MEDIUM TERM FISCAL POLICY STATEMENT

A. FISCAL INDICATORS – ROLLING TARGETS AS PERCENTAGE OF GDP

(at current market prices)

		Revised Estimates 2012-13	Budget Estimates 2013-14	Targets for 2014-15	Targets for 2015-16
1.	Effective Revenue Deficit	2.7	1.8	0.9	0.0
2.	Revenue Deficit	3.9	3.3	2.7	2.0
3.	Fiscal Deficit	5.2	4.8	4.2	3.6
4.	Gross Tax Revenue	10.4	10.9	11.2	11.5
5.	Total outstanding liabilities[2] at the end of the year	45.9	45.7	44.3	42.3

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 Central Government deficit.*

1. The performance on select fiscal indicators during the current fiscal year and the rolling targets for ensuing financial years presented above, marginal slippage of fiscal deficit to 5.2 per cent against the projection made in budget 2012-13 of 5.1 per cent. However, this performance has to be seen against the backdrop of declining GDP growth rate and continued uncertainty globally. Twin deficit challenge faced by the economy during the year made changes in policy stance necessary. Seen against the challenges faced in the current financial year, the above table presents pattern of fiscal consolidation undertaken by the government as part of mid-year course correction.

2. The mid-year course correction has to be analyzed in the context of continued global uncertain economic situation which affected India's Trade. On one hand, exports declined due to falling demands in major economies, high and sticky crude prices led to increasing trade gap. On the other, government spending and consequently fiscal deficit was rising due to fiscal expansionary measures. The sustained high levels of Fiscal deficit though required as a counter-cyclical measure to spur growth, has also caused diverse forms of macroeconomic imbalances, which could not be overlooked and immediate corrective measures were called for to contain the likely growth in Fiscal deficit during 2012-13 and onwards.

3. Macroeconomic analysis of India during the years 2010-11 and 2011-12 therefore showed a trend of rising current account deficit, sticky inflation, falling savings rates, falling investments and even consumption. The uncertainty in global economy along with the monetary policy tightening measures led to a perceptible negative impact on economic growth. Against this background government fiscal position looked grim. On revenue side, there was imminent threat of under achieving due to GDP slowdown while increased international crude prices had put pressure on government spending.

4. Government accordingly appointed Kelkar Committee to suggest corrective measures. Based on its report Government announced roadmap for fiscal consolidation and started slew of measures for reviving economic growth. As a result, despite several challenges government bettered its own target for fiscal deficit which stands at 5.2 per cent against 5.3 per cent announced in the roadmap. The performance has to be seen against the 'do-nothing' scenario which pointed at a fiscal deficit above 6.1 per cent in case immediate corrective measures were not put in place.

5. Performance on fiscal deficit is more credible against the fact that there was revenue shortfall of ₹ 63,857 crore in total net revenue receipts to centre. This shortfall in revenues against increase in Non-

plan expenditure of ₹31738 crore due to rise in subsidies resulted in widening gap in the government fiscals. The revenue deficit therefore increased from 3.4 per cent in BE 2012-13 to 3.9 per cent in RE 2012-13. However, with better fiscal management and control on expenditure government ended the year, 2012-13 with fiscal deficit of 5.2 per cent of GDP, which is 0.1 per cent lower than announced in mid-year review.

6. Fiscal management has to be analyzed in the context of falling resources of the government. Due to declining exports and lower industrial growth taxes on both direct and indirect side were showing slippage from the budgeted target. Net shortfall of ₹28,956 crore on taxes to centre was result of overall slowdown in economy. Similarly, on account of Non-tax revenue there was a shortfall of ₹34,901 crore, due to poor response of 2G spectrum sale.

7. However, government undertook drive to mop up resources, especially on the Non-debt capital receipts from Disinvestment. Committee of secretaries in Ministry of Finance co-ordinated on regular basis to ensure that targets on disinvestment was achieved. It helped in not only mobilizing resources for government but also as positive impetus for enthusing market. With active role, it was ensured that government receipts are as close to budgeted estimates as possible. As a result disinvestment was revised to ₹24,000 crore in RE 2012-13 against BE target of ₹30,000 crore.

