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 that 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. However, the continuance of the expansion well into 2010-11 had macroeconomic implications of higher inflation, which necessitated a tightening of monetary policy and gradually led to a slowdown in investments and GDP growth that resulted in a feedback loop to public finances through lower revenues. Consequently, fiscal consolidation has to be effected through limits on expenditure, which are carried out at RE (revised estimates) stage. The fiscal targets in 2012-13 were achieved by counterbalancing the decline in tax revenue, mainly on account of economic slowdown, with higher expenditure rationalization and compression. Outlining the roadmap for fiscal consolidation, the Budget for 2014-15 envisaged a fiscal deficit target at 4.1 per cent of GDP and sought to reduce it further to 3 per cent of GDP by 2016-17. Achieving this target is daunting in the backdrop of only a moderate increase in indirect taxes and a large subsidy bill despite significant decline in the subsidies burden in 2014-15, mainly due to lower prices of crude oil in the international market in the second half of 2014-15.

5.2 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. The Budget for 2013-14, which was presented against the backdrop of the lowest GDP growth rate for the Indian economy in a decade and persisting uncertainty in the global economic environment, sought to create economic space and find resources for achieving the objective of inclusive development within the overarching framework of fiscal consolidation.

5.3 While the fiscal deficit in the Budget 2014-15 was retained at the interim budget level, additional resources were provided in sync with the objective of the government to meet its social and welfare commitments and to remain focused on the development agenda. It is noteworthy that the government remains committed to fiscal consolidation.However, should the revenues not pick up sufficiently, there is need to persist with some compression in expenditure, so as to meet the deficit target.

5.4 The Budget for 2014-15 sought to contain the fiscal deficit at Rs 5,31,177 crore (4.1 per cent of gross domestic product—GDP) against Rs 5,08,148 crore (4.5 per cent of GDP) in 2013-14 (Provisional Actuals —PA). Revenue deficit (RD) was placed at Rs 3,78,348 crore (2.9 percent of GDP) in 2014-15 (Budget Estimates—BE) against Rs 3,60,311 crore (3.2 per cent of GDP) in 2013-14 (PA). The effective Revenue Deficit (RD), a refined version of RD that captures the shortfall in current receipts over current expenditure and is equal to the difference between the RD and grants given for creation of capital assets, was also expected to come down.

5.5 Post the Fiscal Responsibility and Budget Management (FRBM) Act 2003, the key fiscal indicator, namely fiscal deficit (FD), was gradually brought below the threshold target level (3.0 per cent of GDP) to 2.5 per cent of GDP in 2007-08.However , the same increased to 6.0 % in 2008-09 as the period saw fiscal expansion to counter global crisis .In the post-crisis period except for 2009-10 and 2011-12, nominal GDP growth was higher than the growth of FD which helped bring down the FD to 4.6 per cent of GDP in 2013-14(RE) from 6.5 per cent in 2009-10.

Year	Revenue deficit (RD)	Fiscal deficit (FD)	Primary deficit (PD)	RD as per cent of FD
	(As per cent of GDP)			
Enactment of FRBM				
2003-04	3.5	4.3	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	3.2	4.8	1.8	67.5
2011-12	4.4	5.7	2.7	76.4
2012-13	3.6	4.9	1.8	74.6
2013-14 (Provisional Actual)	3.2	4.5	1.2	71.1
2014-15 (BE)	2.9	4.1	0.8	70.7

Source : Union Budget documents
Notes : BE-Budget Estimates.

Fiscal Policy for 2014-15

Non Debt Receipts:

5.6 Typically, certain assumptions have to be made about the overall macroeconomic outcome, growth in revenues, and at the levels of expenditure that could yield the desired fiscal target. The Budget for 2014-15 envisaged a growth of 18.6 per cent over RE 2013-14 in non-debt receipts which include tax revenue net to centre, non-tax revenue, and non-debt capital receipts (mainly recovery of loans and disinvestment receipts). Revenue receipts were estimated at Rs. 11.90 lakh crore in BE 2014-15, of which the net tax revenue to the centre was Rs. 9.77 lakh crore and non-tax revenue was Rs. 2.12 lakh crore. The total non-debt receipts inclusive of non-debt capital receipts of Rs. 0.74 lakh crore were estimated at Rs. 12.64 lakh crore.

