CHAPTER-5

PUBLIC FINANCE

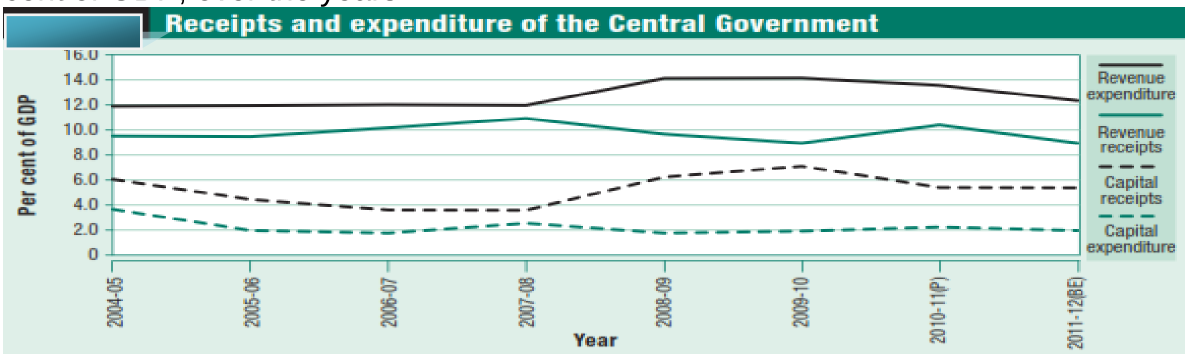
5.1 The macroeconomic environment has been under stress since 2008-09 when the global economic and financial crisis unfolded, necessitating rapid calibration of policies. Fiscal expansion followed in 2008-09 and 2009-10 did yield macroeconomic dividends in the form of a sharp recovery in 2009-10, which stabilized in 2010-11 at the same 8.4 per cent level of growth.

5.2 The macroeconomic situation at the time of formulation of Budget 2011-12 looked positive, even though there was some concern about industrial slowdown. However, the persistence of inflationary pressures and consequent demand slowdown had their impact on public finances with rising costs impairing profit margins and thereby affecting levels of growth in corporate income tax and central excise. With global commodity prices remaining high and given limited flexibility in domestic price setting, there have been some expenditure additionalities with implications for the levels of deficit – both revenue and fiscal.

5.3 The budget of the Union government has huge impact on the economy of the country as a whole. Due to its sheer size, as reflected in high magnitude of receipts and expenditure of Government and various policy prescriptions articulated through the Budget, it can be easily considered to be the prime mover of the growth trajectory of the economy.

Budgetary Developments In 2011-12:

5.4 The Budget for 2011-12 had estimated a modest decline of Rs 4385 crore in revenue receipts over 2010-11, placing it at Rs 7,89,892 crore. The decline was expected largely on account of dip in non tax revenue which had recorded a huge jump in 2010-11.Capital receipts of non debt variety , aided by Rs 40,000 Cr mainly through PSU investment, were supposed to be major source of financing , increasing the total capital receipts during 2011-12 to Rs 46,7837 Cr. It was also envisaged that growth in total expenditure (Revenue & Capital) would be limited to 4.9 per cent and accordingly total expenditure was placed at Rs 12,57,729 crore. Despite of increase in interest payment, due to higher growth in nominal GDP, revenue expenditure as per cent of GDP has been declining of late. Government has also been trying to manage expenditure through subsidies by moving towards direct transfer of subsidy & nutrient based subsidy regime (except urea).The figure below summarizes the movement of governments receipts & expenditure, as per cent of GDP, over the years.



5.5 By efficiently managing the public expenditure, Government intended to bring down (as proportion of GDP) **revenue deficit** to (Rs 307270 Cr) 3.4 per cent and **fiscal deficit** to(Rs 412817) 4.6 per cent, in 2011-12. **Primary deficit** (fiscal deficit –interest payments) was estimated to be around Rs 144831 Cr , 1.6 % of GDP.

