RESEARCH PAPER
Economics
Volume : 4 | Issue : 6 | June 2014 | ISSN - 2249-555X

Fiscal Reforms and Consolidation in India Since 1991

KEYWORDS
Fiscal Reform, Deficits, Fiscal Consolidation.

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ABSTRACT *In the second half of the 1980s, when the Government of India pursued its expansionary fiscal policies to support growth from the deficits, it contributed to the foreign exchange crisis in 1991. In the aftermath of the macroeconomic crisis of 1991, a comprehensive reform programme was launched in India. Since then, the goal of consolidating public finances has been high on the agenda of the Government of India. The structuring of the tax system constitutes major components of fiscal reforms apart from the measures to curb built-in growth in expenditure and to bring about structural changes in the composition of expenditure. Apart from it, Government has made special efforts to deal with the problem of growing fiscal liabilities in the form of internal and external debt. To address the structural issues and expedite the fiscal consolidation process, a concrete step was taken by the Government of India and it enacted the Fiscal Responsibility and Budget Management Act (FRBMA) in 2003. Against the backdrop of these reform measures and enactment of FRBMA, this paper aims at a closer examination of the fiscal health of the Government of India.*

Introduction

In the post-independence period, a mixed-economy model was adopted by India where government regulations and planned economic process had to play a vital role. Since independence, with the planned economy model, India experienced a modestly continuous rate of growth or popularly known as Hindu Rate of Growth for almost 30 years. To this Subramanian & Rodrick (2004) pointed out, "India's economic performance during the first three decades since independence in 1947 was christened the "Hindu" rate of growth, a term connoting a disappointing but not disastrous outcome and the acquiescence in the present that the religion supposedly imbues, because of its greater emphasis on the hereafter." This Hindu Rate of Growth tendency of Indian economy however improved with the commencement of reforms in 1980s. In 1980s, reforms were initiated to open-up the economy resulting in a relatively higher growth performance of Indian economy. During this period, to give a boost to the growth process, expansionary fiscal policy measures were implemented and this expansion was done by borrowed funds from both domestic and external sources. This debt financed growth led to the deterioration of the fiscal position stemming from rising expenditure contributed to the wider Current Account Deficit (CAD) and a very high fiscal deficit. This deteriorating fiscal position along with a run up in world oil prices and increasing demand for petroleum, depreciation of rupee, decline in worker's remittances due to Gulf War and loss of some export markets, resulted in the Macro-Economic Crises of 1991.

This grave fiscal situation and the macroeconomic crisis of 1991, led to a comprehensive reform programme in India.

Since then, the goal of consolidating public finances has been high on the agenda of the Government of India (GoI). Fiscal reform was the key component of the economic reform programme which targeted reforms in taxation structure, expenditure pattern and reforms in borrowing process. GoI appointed a Tax Reform Committee (Chelliah Committee) in August, 1991, to recommend wide-ranging reforms of direct and indirect taxation. In the tax reform process, Modified Value Added tax (MODVAT), which was introduced in 1986, renamed as Central Value Added tax (CENVAT) in 2000. In 1994, service tax was also introduced. In this reform process Chelliah (1999) noted that, "Bringing private sector equity into public enterprises and reducing the government's stake is also one of the reforms. This involves disinvestment as well as issue of new equity. Funds from disinvestment are used to cover government deficit". Therefore, in order to bring in more resources and to bridge the gap between resource income and expenditure, GoI appointed Disinvestment Commission (DC) in August, 1996. Subsequently in April 2003, statewide Value Added Tax (VAT) was introduced to replace the Sales Tax. In the budget of 2007-08, finance minister of India has prepared a roadmap for introducing a national level Goods and Services Tax (GST) with effect from April 1, 2010, however, it has not been implemented till date. Expenditure reforms were also initiated by the GoI and in February 2000, Expenditure Reforms Commission was introduced. Finance commission also stressed the need for consolidating finances of both central and state governments. Apart from it, in various budgets of Central Government, GoI has taken numerous other steps like introduction of Voluntary Retirement Scheme, New Pension Scheme, restriction on fresh recruitments, dismantling of administered price mechanism in the petroleum sector, restructuring and closure of non-working and loss-making Public Sector Undertakings (PSUs). Eleventh Finance Commission introduced Debt Swap Scheme to swap high interest loans to lower interest market loans. To address the structural issues and expedite the fiscal consolidation process, a concrete step was taken by the Government of India and it enacted the Fiscal Responsibility and Budget Management Act (FRBMA) in 2003. Against the backdrop of these reform measures and enactment of FRBMA, this paper aims at a closer examination of the fiscal performance of the Government of India on certain key parameters. For the analysis the study period (1991-91 to 2012-13) has been divided into two sub-periods:i) pre-FRBMA period (1991-92 to 2002-03) and ii) post-FRBMA period (2003-04 to 2012-13). Data has been collected on revenues, expenditures, various deficit indicators (like, revenue deficit, gross fiscal deficit, and primary deficit) and on outstanding public debt of the Central Government at current prices from the Handbook of Statistics on Indian Economy, Reserve Bank of India (RBI) publication. For Gross Domestic Product (GDP) of India, latest data series, given by RBI, will be used. For analysis all the indicators are taken as percent to GDP.

