
Study of
Maharashtra's Finances

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in association with
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EXECUTIVE SUMMARY

MAHARASHTRA STATE FINANCES

Maharashtra is an advanced state of India in terms of per capita income, growth, and as a destination of investment. The State, with only 9.3 per cent of the population of the country, accounted for 13 per cent of total gross capital formation in the country in 1997-98. Its capital Mumbai is the premier city of India and the commercial capital of the country. Yet, Maharashtra may, at best, be referred as an advanced state only of a developing country. Its per capita income of Rs.18,365 was less than US\$ 500 in 1997-98. Its literacy rate at 65 per cent in 1991 and life expectancy at 63.4 years during 1988-92 were not only low by developing country standards, but also not “exceptionally high” by all-India standards. A lot remains to be done in the State.

The Government of Maharashtra (Government hereafter) has to provide leadership in the development process. It has to provide universal primary education and health care, safe drinking water and sanitation, roads and other infrastructure. The Government has more or less maintained a prudent fiscal stance and done a creditable job of promoting development in the State. Maharashtra's public debt at less than 15 per cent of its GSDP is one of the lowest in the country. Furthermore, the State has seldom taken recourse to ways and means advances or overdraft facility of the Reserve Bank of India. However, like many other States in India, Maharashtra also is undergoing severe fiscal stress, particularly after the implementation of the Fifth Central Pay Commission's recommendations.

Deficit and Debt

The second half of the nineties witnessed a steady deterioration in Maharashtra's state finances, with fiscal deficit increasing from 2.1 per cent of GSDP in 1993-94 to above 6 per cent by 1999-2000(R.E.) and revenue deficit creeping up to 4.1 per cent in 1999-2000 (Section 3.3). Along with the worsening of the financial situation, there is

evidence of poor fiscal marksmanship. For example, for 1999-2000, the revised estimates of fiscal deficit and revenue deficit were higher than the budgeted numbers by 1 percentage and 0.6 percentage points of GSDP, respectively.

There was a growing dependence on the use of Public Accounts in financing these deficits: the share of central loans and advances declined from above 60 per cent in the early eighties to below 50 per cent, with a low of 32 per cent in 1999-2000, while that of public accounts increased from around 30 per cent to over 40 per cent, with a high of 56 per cent in 1999-2000. Here interestingly, reserve funds not bearing interest ranked first in importance for net accretion to public accounts, with an average share of over 75 per cent. Reserve funds are not considered a part of the public debt of the government.

In spite of the increasing deficits, however, the ratio of public debt to GSDP remained below 15 per cent throughout the period under consideration. This is largely because, of the net accretions in public accounts, only the accretions to the state provident funds are considered a part of the debt stock of the government. On inclusion of the liabilities in the public accounts, especially those within the reserve funds not bearing interest, into total liabilities of the government, the debt-to-GSDP ratio increases to 25 per cent by 1998-99.

Sporadic increases in the rates of interest and shifts in the composition of debt led to periodic hikes in interest payments as a proportion to revenue expenditure, with the figure for 2000-01 (B.E.), excluding the commitment on account of the guaranteed loans of state PSEs, at 19 per cent. For instance, within central government loans, dependence on small savings collections - the relatively discretionary element of central government loans - increased sharply from 20 per cent in 1981-82 to over 60 per cent in 1998-99. Given the higher interest rate associated with this form of debt, this shift accounted for some increase in the average effective interest rate as well. Increase in the average effective rate of interest from less than 7 per cent in early eighties to over 11.5 per cent in 1999-2000 reflected the growing cost of debt.

Composition of Expenditure

For 1998-99, the wage bill accounted for 43 per cent of revenue expenditure, while interest payments accounted for another 14 per cent (Section 3.4). The acceptance of the recommendations of the Fifth Pay Commission meant that the expenditure on wages, salaries and pensions would rise some more. Growing wages and salaries, together with interest payments, implied a squeeze on capital expenditure, with the level falling from 2.3 per cent of GSDP in 1983-94 to 1.18 per cent in 2000-01 (B.E.). This constraint was sought to be relaxed through increased borrowing by public sector enterprises, with a few being created with such express purpose. (Irrigation corporations are a fine example of such an exercise.) While these borrowings were only against government guarantees, it was well recognized that a significant part, if not the entire debt servicing liability, would rest with the government. The commitment towards interest payment alone for 1999-2000, on account of such debt was Rs. 1024.11 crore. This exercise undermined government finances and hindered effective corporatisation of the underlying activity effectively.

In terms of the functional classification of expenditures, share of general services in revenue expenditure has increased while that of economic services has declined. The former is accounted for by increases in interest payments. On the other hand, there has been a decline in the outlays in irrigation, dairy, power and transport. While the overall share of the social sector has remained fairly stable, the shares of education and health have declined. This could be interpreted as suggesting that the importance of development expenditure in total expenditure has been on the decline, and within development expenditure, the share of infrastructure building activities, both in physical and human, has been going down.

Revenue Receipts

An almost continuous decline in the revenue to GSDP ratio since 1986-87 complicated the management of the State's finances (Section 3.5). This trend has been arrested in the last two years, largely on account of improved performance on the tax

revenue front, which is attributed in turn to the introduction of floor rates on sales tax. Own non-tax revenue as a proportion of GSDP, on the other hand, continues on a path of sharp decline. These trends are partly accounted for by the fact that increases in the rate of growth of GSDP after 1986-87 did not translate into higher revenues for the state, either in terms of tax revenue or in terms of non-tax revenue.

While sales tax continues to be the most important source of own tax revenue, its share in the total collections was on a decline until very recently. On the other hand, share of stamp duties and registration has increased sharply, while that of state excises has registered a modest increase. The declining performance of sales tax can be explained in part by an erosion of the base by the various industrial incentive schemes and by an increase ratio of value added to value of output in manufacturing in the state, suggesting either vertical integration of units or a shift to activities with greater value added, both of which reduce the tax base in the first point tax system.

Decline in non-tax revenue on the other hand is related to a decline in the recovery on non-merit services particularly, transport, irrigation and cooperation. The aggregate recovery rates for non-merit economic services has declined from 18.24 per cent in 1993-94 to 16.85 per cent in 1997-98.

Public Sector Enterprises

An across-the-board decline in the total net profits of all statutory corporations and the group of government companies, has affected the already poor finances of the state. The return on capital employed declined from 11 per cent in 1993-94 to 6.5 per cent in 1997-98. Share of capital employed in statutory corporations out of the total capital employed in all public sector enterprises has gradually grown. There is a marked increase in the total outgo to the public sector enterprises, and mainly in the form of loans and equity. As per the government publication on subsidies, hidden subsidies accounted for almost 93 per cent of total subsidies, of which 99 per cent attributable to 3 corporations:

Maharashtra State Electricity Board (MSEB), Maharashtra State Road Transport Corporation (MSRTC) and Maharashtra Industrial Development Corporation (MIDC).

Extra-budgetary operations

The extra-budgetary operations of the government have three main components: guarantees, commodity market interventions and reserve fund operations (Section 3.6).

- Guarantees, a form of explicit contingent liabilities, have increased almost 23 times from Rs 351 crore in 1989-90 to Rs 8,418 crore in 1997-98, amounting to 4.62 per cent of GSDP. Given the lack of any analysis of the extent of exposure on the guarantees, it is difficult to predict whether the cumulative guarantee fees would be enough to honour the invoked guarantees. Historical evidence suggests that the fees collected exceed the payments made on account of guarantees invoked. However, the scenario after 1999-2000 would look considerably different. With additional guaranteed mobilisation of Rs 9,325 crore by PSUs during 1999-2000, where the interest commitment of Rs 1,024 crore for the year is expected to be borne by the government, the ratio of fees collected to guarantees invoked would be significantly altered. If these numbers are considered a part of the debt of the government, an extreme assumption, the stock of debt increases to 25.5 per cent of GSDP and the interest liability to 17.4 per cent of revenue expenditure. This highlights the need for greater transparency in the treatment of guarantees: neither are the receipts collected from guarantee fees maintained in a separate fund facilitating the maintenance of separate accounts nor does the budget contain any information on the actual exposure on this front, undermining the ability to make any provisions for such contingencies.
- Agricultural commodity market shocks have induced the government to provide stabilizing measures in the form of support prices and procurement. Cotton and onion market interventions in the form of support prices have implied that the agencies involved have gone into the red and would require assistance from the government to make future operations viable.

- Reserve funds transactions have meant a notional increase in the fiscal deficit, along with a diversion of pre-committed resources to other uses, thereby undermining the process of pre-commitment itself.

Forecasts of Receipts and Expenditures

Baseline Assumptions: An average real growth rate of 8.3 per cent, along with 5 per cent inflation, i.e., a 13.43 per cent nominal growth in GSDP have been assumed. The collections of own taxes are estimated on the basis of past buoyancies, with a correction made for the improved collections of sales taxes on account of the floor rates regime. Own non-tax revenues, other interest receipts, grants and shared taxes are projected on the basis of historical trend growth rates, while for interest receipts, the figures submitted to the Eleventh Finance Commission have been used. Revenue expenditure has been decomposed into wages and salaries, interest payments and others. Wages and salaries have been projected with the number of employees remaining unchanged, with dearness allowance (DA) provisions for inflation adjustments. Pensions on the other hand are assumed to increase at 9 per cent per annum. The interest payments are determined endogenously, by applying the average rate of interest to the opening stock of debt. Other revenue expenditure is assumed to remain constant in real terms, implying a complete correction for inflation. Capital expenditure and net loans and advances are assumed to remain constant as a proportion of GSDP. Contingent liabilities assume that the new loans guaranteed to the irrigation corporations, Maharashtra State Electricity Board, Maharashtra State Road Transport Corporation and Maharashtra Jeevan Pradhikaran, the guarantees would be invoked, thereby passing on the liability to the government.

Baseline Results: In the baseline, fiscal deficit is consistently higher than 5 per cent of GSDP, debt to GSDP ratio increases from 23 per cent to 33 per cent, while interest payment as a proportion to revenue expenditure increases from 13 per cent to 32 per cent. Correcting for the net transfers to reserve funds, the figures are more reasonable, with

fiscal deficit coming below the 4 per cent mark (revised fiscal deficit stays below 6 per cent)

The above clearly represents an untenable situation, with revised fiscal deficit creeping up to 7.04 per cent by 2004-05 and the debt to GSDP ratio increasing by 87 per cent over the 1999-2000 level, in a short period of six years. On the other hand, there is urgent need to improve delivery and quality of public service in the social sectors of primary education and health, implying the claims for higher expenditures in these areas. A similar case exists for stepping up investment in the areas of irrigation and slum resettlement, all of which suggest that it is necessary to open up fiscal space to accommodate these extra outlays.

The baseline scenario suggests that persistence of present trends on unchanged policies will imply not only a continuation of the current difficulties in fiscal management, but also a continued inability on the part of the Government to deliver quality public goods and services where it is needed, for instance in basic education, health care, roads and other infrastructure.

A Reform Scenario:

The state's fiscal position, because of years of prudent economic policies, has a lot of strength, which it is imperative to build on, through reform. The focus in the reform scenario is on three categories of budget heads: own tax revenue, own non-tax revenue, and wages and salaries. Within own taxes, sales tax holds the key to potential improvements in collections. With the withdrawal of exemptions, buoyancies for sales tax collections are expected to improve dramatically from the present 0.87 to 0.9765. This along with the improvements due to the implementation of the floor rates regime should significantly augment the revenues of the state. Within non-tax revenue, a comparison of the recovery rates across states for 1993-94 suggests that in most cases, there exist states with higher recovery rates than Maharashtra. Further, there is evidence of a decline in the recovery rates for Maharashtra between 1993-94 and 1997-98. As a

conservative measure, it is therefore proposed that the recovery rates be improved to the 1993-94 levels. A more radical move would be to aim for the "best" recovery rates recorded in the country. And finally on the wages bill front, the proposal is for some stringent measures that would reduce the number of employees by 2 per cent every year. This would require that with a natural rate of attrition of 2.8 per cent, only a little less than a third of the posts becoming vacant, be filled up. Further, the rate of growth of the transfers component of the wage bill, as against the present rate of 19 per cent, be reined in at 9 per cent per annum. These measures would successfully bring down the revised fiscal deficit to below 3 per cent by 2003-04, with the state recording a revenue surplus by 2002-03.

Plausible Measures for Reforms

a Tax Policy and Administration

Elimination of exemptions and concessions within the tax structure offers multiple benefits to the state:

- A wider base permits the government to offer a tax structure with lower rates, thereby reducing the returns to evasion and avoidance. Further, exemptions often have the peculiar effect of corroding the existing tax base, with the exempt new units tending to out-price the tax-paying existing units. Estimates of taxes not collected from exempt units tend to underestimate the net loss.
- Fewer exemptions simplify tax administration and reduce the possibility of costly litigations which also lock up tax dues
- Direct subsidies where seen necessary provide a more easily monitorable mechanism for delivering an incentive or subsidy, with the extent of benefit conferred becoming transparent.
- While it is not clear whether exemptions influence the investment decisions of firms, in an environment where all the states are offering variations on the same theme, a similar quantum of benefit in the form of improved infrastructure might prove to be a greater influence.

The proposal to convert the existing system of sales taxes to a Value Added Tax could provide a context to streamline the tax system, in terms of structure, procedures and administration. It is important however, to properly assess the potential loss from giving tax credit to taxes paid on inputs against the additional revenue from extending the tax net beyond the first stage, so as to ensure that in the transition, the state does not suffer a loss of revenue. Within tax administration too, there could be lot of gain in moving away from the present system of 100 per cent assessment to one of selective assessment, with a greater emphasis on detailed audits.

b. Non-Tax and Expenditure Restructuring:

Improvements in recovery rates here would have to take one of two forms: a higher user charge on services delivery, given the level and form of delivery of services, or a change in the form of delivery of services so as to roll back the level of expenditure on the service. This could call for experimenting with new forms of service delivery.

In the education sector, for instance, increases in school fees to recover 10 per cent of the total cost of employing a teacher could enable an increase of staff strength by 11 per cent at the secondary level, and would imply an increase in the fees by Rs 270 per student per annum. Annual assessments of the fees structure as well as alternative means of augmenting the finances of the schools would go a long way in curtailing the pressure on government finances by way of increased transfers to the schools.

Similarly, the composition of expenditure in public health reveals a high share of "policy formulation", while in water supply and sanitation, the bulk of the expenditure is in the form of transfers to urban and rural local bodies. These suggest a high degree of centralization in decision making, usually with transfers on a normative basis, all of which undermine the decentralized initiative, not necessarily with superior results. A review of the organizational structure along with initiatives for greater decentralization in resource allocation and utilization could improve the effectiveness of public expenditures alongside raising the feasibility of administering higher user charges.

c. Contingent Liabilities Management

There are two major aspects for more efficient management of contingent liabilities:

- First, a proper assessment and documentation of the underlying risks is essential. Where the risks are not covered through the guarantee fees, the government should provide for such potential expenditure in the budget, and ensure that the budgeting process is not undermined. Along with the budget, detailed documents of the guarantees with the underlying risks could be presented to the Legislative Assembly to permit a discussion of the same.
- Second, in cases where the Government feels a need to subsidise the financing of some specific service, it can consider granting an explicit subsidy, which can be assessed on an annual basis. This is a more superior and more transparent alternative to entering into a long-term indirect commitment.

d. Improving Financial Management

The present system can be characterized as a supply driven system, with normative basis for expenditure allocations, where the emphasis is more on inputs and efforts than on performance and deliverables. Further, once a programme is included in a developmental plan, it is rarely subjected to reassessment, and expenditure that is proposed in one plan automatically becomes a part of the non-plan expenditure in subsequent periods. This system of budgeting therefore does not involve procedures that permit systematic reassessment of expenditures, and even in the event of financial crunch, the policy response tends to be ad hoc.

An alternative to the above could be to

- Formulate a Medium-Term Fiscal Policy (MTFP) for Maharashtra that reflects the realities of resources and that seeks to promote a stable economic environment. This exercise is re-evaluated every year and sets out targets for any given year, in the context of the short term and medium term pressures faced by the state economy.
- Promote a greater awareness of the linkages between resources and delivery of services and to ensure that the latter is substantially strengthened.

- Explore the possibilities of economies in expenditure through rationalisation of administrative machinery and the application of EDP technology;
- Promote a greater decentralisation of economic decision making and establish an improved congruence between task-responsibility and power.

Spending ceilings arrived at through this process need to be inviolable for the entire programme to have the desired impact.

Progress in Budget 2001-02:

The government's inability to spend the budgeted amounts in 1999-2000 meant that the balance of the expenditures spilt over into the next financial year thus distorting the fiscal outlook for 2000-01. This situation got further affected by the deterioration in the financial state of the MSEB requiring a transfer of over Rs. 4,000 crore from the government. This reflects the vulnerability of the state's finances to fluctuations in the fortunes of the State Electricity Board.

Efforts at setting the house in order can be seen in a freeze on DA payments with a delinking from the central government DAs, aiming at reining in the rate of growth of the wage bill, at least on account of inflation. Further, attempts at structural reorganization of the service delivery departments to ensure greater coordination in efforts too seem to be afoot, with the proposal for a single field office for five separate corporations operating within welfare activities. Another interesting development is to provide a more decentralized appearance to governance in the state by delegating certain activities to the local bodies and by providing some incentives to the bodies to improve service delivery and revenue collections.

A disturbing feature about the finances of the state, however, is a continuation of the trends of the past. The sensitivity of the government to commodity market fluctuations and their adverse impact on the finances of the state government continue to dog the government. Price support provided to food grain cultivators, through procurement with minimum support price, has implied a cost to the exchequer of Rs. 100

crore. Similarly, the budget announced a decrease in the irrigation dues, thereby undermining the financial viability of the activity and corporations. Relief measures offered to farmers in scarcity affected regions: relaxed norms for employment guarantee scheme (EGS), remission of land revenue, reduction in electricity rates and exemption from payment of examination fees for eligible students, and rescheduling of loan repayments will also have their adverse impact on the state finances. While explicit subsidies could have provided as much relief, the preference for non-transparent indirect subsidies continues.

To summarise, the state of affairs of the state government need serious consideration. Key issues the burgeoning wage bill, expanding commitments on account of guaranteed borrowing which is expected to come home to roost and poor recovery on non-tax revenue reflecting high levels of subsidies. In addition, there is the factor of the government's agricultural market operations which tend to be partly unanticipated and hence have a destabilizing influence on the budgetary aggregates. De-linking of the state DA from the central DA announcements indicates the first serious step towards placing a curb on the rate of growth of the wage bill. The subsidy to be provided to the MSEB towards the proposed subsidy vis a vis the tariffs proposed by the Maharashtra Electricity Regulatory Commission (MERC) also indicates a positive development. For the first time, the subsidy proposed by the government is being explicitly accounted for in the budget. This would be a first step towards making the regime of subsidies in some of the crucial sectors transparent and accountable, thus permitting a re-evaluation at a later date as well.

Maharashtra is the foremost industrialized state in India. The state's rate of growth has outpaced that of the country's in much of the last two decades. The relative prosperity of the state however, does not find adequate reflection in the social indicators such as gross enrollment ratio, infant mortality rate and life expectancy at birth. Furthermore, there is need to augment the road infrastructure. The state needs to enhance its outlays on physical and social infrastructure. Usually commended as one of the best-managed states of India, Maharashtra - like other states- has been in the news for fiscal distress. The steps

indicated above on fiscal consolidation, revenue augmentation and expenditure management should help the state accelerate its development on a sustainable path. Maharashtra being in the vanguard of States in India, should not only reverse the recent negative trends but also build on its inherent strengths to set up a model of how to run government affairs at the sub-national level.

Maharashtra: socio-economic profile

Attribute	Description	Year	Unit	Maharashtra	India
Area		1991	In '000 Sq. Kms.	308	3287
Population	Total	2001	In '000 nos.	96,752	1,027,015
	Urban	2001	Percent of total	42.4	27.7
	Females	2001	Per 1000 males	922	933
	Decennial Growth Rate	1991 - 2001	Percent	22.57	21.34
Infant Mortality Rate	3-year moving average	1991	Nos	47	71
Life Expectancy at Birth		1988 - 1992	Years	63.4	58.7
Literacy Rate	Total	2001	Percent	77.27	65.38
	Males	2001	Percent	86.27	75.96
	Females	2001	Percent	67.51	54.28
Gross Irrigated Area	Out of Gross Cropped Area	1993 - 94	percent	15.4	36.7
Food-grain Production	Tri-ennial Average	1993-94 to 1995-96	Kg. per capita	146.2	206.4
Livestock		1992	In '000 nos.	36,393	470,830
Forest Area		1993 - 94	In Sq. Kms.	63,851	684,210
Electricity	Generation	1996 - 97	Million Kwh	54,037	395,896
	Domestic Consumption	1996 - 97	Per capita Kwh	95.30	59.66
	Industrial Consumption	1996 - 97	Per capita Kwh	207.80	113.39
Road Length		31-3-1995	Kms. Per 100 Sq. Kms.	73	67
Motor Vehicles		31-3-1995	Per one lakh Population	5,133	3,912
Bank Deposits		31-3-1998	Rupees per capita	13,200	6,132
Bank Credit		31-3-1998	Rupees per Capita	9,542	3,403
Income	At Current Prices	1997 - 98	Rupees per capita	18,365	13,193
Domestic Product	At Factor Cost	1997 - 98	Rupees per capita	20,343	14,877

1. Introduction

Maharashtra is an advanced state of India in terms of per capita income, growth, and as a destination of investment. The State, with only 9.3 per cent of the population of the country, accounted for 13 per cent of total gross capital formation in the country in 1997-98. Its capital Mumbai is the premier city of India and the commercial capital of the country (See Box 1.1). Yet, Maharashtra may, at best, be referred as an advanced state only of a developing country. Its per capita income of Rs.18,365 was less than US\$ 500 in 1997-98. Its literacy rate at 65 per cent in 1991 and life expectancy at 63.4 years during 1988-92 were not only low by developing country standards, but also not “exceptionally high” by all-India standards.¹ A lot remains to be done in the State.

Box 1.1: Mumbai – the Commercial Capital

Bombay, now Mumbai – originally a cluster of seven islands Old Woman’s, Colaba, Mumbai, Worli, Parel, Mazagaon and Mahim – is the foremost city of India. The cluster of islands on the Arabian Sea is separated from the mainland by tidal marshes. Although Mumbai is ranked second to Calcutta in population terms, it is the commercial capital of India with the Reserve Bank of India, headquarters of most of the financial institutions, the most active stock market in the country, the Mumbai port, and “Bollywood”, the home of the Hindi film industry, located in the city. Even in terms of manufacturing, in 1981, Mumbai generated 8.6 per cent of the nation’s industrial jobs and 14.5 per cent of the value added in the country.

Often called the New York of the East, Mumbai is the gateway to India from the west, not only by sea, but even by air. But the city is beset with problems with an acute housing shortage, traffic congestion, overstretched urban infrastructure and thousands of slum colonies with millions of people.

¹ The Census for 2001 shows remarkable improvement in the literacy rates for Maharashtra to 77 per cent from the 1991 census level of 65 per cent.

The Government of Maharashtra (Government hereafter) has to provide leadership in the development process. It has to provide universal primary education and health care, safe drinking water and sanitation, roads and other infrastructure. The Government has more or less maintained a prudent fiscal stance and done a creditable job of promoting development in the State. Maharashtra's public debt at less than 15 per cent of its GSDP is one of the lowest in the country. Furthermore, the State has seldom taken recourse to ways and means advances or overdraft facility of the Reserve Bank of India. However, like many other States in India, Maharashtra also is undergoing severe fiscal stress, particularly after the implementation of the Fifth Central Pay Commission's recommendations.

The revenue deficit of the State increased by Rs. 5,230 crore from a revised estimate of Rs. 2,742 crore in 1998-99 to a budget estimate of Rs. 7,972 crore in 1999-2000. In 1999-2000, relative to the Rs. 5,230 crore expansion in the revenue deficit, the Government contained the expansion in fiscal deficit to only Rs. 1,365 crore only by squeezing out capital outlays. The fiscal crunch led the Government to try and impound the arrears from pension revision effective from January 1, 1996. It had to go in for a compromise solution on August 24, 1999 after a protracted legal battle with the pensioners at the Mumbai High Court. In October 1999, CRISIL, the credit rating agency downgraded four bond programmes of Government undertakings – Konkan Irrigation Development Corporation, Maharashtra Krishna Valley Development Corporation, Tapi Irrigation Development Corporation, and Vidarbha Irrigation Development Corporation – from A+ to A. The downgrade reflected, according to CRISIL, the deterioration in the fiscal profile of the Government.

The new Government, immediately after assuming power on October 18, 1999, announced its intention to tackle the State's finances and come out with a status paper. It

came out with a White Paper² on the financial situation of the State Government in December 1999. The White Paper noted the rapid growth in primary, revenue and fiscal deficits in recent years. It drew attention to the unsatisfactory performance of revenue-to-GSDP ratio, the run-away growth in wages and salaries and interest payments, the squeeze on capital expenditure, the ballooning debt, and the 'imprudent' use of borrowed funds both directly and through state enterprises.

The White Paper laid down the aim of achieving revenue balance in five years, and suggested five measures – containing salary related expenditure, better debt management, improved expenditure management, pruning down subsidies and restructuring of State-owned enterprises (including restructuring, divestment and closures). The White Paper announced the intention to "push ahead by taking into confidence the people's representatives, thinkers, economists and the general public with a view to formulating policies in tune with the changing circumstances and transparent governance."

The National Institute of Public Finance and Policies (NIPFP) was engaged by the Government of Maharashtra on August 27, 1999 to undertake a "Study of Maharashtra's Finances". This report contains the findings and recommendations of the Institute's study. The plan of the report is as follows: Part I covers the trends and issues facing State Economy (Chapter 2) and State Finances (Chapter 3). Based on the analysis in Chapter 3, Part II presents a forecast of Receipts and Expenditures (Chapter 4). Part II discusses a baseline as well as a proposed reform scenario, which corrects for the incipient problems thrown up in the baseline. Finally Part III (Chapter 5) fleshes out the reforms proposed in Part II in terms of implied measures and organisational restructuring. The Epilogue at the end provides a brief discussion of the developments in the last budget.

² A government report giving information or proposals.

