Chapter 5

DEFICITS: MANAGEMENT OF FISCAL IMBALANCES

5.1 Alternative deficit measures reflect different facets of fiscal imbalance. The annual budget indicates three types of deficits, *viz*. revenue, fiscal, and primary. There is yet another deficit, the monetised deficit, which is obtained by the amount of increase in the RBI's holdings of the government debt plus any funds drawn by the government out of its cash balances with the RBI.

Deficits: 1999-00 scenario

There was an unduly high fiscal deficit during the year 1999-00 for wrong reasons, as the borrowing was mostly for current use.

5.2 Table 5.1 presents the break-up of the deficit during 1999-00. There was a surplus in the CFI amounting to Rs. 151986 crore and deficit in the Public Account amounting to Rs 152876 crore. Fiscal deficit at Rs 103749 crore amounted to 5.3 percent of the GDP. Revenue deficit was Rs 61642 crore amounting to 3.15 percent of the GDP. Revenue deficit was 59.41 percent of fiscal deficit. Thus, not only fiscal deficit was unduly high, it was necessitated for the wrong reasons, as borrowing was mostly for current use. Appendix V presents deficits for the last 24 years.

5.3 Proper management of fiscal imbalance requires consideration of some important facets of fiscal deficit. Short-term imbalances result from cash flow mismatches between receipts and outflows. More important are the structural imbalances. Actual fiscal deficit may also have cyclical components that are expected to even out over a period. Structural imbalances, however, are more difficult to overcome as they arise from structural features driving revenue receipts as well as expenditures. Persistent mismatch between growth of revenue receipts and expenditures leads to persistence of fiscal deficit, which continues to self-sustain itself due to pressures on interest rates.

5.4 The level of fiscal deficit in relation to the GDP is an important consideration in deciding whether debt is sustainable in conjunction with the trend and structure of other important fiscal aggregates like growth rate of the GDP, interest rate on government borrowing, the tax to GDP ratio, and the structure and productivity of government expenditures.

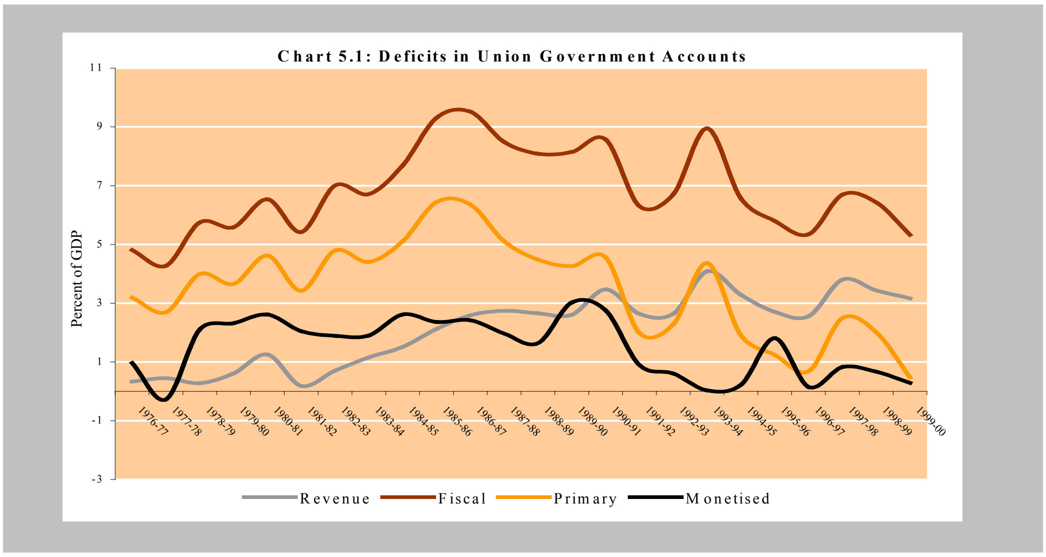
Table 5.1 : Deficits in Government Account

