CHAPTER II

I.Economic and Social Environment – Trends in S.D.P and Government Finances

2.1 Inspite of poor economic parameters in terms of per capita income, GSDP, lack of growth in the Agricultural and Industrial segment, Kerala is acclaimed world wide for its achievement in Education, Public health and Social Development. This remarkable recognition has been obtained as a result of Government's commitment to invest sufficient resources into these essential areas of human resource development. It has to be recognized that private institutions and non-governmental organizations both religious and social, contributed substantially to the growth of education and improvement in health care. Taking cognisance of the role played by non-governmental organizations and in some instances individuals to spread the educational facility to almost every part of the State, the Government thought it necessary to bring them under the Government Aided institutions. However, this coupled with the fact of education having been made free up to secondary level increased the burden of the State with regard to salaries and pensions. Out of the total salary commitment of the State, 14% is towards staff of aided institutions.

2.2 While tremendous progress is perceivable in these sectors Kerala stood to suffer in the growth and development of the primary and secondary segments of the economy.

2.3 Agriculture is the worst to suffer possibly because of the cost of cultivation, cumulative effect of increased cost of unskilled labour, poor productivity, unviable smaller holdings and unremunerative price of products. Instances are not lacking where families dependent on agricultural income having borrowed funds to launch agricultural activity fall victims to a debt trap leading to suicides. Besides, the attitude of the people of Kerala, even with small holdings to hire labour to till and cultivate it, as against the approach of the lower middle class families in Tamilnadu, Andhra Pradesh or Karnataka or even in other States participating themselves in cultivation for a sustainable livelihood, is harmful to the growth of the primary sector.

2.4 We have now a paradoxical situation in the State with substantial sums of State revenue having been invested in human resource development particularly in the areas of education and health, not resulting in conversion of the human skill into economically useful activities including agriculture.

2.5 In Districts of Kerala bordering Tamil Nadu there is migration of labour from Tamil Nadu to Kerala displacing the jobs in the agriculture sector. This problem is further compounded by migration of certain low wage industries from Kerala to bordering States of Karnataka and Tamil Nadu like beedi making, because of increasing demands of wage hike. These inward and outward migrations have also aggravated the unemployment crisis in the State. While achievement in education and health care, pushed up the barometer in human development it appears to have created only job seekers in the white-collar area. Most of the educated unemployed, whose skill at the most can be utilized as mere clerks spend the best part of their life between the 21st and 35th year of their age dreaming of an employment in the Government. The large assembly of people at recruitment centres for different Defence Services and Central Police Organisations is an interesting sight in Kerala.

2.6 Rarely does an educated youth take the initiative to do something on his own. Number of people availing benefits under Jawahar Rozgar Yogana, an exceptionally good finance support scheme for self employment were very low in Kerala when compared with neighbouring States. They would prefer to be an employee rather than a potential employer. In short, one of the best resources which any Nation can take reasonable pride of, namely healthy educated human beings, waste their time and energy without any sense of direction, awaiting results of public service commission examinations and resultant selection to Government service.

2.7 As against this, it is surprising to see that the standard of living in Kerala as evidenced by the physical quality living index is one of the highest, easily comparable to a Developed Asian Economy. It certainly is a contradiction in a State, which ranks very low in per capita income and GSDP to have a living style out smarting all the States with much higher per capita income and sustainable growth in the primary and secondary sector of the economy. This enhanced style of living is obviously supported by external remittances by those Keralites working outside Kerala and outside India including the pensions drawn by Keralites who were working outside Kerala but residing in Kerala on retirement. The extreme consumerism converted Kerala as a paradise for marketing consumer products, consumer durables, white goods and luxury items. This standard and style of living, purely based on money orders and remittances, imposes a burden on others with nominal or meagre domestic income to lead a life similar in style to those in the neighborhood. This is yet another factor which influences the life of the fixed income group like Government servants, with expanding needs beyond the limitations of salary income. Availing advances from Provident Fund and other sources on false pretences and gradually getting indebted to banks, and white goods shops for discharging liabilities of instalment repayments on acquisitions compel him to be always in strait financial circumstances. Education is yet another area where tuitions have to necessarily supplement institutional training or teaching. All these factors cause heavy erosion of their carry home pay packet keeping them always in want. Under these circumstances, a reasonable remuneration consistent with the revenues of the State always becomes a salary far below their expectations. In an environment where the living standards undergo drastic changes and the income does not meet their requirements, frustration overtakes the employees converting them to be an unhappy lot struggling to adjust their living style within their means.

2.8 The responsibility of the State as an ideal employer to provide a reasonable salary to its employees and legitimate pension to those who superannuated from service causes a heavy burden on the State exchequer. Salaries and pension in Kerala constitute a very high percentage of the State revenue when compared with the neighbouring states of Tamil Nadu, Karnataka and Andhrapradesh. Allocations for capital expenditure, meant to provide long standing benefit to the State becomes negligible adversely affecting development. The people who are desirous of investing in private sector are yet to be convinced about a trouble free investment climate in Kerala. With stagnation in the manufacturing and processing sector the scope for increased revenue from Sales Tax or State excise, becomes limited. A cost hike in some products like Petrol or diesel while it adversely affects the economy has enabled the State to realise enhanced sales tax revenue.

2.9 It is noteworthy that the State has achieved substantial growth in the Tertiary sector. But taxation of this sector does not come within the ambit of the State. The centre introduces Service taxes and a large variety of services have been brought under this spectrum. Perhaps a structural change with regard to powers to tax the tertiary sector is a requirement for enhancement of the State revenue. While the Central Government has gone forward with taxation in the service sector it has not got an appropriate apparatus to realize this revenue, offering large scope for evasion. If the State is vested with necessary powers in this area realization can be better and the budgetary deficit can be considerably contained, particularly at a time when we are moving towards a huge salary cost and debt burden which may consume most of the entire State revenue.

2.10 Another important matter to be looked into for preserving resources is containing expenditure. Duplication of work is a malady that is prevailing in Government departments and Kerala is not an exception. The difficulty experienced in not being able to position the teaching staff of colleges handling the +2 curriculum to schools where this has been transferred is a glaring example. Vested interests in the service impeding a reform for personal convenience often cause additional expenditure. Similarly, the excellent concept of de-centralisation of administration and entrustment of developmental responsibilities with delegations of powers to Panchayats has not resulted in movement of the people of various departments looking after the affairs in the Panchayat area to the concerned Panchayats. There are also several instances of overlapping of functions. The interest of the people at large and the government's desire to introduce reforms and changes for the benefit of the people cannot be allowed to be thwarted by vested interests.

2.11 Among others, the Commission had engaged the C.D.S as a consultant to conduct a specialized study on the State of the Government finances in the context of a proposed pay revision and analyse the possible repercussions on an increased wage bill on the revenue and fiscal deficits in the coming years. The study of the C.D.S, being informative, exhaustive and pertinent to the areas covering the terms of reference of the Commission, it is reproduced as a continuation of this chapter.

2.12 Kerala is acclaimed worldwide for the remarkable progress made in social development despite poor economic status in terms of per capita income and growth. To a large extent, the achievement has been the outcome of government expenditure on education, health and other social welfare activities. Thus, Kerala has come to be regarded as a role model to other States and countries. The literature has even conceptualised a "Kerala model" of development, which emphasizes the positive role of public policies and expenditure on welfare measures for achieving a high level of human development. However, some critics (Parayil, 2000) have considered Kerala's development experience as naive romanticism and some others (George, 1993) have underlined "limits to Kerala model". In particular, they have argued that the deteriorating finances of the State government *inter-alia* due to stagnancy in economic growth limit the government expenditure on social welfare measures and thus the sustenance of achievements already made. The deteriorating government finances, it is also argued, constrain investment on improving quality of education, health and other spheres of human development and thus in resolving 'second generation' problems. Some critics even fear the emergence of a development crisis arising from the ever growing fiscal imbalances with increasing expenditure unmatched by adequate revenue resource-mobilization, and the alarming proportion of some other sensitive problems[1], from the slow growth of the economy.

2.13 Whether the prognostication of a development crisis did in fact emerge or not, two major lines of developments, that took place in recent years in Kerala, call for a review of the rationale of government expenditure and public policy on welfare measures as the core development strategy implied in the Kerala experience. One, the Kerala economy, though continued to remain under the spell of stagnancy in growth for a long time since the seventies, showed signs of remarkable recovery - to some scholars (Kannan, 2005) a turn-around – in growth rate towards the late eighties (and clearly in the nineties) and thereafter[2]. The entry of the economy on a high growth trajectory has brought with it the expectations of an increase in the government's revenue resource base[3] and thus the capacity for increasing expenditure. Two, fiscal conditions deteriorated since the mid-eighties marked by growing revenue deficit and public debt in the State government budgets continuously. The finances of the government of Kerala though had shown some improvement in terms of major fiscal indicators in the early nineties, steadily deteriorated from mid nineties onwards both in absolute terms and in comparison with other non-special category States. A large number of factors are said to have been at work in worsening the government's fiscal health. These include: growing interest burden, increasing pension liabilities, large administrative expenditures including wage-bill, losses of State public sector undertakings, inappropriate subsidies and user-charges and deceleration in Central transfers. Added to these is the

[1] Among these problems, the acute one is growing unemployment particularly of educated young men and women.
[2] Some scholars have cast doubts on the State's continued good performance. (for example see, Oomen ,2005 and Pillai and Shanta, 2005).
[3] A positive relationship is observed between State's own tax revenue/GSDP ratio and per capita income
(GOI, Twelfth Finance Commission Report, 2005, Ch.3. p.45.

fact that the State has been increasingly depending on high cost borrowings and issuing guarantees to public sector undertakings, whose poor financial position enhances the risk of such debt service obligations devolving on the State. In short, a vicious circle of deficit, debt, and debt service payments has emerged curtailing the ability of the government to finance the much-needed public investment in physical infrastructure and other basic development activities.

2.14 The State's attempts to correct fiscal imbalances through Medium Term Fiscal Reform Programme brought some improvements in the fiscal indicators in the early nineties but the trend could not be sustained. This indicated the ineffectiveness of discretionary fiscal policy framework and the government sought to achieve fiscal correction by enacting legislation on fiscal responsibility and budget management – the Kerala Fiscal Responsibility Act (KFRA) - in 2003. This legislation involves the setting up of fiscal targets relating to elimination of revenue deficit and containment of fiscal deficit, outstanding liabilities and guarantees. It provides an institutional framework for effective and objective evaluation of fiscal policy and binds the government to follow a prudent and transparent fiscal policy and limits the scope for unbridled expenditure based on populist policies.

2.15 Under this legislation Kerala government has committed itself to bringing down revenue deficit to zero and fiscal deficit to 2 per cent of Gross State Domestic Product (GSDP) by 2007. It has also made provision for setting an upper limit on outstanding guarantees to Rs.14,000. crores through the Kerala Ceiling on Government Guarantees Act. Having enacted the fiscal responsibility legislation it becomes imperative to see how best the State can achieve the targets on deficits. It stands to reason that among alternative courses of policy action, one is expenditure compression. In fact, a public expenditure review committee has been set up, as laid in the KFRA.

2.16 It needs no emphasis that the Pay Revision Commission has to come up with its recommendations *inter-alia* on revision of pay, allowances and other benefits of (1) government employees and (2) pensioners keeping in the background developments of the types briefly sketched above relating to the state of the economy and government finances in Kerala. The basic objective is to trace the recent trends in the growth performance of the State's economy as it is reflected in the growth of gross domestic product (GSDP), and the fiscal health of the government as seen in the growth of resource mobilization especially own revenue, and in the growth of its expenditure especially on salary, pension and other related items of the employees of the government and aided institutions. The focus is on highlighting the growth trend for the period since mid-nineties (to be more precise from 1993-94 onwards) as the last Pay Revision Commission has dealt with the earlier period in its Report.

2.17 The scope of the analysis is confined to the GSDP and government's finances. First we trace the trend in the growth of GSDP in aggregate and by major economic-activity sectors. Second, we deal with the trends in revenue, expenditure and fiscal balances in the government budgets during the period under review. Third, we attempt a forecast of revenue and expenditure until 2010 to assess the size of deficit/surplus of budgets in Kerala. Fourth and final, is to highlight the major findings of the analysis in lieu of conclusions.

2.18 It is logical to assume that the better performance of an economy as measured by the growth-rate in GSDP has in it the imprint of the performance of the government services and hence the government employees are legitimate in expecting a change in their emoluments and other service conditions. Besides, there is the relative cost of living issue.. On the other side, if fiscal conditions are deteriorating despite the increasing trend in GSDP growth (economic growth), it is also logical to see some serious financial constraints to provide a large increase in the wage-bill of government. The core task of the Commission is to strike an optimum increase in the emoluments and other benefits in such a manner that government employees are adequately compensated and have enough incentive to raise their productivity and at the same time, development activities are not impaired due to inadequate budgetary resource allocation. It is a difficult task of arriving at a "win-win" situation!

II. Trends in SDP of Kerala State: A Comparative Analysis

2.19 Generally, the growth performance of a State economy is assessed in terms of the trend in the growth rate of its state domestic product (SDP) over time and as compared to all-India record. Most studies analysing the growth trend are based on net domestic product (NSDP) rather than gross domestic product (GSDP) probably due to the ready availability of time series data. However, the latter is a more reliable data especially for comparative analysis across the States as it has less arbitrariness in estimation because it does not require valuation of capital in-use (deprecation). It must be noted that SDP, whether it is GSDP or NSDP, is estimated on the principle of income generated within the State's geographical boundaries and not on income-accrual methodology. Hence it is inadequate to reflect the actual economic status of a State like Kerala as it does not account for the large amount of remittances accruing from emigrants working outside the State.[4] Notwithstanding this basic drawback of the data we trace below the recent trend in the growth of GSDP of Kerala by analysing average annual growth rates for 1993-94 to 2003-04.

2.20 The choice of 1993-94 as the starting point is influenced by the consideration that though the Central government formally announced a shift in its basic economic policy towards market-oriented liberalisation in industry and trade in June 1991, it took some time for the States to

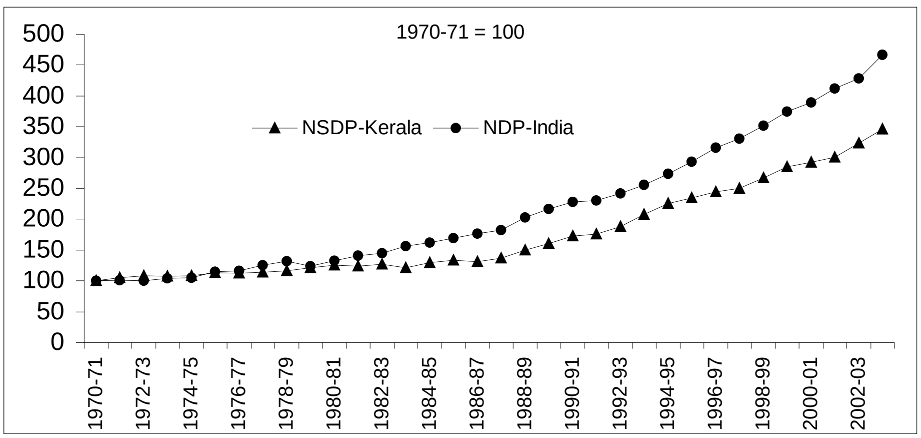
[4] A study (Kannan and Hari 2003) has estimated remittances from workers abroad and has shown it to be roughly equal to one third of the NSDP in 2003.

implement the reforms and clearly there must have been some time-lag in reflecting the effect of reforms on output generation (SDP). Besides, the Central Statistical Organisation has come out with a new series of GDP estimates with 1993-94 as the base. Our period of analysis ends in 2003-04, as the actual estimates beyond that year are not available.

