CHAPTER 7

SUMMARY, CONCLUSIONS AND SUGGESTIONS

In this final Chapter the whole study is summarized and then conclusions based on the foregoing analysis are put together, followed by suggestions to contain the problem of fiscal deficit .

Summary and Conclusions

The present study entitled **"An Analysis of Fiscal Deficits In Government of India - Trends And Issues (1990-91 To 2009-10)"** was undertaken with the aim of analyzing the trends and issues in Central Government's fiscal deficit during the period under reference, against the backdrop of launching of macroeconomic stabilization programme in 1991 in the wake of economic crisis of the nineties, and the Fiscal Reforms And Budget Management Act in 2003, in the wake of deteriorating fiscal situation after 1997-98, which had fiscal consolidation as a major component.

Fiscal deficit is now universally considered as a complete measure to judge the macroeconomic strength and fiscal health. It also reflects the ability of the government to control the core of the problem of fiscal imbalance that the government faces in countries including India.

At present, the need for fiscal consolidation and sustainability is one of the key macroeconomic issues that the Indian economy is confronting. The structural adjustment programme, introduced in 1991, primarily to bring about macroeconomic stabilization and to push growth had deficit reduction and fiscal consolidation as one of its main objectives. The programme did help to reduce the fiscal deficit from a double digit to less than five percent in the mid nineties. Subsequently, a sharp increase in government salaries and pensions and other revenue expenditures halted the process of fiscal improvement, until 2003-2004, when the government introduced the Fiscal Responsibility and Budget Management Act (FRBM), 2003 to control the fiscal deficit. The trend suggests that India's fiscal situation improved significantly after the adoption of FRBM in 2003–2004, until the global crisis hit the Indian economy in early 2008–2009. Thus, it is apparent that even after several years of the launch of economic reforms that accorded high priority to fiscal consolidation, the overall level and quality of Centre's fiscal deficit still continue to be matter of concern.

The main **objective** of the study is to analyze the trends of fiscal deficit of the Union Government, during the period under reference and the factors responsible for ever escalating fiscal deficit, both on expenditure and revenue side. Besides, it aims to examine the measures adopted to curb fiscal deficits so far, the developments which led to enactment of the **Fiscal Responsibility and Budget Management Act,** 2003 and its impact on fiscal scenario. It also seeks to identify areas where a reasonable adjustment can be made to contain the fiscal deficit without adversely affecting growth and equity considerations. The period of the analysis is from the year **1990-91 to 2009-10** only. The analysis has been segregated into pre-FRBMA period (1990-91 to 2003-04) and the post FRBMA period (2004-05 to 2009-10).

The **research methodology** adopted is mainly analysis of secondary data available, the main source of which are publications of Ministry of Finance, Government of India as well as Reserve Bank of India like Annual Budget Estimates and Indian Public Finance Statistics, Report on currency and Finance, RBI Bulletin etc, plan documents of various Five-Year Plans published by Planning Commission, reports of 12th and 13th Finance Commissions. The publications, research studies and occasional papers published by national institutes like National Institute of Public Finance and Policy (NIPFP) and National Council for Applied Economic Research (NCAER), Indian Institute of Public Administration (IIPA), and relevant information from various research journals, newspapers, reports and publications of IMF and World Bank, and articles on various websites etc. have also been perused.

Major **parameters** that are used for the study are revenue deficit/GDP ratio, primary deficit/GDP ratio, fiscal deficit/GDP ratio, revenue deficit as a percentage of fiscal deficit, expenditure/GDP ratio, tax/GDP ratio etc. The statistical tools applied to analyse the trends of revenue and expenditure are averages, extrapolation, and graphical representations.

The analysis begins with tracing the genesis of the fiscal problem in India in the eighties. In the 1970s and early 1980s, there was actually a revenue surplus on the consolidated accounts of the centre and the States. Both deteriorated sharply through the 1980s. There was a sharp run up of the deficit in the late 1980s, which ended with the BOP crisis of 1991. **Chapter 1** gives the significance of the fiscal sector and an overview of the developments in the eighties particularly the runaway increases in the non-plan expenditures, which far exceeded the available tax revenue resources, leading to increasing recourse to borrowings which were mainly responsible for the persistent deterioration in Centre's fiscal stance and subsequent economic crisis of early nineties, and briefly relates it to current fiscal deficit scenario at the Centre.

