Chapter 6

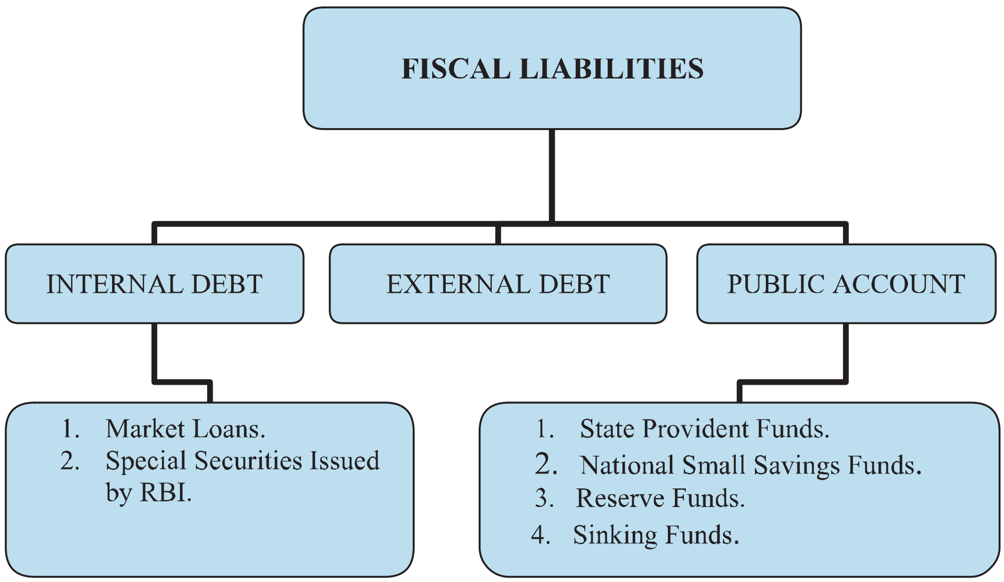
MANAGEMENT OF FISCAL LIABILITIES

Government incurs fiscal liabilities to meet its resource requirements for repayment of debt; discharge of liabilities on the Public Account; capital expenditure and other current expenditure requirements that may remain uncovered by revenue and non-debt capital receipts. The main observations of this chapter are:

- In 2008-09, the incremental total liabilities to GDP ratio was higher than the previous year at 6.84 *per cent* and, therefore, significantly higher than the 5 *per cent* target set by FRBM Act and Rules. ***(Para 6.2).***
- The share of internal debt grew at a higher rate during the post-liberalization period (1992-2009) compared to external debt and Public Account liabilities. While the average annual rate of shift in the ratio of internal debt-GDP was 3.37 *per cent,* significant negative shift rates were observed for the other two components viz. (-) 5.62 *per cent* and (-) 7.67 *per cent* for Public Account and external debt at current rates. ***(Para 6.2)***
- The ratio of assets to liabilities in 2008-09 was only 36 *per cent* compared to the trend ratio of 44 *per cent* for the period 1992-2009. This means that over the years, the liabilities grew faster than the assets. As against a trend growth rate of around 11 *per cent*, total liabilities grew by nearly 15 *per cent* in 2008-09. Comparatively, there was only a marginal increase in the growth in assets (8 *per cent*) in 2008-09 compared to the trend growth rate of around 7.5 *per cent*. ***(Para 6.3)***
- Compared to an average shortfall in resources (incremental revenue expenditure minus incremental revenue receipts) of Rs 20,007 crore for the post-liberalization period of 1992-2009, the resource gap widened alarmingly in 2008-09 to Rs 2,70,942 crore which is almost 14 times the average trend resource gap. ***(Para 6.4)***
- At present, the Union's debt-GDP ratio is close to 53 *per cent*, with external debt measured at current exchange rates, and after excluding NSSF liabilities against which there are assets in the form of state securities and Market Stabilisation Scheme (MSS) liabilities against which an equal amount of cash is held with the RBI. This is lower than the BE figures for 2008-09 viz. 59.6 *per cent* given in the Medium Term Fiscal Policy Statement along with the budget documents in 2008-09. ***(Para 6.5)***
- Continued inadequate planning resulted in avoidable expenditure in the form of commitment charges amounting to Rs. 117.37 crore in 2008-09. ***(Para 6.7)***
- Total outstanding guarantees were 2.1 *per cent* of GDP in 2008-09 and 17 *per cent* of the revenue receipts that accrued to the Union. These guarantees, however, do not include the volume of implicit contingent liabilities in the nature of open-ended pension payments. ***(Para 6.8)***

