FISCAL SYSTEM

Fiscal policy

Definitions

- That part of government policy which is concerned with raising revenue through taxation and with deciding on the amounts and purposes of government spending.
- The government's policy in regard to taxation and spending programs. The balance between these two areas determines the amount of money the government will withdraw from or feed into the economy, which can counter economic peaks and slumps.
- Government spending policies that influence macroeconomic conditions. These policies affect tax rates and government spending, in an effort to control the economy.
- Government policy for dealing with the budget-especially with taxation and borrowing
- The policy of a government in controlling its own expenditures and taxation, which together make up the budget
- Fiscal policy is the means by which a government adjusts its levels of revenue and spending in order to monitor and influence a nation's economy

Fiscal policy involves use of taxation and government spending to influence economy. In other words, fiscal policy relates to raising and spending money in quantitative and qualitative terms.

As far as fiscal receipts are concerned, taxes, user charges (power, water, transport charges etc); disinvestment proceeds; borrowings from internal and external sources are the main channels. All receipts are not earned and some are borrowed. Receipts and expenditure are divided into revenue and capital accounts. Expenditure is also shown as Plan and Non-plan items.

Fiscal policy deals not only with the quantity but the quality of public finance as well. In other words, not merely how much is raised and spent but how has it been raised- is it raised by way of taxes or borrowings; are they excessive or irrational etc. Also, the way the finances so raised are used- wastefully or productively. How much is spent on plan heads and how much populistically targeted etc also is studied.

Fiscal policy can achieve important public policy goals like growth; equity; promotion of small scale industries; encouragement to agriculture; location of industries in rural areas; labour -intensive growth; export promotion; development of sound social and physical infrastructure etc.

Art.112 of the Constitution mandates that expenditure be shown in revenue and other categories.

purchasing power parity :-

Non-Plan expenditure is not a Constitutional term but is in use to emphasize on the point that government spends financial resources for consumption (maintenance) as well as asset creation. It includes expenditure on interest payments; defense; subsidies; and public administration.

A break up of the finances into revenue and capital streams, in general, is as follows:

- Revenue receipts are recurrent receipts. Revenue account includes the following receipts: taxes and non-tax sources. Taxes are income tax , corporation tax, excise duty, customs duty etc; non tax resources include user charges ;interest receipts; dividends; profits etc
- Revenue account expenditure is essentially the non-plan expenditure that does not create assets, that is, - interest payments, defence; subsidies and public administration. It is synonymous with maintenance and consumption expenditure as also welfare expenditure.
- Capital account receipts are recoveries of loans and advances made by the Union Government to States, Uts and PSUs; fresh borrowings from inside the country and from abroad;disinvestment proceeds etc. As is clear from above, some of them are debt and some are non-debt.
- Capital account expenditure is loans made to States, UTs and PSUs; expenditure for asset creation in infrastructure and social areas;loans repaid etc.

Definitions of Deficits

Revenue deficit is the difference between the revenue receipts on tax and non-tax sides and the revenue expenditure. Revenue expenditure is synonymous with consumption and non-development, in general. But in the case of India, the social sector expenditure – flag ship schemes like NREGA is in the revenue expenditure, though as a part of the Plan expenditure (see budget as a glance for further clarity. It is given elsewhere in this Chapter) It is targeted at 3.3% of GDP for 2013-14. FRBMA 2003 says that RD should be zero by the end of 2008-09. The objective is to fund for consumption from government's own resources and not borrowing. In fact, if the FRBM was implemented well, there would have been revenue surplus from 2009-10 onwards that could be used for capital expenditure. But the Great Recession of 2008 made it necessary for the government to borrow more and stimulate the economy thus disrupting the FRBM targets. (More in the classroom)

Fiscal deficit is the difference between what the government earns and its total expenditure. That is, the difference between what is received by the government on revenue account and all the non-debt creating capital receipts like recovered loans and disinvestment proceeds ; and the total expenditure. It amounts to all borrowings of the government in a given period. It is targeted at 5.1% of GDP in 2012-13.

FD= Total expenditure of the Government in a budget minus (Revenue receipts + non-debt creating capital receipts).

Difference must be between Gross FD and Net FD. Net Central Fiscal Deficit is calculated by deducting from the GFD the financial assistance (loans and grants) that the States are given.

Effective revenue deficits - very important.

Budget deficit considers only the difference between the total budgeted receipts and the expenditure. It was abolished in 1997.

Fiscal Deficit mirrors the health of government finances most accurately unlike the budget deficit concept. BD does not cover all borrowings but only that portion of the borrowings for which government relies on printing money by the RBI

Monetised deficit is the borrowings made from the RBI through printing fresh currency. It is resorted to when the government can not borrow from the market (banks and financial institutions like LIC etc) any longer due to pressure on interest rates or for reasons like fresh money injection into the economy is necessary to push growth up. It means infusion of fresh currency into the market. It corresponds to the budget deficit that is discarded as a concept since 1997. It is discontinued from 2006 as a part of the FRBM 2003.

