CARE Ratings
Professional Risk Opinion

Economic Study

September 2010

Government Budgets: Are targeted numbers realized?

Contacts:

Madan Sabnavis
Chief Economist
91-022-6754 3489

Samruddha Paradkar
Associate Economist
91-022-6754 3407

Krithika Subramanian
Associate Economist
91-022-6754 3321

An issue often raised is as to how good are the numbers presented by the government in its Budget. The government starts off with certain assumptions on the behaviour of the economy and accordingly works out the revenue and expenditure. But there could be several conditions that could change during the year which can upset these calculations.

The study looks at both the state governments and central government and examines the deviation of the final numbers from the budgeted ones for FY07-FY09 for states and FY10 additionally for the central government.

The conclusions that may be drawn are that state governments have tended to mange their budgets on an average quite efficiently when economic conditions are normal. In 2 of the three years studied here, revenue has exceeded while expenditure has been reined in within the budgets. In fact, the final expenditures have been lower than what was budgeted.

However in FY09, there were misses on both sides, which may be explained as being a consequence of the economic slowdown where revenue was affected while stimulus led packages did lead to expenditure overshooting budgets.

The central government has managed revenue better than its expenditure during normal times as the latter has exceeded what was budgeted in all the four years considered.

On the whole it is possible to conclude that state governments have done fairly well in this respect considering that their ability to meet targets is based on several externalities which cannot be conjectured at the beginning of the year.

Government Budgets: Are targeted numbers realized?

An issue often raised is as to how good are the Budget numbers of the government. The government makes certain assumptions on the behaviour of the economy for a year and makes projections and allocations accordingly. These numbers may or may not be realized as the data moves into 'revised estimates' that are announced based on developments that have taken place until the announcement of the new Budget and final figures (accounts) which come after a few months. Hence, when the Budget is announced in February, the revised estimates for the previous year are based on certain assumption that may or may not materialize and hence deviate from the actual/accounts numbers subsequently. The actual numbers would be as per the 'accounts' and would be available with a gap of another 3 months or so when the final numbers flow in as the year ends in March and it takes this much of time to finalize the accounts. In this scenario, how good are the budgetary estimates?

It must be realized that state governments make strong assumptions on the behaviour of just not its own economy but also the Centre's performance. Some of the imponderables that have to be taken into account that can upset the applecart are the following:

1. Revenue of state not increasing due to slowdown in economic activity
2. Budgeted earnings not materializing due to certain schemes not working out e.g. fresh property taxes.
3. Centre's allocation declining because its own revenue does not increase. States are dependent on the Centre for both certain tax revenues as per the devolution formula set by the Finance Commission as well as Grants in aid.
4. Expenditures going off the mark due to contingencies such as a calamity or a fiscal stimulus programme.
5. Change of governments necessitating different priorities

Under these conditions, the final numbers of the government would deviate from the projected numbers in the Budget. At times the government would have control over the expenditure and can slash expenditures on programmes towards the end of the year or defer the same for another year in order to meet the targets when revenues do not increase. Therefore, adjustments are possible for state governments which could aid in restoring the fiscal targets.

Objective of the study

The purpose here is to examine the total revenue and expenditure (revenue and capital accounts) of 29 state governments to ascertain whether or not governments are able to meet their projected revenue and expenditure. The approach is aggregative to get a macro view of the subject.

Time period looked at

FY07, FY08 and FY09

Methodology: The budgeted numbers for each of these years are juxtaposed with the actual numbers for FY07 and FY08 and the revised estimates of FY09. The source of information is RBI. FY10 is not covered as the revised estimates are not yet available on all states.

The weighted arithmetic mean and standard deviation are calculated for these three series to check for variations. The coefficient of variation is used to judge whether these deviations have been reducing or not over time.

Results:

A. Revenue

The general picture emerging is that governments have on an average basis managed revenues well and have tended to show positive deviations, meaning thereby that collections turn out to be better than what was projected.

Table 1 gives an idea of the statistics calculated for the revenues for the three years. The mean refers to the weighted average percentage deviation from the budgeted numbers and the standard deviation is that of these deviations from the weighted mean. The coefficient of variation is defined as the standard deviation divided by the weighted mean.

The mean is hence an average of the deviations, while the standard deviation captures the variance of various states around this mean, and the coefficient of variation puts this deviation in perspective vis-à-vis the mean. The number of observations is 29 (the states considered).

Table 1: Analysis of Deviations of Total revenue from the Budgeted numbers

	FY07	FY08	FY09
Mean	4.5	2.1	0.9
Standard deviation	11.8	12.4	8.5
Coefficient of variation	2.6	5.8	9.5

Table 1 shows that the states have tended to on an average garner more revenue than projected at the macro level. But the mean of deviations has been coming down in FY08 and FY09. The standard deviation is however, high indicating that the variations have been significantly high across states, which is buttressed by the coefficient of variation which has been increasing. A conclusion drawn could be that states tend to be conservative when forming their revenue numbers as at the aggregate level, they tend to exceed these collections. But the fact that the deviations on an average are in the positive zone is comforting.