Internal debt, external debt and other liabilities are the three sets of liabilities that constitute the Union Government debt (Box 6.1). Internal and external debts constitute public debt and are secured under the Consolidated Fund of India. Internal debt includes market loans, special securities issued to Reserve Bank of India and various other special securities, compensation and other bonds and other Rupee securities. External debt represents the loans received from foreign governments and bodies. The other liabilities of the government arise more in its capacity as a banker or a trustee rather than a borrower and include small savings, provident funds, reserve funds and sinking funds (created by charging expenditure while actual expenditure/disbursement is yet to be made) deposits. These borrowings or accruals are not secured under CFI and are shown as part of the Public Account. All these liabilities, however, are obligations of the government either in terms of their repayment or specified expenditure.

BOX 6.1: FISCAL LIABILITIES OF GOVERNMENT OF INDIA



6.1 Aggregate Fiscal Liabilities: Trends and Composition

Table 6.1 presents aggregate liabilities of the Government including internal debt and external debt calculated both at the current rate of exchange and at the historic rate (the rate at which the debt was originally contracted) and the Public Account during 1992-2009. Annual total liability in terms of its composition is indicated in **Appendix-VI-A**.

Table 6.1: Aggregate Fiscal Liabilities- Trends & Composition

(Rupees in crore)

Period	Internal Debt	External Debt at historic rates	Public Account*	Total liabilities (at historic rates)	External Debt (at current rates)	Total liabilities (at current rates)
1992-2009(Average)	**872701**	**67835**	**318747**	**1259284**	**179127**	**1370576**
VIII Plan (1992-97) (Average)	272725	49206	218152	540082	137732	628608

(Rupees in crore)

Period	Internal Debt	External Debt at historic rates	Public Account*	Total liabilities (at historic rates)	External Debt (at current rates)	Total liabilities (at current rates)
IX Plan (1997-02) (Average)	655942	61703	292049	1009694	183073	1131064
X Plan (2002-07) (Average)	1274620	72715	368973	1716307	193395	1836987
XI Plan (2007-12)						
2007-08	1799651	112031	466602	2378284	210104	2476357
2008-09	**2019841**	**123046**	**556235#**	**2699122**	**264059**	**2840135**
Average annual Rate of Growth (*per cent*)						
1992-2009(Average)	16.09	5.55	6.00	12.23	3.70	11.29
VIII Plan (1992-97) (Average)	14.13	5.95	14.80	13.62	5.88	12.48
IX Plan (1997-02) (Average)	25.42	6.77	-7.05	12.80	5.05	11.85
X Plan (2002-07) (Average)	10.80	19.75	7.29	10.37	1.05	8.98
XI Plan (2007-12)						
2007-08	16.48	9.07	6.33	13.98	4.41	13.33
2008-09	**12.24**	**9.83**	**19.21**	**13.49**	**25.68**	**14.69**

* *Public Account liabilities since 1999-2000 exclude the liabilities on account of small savings to the extent invested in Special State Government Securities.*

 # As on 31.3.2009, Public Account liabilities stood at Rs.10,16,291 crore, which includes Rs.4,58,556 crore invested in special State Government securities and Rs. 1,500 crore invested in IIFCL from 2007-08.

Table 6.1 indicates that for the period 1992-2009, internal debt grew at an average annual rate of around 16 *per cent*, compared to which its growth in 2008-09 was lower at around 12 *per cent*. In both the other categories of fiscal liabilities, viz. External debt (at current rates) and liabilities in the Public Account, the growth in 2008-09 was much higher than the trend growth rate. External debt at current rate grows as a result of depreciation of Rupee. Growth in Public Account liability was on account of issue of special bonds to fertiliser companies (Rs. 20,000 crore) and Petroleum Bonds (net of redemption Rs. 62,600 crore).

