

Chapter 4

DEFICITS: MANAGEMENT OF FISCAL IMBALANCES

4.1 The budget deficit is an instrument of fiscal management. The different facets of the budget deficit indicate the different nature of fiscal imbalances. The annual budget indicates three types of deficits, viz. revenue, fiscal, and primary. This chapter discusses the nature and magnitude of these deficits, their trend over time and the manner of financing these deficits.

4.2 Table 4.1 presents the break-up of the deficit during 2001-02. There was a deficit in the CFI amounting to Rs 40869 crore and a surplus in the Public Account amounting to Rs 42364 crore. The excess of this surplus amounting to Rs 1495 crore represented the addition to the closing cash balances.

Table 4.1: Deficits in Government Account

(Rupees in crore)

CONSOLIDATED FUND					
Receipt	Amount			Disbursement	Amount
Revenue	265,279	Revenue deficit	110,303	Revenue	375,582
Non-debt Capital Receipts	3,646			Capital	31,295
Recovery of loans & advances	20,733			Disbursement of Loans & advances	38,614
Sub total CFI (other than public debt)	289,658			Sub total CFI (other than Public Debt)	445,491
Public debt	436,689	Fiscal deficit	155,833	Public debt repayment	321,725
Total (CFI)	726,347	A: Deficit in CFI	40,869		767,216
PUBLIC ACCOUNT					
Small savings, provident funds etc.	160,535			Small savings, provident funds etc.	133,676
Reserve Fund	19,168			Reserve Fund	16,396
Deposits & Advances	73,550			Deposits & Advances	61,881
Suspense & miscellaneous	3,822			Suspense & miscellaneous	3,455
Remittances	1,365			Remittances	668
Total Public Account	258,440	B: Surplus in Public Account: 42,364			216,076
Increase in cash balance {B-A} = 1,495					
1. Includes Security Deposits of Railways, Telephone Application Deposits, Postal Deposits, Forest Advances, Departmental Advances etc. 2. Includes Depreciation Reserve Funds – Railways, Revenue Reserve Funds – Railways, Sugar Development Funds, Mines Welfare Funds, National Renewal Funds etc. 3. Includes amounts awaiting final adjustments in the accounts like Pay and Accounts Office Suspense, Suspense Account P&T, Defence, Railways and Tele-communication, Coinage Accounts, Cheques and Bills etc. 4. Includes money in transit like Money Orders, RBI Remittances, Small Coin Depot remittances, Mint remittances etc					

4.3 The surpluses and deficits in Consolidated Fund or Public Account only indicate the excess of receipts or disbursements in these accounts and these do not constitute fiscal deficits or surpluses. Fiscal deficit of the Union Government indicates the excess of its total expenditure consisting of revenue and capital expenditures and loans and advances over its non-debt receipts. In the year 2001-02, total expenditure of the Union government at Rs 445,491 crore exceeded its non-debt receipts by Rs 155,833 crore. The fiscal deficit, at this level, was 6.80 *per cent* of GDP. The Union government resorted to borrowings from internal and external sources as also from the Public Account to meet this deficit.

4.4 There was also a revenue deficit as revenue receipts fell short of the revenue expenditure by Rs 110,303 crore. Revenue deficit accounted for nearly 71 *per cent* of the fiscal deficit and was 4.81 per cent of GDP.

Deficits: Trends

4.5 Fiscal imbalances are both transient and structural. Transient imbalances result from temporary mismatches in revenue and expenditures of the Union Government, management of which requires accommodation in the nature of ways and means advances. These transient mismatches, largely of a cyclical nature, may at times go beyond an accounting time frame of a year, but there could be an automatic correction and over time these may be self-liquidating. However, persisting imbalances are structural and more difficult to address. These may arise from the inability to raise revenues or contain expenditure or a combination of both. As was indicated in the previous two chapters, fiscal imbalances was largely due to poor tax compliance and inadequate returns/user charges on government's investment/services though there was an expenditure contraction relative to GDP over the last seventeen years.

4.6 Fiscal deficit represents the draft of the Union Government from the economy and a net transfer of resources in its favour. This transfer, however, results in creation of fiscal liabilities for the Union government. This makes the issue of debt sustainability critically dependent on the fiscal deficit and the application of resources. Fiscal deficit and current account deficit are also inter-linked and existence of the former essentially spills over to the latter.

