



GOVERNMENT OF KERALA



WHITE PAPER ON STATE FINANCES

JUNE 2016

WHITE PAPER
ON
STATE FINANCES

JUNE 2016

TABLE OF CONTENTS

Preface

CHAPTER I

1. INTRODUCTION	1
1.1. Immediate need for a White Paper	1
1.2. Cash Balances in the Treasury	2
2. PENDING LIABILITIES	4
2.1. Immediate and Short Term Liabilities	4
3. FISCAL DESTABILISATION IN 2011-2016	5
3.1. Fiscal Discipline Goals	5
3.2. Achievements of fiscal targets	6
3.3. Consequences of this fiscal destabilisation	9
4. LIQUIDITY MANAGEMENT (FUNDS IN TREASURY)	10
5. BUDGETING - EROSION IN BASIC PRINCIPLES	12
5.3. Plan Expenditure	13
5.4. Capital Expenditure	15
6. IF 2011-2016 HAD CONTINUED...?	17
7. SUMMARY	18

CHAPTER II

1.	APPROACH IN THIS CHAPTER.....	1
2.	REVENUE EXPENDITURE.....	1
2.1.	Composition of Revenue Expenditure	1
2.2.	Efficiency of Public Expenditure Management.....	3
3.	REVENUE RECEIPTS	6
3.1.	Composition of Revenue Receipts.....	6
3.2.	Share of Components of Revenue Receipts.....	9
3.3.	Growth of Components of Revenue Receipts.....	11
4.	COMMERCIAL TAXES.....	11
5.	WEAKENING OF THE TAX GOVERNANCE MACHINERY	15
5.1.	Hypothesis and surmises.....	15
5.2.	Some suggestive data and pointers.....	16
5.3.	Broad Findings on Revenue Mobilisation (2006-2011)	20
6.	SUMMARY AND FINDINGS.....	21
6.1.	Causes of the crisis	21
6.2.	Expenditure Management.....	21
6.3.	Revenue Mobilisation	21

CHAPTER III

2. IMMEDIATE FISCAL CHALLENGES	1
2.1. No Revenue Deficit Grant after 2017-2018.....	1
2.2. Increased devolution to LSGIs.....	1
2.3. Arrears of Pay revision	2
2.4. Redemption of liabilities.....	2
2.5. Bridging the Infrastructure Deficit.....	2
3. MACROECONOMIC ISSUES.....	4
4. STRATEGY OPTIONS	4
4.1. Sensitivity Analysis of selected Revenue and Expenditure Items.....	4
4.2. Strategy Options.....	6
4.3. Expenditure Management.....	6
4.4. Revenue Mobilisation	6
4.5. Capital Expenditure	7

APPENDIX

1. Revenue Receipts.....	1
1.1. Outline on Revenue Receipts.....	1
1.2. Growth characteristics of Revenue Receipts.....	2
2. Revenue Expenditure.....	3
2.1. Outline on Revenue Expenditure	3
2.2. Growth characteristics of Revenue Expenditure.....	4
3. Revenue Deficit	4
3.1. Outline of Revenue Deficit	4
3.2. Growth characteristics of Revenue Deficit.....	6
4. Capital Expenditure	6
4.1. Outline of Capital Expenditure.....	6
4.2. Growth Characteristics of Capital Expenditure	8
5. Debt Liabilities.....	8
5.1. Outline of Debt Liabilities	8
5.2. Growth Characteristics of Debt Liabilities	9
6. Gross Fiscal Deficit (GFD)	10
6.1. Outline of GFD	10
6.2. Growth Characteristics of GFD	11
7. Salaries, Interest and Pension (SIP).....	12
7.1. Outline on SIP	12
7.2. Growth Characteristics of SIP	13
8. Capital Expenditure/Revenue Deficit/Gross Fiscal Deficit-GSDP Ratio.....	14
8.1. Brief Outline	14



Dr. T. M. THOMAS ISAAC

**MINISTER FOR FINANCE & COIR
GOVERNMENT OF KERALA**

Thiruvananthapuram

Date 28-6-16

PREFACE

Any major crisis strikes those who are affected with great intensity. The distress is felt for protracted periods of time. While the effects are perceptible and often agonizingly painful, most crisis defy quick or simple prognosis. A crisis most often does not respond to easy solutions either.

The financial crisis that has affected the State currently is no exception to this rule. The attempt in this White Paper has been to critically analyse data and evidence available in the accounts and budget documents and correlate it with the reality on the ground. Hence, this starts necessarily, by looking at broad sources of the fiscal worry - viz. the unsustainable increase in some of the components of public expenditures and the failure of the receipts, particularly State taxes to keep pace with the requirements to meet this expenditure. It is through juxtaposing these alongside that will help give some insight into the causative factors that triggered the crisis and give useful pointers to practical solutions, however demanding they be. The analysis would point to a strategy that would ensure greater fiscal consolidation at the same time, greater social security to the poor and a major step-up in capital expenditure. This strategy will be unveiled in the forthcoming budget.

We want to look forward and not dwell on exposing the past misdeeds. But the latter cannot be completely avoided because there are many who do not understand the gravity of the fiscal situation or even refuse to accept the reality of the fiscal crisis. Further, it is important to understand what went wrong, so that we can learn the proper lessons and correct the future course of events. I want to make it clear that the intention of the White Paper is not to malign anyone personally. I sincerely hope it will generate a public discussion which would contribute and enrich the process of correction.

Dr. T. M. Thomas Isaac
Minister of Finance & Coir

Room No. 131, North Block, Secretariat, Thiruvananthapuram

Phone-Office : 0471-2333294, 2333254 Mobile : 9447733600

E-mail : tisaag@kerala.gov.in tisaag@gmail.com

CHAPTER I

DIMENSIONS OF THE CURRENT FISCAL CRISIS

1. INTRODUCTION

1.1. Immediate need for a White Paper

- 1.1.1. The finances of Kerala are in dire straits. Apart from meeting the day-to-day challenge of keeping the Treasury afloat for meeting routine expenditure of the administrative machinery, the State is constantly facing grave paucity of resources for financing all its other plan and capital expenditure. The situation is alarming and has been succinctly brought out by His Excellency, the Governor of Kerala in his first address to the 14th Legislative Assembly on June 24, 2016.

"The State is facing an acute financial crisis. My Government is today facing the unenviable task of steering the State out of this. For the last three years (2013-2016), the implementation of the Annual Plan approved by the people of Kerala through the Legislative Assembly has virtually stagnated. Against the large number of schemes announced in the annual plan budgets of the three years, actual expenditure has been only 60-70% of the budget approved by the Legislature. This, in particular, has had a debilitating impact on public investments in Kerala, and has adversely hit poorer sections of the society the most. The flow of funds to beneficiaries and workers in the coir, fisheries and other traditional sectors have suffered the most in the aftermath of the crisis. This has also severely impeded the overall economic growth, income and employment generation of the State. The entire borrowing ceiling now permitted by the Central Government is just sufficient to meet the day to day expenditure of the State Government. Consequently, my Government is faced with the stark reality that there are no funds left for capital expenditure like construction of roads, bridges and other major infrastructure projects."

- 1.1.2. For the last three years, budgets placed before the State Legislature have not had much of reality with either the resources to finance them or with the actual expenditure incurred at the end of the year. Schemes and projects were announced without the funds to back them up. Additional Resource Measures (ARM) were proposed in the budgets for bridging the gap between budgeted figures and announced projects - but tax and non-tax efforts were not stepped up in line with them. The actual revenue realised through ARM was only a portion of what is announced in the budget speeches year after year. Out of approximately Rs.2400 cr. of ARM announced in the last two budgets, only Rs.1800 cr. has been collected. Every budget in the last five years has had an additional expenditure implication of a few thousand arising

from new pronouncements in the Budget Speech. However, very few of these pronouncements were actually implemented.

1.1.3. Each year, before the Annual Plan Size is fixed an estimate of the Balance in Current Revenues (BCR) is made. This is what the State can contribute to the Plan after meeting its inevitable and routine expenditures. If it is a negative figure, it means that the State has to devote some of its borrowing to first meet its routine expenditure first, and correspondingly less is available for financing the Plan. The State has been persistently running huge negative BCR in both 2013-2014 and 2014-2015 of (-) Rs.6916 cr. and (-) Rs.9533 cr. However, what exacerbated this was that for the last three years, the Annual Plan Size has been fixed about 10-15% even beyond the State's estimated capacity – all done to announce an artificially bloated plan size each year.

1.1.4. Thus three dimensions of the Annual Plan that has in no small measure, contributed to this fiscal situation are the following:

- **The original Plan Size itself was fixed beyond what the State could afford each year.**
- **Schemes were announced in the Budget that had no resources to finance them. The expenditure incurred on them place enormous strains on the budget.**
- **ARM measures announced in the last two years were only achieved to the tune of 75% leaving huge uncovered gaps in meeting plan expenditures.**

1.1.5. In the process, unfortunately, budgets have lost their sanctity and budget speeches have become exercises in conjuring up unachievable visions of schemes and projects. The divergence between the reality and what is professed, has reduced the annual budgets to a ritual of proclaiming a slew of real or imagined dreams and intentions. Thus unfortunately, the State has been living on a financial lie.

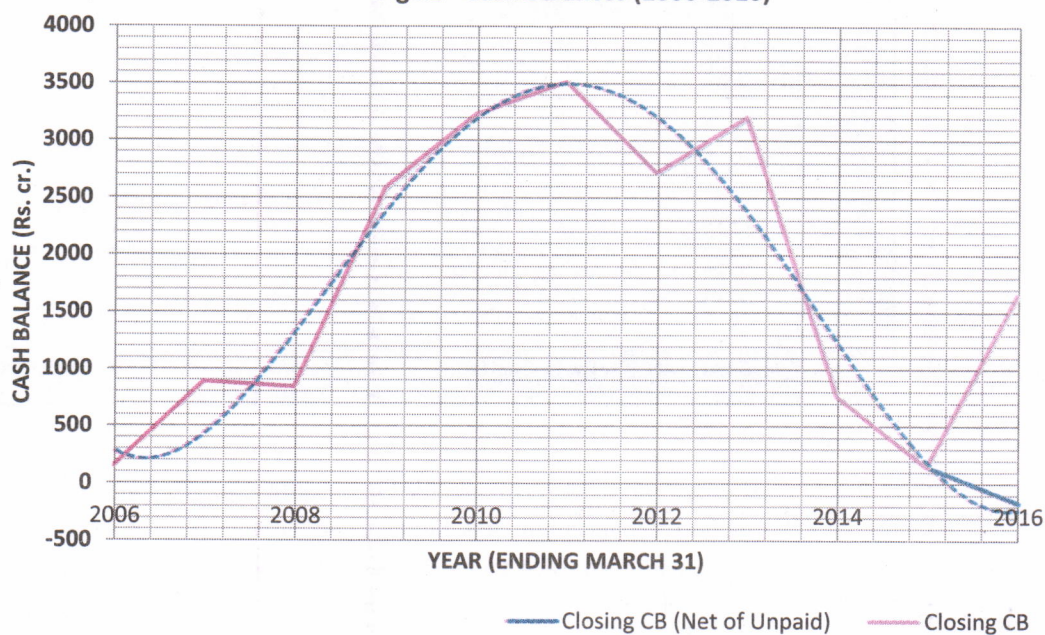
1.1.6. It is in this background that the relevance of a White Paper lies. The people of Kerala have the right to know where their State stands in terms of its financial position and what it holds for them and for their future generations.

1.2. CASH BALANCES IN THE TREASURY

1.2.1. Nothing conveys the unpardonable deterioration in the quality of financial management over the past five years more poignantly than the status of cash reserves of the State. The figure below illustrates the mindless depletion of the cash reserves of the State during the last five years. The vital tax collection machinery, be it in commercial taxes, or excise was pawned away for private gains ignoring public interest.

TABLE I.1 CASH BALANCES		
Year	Closing Cash Balance (Net of Unpaid) (Rs. cr.)	Closing Cash Balance (Rs. cr.)
2006	146.72	147.22
2007	888.64	889.14
2008	840.41	840.91
2009	2584.20	2584.70
2010	3226.37	3226.87
2011	3513.72	3514.22
2012	2711.17	2711.67
2013	3200.77	3201.27
2014	758.56	759.06
2015	142.15	142.65
2016	-173.46	1643.99

Fig I.1 - Cash Balances (2006-2016)



- 1.2.2. The closing balance as on March 31, 2016 with Reserve Bank of India was kept at Rs.1643.99 cr., but in reality approximately Rs.1800 cr. of payment was kept blocked at the Treasuries and at Government level. This has resulted in

artificially depicting a positive cash balance while in reality the State was actually maintaining a negative balance. The position of cash balances over this period is depicted in Figure I.1. The dotted line in the figure shows the trend line of actual closing balances over the period.

2. PENDING LIABILITIES

2.1. Immediate and Short Term Liabilities

- 2.1.1. While on the one hand, the cash balances were maintained to reflect an artificial surplus at the end of March 31, 2016, the immediate and medium term liabilities that the new Government has to discharge is staggering. Table I.2 would show that the immediate commitment that the State Government had to discharge when the new Government assumed office was to the tune of Rs.6302 cr.

TABLE I.2 IMMEDIATE LIABILITIES		
	Items	Amount (Rs. cr.)
1	eLAMS	1431.00
2	Pending in Treasury Queue	100.00
3	Pending for Ways and Means Clearance	450.00
4	Social Security Pensions	806.00
5	BDS/LC (Payment to Banks and Contractors)	1632.00
6	Deposits received from institutions	1365.00
7	Pending Land Acquisition Charges	250.00
8	Other Pensions (Farmers, Fishermen, Coir etc.)	268.00
	TOTAL IMMEDIATE LIABILITIES	6302.00

- 2.1.2. The case of short term liabilities is no different. This means that what the previous Government has bequeathed on the State is a list of unbacked promises which have to be discharged by the new Government. Table I.3 shows only the liabilities for which budget provisions have not been made but where the projects are in various stages of initiation. The list is by no means exhaustive; many important items such as arrears due to LSGIs' housing and SC/ST housing beneficiaries, scholarship to OEC students and so on. Apart from this, payments on infrastructure projects including roads, bridges,

buildings and other infrastructure projects of Rs.10,000 to 15,000 cr. will become due, in the not so very distant future.

TABLE I.3 MAJOR UNBUDGETED SHORT TERM LIABILITIES		
	Items	Amount in Rs. cr. (approx..)
1	Flagship road projects	1620
2	Administrative Sanctions for works issued beyond budget provision	1199
3	Pay Revision Arrears for other than Government Employees (e.g. University/College Teachers)	500
4	Paddy Procurement (Amount due to SUPPLYCO)	471
5	Market Intervention Operations (Payable to Civil Supplies Corporation)	536
	TOTAL MAJOR UNBUDGETED SHORT TERM LIABILITIES	4326

- 2.1.3. Thus in short, for a State that holds a negative cash balance in reality, it is an impossible task to take on immediate and short term liabilities of over Rs.10000 cr. This leads to the distasteful situation of the new Government having to carry forward much of these liabilities. The unavoidable consequence of this financial mismanagement is that the new Government which has assumed office becomes tied down meeting these liabilities and paying up dues left behind by the previous Government.

3. FISCAL DESTABILISATION IN 2011-2016

3.1. Fiscal Discipline Goals

- 3.1.1. The Kerala Fiscal Responsibility Act 2003 mandates that the Medium Term Fiscal Policy and Strategy Statement should be presented before the State Legislature every year along with the annual budget documents. This was intended to stabilise the finances and ensure that balance between revenue expenditure remains sustainable in the long run. In accordance with the provisions of the fiscal responsibility framework, the State Government is expected to contain the Gross Fiscal Deficit at 3% of GSDP and maintain a zero Revenue Deficit.
- 3.1.2. The Fourteenth Finance Commission prescribes certain goals for the State Government in terms of fiscal targets. These fiscal goals are shown in Table I.4. Kerala has been given targets for maintaining the Debt to GSDP Ratios and the Interest Payment to Revenue Receipts as well.

TABLE 1.4
FISCAL RULES PROPOSED BY 14TH FINANCE COMMISSION

Indicators	2015-16	2016-17	2017-18	2018-19	2019-20
RD/GSDP	0.00	0.00	0.00	0.00	0.00
FD/GSDP	3.00	3.00	3.00	3.00	3.00
Debt/GSDP	31.34	30.84	30.40	30.01	29.67
IP/RR	15.70	15.01	14.37	13.78	13.23

3.2. Achievements of fiscal targets

- 3.2.1. Kerala has not been able to achieve the fiscal goals outlined in the Table above except for the Debt sustainability parameter. The actual achievement for 2015-2016 will be known only after the accounts for 2015-2016 are finalised. However, since Debt/GSDP and IP/RR are criteria that have to do more with the historical structure of state finance and manoeuvring these figures in the short term is not easy, focus is often given to the other fiscal stabilisation measures viz. RD/GSDP and GFD/GSDP.
- 3.2.2. Table I.5 shows the Revenue Deficit and Gross Fiscal Deficit in absolute terms and as a percentage of GSDP. The percentage of these figures to the GSDP is shown in Figure I.2.

TABLE I.5
REVENUE DEFICIT AND GROSS FISCAL DEFICIT

Year	Revenue Deficit (RD)	Percentage of RD to GSDP	Gross Fiscal Deficit (GFD)	Percentage of GFD to GSDP
2001	3147.06	4.51%	3877.80	5.56%
2002	2605.64	3.28%	3269.40	4.12%
2003	4122.16	4.53%	4990.05	5.49%
2004	3680.30	3.81%	5539.05	5.73%
2005	3668.92	3.08%	4451.90	3.73%
2006	3129.16	2.29%	4181.72	3.06%
2007	2637.94	1.72%	3821.87	2.49%
2008	3784.84	2.16%	6100.20	3.48%

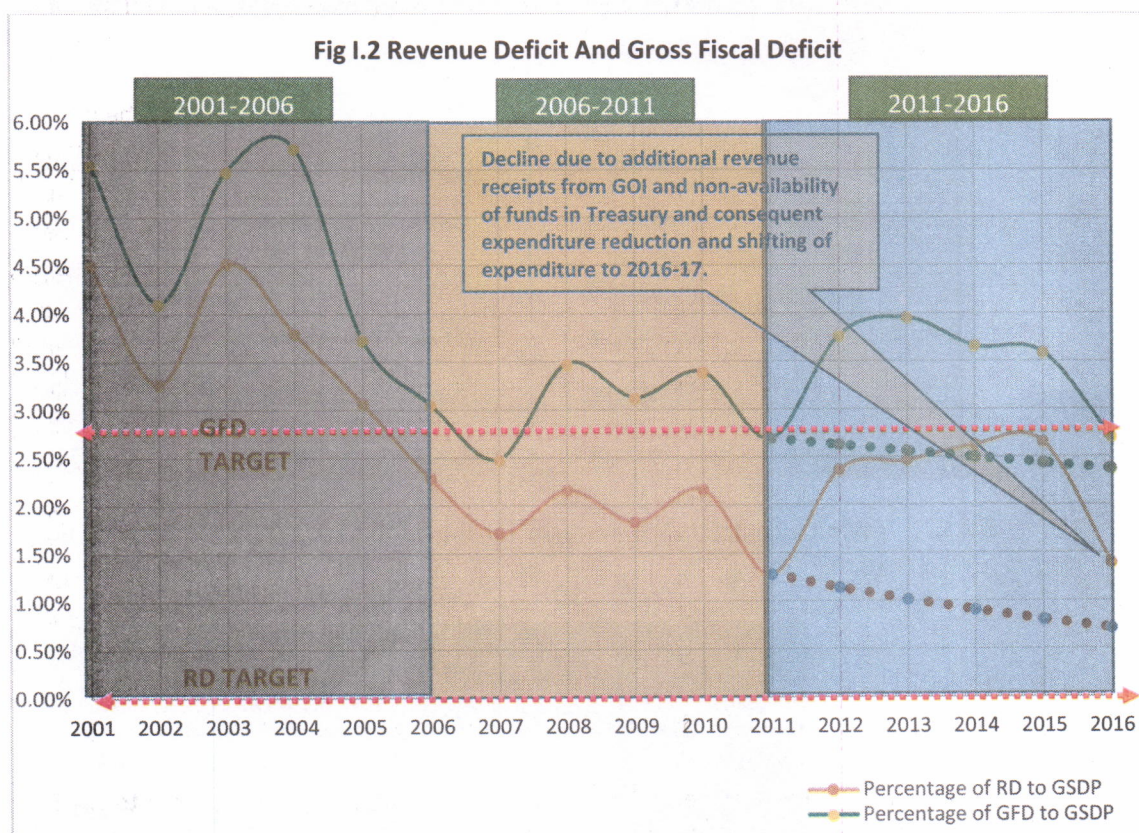
TABLE I.5 REVENUE DEFICIT AND GROSS FISCAL DEFICIT				
Year	Revenue Deficit (RD)	Percentage of RD to GSDP	Gross Fiscal Deficit (GFD)	Percentage of GFD to GSDP
2009	3711.68	1.83%	6346.2)2	3.13%
2010	5022.98	2.17%	7871.61	3.39%
2011	3673.87	1.28%	7730.45	2.70%
2012	8034.26	2.36%	12814.77	3.77%
2013	9351.44	2.46%	15002.46	3.95%
2014	11308.56	2.63%	16944.13	3.66%
2015	13795.96	2.65%	15999.05	3.59%
2016	8199.14	1.40%	15888.17	2.71%

- 3.2.1. Table I.6 contrasts the averages for the period 2001-06, 2006-11 and 2011-16.