Primary deficit is the difference between the fiscal deficit and the interest payments. The concept helps in assessing the progress of the government in its fiscal control efforts.

Deficit Financing

Deficit Financing is the phrase used to describe the financing of gap between Government receipts and expenditure. Such gap is called budgetary deficit. It is financed by printing fresh money by the RBI. The gap can be deliberate as the Government wants to spend on welfare and infrastructure for which it has no money and so borrows from the RBI; or due to bad finances of the government; or mainly for consumption and populism.

Crowding out and crowding in effect.

When the Government has to spend more than what it can raise through tax, non-tax and other sources, it borrows from the market. It can not borrow above a certain amount from the market as it may be inflationary; push up interest rates; increase government's debt burden and thus divert resources from plan to non-plan; burden future generations with unduly high taxation and thus disrupt inter generational parity; and crowd out private investment. Then Reserve Bank of India prints money . In other words, when the resources from taxes, user charges, public sector enterprises, public borrowings, small scale borrowings and others are not enough, RBI prints and gives to the Government. It is called deficit financing.

The money printed by the RBI is called high powered money or reserve money.

The concept of budget deficit was dropped from 1997 budget and as a result deficit financing also was stopped. That is, as a concept both were discontinued as the two were two sides of the same coin- budget deficit is monetized through deficit financing. In fact, FRBM disallows RBI printing money to finance government deficit in normal conditions. But the economic conditions having become adverse since 2008-09, Government is forced to abandon the FRBM rules and is spending well beyond the limits set by the Act. Keynesian stimuli that the government resorted to since 2008 October includes massive borrowing by the Government- from the markets and RBI- to arrest slowdown and stimulate growth.

The beneficial contribution of deficit financing in the early stages of independent India's economic planning and development is manifold. First, in the early 1950s, our domestic savings ratio was less than 9 per cent of GDP, and that constrained the investment and welfare activity of the government.

plan and non plan revenue

Second, the capacity to raise non-inflationary sources of financing (taxes, small savings, genuine public borrowings, etc.) was highly limited.

Third, external aid could supplement domestic funding only to a limited extent. It is better to source debt from inside than outside.

Fourthly, foreign direct investment was discouraged as a source of investment and thus scarcity of investment resulted. Therefore, government borrowing became necessary through monetization.

There are two views on the matter. There are some people who regard deficit financing as essential for the purposes of development and welfare; as a healthy means of stimulating economy. There are those who regard any deficit financing as inflationary and a serious threat to the stability of the economy.

On balance it may be said that, if deficit financing is done prudently and the borrowed money is used well, it is healthy. However, if the borrowed money is wasted for consumption, is it against good economics as it can negatively affect money supply and inflation; and also dampen growth.

The viability and desirability of deficit financing, in short, depends on

- Extent of borrowing
- End use of the money borrowed.

WMAs

Prior to 1997, the RBI lent to central government against ad hoc Treasury bills, (since mid-50's) This provision for extending short-term financing was created to bridge temporary mismatches in receipts and payments. However,, the central government slipped into the practice of rolling over this facility, resulting in automatic monetisation of the government's deficit. Automaticity refers to RBI having to print money if the Government's cash balances with the RBI went below a threshold fixed. It had no choice but to create currency and lend to the Government of India. The process of creating 91-day bills and subsequently funding them into non-marketable special securities at a very low interest rate (4.6%) emerged as a principal source of borrowing. It was thought to be irrational for the reasons that the interest rate is not market driven and was very concessional. Nor did the RBI have any voice in deterring the same. Nor was there a limit to how much could be printed in this way.

In the case of state governments, the RBI provides two types of WMAs. Normal WMAs are clean or unsecured advances extended at the bank rate, while special WMAs are extended against the government securities. The latter is exhausted first and then the former may be sought to a limited extent. If the state government borrows over and above the WMA allowed for it by the RBI, it is called overdraft and there is a limit to that too set by the RBI.

Adhoc treasury bills and WMA

Union Government replaced adhoc treasury bills with WMAs in 1997.
WMAs given by RBI to GOI do not require any collateral. Its amount is limited and arrived at the beginning of the fiscal year through consultation between Government and the RBI. There are penal interest rates if the pre-agreed amount is violated. Ways and Means

Advances are made at the Repo Rate. Overdraft is charged penally at two percent above the repo rate

Replacement of the adhoc bills with WMA represents an advance in fiscal discipline and harmonization of the fiscal and monetary policies as the RBI is consulted in Governmental short term borrowing and the 'automaticity' is dropped in the creation of currency by the RBI to fund governmental expenditure.

How much of Fiscal Deficit is right?

