

# Public Finance

The Union Budget for 2007-08 highlighted the government's success in reining in Fiscal Deficit to targetted levels. This may not have been a one-off achievement, but, rather, a firm step in the direction of realising the targets mandated by the Fiscal Responsibility and Budget Management (FRBM) Act. While a major contributor to this success was improved tax revenue, it is also evident that expenditure growth has not been above the projected GDP growth at nominal value. The pattern of tax revenue growth marks the growing importance of direct taxes, which has become a trend in recent years. Within indirect taxes, the share of import taxes has declined. The rapid rise in service tax collections indicates that the tax base has widened.

On the expenditure front, the share of interest payment in Total Expenditure has declined from levels of about 30 per cent in the period before 2002-03 to about 25 per cent now. Greater government spending may be necessary for achieving balanced growth across sectors and regions during the 11th Plan period. Budget 2007 proposes larger layouts for some of the social sector schemes. In his budget speech, the Finance Minister promises to find additional resources for the Plan should the need arise.

We now provide a brief assessment of the positions taken by the budget in relation to past trends and its implications for the fiscal health of the economy, measured in terms of government deficits and debt.

**Table PF.1: Trends in Central Government's Fiscal Indicators**

<b>Year</b>	<b>Fiscal Deficit (% GDPMP)</b>	<b>Revenue Deficit (% GDPMP)</b>	<b>Primary Deficit (% GDPMP)</b>	<b>RD/FD (%)</b>	<b>Internal Liabilities (% GDPMP)</b>	<b>Interest Payments (% GDPMP)</b>
1990-91	6.6	3.3	2.8	41.6	49.8	3.8
1995-96	4.2	2.5	0.0	49.4	46.7	4.2
2004-05	4.1	2.5	0.0	62.6	61.9	4.1
2005-06	4.1	2.6	0.4	63.0	59.6	3.7
2006-07 (RE)	3.7	2.0	0.1	54.8	58.5	3.6
2007-08 (BE)	3.3	1.5	-0.2	47.4	55.5	3.5

Note: Internal liabilities for 2006-07 and 2007-08 are based on figures available in Medium-term Fiscal Policy Statement of the Ministry of Finance, 2007

### Trends in Fiscal Deficit and Debt of the Central Government

The revised estimates for 2006-07 places the Fiscal Deficit of the Centre at 3.7 per cent of GDP at current market prices. With a decline in the deficit level, the debt to GDP ratio has stabilised. Internal liabilities rose in the second half of the 1990s, touching a high of 61.9 per cent of GDP in 2004-05. The ratio of internal liabilities to GDP is now projected at 55.5 per cent for 2007-08. The external debt to GDP has declined from 8.8 per cent in 2001-02 to 5.4 per cent in 2005-06.

Revenue Deficit is now less than 50 per cent of the total borrowing of the Centre represented by the Fiscal Deficit. It is, however, a huge task to bring the Revenue Deficit down to zero in the next one year to meet the targets set by the FRBM Act. It would require further acceleration in revenue collection and control over expenditure growth. More importantly, sustaining the momentum of fiscal improvement will also depend on continuing the economic growth momentum.

The indicators of deficits and debt

for the Centre and state governments combined have also shown improvement, but the decline in the Fiscal Deficit and Revenue Deficit appears to be mainly due to the improvement in the central government's finances (Table PF 2). If the trend seen in the central finances in 2007-08 budget proposals is also witnessed in the states' finances, then fiscal consolidation could be described as fairly robust.

### Trends in Central Government Revenues

The Gross Tax Revenue collections of the central government reached 11.4 per cent of GDP according to the revised estimates for 2006-07, continuing with the steady rise in the ratio since 2002-03 (Figure PF1). The budget estimates for 2007-08 places the tax revenue projections for 2007-08 at almost 12 per cent of the GDP. This is only a slight increase as compared to the previous year's ratio of 11.4 per cent. However, the proposed increase in Gross Tax Revenue over the previous year is of much slower pace than witnessed in 2006-07. The Gross Tax Revenue of the Centre increased by 27.8 per cent in 2006-07 and they are budgeted to grow at a modest pace of 17.2

**Table PF.2: Trends in Fiscal Indicators for Central Plus State Governments**

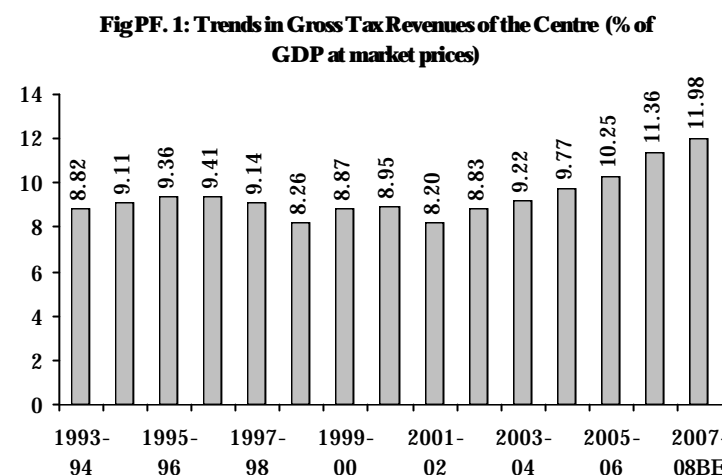
Year	Fiscal Deficit (FD)	Revenue Deficit (RD)	Primary Deficit (PD)	RD/FD	Debt	Interest Payments
	Percent of GDP			Percent	Percent of GDP	
	<b>Combined for Centre and states</b>					
1990-91	9.4	4.2	5.0	44.6	64.9	4.4
1995-96	6.5	3.2	1.6	48.8	61.3	5.0
2004-05	7.5	3.7	1.4	48.9	82.5	6.2
2005-06	7.5	3.1	1.6	41.5	79.5	5.8
2006-07 (RE)	6.5	2.2	0.8	33.6	78.6	5.7

Source: C. Rangarajan and Duvvuri Subbarao, The Importance of Being Earnest About Fiscal Responsibility, Economic Times, February 2007.

per cent in the current year. The projected growth of 17.8 per cent is in fact lower than the actual growth in Gross Tax Revenue over the past five years. Among the major taxes, only Excise has a higher budgeted revenue growth in 2007-08 than in the previous year. The slower growth in corporate income tax revenue is surprising given the expectations of higher excise tax collections. There appears to be greater scope for fiscal consolidation during the year if the economic growth momentum continues.

