सत्यमेव जयते

GOVERNMENT OF INDIA

Medium-term Expenditure Framework Statement laid before Parliament as required under the Fiscal Responsibility and Budget Management Act, 2003

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PREFACE

Section 3 of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 requires the Government to place three Statements of fiscal policy viz., the Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-economic Framework Statement in both Houses of Parliament along with Annual Financial Statement and Demands for Grants. This section was amended to require the Government to lay a fourth statement viz., the Medium Term Expenditure Framework (MTEF) Statement in both Houses of Parliament, immediately following the session of the Parliament in which the budget has been presented.

The MTEF Statement set forth a three-year rolling target for the expenditure indicators with specification of underlying assumptions and risks involved. The MTEF is essentially a vertical expansion of the aggregates of the expenditure projections in the fiscal framework presented along with the Annual Financial Statement and Demands for Grants. The objecive of the MTEF is to provide closer integration between budget and the FRBM Statements. It provides medium term perspective to the fiscal management and furthers the Government's comitment towards fiscal consolidation.

MEDIUM-TERM EXPENDITURE FRAMEWORK

A. MEDIUM-TERM EXPENDITURE PROJECTIONS

(₹ crore)

	Revised Estimates 2014-15	Budget Estimates 2015-16	Projection for next two years 2016-17	2017-18
Revenue Expenditure				
1. Salary	91847	100619	116510	128161
2. Interest	411354	456145	496000	539000
3. Pension	81705	88521	102639	112933
4. Subsidy-				
a. Fertiliser	70967	72969	75000	80000
b. Food	122676	124419	132000	141000
c. Petroleum	60270	30000	32000	34000
5. Centralised provision for Grants to States	121121	112690	106646	106101
6. Defence	142256	155072	179876	197860
7. Postal Deficit	6378	6665	6665	6665
8. External Affairs	8531	9625	10779	11937
9. Home Affairs	15602	15827	17040	18432
10. Tax Administration	13833	18627	14540	4345
11. Finance	24793	30902	33094	35544
12. Education	59472	55916	60440	64616
13. Health	25228	26110	28951	30865
14. Social Welfare	30532	25142	27044	28913
15. Agriculture and Allied	24334	22206	24003	26293
16. Commerce and Industry	13755	14030	15146	16489
17. Urban Development	7586	13259	14700	16228
18. Rural Development	86145	79581	84413	89798
19. Development of North East	1640	2187	2406	2647
20. Planning and Statistics	5516	6064	6510	6967
21. Scientific Departments	8528	10827	11429	12261
22. Energy	7335	9256	9992	11421
23. Transport	17562	14314	15092	16263
24. IT and Telecom	4919	5627	6124	7153
25. UT	5655	6299	6889	7647
26. Others	19241	23148	24547	26075
Total-Revenue Expenditure	**1488780**	**1536047**	**1660475**	**1779614**
of which **Grants for Creation of Capital Assets**	**131898**	**110551**	**149634**	**316754**

(₹ crore)

	Revised Estimates 2014-15	Budget Estimates 2015-16	Projection for next two years 2016-17	2017-18
Capital Expenditure				
1. Defence	83161	98176	107016	117720
2. Home Affairs	5859	9349	9751	10288
3. Finance	11156	11136	12673	14821
4. Health	1050	934	1069	1221
5. Commerce and Industry	1154	1657	1947	2195
6. Urban Development	7547	10068	12125	14708
7. Planning and Statistics	527	375	382	390
8. Scientific Departments	2515	3615	4148	4520
9. Energy	7579	6107	6630	7273
10. Transport	52951	75873	79518	84369
11. IT and Telecom	915	2738	3255	3472
12. Loans to States	11900	12500	13125	13781
13. UT	1484	1946	2138	2348
14. Others	4580	6957	7190	7435
Total-Capital Expenditure	**192378**	**241430**	**260967**	**284541**
Total Expenditure	**1681158**	**1777477**	**1921442**	**2064155**

B. ASSUMPTIONS UNDERLYING THE MEDIUM-TERM EXPENDITURE PROJECTIONS:

Macroeconomic outcomes have improved significantly, primarily with the revival of economic growth and the subsidence of inflationary tendencies. The growth rate of Gross Domestic Product (GDP) at constant (2011-12) market prices increased from 5.1 per cent in 2012-13 to 6.9 per cent in 2013-14 and further to 7.3 per cent in 2014-15 (Provisional Estimates). The growth in Gross Value Added (GVA) at basic prices for agriculture & allied sectors, industry sector and services sector has been estimated at 0.2 per cent, 6.1 per cent and 10.2 per cent respectively in 2014-15, as compared to the corresponding rates of 3.7 per cent, 4.5 per cent and 9.1 per cent respectively in 2013-14.

