CHAPTER I

FINANCES OF THE STATE GOVERNMENT

In Summary

The revenue receipts during the year increased to Rs 11815 crore; the rate of growth being 11.1 *per cent* compared to 17.4 *per cent* in the previous year. But revenue expenditure of Rs 15495 crore for the year grew at 5 *per cent* compared to 26.5 *per cent* in the previous year which led to a reduction in revenue deficit from Rs 4122 crore in the previous year to Rs 3680 crore during the year. The decrease in revenue deficit during the year was on account of showing recoveries in the Consolidated Fund of Rs 581.20 crore that remained unspent out of Plan funds released during 1997-98 to 2002-03 in the Personal Deposit Accounts of Local Self Government Institutions.

During the current year, the increase in revenue receipts was due to 17.3 *per cent* increase in Central Tax transfers, 19 *per cent* increase in non-tax revenue and 10.8 *per cent* in State's own tax revenue. Sales tax was the major source of State's own tax revenue having contributed 74 *per cent* followed by State Excise (8 *per cent*). Of the non-tax sources, Forest Receipts (23 *per cent*) and State Lotteries (17 *per cent*) were principal contributors. About 75 *per cent* of the revenue came from State's own resources during the year. Contribution of Central taxes and duties increased to 17 *per cent* during the year from 16.1 *per cent* in the previous year whereas grants-in–aid from Central Government showed a marginal decline.

Revenue expenditure constituted 89 *per cent* of total expenditure in 2003-04 and grew at 5 *per cent* in 2003-04. Salaries, interest payments and pensions consumed 91 *per cent* of the revenue receipts during the year crowding out the socio-economic developmental expenditure.

The fiscal liabilities grew by 81 *per cent* during 1999-2004 and stood at Rs 39231 crore as at the end of March 2004 i.e., 3.3 times of the revenue receipts. There was a phenomenal increase in internal debt during the year mainly on account of raising more market loans (Rs 693 crore), securitisation of existing house loan portfolio of Government employees with State Bank of India and Canara Bank (Rs 267 crore) and issue of Power Bonds for Rs 1158.25 crore in favour of Central Public Sector Undertakings towards power purchase dues of the State Electricity Board. The fiscal deficit increased to Rs 5539 crore in 2003-04 from Rs 4990 crore in 2002-03 due to the above additional borrowings though revenue deficit had come down during the year. At the end of 2003-04, the fiscal liabilities of the State including unreckoned liabilities like arrears in contractors' bills (Rs 891 crore) and power subsidy payable to the State Electricity Board (Rs 3531 crore) stood at an unsustainable level of 48 *per cent* of GSDP. These liabilities alongwith contingent liabilities in the form of guarantees which accounted for another 16 *per cent* of GSDP are cause of concern for sustained growth and development in the medium to long-term basis.

It is not uncommon for the State to borrow for increasing its social and economic infrastructure base. However, increasing ratios of fiscal liabilities to GSDP and revenue receipts together with a large revenue deficit indicate that the State is gradually getting into a debt trap. Large revenue and fiscal deficits year after year show continued macro fiscal imbalances. Though the Kerala Fiscal Responsibility Act envisages reduction of revenue deficit to 'nil' and fiscal deficit to 2 *per cent* of the estimated GSDP by the end of March 2007, with the current level of revenue deficit of Rs 3680 crore and the fiscal deficit hovering around 6 *per cent* of GSDP for 2003-04, the possibility of achieving the target envisaged in the Act appears bleak.

The State Government will need to take urgent steps to reduce revenue deficit/fiscal deficit by compressing non-developmental revenue expenditure and enhance additional resource mobilization through tax reforms and prudent debt management.

1.1 Introduction

The Finance Accounts of the Government of Kerala are laid out in nineteen statements, presenting receipts and expenditure, revenue as well as capital, in the Consolidated Fund, Contingency Fund and the Public Account of the State Government. The lay out of the Finance Accounts is depicted in Box 1.1

Box 1.1
Lay out of Finance Accounts

Statement No.1 presents the summary of transactions of the State Government – receipts and expenditure, revenue and capital, public debt receipts and disbursements, etc., in the Consolidated Fund, Contingency Fund and Public Account of the State.

Statement No.2 contains the summarised statement of capital outlay showing progressive expenditure to the end of 2003-04.

Statement No.3 gives financial results of irrigation works, their revenue receipts, working expenses and maintenance charges, capital outlay, net profit or loss, etc.

Statement No.4 indicates the summary of debt position of the State, which includes borrowings from internal debt, Government of India, other obligations and servicing of debt.

Statement No. 5 gives the summary of loans and advances given by the State Government during the year, repayments made, recoveries in arrears, etc.

Statement No. 6 gives the summary of guarantees given by the Government for repayment of loans, etc., raised by the statutory corporations, local bodies and other institutions.

Statement No. 7 gives the summary of cash balances and investments made out of such balances.

Statement No.8 depicts the summary of balances under Consolidated Fund, Contingency Fund and Public Account as on 31 March 2004.

Statement No.9 shows the revenue and expenditure under different heads for the year 2003-04 as a percentage of total revenue/expenditure.

Statement No.10 indicates the distribution between the charged and voted expenditure incurred during the year.

Statement No.11 indicates the detailed account of revenue receipts by minor heads.

Statement No.12 provides accounts of revenue expenditure by minor heads under non-plan and plan separately and capital expenditure by major heads.

Statement No.13 depicts the detailed capital expenditure incurred during and to the end of 2003-04.

Statement No.14 shows the details of investment of the State Government in Statutory Corporations, Government Companies, other joint stock companies, co-operative banks and societies, etc., up to the end of 2003-04.

Statement No.15 depicts the capital and other expenditure to the end of 2003-04 and the principal sources from which the funds were provided for that expenditure.

Statement No.16 gives the detailed account of receipts, disbursements and balances under heads of account relating to Debt, Contingency Fund and Public Account.

Statement No.17 presents detailed account of debt and other interest bearing obligations of the Government of Kerala.

Statement No.18 provides the detailed account of loans and advances given by the Government of Kerala, the amount of loan repaid during the year and the balance as on 31 March 2004.

Statement No.19 gives the details of earmarked balances of reserve funds.

Statements 1 to 8 are Summarized Statements and Statements 9 to 19 are Detailed Statements. Statements 5, 6 and 14 are based on information received from Heads of Departments and Finance Department.

1.2 Trend of Finances with reference to Previous year

Finances of the State Government during the current year compared to the previous year were as under:

(Rupees in crore)

2002-03	Sl. No	Major Aggregates	2003-04
10634	**1.**	**Revenue Receipts (2+3+4)**	**11815**
7303	2.	Tax Revenue	8089
678	3.	Non-Tax Revenue	807
2653	4.	Other Receipts	2919
81	**5.**	**Non-Debt Capital Receipts**	**73**
77	6.	*Of which* Recovery of Loans and Advances	73
10715	**7.**	**Total Receipts (1+5)**	**11888**
11731	**8.**	**Non-Plan Expenditure (9+11+12)**	**14308**
11702	9.	On Revenue Account	13101
2947	10.	*Of which* Interest Payments	3328
20	11.	On Capital Account	33
9	12.	Loans and Advances disbursed	1174
3974	**13.**	**Plan Expenditure (14+15+16)**	**3119**
3054	14.	On Revenue Account	2394
679	15.	On Capital Account	607
241	16.	Loans and Advances disbursed	118
15705	**17.**	**Total Expenditure (8+13)**	**17427**
4990	**18.**	**Fiscal Deficit (17-1-5)**	**5539**
4122	**19.**	**Revenue Deficit (9+14-1)**	**3680**
2043	**20.**	**Primary Deficit (18-10)**	**2211**

1.3 Summary of Receipts and Disbursements for the year

Table 1 summarises the finances of the Government of Kerala for the year 2003-04 covering revenue receipts and expenditure, capital receipts and expenditure, public debt receipts and disbursements, Contingency Fund receipts and disbursements and Public Account receipts and disbursements made during the year as emerging from Statement 1 of Finance Accounts and other detailed statements.

Table 1 - Summary of receipts and disbursements for the year 2003-04 (Rupees in crore)

2002-03	Receipts	2003-04	2002-03	Disbursements	2003-04		
Section-A: Revenue							
					Non-Plan	**Plan**	**Total**
10633.89	**Revenue receipts**	**11815.37**	**14756.05**	**Revenue expenditure**	**13101.08**	**2394.59**	**15495.67**
7302.54	Tax revenue	8088.77	6678.03	General services	7251.18	146.75	7397.93
677.76	Non-tax revenue	806.98	5038.29	Social Services	4164.08	861.13	5025.21
1715.22	Share of Union Taxes/Duties	2012.01	2981.67	Economic Services	1612.64	1386.71	2999.35
938.37	Grants from Govt. of India	907.61	58.06	Grants-in-aid / Contributions	73.18	--	73.18
4122.16	**Revenue Deficit carried over to Section B**	**3680.30**					
14756.05	**Total Section - A**	**15495.67**	**14756.05**	**Total Section - A**	**13101.08**	**2394.59**	**15495.67**
Section-B: Capital							
161.62	**Opening Cash Balance**	**(-) 103.22**	**275.56**	**Opening Overdraft from Reserve Bank of India**	**164.85#**		**164.85#**
3.50	**Miscellaneous Capital Receipts**	**--**	**698.66**	**Capital Outlay**	**32.72**	**606.99**	**639.71**
77.29	**Recoveries of Loans and Advances**	**72.89**	**250.01**	**Loans and Advances disbursed**	**1174.21**	**117.73**	**1291.94**
			4122.16	**Revenue Deficit brought down from Section A**	**3680.30#**		**3680.30#**
3965.68	**Public debt receipts***	**6992.46**	**1261.99**	**Repayment of Public Debt***	**2341.25#**		**2341.25#**
22.15	**Contingency Fund receipts**	**--**	**--**	**Contingency Fund disbursements**	**16.88#**		**16.88#**
25528.22	**Public Account receipts**	**26147.18**	**23418.15**	**Public Account disbursements**	**25481.66#**		**25481.66#**
164.85	**Closing Overdraft from Reserve Bank of India**	**280.64**	**(-)103.22**	**Cash Balance at end**	**(-) 226.64#**		**(-) 226.64#**
29923.31	**Total – Section B**	**33389.95**	**29923.31**	**Total – Section B**	**32665.23**	**724.72**	**33389.95**

