

Chapter I

Finances of the State Government

1.1 Introduction

The State of Kerala, located at the southern end of the country, accounts for one *per cent* of the total area of the country and about three *per cent* of the population. The State ranks high in the human development index with a literacy rate of 90.92 *per cent* and life expectancy at birth of 74 years when compared to the General Category States' averages. The infant mortality rate (13 per thousand) of the State is very low compared to the General Category States' average. The Gross State Domestic Product (GSDP) of Kerala has been growing at a compound annual growth rate (12.76 *per cent*) as compared to other General Category States' growth rate (12.54 *per cent*). However, the State has slightly higher urban and rural inequality compared to the All India average (**Appendix 1.1**).

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 1.2**. The methodology adopted for the assessment of the fiscal position of the State is given in **Appendix 1.3**.

1.2 Summary of Current Year's Fiscal Transactions

Table 1.1 presents the summary of the State Government's fiscal transactions during the current year (2009-10) vis-à-vis the previous year, while **Appendix 1.4** 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

(` in crore)

2008-09	Receipts	2009-10	2008-09	Disbursements	2009-10		
Section-A: Revenue					Non Plan	Plan	Total
24512.18	Revenue receipts	26109.40	28223.86	Revenue expenditure	26953.32	4179.05	31132.37
15990.18	Tax revenue	17625.02	12667.37	General services	13564.69	370.83	13935.52
1559.29	Non-tax revenue	1852.22	9362.84	Social services	8119.17	2347.98	10467.15
4275.52	Share of Union Taxes/ Duties	4398.78	3928.53	Economic services	2780.48	1460.24	4240.72
2687.19	Grants from Government of India	2233.38	2265.12	Grants-in-aid and Contributions	2488.98	--	2488.98

2008-09	Receipts	2009-10	2008-09	Disbursements	2009-10		
Section-B: Capital					Non Plan	Plan	Total
9.11	Miscellaneous Capital Receipts	48.96	1695.60	Capital Outlay	157.23	1902.16	2059.39
35.64	Recoveries of Loans and Advances	38.47	983.69	Loans and Advances disbursed	172.48	704.20	876.68
6921.40	Public Debt receipts*	6615.52	1650.34	Repayment of Public Debt*	#	#	1765.06
80.00	Contingency Fund	5.84	5.84	Contingency Fund	#	#	26.27
56284.56	Public Account receipts	61652.53	53627.80	Public Account disbursements	#	#	57949.47
973.79	Opening Cash Balance	2629.55	2629.55	Closing Cash Balance	#	#	3291.03
88816.68	Total	97100.27	88816.68	Total	#	#	97100.27

Source: Finance Accounts of the State for 2008-09 and 2009-10.

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

* Excluding net transactions under Ways and Means advances and overdraft

The following are the significant changes in fiscal transactions during 2009-10 over the previous year.

- Revenue receipts grew by 6.5 *per cent* (` 1,597 crore) relative to the previous year. The increase was under tax revenue (` 1,635 crore), State's share of Union taxes and duties (` 123 crore) and non-tax revenue (` 293 crore). The increase was offset by decrease in grants-in-aid from the Government of India (GOI) (` 454 crore).
- Revenue expenditure and capital expenditure increased by 10.3 *per cent* (` 2,909 crore) and 21.5 *per cent* (` 364 crore) respectively over the previous year.
- Public debt receipts decreased by ` 306 crore, mainly due to decrease in internal debt by ` 100 crore and borrowings from GOI by ` 206 crore. Public debt repayment increased by ` 115 crore.
- Public Account receipts and disbursements increased by ` 5368 crore and ` 4322 crore respectively over the previous year. Thus, increase in net receipts during the year was ` 1046 crore.
- The cash balance of the State as on 31 March 2010 increased to ` 3291.03 crore from ` 2629.55 crore as on 31 March 2009.

The budget estimates and actuals for 2009-10 for some important fiscal parameters are indicated in **Chart 1.1**:

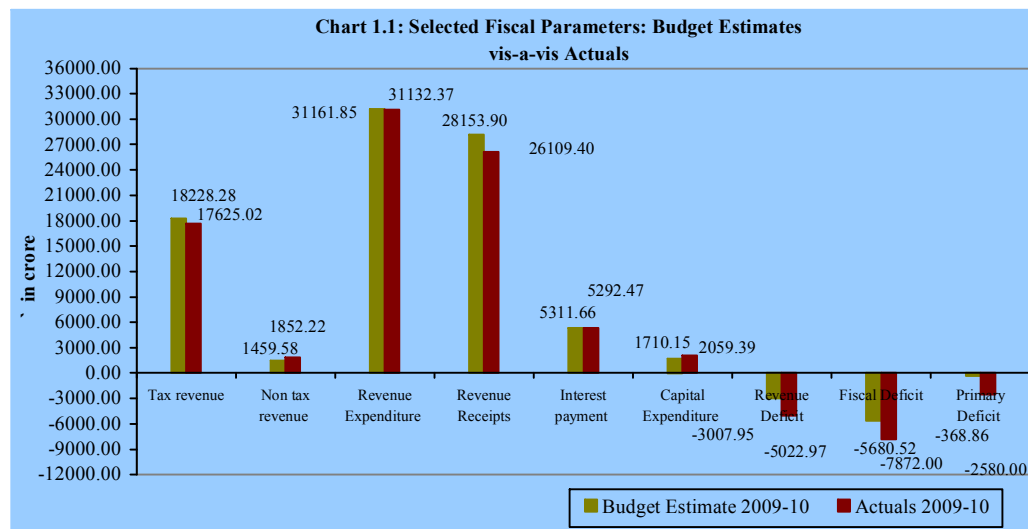
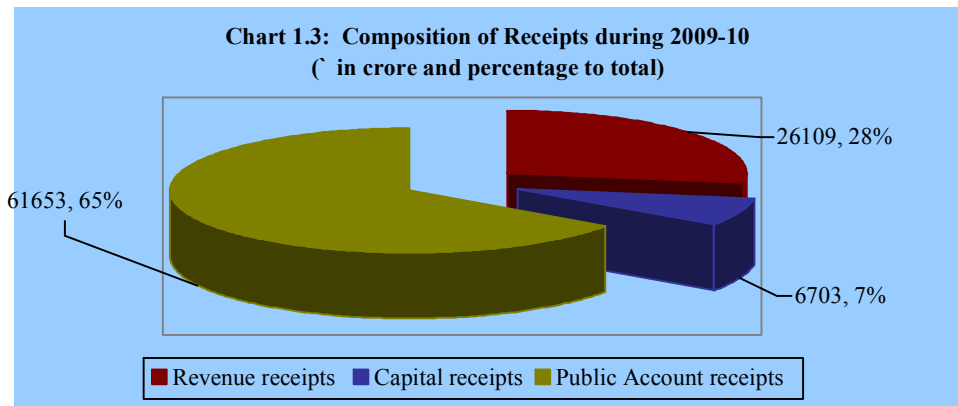
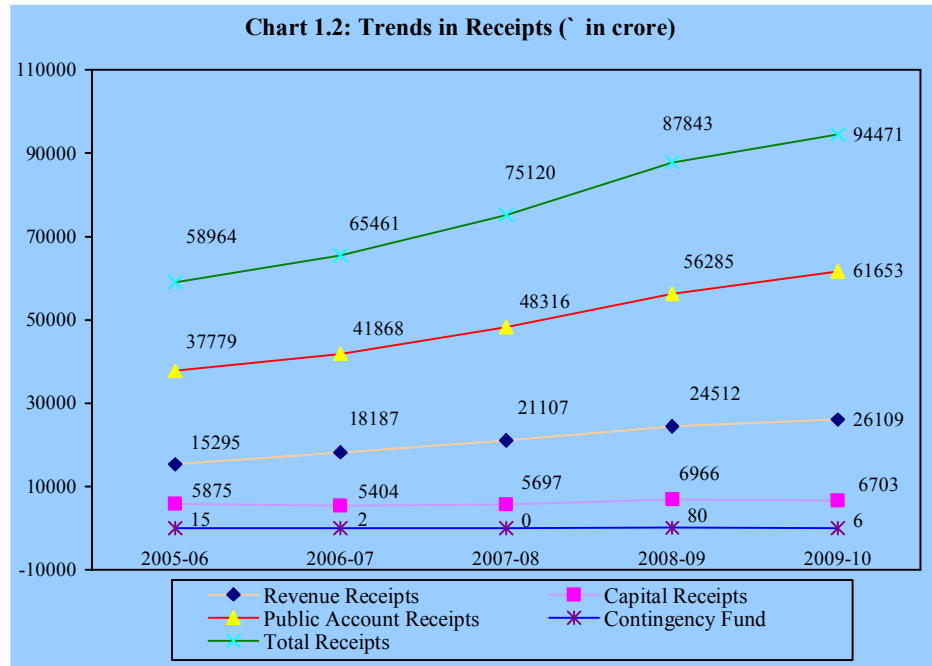


Chart 1.1 shows that the actual revenue expenditure was fairly in line with the budget estimates whereas the actual revenue receipts fell significantly short of the budget estimates by ` 2045 crore (7.3 per cent). The capital expenditure showed an increase of ` 349 crore (20.4 per cent) over the budget estimates. The revenue deficit, the fiscal deficit and the primary deficit were away from the mark mainly due to the differences between the budget estimates and actuals in revenue receipts and expenditure. Against an estimated revenue deficit of ` 3008 crore, the financial year ended with a revenue deficit of ` 5023 crore; an increase of ` 2015 crore. The fiscal deficit and primary deficit were also more by ` 2191 crore and ` 2211 crore respectively over the budget estimates.

1.3 Resources of the State

1.3.1 Resources of the State as per Annual Finance Accounts

The receipts that constitute the resources of the State Government are classified as revenue receipts and capital receipts. Revenue receipts consist of tax revenues, non-tax revenues, State's share of Union taxes and duties and grants-in-aid from the Government of India. 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 Government of India as well as accruals from the Public Account. **Table-1.1** shown earlier presents the receipts and disbursements of the State during the current year as recorded in its Annual Finance Accounts. **Chart 1.2** depicts the trends in various components of the receipts of the State during 2005-10. **Chart 1.3** depicts the composition of resources of the State during the current year.



The total receipts of the State Government for the year 2009-10 were ₹ 94,471 crore. Of these, revenue receipts were ₹ 26,109 crore, constituting 28 per cent of the total receipts, capital receipts constituted seven per cent and Public Account receipts constituted 65 per cent of the total receipts.

1.3.2 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 agencies¹ 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,

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.

