# MEDIUM TERM FISCAL POLICY STATEMENT

## A. FISCAL INDICATORS – ROLLING TARGETS AS PERCENTAGE OF GDP

(at current market prices)

| | | Revised Estimates 2009-10 | Budget Estimates 2010-11 | Targets for 2011-12 | 2012-13 |
|---|---|---|---|---|---|
| 1. | Revenue Deficit | 5.3 | 4.0 | 3.4 | 2.7 |
| 2. | Fiscal Deficit | 6.7 | 5.5 | 4.8 | 4.1 |
| 3. | Gross Tax Revenue | 10.3 | 10.8 | 11.5 | 11.8 |
| 4. | Total outstanding liabilities at the end of the year | 51.5 | 51.1 | 50.0 | 48.2 |

*Notes:—*

1. *"GDP" is the Gross Domestic Product at current market prices.*
2. *"Total outstanding liabilities" include external public debt at current exchange rates. For projections, constant exchange rates have been assumed.*
3. *Comparison with the Thirteenth Finance Commission roadmap is shown in Annex-A.*

1. The medium term fiscal outlook presented above indicates that the fiscal performance during the year 2009-10 was broadly in line with the Budget presented in July 2009.

2. Notwithstanding additional appropriation sought through Supplementary Demands for Grants during the year, the overall expenditure in absolute terms has been retained at almost the same level of BE 2009-10 in RE 2009-10. Gross tax revenue of the Government which was estimated at 10.4 per cent of GDP (10.9 per cent with pre revised GDP) in BE 2009-10 has marginally declined to 10.3 per cent in RE 2009-10. The shortfall in indirect taxes has largely been covered through estimated additional receipts in direct taxes. Also, the shortfall in non-tax revenue on account of non-realisation of 3G auction proceeds during the year 2009-10 has been met to a large extent through the disinvestment proceeds. The overall borrowings of the Government are the same as projected in the BE 2009-10.

3. For the year 2010-11, the fiscal policy is being guided by the Government's commitment in MTFP statement presented in July 2009. Fiscal deficit which was committed to be brought down to 5.5 per cent of GDP, has actually been estimated at the same level in BE 2010-11. This shows the Government's intention to fulfill the commitment to revert back to the path of fiscal consolidation in the coming years. Government is also getting the benefit of the recommendations of the 13$^{th}$ Finance Commission (FC) in calibrating the fiscal consolidation path for the period 2010-15. Tax revenue is estimated to increase from 10.3 per cent of GDP in RE 2009-10 to 10.8 per cent in BE 2010-11, which is however still lower than 12 per cent of GDP achieved during 2007-08. There is further scope of improvement in this with the economy showing signs of returning to the trend growth rate in recent times.

4. In spite of no significant increase in tax to GDP ratio and additional expenditure commitments arising on account of the 13$^{th}$ FC recommendations, the fiscal deficit with the help of disinvestment proceeds and reforms in expenditure management including subsidies, has been reduced from 7.8 per cent in 2008-09 (including securities issued in lieu of subsidies to oil and fertiliser companies) to 5.5 per cent in BE 2010-11. It is further estimated to be brought down to 4.8 per cent of GDP in 2011-12 and 4.1 per cent in 2012-13 which is a slight improvement over the suggested roadmap of the 13$^{th}$ FC.

5. The projected fiscal deficit of 4.8 per cent of GDP in 2011-12 is higher than the earlier projected deficit of 4 per cent in the Medium Term Fiscal Policy (MTFP) Statement, 2009-10. This increase in estimated deficit is largely on account of the impact of the recommendations of the 13th FC and lower than estimated tax to GDP ratio. While total expenditure has been projected to reduce from 16 per cent of GDP in BE 2010-11 to 15.2 per cent of GDP in 2011-12, the additional devolution of share in Central Taxes and larger amount of grants in aid to States have made it difficult to keep the fiscal deficit at earlier projected level of 4 per cent of GDP.

6. For the year 2012-13, the fiscal deficit is estimated at 4.1 per cent of GDP. This factors in reduction in expenditure to 14.6 per cent of GDP and increase in tax to GDP ratio to 11.8 per cent of GDP. The details of assumptions are explained in section B of the Statement. The risks associated with the assumptions are also explained therein. Unforeseen expenditure and further shocks in international commodities prices may however affect the projections given above.