* Includes net ways and means advances but excludes overdraft from Reserve Bank of India
# Bifurcation of plan and non- plan not available

1.4 Audit Methodology

1.4.1 Audit observations on the Finance Accounts bring out the trends in the major fiscal aggregates of receipts and expenditure and from the statements of the Finance Accounts for the year 2003-04 and wherever necessary, show these in the light of time series data and periodic comparisons **(Appendix I to IV)**. The reporting parameters are depicted in the Box 1.2.

Box 1. 2
Reporting Parameters

Fiscal aggregates like tax and non-tax revenue, revenue and capital expenditure, internal and external debt and revenue and fiscal deficits have been presented as percentage to the GSDP at current market prices. The New GSDP series with 1993-94 as base as published by the Bureau of Economics and Statistics Department of the State Government have been used.

For tax revenues, non-tax revenues, revenue expenditure, etc., buoyancy projections have also been provided for a further estimation of the range of fluctuations with reference to the base represented by GSDP.

For most series a trend growth during 1999-2004 has been indicated. The ratios with respect to GSDP have also been depicted. Some of the terms used here are explained in **Appendix V**.

1.4.2 The key indicators adopted for analyzing the State finances are (i) Resources by volumes and sources, (ii) Application of resources (iii) Assets and Liabilities and (iv) Management of deficits. Audit observations have also taken into account the cumulative impact of resource mobilisation efforts, debt servicing and corrective fiscal measures. Overall financial performance of the State Government as a body corporate has been presented by the application of a set of ratios commonly adopted for the relational interpretation of fiscal aggregates.

1.4.3 The accounts of the State Government are kept in three parts viz., Consolidated Fund, Contingency Fund and Public Account. They are defined in Box 1.3.

Box 1.3

State Government Funds and the Public Account

Consolidated Fund	**Contingency Fund**
All revenues received by the State Government, all loans raised by issue of treasury bills, internal and external loans and all moneys received by the Government in repayment of loans shall form one consolidated fund entitled 'The Consolidated Fund of State' established under Article 266(1) of the Constitution of India.	Contingency Fund of State established under Article 267(2) of the Constitution is in the nature of an imprest placed at the disposal of the Governor to enable him to make advances to meet urgent unforeseen expenditure, pending authorisation by Legislature. Approval of the Legislature for such expenditure and for withdrawal of an equivalent amount from the Consolidated Fund is subsequently obtained, whereupon the advances from the Contingency Fund are recouped to the Fund.

Public Account

Besides the normal receipts and expenditure of Government which relate to the Consolidated Fund, certain other transactions enter Government Accounts, in respect of which Government acts more as a banker. Transactions relating to provident funds, small savings, other deposits, etc. are a few examples. The public moneys thus received are kept in the Public Account set up under Article 266(2) of the Constitution and the related disbursement are made from it.

State Finances by key indicators

1.5 Resources by volumes and sources

1.5.1 Resources of the State Government consist of 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 Central Government. Capital receipts comprise of miscellaneous capital receipts like proceeds from disinvestments, recoveries of loans and advances, debt receipts from internal sources, *viz*. market loans, borrowings from financial institutions/ commercial banks, etc., and loans and advances from Government of India as well as accruals from Public Account.

1.5.2 Table 2 shows that the total receipts of the State Government for the year 2003-04 was Rs 45028 crore. Of which, the revenue receipts of the State Government was Rs 11815 crore only, constituting 26 *per cent* of the total receipts. The balance of receipts came from borrowings and receipts from Public Account.

Table 2 – Resources of Kerala

(Rupees in crore)

I Revenue Receipts			***11815.37***
II Capital Receipts			***7065.35***
a	*Miscellaneous Receipts*	--	
b	*Recovery of Loans and Advances*	*72.89*	
c	*Public Debt Receipts**	*6992.46*	
III Contingency Fund Receipts			--
IV Public Account Receipts			***26147.18***
a	*Small Savings, Provident Funds, etc.*	*8773.13*	
b	*Reserve Funds*	*133.70*	
c	*Deposits and Advances*	*3320.48*	
d	*Suspense and Miscellaneous*	*9476.50*	
e	*Remittances*	*4443.37*	
Total Receipts			***45027.90***

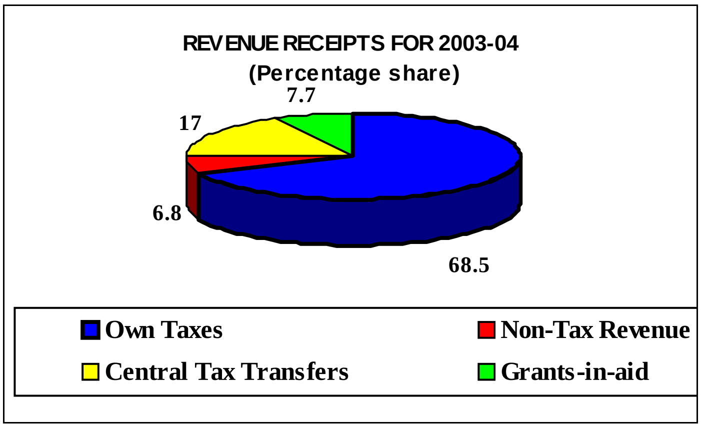
* Excludes ways and means advances from Reserve Bank of India

Revenue receipts

1.5.3 Statement-11 of the Finance Accounts details the Revenue Receipts of the Government. The Revenue Receipts of the State consist mainly of its own tax and non-tax revenues, Central tax transfers and grants-in-aid from Government of India. Overall revenue receipts, its annual rate of growth, ratio of these receipts to the State's Gross Domestic Product (GSDP) and its buoyancy are indicated in Table 3.

Table 3: Revenue Receipts- Basic Parameters
(Values Rupees in crore and others in *per cent*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Revenue Receipts	7942	8731	9056	10634	11815
Own Taxes	65.4	67.2	65.4	68.7	68.5
Non-Tax Revenue	6.7	7.5	6.0	6.4	6.8
Central tax Transfers	19.3	18.2	17.8	16.1	17.0
Grants-in aid	8.6	7.1	10.8	8.8	7.7
Rate of Growth of RR	10.3	9.9	3.7	17.4	11.1
Revenue Receipt/GSDP	12.7	12.5	12.5	13.2	13.1
Revenue Buoyancy	0.9	0.9	1.0	1.5	1.0
GSDP Growth	11.2	11.6	3.7	11.7	11.5



1.5.4 Revenue receipts of the State increased from Rs 10634 crore in 2002-03 to Rs 11815 crore in 2003-04; the growth rate being 11.1 *per cent.* The annual growth rate, which had declined steadily during 2000-01(9.9 *per cent*) and 2001-02 (3.7 *per cent*) from the level of 10.3 *per cent* in 1999-2000 increased sharply to 17.4 *per cent* in 2002-03 but declined to 11.1 *per cent* in 2003-04. The contribution of the State's own taxes in its total revenue receipt increased from 65.4 *per cent* in 1999-2000 to 68.5 *per cent* in 2003-04; the growth rate during the current year being 10.8 *per cent*.

1.5.5 Sales tax was the major source of State's own tax revenue having contributed 74 *per cent* followed by State Excise (8 *per cent*), Taxes on Vehicles (7 *per cent*), Stamps and Registration (7 *per cent*), etc. The significant increase in the tax revenue during the year over 2002-03 was mainly on Sales Tax (Rs 648 crore), Stamps and Registration fees (Rs 63 crore) and Taxes on Vehicles (Rs 73 crore).

1.5.6 Of non-tax revenue sources, Forest Receipts (23 *per cent*) and State Lotteries (17 *per cent*) were principal contributors. However, though the receipts under State Lotteries were Rs 134 crore during the year, with equally high expenditure of Rs 111 crore, the net yield from lotteries was only Rs 23 crore. The Medium Term Fiscal Reforms Programme agreed to by the Government of Kerala with Government of India provides for improving cost recoveries for Government services by enhancing user charges periodically and bringing new areas of Government services for cost recovery. Non-tax revenue in absolute terms has increased by 19 *per cent* from Rs 678 crore in

2002-03 to Rs 807 crore in 2003-04. The contribution of non-tax revenue in its total revenue receipts increased from 6.7 *per cent* in 1999-2000 to 6.8 *per cent* in 2003-04.

