GOVERNMENT BUDGETING

SECTION-A

GOVERNMENT BUDGET

Budget is a statement of estimated receipts and expenditure of the government for the ensuing fiscal year (i.e. 1 April to 31st March). It is also known as 'Annual Financial Statement'. The budget is the most important information document of the government because government implements its plans and programmes through the budget.

As per article 112 of the constitution, the President shall cause to be laid a financial statement before both the Houses of Parliament at the commencement of every financial year of the estimated receipts and expenditure of the government for that year. Article 202 of the constitution provides that a similar financial statement for each state will be placed before the legislature of the respective state.

The annual budget statement presents four kinds of estimates:

(1) Actual estimates of the preceding year

(2) Budget estimates of the current year

(3) Revised estimates of the current year

(4) Budget estimates for the proceeding year

The budget shows the receipts and expenditure of the government (centre and states) under three heads:

(1) **Consolidated Fund:** It is the main account of the government and it consists of all the receipts of the government from taxes, loans and other receipts. No amount can be spent without prior sanction of the Parliament (or state legislature).

(2) **Contigency Fund:** It consists of the sum placed at the disposal of the President to meet unforeseen expenditure. The prior sanction of the Parliament or state legislature is not required under this fund but it is sought to replenish the fund.

(3) **Public Account:** It consists of all receipts and payments which are in the nature of a deposit account with the government such as small savings, provident funds etc. No legislative sanction is required for withdrawal of money from this fund as it does not belong to the government and comes under the public account.

The presentation of Budget is followed by a general discussion on it in both the Houses of Parliament. Estimates of expenditure from the Consolidated Fund of India are placed before the Lok Sabha in the form of 'Demand of Grants'. All withdrawals of money from the consolidated Fund are therefore authorized by an appropriation Act passed by the Parliament every year.

Tax proposals of the budget are embodied in a bill which is passed as the 'Finance Act' of the year. Estimate of receipts and expenditure are similarly presented by the state governments in their legislature before the beginning of the financial year.

Union Finance Minister's speech: Finance minister's speech gives a broad overview of the Budget proposals. Generally it is in two parts. The first deals with a review of implementation of the preceding year's schemes, revised estimates for the completed year and the budget estimate for the next year, without taking into account the impact of budget proposals. Part two of the speech deals with revenue mobilization through tax proposals.

Annual Financial Statement: Annual Financial Statement (AFS) is the main Budget document. Under Article 112 of the Constitution, a statement of estimated receipts and expenditure of the Government of India has to be laid before the Parliament in respect of every financial year from 1 April to 31 March. It shows the receipts and payments of government under three accounts- Consolidated Fund, Contingency Fund and the Public Account.

Demands for Grants: The estimates of expenditure from the Consolidated Fund, included in the Annual Financial Statement and required to be voted by the Lok Sabha, are submitted in the form of Demands for Grants in pursuance of article 113 of the Constitution. Generally, one Demand for Grant is presented in respect of each ministry or department.

Budget at a glance: The Budget at a glance gives an overview of the budgetary proposals. It gives a break up of tax and other receipts as well as expenditures (plan and non-plan), allocations of outlays by ministries and resource transfers to states and UTs, the projections on revenue deficit, fiscal deficit and primary deficit, etc.

Finance Bill: The proposals of government for levy of new taxes, modification of the existing tax structure or continuance of the existing tax structure are submitted to the Parliament through the Finance Bill. To facilitate easy comprehension of the budget, certain explanatory documents are presented along with the budget.

Appropriation Bill: After the Lok Sabha votes on the Demands for Grants, Parliament's approval to the withdrawal from the Consolidated Fund of the amounts so voted and of the amount required to meet the expenditure 'charged' on the Consolidated Fund is sought through the Appropriation Bill.

Rationale of Presentation of Budget

1. To ensure transparency in public finances
2. To ensure accountability of the government
3. To ensures advance planning.
4. To ensure financial control of legislature over the executive.

Objectives of a Government Budget

(i) Economic growth

(ii) Reduction of poverty and unemployment

(iii) Reduction of inequalities/Redistribution of income

(iv) Reallocation of resources

(v) Price stability/Economic stability

(vi) Financing and management of public enterprises:

Structure of the Budget

Structure of the Budget refers to the components of the budget. It has two broad components:

(a) Budget Receipts

(b) Budget Expenditure.

(a) Budget Receipts refer to estimated money receipts of the government from all sources during the fiscal year. Broadly, the budget receipts are classified as:

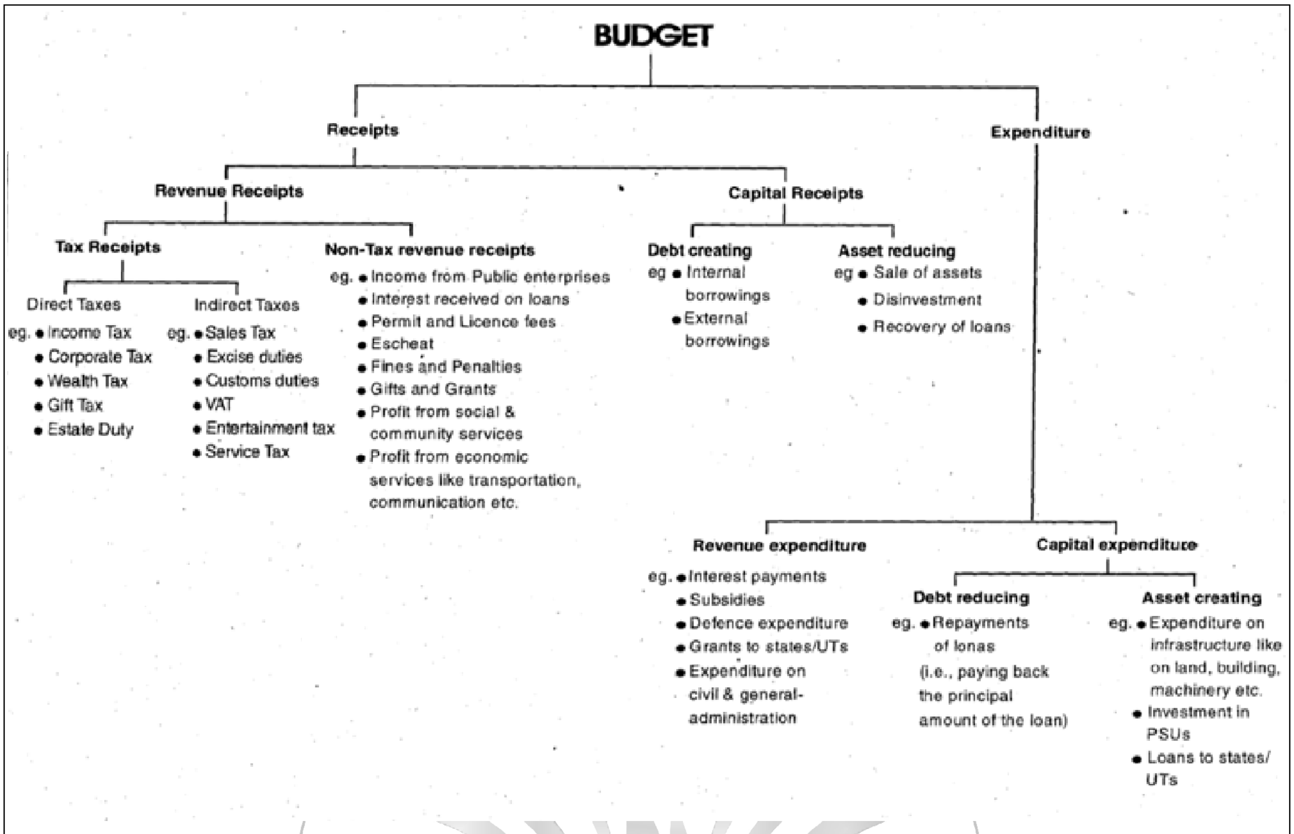
(i) Revenue Receipts: Such receipts accrue to the government on account of its current activities and are generally recurrent in nature. For example tax receipts like income tax, excise tax etc. and non-tax revenue receipts like income from PSUs, interest received etc.

(ii) Capital Receipts: Such receipts either create liabilities (like borrowings) or reduce assets like disinvestment, recovery of loans etc.

(b) Budget Expenditure: Refers to the estimated expenditure of the government on its developmental and non-developmental programmes (or on its plan and non-plan programmes) during the fiscal year. Budget expenditure is also classified into two broad categories:

(i) Revenue Expenditure: Such expenditure is incurred on day-to-day activities of the government and neither create assets nor reduce liabilities e.g. interest payments, subsidies etc.

(ii) Capital Expenditure: Expenditure either creates asset or reduces liability of the government e.g. expenditure on construction of road, bridge, building etc.



