

FISCAL POLICY STRATEGY STATEMENT

A. Fiscal Policy Review

1. The General budget 2014-15 was presented against the background of sub five per cent growth rate in the earlier years. In the current year, there has been marked improvement on the major macro-economic indicators, as enumerated in the Macro-economic Framework Statement. The assumptions underlying the Statements have since been confirmed by release of advance estimates on GDP growth by CSO. As per the revised series based on constant (2011-12) market prices, the growth rate improved from 5.1 per cent in 2012-13 to 6.9 per cent in 2013-14. Economy is poised to record a growth rate of 7.4 per cent in the current financial year, on the back of new optimism and decisive policy environment.

2. The recovery of growth in the current financial year has been outcome of slew of economic reform measures initiated by the government. The market is enthused with new optimism against the backdrop of swift policy action to mop up economic activities. Key initiatives taken in the current financial year include rationalization of administered pricing policies in petroleum and natural gas, removing bottlenecks in the land acquisition and to ensure adequate availability of key inputs like coal and power. The growth agenda of the Government centered on revival of the manufacturing sector, with focus on the "Make in India" initiative, accompanied by liberalization of foreign direct investment, a large array of investment facilitation measures and steps to improve savings. The financial inclusion initiative under the Pradhan Mantri Jan Dhan Yojana (PMJDY), extending financial services to the large hitherto un-served population of the country to unlock growth potential has been successful. Government pursued key policy and legislative reforms in 2014-15. Substantive progress has been made in direct benefit transfer, linked to Aadhar. The approach is to achieve better targeting and delivery mechanism under subsidies.

3. The revival in the economy has been accompanied by favourable external environment. Easing of international crude oil prices helped in containing subsidies bill which has been reduced at the revised estimates stage, reversal of trend from last couple of years. Similarly, active policy intervention helped in containing current account deficit within manageable limits. Inflation, which remained sticky for last several years, began to ease showing signs of softening. Thus, there was overall

upbeat sentiment in the market. The performance has been better than expected and India is poised to be one of few countries to improve upon the growth assessment. Government has taken steps towards strengthening co-operative federalism by replacing Planning Commission with NITI Ayog. The approach to Planning, following independence had been to provide growth impetus through central planning and a top-down approach. However, over the years with development functions being institutionalized in States, there has been growing clamour to dismantle the top-down approach with attendant one-size-fit-all kind of rigid formulation. In the new age, States aspire to build upon their strengths, to make own development strategy based on local needs and aspirations. Accordingly, there was need to streamline the structure of central planning incorporating these changes. NITI Ayog provides the necessary mechanism for institutionalizing the principles of co-operative federalism, reflecting the aspirations of the States. Going forward, there will be concomitant changes in the centre-state fiscal relations, with States taking the lead and centre providing enabling environment.

4. The revival of growth in the current financial year brought back the debate on fiscal consolidation to the centre stage. The present phase of fiscal consolidation, adopted in 2012-13 has spanned out in period which has witnessed lower tax buoyancy. Thus, the consolidation has relied on the expenditure management. However, with economy poised for cyclical upturn, it has been argued that public spending needs to be stepped up in core sectors to tap the growth potential. While, there is general consensus that there should be check on the revenue spending, especially items like subsidies in a benign environment, the spending on capital side needs to be augmented. In the current financial year Government has maintained the deficit target, despite there being pressure on the tax revenues as also from the disinvestment side. With easing of international crude oil prices, the pressure on subsidies was lower, which provided an opportunity to introduce reforms on fuel pricing. Austerity measures to contain establishment costs and other Non-plan expenditure along with rationalization of Plan expenditure helped in meeting the Fiscal targets.

5. While, the path of fiscal consolidation has been adhered to in 2014-15, the budget 2015-16 has adopted a fiscal deficit target of 3.9 per cent. This

shows a deviation from the roadmap which required deficit target to be maintained at 3.6 per cent. Following change in the transfer of resources to States, following the Fourteenth Finance Commission (FFC) award discussed at length in later sections, Government adopted a deviation from the FRBM regime in vogue. It is pertinent, however, to note that the fiscal deficit target has been kept range bound i.e. under 4 per cent while deviating from the announced roadmap.

B. Fiscal Policy for 2015-16

Fourteenth Finance Commission

6. The Budget 2015-16 is being presented as the first year of the FFC award period. The explanatory memorandum as to the action taken on the recommendations alone with the report of the FFC has been presented in the Parliament. After conducting extensive consultations with the States and the Centre, FFC has recommended for greater share of devolution to the States, replacing the transfers through Plan schemes. With a steep jump in States' share of taxes from 32 per cent to 42 per cent of the gross tax revenue, divisible pool, in nominal terms this amounts to increase in states' share by more than 1.5 lakh crores. Additionally, local bodies and revenue deficit grants has also been increased. Thus, from FY 2015-16 the resources available at the disposal of States' will be substantially higher. The central theme of the FFC recommendation is based on the fact that States' have graduated in to designing and implementing development programmes based on local conditions. The emerging consensus is that Centre should partner with States under the new paradigm, playing a supportive role as an enabler rather than executing schemes from the front. As discussed above, the Government had initiated actions in the spirit of Co-operative federalism even before the recommendations of FFC. Thus, FFC formalises the efforts in letter which was underway in spirit.

