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Fiscal Consolidation in India: Performance Insights and Trend Analysis Following Economic Reforms

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Keywords

Fiscal Consolidation, Compound Annual Growth Rate, FRBM Act

Abstract

The present paper attempts to make a brief descriptive and analytical study on the trends of various fiscal indicators of the general government in the context of fiscal consolidation in India. The study has divided the post-reform Indian economy into five distinct phases based on significant events having economic implications. The analysis shows that phases I, III and the recent phase V are the most stable and fiscally prudent years. These years mark the starting of the LPG reforms of 1991, the FRBM Act and the Post-Pandemic recovery. Phases II and IV have been the most challenging years marking two big crises in the form of the Global Financial Crisis of 2008 and the worldwide pandemic of Covid-19. These two periods witnessed unstable public finances with growing deficit and debt levels. The results are based on a CAGR analysis for all the phases separately as well as an overall study from 1991 to 2024. Overall, while India has made significant strides in enhancing revenue generation since the 1991 reforms, the simultaneous rise in fiscal deficits and outstanding liabilities (as indicated by comparatively more positive growth in these as against revenue growth in the analysis) indicates challenges in achieving true fiscal consolidation. The government should prioritize a more effective balance between revenue and expenditure to ensure long-term fiscal sustainability. This involves managing liabilities prudently by minimizing excessive reliance on debt financing and aligning it with the growth rate of GDP. Continued efforts are needed to improve efficiency in public spending and enhance revenue collection mechanisms to achieve a healthier fiscal position moving forward.

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Introduction

Global economic systems are increasingly confronting shared fiscal and macroeconomic challenges, particularly in maintaining responsible and strategic financial management across national and international governance structures (Yadav, 2022). In this context, Fiscal consolidation assumes great importance while making policy decisions by governments. Fiscal consolidation refers to the policies and measures implemented by governments—both at national and sub-national levels—to reduce fiscal deficits and limit the accumulation of public debt. This process is crucial for improving the fiscal health of a government and ensuring long-term economic stability. The primary goals of fiscal consolidation include:

Reducing Fiscal Deficits: This involves decreasing the gap between government revenues and expenditures, which can be achieved by increasing revenue (through taxation or other means) and cutting unnecessary spending.

Managing Public Debt: By controlling annual borrowings and stabilizing debt levels relative to the economy's size, fiscal consolidation aims to ensure sustainable public finances.

Enhancing Macroeconomic Stability: Effective fiscal consolidation can help mitigate inflation, stabilize exchange rates, and create a favourable environment for investment, thereby fostering economic growth.

The economic reforms following the 1991 financial crisis were fundamentally centred on fiscal consolidation strategies. During the 1980s, exponential growth in fiscal deficits, predominantly funded through borrowing from domestic and external sources, ultimately culminated in the significant macroeconomic disruption experienced in 1991. The tumultuous economic landscape of early 1990s India was characterized by political instability and the dramatic oil price escalation during the Gulf crisis, which critically undermined the nation's economic resilience. Responding to these challenges, the Indian government initiated comprehensive macroeconomic reforms in 1991, initially under International Monetary Fund (IMF) conditions for the period 1991-93 and subsequently as a strategic national economic decision. These wide-ranging reforms comprehensively addressed financial, fiscal, and external sector dynamics, fundamentally transforming India's economic architecture from a centrally planned to a more liberalized, market-oriented framework. The reforms were designed to holistically restructure monetary policies, redefine budgetary approaches, and liberalize trade and investment mechanisms, marking a pivotal moment in India's economic evolution. Initially, fiscal policy management was predominantly influenced by the discretionary powers of the ruling political establishment, allowing significant flexibility in public financial decision-making. However, with the introduction of the Fiscal Responsibility and Budget Management (FRBM) Act, a structured legislative framework was established that objectively constrains political discretion, imposing technical and legal limitations on governmental financial manoeuvring and ensuring greater transparency and accountability in public financial management. In 2003, India implemented the Fiscal Responsibility and Budget Management (FRBM) and Fiscal Responsibility Legislation (FRL) at the central and state levels, respectively. The primary legislative objective was to establish fiscal sustainability by implementing strict constraints on central government debt and fiscal deficit levels. Under this framework, the government aimed to progressively reduce fiscal deficit to 3 percent of Gross Domestic Product (GDP) and completely eliminate the Revenue deficit by the Fiscal Year 2009. Karnataka emerged as the pioneering state by adopting Fiscal Responsibility Legislation (FRL) in 2002, even before the central government implemented the FRBM. Following Karnataka's initiative, other states progressively enacted similar legislations, with finance commissions' revenue sharing formulae serving as a strategic incentive for adopting and implementing fiscal responsibility