TYPES OF BUDGETS

1. **Zero Based Budgeting (ZBB)**: This concept was propounded by Peter Phyrr. Under this the financial requirements of various departments are analysed, evaluated and justified annually afresh i.e. on the assumption that there was no budget in the earlier years. Thus each head of expenditure is justified on its merit and unnecessary items continuing from the past are discontinued. It was adopted in India since 1987 as a means to control public expenditure.
2. **Performance (and Programme) Budgeting**: A budget which presents the purpose for which funds are required, cost of programmes proposed and quantitative criteria for measuring the accomplishments under each programme. India adopted performance budgeting in 1969. Since then performance budgets for various departments are prepared and submitted to parliament as supplementary documents to the traditional budget.
3. **Outcome Budget:** An outcome budget is a variant of performance budget. It is an exercise of converting the financial outlays into physical outcomes, with fixed quarterly measurable and moniterable targets, to improve the quality of implementation of developmental programmes. The outcome budget measures the development outcomes of all government programmes. For instance it will tell a citizen if money has been allocated for building a primary health care, whether the centre has indeed come up. In other words, it is a means to develop a linkage between the money spent by a government and the results which follow.

BUDGETARY DEFICITS

1. Budget Deficit

The budget deficit is the difference between the total expenditure and total receipts, other than internal capital receipts. It has to be financed through the sale of 91 day ad-hoc treasury bills to the RBI and drawing down of cash balances.

Budget Deficit = Total Expenditure — Total Receipts

= 91 day adhoc treasury bills + cash withdrawals

The issue of 91 day adhoc treasury bills leads to the monetisation of the deficit (i.e. printing of new money), so government abandoned the practice of issuing such securities to the RBI since 1997. Instead, the government had initiated a scheme of Ways and Means Advances (WMA). Thus, the concept of budget deficit had become redundantin India.

Ways and Means Advances (WMA): It is a type of overdraft facility by RBI to the government. Under this scheme, the RBI, provides facilities for temporary accommodation of the financial needs of the government up to a ceiling. Now, yearly limits are divided into six months each, decided mutually between the government and the RBI at the beginning of a year. Thus, the WMA is purely a mechanism to bridge the temporary mismatch between the receipts and expenditure of the government.

2. Revenue Deficit (RD)

Revenue deficit is the excess of revenue expenditure over revenue receipts of the government during a financial year.

R.D. = Revenue expenditure - Revenue receipts

Revenue deficit shows the extent of reduction of assets or increment in liabilities of the governmentduring a financial year. In simple terms, it can be understood as the excess of current consumption expenditure of the government (which does not yield any future benefit) over its current income. So, it is regarded as the worst kind of deficit from the perspective of economic welfare.

It shows the extent of reduction in assets or increment in the liabilities of the government during a financial year. It may be desirable in emergency/recessionary conditions.

3. Fiscal Deficit (FD)

Fiscal deficit is the excess of total expenditure of the government over the total receipts other than borrowings.

FD = Total Expenditure — Total receipts other than borrowings

In other words, it can be defined as the difference between the total expenditure on one hand and the revenue receipts plus non-debt creating capital receipts on the other.

FD = (Total Expenditure) — (Revenue Receipts + Non-debt creating capital receipts)

Fiscal deficit shows the extent of increment in public debt (i.e. total borrowings from all sources) during a fiscal year.

It is the most comprehensive measure of deficit as it depicts the total resource gap of the government budget. In general it is not desirable. Its impact on economic development depends upon the use of borrowed funds.

Adverse impacts of high fiscal deficit

1. It increases public debt which increases future interest liabilities.
2. It deteriorates fiscal situation of the government which adversely affects developmental expenditure.
3. It creates inflation.
4. It leads to crowding out.
5. Government's ability to intervene in economy to overcome impact of economic shocks reduces because of fiscal deficit.
6. Very high fiscal deficit reduces credit worthiness of government which might deteriorate BOP situation of country.

Crowding Out: It refers to the reduction in private investment as a result of high interest rates due to excessive government borrowings (high Fiscal Deficit).

4. Primary Deficit

Primary deficit is the difference between the fiscal deficit and interest paymentsof the government during a financial year.

P.D. = Fiscal Deficit — Interest Payments

It reflects the status of the current operations of the government. That is, the extent to which current government policy is adding to future burdens stemming from past policy.

5. Monetised Deficit

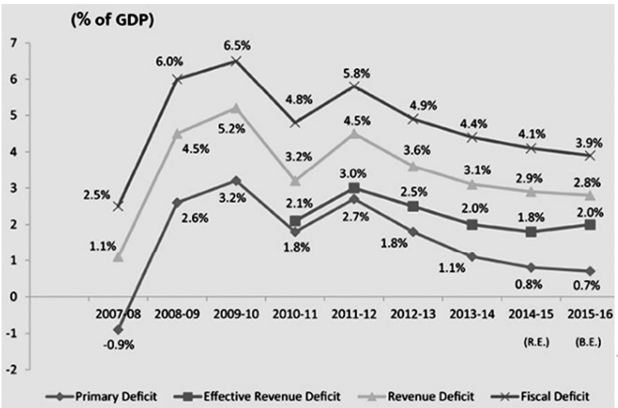
It is defined as the net increase in central bank credit to the government during a fiscal year. Government borrowings from RBI directly add to high powered money i.e. printing of new money. It deficits the increase in the high powered money and leads to a multiple expansion in money supply, which generates inflation. Monetised Deficit is only a part of fiscal deficit as it takes into account borrowings of the government only from the RBI.

Deficit inancing includes

1. Government borrowings from RBI (Monetisation)

2. Printing of one rupee note and coins by government.
3. Withdrawl of cash balances by the government from its account with RBI.

Trend of Budgetary Deficits



Budget at a Glance

(In crore of Rupees)

	2013-2014 Actuals	2014-2015 Budget Estimates	2014-2015 Revised Estimates	2015-2016 Budget Estimates
1. Revenue Receipts	1014724	1189763	1126294	1141575
2. *Tax Revenue (net to centre)*	*815854*	*977258*	*908463*	*919842*
3. *Non-Tax Revenue*	*198870*	*212505*	*217831*	*221733*
4. Capital Receipts (5+6+7)$	544723	605129	554864	635902
5. *Recoveries of Loans*	*12497*	*10527*	*10886*	*10753*
6. *Other Receipts*	*29368*	*63425*	*31350*	*69500*
7. *Borrowings and other liabilities**	*502858*	*531177*	*512628*	*555649*
8. Total Receipts (1+4)$	1559447	1794892	1681158	1777477
9. Non-Plan Expenditure	1106120	1219892	1213224	1312200
10. *On Revenue Account*	*1019040*	*1114609*	*1121897*	*1206027*
of which,				
11. *Interest Payments*	*374254*	*427011*	*411354*	*456145*
12. *On Capital Account*	*87080*	*105283*	*91327*	*106173*
13. Plan Expenditure	453327	575000	467934	465277
14. *On Revenue Account*	*352732*	*453503*	*366883*	*330020*
15. *On Capital Account*	*100595*	*121497*	*101051*	*135257*
16. Total Expenditure (9+13)	1559447	1794892	1681158	1777477
17. *Revenue Expenditure (10+14)*	*1371772*	*1568111*	*1488780*	*1536047*
18. *Of Which, Grants for creation of Capital Assets*	*129418*	*168104*	*131898*	*110551*
19. *Capital Expenditure (12+15)*	*187675*	*226781*	*192378*	*241430*
20. Revenue Deficit (17-1)	357048	378348	362486	394472
	(3.1)	*(2.9)*	*(2.9)*	*(2.8)*
21. Effective Revenue Deficit (20-18)	227630	210244	230588	283921
	(2.0)	(1.6)	(1.8)	(2.0)
22. Fiscal Deficit {16-(1+5+6)}	502858	531177	512628	555649
	(4.4)	(4.1)	(4.1)	(3.9)
23. Primary Deficit (22-11)	128604	104166	101274	99504
	(1.1)	*(0.8)*	*(0.8)*	*(0.7)*

Notes: 1. GDP for BE 2015-2016 has been projected at Rs. 14108945 crore assuming 11.5% growth over the Advance Estimates of 2014-2015 (Rs. 12653762 crore) released by CSO.
2. Individual items in this document may not sum up to the totals due to rounding off.

PUBLIC EXPENDITURE

Public expenditure refers to the total expenses incurred by the government on various heads. Public expenditure can be classified as revenue or capital, developmental or non-developmental and plan or non-plan.

(a) Plan Expenditure and Non-Plan Expenditure *Plan expenditure* refers to that expenditure whose provision is made under the annual budgets for those programmes and projects which are mentioned under the five year plans. It includes expenditure on social services, energy, communication, transportation, agriculture, rural development etc.

Non-Plan expenditure refers to that expenditure whose provision is made under the annual budgets on the items not included in the five-year plans. Simply, any expenditure other than plan expenditure is treated as non-plan expenditure. It includes expenditure on interest payments, defence, subsidies, expenditure on maintenance of existing assets, expenditure on unfinished assets, expenditure on tax collection etc.

(b) Developmental and Non-Developmental Expenditure Developmental expenditure relates to the growth and development activities of the government. This includes expenditure on education, health, industry, agriculture, transport, roads etc.

Non Developmental expenditure is incurred on those items which do not directly promote growth and development of the economy. It includes expenditure on defence, interest payments, tax collection charges, civil administration etc.

Expenditure Reforms Commission (ERC)

It was constituted in 2000 under the chairmanship of Mr. K.P. Geetha Krishnan for suggesting means to control public expenditure. The commission recommended to reduce public expenditure in respect of the following.

