

Chapter 4

DEFICITS: MANAGEMENT OF FISCAL IMBALANCES

4.1 The annual budget indicates three types of deficits, viz. revenue, fiscal, and primary. This chapter discusses the nature and magnitude of these deficits, their trend over time and the manner of financing these deficits. Deficits arise because of imbalances in revenue and expenditure. These imbalances could be transient or structural. In the Indian context, fiscal imbalances have both been large and persistent. Besides the size and regularity, its composition, in particular that of the revenue deficit that finances current consumption has also been a cause of concern. Formulation of fiscal rules in the context of macroeconomic activity essentially involves setting of rules regarding the size of deficit that could be incurred to finance expenditure.

4.2 Revenue deficit is the excess of revenue expenditure of the Government over its revenue receipts. It represents net dis-saving of the Government and its shift to present consumption. Revenue deficit leads to increase in borrowings without corresponding capital/asset formation. Borrowings resorted to meet revenue deficit, therefore, do not have any asset back up and create an asset liability mismatch. Because of these properties, revenue deficit is considered generally less desirable. Section 4(1) of Fiscal Reforms and Budget Management (FRBM) Act 2003, accordingly provides that the Union Government shall take appropriate measures to reduce fiscal deficit and revenue deficit so as to eliminate revenue deficit by 31 March 2009.

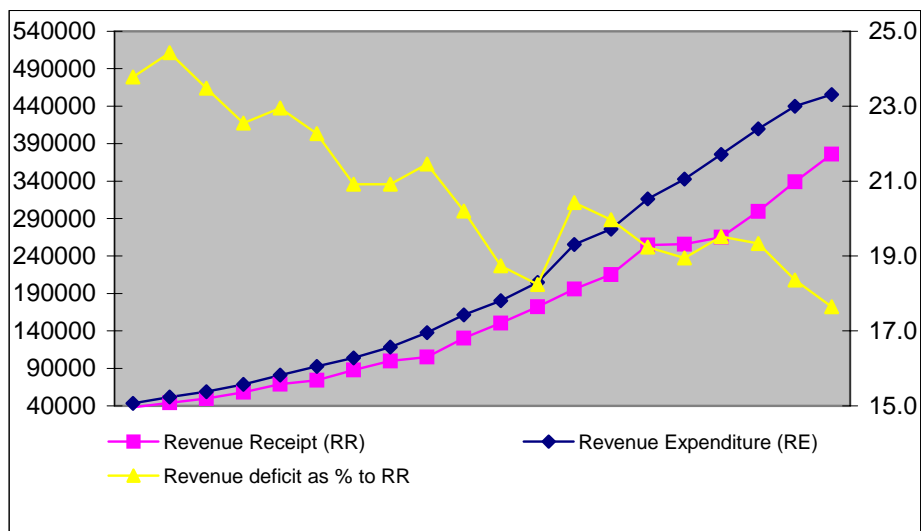
4.3 Trends in revenue deficit and some of its key parameters are indicated in table 4.1 below.

Table 4.1: Revenue Deficit and its parameters

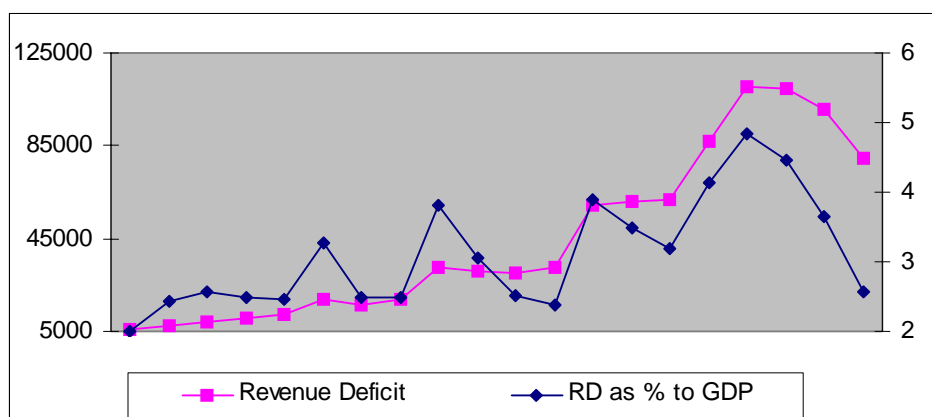
(Rupees in crore)

