

Fiscal Developments and Public Finance

In a developing economy, demand for resources for providing the economic and social infrastructure needs have to be balanced with its resource generating capacity. Since the sectoral claims on resources are enormous, there is often a danger of profligacy leading to fiscal imbalances endangering macro fundamentals of the economy. At the beginning of reforms in 1991, the fiscal imbalances were identified as the root cause of the balance of payments crisis and domestic inflation. The fiscal consolidation, which followed in response, however, failed to sustain itself as it lacked a statutory mandate and the required institutional support. The enactment of the Fiscal Responsibility and Budget Management Act (FRBMA), 2003 provided the required mandate and lent credibility to the fiscal reforms process.

3.2 The fiscal deficit of the Centre as a proportion of GDP came down from 5.9 per cent in 2002-03 to 3.4 per cent in 2006-07 and is estimated to further decline to 3.3 per cent in 2007-08 (BE) (3.2 per cent based on revised GDP estimates) (Table 3.1). Similarly, the revenue deficit declined from 4.4 per cent in 2002-03 to 1.9 per cent in 2006-07 and is estimated to further decline to 1.5 per cent in 2007-08 (BE) (Figure 3.1). The revenue deficit as a percentage of fiscal deficit has declined from 79.7 per cent in 2003-04 to 56.3 per cent in 2006-07 and it is further estimated to improve to 47.4 per cent in 2007-08 (BE) implying a progressively better utilization of borrowed resources towards asset creation.

3.3 States have also joined the process of fiscal consolidation in line with the Twelfth Finance Commission's (TFC) recommendations and are complementing the efforts of the Central Government. As recommended by TFC and following the example of the Central Government, 26 States have already enacted fiscal responsibility

legislations. The fiscal situation of the States has shown considerable improvement, which in fact is even better relative to the performance of the Central Government, post-FRBMA. As a proportion of GDP, the fiscal deficit of the States declined from 4.4 per cent in 2003-04 to 2.3 per cent in 2007-08 (BE). The aggregate revenue deficit of the States was 0.1 per cent in 2006-07 (RE). States on a consolidated basis are expected to have a revenue surplus of 0.3 per cent of GDP in 2007-08. A strong incentive-based fiscal transfers (proposed by TFC) by embedding in it a framework

Table 3.1 Trends in deficits of Central Government

Year	Fiscal deficit	Revenue deficit	Primary deficit	Revenue deficit as per cent of fiscal deficit
(As per cent of GDP)				
1996-97	4.1	2.4	-0.2	58.2
1997-98	4.8	3.0	0.5	63.5
1998-99	5.1	3.8	0.7	74.8
1999-2000	5.4	3.5	0.7	64.6
2000-01	5.7	4.1	0.9	71.7
2001-02	6.2	4.4	1.5	71.1
2002-03	5.9	4.4	1.1	74.4
Enactment of FRBMA				
2003-04	4.5	3.6	0.0	79.7
2004-05	4.0	2.5	-0.1	62.6
2005-06	4.1	2.6	0.4	63.0
2006-07	3.4	1.9	-0.2	56.3
2007-08(BE)	3.2	1.5	-0.2	47.4

Source : Budget documents.

- Note:** 1. The ratios to GDP at current market prices are based on CSO's new 1999-2000 series.
2. Fiscal deficit excludes transfer of States' share in small savings collections.