

## Chapter 5

### DEFICITS: MANAGEMENT OF FISCAL IMBALANCES

Three key fiscal parameters - revenue, fiscal and primary deficits measured relative to GDP - indicate the extent of overall fiscal imbalances in the Finances of the Union or State Government during a specified period. The 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, from the corresponding levels of 4.41 and 3.20 in the previous year. The actual levels of revenue and fiscal deficits in 2007-08 although were higher than their budget estimates respectively by 0.31 and 0.20 percentage points but 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. 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 favor of revenue expenditure-intensive programmes and schemes particularly at the commencement of the XI 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.

Revenue deficit continued to be the dominant component of fiscal deficit, accounting for 65.43 per cent of it during 1992-2008. While the revenue deficit declined by 35.69 per cent in 2007-08 over the previous year but its share in fiscal deficit has declined by only 20.83 percentage points in 2007-08 from the level of 72.62 per cent in the previous year indicating the fact that the share of net capital expenditure in fiscal deficit has increased significantly by 15.25 percentage points during the year primarily due to steep increase in non-plan capital expenditure during the year.

Primary deficit, which represents the current imbalances net of interest payments, declined from an average of 1.76 per cent in relation to GDP during the VIII Plan (1992-1997) to 0.41 per cent in 2002-03. It later turned positive in 2003-04 and 2004-05 but reversed again to the deficits during 2005-06 and 2006-07 although it remained less than one per cent of GDP during these years. 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. Fiscal consolidation of the Union Government under the FRBM Act, 2003 has, however, been a revenue-led, underpinned by a significant increase in the tax-GDP ratio as well as the receipts from the non-tax sources during the current year.

**5.1** Three key fiscal parameters - revenue, fiscal and primary deficits - indicate the extent of overall fiscal imbalances in the Finances of the Union or State Government during a specified period. This chapter presents trends, nature, magnitude 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. This Chapter also presents the assessment of actual levels of revenue and fiscal deficits vis-à-vis targets set under FRBM Act and Rules for the financial year 2007-08.

## Revenue Deficit

**5.2** 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. Trends in revenue deficit and some of its key parameters are indicated in Table 5.1.

**Table 5.1: Revenue Deficit and its parameters**

*(Rupees in crore)*

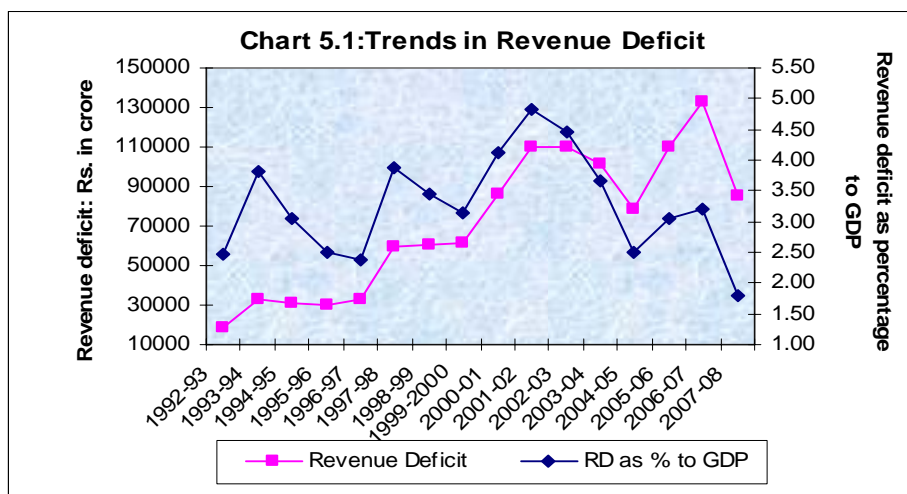
Period	Revenue Receipt	Revenue Expenditure	Revenue Deficit	Revenue Deficit as per cent of		
				GDP	Revenue Receipt	Revenue Expenditure
1992-2008	289087	360380	71293	3.20	24.66	19.78
<b>VIII Plan (1992-97)</b>	<b>148556</b>	<b>177497</b>	<b>28941</b>	<b>2.79</b>	<b>19.48</b>	<b>16.30</b>
<b>IX Plan (1997-02)</b>	<b>252211</b>	<b>327922</b>	<b>75711</b>	<b>3.94</b>	<b>30.02</b>	<b>23.09</b>
<b>X Plan (2002-07)</b>	<b>394426</b>	<b>500825</b>	<b>106399</b>	<b>3.31</b>	<b>26.98</b>	<b>21.24</b>
2002-03	299826	409591	109765	4.47	36.61	26.80
2003-04	339100	440086	100986	3.67	29.78	22.95
2004-05	376871	455571	78700	2.50	20.88	17.28
2005-06	430940	540637	109697	3.06	25.46	20.29
2006-07	525393	658240	132847	3.20	25.29	20.18
<b>XI Plan (2007-12)</b>						
2007-08	649426	734861	85435	1.81	13.16	11.63
<b>Average Annual Rate of Growth (Per cent)</b>						
1992-2008	10.86	11.12	11.92	-0.29	1.00	0.71
<b>VIII Plan (1992-97)</b>	<b>15.02</b>	<b>14.23</b>	<b>10.88</b>	<b>Average Annual Rate of Shift in Relative Share</b>		
<b>IX Plan (1997-02)</b>	<b>4.65</b>	<b>7.63</b>	<b>17.29</b>			
<b>X Plan (2002-07)</b>	<b>14.59</b>	<b>12.24</b>	<b>4.75</b>			
2002-03	13.02	9.06	-0.49			
2003-04	13.10	7.45	-8.00			
2004-05	11.14	3.52	-22.07			
2005-06	14.35	18.67	39.39			
2006-07	21.92	21.75	21.10			
<b>XI Plan (2007-12)</b>						
2007-08	23.61	11.64	-35.69			

