2

Public Finance

Fiscal policy is a critical component of the policy framework for achieving sustained annual growth of 8-10 per cent with macroeconomic stability. High deficits, unproductive expenditure and tax distortions have constrained the economy from realising its full growth potential. The resources for building physical and social infrastructure, so essential for promoting growth, have to be generated within the framework of the Fiscal Responsibility and Budget Management Act (FRBMA), 2003. The emphasis of fiscal policy under FRBMA has been on revenue-led fiscal consolidation, focus on better expenditure outcomes and rationalization of the tax regime to remove distortions and improve competitiveness of domestic goods and services in a globalised economic environment.

2.2 Some of the important fiscal measures implemented included: reducing the peak rates of customs duties; rectifying anomalies like inverted duty structure; rationalising excise duties with a movement towards a median CENVAT rate; revisiting the tax exemptions; relying on voluntary tax compliance through taxpayer facilitation; introduction of State-level VAT for achieving a non-cascading, self-enforcing, and harmonized commodity taxation regime; increasing productivity of expenditure through an outcome budget framework, which seeks to translate outlays into better outcomes through monitorable performance indicators; and innovative financing mechanism like creation of a Special Purpose Vehicle (SPV) for infrastructure projects. While the Centre continued to pursue the path of fiscal consolidation as ordained in the FRBM Rules, these efforts of the Central Government were complemented by the States, which initiated the process of fiscal consolidation in line with the Twelfth Finance Commission's (TFC) recommendations.

2.3 The FRBMA continued to provide a strong institutional mechanism for making sustained progress at fiscal consolidation. Past efforts at fiscal consolidation in the pre-FRBM era, after an initial burst of progress, faltered in the face of strong sectoral short-term needs-driven demand on resources. For instance, while the fiscal deficit of the Central Government, as a proportion of GDP, declined from 6.6 per cent in 1990-91 to 4.1 per cent in 1996-97, this progress could not be sustained and the fiscal deficit again rose to 6.2 per cent in 2001-02 (Table 2.1). Together with the rapid decline in the quality of deficit, indicated by the proportion of revenue deficit to fiscal deficit, the deterioration in the fiscal situation became a cause for serious concern.

2.4 With the FRBMA in place since 2003-04, not only did the fiscal deficit as a proportion of GDP decline to 4.1 per cent of GDP in 2004-05 (Prov)[1], but this was also accompanied by a commensurate decline in the revenue deficit from 4.4 per cent in 2002-03 to 2.5 per cent in 2004-05 (Prov), leading to a marked improvement in the quality of deficit. The fiscal deficit, as a proportion of GDP, in 2004-05 was lower than the budget estimate (BE) of 4.4 per cent. The revenue and fiscal deficit in BE 2005-06, as proportions of GDP, are 2.7 per cent and 4.3 per cent, respectively.

[1] Provisional (unaudited) figures of fiscal aggregates of Union Government accounts have been used in place of revised estimates for 2004-05, wherever possible, in this chapter.

Table 2.1 : Trends in deficits of Central Government

Year	Revenue deficit	Primary deficit	Fiscal deficit	Revenue deficit as per cent 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
1999-2000	3.5	0.7	5.3	64.6
2000-01	4.0	0.9	5.6	71.7
2001-02	4.4	1.5	6.2	71.1
2002-03	4.4	1.1	5.9	74.4
2003-04	3.6	0.0	4.5	79.7
2004-05(Prov.)*	2.5	0.0	4.1	62.2
2005-06(BE)	2.7	0.5	4.3	63.1

* Provisional and unaudited as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.

Note: 1. The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.

2. Fiscal deficit excludes transfer of states' share in small savings collections.

Source : Budget documents.

2.5 The apparent deterioration in BE 2005-06 does not imply a setback and needs to be seen in the context of the fact that these BEs finalised in February 2005 were on the basis of revised estimates (RE 2004-05) of revenue and fiscal deficits as proportions of GDP available at that point in time, which were 2.7 per cent and 4.5 per cent, respectively. The Budget for 2005-06 had explicitly paused the process of fiscal adjustment in revenue deficit, while continuing with the reduction in fiscal deficit. As detailed in the Finance Minister's Statement under Section 7 of the FRBMA, which was laid on the table of the Parliament along with the Budget for 2005-06, this 'pause' was on account of the higher demands on resources, particularly arising out of the award of TFC. The pause was temporary and Budget 2005-06 expressed optimism about resumption of the adjustment process from 2006-07.

2.6 The fiscal situation of the States followed a pattern similar to that of the Centre. As a proportion of GDP, the fiscal deficit of the States, after declining from 3.3 per cent in 1990-91 to 2.7 per cent in 1996-97, rose to reach 4.7 per cent in 1999-2000. This was accompanied by a rapid three-fold rise in the revenue deficit to GDP ratio from 0.9 per cent in 1990-91 to 2.7 per cent in 1999-2000, indicating a deteriorating quality of the deficit. The persistent and large imbalances in State finances necessitated a strong incentive-based restructuring scheme. The terms of reference for TFC included the mandate for restructuring public finances, and the TFC has proposed a scheme of fiscal transfers to serve the objectives of equity and efficiency by embedding it in a framework of fiscal consolidation.

Central Government finances in 2004-05

2.7 With business confidence at an all time high and economic growth broad-based and robust, especially in manufacturing, revenue performance, particularly tax revenues, was buoyant in 2003-04 and 2004-05. The gross tax revenue of the Central Government grew by 17.6 per cent and 19.9 per cent in 2003-04 and 2004-05 (Prov.), respectively. The proportion of gross tax revenue to GDP of the Central Government, which generally had remained sticky in the range of 8-9 per cent, rose to 9.8 per cent in 2004-05 (Prov.).

2.8 The Budget for 2004-05 had envisaged growth of 40.4 per cent and 26.5 per cent over 2003-04 in corporate income tax and personal income tax, respectively. As against this, growth realised were of the order of 31.5 per cent and 16.8 per cent, respectively. With customs revenue exceeding the BE and a robust performance in service tax, the somewhat low-key performance in excise duties was more than compensated and the gross tax revenue was close to RE. Further, with over performance of dividends and profits, non-tax revenues overshot both the BE and RE. Recovery of loans at Rs.60,862 crore in

2004-05 remained high for the third year on account of the prepayment of high cost central loans by the States. Disinvestment receipts were at a modest Rs.4,424 crore. Adjusting for recoveries of loans under the debt swap scheme, the total non-debt receipts were placed at Rs.3,37,798 crore.

2.9 In 2004-05, total expenditure at Rs.4,98,448 crore exceeded the budgeted sum of Rs. 4,77,829 crore on account of the unbudgeted capital expenditure on redemption of securities issued to National Small Savings Fund (NSSF) using the debt swap proceeds (Table 2.2). Excluding this capital expenditure, total expenditure at Rs. 4,65,773 crore was lower than the BE. Revenue expenditure, plan expenditure and non-plan expenditure adjusted for redemption of securities issued to NSSF were also contained within BE. This expenditure containment together with the adequate revenue performance resulted in revenue and fiscal deficits of Rs. 79,558 crore and Rs.1,27,975 crore, respectively. As a proportion of GDP, the revenue deficit was at budgeted level and the fiscal deficit lower than the budgeted proportion by 30 basis points.

Budgetary developments in 2005-06

2.10 Continuing with the process set in motion in the previous year, the Budget for 2005-06 sought to further the NCMP objectives of growth, stability and equity in a calibrated manner. Maintaining a growth rate of 7-8 per cent per annum, promoting investment, generating employment, accelerating fiscal consolidation, ensuring higher fiscal devolution and focusing on agriculture, manufacturing and infrastructure were the key objectives. Budget 2005-06 sought to achieve these objectives through a series of initiatives, which included: hike in gross budgetary support (GBS) for the plan by 16.9 per cent on a like-to-like basis from Rs.1,45,590 crore in 2004-05(BE) to Rs.1,72,500 crore in 2005-06 (BE); provision of livelihood security for crores of poor families through the National Rural Employment Guarantee Scheme (NREGS), the legislation for which was passed by the Parliament on August 24, 2005; a visionary development proposal – Bharat Nirman – for building infrastructure, especially in rural areas; an outlay of Rs.1,100 crore for covering 1.25 lakh villages in five years under a massive programme of rural electrification; creation of an SPV to overcome the infrastructure deficit and provison of guarantees to the extent of the borrowing limit of Rs. 10,000 crore; enhanced outlay on NHDP from Rs. 6,514 crore in BE 2004-05 to Rs. 9,320 crore to speed it up; provision of Rs. 5,500 crore for National Urban Renewal Mission (NURM); and a focus on outcomes rather than outlays.

2.11 The process of fiscal adjustment, through mandated annual reduction in the revenue deficit by 0.5 per cent of GDP, was paused in the Budget for 2005-06. Revenue deficit was budgeted at Rs. 95,312 crore, which as a proportion of GDP, was maintained at the same levels as 2004-05 (RE). This was a one-off measure to accommodate the higher resource requirements due to TFC award. Fiscal deficit, as a proportion of GDP, was budgeted to decline from 4.5 per cent in 2004-05 (RE) to 4.3 per cent.

Revenue and capital receipts

2.12 Given the committed nature of public expenditure, which provide very little head room for compression in the short run, and the need for resources to fulfill the NCMP objectives, the strategy for achieving the targets set under the FRBMA and the rules made thereunder was primarily revenue-led. The Budget for 2005-06 continuing with this revenue led strategy estimated a growth of 16.7 per cent in revenue receipts over 2004-05 (RE), composed primarily of a 20.9 per cent growth in gross tax revenue. The sharp decline in capital receipts projected was mainly on account of the discontinuance of the debt swap scheme. (Table 2.2).

2.13 The tax reforms underway since the mid-80s, especially from the nineties, sought to effect a compositional shift in the structure of the tax system away from the excessive dependence on regressive indirect taxes to direct taxes and provide for enhanced competitiveness of the Indian industry. The direct tax to GDP ratio increased from 1.9 per cent in 1990-91 to 4.2 per cent in 2004-05 (RE). With indirect tax to GDP ratio declining

