Fiscal Developments and Public Finance

In a developing economy, demand for resources for providing the economic and social infrastructure needs have to be balanced with its resource generating capacity. Since the sectoral claims on resources are enormous, there is often a danger of profligacy leading to fiscal imbalances endangering macro fundamentals of the economy. At the beginning of reforms in 1991, the fiscal imbalances were identified as the root cause of the balance of payments crisis and domestic inflation. The fiscal consolidation, which followed in response, however, failed to sustain itself as it lacked a statutory mandate and the required institutional support. The enactment of the Fiscal Responsibility and Budget Management Act (FRBMA), 2003 provided the required mandate and lent credibility to the fiscal reforms process.

3.2 The fiscal deficit of the Centre as a proportion of GDP came down from 5.9 per cent in 2002-03 to 3.4 per cent in 2006-07 and is estimated to further decline to 3.3 per cent in 2007-08 (BE) (3.2 per cent based on revised GDP estimates) (Table 3.1). Similarly, the revenue deficit declined from 4.4 per cent in 2002-03 to 1.9 per cent in 2006-07 and is estimated to further decline to 1.5 per cent in 2007-08 (BE) (Figure 3.1). The revenue deficit as a percentage of fiscal deficit has declined from 79.7 per cent in 2003-04 to 56.3 per cent in 2006-07 and it is further estimated to improve to 47.4 per cent in 2007-08 (BE) implying a progressively better utilization of borrowed resources towards asset creation.

3.3 States have also joined the process of fiscal consolidation in line with the Twelfth Finance Commission's (TFC) recommendations and are complementing the efforts of the Central Government. As recommended by TFC and following the example of the Central Government, 26 States have already enacted fiscal responsibility legislations. The fiscal situation of the States has shown considerable improvement, which in fact is even better relative to the performance of the Central Government, post-FRBMA. As a proportion of GDP, the fiscal deficit of the States declined from 4.4 per cent in 2003-04 to 2.3 per cent in 2007-08 (BE). The aggregate revenue deficit of the States was 0.1 per cent in 2006-07 (RE). States on a consolidated basis are expected to have a revenue surplus of 0.3 per cent of GDP in 2007-08. A strong incentive-based fiscal transfers

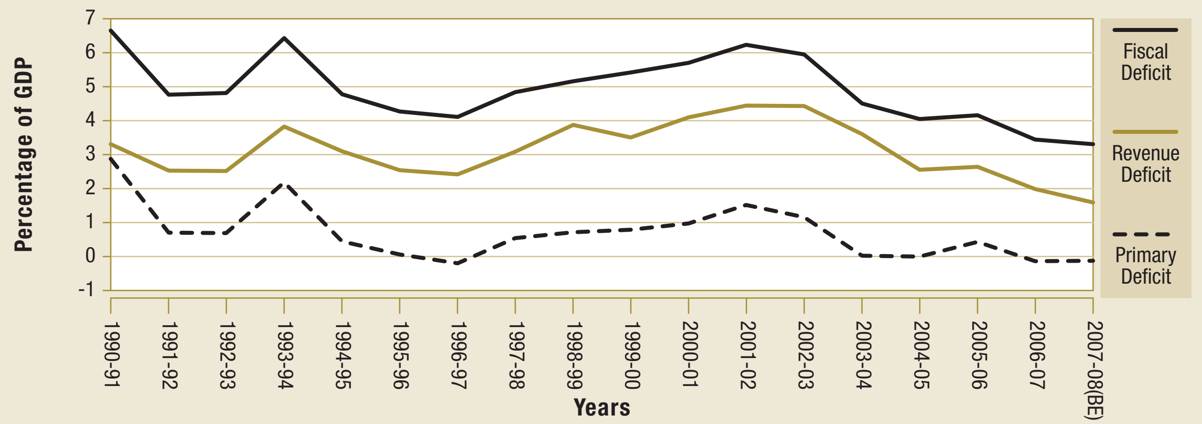
Table 3.1 Trends in deficits of Central Government

Year	Fiscal deficit	Revenue deficit	Primary deficit	Revenue deficit as per cent of fiscal deficit
	(As per cent of GDP)			
1996-97	4.1	2.4	-0.2	58.2
1997-98	4.8	3.0	0.5	63.5
1998-99	5.1	3.8	0.7	74.8
1999-2000	5.4	3.5	0.7	64.6
2000-01	5.7	4.1	0.9	71.7
2001-02	6.2	4.4	1.5	71.1
2002-03	5.9	4.4	1.1	74.4
Enactment of FRBMA				
2003-04	4.5	3.6	0.0	79.7
2004-05	4.0	2.5	-0.1	62.6
2005-06	4.1	2.6	0.4	63.0
2006-07	3.4	1.9	-0.2	56.3
2007-08(BE)	3.2	1.5	-0.2	47.4

Source : Budget documents.

Note: 1. The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.
2. Fiscal deficit excludes transfer of States' share in small savings collections.

Figure 3.1 Trends in deficits of Central Government



(proposed by TFC) by embedding in it a framework of fiscal consolidation has played an important role in this success.

CENTRAL GOVERNMENT FINANCES

3.4 Robust economic growth and improved performance of the manufacturing and services sectors helped to keep tax revenues buoyant during the last five years. Average annual growth of revenue receipts of the Central Government between 2003-04 and 2007-08 (BE) was 16.2 per cent. Improved growth of tax revenue (net to Centre) at 20.7 per cent during the same period generated an overall high growth of revenue receipt (Table 3.2). Gross tax revenue of the Central Government recorded an average annual growth of 20.5 per cent, higher than the 13.8 per cent rate of growth of GDP (at market prices) during this period. The gross tax-GDP ratio, which had stagnated at 8-10 per cent range for more than a decade, increased to 11.4 per cent in 2006-07 and is expected to improve further to 11.8 per cent in 2007-08 (BE) (11.7 per cent based on revised GDP estimates) (Table 3.3). Revenue expenditure during this period recorded lower average annual growth of 10.6 per cent leading to a reduction in revenue deficit in both absolute terms and also relative to GDP. Growth of plan expenditure at 13.1 per cent was higher compared to the growth in non-plan expenditure of 9.7 per cent during the same period (Figure 3.2).

Central Government finances, 2006-07

3.5 The revenues for 2006-07 have exceeded expectations. The Budget for 2006-07 had projected an increase of gross tax revenue of the Central Government by 19.5 per cent over 2005-06 (RE). This was based on a projected rate of growth for corporate income tax and personal income tax of 28.4 per cent and 16.9 per cent, respectively. The realized growth rates in 2006-07 over 2005-06 (RE) of gross tax revenue, corporate income tax and personal income tax were 27.4 per cent, 39.3 per cent, and 29.2 per cent, respectively. In case of customs and excise duties, the budget had estimated a growth of 20 per cent and 6.3 per cent, respectively. Though the realized growth in customs was much higher at 34.4 per cent, in the case of excise duty it was lower at 5 per cent. The revenue receipts from service tax at 63.5 per cent as against 50 per cent envisaged in the 2006-07 Budget were particularly buoyant. Higher direct taxes, service tax and customs duty collections led to overall increase in gross tax collections from Rs. 4,42,153 crore as projected in 2006-07 (BE) to Rs. 4,71,512 crore in 2006-07 (Actual). Non-tax revenue, which was projected to grow at 2.6 per cent, actually grew at the rate of 11.9 per cent, mainly due to increase in other non-tax revenues from Rs. 28,924 crore in 2005-06 (Actual) to Rs. 31,769 crore in 2006-07 (Actual) and increase in dividend and profits from Rs. 25,451 crore to Rs. 29,309 crore during the same period.

3.6 The revenue expenditure in 2006-07 (Actual) grew by 17 per cent and was higher than the budgeted expenditure by 5.4 per cent. Capital expenditure on the other hand recorded a moderate growth of 3.6 per cent and was lower than the budgeted expenditure by 9.3 per cent. This was mainly because of a decline in non-plan capital

Table 3.2 Receipts and expenditure of the Central Government

	2002-03	2003-04	2004-05	2005-06	2006-07 (B.E.)	2006-07	2007-08 (B.E.)
				(Rs. crore)			
1. Revenue receipts (a+b)	**230834**	**263813**	**305991**	**347462**	**403465**	**434387**	**486422**
(a) Tax revenue (net of States' share)	**158544**	**186982**	**224798**	**270264**	**327205**	**351182**	**403872**
(b) Non-tax revenue	**72290**	**76831**	**81193**	**77198**	**76260**	**83205**	**82550**
2. Revenue expenditure	**338713**	**362074**	**384329**	**439761**	**488192**	**514608**	**557899**
of which:							
(a) Interest payments	117804	124088	126934	132630	139823	150272	158995
(b) Major subsidies	40716	43535	44753	44480	44792	52935	51247
(c) Defence expenditure	40709	43203	43862	48211	51542	51681	54078
3. Revenue deficit (2-1)	**107879**	**98261**	**78338**	**92299**	**84727**	**80221**	**71477**
4. Capital receipts	**182414**	**207390**	**192261**	**158661**	**160526**	**148999**	**194099**
of which:							
(a) Recovery of loans[a]	34191	67165	62043	10645	8000	5892	1500
(b) Other receipts (mainly PSU disinvestment)	3151	16953	4424	1581	3840	534	41651[b]
(c) Borrowings and other liabilities[c]	145072	123272	125794	146435	148686	142573	150948
5. Capital expenditure	**74535[d]**	**109129[d]**	**113923[d]**	**66362**	**75799**	**68778**	**122622**
6. Total expenditure [2+5=6(a)+6(b)]	**413248**	**471203**	**498252**	**506123**	**563991**	**583386**	**680521**
of which:							
(a) Plan expenditure	111470	122280	132292	140638	172728	**169860**	205100
(b) Non-plan expenditure	301778	348923	365960	365485	391263	413526	475421
7. Fiscal deficit [6-1-4(a)-4(b)]	**145072**	**123272**	**125794**	**146435**	**148686**	**142573**	**150948**
8. Primary deficit [7-2(a)=8(a)+8(b)]	**27268**	**-816**	**-1140**	**13805**	**8863**	**-7699**	**-8047**
(a) Primary deficit consumption	38607	25037	-275	250	-16864	-28841	-87518
(b) Primary deficit investment	-11339	-25853	-865	13555	25727	21142	79471
				(As per cent of GDP)			
1. Revenue receipts (a+b)	**9.4**	**9.6**	**9.7**	**9.7**	**9.7**	**10.5**	**10.4**
(a) Tax revenue (net of States' share)	**6.5**	**6.8**	**7.1**	**7.5**	**7.9**	**8.5**	**8.6**
(b) Non-tax revenue	**2.9**	**2.8**	**2.6**	**2.2**	**1.8**	**2.0**	**1.8**
2. Revenue expenditure	**13.8**	**13.1**	**12.2**	**12.3**	**11.8**	**12.4**	**11.9**
of which:							
(a) Interest payments	4.8	4.5	4.0	3.7	3.4	3.6	3.4
(b) Major subsidies	1.7	1.6	1.4	1.2	1.1	1.3	1.1
(c) Defence expenditure	1.7	1.6	1.4	1.3	1.2	1.2	1.2
3. Revenue deficit (2-1)	**4.4**	**3.6**	**2.5**	**2.6**	**2.0**	**1.9**	**1.5**
4. Capital receipts	**7.4**	**7.5**	**6.1**	**4.4**	**3.9**	**3.6**	**4.1**
of which:							
(a) Recovery of loans[b]	1.4	2.4	2.0	0.3	0.2	0.1	0.0
(b) Other receipts (mainly PSU disinvestment)	0.1	0.6	0.1	0.0	0.1	0.0	0.9
(c) Borrowings and other liabilities[d]	5.9	4.5	4.0	4.1	3.6	3.4	3.2
5. Capital expenditure	**3.0**	**4.0**	**3.6**	**1.9**	**1.8**	**1.7**	**2.6**
6. Total expenditure [2+5=6(a)+6(b)]	**16.8**	**17.1**	**15.8**	**14.1**	**13.6**	**14.1**	**14.5**
of which:							
(a) Plan expenditure	4.5	4.4	4.2	3.9	4.2	4.1	4.4
(b) Non-plan expenditure	12.3	12.7	11.6	10.2	9.4	10.0	10.1
7. Fiscal deficit [6-1-4(a)-4(b)]	**5.9**	**4.5**	**4.0**	**4.1**	**3.6**	**3.4**	**3.2**
8. Primary deficit [7-2(a)=8(a)+8(b)]	**1.1**	**0.0**	**0.0**	**0.4**	**0.2**	**-0.2**	**-0.2**
(a) Primary deficit consumption	1.6	0.9	0.0	0.0	-0.4	-0.7	-1.9
(b) Primary deficit investment	-0.5	-0.9	0.0	0.4	0.6	0.5	1.7
Memorandum items				(Rs. crore)			
(a) Interest receipts	37622	38538	32387	22032	19263	21371	19308
(b) Dividend and profit	10910	12326	15934	18549	18969	18904	21902
(c) Non-plan revenue expenditure	267144	283436	296835	327903	344430	372190	383545

Source: Budget documents.

a Includes receipts from States on account of Debt Swap Scheme for 2002-03, 2003-04, and 2004-05.

b Includes an amount of Rs. 40,000 crore on account of transaction relating to transfer of RBI's stake in SBI to the Government.

c Does not include receipts in respect of Market Stabilization Scheme, which will remain in the cash balance of the Central Government and will not be used for expenditure.

d Includes repayment to National Small Savings Fund.

Note:1. The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.