7. The fiscal policy of 2015-16 has been calibrated with two fold objectives – first, to aid economy in growth revival; and second, to institutionalize the co-operative federal structure in light of emerging views on the Centre-State fiscal relations. While, allocations in the social and welfare sectors have been protected, it is expected that the States' will be bringing in greater share to give fillip to government spending in these sectors. Under the Central Plan, which falls under the exclusive domain of the Centre, allocation has been increased in the Capital spending. Similarly, higher allocations have been made to core sectors of infrastructure which have the potential to give impetus to manufacturing and job creation. It is noteworthy

that allocations in social and welfare sectors such as Education, Social Justice, Tribal Welfare, Minorities Affairs etc. has been retained or increased, while reducing the central share with respect to some of the schemes. In respect of some of the schemes / programmes, the centre-state funding pattern is being modified in view of the larger devolution of tax resources to States as per the recommendations of the 14th Finance Commission; whereby in these sectors, the revenue expenditure is to be borne by the states. Subsequent to the changed funding pattern, overall expenditure on the programme will not decrease. In certain other cases, the schemes / programmes are being discontinued as centrally sponsored schemes. States may decide to continue (or not) with these schemes / programmes out of their increased resources resulting from the recommendations of the 14th Finance Commission.

8. Apart from containing growth in expenditure, the reduction in fiscal deficit is planned to be achieved in conjunction with targeted revenue augmentation both through tax and non-tax revenues. In FY 2013-14, Tax to GDP stood at 10.0 per cent of GDP. Tax to GDP ratio of 10.6 per cent was targeted in BE 2014-15. However, in RE 2014-15, Tax-GDP ratio has been revised to 9.9 per cent, a growth of 9.9 per cent over the gross tax revenues in 2013-14. Despite the growth rate improving in the current financial year, easing of inflation implied lower growth in nominal terms. Thus, tax revenues continued to be lower than the budgeted level. Accordingly, Budget 2015-16 provides for a realistic growth of 15.8 per cent over RE 2014-15, with tax-GDP ratio at 10.3 per cent. With higher devolution to States, following FFC award, Tax revenue of the centre shows marginal improvement over RE 2014-15, about 1.3 per cent, despite the growth on gross taxes. Non-tax revenue has witnessed higher growth in last few years due to higher dividend payment from PSUs and Banks, higher dividend paid by RBI and increase in estimates of Spectrum charges. However, with higher potential under this item already realized, Budget 2015-16 provides for marginal increase of 1.8 per cent over RE 2014-15. Thus, total revenue receipts of the Centre remains stagnant, with marginal increase of 1.4 per cent over RE 2014-15.

9. Given the resource constraint explained above on the revenue side, only option to raise additional resources remains through borrowing. The debate on easing fiscal deficit roadmap had been argued to give boost to public spending in the core sectors of the economy. However, attempt to raise higher resources from the market has to be viewed in the larger monetary policy context. Easing of inflationary pressure and credible steps to reign in the fiscal deficit

has provided the manoeuvring space to the monetary authority to lower interest rates, a long standing expectation in the economy. Higher Government borrowing will adversely impact private investment and make it difficult for reduction of interest rates. This would adversely affect the revival of growth, which has just started to show positive signs. Therefore, government has decided to continue with the fiscal consolidation phase, albeit with slight modification. Budget 2015-16 has adopted fiscal deficit target of 3.9 per cent, lower than the 4.1 per cent target in FY 2014-15. However, it is pertinent to note that the fiscal deficit target represents a deviation from the target adopted under the revised roadmap for fiscal consolidation. Despite the deviation, Government has continued on the path of fiscal consolidation keeping the deficit range bound. Necessary changes in the Rules will be introduced.

10. Due to resource base of the centre shrinking, following higher sharing of taxes and declining deficit, there was need to contain the Non-Plan spending to provide reasonable Plan outlay. The Non-Plan expenditure in budget 2015-16 provides 8.2 per cent increase over the RE 2014-15, as compared to average growth of 11.1 per cent in last five years (from 2010-11 to RE 2014-15). Thus, despite shrinking resource base, the Budget 2015-16 provides for Plan at the RE level nominally, with marginal decrease of 0.6 per cent. Overall, the budget size increases by 5.7 per cent in BE 2015-16 over RE 2014-15, with fiscal deficit at 3.9 per cent of GDP, lower than 4.1 per cent in FY 2014-15. As percentage of GDP, total expenditure is estimated to be 12.6 per cent in BE 2015-16 as against 13.3 per cent in RE 2014-15.

Tax Policy

11. During the fiscal consolidation period, the tax-GDP ratio improved significantly from 9.2 per cent in 2003-04 to 11.9 per cent in 2007-08. This has been achieved through rationalization of the tax structure (moderate levels and a few rates), widening of the tax base, and reduction in compliance costs through improvement in tax administration. The extensive adoption of information technology solutions and re-engineering of business processes has also fostered a less intrusive tax system and encouraged voluntary compliance. These measures resulted in increased buoyancy in tax revenues till 2007-08 and helped in achieving fiscal consolidation through revenue measures alone. Due to the stimulus measures undertaken largely on the tax side during the global economic crisis in 2008-09 and 2009-10, as a measure to insulate Indian economy from the adverse impacts of global economic crisis and slowdown in domestic growth, the gross tax revenue as percentage of GDP declined sharply to 9.6 per cent in 2009-10.

12. Further, due to high international prices and as a measure to insulate consumers and to reduce under recoveries government had to further reduce taxes/duty on petroleum products in 2011-12. As a result the gross tax receipts as percentage of GDP in 2011-12 declined to 10.1 per cent from 10.2 per cent in 2010-11. With partial roll back of stimulus measures in indirect taxes and additional revenue measures, it was estimated that tax receipt as percentage of GDP would improve to 10.9 per cent in 2013-14. However, global uncertainties and exchange rate volatility and growth rate lower than expectations in 2013-14, the actuals tax-GDP ratio stood at 10.0 per cent. Tax buoyancy has come down to below one, implying thereby that tax collection has failed to keep pace with the growth in GDP. This is more pronounced in case of Indirect taxes than in Direct tax collection. Continuing forward on the path of fiscal consolidation with a view to narrow the gap in government spending and resources, the tax-GDP ratio was targeted at 10.6 per cent in the BE 2014-15 with a growth rate of 19.8 per cent over provisional actuals of 2013-14. In RE 2014-15, after realistic assessment, tax-GDP ratio has been revised at 9.9 per cent which indicates a growth of 9.9 per cent in gross tax receipts over 2013-14. For FY 2015-16 gross tax revenues are estimated to grow at 15.8 per cent over the gross-tax revenues during 2013-14 taking tax-GDP ratio at 10.3 per cent.