The objectives, research methodology and major theoretical concepts involved in defining fiscal deficits have been outlined in **Chapter 2.** The fiscal deficit quantifies the total resource gap in terms of excess of government expenditure over what may be termed as government's own income. It gives an exact measure of the extent by which the government has gone beyond its means, and thus captures the burden of public debt placed on posterity. Revenue deficit is defined as excess of revenue expenditure over revenue receipts. Primary deficit is the difference of fiscal deficit and interest payment. Revenue deficit, Fiscal deficit and Primary deficit are all relevant in the analysis of the fiscal position of the government in India.

An analysis of the profile of fiscal deficits since 1990-91 to 2009-10 **is covered in Chapter 3.** The study elucidates that there has been no consistent improvement in Centre's fiscal position, as this period witnessed serious fiscal slippages. During the period, **1990-91 to 2003-04**, fiscal setbacks were experienced in 1993-94 and again in 1997-98. Initially after the launch of fiscal reforms process it did seem that the fiscal deficit has been reined in, but after 1996-97 due to emergence of coalition politics, frequent change of governments, political instability and implementation of the Fifth Pay Commission's recommendations, the gross fiscal deficit kept on rising till 2002-03 indicating fiscal deterioration. The deteriorating share of primary deficit indicates that a large proportion of fiscal deficit is due to the debt servicing burden of the debt contracted in the past, which has reached unsustainable levels in India.

Besides the overall size of fiscal deficit the quality of fiscal deficit i.e the ratio of revenue deficit to fiscal deficit also deteriorated showing that about four fifth of the borrowings were being used for current consumption in 2003-04. Analysis of the composition of gross fiscal deficit (GFD) reveals that about 80 per cent of it is accounted for by interest payments showing growing unsustainability of public debt. The financing of fiscal deficit is mostly through higher domestic market borrowings and partially through small savings which is also an important source of funding.

In the year 2003, the government enacted the **Fiscal Responsibility and Budget Management Act (FRBMA), 2003** for fiscal consolidation as major objective. Thus the period after 2003-04 witnessed considerable improvement in revenue growth due to implementation of FRBMA in 2004-05, which put the country on a higher growth trajectory which coupled with expenditure compression reduced fiscal deficit and primary deficit. The fiscal correction path, following the enactment of FRBMA, after a pause in 2005-06, was more or less on track till 2007-08, but subsequently, the Indian economy was affected by the global economic crisis in 2008-09 and 2009-10. The anti-recessionary measures adopted by the Government in the wake of global crisis, increasing commodity prices and additional expenditure on implementation of the recommendations of the Sixth CPC and farm loan waiver resulted in reversal of the fiscal correction in 2008-09 and 2009-10. The steady fiscal improvement over the past five years 2003-04 to 2007-08, was sharply reversed and the developments weakened public finances considerably resulting in lower GDP growth rate and deterioration of fiscal imbalances .

It is observed that the quality of Centre's fiscal performance has declined both on the expenditure side as well as on the receipts side. Analysis reveals that rise in fiscal deficit over the years has been due to both expenditure overruns and revenue shortfalls. Thus the factors responsible for high deficits have been analysed in detail for both separately, on the expenditure side **(chapter 4)** and the receipts side **(chapter 5).**

On the expenditure side, both the components of expenditure, the Revenue and Capital expenditure were studied. An examination of the trends in **total expenditure** of the Central Government reveals that during the period 1990-91 to 1996-97, expenditure to GDP ratio lowered from 18.52 per cent to 14.69 per cent and fiscal deficit position improved. But, due to implementation of the report of fifth pay commission and effects of drought in 2002-03 , expenditure to GDP ratio rose from 15.24 in 1997-98 to 17.11 in 2003-04 and subsequently to 17.43 in 2009-10 due to measures taken to counteract impact of global crisis. The total expenditure of the Centre relative to GDP witnessed a significant contraction between 2003-04 and 2006-07, after which it started rising again.

