# Public Finance

02
CHAPTER

*Financial year 2015-16 ushered in a new era of 'co-operative federalism with shared responsibilities' and more coordinated efforts between the centre and states for achieving development goals, following the recommendations of the 14th Finance Commission. The General Budget 2015-16 was presented in a more stable economic environment as compared to the just preceding years, with the economy showing signs of revival of growth. Against this background, the fiscal policy for 2015-16 was calibrated with three main objectives: first, to amplify the growth revival with greater emphasis on public investment at a time when private investment was understandably lean; second, to institutionalize the changing structure of cooperative federalism; and third, to continue the commitment to fiscal consolidation.*

2.2 Budget 2015-16 sought to achieve the delicate equilibrium between the concerns of stirring growth, accommodating the resource transfer that greater fiscal federalism entailed and ensuring fiscal consolidation. This was intended to be achieved through higher capital expenditure, greater net resource transfers to states, higher gross tax revenues and expenditure rationalisation. The Budget also signalled government's intent on fiscal consolidation with respect to all major deficit indicators (Table 2.1), albeit with a revised medium-term framework that opted for shifting the fiscal deficit target of 3 per cent of the GDP by one year, from 2016-17 to 2017-18. Accordingly, the envisaged fiscal deficit to GDP targets were 3.9 per cent in 2015-16, 3.5 per cent in 2016-17 and 3.0 per cent in 2017-18.

**Table 2.1 Major Fiscal Indicators of the Centre**

| Fiscal Indicator | 2012-13 | 2013-14 | 2014-15 P | 2015-16 BE | 2012-13 | 2013-14 | 2014-15 P | 2015-16 BE |
|---|---|---|---|---|---|---|---|---|
| | ₹ lakh crore | | | | Per cent of GDP | | | |
| Revenue receipts | 8.8 | 10.1 | 11.0 | 11.4 | 8.8 | 9.0 | 8.8 | 8.1 |
| Gross tax revenue | 10.4 | 11.4 | 12.5 | 14.5 | 10.4 | 10.1 | 10.0 | 10.3 |
| Net tax to centre | 7.4 | 8.2 | 9.0 | 9.2 | 7.5 | 7.2 | 7.2 | 6.5 |
| Total expenditure | 14.1 | 15.6 | 16.4 | 17.8 | 14.2 | 13.8 | 13.2 | 12.6 |
| Revenue expenditure | 12.4 | 13.7 | 14.6 | 15.4 | 12.5 | 12.2 | 11.7 | 10.9 |
| Capital expenditure | 1.7 | 1.9 | 1.9 | 2.4 | 1.7 | 1.7 | 1.5 | 1.7 |
| Revenue deficit | 3.6 | 3.6 | 3.6 | 3.9 | 3.7 | 3.2 | 2.9 | 2.8 |
| Fiscal deficit | 4.9 | 5.0 | 5.0 | 5.6 | 4.9 | 4.5 | 4.0 | 3.9 |
| Primary deficit | 1.8 | 1.3 | 1.0 | 1.0 | 1.8 | 1.1 | 0.8 | 0.7 |

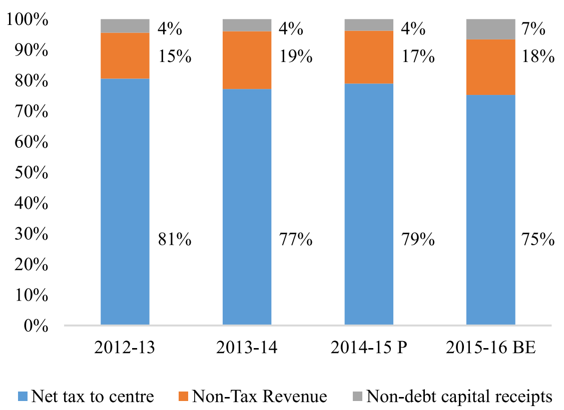
***Source:*** **Budget documents, Controller General of Account (CGA) and Central Statistical Office (CSO).**

***Note:*** **BE is budget estimates      P : Provisional**

## Trends in Receipts

2.3 Central government receipts can broadly be divided into non-debt and debt receipts. The non-debt receipts comprise tax revenue, non-tax revenue, recovery of loans and disinvestment receipts, whereas debt receipts mostly consist of market borrowings and other liabilities, which the government is obliged to repay in the future. The composition of non-debt receipts is plotted in Figure 2.1. The decline in share of net tax revenue to the centre in non-debt receipts 2015-16 is mainly on account of the implementation of the 14th Finance Commission (FFC) recommendations that advocated higher tax devolution to the states for fostering fiscal federalism.

**Figure 2.1: Composition of Non-debt Receipts (per cent)**




***Source:*** **Budget documents & CGA**

### Tax Revenue

2.4 Fiscal consolidation entails revenue augmentation and expenditure rationalization. In the post-FRBMA (Fiscal Responsibility and Budget Management Act 2003) period from 2004-5 to 2007-8, significant fiscal consolidation could be achieved largely due to buoyant tax revenues with net tax revenue to the centre increasing by 1.9 percentage points of GDP. Fiscal consolidation was paused post the financial crisis that led to tax concessions and higher public expenditure, as part of the growth revival strategy and this probably continued somewhat longer than required.

2.5 Budget 2015-16 envisaged a growth of 15.8 per cent in gross tax revenue (GTR) over the revised estimates (RE) of 2014-15. GTR was estimated to be ₹14.49 lakh crore for 2015-16 (Table 2.2), which was 10.3 per cent of GDP (Figure 2.2). The growth in GTR was estimated to be led by a 19.5 per cent growth in indirect taxes (IDT), as against a 13.1 per cent growth envisaged in direct taxes (DT). Roughly 54 per cent of the GTR was estimated to accrue from direct taxes and the remaining 46 per cent from indirect taxes (Figure 2.3).

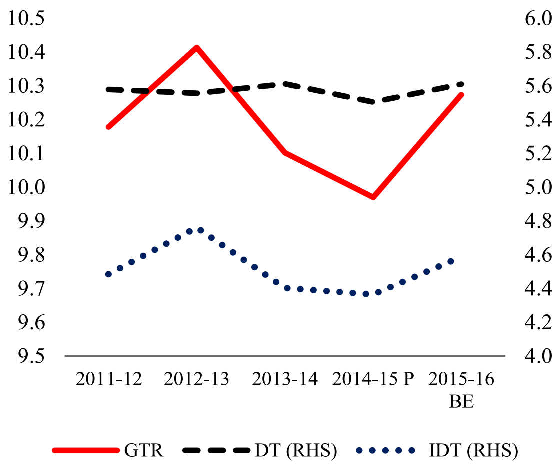
**Table 2.2: Sources of GTR (₹ lakh crore)**

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 P | 2015-16 BE |
|---|---|---|---|---|---|
| GTR | 8.89 | 10.36 | 11.39 | 12.45 | 14.49 |
| CT | 3.23 | 3.56 | 3.95 | 4.29 | 4.71 |
| IT | 1.64 | 1.97 | 2.38 | 2.58 | 3.21 |
| CD | 1.49 | 1.65 | 1.72 | 1.88 | 2.08 |
| UED | 1.45 | 1.76 | 1.69 | 1.89 | 2.29 |
| ST | 0.98 | 1.33 | 1.55 | 1.68 | 2.10 |

**Notes: GTR=gross tax revenue CT= corporation tax IT= income tax UED= union excise duty CD=custom duty ST= service tax**

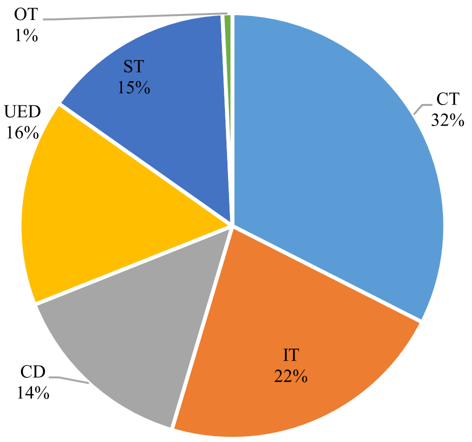
***Source:*** **Budget documents and CGA.**

**Figure 2.2: Tax Revenue as Per Cent of GDP**




***Source:*** **Budget documents, CGA and CSO.**

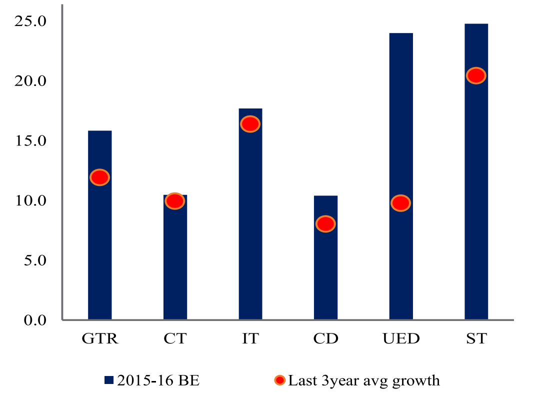
**Figure 2.3: Contribution of Different Taxes in GTR in 2015-16 BE**




*Source:* **Budget 2015-16.**

2.6 The rates of growth of tax revenues envisaged in the budget estimates (BE) of 2015-16 over RE 2014-15 might have initially looked optimistic, especially for indirect taxes, partly because the targeted growth in tax revenue was much higher than the average growth registered in the preceding three years (Figure 2.4). The performance of indirect taxes in the first nine months of 2015-16 indicates that the budget estimates are likely to be achieved and possibly exceeded, partly on account of measures taken by the government to enhance revenue by raising excise duty on petroleum products. Boxes 2.1 and 2.2 enumerate the other major measures initiated on both indirect and direct taxes in 2015-16.

