REPORT OF THE WORKING GROUP ON CENTRE'S FINANCIAL RESOURCES FOR THE ELEVENTH PLAN(2007-2012)

I. INTRODUCTION 4

I.1 Financing of the Eleventh Plan 4

I.2 Components determining gross budgetary support (GBS) 5

I.3 Broad developments in the components of GBS 7

i Current revenues (CR) 7

ii Non-debt capital receipts (NDCR) 7

iii Borrowings and other liabilities (BOL) 8

iv Non-plan revenue expenditure (NPRE) 8

v Non-plan capital expenditure (NPCE) 8

I.4 Implications of TFC recommendations for plan financing 8

I.5 Implications of FRBMA for plan financing 9

I.6 Service tax – a promising source of revenue 10

II. EXPENDITURE CLASSIFICATION -- PLAN AND NONPLAN, REVENUE AND CAPITAL 12

II.1 Expenditure classification system 12

II.2 Plan and non-plan distinction 12

i Background .... **Error! Bookmark not defined.**

ii Non-plan capital and plan revenue expenditure – two problem areas 13

iii Coordination 14

II.3 Revenue and capital distinction 15

i A Constitutional requirement 15

ii Required for policy formulation 15

iii Norms for revenue and capital classification 16

III. IEBR OF CPSUS, SPVS AND PPPS AND PLAN FINANCING 18

III.1 Internal and Extra-Budgetary Resources (IEBR) of Central Public Sector Undertakings (CPSUs) 18

III.2 Special Purpose Vehicles (SPV) 21

III.3 Private-Public Partnership (PPP) 21

IV. CENTRE'S CURRENT REVENUES AND NON-DEBT CAPITAL RECEIPTS FOR THE ELEVENTH PLAN 24

IV.1 Methodology of forecasting tax revenues 24

IV.2 Assumptions 25

i GDP growth in real terms 25

ii Inflation 26

iii Nominal GDP growth 26

IV.3 Direct tax revenues 26

i Buoyancy a la FRBM Task Force 27

ii Elasticity approach 28

iii A mix 30

IV.4 Indirect tax revenues 31

i Revenues from customs duty 32

ii Revenues from excise duty 34

iii Revenues from service tax 36

IV.5 Total tax revenue 37

i Interest receipts 38

ii Dividends from CPSUs and surplus transfer from RBI 39

iii Non-tax receipts of UTs and grants-in-aid 39

iv Other non-tax receipts 40
v Total non-tax revenue 41
IV.7 Non-debt capital receipts (NDCR) 41
V. CENTRE'S NON-PLAN EXPENDITURE DURING THE ELEVENTH PLAN 43
V.1 Components of Non-Plan Expenditure 43
V.2 Interest payments 44
V.3 Defence revenue expenditure 44
V.4 Subsidies 45
V.5 Pay and allowances 46
V.6 Pensions 47
V.7 Grants to States and UTs 47
V.8 Defence capital expenditure 47
V.9 Loans to States and UTs 47
V.10 Other non-plan expenditure 48
V.11 Total non-plan expenditure 48
VI. PROJECTIONS OF CENTRE'S FINANCIAL RESOURCES FOR THE ELEVENTH PLAN 49

I. INTRODUCTION

The Working Group on Assessment of the Centre's Financial Resources was constituted under the Chairmanship of Dr. Ashok K. Lahiri, Chief Economic Adviser, Ministry of Finance by the Planning Commission vide order No. 3/1/2006-FR dated July 24, 2006. The composition and terms of reference of the working group is at Annex I. The group was mandated:-

(i) To analyze the resource position of the Centre in the light of the implementation of the recommendations of the Twelfth Finance Commission (TFC), fiscal responsibility legislation, tax on services, and other policy changes in that regard;

(ii) To examine the relevance of the Plan, Non-Plan distinction in the expenditure of the Central Government and to suggest changes, if required, in the definition of plan expenditure;

(iii) To examine the classification of expenditure in terms of 'Revenue' and 'Capital' especially in light of the requirements under the Fiscal Responsibility Act and its implication for plan programmes;

(iv) To examine whether, and to what extent, investment by Central Public Sector Undertakings (CPSUs) financed through Internal and Extra-budgetary Resources (IEBR) should continue to form a part of the 'Plan';

(v) To examine the role of special purpose vehicles (SPVs), public-private partnerships (PPPs) and other innovative methods of additional resource mobilization by the Central Government, in financing Plan expenditure;

(vi) On the basis of the above, to suggest the basis for making projections for 'resources' and 'expenditure' for the Centre for the Eleventh Plan Period;

(vii) To prepare and present projections(s) on the scheme of financing for the Eleventh Plan for the Centre (including UTs without legislature).

The Working Group constituted four Sub-Groups to undertake comprehensive assessment of the major components: (i) tax revenues, (ii) non-tax revenues, (iii) non-plan expenditures and (iv) IEBR of CPSUs, determining the financial resources of the Centre. The composition of the Sub-groups, including co-opted additional members from outside the Group, is at *Annex II*. The reports of the four sub-group have been used as inputs for this final Report.

I.1 Financing of the Eleventh Plan

The National Development Council at its 52nd meeting on December 9, 2006 has adopted the Approach Paper to the Eleventh Plan setting a "faster, more broad-based and inclusive" growth at the average annual rate of 9 per cent for the five years starting from 2007-08. This, as the Approach Paper points out, requires 'a substantial increase in the allocation of public resources for plan programmes in critical areas' (para 1.4.7), including education, health, agriculture and infrastructure; an improvement in government savings from around -1.5 per cent of gross domestic product (GDP) in 2005-06 to at least +1.0 per cent (para 2.2.4) to support -- without a balance of payments problem -- an increase in the total investment rate (as a proportion of GDP) from 30 per cent in 2005-06 to an average of 35.1 per cent on average during the Eleventh Plan (para 2.2.2); and 'call for additional (public sector) plan expenditure above current levels, of about 1 percentage point of GDP in 2007-08, rising to about 2.5 percentage points of GDP in 2011-12' (para 6.3.1). The Approach Paper points out that 'The final picture on the size of the 11th Plan will only emerge after further consultation with the states and Central Ministries, and taking account of the reports of the various working groups on Plan resources' (para 6.3.1). This report is that of one such working group to help the Planning Commission determine the size of the Eleventh Plan.

In view of the Fiscal Responsibility and Budget Management (FRBM) Act passed by the Centre and similar Acts having been passed by most of the States, the Approach Paper (para 6.3.8) notes that bringing down the combined fiscal deficit of the Centre and the States to no more than 6 per cent of GDP from 2008-09 onwards will require a reduction in the fiscal deficit by around 1 percentage point of GDP in the first two years of the Plan. It notes "Preliminary exercises suggest that the fiscal deficit reduction in the 11th Plan period to attain the FRBM target will be achieved consistent with an increase in GBS for the Plan by 2.3 percentage points of GDP for the Plan period as a whole. This would require an adjustment through lower non-plan expenditure or additional taxation by around 0.2 percentage points of GDP. However meeting the fiscal deficit targets will limit the scope for increasing Plan expenditure in the first two years unless the reduction in non-Plan expenditure can be significantly front loaded."

The plan of the Report is as follows: this introductory chapter provides the background and broad developments on the components that determine the available resources; the implications of the recommendations of the TFC, fiscal responsibility legislation and expansion of the service tax net for the availability of resources. Chapter II analyses the relevance of plan and non-plan expenditure, and the classification of expenditure into 'revenue' and 'capital'. Chapter III addresses the question of appropriate treatment of investment by CPSUs through IEBR vis-à-vis the plan, and the role of SPVs and PPPs in the Plan. Chapter IV assesses availability of Centre's aggregate resources for the Eleventh Plan. Chapter V analyses the likely evolution of non-plan expenditure. Chapter VI concludes with projections for the Centre's financial resources for the Eleventh Plan.

I.2 Components determining gross budgetary support (GBS)

Centre's gross budgetary support (GBS) for the Plan is the balance from current revenues (BCR) less non-plan capital expenditure (NPCE) plus non-debt capital receipts (NDCR), and borrowings and other liabilities (BOL):

$$GBS = BCR - NPCE + NDCR + BOL \qquad \text{….. (1)}$$

During the Tenth Plan, while GBS increased from Rs. 111,470 crore in 2002-03 to Rs. 172,730 crore in 2006-07 (RE), as a proportion of GDP, it declined from 4.5 per cent to 4.2 per cent (Table 1).

BCR is the residual of current revenues (CR) after meeting non-plan revenue expenditure (NPRE):

$$BCR = CR - NPRE \qquad \text{….. (2)}$$

It may be noted that traditionally, the BCR in the Plan documents is computed as given in equation (2) above less defence capital expenditure. With CR growing by 83 per cent and NPRE growing by only 36 per cent, BCR of the Central Government (henceforth, all variables refer to the Centre, unless stated otherwise) steadily turned around from a deficit of Rs. 36,310 crore to a surplus of Rs. 61,148 crore between 2002-03 and 2006-07 (RE). With a rapid increase in Plan revenue expenditure of almost 100 per cent during the reference period, the improvement in BCR of Rs. 97,458 crore was considerably more than the corresponding decline of only Rs. 24,443 crore in revenue deficit of the Centre.

Using (2), (1) can be written as

$$GBS = \left(CR - NPRE\right) - NPCE + NDCR + BOL \qquad \text{….. (3)}$$

or,

$$GBS = \left(CR + NDCR + BOL\right) - (NPRE + NPCE) \qquad \text{….. (4)}$$

or,

$$GBS = AR - NPE \qquad \text{….. (5)}$$

where aggregate resources (AR) is the sum of CR, NDCR and BOL, and non-plan expenditure (NPE) is the sum of NPRE and NPCE. With a tapering off of loan recoveries after the debt-swap scheme introduced for the States to repay their high-cost Central loans, and reduction in market borrowings for fiscal consolidation, NDCR declined by 84 per cent and BOL increased by only 5 per cent between 2002-03 and 2006-07 (RE). Consequently, relative to BCR, AR increased at a slower rate of 41 per cent. With sluggish growth of NPCE of 35 per cent, the growth in NPE was also contained at 35 per cent, below that of AR, during the reference period.

Table 1. Components determining Gross Budgetary Support (In rupees crore)

			2002-03	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**
			Actual	**Actual**	**Actual**	**Actual**	**Revised Estimates**	**Budget Estimates**
1	a+b	**Current Revenue (CR)**	**230,834**	**263,813**	**305,991**	**347,462**	**423,331**	**486,422**
	a	Tax Revenue (Net to Centre)(TR)	158,544	186,982	224,798	270,264	345,971	403,872
	B	Non-Tax Revenue(NTR)	72,290	76,831	81,193	77,198	77,360	82,550
2	c+d	**Non Debt Capital Receipts(NDCR)**	**37,342**	**84,118**	**66,467**	**12,226**	**5,979**	**43,151**
	c	Recoveries of Loans (RoL)	34,191	67,165	62,043	10,645	5,450	1,500
	d	Other Receipts	3,151	16,953	4,424	1,581	529	41,651
		Borrowings and other liabilities (BOL)	**145,072**	**123,272**	**125,794**	**146,435**	**152,327**	**150,948**
4	e+f	**Non-Plan Expenditure (NPE)**	**301,778**	**348,923**	**365,960**	**365,485**	**408,907**	**475,421**
5	e	Non-Plan Revenue Expenditure(NPRE)	267,144	283,436	296,835	327,903	362,183	383,545
6	F	Non-Plan Capital Expenditure(NPCE)	34,634	65,487	69,125	37,582	46,724	91,876
7	1- 5	**Balance from Current Revenue(BCR)**	**(36,310)**	**(19,623)**	**9,156**	**19,559**	**61,148**	**102,877**
8	1+2+3	**Aggregate Resources (AR)**	**413,248**	**471,203**	**498,252**	**506,123**	**581,637**	**680,521**
9	7-6+2+3 = 8-4	**Gross Budgetary Support(GBS)**	**111,470**	**122,280**	**132,292**	**140,638**	**172,730**	**205,100**

I.3 Broad developments in the components of GBS

i Current revenues (CR)

Current revenues consist of tax revenue receipts (TR) and non-tax revenue receipts (NTR):

$$CR = TR + NTR \qquad \text{….. (6)}$$

TR consists of direct taxes (DT) and indirect taxes (IDT), while NTR consists of dividends and profits, interest receipts, NTR of Union Territories (UTs) without legislature, grants-in-aid and contributions and other non-tax receipts.

As the Approach Paper points out (para 6.3.6): "… experience with tax collections during the Tenth Plan has been encouraging, with both the Centre and the states experiencing an increase in revenue collection as a percentage of GDP." During the Tenth Plan (2002-2007), as a proportion of GDP, in gross terms (that is before transfer to States and National Calamity Contingency Fund), Centre's DT increased from 3.4 per cent in 2002-03 to 5.6 per cent 2006-07(RE), while its IDT fluctuated between 5.3 per cent to 5.8 per cent. On a net basis, Centre's TR increased from Rs. 158,544 crore to Rs. 345,971 crore, and, as a proportion of GDP, from 6.5 per cent to 8.4 per cent during the same period.

Dividends and profits increased from Rs. 21,230 crore to Rs. 30,438 crore between 2002-03 and 2006-07 (RE). With swap of high-cost debt by the States, Centre's interest receipts declined rapidly from Rs. 37,622 crore to Rs. 20,131 crore during the same period. However, with some increase in other non-tax revenues, such as charges for economic services, while NTR in nominal terms increased marginally from Rs. 72,290 crore to Rs. 77,360 crore in the Tenth Plan, as a proportion of GDP, it declined from 3.0 per cent to 1.9 per cent.

ii Non-debt capital receipts (NDCR)

Non-debt capital receipts consist of recoveries of loans (RoL), and other receipts, which are disinvestment receipts (DR):

$$NDCR = RoL + DR \qquad \text{….. (7)}$$

A debt-swap scheme for the States to repay their high-cost Central loans was introduced in 2002-03 and picked up speed in the subsequent two years. In reflection of this scheme, after increasing from Rs. 34,191 crore in 2002-03 to Rs. 67,165 crore in 2003-04, RoL declined to Rs. 62,043 crore in 2004-05, and precipitously further to Rs. 5,450 crore in 2006-07 (RE)

With privatization proceeding apace in 2003-04, other NDCR, which was only DR, increased sharply from Rs. 3,151 crore in the previous year to Rs. 16,953 crore in 2003-04. However, with a policy change, it lost steam and fell to Rs. 4,424 crore in 2004-05. In 2005-06, there was also a policy-induced accounting change to credit all DR to a National Investment Fund, the income from which would only be used for financing expenditure on social infrastructure and to provide capital to viable public sector enterprises. In 2007-08, there has been an upsurge in other NDCR because of the inclusion of Rs 40,000 crore as transfer of the stake of Reserve Bank of India (RBI) in State Bank of India (SBI) to Government.

iii Borrowings and other liabilities (BOL)

Government's commitment to fiscal consolidation as reflected in the enactment and notification of the Fiscal Responsibility and Budget Management Act (FRBMA) in 2003 and 2004, respectively, has had a restraining impact on BOL since 2004-05. Because of the financing requirement, BOL has to be equal to the fiscal deficit of the Government, and the FRBMA commits the Government to reduce the fiscal deficit by no less than 0.3 per cent of GDP every year and bring it down to no more than 3 per cent of GDP by 2008-09.