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 in the State, 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
(` in crore)

Programme/Scheme	Implementing Agency in the State	2008-09	2009-10
Mahatma Gandhi National Rural Employment Guarantee Scheme	District Rural Development Agencies (Poverty Alleviation Unit)	200.47	467.71
Pradhan Mantri Gram Sadak Yojana ²	Kerala State Rural Roads Development Agency	84.02	100.11
Rural Housing - Indira Awaas Yojana	District Rural Development Agencies(Poverty Alleviation Unit)	156.56	194.71
Rashtriya Madhyamik Shiksha Abhiyan	Secondary Education Development Society Kerala	Nil	8.93
Swarn Jayanthi Gram Swarozgar Yojana	District Rural Development Agencies(Poverty Alleviation Unit)	44.85	44.27
National Horticulture Mission	Kerala State Horticulture Mission	75.17	Nil
Accelerated Rural Water Supply Programme	Kerala Water Authority	112.90	152.04
Sarva Shiksha Abhiyan	Primary Education Development Society of Kerala	108.54	119.90
Swarn Jayanthi Shahari Rozgar Yojana	State Poverty Eradication Mission (Kudumbashree)	10.30	9.50
Central Rural Sanitation Programme	District Rural Development Agencies(Poverty Alleviation Unit)	33.80	25.95 ³
National Rural Health Mission	State Health and Family Welfare Society	84.96	245.17
MPs Local Area Development Scheme	District Collectors	35.00	86.00
Rashtriya Swasthya Bima Yojana	Comprehensive Health Insurance Agency of Kerala	13.71	18.34
Integrated Watershed Management Programme	District Rural Development Agencies (Poverty Alleviation Unit)	11.46	3.20
Others ⁴		144.06	158.89
Total		1115.80	1,634.72

Source: Appendix VII of Finance Accounts 2009-10 and information furnished by the implementing agencies.

Government of India (GOI) directly transferred ` 1634.72 crore to State implementing agencies during 2009-10. 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 would be difficult to monitor the end use of these direct transfers.

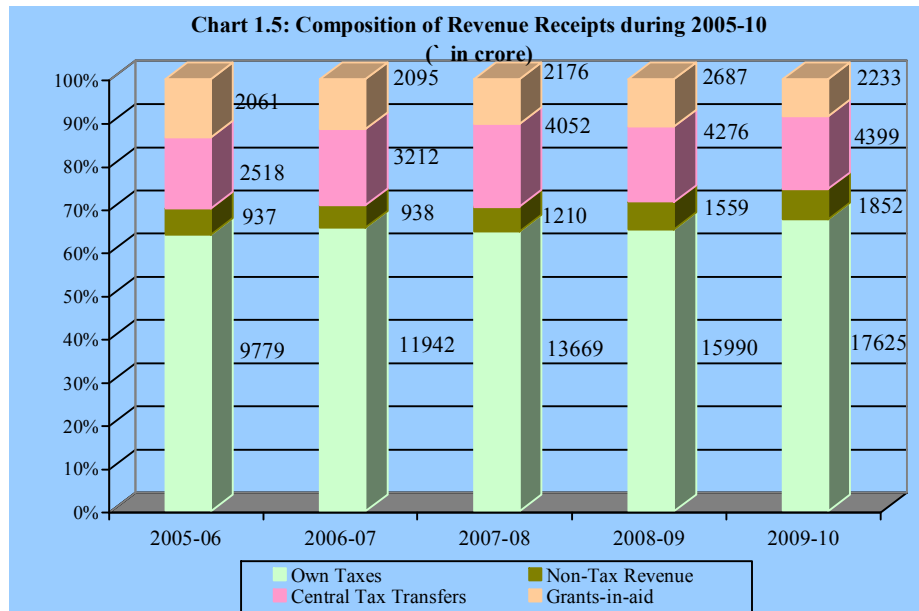
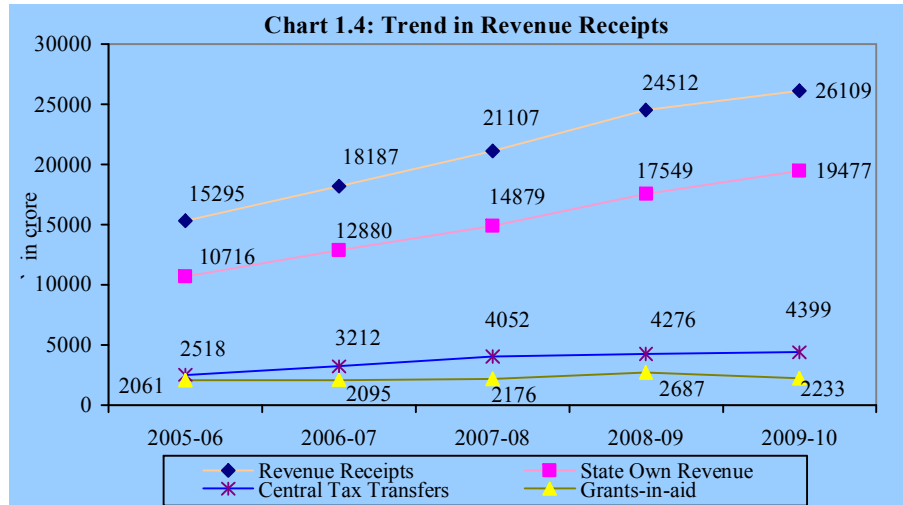
1.4 Revenue Receipts

Revenue receipts consist of the State's own tax and non-tax revenues, Central tax transfers and grants-in-aid from GOI. Statement-11 of the Finance Accounts gives details of the revenue receipts of the Government. The trend and composition of revenue receipts over the period 2005-10 are presented in **Appendix 1.5** and also depicted in **Charts 1.4** and **1.5** respectively.

² The figures include the funds released by National Rural Roads Development Agency (2008-09 : ` 64.48 crore and 2009-10 : ` 23 crore).

³ Includes ` 16.20 crore sanctioned to Block Panchayats as award money under *Nirmal Gram Puraskar* and released to Suchithwa Mission

⁴ Please see Appendix VII of Finance Accounts – Vol.II for details of individual programme/scheme.



Revenue receipts increased from ` 15,295 crore in 2005-06 to ` 26,109 crore in 2009-10. The contribution of the State's own taxes under total revenue receipts increased from 64 per cent in 2005-06 to 67 per cent in 2009-10 whereas the contribution of non-tax revenue increased only marginally from six per cent in 2005-06 to seven per cent in 2009-10. The contribution of grants-in-aid from GOI decreased from 13 per cent in 2005-06 to nine per cent in 2009-10, whereas the contribution of Central tax transfers remained at the same level of 17 per cent in 2009-10 compared to 2005-06.

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

	2005-06	2006-07	2007-08	2008-09	2009-10
Revenue Receipts (RR) (` in crore)	15,295	18,187	21,107	24,512	26,109
State's own taxes (` in crore)	9,779	11,942	13,669	15,990	17,625
Rates of growth					
Revenue Receipt (per cent)	13.3	18.9	16.1	16.1	6.5
State's own taxes (per cent)	9.1	22.1	14.5	17.0	10.2
RR/GSDP (per cent)	12.2	12.5	12.7	12.9	12.2
Buoyancy Ratios⁵					
Revenue Buoyancy w.r.t GSDP	0.96	1.2	1.1	1.1	0.5
State's Own Tax Buoyancy w.r.t GSDP	0.7	1.4	1.01	1.2	0.8

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

- In 2007-08 and 2008-09, the growth rate of revenue receipts was 16.1 per cent each year whereas in 2009-10, the growth rate was only 6.5 per cent. The low growth rate of revenue receipts during 2009-10 compared to 2008-09 was mainly due to decrease of ` 453.81 crore in grant-in-aid from GOI.
- The GSDP was estimated to increase by 13 per cent during 2009-10 over the previous year. However, the growth rate of the State's own taxes during 2009-10 (10.2 per cent) was lesser than the growth rate of GSDP indicating that the State has the potential to widen its tax base and augment revenue.
- The State's own tax buoyancy with reference to GSDP stood at 0.8 as against 1.3 prescribed by TFC. Ideally, the rate of growth of its own taxes should be equal to or more than the increase in GSDP.

Debt waiver under Debt Consolidation and Relief facilities

The Twelfth Finance Commission (TFC) framed a scheme of debt relief of Central loans named Debt Consolidation and Relief Facilities based on fiscal performance of the State linked to the reduction of deficits of the States. Under the scheme, the repayments due on Central loans, from 2005-06 to 2009-10, after consolidation and reschedule of loans, were to be eligible for write off. The amount sanctioned by the GOI as debt relief each year was to be adjusted by showing repayment of Central loans and crediting the amount to the head of account '0075 Miscellaneous receipts'. The States was to be eligible for the benefit, subject to fulfilment of certain conditions, viz. legislating the FRBM Act, gradual abolition of revenue deficit by 2008-09, bringing annual reduction targets for fiscal deficit, bringing out the Annual Fiscal Policy Statement, etc. As assessed by the TFC, in the case of Kerala, the amount of repayment due for the period 2005-10 after consolidation and reschedule of repayment was ` 1063.05 crore. The ratio of total repayment to average revenue deficit (2001-02 to 2003-04) was 0.31, by which repayments were to be written off for every rupee reduction in revenue deficit. Thus, the annual repayment due was ` 212.61 crore. During the period 2005-10, GOI sanctioned ` 250.26 crore as debt relief for the Government as detailed in **Table 1.4.**

⁵Buoyancy ratios indicate the elasticity or degree of responsiveness of fiscal variables with respect to a given change in the base variable. For instance, for 2009-10, revenue buoyancy at 0.5 implies that revenue receipts tend to increase by 0.5 percentage points, if the GSDP increases by one per cent.

Table 1.4: Debt relief sanctioned by GOI

(` in crore)

Year	Debt relief due as per TFC recommendations	Debt Relief sanctioned by the Central Government
2005-06	212.61	0.00
2006-07	212.61	102.40*
2007-08	212.61	147.86**
2008-09	212.61	0.00
2009-10	212.61	0.00
Total	1063.05	250.26

* Received in 2008-09 ** Received in 2009-10

The shortfall of ` 812.79 crore in receipt of the benefit of debt relief scheme, and the non-tax revenue receipts to that extent, was due to non-fulfillment of the conditionalities for receiving the debt relief by the State Government.

1.4.1 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 variations between the budget estimates and the actual receipts under principal heads of tax and non-tax revenue for the year 2009-10 are mentioned in **Table 1.5**.

Table 1.5: Variations between Budget estimates and actuals

(` in crore)

Sl. No	Revenue head	Budget estimates	Actual receipts	Variations increase (+) shortfall(-)	Percentage
Tax revenue					
1.	Taxes/VAT on sales, trade etc.	12733.94	12770.89	36.95	0.3
2.	State Excise	1440.52	1514.81	74.29	5.2
3.	Stamp duty and registration fees	2728.63	1896.41	(-) 832.22	(-) 30.5
4.	Taxes on vehicles	958.63	1131.10	172.47	18.0
5.	Taxes and duties on electricity	47.24	24.78	(-) 22.46	(-) 47.5
6.	Land revenue	52.50	53.93	1.43	2.7
7.	Other taxes and duties on commodities and services	183.81	140.28	(-) 43.53	(-) 23.7
Non-tax revenue					
1.	Non-ferrous mining and metallurgical industries	42.45	39.26	(-) 3.19	(-) 7.5
2.	Forestry and wild life	227.80	272.80	45.0	19.8
3.	Interest receipts	89.20	152.50	63.3	71.0

Source: Annual Financial Statement 2009-10 of the State Government and Finance Accounts 2009-10.

While stamp duty and registration fees, taxes and duties on electricity, etc., showed decrease, other sources such as Value Added Tax, Sales tax, State excise, taxes on vehicles, etc., increased. The following reasons for variations were reported by the concerned departments.

