
Fiscal Situation in India: The Strategy for Consolidation?

M. Govinda Rao

Director, National Institute of Public Finance and Policy,
New Delhi, India

Scheme of Presentation

- Introduction
 - Impact of Global Crisis on India's Economic Growth.
 - Fiscal Trends.
 - Aggregate
 - Centre
 - States.
 - Measures Undertaken by the Government.
 - Concluding Remarks.
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Introduction

- Global financial crisis and impact on India: Irrelevance of decoupling thesis.
 - “Capitalism is the astounding belief that the wickedest of men will do the wickedest of things for the greatest good of everyone”
John Maynard Keynes.
 - Growth Trends in Indian Economy
 - Consequences of Global Economic crisis:
 - Liquidity crisis, capital outflow and slowdown in manufacturing and construction sectors;
 - Slowdown in foreign direct investment;
 - Falling exports, outsourcing and adverse impact on both manufacturing and service sectors (IT and ITES, Textiles, Gems and jewellery; auto parts);
 - Fall in remittances and return of migrants.
 - Economic Slowdown and stimulus packages? Is it adequate?
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Growth Trends in Indian Economy

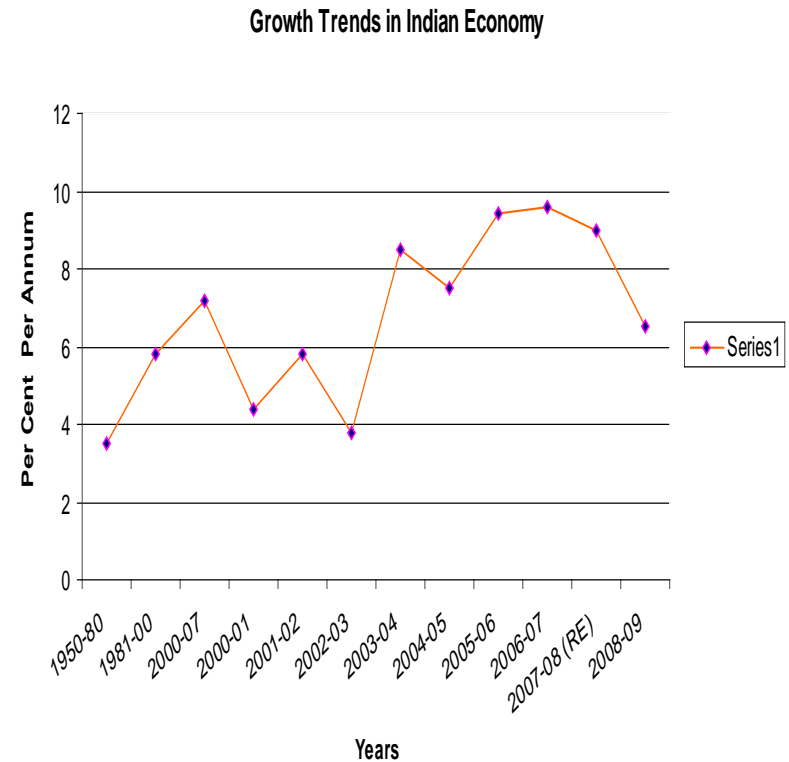
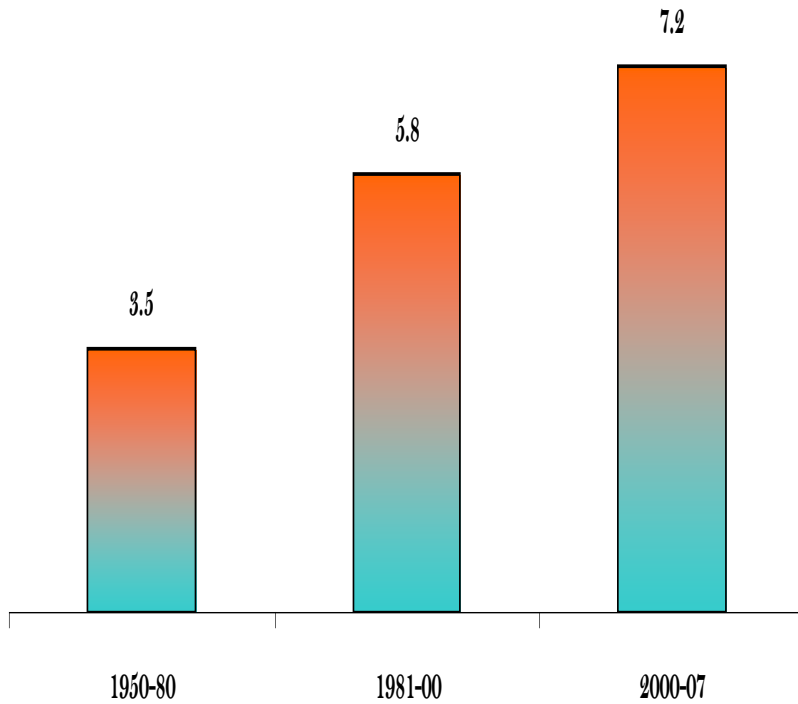
- “Hindu rate of growth” during 1950-80.
- 5.9% during 1980-2000
- 7.8% during 2000-2008.
- Service sector led growth; Over 70 percent of growth is accounted for by the service sector, 27% manufacturing and 5% primary sector.
- Sharp decline in the growth rate in 2008-09; Estimated at 6.5%.

