Chapter 9

MANAGING GOVERNMENT FINANCES: A GENERAL EVALUATION

Summary Indicators of Fiscal Performance

9.1 This chapter presents a summarised position of government finances over 1985-2004, 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 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 -GDP ratio indicates the adequacy of the present flow of resources for the provision of current services. Revenue receipts comprise both 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 1985-2004, the VIII and IX Plans (1992-1997 and 1997-2002) and the two most recent years.

Table 9.1: Indicators of Resource Mobilisation

(per cent)

	1985-2004	VIII Plan (1992-1997)	IX Plan (1997-2002)	2002-03	2003-04
Revenue Receipt/GDP	12.59	12.71	12.40	12.14	12.23
Tax Receipt/GDP	9.12	9.32	8.68	8.76	9.17
Revenue Buoyancy	0.93*	0.94	0.78	1.59	1.07
Tax Buoyancy	0.90*	0.96	0.86	1.90	1.44
Return on Advances	12.84#	11.23	14.15	15.11	15.91
Return on Investment	4.88#	2.35	5.30	8.83	9.84
User Charges Recovery-Social Services	4.87#	9.57	3.59	2.03	1.91
User Charges Recovery-Economic Services	53.48#	57.22	55.80	43.07	45.27

** Revenue and Tax buoyancy coefficients are in ratios. # Pertains to 1987-2004*

9.3 Compared to the values during the VIII Plan (1992-1997), the ratio of revenue receipt and tax collections to GDP was lower in 2003-04. Though there was an improvement in revenue and tax buoyancy in the last two years, this needs to be sustained. Buoyancy coefficients of both these variables were less than one during the VIII and IX Plan periods but acceleration in this was observed in the last two years. 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, eleven indicators 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. Per capita expenditure on social and economic services indicates access provided for these services and their spread. Values of these parameters over the defined time frame are indicated in Table 9.2.

Table 9.2: Indicators of Expenditure Management

(per cent)

	1985-2004	VIII Plan (1992-1997)	IX Plan (1997-2002)	2002-03	2003-04
Total Expenditure/GDP	19.81	19.66	19.56	19.29	18.28
Revenue Expenditure/Total Expenditure	81.38	78.88	83.61	85.99	86.83
Plan Expenditure/Total Expenditure	23.02	23.68	20.99	23.40	24.13
Capital Expenditure/Total Expenditure	8.26	9.61	7.00	6.40	6.98
Development Expenditure/ * Total expenditure	41.35	42.24	40.40	39.96	40.10
Committed Expenditure/Revenue Expenditure	45.62	44.57	47.82	46.26	44.63
Committed Expenditure/Revenue Receipt	58.40	54.38	63.08	63.16	57.93
Per Capita Expenditure-Social services (1993-94 prices, Rupees)	85#	68	105	121	129
Per Capita Expenditure- Economic Services (1993-94 prices, Rupees)	735#	693	795	855	874
Buoyancy of Total Expenditure with Revenue Receipts (Ratio)	0.95	0.76	1.09	0.53	0.49
Buoyancy of Revenue Expenditure with Revenue Receipts (Ratio)	1.07	0.94	1.28	0.70	0.57

* *Development expenditure is total expenditure on social and economic services. Total expenditure excludes loans and advances.*
\# *Pertains to 1987-2004*

9.5 As in the case of parameters on resources mobilisation, movement of parameters relating to expenditure also presented a mixed picture. Capital expenditure witnessed a contraction over time, development expenditure declined, plan expenditure remained stable and revenue expenditure increased.

There was an increase in committed expenditure on salary, pensions and interest payments both relative to revenue receipt and revenue expenditure during the IX Plan, though in the current year a positive improvement was noticed. While there was a sharp deceleration in buoyancy of revenue expenditure and total expenditure relative to revenue receipt in 2002-03 and 2003-04, trend average for the IX Plan (1997-2002) showed deterioration compared to the average buoyancy during the VIII Plan (1992-1997). There was, however, an increase in the per capita expenditure on social and economic services at 1993-94 prices.

Management of Fiscal Imbalances

9.6 Five indicators 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 has also mandated government to take appropriate steps to eliminate revenue deficit by 31 March 2008 and thereafter build adequate revenue surplus. 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)

	1985-2004	VIII Plan (1992-1997)	IX Plan (1997-2002)	2002-03	2003-04
Revenue Deficit/GDP	3.53	2.80	3.95	4.44	3.64
Fiscal Deficit/GDP	5.90	6.04	6.25	5.45	2.92
Primary Deficit/GDP	1.40	1.77	1.49	0.41	-1.70
Revenue Deficit/Fiscal Deficit	59.77	46.26	63.26	81.56	124.77
Balance From Current Revenue (BCR) *(Rupees in crore)*	-11463	-2191	-28622	-38195	-22348

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 124.77 *per cent* in 2003-04. It was for the first time that revenue deficit exceeded fiscal deficit. There was a moderate improvement in the ratio of fiscal deficit to GDP. A significant decline in fiscal deficit-GDP ratio in the current year needs to be seen in the context of a massive recovery of past loans and advances. A decline in this ratio through an increase in revenue receipt would indeed be more desirable. Complete elimination of revenue deficit as mandated by the FRBM Act 2003 may need greater efforts. For the first time in over 30 years, there was a primary revenue balance equal to 1.7 *per cent* of GDP in the current year. Balance from current revenue indicates the non-plan revenue balances. If these are positive, there is to that extent, funding of plan expenditure from the current revenue. BCR turned negative in 1990-91 and continued to be so thereafter.

Management of Fiscal Liabilities

9.8 Sustainability of debt is the key issue in the assessment of government finances. The 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 rate and GDP growth (referred to 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 eight indicators of management of fiscal liabilities are indicated in Table 9.4 below.

Table 9.4: Indicators of Management of Fiscal Liabilities

(per cent)

	1985-2004	VIII Plan (1992-1997)	IX Plan (1997-2002)	2002-03	2003-04
Fiscal Liabilities/GDP	60.10	60.72	59.08	62.69	59.87
Average Interest Rate-Internal Liabilities	9.01	9.37	10.42	10.03	9.24
Average Interest Rate-Total Liabilities	7.85	7.91	9.06	8.90	8.28
Debt Repayment/Debt Receipt	95.01	93.10	94.70	97.87	105.33
Ratio of Assets to Liabilities	53.36	57.68	50.90	44.78	41.48
Fiscal Liabilities/Revenue Receipt	477	478	476	516	489
Domar Gap	6.29	8.63	1.37	-0.69	3.97
Buoyancy of Assets	0.72	0.83	0.70	0.40	

9.9 Trends in parameters relating to the management of fiscal liabilities also present a mixed picture. The debt- GDP ratio after getting consolidated during the IX Plan (1997-2002) witnessed a sharp increase in 2001-02 and 2002-03. However, the ratio got moderated in the current year due to a lower growth of fiscal liabilities relative to GDP. While the interest rate on fiscal liabilities increased during the IX Plan, a deceleration was observed in the recent years. However, due to a larger overhang of debt 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 from an average of 57.68 during the VIII five year plan to 41.48 in 2003-04 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. In 2003-04 there was in fact a decline in the Government assets. Overall buoyancy of assets during 1985-2004 was 0.72 indicating that for each one *per cent* increase in liabilities, assets had grown only at 0.72 *per cent*. Buoyancy of assets continued to decelerate over the years. There was a complete rollover of debt and debt redemption including the interest payments exceeded debt receipts in 2003-04.

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.

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