5.7 Tax Revenue: Direct (Personal Income Tax and Corporate tax) & Indirect Taxes (Customs, Excise &Service Tax) In the immediate post-Fiscal Reforms and Budget Management Act 2003 (FRBMA) period (2004-05 to 2007-08) significant fiscal Consolidation was achieved largely due to growth in tax revenues. Post-2008 crisis, growth in overall gross tax revenue (GTR) as well as its major components (with the exception of personal income tax) was not buoyant enough to facilitate encore performance in terms of revenue-led fiscal consolidation. The Budget for 2014-15 envisaged a growth of 15.8 per cent and 20.3 per cent in direct taxes and indirect taxes respectively over RE 2013-14. The Budget for 2014-15 estimated GDP growth of 13.4 per cent and growth in GTR at 19.8 per cent over PA 2013-14 which implies a tax buoyancy of 1.5. This seems to be an overestimation, given the trends in GDP growth and growth in GTR (for details see the Mid Year Economic Analysis 2014-15). As a proportion of GDP, direct and indirect taxes estimated at 5.7 per cent and 4.8 per cent respectively in 2014-15 (BE), were slightly higher than the 5.6 per cent and 4.6 per cent respectively in 2013-14 (RE). The total direct and indirect taxes for 2014-15 were estimated at Rs 7.3 lakh crore and ` 6.2 lakh crore respectively.

5.8 Non Tax Revenue Receipts: Non-tax revenues of the centre mainly consist of interest and dividend receipts of the government, receipts from the services provided by central government like supply of central police force, issue of passport and visa, registration of companies, patents and licence fees, royalty from offshore oil fields, and various receipts from the telecom and other sectors. After remaining at around 1.4 per cent of GDP in 2011- 12 and 2012-13, non-tax revenue was at 1.8 per cent of GDP in 2013-14 (PA) and the Budget 2014-15 sought to maintain it around 1.7 per cent of GDP. The non-tax revenues were estimated to contribute about 17.9 per cent and 16.8 per cent of revenue receipts and non-debt receipts of the central government respectively in BE 2014-15. The lower estimates of non-tax revenue growth in 2014-15 (BE) over 2013-14(PA) were mainly on account of higher base in 2013-14 due to higher dividends and profits and interest receipts.

5.9 Non Debt Capital Receipts: Non-debt capital receipts (NDCR) comprise recoveries of loans, disinvestment receipts, and miscellaneous receipts. As against Rs 40,057 crore in PA 2013-14, the Budget 2014-15 placed non-debt capital receipts at Rs 73,952 crore, comprising Rs 10,527 crore of recovery of loans and Rs 63,425 crore of other receipts (mainly disinvestment). The recovery of loans has been declining and has become a minor source of non-debt capital receipts mainly because of the Twelfth Finance Commission's recommendation against loan intermediation from the centre to states. Over the years, disinvestment receipts have assumed greater importance under this head. The Budget for 2014- 15 estimated that Rs 58,425 crore would accrue during the fiscal year, of which Rs 43,425 crore would be through disinvestment in central public sector enterprises (CPSE) and Rs 15,000 crore through disinvestment of government stake in nongovernment companies

Expenditure Trends

5.10 The two pillars of fiscal reforms, as mentioned earlier, are revenue augmentation and expenditure rationalization. Efficient and effective expenditure management is a key component of the Fiscal Responsibility and Budget Management Act. Budget 2014-15 estimated total expenditure at Rs 17.95 lakh crore which was 12.9 per cent higher than the 2013-14 (RE) and 14.8 per cent higher than 2013-14 (PA). Within this, the expected growth in capital expenditure was 18.8 per cent and growth in revenue expenditure was 12.0 per cent over RE 2013-14. At disaggregated level, the BE 2014-15 estimated Plan and non- Plan expenditure at Rs 5.75 lakh crore and Rs 12.20 lakh crore respectively, which amounted 4.5 per cent and 9.5 per cent of budgeted GDP , reflecting a growth of 20.9 per cent and 9.4 per cent respectively over RE 2013-14.

5.11 In 2014-15,the centrally sponsored schemes were restructured into 66 programmes for greater synergy and effective implementation and reclassified whereby the funds under these programmes are now being released as central assistance to state plans giving the states greater autonomy, authority, and responsibility in implementation of schemes. As a result, central assistance to state and union territory (UT) plans recorded an increase from Rs 1.19 lakh crore in RE 2013-14 to Rs 3.38 lakh crore in BE 2014- 15. Further, the composition of net revenue and net capital expenditure has broadly remained the same since 2012-13, with both these components individually contributing roughly half of Plan expenditure. Furthermore, the broad sector-wise allocations of central Plan outlay (gross budgetary support in central Plan plus internal and extra-budgetary resources of the CPSEs) indicate that the energy, transport, social service, and industry and minerals, got the maximum share in BE 2014-15.

