An analysis of fiscal deficit in India (1991-92 to 2015-16)

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Abstract: Fiscal deficit is the excess of government's total expenditures over government's total revenue (excluding money from borrowings). A large fiscal deficit implies high government borrowing along with high debt servicing which may force the government to cut back spending on relevant sectors like health, education and infrastructure in the future. Large public borrowing may also lead to crowding out of private investment, inflation and exchange rate fluctuations. The present paper is an attempt to analyze the changes in fiscal deficit as a percentage of GDP and to examine the growth of fiscal deficit, government revenue and government expenditure in the post-reform period using annual data from 1991-92 to 2015-16.

Key Words: fiscal deficit, GDP, government expenditure, government revenue, growth rate.

INTRODUCTION:

Fiscal deficit is defined as excess of government's total expenditures over the revenue that it generates (excluding money from borrowings). Deficit differs from debt, which is an accumulation of yearly deficits. A fiscal deficit is regarded by some as a positive economic event. For example, economist John Maynard Keynes believed that deficits help countries climb out of economic recession. On the other hand, fiscal conservatives feel that governments should avoid deficits in favour of a balanced budget policy.

In India, fiscal deficit is defined as the excess of the sum total of revenue expenditure, capital outlay and net lending over revenue receipts and non-debt capital receipts including the proceeds from disinvestment. A large fiscal deficit implies high government borrowing along with high debt servicing which may force the government to cut back spending on relevant sectors like health, education and infrastructure in the future. This leads to reduction in growth of human capital and physical capital which have a long-term impact on economic growth of an economy. Large public borrowing can also lead to crowding out of private investment, inflation and exchange rate fluctuations. However, if there is an increase in productive public investments then this negative impact of high public borrowings on private investments and economic growth may be offset. Fiscal deficit used for creating infrastructure and human capital will have a different impact in comparison to if it is used for financing ill targeted subsidies and wasteful recurrent expenditure. Thus, the fear of high fiscal deficit is justified if the government incur deficit to finance its current expenditure rather than capital expenditure.

In India, up to the mid-1980s fiscal imbalance was seen in terms of overall budget deficit measured by the gap between the expenditure and the receipts under the revenue and capital accounts taken together. This gap was sought to be filled by deficit financing. The need for deficit financing in India arose on the one hand from the failure of the government to mobilize the desired volume of surplus for the public sector plans and on the other, from its rapidly growing expenditure (mostly on unproductive non-developmental activities).

On account of growing burden of non-developmental expenditure, the fiscal situation deteriorated throughout the 1980s and assumed crises proportions by the beginning of 1991-92. The process of macroeconomic stabilization undertaken within a neo-liberal framework brought about a shift in the approach towards the measurement of fiscal imbalance. Following the U.S. budgetary practices, the concept of fiscal deficit came into use. Fiscal deficit is measured as the different between the total government expenditure over government revenue and grants and thus reflects the total resource gap. This measure has been adopted by the International Monetary Fund as the principal policy target in evaluating the performance of countries seeking assistance.

NEED OF THE STUDY:

In spite of the Indian economy being of the fastest growing economies of the world it faces a number of economic problems. One of the most important issues faced by the Indian economy is the persistently high fiscal deficit in the past few years. Constantly high levels of fiscal deficit even after the adoption of Fiscal Responsibility and Budget Management Act in 2004 pose a serious threat to the macroeconomic stability of the Indian economy. Thus, there arises a need to analyse the fiscal deficit along with government expenditure and government revenue for India in the past few years.

OBJECTIVES OF THE STUDY:

The objectives of the present study are as follows:

1. To investigate the changes in fiscal deficit as a percentage of GDP in the post-reform period.
2. To examine the growth of fiscal deficit, government revenues and government expenditure in the post-reform period