frameworks. Rules have been modified since then. A committee was established in May 2016 to examine the FRBM act and offer a fiscal consolidation strategy. The government has announced a reform of the fiscal blueprint for the Indian economy after suspending the fiscal rules in FY 2020–21 to address the economic crisis (Yadav, 2022).

This article presents a detailed analysis of the Indian experience related to fiscal consolidation under various economic situations including an institutionalised fiscal adjustment programme in the form of FRBM Act. The paper attempts to study the trends in various fiscal indicators over time since reforms of 1991 in light of fiscal consolidation and briefly explains the factors that have caused variations.

Objective

To examine the trends in fiscal indicators over time in the context of fiscal consolidation and to identify the underlying factors driving changes in these indicators.

Research Methodology

The study is descriptive and analytical focussing on historical data analysis. Secondary data is used from RBI's Database on Indian Economy. The period of study is from 1991 till present. Graphs and tables along with the calculation of Compound Annual Growth Rates (CAGR) are used for trend analysis. Qualitative analysis through a review of literature and policy documents contextualises the findings to understand the influence of various factors over time. The data used in the study is at the General Government Level (Both Centre and States combined).

The following acronyms will be used in the study on various fiscal variables. RR= Revenue Receipts, RE= Revenue Expenditure, CR= Capital Receipts, CE= Capital Expenditure, TR= Total Receipts, TE= Total Expenditure, GFD= Gross Fiscal Deficit, GPD= Gross Primary Deficit, RD= Revenue Deficit, TOL= Total Outstanding Liabilities

Dynamics of Fiscal Variables in India since 1991: Analysing Trends and Influencing Factors

A post-reform analysis of fiscal situation at the general government level in India is presented as follows. Our analysis divides the post-reform period into five distinct phases based on significant economic incidents. Phase I (1992-1997), Phase II (1998-2003), Phase III (2004-2008), Phase IV (2009-2020) and Phase V (2021 –2024).