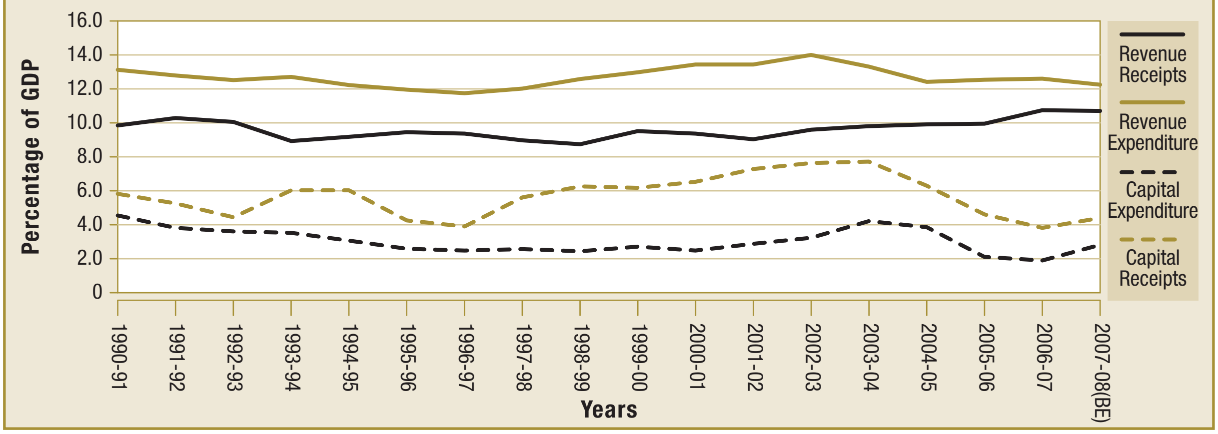
2. The figures may not add up to the total because of rounding approximations.

3. Primary deficit consumption =Revenue deficit-interest payments+interest receipts+dividend & profits.

4. Primary deficit investment =Capital expenditure-interest receipts -Dividend & profits-recovery of loans-other receipts.

5. Figures are exclusive of the transfer of States' share in the small savings collections.

Figure 3.2 Receipts and expenditure of the Central Government



expenditure. Higher growth in revenues relative to the growth in revenue expenditure resulted in a decline in revenue deficit to 1.9 per cent of GDP. Growth in total expenditure in 2006-07 at 15.3 per cent was even lower and reflected in a moderation in the ratio of fiscal deficit to GDP to 3.4 per cent as against the budget estimate of 3.6 per cent.

Budgetary developments in 2007-08

3.7 Both the FRBMA with its medium term fiscal objectives and the National Common Minimum Programme (NCMP) with its economic reforms objectives remained important considerations in formulating the Budget 2007-08. The year 2007-08 is also the first year of the

Table 3.3 Sources of tax revenue

	1995-96 Accounts	2002-03 Accounts	2003-04 Accounts	2004-05 Accounts	2005-06 Accounts	2006-07 Accounts	2007-08 (BE)
	(Rs. crore)						
Direct (a)	**33563**	**83085**	**105090**	**132181**	**165202**	**230174**	**267490**
Personal Income tax	15592	36866	41387	49268	63629	85561	98774
Corporation tax	16487	46172	63562	82680	101277	144306	168401
Indirect (b)	**76806**	**131284**	**147294**	**170936**	**199348**	**241536**	**279190**
Customs	35757	44852	48629	57611	65067	86327	98770
Excise	40187	82310	90774	99125	111226	117612	130220
Service tax	862	4122	7891	14200	23055	37597	50200
Gross tax revenue[a]	**111224**	**216266**	**254348**	**304958**	**366152**	**471512**	**548122**
	(Tax revenue as a percentage of gross tax revenue)						
Direct (a)	**30.2**	**38.4**	**41.3**	**43.3**	**45.1**	**48.8**	**48.8**
Personal Income tax	14.0	17.0	16.3	16.2	17.4	18.1	18.0
Corporation tax	14.8	21.3	25.0	27.1	27.7	30.6	30.7
Indirect (b)	**69.1**	**60.7**	**57.9**	**56.1**	**54.4**	**51.2**	**50.9**
Customs	32.1	20.7	19.1	18.9	17.8	18.3	18.0
Excise	36.1	38.1	35.7	32.5	30.4	24.9	23.8
Service tax	0.8	1.9	3.1	4.7	6.3	8.0	9.2
	(Tax revenue as a percentage of gross domestic product[b])						
Direct (a)	**2.8**	**3.4**	**3.8**	**4.2**	**4.6**	**5.6**	**5.7**
Personal Income tax	1.3	1.5	1.5	1.6	1.8	2.1	2.1
Corporation tax	1.4	1.9	2.3	2.6	2.8	3.5	3.6
Indirect (b)	**6.4**	**5.3**	**5.3**	**5.4**	**5.6**	**5.8**	**5.9**
Customs	**3.0**	**1.8**	**1.8**	**1.8**	**1.8**	**2.1**	**2.1**
Excise	3.4	3.4	3.3	3.1	3.1	2.8	2.8
Service tax	0.1	0.2	0.3	0.5	0.6	0.9	1.1
Total[a]	**9.3**	**8.8**	**9.2**	**9.7**	**10.2**	**11.4**	**11.7**

[a] includes taxes referred in (a) & (b) and taxes of Union Territories and "other" taxes.
[b] Refers to gross domestic product at current market prices.

Note: 1. Direct taxes also include taxes pertaining to expenditure, interest, wealth, gift and estate duty.
2. The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.

Eleventh Five Year Plan with the declared objective of "Faster and more inclusive growth". With growth accelerating from 5.5 per cent per annum during the Ninth Five Year Plan to 7.8 per cent per annum during the Tenth Five Year Plan, the Eleventh Five Year Plan has targeted an average growth of 9 per cent. Consequently, gross budgetary support (GBS) for the annual plan 2007-08 was increased by 20.7 per cent from Rs.1,69,860 crore in 2006-07 (Actual) to Rs. 2,05,100 crore in 2007-08 (BE). The budget support to the Central Plan was placed at Rs. 1,54,939 crore in 2007-08 (BE).

3.8 Bharat Nirman, a time-bound plan for rural infrastructure by the Government of India in partnership with State Governments and Panchayati Raj Institutions, remained the cornerstone of the Government's policy. The allocation for Bharat Nirman (including NER component) was increased by 31.6 per cent to Rs. 24,603 crore in the 2007-08 Budget. The eight flagship programmes of the Government continued to receive high priority and significant increase in allocations were made in Sarva Siksha Abhiyan, Mid-day Meal Scheme, Rajiv Gandhi Drinking Water Mission, Total Sanitation Campaign, National Rural Health Mission, Integrated Child Development Programme, National Rural Employment Guarantee Scheme and Jawaharlal Nehru National Urban Renewal Mission.

3.9 At the time of formulation of 2007-08 Budget only the approach paper to the Eleventh Five Year Plan was available. The above-mentioned gross budgetary support for the 2007-08 plan of Rs. 2,05,100 crore was called Plan "A". To address the need for additional resources, once the Eleventh Five Year Plan was finalized, a Plan "B" was also drawn up to take new initiatives in critical areas. It was emphasized that additional resources would be mobilized through better tax administration to the extent of Rs. 7,000 crore during the course of the year. This was to be allocated amongst sectors such as agriculture, rural development, health, women and child development, urban infrastructure and water resources. The Eleventh Five Year Plan was approved by the NDC on December 19, 2007. The revenue receipts up to April-December have been buoyant and by the end of financial year the revenue realization targets are expected to be met.

Revenue and capital receipts

3.10 During the Tenth Five Year Plan, the buoyancy of tax revenue, with an average annual growth of 21.4 per cent concided with an acceleration in the growth of GDP. Considering such a performance, 2007-08 (BE) projected an increase of 23.4 per cent in tax revenues over 2006-07 (BE). Non-tax revenue, during the same period was budgeted to increase by 8.2 per cent. Capital receipts, comprising the non-debt capital receipts and borrowings and other liabilities, were projected to increase by 20.9 per cent in 2007-08 (BE) over 2006-07 (BE). The increase in non-debt capital receipts from Rs. 11,840 crore in 2006-07 (BE) to Rs. 43,151 crore in 2007-08 (BE) was, however, due to the inclusion of Rs. 40,000 crore on account of transaction relating to transfer of RBI stake in SBI to the Government (Table 3.2).

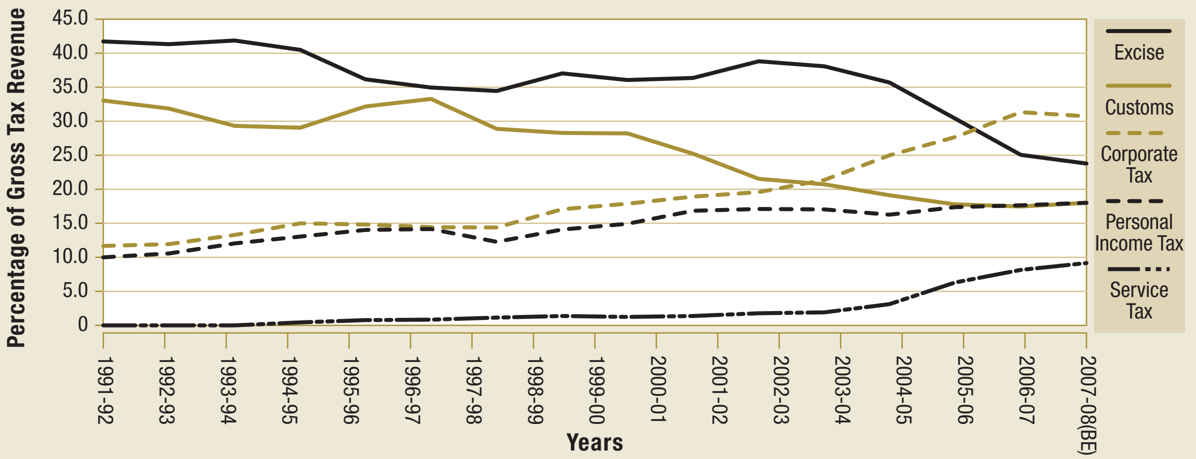
3.11 The shift in the structure of taxes from relatively regressive indirect taxes to direct taxes continued in 2007-08. The direct tax to GDP ratio has seen an uptrend because of the reforms in income and corporate taxes that simplified the tax system, reduced exemptions and tax rates, thus providing an incentive for better compliance. At the same time indirect tax GDP ratio has fallen because of reduction in custom duties and increasing exemptions in excise taxes. The proportion of direct taxes to gross tax collections of the Central Government, which had increased from 30.2 per cent in 1995-96 to 45.1 per cent in 2005-06 attained the level of 48.8 per cent in 2006-07. This is estimated to remain at the same level in 2007-08 though, compared to 2006-07 (BE), it represents an increase of 1.2 percentage points. The direct tax-GDP ratio, which was only 2.8 per cent in 1995-96, improved to 5.6 per cent in 2006-07 and is budgeted at 5.7 per cent in 2007-08. With indirect tax-GDP ratio stabilizing at 5.3 to 5.8 per cent in the Tenth Five Year Plan, it has been budgeted at 5.9 per cent of GDP in 2007-08. The gross tax-GDP ratio is projected to increase to 11.8 per cent in 2007-08 (BE) (Table 3.3 and Figure 3.3).

Tax measures

Direct taxes

3.12 Rising income tax collections and better tax compliance by individuals allowed the Government to raise the basic exemption limit for all assesses from Rs. 1,00,000 to Rs. 1,10,000. Similar increase in exemption limits were provided to women assessees and senior citizens. The

Figure 3.3 Composition of gross tax revenue



deduction in respect of medical insurance premium was also increased by Rs. 5000 for all assessees. The surcharge on income tax for all firms and companies with a taxable income of Rs. 1 crore or less was removed. An additional cess of 1 per cent on the amount of income tax inclusive of surcharge termed as "Secondary and Higher Education Cess" was, however, introduced. This was to fulfil the commitment of the Government to provide and finance secondary and higher education. Several other tax incentives and simplification measures were also introduced in Budget 2007-08 as indicated below.

3.13 The procedural reforms in direct taxes remained focused on expanding the tax base, improving tax compliance and making the tax administration more efficient. At the same time certain new initiatives and exemptions were provided to promote physical infrastructure, research and development in industry, development of the North-Eastern Region, and agriculture. To enable urban local bodies to raise funds for capital investment in urban infrastructure, exemption was provided on interest on notified bonds issued by a notified State Pooled Finance Entity on behalf of the urban local bodies. To provide adequate stock of hotel rooms for the Commonwealth Games to be hosted in Delhi in 2010 and also to boost the number of convention centres, deduction was allowed in respect of profits and gains derived from the business of hotels and convention centres in the National Capital Territory of Delhi and districts of Faridabad, Gautam Budh Nagar, Ghaziabad and Gurgaon. Weighted deduction for expenditure on scientific research on approved in-house R&D facility in the case of a company engaged in the business of biotechnology or in the business of manufacture or production of any drugs, pharmaceuticals, electronic equipment, computers, telecommunication equipment, chemicals or any other article or thing notified by the Board was allowed for a further period of 5 years from March 31, 2007 to March 31, 2012. A package of fiscal incentives and other concessions for the North-East Region, namely, the North-East Industrial and Investment Promotion Policy (NEIIPP) 2007 were provided. Bonds issued by NABARD and notified by the Central Government were included in Section 80C as an additional investment avenue for investors seeking tax benefit.

Indirect taxes

Customs Duties

3.14 As part of a continuous process of bringing about a moderate, rational and simplified tax structure and to reduce rates to ASEAN levels as per announced commitments, the peak rate of customs duty on non-agricultural products was reduced from 12.5 per cent in 2006-07 to 10 per cent in 2007-08, with a few exceptions.

3.15 Some of the important changes in the customs duty structure were as follows:

1. To give a boost to the farm sector, customs duty on food processing machinery, sprinklers and drip irrigation system used for agriculture and horticulture purposes was reduced. Customs duty on refrigerated motor vehicles was reduced to Nil. Countervailing duty on these vehicles was also reduced to 8 per cent in line with a reduction in excise duty for these vehicles.

2. To contain inflation in essential commodities, customs duty on wheat was reduced to zero and duty on edible oils was reduced considerably. Duty on crude palm oil was reduced in two tranches from 60 per cent before budget to 45 per cent effective July 23, 2007. Duty on refined palm oil was reduced by 15 percentage points to 52.5 per cent. Duty on soybean oil was also reduced from 45 per cent to 40 per cent. A 20 percentage point reduction in duty on sunflower crude and refined oil was also effected. The tariff values of palm and soya bean oils were kept unchanged at their July 2006 and September 2006 levels, respectively, so as to reduce the actual incidence of these duties on domestic prices.
3. Duty was reduced on medical equipments, metals and their inputs, some inorganic chemicals and polyester staple fibres to reduce the cost of imported goods for domestic industry/users.
4. In order to conserve mineral resources, an export duty of Rs 50 per tonne on iron ore fines with Fe content of 62 per cent or below was imposed. Export duty on other iron ore exports was fixed at Rs 300 per tonne.
5. Education cess at the rate of 1 per cent on total import duties to finance Secondary and Higher Education was also levied.