Indirect Taxes

13. The performance of key industrial sectors based on the Index of Industrial Production (IIP) reveals the reversal in trends of industrial production in 2014-15, which had slowed down since 2011-12. The revival of manufacturing sector has been unleashed in the "Make-in-India" initiative accompanied with several other initiatives of the Government. The growth momentum is likely to be continued in FY 2015-16 as well. Turnaround in economic activity expected in FY 2015-16 with the improvement in industrial, manufacturing and service industry, growth in exports and expectation of recovery of growth rate will provide a scope for achieving the budget targets in FY 2015-16

14. In the medium term, the most significant step from the point of view of broadening the tax base and improving revenue efficiency through better compliance is the introduction of Goods and Services Tax (GST). As far as Central taxes viz. Central Excise duties and Service Tax are concerned, a fair amount of integration has already been achieved, especially through the cross-flow of credits across the two taxes. It would be possible to realize full integration of the taxation of goods and services only when the State VAT is also subsumed and a full-fledged GST is launched. As a preparation for introduction of Goods and Service Tax (GST), Government has been taking

consistent policy steps to expand the scope of service tax. To broaden the tax base, negative list approach to taxation of services was introduced with effect from 1st July, 2012. Negative List of Services and service tax exemptions were reviewed for broadening the tax base and also as a preparation for introduction of GST, in the following manner:

- (i) The Following services have been brought under the tax net,-
 - Online and mobile advertising;
 - Services provided by radio taxis or radio cabs.
- (ii) The service tax exemption on the following services has been withdrawn,-
 - Clinical research on human participants;
 - Services provided by air-conditioned contract carriages
- (iii) Scope of some of the existing exemption was rationalized.

15. There are several specific proposals in the Budget 2015-16 to recalibrate the tax effort on indirect taxes so that fiscal consolidation may be achieved in the short term. The important and revenue significant proposals include:

- Basic Customs Duty on metallurgical coke is being increased from 2.5% to 5%
- Basic customs duty on Commercial Vehicles is being increased from 10% to 20%.
- Excise duty of 2% without CENVAT credit or 6% with CENVAT credit is being levied on condensed milk put up in unit containers
- Excise duty of 2% without CENVAT credit or 6% with CENVAT credit is being levied on peanut butter.
- Excise duty structure of NIL without credit or 12.5% with credit is being prescribed for solar water heater and systems.
- Excise duty structure for mobile handsets, including cellular phones, is being changed from 1% without credit or 6% with credit to 1% without credit or 12.5% with credit.
- Clean Energy Cess levied on coal, lignite and peat is being increased from Rs.100 per tonne to Rs.200 per tonne.
- Excise duty on cigarettes is being increased by 25% for cigarettes of length not exceeding 65 mm and by 15% for cigarettes of other

lengths. Similar increases are proposed on cigars, cheroots and cigarillos.

- Maximum speed of packing machine is being specified as a factor relevant to production for determining excise duty payable under the Compounded Levy Scheme presently applicable to pan masala, gutkha and chewing tobacco. Accordingly, deemed production and duty payable per machine per month are being notified with reference to the speed range in which the maximum speed of a packing machine falls.
- In Service Tax, rate is being increased from 12% plus education cesses to 14%. Further some of the Negative List entries are being pruned, and some exemptions are being withdrawn.

16. The underlying theme of the indirect tax policy during the year is to boost domestic manufacture, to bring about clarity in tax laws, stability in duty rates & rationalization of duty structure.

Direct Taxes:

17. The Government policy on direct taxes has been to achieve growth in direct taxes by broadening the tax base while maintaining a regime of moderate tax rates. Tax collection is the product of two factors- tax rates and tax base. There will be no change in the rate of personal income tax and the rate of tax for companies in respect of income earned in the financial year 2015-16.

18. It is proposed to levy surcharge @ 12 per cent on individuals, HUFs, AOPs, BOIs, artificial juridical persons, firms, cooperative societies and local authorities having income exceeding ₹1 crore. Surcharge in case of domestic companies having income exceeding ₹ 1 crore and up to ₹10 crore is proposed to be levied @ 7 per cent and surcharge of @ 12 per cent is proposed to be levied on domestic companies having income exceeding ₹10 crore. The rate of surcharge in the case of foreign companies will continue to be the same as in last year.

19. The widening of tax base to achieve growth in tax collection is a continuous process which involves both legislative as well as administrative measures. The major policy proposals, intended to broaden the tax base and augment revenue, in the Union Budget 2015-16 are as under:-

- It is proposed to provide for chargeability of interest paid by a permanent establishment (PE) or a branch of foreign bank in India to its Head office and other overseas branches under the source rule of taxation and for

treating the PE or branch as a taxable entity for computation of income and for purpose of levy of tax and TDS

- It is proposed to provide for penalty on advance taken / repaid in cash above ₹20,000/- for immovable property transactions.
- It is proposed to enable the Central Government / CBDT to capture information regarding prescribed foreign remittances to ensure proper taxation of such payments.