Indeed, as a proportion of GDP, BOL fell from 5.9 per cent in 2002-03 to 4.5 per cent in 2003-04, and further to 4.0 per cent in 2004-05. With the implementation of the Twelfth Finance Commission award, there was a temporary marginal increase in BOL relative to GDP in 2005-06, but it declined to 3.7 per cent of GDP in 2006-07 (RE)).

Other liabilities consist of National Small Savings Fund (NSSF), State Provident Fund, other accounts, reserve fund and special deposits. These liabilities adjusted for NSSF, which are fully allocated to the States since 2004-05, increased from Rs 303,015 crore as on March 31, 2003 to Rs 409,603 crore as on March 31, 2007.

iv Non-plan revenue expenditure (NPRE)

Non-plan revenue expenditure, after sluggish growth from Rs. 2,67,144 crore in 2002-03 to Rs. 2,96,835 crore in 2004-05, shot up in the two subsequent years to Rs. 362,183 crore in 2006-07 (RE). The rapid increase in outlays on defence, pensions, interest payments and subsidies contributed to the steep increase in 2005-06 and 2006-07.

v Non-plan capital expenditure (NPCE)

The treatment of back-to back redemption of NSSF securities with the debt-swap receipts from the States as non-plan capital expenditure rather than a deficit-reducing entry led to an almost doubling of non-plan capital expenditure from Rs. 34,634 crore in 2002-03 to Rs. 65,487 crore and Rs. 69,125 crore in 2003-04 and 2004-05, respectively. After completion of such swap operations, 2005-06 saw a reversion of such expenditure to Rs. 37,582 crore. NPCE increased to Rs 46,724 crore in 2006-07 (RE).

I.4 Implications of TFC recommendations for plan financing

The TFC's recommendations for the period 2005-06 to 2009-10 included, among other things: (i) enhancement of the States' share in the divisible pool of Central taxes from 29.5 per cent to 30.5 per cent; (ii) ordaining the Centre to confine itself to giving only grants as Central assistance for the States' five year plans, doing away with Central loans, and thus in effect dis-intermediating the States' plan borrowing; and (iii) enhanced non-Plan grant-in-aid of revenue deficit to the States. Total transfers to States recommended by the TFC amounted to Rs.7,55,752 crore for 2005-10, up 73.8 per cent from the Eleventh Finance Commission's award for the preceding five years.

Table 2. GBS on new basis for pre-TFC period (In rupees crore)

Year	Gross loans from centre to States and UTs	Repayment of loans to the Centre by States and UTs	GBS on old basis	GBS on new basis	Calculated GBS on new basis
1	2	3	4	5	6= 4-2 until 2004-05, 5 otherwise
1997-98	14,729	7,125	68,308	…	53,579
1998-99	15,935	9,475	83,325	…	67,390
1999-2000	21,462	9,791	76,182	…	54,720
2000-01	20,490	11,691	82,669	…	62,179
2001-02	24,528	14,002	101,194	…	76,666
2002-03	28,231	30,303	111,470	…	83,239
2003-04	25,449	61,179	122,280	…	96,831
2004-05	24,806	59,737	132,292	…	107,486
2005-06	8,954	8,798	…	140,638	140,638
2006-07(RE)	5,948	3,668	…	172,730	172,730
2007-08(BE)	4,556	1,595	…	205,100	205,100

TFC's recommendations have two critical implications for plan financing. First, while there are less of Central resources available for financing the plan post-TFC, more are available at the State level for financing the plan because of the TFC award. Central resources are defrayed for the three purposes of devolving to the States as per the Finance Commission's award, meeting Centre's non-plan expenditure, and GBS. It follows that a greater outgo under one head leaves less for the others. But, simultaneously the States' financial position and hence their capability to finance the plan has improved because of the TFC award. Second, implementation of the TFC's award has also led to a problem of straightforward comparison of GBS in the pre- and post-TFC period. For example, in 2004-05, GBS for the fourth year of the Tenth Plan of Rs. 132,292 crore included Rs. 24,806 crore of State Plan loans intermediated by the Centre. A straightforward comparison with GBS of Rs. 140,638 crore in 2005-06 gives an increase of only 6.3 per cent. However, a like-to-like comparison, after deducting what would have been dis-intermediated in 2004-05 under the TFC award, gives a rise of 30.8 per cent in 2005-06. Table 2 provides, from the Ninth Plan onwards, the GBS after deducting the State Plan loans intermediated by the Centre before the implementation of the TFC award.

I.5 Implications of FRBMA for plan financing

FRBMA, 2003 and the associated rules notified on July 5, 2004, by enjoining the Central Government to reduce the fiscal deficit by no less than 0.3 per cent of GDP every year and to bring it down to no more than 3 per cent of GDP by 2008-09, constrains the scope of enhancing GBS by resorting to more BOL. However, it is necessary to take a more long-term view of the implications of FRBMA than a myopic one of how it constrains BOL and hence GBS in the short run. BOL, by increasing the debt, and hence the interest burden, of the Centre, increases NPRE, and hence reduces GBS in the future. This is particularly true of BOL above a certain sustainable level. It may be argued that high GBS through high BOL beyond a prudent limit in the past, mortgaged the present GBS. A repetition of the same would be highly undesirable.

FRBMA not only prescribes the required reduction in fiscal deficit, but also a reduction in revenue deficit by no less than 0.5 per cent of GDP every year and the elimination of such deficit by 2008-09. This constrains not only NPRE, but within a given total plan expenditure consistent with the FRBMA prescribed fiscal deficit reduction path, the amount of plan revenue expenditure as well. While the working out of such a path of plan revenue expenditure is beyond the scope of this Working Group, it was noted that there is need for extreme care in the revenue-capital composition of plan expenditure to meet the FRBMA requirement.

I.6 Service tax – a promising source of revenue

The gradual expansion of the service tax, introduced in 1994-95 to redress the asymmetric and distortionary treatment of goods and services in the tax regime, has been a buoyant source of revenue in recent years. The number of services liable for taxation was raised from 3 in 1994-95 to 6 in 1996-97, and then gradually to 100 in 2007-08 (Table 3). Simultaneously, the rate of tax was raised from 8 per cent to 10 per cent in 2004-05 and further to 12 per cent in 2006-07. Revenue from service tax, as the combined outcome of expanding tax net, creeping rate, and buoyant service sector growth, increased rapidly from a paltry Rs. 407 crore in 1994-95 to Rs. 38,169 crore in 2006-07 (RE)

Table 3. Service Tax: A Growing Revenue Source

Year	No of services	Number of assessees	Tax rate	Revenue	Growth
			per cent	(Rs.in crore)	per cent
1994-95	3	3,943	5.00	407	…
1995-96	3	4,866	5.00	862	111.8
1996-97	6	13,982	5.00	1,059	22.9
1997-98	15	45,991	5.00	1,586	49.8
1998-99	26	107,479	5.00	1,957	23.4
1999-00	26	115,495	5.00	2,128	8.7
2000-01	26	122,326	5.00	2,613	22.8
2001-02	41	187,577	5.00	3,302	26.4
2002-03	52	232,048	5.00	4,122	24.8
2003-04(with effect from May 14, 2003)	60	403,856	8.00	7,891	91.4
2004-05 (with effect from September 10, 2004)	75	740,267	10.00	14,200	80.0
2005-06	84	805,591	10.00	23,055	62.4
2006-07 (RE) (with effect from April 18, 2006)	99	…	12.00	38,169	65.6
2007-08 (BE)	100	…	12.00	50,200	31.5

*The dates mentioned in parentheses after 2003-04, 2004-05 and 2006-07 are the dates from which the number of services under service tax increased from the previous year.

Service tax indeed is a promising source of revenue, but five caveats are in order. First, the scope for expanding the service tax net to more and more services gets narrower as the net is widened. The contribution of the expanding net will reduce with time. Second, the preponderance of small service providers below the taxable limit on turnover constrains the scope of revenue mobilization beyond a certain level. Third, with resurgence of industry and revitalization of agriculture, the rapid growth in the share of services in GDP may not continue in the medium to long run. This would have implications for service tax revenue as a proportion of GDP. Fourth, service tax was introduced under the residuary entry No.97, List I in the Seventh Schedule of the Constitution. There are already moves afoot for a sharing of the tax base between the Centre and the States, particularly in the context of phasing out of the Central Sales Tax. Any sharing of the tax base with the States will diminish the Centre's available resources to finance the plan. Fifth, with the declared goal of introducing a unified goods and services tax (GST) by April 1, 2010, there is considerable uncertainty about the rates, base, and setting off (that is input tax credit) mechanism with implications for revenue collection.

II. EXPENDITURE CLASSIFICATION -- PLAN AND NONPLAN, REVENUE AND CAPITAL

II.1 Expenditure classification system

The task of any expenditure classification system is to identify basic similarities in government operations and organise individual transactions into relatively homogeneous categories to provide some meaningful information on the nature, composition and impact of these transactions.

The current structure of the budget and accounting classification was introduced in 1974 to replace the previously followed organization-based classification with a function-and-programme-based one. A major effort to harmonise the classification of plan schemes with the accounting classification was attempted in 1987; and a rationalisation of object heads was carried out in 1994. Though the classification system has evolved with the needs of the time, its basic structure has remained more or less the same for over a quarter of a century.

II.2 Plan and non-plan distinction

i) Background

Unlike the classification of expenditure into revenue and capital, the Indian Constitution does not make any distinction between plan and non-plan expenditure. The Five-Year Plans and the consequent distinction between plan and non-plan expenditure evolved after the Constitution was adopted on January 26, 1950.

Table 4. Plan and Non-plan Expenditure of the Central Government (In rupees crore)

Year	Plan Expenditure			Non-plan Expenditure		
	Revenue	Capital	Total	Revenue	Capital	Total
1997-98	35,174	23,903	59,077	145,161	27,814	172,975
1998-99	40,519	26,299	66,818	175,941	36,581	212,522
1999-2000	46,800	29,382	76,182	202,278	19,593	221,871
2000-01	51,076	31,593	82,669	226,762	16,161	242,923
2001-02	61,657	39,537	101,194	239,811	21,305	261,116
2002-03	71,569	39,901	111,470	267,144	34,634	301,778
2003-04	78,638	43,642	122,280	283,436	65,487	348,923
2004-05	87,494	44,798	132,292	296,835	69,125	365,960
2005-06	111,858	28,780	140,638	327,903	37,582	365,485
2006-07(RE)	144,584	28,146	172,730	362,183	46,724	408,907
2007-08(BE)	174,354	30,746	205,100	383,545	91,876	475,421

There has been a lively debate about the plan non-plan distinction, particularly in the context of Article 275. Grants-in-aid of revenues, determined by the twelve Finance Commissions. Plan expenditure, which was 27.0 per cent of total expenditure in 2002-03, decreased to 26.0 per cent in the subsequent year before reviving to 27.8 per cent and 29.7 per cent of such expenditure in 2005-06 and 2006-07 (RE), respectively (Table 4).

Plan expenditure, in principle, should be characterized by additionalities in terms of projects, programmes and schemes. Plan expenditure thus by necessity should be incremental expenditure on new investments, new projects and operationalising new strategies for national development. However, such expenditure often includes carry-overs from the past. Thus, for example, in the Tenth Five Year Plan (2002-07), plan expenditure included outlays connected with all Plan programmes/projects/schemes sanctioned in the Ninth Plan or earlier and incomplete at end-March 2002.

A Working Group on Expenditure Policy for the Ninth Five Year Plan set up under the chairmanship of Shri N. K. Singh in its report submitted in September 1996 stated: " The classification of expenditures as plan and non-plan gained currency with the inception of planning in India; the express purpose being to demarcate new investment or schemes from old ones. To a certain extent, it was supposed to indicate new developmental and capital formation activities which were expected to increase the productive capacity of the economy."

The N. K. Singh group also noted how plan expenditure in one plan led to higher non-plan expenditure and hence a depletion of BCR beyond the relevant plan period. It noted "The current classification of expenditure as plan and non-plan being somewhat arbitrary has distorted priorities in favour of new plan schemes to the neglect of important non-plan expenditure like maintenance. ..Further, the clubbing of revenue and capital components under plan outlay has encouraged the tendency to use borrowings to finance revenue expenditures. Such a diversion of resources in a capital scarce economy, has serious implications for the growth of the economy."

Among the various sub-groups constituted by the N. K. Singh group, there was a sub-group on Expenditure Management and Budget Formulation & Implementation and another on Plan Expenditure. The former sub-group had recommended, " the budget should no longer show the distinction between plan and non-plan and should be limited to the revenue and capital expenditure classification." However, the latter sub-group was of the opinion that "….the distinction between plan and non-plan is historical and the data would be useful for monitoring the actual expenditure on capital projects and revenue schemes under Plan and that before any decision is taken regarding classification, the more important issue to be decided pertains to the roles of the Planning Commission and the Finance Commission. In case their roles are to continue unchanged in the present form, then the current classification in use may be continued for the meantime."

ii Non-plan capital and plan revenue expenditure – two problem areas

All expenditure has to be planned carefully, and the role of the Planning Commission in determining the optimal time profile and composition of particularly capital expenditure can not be overemphasized. Such expenditure of course will depend on the available financial resources of the Government – both Central and states. According to this group, the term non-plan capital expenditure inadvertently gives the impression that India does public investment without any planning. *This Group recommends that all capital expenditure should be called plan capital expenditure, and the category non-plan capital expenditure should cease to exist.*

On the other hand, all revenue expenditure – including, for example, outlays on additional teachers when a decision to invest in and establish a new school is taken, and depreciation of the school building – have longevity beyond the relevant Five Year Plan if not a perpetual character. Thus, the dichotomy between plan and non-plan revenue expenditure is problematic at best and misleading at worst.

According to B. P. R. Vithal and M. L. Sastry (Fiscal Federalism in India, Oxford University Press, New Delhi, 2001, p. 266): "The important point is that Plan revenue expenditure is 'incremental expenditure' under heads of account, which are considered to be developmental heads in the revenue budget and which figure as sectors in a Plan. Base-level expenditure even under such 'developmental' heads of account is non-plan expenditure. However, *all* expenditure under non-developmental heads, base-level and incremental, is non-plan."

Plan expenditure has a connotation of being developmental in nature, and it is possible to argue that all developmental revenue expenditure should be classified as plan revenue expenditure. However, such a connotation is neither backed by statutes or rules, nor impervious to a large amount of subjectivity. Furthermore, experience shows that the classification undergoes changes from time to time. Thus, police housing, once considered non-developmental, has metamorphosed into developmental by virtue of housing being a developmental head, and integrated under plan expenditure. *This Group recommends that the since all revenue expenditure have a longevity beyond any specific Five Year Plan, the category plan revenue expenditure should cease to exist.*

iii Coordination

One of the problems of the plan-non-plan distinction arises from the entailed disjointed decision-making process with reference to revenue and capital expenditure and the corresponding concurrent jurisdiction of the Ministry of Finance, Planning Commission and Finance Commission.

