

## CHAPTER-3

### Patterns and Analysis of Fiscal Deficit from 1990-91 to 2009-10

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*"A wise Chancellor is one who collects revenue so as to increase income and reduce expenditure. He shall take remedial measures if income diminishes and expenditure increases."*<sup>1</sup> - Kautilya

Fiscal imbalance characterised by unabated pressure on government expenditure and growing fiscal deficit in the Central Government's budget continued to remain the concern of the Government since 1990. The rush in India's economic growth rate which came in the early 1980s, financed by domestic credit and external borrowing accelerated growth during the 1980s, but a look at figures of fiscal indicators over the period shows that the fiscal and current account deficits widened significantly causing serious macroeconomic imbalances and culminated in the balance of payment (BOP) crisis of 1991. By and large, it was accepted that the crisis of 1990 was a symptom of underlying fragility of the fiscal condition, hence containing this deficit was one of the key structural adjustments undertaken by the Indian government at that time. These triggered the series of economic reforms that were introduced to bring about macroeconomic stabilization and implement structural measures to push up growth. Thus the reform and stabilization package launched in 1991 had deficit reduction and fiscal consolidation as one of its main components.

Economic reforms helped reduce the fiscal deficit, and the fiscal deficit fell to 4.1% of GDP in 1996-1997. However, a sharp increase in government salaries and pensions in the subsequent year halted the process of fiscal improvement until 2003-2004, when the government introduced the Fiscal Responsibility and Budget Management Act, 2003 (FRBMA) to control the fiscal deficit. India's fiscal situation improved significantly after the adoption of FRBM targets by successive governments since 2003-2004, but the global

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<sup>1</sup> Kautilya, *Arthashastra*, Book 2, Ch.6, Verse 28, 150 AD, as reported

crisis hit the Indian economy in early 2008–2009 which affected the fiscal scenario adversely.

**3.1 Profile of Fiscal Deficit:** The enactment of the FRBM Act in 2003 brought in some fiscal discipline and had a significant impact on the fiscal scenario in the country. Therefore, an attempt has been made to analyse the trends of the fiscal deficit during the period in two parts, the pre -FRBMA period (1990-91 to 2003-04) and the post FRBMA period (2004-05 to 2009-10)

### 3.1.1 The Pre FRBMA period (1990-91 to 2003-04)

The fiscal consolidation package launched in 1991 produced quick results. **Fiscal deficit** could be reined in immediately but showed a cyclical trend thereafter (Figure 3.1). It dropped from 6.6 per cent of GDP in 1990-91 to 4.7 per cent in 1991-92, but rose back to 6.4 per cent in 1993-94, before declining again to 4.1 per cent of GDP in 1996-97. Fiscal setback was repeated again in 1997-98, when fiscal deficit to GDP ratio rose to 4.7 per cent of GDP. The deterioration in fiscal situation continued, till 2001-02 when the ratio reached 6.2 per cent, the highest during the period. But showed improvement thereafter and again declined to 4.5 in 2003-04. Though after 2001-02 the upward trend in fiscal deficit could be reversed it is accepted that progress in fiscal consolidation faltered somewhat from 1997-98.<sup>2</sup>

Table 3.1 and figure 3.1 give the trends of the fiscal deficit, revenue deficit and primary deficit during the period under reference. Their perusal reveals that the deficit of the Centre is characterised by a stop-go pattern<sup>3</sup> and the progress on fiscal consolidation has not been consistent. "Perhaps the most striking aspect of reforms is the lack of progress in restoring fiscal balance.

<sup>2</sup> Government of India, *Economic Survey 2003-04*, Ministry of Finance, New Delhi, Ch.2, p.1.