TABLE I.6 FIVE YEAR AVERAGES OF RD/GSDP AND GFD/GSDP		
PERIOD	AVERAGE RD/GSDP	AVERAGE GFD/GSDP
2001-06	3.40%	4.42%
2006-11	1.83%	3.04%
2011-16	2.30%	3.54%

- 3.2.2. A look at Figure I.2 gives insights into the process of fiscal destabilisation that has happened during the last five years. When the previous Government came to power in 2011, it had inherited a fiscal position with Revenue Deficit and Gross Fiscal Deficit at 1.28% and 2.70% of the Gross State Domestic Product. **This means that by then Kerala had achieved the fiscal goal of maintaining the GFD at less than 3% of the Gross State Domestic Product on March 31, 2011. Its Revenue Deficit had shrunk to the lowest in this millennium.** Kerala was well on its way to achieving the fiscal targets under the Fiscal Responsibility Framework.
- 3.2.3. In fact, if the same incremental reduction in RD and GFD had been sustained, Kerala would today have been able to achieve the mandated fiscal goals with considerable ease. From the data in Table I.5, the average incremental annual reduction is worked out to be 11 basis points and 3 basis points respectively

on the two parameters viz. RD/GSDP and GFD/GSDP. In fact if this could have been maintained, the State today would have been closer to attaining its fiscal sustainability parameters. This would have yielded significant savings in interest costs. Most importantly it would have released funds for the much needed capital expenditure in the State.



3.2.4. Thus Kerala has gone through three different stages on its fiscal progress card. Following the national recession at the turn of the millennium which affected almost all States in India, the conditions that led to a fiscal responsibility framework emerged both in the Centre and the States. The Centre and all State enacted their own fiscal legislations to check the fiscal drift and took measures to bring their finances under control. Figure 1.2 would show the fiscal consolidation that took place in the period 2001-2006 in Kerala. The fiscal consolidation in this period was based on placing extraordinary restrictions on expenditure and new schemes. As the data outlined in Chapter II would show, the emphasis was on bringing down the revenue expenditure and less on accelerating revenue mobilisation.

3.2.5. In the period 2006-2011, Government continued the fiscal consolidation process. However, there was a qualitative difference in the approach. An analysis of the data would reveal that the emphasis was deliberately given more on revenue mobilisation during this period. A lower thrust was given to ruthless expenditure controls, as they were leading to the unwholesome

consequence of bringing down the quality of public infrastructure through cutting down on maintenance outlays and essential expenditure on welfare of the marginalised sections of society as well as workers in the traditional sector. This strategy adopted by Government in 2006-11 earned good dividends. **As seen in Figure 1.2, the ship of state finances was finally steadied with the Gross Fiscal Deficit brought under the mandated 3% limit for the first time.**

- 3.2.6. However, in 2011-2016, the fortunes of the State were reversed. The steady gains in fiscal consolidation that was achieved in 2001-06 and later in 2006-11 was sacrificed at the altar of indiscipline in expenditure and inefficiency and nepotism in revenue mobilisation including administration of taxes. Administrative machinery of the various tax generating departments were held back from operating at the required levels of efficiency. Revenue Deficit and Gross Fiscal Deficit hits its worst highs in the last ten years at 2.65% and 3.08% of GSDP. Finally after four years of losing ground, without any more avenues for borrowing, Government found itself in a position where it could not service budget commitments any longer. This led to a steep crash in expenditure which led to an automatic decline in the RD and GFD line in 2015-16 as seen in Figure 1.2. What is also pertinent is that much of this decline was only due to the extra revenue deficit grant of Rs.4640 cr. in 2015-2016 that Kerala enjoyed as part of the award of the Fourteenth Finance Commission.

3.3. Consequences of this fiscal destabilisation

- 3.3.1. While there are several direct and indirect costs that the State has to pay for the fiscal destabilisation that was seen in 2011-2016, there are some that are immediately startling:
- The State lost out a priceless and historic opportunity to catch up with the rest of the country in infrastructure investment by lowering the RD and increasing Capital Expenditure. Even at the average incremental acceleration of 11 basis points observed in the fiscal target on revenue deficit, the State's estimated loss of capital expenditure is approximately Rs.2516 cr. over the five years (2011-16) on this single measure.
 - The State lost the premium normally earned by financially well managed States for its Open Market Borrowings (OMB) estimated at approximately 20 basis points additionally by way of interest costs. This reflects a cumulative interest loss of approximately Rs.123 cr. reflected over the aggregate borrowing over five years (2011-16).
 - Finally the State lost out on achieving the incentives mentioned in the award of the Fourteenth Finance Commission for good management by availing of the extra additional borrowing given as the award of 0.5% of GSDP. If the process of fiscal consolidation was continued with the same vigour by the previous Government in 2011-16 building on the legacy that its predecessor Government had left behind for it in 2011, the State could

have qualified for the incentives in the period 2011-2016 itself. Thus imprudent financial management has had an opportunity cost of nearly Rs.3000 cr. per annum - money that could have been ploughed into the much needed capital expenditure in the State.

- If the State has to launch its plans to access the capital markets, then it will have to first overcome its image as a State that is not achieving its fiscal targets. Unless, special efforts are demonstrably made evident to investors, this negative image may hamper the borrowing programme of the State in the future. If the image of the State Exchequer is not restored in public minds, then it will detrimentally affect resource generation to finance the major policy initiatives and capital projects of the State outlined in the policy laid before the Legislature by the Honourable Governor of Kerala on June 24, 2016.

4. LIQUIDITY MANAGEMENT (FUNDS IN TREASURY)

- 4.1. One of the indications of the health of the exchequer is the credit availed from the Reserve Bank of India for its day to day operations. The State of Kerala was in a precarious financial position in 2000-01 along with many other States in the aftermath of the national economic recession. In that year availed Ways and Means Advance (WMA) for 148 days and was on Overdraft (OD) for 213 days. As mentioned above, the successive Governments in Kerala in 2001-06 and 2006-11, brought the position under control. By 2010-2011, the Government could steer the State through without availing any WMA or OD. Table I.7 brings out the corresponding data.

<i>Year</i>	<i>Ways and Means Advance</i>	<i>Overdraft</i>
2001	148	213
2002	136	222
2003	161	196
2004	155	177
2005	193	161
2006	179	61
2007	159	61
2008	131	47
2009	73	0
2010	18	0
2011	0	0
2012	0	0
2013	0	0
2014	1	0
2015	18	6
2016	18	0

Fig I.3A WMA and OD - No of days (2001-2016)

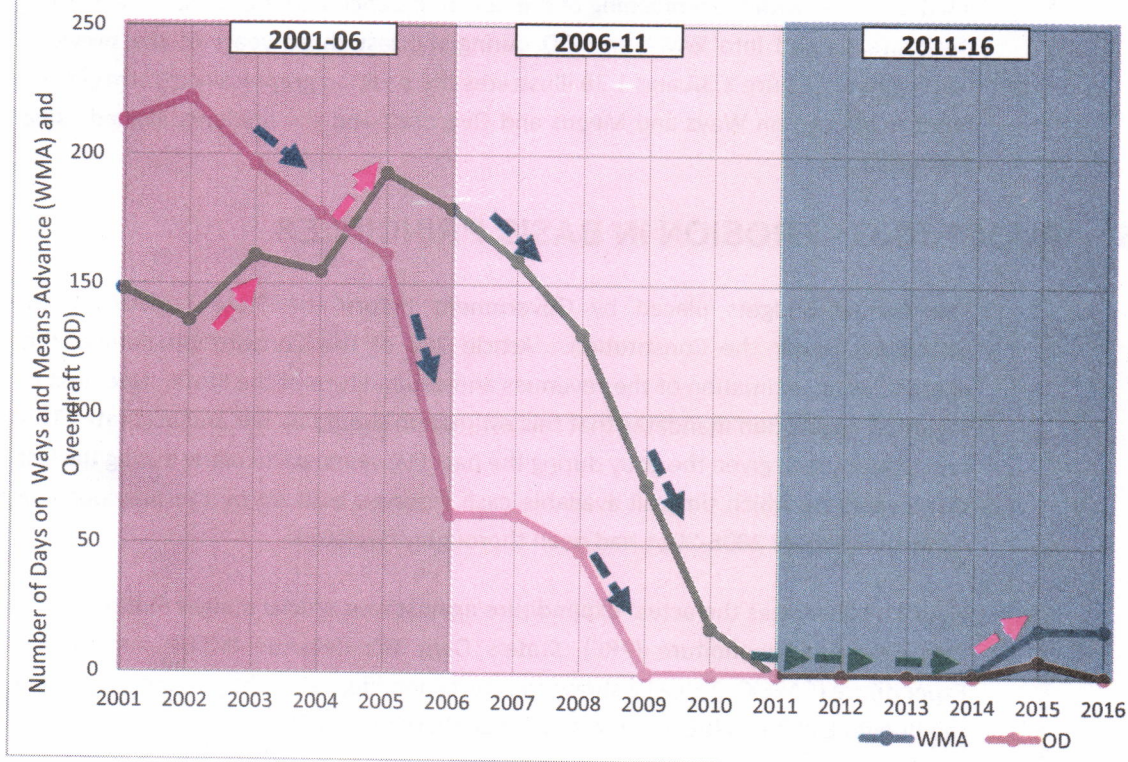
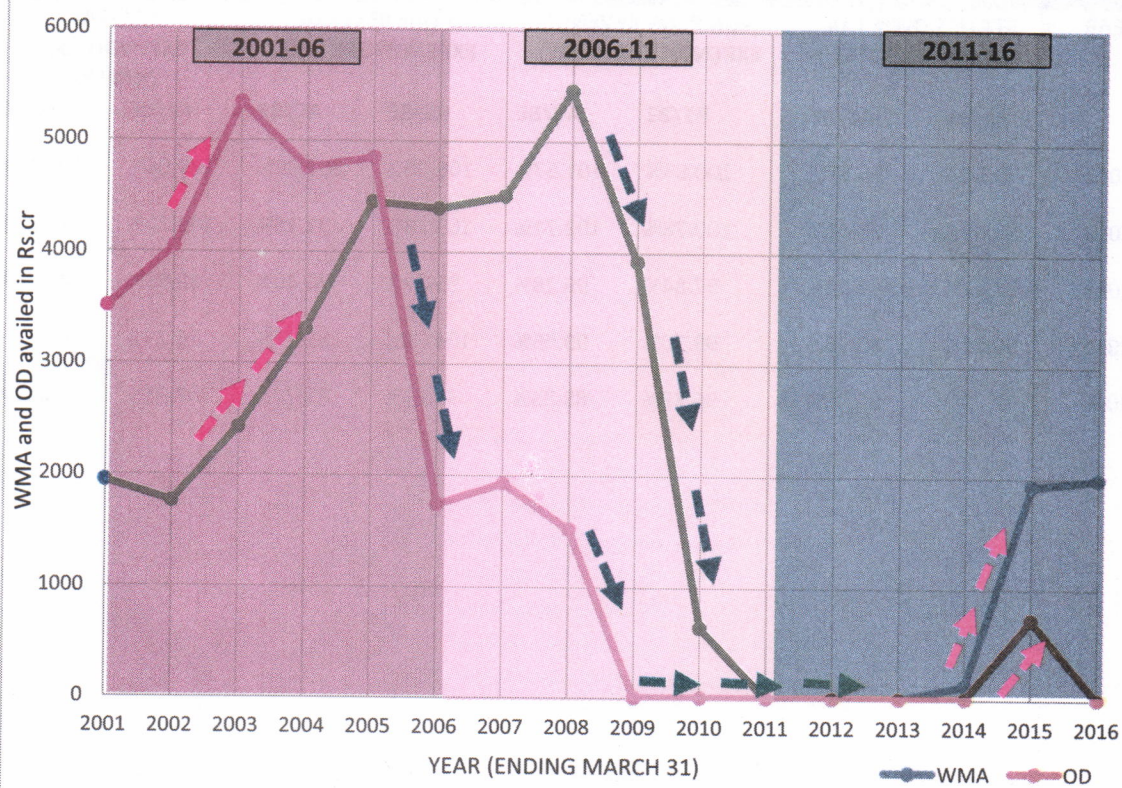


Fig 1.3B WMA and OD (Amount Availed in Rs.cr.)



- 4.2. The State ran on the strength of these efforts for the period 2011-2013, but lost steam in 2013-14. As with the worsening of the Revenue Deficit and the Gross Fiscal Deficit, the State slipped into WMA and OD during the last three years of the previous Government. Figure 1.3A and 1.3B illustrates the position graphically in terms of the number of days on Ways and Means and Overdraft and the amounts availed using that facility.

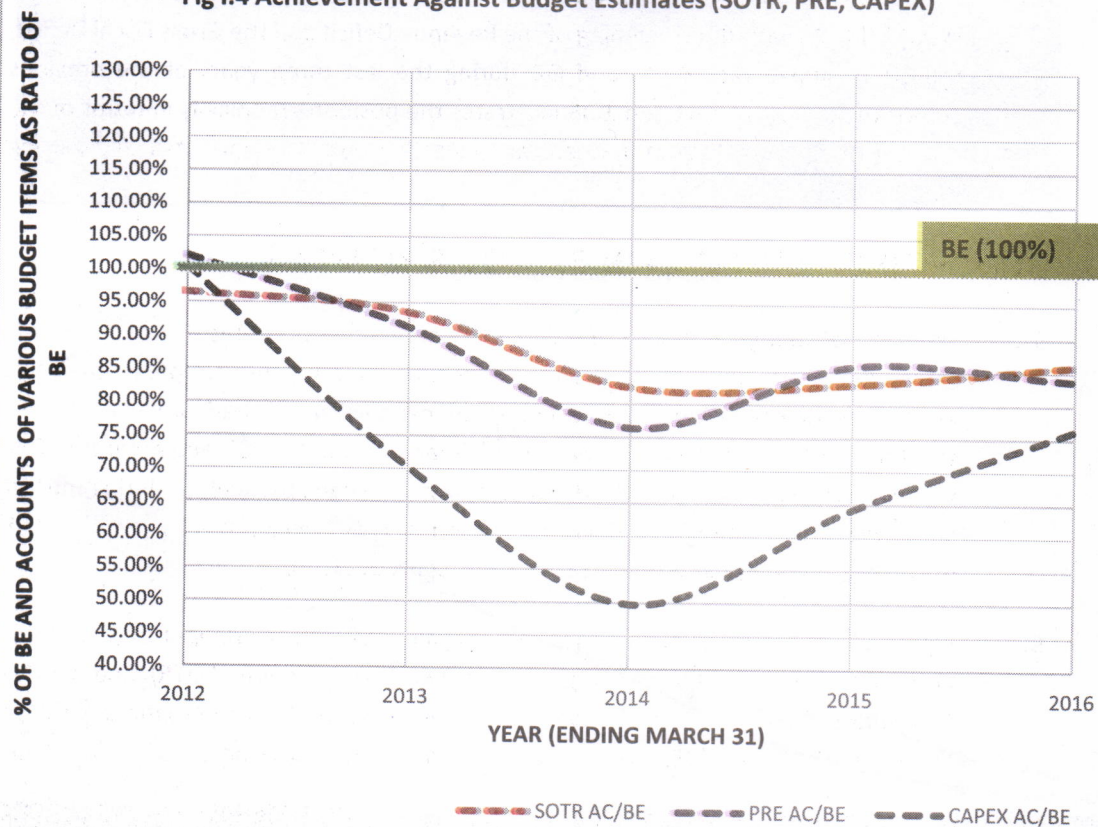
5. BUDGETING - EROSION IN BASIC PRINCIPLES

- 5.1. The Annual Budgets placed by Government before the State Legislature are sacrosanct under the Constitution. Article 202 of the Constitution defines this exercise as an estimation of the revenues and expenditure of the State. Needless to say, the Constitution mandates that this estimation should be fair and accurate. This sanctity has been given the goby during the past five years, particularly during the last three years by which time all available cash reserves built up by the previous LDF Government over 2006-2011 had been thoroughly depleted.
- 5.2. Figure I.4 illustrates the actual expenditure against four crucial budget indicators viz. Plan Revenue Expenditure (PRE), State's Own Tax Revenue (SOTR) and Capital Expenditure (CAPEX). Table I.8 shows the corresponding data. The variances between the Budget Estimates (BE) are too stark in all these vital indicators.

TABLE I.8
REVISED ESTIMATE (RE) AND ACCOUNTS (AC) TO BUDGET ESTIMATE (BE)

YEAR	STATE'S OWN TAX REVENUE (SOTR)		NON PLAN REVENUE EXPENDITURE (NPRE)		PLAN REVENUE EXPENDITURE (PRE)		CAPITAL EXPENDITURE (CAPEX)	
	RE/BE	AC/BE	RE/BE	AC/BE	RE/BE	AC/BE	RE/BE	AC/BE
2012	99.27%	96.54%	100.83%	101.67%	106.90%	102.09%	129.06%	100.48%
2013	98.69%	93.63%	100.78%	102.71%	103.28%	91.36%	105.31%	70.23%
2014	91.67%	82.52%	97.84%	99.28%	95.77%	76.40%	68.33%	49.73%
2015	90.15%	82.96%	99.30%	99.55%	104.79%	85.77%	76.29%	64.11%
2016	87.79%	85.85%	96.39%	88.35%	82.83%	83.72%	67.31%	76.22%

Fig I.4 Achievement Against Budget Estimates (SOTR, PRE, CAPEX)

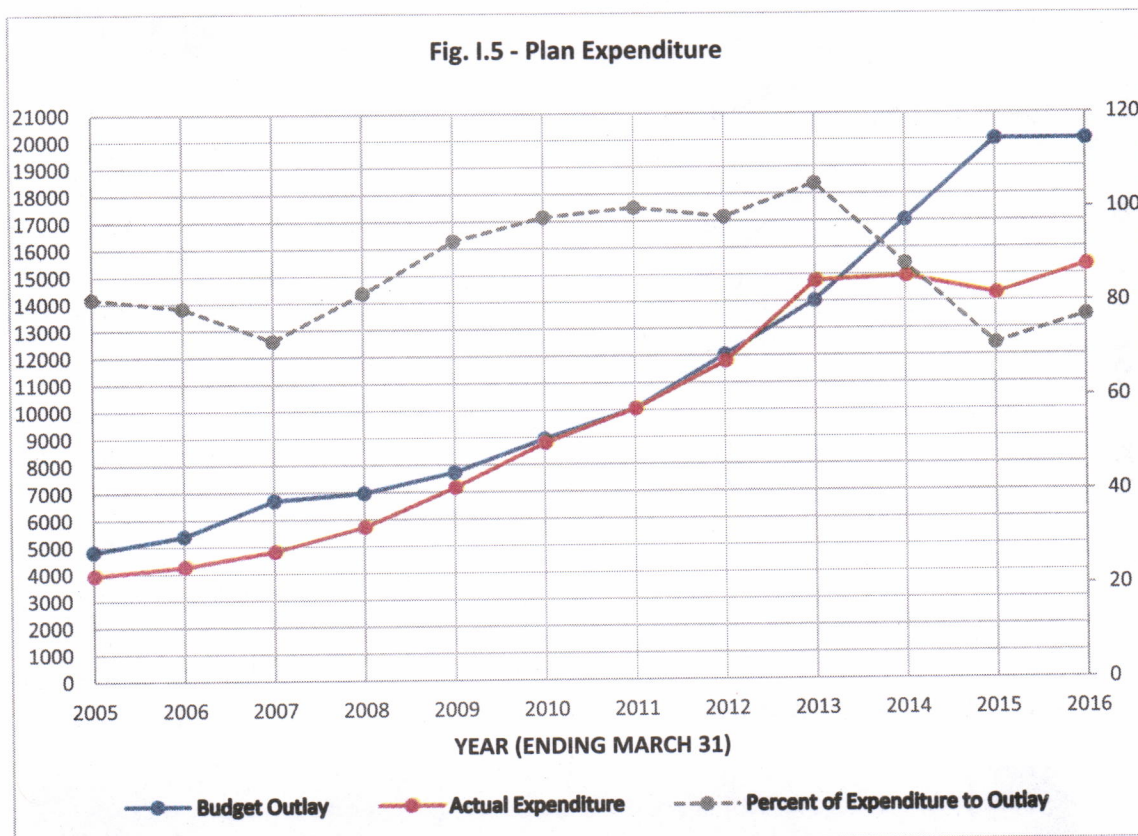


5.3. Plan Expenditure

TABLE I.9
PLAN OUTLAY AND EXPENDITURE

Year (ending March 31)	Budget Outlay	Actual Expenditure	Percent
2005	4800	3907	81
2006	5370	4231	79
2007	6681	4785	72
2008	6950	5690	82
2009	7700	7145	93
2010	8920	8780	98
2011	10025	10025	100
2012	12010	11758	98

2013	14010	14737	105
2014	17000	14901	88
2015	20000	14252	71
2016	20000	15312	77



5.3.1. Table I.9 depicts this picture in the case of the State's Plan Expenditure. The resources mobilized during the period 2006-2011 and the surpluses handed over to the Government in 2011 was used to maintain the Plan Expenditure for the first two years of the previous Government. But thereafter it has been a nosedive in terms of plan expenditure. The expenditure on plan plummeted from 105% in 2012-13 to 88% in 2013-14, skid further down to 71% in 2014-15 and is at 77% in 2015-16. Figure I.5 captures this graphically.

