CHAPTER 1

INTRODUCTION

According to Arther Simithies, fiscal policy is a policy under which government uses its expenditure and revenue programme to produce desirable effects and avoid undesirable effects on the national income, production and employment.

1.1 Significance of the Fiscal Sector

The fiscal sector plays a very significant role in any economy, for two reasons, firstly, the government can attempt to bring about optimal intersectoral allocation of resources through fiscal policies, and on the other , can also attain the task of resource mobilization i.e. transfer of private income to exchequer. Fiscal policy is an additional method to determine public revenue and public expenditure. The importance of fiscal policy has increased in the recent years due to economic fluctuations.

Actually, in most of the developed countries, it was in the fiscal sector that the government through appropriate budgetary instruments tried to achieve larger goals of public policy like increase in production, maintenance of high level of income, employment and steady growth. These budgetary instruments include government expenditure and revenue from tax and non-tax sources to help achieve the goals of public policy.

The Government needs resources for its own functioning and upkeep of infrastructure and also to provide economic support or subsidy to correct distortions caused by the market mechanism, and take care of equity losses from the prevailing distributional disparities. For example, provision of public goods and services like defence, police and civil administration, and large and long term projects demanding huge investments, where the returns are uncertain like national highways, railways, ports and large dams and social infrastructure like health and education.

Thus, the provision of economic infrastructure, public goods, reducing distributional disparities, correction of negative externalities like environmental pollution, creating human capital and economic stabilization are generally accepted as legitimate areas of government activity. However, with the structural transformation of the economy and changing priorities of the Government about the relative role of the state vis-a-vis private sector, the size and composition of government budget also undergoes a change.

Expenditure preferences have to be modified and new revenue resources have to be explored if old ones have become inelastic and unproductive as the expenditures on same item which produced beneficial results initially may become unproductive over time viz. subsidies for farmers which could promote better cropping and encourage the use of high yielding varieties of seeds initially have degenerated into white elephants in our country[1]. Likewise the phenomenal performance and growth of service sector in India and rising incomes of large farmers point towards two potential areas having high ability to pay for widening the tax base. Similarly budget deficits which may be desirable in times of contingencies like natural disasters or war, or as built-in-stabilizers during periods of business cycles become highly undesirable as these result in adding up of public debt, the servicing of which will require increased taxation and revenue generation and if that is not possible then curtailing productive expenditures. Such deficits may become burdensome for posterity because the cost of borrowing may rise beyond the benefits in economic growth. Future generations bear the burden of servicing a debt which was contracted to finance an earlier generation's consumption expenditure. Hence the fiscal envelope has to be designed within affordable limits.

The fiscal situation also has to change with evolving socio-economic realities and changing social values and these changes need to be reflected

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1 Shome, Parthasarathi: *India's Fiscal Matters,* Oxford University Press, New Delhi, 2002, p.6.

and taken care of in the budget process accordingly. Unfortunately, this did not happen in India.

The Indian fiscal system continued to be marked by too many controls and too little transparency for a long time and deterioration in governments' finances became apparent over the period. Subsidies kept mushrooming, tax structure became growingly irrational and the runaway increase in unproductive expenditures forced the government to borrow more and more which resulted in problem of fiscal imbalance in governments' finances both at the Centre as well as at the states but Central Government being the main channel of country's fiscal policy, the state of Central finances remains of paramount importance. Therefore, this study confines itself only to the analysis of Fiscal Deficit of the Centre since 1990-91.

1.2 Fiscal Deficit in India - A Brief History

"In the eighties the high fiscal deficits spilled into large current account BoP deficits, which were financed by unsustainable foreign borrowings that ushered in the crisis of 1991. In the late nineties the rising deficits have taken their toll on savings and investment and thereby growth. What both episodes have in common are damage to sustainable economic development. High fiscal deficits are costly, though the currency of payment may vary." [2]

In the context of Central Government's finances it would be relevant to recall that till the seventies there used to be a surplus on the revenue account of the budget which was utilized for financing development projects on the capital account of the budget. The revenue surplus of the Central Government during the Fourth Plan (1969-74) was Rs. 445.72 crores which actually rose to Rs. 2671.72 crores in the Fifth Plan period (1974-79). It was in the year 1979-80 that the government for the first time incurred a revenue deficit of Rs. 649.09

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[2] Acharya, Shankar. High Fiscal Deficits hurt growth in *India's Economy: Some Issues and Answers*, Academic Foundation, New Delhi, 2003, p.117

crores which was 0.57 per cent of the GDP. In Indian Public finances, this figure though small, heralded the beginning of a very unhealthy trend as since then the government despite good intentions has not been able to reverse this trend.

