2

Public Finance

Fiscal consolidation was an integral part of economic reforms introduced in the early nineties. After a promising start in the early nineties, progress in fiscal consolidation faltered somewhat from 1997-98. Fiscal deficit of the Central Government after declining from 6.6 per cent of GDP in 1990-91 to 4.1 per cent in 1996-97, had risen to 4.8 per cent of GDP in 1997-98 and thereafter maintained a rising trend till 2001-02. However, there is some sign of renewed progress in this area in the most recent years. As per the provisional accounts released by the Controller General of Accounts, fiscal deficit in 2003-04 declined to 4.6 percent of GDP as compared with the budgeted fiscal deficit of 5.6 percent of GDP[1]. The deterioration in the other fiscal indicator, namely, revenue deficit, which was even greater in the recent past, also seems to have been reversed in 2003-04. Revenue deficit as a proportion of GDP, after declining from 3.3 per cent in 1990-91 to 2.4 per cent in 1996-97, reached a level of 4.4 per cent in 2002-03. Provisional unaudited accounts indicate a reduction in revenue deficit to 3.6 per cent of GDP in 2003-04. But, still the level is higher than what obtained in the crisis year of 1990-91. High revenue deficits, indicate a problem in the quality of the fiscal deficit. In 2003-04 (Prov), over three-fourths of the fiscal deficit was on account of the revenue deficit as compared with less than 50 per cent in 1990-91. The main factors that had contributed to the fiscal deterioration are relatively higher level of expenditure on salaries, unfunded pensions, mounting interest payments, improperly targeted subsidies and deterioration in the tax – GDP ratio.

2.2 The deterioration in the fiscal situation has not shown up in a crisis, so far, because of the strong fundamentals of the economy. Inflation has remained low, interest rates have declined and there has been a considerable accretion to the foreign exchange reserves. But the continuation of the present fiscal situation is likely to adversely affect the macroeconomic situation. If private investment picks up, any undue pre-emption of resources by the Government to fund its deficits may lead to a firming up of interest rates and inflation. What is often overlooked is the indirect impact of growing deficits on growth prospects. Growing deficits and public debt and the concomitant declining share of the private sector in total credit have been preventing the economy from realising its growth potential. The unobserved cost of fiscal deterioration is the growth foregone. To sustain the present growth momentum and to put the economy on a virtuous cycle, it is essential that renewed efforts are made towards fiscal consolidation. The enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 marks the beginning of such concerted efforts. The FRBM Act mandates the Central Government to take appropriate measures to reduce the fiscal deficit, to eliminate revenue deficit by 2007-08 and thereafter build up adequate

[1] Provisional (unaudited) figures of fiscal aggregates of Union Government accounts have been used in place of revised estimates for 2003-04, wherever possible, in this chapter.

revenue surplus. The Act provides for greater transparency in budget formulation and execution. A prudent fiscal policy stance is a natural concomitant of this legislation. A few State Governments have also put in place fiscal responsibility legislation, strengthening the efforts being made by the Central Government towards fiscal consolidation. Trends in major fiscal indicators are presented in Table 2.1.

2.3 The fiscal situation of State Governments has also been a cause of concern. The States' fiscal position has been following more or less a similar trend as that of the Central Government. States' fiscal deficit, after declining from 3.3 per cent of GDP in 1990-91 to 2.7 per cent in 1996-97, has been witnessing a rising trend to reach 4.7 per cent of GDP in 1999-2000. Revenue deficit of States after witnessing an improvement in the early nineties started worsening from the mid nineties. Between 1990-91 and 1999-2000, revenue deficit of States as a proportion of GDP more than trebled from 0.9 per cent to 2.8 per cent. Revision of pay and allowances of State Government employees largely explains the sharp rise in the revenue deficit witnessed in 1998-99 and 1999-2000. The decline in the tax-GDP ratio of the Central Government, through the mechanism of tax devolution, had also partly contributed to this deterioration. Fiscal deficit of States, after witnessing a decline in 2000-01 and 2001-02, again shot up to 4.7 percent of GDP in 2002-03 (RE). Recent initiatives to address this situation include introduction of fiscal reform facility and the debt swap scheme.

Table 2.1 : Trends in deficits of Central Government

Year	Revenue deficit	Primary deficit	Fiscal deficit	Revenue deficit as percent of fiscal deficit
		(As per cent of GDP)		
1990-91	3.3	2.8	6.6	49.4
1991-92	2.5	0.7	4.7	52.7
1992-93	2.5	0.6	4.8	51.7
1993-94	3.8	2.2	6.4	59.2
1994-95	3.1	0.4	4.7	64.6
1995-96	2.5	0.0	4.2	59.2
1996-97	2.4	-0.2	4.1	58.2
1997-98	3.1	0.5	4.8	63.5
1998-99	3.8	0.7	5.1	74.8
1999-00	3.5	0.7	5.4	64.6
2000-01	4.1	0.9	5.7	71.7
2001-02	4.4	1.5	6.2	71.1
2002-03	4.4	0.5	5.3	82.2
2003-04(Prov.)*	**3.6**	**0.1**	**4.6**	**78.0**

* Figures for 2003-04 are provisional accounts (unaudited) as released by the Controller General of Accounts.

\# The ratios to GDP for 2003-04 (Prov.) are based on CSO's Advance Estimates released in February, 2004

Note: 1. Ratios to GDP at current market prices.
2. Fiscal deficit excludes the transfer of States' share in the small savings collections.
3. Figures for 2002-03 are accounts as reported in the Interim Budget 2004-05 (Feb, 2004)

Source : Budget documents.

Central Government finances 2002-03

2.4 The year 2002-03 witnessed one of the severest droughts in recent years resulting in a negative growth of 5.2 per cent in the agriculture sector and pulling down the overall real GDP growth to 4.0 per cent from the previous year's 5.8 per cent. However, the industrial sector recorded a higher growth of 6.4 per cent in 2002-03 compared with 3.4 per cent in the previous year, resulting in an improvement in tax collections. Gross tax revenue of the Centre recorded an increase of 15.6 per cent in 2002-03 as compared with a decline of 0.8 per cent in the previous year. Despite a higher growth, gross tax collections fell short of the budget estimate (BE) by Rs.19,534 crore. Non-tax revenues at Rs.72,323 crore exceeded the BE marginally by Rs.183 crore. Total revenue receipts (net to the Centre) were lower than the BE by Rs.13,357 crore on account of shortfall in tax collections. Higher capital receipts on account of prepayment of high cost loans by States were used to redeem special Government of India securities issued to the National Small Savings Fund.

2.5 Total expenditure of the Government remained within the budget estimate. While revenue expenditure was marginally lower than the budget estimate by 0.3 per cent, capital expenditure fell short of the BE by 13 per cent. Non-plan expenditure was contained within the BE. Plan expenditure was lower than the BE by 1.8 per cent. Revenue deficit remained at the previous year's level of 4.4

Table 2.2 : Receipts and expenditure of the Central Government

	1990-91	1999-00	2000-01	2001-02	2002-03	2003-04 (B.E.)	2003-04* (Prov.)
				(Rs crore)			
1. Revenue receipts (a+b) (net)	**54954**	**181482**	**192605**	**201306**	**231748**	**253935**	**263000**
(a) Tax revenue (Net of States' share)	42978	128271	136658	133532	159425	184169	186932
(b) Non-tax revenue	11976	53211	55947	67774	72323	69766	76068
2. Revenue expenditure	**73516**	**249078**	**277838**	**301468**	**339627**	**366227**	**361308**
of which:							
(a) Interest payments	21498	90249	99314	107460	117804	123223	124261
(b) Major subsidies	9581	22678	25860	30094	40416	48636	43569
(c) Defence expenditure	10874	35216	37238	38059	40709	44347	42597
3. Revenue deficit (2-1)	**18562**	**67596**	**85233**	**100162**	**107879**	**112292**	**98308**
4. Capital receipts	**31971**	**115707**	**134184**	**162500**	**168648**	**184860**	**208936**
of which:							
(a) Recovery of loans	5712	10131	12046	16403	34191	18023	66928
(b) Other receipts (mainly PSU disinvestment)	0	1724	2125	3646	3151	13200	16048
(c) Borrowings and other liabilities	26259	103852	120013	142451	131306	153637	125960
5. Capital expenditure	**24756**	**48975**	**47754**	**60842**	**60769**	**72568**	**110628**
6. Total expenditure [2+5=6(a)+6(b)]	**98272**	**298053**	**325592**	**362310**	**400396**	**438795**	**471936**
of which:							
(a) Plan expenditure	28365	76182	82669	101194	111454	120974	122149
(b) Non-plan expenditure	69907	221871	242923	261116	288942	317821	349787
7. Fiscal deficit [6-1-4(a)-4(b)]	**37606**	**104716**	**118816**	**140955**	**131306**	**153637**	**125960**
8. Primary deficit [7-2(a)=8(a)+8(b)]	**16108**	**14467**	**19502**	**33495**	**13502**	**30414**	**1699**
(a) Primary deficit consumption	6358	16316	22955	36180	37341	35365	—
(b) Primary deficit investment	9750	-1849	-3453	-2685	-23839	-4951	—
				(As per cent of GDP)			
1. Revenue receipts (a+b) (net)	**9.7**	**9.4**	**9.2**	**8.8**	**9.4**	**9.2**	**9.5**
(a) Tax revenue (Net of States share)	7.6	6.6	6.5	5.9	6.5	6.7	6.8
(b) Non-tax revenue	2.1	2.7	2.7	3.0	2.9	2.5	2.8
2. Revenue expenditure	**12.9**	**12.9**	**13.3**	**13.2**	**13.8**	**13.3**	**13.1**
of which:							
(a) Interest payments	3.8	4.7	4.8	4.7	4.8	4.5	4.5
(b) Major subsidies	1.7	1.2	1.2	1.3	1.6	1.8	1.6
(c) Defence expenditure	1.9	1.8	1.8	1.7	1.6	1.6	1.5
3. Revenue deficit (2-1)	**3.3**	**3.5**	**4.1**	**4.4**	**4.4**	**4.1**	**3.6**
4. Capital receipts	**5.6**	**6.0**	**6.4**	**7.1**	**6.8**	**6.7**	**7.6**
of which:							
(a) Recovery of loans	1.0	0.5	0.6	0.7	1.4	0.7	2.4
(b) Other receipts (mainly PSU disinvestment)	0.0	0.1	0.1	0.2	0.1	0.5	0.6
(c) Borrowings and other liabilities	4.6	5.4	5.7	6.2	5.3	5.6	4.6
5. Capital expenditure	**4.4**	**2.5**	**2.3**	**2.7**	**2.5**	**2.6**	**4.0**
6. Total expenditure [2+5=6(a)+6(b)]	**17.3**	**15.4**	**15.6**	**15.9**	**16.2**	**15.9**	**17.1**
of which:							
(a) Plan expenditure	5.0	3.9	4.0	4.4	4.5	4.4	4.4
(b) Non-plan expenditure	12.3	11.5	11.6	11.4	11.7	11.5	12.7
7. Fiscal deficit [6-1-4(a)-4(b)]	**6.6**	**5.4**	**5.7**	**6.2**	**5.3**	**5.6**	**4.6**
8. Primary deficit [7-2(a)=8(a)+8(b)]	**2.8**	**0.7**	**0.9**	**1.5**	**0.5**	**1.1**	**0.1**
(a) Primary deficit consumption	1.1	0.8	1.1	1.6	1.5	1.3	—
(b) Primary deficit investment	1.7	-0.1	-0.2	-0.1	-1.0	-0.2	—
				(Rs. Crore)			
Memorandum items							
(a) Interest receipts	8730	33895	32811	35538	37602	39160	37128
(b) Dividend and profit	564	5074	4225	7940	9664	7136	n.a.
(c) Non-plan revenue expenditure	60896	202278	226762	239954	268074	289384	282771

* Figures for 2003-04(Prov.) based on Controller General of Accounts (unaudited).