The **composition of government expenditure** also got seriously distorted in favour of revenue expenditures. An examination of the trends since 1990-91, suggest that the share of revenue expenditure increased largely at the cost of capital expenditure, though there were intermittent attempts for revival of expenditure on capital account. As per cent of total expenditure, revenue expenditure's claim is still massive at about 88 per cent in 2009-10(BE). The largest proportion of revenue expenditure is claimed by four heads - **interest payments, defence, expenditure, subsidies and**

administrative expenditure which together account for 51 percent of revenue expenditure in 2009-10(BE). Rising **revenue expenditure on account of** sharp increase in expenditure on account of interest payments, defence, civil adminitration, as well as subsidies, contributed to growth in total expenditure.

The analysis reveals that the quality of fiscal correction has been impacted by cut in capital expenditures and growth of revenue expenditure has continued unabated having negative impact both for fiscal management and economic development. The current fiscal situation is potentially grave and needs to be corrected to ensure macroeconomic stability and sustained growth performance.

While analyzing **the receipts side**, the main focus has been on analysing the behaviour of tax and non-tax revenue resources over this period and on finding out the reasons responsible for inadequate mobilization of receipts of the government.

The analysis of **tax revenue** has been done keeping in view the thrust areas of tax reforms during this period both in direct taxation as well as indirect taxation. Along with huge expenditures in unproductive directions the low revenue productivity of the tax system too has contributed towards worsening fiscal situation. A deterioration in revenue performance is observed as reflected in a decline in revenue/GDP and tax/GDP ratios. .The following points emerge out of this analysis.

- Poor growth of tax revenue has invariably resulted in high growth of fiscal deficit. The years 1993-94, 1997-98 and 2001-02, 2008-09 which are marked by serious setbacks on fiscal deficit front are also the years when the growth of tax revenue has been poor.
- The tax/GDP ratio declined after showing some improvement has again reached the level of 1991-92. The ratio declined to 8.09 in 2002-03, but the trend was reversed in 2003-04 and the ratio reached 12.56 in

2007-08, to decline again in 2008-09 .

- The tax/GDP ratio from 7.9 per cent in 1990-91 to 5.1 per cent in 2001-02, after which it revived to some extent but declined again in 2008-09 and 2009-10 to its lowest level since 1990-91. The lower tax/GDP ratio is attributable to a fall in indirect tax to GDP ratio during the period under reference .
- In the direct taxes, the tax GDP ratio showed substantial improvement from 1.94 in 1990-91 to 6.61 in 2007-08, after which it showed decline, though marginally.
- In terms of share in tax revenue there is a clear compositional shift in favour of direct taxes particularly Personal Income Tax and Corporate Income Tax and away from Customs and Excise and Service tax
- expansion of revenue base is constrained due to prevalence of many exemptions in both direct and indirect taxation.
- Although the composition of GDP has shifted in favour of the service sector, this sector has yielded very little by tax collections (less than 0.5% of the GDP).
- Quality of tax administration and enforcement is still poor.
- Tax reforms process has been successful in rate rationalization and removing market distortions but there is still scope for greater revenue generation which can help to remedy the fiscal deficit problem.

Non-tax revenue as a proportion of GDP improved from 2.1 per cent in 1990-91 to 3.2 per cent in 2003-04 and declined to 1.79 percent of GDP in 2009-10 and their growth is constrained by the persistence of low user charges in many publically provided services. There is a need to reduce the subsidized services and raise user charges in the relevant subsidized sector for example in Post & Telegraph and Railways and encourage

Central Government financed institutions to become financially self-sufficient.

The last segment of the chapter analyses the **role of saving performance in determining fiscal position** of the Centre. The increasing dissavings of the Central Government get reflected in both revenue deficit and fiscal deficit and increase Centre's recourse to borrowings.

The experience with rule based fiscal policy in India with the enactment of **FRBM Act 2003,** is summarized in Chapter 6. It broadly discusses the background provisions, the targets defined under the Act and the impact of its implementation on the fiscal scenario in the country. The fiscal correction path, following the enactment of **FRBMA** was more or less on track all fiscal indicators registered an improvement till 2007-08, after a pause in 2005-06, but in the years 2008-09 and 2009-10, witnessed sharp deterioration on account of global recession and subsequent expenditure on measures to conteract its impact on economy, and also implementation of pay commission, farm debt waiver etc.