The revenue deficit figure which was Rs. 776.76 crores in 1980-81, at the beginning of the Sixth Plan, reached Rs. 3497.58 crores by the end of it i.e. 1984-85 and further rose to a high figure of Rs. 11914.23 crores by the terminal year of the Seventh plan. The total revenue deficit for the Sixth Plan was only Rs. 8219.78 crores but the runaway increase in government's expenditure in relation to modest increases in its revenue receipts made it balloon to Rs. 44,906.47 crores over the entire Seventh Plan period (1985-90). (Table 1.1 and Fig. 1.1)

Table 1.1: History

Budgetary and Revenue Deficit of the Centre

Year	Budgetary Deficit		Revenue Deficit	
	Total (Rs.Crore)	Ratio to GDP	Total (Rs.Crore)	Ratio to GDP
Sixth Plan 1980-81	2576.00	1.79	776.76	0.54
1981-82	1392.00	0.83	293.44	0.17
1982-83	1655.00	0.88	1254.33	0.67
1983-84	1417.00	0.65	2397.67	1.09
1984-85	3715.00	1.53	3497.58	1.42
Total	10785.00		8219.78	
Seventh Plan 1985-86	4937.00	1.78	5564.52	2.00
1986-87	8261.00	2.65	7776.04	2.50
1987-88	5816.00	1.64	9137.26	2.58
1988-89	5642.00	1.34	10514.42	2.49
1989-90	10594.00	2.18	11914.23	2.45
Total	35250.00		44906.47	
Annual Plan 1990-91	11347.00	2.00	18561.36	3.26

Source: Indian Public Finance Statistics, 2002-03, Department of Economic Affairs, Eco Division, Ministry of Finance, New Delhi.