There was a decline in the rate of gross domestic saving from 33.9 per cent of the GDP in 2011-12 to 31.8 per cent in 2012-13 and further to 30.6 per cent in 2013-14. With the public sector savings remaining more or less the same and the private corporate saving improving, it is the decline in household savings from 22.8 per cent of GDP in 2011-12 to 18.2 per cent in 2013-14 that caused the decline in the overall saving rate. Gross fixed capital formation as a percentage of GDP declined from 31.4 per cent in 2012-13 to 29.7 per cent in 2013-14 to 28.7 per cent in 2014-15. With Government's focus on improving household savings, fiscal consolidation and investment facilitation, saving-investment scenario is expected to improve considerably.

The decisive steps taken by the Government, coupled with decline in crude prices, benign global prices of tradables and tight monetary policy during 2014, helped in lowering inflation in 2014-15 with the average inflation as per Wholesale Price Index declining sharply to 2 per cent, as compared to an average of 6.0 per cent during 2013-14. The headline WPI inflation averaged (-) 2.4 per cent during April-June 2015. The inflation as per the Consumer Price

Index (Combined) declined from 9.5 per cent in 2013-14 to 6.0 per cent in 2014-15 and averaged 5.1 per cent during April-June 2015.

The Current Account Deficit (CAD) narrowed sharply to US$ 27.9 billion (1.3 per cent of GDP) in 2014-15 from US$ 32.4 billion (1.7 per cent of GDP) in the previous year. Net capital inflows increased to US$ 89.3 billion (4.4 per cent of GDP) in 2014-15 from US$ 47.9 billion (2.6 per cent of GDP) in 2013-14, owing largely to higher net inflows of FDI, portfolio investment and NRI deposits. Foreign exchange reserves stood at US$ 356.0 billion at end-June 2015 as compared to US$ 341.6 billion at end-March 2015.The annual average exchange rate of the rupee was 61.14 per US$ in 2014-15 as compared to 60.51 per US$ in 2013-14. The monthly average exchange rate of the Rupee stood at 63.86 per US$ in June 2015. The trade deficit (on customs basis) increased from US$ 135.8 billion in 2013-14 to US$ 138.0 billion in 2014-15. The trade deficit in June 2015 declined to US$ 10.8 billion from US$ 11.8 billion in June 2014.

As per the World Economic Outlook (July 2015 Update) of the International Monetary Fund (IMF), global growth is projected at 3.3 per cent in 2015, as compared to 3.4 per cent in 2014, with gradual pickup in advanced economies and slowdown in emerging market and developing economies. Global growth is projected to accelerate to 3.8 per cent in 2016. The short to medium term downward risks to growth, according to the IMF, include; increased volatility in financial market, disruptive asset price shifts, lower potential output growth in both advanced and emerging market economies and lower commodity prices.

Year 2014-15 witnessed some major policy reforms in the subsidy regime; the modified direct benefit transfer scheme has been launched; the new domestic gas pricing policy has been approved and diesel prices have been deregulated. Expenditure Management Commission has been constituted. EMC is mandated to review the major areas of Central Government expenditure and suggest ways for creating fiscal space to meet developmental expenditure needs, without compromising the commitment to fiscal discipline.

The positive indications emanating from the Government's commitment to reforms, favorable situation on account of oil prices and benign inflationary outlook etc. and Government measures for fiscal prudence and economy to rationalise expenditure provided an opportunity to improve the performance in 2014-15. As committed by Government there was a marked improvement in fiscal situation in 2014-15. As per provisional accounts released by Controller General of Accounts (CGA), the fiscal deficit and revenue deficit have been contained at 4.0 per cent of GDP and 2.8 per cent of GDP respectively against the budgeted target of 4.1 per cent of GDP and 2.9 per cent of GDP respectively in 2014-15.