\# The ratios to GDP for 2003-04 (BE) and (Prov.)are based on CSO's Advance Estimates released in February, 2004.

Note:
1. The figures may not add up to the total because of rounding approximations.
2. Primary deficit consumption =Revenue deficit-interest payments+interest receipts+dividend & profits
3. Primary deficit investment =Capital expenditure-interest receipts -Dividend & profits-recovery of loans-other receipts.
4. Figures are exclusive of the transfer of States' share in small savings collections.
5. Actuals for 2002-03 and RE for 2003-04 are taken from the Interim Budget 2004-05.

Source: Budget Documents

per cent. Fiscal deficit at Rs.1,31,306 crore was lower than that of the previous year, both in absolute terms and in terms of per cent of GDP, mainly on account of lower than budgeted total expenditure (Table 2.2).

Budgetary developments in 2003-04

2.6 The macroeconomic situation that preceded the presentation of Budget 2003-04 remained uncertain, with global recovery remaining sluggish, threat of terrorism looming large and the effect of drought spilling over. Budget 2003-04 enunciated five core priorities, viz., poverty reduction, infrastructure development, fiscal consolidation, development of agriculture and enhancing manufacturing sector efficiency. Fiscal deficit of the Central Government was budgeted at 5.6 per cent of GDP (Rs.1,53,637 crore). Revenue deficit was budgeted at 4.1 per cent of GDP as compared with 4.4 per cent of GDP in the previous year. The reduction in revenue deficit was budgeted to be achieved from higher growth in revenue receipts and lower growth of revenue expenditure. Proposals contained in the Union Budget 2003-04 are discussed below under different heads.

Revenue receipts

2.7 Revenue receipts (net to the Centre) in 2003-04 were budgeted to increase by 9.6 per cent to Rs. 2,53,935 crore compared with Rs.2,31,748 crore in 2002-03 (Table 2.2). The budgeted increase in revenue receipts was sought to be achieved through growth in net tax revenue by 15.5 per cent. Non-tax revenue was budgeted to decline by 3.5 per cent on account of lower interest receipts from States. With tax reforms, the share of direct taxes in total tax revenue of the Centre has been increasing. The share of direct taxes in gross tax revenue increased from 19.1 per cent in 1990-91 to 38.4 per cent in 2002-03. In keeping with the tax reforms underway, the share was budgeted to remain at 38.1 per cent in 2003-04 (BE). The share of indirect taxes was budgeted at 61.3 per cent compared with 60.7 per cent in the previous year (Table 2.3).

2.8 With expenditure-GDP ratio already low in India by international standards and rigidities in compressing expenditure, improvement in tax collections is crucial for fiscal consolidation. The tax-GDP ratio continues to remain low. What is a matter of grave concern is that the ratio has declined and remains at a lower level even as compared with the pre-reform year of 1990-91. The ratio for the Central Government declined from 10.1 per cent in 1990-91 to 8.8 per cent in 2002-03, which was sought to be improved to 9.1 per cent in 2003-04 (BE). The decline in the tax-GDP ratio was entirely on account of the decline in the ratio of indirect taxes to GDP. The indirect tax-GDP ratio witnessed a sharp decline from 7.9 per cent in 1990-91 to 5.3 per cent in 2002-03. Among the indirect taxes, the ratio of customs duty to GDP halved from 3.6 per cent in 1990-91 to 1.8 per cent in 2002-03. The reduction in the ratio of customs duty as a proportion of GDP was on account of a phased reduction in the peak rates as part of tax reforms to improve resource allocation, improve efficiency and make Indian manufacturing globally competitive. There was also a decline in the ratio of excise duty collections to GDP by about one percentage point on account of duty rationalisation. The uncompensated loss of customs and excise revenue by other sources resulted in a lower tax-GDP ratio. The introduction of tax on services in 1994 and its gradual extension to 58 services and increase in the rate of tax from 5 per cent to 8 per cent along with on-going reforms in direct and indirect taxes was expected to result in an improvement in the tax-GDP ratio in 2003-04.

Tax measures

2.9 One of the important commitments made in the Budget was to move away from a suspicion-ridden, harassment generating and coercive regime to a more trust-based regime with a firm belief in voluntary compliance. The guiding philosophy in the tax measures was a harmonious mix of stability and continuity. Rates of income tax and corporation tax were left unchanged.

Table 2.3 : Sources of tax revenue								
	1990-91	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04 (BE)	2003-04@ (Prov.)
				(Rs. crore)				
Direct	**11024**	**46600**	**57958**	**68306**	**69197**	**83080**	**95714**	**105236**
PIT	5371	20240	25654	31764	32004	36858	44070	41441
CIT	5335	24529	30692	35696	36609	46172	51499	63608
Indirect	**45158**	**95871**	**112450**	**118681**	**116125**	**131284**	**154141**	**147279**
Customs	20644	40668	48420	47542	40268	44852	49350	48625
Excise	24514	53246	61902	68526	72555	82310	96791	90764
Service tax	0	1957	2128	2613	3302	4122	8000	7890
Gross tax revenue #	**57576**	**143797**	**171752**	**188603**	**187060**	**216266**	**251527**	**254438**
				Tax revenue as a percentage of gross tax revenue				
Direct	**19.1**	**32.4**	**33.7**	**36.2**	**37.0**	**38.4**	**38.1**	**41.4**
PIT	9.3	14.1	14.9	16.8	17.1	17.0	17.5	16.3
CIT	9.3	17.1	17.9	18.9	19.6	21.3	20.5	25.0
Indirect	**78.4**	**66.7**	**65.5**	**62.9**	**62.1**	**60.7**	**61.3**	**57.9**
Customs	35.9	28.3	28.2	25.2	21.5	20.7	19.6	19.1
Excise	42.6	37.0	36.0	36.3	38.8	38.1	38.5	35.7
Service tax	0.0	1.4	1.2	1.4	1.8	1.9	3.2	3.1
				Tax revenue as a percentage of gross domestic product*				
Direct	**1.9**	**2.7**	**3.0**	**3.3**	**3.0**	**3.4**	**3.5**	**3.8**
PIT	0.9	1.2	1.3	1.5	1.4	1.5	1.6	1.5
CIT	0.9	1.4	1.6	1.7	1.6	1.9	1.9	2.3
Indirect	**7.9**	**5.5**	**5.8**	**5.7**	**5.1**	**5.3**	**5.6**	**5.3**
Customs	3.6	2.3	2.5	2.3	1.8	1.8	1.8	1.8
Excise	4.3	3.1	3.2	3.3	3.2	3.3	3.5	3.3
Service tax	0.0	0.1	0.1	0.1	0.1	0.2	0.3	0.3
Total#	**10.1**	**8.3**	**8.9**	**9.0**	**8.2**	**8.8**	**9.1**	**9.2**

@ Figures for 2003-04 are provisional accounts (unaudited) as released by the Controller General of Accounts.

PIT : Personal income tax CIT : Corporation tax

Note (1) Direct taxes also include taxes pertaining to expenditure, interest, wealth, gift, estate duty and for 1998-99 also VDIS;

(2) The ratios to GDP for 2003-04 (provisional) are based on CSO's Advance Estimates released in February 2004.

 # : Includes taxes referred to in footnote 1 and taxes of Union Territories and "other" taxes.

*** : Refers to gross domestic product at current market prices.**

Source: Budget documents

Surcharge on income tax was withdrawn for individuals and Hindu undivided families (HUF), except for those with an annual income of Rs.8.5 lakh and above. For corporate assessees and certain other categories of institutions, the rate of surcharge was halved from 5 per cent to 2.5 per cent. Other important direct tax measures included incentives for housing and infrastructure and rationalisation of provisions relating to amalgamations and demergers. A number of measures aimed at reforming tax administration were announced. These included outsourcing non-core activities, abolition of discretion based selection of returns for scrutiny, simplification of tax returns, abolition of tax clearance certificates for persons leaving India and simplification of procedures to be followed during search and seizure. Details of various direct tax measures are given in Box 2.1.

2.10 In the case of indirect taxes, emphasis was on rationalisation and simplification of tax rates, procedures, rules and regulations. The peak rate of customs duty was reduced to 25 per cent, excluding agriculture and dairy products. Excise duties were rationalised with the introduction of a three-tier duty structure of 8 per cent, 16 per cent and 24 per cent (except for petroleum products, tobacco products, pan masala, textiles and specific rated products). Other measures in respect of customs duty included reduction in the customs duty on project imports with a

Box 2.1 : Tax proposals — Budget 2003-04

Direct taxes

- No change in personal income tax rates to maintain stability in tax rates. Surcharge on income tax in the case of individuals, Hindu undivided families abolished except for those earning annual income above Rs.8.5 lakh. For those earning above Rs. 8.5 lakh, surcharge of 10 per cent applied. In the case of corporate assessees, firms, foreign companies, cooperatives, and local authorities, surcharge reduced from 5 per cent to 2.5 per cent.
- Standard deduction for salaried employees, whose salary income does not exceed Rs.5 lakh increased to 40 per cent or Rs.30,000, whichever is less. For salaried taxpayers, whose income from salary exceeds Rs.5 lakh, the standard deduction is Rs.20,000.
- VRS payments upto Rs.5 lakh, whether paid in lumpsum or in instalments exempted from income tax.
- Interest deductible under income tax upto Rs.1,50,000 for construction or purchase of self-occupied house property to continue.
- Education expenses up to Rs.12,000 per child for two children made eligible for rebate under Section 88.
- Deduction of interest income under Section 80-L for individual tax payers increased to Rs.12,000. Additional deduction of Rs.3,000 for interest on Government securities continued.
- Tax rebate in case of senior citizens (65 years and above) increased to Rs.20,000.
- Tax rebate in a year in respect of certain life insurance policies restricted to 20 per cent of the sum assured.
- Physically handicapped or persons with such dependants entitled to a deduction of Rs.50,000 for permanent physical disability and an enhanced deduction of Rs.75,000 in case of severe disability.
- Income tax at 12.5 per cent levied on dividend distributed by domestic companies. Dividends made tax free in the hands of the shareholders.
- Income from units of UTI exempted from tax in the hands of unit holders.
- Expenditure tax abolished effective from June 1, 2003.
- Interest payable to assessees on refunds reduced to 6 per cent and that chargeable from the assessees reduced to 12 per cent.
- To promote equity culture, income arising from transfer of eligible equity shares in a company listed on any recognised stock exchange and purchased between March 1, 2003 and March 1, 2004 and held for a period of more than one year exempted from tax.
- Rate of depreciation increased from 25 per cent to 40 per cent in respect of life saving medical equipment.
- Capital gains arising from the transfer of units of Unit Scheme 1964 of UTI exempted from tax effective from the assessment year 2003-04.
- Units in Special Economic Zones (SEZs) and 100 per cent Export Oriented Units (EOUs) allowed the benefit of carry forward of business losses and unabsorbed depreciation.
- Deduction under Sections 10A and 10B of the Income Tax Act allowed to the resulting entity in the case of amalgamation or demerger.
- The existing deduction to units in SEZs and 100 per cent EOUs extended to the business of cutting and polishing of precious and semi-precious stones.
- An additional deduction on account of reinvestment allowance allowed to units in Special Economic Zones, equal to 50 per cent of the profits, credited to a reserve account to be utilised for the purposes of business, for a period of three consecutive years.
- Tax incentive of deduction of 40 per cent of the profits to coffee and rubber industry.
- Premium receivable by banks under the debt buy back offer of the Government eligible for additional deduction, if such premium is declared as business income and used for provisioning of their non-performing assets.
- Sales from the Domestic Tariff Area (DTA) units to units in SEZs made eligible for deduction under Section 80HHC for a period of one year.
- A new provision allowing a ten-year tax holiday for new undertakings as well as existing undertakings on their substantial expansion, located in certain notified areas or engaged in certain thrust sector activities, in Himachal Pradesh, Sikkim, Uttaranchal and the North-Eastern States.
- The benefit of carried forward losses and unabsorbed depreciation in a scheme of amalgamation under section 72A extended to hotels and specified banks.
- Threshold limit for deduction of tax at source enhanced from Rs.1,000 to Rs.2,500 for dividends and income from units.
- Section 197A amended to provide for filing of self-declarations by senior citizens for the purpose of no deduction of tax at source in case of certain payments.
- Section 206 amended to provide for compulsory filing of TDS returns on magnetic media by corporate assessees.
- Section 230 relating to tax clearance certificates rationalised. Persons not domiciled in India, who have come to India as foreign tourists or for any other purpose other than business or employment are not required to furnish ITCC.

certain threshold investment and reduction in customs duty on specified items for promoting the information technology sector. In the case of excise duties, other important measures included an incentive package for the textile industry and extension of maximum retail price (MRP) based levy to chewing tobacco and insecticides. Details of various indirect tax measures are given in Box 2.2.