Trends in Deficits of Central Government

Year	Revenue Deficit	Fiscal Deficit	Primary Deficit	Revenue Deficit as per cent of Fiscal Deficit
	(As per cent of GDP)			
2003-04	3.6	4.5	0.0	79.7
2004-05	2.4	3.9	0.0	62.3
2005-06	2.5	4.0	0.4	63.0
2006-07	1.9	3.3	-0.2	56.3
2007-08	1.1	2.5	-0.9	41.4
2008-09	4.5	6.0	2.6	75.2
2009-10	5.2	6.5	3.2	81.0
2010-11(P)	3.2	4.8	1.8	66.3
2011-12(BE)	3.4	4.6	1.6	74.4

Sources : Union Budget documents and Controller General of Accounts.

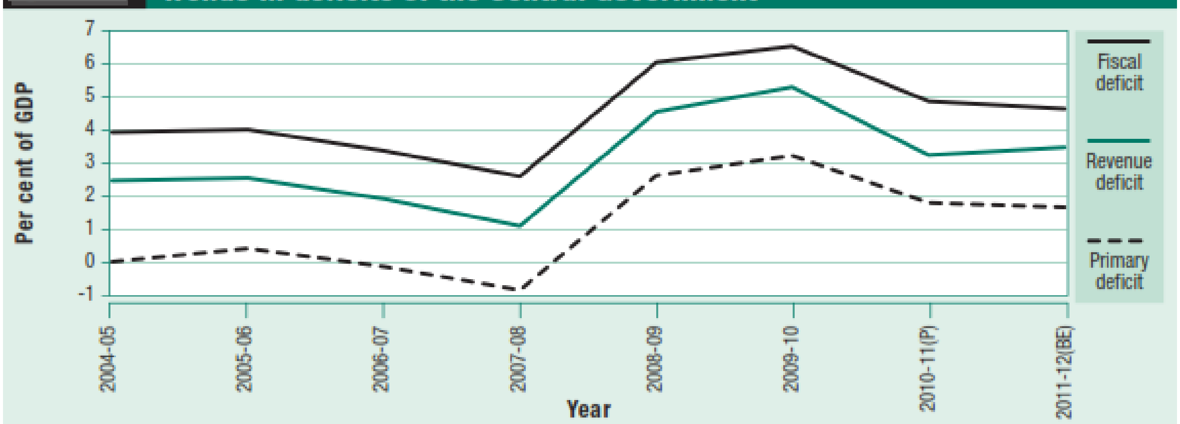
BE : Budget Estimates.

P: Provisional Actuals (Unaudited).

Notes: The ratios to GDP at current market prices (CMP) are based on the Central Statistics Office's (CSO) National Accounts 2004-05 series.

5.6 The year of global financial crisis and the one that followed, affected the economic progress and the deficits as percent of GDP rose (2008-09 & 2009-10). However, they declined sharply during 2010-11.

