Chapter - 1

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INTRODUCTION, RESEARCH METHODOLOGY AND REVIEW OF LITERATURE

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1.1 Introduction

State finance in India are coming under a lot of fiscal stress in recent years. Gross Fiscal Deficit of all States increased from Rs. 18783 crores in 1990-91 to Rs. 31428 crores in 1995-96 and went up to Rs. 110070 crores in 2005-06.[1] In case of Maharashtra Gross Fiscal Deficit rose from Rs. 1610.90 crores in 1990-91 to Rs. 4150.80 crores in 1995-96 and further it was Rs. 13775.97 crores in 2004-05.[2] Rising public expenditure mainly revenue expenditure is a major fiscal trend noticed in state finances especially after 1986-87. Rise in revenue expenditure has resulted in rise in revenue deficit, which in case of Maharashtra has increased from Rs. 54.70 crores in 1990-91 to Rs. 1590.60 crores in 1996-97 and further to Rs. 9199.97 crores in 2004-05. Rise in fiscal deficit is also accompanied by rise in level of State Governments public debt and outstanding debt liabilities compositionwise loan from the centre constitute a major share of a state governments public debt and therefore needs study. In addition, loan from the centre form a sizeable share of transfers made by the centre to states. In this context taking into view the significance of central loan in total transfers and its impact on State finances the present study makes an attempt to study the problem of "Maharashtra's Indebtedness to the Centre : 1990-2004".

1.2 Title of the Dissertation

The present M. Phil. Dissertation is entitled, "Maharashtra's Indebtedness to the Centre: 1990-2004".

1.3 Objectives of the Study

The following are the main objectives of the present study.

1. Review the overall fiscal situation of Maharashtra.
2. Study the growth and composition of the total central transfers to Maharashtra : 1990-2004.
3. Analyse the growth of central loan, gross and net loan transfers to Maharashtra.
4. Study the problems of State's Indebtedness to the Centre and its financial burden.
5. Make suggestions and policy recommendations to reduce the burden of central loan on the State Governments.

1.4 Hypothesis of the Study

Rising volume of central loans to the states is adding to the burden of the outstanding debt liabilities of the states in India. This leads to rise in interest payment liabilities and repayments to centre reduce the net loan availability. Restructuring of the central loan liability and change in the criteria of Planning Commission transfers will go a long way to reduce the problem of State's Indebtedness to the Centre.

1.5 Research Methodology

The present dissertation is essentially a library work based on officially published secondary data. Necessary secondary data was collected from the following sources.

1. Reserve Bank of India Monthly Bulletins
2. RBI : Report on Currency and Finance
3. Reports of the X and XI Finance Commission, Government of India
4. RBI : State Finances : A Study of Budgets : 1990-2004

Secondary data collected from the above sources was tabulated and interpreted with the help of the following statistical tools.

i) Compound Growth Rate

ii) Ratio Analysis and Annual Growth Rates

1.6 Chapter Scheme of the Study

The following is the chapter scheme of the present study.

Chapter – 1	:	Introduction, Research Methodology and Review of Literature
Chapter – 2	:	Study of the Overall Budgetary Situation in Maharashtra
Chapter – 3	:	Central Transfers to Maharashtra and Central Loan Transfers
Chapter – 4	:	Problem and Magnitude of Maharashtra's Indebtedness to the Centre
Chapter – 5	:	Conclusions and Suggestions

1.7 Review of Literature

This section deals with the review of available literature related to Maharashtra States Indebtedness to the Centre.

Dr. V. P. Gupta[3] points out the public debt of state governments in India has been rising in gigantic proportions from year to year. The outstanding public debt of 26 state governments at the end of March 2002 was Rs. 591833 crores, out of which states indebtedness to the centre was 57 percent reflecting fact that state governments are heavily indebted to the centre. The outstanding public debt of Uttar Pradesh was so large that it is equivalent to the combined outstanding debt of three major states viz. Gujarat, Harayana and Madhya Pradesh. Out of six states viz. Gujarat, Harayana, Madhya Pradesh, Punjab, Rajasthan and Uttar Pradesh the state indebtedness to the centre is the highest in case of Gujarat amounting to 72.4 percent of total outstanding debt of Gujarat.

He also says that the loans and advances are given by the central government to state for both plan and non-plan purpose. The pattern of financing for plan and non-plan purpose has not shown any change during the pre reform and post reform period. However, non-plan loans have been greater than plan loans in both periods.

Small saving loan are given by the centre to state largely as an inducement to join the centre in a co-operative effort to mobilise small savings. If the states are allowed to raise small saving as like market borrowing and small saving are made a part of internal debt of state governments than states indebtedness to the centre would be reduced to half.

He concludes by stating that, nearly two third of tax revenue of the Rajasthan government and three fourth of Uttar Pradesh is being absorbed for interest payments reflecting the rising debt burden on these states.