Service tax

2.11 The need for revenue augmentation for financing enhanced public sector outlays on physical and social infrastructure – such

Box 2.2 : Indirect tax proposals — Budget 2003-04

Customs

- Peak rate of customs duty reduced from 30 per cent to 25 per cent, excluding agriculture and dairy products.
- Custom duty on specified life saving drugs and life saving equipment reduced from 25 per cent to 5 per cent with exemption from countervailing duty (CVD). To encourage indigenous manufacturing, excise duty exempted on life saving equipment already enjoying CVD exemption.
- Customs duty on rough ophthalmic blanks reduced from 25 per cent to 5 per cent.
- CVD on 88 specified life saving drugs and life saving medical equipments reduced from 5 per cent to nil.
- Customs duty on specified equipment for high-voltage transmission projects reduced from 25 per cent to 5 per cent.
- Customs duty on Liquefied Natural Gas (LNG) regassification plants reduced from 25 per cent to 5 per cent.
- To encourage modernisation, customs duty on a large number of textile machinery and parts reduced from 25 per cent to 5 per cent.
- Customs duty on capital goods for telecom and information technology reduced from 25 per cent to 15 per cent.
- Customs duty on optical fibre cables reduced from 25 per cent to 20 per cent.
- Customs duty on specified raw materials for manufacture of e-glass roving used for making optical fibres reduced from 30 per cent to 15 per cent.
- Customs duty on cut and polished diamonds and gem stones reduced from 15 per cent to 5 per cent.
- Customs duty on gold reduced from Rs.250 to Rs.100 per 10 grams.
- Duty on crutches, wheel chairs, walking frames and tricycles reduced to 5 per cent without SAD. These items are also exempted from CVD. Domestic manufacturers exempted from excise duty.
- Customs duty on specified veterinary drugs reduced from 15 per cent to 10 per cent.
- Customs duty on shrimp larvae feed reduced from 15 per cent to 5 per cent, with exemption from CVD to promote marine food industry.
- Customs duty on apparel grade raw wool reduced from 15 per cent to 5 per cent.
- Customs duty on passenger baggage reduced from 60 per cent to 50 per cent.
- Drugs and materials for clinical trial exempted from customs duty.
- Customs duty on braillers, artificial limbs, hearing aids and their parts reduced to 5 per cent and also exempted from SAD.
- Customs duty on glucometers and glucometer test strips reduced from 10 per cent to 5 per cent.
- Customs duty on nickel unified at 10 per cent from 5 per cent and 15 per cent, irrespective of the class of importer.

Box 2.2 : Indirect tax proposals — Budget 2003-04 (cont.)

- Customs duty on lead reduced from 25 per cent to 20 per cent.
- Customs duty on routers, modems and fixed wireless terminals reduced from 15 per cent to 10 per cent.
- Customs duty on paraxylene reduced from 10 per cent to 5 per cent.
- Rough coloured gemstones and semi-processed half cut or broken diamonds exempted from customs duty.
- Customs duty on refrigerated trucks reduced from 25 per cent to 20 per cent.
- Customs duty on loco simulators reduced from 25 per cent to 5 per cent.
- Customs duty on spares for diesel locomotives, parts for conversion of DC locos to AC locos reduced from 25 per cent to 15 per cent.

Excise

- Rationalisation of excise rates by a three-tier duty structure of 8 per cent, 16 per cent and 24 per cent, except on petroleum and tobacco products, pan masala, textiles and items attracting specific duty rates.
- Special excise duty (SED) on tyres, aerated soft drinks, polyester filament yarn, air-conditioners and motor cars reduced from 16 per cent to 8 per cent.
- Excise duty reduced from 4 per cent to nil on unbranded surgical bandages, registers & account books, umbrellas, kerosene pressure lanterns, articles of wood, imitation zari, adhesive tapes, tubular knitted gas mantle fabrics, walking sticks, articles of mica, bicycles & parts, toys, mosaic tiles, utensils & kitchen articles, knives, spoons and similar kitchenware, tableware and glasses for corrective spectacles.
- Excise duty on pressure cookers, ophthalmic blanks, biscuits, boiled sweets and dental chairs reduced from 16 per cent to 8 per cent.
- Matches made by non-mechanised sector exempted from excise duty. Matches manufactured in the mechanised and semi-mechanised sector to attract an ad-valorem duty of 8 per cent without CENVAT credit.
- Duty on medicinal and toilet preparations containing alcohol reduced from a range of 20 to 50 per cent to a uniform rate of 16 per cent.
- Duty on electric vehicles reduced from 16 per cent to 8 per cent.
- Excise duty of 8 per cent with CENVAT credit imposed on refined edible oils, vanaspati and other similar edible oil preparations (branded and packed for retail sale).
- Specific rates on cement and clinker increased by Rs.50 per tonne.
- Additional duties of excise on motor spirit and high- speed diesel oil increased from Re. 1 per litre to Rs.1.50 per litre.
- A one per cent duty imposed on polyester filament yarn, motor cars, multi-utility vehicles and two wheelers towards contribution to National Calamity Contingency Fund. Domestic and imported crude subjected to a specific duty of Rs.50 per metric tonne.
- A cess of Re.1 per kg of tea for creating a separate fund for development, modernisation and rehabilitation of plantation sector to replace the excise duty of Re.1 per kg.
- A package of incentives announced for the textile sector. The incentives include, *inter-alia*, reduction in duty on polyester filament yarn from 32 per cent to 24 per cent, on all spun and other filament yarns from 16 per cent to 12 per cent, on woven garments from 12 per cent to 10 per cent, uniform duty of 12 per cent on polyester cotton, cotton viscose and all other spun yarns and excise duty on all knitted cotton fabrics and garments reduced from 12 per cent to 8 per cent.

as roads, water supply, education and basic health – is well recognised. The Tax Reforms Committee headed by Dr.Raja Chelliah made some far reaching recommendations, of which, levying a tax on services was an important one. The Committee felt that the indirect taxes at the Central level should be broadly neutral in relation to production and consumption of goods and should, in course of time cover commodities and services. The Committee emphasised the importance of moving towards a full fledged Value Added Tax (VAT) system to realise the above objective. The tax on services is relatively non-regressive. Keeping in view the fact that the services sector is the fastest growing sector and accounts for about 51 per cent of GDP, Government after introducing the service tax for the first time in 1994, has been extending the scope of the tax. The Budget for 2003-04 extended the service tax to ten new services taking the number of services subjected to tax to 58 and also proposed an increase in the rate of service tax from 5 per cent to 8 per cent. The new services subjected to the levy of the service tax were life insurance including insurance auxiliary services relating to life insurance, inland cargo handling, storage and warehousing services, light agricultural products and cold storage, event management, rail travel agents, health clubs and fitness centres, beauty parlours, fashion designers, cable operators and dry cleaning services. Subsequently, life insurance was exempted and service tax was extended to specialised services provided by banks and non-banking financial companies and corporate bodies. The credit of service tax on input services was extended for payment of service tax in 2002-03, provided the input and the final services were within the same category. Budget for 2003-04 had proposed extension of this to all services even if the input and the final services fell under different categories. The Budget also proposed a Constitutional amendment and enabling legislation that would give the Central Government power to levy the tax and empower the Centre and the States to collect the proceeds. The amendment to the Constitution is in progress.

2.12 Revenue collected from service tax increased from Rs.407 crore in 1994-95 to Rs.4,122 crore in 2002-03 and was budgeted to increase to Rs.8,000 crore in 2003-04. Service tax has a very large base of tax payers per unit of tax collected who are mostly non-corporate in nature, and whose standards of maintenance of accounts are rudimentary. This presents a major challenge to the revenue authorities to design and operationalise a system of tax collection that not only enables the collection of revenues due, but also avoids harassment to tax payers. Keeping this in mind, the Central Excise Department has made the procedure for registration, filing and assessment simple, with the guiding philosophy of voluntary tax compliance. To facilitate the filing of returns and to reduce the compliance cost, certain procedural changes were introduced from January, 2004. These include, simple verification for grant of registration under service tax, single registration and single return for assessees providing more than one taxable service and automation of service tax by extending e-filing of returns and electronic scrutiny from 10 services to all the 58 taxable services.

Expenditure trends

2.13 Total expenditure of the Central Government after witnessing compression in the first half of the nineties started rising in 1997-98. Total expenditure as proportion of GDP declined from 17.3 per cent in 1990-91 to 13.9 per cent in 1996-97. Thereafter, it has been rising to reach a level of 16.2 per cent of GDP in 2002-03. The quality of expenditure has also been witnessing a deterioration over the years. Capital expenditure has declined from 4.4 per cent of GDP in 1990-91 to 2.5 per cent of GDP in 2002-03, indicating that such expenditure has borne the major burden of fiscal adjustment. More than the level of expenditure, which by international standards is not very high, it is the deterioration in the quality of expenditure that is a matter of serious concern. Total expenditure of the Central Government was budgeted to grow by 9.6 per cent in 2003-04 over the actual expenditure in the previous year. Within the total expenditure, revenue expenditure was budgeted to grow at lower rate of 7.8 per cent compared with 12.7 per cent in 2002-03, mainly on account of lower budgeted growth in interest payments and subsidies. Capital expenditure was budgeted to grow by 19.4 per cent compared with the negative growth of 0.1 per cent in the previous year.

2.14 Interest payments, subsidies, pay and allowances and revenue expenditure on defence accounted for 99.2 per cent of net revenue receipts, 68.8 per cent of revenue expenditure and 57.4 per cent of the total expenditure of the Central Government in 2003-04 (BE). These percentages reveal the committed nature of Government expenditure and difficulties in compressing such expenditure. Details of major components of expenditure are discussed below.