Trends in deficits of the Central Government

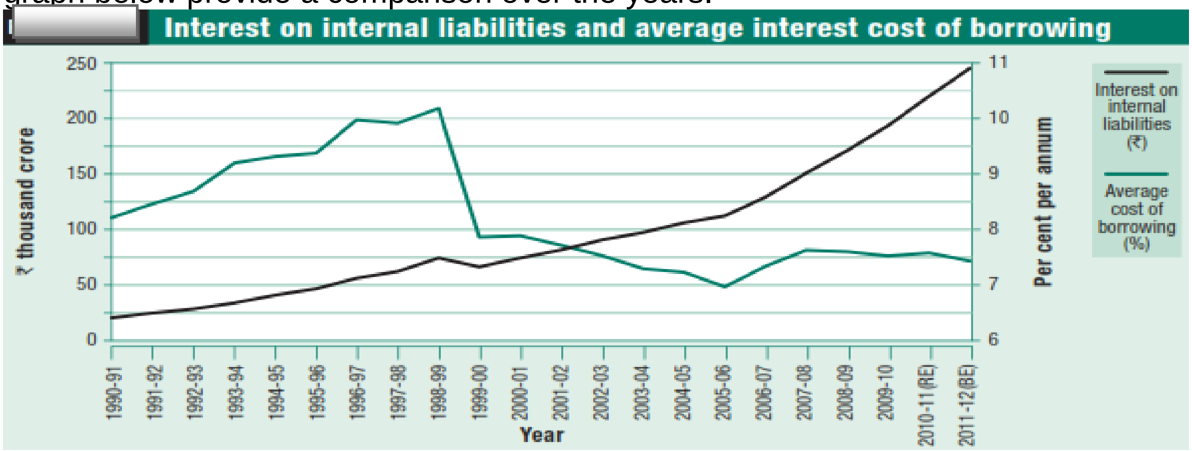


5.7 Given that there were large intergovernmental transfers which typically in an accounting sense could get classified as revenue expenditure, in the Union Budget 2011-12, a new fiscal indicator, namely "**Effective Revenue Deficit**" was introduced to ascertain the actual deficit in the revenue account after adjusting for expenditure of capital nature. The effective revenue deficit for 2011-12 is projected at **1.8 per cent of GDP** as against the revenue deficit estimate of 3.4 per cent of GDP.

5.8 **Revenue & Capital Receipts :** In BE 2011-12, non-tax revenues were estimated at Rs 1,25,435 crore. Adjusted for one-off receipts under spectrum auctions of Rs 1,06,000 crore, BE 2011-12 envisaged a growth of 14.8 per cent year-on-year in non-tax revenues placing it at Rs 125435 Cr , about 1.4 % of GDP. Heterogeneous sources such as dividends, interest, fees, fines, and miscellaneous receipts collected in the exercise of sovereign functions, regulatory charges and licence fees, and user charges for services (economic and social) rendered, comprise non-tax revenues. Dividends and profits and user charges on economic services are the major components of non-tax revenues. The sluggishness in the growth of non-tax revenue is due to the low levels of trend growth in dividends and profits. A part of this owes to the high input costs, particularly of global prices of crude oil and less than commensurate pass through to domestic administered prices. However, a growth in user charges in both economic and social services at much higher levels in recent past is a significant development.
Growth in gross tax revenue in 2011-12 (BE) was estimated at 18.5 per cent over RE 2010-11, taking the tax revenue(net of states share) to Rs 664457 Cr. Details of tax revenue , including the changes in various components of direct & indirect taxes has been discussed in chapter on direct & indirect taxes.

5.9 Capital receipts of the non-debt variety have not been a major source of financing given the disintermediation of loans by the centre to states and the low levels of disinvestment receipts as well as changes in the policy of treating the proceeds therefrom. As against a target of Rs 40,000 crore under other receipts (mainly PSU disinvestment), Rs 22,847 crore was realized in 2010-11. The Budget for 2011-12 indicated that higher-than-anticipated realization in non-tax revenues early in 2010-11 led to the rescheduling of some of the planned disinvestment for that year . Consequently Rs 40,000 crore was budgeted for 2011-12 as well taking the total capital receipts to Rs 467837 Cr.

5.10 **Expenditure trends - Interest Payment:** The annual average cost of borrowing remained sticky at 7.5 – 7.6 per cent in the last four years ending 2010-11 (RE). It has been budgeted to decline to 7.4 per cent in 2011-12 . In the Budget for 2011-12 interest payments accounts for 33.9 per cent of revenue receipts; bringing this proportion down would require lower levels of borrowing. The table & graph below provide a comparison over the years.



Interest on Outstanding Internal Liabilities of Central Government

	Outstanding Internal Liabilities	Interest on Internal Liabilities	Average Cost of Borrowings (per cent per annum)
	(₹ crore)		
2004-05	1603785	105176	7.2
2005-06	1752403	111476	7.0
2006-07	1967870	128299	7.3
2007-08	2247104	149801	7.6
2008-09*	2565991	170388	7.6
2009-10	2902148	192567	7.5
2010-11(RE)	3293369	219356	7.6
2011-12(BE)	3700359	244224	7.4

Source : Union Budget documents.

