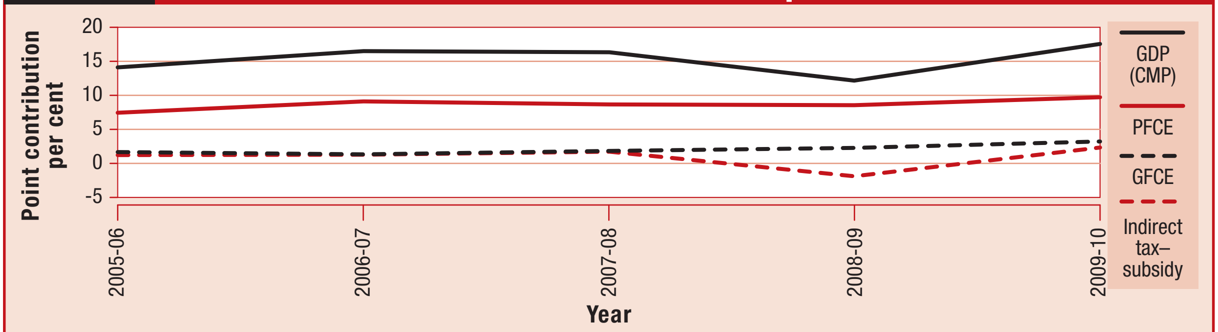
Fiscal Developments and Public Finance

3
CHAPTER

The fiscal outcome in the first nine months of the current financial year remained broadly on the consolidation track charted by the Budget. It might be recalled that the Budget for 2010-11 had begun the process of fiscal consolidation with a partial withdrawal of the stimulus measures as at that juncture there was clear evidence of economic recovery. The policy stance was to continue to aid the growth momentum in the short run to facilitate its attaining pre-crisis levels and simultaneously to address long-run sustainability concerns. With growth reverting to pre-crisis levels in the current fiscal, revenues remaining buoyant, and a much higher than budgeted realization in non-tax revenues arising from telecom 3G/ BWA (third generation/broadband wireless access) auctions, there was headroom for higher levels of expenditure at the given fiscal deficit targets. The combined deficits of State Governments also indicated the overall consolidation process at State level. With continued growth momentum, the prospects for sustaining and deepening the consolidation process remain bright.

3.2 The macroeconomic impact of the global financial and economic crisis and the expansionary fiscal stance was clearly visible in the demand-side components of the national income aggregates. A contraction of the aggregate demand was manifest in the rates of growth of private final consumption expenditure (PFCE) and gross capital formation in 2009-10, which had shares of 58.4 per cent and 35.4 per cent respectively in 2008-09. Net indirect taxes minus subsidies, an important component of the nominal gross domestic product (GDP), also declined. The lower levels of point contribution to growth from these could be partly compensated by the rise in Government final consumption expenditure (GFCE) (Figure 3.1). As the crisis impacted the economy in the second half of 2008-09, movements in quarterly estimates of the demand side of the GDP provided better indication of the recovery process and thus the Budget for 2010-11 envisaged a partial exit from the stimulus measures on the strength of the outcome of the second quarter of 2009-10. This response was broadly in line with the international practices in this regard, which had preferred fiscal policy instruments for counteracting the adverse economic impact of the crisis.

Figure 3.1 Point contribution to GDP at current market prices



3.3 As a proportion of the GDP (purchasing power parity [PPP]), the overall fiscal balance of the world was estimated by the International Monetary Fund (IMF) (Fiscal Monitor 2010) to have risen from - 0.4 per cent in 2007 to - 2.0 per cent and - 6.8 per cent respectively in 2008 and 2009; it was estimated to have moderated to - 6.0 per cent in 2010 and projected at - 4.9 per cent in 2011. At a major grouping level, advanced economies accounted for the bulk of the fiscal expansion. Among the emerging economies, India had one of the largest fiscal expansions of the order of about 10 per cent of the GDP in both 2009 and 2010. In terms of proportions of potential GDP also, the expansion was sizeable in 2009 in the case of India; it was estimated to have declined to - 8.7 per cent in 2010. Going forward, the Fiscal Monitor indicated that the fiscal adjustment in emerging economies in general which was driven by economic recovery in 2010 would be driven by discretionary policies in 2011--a development that would be noteworthy in light of the fact that the discretionary impulse of the expansion was estimated to be small.

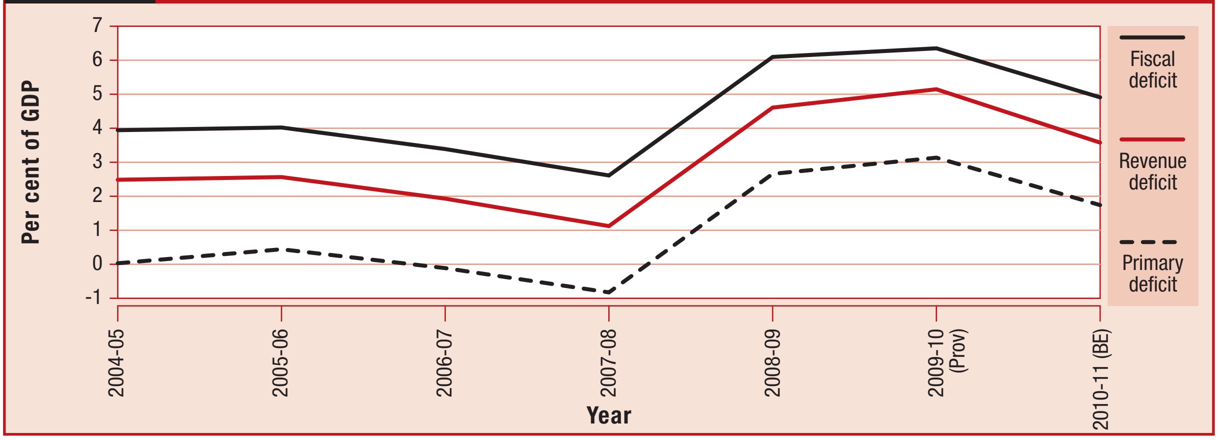
3.4 In actual terms, the Budget for 2010-11 had estimated the level of fiscal deficit at ₹ 3,81,408 crore and revenue deficit at ₹ 2,76,512 crore. At the time of presentation of the Budget for 2010-11 it was envisaged that nominal GDP (GDP at current market prices) would grow by 12.5 per cent and was estimated at ₹ 69,34,700 crore. As proportions of the nominal GDP, fiscal and revenue deficits were estimated at 5.5 per cent and 4.0 per cent respectively. As per the advance estimates (AE) released by the Central Statistics Office (CSO) on 7 February 2011, the nominal GDP for 2010-11 was placed at ₹ 78,77,947 crore, which represents a year-on-year growth of 20.3 per cent, and was 7.8 percentage points higher than envisaged at the time of Budget formulation. As proportions of the GDP as per the AE, budgeted fiscal and revenue deficits work out to 4.8 per cent and 3.5 per cent for the current fiscal. Thus, as proportions of the GDP, the recent trends in deficit indicators, post-crisis, have been influenced to some extent by the swings in the levels of aggregate demand (Table 3.1 and Figure 3.2).

Table 3.1 : Trends in Deficits of Central Government

Year	Revenue Deficit	Fiscal Deficit	Primary Deficit	Revenue Deficit as per cent of Fiscal Deficit
	(As per cent of GDP)			
Enactment of FRBM Act				
2003-04	3.6	4.5	0.0	79.7
2004-05	2.4	3.9	0.0	62.3
2005-06	2.5	4.0	0.4	63.0
2006-07	1.9	3.3	-0.2	56.3
2007-08	1.1	2.5	-0.9	41.4
2008-09	4.5	6.0	2.6	75.2
2009-10(P)	5.1	6.3	3.1	80.7
2010-11(BE)	3.5	4.8	1.7	72.5

Source: Union Budget documents.
BE-Budget estimates
P: Provisional actuals (unaudited)
FRBM : Fiscal Responsibility and Budget Management
Note: The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.

Figure 3.2 Trends in deficits of Central Government



Central Government Finances

3.5 The key driver of the rapid fiscal consolidation after the notification of the FRBM Rules in July 2004 was the buoyancy in tax revenues. As a proportion of the GDP, gross tax revenue rose from a level of 9.2 per cent in 2003-04 to reach a peak level of 11.9 per cent in 2007-08; after falling to 10.8 per cent and 9.6 in 2008-09 and 2009-10 respectively, it was estimated to recover to 10.8 per cent in 2010-11 (BE) as per the then estimated levels of GDP. However, as a proportion of the GDP as per the advance estimates of the CSO, it is at 9.5 per cent. Two significant developments in the recent past in terms of the composition of taxes have been the growth in direct tax revenues, particularly corporate income tax, and in service tax revenues. Union excise duties that have traditionally been the single largest revenue earner ceded place to corporate income tax in 2006-07. In 2009-10, owing to the fiscal stimulus package which envisaged significant reduction in duties and a demand slowdown, union excise duties declined substantially. In 2010-11, with partial restoration in rates and surge in demand, union excise duties have done exceedingly well. With continuance of high growth in corporate income tax and a higher than budgeted outcome in personal income tax in the current year, the prospects of revenue-led medium-term consolidation appears bright.

3.6 While tax revenues provided the anchor for deepening of the fiscal consolidation process in the post FRBM period (2004-05 to 2007-08), there was also some compression in the expenditure to GDP ratio (Table 3.2 and Figure 3.3). Average annual growth in expenditure in the four-year period was 11.2 per cent, below the 16 per cent growth in the nominal GDP. Besides, there were significant reform initiatives in expenditure. First, below-the-line issuance of bonds for financing under-recoveries of petroleum oil companies (as also other such bonds) was discontinued and all such funds were brought into the Budget as subventions booked as cash expenditure. Second, the nutrient-based subsidy policy for fertilizers was put in place. Third, given the elevated levels of prices of international crude petroleum, it was proposed that the level of administered prices for domestic petroleum products would be calibrated to international prices.

Budgetary developments in 2010-11

3.7 Against the backdrop of the fast-paced recovery of the economy in 2009-10 and the elevated levels of food inflation as well as the recommendations of the Thirteenth Finance Commission (ThFC), the budget for 2010-11 resumed the path of fiscal consolidation to make economic growth more broad based and ensure that supply-demand imbalances are managed better. Acting on the ThFC recommendation for limiting the combined public debt to GDP ratio to 68 per cent by 2014-15, the Union Budget for 2010-11 came up with a promise to analyse the issues in a Status Paper, which would also unveil the roadmap for reduction.

3.8 The Budget for 2010-11 indicated that effective management of public expenditure by bringing it in line with the Government's objectives, particularly through proper targeting of subsidies, was a key factor in fiscal management. The Budget for 2010-11 also announced the operationalization of the Nutrient Based Subsidy Policy for fertilizers effective 1 April 2010 and indicated that the recommendations of the Expert Group on a Viable and Sustainable System of Pricing of Petroleum Products would also be operationalized in due course.

