Chapter I
Finances of the State Government

This chapter provides a broad perspective of the finances of the Government of Kerala during the current year and analyses critical changes in the major fiscal aggregates relative to the previous year, keeping in view the overall trends during the last five years. The structure of Government Accounts and the layout of the Finance Accounts are shown in **Appendix 1.1**. The methodology adopted for the assessment of the fiscal position of the State is given in **Appendix 1.2**.

1.1 Summary of Current Year's Fiscal Transactions

Table 1.1 presents the summary of the State Government's fiscal transactions during the current year (2008-09) vis-à-vis the previous year, while **Appendix 1.3** provides details of receipts and disbursements as well as the overall fiscal position during the current year.

Table 1.1 Summary of Current Year's Fiscal Operations

(Rupees in crore)

2007-08	Receipts	2008-09	2007-08	Disbursements	2008-09		
Section-A: Revenue					**Non Plan**	**Plan**	**Total**
21106.79	Revenue receipts	24512.18	24891.64	Revenue expenditure	25012.00	3211.86	28223.86
13668.95	Tax revenue	15990.18	12184.09	General services	12508.42	158.95	12667.37
1209.55	Non-tax revenue	1559.29	7789.88	Social services	7452.54	1910.30	9362.84
4051.70	Share of Union Taxes/ Duties	4275.52	2818.40	Economic services	2785.92	1142.61	3928.53
2176.59	Grants from Government of India	2687.19	2099.27	Grants-in-aid and Contributions	2265.12	--	2265.12
Section-B: Capital							
7.54	Miscellaneous Capital Receipts	9.11	1474.58	Capital Outlay	24.84	1670.76	1695.60
44.85	Recoveries of Loans and Advances	35.64	893.16	Loans and Advances disbursed	404.44	579.25	983.69
5643.66	Public Debt receipts*	6921.40	1432.79	Repayment of Public Debt*	#	#	1650.34
	Contingency Fund	80.00	80.00	Contingency Fund	#	#	5.84
48316.26	Public Account receipts	56284.57	46413.11	Public Account disbursements	#	#	53627.80
1039.97	Opening Cash Balance	973.79	973.79	Closing Cash Balance	#	#	2629.56
76159.07	**Total**	**88816.69**	**76159.07**	**Total**	#	#	**88816.69**

(Source: Finance Accounts of the State for 2007-08 and 2008-09)

\# Figures for Plan and Non-Plan not available in the Finance Accounts.

- Excluding net transactions under Ways and Means advances and overdraft.

Following are the significant changes during 2008-09 over the previous year.

- Revenue receipts grew by 16.1 *per cent* (Rs 3,405 crore) relative to the previous year. The increase was under tax revenue (Rs 2,321 crore), State's share of Union Taxes and Duties (Rs 224 crore), non-tax revenue (Rs 349 crore) and grants-in-aid from the Government of India (GOI) (Rs 511 crore).
- Revenue expenditure and capital expenditure increased by 13.4 *per cent* (Rs 3,332 crore) and 15 *per cent* (Rs 221 crore) respectively over the previous years.
- Public Debt Receipts increased by Rs 1277 crore mainly due to increase in internal debt by Rs 926 crore and borrowings from GOI by Rs 351 crore, as against Public Debt Repayment which also increased by Rs 217 crore.
- Public Account receipts and disbursements increased by Rs 7969 crore and Rs 7215 crore respectively over the previous year. Thus, increase in net receipts during the year was Rs 754 crore.
- Cash balance of the State during 2008-09 increased from Rs 973.79 crore to Rs 2629.56 crore.

Chart 1.1 presents the budget estimates and actuals for some important fiscal parameters.

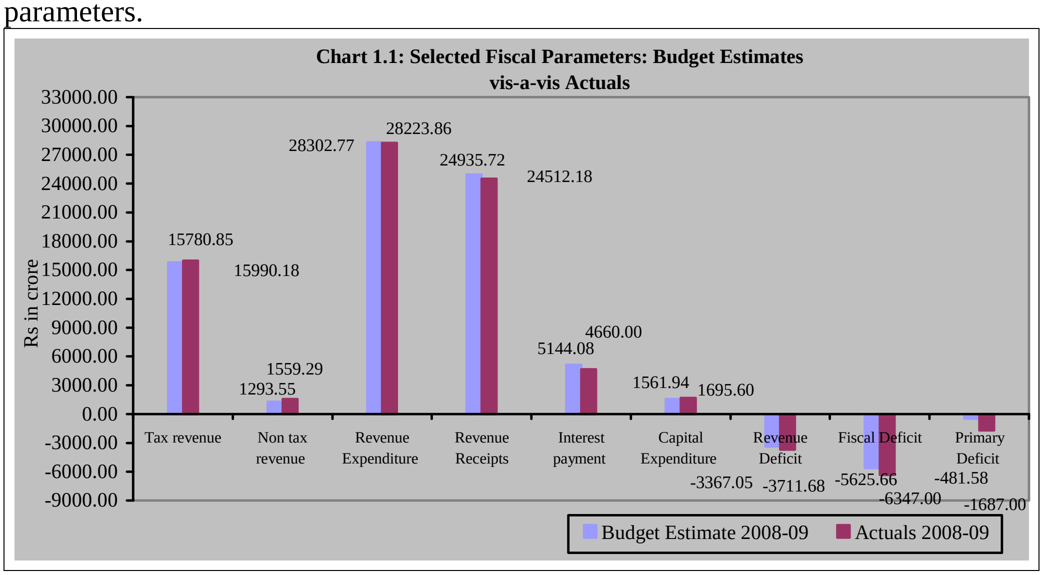


Chart 1.1 shows that compared to the budget estimates, the actual revenue receipts were less by Rs 424 crore, while actual revenue expenditure was less by Rs 79 crore. Resultantly, the revenue deficit increased by Rs 345 crore over the estimated figures. The capital expenditure showed an increase of Rs 134 crore over the budget estimates.

1.2 Resources of the State

1.2.1 Resources of the State as per Annual Finance Accounts

Revenue and capital are the two streams of receipts that constitute the resources of the State Government. Revenue receipts consist of tax revenues, non-tax revenues, State's share of Union taxes and duties and grants-in-aid from the GOI. Capital receipts comprise miscellaneous capital receipts such as proceeds from disinvestments, recoveries of loans and advances, debt receipts from internal sources (market loans, borrowings from financial institutions/commercial banks) and loans and advances from GOI as well as accruals from the Public Account. **Table-1.1** presents the receipts and disbursements of the State during the current year as recorded in its Annual Finance Accounts while **Chart 1.2** depicts the trends in various components of the receipts of the State during 2004-09. **Chart 1.3** depicts the composition of resources of the State during the current year.

Chart 1.2: Trends in Receipts (Rs in crore)

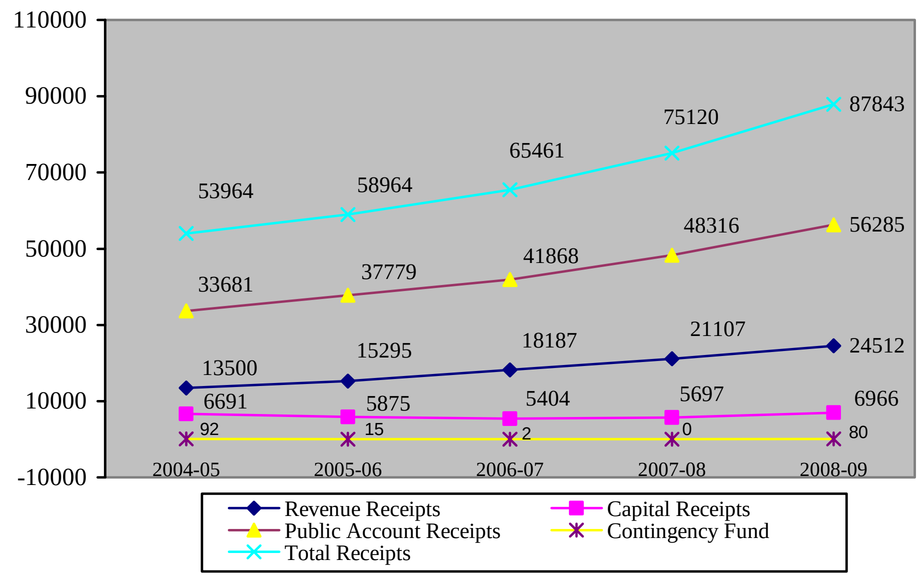
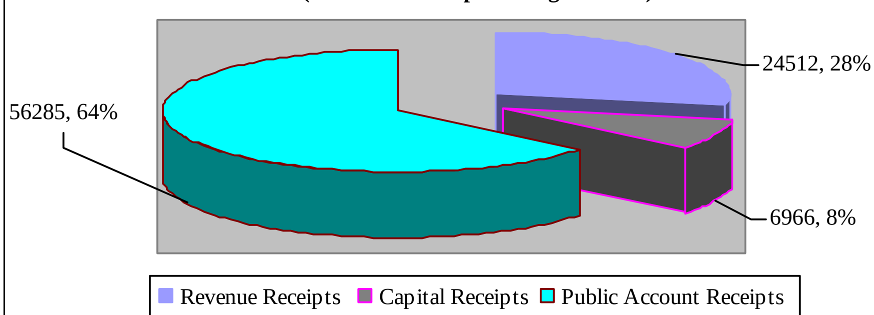


Chart 1.3: Composition of Receipts during 2008-09
(Rs in crore and percentage to total)



The total receipts of the State Government for the year 2008-09 were Rs 87,843 crore. Of these, the revenue receipts were Rs 24,512 crore constituting 28 *per cent* of total receipts, the capital receipts constituted eight *per cent* and Public Account receipts constituted 64 *per cent* of total receipts.

1.2.2 Funds transferred to State Implementing Agencies outside the State Budgets

The Central Government has been transferring a sizeable quantum of funds directly to State implementing agencies[1] for the implementation of various schemes/programmes in social and economic sectors recognized as critical. As these funds are not routed through the State Budget/State Treasury System, the Annual Finance Accounts do not capture the flow of these funds and to that extent, the State's receipts and expenditure as well as other fiscal variables/ parameters derived from them are underestimated. To present a holistic picture on availability of aggregate resources, details of funds directly transferred to the State implementing agencies are presented in **Table 1.2**.

Table-1.2: Funds transferred directly to State implementing agencies

(Rupees in crore)

Programme/Scheme (Central share: State Share)	Implementing Agency in the State	2008-09
National Rural Employment Guarantee Scheme (90:10)	District Rural Development Agency (DRDA)	200.46
Pradhan Mantri Gram Sadak Yojana (100 *per cent*)	Kerala State Rural Roads Development Agency	19.54
Rural Housing - Indira Awaas Yojana (75:25)	DRDA	156.58
Swarn Jayanthi Gram Swarozgar Yojana (75:25)	DRDA	44.85
National Horticulture Mission (85:15)	Kerala State Horticulture Mission	75.18
Accelerated Rural Water Supply Programme (100 *per cent*)	Kerala Water Authority	112.91
Sarva Shiksha Abhiyan (65:35)	Primary Education Development Society of Kerala	108.54
Swarn Jayanthi Shahari Rozgar Yojana (75:25)	State Poverty Eradication Mission (Kudumbashree)	10.32
Central Rural Sanitation Programme (75:25)	DRDA	33.80
National Rural Health Mission (85:15)	State Health and Family Welfare Society	151.29
Total		**913.47**

(Source: Official website of the Controller General of Accounts (e-lekha)).