Excise Duties

3.16 Performance of revenues from excise duty has been relatively slow with average growth of 10.2 per cent during 2002-07. It is budgeted to increase by 10.7 per cent in 2007-08 over 2006-07 (Actual). The overall process of rationalization of the excise duty structure also continued during the year.

3.17 In case of excise duties, the following important changes were announced:

1. To improve competitiveness of the small scale sector, the exemption limit for SSI sector was raised from Rs 1 crore to Rs 1.5 crore.
2. Ad valorem component of excise duty on Petrol and High Speed Diesel was reduced from 8 per cent to 6 per cent.
3. In cement sector, new rates were announced to reduce the incidence of taxes on cement with lower retail prices to make it more affordable and to incentivise the industry to reduce their retail selling prices. Excise duty on cement with retail sale price not exceeding Rs 190 per bag of 50 kgs (Rs 3800 per tonne) was reduced to Rs 350 per tonne. Cement with retail sale price of Rs 190-250 (Rs 3800- Rs 5000 per tonne) was to attract a duty of 12 per cent advaloram. Excise duty on cement above Rs 250 per bag of 50 kgs (Rs 5000 per tonne) was raised to Rs 600 per tonne.
4. Cement manufactured in mini cement plants, however, attracted a lower duty. Excise duty was reduced from Rs 250 per tonne to Rs 220 per tonne for cement with a declared retail price not exceeding Rs 190 per bag (Rs 3800 per tonne). For cement with a declared retail price exceeding this, excise duty rates were raised to Rs 370 per tonne from Rs 250 per tonne earlier.
5. An education cess of 1 per cent to finance Secondary and Higher Education was also made applicable to excise duties.
6. Water purification equipments based on ultra-filtration technology using polysulphone membranes were fully exempted from excise duty.
7. The rate of excise duty on fibre board, particle board and similar board was reduced from 16 per cent to 8 per cent, effective May 3, 2007.

Service tax — a promising source of revenue

3.18 Service tax was introduced in 1994-95 to redress the asymmetric and distortionary treatment of goods and services in the tax framework and to widen the tax net. It has been a buoyant source of revenue in recent years. The number of services liable for taxation was raised from 3 in 1994-95 to 6 in 1996-97, and then gradually to 100 in 2007-08. In 2007-08 Budget, certain services were specified as taxable services, scope of some of the specified taxable services was changed, threshold limit for small service providers was increased and certain exemptions were announced. As in the case of other taxes, a cess of 1 per cent was imposed on service tax to finance Secondary and Higher Education (Box 3.1). The

Box 3.1 Service Tax

A. Following services were individually specified as taxable services:

- Telecommunication service (includes various telecommunication related services which are presently specified as separate taxable services);
- Services outsourced for mining of mineral, oil or gas;
- Services provided in relation to renting of immovable property, other than residential properties and vacant land, for use in the course or furtherance of business or commerce;
- Development and supply of content for use in telecommunication services, advertising agency services and online information and database access or retrieval services;
- Asset management services including portfolio management and all forms of fund management service provided by any person, except a banking company or a financial institution including a non-banking financial company or any other body corporate or commercial concern;
- Design services;
- Services provided in relation to the execution of a works contract.

B. Changes made in the scope of specified taxable services:

- To include (a) sale of space in business directories, yellow pages and trade catalogues which are primarily meant for commercial purposes under sale of space or time for advertisement service, (b) renting of motor vehicles capable of carrying more than 12 passengers under rent-a-cab service. Motor vehicle or maxicab rented to an educational body, other than a commercial training and coaching centre, will be excluded from the scope of the service, (c) services provided in relation to marriage functions under mandap keeper service, pandal or shamiana service and event management service, and (d) computer hardware engineering consultancy under consulting engineer's service.
- To amend (i) Banking and other financial services, so as to (a) substitute the words "any other person" with "commercial concern" in the definition of taxable service (b) include cash management within its scope; and (c) explain the term "financial leasing".
- To amend management consultant service so as to rename it as management or business consultant service and to include explicitly business consultancy within is scope.
- To clarify that (i) Recruitment or supply of manpower service includes services in relation to (a) pre-recruitment screening, (b) verifying the credentials and antecedents of the candidate; and (c) authenticity of documents submitted by the candidates.
- To clarify that "goods" referred to in management, maintenance or repair service includes computer software.

C. Threshold limit for small service providers

The threshold limit for small service providers was increased from Rs. 4 lakh to Rs. 8 lakh in a year.

D. Secondary and Higher Education Cess:

Cess of 1 per cent was imposed to finance Secondary and Higher Education on the service tax leviable.

E. Exemptions

- All taxable services provided by Technology Business Incubators (TBI)/ Science and Technology Entrepreneurship Parks (STEP) recognized by National Science and Technology Entrepreneurship Board of Department of Science & Technology (also known as "incubators");
- Taxable services provided by an incubatee (entrepreneur) whose total business turnover in a year does not exceed Rs. 50 lakh and is located within the premises of an incubator, subject to specific conditions;
- Services provided by resident welfare association to their members, where the monthly contribution of a member does not exceed Rs. 3,000 per month.
- Services provided in relation to electronic delivery of cinema in digital form after encryption electronically;
- Technical testing and analysis services provided in relation to testing of new drugs, including vaccines and herbal remedies, on human participants by a Clinical Research Organisation (CRO) approved to conduct clinical trials by the Drugs Controller General of India.

rate of service tax was retained at 12 per cent. Revenue from service tax, as the combined outcome of expanding tax net, creeping rate, and buoyant service sector growth increased rapidly from a paltry Rs. 407 crore in 1994-95 to Rs. 37,484 crore in 2006-07 (Prov.) and is budgeted to increase to Rs. 50,200 crore in 2007-08 (Table 3.4).

Collection rates

3.19 The peak rate of basic customs duty was brought down progressively from 150 per cent in 1991-92 to 10 per cent on non-agricultural products in the Budget for 2007-08 with a few exceptions. Owing to the calibrated reduction in custom duty, though resulting in a deceleration in the growth of revenue from it, there was an improvement in competitiveness of domestic industries and acceleration in the growth of manufacturing. Revenue from custom duty, in addition to the basic customs duty, also includes additional duty, which is the counterpart of the excise duty on domestically produced items, and special additional duty, a very partial counterpart of State taxes on domestic goods. While the basic duty is the base level of protection to domestic industry, additional and special duties are in the nature of providing a level playing field to domestic industry. Since there were numerous rates and exemptions, the closest approximation to the average effective rates for import duty (Basic+AD+SAD) for different sectors is given by the relevant collection rates. The collection rate for all commodity groups fell from 15 per cent in 2002-03 to 10 per cent in 2005-06 and has remained at that level in 2006-07 (Prov.). Collection rate declined sharply for POL products, from 30 per cent in 1995-96 to 5 per cent in 2006-07. Decline was also sharp for non-POL products. Food products, paper and newsprint and natural fibres, however, did not experience a decline. In case of paper and newsprint and natural fibres the collection rate has remained low. Collection rate for chemicals, metals and capital goods also witnessed a decline. Lower rates for these products significantly contributed to acceleration in growth of these sectors and in improving overall competitiveness of domestic industry (Table 3.5 and Figure 3.4).

Tax expenditure

3.20 According to the “Statement of Revenue Foregone”, tabled along with Budget documents of Budget 2007-08, the provisional tax expenditure in 2005-06 was estimated to be Rs. 2,06,700 crore. For 2006-07, it was estimated to be Rs. 2,35,191 crore. The exemptions and incentives in the tax laws, which result in these tax expenditures, distort resource allocation by impinging upon the efficiency of the market. Further, they complicate the tax laws, increase litigation and raise the compliance cost for the taxpayers and the tax administration. Tax incentives and exemptions are being continuously reviewed so as to eliminate or provide a sunset clause to those that have outlived their rationale. A tax expenditure statement enables a more informed public debate on the efficacy of exemptions and discourages entrenched groups from demanding incentives in perpetuity.

3.21 In Budget 2007-08, the Minimum Alternate Tax (MAT) base was widened to include the profits of STPI units and export-oriented units, which enjoy

Table 3.4 Service tax–A growing revenue source

Year	Number of services	Number of assessees	Tax rate (per cent)	Revenue (Rs. crore)	Growth (per cent)
2000-01	26	122326	5	2613	22.8
2001-02	41	187577	5	3302	26.4
2002-03	52	232048	5	4122	24.8
2003-04	60	403856	5	7891	91.4
2004-05	75	740267	10	14200	80.0
2005-06	84	806585	10	23055	62.4
2006-07P	99	918746	12	37484	62.6
2007-08(BE)	100	na	12	50200	33.9

Source: Receipts Budget, Union Budget.
P- Provisional

Table 3.5 Collection rates for selected import groups

(per cent)

S No.	Commodity Groups	1995-96	2002-03	2003-04	2004-05	2005-06	2006-07 (Prov.)
1	Food products	23	30	19	22	32	23
2	POL	30	11	11	10	6	5
3	Chemicals	44	28	24	22	20	22
4	Man-made fibres	36	31	46	39	34	28
5	Paper & newsprint	8	7	7	7	9	10
6	Natural fibres	12	10	13	11	13	12
7	Metals	52	36	32	26	25	24
8	Capital goods	33	23	19	16	13	14
9	Others	13	9	8	6	5	6
10	Non-POL	28	17	14	12	12	12
	Total	**29**	**15**	**14**	**11**	**10**	**10**

Source: Department of Revenue, Ministry of Finance.

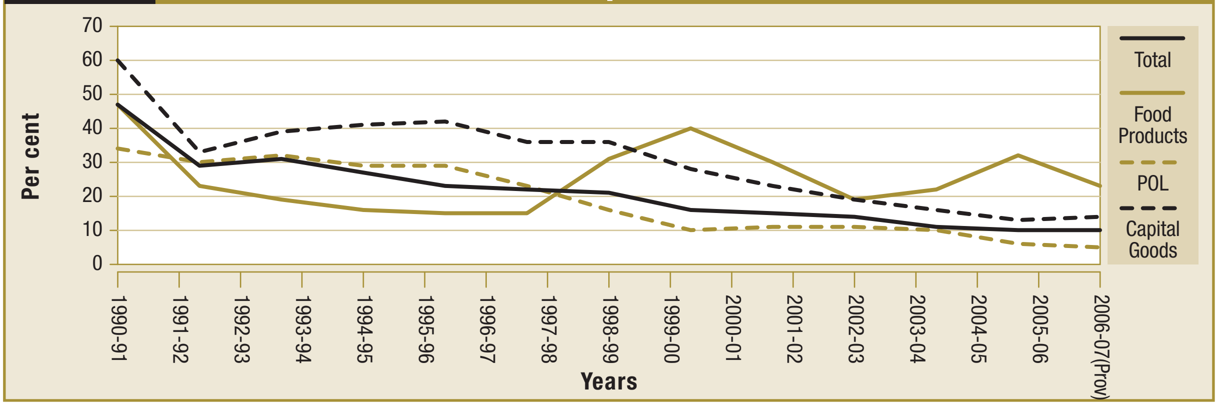
Notes :
1. **Collection rate is defined as the ratio of realized import revenue (including basic duty, additional customs duty/ countervailing duty [CVD], and special additional duty) to the value of imports of a commodity.**
2. **S.No.1 includes cereals, pulses, tea, milk and cream, fruits, vegetables, animal fats and sugar.**
3. **S.No. 3 includes chemical elements, compounds, pharmaceuticals, dyeing and colouring materials, plastic and rubber.**
4. **S.No.5 includes pulp and waste paper, newsprint, paperboards and manufactures and printed books.**
5. **S.No.6 includes raw wool and silk.**
6. **S.No.7 includes iron and steel and non-ferrous metals.**
7. **S.No.8 includes non-electronic machinery and project imports, electrical machinery.**

a tax holiday. Similarly, some incentives to the housing sector and to scientific research and development were allowed to sunset. Simultaneously, in the realm of indirect taxes, 7 exemptions in customs duties and 7 exemptions in Central excise duties were withdrawn.

Expenditure trends

3.22 FRBMA stipulates that public expenditure must be reoriented for the creation of productive assets. Given the existing classification of expenditure, plan expenditure and capital expenditure are the closest approximation to such expenditure. As a proportion of GDP, plan expenditure, which was 4.5 per cent in 2002-03 declined to 3.9 per cent in 2005-06 but recovered to 4.1 per cent in 2006-07. In 2007-08 (BE), plan expenditure is budgeted to increase by 18.7 per cent over 2006-07 (BE) and reach 4.4 per cent of GDP. Non-plan expenditure, after recording a year-on-year growth of 15.6 per cent in each of the two years of 2002-03 and 2003-04, witnessed a

Figure 3.4 Collection rates for selected import



moderation in growth in 2004-05 and in fact had declined in 2005-06. In 2006-07, the non-plan expenditure recorded an increase of 13.1 per cent and such expenditure is proposed to increase by 15 per cent in 2007-08 over the 2006-07 (Actuals). As a proportion of GDP, non-plan expenditure followed a pattern similar to that of plan expenditure. It fell from 12.7 per cent of GDP in 2003-04 to 10 per cent in 2006-07 and is budgeted at 10.1 per cent of GDP in 2007-08 (Table 3.2).

3.23 Capital expenditure comprises expenditure towards asset formation and loans and advances. As a proportion to GDP, capital expenditure declined from 3 per cent in 2002-03 to 1.7 per cent in 2006-07. It is budgeted to increase to 2.6 per cent in 2007-08. However, within capital expenditure, the ratio of capital expenditure towards direct asset formation and intermediation through loans and advances which was 34:66 in 1997-98 has improved to 81:19 and 85:15 in 2005-06 and 2006-07, respectively. This was partly due to a decline in intermediation to States with the creation of National Small Savings Funds (NSSF) and consequent upon the recommendations of the Twelfth Finance Commission (TFC).

