MEDIUM TERM FISCAL POLICY STATEMENT

A. FISCAL INDICATORS – ROLLING TARGETS AS PERCENTAGE OF GDP

(at current market prices)

		Revised Estimates 2008-09	Budget Estimates 2009-10	Targets for	
				2010-11	2011-12
1.	Revenue Deficit	4.4	4.0	0.0	0.0
2.	Fiscal Deficit	6.0	5.5	3.0	3.0
3.	Gross Tax Revenue	11.6	11.1	14.4	15.0
4.	Total outstanding liabilities at the end of the year	59.6	58.2	54.5	51.1

Notes:—

1. *"GDP" is the Gross Domestic Product at current market prices.*
2. *"Total outstanding liabilities" include external public debt at current exchange rates. For projections, constant exchange rates have been assumed.*
3. *Targets for 2010-11 and 2011-12 will be revisited after the implementation of the 13th Finance Commission recommendations from 2010-11.*

1. Several developments having significant economic and budgetary implications have taken place since the presentation of the Union Budget in February, 2008. The medium term fiscal outlook presented above indicates substantial variation over the projections presented along with the Budget 2008-09. The extraordinary economic circumstances in which these developments have taken place have been detailed in the Fiscal Policy Strategy Statement and Macro-Economic Framework Statement. The World economy has never witnessed this kind of unprecedented crises in different sectors in the same fiscal year. In the first half of the current fiscal year, rising prices in the world commodity market including petroleum products required Government to take various fiscal and administrative measures in concert with monitory policy initiatives by the Reserve Bank of India to reduce the impact of inflationary pressures in the economy. Various tax measures were undertaken to reduce the impact of global price rise on Indian economy details of which are enumerated in the Fiscal Policy Strategy Statement. At the same time, Government also made higher provisions for food and fertiliser subsidies to minimize the adverse effect of inflation on the vulnerable sections of the society. These measures along with easing of global price pressures, helped in bringing down the inflation to a moderate level.

2. Post budget rate cuts in taxes/duties (mainly in indirect taxes) and increased subsidy burden resulted in higher than estimated revenue and fiscal deficit in the first half of the fiscal year. However, with direct tax revenue receipts showing higher than the estimated buoyancy in the first half (growth of 35.6 per cent in H1 2008-09 against estimated 17.1 per cent in B.E.2008-09), there were indications that the shortfall in indirect taxes and additional expenditure commitments arising out of post budget developments would be neutralised to some extent in the second half of the fiscal year. But the second half of the current fiscal year brought with it a different problem with the collapse of several international financial institutions. Notwithstanding strong macro-economic fundamentals, the Indian economy was also affected as most emerging market economies were, with the rate of growth slowing down. The growth in 2008-09 as per the Advance Estimates of the Central Statistical Organisation (CSO) has moderated at 7.1 per cent against the average of about 9 per cent achieved during the last four years. In order to keep the economy on the higher growth trajectory, the government took a conscious decision to use fiscal policy as a tool to provide a boost to demand to counter the situation created by the global financial crisis. After factoring in the impact of the measures undertaken on receipts and expenditure sides, the revenue deficit and fiscal deficit is estimated at 4.4 per cent and 6.0 per cent respectively of GDP in R.E.2008-09. The outstanding liabilities at the end of year 2008-09 as percentage of GDP is estimated

at 59.6 per cent in R.E.2008-09. Fiscal consolidation in the last four years with reduced fiscal deficit, in line with the mandate under the FRBM Rules, has resulted in total liabilities of the Government as percentage of GDP declining from 63.3 in 2004-05 to 59.6 in RE 2008-09. Though this level of debt and liabilities is still higher but certainly this correction during the FRBM Act regime has given additional fiscal space to manoeuvre the fiscal policy during the current challenging circumstances.

3. Interim Budget 2009-10 is being presented in this background. With the continuance of reduced tax/duties rates in the phase of slowdown in the growth in economy, the gross tax to GDP ratio is set to decline to 11.1 per cent in B.E.2009-2010. With expenditure at 15.8 per cent of GDP, the revenue and fiscal deficit at 4 per cent & 5.5 per cent shows moderate correction in BE 2009-10. While it does not reflect achievement of mandated target for fiscal deficit as well as revenue deficit in the year 2008-09 and 2009-10, with improvement in prevailing conditions, the process of fiscal consolidation is expected to be back on track from 2010-11. Depending on the response on economy and improvement in the global scenario, the situation will be reviewed and further necessary steps taken in this regard.