Government of India directly transferred Rs 913.47 crore to the State implementing agencies during 2008-09. Direct transfers from GOI to the State implementing agencies without routing them through the State budget can be risky unless uniform accounting practices are diligently followed by all these agencies. Further, without proper documentation and timely reporting of expenditure, it will be difficult to monitor the end use of these direct transfers.

1.3 Revenue Receipts

Statement-11 of the Finance Accounts details the revenue receipts of the Government. The revenue receipts consist of the State's own tax and non-tax revenues, Central tax transfers and grants-in-aid from GOI. The trends and composition of revenue receipts over the period 2004-09 are presented in **Appendix 1.4** and also depicted in **Charts 1.4** and **1.5** respectively.

[1] State implementing agency includes any organization/institution including non-governmental organization which is authorized by the State Government to receive funds from the Government of India for implementing specific programmes in the State, e.g. Primary Education Development Society of Kerala for Sarva Shiksha Abhiyan and Kerala State Health and Family Welfare Society for the National Rural Health Mission.

Chart 1.4: Trends in Revenue Receipts

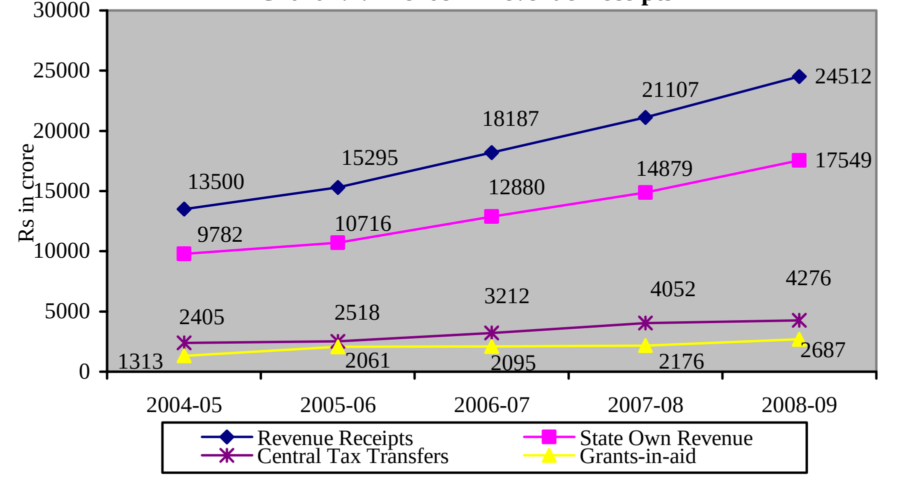
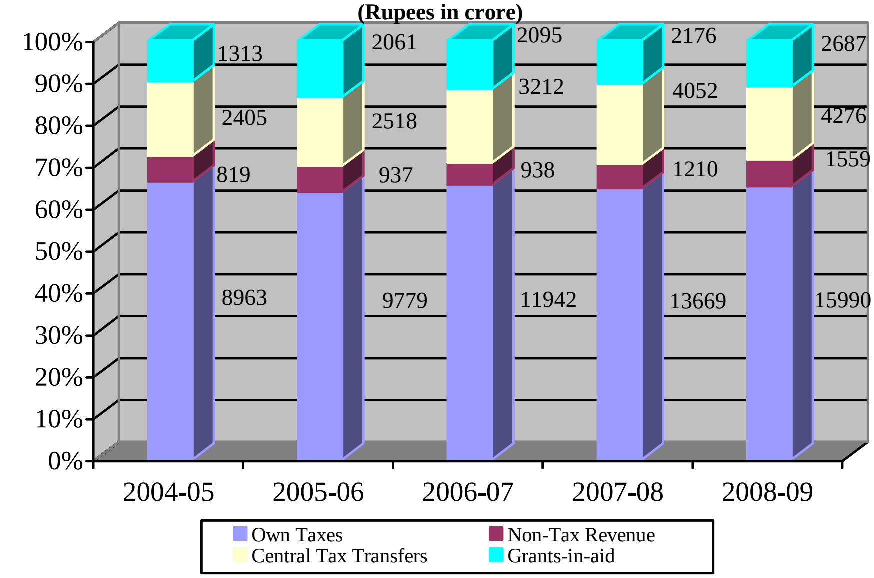


Chart 1.5: Composition of Revenue Receipts during 2004-09
(Rupees in crore)



Revenue receipts increased from Rs 13,500 crore in 2004-05 to Rs 24,512 crore in 2008-09, exhibiting relative stability in the share of its various components. The contribution of the State's own taxes under total revenue receipts decreased marginally from 66 *per cent* in 2004-05 to 65 *per cent* in 2008-09. The contribution of grants-in-aid from GOI increased marginally from 10 *per cent* in 2004-05 to 11 *per cent* in 2008-09, whereas the contribution of Central tax transfers remained at the same level of 18 *per cent* in 2008-09 compared to 2004-05.

The trends in revenue receipts relative to Gross State Domestic Product (GSDP) are presented in **Table 1.3**:

Table 1.3: Trends in Revenue Receipts relative to GSDP

	2004-05	2005-06	2006-07	2007-08	2008-09
Revenue Receipts (RR) (Rupees in crore)	**13500**	**15295**	**18187**	**21107**	**24512**
State's own taxes (Rupees in crore)	8963	9779	11942	13669	15990
Rates of growth					
Revenue Receipt (*per cent*)	14.3	13.3	18.9	16.1	16.1
State's own taxes (*per cent*)	10.8	9.1	22.1	14.5	17.0
RR/GSDP (*per cent)*	12.2	12.3	12.8	13.0	13.6
Buoyancy Ratios[2]					
Revenue Buoyancy w.r.t GSDP	1.02	1.04	1.3	1.2	1.5
State's Own Tax Buoyancy w.r.t GSDP	0.8	0.7	1.5	1.0	1.5
Revenue buoyancy with reference to State's own taxes	1.3	1.5	0.85	1.1	0.95

(Source: Finance Accounts and information furnished by department of Economics and Statistics)

The trends in ratios of revenue receipts and the State's own taxes to GSDP is shown in the above table. During 2004-05 and 2005-06, the growth of GSDP was 14 and 12.8 *per cent* compared to the growth of revenue receipts of 14.3 and 13.3 respectively. In the remaining years, the growth of revenue receipts was more than the growth of GSDP. The ratio of the State's own tax to GSDP increased from 8.4 *per cent* in 2007-08 to 8.9 *per cent* in 2008-09. Its own taxes increased by 17 *per cent* during the current year relative to the previous year. The increase of 16.1 *per cent* in revenue receipts during 2008-09 compared to the previous year was on account of increase in the State's own taxes (17 *per cent*), non-tax revenue (29 *per cent*), Central tax transfers (6 *per cent*) and grants-in-aid from GOI (23 *per cent*).

1.3.1 State's Own Resources

The State's share in Central taxes and grants-in-aid are determined on the basis of recommendations of the Finance Commission, collection of Central tax receipts, Central assistance for Plan schemes etc. The State's performance in mobilisation of additional resources should be assessed in terms of its own resources comprising revenue from its own tax and non-tax sources. The gross collection in respect of major taxes and duties vis-à-vis budget estimates, the expenditure incurred on their collection and the percentage of such expenditure to the gross collection during the years from 2004-05 to 2008-09 are presented in **Appendix 1.5**.

Tax Revenue

Tax revenue increased by 17 *per cent* during the current year (Rs 15,990 crore) as compared to the previous year (Rs 13,669 crore). Taxes on sales, trade, etc., were the major source of State's own tax revenue during the year (71 *per cent)* followed by stamps and registration fees (13 *per cent*), State excise (9 *per cent*) and taxes on vehicles (6 *per cent*).

Taxes on sales, trade, etc have increased by 21.4 *per cent* (Rs 2005 crore) during 2008-09 over the previous year mainly due to increase in receipts under

[2]Buoyancy ratios indicate the elasticity or degree of responsiveness of fiscal variables with respect to a given change in the base variable. For instance, for 2008-09, revenue buoyancy at 1.5 implies that revenue receipts tend to increase by 1.5 percentage points, if the GSDP increases by one *per cent*.

the State Sales Tax Act (Rs 1700 crore), trade tax (Rs 867 crore) and other receipts (Rs 29 crore), partly offset by a decrease in receipts under the Central Sales Tax Act (Rs 591 crore). Receipts under State excise increased by 19.6 *per cent* (Rs 229 crore) during 2008-09 over the previous year, mainly under 'Foreign liquors and spirit' (Rs 154 crore) and 'Country fermented liquors' (Rs 52 crore).

Tax revenue exceeded the budget estimates for the same year by Rs 209.33 crore during 2008-09. This was mainly due to increase in taxes on sales, trade, etc. (Rs 760.74 crore) and State excise (Rs 97.79 crore), partly offset by decrease in receipts under stamps and registration fees (Rs 417.57 crore) and taxes on vehicles (Rs 71.19 crore).

Tax revenue collected during 2008-09 (Rs 15,990.18 crore) fell short of the normative assessment made by Twelfth Finance Commission (TFC) (Rs 16,612.37 crore) by Rs 622.19 crore.

The expenditure on collection in respect of sales tax, stamp duty and registration fees, State excise and taxes on vehicles was higher as compared to the all India average during the period 2004-05 to 2007-08 and Government needs to look into this aspect.

Non-Tax Revenue

Non-tax revenue increased by Rs 349 crore (29 *per cent*) during the current year (Rs 1559 crore) over the previous year (Rs 1,210 crore). Non-tax revenue sources mainly comprised receipts from Forestry and Wildlife (14 *per cent*), State lotteries (31 *per cent*) and interest receipts, dividends and profits (8 *per cent*). The increase was mainly due to State lotteries (Rs 156 crore), receipts on account of adjustments towards debt-waiver for the year 2006-07 (Rs 102 crore) during the current year and receipts under Forestry and Wildlife (Rs 69 crore). However, though the receipts under State lotteries were Rs 481.39 crore during the year, with equally high expenditure of Rs 372.26 crore, the net yield from lotteries was Rs 109.13 crore. Non-tax revenue realised during 2008-09 under various components of non-tax revenue vis-à-vis the budget estimates of 2008-09 was as shown below:

Table 1.4: Non-tax Revenue realised vis-à-vis Budget estimates

(Rupees in crore)

Sl. No.	Component of non-tax revenue	Actuals	Budget estimates 2008-09
1.	Forestry and Wildlife	223.71	191.21
2.	Interest receipts	83.69	51.16
3.	Dividends and profits	33.53	34.50
4.	State Lotteries	481.39	420.00
Overall Non-tax revenue		1559.29	1293.55

(Source: Finance Accounts and Annual Financial Statement 2008-2009 of the State Government)

The non-tax revenue realised during 2008-09 (Rs 1559.29 crore) fell short of the normative assessment made by TFC (Rs 1,730.84 crore) by Rs 171.55 crore.

1.3.2 Loss of revenue due to evasion of taxes, write off/waivers and refunds

Government waived (Forest and Wildlife Department) Rs 1.28 lakh being the re-auction loss sustained from a forest range in Ranni. The details of write off and waiver of revenue were not made available by the Commercial Taxes Department and the Excise Department.