8. At the same time, government undertook the task of limiting spending, in keeping with the emerging view of containing government spending and providing enough space for private investment and easing of monetary policy. Total expenditure of the government was reduced to ₹14,30,825 crore in RE 2012-13 from ₹14,90,925 crore in BE 2012-13. This reduction has to be seen against the backdrop of major subsidies expenditure which increased from ₹1,79,554 crore in BE 2012-13 to ₹2,47,854 crore in RE 2012-13. However, on other Non-plan expenditure there was reduction including interest payments which was reduced from ₹3,19,759 crore in BE 2012-13 to ₹3,16,674 crore in RE 2012-13.

9. On financing side, market borrowing from dated securities was reduced by ₹12,000 crore, by cancelling last weekly borrowing of financial year 2012-13. This was a significant step in conveying government intent to manage the fiscal situation and was viewed by the market positively. With prudent fiscal management government bettered on the deficit projections, thereby giving scope for cut in market borrowing. This cut in market borrowing has to be seen in the backdrop of declining external borrowings. Net external borrowing was revised to ₹2,214 crore in RE 2012-13 against ₹10,148 crore in BE 2012-13. Borrowings from short term Treasury Bills was increased from ₹9,000 crore in BE to ₹29,000 crore in RE 2012-13.

Fiscal Outlook for 2013-14 to 2015-16.

10. Government undertook path of fiscal consolidation with mid-year course correction in 2012-13. Fiscal policy 2013-14 has been designed to meet the macro-economic challenges faced by India in an uncertain international economic situation. By bringing back the focus on fiscal consolidation process, government has undertaken measures to reduce the fiscal deficit from 5.2 per cent of GDP in RE 2012-13 to 4.8 per cent of GDP in BE 2013-14. This reduction in fiscal deficit by 0.4 percentage point is largely revenue driven. While expenditure is retained at the same level of 14.6 per cent of GDP in BE 2013-14, increase in tax revenue and non-tax revenue is of the order of 0.4 per cent and 0.2 per cent of GDP respectively.

11. Revenue deficit has been estimated at 3.3 per cent of GDP in BE 2013-14. The revenue deficit is marginally lower than BE 2012-13 level of 3.4 per cent. However, it is substantially lower than the RE 2012-13 at 3.9 per cent. Slew of policy measures taken to tackle the increasing subsidy bills, especially decision to progressively increase diesel prices to link it to market prices will be yielding results progressively. It is expected that with better expenditure management the revenue deficit will be reduced to 2.7 per cent and 2.0 per cent in financial year 2014-15 and 2015-16 respectively.

12. 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 2013-14. It is further projected to decline to 0.9 per cent in 2014-15 and 0.0 per cent in 2015-16. It is this component of imbalance in revenue account which needs to be addressed in right earnest - through expenditure management and revenue augmentation.

13. Total liabilities of the government, as a percentage of GDP, will also see a decline continuing with the trend in the recent past. At end of 2012-13, a total liability of the Government is estimated at 45.9 per cent of GDP which will reduce to 45.7 per cent by the end of 2013-14. Continuing the declining trend it is likely to reduce to 44.3 per cent in 2014-15 and 42.3 per cent in 2015-16. A progressive reduction in debt-GDP ratio of the Government will ease the interest burden and allow more space for the

government to spend particularly on infrastructure development without taking recourse to additional borrowings

14. Gross tax revenue is estimated to increase from 10.4 per cent of GDP in RE 2012-13 to 10.9 per cent in BE 2013-14 (reflecting growth of 19.1 per cent over RE 2012-13), which is however still lower than peak of 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 11.2 per cent in 2014-15 and 11.5 per cent in 2015-16.

15. 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 14.7 per cent of GDP in BE 2013-14. In the medium term projection, it is estimated to further decline to 13.7 per cent of GDP in 2014-15 and 13.1 per cent in 2015-16.