Part I

Trends and Issues

2. THE STATE ECONOMY

2.1 Growth Performance and Sector Profiles

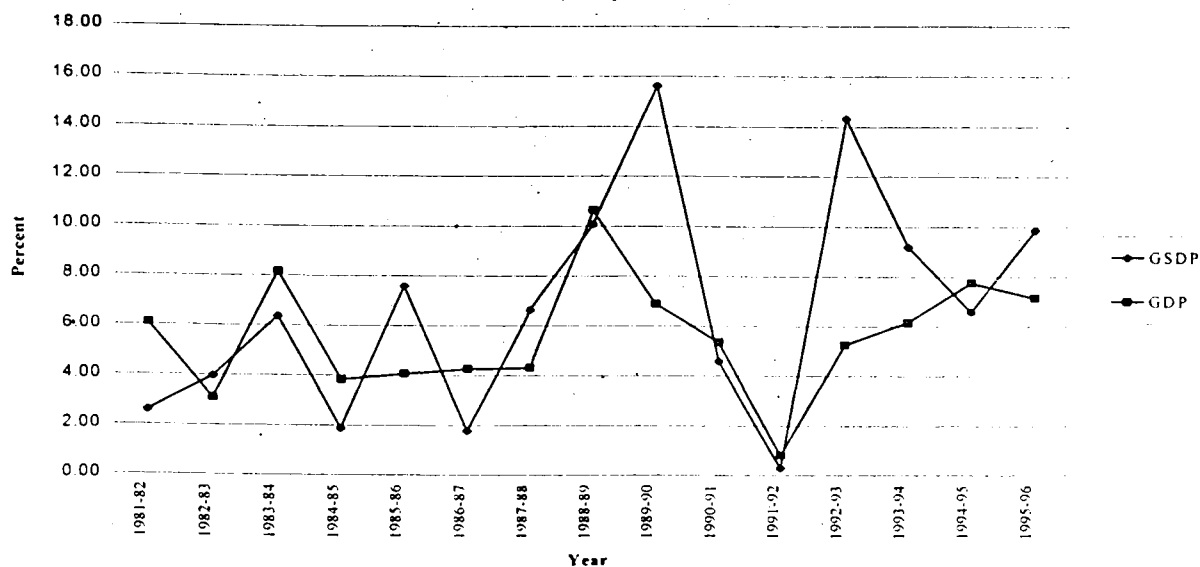
In 1996-97, Maharashtra ranked second among the Indian states in terms of per capita income (Table 2.1). Moreover, with annual (real) growth of GSDP at 7.03 per cent during 1980-81 to 1997-98 Maharashtra was among the fastest growing states of the country. Growth has not only been high, but has accelerated from 4.28 per cent during 1980-86 to 8.37 per cent during 1987-96.

Table 2.1: Growth Performance: A Comparison

	Rates of Growth of GSDP (per cent)		Per capita NSDP (Rs.)
	1980-86	1987-96	1996-97
Goa	2.73	7.32	6,227
Maharashtra	4.28	8.37	4,853
Punjab	5.33	4.60	4,412
Haryana	5.85	5.19	4,029
Gujarat	4.93	7.28	3,717
Tamil Nadu	4.89	6.31	2,918
West Bengal	4.71	6.11	2,876
Karnataka	4.59	5.68	2,641
Andhra Pradesh	2.84	5.01	2,500
Kerala	1.85	6.09	2,325
Rajasthan	5.29	6.29	2,247
Madhya Pradesh	2.66	5.15	1,875
Uttar Pradesh	4.07	3.60	1,748
Assam	3.84	3.58	1,628
Orissa	4.22	3.12	1,595
Bihar	5.60	1.58	1,010

The acceleration in growth between the two parts of the reference period, however, has been accompanied by some dips in the growth performance in selected years. For example, growth decelerated sharply from 15.63 per cent in 1989-90 to 4.59 and then to 0.29 per cent in the two subsequent years (Figure 2.1).

Figure 2.1: Year on Year Growth Rate of Maharashtra (GSDP) and India (GDP) at Constant 1980 - 81 prices



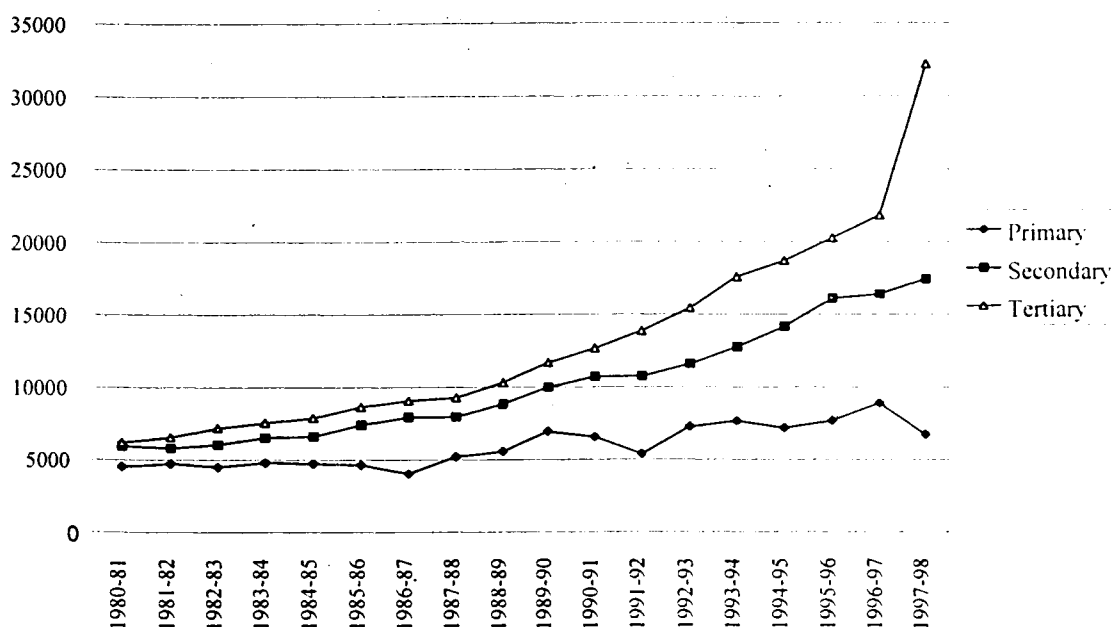
It is observed that, between 1980-81 and 1992-93, the growth rates of both Maharashtra's GSDP and India's GDP moved more or less synchronously. The variation in the rate for Maharashtra, however, was much more pronounced (signifying higher volatility) with a standard deviation of 4.5 as compared to 2.38 for India. In the phase after 1992-93, the growth rates have been totally asynchronous. While growth in the country accelerated till 1994-95, Maharashtra showed a steep decline in growth. Again, growth picked up in Maharashtra in 1995-96, when the country's growth declined.

Table 2.2: Sectoral Growth Rates

Period	(Per cent)		
	1980-81 to 1986-87	1987-88 to 1997-98	1980-81 to 1997-98
GSDP (current prices)	11.74	17.70	16.26
GSDP (1980-81 prices)	4.28	8.37	7.03
Primary	-0.38	5.00	4.37
Secondary	5.35	8.10	7.14
Tertiary	6.63	9.77	8.42
Per Capita GSDP	2.02	5.77	4.69

In terms of the sectoral composition of growth, all the three sectors: primary, secondary and tertiary, recorded significant increases in growth rates after 1986-87. This change is stark in the case of the primary sector, which during the early eighties recorded

Figure 2.2: Gross State Domestic Product (Rs. crore)



no growth, or even some decline in output. This trend was reversed in the subsequent period, with growth rates as high as 5 per cent.

In both sub-periods, of the three sectors, the tertiary sector recorded the fastest growth, followed by the secondary sector. This has meant that the share of primary sector in GSDP has declined over this period from 27 per cent to about 18 per cent, largely in favour of the tertiary sector. The share of the latter has increased from 38 per cent to 46 per cent. The share of the secondary sector, however, has remained stable at around 35 per cent throughout this period. While the rate of growth of industrial activity has been stagnating in the State, Maharashtra continues to be the foremost industrialised state of India. Maharashtra's share in India's secondary sector, however, has declined marginally from about 19.9 per cent in 1980-81 to 19.7 per cent by 1995-96.

2.2 Social Indicators

Maharashtra's rate of growth of population at 2.32 per cent per annum during 1981-91 was considerably higher than not only the all-India average of 2.13 per cent. during the same period, but also other high income states. This high growth in population was caused partly by in-migration of workers from other states in search for employment. High population growth not only exerted a strain on growth in per capita income, but also depressed its social indicators. Maharashtra's relative prosperity in terms of income does not find adequate reflection in its social indicators. While part of the problem may be because of in-migration from poorer states, weak social indicators also reflect the lack of success of the Government in investing in and administering social sector programmes.

a. Elementary education

The literacy rate is above the national average, but significantly lower than that recorded for Kerala. While the total literacy rate in the state is more or less at par with that in the other high income states, a low gross enrollment ratio (particularly for girls) relative to Gujarat and Tamil Nadu does not augur well for development. It reflects an inability of the Government to reach the message of *education for all*, and to create and maintain schools and teaching that attract children and encourage parents to send their wards to school. A high drop out rate at close to 40 per cent indicates inefficiency of the educational sector in retaining the enrolled children.

Table 2.3: Performance Indicators: Education

(Per cent)

Attribute	Literacy Rate			Gross Enrollment Ratio in Primary Education			Drop Out Rates		
	Male	Female	Total	Boys	Girls	Total	Boys	Girls	Total
Year	1991			As on Sept. 30 1993			1989-90		
Gujarat	73.10	48.60	61.30	111.37	95.33	103.59	37.98	46.42	41.73
Karnataka	67.30	44.30	56.00	106.51	93.40	99.96	41.97	49.93	45.67
Kerala	93.60	86.20	89.80	98.93	95.72	97.34	-4.79	-3.27	-4.21
Maharashtra	76.60	52.30	64.90	98.53	91.02	94.87	32.69	41.83	39.96
Punjab	65.70	50.40	58.50	86.21	81.50	83.99	31.17	31.82	31.47
Tamil Nadu	67.20	41.80	54.60	101.96	98.20	100.11	18.78	23.64	21.04
All India	64.10	39.30	52.10	90.04	73.10	81.85	46.5	50.35	48.08

Note: Enrolment ratios and dropout rates refer to Primary Education.

Source: National Council of Educational Research and Training, Sixth All-India Educational Survey, July 1998.

More recent figures for Maharashtra show an improvement, with gross enrolment ratios at 103.5 and drop out rates at 30 per cent. Further rapid decline in drop-out rates are needed to reap the full benefits of educational outlays.

b. Health

In the field of health, both in terms of Infant Mortality rates and Life Expectancy at Birth, Kerala outperforms Maharashtra. In terms of Life Expectancy at Birth, even Punjab does better. The relative under-performance of Maharashtra in the health sector is significant since the other two states represent completely different economic and fiscal performances. Kerala is a middle income state with per capita income close to half that of Maharashtra. On the other hand, Punjab is comparable to Maharashtra in terms of per capita income.

Table 2.4: Performance Indicators: Health

Attribute	Infant Mortality Rate (per '000 live births)		Life Expectancy at Birth (yrs.)
	1991	1997	(1988-92)
Gujarat	69	62	59.5
Karnataka	77	53	62.2
Kerala	17	12	70.9
Maharashtra	60	47	63.4
Punjab	53	51	66.6
Tamil Nadu	57	53	61.5
All India	80	71	58.7

Life Expectancy at Birth of 68.1 for 1997 shows a marked improvement of 5.7 years over 1988-92. This may partly be a reflection of the expenditure composition of health spending. Maharashtra has been spending relatively more on preventive services (defined to include expenditure on public health and family welfare and water supply and sanitation). Nevertheless, the total expenditure - revenue and capital - on health services, preventive and curative put together, amounts to less than 1 per cent of GSDP. Kerala, for

instance, spends more than 1.25 per cent of GSDP on health. Total outlay on health needs augmentation.

2.2 Infrastructural Indicators

a. Irrigation

Yields of crops in Maharashtra are low in comparison to all-India averages. Non-conducive soil and climatic conditions contribute to the low yields. 85 per cent of the land surface of Maharashtra is under basaltic rock and a similar proportion of agriculture is of dry-land type with a third of the state falling in the rain shadow region. According to the Economic Survey of Maharashtra (1998-99), the irrigation potential of Maharashtra is estimated to be only 42 per cent of total cultivable land area. Nevertheless, in terms of gross irrigated area to gross cropped area, the performance of the state at 15.4 per cent is way below not only the national average (37.5 per cent), but also its own potential irrigation capacity. The state has achieved only 37 per cent of its irrigation capacity. Several irrigation corporations have been spun-off in the recent years. But the financial viability of most of these corporations may be severely undermined unless a system of collecting user charges generating revenue streams for the corporations is formalised.

b. Roads

Road length per thousand square kilometers of area in Maharashtra at about 731 kms. is marginally above the national average (Table 2.4). This figure is significantly lower than that for some of the other states namely, Kerala, Tamil Nadu, Punjab and even Orissa (1350 kms.). The state has set up a State Road Development Corporation to undertake road development, especially in places where toll roads appear feasible. Some of the initial investments of this corporation are in fly-overs in Mumbai.

Table 2.4: Transport Infrastructure

	Roads (km. per '000 sq km) (1993-94)	Vehicle Density No. per sq. km	Railways (km. per '000 sq km) (1993-94)
Gujarat	550.2	13.9	26.94
Haryana	584.6	18.9	33.91
Karnataka	728.1	9.4	16.05
Kerala	3550.5	22.8	27.07
Maharashtra	731.3	10.6	17.74
Punjab	1130.7	32.5	42.08
Tamil Nadu	1559.3	16.5	30.91
All India	662.6	8.3	19.00

Source: CMIE, Profile of States, March 1997.

c. Power

In spite of being a high-income as well as a high growth state, per capita consumption of power in Maharashtra is considerably lower than that in other high-income states. Given the diversity of the levels of industrial activity in these states, the proportion of power used by the domestic consumer varies considerably. Correcting for this element, however, it appears that per capita domestic consumption of power too is higher in Punjab and Haryana when compared with Maharashtra. As of 1994, Gujarat, Maharashtra and Tamil Nadu are power surplus states.

Table2.5: Demand for Power

	Per capita Consumption of electricity (kwh)	Share of Domestic consumption in total demand for power	Per capita Domestic Consumption (kwh)
Gujarat	520	11.98	62.30
Haryana	453	21.06	95.40
Karnataka	301	15.15	45.60
Kerala	207	35.04	72.53
Maharashtra	443	18.53	82.09
Punjab	690	15.09	104.12
Tamil Nadu	364	17.06	62.10

Source: CMIE, Profiles of States, March, 1997.

The Maharashtra Electricity Regulatory Commission (MERC) has initiated the process of correcting the downward bias in the electricity tariffs, both industrial and residential, with the express objective of bringing them in line with the costs of supply in a five year time frame. The state has made significant progress in the privatisation of

electricity generation with several projects at various stages of development (Dabhol, Patalganga, Bhadravati). However, with the ongoing dispute between Dabhol Power Company (DPC) and the MSEB, on the interpretation and implementation of the terms of the contract, the effectiveness of power purchase agreements in ensuring pre-committed terms of operation has been severely undermined. Further developments along the lines of privatisation in this sector therefore would be conditioned by the form of resolution of this conflict.

d. Urban development

Maharashtra is the 4th most urbanised state in the country (after Delhi, Mizoram and Goa) with almost 38.7 per cent of its population in urban areas (according to the 1991 census). By the end of 1996-97, there were 12 municipal corporations in the state. Maharashtra is one of the few states that charge an octroi on the goods moving into a municipal area. This has been one of the main sources of revenue for the municipal corporations. However, the urban areas are under severe strain with congested roads, overcrowded public transport system and preponderance of slum colonies lacking in civic amenities. A system of flyovers has been planned to ease the traffic bottlenecks, but doubts are already being raised about their ability to generate revenue and hence financial viability. The slum rehabilitation scheme (Shivshahi Punarvasan Prakash Ltd.) has already lost a lot of steam and money. The public transport system is stretched several times its capacity resulting in high costs of maintenance.

While Maharashtra's performance in the area of economic growth has been one of the best in India, the state needs to build on its strength. There is a need to bolster the social and infrastructural sectors. It is only by building these sectors that the state will be able to sustain its past strong growth performance and maybe even boost it further.

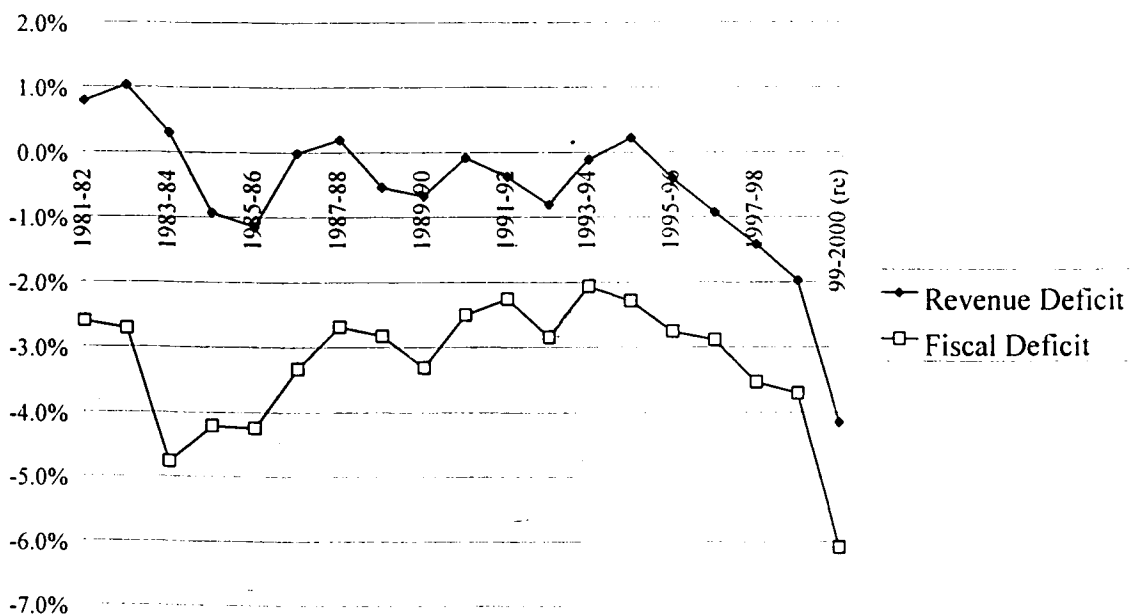
3. STATE FINANCES

3.1 Introduction

Usually commended as one of the best-managed states in India, Maharashtra is now in news for being in fiscal distress. The fiscal deficit was budgeted to go up to 5 per cent of Gross State Domestic Product (GSDP) during 1999-2000. Wages and salaries account for close to 70 per cent of the revenue expenditure of the government. Interest payments account for another 16 per cent of revenue expenditure. Rapid increases in borrowings by public sector enterprises have imposed an additional requirement of 3 per cent of revenue expenditure for servicing the bonds of these enterprises. Thus, wages and salaries and interest payments (including that on public sector enterprise bonds) account for close to 90 per cent of revenue expenditure, and not only exhaust but exceed revenue receipts by 19 per cent.

There has been a steady deterioration in the fiscal position of Maharashtra since 1994-95 (Figure 3.1). Although the revenue balance turned from a deficit in 1993-94 to a surplus in

Figure 3.1: Deficit as a Proportion of GSDP^a



^aNegative figures signify deficits, while positive figures indicate surpluses

1994-95, in terms of GSDP, there was a 0.2 percentage point increase in the fiscal deficit from 2.1 per cent in 1993-94 to 2.3 per cent in 1994-95. In any case, the improvement in

revenue balance was short-lived, with consistent deterioration in almost every year since 1994-95 the revenue deficit reached 4.1 per cent of GSDP in 1999-2000 (RE)³. Redressing the underlying causes for the deterioration is essential for restoring the fiscal health of the State.

3.2 History Revisited – 1984-85 and 1994-95

Maharashtra's fiscal position, after suffering a major setback in 1983-85, portrays cyclical fluctuations along an improving trend line until 1993-94. The fiscal deficit as a proportion of GSDP had increased from 2.7 per cent in 1982-83 to 3.2 per cent in 1983-84 and further to 4.2 per cent in 1984-85. This was mainly due to a 0.4 percentage point increase in revenue expenditure on dairy development during 1983-84. In 1984-85, the corresponding increases in revenue expenditure on Agriculture and Community Development, Public Works and Power respectively by 0.55, 0.21 and 0.20 percentage points propelled the increasing deficit. Since 1984-95, the fiscal deficit as a proportion of GSDP declined every year until 1993-94 except in 1988-89, 1989-90 and 1992-93. However, the State has been unable to turn the revenue balance from a deficit to a surplus since 1983-84 except in 1987-88 and 1994-95.

The deterioration in the fiscal position of the State in 1994-95 bears some similarity with 1984-85. For instance, the revenue balance, as a proportion of GSDP, turned from a deficit of 0.1 per cent in 1993-94 to a surplus of 0.2 per cent in 1994-95. Surges in sales tax collections and in stamp duties and registration fees by 0.28 and 0.34 percentage point (of GSDP) respectively accounted for this shift in fortunes. But a doubling of capital outlays from 1.5 per cent in the previous year to 3.0 per cent resulted in a deterioration in the fiscal deficit by 0.2 percentage points. The increase in fiscal deficit in 1993-94 was contained by a lower net loans and advances by the State government at Rs. 468.74 crore. The net repayment of such loans of Rs. 657.07 crore in 1994-95, resulted in a downturn of almost 1 percentage point of GSDP. The large increase in capital outlay accompanied by a large repayment of loans and advances was the result of a debt-for-equity swap by the MSEB. The deal was motivated not so much by considerations of profits or returns to the Government as much as

³ Only in 1998-99, there was a very marginal improvement in the revenue balance as a proportion of GSDP. The balance improved from 1.4 per cent in the previous year to 1.3 per cent.

by the desire to provide financial support to the ailing MSEB and to shore up its profit and loss account.

Had the revenue surplus and increased capital outlays been sustained, the 1994-95 experiment would have been a success. But the revenue surplus was short lived. It not only turned to a deficit in the subsequent year, but kept on increasing almost continuously to reach an all-time high of an estimated 4.1 per cent of GSDP in 1999-2000 (RE). As loans and advances by the State Government turned back into moderately high positive figures from 1995-96, the fiscal deficit also started to mirror, albeit in an accentuated fashion, the deterioration in the revenue balance. The fiscal deficit as a proportion of GSDP increased almost continuously to reach an all-time high of 6.1 per cent in the revised estimates for 1999-2000. The main difference between the 1984-85 bout of fiscal deterioration and the recent episode since 1994-95 is the depth and protracted nature of the deterioration.

3.3 Deficit and Debt Profile

a. Deficit

Despite the worsening of the fiscal situation in 1983-85, the fiscal and revenue deficit, as a proportion of GSDP, had been fluctuating around 0.1 per cent and 3.0 per cent respectively during 1980-81 to 1993-94. The permanent damage to State Finances by a one shot increase in the fiscal deficit in 1984-85 is clearly visible in the steady increase in interest payments as a proportion of GSDP since 1984-85. Such payments went up from 0.8 per cent in 1983-84 to 1.0 per cent in 1984-85 and increased further to as much as 1.4 per cent by 1986-87 (Table 3.1). The balance from current revenues, used for calculating the Plan size, had always been positive for Maharashtra (Table 3.2). But even this balance turned negative for the first time in 1985-86. Had it not been for this solitary exception, Maharashtra, like Karnataka, could have had the distinction of being a State with a continuously positive balance on current revenues since 1984-85.

Table 3.1: Maharashtra: Fiscal Highlights
(As a per cent of GSDP)

	1981-82	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000 (re)
<i>Tax Revenue (a)</i>	9.35	9.71	10.57	10.29	10.09	9.62	9.48	9.77	8.75	8.41	8.92	8.38	8.15	8.48	8.34	8.47
Own tax revenue	7.38	8.03	8.72	8.53	8.46	7.90	7.95	8.11	7.22	7.01	7.55	7.27	6.82	7.53	7.17	7.33
Shares taxes	1.97	1.69	1.85	1.77	1.62	1.71	1.54	1.66	1.54	1.40	1.37	1.11	1.33	0.95	1.17	1.14
<i>Non tax Revenue (b)</i>	3.38	4.38	4.98	4.48	3.86	3.91	4.02	3.54	3.15	3.41	3.13	2.62	3.07	2.67	2.26	2.21
Own non-tax revenue	2.68	3.29	3.49	3.14	2.54	2.82	2.78	2.44	2.12	2.17	2.32	1.84	2.19	2.00	1.75	1.43
Grants	0.70	1.09	1.49	1.34	1.32	1.09	1.23	1.10	1.02	1.24	0.81	0.78	0.88	0.67	0.51	0.77
Total revenue Receipts (c=a+b)	12.73	14.09	15.55	14.78	13.95	13.52	13.50	13.31	11.90	11.83	12.05	11.00	11.22	11.14	10.60	10.67
<i>Revenue Expenditure (d)</i>	11.94	15.24	15.56	14.58	14.48	14.63	13.72	13.89	13.04	11.94	11.83	11.41	12.14	12.56	12.57	14.82
Of which Interest	0.78	1.05	1.36	1.40	1.40	1.40	1.38	1.60	1.51	1.38	1.41	1.37	1.43	1.59	1.80	2.03
Revenue Surplus/Deficit (+/-)	0.79	-1.14	-0.01	0.20	-0.53	-0.67	-0.08	-0.38	-0.80	-0.11	0.22	-0.40	-0.93	-1.42	-1.97	-4.15
Capital Expenditure	2.09	1.96	2.11	1.85	1.72	1.81	1.50	1.33	1.52	1.52	3.03	1.80	1.58	1.76	1.56	1.74
Net loans and advances by the state govt.	1.30	1.13	1.22	1.03	0.57	0.83	0.92	0.56	0.52	0.43	-0.52	0.56	0.37	0.36	0.17	0.20
Fiscal Surplus/Deficit (+/-)	-2.61	-4.24	-3.33	-2.69	-2.83	-3.31	-2.50	-2.26	-2.84	-2.06	-2.28	-2.76	-2.89	-3.53	-3.70	-6.08

Table 3.2: Balance from Current Revenue : Maharashtra (1984-85 to 1997-98)

(Rs. crore)

Year	Total revenue receipts	Grants from Centre					Total (col.+3+4+5+6)	Net revenue receipts (col.2 - col. 7)	Total Revenue Expenditure	Plan revenue expenditure	Non plan revenue expenditure	Balance From Current Revenue (col.8 - col.11)
		Plan Grants From Centre	Non plan Grants for local bodies	Non plan Grants for Special Problems	Non plan Upgradation grants	Total						
1	2	3	4	5	6	7	8	9	10	11	12	
1984-85	3667.8	306.1	0.0	0.0	0.0	306.1	3361.8	3879.8	722.6	3157.3	204.5	
1985-86	4174.2	286.4	0.0	0.0	0.0	286.4	3887.7	4490.8	501.8	3989.0	-101.3	
1986-87	4978.2	393.1	0.0	0.0	0.0	393.1	4585.2	4978.8	988.0	3990.8	594.3	
1987-88	5578.2	418.9	0.0	0.0	0.0	418.9	5159.3	5504.5	1089.9	4414.5	744.7	
1988-89	6299.9	456.1	0.0	0.0	0.0	456.1	5843.8	6540.7	1284.8	5255.9	587.9	
1989-90	7528.7	435.7	0.0	26.8	0.0	462.5	7066.1	7902.6	1404.2	6498.3	567.8	
1990-91	8699.0	631.9	0.0	7.7	0.0	639.6	8059.4	8753.7	1381.3	7372.4	687.0	
1991-92	9772.6	660.2	0.0	1.8	0.0	662.0	9110.6	10050.4	1438.0	8612.4	498.3	
1992-93	10818.2	793.8	0.0	0.0	0.0	793.8	10024.4	11546.7	1942.9	9603.8	420.6	
1993-94	12986.8	1203.2	0.0	0.0	0.0	1203.2	11783.6	13108.7	1809.0	11299.7	483.9	
1994-95	15089.5	842.3	0.0	0.0	0.0	842.3	14247.2	14812.2	2060.1	12752.1	1495.1	
1995-96	16559.3	968.5	0.0	0.0	0.0	968.5	15590.8	17168.4	3226.7	13941.7	1649.1	
1996-97	19255.2	1443.6	120.0	0.0	0.0	1563.6	17691.6	20845.8	3777.9	17067.9	623.7	
1997-98RE	21721.1	1541.5	95.1	0.0	0.0	1636.6	20084.6	22390.7	3852.0	18538.7	1545.8	

Note: RE = Revised Estimates

Source: Reserve Bank of India Bulletin, various Issues.