5.12 Non-Plan expenditure constituted around 68 per cent of total expenditure in BE 2014-15 which is 3 percentage points less than the levels of 2013-14 (PA). Out of the total non-Plan expenditure in BE 2014-15, the share of non-Plan revenue expenditure is 91.4 per cent, with the balance, a mere 8.6 per cent, being accounted for by capital non-Plan expenditure. Within capital non-Plan expenditure, it is defence expenditure which had the maximum share. As a strategy for achieving fiscal consolidation, expenditure rationalization has major constraints on account of expenditures like interest payments, subsidies, defence services, pension, and non-Plan grants and aid to states and UTs, which constituted around 87.4 per cent of total non-Plan revenue expenditure in BE 2014- 15 The rationalization and reprioritization of non-Plan revenue expenditure is expected to play a vital role in the process of fiscal consolidation and targeting expenditure more towards inclusive and sustained development.

5.13 Subsidies: One of the major reasons for the increase in the centre's FD after 2008-09 has been the build-up in subsidies. The subsidy bill for BE 2014-15 was placed at Rs 2.60 lakh crore which was 23.4 per cent of non-Plan revenue expenditure and 2.0 per cent of GDP. In the post financial crisis period, the subsidy bill had increased from 2.2 per cent of GDP in 2009-10 to 2.5 per cent of GDP in 2012- 13 . The main items under this head from 2009-10 to 2012-13 were food and petroleum subsidies. The deregulation of diesel price in October 2014, along with the introduction of direct benefit (subsidy) transfer into the bank accounts of domestic LPG consumers, coupled with a sharp decline in global crude oil prices will help contain the petroleum subsidy bill. The under recoveries on petroleum products are expected to be Rs 74,664 crore during 2014-15 against Rs 1,39,869 crore in 2013-14. The rationalization of food subsidies is still an area where more effort is required. Recently, the High level Committee for Restructuring of Food Corporation of India recommended several measures including cash transfers to the beneficiaries of the public distribution system (PDS), which will pave the way for rationalization of food subsidies. The cap set on the number of subsidized liquefied petroleum gas (LPG) cylinders per month per family has also been increased from 9 to 12 from April 2014. The single largest component of the wider levels of FD as well as the current account deficit (CAD) owes to the inability to pass through rise in global oil prices to the domestic market. In addition, leakages from the system also contribute substantially to the overall increase in subsidy. An International Monetary Fund (IMF) working paper The fiscal and welfare impacts of Reforming Fuel Subsidies in India (Anand et al, 2013) found fuel subsidies in India to be badly targeted, with the richest 10 per cent of households benefiting seven times more than the poorest 10 per cent. Similarly in the case of food, the Performance Evaluation Report of the Planning Commission on Targeted PDS (2005) states that for every kilogram of grains delivered to the poor, the GOI released 2.4 kg from the central pool. This has grave implications for the cost of delivery of subsidized items through the existing mechanism.

Trend in Subsidies (in ₹ crore)

(in ₹ crores)

Subsidy heads	2009-10	2010-11	2011-12	2012-13	2013-14(RE)
Food	58443	63844	72822	85000	92000
Fertilizer	61264	62301	70013	65613	67971
Petroleum	14951	38371	68484	96880	85480
Major subsidy	134658	164516	211319	247493	245451
Total subsidies	141351	173420	217941	257079	255516
As % of GDP	2.18	2.22	2.42	2.56	2.26

Source : Union Budget Doucement.