B. ASSUMPTIONS UNDERLYING THE FISCAL INDICATORS

1. Revenue Receipts

(a) Tax-Revenue

4. The Gross Tax Revenue as a percentage of GDP has increased from 9.2 in 2003-04 to 12.5 in 2007-08 during the FRBM Act regime. It was estimated to further improve at 13 per cent in B.E.2008-09. The first half of the current fiscal year witnessed growth of 25.3 per cent in gross tax receipts over the same period in the previous financial year. However, due to the moderation in growth in the economy and post budget tax/duty rate cuts, during Q3 in 2008-09 gross tax receipts were 11.6 per cent lower than Q3 of 2007-08. This has brought down the overall tax receipts growth during the first three quarters of the current fiscal year as compared to the corresponding period in the previous year to 9.6 per cent. It is likely that the estimated gross tax revenue of Rs.6,87,715 crore may not be realised during 2008-09 and R.E.2008-09 therefore is estimated at Rs.6,27,949 crore amounting to 11.6 per cent of GDP representing growth of 5.9 per cent over 2007-08. Accordingly assignment to States and net tax revenue of Centre in R.E.2008-09 is estimated at Rs.1,60,179 crore and Rs.4,65,970 crore respectively. The downward revision is primarily on account of change in taxes/duties in indirect taxes (Customs and Union Excise Duties) and lower realization in direct taxes due to slowdown in the economy.

5. In view of the prevailing uncertainty in the world economy and its likely impact on Indian economy during 2009-10, the gross tax revenue is estimated to show lower buoyancy and is estimated at Rs.6,71,293 crore in B.E.2009-10 amounting to 11.1 per cent of GDP. This represents a growth of 6.9 per cent over R.E.2008-09. Direct tax receipts are estimated at Rs.3,80,000 crore in B.E.2009-10 showing a growth of 10.1 per cent over R.E.2008-09 and amounting to 6.3 per cent of GDP. Indirect taxes are estimated at Rs.2,91,293 crore in B.E.2009-10 showing a growth of 2.9 per cent over R.E.2008-09 amounting to 4.8 per cent of GDP. The gross tax to GDP ratio is projected to improve in 2010-11 to 14.4 per cent and 2011-2012 to 15 per cent on the expectation that the economy starts showing signs of revival in the second half of 2009-2010. The direct tax to GDP ratio is projected at 8.6 per cent in 2010-2011 and 9.3 per cent in 2011-2012. At the same time indirect tax to GDP ratio is projected at 5.8 per cent and 5.7 per cent in 2010-2011 and 2011-12 respectively.

6. Assignment to States and net Tax Revenue of Centre in B.E. 2009-10 are placed at Rs.1,71,197 crore, and Rs.4,97,596 crore respectively, representing growth of 6.9 per cent and 6.8 per cent over R.E. 2008-09.

7. The fiscal indicators shown in Table in paragraph A are based on normal tax buoyancy and do not envisage any significant Additional Resources Mobilisation (ARM) measures.

(b) Non-tax-revenue

8. The non-tax revenue (NTR) is estimated to increase from Rs.95,785 crore in B.E. 2008-09 to Rs.96,203 crore in R.E. 2008-09 and Rs.1,11,955 crore in B.E.2009-2010 representing 1.77 per cent and 1.86 per cent of GDP respectively in 2008-09 and 2009-10. Receipts from dividends and profits which constitute the largest component of NTR are estimated at Rs.36,985 crore in BE 2009-10, as compared to Rs.43,204 crore in BE 2008-09.

Interest receipts from States are likely to decline in the medium term, mainly due to Centre's disengagement from financial intermediation on the recommendation of the Twelfth Finance Commission on lending to States except for loans under externally aided projects. Also the incentive linked restructuring of

State Government debt will result in downward trend in interest receipts for some more time. The B.E.2009-10 shows a significant increase in NTR due to factoring in of the likely receipts from auction of spectrum in telecommunication sector. In the medium term, NTR is expected to marginally improve in absolute terms but will show a progressively declining trend as a proportion of GDP.

