

Public Finance

Fiscal consolidation was an integral part of economic reforms introduced in the early nineties. After a promising start in the early nineties, progress in fiscal consolidation faltered somewhat from 1997-98. Fiscal deficit of the Central Government after declining from 6.6 per cent of GDP in 1990-91 to 4.1 per cent in 1996-97, had risen to 4.8 per cent of GDP in 1997-98 and thereafter maintained a rising trend till 2001-02. However, there is some sign of renewed progress in this area in the most recent years. As per the provisional accounts released by the Controller General of Accounts, fiscal deficit in 2003-04 declined to 4.6 percent of GDP as compared with the budgeted fiscal deficit of 5.6 percent of GDP¹. The deterioration in the other fiscal indicator, namely, revenue deficit, which was even greater in the recent past, also seems to have been reversed in 2003-04. Revenue deficit as a proportion of GDP, after declining from 3.3 per cent in 1990-91 to 2.4 per cent in 1996-97, reached a level of 4.4 per cent in 2002-03. Provisional unaudited accounts indicate a reduction in revenue deficit to 3.6 per cent of GDP in 2003-04. But, still the level is higher than what obtained in the crisis year of 1990-91. High revenue deficits, indicate a problem in the quality of the fiscal deficit. In 2003-04 (Prov), over three-fourths of the fiscal deficit was on account of the revenue deficit as compared with less than 50 per cent in 1990-91. The main factors that had contributed to the fiscal deterioration are relatively higher level of expenditure on

salaries, unfunded pensions, mounting interest payments, improperly targeted subsidies and deterioration in the tax – GDP ratio.

2.2 The deterioration in the fiscal situation has not shown up in a crisis, so far, because of the strong fundamentals of the economy. Inflation has remained low, interest rates have declined and there has been a considerable accretion to the foreign exchange reserves. But the continuation of the present fiscal situation is likely to adversely affect the macroeconomic situation. If private investment picks up, any undue pre-emption of resources by the Government to fund its deficits may lead to a firming up of interest rates and inflation. What is often overlooked is the indirect impact of growing deficits on growth prospects. Growing deficits and public debt and the concomitant declining share of the private sector in total credit have been preventing the economy from realising its growth potential. The unobserved cost of fiscal deterioration is the growth foregone. To sustain the present growth momentum and to put the economy on a virtuous cycle, it is essential that renewed efforts are made towards fiscal consolidation. The enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 marks the beginning of such concerted efforts. The FRBM Act mandates the Central Government to take appropriate measures to reduce the fiscal deficit, to eliminate revenue deficit by 2007-08 and thereafter build up adequate

¹ Provisional (unaudited) figures of fiscal aggregates of Union Government accounts have been used in place of revised estimates for 2003-04, wherever possible, in this chapter.

revenue surplus. The Act provides for greater transparency in budget formulation and execution. A prudent fiscal policy stance is a natural concomitant of this legislation. A few

State Governments have also put in place fiscal responsibility legislation, strengthening the efforts being made by the Central Government towards fiscal consolidation. Trends in major fiscal indicators are presented in Table 2.1.

Table 2.1 : Trends in deficits of Central Government

| Year | Revenue deficit | Primary deficit | Fiscal deficit | Revenue deficit as percent of fiscal deficit |
|------------------------|-----------------|-----------------|----------------|--|
| (As per cent of GDP) | | | | |
| 1990-91 | 3.3 | 2.8 | 6.6 | 49.4 |
| 1991-92 | 2.5 | 0.7 | 4.7 | 52.7 |
| 1992-93 | 2.5 | 0.6 | 4.8 | 51.7 |
| 1993-94 | 3.8 | 2.2 | 6.4 | 59.2 |
| 1994-95 | 3.1 | 0.4 | 4.7 | 64.6 |
| 1995-96 | 2.5 | 0.0 | 4.2 | 59.2 |
| 1996-97 | 2.4 | -0.2 | 4.1 | 58.2 |
| 1997-98 | 3.1 | 0.5 | 4.8 | 63.5 |
| 1998-99 | 3.8 | 0.7 | 5.1 | 74.8 |
| 1999-00 | 3.5 | 0.7 | 5.4 | 64.6 |
| 2000-01 | 4.1 | 0.9 | 5.7 | 71.7 |
| 2001-02 | 4.4 | 1.5 | 6.2 | 71.1 |
| 2002-03 | 4.4 | 0.5 | 5.3 | 82.2 |
| 2003-04(Prov.)* | 3.6 | 0.1 | 4.6 | 78.0 |

* Figures for 2003-04 are provisional accounts (unaudited) as released by the Controller General of Accounts.
The ratios to GDP for 2003-04 (Prov.) are based on CSO's Advance Estimates released in February, 2004

Note: 1. Ratios to GDP at current market prices.
2. Fiscal deficit excludes the transfer of States' share in the small savings collections.
3. Figures for 2002-03 are accounts as reported in the Interim Budget 2004-05 (Feb, 2004)

Source : Budget documents.

2.3 The fiscal situation of State Governments has also been a cause of concern. The States' fiscal position has been following more or less a similar trend as that of the Central Government. States' fiscal deficit, after declining from 3.3 per cent of GDP in 1990-91 to 2.7 per cent in 1996-97, has been witnessing a rising trend to reach 4.7 per cent of GDP in 1999-2000. Revenue deficit of States after witnessing an improvement in the early nineties started worsening from the mid nineties. Between 1990-91 and 1999-2000, revenue deficit of States as a proportion of GDP more than trebled from 0.9 per cent to 2.8 per cent. Revision of pay and allowances of State Government employees largely explains the sharp rise in the revenue deficit witnessed in 1998-99 and 1999-2000. The decline in the tax-GDP ratio of the Central Government, through the mechanism of tax devolution, had also partly contributed to this deterioration. Fiscal deficit of States, after witnessing a decline in 2000-01 and 2001-02, again shot up to 4.7 percent of GDP in 2002-03 (RE). Recent initiatives to address this situation include introduction of fiscal reform facility and the debt swap scheme.