Fiscal deficit is bridged by market borrowings and central bank printing fresh currency (monetization), if necessary. To a limited extent, FD is important as the Government's ability to help growth and welfare increases. Government can always return the loans when its revenues improve due to tax buoyancy. However, FD becomes problematic and even destabilizing when it overshoots a rational threshold. Sovereign debt crisis in Europe and the fiscal woes of USA are the result of unsustainably high debt and borrowing. (More in the classroom)

Therefore, moderation of fiscal deficit is important. Large and persistent fiscal deficits are a cause of concern, as they pose several risks.

Fiscal deficits may cause macroeconomic instability by inflating the economy as money supply rises.

Corporate sector is crowded out – they are left with inadequate funds in the markets as the government borrowing requirements increase. Added to that , interest rates will be high as there is pressure on the available money in the market.

If the funding route is through RBI monetization, it means inflation and instability.

Inflation may mean less savings, less investment and eventually it hurts the sustainability of high growth.

Large deficits, even if they do not spill over into macroeconomic instability in the short run, will require higher taxes in the long term to cover the heavy burden of internal debt. It means, as the FRBM Act says , inter generational parity is hurt if debt mounts as future generations will have to pay higher taxes to help the government repay the debt.

Government liabilities- interest payments- increase and there is far less for development.

BOP pressures may mount if inflows drop due to the country being downgraded by rating agencies like Standard and Poor, Moody etc.

Therefore, FDs must be moderated- they are desirable within limits but hurtful beyond the limits.

The above analysis applies to FD in normal times. But in abnormal times like since 2008-09 when the world slipped into recession impacting Indian economy negatively, FD must be allowed to be increased for the fiscal stimuli which are necessary to arrest downturn in the economy and revive growth. FRBM allows such counter-cyclical expenditure. Even then, deficit should be incurred not for populist expenditure but to stimulate the economy.

The sovereign debt crisis in Eurozone (2010 onwards) and particularly the Greece economy is due to excessive FD. It borrowed and spent excessively. Taxes were not collected efficiently and there was large scale evasion. The stimulus package did not work. Government expenditure did not reduce but revenues fell drastically due to recession and tax leakages. The need for massive borrowing and spending increased. But the government was not able to raise the money at normal rates of interest. It had to pay high rates of interest. That means it was debt-trapped- borrow to pay the debt and higher and higher rates. The banks and other financial institutions that invested in Greek government bonds panicked. Their share prices fell. Financial system was in danger of instability. Similar crisis was seen in Ireland later and Spain and Portugal too. These countries are acronymally called PIGS. The lesson from Greek crisis is that FD may be incurred only for productive reasons and ensure good returns. Tax collections should be efficient. Accounts of government should be properly maintained and not dressed up.

Reducing FD

FD has to be reduced and the FRBM targets are to be conformed to, under normal conditions. But upto3% of GDP for FD as laid down by FRBM Act is desirable as the Government can borrow and spend for welfare and growth.

The extent of reduction and the manner of reduction matter. More resources should be raised from taxes, user charges, disinvestment etc. Expenditure control should not involve cuts on social sector expenditure as it hurts poor and demographic dividend can not be reaped.

The level of FD should be determined keeping in consideration the following

- whether the debt can be put to productive deployment
- The rate of return on the borrowed funds' use is adequate
- the impact on private sector investment by way of crowding out effect etc

Even more important is not to cut social spending in a move to reduce deficit. In other words, while FD reduction is needed for macroeconomic stability and inter generational parity. Introduction of GST, the DTC amendments, selective disinvestment, broadening of tax base, tax buoyancy etc will yield enough to moderate borrowings.

Global crisis and the FD in India

Global recession impacted India and our growth rate slipped. Tax revenues were hit. There was a massive fall in demand. Corporate sectors postponed investment. Threat to employment was real. Therefore, Government took it upon itself to spend more by borrowing. The result is that fiscal deficit reached an abnormally high level- 6.8% in the year 2009-10. It is because tax revenues went down and expenditure demands were higher. The gap inevitably widened. The fiscal measures taken by the government to counter the negative fall -out of the global slow down on the Indian economy paid off.

Firstly, the Government responded by providing three focused fiscal stimulus packages in the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets.

Secondly, the RBI took a number of monetary easing and liquidity enhancing measures to facilitate flow of funds from the financial system to meet the needs of productive sectors.

This fiscal accommodation led to an increase in fiscal deficit from 2.7 per cent in 2007-0.8 to 6.2 percent of GDP in 2008-09.
These measures were effective in arresting the fall in growth rate of GDP in 2008-09 and stemmed the fall and achieved a growth of 6.7 per cent. The growth rate further improved to 8.4 % for the next two fiscal years of 2009-10 and 2010-11.

The fiscal stimulus packages

To counter the adverse effects of global recession, government announced the first package in October 2008- tax cuts and additional spending by the government .The package benefited all the sectors – especially textile, housing and real estate sectors. Most significant of the package is the CENVAT rate cut of 4%.