1. Long –term Trend in SDP

2.21 To put the recent trend in a perspective, we first compare the growth performance of Kerala with that of all-India for a longer period of three decades viz., 1970-71 to 2003-04. Plotting indices of NSDP (1970-71 = 100) in figure 1 it is observed that Kerala and all-India moved along a stagnant growth

Figure 1**.** Long-term trend in NSDP/NDP, Kerala and India



path in the seventies. A growth revival was started and gained momentum since the early eighties at all-India; the revival in Kerala began only in the late eighties. In the nineties growth accelerated more or less at the same pace for both Kerala and All India.

2. Recent trend in the growth of GSDP

2.22 We keep in perspective the above finding of Kerala's lag in growth rate relative to all-India average and examine in detail the growth behaviour of GSDP. The growth behaviour of GSDP and its major sub-sectors are looked into during the post-reform period by breaking it into two sub-periods viz., 1993-94 to 1999-2000 and 2000-01 to 2003-04. The results are given in Table 1.

Table 2.1

Average Annual Growth Rates (%) in GSDP/GDP at 1993-94 Prices

Period	*Primary Sector*		*Secondary Sector*		*Tertiary Sector*		*Total GSDP*	
	Kerala	All India	Kerala	All India	Kerala	All India	Kerala	All India

93-94 to 99-00	1.91	3.28	5.19	7.43	7.87	8.71	5.62	6.69
00-01 to 03-04	-4.79	2.23	5.03	5.47	7.73	6.19	4.40	5.66
93-94 to 03-04	-0.77	2.86	5.13	6.65	7.81	7.70	5.13	6.28

Source: EPWRF - Domestic Product for the States of India, India, CSO (Indiastat.com)

2.23 It is seen that Kerala recorded a higher growth-rate in the nineties as compared to the earlier decades and to that extent it can be said that the post-liberalisation period has witnessed a remarkable recovery in economic growth. As compared to all-India average, however, Kerala's growth record appeared lower (5.62 per cent) than that of all- India (6.69 per cent) in the nineties. When we come to the present decade, the available evidence shows a slow down in the pace of growth both in Kerala and all-India but the decline was much sharper in Kerala with the result that its growth record during 2002-01 to 2003-04 was only 4.40 percent as compared to 5.66 per cent for all-India. If we consider the total period under review viz., 1993-94 to 2003-04, Kerala has recorded an average annual growth rate of 5 per cent as compared to 6 per cent at all India.

3. Trend in Per Capita GSDP

2.24 In terms of per capita income, Kerala's performance is seen in a better shade. As for the level of per capita GSDP, Kerala is seen to be better placed than the all-India level in the sense that in four out of ten years under review, its per capita GSDP was higher than and in six years came closer to, all-India level. (See the table 2). Probably, the improved performance record of Kerala in terms of per capita is more due to its favourable demographic transition marked by lower birth rate rather than any remarkable improvement in macro-level output generation within the State.

2.25 The average rate of growth of per capita GSDP in Kerala and GDP all-India are quite close to each other and over time growth rates have declined for both. (see the table 3).

Table 2.2: Ratio of Per capita GSDP/GDP at (1993-94) constant prices

(per cent)

Year	Per capita GSDP/GDP		Ratio of Kerala to all-India
	Kerala	India	
1993-94	8761	8759	100.02
1994-95	9368	9209	101.73
1995-96	9670	9694	99.76
1996-97	9905	10255	96.59

1997-98	10077	10542	95.59
1998-99	10693	11018	97.05
1999-00	11360	11508	98.71
2000-01	11796	11762	100.29
2001-02	11865	12227	97.04
2002-03	12538	12496	100.33
2003-04	13208	13332	99.07

Source: Same as Table 1.

Table 2.3 :
Average annual change in Per Capita GSDP/GDP
at 1993-94 constant prices. (per cent)

Year	Average annual change in Per capita GSDP/GDP (%)	
	Kerala	India
1993-94	-	-
1994-95	6.93	5.13
1995-96	3.22	5.26
1996-97	2.43	5.79
1997-98	1.74	2.80
1998-99	6.11	4.51
1999-00	6.24	4.45
2000-01	3.84	2.21
2001-02	0.58	3.95
2002-03	5.67	2.20
2003-04	5.34	6.69
1994-95 to 1999-00	4.44	4.66
2000-01 to 2003-04	3.86	3.76
1994-95 to 2003-04	4.21	4.30

Source as in table 1.

It is also instructive to note that a comparative study (Subrahmanian, 2005) of the major 17 Indian States places Kerala at twelfth position in terms of growth rates of gross state domestic product and in the growth of States with lower growth rates than all-India for the period 93-94 to 2000-01.

2.26 On the whole, Kerala has witnessed a remarkable growth recovery in GSDP as compared to earlier decades during the nineties. The relative growth performance as compared to all-India is also impressive though it is not above the all-India record. In fact, when we compare Kerala's growth performance with all-India average as well as other major States, Kerala does not present so remarkable a record in growth as is claimed by some recent studies to call it a growth turn-around, meaning thereby a take off into a stage of sustained growth commensurate with its achievement in human development, after the implementation of economic reforms. There is however no denial of the positive impact of the reforms on the macro-level growth performance of Kerala. Naturally, the resource-base of the economy must have been enlarged to mop up additional revenues for raising the government expenditure. What in fact has been the revenue-yielding effect however, depends on the economic sectors, which have led to the growth of the macro economy. This takes us to consider the structural change that accompanied the growth process.

4. Structural transformation.

2.27 To fully comprehend the dynamics of the growth performance, the structural transformation, ie., the relative growth of different economic activity sectors that accompanied the growth has to be analysed (see Table 1).

2.28 It is seen that the tertiary sector has recorded the highest growth rate of 8 per cent in Kerala that compares favourably with all India record. As for the primary and secondary sector, Kerala's rates of growth are far below that of All India. One important point that needs to be taken note of is that Kerala has achieved slightly better growth rates though nothing very extraordinary, and even this has not been maintained in recent years. The tertiary sector alone has consistently maintained a good growth record. The secondary sector with 5 per cent followed. The primary sector has recorded negative growth rates. At the all- India level also it is the tertiary sector, which has shown the highest growth.

2.29 The consistently high growth rate in the tertiary sector has transformed the trend in the sectoral pattern of output, as is made clear from the analysis of the relative shares of different sectors in GSDP. It is seen from the table 4 that the share of the primary sector has declined secondary sector more or less stagnated and tertiary sector alone steadily increased. In Kerala the tertiary sector's share (almost 55 per cent) is higher than of All India (47 per cent) for the entire period under review.

Table 2.4

Average Share (%) sectors in Gross Domestic Product at 1993-94 Prices

Period	*Primary Sector*		*Secondary Sector*		*Tertiary Sector*	
	Kerala	All India	Kerala	All India	Kerala	All India
1993-94 – 99-00	.13	0.50	.81	4.76	.06	4.88
2000-01 – 03-04	.35	5.11	.75	4.71	.90	0.19
1993-94 – 03-04	.57	8.54	.79	4.74	.64	7.00

Source: Same as Table 1

2.30 Analysis of share-weighted contributions to total growth rate reveal that nearly 83 per cent of the growth has come from the tertiary sector in Kerala, while the corresponding figure is 58 per cent at all India level. In Kerala primary sector's contribution is negative, and secondary sector's contribution is around 21 per cent (see Table 5). The heavy reliance on the tertiary sector alone for the growth of the State's economy has serious implications for the sustainability of the growth momentum in the future. Given the present distribution pattern of taxing-powers between the Centre and the States, the growth buoyancy propelled by the tertiary (service) sector in Kerala has also its serious implications on revenue mobilisation by the State government in the future.

Table 2.5:
Weighted Contribution of Different sectors to GSDP Growth at 1993-94 Prices

Period	Primary Sector		Secondary Sector		Tertiary Sector	
	Kerala	All India	Kerala	All India	Kerala	All India
1993-94 – 99-00	9.55	14.96	19.23	27.48	71.46	58.46
2000-01 – 03-04	-19.98	9.91	23.70	23.91	106.95	54.90
1993-94 – 03-04	-3.69	13.01	20.76	26.19	83.15	57.69

Source: Same as in Table 1

2.31 A detailed analysis of the growth rates by sub-sectors is attempted here (see the table 6) to show that the emerging pattern of growth is not very conducive to the stability of growth as well as additional resource mobilisation in Kerala. To note the striking features, the primary sector as a whole and particularly agriculture shows a dismal performance. In the case of the secondary sector, it is electricity, gas & water supply and

Table 2.6:
Average Growth rate of Sub Sectors in GSDP at Constant (1993-94) Price: Kerala

	Industry of origin	93-94 to 99-00	2000-01 to 2003-04	93-94 to 2003-04
1	Agriculture	2.06	-6.62	-1.41
2	Forestry and Logging	1.55	3.00	2.13
3	Fishing	1.09	1.44	1.23
4	Mining and Quarrying	6.92	7.51	7.16
	Primary Sector	**1.91**	**-4.79**	**-0.77**
5	Manufacturing	6.39	-3.08	2.60

5.1	Registered	8.61	-0.92	4.80
5.2	Unregistered	3.81	-6.55	-0.34
6	Construction	1.97	11.26	5.69
7	Electricity, Gas and Water Supply	14.22	24.82	18.46
	Secondary Sector	**5.19**	**5.03**	**5.13**
8	Transport, Storage and Communication	11.38	10.14	10.88
8.1	Railways	6.83	7.11	6.94
8.2	Transport by other means	10.33	9.51	10.00
8.3	Storage	4.26	20.01	10.56
8.4	Communication	16.14	12.31	14.61
9	Trade, Hotels and Restaurants	6.41	7.73	6.93
10	Banking and Insurance	14.87	12.49	13.92
11	ate, Ownership of Dwellings and Business Services	4.07	3.38	3.80
12	Public Administration	7.83	2.84	5.84
13	Other Services	6.65	6.92	6.76
	Tertiary Sector	**7.87**	**7.73**	**7.81**
	Gross State Domestic Product (GSDP)	**5.62**	**4.40**	**5.13**

Source: Same as Table 1

construction that show high growth rates. The performance of the manufacturing sector has been dismally poor with an average annual growth rate of just 3 per cent during the period under review. Instructively, manufacturing has recorded negative growth rate in the recent years 2000-01 to 2003-04. The overall decline in manufacturing growth rate is due to the poor performance of the unregistered sector. Within the tertiary sector, growth rates are more widespread across sub-sectors with communication taking the lead followed by banking and insurance, storage and transport by other means .The growth of the tertiary sector does not seem to have had linkages with the main productive (commodity) sectors of the economy such as manufacturing and agriculture. A study (Pushpangadan, 2003) has shown

5. Trends in Growth and Structural Change in Employment

2.32 We have hitherto examined growth trends in GSDP (income) and structural changes in terms of sectoral output. What have been the employment implications of the growth in GSDP? This question is of vital importance in the context of Kerala, which suffers from high levels of unemployment, and particularly educated unemployment. We go by the findings of secondary sources in the literature for comprehending the growth and structural changes in employment.

2.33 Studies based on the decennial reports of the population census and the NSSO sample surveys of employment and unemployment give the following conclusions: The work participation rates (WPR) measured by the percentage of workers to total population is lower in Kerala (32.3 per cent) as compared to the national average (39.3 per cent) thus suggesting a relatively higher incidence of unemployment in Kerala. Of more serious concern is the fact that the participation rate for females is much lower (15.3 per cent) than that of males (50.3per cent) and is lower than the State's average WPR. It is also far below the national average. The census reports show a marginal increase in WPR at the close of the nineties over the beginning of that decade. (The NSSO surveys also show a trend of marginal rise from 38.3 per cent in 1987-88 to 38.6 per cent in 1993-94 in WPR) (Subrahmanian, 2005).

2.34 We now examine the trends in employment by economic activity sectors. During the nineties, the primary sector has witnessed a significant deceleration in employment growth in Kerala, though the growth rate is still higher than all-India. On the contrary, the acceleration in growth rate is significantly higher than at all India in the secondary and tertiary sector. According to a recent study (Kannan, 2005) between 1993-94 and 1999-2000, employment in the primary sector has declined from 49 per cent to 32 per cent and in the secondary sector it has increased from 21 per cent to 28 per cent while for the tertiary sector the increase has been in the range of 30 per cent to 40 per cent. The bulk of the employment is now in the tertiary sector in Kerala. Similar trends are observed at all-India level also, although the declines and increases have not been very sharp as in the case of Kerala. As the bulk of employment in Kerala is now in the tertiary sector as against the primary sector, it can be said that a structural transformation in terms of employment has taken place.

2.35 It has also been claimed in some studies (Subrahmanian, 2005) that the growth rate of employment of all sectors taken together is higher in Kerala as compared to all-India during the 1990's and that this is reflective of the higher employment elasticity. The employment elasticity of the secondary sector in Kerala is greater than unity and is higher than at the all-India level. More significantly, the employment elasticity of the tertiary sector in Kerala is nearly three times higher than the corresponding figure at all-India. The higher employment elasticity in Kerala is reflective of the relative predominance of traditional products using labour intensive technology both in the secondary and tertiary sectors.

2.36 According to another scholar (Oommen, 2005) the real question is to know if employment of a high order has been there particularly in the secondary and tertiary sector. He shows that that there has been a decline in the absolute numbers in employment in the public and private establishments in Kerala. Public sector taken separately also has shown a decline. This is to substantiate the point that the nineties did not mitigate the acute problem of unemployment in Kerala. Studies that have attempted estimation of unemployment rates based on NSS0 sample surveys have highlighted the increasing incidence of unemployment in general and educated unemployment in particular in Kerala. To put it in rhetoric, unemployment continues to be a bane of Kerala society irrespective of the improved performance in economic growth and the structural change in the sectoral output and occupational pattern. Indeed, the growth of the economy and in particular, of its tertiary sector has had some positive impact on overall growth in employment although it has not made much of a dent in the State's unemployment and particularly educated unemployment problem. The gender dimension of the growth process has also been quite disappointing. Clearly, these are not encouraging portents!

2.37 In conclusion one important aspect that needs to be examined and of particular significance in the context of the appointment of the pay revision commission and in the context of a situation of high levels of unemployment with all its implications for levels of living is the behaviour of prices or the rate of inflation in the economy. Very often it is increased employment and income that lead to increased demand and further stimulation of growth of the economy and better standards of living and vice versa. (1) The analysis of price behaviour is also important from the viewpoint of compensating the Government employees for the inflationary tendencies in the economy in order to make them better off as compared to a previous time-point. (2) We, therefore, examine the behaviour of prices in the Kerala economy in the ensuing section.

6. Inflation in the State

2.38 We analyse price rise in the economy from two angles. First, we examine the consumer price index. Second, we analyse the sectoral variations in price trends by using implicit GSDP deflator. The most commonly used index for measuring the behaviour of prices or inflation in the economy is the consumer price index. The table 7 shows that it has steadily increased from 553 in 1992 to 1131 in 2001 (base is 1970=100)[5]. It is also observed that while the index increased at almost two-digit level in the early nineties, in the latter half of the nineties, there is a gradual decline in the rate of growth of the index and this decline has been sharp in the current decade.