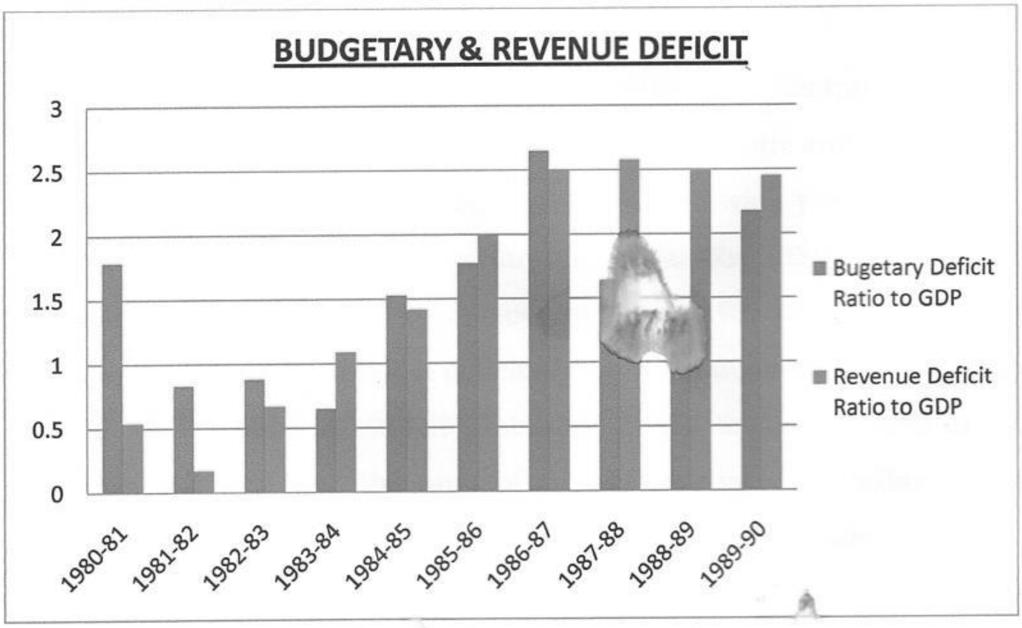

Figure 1.1

The deterioration in revenue balance, according to the Seventh Plan document was mainly due to the sharp rise in non-plan expenditures arising partly out of the inflationary pressures experienced during the Sixth Plan period, which increased the cost of maintenance of normal services and also the emoluments of government employees in terms of additional dearness allowances. Revenues of the government on the other hand did not grow as fast as the cost of goods and services bought by the government.[3] Another factor apart from inflation which affected the revenue position of the government adversely was that certain large items of current expenditure, such as defence, interest payments and subsidies kept growing.

The Long Term Fiscal Policy (LTFP) policy statement too had similar diagnosis for the declining contribution of the Central budget to the financing of the Sixth Plan stating that the stagnation of current revenues at around 10.5 per cent of GDP since mid-seventies in face of a rise in non-plan revenue expenditure is mainly responsible for it. Just two items, interest payments and subsidies on food and fertilizers accounted for nearly 40 per cent of the non-

3 Government of India, *Seventh Plan (1985-90) Part-I*, Planning Commission, New Delhi.

plan revenue expenditure.[4]

In 1989-90 the revenue deficit to GDP ratio for the Central Government was 2.45 per cent (while the combined deficit for the centre and the states was 3.17 per cent) which rose to 3.26 per cent in the following year i.e. in 1990-91 when the revenue deficit in absolute terms was Rs. 18561.36 crores. The budgetary position of the Central Government in 1989-90 was a matter of serious concern with the budget deficit almost doubling to Rs. 11750.00 crores from Rs. 5,642 crores in 1988-89 (Table-1.1) While the expenditure to GDP ratio was 25.4 per cent, the ratio of current revenue (including internal resources of PSUs) to GDP was a mere 14.2 per cent. The revenue receipts of the Centre grew on an average by 16.6 per cent per annum during 1980-81 to 1990-91 while the growth in revenue expenditure was 17.1 per cent.[5] This explains how the revenue deficit/GDP ratio reached 3.26 per cent in 1990-91.

Revenue deficits had serious implications in terms of diversion of high cost borrowed funds for covering the deficit with no return flow to service the borrowings. Recourse to borrowings entailed increase in interest burden in the revenue account leading to further ballooning of revenue deficits which further necessitated more borrowings. Thus the Central finances got into a vicious circle leading close to what is called an internal debt trap. This was one of the most worrisome developments of the fiscal scenario of the eighties as Ninth Finance Commission observed "Incurring of revenue deficits on a large scale year after year implied an infraction of one of the fundamental principles of sound public finance in any economy, particularly in a developing economy." [6] Reflecting these developments the outstanding liabilities of the Central Government as a ratio to GDP rose from 43.9 per cent in 1980-81 to 55.3 per cent in 1990-91. Internal liabilities rose from 35.6 per cent of GDP to 49.8 per cent of GDP over the same period. In absolute terms

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4. Government of India: *Long Term Fiscal Policy: Statement presented by Finance Minister in Parliament,* Dec. 1985

5 Government of India: *Economic Survey, 1990-91,* Ministry of Finance, New Delhi, p.103.

6 Report of The Ninth Finance Commission, New Delhi, 1990.

these grew from Rs. 48451 crores to Rs. 283033 crores registering an increase of 484.16 per cent over this period, nearly a six fold increase within ten years. Among the internal liabilities, other internal liabilities which include small savings collections, provident funds, reserve funds and deposits have witnessed a sharp increase as compared to market borrowings. Other internal liabilities were Rs. 17587 crores in 1980-81. These grew to Rs. 129029 crores in 1990-91 registering an increase of 633.66 per cent, a more than seven fold increase over a decade. Their ratio to GDP shot up from 12.9 per cent at the end of 1980-81 to 22.7 per cent in 1990-91 (Table1.2).