6.2 Fiscal Liabilities relative to GDP

The FRBM Act and Rules prescribed that the Central Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of 9 *per cent* of GDP for the financial year 2004-05 and in each subsequent year, the limit of 9 *per cent* shall be progressively reduced by at least one percentage point of GDP. The incremental total liabilities relative to GDP were at 6.17 *per cent* during 2007-08, which is marginally above the ceiling limit of 6 *per cent* projected for 2007-08 following the rule prescribed under FRBM Act and Rules made there under. In 2008-09, the incremental total liabilities to GDP ratio was higher than the previous year at 6.84 *per cent* and, therefore, significantly higher than the 5 *per cent* target set by FRBM.

The long-term tendency of the ratio of fiscal liabilities to GDP exhibited relative stability with an average annual rate of shift[1] of only (-) 0.90 *per cent* during 1992-2009. Although the fiscal liabilities relative to GDP remained almost stable during the period 1992-2009, the share of its components varied over time with share of internal debt indicating increasing trend over the period (Table 6.2). While the average annual rate of shift in the ratio of internal debt-GDP was 3.37 *per cent,* significant negative shift rates were observed for the other two components viz. (-) 5.62 *per cent* and (-) 7.67 *per cent* for Public Account and external debt at current rates.

Table 6.2: Fiscal Liabilities Relative to GDP

(Per cent)

Period	Internal Debt/GDP	External Debt (at historic rates)/GDP	Public Accounts/GDP	Total liabilities (historic rates)/GDP	External Debt (at current rates)/GDP	Total liabilities (current rates)/GDP
1992-2009(Average)	36.24	2.82	13.24	52.30	7.44	56.92
VIII Plan (1992-97) (Average)	26.20	4.73	20.96	51.89	13.23	60.39
IX Plan (1997-02) (Average)	34.12	3.21	15.19	52.52	9.52	58.84
X Plan (2002-07) (Average)	39.65	2.26	11.48	53.39	6.02	57.14
XI Plan (2007-12)						
2007-08	38.10	2.37	9.88	50.35	4.45	52.43
2008-09	37.95	2.31	10.45	50.72	4.96	53.37
Average Annual Rate of Shift in Relative Shares						
1992-2009	3.37	-6.02	-5.62	-0.07	-7.67	-0.90

6.3 Buoyancy of Assets and Ratio of Assets to Liabilities: It is not uncommon for the government to borrow funds for creating capital assets or for making investment. Though in government accounting system comprehensive accounting of the fixed assets like land and buildings etc., owned by the government is not done, accounts do capture and provide the assets created out of the expenditure incurred. Government's investment, outstanding loans and advances and cumulated capital expenditure could be considered as its assets. The ratio of these assets to its aggregate fiscal liabilities could be considered a surrogate measure of quality of its application of borrowed funds.

[1] Annual rate of shift in any variable refers to the rate of change in that variable compared with rate of change in GDP.

Table 6.3: Buoyancy of assets and Ratio of Assets to Liabilities

(Rupees in crore, Ratio and Growth rates in per cent)

Period	Aggregate Liabilities	Aggregate Assets	Ratio of Assets to Liabilities	Annual Growth of Liabilities	Annual Growth of Assets	Buoyancy of Assets
1992-2009(Average)	1370576	608923	44.43	11.29	7.48	0.66
VIII Plan (1992-97) (Average)	628608	362555	57.68	12.48	10.31	0.83
IX Plan (1997-02) (Average)	1131064	575671	50.90	11.85	8.29	0.70
X Plan (2002-07) (Average)	1836987	739512	40.26	8.98	4.74	0.53
XI Plan (2007-12)						
2007-08	2476357	942507	38.06	13.33	14.37	1.08
2008-09	2840135	1020498*	35.93	14.69	8.27	0.56

* Refers to Table1.4: Summary of Balances of Government Finances in Chapter-1

The ratio of assets to liabilities in 2008-09 was only 36 *per cent* compared to the trend ratio of 44 *per cent*. This means that over the years, the liabilities are growing faster than assets as is shown in Table 6.3. As against a trend growth rate of around 11 *per cent*, total liabilities grew by nearly 15 *per cent* in 2008-09. There was only a marginal growth in assets in 2008-09 as compared to the trend growth rate.