Stamp duty and Registration fees: The decrease was due to decline in the number of documents registered and the number of documents having higher consideration value due to economic recession.

Taxes and duties on Electricity: The decrease was due to non-remittance of surcharge by the Kerala State Electricity Board and due to remittance of duty by some licensees only up to November 2009.

Forestry and Wild life: The increase in revenue was due to effective extraction of teak plantation during the year and making available for sale, more quantity of teak timber through regular and retail outlets.

Taxes on vehicles: The increase was due to increase in the vehicle population.

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 2005-06 to 2009-10 are presented in **Appendix 1.6**. The expenditure on collection in respect of Stamps and Registration fees, State Excise and Taxes on Vehicles was higher as compared to the All India Average during the period 2005-06 to 2008-09. In the case of sales tax, the expenditure on collection was slightly higher than the All India Average during 2006-07 to 2008-09. It would be prudent to improve the tax administration in order to increase the revenue and thereby reduce the cost of collection.

1.4.1.1 Own Tax Revenue

Taxes on sales, trade, etc., were the major sources of the State's own tax revenue during the year (72 *per cent*) followed by stamps and registration fees (11 *per cent*), State excise (nine *per cent*) and taxes on vehicles (six *per cent*). The State's own tax revenue increased by 10.2 *per cent* during the current year (` 17,625 crore) as compared to the previous year (` 15,990 crore).

Taxes on sales, trade, etc., increased by 12.3 *per cent* (` 1394 crore) during 2009-10 over the previous year. This increase was mainly due to increase in receipts under 'Trade Tax'⁶ (` 1353.29 crore) and under the State Sales Tax Act (` 177.73 crore). This was partly offset by decrease in receipts under the Central Sales Tax Act (` 132.43 crore) and other receipts (` 4.84 crore). Receipts under Tax on Vehicles increased by 20.7 *per cent* (` 193.65 crore) due to more receipts mainly under 'Receipts under the State Motor Vehicles Taxation Acts' (` 193.43 crore) . Receipts under 'State Excise' increased by 8.4 *per cent* (` 117.18 crore) during 2009-10 over the previous year which was mainly under 'Foreign liquors and spirits' (` 169.69 crore) partly offset by decrease in receipts under 'Country fermented liquors' (` 53.69 crore).

Stamps and registration fees decreased by 5.3 *per cent* (` 106.58 crore) during 2009-10 over the previous year due to decrease of receipts under 'sale of non-judicial stamps' (` 143.59 crore), fees for registering documents (` 11.81 crore) and other receipts (` 21.37 crore) under 'Registration Fees' partly offset by increase in 'Duty on impressing of documents' (` 61.17 crore) under 'Stamps non-judicial'. The decrease in stamps and registration fees was due to decrease in the number of documents registered and decrease in the number of documents having higher consideration due to economic recession.

Tax revenues collected during 2009-10 (` 17,625.02 crore) fell short of the normative assessment made by TFC (` 18,987.94 crore) by ` 1,362.92 crore (7.2 *per cent*).

⁶ Trade tax includes Value Added Tax (VAT), licence and registration fees under VAT, etc.

1.4.1.2 Non-Tax Revenue

Non-tax revenue increased by ` 293 crore (18.8 per cent) during the current year (` 1852 crore) over the previous year (` 1,559 crore). Non-tax revenue sources mainly comprised receipts from State lotteries (34 per cent), forestry and wildlife (15 per cent) and interest, dividends and profits (10 per cent). The increase was mainly under State lotteries (` 142.67 crore), adjustments towards the debt-waiver scheme (` 45.46 crore), interest receipts (` 68.81 crore) and forestry and wildlife (` 49.09 crore). Though the receipts under State lotteries were ` 624.07 crore during the year, with an equally high expenditure of ` 502.79 crore, the net yield from lotteries was only ` 121.28 crore. The net yield from lotteries during the previous year was, however, ` 109.13 crore. Non-tax revenue realised during 2009-10 under various components vis-à-vis the budget estimates of 2009-10 was as in **Table 1.6**.

Table 1.6: Non-tax Revenue realised vis-à-vis Budget estimates

			(` in crore)
Sl. No.	Component of non-tax revenue	Budget estimates 2009-10	Actuals
1.	Forestry and Wildlife	227.80	272.80
2.	Interest receipts	89.20	152.50
3.	Dividends and profits	36.56	27.28
4.	State Lotteries	474.60	624.07
Overall Non-tax revenue		1459.58	1852.22

Source: Finance Accounts and Annual Financial Statement 2009-2010 of the State Government

The non-tax revenue realised during 2009-10 (` 1852.22 crore) fell short of the normative assessment made by TFC (` 2,010.76 crore) by ` 158.54 crore (7.9 per cent).

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

Test check of the records of 683 units of commercial taxes, motor vehicles, State excise, forest and other departmental offices during 2009-10 revealed underassessment/short levy/loss of revenue aggregating ` 1,659.93 crore in 5,369 cases. During the course of the year, the concerned departments accepted underassessments and other deficiencies of ` 295.27 crore involved in 1,284 cases, of which 494 cases involving ` 285.21 crore were pointed out in audit during 2009-10 and the rest in earlier years. The departments collected ` 7.53 crore in 1,165 cases during 2009-10.

Government waived (December 2009) ` 622.83 crore of motor vehicles tax arrears to be received from the Kerala State Road Transport Corporation (KSRTC) as on 31 March 2008 and ` 197.39 crore being the arrears as on 31 March 2008 towards interest and penal interest on loans given by the Government to KSRTC.

Government also waived (March 2010) ` 4.14 lakh being the lease rent for the period 1 April 1998 to 31 March 2008 due from a Government company.

The number of refund cases pending at the beginning of the year 2009-10, claims received during the year, refunds allowed during the year and cases pending at the close of the year 2009-10 as reported by the Commercial Taxes and Excise departments were as follows:

Table 1.7: Refunds made during the year

(` 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.	State Excise	No. of cases	4	4	5	3
		Amount	1.81	1.45	1.53	1.73
2.	Sales Tax	No. of cases	52	456	347	161
		Amount	101.49	248.36	265.42	84.43
3.	Agricultural Income Tax	No. of cases	2	4	6	Nil
		Amount	0.31	11.44	11.75	Nil
4.	Value Added Tax	No. of cases	1286	5873	4386	2773
		Amount	2392.58	10,459.93	7,526.64	5325.87

Source: Information received from Excise and Commercial Taxes Departments

1.4.3 Revenue Arrears

The arrears of revenue as on 31 March 2010 in respect of some principal heads of revenue amounted to ` 4,422.81 crore, of which ` 2,191.72 crore was outstanding for more than five years as mentioned in **Table 1.8**.

Table 1.8 : Arrears of Revenue

(` in crore)

Sl. No.	Department	Amount of arrears as on 31 March 2010	Arrears outstanding for more than 5 years
1.	Mining and Geology	0.33	0.17
	` 16.50 lakh was under revenue recovery, ` 4.19 lakh stayed by courts, ` 3.25 lakh is likely to be written off.		
2.	Local Fund Audit	94.14	54.15
	Audit charges due from local bodies, Universities etc. The stage of arrears was not furnished by the department. (June 2010).		
3.	Stationery	16.09	12.51
	The stage of recovery of arrears had not been furnished by the department. (June 2010)		
4.	State Excise	189.21	187.27
	` 113.12 crore was under revenue recovery. ` 48.63 crore was stayed by court, etc. Recovery held up due to rectification/review of application in respect of ` 3.22 crore and ` 3.27 crore was likely to be written off.		
5.	Police	46.54	22.86
	` 1.69 crore, ` 22.75 crore, ` 0.31 crore, ` 0.42 crore, ` 1.53 crore and ` 17.63 crore were due from Government of Tamil Nadu, Southern Railway, Bharat Sanchar Nigam Limited, Postal Department, Airport Authority of India and Kerala State Electricity Board respectively.		
6.	Labour	1.27	....
7.	Printing	28.43	16.41
8.	Motor Vehicles	292.21	20.14
	` 12.34 crore was under Revenue Recovery and ` 34.50 lakh stayed by court/Government.		
9.	Electrical Inspectorate	3753.56	1878.12
	` 3746.82 crore was due from Kerala State Electricity Board and ` 3.55 crore was due from Thrissur Municipal Corporation.		
10.	Registration	0.22	....
11.	Factories and Boilers	0.81	0.09
	An amount of ` 66.10 lakh was due from individuals, private firms, private companies, etc. An amount of ` 6.49 lakh is likely to be written off.		
Total		4422.81	2191.72

Source: Information received from the concerned departments.

The State Government have to make efforts to realize the arrears of revenue so that revenue deficit can be reduced to a considerable extent.

1.4.4 Utilisation of grants under Twelfth Finance Commission award

The Finance Commission has the mandate to recommend the principles which should govern the grants-in-aid of revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States, which are in need of assistance under Article 275 of the Constitution of India. The TFC has awarded grant-in-aid of ` 2900.19 crore to the State for the period 2005-2010 under various sectors. The split-up of the award amount, its receipt, and shortfalls in receipt are furnished in **Table 1.9**.

Table 1.9: Details of TFC award

Name of the sector	(` in crore)		
	Amount awarded by TFC	Amount received by the State	Shortfall in receipt
1. Non-plan revenue deficit	470.37	470.37	Nil
2. Maintenance of Roads and Bridges	642.32	481.74	160.58
3. Maintenance of buildings	103.50	90.57	12.93
4. Maintenance of forests	25.00	24.75	0.25
5. Heritage conservation	25.00	22.93	2.07
6. State specific needs	500.00	259.66	240.34
7. Assistance to Local bodies	1134.00	1134.00	Nil
Total	2900.19	2484.02	416.17

Source: TFC Report and information furnished by State Government

From the above table, it is seen that there was a total shortfall in receipt of funds amounting to ` 416.17 crore which was due to non-fulfilment of conditions prescribed by the TFC and not showing adequate progress in utilisation of funds by the State Government. The sectors in which there were substantial shortfalls in receipt of funds are detailed below:

(i) Maintenance of Roads and Bridges and Buildings

According to the conditions prescribed by the TFC for the release of awards for maintenance of roads and bridges, grants were to be budgeted every year from 2006-07 and spent for meeting the Non-Plan revenue expenditure under various heads. The State was eligible for ` 160.58 crore each year from 2006-07 to 2009-10, in two instalments of ` 80.29 crore each. Government of India released ` 80.29 crore as the first instalments in all the four years but did not release second instalments for 2008-09 and 2009-10. Government stated (November 2010) that the reason for non-release of second instalment for 2008-09 was because the expenditure incurred (` 501 crore) under Non-Plan revenue was less compared to the projected Non-Plan revenue expenditure for 2006-07 (` 631.94 crore). The second instalment for 2009-10 was recovered by adjustment towards the second instalment grant for 2006-07 released earlier, due to non-fulfilment of specific conditions of TFC.

In the case of maintenance of buildings, the TFC insisted that the grant-in-aid for maintenance of public buildings other than residential building was to be budgeted and spent towards non-salary maintenance items of Non-Plan revenue expenditure under Major head 2059-Minor head 053 under various sub-major heads. However, the State Government had not budgeted the grants received under separate heads of account as stipulated in the TFC guidelines.