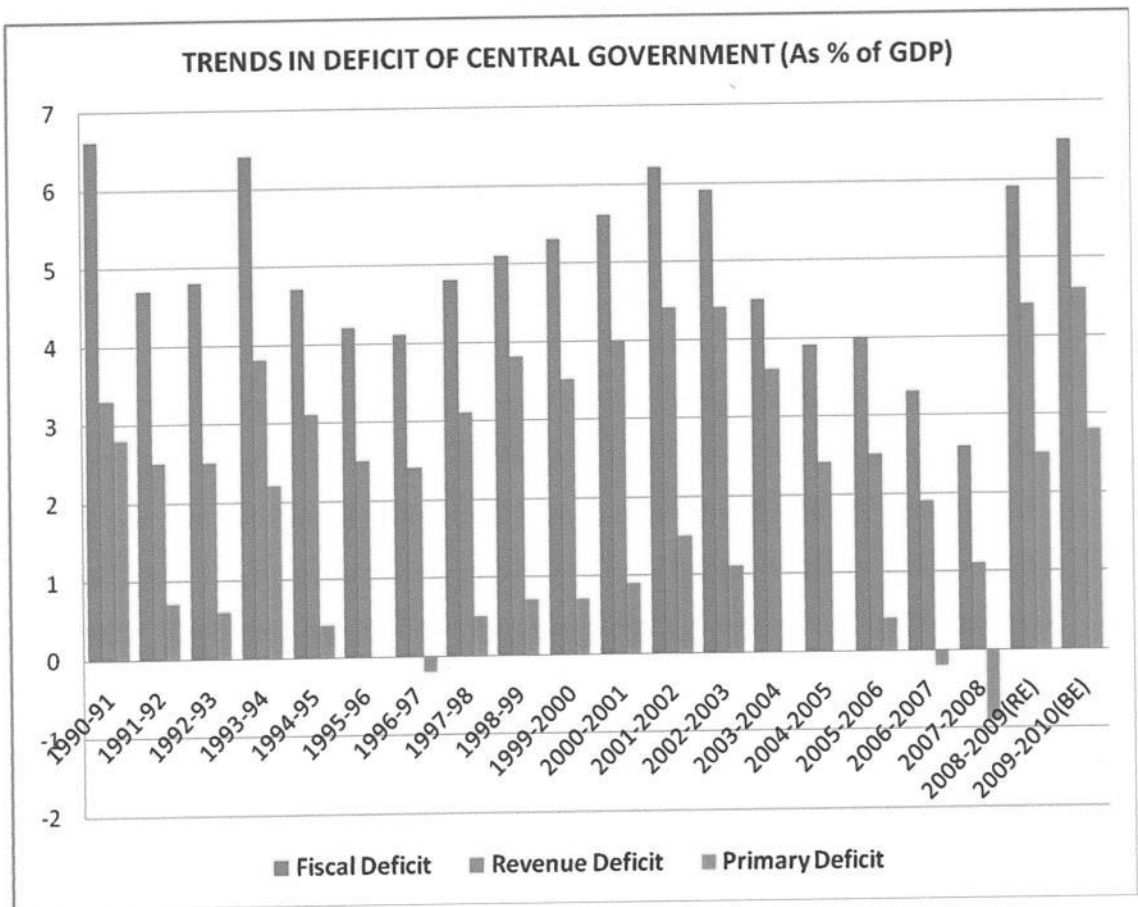
<sup>3</sup> Lahiri, Ashok, K., *Budget Deficits and Reforms, Economic and Political Weekly*, Nov.11, 2000.

**Table - 3.1**  
**Trends in Deficit of Central Government**

Trends in deficit of Central Government					
(As percent of GDP)					
Sl. No.	Year	Fiscal Deficit	Revenue Deficit	Primary Deficit	Revenue Deficit as % of Fiscal Deficit
1	1990-91	6.6	3.3	2.8	49.4
2	1991-92	4.7	2.5	0.7	52.7
3	1992-93	4.8	2.5	0.6	51.7
4	1993-94	6.4	3.8	2.2	59.2
5	1994-95	4.7	3.1	0.4	64.6
6	1995-96	4.2	2.5	0	59.2
7	1996-97	4.1	2.4	-0.2	58.2
8	1997-98	4.8	3.1	0.5	63.5
9	1998-99	5.1	3.8	0.7	74.8
10	1999-2000	5.3	3.5	0.7	64.6
11	2000-2001	5.6	4	0.9	71.7
12	2001-2002	6.2	4.4	1.5	71.1
13	2002-2003	5.9	4.4	1.1	74.4
14	2003-2004	4.5	3.6	0	79.7
	<b>Post FRBM pd.</b>				
15	2004-2005	3.9	2.4	0	62.3
16	2005-2006	4	2.5	0.4	63
17	2006-2007	3.3	1.9	-0.2	56.3
18	2007-2008	2.6	1.1	-0.9	41.4
19	2008-2009(RE)	5.9	4.4	2.5	74.8
20	2009-2010(BE)	6.5	4.6	2.8	70.5

Source: Government of India, Economic Survey 2004-05, Ministry of Finance, New Delhi.