Figure 3.3 Receipts and expenditure of the Central Government

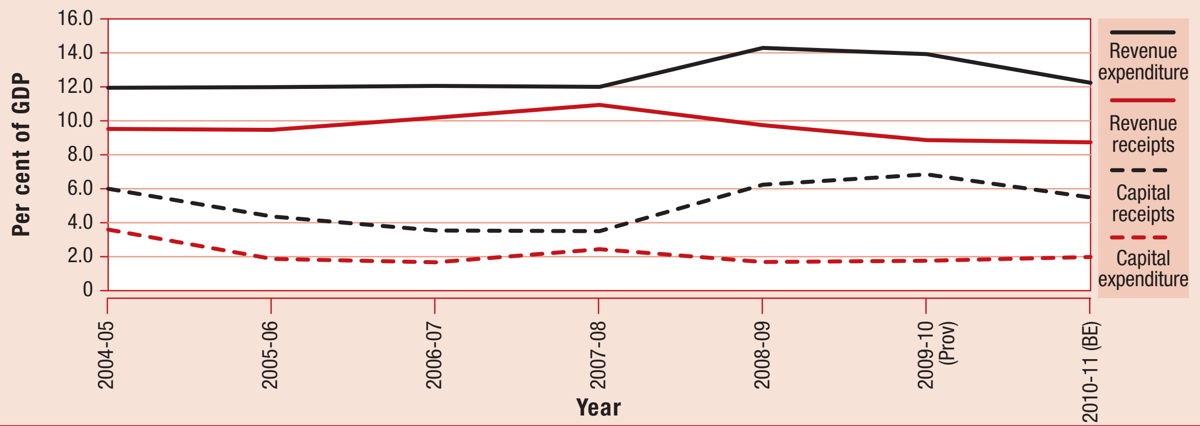


Table 3.2 : Receipts and Expenditure of the Central Government

	2005-06	2006-07	2007-08	2008-09*	2009-10 (BE)	2009-10 (P)	2010-11 (BE)
				(₹ crore)			
1. Revenue Receipts (a+b)	**347077**	**434387**	**541864**	**540259**	**614497**	**575458**	**682212**
(a) Tax Revenue (net of States' share)	270264	351182	439547	443319	474218	459444	534094
(b) Non-tax Revenue	76813	83205	102317	96940	140279	116014	148118
2. Revenue Expenditure	**439376**	**514609**	**594433**	**793798**	**897232**	**908011**	**958724**
of which:							
(a) Interest Payments	132630	150272	171030	192204	225511	211643	248664
(b) Major Subsidies	44480	53495	67498	123581	106004	123396	109092
(c) Defence Expenditure	48211	51682	54219	73305	86879	90668	87344
3. Revenue Deficit (2-1)	**92299**	**80222**	**52569**	**253539**	**282735**	**332553**	**276512**
4. Capital Receipts	**158661**	**149000**	**170807**	**343697**	**406341**	**443068**	**426537**
of which:							
(a) Recovery of Loans	10645	5893	5100	6139	4225	6204	5129
(b) Other Receipts (mainly PSU disinvestment)	1581	534	38795	566	1120	24557	40000
(c) Borrowings and Other Liabilities**	146435	142573	126912	336992	400996	412307	381408
5. Capital Expenditure	**66362**	**68778**	**118238**	**90158**	**123606**	**110515**	**150025**
6. Total Expenditure [2+5=6(a)+6(b)]	**505738**	**583387**	**712671**	**883956**	**1020838**	**1018526**	**1108749**
of which:							
(a) Plan Expenditure	140638	169860	205082	275235	325149	302199	373092
(b) Non-plan Expenditure	365100	413527	507589	608721	695689	716327	735657
7. Fiscal Deficit [6-1-4(a)-4(b)]	**146435**	**142573**	**126912**	**336992**	**400996**	**412307**	**381408**
8. Primary Deficit [7-2(a)]	**13805**	**-7699**	**-44118**	**144788**	**175485**	**200664**	**132744**
				(As per cent of GDP)			
1. Revenue Receipts (a+b)	**9.4**	**10.1**	**10.9**	**9.7**	**10.5**	**8.8**	**8.7**
(a) Tax Revenue (net of States' share)	7.3	8.2	8.8	7.9	8.1	7.0	6.8
(b) Non-tax Revenue	2.1	1.9	2.1	1.7	2.4	1.8	1.9
2. Revenue Expenditure	**11.9**	**12.0**	**11.9**	**14.2**	**15.3**	**13.9**	**12.2**
of which:							
(a) Interest Payments	3.6	3.5	3.4	3.4	3.9	3.2	3.2
(b) Major Subsidies	1.2	1.2	1.4	2.2	1.8	1.9	1.4
(c) Defence Expenditure	1.3	1.2	1.1	1.3	1.5	1.4	1.1
3. Revenue Deficit (2-1)	**2.5**	**1.9**	**1.1**	**4.5**	**4.8**	**5.1**	**3.5**
4. Capital Receipts	**4.3**	**3.5**	**3.4**	**6.2**	**6.9**	**6.8**	**5.4**
of which:							
(a) Recovery of Loans	0.3	0.1	0.1	0.1	0.1	0.1	0.1
(b) Other Receipts (mainly PSU disinvestment)	0.0	0.0	0.8	0.0	0.0	0.4	0.5
(c) Borrowings and Other Liabilities**	4.0	3.3	2.5	6.0	6.8	6.3	4.8
5. Capital Expenditure	**1.8**	**1.6**	**2.4**	**1.6**	**2.1**	**1.7**	**1.9**
6. Total Expenditure [2+5=6(a)+6(b)]	**13.7**	**13.6**	**14.3**	**15.8**	**17.4**	**15.5**	**14.1**
of which:							
(a) Plan Expenditure	3.8	4.0	4.1	4.9	5.6	4.6	4.7
(b) Non-plan Expenditure	9.9	9.6	10.2	10.9	11.9	10.9	9.3
7. Fiscal Deficit [6-1-4(a)-4(b)]	**4.0**	**3.3**	**2.5**	**6.0**	**6.8**	**6.3**	**4.8**
8. Primary Deficit [7-2(a)]	**0.4**	**-0.2**	**-0.9**	**2.6**	**3.0**	**3.1**	**1.7**
Memorandum Items				(₹ crore)			
(a) Interest Receipts	22032	22524	21060	20717	19174	22018	19253
(b) Non-plan Revenue Expenditure	327518	372191	420861	559024	618834	654188	643599

Source: Union Budget documents.

BE-Budget estimates P: Provisional actuals (unaudited)

* Based on provisional actuals for 2008-09.

** Does not include receipts in respect of the Market Stabilization Scheme, which will remain in the cash balance of the Central Government and will not be used for expenditure.

Note: 1. The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.

2. The figures may not add up to total due to rounding/approximations.

Revenue and capital receipts

3.9 The full impact of the fiscal stimulus measures relating to excise duty cuts and the indirect impact on gross tax revenues became evident only in 2009-10. As a proportion of the GDP, gross tax revenues declined from 10.8 per cent in 2008-09 to 9.6 per cent in 2009-10; the levels would have been even lower in 2008-09 had the nominal GDP grown at trend levels. Thus the Budget for 2010-11 partially restored the excise duties and with economic recovery gaining momentum envisaged a rise in the tax to GDP ratio to 10.8 per cent in the current fiscal; this implied a year-on-year growth of 19.1 per cent and amounted to ₹ 7,46,651 crore. The restoration of excise duty levels, albeit partial, was expected to result in a year-on-year growth of 26.1 per cent in 2010-11 as against a level of 29.4 per cent envisaged by the RE. It was also estimated that revenue from customs would grow at 36.5 per cent in 2010-11. With service tax estimated to grow by 16.3 per cent to reach a level of ₹ 68,000 crore, indirect taxes were estimated at ₹ 3,15,000 crore, implying an overall growth of 19.1 per cent in 2010-11 over 2009-10. Overall revenue from direct taxes was expected to grow by 15.0 per cent in 2010-11 to reach ₹ 4,22,500 crore. In part, this owed to some positive developments arising from the economic recovery and growth in manufacturing/ industry on the one hand and the higher levels of exemption arising from broadening of the income tax brackets on the other. This was reflected in the budget estimates of year-on-year growth of 23.2 per cent in corporate income tax and decline of 1.4 per cent in personal income tax. The varying levels of growth in the different components of tax revenues, given the levels of their relative shares in gross tax revenues, indicate changes in the composition of taxes.

3.10 At the beginning of the economic reforms process in 1991-92, the ratio of direct and indirect taxes in gross tax revenue was 22.6 per cent and 74.8 per cent respectively. As part of the larger economic reforms, the reforms in the tax structure effected through a gradual and sequenced reduction in the rates of duties in both customs and excise together with the increase in the levels of income resulted in a gradual shift in the composition of taxes. As a result in 2004-05--the year when the FRBM regime was operationalized--the ratios of direct and indirect taxes were 56.1 per cent and 43.3 per cent of gross tax revenue; in 2009-10, the ratios were 58.6 per cent and 39.5 per cent respectively (Table 3.3 and Figure 3.4).

Direct taxes

3.11 The Budget for 2010-11 carried forward the thrust on maintaining moderate levels of taxation and expanding the tax base. The tax slabs under personal income were broadened and the surcharge on corporate income tax was reduced from 10 per cent to 7.5 per cent. At the same time, the rate of minimum alternate tax was raised to 18 per cent to expand the tax base and improve inter-se equity in the taxation of corporates.

3.12 The Government had signalled its intention to consolidate and comprehensively amend the existing Income Tax Act 1961 and Wealth Tax Act 1957 through a single legislation, by releasing a draft Direct Taxes Code (DTC) and a discussion paper for public comments in August 2009. Based on analysis of the numerous inputs received from stakeholders, a revised discussion paper was released in June 2010 followed by the introduction of the Direct Taxes Code Bill 2010 in Parliament in August 2010. It has now been proposed to make it effective from 1 April 2012 (Box 3.1).

Indirect taxes

3.13 The Budget for 2010-11 had indicated that the formulation of indirect tax proposals was guided by the need to return to the path of fiscal consolidation without affecting the growth momentum of the economy and moving forward on the road to a goods and services tax (GST). There was accordingly a recalibration of the rates and certain rationalization and relief measures in the Budget.

3.14 The following were the important measures taken in the Budget for 2010-11:

- The standard rate of excise duty (CENVAT) which was brought down to 8 per cent after two successive reductions in December 2008 and February 2009 was increased to 10 per cent.
- Excise duty on petrol and diesel was increased by ₹ 1 per litre so as to restore it to pre-June 2008 levels.
- Full or partial excise duty exemptions/ concessions available on some items were withdrawn and duty imposed on them at the rate of 4 per cent or 10 per cent.

Table 3.3 : Sources of Tax Revenue

	2005-06	2006-07	2007-08	2008-09	2009-10 (BE)	2009-10 (P)	2010-11 (BE)
				(₹ crore)			
Direct (a)	**157557**	**219724**	**295938**	**319859**	**370000**	**367415**	**422500**
Personal Income Tax	55985	75093	102644	106046	112850	122280	120566
Corporation Tax	101277	144318	192911	213395	256725	244630	301331
Indirect(b)	**199348**	**241538**	**279031**	**269433**	**269477**	**247357**	**315000**
Customs	65067	86327	104119	99879	98000	84244	115000
Excise	111226	117613	123611	108613	106477	104659	132000
Service Tax	23055	37598	51301	60941	65000	58454	68000
Gross Tax Revenue *	**366151**	**473512**	**593147**	**605298**	**641079**	**626916**	**746651**
			Tax Revenue as a Percentage of Gross Tax Revenue				
Direct (a)	**43.0**	**46.4**	**49.9**	**52.8**	**57.7**	**58.6**	**56.6**
Peronal Income Tax	15.3	15.9	17.3	17.5	17.6	19.5	16.1
Corporation Tax	27.7	30.5	32.5	35.3	40.0	39.0	40.4
Indirect(b)	**54.4**	**51.0**	**47.0**	**44.5**	**42.0**	**39.5**	**42.2**
Customs	17.8	18.2	17.6	16.5	15.3	13.4	15.4
Excise	30.4	24.8	20.8	17.9	16.6	16.7	17.7
Service Tax	6.3	7.9	8.6	10.1	10.1	9.3	9.1
			Tax Revenue as a Percentage of Gross Domestic Product				
Direct(a)	**4.3**	**5.1**	**5.9**	**5.7**	**6.3**	**5.6**	**5.4**
Personal Income Tax	1.5	1.7	2.1	1.9	1.9	1.9	1.5
Corporation Tax	2.7	3.4	3.9	3.8	4.4	3.7	3.8
Indirect(b)	**5.4**	**5.6**	**5.6**	**4.8**	**4.6**	**3.8**	**4.0**
Customs	1.8	2.0	2.1	1.8	1.7	1.3	1.5
Excise	3.0	2.7	2.5	1.9	1.8	1.6	1.7
Service Tax	0.6	0.9	1.0	1.1	1.1	0.9	0.9
Gross Tax Revenue *	**9.9**	**11.0**	**11.9**	**10.8**	**10.9**	**9.6**	**9.5**

Source: Union Budget documents.

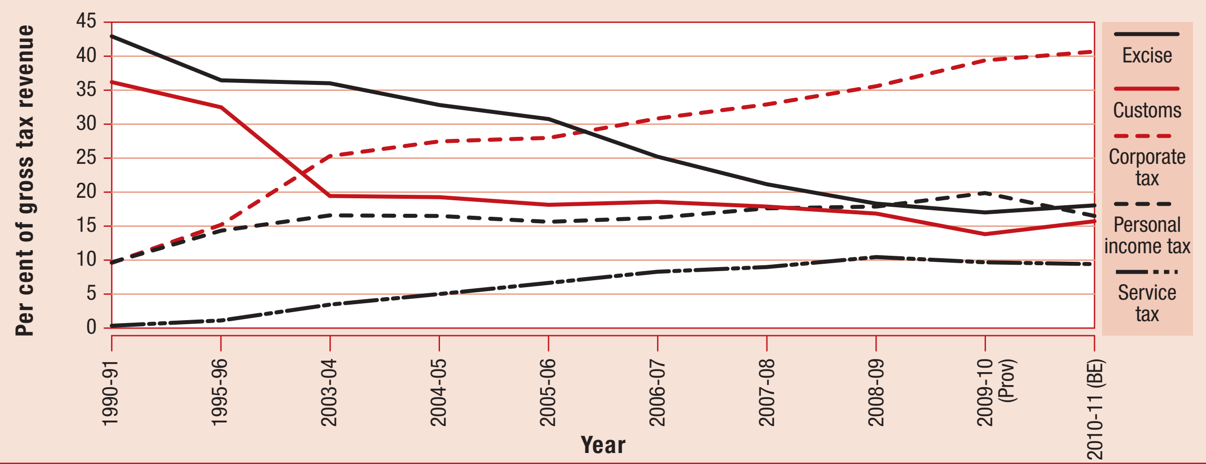
BE-Budget estimates   P: Provisional actuals (unaudited)

* includes Taxes referred to in (a) & (b) and Taxes of Union Territories and 'other' Taxes.

Note: 1. Direct Taxes also include Taxes pertaining to expenditure, interest, wealth, gift, and estate duty.

2. The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.

Figure 3.4 **Composition of gross tax revenue**



Box 3.1 : Direct Taxes Code (DTC)

The Direct Taxes Code Bill, 2010 introduced in Parliament, seeks to consolidate and amend the laws relating to all direct taxes, that is income-tax, dividend distribution tax, and wealth tax so as to establish an economically efficient, effective, and equitable direct tax system which will facilitate voluntary compliance and help increase the tax to GDP ratio. The salient features of the DTC are :

1.0 It consolidates and integrates all direct tax laws and replaces both the Income Tax Act 1961 and the Wealth Tax Act 1957 with a single legislation.

1.1 It simplifies the language of the legislation. The use of direct, active speech, expressing only a single point through one sub-section and rearranging the provisions into a rational structure will assist a layperson to understand the provisions of the DTC.

1.2 It indicates stability in direct tax rates. Currently, the rates of tax for a particular year are stipulated in the Finance Act for that relevant year. Therefore, even if there is no change proposed in the rates of tax, the Finance Bill has still to be passed indicating the same rates of tax. Under the Code, all rates of taxes are proposed to be prescribed in Schedules to the Code, thereby obviating the need for an annual finance bill, if no change in the tax rate is proposed. The Code proposes a corporate tax rate of 30 per cent against the current effective rate of 33.2 per cent and raises the exemption limit as well as broadens the tax slabs for personal income tax.

2.0 It strengthens taxation provisions for international transactions. In the context of a globalized economy, it has become necessary to provide a stable framework for taxation of international transactions and global capital. This has been reflected in the new provisions. The new provisions with regard to international taxation are:

2.1 Advance Pricing Agreements for International Transactions--This will bring in certainty in transfer-pricing issues as any taxpayer can enter into an agreement with the tax administration, which will be valid for a period up to five years, regarding the manner in which the taxpayer would compute arm's length price in respect of the taxpayer's international transactions.

2.2 Alignment of concept of residence (of a Company) with India's tax treaties by introduction of concept of 'place of effective management' instead of 'wholly controlled' in India.