Revenue and Expenditure Position of the Central Government

Table shows that tax-GDP ratio of Central Government was 7.43 per cent in 1991-92 which was highest in pre-FRBMA period. In 1998-99 it was lowest (5.80 per cent) and after showing an improvement for two years it again declined to 5.69 per cent in 2002-03.

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Table 1: Revenue and Expenditure of Central Government as Per cent to GDP in Pre-FRBMA Period

Year	Revenue Receipts		Total Expenditure	
	Tax Revenue (Tax-GDP Ratio)	Non-tax Revenue	Revenue Expenditure	Capital Expenditure
1991-92	7.43	2.37	12.21	4.32
1992-93	6.98	2.59	11.97	3.86
1993-94	6.00	2.47	12.14	3.78
1994-95	6.45	2.26	11.68	3.69
1995-96	6.68	2.30	11.40	3.13
1996-97	6.60	2.30	11.20	2.96
1997-98	6.08	2.43	11.47	3.29
1998-99	5.80	2.49	12.00	3.49
1999-00	6.37	2.64	12.38	2.43
2000-01	6.30	2.58	12.81	2.20
2001-02	5.69	2.89	12.84	2.59
2002-03	6.26	2.86	13.38	2.95

(Source: Handbook of Statistics on Indian Economy, RBI)

However, non-tax revenue remained almost stable till 1996-97, it increased marginally thereafter and by the end of the year 2002-03 it reached to a slightly higher level to 2.86 per cent of GDP.

Revenue expenditure declined continuously for four years from 1993-94 to 1996-97, which was a part of policy measures of Central Government, to keep the revenue account in balance. But since 1997-98 it continuously increased and reached to 13.38 per cent of GDP in 2002-03. Capital expenditure during the pre-FRBMA period had shown some negative developments, because whereas revenue expenditure started increasing in the second half of the 1990s, capital expenditure was declining almost continuously since 1991-92. This indicates that government borrowings were diverted towards financing the current expenditure needs.

Table 2: Revenue and Expenditure of Central Government as Per cent to GDP in Post-FRBMA Period

Year	Revenue Receipts		Total Expenditure	
	Tax Revenue (Tax-GDP Ratio)	Non-tax Revenue	Revenue Expenditure	Capital Expenditure
2003-04	6.59	2.71	12.76	3.85
2004-05	6.93	2.50	11.85	3.51
2005-06	7.32	2.08	11.90	1.80
2006-07	8.18	1.94	11.98	1.60
2007-08	8.81	2.05	11.92	2.37
2008-09	7.87	1.72	14.10	1.60
2009-10	7.05	1.79	14.08	1.74
2010-11	7.31	2.80	13.35	2.01
2011-12	7.02	1.36	12.77	1.77
2012-13	7.41	1.29	12.60	1.67

(Source: Handbook of Statistics on Indian Economy, RBI)

In the post-FRBMA period, for the first five years, i.e., from 2003-04 to 2007-08 tax-GDP ratio improved rapidly and it increased from 5.69 per cent in 2001-02 to 8.81 per cent in 2007-08. However, after 2007-08, global meltdown impacted the economy and tax-GDP ratio declined marginally and by the end of 2012-13 it was 7.41 per cent of GDP. This shows that in the post-FRBMA period tax-GDP ratio has performed much better than in the pre-FRBMA period and tax reforms were successful in improving the revenue position of the Central Government.

Nevertheless, on the non-tax revenue side, performance of the Central Government was very dismal and except for one or two years, non-tax receipts declined continuously and by the end of 2012-13 it was 1.29 per cent of GDP.

On the expenditure side, government kept a check on the increasing revenue expenditure and it remained below 12 per cent of GDP till 2007-08. But in order to revive the economy from the impact of global meltdown, Central Government provided three stimulus packages (first on 7th December 2008, second on 2nd January 2009 and third on 24 February 2009) resulting in a sharp rise in expenditure.

In post-FRBMA, for two years i.e. 2003-04 and 2004-05, capital expenditure increased very rapidly but thereafter it wascut downsharply and became 1.77 per cent of GDP in 2012-13, which is much less as compared to pre-FRBMA period.