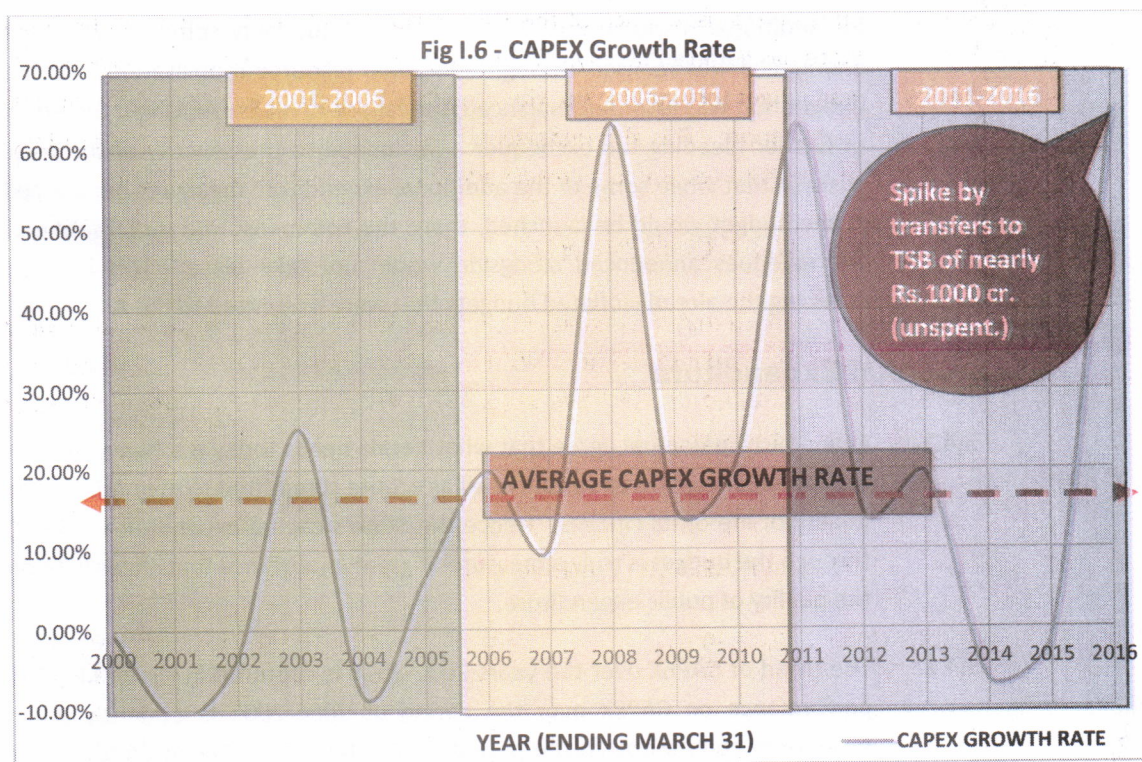
5.3.2. If the total Annual Plan of the State including the Centrally Sponsored outlays is taken into account, the expenditure slips even further below to 70% of the gross outlay. The published figures of the Accountant General reveal that the total plan expenditure in 2013-14 and 2014-15 amounts to only 69% and 62% of the budget outlays respectively.

5.3.3. During the last three years in particular, the budget was being balanced for the purpose of presentation in the Assembly through a number of measures

for additional resource mobilisation (ARM). But, only some of what was announced was realised through additional resource mobilisation. With a budget that was artificially balanced, the failure to realise ARM had the effect of further bleeding the exchequer. This added to the severity of the fiscal crisis, in that while some of the additional expenditure measures announced in the budget would be launched, there the commensurate mobilisation of the revenues announced alongside would not take place. This kept on stressing the already inflated budgets that were presented to the Assembly.

5.4. Capital Expenditure

- 5.4.1. Economists in general agree that what Kerala needs today is a heavy dose of capital infusion if it is to sustain itself as a State committed to maintaining the quality of life of its citizens. Hence the State's capital expenditure (CAPEX) through the budget is truly a measure of great importance that sheds light on the quality of public expenditure.
- 5.4.2. The trend of CAPEX over the years 2001-2016 is captured in Figure I.6. The performance on CAPEX over the period of 2006-2001 is evidently much superior in comparison to the period 2011-2016. The spike in CAPEX in the year 2015-2016 is explained by the amount of approximately Rs.1000 cr. held in the treasury in public deposit and is money not spent.
- 5.4.3. Table I.9 shows the CAPEX over the three periods 2001-06, 2006-11 and 2011-16 to contrast the growth patterns in CAPEX. The average growth rate touched a peak of 34.73% in 2006-2011 while it was an average of 7.97% in 2001-2006 and 18.31% in 2011-2016. If Kerala could have maintained that same level of the growth of the period 2006-2011 in CAPEX into the future, the State could well have been among the best states in terms of its public infrastructure. But that was not to be...



Period	Year	CAPEX (Rs.cr.)	% GR	Average GR (%)
2001-2006	2001-02	558.36	-3.26	7.97
	2002-03	698.66	25.13	
	2003-04	639.71	-8.44	
	2004-05	681.75	6.57	
	2005-06	816.95	19.83	
2006-2011	2006-07	902.58	10.48	34.73
	2007-08	1474.58	63.37	
	2008-09	1695.60	14.99	
	2009-10	2059.39	21.45	
	2010-11	3363.69	63.33	
2011-2016	2011-12	3852.92	14.54	18.31
	2012-13	4603.29	19.48	
	2013-14	4294.33	-6.71	
	2014-15	4254.59	-0.93	
	2015-16	7027.34	65.17	

- 5.4.4. Thus one consequence of the fiscal crisis is that capital expenditure in the State has suffered hugely. What it implies is that the State will have now to wait longer for catching up with advanced States and that the effort will now cost us more. This also underscores the need to find intelligent and rational shortcuts to recover lost ground in capital expenditure in the State.

6. IF 2011-2016 HAD CONTINUED...?

- 6.1. The crucial question that the people of the State have an obvious right to ask is what would have happened if the trend of 2011-2016 in the finances of the State had been allowed to persist into the next five years. Where would the slide in the finances of Kerala have led the State to?

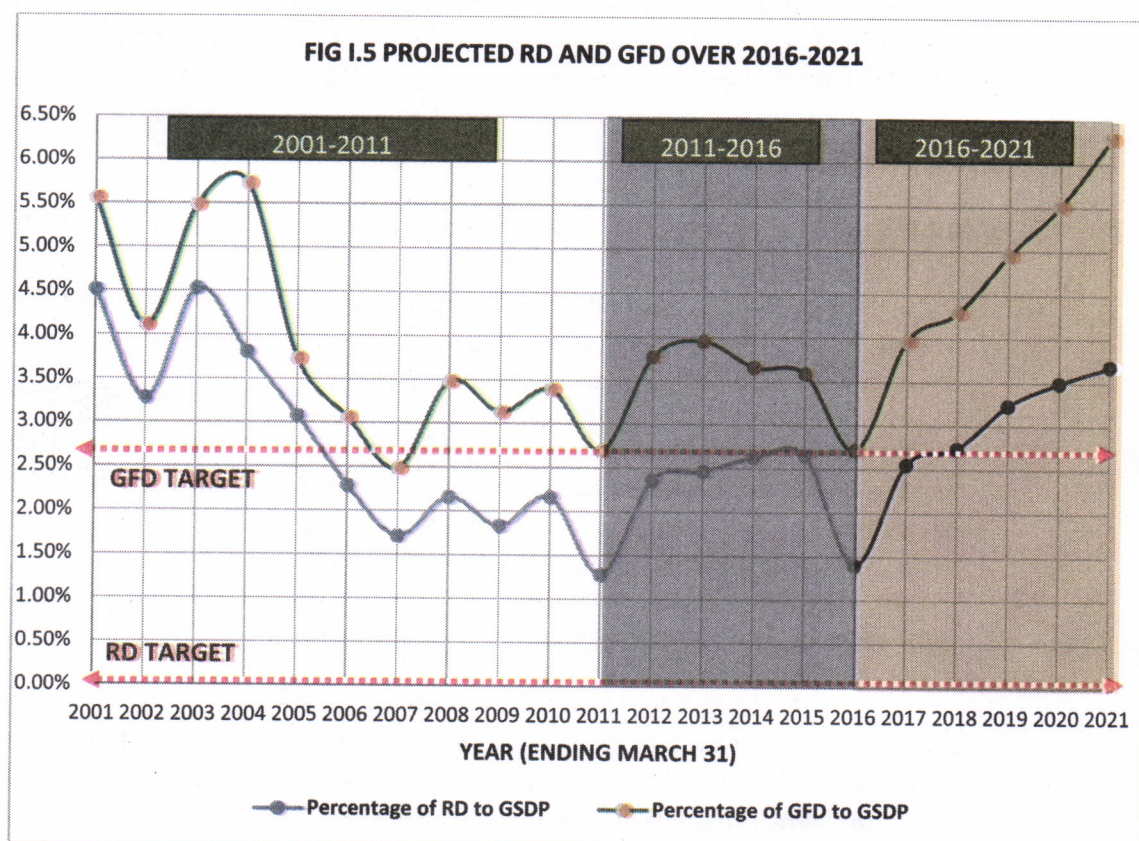


TABLE I.11 PROJECTED RD/GSDP AND GFD/GSDP		
YEAR (ENDING MARCH 31)	RD/GSDP	GFD/GSDP
2017	2.55%	3.97%
2018	2.74%	4.30%
2019	3.23%	4.95%
2020	3.49%	5.51%
2021	3.68%	6.28%

- 6.2. The best way to address this question is to focus on the two vital fiscal parameters viz. RD to GSDP and GFD to GSDP and predict their behaviour over time. Figure I.7 shows the behaviour of these parameters, had the same trend over the last five years (2011-2016) continued. Method of moving averages is used to adapt the past pattern of individual expenditure and receipt items for the forecast period 2016-2021. Table I.II shows the projected figures for the two variables.
- 6.3. If the same fiscal behaviour had continued, then the State would have been in a virtual fiscal anarchy somewhere in 2017-2018. Not only would the State have been on overdraft most of the year, but development and growth of our State would have come to a grinding halt. By 2021, the Revenue Deficit would have exceeded 3.25% of GSDP and the Gross Fiscal Deficit would have reached an unimaginably high level of 6.25%! The State would have no money left to finance its development initiatives or meet the budgeted outlays on welfare expenditure. The State would most certainly have defaulted on its committed payments on salaries, pensions and loan repayment obligations.

7. SUMMARY

- 7.1. The above background is only meant to highlight the imperative need for publishing a White Paper. There is a legitimate duty cast on Government to inform the people of Kerala of the status of the financial health of the State.
- 7.2. In Chapter II we attempt to diagnose the cause of the financial malaise that has set in, focusing on the last ten years, contrasting in particular the periods 2006-2011 and 2011-2016.
- 7.3. Chapter III outlines the immediate challenges/concerns before the new government in the years ahead which are many, some of the major ones being:
- Steeply declining trend of resource mobilisation
 - No Revenue Deficit Grant after 2017-18
 - Commitment on account of increased devolution to LSGIs
 - Arrears payable on account of pay and pension revision of employees
 - Huge outflow due to redemption of public debt in the immediate few years
 - Meeting the huge CAPEX requirements of the State

Chapter III then proceeds to briefly outline an approach that the State intends to adopt through the coming annual budgets.

- 7.4. Finally, for a better understanding of how the State needs to proceed forward and find solutions for the issues outlined above, the historical perspective on finance based on data of the past five decades is traced out in Appendix. In doing so, data on the following measures over the time frame 1970-71 to 2015-16 are presented.

1. Revenue Receipts
2. Revenue Expenditure
3. Revenue Deficit
4. Capital Expenditure
5. Debt Liabilities
6. Gross Fiscal Deficit
7. Salaries
8. Interest
9. Pension

- 7.5. However formidable the challenges are, any Government is duty bound to find creative solutions, however painful or unpleasant they are. These solutions have to be very sensitive to the hopes expectations of the people of Kerala.

CHAPTER II

CAUSES FOR THE CURRENT FINANCIAL CRISIS¹

1. APPROACH IN THIS CHAPTER

- 1.1. To understand the yawning revenue gap as indicated by the widening Revenue Deficit, and the consequent crisis, one needs to examine both the revenue and expenditure side of state finances. While examining the growth in revenue expenditure, we need to closely look at the trend in the various components of the expenditure. It may be a truism that the expenditure has to be contained within the limits of revenue. What one cannot fault is of course, if Plan Expenditure or Capital Expenditure were to overshoot the budget estimates. It may not be possible to influence items like salaries, pension and interest expenditure. But it is a different case with regard to Non Plan Revenue Expenditure net of Salaries, Interest and Pensions. This component can be modulated without adverse impact on development. What has been its behaviour during the last five years? This is the first question that we shall be addressing in this Section.
- 1.2. We shall then proceed to examine the revenue side of the problem. How has the overall revenue grown? Does the overall growth cover up the significant distortion and deterioration that may have set in for some revenue components - which are more amenable to the control of the State Government? We shall therefore, examine the composition and trend in revenue receipts particularly with respect to State own Commercial Taxes. The inferences we draw from the analysis are summarized in the concluding paragraphs.

2. REVENUE EXPENDITURE

2.1. Composition of Revenue Expenditure

- 2.1.1. The bulk of the State's Revenue Expenditure (RE) is taken up by Salaries, Interests and Pensions. The rest of it is apportioned for other Plan and Non Plan expenditure (including items classified under development non development items).

¹ Accounts relating to 2015-16 are based on provisional figures furnished by the Accountant General and are liable to change when the Accounts of the State are finalized.

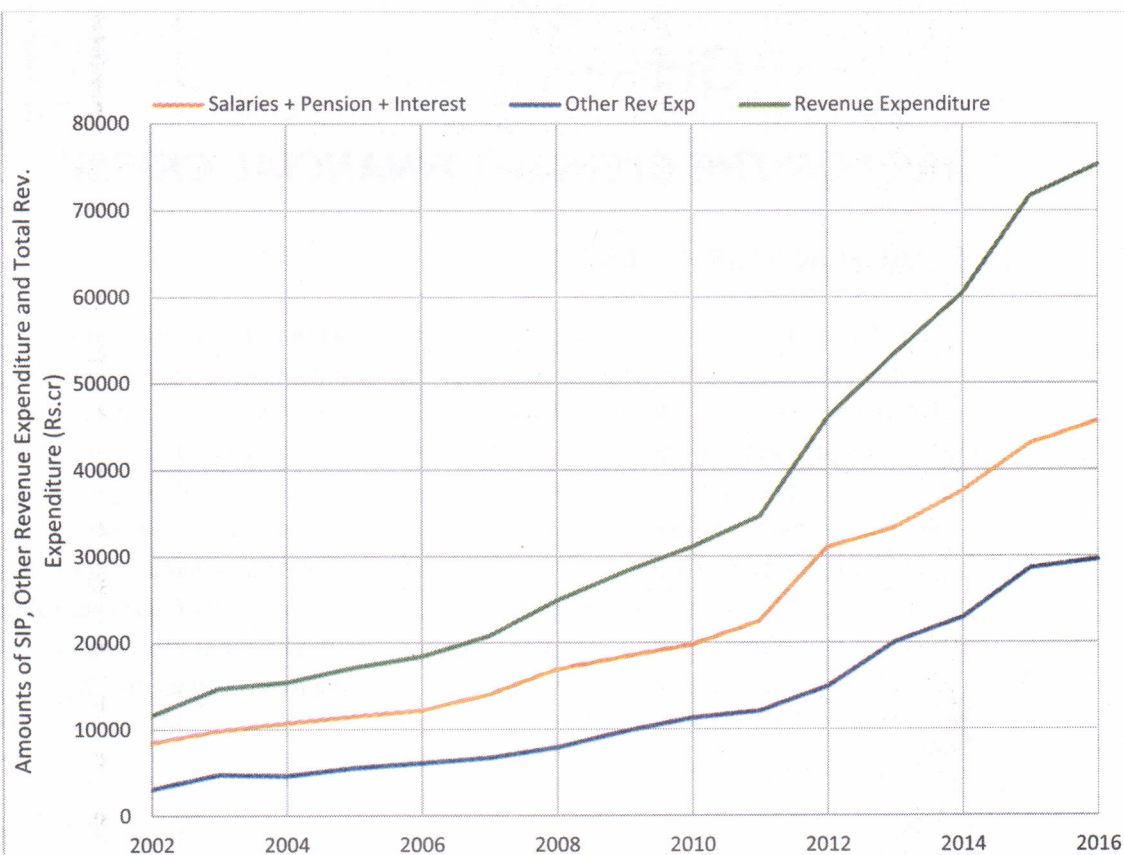


Fig II.1 Components of Revenue Expenditure

2.1.2. Table II.1 shows the trend in increase of the State's Revenue Expenditure. It increased from Rs.18424 cr. in the year ending 2006 to Rs.75249 cr. in the year ending 2016 (309%). During the same period, Salaries rose from Rs.5608 cr. to Rs.23506 cr. (319%), Pensions from Rs.2961 cr. to Rs.13063 cr. (357%) and Interest from Rs.3799 cr. to Rs.9114 cr. Figure II.1 shows the breakup of Revenue Expenditure in the State on the major components viz. Salaries, Interest and Pension (SIP) and other Revenue Expenditure.

TABLE II.1
REVENUE EXPENDITURE

(Rs. Cr.)

