital expenditure is estimated to increase from ₹60,833 crore in

RE 2010-11 to ₹69,199 crore in B.E.2011-12. However, the overall non-plan capital expenditure is estimated to decline from ₹94,802 crore in RE 2010-11 to ₹.82,623 crore. This reduction is primarily on account of inclusion of some items of capital expenditure like equity infusion in Public Sector Banks etc. under Plan expenditure for accurte presentation of data. The reduction in BE 2011-12 is also due to provision of ₹5,000 crore in RE 2010-11 as short term loans to FCI to augment their working capital requirement. It is also due to completion of agricultural debt waiver and debt relief scheme.

4. GDP Growth

49. There is further revision in the base year for the calculation of National Income by the Central Statistical Office (CSO) after the presentation of Budget 2010-11. With this change, historical estimates for GDP have undergone change with effect from 2004-05. The revised series of data shows that during the year 2009-10 annual real GDP growth at factor cost (at constant 2004-2005 prices) has increased to 8.0 per cent as compared to the growth rate of 6.8 per cent during 2008-09. The latest release of data from CSO puts the growth rate for 2010-11 at 8.6 per cent in real term and after factoring in inflation expectation, the GDP growth (at current market prices) for 2010-11 is estimated at 20.3 per cent. Thus the GDP for the year 2010-11 (at current market prices) is set at ₹78,77,947 crore. In the year 2011-12, with the assumption that economy will continue to accelerate to the trend growth rate, the real GDP growth has been assumed at 9.0 per cent. After factoring in estimated inflation of 5 per cent during 2011-12, the GDP growth (at current market prices) for 2011-12 is estimated at 14.0 per cent resulting in GDP of ₹89,80,860 crore (at current market prices). For the period 2012-13 and 2013-14, after factoring in medium term inflation expectation, the GDP growth at current market prices is projected at 13.5 per cent for 2012-13 as well as 2013-14.

C. Assessment of sustainability relating to

(i) The balance between Revenue Receipts and Revenue Expenditure

50. The balance in the revenue account has to be seen in the context of consolidated account of three tier of government i.e. Centre, State and Local Bodies. This is all the more relevant in Indian context as large sum of inter government transfer takes place from Centre to States and States to Local Bodies. This distorts the true depiction of revenue account as one looks at the fiscal account of different tiers of the government in an isolated manner. The present information system provides collated data at the Centre and State level with a lag. However, it would not be incorrect to analyse how much of imbalance in revenue account of the Central government is arising on account of transfers made in the form of grant for the creation of capital assets to the other tiers of government as well as other grantee bodies. This exercise has been undertaken for BE 2011-12 and it explains in a better manner about what is the effective imbalance in revenue account that the government needs to address in right earnest. After taking into account expenditure in revenue account in the form of grants for creation of capital assets, which is of the order of 1.6 per cent of GDP in BE 2011-12, the effective revenue deficit of the Central Government comes down from 3.4 per cent (as per the technical definition) to 1.8 per cent of GDP in BE 2011-12. It will be the endevour of the government to eliminate this deficit in a time bound manner. With the projected level of expenditure for 2012-13 and 2013-14, along with the assumption that the above mentioned grant will increase in medium term at not less than 10 per cent, the effective revenue deficit is estimated to come down to 0.5 per cent of GDP in 2013-14. Policy initiatives and administrative efficiency can make the target of eliminating effective revenue deficit by 2013-14 achievable.

(ii) The use of capital receipts including market borrowings for generating Productive Assets.

51. Non-plan expenditure at 126 per cent of total revenue receipts during 2009-10 has resulted in use of borrowed resources for consumptive expenditure. This brings us back to the issue of structural problems in the composition of expenditure which, if not addressed, will further squeeze out the fiscal space for undertaking developmental works. The Government has addressed these issues in right earnest while formulating the strategy for 2011-12. With focus on curtaining growth in non-plan expenditure, the above mentioned percentage is estimated to decline to 103 per cent in BE 2011-12. With further reallocation of resources towards priority sectors, it is projected to decline to 90 per cent of total revenue receipts in 2013-14.

52. In B.E.2011-12 the total Plan expenditure of ₹4,41,547 crore is about 107 per cent of the estimated fiscal deficit. This was only 72 per cent of the fiscal deficit during 2009-10. This shows a significant improvement in deployment of borrowed resources. The Government will make further efforts for not using debt receipts for financing non-plan expenditure particularly non-plan revenue expenditure. The endeavour will be to bring down the ratio of debt to GDP and interest payment to net tax revenue of Centre gradually to a sustainable level and use the borrowed funds judiciously.

Annexure - I

COMPARISON OF MTFP WITH 13th FINANCE COMMISSION FISCAL ROADMAP

	2010-11	2011-12	2012-13	2013-14
Fiscal Deficit				
MTFP	5.1	4.6	4.1	3.5
13th FC	5.7	4.8	4.2	3.0
Revenue Deficit#				
MTFP	3.4	3.4	2.7	2.1
13th FC	3.2	2.3	1.2	0.0
Debt*				
MTFP	45.3	44.2	43.1	41.5
13th FC	53.9	52.5	50.5	47.5

** Excluding NSSF Loans to States, Loans under MSS and accounting for external debt at current exchange rate.*

 # Difficulties in adhering to the targets for revenue deficit are explained in para 50 above and section C of Fiscal Policy Strategy Statement.