The problem with a deficit for a State is that, while much of the demand side benefit of a deficit financed expenditure programme is lost through leakages to other States, it leaves a permanent mark on the State's finances through a permanent increase in interest liabilities. Thus, a one-shot increase in deficit financed expenditure has a tendency to lead to further deficits in the future. The exception is only when the expenditure itself has a virtuous effect on increasing productivity and output in the State through effectively administered programmes in areas such as basic education and health care, roads and infrastructure.

b. Financing – use of Public Accounts

Maharashtra has been able to finance the relatively large and growing fiscal deficit mainly through the use of balances in the Public Accounts. The State is indebted to the Centre, and Article 293 of the Indian Constitution requires it to obtain the Centre's consent for borrowing. However, balances in the Public Accounts are outside the purview of Article 293.

Table 3.3: Financing of Deficit

(Rs crore)

	1980-81	1985-86	1990-91	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000 (RE)	2000-01 (BE)
Fiscal Surplus/Deficit (+/-)	-463	-1,256	-1,611	-2,861	-4,151	-4,954	-6,442	-7,563	-13,913	-7,361
Financing of deficit										
Internal Debt	8	32	207	467	528	604	637	684	1,610	784
Loans From Central Govt.	266	741	1,015	1060	1440	2462	3137	3985	4,440	3,921
Public Account	188	452	460	1064	1931	1910	2816	2860	7,860	2,668
Of which										
State GPF and Insurance funds (8005)	8	53	164	258	292	405	345	637	2,011	836
Civil Deposits Bearing Interest (8336)	0	50	178	185	213	235	307	397	914	914
Increase in Cash Balances	-2	-32	71	-270	-252	23	147	-35	-4	12

Of the three sources of financing of deficit – namely, internal debt⁴ (market borrowing, ways and means advances, loans from NACF, NABARD, SBI and other banks, and 'other loans'), loans and advances from the Central Government, and Public Accounts – the share of loans and advances from the Central Government has been declining. Central

⁴ The Constitution disallows States from incurring external debt.

loans financed as much as almost 60 per cent of the deficit during 1980-81 to 1985-86, and its percentage share was a high of 76.6 per cent in 1982-83, the share of such loans and advances has come down in a cyclical fashion along a declining trend to 31.9 per cent according to the revised estimates for 1999-2000. A rapidly increasing share of Public Accounts funds has made up for the declining share of Central loans and advances. The share of Public Accounts in financing the deficit has increased from an average of 29 per cent during 1980-81 to 1985-86 to about 56 per cent in the revised estimates for 1999-2000.

Public Accounts consist of six components – (i) small savings, provident fund, etc.⁵, (ii) reserve funds bearing interest, (iii) reserve funds not bearing interest, (iv) deposits and advances, (v) suspense and miscellaneous and (vi) remittances. Reserve funds not bearing interest ranks first in importance for net accretions to Public Accounts, while both small savings, provident funds etc. and deposits and advances follow close to each other at the second place. During 1980-81 to 1988-89, the share of net borrowings under reserve funds not bearing interest in total net borrowings under Public Account was on an average close to 78 per cent, with the shares of small savings, provident funds etc., and deposits and advances between 21-25 per cent. Between 1980-81 and 1998-99, on an average, the contribution of reserve funds bearing interest was insignificant.

The Government in its role as a banker and a trustee maintains the Public Accounts. The routine use of funds under Public Accounts for financing the deficit, particularly revenue deficit, raises some serious questions about prudential issues. Furthermore, the volatility of resource flows under the Accounts also raises doubts about the wisdom about relying on such flows for running the Government.

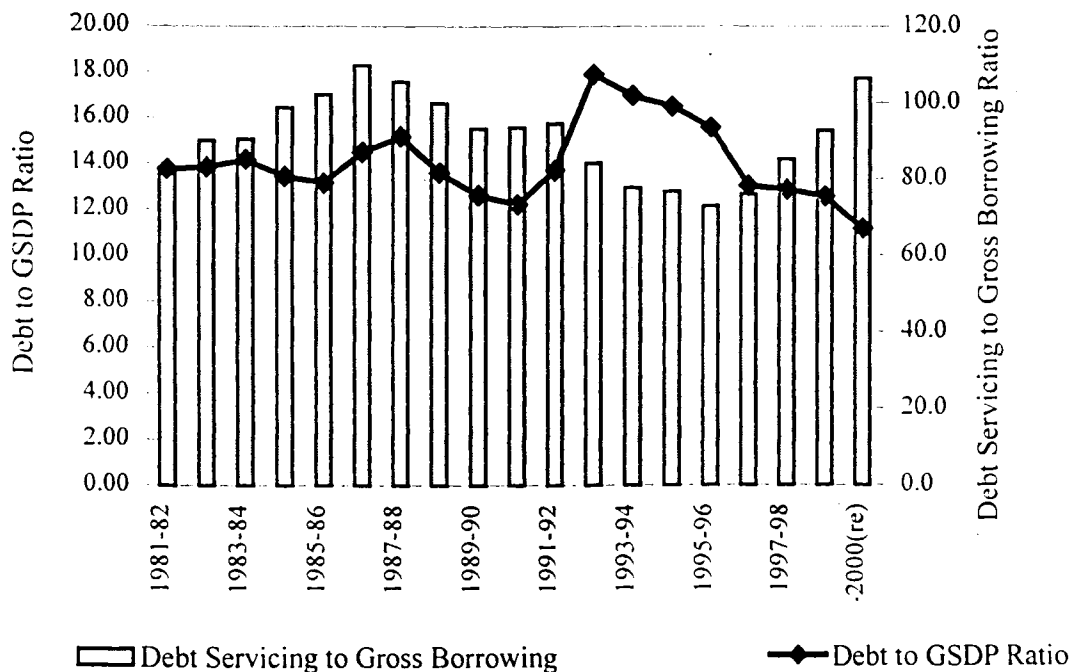
The volatile nature of the funds under Public Accounts is attested by the high coefficient of variation of the components, particularly reserve funds bearing interest, suspense and miscellaneous and remittances. The coefficient of variation, which expresses the standard deviation as a proportion of the average value, was close to 50 per cent and 116 per cent for net receipts of reserve funds bearing interest, and suspense and miscellaneous and remittances, respectively. Apart from the volatility of this source of finance, the relatively higher cost of borrowing under Public Accounts is an added source of concern.

⁵ These small savings, provident fund etc. are separate from funds that accrue under similar schemes to the Central Government's Public Accounts, 75 per cent of which are on-lent by the Centre to the States. Such on-lending by the Centre is captured here as loans and advances from the Centre.

c. Debt – high and growing

The definition of “public debt” – to include only internal debt and loans and advances from the Central Government – leads to the misleading conclusion that the debt problem in Maharashtra is under control. In spite of the upward pressure on the deficit, the ratio of ‘public debt’ to GSDP has remained below 18 per cent through out the period from 1980-81 to 1999-2000 (R.E.). This is to be expected with Public Accounts displacing ‘public debt’ as the major source of financing the deficit. When defined to include liabilities to the Public Accounts as well, total liabilities of the Government shows a five-fold increase from Rs. 8,840 crore in 1980-81 to Rs. 49,428 crore in 1998-99. As a proportion of GSDP, the increase is from 14.0 per cent to 25 per cent. The debt has been rising fast, in the most recent years. Between 1996-97 and 1998-99 alone the debt-to-GSDP increased from 15.8 per cent to 17.9 per cent.

Figure 3.2: 'Public Debt' Statistics



The replacement of internal debt and loans and advances from the Central Government by Public Accounts funds has also led to a rise in debt servicing to gross borrowing under ‘public debt’ (Figure 3.2). Limited fresh borrowings under ‘public debt’ has not only contained the growth of such debt, but also implied that most of the gross borrowings under this category get exhausted by interest payments and repayments falling due. that is debt servicing. Debt servicing as a proportion of gross borrowing has been

declining in the last few years, with the figure for 1999-2000 coming down to 67 per cent from a high of 107 per cent in 1992-93.

During this period, the composition of liabilities has changed with a shift away from internal debt and in favour of the other components of debt (Table 3.4).

d. Rising cost of borrowing

The burden of interest payments on the Government's finances has been on the rise. A steady increase in interest payments is to be expected with a rise in the stock of debt on which such liabilities accrue. However, periodic increases in the rate of interest as well as shifts in the composition of debt have led to sporadic hikes in the share of interest payments in revenue expenditure, for example, in 1986-87 and 1991-92. The latest of such increases began in 1997-98, and the share of interest payments to revenue expenditure crossed 14 per cent in 1999-2000.

The average effective rate of interest on debt has risen from less than 7 per cent in the early 1980s to almost 10 per cent by 1990-91 and further to 11.5 per cent in 1999-2000 (R.E.). While the average rate of interest has increased for all the instruments of borrowing, internal debt continues to be the most expensive form of financing the deficit. Notably, the share of internal debt in total liabilities of the State Government, after declining between 1980-81 and 1990-91, has been increasing since and stood at about 10 per cent in 1998-99. This is a disturbing feature especially given the high borrowing requirements of the State, and the limited flexibility in raising additional debt with the other instruments.

Of Central Government loans, the only component over which the State Government can exercise some modicum of control is the share in small savings collections. Interestingly, within loans and advances from the Central Government, the dependence on small savings collections has shown a steep increase. The share of small savings in total loans and advances from the Central Government has gone up from 20 per cent in 1981-82 to 52.2 per cent in 1991-92, and further to 60.3 per cent in 1998-99. However, the average cost of borrowing in this instrument – 13.6 per cent in 1998-99 – tends to not only be high, but higher than the average rate of interest on the other Central Government loans. A role back in these interest

Table 3.4: Composition of Total Liabilities and Cost of Borrowing (per cent)

	Internal Debt	Loans & Advances from Central Govt.	Public account					Stock of Liabilities (Rs. crore)			Average Interest Rate		
			Small savings	Reserve funds	Deposits and advances	Suspense and Miscellaneous and Remittances	Total	Total Liabilities	Internal Debt	Central Govt. Loans	Provident Funds	Total Debt	
1981-82	13.29	53.55	11.27	13.11	5.24	3.53	33.16	2,795	8.37	5.41	10.89	6.71	
1982-83	14.31	53.17	10.72	11.88	5.34	4.58	32.52	3,313	7.20	5.60	10.04	6.50	
1983-84	11.83	57.38	10.88	12.00	5.86	2.04	30.79	3,807	7.05	5.72	9.92	6.49	
1984-85	10.78	60.56	10.83	11.35	5.80	0.67	28.65	4,304	7.84	6.40	10.45	7.12	
1985-86	9.72	60.88	10.20	10.44	5.81	2.94	29.40	5,210	8.26	6.30	12.25	7.32	
1986-87	8.73	62.40	9.34	9.68	6.01	3.84	28.87	6,270	9.85	7.98	11.35	8.62	
1987-88	8.01	63.58	8.86	9.50	6.32	3.73	28.41	7,288	10.33	8.05	12.33	8.82	
1988-89	7.68	64.32	8.74	9.68	6.67	2.91	28.00	8,204	8.83	8.55	14.12	9.31	
1989-90	7.37	63.05	9.09	9.92	7.42	3.16	29.58	9,456	9.63	9.02	13.29	9.70	
1990-91	7.07	60.66	9.36	11.10	7.74	4.07	32.27	11,226	10.82	8.90	12.57	9.66	
1991-92	7.43	58.15	9.03	10.92	7.88	6.59	34.42	13,456	10.92	10.69	11.81	10.90	
1992-93	7.12	55.60	8.47	11.54	7.63	9.64	37.28	16,260	15.15	10.62	9.54	10.86	
1993-94	7.38	55.75	8.78	13.31	8.17	6.61	36.88	17,758	12.13	10.88	11.28	11.08	
1994-95	7.43	55.33	8.98	14.25	8.42	5.59	37.24	19,841	12.76	11.33	11.69	11.53	
1995-96	8.15	50.55	8.57	14.63	9.01	9.09	41.30	23,814	12.51	11.64	11.99	11.81	
1996-97	9.13	49.83	8.62	15.74	9.42	7.26	41.05	27,051	15.14	12.02	12.03	12.42	
1997-98	9.52	49.40	8.48	15.86	9.54	7.19	41.07	32,268	14.44	12.40	10.97	12.40	
1998-99	10.15	52.17	8.43	16.56	8.60	4.10	37.68	36,568	14.52	12.82	13.41	13.15	
1999-2000 (RE)	9.70	50.90	8.21	16.88	8.86	5.46	39.41	45,312	12.84	13.16	15.76	12.26	

Note: The figures for stock of debt refer to the opening balance of a financial year.

Source: Finance Accounts, Government of Maharashtra, various issues.

rates in the recent times would contribute to relaxing the burden of interest payments in the future. What is not clear is whether this would adversely affect the ability of the state government to mobilise resources from this source. Two of the relatively high cost components of the State Government's debt are also the two components registering increases in their shares and resulting in an adverse shift in the composition of Maharashtra's debt.

In terms of average rate of interest on interest-bearing debt, Maharashtra seems to be less favourably placed in comparison with Tamil Nadu and Gujarat, especially in the case of internal debt. This is a reflection not only of the relative differences in the rate of growth of debt, but also of the proportion of gross borrowing being utilised for repayments. New debt is more costly than old debt. While the market rates of interest faced by the states are similar, the states would differ in terms of additional borrowing and this contributes to differences in the effective rates of interest faced by the states.

Table 3.5: Comparison of Average Cost of Borrowing

(per cent)

	Internal Debt			Central Government Loans			Provident Fund Deposits Etc.		
	Tamil Nadu	Gujarat	Maharashtra	Tamil Nadu	Gujarat	Maharashtra	Tamil Nadu	Gujarat	Maharashtra
1981-82	7	5	8	5	4	5	15	12	11
1985-86	7	6	8	6	6	6	11	10	12
1990-91	10	7	11	9	9	9	10	8	13
1991-92	10	9	11	10	10	11	8	11	12
1992-93	11	11	15	10	11	11	7	12	10
1993-94	11	10	12	11	11	11	17	12	11
1994-95	13	12	13	11	11	11	9	24	12
1995-96	12	11	13	12	12	12	9	12	12
1996-97	12	14	15	12	12	12	8	12	12
1997-98	13	13	14	12	12	12	11	12	11

Source: Computed from Finance Accounts, various issues.

e. Maturity structure of debt

Average maturity profile of a debt portfolio is an important determinant of its robustness or lack thereof, i.e., vulnerability. Longer maturity debt instruments, because of the extra fund utilisation period that they afford to the borrower, also carry higher rates of interest than shorter maturity instruments. The optimum debt structure is a careful balance of the extra maturity with extra cost. No data is readily available on the average maturity of Maharashtra Government's debt over time. However, taking into account the major components of debt, it appears possible to draw a few inferences.

When classified according to the maturity period of the instrument, there are four important components of interest bearing debt of the government

- GPF deposits: no pre-specified term structure. For all effective purposes, it should be treated as debt with no lock-in period.
- Market borrowing: this is a 10-year instrument, with repayment only in the last year.
- Block loans, which constitute a part of central government loans: 20-year maturity period, with an initial moratorium for 5 years.
- Share in small savings collections: 25 year instrument with a 5 year moratorium.

The last two instruments have accounted for 55-60 per cent of total government debt, with the first two instruments commanding more than 30 per cent share. However, what is important is a calculation of the residual maturity of each instrument for calculating the maturity structure of the total debt. An additional source of concern about Public Accounts arises from the lack of any specified term structure. The net inflows from small savings, provident funds etc., have been marked by periods of considerable volatility in the past. Such inflows, for example, after rising from Rs. 292 crore in 1995-96 to Rs. 405 crore in the subsequent year, suddenly declined by Rs. 60 crore to Rs. 345 crore in 1997-98.

3.4 Expenditure Composition

a. Squeeze on capital expenditure

In spite of increasing deficits, growing wages and salaries together with increasing interest payments and insufficient revenues have resulted in a squeeze on capital expenditure. According to the Economic Classification of the Budget, wages and salaries accounted for 45 per cent of revenue expenditure and more than 50 per cent of revenue receipts in 1997-98. Interest payments accounted for about 13 per cent of revenue expenditure in the same year. Wages and salaries together with interest payments thus exhausted as much as 65 per cent of revenue receipts in 1997-98.

Interest is a charged item, and interest liability on debt incurred in the past represents a relatively autonomous component of government expenditure. The acceptance of pay parity for State Government employees with Central Government employees has made the rate of remuneration of State Government employees also a variable autonomous of State Government decision. While the pursuit of a 'job for life' policy in Government has imparted

a downward rigidity in the number of employees, additional recruitment – often for reasons other than provision of public goods or services – has led to rapid rises in Government employment and bloated payroll of the Government. The number of State Government employees in Maharashtra was 6.3 lakh on July 1, 1997, representing 8.2 State Government employees per 1,000 population. Including Zilla Parishad and Nagar Parishad the number increases to 14.6 per 1,000 population⁶.

Wage bill of the government of Maharashtra is composed of two major components: the directly incurred expenditure on account of wages and salaries, including pensions, and the components of grants-in-aid towards payment of salaries. Following the implementation of the higher pay scales in the wake of the recommendations of the Fifth Central Pay Commission for Central Government employees in 1997, Maharashtra implemented its pay rise on December 10, 1999 (with retrospective effect from January 1, 1996). Higher Budget estimates for 1999-2000 suggest that the implementation of these higher pay scales would result in wages and salaries increasing to become 63.5 per cent of revenue receipts, with arrears adding another 30 per cent of revenue receipts. With interest payment taking up 21 per cent of revenue receipts in 1999-2000, these two components of expenditure will more than exhaust the total receipts available. Nothing would be left for capital expenditure or even operation and maintenance under revenue expenditure. Capital expenditure, as a proportion of GSDP, has fallen over time from 2.3 per cent of GSDP in 1983-84 to 1.7 per cent in 1999-2000 (R.E.).

b. Novel ways to boost capital expenditure

Faced with a 'hard' budget constraint, the Government resorted to novel ways of circumventing the constraint and boosting capital expenditure. Public sector enterprises, MSEB, MKVDC, Jeevan Pradhikaran, TIDC, VIDC, GMIDC and KIDC, were utilised to mobilise bond financing worth Rs. 9324 crore between 1996-97 and 1999-2000⁷. In all these cases, the Government provided a guarantee for the servicing of the bonds. Further, MSEB has been permitted to raise Rs. 900 crore, Rs. 600 crore with government guarantee and the balance without the guarantee. In a number of these cases, like in the case of the irrigation corporations, the government does not expect the Corporations to be able to meet the debt

⁶ Aided institutions add further to the numbers – an additional 7.5 employees per 1,000 population.

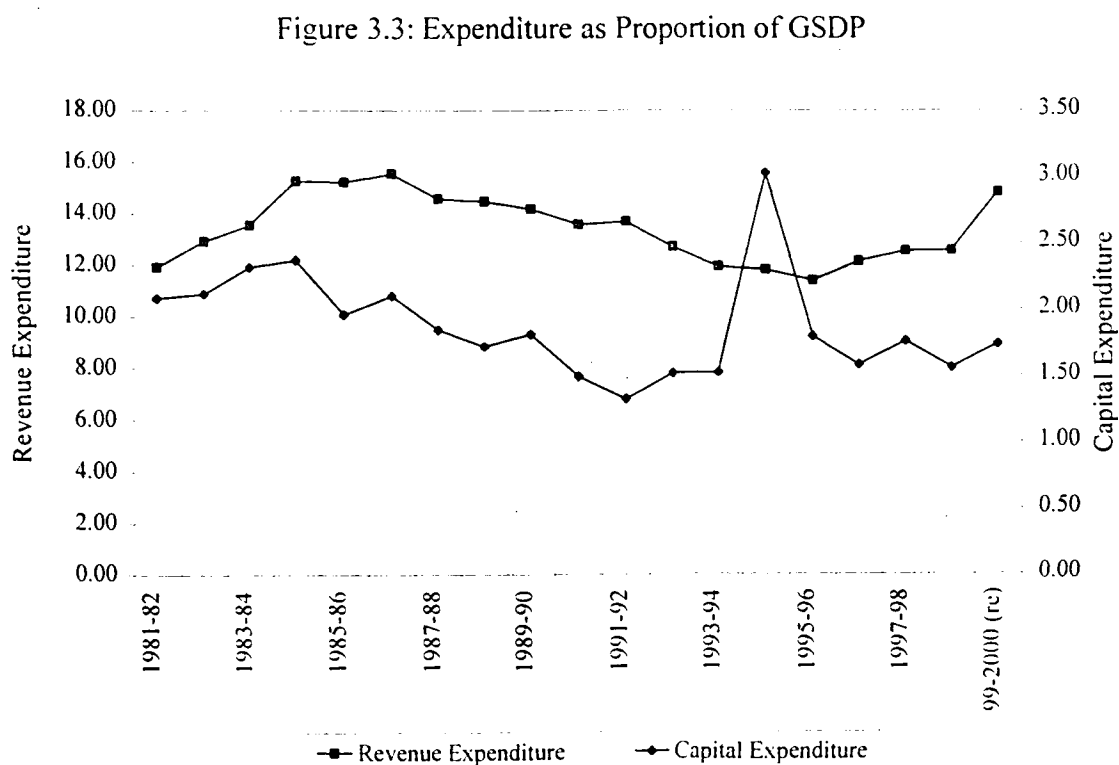
⁷ These figures are as of October 31, 1999.

servicing liabilities, and hence provision for the same is made in the budget. For 1999-2000, the commitment towards interest payment alone stands at Rs. 1024.11 crore.

The wisdom of such novel ways of financing capital expenditure is in serious doubt. First, it results in non-transparency. The operations result in quasi-fiscal deficits that should be integrated with the Government's accounts to derive a true picture of the financial situation. (Section 3.5 provides a more comprehensive discussion of the issues relating to contingent liabilities of the government.) Second, the 'bankability' of many of these corporations that need Government assistance in the form of a guarantee or underwriting of interest payments is highly dubious. The idea behind corporatisation is to endow organisations with management autonomy and to encourage them to run along commercial lines. It is doubtful that corporations starting with such questionable financial deals would ever be capable of running autonomously along commercial lines.

c. Functional classification of expenditure

Revenue expenditure as a proportion of GSDP increased till 1986-87 and then



registered a decline till 1995-96 only to rise again in the subsequent period. A similar trend is in evidence for capital expenditure as well (Figure 3.3)⁸.

In terms of the composition, within revenue expenditure, the share of general services has increased over time, while that of economic services has declined. Social services have maintained a fairly steady share. Largely the increasing share of interest payments in total revenue expenditure explains the increase in the share of general services. The share of interest payments has increased from about 6 per cent in 1980-81 to 16 per cent by 1999-2000 (Table 3.6⁹). Within economic services, there have been sharp declines in outlays in practically every sector, including irrigation, dairy, power and transport. Expenditure on irrigation has shown a decline in the last two years since the establishment of the irrigation corporations. The decline in the shares of irrigation and power has been close to 4 percentage points during the twenty-year period. While expenditure on transport and on dairy development do not account for large shares in total expenditure, there are significant declines in the proportions of expenditure spent on these heads as well. In the social sectors, both education and health have suffered close to 2 percentage points losses in their shares in total revenue expenditure.

Table 3.6: Composition of Revenue Expenditure (per cent)

	1980-81	1985-86	1990-91	1995-96	1996-97	1997-98	1998-99	99-2000 (R.E.)	2000-01 (B.E.)
General Services	32.91	32.76	35.84	39.02	37.72	39.91	41.36	39.73	51.10
of which									
Interest	5.76	6.87	10.06	11.97	11.74	12.68	14.31	13.72	18.97
Social Services	34.14	34.38	34.54	37.86	35.49	37.54	36.74	41.59	35.80
of which									
Education	19.68	17.18	19.02	20.61	19.56	20.26	20.12	27.28	21.30
Health	8.43	10.45	8.08	8.09	7.84	8.80	8.40	7.62	8.19
Economic Services	32.95	32.87	29.61	23.12	26.79	22.55	21.90	18.68	13.10
of which									
Irrigation	5.94	6.86	7.33	7.80	7.29	7.36	6.92	2.46	2.29
Dairy	7.60	9.30	5.44	2.76	3.53	3.72	3.35	2.01	2.29
Power	3.81	1.12	1.00	0.13	4.37	0.11	0.10	0.11	0.10
Transport	0.69	0.43	0.16	0.16	0.13	0.11	0.54	0.06	0.05

Source: Computed from Finance Accounts, various issues and Budget, 2000-01.