**Figure 2.4: Growth in Tax Revenue (per cent)**




*Source:* **Budget documents & CGA.**

## Box 2.1: Indirect Tax Measures in 2015-16

**A. Customs**

**Reduction in duty on certain inputs to address the problem of' duty inversion:** Metal parts for use in the manufacture of electrical insulators; ethylene-propylene-non-conjugated-Diene Rubber (EPDM), water blocking tape and Mica glass tape for use in the manufacture of insulated wires and cables; magnetron upto 1 KW for use in the manufacture of microwave ovens; C- Block for compressor, over load protector & positive thermal co-efficient and Crank Shaft for compressor, for use in the manufacture of Refrigerator compressors; zeolite, ceria zirconia compounds and cerium compounds for use in the manufacture of washcoats, which are further used in manufacture of catalytic converters; anthraquinone for manufacture of hydrogen peroxide; Sulphuric acid for use in the manufacture of fertilizers.

**Reduction in Basic Customs Duty to reduce the cost of raw materials:** ethylene dichloride, vinyl chloride monomer and styrene monomer from 2.5 per cent to 2 per cent; isoprene and liquefied butanes from 5 per cent to 2.5 per cent; butyl acrylate from 7.5 per cent to 5 per cent; ulexite ore from 2.5 per cent to Nil; antimony metal, antimony waste and scrap from 5 per cent to 2.5 per cent; specified components for use in the manufacture of specified CNC lathe machines and machining centers from 7.5 per cent to 2.5 per cent; certain specified inputs for use in the manufacture of flexible medical video endoscopes from 5 per cent to 2.5 per cent; HDPE for use in the manufacture of telecommunication grade optical fibre cables from 7.5 per cent to Nil per cent; black light unit module for use in the manufacture of LCD/LED TV panels from 10 per cent to Nil; organic LED TV panels from 10 per cent to Nil; CVD and SAD are being fully exempted on specified raw materials for use in the manufacture of pacemakers; evacuated tubes with three layers of solar selective coating for use in the manufacture of solar water heater and system to Nil; active energy controller for use in the manufacture of Renewable Power System Inverters to 5 per cent, subject to certification by MNRE; parts, components and accessories for use in the manufacture of tablet computers and their sub-parts for use in manufacture of parts, components and accessories were fully exempted from BCD, CVD and SAD.

**Reduction in SAD to address the problem of CENVAT credit accumulation:** all goods [except populated PCBs], falling under any chapter of the Customs Tariff, for use in manufacture of IT A bound goods from 4 per cent to Nil; naphtha, ethylene dichloride, vinyl chloride monomer and styrene monomer for manufacture of excisable goods from 4 per cent to 2 per cent; metal scrap of iron & steel, copper, brass and aiuminiurn from 4 per cent to 2 per cent; inputs for use in the manufacture of LED drivers and MCPCB for LED lights, fixtures and LED lamps from 4 per cent to Nil.

**Increase in Basic Customs Duty:** metallurgical coke from 2.5 per cent to 5 per cent; tariff rate on commercial vehicles from 10 per cent to 40 per cent and effective rate from 10 per cent to 20 per cent. However, customs duty on commercial vehicles in completely knocked down kits and electrically operated vehicles including those in CKD condition will continue to be at 10 per cent.

**B. Excise**

**Excise duty structure on certain goods was restructured as follows:** mobiles handsets, including cellular phones from 1 per cent without CENVAT credit or 6 per cent with CENVAT credit to 1 per cent without CENV AT credit or 12.5 per cent with CENVAT credit; tablet computers from 12 per cent to 2 per cent without CENVAT credit or 12.5 with CENVAT credit; specified raw materials for use in the manufacture of pacemakers to Nil; wafers for use in the manufacture of integrated circuit (1 C) modules for smart cards from 12 per cent to 6 per cent; inputs for use in the manufacture of LED drivers and MCPCB for LED lights, fixtures and LED lamps from 12 per cent to 6 per cent; duty on Pig iron SO grade and Ferro-silicon-magnesium for use in the manufacture of cast components of wind operated electricity generators reduced to Nil, subject to certification by MNRE; solar water heater and system from 12 per cent to Nil without CENVAT credit or 12.5 per cent with CENVAT credit; round copper wire and tin alloys for use in the manufacture of Solar PV ribbon for manufacture of solar PV cells to Nil subject to certification by Department of Electronics and Information Technology.

**Reduction in number of levies:** Education cess and secondary & higher education cess on excisable goods were subsumed in Basic Excise duty.

**Improving the quality of life and public health through Swachh Bharat initiatives:** Increase in the clean energy cess levied on coal, lignite and peat from Rs. 100 per tonne to Rs.200 per tonne; extension upto 31.03.2016 of the concessional customs and excise duty rates on specified parts of electrically operated vehicles and hybrid vehicles; increase in excise duty on sacks and bags of polymers of ethylene other than for industrial use from 12 per cent to 15 per cent.

**C. Measures post-Budget 2015-16 (Excise and Customs)**

- Basic customs duty on specified steel goods was increased to 10 / 12.5 per cent.
- Anti-dumping duty and safeguard duty was imposed on specified goods.
- Basic customs duty and excise duty was exempted on specified bunker fuels for use in Indian Flag vessels for carrying export-import containers, empty containers and domestic containerized cargo.
- Excise duty was exempted on RBD Palm Stearin, Methanol and Sodium Methoxide for use in the manufacture of specified biodiesel for a period upto 3l.03 .20 16.
- Basic customs duty was increased on sugar from 15 per cent to 25 per cent which was later increased to 40 per cent.
- Excise duty was exempted on ethanol produced from molasses generated from cane crushed in the sugar season 2015-16 i.e. 1st October, 2015 onwards, for supply to the specified public sector oil marketing companies, for the purposes of blending with petrol. Also, input tax credit was allowed to manufacturers of such exempted ethanol.
- Basic customs duty was increased on crude edible oils (of vegetable origin) from 7.5 per cent to 12.5 per cent and refined edible oils (of vegetable origin) from 15 per cent to 20 per cent.
- Basic customs duty was increased on ghee, butter and butter oil from 30 per cent to 40 per cent for a period up to and inclusive of the 31 st day of March, 2016.
- Basic customs duty of 10 was imposed on wheat which was later increased to 25 per cent for a period up to 31.03.2016.
- CVD and SAD exemptions available to specified defence supplies were withdrawn. Exemption from excise duty available to defence PSUs and ordnance factories was withdrawn.

*Contd....*

**D. Service tax**

- Education cess and secondary & higher education cess on taxable services were subsumed in Service tax with effect from 01.06.2015.
- Registration in service tax to be granted within two working days.
- Time limit for taking CENVAT credit of duty/tax paid on inputs and input services was extended from six months to one year.
- For availing CENVAT credit of service tax paid under reverse charge mechanism, the condition of having made the payment of consideration to the service provider was done away with.
- Penalty provisions in service tax were rationalized to encourage compliance and early dispute resolution.
- Service tax assesses were allowed to issue digitally signed invoices and maintain other records electronically.
- Instructions were issued providing for withdrawal of prosecution where a notice was exonerated in quasi-judicial proceedings and such order has attained finality.
- If the export proceeds are not received within the prescribed time period, the exporter would have to reverse the Cenvat Credit. Re-credit of such reversed Cenvat credit was allowed, if such export proceeds are received within one year from the specified period.
- Uniform abatement of 70 per cent from gross value prescribed for transport by rail, road and vessel.
- Restrictions were placed on exemption on specified services of construction, repair, maintenance, renovation or alteration service provided to the Government, a local authority, or a governmental authority.
- Exemption to construction, erection, commissioning or installation of original works pertaining to an airport or port is being withdrawn.
- Exemption to services provided by a performing artist in folk or classical art form of music, or dance, or theatre, would be limited only to such cases where amount charged is upto Rs 1,00,000 for a performance.
- Exemption to transportation of food stuff by rail, or vessels or road would be limited to food grains including rice and pulses, flour, milk and salt. Transportation of agricultural produce is separately exempt.
- Exemptions are being withdrawn on services provided by a mutual fund agent to a mutual fund or assets management company, distributor to a mutual fund or AMC, selling or marketing agent of lottery ticket to a distributor.
- Services by common affluent treatment plants were exempted.
- Certain pre-cold storage services relating to fruits and vegetables were exempted.
- Service provided by way of admission to museum, zoo, national park, wild life sanctuary and a tiger reserve was exempted.
- The negative list entry that covers “admission to entertainment event or access to amusement facility” was omitted.
- Service tax would be levied on services by way of admission to entertainment event of concerts, pageants, musical performances concerts, award functions and sporting events other than the recognized sporting event, if the amount charged is more than Rs. 500 for right to admission to such an event.
- The entry in the negative list was pruned to exclude services related to carrying out production or manufacture of alcoholic liquor for human consumption.