**5.3** Overall revenue deficit of the Union Government increased from an average of Rs. 28941 crore during the VIII Plan (1992-1997) to Rs. 75711 crore during the IX Plan (2002-07) and further to Rs. 106399 crore during the X Plan (2002-07). The revenue deficit exhibited a declining trend from Rs. 110303 crore in 2001-02 and reduced to the level of Rs. 78700 crore in 2004-05. During 2005-06 and 2006-07, revenue deficit, however, increased by 39.39 per cent and 21.10 per cent, respectively, over the corresponding previous years and reached the peak level in 2006-07. The XI Plan (2007-08) began with revenue deficit at Rs. 85435 crore, which is 35.69 per cent lower

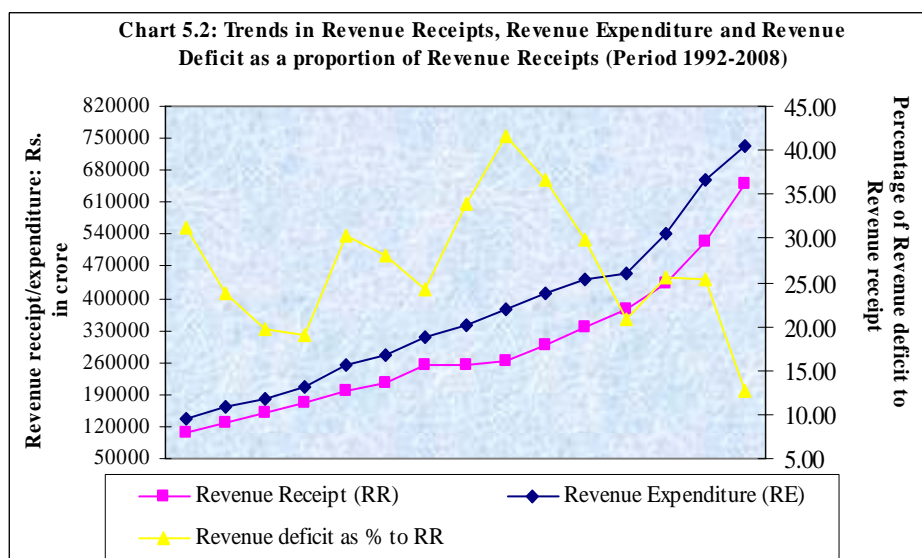
than the peak level attained in 2006-07. The average annual rate of growth of revenue deficit during the period 1992-2008 was 11.92 *per cent*. The rate of growth of revenue expenditure was lower than that of revenue receipt during the first three years of X Plan (2002-07) leading to a negative growth of revenue deficit. These three years witnessed a positive spread of four to seven *per cent* between revenue receipt and revenue expenditure due to relatively buoyant revenue receipt and moderately growing revenue expenditure. As a result, the revenue deficit indicated a declining trend since 2002-03 but the decline was substantial and remarkable of the order of 22.07 *per cent* in the year 2004-05. The rate of growth in revenue expenditure, however, exceeded that of revenue receipts by 4.32 percentage points during 2005-06 while their rates of growth were almost equal in 2006-07 resulting in an upsurge of Rs. 30997 crore and Rs. 23150 crore, respectively, in revenue deficit putting a pause to its declining trend exhibited during the preceding three years. A positive spread of nearly 12 percentage points between the trend growth of revenue receipts and revenue expenditure during the current year again exhibited a deceleration trend in revenue deficit. Buoyant gross tax revenue as well as non tax revenue, which have increased by 25.27 and 20.83 *per cent*, respectively, in 2007-08 over the previous year led to an increase of 23.61 *per cent* in net revenue receipts of the government against an increase of 11.64 *per cent* in revenue expenditure during the current year