6.4 Debt Sustainability

Fiscal liabilities are considered sustainable if the government is able to service the stock of these liabilities over the foreseeable future and the debt-GDP ratio does not grow to unmanageable proportions. A necessary condition for stability is the Domar's Debt Stability Equation. It states that if the rate of growth of economy exceeds the rate of interest on the debt, the debt-GDP ratio is likely to be stable provided primary balances[2] are either zero, positive or are moderately negative. In a situation where the rate of interest is higher than the rate of growth of output, the debt-GDP ratio would continue to rise unless the primary balances turn positive. If the nominal growth rate of the economy exceeds the nominal rate of interest on domestic debt, stabilisation of domestic debt is possible while still running a primary deficit (even in excess of monetisation).

The average interest rate (nominal) on total debt over time, as indicated in Table 6.4, remained lower than the rate of growth of GDP at the market prices[3] during 1992-2009. The average interest rate on internal debt in 2008-09 (8.67 *per cent*) was lower than the trend rate of 9.28 *per cent* for the entire

[2] Primary balances refer to fiscal deficit minus interest payments.
[3] Please refer Table 3.2 in Chapter 3

post- liberalization period. The average interest rate paid on external debt is much lower than that paid on domestic debt.

Table 6.4: Average interest rate on fiscal liabilities at current exchange rates

(Per cent)

Period	Internal liabilities	External debt	Aggregate liabilities	Rate of growth of GDP	Interest spread
1992-2009(Average)	9.28	2.32	8.32	12.31	3.99
VIII Plan (1992-97) (Average)	9.37	3.07	7.91	16.53	8.63
IX Plan (1997-02) (Average)	10.42	2.51	9.06	10.33	1.27
X Plan (2002-07) (Average)	8.91	1.78	8.09	13.93	5.84
XI Plan (2007-12)					
2007-08	8.87	1.95	8.24	14.39	6.15
2008-09	8.67	2.00	8.10	12.67	4.57
Average interest rate is = Interest paid/Outstanding Liabilities at the beginning of the year x 100					

The debt sustainability of the Union Government also depends on (i) the ratio of the debt redemption (principal + interest payments) to total debt receipts and (ii) application of available borrowed funds. The ratio of debt redemption to debt receipts indicates the extent to which the debt receipts are used in debt redemption indicating the net availability of borrowed funds. Table 6.5 shows that debt redemption ratio has consistently increased from an average of 93.10*per cent* in VIII Plan (1992-97) to 98.68 *per cent* during X Plan (2002-07) with inter year variations. In 2008-09, 96 *per cent* of debt receipts was applied towards total debt repayment. The ratio has declined in subsequent years mainly due to enhanced debt receipts, which have increased by 25.75 *per cent* during the current year. An increase in internal debt receipt by Rs. 5,23,450 crore (28.3 *per cent*) led to an increase of Rs. 5,35,155 crore (24.12 *per cent*) in debt receipts during the year.

Table 6.5: Ratio of Debt Redemption to Debt Receipts

Period	Debt Receipts*	Debt Repayment		Principal Debt Repayment (1)/Debt Receipts	Total Debt Repayment (2)/Debt Receipts
		Principal* (1)	Principal +Interest (2)		
	(Rupees in crore) (Annual Average)			*(Per cent)*	
1992-2009(Average)	894648	761052	863215	85.07	96.49
VIII Plan (1992-97) (Average)	266443	203787	248066	76.48	93.10
IX Plan (1997-02) (Average)	530341	411106	502208	77.52	94.70
X Plan (2002-07) (Average)	1250358	1097979	1233839	87.81	98.68