7. On the whole, with improvement in prevailing conditions, the process of fiscal consolidation is back on track. The 13th Finance Commission has assessed the finances of the Union and States and specified a combined debt target of 68% of Gross Domestic Product (GDP) to be met by 2014-15. It has worked out a roadmap for Fiscal Deficit (FD) and Revenue Deficit (RD) for the award period. For Centre, it has recommended RD to be eliminated and FD to be brought down to 3% of GDP by 2013-14. The Government has accepted these recommendations in principle. Detailed proposals for amendment of the FRBM Act, as may be necessary, will be taken up separately.

8. The corrections in fiscal deficit during 2010-2013 period are expected to bring down the debt to GDP ratio for the Central Government from 51.5 per cent in RE 2009-10 to 48.2 per cent in 2012-13. The 13th FC in its report has indicated that the Central Government’s liability is overstated to the extent of NSSF loans to States. In the rolling targets indicated in the table in paragraph A, this anomaly has been corrected from RE 2009-10 onwards. The liabilities shown in the table exclude loans from NSSF to the States. Further, in consolidation of General Government debt other loans from Centre to States (i.e. external loans) should also be excluded from Centre’s liability, and 14-days treasury bills should be excluded from State Government’s liabilities.

## B. ASSUMPTIONS UNDERLYING THE FISCAL INDICATORS

### 1. Revenue Receipts

#### *(a) Tax-Revenue*

9. Fiscal consolidation during the period 2004-08 was primarily revenue driven. Gross Tax Revenue as a percentage of GDP increased from 9.7 in 2004-05 to 12.6 in 2007-08 during the FRBM Act regime. However, with revision in GDP data and change in base year, tax to GDP ratio stands revised as 9.4 per cent for 2004-05 and 12 per cent for 2007-08. Due to the moderation in growth in the economy and tax/duty rate cuts during the second half of 2008-09, the gross tax to GDP ratio declined to 10.9 per cent in 2008-09. The reduced rates of tax/duties were continued in the year 2009-10 as part of the fiscal stimulus measures.

10. Accordingly, the gross tax revenue was estimated to show lower buoyancy and was estimated at Rs.6,41,079 crore in the Budget 2009-10 amounting to 10.4 per cent of GDP (10.9 per cent of pre-revised GDP) and reflecting a growth of 2.0 per cent over the provisional accounts of 2008-09. In the RE 2009-10, gross tax receipts are estimated at Rs.6,33,095 crore reflecting growth of 4.6 per cent over 2008-09 amounting to 10.3 per cent of GDP. The shortfall of 0.1 per cent of GDP in RE 2009-10 compared to BE 2009-10 is the net impact of lower estimated receipts in indirect tax and higher receipts in Direct tax.

11. Direct tax receipts were estimated at Rs.3,70,000 crore in BE 2009-10 showing a growth of 10.8 per cent over 2008-09 (Provisional Accounts) and amounting to 6.0 per cent of GDP. Due to the better than estimated receipts under income tax other than corporation tax, direct tax receipts are estimated at Rs.3,87,008 crore in RE 2009-10. This amounts to 6.3 per cent of GDP, reflecting growth of 15.9 per cent over the provisional accounts 2008-09. Direct tax receipts are showing progressively better result in the second half of 2009-10 and this trend is likely to continue with better growth prospect in 2010-11 in the economy.

12. The Government is committed to take forward the reform process initiated in direct tax regime and realise higher tax to GDP ratio with moderate tax rate structure. Accordingly, the Direct Tax Code is proposed to be implemented with effect from financial year 2011-12. This would simplify the tax structure and bring down the incidences of taxes on individuals as well as corporate bodies. In a prelude to introduction of DTC,

during 2010-11, income slabs have been increased for the prevailing tax rate structure and rate of surcharge has been reduced on Corporation Tax. This would help in putting more money in the hands of tax payers and thereby would continue the process of boosting demand. With this tax concession, the BE 2010-11 has been estimated at Rs.4,30,000 crore for direct taxes reflecting growth of 11.1 per cent over RE 2009-10 and amounting to 6.2 per cent of GDP. This reform is likely to improve compliance and is expected to result in better buoyancy in the coming years. For 2011-12 and 2012-13, direct tax receipts as percentage of GDP is projected to increase from 6.2 per cent in BE 2010-11 to 6.6 per cent and 7.0 per cent respectively. These improvements are associated with projected higher growth in the economy for 2011-12 and 2012-13. Any slippage in the growth forecast would impact these projections.