Year	Salaries	Pension	Interest	Salaries + Pension + Interest	Other RE	RE
2005	5345.58	2600.77	3612.54	11558.88	5610.53	17169.41
2006	5607.78	2861.18	3799.25	12268.21	6155.47	18423.68
2007	6585.45	3294.58	4189.70	14069.73	6754.84	20824.57
2008	7693.66	4924.53	4329.65	16947.84	7943.79	24891.63
2009	9063.81	4686.43	4659.69	18409.93	9813.92	28223.85
2010	9800.20	4705.50	5292.48	19798.17	11334.21	31132.38
2011	11068.38	5767.49	5689.66	22525.53	12139.29	34664.82
2012	16083.27	8700.30	6293.60	31077.17	14967.45	46044.62
2013	17313.70	8866.89	7204.81	33385.40	20103.34	53488.74
2014	19340.98	9971.27	8265.38	37577.64	22907.86	60485.50
2015	22079.90	11252.67	9769.59	43102.16	28644.27	71746.43
2016	23506.42	13062.62	9114.38	45683.42	29665.63	75349.05

2.2. Efficiency of Public Expenditure Management

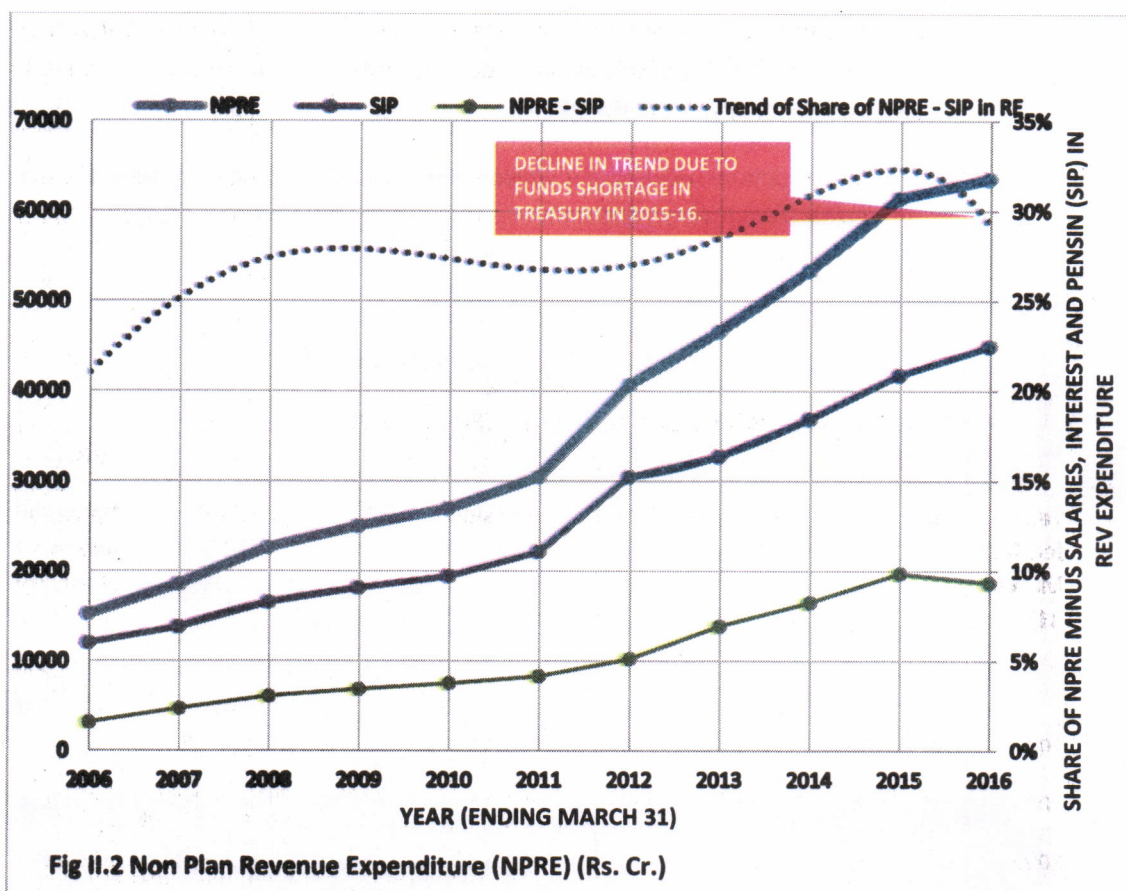
2.2.1. One of the indices of efficiency of public spending of a Government is its control on avoidable expenditure or expenditure that can be postponed. A reasonable measure that is observed for this purpose is the Non Plan Revenue Expenditure (NPRE). NPRE however, has several components of which Salaries, Interest and Pension (SIP) are committed liabilities. SIP is certainly not amenable to short term control measures and can only be controlled in the long run. Salaries are mostly on account of the employees who have been recruited into Government over several years in the past. Interest Payment depends on the previous borrowing and credit record of Government while Pensions, like salaries correlate with the past staffing in Government. Much of this is history and originates from the past.

2.2.2. However, the measure of NPRE net of the committed liabilities on SIP is a variable that should definitely be controlled for prudent financial management. While it does not mean that NPRE *minus* SIP is all wasteful expenditure, it is the only practical measure that can be controlled in the short and medium term by the State through checks and controls on expenditure

and rationalisation of spending. In fact, this measure is also very sensitive and a moderate swing in this will considerably impact the budgetary and liquidity position of Government.

- 2.2.3. Table II.2 shows the breakup of Non Plan Revenue Expenditure (NPRE) of the State for the period 2006-2016. Figure II.2 shows the percentage of NPRE excluding Salaries, Interest and Pension (SIP).

TABLE II.2 NON PLAN REVENUE EXPENDITURE (Rs. Cr.)							
Year (ending March 31)	NPRE	Salaries	Interest	Pension	SIP	NPRE - SIP	Percent age of NPRE minus SIP in Rev Ex.
2007	18516.13	6303.10	4189.70	3294.58	13787.38	4728.75	25.54%
2008	22614.35	7251.87	4329.65	4924.53	16506.05	6108.30	27.01%
2009	25011.99	8782.69	4659.69	4686.43	18128.81	6883.18	27.52%
2010	26953.32	9401.90	5292.48	4705.50	19399.88	7553.44	28.02%
2011	30469.07	10671.39	5689.66	5767.49	22128.54	8340.53	27.37%
2012	40717.41	15483.33	6293.60	8700.30	30477.23	10240.18	25.15%
2013	46639.42	16696.50	7204.81	8866.89	32768.20	13871.22	29.74%
2014	53411.84	18684.50	8265.39	9971.27	36921.16	16490.68	30.87%
2015	61463.85	20725.45	9769.59	11252.67	41747.71	19716.14	32.08%
2016	63618.57	22755.26	9114.38	13062.02	44931.66	18686.91	29.37%



NPRE: Non Plan Revenue Expenditure

SIP: Salary, Interest and Pension

- 2.2.4. NPRE *minus* SIP has clearly been at the highest levels in the last decade in the period 2013 to 2016. This has increased from approximately 27% in 2011 to nearly 30% of NPRE during this period. It touched a peak of 32% of NPRE in 2015. The dotted line in Figure II.2 vividly illustrates the sharp rise in NPRE minus SIP as a percentage of NPRE.
- 2.2.5. There was a minor drop in 2015-2016 in this expenditure, but given the sharp decline in cash balances and the piling up of accumulated liabilities (explained in Chapter I), this decline is more explained by the lack of funds in the Treasury itself.
- 2.2.6. Clearly therefore, one inference from the trend in NPRE that would follow is that even in areas where prudent financial management would demand exercise of control, Government did not exercise adequate control on avoidable expenditure, particularly during the three years (2013-2016).
- 2.2.7. Evidently one of the factors that aggravated the financial crisis during the tenure of the previous Government has been the failure to control avoidable Non Plan Revenue Expenditure.

3. REVENUE RECEIPTS

3.1. Composition of Revenue Receipts

3.1.1. The receipts on account of revenue on the consolidated fund of the State arise mainly from three major streams. They are the following:

- State's Own Tax Revenues
- State's Own Non Tax Revenues
- Central Transfers (Tax share and Grants)

State's Own Tax Revenues (SOTR) constitutes the lion's share of the revenue receipts of Kerala, accounting for as much as sixty five percent of the total revenue receipts over the last ten years. The State Own Non Tax Revenue in Kerala arises largely from lotteries and services rendered in Government Departments and account for on an average about nine percent of the total receipts of revenue. The State's Share of Central Taxes and Grants from Central Government depends on the awards of the Finance Commission and the allocations on account of Central Schemes respectively and together account for twenty six per cent of the revenue receipts.

TABLE II.3 REVENUE RECEIPTS (2001-2016)			
Year (ending March 31)	Revenue Receipts (Rs. Cr.)	Year (ending March 31)	Revenue Receipts (Rs. Cr.)
2001	8731	2009	24512
2002	9056	2010	26109
2003	10634	2011	30991
2004	11815	2012	38010
2005	13500	2013	44137
2006	15295	2014	49177
2007	18187	2015	57950
2008	21107	2016	67150

3.1.2. Table II.3 shows the aggregate figures of revenue over the period 2001-2016. Growth rates of revenue receipts are not a valid measure of inter year comparison especially after Government of India returned to the old practice of routing scheme funds (e.g. NRHM, various Rural Development schemes etc.) through the State Account.

3.1.3. The share of the various components of the revenue receipts of the State are examined in detail. This is necessary to better appreciate the reasons for the fiscal crisis that the State is in now. The Share of Central Tax grew in the year 2016 by a whopping 60%. This was on account of the award of the Fourteenth Finance Commission. Government of India grants also registered an increase as may be seen from the table below. The total amount through Government

of India went up by 40% in 2015-16 in comparison with the previous year. The receipts from Government of India accounted for 32% of the total revenue receipts of the State in 2015-2016. Never before in this millennium had receipts from Government of India accounted for as high a share of the total revenue receipts. While the State, no doubt, has been fortunate to obtain this additional share on account of the revenue deficit grant of Rs.4640 cr., it is of immense concern that the present fiscal crisis is despite this significant additional amount flowing in to the coffers of the State. Table II.4 shows the breakup of the various components of revenue receipts over the period 2006-2016.

TABLE II.4 (2006-2016) (SHARE AND GROWTH RATES OF COMPONENTS IN REVENUE RECEIPTS) (Rs. Cr.)								
	2001	2002	2003	2004	2005	2006	2007	2008
Revenue Receipts	8731	9056	10634	11815	13500	15295	18187	21107
Growth Rate of Rev. Receipts		4%	17%	11%	14%	13%	19%	16%
Total through GOI (Tax share and Grants)	2491	2669	2888	3354	3719	4579	5308	6229
Growth Rate of Total through GOI		7%	8%	16%	11%	23%	16%	17%
Share % of total through GOI	29%	29%	27%	28%	28%	30%	29%	30%
SOTR	5581	5844	7068	7654	8962	9778	11941	13669
Growth Rate of SOTR		5%	21%	8%	17%	9%	22%	14%
Share % of SOTR	64%	65%	66%	65%	66%	64%	66%	65%
Total of all revenues collected by State	6240	6387	7746	8461	9781	10715	12879	14878
Growth Rate of Total State Revenues		2%	21%	9%	16%	10%	20%	16%
Share % by State effort	71%	71%	73%	72%	72%	70%	71%	70%
(Table Continued)								
	2009	2010	2011	2012	2013	2014	2015	2016
Revenue Receipts	24512	26109	30991	38010	44137	49177	57950	67150
Growth Rate of Rev. Receipts	16%	7%	19%	23%	16%	11%	18%	16%
Total through GOI (Tax share and Grants)	6963	6632	7338	9700	9862	11607	15434	21600

TABLE II.4 (2006-2016)
(SHARE AND GROWTH RATES OF COMPONENTS IN REVENUE RECEIPTS) (Rs. Cr.)

Growth Rate of Total through GOI	12%	-5%	11%	32%	2%	18%	33%	40%
Share % of total through GOI	28%	25%	24%	26%	22%	24%	27%	32%
SOTR	15990	17625	21722	25719	30077	31995	35233	39002
Growth Rate of SOTR	17%	10%	23%	18%	17%	6%	10%	11%
Share % of SOTR	65%	68%	70%	68%	68%	65%	61%	58%
Total of all revenues collected by State	17549	19477	23652	28311	34275	37570	42516	45550
Growth Rate of Total by State	18%	11%	21%	20%	21%	10%	13%	7%
Share % by State effort	72%	75%	76%	74%	78%	76%	73%	68%

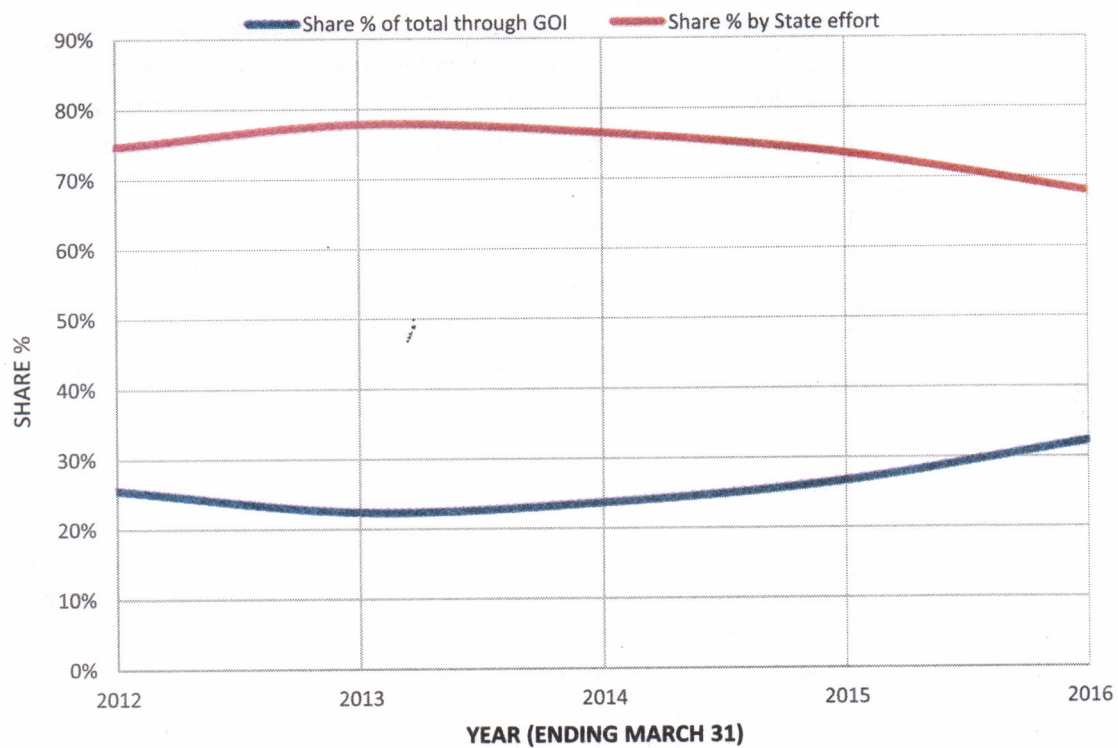
SOTR: State's Own Tax Revenue

- 3.1.4. In absolute terms, Revenue Receipts rose from Rs.15295 cr. in the year ending 2006 to Rs.67150 cr. in the year ending 2016 (339%). Flows from Government of India both as share of central taxes and grants increased from Rs.4579 cr. to Rs.21600 cr. during the corresponding period (372%). State's own Tax Revenues increased from Rs.9778 cr. to Rs.39002 cr. (298%). The revenues raised by the State on its own efforts increased from Rs.10715 cr. to Rs.45550 cr. (325%).

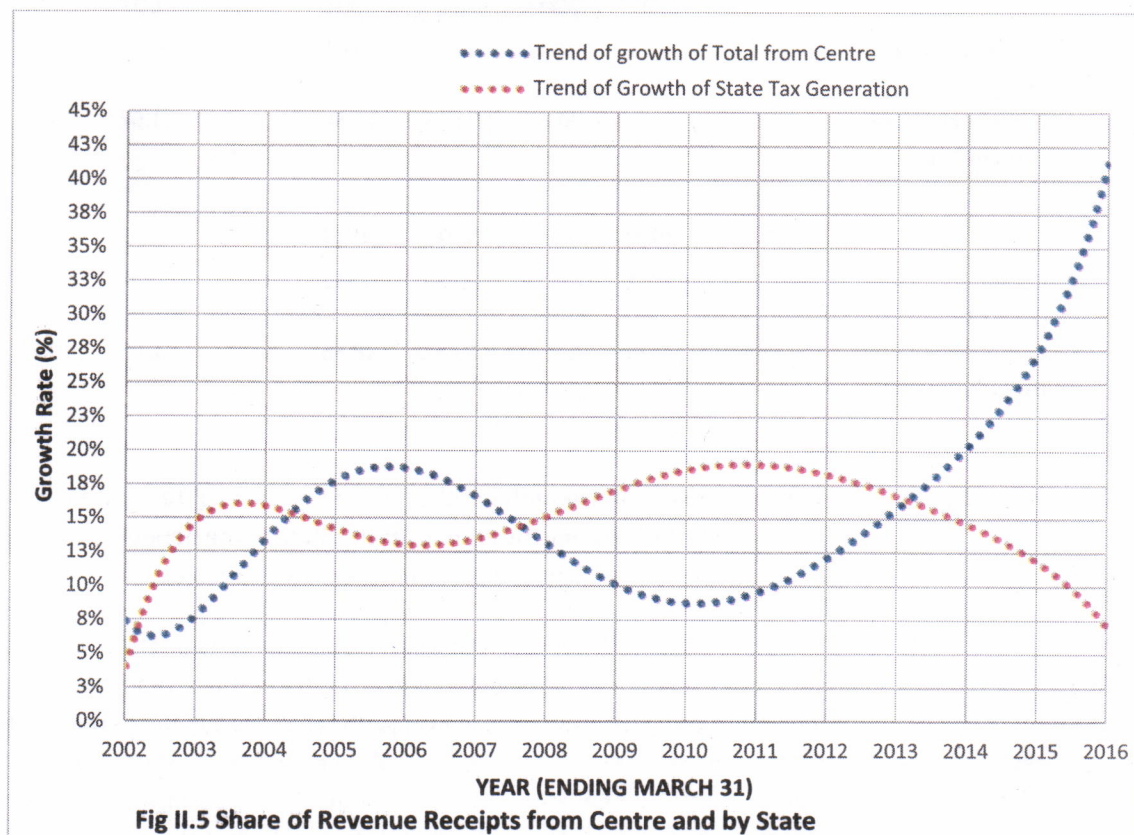
TABLE II.4A (2001-2016)			
FIVE YEAR AVERAGE SHARE AND GROWTH RATES OF COMPONENTS IN REVENUE RECEIPTS (Rs. Cr.)			
	2001-06	2006-11	2011-16
Growth Rate of Total (Share of Central Taxes and Grants) through GOI	13.00%	10.20%	25.00%
Share % of total through GOI in Rev. Receipts	28.40%	27.20%	26.20%
Growth Rate of SOTR	12.00%	17.20%	12.40%
Share % of SOTR in Rev. Receipts	65.20%	66.80%	64.00%
Growth Rate of Total State Revenues	11.60%	17.20%	14.20%
Share % by State effort in Rev. Receipts	71.60%	72.80%	73.80%

3.2. Share of Components of Revenue Receipts

- 3.2.1. Table II.4 also gives the share of each of the components of Revenue Receipts. The share of the contribution, both through the tax devolution and the grants, to the Revenue Receipts rose from 30% in 2006 to 32% in 2016, while the share in the total receipts from the revenue raised by the State itself fell from 70% to 68% during this period. Fig II.5 illustrates the percentage share of each item in the total Revenue Receipts.
- 3.2.2. Table II.4A shows the five year averages for growth rate along with share of the variable in Revenue Receipts. It is pertinent that despite a high growth rate in Total transfers from GOI, on account of the devolution through the XIV Finance Commission, the share in total Revenue Receipts in 2011-2016 has fallen below the average for the prior period 2006-2011. This would that efforts in revenue generation by the State had fallen behind.
- 3.2.3. What is particularly important to note, that the share of tax revenue in the total revenue receipts of the State fell from **64% in 2006 to 58% in 2016 after having peaked to an all-time high of 70% in 2011**. The total revenue effort of the State fell by two percent from 70% to 68% during this period.
- 3.2.4. Figure II.4 showing the relative movement of the state and central contributions more vividly illustrates the increased dependence of the State on the Centre revenues in the last three years (2013-2016).

Fig II.4 Share in RR

3.3. Growth of Components of Revenue Receipts



3.3.1. The growth of individual components of Revenue Receipts over the period 2001-2016 is shown in Table II.4. Fig II.5 graphically illustrates the growth rates of two major source components of the State's Revenue Receipts.

3.3.2. As can be seen from the Table and the Figure above, the items of Tax Revenue and Non Tax Revenue fell drastically from the levels in 2011, falling particularly in the last three years of the previous Government. But what is striking is that no Government in the past twenty years has enjoyed such an extent of growth in funds through the Union Government. As mentioned earlier, the present fiscal crisis is not withstanding this bonanza.

4. COMMERCIAL TAXES

4.1.1. Commercial Taxes constitute the major share of the revenues of Kerala, yielding approximately 50% of the State's total Revenue Receipts. For a fiscally constrained State like Kerala, Commercial Taxes is the mainstay for Government. Any slackening of the mobilization efforts on this front immediately plunges the State into a crisis. No Government can afford to ignore this reality. Table II.5 shows the collection on account of commercial taxes.

TABLE II.5 (COMMERCIAL TAX COLLECTIONS)

YEAR	2001	2002	2003	2004	2005	2006	2007	2008
Commercial Taxes (Rs. Cr.)	4344	4441	5343	5991	6701	7038	8563	9372
Commercial Taxes Growth Rate (%)		2.22	20.32	12.13	11.84	5.03	21.67	9.44

YEAR	2009	2010	2011	2012	2013	2014	2015	2016
Commercial Taxes (Rs. Cr.)	11377	12771	15833	18939	22511	24885	27908	30735
Commercial Taxes Growth Rate (%)	21.40	12.25	23.98	19.62	18.86	10.55	12.15	10.13

- 4.1.2. Figure II.8 contrasts the growth in collection of Commercial Taxes against the growth in Gross State Domestic Product of the State in the period 2006-2016. The broken lines show the trend curve for these two variables.
- 4.1.3. As is starkly evident, from a systematically build up to high growth rate of commercial tax revenues at nearly 24% in 2011, the last five years has seen a gradual followed by a sharp decline in growth rates. During the period 2006-2011, the growth rate of commercial tax collection for the most part exceeded the growth rate of the economy of the State often at impressive levels. However, unfortunately, and more starkly during the last three years of the period 2011-2016, the growth rate of commercial tax revenues lagged behind the economic growth of the State. The Commercial Taxes collection thus grossly underperformed the economy, as may be seen in Figure II.8.