Interest payments

2.15 Interest payments account for about 30 per cent of total expenditure and 35 per cent of revenue expenditure. Interest payments pre-empt nearly 50 per cent of revenue receipts. Following the deregulation of interest rates on market borrowings, as part of economic reforms undertaken in the early nineties, the average cost of market borrowings had increased from 11.4 per cent in 1990-91 to 13.7 per cent in 1996-97, despite reduction in the weighted average maturity from 18.4 years to 5.5 years in this period. With the softening of interest rates in recent years, the average cost of market borrowings witnessed a declining trend, particularly in 2003-04. The average cost of market borrowings had come down by 160 basis points from 7.3 per cent in 2002-03 to 5.7 per cent in 2003-04. The excess liquidity with the banking system and lower off take of credit, also contributed to keeping the cost of market borrowing low. Banks' holdings of Government securities were over 40 per cent of their net demand and time liabilities, as compared with the statutory minimum of 25 per cent. However, credit off take has started picking up from the third quarter of 2003-04 and the trend is likely to continue on account of revival of industrial growth. This may exert pressure on interest rates on fresh borrowings, unless the Government reduces its borrowing. Alongwith the softening of interest rates, there has also been an elongation in the maturity of dated securities. The weighted average maturity of dated securities issued during 2003-04 was 14.9 years compared with 10.6 years in 2001-02. The average cost of total internal liabilities has been witnessing a declining trend since 2000-01, reflecting the general softening of interest rates (Table 2.4).

2.16 The effect of lower interest rates on the total interest burden of the Central Government is not distinctly visible because of the growth in outstanding debt. Interest payments were budgeted to increase by 4.6 per cent in 2003-04 to Rs. 1,23,223 crore as

Table 2.4 : Interest on outstanding internal liabilities of Central Government

	Outstanding Internal liabilities	Interest on internal liabilities	Average cost of borrowings (percent per annum)
	(Rs. crore)		
1990-91	283033	19664	8.2
1991-92	317714	23892	8.4
1992-93	359654	27546	8.7
1993-94	430623	33017	9.2
1994-95	487682	40034	9.3
1995-96	554984	45631	9.4
1996-97	621438	55255	10.0
1997-98	722962	61527	9.9
1998-99	834551	73519	10.2
1999-00	962592	85741	10.3
2000-01	1102596	94900	9.9
2001-02	1294862	103175	9.4
2002-03	1499589	113238	8.7
2003-04 (RE)	1677092	121412*	9.4

Note : Average cost of borrowing is the percentage of interest payment in year 't' to outstanding liabilities in year 't-1'.

* Includes an amount of Rs. 4079.62 crore towards premium on account of domestic debt buyback scheme and prepayment of external debt.

Source : Budget documents.

compared with an increase of 9.6 per cent witnessed in 2002-03. Interest payments budgeted in 2003-04 constituted 33.6 per cent of revenue expenditure and 48.5 per cent of the net revenue receipts of the Central Government.

2.17 In pursuance of the announcement made in the Budget for 2003-04, Government of India in consultation with the Reserve Bank of India formulated a scheme for the buyback of high coupon Government securities held by banks and financial institutions. The scheme was structured as a switch, with the Government of India offering to buy back pre announced high coupon securities at a minimum discount of 7.5 per cent to the market value and reissuing securities of an equivalent face value at a pre announced fixed price. In the first ever buyback auction conducted online on July 19, 2003, Government accepted all the 131 offers in respect of 19 high coupon securities with face value of Rs.14,434 crore. Government had reissued four securities for an equivalent face value of securities bought back. Interest saving on bought back securities amounted to Rs.1,307 crore and with the interest outgo on reissued securities amounting to Rs.790 crore, there was a saving of Rs.517 crore in 2003-04. The estimated saving in interest payments in 2004-05 is Rs. 751 crore.

Subsidies

2.18 Expenditure on major subsidies has increased in nominal terms from Rs. 9,581 crore in 1990-91 to Rs.40,416 crore in 2002-03. It was budgeted to increase by 20.3 per cent to Rs.48,636 crore in 2003-04. Expenditure on major subsidies as per cent of revenue expenditure after declining from 13.0 per cent in 1990-91 to 8.7 per cent in 1995-96 started rising to reach a level of 9.6 per cent in 1998-99. In 2002-03, expenditure on major subsidises increased to 11.9 per cent from 10.0 per cent in 2001-02. With the dismantling of the administered price mechanism for petroleum products from April 1, 2002, subsidies in respect of LPG and kerosene distributed through the public distribution system are now explicity reflected in the budget. This partially explains the spurt of 35.3 per cent in the expenditure on major subsidies in 2002-03. The spurt in major subsidies in 2002-03 was also on account of an increase in food subsidy by Rs. 6,677 crore necessitated by the widespread drought in the country. Some of the major initiatives taken so far to rationalise the budgetary subsidies include targeted approach to food subsidy (BPL families) under Public Distribution System, allowing Food Corporation of India (FCI) to access market loans carrying lower interest rates, encouraging private trade in food grains, liquidating excess food grain stocks, replacing unit based retention price scheme with a group based scheme in the case of fertiliser subsidies and proposed phasing out of subsidies on PDS kerosene and LPG.

Central plan outlay

2.19 The Revised Estimates for 2002-03, the first year of the Tenth Five Year Plan, indicate a shortfall in the Centre’s plan outlay to the extent of 5 per cent as compared with the Annual Plan/Budget Estimates. Budgetary support to the Centre’s Plan was higher by 2 per cent in 2002-03 (RE) as compared with the budget estimates. There was a shortfall in the internal and extra-budgetary resources (IEBR) of the Central Public Sector Enterprises (CPSEs) by 11 per cent over budget estimates.

2.20 In the Budget for 2003-04, a provision of Rs.1,47,893 crore was made towards the annual plan outlay representing an increase of 8 per cent over the revised estimates of the previous year. This outlay was proposed to be financed by budgetary support amounting to Rs.72,152 crore (48.8 per cent) and internal and extra budgetary resources of public enterprises to the extent of Rs.75,741 crore (51.2 per cent). Energy (29.3 per cent), transport (19.5 per cent), communications (10.1 per cent) and social services (21.4 per cent) accounted for bulk of the Central plan outlay. There was a significant step-up in the outlays, as compared to 2002-03(RE), for agriculture (20 per cent) and general economic services

(148 per cent). A lower outlay of Rs.8,181 crore was budgeted for rural development as compared with Rs.12,834 crore in 2002-03 (RE).

2.21 Central assistance to State and Union Territories (UTs) Plans was budgeted to increase by 6.4 per cent to Rs.48,822 crore in 2003-04 over the revised estimates for 2002-03. There was a substantial step-up in Central assistance to State plans under Accelerated Power Development Programme (APDP) and Rashtriya Sam Vikas Yojana (previously known as Development and Reform Facility). While the assistance for APDP was increased from Rs.1,089 crore in 2002-03 (RE) to Rs. 3,500 crore in 2003-04 (BE), assistance under Rashtriya Sam Vikas Yojana was increased from Rs.775 crore to Rs.1,450 crore over the same period.

Government debt

2.22 There is growing concern about the level of indebtedness of the Government and its sustainability. Outstanding liabilities of the Central Government, after declining from 55.3 per cent of GDP in 1990-91 to 51.2 per cent in 1998-99, started rising to reach 63.1 per cent of GDP in 2002-03. These were budgeted to increase to Rs.17,80,064 crore in 2003-04 (64.6 per cent of GDP). While internal liabilities increased from 49.8 per cent of GDP to 60.7 per cent of GDP between 1990-91 and 2002-03, there was a decline in the external liabilities from 5.5 per cent to 2.4 per cent of GDP in the same period. External liabilities valued at year-end exchange rates declined from 11.7 per cent of GDP to 7.9 per cent of GDP between 1990-91 and 2002-03. The increase in the debt-GDP ratio witnessed since 1999-2000 was mainly on account of increase in the internal liabilities of the Central Government. Within internal liabilities, the share of market borrowings has been steadily increasing. The share increased from 24.9 per cent in 1990-91 to 41.3 per cent in 2002-03. It was budgeted to increase to 42.4 per cent in the budget estimates for 2003-04 (Table 2.5).

2.23 The increasing trend in government debt has been a matter of serious concern because of the associated preemption of resources from the private sector. With over three-fourths of the fiscal deficit being accounted for by revenue deficit, there is limited room to deploy the borrowings in a productive manner. Any increase in debt puts pressure on interest payments, which in turn necessitates a further build up of debt. Increase in Government debt by drawing on private savings deprives the private sector of required resources. The indirect cost of debt is the incremental growth foregone by the economy as a result of the diversion of resources from the private to the Government sector. Gross market borrowings of the Central Government (excluding 364-day treasury bills) were budgeted at Rs.1,39,887 crore and the net market borrowings at Rs.1,07,194 crore in 2003-04. A notable development in 2003-04 was that actual net market borrowings of the Central Government at Rs.88,860 crore were considerably lower than the budget estimate, despite additional borrowing to fund pre payment of external debt. This was facilitated by large receipt on account of debt swap scheme. With a view to reducing the debt burden, Government prepaid external debt of US $3753.56 million in 2003-04.

Supplementary demands for grants

2.24 Three supplementary demands for grants were presented in 2003-04. In the first batch of supplementary demands, approval of Parliament was sought for gross additional expenditure of Rs.8,519 crore in respect of 29 grants. These demands involved net cash outgo of Rs.5,580 crore and gross additional expenditure, matched by savings of the Ministries concerned, amounting to Rs.2,939 crore. Major items of additional expenditure involving cash outgo included Rs.607 crore for providing loans to States for making payment to sugarcane growers against dues, Rs.200 crore for implementing the scheme of Price Stabilisation Fund for tea, rubber, coffee and tobacco, Rs.3,650 crore for meeting additional requirement under special

Table 2.5 : Outstanding liabilities of the Central Government

(end-March)

		1990-91	1999-00	2000-01	2001-02	2002-03	2003-04$ (BE)	2003-04$ (RE)
					(Rs. crore)			
1.	**Internal liabilities**	**283033**	**962592**	**1102596**	**1294862**	**1499589**	**1719133**	**1677092**
	a) Internal debt	154004	714254	803698	913061	1020688	1158639	1134020
	i) Market borrowings	70520	355862	428793	516517	619105	728664	704902
	ii) Others	83484	358392	374905	396544	401583	429975	429118
	b) Other Internal liabilities	129029	248338	298898	381801	478901	560494	543072
2.	**External debt(outstanding)***	**31525**	**58437**	**65945**	**71546**	**59612**	**60931**	**47407**
3.	**Total outstanding liabilities (1+2)**	**314558**	**1021029**	**1168541**	**1366408**	**1559201**	**1780064**	**1724499**
4.	**Amount due from Pakistan on account** of share of pre-partition debt	**300**	**300**	**300**	**300**	**300**	**300**	**300**
5.	**Net liabilities (3-4)**	**314258**	**1020729**	**1168241**	**1366108**	**1558901**	**1779764**	**1724199**
					(As percent of GDP)			
1.	**Internal liabilities**	**49.8**	**49.7**	**52.8**	**56.7**	**60.7**	**62.4**	**60.9**
	a) Internal debt	27.1	36.9	38.5	40.0	41.3	42.1	41.2
	i) Market borrowings	12.4	18.4	20.5	22.6	25.1	26.4	25.6
	ii) Others	14.7	18.5	17.9	17.4	16.3	15.6	15.6
	b) Other Internal liabilities	22.7	12.8	14.3	16.7	19.4	20.3	19.7
2.	**External debt(outstanding)***	**5.5**	**3.0**	**3.2**	**3.1**	**2.4**	**2.2**	**1.7**
3.	**Total outstanding liabilities**	**55.3**	**52.7**	**55.9**	**59.9**	**63.1**	**64.6**	**62.6**
	Memorandum items							
	(a) External debt (Rs.crore)@	66314	186791	189990	199639	196067	236604	184088
	(as per cent of GDP)	11.7	9.6	9.1	8.7	7.9	8.6	6.7
	(b) Total outstanding liabilities	349347	1149383	1292586	1494501	1695656	1955737	1861180
	(adjusted) (as per cent of GDP)	61.4	59.3	61.9	65.5	68.7	71.0	67.6
	(c) Internal liabilities(Non-RBI)#	208978	820967	956478	1142698	1337752	1557970	1518040
	(as per cent of GDP)	36.7	42.4	45.8	50.1	54.2	56.5	55.1
	(d) Outstanding liabilities (Non-RBI)# (Rs.crore)	275292	1007758	1146468	1342337	1533819	1794574	1702128
	Outstanding liabilities (Non-RBI) (as per cent of GDP)	48.4	52.0	54.9	58.8	62.1	65.1	61.8
	(e) Contingent liabilities of Central Government (Rs.crore)	n.a.	83954	86862	95859	90617	n.a.	n.a.
	Contingent liabilities of Central Government (as per cent of GDP)	n.a.	4.3	4.2	4.2	3.7	n.a.	n.a.
	(f) Total assets (Rs crore)	236740	607705	676581	760592	840768	956444	892123
	Total assets (as per cent of GDP)	41.6	31.4	32.4	33.3	34.0	34.7	32.4

n.a. : not available

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

@ 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.