B. ASSUMPTIONS UNDERLYING THE FISCAL INDICTORS

1. Revenue receipts.

(a) Tax-Revenue

16. Tax revenues as a percentage of GDP, riding on high economic growth and aided by rich menu of tax reform measures, reached its peak by 2007-08 and touched a level of 11.9 per cent . Average annual tax growth rate during the five year period in 2003-08 was 21.3 per cent , where annual tax growth was highest at 28.9 per cent in 2006-07. These reforms were mainly driven by direct tax whose average annual growth rate during this period was about 28 per cent. The buoyancy of tax revenue with respect to GDP was almost 1.5 per cent during this period.

17. This trend of high tax growth was moderated due to global economic crisis and the tax-GDP ratio slid to 10.8 per cent in 2008-09 and further to 9.7 per cent in 2009-10. With the initial signs of economic recovery and partial roll back of stimulus measures in 2010-11, the tax-GDP ratio increased to 10.2 per cent, with tax revenues witnessing a high growth rate of 27 per cent. Since the stimulus measures were mainly on indirect tax side, the partial roll back caused a high growth of 40.7 per cent in indirect taxes in 2010-11 over 2009-10 actuals.

18. The signs of economic recovery, however, moderated in 2011-12, particularly in the second half, with the economy witnessing 6.2 per cent growth during 2011-12. While the tax growth in the first half of 2011-12 was 14 per cent, the tax growth in second half was only 11 per cent leading to total tax growth of 12.1 per cent for the full year in 2011-12. The tax to GDP ratio in 2011-12 fell to 9.1 per cent, with the major impact coming from direct taxes. The direct tax-GDP ratio fell from 5.7 per cent in 2010-11 to 5.5 per cent in 2011-12, while the indirect tax remained at 4.4 per cent of GDP. Amongst direct taxes, the shortfall mainly came from Corporation Tax which grew only by 8 per cent in 2011-12 as compared to 22 per cent in 2010-11. On the contrary, personal income tax grew at 18 per cent in 2011-12 as compared to 13 per cent in 2010-11. Amongst indirect taxes, while Customs and Excise Duties were impacted by less than expected economic growth, Service Tax grew at 37 per cent overall during 2011-12. Gross Tax Revenues fell short by around ₹43,000 crore as compared to the Budget Estimates in 2011-12.

19. During the current year, due to high level of inflation persistent in the first half alongwith lower than expected economic growth, tax revenues maintained lower than required growth rate in the first half. However, taxes have shown signs of recovery consistently during the course of the year. Based on the trend and the possible revenue enhancement during the remaining part of the year, Revised Estimates of tax revenues have been fixed at ₹39,575 crore lower than the Budget Estimates. Most of this shortfall comes from indirect taxes, Customs and Union Excise Duties in particular. Although Service Tax is expected to perform better than budgeted, the excess on this account would only partially meet the shortfall on other indirect taxes. During 2012-13, the anticipated tax growth is 16.7 per cent over 2011-12 actuals and the tax to GDP ratio is expected to reach 10.4 per cent, marginally higher than 2010-11 levels.

20. Projections for 2013-14 have been made keeping into account a realistic economic recovery and set of tax measures announced in the budget for 2013-14.

Details of Tax Measures

21. With these measures tax revenues in BE 2012-13 are expected to grow at 19.1 per cent. The tax to GDP

ratio estimated in the Budget for 2013-14 is 10.9 per cent. Budget Estimates for 2013-14 assumes a normal tax growth of 17 per cent over RE 2012-13 and remaining tax growth emanating from additional resource mobilization measures.

22. Tax reforms and tax efforts are the most critical elements for the overall process of fiscal consolidation. Without a robust and ambitious tax growth it is not possible to achieve the fiscal roadmap which the Government has embarked upon. While the tax projections need to be realistic, at the same time they need to be ambitious to enable Government in achieving the fiscal roadmap without resorting to more than required expenditure compression. Overall, while tax should increase as percentage of GDP, expenditure should progressively reduce as percentage of GDP till the fiscal consolidation goals are fully met. While the ultimate objective should be to bring back the tax to GDP ratio to the pre-crisis levels, it should be kept in mind that this will happen only gradually over the period of fiscal consolidation. As the tax to GDP ratio increases, further improvements would be more gradual and difficult to achieve. The outlook for tax revenues for the years 2014-15 and 2015-16 have been designed keeping this in mind. As shown in table above the tax to GDP ratio is projected to reach 11.2 per cent in 2014-15 and 11.5 per cent in 2015-16. This would mean an average buoyancy of 1.23 per cent which is realistic but an ambitious target. This will require an average tax growth of 17.5 per cent which would be possible through a combination of better tax effort and certain ARM measures.