Rs in crore

Consolidated Fund

Receipt	Amount			Disbursement	Amount
Revenue	281553	**Revenue deficit**	**61642**	Revenue	343195
Miscellaneous capital receipts (including disinvestment)	1724			Capital	29023
Recovery of loans & advances	12551			Loans & advances disbursement	27359
Sub total CFI (other than public debt)	295828			Sub total CFI (other than Public Debt)	399577
Public debt	560823	**Fiscal deficit**	**103749**	Public debt repayment	305088
Total (CFI)	**856651**	**A: Surplus in CFI**	**151986**		**704665**
	27 [5]	**B: CONTINGENCY FUND**			
		PUBLIC ACCOUNT			
Small savings, provident funds etc.	133580			Small savings, provident funds etc.	294627
Deposits and advances [1]	57825			Deposits and advances	52015
Reserve funds [2]	17614			Reserve funds	17434
Suspense & miscellaneous [3]	5315			Suspense & miscellaneous	2038
Remittances [4]	401			Remittances	1498
Total Public Account[6]	**214736**	**C: Deficit in Public Account:**	**152876**		**367612**
		Decrease in cash balance {C-(A+B)} = 864 [6]			

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 Blls etc.
4. Includes money in transit like Money Orders. RBI Remittances, Small Coin Depot remittances, Mint remittances etc
5. Receipt of Rs. 27 crore in Contingency Fund of India on account of recoupment of previous years expenditure.
6. Differs due to rounding off



Revenue Deficit

The level of revenue deficit is high at 3.15 percent of the GDP.

5.5 Revenue deficit refers to the excess of revenue expenditure over revenue receipts. It indicates the extent to which the revenue expenditure is met out of the borrowed funds. Table 5.2 presents the profile of the revenue deficit for the period 1990-91 to 1999-00.

Table 5.2: Revenue Deficit

Rs in crore

Year	Budget estimates	Actuals		Actual revenue deficit	Revenue deficit as percent to GDP
		Revenue receipt	Revenue expenditure		
1990-91	13031	84403	102964	18561	3.26
1991-92	13854	99830	116091	16261	2.49
1992-93	13882	114220	132794	18574	2.49
1993-94	17629	119602	152317	32715	3.81
1994-95	32727	146670	177699	31029	3.07
1995-96	35541	168571	198302	29731	2.52
1996-97	31475	193718	226372	32654	2.40
1997-98	30265	218299	277732	59433	3.92
1998-99	48068	239889	300456	60567	3.44
1999-00	49147	281553	343195	61642	3.15
TGR	**17.33**	**14.13**	**14.60**	**16.91**	

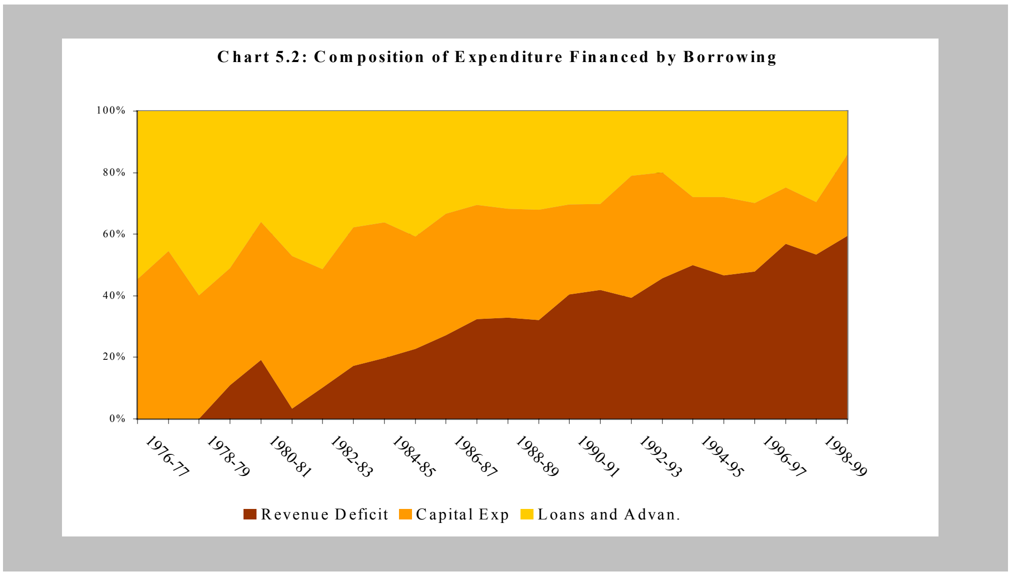
5.6 Revenue deficit increased marginally in 1999-00 as compared to 1998-99 from Rs 60567 crore in 1998-99 to Rs 61642 crore, an increase of just 1.77 per cent. This compares favourably with the trend growth rate of 16.91 percent during the nineties. In terms of GDP, it declined by 0.29 percentage point in 1999-00 compared to 3.44 in 1998-99. The comparison with the immediate previous years (1997-98 and 1998-99) needs to be qualified because in those years revenue deficit was unduly high due to payment of salary arrears. Thus, the fall in the growth rate with respect to the previous year may not provide much ground for satisfaction. The level of revenue deficit is still very high at 3.15 percent of GDP. In terms of GDP, if the average of the first three years is compared with the average for the last three years of the nineties, the revenue deficit has increased by 0.76 percentage point of GDP and 240 percent in nominal terms.