The number of refund cases pending at the beginning of the year 2008-09, claims received during the year, refunds allowed during the year and cases pending at the close of the year 2008-09 as reported by the Commercial Taxes Department were as follows:

Table 1.5: Refunds made during the year

(Rupees in lakh)

Sl. No.	Revenue Head		Claims outstanding at the beginning of the year	Claims received during the year	Refunds made during the year	Balance outstanding at the end of the year
1.	Sales tax	No. of cases	48	438	434	52
		Amount	287.02	491.55	677.08	101.49
2.	Agricultural Income tax	No. of cases	1	28	27	2
		Amount	0.50	3.83	4.02	0.31
3.	Value Added Tax	No. of cases	992	8,350	8,056	1,286
		Amount	8,071.74	14,990.78	20,669.94	2,392.58
4.	Luxury tax	No. of cases	-	1	1	-
		Amount	-	0.09	0.09	-
5.	Refund of tax on Paper Lottery	No. of cases	1	-	1	-
		Amount	56.98	-	56.98	-

(Source: Report of the C&AG (Revenue Receipts), Government of Kerala for the year ended 31 March 2009)

The amount involved in waivers and refunds as reported by the Commercial Taxes Department and the Forest and Wildlife Department works out to Rs 214.09 crore, which is about one *per cent* of the revenue receipts realised during 2008-09.

Test check of the records of commercial tax, State excise, motor vehicles, forest and other departmental offices conducted during the year 2008-09 revealed underassessment/short levy/loss of revenue aggregating Rs 885.70 crore in 3088 cases. During the course of the year, the departments concerned accepted the underassessments and other deficiencies of Rs 59.27 crore involved in 546 cases, of which 121 cases involving Rs 4.79 crore was pointed out in audit during 2008-09 and the rest in the earlier years. The departments collected Rs 2.69 crore in 420 cases during 2008-09.

1.3.3 Revenue Arrears

The arrears of revenue as on 31 March 2009 in respect of some principal heads of revenue amounted to Rs 9,465.95 crore of which Rs 2,615.58 crore were outstanding for more than five years as mentioned in **Table 1.6**.

Table 1.6: Arrears of Revenue

(Rupees in crore)

Sl. No.	Department	Amount of arrears as on 31 March 2009	Arrears outstanding for more than 5 years
1.	Commercial Taxes Department	3,777.26	-
2.	Electrical Inspectorate	3,238.95	1501.14
	Rs. 3,232 crore was due from Kerala State Electricity Board and Rs. 3.55 crore was due from Thrissur Municipal Corporation.		
3.	Land Revenue	1,143.49	391.48
	The details of arrears were not furnished by the department.		
4.	Motor Vehicles	769.55	351.93
	Rs. 15.02 crore was covered under revenue recovery. Rs. 4.41 crore was stayed by courts etc. Rs. 684.45 crore is due from KSRTC.		

Sl. No.	Department	Amount of arrears as on 31 March 2009	Arrears outstanding for more than 5 years
5.	State Excise	289.75	239.46
	Rs. 252.98 crore was due from individuals, private firms, private companies, etc. The stage of recovery of the arrears had been called for from the department but their remarks had not been received (September 2009).		
6.	Forest and Wildlife	148.66	75.06
	Rs 91.53 crore was stayed by Government and Rs. 1.05 crore is likely to be written off		
7.	Police	57.60	32.84
	Rs. 22.75 crore, Rs. 27.79 crore, Rs. 1.84 crore and Rs. 1.49 crore were due from Southern Railway, KSEB, Government of Tamil Nadu and Airports Authority of India respectively.		
8	Printing	26.88	13.27
	The details of arrears were not furnished by the department.		
9.	Stationery	11.88	9.89
	The arrears were due to default of the department as well as autonomous bodies.		
10.	Factories and Boilers	1.33	0.20
	The department stated that an amount of Rs. 0.58 crore was likely to be written off.		
11.	Mining and Geology	0.38	0.17
	Rs. 1.82 lakh was under revenue recovery, Rs 17.38 lakh was stayed by Courts/ Government.		
12.	Ports	0.22	0.14
	Rs. 5.94 lakh was under revenue recovery.		
Total		**9,465.95**	**2,615.58**

(Source: Report of the Comptroller and Auditor General of India (Revenue Receipts), Government of Kerala for the year ended 31 March 2009)

Thus, 74.1 *per cent* of the total outstanding arrears of revenue as on 31 March 2009 were in the Commercial Taxes Department and the Electrical Inspectorate. If efforts had been made by the State Government to realise the arrears, the revenue deficit could have been reduced to a considerable extent.

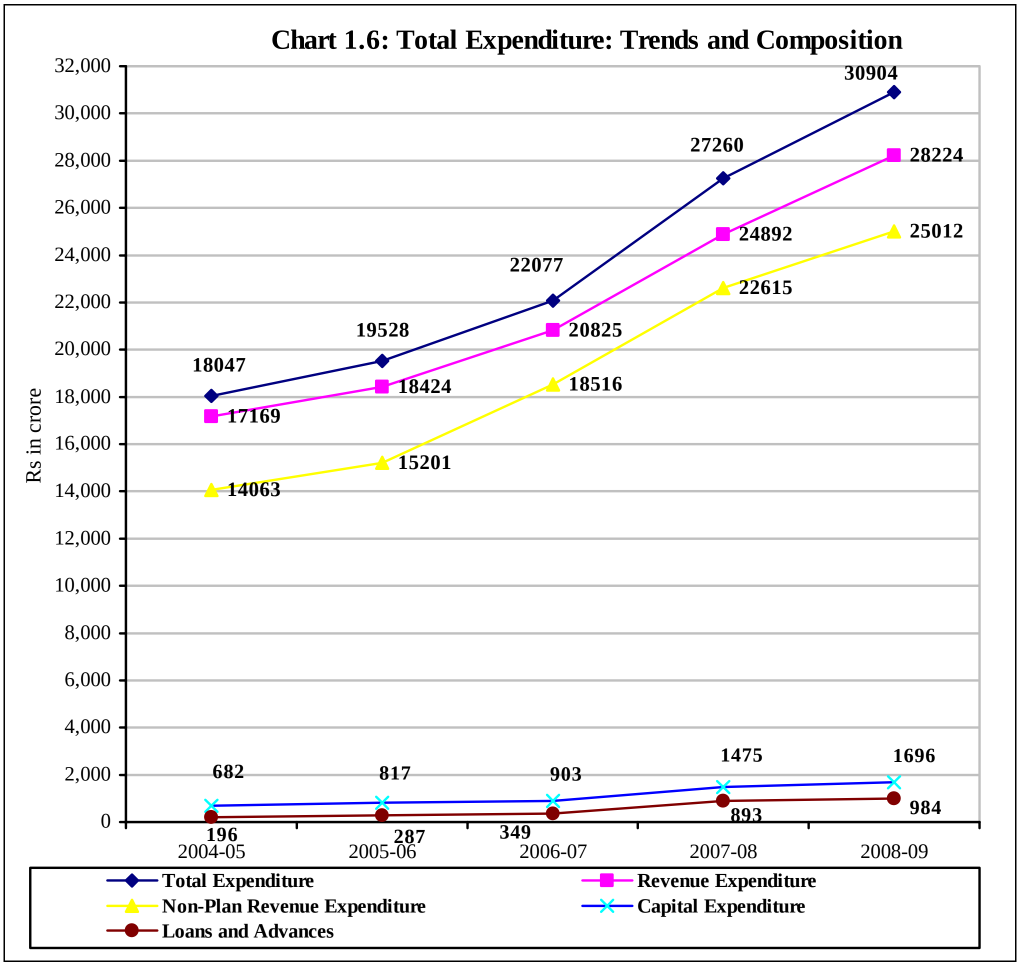
1.4 Application of resources

Analysis of the allocation of expenditure at the State Government level assumes significance since major expenditure responsibilities are entrusted with them. Within the framework of fiscal responsibility legislations, there are budgetary constraints in raising public expenditure financed by deficits or borrowings. It is, therefore, important to ensure that the ongoing fiscal correction and consolidation process[3] at the State level is not at the cost of expenditure, especially expenditure directed towards development and social sectors.

1.4.1 Growth and Composition of Expenditure

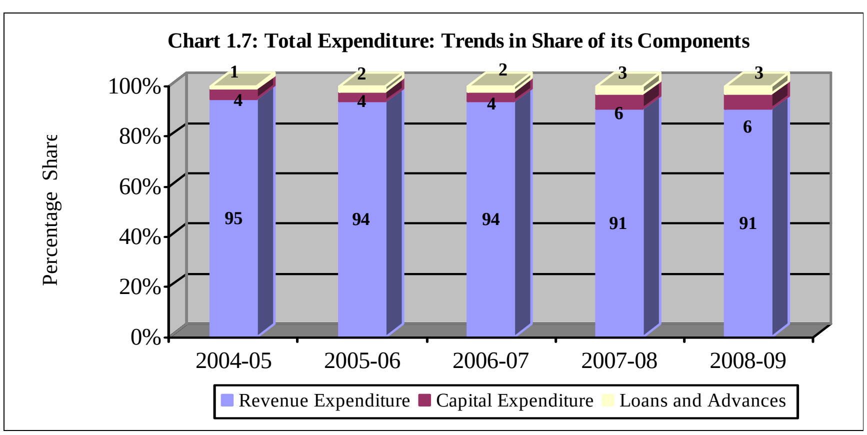
Chart 1.6 presents the trends in total expenditure over a period of five years (2004-09). Its composition, both in terms of 'economic classification' and 'expenditure by activities' is depicted respectively in **Charts 1.7 and 1.8.**

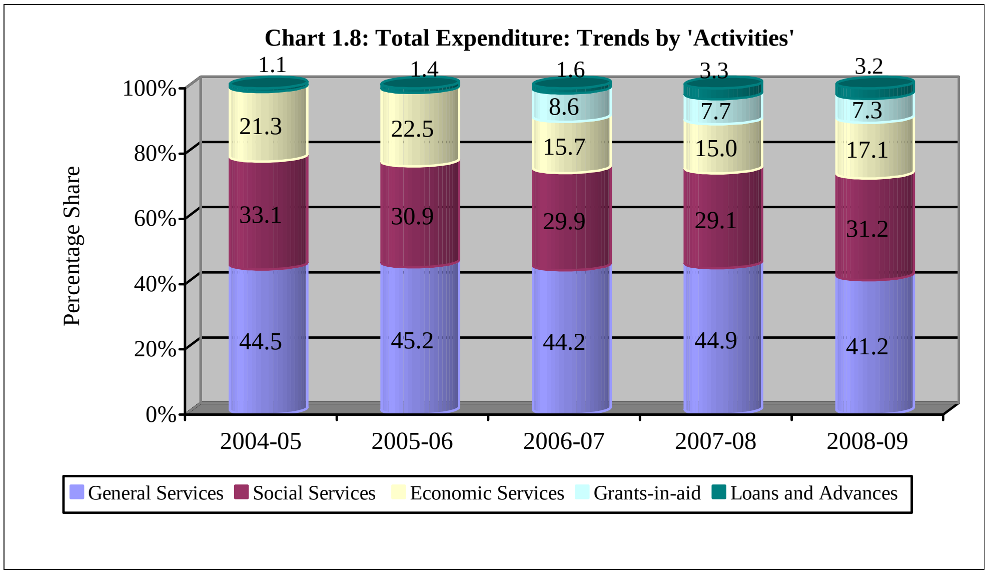
[3] The Twelfth Finance Commission had recommended that all States should restructure their finances through fiscal consolidation (reduction of deficit and debt) and adopt a fiscal correction path by setting clear targets through a fiscal reform legislation.



