

Chapter 5

DEFICITS: MANAGEMENT OF FISCAL IMBALANCES

Three key fiscal parameters - revenue, fiscal and primary deficits - indicate the extent of overall fiscal imbalances in the finances of the Union or State Government during a specified period. The main observations in this chapter are:

The average annual rate of shift in the share of revenue deficit to GDP showed a positive shift of 1.27 *per cent* during the period 1992-2009, which means that for every 1 *per cent* increase in GDP, the revenue deficit rose by a little over 1 *per cent* (**Para 5.1**).

On an average for the period 1992-2009, revenue deficit amounted to over 22 *per cent* of revenue expenditure. This proportion increased to over 35 *per cent* in 2008-09. For every 1 *per cent* increase in revenue expenditure, there was a 1.85 *per cent* increase in revenue deficit (**Para 5.1**).

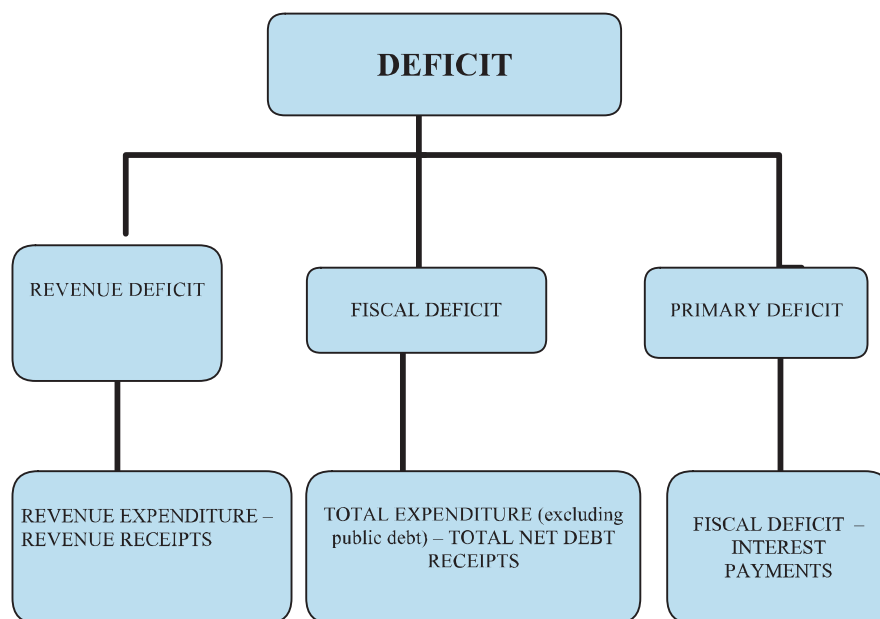
For every 1 *per cent* increase in GDP there was a decrease of 2.62 *per cent* in the fiscal deficit over the period 1992- 2009 (**Para 5.2**).

Over the years, for every one *per cent* increase in non-debt receipts, there has been a 1.57 *per cent* decrease in fiscal deficit (**Para 5.2**).

As against a revenue deficit target of 1 *per cent* set out in the Budget estimates (BE) of 2008-09, the actual revenue deficit was 6.7 *per cent*. In the case of fiscal deficit, as against a target of 2.5 *per cent* , the actual fiscal deficit for the Union Government was 8.16 *per cent* indicating a 226 *per cent* deviation from the target (**Para 5.4**).

This chapter presents trends, nature, magnitude and the manner of financing these deficits. Deficits arise because of imbalances in revenue and expenditure. These imbalances could be transient or structural. In the Indian context, fiscal imbalances have both been large and persistent. Besides the size and regularity, its composition, in particular that of the revenue deficit that finances current consumption has also been a cause of concern. Formulation of fiscal rules in the context of macroeconomic activity essentially involves setting of rules regarding the size of deficit that could be incurred to finance expenditure. This chapter also presents the assessment of actual levels of revenue and fiscal deficits vis-à-vis targets set under FRBM Act and Rules for the financial year 2008-09.

BOX 5.1 COMPONENTS OF DEFICIT



5.1 Revenue Deficit

Revenue deficit is the excess of revenue expenditure of the Government over its revenue receipts. It represents net dissaving of the Government for the sake of present consumption. Revenue deficit leads to increase in borrowings without corresponding capital/asset formation. Borrowings resorted to meet revenue deficit, therefore, do not have any asset back up and create an asset liability mismatch. For these reasons, revenue deficit is considered generally less desirable. Trends in revenue deficit and some of its key parameters are indicated in Table 5.1.