1.5.7 Contributions of Central taxes, duties and grants-in-aid decreased from 28 *per cent* in 1999-2000 to 25 *per cent* in 2003-04. However, contribution of Central taxes and duties increased to 17 *per cent* in 2003-04 compared to 16.1 *per cent* in 2002-03, whereas contribution of grants-in-aid decreased from 8.8 *per cent* in 2002-03 to 7.7 *per cent* in 2003-04. The decrease was mainly under Block grants for State Plan Schemes and Additional Central Assistance for Externally Aided Projects like Modernising Government Programme (Rs 108 crore) and for Special Plan Schemes (Rs 4.91 crore).

1.5.8 The source of revenue receipts under different heads and GSDP during 1999-2004 are indicated in Table 4.

Table 4 – Sources of Receipts: Trends

(Rupees in crore)

Year	Revenue Receipts	Capital Receipts				Total Receipts	Gross State Domestic product
		Non-Debt Receipts	Debt Receipts	Contingency Fund Receipts	Accruals in Public Account		
1999-2000	7942	55	2014	--	20662	30673	62520
2000-01	8731	117	2156	--	21126	32130	69770
2001-02	9056	55	2792	--	18940	30843	72349
2002-03	10634	81	3966	22	25528	40231	80844
2003-04	11815	73	6992	--	26147	45027	90172

1.5.9 The arrears of revenue pending collection as at the end of 2003-04 intimated by departments of Electrical Inspectorate, Factories and Boilers, Local Fund Audit and Mining and Geology were Rs 104.93 crore. As Government ordered (October 2002) netting off of the dues between Kerala State Electricity Board (KSEB) and Government of Kerala as on 31 March 2002 without cash transaction, the arrears of electricity duty due from KSEB as on 31 March 2002 had not been included by the Electrical Inspectorate in calculating the arrears. The actual amount due on either side has not been determined (October 2004).

1.6 Application of resources

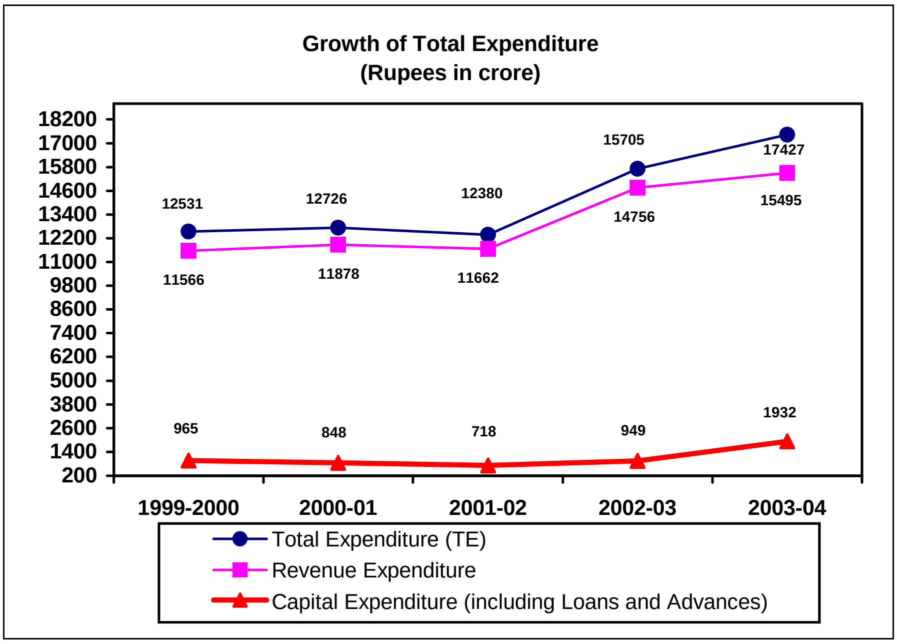
Trend of Growth

1.6.1 Statement 12 of the Finance Accounts depicts the detailed revenue expenditure by minor heads and capital expenditure major head-wise. Total expenditure of the State, its trend and annual growth, ratio of expenditure to the State's GSDP and revenue receipts and its buoyancy with regard to GSDP and revenue receipts are indicated in Table 5 below:

Table 5: Total Expenditure – Basic Parameters
(Value: Rupees in crore and others in *per cent*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Total Expenditure[⊕]	12531	12726	12380	15705	17427
Rate of Growth	21.9	1.6	(-) 2.7	26.9	11.0
TE/GSDP	20.0	18.2	17.1	19.4	19.3
Revenue Receipts/TE	63.4	68.6	73.2	67.7	67.8
Buoyancy of Total Expenditure with					
GSDP	2.0	0.1	(-) 0.7	2.3	1.0
Revenue Receipts	2.1	0.2	(-) 0.7	1.5	1.0

1.6.2 Though the total expenditure during the year increased to Rs 17427 crore, the actual growth rate declined during the year to 11 *per cent* from 26.9 *per cent*. There were, however, significant inter-year variations in the growth rates. The ratio of revenue receipts to total expenditure increased from 63.4 *per cent* in 1999-2000 to 67.8 *per cent* in 2003-04, indicating that approximately 68 *per cent* of the State's total expenditure was met from its current revenue, leaving the balance to be financed from borrowings.



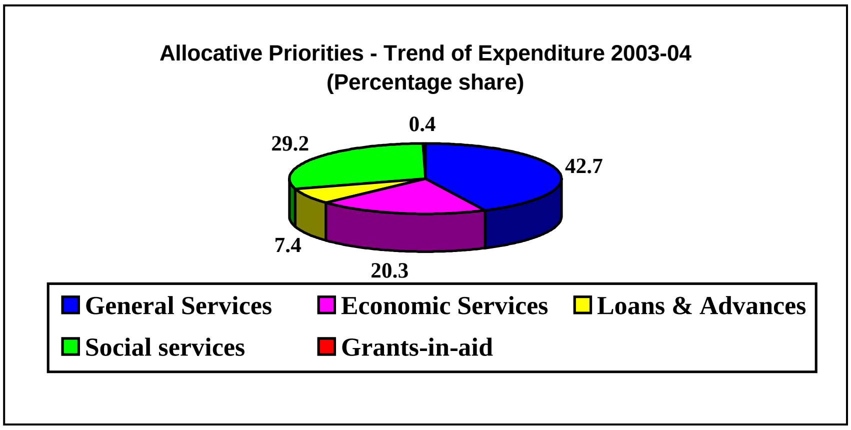
1.6.3 In terms of the activities, total expenditure could be considered as being composed of expenditure on general services including interest payments, social and economic services and loans and advances. The relative share of these components in total expenditure is indicated in Table 6.

Table 6: Components of expenditure – Relative Share (in *per cent*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
General Services	40.1	43.2	45.6	42.8	42.7
Social Services	34.1	33.4	33.4	32.6	29.2
Economic Services	22.7	20.9	19.2	22.6	20.3
Grants-in-aid	0.6	0.4	0.5	0.4	0.4
Loans and advances	2.5	2.1	1.3	1.6	7.4

[⊕]Total Expenditure represents revenue expenditure as well as capital expenditure which includes expenditure on loans and advances.

1.6.4 The movement of relative share of these components indicated that the share of social services and economic services declined from 34.1 and 22.7 *per cent* in 1999-2000 to 29.2 and 20.3 *per cent* respectively in 2003-04. The share of general services which included interest payments considered as non-developmental accounted for 42.7 *per cent* of total expenditure in 2003-04 as compared to 40.1 *per cent* in 1999-2000.



Incidence of Revenue expenditure

1.6.5 Revenue expenditure is usually incurred to maintain the current level of assets and services. Overall revenue expenditure, its rate of growth, ratio of revenue expenditure to State's GSDP and revenue receipts and its buoyancy with both GSDP and revenue receipts are indicated in Table 7 below:

Table 7: Revenue Expenditure- Basic Parameters
(Value: Rupees in crore and others in *per cent*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Revenue Expenditure	11566	11878	11662	14756	15495
Rate of Growth	25.3	2.7	(-)1.8	26.5	5.0
RE/GSDP	18.5	17.0	16.1	18.3	17.2
RE as *per cent* of TE	92.3	93.3	94.2	94.0	88.9
RE as *per cent* of RR	145.6	136.0	128.8	138.8	131.2
Buoyancy of Revenue Expenditure with					
GSDP	2.3	0.2	(-) 0.5	2.3	0.4
Revenue Receipts	2.5	0.3	(-) 0.5	1.5	0.5

1.6.6 Though the revenue expenditure during the year increased to Rs 15495 crore from Rs 14756 crore, the actual growth rate declined to 5 *per cent* from 26.5 *per cent* in the previous year. The increase in the revenue expenditure during the year compared to previous year was mainly due to increased expenditure on interest payment (Rs 382 crore), pension and other retirement benefits (Rs 126 crore), General Education (Rs 99 crore) and additional subsidy to KSEB (Rs 381.46 crore) to cover the gap of the Board as assessed by the State Electricity Regulatory Commission.

1.6.7 The assistance to Local Self Government Institutions (LSGIs) for implementation of 'People's Plan Programme' is being released by debit to the major head '2217-Urban Development' in the case of

Municipalities/Corporations and to the major head '2515-Other Rural Development Programmes' in the case of Panchayats per contra credit to the Personal Deposit (PD) Accounts of the respective LSGIs maintained in the Public Account. In July 2003, Government ordered that all existing PD accounts should be closed with immediate effect and new Plan PD Accounts opened in a financial year shall be closed on 31 March of every year. In April 2004, Government issued directions to all the treasuries to write back to Government the unspent balance (Plan) in PD Account of LSGIs by carrying out reduction in revenue expenditure under the relevant major head. Accordingly, Rs 581.20 crore being the unspent balance from out of the Plan funds released to the LSGIs during 1997-98 to 2002-03 in the PD accounts was adjusted as reduction of revenue expenditure in the current year – Rs 500.58 crore in the major head '2515' and Rs 80.62 crore in the major head '2217'. This had the effect of reducing the revenue expenditure for the current year to that extent. But for this adjustment, the revenue expenditure and its growth rate for 2003-04 would have been Rs 16076 crore and 9 *per cent* instead of Rs 15495 crore and 5 *per cent* respectively as depicted in the accounts.

