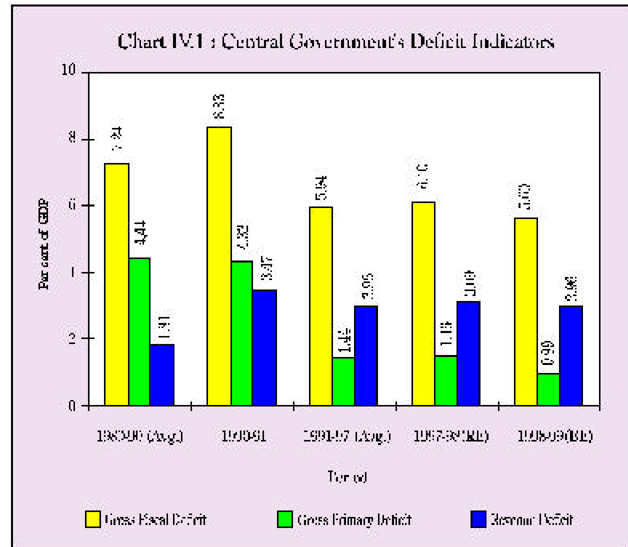
IV

GOVERNMENT FINANCES

CENTRAL GOVERNMENT FINANCES[1]

Central Government Finances : 1997-98

4.1 The central government finances witnessed severe strains in 1997-98 particularly in the latter part, mainly attributable to the sharp shortfall in revenue receipts. During 1997-98, the major indicators of deficit showed a substantial increase over the budget estimates as well as their levels in the previous year. The gross fiscal deficit (GFD) at Rs.86,345 crore in the revised estimates for 1997-98, exceeded the budget estimates by nearly one-third and constituted 6.1 per cent of gross domestic product (GDP) as against 4.5 per cent envisaged in the budget and 5.2 per cent in 1996-97. The revenue deficit at Rs.43,686 crore in the revised estimates, exceeded the budget estimates by nearly 45 per cent and constituted 3.1 per cent of GDP as compared with 2.6 per cent in 1996-97. The projected gross primary surplus of Rs.2,546 crore (0.2 per cent of GDP) in the budget estimates turned into a deficit of Rs.20,645 crore (1.5 per cent of GDP) in the revised estimates (Appendix Table IV.1 and Chart IV.1).



4.2 The fiscal stress witnessed in 1997-98 was also mirrored in a substantial increase in the monetised deficit to Rs.12,914 crore (0.9 per cent of GDP) from Rs.1,934 crore (0.2 per cent of GDP) in 1996-97. There were, however, sharp fluctuations in the level of monetised deficit during the year (Table 4.1). The monetised deficit-GFD ratio increased to 15.0 per cent in 1997-98 from 2.9 per cent in 1996-97 and 11 per cent, on an average, during the six years from 1991-92 through 1996-97 (Appendix Table IV.2).

4.3 As per the supplemental agreement between the Reserve Bank and the Government of India, with effect from April 1, 1997, issuance of *ad hoc* Treasury bills was discontinued and a system of Ways and Means Advances (WMA) was introduced to meet the temporary mismatches in receipts and expenditures of the Union Government. For the fiscal year 1997-98, the WMA limit was fixed at Rs.12,000 crore for the first half (April-September) and at Rs.8,000 crore for the second half (October-March). During the major part of the fiscal year, the Centre did not resort to WMA as a result of strong money market support to the Government's borrowing programme. The Centre had availed of WMA in the initial weeks and in the last quarter of the fiscal year and the amounts availed were well within the stipulated limits. The average utilisation of WMA for the year was Rs. 514 crore and the outstanding WMA was placed at Rs.2,000 crore at end-March 1998.

4.4 The fiscal slippage during 1997-98 occurred partly due to non-realisation of envisaged disinvestment proceeds (Rs.906 crore as against Rs.4,800 crore budgeted) and mostly as a result of substantial shortfall in tax collections. Gross tax receipts (inclusive of receipts from Voluntary Disclosure of Income Scheme (VDIS)) at Rs.1,42,720 crore, were lower by Rs.10,927 crore (7.1 per cent) than the budget estimates. The ratio of Centre's

1. Unless otherwise stated, all data are taken from budget documents.

Table 4.1 : Loans and Advances and Net RBI Credit to the Centre @

(Rupees crore)

Fiscal Year	Loans and Advances		Net RBI Credit		
	1998-99	1997-98	1998-99	1997-98	1996-97
1	2	3	4	5	6
First Quarter (April-June)	7,411	785	6,121	5,165	13,551
Second Quarter (July-September)	4,191 #	0	15,266 #	-3,088	11,030
Third Quarter (October-December)		0		-826	6,913
Fourth Quarter (January-March)		1,022		7,495	3,275
End-March		2,000		12,914	1,934
Fiscal Year Average $		514		2,585	8,328

@ As per RBI Records.

Up to August 14, 1998.

$ Average of all fortnightly reporting Friday figures of Loans and Advances and the end-March figures after the closure of Government accounts.

gross tax revenue to GDP, as a result, remained more or less unchanged at the previous year's level of around 10 per cent but was lower than that of 11.2 per cent, on an average, during the latter half of the eighties (Appendix Table IV.3). While the ratio of direct taxes to GDP stood at 3.6 per cent in 1997-98, the indirect tax-GDP ratio worked out to 6.5 per cent. Among the major taxes, custom duties and excise duties showed maximum shortfall from the budget estimates. While customs revenue was lower by Rs.11,550 crore (22.0 per cent) due to deceleration in imports, Union excise duties fell short of budget estimates by Rs.4,500 crore (8.6 per cent) mainly due to sluggish industrial growth. Collections from income tax (excluding VDIS collections) were lower by Rs.3,000 crore (13.8 per cent), whereas the shortfall in the case of corporation tax was Rs.500 crore (2.3 per cent). The net VDIS collections accruing to the Centre amounted to Rs.2,456 crore, while Rs.7,594 crore was transferred to the state governments. Net tax receipts of the Centre, *i.e.,* after adjusting for states' share in Central taxes and VDIS collection, at Rs.99,158 crore during 1997-98, were lower by 12.6 per cent (Rs.14,235 crore) than the budget estimates. Non-tax receipts at Rs.39,365 crore showed a relatively marginal shortfall of Rs.393 crore (1.0 per cent).

4.5 The pressure on resources resulted in an upward revision of net market borrowings to Rs.42,484 crore, from Rs.33,820 crore envisaged in the budget. As a consequence, the share of net market borrowings in GFD increased sharply to 49.2 per cent in 1997-98 from 30 per cent in the previous year (Appendix Table IV.4). Under 'other liabilities', small savings increased by over 80 per cent to Rs.25,478 crore in the revised estimates. However, three-fourths of the small savings collections are passed on to the state governments in the form of loans. If the increase in expenditure due to such loans is excluded, the GFD would have been placed at 5.8 per cent of GDP in the revised estimates for 1997-98, instead of the 6.1 per cent.