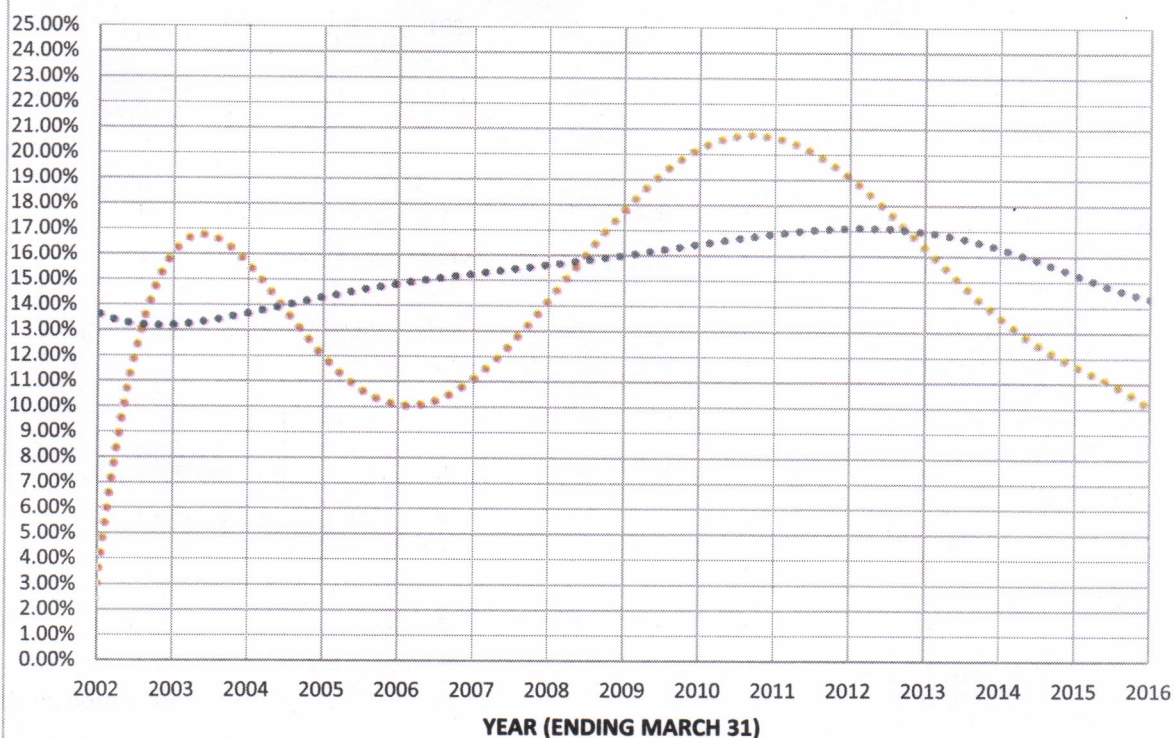


Fig. II.8 Trend in Growth Rates of Commercial Taxes and GSDP

- 4.1.4. Simple average of the three periods 2001-06, 2006-2011 and 2011-2016 were computed. Commercial taxes grew by 10.31% in 2001-2006, by 17.75% in 2006-2011 and then declined to 14.26% in 2011-2016.
- 4.1.5. This also becomes apparent from Figures II.9 and II.10, which shows the trends in share of Commercial Taxes in Revenue Receipts and as a percentage of GSDP respectively. The steep decline that had happened in the latter part of 2001-2005 was steadily corrected by 2006-2008. Thereafter, Commercial Taxes peaked to achieve an unprecedented high of over 51% of the total Revenue Receipts of the State. As a share of the GSDP, the position was built up diligently where the State could generate high levels of tax collection. The rising trajectory of these two curves would clearly suggest that the Government in 2006-2011 had built up a robust, well-oiled and effective tax collection machinery.

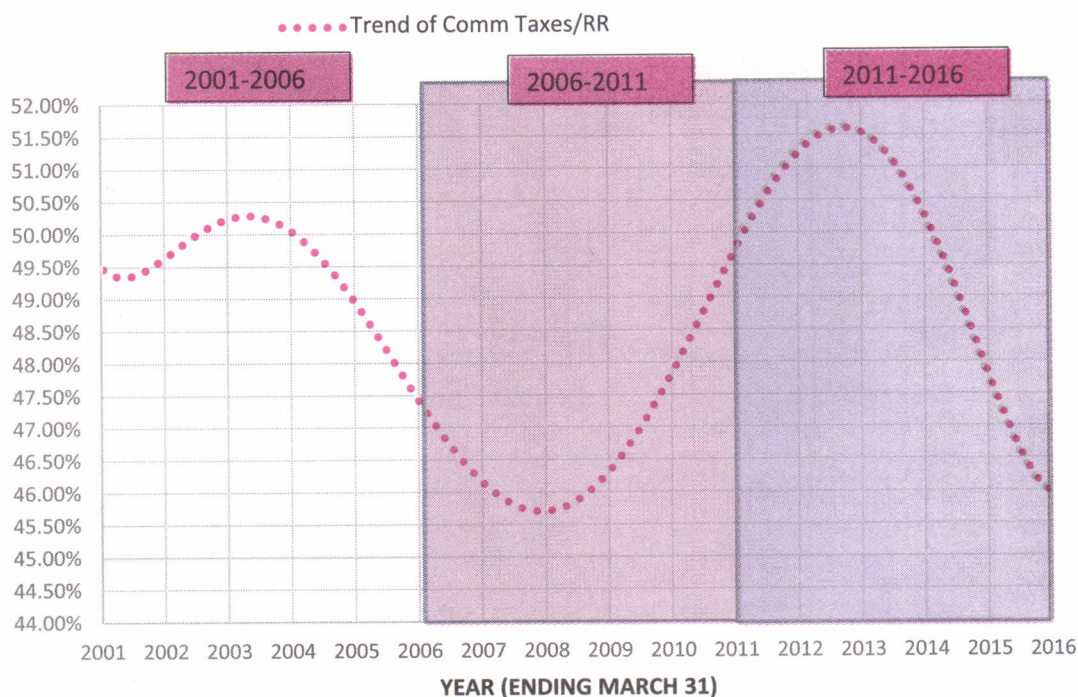


Fig II.9 Trend in Commercial Taxes as Share of Revenue Receipts (%)

- 4.1.6. The UDF Government in 2011-2016, of course did ride on the strength of the efforts for one to two more years, as is seen from the graphs. But just as it frittered away the cash balances as mentioned in Chapter I, the strong advantage in collection of commercial taxes was correspondingly frittered away in the last three to four years of the previous Government when commercial tax as a share of GSDP reached its lowest levels in this decade.

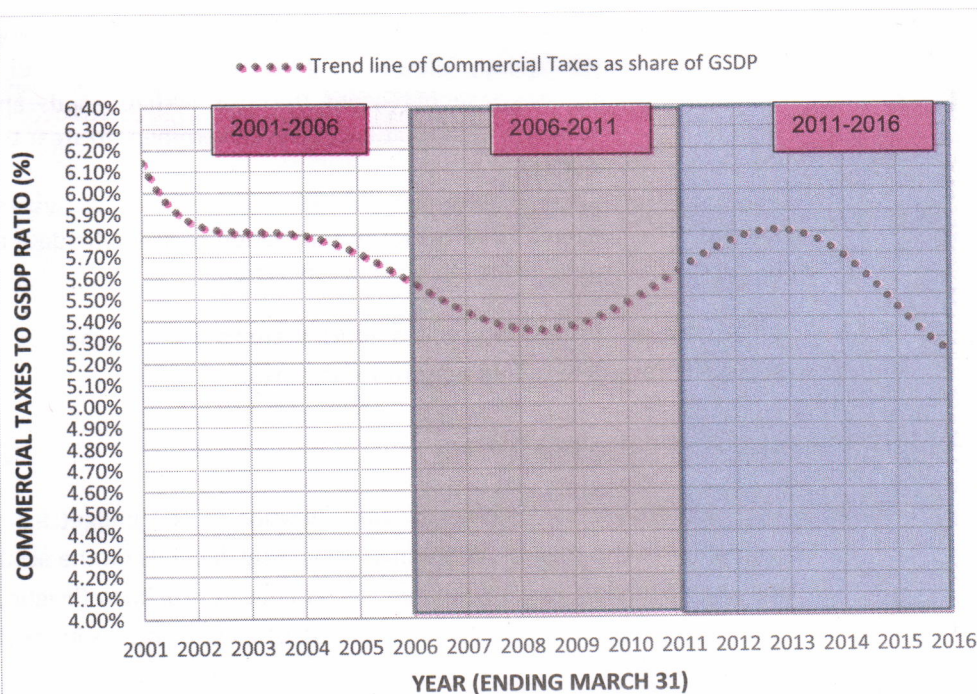


Fig II.10 Trend in Commercial Taxes as share of GSDP

5. WEAKENING OF THE TAX GOVERNANCE MACHINERY

5.1. Hypothesis and surmises

5.1.1. Why did the financial crisis happen? What explained the slide over the five years from a cash surplus state in 2011 well on its way to achieve its fiscal responsibility targets down to a State moving from one devolution from the Union Government to another every month for its survival? Why is it that Government did not perceive the storm coming early in its stage? Or did it shut a blind eye to the reality?

5.1.2. Many explanations are forthcoming. The following are the four reasons explaining the cause of the crisis.

- The crisis itself was due to the lack of cohesiveness in Government during 2011-2016, with one arm in Government doing things without the other arms being aware of it.
- The general lackadaisical directions of governance in general during that period, without the discipline that is so imperative in Government for effective revenue mobilisation. This indiscipline might well have seeped in to the tax administrative machinery in various departments, paving the way for easy subversion of administrative systems in place in these departments.

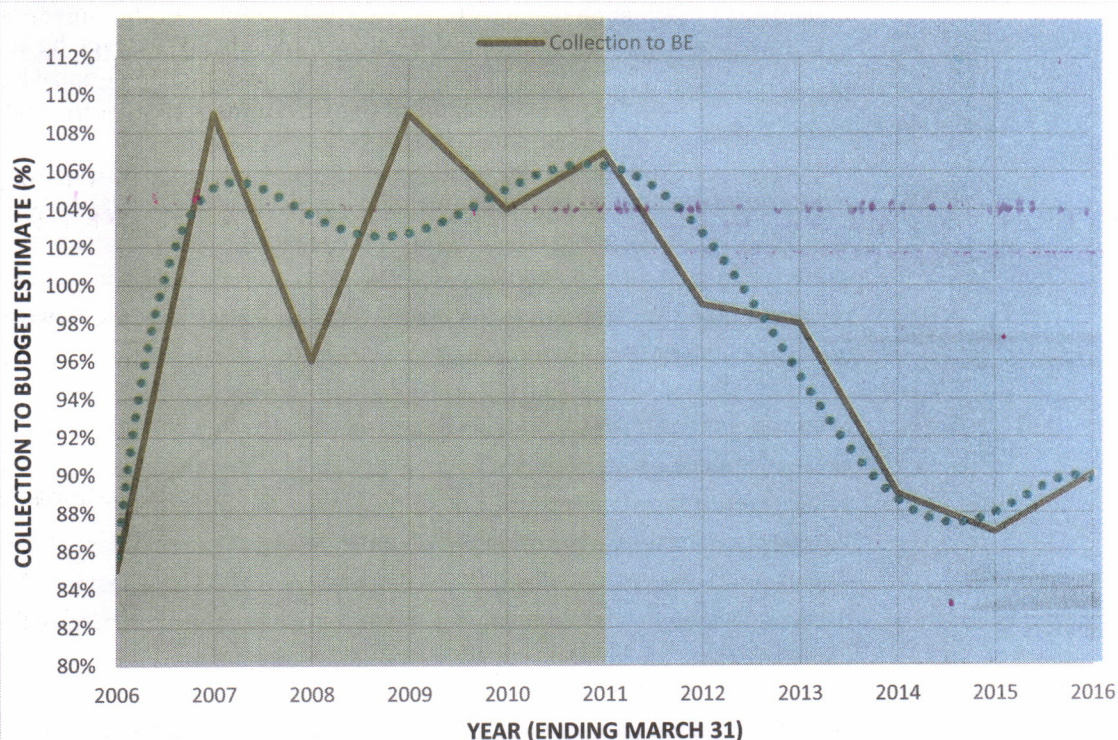
- Corruption and nepotism in the tax administrative apparatus was quietly allowed to grow strangely. Whatever be the reasons or set of reasons, the crisis has happened – and it has fallen on the shoulders of this Government to steer the State out of it.
- Sheer indifference to updating technological systems that should have been the foundation of scientific data analysis needed for effective tax collection.

5.1.3. But, in a paper of this nature, it is appropriate to focus on the quantitative and qualitative data to find reasons for this crisis.

5.2. Some suggestive data and pointers

5.2.1. The record of actual commercial tax collection to the budget estimate is instructive in this regard. While this ratio partly depends on the accuracy of budget estimation, it is a good and robust indicator for the efficiency of tax collection. Table II.6 and Fig II.10 show the peaking up of this index in 2006-2011 followed by a rapid decline in the period 2011-2016.

Year ending March 31	Budget Estimate (BE) (Rs.cr.)	Collection (Rs.cr.)	% with BE
2006	8211	6983	85%
2007	7937	8687	109%
2008	10042	9685	96%
2009	10624	11571	109%
2010	12742	13200	104%
2011	15138	16156	107%
2012	19442	19311	99%
2013	23467	22886	98%
2014	28481	25376	89%
2015	31940	27871	87%
2016	34741	31152	90%



**Fig II.11 Commercial Tax Collection (Actuals to Budget Estimate Ratios)
2005-06 to 2015-16.**

5.2.2. The decline in the ratio of collection to budget estimate would be much sharper if we take into consideration the ARM announced in the budget speeches. The collection figures are inclusive of the ARM collected. Thus for example, for the year 2015-2016, assuming the ARM on account of commercial taxes is Rs.1000 cr. out of the total ARM of Rs.1220 cr. announced in the budget speech and half the ARM announced mid-year, the total percentage of collection would decline from 90% to 85%.

**TABLE II.7
GOVERNMENT STAYS ON COMMERCIAL TAXES**

(Rs. Cr.)					
31.03.2011	31.03. 2012	31.03. 2013	31.03. 2014	31.03. 2015	31.03. 2016
54.31	112.12	249.85	230.19	222.44	116.43

5.2.3. Table II.7 shows the stays granted by Government in various departments. What the Table shows is that Government stays increased from Rs.54 cr. to Rs.250 cr. in 2013 and hovered around this figure for the next two years. It was only after the outbreak of the major fiscal crisis, that in 2015-2016 that some restraint was brought to bear on giving indiscriminate stays on tax collection.

5.2.4. Stays by Government and other appellate bodies together touched Rs.1290.61 cr. by the end of March 2015. This was the year when

Government had gone on Overdraft for the first time in a decade. Notwithstanding this, no control was kept on fresh stays and by the end of March 2016, this figure had shot up by nearly 30% and touched the figure of Rs.1667.38 cr.

- 5.2.5. From figures maintained by the Commercial Taxes Department, it is seen that in 2011-2016, Government issued stays on the collection of commercial taxes alone for an amount of **Rs.440.41 cr.** Clearly this does not suggest a serious response of any Government to the fiscal crisis or to the fact that the Treasury was constantly facing a cash shortage.
- 5.2.6. Even suggestions made by Finance Department in the height of the liquidity crisis, to impose a restricted regime on giving stays were not paid heed to. In some cases, informal directions not to levy taxes and penalties (e.g. Motor Vehicles Department and settlement of under valuation cases in Registration Department) were passed down to the department from the highest levels in these departments, thereby stymying efforts to mobilise resources to face the financial crisis.
- 5.2.7. From the documents mandated under the Kerala Fiscal Responsibility Rules 2005 and included in the Budget in Brief for 2016-2017, it is seen that at the end of the year 2014-2015, there was an accumulated amount of Rs.13019.81 cr. of which sixty percent of the cases were undisputed. Table II.8 shows the breakup of this amount. While there can be no argument that all of that amount can be collected, no special or concerted efforts are seen mounted for attempting to realise even a modest share of that amount.

TABLE II.8 TAX REVENUES RAISED BUT NOT REALISED (End of FY 2014-15)				
	Agri. Income, Profession al Tax	Land Revenue, Stamps and Registration	Sales Tax, CST, Excise, Motor Vehicles Tax	TOTAL
Disputed	62.89	106.73	5013.25	5158.39
Undisputed	65.04	125.20	7695.66	7861.42
TOTAL	127.93	231.93	12608.91	13019.81

- 5.2.8. Even when the finances of the State continued to remain stressed and on the verge of a breaking point, concessions were lavishly handed out on taxes. Even in the four budgets from 2012-13 to 2015-16, concessions worth not less than **Rs.881 cr.** were made in many cases to select groups of taxpayers, who benefited more than others. The reduction in registration fees of family partition deeds is one glaring such example. All partitions irrespective of the

size of the land holding had to pay only Rs.1000. A person owning 10 cents and 100 acres were treated alike. The duty free status of police canteen proved to be another major leakage on state tax revenue. All this clearly suggest that the indiscipline even in the face of the stark reality of a fiscal crisis was so gross that public interest and the finances of the State were all given only a secondary consideration.

- 5.2.9. As on April 30, 2016, an amount of Rs.3720.62 cr. collectable in the Commercial Taxes Department was pending in appeals as seen from Table II.9. In all these cases, the crux of the matter is to what extent Government attempted sincerely to have the blocked amounts recovered. There does not seem to have been any targeted follow up to expedite the cases, even in the wake of the financial crisis. It is also a tragedy that the appeal process often becomes steeped in corruption with the Deputy Commissioners (Appeals) remanding ripe cases overlooking even judicial pronouncements. Those who resisted the pressures found themselves helpless. There is a case where a Deputy Commissioner (Appeal) was changed three times till a pliant officer was found who would oblige the vested interests.

TABLE II.9		
CASES IN APPEAL (As on April 30, 2016)		
Name of Appellate Authority / Court	Number	Amount involved (Rs. cr.)
Deputy Commissioner (Appeals) & Assistant Commissioner (Appeals)	24156	1388.66
Sales Tax Appellate Tribunal	4020	1057.40
High Court	1858	643.37
Supreme Court	131	631.19
TOTAL	30165	3720.62

- 5.2.10. Table II.10 shows the ratio of Offences detected to the Vehicles Inspected ratio by the Commercial Taxes Department. The percentage detection which peaked in 2010-2011 has slid downward particularly sharply in the last two years of the previous Government.

TABLE II.10 – VEHICLE INSPECTION	
Year (ending March 31)	Offences detected to Vehicles Inspected Ratio
2011	12.62%
2012	11.59%
2013	11.18%
2014	11.54%
2015	10.10%
2016	7.11%

- 5.2.11. Returns Scrutiny is a good measure of tax enforcement efforts of the Commercial Taxes Department. Table II.11 shows the ratio of Returns scrutinized to the total number of registered dealers. The intensity of efforts has slackened particularly over the last two years 2014-2016. It should also be borne in mind that the scrutiny that is referred to is mere technical scrutiny – even this was not undertaken for half the persons in the tax net.

TABLE II.11 – SCRUTINY OF RETURNS	
Year (ending March 31)	Returns scrutinized to Dealer Ratio
2012	0.40
2013	0.59
2014	0.54
2015	0.49
2016	0.48

- 5.2.12. The report of the Comptroller and Auditor General on KVATIS in 2015 has documented in detail, how addition of simple validation procedures could have avoided significant leakages. The truth of the matter is that there was no attempt to update the systems since its introduction in 2008. Even the computer server capacity was not expanded, so much so that it became very difficult for taxpayers to access the database for even remitting their tax.

5.3. Broad Findings on Revenue Mobilisation (2006-2011)

- 5.3.1. From the data on Resource mobilisation and its graphical analysis, it is evident that there has been a significant subversion of the tax generating machinery in our State. That the tax collection was lagging behind the growth of the economy further reinforces this finding. The revenue generating departments were not empowered fully to effectively mobilise resources.
- 5.3.2. Stays were given without any restraint, notwithstanding the fiscal crisis. Budgetary concessions were announced to sections of taxpayers. Huge amounts of resources were allowed to idle in stays in various appellate judicial forums. Extra special efforts that were needed to tide over the crisis was not taken to expedite the settlement of cases of revenue collection under litigation.
- 5.3.3. Significant tax concessions were given even through budgetary announcements even at the peril of a collapse of the treasury which was already starved for funds.