(b) Devolution to States

23. The states' share in the net proceeds of Union Tax is based on the recommendations of 13th Finance Commission which has recommended 32 per cent of net proceeds be devolved to states as their share. The projections period crosses the time horizon of 13th Finance Commission and spills over to the first year of the award period of the newly constituted 14th Finance Commission. It has been assumed that States' share will remain constant over the projection period despite this change as there is no better basis for assumption available. The fiscal plan outlined in this document will have to be redesigned if the 14th Finance Commission changes the State share.

(c) Non Tax Revenues

24. Non Tax Revenues of the Centre mainly comprises of interest and dividend receipts of the Government, receipts from the services provided by Central Ministries and Departments like supply of central police force to various agencies, issue of passport and visa, registration of companies, patents and license fees, royalty from off-shore oil fields, profit petroleum and various receipts from telecom sector. During the current year ₹40,000 crore was budgeted from auction of Broadband Wireless Access spectrum and other one-time receipts of telecom sector, which only partially materialized. However, this has been offset by higher receipts on account of dividend and profits to some extent. Other Non-Tax Revenues also have shown moderate increase as compared to Budget Estimates. Overall the non-tax receipts are projected to be 1.3 per cent of GDP in 2012-13.

25. The Budget Estimates for 2013-14 have been prepared keeping in mind telecom auctions schedule in March, 2013 for which it is expected that the amounts will be credited in the initial days of 2013-14. Interest receipts of Government that are from Railways, State Governments and loans extended by central ministries and departments mainly to Central PSUs. Interest receipts from States will be declining overall as net lending from states has considerably reduced after disintermediation as per the recommendations of 12th Finance Commission. Dividends receipts of the Centre may be split into two parts, one from RBI and banks and the other is from various PSUs. While dividends from PSUs should grow as their profit grows, they would be moderate due to disinvestment of Government stake in PSUs. On the contrary, since the Government would be infusing equity into banks to meet the CRAR requirement of BASEL III, the dividend from banks would increase relatively faster due to the coupled effect of increase in profit and increase in GOI stake in public sector banks. With these assumptions in 2012-13 the non tax revenues of the Centre are estimated at 1.3 per cent of GDP.

26. Mostly following the assumptions above, the outlook for non-tax revenues for 2014-15 and 2015-16 have been put in place. Certain one-time receipts budgeted in 2013-14 will not be available in 2014-15 and 2015-16. With regard to dividends from PSUs, the policy of the Government would be to enable them in investing their retained earnings in their capital projects. However, in the absence of any concrete capital investment plan PSUs should pay their cash surpluses as dividend to Government and other share holders. From telecom sector it has been assumed that renewal of licenses issued for 20 years earlier will come up for renewal during the projection period. It is also expected that regular exercises of revising user charges based on cost of service delivery will be undertaken.

Based on the assumptions, the non-tax revenue for 2014-15 and 2015-16 have been projected at 1.2 per cent and 1.1 per cent of GDP respectively.

2. Capital receipts

(a) Recovery of loans and advances

27. 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. Since further loans are not given to State governments, this receipt will decline over years as old loans get liquidated. 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 was estimated at ₹11,650 crore in B.E.2012-13. However, it was revised upward to ₹14,073 crore in RE 2012-13. In BE 2013-14 it is estimated at ₹10,654 crore. For 2014-15 and 2015-16, this component of receipt is estimated to be flat at ₹10,000 crore as the government would not encourage net lending (accept for back to back arrangement made for external loans to States).

(b) Other non-debt capital receipts

28. Disinvestments in Government PSUs are main source of receipts under this head. In last two years government had created National Investment Fund (NIF) as interim measure to account for the proceeds from disinvestment within Consolidated Fund (CFI) separately and deploy the same towards creation of assets within the plan outlay. However, this year government has decided to create a separate fund, NIF under Public Account, with the intent that proceeds from disinvestment will only be deployed for specific authorized purposes. With this major step forward, the proceeds will not be available to fund regular government spending.