 # This includes marketable dated securties held by the RBI.

$ The ratios to GDP at current market prices for 2003-04 are based on CSO's Advance Estimates released in February, 2004.

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

component of Sampoorna Gramin Rozgar Yojana and Rs.500 crore for meeting additional expenditure of Delhi Metro Rail. The second batch of supplementary demands for grants involving 42 grants sought the approval of Parliament for additional expenditure of Rs.7,660 crore. These proposal involved a net cash outgo of Rs.4,888 crore and gross additional expenditure, matched by savings of the Ministries concerned amounting to Rs.2,772 crore. Major items of additional expenditure involving cash outgo were Rs.2,300 crore for providing compensation to Bharat Sanchar Nigam Ltd. for meeting operational losses on rural telephony, Rs.550 crore for meeting additional expenditure under national programme for nutritional support to primary education and another Rs.1,580 crore for meeting additional expenditure under Sampoorana Gramin Rozgar Yojana. The third and final batch of supplementary demands included 63 grants and 5 appropriations involving an additional expenditure Rs.31,105 crore. Out of this, net cash outgo amounted to Rs.2,592 crore and gross additional expenditure matched by savings of the Ministries concerned amounted to Rs.28,513 crore. Major items of additional expenditure involving cash outgo included Rs.682 crore towards pre-payment premium for reduction of external and internal debt, Rs.650 crore towards interest on market loans, Rs.394 crore for establishment related expenditure of para-military forces and Rs.251 crore towards fencing of border etc. In the third supplementary demands for grants, major items of expenditure, not involving cash outgo included Rs.3,398 crore towards payment of premium for reduction of external debt and Rs.15,673 crore towards pre-payment of external debt.

Savings and capital formation

2.25 The economic and functional classification of the Central Government Budget 2003-04 puts total Government expenditure at Rs.4,38,187 crore, an increase of 9.0 per cent over the revised estimates of the previous year. Of this, provision towards gross capital formation amounted to Rs. 87,138 crore or 19.9 per cent of the total expenditure. Gross capital formation of the Central Government has exhibited a secular declining trend. Another disturbing development relates to the growing dis-savings of the Central Government. The dis-savings of the Central Government increased from 1.8 per cent of GDP in 1990-91 to 3.3 per cent of GDP in 2002-03 (RE). The dis-saving was estimated at 3.4 per cent of GDP in 2003-04 (Table 2.6). Expenditure on wages, salaries and pensions of the Central Government as a proportion of its total expenditure was budgeted at 11.9 per cent in 2003-04 as compared with 12.4 per cent in 2002-03 (RE).

Collection rates

2.26 In a tax system, where there is lack of convergence between statutory and effective rates of duty on account of numerous exemptions, nominal rates of duty do not fully reflect the incidence. The collection rate, which is the ratio of realised import revenue to the value of a commodity, broadly indicates the incidence of customs duty and other levies, which are not in the nature of protective tariffs such as special additional duty and countervailing duty on imports. Thus, the collection rate not only captures the element of protection due to customs duties but also the incidence of other duties, which are in the nature of off-sets to mitigate the impact of domestic levies for which producers cannot avail of any credit. Generally, the collection rate is higher than the basic customs duty as the latter excludes other duties and levies. Recent trends in collection rates indicate a sharp decline. The total incidence of duty for all commodity groups has come down to 15 per cent in 2002-03 from a level of 47 per cent noticed in 1990-91. A sharp decline was noticed in the case of petroleum products, chemicals, paper and metals.

Post- budget announcements 2003-04

2.27 In January, 2004, the Government had announced a number of measures to boost the economy. These measures included proposals for setting up of a Agricultural Infrastructure and Credit Fund, a separate fund for the small and medium industry and a fund for infrastructure and manufacturing sector, allowing Food Corporation of India to borrow from the market, a new scheme for rural housing called ‘Atal Grameen Griha Yojana’, liberalisation of external commercial borrowings, easing of loans for students and proposal for the introduction of *Dada-Dadi* bonds.

2.28 In continuation of the on-going rationalisation of customs duties, the Government had announced a number of changes in these duties. Major announcements in respect of customs duties included reduction of peak duty rate from 25 per cent to 20 per cent on non-agricultural goods, abolition of special additional duty of customs (SAD) and reduction of duty on project imports and power transmission and distribution projects. A number of duty

Table 2.6 : Total expenditure and capital formation by the Central Government and its financing

(As per economic and functional classification of the Central Government budget)

		1990-91	1998-99	1999-00	2000-01	2001-02	2002-03 (RE)	2003-04$ (BE)
					(Rs. crore)			
I.	**Total expenditure**	**97947**	**263755**	**307509**	**328265**	**360616**	**401996**	**438187**
II.	**Gross capital formation out of budgetary resources of Central Government**	**28032**	**57807**	**67602**	**66960**	**76888**	**75632**	**87138**
	(i) Gross capital formation by the Central Government	8602	20647	26075	22258	12634	20074	22960
	(ii) Financial assistance for capital formation in the rest of the economy	19430	37160	41527	44702	64254	55558	64178
III.	**Gross saving of the Central Government**	**-10502**	**-41893**	**-41169**	**-56920**	**-76306**	**-81435**	**-92692**
IV.	**Gap(II-III)**	**38534**	**99700**	**108771**	**123880**	**153194**	**157067**	**179830**
	Financed by							
	a. Draft on other sectors of domestic economy	34768	96793	106483	115561	145841	169581	174788
	(i) Domestic capital receipts	23421	97029	105619	116758	147337	164283	174788
	(ii) Budgetary deficit/draw down of cash balance	11347	-236	864	-1197	-1496	5298	0
	b. Draft on foreign savings	3766	2907	2288	8319	7353	-12514	5042
					(As per cent of GDP)			
I.	**Total expenditure**	**17.2**	**15.1**	**15.9**	**15.7**	**15.8**	**16.3**	**15.9**
II.	**Gross capital formation out of budgetary resources of Central Government**	**4.9**	**3.3**	**3.5**	**3.2**	**3.4**	**3.1**	**3.2**
	(i) Gross capital formation by the Central Government	1.5	1.2	1.3	1.1	0.6	0.8	0.8
	(ii) Financial assistance for capital formation in the rest of the economy	3.4	2.1	2.1	2.1	2.8	2.2	2.3
III.	**Gross saving of the Central Government**	**-1.8**	**-2.4**	**-2.1**	**-2.7**	**-3.3**	**-3.3**	**-3.4**
IV.	**Gap (II-III)**	**6.8**	**5.7**	**5.6**	**5.9**	**6.7**	**6.4**	**6.5**
	Financed by							
	a. Draft on other sectors of domestic economy	6.1	5.6	5.5	5.5	6.4	6.9	6.3
	(i) Domestic capital receipts	4.1	5.6	5.5	5.6	6.5	6.7	6.3
	(ii) Budgetary deficit/draw down of cash balance	2.0	0.0	0.0	-0.1	-0.1	0.2	0.0
	b. Draft on foreign savings	0.7	0.2	0.1	0.4	0.3	-0.5	0.2
					(increase over previous year)			
II.	**Gross capital formation out of budgetary resources of Central Government**	**2.8**	**5.5**	**16.9**	**-0.9**	**14.8**	**-1.6**	**15.2**
	Memorandum items							
					(Rs.Crore)			
1	Consumption expenditure	22359	59920	68831	71977	77324	85259	97773
2	Current transfers	45134	137611	161549	183696	201188	233251	248326
					(As per cent of GDP)			
1	Consumption expenditure	3.9	3.4	3.6	3.4	3.4	3.5	3.5
2	Current transfers	7.9	7.9	8.3	8.8	8.8	9.4	9.0

$: The ratios to GDP at current market prices for 2003-2004 are based on CSO's Advance Estimates released in February, 2004.

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 & salaries and commodities & services for current use.
(iii) Interest payments, subsidies, pension etc. are treated as current transfers.
(iv) Gross capital formation & 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 transfered to DCUs, loans written off etc, are excluded from the current account. In the capital account, expenditure financed out of Railways Posts &Telecommunications own funds etc, are included.

Source : Economic and Functional Classification of the Central Government Budgets.

Table 2.7 : Collection rates* for selected import groups

(in per cent)

Sl. No.	Commodity Groups	1990-91	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03 (Prov.)
1	Food products	47	16	15	15	31	40	30
2	POL	34	29	29	23	16	10	11
3	Chemicals	92	37	34	36	38	29	29
4	Man-made fibres	83	36	49	64	49	31	32
5	Paper & newsprint	24	13	11	9	8	6	7
6	Natural fibres	20	17	22	24	18	8	10
7	Metals	95	44	51	55	48	36	36
8	Capital goods	60	41	42	36	36	28	24
9	Others	20	15	11	12	12	9	9
10	Non POL	51	27	23	22	23	19	17
11	Total	47	27	23	22	21	16	15

* Collection rate is defined as the ratio of realised import revenue (including additional customs duty/ countervailing duty (CVD), and special additional duty) to the value of imports of a commodity.

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

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

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

S.No 6 includes raw wool and silk.

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

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

Source : Budget documents.

concessions were also announced in sectors such as information technology, health, civil aviation and water supply. Announcements in respect of trade facilitation included round the clock electronic filing of customs documents and self assessment based customs clearance. There was considerable liberalisation of baggage rules. Changes announced in excise duties included reduction of duties on computers from 16 per cent to 8 per cent, and on aviation turbine fuel from 16 per cent to 8 per cent, abolition of inland air travel tax and foreign travel tax and permission to remove semi-finished and finished goods for further processing without payment of excise duty. Changes announced in respect of service tax included extension of electronic filing of service tax returns to all taxable services, facility of single return for those providing more than one service and simple procedure for grant of registration.

2.29 The changes announced in direct taxes relate to simplification of procedures. These are doing away with the requirement of filing returns by employees having a salary income up to Rs,1,50,000, exempting pensioners from the one-by six scheme and one time approval of infrastructure projects for tax exemption.

Fiscal outcome 2003-04

2.30 The Union Budget for 2003-04 laid considerable emphasis on fiscal consolidation, one of the five priorities enunciated in the Budget speech. In the Budget, gross tax revenue was budgeted to increase by a modest 13.3 per cent over the revised estimates for 2002-03. The growth envisaged for Union excise duties and customs was even lower at 10.8 per cent and 8.5 per cent, respectively. Revenue expenditure was budgeted to grow by 7.2 per cent over RE 2002-03 to Rs.3,66,227 crore. Total expenditure was budgeted to grow at 8.6 per cent. Fiscal and revenue deficits were budgeted at 5.6 per cent and 4.1 per cent of GDP, respectively.