4.6 Notwithstanding the marginal increase of 1.3 per cent in aggregate expenditure in 1997-98 over the budget estimates, qualitatively some deterioration in the pattern of expenditure was evident. First, the higher capital expenditure notwithstanding, the increase in aggregate expenditure was mainly a reflection of the sharp increase (Rs.4,432 crore) in loans to states against small savings which grew in tandem with higher gross collections; excluding such loans, however, capital expenditure showed a decline from the budgeted level. Secondly, the ratio of capital expenditure to GDP increased to 3.8 per cent in 1997-98 from

3.3 per cent in the previous year but was significantly lower than 6.8 per cent in the late 1980s. Thirdly, revenue expenditure showed a marginal decline of Rs.1,208 crore in the revised estimates, notwithstanding the higher outgo in respect of subsidies and additional expenditure on account of implementation of the Fifth Pay Commission awards. The reduction in revenue expenditure was largely brought about by a decline of Rs.2,300 crore in interest payments and a cut back of Rs.2,252 crore in budgetary support to the Central Plan, particularly in respect of heads such as education, social security and welfare and rural development. The decline in budgetary support was exacerbated by a substantial shortfall of Rs.8,305 crore in the internal and extra budgetary resources (IEBR) of the public sector enterprises. As a result, the Annual Plan outlay of the Central Government for 1997-98 was scaled down by 11.8 per cent from the budgeted level. On the other hand, non-Plan expenditures such as interest payments and subsidies remained at around 4.6 per cent and 1.3 per cent of GDP, respectively.

4.7 Apart from the increase in overall borrowing requirements, a disquieting feature of the year was the rise in the revenue deficit to 3.1 per cent of GDP, which was higher than the level prevailing in the late 1980s. In fact, the revenue deficit would have been much higher were it not for the contra adjustment of Rs.12,984 crore reflecting expenditures in respect of securities issued to oil companies. While the immediate cause of the widening of the revenue deficit during 1997-98 was the shortfall in tax collections, the high levels of interest payments and subsidies and the large wage bill have continued to be impediments to fiscal correction. The rigidity of revenue expenditures at around 12-13 per cent of GDP since the initiation of reforms, with capital expenditure (particularly outlays on infrastructure) hovering between 3-4 per cent of GDP as well as the static levels of tax revenues signify the urgent need for a qualitative improvement in the process of fiscal consolidation.

Central Government Budget : 1998-99[2]

4.8 An interim Budget was presented on March 25, 1998 to enable the Government to carry on its business and meet essential expenditure during the first four months of fiscal 1998-99. This was followed by the regular budget presented on June 1, 1998. Thus, the regular budget has left the government with a shorter time-frame of 9 months instead of the usual 12 months for effecting policy measures proposed in the budget.

4.9 Economic growth and macroeconomic stability are the key objectives of the Union Budget for 1998-99. For accelerating growth, the budget has envisaged a sharp increase in Plan outlay. While effecting steep hike in outlays for developmental purposes, the budget has made an attempt to reverse the sharp deterioration in fiscal situation in 1997-98. The budget envisages to bring down the ratio of fiscal deficit to GDP from 6.1 per cent in 1997-98 to 5.6 per cent through additional resource mobilisation and improved expenditure management. The revenue deficit as ratio of GDP is projected to come down marginally from 3.1 per cent in 1997-98 to 3.0 per cent in 1998-99. The ratio of gross primary deficit to GDP is budgeted to decline from 1.5 per cent in 1997-98 to 1.0 per cent in 1998-99 (Appendix Table IV.1).

4.10 Expenditure management constitutes a crucial element in the process of fiscal consolidation. The distortions in the existing expenditure classification are sought to be eliminated by the initiatives that the budget has envisaged. The distinction between Plan and non-Plan expenditure, with excessive focus on the Plan component has gradually neglected maintenance expenditures which are conventionally classified under non-Plan, leading to severe imbalances in resource allocation. With a view to addressing this issue, the budget has proposed to constitute a Task Force to examine these issues in a comprehensive manner and to make recommendations for a functionally viable and more focussed presentation of government expenditure in the budget.

4.11 The achievement under the programme of disinvestment of government holdings in PSUs has been much below the targets during the last two years. However, the restructuring of public sector undertakings has received particular recognition in the budget as it endeavours to strengthen the process of disinvestment, privatisation and reforms of PSUs. The budget has specified the portion of

2. This analysis is based on the regular Union Budget for 1998-99.

equity of select major PSUs which would be divested in a given time frame. Further, the government has indicated that unviable PSUs could be closed down. The government has proposed a safety net to the workers of enterprises destined for closure by providing incentives for voluntary retirement. A separate Restructuring Fund is proposed to be constituted for this purpose. In due course, the government shareholding in public sector enterprises is slated to be brought down to 26 per cent, except in cases of public sector enterprises involving strategic considerations. The role of the State is thus sought to be reduced in many production activities. In the process, the State would take on the role of being a facilitator of economic development and a regulator of activities.

4.12 The tax measures announced in the budget endeavour to provide continuity and further boost to the reform process. The budget aims at raising the tax–GDP ratio mainly through broadening the tax base, reducing tax related distortions and improving tax compliance. The basic philosophy of the tax proposals put forward in the budget is that long-term stability in tax structure would lead to increased productivity, voluntary compliance and tax base widening. In the sphere of direct taxes, the rate structures for individual and corporate taxes have been kept unchanged. The budget has proposed an enhancement of the tax exemption limit from Rs.40,000 to Rs.50,000 and raised the standard deduction from Rs.20,000 to Rs.25,000 for salary earners with annual income upto Rs.1 lakh. However, incomes above Rs.5 lakh have been excluded from the benefit of the standard deduction. At the same time, emphasis has been placed on expanding the tax base and plugging loopholes to curb tax evasion. Measures initiated on this count include making obligatory for assessees to quote their PAN or GIR number in respect of certain high value transactions such as those involving immovable property, motor vehicles, shares in the capital market, fixed deposits and other bank-related activities, and hotel expenses. In order to simplify procedures and promote voluntary tax compliance, the budget has proposed to introduce a one-page tax return form called *Saral* for all non-corporate tax payers. In addition, a new tax scheme called *Samadhan* has been proposed in order to reduce litigation in respect of both direct and indirect taxes by offering waiver of interest, penalty and immunity from prosecution. Widening of tax base is sought to be strengthened by including more services such as those of architects, cost accountants, real estate agents, and credit rating agencies.

4.13 The budget also contained proposals to extend tax holiday to industrial undertakings in backward states/districts, house building activities and to extend infrastructure status to inland waterways and ports. On the indirect tax front, the budget intends to rectify some of the extant anomalies by reducing the divergence in rates. The budget also aims at introducing greater transparency through rationalisation of Union excise duties with a move towards a Central Value Added Tax (VAT) to be then merged with a generalised VAT. The proposed rate structure is to gradually ensure convergence towards a mean rate of 18 per cent *ad valorem*. In order to provide a level playing field to domestic industry the budget has imposed an additional non-modvatable levy of 8 per cent on imports which approximately equals the burden of local taxes on domestic producers, with exemptions for crude oil, newsprint and capital goods sector. The reforms in excise duty structure are also intended to broad base the Maximum Retail Price (MRP) based excise duty introduced in the previous year. After the presentation of the Union Budget, the Finance Minister partially rolled back some of the tax measures like hike in price of petrol, reduction in the rate of additional non-modvatable levy from 8 per cent to 4 per cent and exemption of some commodities from the increase in the excise duties. The Finance Minister, while replying to the debate on the Finance Bill, announced some more concessions in excise duties and customs duties which are expected to result in revenue loss of Rs.192 crore and Rs.71 crore in a year, respectively. It is expected that the loss of revenue would be made good by buoyancy in tax revenue.