During the five year period 2004-09, nearly 91 to 95 *per cent* of the total expenditure constituted revenue expenditure whereas capital expenditure ranged between 3.8 and 5.5 *per cent* of total expenditure during the same period.

The total expenditure increased by 13.4 *per cent* in 2008-09 to Rs 30,904 crore from Rs 27,260 crore in the previous year. The increases were under revenue expenditure (Rs 3,332 crore), capital expenditure (Rs 221 crore) and disbursement of loans and advances (Rs 91 crore).





Trends in share of components of Total Expenditure

The revenue expenditure increased in absolute terms from Rs 17,169 crore in 2004-05 to Rs 28,224 crore in 2008-09 but its percentage to total expenditure decreased from 95 *per cent* to 91 *per cent* during the same period, indicating an increase in the percentage of capital expenditure. Capital expenditure increased from Rs 682 crore in 2004-05 to Rs 1,696 crore in 2008-09 and its percentage to total expenditure increased from four *per cent* to six *per cent* during the same period.

Non-Plan revenue expenditure (NPRE) showed an increasing trend during the period 2004-09, whereas Plan revenue expenditure (PRE) showed inter-year variations with an increasing trend during 2008-09. NPRE showed an increase of 10.6 *per cent* in 2008-09 (Rs 2,397 crore) over 2007-08. The increase in NPRE during the current year compared to the previous year was mainly due to increase in expenditure under General Education (Rs 679 crore), Family Welfare (Rs 126 crore) Police (Rs 154 crore), Roads and Bridges (Rs 321 crore) Interest payment (Rs 330 crore), Appropriation for reduction or avoidance of debt (Rs 122 crore), Medical and Public Health (Rs 202 crore) and devolution of funds to Local Self Government Institutions (Rs 166 crore). PRE showed an increase of 41 *per cent* (Rs 935 crore) during 2008-09 when compared to the previous year. The increase was mainly due to increase in expenditure under Urban Development (Rs 293 crore), General Education (Rs 118 crore) Agriculture and Allied Activities (Rs 191 crore), Water Supply and Sanitation (Rs 60 crore) and Welfare of Scheduled Castes, Scheduled Tribes and Other Backward classes (Rs 51 crore).

The actual NPRE during 2008-09 vis-à-vis the assessment made by TFC for the year is given below:

Table 1.7: NPRE *vis-à-vis* assessment by TFC

(Rupees in crore)

	Assessment made by TFC	Actual Non-Plan Revenue Expenditure
Non-Plan Revenue Expenditure	20788	25012

(Source: Finance Accounts of the State Government and Report of TFC)

Actual NPRE during 2008-09 exceeded the normative assessment made by TFC for the year by Rs 4,224 crore (20.3 *per cent*). The increase was mainly due to increased devolution of funds to Local Self Government Institutions based on recommendations of the Third State Finance Commission (Rs 2137 crore), revision of pension (Rs 937 crore) and increase in expenditure under Economic Services (Rs 946 crore).

1.4.2 Committed Expenditure

The committed expenditure of the State Government on revenue account mainly consists of interest payments, expenditure on salaries and wages, pensions and subsidies. **Table 1.8** and **Chart 1.9** present the trends in the expenditure on these components during 2004-09.

Table 1.8: Components of Committed Expenditure

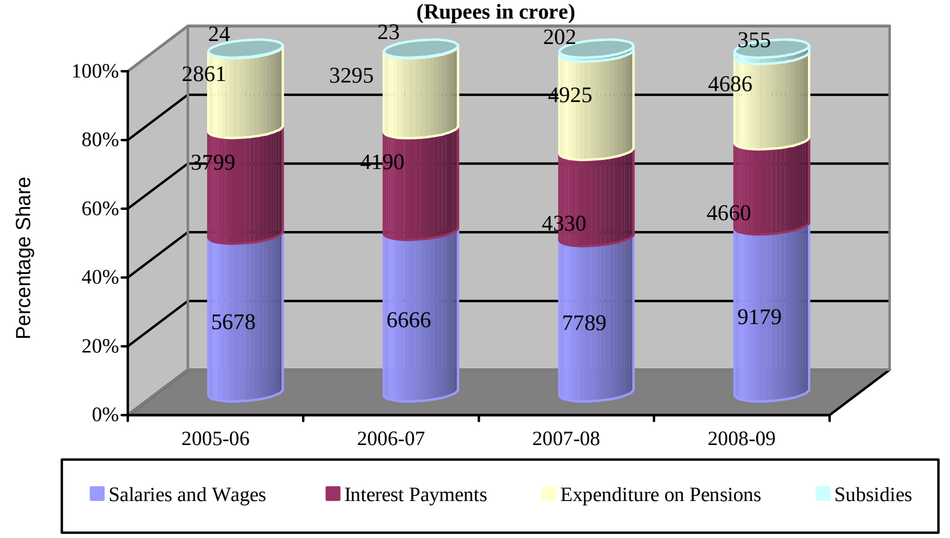
(Rupees in crore)

Components of Committed Expenditure	2004-05	2005-06	2006-07	2007-08	2008-09	
					BE	Actuals
Salaries* and Wages *, Of which*	5410 (40.1)	5678 (37.1)	6666 (36.7)	7789 (36.9)	9326	9179 (37.4)
Non-Plan Head	5186	5440	6391	7464	NA	8914
Plan Head**	224	238	275	325	NA	265
Interest Payments	3613 (26.8)	3799 (24.8)	4190 (23.0)	4330 (20.5)	5144	4660 (19.0)
Expenditure on Pensions	2601 (19.3)	2861 (18.7)	3295 (18.1)	4925 (23.3)	4569	4686 (19.1)
Subsidies	NA	24	23	202 (1)	NA	355 (1.4)
Revenue Expenditure	17169	18424	20825	24892	28303	28224
Revenue receipts	13500	15295	18187	21107	24936	24512

* Salaries include teaching grant paid to aided educational institutions like schools and colleges to meet the salaries of their teaching and non-teaching staff.
** The Plan head also includes the salaries and wages paid under Centrally sponsored schemes
NA: Not available
Figures in the parentheses indicate percentage to Revenue Receipts

(Source: Finance Accounts of the State Government)

Chart 1.9: Trend of Committed Expenditure during 2005-09
(Rupees in crore)



Expenditure on salaries under Non-Plan during 2008-09 was Rs 8,914 crore, recording a growth of 19.4 *per cent* over the previous year, whereas salaries under Plan during 2008-09 declined by 18.5 *per cent* when compared to the previous year. The salary expenditure is about 49 *per cent* of revenue expenditure net of interest and pension payments, which is higher than the norm of 35 *per cent* recommended by TFC. Expenditure under salaries and wages for 2008-09, however, remained within the projection made by the State Government in Medium Term Fiscal Plan (Rs 9,187 crore).

Pension payments decreased by 4.9 *per cent* (Rs 239 crore) from Rs 4,925 crore in 2007-08 to Rs 4,686 crore in 2008-09. During 2008-09, they exceeded the projections made by the State Government in the Medium Term Fiscal Plan (Rs 4,569 crore) by three *per cent* as well as the assessment made by TFC (Rs 3,750 crore) by 25 *per cent*.

The TFC recommended that States should endeavour to keep interest payments as a ratio of revenue receipts to 15 *per cent* by 2009-10. It was, however, observed that interest payments as a percentage of revenue receipts ranged between 19 and 25 *per cent* during the first four years of the TFC award period.

Interest payments increased by 7.6 *per cent* during 2008-09 (Rs 4,660 crore) when compared to the previous year (Rs 4,330 crore).

Payment of subsidies increased steeply from Rs 24 crore in 2005-06 to Rs 202 crore in 2007-08 and again to Rs 355 crore in 2008-09. The increase in payment of subsidies (Rs 153 crore) during 2008-09 over the previous year was mainly due to enhanced payment of subsidy to the Kerala State Civil Supplies Corporation for market intervention operations (Rs 75 crore), enhanced subsidy to agriculture farms (Rs 23 crore), subsidy to handloom industries (Rs 22 crore) and free supply of electricity to small and marginal paddy growers (Rs 20 crore).

The ratio of salaries, interest payments, pensions and subsidies to revenue receipts of the State during the current year was 77 *per cent*, a decrease of five percentage points from the previous year.

1.4.3 Financial Assistance by State Government to local bodies and other institutions

The quantum of assistance provided by way of grants and loans to local bodies and others during the current year relative to the previous years is presented in **Table 1.9.**

Table 1.9: Financial assistance to local bodies, etc

(Rupees in crore)

Financial Assistance to Institutions	2004-05	2005-06	2006-07	2007-08	2008-09
Educational Institutions (Aided Schools, Aided Colleges, Universities, etc.)	2071.80	2144.52	2666.63	2812.88	3306.81
Municipal Corporations and Municipalities	286.96	318.94	385.43	485.85	966.99
Zilla Parishads and Other Panchayati Raj Institutions	1496.21	1719.53	2219.28	2421.93	2600.11
Development Agencies	25.01	14.52	6.15	1.36	1.95
Hospitals and Other Charitable Institutions	28.04	34.28	43.32	53.98	56.66
Other Institutions[4]	798.07	1307.30	916.46	468.50	658.83
Total	**4706.09**	**5539.09**	**6237.27**	**6244.50**	**7591.35**
Assistance as percentage of revenue expenditure	27	30	30	25	27

(Source: Finance Accounts and vouchers compiled by Accountant General (A&E)).

The financial assistance to local bodies and other institutions constituted 25 to 30 *per* cent of revenue expenditure during the period 2004-09. The increase in financial assistance to Zilla Parishads, Municipalities, Corporations, etc., during the period 2006-07 to 2008-09 compared to the previous year was due to devolution of funds to local bodies towards maintenance of assets, expansion and development and traditional functions based on the recommendations of the Third State Finance Commission.

1.5 Quality of Expenditure

The availability of better social and physical infrastructure in the State generally reflects the quality of its expenditure. Improvement in the quality of expenditure basically involves three aspects, viz., adequacy of the expenditure (i.e. adequate provisions for providing public services); efficiency of expenditure use and effectiveness (assessment of outlay-outcome relationships for select services).

1.5.1 Adequacy of Public Expenditure

The expenditure responsibilities relating to the social sector and the economic infrastructure are largely assigned to the State Governments. Enhancing human development levels requires the States to step up their expenditure on key social services like education, health, etc. The low level of spending on any sector by a particular State may be either due to low fiscal priority attached by the State Government or on account of the low fiscal capacity of the State Government or due to both working together. Low fiscal priority (ratio of expenditure category to aggregate expenditure) is attached to a particular sector if it is below the respective all State's average while low fiscal capacity would be reflected if the State's per capita expenditure is below the respective all State's average even after having a fiscal priority that is more than or equal to the all State's average. **Table 1.10** analyses the fiscal priority and fiscal capacity of the State Government with regard to development expenditure, social sector expenditure and capital expenditure during the current year.

[4] Other institutions, *inter alia*, include Kerala State Road Transport Corporation (Rs 135.50 crore), State Council for Science Technology and Environment (Rs 46.07 crore) and Kudumbashree (Rs 30 crore).