Table 2.2 : Receipts and expenditure of the Central Government

	1990-91	2000-01	2001-02	2002-03	2003-04#	2004-05 (B.E.)	2004-05 (Prov.)@	2005-06 (B.E.)
					(Rs crore)			
1. Revenue receipts (a+b)	**54954**	**192605**	**201306**	**230834**	**263878**	**309322**	**305187**	**351200**
(a) Tax revenue (net of States' share)	**42978**	**136658**	**133532**	**158544**	**186982**	**233906**	**224857**	**273466**
(b) Non-tax revenue	**11976**	**55947**	**67774**	**72290**	**76896**	**75416**	**80330**	**77734**
2. Revenue expenditure	**73516**	**277838**	**301468**	**338713**	**362140**	**385493**	**384745**	**446512**
of which:								
(a) Interest payments	21498	99314	107460	117804	124088	129500	126540	133945
(b) Major subsidies	9581	25860	30447	40716	43455	42214	44633	46358
(c) Defence expenditure	10874	37238	38059	40709	43203	43517	43967	48625
3. Revenue deficit (2-1)	**18562**	**85233**	**100162**	**107879**	**98262**	**76171**	**79558**	**95312**
4. Capital receipts (a+b+c)	**31971**	**132987**	**161004**	**182414**	**207490**	**168507**	**193261**	**163144**
(a) Recovery of loans*	5712	12046	16403	34191	67265	27100	60862	12000
(b) other receipts (mainly PSU disinvestment)	0	2125	3646	3151	16953	4000	4424	0
(c) Borrowings and other liabilities$	26259	118816	140955	145072	123272	137407	127975	151144
5. Capital expenditure	**24756**	**47754**	**60842**	**74535****	**109228****	**92336**	**113703****	**67832**
6. Total expenditure [2+5=6(a)+6(b)]	**98272**	**325592**	**362310**	**413248**	**471368**	**477829**	**498448**	**514344**
of which:								
(a) Plan expenditure	28365	82669	101194	111470	122280	145590	132160	143497
(b) Non-plan expenditure	69907	242923	261116	301778	349088	332239	366288	370847
7. Fiscal deficit [6-1-4(a)-4(b)]	**37606**	**118816**	**140955**	**145072**	**123272**	**137407**	**127975**	**151144**
8. Primary deficit [7-2(a)=8(a)+8(b)]	**16108**	**19502**	**33495**	**27268**	**-816**	**7907**	**1435**	**17199**
(a) Primary deficit consumption	6358	22955	36180	38607	25017	-3400	1304	2960
(b) Primary deficit investment	9750	-3453	-2685	-11339	-25833	11307	131	14239
					(As per cent of GDP)			
1. Revenue receipts (a+b)	**9.7**	**9.1**	**8.8**	**9.4**	**9.6**	**9.9**	**9.8**	**10.0**
(a) Tax revenue (net of States' share)	**7.6**	**6.5**	**5.9**	**6.5**	**6.8**	**7.5**	**7.2**	**7.7**
(b) Non-tax revenue	**2.1**	**2.7**	**3.0**	**3.0**	**2.8**	**2.4**	**2.6**	**2.2**
2. Revenue expenditure	**12.9**	**13.2**	**13.2**	**13.8**	**13.1**	**12.3**	**12.3**	**12.8**
of which:								
(a) Interest payments	3.8	4.7	4.7	4.8	4.5	4.1	4.1	3.8
(b) Major subsidies	1.7	1.2	1.3	1.7	1.6	1.4	1.4	1.3
(c) Defence expenditure	1.9	1.8	1.7	1.7	1.6	1.4	1.4	1.4
3. Revenue deficit (2-1)	**3.3**	**4.0**	**4.4**	**4.4**	**3.6**	**2.4**	**2.5**	**2.7**
4. Capital receipts (a+b+c)	**5.6**	**6.3**	**7.1**	**7.4**	**7.5**	**5.4**	**6.2**	**4.6**
(a) Recovery of loans*	1.0	0.6	0.7	1.4	2.4	0.9	1.9	0.3
(b) Other receipt (mainly PSU disinvestment)	0.0	0.1	0.2	0.1	0.6	0.1	0.1	0.0
(c) Borrowings and other liabilities$	4.6	5.6	6.2	5.9	4.5	4.4	4.1	4.3
5. Capital expenditure	**4.4**	**2.3**	**2.7**	**3.0**	**4.0**	**3.0**	**3.6**	**1.9**
6. Total expenditure [2+5=6(a)+6(b)]	**17.3**	**15.4**	**15.9**	**16.9**	**17.1**	**15.3**	**16.0**	**14.6**
of which:								
(a) Plan expenditure	5.0	3.9	4.4	4.6	4.4	4.7	4.2	4.1
(b) Non-plan expenditure	12.3	11.5	11.4	12.3	12.6	10.6	11.7	10.5
7.Fiscal deficit [6-1-4(a)-4(b)]	**6.6**	**5.6**	**6.2**	**5.9**	**4.5**	**4.4**	**4.1**	**4.3**
8.Primary deficit [7-2(a)=8(a)+8(b)]	**2.8**	**0.9**	**1.5**	**1.1**	**0.0**	**0.3**	**0.0**	**0.5**
(a) Primary deficit consumption	1.1	1.1	1.6	1.6	0.9	-0.1	0.0	0.1
(b) Primary deficit investment investment	1.7	-0.2	-0.1	-0.5	-0.9	0.4	0.0	0.4
Memorandum items					(Rs crore)			
(a) Interest receipts	8730	32811	35538	37622	38517	36950	32733	25500
(b) Dividend and profit	564	4225	7940	10910	12326	12979	15553	16092
(c) Non-plan revenue expenditure	60896	226762	239811	267144	283502	293650	297249	330530

@ Provisional and unaudited as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance
 # Based on provisional actuals for 2003-04.
*** Includes receipts from States on account of debt swap scheme for 2002-03, 2003-04 and 2004-05.**
**** Includes repayment to National Small Savings Fund.**
$ Does not include Rs. 60,000 crore for 2004-05(BE), Rs. 65,481 crore for 2004-05(RE) and Rs. 80,500 crore for 2005-06 (BE) to be raised under Market Stabilization Scheme, which will remain in the cash balance of the Central Government and will not be used for expenditure.

Note :
1. **The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.**
2. **The figures may not add up to the total because of rounding approximations.**
3. **Primary deficit consumption =Revenue deficit-interest payments+interest receipts+dividend & profits**
4. **Primary deficit investment =Capital expenditure-interest receipts -Dividend & profits-recovery of loans-other receipts.**
5. **Figures are exclusive of the transfer of States' share in the small savings collections.**

Source : Budget documents.

from 7.9 per cent to 5.5 per cent in the same period, the gross tax-GDP ratio generally remained in the range of 8 per cent to 9 per cent as the growth in direct tax-GDP ratio could not fully offset the decline in the indirect tax-GDP ratio. There was a distinct recovery in the last few years in the gross tax-GDP ratio, which was budgeted to go up to 10.5 per cent in 2005-06 (Table 2.3). Among the direct taxes, the growth in corporate income tax was the dominant one. Disinvestment proceeds were treated as a part of non-debt capital receipts under the head 'other receipts' till 2004-05 and used for financing the fiscal deficit. From 2005-06, these proceeds would be credited to an 'investment fund', the income from which would only be used to finance expenditure on social infastructure and to provide capital to viable public sector enterprises.

Tax Measures

a) Direct taxes

2.14 In the area of direct taxes, the Budget for 2005-06 carried forward the process initiated in the previous Budget. In personal income tax, the tax rates were revised for various tax brackets conferring gain to all taxpayers through higher exemption limits and scaling up, even as standard deduction was withdrawn. In another significant move, neutrality of taxes between forms of savings was achieved through a general rebate on savings in any approved instrument up to Rs.1 lakh. Budget for 2005-06 introduced two new taxes: a fringe benefit tax targeted at those benefits enjoyed collectively by the employees and not attributable to individual employees, which are to be taxed in the hands of employer; and a tax on banking cash transactions (withdrawals) over a certain

Table 2.3 : Sources of tax revenue

	1990-91 Actuals	1995-96 Actuals	2000-01 Actuals	2001-02 Actuals	2002-03 Actuals	2003-04 Actuals	2004-05@ (Prov.)	2005-06 (BE)
				(Rs. crore)				
Direct (a)	**11024**	**33563**	**68306**	**69197**	**83085**	**105082**	**132027**	**177077**
Personal income tax	5371	15592	31764	32004	36866	41379	48312	66239
Corporation tax	5335	16487	35696	36609	46172	63562	83566	110573
Indirect(b)	**45158**	**76806**	**118681**	**116125**	**131284**	**147294**	**171010**	**192215**
Customs	20644	35757	47542	40268	44852	48629	57655	53182
Excise	24514	40187	68526	72555	82310	90774	99155	121533
Service tax	0	862	2613	3302	4122	7891	14200	17500
Gross tax revenue #	**57576**	**111224**	**188603**	**187060**	**216266**	**254348**	**304980**	**370025**
				Tax revenue as a percentage of gross tax revenue				
Direct (a)	**19.1**	**30.2**	**36.2**	**37.0**	**38.4**	**41.3**	**43.3**	**47.9**
Peronal income tax	9.3	14.0	16.8	17.1	17.0	16.3	15.8	17.9
Corporation tax	**9.3**	14.8	18.9	19.6	21.3	25.0	27.4	29.9
Indirect(b)	**78.4**	**69.1**	**62.9**	**62.1**	**60.7**	**57.9**	**56.1**	**51.9**
Customs	35.9	32.1	25.2	21.5	20.7	19.1	18.9	14.4
Excise	42.6	36.1	36.3	38.8	38.1	35.7	32.5	32.8
Service tax	0.0	0.8	1.4	1.8	1.9	3.1	4.7	4.7
				Tax revenue as a per cent of GDP*				
Direct(a)	**1.9**	**2.8**	**3.2**	**3.0**	**3.4**	**3.8**	**4.2**	**5.0**
Personal income tax	0.9	1.3	1.5	1.4	1.5	1.5	1.5	1.9
Corporation tax	0.9	1.4	1.7	1.6	1.9	2.3	2.7	3.1
Indirect(b)	**7.9**	**6.5**	**5.6**	**5.1**	**5.4**	**5.3**	**5.5**	**5.4**
Customs	3.6	3.0	2.3	1.8	1.8	1.8	1.8	1.5
Excise	4.3	3.4	3.3	3.2	3.4	3.3	3.2	3.4
Service tax	0.0	0.1	0.1	0.1	0.2	0.3	0.5	0.5
Total#	**10.1**	**9.4**	**8.9**	**8.2**	**8.8**	**9.2**	**9.8**	**10.5**

@ Provisional and unaudited as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.
 # Includes taxes referred in (a) & (b) and taxes of Union Territories and "other" taxes.
*** Refers to gross domestic product at current market prices.**
Note : (1) Direct taxes also includes taxes pertaining to expenditure, interest, wealth, gift and estate duty.
(2) The ratios to GDP for 2005-06 (BE) based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.

Source : Budget documents

Box 2.1 : Budget 2005-06 : Direct taxes

- The basic exemption limit for personal income tax increased: in general to Rs.1 lakh; for women to Rs.1.35 lakh; and for senior citizens to Rs.1.85 lakh.
- The personal income tax rates modified: to 10 per cent for income between Rs.1 lakh to Rs.1.5 lakh; 20 per cent for income between Rs.1.5 lakh to Rs.2.5 lakh; 30 per cent for income above Rs.2.5 lakh. Surcharge at 2.5 per cent applicable in the case of individuals, HUFs, association of persons and body of individuals on taxable income above Rs.10 lakh.
- Standard deduction withdrawn. All prevailing sectoral caps/rebate under Section 88, 88B and 88C removed.
- Investment in financial instruments hitherto eligible for rebate under section 88 eligible for deduction from income under new section 80C with an overall cap of Rs.1 lakh. Sectoral caps on house loan repayment, tuition fees, contribution to provident fund payment, etc. removed.
- Deduction provided in respect of interest on certain securities etc. under Section 80L withdrawn.
- One-in-six criteria for filing income tax returns modified. Cellular phones removed from the list and expenditure exceeding Rs.50,000 on electricity consumption in any previous year included.
- The corporate income tax rate for domestic companies and firms reduced from 35 per cent to 30 per cent. However, a surcharge of 10 per cent applies.
- A new fringe benefits tax introduced on the value of benefits provided by the employer for the collective enjoyment of the employees. The tax at 30 per cent on the value of such fringe benefits is payable by the employer. The tax would, *inter alia*, include benefits like entertainment, conveyance, tour & travel, use of hotel, boarding & lodging facilities, and gifts.
- Banking Cash Transaction Tax (BCTT) at 0.1 per cent introduced on withdrawal of cash from bank on a single day of Rs.25,000 or more by individuals or HUF and Rs.1 lakh by persons other than individuals and HUF. Banks to report all deposits which are exempt from tax deduction at source on interest. Cash withdrawals from savings account and purchase of demand draft for cash exempt from BCTT.
- BCTT is applicable for encashment of term deposits if cash received during a single day exceeds the limit.
- Credit for MAT paid under section 115JB provided against tax liability that arises in subsequent years.
- Exemption for interest on Non-Resident (External) Account continued.
- Authorities constituted under the Central or State Act and operating, developing and maintaining an infrastructure facility eligible for 100 per cent deduction of profits for a period of 10 years.
- Rates of depreciation on plant & machinery reduced from 25 per cent to 15 per cent.
- Additional depreciation on new plant & machinery acquired after April 1, 2005 increased to 20 per cent.
- The rates for Securities Transaction Tax (STT) for all categories of transactions increased by 33.33 per cent.