(c) Devolution to States

9. Twelfth Finance Commission (TFC) award with incentive to promote fiscal reforms, are enabling the State Governments to actively undertake fiscal correction with taxation reforms and expenditure management. Twenty six States have enacted their own FRBM laws. In so far as sharing of taxes are concerned 30.5 per cent of gross tax revenue from Central Taxes/Duties including Additional Excise Duty on sugar, tobacco and textiles in lieu of Sales Tax but excluding cesses, surcharges and cost of tax collection, devolve to States. TFC has also recommended that if the rental arrangement in respect of Additional duties in lieu of sales tax is terminated and States are allowed to levy sales tax (or VAT) on these commodities without any prescribed limit, the share of the States in net proceeds of shareable central taxes shall be reduced to 29.5 per cent. States share of Taxes and Duties is estimated at Rs.1,60,179 crore in R.E. 2008-09, and is projected to increase to Rs.1,71,197 crore in B.E. 2009-10 reflecting 6.9 per cent increase over R.E. 2008-09. The Twelfth Finance Commission award period is coming to an end in 2009-2010. Devolution to States of their share in the Central Taxes/Duties for the period 2010-2015 will be governed by the recommendations of the Thirteenth Finance Commission. The report of the Thirteenth Finance Commission is expected to be received by November 2009.

2. Capital receipts

(a) Recovery of loans and advances

10. Repayment of receipts against loans extended earlier are estimated to decline over a period of time on account of the two reasons (i) gradual disintermediation by Central Government and (ii) the debt consolidation and debt waiver scheme of the Twelfth Finance Commission. Over time, State Governments and Central Public Sector Undertakings have been encouraged to borrow directly from the market and not from the Central Government. In addition, State Governments have been allowed to prepay high cost loans. In respect of Central Government loans, TFC has awarded relief to State Governments in the form of debt consolidation and waiver subject to enactment of fiscal responsibility legislation and achievement of specified targets relating thereto. The repayment of loans from PSEs is also impacted on account of defaults from PSEs that are either sick or under revival through BIFR. Recovery of loans and advances is estimated at Rs.9,698 crore in R.E.2008-09 and Rs.9,725 crore in B.E.2009-10.

(b) Other non-debt capital receipts

11. Disinvestment proceeds through sale of Government stake in Central Public Sector Undertakings etc. had been the main source of receipts under this head. However, with the setting up of National Investment Fund (NIF) and the decision on not utilising the sale proceeds of Government equity in PSUs to finance the fiscal deficit, there is not much scope for regular non-debt capital receipts in future. The NIF is in Public Account and funds are being invested through professionally managed selected Public Sector Mutual Funds to provide sustainable returns without depleting the corpus proceed. The returns from the investment are being employed to meet capital investment requirement of profitable and revivable CPSE’s and to finance selected social sector schemes which promote education, health and employment.

(c) Borrowings – Public Debt and Other Liabilities

12. The borrowing requirement of the Government is determined by the level of fiscal deficit, which essentially reflects the uncovered gap between expenditure and total non-debt receipts of the Central Government. This deficit is financed largely through domestic public debt and to a smaller extent through external debt and other internal liabilities or through cash draw down. Government is financing major part of its deficit through resources raised at market determined interest rates.

13. Two other items included in the domestic debt/liabilities of the Central Government are Net accretions to NSSF and Borrowing under Market Stabilization Scheme (MSS). Net accretion to the National Small Savings Fund, to the extent of 80 per cent to 100 per cent is transferred to State Government as per their option with effect from 1.4.2007, through investment in State Government special securities issued for the purpose.

However, these are liabilities of the Central Government and are therefore, included as such. Borrowings under Market Stabilization Scheme are raised by Government of India within the overall ceiling mutually agreed between Government of India and Reserve Bank of India (RBI) to assist the RBI in mopping up excess liquidity in the market arising largely from significant forex inflows. The details on sources of financing of deficit are shown in the Receipts Budget.