The second stimulus package

The government in January 2009 announced the second round of fiscal stimulus package with a view to revive economy. The package includes measures such as higher public spending. RBI stepped in easing liquidity for further lending at lower interest rates etc.

The third stimulus package

The third stimulus package for the economy was announced in February 2009 cutting excise duty and service tax two percentage points.

Service tax was cut across the board from 12 per cent to 10 per cent.

The packages increased the fiscal deficit.

Financing the FD

The deficit was financed by raising Internal Debt and from Public Account surplus cash.

The unsustainably high fiscal deficit could not be continued long and had to be phased back to normal levels by a calibrated rollback since 2010-11.

FRBM Act 2003 2013 mains

Fiscal Responsibility and Budget Management (FRBM) Act 2003 was notified in 2004 with the following salient features

- annual targets of reduction in deficits, government borrowing and debt

- Government to annually reduce the revenue deficit by 0.5 per cent and the fiscal deficit by 0.3 per cent beginning fiscal 2004-05.
- elimination of revenue deficit and reduction of fiscal deficit to 3% of GDP by March 31, 2009
- a cap on the level of guarantees and total liabilities of the Government.
- Prohibits Government to borrow from the RBI (primary borrowing) after April 1, 2006. RBI can not print money to lend to the government.
- On a quarterly basis, that Government shall place before both the Houses of Parliament an assessment of trends in receipts and expenditure.
- Annually present the macro-economic framework statement, medium term fiscal policy statement and fiscal policy strategy statement. The three statements would provide the macro-economic background and assessment relating to the achievement of FRBM goals.
- Under exceptional circumstances, Government may be compelled to breach targets. In case of deviations, the Government would not only be required to take corrective measures, but the Finance Minister shall also make a statement in both the Houses of Parliament.

Borrowing from the RBI is permitted in exceptional situations like natural calamities.

FRBM was brought in for fiscal discipline; increase plan expenditure; reduce the amount of borrowings; meet consumption from government's own fiscal resources; leave the RBI with autonomy as far as money creation goes etc .Fiscal consolidation is necessary particularly in the era of globalization when the penalty for irresponsibility is high.

New Zealand was the first country to enact a Fiscal Responsibility Act in 1994, thereby setting legal standards for transparency of fiscal policy and reporting, and holding the Government formally responsible to the public for its fiscal performance. A similar legislation, the Charter of Budget Honesty, has been enacted in Australia. The UK, too, has enacted a Code for Fiscal Stability.

The global recession from 2008 onwards has made the government breach the FRBM targets vastly. We are still gross breach of it .Fiscal 2012-13 saw a fiscal deficit of 5.8% of GDP due to excess expenditure on subsidies, lower divestment receipts and tax receipts.

FRBM 2.0

Union Budget 2012-13 saw introduction of amendments to the FRBM Act as part of Finance Bill, 2012. Concept of "Effective Revenue Deficit" and "Medium Term Expenditure Framework" statement are two important features of amendment to FRBM Act in the direction of expenditure reforms. Effective Revenue Deficit is the difference between revenue deficit and grants for creation of capital assets. This will help in reducing consumptive component of revenue deficit and create space for increased capital spending. "Medium-term Expenditure Framework" statement set forth a three-year rolling target for expenditure indicators.

ERD

An additional fiscal indicator, namely, effective revenue deficit, has been prescribed by an amendment to the FRBM Act by the Finance Act, 2012. Effective revenue deficit has been

Fiscal drag is very important.

Fiscal cliff.

defined as the difference between "the revenue deficit and the grants for creation of capital assets".

Grants for creation of capital assets are defined as "the grants-in-aid given by the Central Government to the State Governments, constitutional authorities or bodies, autonomous bodies and other scheme implementing agencies for creation of capital assets".

The amendment confers a statutory status on the concept of effective revenue deficit which had already featured in the Central Budget 2011-12. The proposed amendment seeks to eliminate effective revenue deficit by 2015.

Fiscal consolidation

Fiscal consolidation means strengthening government finances. Fiscal consolidation is critical as it provides macro economic stability; cuts wasteful expenditure; can enable government to spend more on infrastructure and social sectors. Tax reforms, disinvestment, better targeting of subsidies and so on are the hallmarks of fiscal consolidation.

Enactment of FRBM Act provides an institutional framework and binds the government to adopt prudent fiscal policies. There is a need to involve states to effect overall fiscal consolidation and strengthen the growth momentum.

GST and revised DTC are an important federal effort toward fiscal reforms and consolidation.

Also, without fiscal consolidation- conversion of subsidies into capital expenditure that forms assets- it is not possible to step up public investment, especially in areas such as agriculture, where gross capital formation has dropped from 1.9 per cent to 1.3 per cent of GDP since 1990-91.