threshold in a single day. (Box 2.1). Taking a leaf out of the international best practices, corporate income tax was reduced to 30 per cent, albeit with a higher surcharge of 10 per cent and reduced depreciation allowance that is a better approximation to the replacement life-value. Further, the withholding tax on technical services was reduced from 20 per cent to 10 per cent. To facilitate large taxpayers, new large taxpayer units (LTUs) providing single window service were proposed to be established.

b) Indirect taxes

2.15 Adhering to the pre-announced commitment to align customs duties to ASEAN levels, Budget for 2005-06 reduced peak customs duty on non-agricultural products to 15 per cent with steeper reductions for capital goods and raw materials and corrections for inverted duty structures. As a part of oil prices management, in an era of unprecedented rise in international prices, customs duty on crude petroleum was halved from 10 per cent to 5 per cent; customs duty on petroleum products reduced to 10 per cent from 20 per cent and 15 per cent; customs duty on subsidised products, namely domestic LPG and PDS kerosene, made nil; and excise duties on motor spirit and high speed diesel converted to specific duties together with an

Box 2.2 : Indirect taxes: Customs

- Peak rate of customs duties for non-agricultural products reduced from 20 per cent to 15 per cent.
- To promote investment, customs duties on selected capital goods and parts thereof reduced to 10.5 per cent.
- Duty on textile machinery and refrigerated vans reduced from 20 per cent to 10 per cent.
- Duties on seven specified machinery used in leather and footwear industry reduced to 5 per cent from 20 per cent; duty on ethyl vinyl acetate reduced from 20 per cent to 10 per cent.
- Duty on nine specified machinery used in pharma and biotech sectors reduced to 5 per cent.
- Duties on specified parts of battery-operated road vehicles and for printing presses reduced from 20 per cent to 10 per cent.
- To encourage indigenous industries, duties on primary and semi-finished forms of metal viz., stainless steel, other alloy steel, ferro-alloys, aluminum, copper, zinc, tin etc. reduced from 15 per cent to 10 per cent;
- Customs duty on industrial raw materials such as catalysts, refractory raw materials, basic plastic materials, molasses and industrial ethyl alcohol reduced to 10 per cent; duty on lead reduced from 15 per cent to 5 per cent.
- Duty on coking coal with high ash content reduced to 5 per cent.
- Duty on polyester and nylon chips, textile fibres, yarns and intermediates, fabrics, and garments reduced from 20 per cent to 15 per cent.
- Customs duty on specified capital goods and all inputs required for the manufacture of Information Technology Agreement (ITA) bound items removed.
- A CVD of 4 per cent levied on the imports of ITA bound items and their inputs that attract nil duty; credit for the CVD made available against payment of excise duty; IT software exempted from the proposed CVD.
- Duty on atmospheric drinking water generators reduced from 20 per cent to 5 per cent.
- Customs duty structure of petroleum sector rationalized: duty on crude reduced from 10 per cent to 5 per cent; nil rate of duty on LPG for domestic consumption and on subsidized kerosene; and duty on other petroleum products, including motor spirit (MS) and diesel (HSD) reduced from 20 or 15 per cent to 10 per cent.

Box 2.3 : Indirect taxes : Excise and service tax

Excise:

- Duty on polyester filament yarn, tyres and air conditioners reduced to 16 per cent.
- Independent texturizers given the option to avail the exemption route or pay 8 per cent excise duty with CENVAT credit.
- Excise duties on MS or petrol, and HSD fixed as a combination of *ad valorem* and specific duties: at 8 per cent plus Rs.13 per litre for MS, and 8 per cent plus Rs.3.25 per litre for HSD.
- Duty on Liquified Petroleum Gas (LPG) for supply to domestic households and kerosene for ultimate sale through public distribution system reduced from 8 per cent to nil.
- Excise duty on tyres, tubes and flaps reduced from 24 per cent to 16 per cent.
- Duty on polyester filament yarn including texturised yarn reduced from 24 per cent to 16 per cent and optional duty of 8 per cent extended to processed filament yarns including polyester filament yarn, manufactured from yarn procured from outside by independent processors.
- Duty on branded jewellery pegged at 2 per cent; on mosaic tiles at 8 per cent; and on road tractors for semi trailers of engine capacity exceeding 1800 cc at 16 per cent; agricultural tractors continues to be exempt.
- Surcharge of Re.1 per kg on tea; duty of Re.1 per kg on refined edible oils; and Rs.1.25 per kg on vanaspati abolished.
- Ceiling for annual turnover-based SSI exemption raised from Rs.3 crore to Rs.4 crore. SSI units have two options: either full exemption on the first clearance of Rs.1 crore or normal duty on the first clearance of Rs.1 crore with CENVAT credit.
- Duty on iron and steel raised from 12 per cent to 16 per cent.
- Duty on molasses per MT increased from Rs.500 to Rs.1,000; duty on cement clinkers per MT increased from Rs.250 to Rs.350 as an anti-avoidance measure.
- Cess on MS and HSD increased by 50 paise per litre to raise additional resources for the National Highways Development Project.
- Specific rate on cigarettes raised by about 10 per cent and a surcharge of 10 per cent introduced on other tobacco products including gutka, chewing tobacco, snuff and pan masala excluding biris.

Service Tax

- Service tax rate increased from 8 per cent to 10 per cent.
- From April 1, 2005, an exemption scheme for small service providers with aggregate taxable services of no more than Rs.4 lakh during the preceding financial year.
- Production/processing of goods from the inputs received from a manufacturer, which was returned to the same manufacturer for manufacture of final products, which are cleared on payment of excise duty, exempt.

8 per cent *ad valorem* component (Boxes 2.2 and 2.3). A surcharge was imposed on pan masala and certain specified tobacco products to finance the National Rural Health Mission. This additional duty was charged at specified rates on cigarettes equivalent to 10 per cent of the aggregate of normal rates of excise duty payable on pan masala and other tobacco products except biris. In excise, Government intends to bring as many goods as possible to the median CENVAT rate of 16 per cent. Towards this, the Budget for 2005-06 reduced duties on polyester filament yarn, tyres and air-conditioners from 24 per cent to 16 per cent.

2.16 In a significant move, the Budget for 2005-06 announced Government's intent to rectify the anomaly of State-level taxes on domestic production that is not countervailed on direct import of such products by end-users. This is to be achieved through the levy of a countervailing duty of 4 per cent on all imports. For the current year though, this was only levied on the imports of Information Technology Agreement bound items and their inputs that attract nil duty.

Service tax

2.17 From a modest beginning in 1994-95, service tax has grown into a significant source of revenue, with Rs.14,200 crore realised in 2004-05. It was budgeted at Rs.17,500 crore in 2005-06(BE). A part of the budgeted growth is attributable to the 2-percentage point increase in the rate of tax. Continuing with the practice of bringing additional services in to the tax net, the Budget for 2005-06 added the following 9 items to the list of taxable services: transport of goods through pipeline or other conduit; site preparation and clearance, excavation, earth moving and demolition services, other than those provided to agriculture, irrigation and watershed development; dredging services of rivers, ports, harbours, backwaters and estuaries; survey and map making other than by Government Departments; cleaning services other than in relation to agriculture, horticulture, animal husbandry or dairying; membership of clubs or associations; packaging services; mailing list compilation and mailing; and construction of residential complexes having more than twelve residential units of apartments together with common areas and other appurtenances.

2.18 Besides, the scope of existing services was also expanded. These were : commercial or industrial construction service to include renovation of such building or civil structure, post construction completion and finishing services for such building or civil structure, construction, repair, alteration, renovation or restoration of pipeline or conduits; erection, commissioning or installation services to include specified installation services; maintenance or repair services to include maintenance or management of immovable properties, maintenance or repair including reconditioning or restoration undertaken as part of any contract or agreement; broadcasting services to include charges recovered by broadcasting agencies from multi-system operator and provision of direct to home signals to the customers; sound recording to include recording of sound on any media and includes post production services such as sound mixing or re-mixing; video-tape production to include recording of any programme, event or function on any media and includes post production services; taxable services provided by authorised service station to include reconditioning or restoration of motor-cars, two wheeled and light motor vehicles; beauty parlours service to include all services provided by beauty parlours; manpower recruitment service to include supply of manpower, temporary or otherwise; franchisee service to cover all agreements by which, the franchisor grants representational rights to franchise to sell or manufacture goods or provide services identified with the franchisor; business auxiliary service to include production or processing of goods for or on behalf of the client; and outdoor catering service, to include catering from a place or premises provided, by way of tenancy or otherwise by the person receiving such services. Such measures at widening the tax base and procedures that facilitate voluntary compliance, going forward, would make service tax a buoyant source of revenue commensurate with its high share in GDP.

Expenditure trends

2.19 The NCMP has pledged to raise the level of public spending in education to at least 6 per cent of GDP and on health to at least 2-3 per cent of GDP in a phased manner. Further, it attaches highest priority to the development and expansion of physical infrastructure like roads, highways, ports, power, railways, water supply, sewage treatment and sanitation through higher public investment, even as the role of the private sector is expanded. This has to be accomplished in an overarching framework of fiscal consolidation. As about 86 per cent of the revenue receipts in 2005-06 is appropriated by committed expenditure like interest payments, subsidies, pay, pensions and defence, expenditure reprioritization needs to be calibrated through higher allocation of incremental revenue towards the NCMP objectives.

2.20 A straightforward comparison of the total expenditure in the last three years is misleading because of the large unbudgeted non-plan expenditure on capital account, which was in the nature of a balancing item corresponding to the debt swap prepayment proceeds shown against capital receipts under the head 'recovery of loans'. Adjusting for this entry, total expenditure as a proportion of GDP, works out to 16.3 per cent, 15.5 per cent and 14.9 per cent for 2002-03, 2003-04 and 2004-05, respectively. With similar adjustment, capital expenditure as a proportion of GDP for the same period works out to 2.5 per cent, 2.3 per cent and 2.6 per cent, respectively. As a proportion of GDP, total expenditure of the Central Government was budgeted at 14.6 per cent of GDP in 2005-06. Capital expenditure was budgeted at 1.9 per cent of GDP in 2005-06, the decline reflecting the impact of the discontinuance of State-loan-intermediation by the Central Government.

2.21 An important objective of the FRBMA is that public expenditure must be reoriented for the creation of productive assets. Given the existing classification of expenditure, plan expenditure is arguably the closest approximation to expenditure for creation of productive assets. As a proportion of GDP, plan expenditure, after declining from 5.0 per cent in 1990-91 to 3.8 per cent in 1998-99, started rising again to reach 4.6 per cent in 2002-03 and declined to 4.4 per cent in 2003-04 and 4.2 per cent in 2004-05. Plan expenditure was budgeted at 4.1 per cent of GDP in 2005-06. As a proportion of GDP, non-plan expenditure followed a similar pattern, desirable though, and fell from 12.3 per cent in 1990-91 to reach 10.0 per cent in 1996-97. The proportion rose again to reach 11.5 per cent in 2000-01. With adjustments, the proportion declined to 11.0 per cent and 10.7 per cent in 2003-04 and 2004-05, respectively, and was budgeted at 10.5 per cent in 2005-06.

Interest payments

2.22 Persistent and high deficits seriously impair the counter cyclical ability of fiscal policy, lead to unsustainable debt build up and adversely affect the composition of expenditure through larger and larger interest outgo. As a proportion of GDP, interest payments after remaining at highs of 4.6 per cent to 4.8 per cent in the four-year period from 1999-2000 to 2002-03, started declining to reach 4.1 per cent in 2004-05(Prov.). This virtuous decline was partly on account of the soft interest rate regime in vogue. As a proportion of revenue receipts, interest payments declined from a high of 53.4 per cent in 2001-02 to 41.5 per cent in 2004-05. The proportion was budgeted at 38.1 per cent in 2005-06. These declining trends, both as a proportion of GDP as well as a proportion of revenue receipts, are on account of the progressive reduction in the average cost of borrowing (Table 2.4). The average cost of borrowing, including those under MSS, is budgeted at 8.1 per cent in 2005-06. Bringing down the average cost of borrowing and reducing, in general, the interest outgo are critical to fiscal consolidation, growth and macroeconomic stability.