Table 2.7: Annual Average Consumer Price Index.

(percent)

Year	CPI	% change over previous year
1992	553	
1993	599	8.32
1994	675	12.69
1995	759	12.44
1996	836	10.14
1997	911	8.97

[5] With the base 1998-99=100 we have data only for one year and hence our analysis with 1970 base,

1998	967	6.15
1999	1030	6.51
2000	1092	6.02
2001	1131	3.57

Note: CPI is Annual Average for the year from Jan-1 to Dec-31
Base 1970=100
Source: GoK Economic Review 2005

2.39 The consumer price index has several limitations. Firstly the base is quite far back and so may be the composition of the basket of goods. As a general measure of inflation / price rise in the economy the GSDP implicit deflator seems to be better since its coverage of commodities is much more comprehensive. We therefore estimate the growth in GSDP at current prices and constant prices and take the difference as a measure of inflation. This is done for the different sectors to arrive at the annual rate of inflation for the two sub periods and the period as a whole with 1993-94 as a base year. This is compared with the all India figures (see Table 8). Table shows that for all sectors and overall (except primary sector and for period 2) the rate of inflation was higher in Kerala than all India. As for the trends both at the all India level and Kerala the rate of inflation declined from 10 per cent in the nineties to 5 per cent in the current decade almost half, for the economy as a whole. Sector wise also the same trends are observed both for India and Kerala but the rates of decline vary. While in Kerala the primary sector prices rose by 10 per cent in the nineties, in the second period it was only 2 per cent a decline of 8 points in inflation. For all India it was a decline of 6 points. As for the secondary sector price increase decreased from11 per cent to 6 per cent and for the tertiary, sector it moved from 10 per cent to 6 per cent in Kerala. For all India the figures were 8 per cent to 4 per cent in the secondary and tertiary sector. In Kerala while in the nineties that is when prices rose fast, the rise was almost uniform across sectors ranging around 10-11 per cent. In the new decade while

Table 2.8: Rate of Inflation Kerala and All India (average for the periods)

Sector	Kerala			All India		
	1994-95 to 1999-00	2000-01 to 2003-04	1994-95 to 2003-04	1994-95 to 1999-00	2000-01 to 2003-04	1994-95 to 2003-04
Agriculture	10.02	2.94	7.19	9.19	2.63	6.57
Forestry and Logging	7.50	0.68	4.77	8.20	5.71	7.20
Fishing	12.90	1.20	8.22	11.43	1.58	7.49
Mining and Quarrying	7.31	4.77	6.29	6.63	8.16	7.24
Primary Sector	10.03	2.03	6.83	9.02	3.06	6.63
Manufacturing	8.86	4.42	7.08	6.30	3.92	5.35
Registered	8.55	4.05	6.75	6.11	4.37	5.41
Unregistered	9.28	5.24	7.67	6.70	3.05	5.24
Construction	15.08	6.17	11.51	10.91	4.02	8.16
Electricity, Gas and Water Supply	8.27	5.53	7.18	9.82	-0.23	5.80

Secondary Sector	11.01	5.99	9.00	7.66	3.51	6.00
Transport, Storage and Communication	7.59	4.52	6.36	6.99	1.03	4.61
Railways	7.50	0.09	4.53	3.84	0.09	2.34
Transport by other means	9.49	3.10	6.93	9.76	6.00	8.25
Storage	8.07	-5.51	2.64	10.34	5.86	8.54
Communication	1.15	11.57	5.32	1.53	-2.47	-0.07
Trade, Hotels and Restaurants	12.91	3.38	9.10	7.25	4.37	6.10
Banking and Insurance	3.78	1.04	2.68	6.71	5.91	6.39
Real Estate, Ownership of Dwellings and Business Services	7.95	15.00	10.77	7.91	6.45	7.33
Public Administration	9.23	5.06	7.56	9.48	4.05	7.31
Other Services	9.65	12.69	10.87	9.53	4.12	7.37
Tertiary Sector	9.58	6.00	8.15	7.83	4.32	6.42
Gross State Domestic Product (GSDP)	9.96	5.24	8.07	8.12	3.74	6.37

Source: Same as Table 1.

both secondary and tertiary had almost similar increases in prices, primary sector did not experience much of a rise. All India it was more or less uniform for both periods. Thus for the economy as a whole and for Kerala and for all sectors the rate of inflation has sharply come down.

2.40 In the current decade prices are coming down both in terms of the consumer price index and the implicit GSDP deflator in Kerala. But prices are much higher in Kerala than in India. These findings have two implications. (1) Although price rise in absolute terms does not warrant a major salary revision, there is justification for higher salaries and allowances in the context of cost of living being higher in the State than in the rest of the country. (2) More important, in the context of the still high rates of unemployment in the economy it is imperative that the State continues its social and development activities in the interests of the common people. In the allocation of resources a judicious balance has therefore to be struck between the two. This entails a critical assessment of the finances of the state.

2.41 We therefore turn to analyse the trend in State government's finances – trends in its revenue, expenditure, fiscal balance (deficit) and debt during the nineties and the initial years of the current decade.

III. Trend in the finances of the State Government

2.42 To begin with, we present the overall budgetary position of the government from 1990-91 to 2005-06 in the table 9. It is seen that except for 1990-91 and 1991-92 the State had overall surplus (though fluctuating and small at times) budgets till 1996-97. Since then we see an opposite trend in the sense that government has been continuously facing overall deficit situation given exception to the year 2001-02. More disconcerting is the fact that the overall deficits have been quite large as well. It is important to note that various attempts were initiated in the nineties to tide over the fiscal crisis by giving emphasis on containing budgetary deficits and yet a deficit budget has been the characteristics feature of budgets in most years. Interestingly, the picture of all-States taken together also shows overall deficit budget for some years, but not consistently for several years as in the case of Kerala, during the post-reform period.

Table 2.9:
Overall Budgtery Surplus / Deficit Kerala 1990-91 to 2003-04

Year	Deficit/Surplus	Deficit/Surplus	Deficit/Surplus	oss Fiscal Deficit/Surplus
1	*2=3+4*	*3*	*4*	*5*
1990-01	-16.5	-422.1	405.56	798.5
1991-02	-48.0	-364.3	316.31	803.4
1992-03	90.1	-337.4	427.5	732
1993-04	99.5	-371.3	470.8	935.2
1994-05	399.6	-399.88	799.5	1108.7
1995-06	65.0	-402.81	467.8	1302.7
1996-07	20.9	-643.04	663.93	1542.48
1997-08	-285.2	-1122.93	837.75	2413.85
1998-09	-365.5	-2029.96	1664.3	3012.2
1999-00	-19.8	-3624.22	3604.8	4536.6
2000-01	-420.0	-3147.05	2727.07	3877.8
2001-02	221.9	-2605.64	2827.5	3269.4
2002-03	-209.6	-4122.2	3912.6	4993.4
2003-04	-240.2	-3680.3	3440.1	5539.1

:MIE, Public Finance, various issues.

2.43 The striking feature of the trend in the budgetary surplus/deficit situation in Kerala is the revenue-deficit in all the 15 years under review. Although the revenue deficit was more or less contained in the first half of the nineties, the deficit started increasing substantially since 1997-98. Indeed, all the States in India did not do well in terms of revenue-deficit. That however is no consolation for Kerala, as the revenue deficit in Kerala has been a continuous feature unlike the case in most other States. In the case of Kerala, capital surplus (inclusive of borrowings) has been increasing and it reached an all time high of Rs.3913 crores in 2002-03. And despite the use of capital surplus for meeting the shortage in revenue relative to the revenue expenditure, Kerala continued to face ever increasing revenue deficit. This is a disturbing trend as it implies borrowing to finance government's consumption rather than capital investment on development activities.

1. Major Fiscal Indictors

2.44 Thus seen, the budgetary position of the State of Kerala has gone from bad to worse in terms of deficits since 1997-98. Obviously, this can have serious implications on the State's development activities. To comprehend the full implication, budgetary deficits have to be related to the State's GSDP. We, therefore, turn to an analysis of the major fiscal indicators like ratios of Revenue Deficit to GSDP, (RD/GSDP) Gross Fiscal Deficit to GSDP (GFD/GSDP), Primary deficit to GSDP and Revenue Deficit to Total Revenue Receipts (RD/TRR) and Revenue Deficit to Gross Fiscal Deficit (RD/GFD).

2.45 In the table 10 we have traced trends in the major fiscal indictors. The following striking features emerge from the observations of the relevant ratios. Revenue deficit to GSDP ratio steadily declined from 2.6 per cent in 1990-91 to 1.4 per cent in 1996-97. Since then the ratio has steadily increased from 2.3 per cent in 1997-98 to 4.1 per cent in 2003-04. As for the ratio of revenue deficit to total revenue receipts the same trend is observed, a decline of the ratio till 96-97and a sharp increase since then. The ratio has almost

Table 2.10:

Major Fiscal Indicators of Kerala in relation to GSDP

(percent)

Year	GFD/ GSDP	Primary Deficit/GSDP	Revenue Deficit/GSDP	RD/TRR	RD/GFD
1990-91	4.8	2.8	2.6	17.56	52.85
1991-92	3.9	1.6	1.8	12.77	45.34
1992-93	3.1	0.8	1.4	10.17	46.09
1993-94	3.6	0.9	1.4	9.48	39.70
1994-95	3.5	0.9	1.3	8.57	36.07
1995-96	3.4	1	1	7.43	30.92
1996-97	3.5	1	1.4	10.46	41.69
1997-98	4.9	2.3	2.3	15.78	46.52
1998-99	5.4	2.8	3.6	28.20	67.39
99-2000	7.3	4.1	5.8	45.64	79.89
2000-01	5.6	2.3	4.5	36.05	81.16
2001-02	4.5	1.1	3.6	58.77	79.70
2002-03	6.2	2.5	5.1	38.72	82.54
2003-04	6.1	2.6	4.1	31.15	66.44

Source: Economic Review various issues
Budget in Brief various issues

doubled from 16 per cent to 31 per cent between 1997-98 and 2003-04 suggesting that the deficit is growing at a rate faster than the receipts. As for the gross fiscal deficit /GSDP ratio, it declined from 4.8 per cent in 1990-91 to 3.5 per cent in 1996–97. Since then it has steadily increased with minor fluctuations and stood at around 6.3 per cent in 2003-04.

Similar trends can be observed in the case of the primary deficit/GSDP ratio also. The primary deficit ratio declined from 2.8 per cent to 1 per cent and then rose to 2.6 per cent for the same time points. The difference between the GFD/GSDF ratio and the primary deficit ratio indicates the rising interest component. As for the RD/GFD, the ratio declined from 52.8 per cent in 1990-91 to 30.9 per cent in 1995-96 but rose steadily to reach 82.5 per cent in 2002-03. This is a poor reflection on the quality of the fiscal deficit. True, fiscal deficit as such should not be worrisome if it goes to finance capital expenditure, which would bring returns to investment. But in the case of Kerala nearly 83 per cent of fiscal deficit goes to finance revenue expenditure, which is not in any way desirable, as its implication is the trend of declining capital investments and the consequent potential of slowing down the growth of the economy.

2.46 Indeed, the above trend of using fiscal deficit to meet revenue expenditure is true for all the States in the country. However, the disturbing trend in Kerala is that the ratio is much higher than all-states' average. Kerala's RD/GFD ratio is reported to be the second highest amongst all the States (George, 2005). Also, both revenue deficit and fiscal deficit ratios in Kerala are higher than that of all other States (Twelfth Finance Commission Report (TFCR, 2005)).

2.47 Thus, both in absolute and relative terms, the fiscal condition as reflected in the various fiscal indicators, does not show a healthy trend in Kerala. In particular, deficits in State governments' finances have increased and become persistent. To put in rhetoric, a vicious circle of deficit, debt, and deficit has taken roots in the State's fiscal front. As shown by the TFCR the ratio of Debt to GSDP increased from 27 per cent in 1990-91 to 37 per cent in 2003-04 with sharp increases beginning from 2000. Kerala's debt to GSDP ratio has remained higher than the all-States' average. This is a disturbing sign of the poor fiscal health of the State. If we go by the State's commitment under KFRA to bring down GFD/GSDP ratio from 6.1 per cent in 2003-04 to 2 per cent by 2007, the deficit ratio has to fall by 4 points per year on an average. How far is this feasible? This is a moot question. Since the bulk of the deficit is seen financing revenue expenditure, the task calls for steps for containing revenue expenditure, which has obvious implications on the in-built constraint for raising the wage bill of the government through revision of salary, allowances, and other benefits of the employees and the pensioners of government and aided institutions. A detailed analysis of both revenue expenditure and revenue receipts of the State government during the period under review is useful to throw further light on the ramification, rationale and feasibility of raising the government's revenue expenditure including the wage bill through the upward revision of the pay and pension of employees of government and aided institutions at the present juncture.

2. Trend in Revenue Expenditure

2.48 Our analysis hitherto has highlighted the growing deficit in the economy and the bulk of the fiscal deficit going to cover the revenue deficit and a growing debt burden. The fiscal crisis of the State seems to emerge from the revenue expenditure of the state. To understand the problem facing the state in the proper perspective a detailed analysis of the revenue expenditure and capital expenditure is necessary.

2.49 The Table 11 shows that during the first and second sub-periods of the post-reform period under review, revenue expenditure in Kerala grew faster than that of all-States. On an average, between the first sub-period (i.e, 1990-91 to 95-96) and the second sub-period (i.e, 1996-97 to 1999-2000) the growth of revenue expenditure in Kerala increased from 15.6 per cent to 18.8 per cent per year. In the third sub-period (i.e. initial years of the current decade) it has sharply declined to 8.1 per cent. On an average, the revenue expenditure has increased at the rate of 14.3 per cent per annum throughout the period in Kerala. . For all-States also the situation is more or less the same except that for the current decade, Kerala's growth in revenue expenditure is higher than all-States' average.

Table 2.11

Growth rates in Revenue and Capital Expenditure: Kerala

(percent)

Year	Annual Growth Rate				Expenditure /GSDP Kerala	al Expenditure /GSDP Kerala
	Revenue Expenditure		Capital Expenditure			
	Kerala	All States	Kerala	All States		
1990-91					17.14	3.35
1991-92	13.9	20.1	43.01	12.59	15.69	3.85
1992-93	13.7	11.6	-10.41	6.38	15.68	3.03
1993-94	17.4	13.7	19.6	9.3	16.31	3.21
1994-95	18.0	17.4	5.6	31.0	15.89	2.80
1995-96	15.0	12.9	22.8	-1.6	15.03	2.83
1996-97	16.5	16.5	5.4	3.8	15.27	2.60
1997-98	21.4	10.5	36.6	22.7	16.65	3.19
1998-99	12.0	17.9	-12.3	11.5	16.41	2.46
1999-00	25.3	18.6	-3.5	14.3	18.50	2.13
2000-01	2.7	11.7	-4.8	5.3	17.02	1.82
2001-02	-1.8	8.0	15.7	12.2	16.12	2.03
2002-03	26.5	6.5	50.4	36.1	18.25	2.73
2003-04	5.0	10.9	93.3	77.0	17.18	4.74
1991-92 to 95-96	15.6	15.1	16.1	11.5	16.0	3.2
1996-97 to 99-00	18.8	15.9	6.5	13.1	16.7	2.6
2000-01 to 03-04	8.1	9.3	38.6	32.6	17.1	2.8
1991-92 to 03-04	14.3	13.6	20.1	18.5	16.5	2.9

Source: CMIE, Public Finance, various issues

EPWRF, Domestic Product for the states of India

2.50 Again while the average for all-States capital expenditure grew at 11.5 per cent and 13.1 per cent per year for the first and second half of the nineties respectively. In Kerala it declined from 16 per cent in the first half of the nineties to 7 per cent in the latter half of the nineties. As for the current decade the rates of growth are 39 per cent for Kerala and 36 per cent for all-States**.** The rates of growth in capital expenditure are highly volatile without any particular trend.