Table 5.1: Revenue Deficit and its parameters

(Rupees in crore)

Period	Revenue Receipt	Revenue Expenditure	Revenue Deficit	Revenue Deficit as per cent of		
				GDP	Revenue Receipt	Revenue Expenditure
1992-2009 (Average)	310543	398606	88063	3.66	28.36	22.09
VIII Plan (1992-97) (Average)	148556	177497	28941	2.78	19.48	16.30
IX Plan (1997-02) (Average)	252211	327922	75711	3.94	30.02	23.09

Report of the CAG on
Union Government Accounts 2008-09

Period	Revenue Receipt	Revenue Expenditure	Revenue Deficit	Revenue Deficit as <i>per cent of</i>		
				GDP	Revenue Receipt	Revenue Expenditure
X Plan (2002-07) (Average)	394426	500825	106399	3.31	26.98	21.24
2007-08	649426	734861	85435	1.81	13.16	11.63
2008-09	653847	1010224	356377	6.70	54.50	35.28
Average Annual Rate of Growth (Per cent)						
1992-2009(Average)	10.98	11.66	13.73	1.27	2.47	1.85
VIII Plan (1992-97)	15.02	14.23	10.88	Average Annual Rate of Shift in Relative Share		
IX Plan (1997-02)	4.65	7.63	17.29			
X Plan (2002-07)	14.59	12.24	4.75			
2007-08	23.61	11.64	-35.69			
2008-09	0.68	37.47	317.13			

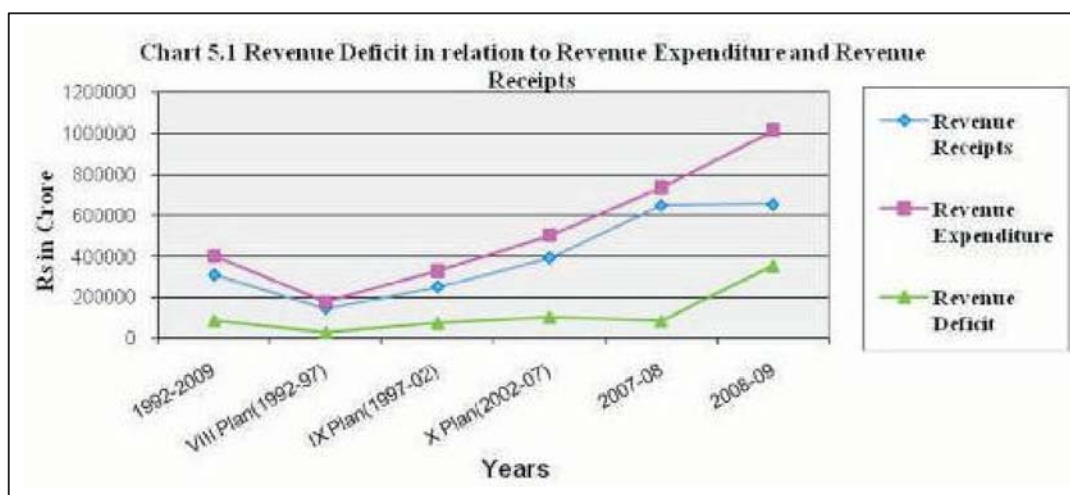


Table 5.1 indicates that revenue receipts grew only marginally by 0.7 *per cent* in 2008-09 over the previous year. Compared to 2007-08, when industry was on the up-swing and the corporate sentiment was positive, the uncertainty and pessimism brought about by the global financial sector meltdown, slowdown in export demand, and consequent demand contraction, as well as tax relief given to boost demand in 2008-09, led to a considerable fall in growth in revenue receipts. Revenue expenditure, however, grew at over 37 *per cent* in 2008-09 because of the 6th Pay Commission Award, the agricultural debt relief scheme as well as the fiscal stimuli introduced by the Government to pump-prime the economy and reduce recessionary effects. As a result, revenue deficit grew by a phenomenal 317 *per cent* over the previous year.

In relation to GDP, revenue deficit amounted to 3.66 *per cent* for the post-liberalization period (1992-2009). In comparison, the revenue deficit to GDP ratio was much smaller in 2007-08 (1.81 *per cent*) but rose sharply to 6.70 *per cent* in 2008-09. The average annual rate of shift in the share of revenue deficit to GDP showed a positive shift of 1.27 *per cent* during the period 1992-

2009, which means that for every one *per cent* increase in GDP, the revenue deficit rose by a little over one *per cent*.