The entire study is summarized, followed by conclusions and suggestions (Chapter 7). The suggestions relate to widening of tax base, removal of tax exemptions and incentives, expenditure prioritization, improving the quality of fiscal management, identifying areas of non-interest expenditure which can be pruned, pension reforms and rationalisation of Centre's staff strength.

SUGGESTIONS

It is well understood that many policy ingredients need to be blended together to form a credible programme of deficit reduction. These range from raising revenue productivity of the tax system to restructuring public expenditure and channelising it into economic infrastructure and social sector to raising of user charges, pension reforms, rationalization of staff strength, limiting and effectively targeting of subsidies and public sector reforms. Such programme will not only help to keep fiscal deficit under control but also improve the overall fiscal performance of the Centre and render public debt sustainable. The following suggestions could be incorporated in such a programme:

- Central expenditure should be more focussed on productive components especially economic and social infrastructure and social sector with adequate provision for maintenance of such infrastructure. Outlays on health, education and infrastructure , therefore , need to be enhanced
- Since the government alone cannot shoulder the responsibility due to financial and resource constraints, the role of private sector for investment becomes crucial to help in execution of government projects in areas like national highways, power, transport, airports and seaports and to involve builders and NGOs (non-governmental organizations)and other experts to jointly execute infrastructure development projects. Public Private Partnership which has the advantage of combining better governance with effective implementation and delivery systems be encouraged in the sectors requiring high investments for infrastructure viz. roads, ports, power, waste management or even education and health services. This will enable the Government to shift its focus from controlling cost to monitoring delivery standards on one hand and getting the much required investment for the creation of infrastructure in the social and economic sector , on the other .
- There should be greater community involvement in social sector programmes like employment generation and poverty alleviation programmes. Decentralisation and social accountability with respect to maintenance of public assets created through these programmes will raise expenditure efficiency.

- Except for pure public goods like defence, police and general administration all other services should not be financed out of general revenues and should be priced in a way as to recover the cost of delivering these services.
- There is a need for a shift from short-term expenditure budgeting to medium term performance budgeting.
- Subsidies extended by the government need to be rationalized and pruned as indicated below:
    - All subsidized services should be carefully scrutinized and non-merit subsidies be reduced or gradually withdrawn after assessing their impact:
    - wherever possible, outright subsidies should be replaced by other forms of benefit like loans, insurance coverage, ready access to public goods etc.
    - During implementation of subsidized programmes, the focus should be on physical achievements and not on financial disbursements.
    - Subsidy extended should be cost effective with its effects monitorable and measurable in terms of quality or quantity.
    - Populist policies like subsidizing pilgrimage etc. should be effectively restrained.
- Implementation of Targetted Public Distribution System be monitored effectively so that subsidized goods reach the intended recipients, and issue prices of foodgrains should be periodically reviewed to check malpractices in distribution..
- Raising of user charges in subsidized deptts like Post and Telegraph and ZXCRailways can be very helpful in mobilizing non-debt resources for the Central Government, their operational efficiency be

improved in a way that these are able to generate internal surpluses .

- tax reforms must focus on gradually eliminating all exemptions and tax linked saving incentives both in direct as well as in indirect taxation.
- Fundamental focus of tax policy should be on improving enforcement and compliance through comprehensive computerisation more careful data processing ,integrating information about a tax entity from all available sources like banks, stock exchange etc. to help in improving tax administration and plugging leakages of tax revenue.
- Steps be taken to increase non tax revenue on account of services.
- All loss making units/ CPSEs beyond any hope of revival should be closed down and their assets realized.
- Further rationalisation of staff strength on the lines suggested by the Pay Commission and Expenditure Reform Commission be undertaken.
- A national high level committee comprising of union ministers/state finance ministers and high officials be designated to ensure compliance of FRBM Act, 2003 and monitor the achievement of targets laid under the act .
- Concurrent and post evaluation by independent agencies of all government programmes needs to be institutionalised.
- Measures for curbing the growth of black economy be implemented strictly in a concerted manner, so that the income lost through activities like tax evasion, undeclared capital gains on sale of immovable assets, and smuggling, hawala transactions etc is gained by the Government and used for developmental purposes and subsequent containment of Fiscal deficit.