

Public Finance

Fiscal consolidation has been high among the reform priorities of the Government. Recent initiatives include pre-payment of high cost external debt, buyback of high cost domestic debt, introduction of contributory pension scheme for new entrants to Government service, widening of the tax base and phased withdrawal of tax exemptions. The current year marks a watershed in fiscal reforms in more than one way. First, the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 has been operationalised with the notification of rules in July, 2004. Under the provisions of the Act and the rules, the Government is mandated to eliminate revenue deficit by March, 2009 and restrict its borrowings within certain limits. Second, the decision of States to introduce value added tax (VAT) from April 1, 2005 marks the culmination of efforts that began almost a decade ago at reforming the domestic trade taxes. The introduction of State-level VAT would help ameliorate the present cascading nature of taxation of commodities and eventually facilitate the establishment of a national common market for goods and services. The NCMP aims at sustaining an average real GDP growth of 7 to 8 per cent per annum. The operationalisation of FRBM Act and the proposed introduction of VAT are expected to help in creating conditions that are necessary for sustaining the growth of the economy with macro-economic stability as envisaged in the National Common Minimum Programme (NCMP).

2.2 Fiscal consolidation, after a promising start in the early 1990s, had started

deteriorating since 1997-98. Fiscal deficit, a comprehensive indicator of fiscal health, after declining from 6.6 per cent of GDP in 1990-91 to 4.1 per cent of GDP in 1996-97 started rising continuously to reach 6.2 per cent of GDP in 2001-02 (Table 2.1). Thereafter, it started declining to a level of 4.6 per cent of GDP in 2003-04 (Prov.)¹. It is

Table 2.1 : Trends in deficits of Central Government

Year	Revenue deficit	Primary deficit	Fiscal deficit	Revenue deficit as per cent 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
1999-2000	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	1.1	5.9	74.4
2003-04(Prov.)*	3.6	0.1	4.6	78.0
2004-05(BE)#	2.5	0.3	4.4	55.4

* Provisional and unaudited as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.

The ratios to GDP for 2004-05 (BE) are based on CSO's Advance Estimates released in February, 2005.

Note: 1. Ratios to GDP at current market prices.
2. Fiscal deficit excludes transfer of states' share in small savings collections.

Source : Budget documents.

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.

budgeted to decline marginally to 4.4 per cent of GDP in 2004-05. Revenue deficit, which in recent years constituted over 70 per cent of fiscal deficit, has followed a similar trend. Rising interest payments, expenditure on subsidies, pay and allowances, and pensions coupled with a near stagnant tax-GDP ratio have mainly contributed to the worsening of the revenue balance. Revenue deficit after reaching a peak of 4.4 per cent of GDP in 2001-02 and remaining at the same level in 2002-03, declined by 0.8 percentage points to 3.6 per cent of GDP in 2003-04 (Prov). With the operationalisation of FRBM Act, fiscal consolidation is expected to gain momentum.

2.3 The fiscal health of the State Governments has been equally worrisome. Fiscal consolidation efforts at the State level have not been significant. Five States have so far enacted fiscal responsibility legislations. As a proportion of GDP, fiscal deficit of States after declining from 4.7 per cent in 1999-00 to 4.3 per cent in 2000-

01, worsened to 5.1 per cent in 2003-04 Revised Estimates (RE). The fiscal deficit of States is budgeted to come down to 3.6 per cent of GDP in 2004-05. As a proportion of GDP, revenue deficit of States increased from 0.9 per cent in 1990-91 to 2.8 per cent in 1999-2000. After declining to 2.2 per cent of GDP by 2002-03, revenue deficit increased again to 2.6 per cent of GDP in 2003-04 (RE). Revenue deficit of States is placed at 1.4 per cent of GDP in 2004-05 Budget Estimates (BE). The pay revision effected by States, following the Fifth Central Pay Commission's award and its implementation by the Central Government, and declining transfers from the Centre as a proportion of GDP, contributed to the deterioration of State finances. A number of initiatives have been taken by the Centre and the States to remedy the situation. These include medium term fiscal reforms programme, debt swap scheme and lowering of interest on Central loans to States.