FISCAL POLICY STRATEGY STATEMENT

A. FISCAL POLICY OVERVIEW

1. Global economic situation during 2008-09 and 2009-10 impacted the performance of emerging market economies and India was no exception. The swift revival during 2010-11, wherein Indian economy grew at 8.4 per cent on the base of similar growth in 2009-10, showed that resilience of Indian economy in steering through difficult international scenarios have further improved. However, continuance of the financial crisis in Euro Zone coupled with exogenous shocks like increase in the international crude prices brought out the vulnerability of Indian economy towards global events back to the forefront. Growth in Indian economy is estimated to moderate to 6.9 per cent in 2011-12 as against the earlier estimate of 9 per cent at the time of presentation of Budget 2011-12. Details of the growth scenario have been enumerated in the Macro-economic Framework Statement.

2. The moderation in growth coupled with sticky inflation at much higher than the comfort level necessitated a change of stance in fiscal policy of the government. The process of fiscal consolidation which resumed in 2010-11 had to be paused once again during 2011-12. However, this change in policy would be temporary in nature and government is committed to get back to the path of fiscal consolidation. While the economy is estimated to register growth of about 7.6 per cent during 2012-13 which is lower than the potential growth rate, yet government has come up with a revised fiscal roadmap with gradually reducing fiscal deficit in coming yea₹

3. The change in fiscal policy stance during 2011-12 should be seen against the backdrop of some significant changes in the macro-economic parameters in the Indian and world economy during 2011. First is the issue of international crude prices; while it was hovering around US $ 85 to 90 per barrel at the time of presentation of Budget 2011-12, it went up sharply and remained sticky at about US $ 110 to 115 per barrel during most part of the calendar year 2011. Presently, it is well above US $ 120 per barrel. In tandem with high crude price, prices of most of the petroleum products in the international market went up sharply. As India imports bulk of its crude requirements and the pricing of petroleum products by oil marketing companies (OMCs) for the purpose of calculating under-recoveries are benchmarked to the international prices, there was significant increase in the estimated under-recovery of OMCs. With high level of prevailing inflation, it was felt that pass through of high international prices to retail level would compound the problem of inflation. The government therefore decided to lower the tax incidences on these products. Along with partial increase in retail prices of petroleum products during June 2011, the under-recoveries of the OMCs were reduced to some extent. Though this intervention reduced the under-recoveries of OMCs, government had to give tax concession to the extent of ₹36,750 crore for the remaining part of fiscal 2011-12. After factoring in States' Share in Central Taxes, the net revenue loss for the Central Government was of the order of ₹26,000 crore. Even with this relief, government had to provide additional ₹45,000 crore in RE 2011-12 for the compensation to OMCs for under-recoveries. Thus the total slippage on account of petroleum sector alone was of the order of ₹71,000 crore amounting to 0.8 per cent of GDP.

4. Secondly, high inflation scenario persisting in the domestic economy had influenced the decision to keep the input prices for farmers under check and accordingly provision for fertiliser subsides have been increased by ₹17,201 crore in RE 2011-12 over BE 2011-12. Provision for food subsidy has also been increased by ₹12,250 crore during the year. The above three subsidy items taken together had a combined impact of ₹1,00,451 crore accounting for slippage of 1.1 per cent of GDP in fiscal deficit during 2011-12.

5. Thirdly, growth in economy which was robust at 8.4 per cent during 2009-10 as well as 2010-11, started showing signs of moderation as it grew at 7.7 per cent, 6.9 per cent and 6.1 per cent in the first three quarters of 2011-12 respectively. It is estimated that Indian economy would grow at 6.9 per cent during 2011-12. This drop in growth rate has impacted the direct tax collection and there is estimated shortfall of ₹32,000 crore from the BE 2011-12 level in RE 2011-12. This would result in shortfall of about ₹22,800 crore in the net tax revenue for Centre amounting to 0.3 per cent of GDP. Lastly, while Indian economy was already showing signs of moderation, the grim outlook for world economy and the prevailing uncertainty in Euro Zone added volatility to the Indian capital market. Government had to recalibrate its disinvestment programme and accordingly ₹13,895 crore has been estimated in RE 2011-12 as against BE of ₹40,000 crore.

