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## **Fiscal deficit and its rising trends in India**

**Abhishek**

Research Scholar, University School of Management Studies (USMS), Guru Gobind Singh Indraprastha University (GGSIPU), Delhi, India

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### **Abstract**

A fiscal deficit occurs when a government's total expenditures exceed the revenue that it generates, excluding money from borrowings. Deficit differs from debt, which is an accumulation of yearly deficits. Government borrows this amount to finance their budget shortfalls.

This study is focused on the major changes in the India's fiscal policy, reasons of rising deficit in the Indian economy, deficit in pre-1991 era, changes after adopting New Economic Policy (Liberalization, Privatization and Globalization), Fiscal Responsibility and Budget Management (FRBM) to restore fiscal discipline, strategies to return a path of fiscal consolidation.

The study found that in fiscal policy was redefined after 1991 policy, after 1980- 81 was a critical phase due to which new economic reforms was to be adopted and economy was restructured. In 2003 FRBM Act was passed to reduce the fiscal deficit as a percentage of GDP leading to a more efficient economy.

**Keywords:** fiscal deficit, primary deficit, monetized deficit, revenue deficit, FRBM Act

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### **Introduction**

Fiscal deficit is commonly used in place of budgetary deficit in the government budget. It is used by economists, analysts, researchers and institutions as a yardstick to evaluate the soundness of the economy as well as budget effectiveness. India's government mostly failed to achieve the target of reducing the fiscal deficit.

Fiscal deficit shows the lapses and the imbalances in the budget and its allocation to different development and non-development expenditures. It simply means shortage of money i.e., the money borrowed by the government to meet the difference between budget revenue and budget deficit.

### **1. Definition, Concept and Measurement of Fiscal deficit**

When balance of the government's total receipts (i.e., revenue + capital receipts) and total expenditures (i.e., revenue + capital expenditures) turns out to be negative, it shows the situation of fiscal deficit. It refers to a financial situation wherein the government's total budget exceeds the total receipts excluding borrowings made during the fiscal year. It is an indication of the total borrowings needed by the government. While calculating the total revenue, borrowings are not included.

The situation of fiscal deficit indicates that the government spending beyond its means. Generally fiscal deficit takes place either due to revenue deficit or a major hike in capital expenditure. A deficit is usually financed through borrowing from either the central bank of the country or raising money from capital markets by issuing different instruments like treasury bills and bonds which increases debt obligations increases. Fiscal deficit is shown in the quantitative form (i.e., the total currency value of the deficit) or in the percentage form of the GDP for that particular year (percentage of GDP). In general, the percentage form is used for domestic or international (i.e., comparative economics) studies and analyses. India has been a country of not only regular but higher fiscal deficits.

### **2. Calculation of Fiscal Deficit**

The definition of fiscal deficit can better be understood by using mathematical equation. So, the formula for measurement of fiscal deficit is as follows:

$$\text{Fiscal Deficit} = \text{Total Expenditure} - \text{Total Receipts Other Than Borrowings}$$

By expanding the term Total Expenditure as Revenue Expenditure and Capital expenditure and Total Receipts as Revenue Receipts and Capital Receipts, above formula can be written as follows;

$$\text{Fiscal Deficit} = (\text{Revenue Expenditure} + \text{Capital expenditure}) - (\text{Revenue Receipts} + \text{Capital Receipts other than borrowings})$$

After rearranging the terms, it can be written as;

Fiscal Deficit = (Revenue Expenditure - Revenue Receipts) + (Capital expenditure – Recoveries of loans + other than borrowings)

### 3. Objectives of Paper

The objective of the study is to analyse the trends of deficit in Indian financial system in different phases i.e., pre-1991, after 1991-2003, after 2003-2018 and adoption of FRBM Act, 2003. We also study the major economic events in these phases relating to budgetary deficit and the financial crises of 2008 in the world.