Note: 1. The ratio to GDP for 2005-06 (BE) are based on CSO's Advance Estimates. GDP at current market prices prior to 1999-2000 based on 1993-94 series and from 1999-2000 based on new 1999-2000 series.  
2. Fiscal deficit excludes transfer of states share in small savings collections.  
3. The fiscal deficit figures presented in Table 3.1 do not take into account the off-budget bonds issued to the oil marketing and fertiliser companies amounting to Rs. 95,942 crore or 1.8 per cent of GDP in 2008-09.



**Figure 3.1**

From 1997-98 onwards, the deficit has widened, returning attention to India's fiscal policy and prospects."<sup>4</sup>

The deterioration in revenue deficit is even more alarming. Since 1997-98 the revenue deficit consistently remained more than 3 per cent of GDP and between 2000-01 and 2002-03 it remained higher than 4 per cent of GDP. It is clear that current expenditures have not been controlled well, reflecting budgetary pressures such as subsidies and the impact of the Fifth Pay Commission Awards (1996-97). The primary deficit which was 2.8 per cent of GDP in 1990-91 declined and even turned negative to -0.2 in 1996-97, with

<sup>4</sup> Singh, Nirvikar and T.N. Srinivasan, Fiscal Policy in India : Lessons and Priorities, NIPFP-IMF Conference on Fiscal Policy in India, New Delhi, Jan. 16-17, 2004.

the exception of 1993-94 when it stood at 2.2, then rose to 1.1 in 2002-03 thereafter it showed a marginal surplus in 2003-04.

The most persistent deterioration is observed in the ratio of revenue deficit to fiscal deficit, which indicates the extent to which borrowings are used to meet current expenditure, thus showing the quality of fiscal deficit. In 1990-91 this ratio was about 49.4 per cent. It increased steadily to 64.6 percent continued to decline over next two years before rising again to 74.8 per cent in 1998-99. Thereafter some decline in this ratio took place but it again rose back to 79.7 per cent in 2003-04 (Table 3.1). It indicates that four fifth of borrowings are being used for current consumption. The Twelfth Finance Commission observed, "Revenue deficits have become malefic fixtures in the Central and State budget and that a restructuring of the public finances was called for to steer public finances away from the self perpetuating spiral of debt and deficit."<sup>5</sup>

The analysis of the composition of gross fiscal deficit of the Central Government reveals that the deficit of the Central Government has shown no clear declining trend over the nineties as the GFD-GDP ratio in 2001-02 was almost at the same level as in the crisis year of 1990-91. The interest payments account for the largest proportion (80.20 per cent) of fiscal deficit, while the proportion of primary deficit<sup>6</sup> (non-interest deficit) is relatively much smaller (19.80 per cent) and has actually declined since 2001-02 (Table-3.2).

The upward trend reversed and the year 2002-03 witnessed a continuous improvement in fiscal deficit at 5.9 per cent of GDP due to significant reduction in primary deficit, which continued till 2003-04. Interest payments which constituted only 57.17 per cent of the gross fiscal deficit in 1990-91 increased significantly to 79.74 per cent in 2002-03 and reached around 100.66 percent in 2003-04. Interestingly the lowest fiscal deficit figure

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<sup>5</sup> *Report of the Twelfth Finance Commission*, Ch.1, p.1.

<sup>6</sup> The Primary deficit is equal to fiscal deficit which represents net inflow of borrowed funds minus interest payments, which represent outflows in the form of transfer payments. Primary deficits accumulate into debt unless offset by an excess of GDP growth rate over interest rate.

of this period was observed in 1996-97 when the Central Government had a primary surplus, as the interest outgo exceeded fiscal deficit.