The traditional debate about the relative importance of such revenue expenditure as teachers' or doctors' salaries or National Rural Employment Guarantee Scheme vis-à-vis capital expenditure such as building a hydroelectric dam or power plant continues. No doubt the revenue expenditure of the types mentioned above will have to be carefully planned, and the Planning Commission will continue to play an important role in their formulation; the suggestion is only to abolish the expenditure category plan revenue expenditure. Similarly, the suggestion is only to abolish the category non-plan capital expenditure; and not to undermine the important role that Ministry of Finance can play in formulating the plan itself for such capital expenditure.

Coordination among the Ministry of Finance, Planning Commission and Finance Commission in drawing up both non-plan revenue expenditure and plan capital expenditure will be critical for this purpose. There will have to be some iterations for this purpose. For example, the Planning Commission will have to provide the Ministry of Finance, in respect of both Centre or State, an initial estimate of plan capital expenditure along with the additional revenue expenditure that such capital expenditure entails. The Ministry of Finance, after factoring in all revenue expenditures, will have to provide the Planning Commission with an estimate of GBS. The Planning Commission then will have to prune or expand the plan capital expenditure to fit the bill. The iterative process will have to be repeated a few times until the plan capital expenditure is fully consistent with the GBS.

The question of coordination between the Planning and Finance Commissions is well summarized by B. P. R. Vithal and M. L. Sastry (Fiscal Federalism in India, Oxford University Press, New Delhi, 2001, p. 271): "The resources of the states are reviewed in September-December by the Planning Commission for finalizing the Annual Plan for the next financial year….this exercise must begin with a review of the BCR. The BCR being the end product of the exercise of a Finance Commission, such a review is, in effect, a review of the Finance Commission's estimate of the resource position of the state concerned. The Finance Commission not being a continuing body, the Planning Commission can, through the instrumentality of this exercise, act as a monitor of the conditions prescribed by the Finance Commission. This, in fact, was a role that the Planning Commission was discharging during the first two decades. If a state underprovided for non-Plan expenditure such as maintenance of roads in its anxiety to have a larger BCR so that it may have a larger Plan outlay, the Planning Commission would insist that the amounts prescribed by the Finance Commission must be provided. It was ensured at that time that the states provided for dearness allowances for staff in accordance with the actual rate of inflation and not at the earlier hypothetical rates."

II.3 Revenue and capital distinction

i A Constitutional requirement

The Constitution requires revenue and capital expenditures to be shown separately in the budget. Article 112 (2) states: "*The estimates of expenditure embodied in the annual financial statement shall show separately – (a) the sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of India; and (b) the sums required to meet other expenditure proposed to be made from the Consolidated fund of India, and shall distinguish expenditure on revenue account from other expenditure.*" The same provision is repeated under Article 202 under the State Section.

The Team of Reforms in the Structure of Budget & Accounts, headed by the then Deputy Comptroller & Auditor General, Sh. Mukherjee noted in its report of 1972, "*Article 112 & 202 of the Constitution which envisage distinguishing in budget, expenditure on revenue account from other expenditure, we cannot completely give up the distinct exhibition of expenditure on revenue and capital accounts, even though this distinction leads to dispersal of programme costs in budget and accounts.*"

ii Required for policy formulation

The distinction between revenue and capital expenditures is not only a constitutional requirement but also an essential ingredient for policy formulation and efficient resource allocation. FRBMA 2003 highlights the significance of keeping the revenue expenditure under control and envisages elimination of the revenue deficit by the end of 2008-09.

Broadly, revenue expenditure is expenditure incurred for purposes other than creation of assets of the Central Government. In many countries, it is known as current expenditure. Revenue deficit is the difference between revenue expenditure and revenue receipts. Broadly, the revenue deficit indicates the excess of current expenditures over revenues, or dis-savings by the Government, while the fiscal deficit captures the excess of overall expenditure over revenue. Revenue deficit implies an increase in the liabilities of the

Central Government without corresponding increase in its assets. The existence of revenue deficit indicates a departure from the observance of the golden rule of public finance whereby all borrowings by the Government is for financing public investment. When the focus is only on reducing the fiscal deficit, the brunt of fiscal correction is often borne by compression in capital expenditure. The change in revenue deficit on the path of fiscal adjustment indicates the quality of fiscal correction, which is as important as the level of fiscal correction itself.

iii Norms for revenue and capital classification

As noted by the Expert Group to Review the Classification System for Government Transactions, "..the current norms for distinguishing revenue and capital expenditures are based on sound accounting principles and are in line with the international practice. It is important to recognize that the Union Government as transferor and states as transferee are two different accounting entities and while a grant from the former to the latter may result in the creation of a national asset(s), it is the ownership of assets that decides whether the expenditure is treated as capital or revenue expenditure. In our view, an expenditure can be classified as capital if it results in creation of assets that are controlled by the entity incurring the expenditure and that are likely to serve the entity over several accounting cycles."

There have been two major areas of concern about the Centre's revenue expenditure. First is the bunching together of all transfer payments, which in a federal set-up constitute a significant portion of the total expenditure of the Union Government, as Grants-in-Aid in the books of accounts without assignment to any function or programme. Such payments are recorded as revenue expenditure of the Government, irrespective of whether the funds are utilized for asset creation or not. Thus, the distribution of government expenditure into revenue and capital shown by the accounts cannot always be taken as a measure of the developmental expenditure undertaken by the Government.

Capital expenditure is classified according to the criteria laid down by the Team of Reforms in the Structure of Budget & Accounts (Mukherjee Committee) in its 1972 report, as, "Expenditure on acquisition of assets of material and permanent character. Expenditure on extinguishing recurring liability is also treated as capital expenditure but the latter is usually written back to revenue over a period of years…..Expenditure on assets which do not vest in Government is not treated as capital expenditure." The General Financial Rules (GFR) and the Government Accounting Rules also define capital expenditure as "Expenditure incurred with the object of increasing concrete assets of a material and permanent character". Note 1 below GFR 291(1) further states that "Expenditure on a temporary asset or on Grants-in-aid cannot ordinarily be considered as a Capital expenditure".

The Expert Group had also noted, "For the sake of disclosure, however, such transfers that are meant for capital expenditure by the transferee may be classified as Capital Grants under the Revenue Section in the books of the transferor. Though there is no presently known evidence of classification of transfer payments as capital expenditure by any government internationally, the Group is aware that a similar debate is currently underway in the UK Treasury. The Group, therefore, recommends that this issue may be kept alive and reviewed in the future based on international developments in the area."

Second, it is often argued that how and why is creation of human capital through outlays on education, health or even poverty alleviation less virtuous or less in the nature of ‘asset creation’ than say the building of a road or bridge or airport. In this connection it would be worth looking at what constitutes an asset. The International Public Sector Accounting Standards (IPSAS) of the International Federation of Accountants (IFAC) defines an asset as the “Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity”. It adds “Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential”. Assets that are used to generate net cash inflows are often described as embodying “future economic benefits””. The Government Financial Statistics (GFS) Manual 2001 of IMF clearly states that two core elements of an asset are ownership rights and deriving of economic benefits by holding or using these assets over a period of time.

Of course, there can be numerous instances when spending on revenue items to augment human capital or just to preserve it (for example, through poverty alleviation) is more important than public investment. While there is no suggestion whatsoever that revenue expenditure of certain variety can not be more meritorious than capital expenditure, classification of outlays such as on teachers’ or doctors’ salaries will lead to confusion and a practice completely out of line with international convention.

This Group concurs with the Expert Group to Review the Classification System for Government Transactions that the current norms and practice of classification of expenditure into revenue and capital may continue.

III. IEBR OF CPSUS, SPVS AND PPPS AND PLAN FINANCING

III.1 Internal and Extra-Budgetary Resources (IEBR) of Central Public Sector Undertakings (CPSUs)

Plan outlay of the Central Government consists of two distinct parts: a part implemented directly by concerned Ministries and Departments; and the other through investment by CPSUs in respect of their own plan projects and programmes.

The investment by CPSUs is financed through the following two modes: (i) budgetary support provided by the Central Government, which is a part of total plan outlay and GBS; and, (ii) IEBR raised by CPSUs on their own. IEBR comprises of internal resources, and extra-budgetary resources. Extra-budgetary resources are the sum of domestic and foreign loans raised directly by CPSUs. Broadly, the internal resources comprise retained profits – net of dividend to Government, depreciation provision and carry forward of reserves and surpluses. The extra-budgetary resources consist of receipts from the issue of bonds, debentures, external commercial borrowing (ECB), suppliers' credit, deposit receipts and term loans from financial institutions. The plan outlays of CPSUs during the Tenth Plan show that out of a total of such outlay of Rs. 507,878 crore, as much as 83 per cent came from IEBR with internal resources and extra-budgetary sources contributing 47 per cent and 36 per cent, respectively (Table 5).

Table 5. CPSUs: Tenth Plan Outlay and IEBR (in rupees crore)

Year	Plan outlay of CPSUs	Budgetary support	IEBR		
			Internal Resources	Extra Budgetary Resources	Total
2002-03 (RE)	83,880	15,232	38,836	29,812	68,648
2003-04(RE)	84,902	15,983	36,255	32,664	68,919
2004-05(RE)	85,294	17,005	38,607	29,682	68,289
2005-06 (RE)	115,447	17,362	51,818	46,267	98,085
2006-07 (RE)	138,355	20,635	73,076	44,644	117,720
Total	507,878	86,217	238,592	183,069	421,661

Projections for IEBR for the Eleventh Plan were prepared by compiling data on all CPSUs (covered in Expenditure Budget - Statements 14 and 15), which are generating resources of their own, and also those which have negative internal resources, but, are raising market loans (Table 6).

Table 6. CPSUs: Projections of Eleventh Plan Outlay and IEBR (in rupees crore)

		IEBR				
Year	Budgetary support	Balance carried forward from previous year	Fresh internal resources	Extra Budgetary Resources	Total IEBR	Plan allocation
2007-08	19,559	-	151,977	91,683	243,660	193,707
2008-09	19,420	69,512	87,482	119,176	276,170	227,704
2009-10	18,929	67,886	82,834	148,031	298,751	241,765
2010-11	17,034	75,915	81,846	125,781	283,542	220,934
2011-12	17,819	79,642	89,694	106,117	275,453	200,117
Format difference	(69)					(270)
Total	92,692	…	493,833	590,788	1,084,621	1,083,957

The annual figures on internal resources and extra-budgetary resources did not reveal any firm trends. Of the total internal and extra budgetary resources of Rs 1,177,313 crore during 2007-2012, bonds and debentures are expected to yield Rs 316,114 (27 per cent); ECB/supplier's credit Rs 121,971 crore (10 per cent); other extra budgetary resources Rs 152,601 crore (13 per cent) and balance almost 50 per cent as internal resources.

A comparison between the Tenth and Eleventh Plans (Table 7) of the extent of contribution of major sectors to the total IEBR and shifts, if any, indicate that the greatest increase in the share of total IEBR during the Eleventh Plan will be in the power sector, followed by civil aviation, atomic energy, shipping, coal and roads. This reflects the growing emphasis in recent times on infrastructure and coal mining.

The terms of reference of the Group includes an examination of whether, and to what extent, investment by CPSUs financed through IEBR should continue to form a part of the 'Plan'. There could be two possible reasons for excluding IEBR from the resources for the plan. First, the budgetary support to the CPSUs was only 17 per cent of their plan outlay in the Tenth Plan period. Secondly, most of CPSUs, particularly the Navratnas and Mininavratnas have been given operational autonomy and they can finance their development programmes independently.

There, however, is an equally strong case for the inclusion of the IEBR of the CPSUs into the Plan of the public sector. After all, the public sector comprises both the core Government and its parastatals. Further, CPSUs are also governed by the guidelines of the Public Investment Board. Budgetary support, even while declining, will continue in the Eleventh Plan as well, and will nonetheless continue to be a significant proportion of GBS. In view of this, *it is recommended that IEBR should be retained as part of Plan financing.*

Table 7. CPSUs: Comparison of Break-up of IEBR under Tenth and Eleventh Plan

Serial Number		Tenth Plan		Eleventh Plan Projection	
	Ministries/Departments	IEBR in rupees crore	Percent of total IEBR	IEBR in rupees crore	Percent of total IEBR
1	Department of Atomic Energy(4)	7,028	1.46	35,721	3.00
2	Department of Chemicals & Petrochemicals(4)	117	0.02	343	0.03
3	Department of Fertilizers(7)	3,234	0.67	6,973	0.59
4	Ministry of Civil Aviation(6)	12,586	2.61	55,933	4.70
5	Ministry of Coal(3)	21,759	4.51	69,927	5.88
6	Department of Telecommunications(3)	82,371	17.06	121,690	10.22
7	Department of Food & Public Distribution(1)	553	0.11	1,008	0.08
8	Department of Heavy Industry(11)	1,657	0.34	4,739	0.40
9	Ministry of Health & Family Welfare (2)	59	0.01	570	0.05
10	Ministry of Information & Broadcasting(2)	63	0.01	144	0.01
11	Ministry of Mines(3)	3,763	0.78	9,498	0.80
12	Ministry of Non-Conventional Energy Sources(1)	1,968	0.41	5,949	0.50
13	Ministry of Petroleum & Natural Gas(15)	135,961	28.15	277,072	23.28
14	Ministry of Power(7)	73,630	15.25	278,780	23.42
15	Department of Shipping(16)	14,688	3.04	58,821	4.94
16	National Highways Authority of India(1)	10,382	2.15	41,615	3.50
17	Ministry of Small Scale Industries(1)	185	0.04	236	0.02
18	Ministry of Steel(12)	21,244	4.40	61,032	5.13
19	Deptt. Of Scientific & Industrial Research(2)	-	0.00	28	0.00
20	Ministry of Urban Development(3)	23,176	4.80	60,871	5.11
21	Ministry of Railways(10)	68,516	14.19	99,237	8.34
Grand Total (113)		482,940	100.00	1,190,187	100.00

Number after Ministries/Departments in parentheses indicate number of PSUs under their jurisdiction. The figures may not tally with Table 6 because of a different reporting format . The difference, however, is very small relative to the numbers.

III.2 Special Purpose Vehicles (SPV)

An SPV is a legal entity or a firm with practically no management or employees, and embodying a financial contract defining its every action. Typically with a trustee receiving and distributing cash according to pre-specified contracts, there is no need for a management team to take independent decisions. SPVs are financially engineered devices for obtaining sound contracting. The Economic Survey 2002-03 (p. 201) provides a useful example of the usefulness of an SPV "As an example, consider a bridge being built by the Indian Railways. One possibility is for the Indian Railways to issue bonds in order to finance the bridge, and augment the general revenues of the Indian Railways by charging the traffic. However, the bondholder would then be exposed to the complexities of the balance sheet of the Indian Railways. An alternative contracting mechanism would be to set up an SPV for the bridge alone."