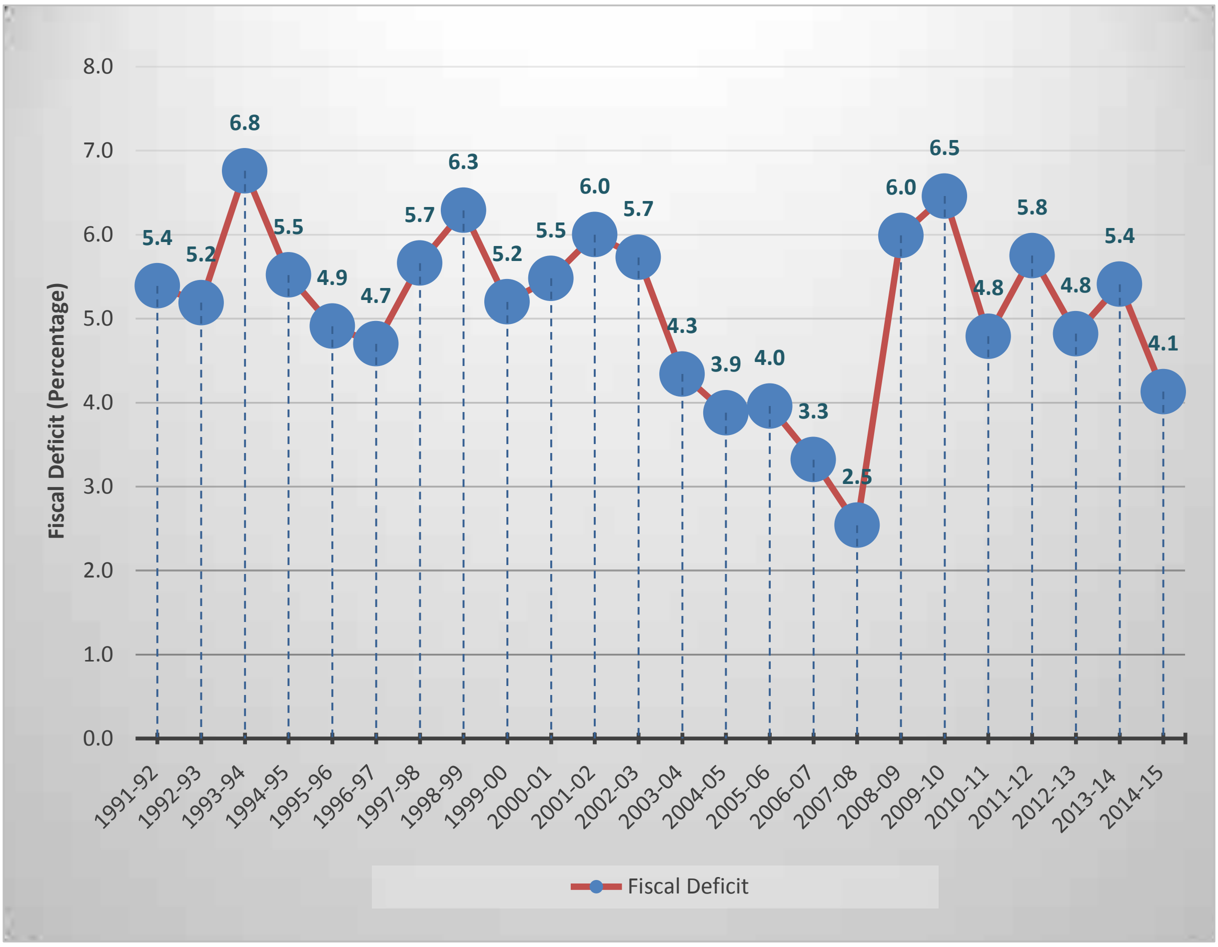
FISCAL DEFICIT AS A PERCENTAGE OF GDP:

Between 1980-81 and 1990-91 the fiscal deficit of the central government in India rose substantially from 5.7 per cent of GDP in 1980-81 to 7.8 per cent of GDP in 1990-91. This unambiguously suggested that the fiscal situation was under mounting pressure throughout the decade 1980-81 to 1990-91.

Such a fiscal situation was unsustainable and required immediate corrective measures. Accordingly, the regular Budget for 1991-92 which was presented to the Parliament on July, 24, 1991, announced some major steps to correct the fiscal imbalance. Though the burden of achieving reduction in fiscal deficit fell heavily on expenditure side, the Budget contained some proposals for raising additional revenue. After the Budget for 1991-92 was passed, the government imposed a 5 per cent cut on the expenditure provisions contained in the sanction Budget estimates for 1991-92 of all Ministries/Departments.