29. As against BE 2012-13 target of ₹30,000 crore in RE 2012-13 has been fixed at ₹24,000 crore. This shortfall should be seen against adverse market conditions and at one point it appeared that there will be major shortfall. However, active stance of government not only helped in realization of receipts under this account but also helped in revival of the market. In BE 2013-14, it is estimated that an amount of ₹40,000 crore will accrue under NIF from disinvestment. Additionally, ₹14000 crore is expected from disinvestment of residual government share in non-government companies. Further, ₹1,814 crore is expected to accrue from the disbanded asset management company, with above mentioned change in NIF. Therefore, an amount of ₹55,814 crore is budgeted with ₹40,000 crore under NIF and ₹15,814 crore under regular receipts. Over the medium term frame work, nominal amount of ₹ 20,000 crore and ₹15,000 crore has been taken for the years 2014-15 and 2015-16 respectively.

(c) Borrowings – Public Debt and other Liabilities

30. Of the overall Central Government debt and liabilities, about 92 per cent is domestic debt and only 8 per cent is external debt. In 2012-13, net market borrowings at ₹ 4,79,000 crore were budgeted to finance 93.3 per cent of gross fiscal deficit during 2012-13. Other sources of financing such as external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 6.7 per cent of GFD. As a result of lower realization than budgeted from external debt and small savings, and also to meet revised fiscal deficit target of 5.2 per cent, the net borrowing from auction treasury bills (ATBs) was increased by ₹ 20,000 crore viz. from BE 2012-13 of ₹9,000 crore to ₹ 29,000 crore. However, better fiscal management resulted in reduction of market borrowings for the year by ₹12,000 crore to ₹4,67,000 crore for fiscal year 2012-13. Borrowings programme for the year was completed smoothly in line with pre-announced calender for borrowings. The weighted average yield of primary issuance of dated securities during 2012-13 was lower at 8.36 per cent as compared with 8.52 per cent in the previous year while weighted average maturity increased to 13.50 years as from 12.66 years in the previous year.

31. Pursuing with Government's commitment to carry on with the fiscal consolidation measures, the fiscal deficit for 2013-14 is budgeted to decline to 4.8 per cent of GDP. Total borrowings requirement for 2013-14 has been budgeted at ₹ 5,42,499 crore or 4.8 per cent of GDP. Net market borrowings of ₹4,84,000 crore has been budgeted to finance nearly 89 per cent of fiscal deficit. In absolute terms, net borrowing is increasing by 3.6 per cent over the previous year. In terms of GDP, however, they are budgeted to decline to 4.3 per cent as compared with 4.7 per cent in the previous year. Borrowings under other sources of financing are budgeted to remain relatively insignificant during 2013-14. A large share of market borrowings is subscribed by the commercial banks, which maintains investment in government securities at around 30 per cent of their aggregate deposits.

32. As year on year growth in aggregate deposits of banks at 13.1 per cent (as on January 25, 2013) much higher than the growth of 3.6 per cent in estimated market borrowings, it is expected that the budgeted market borrowings for 2013-14 will not put any pressure on the markets and ample resources will be available for private investment. Total liabilities of the Government, as a percentage of GDP, will also see a

decline continuing with the trend in the recent past. At end of 2012-13, a total liability of the Government is estimated at 45.9 per cent of GDP which will reduce to 45.7 per cent by the end of 2013-14. Continuing the declining trend it is likely to reduce to 44.3 per cent in 2014-15 and 42.3 per cent in 2015-16. A progressive reduction in debt-GDP ratio of the Government will ease the interest burden and allow more space for the government to spend particularly on infrastructure development without taking recourse to additional borrowings.

33. Gross fiscal deficit is projected to decline progressively to 4.8 per cent of GDP in 2013-14. The MTFP statement projects a further decline in GFD to 4.2 per cent by 2014-15 and to 3.6 per cent by 2015-16. Assuming market borrowings financing at about 90 per cent of the GFD, the net market borrowings are likely to decline significantly in next three years to 4.3 per cent of GDP in 2013-14, 3.8 per cent in 2014-15 and 3.2 per cent in 2015-16. With contraction of government deficit there will be more room for private investment and capital inflows. This will also ease inflationary pressure providing comfort to RBI for easing monetary policy.