These liabilities attracted relatively higher interest rates and hence added to the growth of interest payment liabilities. The growth of government debt led to a substantial increase in gross interest payments which went up from 11.6 per cent of the total Central Government expenditure in 1980-81 to 21.4 per cent in 1990-91. Surprisingly, till the mid-eighties or even later growth of public debt did not catch attention of policymakers and no serious questions were asked about its sustainability. "They saw nothing wrong in the growth of public debt. While it is no doubt preferable that public debt is discharged through public savings, in the event of such savings being inadequate or required for achieving a better economic or social goal, there is no harm in discharging old debts by taking new loans."[7] Even the term fiscal deficit which received prominence as early as the seventies at the global level remained a neglected parameter of fiscal imbalance in India.[8] It was only after the recommendation of the Chakraborty Committee which was constituted in April 1985 to review the working of the monetary system with a view of introducing the quantum of fiscal deficit alongwith the budgetary proposal, that the Ministry of Finance started showing fiscal deficit figure also in its budget document but only as late as

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7 Government of India: *Report of the Eighth Finance Commission (1984)* New Delhi, para 14-16.

8 Lahiri, Ashok K. "Budget deficits and Reforms", *Economic and Political Weekly*, Nov.11, 2000, p.4049

Table- 1.2

Outstanding Liabilities of the Central Government and Payment of Interest

(Rs. Crore)

	1980-81	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
Internal Liabilities (Outstanding	48451 **35.6**	71190 **40**	80141 **38.6**	94884 **41.8**	119331 **45.6**	146247 **50.1**	172338 **51.8**	204025 **51.7**	239849 **54.2**	283033 **49.08**
A) Internal Debt	30864	46939	50264	58537	71039	86312	98646	114498	133193	154004
(a) Market Borrowings	15676	22355	26394	30470	35352	40880	46743	55161	62565	70520
b) others	15188	24584	23870	28067	35687	45432	51903	59337	70628	83484
B) Other Internal Liabilities	17587 **12.9**	24251 **13.6**	29877 **14.4**	38267 **16.5**	48292 **1804**	59935 **205**	73692 **22.2**	89527 **22.7**	106656 **24.1**	129029 **22.7**
External Debt (out-standing)*	11298 **8.3**	13682 **7.7**	15120 **7.3**	16637 **7.2**	18153 **6.9**	20299 **7.4**	23223 **7**	25746 **6.5**	28343 **6.4**	31525 **6.2**
Total out-standing liabilities (1+2)	59749 **43.9**	84872 **47.6**	95261 **45.9**	113441 **49**	137484 **52.5**	166546 **57**	195561 **58.8**	229771 **58.2**	268192 **60.6**	314558 **55.3**
Gross Interest Payments	2604	3937	4795	5974	7512	9246	11252	14278	17735	21850
Net Interest Payments	809	1086	2127	2011	2917	3893	5497	7297	9269	12277
Gross Interest payment as % of Total Expenditure	**11.6**	**12.9**	**13.3**	**13.6**	**14.1**	**14.4**	**16**	**17.5**	**18.5**	**21.4**
Net Interest payment as % of total expenditure	**3.6**	**3.6**	**5.9**	**4.6**	**5.5**	**6.1**	**7.8**	**9**	**9.7**	**12.1**
Memorandum items Internal Debt (outstanding covered at year end exchange rates)	13479 **9.9**	17577 **9.9**	20214 **9.7**	24004 **10.4**	26638 **10.2**	32312 **11.1**	36578 **11**	46838 **11.9**	54100 **12,2**	66017 **12.9**

*External debt figures represent borrowings by Central Government from external sources and are based upon historical rates of exchange.

Note: Figures in decimals are percentages to respective GDPs

Source: Govt. of India, Economic Surveys, 1990-91 and 2004-05

1991-92. It is thus clear that the gross indebtedness of the Centre was not much of concern for the policymakers in the eighties. Fiscal deficit as a parameter of macroeconomic imbalance and fiscal strength became significant only during the era of economic reforms and liberalization.