**5.4** In relation to GDP, revenue deficit increased from an average of 2.79 *per cent* of GDP during the VIII Plan (1992-1997) to a peak of 4.84 *per cent* in 2001-02 before decelerating to the level of 2.50 *per cent* in 2004-05. The ratio, however, again indicated an accelerating trend during 2005-06 and 2006-07 and reached the level of 3.20 *per cent* in 2006-07 mainly on account of a surge in revenue expenditure due to shift in plan priorities in favor of revenue expenditure-intensive programmes and schemes and systemic rigidity in non-plan revenue expenditure in the short term, particularly arising from committed and obligatory expenditure such as interest payments, pensions, salaries, defence and subsidies including payments for under-recoveries to companies engaged in supply of critical products such as food, fuel and fertilisers. The buoyant growth in revenue receipts vis-à-vis revenue expenditure during the current year led to a significant decline (37.42 *per cent*) in revenue deficit which, given the robust growth in GDP, also resulted in its steep decline relative to GDP from 3.20 *per cent* in 2006-07 to 1.81 *per cent* in 2007-08 (Chart 5.1). The average annual rate of shift in the share of revenue deficit to GDP, therefore, turned to negative (-) 0.29 *per cent* during the period 1992-2008.

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**5.5** The ratio of revenue deficit to revenue receipts was more or less in tandem with its ratio with GDP during the period 1992-2008 (Chart 5.2). As a proportion of revenue receipt, the level of revenue deficit in 2005-06 and 2006-07 exceeded the lowest ever level of the decade (1997-2007) attained during 2004-05 (20.88 *per cent*) by more than four percentage points indicating that on an average, revenue receipts fell short of revenue expenditure by around a quarter during this period. As a proportion of revenue expenditure, revenue deficit was around 25 *per cent* both in 2005-06 and 2006-07, which indicates the proportion of revenue expenditure that was debt financed (Table 5.1). During the current year this ratio came down to almost half (13.16 *per cent*) of the levels attained in the preceding two years primarily on account of buoyant growth in revenue receipts vis-à-vis revenue expenditure in 2007-08 over the previous year.



### Fiscal Deficit

**5.6** 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 5.2.

**Table 5.2: Fiscal Deficit and its Parameters**

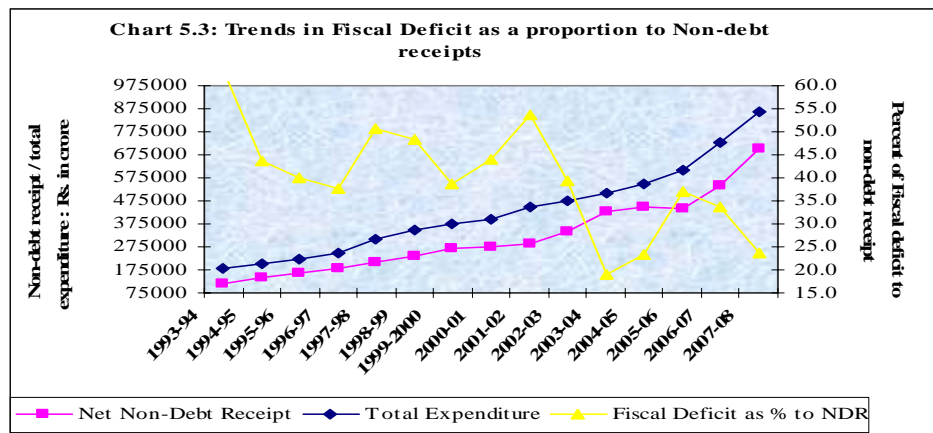
*(Rupees in crore)*

Period	Non-Debt Receipts	Total Expenditure	Fiscal Deficit	Fiscal Deficit as per cent to		
				GDP	Non-Debt Receipts	Total Exp.
1992-2008	314909	423868	108959	4.90	34.60	25.71
<b>VIII Plan (1992-97)</b>	<b>157929</b>	<b>220494</b>	<b>62565</b>	<b>6.03</b>	<b>39.62</b>	<b>28.38</b>
<b>IX Plan (1997-02)</b>	<b>269641</b>	<b>389316</b>	<b>119675</b>	<b>6.23</b>	<b>44.38</b>	<b>30.74</b>
<b>X Plan (2002-07)</b>	<b>440415</b>	<b>573852</b>	<b>133437</b>	<b>4.15</b>	<b>30.30</b>	<b>23.25</b>
2002-03	341722	476310	134588	5.48	39.39	28.26
2003-04	425880	506817	80937	2.94	19.00	15.97
2004-05	445535	549333	103798	3.30	23.30	18.90
2005-06	444322	609249	164927	4.61	37.12	27.07
2006-07	544618	727552	182934	4.41	33.59	25.14
<b>XI Plan (2007-12)</b>						
2007-08	698613	863575	164962	3.50	23.61	19.10
<b>Average Annual Rate of Growth</b>						
1992-2008	11.16	10.26	7.58	-4.19	-3.22	-2.43
<b>VIII Plan (1992-97)</b>	<b>14.08</b>	<b>11.77</b>	<b>6.41</b>	<b>Average Annual Rate of Shift in Proportions</b>		
<b>IX Plan (1997-02)</b>	<b>5.46</b>	<b>6.62</b>	<b>9.00</b>			
<b>X Plan (2002-07)</b>	<b>10.24</b>	<b>10.86</b>	<b>14.18</b>			
2002-03	17.97	6.92	-13.63			
2003-04	24.63	6.40	-39.86			
2004-05	4.62	8.39	28.25			
2005-06	-0.27	10.91	58.89			
2006-07	22.57	19.42	10.92			
<b>XI Plan (2007-12)</b>						
2007-08	28.28	18.70	-9.08			