2.51 The foregoing trends are traced in terms of the changes in expenditure in absolute terms. It is necessary to review the trends in both revenue expenditure and capital expenditure juxtaposed against the GSDP of the State. Thus viewed, revenue expenditure as a percentage of GSDP, which was 17.14 per cent in 1990-91, stood at 17.18 per cent in 2003-04. The capital expenditure-GSDP ratio was 3.3 per cent in 1990-91 and 5 percent in 2003-04 respectively. Over the three periods the ratio declined from 3.2 per cent to 2.6 per cent and stagnated around that level for the rest of the period. In contrast to this, revenue expenditure / GSDP steadily increased from 16 per cent to 16.7 per cent and further to 17 per cent over the three periods. According to the TFCR in comparative terms the revenue expenditure/GSDP of Kerala was above or very close to that of all-States and its decline over time between 1993-96 and 2000-03 less than for all-States. As against this, capital expenditure was lower than the average in 1993-96 and the lowest amongst all States. In 2000-03 the ratio of capital expenditure to GSDP declined from 2.23 per cent to a mere 1.07 per cent.

2.52 In Kerala the ratio of capital expenditure to total expenditure, which was just 17 per cent in the first half of the nineties declined to 13 per cent in second half and continued to remain the same in the current decade (see the table 12).

Table 2.12:Trend in the capital expenditure

Year	Capital Expenditure as % to Total Expenditure
1990-91	16.33
1991-92	19.69
1992-93	16.20
1993-94	16.44
1994-95	14.98
1995-96	15.83
1996-97	14.53
1997-98	16.06
1998-99	13.03
1999-00	10.34
2000-01	9.66
2001-02	11.19
2002-03	13.03
2003-04	21.61
1990-91 to 1995-96	16.58

1996-97 to 1999-00	13.49
2000-01 to 2003-04	13.87
1990-91 to 2003-04	14.92

Source: RBI, Handbook of statistics on Govt. Finances, 2004
CMIE, Public Finance 2005

2.53 Thus viewed, effort of the State of Kerala in containing the growth rate in revenue expenditure so far has not been very satisfactory and hence needs to be made more effective in order to meet the goal of bringing down the fiscal deficit to 2 per cent by 2007 as committed under the KFRA. It is obvious that the increasing trend of revenue expenditure of the State government has been adversely affecting government's capital expenditure. In a sense revenue expenditure has been "stealing" increasing share of resources meant for expenditure on capital formation. In other words, the revenue expenditure has been putting a brake to the pace of development activities in the State of Kerala.

3. Components of Total Expenditure

2.54 Analysis of the economic and functional classification of budgets gives more details on the distribution of expenditure across various components of the total expenditure in the State. The Table 13 shows that out of the final outlay 57 per cent went as consumption expenditure and only around 6 per cent went for capital formation in 1993-94. Within the consumption expenditure 32 per cent went for wages and salaries while pensions absorbed another 12 per cent. In 2000-01, the figures were 58 per cent, and 4 per cent respectively for consumption and capital formation. And, wages and salaries accounted for 32 per cent and pensions accounted for 20 per cent. Thus all in all, hardly any amount of significance went into capital formation for development.

2.55 Apparently, the bulk of the growth in public expenditure in Kerala is accounted by the growth of revenue expenditure and is largely attributed to non-development revenue expenditure especially on account of salary and pension payments to the employees of Government and aided institutions. Analysis of the trends in the development and non-development components of revenue expenditure will give more insights on the pattern of revenue expenditure in the state.

Table 2.13
Total Expenditure (excluding expenditure of departmental commercial undertaking)
(percentage to total)

	Items	1993 -94	1994 -95	1995 -96	1996 -97	1997 -98	1998-99	1999 -2000	2000 -01
	2								
I	Final Outlay	63.11	63.24	67.08	63.21	51.59	52.89	61.83	62.37
(a)	Government consumption of Expenditure	57.58	56.09	59.76	53.65	45.28	48.13	55.30	58.45
a.1	Compensation of Employees	46.42	49.28	51.65	46.11	39.64	43.24	49.51	52.24
	i) Wages & Salaries	34.01	35.54	35.58	32.35	27.10	28.74	31.34	32.36
	ii) Pension	12.41	13.75	16.07	13.76	12.54	14.50	18.17	19.89
a.2	Purchase of Commodities & Services	11.16	6.80	8.11	7.54	5.64	4.90	5.79	6.20
	i) Purchase	10.21	6.67	6.75	6.38	4.77	4.26	4.24	5.28
	ii) Maintenance	3.01	2.02	4.08	3.06	2.83	2.40	3.10	3.01
	iii) Less sales	2.06	1.89	2.72	1.90	1.96	1.77	1.55	2.09
(b)	Gross Capital Formation	5.53	7.16	7.32	9.55	6.31	4.76	6.53	3.92
II	Transfer payments to therest of the economy	34.69	33.78	29.91	34.58	45.52	44.83	36.68	36.35
(a)	Current transfer	30.40	33.15	29.79	34.51	40.83	40.20	27.89	26.86
(b)	Capital transfer	4.28	0.62	0.12	0.07	4.69	4.63	8.79	9.50
III	Financial Investment &loan to the rest of the economy	2.20	2.98	3.02	2.21	2.89	2.27	1.49	1.28
	Total	100	100	100	100	100	100	100	100

Source: Economic and Purpose Classification of Kerala Government Budget, 2000, 2003

4. Trend in Development vs. non-Development Revenue Expenditure

2.56 Analysis of the development and non-development components of revenue expenditure clearly shows (see the table 14) that while development expenditure grew on an average by 13 per cent, non-development expenditure grew by 16 per cent for the entire post-reform period under review. It is also observed that for all sub-periods except the last (current decade) non-development expenditure grew at higher rates than development expenditure.

Table 2.14
Growth in the Development and Non Development expenditure in Kerala

	Total Revenue Expenditure	Development Expenditure		Non- Development Expenditure	
	Annual Growth Rate (%)	Annual Growth Rate (%)	Total Revenue Expenditure	Annual growth rate (%)	% to Total Revenue Expenditure
1990-91			63.81		35.05
1991-92	13.9	9.2	61.22	23.3	37.95
1992-93	13.7	15.8	62.38	9.4	36.53
1993-94	17.4	13.4	60.23	23.3	38.37
1994-95	18.0	16.6	59.52	20.5	39.19
1995-96	15.0	13.2	58.56	17.8	40.15
1996-97	16.5	18.6	59.63	12.2	38.65
1997-98	-4.9	24.3	77.95	17.4	47.74
1998-99	43.0	12.1	61.14	14.8	38.32
1999-00	25.3	15.4	56.29	40.8	43.03
2000-01	2.7	-2.2	53.60	9.6	45.94
2001-02	-1.8	-6.0	51.31	2.8	48.12
2002-03	14.3	21.6	54.54	7.1	45.06
2003-04	15.2	22.3	57.88	6.5	41.66
1990-91 to 1995-96	15.6	13.6	61.0	18.9	37.9
1996-97 to 1999-00	20.0	17.6	63.8	21.3	41.9
2000-01 to 2003-4	7.6	8.9	54.3	6.5	45.2
1990-91 to 2003-04	14.5	13.4	59.9	15.8	41.1

Source: RBI, *Hand book of statistics*

2.57 Analysing the shares of the development and non-development components of revenue expenditure it is seen that development expenditure as a whole declined from 64 per cent in 1990-91 to 58 per cent in 2003-04.

2.58 To give a detailed picture of the expenditure, the share of major items under development and non-development expenditure components for Kerala and all-States are recorded in the Table 15.

Table 2.15

Shares of major items of development and non-development components of expenditure

	1990-91 to 1995-96		1996-97 to 1999-00		2000-01 to2003-04		1990-91 to 2003-04	
	Kerala	All states	Kerala	All states	Kerala	All states	Kerala	All states
Development Expenditure	60.95	64.92	63.75	60.41	54.32	54.90	59.86	60.77
social services	37.65	36.42	30.65	36.60	33.95	34.16	34.59	35.83
of which Education	26.56	20.10	17.52	20.41	19.18	14.42	21.87	18.56
Medical& Public Health	6.66	5.79	4.28	4.77	4.68	4.27	5.42	5.06
Welfare of SC&ST	1.93	2.19	1.75	2.30	1.92	7.08	1.87	3.62
Social Security and Welfare	2.01	1.80	1.45	1.33	1.55	1.90	1.72	1.69
Economic Services	18.45	28.50	19.87	23.82	22.23	25.38	19.93	26.27
Of which Rural Development	5.23	5.95	7.56	4.43	8.66	3.61	6.88	4.85
Non-development Expenditure	39.86	33.97	43.85	38.06	43.34	43.41	41.99	37.84
of which Interest and Debt servicing	16.05	14.57	18.23	16.91	18.89	20.61	17.48	16.96
Pensions	11.96	4.79	15.00	7.02	14.44	9.01	13.54	6.63
Assingnment to Panchayat Raj	1.47	1.51	0.56	1.52	0.49	5.83	0.93	2.75
Total Expenditure	100	100	100	100	100	100	100	100

Source: RBI, op.cit

2.59 Generally, the share of development expenditure in the total revenue expenditure in Kerala has remained below the average for all-States during the post-reform period under review. This trend is seen particularly obvious with respect to Economic Service. For the whole period under review, share of economic services in total expenditure in Kerala stands as 20 per cent only as against 26 per cent at all-States. Indeed, this implies that adequate budgetary allocation is not given on economic infrastructure in Kerala as compared to other States. On the other hand, the share of social services (of which education and health sectors, in particular) in Kerala remained higher than the corresponding figures at all-States' average. Interestingly; the difference in the shares between Kerala and all-States average is seen to have reduced over time. To illustrate, the share of Education expenditure was around 27 per cent in Kerala as against 20 per cent all-State average in the first sub-period, but in the third sub-period (current decade) these figures were 19 and 14 respectively. Perhaps the relatively faster decline in the share of Kerala is the reflection of a tendency of the State government to reduce development expenditure on such items like education and health due to fiscal stress. However as these are critical to maintain human development achievement the trend of government's reduction in expenditure on such items may have serious implication on the quality of human development in the State.

2.60 Analysis of the non-development expenditure brings out that its share in total expenditure in Kerala is higher than that of all-States average and more importantly is increasing over time. Within the non-development component expenditure, the payments on account of interest & debt servicing and pensions take away the largest share. Of course, interest payment is also high at all-States average; though it is relatively higher in Kerala during the period under review. As for the item of pensions, Kerala situation is seen distinct in the sense that its share is significantly higher than the corresponding figures at all-States in all the sub-periods. For the total post-reform period under review, the share of expenditure on pensions (13.5 per cent) is more than double of the share at all-States (6.6 per cent) in the total expenditure.

2.61 Very often, the fiscal crises in Kerala are attributed to rising payments on account of salary, pensions and interest. How true is this? To understand this we make a detailed analysis of the trends in the main components of revenue expenditure namely salary, pensions and interest.

5. Expenditure on Salaries and Pensions and Interest

2.62 In the table 16 we have recorded annual growth rates of interest payment, pension and salaries and their relative proportion to revenue receipts, revenue expenditure and total expenditure in order to capture the size of the payment burden of these items on the State. It appears that the burden of salaries declined from 44.29 per cent during the first sub-period (viz., 1990-91-to 1995-96) to 36.69 per cent in second sub-period (1996-97 to 1999-00) and further to 34.56 per cent in the third sub-period (2001-02 to 2003-04). And as a percentage of revenue receipts it declined from 49.4 per cent in to 46 per cent and stagnated at that level for the same periods. In relation to total expenditure also we see the same trends. Thus seen, the burden on account of salaries in Kerala has shown a declining trend. In terms of level however, the burden of these items of expenditure in Kerala has been higher than for all-States average except for one or two years (TFCR table 4.2.2).

2.63 In terms of growth rates, the post nineties did see a high growth in expenditure on salaries. One important point needs to be noted in this context. In terms of per employee salary expenditure (wage-rate), Kerala’s figures are lower than the average for all states (see table 17 and TFC p478). The increase in this after the salary revision, (that is between 95-96 –97-98 and 1999-00) in Kerala is around 47.63 per cent much below all-States average.

Table 2.16

Relative shares of the payments on account of salary, pension and interests in Kerala

Year	Interest				Pension				Salaries				Salaries + Pension			Salary+ Pension+ Interest		
	Annual % GR	% to RR	% to RE	% to TE	Annual % GR	% to RR	% to RE	% to TE	Annual % GR	% to RR	% to RE	% to TE	% to RR	% to RE	% to TE	% to RR	% to RE	% to TE
1990-91		14.2	12.1	10.1		12.2	10.4	8.7		70.0	59.6	49.8	82.2	69.9	58.5	96.4	82.0	68.6
1991-92	41.9	16.9	15.0	12.1	15.6	11.9	10.5	8.5	-17.8	48.5	43.0	34.5	60.4	53.6	43.0	77.3	68.6	55.1
1992-93	12.2	16.3	14.8	12.4	9.7	11.2	10.2	8.5	2.6	42.8	38.8	32.5	54.0	49.0	41.1	70.3	63.8	53.5
1993-94	26.7	17.5	16.0	13.4	25.0	11.8	10.8	9.0	29.4	46.8	42.8	35.7	58.7	53.6	44.8	76.2	69.6	58.2
1994-95	19.3	17.6	16.2	13.8	21.7	12.1	11.2	9.5	19.5	47.0	43.3	36.8	59.1	54.5	46.3	76.7	70.7	60.1
1995-96	12.7	17.0	15.9	13.4	26.8	13.2	12.3	10.4	1.6	41.1	38.3	32.2	54.3	50.6	42.6	71.4	66.4	55.9
1990-91 to 1995-96	***22.57***	***16.60***	***15.00***	***12.51***	***19.75***	***12.08***	***10.90***	***9.09***	***7.07***	***49.38***	***44.29***	***36.95***	***61.46***	***55.19***	***46.04***	***78.06***	***70.18***	***58.56***
1996-97	19.4	18.0	16.3	13.9	5.1	12.3	11.1	9.5	17.3	42.6	38.5	32.9	54.8	49.7	42.4	72.8	65.9	56.3
1997-98	16.6	18.1	15.6	13.1	21.1	12.8	11.1	9.3	7.1	39.4	34.0	26.0	48.7	40.4	34.5	65.6	54.4	46.4
1998-99	12.5	20.1	15.7	13.6	26.4	16.0	12.5	10.9	16.1	45.2	35.3	30.7	61.3	47.9	41.5	81.3	63.6	55.2
1999-00	35.0	24.6	16.9	15.1	56.7	22.8	15.6	14.0	38.4	56.7	38.9	34.9	79.5	54.6	48.9	104.1	71.4	64.1
1996-97 to 1999-00	***20.85***	***20.17***	***16.10***	***13.94***	***27.34***	***15.97***	***12.58***	***10.92***	***19.73***	***45.97***	***36.69***	***31.13***	***61.07***	***48.13***	***41.84***	***80.94***	***63.83***	***55.49***
2000-01	15.6	25.9	19.0	17.2	6.7	22.1	16.2	14.7	-0.3	51.4	37.8	34.2	73.5	54.1	48.8	99.4	73.1	66.0
2001-02	10.3	27.5	21.3	19.0	-4.7	20.3	15.8	14.0	-6.5	46.4	36.0	32.0	66.7	51.8	46.0	94.2	73.1	64.9
2002-03	18.4	27.7	20.0	11.9	24.2	21.5	15.5	9.2	11.4	44.0	31.7	27.6	65.4	47.2	41.0	93.1	67.2	58.4
2003-04	12.9	28.2	21.5	12.0	5.5	20.4	15.5	8.7	8.3	42.9	32.7	25.6	63.3	48.2	37.8	91.4	69.7	54.7
2000-01 to 2003-04	***14.31***	***27.3***	***20.45***	***15***	***7.92***	***21.06***	***15.76***	***11.64***	***3.24***	***46.17***	***34.56***	***29.84***	***67.24***	***50.32***	***43.42***	***94.54***	***70.77***	***61.00***
1990-91 to 2003-04	***19.13***	***21.12***	***17.11***	***13.72***	***17.69***	***16.11***	***12.97***	***10.43***	***9.32***	***47.40***	***39.02***	***33.03***	***63.28***	***51.68***	***44.05***	***84.32***	***68.68***	***58.55***