### 3.1.2 The Post FRBM act period (2004-05 to 2009-10)

The operationalisation of the Fiscal Responsibility and Budget Management Act (FRBMA) 2003 by the Centre in 2004 ushered in an era of rule-based management of public finances that witnessed a number of important developments which had a bearing on the public finances of the Centre as well as the states. The country entered a higher growth trajectory, marking a distinct break from the past. There was considerable improvement in revenue growth following the higher growth in economy. The fiscal deficit of the Centre showed declining trend from 4.48 per cent of GDP in 2003-04 and touched 2.69 per cent in 2007-08, the lowest since 1990-91, but the trend was reversed in 2008-09 and the figure rose again to 6.5 percent of GDP in 2009-10, close to the situation in 1990-91. The reduction in fiscal deficit between 2003-04 and 2007-08 was largely on account of revenue augmentation and partly on account of capital expenditure compression.

The revenue deficit of the Centre declined by 2.5 points, from 3.6 per cent of Gross Domestic Product (GDP) in 2003-04 to 1.1 per cent of GDP in 2007-08, lowest in the period. Much of this decline came from an improvement in tax revenues. The marginal decline in revenue expenditure of the Centre was entirely on account of the decline in interest payments following softer interest rates. However, it showed an increase to 4.4 and 4.6 percent in the years 2008-09 (provl) and 2009-10 (BE) respectively.

The declining trend in primary deficit which started in 2003-04 continued and the primary balance remained in surplus till 2007-08 with the exception of 2005-06. The year 2008-09 witnessed a sharp increase in primary

deficit to 2.5 per cent of GDP. It was budgeted at 2.8 per cent of GDP in 2009-10, the highest since 1990-91.

The ratio of revenue deficit to fiscal deficit in the post FRBM period showed a falling trend and declined from nearly 80 per cent in 2003-04 to 41.42 per cent by 2007-08. However, this proportion deteriorated sharply to 74.8 per cent in 2008-09 (RE) owing to worsening economic situation which necessitated pumping of expenditure into economy in the form of fiscal stimulus package to counteract the impact of global recession, the ratio thus registered some improvement in 2009-10(BE) to 70.5 percent respectively. (Figure 3.2)