**5.7** Overall fiscal deficit increased from an average of Rs. 62565 crore during the VIII Plan (1992-97) to Rs. 119675 crore during the IX Plan (1997-2002) and further to an average of Rs. 133437 crore during the X Plan (2002-07). The fiscal deficit reached the peak level of Rs. 182934 crore in 2006-07 after surpassing the previous peak of Rs. 164927 crore in the previous year. During the current year, the fiscal deficit declined by around 9 percentage points and reached the level of Rs. 164962 crore, which is marginally more than the level of 2005-06 during the X Plan (2002-07). A steep increase of Rs. 153995 crore (28.28 per cent) in non-debt receipts against the increase of Rs. 136023 crore (18.70 per cent) in total expenditure resulted in decline of

Rs. 17972 crore (9.08 *per cent*) in fiscal deficit in 2007-08 over the previous year. The average rate of growth during the X plan (2002-07) at 14.18 *per cent* exceeded the trend growth rate as well as the average rates of growth of VIII and IX Plan period. The long term trend rate of growth of fiscal deficit was 7.58 *per cent* for the period 1992-2008, which was even higher than the average rate of growth during the VIII Plan (1992-97).

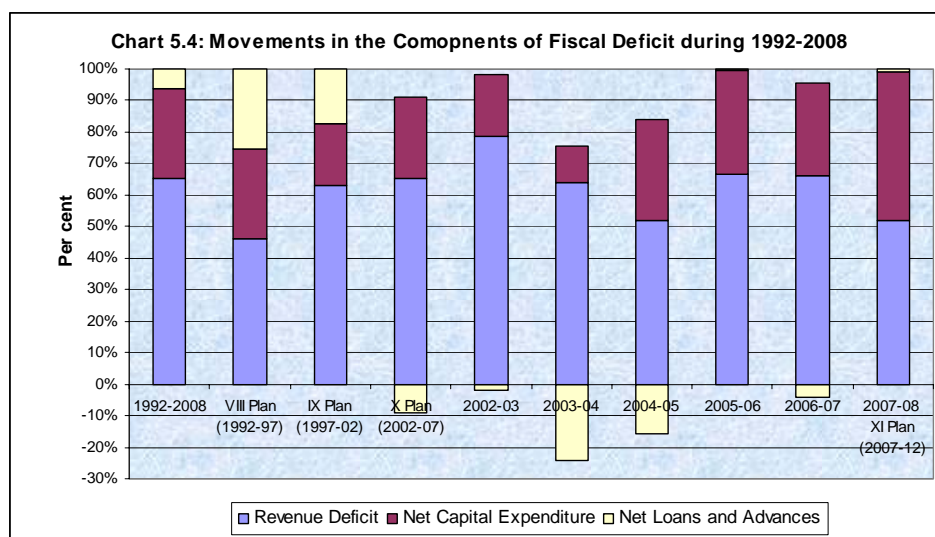
**5.8** Relative to GDP, fiscal deficit increased from 6.03 *per cent* during the VIII Plan (1992-97) to 6.23 *per cent* during the IX Plan with large inter year variations ranging from 6.85 in 1997-98 to 5.31 *per cent* in 1999-2000. The first three years of X Plan (2002-07) witnessed a decline in ratio of fiscal deficit to GDP but during the last two years it has exhibited a significant increase over the lowest level of 2.94 in 2003-04. Despite the upsurge in 2005-06 and 2006-07, the trend growth rate in ratio of fiscal deficit to GDP during the X Plan (2002-07) came down to 4.15 *per cent* from 6.23 *per cent* in the IX Plan (1997-2002). Due to buoyant growth in non-debt receipts, this ratio exhibited a deceleration trend during the current year and reached the level of 3.50 *per cent*, almost a percentage point less than the previous year. The average annual rate of shift in its share, therefore, was (-) 4.19 *per cent* during 1992-2008. As a proportion to non-debt receipts, fiscal deficit witnessed large gyrations varying from 63.6 *per cent* in 1993-94 to 19 *per cent* during 2003-04 (Chart 5.3) with negative shift rate of 3.22 *per cent* during 1992-2008. During the current year this ratio declined by around 10 percentage points which was almost equal to the difference between the growth rates of non-debt receipts and the total expenditure during the year. The negative shift rate of 2.43 *per cent* in the ratio of fiscal deficit to total expenditure during the period 1992-2008 also indicates its declining trend during the decade (1997-2007) from an average of 30.74 *per cent* in IX Plan (1997-2002) to an average of 23.25 *per cent* during X Plan (2002-07). It further came down to 19.10 *per cent* in first year of XI Plan (2007-12) indicating the fact that although debt financed proportion of total expenditure has squeezed over the last decade but still about 19 *per cent* of total expenditure in 2007-08 is met through borrowed funds.