Fiscal Deficit: A Longer-term View

The quality of fiscal deficit steadily worsened during the nineties. Nearly sixty percent of it is being used for current, i.e. revenue expenditure. But even the remaining part gives little satisfaction as the capital expenditure financed by it gives returns much lower than the cost of borrowing.

5.7 Fiscal deficit is the excess of total expenditure including loans, net of repayments, over non-debt receipts comprising revenue receipts and non-debt capital receipts. Ideally, capital expenditure of the government should be financed from the revenue surplus. If such a surplus is not available, fiscal deficit may be used for financing capital expenditure so that assets are created to match the addition to the liabilities. To some extent, subject to some other considerations, financing of revenue expenditure by borrowing may be justified like that on human capital formation. Expenditure on health and education is expected to lead to an increase in productivity and growth. On the other hand, even the financing of capital expenditure by borrowing may not be justified if the return on assets generated by such capital expenditure fall short of the cost, i.e., the interest rate at which borrowing was possible. Appendix VI presents the fiscal deficit for the last 24 years.

5.8 Following the initiation of the stabilization policy in India in 1991, fiscal deficit as a proportion of the GDP (Table 1.11) witnessed a sharp fall by more than 2 percentage points in 1991-92 from 8.07 to 5.94 in terms of GDP. It rose again to 8.34 in 1993-94, which was brought down to 5.30 per cent of



GDP in 1999-00. Fiscal deficit in 1999-00 still exceeded the budget estimates of Rs 81220 crore by Rs 22529 crore. The relationship with budget estimates is discussed further in Chapter 8.

5.9 The trend over the ten-year period indicates a decline in the fiscal deficit of a little more than half a percentage point of the GDP if the average of the first three years of the nineties is compared with the last three years (Table 1.11). Expenditure financed by borrowing during the last 24years are given in Appendix VII.

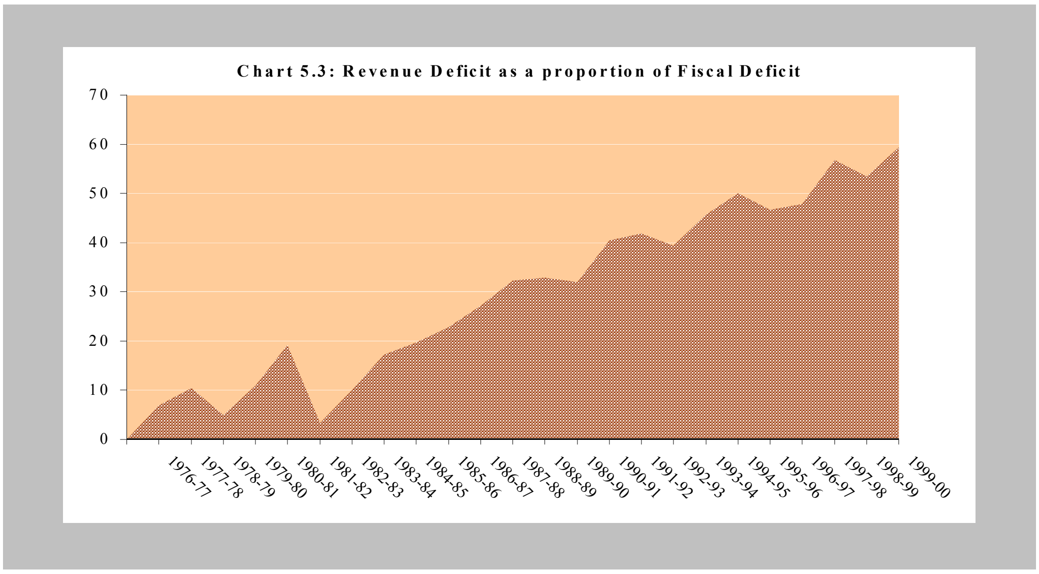
Table 5.3: Composition of Expenditure Financed by Borrowing