Prudent fiscal management demands that revenue receipts should not only meet revenue expenditure but also leave a surplus for financing capital expenditure. Throughout the eighties Central finances remained precarious, callously violating all norms of prudent fiscal management. All the important indicators of fiscal imbalance i.e. conventional budgetary deficit, revenue deficit and gross fiscal deficit were rising throughout the eighties. The situation reached a critical point by 1990-91 and assumed crisis proportion by the fiscal year 1991-92. The Gulf crisis of 1990 worsened the already precarious fiscal situation.[9] As a result of the Gulf crisis there was an increase in fertilizer subsidy and a shortfall in revenue collections attributable to the squeeze on non oil imports. The gulf crisis imposed an unanticipated burden of Rs.300 crores on the exchequer for repatriating Indian citizens from Kuwait. Apart from the Gulf crisis other factors like additional loans to the states, higher interest payments, under funding of the scheme of rural debt relief, increase in food subsidy and higher technical credits[10] contributed towards this deterioration in the fiscal stance of the Centre.

Like other parameters of deficit, gross fiscal deficit too remained disturbingly high. On an average gross fiscal deficit rose from 6.3 per cent of GDP in the Sixth Plan period to 8.2 per cent of GDP in Seventh Plan period. It is necessary to mention that during 1986-87 year of the Seventh Plan the gross fiscal deficit figure reached a record level of 9.4 per cent of GDP. Actually the impressive growth performance of the economy during eighties was

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9 "The crisis has been simmering since the mid-Eighties with governments relying on unsustainable levels of foreign and domestic borrowings. It was brought to boil by the Iraqi invasion of Kuwait in Aug. 1990 resulting in a rise in the price of oil." Joshi and Little: *India's Economic Reforms, 1999-2001*, OUP, New Delhi 1996, p.1.

10 Government of India, *Economic Survey, 1990-91,* Ministry of finance, New Delhi, p.107.

attributable to a sustained record of investment which stood at 27.1 per cent of the GDP. With gross domestic savings at 23.7 per cent of the GDP there resulted a gap of almost 3.4 per cent which was bridged through borrowings both external and internal. The external indebtedness rose to US $ 71b out of which the share of short term debt was 10.2 per cent. The debt service ratio was as high as 35.8 per cent in 1990-91. With fiscal deficit standing at 8.4 per cent of GDP and revenue deficit at 3.5 per cent of GDP Indian economy ran into serious macroeconomic crisis by the end of the eighties.

This fiscal morass was largely due to the runaway increase in the non-plan expenditure in the eighties. As the tax system was highly irrational , government revenue failed to keep pace with its expenditure. An analysis of the economic and functional classification of Central Governments' expenditure[11] shows a steady decline in the proportion of expenditure on capital formation since the mid-eighties (Table 1.3). It hovered around 40 per cent till mid-eighties and steadily fell to 33.1 per cent in 1990-91. This situation resulted mainly from a substantial increase in the expenditure on current transfers. The proportion of transfer payments to total expenditure increased from 30.7 per cent in 1980-81 to 34.5 per cent in 1985-86 and further to 42.8 per cent in 1990-91 (Table 1.3). The increase in current transfers was mainly due to an increase in interest payments. The proportion of expenditure on interest payments increased from 10 per cent in 1980-81 to 18.9 per cent in 1990-91.

The growing mismatch between receipts and expenditure is borne out by the fact that while expenditure to GDP ratio of the Central Government rose from 16.4 per cent of GDP to 19.7 per cent of GDP, revenue receipts grew from 9.1 per cent to 10.3 per cent of GDP over the same period. (Table 1.4)

11 It classifies expenditures into those which directly generate a demand for goods and services by the government and those that are transfers to other spending organisations and sectors. Rest is Gross Capital formation out of budgetary resources by the Central Government.