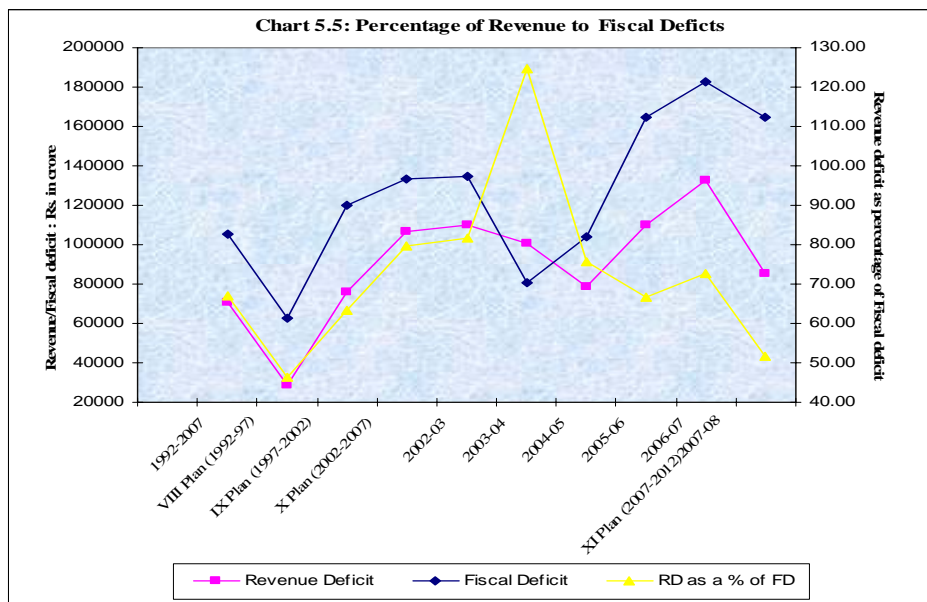
**5.9** It is not uncommon for governments to run fiscal deficit and borrow funds for capital/asset formation or for creation of economic and social infrastructure. The assets created through such borrowings could pay for themselves by generating an income stream. Capital formation may also increase 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 up to a point. Table 5.3 and Chart 5.4 present the movement of components of fiscal deficit over the VIII, IX Plan and the X Plan periods as well as for the current year

**Table 5.3: Components of Fiscal Deficit**

<i>(Per cent)</i>			
Period	Revenue Deficit	Net Capital Expenditure	Net Loans and Advances
1992-2008	65.43	28.21	6.36
<b>VIII Plan (1992-97)</b>	<b>46.26</b>	<b>28.25</b>	<b>25.49</b>
<b>IX Plan (1997-02)</b>	<b>63.26</b>	<b>19.53</b>	<b>17.20</b>
<b>X Plan (2002-07)</b>	<b>79.74</b>	<b>31.22</b>	<b>(-) 10.96</b>
2002-03	81.56	20.32	(-) 1.87
2003-04	124.77	22.79	(-) 47.56
2004-05	75.82	47.43	(-) 23.25
2005-06	66.51	33.07	0.42
2006-07	72.62	32.12	(-) 4.74
<b>XI Plan (2007-12)</b>			
2007-08	51.79	47.37	0.84
<b>Average Annual Rate of Change</b>			
1992-2008	4.08	2.12	-



**5.10** Revenue deficit continued to be the dominant component of fiscal deficit, accounting for 65.43 *per cent* of it during 1992-2008 (Chart 5.4). 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 63.26 *per cent* during IX Plan (1997-2002) and further to an average 79.74 *per cent* during the X Plan (2002-07) after reaching the peak level during 2003-04 (Chart 5.5). Given the steep decline in the share of revenue deficit in fiscal deficit in 2007-08 over the previous year, the ratio although continued to exhibit a large positive shift rate of 4.08 *per cent* during 1992-2008 but it declined from 5.46 *per cent* for the period 1992-2007. While the revenue deficit declined by 35.69 percent (Rs. 47412 crore) but its share in fiscal deficit has declined by only 20.83 percentage points during the current year, which indicates the fact that the share of net capital expenditure in fiscal deficit has increased significantly during the year.