### 4. Methodology

To study and analyse the trends of deficit in the Indian Economy including the fiscal deficit, primary deficit and revenue deficit. It is calculated as percentage of GDP by using time series data of Pre 1991 era to 2018. The trend's study is bifurcated in three phases i.e., pre-1991, 1991- 2003 and 2003-2018. Study also analyses the percentage of revenue receipt and revenue expenditure in total budget receipts and total budget expenditure to calculate the percentage of capital receipts and capital expenditure.

### Trends of Fiscal Deficit in India

To understand the trends in a better way we have divided the trends into three parts: Era of Pre-Liberalization, Post Liberalization and till FRBM Act (1990-91 to 2002-03) and Post FRBM Act, 2003 till 2017-18.

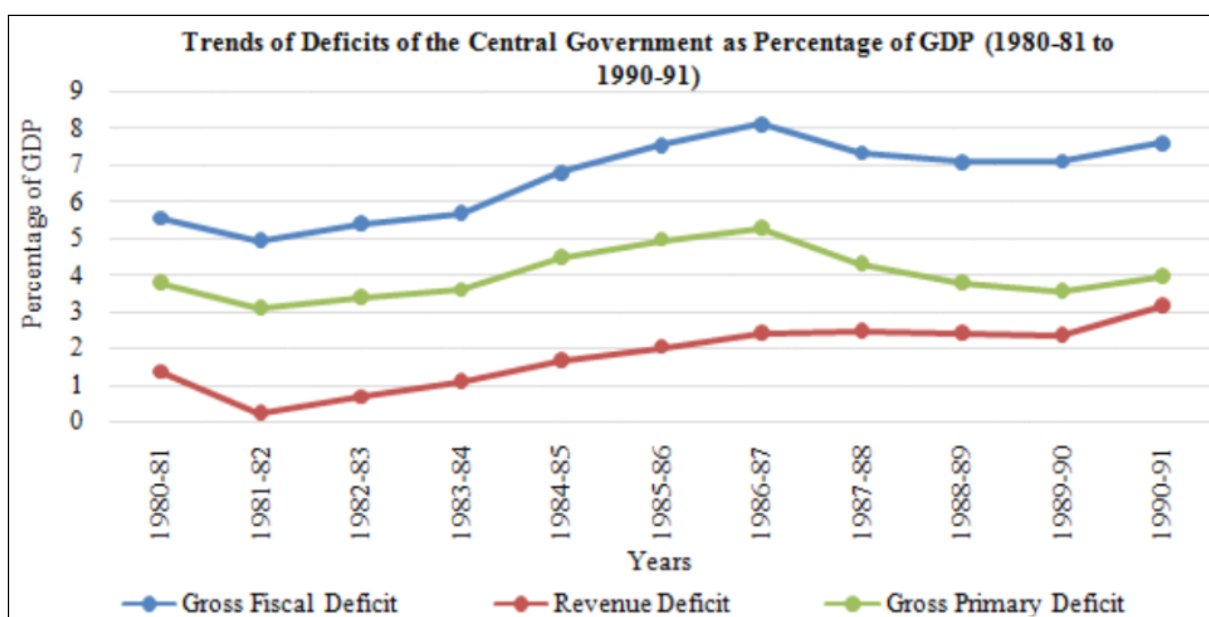
#### 1. Era of Pre-Liberalization

The phase of 1947- 1970 had no concept of fiscal deficit as these were shown as Budgetary Deficits. The phase of 1970-1991 is considered as the period of deficit financing follow up of unsound fundamentals of economics and finally culminating in severe financial crises by 1990-1991.