The administrative and technological initiatives to augment revenue are as under:-

- A non-adversarial and non-intrusive tax regime to enhance ease of doing business is being promoted through modernisation of the business processes of tax administration. Extensive use of information technology is being made for e-enablement of tax payer services. Filing of income tax returns, various forms, audit reports, statements of tax deduction at source have been made compatible with electronic filing and computerised processing.
- The two measures i.e. Centralised Processing Center for income-tax returns at Bangaluru and Centralised Processing Centre – TDS at Vaishali Ghaziabad have enabled tax administration to function in a more efficient and automated environment and reduce the compliance burden on the tax payers. Centralised processing of returns enables the tax administration to track stop filers, non-filers, non-payment of taxes etc. which helps in widening of the tax base.
- Data warehouse and business intelligence project has been undertaken for developing a comprehensive platform for effective utilisation of information to enhance voluntary compliance and deter non-compliance.

20. There has been significant growth in the direct tax collection during the year 2013-14. Tax buoyancy for direct taxes has increased from 1.07 in financial year 2012-13 to 1.17 in financial year 2013-14. This shows that growth in direct tax collection has exceeded the nominal growth in GDP. The personal income tax has shown a higher growth as compared to the corporate income tax. The personal income tax increased by 20.56 per cent whereas the corporate income tax showed a growth of 10.76 per cent. Though there has been an increase in corporate income tax in terms of percentage in financial year 2013-14, the buoyancy remains less than one. The

reason for buoyancy to be less than one in corporate income tax is that the profitability of the business and trade has diminished due to higher component of inflation in nominal GDP growth rate. These factors of inflation do not affect wages which mainly contribute to personal income tax collection.

Contingent and other Liabilities

21. In terms of Article 292 of the Constitution, Central Government gives guarantees for the repayment of borrowings upon the security of the Consolidated Fund of India. The FRBM Act mandates the Central Government to specify the annual target for assuming contingent liabilities in the form of guarantees. Accordingly, FRBM Rules prescribe a ceiling of 0.5 per cent of GDP for incremental guarantees that the Government can assume in a particular financial year. The Central Government extends guarantees primarily for the purpose of improving viability of projects or activities undertaken by the Government entities with significant social and economic benefits, to lower the cost of borrowing as well as to fulfil the requirement in cases where sovereign guarantee is a precondition for bilateral/multilateral assistance. As the statutory corporations, government companies, co-operative institutions, financial institutions, autonomous bodies and authorities are distinct legal entities, they are responsible for their debts. In the process of guaranteeing their financial obligations the Government has the commitment to assess the fulfilment of such obligations and adequately disclose them. The disclosure is being made by the Government as per statutory requirements decided on the advice of Comptroller and Auditor General.

22. For better management of contingent liabilities, Government guarantee policy enumerates various principles which need to be followed before new contingent liabilities in the form of Sovereign Guarantees are undertaken. As guarantees extended by Government have the risk of its devolution on Government, the proposals are examined in the manner of a loan being taken directly by the Government. The principles enunciated in the policy lay down framework for minimization of risk exposure of sovereign while undertaking these contingent liabilities. The principles include assessment of risk including the probability of a future pay-out, priority of the activity, institutional limits on guarantee for limiting exposure towards select sectors and reviewing the requirement of guarantee vis-a-vis other forms of budgetary support or comfort. Additional measures to further streamline the process of assuming risk could include charging of risk based premia disincentive for wilful default, other part sharing of risk by the Government and insisting on guaranteed debt cost to

be near the benchmarked Government Securities rate.

23. The Stock of contingent liabilities in the form of guarantees given by government has increased in absolute terms from ₹1,07,957 crore at the beginning of the FRBM Act regime in 2004-05 to ₹2,49,503 crore at the end of 2013-14. FRBM ceiling on guarantees which can be assumed by Government during a F.Y. has resulted in reduced contingent liability to GDP ratio. Ratio which stood at 3.3 per cent in 2004-05 is now reduced to 2.2 per cent in 2013-14. The disclosure statement on outstanding Guarantees as prescribed in FRBM Rules, 2004 is appended in the Receipt Budget at Annex 5(iii). During the year 2013-14, net accretion to the stock of guarantees was ₹12,972 crore, amounting to 0.11 per cent of GDP, which is within the limit of 0.5 percent set under the FRBM Rules.

24. Government is also assuming liabilities for financing its activities by entering into annuity projects in respect to some infrastructure development activities. The commitments so made in these projects will occupy the fiscal space for future Governments and due care needs to be exercised in assuming these liabilities for the sake of intergenerational equity. As part of amended FRBM Rules, Government discloses its commitment liabilities towards such projects including project costs and annual pay-outs under the annuity projects. These commitments on account of on-going Annuity Projects under Ministries / Departments are disclosed in the prescribed format in Receipts Budget at Annexure-8. The annuity projects contracted by Government have a total committed value of ₹1,00,071.78 crore with annual payment of ₹6,440.29 crore.

Government Borrowings, Lending and Investments

25. Status Paper on Government Debt is published annually to improve transparency in dissemination of information related to public debt. The fourth edition of the document was published in December, 2014. Prudent debt management is corner stone of good economic policy and experience in other part of the world has shown that vulnerability of debt profile to international shocks needs to be closely monitored in emerging global economic order. In India, debt policy is driven by the principle of gradual reduction of public debt to GDP ratio so as to further reduce debt servicing risk and create fiscal space for other/developmental expenditure. The debt policy in India emphasizes maintaining a stable, sustainable, low cost and prudent debt structure. Indian debt profile is characterized by reliance on domestic borrowings, with market

determined rates rather than administered rates. Development of deep and wide secondary market for Government securities is one of the key reforms in this regard. While government is in process of introducing necessary legislation and setting up its own Public Debt Management Agency (PDMA), Middle Office has been established in the interlude, towards this end. The major focus of Middle Office is on skill building and developing expertise required for a fully functional debt management office. The office is assisting government in issuance of calendar for borrowing through G-securities, advice on selection of instruments and other related matters. Making further progress toward transparency and dissemination of information, Government began publishing a Handbook of Statistics on the Central Government Debt in November 2013, which is being updated on annual basis.