**E. Service Tax: post-Budget 2015-16**

- Service tax on Pradhan Mantri Suraksha Bima Yojna, Pradhan Mantri Jeevan Jyoti Bima Yojana; Pradhan Mantri Jan Dhan Yogana; and on services by way of collection of contribution under Atal Pension Yojana were exempted.
- Specified services under Power System Development Fund Scheme were exempted.
- In the case of good transport service, a single composite service need not be broken into its components and considered as constituting separate services, if it is provided as such in the ordinary course of business.
- The service tax payable under section 66B of the Finance Act, 1994, on the service provided by an Indian bank or other entity acting as an agent to the MTSO in relation to remittance of foreign currency from outside India to India, in from the 1st day of July, 2012 and ending with the 13th day of October, 2014, but for the said practice, shall not be required to be paid.
- Charitable activities on advancement of yoga provided by an entity registered under Section 12 AA of the Income Tax Act were exempted.

*Contd....*

- Specified services provided by Business Facilitators/Business Correspondents with respect to a Basic Saving Bank Deposit were exempted.
- Detailed guidelines were issued for speedy disbursal of pending refund claims of exporters of services under rule 5 of the CENVAT Credit Rules, 2004.
- Swachh Bharat Cess was imposed at the rate of 0.5 per cent on all services, which are presently liable to service tax with effect from 15th November 2015 and not otherwise exempt or in the negative list.
- Distinct nature of manpower supply services/ service of job work were clarified.

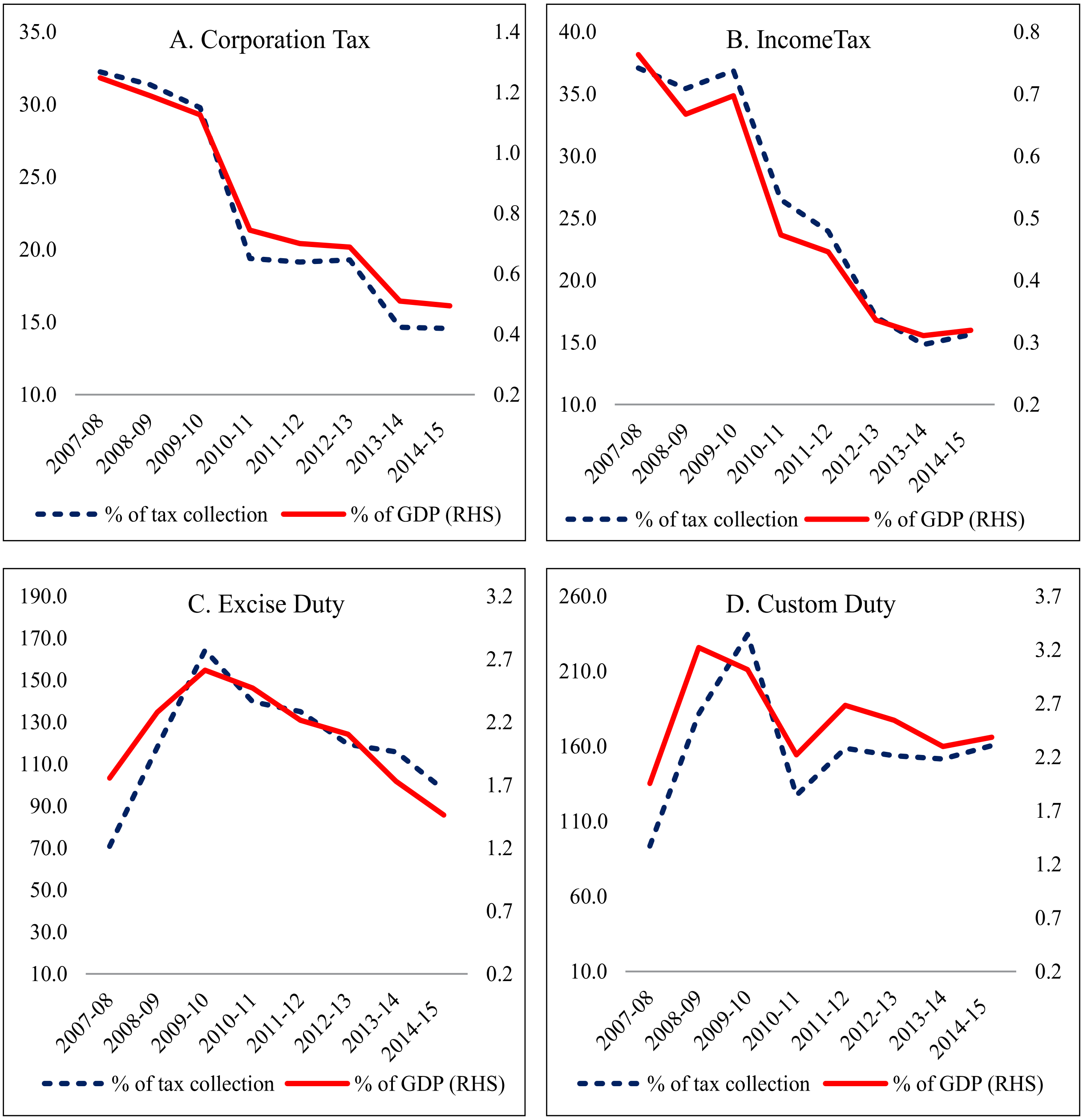
## Box 2.2: Direct Tax Measures in 2015-16

- The levy of wealth tax was abolished and replaced it with an additional surcharge of 2 on the super-rich with a taxable income of over Rs 1 crore.
- Investment in Sukanya Samriddhi Scheme was made eligible for deduction u/s 80C of the Income Tax Act, 1961 (the Act).
- The limit of deduction u/s 80D of the Act was increased from ₹ 15,000/- to ₹ 25,000/- on health insurance premium (in case of senior citizen from ₹ 20,000/- to ₹ 30,000/-).
- The limit of deduction in their case u/s 80DDB of the Act was increased from Rs 60,000/- to Rs. 80,000/- in respect of expenditure on account of specified diseases.
- The limit of deduction u/s 80DD and 80U of the Act was increased from ₹ 50,000/- to ₹ 75,000/- in case of disability and from ₹ 1 lakh to ₹ 1.25 lakh in case of severe disability.
- An additional deduction of ₹ 50,000 was provided for contribution to the New Pension Scheme under Section 80CCD over and above the limit of ₹ 1.5 lakh.
- Exemption limit of transportation allowance was increased from ₹ 800 per month to ₹ 1600 per month to any employee and from ₹ 1600 to ₹ 3200 in case of an employee who is blind, orthopedically handicapped and, deaf and dumb.
- Deduction u/s 80JJAA of the Act was extended to all assesses, hitherto available only to companies along with the reduction in eligibility threshold of minimum hundred workmen to fifty.
- Pass through status was provided to Category-I and Category-II Alternative Investment Funds governed by the regulations of Securities and Exchange Board of India.
- To facilitate relocation of fund managers of offshore funds in India, the permanent establishment norms were modified.
- The rate of tax on royalty and fees for technical services was reduced from 25 per cent to 10 per cent.
- The indirect transfer provisions were modified to provide clarity regarding its applicability.
- The residency requirement regarding companies incorporated outside India was modified.
- Yoga was included as a specific category of activity in the definition of ‘charitable purpose’.
- The period of applicability of reduced rate of tax at 5 per cent on income of foreign investors (FII and QFI) from corporate bonds and government securities was extended from 31.5.2015 to 30.06.2017.
- An additional investment allowance to new manufacturing units set-up during the period 01.04.2015 to 31.03.2020 in notified backward areas of the states of Andhra Pradesh, Bihar, Telangana and West Bengal was provided.
- The scope of reporting of foreign remittances was expanded.
- The scope of TDS on interest on bank deposits was expanded by bringing the interest on recurring deposits within the ambit of TDS.
- The facility for filing self-declaration for certain Insurance payments was provided.
- Tax neutrality on transfer of units on merger of similar schemes of a Mutual Fund was provided.
- Mechanisms to prevent tax disputes and to provide speedy disposal was strengthened. Scope of advance rulings and settlement of cases was further broadened.
- Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015 was enacted and Rules thereunder have been notified.
- For collection of Information in non-intrusive manner third party reporting mechanism was broadened and strengthened. Norms for Mandatory Quoting of PAN were also rationalized and broadened.

### *Tax Expenditure*

2.7 The divergence between the statutory tax rate and effective tax rate (defined as the ratio of total tax revenue collected to the aggregate tax base) is mainly on account of tax exemptions. Tax expenditure is also termed as 'revenue forgone', but it does not necessarily imply that this quantum of revenue has been waived by the government. It should be interpreted as targeted incentives for the promotion of certain sectors that may not, in the absence of such incentives, have come up. Arguably, high tax expenditure can make the tax system unduly complex. Tax expenditures have been brought down significantly as a result of simplification of the tax system and improvements in tax administration in recent years (Figure 2.5).

