Chapter-10

MANAGING GOVERNMENT FINANCES: A GENERAL EVALUATION

Summary Indicators of Fiscal Performance

10.1 Table 10.1 presents a summarized position of government finances over 1985-2002, with reference to certain key indicators that would help assess the adequacy and effectiveness of available resources, highlight areas of concern, and capture important facets of government finances like adequacy, sustainability, autonomy and vulnerability.

10.2 The revenue receipt -GDP ratio, the first indicator, indicates the adequacy of the present flow of resources for the provision of current services. Revenue receipts comprise both tax and non-tax receipts and also captures the element of 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. There is a marked decline in these ratios during the VIII and IX Five-year Plans indicating a declining adequacy of resources. The revenue receipt-GDP ratio recorded a steep fall in 2001-02. Compared to the average level of 13.95 *per cent* during 1985-90, the overall decline was more than 2 percentage points, which works out to a trend annual growth of *(minus)* 0.94 *per cent*.

10.3 The buoyancy of taxes also declined from 1.039 during 1985-90 to 0.856 during 1997-2002. In the current year, it was negative as tax collections recorded a negative growth. A decline in buoyancy indicated that for each one per cent increase in GDP, tax collections were increasing at comparatively lower rates. The ratio of committed expenditure to revenue receipts is also an indicator of the adequacy of resources for capital formation, maintenance of assets already created and availability of funds for non-salary, non-interest purposes. This ratio moved upwards by nearly 20 percentage points from an average of 46.04 *per cent* during 1985-90 to 66.05 *per cent* in 2001-02.

Table 10.1 Summary of Indicators of Fiscal Performance

	Revenue Receipt/ GDP	Tax/GDP	Committed Expenditure/ Total expenditure	Interest Payments/ revenue Receipts	Committed Expenditure/ Revenue Receipts	Total Expenditure/ GDP	Development Expenditure/ Total Exp
	1	2	3	4	5	6	7
1985-2002	13.07	9.60	33.74	31.24	54.03	21.06	43.03
VII Plan (1985-90)	13.95	10.53	27.45	22.77	46.04	23.44	46.10
VIII Plan (1992-97)	12.74	9.34	34.91	33.54	54.43	19.91	42.37
IX Plan (1997-02)	12.45	8.70	39.69	38.04	62.55	19.62	40.68
Annual Values							
1999-2000	13.19	8.90	42.37	37.15	62.02	19.31	40.16
2000-2001	12.26	9.03	42.40	40.32	65.55	18.96	38.25
2001-02	11.58	8.16	39.33	43.04	66.05	19.44	38.74
	Fiscal deficit/ GDP	Revenue Deficit/ GDP	Primary Deficit/GDP	Revenue Deficit/ Fiscal Deficit	Per Capita Expenditure on Economic Services	Per Capita Expenditure on Social Services	Capital Expenditure/ GDP
	8	9	10	11	12	13	14
1985-2002	-6.91	-3.03	-2.87	45.36	718	79	2.16
VII Plan (1985-90)	-8.19	-2.39	-5.02	29.43	675	67	3.03
VIII Plan (1992-97)	-6.22	-2.85	-1.96	45.91	693	68	2.03
IX Plan (1997-01)	-6.27	-3.91	-1.55	62.42	793	104	1.37
Annual Values							
1999-2000	-5.38	-3.19	-0.47	59.41	790	116	1.50
2000-2001	-5.79	4.15	-0.85	71.65	756	114	1.22
2001-02	-6.80	-4.81	-1.82	70.78	825	95	1.37
	Internal Liabilities/ GDP	Total# Liabilities/ GDP	Average Interest Rate (internal debt)	Average Interest Rate (Total debt)	Debt$ Repayment/ Debt Receipts	Balance from Current Revenue	Buoyancy of Taxes
	15	16	17	18	19	20	21
1985-2002	48.21	58.25	8.94	7.99	92.94	-9248	0.888
VII Plan (1985-90)	47.26	53.57	7.37	7.02	89.65	761	1.039
VIII Plan (1992-97)	47.69	61.39	9.29	7.84	93.10	-2191	0.967
IX Plan (1997-01)	49.28	58.94	10.39	9.02	94.48	-28622	0.856
Annual Values							
1999-2000	48.40	58.04	10.79	9.34	98.41	-14811	1.794
2000-2001	50.23	59.33	10.58	9.22	97.02	-35407	1.196
2001-02	52.37	61.09	10.48	9.22	91.71	-48647	-0.084