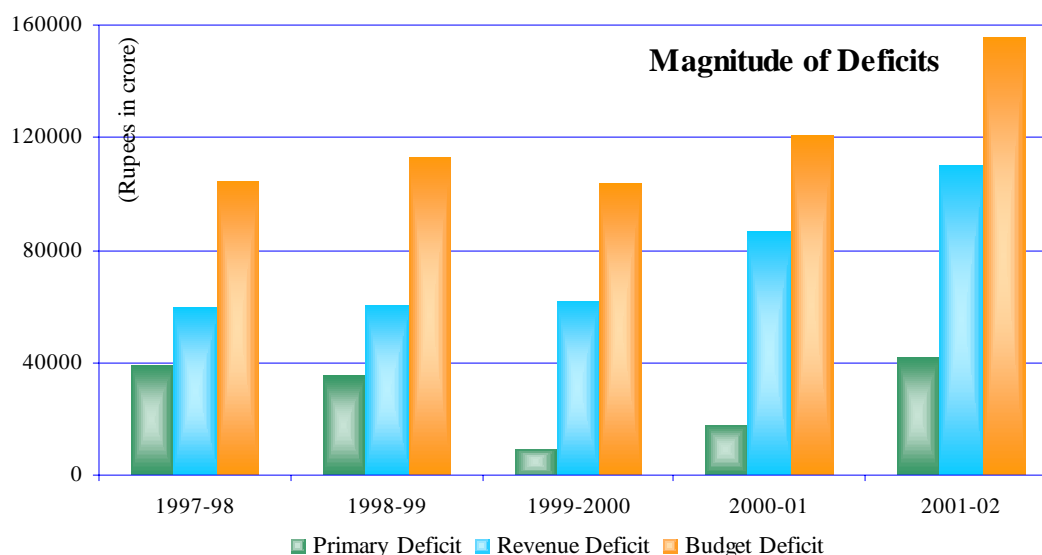
4.7 Table 4.2 indicates the trend in various facets of fiscal imbalances together with the trends of revenue and expenditure. **Appendix-III** presents deficit for the last 26 years. Revenue deficit of the Union government increased from Rs 5,564 crore in 1985-86 to Rs 110,303 crore in 2001-02 nearly eighteen times in seventeen years (1985-2002), at an annual trend rate of 19.01 *per cent*. Revenue deficit was not only a permanent feature of the Union government finances, it rose faster compared to both revenue receipts and revenue expenditure.

Table 4.2: Magnitude of Deficits

(Rs in crore)

	Revenue Receipts	Non-Debt Receipts	Revenue Expenditure	Total Expenditure	Interest Payments	Revenue Deficit	Fiscal Deficit	Primary Deficit
1985-86	37843	41708	43407	66112	7512	5564	24404	16892
1995-96	150560	158956	180291	222645	50045	29731	63689	13644
1999-2000	254595	268869	316237	372619	94593	61642	103750	9157
2000-2001	256036	274960	342647	395834	103224	86611	120874	17650
2001-2002	265279	289658	375582	445491	114173	110303	155833	41660
Average Annual Trend Rate of Growth (per cent)								
1985-2002	13.68	13.46	14.70	12.95	18.66	19.01	11.88	1.64
VII Plan (1985-90)	15.88	15.33	16.49	13.55	24.05	20.33	10.33	2.37
VIII Plan (1992-97)	15.61	14.51	14.64	11.87	17.44	10.88	6.42	-19.36
IX Plan (1997- 2002)	8.12	8.74	10.40	8.86	14.90	17.29	9.00	-5.48
Annual Rate of Growth (per cent)								
1999-2000	18.29	14.76	14.67	7.20	21.46	1.77	-8.43	-74.14
2000-2001	0.57	2.27	8.35	6.23	9.12	40.51	16.51	92.75
2001-2002	3.61	5.35	9.61	12.54	10.61	27.35	28.92	136.03

Negative signs have been omitted for all deficits.