13. Indirect taxes were estimated at Rs.2,69,477 crore in BE 2009-10. However, with negative growth in trade for the larger part of the financial year and due to impact of lowering of taxes and duties, these are estimated at Rs.2,44,477 crore in RE 2009-10 reflecting negative growth of 9.4 per cent over 2008-09. However this give away in the form of fiscal stimulus has helped the economy in bouncing back to the higher growth trajectory. The Government has calibrated the gradual exit strategy to move back to the path of fiscal consolidation without hurting the revival process. Accordingly, the average rate of Excise Duty is being increased from 8 per cent to 10 per cent. This is still lower than 14 per cent rate which was prevailing before the announcements of stimulus measures. The intention of the Government is to bring in a uniform tax rate for goods and services. Without changing the tax rate for Service sector, some more service are being added in the tax net. Further, in partial rollback of tax measures which were initiated during 2008-09 to protect the economy from the adverse impact of higher crude prices, custom duty is being re-imposed on crude and other petroleum products. These additional resource mobilization measures are estimated to yield 0.7 per cent of GDP in BE 2010-11. The BE 2010-11 for indirect taxes is Rs.3,15,000 crore reflecting 28.8 per cent growth over RE 2009-10 amounting to 4.6 per cent of GDP. With the likely introduction of GST from 2011-12, this is further estimated to improve to 4.8 per cent of GDP in 2012-13.

14. Based on the above estimates, gross tax to GDP ratio is estimated to improve from 10.8 per cent in BE 2010-11 to 11.5 per cent in 2011-12 and 11.8 per cent in 2012-13. This would be still lower than tax to GDP ratio of 12 per cent achieved during 2007-08.

15. Assignment to States and net Tax Revenue of Centre in BE 2010-11 are placed at Rs.2,08,997 crore and Rs.5,34,094 crore respectively after factoring the recommendations of the 13$^{th}$ FC.

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

### *(b) Non-tax-revenue*

17. Non-tax revenue (NTR) was estimated at Rs.1,40,279 crore in the BE 2009-10 amounting to 2.3 per cent of GDP and reflecting growth of 44.7 per cent over 2008-09 provisional accounts. The increase was primarily on account of anticipated receipts of Rs.35,000 crore from the telecommunication sector vide auction of 3G spectrum and increased transfer of surplus from RBI which was estimated to increase to Rs.25,000 crore. However, the receipts from 3G auction have not materialized during 2009-10 and thus there is a shortfall in non-tax revenue in RE 2009-10 which is estimated at Rs.1,12,191 crore. After factoring in receipts of Rs.35,000 crore from 3G auction now in BE 2010-11, the non-tax revenue is estimated at Rs.1,48,118 crore in BE 2010-11 amounting to 2.1 per cent of GDP and reflecting growth of 32 per cent over RE 2009-10. For the period 2011-13, this rate of growth may not be possible in non-tax revenue. Interest receipts from States are likely to decline in the medium term, mainly due to Centre's disengagement from financial intermediation following the recommendation of the Twelfth Finance Commission regarding lending to States, except for loans under externally aided projects. Also the incentive linked restructuring of State Government debt at 7.5 per cent interest will result in downward trend in interest receipts for some more time. Therefore, in the medium term, NTR is expected to marginally improve in absolute terms but will show a progressively declining trend as a proportion of GDP, as the GDP increases. With assumed growth of 7 per cent in NTR, it is estimated to decline to 1.4 per cent of GDP in 2011-12 and 1.3 per cent in 2012-13.

### *(c) Devolution to States*

18. 13$^{th}$ FC has recommended for increasing the States' share in net proceeds of Union taxes from the current level of 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 would impact the availability of resources for the Central Government. For BE 2010-11, additional devolution of 1.5 per cent to States would result in about Rs.9,800 crore amounting to 0.14 per cent of GDP.