1.6.8 Though the rate of growth of revenue expenditure was 25.3 *per cent* in 1999-2000 it had decelerated since then and became negative in 2001-02. However, it again accelerated to 26.5 *per cent* during 2002-03 and again decelerated to 5 *per cent* in 2003-04.

1.6.9 Revenue Expenditure accounted for 89 *per cent* of total expenditure during 2003-04. The ratio of revenue expenditure to revenue receipts decreased from 145.6 *per cent* in 1999-2000 to 131.2 *per cent* in 2003-04 indicating continued dependence of the State on borrowings for meeting its current expenditure.

Committed Expenditure

1.6.10 The committed expenditure on Pension, Interest and Salaries constituted 89 to 104 *per cent* of the revenue receipts during 1999-2004 indicating the paucity of resources available for socio-economic developmental activities.

♦ ***High salary expenditure***

1.6.11 As part of enforcement of economy measures to overcome the ways and means position of the State, Government appointed (January 2002) a Committee of Secretaries to identify the excess staff in Government departments and also curtailed some of the benefits, indicated below, of Government employees.

- Discontinuance of Dearness Allowances and other allowances to new recruits joining service on or after 16 January 2002.
- Discontinuance of surrender of earned leave for twenty days per year while in service.
- Enhancement of discounted rate of commuted value of pension to 5.31 *per cent* from the present 4.75 *per cent.*
- Enhancement of the period of restoration of commutation to 15 years from the present 12 years.

1.6.12 The curtailment continued during 2002-03 and from June 2003 some of the curtailed benefits–Dearness allowance and other allowances to new recruits and period of restoration of commutation–were restored and surrender of earned leave was restricted to 10 days a year. From June 2004, the surrender of earned leave was restored to the original level of 20 days in a financial year.

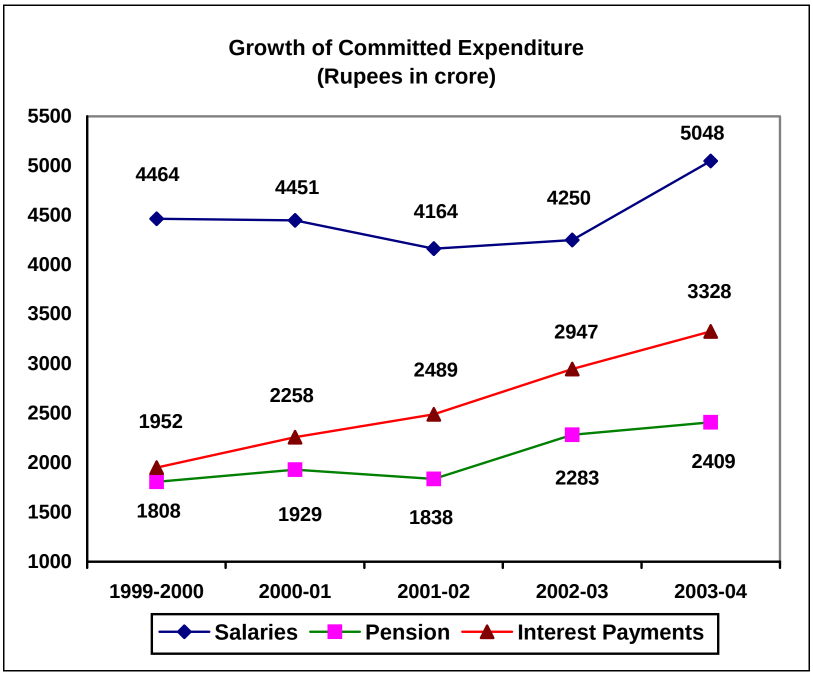
1.6.13 The Committee of Secretaries set up to identify the excess posts identified 11658 posts that could be redeployed/abolished of which 3570 posts have already been abolished. After redeployment of 2915 posts to Local Self Government Institutions (LSGIs), Government ordered (November 2003) redeployment of another 1663 posts to LSGIs. Government also ordered abolition of 3510 more posts and directed that posts not vacant would be treated as supernumerary. The latest position regarding redeployment to LSGIs and continuance of supernumerary posts have not been intimated (October 2004).

1.6.14 In spite of the above measures, salary expenditure during the year increased by 19 *per cent* over the level of 2002-03 and accounted for 43 *per cent* of the revenue of the State during 2003-04 compared to 40 *per cent* in the previous year. Expenditure on salaries had increased by 13 *per cent* from Rs 4464 crore in 1999-2000 to Rs 5048 crore in 2003-04. Year-wise break up of expenditure during 1999-2004 was as under:-

Table 8: Salary expenditure

Year	Salary expenditure[$] (Rupees in crore)	Percentage of salary expenditure with reference to		
		Revenue Receipts	Revenue Expenditure	GSDP
1999-2000	4464	56.2	38.6	7.1
2000-2001	4451	51.0	37.5	6.4
2001-2002	4164	46.0	35.7	5.8
2002-2003	4250	40.0	28.8	5.3
2003-2004	5048	42.7	32.6	5.6

[$] Figures for 1999-2000 to 2001-02 are adopted from 'Budget in brief – 2003-04' of State Government and figures for 2002-03 and 2003-04 are furnished by Accountant General (A&E)



♦ ***Huge expenditure on pension payments***

1.6.15 Pension payments increased by 33 *per cent* from Rs 1808 crore in 1999-2000 to Rs 2409 crore in 2003-04. Year-wise breakup of expenditure during 1999-2004 was as under:-

Table 9: Pension payments

Year	Pension payments (Rupees in crore)	Percentage of pension payments with reference to	
		Revenue Receipts	Revenue Expenditure
1999-2000	1808	22.8	15.6
2000-2001	1929	22.1	16.2
2001-2002	1838	20.3	15.8
2002-2003	2283	21.5	15.5
2003-2004	2409	20.4	15.6

1.6.16 With the increase in the number of retirees, the pension liabilities are likely to increase further in future. The State Government has not constituted any fund to meet the fast rising pension liabilities of the retired State employees.

♦ ***Interest payments***

1.6.17 In absolute terms, Interest payments increased by 70 *per cent* from Rs 1952 crore in 1999-2000 to Rs 3328 crore in 2003-04 primarily due to continued reliance on borrowings for financing the fiscal deficit.

Table 10: Interest payments

Year	Interest payments (Rupees in crore)	Percentage of interest payment with reference to	
		Revenue Receipts	Revenue Expenditure
1999-2000	1952	24.6	16.9
2000-2001	2258	25.9	19.0
2001-2002	2489	27.5	21.3
2002-2003	2947	27.7	20.0
2003-2004	3328	28.2	21.5

1.6.18 It was observed that interest payments constituted 28 *per cent* of revenue receipts during 2003-04 against 18 *per cent* as recommended by the Eleventh Finance Commission.

Subsidy

1.6.19 Subsidy can be defined as the difference between the cost of goods/services provided and realisation from the users. There are two types of subsidies viz. Explicit subsidies and Implicit subsidies. While there is clear identification and budgetary allocation in respect of explicit subsidies, implicit subsidies arise due to non-recovery/short recovery of user charges provided.

1.6.20 The explicit subsidies, compiled from the accounts for the year 1999-2004 ranged from 0.7 *per cent* to 4.3 *per cent* of revenue expenditure. Major schemes on which explicit subsidies are granted were as follows:

Table 11: Subsidy

Schemes/departments to which subsidy was released	Amount of subsidy(Rupees in crore)				
	1999-2000	2000-01	2001-02	2002-03	2003-04
Maithri Housing Scheme	30.00	22.50	18.84	47.84	40.00
Kerala State Civil Supplies Corporation for Market Intervention	60.00	37.00	33.00	50.00	30.00
State Investment Subsidy	17.25	17.06	21.30	22.98	23.69
Kerala State Electricity Board (to liquidate the revenue deficit)	--	--	--	200.00	556.46
Free supply of electricity to small and marginal paddy growers	--	--	--	--	7.97
Rebate on sale of handloom cloth	--	--	--	--	1.50
Macro management in Agriculture	--	9.90	24.14	22.39	3.44
Total	**107.25**	**86.46**	**97.28**	**343.21**	**663.06**

1.7 Expenditure by Allocative Priorities

1.7.1 The actual expenditure of the State in the nature of plan expenditure, capital expenditure and developmental expenditure emerging from Statement 12 of Finance Accounts reflects the allocative priorities of the State. Higher the ratio of these components to total expenditure, better is deemed to be the quality of expenditure. Table 12 below gives the percentage share of these components of expenditure in State's total expenditure*.

Table 12: Quality of expenditure (*per cent* to total expenditure*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Plan Expenditure	22.1	20.3	18.9	24.2	18.6
Capital Expenditure	5.3	4.6	4.6	4.5	4.0
Development Expenditure	58.2	55.4	53.3	56.2	53.4

*Total expenditure does not include Loans and Advances

1.7.2 All the three components of quality of expenditure indicated a decline and the ratios in 2003-04 were significantly lower than their levels in 1999-2000. Plan expenditure, despite its initial low values in 1999-2000 at 22.1 *per cent* further declined to 18.6 *per cent* in 2003-04. Over the years, a lower proportion of incremental expenditure got allocated to plan expenditure. In case of development expenditure, its ratio to total expenditure also declined.