Period	Revenue Receipt	Revenue Expenditure	Revenue Deficit	Revenue Deficit as per cent of		
				GDP	Revenue Receipt	Revenue Expenditure
1985-2005	164051	208664	44613	3.41	27.19	21.38
VIII Plan (1992-1997)	131601	160541	28941	2.80	21.99	18.03
IX Plan (1997-2002)	237397	313109	75711	3.95	31.89	24.18
2003-04	339100	440086	100986	3.66	29.78	22.95
2004-05	376871	455571	78700	2.53	20.88	17.28
Average Annual Rate of Growth (Per Cent)						
1985-2005	12.94	13.74	17.10	2.80	3.67	2.94
VIII Plan (1992-1997)	15.61	14.64	10.88	Average Annual Rate of Shift in Relative Share		
IX Plan (1997-2002)	8.12	10.40	17.29			
2003-04	13.10	7.45	-8.00			
2004-05	11.14	3.52	-22.07			

4.4 Overall revenue deficit of the Union Government increased from an average of Rs. 28,941 crore during the VIII Plan (1992-1997) to Rs. 78,700 crore in 2004-05. The average annual rate of growth of revenue deficit was 17.10 *per cent*. A negative spread between the trend growth of revenue receipts and revenue expenditure contributed to the surge in revenue deficit. In last three years, however, rate of growth of revenue expenditure was lower than that of revenue receipt leading to a negative growth of revenue deficit. In relation to GDP, revenue deficit increased from an average of 2.8 *per cent* of GDP during the VIII Plan (1992-1997) to a peak of 4.80 *per cent* in 2001-02 before decelerating to its current level of 2.53 *per cent* in 2004-05. The average annual rate of shift in the share of revenue deficit to GDP was 2.80 *per cent*. As a proportion of revenue receipt, the level of revenue deficit in 2004-05 was close to the level that prevailed during the VIII Plan (1992-1997). During 1985-2005, on an average, revenue receipts fell short of revenue expenditure by around a quarter. As a proportion of revenue expenditure, revenue deficit averaged 21.38 *per cent* during 1985-2005, indicating the proportion of revenue expenditure that was debt financed.



4.5 In the last three years, however, there was a decline in revenue deficit. In the year 2004-05, decline was of the order of 22.07 *per cent*. The ratio of revenue deficit to GDP, revenue receipt and revenue expenditure also got moderated because of this decline. These three years witnessed a positive spread of four to seven *per cent* between revenue receipt and revenue expenditure. A relatively buoyant revenue receipt and moderately growing revenue expenditure facilitated the decline in revenue deficit and decline in its ratio relative to the major fiscal aggregates. The rate of decline of revenue deficit needs to be maintained for the Government to be able to meet the objective of zero revenue deficits by March 2009 as set out in the FRBM Act.



Fiscal Deficit

4.6 Fiscal deficit is the excess of total expenditure of the Government over its non-debt receipts (revenue receipts, miscellaneous capital receipts and recovery of loans and advances). Fiscal deficit normally represents the net incremental liabilities of the Government or its additional borrowings. The shortfall could be met either by additional public debt (internal or external) or by the use of surplus from public account. Fiscal deficit trends along with the trends of the deficit relative to key fiscal parameters are indicated in table 4.2.

Table 4.2: Fiscal Deficit and its Parameters

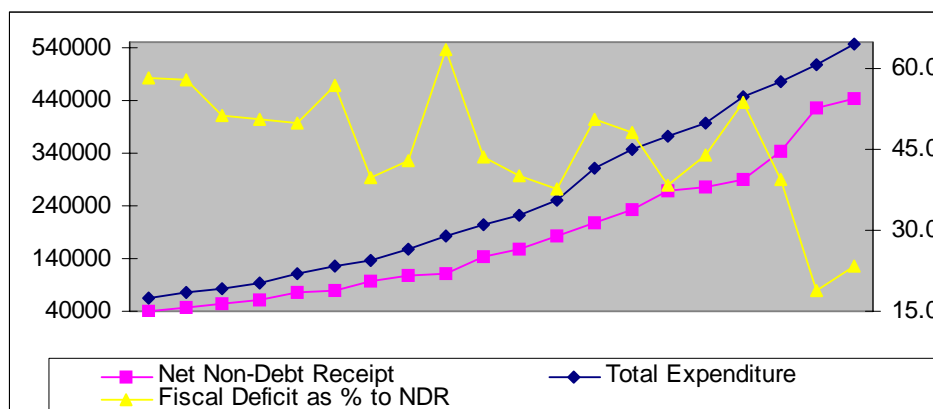
(Rupees in crore)