The following figure, Figure 1, illustrates the trends in fiscal deficit from 1991-92 to 2014-15. These measures enabled the government at the Centre to reduce fiscal deficit from about 7.8 per cent of GDP in 1990-91 to around 5.4 per cent of GDP in 1991-92. Fiscal deficit fell to 5.2 percent of GDP in 1992-93 but rose to 6.8 per cent in 1993-94. In 1996-97, the fiscal deficit fell to 4.7 per cent of GDP. But the expectations with respect to fiscal deficit remained unfulfilled in 1997-98 and as a result fiscal deficit once again rose to 5.7 per cent of GDP. It rose further to 6.3 per cent of GDP in 1998-99 and stood at 6 per cent of GDP in 2001-02.

Figure 1: Fiscal Deficit in India (Percentage of GDP)



Source: *Appendix - Table 2: Fiscal Deficit in India (Percentage of GDP)*

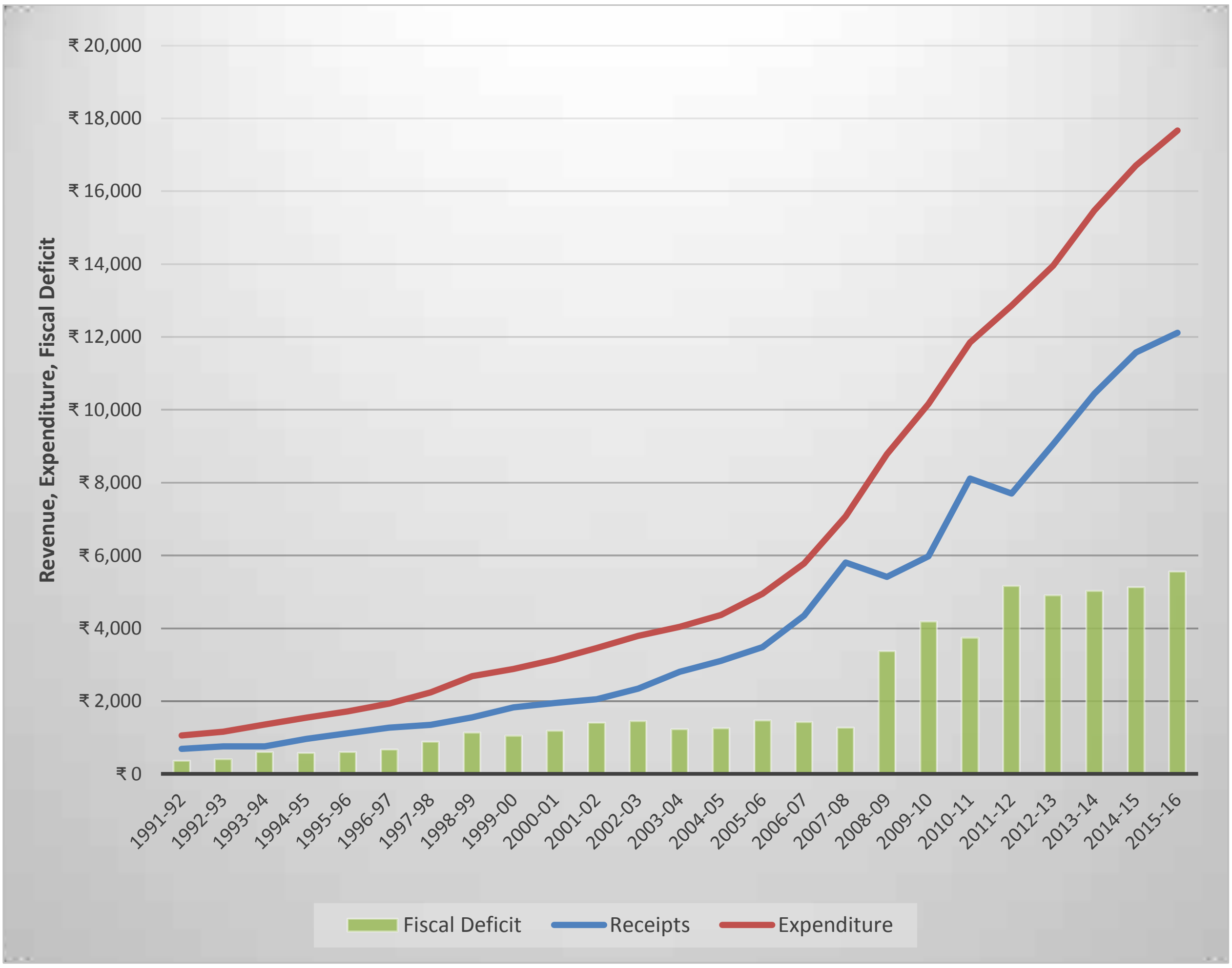
Since 1997-98 two factors contributed to increasing fiscal deficit. First, reduction in tax rates adversely affected tax revenues. Second, non-developmental expenditure continued increasing due to casual approach of the government. Thereafter, as a result of the enactment of the Fiscal Responsibility and Budget Management Act in 2004, there was a steady decline in the fiscal deficit GDP ratio.