Audit observed that GOI released only ` 90.57 crore⁷ out of ` 103.50 crore awarded by TFC. Government stated (November 2010) that the reduction in the Central grant was due to non-adherence to the norms fixed by the TFC.

(ii) State-specific Needs

Under this sector ` 500 crore was sanctioned by the TFC for improvement of inland waterways and canals (` 225 crore), improvement of quality of school education (` 100 crore) and coastal zone management (` 175 crore). The grant for 2006-07 was to be released in four instalments (in May, August, November and February) whereas the release of grants for 2007-08 and 2008-09 was to be based on utilisation of 75 *per cent* of the grant released in the previous years. However, the grant for 2009-10 was to be released in two instalments, the first instalment after 90 *per cent* of the grant was certified as utilised and the remaining 10 *per cent* when completion certificates were provided by the State. In order to utilise the funds, Government had provided ` 469.16 crore for the three sectors⁸ in the budget for 2006-07 to 2009-10. Though ` 325.02 crore was shown as expenditure till March 2010, ` 217.48 crore (67 *per cent*) was the expenditure during 2009-10. Thus, due to slow progress in execution of projects/works during the first three years, the State had received only ` 259.66 crore during the award period, resulting in a shortfall of ` 240.34 crore.

Further scrutiny revealed that the actual utilisation was even less than ` 325.02 crore due to the following:

- Out of ` 101.72 crore (till March 2010) for ‘Improvement of Waterways and Canals’, ` 40 crore was drawn by the Executive Engineer, Inland Navigation division, Kollam in March 2010 and released to three⁹ Public Sector Undertakings(PSUs) as advance payment for executing eight works entrusted to them. As the amount remained unutilised as of May 2010 with the PSUs, the drawal was to prevent lapse of budget provision and to show utilization before the expiry of the award period.
- Similarly out of ` 91.91 crore (till March 2010) shown as expenditure for ‘Improvement of quality of school education’, ` 4.52 crore was kept in the Treasury Savings Bank account of the Director of Higher Secondary Education and remained unutilised as of March 2010. Government stated (November 2010) that the implementation of the scheme was entrusted to Local Self Government Institutions and ` 4.29 crore had been released to them.

⁷ ` 25.88 crore each during 2006-07 and 2007-08, ` 25.87 crore in 2009-10 and ` 12.94 crore during 2008-09 (first instalment).

⁸ Improvement of water ways and canals: `225 crore, Improvement of quality of school education: ` 100 crore and Coastal zone management: ` 144.16 crore

⁹ Kerala Shipping and Inland Navigation Corporation, Travancore Cements Limited and Kerala State Maritime Development Corporation.

(iii) Under-utilisation of grants received under Maintenance of Forests and Heritage Conservation

Audit scrutiny of the utilization of funds received also revealed that the implementing departments of the State Government could not utilise even the funds received in some sectors as detailed below:

- The State Government had received an amount of ` 24.75 crore against the award of ` 25 crore for ‘Maintenance of Forests’, of which ` 23.89 crore was utilised for the intended purposes and ` 0.86 crore remained unutilised at the end of March 2010. The Additional Principal Chief Conservator of Forests (Development) stated (May 2010) that the reasons for non-utilisation of ` 0.86 crore were due to delay in completion of certain works by the contractors and poor response to bids invited for some works.
- Out of the grant-in-aid of ` 22.93 crore received for preservation and protection of historical monuments, archaeological sites, public libraries, museums and archives, etc. under the sector ‘Heritage Conservation’, the State Government could utilize only ` 14.70 crore till March 2010. The Government stated (November 2010) that utilization of funds in the Archeology Department was very meagre (` 0.31 crore) till 2008-09 due to non-availability of a Conservation Engineer in the department. In the State Archives Department, it was due to delay in approving the project by the Public Works Department.

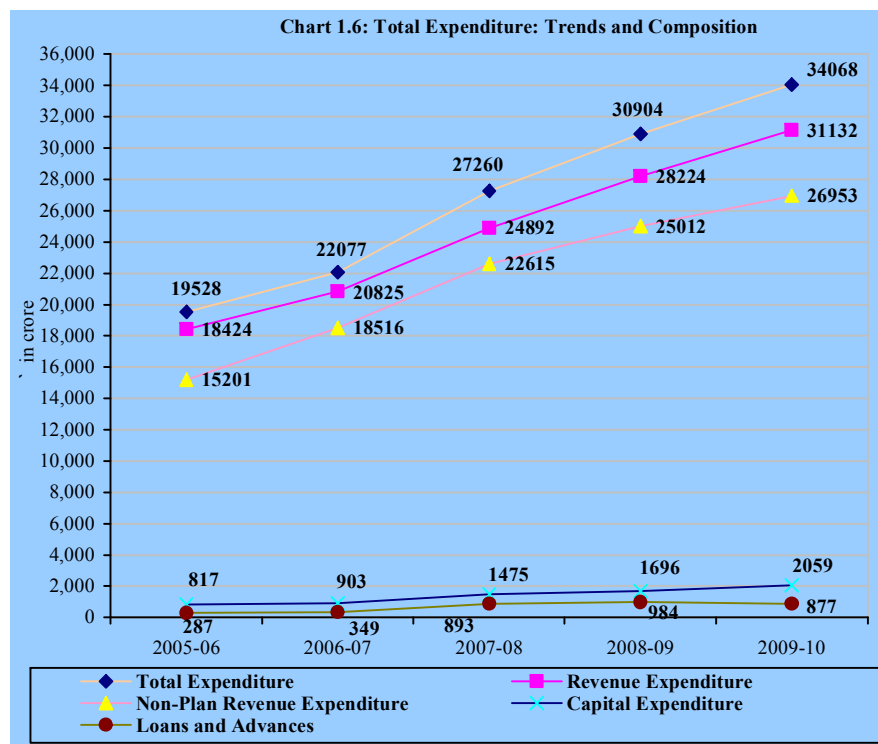
1.5 Application of Resources

Analysis of the allocation of expenditure at the State Government level assumes significance since responsibilities for major expenditure are entrusted with them. There are, however, budgetary constraints in raising public expenditure financed by deficits or borrowings some of which are arising from fiscal responsibility legislations. It is, therefore, important to ensure that the ongoing fiscal correction and consolidation process¹⁰ at the State level is not at the cost of expenditure, especially expenditure directed towards development and social sectors.

1.5.1 Growth and Composition of Expenditure

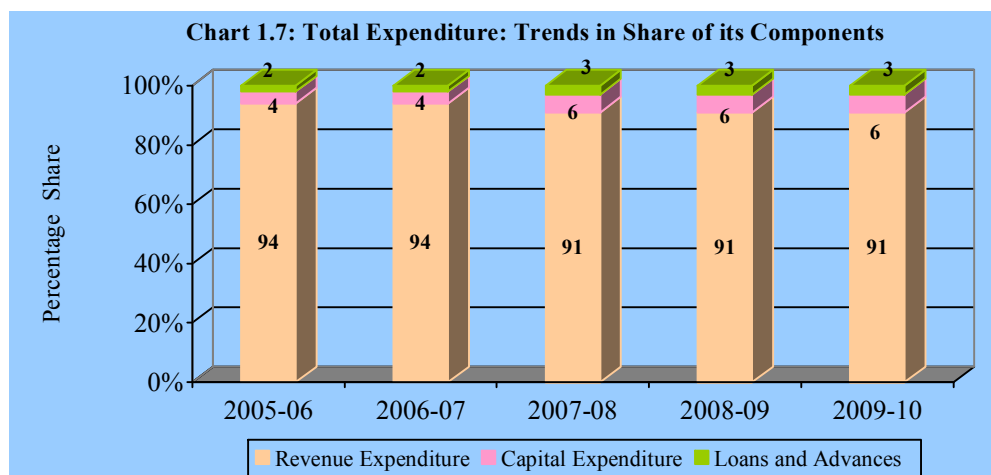
The total expenditure of the State Government consists of revenue expenditure as well as capital expenditure which includes expenditure on loans and advances. The trends in various components of total expenditure-Plan and Non-Plan revenue expenditure, committed expenditure such as salaries and wages, interest payments, pension payments and subsidies, financial assistance to local bodies, etc., are discussed in the succeeding paragraphs. **Chart 1.6** presents the trends in total expenditure of the State Government over a period of five years (2005-10). Its composition, both in terms of ‘economic classification’ and ‘expenditure by activities’ is depicted respectively in **Charts 1.7 and 1.8**.

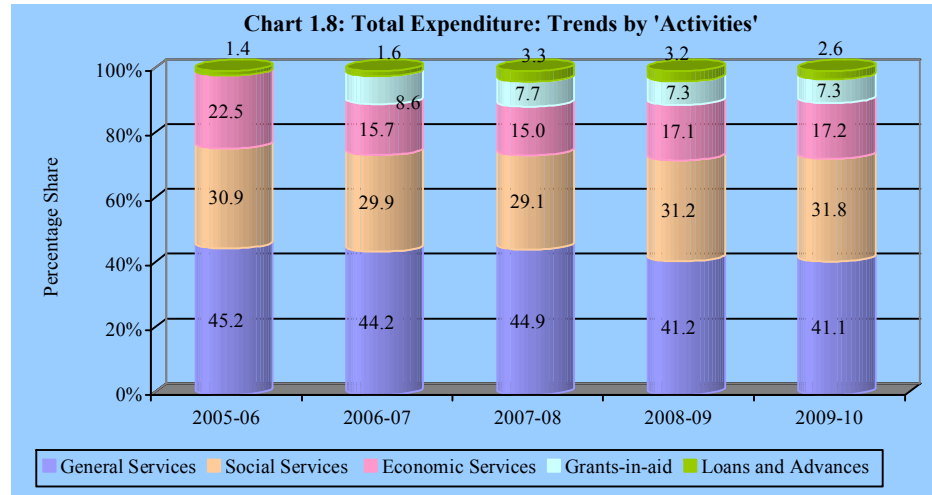
¹⁰ The Twelfth Finance Commission had recommended that all States should restructure their finances through fiscal consolidation (reduction of deficit and debt) and adopt a fiscal correction path by setting clear targets through a fiscal reform legislation.



During the five-year period 2005-10, nearly 91 to 94 *per cent* of the total expenditure constituted revenue expenditure whereas capital expenditure ranged between four and six *per cent* of the total expenditure during the same period.

The total expenditure increased by 10.2 *per cent* in 2009-10 to ` 34,068 crore from ` 30,904 crore in the previous year. The increases were under revenue expenditure (` 2,908 crore) and capital expenditure (` 363 crore) whereas the decrease was under disbursement of loans and advances (` 107 crore).





Trends in share of components of Total Expenditure

The revenue expenditure increased in absolute terms from ` 18,424 crore in 2005-06 to ` 31,132 crore in 2009-10 but its percentage to total expenditure decreased from 94 to 91 *per cent* during the same period. Capital expenditure increased from ` 817 crore in 2005-06 to ` 2,059 crore in 2009-10 and its percentage to total expenditure increased from four to six *per cent* during the same period.