MIE Public Finance

Table 2.17

Per employee salary expenditure - Kerala

	40554	42762	48599	50699	59504	79187	79443	72359	85961
Growth (%)		5.44	13.65	4.32	17.37	33.08	0.32	-8.92	18.80
Weighted average (21 states)	41968	47398	53631	61377	75116	89600	92214	90353	94603
Growth (%)		12.94	13.15	14.44	22.38	19.28	2.92	-2.02	4.70

Source TFCR

2.64 A sector-wise analysis of the distribution of wages and salaries (see the table 18) shows that the share of general services increased from 50 per cent in 1993-94 to 58 per cent in 2000-01 As for education it decreased from 26 per cent to 22 per cent for the same period. . For the health sector it was around 7 to 8 per cent, social security and welfare services around 4-5 per cent Economic services it was fluctuating, and in 2001 it was 7 per cent. Thus the bulk of the Salaries payments were accounted for by general public services and (to a lesser extent) by the educational sector.

Table: 2.18

Wages and salaries including pensions of government employees: sector-wise

	Economic Classification, Functional Classification	Wages & Salaries including Pension							
	2								
1	General public Services	49.60	44.90	45.56	45.82	54.05	54.85	57.75	58.37
1.1	General Administration (External affairs, Public sectors)	49.52	44.90	45.56	45.82	53.98	54.78	57.69	58.30
1.2	General Research	0.07				0.07	0.06	0.06	0.07
2	Defense								
3	Education	26.40	24.01	26.83	27.57	22.67	22.83	21.43	21.59
3.1	Administration, Regulation & Research	1.21	0.86	0.79	0.89	1.21	1.08	0.94	0.89
3.2	University, Schools & other Educational facilities	25.20	23.15	26.04	26.67	21.46	21.75	20.49	20.70
4	Health	8.45	8.66	7.65	8.12	9.97	8.69	8.30	7.83
4.1	Administration, Regulation & Resear ch	0.32	0.22	0.20	0.20	0.42	0.41	0.31	0.46
4.2	Clinic & other Health Services	8.12	8.44	7.45	7.92	9.55	8.28	8.00	7.38
5	Security & Welfare Services	4.72	3.61	5.14	3.83	4.46	4.28	4.25	4.14

6	Housing & Community Amenities	1.01	2.03	1.71	1.86	0.68	0.66	0.50	0.51
7	Recreation & other Religious services	0.56	0.55	0.59	0.55	0.53	0.51	0.27	0.44
8	Economic Services	9.27	16.25	12.53	12.26	7.64	8.13	7.49	7.13
8.1	General Administration, Regulation & Research	1.19	0.91	0.84	0.83	0.98	1.02	0.95	0.89
8.2	Agriculture, Forestry, Fishing & Hunting	5.13	11.24	7.78	7.72	4.38	4.23	4.10	4.31
8.3	Mining, Manufacturing & Construction	0.80	1.07	1.08	1.52	0.66	0.52	0.41	0.42
8.4	Electricity, Gas, Steam &Power	0.01	0.08	0.01	0.31	0.54	1.33	0.01	0.01
8.5	Atomic Energy								
8.6	Transportation & Communication	1.07	2.02	1.74	0.95	0.05	0.03	1.14	0.84
8.7	Other Economic Services	1.08	0.92	1.08	0.93	1.03	1.00	0.89	0.66
9	Other Purposes	0.00					0.07	0.00	0.00
		100	100	100	100	100	100	100	100

Economic and Purpose Classification of Kerala Government Budget, 2000, 2003

2.65 As for pensions as a proportion of revenue expenditure the figure rose from 11 per cent in the first sub-period (1990-91 to 95-96) to 13 per cent in the second period (1996-97 to 1999-00 and rose to 16. per cent in 2000-04. . As a proportion of revenue receipts and total expenditure the same trends are observed. In relative terms also pension expenditure as a proportion of GSDP is the highest in Kerala vis a vis all-States average in 93-96 and the second highest for the period 2000-03 rising from 1.72 per cent to 2.6 per cent. TFCR table3.12.The low age of retirement, longevity plus the contributions to the new pension fund would explain this growth. As for interest payments it increased from 15 per cent of revenue expenditure in 90-91 –95-96,and to 20 per cent in 2000-01-2003-04. As a proportion of revenue receipts and total expenditure also the same trends are observed.

2.66 Salaries and pensions together accounted for 55 per cent of revenue expenditure in 1990-91 to 1995-96 and fell to 50 per cent in 2000-01 to 03-04. As a percentage of revenue receipts, salaries and pensions were 61 per cent in 90-95 and rose to 67 per cent in 2000-01 to 03-04 Salaries and pensions as a per cent of total expenditure were 46 per cent in 1990-95 and fell to 43 per cent 2000-01 to 03-04.

2.67 Salaries, pensions and interest together accounted for 70 per cent of revenue expenditure in 90-95 fell to 64 per cent in the post nineties and again rose to 71 per cent in 2000-04 Salaries, pensions and interest as a per cent of revenue receipts were 78 per cent in 90-95 and steadily rose to 95 per cent in 2000-04. Salaries, pensions and interest as a percentage of total expenditure decreased from 59 per cent in 90-95 to 55 per cent in 96-00 and increased to 61 per cent in 2000-04 .

2.68 Over the entire period the highest growth rate is seen in the case of interest with 19 per cent growth, followed by pension with 18 per cent growth and salaries with the least 9 per cent growth. In relative terms, interest payments /revenue receipts. Kerala stands higher than all states average. (TFC p484) This highlights the debt obligations of the state and takes us to analyse the uses of borrowed funds to cover gross fiscal deficit.

6. Uses of Borrowing to cover Gross Fiscal Deficit

2.69 While borrowing for capital expenditure is desirable, borrowing to meet revenue expenditure is undesirable. Unfortunately, this is what is happening in Kerala. Our earlier analysis clearly pointed out to the poor quality of fiscal deficit namely that nearly 83 per cent of it is going to finance the revenue expenditure. It was also seen that Kerala compares very badly with other States in this respect. That the bulk of the borrowing goes to meet revenue expenditure and leaves very little for capital expenditure is more disconcerting for the implications it has for future growth of the economy and the state discharging its functions. This can be explicitly seen from the decomposition of the fiscal deficit into its component uses (see the table 19).

Table 2.19:
Uses of Borrowings to cover GFD

Year	**Capital Outlay**		**Revenue Deficit/ Surplus**		**Net Lending**		**GFD**	
	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States
1990-91	32.1	49.1	52.8	28.3	15.1	22.6	100	100
1991-92	35.6	53.4	45.3	29.9	19.0	16.7	100	100
1992-93	38.0	51.0	46.1	24.5	15.9	24.5	100	100
1993-94	38.8	60.4	39.7	18.5	21.4	21.0	100	100
1994-95	40.2	62.6	36.1	22.2	23.7	15.1	100	100
1995-96	43.3	58.9	30.9	26.1	25.8	15.1	100	100
1996-97	40.4	47.1	41.7	43.3	18.0	10.2	100	100
1997-98	30.6	51.6	46.5	37.0	22.9	11.5	100	100
1998-99	21.6	31.1	67.4	58.8	11.0	10.8	100	100
1999-00	14.3	27.9	79.9	58.8	5.8	13.3	100	100
2000-01	14.9	34.8	81.2	59.8	4.0	5.4	100	100
2001-02	17.1	33.6	79.7	61.7	3.2	4.7	100	100
2002-03	16.1	35.6	82.5	52.5	2.9	11.9	100	100
2003-04	14.6	48.0	84.2	41.6	1.1	10.4	100	100

Source: RBI, op.cit.

2.70 Analysis of the uses of borrowings to cover the fiscal deficit reveals that very little of the borrowing goes to finance capital outlay, the ratio of capital outlay to GFD declining from 32 per cent in 1990-91 (with some increases for a few years) to just 15 per cent in 2003-04. Compared to all-States average the ratio is much lower in Kerala. For all-States also the ratio is declining but the ratio is still higher than that of Kerala. In contrast to this, the financing of the revenue deficit has increased from 53 per cent in 1990-91 to 84 per cent in 2003-04. Net lending has fallen from 15 per cent to 1 per cent in the whole process. It is important to note that in terms of capital expenditure Kerala holds the worst position among the States (TFCR). We seek to understand the impact of the above trends in the capital and revenue expenditure for social sector spending.

7. Spending on Social Sectors.

2.71 It is interesting to note in this context that the expenditure on social sectors (revenue and capital) as a share in total expenditure (revenue and capital) over the period has declined for almost all the sectors over the period 1990-91 to 2003-04 (see the table 20).

Table 2.20

: Share of expenditure (revenue and capital) on social sectors in total expenditure (revenue and capital)

(percentage)

Year	Education, Sports, Arts and Culture	Nutrition	Medical And Public Health	Supply Sanitation	Housing	Welfare of SC,ST and OBC	Security and Welfare
1990-91	22.97	0.19	6.3	1.95	0.33	1.55	2.18
1991-92	20.87	0.16	5.56	1.73	0.26	1.55	1.61
1992-93	20.89	0.14	5.27	1.63	0.22	1.28	1.49
1993-94	22.29	0.15	5.53	1.62	0.41	1.24	1.62
1994-95	22.67	0.17	5.76	1.48	0.43	1.14	1.59
1995-96	20.73	0.15	4.88	1.47	0.42	1.14	1.38
1996-97	20.35	0.15	4.64	1.30	0.43	2.46	1.49
1997-98	17.94	0.11	4.27	1.48	0.48	1.76	1.50
1998-99	18.45	0.05	4.39	1.41	0.39	1.92	1.51
1999-00	20.23	0.03	4.52	1.41	0.36	1.52	1.24
2000-01	19.93	0.02	4.42	1.24	0.28	1.46	1.87
2001-02	18.82	0.02	4.77	1.00	0.26	1.31	1.66
2002-03	16.7	0.01	3.94	1.38	0.46	1.72	1.58
2003-04	16.88	0.01	4.25	1.76	0.46	1.64	1.12

: Computed From Handbook of Statistics on Indian Economy, Reserve Bank of India

2.72 For almost all sectors it has declined except for housing and welfare of the SC/ST and OBC, which shows some marginal increase. On the whole, it has declined from 35 per cent to 26 per cent. The decline in State expenditure in these sectors can have implications for the maintaining and improvements of the social and human indicators of development achieved by the state particularly for the poor. This needs to be resolved. This calls for a critical evaluation of the revenue receipts of the state.

8. Trends and Patterns in Revenue Receipts

2.73 We begin with an analysis of the growth trends in the various components of revenue receipts to make an assessment of their impact on growth of total revenue receipts and also to trace the changes in the composition /structure of the state revenues. In the table-21 we have worked out annual average growth rates of the different components of tax receipts in Kerala and compared these with all-States average during the post-reform period broken up into three sub-periods.

Table 2.21

Annual average growth of revenue receipt (by components) and total expenditure

Item		Average Annual Growth rate (%)			
		1991-92 to 1995-96	1996-97 to 1999-00	2000-01 to 2003-04	1991-92 to 2003-05
State's Own tax	Kerala	20.4	11.4	12.0	15.07
	All States	16.0	12.6	11.6	13.62
State's Own Non tax	Kerala	21.0	-0.1	11.9	11.69
	All States	20.9	7.3	6.3	12.23
State's OwnTax Revenue+ State's Own Non-Tax Revenue	Kerala	20.5	10.0	12.0	14.63
	All States	17.2	11.2	10.5	13.28
Share in Central Taxes	Kerala	16.5	10.5	7.1	11.74
	All States	15.4	11.4	10.8	12.75
Grants from Centre	Kerala	6.9	13.8	10.4	10.11
	All States	11.1	10.4	12.6	11.37
Total Revenue Transfers from Centre	Kerala	12.2	10.5	7.3	10.17
	All States	13.4	10.8	11.5	12.01
Total Revenue	Kerala	17.7	10.1	10.5	13.17
	All States	15.6	11.0	10.8	12.72
Revenue Expenditure	Kerala	15.6	18.8	8.1	14.28
	All States	15.1	15.9	9.3	13.57

Source: CMIE Public Finance, various issues

2.74 These sub-period refer to (1) first half (1991-92 to 1995-96) of the nineties, (2) second half (1996-97 to 1999-2000) of the nineties and (3) initial years (200-01 to 2003-04) of the current decade. We see that average growth in Kerala's total revenue has sharply decreased from around 18 per cent in the first period (first half of the nineties) to around 10 per cent in the second period (second half of the nineties). The third period remained more or at the same level as that of the second. The growth trend of total revenue receipt in Kerala did not lag behind that of the all-States average. However, the trend in total expenditure was somewhat different in the sense the revenue expenditure increased in the second over the first period both in Kerala and in the average for all-States. However, the increase was sharper in the case of Kerala.

2.75 Another note-worthy characteristic feature in Kerala was that the rate of growth in expenditure was higher than that of the growth of rate in revenue receipt during the second period. For the whole period under review, the rate of growth in revenue receipts (13.17 per cent) remained below the growth rate of expenditure (14.28 per cent). Is the imbalance indicative of the saturation level of the revenue mobilization especially of the own tax-revenue? Or is there still potential to raise own tax revenue? Is there scope for raising resources through augmenting own non-tax revenue (ONTR) by raising the user charges of public services? Are there institutional constraints in improving non-tax user recoveries? These and similar questions relating to revenue augmentation do come up to maintain fiscal health of the State economy if the alternative policy option of expenditure cut (compression) is considered not feasible or desirable from larger social interest.