Subsidies

2.23 Subsidies are an important fiscal policy tool for correcting market failures, particularly under-consumption of basic essentials such as food. With direct provision by the State, major subsidies, mainly on food, fertiliser and petroleum grew from Rs.40,716 crore in 2002-03 to Rs.43,455 crore in 2003-04. Expenditure on major subsidies remained high

Table 2.4 : Interest on outstanding internal liabilities of Central Government

	Outstanding internal liabilities	Interest on internal liabilities*	Average cost of borrowings (per cent 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	933000	85741	10.3
2000-01	1047976	94900	10.2
2001-02	1196245	103175	9.8
2002-03	1323704	113238	9.5
2003-04	1457583	116869	8.8
2004-05(RE)	1605734	123108	8.4
2005-06(BE)	1756460	130833	8.1

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

2. Outstanding internal liabilities exclude NSSF loans to States, with no interest liability on the part of the Centre.

* Excludes Rs.313.61 crore and Rs. 4079.62 crore towards premium on account of domestic debt buyback scheme and prepayment of external debt for 2002-03 and 2003-04 respectively.

Source : Budget documents.

at Rs.45,187 crore in 2004-05 (RE). As a proportion of GDP, subsidies fell from 1.66 per cent in 2002-03 to 1.45 per cent in 2004-05(RE) and was budgeted at Rs.46,358 crore or 1.31 per cent of GDP in 2005-06. However, the apparent decline needs to be seen in the context of the measures taken to facilitate liquidation of stocks and drought conditions that entailed a huge additional outgo in 2002-03 through 2003-04 in the first place.

2.24 The extant food subsidy as a fiscal policy tool seeks to serve two separate and potentially conflicting objectives of protecting producers' interest through payment of 'remunerative' prices and also keeping prices stable/low for consumers. With the inefficiencies and rent-seeking associated with the public provision of goods and services, the income transfer to poor consumers through a unit increase in subsidy goes down. A recent study, "Performance Evaluation of the Targeted Public Distribution system" by the Programme Evaluation Organisation, Planning Commission has estimated that to transfer Re. 1 to the poor, Government spends Rs.3.65 in the form of food subsidy, indicating that cash or near cash transfer could lead to large welfare gains for the poor. With the unprecedented rise in the international prices of petroleum, given the sizeable production through high cost feedstock in urea units, fertiliser subsidy rose sharply from Rs.11,847 crore in 2003-04 to Rs.15,662 crore in 2004-05(RE) and further to Rs.16,254 crore in 2005-06 (BE).

Supplementary demands for grants

2.25 There were two supplementary demands for grants for which Parliament gave its approval. The first batch of demands included 42 grants involving a net cash outgo aggregating to Rs.6,819 crore. Together with the demands for additional expenditure, of a technical nature without cash outgo, of Rs.7,842 crore, the gross additional expenditure authorised amounted to Rs.14,661 crore. The major items involving cash outgo included grants-in-aid to Government of Jammu & Kashmir under Special Central Assistance (SCA) and one time Additional Central Assistance (ACA) for other projects (Rs.632 crore); grants-in-aid to States for irrigation/water resources (Rs.672 crore); grants-in-aid for Accelerated Power Development Programme (Rs.542 crore); loans and advances to States under ACA for externally aided projects (Rs.3,376 crore); and compensation to Bharat Sanchar Nigam Limited for rural telephony (Rs.617 crore). Two major items of expenditure of technical nature were liquidation of audited balances outstanding in the oil pool account through the issue of special securities (Rs.5,763 crore) and transfer of rural electrification provision from Ministry of Finance to Ministry of Power. (Rs.1,100 crore).

2.26 Approval for the second batch of supplementary demands for grants for 48 items accorded by the Parliament authorised gross additional expenditure of Rs. 9,080 crore. Net cash outgo involved was Rs.1,965 crore and the rest were matched by savings or enhanced receipts. The major items of expenditure with cash outgo included:

subsidies on fertilisers (Rs.1,000 crore); settlement of outstanding claims of State Trading Corporation (Rs.104 crore); transfers to States/UTs from National Calamity Contingency Fund (Rs. 200 crore); lump sum provisions for revival and restructuring of public sector enterprises (Rs. 210 crore); and reimbursement of losses to the Cotton Corporation of India (Rs.256 crore). The major items of expenditure of a technical nature, that is, without net cash outgo were compensation through issue of bonds to oil marketing companies towards estimated under recoveries in 2005-06 on account of domestic LPG and PDS Kerosene (Rs.5,750 crore) and meeting additional expenditure of Delhi Metro Rail Corporation Limited (Rs.500 crore).

Central plan outlay

2.27 The Budget for 2004-05 envisaged a Central Plan outlay of Rs.1,63,720 crore, the RE for which was placed at Rs.1,50,818 crore, indicating a shortfall of 7.9 per cent attributable to the 9.9 per cent lower than budgeted internal and extra budgetary resources (IEBR) of Central Public Sector Enterprises (CPSEs). Budget support to the plan was lower than BE by 6.1 per cent. The Budget for 2005-06 hiked the Central Plan outlay by 40.1 per cent to Rs.2,11,253 crore. This outlay is composed of Budget support of Rs.1,10,385 crore and IEBR of CPSEs of Rs.1,00,868 crore. The IEBR and Budget support for this year are 33 per cent and 25.6 per cent higher than BE 2004-05. The relative share of important heads of development are: energy (27.5 per cent); transport (20.1 per cent); communication (5.7 per cent); social services (25.3 per cent); irrigation and flood control (0.2 per cent); rural development (6.6 per cent); agriculture and allied activities (3.0 per cent); and industry and minerals (5.7 per cent). Central assistance for States & UTs plans for 2005-06 is budgeted at Rs.33,112 crore, indicating a decline of 39.6 per cent over 2004-05 (RE) and reflecting the impact of discontinuance of loan intermediation by the Centre.

States and Union Territories

2.28 The resources mobilised for the Annual Plans of States and UTs in 2004-05 (RE) amounted to Rs.1,14,209 crore compared to the BE of Rs.1,17,911 crore. Aggregate resources for the Annual Plan 2005-06 of States and UTs with legislatures were estimated at Rs.1,39,393 crore, consisting of States' own resources of Rs.1,06,281 crore and central assistance of Rs.33,112 crore.

Government debt

2.29 As a proportion of GDP, outstanding liabilities of the Central Government (including external debt at historical exchange rate) declined from 55.3 per cent in 1990-91 to reach 49.4 per cent in 1996-97, reflecting the lower fiscal deficit in the intervening years. This trend got reversed subsequently and outstanding liabilities as a proportion of GDP rose to 63.5 per cent in 2004-05 (RE) and were budgeted to decline marginally to 63.2 per cent in 2005-06 (Table 2.5).

2.30 The Central Government debt is composed primarily of internal debt, which includes market loans (as also treasury bills) and relief/savings bonds and others. The share of debt in total internal liabilities rose from 54.4 per cent in 1990-91 to 65.9 per cent in 2004-05 (RE). Market borrowings, as a proportion of Government debt, after increasing from 22.4 per cent in 1990-91 to 39.7 per cent in 2002-03, declined marginally to 38.3 per cent in 2004-05 (RE). The RBI in consultation with Ministry of Finance fixes biannual indicative issuance calendar for Government borrowings. The Budget for 2005-06 placed the net market borrowings (dated securities and 364-day Treasurey Bills excluding borrowings under MSS) at Rs.1,03,695 crore. With repayments of Rs.61,676 crore, the gross market borrowings is estimated at Rs.1,65,467 crore. The actual gross and net market borrowings of the Central Government (excluding borrowing under MSS) in the financial year up to February 7, 2006 are placed at Rs.1,39,010 crore and Rs.83,329 crore as compared with Rs.98,900 crore and Rs. 61,044 crore in the corresponding period of the previous year. The outstanding balances under MSS declined from Rs. 65,481 crore as at end-March 2005 to Rs. 36,028 crore by February 7, 2006. The banks have been subscribing to Government securities much in excess of their statutory

Table 2.5 : Outstanding liabilities of the Central Government

(end-March)

		1990-91	2000-01	2001-02	2002-03	2003-04	2004-05 (RE)	2005-06 (BE)##
					(Rs. crore)			
1.	**Internal liabilities**	**283033**	**1102596**	**1294862**	**1499589**	**1690554**	**1927155**	**2168671**
	a) Internal debt	154004	803698	913061	1020688	1141706	1270272	1406525
	i) Market borrowings	70520	428793	516517	619105	707965	758999	870836
	ii) Others	83484	374905	396544	401583	433741	511273	535689
	b) Other Internal liabilities	129029	298898	381801	478901	548848	656883	762146
2.	**External debt (outstanding)***	**31525**	**65945**	**71546**	**59612**	**46124**	**54359**	**63215**
3.	**Total outstanding liabilities (1+2)**	**314558**	**1168541**	**1366408**	**1559201**	**1736678**	**1981514**	**2231886**
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**	**1168241**	**1366108**	**1558901**	**1736378**	**1981214**	**2231586**
					(As per cent of GDP)			
1.	**Internal liabilities**	**49.8**	**52.3**	**56.8**	**61.2**	**61.2**	**61.7**	**61.4**
	a) Internal debt	27.1	38.1	40.0	41.7	41.4	40.7	39.9
	i) Market borrowings	12.4	20.3	22.6	25.3	25.6	24.3	24.7
	ii) Others	14.7	17.8	17.4	16.4	15.7	16.4	15.2
	b) Other Internal liabilities	22.7	14.2	16.7	19.5	19.9	21.0	21.6
2.	**External debt(outstanding)***	**5.5**	**3.1**	**3.1**	**2.4**	**1.7**	**1.7**	**1.8**
3.	**Total outstanding liabilities**	**55.3**	**55.4**	**59.9**	**63.6**	**62.9**	**63.5**	**63.2**
	Memorandum items							
	(a) External debt (Rs.crore)@	66314	189990	199639	196067	184177	191182	n.a.
	(as per cent of GDP)	11.7	9.0	8.8	8.0	6.7	6.1	n.a.
	(b) Total outstanding liabilities	349347	1292586	1494501	1695656	1874731	2118337	n.a.
	(as per cent of GDP) (adjusted) (Rs.crore)	61.4	61.3	65.5	69.2	67.9	67.9	n.a.
	(c) Internal liabilities(Non-RBI)#	208978	956478	1142698	1337752	1529571	1772992	2016052
	(as per cent of GDP)	36.7	45.4	50.1	54.6	55.4	56.8	57.1
	(d) Outstanding liabilities (Non-RBI) #	275292	1146468	1342337	1533819	1713748	1964174	n.a.
	Outstanding liabilities (Non-RBI) (as per cent of GDP)	48.4	54.4	58.8	62.6	62.1	62.9	0.0
	(e) Contingent liabilities of Central Government (Rs.crore)	n.a.	86862	95859	90617	87780	n.a.	n.a.
	Contingent liabilities of Central Government (as per cent of GDP)	n.a.	4.1	4.2	3.7	3.2	n.a.	n.a.
	(f) Total assets (Rs crore)	236740	676581	760592	840768	903558	1084398	1242596
	Total assets (as per cent of GDP)	41.6	32.1	33.3	34.3	32.7	34.7	35.7

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.**

\# # **Internal debt includes net borrowing of Rs. 65,481 crore for 2004-05(RE) and Rs. 80,500 crore for 2005-06(BE) under Market Stabilisation Scheme.**

Note: The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.