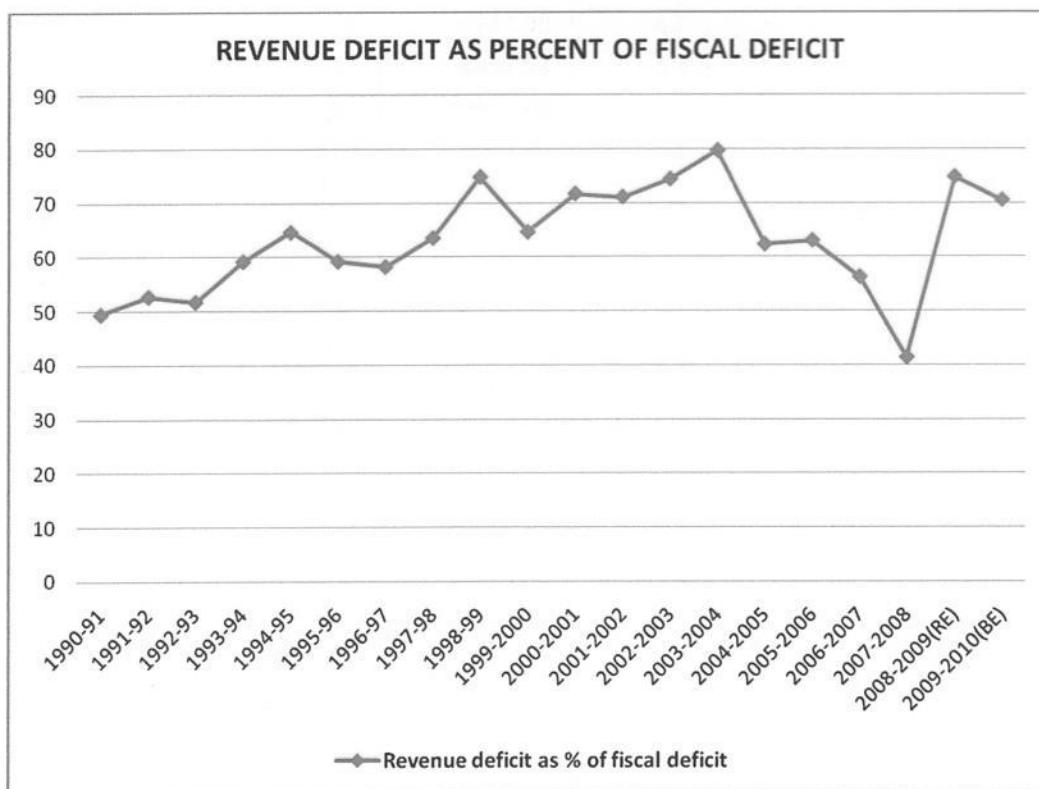


Figure 3.2

Not only the fiscal stimulus measures but the expenditure commitments on pay revision, farm, debt waiver and subsidies on food and fertiliser also contributed substantially to the fiscal burden . The deficit as part

of the fiscal stimulus on account of reduction in tax revenue due to economic slowdown as well as the tax cuts in excise and service taxes effected, as reported by the Economic Advisory Council to the Prime minister in its Economic Outlook for 2009/10, is about 1 per cent of GDP.

