Fiscal Developments and Public Finance

3

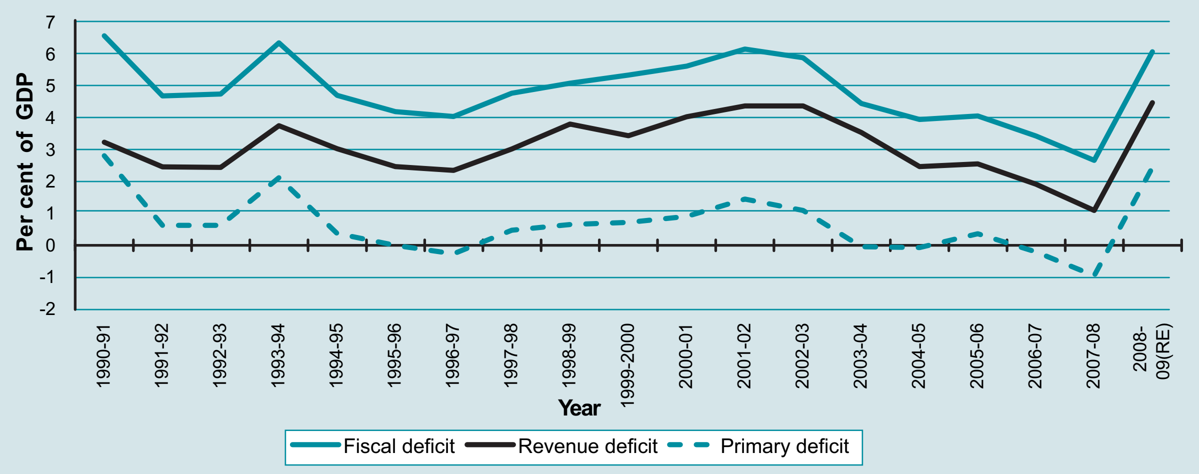
CHAPTER

From a macroeconomic perspective, low levels of budget deficits and public debt are generally considered as key ingredients for economic growth, reducing poverty and improving social outcomes. This owes to the stabilization models attributing resource-expenditure imbalances as the trigger for economic problems of many emerging/developing economies. The fiscal reforms initiated in 1990s as a part of economic liberalization reflected this view point. Fiscal consolidation began in the early 1990s with fiscal deficit declining from 6.6 per cent of GDP in 1990-91 to 4.1 per cent of GDP in 1996-97; however it faltered and started deteriorating in 1997-98 and reached a level of 6.2 per cent of GDP in 2001-02. It was against this background, that operationalization of the Fiscal Responsibility and Budget Management Act of 2003 (FRBMA) assumed urgency leading to the notification of the Rules under the Act in July, 2004. In the post-FRBMA period, progress in fiscal consolidation was more or less close to the targets envisaged thereunder.

3.2 In the five years ending 2007-08 -- a period marked by adherence to fiscal discipline -- Indian economy posted an average annual growth of about 8.8 per cent underscoring the importance of the real growth potential of fiscal consolidation. The fiscal space so generated enabled the Government to put in place the first comprehensive social safety net assuring statutory guarantee for 100 days of employment in a year for able-bodied persons in the rural districts under the National Rural Employment Guarantee Scheme (NREGS) and fund higher levels of plan expenditure. Centre's fiscal deficit at 2.7 per cent of GDP in 2007-08 signified the attainment of FRBMA terminal year target, albeit on cash basis. However, there was sharp deterioration in the fiscal position in 2008-09 owing largely to global commodity price rise and financial meltdown. While such deterioration raised doubts about the sustainability of the process of fiscal consolidation, it is to be noted that this was not due to fiscal laxity; but triggered by endogenous and exogenous factors, which manifested in 2008-09. The instant phase of expansion in the fiscal deficit substantially owes to the conscious and proactive measures that counteract the effects of global shocks. The reversibility of the instant expansionary phase and the commitment to return to the original mandate of the FRBMA once the crisis is over should dispel anxieties regarding the fiscal consolidation in the medium term.

3.3 The Budget for 2008-09, which marked the terminal year of the achievement of the targets under FRBMA, had envisaged fiscal deficit of the Centre at 2.5 per cent of GDP, which was lower than the 3 per cent mandated level; but the other key target, namely elimination of revenue deficit was put off by a year, with the level of deficit estimated at 1.0 per cent of GDP. As the year 2008-09 progressed, the Indian economy was seriously impacted by the twin global shocks – unprecedented increase in the global commodity prices in the first half of the year and the ripple effects of the deepening of the global financial crisis in the second half. This led to conscious fiscal expansion, composed of both tax cuts and expenditure hikes. The slippage in the

Figure 3.1 : Trends in deficits of Central Government



terminal year fiscal targets has also been accentuated by the Supplementary Demands for Grants on account of the farm loan waiver, implementation of the Sixth Pay Commission award and funding on the projects prioritized in the Eleventh Five Year Plan. There was a marked rise in liabilities also on account of issue of oil, fertilizer and food bonds even after greater accommodation of fertilizer subsidies as above the line expenditure in 2008-09. As per the Revised Estimates (RE) for 2008-09, fiscal and revenue deficits of the Centre were placed at 6.1 per cent and 4.5 per cent of GDP, respectively (Figure 3.1). The quality of fiscal deficit indicated by the proportion of revenue deficit to fiscal deficit, which improved to reach a level of 41.4 per cent in 2007-08 also deteriorated sharply in RE for 2008-09 owing to the emerging economic situation, which required fiscal stimuli. (Table 3.1).

Table 3.1 : 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)			
1996-97	2.4	-0.2	4.1	58.2
1997-98	3.0	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
Enactment of FRBM				
2003-04	3.6	0.0	4.5	79.7
2004-05	2.5	0.0	4.0	62.6
2005-06	2.6	0.4	4.1	63.0
2006-07	1.9	-0.2	3.5	56.3
2007-08	1.1	-0.9	2.7	41.4
2008-09 (RE)	4.5*	2.5	6.1*	73.9

Source : Union Budget documents.

* The Interim Budget 2009-10 had placed the Revenue Deficit of 2008-09 (RE) at 4.4 per cent and the Fiscal Deficit at 6.0 per cent, based on GDP data available at that time.

Note: 1. The ratios to GDP at current market prices are based on CSO's National Accounts 1999-2000 series.

2. Fiscal deficit excludes transfer of states' share in small savings collections.

3.4 In comparison, the record of fiscal consolidation by states collectively has been impressive with a revenue surplus in 2006-07 and a level of fiscal deficit of 2.5 per cent of GDP in 2005-06. On the strength of relatively better performance by states and also the record of the Centre, combined gross fiscal deficit of the Centre and states fell from a level of 8.5 per cent of GDP in 2003-04 to a level of 5.2 per cent of GDP in 2007-08. The strong performance by states was expected to continue as evidenced by the BE for states in 2008-09.