1.7.3 Out of the developmental expenditure (Rs 8624 crore) during the year, social services (Rs 5081 crore) accounted for 59 *per cent* and economic services (Rs 3543 crore) accounted for 41 *per cent*. The capital expenditure has also steadily declined from 5.3 *per cent* in 1999-2000 to 4 *per cent* in 2003-04.

Financial assistance to Autonomous bodies and others

1.7.4 Autonomous bodies and authorities perform non-commercial functions of public utility services. These bodies/authorities receive substantial financial assistance from Government. Government also provides substantial financial assistance to other institutions such as those registered under the respective State Co-operative Societies Act, Companies Act, etc. to implement various programmes of Government. The grants are given by Government mainly for maintenance of educational institutions, hospitals, charitable institutions, construction and maintenance of schools and hospital buildings, improvement of roads and other communication facilities under municipalities and local bodies.

1.7.5 The quantum of assistance (grant as well as loan) provided to different bodies during the period of five years ending 2003-04 was as follows:

Table 13: Financial assistance to Autonomous bodies and others

(Rupees in crore)

Sl. No.	Bodies/authorities, etc.	1999-2000	2000-01	2001-02	2002-03	2003-04
1.	Educational Institutions (Aided Schools, Aided Colleges, Universities, etc)	1603.88	1619.77	1540.40	1851.08	1929.60
2.	Municipal Corporations and Municipalities	165.94	146.82	131.57	239.46	230.91
3.	Panchayati Raj Institutions	1021.14	948.74	858.41	1288.76	1554.39
4.	Development Agencies	37.40	43.96	13.07	33.49	28.67
5.	Hospitals and other Charitable Institutions	20.32	19.17	17.17	19.84	23.60
6.	Other Institutions (including statutory bodies)	565.27	483.09	360.37	779.95	1686.32**
	Total	**3413.97**	**3261.55**	**2920.99**	**4212.58**	**5453.49**
	Percentage increase(+)/ decrease (-) over previous year	8	(-) 4	(-) 10	44	29
	Assistance as a percentage of revenue receipts	43	37	32	40	46
	Percentage of assistance to revenue expenditure	29	27	25	29	35

Delay in furnishing utilisation certificates

1.7.6 The financial rules of Government require that where grants are given for specific purposes, certificates of utilisation should be obtained by the departmental officers from the grantees and after verification, these should be forwarded to the Accountant General (Accounts and Entitlements) within one year from the date of sanction of assistance unless specified otherwise.

As of June 2004, 106 utilisation certificates for Rs 117.45 crore paid as grants in respect of nine departments* from 1994-95 to 2003-04 had not been received in the Office of the Accountant General (Accounts and Entitlements).

Delay in submission of accounts by Autonomous Bodies

1.7.7 As on 31 March 2004, there were 55 Autonomous bodies (excluding Local Self Government Institutions) which were substantially financed by grants/loans from Government. In order to identify the institutions which attract audit under Sections 14 and 15 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, Government/Heads of Departments are required to furnish to Audit every year detailed information about the financial assistance given to various institutions, the purpose of assistance granted and the total expenditure of the institutions. The details of 30 institutions which have not furnished annual accounts for the year 2003-04 as of October 2004 are indicated in **Appendix VI.**

** Includes Rs 1158.25 crore being the liability of Kerala State Electricity Board to Central Public Sector Undertakings on power purchase taken over by Government which was treated as loan assistance to the Board during the year for eventual conversion as grant

* Agriculture, Cultural Affairs, General Administration, General Education, Health and Family Welfare, Higher Education, , Planning and Economic Affairs, Science, Technology and Environment and Water Resources

1.7.8 The status of submission of accounts as of October 2004 by autonomous bodies/authorities, audit of accounts of which has been entrusted to the Comptroller and Auditor General of India is indicated in **Appendix VII.**

Misappropriations, defalcations, etc.

1.7.9 State Government reported 182 cases of misappropriations, defalcations, etc., of Government money amounting to Rs 4.60 crore relating to the period from 1963-64 to 2003-04. Final action was pending on all cases at the end of June 2004. The department-wise break-up of pending cases is given in **Appendix VIII.**

Writes off of losses, etc.

1.7.10 According to data received from departments to Audit as of September 2004, sanctions for writes off of Rs 2.58 crore in 6306 cases and waivers amounting to Rs 54.25 lakh in 49 cases were issued by various authorities during 2003-04. The department-wise details are given in **Appendix IX.**

1.8 Assets and Liabilities

1.8.1 The Government accounting system does not attempt a comprehensive accounting of fixed assets, i.e. land, buildings, etc., owned by the Government. However, the Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure. Statement 16 read with details in Statement 17 of Finance Accounts shows the year-end balances under the Debt, Deposit and Remittance heads from which the liabilities and assets are worked out. **Appendix I** presents an abstract of such liabilities and the assets as on 31 March 2004 compared with the corresponding position on 31 March 2003. While the liabilities in this statement consist mainly of money owed by the State Government such as internal borrowings, loans and advances from the Government of India, receipts from the Public Account and Reserve Fund, the assets comprise mainly the capital expenditure and loans and advances given by the State Government. *The liabilities of Government of Kerala depicted in the Finance Accounts, however, do not include the pension liabilities payable to retired State employees, guarantees / letters of comforts issued by the State Government*, etc. **Appendix IV** depicts the Time Series Data on State Government Finances for the period 1999-2004.

Financial results of irrigation works

1.8.2 Statement 3 of the Finance Accounts gives the financial results of irrigation works, their revenue receipts, working expenses and maintenance charges, capital outlay, net profit or loss, etc. In the case of eight irrigation projects, which have been declared commercial, with a cumulative capital outlay of Rs 119.97 crore at the end of 31 March 2004, the revenue realised from them during 2003-04 was Rs 1.76 crore which was 1.5 *per cent* of total outlay. After considering the working and maintenance expenses of Rs 15.62 crore and interest charges of Rs 8.18 crore, these schemes suffered a net loss of Rs 22.04 crore.

Incomplete projects

1.8.3 As per information made available by the department seven[*] irrigation projects commenced between 1970 and 1983 were remaining incomplete even after incurring Rs 859.94 crore as of March 2004. Besides, 97 other capital works on which Rs 333.93 crore were spent up to March 2004 also remained incomplete in Public Works, Harbour Engineering and Water Resources departments. The amount blocked in these projects was 12 *per cent* of the cumulative capital outlay of the State.

Investments and returns

1.8.4 Statement 14 of the Finance Accounts shows the details of investment of the State Government in Statutory Corporations, Government Companies, other joint stock companies, co-operative banks and societies, etc. As on 31 March 2004, Government had invested Rs 2123.57 crore in Statutory Corporations, Joint Stock Companies and Co-operatives. Government's return on this investment was less than one *per cent* as indicated in Table 14 below:

Table 14: Return on Investment (*Rupees in crore*)

Year	Investment at the end of the year	Return	Percentage of Return	Average rate of interest on Government borrowing (in *per cent*)
1999-2000	1774.80	10.01	0.6	12.1
2000-01	1883.09	12.64	0.7	11.4
2001-02	1945.92	5.26	0.3	9.0
2002-03	2059.23	9.61	0.5	7.2
2003-04	2123.57	20.03	0.9	6.1

1.8.5 Apart from the above, as of March 2004 Government had provided equity participation of Rs 136.10 crore (2000-01: Rs 25 crore, 2001-02: Rs 30 crore, 2002-03: Rs 40 crore and 2003-04: Rs 41.10 crore) to the Kerala Infrastructure Investment Fund Board, a statutory body created under the Kerala Infrastructure Investment Fund Act, 1999, though the relevant Act did not envisage equity participation by Government. The matter is under correspondence with Government (November 2004).

1.8.6 Three statutory Corporations and 56 Government Companies with an aggregate Government investment of Rs 1126.20 crore up to 2003-04 were incurring losses and their accumulated loss amounted to Rs 2949.75 crore as per the latest accounts furnished by these companies (**Appendix X**). Of these, six Government Companies with an investment of Rs 13.42 crore upto 31 March 2004 were under liquidation and one Government Company with an investment of Rs 1.25 crore was under lockout from June 1993.

Loans and advances by State Government

1.8.7 In addition to its investment, Government has also been providing loans and advances to many of these bodies. Statement 5 read with details in Statement 18 of the Finance Accounts shows the loans and advances given by the State Government, repayments made and the balance at the close of the financial year. Total outstanding balance of the loans advanced was

[*] Karapuzha, Kuriarkutty-Karappara, Idamalayar, Muvattupuzha, Attappady Valley, Banasura Sagar, Regulator-cum-Bridge at Chamravattom.

Rs 5042 crore as on 31 March 2004 (Table 15). Interest received against these advances declined to 0.5 *per cent* during 2003-04 though the Government has been borrowing funds during the year from the market at rates ranging from 5.8 *per cent* to 6.4 *per cent.* Further, in most cases, Government orders sanctioning the loans did not specify the terms and conditions for these loans.