⁸ The spike in capital expenditure observed in 1994-95 is on account of the increase in expenditure on power: this captures the translation of arrears of interest receipts due from MSEB into equity contribution.

⁹ On preliminary analysis, dairy development emerges as one of the major heads of expenditure. However, these expenditure are gross expenditures, with correspondingly high non-tax receipts from this sector. The objective of this entire exercise is to provide a subsidy to the Greater Mumbai Milk Scheme. Therefore, in the present analysis, expenditure on dairy development is taken in net form.

Economic services claim bulk of the capital expenditure in the Government's budget. Within economic services, while irrigation registered a decline largely on account of the formation of irrigation corporations, transport registered an increase, mostly attributable to an increase in expenditure on roads and bridges. Inadequacy of investment in roads and bridges despite the increase in capital expenditure by the Government is sought to be countered through the operations of the Maharashtra State Road Development Corporation. Some of the initial projects undertaken by the Corporations are flyovers in Mumbai to address the problem of traffic congestion in the city. These projects were to be financed through tolls, a proposal that did not take off well. As a result, imperfect alternatives are being explored in the form of cess on motor spirits sold in the city.

Two other components of capital expenditure, which become important off and on are food storage and warehousing and co-operatives. The shares of both these sectors display consistent volatility. Co-operatives, for instance, recorded a share of 4 per cent in 1990-91 followed by 10 per cent in 1991-92. The following year, the share declined to 3.5 per cent before climbing to 7 per cent again. By 1997-98, the share has fallen to 1.8 per cent.

Table 3.7: Shares in Capital Expenditure (per cent)

	1980-81	1985-86	1990-91	1995-96	1996-97	1997-98	1998-99	1999-2000 (RE)	2000-01 (BE)
General	2.32	2.23	1.96	1.31	1.64	1.57	2.34	1.78	1.52
Social	5.78	6.53	6.73	4.70	4.47	4.28	8.72	13.23	6.27
Of which									
Education	0.48	0.61	0.61	1.42	1.44	0.93	1.32	0.69	0.31
Health	1.58	1.23	2.10	0.60	0.81	0.74	0.80	0.99	2.19
Economic	91.90	91.24	91.31	93.99	93.89	94.15	88.94	84.98	92.22
Of which									
Irrigation	54.06	52.99	59.37	57.78	45.39	55.06	37.36	36.12	46.58
Transport	11.69	10.97	15.74	16.86	20.13	19.47	27.42	23.22	18.24

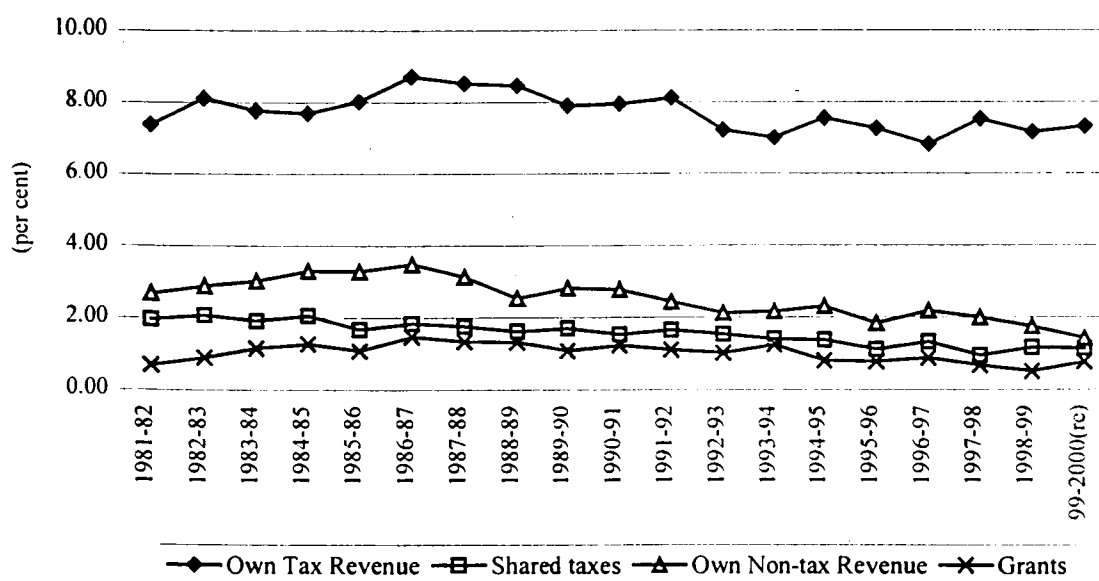
3.5 Declining Revenue Receipts

An almost continuous decline in the revenue-to-GSDP ratio since 1986-87 has complicated the management of the State's finances. Along a fluctuating trend, the ratio had increased from 12.2 per cent in 1980-81 to 15.6 per cent in 1986-87. In the intervening

twelve years between 1986-87 and 1998-99, the revenue-to-GSDP ratio has declined every year except 1991-92 and 1996-97, to reach 10.67 per cent in 1999-(RE)¹⁰.

In terms of components, shared taxes and grants, as a proportion of GSDP, had been declining from even prior to 1986-87. Prior to 1986-87, buoyant own revenues – both tax and non-tax – had more than made up for this decline and resulted in increases in the revenue-to-GSDP ratio. Receipts continued to grow at historical rates, while growth of the State's economy accelerated. While the growth of GSDP registered an increase after 1986-87, this did not translate into higher tax collections or into faster growth of non-tax revenues¹¹. As a proportion of GSDP, the halving of own non-tax revenues from 3.5 per cent in 1986-87 to 1.7 per cent in 1998-99 – compared to the decline in own taxes from 8.7 per cent of 7.2 per cent – was particularly severe.

Figure 3.4: Revenue Receipts as a proportion to GSDP



a. Own tax revenue

A comparison of own tax revenue to GSDP ratios across states shows Maharashtra in a poor light (Table 3.7). For example, in 1997-98, the own tax to GSDP ratio of both

¹⁰ The improvement in revenue-to-GSDP ratio in 1996-97 was 0.2 percentage point, while the increase in 1991-92 was 0.1 percentage point.

¹¹ In the period since 1986-87, average rate of growth of nominal GSDP was 17.7 per cent. However, own tax revenue grew at 15.6 per cent and own non-tax revenues at an average rate of 12.7 per cent. This picture of sluggish revenues is further reinforced by the performance of shared taxes (rate of growth of 11.92 per cent), and of grants (10.8 per cent). In fact, rate of growth of Grants declined from 24 per cent pre-1986-87 to 10 per cent after 1986-87.

Karnataka and Tamil Nadu at 9.9 per cent and of Kerala at 9.0 per cent were substantially higher than that of Maharashtra at 7.5 per cent. Gujarat too performs marginally better than Maharashtra, though the differences in the ratio are smaller in this case. Maharashtra however, does record better rates when compared to Punjab.

Table 3.8: Ratio of Own Tax Revenue To GSDP (per cent)

	Gujarat	Karnataka	Kerala	Tamil Nadu	Punjab	Maharashtra
1980-81	7.2	7.7	7.0	8.1	6.9	6.8
1985-86	7.7	9.3	8.4	10.1	7.1	8.0
1990-91	8.6	10.1	8.7	10.2	6.8	7.9
1991-92	9.4	9.7	7.6	10.4	6.8	8.1
1992-93	8.6	9.5	8.4	10.0	6.7	7.2
1993-94	8.7	10.0	8.4	9.5	6.9	7.0
1994-95	8.0	9.5	8.7	9.9	7.3	7.6
1995-96	8.0	10.4	8.7	10.9	6.6	7.3
1996-97	7.9	10.0	9.1	10.5	6.0	6.8
1997-98	7.6	9.9	9.0	9.9	6.0	7.5
Per Capita Income (Rs.), 1997-98	4559	3125	2786	3451	5005	5323

While sales tax continues to be the most important source of revenue for the state, the yield from the tax relative to GSDP as well as its share in total own tax revenue has declined over time (Tables 3.9 and 3.10). On the other hand, the share of stamp duty and registration fees has increased sharply. State excises too has registered some increase in its share. These three taxes together account for 82 per cent of total own tax receipts. The share of the other taxes have fluctuated over time, but there is not much evidence of any consistent trend.

Table 3.9: Own Tax Collections to GSDP (per cent)

	1980-81	1985-86	1990-91	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000 (R.E.)
Own tax revenue	6.80	8.03	8.02	7.55	7.27	6.82	7.53	7.17	7.33
Stamp duty and Registration fees	0.26	0.32	0.45	0.89	0.82	0.74	0.93	0.79	0.83
State excise	0.53	0.70	0.85	0.75	0.71	0.62	0.91	0.86	0.79
Sales tax	4.51	5.08	4.97	4.60	4.55	4.25	4.29	3.95	4.50
Taxes on vehicle	0.31	0.32	0.32	0.28	0.28	0.36	0.41	0.31	0.30
Tax on goods and Passengers	0.11	0.29	0.32	0.22	0.17	0.12	0.19	0.14	0.13
Taxes and duties on electricity	0.35	0.46	0.43	0.27	0.24	0.23	0.29	0.35	0.18

Source: Computed from Finance Accounts, various issues.

Table 3.10: Composition of Govt Tax Revenue (per cent)

	1980-81	1985-86	1990-91	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000 (RE)
Stamp duty and Registration fees	3.79	3.96	5.59	11.81	11.30	10.88	12.32	10.98	11.34
Sales tax	66.32	63.30	62.00	60.91	62.59	62.23	57.04	55.11	61.38
State excises	7.85	8.69	10.59	9.99	9.79	9.12	12.03	11.95	10.74
Taxes on vehicle	4.56	4.03	3.99	3.64	3.87	5.24	5.48	4.35	4.10
Tax on goods and passengers	1.58	3.65	3.94	2.95	2.27	1.71	2.49	1.92	1.79
Taxes and duties On electricity	5.18	5.67	5.42	3.56	3.27	3.44	3.90	4.86	2.40

Source: Computed from Finance Accounts, various issues.

Sales tax performance:

Sales tax collection as a proportion of GSDP, after increasing until 1986-87, has been on a downtrend (Figure 3.5). The buoyancy of the tax (with respect to GSDP) declined from

Figure 3.5: Ratio of Sales Tax to GSDP (per cent)



1.19 between 1980-81 to 1986-87 to 0.86 between 1987-88 and 1995-96. Sales tax does not apply on services. Even when services are excluded from the base, and the buoyancy is recalculated with respect to GSDP from the primary and secondary sector or from the secondary sector alone, there is clear evidence of a decline in buoyancy in the post 1986-87 period. This trend is stemmed in the last year partly on account of the implementation of the floor rates on sales tax, thereby preventing the corrosion of the base through rate wars.

Table 3.11: Buoyancies: Total Sales Tax Collections

With respect to	1980-81 to 1986-87	1987-88 to 1995-96
GSDP	1.19	0.86
Primary and Secondary	1.31	0.91
Secondary Sector	1.15	0.87

Sales tax revenues consist of two sources: State sales tax and Central Sales Tax(CST). This decline in buoyancy in the post 1986-87 period is primarily attributable to that of State sales tax collections, that is total sales tax collections less CST (Table 3.12). Buoyancy declines in the post 1986-87 period irrespective of whether it is calculated with respect to aggregate GSDP or its components excluding the tertiary sector.

Table 3.12: Buoyancies: State Sales Tax Collections

With respect to	1980-81 to 1986-87	1987-88 to 1995-96
GSDP	1.25	0.81
Primary and Secondary	1.35	0.86
Secondary Sector	1.21	0.81

This consistent decline in buoyancy of sales tax revenues with respect to aggregate GSDP as well as its components suggests that changes in the composition of output do not provide an adequate explanation of the decline in buoyancy. The two major factors that appear to have contributed to the decline in buoyancy are the widespread use of tax exemptions and deferrals since the early 1980s and vertical integration of units to optimise tax liability under a first point regime.

The regime of sales tax incentives in the form of exemptions and deferrals started in 1979 in Maharashtra. This scheme was applicable only to new units. In 1983, the facility was made available for expansion of units, which required minimum investment of 5 times the gross block of the existing unit. However, in 1988 and 1993, the eligibility conditions were significantly diluted. Units undertaking expansion of a minimum of 25 per cent of existing capacity were made eligible in 1988. In 1993, the capacity concept was done away with and

the new requirement stipulated that the minimum investment be 25 per cent of the gross block of the existing unit. Internal estimates of the Ministry of Finance indicate that the loss of revenue in 1999-2000 because of tax concessions would be in the range of Rs. 2,273 crore¹². Using these estimates of loss of revenue, the tax to GSDP ratio is computed for the scenario without incentives (Figure 3.5). Interestingly, without incentives, the sales tax to GSDP ratio continues to fluctuate around a mildly declining trend, but the downward tendency is relatively limited.

High tax rates are well known for inducing tax-payers to do intensive tax planning and seek ways to minimise tax liability. A first point tax regime, unlike a Value Added Tax (VAT), attaches a premium on vertical integration of activities by tax payers. With vertical integration, under a first point tax regime, hitherto taxable turnovers become endogenous to the firm and hence cannot be subject to a tax, and the tax base narrows.

A turnover tax may have exacerbated the incentive for vertical integration. While actual sales tax rates according to the Bombay Sales Act may not have changed in the state, a turnover tax of 1.25 per cent of taxable sales was introduced on July 13, 1986. This tax was payable by dealers with turnover exceeding Rs. 12 lakh.¹³ Given the form of the tax, it could not be passed on to the final consumer, since the small dealers would be transacting without the tax. This may have provided further incentive to the affected dealers to find ways of avoiding this tax, including through vertical integration.

The Additional Tax introduced in 1975 as a tax of 6 per cent on tax liability and dedicated towards financing of Employment Guarantee Scheme may have added to the tendency for vertical integration. The Additional Tax is payable by dealers with a tax liability exceeding Rs. 1 lakh¹⁴.

¹² The annual loss is computed in the following manner: Each unit availing this facility is assigned a total benefit limit depending on the size of the firm under consideration. For want of better information, this amount is uniformly distributed over the entire period over which the scheme is applicable. Total annual loss is the sum over all such firms.

¹³ The rate and coverage were changed subsequently: in 1991, the rate was increased to 1.5 per cent of taxable sales and was payable by dealers with a turnover exceeding 1 crore. This tax was abolished in 1995 with the introduction of VAT, but subsequently brought back, when VAT was abolished. In the new form, it is applicable to all dealers at the rate of 1 per cent of taxable sales.

¹⁴ The rate was increased to 12 per cent in 1982 and further to 15 per cent in 1994. With the introduction of VAT, the tax was abolished. With the abolition of VAT in 1998, this tax was reintroduced as a surcharge of 10 per cent of tax liability for turnover exceeding Rs. 1 crore.

The increase in the share of value added in total output of the manufacturing sector from 19.8 per cent to more than 21 per cent during the period 1991-92 to 1994-95 provides some evidence towards the ongoing tendency for vertical integration. The increasing share of value added in output could be because of not only vertical integration within the industry but also a change in the composition of industry in favour of those with a higher value added content. In either case, however, sales tax revenue would be adversely affected. With sales tax applicable on output and not value added, a change in the composition of output towards higher value added products would reduce sales tax revenue as a proportion of GSDP of the sector.

On October 1, 1995, Maharashtra introduced Value Added Tax. Manufacturers were permitted to claim input tax credit.¹⁵ Resellers above a certain threshold (Rs. 40 lakh turnover) were to remit a tax on value added, computed by the subtraction method. As noted in the earlier chapters, this happened to be a period of sluggish industrial growth. As a result, the rate of growth of sales tax revenue was noticeably lower than in earlier years. This, however, prompted the Government to revert back to a first-point sales tax. Interestingly,

Cost of Collection: Sales Tax

Maharashtra spends less than most other states per Rs. 100 of revenue collected. While most other states spend over Re. 1, Maharashtra has been spending close Rs. 0.80 per Rs. 100 of receipts. These figures have however fluctuated over time. For Maharashtra, this cost was rising until 1984-85, after which there was a decline until 1994-95. Only in the last two years is there a reversal of the trend. While the above cannot be treated as evidence of inefficiency in tax collection resulting from inadequate expenditures, the temporal coincidence of the change in expenditures with those in collections do suggest the need to explore further.

Cost of Collection: Sales Tax

	1980-81	1985-86	1990-91	1993-94	1994-95	1995-96	1996-97
Gujarat	1.24	1.31	1.10	0.90	0.88	0.91	0.87
Karnataka	1.41	1.36	1.45	1.31	1.38	1.27	1.19
Tamil Nadu	1.46	1.48	1.39	1.29	1.18	1.13	1.21
Rajasthan	1.93	1.76	1.79	1.72	1.76	1.73	1.83
Punjab	1.49	1.16	1.38	1.12	1.20	1.37	1.50
Haryana	2.06	1.95	1.94	1.86	1.82	1.70	1.50
Maharashtra	0.98	1.03	0.89	0.81	0.77	0.78	0.82

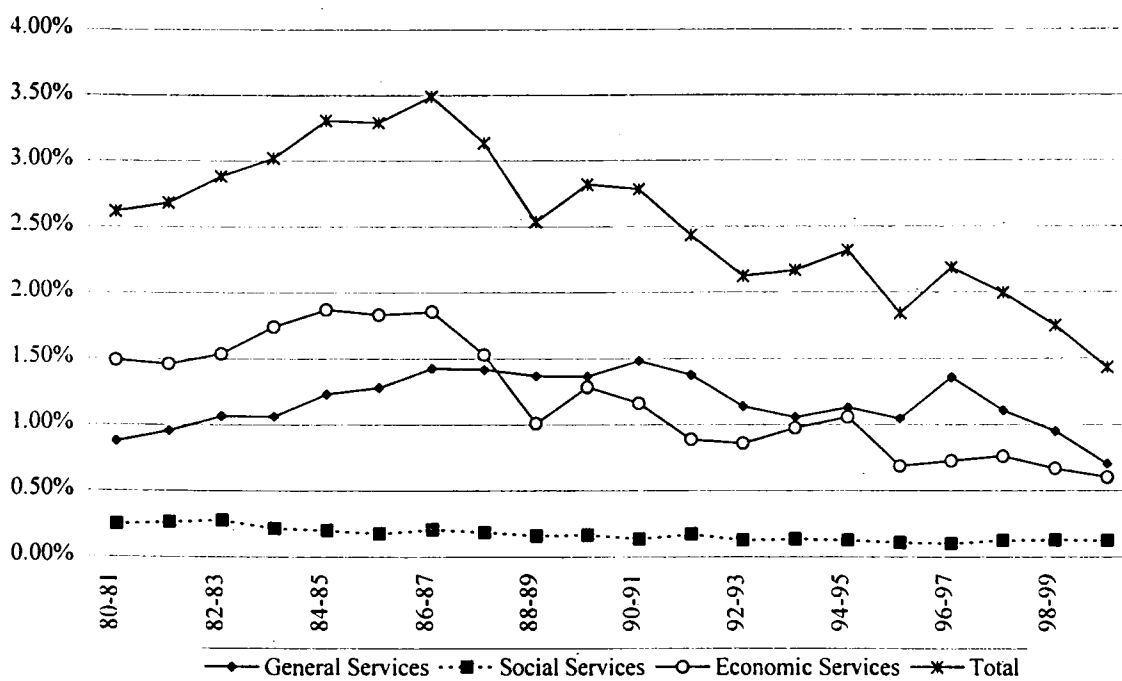
Note: The above are cost (in Rs.) of collecting Rs. 100 of sales tax revenue.

this happened in spite of the fact that the Report of the Committee constituted to examine the performance under VAT did not conclude that the decline in receipts was attributable to the new tax structure. Instead, the report provides evidence that this was more related to general sluggishness in the nation-wide industrial growth.¹⁶

b. Own non-tax revenue

Like in the case of own taxes, the ratio of own non-tax revenue to GSDP, after increasing from 2.6 per cent in 1980-81 to 3.5 per cent in 1986-87, has been on the decline ever since. This declining trend is primarily accounted for by the behaviour of non-tax revenue in the field of economic services (Figure 3.6). Own non-tax revenues from social and economic services can be treated as recoveries by the government for services provided. Under revenue expenditure, the Government makes outlays in the form of current expenditure for provision of these services. Comparing the recoveries with these outlays, the

Figure 3.6: Ratio of Non-tax Revenue to GSDP (per cent)



recovery rates can be computed to indicate the extent of subsidisation of these services by the Government. The recovery rates for economic and social services are generally low for almost all States in India. However, there are some differences across States. Karnataka provides evidence of a turn around in recovery rates for social services after 1991-92, while

¹⁵ For revenue considerations, incomplete input tax credit was permitted. Initially the retention rate of the tax was 2 per cent, but subsequently it was raised to 3 per cent.

¹⁶ The ratio of sales tax collections in Maharashtra to Central excise collections does not register any marked change.

Kerala (1990-91 onwards) and Gujarat (until 1991-92) show increasing ratios in the case of economic services (Figures 3.7 and 3.8)¹⁷. Although Maharashtra has fared better than Kerala in terms of recovery rates in economic services, the downward trend in the rate in

Figure 3.7: Ratio of non-tax revenue to revenue expenditure: social services

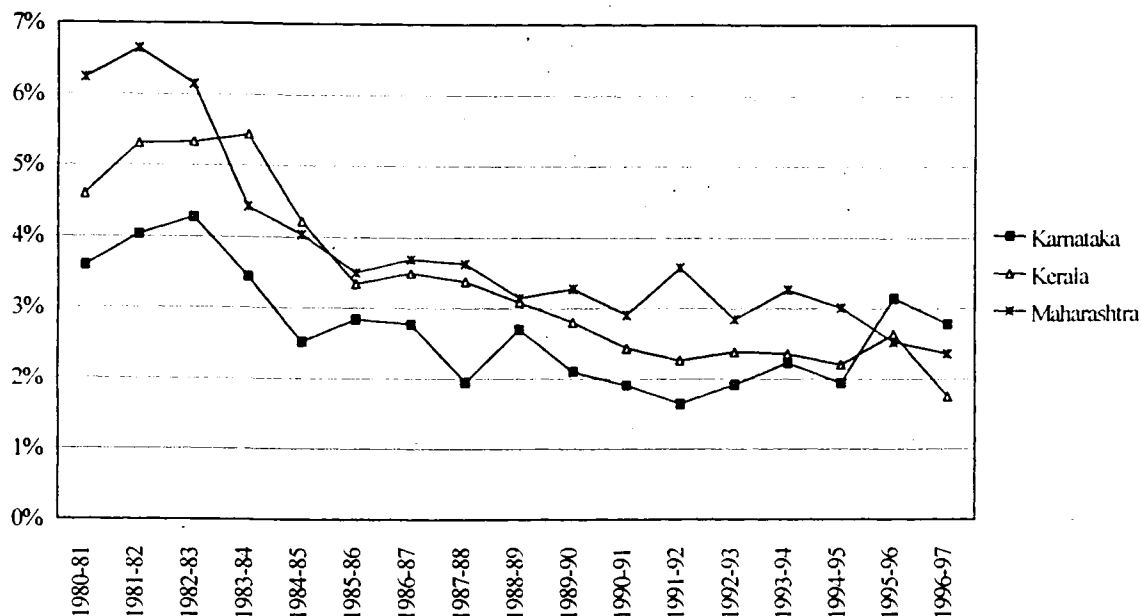
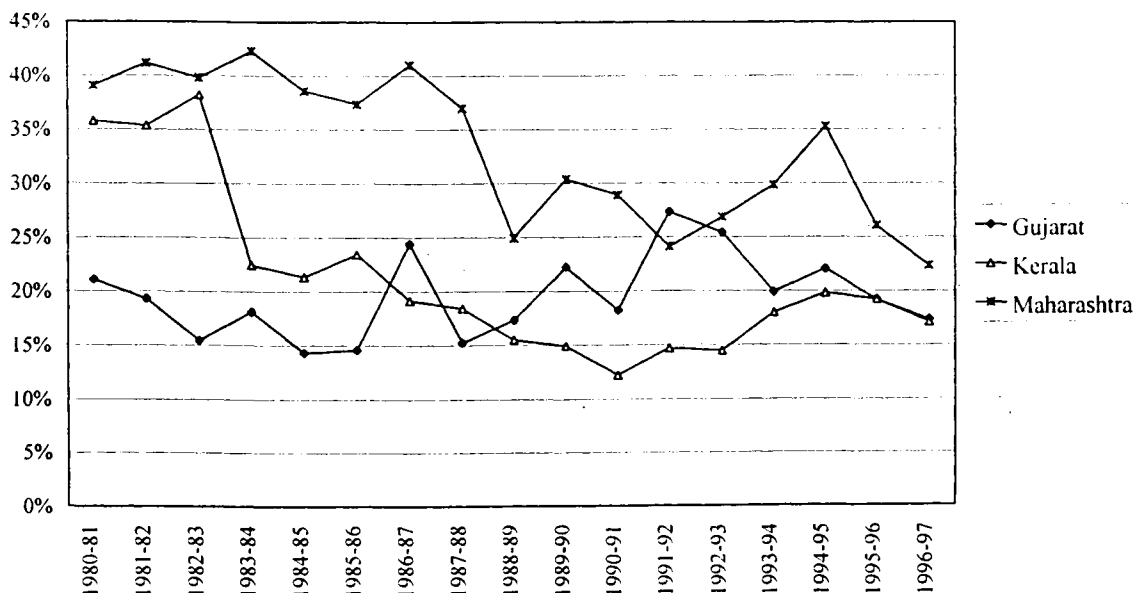


Figure 3.8: Non-tax revenue to revenue expenditure: Economic Services



Maharashtra has resulted in Kerala catching up with the State in recent years.

¹⁷

Given the specific accounting practices of Maharashtra, involving transfers to and from reserve funds, the expenditures in social and economic heads would tend to be underestimated, since they are shown net of such transfers. The rates thus computed may therefore not be exactly comparable with other states. The time trends however tell a poor story.