2.31 The office of the Controller General of Accounts (CGA) has recently released the provisional unaudited accounts for the year 2003-04. These accounts indicate that the fiscal outcome in 2003-04 is better than that envisaged in the budget estimates. As per the provisional accounts, gross tax revenue of the Centre exceeded the BE by Rs.2,911 crore. While collections under corporation tax exceeded the BE, collections under other taxes fell short of the BE. However, the increase in the corporate tax revenue by Rs.12,109 crore over the BE more than offset the shortfall in revenue from other taxes. Non-tax revenue also exceeded the BE by Rs. 6,302 crore, mainly on account of higher than budgeted dividends from public sector enterprises.

2.32 Capital receipts exceeded the BE by Rs.24,076 crore on account of prepayment of high cost debt by States. This was reflected in the recovery of loans, which amounted to Rs.66,928 crore as compared with the budgeted amount of Rs.18,023 crore. A significant development in 2003-04 relates to lower than budgeted market borrowings. As compared with the BE of Rs.1,07,194 crore, net market borrowings as per provisional accounts were lower at Rs.88,860 crore.

2.33 Aggregate expenditure of the Central Government was higher than the BE by Rs.33,141 crore mainly on account of the higher expenditure under capital account. The pre-paid loans under the debt swap scheme were used by the Central Government to discharge its liabilities under the National Small Savings Fund (NSSF), thus increasing the non-plan capital expenditure. This explains the significant growth in capital expenditure as per the provisional accounts. Net of repayments to NSSF, total expenditure was lower than the BE. Revenue expenditure was lower than the BE by Rs.4,919 crore, mainly because of compression of non plan expenditure. Plan revenue expenditure exceeded the BE by Rs.1,694 crore.

2.34 Fiscal deficit turned out to be lower at 4.6 per cent of GDP than the BE of 5.6 per cent of GDP, mainly on account of higher than budgeted revenue receipts and lower than budgeted revenue expenditure. Revenue deficit was lower at 3.6 per cent of GDP compared with the budgeted level of 4.1 per cent of GDP (Table 2.8).

Interim Budget 2004-05

2.35 An Interim Budget was presented on February 3, 2004 seeking a Vote-on-Account to enable the Government to meet all essential expenditure during the first four months of 2004-05. The Interim Budget reiterated adherence to the five priorities enunciated in the Budget for 2003-04 and laid emphasis on preserving the strength of macroeconomic fundamentals and fiscal consolidation. Some of the initiatives proposed in the Interim Budget included extension of coverage under the Antyodaya Anna Yojana from 1.5 crore families below the poverty line (BPL) to 2.0 crore families, setting up of six hospitals in the Government sector on the pattern of All India Institute of Medical Sciences (AIIMS), facilitation of cheaper credit to farmers, issue of Kisan Credit Cards to all eligible farmers by March 31, 2004, extension of Farm Income Insurance Scheme originally introduced on a pilot basis in 20 districts, to 100 districts, setting up of a National Cattle Development Board, liberalized credit under Laghu Udyami Credit Card Scheme and accelerated drinking water supply scheme for mega cities.

2.36 In the area of taxation, the Interim Budget proposed raising of baggage allowance from Rs. 12,000 to Rs. 25,000, reduction of customs duty on baggage from 50 per cent to 40 per cent, and reduction of stamp duty by 50 per cent where the authority to fix rates is the Central Government.

2.37 Revenue receipts (net to the Centre) was budgeted to increase by 10.6 per cent over 2003-04 (RE) to Rs. 2,90,882 crore in 2004-05. Total expenditure is budgeted to decline by 3.5 per cent in 2004-05. Accordingly,

Table 2.8 : Central Government finances						
		2002-03 Actuals	2003-04 Budget estimates	2003-04* (Provisional)	Col. 4 as % of 2003-04 (BE)	% Change 2003-04 (Prov) over 2002-03 (Col. 4/2)
	1	2	3	4	5	6
			(Rs. crore)			
1.	**Revenue receipts (net to Centre)**	**231748**	**253935**	**263000**	**103.6**	**13.5**
	Gross tax revenue	**216266**	**251527**	**254438**	**101.2**	**17.7**
	Tax (net to Centre)	159425	**184169**	**186932**	**101.5**	**17.3**
	Non Tax	72323	69766	76068	109.0	5.2
2.	**Capital receipts**	**168648**	**184860**	**208936**	**113.0**	**23.9**
	of which:					
	Recovery of loans	34191	18023	66928	371.3	95.7
	Other Receipts	3151	13200	16048	121.6	409.3
	Borrowings and other liabilities	131306	153637	125960	82.0	-4.1
3.	**Total receipts (1+2)**	**400396**	**438795**	**471936**	**107.6**	**17.9**
4.	**Non-Plan expenditure (a)+(b)**	**288942**	**317821**	**349787**	**110.1**	**21.1**
	(a) Revenue account	268074	289384	282771	97.7	5.5
	Of which:					
	Interest payments & debt servicing	117804	123223	124261	100.8	5.5
	Major subsidies	40416	48636	43569	89.6	7.8
	Pensions	14496	15466	15744	101.8	8.6
	(b) Capital account	20868	28437	67016	235.7	221.1
5.	**Plan expenditure (i)+(ii)**	**111455**	**120974**	**122149**	**101.0**	**9.6**
	(i) Revenue account	71554	76843	78537	102.2	9.8
	(ii) Capital account	39901	44131	43612	98.8	9.3
6.	**Total expenditure (4)+(5)=(a)+(b)**	**400396**	**438795**	**471936**	**107.6**	**17.9**
	(a) Revenue expenditure	339628	366227	361308	98.7	6.4
	(b) Capital expenditure	60769	72568	110628	152.4	82.0
7.	**Revenue deficit**	**107880**	**112292**	**98308**	**87.5**	**-8.9**
8.	**Fiscal deficit**	**131306**	**153637**	**125960**	**82.0**	**-4.1**
9.	**Primary deficit**	**13502**	**30414**	**1699**	**5.6**	**-87.4**

*** The ratios to GDP for 2003-04(BE) and provisional are based on CSO's Advance Estimates relased in February 2004.**

Notes: 1. Actuals for 2002-2003 and 2003-04 (Prov.) include receipts from States on account of debt-swap scheme in the case of recoveries of loans.

2. Actuals for 2002-03 and 2003-04 (Prov.) include repayment to National Small Savings Fund in respect of capital account.

3. Actuals for 2002-03 are taken from the Interim Budget 2004-05.

Source : Controller General of Accounts.

all major fiscal indicators are budgeted to improve over 2003-04 (RE). Revenue deficit was budgeted at 2.9 per cent of GDP compared with 3.6 per cent in 2003-04 (RE). Fiscal deficit was budgeted to be brought down to 4.4 per cent in 2004-05 from 4.8 per cent in 2003-04 (RE).

Fiscal Responsibility and Budget Management Act, 2003

2.38 Concerned over the deterioration in the fiscal situation, in 2000, the Government of India had set up a Committee to recommend draft legislation for fiscal responsibility. Based on the recommendations of the Committee, the Government introduced the Fiscal Responsibility and Budget Management (FRBM) Bill in December 2000. In this Bill, numerical targets for various fiscal indicators were specified. The Bill was referred to the Parliamentary Standing Committee on Finance. The Standing Committee recommended that the numerical targets proposed in the Bill should be incorporated in the rules to be framed under the Act, rather than the Act itself. Taking into account the recommendations of the Standing Committee, a revised Bill was introduced in April, 2003. The Bill was passed in Lok Sabha in May, 2003 and in Rajya Sabha in August, 2003. After receiving the assent of the President, it became an Act in August, 2003.

The enactment of FRBM Act marks a watershed in fiscal reforms. The Act provides an institutional framework binding the Government to pursue a prudent fiscal policy. The Act casts responsibility on the Central Government to ensure inter-generational equity in fiscal management and long-term macroeconomic stability by achieving sufficient revenue surplus, removing fiscal impediments in the effective conduct of monetary policy and prudential debt management through limits on borrowings and deficits. The rules under the Act would be notified shortly. The main features of the legislation are listed in Box 2.3.

Box 2.3 : The Fiscal Responsibility and Budget Management Act, 2003

- Central Government to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by March 31, 2008 and thereafter build up adequate revenue surplus.
- Rules to be made under the Act to specify the annual targets for reduction of fiscal deficit and revenue deficit, contingent liabilities and total liabilities.
- The revenue deficit and fiscal deficit may exceed the targets specified in the rules only on grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify.
- The Central Government shall not borrow from the Reserve Bank of India except by way of advances to meet temporary excess of cash disbursements over cash receipts.
- Reserve Bank of India not to subscribe to the primary issues of the Central Government securities from the year 2006-07.
- Central Government to take suitable measures to ensure greater transparency in its fiscal operations.
- Central government to lay in each financial year before both Houses of Parliament three statements viz., Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macroeconomic Framework Statement along with the Annual Financial Statement and Demands for Grants.
- Finance Minister to make a quarterly review of trends in receipts and expenditure in relation to the Budget and place the review before both Houses of Parliament.

Pension reforms

2.39 International experience has amply demonstrated the sustainability problems of unfunded pension systems. Pensions is one of the fastest growing items of expenditure. Expenditure on pensions of the Central Government, after increasing from Rs.2,138 crore in 1990-91 to Rs. 14,496 crore in 2002-03, was budgeted to increase to Rs.15,466 crore in 2003-04. Expenditure on pensions as a proportion of GDP increased from 0.38 per cent in 1990-91 to 0.59 per cent in 2002-03. Expenditure on pensions is now almost 50 per cent of the expenditure on pay and allowances. With increasing longevity, the situation is bound to worsen. Concerned over the rising and unsustainable expenditure on pensions, in the Budget for 2003-04, the Government announced a new system of pension. On August 23, 2003, Government approved a new defined contribution pension system for new entrants to Central Government service (Defence personnel excluded). This system provides for a defined contribution, shared equally by Government employees and the Government. The new pension scheme has portability, allowing transfer of benefits in case of change of employment. The existing scheme of pension, GPF and gratuity would continue for existing employees of the Central Government. The main features of the new pension system notified on December 22, 2003 and effective from January 1, 2004 are as follows.

- It is based on defined contribution. New entrants to the Central Government to make a monthly contribution of 10 per cent of the salary and dearness allowance (DA), which will be matched by the Central Government.
- Employees to have the option of a voluntary tier-II withdrawable account in the absence of the facility of General Provident Fund (GPF). Government to make no contribution to this account.
- Employees to normally exit the system at or after the age of 60 years. At the time of exit, it is mandatory for the employee to invest 40 per cent of pension wealth to

purchase an annuity to provide for life time pension of the employee and his dependent parents and spouse. Remaining 60 per cent of pension wealth to be paid in lump sum at the time of exit.

- The new system to have a central record keeping and accounting infrastructure and several fund managers to offer three options. Under option 'A', investment will be predominantly in fixed income instruments and some investment in equity. Under option 'B', there will be greater investment in equity. Option 'C' implies equal investment in fixed income and equity instruments.

2.40 The new system will also be available, on a voluntary basis, to all persons including self employed professionals and others in the unorganised sector. However, mandatory programmes under the Employees Provident Fund Organisation (EPFO) and other special provident funds would continue to operate as per the existing system under the Employees Provident Fund and Miscellaneous Provisions Act, 1952 and other special Acts governing these funds.

2.41 The Pension Fund Regulatory and Development Authority (PFRDA) will regulate and develop the pension market. An interim PFRDA appointed by the executive has been proposed till a statutory PFRDA is established. An interim Pension Fund Regulatory and Development Authority (PFRDA) has already been constituted.