3. Total Expenditure

(A) Revenue account.

(i) Plan Revenue Expenditure.

34. The Plan Revenue Expenditure of the Government remained at an average level of 4.2 per cent of GDP during the 11th Plan Period. However, due to the stimulus measures undertaken to counter global slowdown of Indian economy, the overall Plan Expenditure during the 12th Plan Period was at 4.6 per cent of GDP.

35. To meet the twin objective of sustained economic growth and fiscal consolidation, it is very essential to keep the Plan Expenditure at optimal levels. During 2008-09 the Government could resort to fiscal expansion only because it was riding on a lower fiscal deficit base and could afford any increase in its deficit. This kind of a policy cannot be followed again until the fiscal deficit is brought down to acceptable level. While the effort should be to reduce the unproductive expenditure of the government, the Plan Expenditure has to remain within the affordable levels, at least till the process of fiscal consolidation is over.

36. During 2012-13, the Plan Expenditure was rationalised by 0.9 per cent of GDP and the Revised Estimates of 2012-13 for Plan Expenditure stands at 4.3 per cent of GDP. The Plan Expenditure for 2013-14 has been estimated to grow by 6.6 per cent over 2012-13 BE which works out to 29.4 per cent over 2012-13 RE. The Plan Expenditure has been projected during the projections period keeping in view the fiscal targets and the available resources.

(ii) Non Plan Revenue Expenditure

37. Non Plan Revenue Expenditure of government mainly consists of its establishment expenditure, interest payments, defence expenditure, subsidies, statutory grants to States and other residual items. The Non Plan Revenue Expenditure jumped from 8.4 per cent of GDP in 2007-08 to 10.2 per cent of GDP in 2009-10 mainly due to implementation of Sixth Pay Commission's recommendations. Since then it has come down to 8.7 per cent in 2013-14 BE due to various expenditure reform measures undertaken by the Government. Non Plan Revenue Expenditure is estimated to be ₹9.17 lakh crore in RE 2012-13 and ₹9.93 lakh crore in BE 2013-14. Various components of Non Plan Revenue Expenditure are detailed below.

(a) Interest Payments

38. Due to fiscal expansion undertaken by the Government, interest payments increased sharply post global economic crisis. As a percentage of net tax revenue of the Centre, interest payments jumped from 38.9 per cent in 2007-08 to 43.4 per cent in 2008-09 and further to 46.7 per cent in 2009-10. In the current year the interest payment would be at 42.7 per cent of net tax to Centre. The factors that have impacted interest payment during the recent period are the increased debt stock due to stimulus measures alongwith the fiscal slippage during 2011-12 and relatively tougher interest rate regime that has been in existence for quite some time now.

39. With the government deficit coming down and government's efforts to control inflation, it is expected that interest rates would be falling in the years to come. Deficit reduction and fall in interest rates would create positive space for the private sector to raise resources at lower cost.

(b) Defence Services

40. Defence Expenditure on the revenue account mainly comprises of salary expenditure of defence forces and their operational expenses. Defence Revenue Expenditure is estimated at ₹1.09 lakh crore in RE 2012-13 and ₹1.17 lakh crore in BE 2013-14. During the projection period Defence Revenue Expenditure is projected to grow at 7 per cent.

(c) Pensions

41. The expenditure on pension payments of the Central Government includes both defence as well as civil pensions. Pension payment, in nominal terms is estimated at ₹63,836 crore in RE 2012-13 and ₹70,726 crore in BE 2013-14. The pension payment of Central Government for the past few years has been growing faster than the salary expenditure. The main reason for this is that there is an increase in number of pensioners due to higher retirements and increased

life expectancy. Accordingly, keeping past trend in view the Pension Expenditure of the Government has been projected to grow at 10 per cent.