**Figure 2.5: Tax Expenditure as Per Cent of Tax Collection under Respective Heads and as Per Cent of GDP**




***Source:*** Statement of Revenue Foregone, Budget documents and CSO.

Note : Numbers for 2014-15 are projected.

### *Non-Tax Revenue*

2.8 Non-tax revenue mainly consists of interest and dividend receipts, external grants and receipts from services provided by the central government which include fiscal services like currency and mint, general services like the Union Public Service Commission police, etc.; social services like education, health, etc. and economic services like irrigation and transportation. The Budget for 2015-16 envisaged generation of ₹ 2.22 lakh crore (Table 2.3) from non-tax revenue, which was 1.6 per cent of GDP and constituted 18 per cent of non-debt receipts.

**Table 2.3: Trend in Non-tax Revenue**
**(₹crore)**

| | 2013-14 | 2014-15 P | 2015-16 BE |
|---|---|---|---|
| Interest receipts | 21868 | 24265 | 23599 |
| Dividend and profit | 90435 | 89912 | 100651 |
| External grants | 3618 | 1268 | 1774 |
| Others | 81475 | 80209 | 94413 |
| Receipts of UTs | 1474 | 1305 | 1296 |
| **Total** | **198870** | **196959** | **221733** |

*Source:* **Budget documents and CGA.**

### *Non-Debt Capital Receipts*

2.9 Non-debt capital receipts mainly consist of recovery of loans and advances, and disinvestment receipts. The share of recovery of loans has been declining in non-debt capital receipts mainly because of the 12th Finance Commission's recommendation against loan intermediation from the centre to states, and allowing the states to directly borrow from the market. The Budget for 2015-16 placed non-debt capital receipts at ₹80,253 crore, comprising ₹10,753 crore of recovery of loans and ₹ 69,500 crore of other receipts (mainly disinvestment).

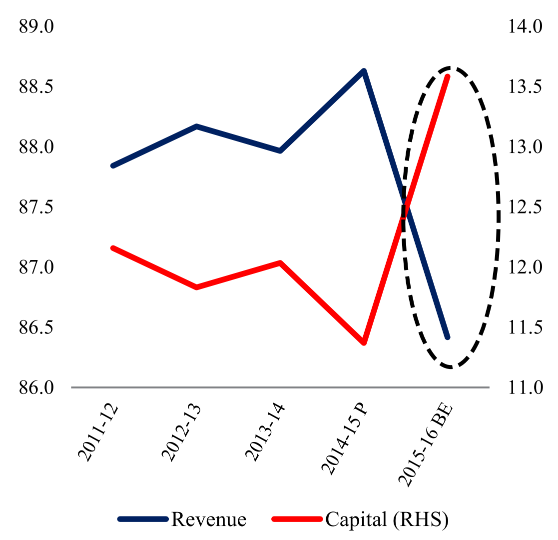
## Trends in Expenditure

2.10 Rationalization and reprioritization of public expenditure is integral to fiscal reforms. In particular, it is a challenge to attain fiscal consolidation while ensuring that sufficient funds are allocated for public investment, in the face of low tax to GDP ratio. Therefore, improving the quality of expenditure becomes central to achieving sustained fiscal consolidation.

### *Quality of Expenditure*

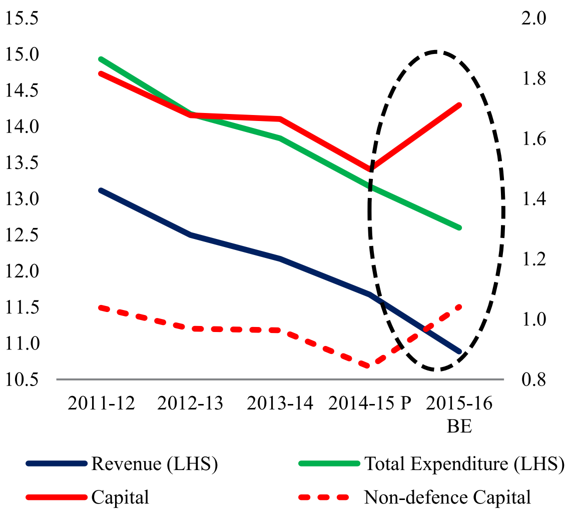
2.11 The Budget for 2015-16 estimated a total expenditure at ₹17.77 lakh crore, which was 5.7 per cent higher than the 2014-15 RE and 8.1 per cent higher than the provisional estimates (P) of 2014-15. Within this, the expected growth in capital expenditure was 25.5 per cent and growth in revenue expenditure was 3.2 per cent over RE 2014-15. Underlining the need for greater public investment to aid growth revival, Budget 2015-16 ensured a higher share for capital expenditure from the total pool of expenditure (Figure 2.6). As a proportion of GDP, total capital expenditure and non-defence capital expenditure were both raised by more than 0.2 percentage points of GDP (Figure 2.7). Budget 2015-16 sought to achieve the proposed expansion of capital expenditure on railways, roads and others without compromising defence capital expenditure.

**Figure 2.6: Revenue and Capital expenditure as per cent of total expenditure**



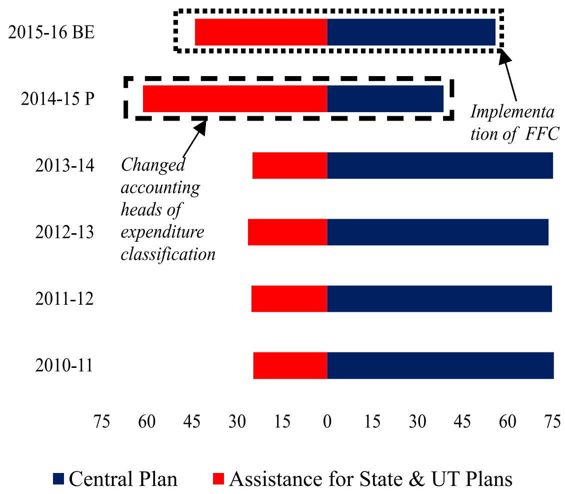

*Source:* **Budget documents and CGA**

**Figure 2.7: Revenue and Capital expenditure as per cent of GDP**




***Source:*** **Budget documents, CGA and CSO.**

**Figure 2.8: Share of Central Plan and Central Assistance for State and UT Plans in of Total Plan Expenditure (Per Cent)**



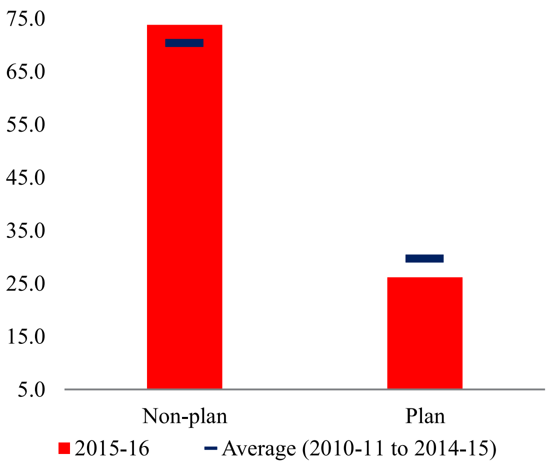

***Source:*** **Budget documents and CGA.**

## Plan Expenditure

2.12 Two major developments that took place in two consecutive years transformed the whole plan expenditure regime. First, in the Budget for 2014-15, the centrally sponsored schemes were restructured and reclassified into 66 programmes for greater synergy and effective implementation. CSS funds are released as central assistance to state plans and also routed through the states' budgets. This provides greater autonomy, authority and responsibility to the states in implementation of schemes. As a result, central assistance to the plans of states and union territories (UT) recorded a significant increase in 2014-15(P) (Figure 2.8).

2.13 Second, there was a readjustment in the manner of allocation of plan funds to the states in the Budget for 2015-16 following the acceptance of major recommendations of FFC. The FFC had recommended allocation of greater resources to states through the automatic route by increasing the states' share in the divisible pool of taxes from 32 per cent to 42 per cent, and counterbalancing this increase in devolution by curtailing the resources transferred under central plan assistance to the states and by changing the expenditure-sharing pattern. These developments translated into a decline in central assistance to the states (Figure 2.8) and also led to a decline in the share of plan expenditure in 2015-16 (BE) vis-à-vis the average of shares during 2010-11 to 2014-15 (Figure 2.9). However, there has been an increase in overall resource transfer to states as discussed later in the chapter.

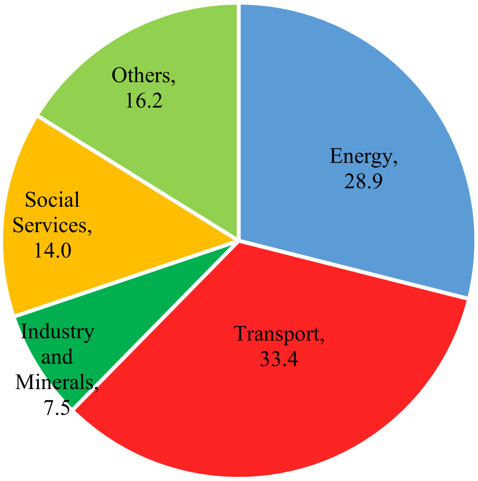
**Figure 2.9: Plan and Non-plan Expenditure of the Centre as Per Cent of Total Expenditure**




***Source:*** **Budget documents and CGA.**

2.14 Given the change in the pattern of plan expenditure, the budget did well to allocate a plan outlay of ₹4.65 lakh crore in 2015-16 (₹2.60 lakh crore for central plan and ₹2.05 lakh crore for central assistance to states and UTs) as against ₹4.54 lakh crore in 2014-15 (P). Furthermore, the broad sector-wise allocations of central plan outlay (gross budgetary support to central plan plus internal and extra-budgetary resources of the central public sector enterprises) indicate that transport, energy, social services and industry and minerals together constituted roughly 84 per cent of the BE of 2015-16 (Figure 2.10).