### Trends in Central Government Expenditure

The desired direction of fiscal adjustment on the expenditure front is focussing spending on more productive uses of scarce resources while at the same time addressing broader social concerns of equity and welfare. At the aggregate level, there has been some success in keeping the Total Expenditure of the central govern-



ment in line with the growth of the economy as a whole. The ratio of total central government expenditure to GDP at market prices has declined from a high of about 20 per cent in 1986-87 and 1987-88 to about 14 per cent now. The reduction to levels below 16 per cent has been difficult and as recently as 2004-05 it was almost at 16 per cent of GDP.

**Table PF.3: Trends in Gross Tax Revenues of the Centre**

Item	1994-95	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07RE	2007-08BE
<b>Growth % YOY</b>									
Corp tax	37.40	16.30	2.56	26.12	37.66	30.08	22.49	44.65	14.95
Income tax	31.81	23.82	0.76	15.17	12.29	19.02	29.17	29.67	19.71
Customs	20.71	-1.81	-15.30	11.38	8.42	18.47	12.94	25.72	20.75
Excise	17.83	10.70	5.88	13.44	10.28	9.20	12.21	5.43	11.05
Service	NA	22.79	26.37	24.83	91.44	79.95	62.36	65.56	31.52
Sub-total	23.14	10.28	-0.75	16.01	17.70	20.07	20.27	28.00	17.18
Other	-13.48	-16.71	-5.69	-15.93	7.84	-1.05	-8.88	-15.38	9.40
Gross tax	21.85	9.81	-0.82	15.61	17.61	19.90	20.07	27.77	17.16
<b>As % of GDPMP</b>									
Corp tax	1.36	1.69	1.60	1.88	2.30	2.65	2.84	3.56	3.68
Income tax	1.19	1.51	1.40	1.50	1.50	1.58	1.78	2.00	2.16
Customs	2.65	2.26	1.77	1.83	1.76	1.85	1.82	1.99	2.16
Excise	3.69	3.25	3.18	3.36	3.29	3.18	3.11	2.85	2.85
Service	0.00	0.12	0.14	0.17	0.29	0.45	0.65	0.93	1.10
Sub-total	8.88	8.83	8.10	8.75	9.14	9.70	10.20	11.32	11.94
Other	0.23	0.12	0.10	0.08	0.08	0.07	0.05	0.04	0.04
Gross tax	9.11	8.95	8.20	8.83	9.22	9.77	10.25	11.36	11.98

The reduction in the pace of expenditure, relative to GDP growth, has been achieved by the slower growth of Non-Plan expenditure. As shown in Table PF4, there has been a gradual decline in the ratio of Non-Plan expenditure to GDP in the period starting from 1997-98. The Plan expenditure has increased, suggesting that there been some attempt to target resources towards developmental programmes. A closer look at some of the expenditure categories shows that the decline in Non-Plan expenditure has been contributed mainly by interest payments. The financial sector reforms that led to a decline in interest rates also helped bring down the interest payment burden to the government and helped in focussing spending on other developmental needs. Expenditure on direct subsidies has been more difficult to

bring down although there is an attempt in the current year's budget to reduce the subsidies in terms of their share in Total Expenditure.

Budget 2007 has noted the need for revival of the agricultural sector, rural development, expansion of infrastructure services, employment guarantee and the need for investments to meet the goal of higher and inclusive growth articulated in the Approach Paper for the 11th Plan. The trends seen so far in terms of slower growth of Non-Plan expenditure and attempts to raise Plan expenditures are in the desired direction. However, understanding whether resources are channeled to the sectors such that overall productivity in the economy is enhanced or where the need for welfare support is the greatest would require detailed analysis.

**Table PF .4: Trends in Central Government Expenditures: Selected Items**

Selected Expenditure Items	Averages of Annual Ratios			2006-07	2007-08
	1997-98 to 1999- 00	2000-01 to 2002- 03	2003-04 to 2005- 06	RE	BE
<b>Ratio to GDP %</b>					
Interest Payments	4.48	4.74	4.07	3.55	3.48
Subsidies	1.28	1.47	1.44	1.30	1.19
Defense	2.35	2.34	2.30	2.09	2.10
Plan expenditure	3.88	4.30	4.23	4.20	4.48
Non-Plan expenditure	11.67	11.76	11.52	9.93	9.52
Total expenditure	15.56	16.07	15.75	14.13	14.00
<b>Share in expenditure %</b>					
Interest Payments	28.82	29.56	25.80	25.13	24.82
Subsidies	8.22	9.13	9.13	9.19	8.48
Defense	15.09	14.56	14.68	14.79	15.00
Plan expenditure	24.98	26.76	26.93	29.70	32.02
Non-Plan expenditure	75.02	73.24	73.07	70.30	67.98

Note: The amount of Rs 40,000 crore towards acquisition of SBI shares from RBI are not included in Non-Plan expenditure and Total Expenditure in 2007-08 BE figures.