Table 1.10: Fiscal Priority and Fiscal Capacity of the State in 2005-06 and 2008-09

Fiscal Priority by the State	AE/GSDP	DE/AE	SSE/AE	CE/AE
All States/National Average* (Ratio) 2005-06	**19.50**	**61.44**	**30.41**	**14.13**
Kerala's Average (Ratio) 2005-06	17.49	54.80	30.87	4.18
All States/National Average* (Ratio) 2008-09	19.16	67.68	33.90	16.87
Kerala's Average (Ratio)* 2008-09	17.14	51.49	31.24	5.49
Fiscal Capacity of the State	**DE#**	**SSE**	**CE**	
All States Average Per capita Expenditure 2005-06	3010	1490	692	
Kerala's Per Capita Expenditure (Amount in Rupees) in 2005-06	3233	1821	247	
Adjusted Per Capita ** Expenditure (Amount in Rupees) in 2005-06	4041	NR	930	
All States Average Per capita Expenditure 2008-09	5030	2520	1254	
Kerala's Per Capita Expenditure (Amount in Rupees) in 2008-09	4694	2847	500	
Adjusted Per Capita ** Expenditure (Amount in Rupees) in 2008-09	6896	3455	1719	

*As *per cent* to GSDP
Calculated as per the methodology explained in the **Appendix 1.2
AE: Aggregate Expenditure DE: Development Expenditure SSE: Social Sector Expenditure
CE: Capital Expenditure
Population of Kerala: 3.31 crore in 2005-06 and 3.39 crore in 2008-09.
Development Expenditure includes Development Revenue Expenditure, Development Capital Expenditure and Loans and Advances disbursed
Source: (1) For GSDP, the information was collected from the State's Directorate of Economics and Statistics
(2) Population figures were taken from Projection 2001-2006 of the Registrar General and Census Commissioner, India (Website : http://www.censusindia.gov.in) Population = Average of Projected population for 2005 and 2006
NR = No adjustment required since the State is giving adequate fiscal priority.
Data for Arunachal Pradesh has not been included in all States Average

In Table 1.10, we are comparing the fiscal priorities given to various categories of expenditure and the fiscal capacity of the State in 2005-06 (first year of the Award Period of the TFC) and the current year (2008-09). In both years under consideration, the Government of Kerala spent less as a percentage of GSDP compared to the all States Average. The fiscal priority given to Development Expenditure (DE) and Capital Expenditure (CE) in 2005-06 and 2008-09 was inadequate as the ratio of DE and CE in terms of Aggregate Expenditure was less than the all States Average. However, in 2005-06, the fiscal priority given to Social Sector Expenditure (SSE) was marginally higher than the all States Average. In the current year, the situation worsened since Development Expenditure, Social Sector Expenditure and Capital Expenditure were given less fiscal priority when compared to the all States Averages.

In 2005-06, the per capita expenditure of DE (Rs 3233) and SSE (Rs 1821) was higher than the all States Average per capita expenditure in these categories (Rs 3010 and Rs 1490 respectively), which indicates that these schemes were more effectively implemented. However, the per capita expenditure of CE (Rs 247) was much lower than all States Average (Rs 692), indicating low priority accorded for capital expenditure. The position deteriorated further in 2008-09, as the per capita expenditure of DE and CE was lower than the all States Average (Rs 4694 and Rs 500 against the all States' Average per capita expenditure of Rs 5030 and Rs 1254 respectively) but the per capita expenditure of SSE was higher at Rs 2847, than the all States Average per capita expenditure of Rs 2520. This indicates that the per capita expenditure on Economic Services in Kerala is very low.

Since the priority given to CE was lower than the all States Average during 2005-06 and 2008-09, the State may consider enhancing the priority it gives to CE as a proportion of AE and also improve the effectiveness of CE programmes/schemes so that the benefits are realised by the people. One way to achieve this is by timely completion of projects so that the money spent is actually translated into capital assets.

1.5.2 Efficiency of Expenditure Use

In view of the importance of public expenditure on development heads from the point of view of social and economic development, it is important for the State Governments to take appropriate expenditure rationalisation measures and lay emphasis on provision of core public and merit goods[5]. Apart from improving the allocation towards development expenditure[6], particularly in view of the fiscal space being created on account of decline in debt servicing in recent years, the efficiency of expenditure use is also reflected by the ratio of capital expenditure to total expenditure (and/or GSDP) and the proportion of revenue expenditure being spent on operation and maintenance of the existing social and economic services. The higher the ratio of these components to total expenditure (and/or GSDP), the better would be the quality of expenditure. While **Table 1.11** presents the trends in development expenditure relative to the aggregate expenditure of the State during the current year vis-à-vis budgeted and the previous years, **Table 1.12** provides the details of capital expenditure and the components of revenue expenditure incurred on the maintenance of the selected social and economic services.

[5] *Core public goods* are which all citizens enjoy in common in the sense that each individual's consumption of such a good leads to no subtractions from any other individual's consumption of that good, e.g. enforcement of law and order, security and protection of our rights; pollution free air and other environmental goods and road infrastructure etc. *Merit goods* are commodities that the public sector provides free or at subsidized rates because an individual or society should have them on the basis of some concept of need, rather than ability and willingness to pay the Government and therefore, wishes to encourage their consumption. Examples of such goods include the provision of free or subsidized food for the poor to support nutrition, delivery of health services to improve quality of life and reduce morbidity, providing basic education to all, drinking water and sanitation etc.

[6] The analysis of expenditure data is disaggregated into development and non-development expenditure. All expenditure relating to Revenue Account, Capital Outlay and Loans and Advances is categorized into Social Services, Economic Services and General Services. Broadly, the social and economic services constitute development expenditure, while expenditure on general services is treated as non-development expenditure.

Table 1.11: Development expenditure

(Rupees in crore)

Components of Development Expenditure	2004-05	2005-06	2006-07	2007-08	2008-09	
					BE	Actuals
Development Expenditure (a to c)						
a. Development Revenue Expenditure	9186 (50.9)	9668 (49.5)	9190 (41.6)	10609 (38.9)	13209	13292 (43.0)
b. Development Capital Expenditure	640 (3.5)	747 (3.8)	863 (3.9)	1418 (5.2)	1540	1643 (5.3)
c. Development Loans and Advances	192 (1.1)	282 (1.4)	343 (1.6)	887 (3.3)	764	979 (3.2)
Figures in parentheses indicate percentage to aggregate expenditure						

(Source: Finance Accounts and Annual Financial Statement of the State Government for 2008-09)

Development revenue expenditure increased by 25 *per cent* (Rs 2,683 crore) from Rs 10,609 crore in 2007-08 to Rs 13,292 crore in 2008-09. The increase was mainly due to increase in expenditure under the accounts heads; General Education (Rs 797 crore), Roads and Bridges (Rs 325 crore), Urban Development (Rs 295 crore), Medical and Public Health (Rs 260 crore), Crop Husbandry (Rs 165 crore), Food Storage and Warehousing (Rs 82 crore), Other Rural Development Programmes (Rs 73 crore), Water Supply and Sanitation (Rs 68 crore) and Technical Education (Rs 61 crore).

Development capital expenditure increased by 16 *per cent* (Rs 225 crore) from Rs 1,418 crore in 2007-08 to Rs 1,643 crore in 2008-09. The increase was mainly due to increase in expenditure under the accounts heads; Housing (Rs 121 crore), Irrigation and Flood Control (Rs 69 crore) and Industry and Minerals (Rs 82 crore), partly offset by decrease in expenditure under Transport (Rs 91 crore).

Table 1.12 Efficiency of expenditure in selected Social and Economic Services

(Per cent)

Social/Economic Infrastructure	2007-08		2008-09	
	Ratio of CE to TE	In RE, the share of S &W	Ratio of CE to TE	In RE, the share of S&W
Social Services (SS)				
General Education	0.2	90	0.2	89
Health and Family Welfare	3.6	74	2.8	73
Water Supply, Sanitation, Housing and Urban Development	1.1	4	10.7	3
Total (SS)	**1.6**	**67**	**2.8**	**66**
Economic Services (ES)				
Agriculture and Allied Activities	8.2	41	5.7	34
Irrigation and Flood Control	39.2	51	42.4	40
Power and Energy	--	3	--	0.2
Transport	50.4	14	36.2	11
Total (ES)	29.7	32	24.1	26
Total (SS+ES)	**11.0**	**58**	**10.3**	**54**
TE: Total Expenditure; CE: Capital Expenditure; RE: Revenue Expenditure; S&W: Salaries and Wages.				

(Source: Finance Accounts and information furnished by Accountant General (A&E))

During the current year, the ratio of capital expenditure to total expenditure under Social Services increased from 1.6 *per cent* to 2.8 *per cent* over the previous year. The increase was mainly due to assigning priority to capital expenditure under Water Supply, Sanitation, Housing and Urban Development which increased from 1.1 *per cent* to 10.7 *per cent.* The percentage of capital expenditure to total expenditure under Economic Services decreased from 29.7 *per cent* in 2007-08 to 24.1 *per cent* in 2008-09. The lower priority of capital expenditure under Economic Services was mainly under Agriculture and Allied activities and Transport where capital expenditure as a percentage of total expenditure decreased from 8.2 *per cent* and 50.4 *per cent* to 5.7 *per cent* and 36.2 *per cent* respectively.

The share of salaries and wages in revenue expenditure under Economic Services decreased from 32 *per cent* in 2007-08 to 26 *per cent* in 2008-09 due to decrease in the share of salaries and wages, mainly under Agriculture and Allied Activities, Irrigation and Flood Control and Transport.

1.6 Analysis of Government Expenditure and Investments

In the post-FRBM framework, the State is expected to keep its fiscal deficit (and borrowings) not only at low levels but also meet its capital expenditure/investment (including loans and advances) requirements. In addition, in a transition to complete dependence on market-based resources, the State Government needs to initiate measures to earn adequate returns on its investments and recover its cost of borrowed funds rather than bearing the same on its budget in the form of implicit subsidies and take requisite steps to infuse transparency in financial operations. This section presents the broad financial analysis of investments and other capital expenditure undertaken by the Government during the current year vis-à-vis previous years.

1.6.1 Financial results of Irrigation Works

In the case of eight irrigation projects, which have been declared commercial, with a cumulative capital outlay of Rs 123.26 crore at the end of 31 March 2009, the revenue realised from them during 2008-09 was Rs 1.56 crore which was one *per cent* of the total outlay. After considering the working and maintenance expenses of Rs 28.02 crore and interest charges of Rs 12.60 crore, these projects suffered a net loss of Rs 39.06 crore.

1.6.2 Incomplete projects/works

Department-wise information pertaining to incomplete projects/works (each costing above Rupees one crore) as on 31 March 2009 is given in **Table 1.13**.