26. One of the key features on country's debt profile is diminishing proportion of external debt as percentage of total borrowing, which amounts to 8.3 per cent of Central Government's total liabilities, and 5.0 percent of general government debt as on March 31, 2014. External borrowing is limited to multilateral/bilateral loans from select development partners for financing development projects and, thus, not exposed to reversal of capital flows. Loans from multilateral institutions constituted significant portion (71.7 per cent) of external debt at end- March 2014, which are largely on concessional terms. The external funding has increased from ₹ 5,734 crore in BE 2014-15 to ₹ 9705 crore in RE 2014-15, resulting in increase of net financing. The BE 2015-16 for external debt is also kept higher at ₹ 11,173 crore. A greater dependence on domestic debt and a lower share of external debt in the total debt insulates the debt portfolio of the Government from volatility in international capital markets. This also minimises currency risk and has less significant impact on BoP. Low interest rates in the international financial markets in recent past suggested that it may be beneficial to borrow from international financial market. Further, gradual decline in net inflow from Multilateral Institutions in the coming years also gives government an option of exploring other sources of external debt, for example in the form of sovereign bond issuance, to maintain a reasonable mix of domestic and external debt in its portfolio. The decision to issue foreign currency denominated sovereign bonds, however, cannot be based on relative cost alone. The need to access international capital markets should be justified in the context of overall savings and investment requirements of the economy. Therefore, decision to issue sovereign bonds would require establishing a regular and predictable schedule of issuance leading to a build-up of interest and

redemption payments and, thus, balance of payments (BoP) implications of external borrowing should also be appreciated.

27. Developing a liquid and vibrant secondary market for government securities and broadening the investor base are the key factors to ensure that debt is raised in a cost effective manner. The initiatives to develop market are undertaken in close coordination with the Reserve Bank of India. Primary issuance strategy of the Government remains focussed on issuing new securities under benchmark maturities and building volumes under existing securities to improve liquidity in the secondary market, with internal ceilings on outstanding amount of individual securities to manage liquidity risk of the government. During 2014-15, six new securities worth ₹30,000 crore were issued constituting 10.3 per cent of total issuances during the year, implying that 89.7 per cent issuances were in terms of re-issues. Broadening of investor base is another key factor in the stability of demand for government securities.

28. Apart from greater focus on market borrowings, the Government is also moving toward alignment of administered interest rates with the market rates. Interest rates on small savings are now linked with yields in secondary market for dated securities. The interest rates for every financial year are notified before 1st April. Collections under various small saving schemes, net of withdrawals, during the financial year form the source of funds for National Small Savings Fund (NSSF). The net collection is invested in Central and State Government Securities as per the recommendation of the Committee on Small Savings constituted in July, 2010. Redemption of these securities is reinvested in Central and State Government Securities in 50:50 ratio at prevailing rate of interest. States are provided excess interest relief based on their compliance with fiscal targets in respective FRBM Act. Interest payment to subscribers and cost of management constitute the expenditure under the fund and interest on Central and State Government Securities forms the income of the fund.

29. In 2014-15, net market borrowings at ₹ 4,61,205 crore were budgeted to finance 86.8 per cent of gross fiscal deficit. Other sources of financing such as external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 13.2 per cent of GFD. During 2014-15, the net inflow in the small savings account is expected to increase substantially as compared to previous years, pointer to better retail savings. The rollover risk in the Government debt portfolio continues to be low with weighted average maturity of outstanding dated securities, close to 10.2 years as on date, which is

high compared to international standards. Furthermore, the share of short-term debt in outstanding dated securities at end-December 2014 was around 4.6 per cent and debt maturing in next 5 years was around 26.5 per cent of total outstanding dated securities, indicating a low level of rollover risks. Notwithstanding a low rollover risk, the Government is continuing its efforts to elongate the maturity profile of its debt portfolio. During the 2014-15, weighted average maturity of primary issuance of issuance was raised to 14.66 years from 14.28 years in the previous year. Noticeably, the increase in weighted average maturity was achieved without substantial increase borrowings costs. The weighted average yields of primary issuance during 2014-15 saw only marginal increase to 8.51 per cent from 8.48 per cent in the previous year. The increased maturity of primary issuances without a substantial increase in borrowings cost reflects the greater demand for longer tenor securities by insurance companies and provident funds which will continue to support the Government efforts to elongate its maturity profile in medium term. During 2014-15, there were devolvement in 4 issuances of G-securities worth ₹ 5,271 crore as against devolvement in 26 issuances worth ₹ 17,451 crore in 2013-14, indicating a less volatile and stable G-Sec market in 2014-15.

30. Pursuing with Government's commitment to carry on with the fiscal consolidation measures, the fiscal deficit for 2015-16 is budgeted to decline to 3.9 per cent of GDP. Total borrowings requirement for 2015-16 has been budgeted at ₹ 5,55,649 crores. Net market borrowings (adjusted for repurchases/ switches in 2015-16) of ₹ 4,56,405 crore has been budgeted to finance 82.1 per cent of gross fiscal deficit. The net market borrowing projection shows an increase of 2.1 per cent over the previous year. In terms of GDP, however, net market borrowings are budgeted to decline to 3.2 per cent as compared with 3.5 per cent in the previous year. Borrowings under other sources of financing are budgeted at 17.9 per cent during 2015-16. In terms of debt financing, the borrowings strategy during 2015-16 will continue to rely on domestic sources with external sources financing only 2.0 per cent of the fiscal deficit. Nearly, 98 per cent of GFD of ₹ 5,55,649 crore would be financed from the domestic sources. Borrowing strategy will continue its focus on raising resources through on market oriented instruments to meet both the short-term and medium term borrowings requirements of the Government.