Table - 1.3

Economic Classification of Total Expenditure in Central Budget

		1980-81	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
1	Consumption Expenditure	5174 23	8130 22.6	9428 21.5	11210 21.1	14665 22.9	16551 23.5	18763 23	20784 21.9	23102 21.4	24655 20.8
a)	Defence	3571 15.9	5823 16.2	6647 15.1	7962 15	10419 16.3	11875 16.9	13237 16.3	14298 15	15643 14.5	16227 13.7
b)	Other Govt. Administra-tion	1603 7.1	2307 6.4	2781 6.3	3248 6.1	4226 6.6	4676 6.7	5526 6.8	6486 6.8	7459 6.9	8428 7.1
2	Transfer Payments (current)	6912 30.7	11436 31.8	14938 34	18347 34.5	21243 33.2	25380 36.1	31399 38.6	37877 39.8	46177 42.8	51207 43.2
a)	Interest payments	2253 10	4450 12.4	5646 12.9	7090 13.3	8648 13.5	10702 15.2	13347 16.4	16525 17.4	20316 18.8	25835 21.8
b)	Subsidies	1912 8.5	2886 8	4484 10.2	5070 9.5	5542 8.7	5976 8.5	7859 9.7	10862 11.4	10722 9.9	8789 7.4
c)	Grants to States & UTs (including local bodies)	1810 8	2526 7	2863 6.5	3922 7.4	4205 6.6	4962 7.1	5831 7.2	5725 6	7997 7.4	8883 7.5
d)	Others	937 4.2	1574 4.4	1945 4.4	2265 4.3	2848 4.4	3740 5.3	4362 5.4	4765 5	7142 6.6	7700 6.5
3	Gross Capital Formation out of Budgetary Resources	9012 40.1	14702 40.9	17551 40	21477 404	24320 38	25770 36.7	28977 35.6	33012 34.7	35727 33.1	37414 31.6
a)	Physical Assets	1907 8.5	3356 9.3	4123 9.4	4558 8.6	5905 9.2	5961 8.5	7056 8.7	8136 8.6	8683 8	9750 8.2
b)	Financial Assets	7105 31.6	1346 31.5	13428 30.6	16919 31.9	18415 28.8	19809 28.2	21921 26.9	24876 26.2	27044 25.1	27664 23.3
4	Others	1397 6.2	1720 4.8	1962 4.5	2078 3.9	3795 5.9	2603 3.7	2263 2.8	3376 3.6	2923 2.7	5223 4.4
5	Total Expenditure	22495	35988	43879	53112	64023	70304	81402	95049	107929	118501

Note: Figures in decimals are percentage to respective total expenditures.

Source: Government of India, Economic Survey, 1991-92, Ministry of Finance, New Delhi.

Table- 1.4

Receipts and Expenditure of the Central Government

(Rs. Crore)

		1980-81	1990-91	2000-01	2007-08
1	**Revenue receipts (2+3)**	**12419**	**54954**	**192605**	**541864**
2	Tax Revenue (net of State's share)	9358	42978	136658	439547
3	Non-Tax Revenue	3061	11976	55947	102317
4	**Revenue Expenditure**	**14455**	**73516**	**277838**	**594433**
	(a) Interest Payments	2604	21498	99314	171030
	(b) Subsidies	1851	12158	25860	67498
	(c) Defence Expenditure	3604	10874	37238	54219
5	**Revenue deficit**	**2037**	**18562**	**85233**	**52569**
6	**Capital Receipts**	**7261**	**38997**	**134184**	**170807**
	(a) Recovery of loans	2104	5712	12046	5100
	(b) Other receipts (mainly PSU disinvestment)			2125	38795
7	**Capital expenditure**	**7801**	**31782**	**47754**	**118238**
8	**Total expenditure of which**	**22256**	**105298**	**325592**	**712671**
	(a) Plan expenditure	8994	28365	82669	205082
	(b) Non-plan expenditure	13262	76933	242923	507589
9	**Fiscal Deficit**	**7733**	**44632**	**118816**	**126912**
10	**Revenue receipts (2+3)**	**9.1**	**10.3**	**9.1**	**11**
11	Tax Revenue (net of State's share)	6.9	8	6.5	8.9
12	Non-Tax Revenue	2.3	2.2	2.7	2.1
13	**Revenue Expenditure**	**10.6**	**13.7**	**13.2**	**12**
	(a) Interest Payments	1.9	4	4.7	3.5
	(b) Subsidies	1.4	2.3	1.2	1.4
	(c) Defence Expenditure	2.6	2	1.8	1.1
14	**Revenue deficit**	**1.5**	**3.5**	**4**	**1.1**
15	Capital Receipts	5.3	7.3		3.5
	(a) Recovery of loans	1.5	1.1	0.6	0.1
	(b) Other receipts (mainly PSU disinvestment)	0	0	0.1	0.8
16	**Capital expenditure**	**5.7**	**5.9**	**2.3**	**2.4**
17	**Total expenditure of which**	**16.4**	**19.7**	**15.4**	**14.4**
	(a) Plan expenditure	6.6	5.3	3.9	4.1
	(b) Non-plan expenditure	9.8	14.4	11.5	10.3
18	Fiscal Deficit	5.7	8.3	5	2.6
19	Primary deficit		2.8	0.9	-0.9

Note: The figures may not add upto the total because of rounding approx.