Growth Trends in Indian Economy (Per Cent Per Annum)

	GDP	Population	Per Capita GDP
1951-61	3.9	2.1	1.8
1960-70	3.4	2.3	1.1
1970-80	3.6	2.1	1.5
1980-90	5.7	2.2	3.6
1990-00	6	1.9	4.2
2001-03	4.6	1.7	2.9
2003-04	8.5	1.7	5.8
2004-05	7.5	1.7	5.8
2005-06	8.4	1.7	6.7
2006-07	9.4	1.7	7.7
2007-08	9	1.7	7.3
2008-09*	6.7	1.7	5.0

*Estimated

GDP growth at constant prices (Percent per annum)



Combating Slowdown: Fiscal Space

- Fiscal consolidation since 2001-02.
 - Significant improvements since 2003-04.
 - Is it due to FRBMA?
 - Sharp deterioration in 2008-09.
 - Is it due to fiscal stimulus packages? Is the fiscal problem cyclical or structural?
 - Need to examine the fiscal trends at Central and State levels separately.
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Fiscal Indicators of Central and State Governments (Per Cent of GDP)

Years	State			Centre			Consolidated		
	Revenue Deficit	Primary Deficit	Fiscal deficit	Revenue Deficit	Primary Deficit	Fiscal deficit	Revenue Deficit	Primary Deficit	Fiscal deficit
1996-97	1.18	0.85	2.72	2.39	-0.20	4.10	3.60	1.30	6.40
1997-98	1.07	0.93	2.90	3.05	0.50	4.80	4.10	2.10	7.30
1998-99	2.51	2.20	4.27	3.85	0.70	5.10	6.40	3.70	9.00
1999-00	2.78	2.39	4.72	3.49	0.75	5.40	6.30	3.80	9.50
2000-01	2.54	1.81	4.25	4.08	0.93	5.70	6.60	3.70	9.50
2001-02	2.65	1.43	4.14	4.40	1.47	6.19	7.05	2.90	10.32
2002-03	2.33	1.25	4.06	4.40	1.11	5.91	6.72	2.36	9.97
2003-04	2.30	1.46	4.38	3.57	-0.03	4.48	5.87	1.43	8.85
2004-05	1.24	0.68	3.42	2.49	-0.04	3.99	3.73	0.64	7.42
2005-06	0.20	0.17	2.52	2.58	0.39	4.09	2.77	0.55	6.61
2006-07	-0.60	-0.38	1.87	1.94	-0.19	3.44	1.34	-0.56	5.31
2007-08	-0.9	-0.60	1.30	1.10	-0.90	2.70	0.20	-1.50	4.00
2008-09 (RE)	-0.2	0.70	2.50	4.40	2.60	6.20	4.20	3.30	8.70
2009-10 (BE)	0.4 (0.8)	0.9 (1.7)	2.7 (3.5)	4.8	3	6.8	5.20 (5.6)	3.90 (4.7)	9.50 (10.3)

(Figures in the parenthesis are author's estimates).