**Figure 2.10: Central Plan Outlay by Sectors in BE 2015-16 (in per cent)**

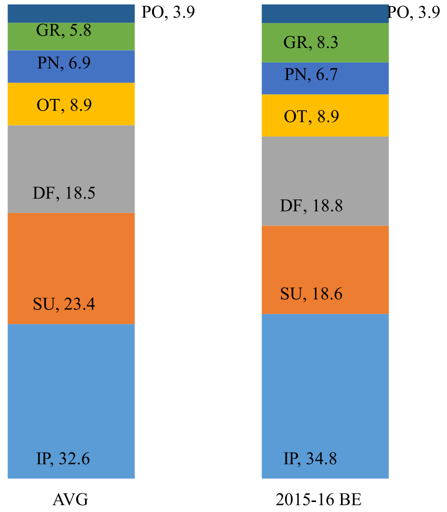



***Source:*** **Budget documents and CGA.**

## Non-plan Expenditure

2.15 Non-plan expenditure constituted 73.8 per cent of the total expenditure in BE 2015-16, which is 3 percentage points higher than the average of the last five years ending 2014-15. Out of the total non-plan expenditure of ₹13.12 lakh crore in BE 2015-16, revenue expenditure accounted for around 92 per cent; the remaining 8 per cent was mainly defence capital expenditure. Second, the share of committed expenditure (interest payment and pension) was roughly 41.5 per cent as against the last five years' (ending 2014-15) average of approximately 38.6 per cent (Figure 2.11).

**Figure 2.11: Composition of Non-plan Expenditure (in per cent)**




***Source:*** **Budget documents and CGA.**

Note:

IP=Interest payment DF=Defence
SU=Subsidies PO=Police
PN= Pension OT=Others
GR=Grants to states and UTs
AVG= Average of last five year ending to 2014-15.

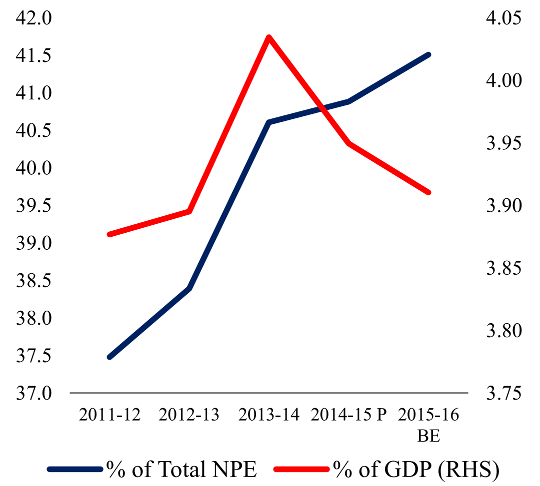
2.16 One of the major constraints in the rationalization of non-plan expenditure is committed expenditure. Committed expenditure occurs on two counts: first, interest liability on debt incurred in the past, and second, pension payment to superannuated/retiring workforce from government services. BE 2015-16 estimated committed expenditure at ₹5.45 lakh crore, as against ₹4.87 lakh crore in 2014-15(P) (Table 2.4). The share of committed expenditure in total non-plan expenditure (NPE in Figure 2.11) has been constantly increasing, but it started declining post 2013-14 as a per cent of the GDP and BE 2015-16 estimated a decline to 3.86 per cent of the GDP, from 3.90 per cent in 2014-15 (Figure 2.11). The diverging trends in committed expenditure seen under two different indicators (Figure 2.12a) are also the result of rationalization in other categories of non-plan expenditure. For example, the decline in the subsidy bill increased the relative share of committed expenditure in non-plan expenditure.

**Table 2.4: Committed Expenditure (₹ crore)**

| | 2013-14 | 2014-15 P | 2015-16 BE |
|---|---|---|---|
| Interest payments | 374254 | 404019 | 456145 |
| Pensions | 74896 | 82954 | 88521 |
| **Total** | **449150** | **486973** | **544666** |

***Source:*** **Budget documents & CGA.**

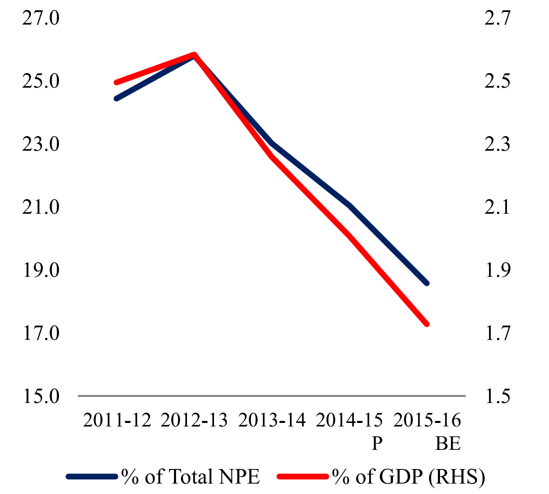
**Figure 2.12a: Committed Expenditure**




***Source:*** **Budget documents, CGA and CSO.**

2.17 The subsidy bill for BE 2015-16 was placed at ₹2.44 lakh crore, which was 1.7 per cent of GDP. The deregulation of petrol and diesel prices and direct benefit transfer of subsidy for domestic LPG, along with a decline in global crude oil prices, helped in containing the petroleum subsidy bill at ₹30,000 crore in BE 2015-16 as against ₹57,769 crore in 2014-15 (P) (Table 2.5). The total subsidy bill as a proportion of GDP has been declining since 2012-13 and is expected to be below 2 per cent of GDP as per BE 2015-16 (Figure 2.12b). The rationalization and reprioritization of subsidies through better targeting would play a vital role in fiscal consolidation and in targeting expenditure more towards inclusive development (Box 2.3).

**Figure 2.12b: Subsidy Bill as Per Cent of GDP**




***Source:*** **Budget documents, CGA and CSO.**

**Table 2.5: Total Subsidies (₹crore)**

| | 2013-14 | 2014-15 P | 2015-16 BE |
|---|---|---|---|
| Food | 92000 | 122676 | 124419 |
| Fertilizer | 67339 | 70967 | 72969 |
| Petroleum | 85378 | 60270 | 30000 |
| Others | 9915 | - | 16423 |

***Source:*** **Budget documents & CGA.**

## Box 2.3: Trends in Subsidies on Petroleum Products

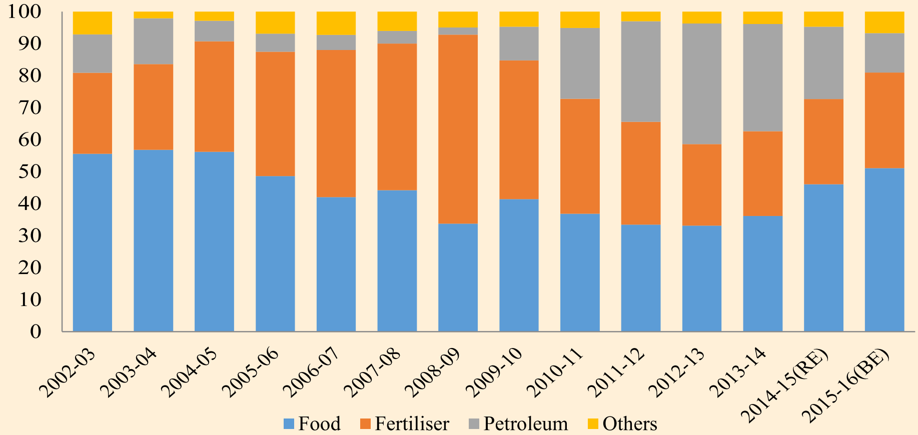
Provision of subsidies to the poor has large welfare dimensions; but fiscal prudence considerations required to containing subsidies to sustainable levels. These seemingly conflicting objectives can be reconciled by making subsidies transparent, efficient and targeted through initiatives like direct benefits transfer wherever feasible. Petroleum subsidy is a major subsidy with somewhat limited welfare dimension, but has resulted in a fiscal drag. This box traces the problem in detail.

The explicit subsidies paid from the union budget increased over six-fold from around ₹ 43,000 crore in 2002-03 to nearly ₹2,67,000 crore in 2014-15 (RE). As a ratio of GDP, subsidies from the union budget peaked in 2012-13 to reach 2.58 per cent. The share of major sectors, namely food, fertilizer and petroleum, along with 'others' receiving these subsidies is depicted in Figure 1.