3.24 Revenue expenditure is expenditure incurred for purposes other than creation of assets of the Central Government. Revenue deficit is the difference between revenue expenditure and revenue receipts. Broadly, the revenue deficit indicates the excess of current expenditures over revenues, or dissavings by the Government. The fiscal deficit captures the excess of overall expenditure over revenue comprising current receipts and non debt capital receipts. Revenue deficit implies an increase in the liabilities of the Central Government without a corresponding increase in its assets. The existence of revenue deficit indicates that a part of the borrowings by the Government is not being used for financing public investment. When the focus is only on reducing the fiscal deficit, the brunt of fiscal correction is often borne by compression in capital expenditure. The change in revenue deficit on the path of fiscal adjustment indicates the quality of fiscal correction, which is as important as the level of fiscal correction itself. FRBMA highlights the significance of keeping the revenue expenditure under control and envisages elimination of the revenue deficit by the end of 2008-09.

3.25 As a proportion to GDP, revenue expenditure after increasing to 13.8 per cent in 2002-03, declined to 12.4 per cent in 2006-07. It is budgeted to decline further to 11.9 per cent in 2007-08. In terms of economic classification, revenue expenditure is composed of pay and allowances; interest payments; grants to the States and Union Territories; subsidies and others (Figures 3.5 and 3.6).

Interest payments

3.26 Persistent and high deficits seriously impair the counter cyclical ability of fiscal policy, lead to unsustainable debt build up and adversely affect the composition of expenditure through larger interest outgo. As a proportion of GDP, interest payments after remaining at a high level of 4.8 per cent in 2002-03, started declining to reach 3.6 per cent in 2006-07. It is budgeted to decline further to 3.4 per cent of GDP in 2007-08. As a proportion of revenue receipts, the corresponding decline was

Figure 3.5 Trends in Centre's revenue expenditure

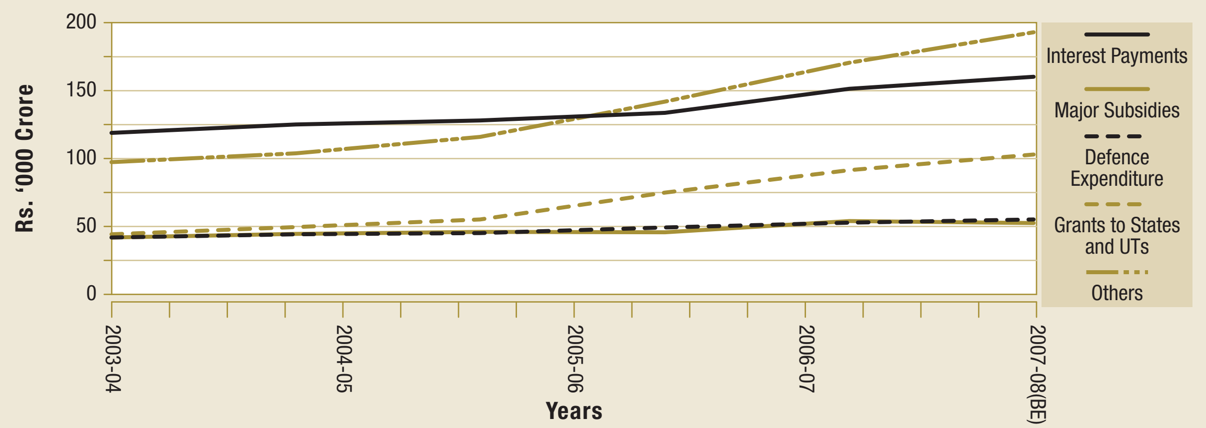
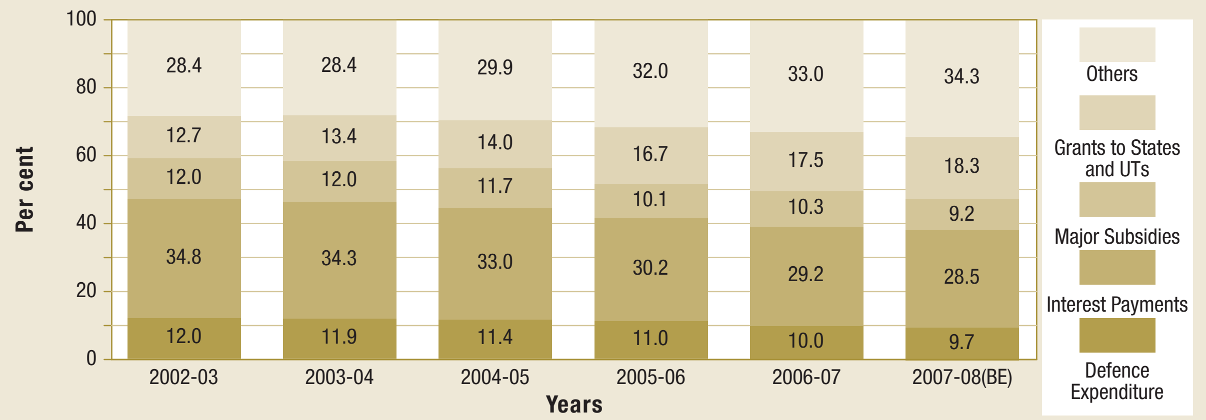


Figure 3.6 Composition of revenue expenditure



from a high of 51 per cent in 2002-03 to 34.6 per cent in 2006-07, and further to 32.7 per cent in 2007-08 (BE). These declining trends, as proportion of both GDP and revenue receipts, were partly on account of the softening of interest rates which resulted in progressive reduction in the average cost of borrowing and slower growth of debt (Table 3.6). The average cost of internal borrowing, including those under Market Stabilisation Scheme (MSS), is budgeted at 7.9 per cent in 2007-08 (Figure 3.7).

Table 3.6 Interest on outstanding internal liabilities of Central Government

	Outstanding internal liabilities	Interest on internal liabilities[a]	Average cost of borrowings (per cent per annum)
	(Rs. crore)		
2000-01	1047976	94900	10.2
2001-02	1196245	103175	9.8
2002-03	1323704	113238	9.5
2003-04	1457583	116869	8.8
2004-05	1603785	124126	8.5
2005-06	1752404	129474	8.1
2006-07(RE)	1963840	142324	8.1
2007-08(BE)	2099458	154678	7.9

Source: Budget documents.

a Excludes Rs. 313.61 crore and Rs. 4,079.62 crore towards premium on account of domestic debt buyback scheme and prepayment of external debt for 2002-03 and 2003-04, respectively.

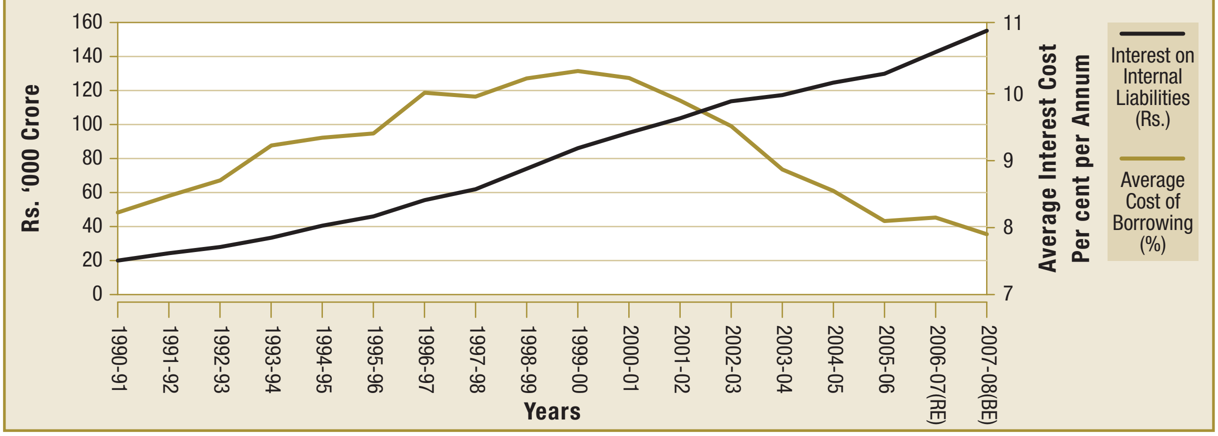
Note : 1. Average cost of borrowing is the percentage of interest payment in year ' t' to outstanding liabilities in year 't-1'.

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

Subsidies

3.27 The impact of subsidies on specific goods and services is the opposite of that of excise and service taxes. By reducing relative prices, subsidies can increase the use of products like food, fertilizer and petroleum products. Market solutions often result in under consumption of various goods and services by vulnureable sections, either because of higher prices or because of competing claims on their income of other goods. By reducing the prices, across the board or for the specific groups, subsidies increase affordability, improve access, and correct under consumption of these goods with positive externalities. With direct provision by the Centre, major subsidies, mainly on food, fertilizer and petroleum, grew from Rs. 40,716 crore in 2002-03 to Rs. 52,935 crore in 2006-07, and are budgeted at Rs. 51,247 crore in 2007-08. As a proportion of GDP, however, subsidies fell from 1.7 per cent in 2002-03 to 1.3 per cent in 2006-07 and 1.1 per cent in 2007-08 (BE) (Figure 3.8). Subsidies constituted 12.6 per cent of the current receipts in 2007-08 (BE). Though, as a proportion to GDP, major subsidies have declined in the last five years, as a percentage of total expenditure, these are still at a significantly high level of about 8 per cent. As included in the first batch of supplementary demand for grants, the expenditure on subsidies is expected to further increase by Rs. 6,550 crore in 2007-08 over the BE levels. These budgetary subsidies, however, do not include compensation provided through the issue of special securities to oil marketing companies, Food Corporation of India and fertilizer units. However, besides the issues relating to fiscal cost of subsidies and their distortionary impact on price

Figure 3.7 Interest on internal liabilities and average interest cost of borrowing



mechanism, there are important governance issues of leakages, inefficient delivery mechanism and inclusion/exclusion error associated with subsidies. The NCMP, therefore, mandates the Government to target all subsidies sharply at the poor and needy.

Supplementary demands for grants

3.28 Till December 2007 there were two supplementary demands for grants in 2007-08 for which Parliament gave its approval. The first batch of demands included 39 grants involving a net cash outgo aggregating to Rs. 10,428 crore. Together with the demands for additional expenditure of Rs. 9,984 crore of a technical nature without cash outgo, the gross additional expenditure authorized was Rs. 20,412 crore. The major items involving cash outgo included subsidy on imported decontrolled fertilizers, indigenous decontrolled fertilizers, imported urea and nitrogenous fertilizers (Rs. 6,550 crore). The second batch of supplementary demands for grants for 42 items authorized gross additional expenditure of Rs. 33,291 crore. Net cash outgo involved was Rs. 11,870 crore and the balance amount of Rs. 21,421 crore was matched by savings or enhanced receipts. The major items of expenditure with cash outgo included additional expenditure on account of interest liabilities under "Market Stabilisation Scheme" (Rs. 4,500 crore).

Central Plan outlay

3.29 The 2006-07 (RE) had envisaged a Central Plan outlay of Rs. 2,44,229 crore comprising gross budgetary support of Rs. 1,26,510 crore (51.8 per cent) and Internal and Extra Budgetary Resources (IEBR) of public enterprises of Rs. 1,17,719 crore. The Budget for 2007-08 has raised the Central Plan outlay by 31 per cent over 2006-07 (RE) to Rs. 3,19,992 crore. The outlay is composed of Budgetary Support of Rs. 1,54,939 crore and IEBR of CPSEs of Rs. 1,65,053 crore. The broad sector-wise allocations for important sectors are: Energy (24.7 per cent); social services (25.1 per cent); transport (22.4 per cent); communication (8.1 per cent); rural development (6.4 per cent); industry and minerals (6.4 per cent); agriculture and allied activities (2.7 per cent); and irrigation and flood control (0.2 per cent). Central assistance for States' and UTs' Plans in 2007-08 (BE) is placed at Rs. 50,161 crore, a rise of 8.5 per cent from 2006-07 (RE).

Government debt

3.30 As a proportion of GDP, outstanding liabilities (including external debt at historical exchange rate) of the Central Government was 63.5 per cent in 2002-03. With the nominal rate of growth of GDP accelerating to 13.7 per cent, 15.8 per cent and 13.2 per cent in 2005-06, 2006-07 and 2007-08 (Advanced Estimates), respectively, coupled with a relatively slower growth in outstanding liabilities, these declined to 63.1 per cent of GDP in 2005-06, 61.2 per cent of GDP in 2006-07 (RE) and 58.5 per cent of GDP in 2007-08 (BE) (Table 3.7 and Figure 3.9).