6. SUMMARY AND FINDINGS

6.1. Causes of the crisis

- 6.1.1. Clearly as seen from Chapter I and the narrative above, the present crisis has clearly two dimensions viz. on the expenditure and the revenue side. The financial stress build up seems to be a failure both on expenditure control and resource mobilisation. As seen from Chapter I and the discussions above in this Chapter, there seems to have been little thrust on pruning expenditure or on the implementation of the economy measures. Similarly, all caution was thrown to the winds in announcing new schemes without matching budget provisions in the hope that tomorrow would take care of itself!

6.2. Expenditure Management

- 6.2.1. On the dimension of expenditure management, the following seem to be the primary reasons for the present situation.
- Overinflated Plan budgets beyond estimated resource capacity leading to underachievement on the Annual Plans, but not before severe fiscal stresses are triggered off through the administrative sanctions that are issued annually for these schemes but which do not have the underlying funds.
 - Announcing major projects in budget which are not matched by the ARM needed to bring in resources for the expenditure on the projects. These projects are taken up for implementation and in the process the annual budgets get breached.
 - Less effective control on Revenue Expenditure explains the rise of this variable. This is reflected in the measure computed from total Non-Plan Revenue Expenditure minus Salaries, Interest and Pensions (NPRE *minus* SIP).

6.3. Revenue Mobilisation

- 6.3.1. On the revenue mobilisation dimension, the following are the major reasons that explain the current crisis.
- Underperformance of the tax collection machinery in general over most part of 2011-2016 to the extent that the revenue generation rate lags behind the growth of the economy for most of the period 2011-2016.
 - Huge amounts of stays issued by Government during the period 2011-2016.

- Very little progress and initiative to expedite the disposal of cases in appeals and stays.
- Non realization of ARM announced and hence consequent pressure and imbalance in the budget.
- Concessions offered to benefit certain groups of tax payers which amounted to sacrifice of revenues already being received.
- Unwritten reluctance in certain cases to ensure that legally mandated revenue generation measures are implemented.
- Failure to implement technology support in the major tax collection departments to give advanced data analytics support for tax collection and monitoring

CHAPTER III

OUTLINES OF A STRATEGY

1. The grave fiscal crisis that the State faces is a reality that every one of us has got to accept. The present ways and means impasse will very soon deteriorate into fiscal breakdown if the present trends are allowed to continue. This is a major conclusion of the opening Chapter. It can be no more camouflaged through window dressing of the budget. Our discussion in the second Chapter identified the twin factors responsible for the situation. One is growth of the Non Plan Revenue Expenditure net of Salaries, Pension and Interest. The second is the sharp deceleration in the growth of State tax revenue. These twin factors also point out to possible interventions needed to moderate the crisis situation. It is imperative that remedial actions be taken immediately to meet the new fiscal challenges that are looming large before us.

2. IMMEDIATE FISCAL CHALLENGES

2.1. No Revenue Deficit Grant after 2017-2018

- 2.1.1. The Revenue Deficit Grants for Kerala in the award of the XIV Finance Commission is as shown below:

TABLE III.1 – REVENUE DEFICIT GRANTS UNDER XIV FC AWARD				
2015-16	2016-17	2017-18	2018-19	2019-2020
4640	3350	1529	0	0

- 2.1.2. The grants taper off to 0 by 2018-2019. Thus there will be a shortfall of Rs.1290 cr. in 2016-2017 and Rs.3111 cr. in 2017-2018 than what was received in the last year of the previous Government viz. 2015-2016. In this fiscally strained situation, the reduction will impose considerable pressure on the budget particularly in the current year.

2.2. Increased devolution to LSGIs.

- 2.2.1. It is this Government's avowed intention to ensure that the decentralisation process is strengthened further and increased allocations are made to LSGIs. The previous Government had not made any devolution in the budget on the basis of the award of the V State Finance Commission.

- 2.2.2. Government will have to consider this Award afresh and make necessary allocation on the basis of that. This will put further load on the State Exchequer.

2.3. Arrears of Pay revision

- 2.3.1. The arrears on account of Pay revision under the X Pay Revision have been staggered to be paid in four instalments over the years 2017-18 and 2018-2019. The first instalment of these arrears amounts to Rs.4442.26 cr. and will fall due on April 1, 2017.
- 2.3.2. Clearly, this amount is about 180% of the current monthly salary bill. Government will have to save this amount during the current year itself for making the payment successfully on April 1, 2017. This will need careful treasury management to ensure that the payments are not disrupted.

2.4. Redemption of liabilities

TABLE III.2 - DEBT SERVICING CHARGES (2017-2022) (Rs.cr.)				
	Maturity Redemptions	Interest Payments	Total Debt Servicing	Average monthly requirement
2017	3851.02	8798.15	12649.17	1054.10
2018	5529.18	8609.03	14138.20	1178.18
2019	6772.64	8143.59	14916.23	1243.02
2020	6726.08	7574.56	14300.65	1191.72
2021	6727.99	7084.50	13812.48	1151.04
2022	10071.15	6419.08	16490.23	1374.19

- 2.4.1. A significant bulge is observed in the repayment profile of the State loans availed by way of internal debt during the next five years. There is a huge outflow due to redemption of public debt in the next few years as shown in Table III.2.
- 2.4.2. This means an average of Rs.1050 to 1375 cr. will have to be found each month on an average to service past debt liabilities in the next five years.

2.5. Bridging the Infrastructure Deficit

- 2.5.1. Because of the high fiscal deficits that have been typical of the State finances, capital expenditure (CAPEX) has suffered hugely. The pickup in CAPEX during 2006-11 could not be sustained thereafter. This is one of the reasons why Kerala does not enjoy quality infrastructure in comparison with several states in India. It is also pertinent to note that many of States who focus better on their CAPEX also have substantial off-budget borrowing for

infrastructure through their corporations. Kerala has not been able to invest modestly through its corporations (KSEB, KWA, KINFRA, KRFB etc.) in infrastructure largely for lack of budget financing.

- 2.5.2. The Table below has been compiled from data using the Study on State Finances (2015-16) by RBI and available data published by Government of India on GSDP for the year 2013-14.¹ But this table is indicative and is a pointer to the huge deficit in capital expenditure that Kerala is suffered year after year. Grants to the Local Self Governments are now booked as revenue grants even though it is estimated that nearly 40-50% of the amount is spent on capital works. Even if this correction is made, the infrastructure deficit is very evident in the figures.

TABLE III.3 CAPEX/GSDP Ratios for 2013-14	
State	CAPEX/GSDP
Uttar Pradesh	7.05%
Andhra Pradesh	5.74%
Rajasthan	5.58%
Karnataka	5.39%
Orissa	5.23%
Gujarat	4.91%
Madhya Pradesh	4.53%
Tamil Nadu	3.57%
Maharashtra	2.23%
Haryana	1.98%
West Bengal	1.85%
Kerala	1.79%
Punjab	1.27%

- 2.5.3. Even assuming that the State should be targeting a rate at the average of the CAPEX/GSDP ratios of the neighbouring states, Kerala would have to invest about 4% of its GSDP in capital works. This would mean a CAPEX outlay of Rs.24000 cr. in the current year itself. Had the State continued the high rate of growth in CAPEX that was achieved in 2006-11, then it should have been possible to do so by now. But given the present fiscal situation, the task is simply impossible. This will need innovative solutions through the Annual Budgets.

¹ These figures are liable to be marginally altered on the basis of corrections in GSDP.

3. MACROECONOMIC ISSUES

- 3.1. Needless to say, the growth of the economy of Kerala, and that for matter any State or region of the country is inextricably linked to the national Growth. There is a degree of correlation between GDP growth rate and GSDP growth rate in general.
- 3.2. Events like **Brexit** and the oil price recession will have its effect on our national economy as well. The shocks and the triggers—both the pain and the gain—will no doubt be transmitted to our State in varying degrees. However, it is not feasible to take advance steps to plan for all the various eventualities and their outcomes. We will therefore have to be flexible in adapting to situations that might emerge in the future. The key is to anticipate sufficiently in advance and nimbly adapt to such situations as they unfold.
- 3.3. The immediate concerns as a State economy is the risk of our foreign NRI remittances dwindling. As seen from the figures circulated in the State Level Bankers Committee, the total volume of NRI remittances in rupee terms, has not shown any serious signs of shrinking. However, once an allowance is made for the exchange rate variations, the figures might just belie any optimism.
- 3.4. The decline in the rubber and price of other commercial crops has had a deleterious impact on the regional economy. In fact the growth rate of GSDP has declined to below the national average after maintaining exemplary robustness for more than two decades. These are times when the State Government has got to resolutely intervene to sustain the growth process. But unfortunately the State Government has been stymied by the fiscal crisis.
- 3.5. Having realised the gravity of the situation, the Government of Kerala shall work out a strategy for greater fiscal consolidation without impairing accelerated public/public-led investment so that we meet the challenge of economic deceleration.

4. STRATEGY OPTIONS

4.1. Sensitivity Analysis of selected Revenue and Expenditure Items

- 4.1.1. Table III.3 contains the results of a sensitivity analysis done with available past data. For this purpose, the revenue variables used are Commercial Taxes, all other tax revenue (e.g. Excise, Transport, Registration etc.). The expenditure components examined are Salaries, Interest and Pension (SIP) and Non Plan Revenue Expenditure *minus SIP (NPRE minus SIP)*.
- 4.1.2. For, projections for 2016-17, moving averages of the previous five years are used. However where future values on account of Share of Central Taxes,

Revenue Deficit Grant etc., are available the actual available data are used. GSDP figures are as estimated with a 13% Growth Rate.

- 4.1.3. One obvious limitation of this analysis is that the forward impact on GSDP on account of the changes in the Revenue and Expenditure variables are ignored. But this does not affect the accuracy for the purposes of this Paper.
- 4.1.4. For instance, a 1% increase in a revenue item like Commercial Taxes will improve the RD/GSDP and GFD/GSDP ratio by 0.04662% in 2016-2017 as shown in Col (1). This increase will have an effect of net addition in receipts by Rs.307.35 cr. The figures in the column (2) to (5) similarly reflect the increases for a 1% increase in an item subject to the condition that a similar increase of 1% has been made in the all previous years in that revenue item.
- 4.1.5. Similarly a 1% decrease in an expenditure item like Salaries, Interest and Pension (SIP) leads to an improvement of 0.06815% in RD/GSDP and GFD/GSDP. This decrease will cause a net reduction of expenditure by Rs.449.32 cr. in absolute terms. The figures in the column (2) to (5) similarly reflect the decreases for a 1% decrease in an item subject to the condition that a similar decrease of 1% has been made in the all previous years in that expenditure item.

TABLE III.3 SENSITIVITY TABLE

(A) is the effect of 1% change in the variable on RD/GSDP and GFD/GSDP (B) is the effect of 1% change in absolute terms in Rs.cr.						
YEAR (ENDING MARCH 31)		2017	2018	2019	2020	2021
		(1)	(2)	(3)	(4)	(5)
REVENUE COMPONENTS						
Commercial Taxes	(A)	0.04662	0.05532	0.06509	0.07699	0.09118
	(B)	307.35	412.16	547.96	732.40	980.14
Other Items of Revenue (Excise, Motor Vehicle Taxes etc.)	(A)	0.01254	0.01487	0.01748	0.02065	0.02443
	(B)	82.67	110.77	147.13	196.47	262.65
Central Government Transfers	(A)	0.03686	0.03166	0.02723	0.02527	0.0227
	(B)	243.02	235.90	229.26	240.35	244.05
EXPENDITURE COMPONENTS						
Salaries, Interest and Pension (SIP)	(A)	0.06815	0.15017	0.24604	0.35788	0.48746
	(B)	449.32	1118.76	2071.37	3404.53	5240.09
NPRE minus SIP	(A)	0.0283	0.0647	0.1088	0.1605	0.2195
	(B)	186.87	482.39	915.61	1526.85	2359.68

4.2. Strategy Options

- 4.2.1. Government will have to take into account the above reality while charting a course of action to steer the state finances out of the crisis it has landed in. The course of action will have to be built around Government's avowed policy commitment on increased outlays on welfare pensions and support for the workers in traditional workers in coir, fisheries, handloom, textiles, cashew etc. It will have to invest in maintaining an efficient public distribution system. It has to invest in the maintenance of public infrastructure like hospitals, schools and colleges. Finally, the savings from fiscal consolidation will have to reflect in enhanced capital expenditure.
- 4.2.2. Some of the variables show a high sensitivity. For instance, SIP has the highest sensitivity as shown in the Table. But change in the short term is not possible in this variable as the expenditure whether it is on salaries, or pension or interest on loans availed is committed or historically built up and is part of the financial legacy that successive Governments inherit. So also, Grants from the Centre are solely under the control of the Union Government and the State has absolutely not much discretion over this except to ensure that new proposals are submitted in time and that available claims and requests are submitted to Government of India on time for release of funds under the Centrally Supported schemes. Share of Central Taxes is as per the formula decided by the Finance Commissions and the amount that flows on share is linked to the direct and indirect tax collections of the Union.

4.3. Expenditure Management

- 4.3.1. One important insight derived from the sensitivity table (Table III.3) is that there is no easy shortcut to fiscal consolidation.

Given this caveat, Government will have to devise a financial strategy on the expenditure side that will be centred around two principles:

- 1. Firstly, exercise of strict control over Non Plan Revenue Expenditure minus Salaries Interest and Pension (SIP).***
- 2. Secondly, ensuring that SIP is moderated at reasonable and sustainable levels.***

4.4. Revenue Mobilisation

- 4.4.1. Given the relative insensitivity and the rigidity attached to the variables on the expenditure side, the only practical course would be to galvanize the tax collection machinery in all departments, particularly in the major revenue

earning departments like Commercial Taxes, Motor Vehicles, Registration, Revenue and Excise. Given the high sensitivity of Commercial Taxes in fiscal consolidation, this obviously has to be the mainstay of our steering the State out of this crisis.

Kerala would have to gear up its tax machinery and ensure that growth rates in tax collection are sustained at 20-25% per annum for the next five years. There is no escape from this conclusion given the limited range of fiscal choices available to the State.

4.5. Capital Expenditure

4.5.1. Kerala cannot wait for the fiscal crisis to be resolved to step up capital expenditure in the State. There is already a recession gripping the economy and CAPEX will have to go up. Major step up in CAPEX is necessary to give the desired boost to the economy.

4.5.2. Bridging the infrastructure deficit will have to be one of the foremost critical priorities of Government. Given the constraints identified above in charting the fiscal trajectory, clearly there will be a limit to the quantum of capital expenditure, we can carry within the budget itself. Therefore, the key is to use innovative methods adopted by countries all over the world and by many of our States who are ahead in building their public infrastructure. Essentially this will lie in mobilising off-budgetary resources through the various financial and infrastructure institutions in the State for taking up and completing major capital projects that the State badly needs.

To this end, wherever necessary, we shall innovatively adapt the legal framework for existing institutions and wherever needed create special purpose vehicles for launching implementation of major capital projects in the State on a massive scale.

We will only say that whatever limited resources that we can mobilise for capital expenditure should be utilised to leverage much larger extra budgetary resources.

4.5.3. ***In short, from among the variables discussed above, an appropriate choice has to be made prudently. The mix of strategies will have to be weighed and calibrated against***

the development aspirations of the State. This no doubt, will have to unfold in the annual budget in the coming years. The way we intend to take up this challenge will be reflected in the forthcoming budget. Nevertheless we would like to emphasise that even for this strategy to succeed, we have to definitely adhere to the basic principles of fiscal consolidation.

APPENDIX

HISTORICAL PERSPECTIVE ON STATE FINANCES

1. Revenue Receipts

1.1. Outline on Revenue Receipts

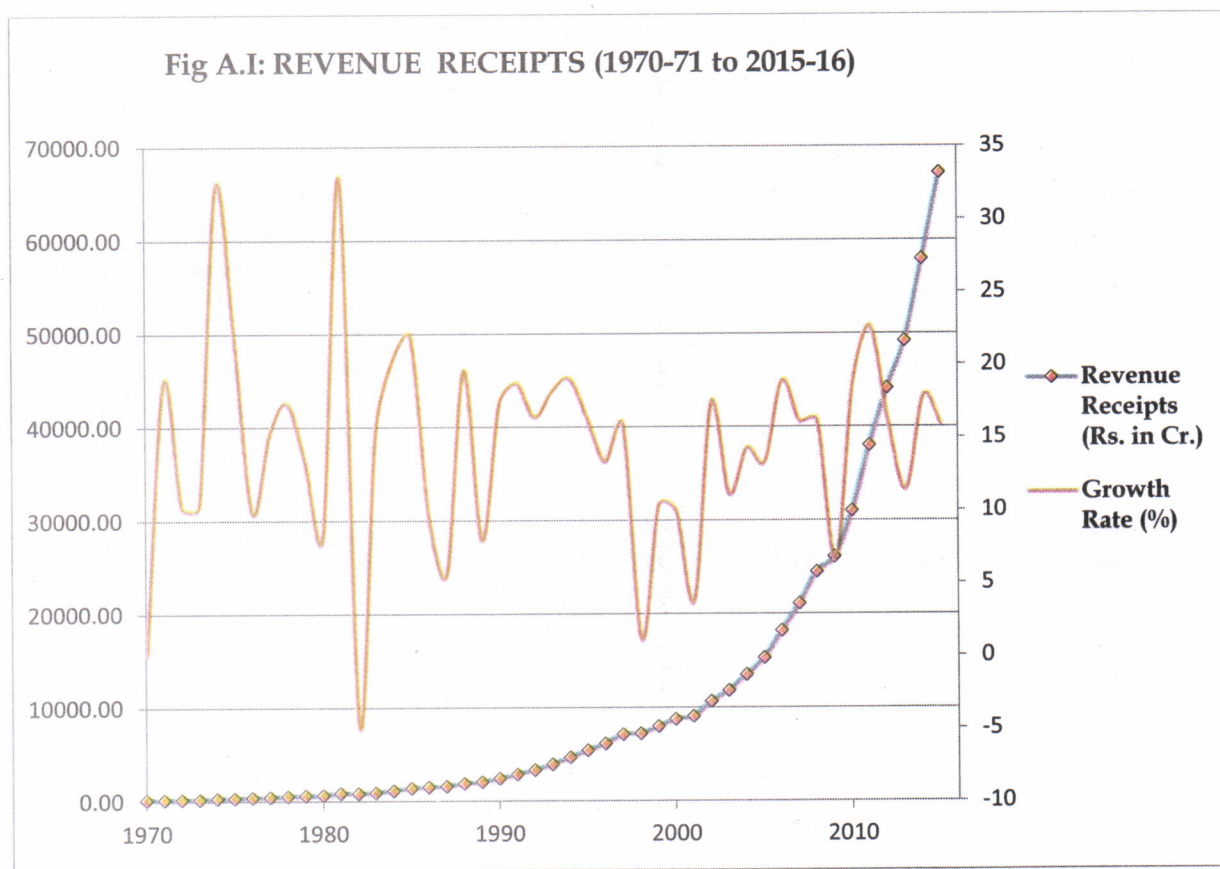
- 1.1.1. Table A.I shows the figures for Revenue Receipts over the four decades from 1970-71 to 2009-10. Fig A.I graphically depicts the growth of Revenue Receipt over this period. In the interim budget 2016-17 the revised estimate of revenue receipts for 2015-16 is Rs.71019.72 cr. and budget estimate for 2016-17 is Rs.84092.60 cr.. However, the latest provisional accounts of the Accountant General shows a figure of Rs.67149.90 cr. for 2015-16. The growth characteristics of revenue receipts in the State over the last four decades are shown in Table A.II.
- 1.1.2. The average growth rate of revenue receipts for the four decades is 13.90%. The growth rate of revenue receipts has been showing a decline trend in the first three decades with 16.49 %, 13.69%, 12.67% for seventies, eighties and nineties respectively. Revenue receipts has shown a marginal improvement in two thousands and recorded a growth rate of 12.74 %. During the last six years this has shown a growth rate of 17.10%.
- 1.1.3. The increase in revenue receipts is mainly on account of routing of grant-in-aid in respect of direct funding Centrally Sponsored Schemes through State budget in 2014-15 and higher tax devolution from 14th Finance Commission in 2015-16.