6. The above items taken together would have resulted in overall slippage of about ₹1,49,356 crore amounting to 1.7 per cent of GDP. However, with savings in other expenditure and better than estimated receipts from Service Tax, fiscal deficit is estimated to increase by 1.3 per cent of GDP to 5.9 per cent of GDP in RE 2011-12. Revenue deficit is estimated to increase by 1 per cent of GDP from the earlier estimated level of 3.4 per cent of GDP in BE 2011-12 to 4.4 per cent of GDP in RE 2011-12.

7. Though fiscal deficit increased by 1.3 per cent of GDP, debt and liabilities of the Central Government is estimated to reduce marginally to 45.7 per cent in RE 2011-12 from 46.0 per cent in 2010-11. This reduction is largely on account of higher than estimated growth in nominal GDP during 2011-12. Also, the comparison with last year's performance when fiscal deficit was 4.9 per cent of GDP may be seen in the context of government having the benefit of higher than estimated non-tax revenue of about 0.9 per cent of GDP from auction of 3G & BWA spectrum during 2010-11. The fiscal deficit, net of this additional receipt, would have been at 5.8 per cent of GDP in 2010-11.

8. The windfall gain in the form of auction proceeds from 3G and BWA spectrum during 2010-11 had not only helped in bringing down the fiscal deficit for 2010-11, it also helped in taking certain decisions which resulted in avoidance or reduction of debt by ₹48,218 crore. This mainly includes (a) reduction in market borrowings through dated securities by ₹ 20,000 crore, (b) buy back of fertilizers bonds amounting to ₹ 11,795 crore issued in lieu of subsidy, (c) redemption of liability to National Small Savings Fund (NSSF) by ₹ 9,000 crore, and (d) reduction in estimated loans from IBRD for recapitalization of Public Sector Banks by ₹5,400 crore. This avoidance or reduction in debt works out to 68 per cent of the receipts in excess of estimates from the auction of 3G and BWA spectrum.

9. The decline in tax to GDP ratio coupled with higher expenditure brought out the problems of structural imbalance in fiscal account. Though part of this imbalance is cyclical in nature, however a large proportion of the increase in fiscal deficit could be attributed to structural problems. The Medium Term Fiscal Policy Statement brings out in detail the strategy of the government to reduce the fiscal deficit gradually closer to the existing mandated level under the FRBM Act and Rules. However, the revenue deficit as percentage of GDP is estimated to remain well above the present mandated level. This must however be seen in the context of bringing in all subsidy related expenditure into the government's fiscal accounting. It may be recalled that the Government had made a conscious effort to avoid issuing Government securities in lieu of cash subsidies to oil and fertiliser companies. This trend of extending Government subsidy in cash rather than by way of bonds has been continued despite adverse fiscal situation.

10. Government is determined to bring the deficit down to a more sustainable level and at the same time re-orient government expenditure towards priority sectors like health, education, irrigation with added focus on infrastructure and investment related activities. The fiscal policy of the government for the ensuing year would be guided by the above principle. To reinforce its commitment towards fiscal consolidation with reorientation in resource allocation as mentioned above, Government is bringing out amendment in the FRBM Act, 2003 as part of Finance Bill, 2012.

FRBM Act Amendment

11. It may be recalled that government had outlined its intention to bring out amendment in the FRBM Act during 2011-12. The rule based legislation for fiscal consolidation had helped India in achieving lower deficit and in turn lower debt as percentage of GDP during 2004-05 to 2007-08. Gaining from this experience, the present set of amendments further aim to bring out consistency in the conduct of government's fiscal policy with shifting of priority towards quality of expenditure and not only reduction of deficit. The most important part of the proposed amendment is to give statutory recognition of the concept of *effective revenue deficit* which was introduced in the Budget for 2010-11. This is defined as the difference between revenue deficit and grants for creation of capital assets.

12. Effective Revenue Deficit reflects the structural component of imbalance in the revenue account. In a federal set up like India, large amount of transfer of resources from the Central Government takes place to States, local bodies and other scheme implementing agencies who are mandated to provide certain services. All of such transfers are shown as revenue/ current expenditure in the books of Central Government. However, significant proportion of such transfers is specifically meant for creation of capital assets which are public goods in nature. In the present scheme of things, most of the public goods are being provided by States and sector specific bodies. Central Government's role is limited to augmenting or providing resources to these institutions as it can't create these infrastructures directly (e.g. State or rural

roads; irrigation infrastructure; power generation, transmission and distribution facilities; telecommunication networks, major ports or airports etc.). Since the Central Government does not own these assets, the resources transferred even for creation of physical infrastructure are shown as revenue expenditure.