Rs in crore

Year	Revenue expenditure		Capital Expenditure		Loans and Advances	
	Amount	Percent	Amount	Percent	Amount	Percent
1990-91	18561	40.45	13387	29.17	13939	30.38
1991-92	16261	41.87	10873	28.00	11702	30.13
1992-93	18574	39.40	18625	39.51	9941	21.09
1993-94	32716	45.64	24698	34.46	14263	19.90
1994-95	31029	49.98	13659	22.00	17391	28.01
1995-96	29731	46.68	16147	25.35	17811	27.97
1996-97	32654	47.85	15249	22.35	20339	29.80
1997-98	59433	56.81	19313	18.46	25875	24.73
1998-99	60567	53.46	19326	17.06	33405	29.48
1999-00	**61642**	**59.42**	**27299**	**26.31**	**14808**	**14.27**

5.10 Table 5.3 indicates that during the nineties, the proportion of borrowed funds deployed for revenue expenditure, i.e., to the extent of revenue deficit, witnessed a steady rise at the expense of capital expenditure. Around

59.42 percent of the borrowed funds were applied to meet the revenue expenditure in 1999-00 compared to 40.45 per cent in 1990-91. The proportion of borrowed funds devoted to capital expenditure mirrors a corresponding fall during the same period.



5.11 The sources of borrowing have also undergone a change during the nineties. The government has been veering towards internal debt from the other two sources, external debt and small savings and provident funds, etc. (till 1998-99) gradually enhancing the cost of borrowing. Different sources of borrowing are summarized in Table 5.4.

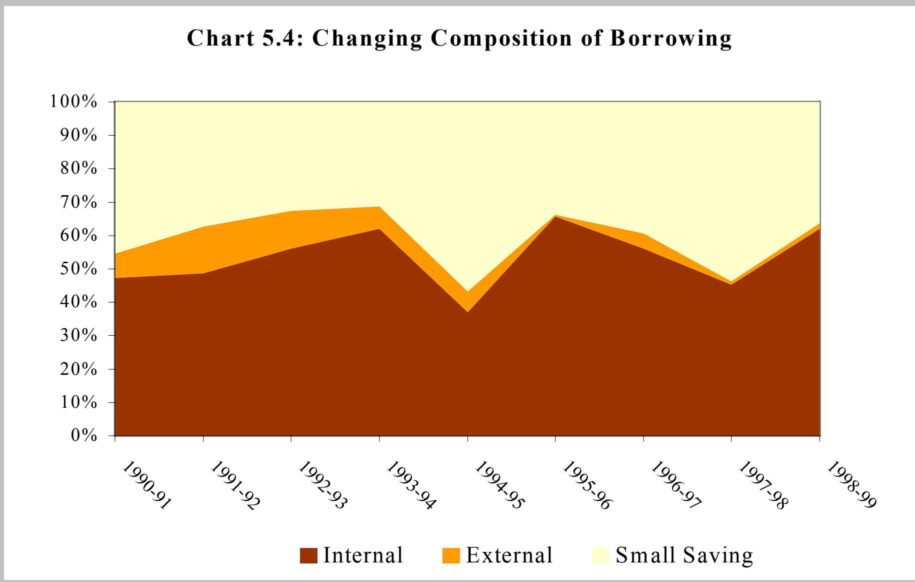
Table 5.4: Composition of Sources of Borrowing

Rs in crore

Year	Internal debt (Net)		External debt (Net)		Small savings provident fund, etc. (net)[1]		Others [2]	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
1990-91	20810	48.44	3181	7.41	20049	46.67	-1083	-2.52
1991-92	18746	48.27	5421	13.96	14394	37.06	275	0.71
1992-93	26351	55.90	5319	11.28	15304	32.46	166	0.35
1993-94	46612	65.03	5074	7.08	23554	32.86	-3564	-4.97
1994-95	20754	33.43	3581	5.77	31869	51.34	5875	9.46
1995-96	41402	65.01	318	0.50	21217	33.31	752	1.18
1996-97	36606	53.64	2987	4.38	25637	37.57	3012	4.41
1997-98	44524	42.56	1091	1.04	52826	50.49	6180	5.91
1998-99	70698	62.40	1920	1.69	41396	36.54	-716	-0.63
1999-00	**254555**	**245.36**	**1180**	**1.14**	**-161047**	**-155.23**	**9061**	**8.73**

1 The negative figure for 1999-00 is due to investment in government securities in CFI from Public Account.

2 Includes Deposits and Advances (net), Reserve funds (net), Suspense and Miscellaneous (net), Remittances (net) and Increase (+) and decrease (-) in cash balances.