$ *Includes payment of interest*

 # at current exchange rate from 1991-92 and at historic rates prior to that

10.4 The share of committed expenditure to total expenditure of the government indicates the extent of flexibility. A rising ratio would indicate reduced availability of resources for new activities. The increase in this ratio over the years, indicates a decline in government's fiscal flexibility. The ratio of interest payments to revenue receipts indicates the extent of availability of resources for current services. This ratio also increased by over 20 percentage points by 2001-02 compared to the VII Plan average pointing to a lower availability of resources for application to current services. The ratios of development expenditure to total expenditure and the capital expenditure to GDP also indicate a declining trend. Increasingly, a larger proportion of Government expenditure was incurred on non-developmental activities and Government was spending less for asset creation.

10.5 The ratios of deficits to GDP and the ratio of revenue deficit to the fiscal deficit indicate the vulnerability of the 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 since there is no asset back up for the liabilities incurred. This ratio increased from an average of 29.43 *per cent* during 1985-90 to 70.78 *percent* in 2001-02, an increase of over 40 percentage points in a little over a decade. The continuous increase in fiscal deficit along with an increasing ratio of revenue deficit is in sharp contrast to the long-term target of complete elimination of revenue deficit by March 2006 and reduction of fiscal deficit GDP ratio to 2 *per cent* by then, as enunciated in the draft Fiscal Responsibility and Budget Management Bill (FRBM), 2000.

10.6 Debt redemption, inclusive of interest as a percentage of borrowing also indicates the degree of autonomy in utilizing available resources for capital formation and investment. The higher this ratio, lower is the amount available from borrowings for application for these activities. This ratio, at 91.71 in 2001-02, though it showed a marginal improvement over the long-term trend of 92.94 *per cent,* was still very high.

10.7 Sustainability of debt is the key issue in the assessment of government finances. The higher the debt to GDP ratio, the higher is likely to be the cost at which the government is able to borrow. Columns 17 and 18 of Table 10.1 give the movement of average interest rate on internal and total liabilities. Average interest rate on internal liabilities increased from an average of 7.37 *per cent* during 1985-90 to 10.48 *percent* in 2001-02. The average interest rate on internal liabilities exceeded the GDP growth in the last two years. This has made debt sustainability a critical issue. Further due to the overhang of debt, government could not derive much benefit from the softening of interest rates.

10.8 A reduction in the debt-GDP ratio is called for in the context of debt sustainability. The Eleventh Finance Commission had suggested a reduction of 5 percentage points in the debt-GDP ratio within five years time. The FRBM, 2000 also envisages a reduction in total liabilities (including external debt at current exchange rate) of the Centre to no more than 50 *per cent* of GDP by March 2011. However, in the last three years, debt/GDP ratio increased significantly and reached 61.09 per cent in 2001-02, which was nearly 3-percentage points higher than the trend average. The increasing debt – GDP ratio would make it increasingly difficult to attain the desirable level, consistent with sustainability, unless additional remedial measures are taken for medium term adjustment.

10.9 Compared to the period 1985-90, 16 of the 21 fiscal performance indicators show a worsening of the situation in 2001-02. The combined index of these fiscal indicators would be 0.848 in 2001-02 compared to one in 1985-90 indicating a deceleration of around 16 per cent in the overall fiscal health index of the Union government.

10.10 These issues and others pointed out elsewhere in the Report call for various measures of reform in government finances and accounts, including budgetary operations of the government.

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