

Chapter 10

MANAGING GOVERNMENT FINANCES: SUMMING UP

10.1 This chapter presents a summarised position of government finances over 1992-2008 focusing on the trends in current year, 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

10.2 Eight indicators shown in Table 10.1 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 to GDP ratio indicates the adequacy of the present flow of resources for the provision of current services. Revenue receipts comprise tax and non-tax receipts, which *inter alia* includes 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 remaining four parameters are indicators of return on past investment and recovery of user charges. Table 10.1 summarises the movement in value of these indicators over 1992-2008 encompassing the VIII, IX and X Plan periods as well as the first year of the XI Plan (2007-12).

Table 10.1: Indicators of Resource Mobilisation

Period	Revenue Receipt/ GDP	Gross Tax Receipt/ GDP	Revenue Buoyancy*	Tax Buoyancy*	Return on Advances	Return on Investment	<i>(Per cent)</i>	
							User Charges Recovery-Social Services	User Charges Recovery-Economic Services
1992-2008	15.14	9.89	1.001	1.111	13.63	8.65	3.04	49.67
VIII Plan (1992-97)	15.23	9.31	0.922	0.951	11.23	2.35	9.57	57.13
IX Plan (1997-02)	14.67	8.64	0.831	0.871	14.15	5.30	3.59	55.80
X Plan (2002-07)	14.84	10.04	1.116	1.522	14.18	12.40	2.17	44.56
2002-03	14.50	8.81	1.542	2.026	15.11	8.83	2.03	43.07
2003-04	14.70	9.23	1.124	1.440	15.91	9.84	1.91	45.27
2004-05	14.46	9.68	0.872	1.388	14.30	13.29	1.49	51.37
2005-06	14.67	10.23	1.121	1.467	13.36	14.79	4.28	45.39
2006-07	15.58	11.42	1.451	1.857	11.49	14.67	1.03	40.32
XI Plan (2007-12)								
2007-08	17.00	12.58	1.760	1.846	15.68	14.79	1.21	45.92

* Revenue and Tax buoyancy coefficients are in ratios.

10.3 The ratio of revenue receipts to GDP witnessed a decelerating trend. Compared to the values during the VIII Plan (1992-1997), the ratio declined to 14.67 during the IX Plan (1997-2002) although improved marginally to 14.84 during the X Plan (2002-07). Revenue buoyancy, which was less than one during the VIII Plan (1992-1997) and deteriorated further during IX Plan (1997-2002), not only improved but also exceeded the unity in four out of five years during the X Plan period. The revenue buoyancy continued to improve in 2007-08 as the ratio of revenue receipts to GDP increased by 1.42 percentage points during the year. These trends were also reflected in consistently increasing tax-GDP ratio during the X Plan period and exceeded 10 *per cent* in 2005-06 for the first time since 1992-93. The momentum was sustained and it reached the level of 12.58 *per cent* during the current year. Though there was an improvement in tax buoyancy during the recent years, this needs to be sustained by expanding the scope of deepening fiscal empowerment through improved tax revenues, which lies in moderate tax structure. There was significant improvement in revenue buoyancy vis-à-vis tax buoyancy in 2007-08 relative to the previous year indicating the fact that during the current year resources mobilised through non-tax resources contributed relatively more in incremental revenue receipts during the year. There was not only improvement in return from investment and loans and advances during the year but recovery of user charges witnessing substantial decline over the years especially during 2006-07 indicated significant improvements during the current year. Resource mobilisation efforts, therefore, presented encouraging trends during 2007-08.

Management of Expenditure

10.4 In expenditure management, eight indicators shown in Table 10.2 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. Values of these parameters over the defined time frame are indicated in Table 10.2.

Table 10.2: Indicators of Expenditure Management

Period	<i>(Per cent)</i>							Buoyancy of RE to NRR
	TE/GDP	RE/ GDP	RE/ TE	PE/TE	CE/TE	DE*/TE	Buoyancy of TE to NRR	
1992-2008	19.05	16.20	85.02	22.60	8.56	40.86	0.94	1.02
VIII Plan (1992-97)	21.25	17.11	80.50	21.86	8.87	38.60	0.78	0.95
IX Plan (1997-02)	20.25	17.06	84.23	20.19	6.74	38.71	1.42	1.64
X Plan (2002-07)	17.84	15.57	87.27	24.17	8.19	41.16	0.74	0.84
2002-03	19.41	16.69	85.99	23.40	6.40	39.96	0.53	0.70
2003-04	18.40	15.98	86.83	24.13	6.98	40.10	0.49	0.57

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(Per cent)

Period	TE/GDP	RE/ GDP	RE/ TE	PE/TE	CE/TE	DE*/TE	Buoyancy of TE to NRR	Buoyancy of RE to NRR
2004-05	17.44	14.47	82.93	24.20	9.77	38.69	0.75	0.32
2005-06	17.02	15.10	88.74	23.08	9.21	41.31	0.76	1.30
2006-07	17.55	15.88	90.47	25.57	8.15	44.23	0.89	0.99
XI Plan (2007-12)								
2007-08	18.32	15.59	85.09	23.75	13.54	47.00	0.79	0.48

TE = Total Expenditure, RE = Revenue Expenditure; PE = Plan Expenditure; CE = Capital Expenditure; NRR = Net Revenue Receipts and DE denotes Development expenditure, which is total expenditure on social and economic services and the denominator total expenditure here excludes loans and advances.