Fiscal consolidation in India includes the following reforms:

- Revenue reforms include tax reforms on both direct and indirect tax front; rationalization of tax exemptions, improving efficiency of tax collection, and tax stability.
- On the expenditure side, reform areas include cutting out non-essential and unproductive activities, schemes and projects, allocation of resources to priority areas, reducing cost of services, rationalizing subsidies; reduction of time and cost overruns on projects, getting proper 'outcome' from output

Austerity measures as were announced in September 2013 : ban on five-star venues for government meetings; foreign locations for conferences, exhibitions and seminars; and executive class airline tickets for officials;keep the size of delegations going abroad at an "absolute minimum; banned recruitment for central government posts for one year and the purchase of new vehicles.

Fiscal consolidation

The FRBM targets were more or less followed till the fiscal year 2007-08. But from 2008-09, as global economic conditions turned bad and Indian economy was also affected negatively –

slow down in growth rate-, the Government necessarily had to pump prime the economy with an expansionary fiscal policy- tax reliefs and massive public investment- infrastructure spending, NREGA being stepped up etc. As a result, the FRBM targets could not be complied with. However, the recovery plan has been made with statutory commitments in 2012-13. (More in the classroom)

13th Finance Commission and Fiscal Consolidation

Thirteenth Finance Commission recommended a calibrated exit strategy from the expansionary fiscal stance of the previous two years. The Commission recommended a capping of the combined debt of the Centre and the States at 68 per cent of the GDP to be achieved by 2014-15.

As a part of the fiscal consolidation process, government for the first time targeted an explicit reduction in its domestic public debt-GDP ratio.

Plan and Non Plan Expenditure classification and its unsustainability

In the Budget, expenditure is shown both as revenue and capital and also as plan and non-plan. 'Plan' expenditures, as the name implies, relate to expenditures on annual plan projects contributing to five-year plan; these include projects like dams, roads, power plants etc. Non-Plan expenditure relates to maintenance, consumption and welfare. Non-plan expenditure does not create assets. When a project is being built , it is a plan item of expenditure. When completed and being maintained, it is a non-plan item of expenditure.

'Non-plan' expenditure is a generic term, which is used to cover all expenditures of government not included in its annual plan programmes. But essentially covers consumption and maintenance expenditure. Non plan expenditures has the following items

- Interest payments
- Subsidies
- Defence
- Public admn

It is important to mention that not only that maintenance expenditures subsequent to the completion of plan programmes are non-plan, but even "expenditures on research projects and operating expenses of power stations are classified as non-plan.

The distinction between plan and non-plan expenditure items has become simplistic and is artificial and untenable. The building of a new school or a primary health centre is considered a Plan investment but its running and maintenance is considered non-Plan spending. Thus, very often it had led to Government allocation being reduced for maintenance as it is classified as non-plan item and will be criticized. Thus, assets are neglected. New projects are allotted money while the completed projects are neglected.

It is important to take a consolidated view of finances keeping in perspective the interdependence of Plan and non-Plan expenditures.

Rangarajan panel on public expenditure 2012

An 18-member high-level expert committee was set up in 2010 under the Chairmanship of Dr C. Rangarajan to suggest measures for efficient management of public expenditure.

This committee was mandated to see whether the classification of expenditure into Plan and Non-Plan is rational and can be continued.
The report of the Committee was presented in mid-2011 and the following are the salient points:

- 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.
- 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
- "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. It has therefore become dysfunctional. The committee, therefore, it recommends that Plan and Non-Plan distinction in the budget should be removed.
- The report suggested a basic shift in budgeting approach from ".From input based budget to outputs and outcomes".
- As regards the new roles of key entities, it said, 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".
- The report also called for strengthening the Central Plan Monitoring System (CPMS) and empowering the citizens to seek information on flow of resources and utilisation with a view to promoting transparency and accountability.

Kelkar committee 2012

A new roadmap for fiscal consolidation worked out by a committee headed by former Chairman of the Finance Commission Vijay Kelkar envisages pruning fiscal deficit to less than 5% of the GDP by 2013-14 to put the economy in a better shape.

The committee re-assessed the fiscal deficit for 2012-13 and recommended an annual reduction of half a percent or 0.5% up to 2013-14. Fiscal deficit, as stated in the notes above, is the difference between total expenditure and total non-borrowed receipts.

The Kelkar committee said that the proposed reduction in deficit could be achieved through a combination of share sale of state-owned companies, pruning petro-product subsidies through raising prices of diesel and LPG or cooking gas and implementation of the Goods and Services Tax or GST, which has long been in the works. Administrative reforms including beefing up of IT infrastructure have also been suggested to improve compliance.

The 13th Finance Commission, which was headed by Kelkar, advised that fiscal deficit be pegged at 3% in 2013-14 when it unveiled its report.

Public debt

Public debt includes internal debt comprising borrowings inside the country like market loans; borrowing from the RBI on the basis of special securities bills; and external debt comprising loans from foreign countries, international financial institutions, NRI deposits etc. In the expression `public debt and "other liabilities".