The fiscal deficit declined to 3.3 per cent of GDP in 2006-07 and further to 2.5 per cent of GDP in 2007-08 as a result of substantial effort at fiscal correction. The target for fiscal deficit was kept at 2.5 per cent of GDP for the financial year 2008-09. However, because of slowdown in the world economy and therefore the India economy in the latter half of the year, there was a fall in tax collections. At the same time, the government had to increase expenditure substantially in a bid to generate demand in the slowing economy. As a result, the fiscal deficit increased considerably to 6.5 per cent of GDP in 2009-10. After declining to 4.8 per cent of GDP in 2010-11 it again rose to 5.8 per cent of GDP in 2011-12. It has shown some reduction in the recent years and stood at 4.1 per cent in 2014-15.

FISCAL DEFICIT, REVENUE AND EXPENDITURE:

In India fiscal deficit, government revenue and government expenditure have shown a consistent increase over time. India has persistently maintained a fiscal deficit in all the subsequent years in the post-reform period without having a fiscal surplus even is a single year. India’s fiscal deficit, revenue and expenditure have been presented in Figure 2 as follows.

Figure 2: India’s Fiscal Deficit, Revenue and Expenditure (₹ Billion)



Source: *Appendix - Table 3: Centre's Gross Fiscal Deficit and its Financing (₹ Billion)*

The figure clearly shows that government expenditure has increased continuously over the period of study. However, there has been a slight fall in government revenue in 1993-94. There has also been a fall in government revenue in 2008-09 and 2011-12 which can be majorly attributed to the fall in tax revenues due to the global slowdown in this period.