3.31 The Central Government liabilities are composed primarily of external and internal liabilities, which include market loans (as also Treasury Bills) and relief/savings bonds and others. The share of debt in total internal liabilities rose from 54.4 per cent in 1990-91 to 66 per cent in 2004-05 and is budgeted at 64 per cent in 2007-08. Market borrowings as a proportion of

Table 3.7 Outstanding liabilities of the Central Government

	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)
						(end-March)
	(Rs. crore)					
1. Internal liabilities	**1499589**	**1690554**	**1933544**	**2165902**	**2434329**	**2633197**
a) Internal debt[a]	1020688	1141706	1275971	1389758	1554238	1683967
i) Market borrowings	619105	707965	758995	862370	973323	1091903
ii) Others	401583	433741	516976	527388	580915	592064
b) Other Internal liabilities	478901	548848	657573	776144	880091	949230
2. External debt (outstanding)[b]	**59612**	**46124**	**60878**	**94243**	**102135**	**111245**
3. Total outstanding liabilities (1+2)	**1559201**	**1736678**	**1994422**	**2260145**	**2536464**	**2744442**
4. Amount due from Pakistan on account of share of pre-partition debt	300	300	300	300	300	300
5. Net liabilities (3-4)	**1558901**	**1736378**	**1994122**	**2259845**	**2536164**	**2744142**
	(As per cent of GDP)					
1. Internal liabilities	**61.1**	**61.4**	**61.4**	**60.5**	**58.7**	**56.1**
a) Internal debt[a]	41.6	41.4	40.5	38.8	37.5	35.9
i) Market borrowings	25.2	25.7	24.1	24.1	23.5	23.3
ii) Others	16.4	15.7	16.4	14.7	14.0	12.6
b) Other Internal liabilities	19.5	19.9	20.9	21.7	21.2	20.2
2. External debt (outstanding)[b]	**2.4**	**1.7**	**1.9**	**2.6**	**2.5**	**2.4**
3. Total outstanding liabilities	**63.5**	**63.0**	**63.3**	**63.1**	**61.2**	**58.5**
Memorandum items						
(a) External debt (Rs. crore)[c]	196043	184177	191182	194078	201209	212260
(as per cent of GDP)	8.0	6.7	6.1	5.4	4.9	4.5
(b) Total outstanding liabilities (adjusted) (Rs. crore)	1695632	1874731	2124726	2359980	2635538	2845457
(as per cent of GDP)	69.1	67.1	67.5	65.9	63.6	60.6
(c) Internal liabilities (non-RBI)[d]	1337752	1529571	1771117	1969106	2225778	2435399
(as per cent of GDP)	54.5	55.5	56.2	55.0	53.7	51.9
(d) Outstanding liabilities (non-RBI)[c] (Rs. crore) Outstanding liabilities (non-RBI)	1533795	1713748	1962299	2163184	2426987	2647659
(as per cent of GDP)	62.5	62.2	62.3	60.4	58.5	56.4
(e) Contingent liabilities of Central Government (Rs. crore) Contingent liabilities of Central Government	90617	87780	107957	110626.0	n.a.	n.a.
(as per cent of GDP)	3.7	3.2	3.4	3.1	n.a.	n.a.
(f) Total assets (Rs. crore) Total assets	840768	903558	1083422	1194446	1361405	1497404
(as per cent of GDP)	34.3	32.8	34.4	33.4	32.8	31.9

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

n.a. : not available

a Internal debt includes net borrowing of Rs 64,211crore for 2004-05, Rs 29,062 crore for 2005-06, Rs.70,000 for 2006-07(RE) and Rs 80,000 crore for 2007-08(BE) under Market Stabilisation Scheme.

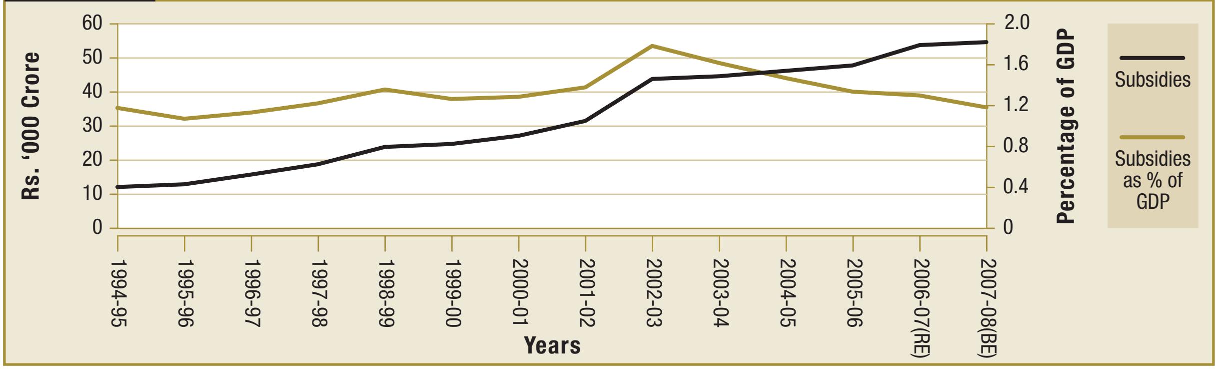
b External debt figures represent borrowings by Central Government from external sources and are based upon historical rates of exchange.

c Converted at year-end exchange rates. For 1990-91,the rates prevailing at the end of March 1991; For 1999-2000,the rates prevailing at the end of March 2000 and so on. Figures for 2007-08 are based on revised estimates.

d This includes marketable dated securties held by the RBI.

Note: The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.

Figure 3.8 Subsidies as percentage of GDP



Government debt has hovered around 38-39 per cent. The RBI as the Government's debt manager fixes biannual indicative issuance calendar for the Government borrowings, in consultation with the Ministry of Finance. The Budget for 2007-08 placed the net market borrowings (dated securities and 364-day Treasury Bills excluding borrowings under MSS) at Rs. 1,09,579 crore.

3.32 Borrowings should generally be resorted to only for the purpose of asset creation. However, with the existence of a revenue deficit all through these years, a significant proportion of liabilities were contracted to meet the current expenditure commitments. Government accounting systems do not provide a comprehensive accounting of its assets, particularly land, building, etc., owned by it. But Government accounts do capture the assets created in the form of capital expenditure and outstanding loans receivable by the Central Government. These two together form the assets of Government created out of its annual fiscal operations. Though the assets, for example, machinery and buildings, are of different vintages, their sum total nonetheless provides an assessment of Government's assets. Total assets as defined above were 54.6 per cent of Government's outstanding liabilities, indicating that cumulatively so far nearly 46 per cent of the outstanding liabilities went to meet the current expenditure of Government.

Economic and functional classification

3.33 The economic and functional classification of the Central Government Budget for 2007-08, which reclassifies budgetary transactions into the significant economic categories on the lines of national income accounts, indicates total expenditure as 18.1 per cent higher than 2006-07 (RE). Of total expenditure, consumption expenditure was 19.9 per cent, current transfers 57.8 per cent, gross capital formation 21.6 per cent and others 0.7 per cent (Table 3.8). In terms of functional classification, general services accounted for 21.6 per cent of total expenditure, while social and economic services accounted for 14.2 per cent and 29.9 per cent, respectively, with the balance 34.3 per cent (being in the nature of statutory grants-in-aid to States, non-plan grants, food and other consumer subsidies, etc.) categorized as unallocable (residual).

Figure 3.9 Debt GDP ratios

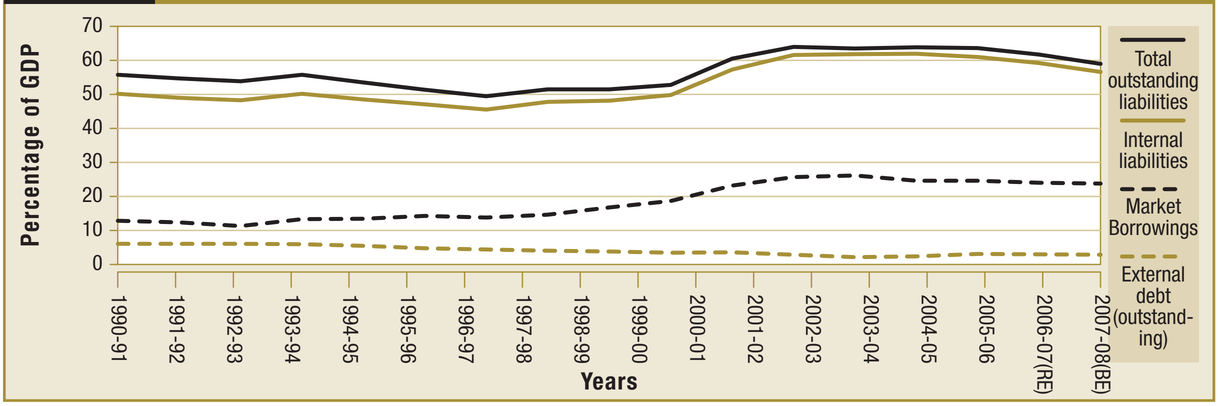


Table 3.8 Total expenditure and capital formation of the Central Government

	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)
			(Rs. crore)			
I. Total expenditure	**398879**	**426132**	**463831**	**501083**	**578606**	**683348**
II. Gross capital formation out of budgetary resources of Central Government	**76782**	**82561**	**92855**	**84757**	**100333**	**147921**
(i) Gross capital formation by the Central Government	21697	23997	27396	34450	46471	49968
(ii) Financial assistance for capital formation in the rest of the economy	55085	58564	65459	50307	53862	97953
III. Gross saving of the Central Government	**-81734**	**-71968**	**-60378**	**-61431**	**-39260**	**-32530**
IV. Gap (II-III)	**158516**	**154529**	**153233**	**146188**	**139593**	**180451**
Financed by						
a. Draft on other sectors of domestic economy	168582	165858	135918	109799	129232	169205
(i) Domestic capital receipts	166699	169800	208259	130687	118306	169205
(ii) Budgetary deficit/draw down of cash balance	1883	-3942	-72341	-20888	10926	0
b. Draft on foreign savings	-10066	-11329	17315	36389	10361	11246
			(As per cent of GDP)			
I. Total expenditure	**16.3**	**15.5**	**14.7**	**14.0**	**14.0**	**14.6**
II. Gross capital formation out of budgetary resources of Central Government	**3.1**	**3.0**	**2.9**	**2.4**	**2.4**	**3.2**
(i) Gross capital formation by the Central Government	0.9	0.9	0.9	1.0	1.1	1.1
(ii) Financial assistance for capital formation in the rest of the economy	2.2	2.1	2.1	1.4	1.3	2.1
III. Gross saving of the Central Government	**-3.3**	**-2.6**	**-1.9**	**-1.7**	**-0.9**	**-0.7**
IV. Gap (II-III)	**6.5**	**5.6**	**4.9**	**4.1**	**3.4**	**3.8**
Financed by						
a. Draft on other sectors of domestic economy	6.9	6.0	4.3	3.1	3.1	3.6
(i) Domestic capital receipts	6.8	6.2	6.6	3.7	2.9	3.6
(ii) Budgetary deficit/draw down of cash balance	0.1	-0.1	-2.3	-0.6	0.3	0.0
b. Draft on foreign savings	-0.4	-0.4	0.5	1.0	0.2	0.2
			(Increase over previous year)			
II. Gross capital formation out of budgetary resources of Central Government	**-0.1**	**7.5**	**12.5**	**-8.7**	**18.4**	**47.4**
Memorandum items						
			(Rs. crore)			
1 Consumption expenditure	85389	87170	105692	116305	123583	135907
2 Current transfers	228501	248436	259529	297267	348552	394681
			(As per cent of GDP)			
1 Consumption expenditure	**3.5**	**3.2**	**3.4**	**3.2**	**3.0**	**2.9**
2 Current transfers	**9.3**	**9.0**	**8.2**	**8.3**	**8.4**	**8.4**

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

Notes:
(i) Gross capital formation in this table includes loans given for capital formation on a gross basis. Consequently domestic capital receipts include loan repayments to the Central Government.
(ii) Consumption expenditure is the expenditure on wages & salaries and commodities & services for current use.
(iii) Interest payments, subsidies, pensions etc. are treated as current transfers.
(iv) Gross capital formation & total expenditure are exclusive of loans to States/UTs against States/UTs share in the small savings collection.
(v) The figures of total expenditure of the Central Government as per economic and functional classification do not tally with figures given in the Budget documents. In the economic and functional classification, interest transfered to DCUs, loans written off etc, are excluded from the current account. In the capital account, expenditure financed out of railways, posts & telecommunications' own funds, etc, are included.
(vi) The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.

3.34 The share of wages and salaries within consumption expenditure at 38.7 per cent in 2007-08 (BE) was marginally less than 39.9 per cent in 2006-07 (RE). The reclassification shows that share of current grants in total expenditure went up from 21.7 per cent in 2006-07 (RE) to 22.7 per cent in 2007-08 (BE), reflecting the impact of implementation of the TFC award. Dissavings of the Central Government, which grew steadily from Rs. 10,502 crore in 1990-91 to Rs. 81,734 crore in 2002-03, was reduced to Rs. 71,968 crore in 2003-04 and further to Rs. 39,260 crore in 2006-07 (RE). It is budgeted to decline further to Rs. 32,530 crore in 2007-08 (BE). As a proportion to GDP, total expenditure is budgeted at 14.6 per cent, a decline from 16.3 per cent in 2002-03. All the three components, viz., consumption expenditure, current transfers and gross capital formation, shared the decline. As a proportion of GDP, dissavings were placed at 0.9 per cent in 2006-07 (RE) and 0.7 per cent in 2007-08 (BE).

Expenditure management

3.35 Public expenditure management is an integral part of the fiscal reforms and Government has been taking a series of initiatives in this regard, like avoiding rush of expenditure through releases in a time-sliced manner and simplification of procedures. Performance audit by the Comptroller & Auditor General of India (C&AG) of selected programmes continued to throw up important lessons for expenditure management. Further, the C&AG has recently framed and notified Regulations of Audit and Accounts for the Government departments and other bodies and authorities under their control. Notification of the regulations has brought transparency in Government audit and accounting process of C&AG (Box 3.2).

Fiscal outcome so far for Budget 2007-08

3.36 As per the data on Central Government finances published by the Controller General of Accounts for the period April-December 2007, gross tax revenue was placed at Rs. 3,89,345 crore and total expenditure at Rs. 4,74,253 crore. As against an assumed growth of 24 per cent in gross tax receipt in 2007-08 (BE) over 2006-07 (BE), the realized growth during April-December has been 27 per cent over the same period last year. Up to December 2007, 71 per cent of the budgeted amount

Box 3.2 Framing of Regulations of Audit and Accounts by C&AG

As contained in Article 149 of the Constitution, the Comptroller and Auditor General of India performs such duties and exercises such powers in relation to accounts of the Union and of the States and of any other authority or body as is prescribed by or under any law made by Parliament. Accordingly, the C&AG's (Duties, Powers and Conditions of Services) Act, 1971 was passed by the Parliament in 1971. Section 23 of the Act empowers the C&AG to make regulations for carrying into effect the provisions of the Act insofar as they relate to the scope and extent of audit, including laying down for the guidance of the Government departments the general principles of Government accounting and broad principles in regard to the audit of receipts and expenditure. In pursuance of these provisions, the C&AG of India has framed the Regulations on Audit and Accounts. The Regulations have been notified in the Official Gazette of Government of India in November 2007. The Regulations will be useful in informing the Government Departments and other bodies and authorities under the control of Government regarding principles of government audit and accounting. The Regulations will also act as guide for audit personnel. Notification in Official Gazette of Government of India makes it a public document available to even general public. This is a step forward from the earlier system of departmental instructions through manuals and other means which were meant for in-house circulation only. Framing of Regulations for the knowledge of all concerned is thus a welcome step taken by the C&AG in bringing transparency in the Government audit and accounting process.