"other liabilities" include outstanding against the various small saving schemes, provident funds etc. External debt means what the nation owes to foreign lenders- includes private sector borrowings too. However, public debt includes what the government owes to lenders inside and outside the country. (More in the classroom)

Public debt is justified as the government does not have adequate resources and taxation can not be done beyond a point. It should be for productive reasons and also welfare reasons. The spiral of deficit and debt run the risk of undermining the country's creditworthiness, devaluing the currency and destabilising the entire economy with grave social consequences. Therefore, it should be incurred judiciously.

The outstanding internal and external debt and other liabilities of the Government of India at the end of 2013-2014 is estimated to amount to ` 56,51,484.22 crore, as against ` 50,39,131.01 crore at the end of 2012-2013 .

India recorded a Government Debt to GDP of 67.57 percent of the country's Gross Domestic Product in 2012. Government Debt To GDP in India is reported by the Ministry of Finance, Government of India. From 1991 until 2012, India Government Debt to GDP averaged 74.6 Percent. Generally, Government debt as a percent of GDP is used by investors to measure a country ability to make future payments on its debt, thus affecting the country borrowing costs and government bond yields.

External Debt

India's external debt in mid-2013 stood at 388 billion US dollars on account of significant increase in commercial borrowings, short-term trade credits, and rupee denominated debt. In terms of major components, the share of ECBs continued to be the highest at 30.7 per cent of total external debt, followed by short term debt (24.9 per cent) and NRI deposits (18.3 per cent).The share of short-term debt in total debt rose over the preceding as well as corresponding quarter of the previous year. The long-term debt at US$ 291.8 billion and short-term debt at US$ 96.8 billion accounted for 75.1 per cent and 24.9 per cent, respectively, of the total external debt as at end-June 2013.The ratio of short-term debt (original maturity) to foreign exchange reserves rose to 34.3 per cent as at end-June 2013 from 33.1 per cent as at end-March 2013. Based on residual maturity, the short-term debt accounted for 43.8 per cent of total external debt as at end-June 2013. Within the short-term debt, the share of NRI deposits was 28.1 per cent.

External debt includes both the government and private debt as can be seen from the above given highlights of the external debt profile.

The share of non-government debt in total external debt is about 75%.

Com

The strategy of the government in external debt management consists of emphasis on raising sovereign loans on concessional terms with longer maturities, monitoring short term debt and encouraging non-debt creating capital flows.

External debt consists of

- long-term external debt which is the bulk part
- NRI deposits
- multilateral loans
- commercial borrowings
- bilateral loans and
- Trade credit

As reported in the Hindu newspaper in 2013: India's short-term debt maturing within a year stood at $172 billion end-March 2013. This means the country will have to pay back $172 billion by March 31, 2014. The corresponding figure in March 2008 — before the global financial meltdown that year — was just $54.7 billion. India has accumulated short-term debt with *residual maturity* of one year after 2008. The figure has gone up over three times largely because this period also coincided with the unprecedented widening of the current account deficit from roughly 2.5 percent in 2008-09 to nearly 5 per cent in 2012-13. Much of this expanded CAD has been funded by debt flows.Short-term debt maturing within a year is now nearly 60 per cent of India's total foreign exchange reserves. In March 2008, it was only 17 per cent of total forex reserves. This shows the actual increase in the country's repayment vulnerability since 2008.

Internal debt

Internal debt includes loans raised by the government in the open market through treasury bills and government securities, special securities issued to the RBI and most importantly, various bonds like the oil bonds, fertilizer bonds etc.

The money sterilized from the market in by the Market Stabilisation Scheme (MSS) is also shown in the government's statement of liabilities. Introduced in 2004, MSS envisages the issue of treasury bills and/or dated securities to absorb excess liquidity arising out of the excessive foreign exchange inflows.

The debt of the government also includes others like the outstanding against small-savings schemes, provident funds, deposits under special deposit schemes etc.These debts are shown under a separate head titled 'other liabilities'.

Debt should be moderated for the reasons cited in the discussion on FD above.

Zero Base Budgeting

Tenth Plan Approach Paper says that ZBB will be followed for rationalization of expenditure. The ZBB methodology was taken up first in 1987 in the Union Budget and was recommended for the Government departments and PSUs. Many state governments also applied it, for example, Government of Rajasthan and Maharashtra. The Maharashtra Government renamed it ' Development –based budget '.

Under the ZBB, a close and critical examination is made of the existing government programmes, projects and other activities to ensure that funds are made available to high priority items by eliminating outdated programmes and reducing funds to the low priority items. Governmental programmes and projects are appraised every year as if they are new and funding for the existing items is not continued merely because a part of the project cost has already been incurred. Programmes are discarded if the cost-benefit ratio is below the prescribed norms.

The objective of the ZBB is to overhaul the functioning of the government departments and PSUs so that productivity can be increased and wastage can be minimised. Scarce government resources can be deployed efficiently.