**Table 1:** Deficits of the Central Government as Percentage of GDP (1980-81 to 1990-91)

Years	Gross Fiscal Deficit	Revenue Deficit	Gross Primary Deficit
1980-81	5.55	1.36	3.81
1981-82	4.93	0.22	3.11
1982-83	5.4	0.67	3.4
1983-84	5.69	1.11	3.6
1984-85	6.79	1.65	4.46
1985-86	7.55	2.03	4.96
1986-87	8.13	2.4	5.28
1987-88	7.34	2.48	4.29
1988-89	7.08	2.41	3.81
1989-90	7.1	2.37	3.56
1990-91	7.61	3.17	3.95

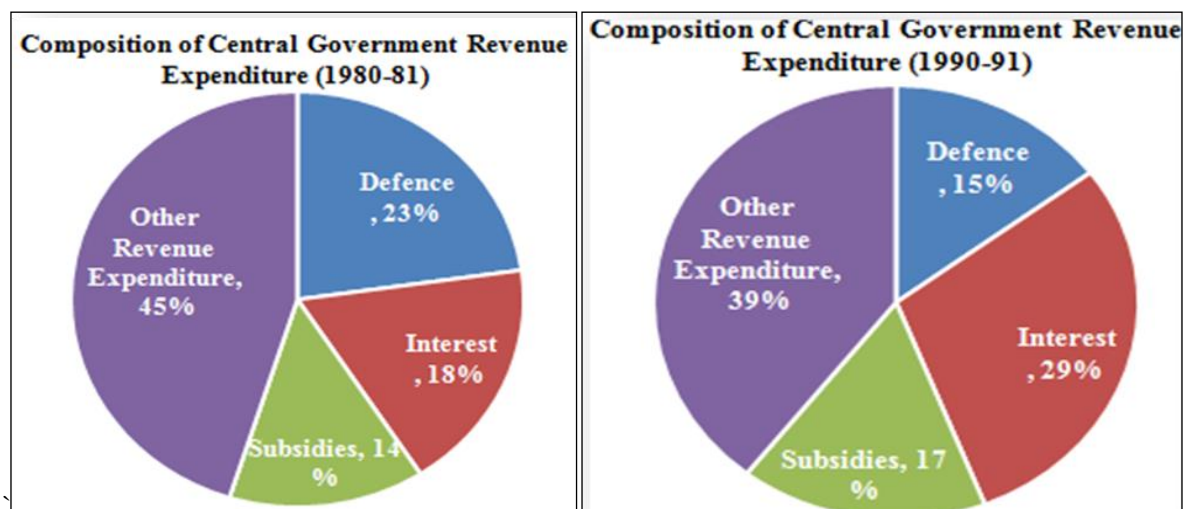
Source: Select Fiscal Indicators of the Central Government, (As percentage of GDP), Handbook of Statistics on Indian Economy 2014-15, Reserve Bank of India.



Source: Author's Calculations based on Table 1.

**Fig 1**

Table 1& Figure 1 shows that from the period 1980-81 to 1990-91, the fiscal deficit of the Central Government rose sharply from 5.55% of GDP in 1980-81 to 8.13% in 1986-87 and stood at 7.61% of GDP in 1990-91. This period witnessed rapid deterioration of the fiscal balances largely attributable to unchecked growth of non-planned revenue expenditure particularly on interest payments and subsidies rose sharply during 1980s. With respect to the revenue deficit, as interest payments and subsidies rose sharply during 1980s. With respect to the revenue deficit, as the higher interest payments led revenue deficit as percentage of GDP to increase from 1.36% in 1980-81 to 2.48% in 1987-88 to and to 3.17% in 1990-91.



Source: Author's Calculation by using database from Table A-1.