2.3 Controlled Foreign Company Regulations--This is a provision which will assist in taxation of profits of a foreign company in the hands of resident share- holders who may have incorporated such a company in low tax jurisdictions and are accumulating passive income (i.e. interest, dividends, capital gains, etc.) in the company without repatriating the income to India.

2.4 Branch Profit Tax on Foreign Companies--Currently, foreign companies are taxed at the rate of 42.2 per cent (inclusive of surcharge and cess) while domestic companies are taxed at the rate of 33.2 per cent (inclusive of surcharge and cess) plus a dividend distribution tax at the rate of 16.6 per cent when they distribute dividend from accumulated profits. It is proposed to equate the tax rate of foreign companies with that of domestic companies by prescribing the rate at 30 per cent and levying a branch profit tax (in lieu of dividend distribution tax) at the rate of 15 per cent. This will provide tax neutrality between a branch and a subsidiary of a foreign company in India.

2.5 Taxation of assets held abroad under wealth tax—It is proposed to include certain assets of residents which are held abroad, such as deposits in bank accounts in the case of individuals and interest in a foreign trust or in a controlled foreign corporation. This will create a reporting requirement mechanism for assets held abroad.

3. Phasing out Profit-linked Tax Incentives and Replacing them by Investment-linked Incentives--It has been observed that profit-linked deductions are inherently discriminatory, prone to misuse by shifting of profits from non-exempt to exempt entity or by reporting higher profits in exempt income entity, and also lead to high level of litigation and revenue foregone. They also impede the Government's efforts to give a moderate tax rate to other taxpayers as the higher taxes paid by others by implication cross-subsidize the lower tax rates of the profit-linked deduction sectors. Such profit-linked deductions are being phased out of the Income Tax Act and have also been dropped in the DTC. They are being replaced by investment-linked deductions for specified sectors. Investment-linked incentives are calibrated to the levels of creation of productive capacity and therefore are superior instruments. Profit-linked deductions currently being availed of have been protected for the unexpired period in the DTC.

4. Rationalization of Tax Incentives for Savings--In order to focus savings incentives on long-term savings for social security of the taxpayer during his non-working life, deduction of up to Rs 1 lakh has been provided for investments in approved provident funds, superannuation funds, and pension funds.

5. General Anti Avoidance Rule to Curb Aggressive Tax Planning—Direct tax rates have been moderated over the last decade and are in line with international norms. A general anti-avoidance rule assists the tax administration in deterring aggressive tax avoidance in a globalized economy. Such general anti-avoidance rules already form a part of the tax legislation in a number of G-20 countries.

6. Taxation of Non-profit Organizations: It is proposed to tax non-profit organizations set up for charitable purposes on their surplus (at the rate of 15 per cent), after allowing for accumulation of a specified proportion for creation of assets or for long-term projects, a further carry forward for receipts of the last month of the year, and also after a basic exemption limit of Rs 1 lakh. Donations to these non-profit organizations will be eligible for tax deduction in the hands of the donor.

- Excise duty on cigarettes and other tobacco products was increased.
- Ad-valorem component of excise duty on large cars, multi utility vehicles, and sports utility vehicles was increased from 20 per cent to 22 per cent.
- Customs duty was increased on crude petroleum from nil to 5 per cent; petrol and diesel from 2.5 per cent to 7.5 per cent; and other specified petroleum products from 5 per cent to 10 per cent—once again to restore these duties to pre-June 2008 levels.
- Customs duty on gold, silver, and platinum increased by 50 per cent of the earlier applicable specific rates.
- Eight new services were brought under the service tax net to broaden the tax base. In addition, scope of some existing taxable services was expanded.

3.15 Fiscal concessions were given to priority/ thrust areas of the economy like agriculture, food processing, renewable energy and conservation of energy, and infrastructure. The objective was to attract fresh investments in the agricultural/food processing and other related sectors like horticulture/ apiary/diary/poultry for: (a) creation of farm to market supply chains; (b) prevention of wastage of produce; and (c) infusion of technology to boost production. In the energy sector, the aim was to reduce dependence on fossil fuels and harness the new and clean sources of energy. In specific terms, the following major fiscal concessions were granted:

- Project imports status, with concessional rate of basic customs duty of 5 per cent, for installation of mechanized handling systems and pallet racking systems in *mandis* or warehouses for foodgrains and sugar along with exemption from additional customs duty and special additional customs duty . Installation and commissioning of such systems is also exempt from service tax.
- Project imports status, with concessional rate of basic customs duty of 5 per cent, and full exemption from service tax for the initial setting up or substantial expansion of a cold storage, cold room (including farm pre-coolers) for preservation or storage or an industrial unit for processing of agricultural, apiary, horticultural, dairy, poultry, aquatic and marine produce, and meat.
- Full exemption from basic customs duty for truck refrigeration units for the manufacture of refrigerated vans/trucks. Such units are already exempt from excise duty.
- Reduction of basic customs duty from 7.5 per cent to 5 per cent on specified agricultural machinery such as paddy transplanters, laser land levellers, cotton pickers, reaper-cum-binders, straw or fodder balers, sugarcane harvesters, tracks used for manufacture of track-type combine harvester, etc.
- Full exemption from excise duty on specified equipment for preservation, storage, or transportation of apiary, horticultural, dairy, poultry, aquatic and marine produce, and meat and processing thereof.
- Exemption from service tax for transportation of cereals and pulses by road.
- Exemption from service tax for testing and certification of seeds.
- Concessional basic customs duty rate of 5 per cent on machinery items, instruments, and appliances required for initial setting up of solar power generation projects or facilities. These items are also exempt from excise duty.
- Full exemption from basic customs duty and special additional customs duty for ground source heat pump to tap geo-thermal energy.
- Full exemption from excise duty on additional specified raw materials for the manufacture of rotor blades for wind-operated electricity generators.
- Mono Rail Projects for urban transport granted project imports status with concessional rate of 5 per cent basic customs duty. Concessional customs duty rate of 5 per cent presently available up to 6 July 2010 on specified machinery for tea, coffee, and rubber plantations extended up to 31 March 2011. Excise duty exemption has also been reintroduced on these items up to 31 March 2011.
- A uniform concessional rate of duty of 4 per cent prescribed for parts, required for manufacture of all categories of electrical vehicles including cars, two wheelers, and three wheelers (like 'Soleckshaw') subject to actual user condition. Such vehicles will also be charged excise duty at the rate of 4 per cent.

- Excise duty reduced from 8 per cent to 4 per cent on LED lights/lighting fixtures.

3.16 As regards simplification of procedures, with effect from 1 April 2010 small-scale industrial (SSI) units were allowed to take full CENVAT credit on capital goods in one instalment in the year of receipt of such goods. Facility of payment of excise duty on quarterly basis was extended to SSI units. The relaxation from brand name restriction under the general SSI exemption scheme was extended to plastic bottles and plastic containers used as packing material.

3.17 The following important relief and rationalization measures were also extended:

- Varying rates of customs duty on medical equipment were done away with and now all medical equipment (with some exceptions) attracts 5 per cent basic customs duty, 4 per cent countervailing duty (CVD)/excise duty, and nil special additional customs duty (i.e. effective duty of 9.2 per cent). Parts required for the manufacture and accessories of medical equipment were also charged 5 per cent concessional basic customs duty with nil special CVD.
- Prior to the Budget, umbrellas attracted 4 per cent excise duty while umbrella parts were charged 8 per cent excise duty and umbrella cloth was fully exempt. The rate of excise duty on umbrellas and all umbrella parts was unified at 4 per cent in the Budget.
- Full exemption from excise duty was provided on articles of bedding wholly made of quilted textile materials; toy balloons made of natural rubber; betel nut product known as '*supari*'; dementholised oil, deterpenated mentha oil, spearmint/ mentha piperita oils, and all intermediates and by-products of menthol.
- Excise duty was reduced from 8 per cent to 4per cent on replaceable kits for all household-type water filters (except those operating on RO technology); corrugated boxes/ cartons manufactured by stand-alone manufacturers; and latex rubber thread
- Basic customs duty was reduced from 10 per cent to 5 per cent on magnetrons of up to 1000 kw for the manufacture of microwave ovens.
- Promotional material like trailors of films are imported free of cost in the form of electronic promotion kits /betacams were fully exempted from basic customs duty and CVD. Project imports status was accorded to 'Setting up of Digital Head End' with 5 per cent concessional basic customs duty and nil special additional customs duty .
- Basic customs duty on rhodium which is used primarily for the manufacture of gold jewellery, was reduced from 10 per cent to 2 per cent.
- The limit of ₹ 1 lakh per annum on duty-free import of samples was enhanced to ₹ 3 lakh per annum.
- The list of exempted components, raw materials, and accessories for the manufacture of sports goods was enlarged by including some additional items.

Collection rates

3.18 Various measures like simple average tariffs, weighted average tariffs, and tariff dispersion indicate the levels of protection in an economy and are often used for cross-country comparisons. In many emerging economies, the level of nominal tariffs as indicated in the schedule under the customs acts might be very different from the applied levels as there are numerous exemptions. It is therefore useful to refer to such measures as collection rates for understanding the inter-temporal changes within the country better. The collection rates have steadily declined over the years. Given the fact that the rates include CVDs, which are not counted as protection, the real levels of protection in India are much smaller. Barring chemicals, man-made fibres, metals, and capital goods, the collection rates are in single digit (Table 3.4 and Figure 3.5).

Service Tax

3.19 Since its introduction in 1994-95, service tax has helped widen the tax base of indirect taxes. There has been an increase in the number of services over the years (Table 3.5). The Budget for 2010-11 announced the following measures:

(a) Rate of service tax was retained at 10 per cent (which had earlier been reduced from 12 per cent in February 2009 as part of the fiscal stimulus package).

(b) Eight new services were brought under the service tax net:

 (i) Services of promoting, marketing, or organizing of games of chance, including lottery.

Table 3.4 : Collection Rates for Selected Import Groups*

(per cent)

Sl. No.	Commodity Groups	1990-91	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 (Prov.)
1.	Food Products	47	22	32	23	19	4	3
2.	POL	34	10	6	5	6	3	2
3.	Chemicals	92	22	20	22	22	16	14
4.	Man-made Fibres	83	39	34	28	30	17	22
5.	Paper & Newsprint	24	7	9	10	10	8	8
6.	Natural Fibres	20	11	13	12	13	6	4
7.	Metals	95	26	25	24	24	17	17
8.	Capital Goods	60	16	13	14	16	13	11
9.	Others	20	6	5	6	6	4	4
10.	Non-POL	51	12	12	12	13	9	8
11.	**Total**	**47**	**11**	**10**	**10**	**10**	**7**	**6**

Source: Department of Revenue, Ministry of Finance

* Collection rate is defined as the ratio of revenue collection (basic customs duty + countervailing duty) to value of imports unadjusted for exemptions, expressed in percentage.

POL-Petroleum oil and lubricants

Sl.No. 1 includes cereals, pulses, tea, milk and cream, fruits, vegetables, animal fats, and sugar.

Sl.No. 3 includes chemical elements, compounds, pharmaceuticals, dyeing and colouring materials, plastic and rubber.

Sl.No. 5 includes pulp and waste paper, newsprint, paperboards and manufactures, and printed books.

Sl.No. 6 includes raw wool and silk.

Sl.No. 7 includes iron and steel and non-ferrous metals.

Sl.No. 8 includes non-electronic machinery and project imports and electrical machinery.

(ii) Health services, namely health check up undertaken by hospitals or medical establishments for the employees of business entities and health services provided under health insurance schemes offered by insurance companies.

(The tax on these health services would be payable only to the extent payment for such medical check-up or preventive care or treatment, etc. is made directly by the business entity or the insurance company to the hospital or medical establishment);

(iii) Services provided for maintenance of medical records of employees of a business entity;

(iv) Services of promoting of a 'brand' of goods, services, events, business entity, etc.;

(v) Services of permitting commercial use or exploitation of any event organized by a person or organization;

(vi) Services provided by electricity exchanges;

Figure 3.5 **Collection rates for selected import groups**

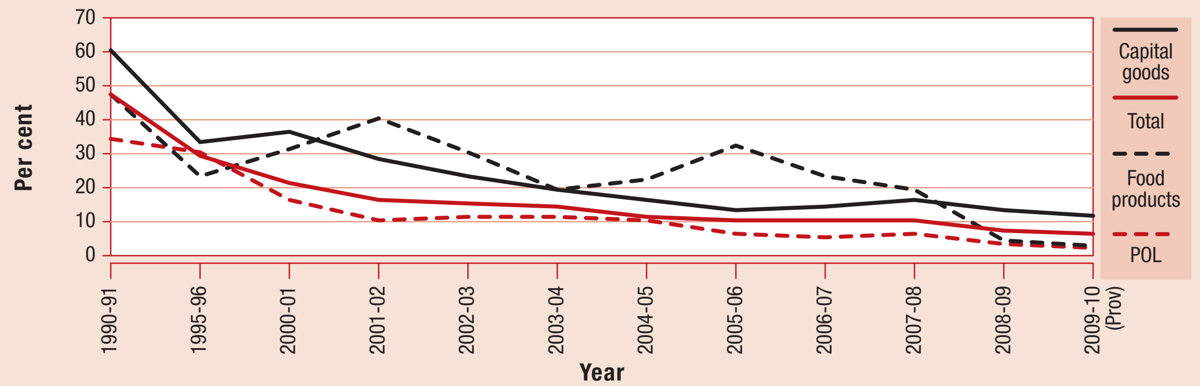


Table 3.5 : Service Tax-A Growing Revenue Source

	No. of Services*	Tax Rate in per cent	Revenue (₹ crore)	Growth in per cent over Previous Year**
2004-05	75	10	14200	80.0
2005-06	78	10	23055	62.4
2006-07	93	12	37598	63.1
2007-08	100	12	51301	36.4
2008-09	106	12***	60941	18.8
2009-10(P)	109	10	58454	-4.1
2010-11 (April-December)	117	10	44081	19.2

Source : Receipts Budget and Controller General of Accounts.
*** Based on new entries added each year.**
**** Growth for 2010-11 (April-December) is over corresponding period previous year.**
***** Reduced to 10 per cent w.e.f. 24-2-2009.**
P : Provisional actuals (unaudited)

(vii) Services related to two types of copyrights hitherto not covered under existing taxable service 'Intellectual Property Right (IPR)', namely those on (a) cinematographic films; and (b) sound recording;

(viii) Special services provided by a builder, etc. to prospective buyers such as providing preferential location or external or internal development of complexes on extra charges.