31. Apart from ₹6,00,000 crore proposed to be raised through dated securities, a provision of ₹30,063 crore is also made to be realised through treasury bills. In

addition to providing a greater manoeuvrability for cash management, treasury bills also provide benchmark and momentum to trading activity in the money market therefore facilitating the financial and corporate sector in meeting their short-term cash requirements. In addition, Small Savings, State Provident Fund and other receipts from Public Account would finance remaining portion of the deficit. There was no balance estimated at the end of financial year 2014-15 under Market Stabilization Scheme (MSS). Net accretion in MSS to the tune of ₹ 20,000 crore is however estimated in BE 2015-16.

32. In view of redemption pressures in coming years, particularly during 2015-16 to 2017-18, the Government in coordination with Reserve Bank made progress since 2013-14 in putting in place an active debt management strategy in the form of buyback as well as switching of securities, with an objective to manage its debt portfolio, improving liquidity in securities, reducing roll over risk as well as utilizing the cash surplus. During 2013-14, the switching / buyback operations were undertaken whereby the securities worth about ₹31,000 crore maturing in 2014-15 and 2015-16 were switched for longer tenor securities and securities worth ₹ 15,590 crore maturing in 2013-14 were bought back towards end of FY 2013-14. Continuing further with this debt management strategy, ₹50,000 crore was budgeted in FY 2014-15. Thus far in the current financial year ₹30,602 crore worth of dated securities have been switched and ₹6,283 crores have been bought back. To prematurely redeem the Government Stocks by utilizing surplus cash balances, repurchases (buyback) of government securities (G-Sec) worth ₹18,805 crore were carried out during September 2014 for securities maturing in FY 2014-15 and FY 2015-16. An amount of ₹12,522 crore worth G-Sec of this repurchase amount was maturing during current year and has already matured. An amount of ₹6,283 crore worth G-Sec will mature in FY.2015-16. Buyback of the debt serves twin purposes of effective cash management and smoothening of maturity profile. It is expected that Switching / Buy-backs will ease redemption pressure in the initial part of ensuing financial year. Moreover, with redemption pressure rising over next three financial years, active debt management synchronized with cash management will help in managing redemptions with optimal costs. Therefore, in FY 2015-16 further provision of ₹50,000 crores has been made to undertake buyback / switch operation of shorter tenor G-securities with longer tenors G-securities.

33. Cash management framework is an essential ingredient of the overall debt management strategy.

Government is moving toward a market based cash framework with reduced dependence on the central bank. With the introduction of Cash Management Bills in 2010-11, cash deficit requirements are now largely managed through the market.

Initiatives in Public Expenditure Management

Expenditure Management Commission:

34. While Government has managed to control the expenditure through rationalization in the fiscal consolidation phase, quality of expenditure remains an area that needs to be addressed. The ongoing fiscal consolidation has been successful in taming the fiscal deficit; however the public finance on the revenue side requires attention in the view of accomplishment of target set for the revenue deficit and effective revenue deficit under the new FRBM regime. This entails structural changes in the Plan spending and definitive measures to contain Non-Plan spending within sustainable limits.

35. The Government has recognised the need for reviving the major areas of Central Government expenditure and to look into the ways for creating fiscal space required to meet developmental expenditure needs, without compromising the commitment to fiscal discipline. The need has been felt to increase the allocative efficiencies of the government expenditure and to improve operational efficiency of expenditures through focus on utilization, targets and outcomes. Further, measures are required to achieve reduction in financial costs through better Cash Management System, to make greater use of IT tools for expenditure management and to improve the financial reporting system. In the view of this, Government has constituted Expenditure Management Commission (EMC) and the concerns as pointed out above finds the place in the Terms of Reference of EMC. The Expenditure Management Commission has submitted its interim report to the Finance Minister in January, 2015. The interim report includes various suggestions to improve Expenditure Management of the Central Government.

Expansion of Direct Benefit Transfer:

36. DBT is a major reform process where cash/benefits are transferred directly in the bank accounts of beneficiaries, preferably Aadhaar seeded, cutting several layers in the delivery process. It envisages achieving accurate targeting of beneficiaries, de-duplication and reduction of fraud, efficiency in delivery process, ensuring greater inclusion, elimination of waste, curbing leakage thereby controlling expenditure and greater accountability and transparency. Savings can accrue due to de duplication and reduction in

Administrative cost in transfer of benefits which can be ploughed back for greater outreach to all the intended and eligible beneficiaries of the Schemes. DBT is operational in 27 Schemes in 121 selected districts since 1.1.2013 and efforts were on to expand it both geographically and by bringing new schemes, where cash/benefits are provided to individual beneficiaries in their bank accounts. In December, 2014, it has been decided:

- i. To expand DBT beyond the 121 selected DBT districts, across the entire country. This will increase the no. of beneficiaries to about 5.5 crore and ensure 17,777 crore annually to flow through DBT platform.
- ii. To include 7 new Scholarship Schemes of Department of Higher Education, Ministry of HRD on DBT, across the entire country
- iii. Rollout of MGNREGS on DBT platform in 300 districts with higher Aadhar enrollment. This will ensure flow of fund to the tune of ₹15, 000 Cr per annum on DBT platform and will affect 4.3crore beneficiaries.

Thus the total number of beneficiaries under 35 DBT schemes will grow from the present about 1.0 crore to about 10 crore and about ₹ 33,000 crore per annum will flow on the DBT platform across the country. Out of 35 DBT schemes approved for expansion across the country, 32 schemes are currently under implementation and total number of beneficiaries under DBT in 2014-15, are approximately 7.6 crore.