Period	Non-Debt Receipts	Total Expenditure	Fiscal Deficit	Fiscal Deficit as per cent to		
				GDP	Non-Debt Receipts	Total Exp.
1985-2005	182644	255895	73251	5.60	40.11	28.63
VIII Plan (1992-1997)	140973	203539	62565	6.04	44.38	30.74
IX Plan (1997-2002)	254827	374502	119675	6.25	46.96	31.96
2003-04	425880	506817	80937	2.93	19.00	15.97
2004-05	445535	549333	103798	3.34	23.30	18.90
Average Annual Rate of Growth						
1985-2005	13.23	12.22	9.55	Average Annual Rate of Shift in Proportions	-3.82	-3.25
VIII Plan (1992-1997)	14.51	11.87	6.42			
IX Plan (1997-2002)	8.74	8.86	9.00			
2003-04	24.63	6.40	-39.86			
2004-05	4.62	8.39	28.25			

4.7 Overall fiscal deficit increased from an average of Rs. 62,565 crore during the VIII Plan (1992-97) to Rs. 103,798 crore in 2004-05. The trend rate of growth of fiscal deficit was 9.55 per cent during 1985-2005. A moderate positive spread between the rate of growth of non-debt receipts and total expenditure lead to relatively lower increase in fiscal deficit, compared to

**Report of the CAG on
Union Government Accounts 2004-05**

these fiscal aggregates. The rate of growth of fiscal deficit was also lower than the rate of growth of GDP. The ratio of fiscal deficit to GDP, therefore, declined from an average of 6.04 *per cent* during the VIII Plan (1992-97) to 3.34 *per cent* in 2004-05. The average annual rate of shift in its share was (-) 3.8 *per cent*. The average annual rate of shift in the proportion of fiscal deficit to non-debt receipts and total expenditure was also negative.

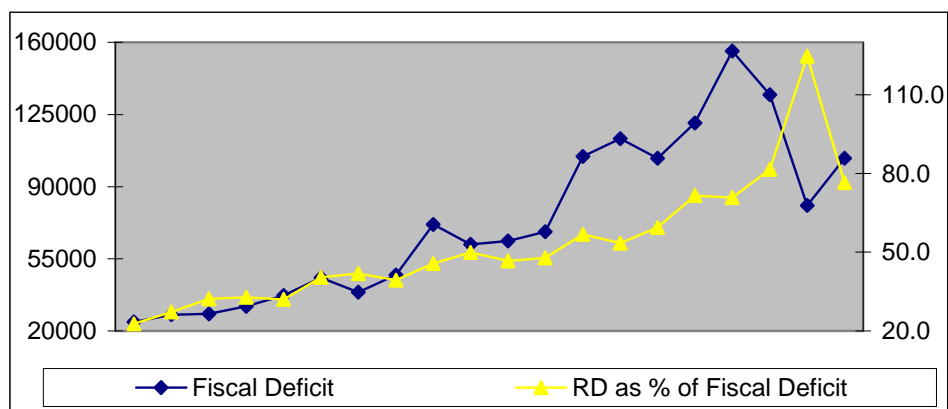


4.8 It is not uncommon for governments to run fiscal deficit and borrow funds for capital/asset formation or for creation of economic and social infrastructure. The assets created through such borrowings could pay for themselves by generating an income stream. Capital formation may also increase the overall income generating capacity of the economy, directly or indirectly and may enlarge the tax base. Further, in a situation where infrastructure becomes a binding constraint for growth, such capital formation by the government could make acceleration of growth more feasible. It may, therefore, be necessary to analyse various components of the fiscal deficit. If bulk of fiscal deficit is for sustaining capital expenditure or for providing financial accommodation to entities for capital formation, such deficits may be considered desirable upto a point. Table 4.3 below provides the movement of components of fiscal deficit over plan periods and the most recent two years.