Table 15: Average interest received on loans advanced by the State Government

(Rupees in crore)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Opening Balance	3127	3391	3545	3650	3823
Amount advanced during the year	317	271	160	250	1292*
Amount repaid during the year	53	117	55	77	73
Closing Balance	3391	3545	3650	3823	5042
Interest received	20	20	16	24	23
Interest received as *per cent* to outstanding loans and advances	0.6	0.6	0.4	0.6	0.5
Average rate of interest paid by the State	12.1	11.4	9.0	7.2	6.1
Difference between interest paid and received	(-) 11.5	(-) 10.8	(-) 8.6	(-) 6.6	(-) 5.6

Commercial activities

1.8.8 *Lack of accountability for the use of public funds in departmental commercial undertakings*

Activities of quasi-commercial nature are performed by the departmental undertakings of certain Government departments. These undertakings are to prepare *pro forma* accounts in the prescribed format annually showing the results of financial operation so that the Government can assess the results of their working. The Heads of Departments in the Government are to ensure that the undertakings, which are funded by the budgetary release, prepare the accounts on timely basis and submit the same to the Accountant General for audit. The department-wise position of arrears in preparation of accounts as of June 2004 in respect of these undertakings is indicated in **Appendix XI**.

Management of cash balances

1.8.9 It is generally desirable that State's flow of resources should match its expenditure obligations. However, to take care of any temporary mis-matches in the flow of resources and the expenditure obligations, a mechanism of Ways and Means Advances (WMA) from Reserve Bank of India has been put in place. Special WMA not exceeding Rs 38.40 crore are given to Kerala against marketable securities issued by Government of India. After this Ordinary WMA up to a maximum of Rs 270 crore are also allowed. From 1 April 2003, no State shall be allowed to run on overdraft for more than fourteen consecutive working days in a calendar year or more than 36 working days in a calendar quarter. The overdraft shall not exceed 100 *per cent* of the Ordinary Ways and Means limit. If the overdraft exceeds this limit continuously for five working days for the first time in a financial year, the Bank will advise the State to bring down the overdraft level. If such irregularity persists on a second or subsequent occasion, payment will be stopped. Statement 7 of the Finance Accounts gives the summary of cash

* Includes Rs 1158.25 crore being the liability of Kerala State Electricity Board to Central Public Sector Units on purchase of power taken over by Government by issue of Power Bonds which was treated as loan to the Board during this year temporarily to be converted as grant eventually.

balances.

1.8.10 During the year, the State has used this mechanism for 156 days as against 163 days last year although it raised borrowings of Rs 1931 crore from the market on nine occasions. Resort to overdraft, which is over and above the WMA limits, is all the more undesirable. The State used the overdraft facilities for 177 days during the year as against 196 days last year.

Table 16: Ways and Means Advances and Overdrafts of the State

(*Rupees in crore)*

	1999-2000	2000-01	2001-02	2002-03	2003-04
Ways and Means Advances[#]					
Taken during the year	2573.59	1978.25	1797.42	2463.36	3346.77
Balance outstanding at the end of the year	45.79	228.28	228.54	283.97	284.70
Interest paid	4.91	9.49	14.53	13.23	15.58
Number of days State availed WMA	204	150	137	163	156
Overdraft					
Taken during the year	1344.12	3506.13	4041.25	5337.51	4750.53
Balance outstanding at the end of the year	Nil	357.09	275.56	164.85	280.64
Interest paid	0.83	3.48	8.61	7.54	8.32
Number of days State was in overdraft	85	213	222	196	177

1.9 Undischarged Liabilities

Fiscal liabilities – public debt and guarantees

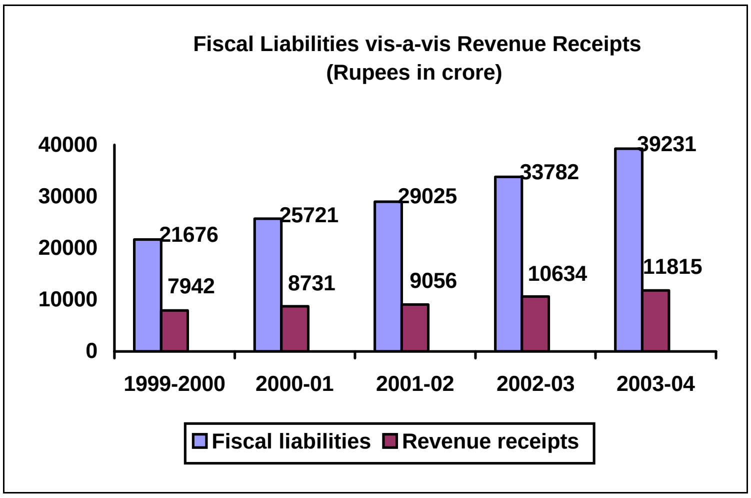
1.9.1 The Constitution of India provides that State may borrow within the territory of India upon the security of its Consolidated Fund, within such limits, as may from time to time, be fixed by an Act of Legislature. A State may not raise any loan without the consent of Government of India if there is any outstanding loan for which a guarantee has been issued by GOI. The Kerala Fiscal Responsibility Act which came into force on 5 December 2003 provides for reduction of fiscal deficit to 2 *per cent* of the estimated GSDP by March 2007. However, the fiscal deficit for 2003-04 (Rs 5539 crore) stood at 6.1 *per cent* of the estimated GSDP for 2003-04. Thus the possibility of achieving the fiscal deficit target envisaged in the Act by March 2007 appears remote. Statement 4 read with Statements 16 and 17 of Finance Accounts shows the year-end balances under Debt, Deposit and Remittance heads from which the liabilities are worked out.

1.9.2 Table 17 below gives the fiscal liabilities of the State, its rate of growth, ratio of these liabilities to GSDP, revenue receipts and own resources and buoyancy of these liabilities with respect to these parameters.

[#] Includes shortfall also

Table 17: Fiscal Liabilities- Basic Parameters (Values Rs in crore and others in *per cent)*

	1999-2000	2000-01	2001-02	2002-03	2003-04
Fiscal Liabilities[$]	21676	25721	29025	33782	39231
Rate of Growth	24.8	18.7	12.8	16.4	16.1
Ratio of Fiscal Liabilities to					
GSDP	34.7	36.9	40.1	41.8	43.5
Revenue Receipt	272.9	294.6	320.5	317.7	332.0
Own Resources	378.6	394.0	448.8	423.3	441.0
Buoyancy of Fiscal Liabilities with					
GSDP	2.2	1.6	3.5	1.4	1.4
Revenue Receipt	2.4	1.9	3.5	0.9	1.5
Own Resources	2.5	1.3	(-)14.2	0.7	1.4



1.9.3 The fiscal liabilities of the State increased from Rs 21676 crore in 1999-2000 to Rs 39231 crore in 2003-04, an increase of 81 *per cent* during the five year period. These liabilities as ratio to GSDP increased from 34.7 *per cent* in 1999-2000 to 43.5 *per cent* in 2003-04 and stood at 3.3 times of its revenue receipts and 4.4 times of its own resources comprising its own tax and non-tax revenue. The direct fiscal liabilities of the State had grown much faster as compared to its rate of growth of GSDP. These fiscal liabilities, however, do not include the pension liabilities payable to retired State employees, off budget liabilities, risk weighted guarantees/contingent liabilities, power subsidies payable to KSEB, etc.

1.9.4 The increase in fiscal liabilities during 2003-04 as compared to previous year was mainly under internal debt which was primarily due to incurring of additional liabilities as indicated below:-

- **Securitisation of dues of Kerala State Electricity Board (KSEB) to Central Public Sector Undertakings (CPSUs) by issue of 8.5 *per cent* Government of Kerala Special Bonds (Power Bonds)**

As part of the Tripartite agreement entered into by Government of India, Government of Kerala and the Reserve Bank of India on Power Sector, State Government took over the liability of the KSEB to CPSUs[#] amounting to Rs 1158.25 crore as on 30 September 2001 by issuing 8.5 *per cent* Tax Free

[$] Includes Internal Debt, Loans and Advances from GOI., Small Savings, Provident Funds, etc., Reserve Funds (Gross) and Deposits

[#] National Thermal Power Corporation, Power Grid Corporation of India Limited, Neyveli Lignite Corporation and Nuclear Power Corporation of India Limited

Government of Kerala Special Bonds in August 2003 with date of maturity varying from October 2006 to April 2016. The interest paid on these bonds during 2003-04 was Rs 147.68 crore. This increased the internal debt by nearly 10 *per cent*.

- **Securitisation of existing House loan portfolio of Government employees**

State Government ordered (February and March 2004) securitisation of principal (Rs 132.15 crore) and interest portion (Rs 134.85 crore) of the existing house loan portfolio of State Government employees (outstanding as of December 2003) with State Bank of India and Canara Bank. Accordingly, State Government received Rs 267 crore in March 2004 at a fixed rate of interest of 7.5 *per cent*. The entire amount with interest is to be repaid over a period of 15 years with an EMI of Rs 123.76 lakh to each Bank. However, consent of the Government of India under Article 293(3) of the Constitution of India has not been obtained for raising the above loan.

- **Market loans**

State Government raised Rs 1930.66 crore by way of market loan during 2003-04 which was Rs 693.24 crore more than that raised during the previous year.

1.9.5 Increasing liabilities had raised the issue of sustainability of the finances of the State Government. Fiscal liabilities are considered sustainable if the average interest paid on these liabilities is lower than the rate of growth of GSDP. Debt sustainability with reference to weighted interest rate, GSDP growth rate and interest spread is indicated in Table 18.