37. Ministry of Skill Development and Entrepreneurship has been requested to submit a comprehensive plan regarding 73 Skill development Schemes running across sectors and implemented through 22 Ministries on DBT. Centrally Sponsored Schemes and 33 Central Sector Schemes are being examined and concerned Ministries will be consulted before they can be on boarded on DBT platform from the year 2015-16. There are about 39 lakh Para workers like ASHA workers, Para teachers etc in the country getting monthly stipend as cash. The DBT platform may be adopted for making payment to bank accounts of beneficiaries. States were requested to adopt DBT architecture in State run schemes where cash is provided to individual beneficiaries.

38. The Government has launched a scheme for direct transfer of LPG subsidy to consumers across 54 districts on 14.11.2014. The scheme is named as 'PAHAL'. From 1st January, 2015, the scheme has been rolled out across the entire country. It will benefit over 15 crore LPG consumers and will be the largest direct cash transfer scheme in the world. Life Insurance Corporation of India has laid the systems and procedures for crediting of benefits under Aam Admi Bima Yojana (AABY) to Aadhaar enabled bank

accounts of the beneficiaries in the pilot districts, Mysore and Pathanamthitta. Under AABY, Life Insurance Cover, Accident and Disability Claim benefits and Scholarships are payable to the Below Poverty Line and marginally Above Poverty Line beneficiaries of the scheme.

Expansion of e-Payment System:

39. Government e-Payment System, inaugurated by then Hon'ble Finance Minister on 31.10.2011, is a secure electronic payment system for direct credit of dues from the Government of India into the accounts of beneficiaries using digitally signed electronic advices (e-advice) through the 'Government e-Payment Gateway' (GePG). The e-payment system is an important tool for good governance and anti-corruption measure. This reduces the beneficiary's dependence on Govt. offices and officials to receive their dues/payments. The System also helps the employees in improving efficiency as it facilitates faster payment, quicker receipt of scrolls and hassle free reconciliation. Besides, this is a major green –initiative as it helps environmental protection by eliminating paper based physical instruments of payments and e-scrolls. The e-payment system using GePG has since covered 414 PAOs in 51 Central Ministries/ Departments through 22 banks. The scope of e-payment system has been expanded to cover Cheque Drawing & Disbursing offices (CDDOs) of CPWD and has since been implemented in 142 CDDOs. Volume of e-payment has been increasing steadily and has reached to a level of over 90% of all payments to vendors, suppliers, contractors and staff in PAOs covered by the system.

Railway Budget

40. Railways Budget is presented separately from the General Budget. However, the earnings and expenditure and all other major financial figures are also incorporated in the General Budget. Government support is provided to Railways in the form of Gross Budgetary Support (GBS) and a return on this investment, called Dividend, is paid every year. The rate of Dividend is determined by the Railways Convention Committee and is presently at 5 per cent. There has been no default in the payment of dividend in the last ten years. Railway revenues are primarily earned through two major traffic streams, passenger and freight. Some earnings are also contributed by luggage/parcels, commercial utilization of land, siding charges, advertisement and dividend paid by Railways' PSUs. The earnings are utilized to meet the operating expenses called Ordinary Working Expenses (OWE) and pensionary charges. The remaining surplus is used to pay dividend and balance is ploughed back

as plan investment for meeting safety and development needs of the system.

41. Railways finances improved in the last decade in as much as that it attained the Operating Ratio of 75.9 per cent in 2007-08. This was primarily due to buoyancy in the national economy getting reflected in railway traffic also and the average growth in railway expenditure. However, after 2007-08, the OWE and pension payment soared consequent upon implementation of the 6th Central Pay Commission (CPC), whereas the momentum of growth in earnings witnessed earlier could not be maintained. As a result the Operating Ratio deteriorated to the extent of 95 per cent during 2009-10. The Railway Plan could be sustained by drawing down from the Railway Reserve Funds. In fact, the balances in Railway Reserve Funds become negative to the extent of ₹ 2,100 crore and ₹ 385 crore during 2010-11 and 2011-12 respectively. Ministry of Finance provided a loan of ₹ 3,000 crore in 2011-12 to bridge the negative balances in the Railways Funds.

42. After stabilization of the impact of 6th Central Pay Commission (CPC) and also due to various measures taken including additional resources mobilization through rationalizing the fare and freight tariffs, the financial position of the Railways has started showing signs of improvement in the subsequent years. The entire loan of ₹ 3,000 crore was also returned to general revenues in 2012-13 with interest. The revenue earnings of the Railways at ₹ 1,59,248 crore are likely to register a growth of 14.1 per cent in RE 2014-15 over the previous year, whereas the OWE and the pension expenditure at ₹ 1,38,258 crore are estimated to increase by 13.02 per cent. The internal resource generation is likely to be ₹ 15,053 crore in RE 2014-15 against ₹ 11,668 crore in 2013-14. The Operating Ratio in RE 2014-15 is likely to be at 91.8 per cent. Traditionally the passenger services of railways have been loss making and the under recovery has exceeded ₹ 25,000 crore.

43. The plan investment in railways is funded through GBS, internal resources and extra budgetary resources (EBR). The 12th Five Year Plan for railways has been approved at ₹ 5.19 lakh crore, targeting investment of ₹ 1.94 lakh crore through GBS, ₹ 1.05 lakh crore of internal resources and ₹ 2.20 lakh crore of EBR. An amount of ₹ 1,00,011 crore has been provided in BE 2015-16 as against investment of ₹ 65,798 crore in RE 2014-15 and ₹ 53,109 crore in Actuals 2013-14. The plan resources are targeted to be invested judiciously and operationally important projects will provided assured funding during the 12th Plan. This will help the railways in not only removing the infrastructure bottlenecks but also augment the revenue earning capacity of the system.