Audit of fraud and corruption cases

In view of the increasing risk perception for fraud and corruption cases and higher incidence of such cases coming to notice during audit, the C&AG has taken proactive action and has framed guidelines for audit in relation to fraud and corruption cases. A detailed standing order has been issued by the C&AG in this regard in September 2006 to serve as guidance to audit personnel. The order gives red flag areas which may indicate the possibility or higher risk of a fraud or corruption. The order is benchmarked to international best practices and its issue is timely and appropriate. The order can also be of use to the executive for identifying red flag areas with a view to undertake appropriate examination and remedial action.

was collected. The overall growth in gross tax revenue so far vis-à-vis the growth assumed in BE for 2007-08 suggests that the current financial year may end up with collection higher than initially estimated. Non-tax revenue for the first nine months of this financial year recorded a significantly high growth of 22.4 per cent over the corresponding period of the previous year which was 1.5 per cent. The collection up to December 2007 is 72.3 per cent of 2007-08 (BE) (Table 3.9).

3.37 Month-to-month movement of major fiscal parameters (Table 3.10) reveal that both revenue and expenditure have generally been well time-spaced. Revenue receipts generally become buoyant in September and December with quarterly advance tax payments falling due during these months, while both revenue and total expenditure are more evenly spread. Higher realization from taxes in September and December get associated with a reduction in revenue and fiscal deficit in these months.

Financing of the Eleventh Five Year Plan

3.38 The National Development Council at its 54th meeting on December 19, 2007, adopted the Eleventh Five Year Plan starting from 2007-08. The Eleventh Five Year Plan builds on the strength of average growth of 7.8 per cent of GDP achieved in the Tenth Five Year Plan period, the highest in any plan period so far, and targets an average growth of 9 per cent during the Plan. The Planning Commission projects an increase in public sector resources for the Plan from 9.46 per cent of GDP

Table 3.9 Central Government finances

		2007-08 Budget estimates	April-December		Column 4 as % of column 2	% Change (column 4/3)
			2006-07	2007-08		
1	2	3	4	5	6	7
			(Rs. crore)			
1.	**Revenue receipts (net to Centre)**	**486422**	**280915**	**355646**	**73.1**	**26.6**
	Gross tax revenue	**548122**	**306527**	**389345**	**71.0**	**27.0**
	Tax (net to Centre)	403872	232171	295994	73.3	27.5
	Non-tax	82550	48744	59652	72.3	22.4
2.	**Capital receipts**	**194099**	**102806**	**118607**	**61.1**	**15.4**
	of which:					
	Recovery of loans	1500	7952	3304	220.3	-58.5
	Other receipts	41651[a]	0	37725[b]	90.6	-
	Borrowings and other liabilities	150948	94854	77578	51.4	-18.2
3.	**Total receipts (1+2)**	**680521**	**383721**	**474253**	**69.7**	**23.6**
4	**Non-plan expenditure (a)+(b)**	**475421**	**272203**	**337090**	**70.9**	**23.8**
	(a) Revenue account	383546	253791	280050	73.0	10.3
	of which:					
	Interest payments	158995	92634	111764	70.3	20.7
	Major subsidies	50987	40225	49259	96.6	22.5
	Pensions	23488	15050	16551	70.5	10.0
	(b) Capital account	91875[a]	18412	57040	62.1	209.8
5.	**Plan expenditure (i)+(ii)**	**205100**	**111518**	**137163**	**66.9**	**23.0**
	(i) Revenue account	174354	93901	114806	65.8	22.3
	(ii) Capital account	30746	17617	22357	72.7	26.9
6.	**Total expenditure (4)+(5)=(a)+(b)**	**680521**	**383721**	**474253**	**69.7**	**23.6**
	(a) Revenue expenditure	557900	347692	394856	70.8	13.6
	(b) Capital expenditure	122621	36029	79397	64.7	120.4
7.	**Revenue deficit**	**71478**	**66777**	**39210**	**54.9**	**-41.3**
8.	**Fiscal deficit**	**150948**	**94854**	**77578**	**51.4**	**-18.2**
9.	**Primary deficit**	**-8047**	**2220**	**-34186**	**424.8**	**-1639.9**

Source: Controller General of Accounts.

a Includes an amount of Rs. 40,000 crore on account of transaction relating to transfer RBI's stake in SBI to the Government.

b Includes an amount of Rs. 34,308.6 crore on account of transfer of profit on sale of RBI's stake in SBI.

Table 3.10 Trends in cumulative Central Government finances for 2007-08

(Rs. crore)

		2007-08 (BE)	April	April-May	April-June	April-July	April-August	April-Sept.	April-Oct.	April-Nov.	April-Dec.
1		2		3	4	5	6	7	8	9	10
1.	**Revenue receipts**	486422	8106	25899	64428	95291	164083	197956	246546	274633	355646
	Per cent to BE		1.7	5.3	13.2	19.6	33.7	40.7	50.7	56.5	73.1
2.	**Capital receipts**	194099	28126	64851	115472	132772	107284	119936	122356	136742	118607
3.	**Total receipts**	680521	36232	90750	179900	228063	271367	317892	368902	411375	474253
	Per cent to BE		5.3	13.3	26.4	33.5	39.9	46.7	54.2	60.5	69.7
4.	**Non-Plan expenditure**	475421	27226	67615	131999	168244	199042	231134	269549	298756	337090
	Per cent to BE		5.7	14.2	27.8	35.4	41.9	48.6	56.7	62.8	70.9
5.	**Plan expenditure**	205100	9006	23135	47901	59819	72325	86758	99353	112619	137163
	Per cent to BE		4.4	11.3	23.4	29.2	35.3	42.3	48.4	54.9	66.9
6.	**Total expenditure**	680521	36232	90750	179900	228063	271367	317892	368902	411375	474253
	Per cent to BE		5.3	13.3	26.4	33.5	39.9	46.7	54.2	60.5	69.7
7.	**Revenue expenditure**	557900	34081	85234	133074	177691	217598	259080	304108	344607	394856
	Per cent to BE		6.1	15.3	23.9	31.8	39.0	46.4	54.5	61.8	70.8
8.	**Revenue deficit**	71478	25975	59335	68646	82400	53515	61124	57562	69974	39210
	Per cent to BE		36.3	83.0	96.0	115.3	74.9	85.5	80.5	97.9	54.9
9.	**Fiscal deficit**	150948	27814	62135	112404	129408	103338	81200	82256	96274	77578
	Per cent to BE		18.4	41.2	74.5	85.7	68.5	53.8	54.5	63.8	51.4

Source: Controller General of Accounts, Department of Expenditure, Ministry of Finance

in the Tenth Five Year Plan to 13.54 per cent in the Eleventh Five Year Plan. The Plan highlights that this depends critically on achievement of buoyancy in tax revenue, effective control over consumption expenditure and subsidies, and an improvement in the resource mobilizing capacity of PSUs both at the Central level and at the State level. It notes that developments like implementation of FRBM Act, 2003, the Twelfth Finance Commission (TFC) award for 2005-10, emergence of service tax as a very promising source of revenue, Sixth Central Pay Commission award (forthcoming) and the proposed unified Goods and Service Tax (GST) (from April 1, 2010) will have implications on financing of the Eleventh Five Year Plan.

3.39 The Centre's Gross Budgetary Support (GBS) for the Eleventh Five Year Plan is estimated at Rs. 14,21,711 crore at 2006-07 prices, out of which Central assistance to States and UTs plan works out to Rs. 3,24,851 crore. IEBR of CPSUs is estimated at Rs.10,59,711 crore. Total resources available for the Central Plan are projected at Rs. 21,56,571 crore. Plan resources of States & UTs have been projected to be Rs.14,88,147 crore at 2006-07 prices. This comprises Rs.11,63,296 crore of own resources (including borrowings) and Rs. 3,24,851 crore of Central assistance. Union Territories account for 3.8 per cent of the combined aggregate Plan resources of States and UTs. As per the Eleventh Five Year Plan document, the most notable feature of the Eleventh Five Year Plan projections is relatively modest dependence on borrowings amounting to 38.9 per cent of the total plan resources compared with 73.9 per cent in the Tenth Five Year Plan realization.

3.40 The Eleventh Five Year Plan focuses on poverty reduction, ensuring access to basic physical infrastructure, and better access to health and education services, while giving importance to bridging regional, social and gender disparities. The allocation of the outlays of the Eleventh Five Year Plan to various sectors has been in terms of the sectoral priorities (Table 3.11). It indicates a substantial increase, over the Tenth Five Year Plan, in the combined Centre and States allocations, of public sector resources for social services, energy, industry and agriculture.

3.41 The Eleventh Five Year Plan document points out the following major challenges in financing the plan. (i) The total resources for the Central and State Plans taken together have to increase from an average of 9.46 per cent of GDP

Table 3.11 Overall sectoral allocation of plan resources (Centre and States)

(Rs. crore)

	Eleventh Five Year Plan				Tenth Plan	Increase over 10th Plan (%)	Share of States in 11th Plan (%)
	Centre	IEBR	States	Total			
Agriculture	50924		85458	136382	60702	124.7	62.7
Rural development	190330		110739	301069	137710	118.6	36.8
Area programmes			26329	26329	16423	60.3	100.0
Irrigation	6747		203579	210326	112415	87.1	96.8
Energy	36912	591826	225385	854123	363635	134.9	26.4
Industry	54382	67196	32021	153599	64655	137.6	20.8
Transport	120188	266118	186137	572443	263934	116.9	32.5
Communication	16133	79204	43	95380	82945	15.0	0.0
Science & technology	75421	25	12487	87933	28673	206.7	14.2
Other eco services	13920	891	47712	62523	30349	106.0	76.3
Social services	524414	54450	523463	1102327	436529	152.5	47.5
General services	7489		34794	42283	20489	106.4	82.3
Total	**1096860**	**1059711**	**1488147**	**3644718**	**1618460**	**125.2**	**40.8**

Source: Planning Commission.

in the Tenth Five Year Plan to an average of 13.54 per cent of GDP in the Eleventh Five Year Plan. It may be noted that while the total size of the Plan is projected at 13.54 per cent of GDP, the total public investment in the economy is projected to be lower at 8.0 per cent. This difference reflects the fact that a great deal of Plan expenditure finances current expenditure on various items of public service delivery which are not counted as investment. (ii) The increase of 4.08 per cent of GDP in total resources for the Plan has to be achieved while keeping borrowing within the FRBM requirement of reducing the fiscal deficit of the Centre and the States to 3 per cent of GDP on each account. (iii) The combined BCR of the Centre and the States has to increase by more than the projected increase in Plan resources. As against the Centre's BCR of an average of (-) 0.84 per cent of GDP, realized in the Tenth Five Year Plan, it is projected to average 2.31 per cent of GDP over the Eleventh Five Year Plan, i.e., an improvement of 3.15 percentage points of GDP. Similarly, the BCR of States is also expected to improve substantially from (-) 0.18 per cent of GDP as realized in the Tenth Five Year Plan to 1.41 per cent of GDP in the Eleventh Five Year Plan. The projected improvement required in the combined BCR of the Centre and the States taken together is therefore 4.74 percentage points of GDP. The achievement of these BCR targets is a key element in the financing of the Plan.

3.42 The Eleventh Five Year Plan also proposes to address many outstanding issues that have emerged over the years with the changing structure of Centre-State financial relations such as increasing role of Centrally Sponsored schemes, financial discipline following the adoption of Twelfth Finance Commission Report and the distinction between Plan and non-Plan expenditure and revenue and capital expenditure. The traditional distinction along the above lines has created situations such as poor provision for maintenance expenditure, illogicality of treating certain expenditure for similar objectives as Plan and certain others as non-Plan. There are also issues relating to resource transfer to agencies of Government not getting captured in the accounting system and thus nullifying the larger objective of transparency in public finance. Furthermore, the issue of non-comparability of the size of the State Plans across different States, arising out of different practices being followed among States, has to be dealt with. Some States cover public sector entities (except Financial Intermediaries) within the scope of the State as an economic entity but many do not (Box 3.3).

PERFORMANCE OF THE DEPARTMENTAL ENTERPRISES OF THE CENTRAL GOVERNMENT

Railways

3.43 Indian Railways achieved freight loading of 727.8 million tonnes in 2006-07, representing an increase of 61.2 million tonnes over 2005-06. As a consequence, the freight revenue also grew by 15 per cent to Rs. 41,716 crore in 2006-07. The gross traffic receipts grew by 15 per cent to Rs. 62,732 crore in 2006-07. The additional traffic revenue has been realized with minor adjustments in freight structure, despite various concessions allowed to passenger traffic.

3.44 Ordinary Working Expenses of the Indian Railways increased by 7.7 per cent to Rs. 37,433 crore in 2006-07. The total working expenses including appropriations to Depreciation Reserve Fund and Pension Fund increased by 8.3 per cent to Rs. 49,047 crore in 2006-07. Taking into account the net variation of the miscellaneous receipts and miscellaneous expenditure, the net revenues of the Railways improved to Rs 14,453 crore in 2006-07.

Box 3.3 Certain Issues relating to accounting system

Distinction between plan and non-plan

It is argued that the distinction between plan and non-plan expenditure is illogical and even dysfunctional. The distinction has led to ever increasing tendency to start new schemes/projects to the utter neglect of maintenance of existing capacity and service levels. The distinction also often leads to the misperception that non-plan expenditure is inherently wasteful and should be avoided. This dichotomy has resulted in fragmented view of resource allocation to various sectors. The problem is assuming greater significance with higher priority to social sectors where salary constitutes an important element of the programme. The embargo imposed on recruitment for non-plan posts have caused serious problems of service delivery in health and education sectors. A need has been felt to draw protocols that will specify the agency for specific function and provide arrangements for coordinated activity.