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

liquidity ratio (SLR) requirement. With the pick up in non-food credit (details in Chapter 3), such investments are placed at 32.1 per cent of net demand and liabilities of scheduled commercial banks as on January 20, 2006.

Economic and functional classification

2.31 The economic and functional classification of the Central Government Budget 2005-06, which reclassifies budgetary transactions in significant economic categories on the lines of national income accounts, places the total expenditure at Rs.5,12,995 crore, indicating an increase of 8.5 per cent over 2004-05 (RE). The total expenditure was composed of consumption expenditure of Rs.1,25,607 crore (24.5 per cent), transfers of Rs.3,05,576 crore (59.6 per cent) and gross capital formation of Rs.81,812 crore (15.9 per cent) (Table 2.6). In terms of functional classification, general

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	2000-01	2001-02	2002-03	2003-04	2004-05 (RE)	2005-06 (BE)
					(Rs. crore)			
I.	**Total expenditure**	**97947**	**328265**	**360616**	**398879**	**426132**	**473010**	**512995**
II.	**Gross capital formation out of budgetary resources of Central Government**	**28032**	**66960**	**76888**	**76782**	**82561**	**95234**	**81812**
	(i) Gross capital formation by the Central Government	8602	22258	12634	21697	23997	30807	36871
	(ii) Financial assistance for capital formation in the rest of the economy	19430	44702	64254	55085	58564	64427	44941
III.	**Gross saving of the Central Government**	**-10502**	**-56920**	**-76306**	**-81734**	**-71968**	**-70854**	**-74475**
IV.	**Gap(II-III)**	**38534**	**123880**	**153194**	**158516**	**154529**	**166088**	**156287**
	Financed by							
	a. Draft on other sectors of domestic economy	34768	115561	145841	168582	165858	153988	143413
	(i) Domestic capital receipts	23421	116758	147337	166699	169800	132456	139823
	(ii) Budgetary deficit/draw down of cash balance	11347	-1197	-1496	1883	-3942	21532	3590
b.	Draft on foreign savings	3766	8319	7353	-10066	-11329	12100	12874
					(As per cent of GDP)			
I.	**Total expenditure**	**17.2**	**15.6**	**15.8**	**16.3**	**15.4**	**15.2**	**14.5**
II.	**Gross capital formation out of budgetary resources of Central Government**	**4.9**	**3.2**	**3.4**	**3.1**	**3.0**	**3.1**	**2.3**
	(i) Gross capital formation by the Central Government	1.5	1.1	0.6	0.9	0.9	1.0	1.0
	(ii) Financial assistance for capital formation in the rest of the economy	3.4	2.1	2.8	2.2	2.1	2.1	1.3
III.	**Gross saving of the Central Government**	**-1.8**	**-2.7**	**-3.3**	**-3.3**	**-2.6**	**-2.3**	**-2.1**
IV.	**Gap(II-III)**	**6.8**	**5.9**	**6.7**	**6.5**	**5.6**	**5.3**	**4.4**
	Financed by							
	a. Draft on other sectors of domestic economy	6.1	5.5	6.4	6.9	6.0	4.9	4.1
	(i) Domestic capital receipts	4.1	5.5	6.5	6.8	6.2	4.2	4.0
	(ii) Budgetary deficit/draw down of cash balance	2.0	-0.1	-0.1	0.1	-0.1	0.7	0.1
	b. Draft on foreign savings	0.7	0.4	0.3	-0.4	-0.4	0.4	0.4
					(increase over previous year)			
II.	**Gross capital formation out of budgetary resources of Central Government**	**2.8**	**-0.9**	**14.8**	**-0.1**	**7.5**	**15.3**	**-14.1**
	Memorandum items							
					(Rs. crore)			
1	**Consumption expenditure**	**22359**	**71977**	**77324**	**85389**	**87170**	**113574**	**125607**
2	**Current transfers**	**45134**	**183696**	**201188**	**228501**	**248436**	**256959**	**300156**
					(As per cent of GDP)			
1	**Consumption expenditure**	**3.9**	**3.4**	**3.4**	**3.5**	**3.2**	**3.6**	**3.6**
2	**Current transfers**	**7.9**	**8.7**	**8.8**	**9.3**	**9.0**	**8.2**	**8.5**

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.
(vi) The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.

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

services account for 24.7 per cent of total expenditure, social and economic services account for 35.8 per cent, and 39.5 per cent was unallocable being in the nature of statutory grants-in-aid to States, non-plan grants, food and other consumer subsidies, etc.

2.32 The share of wages and salaries within consumption expenditure fell marginally from 39.8 per cent in 2004-05(RE) to 39.4 per cent in 2005-06 (BE). The reclassification shows that share of grants in total expenditure went up from 20.8 per cent in 2004-05 (RE) to 26.9 per cent in 2005-06 (BE), reflecting the impact of implementation of the TFC award. Gross capital formation out of the budgetary resources of the Central Government improved to 20.1 per cent of total expenditure in 2004-05 (RE) and was budgeted at 15.9 per cent in 2005-06 (BE). The apparent decline needs to be seen in the light of the discontinuance of loan intermediation by the Centre. Dissavings of the Central Government, which grew steadily from Rs.10,502 crore in 1990-91 to Rs.81,734 crore in 2002-03, was reduced to Rs.71,968 crore in 2003-04 and further to Rs.70,854 crore in 2004-05 (RE). It was budgeted to increase to Rs.74,475 crore in 2005-06. As a proportion of GDP, dissavings were placed at 2.3 per cent in 2004-05 (RE) and 2.1 per cent in 2005-06 (BE).

Expenditure management

2.33 Public expenditure management is an integral part of the fiscal reforms and the Government has been taking a series of initiatives in this regard, like avoiding rush of expenditure through releases in a time sliced manner and simplification of procedures. Recent initiatives include: special drive to bring down outstanding 'unspent balances' and 'utilisation certificates' from States and other implementing agencies; instructions that prohibit relaxation of conditionalities attached to transfer of funds under Plan schemes; revision of General Financial Rules (Box 2.4); to ensure transparency, competition, fairness and objectivity in the procurement/bidding processes in the Government, constitution of three Working Groups, one each for 'Goods', 'Works' and 'Consultancy', for preparation of 'Manual of Policies and Procedures', 'Bidding Documents', 'Guidelines to Purchaser', 'Guidelines to supplier', and 'Draft Standard Contracts' for different categories; to speed up the process of transmission of funds and simultaneously to facilitate faster feedback on unspent balances through utilization certificates; and e-banking scheme for transfer of funds to district level implementation agencies by three big social sector Ministries, namely, the Ministries of Human Resource Development, Rural Development and Health & Family Welfare has been taken up and expected to cover all District Rural Development Agencies.

Collection rates

2.34 The peak rate of customs duty was brought down from 150 per cent in 1991-92 progressively to 15 per cent in the Budget for 2005-06. As the spread between peak rate and average effective rate of duty was high to begin with, the initial reductions in the former did not have significant adverse impact on revenues. However, with the spread coming down, revenue growth from customs decelerated. Since there were numerous rates and exemptions, the closest approximation to the average effective rates for customs duty for different sectors are given by the relevant collection rates. The collection rate for all commodity groups combined fell from 47 per

Box 2.4 : General Financial Rules 2005

General Financial Rules (GFRs) are a compendium of general provisions to be followed by all offices of the Government of India while dealing with matters of a financial nature. The unamended rules, which were in the nature of executive instructions, had become obsolete with developments in the delivery system like outsourcing and the use of information technology. A Task Force was set up for revising the rules. The existing rules as well as the plethora of Government decisions were reviewed by a Task Force with the following basic approach: -

- To take into account recent developments in the financial sector, availability of new instruments in banking, insurance, material sourcing, information technology, communications, etc.
- To simplify procedures, causing unnecessary movement of papers between several layers of Government, devolving necessary authority, responsibility and direct accountability on the vital functionaries in Government to ensure speedier decision-making.

Based on their Report, the new General Financial Rules were notified from July 1, 2005. It is expected that General Financial Rules, 2005 will provide greater flexibility to officers in transacting government business while ensuring accountability commensurate with responsibility at different levels.

cent in 1990-91 to 12 per cent in 2004-05 (Prov). There are large variations in the collection rates for various groups with a continued high of above 40 per cent only in the man-made fibre group. Metals and chemicals also continue to have high collection rates, though they have come down in the last few years (Table 2.7).

Post Budget developments

2.35 The NCMP has pledged to provide livelihood security through guaranteed minimum 100 days' employment to people in rural areas. The NREG bill was passed by Parliament in August 2005 and the implementation arrangements were put in place. International oil prices, with brief respites, continue to remain high, posing a challenge to the macro-economic management in general and the financial health of public sector oil companies in particular. Prices of petroleum products were revised twice on June 20, 2005 and September 6, 2005. The burden of the adverse impact of the rise in international oil prices was borne equitably by the Government and public sector oil companies, both upstream and downstream. The oil companies have posted cash losses and are estimated to be saddled with 'under-recoveries' to the extent of about Rs.40,000 crore in 2005-06. As per the decision taken at the time of last revision of prices on September 6, the Government decided to absorb a part of the burden through the issue of special oil bonds. An amount of Rs. 5,750 crore has been provisioned in the supplementary demand for grants for this purpose.

2.36 To overcome the serious infrastructure deficit that has been constraining the economy from realising its full growth potential, a scheme of viability gap funding has been envisaged. The public-private partnership (PPP) infrastructure projects at the margin that would otherwise not have taken off are being facilitated through a capital grant (not exceeding 20 per cent of total cost) at the stage of construction. With the establishment and commencement of operations of IIFCL, the SPV for infrastructure financing, the sector is likely to get the much-awaited long-term finances.

Table 2.7 : Collection rates* for selected import groups

(in per cent)

Sl. No.	Commodity Groups	1990-91	1995-96	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05 (Prov.)
1	Food products	47	23	15	31	40	30	19	22
2	POL	34	30	23	16	10	11	11	10
3	Chemicals	92	44	36	38	29	28	24	23
4	Man-made fibres	83	36	64	49	31	31	46	40
5	Paper & newsprint	24	8	9	8	6	7	7	8
6	Natural fibres	20	12	24	18	8	10	13	11
7	Metals	95	52	55	48	36	36	32	27
8	Capital goods	60	33	36	36	28	23	19	16
9	Others	20	13	12	12	9	9	8	6
10	Non POL	51	28	22	23	19	17	14	12
11	**Total**	**47**	**29**	**22**	**21**	**16**	**15**	**14**	**12**

* 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, project imports and electrical machinery.

Source : Department of Revenue, Ministry of Finance

2.37 The Budget for 2005-06 had cautioned that outlays do not necessarily translate into outcomes. With a view to facilitate civil society's active involvement in the development process, an outcome budget was unveiled on August 25, 2005, which provides a framework of monitorable performance indicators for the plan programmes. This, together with independent and in-depth evaluation of the plan schemes and programmes once every five years, would provide transparency and accountability and enable the citizens to objectively judge the performance of the schemes, which remains a critical element in the working of a democratic polity. (Box 2.5)

Fiscal outcome 2005-06 so far

2.38 The demands on resources from various quarters, including that arising from the implementation of the TFC award, have led to the pressing of the 'pause' button in respect of revenue deficit in the very second year of the operation of FRBMA. The Budget for 2005-06 had estimated a growth in gross tax revenue of 21.3 per cent with the gross tax to GDP ratio rising to 10.5 per cent from 9.8 per cent in 2004-05 (Prov.). This budgeted growth in gross tax revenue, in spite of a decline in customs revenues by 7.8 per cent, was composed of growth in: corporate income tax of 32.3 per cent; personal income tax of 37.1 per cent; excise revenues of 22.6 per cent; service tax revenues of 23.2 per cent. With total expenditure budgeted to grow at 3.2 per cent, fiscal and revenue deficits as proportions of GDP were estimated at 4.3 per cent and 2.7 per cent, respectively.