While traditionally the Government provided public services through *in-house* facilities, *financed and managed directly by the Government itself*, under public-private-partnership (PPP, see below), the Government retains the responsibility for providing the services, but the services are delivered by the private sector. This arrangement requires the government to either enter into a *"contract"* with the private partner or *pay for the services* (*reimburse)* rendered by the private sector. *Contracting* prompts a new activity, especially so, when neither the public sector nor the private sector *existed* to provide the service. This is where SPVs can play a useful role.

III.3 Public-Private Partnership (PPP)

Public-Private-Partnership (PPP) is a generic term describing the financing, designing, construction, and operation and maintenance of public sector programmes and projects through private sector participation. PPP can be privately managed and privately delivered public services with full, partial or no public funding. The potential benefits expected from PPP are: cost-effectiveness, higher productivity, accelerated delivery, clear customer focus, enhanced social service, and recovery of user charges. Although initially, in the 1970s, the enthusiasm for PPP stemmed from saving the fiscal resources of the government and safeguarding the deficit and public debt, slowly the emphasis has shifted to the 'value for money' in PPPs. The essence of PPP is in shifting the emphasis of the Government from delivering services directly, to service management and coordination. Examples of such PPP abound both in India and abroad.

India has practised PPP since the First Five Year Plan, but there was no explicit recognition of the PPP model. 'Community support' for publicly funded construction of irrigation canals was sought during the First Five Year Plan itself. CAPART was set up by the Ministry of Rural Development during the Seventh Five Year Plan for implementing rural development programmes through *non-profit agencies*. The system of extending *grants-in-aid* to educational institutions by the Ministry of Human Resources Development is another example of PPP.

In the aftermath of the January 26, 2001 earthquake in Bhuj, the 'reconstruction' involving expenditure of around US$2 billion was implemented by the Government of Gujarat through the PPP mode. Community school buildings, private health centers and private housing were built more cost-effectively through PPP. National Institute for Smart Government (NISG), Hyderabad, a not-for-profit company incorporated in 2002 with

National Association of Software and Service Companies (NASSCOM), Central and State governments as the principal promoters, is another example. NISG under PPP was designed to combine the immense potential and resources of the private sector with the principles of accountability and transparency of the public sector. The goal of NISG is to lead the nation to a preeminent position in providing integrated online services to the citizens and businesses.

Reports of the *PPP Sub-Group on Social Sector* constituted in September 2003 under the chairmanship of Secretary, Planning Commission provide good insight into the role that PPP can play in the planning process. On examples of PPPs abroad, as the former sub-group reports: “One of the earliest evidence of *contracting out of public services* (on a long term) is found in regard to implementation of ‘*the war on poverty’* programme of the federal government in the United States of America *during the 1960s’*. Title II-A of the ‘Economic Opportunity Act, 1964’ required the poor/people themselves to assume the responsibility, *both for planning and implementing* the war on poverty at the local level. Financial resources were accordingly allocated among the city’s low-income neighborhoods through the *Community Action Agency (CAA)*, and residents were to elect individuals as members from their neighborhoods on the CAA Board of Directors.” In the United Kingdom, the examples include National Air Traffic Services since 2001 and maintenance of the London Underground since 2003. In Australia, the examples include Eastern Distributor, Lane Cove Tunnel, M2 Hills and M4 Western Motorways, all in Sydney and City Link and East Link in Melbourne. In Canada, the examples include 407 ETR toll road in Toronto, Royal Ottawa Hospital in Ottawa and Confederation Bridge in Prince Edward Island.

The Approach Paper (para 7.8.2) states that: “….the total resources required to correct the infrastructure deficit exceed the capacity of the public sector. The strategy for infrastructure development must therefore encourage public private partnerships wherever possible. However the PPP strategy must be based on principles which ensure that PPPs are seen to be in the public interest in the sense of achieving additional supply at reasonable cost. PPPs must serve to put private resources into public projects and not the other way around.” According to this Group, there is considerable scope for reducing unit cost of public service delivery and getting more public services with the same amount of budgetary outlays through PPP in both physical and social infrastructure during the Eleventh Plan.

Table 8. PPP Projects in Infrastructure - Government of India

Project Name	No of Projects	Estimated Cost	Government Support/Equity
		In rupees crore	
Road Transport & Highways	84	22,752	1,786
Ports	30	9,770	Not Indicated
Civil Aviation	5	21,144	457 +26% Equity
Industrial Infrastructure	26	1,764	952
Urban Infrastructure	3	4,363	650
Total	148	59,793	…

In the sphere of physical infrastructure so far, 148 PPP projects have been approved or are under consideration (Table 8). A total of Rs 59,793 crore of investment is envisaged in these projects with total support from Government in terms of equity/grant of Rs 3,845 crore in cash and non-cash equity participation of Rs 5,497 crore. Total Government participation, therefore, works out to 15.6 per cent of the proposed investment. It is, therefore, possible to achieve a leveraging of more than 6 times through PPP.

The Group strongly recommends *adopting the PPP model in the implementation of the Eleventh Plan schemes for physical and social infrastructure for cost-effectiveness, higher productivity, accelerated delivery, clear customer focus, enhanced social service, and recovery of user charges not only for financial prudence but also for developing a sense of popular ownership of projects*.

IV. CENTRE’S CURRENT REVENUES AND NON-DEBT CAPITAL RECEIPTS FOR THE ELEVENTH PLAN

IV.1 Methodology of forecasting tax revenues

Forecasting tax revenue is by either the conditional or the unconditional method. An unconditional forecast disregards structural changes and is based on the historical evolution of revenues. It is based on either a simple extrapolation of an established linear trend in revenues, or some regression of tax receipts on such receipts in the past, without the use of any knowledge that the forecaster may have of the structure of the tax and of the portable relations between the revenues that it generates and other economic variables. While such unconditional predictions can be quite accurate for the short term, they tend to have large errors in the medium to long term.

A conditional forecast, as the name suggests, is conditional on another variable. In the context of tax revenues, the other variable is the base for the relevant tax. The statutory tax base is usually too complex to be useful for forecasting, and is generally not used in practice. An alternative or proxy tax base is used for forecasting. For example, GDP may be a proxy base for personal income (assuming that household income grows at the same rate as GDP), consumption could serve as a proxy for the base of a value added or sales tax, production could serve as a proxy for excises, and imports may be a good proxy for customs duty. The various techniques using proxy tax bases include the effective tax rate approach, the buoyancy approach and the elasticity approach.

The effective tax rate approach is a concept based on ‘the average’, that is on the assumption of no changes in the structure of the tax base, tax rate and compliance level. This approach effectively assumes a tax buoyancy of unity – that is one per cent change in tax revenue for one per cent change in the tax base. In the context of the present exercise, this approach is of no relevance since a number of initiatives in the recent past affecting both the tax structure and the compliance level will have a positive effect on revenue productivity in future. Any revenue forecast based on this approach is likely to be an underestimate.

An alternate to the average concept underlying the effective tax rate approach is the ‘marginal approach’ using the same variables that links changes in tax revenues to changes in the tax base. This marginal approach can be used to estimate both the buoyancy and the elasticity of tax revenues with respect to the tax base. The buoyancy of tax revenues is estimated using the actually observed data for both the revenue and the tax base. The elasticity is estimated by adjusting the actually observed revenue data for changes in the tax system. The elasticity and buoyancy of tax revenues are the same during any period when the tax system remains unchanged. The difference between buoyancy and elasticity measures gives an idea of the impact of discretionary changes in the tax structure.

Normally, measures of tax buoyancy tend to be volatile on account of variation in the annual discretionary changes. Use of buoyancy to estimate tax revenue can sometimes severely bias the results, because, if the tax law does not continue to change in the same direction and at the same pace as in the past, the regression nevertheless will suggest that revenues would respond faster (or slower) to changes in the tax base than they actually will. The regression does not distinguish between tax revenue changes from a change in the tax base and those from a change in the tax law. To remove the effect of changes in tax law, i.e. discretionary effects, the underlying responsiveness of a tax to the base is captured by the elasticity method, which uses the proportional adjustment method or regression using dummies.

IV.2 Assumptions

Revenues – particularly tax revenues – of the Government depend critically on the pace of economic activity and inflation in the country through their impact on the revenue base. Thus, an assessment of the Centre's resources for the Eleventh Plan has to be based on a realistic assumption about the growth of the economy in real terms and inflation.

i GDP growth in real terms

This Group has assumed an annual average rate of growth of 9 per cent for the five years starting from 2007-08 as per the Approach Paper to the Eleventh Plan as adopted by the National Development Council at its 52nd meeting on December 9, 2006.

Table 9. Macroeconomic Assumptions (in per cent)

	Growth of GDP at market prices			Period-average inflation	
	At constant prices	At current prices		WPI	GDP deflator
2007-08	8.70	13.0		5.00	3.94
2008-09	8.90	13.0		4.75	3.75
2009-10	9.10	13.0		4.50	3.55
2010-11	9.30	13.0		4.25	3.35
2011-12	10.00	13.5		4.00	3.15

The Approach Paper, building on the average growth of 8 per cent in the last 4 years of the 10th Plan, targets an acceleration of the growth rate "from 8% growth at the end of the 10th Plan to 10% by the end of the 11th Plan, yielding an average GDP growth rate of about 9% in the 11th Plan". The Union Budget 2007-08 has taken a growth of 13 per cent in GDP at current market prices. The Group has taken this growth for 2007-08. Assuming GDP deflator as indicated in the next section, at 3.94 during 2007-08, GDP growth at constant prices works out to 8.70 per cent. For the remaining years, a 20 basis point increase is assumed in the GDP growth rate for the next three years to reach 9.30 per cent in 2010-11. The GDP growth for the terminal year has been taken at 10 per cent, consistent with the Approach Paper.

ii Inflation

The Approach Paper also assumes an average annual inflation rate between 4 per cent and 5 per cent for the Eleventh Plan period. Inflation in India is commonly measured in terms of the Wholesale Price Index (WPI) and Consumer Price Index for Industrial Workers (CPI-IW). The average inflation measured in WPI was 5.4 per cent in the 53 weeks of 2006-07, while that measured by CPI-IW was 6.7 per cent in the twelve months ending in March 2007. WPI inflation has been assumed to decline from 5.0 per cent in 2007-08 by 0.25 percentage points every year to reach 4.0 per cent in 2011-12.

What is relevant for the projection of financial resources of the Centre, however, is the inflation in terms of the GDP deflator, which together with GDP growth in real terms, determines the growth in GDP in nominal terms. Quarterly GDP data from the first quarter of 2000-01 to the second quarter of 2006-07 indicates that, on average, in a quarter, inflation in terms of GDP deflator was only 78.9 per cent of the corresponding average WPI inflation. Thus, the annual inflation in terms of GDP deflator has been taken as 78.9 per cent of the assumed average WPI inflation in the same year.

iii Nominal GDP growth

The GDP growth rates in nominal terms for the five years of the Eleventh Plan have been obtained by compounding the assumed GDP growth in real terms by the inflation in terms of the GDP deflator, and rounding off to the first decimal place.

GDP at factor cost at current prices is needed for projecting indirect tax revenues. The data for GDP at factor cost and at market prices – both at current prices – from 1994-95 to 2005-06, available under the new series, indicate that out of the 12 years, while growth of GDP at market prices exceeded that of GDP at factor cost only in three years, the average difference between the two growth rates is marginal at 0.01 percentage points. Thus, for simplicity, the growth rate of GDP at factor cost at current prices has been taken as the same as GDP at current market prices.

IV.3 Direct tax revenues

There are two major types of direct taxes:

$$DT^1 = PIT \qquad \text{.....(8)}$$

and

$$DT^2 = CIT \qquad \text{.....(9)}$$

where PIT is personal income tax and CIT is corporate income tax. There are other direct taxes, namely Securities Transactions Tax (STT), Fringe Benefit Tax (FBT), Bank Cash Transactions Tax (BCTT) and Wealth Tax (WT), which for simplicity, the Group has treated as part of PIT.

Direct taxes have been projected for the Eleventh Plan period by three alternative methodologies: first, on the basis of buoyancies adopted by the Task Force on implementation of the FRBM; second, on the basis of elasticities estimated by the Sub Group on Direct Taxes; and third, with a hybrid approach using the elasticity estimate to proxy the buoyancy estimate in respect of corporate tax and the buoyancy estimate itself adopted by the Task Force in respect of personal income tax. Since the budget figures had become available at the time of finalization of the report, these figures have been taken for 2007-08 and forecast has been made for the remaining four years of the plan. A similar approach has been adopted for other tax, non-tax receipts and non-plan revenue expenditure.

Losses in CIT because of the newly introduced Special Economic Zones (SEZ) had to be factored into the calculation of tax revenue for the Eleventh Plan period. The Group assumed that, in terms of what CIT revenues would have been without SEZs, such losses are 10 per cent in 2008-09, 12.5 per cent in 2009-10 and, and 15 per cent in each of the two subsequent years of 2010-11 and 2011-12.

i Buoyancy a la FRBM Task Force

Direct taxes have been estimated by the buoyancy approach as

$$DT_t^i = DT_{t-1}^i \times \left\{ 1 + \left(\frac{\Delta GDPMP_t^E}{GDPMP_{t-1}} \times \beta^i \right) \right\} \qquad \text{…..(10)}$$

where DT_t^i denotes direct tax of variety 'i' at time t, $GDPMP_t^E$ denotes expected GDP at current market prices, $\Delta X_t = X_t - X_{t-1}$ denotes change in the value of a variable X at time t, superscript E denotes an expected variable, and β^i denotes buoyancy of the direct tax of variety 'i'. Buoyancy, β^i, measures the percentage change in DT^i for a percentage change in $GDPMP$, and is usually estimated from the past data.

Buoyancies of personal income tax and corporate tax estimated by the Task Force on implementation of the FRBM Act 2003 for the period 1980-81 to 2002-03 at 1.69 and 1.98 have been used for the projections of PIT and CIT in this Report. Based on these buoyancy estimates and the revenue gain from the package of tax reforms recommended by it, the direct tax revenues for the financial year 2006-07 were estimated at Rs. 2,09,070 crore. The proximity of this estimate to Rs. 2,10,419 crore for 2006-07(BE) reinforced confidence in the Task Force's buoyancy estimates.

On the basis of the buoyancy estimates of 1.98 and 1.69 for corporate tax and personal income tax, respectively, the revenues from direct taxes were projected to increase steadily from Rs. 229,272 crore in 2006-07 (RE) to Rs. 580,442 crore in 2011-12 (Table 10). As a proportion of GDP, the corresponding increase is from 5.59 per cent in 2006-07 to 7.66 per cent in 2011-12 .