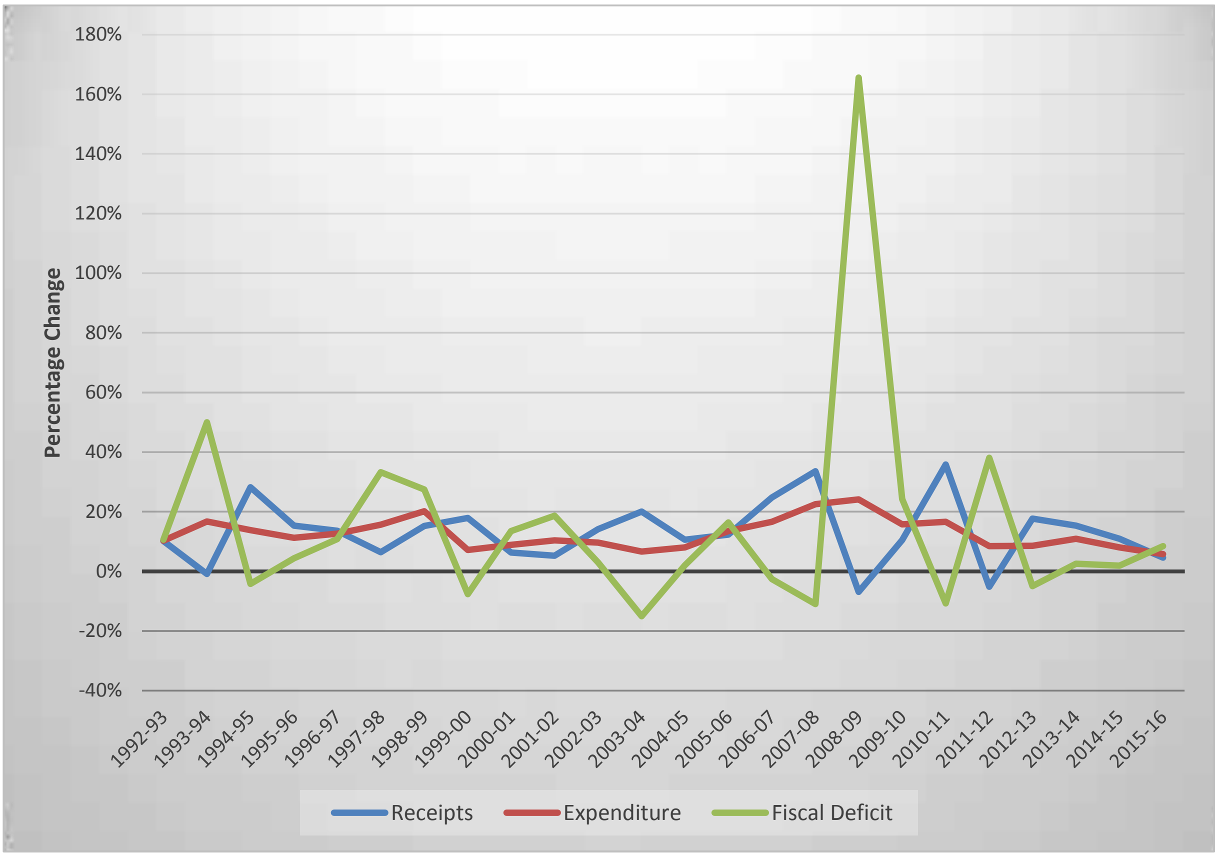
Further Table 1 and Figure 3 illustrate the growth rate of India's fiscal deficit, government revenue and government expenditure. The data clearly shows that government expenditure has increased continuously in the range of 10 per cent to 20 per cent throughout the period of study except in years 1998-99, 2007-08 and 2008-09 where it increased by20.10 per cent, 22.52 per cent and 24.06 per cent respectively, which can again be associated with the Asian Crises of 1997 and global meltdown of 2008. Government revenue has also shown a positive growth over the period of study. However, it witnessed negative growth in 2008-09 by 6.86% and in 2011-12 by 5.15%.

Table 1: Growth Rate of India's Fiscal Deficit, Revenue and Expenditure (₹ Billion)

Year	Receipts	Expenditure	Fiscal Deficit	Year	Receipts	Expenditure	Fiscal Deficit
1992-93	10.16%	10.31%	10.59%	2004-05	10.56%	7.96%	2.05%
1993-94	-0.90%	16.69%	49.99%	2005-06	12.32%	13.50%	16.41%
1994-95	28.23%	13.81%	-4.24%	2006-07	24.74%	16.64%	-2.64%
1995-96	15.34%	11.25%	4.40%	2007-08	33.51%	22.52%	-10.98%
1996-97	13.64%	12.63%	10.77%	2008-09	-6.86%	24.06%	165.53%
1997-98	6.36%	15.64%	33.27%	2009-10	10.46%	15.73%	24.18%
1998-99	15.25%	20.10%	27.45%	2010-11	35.81%	16.64%	-10.73%
1999-00	17.92%	7.15%	-7.62%	2011-12	-5.15%	8.49%	38.12%
2000-01	6.29%	8.90%	13.46%	2012-13	17.62%	8.54%	-5.00%
2001-02	5.25%	10.32%	18.63%	2013-14	15.35%	10.87%	2.58%
2002-03	14.17%	9.58%	2.92%	2014-15	10.88%	7.97%	1.94%
2003-04	19.99%	6.59%	-15.03%	2015-16	4.62%	5.77%	8.39%

Source: *Appendix - Table 3: Centre's Gross Fiscal Deficit and its Financing (₹ Billion)*

Figure 3: Growth Rate of India's Fiscal Deficit, Revenue and Expenditure



***Source:** Appendix - Table 3: Centre's Gross Fiscal Deficit and its Financing (₹ Billion)*

Thereafter there was a fall in fiscal deficit in 1994-95 due to substantial increase in government revenues. In 1997-98 and 1998-99 fiscal deficit rose to alarming levels of 33.27% and 27.45% main because of the Asian Crises of 1997.