(a) Food subsidy
(b) Fertilizer subsidy
(c) Government staff.

EXPENDITURE MANAGEMENT COMMISSION (EMC)

The Government has constituted the Expenditure Management Commission (EMC) through Resolution dated 4th September, 2014. The Commission is headed by Dr. Bimal Jalan, former governor of RBI.

EMC will look into various aspects of expenditure reforms to be undertaken by the Government such as review of the institutional arrangements including budgeting process and Fiscal Responsibility and Budget Management (FRBM) rules, suggest ways to improve allocative efficiencies in the existing expenditure classification system, and other issues concerning Public Expenditure Management.

The Commission had submitted its interim report in January, 2015 and is mandated to submit the final one before Budget 2016-17.

Interim Report

Rationalisation and merger of the plethora of Centrally-sponsored schemes, extension of the Direct Benefit Transfer (DBT) scheme to cover almost all government subsidies and welfare payments, using the Post Office as a payments bank to facilitate such transfers, and eliminating the distinction between plan and non-plan expenditures are among the recommendations of the Expenditure Management Commission headed by former RBI Governor, Bimal Jalan.

The Commission is said to have strongly batted for using the DBT route in combination with the Aadhaar unique identification numbers for authentication of the intended beneficiaries. This process would be further enabled with India Post being given a payments bank licence by the RBI, based on its recently released guidelines for such financial institutions specialising in providing small savings accounts and remittance/cash withdrawal facilities.

The EMC has reportedly favoured switching to accrual-based accounting of receipts and expenses from cash-based accounting method that is currently followed. It has expressed strong disapproval of the practice of deferring/postponing major payments, especially subsidies to the following year.

Under the existing dispensation of accounting on cash basis, income/receipt is counted when the cash (or a cheque) is received and expenses are recorded when actual payments are made. On the other hand, as per the accrual basis, transactions are recorded when they happen irrespective of when the money is received or paid.

The other significant proposal made by the Commission is doing away with the distinction between plan and non-plan expenditures. This, the official pointed out, is logical given that the government has disbanded the Planning Commission and replaced it with the NITI Aayog whose main remit is in providing technical and strategic advice to the Centre and the states.

The High Level Committee on Effective Management of Public Expenditure (2011) Headed by Dr. C. Rangarajan

Remove Plan, Non-Plan Expenses' Distinction the government should do away with the distinction between Plan and Non-Plan expenditure and redefine roles of the Planning Commission and the Finance Ministry.

It recommended that public expenditure should be split into 'capital' and 'revenue' expenditure.

While the Planning Commission should be responsible for formulation of the Five-Year Plan, the task of firming up annual budgets should be entrusted to the Finance Ministry based on inputs from the Plan panel, it said.

The report said that Commission should dispense with the exercise of approving annual Plans of states. The Commission, it added, could hold a strategy or review meeting with representatives of the states.

"Plan and Non-Plan distinction in the budget is neither able to provide a satisfactory classification of developmental and non-developmental dimensions of government expenditure nor an appropriate budgetary framework. It has therefore become dysfunctional "The committee, therefore, recommended that Plan and Non-Plan distinction in the budget should be removed".

As regards the new roles of key entities, it recommended, the Planning Commission should be made "responsible for consolidation of Five-Year Plan over all services based on the input from the Ministry of Finance. (while) Ministry of Finance (be) made responsible for the preparation of Annual Budget based on the inputs from the Planning Commission".

SECTION-B

SUBSIDY

Subsidies are government grants to the producers, and suppliers of goods and services. Such grants are intended to keep the price down, to maintain income of producers or to maintain service or employment. Subsidies also refer to the unrecovered cost in the provision of non-public goods. The estimation of subsidy is entrusted on National Institute of Public Finance and Policy (NIPFP). In 1997, it published a 'white paper on subsidies' which defined subsidies as 'economists nightmare and politicians delight'. As per NIPFP subsidies in India are unduly large, non transparent, largely input based, poorly targeted, generally regressive, inducing wastage and misallocation of resources. It categorised the subsidies into these categories:

(1) **Public Goods**: Such goods satisfy collective or social wants in general like defence, police and general administration etc. Since they are very general and for everybody, therefore, technically subsidy for them is not calculated.

(2) **Merit Goods**: Subsidy on such goods benefits the society much more than it benefits an individual e.g. primary education, public health, sewage and sanitation, flood control etc.

(3) **Non-merit Goods**:- Subsidy on such goods benefits the individuals or groups more than the society as a whole e.g.higher education, food subsidy, fertilizer subsidy, road transport subsidy etc.

Govt provides subsidy to achieve social objectives and raise level of employment in the country. Government has limited funds, but by reducing subsidies developmental expenditure can be increased. Developmental expenditure increases he capabilities of people. It is self sustaining and have long term effect.

Problems created by subsidies

1. Unsustainable fiscal deficit.
2. Subsidies are paid at the cost of development expenditure.
3. It discourages use of traditional inputs which are usually environment friendly.
4. It leads to degradation of environment and depletion of natural resources.
5. Excessive use of chemical fertilizers creates adverse health impacts.
6. They distort cropping pattern also.
7. Fertiliser subsidy primarily benefits the fertiliser producers and big farmers.
8. It reduces the incentive to improve, thus encourage inefficiency.
9. There are significant leakages which leads wastage of government funds.
10. Most of the subsidies are guided by populist sentiments or political considerations rather than socio-economic considerations.

The debate is not about whether but how best to provide support to the poor and vulnerable. The government subsidises a wide variety of goods and services with the aim of making them affordable for the poor, including: rice, wheat, pulses, sugar, railways, kerosene, LPG, naphtha, iron ore, fertiliser, electricity, water.

The direct fiscal cost of these select subsidies is roughly Rs. 378,000 crore or 4.2 percent of 2011-12 GDP. This is roughly how much it would cost to raise the expenditure of every household to the level of a 35th percentile household (well above the 21.9 percent Tendulkar Committee poverty line).

Are these subsidies effectively targeted at the poor? Unfortunately, subsidies can sometimes be regressive and suffer from leakages. For example, electricity subsidies by definition only help electrified households. Even in the case of kerosene, 41 percent of PDS kerosene is lost as leakage and only 46 percent of the remaining 59 percent is consumed by households that are poor.

Suggestions to make subsidies more productive and effective:

1. Subsidies should be time bound rather than permanent. Focus should be on enhancing capabilities.
2. Better targeting of subsidies by linking them to specific crops, size of farms, area, regions etc.
3. Subsidies should be rationed i.e. ceiling on credit per beneficiary.
4. Appropriate point of provision of subsidy should be identified.
5. Subsidies should not distort resource allocation and overuse of resources.
6. Subsidies should not be given in lump sum but on marginal use.
7. Impact of subsidy should be assesses periodically.
8. Subsidy should be provided on final products rather than on inputs as far as possible like through MSP.

THE JAM NUMBER TRINITYSOLUTION

Eliminating or phasing down subsidies is neither feasible nor desirable unless accompanied by other forms of support to cushion the poor and vulnerable and enable them to achieve their economic aspirations. The JAM Number Trinity

– ***J****an Dhan Yojana*, ***A****adhaar* and ***M****obile numbers* – allows the state to offer this support to poor households in a targeted and less distortive way.

As of December 2014, over 720 million citizens had been allocated an Aadhaar card. These enrolments are increasing at a rate of 20 million per month and by December 2015, the total number of Aadhaar enrolments in the country is expected to exceed 1 billion. Linking the Aadhaar number to an active bank account is key to implementing income transfers. To this effect, the government had seeded over 100 million bank accounts with registered Aadhaar numbers by December 2014. With the introduction of Jan Dhan Yojana, the number of bank accounts is expected to increase further and offering greater opportunities to target and transfer financial resources to the poor. Indeed, the government is already attempting this transition in certain areas by paying cooking gas subsidies directly via Direct Benefit Transfer into the bank accounts of 9.75 crore recipients. We describe two alternative financial delivery mechanisms below:

- ***Mobile Money*** – With over 900 million cell phone users and close to 600 million unique users, mobile money offers acomplementary mechanism of delivering direct benefits to a large proportion ofthe population. 16 Moreover, 370 million of these cell phone users are based in rural areas, and this number is increasing at arate of 2.82 million every month. Mobilemoney therefore offers a very viable alternative to meet the challenge of last mile connectivity. Given that Aadhaar registrations include the mobile number ofa customer, the operational bottlenecks required to connect mobile numbers with unique identification codes is also small.With several cell phone operators reportedly applying for a payment bank license in February 201517, mobile money platforms offer tremendous opportunities to direct Aadhaar based transfers.
- ***Post Offices –*** India has the largest Postal Network in the world with over 1,55,015 Post Offices of which (89.76 percent) arein the rural areas.18 Similar to the mobilemoney framework, the Post Office (eitheras payment transmitter or a regular Bank) can seamlessly fit into the Aadhaar linked benefits-transfer architecture by applyingfor an IFSC code which will allow postoffices to start seeding Aadhaar linked accounts. The post office network alsoenjoys a long-standing reputation of usingits deep network to serve many geographically isolated consumers in thecountry.