C. Policy Evaluation

44. Government has adopted active policy stance to revive the economic growth in the current financial year. Apart from slew of policy interventions in critical sectors such as manufacturing, infrastructure etc., Government has also adopted institutional reforms such as 'minimum government, maximum governance', replacing Planning Commission with NITI Ayog. The thrust of these reforms have been to streamline the government structure to meet the aspirations of a new, vibrant nation in the modern age. There has been definite and decisive move towards co-operative federalism where Centre-State relationship is put on a new footing as partners in development. Central theme of the government has been to re-define the manner of engagement between the centre and states on the development agenda. Recommendations of Fourteenth Finance Commission (FFC) and Government's decision to implement the award in letter and spirit, despite its far reaching implications on range of issues, has to be seen in this context.

45. The award is in line with government's thrust towards greater co-operative federalism and re-defining the centre-state fiscal relations. There had been growing demand from States across for greater devolution and flexibility to design and implement development programmes suited to its requirement. 'One-size-fit-all' approach of the Planning Commission was decried by all as being anachronistic. In the initial phase of growth following independence, there was need for singular approach to nation building to develop capacities across the spectrum. However, with time different States have built-up their capacities and are aspiring to embark on development strategy based on their local requirements and aspirations. It was argued that rigid programme design of the centre was stifling the local aspirations. States' clamoured greater flexibility in design and implementation of development agenda. FFC has taken this aspect as the central theme of its recommendation for devolution.

46. Budget 2015-16 is landmark budget in many ways. It has altered fundamental approach to development. Building on the FFC award, Government has integrated it with its drive towards co-operative federalism and re-designing of the Planning Commission. NITI Ayog provides the ready platform for building upon the institutional framework recommended by the FFC. As a result, Central Plan outlays have been provided adequately for the Centre to carry out its mandate on the Union list. Attempt has been made to provide substantive allocations for the core activities under the Central subject under the Umbrella schemes. Various activities performed disparately under the Central Plan have been merged

under the larger schemes. Going forward, the schemes under Central Plan need to be streamlined by weeding out smaller programmes that have outlived their purposes.

47. The Finance Commission has enhanced devolution of the divisible pool of taxes as a compositional shift in transfers from grants to tax devolution. Based on this principle, over 30 Centrally Sponsored Schemes have been identified which ought to have been transferred to the States because expenditure on them has already been taken into account as State expenditure, in arriving at the greater devolution of 42 per cent to the States. However, keeping in mind that many of these schemes are national priorities, and some are legal obligations (such as MGNREGA) and in order to underline the Central Government's continued support to national priorities, especially with regard to schemes meant for the poor, most of these are proposed to be continued. It is proposed that only 8 Centrally Sponsored Schemes be delinked from support from the Centre. Similarly, in certain programmes of the Government will have to continue unaltered as they are either legal / Constitutional obligations, or are privileges available to the elected representatives for welfare of their constituents. Further, and more importantly it is proposed that the Union Government may continue to support certain programmes which are for the benefit of socially disadvantaged in an unaltered manner from its own resources. In respect of various other Centrally Sponsored Schemes, the sharing pattern will have to undergo a change with States sharing a higher fiscal responsibility in terms of scheme implementation. Going forward, details of changes in sharing pattern will have to be worked out by the administrative Ministry/Department on the basis of available resources from Union Finances. In order to make the transition non-disruptive, Budget 2015-16 provides for allocations to meet the requirement in the initial part of the year, which will provide time to make necessary structural changes in the scheme design.

48. Concomitantly, there is a need to strengthen activities which will be critical in the emerging scenario. With greater devolution, States will have larger resource pool at their command to undertake number of development activities. To avoid duplication, Centre will be re-orienting its role to provide quality inputs. This could be in areas like inter-state comparisons,

international best practices etc. Thus, gamut of activities in the Centre and States need to be re-oriented in face of the changes initiated in FY 2015-16. A beginning has been made by alterations in the Centrally Sponsored Schemes, Central Assistance to State Plans etc. This exercise will be carried forward in the next financial year and beyond in consonance with the changes affected in this budget.

49. The current financial year witnessed revival of growth in the economy, as reported by CSO advance estimates. Economy is poised for a major leap with cyclical upturn, on the back of strong policies and a whiff of new optimism. However, the turnaround has brought back focus on the FRBM. Public discourse has centered around the fact that the process of growth revival can be hastened with higher public spending on infrastructure. The argument of pro-cyclical, structurally adjusted fiscal targets has been furthered. One of the major criticisms of the current phase of fiscal consolidation has been that it has relied entirely on expenditure management in the backdrop of shrinking revenues. Higher devolution to States, following FFC award has brought the fiscal consolidation debate back to the centre stage.

50. Given the debt profile, in the Indian context the critical question is not the quantum of borrowing but the deployment of the borrowed resources. Public spending in core sector can be helpful as a trigger point, but it also needs to be balanced with need for private capital and monetary policy concerns. The balance has been maintained in the budget 2015-16. The deficit target at 3.9 per cent of GDP has been contained within the 4 per cent limit, though it represents a deviation from the roadmap of fiscal consolidation notified under the new FRBM Rules. Rules will be notified adopting the changes, including deviations on the Revenue account. While, the 3 per cent goal post has been shifted by a period of one year, it has been decided to keep the fiscal deficit range bound during the FFC award period to tide over the changes. At the same time allocations to Capital spending has been substantially augmented to ensure that additional borrowing is put to effective use. The capital spending in BE 2015-16 has been increased to ₹ 2,41,431 crore, up from ₹ 1,92,378 crore in RE 2014-15. This has been achieved with judicious mix of key initiatives in Railways, Roads and other Infrastructure sectors. In addition public investment has also been targeted through mobilisation of resources by the public sector.