Table 2 below gives a distribution of states in terms of how many of them have exceeded their targets or missed it. The numbers are impressive in so far as that between 55-72% of the states have exceeded their targets.

Table 2: Deviations from Budgeted targets: Number of states

	FY07	FY08	FY09
Exceeded Budget	20	16	21
Fell short of Budget	9	13	8

A question that arises is whether the size of the Budget has a bearing on its ability to exceed or miss the budgeted numbers or rather that whether states with larger budgets do better or worse than the others in terms of meeting their targets. Table 3 provides a frequency distribution of the number of states that have exceeded or missed the targets based on size of the total receipts.

Table 3: Size wise distribution of states according to Budget Adherence

Range of Total receipts (Rs cr)	FY07		FY08		FY09	
	Exceeded	Missed	Exceeded	Missed	Exceeded	Missed
>50,000	2	0	1	2	2	3
40-50,000	1	0	1	1	-	-
30-40,000	2	0	1	1	5	0
20-30,000	4	2	3	2	4	1
10-20,000	5	3	5	2	3	2
<10,000	6	4	5	5	7	2
All	**20**	**9**	**16**	**13**	**21**	**8**

Table 3 shows that there was not much of a correlation between size of the budget and the ability to meet the target. In FY07, the larger states managed their revenue better, and maintained the same in FY08. However in FY09, the shortfalls were evenly distributed. The larger states would have been affected more by the economic slowdown which in turn would have affected their revenue collections.

B. Expenditure

The state governments had a similar performance with respect to expenditure targets. In FY07 and FY08 the average deviation from budgeted numbers was in the savings zone meaning thereby that they tended to spend less than targeted. However, in FY09 the average increased to excess spending. This may be attributed to the higher spending undertaken by state governments in the face of an economic slowdown. Moreover states have supplemented these absolute increases along with changes in the composition of expenditure (diversion of capital expenditure to meet social spending) in a bid to limit over-expansion of budget size.

Table 4: Analysis of Deviations of Total revenue from the Budgeted numbers

	FY07	FY08	FY09
Mean	-1.3	-2.6	4.9
Standard deviation	12.3	11.2	11.3
Coefficient of variation	9.5	4.4	2.3

The standard deviation across states was stable for the three years, while the coefficient of variation came down along the way.

Table 5: Deviations from Budgeted targets: Number of states

	FY07	FY08	FY09
Excess spending	16	12	25
Savings in spending	13	17	4

In terms of the number of states spending less than budgeted, it was lower at 45% in FY07 and 59% in FY08. In FY09, it came down to just 14%. The fact that the average deviation was in the savings zone indicates that the larger states must have been responsible for spending less. This comes out in Table 6 where there was a mild relationship between the size of the state and the savings made on spending.

Table 6: Size wise distribution of states according to Budget Adherence

Range of Total receipts (Rs cr)	FY07		FY08		FY09	
	Exceeded	**Saved**	**Exceeded**	**Saved**	**Exceeded**	**Saved**
>50,000	2	1	0	4	3	2
40-50,000	1	1	0	2	2	0
30-40,000	1	1	3	1	4	0
20-30,000	2	3	1	2	4	0
10-20,000	5	3	3	4	5	1
<10,000	5	4	5	4	7	1
All	**16**	**13**	**12**	**17**	**25**	**4**

How is it for the central government faring here?

Table 7 provides the deviations of the revenue and expenditure for the central government in the last 4 years. The ideas emerging are that:

1. Revenue has exceeded budgeted numbers in FY07 and FY08, but was lower in case of FY09 and FY10 when the economy was affected by the economic slowdown. The government had invoked several duty cuts in this year to provide a boost to the economy which did impact its revenue.
2. Expenditure has always exceeded what has been targeted at the time of the Budget. The high deviation in FY09 may be attributed to the fiscal stimulus on both the revenue and expenditure sides.

Table 7: Deviations in final numbers (%)

Year (final accounts)	Deviation
Revenue	
FY07	6.1
FY08	10.6
FY09	-11.4
FY10 (Revised)	-2.0
Expenditure	
FY07	3.4
FY08	4.7
FY09	17.7
FY10 (Revised)	0.06

Conclusion

On the whole it appears that states have managed their budgets quite well under normal economic conditions. Revenue collections have tended to be higher than targeted while expenditure has been under control on an average basis. The Centre on the other hand has had better performance on revenue than on expenditure. However, when external conditions turned adverse as was the case in FY09 and FY10, both the states and centre could not meet their targeted numbers.