4.14 The budget has underscored the importance of a sound federal fiscal set-up and policy steps are initiated to further strengthen Centre-State financial relations. The government is examining the recommendations of the Special Task Force on Devolution of Powers to States (Chairman: Shri Bhairon Singh Shekhawat) in consultation with the Reserve Bank on measures for devolution of

additional financial powers to the states and additional or alternative means by which states can raise more resources. Furthermore, the government has ratified the scheme of sharing of Centre's tax revenues with states as recommended by the Tenth Finance Commission. The government proposes to introduce a Constitution Amendment Bill shortly, to give effect to the alternative scheme subject to a modification that the percentage of states' share in the gross proceeds of Central taxes may be reviewed by successive Finance Commissions instead of freezing it for fifteen years as suggested by the Tenth Finance Commission.

4.15 For the year 1998-99, the limit for WMA to the Centre has been set at Rs.11,000 crore for the first half (April-September) and Rs.7,000 crore for the second half (October-March).

4.16 The fiscal restoration envisaged in the budget would be attempted through larger resource mobilisation from tax sources and from disinvestment as also through moderation of expenditure. The budget projects a growth of 17.0 per cent in revenue receipts and a relatively low growth of 13.9 per cent in aggregate expenditure. Tax receipts would contribute 75.4 per cent (Rs.17,699 crore) of the increase in revenue receipts. The budget has estimated gross tax receipts at Rs.1,57,711 crore during 1998-99, which would represent a rise of 10.5 per cent as compared with 10.8 per cent in the previous year. The additional resources to be mobilised through taxation measures are estimated at Rs.9,205 crore. Of this, the states' share would be Rs.1,780 crore while the balance of Rs.7,425 crore would accrue to the Centre. In spite of the substantial tax efforts, gross tax-GDP ratio is expected to decline to 9.7 per cent from 10.1 per cent in 1997-98. Non-tax revenue is budgeted to increase by 14.7 per cent (Rs.5,781 crore) as compared with 20.8 per cent in the previous year. Surplus profits of the Reserve Bank transferred to government are estimated at Rs.4,200 crore in 1998-99 as against Rs.2,500 crore in 1997-98, facilitated as it is by the reduction in the contribution for exchange loss on FCNR Account. Disinvestment proceeds are estimated at Rs.5,000 crore (as against Rs.906 crore for 1997-98).

4.17 Net market borrowings (comprising normal, short term, medium and long term borrowings) budgeted at Rs.48,326 crore would be higher by Rs.5,842 crore (13.8 per cent) than the previous year. There would be a compositional shift in the financing of GFD, in favour of market borrowings. Market borrowings are estimated to finance 53.1 per cent of the GFD (49.2 per cent in 1997-98), while the shares of other liabilities would be 44.3 per cent (46.7 per cent) and that of external loans 2.6 per cent (1.4 per cent).

4.18 The budget estimates a lower growth of 13.9 per cent in expenditure as against 17.0 per cent in 1997-98. With the moderation in expenditure, the expenditure-GDP ratio would decline, *albeit* marginally, to 16.5 per cent in 1998-99 from 16.6 per cent in 1997-98. However, the pattern of expenditure indicates that of the total budgeted increase in expenditure (Rs.32,682 crore), 85.3 per cent would be under revenue expenditure, and the remaining 14.7 per cent (Rs.4,820 crore) under capital expenditure. The increase in non-Plan expenditure constitutes 72.6 per cent of the rise in revenue expenditure and is mainly due to increased provisions under interest payments (Rs.9,300 crore), subsidies (Rs.2,381 crore), defence (Rs.4,038 crore) and non-Plan grants to states and union territories (Rs.2,128 crore). The share of Plan expenditure in the aggregate expenditure is, however, estimated to increase to 26.9 per cent in 1998-99 from 25.8 per cent in 1997-98. The Central Plan Outlay for 1998-99 has been budgeted higher at Rs.1,05,187 crore, representing an increase of Rs.24,154 crore (29.8 per cent) over the revised estimates for 1997-98. On the financing side, budgetary support to the Central Plan is estimated to rise by Rs.8,835 crore (26.3 per cent) to Rs.42,464 crore while the internal and extra budgetary resources (IEBR) of public sector enterprises are projected to rise by Rs.15,319 crore (32.3 per cent) to Rs.62,723 crore in 1998-99.

4.19 The Union Government has committed to implement the new devolution scheme for sharing resources between the Centre and states as suggested by the Tenth Finance Commission with some modifications. The implementation of the new devolution scheme is expected to provide more resources to the states, which would cause a stress on Centre's resources. The Union budget has not made any provision for additional amount on account of implementation of alternative scheme of devolution. Gross transfer of resources from the Centre to the state and union territory governments, comprising shareable tax

revenue, grants, and loans is estimated at Rs.98,194 crore in 1998-99 which shows a modest rise of 2.2 per cent over Rs.96,054 crore in 1997-98 (16.2 per cent). For the previous year, states had received additional resources of Rs.7,594 crore as their share in the VDIS collection. Moreover, during the current year, the collections of small savings are estimated to be lower and as a result, non-Plan loans to states are budgeted to be lower by Rs.1,524 crore. Given the change in the fiscal stance entailing more vertical resource transfers in the event of the implementation of the new devolution scheme from Centre to states, efforts would be required to further step up revenue mobilisation by the Centre to keep the fiscal deficit under reasonable limits.

4.20 The emerging trend in the finances of the Union Government indicates that the pressure on the fiscal system would persist with the ratio of revenue deficit to gross fiscal deficit rising from 50.6 in 1997-98 to 52.8 in 1998-99. The gross market borrowing during 1998-99 is budgeted at Rs.79,376 crore which is 33.1 per cent higher than that of Rs.59,637 crore in 1997-98. The budget has taken a credit for an amount of Rs.5,000 crore from disinvestment. Unless this amount is realised, there would be further pressure on borrowing and interest payments leading to a possible crowding out impact on private sector.

4.21 The sustainability of fiscal policy requires that the fiscal consolidation process is strengthened by concerted efforts to boost revenue flows to meet the growing expenditure requirements. At the same time, expenditure prioritisation to release adequate resources for productive sectors is imperative for long-term sustainability of fiscal policy. In the Indian context, public sector investment is found to be necessary for creation of physical and social infrastructure, and for complementing private investment (Box IV.1). Considerations of growth and fiscal consolidation require that predominantly large amount of resources of the government are channelled for investment purposes. This has a special significance in the context of the trends witnessed in public investment outlays in recent years and the urgent need to step up infrastructure investment for improving the growth prospects of the economy. Although capital outlay has been stepped up in the budget by Rs.4,596 crore and its share in GDP would show a marginal improvement to 1.4 per cent from 1.3 per cent in 1997-98, this ratio represented a fall from 1.9 per cent in 1991-92 and an average of 1.6 per cent during the first six years of reform (1991-97).

