8. Fiscal Crisis in Maharashtra

There has been sharp deterioration in the fiscal position of the State during the 1990s, particularly since the 1995. World Bank went to the extent of commenting, “Better known for its fiscal conservatism, Maharashtra is now faced with a fiscal problem of unprecedented magnitude”.[1] In a similar vein the Economic Survey for 2002-03 of the Maharashtra Government noted, “For the last few years, finances of Maharashtra State Government are under severe strain” (p. 136). In fact, the World Bank Report has warned that the State is heading towards insolvency by 2005-06 unless its revenue and deficits besides debt including the off-budget borrowings are reigned in. All the major deficit indicators showed sharp deterioration particularly after the mid-1990s; e.g., fiscal deficit as a proportion to SDP, which hovered around 2.0 per cent till mid-1990s rose sharply to 4.9 per cent by the end of the decade and has been estimated to be 4.1 per cent for 2001-02. More significantly, the balance on the revenue account that has been in surplus till 1994-95, turned negative since the mid 1990s. The sharp deterioration since mid-1990s has actually been traced in: a) sharp increase in the spending on salaries and pensions on account of Fifth Pay Commission, b) huge off-Budget borrowings, c) market intervention by the State Government in case of commodities like sugar, cotton or onion, and d) high subsidies on the public services (Table 8).

Table 8: Select Fiscal Indicators of Maharashtra

(As percentage of GSDP)

Year	Gross Fiscal Deficit	Revenue Deficit	Own Tax Revenue	Share in Central Taxes	Own non- Tax Revenue	Grants from Centre	Total Expenditure	Revenue Expenditure	Interest Payments
1981	2.6	-0.7	6.3	1.9	2.4	0.7	14.1	10.7	0.6
1991	2.4	0.1	7.6	1.5	2.7	1.2	16.0	13.0	1.3
1995	1.8	-0.2	6.0	1.1	1.8	0.6	12.7	9.4	1.1
2000	4.9	1.8	7.2	1.1	1.6	0.6	15.8	12.2	2.0

Source: Budget Documents, Government of Maharashtra.

[1] World Bank, *India - Maharashtra: Reorienting Government to Facilitate Growth and Reduce Poverty*, 2002, p. 8.

Furthermore, you are aware that as per the Indian federal structure almost all the taxes collected by the Central Government are sharable – and that includes both direct and indirect taxes like those on personal & corporate income, excise & customs duty. Now when the collection by the Central Government on account of these taxes failed to increase at a pace consistent with the high growth of the economy during the 1990s, so have the State's share. Interestingly the prime responsibility of this goes to a cut in customs duty as a part of the fiscal reforms. Thus, sluggishness in Central transfers put further pressure on state government finances.

How did the State Government finance its resource gap? During the 1990s nearly half the fiscal gap was financed through borrowings from the Central Government, about 40 per cent came form sources like small savings and provident fund collections, and the remaining 10 per cent through market borrowings. Reflecting on the alternative sources employed by the Maharashtra Government, for financing the resource gap, my friend Professor Ajit Karnik of Mumbai University, has pointed out that dependence on resources over which the State has little control (e.g., loans & advances from the Central Government) has been growing since the early 1990s.[2] It implies higher dependency and fiscal stress on the State Government.

Growing fiscal deficit and resultant borrowings led to steep rise in the outstanding liabilities of the state Government. The outstanding debt of the State Government as a proportion to GSDP is as high as 15.9 per cent in 1999-2000. Seriousness could also be gauged from the fact that a significant proportion of the revenue mobilized by the Government is preempted by the interest payments, which accounted for only 7 per cent of State's own revenue in 1980-81, presently consumes about one fourth of its revenue.

---

[2] Ajit Karnik (2002), "Ready for Second Generation Reforms? An Evaluation of Progress made by Maharashtra" in *Reform and Employment*, Institute of Applied Manpower Research, New Delhi, pp. 526-52.

These are not the only bad news. The scenario looks much grim if one adds the off-budget borrowings like the contingent liabilities on account of guarantees extended by the state to its PSUs. Let me elaborate on this point further. When a state undertaking comes with a bond issue, the investors generally subscribe not on the basis of the balance sheet of the company, but on the strength on guarantee extended by the Government. One needs to recognize that these PSUs are not doing well, and in such a situation these burden of borrowings effectively falls on the shoulder of the state Government. Thus, when we add such contingent liabilities, the liability to income ratio for the Maharashtra would work out to be much higher and is a matter of serious concern. Contingent liabilities could be serious issue is evident from a recent episode of some delay on the part of the State Government in meeting its guaranteed obligations towards bonds issued by the Maharashtra Krishna Valley Development Corporation. Though Maharashtra Government has cleared the payments and compensated the investors with overdue interest for the delay, a major rating agency in India *viz.*, The Investment and Credit Rating Agency (ICRA) has lowered the rating of the Maharashtra Government.

Let me add that the State Government has recognized the need to reform the fiscal situation and has consequently embarked upon a host of measures focusing on revenue augmentation, expenditure containment and PSUs reforms. Reforms are being pursued in different sectors, like power, irrigation, or rural infrastructure. The state has prepared a Medium Term Fiscal Reform Programme, which defines a path towards fiscal sustainability and sets target for broad fiscal indicator in the medium term. MTFRP covers areas such as fiscal consolidation, PSU reforms, power sector reforms and fiscal transparency.

Maharashtra is among the few states in the country along with Karnataka and Punjab that have taken steps to introduce Fiscal Responsibility and Budget Management Bill. The bill intends to bring about surplus on the revenue account, identifying all liabilities, estimating pension liabilities, restriction on borrowing, regulating salary expenditure, ceiling on grants and subsidies. Other important elements of the proposed bill are: Amount at risk due to guarantees not to exceed 1.5 per cent of the expected revenue receipts and classify the guarantee obligation according to the risk of development and constitution of Fiscal Advisory Board to advise the government on issues relating to implementation of the fiscal responsibility bill. Nevertheless, all these measures need to be implemented in letter and spirit so as to avert any imminent fiscal crisis in Maharashtra.