2.76 To seek answers to these questions, we need to analyse the trend in the growth of the components (structure) of the revenue receipts recorded in the table 22. First, consider the trend in the tax revenue, which consists of the State's own tax revenue and the State's share in the Central taxes As for the State's own tax revenue, the trend does not give a rosy picture in as much as it has sharply. Declined from 20.4 per cent in the first period to 11.4 per cent in the second period. The third period has shown a marginal improvement by recording annual average growth of 12 per cent. It is interesting to note that for the total post-reform under review the growth in the State's own taxes in Kerala is higher than the corresponding average for all-States. Interestingly, the growth in own tax revenues of he average for all-States also showed a declining trend in the second and the third period. However, the rate of decline in the growth rate of own tax revenues is relatively higher in the case of Kerala.

Table 2.22
Annual average growth of revenues (by components)

Item		Average Annual Growth rate (%)			
		1991-92 to 1995-96	1996-97 to 1999-00	2000-01 to 2003-04	1991-92 to 2003-05
State's Own tax	Kerala	20.4	11.4	12.0	15.07
	All States	16.0	12.6	11.6	13.62
State's Own Non tax	Kerala	21.0	-0.1	11.9	11.69
	All States	20.9	7.3	6.3	12.23
State's Own Tax Revenue + State's Own Non-Tax Revenue	Kerala	20.5	10.0	12.0	14.63
	All States	17.2	11.2	10.5	13.28
Share in Central Taxes	Kerala	16.5	10.5	7.1	11.74
	All States	15.4	11.4	10.8	12.75
Grants from Centre	Kerala	6.9	13.8	10.4	10.11
	All States	11.1	10.4	12.6	11.37
Total Revenue Transfers from Centre	Kerala	12.2	10.5	7.3	10.17
	All States	13.4	10.8	11.5	12.01
Total Revenue Receipts	Kerala	17.7	10.1	10.5	13.17
	All States	15.6	11.0	10.8	12.72
Revenue Expenditure	Kerala	15.6	18.8	8.1	14.28
	All States	15.1	15.9	9.3	13.57

Source: CMIE Public Finance, various issues

2.77 All considered the growth trend of State’s own tax revenue in Kerala is not poor as it is seen to be higher than the average for all-States. However, it is discouraging to note that the rate of growth has been slowing down more sharply in the case of Kerala To some measure, this is indicative of a saturation level to the capacity of the State government to mobilize own tax revenue from the existing tax-structure despite the high growth of the macro economy in Kerala. As the economic growth in Kerala, as shown earlier, is led by the service sector its capacity to mobilize resources adequate to meet the increasing expenditure seems rather difficult unless the power to tax the service sector is assigned to the State and its tax-structure is thus made more diversified. This is not to say that there is no room to augment resource mobilization by ensuring stricter compliance by the taxpayers and improving efficiency of the administrative machinery in collecting the taxes [6]

[6] It is relevant to mention here some studies (Rakhe,) have shown loss of around one third of sale-tax to the exchequer on account of accounted leakges.

2.78 Another component of the State's tax revenue is its share in central taxes on which the State has no control.[7] As for the share in Central taxes the rate of growth of this tax source consistently declined from 16.5 per cent in the first period to 11.2 per cent in the second period and further to 7.3 in the third period of the whole post-reform period under review. A declining trend was there in the average for all-States also. However, the decline was sharper in the case of Kerala. If the whole post-reform period is considered, the rate of growth of the revenue from the share in Central the tax in Kerala (11.74 per cent) is seen to be much below the corresponding figure (12.75 per cent) for all-States average. The declining share of the States in Central taxes is suggestive of the general decline in the tax/ GDP ratio at the Centre itself. The sharper decline in the case of Kerala implies that the criterion for inter-states distribution is not favourable to the State.

2.79 We now turn to trace the trend in the non-tax receipts, which consists of the State's own non-tax revenue from sources like interest, dividends, user charges for social and economic services etc., and the grant-in-aid and other resources transfer to the State from the Centre. As for the State's own non-tax revenues (ONTR), the second and third periods witnessed a decline as compared to the first period. In fact in the second period, Kerala has recorded a negative growth rate. Indeed, a declining trend is seen in all-States average as well. However, if the whole post reform period is considered, the rate of growth in Kerala is seen to be lower than the corresponding figure for all-States average. Clearly, there is room for Kerala State to improve its resource mobilisation from own non-tax revenue (ONTR) by raising the user charges and or expanding the overage of ONTR in such a way that the social welfare is not adversely affected.

2.80 As for grants from the centre which is another source of non-tax receipts, the growth rates in Kerala appeared lower than the corresponding figures for all-States average in all the three sub-periods as well as the whole post-reform period. Also the growth rate in the third sub-period (10.4 per cent) was lower than the second period (13.8 per cent). The growth trends of grants from the Centre give some empirical support to the allegation raised in some circles that the fiscal stress of Kerala is due to the declining flow of resources from the Centre. If the growth rates of the total revenue transfer from the Centre are considered, the striking feature is the consistent decline in Kerala m from sub-period to sub-period absolutely and relative to the corresponding figures for all-States average. There is an implicit suggestion here of the unfavourable treatment received by the State of Kerala from the awards of the Finance Commission.

9. Finance Commission Awards

2.81 A few lines on the Finance Commission Awards may not be out of context, if it would like a digression. Analysis of the share of Kerala in the total FC transfers to the states clearly shows that Kerala's share is declining on every count While share in central taxes

[7] 1 as is well known under Article 280 of the Constitution, the Finance Commission is constituted every five years to recommend devolution of a portion of tax revenues of the Centre to the States. After eighties Constitutional amendment, the divisible pool consists of all taxes and duti8es other than surcharges and cess. The eighty-eight amendments, which introduced Article 268A, have however excluded service tax levied by the Centre from the divisible pool of Taxes.

and duties declined from 3.5 per cent to 2.7 percent, grants declined from 2.5 per cent to 2.3 per cent and total transfers from 3.4 percent to 2.6 per cent over the tenth, eleventh and 12th finance omissions. Kerala's share in the total transfers to the States in each of the last three commissions is shown in the table 23.

2.82 It appears that Kerala has not been getting her due share. This is because of (1) the use of criteria inappropriate for the State; (2) use of inappropriate indicators for the criteria used; (3) inappropriate weight age given for the different criteria; and (4) failure to use criteria which are relevant to the State. Kerala has been losing on several counts which according to scholars (e.g. George,2005) could have been turned to its favour for getting

Table 2.23

Share of Kerala in the Total Finance Commission Transfers to States ((Rs. In Crores)

		Tenth FC	Eleventh FC	Twelfth FC
1. Share in Central Taxes and Duties		7217 (3.5)	11504 (3.1)	16353.21 (2.7)
2. Non-Plan Revenue Deficit Grants		0 (0.0)	0 (0.0)	470.37 (0.8)
3.Upgradation and Special Problems		81.83 (3.1)	129 (2.6)	1295.82 (2.9)
Aid to Local Bodies	4. Panchayat	178.81 (4.1)	330 (4.1)	985 (4.9)
	5. Municipalities	25.43 (2.5)	75 (3.8)	149 (3.0)
	6. Total	204.24 (4.6)	405 (4.0)	1134 (4.5)
7. Grants for relief Expenditures		218.74 (4.6)	279 (3.4)	354.32 (2.2)
8. Total Grants		504.81 (2.5)	813 (1.4)	3254.51 (2.3)
9. Total Transfers		7721.81 (3.4)	12317 (2.8)	19607.72 (2.6)

Note: Figures in the Brackets indicates the percentage Share in to Total Finance Commission Transfers to States

Source: Tenth, Eleventh and Twelfth Finance Commission Reports

funds from the finance commissions. For example, unemployment could be taken as a sign of backwardness, Similarly there is no grant at all for upgrading state's health or education services; special problem grants required for tackling arising out of the early development in social indicators such as the problems attendant to ageing These could relate to health and increasing social security payments, growing pension expenditure etc. Similarly in the case of education, the demand for higher education could be addressed. Whatever be the reasons and however could it have been resolved, the fact remain that the inadequate resource flow from the finance commission awards have serious implications for the fiscal stability of the State of Kerala.

2.83 Reverting to the discussion on the trends and patterns in revenues in Kerala, what we have so far discussed is the rates of growth in the total and different components of revenue receipts of the State. And we observed a slow-down in the growth of total revenues and most of its components over time during the post-reform period under consideration. We now examine the impact of this growth process on the changes in the structure – meaning the relative shares of different revenue sources in the total revenue - of the revenue of the State.

10. Structure of State Revenues

2.84 We have captured the changing structure of the State's revenue by estimating the relative shares of the major revenue sources in the Table 24, which highlights the following striking features: State's own tax predominates the structure and its share has increased from 56 per cent in 90-91 to 69 per cent in 2003-04. These figures remained much higher than the corresponding one for all-States average. Sub-period wise, the share of State's Own Tax in the total revenue increased from 58.8 per cent in first sub-period to 64.2 in the second-sub-period and 67.4 per cent in the third sub-period. Clearly, Kerala's performance record in mobilising revenues through its own taxes deserves to be well appreciated compared to the record of all-States average. It is even suggestive of a point of saturation for the State to use own tax-net (in its present structure) for further revenue mobilisation though Karala has recorded a high growth in GSDP after the path of economic reforms that the country chose since the nineties.

2.85 At this point it is useful to have look into the present structure (components) of OTR in Kerala. The Table 25 gives the share of different taxes in own tax revenue net of Kerala. It is seen that State Sales Tax has always remained the most important source of OTR; it accounted for 67 per cent of the total OTR in 203-04. The next important single source has remained to be the State Excise. The Stamps and Registration fees coming under group of Taxes on Property and Capital transactions and Taxes on Vehicles follow this. The scope for raising revenue by enhancing the rates on these items seems limited. Rest of the items (e.g. agricultural income tax, land revenue etc.) in the tax-net are more in the nature of minor taxes and hence less likely to mop up large resources net of the collection and compliance cost. Prima face, it appears the potential for mobilising own tax revenue is not great in Kerala unless the State is given the power to tax services and diversify its tax structure.

2.86 We now turn to the share of State's own non-tax (ONTR) in the total revenue in Kerala (see Table 26). This is not only low but also declining in its importance. Its share in total revenue in Kerala is just about half of what it is as all-States average. Kerala's performance is rather dismal with respect to ONTR. The major sources of non-tax revenue are from general services, mainly state lotteries, and economic services, here again mainly from forestry and wildlife. It reflects the recovery of cost of public services rendered, interest on loans and advances extended, and dividends on investments made by the state government. It also includes receipts from state lotteries and forestry and royalties on minerals.

2.87 There are some striking contrasts in the sources of non-tax revenues between Kerala and all states. Kerala largely relied on general services or rather lotteries within it, on economic services here again mainly from forestry and wildlife and to a certain extent on social and community services and lastly interest. Industries and dividends and profits had no role at all. In contrast to this pattern of non-tax revenues, for all states interest, general services economic services and industries gave good revenues. For the state revenue from interest fluctuated or rather declined, and general services (and lotteries) declined, social and community services also declined. Economic services showed some increase. Thus in terms of structure and performance, the State's non-tax revenues do not seem to have done well. In fact Kerala's performance has been rather poor in ONTR as compared to the all-States average.

2.88 The poor picture is also seen in the case of the share of central taxes and grants; Kerala's share has been less than all-States average. And as shown earlier the resource transfer from this source to Kerala is also declining overtime. It is obvious that the State of Kerala has no direct control in augmenting the flow of NTR from the Centre; it has to manage with its own tax revenue (OTR) and non-tax revenue (NTR) sources. Clearly, there is some leeway to mobilise resources from ONTR by expanding the avenues and raising the rates, of user charges, which of course is a difficult choice from political view point. And probably, the scope for using OTR is limited, as saturation level revenue mobilisation has already reached in the major sources. The analysis thus implicitly suggests the limited potential of revenue augmentation leaving the reliance of expenditure compression to maintain fiscal stability.

Table 2.24 **:**
Changing Structure of State Revenues

Year	State's Own tax		State's Own Non tax		State's OwnTax Revenue+State's Own Non-Tax Revenue		Share in Central Taxes		Grants from Centre		Revenue Transfers from Centre		Total Revenue	
	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States
1990-91	55.8		8.7		64.5		20.2		15.3		35.5		100	
1991-92	58.7		8.2		66.9		20.2		12.9		33.1		100	
1992-93	56.9	43.8	8.4	14.1	65.3	57.9	20.7	22.6	14.0	19.5	34.7	42.1	100	100
1993-94	58.9	44.0	8.1	14.7	67.0	58.7	18.9	21.2	14.1	20.1	33.0	41.3	100	100
1994-95	60.0	45.6	8.5	17.7	68.5	63.3	18.0	20.4	13.6	16.4	31.5	36.7	100	100
1995-96	62.4	46.7	9.9	16.7	72.2	63.4	19.1	21.2	8.6	15.3	27.8	36.6	100	100
1996-97	63.4	12.0	8.4	25.4	71.8	37.3	20.2	37.7	8.0	24.9	28.2	62.7	100	100
1997-98	63.2	48.0	7.6	13.7	70.8	61.7	18.4	22.6	10.8	15.6	29.2	38.3	100	100
1998-99	64.6	50.4	7.7	13.7	72.3	64.1	19.2	22.3	8.5	13.5	27.7	35.9	100	100
1999-00	65.4	49.5	6.7	14.4	72.1	63.9	19.3	21.3	8.6	14.8	27.9	36.1	100	100
2000-01	67.2	49.6	7.5	13.2	74.8	62.8	18.2	21.3	7.1	15.9	25.2	37.2	100	100
2001-02	65.2	50.1	6.5	12.6	71.7	62.7	17.6	20.4	10.7	16.9	28.3	37.3	100	100
2002-03	68.8	50.7	6.4	12.8	75.2	63.5	16.0	20.2	8.8	16.3	24.8	36.5	100	100
2003-04	68.5	51.0	6.8	12.2	75.4	63.2	17.0	21.2	7.7	15.7	24.6	36.8	100	100
1990-91 to 1995-96	58.8	45.0	8.6	15.8	67.4	60.8	19.5	21.3	13.1	17.8	32.6	39.2	100.0	100.0
1996-97 to 1999-00	64.2	40.0	7.6	16.8	71.8	56.8	19.3	26.0	9.0	17.2	28.2	43.2	100.0	100.0
2000-01 to 2003-04	67.4	50.3	6.8	12.7	74.2	63.0	17.2	20.8	8.6	16.2	25.8	37.0	100.0	100.0