**2. Capital receipts**

***(a) Recovery of loans and advances***

19. Repayment of loans extended to States earlier are estimated to decline over a period of time on account of (i) gradual disintermediation by Central Government and (ii) the debt consolidation and debt waiver scheme based on the Twelfth Finance Commission (TFC) recommendations. Over time, State Governments and Central Public Sector Undertakings have been encouraged to borrow directly from the market and not from the Central Government. In addition, State Governments were allowed to prepay their high cost loans. In respect of Central Government loans, TFC had awarded relief to State Governments in the form of debt consolidation and waiver subject to enactment of fiscal responsibility legislation and achievement of specified targets relating thereto. However, during the 13$^{th}$ FC award period, Government would get repayments from State Governments as the waiver recommended by the 12$^{th}$ FC would come to an end in 2009-10. 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. Recovery of loans and advances is estimated at Rs.4,254 crore in RE 2009-10 and Rs.5,129 crore in BE 2010-11.

***(b) Other non-debt capital receipts***

20. Disinvestment proceeds through sale of Government stake in Central Public Sector Undertakings etc. had been the main source of receipts under this head. In departure from the existing policy of uses of disinvestment proceeds, Government has decided to use the disinvestment proceeds received during 2009-12 period for the purpose of financing the social sector programmes which are creating capital assets. Disinvestment receipts are estimated at Rs.25,000 crore in RE 2009-10 and Rs.40,000 crore in BE 2010-11. In the future years also, this receipts is estimated at the same level as in BE 2010-11. Also, the returns from the investments 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.

***(c) Borrowings – Public Debt and Other Liabilities***

21. The deficit of the Government is financed largely through domestic public debt and to a smaller extent through external debt and other internal liabilities or through cash draw down. Government is financing major part of its deficit through resources raised at market determined interest rates. For the year 2009-10, the borrowing programme has been completed as per the announced borrowing calendar. The large borrowing during the year was done without disrupting the market or increasing the yield. In the year, 2010-11 the Government would continue to rely on the above mentioned policy of raising resources largely through domestic debt at market determined interest rates. The net borrowing from the open market in 2010-11 will leave enough space for the private sector requirements.

22. Two other items included in the domestic debt/liabilities of the Central Government are Net accretions to NSSF and Borrowings under Market Stabilization Scheme (MSS). Net accretion to the National Small Savings Fund, to the extent of 80 per cent to 100 per cent is transferred to State Governments as per their option with effect from 1.4.2007, through investment in State Government special securities issued for the purpose. While accounting for Central Government 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 may not be taken as GoI liabilities. After factoring in this adjustment, the estimated debt to GDP ratio for Central Government would be 51.5 per cent in RE 2009-10 and 51.1 per cent in BE 2010-11 respectively. With the projected level of fiscal deficit of 4.8 per cent of GDP in 2011-12 and 4.1 per cent of GDP in 2012-13, the estimated debt to GDP ratio would be 50.0 per cent and 48.2 per cent respectively. These estimates indicate that the Government would be able to bring down the debt to GDP ratio for Central Government to the recommended level of 45 per cent by the 13$^{th}$ Finance Commission by 2014-15. The details on sources of financing of deficit are shown in the Receipts Budget.

**3. Total expenditure**

**(A) Revenue account**

***(i) Plan Revenue expenditure***

23. Stepping up of plan expenditure for boosting demand and investment in infrastructure sector were part of the fiscal stimuli provided by the Government to minimise the impact of the global slowdown on the Indian economy. Accordingly, plan revenue expenditure has increased from Rs.1,73,572 crore in 2007-08 to

Rs. 2,34,774 crore in 2008-09 and further to Rs.2,64,411 crore in RE 2009-10. This results in average growth of 23.4 per cent in 2008-09 and 2009-10. Plan revenue expenditure is further estimated at Rs.3,15,125 crore in BE 2010-11 reflecting growth of 19.2 per cent over RE 2009-10.

24. With this significant increase in outlay over the last three years, the focus should shift to ensuring effective implementation and outcomes from financial outlays. The increase in plan expenditure is primarily accounted for by higher allocations to the social sector along with urban and rural infrastructure. Notwithstanding decline in revenue and higher liabilities on specific components of non-plan expenditure including inter alia, for meeting salary commitments, interest obligations, subsidy, defence establishment and capital acquisitions, internal security, pensions, etc., adequate provisions have been ensured for all important developmental schemes particularly those benefiting the common man and disadvantaged sections of society. While actual expenditures during the Ninth and Tenth Plan period were only about 84 per cent of projected resources in the respective plan period, it is likely that the overall provision for plan expenditure would be broadly in line with the projected resources for the Eleventh Plan.