Distinction between revenue and capital expenditure

The distinction between revenue and capital expenditure has acquired significance, and needs a relook, consequent to the emergent situation in the post-FRBM period. The FRBM Act stipulates that revenue deficit should be eliminated by the end of 2008-09. More than three-fourths of plan expenditure is now revenue expenditure. Strict adherence to the FRBM stipulation has a bearing on the ability of the Centre to formulate plan schemes aimed at addressing these new national priorities. Defence expenditure is treated, in national accounts, as consumption and there are instances when capital expenditure does not necessarily lead to more investments in the economy.

Accounting reform

An increasing proportion of fund transfer to the States in the recent years take place under CSS. These funds are routed to States and district level bodies directly from the Central Government. This practice is motivated by the desire to avoid delays and to prevent diversion of CSS funds by the States to support their ways and means position. Of late, the emerging concern is ensuring accountability on the usage of these funds.

The existing system of accounting for plan schemes, both for States and the Centre, does not adequately support informed planning, budgeting, effective monitoring, and decision making. The current accounting system does not capture transaction-oriented information. It also does not distinguish between transfer to States, final expenditure, and advance payments against which accounts have to be rendered. The extant accounting framework is not structured to generate State-wise and scheme-wise releases of funds by the Central Government to States, and other recipients, and also the actual utilization for the intended performance.

There is a need to design and implement a scheme that would aim at reforming this process. The scheme would naturally modify the existing code of accounts so as to fully capture the entire range of plan schemes operated by the Government of India and the State Governments. The Code of Accounts needs to be restructured to provide information relating to each implementing agency. Though there are stand-alone efforts, yet there is no consolidated financial information system based on the accounting structure. A comprehensive Decision Support System (DSS) and Management Information System (MIS) for effective monitoring of plan schemes is the need of the hour. This will work through a core accounting solution on a central data centre. A detailed scheme would be finalized during the Eleventh Five Year Plan.

3.45 Railways fully discharged the dividend liability for 2006-07 which amounted to Rs. 3,584 crore and have also paid Rs. 663 crore towards outstanding deferred dividend liability. After payment of total dividend from the net revenues earned, Railways in 2006-07 have generated a net surplus of Rs.10,206 crore. A healthy growth in traffic revenues and prudent economy measures adopted in expenditure management during 2006-07 have further consolidated the financial health of the Railways which is reflected in the operating ratio improving to 78.7 per cent as against 83.7 per cent in the previous year. The net revenue as a proportion of capital-at-charge and investment from capital fund has also improved to 19 per cent in 2006-07.

3.46 The Plan Expenditure of Railways for 2006-07 stood at Rs. 25,002 crore including internally generated resources of Rs. 12,233 crore (i.e. 49 per cent of the total outlay). This included market borrowings of Rs. 4,161 crore by the Indian Railway Finance Corporation (IRFC) and borrowings of Rs. 450 crore for Rail Vikas Nigam Limited (RVNL). Besides, Plan outlay also includes Rs. 244 crore under Wagon Investment Schemes (WIS) as private participation. While certain important projects and strengthening of golden quadrilateral under National Rail Vikas Yojana are in progress, Railways have incorporated the Dedicated Freight Corridor Corporation of India Ltd., to meet the large increase in volume of freight traffic over the years. Railways are also modernizing and upgrading the rail services, especially keeping in view the prevailing boom in the economy.

Posts

3.47 The gross receipts in 2006-07 of the Department of Posts were Rs. 5,322.4 crore. During the same year, gross and net working expenses were Rs. 6,779.1 crore and Rs. 6,572.0 crore, respectively. There was, therefore, a deficit of Rs. 1,249.5 crore. In 2007-08 (BE), the gross receipts are budgeted to increase to Rs. 5,539.7 crore, with gross and net working expenses estimated at Rs. 7,237.4 crore and Rs. 7,021.9 crore, respectively. The deficit is projected to be Rs. 1,482.2 crore.

3.48 The universal service obligations of the Postal Department primarily consist of the social obligation to deliver letters/parcels/moneyorders to rural and remote areas. In a bid to reduce the deficit, the Department of Posts has, over the last few years, made several efforts which include efforts to increase revenue generation and cutting down costs. The efforts to increase revenue generation and cutting down costs include introduction of new products and services, strengthening the existing ones and harnessing the potential of its vast network to earn more revenues. Moreover, with the Indian economy growing at 8 to 9 per cent annually, the vast network of 1,55,516 post offices has caught the attention of many organizations, such as telecom companies, banks, financial institutions and NGOs who are eager to expand their services through the postal network. The Department of Posts is expected to actualize this commercial potential through its vast network and delivery capabilities.

Broadcasting

3.49 Prasar Bharti, a public service broadcaster, gives due priority to the matters of national importance as determined by the Government of the day. The total expenditure of Prasar Bharti in 2006-07 was Rs.1,921.39 crore as compared to the commercial receipts of Rs. 1,136.78 crore (gross) and Rs. 975.67 crore (net). Prasar Bharti has taken a number of steps to modernize and increase its commercial revenue. Some of the important steps include launching a new entertainment programme under J&K special package, running of Urdu channel for 24 hours, purchase of right to telecast cricket matches and other sports events, automation and digitization of studios and transmitters, and modernization of satellite broadcast equipment. However, a resource gap continues to exist and Rs.1,346.37 crore has been allocated in 2007-08 (BE) to cover the resource gap of Prasar Bharti.

FINANCES OF STATE GOVERNMENTS

3.50 The finances of State Governments traditionally follow a pattern similar to that of the Centre. State's own tax receipts, as a proportion of GDP, increased from 5.6 per cent in 2002-03 to 6.2 per cent in 2006-07 (RE) and are projected to further improve to 6.3 per cent of GDP in 2007-08 (BE). The tax receipts inclusive of tax transfers from the Centre during the same period increased from 7.9 per cent to 9 per cent and further to 9.2 per cent respectively. The total revenue receipts increased to 12.9 per cent of GDP in 2007-08 (BE). The total expenditure, on the other hand, declined from 18.7 per cent of GDP in 2003-04 to 16.3 per cent in 2007-08 (BE). As a result, in 2006-07 (RE) all States put together have achieved revenue deficit of 0.1 per cent and fiscal deficit of 2.7 per cent of GDP. The States were, therefore, close to achieving the FRBMA mandated target of eliminating revenue deficit two years ahead of the scheduled year of 2008-09. Similarly, with significant reduction in total disbursements as a proportion to GDP, the consolidated fiscal deficit of all the States put together is already lower than the FRBMA mandated target of 3 per cent since 2005-06, ahead of schedule. Further during the current financial year, 2007-08, the States are estimated to have a revenue surplus of 0.3 per cent and fiscal deficit of 2.3 per cent, of GDP (Table 3.12 and Figure 3.10).

3.51 Most recent indicators of State finances show a distinctly improved picture. The causative factors of fiscal deterioration in the past will, however, need to be monitored in the future as well to sustain this progress and keep the balance at the desired level. The causative factors are: interest payment; pension liabilities; losses of State PSUs; lack of proper user charges; and a possible

Table 3.12 Receipts and disbursements of State Governments[a]

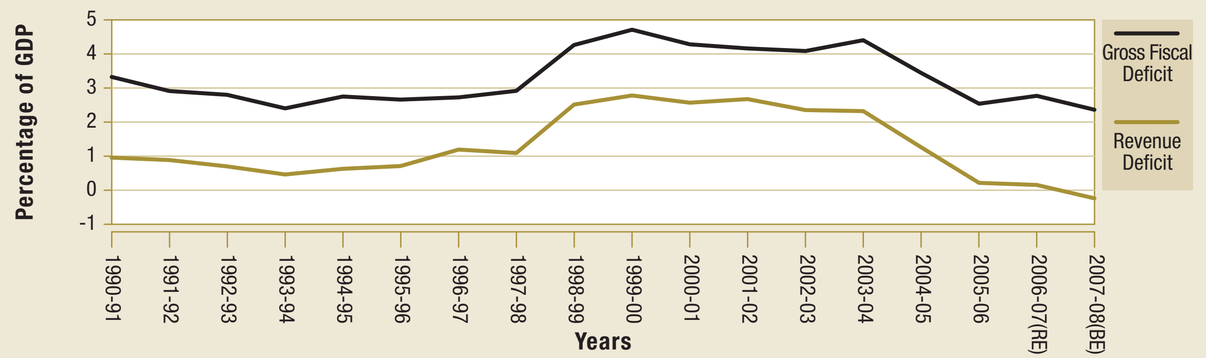
		2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)
1	2	3	4	5	6	7	8
		(Rs. crore)					
I	**Total receipts (A+B)**	**4,14,539**	**5,14,829**	**5,63,661**	**5,95,629**	**6,74,736**	**7,67,845**
	A Revenue receipts (1+2)	2,73,673	3,09,187	3,63,513	4,31,022	5,31,429	6,06,733
	1 Tax receipts	1,93,474	2,21,115	2,60,577	3,06,332	3,72,817	4,30,222
	of which						
	State's own tax revenue	1,36,819	1,54,037	1,82,027	2,12,307	2,57,080	2,94,038
	2 Non-tax receipts	80,199	88,072	1,02,936	1,24,690	1,58,612	1,76,511
	of which:						
	Interest receipts	9,031	7,748	8,648	9,380	9,302	11,008
	B. Capital receipts	1,40,866	2,05,642	2,00,148	1,64,607	1,43,307	1,61,112
	of which:						
	Recovery of loans & advances	3,698	16,158	8,039	8,904	8,482	4,592
II.	**Total disbursements (a+b+c)**	**4,10,248**	**5,14,303**	**5,53,427**	**5,61,682**	**6,87,946**	**7,66,619**
	a) Revenue	3,30,852	3,72,594	4,02,670	4,38,034	5,36,995	5,94,760
	b) Capital	68,806	1,19,899	1,34,235	1,09,224	1,36,010	1,55,666
	c) Loans and advances	10,590	21,810	16,522	14,424	14,941	16,193
III.	**Revenue deficit**	**57,179**	**63,406**	**39,157**	**7,012**	**5,566**	**-11,973**
IV.	**Gross fiscal deficit**	**99,727**	**1,20,631**	**1,07,774**	**90,084**	**1,13,913**	**1,08,323**
		(As per cent of GDP)					
I.	**Total receipts (A+B)**	**16.9**	**18.7**	**17.9**	**16.6**	**16.3**	**16.4**
	A. Revenue receipts (1+2)	11.1	11.2	11.5	12.0	12.8	12.9
	1. Tax receipts	7.9	8.0	8.3	8.6	9.0	9.2
	of which						
	State's own tax revenue	5.6	5.6	5.8	5.9	6.2	6.3
	2. Non-tax receipts	3.3	3.2	3.3	3.5	3.8	3.8
	of which:						
	Interest receipts	0.4	0.3	0.3	0.3	0.2	0.2
	B Capital receipts	5.7	7.5	6.4	4.6	3.5	3.4
	of which:						
	Recovery of loans & advances	0.2	0.6	0.3	0.2	0.2	0.1
II.	**Total disbursements (a+b+c)**	**16.7**	**18.7**	**17.6**	**15.7**	**16.6**	**16.3**
	a) Revenue	13.5	13.5	12.8	12.2	13.0	12.7
	b) Capital	2.8	4.4	4.3	3.1	3.3	3.3
	c) Loans and advances	0.4	0.8	0.5	0.4	0.4	0.3
III.	**Revenue deficit**	**2.3**	**2.3**	**1.2**	**0.2**	**0.1**	**-0.3**
IV.	**Gross fiscal deficit**	**4.1**	**4.4**	**3.4**	**2.5**	**2.7**	**2.3**

Source: Reserve Bank of India.

a Data pertains to 28 State Governments.

Note: 1. The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.
2. Capital receipts include accounts on a net basis.
3. Capital disbursements are exclusive of public accounts.
4. Negative sign indicates surplus.

Figure 3.10 Revenue and fiscal deficit of states



moderation in buoyancy in taxes. The successful introduction of VAT by 30 States/UTs and the TFC incentive to enact State level FRBM legislations appear to have deepened State level fiscal reforms and put them on the path towards fiscal sustainability.

State level reforms

3.52 The pace of fiscal adjustment and corrections at State level has gained further momentum during 2007-08. So far 26 out of 28 States have enacted FRBMAs. Sikkim and West Bengal are the two States yet to enact FRBMAs.

3.53 Debt Consolidation and Relief Facility (DCRF), formulated as per recommendations of Twelfth Finance Commission (TFC), has two components – consolidation of Central loans (from the Ministry of Finance); and debt waiver. So far, Central loans (from the Ministry of Finance) of 24 out of 28 States have been consolidated to the extent of Rs. 1,09,977 crore. Jharkhand and Jammu and Kashmir are among the States that have enacted FRBMAs, a prerequisite for availing of benefits under DCRF, whose debts are to be consolidated. Debt consolidation has provided interest relief to the States to the extent of Rs. 4,392 crore and Rs. 3,995 crore in 2005-06 and 2006-07, respectively.

3.54 The second component of DCRF is debt waiver. For 2005-06, consolidated debt of 14 States amounting to Rs. 3,879 crore was waived, and for 2006-07, debt of 19 States to the extent of Rs. 4,595 crore was waived. During 2007-08, 21 States are estimated to get debt waiver of Rs. 4,812 crore. Debt consolidation and waiver have facilitated States to achieve targets of elimination of revenue deficit and containing fiscal deficit to GSDP ratio at 3 per cent well ahead of 2008-09. It also poses a challenge to States to sustain this momentum; and provides an opportunity to leverage gains achieved to concentrate on social sectors to make the growth process more inclusive.

3.55 In 2006-07, the States have been able to have larger corrections, which are expected to lead to lower fiscal deficit as compared to the revised estimates. During the current year also, against the budgeted fiscal deficit of 2.3 per cent of GDP, the States could do better.

3.56 In pursuance of the provisions of Article 280 of the Constitution of India, the Thirteenth Finance Commission has been constituted by the President of India under the Chairmanship of Dr. Vijay L. Kelkar vide a notification dated November 13, 2007. The Commission shall make recommendations covering a period of five years commencing on April 1, 2010. In making its recommendations, the Commission shall have regard, among other considerations, to the impact of the proposed implementation of goods and services tax with effect from April 1, 2010, including its impact on the country's foreign trade, the need to manage ecology, environment and climate change consistent with sustainable development, and the need to improve the quality of public expenditure to obtain better outputs and outcomes.