Table 1.13: Status of incomplete projects in the State

(Rupees in crore)

Sl. No	Name of the department/project	No. of incomplete projects/ works	Initial budgeted cost	Revised cost of projects	Cost over-runs	Expenditure as on 31.3.2009
1.	Water Resources Department – (Major irrigation project)	5	66.78	1920.77	1853.99	1293.31
2.	Water Resources Department – (Irrigation and Minor Irrigation Works)	2	4.19	4.76	0.57	2.12
3.	Public Works Department – (Roads and Bridges)	68	256.43	302.66	46.23	165.51
4.	Public Works Department – (Buildings)	35	102.48	121.35	18.87	77.68
5.	Harbour Engineering Department	11	122.12	137.53	15.41	114.70
	Total	**121**	**552**	**2487.07**	**1935.07**	**1653.32**

(Source: Details furnished by Departments)

As per the information made available by the Irrigation Department, five[7] projects which were commenced between 1974 and 2004 were incomplete even after incurring Rs 1293.31 crore. The delays in completion of these projects also resulted in a huge cost overrun of Rs 1854 crore at the close of the current year. Besides, 116 other capital works on which Rs 360.01 crore spent up to March 2009 also remained incomplete in the Public Works, Harbour Engineering and Water Resources Departments, involving cost overruns amounting to Rs 81.08 crore as on 31 March 2009. The reasons attributed by the departments for the slow implementation of projects/works were paucity of funds, shortage of staff, delay in getting land, changes in alignment, delays in sanctioning revised estimates, delays in getting designs approved, slackness on the part of contractors, labour problems, protests from local people, etc.

The amount blocked in these projects was 11 *per cent* of the cumulative capital outlay of the State. Due to their non-completion within the stipulated time frame, not only were the benefits to be accrued to the society delayed but the cost to the exchequer also increased due to time overruns involved in their completion.

1.6.3 Investment and returns

As of 31 March 2009, Government had invested Rs 2754.17 crore in Statutory Corporations, Government Companies, Joint Stock Companies and Co-operatives **(Table 1.14)**. The average return on these investments was 1.2 *per cent* in the last five years while the Government paid an average interest rate ranging from 7.5 *per cent* to 8.7 *per cent* on its borrowings during 2004-2009.

Table 1.14: Return on Investments

Investment/Return/Cost of Borrowings	2004-05	2005-06	2006-07	2007-08	2008-09
Investment at the end of the year (Rs in crore)	2105.84	2145.04	2392.03	2483.99	2754.17
Return (Rs in crore)	29.11	18.19	30.17	28.63	33.53
Return *(per cent)*	1.4	0.8	1.3	1.2	1.2
Average rate of interest on Government borrowing *(per cent)*	8.7	8.3	8.4	7.9	7.5
Difference between interest rate and return *(per cent)*	7.3	7.5	7.1	6.7	6.3

(Source: Finance Accounts of the State Government)

During 2008-09, the State Government invested Rs 175.50 crore in Statutory Corporations, Rs 68.83 crore in Government Companies, Rs 0.52 crore in Other Joint Stock Companies and Rs 34.43 crore in Co-operative Banks and Societies. Two Statutory Corporations and 56 Government Companies with aggregate Government investments of Rs 968.37 crore were incurring losses and their accumulated losses amounted to Rs 4002.76 crore as per the latest accounts furnished by these Companies. Of the loss-making Companies, six Companies with an investment of Rs 13.42 crore up to 31 March 2009 were under liquidation and one Company with an investment of Rs 1.35 crore was under lockout from June 1993.

1.6.4 Departmental Commercial Undertakings

Activities of quasi-commercial nature are performed by three Government departments. The department-wise position of the investments made by the Government up to the year for which *pro forma* accounts were finalised, net

[7] Banasurasagar, Idamalayar, Karappuzha, Muvattupuzha and Palakappandy.

profit/loss as well as return on capital invested in these undertakings are given in **Appendix 1.6.** The following was observed:

- An amount of Rs 137.92 crore had been invested by the State Government in three undertakings at the end of the financial year up to which their accounts were finalised.
- Of the three undertakings, only one undertaking viz. the Kerala State Insurance Department could earn a net profit amounting to Rs 68.64 crore against the capital of Rs 14.48 lakh invested by the Government.
- The two loss making undertakings viz. State Water Transport Department and Text Book Office were incurring losses continuously for more than five years.
- The accumulated losses of the State Water Transport Department were Rs 119.44 crore as against the total investment of Rs 127.41 crore.

In view of the heavy losses of the two undertakings, Government should review their working.

1.6.5 Loans and advances by the State Government

In addition to investments in co-operative societies, Corporations and Companies, the Government has also been providing loans and advances to many institutions/ organisations. **Table 1.15** presents the outstanding loans and advances as on 31 March 2009, interest receipts vis-à-vis interest payments during the last five years**.**

Table 1.15: Average interest received on loans advanced by the State Government

(Rupees in crore)

Quantum of Loans/Interest Receipts/ Cost of Borrowings	2004-05	2005-06	2006-07	2007-08	2008-09
Opening balance	5,042	5,210[8]	5,431[9]	5,562[10]	6,280[11]
Amount advanced during the year	196	287	349	893	984
Amount repaid during the year	95	52	66	45	36
Closing balance	5,143	5,445	5,714	6,410	7228
Net addition	101	235	283	848	948
Interest receipts	30	31	28	51	48
Interest receipts as a percentage of outstanding loans and advances	0.6	0.6	0.5	0.9	0.7
Interest payments as a percentage of outstanding fiscal liabilities of the State Government.	8.7	8.3	8.4	7.9	7.5
Difference between interest payments and interest receipts (*per cent*)	(-) 8.1	(-) 7.7	(-) 7.9	(-) 7.0	(-) 6.8

(Source: Finance Accounts of the State Government)

Total outstanding loans and advances as on 31 March 2009 increased by Rs 948 crore compared to those of the previous year. The major disbursement of loans during the current year was to the Kerala Water Authority for implementing the Water Supply Project assisted by the Japan Bank for International Co-operation (Rs 379 crore), the Kerala State Housing Board for

[8] Difference of Rs 66.55 crore with reference to the previous year's closing balance was on account of *pro forma* adjustments vide footnote (b) of Statement 5 of the Finance Accounts 2005-06.

[9] Difference of Rs 13.89 crore with reference to the previous year's closing balance was on account of *pro forma* adjustments vide footnote (b) of Statement 5 of the Finance Accounts 2006-07.

[10] Difference of Rs 152.42 crore with reference to the previous year's closing balance was on account of *pro forma* adjustments vide footnote (b) of Statement 5 of the Finance Accounts 2007-08.

[11] Difference of Rs 130.26 crore with reference to the previous years closing balance was on account of *pro forma* adjustments vide footnotes b, d and e of Statement 5 of the Finance Accounts 2008-09.

settlement of dues to HUDCO (Rs 255 crore) and the Kerala State Road Transport Corporation (Rs 136 crore). Interest received against these loans remained less than one *per cent* during the period 2004-05 to 2008-09 and was 0.7 *per cent* during 2008-09 as against the cost of borrowing of 7.5 *per cent* during the year.

1.6.6 Cash Balances and Investment of Cash Balances

Table 1.16 depicts the cash balances and investments made by the State Government out of the cash balances during the year.

Table 1.16: Cash Balances and Investment of Cash balances

(Rupees in crore)

Particulars	As on 1 April 2008	As on 31 March 2009	Increase/ Decrease(-)
Cash balances	973.79	2629.56	1655.77
Investments from cash balances (a + b)	850.05	2589.73	1739.68
a. GOI Treasury Bills	838.75	2579.24	1740.49
b. GOI Securities	11.30	10.49	(-) 0.81
Fund-wise break-up of investments from earmarked balances (a to c)	374.07	758.26	384.19
a. Reserve funds bearing interest	-	-	
b. Reserve funds not bearing interest	374.07	758.26	384.19
c. Deposit bearing interest	-	-	-
d. Deposit not bearing interest	-	-	-
Interest realised	7.34	22.71	15.37

(Source: Finance Accounts of the State Government)

The interest received against investments on the cash balances was 0.9 *per cent* during 2008-09 while Government paid interest at 7.5 *per cent* on its borrowings during the year. The State Government's investment of cash balances at the end of the current year amounted to Rs 2590 crore. It increased by Rs 1740 crore over the previous year. It was observed that Rs 2590 crore was invested in GOI securities, which earned an interest of Rs 23 crore during the year. Further, Rs 758 crore was invested in earmarked funds. However, deposits with the Reserve Bank of India were Rs 14.02 crore as on 31 March 2009.

The efficiency of handling of cash balances by the State can also be assessed by monitoring the trends in the monthly daily average of cash balances held by the State to meet its normal banking transactions. **Table 1.17** presents the trends of monthly average daily cash balances and the investments in 14 day Treasury Bills for the last three years (2006-09).

Table 1.17: Trends in Monthly Average Daily Cash Balances and Investments in Treasury Bills

(Rupees in crore)

Month	Monthly Average Daily Cash Balances			Investment in 14 day Treasury Bills		
	2006-07	2007-08	2008-09	2006-07	2007-08	2008-09
April	(-) 155.20	332.16	26.26	186.63	620.69	319.81
May	197.58	(-) 318.13	(-) 52.53	1261.53	…	941.15
June	173.68	(-) 104.16	273.52	641.72	219.54	1101.57
July	(-) 31.43	(-) 101.21	156.33	160.36	179.46	608.35
August	(-) 163.47	(-) 248.19	566.80	66.05	217.15	1879.57
September	(-) 274.49	(-) 324.55	(-) 107.36	…	156.28	263.70
October	(-) 155.03	(-) 98.45	75.29	272.31	226.95	576.34
November	(-) 316.08	(-) 37.55	(-) 50.18	…	557.01	525.27
December	(-) 354.21	(-) 174.39	66.05	191.58	171.11	873.50
January	(-) 348.40	(-) 61.43	1158.73	…	442.96	3068.55
February	123.00	170.31	1338.03	918.80	770.47	2694.07
March	676.22	605.12	2060.49	1975.46	2059.98	4825.69

(Source : Information received from State Government and Accountant General(A&E))

Government of India Treasury Bills amounting to Rs 17677.58 crore were purchased and Rs 15937.09 crore were discounted during 2008-09. Resultantly, the investment from cash balances increased by Rs 1740 crore over the previous year.

1.7 Assets and Liabilities

1.7.1 Growth and composition of Assets and Liabilities

In the existing Government accounting system, comprehensive accounting of fixed assets like land and buildings owned by the Government is not done. However, the Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure incurred. **Appendix 1.3** gives an abstract of such liabilities and the assets as on 31 March 2009, compared with the corresponding position on 31 March 2008. While the liabilities in this Appendix consist mainly of internal borrowings, loans and advances from GOI, receipts from the Public Account and Reserve Funds, the assets mainly comprise the capital outlay and loans and advances given by the State Government and its cash balances.

According to the definition given in the Kerala Fiscal Responsibility Act, 2003, total liabilities means liabilities upon the Consolidated Fund and the Public Account of the State.