***(ii) Non Plan Revenue expenditure***

25. Expenditure on interest payments, defence services, subsidies, salary and pensions and grants to States constitutes bulk of the non-plan revenue expenditure. These items of expenditure are rigid in nature and likely to remain so in the short to medium term. However, sharp increase in the non-plan expenditure witnessed during 2008-09 continues in the current financial year also. Non-plan revenue expenditure has been estimated to increase from Rs.6,18,834 crore in BE 2009-10 to Rs.6,41,944 crore in RE 2009-10 reflecting growth of 14.8 per cent over non-plan revenue expenditure in 2008-09. Though this growth is lower than what was witnessed in 2008-09 (32.8 per cent), it still highlights the concerns on sustainability of the pace of growth of this component of expenditure. This is further estimated to increase from Rs.6,43,599 crore in the BE 2010-11 reflecting marginal increase of 0.26 per cent over RE 2009-10. The growth in non-plan revenue expenditure has plateaued mainly on account of payment of arrears for salary and pension due to the implementation of the Sixth Central Pay Commission recommendations in 2009-10 and anticipated reduction in subsidy. The major items of non-plan expenditure are detailed below.

***(a) Interest payments***

26. Due to the fiscal consolidation in the last four years, interest payments as percentage of total revenue receipts (net) of the Central Government has shown a significant improvement from 47 per cent in 2003-04 to 31.6 per cent in 2007-08. However, due to increased borrowings to finance higher fiscal deficits during 2008-09 and 2009-10, this ratio has deteriorated to 38 per cent in RE 2009-10. Interest payments are estimated at Rs.2,48,664 crore in BE 2010-11 against Rs.2,19,500 crore in RE 2009-10 constituting about 38.6 per cent of non-plan revenue expenditure in BE 2010-11. The increase is primarily on account of the higher borrowings to finance the higher deficit and interest on Special Securities issued to Oil Marketing Companies during 2008-09. With the gradual start of fiscal consolidation process in 2010-11, this ratio is estimated to improve to 36.4 per cent in BE 2010-11 and further to 34.6 per cent in 2012-13. For projecting interest payments in 2011-12 and 2012-13, incremental debt is assumed at average interest rate of 7.75 per cent. 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. It would be the endeavour of the Government to bring the interest payment as percentage of total revenue receipts to a sustainable level.

***(b) Defence Services***

27. Defence Services expenditure in revenue account is budgeted to increase from Rs.86,879 crore in BE 2009-10 to Rs.88,440 crore in RE 2009-10 due to the additional requirements on account of implementation of the Sixth Central Pay Commission recommendations. This is estimated to marginally reduce to Rs.87,344 crore in BE 2010-11 on account of payments of salary arrears made in 2009-10. This component of expenditure has increased from 1.1 per cent of GDP in 2007-08 to 1.4 per cent of GDP in RE 2009-10 due to the implementation of the recommendations of the Sixth Central Pay Commission. However, with payment of arrears being taken care of, it is estimated to reduce to 1.3 per cent of GDP in BE 2010-11 and come back to the level of 1.1 per cent in 2012-13.

### *(c) Major subsidies*

28. Developments in the world commodity market post Budget 2008-09 resulted in higher economic cost of petroleum products and fertilisers. With the objective of insulating the consumer from unprecedented rise in the cost of fertilser, petroleum and food products, the expenditure on subsidies for these items were increased substantially in 2008-09. After including Rs.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 Rs.2,19,148 crore amounting to about 40 per cent of revenue receipts of the Government and 3.9 per cent of GDP. This level of subsidy payment is certainly not sustainable and the Government had indicated its intent for reforms in subsidy administration.

29. Accordingly, as part of fertiliser subsidy reform, system of nutrient based subsidy is being introduced from 2010-11. The details of this have been enumerated in the Fiscal Policy Strategy Statement. Further, in order to rationalize petroleum subsidy regime, the report of Parikh Committee is under active consideration of the Government. At the same time, in a departure from the past practice, the Government has decided to provide petroleum subsidy in cash instead of securities. The 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.