Fig 2

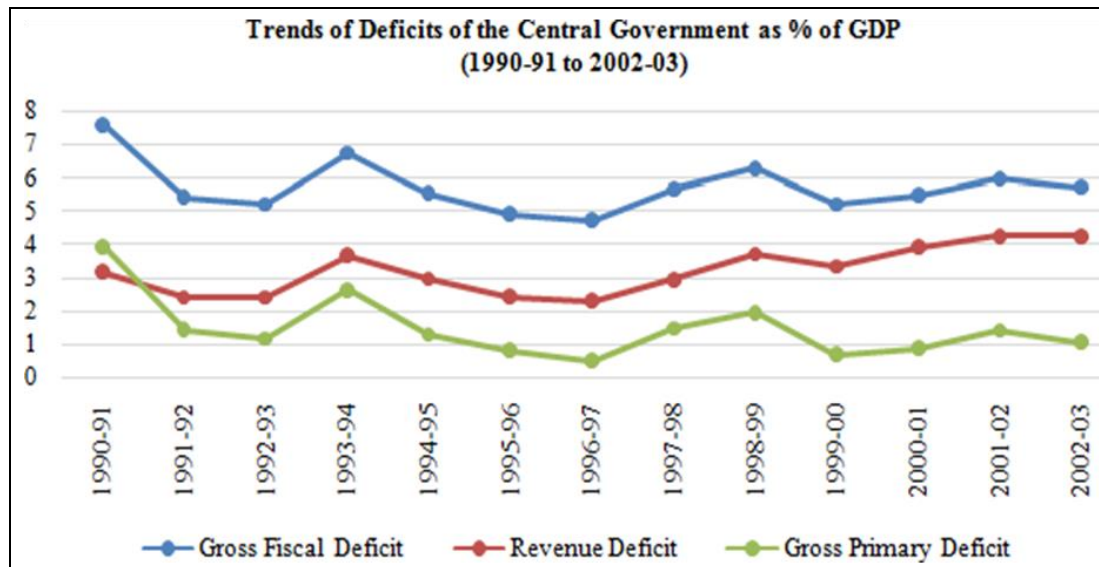
## 2. 1990-91 till FRBM Act, 2002-03

This started with the initiation of the economic reforms process under the conditionalities put forth by the IMF (controlling fiscal deficit was one amongst them). As the economy moved from government dominance to market dominance, things needed a restructuring and public finance also needed a touch of rationality. Thus, the rigorous process of fiscal reforms aiming at fiscal consolidation started in India.

Table 2: Deficits of the Central Government as Percentage of GDP (1990-91 to 2002-03)

Years	Gross Fiscal Deficit	Revenue Deficit	Gross Primary Deficit
1990-91	7.61	3.17	3.95
1991-92	5.39	2.41	1.44
1992-93	5.19	2.4	1.17
1993-94	6.76	3.67	2.64
1994-95	5.52	2.97	1.3
1995-96	4.91	2.42	0.83
1996-97	4.7	2.3	0.51
1997-98	5.66	2.95	1.48
1998-99	6.29	3.71	1.97
1999-00	5.18	3.34	0.72
2000-01	5.46	3.91	0.9
2001-02	5.98	4.25	1.42
2002-03	5.72	4.25	1.08

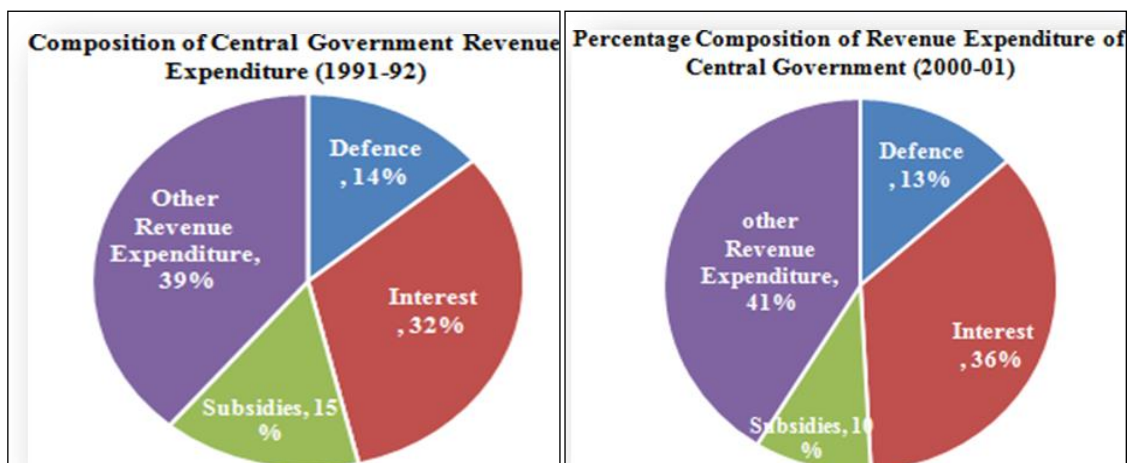
Source: Select Fiscal Indicators of the Central Government, (As percentage of GDP), Handbook of Statistics on Indian Economy 2014-15, Reserve Bank of India.



