Chapter 9

MANAGING GOVERNMENT FINANCES: A GENERAL EVALUATION

Indicators of Fiscal Performance

9.1 This chapter presents a summarised position of government finances over 1985-2006, with reference to certain key indicators that help in assessing the adequacy and effectiveness of available resources, highlighting the areas of concern, and capturing important facets of government finances. Fiscal parameters of the Union Government have broadly been grouped under four major components and for each component sets of indicators have been conceived to assess the fiscal developments over time. The four major components are resource mobilisation; expenditure management; management of fiscal imbalances and management of fiscal liabilities.

Resource Mobilisation

9.2 Eight indicators shown in table 9.1 are included under this major component to capture the adequacy of resources, growth of these resources and returns on past investments, financial intermediation and capital expenditure incurred to date. The revenue receipt to GDP ratio indicates the adequacy of the present flow of resources for the provision of current services. Revenue receipts comprise tax and non-tax receipts as well as recovery of user charges for social and economic services provided by the government. The second indicator of adequacy of resources is the tax-GDP ratio, a sub-set of the revenue receipts. This ratio indicates the government's access to such resources for which there is no direct service provision obligation. Revenue and tax buoyancy indicate the pace of resource mobilisation efforts. The other four are indicators of return on past investment and recovery of user charges. Table 9.1 summarises the movement in value of these indicators over 1985-2006, the VIII and IX Plans (1992-1997 and 1997-2002) and for the first four years of the X Plan (2002-07).

Table 9.1: Indicators of Resource Mobilisation

(Per cent)

Indicator	1985-2006	VIII Plan (1992-1997)	IX Plan (1997-2002)	2002-03	2003-04	2004-05	2005-06
Revenue Receipt/GDP	12.51	12.71	12.40	12.14	12.29	12.14	12.20
Gross Tax Receipt/GDP	9.35	9.32	8.68	8.76	9.22	9.82	10.37
Revenue Buoyancy*	0.94	0.94	0.78	1.59	1.11	0.89	1.05
Tax Buoyancy*	0.93	0.96	0.86	1.90	1.50	1.59	1.46
Return on Advances	11.96	11.23	14.15	15.11	15.91	14.30	13.36
Return on Investment	5.21	2.35	5.30	8.83	9.84	13.29	18.78
User Charges Recovery-Social Services	6.68	9.57	3.59	2.03	1.91	1.49	4.28
User Charges Recovery-Economic Services	52.34	57.22	55.80	43.07	45.27	51.37	45.39

** Revenue and Tax buoyancy coefficients are in ratios.*

9.3 The ratio of revenue receipts to GDP witnessed a decelerating trend. Compared to the values during the VIII Plan (1992-1997), the ratio declined to 12.40 during the IX Plan (1997-2002) and further to an average of 12.19 during the first four years of X Plan (2002-07). Tax collections, however, remained buoyant during the first four years of X Plan period and the same was reflected in an increase in tax-GDP ratio. The ratio indicated continuous improvement during the first four years of the X Plan (2002-07) and exceeded 10 *per cent* in the current year for the first time since 1992-93. Though there was an improvement in tax buoyancy during the recent years, this needs to be sustained. Revenue buoyancy, which was less than one during the VIII Plan (1992-2002) and deteriorated further during IX Plan (1997-2002), not only improved but also exceeded one in three out of four years during the X Plan period. There appeared a positive improvement in return from investment and loans and advances, but recovery of user charges witnessed significant decline over the years. Resource mobilisation efforts, therefore, presented a somewhat mixed picture.

Management of Expenditure

9.4 In expenditure management, eight indicators shown in table 9.2 were identified to capture its growth and quality. Plan expenditure, capital expenditure and development expenditure are indicators of the quality of expenditure. The parameters of ratio of expenditure to GDP and buoyancy (with reference to revenue receipt) indicate relationship of expenditure with GDP and its responsiveness to changes in these parameters. Values of these parameters over the defined time frame are indicated in Table 9.2.