Shri Y. K. Mulani (1986)[4] elaborates in his M. Phil. dissertation the State Indebtedness to the Union Government has increased rapidly. It increased from Rs. 240.48 crores at the end of March 1956. He further states indebtedness to Union Government increased from Rs. 2013.99 crores at the 31st March 1961 to Rs. 8579.00 crores and Rs. 15739.00 crores at the end of March 1974 and March 1980 respectively. Whereas the share of central loans in the total debt of states was 53.6 percent at the end of March 1952, this percentage increased to 75.4 percent at the end of March 1980.

He states that out Maharashtra's indebtedness to the government of India has been increasing rapidly from 1951 when government of India partially accepted the policy of Economic Planning in 1957 the total loans, the Maharashtra (previous Bombay) owned to the centre amounted to a more total of Rs. 118.83 crores by the end of March 1956. The amount had risen to Rs. 332.06 crores.

He also concluded the outstanding union loans to the Maharashtra was amounted to a total of Rs. 686 crores at the end of the IVth Five Year Plan. It increased to a total of Rs. 1497 crores at the end of March 1981. Further more its budget estimated to a total of Rs. 2926 crores at the end of the March 1983. Thus, the share of outstanding union loan to total debt of Maharashtra has been more or less stable around 65 percent.

Suchitra Shrinivas (2000)[5] studied the depressing trends in state finance, which one causing great deal of concern to the nation. Several state governments have been issuing 'Stop Payment' orders for lack of funds. Cheques issued by it have bounced further more; there is sharp decline in development expenditure. Gross Fiscal Deficit (GFD) to Gross Domestic Product (GDP) ratio of the state government touched it is highest ever level in 1998-99 at 4.3 percent.

The indebtedness of the states has also been going up steeply. Outstanding liabilities of the governments were projected to go up from Rs. 341259 crores in March 1999 to 409258 crores by March 2000. Their indebtedness then reached 20.5 percent of GDP. Debt servicing as a percentage of gross loans from the centre to states has gone up from 65.5 percent in 1990-91 to 79.9 percent in 1998-99.

Dr. A. A. Dange (1991)[6] has studied increase in dependency on central loans by the government of Maharashtra which has in turn increased the outstanding central loans liability. Outstanding total debt of the government of Maharashtra increased from Rs. 261.79 crores in 1960-61 to Rs. 8551.00 crores in 1989-90. An increase of 32 times of this outstanding central loans of Maharashtra increased from Rs. 115.21 crores in 1961 to nearly Rs. 6736.44 cores in 1990 (78.77 percent of total debt outstanding in 1990). Therefore, one of the major conclusion of his study is that during the period under study indebtedness of the government of Maharashtra to the central has increased and the debt servicing burden of central loans forms the main burden of rising public debt of Maharashtra.

Madhav Godbole (2002)[7] argued that Maharashtra was once considered to be one of the best governed state in the country with sound financial management, but now serious questions are being raised whether a state of financial emergency need to be declared under Article 360 of Indian Constitution which was 12.5 percent of Gross State Domestic Product (GSDP) in 1994-95 has down to 10.4 percent in 1999-2000 further more, the share in the central income tax, union excise duties transfers since the Second Finance Commission to the Eleventh Finance Commission has came down from 15.97 percent and 12.17 percent respectively. Fiscal deficit increased from 2.1 percent of GSDP in 1993-94 to above 6 percent in 1999-2000. Expenditure on salaries and wages gone up steeply from 47 to 48 percent of revenue receipts in 1991-92 to 69 percent in 1999-2000 and 58 percent in 2000-01. Interest payment on loans percentage of revenue receipts went up from 10 percent to 23 percent between 1990-91 to 2001-02. Expenditure on salaries, wages and interest payment accounted for over 80 percent of revenue receipts.

He also find out the outstanding debt rose from Rs. 10040 crores in 1990-91 to Rs. 57864 crores in 2001-02. Though the ratio of public debt to GSDP has remained below 15 percent, it is because of growing dependency on the use of public accounts in financing deficit. If we include the liabilities in the public account into total liabilities of the government, the debt to GSDP ratio will be 25 percent in 1998-99.

Miss Suneeta M. Jog (1994)[8] concluded in her M. Phil. dissertation that the central loan are the major source of capital receipts of the state in India. Ever since the inception of planning in India, states are indebted to the centre with the continuous rise in plan assistance to states. Developed state like Maharashtra received more amount of central loans due to high loan component of plan assistance..