Source: Author’s Compilation based on Table 2

Fig 2

As seen, from the high 7% in the latter end of 1980s the fiscal deficit measure reduced to 5.4% in 1991- 92 and the downward trend continued up to 1996-97 when the fiscal deficit stood at 4.7% of GDP. Since 1997- 98, fiscal deficit had again started increasing. It stood at 5.5% in 2000-01. The period from 1996-97 to 2002-03 was characterized by large rise in public debt involving large interest payments year on year which led to the diversion of resources from investment to debt servicing. The Government introduced Fiscal Responsibility and Budget Management (FRBM) Act, 2003 to check the deteriorating fiscal situations.



Source: Author’s Calculation by using database from Table A-1

Fig 3

**3. FRBM Act, 2003 till 2017-18**

Fiscal Responsibility and Budget Management (FRBM) bill introduced in Parliament in December 2000 in order to restore fiscal discipline. The Fiscal Responsibility and Budget Management (FRBM) Act, 2003, was brought into force on July 5, 2000. The macroeconomics environment has been under stress since 2008-09 when the global economic and financial crisis unfolded, necessitating rapid calibration of policies. Fiscal Expansion that followed in 2008-09 and 2009-10 did yield macroeconomic dividend in the form of a sharp recovery in 2009-10. Outlining the roadmap for fiscal consolidation, Finance Minister, Arun Jaitley said, “For the year 2015-16 government would meet the fiscal deficit of 3.9 % of gross domestic product, and reduce it further of 3.5 % in the next year 2016-17”.

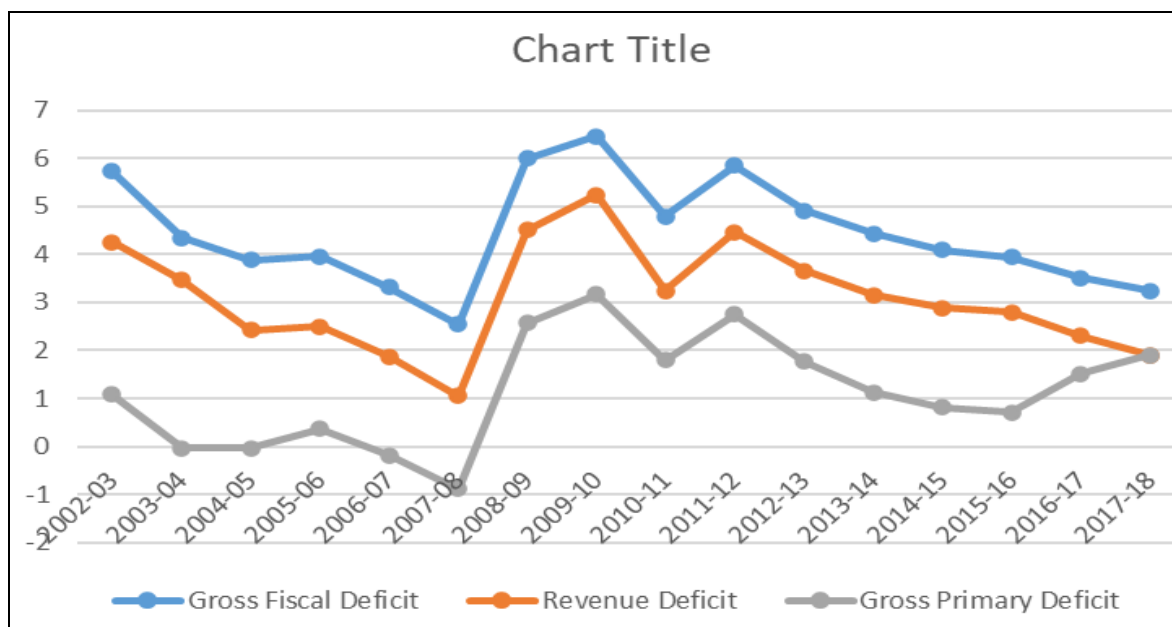
**Table 3:** Deficits of the Central Government as Percentage of GDP (2002-03 to 2017-18)