When revenue deficit is compared to revenue receipts, it is observed that on an average for the period 1992-2009, revenue deficit accounted for more than 28 *per cent* of the revenue receipts. This figure rose sharply in 2008-09 to over 54 *per cent*. As a result, for the period 1992-2009, there was an average annual rate of shift in revenue deficit as a proportion of revenue receipts – for every one *per cent* increase in revenue receipts there was an increase of nearly 2.5 *per cent* in revenue deficit.

In comparison with revenue expenditure, on an average for the period 1992-2009, revenue deficit amounted to over 22 *per cent* of revenue expenditure. This proportion increased to over 35 *per cent* in 2008-09 resulting in a positive annual average shift in revenue deficit as a percentage of revenue expenditure over the years. For every one *per cent* increase in revenue expenditure there was a 1.85 *per cent* increase in revenue deficit.

5.2 Fiscal Deficit

Fiscal deficit is the excess of total expenditure of the Government over its non-debt receipts (revenue receipts, miscellaneous capital receipts and recovery of loans and advances). Fiscal deficit normally represents the net incremental liabilities of the Government or its additional borrowings. The shortfall could be met either by additional public debt (internal or external) or by the use of surplus funds from Public Account. Fiscal deficit trends along with the trends of the deficit relative to key fiscal parameters are indicated in Table 5.2.

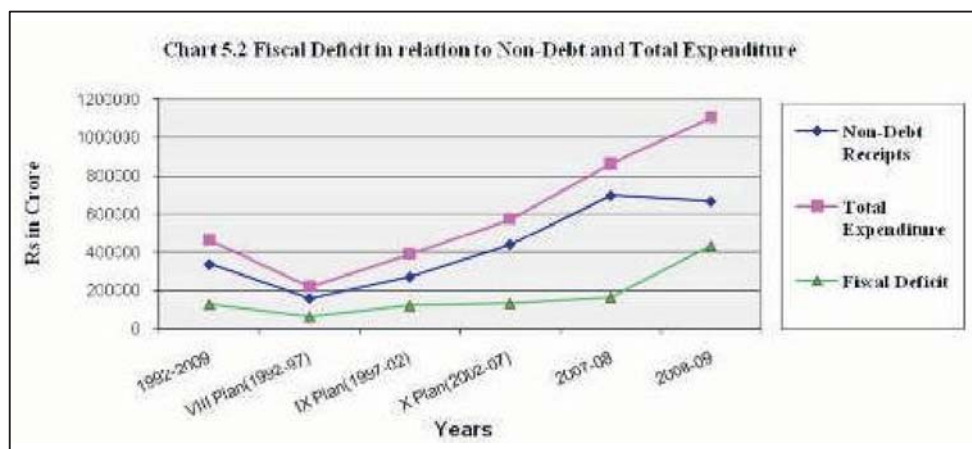
Table 5.2: Fiscal Deficit and its Parameters

(Rupees in crore)

Period	Non-Debt Receipts	Total Expenditure	Fiscal Deficit	Fiscal Deficit as <i>per cent</i> to		
				GDP	Non-Debt Receipts	Total Exp.
1992-2009(Average)	335674	463780	128105	5.32	38.16	27.62
VIII Plan (1992-97) (Average)	157929	220494	62565	6.01	39.62	28.38
IX Plan (1997-02) (Average)	269641	389316	119675	6.23	44.38	30.74
X Plan (2002-07) (Average)	440415	573852	133437	4.15	30.30	23.25
2007-08	698613	863575	164962	3.49	23.61	19.10
2008-09	667922	1102366	434444	8.16	65.04	39.41

**Report of the CAG on
Union Government Accounts 2008-09**

Period	Non-Debt Receipts	Total Expenditure	Fiscal Deficit	Fiscal Deficit as <i>per cent</i> to		
				GDP	Non-Debt Receipts	Total Exp.
Average Annual Rate of Growth						
1992-2009	11.10	10.75	9.36	-2.62	-1.57	-1.26
VIII Plan (1992-97)	14.08	11.77	6.41	Average Annual Rate of Shift		
IX Plan (1997-02)	5.46	6.62	9.00			
X Plan (2002-07)	10.24	10.86	14.18			
2007-08	28.28	18.70	-9.82			
2008-09	-4.39	27.65	163.36			