4.8 Fiscal deficit recorded a comparatively lower growth of 11.88 per cent during 1985-2002. In absolute terms it increased nearly six fold from Rs 24,404 crore in 1985-86 to Rs 155833 crore in 2001-02. The comparatively lower growth in fiscal deficit was due to a relatively lower

growth of capital expenditure, which moderated the growth in total expenditure of the Union government. Primary deficit, which indicates fiscal deficit net of the interest payments, showed a negative trend growth. But this was due to a much faster increase in interest payments, which averaged 18.66 *per cent* per annum during 1985-2002. **Appendix-III** presents the fiscal deficits and interest payments for the last 26 years.

4.9 The comparative picture of the three deficits over the Five-Year plans indicates a mixed trend. Revenue deficit witnessed a deceleration in the average annual growth rates during the VIII Plan (1992-97) compared to the earlier plan. However, during the IX Plan (1997-2002), growth further accelerated.

4.10 In 2001-02, all the three variants of deficit witnessed significant increases. In case of revenue deficit, the increase was of the order of 27.35 *per cent*, as against a modest growth of 1.77 *per cent* in 1999-2000. The fiscal deficit grew by 28.92 *per cent* in 2001-02. In the primary deficit, the rate of growth at 136.03 *per cent* was even higher. All these indicated a further deterioration in the fiscal situation in 2001-02 and increasing fiscal imbalances.

Revenue Deficit

4.11 Revenue deficit represents government's dis-saving and inter-temporally, a shift to present consumption. Of the three variants of deficit, persistent revenue deficit is considered most undesirable in view of its adverse impact on capital formation by the government.

4.12 Table 4.3 summarises the magnitude of the revenue deficit relative to revenue receipts, revenue expenditure and GDP over the plans and during the last three years.

Table 4.3: Revenue Deficit Relative to GDP, Revenue Receipts & Expenditure
(*per cent*)

	GDP	Revenue Receipts	Revenue Expenditure
1985-2002	3.03	23.51	18.78
VII Plan (1985-90)	2.39	17.14	14.62
VIII Plan (1992-97)	2.85	22.45	18.22
IX Plan (1997-02)	3.91	31.62	23.88
Annual Relative Share (<i>per cent</i>)			
1999-2000	3.19	24.21	19.49
2000-01	4.15	33.83	25.28
2001-02	4.81	41.58	29.37

4.13 Revenue deficit increased from an average of 2.39 *per cent* of GDP during the VII Plan (1985-90) to an average of 3.91 *per cent* during the IX Plan (1997-2002). It was around 17 *per cent* of the revenue receipts and around 15 *per cent* of revenue expenditure during 1985-90, which increased to 32 *per cent* of revenue receipts and 24 *per cent* of revenue expenditure during 1997-2002. The ratio of revenue deficit to revenue receipts/expenditure indicates the increase/ decrease in revenue receipts/expenditure that was needed to have current expenditure being fully met by current receipts without net dis-saving by the government.

4.14 There was a further deterioration of the revenue deficit situation in 2001-02. It reached a level of 4.81 *per cent* of GDP and accounted for 29.37 *per cent* of revenue expenditure. As percentage to revenue receipts, revenue deficit reached 41.58 *per cent* indicating that revenue receipts needed to increase by nearly 42 *per cent* to finance the entire revenue expenditure. The growing revenue deficit indicated increasing dependence on debt for meeting even the current expenses.

Fiscal Deficit

4.15 Table 4.4 indicates the ratio of fiscal deficit to GDP, non-debt receipts and total expenditure over the Plans and during the last three years.

Table 4.4: Ratio of Fiscal deficit to GDP, Non-debt Receipts and Total Expenditure
(*per cent*)

	GDP	Non-Debt Receipts	Aggregate Expenditure
1985-2002	6.91	48.74	32.60
VII Plan (1985-90)	8.19	53.74	34.92
VIII Plan (1992-97)	6.22	45.59	31.06
IX Plan (1997-2002)	6.27	47.08	31.92
Annual Relative Share (<i>per cent</i>)			
1999-2000	5.38	38.59	27.84
2000-01	5.79	43.96	30.54
2001-02	6.80	53.80	34.98

4.16 The ratio of fiscal deficit to GDP however, showed a decelerating trend over the Plans. It declined from an average of 8.19 *per cent* of GDP during 1985-90 (VII Plan) to an average of 6.27 *per cent* during 1997-2002 (IX Plan). Fiscal deficit financed nearly 35 *per cent* of total expenditure during 1985-90. This ratio marginally declined to 31.92 *per cent* during 1997-2002. As a percentage to non-debt receipts, fiscal deficit declined from an average of

53.74 per cent during 1985-90 to an average of 47.08 during 1997-2002. This ratio indicates the increase in non-debt receipts that would have been needed to meet the expenditure levels.