30. With respect to bringing down the cost of administering Targetted Public Distribution System (TPDS) through FCI, Government will provide working capital assistance as ways and means advance to FCI which would be recovered during the same financial year. Correspondingly FCI will reduce its cash credit limits and borrowings from the banks. This would result in lower cost of working capital and thereby reduce the interest component in food subsidy. This arrangement will be made operational from 2010-11 onwards. Moreover, FCI is being advised to rationalize their administrative cost and States are being requested to join the De-centralised Procurement System in order to bring down the overall food subsidy expenditure.

31. On the assumptions that current price level may prevail during 2010-11 in the world commodity markets and factoring in impact of reform measures, provision for fertiliser subsidy has been kept at Rs.49,981 crore in BE 2010-11. Food subsidy is estimated at Rs.55,578 crore in BE 2010-11. The increase in food subsidy is to ensure food security for BPL families. However, compared to Rs.1,23,936 crore RE 2009-10, the total of major subsidies is estimated to decline to Rs.1,08,667 crore amounting to 1.6 per cent of GDP in BE 2010-11. 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. 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. On the above assumptions, the major subsidy expenditure is estimated to decline to 1.5 per cent of GDP in 2011-12 and 1.3 per cent of GDP in 2012-13. There is a need to focus on further measures and means to cap this expenditure to create further fiscal space for increased investment in physical and social infrastructure.

### *(d) Non-Plan Grants to States and UTs*

32. The Non-Plan Grants to States/UTs is estimated at Rs.46,001 crore in BE 2010-11 after factoring in the recommendations of the 13th Finance Commission and other non-FC grants. This is significantly higher than the average of Rs.35,034 crore provided during the first four years of the 12th Finance Commission award period. Under the following categories, grants have been recommended by the 13th FC and the same have been provided in BE 2010-11 and factored in the estimates for 2011-12 and 2012-13:

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 2010-11 but factored in for 2011-12 and 2012-13).

33. The total grants recommended during the 13th FC award period is Rs.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.

34. The Central Government continues 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 Rs.10,000 crore has been made in BE 2010-11 for this purpose.

35. 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 2011-12 and 0.8 per cent of GDP in 2012-13. These estimates show that non-plan grants to States and UTs as percentage of tax revenue (net) to Centre would increase from 8.6 per cent in BE 2010-11 to 9.3 per cent in 2012-13.

### *(e) Pensions*

36. Subsequent to the implementation of Sixth Pay Commission, this component of expenditure along with Salary related expenditure has increased significantly. 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 9.1 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 0.6 per cent in BE 2010-11. With the assumption that pension related expenditure may grow at 9 per cent in the coming years, it is estimated that pension payments would stabilize at 0.6 per cent of GDP by 2012-13 and would decline to 6.7 per cent of net tax revenue to Centre in 2012-13.

### (B) Capital accounts

### *(i) Loans and advances*

37. Loans and advances to State Governments had earlier constituted major component of loans and advances extended by Central Government. The Twelfth Finance Commission has recommended disintermediation by Central Government in the matter of loans to State Governments, albeit with support to fiscally weak States, which are unable to raise resources directly. States now raise loans directly from the market. External loans however continue to pass-through the Central Government. The above arrangements are going to be continued during the 13th FC award period.

38. 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*

39. The total expenditure on capital outlay is set to increase from Rs.90,158 crore in 2008-09 to Rs.1,15,192 crore in RE 2009-10 and further to Rs.1,50,025 crore in BE 2010-11. This shows estimated average growth of 29 per cent during 2009-10 and 2010-11.

40. Plan capital expenditure is estimated to increase from Rs.40,461 crore in 2008-09 to Rs.57,967 crore in BE 2010-11 reflecting average growth of 19.7 per cent in the two years period. 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 24.2 per cent from Rs.1,96,427 crore in RE 2009-10 to Rs.2,43,884 crore in BE 2010-11.

41. Non-plan capital expenditure is estimated to increase from Rs.49,697 crore in 2008-09 to Rs.92,058 crore in BE 2010-11. Defence Capital Outlay constitutes the largest component of non-plan capital expenditure and it is estimated at Rs.60,000 crore in BE 2010-11. Also Rs.16,500 crore has been provided for the recapitalization of public sector banks in BE 2010-11.