Non-Plan revenue expenditure (NPRE) showed an increasing trend during the period 2005-10, whereas Plan revenue expenditure (PRE) showed inter-year variations with an increasing trend during 2008-09 and 2009-10. NPRE showed an increase of 7.8 *per cent* in 2009-10 (` 1,941 crore) over 2008-09. The increase in NPRE during the year compared to the previous year was mainly due to increase in expenditure under Interest Payment (` 633 crore), General Education (` 357 crore), Compensation and Assignment to Local Bodies and Panchayat Raj Institutions (` 224 crore), Miscellaneous General Services (` 165 crore), Medical and Public Health (` 106 crore), Labour and Employment (` 92 crore) and Social Security and Welfare (` 85 crore). This was partly offset by decrease in expenditure under Roads and Bridges (` 160 crore). PRE showed an increase of 30 *per cent* (` 967 crore) during 2009-10 when compared to the previous year. The increase was mainly due to increase in expenditure under Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes (` 226 crore), District Administration (` 203 crore), Family Welfare (` 100 crore), General Education (` 84 crore), Sports and Youth Services (` 76 crore), Rural Development (` 82 crore) and Roads and Bridges (` 67 crore). This was partly offset by reduction of expenditure under Urban Development (` 195 crore) and Power (` 68 crore).

The actual NPRE during 2009-10 *vis-à-vis* the normative assessment made by TFC for the year is given in **Table 1.10**.

Table 1.10: NPRE *vis-à-vis* assessment by TFC

(` in crore)

	Assessment made by TFC	Actual Non-Plan Revenue Expenditure
Non-Plan Revenue Expenditure	22,562	26,953

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

Actual NPRE during 2009-10 exceeded the normative assessment made by TFC for the year by ` 4,391 crore (19.5 per cent). The increase was mainly due to increased devolution of funds to Local Self Government Institutions based on the recommendations of the Third State Finance Commission (` 2,345 crore), increased expenditure under pension (` 581 crore), interest (` 199 crore), Economic Services (` 816 crore) and Social Services (` 376 crore).

1.5.2 Committed Expenditure of the Government

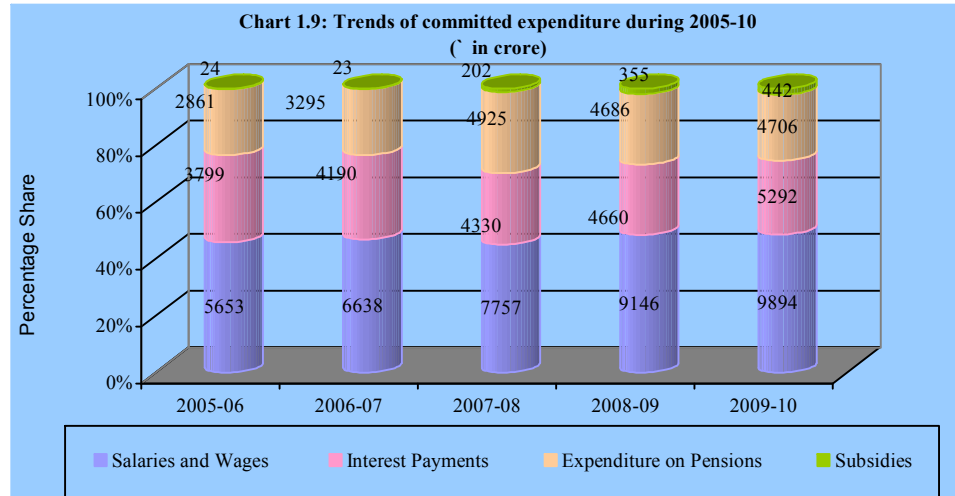
The committed expenditure of the State Government on revenue account mainly consists of interest payments, expenditure on salaries and wages, pensions and subsidies. **Table 1.11** and **Chart 1.9** present the trends in the expenditure on these components during 2005-10.

Table 1.11: Components of committed expenditure

(` in crore)

Components of Committed Expenditure	2005-06	2006-07	2007-08	2008-09	2009-10	
					BE	Actuals
Salaries* and Wages , <i>Of which</i>	5653 (37)	6638 (36.5)	7757 (36.8)	9146 (37.3)	10277	9894 (37.9)
Non-Plan Heads	5428	6377	7448	8895	NA	9529
Plan Heads**	225	261	309	251	NA	365
Interest Payments (MH 2049)	3799 (24.8)	4190 (23.0)	4330 (20.5)	4660 (19.0)	5312	5292 (20.3)
Expenditure on Pensions (MH 2071)	2861 (18.7)	3295 (18.1)	4925 (23.3)	4686 (19.1)	5006	4706 (18.0)
Subsidies	24	23	202 (1)	355 (1.4)	NA	442 (1.7)
Revenue Expenditure	18424	20825	24892	28224	31162	31132
Revenue receipts	15295	18187	21107	24512	28154	26109
* 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 heads also include 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



Expenditure on salaries under Non-Plan heads during 2009-10 was ` 9,529 crore, recording a growth of 7.1 per cent over the previous year, whereas salaries under Plan during 2009-10 increased by 45.4 per cent when compared to the previous year. The salary expenditure was about 47 per cent of revenue expenditure net of interest and pension payments. This was higher than the norm of 35 per cent recommended by TFC. The salary expenditure will increase further in the coming years once the recommendations of the new State Pay Revision Commission are implemented.

Pension payments increased marginally by 0.4 per cent (` 20 crore) from ` 4,686 crore in 2008-09 to ` 4,706 crore in 2009-10. However, in 2009-10, they were less than the projections made by the State Government in the Medium Term Fiscal Plan (` 5,006 crore) by six per cent but exceeded the assessment made by TFC (` 4,125 crore) by 14 per cent.

Interest payments increased by 13.6 per cent during 2009-10 (` 5,292 crore) when compared to the previous year (` 4,660 crore). The TFC recommended that States should endeavour to keep interest payments as a ratio of revenue receipts at 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 TFC award period.

Payment of subsidies increased steeply from ` 23 crore in 2006-07 to ` 202 crore in 2007-08 and thereafter to ` 355 crore in 2008-09 and ` 442 crore in 2009-10. The huge increase in subsidy in 2007-08 over the previous year was mainly due to payment of subsidy to Food Corporation of India in respect of rice and wheat distributed to ration cardholders of BPL¹¹ families and subsidy to Kerala State Civil Supplies Corporation for market intervention operations. The increase of ` 87 crore in subsidy during 2009-10 over the previous year was mainly due to enhanced payment of subsidy to Food Corporation of India in respect of rice and wheat distributed to cardholders of BPL families (` 80 crore) and subsidy towards free supply of electricity to small and marginal paddy growers (` 21 crore). This was partly offset by

¹¹ Below Poverty Line

reduction in payment of subsidy to Kerala State Civil Supplies Corporation Limited for market intervention operations (` 22 crore).

The ratio of salaries, interest payments, pensions and subsidies to revenue receipts of the State during the current year was 78 *per cent*, an increase of one percentage point from the previous year.

1.5.3 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, educational institutions, Government companies, Welfare Fund Boards, etc during the current year relative to the previous years is presented in **Table 1.12**.

Table 1.12: Financial assistance to local bodies, etc

(` in crore)

Financial Assistance to Institutions	2005-06	2006-07	2007-08	2008-09	2009-10
Educational Institutions (Aided Schools, Aided Colleges, Universities, etc.)	2144.52	2666.63	2812.88	3306.81	3546.61
Municipal Corporations and Municipalities	318.94	385.43	485.85	966.99	834.46
Zilla Parishads and Other Panchayati Raj Institutions	1719.53	2219.28	2421.93	2600.11	2996.66
Development Agencies	14.52	6.15	1.36	1.95	2.04
Hospitals and Other Charitable Institutions	34.28	43.32	53.98	56.66	76.40
Other Institutions ¹²	1307.30	916.46	468.50	658.83	1159.47
Total	5539.09	6237.27	6244.50	7591.35	8615.64
Assistance as percentage of revenue expenditure	30	30	25	27	28

Source: Finance Accounts and information received from State Government

The financial assistance to local bodies and other institutions constituted 25 to 30 *per cent* of revenue expenditure during the period 2005-10. The increase in financial assistance to Zilla Parishads, Municipalities, Corporations, etc., during the period 2006-07 to 2009-10 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.

1.6 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 public expenditure (i.e. adequate provisions for providing public services); efficiency of expenditure use and its effectiveness (assessment of outlay-outcome relationships for select services).

¹² Other institutions, *inter alia*, include Kerala Road Fund Board (` 208.55 crore), Kerala State Road Transport Corporation (` 105 crore), Kerala Urban Development Finance Corporation (` 85.75 crore), Kerala Agricultural Workers Welfare Fund Board (` 75.50 crore) and State Poverty Eradication Mission (` 36.50 crore).

1.6.1 Adequacy of Public Expenditure

The responsibilities relating to expenditure on the social sector and the economic infrastructure assigned to the State Governments are largely State subjects. Enhancing human development levels requires the States to step up their expenditure on key Social Services like education, health, etc. Low fiscal priority (ratio of expenditure category to aggregate expenditure) would be attached to a particular sector if it is below the national average. **Table 1.13** analyses the fiscal priority of the State Government with regard to development expenditure, social sector expenditure and capital expenditure during 2005-06 and 2009-10.

Table 1.13: Fiscal Priority of the State in 2005-06 and 2009-10

(in per cent)

Fiscal Priority by the State	AE/GSDP	DE/AE	SSE/AE	CE/AE	Education /AE	Health/AE
General Category States Average (Ratio) 2005-06	17.75	61.76	30.76	13.97	14.95	4.05
Kerala State's Average (Ratio) 2005-06	15.55	54.78	31.42	4.18	17.91	5.12
General Category States Average (Ratio) 2009-10	18.24	66.05	35.76	14.85	16.21	4.28
Kerala State's Average (Ratio) 2009-10	15.88	51.43	33.02	6.04	17.70	5.04
AE: Aggregate Expenditure DE: Development Expenditure SSE: Social Sector Expenditure CE: Capital Expenditure Development Expenditure includes Development Revenue Expenditure, Development Capital Expenditure and Loans and Advances disbursed Source: For GSDP, the information was collected from the State's Directorate of Economics and Statistics						

- In 2005-06 and 2009-10, the Kerala Government spent relatively less as a proportion of GSDP compared to the General Category States' average.
- In 2005-06 and 2009-10, the fiscal priority given to DE was inadequate as the ratio of DE in terms of AE was less than the all States' average. During 2005-06 and 2009-10 the fiscal priority given to Education and Health which formed part of SSE was higher than the all States' average. This indicates that the fiscal priority given to the Economic Services sector during the period was very low.
- The priority given to CE continues to be much lower in comparison with the General Category States' average as the CE/AE ratios of the State at 4.18 and 6.04 per cent during 2005-06 and 2009-10 respectively were much lower than the General Category States' average ratio of 13.97 and 14.85 per cent in those years.

Government may consider enhancing the proportion of expenditure on economic and capital sectors in order to create the much needed assets to stimulate growth.