Table 3.13: Comparison of recovery rates: Social Services

State	Maharashtra		Gujarat		Kerala		Karnataka		Tamil Nadu		Best Recovery Rate in 1993-94	
	1997-98	1993-94	1997-98	1993-94	1997-98	1993-94	1997-98	1993-94	1997-98	1993-94	State	Rate
Education, Sports, Art & Culture	0.94	1.43	1.74	2.26	3.01	3.34	1.45	2.73	2.08	2.59	Kerala	3.34
Medical & Family Welfare	3.37	2.90	1.62	2.41	0.69	0.77	0.95	2.00	0.82	0.81	West Bengal	3.25
Water Supply & Sanitation	11.48	15.54	0.28	0.33	0.28	0.00	0.32	0.48	0.86	0.63	Goa	23.84
Housing	5.75	9.97	2.71	0.00	1.96	2.37	3.66	6.78	9.31	13.27	Goa	14.15
Urban Development	13.75	8.33	4.26	6.60	2.53	16.09	78.23	0.96	0.24	0.58	Haryana	29.98
Social Security & Welfare	0.05	0.03	0.45	0.00	0.00	17.66	0.00	29.39	0.00	9.30	Orissa	54.41
Other Social Services	60.69	8.48	81.00	14.85	14.94	0.90	13.94	6.19	13.66	4.45	Gujarat	14.85

Table 3.14: Comparison of Recovery Rates: Economic Services

State	Maharashtra		Gujarat		Kerala		Karnataka		Tamil Nadu		Best Recovery Rate in 1993-94	
	1997-98	1993-94	1997-98	1993-94	1997-98	1993-94	1997-98	1993-94	1997-98	1993-94	State	Rate
Agriculture & Allied Activities	45.49	48.19	7.04	6.95	30.95	4.91	20.01	22.82	11.22	14.10	Maharashtra	48.19
Co-operation	14.22	21.53	32.35	6.78	58.42	21.02	40.35	26.29	34.27	17.10	Himachal Pradesh	72.09
Rural Development	10.67	12.63	1.51	1.92	0.02	0.66	0.25	0.83	1.41	0.94	Maharashtra	12.63
Special Area Programmes	8.95	1.85	47.42	94.62	0.17	0.11	0.00	0.01	0.00	3.06	Gujarat	94.62
Irrigation	1.37	3.76	4.08	2.57	1.38	1.17	0.92	1.33	1.63	1.72	Uttar Pradesh	10.01
Power	26.06	7.50	0.25	0.09	0.00	0.00	3.41	13.68	0.01	0.02	Goa	96.30
Industries	17.01	9.82	21.02	1.21	0.84	5.46	10.29	11.45	8.09	2.86	West Bengal	16.93
Transport	0.28	6.31	0.17	0.11	8.10	7.47	2.32	2.78	5.95	11.51	Haryana	88.15
Civil Supplies	-	-	2.71	0.00	39.05	49.92	0.09	0.00	0.25	0.83	Orissa	91.26
Other economic Services	98.82	16.89	58.42	11.15	73.32	5.18	49.56	19.16	58.25	10.58	Karnataka	19.16

Source: Computed from Finance Accounts, various issues.

The recovery rates reported here have an upward bias because of exclusion of capital costs from the calculations. In some cases, such as irrigation, where investment requirements are considerable, the bias would be significant. In order to arrive at a better estimate of the extent of cost recoveries in some of the service sectors, the methodology used in Srivastava and Sen (1997) has been applied and presented in Tables 3.13 and 3.14¹⁸. Goods and services provided by the public sector are classified as 'merit' and 'non-merit' categories. Merit goods and services are those goods and services that have strong externalities associated with their provision. Non-merit ones are the others. While low recoveries may have some justification in case of merit goods and services, it is hard to defend very low recovery rates for non-merit categories. After the presentation of the White Paper on subsidies in Parliament in May 1997, there has been considerable public discussion on the need for raising recovery rates and phasing out subsidies in non-merit categories. The calculations for non-merit categories indicate significant scope for improving recovery rates.

Recovery on non-merit services:

The recovery rates have been calculated by taking into account both the costs of financing investment (either in the form of capital expenditure or in the form of loans and advances) in the sector as well as operating costs and depreciation. They measure the extent to which the receipts from a service cover the costs for their provision. For a service to be self-sustaining, the cost recovery should be 100 per cent. Any shortfall from 100 per cent indicates the subsidy extended by the Government towards the sustenance of the service.

Of the 7 social service sectors and 10 economic service sectors considered non-merit (Box 3.1), the recovery rates for Maharashtra have been less than 50 per cent for almost all services (the only exceptions is other economic services and other social services). Within social services, the highest recovery rates recorded in Maharashtra are for 'other social services', followed by urban development and water supply and sanitation. These are also the few social services, where there is evidence of an improvement in the recovery rates in 1997-98 when compared to 1993-94. Within economic services, agriculture and allied services along with 'other economic services' recorded relatively good performances. When compared to 1993-94, there is improvement of performance in special area programmes, power, industries, and 'other economic services'. While the performance of agriculture and allied activities has declined marginally, there is a deterioration in transport, irrigation and

¹⁸ Srivastava, D.K. and T.K. Sen (1997): Government Subsidies in India, National Institute of Public Finance and Policy, New Delhi.

co-operation. Given that the sectors with deteriorating performance are also the important spending sectors, the results suggest an aggregate decline in recovery rates from already low levels for non-merit economic services. The aggregate recovery rate for non-merit economic services has declined from 18.24 per cent in 1993-94 to 16.85 per cent in 1997-98 for Maharashtra. A comparing with other states for highest-recorded recovery rates suggests that the rates for many of the sectors in Maharashtra can be improved.

Box 3.1: Non-Merit Goods and Services

Goods/services where consumption is *rival* and *exclusion* is possible are classified as non-merit. Given this feature of the goods/services, in principle, it should be possible to recover the costs of providing the service through user charges. On the other hand, in the case of goods/services characterised by strong externalities, i.e., merit goods, user charges designed to recover the full cost of service provision may provoke undesired under-consumption. Therefore, in the case of merit goods, the issues of concern relate to *quality* of subsidy, that is issues of targeting and efficacy of subsidy, while in the case of non-merit goods / services it is the *quantum* of subsidy.

Within budgetary categories, the following heads of expenditure have been identified by Srivastava and Sen as non-merit goods and services. Within social services, figure *Education, Sports, Art & Culture (excluding Elementary Education), Medical & Family Welfare (excluding Public Health), Water Supply & Sanitation (excluding Sewerage & Sanitation), Housing, Urban Development, Social Security & Welfare and Other Social Services*, Among economic services, the list includes *Agriculture & Allied Services (excluding Soil & Water Conservation, Environmental Forestry & Wild Life, Agricultural Research & Education), Co-operation, Rural Development, Special Area Programmes, Irrigation (excluding Flood Control & Drainage), Power, Industries, Transport (excluding Roads & Bridges), Civil Supplies and Other Economic Services*.

3.5 Public Sector Enterprises

The Government of Maharashtra, in 1997-98, had a stake in 58 companies¹⁹ (24 of them are subsidiaries) and 5 statutory corporations (See Table 3.15). 14 of these companies have been declared to be defunct and 2 of them are under liquidation (since 1995-96). There has been an attempt at privatisation with the Government successfully divesting some of its stake in SICOM (State Industrial and Investment Corporation of Maharashtra Limited).

The number of companies under the effective control of the Government²⁰ has remained fairly steady, but the total paid-up capital almost doubled between 1990-91 and 1997-98 from Rs. 281 crore to Rs. 577.5 crore (See Table 3.16).²¹

Table 3.15: Government Companies and Statutory Corporations

Year	Government Companies							Stat. Corp.	Stat. Corp. Finalising their Accounts
	Number of Cos. (incl. subsidiaries)	Subs.	Cos. with finalised Accts.	of which		Defunct	Under Liqn.		
				Profit Making	Loss Making				
1990-91	59	23	21	9	12			5	5
1991-92	59	23	19	8	10			5	5
1992-93	59	23	23	8	14			5	5
1993-94	58	23	16	9	7			5	5
1994-95	60	25	14	7	7			5	5
1995-96	60	25	21	8	12	7	2	5	5
1996-97	57	23	15	6	9	7	2	5	4
1997-98	58	24	13	5	8	14	2	5	4

Notes: Cos. = Companies, Subs. = Subsidiaries, Stat. Corp. = Statutory Corporations, Liqn. = Liquidation.

Source: Reports of the Comptroller and Auditor General of India, Commercial, Govt. of Maharashtra.

The equity stake of the state government has however reduced in these companies from about 90 per cent in 1990-91 to 81 per cent in 1997-98 of the total paid-up capital. Concurrently, the total loans outstanding with the PSEs has also doubled over the period 1990-91 and 1997-98.²²

¹⁹ This section covers only those corporations where the government has a majority stake either directly or through a holding company.

²⁰ The other major stakeholder in these companies is the Central Government with only an insignificant participation by others.

²¹ There may be some inconsistency as the accounts for all the companies are not finalised concurrently. As a result the numbers are approximately correct to the extent of availability of latest data pertaining to each of these organisations.

²² The debt-equity ratio however has varied widely. It had peaked at 5.62 in 1995-96 and has come down to 3.17 in 1997-98.

The share of capital employed²³ in the statutory corporations out of the total capital employed in all Public Sector Enterprises has gradually grown (See Table 3.17). Conversely, the proportion of capital employed in Government companies has gradually declined from about 14.51 per cent in 1993-94 to about 10.16 per cent in 1996-97. Among the 5 statutory corporations, the MSEB (Maharashtra State Electricity Board) has continued to attract the largest share of capital employed (almost 90 per cent, see Box 3.2 on MSEB) and has in fact strengthened its position in the last couple of years. The only other statutory corporation that shows some increase in the proportion of capital employed is the MSFC (Maharashtra State Financial Corporation).

Table 3.16: Share Capital and Loans in Government Companies including Subsidiaries

Year	Number of Companies	Paid-up Capital as at the end of Current Year (Rs. crore)		State Govts. Share in Total Paid-up Capital (per cent)	Loans Outstanding at the close of the Current Year (Rs. crore)	Debt-Equity Ratio
		State Govt.	Total			
1990-91	59	252.06	280.98	89.71	941.46	3.35
1991-92	59	264.59	293.99	90.00	1003.27	3.41
1992-93	59	273.08	303.38	90.01	1098.78	3.62
1993-94	58	273.47	304.77	89.73	1262.59	4.14
1994-95	60	281.77	318.71	88.41	1321.17	4.15
1995-96	60	271.39	346.32	78.37	1946.13	5.62
1996-97	57	260.06	312.88	83.12	1434.28	4.58
1997-98	58	467.92	577.47	81.03	1828.12	3.17

Notes: Statutory Corporations are not included above. Paid-up Capital = Share Capital (Equity + Loans converted into equity).

Source: Reports of the Comptroller and Auditor General of India, Commercial, Government of Maharashtra.

²³ Capital Employed is the sum of net fixed assets (excluding capital works-in progress) and the working capital. The capital employed relates to the total by the state government, central government and other agencies. Note that this is different from capital invested, which is given as the sum of paid-up capital plus loans and reserves & surplus.

Table 3.17: Capital Employed in the Public Sector Enterprises (Rs. Crore)

Year		1997-98	1996-97	1995-96	1994-95	1993-94	1992-93	1991-92	1990-91	
S t a t e	M S E	Cap. Empl.	14301.98	12584.26	8581.78	9581.57	7976.42	7013.88	6114.13	5200.02
		Profit	342.27	346.58	349.80	320.78	288.90	272.16	125.27	85.50
		RoCE	1124.99	1024.60	1015.94	965.83	955.86	869.80	623.48	467.31
u t o r y	M S R T	Cap. Empl.	222.13	346.81	444.38	377.46	306.84	311.15	339.10	313.09
		Profit	-169.95	-138.39	-3.17	3.51	43.91	4.48	-26.72	5.58
		RoCE	-131.79	102.21	26.27	25.94	78.90	43.83	17.77	45.39
C o r p o r a t i o n s	M I D C	Cap. Empl.	33.89	35.43	36.63	37.12	36.74	36.60	37.05	38.43
		Profit	0.16	0.27	0.32	0.32	0.09	0.19	0.25	0.09
		RoCE	2.83	3.16	3.04	2.98	2.70	2.77	2.80	2.96
a n d	M S F C	Cap. Empl.	1167.71	1167.71	985.95	759.24	650.59	561.34	458.21	379.32
		Profit	-22.39	-22.39	16.61	14.14	12.93	10.86	11.36	1.33
		RoCE	122.71	122.71	127.29	91.86	78.81	60.19	47.75	32.16
t o t a l	M S W C	Cap. Empl.	61.42	53.20	38.67	36.47	36.62	33.51	30.64	28.02
		Profit	14.86	14.02	4.21	0.53	1.93	0.35	1.64	2.26
		RoCE	15.43	15.31	5.41	1.60	3.06	1.19	2.57	3.42
G o v t.	C o r p o r a t i o n s	Cap. Empl.	1848.78	1604.94	2157.79	1754.98	1529.32	n.a.*	n.a.	n.a.
		Profit	-19.99	-3.00	48.34	23.11	n.a.	n.a.	n.a.	n.a.
		RoCE	9.59	41.52	169.70	118.38	36.41	n.a.	n.a.	n.a.
T o t a l		Cap. Empl.	17635.91	15792.35	12245.20	12546.84	10536.53	7956.48	6979.13	5958.88
		Profit	144.96	197.09	416.11	362.39	347.76	288.04	111.80	94.76
		RoCE	1143.76	1309.51	1347.65	1206.59	1155.74	977.78	694.37	551.24

Notes: Profit or Loss is shown as a proportion of the capital employed (Cap. Empl.). The Return on Capital Employed (RoCE) is the profit before Interest. Data for MSFC is same for the years 1996-97 and 1997-98. MSEB (Maharashtra State Electricity Board), MSRTC (Maharashtra State Road Transport Corporation), MIDC (Maharashtra Industrial Development Corporation), MSFC (Maharashtra State Financial Corporation), MSWC (Maharashtra State Warehousing Corporation).

*: Comparable figures are not available

Source: Reports of the Comptroller and Auditor General of India, Commercial, Government of Maharashtra.

Strikingly, all statutory corporations (except MSWC) and the group of Government companies (combined) have shown a decline in their total net profits²⁴. While the net profits have fallen to less than 1 per cent of the capital employed, the return (including interest

²⁴ The number of companies that are successfully able to finalise their accounts within reasonable time (about one year) has dwindled (See Table 1). While 21 companies could finalise their accounts in 1990-91, the number had reduced to 13 by 1997-98.

payments made) on capital employed has declined from about 11 per cent in 1993-94 to about 6.5 per cent in 1997-98. This also indicates that the interest burden (as a proportion of the capital employed) has declined marginally. Overall the profitability of the PSEs and the total returns seem to have peaked in 1995-96 and subsequently declined sharply.

Box 3.2: MSEB (Maharashtra State Electricity Board)

The MSEB is the largest PSE in the state of Maharashtra. This statutory corporation takes up almost 81 per cent of the total capital employed in all the PSEs of the state. Both the rate of profit as well the rate of return on capital employed have steadily declined in the decade of the 1990s. The subsidy burden of operating the MSEB has therefore risen dramatically in the last few years (the Government steps in with a subsidy to ensure a 4.5 per cent mandatory rate of return). Infrequent and inadequate revision of tariffs seems to have contributed to the present state. The other indirect form of subsidy obtained by the MSEB are in the form of guarantees for resources raised from the market. While so far the MSEB has not defaulted on such loans, magnitude of risk remains largely un-assessed. Further, whenever the MSEB enters into power purchase agreements, given the requirement of a minimum rate of return on gross block, the risk involved in such agreements too passes on to the Government.

Not only does MSEB receive subsidies, it disburses some as well. The differential tariff policies followed by most SEBs with a view to cross subsidisation implies disbursement of some subsidies. The subsidy pertains to agricultural consumers in drought and scarcity affected areas, concessional tariffs to domestic consumers, street light supply to gram-panchayats, PWW (LT) and rural drinking water schemes. As per the figures provided by the Public Sector Enterprises Survey, the magnitude of subsidy disbursed by MSEB far exceeds the amounts received by it from the Government. There are two implications of the above:

- Rationalisation of tariffs is of utmost importance. Maharashtra Electricity Regulatory Commission (MERC) tariffs make some progress in this direction.
- If the State perceives the need to subsidise consumption of power of some segments of the population, a direct subsidy would be a better measure than the present one of a minimum assured return on gross block. An improvement on this front too is in evidence, with the government proposing an explicit subsidy with respect to tariffs proposed by the MERC. This has been provided for in the budget for 2001-02.

Given the magnitude of investments required in this sector, corporatisation along with unbundling of activities may be desirable. The economic viability of any such new entities created however needs to be examined in great detail in order to ensure that the process does not create future liabilities for the Government.

Of the 5 statutory corporations, in 1997-98 MSEB, MIDC and MSWC earned profits while the losses of MSRTC (see Box 3.3 on MSRTC) and MSFC were as much as Rs. 169.95 crore and Rs. 22.39 crore respectively.

Box 3.3: MSRTC (Maharashtra State Road Transport Corporation)

The MSRTC, one of the 5 statutory corporations of the Government of Maharashtra, was generating profits until 1994-95. In the subsequent years however, the corporation has been in the red. The asset base has eroded severely while the interest burden has remained almost constant. The return on capital employed has become negative indicating a steep deterioration in its financial position.

The general reasons assigned for the inefficiency in service provision by the MSRTC include, slow pace of revision of fares, large scale concessions, decline in load factor, increase in the proportion of buses of older vintage - low replacement rate and shortage of manpower for maintenance of depots

There have been some changes in the external economic environment as well. Early 90's saw the entry of private operators offering alternatives for this form of public transport. Maxi-cabs and Contract carriages, licensed for operation as commercial vehicles for contract, extended their operations beyond this form. Given the possibility of variations in size as well as the routes offered, the private operators possibly deliver a more attractive package to the consumer, though this may be an unauthorised service, undermining the clientele of MSRTC. This competition in the economically profitable routes, with mandatory services on the relatively less viable routes meant that the Corporation could not sustain itself.

There is thus a need to introduce a greater flexibility in designing the fare structure (in keeping with the changes in the costs of components and consumables) and a closer look at the viability of services on the less lucrative 'C-routes' along with stricter vigilance to crack down upon clandestine operations (that is, use of private vehicles for commercial activities). The operation and maintenance costs on the fleet can only be reduced by a phased reduction in the number of vehicles of older vintage and simultaneous replacement by new vehicles.

The total budgetary outgo on account of the PSEs has fluctuated widely between the years 1992-93 and 1997-98. But such outgoes, mostly in the form of equity participation and loans, have shown a marked increase in the latest years (Table 3.18).²⁵

Table 3.18: Budgetary Outgo and Waiver of Dues (Rs. Crore)

Year	Equity Capital Outgo from Budget	Loans given out from Budget	Subsidy (excluding Grants)	Total Outgo
1997-98	41.77	175.82	3.40	220.99
1996-97	3.89	44.10	0.00	47.99
1995-96	-12.52	52.91	3.44	43.83
1994-95	8.30	84.45	24.80	117.55
1993-94	6.68	61.74	41.10	109.52
1992-93	9.38	62.11	36.31	107.80

Notes: The above refers only to a sub-set of all state government enterprises.

Source: Reports of the Comptroller and Auditor General of India, Commercial, Government of Maharashtra.

The subsidy to PSEs from the Government appears to have declined substantially since 1992-93. However, the subsidy numbers relate only to a subset of the government companies that have finalised their accounts (as given in the CAG reports). These are subsidies explicitly identified in the budget; contingent liabilities of various kinds go unreported.

The other aspect of subsidies in the context of PSEs is the subsidy extended by these corporations through differential pricing strategies. Given the fact that the Government usually controls (in an indirect way) the pricing policies of these organisations, these subsidies are often costs imposed on the operations of these organisations. As per the estimates provided in the Performance of State Public Enterprises, the total subsidy bill, amounts to Rs. 3,991.2 Crore in 1996-97 (See Table 3.19)²⁶. This includes both explicit and hidden subsidies, the bulk of which (almost 93 per cent) is in the form of hidden subsidy by MSEB.²⁷ Almost 99 per cent of the subsidy is attributable to the 3 statutory corporations: MSEB, MSRTC (Maharashtra State Road Transport) and MIDC (Maharashtra Industrial Development Corporation). These (subsidies) may be considered as rough estimates of the

²⁵ The government at various stages converts its loans (that are almost irrecoverable) into equity. This effectively amounts to a subsidy later.

²⁶ This report covers only 39 enterprises (including government companies, subsidiaries and statutory corporations). However, these enterprises together constitute more than 95 per cent of the government involvement in the state enterprise.

²⁷ In fact, the profitability of MSEB is due to a huge subsidy extended by the government.

extent to which the PSEs are loaded with *additional* objectives, undermining their commercial viability.

Table 3.19: Subsidies Disbursed by State Public Enterprises (Rs. Crore)

Year		1996-97	1995-96	1994-95
Total	Explicit	127.29	105.16	112.24
	Hidden	3,863.88	3,416.49	2,610.43
	Total	3,991.17	3,521.65	2,722.67
Of which				
MSEB	Explicit	0.00	0.00	0.00
	Hidden	3,699.43	3,325.42	2,503.13
	Total	3,699.43	3,325.42	2,503.13
MSRTC	Explicit	84.55	68.16	60.37
	Hidden	68.28	51.72	50.49
	Total	152.83	119.88	110.86
MIDC	Explicit	0.00	0.00	0.00
	Hidden	92.95	37.07	52.24
	Total	92.95	37.07	52.24

Source: Performance of State Public Enterprises, State Bureau of Public Enterprises, Finance Department, GoM.

Due to extended periods of poor profitability for most state enterprises and their continued reliance on subsidies, most of them (including the new ones) are now finding it difficult to raise finances from the market. Any attempt by them to approach the market has to be usually backed by guarantees from the government. The discussion in section 3.9 below reveals that the total amount of outstanding guarantees grew at a compounded annual rate of about 5.1 per cent between 1990-91 and 1997-98.²⁸ Moreover, the state corporations (including statutory boards and Government companies) account for almost 99 per cent of the outstanding guarantees.

While the performance of most of the public sector enterprises has deteriorated sharply during the nineties, there has not been much success in winding up defunct and perennially loss-making units or in reducing the staff manning these enterprises. A large majority of the employees are engaged by a handful of public utilities.²⁹

²⁸ If we include the figure for the year 1989-90, then the CAGR shoots up to 11.12 per cent between 1989-90 and 1997-98.

²⁹ These include MSEB, MSRTC, MHADA, Maharashtra Jeevan Pradhikaran, MKVDC.

Table 3.20: Workers by Broad Groups of Sectors (Per cent)

Year	Commercial	Commercial cum Promotional	Promotional	Financial	Public Utilities
1996-97	8.80	0.79	1.84	0.28	88.30
1995-96	8.52	0.87	2.00	0.35	88.26
1994-95	8.88	0.94	1.95	0.45	87.78

Source: Performance of State Public Enterprises, State Bureau of Public Enterprises, Finance Department, Government of Maharashtra.

Although there has been some reduction in the number and proportion of class I employees, the numbers have swollen in the lower rungs (Table 3.21).

Table 3.21: Workers by Broad Classes (Per cent)

Year	Officers / Supervisors	Clerks	Skilled Workers	Unskilled / Class IV Workers
1996-97	7.19	45.30	9.28	38.22
1995-96	8.82	49.83	9.49	31.86
1994-95	8.65	49.68	8.73	32.94

Source: Performance of State Public Enterprises, State Bureau of Public Enterprises, Finance Department, Government of Maharashtra.

Even after excluding the commercial cum promotional, purely promotional and financial enterprises from the list of PSEs, it is found that the profitability of the commercial enterprises and the public utilities together has declined sharply. Net profits of commercial enterprises and public utilities together declined from Rs. 390.75 crore in 1994-95 to Rs. 176.44 crore, in a period when equity was growing. Simultaneously, the contingent liabilities (outstanding guarantees) of the state government have also increased significantly in the last decade exposing it to greater risks in the wake of tenuous financial resources (Section 3.7).

3.6 Growing Extra-budgetary Operations

Apart from budgetary factors, growing extra-budgetary operations have had an adverse impact - albeit with a lag - on fiscal performance of the State. Extra-budgetary operations do not have any immediate impact on the budget, but quasi-fiscal deficits incurred by the public sector through such operations today often come back to the budget as a considerably higher transparent deficit after a lapse of time. The off-budget operations in

Maharashtra mainly consist of guarantees extended to various public sector enterprises, commodity market interventions, and reserve fund operations.

a. Guarantees

Guarantees are contingent liabilities. Guarantees given today show up as expenditure tomorrow, if and when the contingency, like default by the borrower that triggers the guaranty, occurs and the guaranty is invoked. Guarantees extended by the Maharashtra Government have gone up almost 23-times from Rs.351 crore in 1989-90 to Rs. 8,418 crore in 1997-98 (Table 3.22). In 1997-98, guarantees accounted for 41.4 per cent of revenue receipts.

Given their limitations on borrowing and hence spending capacities, many Governments have transferred some of the activities, hitherto performed by themselves, to statutory corporations or public sector enterprises. Some commendable activities, identified as potentially sustainable as self-supporting independent activities, have also been assigned to such corporations or enterprises. In the interim, as a credit enhancement measure, the Governments have extended guarantees for the loans and bonds issued by such bodies.

In Maharashtra, a number of such corporations have been created: the irrigation corporations, Maharashtra State Road Transport Corporation, Maharashtra State Road Development Corporation, Jeevan Pradhikaran, to name a few. Guarantees extended by the State Government for the loans/bond issues of these statutory corporations and other Government companies accounted for as much as Rs. 8,335 crore or 99 per cent of total guarantees given by the Government.

Table 3.22: Guarantees Given by the State Government (in Rs. crore)

Year	Maximum Amount Guaranteed	Total Outstanding Guarantees	Guarantees Invoked	Sum Outstanding for State Corporations and Government Companies	Recovery of Guarantee Fee
1997-98	24,442	8,418	6.47	8,335	44.62
1996-97	20,641	7,636	1.75	7,493	39.50
1995-96	19,231	8,127	15.14	7,232	37.11
1994-95	16,944	7,706	0.00	7,418	32.08
1993-94	15,821	7,304	0.00	7,105	19.65
1992-93	13,587	6,132	0.00	5,775	29.52
1991-92	12,564	7,351	0.00	6,087	25.31
1990-91	552	782	12.60	5,882	10.57
1989-90	182	351	6.71	3,584	6.32

Note: Outstanding amounts presented are as at the close of the financial year.

Source: Finance Accounts, various issues.