14th Finance Commission (FFC) Award has been one of the themes of the budget 2015-16. Government had set in motion the institutional changes necessary for implementing co-operative federalism by way of replacing Planning Commission with National Institute for Transforming India (NITI), re-designing many of the centrally sponsored schemes etc. By providing a quantum jump in the States' share of taxes, FFC has enlarged the scope of development programme by sharing the onus between Centre and States.

As the first year of the 14th Finance Commission Award period, with higher devolution of taxes to States, Budget 2015-16 is presented with lower tax resources at the disposal of the Centre. Thus, the budget size contracted marginally as compared to B.E. 2014-15, though it marks an increase of 5.7 per cent over R.E. However, Government approach of progressively bringing down the deficit has been retained in the Budget 2015- 16 despite resource crunch following changes in the revenue sharing.

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 has been amended in 2015 and as mandated under this Act, the date of achieving fiscal deficit target of 3.0 per cent of GDP is now 31st March, 2018. It has been stated that, the additional fiscal space will go towards funding public investment. Continuing on the path of fiscal consolidation, the fiscal deficit target has been set at 3.9 per cent of GDP for 2015-16 and it is projected to reduce to 3.5 per cent and 3.0 per cent of GDP at the end of 2016-17 & 2017-18 respectively. Revenue targets have also been recalibrated. The date for achieving the target in respect of Revenue Deficit (R.D.) and Effective Revenue Deficit (E.R.D.) has been re-aligned with the target date for fiscal deficit i.e. 31st March, 2018. R.D. is estimated to 2.8 per cent of GDP in 2015-16 and it is projected to reduce to 2.4 per cent of GDP in 2016-17 and to 2.0 per cent of the GDP by the end of 2017-18. Similarly, E.R.D. is estimated at 2.0 per cent of GDP in 2015-16 and over the medium-term; it will be reduced to 1.5 per cent of GDP in 2016-17 and to 'zero' by the end of 2017-18.

In the process of achieving above mentioned fiscal targets it has been estimated that the total outstanding liabilities as Percentage of GDP will be reduced to 44.7 per cent and 42.8per cent of GDP in 2016-17 and 2017-18 respectively from 46.1 per cent of GDP in R.E. 2014-15. Further Gross Tax revenues as a percentage of GDP is expected to progressively rise to 10.5 per cent and 10.7 per cent of GDP in 2016-17 and 2017-18 respectively from 10.3 per cent of GDP estimated in Budget 2015-16.

The above mentioned fiscal targets have been informed in the Medium Term Fiscal Policy (MTFP) statement presented along with General Budget 2015-16 in the Parliament. Assessment of the fiscal position and consequent expenditure projection of the Government has to be made in this macroeconomic backdrop.

Increase from Tax to GDP ratio of 10.3 per cent to 10.7 per cent will require an average Y-o-Y growth of 14.6 per cent and an average tax buoyancy of about 1.2. In pre-crisis period, growth in gross tax revenue for 2006-07 and 2007-08 was about 29 per cent and 25 per cent respectively. These reforms were driven mainly by direct taxes, whose average annual growth rate during 2003-08 was about 29 per cent. The buoyancy of tax revenue with respect to GDP was nearly 1.5 during this period. Therefore, fiscal consolidation strategy of Government hinges on reclaiming high growth in gross tax revenues achieved in the past. This is also essential for creating space for financing programmes of Government.

Non-tax revenues of Centre mainly comprises interest and dividend receipts of the Government, receipts from services provided by Central Ministries and Departments like supply of Central Police Force to various agencies, issue of passport and visa, registration of companies, patent and license fees, royalty from off-shore oil fields, various receipts from telecom sector etc. Budget 2015-16 has been presented with non-tax revenues of 1.6 per cent of GDP. During projection period, ratio of Non-Tax revenue to GDP has been estimated to 1.5 per cent of GDP in 2016-17 and to 1.4 per cent in 2017-18.

In the Budget 2015-16, Non-debt capital receipts have been estimated at ₹ 80,253 crore. This include recoveries of loans of ₹ 10,753 crore and other receipts (including disinvestment receipts) of ₹ 69,500 crore. Over the projection period, an amount of ₹ 65,500 crore and ₹ 60,500 crore has been estimated during the year 2016-17 and 2017-18 respectively. With the resources outlined above and underlying assumptions, a projection for various items for expenditure over a medium term framework has been made.