Year	Gross Fiscal Deficit	Revenue Deficit	Gross Primary Deficit
2002-03	5.72	4.25	1.08
2003-04	4.34	3.46	-0.03
2004-05	3.88	2.42	-0.04
2005-06	3.96	2.5	0.37

2006-07	3.32	1.87	-0.18
2007-08	2.54	1.05	-0.88
2008-09	5.99	4.5	2.57
2009-10	6.46	5.23	3.17
2010-11	4.79	3.24	1.79
2011-12	5.84	4.46	2.75
2012-13	4.91	3.65	1.77
2013-14	4.43	3.15	1.13
2014-15	4.09	2.89	0.81
2015-16	3.94	2.8	0.71
2016-17	3.51	2.3	1.52
2017-18	3.24	1.9	1.90

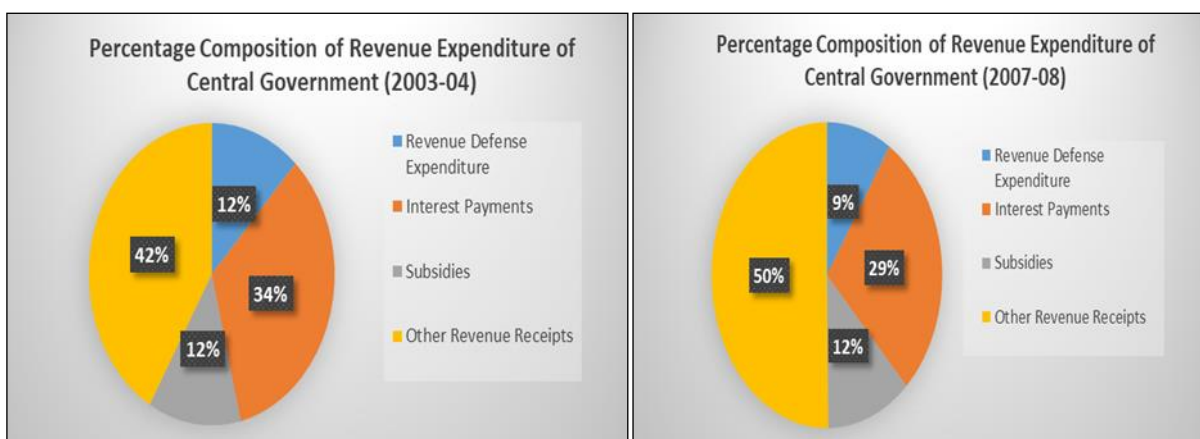
**Source:** Select Fiscal Indicators of the Central Government, (As percentage of GDP), Handbook of Statistics on Indian Economy 2017-18, Reserve Bank of India.