Period	Debt Receipts*	Debt Repayment		Principal Debt Repayment (1)/Debt Receipts	Total Debt Repayment (2)/Debt Receipts
		Principal* (1)	Principal +Interest (2)		
	(Rupees in crore) (Annual Average)			*(Per cent)*	
XI Plan (2007-12)					
2007-08	2219076	1919363	2099350	86.49	94.60
2008-09	2754231	2454164	2654744	89.11	96.39

**Debt receipt and repayments include debt figures in CFI net of ways and means advances plus receipt and repayments in Public Account.*

Debt sustainability issues were discussed by successive Finance Commissions. The Ninth Finance Commission observed that ultimately the solution to the government debt problem lies in borrowed funds – (a) not being used for financing revenue expenditure and (b) being used efficiently and productively for capital expenditure, which either provides returns directly or results in increased productivity of the economy in general, which may result in increase in government revenue. The Eleventh Finance Commission (EFC) suggested that debt sustainability could be significantly facilitated if incremental revenue receipts could meet the incremental interest burden and the incremental primary expenditure. The Twelfth Finance Commission (TFC) while endorsing the approach suggested by the EFC felt that the pre-requisite to this is the achievement of revenue balance by instituting measures for augmenting revenue receipts and compressing expenditure.

Table 6.6 indicates that compared to an average shortfall in resources (incremental revenue expenditure minus incremental revenue receipts) of Rs 20,007 crore for the post-liberalization period of 1992-2009, the resource gap widened alarmingly in 2008-09 to Rs 2,70,942 crore, which is almost 14 times the average trend resource gap.

Table 6.6: Shortfall of incremental revenue receipts to meet incremental revenue expenditure and interest payments

(Rupees in crore)

Period	Incremental				Resource Gap
	Revenue Receipts	Non-interest Revenue Expenditure	Interest Expenditure	Revenue Expenditure	
1992-2009(Average)	32589	42362	10234	52596	-20007
VIII Plan (1992-97) (Average)	18778	15480	6576	22056	-3278
IX Plan (1997-02) (Average)	14312	18903	10939	29842	-15530
X Plan (2002-07) (Average)	52023	48510	8021	56532	-4509
XI Plan (2007-12)					
2007-08	124033	50914	25707	76621	47412
2008-09	4421	254770	20593	275363	-270942

6.5 Fiscal Deficit and Debt Sustainability

In the context of fiscal sustainability, TFC felt that the issue of debt sustainability also needs to be viewed for combinations of debt and fiscal deficit as debt would become unsustainable, if fiscal deficits follow a course that leads to a self-perpetuating rise in the debt-GDP ratio. A sustainable debt-deficit combination would be stable in terms of debt- GDP ratio and fiscal deficit-GDP ratio consistent with the permissible levels of primary expenditure. The issue, therefore, involved is one of determining that level of fiscal deficit, which will stabilize the debt-GDP ratio and, at the same time, can promote growth. The FRBM Act 2003, read with its rules and subsequent amendment, specifies the target for achieving a fiscal deficit to GDP ratio of 3 *per cent* by the Central Government by 2008-09. Given this fiscal deficit target, for a combination of 12 *per cent* nominal growth rate and 7 *per cent* interest rate, the TFC in the suggested programme for restructuring public finances has recommended that the primary deficit should be equal to 1.25 *per cent* of GDP. TFC had further estimated that once the adjustment phase is over and the fiscal deficit of the Centre being contained at 3 *per cent*, the debt-GDP ratio of the Union would stabilize at 44 *per cent* of GDP by 2008-09.

At present, the Union's debt-GDP ratio is around 53 *per cent* (Table 6.2), with external debt measured at current exchange rates, and after excluding NSSF liabilities against which there are assets in the form of state securities and Market Stabilisation Scheme (MSS) liabilities against which an equal amount of cash is held with the RBI. This is lower than the BE figures for 2008-09 viz. 59.6 *per cent* given in the Medium Term Fiscal Policy Statement along with the budget documents in 2008-09.