(c) Certain modifications were made in the definition of existing taxable services to widen the scope of the levy of service tax:

- The scope of the taxable service 'Air Passenger Transport Service' expanded to include domestic journeys and international journeys in any class;

- Prior to the Budget, 'Information Technology (IT) Software Service' was subject to tax only in cases where such IT software is used for furtherance of business or commerce. The scope of the taxable service expanded to tax such service even if the service provided is used for purposes other than business or commerce;

- An explanation was added in the definition of the taxable service 'Commercial Training or Coaching Service' to clarify that the term 'commercial' appearing in the relevant definitions only means that such training or coaching is being provided for a consideration whether or not such training or coaching is conducted with a profit motive. This change was given retrospective effect from 01.07.2003;

- In the definition of the taxable service 'Sponsorship Service', the exclusion relating to sponsorship pertaining to sports was removed;

- In the definition of 'Construction of Complex Service', and 'Commercial or Industrial Construction Service', it was provided that unless the entire consideration for the property is paid after the completion of construction (i.e. after issuance of completion certificate by the competent authority), the activity of construction would be deemed to be a taxable service provided by the builder/promoter/developer to the prospective buyer and the service tax would be charged accordingly;

- Amendments were made in the definition of the taxable service 'Renting of Immovable Property' to: (i) provide explicitly that the activity of 'renting' itself is a taxable service. This change was given retrospective effect from 1June 2007; and (ii) provide that renting of vacant land, where the agreement or contract between the lessor and lessee provides for undertaking construction of buildings or structures on such land for furtherance of business or commerce during the tenure of the lease, shall be subject to service tax;

- The definitions of the taxable services, 'Airport Services', 'Port Services', and the 'Other Port Services' were amended to provide that (a) all services provided entirely within the airport/port premises would fall under these services; and (b) an authorization from the airport/port authority would not be a precondition for taxing these services;

- An explanation was added in the definition of the taxable service' Auctioneer's Service' to clarify that the phrase 'auction by Government' means an auction involving sale of Government property by any auctioneer and not when the Government acts as an auctioneer for sale of a private property;

- The definition of 'Management of Investment under ULIP Service' was amended to provide that the value of the taxable service for any year of the operation of policy shall be the actual amount charged by the insurer for management of funds under ULIP or the maximum amount of fund management charges fixed by the Insurance Regulatory and Development Authority (IRDA), whichever is higher;

(d) Certain exemptions from service tax were provided:

- Statutory taxes charged by any Government (including foreign Governments, where a passenger disembarks) on air passengers were excluded from taxable Value for the purpose of levy of service tax under the Air Passenger Transport Service;

- Exemption was provided from service tax on air transport of passengers for journeys originating from the north-eastern Region;

- Exemption from service tax was provided to services relating to 'Erection, Commissioning or Installation' of,

  - Mechanized Food Grain Handling Systems, etc.;

  - Equipment for setting up or substantial expansion of cold storage; and

  - Machinery/equipment for initial setting up or substantial expansion of units for processing of agricultural, apiary, horticultural, dairy, poultry, aquatic, marine, or meat products;

- Packaged IT software, pre-packed in retail packages for single use, was exempted from service tax leviable under IT Software Service, subject to specified conditions. These conditions include that either the customs duty (in case of import) or excise duty (in case of domestic production) has been paid on the entire amount received from the buyer;

- scope of exemption from service tax available for transport of fruits, vegetables, eggs, or milk by road by a goods transport agency was expanded by including foodgrains and pulses in the list of exempted goods;

- Exemption from service tax was provided to Indian news agencies under 'Online Information and Database Retrieval Service' and 'Business Auxiliary Service' subject to specified conditions ;

- Exemption from service tax for 'Technical Testing and Analysis Service' and 'Technical Inspection and Certification Service' provided by Central and State seed testing laboratories, and Central and State seed certification agencies;

- Exemption from service tax provided for transmission of electricity.

Tax Expenditure

3.20 Tax expenditure statement (Statement of revenue foregone on account of tax incentives or preferences) was first placed before Parliament in the Budget for 2007-08. The estimates are somewhat counterfactual in nature and seek to quantify the potential revenue (including through a sampling process) had these exemptions been not given; assume that tax base and other conditions remain unaltered. Subsequently this continued to be published every year and in the Budget for 2010-11, tax foregone on account of exemptions under corporate income tax for 2008-09 and 2009-10 was estimated at ₹ 66,901 crore and ₹ 79,554 crore respectively. Accelerated depreciation, deduction of export profits of units located in software technology parks and of export-oriented units (EOUs) were some of the major items under such corporate exemptions. Tax foregone on account of exemptions under personal income tax was estimated at ₹ 33,216 crore and ₹ 36,186 crore respectively in 2008-09 and 2009-10 with deduction on account of certain eligible investments and expenditures under section 80C of the IncomeTax Act being the main exemptions.

3.21 Revenue foregone estimates in excise and customs broadly correspond to the differences in statutory or Schedule rates of duties and the effective or applied rates of duties multiplied by the value assessed. Total revenue foregone in excise for 2008-09 was estimated at ₹ 1,35,496 crore, of which area-based exemptions amounted to ₹ 10,589 crore. Tax expenditure is estimated to have risen to ₹ 1,70,765 in 2009-10 with area-based exemptions accounting for only ₹ 5,882 crore. In customs, revenue foregone under various exemptions was estimated to be of the order of ₹ 2,02,240 crore in 2008-09 and ₹ 2,18,191 crore in 2009-10. The following sectors benefited the most from such exemptions: crude oil and mineral oils; machinery; diamond, gold and jewellery; edible vegetable, fruits, cereals, edible oils; chemicals and plastics; and primary metals and articles thereof. Revenue foregone on account of various export promotion schemes was estimated at ₹ 44,417 crore in 2008-09 and ₹ 37,970 crore in 2009-10. Overall, tax expenditure as a proportion of aggregate tax collection was placed at 68.6 per cent in 2008-09 and is estimated to have risen to 79.5 per cent in 2009-10.

Expenditure trends

3.22 In a 2x2 schema of classification of public expenditure into revenue and capital, and Plan and non-Plan, the thrust of public expenditure management policies, particularly in terms of FRBM commitments, has been on containing non-Plan revenue expenditure and raising the levels of Plan expenditure, preferably the capital variety. Non-Plan revenue expenditure has five major components, namely interest payments, subsidies, defence expenditure, pay, and pensions. As a proportion of the GDP, defence expenditure and interest payments have been more or less stable. Given the committed nature of other expenditure, the immediate and real compression under this classification could only come from subsidies; hence the focus on reforms in subsidies in recent budgets. Front loading of Plan expenditure was possible in 2008-09 and 2009-10 in view of the fiscal expansion to combat the adverse impact of the global crisis. Though an amount of ₹ 3,25,149 crore (equivalent of 5.6 per cent of the GDP) was earmarked as Plan expenditure in Budget estimates for 2009-10, as per the provisional actual data released by the Controller General of Accounts (CGA), plan expenditure was at ₹ 3,02,199 crore (equivalent of 4.6 per cent of the GDP). As per the Budget for 2010-11, plan expenditure for the current fiscal was placed at ₹ 3,73,092 crore, equivalent of 4.7 per cent of the GDP. (Figures 3.6 and 3.7)

Interest payments

3.23 The levels of outstanding liabilities in end-March and assumption of incremental liabilities during the fiscal have a crucial bearing on the levels of interest payments in a given year. Reflecting the less than prudent fiscal management of the past, interest payments have been growing at a steady rate and appropriating about 35 per cent of the revenue receipts in the last five years. Given the fact that the levels of outstanding liabilities could only come down in the medium to long term with fiscal consolidation, one of the important targets of the FRBM framework was the progressive reduction in assumption of incremental liabilities. Reflecting this, as a proportion of the GDP, interest payments came down from 4.5 per cent in 2003-04 to 3.4 per

Figure 3.6 Trends in Centre's revenue expenditure

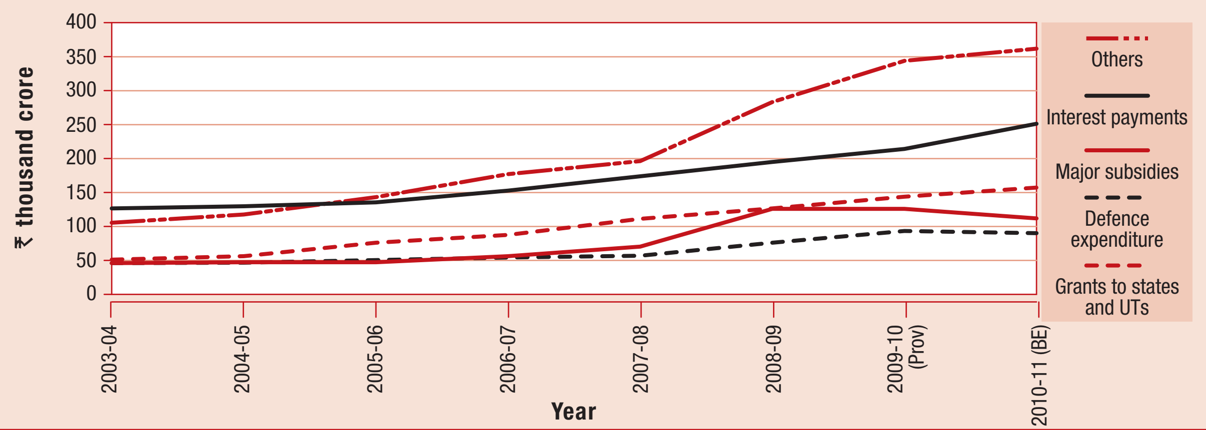
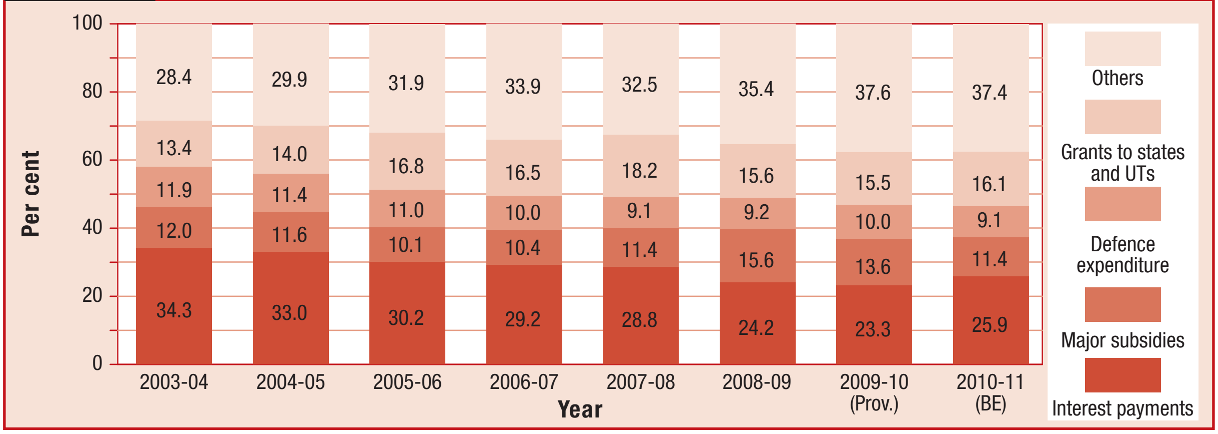


Figure 3.7 **Composition of revenue expenditure**



cent in 2007-08. Net of the interest payments on the National Small Savings Fund (NSSF), the average cost of borrowing has risen to 7.9 per cent from 7.7 per cent in 2010-11 in the current fiscal reflecting the higher levels of debt outstanding last year (Table 3.6 and Figure 3.8).

Subsidies

3.24 As a proportion of the GDP, subsidies have grown from 1.4 per cent in 2004-05 to 2.3 per cent in 2008-09 (Figure 3.9). Below-the-line bonds issued in lieu of subsidies also rose to a level of ₹ 1,10,510 crore in 2008-09 (2 per cent of the GDP). This rise in subsidies owes to the elevated levels of global crude oil prices and the less than full pass through of the international prices to the domestic markets and is also reflected in fertilizer subsidies as cost of feedstock is the major cost. Following the global financial crisis, there was a brief respite; nevertheless global crude prices have started to trend up. Some of the subsidies were also not targeted properly. The Budget for 2010-11 also announced the intent of bringing all subsidy-related liabilities to fiscal accounting. It was in this context that the recent Budgets have focused on restructuring the subsidy regime in fertilizers and petroleum. As a first step, pricing of petrol (motor spirit) was liberalized and a modest hike in administered prices of kerosene and LPG (liquefied petroleum gas) was announced. The retail selling price of public distribution system (PDS) kerosene was increased by ₹ 3 per litre in Delhi with corresponding increase in the rest of the country and the price of domestic LPG was increased by ₹ 35 per cylinder (14.2 kg) in Delhi with corresponding increase in the rest of the country.