Thus we can say that as far as tax revenue is concerned, economy has performed very well in post-FRBMA period. On the revenue expenditure side, it represents a mix picture. While performance of non-tax revenue and capital expenditure was very depressing in post-FRBMA period as compared to pre-FRBMA period.

Key Fiscal Indicators of the Central Government

Fiscal profligacy was seen to have caused the balance of payment crisis of 1991, and reduction in fiscal deficit was therefore an urgent priority at the start of the reforms. Table 3, indicates that fiscal deficit of the Central Government declined initially except for 1993-94 and from 5.39 per cent in 1991-92, it declined to 4.70 per cent in 1996-97 as per cent to GDP. However this progress was short-lived and gross fiscal deficit once again started increasing and reached at the same level as was in 1991. During this period, initially revenue deficit remained at almost same level and increased at once in 1993-94and declined subsequently only to increase again andfrom 1996-97 it continuously increased and became almost doubled (4.26 per cent) in 2002-03 from a much lower level of 2.41 per cent in 1991-92. Primary deficit, which is gross fiscal deficit minus interest payments, fluctuated between 0.72 per cent to 1.48 per cent in pre-FRBMA period except for the year 1993-94 when it jumped at the highest level of 2.64 per cent of GDP.

Table 3: Key Deficit Indicators of the Central Government in Pre-FRBMA Period

Year	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	RD/FD
1991-92	5.39	2.41	1.44	44.71
1992-93	5.19	2.40	1.17	46.24
1993-94	6.76	3.67	2.64	54.29
1994-95	5.52	2.97	1.30	53.80
1995-96	4.91	2.42	0.83	49.29
1996-97	4.70	2.30	0.51	48.94
1997-98	5.66	2.95	1.48	52.12
1998-99	6.29	3.71	1.97	58.98
1999-00	5.20	3.36	0.72	64.62
2000-01	5.48	3.93	0.90	71.72
2001-02	6.00	4.27	1.43	71.17
2002-03	5.73	4.26	1.08	74.35

(Source: Handbook of Statistics on Indian Economy, RBI)

Even more worrisome feature was worsening quality of deficits. Revenue deficit as per cent to gross fiscal deficit continuously increased and it became 74.35 per cent in 2002-03 as compared to 44.71 per cent in 1991-92. This indicates that

Volume : 4 | Issue : 6 | June 2014 | ISSN - 2249-555X

more and more expenditure was made to finance the current needs instead of investing the funds for capital projects.

These trends indicate that in spite of initial fiscal adjustment measures for correcting the fiscal imbalances, immediately after the macroeconomic crisis and subsequent reforms measures, a high level of deficits were recorded in the government budgets particularly during the second half of 1990s continue to restrain growth prospects for the economy. The level of fiscal deficit for the Central Government was more or less at the same level at the end of 1990s as it was at the beginning

This shows that in the pre-FRBMA period, barring a few years, fiscal performance of the deficit indicators was very gloomy. This led to the implementation of the FRBMA in 2003, so that in a time bound manner, government can improve its fiscal performance within the prescribed targets.

Table 4: Key Deficit Indicators of the Central Government in Post-FRBMA Period

Year	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	RD/FD
2003-04	4.34	3.46	-0.03	79.72
2004-05	3.88	2.42	-0.04	62.37
2005-06	3.96	2.50	0.37	63.13
2006-07	3.32	1.87	-0.18	56.33
2007-08	2.54	1.05	-0.88	41.34
2008-09	5.99	4.50	2.57	75.13
2009-10	6.46	5.23	3.17	80.96
2010-11	4.79	3.24	1.79	67.64
2011-12	5.75	4.39	2.71	76.35
2012-13	4.90	3.65	1.77	75.00

(Source: Handbook of Statistics on Indian Economy, RBI)

Period immediate after the FRBMA indicates that fiscal deficit declined significantly and it became 2.54 per cent of GDP which was lowest during the entire study period. Revenue deficit also declined significantly and became 1.05 per cent in 2007-08 which was also lowest since 1991-92. Primary surpluses also took place during this period and quality of deficits started improving. This indicates that in the immediate post-FRBMA period, fiscal performance was very impressive and FRBMA proved very effective.

However, economy performed impressively well during the initial years of FRBMA period, this good performance overturned when the global depression hit the economy. This is clearly visible in the period subsequent to 2007-08. In 2008-09, as compared to 2007-08, increase in fiscal deficit was more than double, revenue deficit increased more than three times and primary deficit increased nearly four times (partly due to decline in revenues and partly because of increasing government expenditure, to bring out the economy from the grip of recession). Although, in 2010-11, deficit indicators showed some improvements but this disappeared the very next year and fiscal deficit remained more than 5 per cent and revenue deficit nearly 4 per cent of GDP in 2011-12, however, deficits declined slightly in the subsequent year.