10.5 As in the case of parameters on resource mobilisation, movement of parameters relating to expenditure also presented a mixed picture. Capital expenditure as a percentage of total expenditure witnessed deceleration to 6.74 per cent during IX Plan (1997-2002) from the level of 8.87 per cent in VIII Plan (1992-97). It, however, exhibited an acceleration trend during the X Plan period and almost approached the trend growth rate during 1992-2008. After recording a relatively low average growth rate of 5 per cent during 2005-06 and 2006-07, it increased by an ever highest rate of 97.22 per cent in 2007-08 mainly on account of steep increase in capital expenditure in the form of investment in general financial and trading institutions from Rs. (-) 4009 crore in 2006-07 to Rs. 45627 crore in 2007-08 as well as from Rs. 33828 crore to Rs. 37462 crore in defence services besides a fresh investment of Rs. 304 crore in agricultural financial institutions under non-plan heads. In spite of such a steep increase in capital expenditure during the current year, it was less than the level projected by TFC (Rs. 137524 crore) for 2007-08. Revenue expenditure continued to be the dominant component of the total expenditure and its share increased from an average of 80.50 per cent during the VIII Plan to 84.23 per cent in IX Plan (1997-2002) and further to an average of 87.27 per cent during the X Plan (2002-07) after reaching the peak level of 90.47 per cent during 2006-07. During the current year, its share declined to 85 per cent mainly on account of its relatively slower growth rate of 11.6 per cent over the previous year vis-à-vis a steep increase of 97.22 per cent in capital expenditure during the year. The share of development expenditure and plan expenditure in total expenditure, however, exhibited relative stability over time. The explanation for a marginal decline in the share of plan expenditure against an increase of development expenditure in total expenditure also lies in a steep increase in non-plan capital expenditure during the year. The buoyancies of total and revenue expenditures with revenue receipts, however, indicated a mixed trend during the period 1992-2008.

Management of Fiscal Imbalances

10.6 Five indicators shown in table 10.3 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 and Rules made there under, as they stand now, has mandated the Government to take appropriate steps to (i) eliminate revenue deficit by 31 March 2009 and thereafter build adequate revenue surplus, and (ii) to bring down the fiscal deficit to not more than 3 *per cent* of GDP by 31 March 2009. Union Government has, however, amended the dates originally envisaged in the Act for achieving the deficit targets. The targets relating to fiscal deficit were set to be achieved as per the mandate in the Act, while those relating to revenue deficit were rescheduled for its elimination by 2009-10. The values of these parameters over the specified periods as mentioned above are indicated in Table 10.3.

Table 10.3: Indicators of Management of Fiscal Imbalances

Period	Revenue Deficit/GDP	Fiscal Deficit/GDP	Primary Deficit/GDP	Revenue Deficit/Fiscal Deficit	Balance From Current Revenue (Rupees in crore)
1992-2008	3.20	4.90	0.58	65.43	-5609
VIII Plan (1992-97)	2.79	6.03	1.76	46.26	-2192
IX Plan (1997-02)	3.94	6.23	1.49	63.26	-28622
X Plan (2002-07)	3.31	4.15	-0.08	79.74	-4764
2002-03	4.47	5.48	0.41	81.56	-38196
2003-04	3.67	2.94	-1.71	124.77	-22348
2004-05	2.50	3.30	-0.86	75.82	8794
2005-06	3.06	4.61	0.66	66.51	2161
2006-07	3.20	4.41	0.69	72.62	25771
XI Plan (2007-12)					
2007-08	1.81	3.50	-0.32	51.79	88137

10.7 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. The ratio of fiscal deficit to GDP, which had witnessed a sharp improvement in 2003-04 due to augmented recovery of past loans, could not sustain the momentum during subsequent years even though recoveries of loans and advances continued to exceed fresh advances. Similarly, revenue deficit to GDP ratio, after reaching the minimum level of 2.50 *per cent* during 2004-05, has increased to 3.20 *per cent* in 2006-07. The deficit indicators, however, took a turn around during the current year and fiscal and revenue deficits relative to GDP as per Union Finance Accounts for 2007-08 declined to 3.50 and 1.81 *per cent*, respectively. The actual levels of revenue and fiscal deficits were, however, higher than their budget estimates respectively by 0.31 and 0.20 percentage points. Notwithstanding the slippages in deficit indicators, the fiscal correction during 2007-08 was higher than the minimum reductions of 0.3 *per cent* and 0.5 *per cent* (relative to GDP) for fiscal and revenue deficit, respectively, stipulated per year under the FRBM Rules, 2004.