1. REVENUE EXPENDITURE:

Major items of Revenue expenditure include:

(a) Salaries: -

An important requirement for projections of salaries is to adequately provide for the increase in Dearness Allowance and normal annual increments. However, the projection period falls under the award period of the VII Central Pay Commission (VII CPC). In view of this, a higher than normative growth over the outlay of 2015-16 (B.E.) has been provided for 2016-17; whereas, a normative growth has been provided in 2017-18 (second year of projection period). Salaries shown in the Medium term expenditure framework also includes "Grants-in-aid for salaries". It is pertinent to mention here that, award of VII CPC and its impact on Government finances poses a risk.

(b) Pensions: -

Expenditure on Pension payment includes both Defence and Civil pensions. In nominal terms a provision of ₹ 88,521 crore has been made in B.E. 2015-16 for Pensions. Like in salaries, higher than normative growth has been provided for the projection of outlay on Pensions during 2016-17.For the second year of the projection period (2017-18), a normative growth has been assumed. Award of VII CPC and its impact on Government finances poses a risk.

(c) Interest payment: -

One of the largest items of revenue expenditure is the Interest payment commitment of the Government. As per the Constitutional provisions this is a charged item of expenditure. Fiscal expansionary measures undertaken by Government post crisis have resulted in sharp increase in the Interest payment commitments. Due to accumulation in the debt stock of the Government, interest payments as a percentage of net tax revenue jumped from 38.9 per cent in 2007-08 to 46.7 per cent in 2009-10. In 2014-15, it has been declined to 44.8 per cent (provisional).

In B.E. 2015-16, interest payment is projected at 49.6 per cent of net tax to Centre, which is marked increase over the last year despite fiscal consolidation underway. The increase is again due to the shrinking revenue base of the centre following higher devolution recommended by FFC. In fact interest payments of the centre as a ratio of gross tax revenues show the secular trend of decline from 32.9 per cent in 2013-14 to 32.4 per cent (provisional) in 2014-15 and further reduction to 31.5 per cent in B.E. 2015-16. With the fiscal deficit coming down and easing of inflationary pressure, it is expected that interest rates would be falling in the years to come. It has been assumed that with Government deficit coming down in the medium term and softening of interest rate regime, commitment on this count as a percentage of tax revenues will decline further.

(d) Major Subsidies: -

As per provisional accounts released by CGA, in 2014-15, total expenditure on major subsidies was ₹ 2,50,691 crore which is about 2.0 per cent of GDP. For 2015-16, total subsidies have been budgeted at ₹ 2,43,811 crore in which outlay on major subsidies is ₹ 2,27,388 crore which is about 1.6 per cent of GDP. In order to achieve the fiscal targets of fiscal consolidation it is essential that government follows the policy of progressively reducing the expenditure on subsidy through subsidy reforms.

Government is committed to progressively pursuing subsidy reforms in a manner that will ensure efficient targeting of subsidies to the poor and needy, while also saving scarce financial resources for investment in infrastructure and pursuit of new development programmes announced by the Government.

Government has initiated measures for subsidy reforms. It is pertinent to mention that both petroleum and diesel are now fully decontrolled. The Government has launched a new universal Direct Benefit Transfer Scheme for LPG from 1st January, 2015 onwards. Government had notified the New Investment Policy (NIP) to encourage investments in urea sector leading to increase in indigenous capacities and reduction in import dependence. Government has also launched a dedicated scheme for end-to-end computerization of Public Distribution System throughout the country. Decentralised Procurement and distribution of food grains, end-to-end computerization, combined with universal Aadhaar coverage, improving the operational efficiency of the FCI are some of the measures that will set the stage for the next generation food subsidy reforms.

In view of above reform measures and the requirement of resources for pursuing other developmental programmes of the Government, it is expected that expenditure on major subsidies as a percentage of GDP will progressively reduce over the projection period. However; adequate provisions have been kept in 2016-17 & 2017-18 keeping in view Government commitments on this count.

(e) Defence Services: -

Defence expenditure on Revenue account mainly comprises of salary expenditure of armed forces and their operational expenses. In view of likely impact of the award of the VII CPC, higher than a normative growth over the base of ₹ 1.52 lakh crore (B.E. 2015-16) has been provided during first year (2016-17) of the projection period. During 2016-17, a normative growth has been assumed. Award of VII CPC and its impact on Government finances poses a risk.