13. In the present Act, when it is mandatory to eliminate revenue deficit, the pressure is to reduce revenue expenditure which also includes the above mentioned transfe₹ With the structural rigidity associated with certain components of revenue expenditure namely, salary and pension payments, interest payment, statutory grants to States; reduction or squeeze on revenue expenditure in the medium term will most likely be on discretionary items like transfer for creation of capital assets. This approach may lead to overall reduction in investment related expenditure in the economy and certainly this is not the desired objective of the existing Act.

14. With the introduction of the concept of effective revenue deficit and by mandating its elimination by March 2015, government would address the structural component of imbalance in the revenue account, namely, consumptive expenditure, in the right earnest without sacrificing development related expenditure. Coupled with fiscal deficit target, this fiscal indicator would ensure allocation of borrowed resources in productive sector through creation of capital assets and at the same time would bring the debt and liabilities as percentage of GDP to a more sustainable level. The emphasis to eliminate effective revenue deficit by 2014-15, and generate adequate surplus thereafter would help in augmenting resources for financing investment and capital expenditure (including grants for creation of capital assets). In the rolling targets for select fiscal indicators, this component has been included in the Medium Term Fiscal Policy Statement.

15. The second important feature of the proposed amendment is the introduction of Medium-term Expenditure Framework Statement along with the existing three FRBM statements. This new statement would provide certainty of allocation to Ministries and Departments over three year time frame. This would help Ministries/Departments in undertaking de-novo exercise for allocating resources on prioritized schemes and weeding out such schemes which have outlived their utility. This statement would set forth a three year rolling target for expenditure indicators with specification of underlying assumptions and risk involved.

16. The Budget 2012-2013 is being presented when the growth scenario for the world economy is still uncertain and problems of high crude prices have further aggravated due to geo-political situation in some of the oil producing countries. Notwithstanding the above uncertainties, government has made efforts in BE 2012-13 to once again kick start the growth revival without losing sight of fiscal consolidation. On one hand the government has to ensure that the revival of economy is aided through policy actions and at the same time the fiscal policy has to be balanced with concerns on inflation and high policy rates impacting investment. With 2012-13 being the first year of the Twelfth Five Year Plan, efforts have been made to provide adequate resources for health, education, irrigation and other infrastructure secto₹ At the same time, growth in subsidy related expenditure is proposed to be contained within sustainable levels.

B. FISCAL POLICY FOR 2012-13

17. The fiscal policy of 2012-13 has been calibrated with two fold objectives – first, to aid economy in growth revival; and second, to bring down the deficit from 2011-12 level so as to leave space for private sector credit as the investment cycle picks up. Being the first year of the 12th Five Year Plan, an ambitious outlay which is 22.1 per cent higher than RE 2011-12 has been provided. Even with higher increase in plan allocation, fiscal deficit has been reduced from 5.9 per cent of GDP in RE 2011-12 to 5.1 per cent in BE 2012-13. With policy measures, it is estimated that non-plan expenditure could be controlled with a growth of 8.7 per cent in BE 2012-13 over RE 2011-12. This would result in overall expenditure increase of 13.1 per cent in BE 2012-13 over RE 2011-12. As percentage of GDP, total expenditure is estimated to marginally reduce to 14.7 per cent in BE 2012-13 from 14.8 per cent in RE 2011-12.

18. Thus most of the correction in fiscal deficit has been targeted through revenue augmentation. It may be recalled that gross tax revenue as percentage of GDP declined sharply from high of 11.9 per cent in 2007-08 to 9.7 per cent in 2009-10. It is now estimated to increase from 10.1 per cent of GDP in RE 2011-12 to 10.6 per cent in BE 2012-13 (reflecting growth of 19.6 per cent over RE 2011-12). This level of growth may look ambitious if seen in isolation. However, after netting off the impact of additional resource mobilization proposed in indirect taxes, BE 2012-13 is estimated at a growth of 15.0 per cent over RE 2011-12.