TABLE A.I							
Revenue Receipts (Rs. in Cr)							
(1957-58 and 1970-71 to 2015-16)							
Year	Amount	Year	Amount	Year	Amount	Year	Amount
1957-58	31.50						
1970-71	150.79	1982-83	810.20	1994-95	4666.42	2006-07	18186.62
1971-72	179.19	1983-84	934.26	1995-96	5423.56	2007-08	21106.79
1972-73	197.40	1984-85	1124.99	1996-97	6145.07	2008-09	24512.18
1973-74	217.71	1985-86	1371.17	1997-98	7118.19	2009-10	26109.40
1974-75	287.97	1986-87	1502.53	1998-99	7198.12	2010-11	30990.95
1975-76	351.56	1987-88	1586.09	1999-00	7941.75	2011-12	38010.36
1976-77	386.18	1988-89	1897.06	2000-01	8730.86	2012-13	44137.30
1977-78	444.94	1989-90	2047.64	2001-02	9056.39	2013-14	49176.94
1978-79	522.15	1990-91	2402.94	2002-03	10633.89	2014-15	57950.47

1979-80	591.62	1991-92	2852.12	2003-04	11815.37	2015-16	67149.90
1980-81	640.38	1992-93	3318.70	2004-05	13500.49		
1981-82	850.48	1993-94	3921.76	2005-06	15294.53		

1.2. Growth characteristics of Revenue Receipts

TABLE A.II					
Growth Characteristics of Revenue Receipts					
40 year Growth Rate					
	G R	G R	G R	G R	G R
	70s	80s	90s	2000s	2011-16
13.90%	16.49%	13.69%	12.67%	12.74%	17.10%



2. Revenue Expenditure

2.1. Outline on Revenue Expenditure

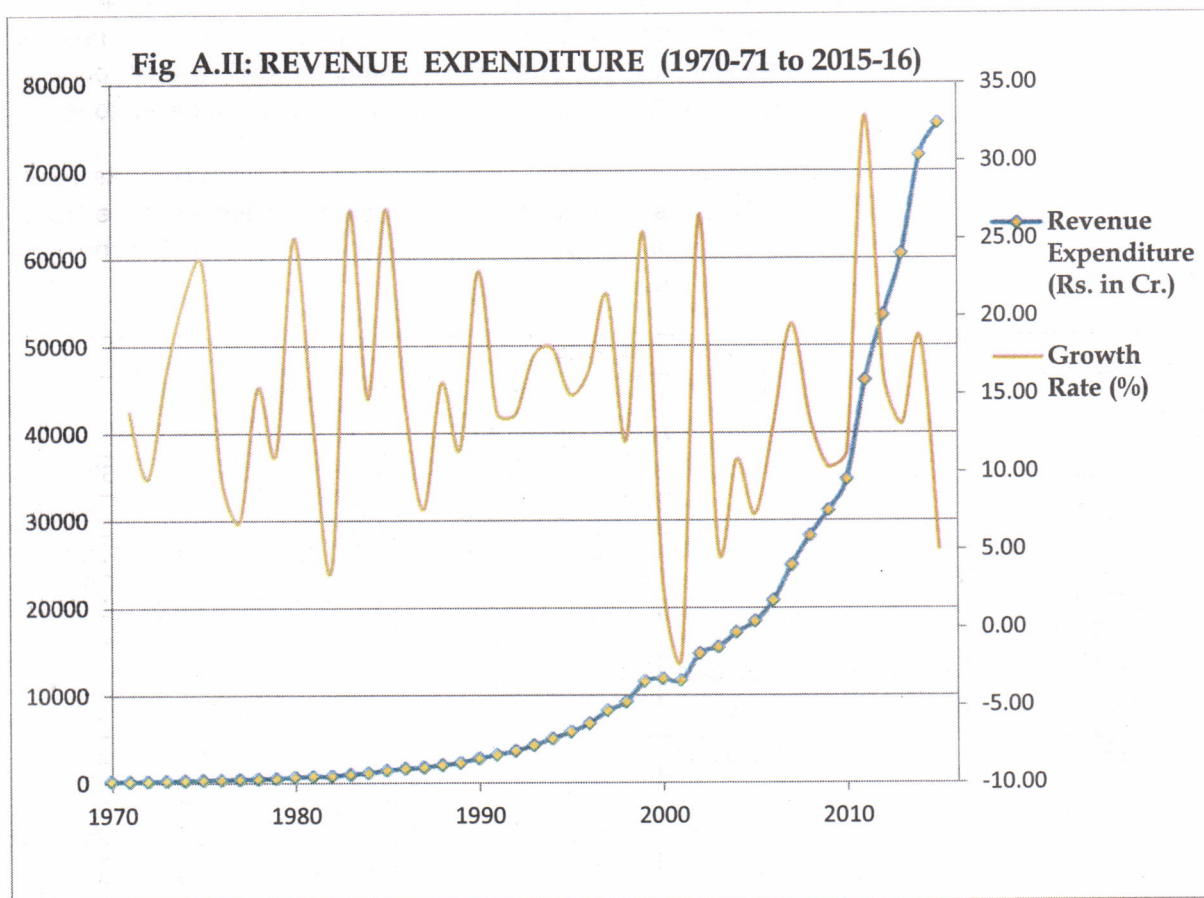
2.1.1. The figures for revenue expenditure for the four decades under analysis are presented in Table A.III and Fig A.II. The revised estimate of revenue expenditure for 2015-16 is Rs.81834.21 cr. and the budget estimate for 2016-17 is Rs.93990.06 cr. However, the provisional figures for 2015-16 released by the Accountant General shows a revenue expenditure of only Rs.75349.05 cr.

2.1.2. The growth rates during the first three decades have been around 15-16 % which declined to 10.68 % in two thousands. The average growth rate during the last six years is 16.18 %. This is attributed to increase in Salary Expenditure due to 9th pay revision, 4th SFC recommendations and enhanced DA/DR allowance given to State employees due to inflationary pressures in the economy.

TABLE A.III							
Revenue Expenditure (Rs. in Cr)							
(1957-58 and 1970-71 to 2015-16)							
Year	Amount	Year	Amount	Year	Amount	Year	Amount
1957-58	32.9						
1970-71	163.8	1982-83	783.39	1994-95	5066.3	2006-07	20824.57
1971-72	186.51	1983-84	992.44	1995-96	5826.38	2007-08	24891.63
1972-73	204.35	1984-85	1138.66	1996-97	6788.1	2008-09	28223.85
1973-74	237.37	1985-86	1445.34	1997-98	8241.09	2009-10	31132.38
1974-75	287.66	1986-87	1654.77	1998-99	9228.08	2010-11	34664.81
1975-76	355.05	1987-88	1780.68	1999-00	11565.96	2011-12	46044.62
1976-77	389.48	1988-89	2061.00	2000-01	11877.92	2012-13	53488.74
1977-78	415.89	1989-90	2298.09	2001-02	11662.03	2013-14	60485.50
1978-79	479.94	1990-91	2824.98	2002-03	14756.05	2014-15	71746.43
1979-80	533.78	1991-92	3216.47	2003-04	15495.67	2015-16	75349.05
1980-81	667.61	1992-93	3656.14	2004-05	17169.41		
1981-82	754.5	1993-94	4293.36	2005-06	18423.68		

2.2. Growth characteristics of Revenue Expenditure

TABLE A.IV					
Growth Characteristics of Revenue Expenditure					
40 year Growth Rate	G R	G R	G R	G R	G R
	70s	80s	90s	2000s	2011-16
	15.03%	15.93%	14.69%	10.68%	16.18%



3. Revenue Deficit

3.1. Outline of Revenue Deficit

- 3.1.1. Revenue Deficit is the difference between revenue expenditure and revenue receipts. In other words, it indicates the extent of funds needed to supplement the income of the State for meeting its day – to – day expenditure. The State Government has been devolving huge fund to

Local Self Governments as revenue grants. Over 50 % of this revenue grants to Local Self Governments is spent to create capital assets and present accounting system prevents to classify this grants as capital expenditure. Hence, if this portion of revenue expenditure is reclassified as capital expenditure the revenue deficit would reduce to that extent. Moreover, State is not able to reduce revenue expenditure beyond certain extent because of its commitments in social sector and increase in salary, interest payments and pension, which is mainly attributed as reason for the burgeoning revenue deficit of the State.

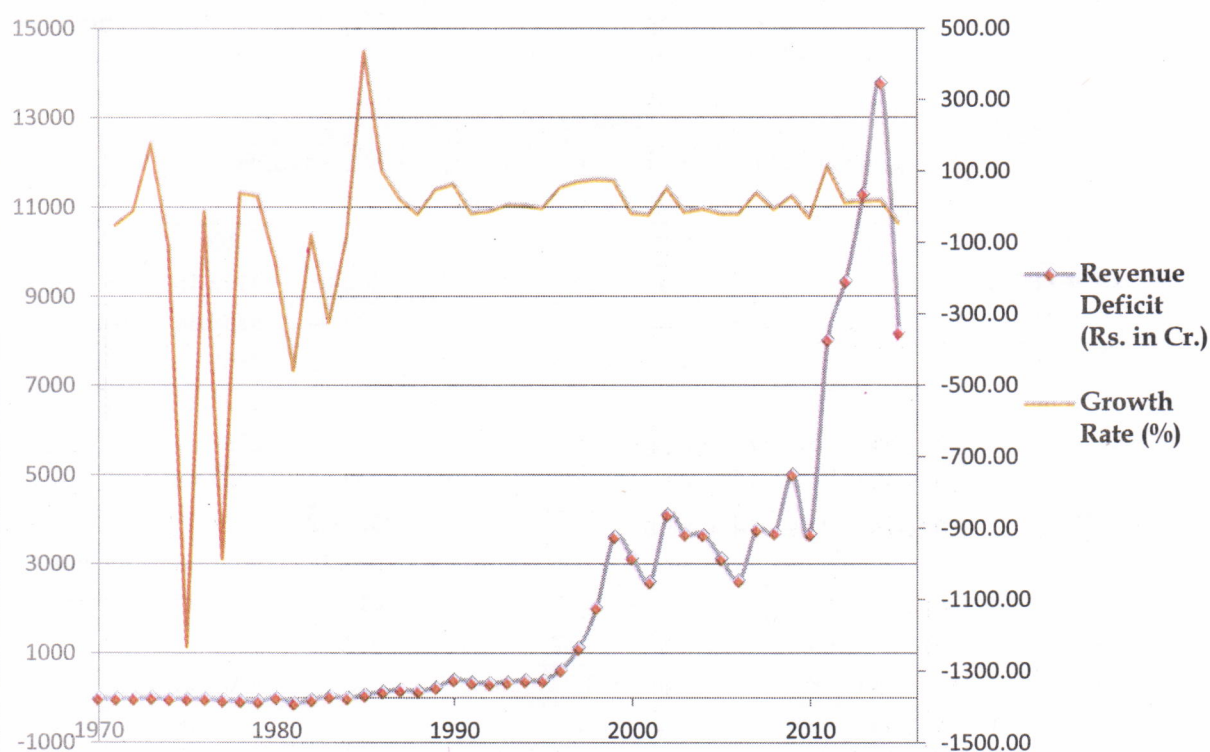
- 3.1.2. The revised estimate of Revenue Deficit for 2015-16 is Rs.10814.49 cr. and the budget estimate for 2016-17 is Rs.9897.46 cr. The provisional figure of revenue deficit assessed by the Accountant General for the year 2015-16 is lower at Rs.8199.15 cr. The table reveals that, revenue deficit has shown steep increase in the years in which cash outflows had taken place due to various pay commission recommendations.
- 3.1.3. Revenue Deficit has increased from Rs.2030 cr. in 1998-99 to Rs.13796 cr. in 2014-15. As against the State targets to reduce Revenue Deficit to Nil by 2014-15 as envisaged in the Fiscal Responsibility Act, the State has not been able to achieve the target.

TABLE A.V								
Revenue deficit (RD) (Rs. in Cr) with annual growth rates (GR)% (1970-71 to 2015-16)								
Year	RD	GR	Year	RD	GR	year	RD	GR
1970-71	13.01		1986-87	152.24	105.26%	2002-03	4122.16	58.20%
1971-72	7.32	-43.74%	1987-88	194.59	27.82%	2003-04	3680.30	-10.72%
1972-73	6.95	-5.05%	1988-89	163.94	-15.75%	2004-05	3668.92	-0.31%
1973-74	19.66	182.88%	1989-90	250.45	52.77%	2005-06	3129.16	-14.71%
1974-75	-0.31	-101.58%	1990-91	422.04	68.51%	2006-07	2637.94	-15.70%
1975-76	3.49	-1225.81%	1991-92	364.35	-13.67%	2007-08	3784.84	43.48%
1976-77	3.3	-5.44%	1992-93	337.44	-7.39%	2008-09	3711.68	-1.93%
1977-78	-29.05	-980.30%	1993-94	371.6	10.12%	2009-10	5022.98	35.33%
1978-79	-42.21	45.30%	1994-95	399.88	7.61%	2010-11	3673.87	-26.86%
1979-80	-57.84	37.03%	1995-96	402.82	0.74%	2011-12	8034.26	118.68%
1980-81	27.23	-147.08%	1996-97	643.03	59.63%	2012-13	9351.44	16.39%
1981-82	-95.98	-452.48%	1997-98	1122.9	74.63%	2013-14	11308.56	20.93%
1982-83	-26.81	-72.07%	1998-99	2029.96	80.78%	2014-15	13795.96	22.00%
1983-84	58.18	-317.01%	1999-00	3624.21	78.54%	2015-16	8199.15	-40.57%
1984-85	13.67	-76.50%	2000-01	3147.06	-13.17%			
1985-86	74.17	442.57%	2001-02	2605.64	-17.20%			

3.2. Growth characteristics of Revenue Deficit

TABLE A.VI					
Growth Characteristics of Revenue Deficit					
40 year Growth Rate					
	G R	G R	G R	G R	G R
	70s	80s	90s	2000s	2011-16
-58.99%	-232.97%	-45.25%	35.95%	6.33%	18.43%

Fig A.III: REVENUE DEFICIT (1970-71 to 2015-16)



4. Capital Expenditure

4.1. Outline of Capital Expenditure

4.1.1. The capital expenditure in the State over the period 1970-71 to 2015-16 presented in Table A.VII and Fig. A.IV The revised estimate of capital

expenditure for 2015-16 is Rs.6206.21 cr. and the budget estimate for 2016-17 is Rs.9572.90 cr.. The growth characteristics of capital expenditure over the last four decades are shown in Table A.VIII. As against the revised estimate in the interim budget of Rs.6206.21 cr., the provisional accounts for the year 2015-16 reveals that expenditure on the capital account is only Rs.7027.34 cr..

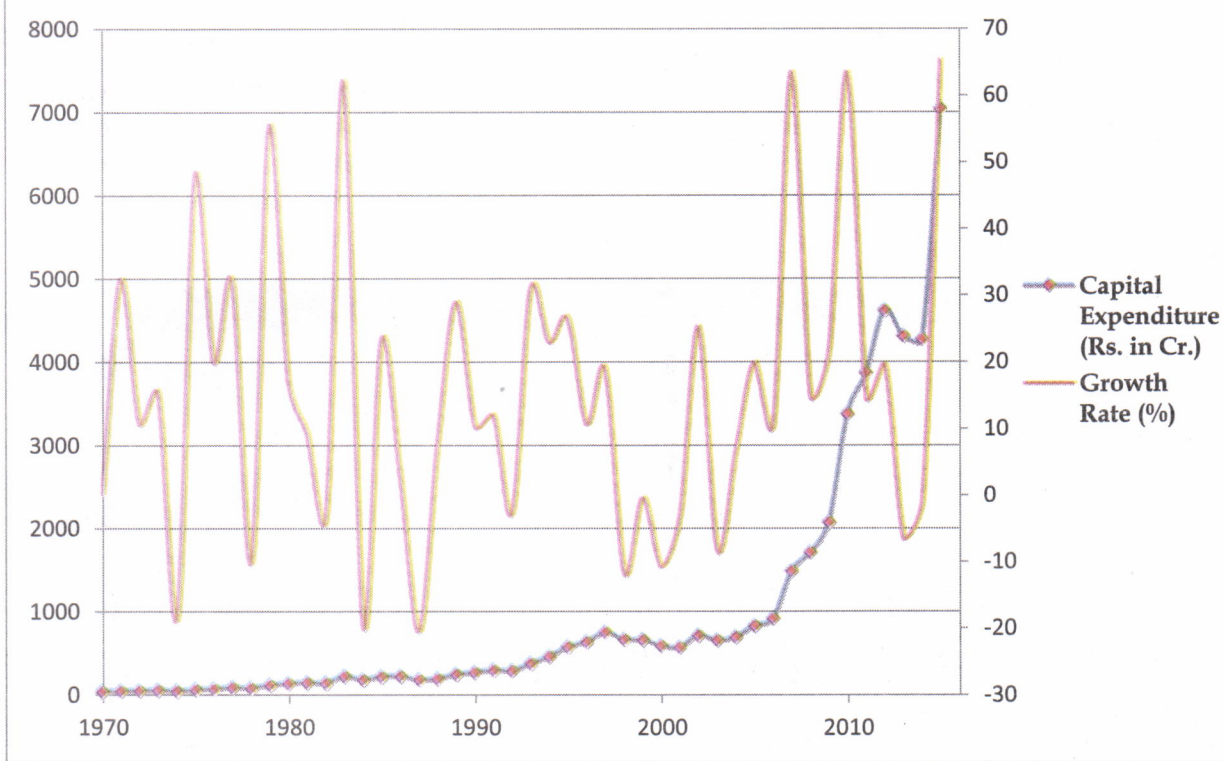
- 4.1.2. Average growth rate of capital expenditure during the last four decades has been around 12.73%. capital expenditure has shown a growth rate of 16.82 % in seventies which fell to almost half in eighties and increased to 12.06 % and 13.92 % in nineties and two thousands respectively. The last five years of 2011-15 the average growth rate is 17.94 %. The steep increase in capital expenditure in 2015-16 compared to 2014-15 is due to expenditure of Rs. 1126.16 cr. in respect of major infrastructure projects out of Rs.2000 cr. earmarked for this purpose.
- 4.1.3. It is worth to note that the devolution to local governments is regarded as revenue grants. However, over 50 % of revenue grant transferred to local bodies is spent on capital works. Therefore, if this portion of revenue expenditure is also reckoned as capital expenditure, the growth rate of capital expenditure would have gone up.

TABLE A.VII							
Capital Expenditure (Rs.in Cr)							
(1957-58 and 1970-71 to 2015-16)							
Year	Amount	Year	Amount	Year	Amount	Year	Amount
1954-58	8.44						
1970-71	23.41	1982-83	128.47	1994-95	446.01	2006-07	902.58
1971-72	30.97	1983-84	208.13	1995-96	563.47	2007-08	1474.58
1972-73	34.24	1984-85	167.04	1996-97	622.52	2008-09	1695.60
1973-74	39.45	1985-86	205.82	1997-98	738.87	2009-10	2059.39
1974-75	32.11	1986-87	211.04	1998-99	651.63	2010-11	3363.69
1975-76	47.39	1987-88	167.4	1999-2000	648.18	2011-12	3852.92
1976-77	56.8	1988-89	180.29	2000-01	577.20	2012-13	4603.29
1977-78	74.91	1989-90	232.29	2001-02	558.36	2013-14	4294.33
1978-79	67.14	1990-91	255.97	2002-03	698.66	2014-15	4254.59
1979-80	104.17	1991-92	286.12	2003-04	639.71	2015-16	7027.34
1980-81	121.86	1992-93	277.9	2004-05	681.75		
1981-82	132.92	1993-94	363.33	2005-06	816.95		

4.2. Growth Characteristics of Capital Expenditure

TABLE A.VIII					
Growth Characteristics of Capital Expenditure					
40 year Growth Rate	G R	G R	G R	G R	G R
	70s	80s	90s	2000s	2011-16
12.73%	16.82%	8.13%	12.06%	13.92%	25.81%

Fig A.VI: CAPITAL EXPENDITURE (1970-71 to 2015-16)



5. Debt Liabilities

5.1. Outline of Debt Liabilities

- 5.1.1. Debt liabilities of the State consist of Internal Debt of the State, Loans and Advances from Government of India, Public Account Liabilities. The debt obligations of the State for the four decades with the annual growth rates are shown in the Table A.IX (Fig.A.V). The growth characteristics

of the debt obligations over the last 40 years are given in Table A.X. The growth rate of debt has decreased from 17% in eighties to 13.46% in two thousands. The growth rate for the last six years is 13.96%.