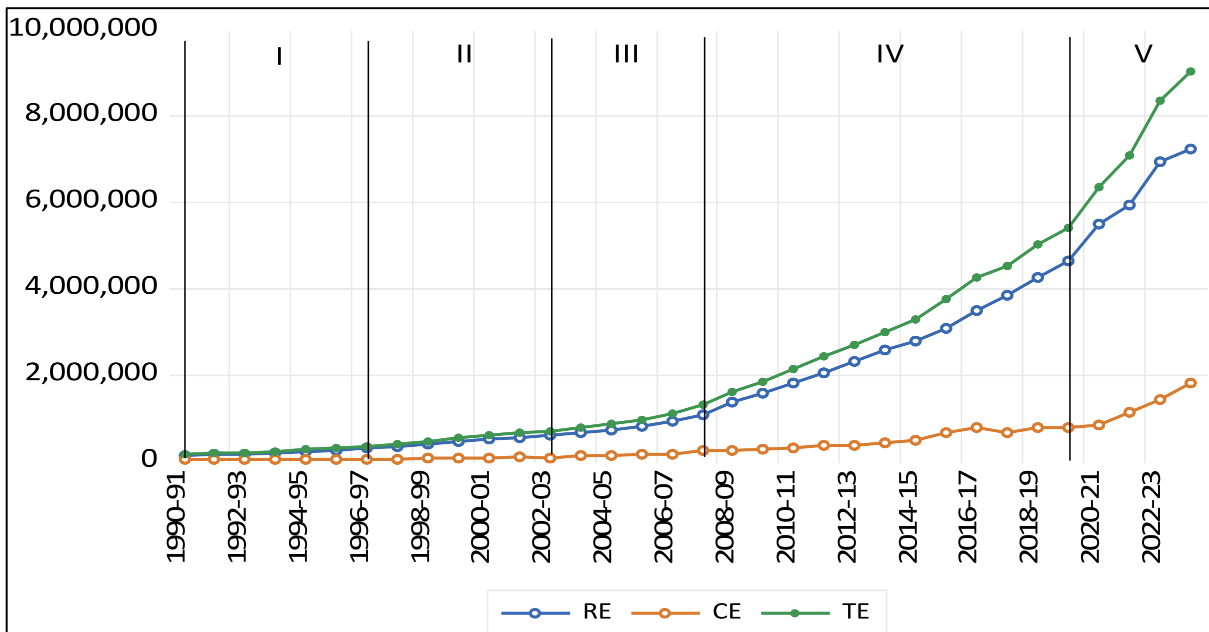
The 1990–1991 macroeconomic crisis made it necessary to implement a fiscal adjustment program beginning in July 1991 in order to restore fiscal balance. The reforms included, among other things, institutional improvements, expenditure management reforms, and tax and non-tax reforms. The budget deficit and public debt as a percentage of GDP decreased significantly as a result of these measures until 1996–1997; however, the trend soon reversed. As is visible in Fig.-02, Revenue Deficit, Gross Fiscal Deficit and Gross Primary Deficit are at low, manageable levels in Phase I but jump upwards from 1997 onwards up until 2008. A CAGR analysis for the First two phases (Table-01) reveal that GFD was 11.32% in the first phase but increased to 13.36% in Phase II showing reversal in fiscal consolidation situation. CAGR of GPD and RD stand at 2.43% and 14.27% for phase I and increase to an alarming 15.21% & 17.23% in phase II respectively. Revenue receipts have witnessed a fall (11.62% to 9.47%) whereas growth in receipts in Capital account have almost doubled (6.91% to 12.59%) showing increased borrowings and liabilities, a trend opposite to fiscal prudence. Growth rate of Capital expenditure has however risen from 4.76% to 6.97%, a sign of more policy stress given to asset creation. Revenue expenditure has deceased marginally from 12.03% to 11.19% meaning that unproductive spending has been carried forward. This reversal of fiscal correction during Phase II