19. In order to keep the overall expenditure under the estimated level, government has taken certain decisions to control the growth of expenditure in subsidies and other related items. Decision of the Government on move towards nutrient based subsidy (NBS) regime in fertiliser is expected to reduce expenditure on this component of fertilser subsidy during 2011-12. At the same time, NBS regime is also expected to promote balanced use of fertilizer leading to increase in agricultural productivity.

20. With respect to rationalization of petroleum subsidy, government has already decontrolled the pricing of petrol. With the help of AADHAAR (unique identity programme), it would be possible to attempt a direct cash transfer mechanism in phased manner for LPG and kerosene which in turn may reduce the subsidy requirement. States have been given this option to opt for direct cash transfer mechanism. Though in principle decision regarding decontrol of diesel price has been taken, the implementation of this decision has not yet not taken place in view of prevailing high international prices.

Tax *Policy*

21. During the fiscal consolidation period, the tax-GDP ratio improved significantly from 9.2 per cent in 2003-04 to 11.9 per cent in 2007-08. This was achieved through rationalisation of the tax structure (moderate levels and a few rates), widening of the tax base and reduction in compliance costs through improvement in tax administration. The extensive adoption of information technology solutions and re-engineering of business processes have also fostered a less intrusive tax system and encouraged voluntary compliance. These measures have resulted in increased buoyancy in tax revenues till 2007-08 and helped in fiscal consolidation. However, due to the stimulus measures undertaken during the crisis period of 2008-09 and 2009-10 to insulate Indian economy from the adverse impact of global economic crisis and lower growth in economy, the gross tax revenue as percentage of GDP declined sharply to 9.7 per cent in 2009-10.

22. On the positive side, however, the results of these stimulus measures have helped in swift and broad based recovery, particularly in manufacturing and services sector during 2010-11. With the moderation in growth in 2011-12 and prevailing high inflation situation, government had to further reduce taxes/duty on petroleum products. During 2011-12, gross tax receipts as percentage of GDP is estimated to decline to 10.1 per cent from 10.3 per cent in 2010-11. However, with partial roll back of stimulus measures in indirect taxes, it is estimated that tax receipt as percentage of GDP would improve to 10.6 per cent.

Indirect taxes

23. In keeping with the overall thrust of fiscal policy, in the realm of indirect taxes too, the stance during 2012-13 would be in favour of further fiscal consolidation. This agrees with the medium term objective of enhancing the tax-GDP ratio both through base expansion as well as administrative improvement. Among the latter, the emphasis is on more intense deployment of Information Technology in business processes so that physical interface between the taxpayer and the Department is reduced and return data critical for developing compliance strategies and interventions is captured and updated seamlessly.

24. In the medium term, the most significant step from the point of view of broadening the tax base and improving revenue efficiency through better compliance is the introduction of Goods and Services Tax (GST). As far as Central taxes viz. Central Excise duties and Service Tax are concerned, a fair amount of integration has already been achieved, especially through the cross-flow of credits across the two taxes. Further measures such as adoption of a common return format are proposed in the Budget. It would be possible to realise full integration of the taxation of goods and services only when the State VAT is also subsumed and a full-fledged GST is launched. The Constitution Amendment Bill to put in place the enabling legal framework has already been introduced in the Lok Sabha and is currently being examined by the Standing Committee on Finance. In the meanwhile, the dialogue with the State Governments for finalizing the structure, design and roadmap for the implementation of GST would continue.

25. There are several specific proposals in the Budget 2012-13 to recalibrate the tax effort on indirect taxes so that fiscal consolidation may be achieved in the short term. The important and revenue significant proposals include:

- Shift from a “positive” list approach to a “negative” list approach in the taxation of services;
- Review and withdrawal of several exemptions from service tax;
- Enhancement in the standard rate of Service Tax from 10% to 12%;

- Increase in the standard rate of excise duty from 10% to 12% by way of partial roll back of the fiscal stimulus (provided in 2008-09);
- Increase in the merit rate of excise duty from 5% to 6% and lower merit rate from 1% to 2% (except coal, fertilisers and precious metal jewellery);
- Increase in excise duty on cars –both small and large, MUVs, SUVs etc.;
- Increase in excise duty on "demerit" goods such as cigarettes, bidis, and other tobacco products;
- Rationalisation of the scheme of levy/ rate structure applicable to precious metal jewellery and chassis for automobiles;
- Increase in the rate of cess on indigenously produced crude petroleum from ₹2500 per tonne to ₹4500 per tonne.