1.7.2 Fiscal Liabilities

The trends of outstanding fiscal liabilities of the State are presented in **Appendix 1.4.** The composition of fiscal liabilities during the current year vis-à-vis the previous year are presented in **Charts 1.10** and **1.11.**

Chart 1.10: Composition of Outstanding Fiscal Liabilities as on 01 April 2008 (Rupees in crore)

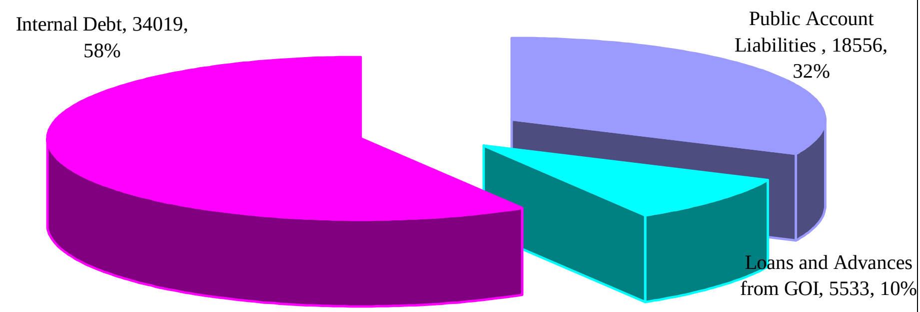
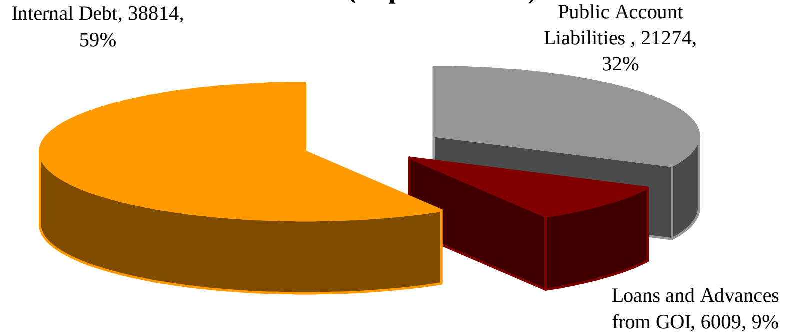


Chart 1.11: Composition of Outstanding Fiscal Liabilities as on 31 March 2009 (Rupees in crore)



The overall fiscal liabilities of the State increased from Rs 43,692 crore in 2004-05 to Rs 66,097 crore in 2008-09. Fiscal liabilities of the State comprised Consolidated Fund liabilities and Public Account liabilities. As at the end of March 2009, the Consolidated Fund liabilities (Rs 44,823 crore) comprised market loans (Rs 21,263 crore), loans from Government of India (Rs 6,009 crore) and other loans (Rs 17,551 crore). The Public Account liabilities (Rs 21,274 crore) comprised Small Savings, Provident Fund, etc., (Rs 18,447 crore), interest bearing obligations (Rs 33 crore) and non-interest bearing obligations like deposits and other earmarked funds (Rs 2,794 crore). The growth rate was 13.7 *per cent* during 2008-09 over the previous year. The ratio of fiscal liabilities to GSDP increased from 35.8 in 2007-08 to 36.7 in 2008-09. The ratio of fiscal liabilities to GSDP was 36.7 *per cent* in 2008-09 and was higher than the norms of 30 *per cent* recommended by TFC for the terminal year (2009-10). These liabilities stood at 2.7 times the revenue receipts at the end of 2008-09 compared to 2.8 times at the end of 2007-08.

The State Government had set up a Consolidated Sinking Fund during 2005-06 for amortisation of open market loans. A revised scheme of Consolidated Sinking Fund came into effect from 2007-08, according to which the Fund was to be utilised as an Amortisation Fund for redemption of all outstanding liabilities. The rate of contribution to the Consolidated Sinking Fund was 0.5 *per cent* of the outstanding liabilities as at the end of the previous year. The Fund was to be credited with contributions from revenue at the prescribed rate and interest accrued on investments made out of the Fund. Only the interest accrued and credited in the Fund was to be utilised for redemption of the open market loans of the Government in 2010-11 and 2011-12 and for redemption of all outstanding liabilities of the Government from 2012-13 onwards as per the revised scheme. During the year, the State Government contributed Rs 344.34 crore to the Fund. As on 31 March 2009, the outstanding balance in the Sinking Fund was Rs 753.70 crore.

1.7.3 Status of Guarantees – Contingent liabilities

Guarantees are liabilities contingent on the Consolidated Fund of the State in cases of default by borrowers for whom the guarantees have been extended. Section 3 of the Kerala Ceiling on Government Guarantees Act, 2003 which came into effect on 5 December 2003 stipulates that the total outstanding

Government Guarantees as on the first day of April every year shall not exceed Rs 14,000 crore. As per Section 6 of the Act, Government was to constitute a Guarantee Redemption Fund. The guarantee commission charged under Section 5 of the Act was to form the corpus of the Fund. However, the Fund had not been constituted and consequently, guarantee commission of Rs 250.62 crore collected during 2003-04 to 2008-09 could not be credited to the Fund but was treated as non-tax revenue and used for meeting the revenue expenditure of the Government.

As per Statement 6 of the Finance Accounts, the maximum amount for which guarantees were given by the State and outstanding guarantees at the end of the year since 2004-05 is given in **Table 1.18.**

Table 1.18: Guarantees given by the Government of Kerala

(Rupees in crore)

Guarantees	2004-05	2005-06	2006-07	2007-08	2008-09
Maximum amount guaranteed (Principal only)	14783.36	13751.80	12646.70	14871.08	11385.54
Outstanding amount of guarantees (including interest)	12315.96	11934.69	9405.33	8317.34	7603.32
Percentage of maximum amount guaranteed to total revenue receipts	110	90	70	70	46
Criteria as per Kerala Ceiling on Government Guarantees Act, 2003 (Outstanding amount of guarantees as on the first day of April)	14,000	14,000	14,000	14,000	14,000

(Source: Finance Accounts of the State Government)

The outstanding guarantees at the end of the past five years i.e. 2004-09 ranged between Rs 7603 crore and Rs 12316 crore, which were well within the ceiling prescribed by the Kerala Ceiling on Government Guarantees Act.

The arrears of guarantee commission receivable as of March 2009 were Rs 58.36 crore. Out of this, Rs 53.14 crore related to 11 institutions which had arrears exceeding Rupees one crore in each case.

1.8 Debt Sustainability

Apart from the magnitude of debt of the State Government, it is important to analyse various indicators that determine the debt sustainability[12] of the State. This section assesses the sustainability of debt of the State Government in terms of debt stabilisation[13]; sufficiency of non-debt receipts[14]; net availability

[12] The Debt sustainability is defined as the ability of the State to maintain a constant debt-GDP ratio over a period of time and also embodies the concern about the ability to service its debt. Sustainability of debt, therefore, also refers to sufficiency of liquid assets to meet current or committed obligations and the capacity to keep a balance between costs of additional borrowings with returns from such borrowings. It means that the rise in fiscal deficits should match the increase in the capacity to service the debts.

[13] A necessary condition for stability states that if the rate of growth of the economy exceeds the interest rate or the cost of public borrowings, the debt-GDP ratio is likely to be stable provided primary balances are either zero or positive or are moderately negative. Given the rate spread (GSDP growth rate – interest rate) and quantum spread (Debt x rate spread), the debt sustainability condition states that if the quantum spread together with the primary deficit is zero, their debt-GSDP ratio would be constant or their debt would stabilize eventually. On the other hand, if the primary deficit together with the quantum spread turns out to be negative, the debt-GSDP ratio would be rising. In case it is positive, the debt-GSDP ratio would eventually be falling.

[14] Adequacy of incremental non-debt receipts of the State to cover the incremental interest liabilities and incremental primary expenditure. The debt sustainability could be significantly facilitated if the incremental non-debt receipts could meet the incremental interest burden and the incremental primary expenditure.

of borrowed funds[15]; burden of interest payments (measured by interest payments to revenue receipts ratio) and the maturity profile of State Government securities. **Table 1.19** analyses the debt sustainability of the State according to these indicators for the period of three years beginning from 2006-07.

Table 1.19: Debt Sustainability: Indicators and Trends

(Rupees in crore)

Indicators of Debt Sustainability	2006-07	2007-08	2008-09
Debt Stabilisation (Quantum Spread + Primary Deficit)	3286	1412	347
Sufficiency of Non-debt Receipts (Resource Gap)	(+) 359	(-) 2278	(-) 247
Net Availability of Borrowed Funds	152	1629	3334
Burden of Interest Payments (IP/RR *per cent*)	23	21	19
Maturity Profile of State Debt (In Years)			
0 - 1	Details not included in the Finance Accounts	1.65	1.59
1 – 3		4913.86 (12.4)	5852.42 (13.1)
3 – 5		4863.95 (12.3)	5349.27 (11.9)
5 – 7		5447.94 (13.8)	6241.10 (13.9)
7 and above		23385.70 (59.1)	26576.50 (59.3)
Information not furnished by State Government		938.69 (2.4)	801.97 (1.8)
Figures in parentheses indicate the percentage to total State debt.			

(Source: Finance Accounts of the State Government)

The quantum spread together with the primary deficit was positive during the period 2006-07 to 2008-09, indicating a declining trend in debt-GSDP ratio. These trends indicate that the State is moving towards debt stabilisation, which, if continued would eventually improve the debt sustainability position of the State. However, the non-debt-receipts (resource gap) indicated a declining trend in 2007-08 compared to the previous year. But, during 2008-09, non-debt receipts increased by Rs 3397 crore while the total expenditure increased by Rs 3644 crore. The net funds available from borrowings after providing for interest and repayment increased from Rs 152 crore in 2006-07 to Rs 3334 crore in 2008-09. The ratio of interest payments to revenue receipts decreased from 23 *per cent* in 2006-07 to 19 *per cent* in 2008-09.

1.9 Fiscal Imbalances

Three key fiscal parameters - revenue, fiscal and primary deficits - indicate the extent of overall fiscal imbalances in the finances of the State Government during a specified period. The deficit in the Government accounts represents the gap between its receipts and expenditure. The nature of deficit is an indicator of the prudence of fiscal management of the Government. Further, the ways in which the deficit is financed and the resources raised are applied are important pointers to its fiscal health. This section presents the trends, nature, magnitude and the manner of financing these deficits and also the

[15] Defined as the ratio of the debt redemption (Principal + Interest Payments) to total debt receipts and indicates the extent to which the debt receipts are used in debt redemption indicating the net availability of borrowed funds.

assessment of actual levels of revenue and fiscal deficits vis-à-vis targets set under the Fiscal Responsibility Act/Rules for the financial year 2008-09.

1.9.1 Trends in Deficits

Chart 1.12 and **1.13** presents the trends in deficit indicators over the period 2004-09.

Chart 1.12: Trends in Deficit Indicators (Rupees in crore)

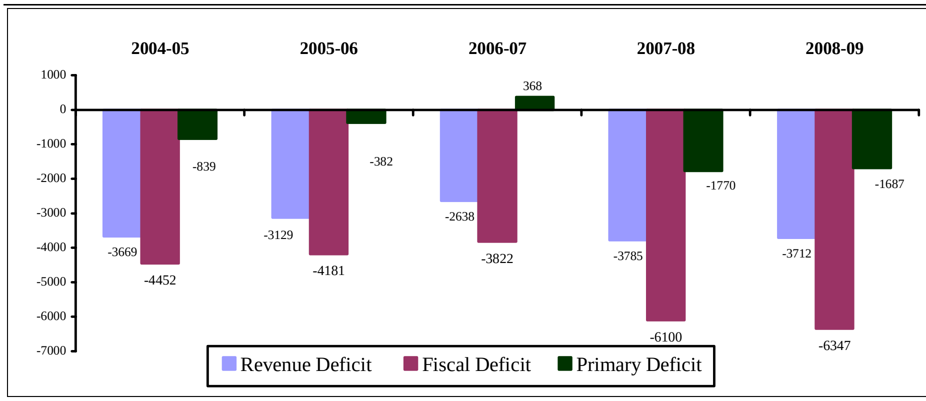
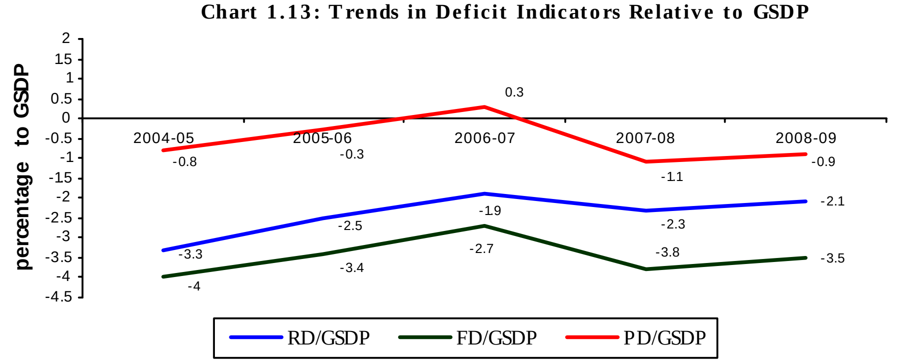


Chart 1.13: Trends in Deficit Indicators Relative to GSDP



The revenue deficit of the State which indicates the excess of its revenue expenditure over revenue receipts showed inter-year variations during 2004-09. However, it decreased steadily from 2004-05 to 2006-07 and increased to Rs 3785 crore in 2007-08 but then decreased to Rs 3,712 crore in 2008-09. The marginal decrease in revenue deficit during the current year was due to increase of 16.1 *per cent* in revenue receipts when compared to 13.4 *per cent* increase in revenue expenditure.