1.6.2 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 Government to take appropriate expenditure rationalisation measures

and lay emphasis on provision of core public and merit goods¹³. Apart from improving the allocation towards development expenditure¹⁴, 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 1.14** 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 1.15** provides the details of capital expenditure and the components of revenue expenditure incurred on the maintenance of the selected social and economic services.

Table 1.14: Development expenditure

Components of Development Expenditure	2005-06	2006-07	2007-08	2008-09	2009-10	
					BE	Actuals
Development Expenditure (a to c)						
a. Development Revenue Expenditure	9668 (49.5)	9190 (41.6)	10609 (38.9)	13292 (43.0)	14,707	14,708 (43.2)
b. Development Capital Expenditure	747 (3.8)	863 (3.9)	1418 (5.2)	1643 (5.3)	1,677	1,993 (5.9)
c. Development Loans and Advances	282 (1.4)	343 (1.6)	887 (3.3)	979 (3.2)	1,028	822 (2.4)
Figures in parentheses indicate percentage to aggregate expenditure						

Source: Finance Accounts and Annual Financial Statement of the State Government for 2009-10

Development revenue expenditure increased by 10.7 per cent (₹ 1,416 crore) from ₹ 13,292 crore in 2008-09 to ₹ 14,708 crore in 2009-10. The increase was mainly due to increase in expenditure under the accounts heads; General Education (₹ 441 crore), Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes (₹ 234 crore), Social Security and Welfare (₹ 161 crore), Medical and Public Health (₹ 106 crore), Labour and Employment (₹ 98 crore), Sports and Youth Services (₹ 85 crore), Water Supply and Sanitation (₹ 80 crore) and Crop Husbandry (₹ 78 crore).

Development capital expenditure increased by 21.3 per cent (₹ 350 crore) from ₹ 1,643 crore in 2008-09 to ₹ 1,993 crore in 2009-10. The increase was mainly due to increase in expenditure under the accounts heads; Roads and Bridges (₹ 248 crore), Water Supply and Sanitation (₹ 169 crore) and

¹³ Core public goods are goods which all citizens enjoy in common in the sense that each individual's consumption of such goods 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.

¹⁴ 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.

Telecommunication and Electronic Industries (` 76 crore). This was partly offset by decrease in expenditure under Housing (` 121 crore) and Major Irrigation (` 64 crore).

Table 1.15: Efficiency of expenditure in selected Social and Economic Services

(Per cent)

Social/Economic Infrastructure	2008-09			2009-10		
	Ratio of CE to TE	In RE, the share of		Ratio of CE to TE	In RE, the share of	
		S&W	O&M		S&W	O&M
Social Services (SS)						
General Education	0.2	89	NA	0.4	87.3	...
Health and Family Welfare	2.8	73	NA	3.7	74.8	0.1
Water Supply, Sanitation, Housing and Urban Development	10.7	3	NA	15	3.6	2.5
Total (SS)	2.8	66	NA	3.2	63.4	0.8
Economic Services (ES)						
Agriculture and Allied Activities	5.7	34	NA	8.1	31.8	0.4
Irrigation and Flood Control	42.4	40	NA	46.6	50.1	49.5
Power and Energy	--	0.2	NA	..	0.3	
Transport	36.2	11	NA	43.2	12.9	34.7
Total (ES)	24.1	26	NA	26.0	26.7	12.1
Total (SS+ES)	10.3	54	NA	11.4	52.8	4.1
TE: Total Expenditure; CE: Capital Expenditure; RE: Revenue Expenditure; S&W: Salaries and Wages; O&M: Operations and Maintenance; NA: Not Available						

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 to 3.2 per cent from 2.8 per cent in 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 10.7 per cent to 15 per cent. The percentage of capital expenditure to total expenditure under Economic Services increased from 24.1 per cent in 2008-09 to 26 per cent in 2009-10. The higher priority of capital expenditure under Economic Services was mainly under Irrigation and Flood Control and Transport where capital expenditure as a percentage of total expenditure increased from 42.4 per cent and 36.2 per cent to 46.6 per cent and 43.2 per cent respectively.

The share of salaries and wages in revenue expenditure under Social Services decreased from 66 per cent in 2008-09 to 63.4 per cent in 2009-10. But the share of salaries and wages in revenue expenditure under Economic Services increased marginally from 26 per cent to 26.7 per cent in 2009-10 mainly due to increase in share of salaries and wages under 'Irrigation and Flood Control' and 'Transport'.

1.7 Financial 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. The State should also 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.

1.7.1 Financial results of Irrigation Works

In the case of eight irrigation projects, which have been declared commercial, with a cumulative capital outlay of ` 123.30 crore as on 31 March 2010, the revenue realised from them during 2009-10 was ` 1.51 crore which was one *per cent* of the total outlay. After considering the working and maintenance expenses of ` 25.80 crore and interest charges of ` 11.04 crore, these projects suffered a net loss of ` 35.33 crore.

1.7.2 Incomplete projects/works

Department-wise information pertaining to incomplete projects/works (each costing above ` one crore) as on 31 March 2010 is given in **Table 1.16**.

Table 1.16: Status of incomplete projects in the State

(` in crore)

Sl. No	Name of the department/project	No. of incomplete projects/ works	Initial budgeted cost	Revised cost of projects	Cost over-runs	Cumulative actual expenditure as on 31.3.2010
1.	Water Resources Department – (Major irrigation project)	5	200.10	748.27	548.17	451.35
2.	Water Resources Department – (Irrigation and Minor Irrigation Works)	22	59.63	61.42	1.79	25.16
3.	Public Works Department – (Roads and Bridges)	87	299.16	320.30	21.14	234.27
4.	Public Works Department – (Buildings)	57	158.15	178.74	20.59	114.09
5.	Harbour Engineering Department	16	150.14	181.99	31.85	148.57
	Total	187	867.18	1490.72	623.54	973.44

Source: Details furnished by Departments

As per the information made available by the Irrigation Department, five¹⁵ projects which were to be completed between 1981 and 2010 were incomplete even after incurring ` 451.35 crore. The delays in completion of these projects also resulted in a huge cost overrun of ` 548.17 crore at the close of the current year. Besides, 182 other capital works on which ` 522.09 crore was spent up to March 2010 also remained incomplete in the Public Works, Harbour Engineering and Water Resources Departments, involving cost overruns amounting to ` 75.37 crore as on 31 March 2010. 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 six *per cent* of the cumulative capital outlay of the State. Due to non-completion of projects 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.

¹⁵ Banasurasagar, Idamalayar, Karappuzha, Muvattupuzha and Palakappandy.

1.7.3 Investment and returns

As of 31 March 2010, Government had invested ` 3,322.76 crore in Statutory Corporations, Government Companies, Joint Stock Companies and Co-operatives (Table 1.17). The average return on these investments was one per cent in the last five years while the Government paid an average interest rate ranging from 7.5 per cent to 8.4 per cent on its borrowings during 2005-2010.

Table 1.17: Return on Investments

Investment/Return/Cost of Borrowings	2005-06	2006-07	2007-08	2008-09	2009-10
Investment at the end of the year (` in crore)	2145.04	2392.03	2483.99	3153.10	3322.76
Return (` in crore)	18.19	30.17	28.63	33.53	27.29
Return (per cent)	0.8	1.3	1.2	1.1	0.8
Average rate of interest on Government borrowing (per cent)	8.3	8.4	7.9	7.5	7.5
Difference between interest rate and return (per cent)	7.5	7.1	6.7	6.4	6.7

Source: Finance Accounts of the State Government

During 2009-10, the State Government invested ` 15.50 crore in Statutory Corporations, ` 109.84 crore in Government Companies and ` 61.77¹⁶ crore in Co-operative Banks and Societies. Two Statutory Corporations and 57 Government Companies with aggregate Government investments of ` 1508.64 crore were incurring losses and their accumulated losses amounted to ` 3790.58 crore as per the latest accounts furnished by these Companies. Of the loss-making Companies, six Companies with an investment of ` 13.42 crore up to 31 March 2010 were under liquidation and one Company with an investment of ` 1.35 crore was under lockout from June 1993.

Nine major Companies which had accumulated profits as per the latest accounts furnished by them are listed in Table 1.18:

Table 1.18: Major profit making companies

Sl. No	Name of Government Company	Accumulated profit (` in crore)
1.	Kerala State Electricity Board	1245.46
2.	The Kerala Minerals and Metals Limited	451.74
3.	Kerala State Beverages (Manufacturing and Marketing) Corporation Limited.	187.72
4.	Malabar Cements Limited	126.42
5.	The Kerala State Financial Enterprises Limited	114.43
6.	The Rehabilitation Plantations Limited	90.05
7.	The Kerala Agro-Machinery Corporation Limited.	74.46
8.	The Plantation Corporation of Kerala Limited	56.81
9.	Kerala State Industrial Development Corporation Limited	63.15

Source: Annexure 2 of Audit Report (Commercial) for the year ended 31 March 2010

1.7.4 Departmental Commercial Undertakings

Activities of quasi-commercial nature are performed by certain Government departments. There were three¹⁷ departmental commercial undertakings in the State as of March 2010. The department-wise position of the investments made by the Government up to the year for which *pro forma* accounts were

¹⁶ Actual increase in investment in Co-operative banks and societies during the year was ` 44.32 crore due to decrease of ` 17.45 crore consequent on retirement of capital vide footnotes (ww), (xx),(yy), (zz), (AA),(BB) and (CC) of Statement 14 of Finance Accounts 2009-10.

¹⁷ Kerala State Insurance Department, Text Book Office and State Water Transport Department

finalised, net profit/loss as well as return on capital invested in these undertakings are given in **Appendix 1.7**. The following was observed:

- An amount of ` 882.16 crore had been invested by the State Government in these undertakings at the end of the financial year up to which their accounts were finalised.
- One undertaking, viz., the Kerala State Insurance Department earned a net profit of ` 9.82 crore against the capital of ` 720.35 crore invested by the Government.
- 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 ` 133.17 crore as against the total investment of ` 140.55 crore.

In view of the heavy losses of State Water Transport Department and Text Book Office, Government should review their working.

1.7.5 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 1.19** presents the outstanding loans and advances as on 31 March 2010 and interest receipts vis-à-vis interest payments during the last five years.

Table 1.19: Average interest received on loans advanced by the State Government

(` in crore)

Quantum of Loans/Interest Receipts/ Cost of Borrowings	2005-06	2006-07	2007-08	2008-09	2009-10
Opening balance	5,210 ¹⁸	5,431 ¹⁹	5,562 ²⁰	6,280 ²¹	6910 ²²
Amount advanced during the year	287	349	893	984	877
Amount repaid during the year	52	66	45	36	38
Closing balance	5,445	5,714	6,410	7228	7749
Net addition	235	283	848	948	839
Interest receipts	31	28	51	48	46
Interest receipts as a percentage of outstanding loans and advances	0.6	0.5	0.9	0.7	0.6
Interest payments as a percentage of outstanding fiscal liabilities of the State Government.	8.3	8.4	7.9	7.5	7.5
Difference between interest payments and interest receipts (per cent)	(-) 7.7	(-) 7.9	(-) 7.0	(-) 6.8	(-) 6.9

Source: Finance Accounts of the State Government.