This indicates that FRBMA was effective under normal circumstances but it failed to save the economy from the wrath of the global meltdown and rejuvenation of the economy is still required.

Table 5: Debt Burden of the Central Government in Pre-FRBMA Period

Year	Internal Debt	External Debt	Total Debt	Interest payment
1991-92	47.15	16.28	63.42	3.95
1992-93	46.43	15.62	62.05	4.01
1993-94	48.31	14.34	62.65	4.12
1994-95	46.64	13.63	60.27	4.21
1995-96	45.24	12.10	57.34	4.08
1996-97	43.79	10.54	54.32	4.19
1997-98	45.98	10.27	56.24	4.17
1998-99	46.28	9.87	56.14	4.32
1999-00	47.84	9.28	57.12	4.49
2000-01	50.84	8.76	59.60	4.58
2001-02	55.14	8.50	63.64	4.58
2002-03	59.26	7.75	67.00	4.66

(Source: Handbook of Statistics on Indian Economy, RBI)

Indian economy was under huge debt stress in 1991 and debt-GDP ratio was 63.42 per cent. Government of India adopted various reform measures in 1991 and subsequently it started declining but by the end of the 1990s it started increasing and reached at the same level as it was in 1991-92. In 2002-03 it reached to a peak level of 67 per cent of GDP. However one major change which had occurred during this period was that share of external debt declined throughout the study period. This increasing debt burden led to the problem of increasing interest liabilities. Table 5 clearly indicates that interest payments continuously rise in the pre-FRBMA period. Interest payments were 3.95 per cent to GDP in 1991-92 which increased continuously and reached to 4.66 per cent in 2002-03. Thus Central Government faced two folded burden with increased debt on the one side and rising interest payments on the other.

Table 6: Debt Burden of the Central Government in Post-FRBMA Period

Year	Internal Liabilities	External Liabilities	Total Liabilities	Interest payment
2003-04	59.57	6.49	66.06	1.29
2004-05	59.64	5.9	65.53	1.36
2005-06	58.64	5.25	63.9	1.35
2006-07	56.72	4.68	61.4	1.38
2007-08	54.65	4.21	58.86	1.32
2008-09	53.93	4.69	58.62	1.38
2009-10	52.42	3.85	56.27	1.39
2010-11	48.51	3.58	52.08	1.27
2011-12	48.28	3.6	51.88	1.20
2012-13	48.57	3.31	51.88	1.18

(Source: Handbook of Statistics on Indian Economy, RBI)

Debt liabilities of the Central Government started declining in the post-FRBMA period. Total liabilities declined from 66.06 per cent of GDPto 58.62 per cent in 2008-09 and further 51.88 per cent by the end of the year 2012-13. During this period, both, internal and external liabilities fall at a considerable level. Table 7 clearly indicate this trend and shows that share of internal liabilities in total debt declined from 59.57 per cent in 2003-04 to 48.57 per cent in 2012-13. Similarly, external liabilities declined from 6.49 per cent of GDP in 2003-04 to 3.31 per cent of GDP in 2012-13. This

Volume : 4 | Issue : 6 | June 2014 | ISSN - 2249-555X

significant decline in debt also relaxed the burden of interest liabilities. It is evident from table 7 that interest burden of the Central Government relived considerably. The share of interest payments to GDP declined from 4.66 per cent in 2002-03 to 1. 29 per cent in 2003-04 and remained at this lower level in subsequent years.

Conclusion

The rapid deterioration in the Central Government finances during the second half of the 1980s was caused by a faster rise in growth of expenditure in comparison to the growth of revenues which culminated into the macroeconomic crises of 1991. The macroeconomic crisis of 1991 created an exigency and led to the chartering of a strong reversal of hitherto followed policies. Fiscal reforms undertaken during this period helped to increase revenue mobilization, especially tax revenues, focused on compressing expenditure and reducing liabilities. However, the analysis shows that performance on the non-tax revenue front is very dismal and there is an urgent need to improve the system of collecting revenues from the services provided by the government. Deficit indicators also improved in the post-FRBMA period but global meltdown reversed the progress made by the Central Government in improving the fiscal performance. In spite of this, Central Government successfully controlled the increasing debt burden and it reduced continuously in the post-FRBMA period subsequently causing a reduced burden of interest payments. Even then some major problems needs a close examination like unproductive and committed expenditure needs to be cut back, subsidies should be rationalised and targeted, capital expenditure should be increased in order to boost the economic growth. However, reforms have shown mixed results, there is a need of furthering this reform process in order to rejuvenate the economy.

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