Source:RBI, Handbook of Statistics on State Govt. finances, 2004

Table 2.25

Share of components of own tax revenue in Kerala

		1990-91	1991-92	1992-93	1993 94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
1	Taxes on Income (Agricultural Income Tax)	1.8	2.1	0.7	0.9	0.6	0.8	0.3	0.5	0.6	0.3	0.1	0.0	0.0	0.0
2	Property and Capital transactions (i to iii)	10.2	10.0	11.1	11.0	11.6	11.4	10.0	8.2	7.5	6.4	6.9	7.9	8.0	7.9
(i)	Land Revenue	0.8	0.7	0.6	0.8	0.8	0.7	0.6	0.5	0.7	0.7	0.7	0.6	0.6	0.5
(ii)	Stamps and Registration fees	9.1	9.1	10.0	9.8	10.6	10.5	9.2	7.4	6.5	5.4	5.8	6.7	6.9	7.0
(iii)	Urban Immovable Property	0.3	0.2	0.4	0.4	0.3	0.2	0.2	0.3	0.3	0.4	0.4	0.6	0.4	0.4
3	Taxes on commodities and services (i to vii)	88.0	87.9	88.3	88.1	87.8	87.8	89.6	91.3	91.9	93.3	93.0	92.1	92.0	92.1
(i)	Sales Tax (a to f)	67.0	67.0	69.2	65.4	66.6	67.6	71.1	68.5	72.4	74.2	74.0	75.0	72.9	73.9
	a) State Sales Tax	59.7	61.1	64.3	58.7	60.3	58.4	66.7	64.7	66.5	68.4	67.7	70.3	67.3	67.3
	b) Central Sales Tax	7.2	5.9	4.8	5.5	5.8	4.9	4.3	3.6	5.9	5.5	6.1	4.4	5.4	6.3
	c) Surcharge on Sales Tax	0.0		0.0	0.0								0.0		
	d) Other Receipts	0.0	0.0	0.0	1.3	0.5	4.2	0.1	0.2	0.0	0.2	0.3	0.3	0.3	0.3
(ii)	State Excise	13.1	12.6	11.8	14.1	12.6	13.3	10.7	12.1	11.4	11.4	11.7	9.1	8.8	9.2
(iii)	Taxes on Vehicles	5.5	5.7	5.9	6.4	6.6	6.6	6.4	6.7	7.0	7.3	6.7	7.6	7.0	6.7
(iv)	Taxes and Duties on Electricity	2.3	2.5	1.2	1.9	1.8	0.2	1.2	3.7	0.8	0.1	0.3	0.1	3.0	2.0
(v)	Other Taxes and Duties	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2
	State’s own Tax Revenue(1to3)	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Source:RBI, Handbook of Statistics on State Govt. finances, 2004

Table: 2.26

Share of Own Non-Tax Revenue in Total Revenue

	1990-91 to 1999-00		2000-01 to 2003-04		1990-91 to 2003-04	
	Kerala	All States	Kerala	All States	Kerala	All States
State's own Non-Tax Revenue (1 to 6)	7.11	13.73	5.04	10.50	6.56	12.79
Interest Receipts	0.76	4.21	0.26	2.94	0.62	3.82
Dividends and Profits	0.09	0.07	0.07	0.06	0.08	0.07
General Services	2.27	3.16	1.91	2.67	2.17	2.99
which: State lotteries	1.48	1.48	1.07	1.59	1.38	1.49
Social Services (i to viii)	0.86	0.74	0.69	0.81	0.82	0.75
Education, Sports, Art and Culture	0.46	0.21	0.41	0.22	0.45	0.21
Medical, Public Health and Family Welfare	0.28	0.23	0.20	0.20	0.26	0.22
	0.02	0.05	0.02	0.05	0.02	0.05
Urban Development	0.04	0.05	0.01	0.04	0.03	0.04
Labour and Employment	0.04	0.05	0.04	0.04	0.04	0.04
Social Security and Welfare	0.01	0.07	0.00	0.06	0.01	0.07
Water Supply and Sanitation	0.01	0.10	0.01	0.10	0.01	0.10
Others	0.01	0.11	0.01	0.10	0.01	0.11
Fiscal Services		0.00		0.00		0.00
Economic Services (i to xvii)	3.13	5.47	2.11	4.01	2.86	5.10
Crop Husbandry	0.17	0.12	0.14	0.08	0.16	0.11
Animal Husbandry	0.07	0.03	0.05	0.02	0.06	0.03
Fisheries	0.03	0.02	0.01	0.02	0.02	0.02
Forestry and Wildlife	1.93	1.14	1.20	0.50	1.73	0.97
Plantations		0.00		0.00		0.00
Co-operation	0.21	0.10	0.18	0.08	0.20	0.10
Other Agricultural Programmes	0.00	0.03	0.00	0.02	0.00	0.03
Major and Medium Irrigation projects	0.05	0.28	0.03	0.25	0.04	0.28
Minor Irrigations	0.02	0.06	0.01	0.03	0.01	0.05
Power		0.28		0.27		0.28
Petroleum		0.21		0.17		0.20
Village and Small Industries	0.04	0.06	0.02	0.02	0.04	0.05
Industries@	0.17	2.04	0.16	1.67	0.16	1.95
Ports and Light Houses	0.02	0.01	0.01	0.02	0.02	0.01
Road Transport		0.32		0.21		0.29
Tourism	0.04	0.01	0.01	0.01	0.03	0.01
Others*	0.40	0.75	0.29	0.49	0.37	0.68

Source:RBI, Handbook of Statistics on State Govt. finances, 2004

2.89 Indeed it can be argued that the revenue raising capacity of a state is to be seen in relation to GSDP at factor cost, as there is a positive correlation between the per capita GSDP and tax revenues. We therefore turn to analyse the trend in the revenue in relation to GSDP since the nineties. This is all the more important because Kerala economy is seen to have witnessed a remarkable recovery from the stagnation of the earlier decade and is now moving on a higher growth trajectory.

11. Tax-Effort (Tax-GSDP ratios)

2.90 We have traced trends in the value of each revenue components as a proportion to the GSDP (Tax-GSDP ratio) of Kerala in the table 27.

2.91 It is seen that State's own tax revenue has been more or less stable within the range of 8 and 9 per cent of the GSDP. The share of own non-tax revenue/GSDP ratio is negligible and is declining. The ratios of grants and share in taxes from the centre to the States GSDP have declined. Total revenue receipts as a proportion of GSDP has decreased from 15 per cent in1990-91 to 13 percent in 2000- 03. On the whole, the picture emerging from the trends in revenues when related to the State's GSDP is more or less the same as the one presented in the earlier section.

2.92 Thus it is to the credit of the State that it has maintained its own tax/GSDP ratio (and this is higher than for most states) but to its discredit that the ratio of own non-tax/GSDP ratio has declined. It seems much remains to be done in respect non-tax revenue.

2.93 A clearer picture of the relationship between revenue and GSDP can be expected to emerge from the analysis of tax buoyancy (i.e., the ratio of growth of tax revenue and growth of SDP, (R.P.Nair, 2005)) of own tax revenue and its different components.

Table 2.27
Trends in current revenue - Kerala

Year	State's Own tax /GSDP	State's Own Non tax/ GSDP	State's Own Tax Revenue+ State's Own Non-Tax Revenue/ GSDP	Share in Central Taxes/ GSDP	Grants from Centre/ GSDP	l Revenue Transfers from Centre/ GSDP	Total Revenue /GSDP	Revenue Expendi ture/ GSDP
1990-91	8.13	1.27	9.40	2.95	2.23	5.18	14.58	17.14
1991-92	8.17	1.15	9.31	2.81	1.79	4.60	13.92	15.69
1992-93	8.09	1.20	9.29	2.95	2.00	4.94	14.24	15.68
1993-94	8.91	1.23	10.13	2.85	1.91	4.76	14.90	16.31
1994-95	8.78	1.24	10.02	2.63	1.98	4.61	14.64	15.89
1995-96	8.73	1.38	10.11	2.68	1.21	3.88	13.99	15.03
1996-97	8.77	1.16	9.92	2.79	1.10	3.90	13.82	15.27
1997-98	9.10	1.12	10.21	2.57	1.60	4.17	14.38	16.65
1998-99	8.27	0.99	9.26	2.46	1.08	3.54	12.80	16.41

1999-00	8.31	0.85	9.16	2.46	1.09	3.55	12.70	18.50
2000-01	8.41	0.94	9.36	2.27	0.88	3.16	12.51	17.02
2001-02	8.20	0.75	8.95	2.22	1.35	3.56	12.52	16.12
2002-03	9.05	0.84	9.89	2.11	1.16	3.27	13.15	18.25
2003-04	8.98	0.89	9.87	2.22	1.01	3.23	13.10	17.18

Source: CMIE Public Finance various issues

12. Tax Buoyancy

2.94 Tax buoyancies estimated for the period 1990-91 to 2003-04 are recorded in the table 28. The tax-buoyancy is greater than unity for the State's sales tax as well as for taxes on vehicles. However, the buoyancy is less than one (0.72) for non-tax revenues.

2.95 In analysing the tax-buoyancy of taxes in Kerala it is useful to recall here that according to the TFCR the ratio of the own tax/GSDP, which is quite high for the State, has slightly declined from 8.45 per cent in 1993-96 to 8.11 per cent in 2000-03. The tax buoyancy for the period 1993-2003 is estimated as 0.946 (TFCR p44) implying a fall in the tax/GSDP ratio over time. To quote another major study (Mohan and Shyjan, 2005)

Table 2.28:
Tax Buoyancy

	Regression coefficient*	t value	R^2
Tax Revenue	0.9769	47.2903	0.9947
State's own tax revenue	1.0275	43.3246	0.9936
Tax on property and capital transactions	0.7364	8.8133	0.8662
Sales tax revenue	1.1037	81.9271	0.9982
State's sales tax revenue	1.1104	74.8458	0.9979
Taxes on vehicles	1.1843	37.0117	0.9913
Excise duties	0.8019	12.4363	0.9280
Agri. Income tax	-1.3231**	-3.7328	0.5373
Non-tax revenue	0.6094	13.1553	0.9352
State's Own non-tax revenue	0.7238	11.5126	0.9170

*Coefficient for all (except agricultural come) are significant at 1 per cent level

** Significant at 5 per cent level.

Source: CMIE Public Finance, various issues in this area, "The relationship between the growth rates of tax revenue and SDP an indicator of tax effort shows that the increases in SDP has not been acting as an increasing resource base for the government (pp.10). In other words, though tax/SDP ratio has risen, it has increased at a decreasing rate in the 1990s. If this decrease in rate of increase continues it can lead to a fall in tax/SDP ratio in future. The Twelfth Finance Commission while prescribing normative buoyancy rates for States has fixed a higher rate of 1.30 for Kerala compared to many other states. Higher normative buoyancy is fixed when the tax/SDP ratio needs to rise more when per capita SDP is high. The Twelfth Finance Commission considers this necessary if the tax/SDP ratio should not fall in future.

2.96 One important point to be taken note of in this context is that in the own tax revenue, the largest source has been the sales tax. The VAT has replaced this with effect from 1st April 2005. Initial reports on the operation of this tax tend to suggest that tax revenue is declining. This may not pose a problem in the immediate future since the Centre has agreed to make good any losses on this account to the tune of 100 cent in the early years and reducing the support gradually. However, some scholars (Bagchi, 2005) have pointed a more important point that the act of agreeing to the list of commodities to be brought under the specified rate category can have serious implications for fiscal autonomy of the States. The power to set the level of taxes suited to each region has been lost in the process although the fixing of a floor rate helps to avoid unhealthy competition across states.

2.97 On the issue of the relationship between the tax and GSDP and the expectation of a growing resource base and increasing revenues with the high economic growth rate since the nineties in Kerala, a study (Mohan and Shyajan, 2005) GSDP, has opined that "it is during the period when SDP has grown faster…that the ratio of growth of own tax revenue and growth of SDP has fallen." (PP. 11). The explanation provided by the study is that under the Indian Constitution States can tax the sale of commodities and not the services except a few ones like electricity duty, entertainment tax etc. Thus, Kerala is constitutionally barred from taxing the fastest growing sector of its economy viz., the tertiary sector. We share the view that the pattern of growth of the economy has been such that the State of Kerala is having sectors and sub-sectors, which grow fast, but are out of its tax-net, and thus the faster economic growth will not act as a resource base.

2.98 Two inferences then follow from the viewpoint of augmenting tax-revenues of the State in order to reduce the fiscal deficit and to maintain the fiscal stability in Kerala. One, the process of economic growth has to revitalize the productive sectors of the State's economy. It is imperative for Kerala to expand the commodity sectors of the economy and highlight the dangers of the concentration of growth in any one sector as against a balanced growth of the economy with inter-sectoral linkages. Two, apart from reforming the existing tax administration and tapping the present taxes in a better way, the taxing powers of the State has to be enlarged to capture the faster growing service (tertiary) sector of the economy. This inference is valid for other States as well. Thus viewed, the fiscal stability of the States especially of Kerala calls for a restructuring of the Centre-State fiscal relations.

These are some fundamental structural issues and perhaps require long time to settle. Meanwhile, the State has to manage its expenditure on general administration (including periodic pay and pension revisions), economic services and social sector welfare measures etc., in such a way that the State budget should not have revenue deficit and its fiscal deficit is restricted to 2 per cent by 2007 in terms of the Fiscal Responsibility Act of 2003. Will this be feasible in practice? To put in another way, if it is to be made feasible, then the Government to be concerned with expenditure compression and cautious in shouldering the burden of the resources required for such policies as the revision of pay and pension. :

13. Debt Situation in Kerala

2.99 No study on the finances of the state would be complete without an understanding of the debt position of the state and its sustainability. It is the totality of the state's spending and the resource mobilisation that gets reflected in a state's level of debt and its sustainability. This has also implications on the future growth of the economy. Particularly in the context of the state committing itself to bringing down the fiscal deficit/GSDP ratio to 2 per cent in 2007, an understanding of the debt position of the state is necessary for drawing up a strategy for corrective action.

2.100 While a detailed analysis of the debt position of the state is outside the purview of this study it is important to highlight the gravity of the situation faced by the state in this regard. We therefore give a quick overview of the debt position of the state. The table 29 shows that debt as a proportion of GSDP increased from 27 per cent in 1990-91 to 42 per cent in 2003-04. According to TFCR, outstanding debt of Kerala as a percentage of GSDP was much higher than the average for all states. Again as seen from the table there is a rising share of the high cost loans in the borrowings of the state such as loans from provident funds, savings deposits, non-market loans etc which is increasing from 27 per cent in 1990-91 to 32 per cent in 2003-04. Loans from the centre on the other hand have declined from 49 per cent to 20 per cent over the period. The share of internal debt has also increased from 25 per cent to 38 per cent.

Table 2.29:

Trend and composition of debt in Kerala.

	Internal proportion of Total Debt	Loans from centre Govt. as proportion of Total Debt	Provident Fund as proportion of Total Debt	Total Debt as (%) of GSDP
1990-91	24.76	48.76	26.47	26.95
1991-92	25.49	46.91	27.61	25.33
1992-93	26.32	46.08	27.60	25.33
1993-94	24.10	43.26	32.64	27.35
1994-95	23.57	42.24	34.19	27.67
1995-96	24.58	41.91	33.51	27.51
1996-97	26.01	40.39	33.60	25.69
1997-98	27.86	38.78	33.36	26.01
1998-99	28.18	35.97	35.85	27.91
99-2000	28.42	29.26	42.32	32.27
2000-01	31.89	25.51	42.60	34.28
2001-02	34.66	23.55	41.79	37.25
2002-03	37.82	22.35	36.37	38.42
2003-04	37.65	20.02	32.33	41.53

Source: RBI op. cit

2.101 Over and above this, outstanding guarantees of the state have sharply increased most of which is bound to devolve on the state. The state has been guaranteeing the loans of the public sector. In the case of default by borrowing units the obligations will devolve on the state. Given the state of the public sector units and the experience on this account these guaranteed amounts are likely to add to the state's liabilities. The increase in the amounts is clear from the Table 30 from Rs. 2374 crores in 1990-91 to Rs14922 crores in 2002-03. The high level of the ratio of amount outstanding to amount guaranteed reflects the poor repayments to the states. It is heartening to note that the State has enacted the Kerala ceiling on Government Guarantees Act 2003 to curtail this practice. As per ceiling, the outstanding government guarantees as on the first day of April of any year shall not exceed Rs.14,000 crores.