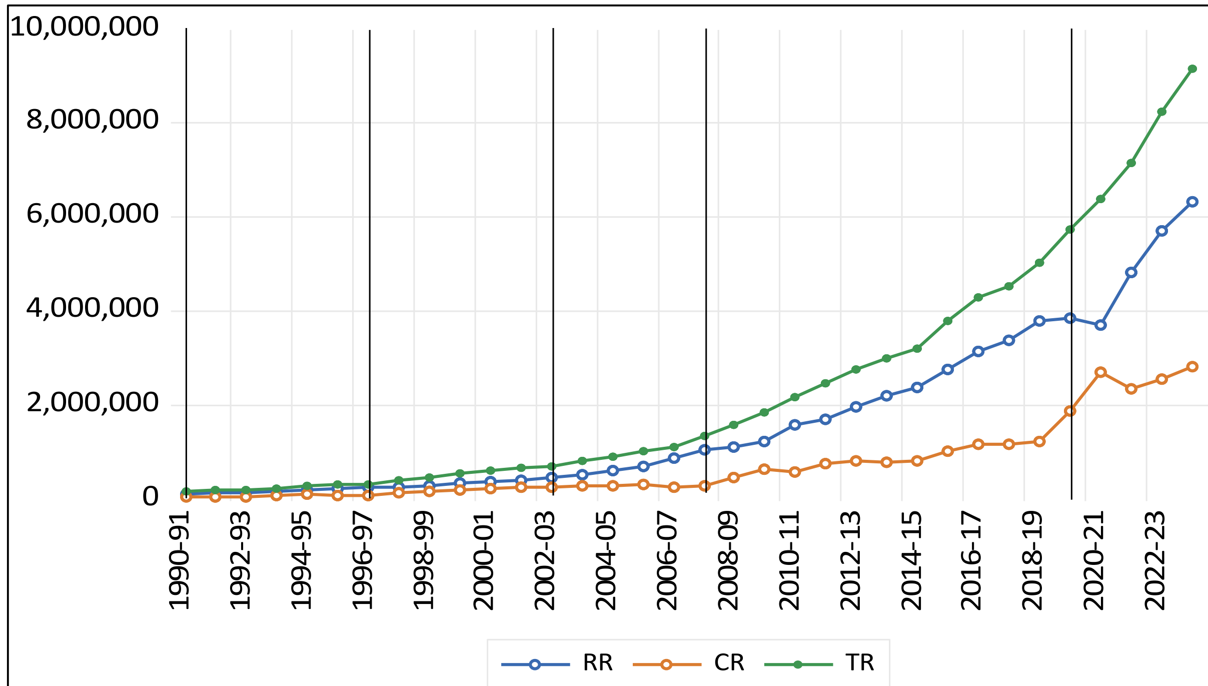
was largely on account of downward rigidity in revenue expenditure, fall in tax buoyancy, slow down in PSU restructuring and implementation of award of Fifth Pay Commission for the government employees and the Asian crisis of 1997. With the debate for a rule based fiscal framework gathering momentum, the fiscal position of Central Government improved starting with 2003-04.

The Fiscal Responsibility and Budgetary Management (FRBM) Act of 2003 and the FRBM Rules of 2004 have implemented FRBM for the Centre and the States since 2004-05. According to data from the Reserve Bank of India (Annual data) and the Government of India (Economic Surveys), the budgetary positions of the Central Government and State Governments have significantly improved throughout this time (Misra & Khundrakpam, 2009).

As can be seen from Fig.-01, Revenue Receipts, Revenue Expenditure, Capital Receipts, Capital Expenditure and Total Receipts & Total Expenditure have followed a close trajectory and hence a more or less stable Deficit levels (Fig.-02). Due to the previously described variables, this trajectory had a reversal from 1998 to 2003. Fiscal consolidation was given top priority, and the fiscal position significantly improved as a consequence of the Centre's and the FRLs' execution of the institutional fiscal management program in the form of the FRBM Act, 2003. However, during 2008-09, due to the impact of the global financial crisis, the economy experienced a significant slowdown. Thus, this is the Phase III in which the implementation of FRLs brought about considerable fiscal betterment until the Global financial crisis of 2008 emerged. Fig.-02 clearly points to the improved deficit situations with falling curves of RD, GFD and GPD. In fact, by the end of Fiscal Year 2007-08, GPD was in surplus (Rs. -59675 Crore), RD has been the lowest ever achieved after reforms of 1991(Rs. 9626 Crore) and GFD has been the lowest since year 2000 (Rs. 199110 Crore).

Fig.-01: Trends in Revenue Expenditure, Capital Expenditure, Total Expenditure, Revenue Receipts, Capital Receipts and Total Receipts (In INR Crore)