(d) Non Plan Grants to States

42. Non Plan Grants to States mainly comprises of the grants recommended by the Finance Commission. In RE 2012-13 the Non Plan Grants are estimated at ₹57,901 crore and in BE 2013-14 at ₹76,981 crore. BE 2013-14 also includes the compensation for loss of CST to States which is critical for an agreement between Centre and States towards finalization of GST. The projection for 2014-15 has been done keeping the recommendations of 13th Finance Commission in view and the fact that CST compensation would continue in 2014-15 as well.

43. Non Plan Grants in 2015-16 have been marginally increased over 2014-15 as recommendations of 14th Finance Commission will come into force. Normally most of the grants recommended by Finance Commission are recommended to flow from second year of the award period to ensure a convenient preparatory period for the State Governments. Based on these assumptions Non Plan Grants have been projected at 0.7 per cent of GDP in 2014-15 and 0.6 per cent of GDP in 2015-16.

(e) Major Subsidies

44. Major subsidies in the Revised Estimates for 2012-13 have increased to ₹2,47,854 crore as compared to the Budget Estimates for 2012-13 of ₹1,79,554 crore. The major part of increase has come from petroleum subsidies that went up from ₹43,580 crore in BE 2012-13 to ₹96,880 crore in RE 2013-14. Major subsidies are budgeted at ₹2,20,972 crore in BE 2013-14. Total subsidies are at 2.6 per cent of GDP in RE 2012-13 and are budgeted to be at 2 per cent of GDP in 2013-14.

45. Major subsidies are extremely critical from the viewpoint of fiscal consolidation and are the most important factor in determining the success of Government in meeting its fiscal targets. The effort of Government would be to address this issue with a too pronged strategy. Firstly, the Government will have to align the pricing policy for subsidized goods to ensure that the total subsidies remain within the affordable levels. Secondly, it is extremely essential to ensure that proper systems are put in place for better targeting of subsidies provided by Government.

46. To improve targeting of subsidies, Government has embarked upon an ambitious programme to directly transfer government benefits into Aadhar linked bank accounts of beneficiaries using the UID platform. Although, currently the scheme is at a pilot stage covering limited schemes in limited districts, once the pilot is found to be satisfactory, the system can be expanded nationwide to various transfer of all benefits. Since the system is based on the UID platform to begin with, it will ensure that transfers to duplicate beneficiaries and non-existent beneficiaries will not be there even from day-one. Even the issue of eligibility can be much easily tackled in due course.

47. On the pricing issue, especially on petroleum, side the most important commodity which poses the greatest risk to the fiscal consolidation process is diesel. The basic problem with diesel pricing that the Government has been facing is that any delay in price correction makes further required price corrections steeper and hence even more difficult. This triggers a vicious cycle of high subsidy and rigidity in the administered prices. To resolve this issue, after effecting a substantial price hike of ₹5 per litre, the Government has allowed Oil Marketing Companies to apply a 'small' price corrections on a frequent basis. This approach will ensure that the consumer will not feel the pinch of upward revisions as revisions will be small and at the same time it will help the Government move towards eventual decontrol. It will also ensure that the impact of diesel price increase on inflation is minimised. If there are no international shocks in the oil sector, it is expected that in a year or two the Government will be able to decontrol diesel fully.

48. On fertilizers, Nutrient Based Subsidy regime has been working well in the P&K sector. What is now urgently required are certain pricing reforms in the urea sector with an immediate price correction for urea. This is not only essential from viewpoint of the size of the subsidy bill but also from the viewpoint of balanced use of N,P&K nutrients. Over long term, Government will be working towards increase in indigenous production of fertilizers which will help reducing dependence on imports and make prices much more stable.

49. The food subsidy regime, in the coming years, will have to undergo a massive overhaul with introduction of Food Security Act. Alongwith the legislation coming into force, Government will have to focus on strengthening of public distribution systems, better tracking of delivery chain, reduction in administrative costs of FCI and other entities involved and other related reforms.

50. As already explained without focused subsidy reforms, the process of fiscal consolidation will be next to impossible. The expenditure of Government on major subsidies is expected to come down from 2 per cent of GDP in 2013-14 BE to 1.8 per cent of GDP in 2014-15 and 1.6 per cent of GDP in 2015-16.