4.22 It is widely recognised that economic reforms need large scale restructuring and redeployment of workforce. Fiscal consolidation often entails reduction in consumption expenditures as well as cutbacks in distortionary expenditures like subsidies. The budget has proposed to constitute a separate Restructuring Fund which would take care of the fund requirements of public sector enterprises to offer compensation packages to the workers. This would, however, solve the issue of only a small segment of the work force. In order to make the reforms sustainable, alongwith economic restructuring, adequate protection would need to be provided, particularly, to the weaker segments of the population by creating suitable safety nets (Box IV.2). This would be in addition to the existing poverty alleviation programmes, such as the Integrated Rural Development Programme (IRDP), the Nehru Rozgar Yojana (NRY), the Prime Minister's Rozgar Yojana (PMRY) and the Targetted Public Distribution System (TPDS). The budget for 1998-99 has provided an amount of Rs.7,281 crore for rural employment and poverty alleviation programmes. The major programmes included under these are provision of Rs.1,990 crore under the Employment Assurance Scheme for providing assured unskilled wage employment of 100 days, construction of 13 lakh houses for rural poor under the Indira Awas Yojana and Rs.800 crore under the IRDP. The budget has also provided an amount of Rs.110 crore under the PMRY to assist 2 lakh educated unemployed youth and Rs.140 crore for rural employment generation programme.

STATE GOVERNMENT FINANCES[3]

Budgetary Operations of State Governments: 1998-99

4.23 A preliminary analysis of the consolidated budgetary position of twenty three state governments reveals a rise in almost all the

3. Based on provisional data relating to the budgets of 23 state governments including the National Capital Territory of Delhi, of which two are Vote-on-Account.

Box IV.1

Complementarity between Public and Private Investment

The impact of public investment on private investment has been a highly debated issue, giving rise to two divergent views. The proponents of one view, based upon the 'displacement effect' of government's expansionary policy, believe that public sector investment leads to 'crowding out' of private investment. The crowding out can be of three different forms as discussed by Blinder and Solow (1973), and Carlson and Spencer (1975). One form of crowding out belonging to the classical tradition, occurs when government utilises scarce physical and financial resources, that would otherwise be available to the private sector. The second concept of crowding out is Keynesian in flavour. It is argued that deficit spending leads to government incurring public debt which competes with private debt in the financial markets. The resulting rise in interest rates will adversely affect private investment which is assumed to be interest elastic. This type of crowding out is also referred to as 'transactions crowding out'. The third form of crowding out is through the 'wealth effect' of government debt on private consumption. The theoretical base of this argument rests on the non-Ricardian behaviour of the consumer. Deficit financing results in the creation of bonds which are considered net wealth of the private sector. This results in an increase in private consumption in the economy. If the wealth effect operating through private consumption is strong, there would be a net increase in private investment while if it is relatively weak then debt financing would reduce private investment.

The advocates of the second view, mainly the Keynesians, believe that public sector investment in infrastructure and public goods can be complementary to private investment and thus emphasise the role of expansionary fiscal policy. The complementarity or 'crowding in' occurs because public expenditure on lumpsum investment can enhance the productivity of the private investment, increase the demand for private output through increased demand for inputs and ancillary services, and, therefore, augment overall resource availability by expanding aggregate output and saving.

The empirical literature on crowding out mainly focuses on developed economies. In the case of developing economies, the assumptions underlying the crowding out phenomena are not satisfied mainly due to absence of efficient capital markets and market related interest rates, existence of captive market, and the need for a relatively larger role of public investment (Greene and Villanueva, 1991). Nevertheless, a few empirical studies have been attempted to analyse the interrelationship between public and private investment in the context of developing countries (Sundararajan and Thakur, 1980; Wai and Wong, 1982; Blejer and Khan, 1984). These studies conclude that, in the short-run, public investment crowds out private investment, while in the long-run, it bears complementarity with private investment.

In India, the empirical studies investigating the relationship between public and private investments are few, as the concept of crowding out had little relevance till 1991 in view of the highly regulated interest rates, deliberately maintained low coupon rates on government securities, existence of captive market and regulated banking and financial sectors. Sundararajan and Thakur (1980) observed that the enhanced requirement of resources by the government reduces the availability of real resources to the private sector and thereby crowds out private sector investment in India. Rangarajan (1982), however, concludes that in the case of total private investment, the positive effect (complementarity) almost cancels out the negative effect (crowding out), whereas in the case of private corporate investment, the positive effect seems to dominate the negative. Gopalakrishnan (1987) concludes that debt-financing crowds in private investment. On the other hand, empirical investigations by Krishnamurthy and Saibaba (1982), Bardhan (1984), Pradhan, Rath and Sarma (1990) and Bhattacharya *et al.* (1994) indicate that while there is some complementarity in certain sectors, the evidence on the overall impact of public investment on private investment is not definitive.

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major deficit indicators. The deterioration in the state finances emanates from a lower growth of 14.6 per cent in revenue receipts in 1998-99 than that of 16.8 per cent in the previous year, and a sharp rise of 16.2 per cent in revenue expenditure on top of an increase of 17.4 per cent in 1997-98. As a consequence, there would be a marked rise in the revenue deficit to Rs.24,861 crore (1.5 per cent of GDP) in 1998-99 from Rs.19,053 crore (1.3 per cent of GDP) in the previous year. The widening of the revenue deficit would, in

Box IV.2
Economic Reforms and Social Safety Net

Social safety net schemes are publicly managed income maintenance measures intended to protect the people against invalidity, unemployment or old age. Provision of a 'minimum living standard' and selective 'redistribution of income' are the two basic elements of social security. The objective of maintaining a minimum living standard is achieved through the 'protective' as well as the 'promotional' role of social security. The protective role is concerned with the prevention of a decline in living standards, while promotional aspect relates to enhancement of normal living condition.

Social safety net would alleviate the adverse effects of reforms that underline economic restructuring and fiscal consolidation. In advanced economies, old-age pension and unemployment insurance are often regarded as two major mandatory social safety net schemes. Benefits from such schemes are related to workers' earnings and these are financed by a tax on pay roll or wages, on a *pay-as-you-go* basis. However, the experience of countries in America, Europe and Asia-Pacific Region reveals that these welfare systems, generally publicly managed unfunded schemes, have over time, turned out to be a major drain on public budget and have built up huge future tax liabilities for the government. High pay-roll tax rates that are not linked to benefits not only led to large scale tax evasion, growth of informal sector, high incidence of early retirement from work and misallocation of public resources but also contributed to erosion in national saving, capital formation and growth potential. World Bank studies analysing working of the old-age security systems have underlined that saving, redistribution and insurance are the three functions of the social security and are to be carried out in the best way through a 'multipillar' system with separate administrative and financing arrangements. These arrangements are: (a) mandatory privately managed, fully funded pillar that requires people to save and manage their savings, (b) publicly managed, tax-financed public pillar for redistribution to keep old people out of poverty and (c) a voluntary pillar for people who want more savings and large pension. The experience of western economies has, by and large, given clues to emerging economies to take sufficient safeguards while evolving social safety nets as part of their economic reform processes. For instance, East Asian countries have evolved innovative ways to finance social security spending. Singapore has a fully funded pension saving scheme, which obliges individuals to save for their retirement. Malaysia operates a similar scheme and Hongkong is intending to adopt the same model. Chile had initiated pension reforms in 1981 and the major planks of the reforms include a shift from the conventional unfunded and 'defined–benefit' plan to a funded 'defined-contribution' plan; replacement of public administration of the programme with private administration by competing pension funds and separation of the social assistance element from the mandated saving element of retirement provision. Other Latin American countries such as Argentina, Peru, Columbia and Mexico and the former centrally planned economies like Hungary, Lativia and Poland are expected to follow the Chilean model.