**Petroleum pricing policies, under-recoveries of oil marketing companies and subsidies provided by government:** The prices of petroleum products were determined by the government under what is known as the administrative pricing mechanism (APM), with effect from July 1975 and this continued till 2002. Under the APM, the oil refining and marketing companies were compensated to meet operating costs and certain return on net worth. An oil pool account was maintained to ensure stable domestic prices of petroleum products (to

*Contd....*

**Figure 1: Sectoral Distribution of Subsidies in India (per cent)**




prevent the fluctuating international prices from affecting domestic oil prices). Products like LPG for cooking and kerosene oil for domestic users were provided at subsidized rates and, to compensate for it, products like motor spirit and aviation turbine fuel were charged at higher rates.

However, it was being increasingly realized that the APM was coming in the way of expansion programmes of the refinery and marketing companies and that private companies would find it difficult to invest in the sector. Hence, following the recommendations of the Strategic Planning Group on Restructuring of Oil Industry (also known as the 'R' group), the government decided to dismantle the APM in a phased manner.

Since the dismantling of the APM, petroleum pricing and subsidy regimes have followed a rather chequered path. In the post APM phase, subsidies were to be provided only for kerosene oil and domestic cooking gas for a limited time. However, following the sustained increase in international prices of crude oil, particularly since 2004-5, the government was in effect controlling the revision in prices of almost all petroleum products. Higher levels of international oil prices were not commensurately passed on to the consumers, leading to significant escalation in under-recoveries of the oil marketing companies. These under-recoveries were financed through a mix of (i) issuing of 'oil-bonds' (below-the-line budget entity); (ii) requiring the upstream companies like the Oil and Natural Gas Corporation (ONGC) and Oil India Limited (OIL) to charge discounted prices on crude oil sold to the oil marketing companies (OMCs) and (iii) direct subsidy from the budget. Prices of petroleum products were also controlled through downward revision of taxes and duties, which impacted indirect tax collections directly, and with less than full pricing and burden-sharing arrangements by upstream companies like the ONGC, direct tax revenue and non-tax revenues, i.e. profits and dividends, also declined.

Clearly, the system in place could not be sustained for long, keeping in view the fact that crude oil prices had more than doubled between 2004-5 and 2008-9. Following the recommendations of the Committee on Taxation of Petroleum Products, the government decided to discontinue issuance of oil bonds with effect from 2009-10 and provide the subsidy directly from budgetary resources. However, the upstream oil companies continued to share the burden by providing crude oil to OMCs at discounted prices. As international oil prices remained high, budgetary subsidies to the petroleum sector increased from nearly ₹3000 crore in 2004-5 to ₹15000 crore in 2009-10 and further to ₹97,000 crore in 2012-13, accounting for 38 per cent of total subsidies. They fell to close to ₹85,000 crore in 2013-14.

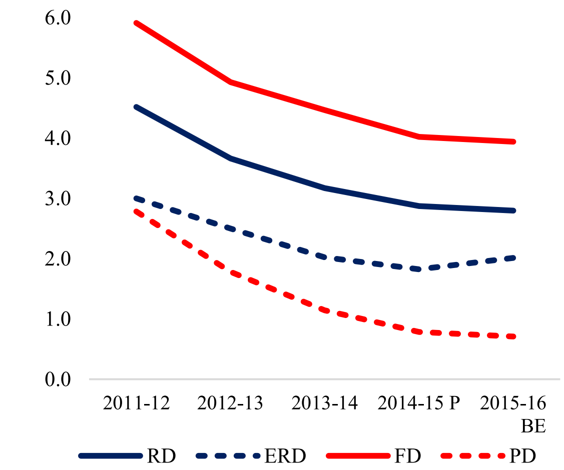
Following the recommendations of the Expert Group on A Viable and Sustainable System of Pricing of Petroleum Products, the government deregulated the prices of petrol with effect from June 2010. Similarly, OMCs were permitted to raise the prices of diesel oil in small doses (typically 40-50 paisa per litre per month) from January 2013. They were also allowed to sell diesel to bulk consumers at non-subsidized rates. Caps were imposed on the number of LPG cylinders that could be sold to domestic consumers at subsidized rates.

The under-recoveries of the OMCs started declining as a result of these measures and more so on account of a significant reduction in international prices of crude oil. The government announced the decision to decontrol the prices of diesel in October 2014, ending under-recoveries in diesel which formed the bulk of the under-recoveries. The continuing reduction in international prices of crude oil since the second half of 2014 has also had significant impact on the level of subsidies and overall public finance. As a result of these developments, subsidies on petroleum products declined to around ₹60,000 crore in 2014-15 and around ₹28,000 crore in April-December 2015.

## Trends in Deficit and Financing of the Deficit

2.18 Budget 2015-16 sought to contain the fiscal deficit at ₹5.56 lakh crore (3.9 per cent of GDP) as against ₹5.13 lakh crore (4.1 per cent of GDP) in 2014-15 (RE). Revenue deficit (RD) was estimated at ₹3.94 lakh crore (2.8 per cent of GDP) in 2015-16 (BE) as against ₹3.62 lakh crore (2.9 per cent of GDP) in 2014-15 (RE) (Figure 2.13).

**Figure 2.13: Trend in Deficits as per cent of GDP**




***Source:*** **Budget documents, CGA and CSO.**

2.19 Unlike some other countries, the financing of fiscal deficit in India is mostly from domestic sources. Domestic sources constitute roughly 98 per cent of the deficit financing, and approximately 84 per cent of domestic financing is from market borrowings (Figure 2.14).

**Figure 2.14: Financing of Fiscal deficit**

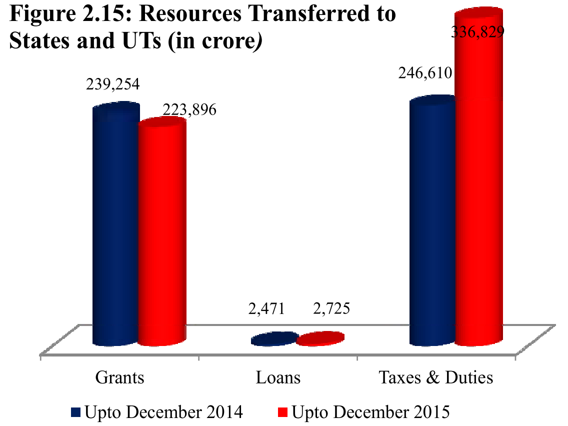

***Source:*** **Budget documents and CGA.**

## Provisional Outcome in 2015-16 (up to December) vis-à-vis BE 2015-16

2.20 The accounts for April-December 2015-16, released by the Controller General of Accounts show that the fiscal deficit of the union government at end-December 2015, as a percentage of BE, is lower than in the corresponding period of the last year (Table 2.6), but slightly higher than the average of the last five years, which was 82.3 per cent. This benign fiscal outcome so far in the year was due to improved tax buoyancy and prudent expenditure management with assistance from the decline in oil prices. The other notable highlights of the fiscal outcome in the current year till December 2015 included increased tax devolution to the states in line with the recommendations of the FFC, achieving the highest increase in capital expenditure in the last six years and decline in major subsidies.

2.21 The acceptance of the recommendations of the FFC for increased tax devolution has marked a watershed in India's cooperative federalism. In keeping with the changed rules for devolution, the taxes assigned to states/ UTs were raised by 36.6 per cent in the current year so far. Hence, the growth so far in taxes net to the centre was less than the growth in GTR (Table 2.6). With the grants and loans to states/UTs declining by about 5.7 per cent, the total resources transferred to states/UTs (during April-December 2015) increased by about 15.4 per cent, as compared to April-December 2014 (Figure 2.15).

**Figure 2.15: Resources Transferred to States and UTs (in crore)**



2.22 The robust growth in GTR in the first three quarters of the year (Table 2.6) was aided by the 34.8 per cent growth in indirect taxes, with union excise duties growing by about 68 per cent. Excise collections may have been bolstered by improving dynamics of economic activity and also measures like increasing the excise duty on petrol and diesel in the backdrop of falling international prices of crude oil. Consequently, indirect tax collections as a ratio of BE at end-December 2015 stood at 71.3 per cent of BE, as compared to 54.8 per cent at end-December 2014. Direct taxes—both on personal income and corporate income--grew by more than 10 per cent during the period. While growth in non-tax revenue remained robust, disinvestment receipts (included in other capital receipts in Table 2.6) at end-December 2015, though higher than in the previous year, stood only at 18.5 per cent of the BE.