4.17 In 2001-02, the fiscal deficit/GDP ratio at 6.80 per cent was only marginally lower compared to the trend value. However, it worsened compared to a level of 5.38 per cent reached in 1999-2000. Fiscal deficit financed 34.98 per cent of total expenditure, as against 27.84 per cent in 1999-2000 and reached a level higher than the average of 1985-90 (VII Plan). This level of fiscal deficit triggered the economic reforms during the early 1990s.

4.18 It is necessary to study the components of fiscal deficit and their movement over the Plan periods.

Table 4.5: Components of Fiscal Deficit- Relative Share

	Revenue Deficit	Capital Expenditure	Net Loans & Advances
1985-2002	45.36	30.58	24.06
VII Plan (1985-90)	29.43	36.91	33.66
VIII Plan (1992-97)	45.91	31.93	22.16
IX Plan (1997-2002)	62.42	22.13	15.44
Annual Relative Share (per cent)			
1999-2000	59.41	27.97	12.61
2000-01	71.65	21.04	7.31
2001-02	70.78	20.08	9.13

4.19 Revenue deficit accounted for 45.36 per cent of the fiscal deficit over 1985-2002. This ratio witnessed a continuous increase over the Plans. From an average of 29.43 per cent during 1985-90, it increased to 62.42 per cent during 1997-2002. Ideally, even capital expenditure of the Government should be financed from revenue surpluses. Continuous recourse to fiscal deficit for meeting the current expenses is not desirable as it indicates the proportion of liabilities which are not backed up by assets.

4.20 In 2001-02, revenue deficit accounted for 70.78 per cent of the fiscal deficit. Capital expenditure accounted for 20.08 per cent and the balance 9.13 per cent was utilized for making loans and advances. Expenditure financed by borrowings during the last 26 years is given in **Appendix-IV**.

Primary Deficit

4.21 Table 4.6 indicates the ratio of primary deficit to GDP, non-debt receipts of the Union Government and revenue expenditure. Primary deficit/GDP ratio declined from an average of 5.02 *per cent* during 1985-90 to a level of 1.55 *per cent* in 1997-2002. After an improvement in the primary deficit/GDP ratio in 1999-2000, there was a slippage in two successive years. In the current year also primary deficit more than doubled and stood at 1.82 per cent of GDP.

Table 4.6: Primary deficit- Selected Ratios

(per cent)

Period/Year	GDP	Non Debt Receipts	Revenue Expenditure
1985-2002	2.87	19.83	17.72
VII Plan (1985-90)	5.02	32.90	30.78
VIII Plan (1992-97)	1.96	14.35	12.39
IX Plan (1997-2002)	1.55	11.64	9.45
Annual Values			
1999-2000	0.47	3.41	2.90
2000-01	0.85	6.42	5.15
2001-02	1.82	14.38	11.09

Non- Debt Receipts of the Union Government include – Revenue Receipts (net of the share of the States' in Union taxes) and the non-debt capital receipts.

4.22 Improvement in primary deficit would indicate a better outlook for the future, as the revenue receipts and non-debt capital receipts would cover current operations as interest payments are for the liabilities incurred in the earlier years. Existence of the primary deficit indicates that even the interest on past fiscal liabilities had to be funded through fresh borrowings to that extent. In 2001-02, the primary deficit increased sharply and shortfall in non-debt receipt to meet the current expenditure (total expenditure – interest payment) increased from 6.42 per cent in 2000-01 to 14.38 per cent. As percentage to revenue expenditure also, primary deficit reached 11.09 per cent compared to 2.90 per cent in 1999-2000.