Table 10. Buoyancy Approach -- Direct Tax Revenue (in rupees crore)

	2005-06	2006-07 (RE)	Buoyancy	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
Growth of GDP at current market prices in per cent	14.10	15.0		12.99	12.98	12.97	12.96	13.47
GDP at current market prices	3,567,177	4,100,636		4,633,150	5,234,502	5,913,507	6,680,095	7,579,899
Gross corporate tax before SEZ loss	101,277	146,497	1.98	168,401	211,678	266,046	334,333	423,501
Loss due to SEZ	…	…		-	21,168	33,256	50,150	63,525
Gross corporate tax less SEZ loss	101,277	146,497		168,401	190,511	232,790	284,183	359,976
Personal income tax (including STT, FBT, BCTT and WT)	63,925	82,775	1.69	99,089	120,824	147,312	179,585	220,466
Projected Direct Tax Revenues	165,202	229,272		267,490	311,335	380,102	463,768	580,442
Direct Tax –GDP ratio	4.63	5.59		5.77	5.95	6.43	6.94	7.66

ii Elasticity approach

The estimation of elasticities of tax revenues is extremely complex in the absence of a data base for estimating the ex-post impact of discretionary changes. Under the elasticity approach, the revenues from PIT and CIT have been decomposed into (a) voluntary payments (VP), (b) enforced collections (EC), and (c) refunds (REF). The time series data for the 20-year sample period of 1986-87 to 2005-06 for each component have been ‘cleaned’ to exclude the impact of discretionary changes. Regression analysis of the adjusted times series data is then used to generate elasticity estimate of each component separately:

For CIT:

$$\log VP_t = -5.28 + 1.69 \log GDP_t - 1.11 \log EC_t - 0.49 \log REF_t$$

$$+ 0.00667 \log GDP_t \times \log EC_t \times \log REF_t - 0.137t - 0.013t \times D4$$

$$R^2 = 0.99, DW = 2.14 \qquad \ldots..(11)$$

For PIT:

$$\log VP_t = -5.7 + 1.48\log GDP_t - 0.62\log EC_t - 0.66\log REF_t$$
$$+ 0.005\log GDP_t \times \log EC_t \times \log REF_t$$

$$R^2 = 0.99, DW = 1.69 \qquad \text{.....(12)}$$

where GDP denotes nominal GDP at factor cost, REF is amount of refunds issued during the year, EC denotes enforced collections, that is post assessments collections., t denotes time and D4 is a dummy variable, $D4 = 1$ for 2003-04 onwards and 0 otherwise. GDP is used as a proxy for the tax base while refund and enforced collections are used as proxies for enforcement. Refunds have been taken as an independent variable because of two reasons. First, refunds are not simply returns of the excess payments, they indicate that all such returns have been processed. Second, refunds improve compliance as tax payers factor in the possibility of the returns being examined.

The elasticities of voluntary PIT and CIT with respect to GDP may be obtained by consolidating the coefficients of GDP in equations (11) and (12). Thus, in 1995-96, for CIT, with EC at Rs. 5,264 crore and REF at Rs. 6,462 crore, the elasticity is obtained as

$$1.69 + 0.00667 * Ln5264 * Ln6462 = 2.19 \qquad \text{.....(13)}$$

The estimated elasticities (Table 11) for the years 1995-96 to 2005-06 displayed an upward trend. Based on the estimated elasticities of 2.3 for CIT and of 1.8 for PIT, projections of direct tax revenues (Table 12) for the Eleventh Plan indicate an increase in such revenues from 5.59 per cent of GDP in 2006-07 (RE) to 8.46 per cent of GDP in 2011-12. These estimates are net of the loss in revenues on account of the proliferation of SEZs. The increase of 2.87 percentage points of GDP in direct taxes during the Eleventh Plan period is an acceleration from the corresponding increase of 2.3 percentage points of GDP during the Tenth Plan period.

Table 11. Estimated Elasticities of Corporate and Personal Income Taxes

Financial Year	Corporate Income Tax	Personal Income Tax
1995-96	2.19	1.75
1996-97	2.21	1.77
1997-98	2.18	1.78
1998-99	2.22	1.79
1999-2000	2.25	1.81
2000-2001	2.26	1.80
2001-2002	2.29	1.78
2002-2003	2.29	1.82
2003-2004	2.33	1.84
2004-2005	2.29	1.83
2005-2006	2.31	1.84

Table 12. Elasticity Approach -- Direct Tax Revenues (In rupees crore, unless otherwise stated)

	Elasticity (pure number)	2005-06	2006-07 (RE)	2007-08(BE)	2008-09	2009-2010	2010-11	2011-12
Growth of GDP at current market prices in per cent	…	14.1	15.0	13.0	13.0	13.0	13.0	13.5
GDP at current market prices	…	3,567,177	4,100,636	4,633,150	5,234,502	5,913,507	6,680,095	7,579,899
Gross corporate tax before SEZ loss	2.30	101,277	146,497	168,401	218,673	283,914	368,565	482,749
Loss due to SEZ	…	…	…		21,867	35,489	55,285	72,412
Gross corporate tax less SEZ loss	…	101,277	146,497	168,401	196,806	248,425	313,280	410,337
Personal income tax (including STT, FBT, BCTT and WT)	1.80	63,925	82,775	99,089	122,239	150,781	185,964	231,052
Projected Direct Tax Revenues	…	165,202	229,272	267,490	319,045	399,205	499,244	641,389
Direct tax-GDP ratio in per cent	…	4.63	5.59	5.77	6.10	6.75	7.47	8.46

iii A mix

With full compliance, and no change in tax structure, buoyancy and elasticity should be unity. Both buoyancy and elasticity, even with full compliance and unchanged tax structure may exceed unity because of bracket creep in a progressive tax system, but ultimately as income exceeds the highest bracket threshold and there is no bracket creep, they would converge to unity.

Table 13. Mixed Approach -- Direct Tax Revenues (In rupees crore, unless otherwise stated)

	Elasticity (pure number)	2005-06	2006-07 (RE)	2007-08(BE)	2008-09	2009-2010	2010-11	2011-12
Growth of GDP at current market prices in per cent	…	14.1	15.0	13.0	13.0	13.0	13.0	13.5
GDP at current market prices	…	3,567,177	4,100,636	4,633,150	5,234,502	5,913,507	6,680,095	7,579,899
Gross Corporate Tax	2.27	101,277	146,497	168,401	217,973	282,101	365,041	476,560
Loss due to SEZ	…	…	…		21,797	35,263	54,756	71,484
Net Corporate tax	…	101,277	146,497	168,401	196,176	246,838	310,285	405,076
Personal IT (including STT/FBT/BCTT/WT)	1.79	63,925	82,775	99,089	122,097	150,432	185,319	229,977
Projected Direct Tax Revenues	…	165,202	229,272	267,490	318,274	397,270	495,604	635,053
Direct tax-GDP ratio in per cent	…	4.63	5.59	5.77	6.08	6.72	7.42	8.38

The buoyancy method assumes a ‘business as usual’ scenario, which means that the pace and directions of tax reforms in the past will continue in the future. For much of the past, the discretionary changes were essentially in the nature of tax relief resulting in revenue loss and lower buoyancy. Thus, not only do the elasticities of CIT and PIT exceed the corresponding buoyancy estimates, but the elasticities also tend to increase in the recent years. This is particularly true for corporate taxes, where there is a flat rate of tax and exemptions and tax concessions have been more in abundance.

It appears that the scope for reduction in direct tax rate is limited. The exemptions are sticky in nature, and there is little likelihood of their removal over the next five years. Therefore, it is safe to consider some moderation in the rate of growth observed in the recent past. It has, therefore, been considered to project direct tax revenues by taking a weighted average of the buoyancy and elasticity figures with weights of 0.1 and 0.9, respectively (Table 13). Projections yielded by the ‘mix’ indicates direct tax revenues increase from 5.59 per cent of GDP in 2006-07 (RE) to 8.38 per cent of GDP in 2011-12.

IV.4 Indirect tax revenues

There are three major types of indirect taxes: customs duty, Central excise duty and service tax. The significant departure of actual indirect tax revenue collection from that projected for the Tenth Plan under two of the three methodologies caused some concerns about the appropriate methodology to be followed for each of these three taxes for the Eleventh Five Year Plan

For the Tenth Five Year Plan, projections had been made for two scenarios: Scenario-I with GDP growth at 8.5 per cent and inflation at 4.75 per cent, and Scenario-II with GDP growth at 7 per cent and inflation at 5.5 per cent. Three different buoyancies adopted in each scenario, namely the buoyancy projected by the Eleventh Finance Commission (EFC), historical buoyancy and the Working Group graded buoyancy, were considered for comparison vis-à-vis the actual revenue collected.

For the Tenth Plan, EFC buoyancies tended to overestimate revenues. For example, under Scenario I, for 2006-07, use of EFC buoyancy estimates yielded excise and service tax revenues of Rs. 178,303 crore against the RE of Rs. 155,435 crore. Similarly, for the same year, EFC buoyancy yielded a customs revenue figure of Rs. 113,593 crore against the RE of Rs. 81,800 crore. Historical buoyancies, on the other hand, tended to under-predict revenues primarily because of buoyant growth of service tax revenues. With the Working Group's graded buoyancy, while excise was under-predicted, the over-prediction of customs revenues made up for the underestimation of excise and the overall projection of indirect tax revenues was close to the actual figure. It appears that the reduction in rates of duty and a number of other factors, such as area-based duty exemptions, bilateral and multilateral treaty agreements, and SEZs, led to an erosion of the tax base and resulted in the shortfall of actual indirect tax revenues, excluding service taxes, from those yielded by the buoyancy estimates.

In this Report, incorporating the lessons from the projections for the Tenth Five Year Plan, revenues from customs duty, excise duty and service taxes have been separately estimated as follows.

i *Revenues from customs duty*

Revenues from customs duty is essentially a function of the value of imports and collection rate. With the opening up of the economy, the past trend of increasing import-GDP at factor cost at current prices (GDPFC) ratio, observed particularly since 2001-02, is likely to continue during the Eleventh Plan period. Within imports, it is useful to distinguish between petroleum, oil and lubricants (POL) and non-POL imports.

From POL

With India importing almost 70 per cent of its petroleum requirement – mainly in the form of crude – customs revenue from POL account for roughly 15 per cent of overall customs revenues. Though POL accounts for about a third of total imports, with low collection rates, particularly after the reduction in duty rates in 2005-06, customs revenue from POL are a little less than 15 per cent of the total customs collections. There has been some instability in the growth of customs revenue from POL on account of the simultaneous operation of conflicting forces such as expanding demand, growing energy efficiency, and volatility of international crude prices. For example, while gross crude imports grew by 5.4 million MT (MMT) to 39.9 MMT in 1998-99, value of oil imports declined by 25 per cent with a decline in fob prices of crude per barrel from US$16.72 in 1997-98 to US$11.94. Similarly, in 2005-06, while imports increased by less than 4 per cent in quantity terms, in value terms, the increase was 47 per cent. Thus, no attempt has been made in this report to project POL imports.

For POL, at the current rate of custom duty, the growth in customs revenue appears to be 5 per cent. But, there is considerable pressure on the Government to keep the prices of petroleum products – universal intermediates – low by rationalization of customs duty on POL. Thus, it is assumed that the collection rate for POL ($colrate_t^{POL}$), which in 2006-07 is close to 6 per cent and is expected to remain at that level in 2007-08, would be lower by 0.5

percentage points than the previous year in each of the four subsequent years of the Eleventh Plan. Thus, customs revenue from petroleum products (Table 14) in year t (CUS_t^{POL}) has been projected as:

$$CUS_t^{POL} = 1.05 \times CUS_{t-1}^{POL} \times \frac{colrate_t^{POL}}{colrate_{t-1}^{POL}} \qquad \text{.....(14)}$$

From non-POL

Non-POL imports as a proportion of GDPFC were 15.1 per cent in 2006-07. It is estimated at 16.5 per cent in 2007-08, and to rise thereafter by 0.5 percentage points every year until 2011-12.

Progressive reduction in peak rate of customs duty rates and accelerated reduction of rates on raw materials and intermediaries, which have been continuing for some years, is likely to continue in the future as per the Government's announced policy decision. This has, and will, lead to a decline in the customs collection rate. Furthermore, customs duty concessions under Free Trade Agreements (FTA) or Comprehensive Economic Cooperation Agreements (CECA) or Comprehensive Economic Partnership Agreements (CEPA) have had, and will have, a major bearing on revenue collection from customs. During 2005-06, for example, customs revenue foregone on account of various FTAs/CECAs/CEPAs is estimated at around Rs. 1,500 crore. With the signing of the FTAs/CECAs/CEPAs currently being negotiated and the higher growth in value of imports from these partner countries with special agreements, the buoyancy in customs duty collection is likely to get further reduced during the Eleventh Plan period.

Revenue loss on account of various customs duty exemptions provided in Budget 2006-07 and thereafter was estimated at about Rs. 3,800 crore. Based on the projected investment lined up for about 70 SEZs initially approved by the Board of Approval, customs revenue loss on account of development of such SEZs alone was estimated at Rs. 29,700 crore during 2006-07 to 2009-10. Board of Approval has subsequently granted approval for more than 405 SEZs so far, and reportedly a number of applications are under consideration for approval. Therefore, customs revenue loss on account of development of SEZs alone could be many times more than the projected revenue loss. Furthermore, there is apprehension of revenue loss due to potential diversion of goods meant for use in SEZs. Duty differentials will provide incentives for diversion and leakage of revenue, particularly with a large number of SEZs around. There is also the possibility of a major loss of both customs and central excise duty from petroleum products under the impact of the SEZ policies.

Table 14 : Customs Revenue (in rupee crore, unless otherwise stated)

	2005-06	2006-07 (RE)	2007-08(BE)	2008-09	2009-2010	2010-11	2011-12
Growth of GDP at factor cost at current prices in per cent	13.8	14.4	13.0	13.0	13.0	13.0	13.5
GDP at factor cost at current prices	3,250,932	3,717,465	4,200,220	4,745,381	5,360,938	6,055,895	6,871,619
Non-POL import as a percent of GDP	14.33	15.10	16.5	17.0	17.5	18.0	18.5
Non-POL imports	465,759	561,456	693,036	806,715	938,164	1,090,061	1,271,249
Customs collection rate for non-POL imports, in per cent		12.5	12.4	11.4	10.4	9.4	8.4
Customs revenue from non-POL		70,300	86,120	92,179	97,817	102,754	107,122
Customs collection rate for POL imports, in per cent		6.0	6.0	5.5	5.0	4.5	4.0
Customs revenue from POL		11,500	12,650	12,176	11,622	10,983	10,251
Projected Customs Revenues	-	81,800	98,770	104,355	109,440	113,737	117,372
Customs revenue-GDP at factor cost ratio in per cent		2.20	2.35	2.20	2.04	1.88	1.71

Thus, collection rate for non-petroleum (non-POL) products, which works out to 12.5 per cent for 2006-07 (RE), has been assumed to be 12.4 per cent for 2007-08(BE), and thereafter lower by 1 percentage point from the previous year until the end of the Eleventh Pan period. The projection of customs revenue during the Eleventh Plan (Table 14) shows that customs revenue, increases gradually from Rs. 81,800 crore in 2006-07 (RE) to Rs. 98,770 crore in 2007-08 (BE), and further to Rs. 117,372 crore in 2011-12, the last year of the Eleventh Plan. As a proportion of GDP at factor cost at current prices, however, such revenues decline from 2.35 per cent in 2007-08 (BE) to 1.71 per cent in 2011-12. The evolution of the actual outcome vis-à-vis the projection will depend on the speed of implementation, content and extent of duty relief under the FTAs and SEZs.

ii Revenues from excise duty

Performance of revenues from excise duty has been quite disappointing in the last few years. For example, the growth of such revenues declined steadily from 13.4 per cent in 2002-03 to 10.3 per cent and 9.2 per cent in the two subsequent years, before reviving somewhat to 12.8 per cent in 2005-06 and then decelerating again to 5.4 per cent in 2006-07 (RE). Among others, three factors, which have had – and continue to have – a major bearing on excise duty collection, are: area-based excise duty exemptions, small-scale industries' (SSI) excise duty exemption scheme, and SEZs.