2.23 Most of the 33.5 per cent increase in capital expenditure was on the plan side. Revenue expenditure in April-December 2015 was only modestly higher; mainly on account of the 18.3 per cent decline in plan revenue expenditure largely reflecting the change in pattern of devolution to the states/ UTs. Grants-in-aid to states under this head

**Table 2.6: Provisional Outcome for 2015-16 (Till December 2015)**

| | | BE (₹crore) | April-December | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Absolute number (₹crore) | | Per cent of respective BE | | Growth over last year (per cent) | |
| | | 2015-16 | 2014-15 | 2015-16 | 2014-15 | 2015-16 | 2014-15 | 2015-16 |
| 1 | Revenue receipts | 1141575 | 693773 | 803808 | 58.3 | 70.4 | 9.4 | 15.9 |
| | Gross tax revenue | 1449490 | 795686 | 963229 | 58.3 | 66.5 | 7.0 | 21.1 |
| | Tax (net to centre) | 919842 | 545714 | 622248 | 55.8 | 67.6 | 5.4 | 14.0 |
| | Non-tax revenue | 221733 | 148059 | 181561 | 69.7 | 81.9 | 27.3 | 22.6 |
| 2 | Capital receipts | 635902 | 542615 | 510189 | 89.7 | 80.2 | 2.4 | -6.0 |
| | Recovery of loans | 10753 | 8282 | 9138 | 78.7 | 85.0 | 3.0 | 10.3 |
| | Other receipts | 69500 | 1952 | 12866 | 3.1 | 18.5 | -64.1 | 559.1 |
| 3 | Total receipts | 1777477 | 1236388 | 1313997 | 68.9 | 73.9 | 6.2 | 6.3 |
| 4 | Non-Plan expenditure | 1312200 | 883757 | 968019 | 72.4 | 73.8 | 8.8 | 9.5 |
| | a) Revenue account | 1206027 | 813270 | 895386 | 73 | 74.2 | 11.2 | 10.1 |
| | Interest payments | 456145 | 275220 | 302298 | 64.5 | 66.3 | 10.8 | 9.8 |
| | Major subsidies | 227388 | 212418 | 208759 | 84.5 | 91.8 | 12.5 | -1.7 |
| | Pensions | 88521 | 68104 | 69467 | 83.1 | 78.5 | 26.4 | 2.0 |
| | b) Capital account | 106173 | 70487 | 72633 | 67 | 68.4 | -13.4 | 3.0 |
| 5 | Plan expenditure | 465277 | 352631 | 345978 | 61.3 | 74.4 | 0.4 | -1.9 |
| | a) Revenue account | 330020 | 282278 | 230656 | 62.2 | 69.9 | 3.0 | -18.3 |
| | b) Capital account | 135257 | 70353 | 115322 | 57.9 | 85.3 | -8.9 | 63.9 |
| 6 | Total expenditure | 1777477 | 1236388 | 1313997 | 68.9 | 73.9 | 6.2 | 6.3 |
| | a) Revenue expenditure | 1536047 | 1095548 | 1126042 | 69.9 | 73.3 | 9.0 | 2.8 |
| | b) Capital expenditure | 241430 | 140840 | 187955 | 62.1 | 77.9 | -11.2 | 33.5 |
| 7 | Revenue deficit | 394472 | 401775 | 322234 | 106.2 | 81.7 | 8.2 | -19.8 |
| 8 | Effective revenue deficit | 283921 | 303912 | 229446 | 144.6 | 80.8 | 10.4 | -24.5 |
| 9 | Fiscal deficit | 555649 | 532381 | 488185 | 100.2 | 87.9 | 3.1 | -8.3 |
| 10 | Primary deficit | 99504 | 257161 | 185887 | 246.9 | 186.8 | -4.0 | -27.7 |

*Source:* **CGA monthly account and Budget documents.**

declined from ₹2.05 lakh crore last year (April-December) to ₹1.50 lakh crore this year. However, non-plan grants to states increased from ₹0.35 lakh crore to ₹0.74 lakh crore during the period.

2.24 The 1.7 per cent decline in major subsidies was due to a near 44.7 per cent decline in petroleum subsidy (April-December) that occurred due to a steep decline in international crude oil prices. The other major subsidies—food and fertilizer—increased by 10.4 per cent and 13.7 per cent respectively during the period.

## Performance of Departmental Enterprises of the Central Government

### Department of Posts

2.25 The gross receipts of the Department of Posts in 2014-15 were placed at ₹11,636 crore. The gross and net working expenses during the year were ₹18,557 crore and ₹17,895 crore respectively, which resulted in a deficit of ₹6259 crore. In 2015-16, the gross receipts are expected to increase to ₹12,237 crore, with gross and net working expenses estimated at ₹20,185 crore and ₹19,540 crore respectively. The deficit is projected to be ₹7303 crore.

### Railways

2.26 The key focus areas for Indian Railways include fast tracking of capacity augmentation, network modernization, improvement in asset utilization and productivity, modernization of rolling stock and maintenance practices, improving the quality and pricing of services and improving energy efficiency in operations. Investments are being prioritized in important areas like dedicated freight corridors, high speed rail, high-capacity rolling stock, last mile rail linkages and port connectivity. During 2014-15, the freight earnings, passenger earnings (including coaching earnings) and gross traffic receipts of the Railways grew by 12.7 per cent, 14.9 per cent and 12.3 per cent respectively over 2013-14. Gross traffic receipts of the Railways were estimated to increase to ₹1.84 lakh crore in BE 2015-16, as against ₹1.57 lakh crore in 2014-15. The operating ratio of the Railways, which stood at 91.3 per cent in 2014-15, and net revenue as a proportion of capital-at-charge, which was 7.0 per cent in the previous year, are also likely to see improvements in 2015-16.

## Government Debt

2.27 The public debt management policy in India focuses on maintaining a long-run sustainable debt structure at lowest possible cost. Prolonged fiscal deficits lead to accumulation of debt beyond levels that are sustainable and can result in higher real and nominal interest rates, slower growth in capital formation and potentially lower rates of output growth. High and rising public debt levels may also impact public finances through debt servicing dynamics that worsen the government's fiscal position.

2.28 The total outstanding liabilities of the central government were ₹62.78 lakh crore at end-March 2015, accounting for 49.6 per cent of GDP and comprising 39.2 per cent public debt (internal debt plus external debt) and 10.3 per cent other liabilities (small savings, provident funds, etc.) (Table 2.7). Total outstanding liabilities were estimated at ₹68.94 lakh crore in BE 2015-16.

2.29 Figure 2.16A shows how robust GDP growth kept the increasing debt of the central government at sustainable levels, relative to the size of the economy. The figure also brings forth an issue of the temporal valuation of the external liabilities of the centre. The degree of external liability of the government, as shown in Figure 2.16 B, may change purely on account of currency movements, even without new borrowing. By any measure, however, external debt is only a small fraction of the total liabilities of the centre and is a declining proportion of GDP (Table 2.7).

**Table 2.7: Total Outstanding Liabilities of the Central Government at end-March**

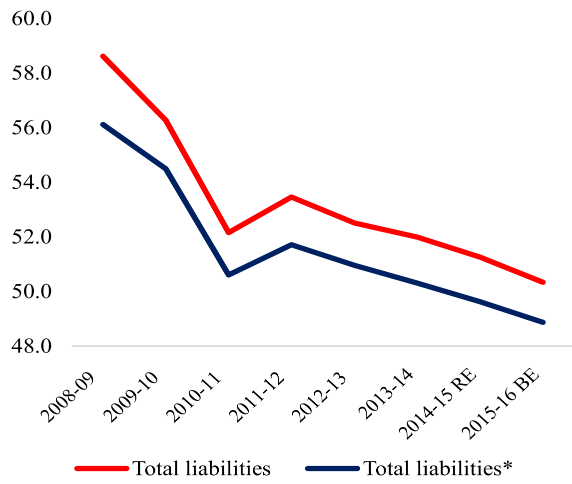
(as per cent of GDP)

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 RE | 2015-16 BE |
|---|---|---|---|---|---|
| 1.Internal liabilities # | 49.8 | 49.2 | 48.7 | 48.1 | 47.4 |
| a)Internal debt | 37.0 | 37.8 | 37.6 | 37.7 | 37.6 |
| i)Market borrowings | 28.8 | 30.0 | 30.5 | 30.8 | 30.9 |
| ii)Others | 8.2 | 7.8 | 7.1 | 7.0 | 6.7 |
| b).Other internal liabilities | 12.8 | 11.3 | 11.0 | 10.3 | 9.9 |
| 2.External debt(outstanding)* | 1.9 | 1.8 | 1.6 | 1.5 | 1.5 |
| 3.Total outstanding liabilities (1+2) | 51.7 | 51.0 | 50.3 | 49.6 | 48.9 |

***Source:*** **Union budget documents and DMO.**

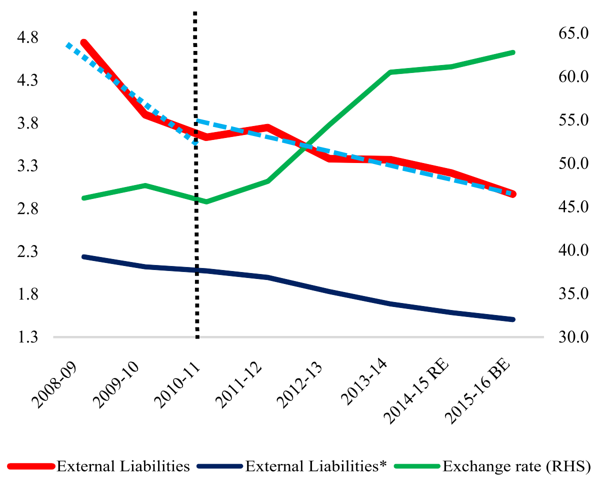
**Notes: * External debt figures represent borrowings by central government from external sources and are based upon historical rates of exchange; # Internal debt includes net borrowing of ₹20,000 crore for 2015-16 (BE) under the Market Stabilization Scheme.**

**Figure 2.16 A: Central Government Total Liabilities as Per Cent of GDP**




***Source:*** **Union budget documents, Reserve Bank of India (RBI) and Debt Management Office (DMO).**

**Figure 2.16 B: Central Government External Liabilities as Per Cent of GDP**




***Source:*** **Union budget documents, RBI and DMO.**

***Notes:**** **External liabilities at historical exchange rate otherwise it is at current exchange rate.**

## Fiscal performance of the General Government

2.30 In the new regime of fiscal federalism, an analysis of the general government offers greater insights than a separate analysis of either the centre or the states, mainly for two reasons. First, since the implementation of the recommendations of the 12th Finance Commission, the share of states in national taxes has been increasing (Figure 2.17A); and, second, with the acceptance of the FFC recommendations, the transfer of untied resources from the centre to the states has increased considerably (Figure 2.17 B).