6.6 Cash Management

Effective April 1997, a new scheme of Ways and Means Advances (WMA) was introduced to facilitate the government to overcome the temporary mismatches in its cash flows. With the Reserve Bank of India withdrawing from participation in the primary issuance of Central Government securities with effect from April 1, 2006 in accordance with the FRBM Act 2003, the WMA arrangements were revised from 2006-07. In order to facilitate the transition necessitated by the FRBM provisions, under the revised arrangements, the limits for 2006-07 were fixed on quarterly basis. The Reserve Bank, however, retained the flexibility to revise the limits in consultation with the Government, taking into consideration the transitional issues and prevailing circumstances.

During the year 2008-09, amount of Rs. 2,26,012 crore was obtained and discharged by the Government as Ways and Means Advances. The details of

WMA availed by the Union Government since 1999-2000 are presented in Table 6.7, which reveals that there were no outstanding WMA balances after the year 2001-02 (Table 6.7).

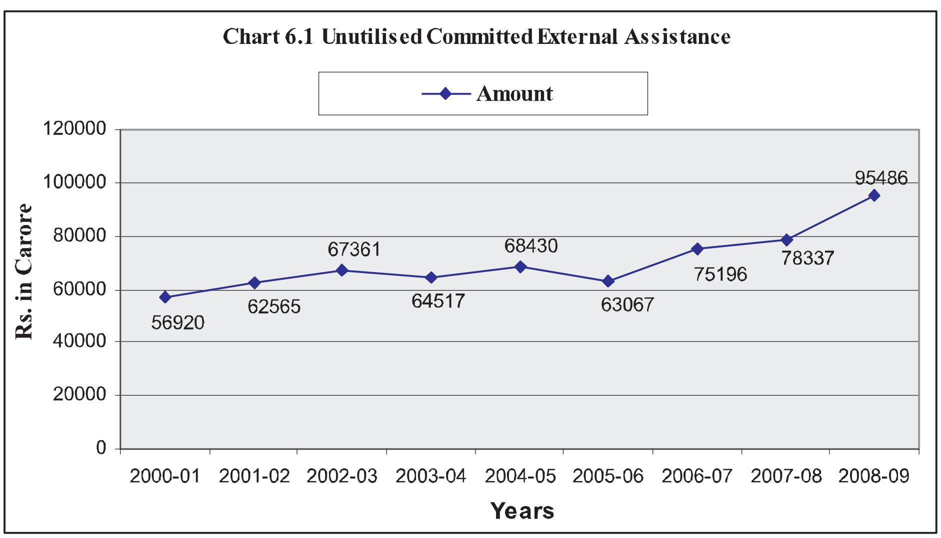
Table 6.7: Ways and Means Advances

(Rupees in crore)

Year	Opening Balance	Addition during the Year	Discharge during the Year	Outstanding Ways and Means Advances
1999-00	3042	124972	127032	982
2000-01	982	131300	126887	5395
2001-02	5395	170953	171172	5176
2002-03	5176	118961	124137	Nil
2003-04	Nil	96615	96615	Nil
2004-05	Nil	62080	62080	Nil
2005-06	Nil	1134	1134	Nil
2006-07	Nil	25226	25226	Nil
2007-08	Nil	110007	110007	Nil
2008-09	Nil	226012	226012	Nil

6.7 Unutilised Committed External Assistance

As on 31 March 2009, unutilised committed external assistance was of the order of Rs. 95,486 crore, which was nearly 22 *per cent* higher than the corresponding figure for the previous year. The sector-wise details of unutilised external assistance are given in **Appendix-VI-B** and **Chart 6.1** shows the year-wise total un-drawn balance of external assistance from various sources. The sector-wise details from the office of the Controller of Aid, Accounts and Audit indicates that there were large undrawn balances in urban development, water resources, infrastructure and health sectors.



Commitment charges on un-drawn external assistance are to be paid on the amount of principal rescheduled for drawal on later dates. As there is no distinct head in the accounts for reflecting the payment of commitment charges, it is shown under the head 'interest obligation'. Table 6.8 indicates charges paid to various bodies/governments during 2000-2009 as commitment charges for rescheduling of drawal of assistance at a later date. This points to continued inadequate planning resulting in avoidable expenditure in the form of commitment charges amounting to Rs. 117.37 crore in 2008-09.