Area based excise exemptions, which started with the North East Region in 1999, were extended to Kutch in Gujarat in 2001, Jammu & Kashmir in 2002 and to Sikkim, Uttaranchal and Himachal Pradesh in 2003. Exemption is generally available both to new units and existing units which undertake substantial expansion in the designated areas. Estimated revenue foregone on account of these exemptions during 2003-04, 2004-05 and 2005-06 was about Rs.1,400 crore, Rs. 2,700 crore and Rs. 6,200 crore, respectively. Area-based exemptions have resulted in large scale migration of units from non-exempt areas to exempt areas, and revenue loss is likely to increase during the Eleventh Plan with more and more units being setup in such exempted areas.

SSIs having annual turnover less than Rs. 4 crore enjoy full exemption from excise duty on clearances up to Rs. 1 crore in a financial year. There are about 40 lakh SSI units in the country, which constitute about 95 per cent of the industrial units in the country. As per Ministry of SSI, total production of SSIs during 2004-05 was Rs. 4,18,263 crore, with exports of about Rs. 1,24,416 crore. SSI sector, with about 13.5 per cent share of GDP, contributed only 2.5 per cent of total excise revenue in 2004-05. Excise revenues from SSI at about 0.08 per cent of GDP signified an effective collection rate of a little over 3 per cent. According to National Institute of Public Finance and Policy (NIPFP) research paper, estimated revenue foregone on account of SSI exemption during 2004-05 was about Rs. 11,300 crore.

As per the Tax Expenditure Statement laid by the Government before the Parliament, the revenue forgone due to various excise duty exemptions during 2004-05 was estimated at Rs. 18,000 crore. During 2005-06, 36 excise exemption notifications (including exemptions issued as part of 2005-06 Budget) have been issued involving a revenue loss of about Rs. 2,600 crore.

Excise duties for a large number of commodities have been made specific. In 2006-07 (RE), of the total excise duty collection of Rs 117,266 crore, as much as Rs 70,970 crore came from the duties that were specific in nature. In view of such a high proportion of excise revenues being generated through specific duties, forecast for excise revenue has been made separately for the specific and advaloram component. For the advaloram component, it was considered appropriate to follow the historic buoyancy method for projecting excise revenues. Data on advalorem component of excise revenue (EXC) and GDP at factor cost (GDPFC) for the years 2001-02 to 2007-08 yielded the following buoyancy equation :

$$\text{Log EXCt} = 0.163+0.8334\text{Log GDPFCt}$$
$$R^2 = 0.982 \qquad \ldots\ldots(15)$$

For the specific component of excise duty, it was projected to increase at the rate at which GDP (at constant prices) was assumed to grow. The projection of excise revenue using a buoyancy of 0.8334 during the Eleventh Plan (Table 15) for the advaloram component and GDP growth rate at constant prices for the specific component shows that excise revenue increases gradually from Rs. 130,220 crore in 2007-08 (BE) to Rs. 193,352 crore in the last year of the Eleventh Plan. As a proportion of GDP at factor cost at current prices, however, such revenues marginally decline from 3.10 per cent in 2007-08 (BE)to 2.81 per cent in 2011-12.

Table 15. Excise Revenue (In rupees crore, unless otherwise stated)

	2005-06	2006-07 (RE)	2007-08 (BE)	2008-09	2009-2010	2010-11	2011-12
Growth of GDP at factor cost at current prices in per cent	13.8	14.4	13.0	13.0	13.0	13.0	13.5
GDP at factor cost at current prices	3,250,932	3,717,465	4,200,220	4,745,381	5,360,938	6,055,895	6,871,619
Projected excise revenues	111,226	117,266	130,220	145,129	159,296	175,035	193,352
Advaloram Component		46,296	52,088	60,043	66,467	73,574	81,744
Specific Component		70,970	78,132	85,086	92,829	101,462	111,608
Excise revenue-GDP at factor cost ratio in per cent	3.42	3.15	3.10	3.06	2.97	2.89	2.81

iii Revenues from service tax

For projecting service tax, the most buoyant source of revenue, in view of the major changes since its introduction in 1994-95, historical buoyancy was not considered to be a reliable method to follow. The 2007-08 (BE) figures were taken as the base and though the scope for further expansion of base and rate is limited, given the room for improvement in the level of compliance and probable loss because of SEZ development, it was assumed that service tax collection will grow by 25 per cent in the four years of the Eleventh Five Year Plan, beginning from 2008-09.

Table 16. Service Tax Revenue (In rupees crore, unless otherwise stated)

	2005-06	2006-07 (RE)	2007-08(BE)	2008-09	2009-10	2010-11	2011-12
Growth of GDP at factor cost at current prices in per cent	13.8	14.4	13.0	13.0	13.0	13.0	13.5
GDP at factor cost at current prices	3,250,932	3,717,465	4,200,220	4,745,381	5,360,938	6,055,895	6,871,619
Growth of service tax revenue	62.36	65.56	40.00	25.00	25.00	25.00	25.00
Projected Service Tax Revenues	23,055	38,169	50,200	62,750	78,438	98,047	122,559
Service tax revenue-GDP at factor cost ratio in per cent	0.71	1.03	1.20	1.32	1.46	1.62	1.78

Service tax revenues, according to the projections (Table 16), increase more than three-fold from Rs. 38,169 crore in 2006-07 (RE) to Rs. 122,559 crore in 2011-12. As a proportion of GDP, the increase is from a little over 1 per cent of GDP in 2006-07 (RE) to 1.78 per cent in 2011-12.

As on April 4, 2007, Ministry of Commerce had notified 63 SEZs under the SEZ Act, 2005 while formal approval has been granted for 234 SEZs and in-principle approval has been granted for 171 SEZs. The total area covered by the notified SEZs is 67 square kilometers, while area covered by the formally approved SEZs would be 350 square kilometers, which is small in comparison to the area covered under domestic tariff area (DTA) units. Exports from SEZs is expected to cross Rs 100,000 crore in 2008-09. The units in SEZs will be exempt from customs duties, income and corporate tax, and service tax . The movement of goods to DTA areas will be on payment of applicable rates of duty. The loss of revenue for 2005-2010 from indirect taxes, viz, customs duties, excise duties and service tax assessed, based on investment lined up for 70 SEZs, was estimated at Rs 29,700 crore, Rs 10,368 crore and Rs 8,813 crore, respectively. Loss of revenue from SEZs for the four years of the Eleventh Five Year Plan have been assumed at 5 per cent for customs revenue and 2 per cent each for excise duties and service taxes, based on the investment of 70 SEZs.

IV.5 Total tax revenue

Combining the direct and indirect tax revenue projections, the forecast for total tax revenue for the Centre (Table 17) indicates that such revenues more than double from Rs. 466,507 crore in 2006-07 (RE) to Rs. 1056,149 crore in 2011-12, the last year of the Eleventh Plan. As a proportion of GDP, the increase is from 11.4 per cent to 13.9 per cent in 2011-12, an increase of 2.5 percentage points. One interesting dimension of the projections is that, for the first time in history, direct tax collections of the Centre is likely to exceed the collections under indirect taxes from 2008-2009.

Table 17: Tax Revenue (in rupees crore)

	2006-07 (BE)	2007-08	2008-09	2009-2010	2010-11	2011-12
GDP at market prices	4,100,636	4,633,719	5,235,145	5,914,233	6,680,915	7,580,829
Direct tax	229,272	267,490	318,274	397,270	495,604	635,053
Corporate tax	146,497	168,401	196,176	246,838	310,285	405,076
Personal Income Tax (including STT, FBT, BCTT and WT)	82,775	99,089	122,097	150,432	185,319	229,977
Indirect tax	**237,235**	**279,190**	**302,858**	**336,946**	**375,671**	**421,096**
Customs	81,800	98,770	104,355	109,440	113,737	117,372
Excise	117,266	130,220	145,129	159,296	175,035	193,352
Service tax	38,169	50,200	62,750	78,438	98,047	122,559
Loss of revenue on account of SEZs in indirect tax			9,375	10,227	11,149	12,187
Total tax	**466,507**	**546,680**	**621,132**	**734,216**	**871,275**	**1056,149**
Tax as proportion of GDP	11.4	11.8	11.9	12.4	13.0	13.9

IV.6 Non-tax revenue (NTR)

Non-tax revenues can be broadly categorized into four broad groups, namely, (i) interest; (ii) dividends from CPSUs and surplus transfer from RBI; (iii) non-tax receipts of UTs and grants-in-aid; and (iv) other non-tax revenues. Given the heterogeneous nature of these receipts, and the volatility in these receipts arising from sectoral or other policy changes, the projections could not be made mechanically on the basis of past trends alone.

i Interest receipts

Interest receipts declined rapidly during the Tenth Plan period (Table 18) because of the impact of two factors: (i) the debt-swap scheme wherein the prepayment of high cost loans of 13 per cent and above was enabled through lower coupon small savings transfer and additional market borrowings, and (ii) the TFC award which resulted in dis-intermediation of Central Government from loan assistance to States for financing their plan except for loans under externally aided projects, as also the consolidation and rescheduling of outstanding loans at lower rates of interest to eligible States.

Table 18. Interest Receipts during the Tenth Plan (In rupees crore)

	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)
Interest receipts	37,622	38,538	32,387	22,032	20,131	19,308
Of which						
From States and UTs	29,600	28,641	22,988	NA	12,237	11,616
Interest dividends from Railways	2,689	3,361	3,084	NA	4,242	4,573

Further decline in interest receipts, in the future, are anticipated as more and more states become eligible for debt consolidation and interest rate concessions together with the declining stock of debt resulting from the closure of the lending window for states from the Centre with effect from 2005-06 as per the TFC-award.

The projections for interest receipts (Table 19) have been derived on the basis of the following four assumptions: (i) implicit interest rate on total state and UT debt owed to the centre is taken as 8.0 per cent (the implicit rate of interest for 2007-08 (BE) works out to 8.0 per cent); (ii) there will be further decline in interest receipts with States becoming eligible for debt consolidation, rescheduling repayments and average annual reduction in debt stock assumed at Rs 7,000 crore in the next four years beginning 2008-09 ; (iii) interest receipts from Railways is expected to increase by 9.88 per cent annually (average growth was 10 per cent in the last four years); and (iv) other interest receipts (which comprise of such receipts from organizations such as port trusts, public sector undertakings (PSUs) and other statutory bodies) will decline by 9.41 per cent per annum (annual average decline during the Tenth Plan was around 9 per cent).

Table 19. Interest Receipts during the Eleventh Plan (In rupees crore)

	2006-07 (RE)	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
Interest receipts	20,131	19,308	18,864	18,535	18,279	18,100
Of which						
From States and UTs	12,237	11,616	11,014	10,454	9,894	9,334
Interest dividends from Railways	4,242	4,573	5,025	5,521	6,067	6,666
Other	3,652	3,119	2,826	2,560	2,319	2,101

The annual interest receivable by the Centre from States and UTs , over the Eleventh Plan period, are projected to decline by around Rs 2,900 crore. The interest receipts from Railways projected to increase from Rs. 4,242 crore in 2006-07(RE) to Rs. 6,666 crore in 2011-12, are not adequate to offset the decline in interest receipts from States and UTs and from other sources like PSUs, Port Trusts and other Statutory bodies. Consequently, the overall interest receipts are projected to decline from a level of Rs. 20,131 crore in 2006-07 (RE) to Rs. 18,100 crore in 2011-12.

ii Dividends from CPSUs and surplus transfer from RBI

Overall dividend receipts of the Central Government comprising dividends from CPSUs, public sector banks and financial institutions, and transfer of surplus from RBI showed an increasing trend during the Tenth Plan period (Table 20). In spite of a decline in transfers from the RBI, such receipts overall increased because of the healthy increase in dividends from public sector banks and financial institutions, reflecting the buoyancy in the economy. Compound average annual rate of growth in dividend receipts from CPSUs (excluding the surplus transferred by the RBI) during 2002-03 to 2006-07 (RE) was 21.8 per cent.

Table 20. Trends in Dividend and Profits during the Tenth Plan (In rupees crore)

	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)
Dividends and profits	21,230	21,160	22,939	25,451	30,438
Of which: transfers from RBI	10,320	8,834	5,400	5,400	6,400

To estimate the likely growth in dividend receipts, the views of the administrative ministries were sought. This was considered important to take into account the likely evolution of output and input prices and the expansion plans and hence retained earning decisions of the relevant organizations. On the basis of current prices, estimated output, sales and profit after tax, the Petroleum Ministry has projected that receipts from the PSUs under its administrative control will marginally decline. In the telecom sector, it is assumed that the dividend from Bharat Sanchar Nigam Limited (BSNL) currently payable at 10 per cent of equity capital and 9 per cent of preference share capital would continue. Projections by Ministry of Power show that the payout by the power sector PSUs is anticipated to grow at an average rate of 11 per cent during the Eleventh Plan period. The Ministry of Steel has projected that the payout by the PSUs under it will grow at an average annual rate of 20 per cent during the Eleventh Plan.

Taking into consideration all the projections given by the major administrative Ministries and Departments, the Group has assumed 8 per cent annual growth in the dividend receipts from CPSUs in the next four years beginning 2008-09. Together with the surplus transferred from RBI, overall dividend receipts are projected to increase to Rs 43,951 crore in 2011-12 compared to Rs 33,925 crore in 2007-08(BE). (Table 21)

Table 21. Dividend and Profits during the Eleventh Plan (In rupees crore)

	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
Dividends and profits	33,925	36,539	38,822	41,288	43,951

iii Non-tax receipts of UTs and grants-in-aid

Non-tax receipts of UTs

Non-tax revenue receipts of UTs without legislature, which from Rs. 558 crore in 2002-03 had grown to Rs. 791 crore in 2005-06 with sustained growth during 2004-05 and 2005-06, declined in next two years. The Group, however, has estimated an average annual growth of 10 per cent in such receipts in the next four years. Thus, such revenues are expected to grow from Rs. 711 crore in 2007-08 (BE) to Rs. 1,041 crore in 2011-12, the last year of the Eleventh Plan (Table 22).