Finances of State Governments

2.42 The deterioration in the finances of State Governments has been sharper than that of the Central Government. All the major fiscal indicators reveal a worsening of the fiscal situation as compared with the position obtaining in 1990-91. Fiscal deficit of States as a proportion of GDP increased from 3.3 per cent in 1990-91 to 4.7 per cent in the revised estimates for 2002-03. Revenue deficit witnessed a sharper deterioration from 0.9 per cent of GDP to 2.5 per cent of GDP in the same period. The factors responsible for such a deterioration include growing burden of interest payments, pension liabilities and administrative expenditure. Losses of state owned public enterprises, inappropriate user charges and deceleration in Central transfers compounded the problem. In recent years, the need for State level fiscal reforms has been well recognised. The problem of fiscal consolidation cannot be addressed unless reforms encompass both the Centre and States. With the worsening of the fiscal situation, particularly since 1998-99, a number of States have taken up fiscal reforms in right earnest.

2.43 The fiscal situation of States, which has been witnessing sharp worsening since 1998-99, improved somewhat in the years 2000-01 and 2001-02. Fiscal and revenue deficits as proportion of GDP in these years were lower as compared with the levels obtaining in 1999-2000. Revised estimates for 2002-03, however, indicate a worsening of the fiscal deficit to 4.7 per cent of GDP from 4.2 per cent in the previous year. Despite an increase in the fiscal deficit, the revenue deficit marginally declined to 2.5 per cent in 2002-03 (RE) as compared with 2.6 per cent of GDP in 2001-02 indicating that the increase in fiscal deficit was driven by an increase in capital outlay and net lending. The capital expenditure (excluding loans and advances) of States increased from Rs.50,145 crore in 2001-02 to Rs.69,376 crore in 2002-03. The increase in fiscal deficit over the years, resulted in an increase in the outstanding liabilities-GDP ratio of States to 27.9 per cent in 2002-03 from 25.7 per cent in the previous year (Table 2.10). The growth in outstanding liabilities of State Governments is attributable to a build up of internal debt and loans from the Centre. As per the budget estimates for 2003-04, at the end of March, 2004, loans from the Centre and internal debt accounted for 31.8 per cent and 52.6 per cent of the outstanding liabilities of States, respectively. In recent years, there has been a build up of internal debt on account of higher small saving proceeds and higher market borrowings. The share of internal debt in total outstanding debt increased from 42.4 per cent at the end of March, 2002 to 52.6 per cent at the end of March, 2004.

2.44 In the State Budgets for 2003-04, fiscal and revenue deficits were placed at a lower level even in absolute terms as compared with the revised estimates for 2002-03.The budgeted reduction in fiscal deficit as proportion of GDP was from 4.7 per cent to 4.2 per cent and the reduction in revenue deficit was from 2.5 per cent to 1.8 per cent. The improvement was sought to be achieved through an increase in own tax revenue and containment of revenue expenditure (Table 2.9).

State level reforms

2.45 A number of reform initiatives have been taken both by the Central Government and States to address the problem of fiscal consolidation at the sub national level. A few States have put in place fiscal responsibility legislations to strengthen the institutional backing for fiscal reforms. These States include Karnataka, Kerala, Punjab, Tamil Nadu and Uttar Pradesh. Based on the recommendations of the Eleventh Finance

Table 2.9 : Receipts and disbursements of the State Governments

	1990-91	1998-99	1999-2000	2000-01	2001-02	2002-03 (RE)	2003-04# (BE)
			(Rs. in Crore)				
I. Total Receipts(A+B)	91160	262841	310775	349544	373886	437452	481225
A. Revenue Receipts (1+2)	66467	176447	207201	237953	255675	294009	334290
1. Tax Receipts	44586	128416	146703	168715	180312	202503	229313
of which:							
State's own tax revenue	30344	88995	102582	117981	128097	145141	166327
2. Non-Tax Receipts	21881	48031	60498	69238	75363	91506	104977
of which:							
Interest receipts	2403	7478	9294	11438	9205	8869	9296
B. Capital Receipts	24693	86394	103574	111591	118211	143443	146935
of which:							
Recovery of loans & advances	1501	3302	3361	6898	7766	4186	3269
II. Total disbursements(a+b+c)	91088	266361	313889	347199	377311	442641	488360
a) Revenue	71776	220090	260998	291522	314863	355248	382616
b) Capital	13556	34924	37359	43945	50145	69376	90344
c) Loans and Advances	5756	11347	15532	11732	12303	18017	15400
III. Revenue deficit	5309	43643	53797	53569	59188	61240	48326
IV. Gross fiscal deficit	18787	74254	91480	89532	95994	116636	116175
			(As per cent of GDP)				
I. Total Receipts(A+B)	16.0	15.1	16.0	16.7	16.4	17.7	17.5
A. Revenue Receipts (1+2)	11.7	10.1	10.7	11.4	11.2	11.9	12.1
1. Tax Receipts	7.8	7.4	7.6	8.1	7.9	8.2	8.3
of which:							
State's own tax revenue	5.3	5.1	5.3	5.6	5.6	5.9	6.0
2. Non-Tax Receipts	3.8	2.8	3.1	3.3	3.3	3.7	3.8
of which:							
Interest receipts	0.4	0.4	0.5	0.5	0.4	0.4	0.3
B. Capital Receipts	4.3	5.0	5.3	5.3	5.2	5.8	5.3
of which:							
Recovery of loans & advances	0.3	0.2	0.2	0.3	0.3	0.2	0.1
II. Total disbursements(a+b+c)	16.0	15.3	16.2	16.6	16.5	17.9	17.7
a) Revenue	12.6	12.6	13.5	14.0	13.8	14.4	13.9
b) Capital	2.4	2.0	1.9	2.1	2.2	2.8	3.3
c) Loans and Advances	1.0	0.7	0.8	0.6	0.5	0.7	0.6
III. Revenue deficit	0.9	2.5	2.8	2.6	2.6	2.5	1.8
IV. Gross fiscal deficit	3.3	4.3	4.7	4.3	4.2	4.7	4.2

 # The ratios to GDP at current market prices for 2003-04 (BE) are based on CSO's Advance Estimates released in February, 2004.

Source : Reserve Bank of India.

Table 2.10 : Outstanding liabilities of States

Year	Total liabilities (Rs crore)	Col(2)as per cent of GDP
1	2	3
1993-94	160077	18.6
1994-95	184527	18.2
1995-96	212225	17.9
1996-97	243525	17.8
1997-98	281207	18.5
1998-99	341978	19.6
1999-2000	420132	21.7
2000-01	498092	23.8
2001-02	586687	25.7
2002-03(RE)	688421	27.9
2003-04(BE)	791400	28.7

Source : Reserve Bank of India

Commission, a monitorable fiscal reforms facility covering the years 2000-01 to 2004-05 was drawn up by the Central Government. An incentive fund of Rs.10,607 crore was earmarked to encourage States to implement fiscal reforms. Under the facility, release of incentive amount is linked to a minimum improvement of 5 percentage points in the revenue deficit-revenue receipts ratio every year with reference to the base year 1999-2000. So far, 23 States have drawn up medium term fiscal reforms programmes under the facility. Under the States' Fiscal Reforms Facility, there is also provision for additional market borrowings for meeting the structural adjustment burden.

2.46 To take advantage of the soft interest rate regime, a debt swap scheme is in operation since 2002-03. Under the scheme, mutually agreed between the States and the Centre, States are allowed to retire loans taken from the Central Government bearing a coupon rate in excess of 13 per cent. The retirement of high cost loans will be funded through additional market borrowings and a specified percentage of small saving collections. High cost Central loans amounting to Rs.13,766 crore were retired in 2002-03, of which Rs. 10,000 crore was retired through additional market borrowings and the remaining through small saving collections. The amount retired in 2003-04 was Rs.46,211 crore. Of which, amount retired through additional market borrowings was Rs.26,623 crore and the rest through small saving proceeds. Over the three year period ending 2004-05, all the Central loans bearing coupon rate of 13 per cent and above are expected to be swapped, resulting in substantial saving in interest payments to States.

2.47 The Accelerated Power Development Programme (APDP) was redesigned as the Accelerated Power Development and Reform Programme (APDRP) in 2002-03. States can access the Fund on the basis of an agreed reform programme. The Fund has two main components, viz., an investment component for strengthening and upgrading the transmission and distribution system, and incentive component for encouraging utilities to reduce cash losses. Under the incentive component, States would be given incentive up to 50 per cent of the loss reduction by the State Electricity Boards/utilities.

2.48 Another programme linked to State level reforms was initiated by the Central Government in 2002-03 to encourage States to take up urban reforms. The Urban Reforms Fund has a corpus of Rs.500 crore per annum, to be given as additional Central assistance to States during the Tenth Plan period. The entire additional Central assistance under the Fund is being released as 100 per cent grant.

Consolidated General Government

2.49 Fiscal consolidation would be meaningful only if the combined fiscal position of the Centre and the States improves. The combined fiscal deficit, which witnessed a reduction in the early nineties, slipped back to the pre-reform level at the end of nineties. In fact, the situation worsened with the combined fiscal deficit reaching a level of 10.1 per cent of GDP in 2002-03 (RE), higher than the pre-reform level of 9.4 per cent. Revenue deficit followed a more disturbing trend and worsened more sharply than the fiscal deficit. The combined revenue deficit as proportion of GDP after declining from 4.2 in 1990-91 to 3.6 per cent in 1996-97 increased to 7.0 per cent in 2001-02. The combined fiscal deficit was budgeted at Rs.2,59,265 crore constituting 9.4 per cent of GDP in 2003-04. The share of capital expenditure (excluding loans) in total expenditure which was 13.5 per cent in 1990-91 came down to 10.3 per cent in 2001-02. The share subsequently improved to 11.8 per cent in 2002-03 with sustained efforts at stepping up capital expenditure. It was budgeted to go up to 14.5 per cent in 2003-04. Details regarding the consolidated position of Central and State Government finances are given in Table 2.11.

Disinvestment in public sector undertakings

2.50 The rationale behind disinvestment in PSUs is to be found in the changing role of the State from a provider of wide range of goods and services to a selective provider of goods and services that are classifiable as public goods and services with a sharper focus on the provision of physical and social infrastructure. This process was also necessitated by budgetary considerations and the need to enhance public investment to facilitate higher growth. The process of disinvestment began in 1991-92 through the sale of minority share holding in small lots. From 1999-2000 onwards, the emphasis changed in favour of strategic sale. The primary objective of disinvestment, especially through the strategic sale route is that with the transfer of management control into private hands, private capital and management practices would be used effectively to increase the operational efficiency of the company. In the Budget for 2000-01, Government made an announcement that strategic sale would be used increasingly for the purpose of disinvestment. In a statement laid in both the houses of Parliament on December 9, 2002, Government indicated that the objective of disinvestment was to facilitate modernisation, creation of new assets, generation of employment, retirement of public debt and setting up a Disinvestment Proceeds Fund.

2.51 In 2003-04, the disinvestment strategy was broadened to include offers for sale of residual shares in privatised PSUs and a minority portion of Government equity in select PSUs. There was an initial public offering by Maruti Udyog Ltd. in June 2003, which received an overwhelming response from institutional and retail investors. This was followed by offers for sale of residual shares of privatised PSUs,viz., CMC Ltd., IBP Ltd and Indian Petro Chemicals Corporation Ltd and a portion of Government equity in Dredging Corporation of India Ltd, Gas Authority of India Ltd., and Oil and Natural Gas Corporation Ltd. During the year 2003-04, as per provisional accounts, an amount of Rs.16,047 crore was realised through disinvestment exceeding the target of Rs.14,500 crore set in the revised estimates.