If the JAM Number Trinity can be seamlessly linked, and all subsidies rolled into one or a few monthly transfers, real progress in terms of direct income support to the poor may finally be possible. The heady prospect for the Indian economy is that, with strong investments in state capacity, that *Nirvana* today seems within reach. It will be a *Nirvana* for two reasons: the poor will be protected and provided for; and many prices in India will be liberated to performtheir role of efficiently allocating resources inthe economy and boosting long run growth. Evenas it focuses on second generation and third generation reforms in factor markets, India will then be able to complete the basic first generation of economic reforms.

SECTION-C

PUBLIC DEBT

Public debt refers to the total accumulated borrowings of the government. Public debt consists of the following three components.

1. ***Internal Debt*** comprising borrowings inside the country like market loans, compensation and other bonds, treasury bills, special securities issued to the RBI and financial institutions as well as non-negotiable non-interest bearing rupee securities issued to the international financial institutions.
2. ***External Debt*** comprises of loans from foreign countries (Bilateral borrowings) and from international financial institutions like IBRD, IMF, ADB etc (Multilateral borrowings).
3. ***Other Liabilities*** include outstandings against various small saying schemes, provident funds, deposits under special deposit schemes, reserve funds and deposits. While 'public debt' obligations are raise on the security of consolidated fund of India and are repayable out of it, 'Other liabilities' are payable out of Public Account Fund of India.

Debt of State Governments: The state governments can borrow under Article 293 of the constitution upon the security of their respective Consolidated Funds. A state can borrow only within the territory of India. The composition of the debt of the state governments is as follows:

1. Internal Debt.
   (a) Market loans and Bonds
   (b) Ways and Means Advances from RBI
   (c) Loans from Banks and other institutions
2. Loans and Advances from the centre
3. Provident Funds etc.

GOVERNMENT DEBT

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

Public Debt Management Agency (PDMA)

PDMA is a specialized independent agency that manages the internal and external liabilities of the Central Government in a holistic manner and advises on such matters in return for a fee. In other words, PDMA is the Investment Banker or Merchant Banker to the Government. PDMA manages the issue, reissue and trading of Government securities, manages and advises the Central Government on its contingent liabilities and undertakes cash management for the central government including issuing and redeeming of short term securities and advising on its cash management.

PDMA was proposed to be established in India through the Finance Bill, 2015. As a corollary of the decision to create a PDMA, the RBI or the Central Bank in India was given the task of inflation targeting under a monetary policy framework agreement. However, the creation of PDMA was put on hold due to the difference of opinion on the matter and the relevant clauses were dropped from the Finance Bill, 2015 while the latter was passed.

PDMA is considered to be set up with the objective of "minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk at all times, under the general superintendence of the central government". This will guide all of its key functions, which include managing the public debt, cash and contingent liabilities of Central Government, and related activities.

Need for PDMA

The need for PDMA was felt due to the following reasons:

1. **Consolidation:** Curently, the RBI has been managing the market borrowing programmes of Central and State Governments. On the other hand, external debt was managed directly by the Central Government. Establishing a debt management office would consolidate all debt management functions in a single agency and bring in holistic management of the internal and external liabilities.

   A well structured debt management office is one where all information about onshore and offshore liabilities, and contingent liabilities, is centralized into a single database and will enables better information transmission to the bond market.

2. **Financial repression:** Debt management is relatively simple when financial firms are forced to purchase government bonds through financial repression. In this context, the task of funding public debt will become more complex. It is hence important to undertake institutional reform that strengthens debt management alongside the process of financial sector reforms that eases financial repression.

3. **International best practice:** It is considered as an internationally accepted best practice that debt management should be disaggregated from monetary policy, and taken out of the realm of the central bank. Most advanced economies have dedicated debt management offices. Several emerging economies, including Brazil, Argentina, Colombia, and South Africa, have restructured debt management in recent years and created an independent agency for the same.

4. Conflicts of interest- The sources of these conflict of interest in RBI managing the Government debt, as listed out in the 2008 report of the Government are as under:

   There is a severe conflict of interest between setting the short term interest rate (i.e. the task of monetary policy) and selling bonds for the government. If the Central Bank tries to be an effective debt manager, it would lean towards selling bonds at high prices, i.e. keeping interest rates low. This leads to an inflationary bias in monetary policy.

   If the Central Bank tries to do a good job of discharging its responsibility of selling bonds, it has an incentive to mandate that banks hold a large amount of government paper. This bias leads to flawed banking regulation and supervision, so as to induce banks to buy government bonds, particularly long-dated government bonds. This, in turn, hampers the development of the corporate bond market - the absence of a benchmark sovereign yield curve makes it difficult to price corporate bonds.

   If the Central Bank administers the operating systems for the government securities markets, as the RBI currently does, this creates another conflict, where the owner/ administrator of these systems is also a participant in the market.

Background

Genesis of the thinking on an independent debt management office is traced back to the Committee on Capital Account Convertibility (1997) and the Review Group of Standing Committee on International Financial Standards & Codes (2004). Various committees suggested the establishment of PDMA, namely: Percy Mistry Committee (High Powered Expert Committee) on Making Mumbai an International Financial Centre (2007), Dr. Raghuram Rajan chaired Committee on Financial Sector Reforms (2009), Justice B. N. Srikrishna chaired FSLRC or Financial Sector Legislative

Reforms Commission report (2013), Internal Working Group on Debt Management of Finance Ministry, Chaired by Shri. Jahangir Aziz etc.

Debt Management Office (DMO)

The Union Budget for 2007-08 stated that "World over, debt management is distinct from monetary management. Accordingly, I propose to set up an autonomous DMO and, in the first phase, a Middle Office will be set up to facilitate the transition to a full-fledged DMO."

Following this announcement, the Middle Office was established in September 2008 in the Ministry of Finance. The Middle Office would be merged into the Debt Management Office (DMO), when it is established.

Status of PDMA

The creation of PDMA is put on hold as the proposals mentioned above in the Finance Bill 2015 could not be agreed upon in the Parliament. Accordingly, Clauses relating to the PDMA, amendments to the RBI Act 1934 and the Government Securities Act 2006 were withdrawn from the Finance Bill, 2015. The Finance Minister also announced that the Union government would now work on a roadmap for the PDMA and unified financial market regulator in consultation with the RBI. The government plans to proceed with the setting up of PDMA in a "phased manner" to ensure that the transition is smooth and there is no disruption.

SECTION-D

FISCAL ISSUES

Fiscal Policy

Fiscal policy concerns itself with the aggregate effect of government expenditure and taxation on income, production and employment. It refers to the revenue and expenditure policy of the government to influence the pattern and level of economic activity. Fiscal policy involves the use of taxation, public expenditure and the management of the public debt in order to achieve certain specified objectives. The main objectives of the fiscal policy are to mobilize resources for economic growth and to ensure equitable distribution of income and wealth. It operates through three important tools i.e.

(1) Taxation

(2) Government Expenditure

(3) Public Debt Budget is the vehicle through which these tools are operated, therefore it is also called Budgetary Policy.

Types of Fiscal Policies

Expansionary Fiscal Policy: It endeavours to increase total expenditure (or demand) in the economy by reducing taxes and borrowings and increasing government expenditure. It is adopted during recession or depression.

Contractionary Fiscal Policy: It is just reverse of the expansionary fiscal policy and it is pursued to counter inflation.

Fiscal Responsibility and Budget Management Act, 2003 (FRBMA)

The Fiscal Responsibility and Budget Management Act, 2003 (FRBMA) was enacted by the Parliament of India to institutionalize financial discipline, reduce India's fiscal deficit, improve macroeconomic management and the overall management of the public funds by moving towards a balanced budget. The main purpose was to eliminate revenue deficit of the country (building revenue surplus thereafter) and bring down the fiscal deficit to a manageable 3% of the GDP by March 2008.

Main Objectives

- To ensure inter-generational equity in fiscal management
- Long-term macro-economic stability by achieving sufficient revenue surplus
- Removing fiscal impediments in the effective conduct of monetary policy
- q Prudential debt management consistent with fiscal sustainability through limits on the central Government borrowings, debt and deficits
- q Greater transparency in fiscal operations of the central government and

Conducting fiscal policy in a medium-term framework

To introduce transparent fiscal management systems in the country

Main Features

(a) The Act mandates the central government to take appropriate measures to reduce fiscal deficit and revenue deficits so as to eliminate the revenue deficit by March 31, 2009 and thereafter build up adequate revenue surplus.

(b) It requires the reduction in fiscal deficit by 0.3 per cent of GDP each year and the revenue deficit by 0.5 per cent. If this is not achieved through tax revenues, the necessary adjustment has to come from a reduction in expenditure.

(c) The central government shall not borrow from the Reserve Bank of India except by way of advances to meet temporary excess of cash disbursements over cash receipts.

(d) The Reserve Bank of India must not subscribe to the primary issues of central government securities from the year 2006-07.

(e) Quarterly review of the trends in receipts and expenditure in relation to the budget be placed before both Houses of Parliament.