5.12 The reduction of fiscal deficit as a percentage of GDP from 5.39 percent in 1995-96 to 5.30 percent in 1999-00 was achieved through compression in capital expenditure. As shown in Table 5.5, the impact of fiscal deficit has mainly been on capital expenditure.

Table 5.5 : Impact of Fiscal Deficit

Percent of GDP

Year	Revenue receipt	Fiscal deficit	Revenue expenditure	Capital expenditure
1990-91	14.84	8.07	18.10	2.35
1991-92	15.28	5.94	17.77	1.66
1992-93	15.28	6.31	17.77	2.49
1993-94	13.92	8.34	17.73	2.87
1994-95	14.52	6.15	17.60	1.35
1995-96	14.26	5.39	16.78	1.37
1996-97	14.22	5.01	16.62	1.12
1997-98	14.40	6.90	18.32	1.27
1998-99	13.64	6.44	17.09	1.10
1999-00	14.39	5.30	17.54	1.39

Primary Deficit

5.13 Primary deficit is measured by subtracting the interest payments from fiscal deficit. It is a measure of current year's fiscal operation after excluding the liability of interest payment created due to borrowings undertaken in the past. The profile of primary deficit during the period 1990-91 to 1999-00 is given in Table 5.6.

Table 5.6: Primary Deficit

Rs in crore

Year	Fiscal deficit	Interest payment	Primary deficit (2-3)	Primary deficit Percent to GDP
1	2	3	4	5
1990-91	45887	21498	24389	4.29
1991-92	38835	26596	12239	1.87
1992-93	47140	31075	16065	2.15
1993-94	71676	36741	34935	4.07
1994-95	62079	44060	18019	1.78
1995-96	63689	50045	13644	1.15
1996-97	68242	59478	8764	0.64
1997-98	104621	65637	38984	2.57
1998-99	113298	77882	35416	2.01
1999-00	103749	94593	9156	0.47

5.14 Improvement in primary deficit would indicate a better outlook for future as current operations of the government would be covered by revenue receipts and non-debt capital receipts. If, however, improvement in the primary deficit is at the cost of cut back in non-interest, i.e. primary expenditures, it means undesirably lower provision for services and capital expenditures. The fall in the average of the primary deficit from 2.77 percent of the GDP during 1990-93 to 1.68 percent of the GDP during 1997-00 suggest worrying adjustments of that nature.

Monetised Deficit

1999-00 saw for the first time in the nineties a negative monetised deficit.

5.15 Monetised deficit represents increase in the net RBI credit to the Union government, which is the sum of increases in the RBI's holdings of government debt, plus any draw down by the government of its cash balance with the RBI. Monetised deficit adds to reserve money and thereby to money supply. The monetised deficit during the last ten years were as given in Table 5.7. In 1999-00, the net RBI credit to the central government fell in absolute terms giving rise to a negative monetised deficit of Rs 5587 crore, for the first time since 1977-78. This unusual development was occasioned by, according to the RBI's annual report 1999-00, the increased investments of the scheduled commercial banks in government securities.

Table 5.7: Monetised deficit

Rs in crore

Year	Amount	Percent to fiscal deficit	Percent to GDP
1990-91	14746	32.14	2.59
1991-92	5508	14.18	0.84
1992-93	4257	9.03	0.57
1993-94	260	0.62	0.03
1994-95	2130	3.43	0.21
1995-96	19855	31.17	1.68
1996-97	1934	2.83	0.14
1997-98	12914	12.34	0.85
1998-99	11800	10.41	0.67
1999-00	(-)5587	-	-

5.16 Projections of alternate deficit indicators in the annual budget is an indicative exercise whose main purpose should be to hold out a fiscal mirror at all times during the ensuing year when the various organs of the government operationalise the budget, to inculcate necessary fiscal discipline. Any budgetary engineering to hold out highly ambitious projections would run counter to that intent.