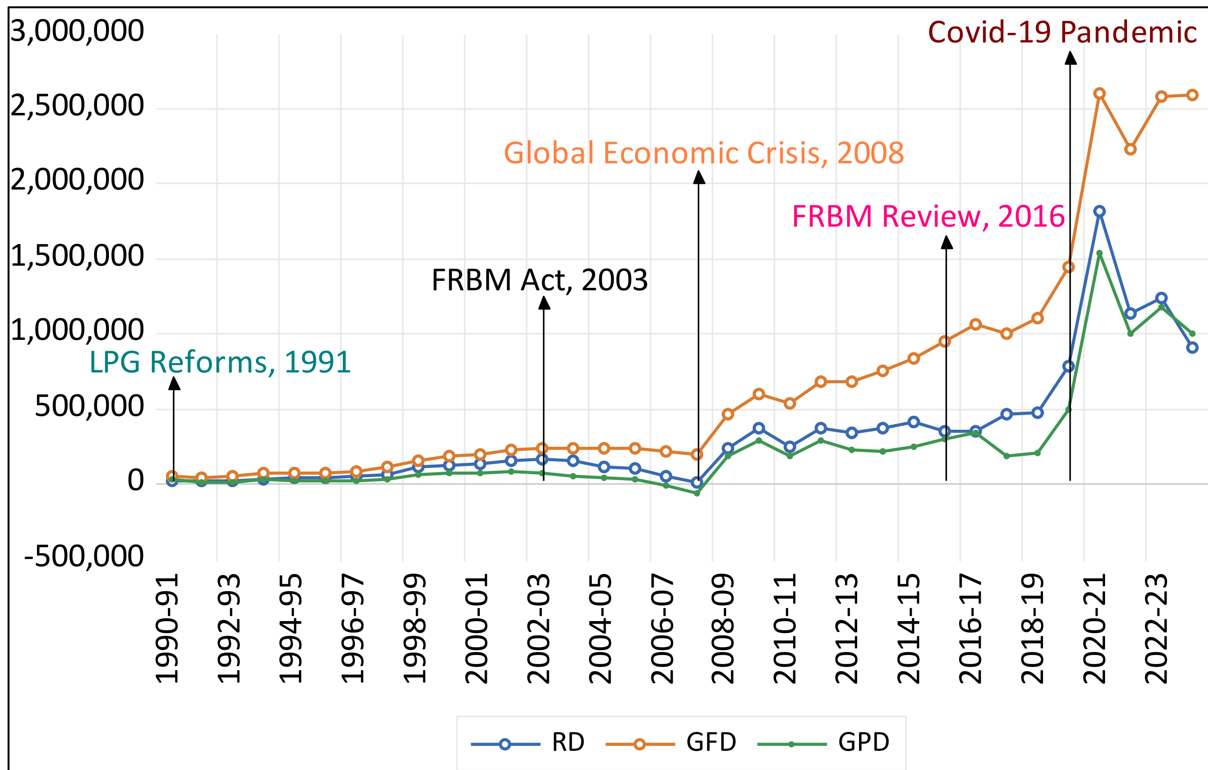




Source: Created by author based on data from RBI's Database on Indian Economy

Table-01 on CAGR presents the impressive compound growth rate situations of different fiscal variables in phase III (2004-2008). GFD and RD are falling at an average annual rate of -3.22% and -42.99% respectively. GPD decreased at a CAGR of -200.95% ultimately creating a surplus. Whereas Revenue Receipts have increased at a CAGR of 15.39%, more than 1.5 times the previous CAGR growth in phase II (9.47%), receipts on Capital account have decreased to 1 % rate from the previous 12.59% which is a great achievement on fiscal consolidation parameter. Revenue expenditure has also declined (11.19% to 9.57%) and Capital expenditure has strengthened (6.97% to 15.64%) showing not just improved fiscal discipline but also a qualitative shift towards productive nature of the expenditure and more reliance on tax-based revenues. However, these achievements were short-lived as the global financial crisis of 2008 led to a severe blow to the economy. Revenue losses, cuts in duties, and more spending to offer fiscal stimulus to limit the recession also caused the government's budgetary circumstances to deteriorate considerably (Misra & Khundrakpam, 2009). Consequently, the Deficits rose again. This marks the beginning of Phase IV which will last till another crisis in the form of Covid-19 Pandemic will again hit the economy.