(f) The central government to lay before both Houses of Parliament three statements – Medium-term Fiscal Policy Statement, The Fiscal Policy Strategy Statement, The Macroeconomic Framework Statement along with the Annual Financial Statement.

(g) The actual deficits may exceed the targets specified only on grounds of national security or natural calamity or such other exceptional grounds as the central government may specify.

Due to the 2007 international financial crisis, the deadlines for the implementation of the targets in the act was initially postponed and subsequently suspended in 2009. In 2011, Economic Advisory Council publicly advised the Government of India to reconsider reinstating the provisions of the FRBMA.

Amendments to FRBM Act

Amendments to the FRBM Act were introduced subsequent to the recommendations of 13th Finance Commission. Through Finance Act 2012, amendments were made to the FRMBA, 2003 through which it was decided that in addition to the existing three documents, Central Government shall lay another document - the Medium Term Expenditure Framework Statement (MTEF) - before both Houses of Parliament. “Medium-term Expenditure Framework” statement will set forth a three-year rolling target for expenditure indicators.

Concept of “Effective Revenue Deficit” and “Medium Term Expenditure Framework” statement are the two important features of amendment to FRBM Act in the direction of expenditure reforms.

As per the amendments in 2012, the Central Government has to take appropriate measures to reduce the fiscal deficit and revenue deficit and to eliminate the effective revenue deficit by the 31st March, 2015 and thereafter build up adequate effective revenue surplus and also to reach revenue deficit of not more than 2 % of Gross Domestic Product by the 31st March, 2015 and thereafter as may be prescribed by rules made by the Central Government.

Further, the Central Government may entrust the Comptroller and Auditor-General of India to review periodically as required, the compliance of the provisions of FRBM Act and such reviews shall be laid on the table of both Houses of Parliament.

Vide the Finance Act 2015, the target dates for achieving the prescribed rates of effective deficit and fiscal deficit were further extended. The effective revenue deficit which had to be eliminated by March 2015 will now need to be eliminated only after 3 years i.e., by March 2018. The 3% target of fiscal deficit to be achieved by 2016-17 has now been shifted by one more year to the end of 2017-18.

Committee on Roadmap for Fiscal Consolidation

The Kelkar Committee (KC) set up by the government to outline a roadmap for fiscal consolidation released its report in September 2012. The KC recommended thatthe government should lower its deficit to 5.2% of GDP in FY13, and further to 4.6% and 3.9% in FY14 and FY15, respectively.

Tax measures and better administration: Review introduction of the direct tax code since that could lead to considerable revenue losses, penalize non-compliance on tax payments, review commodities that attract excise tax duty of 6% or lower and prune the negative list on services tax.

Increase disinvestment proceeds: The KC suggests the government should consider disinvesting through multiple routes, including the exchange traded fund (ETF) route, sell minority stakes in private entities and calls for a special dividend from the central public sector enterprises (CPSE). It also suggests that the government could consider monetizing its land resources.

Cut subsidies: Raise prices of diesel (Rs4/ litre), LPG cylinder (INR50/cylinder) and kerosene (Rs2/litre), cap the number of LPG cylinders per consumer (already implemented) and hike urea (fertilizer) prices by 10% in FY13. Ensure better efficiency in food grain distribution and raise Central Issue Price to contain the food subsidy. The KC suggests regular revision of fuel and fertilizer prices to reduce the subsidy bill from 2.2% of GDP in FY13 to 1.5% by FY15.

Right-size plan expenditure: The committee states that the increase in Plan expenditures (funding for five year plans) has seen a very rapid growth (of 26% y-o-y) in FY13. Reallocation of resources can lead to a saving of INR200bn in FY13 on plan expenditure. Further, it states that plan expenditures should rise at a slower pace of 15% and 18% y-o-y in FY14 and FY15 respectively, helping to create additional savings.

Implement Direct Benefit Transfer (DBT) to transfer subsidy to nedy.

Amendment of relevant laws to ensure mandatory quoting of PAN or UID for all economic transactions including bank accounts, fixed deposits, all financial transactions and immovable property transactions. Online verification of PAN could be mandatory for all high value transactions.

Government should sell unused land owned by railways, port trusts and various ministries, if it is not generating any revenue.

Government announced austerity measures

Unveiling an austerity drive to cut non-plan expenditure by 10 per cent, the Union government has barred bureaucrats from travelling first class on overseas visits and have been asked to use video conferencing as much as possible.

With an aim to restrict fiscal deficit to 4.1 per cent of GDP in 2014-15, the finance ministry has barred officials from holding meetings in 5-star hotels and put a freeze on fresh appointments and filling up posts lying vacant for over one year.

While officers are entitled to various classes of air travel depending on seniority, utmost economy would need to be observed while exercising the choice keeping the limitations of budget in mind. However, there would no bookings in the first class said the office memorandum. The facility of video conferencing, it said, “may be used effectively”.

The finance ministry said purchase of new vehicles to meet operational requirement of defence forces, paramilitary forces and security organisations are permitted but ban on purchase of any other vehicles would continue.

“Such measures are intended at promoting fiscal discipline, without restricting the operational efficiency of the government. In the context of the current fiscal situation, there is a need to continue to rationalise expenditure andoptimise available resources.

The government proposes to lower the fiscal deficit to 3 per cent of GDP by 2016-17. The deficit which had touched a high of 5.7 per cent in 2011-12, was brought down to 4.8 per cent in 2012-13 and further to 4.5 per cent in 2013-14 by way of austerity measures.

“The task before the government is very challenging because government need to revive growth, particularly in manufacturing sector and infrastructure.

The finance ministry said that the “mandatory 10 per cent cut” in plan expenditure will exclude interest payments, repayment of debt, defence, capital, salaries, pensions and grants to the state.

"No re-appropriation of funds to augment the non-plan heads of expenditure on which cuts have been imposed, shall be allowed during the current fiscal.

It said the austerity measures would also apply to autonomous bodies, adding that no fresh commitments would be made over and above what was provided in the budget.

Only seminars and conferences that are absolutely essential should be organised, it said, adding that "holding of exhibitions/seminars/conferences abroad is strongly discouraged except in case of exhibitions for trade promotions."

Referring to jobs in government departments, Finance ministry said there will be a total ban on new posts and those that have remained vacant for more than a year will not be filled except "under very rare and unavoidable circumstances".

The finance ministry has also asked the departments to avoid bunching up expenditure in the last quarter to ensure that there is no infructuous or wasteful spending.

It said the secretaries would be responsible to ensure compliance of the austerity measures and the financial advisors would be required to submit reports to the finance ministry on a quarterly basis

Comments from economic survey on Fiscal Framework

India must adhere to the medium-term fiscal deficit target of 3 percent of GDP. This will provide the fiscal space to insure against future shocks and also to move closer to the fiscal performance of its emerging market peers.

India must also reverse the trajectory of recent years and move toward the golden ruleof eliminating revenue deficits and ensuring that, over the cycle, borrowing is only for capital formation.

Expenditure control combined with recovering growth and the introduction of the GST will ensure that medium term targets are comfortably met.

In the short run, the need for accelerated fiscal consolidation is lessened by the dramatically changed macro-circumstances and the less-than-optimal nature of pro-cyclical policy. The ability to do so will be conditioned by the recommendations of the Fourteenth Finance Commission (FFC).

Nevertheless, to ensure fiscal credibility and consistency with medium-term goals, the process of expenditure control to reduce the fiscal deficit should be initiated. At the same time, the quality of expenditure needs to be shifted from consumption, by reducing subsidies, towards investment.

Finally, implementing the FFC recommendations will lead to states accounting for a large share of total tax revenue. This has the important implication that, going forward, India's public finances must be viewed at the consolidated level and not just at the level of the central government. If recent trends in state-level fiscal management continue, the fiscal position at the consolidated level will be on a sustainable path.

India needs to create additional fiscal space in order to ensure macro stability and to create buffers for future economic downturns.

The Survey advocates a medium-term fiscal strategy to create this space. The space, it says, is necessary to insure against future shocks. The recommended strategy would also take India closer in fiscal performance, to that of its emerging market peers.

The Survey outlines the two pillars of this medium-term strategy:

1. Reduce deficits
   a. Reduce fiscal deficit over the medium term to the established target of 3% of GDP
   b. Move towards the golden rule of eliminating the revenue deficit
   c. Ensure thereby that borrowing over the cycle is only for capital formation
2. Expenditure Control and Expenditure Switching
   a. Maintain a firm control on expenditures, in order to achieve the above targets
   b. Improve quality of public expenditure; shift away from public consumption (by reducing subsidies) towards investment.

The medium-term fiscal strategy is based on fundamental principles of fiscal policy, as well as on the need to maintain fiscal credibility. The Survey invokes the following golden rule: Governments are expected to borrow over the cycle only to finance investment, and not to fund current expenditures. Short-term targets should be set accordingly. This, the Survey argues, would assist the Government to take the Indian economy back to a durably higher growth path.

These considerations are reinforced by legacy and credibility issues. Adhering to fiscal deficit target set earlier is essential to maintain credibility and provide policy stability.The Survey explains how an analysis of India's recent fiscal history too buttresses this strategy.