Supplementary demands for grants

3.25 Supplementary demands for grants are placed before the Parliament to include all those expenditure proposals (excess or fresh or reappropriations) that were not envisaged at the time of presentation of the Budget and have to be incurred in the current year. Two supplementary demands for grants have so far been presented in the current fiscal. The first batch was approved by Parliament in August 2010

Table 3.6 : Interest on Outstanding Internal Liabilities of Central Government

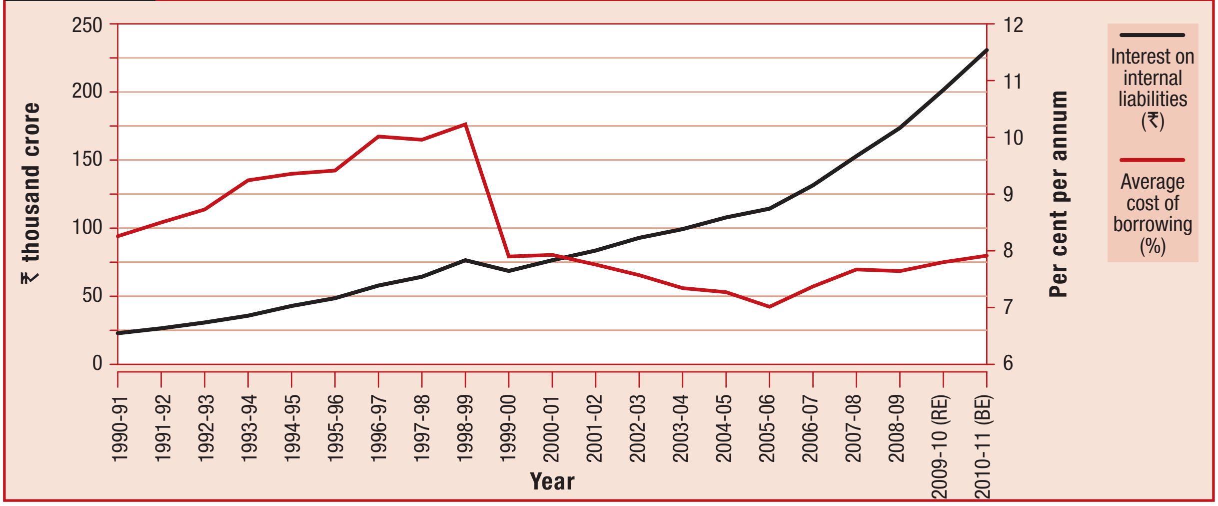
	Outstanding Internal Liabilities	Interest on Internal Liabilities	Average Cost of Borrowings (per cent per annum)
	(₹ crore)		
2004-05	1603785	105176	7.2
2005-06	1752403	111476	7.0
2006-07	1967870	128299	7.3
2007-08	2247104	149801	7.6
2008-09*	2565991	170388	7.6
2009-10(RE)	2902990	198797	7.7
2010-11(BE)	3306626	227942	7.9

Source: Union Budget documents.

*** Excludes ₹ 563 crore towards premium on account of domestic debt buyback scheme and prepayment of external debt.**

Note:
1. **Average cost of borrowing is the percentage of interest payment in year 't' to outstanding liabilities in year 't-1'.**
2. **Outstanding internal liabilities exclude NSSF loans to States, with no interest liability on the part of the Centre.**
3. **The figures of interest payments reported in the earlier issues may differ as these figures are net of interest payments on NSSF paid by the Government since 1999-2000 i.e. constitution of the NSSF.**

Figure 3.8 Interest on internal liabilities and average interest cost of borrowing

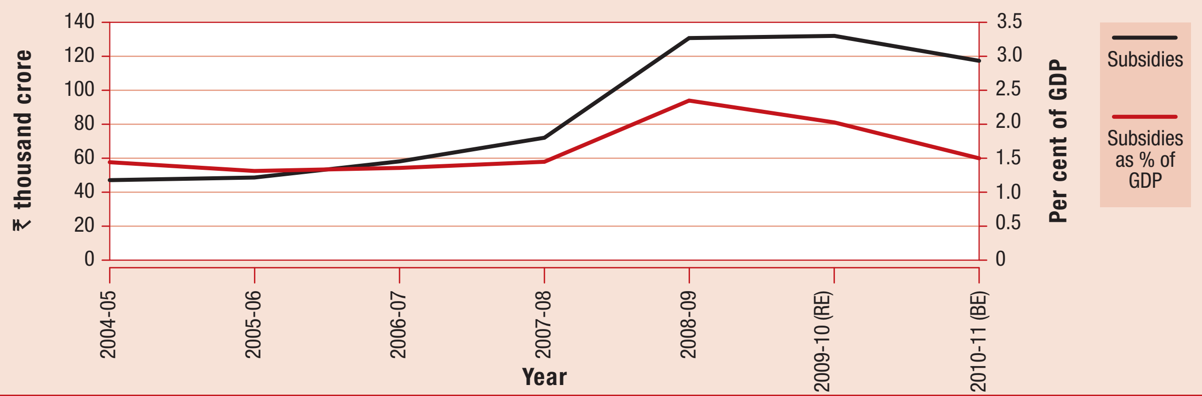


(61 grants and two appropriations) for total gross additional expenditure of ₹ 68,294.3 crore, of which those with a net cash outgo aggregated to ₹ 54,588.6 crore. The main items entailing cash outgo included compensation to oil companies (₹ 14,000 crore); additional requirement of the Pradhan Mantri Gram Sadak Yojana(PMGSY) (₹ 7,337.5 crore); and transfers to State and Union Territories Governments (₹ 6,379 crore). The second batch of supplementary demands for grants approved by Parliament in December 2010 included 56 grants and two appropriations. Total gross additional expenditure approved by Parliament was ₹ 44,945.5 crore. This involves a net cash outgo aggregate of ₹ 19,812.4 crore and technical supplementary involving gross additional expenditure, matched by savings of the ministries/departments or by enhanced receipts/ recoveries aggregates of ₹ 25,132.5 crore. The main items entailing cash outgo included compensation to the Department of Fertilizers (₹ 5,000 crore) and the Department of Food and Public Distribution (₹ 5,000 crore); additional requirement for Central paramilitary forces (₹ 2,000 crore); and additional requirement of the PMGSY (₹ 3,000 crore).

Central Plan outlay

3.26 With a higher level of gross budgetary support (GBS) of ₹ 2,29,163 crore and internal and extra budgetary resources (IEBR) of Central public-sector enterprises (CPSEs) of ₹ 1,96,427 crore, Central Plan outlay was placed at ₹ 4,25,590 crore for 2009-10 (revised estimates—RE). The GBS constituted 53.8 per cent of the total outlay. With a growth of 23.2 per cent over 2009-10 (RE), the Central Plan outlay now stands at ₹ 5,24,484 crore in the Budget for 2010-11. The outlay comprised budgetary support of ₹ 2,80,600 crore and IEBR of CPSEs of ₹ 2,43,884 crore. The broad sector-wise allocations for important sectors included energy (27.9 per cent); social services (24.3 per cent); transport (19.4 per cent); communication (3.5 per cent); rural development (10.5 per cent); industry and minerals (7.4 per cent); agriculture and allied activities (2.3 per cent); and irrigation and flood control (0.1 per cent). Central

Figure 3.9 Subsidies as per cent of GDP



assistance to State and UT Plans in 2010-11 (BE) is placed at ₹ 92,492 crore, a growth of 7.5 per cent over 2009-10 (RE).

Government debt

3.27 In many countries, the fiscal rules also include a debt reduction target. The FRBM Rules 2004 contain an incremental assumption rule for public debt which states that 'the Central Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of 9 per cent of GDP for the financial year 2004-05 and in each subsequent financial year, the limit of 9 per cent of GDP shall be progressively reduced by at least one percentage point of GDP'. There is, however, no explicit rule targeting reduction in the overall level of public debt. As a proportion of the GDP, public debt could come down through limiting its growth relative to growth in nominal GDP or through lower assumption of incremental liabilities or retirement of debt. The ThFC had recommended limiting the combined debt of the Centre and States to 68 per cent of the GDP by 2014-15. The Budget for 2010-11 announced the intent of bringing out a status paper giving detailed analysis of the situation and a roadmap for curtailing overall public debt within six months. A status paper was presented to the Parliament on November 2010 (Box 3.2).

3.28 As a proportion of the GDP, the outstanding internal liabilities of the Central Government fell from a level of 58.7 per cent in 2005-06 to 51.5 per cent in 2009-10 (RE). They were budgeted at 48 per cent of the GDP in 2010-11 (Table 3.7A and Figure 3.10). There has been steady decline in the levels till 2007-08 subsequent to the operation of the FRBM Act. Thereafter there has been moderation in decline following the fiscal expansion in 2008-09 and 2009-10; a modest deterioration is evident in 2010-11 (BE) (Table 3.7B). This is also reflected in the assumption of incremental liabilities, which have significantly gone up in the last two years.

Economic and functional classification of the Budget

3.29 While analysis on the basis of fiscal indicators are instructive in understanding the fiscal situation and management thereof, the macroeconomic dimensions of fiscal policies are better understood though a reclassification of the fiscal magnitudes in terms of national income aggregates. The Economic and Functional Classification of the Central Government Budget details the impact of the operations of the Central Government on the levels of consumption expenditure and capital formation. Of the total expenditure of ₹ 10,79,985 crore in BE 2010-11 (equivalent of 13.7 per cent of the GDP), 21 per cent was used up as consumption expenditure (amounting to ₹ 2,24,027 crore or 2.8 per cent of the GDP) and 18 per cent resulted in capital formation (amounting to ₹ 1,94,473 crore or 2.5 per cent of the GDP) with the rest being accounted for as transfer payments (mainly to States).The levels of dissavings of the Government came down progressively and in 2007-08 became positive savings; however, the fiscal expansion resulted in the re-emergence of dissavings in 2008-09 (Table 3.8). After briefly going up in 2008-09 to a level of ₹ 2,53,712 crore, the dissavings of the Government were estimated at ₹ 1,92,705 crore in 2010-11 (BE). As the gap between the level of savings and capital formation is financed preponderantly by draft on the other sectors of the domestic economy, the reversal of dissavings is an imperative.

Fiscal outcome

3.30 The outcomes in terms of key fiscal indicators were much better than was envisaged by the Budget estimates on account of the higher than estimated revenue from telecom 3G/BWA auctions and indirect taxes. The headroom so available facilitated additional expenditure proposed through supplementary demands for grants. The data on Union finances for April-December 2010 released by the CGA on 31 December 2010 indicated that the key fiscal indicators were broadly on the consolidation track charted by the Budget for 2010-11. Growth in gross tax revenue in the nine months of the current fiscal was 26.8 per cent (year-on-year) as against a level of 17.9 per cent envisaged for the fiscal by the BE. Non-tax revenues grew by 136.4 per cent in the first nine months of current fiscal as against a level of growth of 23.7 per cent in the corresponding period last year and 32 per cent envisaged by the BE. Revenue receipts grew by over 50 per cent in the first nine months (Table 3.9). In major taxes the following were the year-on-year growth rates (as against growth envisaged by the BE): customs 65.8 per cent (36.1 per cent); Central excise 36.5 per cent (29.4 per cent), service tax 19.7 per cent (17.2 per cent); corporate income tax 20.4 per cent (18.1 per cent), and personal

Box 3.2 : Government Debt Report

In pursuance of the announcement made in the Budget for 2010-11 to this effect, a status paper on Government debt was presented in November 2010. The paper made a detailed analysis of the situation and chalked out a roadmap for reduction in overall debt as a percentage of the GDP for the General Government during the period 2010-11 to 2014-15. The salient features of the report are detailed as follows:

- The objectives of the debt management policy are to meet Central Government's financing need at the lowest possible long-term borrowing costs and also to keep the total debt within sustainable limits . Additionally, it aims at supporting development of a well-functioning and vibrant domestic bond market.
- The three important attributes of Government debt include source of financing, fixed interest nature of debt, and long residual maturity. Of the overall Central Government debt, about 92 per cent is internal debt and 8 per cent is external debt. Internal debt largely consists of market loans in the form of dated securities which are contracted through auction. Most of the dated securities (97 per cent) are fixed coupon and only the balance 3 per cent are floating rate bonds. The weighted average maturity of these dated securities is about 10 years while the weighted average interest rate is about 7.8 per cent per annum.
- Subsequent to the Report of the ThFC which had estimated debt to GDP ratios and a roadmap for its reduction, the CSO revised the nominal GDP significantly and as per the revised data the reduction in the levels of debt as proportion of the GDP could be made even with higher than recommended fiscal deficits. As such, a higher than ThFC recommended target was preferred whereby the fiscal deficit of the Centre would be reduced to 3 per cent of the GDP by 2014-15 and accordingly debt as a proportion of the GDP would come down from 50.5 per cent in 2009-10 to 43 per cent in 2014-15.
- The outstanding debt of State Governments is estimated at 26.3 per cent of the GDP for 2009-10. However, after netting of the liabilities on account of investments made in 14-days treasury bills of Central Government, this comes down to 24.8 per cent of the GDP. The roadmap for States has been prepared with fiscal deficit as a percentage of the GDP at the level recommended by the ThFC. With the foregoing assumption on fiscal deficit, consolidated debt for State Governments is estimated to reduce from 24.8 per cent of the GDP in 2009-10 to 23.1 per cent in 2014-15.
- After factoring in the impact of Central loans to States, the consolidated debt of General Government has come down from 79.3 per cent in 2004-05 to 68.7 per cent in 2007-08. However, it has subsequently increased during the global economic crisis period to 71.1 per cent in 2008-09 and further to 73 per cent of the GDP in 2009-10. *It may be recalled that the 12th Finance Commission had recommended a consolidated debt for the Centre and State Governments at 74 per cent of the GDP for the year 2009-10. Even with slippage in 2008-09 and 2009-10 on fiscal deficit targets, the overall General Government debt at 73 per cent of the GDP in 2009-10 has remained within the recommended target.*
- The suggested roadmap for consolidated General Government debt sets a target of reduction from 73 per cent of the GDP in 2009-10 to 64.9 per cent in 2014-15. This shows a reduction of 8.1 per cent of the GDP in the consolidated debt for the General Government.
- In the roadmap suggested for debt reduction during the period 2010-11 to 2014-15, the Government's commitment towards fiscal consolidation has been reiterated. With the reduction in fiscal deficit for 2010-11, the trend witnessed in the last two years of increasing debt has been arrested. *The Government has undertaken concerted efforts to reduce the fiscal deficit gradually so as to bring down the debt as a proportion of the GDP to the pre-crisis level of 68.7 per cent by 2013-14 and further improve to about 65 per cent of the GDP in 2014-15.*