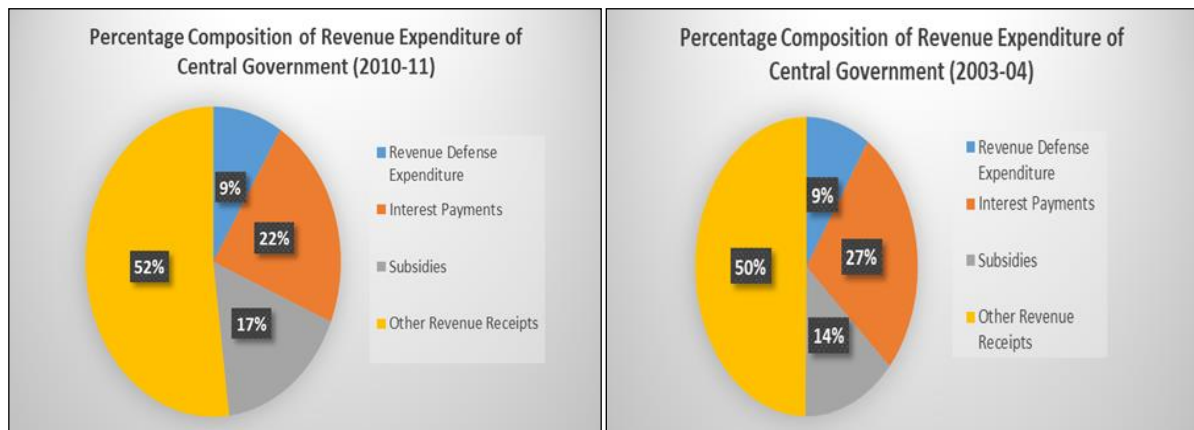
As Table 3 & Figure depicted that during 2003-04, fiscal deficit was 4.34%, which declined to 3.32% and 2.54% in 2006-07 and 2007-08 respectively. Consequently, the revenue deficit also declined 3.46% in 2003-04 to 1.05% in 2007-08. The primary deficit remained negative over the same period. The fiscal consolidation objectives of bringing down the share of interest expenses in the revenue expenditure did achieve the desired results, with interest outlay as share of the revenue expenditure reducing from 34% in 2003-04 to 29% in 2007-08 and further to 22% in 2010-11.



Source: Author’s Calculation based on Table 3.

**Fig 4**





Source: Authors' Calculation by using database from Table A-1.

**Fig 5**

**Table A-1: Revenue Expenditure of Central Government (190-81 to 2017-18)**

(Rs. Billion)

Year	Revenue Defense Expenditure	Interest Payments	Subsidies	Other Revenue Receipts	Revenue Expenditure
1980-81	32.78	26.04	20.28	65.00	144.10
1981-82	38.44	31.95	19.41	64.28	154.08
1982-83	44.94	39.38	22.62	80.48	187.42
1983-84	51.89	47.95	29.02	93.65	222.51
1984-85	63.24	59.74	40.38	113.55	276.91
1985-86	70.21	75.12	47.96	145.95	339.24
1986-87	91.79	92.46	54.51	169.84	408.60
1987-88	88.61	112.51	59.80	200.82	461.74
1988-89	95.58	142.78	77.32	225.38	541.06
1989-90	101.94	177.57	104.74	257.85	642.10
1990-91	108.74	214.98	121.58	289.86	735.16
1991-92	114.42	265.96	122.53	320.01	822.92
1992-93	121.09	310.75	108.24	386.94	927.02
1993-94	149.78	367.41	116.05	448.45	1081.69
1994-95	164.26	440.60	118.54	497.72	1221.12
1995-96	188.41	500.45	126.66	583.09	1398.61
1996-97	209.97	594.78	154.99	629.59	1589.33
1997-98	261.74	656.37	185.40	699.84	1803.35
1998-99	298.61	778.82	235.93	851.25	2164.61
1999-00	352.16	902.49	244.87	991.26	2490.78
2000-01	372.38	993.14	268.38	1144.49	2778.39
2001-02	380.59	1074.60	312.10	1247.39	3014.68
2002-03	407.09	1178.04	435.33	1366.67	3387.13
2003-04	432.03	1240.88	443.23	1504.60	3620.74
2004-05	438.62	1269.34	459.57	1675.76	3843.29
2005-06	482.11	1326.30	475.22	2110.13	4393.76
2006-07	516.82	1502.72	571.25	2555.30	5146.09
2007-08	542.19	1710.30	709.26	2982.58	5944.33
2008-09	733.05	1922.04	1297.08	3985.81	7937.98
2009-10	906.69	2130.93	1413.51	4666.96	9118.09
2010-11	920.61	2340.22	1734.20	5412.20	10407.23
2011-12	1030.11	2731.50	2179.41	5516.83	11457.85
2012-13	1112.77	3131.70	2570.79	5619.88	12435.14
2013-14	1243.74	3742.54	2546.32	6185.12	13717.72
2014-15	1368.07	4024.44	2582.58	6694.83	14669.92
2015-16	1459.37	4416.59	2641.06	6860.60	15377.61
2016-17	1654.10	4807.14	2348.09	8096.51	16905.84
2017-18	1806.08	5308.43	2641.25	9687.28	19443.05

Source: Major Heads of expenditure of the Central government, Handbook of Statistics on Indian Economy 2017-18, Reserve Bank of India.