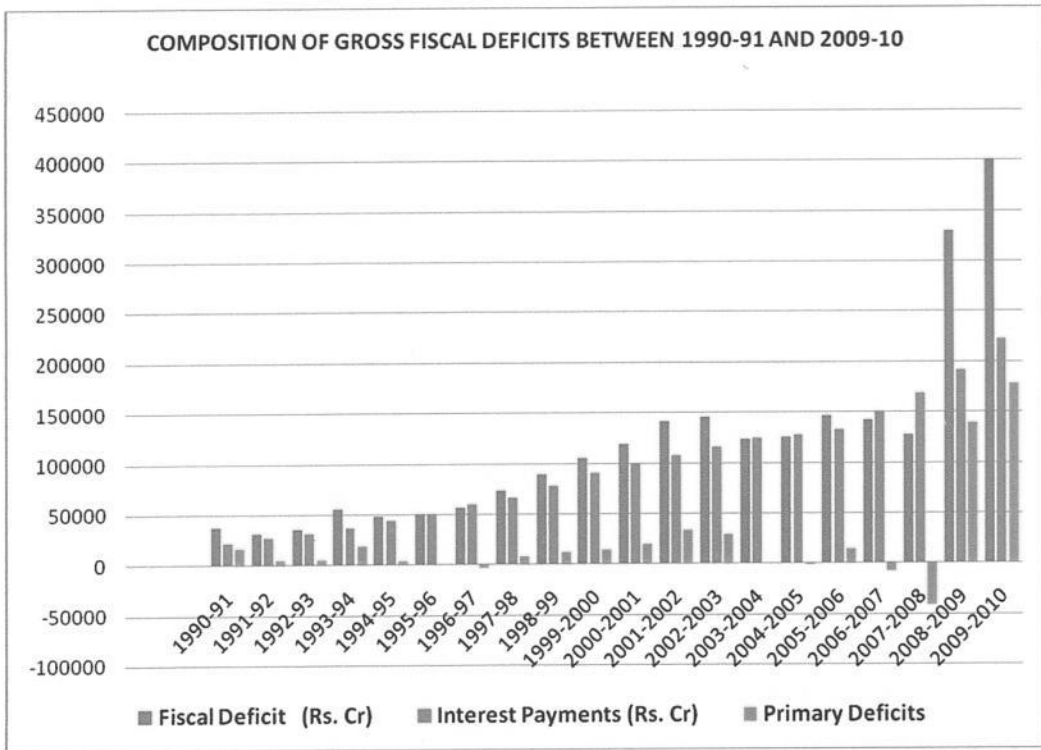
Table 3.2

COMPOSITION OF GROSS FISCAL DEFICIT OF CENTRAL GOVERNMENT

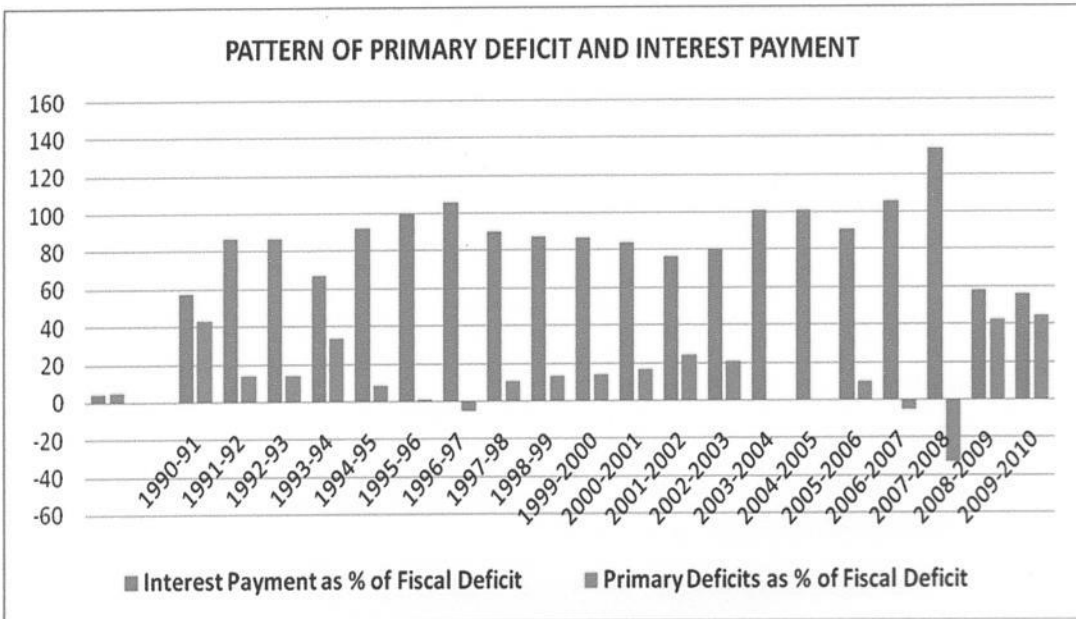
Years	Fiscal deficit	Interest payments	Primary Deficits	GFD as %of GDP	Interest Payment as % of FD	Primary Deficits as % of FD	total
	1	2	3	4	5	6	7
	Rs.in crores			as percent			
1990-91	37606	21498.25	16107.75	6.6	57.17	42.83	100.00
1991-92	30844	26596.00	4248.00	4.7	86.23	13.77	100.00
1992-93	35909	31075.47	4833.53	4.8	86.54	13.46	100.00
1993-94	55257	36740.55	18516.45	6.4	66.49	33.51	100.00
1994-95	48030	44060.01	3969.99	4.7	91.73	8.27	100.00
1995-96	50253	50045.03	207.97	4.2	99.59	0.41	100.00
1996-97	56242	59478.41	-3236.41	4.1	105.75	-5.75	100.00
1997-98	73204	65637.27	7566.73	4.8	89.66	10.34	100.00
1998-99	89560	77882.38	11677.62	5.1	86.96	13.04	100.00
1999-00	104717	90249.32	14467.68	5.3	86.18	13.82	100.00
2000-01	118816	99314.21	19501.79	5.6	83.59	16.41	100.00
2001-02	140955	107460.24	33494.76	6.2	76.24	23.76	100.00
2002-03	145466	115994.29	29471.71	5.9	79.74	20.26	100.00
2003-04	123272	124088.00	-816.00	4.5	100.66	-0.66	100.00
2004-05	125794	126933.00	-1139.00	3.9	100.91	-0.91	100.00
2005-06	146435	132630.00	13805.00	4	90.57	9.43	100.00
2006-07	142573	150271.00	-7698.00	3.3	105.40	-5.40	100.00
2007-08	126912	169179.00	-42267.00	2.6	133.30	-33.30	100.00
2008-09	330114	191524.00	138590.00	5.9	58.02	41.98	100.00
2009-10(BE)	400996	222773.00	178223.00	6.5	55.55	44.45	100.00

Source: Compiled from Indian Public Finance Statistics 2003-04 and Economic Surveys 2000-01, 2003-04 and 2009-10.