Table 18: Debt Sustainability- Interest Rate and GSDP Growth (in *per cent*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Weighted Interest Rate	10.0	9.5	9.1	9.4	9.1
GSDP Growth	11.2	11.6	3.7	11.7	11.5
Interest spread	1.2	2.1	(-) 5.4	2.3	2.4

1.9.6 Another important indicator of debt sustainability is the net availability of the funds after payment of the principal on account of the earlier contracted liabilities and interest. Table 19 below gives the position of the receipts and repayments of public debt over the last 5 years.

Table 19: Net availability of Borrowed Funds (*Rupees in crore*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Internal Debt@					
Receipt	941	1491	2011	2717	6023
Repayment (Principal + Interest)	706	874	1133	1377	1944
Net funds available	235	617	878	1340	4079
Net funds available (*per cent)*	25	41	44	49	68
Loans and Advances from Government of India					
Receipt	1073	483	781	1193	968
Repayment (Principal + Interest)	951	1016	1315	1809	2685
Net funds available	122	(-) 533	(-) 534	(-) 616	(-)1717
Net funds available (*per cent)*	11	(-) 110	(-) 68	(-) 52	(-) 177
Total Public Debt @					
Receipts	2014	1974	2792	3910	6991
Repayment (Principal + Interest)	1657	1890	2448	3186	4629
Net funds available	357	84	344	724	2362
Net funds available (*per cent)*	18	4	12	19	34

@ Excluding ways and means advances from Reserve Bank of India

1.9.7 The net funds available on account of the internal debt and loans and advances from Government of India after providing for the interest and repayments ranged between 12 and 34 *per cent* during 2001-02 to 2003-04. The increase in net funds under internal debt during 2003-04 was mainly due to increase in open market borrowing (Rs 693 crore), taking over the liability of KSEB's dues to CPSUs (Rs 1158.25 crore), securitisation of existing house loan portfolio of State Government employees (Rs 267 crore) and Special Securities issued to National Small Savings Fund of Central Government (Rs 1115 crore). Under loans and advances from Government of India the net funds available continued to be negative due to more repayments with a view to reducing the high cost debt of previous years under 'Debt Swap Scheme'.

1.9.8 The State Government raised market loans of Rs 1930.66 crore during the year. Of this, Rs 450 crore was raised through auction sale at an average rate of interest of 5.9 *per cent* and Rs 1480.66 crore through tap issue at an average rate of 6.1 *per cent*. As on 31 March 2004, 52 *per cent* of the existing market loans carried interest rate exceeding 10 *per cent*. Thus the effective cost of borrowings on their past loans is much higher than the rate at which State was able to raise resources at present from the market. The maturity profile of market loans indicates that 29 *per cent* of the total market loans are repayable within the next five years while the remaining 71 *per cent* of the loans are required to be repaid within 5 to 10 years.

1.9.9 Under the 'Debt Swap Scheme' introduced by Government of India to enable the States to prepay high cost debt, the State Government raised loans of Rs 671.06 crore from open market at varying interest rates of 5.9, 6.2 and 6.35 *per cent* during 2003-04. A sum of Rs 1165.08 crore being the balance outstanding as on 1 April 2003 in respect of small savings loans released during 1991-92, 1992-93 and 1994-95 to 1998-99 at interest rates ranging from 13.5 to 15 *per cent* were repaid using Rs 671 crore from out of funds raised from the open market and by adjustment (Rs 494.08 crore) from the Special Securities issued to National Small Savings Fund of Central Government by Government of Kerala during the year. In addition, Government prepaid (March 2004) the loans amounting to Rs 46.55 crore carrying effective rate of interest of 15 *per cent* to National Co-operative Development Corporation by borrowing a fresh loan at 9 *per cent* interest repayable in five years.

Guarantees

1.9.10 The guarantees are in the nature of contingent liabilities of the State and in the event of non-payment of loans there may be an obligation on the State to honour these commitments. 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 14000 crore.

1.9.11 Statement 6 of the Finance Accounts gives the summary of guarantees provided by the State Government for repayment of loans, etc., raised by Statutory Corporations, Government Companies, local bodies and other institutions based on statement of guarantees made available by the Finance Department of Government.

1.9.12 Audit scrutiny revealed the following:

- According to the data furnished by Government (July 2004), the guarantees outstanding (including interest) as on 31 March 2004 was Rs 14009 crore which exceeded the prescribed ceiling. In addition, the guarantees outstanding against three* institutions amounting to Rs 134.66 crore were not taken into account by Government. Thus, the guarantees outstanding represented 16 *per cent* of GSDP.
- In case of guarantees of Rs 429.81 crore outstanding against 16 Government Companies, whose paid up capital was completely eroded due to accumulated loss, the default risk is greater.
- Government issued orders in April – May 2004 extending the guarantee of Rs 129 crore in favour of United Electrical Industries Limited and Kerala State Cashew Development Corporation Limited with retrospective effect from 1 January 2004 without receiving the arrears of guarantee commission of Rs 4.49 crore in contravention of provisions in Section 5(3) of the Act.
- Kerala Power Finance Corporation paid Rs 3.15 crore towards guarantee commission for 2003-04 after deducting the rebate of 0.25 *per cent* for prompt payment. Of this, Rs 2.15 crore was paid on 30 March 2004 after notification of the Act in December 2003 though the Act does not provide for claiming rebate on guarantee commission.
- The arrears of guarantee commission receivable from 41 institutions were Rs 61.92 crore. Out of this Rs 56.56 crore related to 13 institutions which had arrears exceeding Rs one crore in each case.

1.9.13 Government stated (November 2004) that the outstanding guarantees would be less than the Statutory Ceiling because interest already paid or not due in respect of two Public Sector Companies were wrongly included in the Statement already furnished to Accountant General. Government also admitted to omission of certain cases and pointed out that they were yet to identify whether there were similar errors in other cases as well. In view of the above, it is evident that the data available with Finance Department cannot be relied upon for ensuring compliance with the provisions in the Act.

Off-budget liabilities

1.9.14 In addition to the liabilities disclosed through the accounts, the unreckoned liabilities of the nature indicated below increase the vulnerability of the State's financial health in the coming years:

- ***Subsidy payable to Kerala State Electricity Board (KSEB)***

Government agreed (August 1995) to give financial assistance to KSEB, to avail loan from Power Finance Corporation Limited, in case the Board could not achieve a minimum rate of return of three *per cent* in the year. Based on this, KSEB had been exhibiting every year the subsidy receivable from Government in their annual accounts from 1995-96. The latest annual accounts of the Board for the year 2002-03 (provisional) showed revenue

* Plantation Corporation of Kerala Limited, Handicrafts Development Corporation of Kerala Limited and Kerala Transport Development Finance Corporation Limited

subsidy of Rs 3531 crore (3.9 *per cent* of GSDP) as receivable up to the end of the year from State Government. During 2003-04, Government had released subsidy of Rs 556.46 crore to KSEB to cover the revenue gap of the Board for the year 2003-04 as assessed by the State Electricity Regulatory Commission.

- ***Arrears in payment of Contractors' bills***

According to information made available by departmental Officers, the arrears in payment of contractor's bills as of March 2004 in Public Works, Water Resources, etc., departments amounted to Rs 890.74 crore (1 *per cent* of GSDP).

1.10 Management of deficits

Fiscal imbalances

1.10.1 The deficits in Government accounts represent 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 so raised are applied, are important pointers to the fiscal health.

1.10.2 The revenue deficit (Statement I of Finance Accounts) of the State, indicates the excess of its revenue expenditure over revenue receipts. Though the revenue deficit showed a declining trend during the first three years of the five-year period 1999-2004, it increased significantly in 2002-03 but apparently declined in 2003-04. This was achieved notionally by adjusting the unspent balance of Rs 581 crore in the Plan Personal Deposit accounts of Local Self Government Institutions as reduction of revenue expenditure. But for this adjustment, the revenue deficit for 2003-04 would have been Rs 4261 crore which was more than that of last year. However, the fiscal deficit increased from Rs 4534 crore in 1999 - 2000 to Rs 5539 crore in 2003-04 mainly due to taking over of KSEB's liability due to CPSUs by issue of Power Bonds, securitisation of existing house loan portfolio of Government employees, raising of more market loans for 'debt swap', etc.