**5.11** Net capital expenditure (capital expenditure- capital receipts) accounted for 28.21 *per cent* of fiscal deficit during 1992-2008. Increasing share of revenue deficit in fiscal deficit over the period 1992-2002 pushed down the average share of net capital expenditure during VIII and IX Plan periods. During the X Plan (2002-07), although the share of revenue deficit in fiscal deficit has also increased but due to a net decline of 15.25 *per cent* in loans and advances disbursed to States, the share of net capital expenditure has exhibited a buoyancy during the period. Despite an increase of Rs. 33875 crore in Miscellaneous Capital Receipts and Rs. 4387 crore in disinvestment proceeds in 2007-08 over the previous year, net capital expenditure during the current year increased by Rs. 19382 crore (32.98 *per cent*) resulting in steep increase in its share in fiscal deficit by 15.25 percentage points during the year. The sharp increase in net capital expenditure during the current year was primarily on account of a steep increase of Rs. 55250 crore (138.54 *per cent*)



in Non-plan capital outlay over the previous year which grew from Rs. 39879 crore in 2006-07 to Rs. 95131 crore in 2007-08. This step up in non-plan capital outlay was observed mainly on account of Union Government's enhanced investment in General Finance and Trading Institutions (Rs. 49636 crore); International Financial Institutions (Rs. 1594 crore) and in Agricultural Financial Institutions (Rs. 304 crore) and defence capital expenditure (Rs. 3634 crore) during the current year. It was observed that in 2005-06 and 2006-07, the net capital expenditure has contributed around one third of the fiscal deficit while share of revenue deficit during the X Plan has exhibited the declining trend, which becomes more perceptible during the current year when share of revenue deficit declined to 51.79 *per cent* while the share of net capital expenditure increased to 47.37 *per cent*. Given the fact that rate of return on government investment witnessed a significant acceleration and at current levels it exceeded the cost of raising the resources significantly (6.55 percentage points), this qualitative improvement in the composition of the fiscal deficit could be one of explanatory factors for increasing fiscal deficit coexisting with high growth trajectory during the recent years.

**5.12** The overall trends over the period (1992-2008) however reveal that as interest payments (along with the other components of committed expenditure) increase relative to current revenues of the government, a process of adjustment starts in government expenditure, which is normally unfavorable to capital expenditure of the Government. Trends in the co-movements of interest payments, capital expenditure and revenue receipts indicated that while increase in interest payments affected negatively the government capital expenditure, the increase in revenue receipts had a positive impact.

**5.13** Fiscal deficit financed around six *per cent* of net loans and advances during the period 1992-2007. The net loans and advances which constituted around one-fourth of the fiscal deficit during VIII Plan reduced to an average of 17.20 *per cent* during the IX Plan (1997-02). During the X Plan, the recovery of loans and advances almost exceeded the issue of fresh loans and the surplus actually financed around 11 *per cent* of the fiscal deficit (Chart 5.4). The loans and advances disbursed by the Union Government has, however, indicated an increase of Rs. 1758 crore (17.55 *per cent*) in 2007-08 over the previous year mainly on account of an increase of Rs. 1741 crore in (35.58 *per cent*) in loans and advances to States while their recovery declined by Rs. 8300 crore (44.41 *per cent*) resulting in a net increase of Rs. 1386 crore in disbursement in 2007-08 from the level of net recovery of 8672 crore in the previous year. Continuous use of borrowed funds for meeting current expenditure not only indicated erosion in asset back up, it also made capital expenditure (inclusive of loans and advances) as variable of adjustment.

### **Primary Deficit**

**5.14** 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

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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. 18286 crore during VIII Plan (1992-97) increased to Rs. 28573 crore during IX Plan (1997-2002) but the trend was reversed during X Plan as it exhibited an average surplus of Rs. 2423 crore. The primary account of the Union Government had shown large fluctuations during the X Plan indicating a peak level surplus of Rs. 47177 crore in 2003-04 as interest payments exceeded the fiscal deficit during the year, which was the lowest level of fiscal deficit since 1997-98. The peak level surplus, however, witnessed a decelerating trend in the next year and culminated once again into deficits during 2005-06 and 2006-07, mainly due to steep increases in fiscal deficits relative to increases in interest payments. The interest payments during the current year increased by Rs. 25707 crore from the level of Rs. 154280 crore in 2006-07 which along with a decline in fiscal deficit of Rs. 17972 crore led to situation of primary surplus of Rs. 15025 crore in 2007-08 from the primary deficit of Rs. 28654 crore in the previous year.