She also find Maharashtra's total outstanding debt increased from Rs. 261.99 crores in March 1961 to Rs. 782.69 crores in March 1991 and to 2182.88 crores by the end of March 1981 and in March 1990 it reached to Rs. 9850.00 crores and estimated at Rs. 11332.00 crores by the end of March 1991. Thus during the period under study outstanding total debt of government of Maharashtra increased by nearly 43 times in 1991 over 1961 of this outstanding total debt liability. She find that Maharashtra's indebtedness to the centre was also increased from Rs. 155.21 crores by end of March 1961 to Rs. 7826 crores by end of March 1989 and were estimated at Rs. 8902 crores by end of March 1991. The outstanding central loan liability increased by nearly 57 times in 1991 over 1961, which proves that central loan outstanding increased faster than the total debt liabilities of Maharashtra.

Dr. J. F. Patil (2005)[9] analysed the indebtedness of the government of Maharashtra in chapter number 3 of his book entitled 'States Indebtedness in India. A Fiscal Bane for Indian Polity' he pointed out the outstanding liabilities of the state governments have been consistently increasing during the period 1980-81 to 2003-04. The outstanding liabilities of Maharashtra government increased from Rs. 2183 crores to Rs. 71659 crores. He also find increasing share of internal debt as against the decreasing share of loans and advance from central government in the total debt structure. The relative share of internal debt was 17 percent in 1980-81, which increased 55.13 percent in the year 2003-04, on the other hand, the relative share of loans and advance from the centre in total debt of state was 65.58 percent in the year 1980-81, which went on decreasing and become only 33.05 percent in 2003-04.

He also noted that central loans to Maharashtra as proportion of total capital receipts, dipped to a very low level in the 21st century. In the year 2000-01, the share was 5.47 percent, in the year 2003-04 it was 14.58 percent. This situation must have compelled the state government to go for in larger market borrowing which in term causes larger interest burden and increasing revenue deficits being financed by such capital receipts, which collectively lead to greater public debt.

Dr. H. L. Bhatia (1979)[10] in his book 'Centre-State Financial Relations in India' studied addresses itself to the task of an objective analysis of current dissatisfaction with centre-state financial relation in India. A description of the basic nature of this dissatisfaction is followed by theoretical underpinning of federal financial relations and a bird's overview of the relevant constitutional provision regarding federal resources transfers in some other countries. Underlying causes of the malfunctioning of centre-state financial relations in India, which has created a vicious circle of their own have been analysed with reference to our constitutional provisions and an assessment of the attitudes and roles of the Finance Commission, the centre and states. He also detailed discussion of the working of the Finance Commission, which according to the findings of this study is the point from where corrective measures should start. He also done analysis of the system in operation is highlighted with that of specific problems like mounting indebtedness of the states to the centre. There is also a discussion and specification of corrective measures indicated by the findings of the actual analysis of the system and its working.

Subhash Chandra Garg (2006)[11] in his article "Transformation of Central Grants to States", Growing Conditionality and By Passing State Budgets says that Central grants financing of state sector subjects is the principle instrument used by the centre to influence state's policies and expenditure. Such grants financing has increased over the years. The earlier limits on centrally sponsored schemes no longer exit and state plan assistance has also assumed a non block character with the increase of additional central assistance schemes. The author says that centre has introduced purely discretionary schemes. Another major change has been witnessed in the form of central schemes which by pass state budgets and directing funds to state agencies and local bodies.

R. Kanhan and et. al. [12] have in the article "Finance Commission Awards and Fiscal Stability in State's examined the growing inter state disparity in respect of transfers and its implication for wide difference in fiscal performance. While the tax devolution effected by the Finance Commission had a progressive distribution, the grant-in-aid were not related to the level of income sin the states. Further, the approach of the Finance Commission concentrates only on common factors like population, poverty and backwardness. When collection was given greater weightage in tax transfers, more advanced state like Maharashtra, West Bengal, Gujarat and Tamil Nadu received the maximum share whereas, when population was given more weightage, states like Uttar Pradesh, Andhra Pradesh, Kerala, Madhya Pradesh, Karnataka, Rajasthan and Orissa were the gainers. Similarly, when backwardness through inverse of per capita income (PCI) was given more weightage backwards states like Bihar, Madhya Pradesh, Uttar Pradesh, Orissa were the major beneficiaries. Thus the magnitude of the transfers was found to be highly sensitive to the weight assigned to the distribution criteria.

Pratap Jena[13] in his article "Fiscal Marksmanship" studies the problems caused by inaccurate forecasting of both central and state's revenues for the fiscal management of the states. He concludes that poor forecasting methodologies employed to forecast central and state tax revenue share has an adverse impact on the fiscal management of states.

Sr. R. Reddy[14] in his article "Twelfth Finance Commission and Backward State's" is mainly concerned with equity in transfers of the Finance Commission. with this objective in view he says that the Commission recommended an increase in the share of grants in total transfers. The benefit and sizeable specific maintenance grants for roads and buildings has mostly gone to better off states. The scheme of debt write off recommended by the TFC was guided more by the need for fiscal consolidation rather than providing relief to indebted states.

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