Table 22. Non-tax Receipts of UTs without Legislature (In rupees crore)

						Projections				
	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
Non-tax receipts of UTs without legislature	558	645	755	791	724	711	782	860	946	1,041

Grants-in-aid

Receipts from grants-in-aid followed a similar pattern as the non-tax receipts of the UTs without legislature, increasing up to 2005-06 and declining in the next two years thereafter. The average annual growth in four years from 2002-03 to 2006-07 (RE), however, has been 8.48 per cent. Group has assumed an annual growth of 8 per cent in the next four years beginning 2008-09 (Table 23).

Table 23. Grants-in-aid receipts (In rupees crore)

						Projections				
	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08(BE)	2008-09	2009-10	2010-11	2011-12
Grants-in-aid	1,868	2,159	2,562	3,023	2,469	2,135	2,306	2,490	2,689	2,905

iv Other non-tax receipts

The 'other' non-tax receipts can be grouped in four sub-categories of fiscal services, other general services, social services, and economic services. The receipts of commercial departments and entities such as Posts, Canteen Stores Department, Opium & Alkaloid factories, Heavy Water Pool Management, and Delhi Milk Scheme, have not been discussed since, in the Budget, the receipts of these organizations is netted from the expenditure on these and shown only as net expenditure.

While projecting the revenue stream under 'other non tax revenues', future policy decisions having a bearing on such receipts are difficult to predict, and therefore to factor in. On the other hand, because of the presence of one-off receipts during the Tenth Plan period (Table 24), trend growth rates from the recent past are also inappropriate for prediction purposes.

For the Eleventh Plan period, revenues from fiscal services, general services, and social services have been projected on the basis of an assumed 10 per cent growth per year. For economic services, projections received from the Department of Telecommunication and

Ministry of Petroleum and Natural Gas have been used and the residual ‘other receipts’ under economic services have been projected on the same basis of an assumed 10 per cent annual growth as under fiscal, general and social services. (Revenue during 2007-08 has been taken as per the budget estimates.) The projections show receipts under ‘other non tax revenues’ during the Eleventh Plan increasing from Rs. 23,598 crore in 2006-07 (RE) to Rs. 37,279 crore in 2011-12.

Table 24. Other Non-tax Revenue (In rupees crore)

						Projections				
	2002-03	**2003-04**	**2004-05**	**2005-06**	**2006-07 (RE)**	**2007-08 (BE)**	**2008-09**	**2009--10**	**2010-11**	**2011-12**
Fiscal services	274	335	290	861	252	522	574	632	695	764
Other general services	3,508	1,804	4,330	4,706	5,502	5,309	5,840	6,424	7,066	7,773
Social services	424	449	451	1,615	495	500	550	605	666	732
Economic services	6,806	11,741	17,479	18,719	17,349	20,140	21,951	23,574	24,974	8,010
Total	11,012	14,329	22,550	25,901	23,598	26,471	28,915	31,235	33,401	37,279

v Total non-tax revenue

Total non-tax revenue is projected to increase from Rs 82,550 crore in 2007-08 (BE) to Rs. 103,276 crore in 2011-12 (Table 23).

Table 25. Total Non-tax Revenue during the Eleventh Plan (In rupees crore)

	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
Interest receipts	19,308	18,864	18,535	18,279	18,100
Dividends and profits	33,925	36,539	38,822	41,288	43,951
Non-tax receipts of UTs without legislature	711	782	860	946	1,041
Grants-in-aid	2,135	2,306	2,490	2,689	2,905
Other non-tax revenues	26,471	28,915	31,235	33,401	37,279
Total	**82,550**	**87,406**	**91,942**	**96,604**	**103,276**

IV.7 Non-debt capital receipts (NDCR)

Non-debt capital receipts, comprising mainly of ‘recoveries of loans’ and ‘other receipts’, witnessed sharp fluctuations during the Tenth Plan period (Table 26). Recoveries of loans, after doubling almost from Rs 34,191 crore in 2002-03 to Rs. 67,165 crore in 2003-04 and remaining high at Rs. 62,043 crore in 2004-05, declined steeply thereafter. These sharp fluctuations were mainly on account of the impact of the debt-swap scheme. Disinvestment receipts also witnessed sharp swings – it peaked at Rs. 16,953 crore in 2003-04, only to fall rapidly to Rs 1,580 crore in 2005-06.

Taking into consideration the likely impact of TFC-award as regards debt consolidation and rescheduling, disintermediation by the Centre in respect of loans to States for plan financing, and debt waiver available to eligible States, recoveries of loans is projected to decline sharply from Rs. 10,645 crore in 2005-06 to Rs 1,500 in 2007-08 (BE). Group has taken the same figures for the next four years. In 2007-08(BE), Rs 41,651 crore expected as other non-debt capital receipts includes an amount of Rs 40,000 crore on account of transaction relating to transfer of RBI's stake in SBI to Government. No receipt is projected under this head in the next four years. Further, while recovery of loans has been assumed at Rs 7,000 crore annually, in non-debt capital receipt, under the head recovery of loans, an amount of Rs 1,500 crore only has been included, balance being the subventions as debt waiver (Table 26).

Table 26. Total Non-Debt Capital Receipts (In rupees crore)

						Projections				
	2002-03	**2003-04**	**2004-05**	**2005-06**	**2006-07 (RE)**	**2007-08 (BE)**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Recoveries of loans	34,191	67,165	62,043	10,645	5,450	1,500	1,500	1,500	1,500	1 ,500
Other receipts (disinvestment)	3,151	16,953	4,424	1,581	529	41,651	-	-	-	-
Total	37,342	84,118	66,467	12,226	5,979	43,151	1,500	1,500	1,500	1,500

V. CENTRE'S NON-PLAN EXPENDITURE DURING THE ELEVENTH PLAN

V.1 Components of Non-Plan Expenditure

The principle components of non-plan expenditure are: i) interest payments, ii) defence revenue expenditure, iii) subsidies (food, fertilizer, petroleum and others), iv) pay and allowances, v) pensions, vi) grants to States and Union Territories (UTs), vii) defence capital expenditure, viii) loans to States and UTs, and ix) other non-plan expenditures.

Table 27. Non-Plan Expenditure during the Tenth Plan (In rupees crore)

YEAR	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	Tenth Plan total
Non-Plan Expenditure (A+B)*	**288,012**	**302,712**	**331,710**	**365,485**	**408,907**	**1,696,826**
A. Revenue Expenditure	**267,144**	**283,436**	**296,835**	**327,903**	**362,183**	**1,537,501**
A.1 Interest Payments	117,804	124,088	126,934	132,630	146,192	**647,648**
A.2 Defence	40,709	43,203	43,862	48,211	51,542	**227,527**
A.3 Total Subsidies	43,533	44,323	45,957	47,520	53,463	**234,796**
i) Food Subsidy	24,176	25,181	25,798	23,077	24,204	**122,436**
ii) Fertiliser Subsidy	11,015	11,847	15,879	18,460	22,452	**79,653**
iii) Petroleum Subsidy	5,225	6,351	2,957	2,683	2,785	**20,001**
iv) Other Subsidy	3,117	944	1,323	3,300	4,022	**12,706**
A.4 Pay and Allowances	18,253	18,793	20,580	22,413	23,232	**103,271**
A.5 Pensions	14,496	15,905	18,300	20,255	22,225	**91,181**
A.6 Grants to States and UTs	13,305	13,720	14,784	30,475	36,152	**108,436**
A.6 Other Non Plan Revenue Expenditure	19,044	23,404	26,418	26,399	29,377	**124,642**
B. Capital Expenditure*	**20,868**	**19,276**	**34,875**	**37,582**	**46,724**	**159,325**
B.1 Defence capital	14,953	16,863	31,994	32,338	34,458	**130,606**
B.2 Loans to States and UTs	2,491	78	612	89	102	**3,372**
B.3 Other Non plan Capital Expenditure*	3,424	2,335	2,269	5,155	12,164	**25,347**

** Excludes expenditure during 2002-03 to 2004-05 on redemption of securities issued to National Small Savings Fund which was backed by receipts under the State Debt-Swap scheme implemented during this period.*

Broad assessment of non-plan expenditures during the Tenth Plan (Table 27) period shows that such expenditure increased by 42.0 per cent from Rs.288,012 crore in 2002-03 to Rs.408,907crore in 2006-07(RE), as compared to an increase of 51.0 per cent during the Ninth Plan period from Rs.172,976 crore in 1997-98 to Rs.261,116 crore in 2001-02. Of the total non-plan expenditure during the Tenth Plan period of Rs.1,696,826 crore, interest payments, defence and subsidies accounted for as much as 65.4 per cent.

V.2 Interest payments

The increase of 24.1 per cent in expenditure on interest payments during the Tenth Plan reflected the two contradictory influences of a 49.4 per cent increase in interest bearing liabilities of the Centre from Rs. 1,340,316 crore to Rs. 2,002,759 crore between 2002-03 and 2006-07 (RE), while the average interest cost declined by 149 basis points during the same period (Table 28). During the Eleventh Plan, in contrast, with the fiscal deficit declining in line with the FRBM requirements to 3.0 per cent of GDP from 2008-09 onwards, the interest bearing liabilities are projected to grow at a lower rate of 35.4 per cent, while the average interest rate hardens from 7.30 per cent in 2006-07 (RE) to 7.38 per cent in 2007-08 (BE), 7.60 per cent in 2008-09 and further to 7.80 per cent in each of the three subsequent years.

Table 28. Interest Payments of the Central Government (In rupees crore, unless stated otherwise)

	Tenth Plan					Eleventh Plan Projections				
	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
Interest expenditure	117,804	124,088	126,934	132,630	146,192	158,995	175,712	194,173	209,805	227,542
Interest bearing liabilities at year-end	1,340,316	1,457,908	1,617,876	1,790,834	2,002,759	2,154,963	2,311,998	2,489,403	2,689,806	2,917,203
Average interest cost in per cent	8.79	8.51	7.85	7.41	7.30	7.38	7.60	7.80	7.80	7.80
GDP at current market prices	2,458,084	2,765,491	3,126,596	3,567,177	4,100,636	4,633,150	5,234,502	5,913,507	6,680,095	7,579,899

In the projections, no distinction has been made between domestic debt and external debt to finance the deficit. The outstanding interest bearing liabilities at the end of March 2008 are as per the budget estimates. In the next four years, these are assumed to increase by 3 per cent of GDP, the maximum fiscal deficit permitted by FRBM Act, 2003.

V.3 Defence revenue expenditure

Defence revenue expenditure, which increased by 26.6 per cent during the Tenth Plan period from Rs. 40,709 crore in 2002-03 to Rs. 51,542 crore in 2006-07 (RE), consists of two components: i) non-salary items like transportation, stores, repairs & refits, renewals and replacements, research and development, and works, and ii) pay & allowances of the armed forces.

‘Non-salaries’ part of defence revenue expenditure grew at an average annual rate of 7.36 per cent during the Tenth Plan period. Such expenditure has been projected on the basis of an annual growth rate of 7.4 per cent. Expenditure on pay & allowances, on the other hand, have been projected to grow at the 5 per cent annual rate observed during the Tenth Plan subject to adjustments for the implementation of the Sixth Pay Commission award. Thus, defence revenue expenditure is projected to rise at an average annual growth rate of 7.2 per cent in the five years of the Eleventh Plan from Rs. 54,078 crore in 2007-08 (BE) to Rs. 71,760 crore in 2011-12 (Table 29).

Table 29. Non-Plan Expenditure during the Eleventh Plan (In rupees crore)

		2006-07(BE)	2007-08	2008-09	2009-2010	2010-11	2011-12
Total non-plan expenditure		**408,907**	**475,421**	**477,879**	**530,230**	**562,536**	**608,590**
Non-plan revenue expenditure		**362,183**	**383,545**	**419,135**	**464,855**	**489,752**	**527,523**
Interest payments		146,192	158,995	175,713	194,177	209,810	227,549
Defence revenue expenditure		51,542	54,078	57,529	65,927	67,461	71,760
Subsidies		53,463	54,330	61,038	65,416	65,722	70,400
Food		24,204	25,696	28,050	28,900	30,300	31,200
Fertilizers		22,452	22,451	26,805	30,333	29,239	33,017
Petroleum		2,785	2,840	2,840	2,840	2,840	2,840
Others		4,022	3,343	3,343	3,343	3,343	3,343
Pay and allowances		23,232	24,394	25,613	31,979	30,612	32,142
Pensions		22,225	24,448	26,892	29,581	32,540	35,794
Grants to States and UTs		36,152	38,403	41,283	44,379	47,708	51,286
Other non-plan revenue expenditure		29,377	28,898	31,065	33,395	35,900	38,592
Non-plan capital expenditure		**46,724**	**91,876**	**58,744**	**65,374**	**72,784**	**81,066**
Defence capital expenditure		34,458	41,922	47,099	52,916	59,451	66,794
Loans to States and UTs		102	95	800	800	800	800
Other non-plan capital expenditure		12,164	49,859	10,845	11,658	12,533	13,473

V.4 Subsidies

During the Tenth Plan, expenditure on subsidies increased by 22.8 per cent from Rs. 43,533 crore in 2002-03 to Rs. 53,463 crore in 2006-07 (RE). The main factor behind the increase was fertilizer subsidy, which more than doubled While food subsidy remained stable and other subsidies increased by 29.0 per cent, petroleum subsidies went down in nominal terms. The decline in petroleum subsidies, however, do not reflect the quasi-fiscal subsidization through the off-budgetary oil bonds and contributions by oil PSUs.

Subsidy rationalization, including targeting of the poor, has been an announced policy objective of the Government for over a decade. However, success in this area has been rather limited. For the Eleventh Plan period, the estimation of subsidies was done with the exchange rate at Rs. 45.00 per US dollar, and other assumptions as contained in Table 30.

Table 30. Assumptions underlying subsidy projections for the Eleventh Plan

Subsidy	Assumptions
Food	1. Advance subsidy payment changed from equated quarterly installments to two installments -- one at the beginning of the year and the other at the beginning of the second quarter for the rest of the year. 2. Increase in common issue price of Rs. 100 per quintal for Above Poverty Line (APL) families; no change in issue price for Below Poverty Line (BPL) families. 3. Allocations for APL reduced to the minimum of off-take on average in the last three years and in 2005-06; no change in allocations for BPL families.
Fertilizer	1. Average annual agricultural growth at an average of 3 per cent. 2. Maximum retail price (MRP) of urea and Muriate of Potash raised by 10 per cent in 2008-09. 3. The conversion of high-cost fertilizer units at an average price of US$5/MMBTU for natural gas and liquefied natural gas. 4. Conversion to gas as feedstock takes place by 2009-10. 5. Raw material and intermediate cost to phosphatic industry increases by 2 per cent per annum in real terms. 6. World potash prices increase by 2 per cent per annum in real terms.
Petroleum	1. Petroleum subsidy on account of domestic liquefied petroleum gas (LPG) and public distribution system (PDS) kerosene alone. Such subsidy will continue beyond March 31, 2008 at the current level of Rs.2,840 crore per annum. 2. Under recoveries on petroleum items not part of subsidy regime.
Other subsidies	1. At the level as in 2007-08 budget.