ZBB as a resource planning and control technique and process yielded substantial benefits in the advanced countries like New Zealand, UK, Australia and Sweden in terms of efficiency gains, better resource use, lower costs and finally surplus budgets, particularly in New Zealand.

However, the use of ZBB to human development programmes and poverty alleviation and employment generation programmes is limited and the results are cumulative and can not be assessed annually.

Fringe benefit tax (FBT)

Fringe benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees singly.They are taxed in the hands of the employer who may or not pass it on to the employee. Examples are transport services for workers and staff, gym, club, etc.

The rationale for levying a FBT on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. It is abolished in the Union Budget 2009-10.

Perquisites

Perquisites are benefits in addition to normal salary to which employee has a right by virtue of his employment. To put it simply or 'perks' as they are called colloquially, are benefits generally in cash/kind, received by an employee by virtue of his employment.

Perks are taxable as a part of salary as per the India income tax laws and includes:

- the value of rent-free accommodation
- the value of any concession in the matter of rent respecting any accommodation provided etc
- car
- club membership
- travel

Some words

Fiscal Drag

A situation where inflation pushes income into higher tax brackets- bracket creep. The result is increase in income taxes but no increase in real purchasing power. This is a problem during periods of high inflation. Government gains due to higher tax collections and the economy suffers as growth is dragged down due to less demand. In high-growth and high inflation economies ('overheated'), fiscal drag acts as an automatic stabiliser, as it acts naturally to keep demand stable.

Fiscal neutrality

When the nèt effect of taxation and public spending is neither neutral, neither stimulating nor dampening demand- a balanced budget. It is neutral, as total tax revenue equals total public spending.

Crowding Out

Excessive government borrowing can lead to shrinkage of the liquidity in the market; forces the interest rates to go up; private investment is crowed out for two reasons: liquidity availability is less and the rates are high. Investment suffers and growth decelerates. The Government also may not spend the borrowed resources well to generate returns. If the government deploys the funds well, it may have a 'crowding in effect': the infrastructure built can have a multiplier effect on investment, tax collections and growth.

Pump-priming

Deficit financing and spending by a government on public works in an attempt to revive economy during recession – countercyclical measures. It can raise the purchasing power of the people and thus stimulate and revive economic activity to the point that deficit spending will no longer be considered necessary to maintain the desired economic activity.

Small Savings

Small savings instruments are Post Office Monthly Income Schemes and Time Deposits; National Savings Scheme; Indira Vikas Patra; Kisan Vikas Patra;Public Provident Fund and so on. They are aimed at promoting safe and long-term savings by individuals. They are called small savings because the amount saved is relatively small. They are initiated by the central Government but mobilized by the State Governments ; and are deposited with and managed by the central government. As a reward State Governments receive all such savings as loan.

Small savings are a sizeable portion of the financial savings of the country. They contribute to the finances of the Government- federal and State- that is, they are an important source of borrowing for the government. These schemes have a built in tax concession that enhances their attraction for the small savers. They also earn a rate of interest that is higher in comparison to what the banks offer- approximately 8%. They are called small savings as savings are made in small amounts by low income and other groups.

Small savings instruments in India are retailed through 1.53 lakh post offices of which about 1.29 lakh are in rural areas.

The National Small Savings Fund (NSSF), in the Public Account of India has all the small savings. They are completely onlent to the state in which they are collected.

Public goods, merit goods and demerit goods
Public goods are those goods whose consumption by some does not diminish them for others. That is, they are non-rivalrous. Common examples include law and order, parks, street-lighting, defence etc. They are goods meant for the entire public. Merit goods are goods like education, health care etc that are important for the society as a whole- that is, they have positive externalities. Market may not supply them in adequate quantities. Government supplements the market.Demerit goods are those whose consumption should be discouraged. They have negative externalities. Examples include: tobacco, alcohol etc. Thirteenth Finance Commission calls them sin goods and wants them to be harshly taxed.

Giffen goods
They include goods whose demand goes up when the price increases. They are the status markers and exclusivist in nature.

Twin deficits

Budget deficit (fiscal deficit) and current account deficit-the former fuelling the latter as the borrowings increase are known as twin deficits. USA is a prime example.So is India!!!!

(Recent developments in the classroom)

'Fiscal Cliff'

A combination of expiring tax cuts and across-the-board government spending cuts scheduled to become effective Dec. 31, 2012. The idea behind the fiscal cliff was that if the federal government allowed these two events to proceed as planned, they would have a detrimental effect on an already weak economy, perhaps sending it back into an official recession as it cut government spending and investment, collected more taxes which cut down both consumption and investment, increased unemployment rates and undermined consumer and investor confidence.