**Table 5.4: Primary Deficit and its Parameters**

*(Rupees in crore)*

Period	Revenue Deficit	Fiscal Deficit	Interest Payments	Primary Deficit*	Primary Deficit as per cent of GDP
1992-2008	71293	108959	96012	12947	0.58
<b>VIII Plan (1992-97)</b>	<b>28941</b>	<b>62565</b>	<b>44280</b>	<b>18286</b>	<b>1.76</b>
<b>IX Plan (1997-02)</b>	<b>75711</b>	<b>119675</b>	<b>91102</b>	<b>28573</b>	<b>1.49</b>
<b>X Plan (2002-07)</b>	<b>106399</b>	<b>133437</b>	<b>135860</b>	<b>-2423</b>	<b>-0.08</b>
2002-03	109765	134588	124573	10015	0.41
2003-04	100986	80937	128114	-47177	-1.71
2004-05	78700	103798	130958	-27160	-0.86
2005-06	109697	164927	141375	23552	0.66
2006-07	132847	182934	154280	28654	0.69
<b>XI Plan (2007-12)</b>					
2007-08	85435	164962	179987	-15025	-0.32
<b>Average annual trend rate of growth (per cent)</b>					
1992-2008	11.97	7.58	11.87	Average Annual Rate of Change.	
<b>VIII Plan (1992-97)</b>	<b>10.88</b>	<b>6.41</b>	<b>17.44</b>		
<b>IX Plan (1997-02)</b>	<b>17.29</b>	<b>9.00</b>	<b>14.90</b>		
<b>X Plan (2002-07)</b>	<b>4.75</b>	<b>14.18</b>	<b>5.40</b>		
2002-03	-0.49	-13.63	9.11		
2003-04	-8.00	-39.86	2.84		
2004-05	-22.07	28.25	2.22		
2005-06	39.39	58.89	7.95		
2006-07	21.10	10.92	9.13		
<b>XI Plan (2007-12)</b>					
2007-08	-35.69	-9.82	16.66		

\* A negative figure indicates existence of primary surplus

**5.15** In relation to GDP, primary deficit declined from an average of 1.76 *per cent* during the VIII Plan (1992-1997) to 1.49 *per cent* during IX Plan (1997-2002) and it turned into a marginal surplus of Rs. 2423 crore, i.e. 0.08 *per cent* of GDP during the X Plan (2002-07). The X Plan in fact began with primary deficit, which relative to GDP was 0.41 *per cent* during 2002-03. It, however, turned into the situation of large primary surpluses in 2003-04 and 2004-05 but during the last two years of the Plan, this trend was reversed again and primary deficit relative to GDP increased to 0.69 *per cent* during 2006-07. Improvement in primary deficit from 0.41 *per cent* of GDP in 2002-03 to primary surplus of 1.71 and 0.86 *per cent* of GDP, respectively, in 2003-04 and 2004-05 clearly indicates that non-debt receipts were adequate to meet the primary expenditure incurred during these years. However, that was largely due to increase in recovery of loans with the prepayment of high cost loans by States as well as by some public sector undertakings under the debt swap scheme in 2003-04 and 2004-05 to take advantage of the soft-interest regime. As a result, contraction in non-debt receipts along with an increase in government expenditure at relatively higher pace led to the deterioration in fiscal deficit, which in turn also worsened the primary deficit situation in 2005-06 and 2006-07. A steep increase in interest payments (16.66 *per cent*) accompanied with a moderate decline in fiscal deficit (9.82 *per cent*) during the current year again led to a situation of primary surplus, which relative to GDP was only 0.32 *per cent* during the current year. Recovery of loans or accruals of miscellaneous capital receipts, however, indicate a decline in assets base of the government and at best could be viewed as a limited and a temporary option.

#### **Actual Deficits vis-à-vis Targets/Requirements of FRBM Act/Rules**

**5.16** The FRBM Act, 2003 came into effect from July 2004 following the issue of Government notification and formulation of FRBM Rules, 2004. Section 4(1) of Fiscal Responsibility and Budget Management (FRBM) Act 2003, as amended, 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. The *Act* and the *Rules*, as these presently stand, have provided for the elimination of the revenue deficit by 2008-09, with 0.5 percentage point of GDP as the minimum annual reduction target, and fiscal deficit to be brought to the level of 3 *per cent* of GDP, with 0.3 percentage point of GDP, as the minimum annual reduction target. The targets/requirements prescribed under FRBM Act/Rules are to ensure, *inter alia*, inter-generational equity in fiscal management and long term macroeconomic stability.

**5.17** The FRBM Act, however, had some built-in flexibility in achieving revenue and fiscal deficit reduction targets as there is a provision that the specified limits may be exceeded 'due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify'. Invoking this provision of the FRBM Act, the

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Union Government has 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 primarily on account of a conscious shift in plan priorities in favor of revenue expenditure-intensive programmes and schemes particularly at the commencement of the XI Five Year Plan. The systemic rigidity of containing non-Plan committed revenue expenditures in the short term, particularly arising from committed and obligatory expenditure such as interest payments, subsidies – both explicit and implicit, pensions, salaries and defence sector was stated to be another contributory factor.