The Survey states that fiscal action cannot wait; it should continue in the upcoming year as well. It however adds that the need for accelerated fiscal consolidation has reduced, in view of reduced macroeconomic pressures.

Despite domestic challenges and external vulnerabilities, the government adhered to fiscal consolidation in 2013-14. The 4.1 per cent fiscal deficit target of 2014-15 seems achievable in spite of slow growth of revenues and delayed disinvestment. To meet this target, the government may have to resort to some expenditure compression. Nevertheless, declining global oil prices, along with the diesel-price deregulation and direct transfer of domestic LPG subsidies to bank accounts, are expected to help lower the fuel subsidy bill. Increased revenues are expected through increase in excise duties on petroleum and diesel.

Going forward, enhanced revenue generation is a priority. To some extent this will be helped by raising the growth rate of the economy. The implementation of a well-designed GST and other tax reforms would also play a crucial role in this regard. Overhauling the subsidy regime which should entail further reducing fuel (LPG and kerosene) subsidies, tackling fertilizer subsidies, and moving to Aadhaar-based direct cash transfers of food subsidy and other transfers would pave the way for expenditure rationalization. Fiscal consolidation is a necessity but the quality of consolidation is imperative to make it sustainable. To achieve this end, it would be necessary to put in place a medium-to-long- term fiscal policy framework with explicit revenue, expenditure, and deficit targets.

DIRECT BENEFITS TRANSFER (DBT) SCHEME

A decision was taken in the meeting of the National Committee on Direct Cash Transfer held by Hon'ble Prime Minister that Direct Benefit Transfer (DBT) will be rolled out from 1 January 2013 in 43 identified districts. The purpose of Direct Benefits Transfer is to ensure that benefits go to individuals' bank accounts electronically, minimising tiers involved in fund flow thereby reducing delay in payment, ensuring accurate targeting of the beneficiary and curbing pilferage and duplication. 28 schemes were identified for DBT rollout in 43 identified districts from 1.1.2013.

The starting point for DBT is that every resident has an Aadhaar number. This Aadhaar number is linked to his or her bank account (where bank accounts don't exist, these are opened using Aadhaar, which has now been authorised by the Reserve Bank of India (RBI) as valid proof for opening a bank account). Entitlements and benefits are transferred directly to beneficiaries through Aadhaar-linked bank accounts.

The primary aim of this Direct Benefit Transfer program is to bring transparency and terminate pilferage from distribution of funds sponsored by Central Government of India. In DBT, benefit or subsidy will be directly transferred to citizens living below poverty line. Central Plan Scheme Monitoring System (CPSMS), being implemented by the Office of Controller General of Accounts, will act as the common platform for routing DBT. CPSMS can be used for the preparation of beneficiary list, digitally signing the same and processing of payments in the bank accounts of the beneficiary using the Aadhaar Payment Bridge of NPCI.

Benefits of DBT

- Better targeting.
- Reduction in leakages.
- Wastage and overuse will reduce.
- Delays in delivery of funds will be reduced.
- Administrative cost will reduce.
- Inefficiency will reduce.
- Transparency will be more.
- Duplication of beneficiaries will Reduce.

Reduction of Fraud

Process re-engineering of schemes for simpler flow of information and funds.

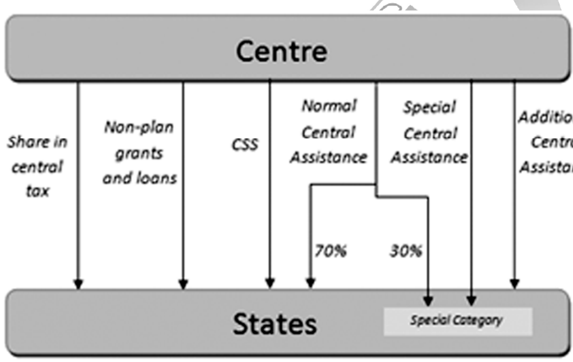
Greater Accountability

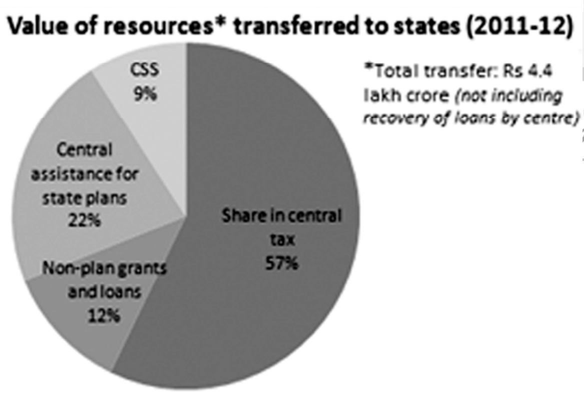
SECTION-E

FISCAL FEDERALISM

Distribution of Resources between the Centre and States

India is a federation with functions and finances that are constitutionally segregated between the Union and its 29 states and seven Union Territories. Most broad-based taxes are assigned to the Centre while most expenditure functions are assigned to states.





The expenditure-to-revenue ratio of Indian states is higher than that for most other fiscal federations. The resultant vertical imbalance necessarily has to be resolved through intergovernmental transfers. Financial assistance from the Centre to the states for implementing planned development has been the hallmark of Indian planning and development process.

The two most important institutions determining the levels of these transfers are the Finance Commission and the Planning Commission. In India, resources can be transferred from the centre to states in many ways. The Finance Commission and the Planning Commission are the two institutions responsible for centre-state financial relations.

The Finance Commission determines how tax revenues are shared between the Centre and the states. It also prescribes the proportion of grants that should be allocated to states. Both tax devolution and grants are decided by separate formulae, usually a weighted average of a combination of variables that are intended to equalise inter-state or horizontal differences.

The Planning Commission also transfers resources for implementing Five-Year Plans, based on a formula similar to the one used by the Finance Commission. Up to 3rd Five Year Plan (FYP) [1961-66] and during Plan Holiday (1966-69), allocation of Central Plan Assistance was schematic and no formula was in use. The Gadgil Formula comprising: (i) Population [60%], (ii) Per Capita Income (PCI) [10%], (iii) Tax Effort [10%], (iv) On-going Irrigation & Power Projects [10%] and (v) Special Problems [10%].

It was used during 4th FYP (1969-74) and 5th FYP (197478).

However, since item (IV) was perceived as being weighted in favour of rich states, the formula was modified by raising the weightage of PCI to 20%. The National Development Council (NDC) approved the modified Gadgil formula in August 1980. It formed the basis of allocation during 6th FYP (1980-85), 7th FYP (1985-90) and Annual Plan (AP) 1990-91. Due to reservations of State Governments on revision, a Committee under Shri Pranab Mukherjee, then Deputy Chairman, Planning Commission was constituted to evolve a suitable formula. The suggestions made by the Committee were considered by NDC in December 1991, where following a consensus, the Gadgil-Mukherjee Formula was adopted. It was made the basis for allocation during 8th FYP (1992-97) and it has since been in use. After setting apart funds required for (a) Externally Aided Projects and (b) Special Area Programme, 30% of the balance of Central Assistance for State Plans is provided to the Special Category States. The remaining amount is distributed among the non-Special Category States, as per Gadgil-Mukherjee Formula.

Gadgil-Mukherjee Formula			
Sl. No.	**Criteria**	**Weight**	**Remarks**
1.	Population (1971)	60%	
2.	Per capita Income	25%	
	(a) Deviation method	20%	Covering states with per capita SDP below national average
	(b) Distance method	5%	For all states
3.	Performance (Tax Effort, Fiscal Management and Progress in respect of National objectives)	7.5%	Tax policy [2.5%], Fiscal Management [2.0%], National objectives [3%] comprising population population control (1.0%), elimination of illiteracy (1.0%), timely completion of Externally Aided Projects (0.5%)&land reforms (0.5%)
4.	Special Problems	7.5%	

Special Category: The concept of a special category state was first introduced in 1969 when the 5th Finance Commission sought to provide certain disadvantaged states with preferential treatment in the form of central assistance and tax breaks. Initially three states Assam, Nagaland and Jammu & Kashmir were granted special status but since then eight more have been included (Arunachal Pradesh, Himachal Pradesh, Manipur, Meghalaya, Mizoram, Sikkim, Tripura and Uttarakhand). The rationale for special status is that certain states, because of inherent features, have a low resource base and cannot mobilize resources for development.

Special category status is accorded to a state on the basis of five conditions:

1. *hilly and difficult terrain;*
2. *low population density or sizeable share of tribal population;*
3. *strategic location along borders with neighbouring countries;*
4. *economic and infrastructural backwardness; and*
5. *non-viable nature of state finances.*

The decision to grant special category status lies with the National Development Council, composed of the Prime Minster, Union Ministers, Chief Ministers and members of the Planning Commission, who guide and review the work of the Planning Commission. The Planning Commission allocates funds to states through central assistance for state plans. Central assistance can be broadly split into three components: 1. Normal Central Assistance (NCA), 2. Additional Central Assistance (ACA) and 3. Special Central Assistance. NCA, the main assistance for state plans, is split to favour special category states: the 11 states get 30% of the total assistance while the other states share the remaining 70%. The nature of the assistance also varies for special category states; NCA is split into 90% grants and 10% loans for special category states, while the ratio between grants and loans is 30:70 for other states.