2.39 As per the data on Central Government finances published by the

Box 2.5 : Outcome Budget

A system of performance budgeting by Ministries handling development programmes was introduced in 1969 following the recommendations of the Administrative Reforms Commission. For long, a need has been felt to address certain weaknesses that have crept into the performance budgeting framework such as lack of clear one-to-one relationship between the financial and the performance budgets and inadequate target-setting in physical terms for the ensuing year. Besides, there is a growing concern to track not just the more readily measurable intermediate physical "outputs" but the "outcomes", which are the end objectives of State intervention, as articulated by the Finance Minister in Para 100 of his 2005-06 Budget Speech. Outcome Budget 2005-06, with a conceptual framework and a broad roadmap of future reforms in this area, was accordingly presented to Parliament on August 25, 2005.

Outlays or inputs; outputs; outcomes or impact:

The process of conversion of outlays into outcomes is a long one with several intermediate stages and complementary resources required in achieving intended impact. The cause and effect chain is not always direct, and several environmental factors influence the actual impact and outcomes.

Outlays are financial resources deployed for achieving certain outcomes. Part of the money may be directly from the budget and part from other stakeholders such as State Governments, public sector undertakings (PSUs) or even private parties in the growing area of PPP. **Inputs** are physical resources subsumed under outlays.

Outputs are a measure of the physical quantity of the goods or services produced through a government scheme or programme. They are usually an intermediate stage between 'outlays' and 'outcomes'. For example, construction of a school building is the 'output', while increase in the literacy rate is the 'final outcome' or impact.

Outcomes or impact are the end results of various Government initiatives and interventions. Going beyond mere 'outputs', they cover the quality and effectiveness of the goods or services produced as a consequence of an intervention. In poverty monitoring, impact is placed at a higher level than outcomes. Overall well-being or living standards of the poor is treated as a higher level impact with outcome defined as poor's access to and use of goods and services.

Goals, indicators and targets have been drawn up for various schemes and programmes. The Ministries/ Departments would engage independent evaluators and assessment agencies for scrutiny/evaluation of the achievements against physical outputs and final outcomes of major flagship schemes. Guidelines for preparation of the outcome budget by various Ministries have been issued. The Outcome Budget 2006-07 and the Performance Budget 2005-06 would shortly be presented to Parliament by the Ministries/Departments.

Controller General of Accounts, for the period April-December, 2005, gross tax revenue was placed at Rs.2,30,839 crore and total expenditure at Rs.3,32,499 crore. The actual growth recorded in the period April-Dec, 2005 in customs and service tax were above the rates assumed in the budget. The growth in excise, corporate income tax and personel income tax were lower at 9 per cent, 22 per cent and 15 per cent respectively. However the overall growth in gross tax revenue at 18.8 per cent as against 21.3 per cent assumed in BE 2005-06 and 18.3 per cent recorded last year in the same period suggest a broadly similar outlook for the full financial year. Furthermore, gross tax revenue as proportion of BE is higher in April-Dec. 2005 over the corresponding period last year. Non-tax revenue at Rs.48,031 crore for the first nine months of this financial year recorded a modest growth of 1.7 per cent over the corresponding period of the previous year. Adjusted for debt swap, non-debt receipts in the first 9 months at Rs.2,24,165 crore is up 8.2 per cent from the corresponding period of the previous year. As a proportion of BE, revenue realisation in 2005-06 was lower in excise, personal income tax, corporate income tax and non-tax revenue. Similar comparisons for expenditure items indicate lower levels in major non-plan expenditure like interest payments, major subsidies and pensions (Table 2.8). In a welcome sign of improved expenditure management, 66 per cent of plan expenditure budgeted has been spent by December, 2005 indicating a growth of 16.5 per cent. Non-plan expenditure grew only by 6.7 per cent upto December, 2005.

Table 2.8 : Central Government finances

		Budget estimates 2005-06	April-December 2004-05	April-December 2005-06	Col. 4 as per cent of BE 2005-06	Percentage change over 2004-05 (Col. 4/3)
1		2	3	4	5	6
				(Rs. crore)		
1.	**Revenue receipts(net to Centre)**	**351200**	**188493**	**216746**	**61.7**	**15.0**
	Gross tax revenue	370025	194231	230839	62.4	18.8
	Tax (net to Centre)	273466	141246	168715	61.7	19.4
	Non tax	77734	47247	48031	61.8	1.7
2.	**Capital receipts**	**163144**	**138298**	**115753**	**71.0**	**-16.3**
	of which:					
	Recovery of loans	12000	45153	7408	61.7	-83.6
	Other receipts	0	2906	11	0.0	-99.6
	Borrowings and other liabilities	151144	90239	108334	71.7	20.1
3.	**Total receipts (1+2)**	**514344**	**326791**	**332499**	**64.6**	**1.7**
4.	**Non-plan expenditure (a)+(b)**	**370847**	**245567**	**237904**	**64.2**	**-3.1**
	(a) Revenue account	330530	198208	221552	67.0	11.8
	of which:					
	Interest payments	133945	79885	80972	60.5	1.4
	Major subsidies	46098	32293	33230	72.1	2.9
	Pensions	19542	12480	14621	74.8	17.2
	(b) Capital account	40317	47359	16352	40.6	-65.5
5.	**Plan expenditure (i)+(ii)**	**143497**	**81224**	**94595**	**65.9**	**16.5**
	(i) Revenue account	115982	53254	74875	64.6	40.6
	(ii) Capital account	27515	27970	19720	71.7	-29.5
6.	**Total expenditure (4)+(5)=(a)+(b)**	**514344**	**326791**	**332499**	**64.6**	**1.7**
	(a) Revenue expenditure	446512	251462	296427	66.4	17.9
	(b) p3Capital expenditure	67832	75329	36072	53.2	-52.1
7.	**Revenue deficit**	**95312**	**62969**	**79681**	**83.6**	**26.5**
8.	**Fiscal deficit**	**151144**	**90239**	**108334**	**71.7**	**20.1**
9.	**Primary deficit**	**17199**	**10354**	**27362**	**159.1**	**164.3**

Source : Controller General of Accounts.

Mid-term appraisal of the Tenth Plan

2.40 The mid-term appraisal (MTA) of the Tenth Plan takes mid-course stock of the economy with particular reference to the projected macroeconomic aggregates. The MTA lowers the growth projections for the Plan identifying less than adequate investment as the main bottleneck. The MTA makes an assessment of the public finances and highlights the following: total investment for the Plan initially estimated at Rs.12,12,802 crore was revised to Rs.9,81,113 crore on account of the lower public investment, particularly poor internal resource mobilisation by PSUs; GBS is placed at 4.1 per cent of GDP in the last two years of the Plan, namely 2005-06 and 2006-07; total non-Plan expenditure, as a proportion of GDP, is expected to go down by nearly 1.5 percentage points over the Plan period, which is more or less in line with the decline projected in the Tenth Plan; on the tax revenue front, the projections made in the Union Budget 2005-06, suggest that the Tenth Plan targets of the gross tax/GDP ratio would be met; despite a positive outlook on taxes, total non-debt receipts of the Centre would fall significantly short of the Tenth Plan projections (Box 2.6).

Performance of the departmental enterprises of the Central Government

Railways

2.41 The Railways, with the objective of maximizing the throughput capacity to cater to the growing transportation demand of the economy, have recorded significant improvement in the traffic performance, particularly in the freight segment. Following an incremental freight loading of 38.65 million tonnes in 2003-04, Railways achieved a record incremental freight loading of 44.71 MT in 2004-05 yielding additional freight revenues of Rs.3,160 crore over 2003-04. The overall traffic revenues grew by 9.8 per cent over 2003-04 to reach Rs.47,038 crore in 2004-05. These improvements were realised without any major changes in freight rates, and with no increase in passenger fares. The implementation of 'Electronic Payment Gateway' with Badarpur Thermal Power Station enabled the realisation of a substantial amount of Rs.332 crore of the outstanding traffic dues. In the aggregate, gross traffic receipts of the Railways for 2004-05 at Rs.47,370 crore represents a growth of 10.4 per cent over Rs.42,905 crore in 2003-04. With

Box 2.6 : Mid-term appraisal of the Tenth Plan

- Buoyancy of around 1.7, initially for the two remaining years of the Tenth Plan, and 1.9 later for the Eleventh Plan would be required. In the four year period 2004-05 to 2008-09, taxes would have to grow at 22 per cent annually.
- Public investment will have to rise to 31 per cent of total investment in the country in the post-Plan period, as compared to a likely 27.5 per cent during the Tenth Plan, to achieve an 8 per cent growth target during the Eleventh Plan.
- With the expected increase in private investment demand, and the consequent hardening of market terms, States may require Central borrowing support. Otherwise the fiscal deficit targets of the FRBM may turn out to be more binding constraint than the revenue deficit in so far as the size of the Plan is concerned.
- As far as macroeconomic balance is concerned, it appears that there is sufficient slack in the savings-investment balances of the economy (including external inflows) to be able to absorb higher fiscal deficits without any perceptible crowding out. However, care would need to be taken to ensure that the widening of the fiscal deficit does not lead to a spiralling interest burden on the exchequer, which would have sustainability implications, or to an increase in inflationary pressures.
- The principal source of the contradiction between the intent of the FRBM and its impact in practice is the budgetary classification that is followed in India, especially with regard to Additional Central Assistance (ACA) in support of the States or Centrally Sponsored Schemes (CSS). Since both these forms of support are by way of grants, they are routinely classified as revenue expenditures regardless of the purpose for which they are applied. Therefore, there is a need to change the classification system.
- Although the fiscal position of the States as a collective is not very different from the Centre, their ability to sustain such high levels of deficit is much less.

a 9.0 per cent growth in ordinary working expenses over 2003-04, the total working expenses in 2004-05, including appropriations to Depreciation Reserve and Pension Funds, amounted to Rs.42,759 crore, up 8.3 per cent over the previous year. Adjusting for the miscellaneous receipts and expenditure, Railways' net revenue in 2004-05 at Rs.5,273 crore was Rs.795 crore more than that achieved in 2003-04.

2.42 Railways fully discharged the dividend liability for 2004-05 amounting to Rs.2,716 crore. Besides, Railways paid Rs.483 crore towards outstanding deferred dividend liability of Rs.2,473 crore, and with the improved financial position, have committed to clear the entire liability within five years, much ahead of the time frame of eight years decided by the Government. The operating ratio of Railways improved to 91.0 per cent in 2004-05 from 92.1 per cent in 2003-04. The net revenue as a proportion of capital-at-charge and investment from Capital Fund also improved from 8.0 per cent in 2003-04 to 8.9 per cent in 2004-05. The plan outlay for 2004-05 (RE) stood at Rs.15,675 crore, which included market borrowings of Rs.2,992 crore by the Indian Railways Finance Corporation (IRFC) and Rs.50 crore through a build-operate-transfer (BOT) project. Against this, the actual plan expenditure in 2004-05 amounted to Rs.15,372 crore, excluding BOT project and including Rs.721 crore for Udhampur-Srinagar-Baramulla new line project, which is a national project being funded separately.

Posts

2.43 The gross receipts of the Department of Posts increased from Rs.4,257 crore in 2003-04 to Rs.4,432 crore in 2004-05. With gross working expenses at Rs.5,965 crore in 2004-05 as compared to Rs.5,736 crore in 2003-04 and net working expenses at Rs.5,814 crore in 2004-05 as compared to Rs.5,632 crore in 2003-04, the deficit rose to Rs.1,382 crore in 2004-05 from Rs.1,375 crore in 2003-04. During the year 2005-06, as per the budget estimates, the gross receipts are estimated at Rs.4,714 crore. With gross working expenses estimated at Rs.6,275 crore and net expenses estimated at Rs.6,163 crore, the deficit works out to Rs.1,449 crore. Department of Posts has taken a series of initiatives at increased revenue generation through the introduction of many new value-added services in the last few years. However, given the predominantly establishment-intensive public good nature of the postal services, with its phenomenal outreach, the deficit in operation, though at higher levels, has remained relatively stable in the recent years.