Against these guarantees, the state government charges a fee at the rate of 1 per cent³⁰. The guarantees invoked constitute a small amount, less than the collections on account of guarantee fee (Table 3.22). Reportedly, the guarantees on a number of loans that are already in default have not been invoked as yet, and the Government is yet to settle some of the guarantees already invoked. It is difficult to predict how much will be invoked in future, and whether the cumulative guaranty fees would be enough to honour the invoked amounts. Doubts about the safety of the Government's guarantee, arise both on account of the large sums that have been guaranteed to individual corporations in the recent past as well as the nature of their operations.

As on October 31, 1999, state PSUs are estimated to have raised Rs 9325 crore through the issue of bonds. Some issues are still pending in the market. Of these Rs. 4578 crore are by Irrigation Corporations, Rs 1294 crore by Maharashtra Jeevan Pradhikaran and Rs. 2221 crore by Maharashtra State Road Development Corporation. Since many of these activities are not likely to break even in the current fiscal year, the budget makes a provision of about Rs. 1024.11 crore towards the interest commitments on these bonds and loans. Towards the commitment on irrigation corporations alone, the budget made a provision of Rs. 300 crore, while supplementaries have been sought to the tune of another Rs. 300 crore. Integrating the contingent liabilities with other liabilities of the government on a one-to-one basis – a rather extreme assumption – increases the stock of debt of the State Government to 25 per cent of GSDP. The correspondingly higher figure for interest payments increase to 21 per cent of revenue expenditure.

The present system of accounting for guarantees lacks transparency. The amount collected against guarantee fees is credited to the consolidated fund of the state. The budget does not contain any assessment on the actual exposure on this front, and this renders the provisions made in the budget to meet such liabilities somewhat arbitrary. Since the stock of debt as reflected in the accounts of the Government, does not include these commitments, provisions made for the financing of such expenditure pass off as expenditure on the provision of the service, instead of being accounted for as interest payments. If the objective behind providing guarantees is to provide an insurance service to the corporations as well as to the investors, the service should be offered at a charge that reflects an assessment of the estimated exposure on the given instrument of debt. In effect, this service should then be self-

³⁰ The fees charged was Rs. 0.50 per 100 rupees guaranteed, till November 1, 1998. Some concessional rates exist for weaker sections.

sustaining. On the other hand, if the government wishes to build in a subsidy into this service, the charges can be uniformly or non-uniformly deflated to the extent of the subsidy. Both these procedures would however, call for a more professional approach to assessing the guarantees and explicitly accounting for the budgetary implications of the same.

b. Commodity market interventions

The Government's proposed interventions in the commodity markets are not explicitly provided for in the budget, but result from some shock to the economy during the year. There are at least two schemes that have exerted upward pressures on Government expenditure. These are in the cotton and onion markets.

Cotton market interventions

The Cotton Monopoly Act was purported to provide a mechanism for stabilising prices of raw cotton. In conception, it was supposed to be a self sustaining, no-profit, no-loss scheme. The Maharashtra Cotton Farmers Marketing Federation was to procure the cotton and sell the same. Of the total profits earned on these transactions, 75 per cent was to be distributed to farmers and 25 per cent was to be dedicated to a price fluctuations fund. In 1993-94 and 1994-95, the reigning international prices were high and the initial purchase price was increased. Cotton export quotas however, meant that the federation could not fully benefit from the favourable international market conditions. In the subsequent years, this high price became a floor price for purchases from the farmers. However, with the international prices moving south, the lower bound on purchase price of cotton become unsustainable. The Federation started to incur losses. Accumulated losses amounted to Rs. 530 crore in 1998-99, requiring support from the Government. Interestingly, of the losses of Rs. 458 crore for 1998-99, Rs 248 crore was on account of interest payment. The Federation does not have reserves or own funds, and financing of losses through borrowing is leading to a compounding of the financial problems through mounting interest payments.

Onion market interventions

A bumper crop of onions in the year 1999-2000 has meant that there was an expectation of prices crashing. On January 4, 1999, the Government announced a floor price for onions produced in the State. Perhaps the uncomfortable association of fluctuations in

onion prices with fluctuations in political fortunes in the country contributed to the decision. The proposed scheme provides a subsidy of Rs. 80 to Rs. 100 per quintal. Estimates of the net cost to the exchequer of this policy stance range from Rs 40 crore to 100 crore.

c. Reserve Funds

The budget of Maharashtra has a number of transactions to and from reserve funds³¹. Typically, associated with most taxes is a cess or a surcharge dedicated to the provision of a specific service. The accounting practice requires that the receipts against the same, net of collection charges, be transferred to a reserve fund and the expenditure on the service be financed through withdrawals from the fund. It is therefore expected that while the accounts for these funds may not balance in any given year, over time, transfers to the funds should match withdrawals from the funds. This would indicate that the resources mobilised towards the provision of specific services are actually utilised towards the provision of such services.

The actual practice with reserve funds in Maharashtra does not conform to this principle. Net accruals to the Public Accounts during the year have been used to finance a part of the deficit (see Section 3.3). If the earmarked nature of the reserve funds is ignored and such transfers to and from reserve funds are netted out of revenue expenditure, the revenue balance was a surplus until 1990-91. The revenue deficit, under this methodology, starts from 1991-92 instead of 1982-83. The changes in the revenue deficit spills over into fiscal deficit as well.

The scale of the problem regarding transfers to and from the reserve funds has increased significantly after 1986-87. This accounting practice is likely to contribute almost 1 percentage point to the fiscal deficit in 1999-2000. The idea behind the reserve funds was to create special purpose earmarked fund. However, the routine budgetary practice of using reserve funds for financing the deficit has converted resources mobilised for specific purposes into general purpose resources. The extent of this reallocation is captured in the ratio of net transfers to gross transfers: this ratio, which captures what proportion of mobilised dedicated resources were used for other purposes, increased from 24 per cent in 1987-88 to 78 per cent in 1998-99.

³¹ All reserve funds are maintained under Public Accounts. A few of the reserve funds are interest bearing, while most of them are not, e.g., Famine relief Fund, Roads and Bridges Fund, Employment Guarantee Fund.

Part II

Forecasts of Receipts and Expenditures

4. FORECASTS OF RECEIPTS AND EXPENDITURES

4.1 Introduction

The State's fiscal position, because of years of prudent economic policies, has a lot of strength, which it is imperative to build on. However, recent trends in Government finances indicate that instead of building on the inherent strengths of the State, there is a tendency for dilution. Persistence of present trends will not only make the State lose its advantage that it has built up over decades but also result in an attenuation of the unfavourable developments, such as a squeeze on capital expenditure, relatively declining infrastructure and burgeoning debt, observed in recent years. This chapter seeks to provide a probable future scenario for the period until 2003-04 if the present trends persist.

4.2 Axiomatic Framework for Forecasting

Within the Indian Constitutional framework, the States have operated under a semi-hard budget constraint. As long as they are indebted to the Centre, the States can not borrow without the Centre's approval. The only financing that are not subject to explicit controls are the share in national small savings collections (part of loans and advances from the Central Government until the change in 1999-2000 Union Budget), loans obtained from NABARD and NCDC and deposits in Provident Funds. The last component, namely Provident Funds, is a function of the wage bill and is not amenable to discretionary mobilisation efforts. NABARD and NCDC loans, extended to specific cooperatives and such other institutions, are only directed through the Government treasury, and provide little succour to the Government in financing its own deficit. The

share in national small savings collection is therefore the only component where the state can hope to mobilise additional revenues through additional efforts or incentives.

The States have always had some leeway to circumvent the hard budget constraint imposed by the Centre through additional channels such as *ways and means* advances from the Reserve Bank of India, quasi-fiscal operations such as guarantees to PSEs, and ingenuous use of Public Accounts. There are indications that the States have started to master the art of softening the hard budget constraint by activating these additional channels, particularly the use of guarantees. Maharashtra provides a good example of such measures.

The Irrigation Corporations of Maharashtra set up between February 1996 and December 1997, for example, mobilised as much as Rs 5,000 crore through Government guaranteed bonds between 1996-97 and 1997-98. While the liability to service the bonds stayed with the Government, the operation eased the pressure on cash outflows in the Government budget by reducing the growth of budgetary expenditure on irrigation. The operation opened up – of course, only temporarily – fiscal space to finance other expenditure. Furthermore, the tenuous budget accounting practices in Maharashtra regarding transfers to and from reserve funds have not only created a complication in the calculation of the deficit, but in difficult years also allowed the Government to finance the deficit without increasing its public debt. Similarly, withdrawals from interest bearing deposits under Public Accounts, which are deposits kept by various corporations and other PSEs, has constituted another flexible source of financing. Interest bearing deposits under Public Accounts have allowed the Government another way to incur deficits without an immediate build-up of debt under the present accounting practices.

In view of the ingenuous ways adopted to circumvent the hard budget constraints, under the baseline scenario, the fiscal deficit has been assumed to be an endogenous variable without any ceiling imposed by the financing constraint. Given the estimates of net capital receipts (from internal debt, central government loans and debt on Public

Account) as provided to the Eleventh Finance Commission, the above yields figures of the additional borrowing required to finance the Forecasted Scenario.

4.3 Baseline Assumptions

These projection exercises take 1999-2000 as the base year and provide estimates for subsequent years.

a. Growth

The State has witnessed an average real growth rate of 8.3 per cent in the post 1986-87 period. Given the current trend of low inflation, annual rate of inflation has been assumed to be 5 per cent, which together with the 8.3 per cent real growth yields an annual nominal growth of 13.43 per cent. This growth of nominal GSDP underpins the baseline tax revenue projections.

b. Tax revenue

Own tax revenue: The three important components of own tax revenue, namely sales tax, State excise and stamps and registration fees, have been projected separately.

After the deterioration in the performance of sales tax, the buoyancy of sales tax with respect to GSDP stands at 0.8505 (Table 3.11). This same buoyancy coefficient has been used for sales tax projections. Significant changes in the sales tax regime in the 1999-2000 have contributed to a sharp increase in the collections: a 27 per cent increase over the previous year or more importantly, a 6 per cent increase over the budget estimates for 1999-2000. An important factor for this increase in collections would be the implementation of floor rates from January 1, 2000. Clearly, the additionality on this count in 1999-2000 can only be for the last quarter, implying thereby that the next year should capture the impact of a full year, thereafter returning a growth determined by the buoyancy of sales tax. Using the difference between the budget estimates and the revised

estimates for 1999-2000 as a measure of the additional revenue attributable to the floor rates regime, the estimates for 2000-01 are derived by stepping the buoyancy based numbers up by twice the this estimated yield, i.e. Rs 1162 crore.

For state excise, the estimated buoyancy of 0.944954 between 1986-87 and 1996-97 is used for projections. In the case of stamp duty and registration fees, the computed buoyancy is 1.4433 and for the other taxes, the estimated buoyancy is 0.734392. These estimated buoyancies are used for forecasting these tax revenues.

Shared taxes: The trend rate of growth of shared taxes of 11.91 per cent is assumed to persist.

c. Non-tax revenue

Own Non-tax Revenue: The two heads composing receipts under this head, namely interest receipts and other non-tax revenue, are again projected on a separate basis. The terms and conditions of existing loans and advances that have already been extended by the State Government together with what the Government wants to lend in the future determine future interest receipts. Hence, these receipts are taken to be the same as the forecasts submitted by the Government to the Eleventh Finance Commission. For other non-tax revenue, projections have been obtained on the basis of the trend rate of growth of 10 per cent observed between 1986-87 and 1996-97.

Grants: Grants have been assumed to grow at 9 per cent, the trend growth observed between 1986-87 and 1996-97.

d. Revenue expenditure

Wages and Salaries: Provisions made towards payment of wages and salaries can be decomposed into four broad categories: current wages and salaries of the State Government, provisions for payment of dearness allowance (DA), pensions, and transfers

made towards payment of salaries and wages. The transfers towards payment of salaries and wages include grants-in-aid, subsidy and contributions towards salaries. Each of these components is forecasted separately.

On the conservative assumption of the number of state government employees remaining unchanged at the current level, the current wages and salaries bill of the State Government is expected to increase by about 4 per cent on account of the annual increments to salaries. An unchanged number of employees implies that fresh recruitment would occur only to the extent of average annual rate of attrition, currently estimated at about 2.7 per cent. With annual inflation at 5 per cent, the DA payments of these employees too are expected to be 5 per cent of salaries, inclusive of increments.

Pensions have registered an average annual growth of 9 per cent, a part on account of inflation and another on account of the new pensioners entering the roles. The same rate of growth is assumed to persist (with the recent revision in pay-scales, this may be a conservative estimate). Finally, transfers towards payments of salaries have been the fastest growing component of wages and salaries. With unabated growth of grant-in-aid institutions (Chapter 3, section 3.3), such transfers: grant-in-aid salary, subsidy salary and contribution salary, have grown much faster than the current wages and salary bill of the State Government. Such transfers recorded a rapid growth of 14 per cent in 1998-99, and this growth is assumed to continue.

Table 4.1: Forecasts for Wage Bill

	(Rs. crore)					
	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05
Salaries	4,837	5,031	5,232	5,441	5,659	5,885
Wages	552	574	597	621	645	671
Provision for DA payment	1,080	1,165	1,278	1,404	1,546	1,706
Grants-in-aid salary	6,411	7,308	8,331	9,498	10,827	12,343
Subsidy salary	18	20	23	26	30	34
Contribution salary	12	14	16	18	21	24
Arrears	7,100					
Pensions	2,224	2,424	2,642	2,880	3,139	3,422
Total current wages	15,133	16,536	18,119	19,888	21,867	24,085

Interest payments: This category is determined endogenously. Adding the fiscal deficit to the pre-existing amount of debt derives debt for a particular year. An average rate of interest of 13 per cent has been applied to the stock of debt to project the figure for interest payments.

Other revenue expenditure: 'Other revenue expenditure' grew by 5 per cent in 1998-99, while those 1999-2000 (R.E) would show a decline in nominal terms if the estimates of wage bill for 1999-2000 above are met during the year. In order to utilise the personnel accounted for by the wage bill, at the very minimum, the level of expenditure on non-wage, non-interest categories of expenditure will have to be maintained. This requires the residual category to grow at least at the same rate as prices. Thus, other revenue expenditure has been assumed to grow at 5 per cent, over the levels achieved in 1998-99.

e. Capital expenditure and net loans and advances

The ratio of this broad head of expenditure to GSDP has steadily declined, with the figure for 1998-99, being 1.73 per cent. Revised estimates for 1999-2000 capture a moderate stemming of this trend, with a level of 1.94 per cent. Of this, capital expenditure accounts for 90 per cent and net loans and advances for the residual 10 per cent. The ratio of capital expenditure and net loans and advances for the projection period is maintained at the same level as in 1999-2000. This may be a conservative projection considering the large commitments for the irrigation corporations.

f. Contingent liability

With the burden of debt servicing falling on the Government in the case of default, the risk of default on guaranteed loans is accentuated a large subset of contingent liabilities. For instance, the present structure of the finances of irrigation corporations, together with the dynamics of irrigation and water charges, implies that the contingency of the corporations failing to honour their debt obligations are highly probable (almost

imminent), and the Government guaranty may have to be invoked. The Department of Finance provided estimates of the required expenditure to honour the guarantees, and these have been utilised to construct the baseline scenario. The numbers refer to only a part of the total loans guaranteed (to irrigation corporations, MSEB, MSRTC, MJP). While it is very difficult to predict how much of the contingent liabilities will devolve on the Government, the figures assumed in the baseline may be considered as conservative estimates.

4.4 Baseline Scenario

In the baseline scenario, the fiscal deficit remains consistently above 5 per cent of GSDP over the entire five-year period (Table 4.2). Further, the additional borrowing requirements increase from 1.66 per cent (of GSDP) in 2000-01 to about 3.17 per cent by the end of the 2003-04. The stock of debt, as a proportion of GSDP, increases from 16 per cent to 33 per cent, while interest payments on Government debt, as a proportion of revenue expenditure, increase from about 21 per cent to 32 per cent. Total debt service, that is interest payments together with debt repayments, as a proportion of revenue expenditure, increases from 17 per cent to 38 per cent. Debt service, as a proportion of revenue receipts, rise from 26 per cent to 54 per cent.

Clearly, the baseline scenario is rather dismal. However, the present accounting practices regarding net transfers to reserve funds partly contributes to the grimness. This is particularly so because such net transfers to reserve funds have been increasing faster than revenue expenditure in the past (Figure 4.1).

Alternatively, if the exercise is repeated correcting for net transfers to reserve funds, expenditure on wages and salaries as well as expenditure on interest payments remain unchanged, but other expenditures get reduced by the relevant transfer to the reserve funds.

Table 4.2: Baseline Scenario

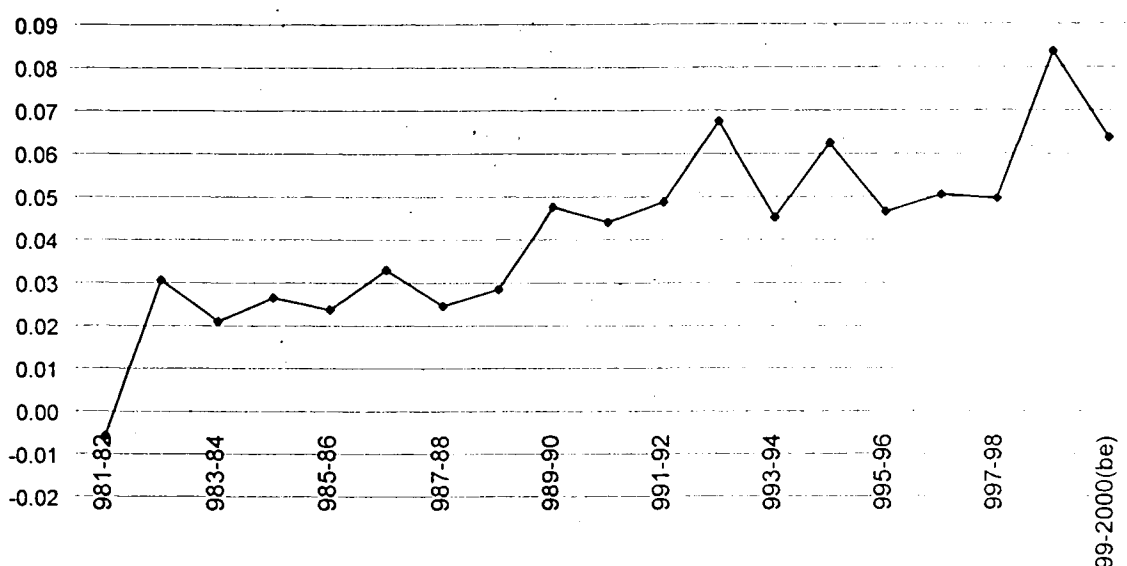
(Percentage of GSDP)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Total revenue Receipts	10.81	10.63	10.46	10.29	10.13
Tax Revenue	8.82	8.72	8.63	8.54	8.46
Own tax revenue	7.69	7.61	7.53	7.46	7.39
Shared taxes	1.13	1.11	1.10	1.08	1.07
Non tax Revenue	1.99	1.91	1.83	1.75	1.67
Own non-tax revenue	1.20	1.15	1.10	1.05	1.00
Grants	0.79	0.76	0.73	0.70	0.67
Revenue Expenditure	14.03	13.81	13.61	13.46	13.34
Wages and Salaries	6.38	6.16	5.96	5.78	5.61
Interest	3.01	3.36	3.67	4.01	4.32
Other Expenditure	4.64	4.30	3.98	3.68	3.41
Revenue Surplus/Deficit (+/-)	-3.22	-3.18	-3.15	-3.18	-3.21
Capital Expenditure	1.94	1.94	1.94	1.94	1.94
Fiscal Surplus/Deficit (+/-)	-5.16	-5.12	-5.09	-5.12	-5.15
Contingent Liability: Bond Financing	0.96	1.09	1.63	1.76	1.89
Revised Fiscal Deficit	-6.12	-6.21	-6.73	-6.88	-7.04
Net Capital Receipts	3.64	3.36	3.08	2.79	
Additional Borrowing required	2.48	2.85	3.64	4.08	
GSDP (Rs. '00 crore)	2594	2942	3337	3785	4294
Net of Transfers of Reserve Funds					
Revenue Surplus/Deficit (+/-)	-2.17%	-2.09%	-2.03%	-2.02%	-2.02%
Fiscal Surplus/Deficit (+/-)	-4.11%	-4.03%	-3.97%	-3.97%	-3.97%
Revised Fiscal Deficit	-5.07	-5.13	-5.60	-5.72	-5.86
Additional Borrowing required	2.12	2.43	3.16	3.52	

Note: 1. The figures for net capital receipts are obtained from the memorandum submitted to the Eleventh Finance Commission and hence cover only the period upto 2004-05. This consequently defines the information for additional borrowing requirements.

2. When considered net of transfers to reserve funds, the net capital receipts too are lower, but not by the total amount of transfers. Thus the estimates for additional borrowing requirements are lower in this case.

Figure 4.1: Net transfers to Reserve Funds as a ratio of Revenue Expenditure



Compared to the results of the baseline scenario, there is a decline in both the revenue and fiscal deficits. The debt-to-GSDP ratio improves and so does the ratio of interest payment to revenue receipts. However, since the adjustment on account of reserve funds is largely in revenue expenditure, the ratio of interest payment to revenue expenditure deteriorates somewhat. In 2003-04, additional borrowing requirement, as a proportion of GSDP is lower at 3.52 per cent compared to 4.08 per cent in the baseline.

The baseline scenario suggests that persistence of present trends on unchanged policies will imply not only a continuation of the current difficulties in fiscal management, but also a continued inability on the part of the Government to deliver quality public goods and services where it is needed, for instance in basic education, health care, roads and other infrastructure.

4.5 Causes for Concern

The baseline scenario indicates four sources of concern. First, although the fiscal deficit as a proportion of GSDP comes down from a high of 6.08 per cent in 1999-2000

(R.E.) to 5.09 per cent in 2002-03, it starts to rise again and reaches 5.16 per cent in the terminal year of projection, namely 2003-04. Second, the debt-to-GSDP ratio increases by almost 45 per cent from 23 per cent to 33 per cent in a short period of five years. Third, there are signs of an emerging debt trap. Although the debt-to-GSDP ratio continues to be modest, the rise in this ratio as well as the rapid increase in interest payments as a proportion of revenue receipts from 28 per cent in 2000-01 to 48 per cent in 2004-05 are disturbing signs. Fourth, the social indicators for Maharashtra are not in consonance with its economic achievements. While there is an urgent need to improve delivery and the quality of public service in the social sectors such as primary education and health, persistence of present trends will imply a continuation of the modest spending in these areas.

Last but not the least, in recent years, the Government has passed on some of its conventional activities such as irrigation and urban development to statutory corporations such as the MKVDC, VIDC, MSRDC, etc. While this hiving-off allowed the Government to reduce its own expenditure in these areas, it had to guarantee the bonds of these organisations for them to mobilise the funds. Insufficient user charges and management inadequacies are likely to result in the guarantees being invoked. In the future – including in the projection period – many of the contingent liabilities will become actual liabilities and the Government will have to meet these obligations. While guarantees are invoked, the Government will also need to find ways of augmenting its outlays on areas such as irrigation and slum resettlement either again through statutory corporations or through its own budget. Either way, it will be necessary to open up fiscal space to accommodate these extra outlays.

There is an immediate need for a change of course to stem the slide. With the Government in fiscal distress unable to support human and infrastructure development at an appropriate speed, postponement of adjustments will have an adverse impact not only on the welfare of the people but also on the growth prospects of the State's economy. Furthermore, the cost of adjustment goes up with postponement of the necessary changes. The State should act now and here.

4.6 A Reform Scenario

Reforms appear to be possible under three categories of budget heads: own tax revenue, own non-tax revenue, and wages and salaries.

There exists considerable scope for raising additional own tax revenues. The recent implementation of the floor rates of sales tax and abolition of sales tax incentives for new and expanding units are steps in the right direction. Given the decision of the Chief Ministers about the introduction of VAT by April 1, 2002³², the State could also try to introduce a State-level VAT with a wide base, multi-point taxation, and a moderate rate at an early date. The reform scenario assumes considerable improvement in tax administration, including computerised assessment, scrutiny and audit.

The revenue in the reform scenario is projected as follows: potential sales tax collections in the absence of exemptions are computed by adding the actual revenue with the estimated loss in revenue. This new series is used to re-estimate the buoyancy for the post 1986-87 period at 0.976545. This buoyancy along with the forecasted figures for GSDP, yield potential revenue for the projection period. To obtain estimates of the actual receipts, these numbers are adjusted downwards for the estimated loss of revenue on account of exemptions given in the past. The above, however, represents the likely stream of receipts without any additional effort. Some additional measures that could yield fruits are sketched in the next chapter.

In the area of own non-tax revenue, a comparison of the recovery rates across states for 1993-94 suggests that in most cases, there exist States with higher recovery rates than that in Maharashtra. In other words, Maharashtra does not have the “best practices” even within the country. Furthermore, even when compared to its own practice

³² The Meeting of Chief Ministers on November 16, 1999 initially proposed April 1, 2001 as the date for introduction of Value Added Tax (VAT). This date now stands revised to April 1, 2002, so as give the states time to prepare.

in the recent past (1993-94), there is evidence of a deterioration in performance by 1997-98. There are two possibilities: (i) for those sectors where performance was better in 1993-94, the State should aim to increase recovery rates to the 1993-94 level, and (ii) under a somewhat more ambitious programme, the State pegs the recovery rates at the highest level achieved in the sector by all States in the country. The projections presented below assume the first alternative wherein only the deterioration since 1993-94 is reversed. It is assumed that the rates for the specific sectors under consideration are revised upwards in the year 2000-01 itself.

Given the average natural attrition rate of State government employees of 2.8 per cent, only limited filling of posts falling vacant will allow the Government to reduce the number of employees by 2 per cent per year. This along with the natural increase in wage bill due to annual increments and DA payments yields an annual increase of about 7 per cent in the wage bill under the reform scenario. The 'transfers' component, which has been growing more rapidly than the Government's own wage bill, is allowed to increase by 8 per cent per year. This growth of 8 per cent in transfers would allow the government to cover the expenditure on account of annual increments and DA payments for the existing number of employees in aided institutions. Similarly, pensions are assumed to grow at 8 per cent per annum. The burden of adjustment under the reform scenario is the most severe for 'transfers'; the rate of growth is down from around 19 per cent to 8 per cent. Alongside, non-wage, non-interest expenditure has been pegged as a proportion of the wage expenditure, at the 1999-2000 (R.E) level. The rationale for this move is that the with a compression in the administrative machinery, by way of freeze of recruitment, the complementary expenditure too would adjust accordingly.