Fiscal Consolidation – Centre and States

Fiscal Stimulus Measures

- ❑ Fiscal stimulus packages. Reduction in central excise (6 percentage points) and service tax rates (four percentage points). Tax free bonds to be issued to Indian Infrastructure Finance Co. Ltd. Additional space for States.
- ❑ Additional spending for Infrastructure Rs. 200 billion.
- ❑ Monetary policy: Reduction in CRR from over 9 per cent to 5 per cent. SLR to 24%;
- ❑ Repo rate reduction from 9% to 5.0% and reverse repo rate from 6% to 3.5%.
- ❑ Use of MSS for financing IIFCL (Rs. 700 billion).
- ❑ Additional ECB provision for infrastructure and construction sector. Relaxation of reform conditions for JNURM.
- ❑ Is there further space for fiscal stimulus?

Budget 2009-10



- Challenge of balancing growth with stability;
- Fiscal deficit at 6.8% of GDP; Revenue deficit at 4.8%. Unprecedented.
- Growth acceleration: maintaining the stimulus; increase in capital expenditures (26.8%). Plan expenditures (14.9%); Higher allocation to flagship schemes; Infrastructure spending through PPP, IIFCL refinancing 60% incremental lending by commercial banks for infrastructure.
- Reform initiatives:
 - Reform of fertilizer subsidy regime: nutrient based subsidy;
 - Commitment to GST in April 2010.
 - Removal and FBT and CTT: STT continues;
 - Promise of simpler broad based tax system;
 - Direct taxes code within 45 days.

Trends in Central Government Finances

- Fiscal and revenue deficits were the highest in 2001-02.
 - Steady improvements since 2001-02, ; faster improvement since 2003-04.
 - Sources of improvement: Central direct taxes (2.8 points) and service tax (0.8).
 - Expenditure reduction mainly due to lower interest payments.
 - Is the improvement due to FRBMA?
 - Revenue side adjustment was broadly according to the plan;
 - Compression of revenue expenditure from 13.1% of GDP to 11.3% did not materialise. Adjustment was mainly in interest payments.
 - Capital expenditure contrary to the plan declined.
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Table 2
Trends in Central Finances

	Percent of GDP				Percentage Points		
	2001-02	2003-04	2007-08	2008-09 (RE)	Improvement in 2007-08 over 2001-02	Improvement in 2007-08 over 2003-04	Deterioration in 2008-09 over 2007-08
Net Revenue Receipts	8.83	9.58	11.55	10.36	2.71	1.97	1.19
Tax Revenue (Net)	5.86	6.79	9.36	8.59	3.51	2.58	0.78
Non-tax Revenue	2.97	2.79	2.18	1.77	-0.79	-0.61	0.41
Gross Revenue Receipts	11.18	12.02	14.82	13.35	3.64	2.80	1.47
Gross Tax Revenue	8.21	9.23	12.64	11.57	4.43	3.40	1.06
Personal Income Tax	1.40	1.50	2.53	2.26	1.13	1.03	0.27
Corporation Tax	1.61	2.31	4.11	4.09	2.50	1.80	0.02
Customs	1.77	1.77	2.22	1.99	0.45	0.45	0.23
Excise	3.18	3.30	2.63	2.00	-0.55	-0.66	0.64
Service Tax	0.14	0.29	1.09	1.20	0.95	0.81	-0.10
Others	0.10	0.08	0.05	0.04	-0.05	-0.03	0.01
Revenue Expenditure	13.23	13.14	12.67	14.81	0.56	0.48	2.14
of which							
Interest Payments	4.72	4.50	3.64	3.55	1.07	0.86	-0.09
Major Subsidies	1.34	1.58	1.49	2.38	-0.15	0.09	0.90
Defence Expenditure	1.67	1.57	1.22	1.42	0.45	0.35	0.20
Capital Outlay	2.67	3.96	2.52	1.80	0.15	1.44	-0.72
Total Expenditure	15.90	17.11	15.19	16.60	0.71	1.92	1.42
Fiscal Deficit	6.19	4.48	2.70	6.02	3.48	1.77	3.31
Revenue Deficit	4.40	3.57	1.12	4.45	3.28	2.45	3.33