Value Added Tax (VAT)

3.57 Introduction of State level VAT is the most significant tax reform measure at State level. The State level VAT being implemented presently has replaced the erstwhile sales tax system of the States. Under Entry 54 of List II (State List) in the Seventh Schedule to the Constitution of India, "tax on sale or purchase of goods within a State" is a State subject. The decision to implement State level VAT was taken in the meeting of the

Empowered Committee (EC) of State Finance Ministers held on June 18, 2004, where a broad consensus was arrived at amongst the States to introduce VAT from April 1, 2005. Accordingly, VAT has been introduced by all States/UTs by now. Uttar Pradesh is the latest State which has introduced VAT on January 1, 2008.

3.58 Since sales tax/VAT is a State subject, the Central Government is playing the role of a facilitator for successful implementation of VAT. A compensation formula has also been finalized in consultation with the States, for providing compensation to them, during 2005-06, 2006-07 and 2007-08, for any loss on account of introduction of VAT and compensation is being released according to this formula. Technical and financial support has also been provided to the States for VAT computerization, publicity and awareness and other related aspects.

3.59 The Empowered Committee, through its deliberations over the years, finalized a design of VAT to be adopted by the States, which seeks to retain certain essential features commonly across States while, at the same time, providing a measure of flexibility to the States to enable them to meet their local requirements. Box 3.4 gives the salient features of the VAT design finalized by the Empowered Committee.

Box 3.4 Salient features of the VAT design

- The rates of VAT on various commodities shall be uniform for all the States/UTs. There are two basic rates of 4 per cent and 12.5 per cent, besides an exempt category and a special rate of 1 per cent for a few selected items. The items of basic necessities and goods of local importance (up to 10 items) have been put in the 0 per cent or the exempted schedule. Gold, silver and precious stones have been put in the 1 per cent schedule. The 4 per cent rate applies to other essential items and industrial inputs. The 12.5 per cent rate is residual rate of VAT applicable to commodities not covered by other schedules. There is also a category with 20 per cent floor rate of tax, but the commodities listed in this schedule will not be VATable. This category covers items like motor spirit (petrol, diesel and aviation turbine fuel), liquor, etc.
- There is provision for eliminating the multiplicity of taxes. In fact, several State taxes on purchase or sale of goods (excluding entry Tax in lieu of octroi) have been subsumed in VAT or made VATable.
- Provision has been made for allowing "Input Tax Credit (ITC)". However, since the VAT being implemented is intra-State VAT only and does not cover inter-State sale transactions, the ITC will not be available on inter-State purchases.
- Exports will be zero-rated, and at the same time, credit will be given for all taxes on inputs/ purchases, related to such exports.
- There are provisions to make the system more business-friendly. These include provision for self-assessment by the dealers, provision of a threshold limit for registration of dealers in terms of annual turnover of Rs. 5 lakh, and provision for composition of tax liability up to annual turnover limit of Rs. 50 lakh.
- States have been allowed to continue with the existing industrial incentives, without breaking the VAT chain. However, no fresh sales tax/ VAT-based incentives are permitted.

VAT Implementation – Experiences and challenges

3.60 The initial experience of implementation of VAT has been very encouraging. The new system has been received well by all the stakeholders. The transition to the new system has been quite smooth. The EC is constantly reviewing the progress of implementation of VAT. The revenue performance of VAT implementing States/UTs has been very encouraging so far, as can be seen from the following:

(i) During 2005-06, the tax revenue of the 25 VAT implementing States/UTs had registered an increase of around 13.8 per cent over the tax revenue of 2004-05, which is higher than the Compound Annual Growth Rate (CAGR) of sales tax revenues of these States for the last five years up to 2004-05.

(ii) During 2006-07, the tax revenue of the 31 VAT State/UTs had collectively registered a growth rate of about 21 per cent over the tax revenue of 2005-06. This indicates that the VAT system is gradually stabilizing and has started yielding the desired results.

(iii) During 2007-08, the tax revenue of 32 VAT States/UTs showed a further growth of 14.6 per cent during the first six months of 2007-08 (April-September) as compared to the corresponding period of last year.

Status of VAT compensation

3.61 The Central Government had announced a compensation package under which the States are compensated for any revenue loss on account of VAT introduction at the rate of 100 per cent of revenue loss during 2005-06, 75 per cent during 2006-07 and 50 per cent during 2007-08. Central Government has received claims totaling Rs. 13167.3 crore during 2005-06, 2006-07 and 2007-08 (January 31, 2008). It has already released Rs. 9247.6 crore and claims of the balance amount are in process (Table 3.13).

Central Sales Tax Reforms

3.62 It is generally agreed that the Central Sales Tax (CST), being an origin-based non-rebatable tax, is inconsistent with the concept of VAT and needs to be phased out. After deliberations with the Empowered Committee of States, the roadmap for this has been finalized, which provides for a gradual phase out by reducing the CST rate from its level of 4 per cent with effect from April 1, 2007, by 1 per cent every year, to be finally phased out completely by March 31, 2010. Accordingly, the rate has been reduced to 3 per cent with effect from April 1, 2007. This is due to be reduced further to 2 per cent with effect from April 1, 2008. One critical issue involved in phasing out of CST is that of compensating the States for revenue losses on account of such phase out. The scheme for compensation of CST revenue loss due to the reduction of CST rate to 3 per cent with effect from April 1, 2007 had been finalized in consultation with the Empowered Committee of States. During 2007-08 (BE), total amount of Rs. 2,500 crore has been provided for compensating the States/UTs. Claims for total amount of Rs. 1,865.9 crore have been received from 9 States as on January 31, 2008. Out of this, an amount of Rs. 876.05 crore has been released and for the balance amount of Rs. 992.8 crore, the claims are under process.

Planning to introduce goods & services tax

3.63 To avoid double taxation and tax cascading and have a simple and progressive taxation system for goods as well as services, it is proposed to introduce a combined national level goods and services tax (GST). This is similar in concept to State VAT for goods. It provides for input tax credit at every stage for tax already paid till the previous transaction. This will also attempt to provide a rational system by subsuming several State and Central level indirect taxes on goods and services. The design and roadmap for this is being finalized in consultation with the Empowered Committee of States. This is targeted to be introduced with effect from April 1, 2010.

CONSOLIDATED GENERAL GOVERNMENT

3.64 The macroeconomic impact of the state of public finances are best analyzed through the construct of “Consolidated General Government”. With very limited data on local finances and the grant-dependent nature of local bodies in India, the aggregation of State and Central Government finances, after due process of adjustment for inter-Governmental transfers, is usually taken as the General Government finances. As a proportion of GDP, tax receipts of the General Government has consistantly increased from 14.4 per cent in 2002-03 to reach 17.3 per cent in 2006-07 (RE) and is budgeted at 17.8 per cent in 2007-08. The total expenditure stood at 28.3 per cent in 2002-03 and has remained in the range of 26.8-28.5 per cent of GDP. There have been consistent reductions in the revenue and fiscal deficits as proportions to GDP since 2002-03 (Table 3.14). This reduction was possible through the harmonized fiscal policies being followed by both the Central and State Governments. Sustaining this harmony in fiscal balances is a critical requirement for reaping the growth dividend through macroeconomic linkages and to attain the FRBM targets. Figure 3.11 gives the trend of combined revenue and fiscal deficits, as percentage of GDP, for the Centre and States.

Table 3.13 Release of funds under VAT compensation package

(Rs. Crore)

Year	Claims received	No. of States	Release in 2005-06	Release in 2006-07	Release in 2007-08	Balance
2005-06	6942.9	10	2471.3	3696.2	597.9	177.5
2006-07	4334.1	9	-	395.9	896.3	3041.9
2007-08	1890.3	2	-	-	1190.0	700.3

Source : Ministry of Finance, Department of Revenue.

Table 3.14 Combined rceipts and disbursements of the Central and State Governments

	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)
1	2	3	4	5	6	7
	(Rs. crore)					
I. Total receipts (A+B)	**7,10,177**	**8,40,675**	**8,75,621**	**10,14,689**	**11,24,687**	**13,11,122**
A Revenue receipts (1+2)	4,46,749	5,11,038	6,05,180	7,07,054	8,69,940	9,96,266
1 Tax receipts	3,52,899	4,08,097	4,85,375	5,76,596	7,18,788	8,34,094
2 Non-tax receipts	93,850	1,02,941	1,19,805	1,30,458	1,51,152	1,62,173
of which						
Interest receipts	17,060	17,987	16,500	18,735	17,301	18,805
B Capital receipts	2,63,428	3,29,637	2,70,441	3,07,635	2,54,747	3,14,856
of which:						
a) Disinvestment proceeds	3,151	16,953	4,424	1590[a]	3582[a]	51752[a]
b) Recovery of loans & advances	12,709	26,062	14,441	11,651	11,359	5,592
II Total disbursements (a+b+c)	**6,95,203**	**7,86,112**	**8,57,644**	**9,59,855**	**11,48,824**	**13,09,897**
a) Revenue	6,11,809	6,72,702	7,22,675	8,06,366	9,58,942	10,55,770
b) Capital	64,757	85,821	1,12241	1,32,585	1,70,106	2,33,920
c) Loans and advances	18,637	27,589	22,728	20,904	19,776	20,207
III. Revenue deficit	**1,65,060**	**1,61,664**	**1,17,495**	**99,312**	**89,002**	**59,504**
IV. Gross fiscal deficit	**2,33,594**	**2,32,059**	**2,33,236**	**2,39,560**	**2,63,944**	**2,56,286**
	(As per cent of GDP)					
I Total receipts (A+B)	**28.9**	**30.5**	**27.8**	**28.3**	**27.1**	**27.9**
A Revenue receipts (1+2)	18.2	18.6	19.2	19.7	21.0	21.2
1 Tax receipts	14.4	14.8	15.4	16.1	17.3	17.8
2 Non-tax receipts	3.8	3.7	3.8	3.6	3.6	3.5
of which						
Interest receipts	0.7	0.7	0.5	0.5	0.4	0.4
B Capital receipts	10.7	12.0	8.6	8.6	6.1	6.7
of which:						
a) Disinvestment proceeds	0.1	0.6	0.1	0.0	0.0	0.0
b) Recovery of loans & advances	0.5	0.9	0.5	0.3	0.3	0.1
II Total disbursements (a+b+c)	**28.3**	**28.5**	**27.2**	**26.8**	**27.7**	**27.9**
a) Revenue	24.9	24.4	22.9	22.5	23.1	22.5
b) Capital	2.6	3.1	3.6	3.7	4.1	5.0
c) Loans and advances	0.8	1.0	0.7	0.6	0.5	0.4
III. Revenue deficit	**6.7**	**5.9**	**3.7**	**2.8**	**2.1**	**1.3**
IV. Gross fiscal deficit	**9.5**	**8.4**	**7.4**	**6.7**	**6.4**	**5.5**

Source: Reserve Bank of India.

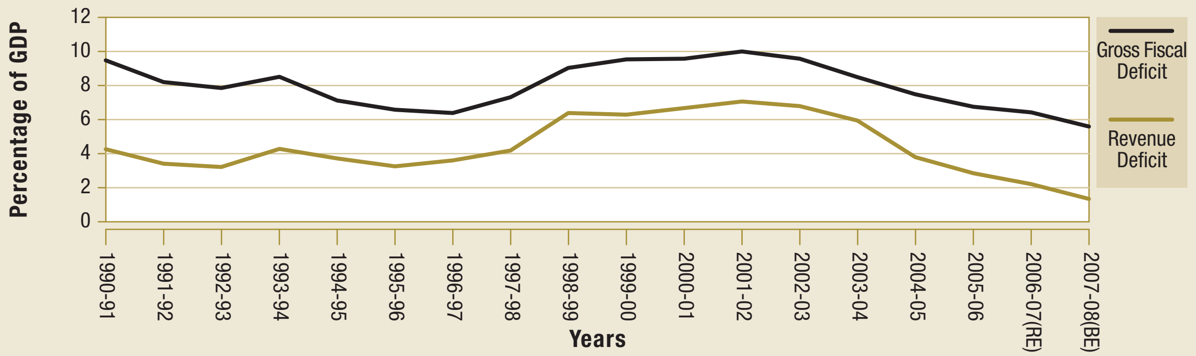
a Also includes sale of "land and propoerty" and debt relief.

Note: 1. The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.

2. Data pertaining to State Governments relates to budget of 28 State Governments and are provisional from 2006-07 onward.

3. The data do not cover Union Territories with Legisltature, *i.e.* National Capital Region Territory of Delhi and Puducherry.

Figure 3.11 Combined (centre and states) revenue and fiscal deficit



CHALLENGES AND OUTLOOK

3.65 In the year 2007-08, the process of fiscal consolidation was carried forward on the strength of buoyant tax revenues and prudent expenditure management. The targets of revenue and fiscal deficits for the year 2007-08, indicated in the Medium Term Fiscal Policy Statement of the Government, in terms of the FRBMA 2003, appear to be well within the reach. Further, as the trends of receipts indicate, it may not be very difficult to achieve the target of 3 per cent fiscal deficit by 2008-09. However, the target of bringing revenue deficit to zero by the end of the 2008-09 would remain a challenge. In this context it is important to note that, to a large extent, the current revenue buoyancy is riding on the performance of the economy which is more globalized than ever before. A closer monitoring of the global economic developments that have a bearing on India's domestic economy would remain critical.

3.66 The enactment of fiscal responsibility legislation by 26 States has moved the rule-based programme of fiscal reforms further ahead. Notwithstanding the variation across the States, the consolidated revenue balance is budgeted to show a surplus of 0.3 per cent of GDP in 2007-08. Achievement of the targets set under the fiscal responsibility legislations has not only consolidated the fiscal health of the States but it has also improved the credibility of their budgetary operations. However, it is necessary to remain vigilant. The real challenge lies in improving the deficiencies in their targeted expenditure to achieve the goal of inclusive growth envisaged in the Eleventh Five Year Plan.