(f) Other revenue expenditure: -

Projection for budgetary allocation in the medium term in respect of health and education, agriculture and allied activities, rural development, social welfare programmes, external affairs, home affairs, scientific department, commerce and industry, tax administration etc. has been done keeping in view the availability of resources and financing requirement for various programmes of Government in line with various decisions and commitments. In B.E. 2015-16 a provision of ₹ 6,665 crore has been made for Postal deficit. In the medium term it has been kept at the same level. Centralised provisions for Grants to States mainly include Grants under Article 275 (1) of the Constitution as recommended by Finance Commission. Additional Provision has also been kept during the projection year 2016-17 on account of Central Sales Tax (CST) compensation to State / UT Govts.

2. GRANTS-IN-AID FOR CAPITAL ASSETS:

Fiscal consolidation roadmap adopted in 2012-13, following amendment to the FRBM Act, 2003 mandated to eliminate the effective revenue deficit (revenue deficit *less* Grants-in-aid for creation of capital assets) and to limit revenue deficit at the level not more than 2.0 per cent of GDP by 31st March, 2015. However, while adhering to the path of fiscal consolidation, the imbalances on revenue account on this count could not corrected to the extent mandated.

Keeping in view the additional fiscal space required to fund the public investments and the imbalance on the revenue account; the FRBM Act, 2003 has been amended in 2015. Subsequently, the FRBM (Amendment) Rules, 2015 have also been notified. With this amendment, the date of achieving fiscal deficit target of 3.0 per cent of GDP is 31st March, 2018. Further, the date for achieving the targets on revenue account i.e. R.D & E.R.D. has also been re-aligned with the date for achieving the fiscal deficit target.

In order to eliminate E.R.D. by 31st March, 2018, an amount of about ₹ 1.50 lac crore and ₹ 3.17 lac crore has been assumed for Grants-in-Aid for creation of capital assets during 2016-17 & 2017-18 respectively. With this provision E.R.D. will come down to 1.4 per cent of GDP in 2016-17 and to '*zero*' in 2017-18.

As seen from above, in the second year of projection period, allocation for Grants-in-Aid for creation of capital assets required to increase to more than double of the previous year allocation. Therefore, elimination of E.R.D. by stipulated date requires compositional shift in the designing of Plan schemes with greater emphasis in transfer of funds for creation of capital assets. Redesigning of centrally sponsored schemes (CSS) was initiated in 2014-15, the scope was however limited as the changes have to be balanced keeping in view the spending in social and welfare sectors for the protection of vulnerable sections.

The recommendations of the XIV Finance Commission have impacted the fund flow from Central Government to State Governments. In addition, this will also impact the way in which schemes and programmes are implemented in the States. Government has constituted a Sub-Group of Chief Ministers to examine the current CSS and recommend their rationalisation. The report of the Sub-Group is awaited.

3. CAPITAL EXPENDITURE:-

(a) Plan: -

Major sectors of Plan Capital expenditure of Government includes gross budgetary support to Indian Railways, investment in National Highways and various Urban Metro construction and recapitalization of Public Sector Banks, external assistance backed loans to Public sector banks and equity infusion in PSUs. Since the fiscal consolidation mandates reduction of both fiscal and revenue deficit to the specified level, it is required that within the overall Plan expenditure, the expenditure on Capital components grows faster than the revenue component. In 2014-15 (provisional), Plan Capital expenditure was 21.2 per cent of total plan expenditure and this has been increased to about 29 per cent in B.E. 2015-16. Keeping in view the requirement of resources from various sectors, adequate provision for plan capital expenditure has been made over the projection period. It may be relevant to mention here that more items of Plan capital expenditure will be financed from National Investment Fund. This is being funded through disinvestment proceeds.

(b) Non-Plan:

On the Non-Plan side, the major portion of Capital expenditure consists of outlay on Defence Capital expenditure. In BE 2015-16 a provision of ₹ 94,588 crore has been made for capital outlay on the Defence Services. In view of requirement of resources for modernization of Defence Forces, adequate growth has been provided over the projection period. Other important items of Non-plan expenditure include expenditure for production of Heavy Water, investment in International Financial Institutions and for construction of certain strategic roads in border areas etc.