Total outstanding loans and advances as on 31 March 2010 increased by ` 839 crore compared to those of the previous year. The major disbursement

¹⁸ Difference of ` 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.

¹⁹ Difference of ` 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.

²⁰ Difference of ` 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.

²¹ Difference of ` 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.

²² Difference of ` 317.93 crore with reference to previous years closing balance was on account of *pro forma* adjustments vide footnote (pp) of Statement No.16 of Finance Accounts 2009-10.

of loans during the current year was to the Kerala Water Authority for implementing the Water Supply Project assisted by the Japan International Co-operation Agency (` 324 crore), Industry and Minerals (` 122 crore), Roads and Bridges Development Corporation (` 156 crore) and Kerala State Road Transport Corporation (` 105 crore). Interest received against these loans remained less than one *per cent* during the period 2005-06 to 2009-10 and was 0.6 *per cent* during 2009-10 as against the cost of borrowing of 7.5 *per cent* during the year.

1.7.6 Cash Balances and Investment of Cash Balances

Table 1.20 depicts the cash balances and investments made by the State Government out of the cash balances during the year.

Table 1.20: Cash Balances and Investment of Cash balances

(` in crore)

Particulars	As on 1 April 2009	As on 31 March 2010	Increase/ Decrease(-)
Cash balances	2629.55	3291.03	661.48
Investments from cash balances (a + b)	2589.73	3230.42	640.69
a. GOI Treasury Bills	2579.25	3219.94	640.69
b. GOI Securities	10.48	10.48	...
Fund-wise break-up of investments from earmarked balances (a to d)	758.26	1097.23	338.97
a. Reserve funds bearing interest	...	...	...
b. Reserve funds not bearing interest	758.26	1097.23	338.97
c. Deposit bearing interest	...	...	...
d. Deposit not bearing interest	...	...	...
Interest realised during the year on investment of cash balances	22.71	95.21	72.50

Source: Finance Accounts of the State Government

- The cash balance as on 31 March 2010 increased by ` 661.48 crore over the previous year.
- The interest realised during the year on investment of cash balances increased by ` 72.50 crore as compared to the previous year.

1.8 Assets and Liabilities

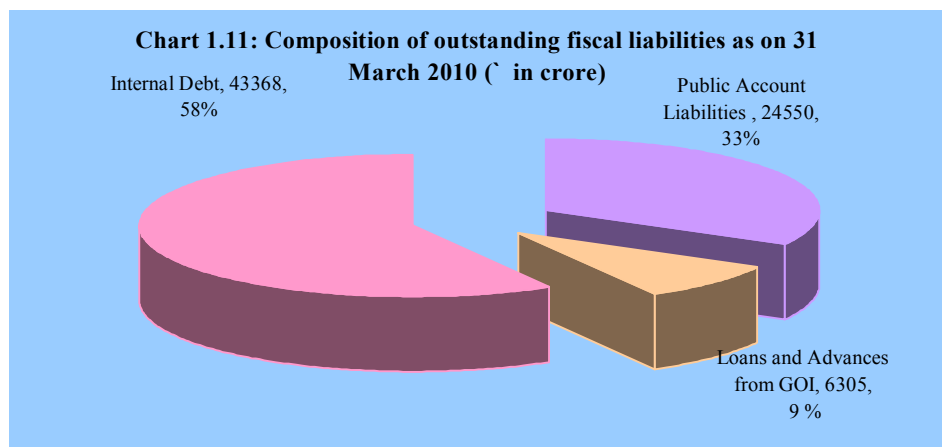
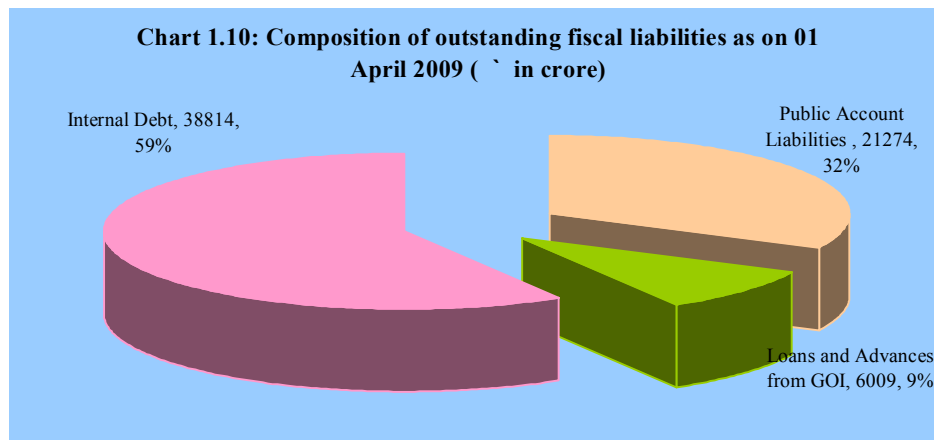
1.8.1 Growth and composition of Assets and Liabilities

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 1.4** gives an abstract of such liabilities and assets as on 31 March 2010, compared with the corresponding position on 31 March 2009. 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.

1.8.2 Fiscal Liabilities

The trends of outstanding fiscal liabilities of the State are presented in **Appendix 1.5**. The composition of fiscal liabilities during the current year vis-à-vis the previous year are presented in **Charts 1.10** and **1.11**.



The overall fiscal liabilities of the State increased from ` 47,832 crore in 2005-06 to ` 74,223 crore in 2009-10. Fiscal liabilities of the State comprised Consolidated Fund liabilities and Public Account liabilities. As at the end of March 2010, the Consolidated Fund liabilities (` 49,673 crore) comprised market loans (` 25,973 crore), loans from Government of India (` 6,305 crore) and other loans (` 17,395 crore). The Public Account liabilities (` 24,550 crore) comprised Small Savings, Provident Funds, etc., (` 21,296 crore)²³, interest bearing obligations (` 10 crore) and non-interest bearing obligations like deposits and other earmarked funds (` 3,244 crore). The growth rate was 12.3 *per cent* during 2009-10 over the previous year. The ratio of fiscal liabilities to GSDP decreased marginally from 34.8 in 2008-09 to 34.6 in 2009-10. The ratio of fiscal liabilities to GSDP was 34.6 *per cent* in 2009-10 and was higher than the norm of 30 *per cent* recommended by the

²³ This includes liabilities from the treasury savings bank account (` 3745 crore) and treasury fixed deposits (` 5521 crore)

TFC for the year. These liabilities stood at 2.8 times the revenue receipts at the end of 2009-10 compared to 2.7 times at the end of 2008-09. The Thirteenth Finance Commission recommended that the debt stock of the States should be reduced to less than 25 per cent of GSDP by 2014-15. In order to achieve this target, the State Government may consider adopting a well-planned strategy to review the stock of fiscal liabilities.

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 ` 276.36 crore to the Fund. As on 31 March 2010, the outstanding balance in the Sinking Fund was ` 1092.67 crore.

1.8.3 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 ` 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 ` 282.63 crore collected during 2003-04 to 2009-10 had not been credited to the Fund but was treated as non-tax revenue and used for meeting the revenue expenditure of the Government.

As per Statement 9 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 2005-06 are given in **Table 1.21**.

Table 1.21: Guarantees given by the Government of Kerala

Guarantees	2005-06	2006-07	2007-08	2008-09	2009-10
Maximum amount guaranteed (Principal only)	13751.80	12646.70	14871.08	11385.54	10,225.78
Outstanding amount of guarantees (including interest)	11934.69	9405.33	8317.34	7603.32	7495.00
Percentage of maximum amount guaranteed to total revenue receipts	90	70	70	46	39
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. 2005-10 ranged between ` 7,495 crore and ` 11,935 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 2010 were ` 113.99 crore. Out of this, ` 107.59 crore related to eight²⁴ institutions which had arrears exceeding ` one crore in each case.

1.9 Debt Sustainability

Apart from the magnitude of debt of the State Government, it is important to analyse various indicators that determine the debt sustainability²⁵ of the State. This section assesses the sustainability of debt of the State Government in terms of debt stabilisation²⁶; sufficiency of non-debt receipts²⁷; net availability of borrowed funds²⁸; burden of interest payments (measured by interest payments to revenue receipts ratio) and the maturity profile of State Government securities. **Table 1.22** analyses the debt sustainability of the State according to these indicators for the period of three years beginning from 2007-08.

Table 1.22: Debt Sustainability: Indicators and Trends

	(` in crore)		
Indicators of Debt Sustainability	2007-08	2008-09	2009-10
Debt Stabilisation (Quantum Spread + Primary Deficit)	1568	2439	1055
Sufficiency of Non-debt Receipts (Resource Gap)	(-) 2278	(-) 247	(-) 1525
Net Availability of Borrowed Funds	1629	3334	2834
Burden of Interest Payments (Interest Payment/Revenue Receipts <i>per cent</i>)	21	19	20
Maturity Profile of debt (in years)			
0 – 1	1.65	1.59	1587.67 (3.2)
1 – 3	4913.86 (12.4)	5852.42 (13.1)	4503.59 (9.1)
3 – 5	4863.95 (12.3)	5349.27 (11.9)	5215.70 (10.5)
5 – 7	5447.94 (13.8)	6241.10 (13.9)	6786.36 (13.7)
7 and above	23385.70 (59.1)	26576.50 (59.3)	27363.90 (55.1)
Information not furnished by State Government	938.69 (2.4)	801.97 (1.8)	4216.09 (8.4)
Figures in parentheses indicate the percentage to total State debt			

Source: Finance Accounts of the State Government

During 2007-08 to 2009-10, the quantum spread together with primary deficit was positive, indicating a declining trend in Debt-GSDP ratio. The resource

²⁴ Kerala State Housing Board (` 66.04 crore), Kerala State Electricity Board (` 2.99 crore), Kerala State Financial Enterprises Ltd (` 16.41 crore), Kerala State Power and Infrastructure Finance Corporation Ltd (` 1.66 crore), Kerala Industrial Infrastructure Development Corporation (` 1.88 crore), The Travancore Rayons Ltd. (` 5.13 crore), Kerala State Co-operative Agricultural and Rural Development Bank Ltd. (` 11.92 crore), United Electrical Industries Ltd (` 1.56 crore).

²⁵ 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.

²⁶ 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.

²⁷ 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.

²⁸ Defined as the ratio of 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.

gap (sufficiency of non-debt receipts) was negative throughout the period 2007-10 which showed that the incremental non-debt receipts were inadequate to finance incremental primary expenditure and incremental interest burden. This means that the Government would have no option but to go for debt receipts to meet its operational expenditure. Moreover, the net availability of borrowed funds after providing for interest and repayment of principal decreased during 2009-10 from the previous year which showed that a larger part of the borrowings was being used for current consumption including debt servicing, leaving only a small portion of the borrowed funds to be spent for developmental activities. The burden of interest payments (Interest Payment/Revenue Receipts ratio) was much higher in Kerala (20 per cent) than the TFC recommended norm of 15 per cent.