In India, the issues relating to the introduction of a social safety net are multifarious. First, the general provision of social services are essentially facilitated by state governments. Government expenditure on social services constitutes about 33 per cent of the total expenditures by state governments or nearly 6 per cent of GDP. Considering social security alone, its share in GDP is negligible. In India although social security schemes like work injury benefit were started as far back in 1923, sickness, maternity and medical care in 1948 and old age invalidity and survivors pension in 1952, these schemes are restricted to a small proportion of the workforce in the organised sector. The majority of the population, which works in subsistence agriculture or in urban informal sector, does not come under the purview of any formal social security system. Moreover, the protection given to workers during the transition period through the provision of National Renewal Fund (NRF) does not amount to a comprehensive social safety net providing social security to the population at large. The common elements of social safety net as part of economic reform package, as specified by the World Bank, encompass targeted subsidies, provision of permanent social security and unemployment benefits.

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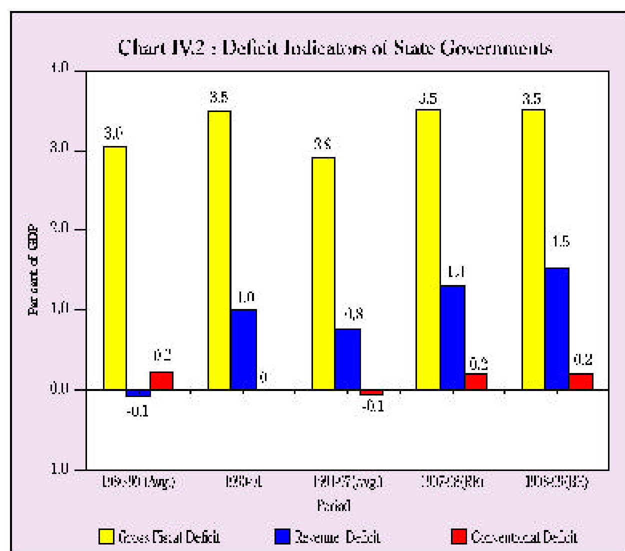


turn, cause the gross fiscal deficit (GFD) to go up sharply to Rs.56,660 crore (3.5 per cent of GDP) in 1998-99 from Rs.49,708 crore (3.5 per cent of GDP) in 1997-98. The conventional budget deficit would likewise increase to Rs.3,540 crore in 1998-99, from the level of Rs.3,256 crore in the previous year (Appendix Table IV.5 and Chart IV.2). The sharp rise in revenue expenditure in 1998-99 would be mainly on account of the additional burden emanating from the implementation of the Fifth Pay Commission awards and the rising interest burden. The pressure on resources would adversely impact upon allocations for capital outlay which is estimated to show a decline of 1.0 per cent as against a rise of 38.0 per cent in the previous year.

4.24 The expenditure pattern of states in 1998-99 continues to reflect an imbalance in the quality of expenditure undertaken. In the revenue account, social expenditure shows a modest rise of 8.5 per cent to Rs.76,577 crore, and on economic services it would record a marginal increase of 0.2 per cent in 1998-99. Non-developmental revenue expenditure, on the other hand, would significantly spurt up by 34.3 per cent to Rs.93,528 crore in 1998-99. Administrative expenditures and interest payments alone are estimated to absorb 34.1 per cent of the revenue receipts as compared with 28.0 per cent in 1997-98. Non-developmental expenditure, as a whole, would form 36.5 per cent of aggregate disbursements as against 31.2 per cent in the previous year. Owing to the sharp rise in non-developmental expenditure, resources for developmental purposes would show a deceleration. Developmental capital outlay is estimated to decline by Rs.262 crore in 1998-99 as compared with a rise of Rs.6,073 crore in the previous year. Besides the qualitative deterioration in expenditure in 1998-99, there is also an estimated deceleration in the revenue receipts. Revenue receipts in 1998-99 at Rs.1,93,482 crore show a lower increase of 14.6 per cent than that of 16.8 per cent recorded in 1997-98. The sluggishness in revenue receipts is partly due to a lower increase in non-tax receipts at 7.5 per cent in 1998-99 as compared with 14.3 per cent in 1997-98. The new tax-sharing arrangement recommended by the Tenth Finance Commission and ratified in the Union Budget 1998-99, wherein 29 per cent of the total divisible pool of central taxes are to be transferred, would provide more resources to state governments.

4.25 The nature of expenditures and mobilisation of resources raise issues regarding the management of state finances. The first of them relates to the issue of fiscal consolidation by state governments, through its accent on controlling current expenditures rather than relying on increases in taxes. The second relates to private initiative in the financing of key infrastructure sectors. The India Infrastructure Report (Chairman: Dr. Rakesh Mohan) had urged the government to encourage private sector participation in the infrastructure sector to enhance efficiency and relieve state governments of the burden of raising resources. The states on their part could, like the Union Government, offer some contractual guarantees to the private investors, given the quantum of investment required but the risks associated with guarantees, and the sheer magnitude of guarantees may raise issues regarding the sustainability of the fiscal position of governments. Thirdly, many state governments have started raising resources outside the budget through mobilisation of resources for meeting expenditure on specific areas like infrastructural development through flotation of infrastructural bonds, *etc.*

4.26 Notwithstanding the deterioration in their financial position during 1998-99, several states have continued to take policy initiatives to provide an enabling environment for inflow of private investment into infrastructure

sectors. Andhra Pradesh has sought to create a Road Development Fund, Karnataka has set up an Infrastructure Development and Finance Corporation and Maharashtra has taken to flotation of bonds to finance irrigation projects. Certain states have encouraged private sector participation in creation of roads and bridges. Karnataka envisages an infrastructure cess to raise funds for important projects. Information technology and software has received a fillip with several states planning to set up software technology parks. Agriculture and horticulture have received focus and been delineated as thrust areas in some states.