Fig.-02: Trends in Revenue Deficit, Gross Fiscal Deficit and Gross Primary Deficit (In INR Crore)



Source: Created by author based on data from RBI's Database on Indian Economy

From Fig.-01 we can see a sharp rise in all the variables but revenue expenditure is steeper, which means more rate of growth and capital receipts have risen drastically. CAGR of revenue receipts and capital receipts are 10.87% and 12.72% respectively which are significantly lower in case of RR and higher in case of CR from the preceding phase. Capital expenditure has borne the most brunt in expenditure rationalisation with a fall of CAGR 10.15% from 15.64% with revenue expenditure witnessing an increase. Deficit measures GFD, RD and GPD have, as a result, increased tremendously (refer Fig.-02 and Table-01). Through measures such as reforms in taxes and strict adherence to the fiscal consolidation process, the Indian economy performed well in terms of lowering the deficit over the years in phase IV so that it reached more manageable levels (Gupta & Singh, 2016). However, again in 2020-21, the GFD reached a record high of 13.1 per cent of GDP (Rs. 2600335 Crore), GPD (Rs. 1539733 Crore) and RD (Rs. 1820823 Crore) due to an increase in expenditure on account of the outbreak of COVID-19 and low revenue collection during this fiscal year.

The last phase V in our study is the post-pandemic economy till present. Remarkable recovery has been made in the economy through careful policy decisions. India's post-pandemic fiscal consolidation efforts have focused on reducing the fiscal deficit through enhanced revenue collection, targeted expenditure management, and adherence to established fiscal frameworks. While progress has been made, ongoing challenges will require careful navigation to ensure sustainable economic recovery and fiscal health. CAGR between the years 2021 and 2024 shows improvement in all fiscal indicators. Revenue receipts have increased to a compound annual average rate of 14.45%, capital receipts have fallen to 0.94%, among expenditure capital spending has risen to 20.88% while revenue spending has declined to 7.08%. GFD, GPD and

RD all three show declining trend with a reduction at the rate of -0.11%, -10.25% and -16.04% respectively, a representation of enhanced budget consolidation.

Fig,-03 on trend in Total Outstanding Liabilities of the general government is in line with the analysis above. It is observed that this variable has increased exponentially over time at different rates. As of FY25, the general government's outstanding liabilities are expected to comprise approximately 55.7% from the central government and 27.4% from state governments, reflecting a more balanced fiscal structure. The government aims to manage these liabilities within the limits prescribed by the 15th Finance Commission, which suggests a gradual reduction in the debt-to-GDP ratio over the coming years. For FY25, the reforms and external factors. The post-pandemic period has necessitated careful management of these liabilities to ensure fiscal sustainability while supporting economic recovery.

Table-01: CAGR of Various Fiscal Indicators at the General Government Level (In %)

Variables	1992-1997	1998-2003	2004-2008	2009-2020	2021-2024
Revenue Receipts	11.6224	9.4697	15.3902	10.8653	14.4918
Revenue Expenditure	12.0301	11.1853	9.5654	10.7812	7.0774
Capital Receipts	6.914	12.5888	1.0049	12.7147	0.942
Capital Expenditure	4.7585	6.9647	15.6359	10.1521	20.8819
Total Receipts	10.3672	10.5191	11.1517	11.4297	9.3593
Total Expenditure	10.7769	10.5914	10.5553	10.6886	9.2327
Gross Fiscal Deficit	11.3182	13.3586	-3.2191	9.8942	-0.1128
Gross Primary Deficit	2.4258	15.2112	-200.9470	8.5834	-10.2468
Revenue Deficit	14.2638	17.2342	-42.959	10.3819	-16.0408
Total Outstanding Liabilities	10.8963	12.3986	8.5412	11.5684	8.5399