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

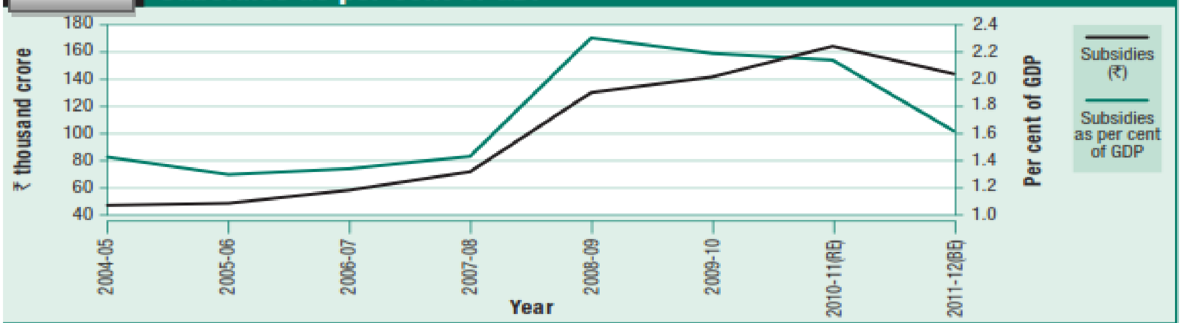
Notes: 1. Average cost of borrowing is the percentage of interest payment in year 't' to outstanding liabilities in year 't-1'.

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

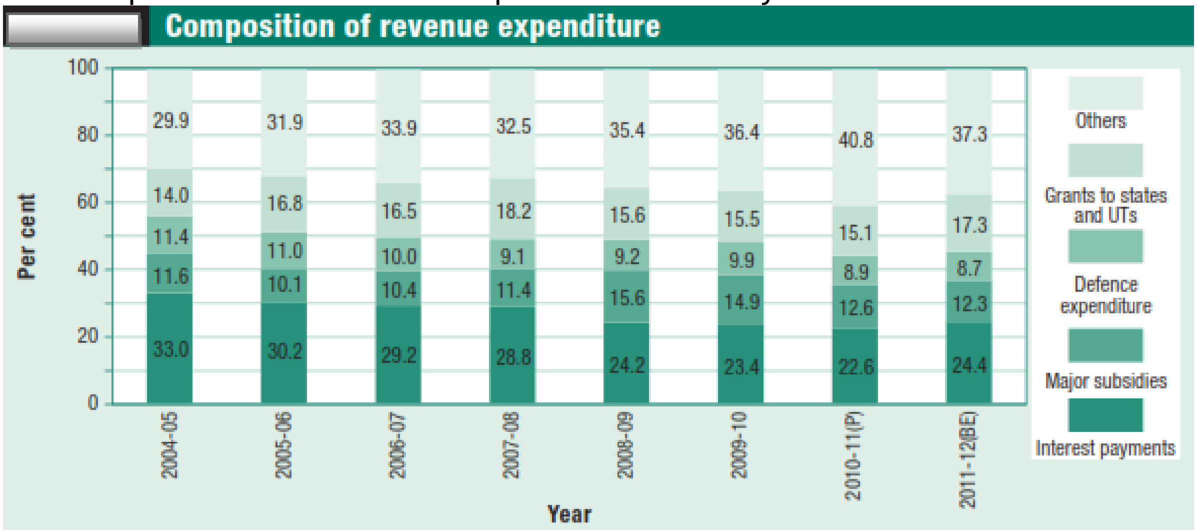
3. The figures of interest payment reported in the earlier issues may differ as these figures are net of interest payments on the National Small Savings Fund (NSSF) paid by the Government since 1999-2000, i.e. constitution of the NSSF.