Figure 3.10 **Debt GDP ratios**

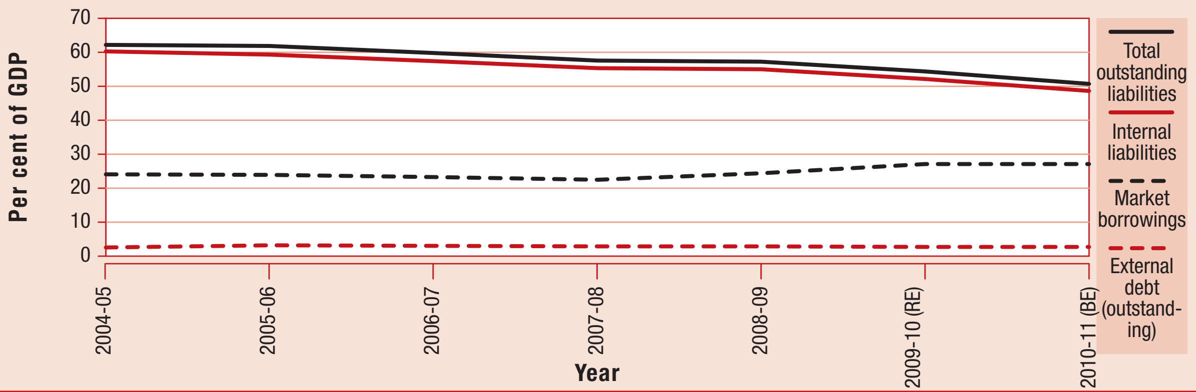


Table 3.7A : Outstanding Liabilities of the Central Government

(end-March)

	2005-06	2006-07	2007-08	2008-09	2009-10 (RE)	2010-11 (BE)
			(₹ crore)			
1. Internal Liabilities #	**2165902**	**2435880**	**2725394**	**3036132**	**3376325**	**3782553**
a) Internal Debt	1389758	1544975	1808359	2028549	2337682	2736754
i) Market Borrowings	862370	972801	1092468	1326094	1734505	2079535
ii) Others	527388	572174	715891	702455	603177	657219
b) Other Internal Liabilities	776144	890905	917035	1007583	1038643	1045799
2. External Debt (Outstanding)*	**94243**	**102716**	**112031**	**123046**	**139581**	**162045**
3. Total Outstanding Liabilities (1+2)	**2260145**	**2538596**	**2837425**	**3159178**	**3515906**	**3944598**
4. Amount Due from Pakistan on Account of Share of Pre-partition Debt	300	300	300	300	300	300
5. Net Liabilities (3-4)	**2259845**	**2538296**	**2837125**	**3158878**	**3515606**	**3944298**
			(As per cent of GDP)			
1. Internal Liabilities	**58.7**	**56.7**	**54.7**	**54.4**	**51.5**	**48.0**
a) Internal Debt	37.6	36.0	36.3	36.3	35.7	34.7
i) Market Borrowings	23.4	22.7	21.9	23.8	26.5	26.4
ii) Others	14.3	13.3	14.4	12.6	9.2	8.3
b) Other Internal Liabilities	21.0	20.7	18.4	18.0	15.9	13.3
2. External Debt (Outstanding)*	**2.6**	**2.4**	**2.2**	**2.2**	**2.1**	**2.1**
3. Total Outstanding Liabilities	**61.2**	**59.1**	**56.9**	**56.6**	**53.7**	**50.1**
Memorandum Items						
(a) External Debt (₹ crore)@	194078	201204	210083	264076	249311	272779
(as per cent of GDP)	5.3	4.7	4.2	4.7	3.8	3.5
(b) Total Outstanding Liabilities (adjusted) (₹ crore)	2359980	2637084	2935477	3300208	3625636	4055332
(as per cent of GDP)	63.9	61.4	58.9	59.1	55.4	51.5
(c) Internal Liabilities (Non-RBI)(₹ crore)##	1969106	2217671	2471396	2687037	3041134	3447362
(as per cent of GDP)	53.3	51.6	49.6	48.1	46.4	43.8
(d) Outstanding Liabilities (Non-RBI)(₹ crore)##	2163184	2418875	2681479	2951113	3290445	3720141
Outstanding Liabilities (Non-RBI) (as per cent of GDP)	58.6	56.3	53.8	52.9	50.2	47.2
(e) Contingent Liabilities of Central Government (₹ crore)	110626	109826	104872	113335	n.a.	n.a.
Contingent Liabilities of Central Government (as per cent of GDP)	3.0	2.6	2.1	2.0	n.a.	n.a.
(f) Total Assets (₹ crore)	1194446	1339119	1571668	1569043	1590027	1754040
Total Assets (as per cent of GDP)	32.3	31.2	31.5	28.1	24.3	22.3

Source: 1. Union Budget documents. 2. Controller of Aid Accounts and Audit. 3. Reserve Bank of India.

n.a. : not available

* External debt figures represent borrowings by Central Government from external sources and are based upon historical exchange rates.

@ Converted at year end exchange rates. For 1990-91, the rates prevailing at the end of March,1991; For 1999-2000, the rates prevailing at the end of March, 2000 and so on.

\# Internal debt includes net borrowing of ₹ 29,062 crore for 2005-06, ₹ 62,974 crore for 2006-07, ₹ 1,70,554 crore for 2007-08, ₹ 88,773 crore for 2008-09, ₹ 2,737 crore for 2009-10(RE) and ₹ 50,000 crore for 2010-11(BE) under the Market Stabilisation Scheme.

\## This includes marketable dated securities held by the RBI.

Note : The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.

Table 3.7B : Incremental Net Liabilities of the Central Government*

	2005-06	2006-07	2007-08	2008-09	2009-10 (RE)	2010-11 (BE)
Target as per FRBM Rules (as per cent of GDP)	8	7	6	5	4	3
Actual (₹ crore)	265723	278451	298829	321753	356728	428692
Actual as per cent of GDP	7.2	6.5	6.0	5.8	5.4	5.4

***Incremental net liablities assumed has been compiled from data on liabilities given in Annex 3(i) of Receipts Budget, 2010-11.**

income tax 13.1 per cent (-3.6 per cent).

3.31 Year-on-year growth in total expenditure in the first nine months of the current fiscal was at 11.2 per cent as against a level of 18.5 per cent in 2009-10 (April-December) and 8.5 per cent envisaged for the full year by BE 2010-11. While Plan expenditure grew by 18.9 per cent in April-December 2010-11 as against 23.0 per cent in 2009-10 (April-December), non-Plan expenditure grew by 7.9 per cent as against 16.6 per cent. As per the CGA, 84.7 per cent of the gross market borrowings were completed by end of December 2010. Reflecting the above trend in revenue and expenditure, revenue deficit was placed at ₹ 1,16,309 crore, which was 42.1 per cent of its BE and lower by 53.7 per cent than the April-December 2009 level. Fiscal deficit was ₹ 1,71,249 crore, which came to 44.9 per cent of its BE (Table 3.10) and represented a decline of 44.8 per cent over the level in April-December 2009. The deficit indicators would thus remain at targeted levels even with a pickup in expenditure in the next three months.

Performance of Departmental Enterprises of The Central Government

Railways

3.32 Indian Railways achieved a freight loading of 887.79 million tonnes in 2009-10 with an incremental loading of 54.40 million tonnes over the levels in 2008-09. However, freight loading during 2009-10 fell short of the revised target by 2.2 million tonnes. Consequently freight earnings at ₹ 58,502 crore, though registering a growth of 9.5 per cent over 2008-09, fell short of the revised target for 2009-10 by ₹ 214 crore. Passenger earnings (excluding other coaching earnings) during 2009-10 were ₹ 23,488 crore as against ₹ 21,931 crore in 2008-09, registering an increase of 7.1 per cent. Overall traffic revenues for 2009-10 at ₹ 87,105 crore posted a growth of 9.1 per cent over 2008-09. Taking into account further accumulation of ₹ 141 crore in the traffic outstandings, the gross traffic receipts of the Railways for 2009-10 stood at ₹ 86,964 crore.

3.33 Ordinary working expenses at ₹ 65,810 crore during 2009-10 showed an increase of 21.1 per cent over the preceding year. This higher growth in ordinary working expenses was primarily attributable to payment of the second instalment (60 per cent) of arrears of the Sixth Central Pay Commission. The total working expenses including appropriations for Depreciation Reserve Fund and Pension Fund at ₹ 82,915 crore recorded an increase of 15.4 per cent over the preceding year.

3.34 Taking into account the net variation of the miscellaneous receipts and miscellaneous expenditure, Railways net revenue in 2009-10 was ₹ 5,544 crore. After fully discharging the dividend liability of ₹ 5,543 crore for the fiscal, Railways during 2009-10 generated an excess of around ₹ 1 crore. Lower growth of traffic revenues on account of prevailing economic conditions, stiff increase in working expenses due to implementation of the Sixth Central Pay Commission recommendations and inflationary factors have adversely affected the financial health of the Railways in 2009-10, which is reflected in its Operating Ratio[1] deteriorating to 95.3 per cent as against 90.5 per cent in 2008-09. The net revenue as a proportion of capital-at-charge and investment from the Capital Fund for the fiscal was 4.5 per cent.

3.35 The Plan Outlay for 2009-10 stood at ₹ 39,235 crore including internally generated resources of ₹ 12,196 crore (31 per cent of the total outlay) and market borrowings of ₹ 9,323 crore by the Indian Railway Finance Corporation which also includes borrowing for Rail Vikas Nigam Limited. Apart from strengthening of the golden quadrilateral under the

[1]The Operating Ratio represents the percentage of working expenses to traffic earnings.

Table 3.8 : Total Expenditure and Capital Formation by the Central Government and its Financing

(As per Economic and Functional Classification of the Central Government Budget)

	2005-06	2006-07	2007-08	2008-09	2009-10 (RE)	2010-11 (BE)
			(₹ crore)			
I. Total Expenditure	**501083**	**570185**	**688908**	**864530**	**1005297**	**1079985**
II. Gross Capital Formation out of Budgetary Resources of Central Government	**84757**	**87885**	**143892**	**136935**	**154827**	**194473**
(i) Gross Capital Formation by the Central Government	34450	36487	43652	51464	61190	71537
(ii) Financial Assistance for Capital Formation in the Rest of the Economy	50307	51398	100240	85471	93637	122936
III. Gross Savings of Central Government	**-61431**	**-33918**	**13674**	**-176082**	**-253712**	**-192705**
IV. Gap (II-III)	**146188**	**121803**	**130218**	**313017**	**408539**	**387178**
Financed by						
a. Draft on Other Sectors of Domestic Economy	109799	110801	118180	299208	361926	362654
(i) Domestic Capital Receipts	130687	106284	145351	246612	367507	362654
(ii) Budgetary Deficit/Draw Down of Cash Balance	-20888	4517	-27171	52596	-5581	0
b. Draft on Foreign Savings	36389	11002	12038	13809	46613	24524
			(As per cent of GDP)			
I. Total Expenditure	**13.6**	**13.3**	**13.8**	**15.5**	**15.3**	**13.7**
II. Gross Capital Formation out of Budgetary Resources of Central Government	**2.3**	**2.0**	**2.9**	**2.5**	**2.4**	**2.5**
(i) Gross Capital Formation by the Central Government	0.9	0.8	0.9	0.9	0.9	0.9
(ii) Financial Assistance for Capital Formation in the Rest of the Economy	1.4	1.2	2.0	1.5	1.4	1.6
III. Gross Savings of Central Government	**-1.7**	**-0.8**	**0.3**	**-3.2**	**-3.9**	**-2.4**
IV. Gap (II-III)	**4.0**	**2.8**	**2.6**	**5.6**	**6.2**	**4.9**
Financed by						
a. Draft on Other Sectors of Domestic Economy	3.0	2.6	2.4	5.4	5.5	4.6
(i) Domestic Capital Receipts	3.5	2.5	2.9	4.4	5.6	4.6
(ii) Budgetary Deficit/Draw Down of Cash Balance	-0.6	0.1	-0.5	0.9	-0.1	0.0
b. Draft on Foreign Savings	1.0	0.3	0.2	0.2	0.7	0.3
			(increase over previous year)			
II. Gross Capital Formation out of Budgetary Resources of Central Government	**-8.7**	**3.7**	**63.7**	**-4.8**	**13.1**	**25.6**
Memorandum Items			(₹ crore)			
1 Consumption Expenditure	116305	121609	131396	174345	226987	224027
2 Current Transfers	297267	356560	408676	543347	594989	651168
			(As per cent of GDP)			
1 Consumption Expenditure	**3.1**	**2.8**	**2.6**	**3.1**	**3.5**	**2.8**
2 Current Transfers	**8.1**	**8.3**	**8.2**	**9.7**	**9.1**	**8.3**

Source: Ministry of Finance, An Economic and Functional classification of the Central Government Budget-various issues.

Notes:
(i) Gross capital formation in this table includes loans given for capital formation on a gross basis. Consequently domestic capital receipts include loan repayments to the Central Government.
(ii) Consumption expenditure is the expenditure on wages and salaries and commodities and services for current use.
(iii) Interest payments, subsidies, pension etc. are treated as current transfers.
(iv) Gross capital formation and total expenditure are exclusive of loans to States'/UTs' against States'/UTs' share in the small savings collection.
(v) The figures of total expenditure of the Central Government as per economic and functional classification do not tally with figures given in the Budget documents. In the economic and functional classification, interest transferred to DCUs, loans written off etc, are excluded from the current account. In the capital account, expenditure financed out of Railways, Posts and Telecommunications own funds, etc. is included.
(vi) The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.