### 4. GDP Growth

42. There is a revision in the base year for the calculation of National Income. The base year has been changed from 1999-2000 to 2004-05. 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 2008-09 annual real GDP growth at factor cost (at constant 2004-2005 prices) has moderated to 6.7 per cent as compared to the

growth rate of 9.2 per cent during 2007-08. The latest release of data from CSO puts the growth rate for 2009-10 at 7.2 per cent in real term and after factoring in inflation expectation, the GDP growth (at current market prices) for 2009-10 is estimated at 10.6 per cent. Thus the GDP for the year 2009-10 (at current market prices) is set at Rs.61,64,178 crore. In the year 2010-11, with the assumption that economy will start climbing back to the trend growth rate, the real GDP growth has been assumed at 8.5 per cent. After factoring in estimated inflation of 4 per cent during 2010-11, the GDP growth (at current market prices) for 2010-11 is estimated at 12.5 per cent resulting in GDP of Rs.69,34,700 crore (at current market prices). For the period 2011-12 and 2012-13, the real growth rate is assumed at 8.5 per cent and 9 per cent respectively and after factoring in medium term inflation expectation, the GDP growth at current market prices is projected at 13 per cent and 13.5 per cent respectively for 2011-12 and 2012-13.

**C. Assessment of sustainability relating to**

***(i) The balance between Revenue Receipts and Revenue Expenditure***

43. The task ahead in order to continue the process of fiscal consolidation is admittedly more challenging, especially with regard to the elimination of revenue deficit. The Thirteenth Finance Commission has recommended the roadmap for fiscal adjustment and suggested a suitably revised roadmap to maintain the gains of fiscal consolidation through 2010 to 2015, particularly keeping in view the need to bring in the liabilities of the Central Government on account of oil, food and fertiliser bonds into the fiscal accounting, and the impact of various other obligations of the Central Government on the deficit targets. Primarily the fiscal consolidation during the period 2004-08 was revenue driven, and therefore it has created a stress when the revenue buoyancy fell on account of moderation in economic growth. The focus now has to be on expenditure reform in order to make the fiscal consolidation process sustainable and bring in inter-generational equity in fiscal management. This is a major challenge, as many of the components of revenue expenditure are rigid in nature and difficult to come down in medium term. At the same time, revenue receipts of the Central Government would be lower on account of higher tax devolution to States. This may be read with the section C on Policy Evaluation in the Fiscal Policy Strategy Statement, wherein difficulties in achieving revenue surplus have been explained.

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

44. Non-plan expenditure of Rs.7,06,371 crore in RE 2009-10 has exceeded non debt receipts of Rs.6,07,506 crore (comprising of Rs.5,77,294 crore of Revenue Receipts and Rs.30,212 crore of non-debt capital receipts). This trend is estimated to continue in BE 2010-11 also. It shows that the Government has to resort to borrowings for even meeting non-plan expenditure commitments. 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 is addressing these issues in right earnest.

45. In BE 2010-11 the total Plan expenditure of Rs.3,73,092 crore is about 97.8 per cent of the estimated fiscal deficit. This was only 81.1 per cent of the estimated fiscal deficit in BE 2009-10. It indicates 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 is to bring down the ratio of debt to GDP gradually to a sustainable level and use the borrowed funds for creating productive assets. In the projections for 2011-12 and 2012-13, plan expenditure as percentage of fiscal deficit is further estimated to improve to 109.2 per cent and 122.9 per cent respectively.

*Annex - A*

**COMPARISON OF MTFP WITH 13th FINANCE COMMISSION FISCAL ROADMAP**

| | 2010-11 | 2011-12 | 2012-13 |
|---|---|---|---|
| **Fiscal Deficit** | | | |
| MTFP | 5.5 | 4.8 | 4.1 |
| 13th FC | 5.7 | 4.8 | 4.2 |
| **Revenue Deficit#** | | | |
| MTFP | 4.0 | 3.4 | 2.7 |
| 13th FC | 3.2 | 2.3 | 1.2 |
| **Debt*** | | | |
| MTFP | 51.1 | 50.0 | 48.2 |
| 13th FC | 53.9 | 52.5 | 50.5 |

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

\# *Difficulties in adhering to the targets for revenue deficit are explained in para 43 above and section C of Fiscal Policy Strategy Statement.*