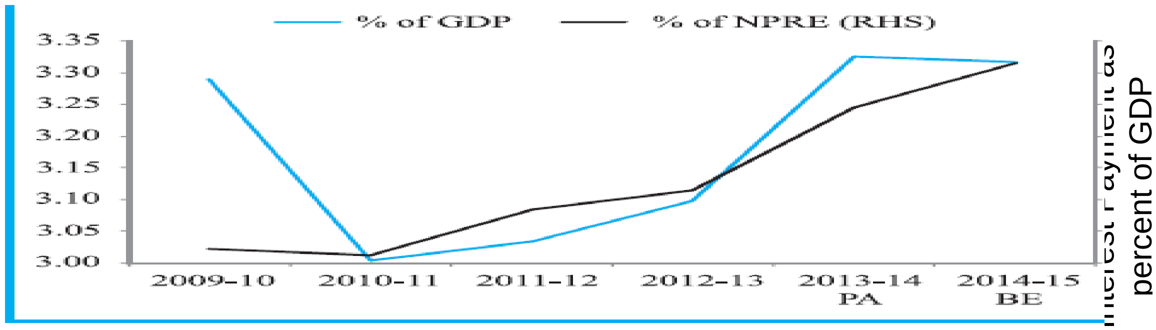
5.14 Interest Payment: Fiscal deficit is a flow variable which gets added into the stock variable (public debt and liabilities) every year, thus attracting interest liability. Interest payments were placed at Rs. 4.27 lakh crore in BE 2014-15, accounting for 38.31 per cent of non-Plan revenue expenditure and 3.3 percent of GDP. As a proportion of GDP, interest payments had been declining in the post-FRBM period. However, due to expansionary fiscal policy to obviate the adverse impact of the global crisis, interest payments as a proportion of GDP increased somewhat in the post-crisis period . The average cost of borrowing is placed at 8.4 per cent in 2014-15 (BE) as against 7.7 per cent in 2012-13. While typically the focus of fiscal policy is on the key indicator, Fiscal Deficit (FD) expressed as a proportion of GDP, the absolute levels of FD are important as they feed into interest payments with a lag.

Average Cost of Borrowings

	OIL	IIL	ACB
	In ₹ crore		
2009-10	2874683	192567	7.50
2010-11	3212521	212707	7.40
2011-12	3765153	251634	7.83
2012-13	4295575	290278	7.71
2013-14(RE)	4782585	355438	8.27
2014-15(BE)	5387174	402143	8.41

Source : Union Budget documents.
OIL=Outstanding Internal Liabilities excluding NSSF
IIL= Interest on Internal Liabilities excluding NSSF
ACB= Average cost of borrowing

Interest Payment Trends



Note : NPRE-Non Plan Revenue Expenditure.

5.15 Some of the measures to boost revenue included increases in excise duty on petrol and diesel, amid a dip in global oil prices. The four excise duty hikes since November 2014 are expected to bring in Rs. 20,250 crore in additional revenue this financial year. The government recently announced stake sales in four companies, including 10 per cent in Coal India which at current market prices has yielded the government Rs. 22,557 crore. The government is also expecting a surge in revenue through spectrum sales and auction of coal blocks by March this financial year. The forthcoming recommendations of the Expenditure Management Commission will also be helpful in reprioritizing expenditure and curtailing expenditure leakages.

5.16 Government Debt: The debt policy emphasizes maintaining a longer-term and sustainable debt structure at lowest possible cost and is progressively resorting to market-oriented active debt management. To adhere to the debt policy objectives, the government started conducting buyback and switching of securities in 2013-14 in order to improve liquidity in securities and reduce rollover risk as well as utilizing the cash surplus. The total outstanding liabilities of the central government were Rs. 55.87 lakh crore, accounting for 49.2 percent of GDP, comprising 39 per cent public debt and 10.2 per cent other liabilities at end- March 2014 (Table 2.9). Of total public debt, internal debt constituted 95.9 per cent and the remaining was external debt (at book value). Total outstanding liabilities were estimated at Rs.` 62.22 lakh crore in BE 2014-15.

Outstanding Liabilities of the Central Government as Per Cent of GDP (at end-March)

	2009-10	2010-11	2011-12	2012-13	2013-14(RE)	2014-15 (BE)
1. Internal liabilities (a)+(b)	52.4	48.6	48.2	48.4	47.6	46.9
a. Internal debt	35.9	34.3	35.9	37.2	37.4	37.1
i. Market borrowings	27.0	26.6	27.9	29.5	30.3	30.4
ii. Others	9.0	7.6	7.9	7.7	7.1	6.7
b. Other internal liabilities	16.5	14.3	12.4	11.2	10.2	9.8
2. External debt #	2.1	2.0	1.9	1.8	1.6	1.5
3. Total outstanding liabilities	54.5	50.6	50.1	50.1	49.2	48.3

Source : Union Budget Documents.

Notes : # External debt figures represent borrowings by central government from external sources and are based upon historical exchange rates.

5.17 Source of Data on Public Finance : Union Budget Document prepared by **Ministry of Finance** is the primary source of Information related to Public 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.

5.18 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:** It 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.
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.

References: Economic Survey, 2015, Ministry of Finance.