Table 4.3: Reform Scenario

	(Percentage of GSDP)				
	2000-01	2001-02	2002-03	2003-04	2004-05
Total revenue Receipts	11.24	11.48	11.72	11.89	12.08
Tax Revenue	9.22	9.50	9.78	10.01	10.25
Own tax revenue	8.07	8.35	8.63	8.84	9.08
Shared taxes	1.15	1.15	1.16	1.16	1.17
Non tax Revenue	2.03	1.98	1.93	1.88	1.84
Own non-tax revenue	1.31	1.28	1.24	1.21	1.18
Grants	0.81	0.79	0.77	0.76	0.74
Revenue Expenditure	12.49	11.80	11.54	11.30	11.04
Wages and Salaries	5.94	5.34	5.08	4.83	4.60
Interest	2.95	3.25	3.45	3.64	3.79
Other Expenditure	3.78	3.56	3.36	3.17	2.99
Revenue Surplus/Deficit (+/-)	-1.16	-0.17	0.39	0.87	1.39
Capital Expenditure	1.94	1.94	1.94	1.94	1.94
Fiscal Surplus/Deficit (+/-)	-3.10	-2.11	-1.55	-1.07	-0.56
Contingent Liability: Bond Financing	0.98	1.13	1.73	1.89	2.07
Revised Fiscal Deficit	-4.08	-3.25	-3.28	-2.97	-2.63
Net Capital Receipts	3.00	2.80	2.58	2.38	
Additional Borrowing required	1.08	0.45	0.69	0.59	

In the reform scenario, the fiscal deficit in 2000-01 declines from 4.08 per cent to 2.63 per cent. It continues to decline in subsequent years to reach a figure of around 3.79 per cent in 2004-05. Additional borrowing requirements are considerably reduced which, given the estimates of feasible net borrowing, reduces the demand for additional funds to 0.60 per cent of GSDP by 2003-04.

The burden of adjustment is somewhat asymmetric with expenditure side of the budget bearing the brunt of the adjustment (Table 4.4). The proposals for reform on sales tax envisage limited progress in the short run. Similarly, non-tax revenue receipts are revised only through restoration of the recovery rates to the same level as that recorded in the State in 1993-94. Of course, any additional revenue mobilisation effort on this front or others would provide the flexibility to undertake less stringent reforms on the expenditure side. For instance, if the buoyancy of sales tax could be increased from the present .976545 to say 1.05, the additional receipts so obtained would be sufficient to allow keeping the number of State Government employees unchanged at least for the first couple of years.

Table 4.4: Contribution to Reduction of Fiscal Deficit

	(Rs. crore)				
	2000-01	2001-02	2002-03	2003-04	2004-05
Wages	1403	2908	3716	4656	5749
Non-tax Revenue	2060	2243	2442	2659	2895
Sales tax Reforms	587	1270	2092	2839	3781

Part III

Proposed Reforms

5. PLAUSIBLE MEASURES FOR REFORM

5.1 Introduction

The Government needs to introduce comprehensive reforms of its fiscal sector to reverse the unfavourable developments observed since 1994-95. Maharashtra, being in the vanguard of States in India, should not only reverse the recent negative trends but also build on its inherent strengths to set up a model of how to run government affairs at the subnational level. The revenue balance must be turned into a surplus to open up fiscal space for augmenting capital expenditure. The debt-to-GSDP ratio has traditionally been low in the State. The fiscal deficit, on an upward trend in the recent past, must be rolled back and contained within 2.5 per cent to 3.0 per cent of GDP to keep the debt-to-GSDP ratio at around 20 per cent (see Appendix). The reforms must initiate complete fiscal restructuring, including revenue enhancement, better expenditure control and management, and more effective delivery of public services.

The last chapter presented a synoptic view of a possible reform scenario. There were three broad summary measures proposed. On the taxation side, the reform was to concentrate on sales tax, since it is believed that there is considerable scope for enhancing receipts on this front. Beyond taxes, the issue of fiscal restructuring can broadly be thought of synonymous with improvements in the recovery rates of services, especially social and economic services. This goal could be achieved either through enhancements in user charges with improved collections, or control on growth of expenditures, or a combination of the two. When presented in this fashion, these measures may appear independent of each other, but often may not be so. For instance, consider a department, where the level of the service delivery is not adequate. In other words, curtailing the rate of growth of expenditures may not be a feasible strategy either from the point of view of the level of service or in terms of the ability to enforce higher user charges. In such cases, the department would have to explore alternative means of service delivery, so that the level and quality of service is not compromised, in the attempt to ensure fiscal viability. In the sections on non-tax

revenue (section 5.3) and expenditure restructuring (section 5.4) therefore, no attempt is made to lay down specific measures, which would ensure a turn around. The discussion instead seeks to identify the possible directions of change in the individual departments considered. Clearly, for the huge dimension of change proposed in the earlier chapter, each department would have to find its own ways of achieving the goals. This and related issues of improving financial management of the state are taken up in the last section (section 5.5).

5.2 Improving Performance of Taxes

On the taxation side, the reform should concentrate on sales tax, given the considerable scope for enhancing receipts on this front. However, for every tax, effort has to be directed to all the key issues under the two broad categories of tax policy and tax administration. These issues are elaborated upon in the context of the sales tax, the most important tax for the state.

a. Tax policy

Exemptions and concessions complicate tax administration and involve loss of revenue. The figures provided by the Ministry of Finance on estimated loss of revenue on account of sales tax concessions illustrate the extent of the revenue loss from sales tax incentives.

The tax incentives were granted with the avowed objective of attracting investment into the State. Without any audit or evaluation of such incentives, no firm estimates exist about their effectiveness. However, estimates available for other States indicate that the role of incentives in encouraging investment has been limited. Tax incentives play a very minor or negligible role in the economics of location in India. Factors, such as availability of power, roads and other infrastructure, and the state of industrial relations, are far more important than tax incentives at the margin. While traditionally, Maharashtra was considered to have better infrastructure than most of the other States, this position cannot be taken for granted.

It could be argued that tax incentives are not only ineffective, but actually affect industrial investment in the State in an adverse way. Tax incentives should be looked upon as tax expenditure. In attracting investment in the State, the effectiveness of Rs. 100 crore invested in roads or power is likely to be much more than that of an equivalent sum of tax incentives. Furthermore, in selective cases, if the State so desires, it can opt for direct subsidies, which are explicitly accounted for in the budget. This would ensure that the amount of subsidy to be given is regularly monitored and at any point in time, when there is need for restructuring of expenditures, the need as well as use of such subsidies can be clearly evaluated. Like in the case of sales tax, no further tax incentives should be granted in any tax, and the incentives already granted should be phased out as early as possible.

The second issue of tax policy relates to a complex tax structure with possibly high rates of taxation (Box 5.1: Effects of High Tax Rates). Interestingly, the decline in the buoyancy of sales tax collection coincided with the introduction of a surcharge in 1987.³³ A solution to the myriad problems of commodity taxation is the adoption of a State-level VAT with a wide base, multi-point taxation, and a moderate rate. Such a tax, by ensuring that value added at all stages of production and trade are taxed, prevents artificial manipulations with the tax base. However, for ensuring that the tax generates adequate resources, the tax rate(s) needs to be suitably chosen. Specifically, when shifting from a first point tax to a VAT, the department is likely to lose revenue on some fronts and gain on some others. The process of giving credit for taxes paid on inputs would mean a leakage of revenue when compared to the present scenario. On the other hand, extending the tax beyond the first point would yield additional revenue on value added at these later stages. These two effects need to be assessed and balanced to ensure that total receipts do not decline. A properly administered VAT has been found to be revenue-enhancing in most countries of the world. Given the unanimous resolution at the Chief Ministers of all states about introducing VAT in all States by April 1, 2002, Maharashtra should take all possible steps to meet the deadline.

³³ While a part of this decline is accounted for by the increased coverage of exemptions, the latter does not provide an adequate explanation (Figure 3.5).

Box: 5.1: Possible Effects of “High” Tax Rates

- A high rate relative to other States, say far above the prescribed ‘floor’ rate, often results in trade diversion.
- In a first point sales tax regime, such as in Maharashtra, a perception of high rates can lead to evasion at the first point through understated values of sales. The first point dealer can choose to account for a larger proportion of value added at a subsequent point of sale to minimise the tax incidence. Although requiring the tax to be paid on the maximum retail price (MRP) sometimes gets round the problem, the relatively small number of commodities sold at manufacturer determined MRPs limits scope of this option.
- A perception of high rates also encourages vertical integration of activities. In a first point tax, vertical integration of activities, i.e., merger of activities up- or down-stream, reduces the tax base, by making formerly taxable activities intra-firm transactions and hence not taxable.

b. Tax administration

The objective of good tax administration is to ensure that there is minimum leakage of taxes due and compliance cost for the tax-payer is low. A good administration promotes voluntary tax compliance. Presently, the department undertakes assessment of the returns of all dealers. Given the enormity of the task involved, reportedly the exercise in most cases is a cursory one. Further, since this exercise is undertaken at the department, where the dealer is expected to bring all the records, the department in most cases is likely to be looking at suitably doctored documents corroborating the claims on the returns. An alternative strategy of selecting high-risk categories of dealers by some objective criteria and subjecting them to intensive audit, possibly at the place of business, will permit the department to focus its energies, and carry out the exercise in a more thorough fashion.

The alternative procedure would result in the department asserting a presence in the relevant segment of dealers and improvement in compliance by all dealers. The design of a suitable audit strategy, including a scheme whereby high risk elements are identified and taken up for detailed audit, is crucial for the success of the alternative strategy. This in turn requires the department to have a good database on the dealers. The database should be carefully collated with supplementary information from other related sources. For instance, the department should maintain information about the collection of taxes by commodities. Since production figures can be obtained from other sources, these two bits of information – one about production and the other about tax collection – can be juxtaposed to infer about the level of compliance by a particular segment of dealers.

Currently, the information base of the sales tax department appears to be far from satisfactory. For example, it has a scanty database on tax collection by commodities. Presently, the department seems to have access to the following information: the collection by commodities for only about 58 commodities for the year 1993-94, and for 150 commodities for 1997-98 and 1998-99. In all, these cover about 50 per cent of total receipts of the department. Clearly, such information would be inadequate for the department to pursue any systematic strategy for checking evasion and improving compliance. Improving the database and having an efficient and quick way of retrieving data is a prerequisite for improved tax administration.

5.3 Non-tax Policy

For all non-merit services, it is imperative to immediately restore recovery rates to at least the same level as that of 1993-94 and reverse the deterioration that has taken place in the intervening years. Furthermore, in some of these sectors, the performance of Maharashtra does not compare well with that of some other States (Tables 3.12 and 3.13). For instance, the recovery rates are significantly higher in Haryana for transport and urban development, and in Goa for housing. Maharashtra should adopt the best-practices in India and significantly enhance its non-tax

revenues. The State should increase the recovery rates in all sectors which have witnessed declines in these rates.

a. Social services

Recovery rates in 1997-98 were significantly lower compared to 1993-94 in the following sub-sectors:

- Education, sports, art and culture (excluding elementary education),
- Water supply and sanitation (excluding Sewerage and Sanitation), and
- Housing.

The restoration of the recovery rates to the 1993-94 levels could generate additional revenues of Rs. 13.5 crore, Rs. 30.5 crore and Rs. 13 crore, respectively, in the three sub-sectors. While these additional revenues will only be a fraction of the enhanced levels of expenditure in the years following 1997-98, the minimalist strategy of restoring recovery rates to their 1993-94 level should be feasible to implement.

Education, sports, art and culture (excluding elementary education)

Growth of total receipts by only 20 per cent while expenditures grew by 83 per cent has resulted in a rapid deterioration in the recovery rates in education, sports, art and culture from 1.43 per cent in 1993-94 to 0.94 per cent in 1997-98. It is imperative to augment the revenue stream to improve recoveries.

Among the sources of non-tax revenue, recoveries (in rupees) from technical education increased by 120 per cent, but those from secondary education grew by 41 per cent, while those from university education increased only by 21 per cent. The slow growth in recoveries from university education needs to be reversed. Furthermore, the Rs. 2.52 crore decline in receipts from the category 'general' – a category about which details are not available in the Finance Accounts of the Budget Documents – needs investigation and redressal.³⁴

³⁴ There is another category, namely 'other receipts' within 'general education' that is not explained in the these documents as well, and that suffered a decline in receipts of Rs. 0.17 crore.

With enrolment of 735.562³⁵ in institutions of higher education in the state, and with three terms per year, an increase in fees of Rs. 10 per term in higher education can augment revenues by Rs. 2.2 crore per year. Similarly, with the enrolment in secondary and higher secondary schools at 7,728,585, an increase in fee of Rs 4 per student per term can yield additional revenues of Rs. 9.3 crore.³⁶ These marginal fee enhancements together with measures to restore General and Other Receipts at their 1993-94 levels can mobilise Rs. 13.5 crore of additional non-tax revenue.

Water supply and sanitation (excluding sewerage and sanitation)

Total non-tax receipts in water supply and sanitation went down between 1993-94 and 1997-98. The component of receipts that caused the decline is an innocuous head: 'other receipts'. This head recorded 96 per cent of total receipts in this sector in 1993-94. Given the sheer size of this source of receipts, it is essential to enlarge it by suitable measures.

Housing

In housing again, receipts were lower in 1997-98 than in 1993-94, by 25 per cent. The receipts from both Government Residential Buildings and Urban Housing have declined sharply. On the other hand, the expenditures on housing have registered an increase. Without better cost recovery, it will not be possible to provide for the enhanced housing needs of the people. Even restoring receipts to the level recorded in 1993-94 would raise the recovery rates to 7.3 per cent from the present level of 5.75 per cent, and would fetch in an extra Rs. 4.8 crore.

b. Economic services

Restoration of recovery rates in economic services to their 1993-94 level can mobilise additional revenues worth Rs. 160.9 crore. Recovery rates are found to have

³⁵ All the enrolment figures are from "Education at a Glance: 1987-88", a publication of the Department of Education, Government of Maharashtra.

³⁶ This represents a minimum requirement for ensuring the same recovery rates as in 1993-94. Given the requirements for additional schools/teachers in secondary education, the recommended increases in fees would be higher (Section 5.4).

deteriorated in five areas of economic services between 1993-94 and 1997-98. The area-wise additional revenue yields are as follows:

- Agriculture and Allied activities would contribute Rs. 35.66 crore,
- Co-operation would yield additional revenue of Rs. 12.83 crore,
- Rural Development, Rs. 9.18 crore,
- Irrigation, Rs. 101.41 crore, and
- Transport, Rs. 1.78 crore.

Within economic services, irrigation and transport are the two sectors where revenue receipts in rupee terms declined between 1993-94 and 1997-98. In the other sectors, while both receipts and expenditures increased over time, the growth of expenditure exceeded that of receipts and resulted in a decline in the recovery rates.

Agriculture and allied activities:

Some sub-sectors, which have recorded very sluggish growth of non-tax revenue, if not a decline, are crop husbandry, forestry and food, storage and warehousing. Within crop husbandry, receipts from sale of seeds, commercial crops, sale, hire and services of agricultural implements and machinery including tractors, have not registered adequate growth. In fact the receipts against some of these categories of receipts actually declined, along with receipts in the summary category of 'others'. It is not immediately obvious whether the government's participation in these sectors has declined over these four years or not. If not, these would be some of the areas that the government could hope to raise some additional resources in the form of non-tax revenue.

Further, there is a decline in the ratio of interest received to interest payable³⁷ as well, from 16 per cent to 7.6 per cent. Improving the recovery rate therefore would have to work on both these fronts.

Co-operation

³⁷ This amount is the interest that the government would have to pay on the outstanding balances of loans and advances, at the average rate of interest applicable to government debt. In other words, this is the opportunity cost of the loan to the government.

The decline in recovery rates in the area of co-operation is the result of fairly consistent increases in the interest payable, but very little flowing into the coffers of the department in terms of interest received. Between 1993-94 and 1997-98, interest payable on loans and advances extended by the state government has increased by 2.4 times but the actual interest receipts have declined. The emphasis has to be on improving the recovery of debt servicing charges from the borrowers. In the absence of a significant improvement in recovery rates, the whole issue of extending loans to the co-operatives on the basis of loans received from organisations such as the National Co-operative Development Corporation should be re-examined.

Irrigation

With the formulation of 5 statutory corporations for irrigation services, it is important to take account of the quasi-fiscal operations of these corporations in any analysis of recovery rates in this sub-sector. A large part of the erstwhile operations of the Government in irrigation is likely to be passed on to the corporations, and the level of expenditure by the Government on irrigation is likely to decline with a commensurate decline in receipts. Insufficient recoveries by the corporations will not affect the Government's fiscal position with immediate effect. But such insufficiencies will require the corporations to borrow in order to meet current expenditure commitments. Borrowing in turn would require Government guarantees for credit enhancement. In this manner, sustained losses of the corporations are bound to devolve on the Government budget with a lag.

For continued economic viability, the irrigation corporations need access to some steady and buoyant sources of revenue. Non-tax revenue in the nature of irrigation charges should therefore accrue to these corporations. The cost of maintaining the irrigation related assets of the Government transferred to the corporations will also have to be borne by these corporations. The corporations will be expected to fund their activities out of irrigation charges levied, resources raised from the market as well as loans received from the Government. All past investment by the Government in this sector would then be treated as investment in the corporations. If the corporations become financially viable units, the Government should be receiving interest on the loans extended and dividends on the investment made. This would be a scenario with 100 per cent recovery for the Government. Full

recovery by the Government in the field of irrigation or the prospect thereof will be crucially dependent on the corporations being able to mobilise significant amount of resources in the form of user charges and the prospects of full recoveries in the near future.

The current structure of irrigation charges in the State raise serious doubts about the financial viability of the irrigation corporations. In October 1999, CRISIL, the credit rating agency, downgraded the bond programmes of four Government undertakings, namely, Konkan Irrigation Development Corporation, Maharashtra Krishna Valley Development Corporation, Tapi Irrigation Development Corporation and Vidarbha Irrigation Development Corporation from A+ to A. Without a revision of the irrigation charges, the corporations are likely to be able to meet only a part of the current expenditures out of their receipts and will require the Government to step in and provide them with financial support. This would increase the expenditure of the Government without substantially altering the receipts. In other words, the recovery rate for the Government in irrigation would continue to be considerably lower than 100 per cent.

Irrigation charges need to be revised upwards. For reasons other than economic, if the user charges cannot be raised upwards adequately to ensure financial viability of the irrigation corporations, the Government should actively consider giving an explicit subsidy to these corporations. The subsidy could be based on the number of acres irrigated. The Government could ensure that this explicit subsidy is the only financial disbursement made to the corporation to encourage their self-sufficiency. This would also allow the Government to reassess the extent of the subsidy for this sector on an annual basis.

Transport

This sector is defined to include all activities relating to transport, other than roads and bridges, which are treated as merit goods. In 1993-94, two major sources of non-tax revenue here were against ports and light-houses, and receipts from Indian railways, on commercial lines. Surprisingly, there are no receipts against the first source in 1997-98, which includes receipts from ferry services, registration and other fees at minor ports. However, the expenditure on these services grew by 79 per cent

over this four-year period. This source of receipts needs to be re-harnessed for turning the recovery rates this sector around.

5.4 Expenditure Restructuring

As already discussed in the reform scenario in Chapter 4, the number of State Government employees should be reduced by 2 per cent every year, and the transfers for wages and salaries in aided institutions should not be allowed to grow at more than 9 per cent per year. Reduction of State Government employees by 2 per cent per year would imply filling up only a limited number of posts against posts falling vacant through the average natural attrition rate of 2.8 per cent per year. However, in order to ensure that the service delivery is not adversely affected, the State will have to devise means of identifying slack wherever it exists on the one hand and develop alternative means of ensuring service delivery on the other. It would be instructive to explore the possibilities in the case of a few sectors in order to obtain an idea of the alternative available to the state.

Public sector enterprises are developing an increasing interface with the budget of the Government. While these are meant to be organisations which function on commercial lines, which should ensure that they provide adequate return to the State on capital invested, the actual performance has been far from desirable. The performance of the Public Sector Enterprises has been far from satisfactory and the Government needs to find ways of solving the problem of such enterprises acting as drains on Government finances. The Government also needs to improve the management of its contingent liabilities.

a. Special Sectors

School Education Department

An important feature of the expenditures of the School Education Department is the predominance of transfers in total expenditure. Transfers not only account for more than 90 per cent of total expenditure, but this proportion has been increasing at the cost of other current expenditure. These transfers are meant largely for meeting

the expenses on account of wages and salaries. These transfers are meant largely for meeting the expenses on account of wages and salaries. The School Education Department accounts for 40.3 per cent of the total transfers made by the Government.

Most of the schools and other educational institutions in the State are run by local bodies or are autonomous entities. The preponderance of transfers in the Department is on account of the Government grants given to these institutions. Among the various sub-heads of expenditure, elementary education claims the lion's share of 52 per cent, followed by secondary education with 45 per cent.

Given the overall target of reining in the rate of growth of wage-related transfers to 9 per cent, it is essential that the School Education Department controls its transfer as well. The Department has two options. Either it can keep the number of aided institutions and posts supported in such institutions unchanged, and permit the transfers to these institutions to grow in line with inflation and other such natural increases in costs. Or, it can reduce the subsidy provided to each institution and for each post supported by a fixed proportion, and create some space extending the subsidy to some additional institutions.

At the elementary school level, "Education at a Glance" suggests that a gross enrolment ratio of more than 100 per cent has been achieved. Now there are very few villages that do not have access to a school within the prescribed 1.5 km radius, and the need for expanding the number of elementary schools is limited. The problem of high drop-out rates persists (Table 2.3), but the solution to the problem may not lie in augmenting wage related expenditures for elementary education.

The problem in secondary schools appears to be somewhat different from that in elementary education. While secondary schools share the problem of somewhat high drop-out rates with elementary schools, they have the added complication of a low enrolment ratio. There will be need to augment the number of secondary schools as enrolment increases and drop-outs decline. The advocacy of keeping the number of schools more or less unchanged will not be appropriate for secondary education. Given this need to increase the number of secondary schools, it will be necessary to reduce the transfer to each school to less than 100 per cent of their wages and salaries.

and open up space for transfers to additional schools. The secondary schools will have to be encouraged to tap other possible sources of finance including charging fees from the students.

In order for the schools to recoup for instance, 10 per cent of the total cost of employing a teacher from the students, the required raise in fees would be about Rs. 270 per annum per student or Rs. 23 per month.³⁸ With the enrolment numbers and expenditure figures for 1997-98, this figure would enable an 11 per cent increase in the number of teachers at the secondary level.

A one shot increase in fees will not allow a sustained increase in the number of secondary schools or number of secondary school teachers with Government transfers to such schools growing at 9 per cent. The fee structure in secondary education should be evaluated on an annual basis to explore possibilities of improving the student-teacher ratio and the quality of secondary education, and enhancing parent participation in the child's education.

The schools or the authority controlling the schools, e.g., local bodies in many cases, can explore other avenues for raising resources as well. Given that many of the schools have an established position in the society, they may be able to explore ways of making the community contribute towards their sustenance.

Irrigation

With the constitution of five irrigation corporations to step up the pace of investment in this sector, total expenditure by the Irrigation department is to decrease over 1997-98 to 1999-2000.³⁹ The corporations have been assigned the role of completing and maintaining the existing projects, and of initiating investment in new projects. This is reflected in the fact that the share of expenditure on 'Policy

³⁸ This fee hike of Rs. 23 per month differs from the figure of Rs 12 per annum proposed in the earlier section. The latter was proposed as minimal requirement in order to improve the recovery rates to those recorded in 1993-94. It would however not leave any room for augmenting the service given the constraint on expenditures proposed. The new figures take this address this additional consideration.

³⁹ These five corporations are MKDVC, established in February 1996, VIDC established in March 1997, KIDC and TIDC, established in December 1997, and GMIDC, established in August 1998.

Formulation⁴⁰ has increased from 7.3 per cent 1997-98 to 13.5 per cent in 1999-2000 (Table 5.1).

Table 5.1: Proportion of Expenditure on Policy Formulation (per cent)

Year	1997-98	1998-99 (R.E)	1999-2000 (B.E)
Dept.			
School Education Department	3.25	2.70	2.50
Irrigation Department	7.35	8.58	13.47
Public Health Department	43.28	43.82	42.33
Water Supply and Sanitation Department	0.12	0.20	0.32

The decline in the share of wages and salaries as well as other current expenditure and capital expenditure by the Department however has been accompanied by an increase in the share of transfers in the Department's total expenditure. This is partly a reflection of the spill-over of the debt servicing commitments of these corporations onto the Government, through invoked guarantees. Discussions suggest that this is likely to be regular phenomenon. In a letter issued to their investors, the Chairman of MKVDC indicates that "The annual revenue from the sale of water for irrigation, drinking water supplies and industrial use will be used for the payment of the interest on the open market borrowings by the MKVDC....During the initial gestation period till the irrigation has fully developed, Government is providing for the shortfall in the revenue by budgetary provisions." Further, "...even after the completion of the projects in the MKVDC, the government will continue to make provisions in the budget; and this will be utilised towards the repayment of the capital." For the year 1999-2000, for this corporation alone, the Government has provided Rs 251.99 crore towards the payment of interest to the bondholders. Figures available for VIDC suggest that income from sale of water contributed to less than 4 per cent of current expenditure in 1997-98. In other words,

⁴⁰ Policy Formulation (mainly constituting expenditures on Direction & Administration, Training, Employees Insurance Schemes, Research, Inspection and Survey & Investigation).

at least in the interim, a significant component of this commitment of servicing debt is likely to rest with the government.

From the perspective of expenditure management of the Government, it may be preferable to recognise a priori the likely incidence of expenditure and provide for the same. Making this an explicit transfer would encourage the corporations too, to find ways of regulating their own finances and economising on costs where feasible. In other words, it should help in making them function as self-sufficient entities, which have to fend for themselves.

In terms of the proposed targets to reduce or contain the expenditures on wages and salaries, the Department will be in more than full conformity if the proposed figures for wages and salaries are realised. However, the irrigation corporations seem to have returned about 5000 of the employees transferred to them by the Department in the process of transferring activities to the former. This would mean that the effective wage bill for the department would be higher than that proposed in the budget estimates. While this component may not change the basic trend in the figures, in order to make this expenditure useful, the department would have to explore ways of re-deploying them, failing which the only alternative would be to roll back to the full extent of the natural rate of attrition.