3. Total expenditure

(a) Revenue account

(i) Plan Revenue expenditure

14. In order to provide fiscal stimulus to revive the economy and put it back on higher growth trajectory, Plan revenue expenditure has been increased from Rs.2,09,767 crore in B.E.2008-09 to Rs.2,41,656 crore in R.E.2008-09. If this is compared with 2007-08 plan revenue expenditure (provisional actuals) of Rs.1,73,572 crore, the increase is almost 40 per cent. The focus now should shift on ensuring effective implementation and outcomes from financial outlays. The increase in plan expenditure is primarily accounted for by higher allocations to the social sector along with urban and rural infrastructure. The estimates of plan revenue expenditure in B.E.2009-10 is Rs.2,48,349 crore showing increase of 18.4 per cent over that of B.E.2008-09. Notwithstanding decline in revenue and higher liabilities on specific components of non-plan expenditure including interalia, for meeting salary commitments, interest obligations, subsidy gross Defence Establishment and capital acquisitions, Internal Security, Pensions, etc. adequate provisions have been ensured for all important developmental schemes particularly those benefiting the common man and disadvantage sections of society.

(ii) Non Plan Revenue expenditure

15. Majority of constituents of non-plan revenue expenditure are rigid in nature and inelastic in the short term. However, unprecedented increase in the non-plan expenditure witnessed in the current financial year highlights the concerns of sustainability of the pace of growth of this component of expenditure. Non-plan revenue expenditure is estimated to increase from Rs.4,48,352 crore in B.E.2008-09 to Rs.5,61,790 crore in R.E.2008-09. This represents growth of 33.5 per cent over non-plan revenue expenditure in 2007-08. This is further estimated to increase to Rs.5,99,736 crore in B.E.2009-10. The increase is mainly on account of higher wage and pension bills due to the implementation of the Sixth Central Pay Commission recommendations, increased subsidies and interest payments. The major items of non-plan expenditure are detailed below.

(iii) Interest payments

16. Interest payments at Rs.1,92,694 crore constitute about 34 per cent of non-plan revenue expenditure in R.E.2008-09. It is further estimated to increase to Rs.2,25,511 crore which is about 38 per cent of non-plan revenue expenditure in B.E.2009-10. The increase is primarily on account of the higher borrowings resorted to during 2008-09 to finance the higher deficit and interest on Special Securities issued to Oil Marketing Companies and Fertilizer Companies. Due to the fiscal consolidation in the last four years, interest payments as percentage of total revenue receipts (net) of the Central Government has shown a significant improvement from 47 per cent in 2003-04 to 31.5 per cent in 2007-08. However, due to increased deficit and hardening of interest rates during the first half of the financial year 2008-09, this ratio is estimated to deteriorate to 34.3 per cent in R.E.2008-09 and further to 37 per cent in B.E.2009-10. It is the endeavour of the Government to bring the interest payment as percentage of total revenue receipts to a sustainable level.

(iv) Defence Services

17. Defence Services expenditure in revenue account is budgeted to increase from Rs.57,593 crore in B.E. 2008-09 to Rs.73,600 crore in R.E. 2008-09 and further to Rs.86,879 crore in B.E.2009-10 due to the implementation of the Sixth Central Pay Commission recommendations.

(v) Major subsidies

18. This year has witnessed unprecedented rise in the subsidy bill of the Government. Provision for major subsidies on food, fertiliser and petroleum products were Rs.66,537 crore in B.E.2008-09 accounting for 11 per cent of net revenue receipt of the Government. However, post budget developments in the world commodity market resulted in higher economic cost of petroleum products and fertilisers. With the objective of insulating the consumer from unprecedented rise in the cost of these products, the subsidy component provisions have been increased substantially. Subsidy provisions for fertilisers have increased from Rs.30,986 crore in B.E.2008-09 to Rs.75,849 crore in R.E.2008-09. In addition Special Securities amounting to Rs.20,000 crore was issued in lieu of subsidy to Fertiliser companies during 2008-09. Thus, the total provision for fertiliser