For allocation among special category states, there are no explicit criteria for distribution and funds are allocated on the basis of the state's plan size and previous plan expenditures. Allocation between non special category states is determined by the Gadgil Mukherjee formula which gives weight to population (60%), per capita income (25%), fiscal performance (7.5%) and special problems (7.5%). Special category states also receive specific assistance addressing features like hill areas, tribal sub-plans and border areas. Beyond additional plan resources, special category states can enjoy concessions in excise and customs duties, income tax rates and corporate tax rates as determined by the government. The Planning Commission also allocates funds for ACA (assistance for externally aided projects and other specific project) and funds for Centrally Sponsored Schemes (CSS). State-wise allocation of both ACA and CSS funds are prescribed by the centre.

Budget on Special Category Status

The Budget 2015-16 indicates as if the Government has already agreed to the recommendation of the Fourteenth Finance Commission for abolition of the category of Special Category States. The Centre is considering using the Rs 20,000 crore 'flexible fund' allocated to NITI Aayog to meet the demand of special category states as well as compensate states for the financial loss they claim to have incurred following the recommendations of the 14th Finance Commission.The sub-group of chief ministers chaired by Madhya Pradesh chief minister Shivraj Singh Chouhan is finalising its recommendations for funding pattern of over two dozen centrally sponsored schemes and its report could suggest utilisation of this fund to bridge the deficit claimed by states in implementing the social sector schemes.

Committee on Restructuring of Centrally Sponsored Schemes (CSS)

In order to deal with the problems associated with CSS, the **B. K. Chaturvedi** Committee on Restructuring of Centrally Sponsored Schemes was constituted by the Central Government in 2011. The committee has taken into account the major criticisms surrounding the character and structure of the CSS and provided the following recommendations for restructuring those:

- Reducing the number of CSS for better monitoring and implementation;
- Merging smaller schemes of less than Rs. 100 crore as annual outlay into larger schemes;
- Increasing flexibility and enabling better utilization of funds by transferring some schemes to States;
- Restructuring CSS into three categories:

Flagship schemes, Sub-sectoral schemes and Umbrella programmes

Flagship schemes comprising nine major CSS and six Central Sector Schemes implemented through Additional Central Assistance (ACA) for State Plans; 2 Central Sector Schemes are different from CSS. Those Central schemes in which the Centre provides the entire funding are referred to as Central Sector Schemes. Some examples being the National Agricultural Insurance.

Proposals in budget 2015-16 regarding various schemes

The plan outlay of 2015-16 reflects the compositional shift in the allocations for various Programmes and Schemes in view of high devolution; 42% of Union Taxes, to States as per the recommendation of 14th Finance Commission. Making his Budget Speech while presenting the General Budget 2015-16, the Finance Minister, Shri Arun Jaitley said that consequent to this substantially higher devolution, many schemes on the State subjects are to be delinked from Central support. However, keeping in mind that some of these schemes represent national priorities especially those targeted at poverty alleviation, Centre has decided that it will continue to contribute to such schemes, the Minister added. Besides, the schemes mandated by legal obligations and those backed by Cess collection have been fully provided for.As per the Budget 2015-16, centre has decided to support fully which are targeted to the benefits of socially disadvantaged group. In case of some Centrally Sponsored Schemes, the Centre: State funding pattern will undergo a change with States to contribute higher share. Details of changes in sharing pattern will have to be worked out by administrative Ministry/Department. The details of Plan outlays in 2015-16 are to be seen against this backdrop. In the General Budget 2015-16, there are 31 Schemes to be fully sponsored by the Union Government, 8 Schemes have been delinked from support of the Centre and 24 Schemes will now be run with the changed sharing pattern.

Distribution of Taxes Between Centre and Stares

(as per Schedule-VII of the Constitution)

Article-270 Central Pool of Shareable Taxes (Union List)	State's Taxes (State List)	Article-269. Taxes levied and collected by the Union but assigned to the States	Article-268. Duties levied by the Union but collected and appropriated by the States	268A. Duty levied by Union and collected and approp. by the Union and the States
Corporate income tax	Agriculture income tax, Land revenue, Stamp duties on agriculture properties, Estate duty and Succession Duty in respect of agricultural land.	Estate duty and Succession Duty in respect of property other than agricultural land.	Excise duty on medical and toilet preparations containing liquor or narcotics	Service Tax
Custom duties	Taxes on goods and passengers carried by road or on inland waterways.	Terminal taxes on goods and passengers carried by rail, air and sea	Stamp duties except on agricultural property and financial documents.	
Stamp duties on financial documents	Taxes on the entry of goods into a local area for consumption, use or sale therein and Toll tax	Taxes on futures trading and commodities		
Wealth Tax	Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.	Taxes on newspaper and advertisements there in.		
Gift Tax	Taxes on professions, trades, callings and employments.	Taxes on interstate consignments of goods		
Taxes on the capital value of the assets	Excise on liquor and narcotics	Taxes on railway freight and fares		
Taxes on the capital of companies.	Sales tax			
Income Tax	Taxes on lands and buildings			
Union Excise duties	Capitation taxes			
	Taxes on registration of vehicles			
	Taxes on mineral rights			
	Taxes on animals and boats.			
	Duty on electricity			

Note: Prior to the 80th constitutional amendment, 2000 only two taxes viz. Income Tax and Excise Duties were shareable between the centre and the states. Currently, all the taxes of the Union List are shared between the centre and the states except the revenue from Cess and Surcharge (Article-271).

Article-271. Surcharge on certain duties and taxes for purposes of the Union.

Notwithstanding anything in articles 269 and 270, Parliament may at any time increase any of the duties or taxes referred to in those articles by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part of the Consolidated Fund of India.

Article-270. Taxes levied and collected by the Union and distributed between the Union and the States

270(1). All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268 and 269, respectively, surcharge on taxes and duties referred to in article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States.

FINANCE COMMISSION

Article-280: The President shall, within two years from the commencement of this Constitution and thereafter at the expiration of every fifth year or at such earlier time as the President considers necessary, by order constitute a Finance Commission which shall consist of a Chairman and four other members to be appointed by the President.

Functions of Finance Commission

It shall be the duty of the Commission to make recommendations to the President as to-

(a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter and the allocation between the States of the respective shares of such proceeds;

(b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;

(c) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State;

(d) any other matter referred to the Commission by the President in the interests of sound finance.

Qualifications of the Members

The Chairman of the Finance Commission is selected among people who have had the experience of public affairs. The other four other members are selected from people who:

Are, or have been, or are qualified, as judges of High Court, or

Have knowledge of Government finances or accounts, or

Have had experience in administration and financial expertise; or

Have special knowledge of economics

Finance Commission	Year of Establish-ment	Chairman	Operational Duration
First (1st)	1951	K. C. Neogy	1952–57
Thirteenth (13th)	2007	Dr. Vijay L. Kelkar	2010–2015
Fourteenth (14th)	2013	Dr. Y. V Reddy	2015–2020

BOX-1

FINANCE COMMISSION - CONCEPTS AND DEFINITIONS

Tax Devolution

One of the core tasks of a Finance Commission as stipulated in Article 280 (3) (a) of the Constitution is to make recommendations regarding the distribution between the Union and the states of the net proceeds of taxes. This is the most important task of any Finance Commission, as the share of states in the net proceeds of Union taxes is the predominant channel of resource transfer from the Centre to states.

Divisible Pool

The divisible pool is that portion of gross tax revenue which is distributed between the Centre and the States. The divisible pool consists of all taxes, except surcharges and cess levied for specific purpose, net of collection charges.

Prior to the enactment of the Constitution (Eightieth Amendment) Act, 2000, the sharing of the Union tax revenues with the states was in accordance with the provisions of articles 270 and 272, as they stood then. The eightieth amendment of the Constitution altered the pattern of sharing of Union taxes in a fundamental way. Under this amendment, article 272 was dropped and article 270 was substantially changed. The new article 270 provides for sharing of all the taxes and duties referred to in the Union list, except the taxes and duties referred to in articles 268 and 269, respectively, and surcharges on taxes and duties referred to in article 271 and any cess levied for specific purposes.

Grants-in-aid

Horizontal imbalances are addressed by the Finance Commission through the system of tax devolution and grants- in-aid, the former instrument used more predominantly. Under Article 275 of the Constitution, Finance Commissions are mandated to recommend the principles as well as the quantum of grants to those States which are in need of assistance and that different sums may be fixed for different States. Thus one of the pre-requisites for grants is the assessment of the needs of the States.

The First Commission had laid down five broad principles for determining the eligibility of a State for grants. The first was that the Budget of a State was the starting point for examination of a need. The second was the efforts made by States to realize the potential and the third was that the grants should help in equalizing the standards of basic services across States. Fourthly, any special burden or obligations of national concern, though within the State's sphere, should also be taken into account. Fifthly, grants might be given to further any beneficent service of national interest to less advanced States.