**Figure 3.3**



**Figure 3.4**

The gross fiscal deficit continued to decline even after 2003-04 till 2007-08 when the Fiscal deficit became 2.6 per cent of GDP, but the trend reversed in 2008-09(RE) and reached a level of 6.5 in 2009-10(BE).

The Interest payments remained constant at around 100 percent of fiscal deficit in the year 2004-05, and declined in the subsequent year after which it rose significantly to 133.30 percent before declining to 55.5 percent in 2009-10 (BE). It indicates 55 percent of fiscal deficit is due to the servicing of the past debt in 2009-10.

### **Financing Pattern of Fiscal Deficit of Central Government**

It is not surprising when the fiscal situation is analysed with reference to relative proportion of various sources of financing of gross fiscal deficit. While in 1990-91, the contribution of other liabilities, budget deficit, market borrowings and external finance in the financing of gross fiscal deficit of the Central Government was 40.1 percent, 30.2 per cent 21.3 per cent and 8.5 per cent respectively, the same in 2003-04 was 38.9, 0.0, 72.1, and -10.9, percent respectively. In 2009-10, the contribution of other liabilities, budget deficit, market borrowings and external finance to financing of GFD was -3.2 percent, 0.0 percent, 99.2 per cent and 4 percent respectively.

The market borrowing registered a huge jump from 21.3 per cent to 72.1 per cent (2003-04) and then to 99.2 percent (2009-10) over the same period. In absolute terms market borrowings increased from Rs. 8001 crores to Rs. 397957 crores (Table 3.3) and (Fig.3.5).

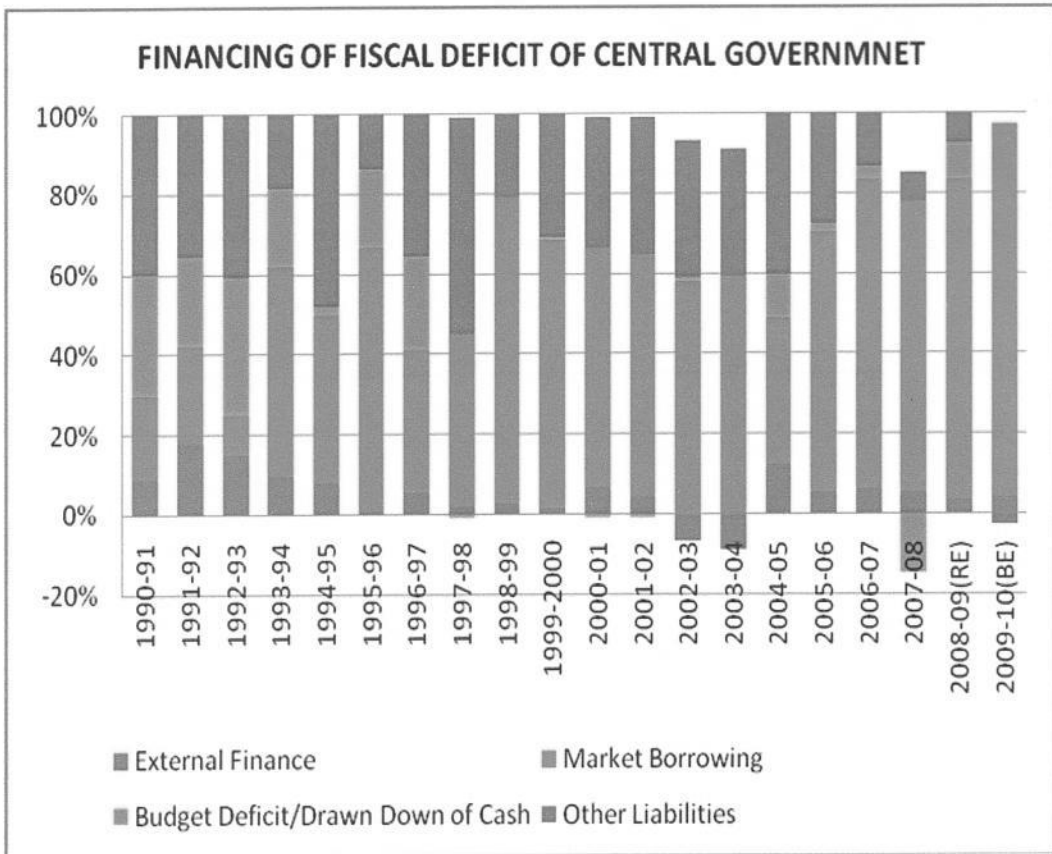
The huge increase in the market borrowings during the period under reference explains why interest payments have assumed such large proportions between 1990-91 and 2009-10(BE).