Ways and Means Advances and Overdrafts of States

4.27 During 1997-98, 16 states resorted to overdrafts of which nine states more frequently resorted to overdrafts as compared with eight states in the previous year, reflecting a persistent stress on liquidity management and the underlying structural imbalances in their finances. Moreover, three states could not clear their overdrafts with the Reserve Bank within the stipulated time limit of ten consecutive working days. As a consequence, the Reserve Bank had to stop payment on behalf of these state governments. One state, in fact, breached the ten-day limit on as many as eight occasions. The deterioration in the liquidity position occurred despite the doubling of the WMA limits with effect from August 1, 1996. The interest rate on WMA and overdrafts was placed at the Bank Rate and 2 percentage points above the Bank Rate, respectively. The progressive reduction in the Bank Rate had brought the interest rates on WMA and overdrafts to 9 per cent and 11 per cent, respectively. However, when the Bank Rate was raised from 9 per cent to 11 per cent on January 16, 1998, due to developments in the financial markets, the interest rates in respect of WMA and overdrafts of state governments were maintained at 9.0 per cent and 11.0 per cent, respectively, so as not to impose any additional burden on the interest payment obligations of the states.

COMBINED BUDGETARY POSITION OF THE CENTRE AND STATES

4.28 The combined gross fiscal deficit of the Centre and states[4] is estimated at 8.0 per cent of the GDP during 1998-99 which is lower than that of 8.1 per cent in 1997-98, owing to the expected moderation in the Centre's deficit. The combined revenue deficit would, however, be higher at 4.6 per cent of the GDP in 1998-99 as compared with 4.4 per cent in 1997-98. The net primary deficit is budgeted to decline to 2.5 per cent of GDP from 2.8 per cent in the previous year, reflecting improved sustainability in the fiscal situation (Table 4.2).

4.29 The reduction in the combined deficit indicators is envisaged through larger resource mobilisation and expenditure management. While combined receipts are budgeted to grow by 15.9 per cent over and above an increase of 17.8 per cent in the previous year, the increase in combined aggregate disbursements is estimated at about the previous year's level of 16.5 per cent (Appendix Table IV.6). The combined expenditure–GDP ratio would, however, show a marginal increase to 27.9 per cent in 1998-99 from 27.5 per cent in 1997-98. On receipts side, combined revenue receipts are budgeted to increase by 17.5 per cent and would account for about 76.0 per cent of the rise in the overall increase in receipts. The improvement in revenue receipts would be largely on account of tax revenue which is estimated to show an enlargement of 16.5 per cent and would contribute 77.9 per cent of the increase in revenue receipts, reflecting the concerted efforts of both the Centre and the states on additional resource mobilisation. Consequently, the combined tax-GDP ratio would improve to 15.8 per cent in 1998-99 from 15.6 per cent in 1997-98, but would still be lower than 16.7 per cent in 1991-92. Non-tax receipts are also budgeted to increase significantly by 22.5 per cent during 1998-99 as compared with 10.8 per cent in 1997-98.

4.30 The combined aggregate disbursements budgeted at Rs.4,52,909 crore, would record a rise of Rs.64,181 crore (16.5 per cent) over the previous year. The pattern of expenditure indicates that the moderation in expenditure would be effected largely in the developmental components. The growth in developmental expenditure is budgeted at 12.7 per cent as compared with that of 14.1 per cent in

4. Combined gross fiscal deficit accounts for the resource gap of the Centre and states, excluding inter-governmental transfers.

Table 4.2 : Measures of Deficit of the Central and State Governments as proportion to GDP*

(Per cent)

Year	Gross Fiscal Deficit	Conventional Deficit	Revenue Deficit	Net Primary Deficit
1	2	3	4	5
1985-90 (Average)	9.4	2.0	2.8	5.1
1990-91	10.0	2.1	4.5	4.9
1991-92	7.4	1.1	3.6	3.1
1992-93	7.4	1.5	3.4	2.6
1993-94	8.8	1.4	4.5	3.6
1994-95	7.4	-0.4	3.9	2.2
1995-96	6.9	0.6	3.4	1.9
1996-97 #	6.8	0.5	3.8	1.9
1991-97 (Average)	7.5	0.8	3.8	2.6
1997-98 (RE) #	8.1	0.2	4.4	2.8
1998-99 (BE) #$	8.0	0.2	4.6	2.5

RE Revised Estimates. BE Budget Estimates.

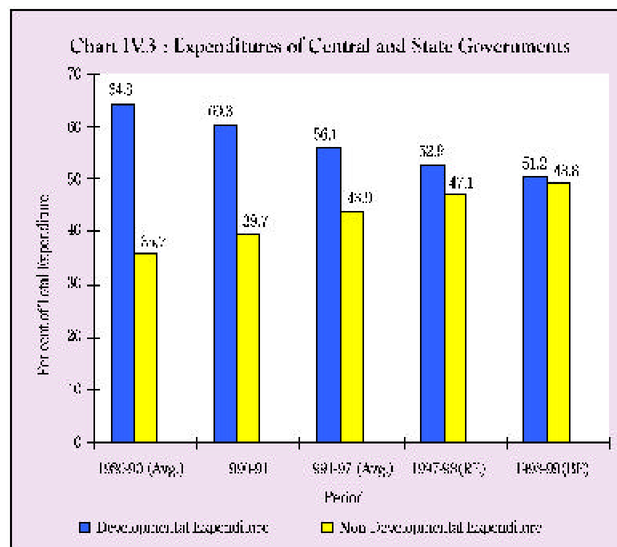
(-) Indicates Surplus.

* The combined deficit indicators have been worked out after netting out the inter-governmental transactions between the Centre and states. As such these figures will not be equal to the total deficits as worked out separately for the Centre and for the states. Details of the adjustments in respect of each deficit indicator are given in the note below.

\# Data in respect of State governments are provisional and relate to the budgets of 23 states including the National Capital Territory of Delhi.

$ Worked out on the basis of the implicit nominal GDP underlying the Union budget estimates of GFD/GDP ratio of 5.6 per cent for 1998-99.

Note :
1. Combined GFD is the GFD of the Central Government *plus GFD* of the state governments *minus* net lending from the Central Government to state governments.
2. Conventional deficit is the difference between aggregate receipts and aggregate expenditures of the Central and state governments net of inter-governmental transactions in the revenue and capital account.
3. Revenue deficit is the difference between revenue receipts and revenue expenditures of the Central and state governments net of inter-governmental transactions in the revenue account.
4. Net primary deficit is defined as combined GFD *minus* net lending and net interest payments.



1997-98. As a result, the share of developmental expenditure in total expenditure would decline to 51.2 per cent in 1998-99 from 52.9 per cent in 1997-98 (Chart IV.3). Of the developmental expenditure, outlays on the social sector would be placed at 7.8 per cent of GDP in 1998-99 as compared with 8.0 per cent in the previous year. The combined capital outlay as a ratio to GDP would decline further to 2.8 per cent during 1998-99 from 3.0 per cent in 1997-98.