(B) Capital Outlay

51. The total capital expenditure of Government is estimated to be ₹1,67,753 crore in the Revised Estimates for 2012-13 which is projected to go upto ₹2,29,129 crore in the Budget Estimates for 2013-14. Out of this, the Plan Expenditure is expected to be at ₹85,814 crore in the Revised Estimates going upto ₹1,12,062 crore in the Budget Estimates. The Non Plan Capital Expenditure is estimated to be at ₹81,939 crore in the Revised Estimates and is budgeted to be ₹1,17,067 crore in 2013-14.

52. On the non-plan side, the major portion of Capital Expenditure consists of the Defence Capital Expenditure. The Defence Capital Expenditure is estimated to ₹69,579 crore in RE 2012-13 and is expected to go up to ₹86,741 crore in 2013-14 BE. During the projection period Defence Capital Expenditure is projected to grow at 9 per cent which is consistent with the overall resource availability and other demands on Centre's resources.

53. The Plan Expenditure of GOI mainly consists of gross budgetary support to gross Railway Expenditure, of national highways investments in government companies and banks and loans to State Govt. and PSUs. Since the overall effort has to be to reduce the revenue deficit of the Government, it is essential that within the overall Plan Expenditure, the expenditure on capital components grows faster than the revenue component. Plan Capital Expenditure is budgeted at 20.2 per cent of total Plan Expenditure in 2013-14 and is projected to increase to 21 per cent and 21.5 per cent of total Plan Expenditure in 2014-15 and 2015-16 respectively.

(C) Fiscal outlook for 2013-14 to 2015-16

54. The Budget of 2012-13 was presented with a fiscal deficit estimate of 5.1 per cent of GDP when signs of moderation in economic growth had already become visible. During 2011-12 the tax receipt had fallen short by almost ₹31,000 crore in the Revised Estimates as compared to Budget Estimates when the Budget for 2012-13 was presented. The Revised Estimates for fiscal deficit for 2011-12 was 5.9 per cent as compared to Budget Estimate of 4.6 per cent. The fiscal slippage of 2011-12 was staring to repeat again in 2012-13 with the first half showing lesser than expected economic growth and shortfall in tax revenues. Simultaneously, the demand on petroleum subsidy account was increasing as the under recoveries on petroleum products increased.

55. The Government took note of the difficult fiscal situation and constituted a committee headed by Dr. Vijay Kelkar to assess the existing fiscal position and suggest measures to ensure that the Government meets its fiscal targets in the current year and suggest a fiscal consolidation roadmap for the future. The Committee analyzed the resource position and the demands on resources and recommended various measures to increase government resources, reduce subsidy expenditure and rationalize plan expenditure.

56. Based on the recommendations of Kelkar Committee, government announced a fiscal consolidation roadmap and initiated a set of measures to avoid any fiscal slippage during 2012-13. During the year, a detailed analysis of expenditure under various schemes was done and a tight envelop for Revised Estimates for Plan as well as Non Plan Expenditure was worked out. Expenditure Departments and Ministries were advised for fiscal prudence and austerity. The Kelkar Committee had assessed that any absence of any reform measure the fiscal deficit of Central Government would reach 6.1 per cent of GDP in 2012-13. It suggested that Government should take set of reforms recommended by it and limit its fiscal deficit to 5.3 per cent. The Government in its fiscal roadmap, announced on the basis of recommendations of Kelkar Committee, had set a target of 5.3 per cent of GDP for fiscal deficit in 2012-13. The Revised Estimates for 2012-13 for the fiscal deficit stands at 5.2 per cent of GDP.

57. The fiscal policy for 2013-14 has been designed on the lines of the roadmap already announced by the Government. With its approach in the Budget, Government establishes its credibility and commitment to the process of fiscal consolidation. The fiscal deficit, revenue deficit and effective revenue deficit targets of the government as outlined in the table above are in line with the fiscal consolidation roadmap announced by the Government. The roadmap has been laid out to ensure that it remains achievable and at the same time establishes the credibility of the Government and its commitment towards the fiscal consolidation roadmap. The assumptions of various constituents are the building blocks of the roadmap outlined above are explained in this chapter.