2.102 We have earlier seen that in relative terms interest payments / revenue receipts for Kerala stands higher than All States average. The gravity of the matter can be better understood from the grouping of the state by the TFCR according to levels of debt. It is important to note that in the context of grouping states by sustainable levels of debt the

Table 2.30

Outstanding guarantees of the state. (Rs. In crores)

Year	Max. amount Guaranteed	Amount Outstanding	Ratio
1	***2***	***3***	***4=3*100/2***
1990-91	2373.69	1405.26	59.20
1991-92	2833.1	1744.43	61.57
1992-93	2732.51	2295.73	84.02
1993-94	3680.76	2319.99	63.03
1994-95	4407.14	3228.64	73.26
1995-96	5167.48	2082.32	40.30
1996-97	5867.82	1948.97	33.21
1997-98	6656.89	3292.29	49.46
1998-99	9078.16	5112.96	56.32
1999-00	11431.59	7952.24	69.56
2000-01	12797.8	9553.17	74.65
2001-02	14122.46	11817.53	83.68
2002-03	14922.61	12623.38	84.59

Source: Finance Department, Govt. of Kerala
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EFCR had suggested that the proportion of interest payments to revenue receipts should be below 18 per cent (including tax devolution and grants). Kerala falls in the category (22 per cent-28 per cent) clearly showing that we have reached unsustainable levels of debts. This is potent with dangerous signals for the solvency of the states itself unless corrective measures are taken. Solvency of the state is critical since henceforth the state is expected to approach the market for borrowings.

IV. Forecast of Receipts and Expenditure of the government.

2.103 We have made an attempt towards forecasting the receipts and expenditure of the State government till 2010 by fit6ting an exponential function of time to the trends in the period since mid eighties. Of the alternative methods used for exponential smoothing, the best fit was obtained from using Brown's Linear Exponential Smoothing. It is seen in the figures 2 to 4 that the actual and predicted values are more or less same. One advantage of Brown's smoothing model is its emphasis on the non-stationery character. The function used for forecasting takes the following mathematical form:

$$\hat{Y}(t) = 2Y(t-1) - Y(t-2) - 2(1-\alpha)e(t-1) + ((1-\alpha)^2 e(t-2))$$

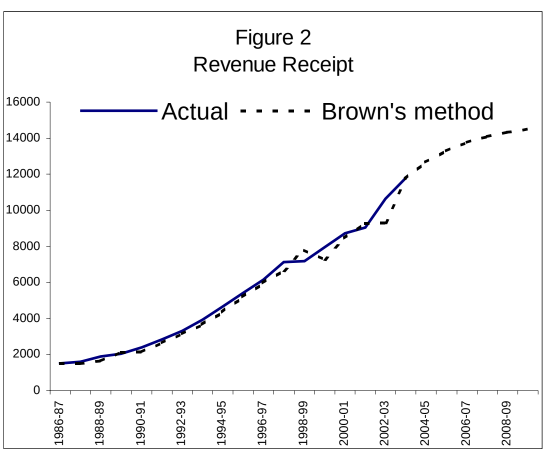
In this equation alpha denote a smoothing constant (a number between 0 and 1) and it controls the closeness of the interpolated value to the most recent observation. We have fixed alpha as 0.85, which has given the best fit.

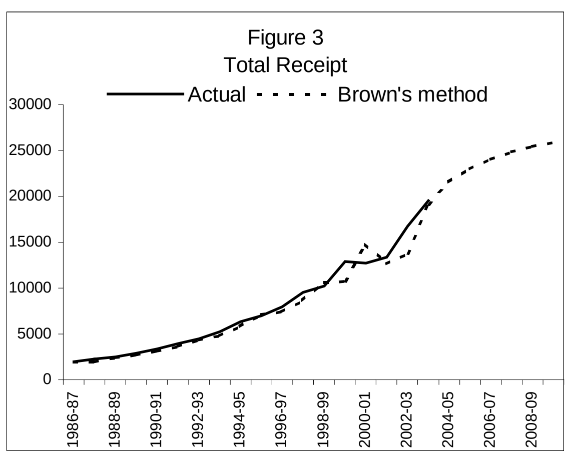
2.104 The forecast values of revenue receipts, capital receipts, total receipts and total expenditure until 2010 are recorded in the table 31

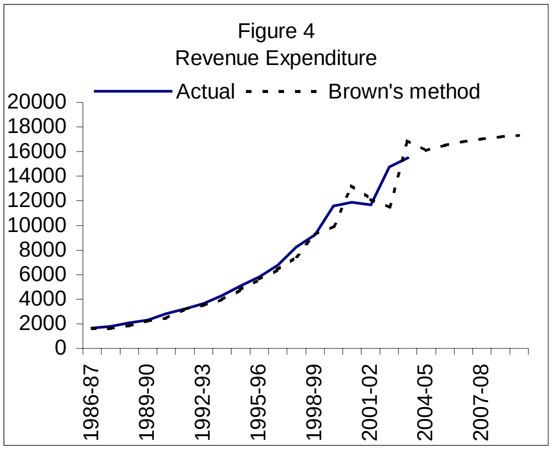
Table 31
Forecast of Revenues and Expenditures (2004-05 to 2009-10)

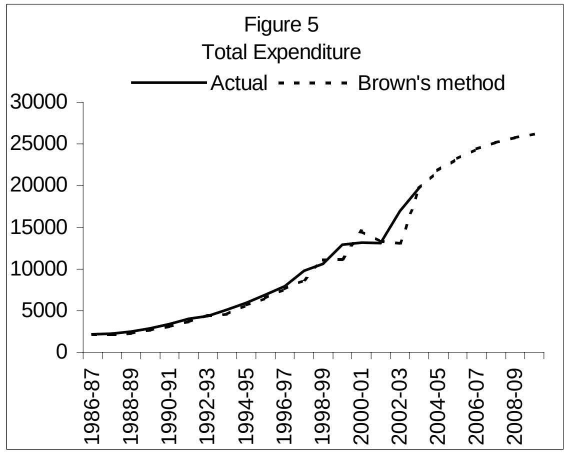
Year	Revenue Receipt	Revenue Expenditure	Total Receipt	Total Expenditure	Revenue Surplus/ Deficit	Budgetary Surplus/ Deficit
2004-05	12677	16084	21544	21817	-3406	-272
2005-06	13307	16512	23018	23313	-3204	-295
2006-07	13768	16824	24095	24407	-3057	-312
2007-08	14104	17053	24882	25206	-2949	-324
2008-09	14350	17220	25457	25790	-2870	-333
2009-10	14530	17342	25878	26217	-2812	-339

Source: RBI









2.105 It seems that given the present trend, the revenue deficit in 2010 is unlikely to be zero. The overall budgetary position is likely to remain a deficit even in 2010. Clearly, the exercise on forecasting does not present a promising picture. Contrarily, the exercise draw the contours of the financial constraints for planning any substantial increase in the government expenditure on account of the revision of pay and pensions of the employees of the government and aided-institutions and other items of general administration unless there is a drastic compression in the expenditure on social welfare measures, which has been at the heart of Kerala's much acclaimed development experience. Will not a drastic cut in the government's expenditure on welfare and social security measures to finance substantial addition to the general administration expenditure on account of the revision of pay and pensions of the government employees reduce the social welfare? This is the critical question that evades a definite answer! With this observation we close the study by highlighting the major findings on the trends in GSDP and government finances in Kerala during the post-liberalisation (reform) period and indicate their constraining implications on raising government's non-development expenditure by way of revision of pay & allowance and pensions of employees of government and aided institutions.

V. Highlights of the Study Findings and their Implication on Pay Revision.

2.106 To highlight the major findings, the study shows that Kerala State has recorded a higher growth-rate in GSDP since the nineties as compared to earlier decades of seventies and eighties after the country opted for market-oriented economic reforms. The State can claim to have achieved remarkable recovery in economic growth and placed on a high growth trajectory, though the growth record is not very high and above the all-India average. Further, the trend of high growth has not been sustained in the current decade. The finding on the growth recovery of the macro-economy of Kerala has important implication on the State's capacity to raise revenue and expenditure. With the high growth rate in the economy it is logical to assume that the State government can mobilise additional revenues from expanded tax-base and increase its expenditure including on account of the revision of salary and pensions payments to its employees without fiscal stress. However, the study underlines a word of caution as the expectation of a rise in resource base leading to higher revenues in Kerala may not be realised despite its high economic growth for the reasons that (1) the trend of high growth record in Kerala is accounted by the fast growth of a single activity sector viz., tertiary (service) sector, and (2) under the existing Constitutional provisions a State government has no power to tax the service sector.

2.107 The study finds that the fiscal health of the State of Kerala is deteriorating over time with the trend of increasing non-developmental revenue expenditure. As the revenues are growing at a rate lower than the expenditure, government budgets invariably get into a vortex of deficit and in particular, revenue-deficit and fiscal deficit. It is seen that the Kerala's revenue deficit has been relatively higher and growing faster than the all-States average with the result that borrowing is resorted increasingly to finance revenue expenditure. The trend of increased borrowing has meant increasing burden of debt servicing which in turn raises the revenue-deficit and forces further debt. The government finance in the State is thus seen to be in a vicious circle of "deficit-debt-deficit" in the sense that unbridled non-development revenue expenditure forces government to have deficit in budget which in turn leads it to go in for more borrowing and debt, the servicing of which requires more debt and leads to larger deficit. One policy option to get out of the vicious circle of "deficit-debt-deficit" is expenditure compression, which but puts constraints on the government to opt for hefty revision of salary, pensions and other benefits to the employees.

2.108 There is no suggestion in the study to the effect that the revision of pay at the present juncture is not justified. On the contrary, there are some findings in the study that support the salary revision of the employees of government and aided institutions. Although the popular perception is to regard the rate of increase in salary as eating up the lion's share of the revenue and pushing the government finance into fiscal crises, there is no clear empirical evidence to support the above perception. True, the aggregate amount of interest, salary and pensions constitutes the major component of government's revenue expenditure and eats up the bulk of revenue. But more importantly, the trend is for the rate of increase on salary to decrease over time. Besides, the rate of salary per employee (wage-rate) is lower in Kerala as compared to all States average. The study shows that the expenditure on the salary component has declined and has even reached the level prescribed by the TFC that is, the total salary bill relative to revenue expenditure net of interest payments and pensions does not exceed 35 per cent. In Kerala the relevant ratio is 33 per cent in 2003-04. The study also shows that the rate of inflation (though it has declined over time to a single digit) is higher in Kerala as compared to all India. These and similar findings of the study provide the rationale for an increase in the wages and salaries of government employees through appropriate revisions of the existing scales of pay.

2.109 However, the process of salary revision is bound to raise government's non-development expenditure. Pensions are bound to increase for some time to come given the rising trend in ageing population. Many findings of the study tend to suggest that any substantial increase in the aggregate wage-bill as a result of pay revision has the risk of enlarging the deficit, both revenue deficit and fiscal deficit, in view of the limited potential for resource mobilisation through additional taxation. If that takes place, the prevailing tendency of allocating borrowings to non-development revenue expenditure will take ugly shapes at the cost of the fiscal health of the State. And more significantly, the increased expenditure on account of increased wage bill will put a break to the development activities and thus slow down the rate of growth of the economy.

2.110 The rising revenue deficits and the high cost of loans will aggravate the situation. This has to be corrected. This becomes all the more relevant in the context of the State having reached unsustainable levels of debt. What is required is to reduce wasteful expenditure and find ways and means for reducing the fiscal stress of major elements in revenue expenditure.

2.111 The thrust of the findings is to rely upon expenditure management for reducing the fiscal stress. The State has started on a programme of fiscal correction and enacted the fiscal responsibility legislation and several steps have been taken to contain the situation. The pension reform, a near freeze on new employment, the setting up of public expenditure committee, the passing of the guarantees Act limiting outstanding guarantees, the setting up of the electricity regulatory authority are all expected to show up favourable impact on government finances of the state in future.

2.112 The alternative policy option is to enhance resource mobilisation. The study, however, does not see any encouraging sign now or prospects for it in future. Contrarily, the study uncovers some discouraging trends. A saturation level seems to have reached to the State's own-tax revenue sources. The major source of tax revenue has been the sales tax, which now is replaced by VAT. The implications of VAT on revenues are yet to be known. Overall, tax-effort of the State has been more intense than the all-States average. And tax-buoyancy has been greater than unity. However, the bright shades of this aspect are gradually deteriorating. Tax buoyancy is now less than one. The increase in revenue is at a decreasing rate. Besides, the resource-transfer from the Centre both in terms of share in taxes and grants is growing at a decreasing rate. The State has not been getting its due share from the Awards of the Finance Commissions. The potential for mobilising additional resources is thus not very bright.

2.113 The findings of the study do not suggest that there is no room for improvement in resource mobilisation. There are leakage and inefficiencies in the revenue collection, which, if corrected by improving the administrative efficiency, can be utilised to augment resource mobilisation. Besides, given the political will, there is scope to tap the State's own non-tax revenue sources which by far has remained relatively under utilised as compared to all-States average. This involves improving efficiency of public sector investment and introduction of user charges for government's economic and social services without adversely affecting the welfare of the poorer sections. of the society. With pro-active policies, the private sector can be attracted to increase investment and commodity production and exchange, which also help expand the tax base and raise additional resource mobilisation to meet government's increased spending including on wages and salary bill.

2.114 Another interesting finding is that the State's commitment to reducing the revenue deficit to nil and the Fiscal Deficit/GSDP ratio to 2 per cent in 2007 cannot be that easily tackled. It can be argued that rigid limits to fiscal and revenue deficits particularly through sharp cutting down of expenditure, and particularly capital expenditure, can cause slumps and lead to high levels of unemployment and levels of economic activity well below potential. Decline in capital expenditure can also affect debt sustainability since the latter depends upon the relation between interest rate and anticipated return from public investment. Given the very low levels of capital expenditure in the economy this needs to be urgently stepped up.

2.115 More importantly, the State has to take measures to reduce the interest and debt burden. Efforts should be made to get as much advantage as possible from the debt swap scheme. This helps to change the composition and maturity profile of the debt, though not the overall stock of debt. It is important that the State takes advantage of the centre's scheme of debt waivers and write off. This however is linked to the absolute amount by which the revenue deficit is reduced in each successive year over the entire period. Perhaps, a fund for redemption of debt could be thought of. It must be recognised that reducing fiscal deficit without the Debt/GSDP ratio declining has no meaning; they have to be addressed together (Rangarajan.2005)

2.116 As for the overall implication of the study's findings on salary revision, the findings may appear to have contradictory implications. On the one side, there is justification for the employees to demand revision of their scale of pay and emoluments. And the revision is needed to provide incentive to improve the efficiency of administration and also to compensate for the relatively higher inflation rate in the State. And, if the macro economy has improved its growth performance, some credit should be given to the employees of government as well. Clearly, therefore, there is rationale for revision of scales of pay and emoluments of government employees. On the other hand, any substantial rise in the non-development expenditure on account of salary revision is not only infeasible without adding the States' debt burden but also has the potential danger of turning to be suicidal to the development activities and the pace of economic growth. An optimal solution has to be found to resolve the contradictions. Perhaps, the option lies in the revision of scales of pay accompanied by restructuring and rationalisation of posts and positions in such a way that the aggregate wage-bill of pay-revision does not impose heavy burden on the non-development revenue expenditure of the State government and put a brake to the development activities and pace of economic growth. Indeed, enhanced pay scale with a rationalised structure of posts also goes well with the ongoing efforts towards the introduction of e-governance in the State.