Shutdown

In U.S. politics, a government shutdown is the name for the process the Executive Branch must enter into, when the Congress creates a "funding gap" by choosing not to or failing to pass legislation funding government operations and agencies. If interim or full-year appropriations are not enacted into law, the United States Constitution requires the federal government begins a "shutdown" of the affected activities. If the funding gap lasts long enough, the law requires the furlough (temporary lay offs) of non-emergency personnel and curtailment of agency activities and services. It is essentially a fiscal issue as the Congress may not like the revenue and expenditure models and priorities of the Presidency as Obamacare in 2013.

Stimulus vs Austerity (In the class)

बजट का सार Budget at a Glance

(करोड़ रुपए) (In crore of Rupees)

		2011-2012 वास्तविक Actuals	2012-2013 बजट अनुमान Budget Estimates	2012-2013 संशोधित अनुमान Revised Estimates	2013-2014 बजट अनुमान Budget Estimates
1. राजस्व प्राप्तियां	**1. Revenue Receipts**	751437	935685	871828	1056331
2. कर राजस्व (केन्द्र को निवल)	*2. Tax Revenue (net to centre)*	629765	771071	742115	884078
3. कर-भिन्न राजस्व	*3. Non-Tax Revenue*	121672	164614	129713	172252
4. पूंजी प्राप्तियां (5+6+7)$	**4. Capital Receipts (5+6+7)$**	552928	555241	558998	608967
5. ऋणों की वसूली	*5. Recoveries of Loans*	18850	11650	14073	10654
6. अन्य प्राप्तियां	*6. Other Receipts*	18088	30000	24000	55814
*7. उधार और अन्य देयताएं**	*7. Borrowings and other liabilities**	515990	513590	520925	542499
8. कुल प्राप्तियां (1+4)$	**8. Total Receipts (1+4)$**	1304365	1490925	1430825	1665297
9. आयोजना-भिन्न व्यय	**9. Non-Plan Expenditure**	891990	969900	1001638	1109975
10. राजस्व खाते पर जिसमें से	*10. On Revenue Account of which,*	812049	865596	919699	992908
11. ब्याज भुगतान	*11. Interest Payments*	273150	319759	316674	370684
12. पूंजी खाते पर	*12. On Capital Account*	79941	104304	81939	117067
13. आयोजना व्यय	**13. Plan Expenditure**	412375	521025	429187	555322
14. राजस्व खाते पर	*14. On Revenue Account*	333737	420513	343373	443260
15. पूंजी खाते पर	*15. On Capital Account*	78639	100512	85814	112062
16. कुल व्यय (9+13)	**16. Total Expenditure (9+13)**	1304365	1490925	1430825	1665297
17. राजस्व व्यय (10+14)	*17. Revenue Expenditure (10+14)*	1145785	1286109	1263072	1436169
18. जिसमें, पूंजी परिसम्पत्तियों के सृजन हेतु अनुदान	*18. Of Which, Grants for creation of Capital Assets*	132582	164672	124275	174656
19. पूंजी व्यय (12+15)	*19. Capital Expenditure (12+15)*	158580	204816	167753	229129
20. राजस्व घाटा (17-1)	**20. Revenue Deficit (17-1)**	394348 (4.4)	350424 (3.4)	391245 (3.9)	379838 (3.3)
21. प्रभावी राजस्व घाटा (20-18)	**21. Effective Revenue Deficit (20-18)**	261766 (2.9)	185752 (1.8)	266970 (2.7)	205182 (1.8)
22. राजकोषीय घाटा {16-(1+5+6)}	**22. Fiscal Deficit {16-(1+5+6)}**	515990 (5.7)	513590 (5.1)	520925 (5.2)	542499 (4.8)
23. प्राथमिक घाटा (22-11)	**23. Primary Deficit (22-11)**	242840 (2.7)	193831 (1.9)	204251 (2.0)	171814 (1.5)

इस दस्तावेज में वर्ष 2011-12 के वास्तविक आंकड़े अनंतिम हैं। Actuals for 2011-12 in this document are provisional.

$ बाजार स्थिरीकरण योजना के अंतर्गत प्राप्तियों को छोड़कर। Excluding receipts under Market Stabilisation Scheme.

* इसमें नकदी शेष में आहरण द्वारा कमी शामिल है। Includes draw-down of Cash Balance.

टिप्पणियां: 1. सीएसओ द्वारा जारी 2012-2013 के अग्रिम अनुमानों (₹10028118 करोड़) की तुलना में 13.4% की वृद्धि मानते हुए 2013-2014 के बजट अनुमान में सघउ बढ़कर ₹11371886 करोड़ होने का पूर्वानुमान है।

2. इस दस्तावेज में पृथक-पृथक मदें पूर्णांकन के कारण संभवतः जोड़ से मेल न खाएं।

Notes: 1. GDP for BE 2013-2014 has been projected at ₹ 11371886 crore assuming 13.4% growth over the Advance Estimates of 2012-2013 (₹ 10028118 crore) released by CSO.

2. Individual items in this document may not sum up to the totals due to rounding off.