Table 3.9 : Central Government Finances

	Budget Estimates 2010-11	April-December 2009-10	April-December 2010-11	Col.4 as per cent of 2010-11 (BE)	Per cent change over 2009-10
1	2	3	4	5	6
		(₹ crore)			
1. Revenue Receipts	**682,212**	**389,271**	**584,268**	**85.6**	**50.1**
Gross Tax Revenue	**746,651**	**416,094**	**527,782**	**70.7**	**26.8**
Tax (net to Centre)	534,094	307,591	391,148	73.2	27.2
Non Tax	148,118	81,680	193,120	130.4	136.4
2. Capital Receipts	**426,537**	**318,269**	**202,584**	**47.5**	**-36.3**
of which:					
Recovery of Loans	5,129	3,983	8,591	167.5	115.7
Other Receipts	40,000	4,306	22,744	56.9	428.2
Borrowings and Other Liabilities	381,408	309,980	171,249	44.9	-44.8
3. Total Receipts (1+2)	**1,108,749**	**707,540**	**786,852**	**71.0**	11.2
4. Non-Plan Expenditure (a)+(b)	**735,657**	**497,381**	**536,898**	**73.0**	**7.9**
(a) Revenue Account	643,599	460,970	487,692	75.8	5.8
of which:					
Interest Payments	248,664	130,005	146,304	58.8	12.5
Major Subsidies	108,667	96,740	94,318	86.8	-2.5
Pensions	42,840	37,465	40,210	93.9	7.3
(b) Capital Account	92,058	36,411	49,206	53.5	35.1
5. Plan Expenditure (i)+(ii)	**373,092**	**210,159**	**249,954**	**67.0**	**18.9**
(i) Revenue Account	315,125	179,555	212,885	67.6	18.6
(ii) Capital Account	57,967	30,604	37,069	63.9	21.1
6. Total Expenditure (4)+(5)=(a)+(b)	**1,108,749**	**707,540**	**786,852**	**71.0**	**11.2**
(a) Revenue Expenditure	958,724	640,525	700,577	73.1	9.4
(b) Capital Expenditure	150,025	67,015	86,275	57.5	28.7
7. Revenue Deficit	**276,512**	**251,254**	**116,309**	**42.1**	**-53.7**
8. Fiscal Deficit	**381,408**	**309,980**	**171,249**	**44.9**	**-44.8**
9. Primary Deficit	**132,744**	**179,975**	**24,945**	**18.8**	**-86.1**

Source: Controller General of Accounts, Ministry of Finance.

National Rail Vikas Yojana, certain important projects and land acquisition work on dedicated freight corridors are in progress. Railways has also started work on setting up of some mega workshops to meet its rolling stock requirements. It is also modernizing and upgrading its systems to augment rail services.

Department of posts

3.36 The gross receipts of the Department of Posts in 2009-10 were placed at ₹ 6,266.7 crore. The gross and net working expenses during the year were ₹ 13,346.9 crore and ₹ 12,908 crore respectively, yielding a deficit of ₹ 6,641.3 crore. In the current fiscal as per BE 2010-11, the gross receipts are budgeted to go up to ₹ 6,955.5 crore and with gross and net working expenses estimated at ₹ 11,328.8 crore and ₹ 10,892.1 crore respectively, the deficit is projected to be ₹ 3936.6 crore.

3.37 India Post is the largest Postal network in the world and provides access to postal services at affordable rates to all citizens in the country through its vast network, which has grown from 23,344 post offices at time of Independence to 1,54,979 post offices as on 31 March 2010. Of the total, 1,39,173

Table 3.10 : Trends in Cumulative Central Government Finance (April-December) for 2010-11

	Budget Estimates	April	April-May	April-June	April-July	April-August	April-Sept.	April-Oct.	April-Nov.	April-Dec.
1. Revenue Receipts (₹ crore)	682212	12979	44657	199810	238524	290799	398234	447625	476716	584268
Per cent to BE		1.9	6.5	29.3	35.0	42.6	58.4	65.6	69.9	85.6
2. Capital Receipts (₹ crore)	426537	54247	102252	42398	94176	156904	139743	169810	213971	202584
3. Total Receipts (₹ crore)	1108749	67226	146909	242208	332700	447703	537977	617435	690687	786852
Per cent to BE		6.1	13.2	21.8	30.0	40.4	48.5	55.7	62.3	71.0
4. Non Plan Expenditure (₹ crore)	735657	48206	100101	154148	222900	311249	368270	424893	479771	536898
Per cent to BE		6.6	13.6	21.0	30.3	42.3	50.1	57.8	65.2	73.0
5. Plan Expenditure (₹ crore)	373092	19020	46808	88060	109800	136454	169707	192542	210916	249954
Per cent to BE		5.1	12.5	23.6	29.4	36.6	45.5	51.6	56.5	67.0
6. Total Expenditure (₹ crore)	1108749	67226	146909	242208	332700	447703	537977	617435	690687	786852
Per cent to BE		6.1	13.2	21.8	30.0	40.4	48.5	55.7	62.3	71.0
7. Revenue Expenditure (₹ crore)	958724	63617	125877	210387	288599	391151	473155	542455	616874	700577
Per cent to BE		6.6	13.1	21.9	30.1	40.8	49.4	56.6	64.3	73.1
8. Revenue Deficit (₹ crore)	276512	50638	81220	10577	50075	100352	74921	94830	140158	116309
Per cent to BE		18.3	29.4	3.8	18.1	36.3	27.1	34.3	50.7	42.1
9. Fiscal Deficit (₹ crore)	381408	53993	100907	40196	90915	151425	133252	162336	186522	171249
Per cent to BE		14.2	26.5	10.5	23.8	39.7	34.9	42.6	48.9	44.9

Source: Controller General of Accounts, Ministry of Finance.

post offices are in rural areas and 15,797 in urban. India Post has introduced franchisee outlets to cater to the growing demand for postal services where it is not possible to open departmental post offices. As on 31 March 2010, 1082 franchised outlets have been opened. The Department of Posts has been given the responsibility of disbursing wages to the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) beneficiaries through post office savings bank accounts. Nearly 4.67 crore MGNREGS Accounts have been opened up to October 2010 and the wages amounting to ₹ 7113 crore have already been disbursed during the current financial year (up to October 2010). A total of ₹ 18,876 crore has been disbursed as wages to MGNREGS beneficiaries through post offices since the inception of the scheme.

Broadcasting

3.38 Prasar Bharati, a public service broadcaster, incurred a total expenditure of ₹ 2949.4 crore in 2009-10 (excluding charges on account of the space segment and spectrum charges and interest and depreciation costs). The total gross revenue earned in 2009-10 was ₹ 1352.7 crore and the net revenue worked out to ₹ 1176.3 crore. Prasar Bharati has taken a number of steps to increase revenue generation by adopting aggressive marketing strategy and catering to the advertising needs of various entities through a single window facility. Doordarshan as Host Broadcaster for the Commonwealth Games (CWG) provided the entire TV coverage of the CWG in HDTV format, a noteworthy achievement in the broadcasting sector. As Right Holder Broadcaster, Doordarshan provided customized TV coverage of CWG for Indian viewers besides launching an HDTV channel called DDHD to provide high quality services. Digitalization of the All India Radio network is one of the major thrust areas of the Eleventh Plan. There is an approved scheme of digitalization of transmitters, studios, and connectivity which, inter alia, envisages digitalization of 98 studios and connectivity and 100 watts FM digital compatible transmitters at 100 locations. Government has allocated a total ₹ 2,050 crore including CWG 2010 in BE 2010-11 to cover the resource gap in Prasar Bharati.

State-level finances

3.39 In the post-FRBMA period the performance of combined States was impressive with fiscal deficit declining to 2.4 per cent of the GDP in 2005-06 and further to 1.5 per cent in 2007-08. With the exception of 2009-10 (RE), the level of fiscal deficit had remained below the 3 per cent of GDP mark. In 2010-11 (BE), it has been estimated at 2.5 per cent of the GDP (Table 3.11 and Figure 3.11). A more noteworthy feature has been that a surplus on revenue account has been recorded in the three-year period 2007-08 and 2008-09. Revenue receipts grew at the rate of 17.6 per cent and 10.7 per cent for 2007-08 and 2008-09 respectively. Buoyant revenues of the States (as also Centre) and non-tax receipts combined with a moderate growth in revenue have helped in this regard. However, there are significant variations among States in respect of these indicators.

State-level Reforms

3.40 Given the exceptional circumstances of 2008-09 and 2009-10, the fiscal consolidation process of the States was disrupted. States would be able to get back to their fiscal correction path by 2011-12, allowing for a year of adjustment in 2010-11. The stimulus packages of the Central Government as well as those announced by individual States coupled with the increased transfers recommended by the ThFC have implications for the financial position of the States in the medium term. The recommendations of ThFC for the period 2010-15 are presently under implementation. The recommendations take into account the current and likely macroeconomic and fiscal scenarios so as to secure fiscal stability and adequate resource availability for the Centre, the States, and the local bodies. The higher levels of devolution of taxes and the inter-se sharing thereof together with higher levels of non-Plan grants under Article 275 of the Constitution which include specific grants like grants for elementary education, outcomes and environment related grants, maintenance grants, and state-specific grants are likely to bring the combined deficit of the States down to the targeted levels faster. The borrowing ceiling for each State for the year 2010-11 has been fixed by the Government of India, keeping in view the recommendations of the ThFC based on targets for fiscal deficit. Besides, the ThFC has also provided a basis for the finances of local bodies through a basic grant and a performance grant based on a percentage of the divisible pool of the preceding year. The estimated total grant recommended for local bodies aggregates to ₹ 87,519 crore over the award period of the ThFC.

3.41 In this year's Budget, measures were also taken to facilitate movement towards a goods and services tax (GST). These included unification of rates between central excise (goods) and service tax (services) at 10 per cent; removal of certain exemptions in central excise; widening of service tax base through inclusion of eight new services and expansion of scope of some of the existing ones; reduction in excise duty from 16 per cent to 10 per cent on medicines and toilet preparations containing alcohol (excise duty on medicinal and toilet preparations is one of the taxes to be subsumed under the GST); approval of a Mission Mode Project for the computerization of State Commercial Tax Departments.

3.42 Though considerable progress has been made in moving towards a comprehensive GST, the timeline of April 2011 for its introduction is not likely to be met. This is because the convergence of views between the Centre and States needed for the introduction of legislation for a constitutional amendment in this regard is yet to be achieved. In the meantime, the working groups involved in developing the IT architecture, business processes, and draft legislations for the effective implementation of GST are continuing their work. An empowered group under the Chairmanship of Dr Nandan Nilekani, Chairman UIDAI, is working out the modalities for creation of a special purpose vehicle (SPV) which envisages the setting up of a common portal for the Centre and State Governments through which taxpayers could interact with the two tax administrations. Work is also under way to create and strengthen the IT infrastructure in State VAT(value-added tax) departments so that their transition to the GST becomes easier.

Consolidated General Government

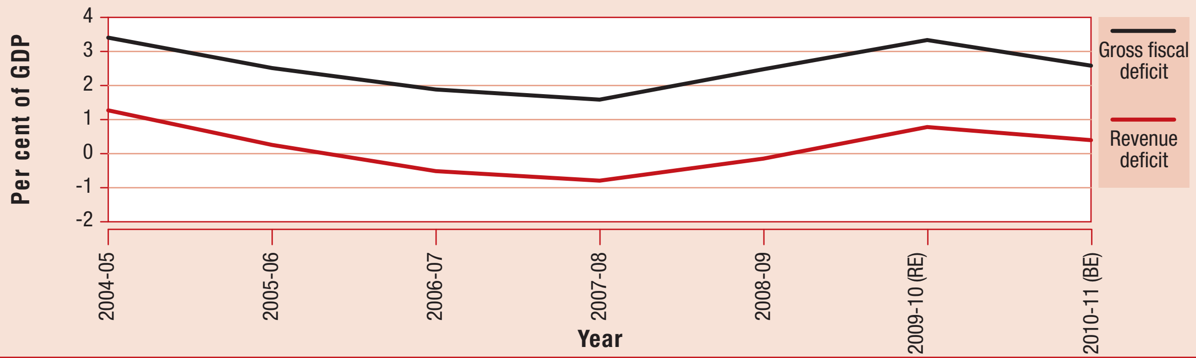
3.43 Given the grant dependance of local bodies and limited availability of data, consolidated General Government finances are taken to be the aggregation of Union and combined State finances after due process of netting of inter-Governmental transactions. The macroeconomic impact of the Government's fiscal operations is thus evaluated by looking at consolidated General Government finances. As with the Centre and States individually, collectively also a revenue buoyancy and relatively limited growth in expenditure helped in the fiscal consolidation phase in the post-FRBM period up to 2007-08. In 2007-08, the gross fiscal deficit of the consolidated General Government was placed at 4.1 per cent of the GDP on a cash basis (Table 3.12 and Figure 3.12); and revenue deficit was close to zero. After the fiscal expansion in 2008-09 and 2009-10,

Table 3.11 : Receipts and Disbursements of State Governments*

	2005-06	2006-07	2007-08	2008-09	2009-10 (RE)	2010-11 (BE)
			(₹ crore)			
I. Total Receipts(A+B)	**595,628**	**673,605**	**765,735**	**886,875**	**1,049,437**	**1,149,031**
A. Revenue Receipts (1+2)	**431,021**	**530,556**	**623,748**	**690,581**	**802,708**	**906,495**
1. Tax Receipts	306,332	372,841	437,948	481,854	529,740	624,380
of which:						
State's Own Tax Revenue	212,307	252,548	286,546	321,351	364,997	426,014
2. Non-tax Receipts	124,690	157,714	185,799	208,727	272,968	282,114
of which:						
Interest Receipts	9,380	11,825	12,637	16,594	16,782	16,331
B. Capital Receipts	**164,607**	**143,049**	**141,987**	**196,294**	**246,728**	**242,536**
of which:						
Recovery of Loans & Advances	8,904	7,579	7,770	11,068	7,960	4,208
II. Total Disbursements (a+b+c)	**561,682**	**657,280**	**752,324**	**877,747**	**1,073,800**	**1,167,404**
a) Revenue	438,034	505,699	580,805	678,856	849,571	932,683
b) Capital	109,224	137,793	157,258	183,013	207,073	220,022
c) Loans and Advances	14,424	13,789	14,261	15,879	17,155	14,699
III. Revenue Deficit	**7,013**	**-24,857**	**-42,943**	**-11,725**	**46,863**	**26,189**
IV. Gross Fiscal Deficit	**90,084**	**77,508**	**75,455**	**134,245**	**214,137**	**198,097**
			(As per cent of GDP)			
I. Total Receipts(A+B)	**16.1**	**15.7**	**15.4**	**15.9**	**16.0**	**14.6**
A. Revenue Receipts (1+2)	**11.7**	**12.4**	**12.5**	**12.4**	**12.3**	**11.5**
1. Tax Receipts	8.3	8.7	8.8	8.6	8.1	7.9
of which:						
State's Own Tax Revenue	5.7	5.9	5.7	5.8	5.6	5.4
2. Non-tax Receipts	3.4	3.7	3.7	3.7	4.2	3.6
of which:						
Interest Receipts	0.3	0.3	0.3	0.3	0.3	0.2
B. Capital Receipts	**4.5**	**3.3**	**2.8**	**3.5**	**3.8**	**3.1**
of which:						
Recovery of Loans & Advances	0.2	0.2	0.2	0.2	0.1	0.1
II. Total Disbursements (a+b+c)	**15.2**	**15.3**	**15.1**	**15.7**	**16.4**	**14.8**
a) Revenue	11.9	11.8	11.6	12.2	13.0	11.8
b) Capital	3.0	3.2	3.2	3.3	3.2	2.8
c) Loans and Advances	0.4	0.3	0.3	0.3	0.3	0.2
III. Revenue Deficit	**0.2**	**-0.6**	**-0.9**	**-0.2**	**0.7**	**0.3**
IV. Gross Fiscal Deficit	**2.4**	**1.8**	**1.5**	**2.4**	**3.3**	**2.5**

Source: Reserve Bank of India.
***: Data from 2008-09 onwards pertain to 27 State Governments.**
RE: Revised Estimates.
Note: (1) Negative (-) sign indicates surplus in deficit indicators.
(2) The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.
(3) Capital receipts include public accounts on a net basis.
(4) Capital disbursements are exclusive of public accounts.