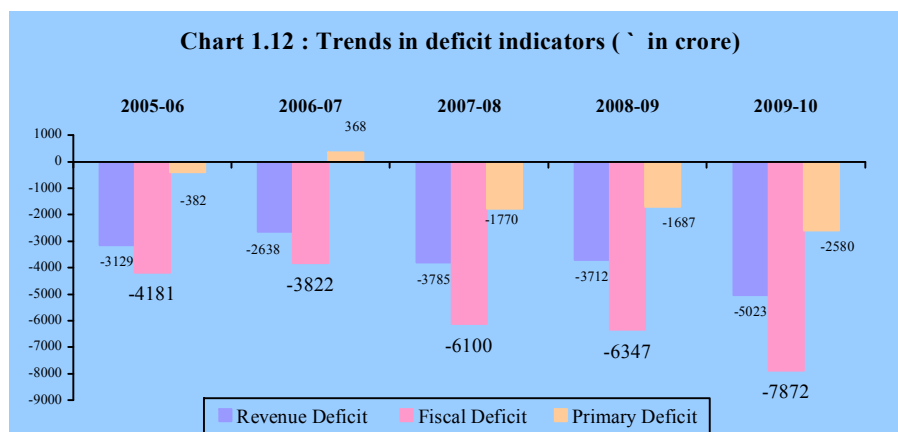
The maturity profile of State debt indicates that the Government will have to repay 33.3 per cent of its debt between one and seven years. Government may consider following a debt management strategy in such a way that fresh loans do not have to be repaid during the years in which huge repayments are due as this would put a strain on the Government budget during that period. The State may have to borrow further during these years to repay those loans.

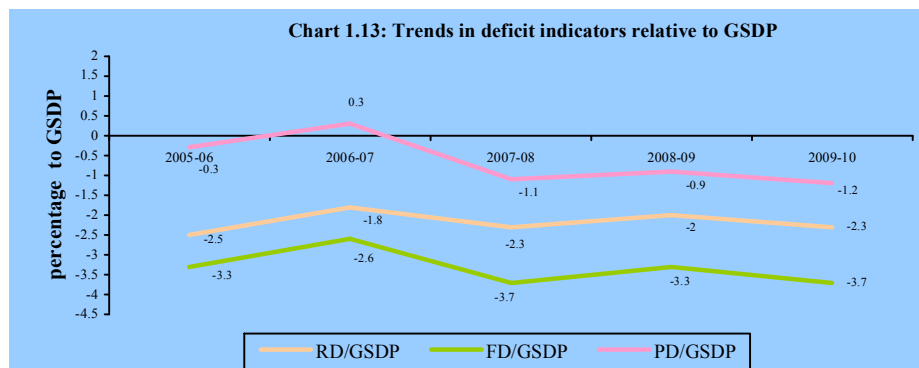
1.10 Fiscal Imbalances

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 assessment of actual levels of revenue and fiscal deficits vis-à-vis targets set under the Fiscal Responsibility Act/Rules for the financial year 2009-10.

1.10.1 Trends in Deficits

Charts 1.12 and 1.13 presents the trends in deficit indicators over the period 2005-10.





The revenue deficit of the State which indicates the excess of its revenue expenditure over revenue receipts showed inter-year variations during 2005-10. It decreased from ` 3,129 crore in 2005-06 to ` 2,638 crore in 2006-07 but increased to ` 3,785 crore in 2007-08. Even though it showed a marginal decline to ` 3,712 crore in 2008-09, it again increased sharply to ` 5,023 crore in 2009-10. The increase of 35.3 *per cent* in revenue deficit during the current year was due to increase of 10.3 *per cent* in revenue expenditure compared to 6.5 *per cent* in revenue receipts.

The fiscal deficit, which represents the total borrowing of the Government and its total resource gap increased steadily from ` 3,822 crore in 2006-07 to ` 7,872 crore in 2009-10. The increase in revenue deficit and in capital expenditure (` 364 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 increased to 2.3 *per cent* and the fiscal deficit to 3.7 *per cent* in 2009-10 (within the limit of four *per cent* of GSDP fixed by GOI for the year) from two *per cent* and 3.3 *per cent* in 2008-09.

The ratio of revenue deficit to fiscal deficit declined steadily from 74.8 *per cent* in 2005-06 to 58.5 *per cent* in 2008-09 but increased in the subsequent year 2009-10 to 63.8 *per cent* which indicated that borrowed funds were increasingly being used for revenue expenditure rather than for creation of assets.

1.10.2 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 1.23**.

Table 1.23: Components of Fiscal Deficit and its Financing Pattern

Particulars		2005-06	2006-07	2007-08	2008-09	2009-10
<i>(` in crore)</i>						
Decomposition of Fiscal Deficit						
1	Revenue Deficit	3129 (75)	2638 (69)	3785 (62)	3712 (58)	5023 (64)
2	Net Capital Expenditure	817 (19)	901 (24)	1467 (24)	1687 (27)	2010 (25)
3	Net Loans and Advances	235 (6)	283 (7)	848 (14)	948 (15)	839 (11)
Total Fiscal Deficit		4181	3822	6100	6347	7872
Financing Pattern of fiscal deficit*						
1	Market Borrowings	1456 (34.8)	1786 (46.7)	3634 (59.6)	4782 (75.3)	4710 (59.8)
2	Loans from Government of India	6.0 (0.1)	(-) 46 (-1.2)	161 (2.6)	476 (7.5)	297 (3.8)
3	Special Securities Issued to National Small Savings Fund	2649 (63.4)	2177 (56.9)	107 (1.8)	(-) 102 (-1.6)	(-) 140 (-1.8)

	Particulars	2005-06	2006-07	2007-08	2008-09	2009-10
4	Loans from Financial Institutions	(-) 111 (-2.7)	336 (8.8)	309 (5.0)	116 (1.8)	(-) 16 (-0.2)
5	Small Savings, PF etc	50 (1.2)	(-) 306 (-8)	1324 (21.7)	2589 (40.8)	2849 (36.2)
6	Deposits and Advances	(-) 29 (-0.7)	428 (11.2)	492 (8.1)	132 (2.1)	437 (5.6)
7	Suspense and Miscellaneous	375 (9)	319 (8.3)	118 (1.9)	(-) 85 (-1.3)	370 (4.7)
8	Remittances	(-) 37 (-0.8)	(-) 4 (-0.1)	49 (0.8)	23 (0.4)	57 (0.7)
9	Others	131 (3.1)	(-) 43 (-1.1)	(-) 160 (-2.6)	72 (1.1)	(-) 31 (-0.4)
10	Overall Surplus/Deficit	(-) 309 (-7.4)	(-) 825 (-21.5)	66 (1.1)	(-)1656 (-26.1)	(-) 661 (-8.4)

*All these figures are net of disbursements/outflows during the year.
 Figures in the brackets indicate percentage to fiscal deficit

Source: Finance Accounts of the State Government

During 2005-06 and 2006-07, market borrowings and special securities issued to National Small Savings Fund financed a major part of the fiscal deficit. However, during 2007-08 to 2009-10, the special Securities issued to National Small Savings Fund showed a declining trend and the fiscal deficit was financed mainly by market borrowings, provident funds and Small Savings.

1.10.3 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 1.24**) 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 1.24 : Primary deficit/Surplus – Bifurcation of factors

(` 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)
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
2009-10	26,196	25,840	2,059	877	28,776	(+) 356	(-) 2580

Source: Finance Accounts of the State Government

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 revenue expenditure²⁹ requirements during 2005-10. However, the surplus non-debt receipts were not enough to meet the expenditure requirements under the capital account during the period 2005-10 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.

²⁹ Primary revenue expenditure represents revenue expenditure less expenditure on interest.

1.11 Conclusion

Revenue receipts: Revenue receipts during the year increased by 6.5 *per cent* over the previous year. The low growth rate was mainly due to decrease of ` 453.81 crore in grant-in-aid from Government of India. Tax revenue collected during the year fell short of the normative assessment made by TFC by 7.2 *per cent*. Non-tax revenue also fell short of the normative assessment made by the TFC by 7.9 *per cent*. There was a shortfall of ` 812.79 crore during the award period 2005-10 in receipt of the benefit of debt relief scheme formulated by the TFC due to non-fulfilment of the conditionalities for receiving the debt relief.

Revenue expenditure: Revenue expenditure constituted 91 *per cent* of the total expenditure and increased by 10.3 *per cent* during the year over the previous year. Non-Plan Revenue Expenditure exceeded the normative assessment made by the TFC by 19.5 *per cent*. The ratio of salary and wages, pension liabilities, interest payments and subsidies to revenue receipts was 78 *per cent*, an increase of one percentage point from the previous year. Interest payments as a percentage of revenue receipts ranged between 19 and 25 *per cent* during the TFC award period as against the TFC recommendation to keep the ratio to 15 *per cent* by 2009-10.

Capital expenditure: Capital expenditure during the year constituted only six *per cent* of the total expenditure. The priority given to capital expenditure continued to be much lower in comparison to the General Category States' average during 2005-06 and 2009-10.

Fiscal parameters: Kerala passed the Fiscal Responsibility Act early. The fiscal position of the State, viewed in terms of the trends in fiscal parameters, i.e., revenue, fiscal and primary deficits indicated an increasing trend in 2009-10 when compared to the previous year. The revenue, fiscal and primary deficits increased from ` 3712 crore, ` 6347 crore and ` 1687 crore in 2008-09 to ` 5023 crore, ` 7872 crore and ` 2580 crore respectively in 2009-10. The ratio of revenue deficit to fiscal deficit increased from 58.5 *per cent* in 2008-09 to 63.8 *per cent* in 2009-10 which indicated that borrowed funds were increasingly being used for revenue expenditure rather than for creation of assets.

The ratio of fiscal liabilities to GSDP was 34.6 *per cent* in 2009-10 and was higher than the norm of 30 *per cent* recommended by the TFC.

Government investment: The average return on the Government's investment in Statutory Corporations, Government Companies, Joint Stock Companies and Co-operatives was one *per cent* in the last five years while Government paid an average interest rate ranging from 7.5 *per cent* to 8.4 *per cent* on its borrowings during this period.

Transfer of funds to State implementing agencies: Government of India directly transferred ` 1634.72 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 in the absence of uniform accounting policies and effective monitoring system.

Cash balance: The cash balance of the State as on 31 March 2010 increased to ` 3291.03 crore from ` 2629.55 crore as on 31 March 2009. The interest realised during the year on investment of the cash balance increased as compared to the previous year.

1.12 Recommendations

- The State Government needs to make efforts to increase tax collection, to collect revenue arrears and curtail unproductive expenditure so that deficits are contained within the level envisaged in the Medium Term Fiscal Plan (2009-10 to 2011-12).
- Government may consider enhancing the proportion of expenditure on economic and capital sectors as a proportion of aggregate expenditure in order to create the much needed assets to stimulate growth.
- Borrowed funds should be used as far as possible only for creation of assets and revenue expenditure should be met fully from revenue receipts.
- The State Government may consider adopting a well-planned strategy to review the stock of fiscal liabilities in order to adhere to the target of reducing it to less than 25 *per cent* of GSDP by 2014-15 set by the Thirteenth Finance Commission.
- The performance of public sector undertakings needs to be monitored to improve the average rate of returns on the capital invested.
- The State Government needs to build a system to monitor the funds directly received by the implementing agencies of the State Government from the Government of India.