Broadcasting

2.44 Prasar Bharati a statutory autonomous body vested with the objective of public service broadcasting, has taken a number of steps to increase its financial performance in the last few years. The total expenditure of Prasar Bharati in 2004-05 rose to Rs.1,692 crore from Rs.1,670 crore in 2003-04. With total receipts increasing from Rs.674 crore in 2003-04 to Rs.831 crore in 2004-05, there was an improvement of 8.8 percentage points in the ratio of total commercial receipts to total expenditure. The declining trend in commercial receipts was reversed and Doordarshan earned the highest revenue since 2000-01 amounting to Rs.670 crore. In the Budget for 2005-06, the Government has provided a sum of Rs.1,292 crore (Non-Plan Rs.847 crore and Plan Rs.445 crore) to cover the resource gap of Prasar Bharati.

Pension reforms

2.45 The problems associated with the ageing of populations afflict not only the developed countries but also emerging economies with varying intensities. As a country's population ages, the economy's capacity to sustain the higher elderly population needs to be enhanced. India is fortunately better placed in terms of demographic profile and richer through the experiences of other countries' pension reforms. In the next 20 years, a substantial decline in the dependency ratio is expected with a large number of people coming into the labour force. The time is opportune for the creation of a modern and sustainable pension system. Given the increase in life expectancy, in the foreseeable future, a large part of the population will also be past the working age. With improved medical facilities, this number would only increase over time. An average retired person is expected to draw pension for at least 17 years. Given this scenario, a worker would have to save enough to last for nearly two decades after retirement.

2.46 With some exceptions like the National Old Age Pension Scheme, social protection is practically non-existent for a large majority of the population. Pension benefits are not available to about 87 per cent of the population and 74 per cent of the work force, the bulk of whom are in the unorganised sector. With the absence of a choice to individuals and lack of portability, there is a limitation on the mobility of labour.

Pension reform initiatives

2.47 India has embarked on the path of pension reforms after an extensive process of discussion and policy debate starting from 1998 and several Budget announcements to this effect. The new pension system (NPS) is the outcome of the policy efforts and recommendations of Project OASIS (Old Age Social and Income Security) of the Ministry of Social Justice and Empowerment, of a Ministry of Finance Working Group on this subject, and a high level expert group headed by Shri B.K. Bhattacharya. After examining these reports, NPS was implemented for Central Government employees (excluding defence personnel) recruited on or after April 1, 2004. The NPS architecture is designed for scalability, outreach, fairplay and low cost, and provides choices to individual participants. For such a system, a sound regulatory framework is an imperative. The NPS envisages individual retirement-based accounts, with the worker empowered to exercise investment choice. There are features such as full portability and flexible switching in the hands of the workers. It is important to note that the scalability of the NPS extends to cover even the low-paid unorganized workers. In the past all attempts to provide social security to low-paid workers have failed mainly because of problems in the delivery mechanism. Already over 1,00,000 employees of the Central Government are mandatorily covered under the system and about 15 State Governments have notified defined-contribution pension systems based on the NPS.

2.48 The Budget for 2004-2005 announced that suitable legislation to provide a regulatory framework for the scheme would be introduced in Parliament. Accordingly, the Pension Fund Regulatory and Development Authority Ordinance, 2004 was promulgated on December 29, 2004. A Bill replacing the Ordinance was introduced in Parliament on March 21, 2005. The Bill was referred to the Standing Committee on Finance. The Committee presented their report in Parliament on July 26, 2005. The recommendations of the Committee, inter alia, include:

(i) allowing withdrawal from Tier I account[2] also;

(ii) specifying in clear terms in the Bill that one of the pension funds would be from the public sector;

(iii) giving preference in selection to such pension fund managers that guarantee returns, and spelling out the pre-requisites relating to capital structure and experience criteria for selection of pension funds and other intermediaries in the Bill;

(iv) making available to subscribers an option of 100 per cent investment in Government securities and indicating this in the Bill;

(v) stipulating that any decision relating to permitting FDI in the pension sector should be implemented only by way of suitable amendments in the legislation;

[2] **Tier-I account:** This is the account into which the mandatory monthly contribution under the NPS by the employee, the matching contribution by Government and investment returns would be deposited. Withdrawals would not be permitted from this account.

Tier-II account: In addition to the non-withdrawable pension Tier-I account, each individual may also voluntarily opt for another account called Tier-II account from which he/she would be free to withdraw a part or all of his Tier-II money. This option is to be given as General Provident Fund would no longer be available to new recruits to Government service with effect from January 1, 2004. Government would not make any contribution to this account.

and further that such decisions and decisions relating to deployment of pension funds outside the country should not be at variance with related provisions applicable to the insurance sector;

(vi) including the differentiation between Tier-I and Tier II accounts as a part of the basic or essential features of the NPS in clause 20 of the Bill; and

(vii) bringing forward a comprehensive legislation in order to cater to the social security of the unorganized sector, inclusive of pension coverage of the workforce simultaneously with the setting up of PFRDA as a statutory body.

The recommendations of the Committee have been examined and a proposal for amending the PFRDA Bill, 2005, based on the recommendations of the Committee is under the Government's consideration.

Finances of State Governments

2.49 The finances of State Governments traditionally follow a pattern similar to that of the Centre, albeit with a lag. With States' own tax receipts stagnant at around 5-6 per cent of GDP and declining transfers from Centre on the one hand and high levels of total disbursement (around 15-19 per cent of GDP) on the other, the deterioration in revenue and fiscal deficits could not be reversed significantly. As a proportion of GDP, revenue deficit of the States shot up from 0.9 per cent of GDP in 1990-91 to 2.5 per cent in 2000-01 (Table 2.9). The proportion declined to 2.2 per cent in each of the two years 2002-03 and

Table 2.9 : Receipts and disbursements of State Governments

	1990-91	2000-01	2001-02	2002-03	2003-04	2004-05 (RE)	2005-06 (BE)
				(Rs. crore)			
I. Total receipts(A+B)	91160	349544	373886	425073	527097	588810	581684
A. Revenue receipts (1+2)	66467	237953	255675	280339	316535	384439	430270
1. Tax receipts	44586	168715	180312	198798	226999	268170	305248
of which							
State's own tax revenue	30344	117981	128097	142143	159921	187415	215245
2. Non-tax receipts	21881	69238	75363	81541	89536	116269	125022
of which:							
Interest receipts	2403	11438	9205	9502	8617	11827	8299
B. Capital receipts	24693	111591	118211	144734	210562	204371	151413
of which:							
Recovery of loans & advances	1501	6898	7766	3905	16414	9668	5505
II. Total disbursements(a+b+c)	91088	346971	377311	420461	526023	594129	577986
a) Revenue	71776	291522	314863	335450	377681	428741	455040
b) Capital	13556	43717	50145	70664	122429	144616	108904
c) Loans and advances	5756	11732	12303	14347	25913	20771	14041
III. Revenue deficit	5309	53569	59188	55111	61145	44302	24770
IV. Gross fiscal deficit	18797	89532	95994	102123	123070	123635	110070
				(As per cent of GDP)			
I. Total receipts(A+B)	16.0	16.6	16.4	17.4	19.1	18.9	16.5
A. Revenue receipts (1+2)	11.7	11.3	11.2	11.4	11.5	12.3	12.2
1. Tax receipts	7.8	8.0	7.9	8.1	8.2	8.6	8.6
of which:							
State's own tax revenue	5.3	5.6	5.6	5.8	5.8	6.0	6.1
2. Non-tax receipts	3.8	3.3	3.3	3.3	3.2	3.7	3.5
of which:							
Interest receipts	0.4	0.5	0.4	0.4	0.3	0.4	0.2
B. Capital receipts	4.3	5.3	5.2	5.9	7.6	6.5	4.3
of which:							
Recovery of loans & advances	0.3	0.3	0.3	0.2	0.6	0.3	0.2
II. Total disbursements(a+b+c)	16.0	16.5	16.5	17.2	19.1	19.0	16.4
a) Revenue	12.6	13.8	13.8	13.7	13.7	13.7	12.9
b) Capital	2.4	2.1	2.2	2.9	4.4	4.6	3.1
c) Loans and advances	1.0	0.6	0.5	0.6	0.9	0.7	0.4
III. Revenue deficit	0.9	2.5	2.6	2.2	2.2	1.4	0.7
IV. Gross fiscal deficit	3.3	4.2	4.2	4.2	4.5	4.0	3.1

Note : 1. The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.
2. Capital receipts (including public account) are on a net basis.
3. Capital disbursements exclude heads of public account.

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
1990-91	128095	22.5
1991-92	146966	22.5
1992-93	168293	22.5
1993-94	187912	21.9
1994-95	217023	21.4
1995-96	250813	21.1
1996-97	286704	21.0
1997-98	336347	22.1
1998-99	397370	22.8
1999-2000	505009	25.8
2000-01	592743	28.1
2001-02	685474	30.0
2002-03	797684	32.6
2003-04	922263	33.4
2004-05(RE)	1040834	33.3
2005-06(BE)	1152530	32.7

The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.

Note: Total liabilities have been revised by broadening its composition to include reserve funds, deposits and advances and contingency funds.

Source : Reserve Bank of India.

2003-04 and is placed at 1.4 per cent in 2004-05 (RE). Following the TFC award, which includes a quantum jump in grants-in-aid, the position is budgeted to improve to 0.7 per cent of GDP in 2005-06. As a proportion of GDP, fiscal deficit, after increasing from 3.3 per cent in 1990-91 to 4.5 per cent in 2003-04, declined to 4.0 per cent in 2004-05 (RE). It is budgeted at 3.1 per cent of GDP in 2005-06. The budgeted revenue and fiscal deficit as proportions of GDP are very proximate to the fiscal consolidation goals enunciated by the TFC. The outstanding liabilities of States were Rs.10,40,834 crore (33.3 per cent of GDP) in 2004-05(RE) and are placed at Rs.11,52,530 crore (32.7 per cent of GDP) in 2005-06(BE) (Table 2.10). With the TFC's debt consolidation and write-off scheme in place, the position might improve further.

2.50 While the most recent indicators of State finances show a somewhat improved picture, the causative factors of fiscal deterioration have to be addressed to sustain this progress and keep the balance at the desired level. The causative factors are: growing burden of interest payment; pension liabilities; losses of State PSUs; lack of proper user charges; and lack of buoyancy in taxes. With the successful introduction of VAT by 25 States/UTs and the TFC incentive to enact State-level FRBM legislations, the deepening of State level reforms contributed to the foundations of fiscal reform and their sustainability in the States.