The fiscal deficit, which represents the total borrowing of the Government and its total resource gap increased steadily from Rs 3,822 crore in 2006-07 to Rs 6,347 crore in 2008-09. The increase in Capital Expenditure (Rs 221 crore) and loans and advances disbursed (Rs 91 crore) led to the increase in fiscal deficit during the year when compared to the previous year.

As a proportion of GSDP, the revenue deficit has come down to 2.1 *per cent* and the fiscal deficit to 3.5 *per cent* in 2008-09 from 3.3 *per cent* and 4 *per cent* in 2004-05.

1.9.2 Components of Fiscal Deficit and its Financing Pattern

The financing pattern of the fiscal deficit has undergone a compositional shift as reflected in the **Table 1.20.**

Table 1.20: Components of Fiscal Deficit and its Financing Pattern

(Rupees in crore)

	Particulars	2004-05	2005-06	2006-07	2007-08	2008-09
Decomposition of Fiscal Deficit						
1	Revenue Deficit	3669 (3.3)	3129 (2.5)	2638 (1.9)	3785 (2.3)	3712 (2.1)
2	Net Capital Expenditure	682 (0.6)	817 (0.7)	901 (0.6)	1467 (0.9)	1687 (0.9)
3	Net Loans and Advances	101 (0.1)	235 (0.2)	283 (0.2)	848 (0.5)	948 (0.5)
Financing Pattern of Fiscal Deficit*						
1	Market Borrowings	1376 (1.2)	1456 (1.2)	1786 (1.3)	3634 (2.2)	4782 (2.7)
2	Loans from GOI	(-) 217 (- 0.2)	6.0 ([16])	(-) 46 (0.03)	161 (0.1)	476 (0.3)
3	Special Securities Issued to NSSF**	2795 (2.5)	2649 (2.1)	2177 (1.5)	107 (0.07)	(-) 102 (-0.06)
4	Loans from Financial Institutions	84 (0.08)	(-) 111 (-0.09)	336 (0.2)	309 (0.2)	116 (0.06)
5	Small Savings, PF etc	388 (0.4)	50 (0.04)	(-) 306 (-0.2)	1324 (0.8)	2589 (1.4)
6	Deposits and Advances	(-) 82 (-0.07)	(-) 29 (-0.02)	428 (0.3)	492 (0.3)	132 (0.07)
7	Suspense and Misc	96 (0.08)	375 (0.3)	319 (0.2)	118 (0.07)	(-) 85 (-0.05)
8	Remittances	21 (0.02)	(-) 37 (-0.03)	(-) 4 ([16])	49 (0.03)	23 (0.01)
9	Others	124 (0.1)	131 (0.1)	(-) 43 (-0.03)	(-) 160 (-0.10)	72 (0.04)
10	Overall Surplus/Deficit	(-) 133 (-0.1)	(-) 309 (-0.2)	(-) 825 (-0.6)	66 (0.04)	(-) 1656 (-0.9)

Figures in brackets indicate the *per cent* to GSDP.
*All these figures are net of disbursements/outflows during the year
**National Small Savings Fund

(Source: Finance Accounts of the State Government)

During 2004-05 to 2006-07, market borrowings and special securities issued to NSSF financed a major part of fiscal deficit. However, during 2007-08 and 2008-09, the special Securities issued to NSSF showed a declining trend and the fiscal deficit was financed mainly by Provident Funds, Small Savings and market borrowings.

1.9.3 Quality of Deficit/Surplus

The ratio of revenue deficit to fiscal deficit and the decomposition of primary deficit into primary revenue deficit and capital expenditure (including loans and advances) would indicate the quality of deficit in the States' finances. The ratio of revenue deficit to fiscal deficit indicates the extent to which borrowed funds were used for current consumption. Further, persistently high ratios of revenue deficit to fiscal deficit also indicates that the asset base of the State was continuously shrinking and a part of the borrowings (fiscal liabilities) did not have any asset backup. The bifurcation of the primary deficit **(Table 1.21)** indicates the extent to which the deficit has been on account of enhancement in capital expenditure which may be desirable to improve the productive capacity of the State's economy.

Table 1.21: Primary deficit/Surplus – Bifurcation of factors

(Rupees in crore)

Year	Non-debt receipts (NDR)	Primary revenue expenditure	Capital expenditure	Loans and advances	Primary expenditure	Primary revenue deficit (-) / surplus (+)	Primary deficit (-) / surplus (+)
1	**2**	**3**	**4**	**5**	**6 (3+4+5)**	**7 (2-3)**	**8 (2-6)**
2004-05	13595	13556	682	196	14434	(+) 39	(-) 839
2005-06	15347	14625	817	287	15729	(+) 722	(-) 382
2006-07	18255	16635	903	349	17887	(+) 1620	(+) 368
2007-08	21160	20562	1475	893	22930	(+) 598	(-) 1770
2008-09	24557	23564	1696	984	26244	(+) 993	(-) 1687

(Source: Finance Accounts of the State Government)

[16] Insignificant.

The ratio of revenue deficit to fiscal deficit declined steadily from 82.4 *per cent* in 2004-05 to 58.5 *per cent* in 2008-09, indicating improvement in the quality of deficit during the period. As a proportion of GSDP, revenue deficit has come down to 2.1 *per cent* and fiscal deficit to 3.5 *per cent* in 2008-09 from 3.3 *per cent* and 4 *per cent* respectively in 2004-05.

Bifurcation of the factors leading to primary deficit or surplus of the State reveals that the primary deficit was on account of capital expenditure incurred and loans and advances disbursed by the State Government. In other words, non-debt receipts of the State were enough to meet the primary expenditure requirements in the revenue account during 2004-09. However, the surplus non-debt receipts were not enough to meet the expenditure requirements under the capital account during the period 2004-09 except during 2006-07, which resulted in the primary deficit. This indicates the extent to which the primary deficit has been on account of enhancement in capital expenditure which to some extent may be desirable to improve the productive capacity of the State's economy.

1.9.4 State's Own Revenue and Deficit Correction

It is worthwhile to observe the extent to which deficit correction is achieved by the State on account of improvements in its own resources, which is an indicator of the durability of the correction in deficit indicators. **Table 1.22** presents the changes in revenue receipts of the State and the correction of the deficit during the last three years.

Table 1.22: Changes in revenue receipts and correction of deficit

(*Per cent* of GSDP)

Parameters	2006-07	2007-08	2008-09	
			BE	Actual
Revenue Receipts (a to d)				
a. State's Own Tax Revenue	8.4	8.4	9.6	8.9
b. State's Own Non- tax Revenue	0.7	0.8	0.8	0.9
c. State's Share in Central Taxes and Duties	2.2	2.5	2.9	2.4
d. Grants-in-Aid	1.5	1.3	1.9	1.5
Revenue Expenditure	14.6	15.3	17.2	15.7
Revenue Deficit/Surplus	(-) 1.9	(-) 2.3	(-) 2.0	(-) 2.1
Fiscal Deficit/Surplus	(-) 2.7	(-) 3.8	(-) 3.4	(-) 3.5

(Source : Finance Accounts, Annual Financial Statement for 2008-09, Government of Kerala and information furnished by Director of Economics and Statistics, Government of Kerala)

The Fiscal Responsibility Act, 2003 enacted on 5 December 2003 envisaged elimination of revenue deficit and reduction of fiscal deficit to two *per cent* of the estimated GSDP by 31 March 2007. Though TFC recommended elimination of revenue deficit and reduction of fiscal deficit to three *per cent* of GSDP by March 2009, the State Government could not adhere to the targets primarily due to the financial impact of the State Pay Commission's award. However, State Government aims to achieve these targets by the end of 2010-11 in the Medium Term Fiscal Plan presented to the Legislature with the budget for 2008-09. Necessary amendments to the Kerala Fiscal Responsibility Act were to be made to bring about a postponement in achieving deficit targets. Achieving targets of zero revenue deficit by 2010-11 would require pruning down of unproductive expenditure and improved resource mobilisation.

1.10 Conclusions

During the current year, the revenue deficit decreased only marginally by Rs 73 crore as the growth of revenue receipts was 16.1 *per cent* while growth of revenue expenditure was 13.4 *per cent* over the previous year. Tax revenue and non-tax revenue receipts fell short of the normative assessment made by the Twelfth Finance Commission (TFC) by Rs 622 crore and Rs 172 crore respectively.

The Non-Plan revenue expenditure increased by 10.6 *per cent* over the previous year and exceeded by 20.3 *per cent* against the normative assessment made by TFC. The Plan revenue expenditure also showed an increase of 41 *per cent* over the previous year.

The expenditure on salaries and wages at 49 *per cent* of the revenue expenditure net of interest and pension payment was higher than the norm of 35 *per cent* recommended by TFC. Pension payments exceeded the normative assessment made by TFC by 25 *per cent.*

Capital expenditure increased during the year by 15 *per cent* over the previous year.

The return on investments made by the State Government ranged between 0.8 and 1.4 *per cent* in the last five years against an average interest of 7.5 to 8.7 *per cent* on its borrowings.

The ratio of fiscal liabilities to GSDP at 36.7 *per cent* during 2008-09 was higher than the norm of 30 *per cent* recommended by the TFC.

Government of India directly transferred Rs 913.47 crore to State implementing agencies during the year. Direct transfer of funds from the Government of India to the State implementing agencies ran the risk of improper utilisation of funds by these agencies.

1.11 Recommendations

The State Government had not achieved the Kerala Fiscal Responsibility Act, 2003 targets in reducing the revenue deficit to nil and the fiscal deficit to two *per cent* of the GSDP, which needs urgent attention by effective revenue collection and curtailing unproductive expenditure.

Government may consider enhancing the priority to capital expenditure, as the proportion of capital expenditure to aggregate expenditure in Kerala is lower than the all State's average.

The performance of Public Sector undertakings needs to be monitored to improve the average rate of returns on the capital invested.

Systems have to be built to monitor funds directly received by the State implementing agencies from the Government of India.