**5.18** Along with the Budget, and as required under the FRBM Act, the Central government has been laying from 2004-05, *inter alia* the Medium-term Fiscal Policy Statement (MTFPS), specifying 3-year rolling targets for revenue and fiscal deficits as well as for tax revenue and total outstanding liabilities of the Central Government as percentages of GDP. These have been derived on the basis of assumptions on growth and the policy stance of the government. The targets for revenue and fiscal deficits set for 2007-08 in MTFP Statements for 2005-06, 2006-07 and 2007-08 along with their actual levels as brought out in Union Government's Finance accounts for 2007-08 are given in Table 5.5

**Table 5.5: Outcome vis-à-vis Targets under FRBM Rules (As per cent of GDP)**

Fiscal Indicator	Targets set in MTFPS 2005-06 for the year 2007-08	Targets set in MTFPS 2006-07 for the year 2007-08	Targets set in MTFPS 2007-08	Actual Levels (As deduced from Finance Accounts 2007-08)	Deviation with BE 2007-08
Revenue Deficit	1.1	1.1	1.5	1.81	0.31
Fiscal deficit	3.1	3.4	3.3	3.50	0.20

**5.19** Table 5.5 presents the targets set for the key fiscal parameters – revenue and fiscal deficits - for the 2007-08 in Medium Term Fiscal Policy Statements (MTFPS) placed along with the Budgets for 2005-06, 2006-07 and 2007-08 vis-à-vis their actual levels as deduced from the Finance Accounts of the Union for 2007-08. The targets set for fiscal deficit for 2007-08 in MTFPS for 2006-07 was revised upwards to 3.4 *per cent* of GDP from 3.1 *per cent* as envisaged in MTFPS placed along with the Budget for 2005-06. The budget estimates for fiscal deficit for 2007-08 was marginally reduced to 3.3 *per cent* however the target of revenue deficit to GDP ratio was raised to 1.5 *per cent* of GDP in MTFP Statement of 2007-08 from 1.1 *per cent* of GDP sustained in MTFPS for 2005-06 and 2006-07. The actual levels of revenue and fiscal deficits as per Union Finance Accounts for 2007-08 were higher than their budget estimates respectively by 0.31 and 0.20 percentage points.

**5.20** Notwithstanding the slippages in deficit indicators vis-à-vis their budget estimates, the fiscal deficit and revenue deficit, as percentages to GDP, at 3.50

*per cent* and 1.81 *per cent*, respectively, in 2007-08 as emerged from Finance Accounts for 2007-08 were lower by 0.91 and 1.39 percentage points than those in 2006-07. The fiscal correction during 2007-08, thus, turned out to be higher than the minimum reductions of 0.3 *per cent* and 0.5 *per cent* (relative to GDP) for GFD 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.

**5.21** Fiscal consolidation of the Central Government under the FRBM Act, 2003 has been revenue-led, underpinned by a significant increase in the tax-GDP ratio. The gross tax/GDP ratio maintained the upward trend to reach 12.58 *per cent* in 2007-08. A steady increase in the tax-GDP ratio for the Central Government was led by direct tax revenues. The robust economic growth and macroeconomic stability, in general, resulted in higher than anticipated tax revenues and created fiscal space for meeting the demand for resources. Expenditure management efforts however also focused on moderating non-plan expenditure, while increasing plan expenditure. Capital outlay, however, continued to remain at a low level of 2.48 *per cent* of GDP in 2007-08 despite a steep increase of Rs. 55252 crore (138.55 *per cent*) in non-plan capital outlay over the previous year which was mainly on account of Union Government's enhanced investment in General Finance and Trading Institutions; International Financial Institutions and in Agricultural Financial Institutions besides a normal growth in defence capital outlay during the year.

**5.22** Notwithstanding the improved position, there are several underlying fiscal pressures that are not entirely evident in the headline fiscal indicators. Although implementation of fiscal rules has had a positive effect of focusing attention on fiscal issues, there has been an increased recourse to extra-budgetary fiscal liabilities. The issuance of bonds has been resorted to frequently for financing not only fuel, food and fertiliser subsidies, but also deferred liabilities with regard to bank loan waivers and contribution to capital of public sector banks. The significant quasi-fiscal transactions to finance recurrent revenue expenditures through *de facto* borrowings not only create apprehensions about the quality of the fiscal consolidation process that is underway but raises the issue of transparency in fiscal operations and inter-generational equity in fiscal management and long term macroeconomic stability.

**5.23** While adhering to the FRBM targets in respect to revenue and fiscal deficits is considered to be critical for macroeconomic, financial, external sector and budgetary sustainability but a stand alone deficit target is incomplete unless the receipts or expenditure levels are specified too as given level of deficit can be achieved at different levels of receipts and expenditure. Besides, the mode of financing of the fiscal deficit and the appropriate use of resources so raised are equally important, particularly in view of the fact that

the Indian economy is undergoing structural transformation and it needs large investments in certain critical areas such as education, health care and physical infrastructure especially when the focus is on inclusive growth. Furthermore, as use of borrowed funds for meeting the current expenditure requirements has resulted in widening of asset-liability mismatches over the years, it is essential to eliminate the revenue deficit and generate sufficient revenue surplus which may be utilised for asset creation without creating liabilities. In this context, there is a need for durable fiscal correction and consolidation through fiscal empowerment, *i.e.*, by expanding the scope and size of revenue flows.