Source: Government of India, Economic Survey, Ministry of Finance, New Delhi. 1996-97, 2007-08,2009-10

The ratio of non-plan expenditure to GDP which was 9.8 per cent in 1980-81 grew to 14.4 per cent in 1990-91 of which only interest payments, subsidies and defence expenditure accounted for 8.3 per cent. Over this period the percentage growth of revenue expenditure actually exceeded not only the percentage growth of revenue receipts i.e. current revenue, but also of total expenditure. As compared to 1980-81, revenue expenditure grew by 408.58 per cent in 1990-91 while revenue receipts grew by 342.50 per cent and total expenditure by 373.12 per cent only. A high growth of revenue expenditures and a relatively sluggish growth of current revenue led to a yawning resource gap which was increasingly being filled by borrowings from all sources. This explains how the gross fiscal deficit shot up from 5.7 per cent in 1980-81 to 8.3 per cent in 1990-91. The unabated growth of non-plan expenditures and poor returns from investment made in public sector were the main contributory factors in this fiscal crises.[12]

Another related development of the fiscally turbulent eighties was that in mid-eighties (1984-85) for the first time gross savings of the government turned negative and remained negative all through the eighties. The dissavings of the government increased from Rs. 1441 crores to 1985-86 to Rs. 6218 crores in 1990-91.

Fiscal imbalance and persistence of high fiscal deficit in particular led to crowding out of private investment, soaring inflation and balance of payments difficulties. By the end of eighties inflation was running high at an annual rate of 13 per cent per annum. The growth rate of GDP came down from 5.7 per cent in the Seventh Five Year Plan to 0.8 per cent in 1991-92. The current account deficit stood at 3.2 per cent of the GDP. This marked deterioration in public finances was responsible both for the persistence of current account deficits and the inflationary upsurge by the end of eighties and beginning of nineties. That the fiscal situation has grown unsustainable

[12] Government of India, *Economic Survey 1991-92*, Ministry of Finance, New Delhi, p.2.

was being growingly realised.[13] It finally culminated in the launching of macroeconomic stabilization programme by the government. The immediate objective was to reduce inflation, improve the balance of payments and bring down fiscal deficit and thus to place the economy on a high growth path as rapidly as possible. The stabilization and reform package produced quick results. The balance of payments improved dramatically. The current account deficit was below 1 per cent of GDP in all but one year from 1991-92 to 1994-95. There was a large surge in private capital inflows. By March 1995 the Forex reserves increased to US $21 billion.

Table 1.5
Gross Fiscal Deficit of Central Government

Year	GFD (Rs. Crore)	As % of G.D.P.
1990-91	37606	6.6
1991-92	30844	4.7
1992-93	35909	4.8
1993-94	55257	6.4
1994-95	48028	4.7
1995-96	50253	4.2
1996-97	56242	4.1
1997-98	73205	4.8
1998-99	89560	5.1
1999-00	104716	5.4
2000-01	118816	5.7
2001-02	140955	6.2
2002-03	145466	5.9
2003-04	132103	4.5
2004-05	125202	3.9
2005-06	146435	4.0
2006-07	142573	3.3
2007-08	126912	2.6
2008-09	326515	5.9
2009-10(BE)	400996	6.5

Source: Monthly Economic Review, Centre for Monitoring Indian Economy, Nov. 2004, Economic Survey 2009-10, Govt of India , Ministry of Finance

13 "The process of fiscal adjustment cannot be postponed any further. In the present scenario there are no soft options and no time to lose." Government of India, *Economic Survey, 1991-92*, Ministry of Finance, New Delhi, p.3.