DOMESTIC PUBLIC DEBT AND CONTINGENT LIABILITIES

4.31 The fiscal slippage in 1997-98 reversed the steadily declining trend in the debt-GDP ratio which increased to 54.6 per cent at end-March 1998 from 52.9 per cent as at end-March 1997 (Appendix Table IV.7). The adverse debt dynamics is reflected in the persistent increase in the interest burden on public debt (*i.e.,* interest payments as ratio to revenue receipts) from 39.1 per cent in 1990-91 to 47.4 per cent in 1997-98. The sharp increase in interest payments, *inter-alia*, stemmed from larger recourse to market borrowings at market-related interest rates. Net market borrowings constituted 49.2 per cent of GFD in 1997-98 as against 20.7 per cent in 1991-92 (Appendix Table IV.4). Although the weighted average interest rates on dated securities declined from 13.69 per cent in 1996-97 to 12.01 per cent in 1997-98 in view of the easy liquidity conditions, the reduction was not appreciable when compared to that of 11.78 per cent prevailing at the beginning of reforms

in 1991-92 (Table 4.3). Moreover, with the sharp decline in the inflation rate during 1997-98, real interest rates (*i.e.*, nominal interest rate *minus* realised inflation) on market borrowings remained at a high level of 7.1 per cent in 1997-98 nearly the same as that in 1996-97, and much above the level of 1.2 per cent in 1990-91. Although the present level of public debt may not pose any immediate problem to fiscal stability, it has implications for the medium-term sustainability of fiscal policy (Box IV.3).

4.32 Another area of concern is a shift in the maturity structure of debt. The high overhang of public debt and market expectations of high interest premium on longer maturity debt have triggered a policy of placing borrowings at the shorter end of the market, so as to minimise the cost of borrowing. As a consequence, the share of shorter maturity market loans (loans maturing within a period of 5 years) in total outstanding market loans stood at 45.2 per cent at end-March 1997, as against 8.6 per cent at end-March 1991. This has resulted in a high repayment burden in the medium term horizon ranging between Rs.20,252 crore and Rs.27,763 crore between 1999-2000 and 2003-2004.

4.33 The Centre's public debt-GDP ratio is placed at 53.9 at end-March 1999, reflecting 0.7 percentage point decline over end-March 1998. Notwithstanding this, the pressure on the fiscal system continues as evident from the near stagnation in tax-GDP ratio, the low rate of return on Government investment against relatively high cost of borrowed funds, and the high overhang of public debt with the compositional shift in favour of high cost debt.

4.34 The ratio of aggregate debt of state governments to GDP, hovered between 18 and 20 per cent during the late 1980s and in early 1990s. The state debt-GDP ratio stood at 20.0 per cent at end-March 1998, which shows an increase of 1.1 percentage points over 18.9 per cent at end-March 1997 (Appendix Table IV.8). As a corollary, the interest burden of debt showed a steady rise from 8.8 per cent in 1985-86 to 13.0 per cent in 1990-91 and further to 17.9 per cent in 1997-98 putting

Box IV.3

Sustainability of Public Debt

The growing government deficits and rising debt obligations in both industrialised and developing countries during the eighties drew considerable attention to the issue of sustainability of public debt. The concept of sustainability raised the question whether the present set of budgetary policies of the government could be pursued indefinitely without leading the economy into a debt trap. The debate on fiscal sustainability was initiated by the pioneering work of Domar (1944) and later, important contributions have been made by Buiter (1985), Masson (1985), Hamilton and Flavin (1986), Spaventa (1987), Bispham (1987) and Blanchard (1990). The underlying theoretical premise of fiscal sustainability implies that the debt-income ratio does not grow inexorably to explosive proportions. An alternative way of assessing sustainability is based on the government's solvency constraint. Buiter (1985) observed that a government is solvent when the present value of its expected eventual net liabilities in future (*i.e.* net indebtedness at the end of the planning horizon) becomes nil. When real interest rate exceeds the growth rate of income, a sufficient condition for this solvency constraint to be satisfied is that the ratio of net marketable public sector debt to trend output remains within limits.

The macroeconomic tool used in empirical literature to assess fiscal sustainability is the primary balance (*PB*) which is the difference between revenue receipts and non-interest expenditure of the government. The government debt stability equation [$PB/GDP = (r-g)(debt/GDP)$] evaluates the sustainability of public debt in the economy. The equation stresses that if the real interest rate on debt (r) is equivalent to the rate of growth of the economy (g), then debt/GDP ratio will stabilise so long as primary balance is zero. The equation thus, underscores the importance of the primary balance in stabilising the debt burden.

Even if growth in output exceeds the real interest rate, persistent primary deficits may lead to a steady growth in debt/GDP ratio to a limit where private saving may become inadequate to absorb the borrowing requirements of the government. The need to raise resources through tax and non-tax revenue measures required to stabilise the debt/GDP ratio will be higher, the larger is the stock of debt. The solvency condition, finally requires generation of adequate primary surpluses. Besides this, the unwillingness of the public to accept bonds beyond a certain limit and given the limited taxable capacity of the economy, the need for larger resources may eventually lead to growth in monetisation of deficits with consequential generation of inflationary pressures. Sustainable debt is, thus, identified with stable long-run equilibrium path of the economy. Uncertainty about the sustainability of fiscal policy influences investors' subjective assessment of alternative financing policies of the government, which then has implications for interest rates and demand for government bonds. The

(Contd. ......)

(...... Concld.)

rising interest burden on accumulated debt and fresh borrowings at market related interest rates further accentuates the debt/GDP ratio.

In the Indian context, the sustainability of fiscal policy came under pressure towards the late 1970s. The debt dynamics turned out to be more adverse in the 1980s, essentially as a result of a sharp deterioration in the primary deficit, with the level of debt increasing rapidly. For instance, the internal liabilities/GDP ratio which was placed at 28.8 per cent in 1975-76 increased to 52.9 per cent in 1990-91. The sharp rise in debt has three major implications. First, the concomitant interest burden absorbs an increasing proportion of revenue receipts, estimated at as much as 46.3 per cent in 1998-99. Second, the rising level of borrowings casts an upward pressure on interest rates, crowds out interest-sensitive investments in the short-run and thereby adversely impacts upon economic growth. Third, the substantial additional borrowings add to the repayment burden and may result in the problem of frequent debt rollovers. The fiscal reform measures initiated in 1991 with the aim of reducing the Central Government's gross fiscal deficit, have been able to contain the rising trend in the debt/GDP ratio and the real interest rate on debt has been lower than the real GDP growth rate. However, the growing volume of interest payments continues to be the single most important stress factor on government finances in an intertemporal framework. It is in this context, a Reserve Bank of India study (1997) has suggested that consideration may be given to placing a statutory ceiling on public debt through an amendment to the Constitution. The ceiling on debt could be fixed as a proportion of GDP or in absolute amount.

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Table 4.3 : Weighted Average Coupon Rates on Government of India Dated Securities

(Per cent per annum)

Fiscal Year	Weighted Average Rates	Range
1	2	3
1980-81	7.03	6.00-7.50
1985-86	11.08	9.00-11.50
1990-91	11.41	10.50-11.50
1991-92	11.78	10.50-12.50
1992-93	12.46	12.00-12.75
1993-94	12.63	12.00-13.40
1994-95	11.90	11.00-12.71
1995-96	13.75	13.25-14.00
1996-97	13.69	13.40-13.85
1997-98	12.01	10.85-13.05

Source : Reserve Bank of India Records.

severe pressure on state finances. The impact of the declining share of loans and advances from the Centre to states is reflected in the rising share of market loans in aggregate liabilities from 14.2 per cent in 1991 to 17.4 per cent at end-March 1998. Interest rates on loans from the Central Government, which constitute around 50 per cent of the financing of their GFD, have also witnessed a rising trend.