Source: Author’s Calculation based on Data from RBI’s Database on Indian Economy

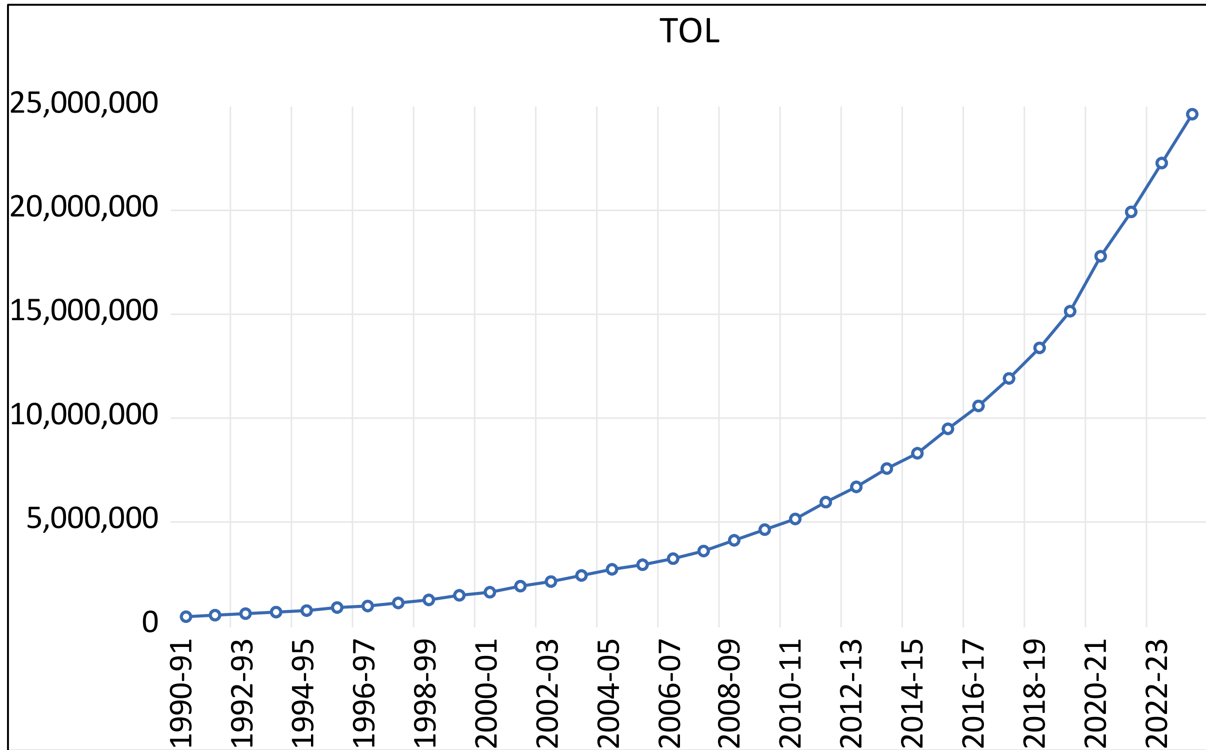


Fig.-03: Trend in Total Outstanding Liabilities (In INR Crore)

Source: Created by author based on data from RBI's Database on Indian Economy

Overall CAGR Analysis Since Reforms

Table-02: CAGR of Overall Fiscal Variables Since 1991 till present (In %)

Variables	CAGR
Revenue Receipt	Increased at 12.57%
Capital Receipt	Increased at 12.89%
Revenue Expenditure	Increased at 12.48%
Capital Expenditure	Increased at 12.54%
Gross Fiscal Deficit	Increased at 13.00%
Gross Primary Deficit	Increased at 13.60%
Revenue Deficit	Increased at 11.94%
Total Outstanding Liabilities	Increased at 12.59%

Source: Author's Calculation based on data from RBI's Database on Indian Economy

As presented in Table-02 above, we also undertake an overall fiscal performance analysis since reforms of 1991 till present using CAGR.

Interpretation in Terms of Fiscal Consolidation Performance

Revenue Growth vs. Expenditure Growth:

The growth rates of both revenue receipts (12.57%) and capital receipts (12.89%) indicate a robust improvement in the government's ability to generate income, which is crucial for fiscal sustainability. However, revenue expenditure growth (12.48%) is slightly lower than capital expenditure growth (12.54%). This suggests that while the government is investing in infrastructure and development, it is also managing to keep operational expenditures in check relative to capital investments.