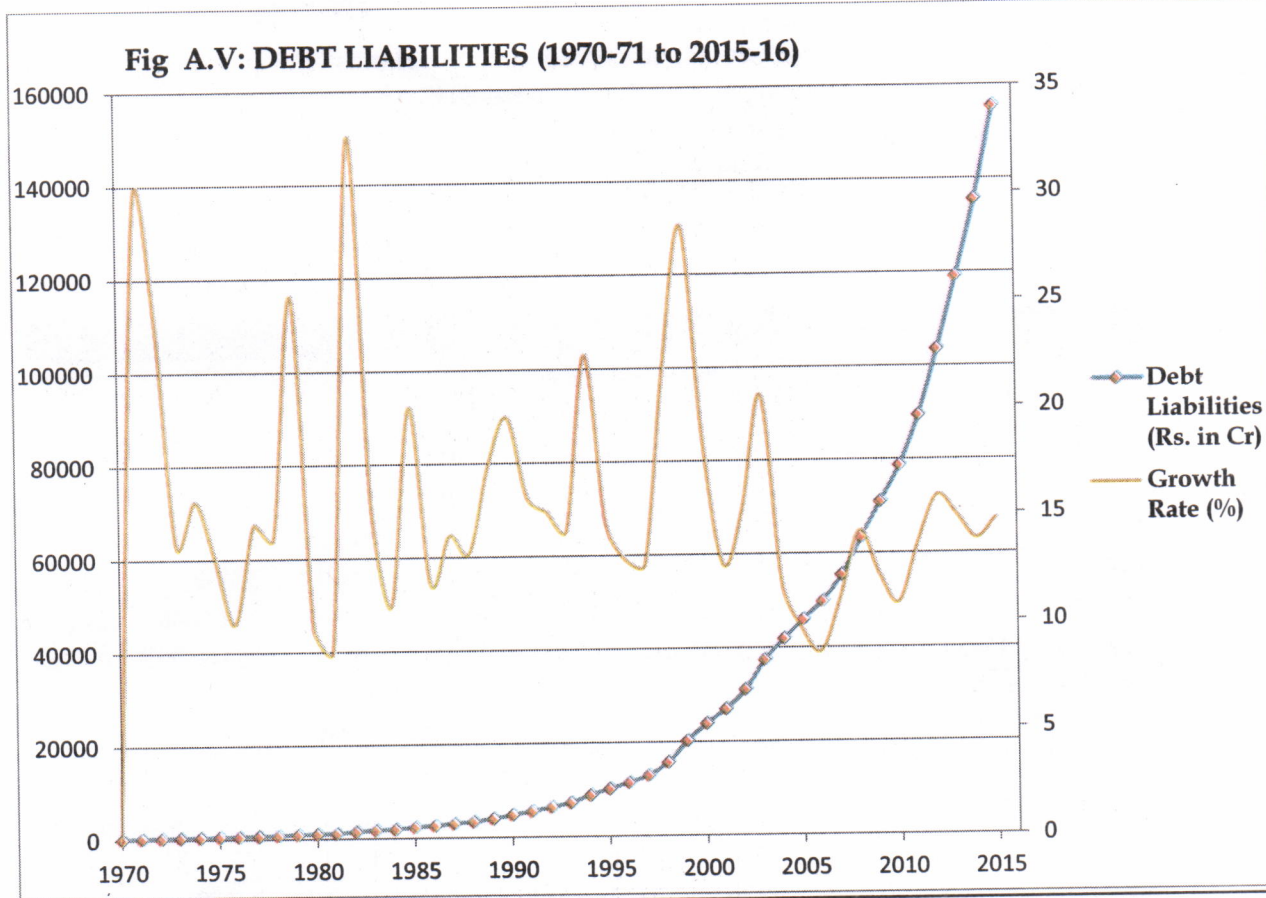
- 5.1.2. The sustainability of debt is assessed with reference to GSDP. The State has been able to contain the Debt- GSDP ratio within the limit prescribed by the 13th Finance Commission. Therefore, the State is debt sustainable with reference to the GSDP factor.
- 5.1.3. However, around 50 percent of the debt outstanding as at 2012-13 will be maturing in the six years since 2017-18 and such a huge outflow over a short span of time will put enormous pressure on State finances which is a major concern to the State.

TABLE A.IX								
Debt Liabilities of the State (Rs. in Cr.)								
(1970-71 to 2015-16)								
Year	Amount	Growth Rate	Year	Amount	Growth Rate	Year	Amount	Growth Rate
1970-71	217.34		1986-87	2596.65	11.95%	2002-03	31060.27	15.25%
1971-72	282.4	29.93%	1987-88	2964.4	14.16%	2003-04	37452.23	20.58%
1972-73	351.39	24.43%	1988-89	3359.08	13.31%	2004-05	41877.88	11.82%
1973-74	399.96	13.82%	1989-90	3941.87	17.35%	2005-06	45929.05	9.67%
1974-75	463.37	15.85%	1990-91	4716.79	19.66%	2006-07	49875.19	8.59%
1975-76	524.4	13.17%	1991-92	5466.56	15.90%	2007-08	55409.57	11.10%
1976-77	577.43	10.11%	1992-93	6297.13	15.19%	2008-09	63269.68	14.19%
1977-78	662.61	14.75%	1993-94	7198.67	14.32%	2009-10	70969.43	12.17%
1978-79	755.85	14.07%	1994-95	8820.87	22.53%	2010-11	78673.24	10.86%
1979-80	947.99	25.42%	1995-96	10113.54	14.65%	2011-12	89418.18	13.66%
1980-81	1041.6	9.87%	1996-97	11420.91	12.93%	2012-13	103560.84	15.82%
1981-82	1133.2	8.79%	1997-98	12868.14	12.67%	2013-14	119009.07	14.92%
1982-83	1505.18	32.83%	1998-99	15700.28	22.01%	2014-15	135440.24	13.81%
1983-84	1740.94	15.66%	1999-2000	20176.00	28.51%	2015-16	155389.33	14.73%
1984-85	1929.9	10.85%	2000-01	23918.98	18.55%			
1985-86	2319.48	20.19%	2001-02	26950.57	12.67%			

5.2. Growth Characteristics of Debt Liabilities

TABLE A.X
Growth Characteristics of Debt Liabilities

40 year Growth Rate					
	G R	G R	G R	G R	G R
	70s	80s	90s	2000s	2011-16
15.63%	15.65%	16.67%	16.73%	13.46%	13.96%



6. Gross Fiscal Deficit (GFD)

6.1. Outline of GFD

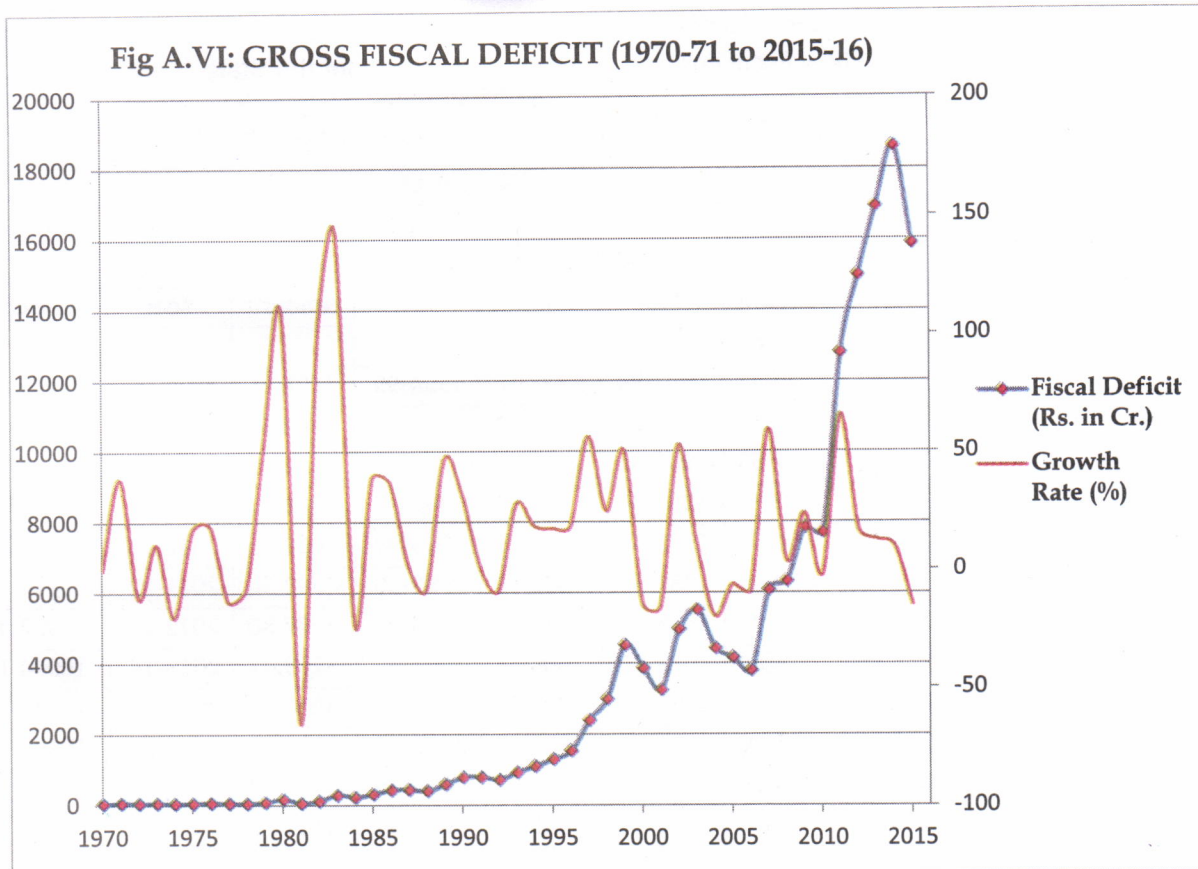
6.1.1. The growth characteristics of Gross Fiscal Deficit over the last four decades are presented in Table III.XI and Fig.A.VI shows the growth in fiscal deficit graphically. The growth characteristics of the Gross Fiscal Deficit over the last 40 years are given in Table A.XII. Fiscal Deficit which represents total borrowings of the State Government and its total resource gap has shown a sharp decline from 22.18 % in eighties to 8.69% in two thousands, which further increased to 14.87 % during 2011-16 period. GFD has steadily increased from Rs.7731 cr. in 2010-11 to Rs.15888cr. in 2015-16. The State has not been able to keep the GFD at the prescribed level of 3% of GSDP as envisaged by the 13th

Finance Commission. The increasing revenue and fiscal deficits, which show fiscal imbalance is a major concern for the State.

TABLE A.XI							
Gross Fiscal Deficit (Rs. in Cr.)							
(1957-58 and 1970-71 to 2015-16)							
Year	Amount	Year	Amount	Year	Amount	Year	Amount
1957-58	9.84						
1970-71	47.41	1982-83	122.88	1994-95	1108.65	2006-07	3821.88
1971-72	65.63	1983-84	299.31	1995-96	1302.66	2007-08	6100.20
1972-73	57.63	1984-85	232.26	1996-97	1542.48	2008-09	6346.21
1973-74	63.81	1985-86	322.31	1997-98	2413.85	2009-10	7871.62
1974-75	50.69	1986-87	440.78	1998-99	3012.20	2010-11	7730.45
1975-76	59.08	1987-88	448.09	1999-00	4532.56	2011-12	12814.77
1976-77	69.93	1988-89	412.13	2000-01	3877.80	2012-13	15002.46
1977-78	60.4	1989-90	604.53	2001-02	3269.41	2013-14	16944.12
1978-79	55.77	1990-91	796.57	2002-03	4990.04	2014-15	18641.73
1979-80	85.88	1991-92	803.45	2003-04	5539.05	2015-16	15888.17
1980-81	178.99	1992-93	732.02	2004-05	4451.90		
1981-82	61.7	1993-94	935.45	2005-06	4181.72		

6.2. Growth Characteristics of GFD

TABLE A.XII					
Growth Characteristics of Gross Fiscal Deficit					
40 year Growth Rate	G R	G R	G R	G R	G R
	70s	80s	90s	2000s	2011-16
14.36%	7.48%	22.18%	19.08%	8.69%	14.87%



7. Salaries, Interest and Pension (SIP)

7.1. Outline on SIP

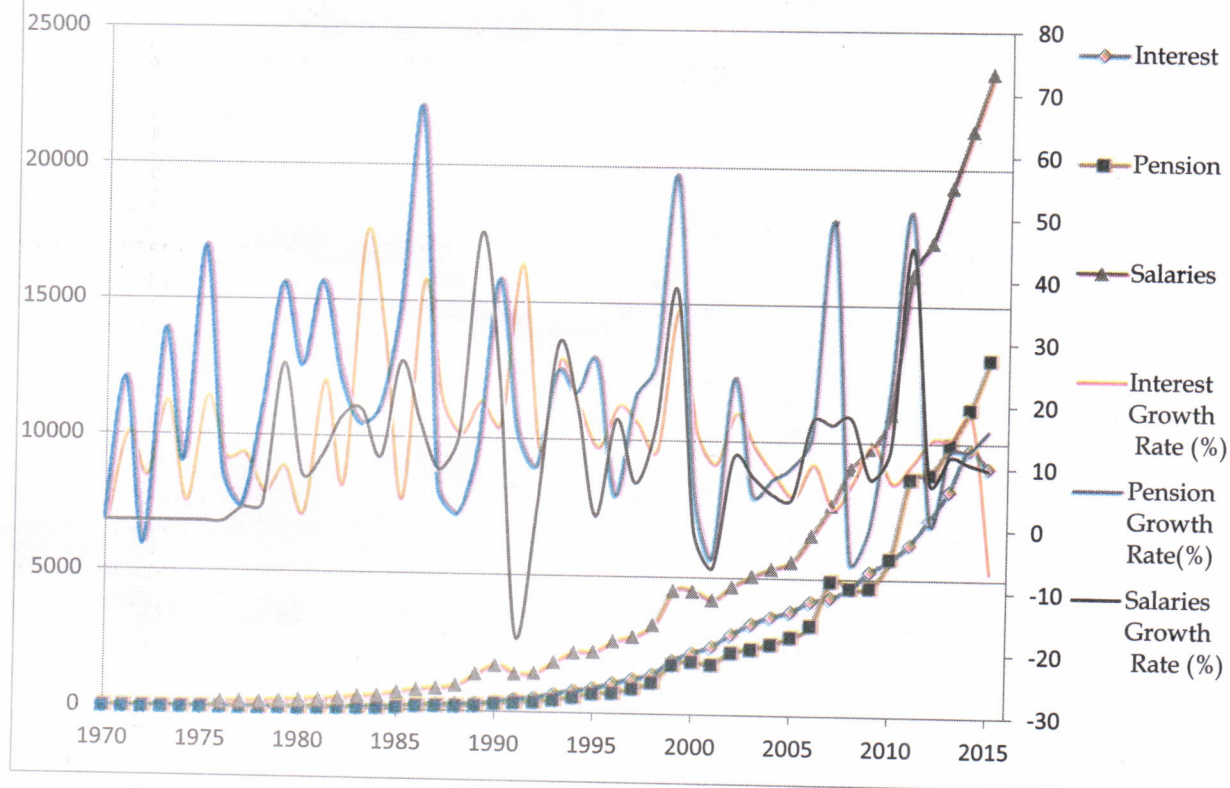
- 7.1.1. The growth characteristics of salaries and interest, pension (SIP) over the four decades are given in Table A.XIII (Fig A.VII). The growth characteristics of the Interest, Pension and Salaries over the last 40 years are shown in Table A.XIV. The interest, pension and salaries have grown at the rate of 9.8 %, 19.45 %, and 16.35 % during the last six years.
- 7.1.2. The revised estimates for Interests, pension and salaries for the year 2015-16 are Rs.10861.24 cr. Rs.13126.12 cr. Rs.23235.56 cr. respectively. The Budget estimate for interest, pension and salaries for the year 2016-17 are Rs.12629.95 cr., Rs.15503.43 cr. and Rs.27742.01 cr.

TABLE A.XIII							
Interest Pensions and Salaries (Rs. in Cr)							
(1957-58 and 1970-71 to 2015-16)							
Year	Interest	Pension	Salaries	Year	Interest	Pension	Salaries
1957-58	2.01	1.08					
1970-71	18.91	5.51		1993-94	687.16	464.72	1836.13
1971-72	21.59	6.80		1994-95	819.67	565.45	2194.25
1972-73	23.17	6.56		1995-96	924.15	716.85	2230.40
1973-74	27.64	8.61		1996-97	1103.41	753.67	2616.66
1974-75	28.53	9.48		1997-98	1286.08	913.02	2803.26
1975-76	34.24	13.73		1998-99	1446.26	1154.32	3254.68
1976-77	37.82	14.93	207.9	1999-00	1952.27	1808.29	4502.86
1977-78	41.94	15.37	212.71	2000-01	2257.6	1929.48	4491.61
1978-79	44.01	18.27	218.68	2001-02	2489.47	1837.93	4200.82
1979-80	47.91	25.38	274.8	2002-03	2946.76	2282.9	4678.99
1980-81	48.71	31.87	296.21	2003-04	3328.3	2408.83	5067.09
1981-82	59.83	44.37	327.87	2004-05	3612.54	2600.77	5345.58
1982-83	63.76	54.9	384.19	2005-06	3799.25	2861.18	5607.78
1983-84	93.46	63.87	454.67	2006-07	4189.7	3294.58	6585.45
1984-85	122.51	76.04	503.71	2007-08	4329.65	4924.53	7693.66
1985-86	127.46	103.02	635.43	2008-09	4659.69	4686.43	9063.81
1986-87	177.28	172.21	739.71	2009-10	5292.48	4705.5	9800.20
1987-88	213.17	183.03	804.85	2010-11	5689.66	5767.49	11068.38
1988-89	244.44	186.32	922.03	2011-12	6293.6	8700.3	16083.27
1989-90	293	209.59	1356.06	2012-13	7204.81	8866.89	17313.70
1990-91	340.63	293.14	1682.65	2013-14	8265.38	9971.27	19340.98
1991-92	483.41	338.96	1383.59	2014-15	9769.59	11252.7	21410.92
1992-93	542.5	371.87	1419.46	2015-16	9114.38	13062.02	23506.43

7.2. Growth Characteristics of SIP

TABLE A.XIV						
Growth Characteristics of Interest, Pension and Salaries						
Items	year Growth Rate	G R	G R	G R	G R	G R
		70s	80s	90s	2000s	2011-16
Interest	15.21%	0.51%	3.08%	6.65%	0.58%	9.80%
Pension	18.23%	0.57%	2.95%	8.39%	0.99%	19.45%
Salaries	NA	2.03%	7.85%	1.30%	8.36%	16.35%

Fig A.VI : INTEREST, PENSION, SALARIES (1970-71 to 2015-16)



8. Capital Expenditure/Revenue Deficit/Gross Fiscal Deficit-GSDP Ratio

8.1. Brief Outline

- 8.1.1. GSDP is treated as the market value of all final goods and services produced within the State and hence growth of GSDP is an important indicator of the State's economy. As GSDP is assumed as a good indicator of the performance of the State's economy, major fiscal aggregates such as Capital expenditure, Revenue Deficit and Fiscal Deficit need to be measured as a proportion to the GSDP at current market prices.
- 8.1.2. The ratio of Capital Expenditure to GSDP reflects the efficiency of expenditure spending. The higher the ratio of Capital Expenditure to GSDP, the better would be the quality of expenditure.
- 8.1.3. In order to ensure prudence in fiscal management and fiscal stability as envisaged in the Kerala Fiscal Responsibility Act, State is required to eliminate Revenue Deficit by 2014-15 and to achieve Fiscal Deficit of 3

% of GSDP. But the State has not been able to reduce Revenue Deficit and achieve Fiscal Deficit of 3% of GSDP. The average of Revenue Deficit to GSDP ratio during the nineties has been at 2.36% and increased to 2.88% in two thousands. The average of Revenue Deficit to GSDP ratio, which fell to 2.10% in 2011-16, has shown some improvements compared to last two decades. The Fiscal Deficit to GSDP ratio during the nineties has been at 4.52% declined to 3.95% and 3.40% in two thousands and in 2011-16 respectively. Table A.XV shows the data for the period 1990-91 to 2015-16

TABLE A.XV
Capital Expenditure/Revenue Deficit/Gross Fiscal Deficit-GSDP ratio
(1990-91 to 2015-16)

Year	Capital Expenditure /GSDP ratio	Revenue deficit/GSDP ratio	Gross Fiscal Deficit/GSDP ratio
1990-91	1.82	2.99	5.65
1991-92	1.63	2.08	4.58
1992-93	1.39	1.69	3.67
1993-94	1.38	1.41	3.55
1994-95	1.40	1.25	3.48
1995-96	1.45	1.04	3.36
1996-97	1.40	1.45	3.47
1997-98	1.49	2.27	4.88
1998-99	1.16	3.61	5.36
1999-00	1.04	5.80	7.25
2000-01	0.73	3.98	4.91
2001-02	0.70	3.28	4.12
2002-03	0.77	4.53	5.49
2003-04	0.66	3.81	5.73
2004-05	0.57	3.08	3.73
2005-06	0.60	2.29	3.06
2006-07	0.59	1.72	2.49
2007-08	0.84	2.16	3.48
2008-09	0.84	1.83	3.13
2009-10	0.89	2.17	3.39
2010-11	1.17	1.28	2.70
2011-12	1.13	2.36	3.77
2012-13	1.21	2.46	3.95
2013-14	0.93	2.44	3.66
2014-15	0.82	2.65	3.59
2015-16	1.20	1.40	2.71