Table 4.3 Components of Fiscal Deficit

Period	<i>(Per cent)</i>		
	Revenue Deficit	Net Capital Expenditure	Net Loans and Advances
1985-2005	60.90	25.92	13.18
VIII Plan (1992-1997)	46.26	28.25	25.49
IX Plan (1997-2002)	63.26	19.53	17.20
2003-04	124.77	22.79	-47.56
2004-05	75.82	47.43	-23.25
Average Annual Rate of Change			
1985-2005	6.88	-2.86	

4.9 Revenue deficit continued to be the dominant component of fiscal deficit, accounting for nearly 61 *per cent* of it during 1985-2005. The proportion of revenue deficit in overall fiscal deficit increased from an average of 46.26 *per cent* during the VIII Plan (1992-1997) to 75.82 *per cent* in the current year. The ratio of revenue deficit to fiscal deficit had a positive shift rate of 6.88 *per cent* during 1985-2005. Net capital expenditure (capital expenditure- capital receipts) accounted for little over a quarter of fiscal deficit during 1985-2005. It also had a negative shift rate of 2.86 *per cent*. Fiscal deficit financed around 13 *per cent* of net loans and advances. In last three years, the recovery of loans and advances exceeded the issue of fresh loans and the surplus actually financed part of the fiscal deficit. Continuous use of borrowed funds for meeting current expenditure not only indicated erosion in asset back up, it made capital expenditure (inclusive of loans and advances) as variable of adjustment. Scarce borrowed resources could only be partly allocated for capital formation.



Primary Deficit

4.10 While fiscal deficit represents the need for additional resources in general, a part of such resources may be needed to finance interest payments. Interest payments represent the expenditure of past obligations and are independent of current allocative priorities. To look at the imbalances of the current nature, these payments need to be separated and deducted from the total imbalances. Primary deficit, which represents the current imbalances net of interest payments, averaged Rs. 14,817 crore during 1985-2005, though it witnessed a decelerating trend. In 2003-04 and 2004-05, there was a primary surplus as interest payments exceeded the fiscal deficit. In relation to GDP, primary deficit declined from an average of 1.77 *per cent* during the VIII Plan (1992-1997) to 0.41 *per cent* in 2002-03. It later turned positive in 2003-04 and 2004-05. Trends in primary deficit and its parameters are indicated in table 4.4 below.

Report of the CAG on
Union Government Accounts 2004-05

Table 4.4: Primary Deficit and its Parameters

(Rupees in crore)

Period	Revenue Deficit	Fiscal Deficit	Interest Payments	Primary Deficit*	Primary Deficit as per cent of GDP
1985-2005	44613	73251	58434	14817	1.13
VIII Plan (1992-1997)	28941	62565	44280	18285	1.77
IX Plan (1997-2002)	75711	119675	91102	28573	1.49
2003-04	100986	80937	128114	-47177	-1.71
2004-05	78700	103798	130958	-27160	-0.87
Average annual trend rate of growth (per cent)					
1985-2005	17.1	9.55	16.89	Average Annual Rate of Change.	
VIII Plan (1992-1997)	10.88	6.42	17.44		
IX Plan (1997-2002)	17.29	9.00	14.90		
2003-04	-8.00	-39.86	2.84		
2004-05	-22.07	28.24	2.22		

* A negative figure indicates existence of primary surplus

4.11 Improvement in primary deficit from an average of 1.77 per cent of GDP to (-) 0.87 per cent of GDP in 2004-05 clearly indicates that in 2003-04 and 2004-05 non-debt receipts were adequate to meet the expenditure incurred in that year, including the capital expenditure and loans and advances net of interest payments. However, that was largely due to increase in recovery of loans and not because of any acceleration in revenue receipts. Recovery of loans or accruals of miscellaneous capital receipts indicate a decline in assets base of the government and at best could be viewed as a limited and a temporary option.