subsidies stands at Rs.95,849 crore. Similarly, factoring in the provision of Rs.75,942 crore for issue of securities to Oil Marketing Companies against under recoveries on the sale of sensitive petroleum products, the total provision for petroleum subsidy has increased from Rs.2,884 crore in B.E.2008-09 to Rs.78,818 crore. The enhanced minimum support price for wheat and rice is one of the factors contributing to the increase in the food subsidy bill from Rs.32,666 crore in B.E.2008-09 to Rs.43,627 crore in R.E.2008-09. Thus total provision for subsidies on these three items, including Rs.95,942 crore of Special Securities, has gone up from Rs.66,537 crore in B.E.2008-09 to Rs.2,18,294 crore in R.E.2008-09 amounting to about 4 per cent of GDP. Interest and other subsidies are also estimated to increase from Rs.4,893 crore in B.E.2008-09 to Rs.6,890 crore in R.E.2008-09. On the assumption that current price level may prevail in the next financial year in the world commodity markets, provision for fertiliser subsidy has been kept at Rs.49,980 crore in B.E.2009-10. Food subsidy is estimated at Rs.42,490 crore in B.E.2009-10. Total subsidy is estimated to decline to Rs.1,00,932 crore amounting to 1.7 per cent of GDP in B.E.2009-10. In medium to long term, there is a need for policy objectives to focus on measures and means to cap this expenditure to create further fiscal space for increased investment in physical and social infrastructure.

(vi) Non-Plan Grants to States

19. The Non-Plan Grants to States/UTs is estimated at Rs.46,626 crore in B.E.2009-10 up from Rs.43,294 crore in B.E.2008-09. The Central Government continues its commitment to compensate the State/UT Governments for loss of revenue that may arise on account of phase out of Central sales Tax (CST). A provision of Rs.6,000 crore has been made in B.E.2009-10 for this purpose, as against B.E. of Rs.2,450 crore in 2008-09.

(b) Capital accounts

(i) Loans and advances

20. Loans and advances to State Governments had earlier constituted major component of loans and advances extended by Central Government. The Twelfth Finance Commission has recommended disintermediation by Central Government in the matter of loans to State Government, albeit with support to fiscally weak states, which are unable to raise resources directly. States now raise loans directly from the market. External loans however continue to pass-through Central Government. Non-Plan loans are also extended to CPSUs for various purposes, including budgetary support for investments, restructuring/revival and Voluntary Retirement Scheme/Voluntary Separation Scheme.

(ii) Capital outlay

21. The total Capital expenditure is set to increase from Rs.92,765 crore in B.E. 2008-09 to Rs.97,507 crore in R.E.2008-09 and further to Rs1,05,146 crore in B.E. 2009-10. Of this, total non-plan capital expenditure is Rs.56,206 crore in R.E.2008-09 and Rs.68,346 crore in B.E.2009-10. Defence Capital Outlay constitutes the largest component of non-plan capital expenditure and it is estimated at Rs.41,000 crore in R.E.2008-09 and Rs.54,824 crore in B.E.2009-10.

22. The plan capital expenditure is estimated to increase from Rs.33,619 crore in B.E.2008-09 to Rs.41,301 crore in R.E.2008-09. The plan capital expenditure is estimated at Rs.36,800 crore in B.E.2009-10. In the current scenario when most of the capacity addition in form of capital expenditure is taking place under the Public Private partnership mode. Central Public Sector Undertakings (CPSUs) have been meeting a large part of their capital expenditure through Internal and Extra Budgetary Resources (IEBR). The IEBR of CPSUs (including Railways) is estimated to increase by 6 per cent from Rs.1,95,531 crore in B.E. 2008-09 to Rs.2,07,241 crore in B.E. 2009-10.