26. Measures proposed to contain the Current Account Deficit such as enhancement in customs duty on standard gold bars and platinum bars from 2% to 4% may also have a favourable impact on revenue collections in the immediate future.

Direct Taxes

27. The policy in the case of direct taxes has been to achieve growth while maintaining moderate rates of tax. To this end, the initiative has been to reduce the tax revenue foregone on account of exemptions and deductions. This has been attempted primarily through the gradual phase out of profit linked deductions and the levy of Minimum Alternate Tax (MAT) on all companies to ensure a minimum level of tax contribution by all sectors. The other aspect of this policy has been to use information technology to widen the reported tax base, e.g., electronic filing of annual information returns regarding third party transactions, in order to ensure the reporting of major financial transactions for tax purposes. Electronic filing of income tax returns and tax deduction at source statements as well as e-payment of taxes is also a part of this strategy in order to more effectively monitor taxpayer compliance, besides reducing the compliance burden of tax payers The current direct tax legislation is proposed to be simplified and consolidated through the Direct Taxes Code Bill 2010 which was introduced in Parliament in August 2010. The Standing Committee on Finance has recently (on 9th March 2012) submitted its report on the Bill which will now be examined for appropriate action.

28. The major policy proposals in the Union Budget 2012-13 intended to broaden the tax base are:

- Introduction of Alternate Minimum Tax (AMT) at the rate of 18.5 per cent on all persons (other than companies) claiming profit linked deductions;
- Introduction of a General Anti-Avoidance Rule to deter aggressive tax avoidance schemes;
- Introduction of compulsory reporting requirement in case of assets held abroad;
- Allowing for reopening of assessment upto 16 years in relation to assets held abroad;
- Tax collection at source on purchase in cash of bullion or jewellery in excess of ₹ 2 lakh;
- Tax deduction at source on transfer of immovable property (other than agricultural land) above a specified threshold;
- Tax collection at source on trading in coal, lignite and iron ore;
- Increasing the burden of proof on closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value;
- Taxation of unexplained money, credits, investments, expenditures etc., at the highest rate of 30 per cent irrespective of slab of income;
- Strengthening penalty provisions for undisclosed income found during search;
- Streamlining and strengthening of prosecution provisions under the Income Tax Act.

29. The administrative and information technology initiatives are:

- Centralised Processing Centre for the computerised processing of tax deduction at source (TDS) statements. This initiative follows from the Centralised Processing Centre at Bengaluru which currently processes all electronically filed income tax returns.
- Besides the 50 taxpayer help centres called Aayakar Seva Kendras (ASKs) functional in this year, another 100 ASKs will be commissioned in the coming financial year.

- Payment of taxes through Automatic Teller Machines (ATMs) and all India coverage of the Refund Bankers Scheme for refund of direct taxes has already been introduced in the current year.

30. The direct tax buoyancy in the last four years has been less than one mainly on account of higher inflation. The major challenge, therefore, for direct tax collections in the medium term is to maintain buoyancy in the face of lower profitability of companies owing to higher rate of inflation while maintaining moderate rates of tax.

Contingent and other Liabilities

31. The FRBM Act mandates the Central Government to specify the annual target for assuming contingent liabilities in the form of guarantees. Accordingly the FRBM Rules prescribe a cap of 0.5 per cent of GDP in any financial year on the quantum of guarantees that the Central Government can assume in the particular financial year. The Central Government extends guarantees primarily on loans from multilateral/bilateral agencies, bond issues and other loans raised by various Public Sector Undertakings/Public Sector Financial Institutions.

32. For better management of contingent liabilities, government guarantee policy had been released during 2010-11. It enumerates various principles which need to be followed before new contingent liabilities in the form of sovereign guarantees are undertaken. These principles inter alia include assessment of risk and probability of devolvement, institutional limits on guarantees for limiting exposure towards select sectors and requirement of guarantee vis a vis other forms of budgetary support or comfort. Additional measures to further streamline the process of assuming risk could include charging of risk based premia, disincentive for wilful default, only part sharing of risk by the government and insisting on guaranteed debt cost to be near the bench marked government securities rate.