Figure 3.11 Revenue and fiscal deficit of states



both revenue and fiscal deficits are estimated to decline sharply in 2010-11 (BE). Thus the outlook for the economy as whole is bright with continued fiscal consolidation.

Figure 3.12 Combined (centre and states) revenue and fiscal deficit

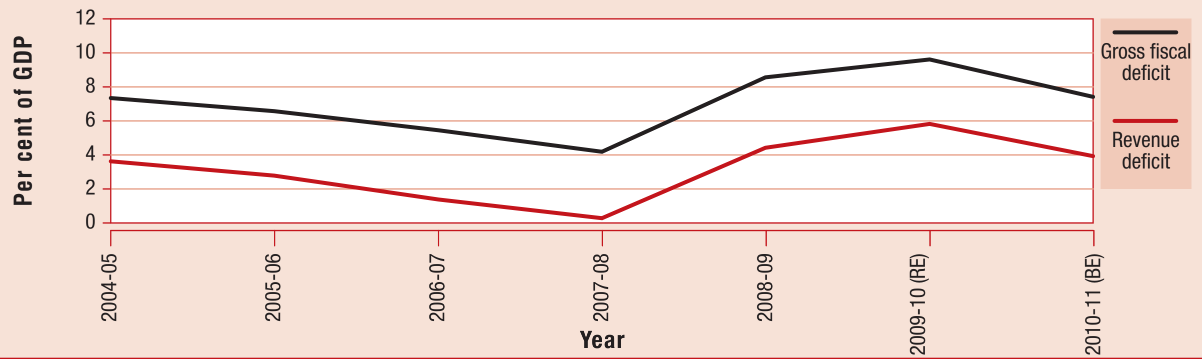


Table 3.12 : Receipts and Disbursements of Consolidated General Government

	2005-06	2006-07	2007-08	2008-09	2009-10 (RE)	2010-11 (BE)
			(₹ crore)			
I. Total Receipts (A+B)	**1,014,689**	**1,125,252**	**1,329,654**	**1,604,238**	**1,885,017**	**2,052,774**
A. Revenue Receipts (1+2)	707,054	877,075	1,061,892	1,112,877	1,250,511	1,446,332
1. Tax Receipts	576,596	724,023	877,496	925,173	994,843	1,158,475
2. Non-tax Receipts	130,458	153,052	184,396	187,704	255,668	287,857
of which: Interest Receipts	18,735	21,744	22,584	25,462	24,774	25,120
B. Capital Receipts	307,635	248,177	267,762	491,361	634,506	606,442
of which: a) Disinvestment Proceeds	1,590	2,440	45,750	832	26,319	43,155
b) Recovery of Loans & Advances	11,651	-773	4,682	8,935	9,505	5,520
II. Total Disbursements (a+b+c)	**959,855**	**1,109,174**	**1,316,246**	**1,595,110**	**1,909,380**	**2,071,147**
a) Revenue	806,366	932,441	1,071,518	1,354,691	1,626,434	1,749,031
b) Capital	132,585	157,316	225,803	217,476	257,787	296,787
c) Loans and Advances	20,904	19,417	18,925	22,943	25,159	25,329
III. Revenue Deficit	**99,312**	**55,366**	**9,626**	**241,814**	**375,923**	**302,699**
IV. Gross Fiscal Deficit	**239,560**	**230,432**	**203,922**	**472,466**	**623,045**	**576,140**
			(As per cent of GDP)			
I. Total Receipts (A+B)	**27.5**	**26.2**	**26.7**	**28.7**	**28.8**	**26.1**
A. Revenue Receipts (1+2)	19.1	20.4	21.3	19.9	19.1	18.4
1. Tax Receipts	15.6	16.9	17.6	16.6	15.2	14.7
2. Non-tax Receipts	3.5	3.6	3.7	3.4	3.9	3.7
of which: Interest Receipts	0.5	0.5	0.5	0.5	0.4	0.3
B. Capital Receipts	8.3	5.8	5.4	8.8	9.7	7.7
of which: a) Disinvestment Proceeds	0.0	0.1	0.9	0.0	0.4	0.5
b) Recovery of Loans & Advances	0.3	0.0	0.1	0.2	0.1	0.1
II. Total Disbursements (a+b+c)	**26.0**	**25.8**	**26.4**	**28.6**	**29.1**	**26.3**
a) Revenue	21.8	21.7	21.5	24.3	24.8	22.2
b) Capital	3.6	3.7	4.5	3.9	3.9	3.8
c) Loans and Advances	0.6	0.5	0.4	0.4	0.4	0.3
III. Revenue Deficit	**2.7**	**1.3**	**0.2**	**4.3**	**5.7**	**3.8**
IV. Gross Fiscal Deficit	**6.5**	**5.4**	**4.1**	**8.5**	**9.5**	**7.3**

Source: Reserve Bank of India.
Note: The ratios to GDP at current market prices are based on the CSO's National Accounts 2004-05 series.

The nature of fiscal consolidation

3.44 The impact of the global financial crisis brought to the fore the criticality of fiscal policies in combating economic shocks. With little monetary headroom in advanced economies and given the transmission lags in emerging market economies, fiscal policies were the preferred policy instruments across the globe. As per international institutional research on the subject, advanced economies were able to put in place large doses of fiscal stimuli as they had the advantage of automatic stabilizers while emerging markets, including India, had large fiscal expansion given the very low discretionary fiscal stimuli. In the fiscal consolidation phase in the post-FRBMA period (2004-05 to 2007-08), there was considerable fiscal space generated that facilitated the high levels of expansion that India had. It is therefore instructive to analyse the nature of fiscal deficits in India through their decomposition into structural and cyclical components (Box 3.3).

Prospects/Outlook

3.45 With significant levels of reduction envisaged

Box 3.3 : Decomposition of Fiscal Deficit into Structural and Cyclical Components

The Government budget balance is basically influenced by both cyclical (temporary) and structural (permanent) factors, entailing that change in the fiscal deficit could arise either in response to cyclical changes in output or to structural factors. The cyclical changes in output have a transitory effect on the fiscal deficit, whereas the structural factors have a more durable impact. A structural deficit occurs when a country generates a deficit even when the economy of the country is operating at its full employment level. On the other hand, a cyclical deficit occurs when an economy is not performing to its potential, for example if an economy is struggling through a recession. A structural deficit means that a deficit will be posted regardless of how well an economy if functioning-–recession or boom. When the economy is functioning strongly, revenue generation is higher due to more jobs, more spending, etc. but with structural deficit the good and strong health of the economy is irrelevant--a deficit will be generated regardless.

Structural deficit could be further decomposed into three parts that is (a) fiscal drag, (b) discretionary fiscal policy action, and (c) base year balance, to gain still more insight into the determinants of the structural deficit. Of the three listed components, the first two are important from the point of understanding fiscal stance.

Fiscal Drag

Among the components of the structural deficit, the fiscal drag is important and normally refers to increase in average tax rates in a progressive income tax scheme as a consequence of increase in nominal income over time--either on account of higher levels of inflation or real GDP growth. It has been observed that fiscal drag is the dominant contributory factor for structural deficit of Central Government balances.

Discretionary Fiscal Policy Action

On the other hand, the second component, i.e. discretionary fiscal policy actions, after remaining relatively weak up to 2007-08, had shown increases in 2008-09 and 2009-10 which can be attributed to revenue losses due to slowdown in the economy and duty cut together with higher expenditure to provide fiscal stimulus to sustain economic growth.

Traditional deficit indicators normally do not discriminate between these two effects, and hence fail to correctly evaluate and portray the impact of fiscal operations on the economy as a whole. The decomposition of the budget balance into its structural and cyclical components is obtained normally through the application of two important methodologies, namely the IMF and Organization for Economic Cooperation and Development (OECD) methodologies. The earlier research on the subject that had been done mostly in the pre-FRBMA period had indicated the presence of the large structural rigidities in the composition of fiscal deficits in India and a very small cyclical component. The preliminary findings of the study on this subject commissioned in the post-FRBMA period using OECD methodology too have indicated continued dominance of the structural component in the budgetary balance of the Government; this observation holds good in the decomposition of primary deficits of the Centre, combined States, and consolidated General Government.

(Contd....

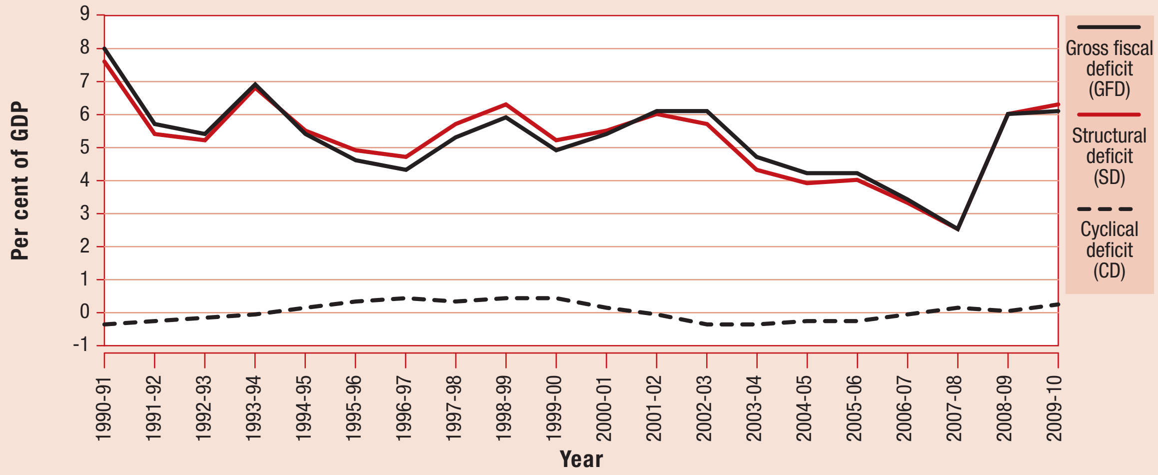
Box 3.3 Contd....)

Estimates of Structural and Cyclical Components of the GFD

(As per cent of GDP)

Year	Structural Deficit(SD)	Cyclical Deficit(CD)	Gross Fiscal Deficit(GFD)	Year	Structural Deficit(SD)	Cyclical Deficit(CD)	Gross Fiscal Deficit(GFD)
1990-91	8.0	-0.4	7.6	2000-01	5.4	0.1	5.5
1991-92	5.7	-0.3	5.4	2001-02	6.1	-0.1	6.0
1992-93	5.4	-0.2	5.2	2002-03	6.1	-0.4	5.7
1993-94	6.9	-0.1	6.8	2003-04	4.7	-0.4	4.3
1994-95	5.4	0.1	5.5	2004-05	4.2	-0.3	3.9
1995-96	4.6	0.3	4.9	2005-06	4.2	-0.3	4.0
1996-97	4.3	0.4	4.7	2006-07	3.4	-0.1	3.3
1997-98	5.3	0.3	5.7	2007-08	2.5	0.1	2.5
1998-99	5.9	0.4	6.3	2008-09	6.0	0.0	6.0
1999-2000	4.9	0.4	5.2	2009-10	6.1	0.2	6.3

Decomposition of gross fiscal deficit into structural and cyclical components (As per cent of GDP)



in the combined State Government deficit in 2010-11 (BE) and the progress in the current fiscal in respect of Central Government finances, the resumption of the process of fiscal consolidation at both Centre and State levels as also of the consolidated General Government has really begun after two years of purposive expansion. With the roadmap laid out by the Medium Term Fiscal Policy Statement coupled with that indicated in the Government Debt Report 2010, the prospects of extending this process to the medium term and beyond are bright. While the roadmap in terms of deficit indicators is important in itself, these being in the nature of derived indicators, it is useful to look at the process by which the reduction is sought to be achieved. The Government Debt Report 2010 indicates that between 2010-11 (BE) and 2014-15 the terminal year of the award of the ThFC, the proportion of total expenditure to the GDP is to go down by 2.5 percentage points to reach 13.5 per cent of the GDP in 2014-15 and at the same time the proportion of tax to GDP is set to rise by 1.4 percentage points to reach 12.2 per cent of the GDP in 2014-15. This estimated level of growth in tax revenues seems likely given the recovery in the economy to the pre-crisis levels and the fact that it was at the same levels before the crisis. Thus it is critical to anchor expenditure reforms to realize the projected deficit levels. A beginning has already been made with the reforms announced in subsidies, some of which have already been implemented. Going forward, deepening the reform process would hold the key to sustaining the fiscal consolidation process.