4. GDP Growth

23. During the year 2008-09 annual real GDP growth (at constant 1999-2000 prices) is likely to moderate at 7.1 per cent (Advance Estimates) as compared to the growth rate of 9.1 per cent during 2007-08 (Quick Estimates). The nominal growth rates of GDP at current market prices during the respective years are 14.9 per cent and 14.4 per cent. As such the GDP at current market prices for the year 2008-09 stands at Rs.54,26,277 crore as against Rs.47,23,400 crore in 2007-08. Due to the prevailing uncertainty in the world economy, the real GDP growth has been assumed at 7 per cent in 2009-10. After factoring in inflation expectation, the GDP growth (at current market prices) for 2009-10 is assumed at 11 per cent. Thus the GDP for the year 2009-10 (at current market prices) is set at Rs.60,21,426 crore. In the following two years, with the assumption that economy will start showing signs of revival, the real GDP growth has been assumed at 8 and 9 per cent respectively. After factoring in medium term inflation expectation, the GDP growth at current market prices is projected at 13 per cent and 13.4 per cent respectively for 2010-11 and 2011-12.

C. Assessment of sustainability relating to

(i) The balance between Revenue Receipts and Revenue Expenditure

24. In a reversal of the trend of the last three years, growth in Revenue Receipts has been outpaced by the growth in Revenue Expenditure, resulting in worsening of revenue deficit in R.E. 2008-09. Post budget developments have resulted in reduction in tax/duty rates and increase in expenditure commitments. Total Revenue Receipts (net) is estimated at 3.7 per cent over 2007-08 in R.E. 2008-09 whereas the revenue expenditure is estimated at 35.1 per cent over 2007-08 in R.E. 2008-09. The revenue deficit is estimated to increase from the projected level of 1 per cent of GDP in B.E. 2008-09 to 4.4 per cent in R.E. 2008-09. This deterioration can be mainly attributed to the increased subsidy bill, increased wage bill due to the implementation of Sixth Central Pay Commission recommendations and additional expenditure commitments arising out of the fiscal stimulus package aimed at boosting demand and maintaining the phase of economic growth. The impact of increased expenditure in flagship programmes would be visible in the medium term.

25. In the background of the current economic slow down, the gross tax to GDP ratio is not likely to improve in the next fiscal. Coupled with higher expenditure commitments in form of continuing higher plan outlay and increased wage bill, the revenue deficit is estimated in B.E. 2009-10 at 4 per cent of GDP. Total expenditure in B.E. 2009-10 is estimated at 15.8 per cent of GDP whereas the Revenue receipts is likely to fall to 10.1 per cent of GDP. As any reduction in plan outlay would have led to further moderation in the growth of economy and it would also have exposed the vulnerable sections of society to the impact of economic slowdown, the government has taken a conscious decision to temporarily shift its fiscal stance to accommodate a higher fiscal deficit than the mandated three per cent target under the FRBM Rules during 2008-09 & 2009-10. On the assumption that the economy would soon revert to its recent high trend growth in the second half of 2009-10, the estimates for 2010-11 and 2011-12 of the fiscal deficit is envisaged to be brought down to the mandated level of three per cent.

(ii) The use of capital receipts including market borrowings for generating Productive Assets.

26. In R.E. 2008-09 the total Plan expenditure of Rs.2,82,957 crore is about 86.7 per cent of the Fiscal deficit estimated at Rs.3,26,515 crore. This shows a reversal in the healthy trend of last two fiscal years when the fiscal deficit was lower than the plan expenditure. This reversal is temporary as it has arisen due to higher subsidy outgo and due to payments of arrears to the tune of 40 per cent to employees and pensioners subsequent to the implementation of the Sixth Central pay Commission recommendation. However, reliance on debt financing to meet large component of developmental expenditure is expected to continue over the medium term

27. The task ahead in order to continue the process of fiscal consolidation is admittedly more challenging, especially the elimination of revenue deficit. The Thirteenth Finance Commission through an additional Term of Reference has been mandated to review the roadmap for fiscal adjustment and suggest a suitably revised roadmap to maintain the gains of fiscal consolidation through 2010 to 2015, particularly keeping in view the need to bring in the liabilities of the Central Government on account of oil, food and fertiliser bonds into the fiscal accounting, and the impact of various other obligations of the Central Government on the deficit targets. Primarily the fiscal consolidation during the period 2004-08 was revenue driven, and therefore it has created a stress when the revenue buoyancy has fallen on account of moderation in economic growth. The focus now should also be on expenditure reform in order to make the fiscal consolidation process sustainable and bring in inter-generational equity in fiscal management.