33. The stock of contingent liabilities in the form of guarantees given by the government has increased in absolute terms from ₹1,07,957 crore at the beginning of the FRBM Act regime in 2004-05 to ₹1,51,292 crore at the end of 2010-11. However, as a percentage of GDP, it has reduced from 3.3 per cent in 2004-05 to 2.0 per cent in 2010-11. The disclosure statement on outstanding Guarantees as prescribed in the FRBM Rules, 2004 is appended in the Receipts Budget as Annex 5 (iii).

34. During the year 2010-11, gross addition in guarantees was ₹22,745 crore amounting to 0.30 per cent of GDP which was well below the mandated target of 0.5 per cent of GDP set under the FRBM Rules. Further, net addition in guarantees during 2010-11 was ₹13,428 crore amounting to 0.2 per cent of GDP.

Government Borrowings, Lending and Investments

35. With the objective of improving transparency in dissemination of information related to public debt, the second edition of Status Paper on Government Debt was brought out in March 2012. Government is committed to implement prudent debt management strategies so as to ensure that the public debt remains within sustainable limits and does not crowd out private borrowing for investment. The policy of the Government is driven by the principle of gradual reduction of public debt to GDP ratio so as to further reduce debt servicing risk and create fiscal space for developmental expenditure. On the financing side, the Government policy continues to remain anchored on the following principles, namely (i) greater reliance on domestic borrowings over external debt, (ii) preference for market borrowings over instruments carrying administered interest rates, (iii) consolidation of the debt portfolio and (iv) development of a deep and wide market for Government securities to improve liquidity in secondary market.

36. One of the key public debt management reforms under implementation is the establishment of a Debt Management Office (DMO) in the Ministry of Finance. It is proposed to introduce necessary legislation in this regard in the Budget session for 2012-13. Middle office, which was established as a prelude to functional DMO, is bringing out various reports and information with respect to public debt. The debt issuance calendar along with selection of instruments for issuance is now being done in consultation with Middle Office and RBI.

37. Committee on Small Savings which was constituted in July 2010 has given its recommendations regarding review of the existing parameters for the small saving schemes in operation and recommended mechanisms to make them more flexible and market linked. The Committee also reviewed the existing terms of the loans extended from the NSSF to the Centre and States and recommended changes in the arrangement of lending the net collection of small savings to Centre and States along with other possible investment opportunities for the net collections from small savings and the repayment

proceeds of NSSF loans extended to States and Centre. The recommendations of the Committee were considered in detail and certain decisions were taken which would change the administration of NSSF in coming yea₹ Based on the recommendation of the above Committee, the rates on small saving instruments have been aligned with the prevailing market rates with effect from 1st December, 2011.

38. During 2011-12, there was a significant shortfall in small savings collection when compared to Budget Estimates 2011-12. Lower collection during the latter part of 2010-11 created a cash shortfall in NSSF and impacted Government's closing cash balance in March 2011. Due to the above shortfall, government deficit financing was impacted during 2011-12. The estimated shortfall would be ₹34,484 crore in financing from National Small Savings Fund (NSSF) in RE 2011-12 when compared to BE 2011-12. Further, ₹20,000 crore which was estimated as cash draw-down in the financing of deficit for 2011-12 is not available as NSSF ended in cash deficit.

39. Due to the combined impact of above shortfalls and increase in fiscal deficit by ₹1,09,163 crore in absolute terms in RE 2011-12 over BE 2011-12, Government had to increase the net market borrowings through dated securities and auction treasury bills by ₹93,000 crore and ₹1.01 lakh crore respectively. This level of additional borrowing would also take care of emerging cash requirements during the first quarter of ensuing year (2012-13) when the redemptions of existing debt stock is of higher level.

40. During 2011-12, gross and net market borrowings of the Central Government through dated securities are at ₹5.10 lakh crore and ₹4.36 lakh crore respectively as compared to ₹4.37 lakh crore and ₹3.25 lakh crore respectively during 2010-11. The weighted average maturity of dated securities issued during 2011-12 at 12.66 years is higher than 11.62 years during 2010-11. Reflecting the impact of increase in policy rates and higher amount of borrowing, the weighted average yield of issuance during 2011-12 has increased to 8.52 per cent from 7.92 per cent during 2010-11.