On an average, fiscal deficit grew by over 9 *per cent* during the post-liberalization period of 1992-2009. In comparison to this, there was a negative growth in fiscal deficit in 2007-08 and a staggering growth of over 163 *per cent* in 2008-09 over the previous year. As indicated in Table 5.2, there was a negative growth in non debt receipts of over 4 *per cent* in 2008-09 but a positive growth of over 27 *per cent* in total expenditure. Fiscal deficit as a percentage of GDP was higher at over 8 *per cent* in the current year when compared to the trend of 5.3 *per cent* for the period 1992-2009. For every 1 *per cent* increase in GDP there was a decrease of 2.62 *per cent* in the fiscal deficit over the period 1992- 2009.

Fiscal deficit as a percentage of non-debt receipts was around 38 *per cent* for the entire period 1992-2009. In comparison, in 2008-09, fiscal deficit was as high as nearly 65 *per cent* of non-debt receipts. Over the years, for every one *per cent* increase in non-debt receipts, there has been a 1.57 *per cent* decrease in fiscal deficit. Fiscal deficit as a *per cent* of total expenditure was over 39 *per cent* in 2008-09 compared to the trend proportion of 28 *per cent* for the post-liberalization period.

5.2.1 Quality of Fiscal Deficit: If the bulk of fiscal deficit is for sustaining capital expenditure or for providing financial accommodation to entities for

capital formation, such deficits may be considered desirable up to a point. Table 5.3 presents the movement of components of fiscal deficit over the VIII, IX Plan and the X Plan periods as well as for the current year.

Table 5.3: Components of Fiscal Deficit

(Per cent)

Period	Revenue Deficit	Net Capital Expenditure	Net Loans and Advances
1992-2009	68.74	26.11	5.14
VIII Plan (1992-97)	46.26	28.25	25.49
IX Plan (1997-02)	63.26	19.53	17.20
X Plan (2002-07)	79.74	31.22	-10.96
2007-08	51.79	47.37	0.84
2008-09	82.03	17.72	0.25
Average Annual Rate of Change			
1992-2009	4.00	0.95	

Revenue deficit continued to be the dominant component of fiscal deficit, accounting for nearly 69 *per cent* of it during 1992-2009. There was a steep decline in the share of revenue deficit in fiscal deficit in 2007-08 but in 2008-09, revenue deficit accounted for almost 82 *per cent* of the fiscal deficit. During the period 1992-2009, there was a large positive shift rate of 4 *per cent* in the share of revenue deficit to the total fiscal deficit. Net capital expenditure (capital expenditure- capital receipts) accounted for 26.11 *per cent* of fiscal deficit during 1992-2009 but the share fell to around 18 *per cent* in 2008-09. Fiscal deficit financed 5 *per cent* of net loans and advances during the period 1992-2009.

5.3 Primary Deficit

While fiscal deficit represents the need for additional resources in general, a part of such resources may be needed to finance interest payments. Interest payments represent the expenditure of past obligations and are independent of current allocative priorities. To look at the imbalances of the current nature, these payments need to be separated and deducted from the total imbalances.

Table 5.4: Primary Deficit and its Parameters

(Rupees in crore)

Period	Revenue Deficit	Fiscal Deficit	Interest Payments	Primary Deficit*	Primary Deficit as per cent of GDP
1992-2009	88063	128105	102163	25942	1.08
VIII Plan (1992-97)	28941	62565	44280	18286	1.76
IX Plan (1997-02)	75711	119675	91102	28573	1.49
X Plan (2002-07)	106399	133437	135860	-2423	-0.08
2007-08	85435	164962	179987	-15025	-0.32
2008-09	356377	434444	200580	233864	4.39

Report of the CAG on
Union Government Accounts 2008-09

(Rupees in crore)

Period	Revenue Deficit	Fiscal Deficit	Interest Payments	Primary Deficit*	Primary Deficit as per cent of GDP
Average annual trend rate of growth (per cent)					
1992-2009	13.73	9.36	11.67		
VIII Plan (1992-97)	10.88	6.41	17.44		
IX Plan (1997-02)	17.29	9.00	14.90		
X Plan (2002-07)	4.75	14.18	5.40		-
2007-08	-35.69	-9.82	16.66		
2008-09	317.13	163.36	11.44		

* A negative figure indicates existence of primary surplus

As indicated in Table 5.4, during the period, 1992-2009, interest payments grew at an average annual rate of nearly 12 *per cent* compared to which, the growth in interest payments in 2008-09 was over 11 *per cent*. There was a primary surplus in the X Plan period since the interest payments were higher than the fiscal deficit and also in 2007-08 but in 2008-09, a large primary deficit of Rs 2,33,864 crores was observed as the fiscal deficit was much larger than the interest payments.