4.35 The ratio of combined domestic debt of Central and state governments (net of inter-governmental loans and advances) to GDP rose to 58.9 per cent in 1997-98 from 56.2 per cent in 1996-97, reflecting that the fiscal consolidation measures could not bring about the required extent of downward adjustment in domestic debt. This is clearly manifested in the persistence of the combined net primary deficit estimated at 2.8 per cent of GDP in 1997-98, interest burden of 29.2 per cent in 1997-98 and downward stickiness of revenue deficit ranging between 3.4 and 4.5 per cent of GDP during the period 1990-91 to 1997-98.

4.36 An issue that has significant implications for the sustainability of the fiscal position of governments, particularly in the context of the existing heavy burden of debt, is that of providing state guarantees. Governments grant guarantees to promote certain economic enterprises by reducing the credit risk for investors, especially in those activities or areas where the nature of investment is characterised by long gestation periods. While guarantees or contingent liabilities do not form part of debt as conventionally measured, these have, in the eventuality of default, the potential of exacerbating an apparently sound fiscal system; to the extent the existing burden of debt is already high, the concerns are that much more

Table 4.4 : Outstanding Guarantees

(as at end-March)

(Rupees crore)

	1996	1995	1994	1993	1992
1	2	3	4	5	6
States*	52,631	48,479	48,866	42,515	40,159
Centre	65,573	62,468	62,834	58,088	50,575
Total	1,18,204	1,10,947	1,11,700	1,00,603	90,734
% to GDP	**10.6**	**11.5**	**13.8**	**14.3**	**14.7**

* Seventeen Major States

Source: Finance Accounts, Government of India and state governments.

serious. In India, the issue of guarantees assumes significance in the context of the growing need for infrastructure and the need for participation by the private sector in projects requiring large lumpsum investments. Articles 292 and 293 of the Constitution empower the Central and state governments, respectively, to offer guarantees within such limits, if any, as may be fixed from time to time by the Parliament/Legislative Assemblies. The Central Government gives guarantees for loans raised by government companies/ corporations, railways, union territories, state governments, local bodies, joint stock companies, co-operative institutions, *etc.* Similarly, the state governments provide guarantees for loans raised by statutory corporations and boards, government companies, joint stock companies, co-operative banks and societies, local bodies, other institutions and private parties. The aggregate outstanding guarantees of the Centre and seventeen major states[5] increased from Rs.90,734 crore at end-March 1992 to Rs.1,18,204 crore at end-March 1996, although as a proportion of GDP it declined steadily from 14.7 per cent to 10.6 per cent during the period (Table 4.4).

Market Borrowings

Central Government

4.37 During 1997-98, the Central Government's net market borrowings amounted to Rs.40,494 crore (gross Rs.59,637 crore) as against Rs.26,356 crore (gross Rs.36,152 crore) in 1996-97 (Appendix Table IV.9). Of the total market borrowings, the gross amount mobilised through dated securities and 364-day Treasury Bills aggregated Rs.43,390 crore (net Rs.32,488 crore) and Rs.16,247 crore (net Rs.8,006 crore), respectively. The comfortable liquidity position and domestic monetary policy measures enabled a reduction in nominal interest rates across all maturities and facilitated the successful completion of the major part of the borrowing programme during the first half of the financial year itself. Moreover, the weighted average maturity of dated stock lengthened to 6.6 years in 1997-98 from 5.5 years in 1996-97. The subscription by the Reserve Bank in the auctions of dated securities amounted to Rs.2,028 crore as compared with Rs.3,698 crore in 1996-97. Besides, there were large private placements of Rs.11,000 crore with the Reserve Bank during 1997-98. As a part of market diversification, during 1997-98 the government introduced capital-indexed bonds of 5-year maturity bearing 6.0 per cent interest. As a new instrument with a provision of complete hedge against inflation for the principal amount, it is expected to broad base the investment opportunities for varied categories of investors. The inflation adjustment for the repayment of the principal will be based on the monthly average of the Wholesale Price Index (WPI). Apart from the fresh issues of dated securities, during the months of June, August and September 1997, special securities held by the Reserve Bank amounting to Rs.20,000 crore were converted into marketable lots of varying coupon rates and maturities. Though these converted stocks have not added to the borrowings of the government during the fiscal year, they facilitated the Reserve Bank to build up marketable stocks and conduct open market operations.

4.38 The Union Budget for 1998-99 has placed net market borrowings of the Central Government at Rs.48,326 crore (gross Rs.79,376 crore). At this level, net borrowings would show a sharp growth of 19.3 per cent over 1997-98. Market borrowings would finance 53.1 per cent of GFD (Rs.91,025 crore), which is much higher than that of 46.9 per cent in 1997-98. The high volume of borrowings from the market would place pressure on interest rates. The budget has already placed interest

5. Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Himachal Pradesh, Jammu and Kashmir, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

payment burden at a high level of 46.3 per cent of revenue receipts. During 1998-99 so far (upto August 18, 1998), Central Government has raised a net amount of Rs.35,700 crore (Rs.54,429 crore gross) through market borrowings.

State Governments

4.39 As a part of the allocated market borrowings of Rs.7,749 crore for the fiscal 1997-98, 25 state governments entered the market on April 30, 1997 for a notified amount of Rs.2,500 crore at a coupon rate of 13.05 per cent (Appendix Table IV.9). Excess liquidity in the money market led to oversubscription and the full amount of Rs.5,382 crore was retained. In the second tranche, issued on October 6, 1997, Rs.2,368 crore was mobilised as against the notified amount of Rs.1,500 crore at a coupon rate of 12.30 per cent. The gross borrowings during 1997-98 showed an increase of 18.6 per cent over that of Rs.6,536 crore mobilised in 1996-97.

4.40 During 1998-99, 24 state governments entered the market in the first tranche on April 20, 1998 for a 10-year loan with a notified amount of Rs.2,780 crore. The issue was oversubscribed and an amount aggregating Rs.5,130 crore was accepted at a lower coupon rate of 12.15 per cent.

4.41 The downward movement in the interest rates on market borrowings continued during 1997-98, largely on account of comfortable liquidity position. Interest rate on the longest maturity loan (*i.e.*10-year) moved down from 13.05 per cent in April 1997 to 12.15 per cent by end-March 1998 and further to 12.00 per cent in May 1998. The interest rate on the shortest maturity loan (*i.e.* 3-year) witnessed sharper reduction to 12.14 per cent in May 1997 from 13.40 - 13.70 per cent during 1996-97. The weighted average interest rates on central government securities, thus, declined to 12.01 per cent in 1997-98 from 13.69 per cent in 1996-97 (Table 4.3). The interest rates on 10-year maturity stock of state governments declined from 13.05 per cent in April 1997 to 12.30 per cent in October 1997 and further to 12.15 per cent in April 1998. The cut-off yield on 364-day Treasury Bills dropped 212 basis points from 10.10 per cent at end-March 1997 to 7.98 per cent at end-March 1998. However, owing to a fall in the inflation rate, the real interest rate continued to be high in 1997-98.