Deterioration in Central Finances

- Alarming situation.
 - Is the deterioration due to fiscal stimulus?
 - Consequences of FRBMA.
 - Creative accounting – Off budget liabilities.
 - Cutting productive expenditures.
 - Large supplementary demands and poor budget implementation.
 - Ownership for legislated discipline should be with the government and not just the Finance Ministry.
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Table 3
Supplementary Demand for Grants of the Central Government

	Supple. 1 Rs. billion	Supple-2 Rs. billion	Total Rs. billion	Total (Percent of GDP)
I. Cash Expenditures				
1. Pay Revision	227	-	227	0.43
2. Fertilizer Subsidy	388.63	60	344.63	0.85
3. Food Subsidy	50.64	65.00	115.64	0.22
4. Creation of farmers' debt relief Fund	150.00	-	150.00	0.28
5. NREGS (Contribution to fund)	105.00	-	105.00	0.2
6. Transfers to states and implementing agencies for other schemes	-	220.00	220.00	0.41
6. Others	134.86	79.80	214.66	0.4
7. Total	1056.13	4.20	1480.93	2.79
II. Expenditure matched by Receipts/recoveries/ savings				
1. Fertilizer Subsidy Bond	140.00	76.56	216.56	0.41
2. Subscription to IMF Quota	86.23	-	86.23	0.16
3. Securities for Oil Marketing Cos	659.42	-	659.42	1.24
6. Others	71.07	19.69	90.76	0.17
Total	956.72	96.25	1052.97	1.98

Trends in State Finances

- Significant improvement since 2003-04.
- Of the 2.8 percentage point improvement in Revenue Deficit, 2.2 points from the revenue side and 0.6 point from expenditure side.
- Central transfers had a predominant role (1.5 points). Own revenues increased by 0.6 point.
- Expenditure side adjustment mainly due to interest payments.
- 2008-09 has seen deterioration and the FD is estimated at 3% of GDP. The budget has allowed the states to have fiscal deficit of 3.5% in 2009-10.

Table 4
Trends in State Finances

	Per Cent of GDP					Percentage Point Improvement	
	2001-02	2003-04	2006-07	2007-08	2008-09	2007-08	2007-08
				(RE)	(BE)	over 01-02	over 03-04
Fiscal deficit	4.14	4.38	1.87	2.30	2.08	1.84	2.08
Revenue Deficit	2.65	2.30	-0.60	-0.48	-0.52	3.13	2.78
Revenue Receipts	10.94	11.22	12.80	13.40	13.27	2.45	2.17
Own tax Revenue	5.41	5.59	6.09	6.25	6.21	0.84	0.66
own non-tax	1.38	1.35	1.53	1.33	1.23	-0.04	-0.02
Tax Devolution	2.29	2.44	2.90	3.16	3.19	0.86	0.72
Grants	1.87	1.85	2.28	2.66	2.64	0.79	0.81
Revenue Expenditure	13.59	13.53	12.20	12.92	12.74	0.68	0.61
Interest Payment	2.70	2.92	2.25	2.19	2.00	0.51	0.73
Capital Outlay	1.39	1.87	2.37	2.73	2.68	-1.35	-0.86
Net Lending	0.10	0.21	0.15	0.22	0.20	-0.13	-0.02

Concluding Remarks

- Despite improvement until 2007-08, the fiscal situation in 2008-09 was alarming and the situation will continue in 2009-10.
- The worsening fiscal situation is not due to the stimulus packages given. This is mainly due to the inability to contain unproductive expenditures in earlier years and proliferation of expenditures on emoluments, loan waiver and subsidies.
- Legislation for fiscal discipline should be owned by the government and not just the Finance Ministry. Fiscal responsibility Legislations should be accompanied by Medium Term Fiscal Framework with the participation of spending departments.
- Under-budgeting expenditures to conform to the FRBMA targets without real intention will only result in poor expenditure implementation.
- Fiscal consolidation is a major challenge for the new government. Problems of selectivity and discretion; Need to return to reform agenda.
- The government will have a difficult challenge of undertaking fiscal correction once again. The election manifestos of all political parties do not take cognizance of this fact.