Table 9.2: Indicators of Expenditure Management

(Per cent)

Indicator	1985-2006	VIII Plan (1992-97)	IX Plan (1997-2002)	2002-03	2003-04	2004-05	2005-06
Total Expenditure/GDP	19.29	19.66	19.56	19.29	18.36	17.69	17.25
Revenue Expenditure/GDP	15.88	15.51	16.36	16.59	15.95	14.67	15.31
Revenue Expenditure/Total Expenditure	82.31	78.88	83.61	85.99	86.83	82.93	88.74
Plan Expenditure/Total Expenditure	23.14	23.68	20.99	23.40	24.13	24.20	23.08
Capital Expenditure/Total Expenditure	8.50	9.61	7.01	6.40	6.98	9.77	9.21
Development Expenditure*/ Total expenditure	42.01	42.24	40.40	39.96	40.10	38.69	41.31
Buoyancy of Total Expenditure with Net Revenue Receipts (Ratio)	0.93	0.76	1.09	0.53	0.49	0.75	0.76
Buoyancy of Revenue Expenditure with Net Revenue Receipts (Ratio)	1.04	0.94	1.28	0.70	0.57	0.32	1.30

** Development expenditure is total expenditure on social and economic services and the denominator total expenditure here excludes loans and advances.*

9.5 As in the case of parameters on resources mobilisation, movement of parameters relating to expenditure also presented a mixed picture. Capital expenditure as a percentage of total expenditure witnessed deceleration to 7.01

per cent during IX Plan (1997-2002) from the level of 9.61 *per cent* in VIII Plan (1992-97). It however exhibited an acceleration trend during the last two years and it almost regained the average level of VIII Plan period. The share of development expenditure and plan expenditure in total expenditure remained almost stable over time while that of revenue expenditure has reflected an increasing trend and risen from an average of 78.88 *per cent* in VIII Plan (1992-97) to 83.61 *per cent* in IX Plan (1997-2002) and further to an average of 86.12 *per cent* during the first four years of the X Plan (2002-07). The buoyancy of total and revenue expenditure with revenue receipts indicated a mixed trend during the period 1985-2006.

Management of Fiscal Imbalances

9.6 Five indicators shown in table 9.3 were identified to capture management of fiscal imbalances. These included the ratio of revenue, fiscal and primary deficit to GDP, the ratio of revenue deficit to fiscal deficit and the balance from current revenue (BCR). Though deficits are essentially the outcomes of the government's policy with regard to its receipts and expenditure, they serve as useful proxies for fiscal health. The Fiscal Responsibility and Budget Management (FRBM) Act of 2003 and Rules made thereunder, as they stand now, has mandated the government to take appropriate steps to (i) eliminate revenue deficit by 31 March 2009 and thereafter build adequate revenue surplus, and (ii) to bring down the fiscal deficit to not more than 3 *per cent* of GDP by 31 March 2009. The values of these parameters over the specified periods as mentioned above are indicated in Table 9.3.

Table 9.3: Indicators of Management of Fiscal Imbalances

(Per cent)

Indicator	1985-2006	VIII Plan (1992-97)	IX Plan (1997-2002)	2002-03	2003-04	2004-05	2005-06
Revenue Deficit/GDP	3.37	2.80	3.95	4.44	3.66	2.53	3.11
Fiscal Deficit/GDP	5.49	6.04	6.25	5.45	2.93	3.34	4.67
Primary Deficit/GDP	1.08	1.77	1.49	0.41	-1.70	-0.87	0.67
Revenue Deficit/Fiscal Deficit	61.47	46.26	63.26	81.56	124.77	75.82	66.51
Balance From Current Revenue *(Rupees in crore)*	-9849	-2191	-28622	-38195	-22348	8794	2161

9.7 The ratios of deficits to GDP and the ratio of revenue deficit to the fiscal deficit indicate vulnerability of Union finances. Finances become vulnerable to the extent that fiscal deficit is not used for creating assets, as there is no addition to the repayment capacity and no asset back up for the liabilities incurred. This ratio increased from an average of 46.26 *per cent* during the VIII Plan (1992-1997) to the peak level of 124.77 *per cent* in 2003-04. It was for the first time that revenue deficit exceeded fiscal deficit. During the subsequent years though the ratio indicated an improvement but still it is considerably higher and exceeds the levels already achieved in VIII and IX