2.52 To protect the interests of the employees of the PSUs that are being sold, Government through appropriate provisions in the Transaction Agreements entered into with the strategic partner/purchaser at the time of disinvestment, seeks to ensure that there is no retrenchment of employees at least for a period of one year after privatisation. Thereafter, retrenchment is possible only under the Voluntary Retirement Scheme (VRS) as applicable under the Department of Public Enterprises' guidelines or the Voluntary Separation Scheme, which was prevailing in the company prior to disinvestment, which ever is more beneficial to the employees. The National Common Minimum programe pledges to devlove full managerial and commercial autonomy to successful, profit-marking companies operating in a competitive environment. It makes a committment that "navaratna" companies will remain as PSUs. It also states that generally profit-making companies will not be privatised and all privatisation will be considered on a transparent and consultative case-by-case basis.

Table 2.11 : Combined receipts and disbursements of the Central and State Governments							
	1990-91	1998-99	1999-2000	2000-01	2001-02	2002-03 (RE)	2003-04 (BE)
				(Rs. crore)			
I. Total receipts(A+B)	152398	459746	542701	597944	649686	746760	816507
A Revenue receipts (1+2)	105757	287686	343741	378817	400305	471735	521691
1. Tax receipts	87564	233069	274974	305374	313974	366680	413482
2. Non-Tax receipts	18193	54617	68767	73443	86331	105055	108209
Interest receipts	24995	16175	18202	18050	17141	20118	18427
B. Capital receipts	46641	172060	198960	219127	249382	275025	294816
of which:							
a) Disinvestment proceeds	-	6379	1724	2125	3646	3360	13200
b) Recovery of loans & advances	4336	7115	5905	10466	14514	11298	8076
II. Total disbursements(a+b+c)	163673	463265	545813	595598	653111	751950	823642
a) Revenue	129628	399237	465135	517620	559655	637687	682309
b) Capital	22177	46014	59166	60211	67048	88582	119310
c) Loans and advances	11868	18014	21512	17767	26408	25681	22023
III. Revenue deficit	23871	111551	121394	138803	159350	165952	160618
IV. Gross fiscal deficit	53580	157053	184826	199852	226425	248885	259265
				(As per cent of GDP)			
I. Total receipts(A+B)	26.8	26.4	28.0	28.6	28.5	30.2	29.6
A Revenue receipts (1+2)	18.6	16.5	17.7	18.1	17.5	19.1	18.9
1. Tax receipts	15.4	13.4	14.2	14.6	13.8	14.8	15.0
2. Non-tax receipts	3.2	3.1	3.6	3.5	3.8	4.3	3.9
of which:							
Interest receipts	4.4	0.9	0.9	0.9	0.8	0.8	0.7
B. Capital receipts	8.2	9.9	10.3	10.5	10.9	11.1	10.7
of which:							
a) Disinvestment proceeds	0.0	0.4	0.1	0.1	0.2	0.1	0.5
b) Recovery of loans & advances	0.8	0.4	0.3	0.5	0.6	0.5	0.3
II. Total disbursements(a+b+c)	28.8	26.6	28.2	28.5	28.6	30.4	29.9
a) Revenue	22.8	22.9	24.0	24.8	24.5	25.8	24.8
b) Capital	3.9	2.6	3.1	2.9	2.9	3.6	4.3
c) Loans and advances	2.1	1.0	1.1	0.9	1.2	1.0	0.8
III. Revenue deficit	4.2	6.4	6.3	6.6	7.0	6.7	5.8
IV. Gross fiscal deficit	9.4	9.0	9.5	9.6	9.9	10.1	9.4

 # The ratios to GDP at current market prices for 2003-04 (BE) are based on CSO's Advance Estimates released in February, 2004.

Source : Reserve Bank of India.

Performance of departmental enterprises of the Central Government

Railways

2.53 On account of the efforts to augment earnings and contain expenditure, considerable improvement was noticed in the performance of Railways in 2002-03 over 2001-02. The gross traffic receipts of the Railways at Rs.41,068 crore registered a growth of 8.5 per cent in 2002-03. Ordinary working expenses in 2002-03 increased marginally by 3.4 per cent. Total working expenses including appropriations to Depreciation Reserve Fund and Pension Fund at Rs.38,026 crore reflect an increase of 4.8 per cent over the previous year. Taking into account the net variation of the miscellaneous receipts and miscellaneous expenditure, Railways' net revenue in 2002-03 went up to Rs.3,830 crore from Rs.2,338 crore in 2001-02.

2.54 The dividend liability for 2002-03 worked out to Rs.2,665 crore and was discharged fully. Besides, Railways also repaid Rs.50 crore towards deferred dividend liability of Rs.2,823 crore of the past two years. The operating ratio of Railways has improved substantially to 92.3 per cent in 2002-03 as compared with 96 per cent in 2001-02. The net revenue as a proportion of capital-at-charge and investment from Capital Fund, which had declined from 11.7 per cent in 1996-97 to 5.0 per cent in 2001-02, also improved to 7.5 per cent in 2002-03.

2.55 To adapt to increasing competitive freight and passenger traffic environment, rationalisation of freight structure initiated in 2002-03 was continued in 2003-04 reducing the cross-subsidy between services. The freight loading target for 2003-04 was set at 540 million tonnes, 21.26 million tonnes more than that carried in 2002-03. In view of the buoyancy, the freight loading target was enhanced by 10 million tonnes to 550 million tonnes in the revised estimates for 2003-04. Railways achieved a freight loading of 557.39 million tonnes, which is 7.39 million tonnes higher than the revised estimates for 2003-04. Growth in originating number of passengers was estimated to fall short of the growth of 3.2 per cent envisaged in 2003-04(RE). Overall earnings from traffic amounted to Rs.42,845 crore in 2003-04, exceeding the revised estimate by Rs. 240 crore, despite an estimated shortfall in the passenger segment.

2.56 The plan outlay for 2003-04(RE) stood at Rs.13,918 crore, including market borrowings of Rs.2,970 crore by the Indian Railway Finance Corporation (IRFC) and Rs.30 crore through a "BOT" project. Actual plan expenditure in 2003-04 amounted to about Rs. 13,311 crore, including an amount of Rs. 2,789 crore financed by market borrowings of IRFC and Rs. 30 crore through 'BOT' project.

2.57 Railways are continuing to take up certain important projects on cost-sharing basis with the State Governments. The Udhampur-Srinagar-Baramulla project, declared a national project, is being separately funded, with an allocation of Rs.500 crore in 2003-04. Further, with a view to strengthening the golden quadrilateral, providing port connectivity and constructing mega bridges, the National Rail Vikas Yojana has been initiated. A company named 'Rail Vikas Nigam Ltd.' has been set up to execute the major projects of the 'Yojana', excepting construction of bridges. An outlay of Rs.730 crore was provided to this company during the year 2003-04.

Broadcasting

2.58 The total expenditure of Prasar Bharti, during 2003-04, decreased marginally over the previous year to Rs.1,665 crore. Total receipts decreased from Rs.686 crore in 2002-03 to Rs.674 crore in 2003-04. Consequently, the ratio of total commercial receipts to total expenditure increased from 38.8 per cent in 2002-03 to 40.5 per cent in 2003-04. Total commercial receipts of Doordarshan have been declining and were Rs.554 crore in 2002-03 and Rs.533 crore in 2003-04. In the Union Budget for 2003-04, a provision for a grant of Rs.915.97 crore was made for Prasar Bharti to cover the gap in resources for meeting its revenue expenditure (non-Plan). Further, a provision of Rs.119.37 crore was made under revenue expenditure (plan).

Posts

2.59 The gross receipts of the Department of Posts during the year 2002-03 amounted to Rs.4,010 crore. Gross and net working expenses amounted to Rs.5,476 crore and Rs.5,374 crore respectively. Thus, there was a deficit of Rs.1,364 crore. As per 2003-04 (BE), the gross receipts were placed at Rs.4,200 crore and the gross working expenses at Rs.5,595 crore with net expenses being Rs.5,510 crore. The deficit was estimated to be Rs.1,310 crore for 2003-04.

2.60 Department of Posts has taken up a number of initiatives aimed at improving revenue performance and service delivery. Apart from the conventional services, new premium services such as Speed Post, Net Post, Greeting Post, Media Post, e-Bill Post and customised postal services for the corporate sector have been introduced. An agreement has been entered into with US based Western Union and several post offices are engaged in international money transfer services.

Outlook

2.61 Fiscal consolidation is a critical component of economic reforms programme for two main reasons. First, it has a direct bearing on economic growth by improving the quality of Government expenditure with higher outlays on infrastructure and social sectors. Second, it reduces pre-emption of private savings by the Government and creates more space for the private sector, thus indirectly promoting growth. The deterioration in the fiscal situation since 1997-98 has not resulted in any fiscal crisis so far because of the relative stability of the revenues, an increase in the average maturity period of Central Government loans, a low proportion of external debt to total debt, high credibility of the Government's fiscal consolidation plans and the subdued demand for non-food credit in recent years. While the reduction in interest rates has helped at the margin, its effect in terms of reduction in the average cost of Government debt is yet to be felt. For this to happen, interest rates should remain at a lower level for a number of years. With fiscal deficit remaining high and signs of a pick up in the flow of credit to the commercial sector, the possibility of interest rates moving northwards cannot be ruled out. Government has taken a number of initiatives as discussed above to address the problem. These initiatives, however, need to be stepped up. While reforms can be designed better when the economy is doing well and there is no crisis, mobilising popular support for such reforms is a challenge in the absence of an impending crisis. Though the growth of the Indian economy has improved from an average of 2.9 per cent in the seventies to 5.8 per cent in the nineties, the per capita income in India remains very low in comparison with a number of East Asian countries, particularly China, which had the same level of per capita income as India in the seventies. To achieve the targeted annual average growth of 8 per cent, the Tenth Five-Year Plan envisaged an acceleration in the investment rate from 24.4 per cent in the base year to 32.3 per cent in 2006-07, the terminal year of the Plan. Of the 7.9 percentage point increase in the investment rate envisaged in the Plan, 2.6 percentage increase would have to come from the public sector. Without fiscal consolidation, such a step up in public investment cannot be attained.

2.62 In the process of fiscal consolidation, with a low tax-GDP ratio, tax revenue augmentation should be the prime concern. The Kelkar Task Force has outlined the road map for re-engineering business processes in both direct and indirect taxes. A number of measures have been taken in pursuance of this and a lot more remains to be done. There is a clear need to overhaul the regime of exemptions, reduce the number of notifications, simplify procedures and move towards a paper-less and transparent administration, anchored on trust. It is equally important to establish a rigorous penal and enforcement mechanism that takes care of those who violate the trust imposed, as is the practice in countries with low rates, simple tax laws and procedures. The crux of business process re-engineering of tax administration lies in moving from the present officer based assessment to a system of self-assessment, random validation and enforcement. This process is likely to be hindered by the presence of large-scale evasion-prone cash transactions. Innovative tax laws and procedures need to be evolved in consultation with major stake holders and a strict penal mechanism put in place.

2.63 The enactment of the FRBM Act provides an institutional framework and binds the Government to adopt prudent fiscal policies. As the economy is doing well now, the adjustments required to eliminate revenue deficit by March, 2008, as stipulated in the Act need to be front loaded. The limitation of the FRBM Act is that it applies only to the Central Government. Fiscal consolidation remains incomplete without the involvement of States. The burden of fiscal adjustment has to be borne both by the Centre and the States. Though a few States have enacted fiscal responsibility legislation, the majority of States are yet to follow suit. There is greater need to involve all the States to effect overall fiscal consolidation and strengthen the growth momentum with macroeconomic stability.