**TABLE 3.3**  
**FINANCING OF FISCAL DEFICIT OF CENTRAL GOVERNMENT**

Year	External Finance	Market borrowing	Budget Deficit/ Drawing Down of Cash Balances	Other Liabilities	Total	External Finance	Market Borrowing	Budget Deficit/ Drawing down of Cash Balances	Other Liabilities	Total
	(Rs. crore)					As proportion of total (Percent)				
1990-91	3181	8001	11347	15077	37606	8.5	21.3	30.2	40.1	100.
1991-92	5421	7510	6855	11058	30844	17.6	24.3	22.2	35.9	100.
1992-93	5319	3676	12312	14602	35909	14.8	10.2	34.3	40.7	100.
1993-94	5074	28928	10960	10295	55257	9.2	52.4	19.8	18.6	100.
1994-95	3582	20326	961	23161	48030	7.5	42.3	2.	48.2	100.
1995-96	318	33087	9807	7041	50253	.6	65.8	19.5	14.	100.
1996-97	2987	20006	13184	20065	56242	5.3	35.6	23.4	35.7	100.
1997-98	1091	32499	-910	40524	73204	1.5	44.4	-1.2	55.4	100.
1998-99	1920	68988	-209	18861	89560	2.1	77.	-.2	21.1	100.
1999-00	1180	70277	864	32396	104717	1.1	67.1	.8	30.9	100.
2000-01	7505	72931	-1197	39577	118816	6.3	61.4	-1.	33.3	100.
2001-02	5601	87724	-1496	49126	140955	4.	62.2	-1.1	34.9	100.
2002-03	-11934	97588	1883	57535	145072	-8.2	67.3	1.3	39.7	100.
2003-04	-13488	88860	0	47900	123272	-10.9	72.1	0.0	38.9	100.
2004-05	14753	46031	13597	50821	125202	11.8	36.8	10.9	40.6	100.
2005-06	7472	95374	3140	40449	146435	5.1	65.1	2.1	27.6	100.
2006-07	8472	110446	4517	19138	142573	5.9	77.5	3.2	13.4	100.
2007-08	9315	131768	-27171	13000	126912	7.3	103.8	-21.4	10.2	100.
2008-09(RE)	9603	261972	29984	24956	326515	2.9	80.2	9.2	7.6	100.
2009-10(BE)	16047	397957	0	-13008	400996	4.	99.2	0.0	-3.2	100.

Source: Indian Public Finance Statistics, 2009-10, Ministry of Finance, New Delhi.

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**Figure 3.5**

It is thus clear that not only the size of gross fiscal deficit but also its composition and financing throw serious challenges to macroeconomic balance of the Indian economy.

All fiscal indicators, after registering an improvement in the years following the enactment of the FRBMA, have witnessed sharp deterioration in 2008-09 and 2009-10. Even when the interest rates have fallen, persistent revenue deficits have been financed by new debt. This has led to an escalation of the Debt.

The effort of the Government has to hold down the fiscal deficit has thus been unsuccessful. The Fiscal deficit is still too large to be sustainable in the long

run<sup>7</sup> and the current fiscal position is not very encouraging. It is time now to move away from the stimulus packages and concentrate on long-term policy scenarios to control the fiscal situation as well as improve GDP growth.

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<sup>7</sup> Joshi, Vijay and Little, *India's Economic Reforms 1991-2001*, OUP, New Delhi, 1996, p.3.