State level reforms

2.51 On the recommendation of the Eleventh Finance Commission (EFC), Government of India implemented a scheme called the "States Fiscal Reforms Facility (2000-01 to 2004-05)", to incentivise the States to undertake fiscal reforms. Under this scheme, which came to an end on March 31, 2005, all the 28 States had submitted their medium-term fiscal reforms programme and all but Government of Goa entered into memorandum of understanding with Government of India, individually. As on March 31, 2005, an amount of Rs.7,217 crore was released to States from incentive fund (Total fund Rs.10,608 crore) on the basis of improvement in revenue deficit as a proportion of revenue receipts. States, (excluding NCT Delhi) in aggregate, have registered an improvement of 14.95 percentage points in the ratio of revenue deficit to total revenue receipts during EFC award period (2000-01 to 2004-05), over the base year 1999-2000 (Table 2.11)

2.52 As per the latest information available for 2004-05 (pre-Actual), nine States, namely Bihar, Chattisgarh, Jammu & Kashmir, Karnataka, Madhya Pradesh, Manipur, Mizoram, Nagaland and Sikkim, are expected

Table 2.11 : State Governments—Revenue deficit as a proportion of total revenue receipts (RD/TTR)

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
RD/TTR	26.88	23.79	24.22	20.89	20.51	12.29

to be revenue surplus. The TFC discontinued this facility beyond March 31, 2005 and suggested a debt consolidation and waiver scheme. The TFC's recommendations for restructuring public finances envisage a positive growth dividend through fall in dissavings, The major reform initiative that underpins the TFC award is this recommendation for a debt consolidation and waiver scheme for States linked to fiscal responsibility. Under the general debt relief scheme applicable to all States during the award of the TFC, all central loans, contracted till March 31, 2004 and outstanding as on March 31, 2005, get consolidated as loans for a fresh period of 20 years payable in 20 equal annual installments at a reduced interest rate of 7.5 per cent effective from the year in which the FRBM legislation is enacted by the States. TFC has estimated that this would benefit the States in the entire period of its award through lower interest payments of Rs.21,276 crore and through relief on deferment of principal repayment of Rs.11,929 crore. A second scheme of debt write-off under the TFC award linked to fiscal performance is calibrated in a manner that incentivises a self-laid down fiscal correction path on a year-on-year basis leading to elimination of revenue deficit by 2008-09 and containing fiscal deficit.

2.53 As on February 2, 2006, 18 state Governments had passed their FRBM Acts and 13 States had drawn up their fiscal correction path. States have also strived to explore all possibilities of revenue generation, while at the same time trying to prioritize their expenditure needs. A Central Monitoring Committee, set up to for the purpose, has recommended consolidation of Central loans to 12 States, namely Andhra Pradesh, Assam, Haryana, Chhattisgarh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Manipur, Orissa, Rajasthan and Tamil Nadu. Besides debt liability, there has been a significant increase in the outstanding guarantees given by State Governments during the past few years. However, to control the proliferation of State Government guarantees, as per the latest information available, nine States have imposed cap on guarantees — six (Goa, Gujarat, Karnataka, Kerala, Sikkim and West Bengal) of the statutory variety and three (Assam, Orissa and Rajasthan) of the administrative kind. In pursuance of the accepted recommendations of the TFC, external loans to State Governments are now to be given on a back-to-back basis, i.e. on the same terms and conditions — including interest rate, maturity, commitment charges and foreign exchange variation risk — as it is received by the Central Government.

Value Added Tax (VAT)

2.54 Following the June 18, 2004 decision of the Empowered Committee (EC) of State Finance Ministers to implement State-level VAT from April 1, 2005, 25 States/UTs had introduced VAT to replace the sales tax by December 31, 2005. Andaman & Nicobar Islands and Lakshadweep do not have a sales tax. The eight States/UTs yet to introduce the VAT are Chattisgarh, Gujarat, Jharkhand, Madhya Pradesh, Pondicherry, Rajasthan, Tamil Nadu and Uttar Pradesh. Since Sales Tax/VAT is essentially a State subject, the Central Government is playing the role of a facilitator for the successful implementation of VAT. A formula has also been finalised in consultation with the States for providing compensation to them, during the first three years, for any loss on account of introduction of VAT. Technical and financial support has also been provided to the States for VAT computerization, publicity and awareness and other related aspects. Despite the initial transitional problems and lack of clarity, the implementation of VAT has been smooth and the results encouraging. The EC constantly reviews the progress and tries to sort out the difficulties. The EC has advised the States to constantly interact with trade and industry to remove their apprehensions, if any, and to ensure that the benefits of VAT due to input tax credit and reduction in tax rates (wherever applicable) are passed on to the consumers. The EC is also persuading the remaining States/UTs to implement VAT at the earliest.

2.55 The initial trend in revenue collection in the VAT implementing States is quite encouraging. During the first 7 months of VAT implementation (April-October 2005), the total revenue (Provisional) for VAT implementing States showed an increase of around 14.4 per cent, which is higher than the compound annual growth rate of these States for the last 5 years. Up to January 15, 2006, VAT compensation claims for about Rs.1,674 crore had been filed by eight States, out of which claims for Rs.1,317 crore had been settled. Based on trends so far, the compensation liability for the year 2005-06 is likely to be contained within BE. The non-implementation of VAT by eight States/UTs is creating complications and may also lead to undesirable diversion of trade and business from one State to another. Further, the benefits of the VAT system like simple and uniform tax structure all over the country and achieving a common market for goods would not accrue until all the States/UTs implement VAT. In view of this, it is imperative that the remaining eight States/UTs also implement VAT at the earliest. While the VAT Acts of the States follow a broadly uniform pattern, there is a considerable amount of diversity in the VAT Rules and procedures. The internationally accepted coding system is the harmonized system of commodity description and coding (HS). While foreign trade and tariffs associated are based on HS, VAT system is not. The EC is looking into this issue of aligning the classification system of VAT with HS.

2.56 With input tax credit being allowed in respect of locally purchased inputs involved in inter-State transactions, the central sales tax (CST) reforms have already begun. However, the CST is basically inconsistent with the concept of VAT and needs to be phased out. In fact, it has already been decided, in principle, to phase out the CST. But before doing that, it is essential that the system of information exchange between the States, namely, TINXSYS, is put in place. Further, successful implementation of CST reforms would require that all the States/UTs first successfully implement the State-level VAT. Another critical issue involved in phasing out of CST is that of compensating the States, particularly the developed States where a lot of inter-State sales originate, for revenue losses on account of such a phase out. During 2004-05, the total revenue collection from CST for all States was around Rs.15,100 crore. If CST is phased out, this revenue will be permanently lost and, hence, their insistence on a compensation mechanism on a permanent basis through alternative taxation powers. The Empowered Committee is deliberating on this issue. The EC is expected to finalize its recommendations and place the same before the Central Government, after which the Government of India will take an appropriate decision on this matter.

Consolidated General Government

2.57 The macroeconomic impact of the state of public finances are best analysed through the construct ‘Consolidated General Government’. With very limited data on local finances and the grant dependent nature of local bodies in India, the aggregation of State and Central Government finances after due process of adjustment for inter-Governmental transfers, are usually taken as the General Government finances. As a proportion of GDP, tax receipts of the General Government fell from 15.4 per cent in 1990-91 to 13.8 per cent in 2001-02. Thereafter the proportion picked up to reach 15.8 per cent in 2004-05 (RE) and is budgeted at 16.4 per cent in 2005-06 (Table 2.11). With total expenditure at around 30 per cent of GDP, revenue and fiscal deficit remained intractably high. In the recent years, there has been a significant reduction in revenue and fiscal deficits (Table 2.12). This reduction was possible through the harmonized fiscal policies being followed by both Central and State Governments. Sustaining this harmony in fiscal balances is a critical requirement for reaping the growth dividend through macroeconomic linkages.

Outlook

2.58 The process of realising the full growth potential of the economy through appropriate fiscal adjustment is a long haul requiring perseverance with the extant policies and strategy. While in many other countries the experience of successful fiscal adjustment process has essentially been achieved through expenditure compression, the fiscal correction in the country since 2003-04 has been achieved on the strength of higher revenues. In the current year, with a growth of 18.8 per cent in gross tax revenues in the first nine months, which is the highest in the last five years, the outlook for achieving the targets for gross tax revenue remains bright, though

Table 2.12 : Combined receipts and disbursements of the Central and State Governments							
	1990-91	2000-01	2001-02	2002-03	2003-04	2004-05 (RE)	2005-06 (BE)
				(Rs. crore)			
I. Total receipts(A+B)	151746	594804	642817	707634	799162	876682	978565
A Revenue receipts (1+2)	105757	378817	400161	453850	518611	624054	701296
1. Tax receipts	87564	305374	313844	358224	413981	493974	578711
2. Non-tax receipts	18193	73443	86317	95626	104630	130080	122584
of which Interest receipts	5975	18050	17164	18217	19083	18853	15650
B. Capital receipts	45989	215987	242656	253784	280550	252628	277270
of which:							
a) Disinvestment proceeds	-	2125	3646	3151	16953	4091	–
b) Recovery of loans & advances	3233	10466	14514	12917	26318	13897	7639
II. Total disbursements(a+b+c)	163021	591258	644746	704905	796383	904473	979835
a) Revenue	129628	517618	559511	616840	678019	753521	821377
b) Capital	21805	55874	58826	65671	86673	124150	138944
c) Loans and advances	11588	17766	26409	22394	31691	26802	19514
III. Revenue deficit	23871	138801	159350	162990	159408	129467	120081
IV. Gross fiscal deficit	53580	199852	226425	234987	234501	262430	270901
				(As per cent of GDP)			
I. Total receipts(A+B)	26.7	28.2	28.2	28.9	29.0	28.1	27.7
A .Revenue receipts (1+2)	18.6	18.0	17.5	18.5	18.8	20.0	19.9
1. Tax receipts	15.4	14.5	13.8	14.6	15.0	15.8	16.4
2. Non-tax receipts	3.2	3.5	3.8	3.9	3.8	4.2	3.5
of which Interest receipts	1.1	0.9	0.8	0.7	0.7	0.6	0.4
B. Capital receipts	8.2	10.2	10.6	10.4	10.2	8.1	7.9
of which:							
a) Disinvestment proceeds	–	0.1	0.2	0.1	0.6	0.1	–
b) Recovery of loans & advances	0.6	0.5	0.6	0.5	1.0	0.4	0.2
II. Total disbursements(a+b+c)	28.7	28.1	28.3	28.8	28.9	29.0	27.8
a) Revenue	22.8	24.6	24.5	25.2	24.6	24.1	23.3
b) Capital	3.8	2.7	2.6	2.7	3.1	4.0	3.9
c) Loans and advances	2.0	0.8	1.2	0.9	1.1	0.9	0.6
III. Revenue deficit	4.2	6.6	7.0	6.7	5.8	4.1	3.4
IV. Gross fiscal deficit	9.4	9.5	9.9	9.6	8.5	8.4	7.7

Note : 1. The ratios to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.

2. Total disbursement/receipts are net of repayments of the Central Government [inclusive of repayments to National Small Savings Fund (NSSF)] and State Governments.

Source : Reserve Bank of India.

some pressure points are there in the form of below par performance in excise and corporate tax. While some down side risks of not achieving BE under revenue receipts remain, the fact that there is room for some expenditure compression with tight financial discipline, the fiscal and revenue deficits budgeted could be met.

2.59 The challenge of achieving fiscal adjustment as mandated by the FRBMA lies in the medium term process and strategy pursued. It is critical to raise the tax-GDP ratio to 13 per cent by 2008-09 and effect shift in the composition of expenditure in favour of those creating productive assets. The average annual growth in gross tax revenue at around 22 per cent is predicated on the strength of broad based and high growth in real GDP, particularly in manufacturing, and deepening the tax reforms through wider tax payer base, withdrawal or grand fathering tax exemptions, moderate rates, taxpayer facilitation, reliance on voluntary compliance with an effective and fast penal mechanism, and simplification and digitization of tax administration. While public expenditure as a proportion of GDP is low by international comparison, fiscal expansion is not a solution that is sustainable given the large body of international evidence and the nation's own experience in the not too distant past. While the fiscal space opened up through higher tax to GDP ratio could be used to bridge the deficits in social infrastructure and other development needs, there is much scope to increase the productivity of public expenditure through convergence of schemes with similar objectives, cutting down time and cost overruns, collecting appropriate user charges, realising value for money in subsidies, and ensuring better outcomes. With dissavings of the public sector going down through the fiscal adjustment underway, in both Centre and States, the savings and investment rates have been climbing up promising richer growth dividends in the medium term. The policies promoting this virtuous and mutually reinforcing process need to continue.