2.31 The general government (centre plus states) has been on the path of fiscal consolidation and fiscal discipline, as reflected in the debt dynamics (Figure 2.18). The fiscal deficit of general government is further expected to decline from 6.9 per cent of GDP in 2014-15 (RE) to 6.3 per cent of GDP in 2015-16 (BE) (Figure 2.19).

2.32 Based on the first eight months' data of the current year, it is observed that both the centre and the states have stuck to the plan of ensuring quality of expenditure and boosting public investment. The general government capital expenditure in first the eight months of 2015-16 increased by 26.9 per cent over the corresponding period of the previous year (Figure 2.20).

Figure 2.17A: Share of Centre and States in National Taxes (per cent)

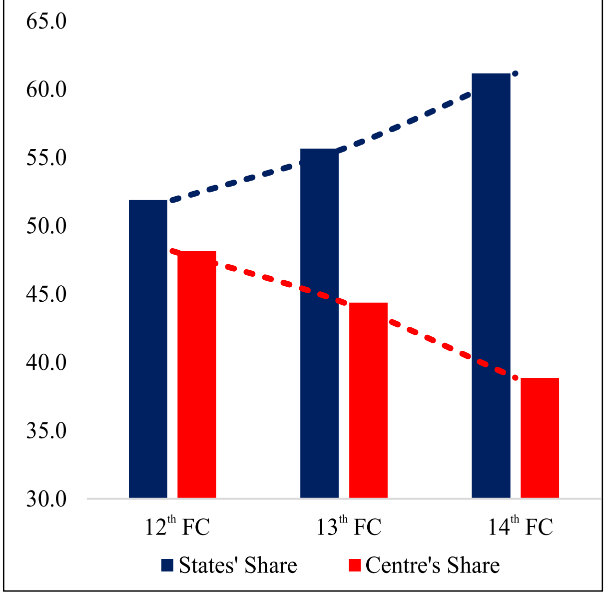
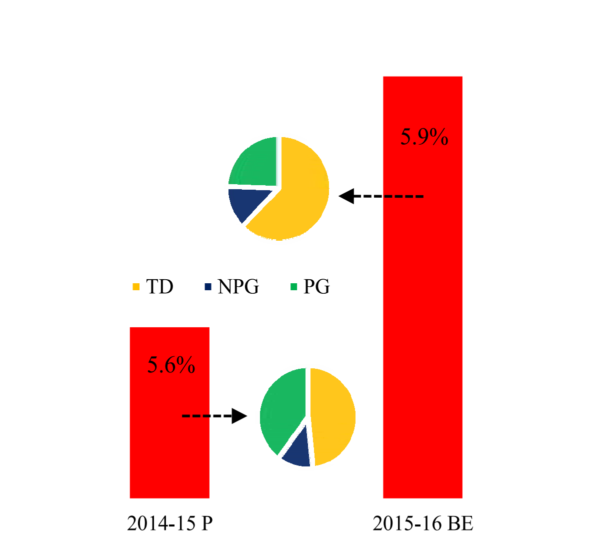



Figure 2.17B: Resources Transferred to States (% of GDP)




***Source:*** **Budget documents of centre and CAG.**

***Source:*** **Budget documents of centre and CAG.**

TD= Tax devolution NPG= Non-plan grants PG=Plan grants

National taxes is sum of gross tax revenue of the Centre and States' own tax revenue. Period under 12th FC is 2005-10, 13th FC is 2010-15 and for 14th FC is 2015-16.

Figure 2.18: General Government Liabilities (per cent of GDP)

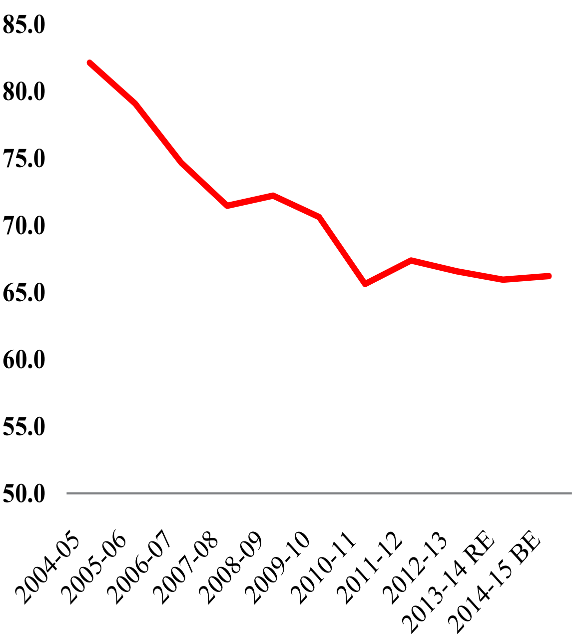
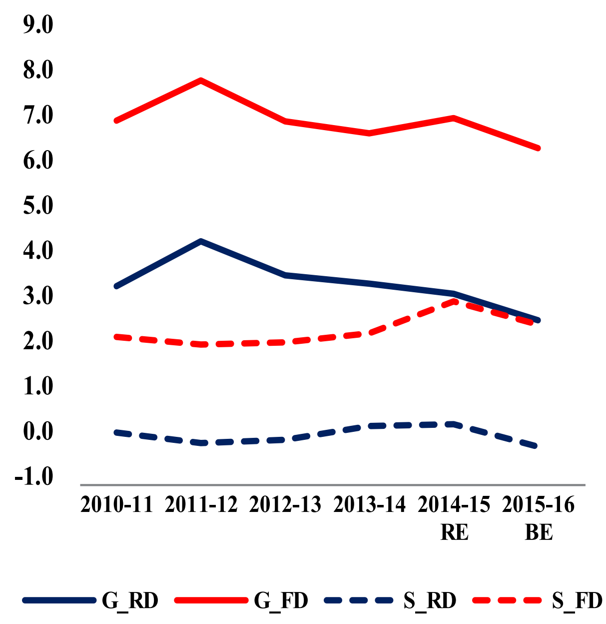



Figure 2.19:General and State Government RD and FD (% of GDP)

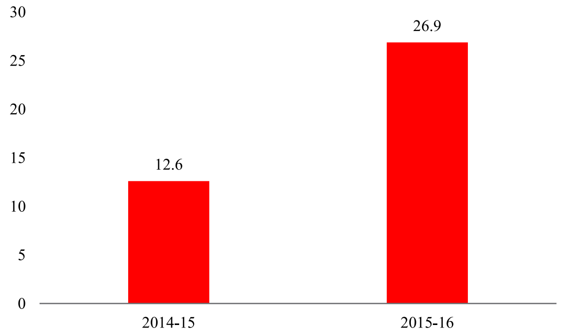



***Source*****: RBI.**

***Source*****: RBI.**

**Notes: G_RD=General Government Revenue deficit. G_FD=General Government Fiscal deficit. S_RD=State Governments Revenue deficit. S_FD=State Governments Fiscal deficit.**

**Figure 2.20: Growth in General Government Capital Expenditure in (April-November) (per cent)**




***Source:*** **CAG**

## Outlook

2.33 Significant increase in revenue receipts, led by buoyant indirect tax collections, higher level of capital expenditure on the plan side, lower level of subsidies on petroleum products helped in a large measure by declining international prices of crude oil, and enhanced untied resources transferred to the states following the acceptance of the recommendations of the FFC are some of the salient developments of the fiscal performance in 2015-16 so far. Given the pattern of revenue and expenditure in the first nine months of the current financial year, in spite of the challenges posed by a lower than projected nominal GDP growth, the fiscal deficit target of 3.9 per cent of GDP seems achievable.

2.34 The coming year is expected to be a challenging one from the fiscal point of view. With global slowdown likely to persist, the chances of India's growth rate in 2016-17 increasing significantly beyond 2015-16 levels are not very high. Similarly, in contrast to the current year, the subsidy bill on petroleum products may not reap the advantages of steeply declining oil prices. The implementation of the Pay Commission recommendations and the One Rank One Pension (OROP) scheme will put additional burden on expenditure. Improving tax compliance through better tax administration, tapping new sources of revenue, etc. could help raise more revenue and keep the fiscal deficit at levels projected in the revised fiscal road map.