Furthermore, the Finance Accounts showed primary surplus of Rs. 15025 crore (which was, however, only 0.32 *per cent* of GDP) from the huge deficit of Rs. 28654 crore in 2006-07 reflecting containment of non-interest expenditure below the non-debt receipts. Although the management of public finances during 2007-08 was as per the process of fiscal consolidation under FRBM Rules, 2004 but keeping in view the conscious shift in plan priorities in favour of revenue expenditure-intensive programmes and schemes particularly at the commencement of the Eleventh Five Year Plan and recognising the systemic rigidity in containing non-Plan committed revenue expenditures in the short term, the targets relating to revenue deficit were rescheduled for its elimination by 2009-10, while those relating to fiscal deficit were set to be achieved as per the mandate in the Act.

10.8 The ratio of revenue deficit to fiscal deficit increased from an average of 46.26 *per cent* during the VIII Plan (1992-1997) to the peak level of 124.77 *per cent* in 2003-04. It was for the first time that revenue deficit exceeded fiscal deficit. The ratio indicated an improvement during the subsequent years especially during the current year when it declined by 20.83 percentage points but still it is considerably higher and exceeds the levels already attained during the VIII Plan period. The fiscal policy has a significant role in maintaining the macroeconomic stability but its efficacy and effectiveness depends upon the structure of fiscal deficit. However, the large structural fiscal deficit caused due to dominant share of structural primary deficit and structural interest payments have reduced the role that cyclical component of fiscal deficit can play during the periods of macroeconomic fluctuations. Balance from the current revenue indicates the non-plan revenue balances and if these are positive, there is to that extent, funding of plan expenditure from the current revenue. BCR, which had turned negative in 1990-91, became positive in 2004-05 and continued to be positive thereafter.

Management of Fiscal Liabilities

10.9 Sustainability of debt is the key issue in the assessment of government finances. 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 and GDP growth (referred 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 seven indicators of management of fiscal liabilities are indicated in Table 10.4 below.

Table 10.4: Indicators of Management of Fiscal Liabilities

Period	Fiscal Liabilities/ GDP	Debt Redemption to Debt Receipt	Average Interest Rate on Total Liabilities	Domar Gap	Ratio of Assets to Liabilities	Fiscal Liabilities/ Revenue Receipts	Buoyancy of Assets
1992-2008	57.48	96.51	8.34	3.94	45.61	442	0.66
VIII Plan (1992-97)	60.59	93.10	7.91	8.81	57.68	423	0.83
IX Plan (1997-02)	58.84	94.70	9.06	1.27	50.90	448	0.70
X Plan (2002-07)	57.10	98.68	8.09	5.91	40.26	472	0.53
2002-03	63.07	97.87	8.90	-1.20	44.78	516	0.40
2003-04	60.25	105.33	8.28	3.95	41.48	489	-0.10
2004-05	57.89	95.78	7.89	6.44	39.36	484	0.43
2005-06	54.99	99.44	7.75	5.93	39.32	457	0.98
2006-07	52.70	97.20	7.84	7.96	37.71	416	0.59
XI Plan (2007-12)							
2007-08	52.54	94.60	8.24	5.45	38.06	381	1.08

10.10 Trends in parameters relating to the management of fiscal liabilities also present a mixed picture. The debt to GDP ratio after getting consolidated during the IX Plan (1997-2002) witnessed a sharp increase in 2001-02 and after reaching the peak level in 2002-03, it exhibited declining trend in subsequent years. However, while the ratio got moderated in the last three years due to a lower growth of fiscal liabilities relative to GDP, it is still considerably higher. While the interest rate on fiscal liabilities increased during the IX Plan, a deceleration was observed in the recent years. Nevertheless, due to a larger overhang of debt, the 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 consistently from an average of 57.68 *per cent* during the VIII five year Plan to 50.90 in IX Plan (1997-2002) and further to an average of 40.26 during the X Plan (2002-07). The ratio exhibited relative stability in recent years varying from 39.36 in 2004-05 to 38.06 in the 2007-08. Buoyancy of the assets to the liabilities also declined from 0.83 *per cent* during the VIII Plan (1992-1997) to 0.70 *per cent* during the IX Plan (1997-2002) and further to an average of 0.53 *per cent* during the X Plan (2002-07). In 2003-04, aggregate assets actually declined due to the accelerated recovery of the loans and advances, while liabilities continued to grow. It has, however, indicated an increasing trend after attaining the negative value during 2003-04 and reached the peak level of 0.98 during 2005-06 and, thereafter, declined in subsequent year to 0.59. The assets of the Government, however, increased by 14.37 *per cent* during the current year which was marginally higher than the growth rate of 13.33 *per cent* in aggregate liabilities resulting in buoyancy of assets exceeding unity for the first time during the period 1992-2008. The sharp increase in assets during the current year was primarily on account of steep increase in non-plan capital expenditure (138.55 *per cent*) over the previous year. Despite the steep increase in growth of assets during the current year, around 62 *per cent* of the Union Government liabilities still ceased to have any asset back up in 2006-07 and 2007-08.

10.11 As resources available for application for current services have depleted relative to GDP during the period 1992-2008, 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.

New Delhi

Dated

(R.G. VISWANATHAN)

Principal Director of Audit

Countersigned

New Delhi

Dated

(VINOD RAI)

Comptroller and Auditor General of India