41. The debt financing strategy for 2012-13 has been formulated with continued reliance on domestic dated securities market. Along with other components of financing, fiscal deficit of ₹5,13,590 crore is proposed to be financed to the extent of ₹4,79,000 crore (amounting to 93.3 per cent of deficit) through issuance of dated securities, ₹12,000 crore (2.3 per cent of deficit) through net proceeds from State Provident Funds, ₹9,000 crore through Treasury Bills (1.8 per cent of deficit) and ₹10,148 crore through external debt (2.0 per cent of deficit).

42. Proportion of external debt in the Central Government debt has declined consistently in the recent years from 10 per cent in 2005-06 to 7.9 per cent in 2010-11. With gradual decline in net inflow from Multilateral Institutions in the coming years (in view of their exposure norms and income norms), government would have the option of exploring other sources of external debt in the form of sovereign bond issuance to maintain a reasonable mix of domestic and external debt in its portfolio.

43. There is no balance estimated at the end of financial year 2011-12 under Market Stabilisation Scheme (MSS). Net accretion in MSS to the tune of ₹20,000 crore is estimated for BE 2012-13.

44. With the above projected financing, debt and liabilities of the Central Government is estimated to decline to 45.5 per cent of GDP in BE 2012-13 from 45.7 per cent of GDP in RE 2011-12. In the medium term outlook, as projected in the MTFP Statement, debt and liabilities of the Central Government is projected to decline to 44.0 per cent in 2013-14 and 41.9 per cent in 2014-15, well below the 13th FC recommended target of 44.8 per cent for the year 2014-15.

45. Recent experience in sovereign debt management has shown that analysis of sovereign debt sustainability should not be merely based on the classical definition of principles related to Primary deficit along with differential in interest and growth rate. It should factor in some of the important parameters of the debt and macro-economic situation such as maturity profile, composition, carrying cost, external or domestic investor base along with savings rate, potential and realised tax to GDP ratio. The characteristics of existing debt stock and economic parameters in the case of India such as high domestic savings rate, longer residual maturity, fixed rate of interest on bulk of the existing stock, higher proportion of domestic currency denominated debt and wide gap between potential and realised tax to GDP ratio, put India in a better position when compared to equally or even lower level of indebted economies.

46. With regard to future financing scenario, an analysis presented in the Debt Status Paper released in March 2012, shows that Central Government would be able to raise debt of the order of 4.9 per cent of GDP in 2012-13 and in the range of 4.2 per cent to 4 per cent of GDP during the coming years through dated securities. This augurs well as more resources

could be released from the banking system towards private sector, as the above financing analysis has assumed gradual reduction in Statutory Liquidity Ratio (SLR) requirement.

47. The shift in policy on the uses of disinvestment proceeds from Central PSUs received under the National Investment Fund (NIF) will continue for the year 2012-13. The disinvestment proceeds estimated at ₹30,000 crore in BE 2012-13 have been reckoned as resources for the purpose of financing the social sector programmes which are creating capital assets. The income from investments made from proceeds received upto 2008-09 under NIF would continue to be used to finance social infrastructure and to provide capital to viable public sector enterprises without depleting the corpus of NIF. During 2010-11 and 2011-12, when the earlier NIF modality was kept in abeyance, government is estimated to raise disinvestment proceeds of ₹36,039 crore. Incidentally, during the same period, Government is estimated to invest ₹36,316 crore in capitalization of public sector banks, regional rural banks and other financial institutions including NABARD.

Initiatives in Public Expenditure Management

48. Central Plan Scheme Monitoring System (CPSMS) is an initiative towards establishing a suitable on-line management information and decision support system. It is proposed to expand the Scheme of Central Plan Scheme Monitoring System (CPSMS). This would improve the tracking of funds released by the Central Government and also ensure better utilisation of borrowed resources. This MIS tracks deployment/transfer of funds as well as their utilization through all tiers of implementing agencies and in some cases upto the end beneficiaries. The real time availability of information on status of fund utilization and balances in respective bank accounts will enable better cash management system with timely release of adequate funds and avoidance of parking of funds without actual requirement. While ensuring reduced cost of carrying borrowed fund, it would also improve accountability as people can access information about a particular scheme in their respective areas.