Fiscal Deficits:

The increase in Gross Fiscal Deficit (13.00%) and Gross Primary Deficit (13.60%) indicates that despite improvements in revenue generation, the government has been running larger deficits, possibly due to increased spending on welfare and recovery measures post-pandemic. The fact that these deficits are growing faster than revenue receipts points to a need for more stringent fiscal discipline to ensure that deficits do not spiral out of control.

Outstanding Liabilities:

The growth in Total Outstanding Liabilities (12.59%) reflects the cumulative impact of past deficits and indicates that the government is increasing its debt levels as it seeks to finance its expenditures. This trend raises concerns about long-term sustainability, especially if economic growth does not keep pace with debt accumulation.

Revenue Deficit:

The increase in Revenue Deficit (11.94%) suggests that the government is not generating enough revenue to cover its day-to-day expenses, which is a critical indicator of fiscal health. A persistent revenue deficit can lead to reliance on borrowing for operational needs, further exacerbating outstanding liabilities.

Overall, while India has made significant strides in enhancing revenue generation since the 1991 reforms, the simultaneous rise in fiscal deficits and outstanding liabilities indicates challenges in achieving true fiscal consolidation. The government must focus on balancing its revenue and expenditure more effectively to ensure long-term fiscal sustainability and avoid excessive reliance on debt financing. Continued efforts are needed to improve efficiency in public spending and enhance revenue collection mechanisms to achieve a healthier fiscal position moving forward.

Conclusion

A brief analysis of the trends in fiscal indicators of the general government (both centre and states combined) presented above shows an overall fiscal situation in India in the context of fiscal consolidation. The division of the post-reform Indian economy into five distinct phases based on significant events having economic implications shows that phases I, III and the recent phase V are the most stable and fiscally prudent years. These years mark the starting of LPG reforms of 1991, the FRBM Act and the Post-Pandemic recovery. While Phases II and IV have been the most challenging years marking two big crises in the form of the Global Financial Crisis of 2008 and the worldwide pandemic of Covid-19. These two periods witnessed unstable public finances with growing deficit and debt levels.

Ranking all the phases on various fiscal parameters, Phase III has been the most impressive in terms of improved RR, GFD, GPD and RD levels. Phase V has been the most impressive in terms of improved RE, CR, CE and TOL. Concerning the worst performance in RR, GFD, GPD, RD, and TOL, Phase II could be attributed to this. Phase I was the worst in terms

of most RE and least CE. CR has been the most in Phase IV thus making these years worse on average when it comes to the creation of most liabilities.

Additionally, an overall CAGR analysis since 1991 till present shows that RR has increased at a rate of 12.57%, CR at 12.89%, RE at 12.48%, CE at 12.54%, GFD at 13.00%, GPD at 13.60%, RD at 11.94% and TOL at 12.59%. Since the deficit levels have witnessed more positive growth when compared with revenues, it infers slightly weak fiscal consolidation performance and warrants stricter action on the Government's part to ensure fiscal sustainability while keeping the liabilities contained and within GDP growth rates.

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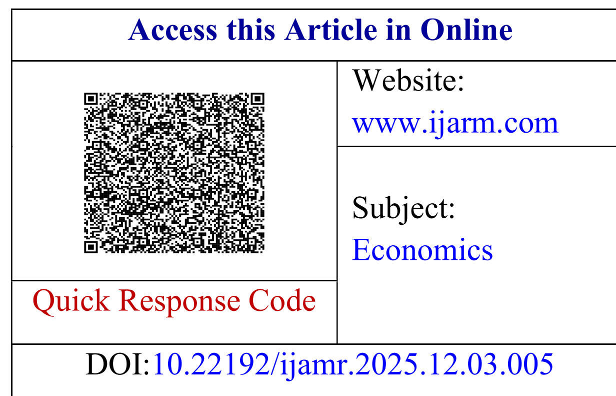
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