Public health:

The Public Health Department has devoted a large share of total expenditure to 'Policy Formulation'. The share has decreased only marginally from 43.28 per cent in 1997-98 to 42.33 per cent in 1999-2000 (B.E.). Consequently, a relatively smaller proportion remains for actual service provision. The high allocation of expenditure for 'policy formulation' is perhaps an indicator of the extent of centralisation in the decision making process. Given the wide variations in the health problems faced by people, both over time and across space, for effective delivery of service in a centralised fashion, the State would have to maintain an extensive database. This database would constitute the basis for developing an appropriate mechanism for service delivery.

The centralised nature of the expenditures of the Department together with norm based provisions for expenditure suggest lack of adequately customised delivery of service. It may be possible to achieve this end even without significant changes in the levels of service through more decentralised decision-making procedures. The possibilities, however, remain unexplored.

Water supply and sanitation

Like in Department of School Education, a large proportion of expenditure of the Water Supply and Sanitation Department goes towards transfers. With the urban and rural local bodies constituting the two main arms of service delivery, transfers would constitute an important component of the Department's expenditure. However, the general problem of inefficiency of norm based expenditure appears to hold in the case of this Department as well. There are norms formulated for provision of water supply and sanitation,⁴¹ but there is a severe dearth of studies to corroborate if the norms are achieved. Further, projects undertaken to satisfy such a norm may shift the focus from resource-based planning to people/population-based planning.⁴² Such a scheme would essentially result in very thin and uneconomic allocation of resources. The problem in this sector is accentuated by the prevalent notion of water not being considered as an economic good. In the absence of appropriate system of water rights, there is not only mis-allocation but also overexploitation of this resource. Moreover, in the absence of integrated planning, the use of water for irrigation and piped supply seem to compete, and involve monitoring difficulties.

The prevalent policy in the area of water supply and sanitation has been to supply these services without giving much consideration for the demand side and ability or willingness to pay. This has resulted in poor recoveries for most of the sectors. It is most often assumed that the social benefits would outweigh the economic and financial costs; and almost little or no effort is made towards charging user fees. There is a need to address the more subtle issue of pricing of these services and enable

⁴¹ For example, the drinking water mission had envisaged that in the plains areas no person will have to travel more than 1.5 kms (Government of Maharashtra has adopted a norm of 0.5 kms) and in hilly areas more than 100 meters for potable water source.

⁴² Population-based planning has indeed been the focus of the National Drinking Water Missions both for Rural Water Supply and Rural Sanitation programmes.

the local institutions to collect the charges. The proper organisational structure and institutional powers and responsibilities also needs a review.

Table 5.2: Object-wise Classification of the Budget (Rs. crore)

Object of Expenditure		Salaries and Wages	Trans.	Loans and Adv.	Oth. Curr. Exp.	Cap. Exp.	Suspense	Recoveries
Dept. 43	Year							
S.E.D	1997-98	44	4,119	1	206	1	-	67
	1998-99 (R.E)	51	4,434	1	232	-	-	89
	1999-00 (B.E)	61	5,110	1	475	-	-	94
I.D	1997-98	545	963	8	1,618	839	155	297
	1998-99 (R.E)	413	636	11	1,511	756	198	570
	1999-00 (B.E)	232	899	11	693	432	56	173
P.H.D	1997-98	340	276	8	166	11	-	-
	1998-99 (R.E)	359	245	9	211	16	-	-
	1999-00 (B.E)	454	270	8	260	30	-	-
W.S & S.D	1997-98	19	666	164	21	6	-	9
	1998-99 (R.E)	26	711	160	24	7	-	7
	1999-00 (B.E)	24	801	192	30	8	-	7

Public Sector Enterprises: The Public Sector Enterprises Board, proposed in the White Paper on Maharashtra's Finances, provides an institutional framework to undertake an assessment of the restructuring of government's role in the public sector enterprises. A few key areas that the Board can look at are:

- Speedier efforts at closing down and liquidation of sick units (after final assessment by BIFR) – implementation of innovative schemes of *Golden Handshake and Voluntary Retirement* to cut down on the size of public sector employment.
- Pricing rationalisation to ensure the financial viability of the corporations.

- Adequate initial funding – both revenue and capital – for corporations taking over activities formerly resting directly with the Government. This is essential for sustaining these corporations as independent and financially viable entities.
- Any loading of PSEs with objectives other than basic service delivery, for example, subsidisation beyond the call of the market, should be accompanied by explicit and transparent subsidies from the budget to the relevant PSE.
- Measures to enhance the skills and capacities of employees to reduce preponderance of low skill employees and to encourage use of new technology including electronic data processing (EDP) to reduce clerical work and excessive human interaction.
- Procedures to ensure that decisions about additional Government investment in PSEs is based on sound economic criteria alone.

b. Contingent liabilities management

Proper management of contingent liabilities requires a broad classification of such liabilities into two kinds: guarantees extended to activities which are assessed to be independent and self-sustaining, and guarantees extended for activities that may not be self-sustaining. The management of these two types of guarantee-based liabilities requires two alternative approaches.

In the first case, the guarantees are required to serve as an insurance mechanism to cover the risk in operations. In this case, since firms are expected to be viable by themselves, it is possible to design the structure of fees such that it covers the expected risk assessed for each unit. This would make the scheme self-financing as well.

In the second case, where the activity may not be independently self-sustaining, the event of default is more likely. However, the Government perhaps perceives that the activity needs to be sustained in spite of such an assessment. This

43 S.E.D. stands for School Education department. I.D. for Irrigation department. P.H.D. for Public Health department and finally, W.S.&S.D. stands for Water Supply and Sanitation department.

would mean that the costs of covering the underlying risk cannot be covered by the guarantee fees that the government can or would like to collect from the organisation. In this case, with a positive net potential liability resting with the Government, proper liability management requires the Government to set a cap on the total amount of outstanding guarantees. This could, for instance, be fixed as a percentage of total GSDP or of total revenue receipts of the Government.

There are problems, however, with both these approaches. The first approach, for example, requires the sanctioning authority to conduct a thorough evaluation of the risk implied. This being a technical exercise, Government agencies may not be the best equipped to undertake such an exercise. Furthermore, if the objective is to determine fees for extending guarantees so as to cover all the underlying risks, with perfectly functioning markets, the effective cost of borrowing with a guaranty would turn out to be the same as the cost of borrowing without a guaranty. Thus, there would be no need for government intervention at all. However, in the absence of a complete set of futures markets and/or in the absence of an appropriate insurance providing institution, the Government could enter the picture to fill in this gap.

The second approach of placing a cap on the total outstanding guarantees runs the risk of a few large loans exhausting the cap and displacing a number of smaller ones. Further, since the emphasis is on remaining within the limits set by the cap, there may be inadequate examination of the potential risk that the Government faces. Thus, bad guarantees may crowd out good ones, increasing the costs to the Government. What is required is a judicious mix of an appropriate cap with a carefully chosen premium.

The Government should pay special attention to two aspects in its management of contingent liabilities:

- First, whatever be the rationale for extending guarantees and what ever be the extent to which potential costs are recovered through guarantee fees, each potential case of guarantee needs to be carefully examined and the underlying risks documented. When the risks are not covered through the guarantee fees, the Government will have to provide for such potential expenditure in the budget, and

ensure that the budgeting process is not undermined. Detailed documents of the guarantees with the underlying risks could be presented to the Legislative Assembly along with the budget, to permit a discussion of the same.

- Second, in cases where the Government feels a need to subsidise the financing of some specific service, it can consider granting an explicit subsidy, which can be assessed on an annual basis, instead of entering into a long-term indirect commitment.

In addition to the above, in order to avoid a moral hazard problem, some mechanism for risk sharing between the guarantor and the guarantee receiving organisation, in the event of a default, should be devised.⁴⁴

5.5 Improving Financial Management of Government

Given the fact that the proposed reform measures require significant control of expenditures, especially on wages and salaries, with the requirement that the delivery of services is not adversely affected, there is need to put into place a well-designed system for financial management in government. Before exploring the options here, it might be of some use to highlight some of the key features of the present system.

- Most programmes, particularly those that are implemented as a part of the Plan, are supply driven and have a tendency to lead to a steady ratcheting of expenditures. Usually the programmes are specified on a normative basis, where the norms relate to the desired access to a service. In the case of education, for instance, it would be in terms of the maximum distance from a habitation for setting up of a new school, and maximum number of students per teacher in the case of expansion. Similarly, in the case of health care, the norms tend to be in terms of the number of beds per thousand of population. These norms translate into required expenditure, given the prevailing costs and wage rates. Given these norms which are often determined by organisations like the Planning

⁴⁴ It is often argued that moral hazard is a frequently faced problem in the context of NCDC loans received by the State. The loan is directed to a co-operative in the State. The delivery mechanism is one where the loan is extended to the State Government, which in turn extends the same to the co-operative. The NCDC does not have much incentive to examine the viability of the project in great detail since the responsibility for debt servicing rests with the State Government. Since the former accepts the proposed project, the latter does not examine the proposal afresh.

Commission, the individual departments have very little incentive to explore alternative ways of achieving the desired goal.

- Given this normative basis for expenditures, there are very few instances, if at all, where the quality of service delivered is monitored and related to further expenditures in the same direction. In other words, the emphasis is more on inputs and efforts rather than on performance.
- Once a programme is included in a development plan, it acquires a legitimacy of its own and is rarely subjected to a reassessment, implying that it is rarely abandoned.
- Since all plan programmes become a part of revenue expenditure after the completion of the plan period, the forces that contribute to the increase in plan spending also contribute to the increase in expenditure on current account.
- Decisions tend to be skewed when the language used in the budget masks the real nature of the financial transactions. In some cases, assistance provided to organisations and the community is included in the budget as a loan for purposes of appropriations, although the payment of interest and principal is assumed by the Government from the beginning.

In other words, the budgeting process does not involve procedures that permit systematic reassessment of expenditures even in the event of financial crunch. The result therefore, often is ad hoc policy measures. For instance, the Government of Maharashtra has issued some notifications as a part of the austerity drive: most of the measures relate to the entitlements of employees in the discharge of work. For instance, the extent of free telephone calls, entitlement to air-travel and petrol consumption figure high on this list. The next set of measures proposed relate to freeze on recruitment to positions falling vacant, finally followed by identification of surplus staff in each department. The first set of measures on entitlements usually does not make a significant dent on the expenditures. On the other hand, with normative basis of expenditures, the curbs on recruitment are likely to adversely affect service delivery, which may not be the desired outcome.

To add to this process of ad hocism is the legality that permits the processing of supplementary budgets three times a year. This makes the entire exercise of the

initial budget a putative one that can be viewed by the Government as a soft constraint. The figure of aggregate expenditure no longer remains sacrosanct; further, the allocation of expenditures too becomes alterable during the course of the year.

Proposed Alternative

The problems described above are of a deep-rooted type and therefore do not lend themselves to a quick and immediate resolution. Rather, a programme containing policy measures and efforts aimed at strengthening the institutional and operational infrastructure should be formulated for the medium term. The objective is to put into place a viable fiscal policy and provide a stable economic environment. Towards this end, it is necessary to ensure that adjustment is treated not only as an effort at reducing the deficit levels but as an overarching theme aimed at improved utilisation of resources. While a similar approach is suggested in the White Paper, the proposal here is for a more broad-based programme. The objectives of the programme is to put into place a machinery to ensure that the following are delivered:

- Formulate a medium-term fiscal policy for Maharashtra that reflects the realities of resources and that seeks to promote a stable economic environment;
- Promote a greater awareness of the linkages between resources and delivery of services and to ensure that the latter is substantially strengthened;
- Explore the possibilities of economies in expenditure through rationalisation of administrative machinery and the application of EDP technology;
- Promote a greater decentralisation of economic decision making and establish an improved congruence between task-responsibility and power.

A framework for achieving the above objective can be structured along the following lines:

- The Department of Finance formulates a medium-term fiscal policy (MTFP): an exercise which is re-evaluated every year and sets out targets for the extent of adjustment to be achieved within a given fiscal year, in the context of the short- as well as medium-term pressures faced by the State's economy.

- The High Powered Committee on Expenditure and the Public Sector Enterprises Board propose a plan of action for achieving the targets identified by the MTFP.
- This action plan is incorporated into the budget document.
- Since the budget would propose measures that alter the expenditure patterns, revenue and the spending departments will have to agree on the targets. Once these are agreed upon, these departments can sign concordats to give a documentary shape to the agreement. This would also help in monitoring the progress.
- In order to ensure that the objectives set out in the budget document are actually achieved, a Budget Enforcement Committee, to be chaired by the CM, is constituted. This Committee meets on a quarterly basis and evaluates the progress.

Medium term Fiscal Policy (MTFP) would be an annual exercise presenting rolling forecasts of expenditures and resources for a three to five year period. This exercise would provide an assessment of the extent to which the projected expenditures can be financed out of available revenues and in the process zero in on the magnitude of adjustment required. Clearly, this document is different from the standard plan documents in that the focus is not only on development expenditure but on all expenditures, actual as well as potential. It will facilitate future decision making in that any addition can be quickly analysed in terms of the impact on expenditure levels and consequently on the levels of deficit.

In arriving at this figure of impact of a proposed program, care should be taken so that all actual and potential claims for expenditure on the government are accounted for. For instance, the forecasts should contain an estimate of the extent of expenditure anticipated on account of contingent liabilities, like guarantees, assumed commitments of debt servicing on behalf of the government companies and/or various local bodies. Further, the forecasts of expenditures should show the future financial implications of the outstanding commitments, and current policies.

The preparation of forecasts would involve, as in the case of the annual budget, the participation of the revenue and spending departments. Their estimates should be reviewed by the finance department, which should ideally prepare its own

forecasts so that they could provide a basis for evaluating the estimates furnished to them.

The estimated figure for the magnitude of adjustment would be a crucial input for the formulation of the budget for the year. The budget has to take this figure into account and propose means of achieving the same.

Here enters the role of the High Powered Expenditure Committee and the Public Sector Enterprises Board. At the beginning of each fiscal year, the Expenditure Committee should be asked to look into the following:

- In the light of the estimated magnitudes of adjustment revealed in the MTFP, identify areas and means through which economies may be procured, in particular, economies from amalgamation, pooling, abandoning of programmes, alternative means of delivery, etc.
- Areas where efficiency gains may be made through the introduction of EDP technology
- Areas that could be devolved to autonomous agencies and lower levels of government
- Areas where there could be better utilisation of benefits accruing from public expenditures
- Economies from procurement streamlining
- Identification of high-risk expenditure programmes and as to how the risks may be addressed.

The High Powered Committee should submit its findings to the Finance Department, which would then arrange for the processing of the findings and for the inclusion of decisions taken in the annual budget. Similarly, the Public Sector Enterprises Board would formulate the requisite and feasible measures for the year, which would then be incorporated into the budget.

In the light of the recommendations thus received, the formulation of the budget would involve,

- (a) formulation of expenditure ceilings for each agency,
- (b) consideration of new items of expenditure in lieu of existing programmes.

- (c) identification of high risk programmes including contingent liabilities,
- (d) identification of programmes that could be considered for scaling down, and
- (e) additional development programmes.

Once the budget is formulated, every spending department should be assigned spending ceilings. There is a need for ensuring that these ceilings are not violated. This is the role assigned to the *Budget Enforcement Committee*: to enforce discipline. Such discipline, as experience shows, can be a casualty of pulls and pressures generally associated with coalition politics. It is therefore suggested that a Cabinet Committee presided over by the Chief Minister be organised to secure consensus on the direction of fiscal policy and on measures for its implementation. The Committee should be responsible for the approval of the MTFP, content of the annual budget circular, and the approval of the annual budget. It should also meet, once every quarter, to monitor progress and to ensure full compliance of the budget. The Committee should be responsible for ensuring that the budget outcome is fully congruent with budget estimates. In view of the diverse responsibilities entrusted to the Committee, it may be called "Budget Enforcement Committee"

Concordats

The review by itself is unlikely to have requisite "punch" unless it is preceded by measures aimed at securing the co-operation and active participation of the major spending agencies. Toward this end, based on the detailed work done by the High Power Expenditure Committee, the Finance Department should sign concordats about the measures to be taken by each of the agencies selected for the purpose. These concordats should cover measures aimed at reducing the growth of expenditure or even reduction in levels when indicated, improving the delivery of services, introducing electronic technology and related aspects. These concordats should be given wide publicity.

Arrangement with local bodies

In the existing system, there is a basic separation between funding and the provision of services at the level of local government. The funding is mostly by the State and Central governments. To ensure utilisation of funds in the manner specified, a variety of conditions are attached to the programmes. The local bodies have, in

general, little flexibility in the use of resources, and for all practical purposes, they have become an extended accounting arm of the funding agencies. In this situation, they have little interest to economise. Indeed the bodies have little interest in looking for economies. If local bodies are provided with flexibility, they will have a greater interest to manage the funds better. Toward this end, the possibility of introducing 'bulk grants' covering clusters of programmes, should be considered.

To sum up, the proposed financial management framework seeks adjustment through a medium term framework, compliance and discipline through a high powered enforcement committee, economies in expenditures through rationalisation measures, and improved delivery of services through decentralised decision-making. The framework seeks to promote consensus through an open discussion of resource realities among the stakeholders. It recognises that a radical departure from traditions is needed, and it is time now to make a new beginning.

Deficits to Stabilise Debt

Let D_t represent the stock of debt in period 't', FD_t , the fiscal deficit in the period and Y_t , the level of GSDP.

$$D_{t+1} = D_t + FD_{t+1}$$

and

$$Y_{t+1} = Y_t(1+r),$$

where 'r' is the rate of growth of GSDP.

Then,

$$\frac{D_{t+1}}{Y_{t+1}} = \frac{D_t + FD_{t+1}}{(1+r)Y_t} = \frac{D_t}{Y_t} \cdot \frac{1}{(1+r)} + \frac{FD_{t+1}}{Y_{t+1}}$$

For the ratio of debt to GSDP, $\frac{D_t}{Y_t}$, to remain stable at 'd', over time, the above would translate into,

$$d = \frac{d}{(1+r)} + f$$

where 'f' is the ratio of fiscal deficit to GSDP. The above can be rewritten to yield

$$f = \frac{r \cdot d}{(1+r)}$$

Using the above formula, it is possible to arrive at the steady-state ratio of deficit to GSDP, corresponding to a chosen growth rate of GSDP and a stable value for debt-to-GSDP ratio. The following table gives some illustrative numbers for the same.

Table A.1: Steady State Deficit to GSDP ratio (per cent)

$f \rightarrow$	0.15	0.16	0.17	0.18	0.19	0.2	0.21	0.22	0.23	0.24	0.25
$r \downarrow$											
0.14	1.84	1.96	2.09	2.21	2.33	2.46	2.58	2.70	2.82	2.95	3.07
0.15	1.96	2.09	2.22	2.35	2.48	2.61	2.74	2.87	3.00	3.13	3.26
0.16	2.07	2.21	2.34	2.48	2.62	2.76	2.90	3.03	3.17	3.31	3.45
0.17	2.18	2.32	2.47	2.62	2.76	2.91	3.05	3.20	3.34	3.49	3.63
0.18	2.29	2.44	2.59	2.75	2.90	3.05	3.20	3.36	3.51	3.66	3.81
0.19	2.39	2.55	2.71	2.87	3.03	3.19	3.35	3.51	3.67	3.83	3.99

Epilogue

The budget for 2001-02 documents some interesting developments in the finances of Maharashtra. A few significant figures are lower actual revenue expenditure, and higher revenue receipts when compared with the revised estimated for 1999-2000. The sharp decline in revenue expenditure is spread across the board with expenditure on general services being lower by Rs. 926 crore, those on social services by Rs. 2915 crore and economic services by Rs. 512 crore. This is accompanied by a small fall in capital expenditure. All put together, these moves have meant a lower revenue deficit and a lower fiscal deficit when compared to the levels suggested by the revised estimates.

One of the major factors accounting for this deviation of the actual expenditures from the revised estimates rests in the sharp fall in transfers to reserve funds, employment guarantee fund and state road fund, in spite of an increase in the collection of the corresponding taxes. While this does reduce the extent of paper transactions, which tend to artificially inflate the fiscal deficit, this change should have been brought about in an explicit manner, with appropriate legislation for rolling-back the dedication of the relevant cess/surcharge to a specific use. This however is not the complete explanation for the deviation of actuals from the revised estimates for 1999-2000. Considering the picture net of transfers to reserve funds, the revised estimates continue to be higher than the actuals by about Rs 3000 crore.

These sharp deviations call for some explanations. The budget document provides some clues: staggering in the payment of arrears of both salaries and pensions has distributed the burden away from the present year. Such a shift has meant a decline in the expenditure allocation for education (general and technical put together) by Rs. 2112 crore in the actuals for 1999-2000.

A comparison of the actuals with the figures projected in the baseline scenario in this study reveals a difference of Rs 7549 crore, somewhat larger than the figures

emerging from the budgetary numbers. If this is a reflection of the under-budgeting for the payment of arrears in 1999-2000, it is likely that the spillover in expenditure into 2000-01 would be higher than that accounted for the figures quoted above.

The aggregates for 1999-2000 also include a few heads of expenditures where an increase is in evidence: increase in expenditure in the irrigation sector presumably accounted for by the cost of servicing the bonds of the irrigation corporations. While these expenditures are usually not budgeted for, since they are in the nature of contingent liabilities, the experience of this year justifies a claim that they should be explicitly budgeted for.

Further, there is evidence of a decline in the transfers to local bodies on account of rural employment and other rural development programmes as well as in grants-in-aid to local bodies on account of elementary education. On the other hand, there is an increase in the compensation and assignment to local bodies. While a shift from specific purpose transfers to general-purpose transfers, in accordance with the recommendations of the First State Finance Commission could explain a part of the decline in specific purpose transfers, the rest of the explanation rests in the staggering of the payment of arrears in salaries.

On the receipts front, there is higher collection mainly in sales tax and as a part of non-tax revenue, in interest receipts and receipts from dairy development. The former is attributable to the floor rates regime, while the increase in receipts dairy development accrues due to an increase in the price of milk. The budget estimates for 2000-01 suggest that the increase in interest receipts is expected to be a sporadic event, rather than a systematic improvement in the recoveries on this front.

These developments suggest that 1999-2000 did not capture major changes in the finances of the government of Maharashtra. The apparent improvements in the finances in 1999-2000 have meant a spillover of expenditures in the next financial year. 2000-01 therefore witnesses an increase of revised estimates over budgeted estimates in revenue

expenditure by Rs 4615 crore and of revenue deficit by Rs. 2285 crore. Correspondingly, fiscal deficit is higher by Rs. 2630 crore.

Other than the spillover of expenditure from the earlier year, a major shock to the revised estimates for 2000-01 comes from a deterioration in the financial position of the Maharashtra State Electricity Board. To shore up the financial position of the MSEB and bring it to a position where it can borrow from the market, a three pronged strategy has been adopted: first, direct transfers to the extent of Rs. 2371 crore was called for to ensure that the statutorily mandated rate of return on capital of 3 per cent could be maintained for the years 1997-98 to 1999-2000. Second, Rs. 745 crore was provided towards the subsidies proposed by the government against the tariff set by the MERC. Finally, loans to the extent of Rs. 1986 crore were converted to equity. This is reflected in a sharp increase in the capital expenditure accompanied by a spike in the repayments of loans by the state government.

Efforts at setting the house in order can be seen in a freeze on dearness allowance payments with a delinking from the central government DAs, aiming at reining in the rate of growth of the wage bill, at least on account of inflation. Further, attempts at structural reorganization of the service delivery departments to ensure greater coordination in efforts, too seem to be afoot, with the proposal for a single field office for five separate corporations operating within welfare activities.

Another interesting development is to provide a more decentralized appearance to governance in the state by delegating certain activities to the local bodies and by providing some incentives to the bodies to improve service delivery and revenue collections. Yashwant Gram Samruddhi Yojana, and awards instituted for encouraging competition among local bodies at various levels to ensure improvements in service delivery and in revenue collections are a few such measures.

Taking into account the increase in revenue expenditure on account of the Maharashtra State Electricity Board, the net decrease in revenue expenditure over and

above the budgeted level by about Rs 170 crore. Presuming the figures used in the present study for wages and salaries are good approximations of the actual levels, the step to freeze DA payments would release about Rs 1165 crore, which together with the above figures would provide Rs 1000 crore for taking care of expenditure spill-over from the earlier year, which is far short of the shortfall of 1999-2000 of Rs 4615 crore.

The above picture worsens considerably if one uses the baseline scenario of the present study as a benchmark for comparison. The actuals for 1999-2000 are lower by Rs 7549 crore while the revised estimates for 2000-01 are higher by Rs 786 crore after correcting for the impact of the power sector. This suggests that the net claims on the state exchequer can be significantly higher than those suggested by the revised estimates for 2000-01.

Apart from the above, a disturbing feature about the finances of the state is a continuation of the trends of the past. While the figures for 1999-2000 reflect the inability of the state government to spend the budgeted amount during the financial year, implying a spillover of the expenditures into the next financial year, the past trends of poor fiscal marksmanship continue to dog the budgeting process. The sensitivity of the government to commodity market fluctuations and their adverse impact on the finances of the state government continue to dog the government. Price support provided to food grain cultivators, through procurement with minimum support price, has implied a cost to the exchequer of Rs. 100 crore. Similarly, the budget continues to announce a decrease in the irrigation dues and thereby further undermines the viability of the corporations setup as well as of itself, while at the same time, not making any explicit provisions for the servicing of the liabilities of these corporations, implicitly building up a factor which would distance the actual expenditures from the revised estimates for this year as well. Another similar development is the form of relief measures offered to farmers in scarcity affected regions: relaxed norms for EGS, remission of land revenue, reduction in electricity rates and exemption from payment of examination fees for eligible students, and rescheduling of loan repayments. In addition provisions have been made to make fodder and water available in these areas. While explicit subsidies could have provided as

much relief, the government has chosen to provide relief in a manner which could undermine the viability of a number of other institutions, most of them in the public sector. Further, the cost of these subsidies would remain non-transparent. As has been discussed elsewhere in the report, this form of providing relief could undermine the ability of the legislature to take effective decisions on the extent of subsidy desired.

While the above underlines the need for urgent measures to correct the fiscal imbalance, this study attempts to establish the feasibility of such an exercise. Being the foremost industrialized states in the country, Maharashtra is relatively better placed to experiment with alternative forms of service delivery, so as to ensure that there are sustainable improvements in the quality of life in the state as well as in the environment for business and industry. This therefore needs to be the driving force for radical fiscal reforms in the state.