Growth rate which had declined from 5.4 per cent in 1990-91 to 0.8 per cent in 1991-92 rapidly bounced back to around 5 per cent in each of the two successive years and further to around 7.7 per cent between 1995-96 to 1997-98. However this high rate could not be sustained in subsequent years. The real weakness of the Indian economy emerged during 2002-03 when the GDP growth rate stuck to the level of 4.4 per cent (Table 1.5) as a result of severe drought in most parts of the country. The inflation rate as measured by annual average WPI was 3.4 per cent in 2002-03 which rose up to 5.4 per cent in 2003-04. The Forex reserve position also became very comfortable with a reserve of US $72 billion at the beginning of 2004.

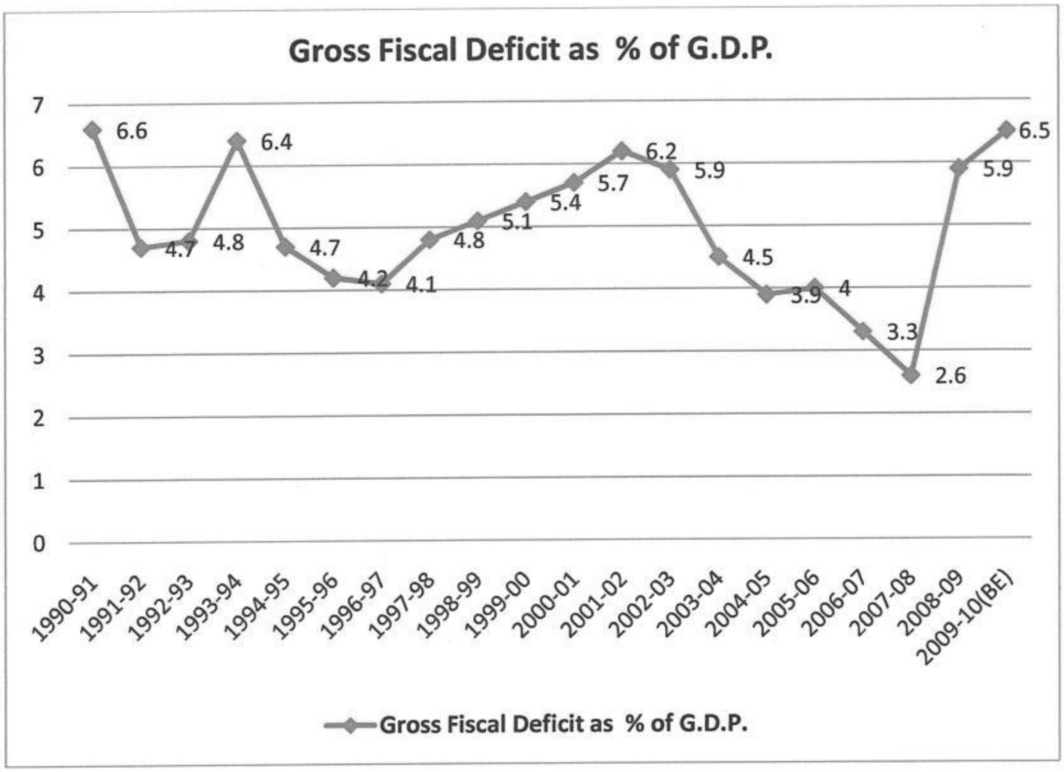

Figure 1.2

Thus the major parameters showed sound health of the economy but high fiscal deficit which remained high at 6.2 per cent of GDP in 2001-02 and 5.9 per cent of GDP in 2002-03, though in the subsequent years it showed a declining trend.

During 2007-08, finances of the Central Government registered a significant improvement in the position , and all the key deficit indicators, viz., gross fiscal deficit, revenue deficit and primary deficit were lower in comparison with their levels in 2002-03, (a high real GDP growth rate of 8.5 per cent supported revenue mobilization efforts thereby easing the fiscal situation), But the years 2008-09 and 2009-10 saw a derioration in the deficit indicators on account of the fiscal stimulus package and other steps taken to counter the impact of global recession. Thus, it is clear that the inability of the Government to rein in fiscal deficit is the core of the problem of fiscal imbalance in India. In the light of the circumstances given before, the proposed study is highly relevant for the society and economy.