5.11 **Subsidies:** In so far as food subsidies are concerned, the National Food Security Bill seeks to correct the under-consumption by the poor and other vulnerable sections and might entail some rise in levels of subsidy when operationalized. In so far as fertilizer subsidies are concerned, with the exception of urea, a nutrient-based fertilizer subsidy regime is in place. Petroleum products' subsidies have also gone up in the recent years on account of high global prices of crude petroleum. Given the high headline inflation levels, the pass through of global prices to the domestic market was limited. Major subsidies grew appreciably in 2010-11 and were at Rs1,31,212 crore. While BE 2011-12 placed them at Rs1,34,411 crore, given the build-up so far in crude prices, they are likely to be much higher this year. As a proportion of GDP major subsidies exceeded the 2 per cent mark in 2008-09 and 2009-10. In BE 2011-12, they were placed at 1.5 per cent of GDP.

Subsidies as per cent of GDP



5.12 The composition of revenue expenditure has varied during different financial years. Interest payments , grants to states and major subsidies were estimated to comprise about 24.4, 17.3 and 12.3 % of total revenue expenditure during 2011-12 . The composition of the revenue expenditure over the years is summarized below :



5.13 **Source of Data on National Finance :** Union Budget Document prepared by Ministry of Finance is the primary source of Information related to National Finance. The Union Budget is presented to the Lok Sabha, as a matter of practice, on the last of February of the year. Immediately after the presentation of the Budget, the following three statements under the Fiscal Responsibility and Budget Management Act, 2003 are also laid on the Table of Lok Sabha:- (i) The Medium Term Fiscal Policy Statement; (ii) The Fiscal Policy Strategy Statement; and (iii) The Macro Economic Framework Statement. Simultaneously, a copy of the respective Budgets is laid on the Table of Rajya Sabha. The Union Budget contains following information:

(i) Revenue Receipts: Revenue receipts consist of tax collected by the government and other receipts consisting of interest and dividend on investments made by government, fees and other receipts for services rendered by government

(ii)Revenue expenditure: is for the normal day-to-day running of the Government departments and various services, interest charged on debt incurred by Government, subsidies, etc. Usually, revenue expenditure covers all the expenditure that does not create assets. However, all grants given to State governments and other parties are also clubbed under revenue expenditure, although some of them may go into the creation of assets.

(iii)Capital Receipts: The major items of capital receipts are loans raised by the Government from the public (called market loans); Borrowings by the Government from the Reserve Bank of India (RBI) and other parties through sale of Treasury Bills, Loans received from foreign governments and bodies; and recoveries of loans granted by the Union Government to State governments, Union Territories and other parties

(iv)Capital Expenditure/Payments: It comprises of expenditure on acquisition of assets like land, building and machinery, and also investments in shares, etc.; and loans and advances granted by the Union Government to State and Union Territory governments, government companies, corporations and other parties.

(v)Classification of Budget: Information on the working of the budgetary process is obtained from the system of classification. Since such a process has a multitude of functions and objectives, different types of classification are needed, either singly or in a combination to serve the purpose of appropriation, programme management and review, evaluation of plan implementation and financial and economic analysis. Transactions of the government can be classified by :

- Objects such as salaries and wages;
- Organisation and department;
- Functions such as defence, education, agriculture, etc.;
- Their economic character such as consumption expenditure, capital formation, and the like.

(vi)Economic Classification: It categorizes total government's expenditure into meaningful economic heads like investment, consumption, generation of income, capital formation etc. According to the Economic and Social Council of the United Nations, economic classification provides "an analysis of the transactions of government bodies according to homogeneous economic categories of transactions with the other sectors of the economy directly affected by them. This analysis is contained in a separate document called Economic and Functional classification of the Central Government Budget. It is brought out by Ministry of Finance.

Acknowledgement : Information included in the chapter has largely been taken from Economic Survey , 2012