Grants recommended by the Finance Commissions are predominantly in the nature of general purpose grants meeting the difference between the assessed expenditure on the non-plan revenue account of each State and the projected revenue including the share of a State in Central taxes. These are often referred to as 'gap filling grants'. Over the years, the scope of grants to States was extended further to cover special problems. Following the seventy-third and seventy-fourth amendments to the Constitution, Finance Commissions were charged with the additional responsibility of recommending measures to augment the Consolidated Fund of a State to supplement the resources of local bodies. This has resulted in further expansion in the scope of Finance Commission grants. The Tenth Commission was the first Commission to have recommended grants for rural and urban local bodies. Thus, over the years, there has been considerable extension in the scope of grants-in-aid.

Fiscal capacity/Income distance

The income distance criterion was first used by Twelfth FC, measured by per capita GSDP as a proxy for the distance between states in tax capacity. When so proxied, the procedure implicitly applies a single average tax-to- GSDP ratio to determine fiscal capacity distance between states. The Thirteenth FC changed the formula slightly and recommended the use of separate averages for measuring tax capacity, one for general category states (GCS) and another for special category states (SCS).

Fiscal discipline

Fiscal discipline as a criterion for tax devolution was used by Eleventh and Twelfth FC to provide an incentive to states managing their finances prudently. The criterion was continued in the Thirteenth FC as well without any change. The index of fiscal discipline is arrived at by comparing improvements in the ratio of own revenue receipts of a state to its total revenue expenditure relative to the corresponding average across all states.

14th Finance Commission

The 14th Finance Commissionwas constituted on 2 January 2013 under the Chairmanship of ***Dr.Y.V.Reddy***, former RBI Governor. The Commission comprise Abhijit Sen, Member, Planning Commission; Sushama Nath, Former Union Finance Secretary; M Govinda Rao, former Director of National Institute of Public Finance and Policy; Sudipto Mundle, former Acting Chairman, National Statistical Commission; and AN Jha, Secretary to the Commission.

The 14th finance commission had submitted its report to the President in December 2014, specifying a new set of formulae for distribution of tax revenues and grants between states and the Centre.The FFC has submitted its recommendations for the period 2015-16 to 2019-20. They are likely to have major implications for center-state relations, for budgeting by, and the fiscal situation of, the center and the states.

MAJOR RECOMMENDATIONS OFFFC

The FFC has radically enhanced the share of the states in the central divisible pool from the current 32 percent to 42 per cent which is the biggest ever increase in vertical tax evolution.

The 14th Finance Commission is of the view that tax devolution should be the primary route for transfer of resources to the States.

According to the Commission, the increased devolution of the divisible pool of taxes is a 'compositional shift in transfers' – from grants to tax devolution.

The FFC has also proposed a ***new horizontal formula*** for the distribution of the states' share in divisible pool among the states. There are changes both in the variables included/ excluded as well as the weights assigned to them. Relative to the Thirteenth FinanceCommission, the FFC has incorporated two new variables: 2011 population and forest cover; and excluded the fiscal discipline variable.

Table 1

Horizontal Devolution Formula in the 13th and 14th Finance Commissions

Variable	Weights accorded	
	13th	14th
Population (1971)	25	17.5
Population (2011)	0	10
Fiscal capacity/Income distance *(See box-1)*	47.5	50
Area	10	15
Forest Cover	0	15
Fiscal discipline *(See box-1)*	17.5	0
Total	100	100

In understanding the States' needs, it has ignored the Plan and non-Plan distinctions.

The Commission is of the view that sharing pattern in respect to various Centrally sponsored schemes (CSS) need to change. It wants the States to share a greater fiscal responsibility for the implementation of such schemes and to restore the predominance of formula based plan grants.

It has identified 30 schemes for transfer to the states and 8 schemes to be delinked from support from the Centre after taking into account higher devolution.

After assessing the revenue and expenditure of the states for the period 2015-20, the Commission has recommended a grant of Rs 1.94 crore to meet the deficit of 11 states.

The FFC has not made any recommendation concerning sector specific-grants unlike the Thirteenth Finance Commission.

Do away with the distinction between the special category states and the other states.

The total grants to Panchayati Raj Institutions recommended by the commission are Rs 2,87,436 crore for a five-year period 2015-20. Of this, Rs 2,00,292.20 crore will be given to panchayats and Rs 87,143.80 crore to municipalities.

The panel has recommended the grants to states for local bodies be in two parts, a basic grant and a performance grant. The ratio of basic to performance grant is 90:10 with respect to panchayats and 80:20 in the case of municipalities.

A target of 62% of GDP for the combined debt of centre and states.

States need to address the problem of losses in the power sector in time bound manner

An autonomous and independent GST Compensation Fund to be created through legislative actions in a manner that it gives reasonable comfort to States to implement GST.

Fiscal deficit of centre should come down to 3.6 per cent of GDP in 2015-16 from projected 4.1 per cent in 2014-15 and then 3 per cent in 2016-17. Suggested revenue deficit to come down from 2.9 per cent in FY15 progressively to 0.93 per cent by 2019-20.

Fiscal deficit of States should be at 2.76 per cent in FY16, to come down to 2.74 per cent by FY20 though it would increase in between. To be revenue surplus in all these years.

Replace the advisory body with a statutory body viz. Rail Tariff Authority, through necessary amendments to the Railways Act, 1989.

Abhijit Sen, one of the four members of the Finance Commission, has submitted a dissent note suggesting that devolution to the states should be pegged at 38 % in the first year and should be maintained at that level unless there is an agreement to deal with the fiscal problems.

The Fourteenth Finance Commission (FFC) will enhance Fiscal Federalism in India: Economic Survey 2014-15

According to the Economic Survey "all States stand to gain from FFC transfers in absolute terms." The Survey observes that Fourteenth Finance Commission recommendations will enhance cooperative and competitive federalism.

The biggest gainers in absolute terms under general category states are Uttar Pradesh, West Bengal and Madhya Pradesh. Jammu & Kashmir, Himachal Pradesh and Assam are most benefitted in the Special Category States.

The Survey says that the FFC recommendations are expected to add substantial spending capacity to the States' budget.

The Survey identifies the FFC recommendations as progressive. The states with lower per capita Net State Domestic Product receive larger transfers on average per capita.

The Survey says that "Balancing the enhanced fiscal autonomy of the states with preserving fiscal space of the Centre entails reduction in Central Assistance to States".

The Economic Survey concludes, the FFC's Recommendations–

- Will bring about greater fiscal federalism
- Will reduce other Central transfers to states
- Will give greater autonomy to states on revenue and expenditure.

COMMITTEE FOR EVOLVING A COMPOSITE DEVELOPMENT INDEX OF STATES

In May 2013, the Union government constituted a committee headed by **Mr. Raghuram Rajan**, now RBI Governor, to suggest ways to identify indicators of the relative backwardness of the States for equitable allocation of Central funds. The Raghuram Rajan Committee has released its report in September, 2013.

The methodology developed by the Committee first allocates funds across states based on need, in line with recommendations of previous committees. Need is based on a simple index of (under) development namely, Multi Dimensional Index (MDI) of backwardness of state.

The index composed of 10 equally weighted indicators: (i) monthly per capita consumption expenditure, (ii) education, (iii) health, (iv) household amenities, (v) poverty rate, (vi) female literacy, (vii) percent of SC-ST population, (viii) urbanization rate, (viii) financial inclusion, and (x) connectivity. Less developed states rank higher on the index, and would get larger allocations based on the need criteria.

The Report has recommended the categorisation of the states in 3 groups-least developed, less developed and relatively developed, with no provision for 'Special Category States'.

The 10 States that score above 0.6 (out of 1) on the composite index have been classified as "least developed," the 11 States that scored from 0.4 to 0.6 are "less developed" and the seven States that scored less than 0.4 are "relatively developed.

Using the index, the Committee has identified 10 states as the *"Least Developed"* States namely, (i) Odisha, (ii) Bihar, (iii) Madhya Pradesh, (iv) Chhattisgarh, (v) Jharkhand,(vi) Arunachal Pradesh, (vii) Assam, (viii) Meghalaya, (ix) Uttar Pradesh and(x) Rajasthan.Gujarat as one of the "less developed" States. Goa as the India's most developed State.

Fund Allocation

The Committee recommends that each state get a fixed basic allocation of 0.3 percent of overall funds, to which will be added its share stemming from need and performance to get its overall share. In sum, given there are 28 states included for the construction of index, (28 x 0.3) 8.4% of funds will be allocated as a fixed basic allocation. Of the remaining 91.6%, we choose parameters such that

3/4th of it is allocated based on need and 1/4th based on performance. While allocating funds, share of the state's population to country's will get 80 per cent weightage and its area share will get 20 per cent weightage.

Appraisal of the Recommendations

The Economic Survey 2012-13 pointed out that "the inter-state comparison of performance of states based on different indicators shows that while some states have performed well in terms of growth indicators, they have performed poorly in terms of other indicators like poverty, rural urban disparity, unemployment, education, health and financial inclusion. This calls for a rethink on the criteria used for devolution of funds to states under Finance Commissions where criteria like income distance (12th Finance Commission) or fiscal capacity distance (13th Finance Commission) along with population are given high weightage and none of the human development indicators or financial inclusion indicators are used. Similarly, the criteria used for awarding 'special category status' to states need to be revisited."