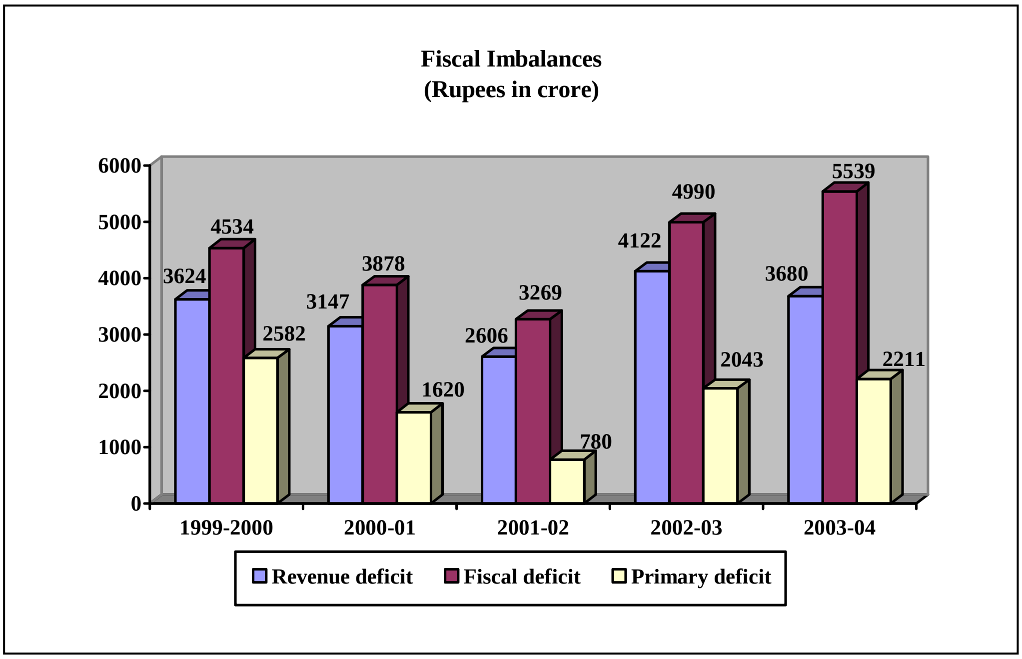
1.10.3 Section 4 of the 'The Kerala Fiscal Responsibility Act, 2003' which came into effect on 5 December 2003 prescribes that Government shall reduce the revenue deficit to 'nil' and fiscal deficit to 2 *per cent* of the estimated GSDP within a period of four years commencing from 1 April 2003 and ending on 31 March 2007. With the current level of revenue deficit of Rs 3680 crore and the fiscal deficit hovering around 6 *per cent* of GSDP during the current year, the possibility of achieving the above targets by the end of March 2007 appears remote.

1.10.4 Table 20 below indicates the basic parameters of fiscal imbalance.

Table 20: Fiscal Imbalances- Basic Parameters
(Values Rupees in crore and Ratios in *per cent*)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Revenue Deficit	3624	3147	2606	4122	3680
Fiscal Deficit	4534	3878	3269	4990	5539
Primary Deficit	2582	1620	780	2043	2211
RD/GSDP	5.8	4.5	3.6	5.1	4.1
FD/GSDP	7.3	5.6	4.5	6.2	6.1
PD/GSDP	4.1	2.3	1.1	2.5	2.5
RD/FD	79.9	81.2	79.7	82.6	66.4

1.10.5 Persistent large revenue deficit indicated that the revenue receipts of the State were not able to meet its revenue expenditure and Government had to borrow funds to meet its current obligations. The ratio of revenue deficit and fiscal deficit had decreased from 82.6 *per cent* in 2002-03 to 66.4 *per cent* in 2003-04. High ratio of revenue deficit to fiscal deficit indicated that a larger part of borrowings were not being used for asset creation. As proportion to the GSDP, revenue deficit had reached 4.1 *per cent* and fiscal deficit to 6.1 *per cent* in 2003-04.



Fiscal Reforms Programme

1.10.6 Based on the recommendations of Eleventh Finance Commission to motivate the States to undertake Medium Term Fiscal Reforms Programme (MTFRP), GOI set up an Incentive Fund to provide assistance to each State for fiscal performance based on a single monitorable fiscal objective. Release from the Incentive Fund was to be based on achieving a minimum improvement of five percentage points in the revenue deficit as a proportion of its revenue receipts each year till 2004-05 over the base year 1999-2000.

1.10.7 Information received from Finance Department revealed that the State Government exchanged with GOI on 4 February 2002 a document of shared fiscal goals and objectives for the years 2000-01 to 2004-05 on the Kerala MTFRP. GOI released Rs 64.44 crore during 2001-03 from the Incentive Fund for adhering to the projections made in the document for the years 2000-01 and 2001-02. Further, according to the agreement, the revenue deficit as a proportion of revenue receipts should achieve a minimum improvement of five percentage points each year from 1999-2000 (base year). Accordingly, as a percentage of revenue receipts, the revenue deficit of 45.60 *per cent* projected during 1999-2000 was to be restricted to 18.04 *per cent* and 9.61 *per cent* during 2002-03 and 2003-04 respectively. But the actual figures during 2002-03 and 2003-04 were 38.8 *per cent* and 31.2 *per cent* respectively. Hence, State Government did not receive Rs 44.30 crore from the Incentive Fund for the fiscal performance during 2002-03 and likely to lose Rs 49.52 crore for the year 2003-04 as well in view of the non-adherence to the projections.

1.11 Fiscal Ratios

1.11.1 The finances of a State should be sustainable, flexible and non-vulnerable. Table 21 below presents a summarized position of Government Finances over 1999-2004, with reference to certain key indicators that help to assess the adequacy and effectiveness of available resources and their applications, highlight areas of concern and capture its important facets.

1.11.2 The ratio of revenue receipts and State's own taxes to GSDP indicate the adequacy of the resources. The buoyancy of the revenue receipts indicates the nature of the tax regime and the State's increasing access to resources with increase in GSDP. Though the ratio of State's own taxes to GSDP remained static in 2003-04 compared to the previous year, the other two ratios i.e. revenue buoyancy and revenue receipts to GSDP declined in 2003-04 indicating a need for improving tax compliance and coverage.

1.11.3 Various ratios concerning expenditure management indicate quality of its expenditure and sustainability of these in relation to its resource mobilisation. The ratio of revenue expenditure, capital expenditure and development expenditure to total expenditure declined in 2003-04 as compared to 1999-2000. About 68 *per cent* of the total expenditure was met out of revenue receipts during 2003-04. All these indicate State's increasing dependence on borrowings for meeting its revenue expenditure and inadequate expansion of its development activities.

1.11.4 Though revenue deficit had come down apparently in 2003-04 because of adjustment of the unspent balance of Rs 581 crore of Local Self Government Institutions as reduction of revenue expenditure, the fiscal deficit had increased due to increase in disbursements of loans and advances by 417 *per cent* during 2003-04. The ratio of revenue deficit to fiscal deficit indicated that the application of borrowed funds had largely been to meet current consumption.

Table 21: Ratios of Fiscal Efficiency (in *per cent*)

Fiscal Ratios	1999-2000	2000-01	2001-02	2002-03	2003-04
Resource Mobilization					
Revenue Receipts/GSDP	12.7	12.5	12.5	13.2	13.1
Revenue Buoyancy	0.9	0.9	1.0	1.5	1.0
Own tax/GSDP	8.3	8.4	8.2	9.0	9.0
Expenditure Management					
Total Expenditure (TE)/GSDP	20.0	18.2	17.1	19.4	19.3
Revenue Receipts (RR)/ TE	63.4	68.6	73.2	67.7	67.8
Revenue Expenditure (RE)/TE	92.3	93.3	94.2	94.0	88.9
Plan Expenditure/TE	22.1	20.3	18.9	24.2	18.6
Capital Expenditure/TE	5.3	4.6	4.6	4.5	4.0
Development Expenditure/TE	58.2	55.4	53.3	56.2	53.4
Buoyancy of TE with RR	2.1	0.2	(-) 0.7	1.5	1.0
Buoyancy of RE with RR	2.5	0.3	(-) 0.5	1.5	0.5
Management of Fiscal Imbalances					
Revenue Deficit (Rs in crore)	3624	3147	2606	4122	3680
Fiscal Deficit (Rs in crore)	4534	3878	3269	4990	5539

Fiscal Ratios	1999-2000	2000-01	2001-02	2002-03	2003-04
Primary Deficit (Rs in crore)	2582	1620	780	2043	2211
Revenue Deficit/Fiscal Deficit	79.9	81.2	79.7	82.6	66.4
Management of Fiscal Liabilities					
Fiscal Liabilities (FL)/GSDP	34.7	36.9	40.1	41.8	43.5
Fiscal Liabilities/RR	272.9	294.6	320.5	317.7	332.0
Buoyancy of FL with RR	2.4	1.9	3.5	0.9	1.5
Buoyancy of FL with OR	2.5	1.3	(-) 14.2	0.7	1.4
Interest spread	1.2	2.1	(-) 5.4	2.3	2.4
Net Fund Available	18	4	12	19	34
Other Fiscal Health Indicators					
Return on Investment	0.6	0.7	0.3	0.5	0.9
Balance from Current Revenue (BCR) (Rs in crore)	(-) 2069	(-) 1704	(-) 1660	(-) 1811	(-) 1983
Financial Assets/Liabilities	0.5	0.5	0.4	0.4	0.4

1.12 Conclusions

1.12.1 Persistent high negative BCR coupled with low investment returns and increasing ratio of fiscal liabilities to GSDP and revenue receipts eroded the sustainability of the State finances. About 97 *per cent* of revenue was spent on committed liabilities like interest payments, pension, salaries, subsidies and fresh borrowings were needed to sustain the current revenue expenditure. This resulted in dwindling expenditure on creation of assets. A high ratio of revenue deficit to fiscal deficit (0.7) and low ratio of assets to liabilities (0.4) increased the vulnerability of State finances as the Government was heavily dependent on outside sources to maintain even the revenue expenditure. This also indicated that about two-third of the liabilities had no asset backup. As most (67 *per cent*) of the borrowings were spent on meeting revenue expenditure, there was little scope of increasing infrastructure development (for capital formation). Thus as Government was forced to borrow more and more to meet the rising expenditure, the interest liability is bound to increase and further reduce the net availability of funds for capital formation in years to come. Thus State finances are not only heading towards unsustainability but also getting gradually into the debt trap.

1.12.2 The State Government will need to take urgent steps to reduce revenue deficit/fiscal deficit by compressing non-developmental revenue expenditure and enhance additional resource mobilization through tax reforms and prudent debt management.