Table 6.8: Commitment Charges

(Rupees in crore)

Year	ADB	France	Germany	IBRD	Total
2000-01	13.52	0.27	0.19	26.25	40.23
2001-02	12.84	0.22	0.76	34.64	48.46
2002-03	26.45	0.19	0.95	39.60	67.19
2003-04	38.23	0.02	8.99	45.91*	93.15
2004-05	45.10	Nil	2.07	117.94*	165.11
2005-06	53.42	0.0	1.86	92.89*	148.17
2006-07	59.56	0.0	1.93	79.02	140.51
2007-08	62.55	0.0	1.72	60.27	124.54
2008-09	62.62	0.0	4.17	50.58*	117.37

Source: Controller of Aid Accounts & Audit

**includes International Development Agency assistance*

6.8 Growth in Contingent Liabilities of the Union Government

Contingent liabilities of the Union Government arise because of its role in promoting investment and in reducing the credit risk for investors, especially in those activities where the nature of investment is characterised by long gestation periods. While guarantees do not form part of debt as conventionally measured, in the eventuality of default, this has the potential of aggravating the debt position of the Government. The issue of guarantees assumes significance in the context of the growing investment needs for infrastructure, participation by the private sector in such projects and its increasing probability of being invoked. Table 6.9 gives the position regarding the maximum amount of guarantees and sums guaranteed and outstanding at the end of the financial year from 1999-2000 to 2008-09.

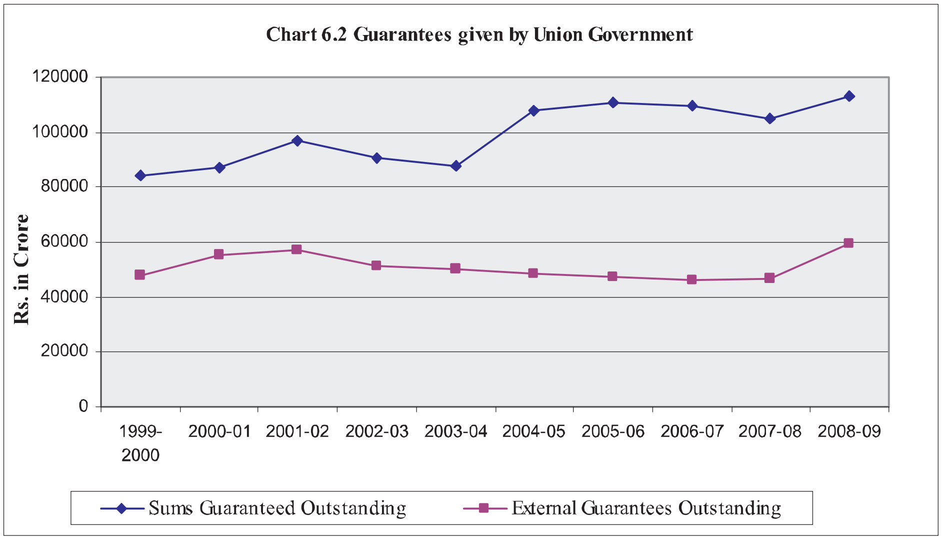


Table 6.9: Guarantees given by Union Government

(Rupees in crore)

Position at the end of the year	Maximum amount of guarantee	Sums Guaranteed Outstanding	External Guarantees Outstanding	Outstanding External Guarantees as a percentage of Total Outstanding Guarantees
(1)	(2)	(3)	(4)	(5)
1999-2000	144438	83954	47663	56.77
2000-01	135678	86862	55664	64.08
2001-02	168712	96859	57006	58.85
2002-03	174487	90617	51097	56.39
2003-04	184420	87780	50328	57.33
2004-05	132728	107957	48276	44.72
2005-06	118560	110626	47358	42.81
2006-07	114671	109826	46340	42.19
2007-08	114001	104872	46459	44.30
2008-09	117659	113335	59343	52.36

Total outstanding guarantees were 2.1 *per cent* of GDP in 2008-09 and 17 *per cent* of the revenue receipts that accrued to the Union.