Post 2001-02 fiscal deficit witnessed very low growth rates (even negative in 2003-04 0f -15.03%) in subsequent years which showed the seriousness of the government to exhibit financial prudence. After witnessing a fall in fiscal deficit by almost 11% in 2007-08 there was a humungous rise in fiscal deficit in 2008-09 by 165.53% majorly due to increasing expenditure and falling revenues. There was again a huge rise in fiscal deficit of 38.12% in 2011-12 due to falling revenue. In 2012-13 and 2013-14 there was a mild increase in fiscal deficit and finally it rose by 8.39% in 2015-16.

CONCLUSION:

The study concludes that fiscal deficit, government expenditure and government revenue have increased significantly in the post-reform period in India. The main findings of the study are as follows:

1. Fiscal deficit witnessed huge growth in 1993-94 of approximately due to substantial increase in government expenditure and fall in government revenue.
2. There was again enormous increase in fiscal deficit in 1998-99 which may be mainly attributed to the Asian financial crises of 1997.

3. Since 1997-98 two factors contributed to increase in fiscal deficit i.e. reduction in tax rates which adversely affected tax revenues and continuously increasing non-developmental expenditure due to casual approach of the government.
4. Thereafter, as a result of the enactment of the Fiscal Responsibility and Budget Management Act of 2004, there was a steady decline in the fiscal deficit to GDP ratio till 2007-08.
5. However due to the global recession of 2008 there was again significant rise in fiscal deficit. Fiscal deficit has shown some reduction in the recent years and stood at 4.1 per cent in 2014-15.
6. Government revenue has increased throughout the period of study except in three years 1993-94, 2008-09 and 2011-12, which can be majorly attributed to the fall in tax revenues due to the global slowdown in this period.
7. Government expenditure has increased continuously in the range of 10 per cent to 20 per cent throughout the period of study except higher levels of growth in years 1998-99, 2007-08 and 2008-09, which can again be associated with the Asian Crises of 1997 and global meltdown of 2008.

APPENDIX:

Table 2: Fiscal Deficit in India (Percentage of GDP)

Year	Fiscal Deficit	Year	Fiscal Deficit
1991-92	5.39	2003-04	4.34
1992-93	5.19	2004-05	3.88
1993-94	6.76	2005-06	3.96
1994-95	5.52	2006-07	3.32
1995-96	4.91	2007-08	2.54
1996-97	4.7	2008-09	5.99
1997-98	5.66	2009-10	6.46
1998-99	6.29	2010-11	4.79
1999-00	5.2	2011-12	5.75
2000-01	5.48	2012-13	4.82
2001-02	6.00	2013-14	4.62
2002-03	5.73	2014-15	4.13

Source: *Reserve Bank of India, Central Statistical Organisation and Ministry of Finance.*

Table 3: Centre's Gross Fiscal Deficit and its Financing (₹ Billion)

Year	GFD receipts	GFD expenditure	Gross fiscal	Year	GFD receipts	GFD expenditure	Gross fiscal
1991-92	690.69	1053.94	363.25	2004-05	3104.15	4362.09	1257.94
1992-93	760.89	1162.62	401.73	2005-06	3486.58	4950.93	1464.35
1993-94	754.05	1356.62	602.57	2006-07	4349.21	5774.94	1425.73
1994-95	966.91	1543.94	577.03	2007-08	5806.59	7075.71	1269.12
1995-96	1115.27	1717.7	602.43	2008-09	5408.25	8778.17	3369.92
1996-97	1267.34	1934.68	667.33	2009-10	5973.92	10158.74	4184.82
1997-98	1347.98	2237.35	889.37	2010-11	8113.17	11849.08	3735.92
1998-99	1553.59	2687.07	1133.49	2011-12	7695.25	12855.15	5159.9
1999-00	1832.06	2879.22	1047.16	2012-13	9051.22	13953.12	4901.9
2000-01	1947.3	3135.46	1188.16	2013-14	10440.92	15469.5	5028.58
2001-02	2049.52	3459.07	1409.55	2014-15	11576.44	16702.72	5126.28
2002-03	2339.85	3790.57	1450.72	2015-16	12110.75	17667.24	5556.49
2003-04	2807.65	4040.38	1232.73				

Source: *Table 104: Centre's Gross Fiscal Deficit and its Financing (₹ Billion), Handbook of Statistics on Indian Economy 2015, Reserve bank of India, Budget documents of the Government of India.*

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