### Findings

While India is considered a mixed economy, until 1990-1991 the balance of the economic structure was tilted more towards socialism. The vision of the policy makers had that post-independence the country needed significant expenditure into key long-term industries and projects which the private sector may not undertake as these initiatives had long gestation period. As a result of a protectionist approach most of the capital expenditure was being funded by the government sector and its funding for these put a lot of burden on the government to continue incurring capital expenditure and thereby running high level of deficit.

By 1990-91s the Indian economy was quite weak, it was burdened with heavy debt rising interest cost and deficits. India traditionally had a current account deficit with significant portion of the imports being that of oil and petroleum products. The weak economic situation further worsened with the Gulf-war which led to rise in oil prices coupled with drying up of credit lines and investors pulling out money. The country's foreign exchange reserves had depleted significantly and the level of reserves was only sufficient to finance imports of another three weeks.

The measure proposed above to meet the crises are often referred to as the New Economic Policy of 1991. These measures could broadly be classified under three heads *viz.* liberalization, privatization & globalization. Under liberalization many industries were freed from the licensing requirement, the investment limit in small scale industries was enhanced, free determination of interest rates by commercial banks and abolition of restrictive trade practices. With privatization, the government invited the private sector to own and manage part of Public Sector Enterprises. And, among the measures for globalization included reducing tariffs, partial convertibility of the currency and increasing limits of foreign investment in India.

The government introduced Fiscal Responsibility and Budget Management (FRBM) Act, 2003 to check the deteriorating fiscal situations. FRBM Act gave medium term targets for balancing current revenues and expenditures and set overall limits to the fiscal deficit at 3% of GDP to be achieved according to a phased deficit reduction roadmap. The FRBM Act enhanced budgetary transparency by requiring the government to place before the Parliament on an annual basis reports related to its economic assessments, taxation and expenditures strategy and three-year rolling targets for the revenue and fiscal balance. It also required quarterly progress reviews to be placed in the Parliament.

### Conclusion

In India the concept of fiscal deficit was first introduced in 1991 and was first introduced in 1991 and was defined as the sum of revenue deficit, capital expenditure less recovery of loans and other receipts. Since then, fiscal deficit has been a closely tracked parameter to measure the health of the Indian Economy. This study traced the major changes in the India's fiscal policy since 1980-81 through the country's balance of payment crisis of 1991, the post economic liberalization and high growth period, in introduction of FRBM Act in 2003, adjustment to the global financial crisis of 2008 and the recent post-crisis changes to return to a path of fiscal consolidation. Post 1991 period had private sector share the burden of long-term development and contribute to capital receipts in the form of disinvestment. This coupled with tax reforms had the fiscal deficit in control until 1996-97. Later, the Asian crisis of 1996-97 led it to move higher and fiscal deficit reached unjustified levels by 2003. As a pragmatic solution to the problem FRBM Act of 2003 was introduced which set out a phased reduction roadmap, this put the Indian economy on the right track however was faced with a hiccup in the form of 2008 global credit crisis.

Overall, during 1980-81 to 2002-03 it was seen that the periods of crisis led to the burgeoning of the deficit to unsustainable levels and promoted the government to introduce and adopt economic reforms to ensure that the deficit stood at more reasonable levels. However, since 2003-04 the government has been more proactive and has undertaken fiscal policy reforms to ensure a steady reduction in fiscal deficit as a percentage of GDP leading to a more resilient economy.

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