Plan periods. Complete elimination of revenue deficit as mandated by the FRBM Act 2003 may therefore need greater efforts. The ratio of fiscal deficit to GDP, which had witnessed a sharp improvement in 2003-04 due to augmented recovery of past loans, could not sustain the momentum even though recoveries of loans and advances continued to exceed fresh advances till 2004-05 and in the current year, the shortfall was only marginal. The fiscal policy has a significant role in maintaining the macroeconomic stability but its efficacy and effectiveness depends upon the structure of fiscal deficit. However, the large structural fiscal deficit caused due to dominant share of structural primary deficit and structural interest payments have reduced the role that cyclical component of fiscal deficit can play during the periods of macroeconomic fluctuations. The primary surplus, which was experienced consecutively for two years in 2003-04 and 2004-05 for the first time in over 30 years again turned into a deficit in the current year mainly on account of enhanced spending on social and economic services and grants in aid to States and UT Governments. Balance from the current revenue indicates the non-plan revenue balances and if these are positive, there is to that extent, funding of plan expenditure from the current revenue. BCR, which had turned negative in 1990-91, became positive in 2004-05. BCR continued to be positive in the current year but exhibited a declining trend. Greater efforts are needed to address the fiscal imbalances which indicate deteriorating trend during the current year.

Management of Fiscal Liabilities

9.8 Sustainability of debt is the key issue in the assessment of government finances. Higher the debt to GDP ratio, larger is likely to be the cost at which the government is able to borrow. Average rate of interest, difference between the interest and GDP growth (referred as Domar gap) and the ratio of assets (utilisation of borrowed funds) to fiscal liabilities are important indicators of debt management. Debt redemption inclusive of interest as percentage of borrowing also indicates the degree of autonomy in utilising available resources for current applications. The higher this ratio, the lower is the amount available from borrowings for application for current services. Values of the seven indicators of management of fiscal liabilities are indicated in Table 9.4 below.

Table 9.4: Indicators of Management of Fiscal Liabilities

(Per cent)

Indicator	1985-2006	VIII Plan (1992-97)	IX Plan (1997-2002)	2002-03	2003-04	2004-05	2005-06
Fiscal Liabilities/GDP	59.46	60.72	59.08	62.69	60.13	58.71	55.75
Debt Redemption to Debt Receipt	95.89	93.10	94.70	97.87	105.33	95.78	99.44
Average Interest Rate-Total Liabilities	7.93	7.91	9.06	8.90	8.28	7.89	7.75
Domar Gap	5.79	8.63	1.37	-0.69	3.48	4.63	5.97
Ratio of Assets to Liabilities	45.96	57.68	50.90	44.78	41.48	39.36	39.32

(Per cent)

Indicator	1985-2006	VIII Plan (1992-97)	IX Plan (1997-2002)	2002-03	2003-04	2004-05	2005-06
Fiscal Liabilities/ Revenue Receipt	476	478	476	516	489	484	457
Buoyancy of Assets	0.73	0.83	0.70	0.40	-0.10	0.43	0.98

9.9 Trends in parameters relating to the management of fiscal liabilities also present a mixed picture. The debt to GDP ratio after getting consolidated during the IX Plan (1997-2002) witnessed a sharp increase in 2001-02 and after reaching the peak level in 2002-03 it exhibited the declining trend in subsequent years. However, while the ratio got moderated in the last three years due to a lower growth of fiscal liabilities relative to GDP, it is still considerably higher. While the interest rate on fiscal liabilities increased during the IX Plan, a deceleration was observed in the recent years. Nevertheless, due to a larger overhang of debt, the Government could not avail of the full benefits of moderation in the interest rate. The Domar gap remained positive except during 2002-03. The ratio of assets to liabilities declined consistently from an average of 57.68 *per cent* during the VIII five year plan to 39.32 *per cent* in 2005-06 indicating that around 60 *per cent* of the aggregate fiscal liabilities of the Union Government did not have any assets back up. Assets were also growing at a lower rate than the fiscal liabilities. Overall buoyancy of assets during 1985-2006 was 0.73 indicating that for each one *per cent* increase in liabilities, assets had grown only at 0.73 *per cent*. Buoyancy of assets continued to decelerate from VIII Plan period to 2003-04 when the assets actually declined over the previous year but in the subsequent years buoyancy has picked up and reached the peak level in the current year.

9.10 As resources available for application for current services have depleted relative to GDP, it is critical that these are used with optimal efficiency. These inefficiencies result from the inability to use the resources in time, delaying projects and programme implementation rigidities like lapsing of funds and opacities in budget proposals. These and other issues pointed out elsewhere in this Report call for various measures of reform in government finances and accounts, including budgetary operations of the government.

(Dr. A.K. BANERJEE)

New Delhi **Director General of Audit**

Dated **Central Revenues**

Countersigned

New Delhi **(VIJAYENDRA N. KAUL)**

Dated **Comptroller and Auditor General of India**