49. In order to have more effective monitoring of deployment of resources and a robust Public Financial Management System, a need has been felt to review the present classification of government transactions. Accordingly, a committee under the Chairmanship of the Controller General of Accounts which was formed to conduct a comprehensive review of the existing system and suggest a new system keeping in view the needs of better presentation of data across national and sub-national governments and improved reporting of transfer payments from one level of government to another. The committee has submitted its report. It has recommended to replace the existing six tier hierarchical structure into separate logical dimensions for depicting administrative responsibility, functional classification for macro level planning, recipient categories, intended beneficiaries and geographical location. Government is examining the proposed change in structure in consultation with various stakeholders including State Governments.

50. The quarterly exchequer control based cash and expenditure management system which inter alia involves preparing a Monthly Expenditure Plan (MEP) is being expanded from existing 23 Demands for Grants during 2011-12 to additional 23 Demands for Grants with effect from 2012-13. Initiatives have also been taken with the MIS system from e-lekha to evenly pace the plan expenditure during the year and also to avoid rush of expenditure at the year end. The practice of restricting the expenditure in the month of March to 15 per cent of budget allocation within the fourth quarter ceiling of 33 per cent is being enforced. The emphasis is on right pacing plan expenditure by ensuring adequate resources for execution of budgeted schemes.

51. While designing programmes and schemes for the XIIth Five Year Plan, government would get benefit from the recommendations of the Expert Committee to streamline various Centrally Sponsored Schemes and reduce their number only to the critical areas. Further, the recommendation of the Expert Committee on the issue of plan and non-plan classification is being examined. Also, its recommendation regarding direct releases to State Treasury merits consideration for various Centrally Sponsored Schemes.

C. POLICY EVALUATION

52. Budget 2011-12 was presented against the backdrop of robust revival of growth in Indian economy. Indian economy was estimated to grow at 9 per cent over the then estimated growth of 8.5 per cent in 2010-11. However, after budget presentation, happenings around the globe including hardening of

global crude prices and sticky high inflation scenario in the domestic economy, forced the government to make necessary changes in policy during 2011-12 to address the emerging challenges.

53. Fiscal deficit which was estimated at 4.6 per cent of GDP in BE 2011-12 has increased to 5.9 per cent of GDP in RE 2011-12. This increase in deficit could be attributed to moderation in growth, which impacted direct tax collection and high inflation necessitating additional expenditure on food, fertilizer and petroleum subsidies. In the budget 2012-13, Government is addressing the two main reasons of slippage by controlling rise in subsidy related expenditure and improving tax receipts as percentage of GDP through additional resource mobilisation measures (ARM) in indirect taxes. With ARM from indirect taxes, coupled with estimated receipts of ₹40,000 crore from telecommunication spectrum auction and disinvestment proceeds of ₹30,000 crore, the fiscal deficit for 2012-13 is estimated at 5.1 per cent of GDP. The reduction in deficit has been estimated without compromising on allocations for developmental expenditure.

54. The strategy adopted for fiscal consolidation over the medium term has to balance the need for aiding the revival in growth without stoking inflationary expectation through domestic policy actions. The suggested roadmap of fiscal consolidation will help in reducing the debt to GDP ratio from 46.0 per cent in 2010-11 to 45.7 per cent in RE 2011-12 and 45.5 per cent in BE 2012-13. Gradually it is projected to decline to 41.9 per cent by 2014-15 as against the recommended debt level of 44.8 per cent of GDP by the 13th FC.

55. The proposed amendment in the FRBM Act would address the structural issue of imbalance in the revenue account of the Government. With mandated elimination of effective revenue deficit by March 2015, more resources could be made available for investment and capital expenditure. The introduction of Medium-term Expenditure Framework Statement along with the existing three FRBM statements would provide certainty of allocation to Ministries and Departments over the three year time frame. With the introduction of three year rolling target for expenditure indicators with specification of underlying assumptions and risk involved, there would be close monitoring of allocation of expenditure to priority sectors thereby improving the quality of expenditure.