General Elective Economics 4th Semester Public Finance

Part B: Issues from Indian Public Finance

Unit 3: Analysis of Budget and Deficits

Reading 1: Report of the Fourteenth Finance Commission, Chapter 3 (pp. 21-24)

This Unit focusses on the Budget and Deficits of the Union Government. First, we look at review of Union Finances given in the Report of the Fourteenth Finance Commission which was submitted on 15th December 2014. The Report reviewed the finances of the Union Government for a period of ten financial years (2004-05 to 2014-15).
We then look at the current Budget presented by Finance Minister on 5th July 2019. This gives a clear picture from where the revenue comes from and where the expenditure goes to.
Lastly, we will be looking at the Macro-Economic Framework, this explains briefly how each sector of the economy, prices and Central government finances have been behaving in comparison to the previous year.

As mentioned earlier the Report of the Fourteenth Finance Commission reviewed the finances of the Union Government from 2004-05 to 2014-2015. Until 2007-08 there has been a considerable improvement in the finances of the Union Government due to high growth, tax reforms with increase in revenue. From 2008-09 onwards there has been a deterioration in the fiscal health of the Union Government characterised by an expansionary fiscal policy. From 2009-10 onwards, the revenue and fiscal deficits of the Union as a ratio of gross domestic product (GDP) increased to levels higher than targets in the fiscal adjustment path set by the Thirteenth Finance Commission. The tax-GDP ratio reached high level in 2007-08, but since then declined even though the revenue expenditure to GDP ratio continued to increase from 2008-09 onwards. There has been a decline in the capital expenditure as a proportion to GDP due to pressure to contain the deficits. The 2008 financial crisis which affected many countries globally, but India's growth rate wasn't affected and continued to remain high till 2011-12, although the fiscal parameters deteriorated. A significant deceleration in economic growth have been observed from 2012-13 onwards.

Fiscal Deficit is difference between revenue receipts plus non-debt capital receipts and revenue expenditure. The FRBM Act had laid down the target of bringing the fiscal deficit down to 3 per cent of GDP and eliminating revenue deficit by 2008-09. The fiscal deficit of the Union Government relative to GDP declined steadily from 6.1 per cent in 2001-02 to 4.5 per cent in 2003-04. The Union Government achieved the target set by FRBM Act in 2007-08. But it increased in 2008-09 and the following year due to the several fiscal expansionary measures such as revision of pay scales based on the recommendations of the Sixth Pay Commission, waiver of farm loans and the expansion of the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) to all districts from the 200 districts it was originally slated to cover. In addition, oil prices escalated sharply, leading to a rise in subsidy. The total expenditure as a ratio of GDP increased by 1.5 percentage points from 2007-08 to 2009-10. At the same time, there has been a decline in the gross tax revenues by more than 2 percentage points in 2007-08 to 2009-10.Though the fiscal deficit declined in 2010-11, this was due to additional revenue from the proceeds of the auction of telecom spectrum. The fiscal deficit again increased sharply to 5.7 per cent of GDP in 2011-12. In 2012, the Union Government amended the FRBM Act and laid down a revised fiscal adjustment path of achieving fiscal deficit of 3 per cent of GDP by 2016-17 and reducing revenue deficit to below 2 per cent of GDP by 2014-15. After 2011-12, there has been a rapid decline in the growth rate. In this situation, the Union government severely compressed Plan expenditures to achieve the budgeted levels of fiscal deficit.

Revenue Deficit is the difference between revenue receipts and revenue expenditure. It was at 1.1 per cent of GDP in 2007-08, but rose thereafter due to the substantial increase in revenue expenditures on subsidies, interest payments and salaries and pensions. The Union Government introduced the concept of effective revenue deficit through an amendment to the FRBM Act in 2012. Effective revenue deficit makes a distinction between the grants given to the States and implementing agencies for the creation of capital assets and grants for meeting revenue expenditures. The amended FRBM Act has revised the target of revenue deficit – it is now to be brought below 2 per cent of GDP by 31 March 2015 against the original goal of eliminating it entirely. However, it appears that even this revised target may not be met.

Primary Deficit is the fiscal deficit minus the interest payment of the Union Government. Like other deficit indicators, primary deficit of the Union Government increased to 2.6 per cent of GDP in 2008-09 and 3.2 per cent of GDP in 2009-10. The ratio of revenue deficit to fiscal deficit broadly measures the extent of borrowings used for revenue expenditure. this ratio almost doubled within a span of two years to over 81 per cent in 2009-10 and has since remained consistently above 70 per cent (with the exception of 2010-11), thereby reflecting the levels of persistent structural imbalance in Union Government expenditures.