In relation to GDP, primary deficit declined from an average of 1.76 *per cent* during the VIII Plan (1992-1997) to 1.49 *per cent* during IX Plan (1997-2002) and it turned into a marginal surplus of Rs. 2,423 crore, i.e. 0.08 *per cent* of GDP during the X Plan (2002-07). In 2007-08, there was a primary surplus but in 2008-09, the primary deficit rose to 4.39 *per cent* of the GDP.

5.4 Actual deficits vis-à-vis targets/requirements of FRBM Act/Rules

The FRBM Act, 2003 came into effect from July 2004 following the issue of Government notification and formulation of FRBM Rules, 2004. The *Act* and the *Rules* had provided for the elimination of the revenue deficit by 2008-09, with 0.5 percentage point of GDP as the minimum annual reduction target, and fiscal deficit to be brought to the level of 3 *per cent* of GDP, with 0.3 percentage point of GDP, as the minimum annual reduction target. The targets/requirements prescribed under FRBM Act/Rules are to ensure, *inter alia*, inter-generational equity¹ in fiscal management and long term macroeconomic stability. The FRBM Act, however, had some built-in flexibility in achieving revenue and fiscal deficit reduction targets as there is a provision that the specified limits may be exceeded 'due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify'. Invoking this provision of the FRBM Act, the Union Government amended the dates originally envisaged in the Act for achieving the deficit targets. The targets relating to fiscal deficit were set to

¹ Reducing the burden of future generations to pay for present fiscal imprudence.

be achieved as per the mandate in the Act, while those relating to revenue deficit were rescheduled for its elimination by 2009-10 primarily on account of a conscious shift in plan priorities in favor of revenue expenditure-intensive programmes and schemes particularly at the commencement of the XI Five Year Plan. The systemic rigidity of containing non-Plan committed revenue expenditures in the short term, particularly arising from committed and obligatory expenditure such as interest payments, subsidies – both explicit and implicit, pensions, salaries and defence sector was stated to be another contributory factor.

Along with the Budget, and as required under the FRBM Act, the Central Government has been laying down, from 2004-05, *inter alia* the Medium-term Fiscal Policy Statement (MTFPS), specifying 3-year rolling targets for revenue and fiscal deficits as well as for tax revenue and total outstanding liabilities of the Central Government as percentages of GDP. These have been derived on the basis of assumptions on growth and the policy stance of the government. The targets for revenue and fiscal deficits set for 2008-09 in MTFP Statements for 2006-07, 2007-08 and 2008-09 along with their actual levels as brought out in Union Government's Finance accounts for 2008-09 are given in Table 5.5

Table 5.5: Outcome vis-à-vis Targets under FRBM Rules (As per cent of GDP)

Fiscal Indicator	Targets set in MTFPS 2006-07 for the year 2008-09	Targets set in MTFPS 2007-08 for the year 2008-09	Targets set in MTFPS 2008-09	Actual Levels (As deduced from Finance Accounts 2008-09)	Deviation from BE 2008-09
Revenue Deficit	0.0	0.0	1.0	6.70	570 %
Fiscal deficit	3.0	3.0	2.5	8.16	226 %

Table 5.5 presents the targets set for the key fiscal parameters – revenue and fiscal deficits for the 2008-09 in Medium Term Fiscal Policy Statements (MTFPS) placed along with the Budgets in earlier years. As against a revenue deficit target of 1 *per cent* set out in the BE of 2008-09, the actual revenue deficit was 6.7 *per cent*. In the case of fiscal deficit, as against a target of 2.5 *per cent*, the actual fiscal deficit for the Union Government was 8.16 *per cent* indicating a 226 *per cent* deviation from the target. The main reasons for the slippages have been the conscious fiscal expansion of the Government in view of the slowdown in the economy – Tax cuts along with expenditure hikes resulted in high revenue deficit as well as high fiscal deficit and non-compliance to the original targets envisaged by the FRBM Act.