Subsidies in the first year of the Eleventh Five Year Plan have been taken as per 2007-08(BE). However, in the second year of the plan, i.e., 2008-09, subsidies increase sharply (Table 29) by Rs. 6,708 crore, mainly on account of burgeoning fertilizer subsidy. Fertilizer subsidy declines in 2010-11 as it is assumed that conversion to gas as feedstock gets completed by 2009-10. While as a proportion of GDP at current market prices, total subsidies decline from 1.17 per cent in 2007-08 (BE) to 0.93 per cent in 2011-12, the figures, however, indicate that the subsidy estimates in the Approach Paper may be slightly understated, even when major element of "under recovery" on petroleum products is discounted.

V.5 Pay and allowances

Pay and allowances grew by 27.3 per cent during the Tenth plan period from Rs. 18,253 crore in 2002-03 to Rs.23,232 crore in 2006-07 (RE). For the year 2006-07 (BE), the expenditure on pay and allowances for civilian employees (excluding Railways) consist of

Rs. 11,300 crore on pay and Rs.11,932 crore towards dearness pay and allowances. The expenditure on pay and allowances has, by and large, not deviated substantially from the budget estimate in the last 2-3 years. While following the past trends, pay and allowances may be estimated to grow annually at 5.0 per cent, the expected Sixth Central Pay Commission award introduces a big element of uncertainty.

Under the heroic assumption that fixation benefit of 20 per cent and no change in allowances will be awarded by the Sixth Central Pay Commission, Rs. 2,260 crore may need to be made annually for increase in salaries on account of this fixation benefit. Including arrears from January 1, 2008, pay & allowances in 2009-10 may be expected to jump to Rs. 31,979 crore and then grow thereafter at 5 per cent per year again (Table 29) to Rs. 32,142 crore in 2011-12.

V.6 Pensions

Pensions grew by 53.3 per cent from Rs. 14,496 crore in 2002-03 to Rs. 22,225 crore in 2006-07 (RE). This growth of pension was higher than the corresponding growth in pay and allowances because of increased longevity and higher number of retirees. While it is likely that pensions will surpass pay and allowances by 2008-09 (except in 2009-10, because of payment of arrears on pay & allowances), it is important to note that while pay and allowances relate only to civilian employees, pensions include Government employees of both civil and defence organizations.

The recommendations of the Fifth Central Pay Commission had liberalized the pension by bringing full parity between pre- and post-1.1.1996 pensioners and a modified parity between pre- and post-1.1.1986 pensioners. This created a substantial burden in the form of payment of higher pensions. This time around, the impact on account of pension may not be so high as these have already been liberalized considerably and no further scope to liberalize exists. The Terms of Reference of the Sixth Central Pay Commission reflects this limited scope for increase.

From Rs. 24,448 crore budgeted in 2007-08, pensions have been projected to grow at 10 per cent per year during the Eleventh Plan to reach Rs. 35,794 crore in 2011-12 (Table 29).

V.7 Grants to States and UTs

From Rs. 38,403 crore budgeted in 2007-08, grants to States and UTs have been projected to grow at an annual rate of 7.5 per cent during the Eleventh Plan to reach Rs. 51,286 crore in 2011-12 (Table 29).

V.8 Defence capital expenditure

Defence capital expenditure during the Tenth Plan period grew by 130 per cent from Rs. 14,953 crore in 2002-03 to Rs. 34,458 crore in 2006-07 (RE). An annual growth rate of 12.35 per cent has been assumed for defence capital expenditure for the Eleventh Plan, and such expenditure increase to Rs. 66,794 crore in 2011-12 (Table 29)

V.9 Loans to States and UTs

Total loans to States and UTs for the Eleventh Plan period have been estimated at Rs. 800 crore annually from 2008-09 onwards. For 2007-08, the same figures as provided for in the Budget have been taken. (Table 29).

V.10 Other non-plan expenditure

The residual category of 'Other Non-Plan Expenditure' covers items such as non-salary establishment and maintenance expenditure, expenditure on supplies & materials, machinery & equipment related to internal security, Border Roads and Coast Guard organizations, maintenance of national highways, grants to autonomous bodies for salary and establishment expenditure, transfers to Universal Service Obligation Fund (USOF) for Telecom, working capital and other non-plan loans to PSUs, loans and grants to foreign governments and budgetary support to financial institutions. From the base figures for 2007-08 the same as those provided in the Budget (with other non-plan capital expenditure adjusted for the one-off Rs. 40,000 crore related to the transfer of RBI's shares in the SBI), such expenditure, both on the revenue and capital account, have been assumed to grow at an annual 7.5 per cent rate during the subsequent four years of the Eleventh Plan (Table 29).

V.11 Total non-plan expenditure

Total non-plan expenditure is projected to increase from Rs. 408,907 crore in 2006-07(RE) to Rs. 475,421 crore in 2007-08 (BE) and with an annual average growth of 6.4 per cent in the next four years to Rs. 608,590 crore in 2011-12. Other capital expenditure under non-plan decline sharply in 2008-09 because of one-off increase in such outlays in 2007-08(BE) on account of the transfer of RBI's stake in SBI to the Government. Adjusted for this one-off increase, other capital expenditure is projected to increase at 10 per cent per annum from 2008-09 onwards. Total non-plan expenditure, as a proportion of GDP, gradually declines from 10.3 per cent in 2007-08 (BE) to 8.0 per cent in 2011-12.

VI. PROJECTIONS OF CENTRE'S FINANCIAL RESOURCES FOR THE ELEVENTH PLAN

Combining the projections from Chapters IV and V, the feasible GBS for the Eleventh Plan is found to increase from Rs 205,100 crore in 2007-08(BE) to Rs 506,873 crore in 2011-12 (Table 31). Relative to GDP, the increase is expected to be from 4.43 per cent of GDP in 2007-08 (BE) to 6.69 per cent of GDP in 2011-12.

Table 31. Gross Budgetary Support during Eleventh Plan (In rupees crore)

			2006-07 (RE)	2007-08 (BE)	2008-09	2009-10	2010-11	2011-12
1	a+b	**Current Revenue (CR)**	**423,331**	**486,422**	**548,049**	**636,452**	**742,759**	**886,538**
	a	Tax Revenue (Net to Centre)(TR)	345,971	403,872	460,644	544,510	646,155	783,262
	b	Non-Tax Revenue(NTR)	77,360	82,550	87,406	91,942	96,604	103,276
2	c+d	**Non Debt Capital Receipts(NDCR)**	**5,979**	**43,151**	**1,500**	**1,500**	**1,500**	**1,500**
	c	Recoveries of Loans (RoL)	5,450	1,500	**1,500**	**1,500**	**1,500**	**1,500**
	d	Other Receipts	529	41,651	0	0	0	0
3		**Borrowings and other liabilities (BOL)**	**152,327**	**150,948**	**157,054**	**177,427**	**200,427**	**227,425**
4	e+f	**Non-Plan Expenditure (NPE)**	**408,907**	**475,421**	**477,879**	**530,230**	**562,536**	**608,590**
5	e	Non-Plan Revenue Expenditure(NPRE)	362,183	383,545	419,135	464,855	489,752	527,523
6	f	Non-Plan Capital Expenditure(NPCE)	46,724	91,876	58,744	65,374	72,784	81,066
7	1- 5	**Balance from Current Revenue(BCR)**	**61,148**	**102,877**	**128,915**	**171,596**	**253,007**	**359,014**
8	1+2+3	**Aggregate Resources (AR)**	**581,637**	**680,521**	**706,604**	**815,378**	**944,686**	**111,5463**
9	7-6+2+3 = 8-4	**Gross Budgetary Support(GBS)**	**172,730**	**205,100**	**228,725**	**285,149**	**382,150**	**506,873**

The projections of Centre's financial resources given above are conditional on a set of assumptions incorporating the current buoyant economic trend and optimistic outlook on revenues. According to the Group, risks on the downside exist, but are limited. Materialization of such risk will require paring down of GBS for the Government to remain compliant with FRBMA, 2003 targets. The Group, however, believes that the current phase of buoyancy is likely to persist in the medium to long term. Barring short term fluctuation, which will need to be handled as they arise, long term growth projections may not be under much of a downward pressure. On the other hand, in case the economy over-performs relative to the projections, what the Group recommends is activation of 'Plan B' mentioned by the Finance Minister in his 2007-08 Budget speech. In such a happy situation, there will be scope for topping up GBS with additional funds. But, it is safer to be cautious and stick with the current projections until such a happy situation arises.

Annex – I

Composition and Terms of Reference of the Working Group on the assessment of the Centre's Financial Resources

Composition of the Working Group

1.	Chief Economic Adviser (Dr. Ashok Lahiri), M/o Finance	Chairman
2.	Adviser to Finance Minister	Member
3.	Pr. Adviser (PPD), Planning Commission	Member
4.	Chairman, CBDT, M/o Finance	Member
5.	Chairman, CBEC, M/o Finance	Member
6.	Financial Commissioner, M/o Railways	Member
7.	CGA, M/o Finance	Member
8.	Joint Secretary (PF-II), M/o Finance	Member
9.	Joint Secretary (Budget), M/o Finance	Member
10.	Joint Secretary, D/o Public Enterprises	Member
11.	Joint Secretary & FA, M/o Petroleum & Natural Gas	Member
12.	Joint Secretary & FA, M/o Power	Member
13.	Joint Secretary (Pers), Deptt. of Expenditure, M/o Finance	Member
14.	Officer on Special Duty (P&C), M/o Finance	Member
15.	Adviser, Department of Economic Affairs, M/o Finance	Member
16.	Joint Secretary (TPL), Deptt. of Revenue, M/o Finance	Member
17.	DDG, D/o Telecommunication	Member
18.	Adviser (FR), Planning Commission	Member
19.	Prof. Masood Ahmed Khan, Jamia Millia Islamia University	Member
20.	Dr. Shashank Bhide, NCAER	Member
21.	Dr. Indira Rajaraman, Senior Fellow, NIPFP	Member
22.	Dr. Tapas Kumar Sen, Senior Fellow, NIPFP	Member
23.	Executive Director (RBI)	Member
24.	Director (PPD), Planning Commission	Member
25.	Deputy Adviser (FR), Planning Commission	Member Secy.

Terms of reference of the Working Group is as follows:

(i) To analyse the resource position of the Centre in light of the implementation of the recommendations of the Twelfth Finance Commission, fiscal responsibility legislation, tax on services, and other policy changes in that regard;

(ii) To examine the relevance of the Plan-Non-Plan distinction in the expenditure of the Central Government and to suggest changes, if required, in the definition of plan expenditure;

(iii) To examine the classification of expenditure in terms of 'Revenue' and 'Capital' especially in light of the requirements under the Fiscal Responsibility Act and its implication for plan programmes;

(iv) To examine whether, and to what extent, investment by PSUs (Central) financed through Internal and Extra-budgetary Resources (IEBR) should continue to form a part of the ‘Plan’.

(v) To examine the role of SPVs, PPP and other innovative methods of additional resource mobilisation by the Central Government, in financing Plan expenditure;

(vi) On the basis of the above, to suggest the basis for making projections for ‘resources’ and ‘expenditure’ for the Centre for the Eleventh Plan period;

(vii) To prepare and present projection(s) on the scheme of financing for the Eleventh Plan for the Centre (including UTs without legislature).

- -

Annex – II

Composition of Sub Groups and their TOR

Sub Group on	Composition of Sub Group	
Tax Revenues	Joint Secretary (TRU)	Convener
	Joint Secretary (TPL)	Member
	Joint Secretary(Budget)	Member
	Dr. Tapas Kumar Sen	Member
	Adviser(MCS)	Member
	Adviser (FR) , Planning Commission	Member
	Prof . Masood Ahmed Khan, Jamia Millia Islamia University	Member
Terms of Reference	▪ To analyse the gross and net tax revenues in the light of the implementation of the recommendations of the Twelfth Finance Commission, fiscal responsibility legislation, other policy changes in that regard. ▪ Suggest basis for making projections for resources for the centre for the Eleventh Plan ▪ To make projections for the resources for the Centre for the Eleventh Plan period.	
Non Tax Revenues	Joint Secretary (Budget)	Convener
	Executive Director RBI	Member
	Joint Secretary, (Infra)&IT Manager	Member
	Joint Secretary, Deptt. Of Public Enterprises	Member
	CCA(Finance)	Member
	Dr. Indira Rajaraman , Senior Fellow, NIPFP	Member
	Director(PPD),Planning Commission	Member
	Dr. Shashank Bhide, NCAER	Member
TOR	▪ To analyse the non –tax revenues of the Centre in the light of the implementation of the recommendations of the Twelfth Finance Commission, fiscal responsibility legislation, other policy changes in that regard. ▪ Suggest basis for making projections for resources for the centre for the Eleventh Plan ▪ To make projections for the resources for the Centre for the eleventh Plan period.	

Internal and Extra – budgetary Resources	Joint Secretary(PF-II)	Convener
	OSD(P&C)	Member
	Director (Budget)	Member
	Jt.CGA/ Dy CGA	Member
	FA(Petroleum)	Member
	FA(Power)	Member
	FA(Telecom)	Member
	Deputy Adviser,FR Div, Planning Commission	Member
Terms of Reference	▪ Examine resource mobilization through Internal and Extra – budgetary Resources of PSUs (Central) ▪ To analyse the expenditure position of the Centre in the light of the implementation of the recommendations of the Twelfth Finance Commission, fiscal responsibility legislation, other policy changes in that regard. ▪ Examine whether and to what extent investments by central PSUs financed through IEBR should continue to be part of the Plan ▪ Examine the role of SPVs, PPP, and other innovative methods of additional resource mobilization by Central Govt. in financing plan expenditure ▪ Suggest basis for making projections for expenditures for the centre for the Eleventh Plan ▪ To make projections for the expenditures for the Centre for the Eleventh Plan period.	
Non Plan Expenditures	Joint Secretary (Pers)	Convener
	OSD(P&C)	Member
	Director (Budget)	Member
	Director (Capital Markets)	Member
	Jt.CGA/ Dy CGA	Member
	AEA(BOP)	Member
	DIR(PF-II)	Member
	ABO, Budget Div.	Member
Terms of Reference	▪ To analyse the expenditure position of the Centre in the light of the implementation of the recommendations of the Twelfth Finance Commission, fiscal responsibility legislation, other policy changes in that regard. ▪ Suggest basis for making projections for expenditures for the Centre for the Eleventh Plan ▪ To make projections for the expenditures for the Centre for the eleventh Plan period.	