KERALA
PUBLIC EXPENDITURE
REVIEW COMMITTEE

SECOND COMMITTEE

FIRST REPORT(2007-08)

DECEMBER 2008

Finance Department

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[Constituted as per Gazette Notification No. 441/08/Fin dated 30-09-2008 (S.R.O. No. 1023/2008) as prescribed under Section 6 of the Kerala Fiscal Responsibility Act, 2003(29 of 2003)]

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Foreword

This is the First Report of the Second Public Expenditure Review Committee (PERC) constituted by Government of Kerala under section 6 of the Kerala Fiscal Responsibility Act of 2003 (Act 29 of 2003). The Committee started functioning with the first meeting held at Thiruvananthapuram on 31st October, 2008. However the audited Finance Accounts for 2007- 08, certified by the Comptroller & Auditor General of India, was made available to the Committee only by the last week of November, 2008 after it was presented to the State Legislature on 25th November 2008. As such the Committee could finalise the Report only on 31st December, 2008. This Report contains our views and recommendations for the year 2007-08.

The Committee met several times at Thiruvananthapuram before finalising this Report and also had detailed discussions with senior officials, among others, in the Departments of Finance, Local Self Government, Industries and Public Works. We wish to place on record a special word of thanks to Sri. K.V.Rabindran Nair, former Chief Secretary, Sri K. Jose Cyriac, former Additional Chief Secretary (who was in charge of Finance Department during 2007- 08) and now Additional Secretary, Ministry of Finance, Government of India, Sri. L. C. Goyal, Principal Secretary (Finance), Sri. S.M. Vijayanand, Principal Secretary (LSG), Sri. Anand Kumar, Secretary (Finance Resources) and Sri. T.K. Manojkumar, Secretary (Expenditure) for the co-operation in discussing with the Committee a number of issues dealt with in this Report.

In addition, the Committee would like to place on record its appreciation of the support and co-operation extended by Sri. L.C. Goyal, Principal Secretary (Finance) for its smooth functioning.

Sri. R. Venkitaramanan, Secretary to the Committee, besides taking care of the logistics, was closely associated with it in providing the relevant inputs as well as in preparing the draft of the Report for discussion and finalisation.

Dr. Pinaki Chakraborty
Member

Dr. K.P. Kannan
Member

Dr K.K Subrahmanian
Chairman

Thiruvananthapuram
31, December, 2008

1. INTRODUCTION

1.1 The Kerala Fiscal Responsibility Act of 2003 requires constitution of Public Expenditure Review Committee (PERC). The term of the Committee is for a period of two years from the date of appointment. The first PERC was constituted by the Government of Kerala on 25th November, 2005 in exercise of the powers conferred by Section 6 of the Kerala Fiscal Responsibility Act, 2003. The Second Committee was appointed on 30th September, 2008 and Gazette Notification issued on 3rd October, 2008. It is required to submit to the Government of Kerala a review report in November every year on the fiscal performance of the State during the previous year. This is the First Report of the second PERC. Since the appointment of the Committee was notified in October 2008 the Report could be finalised only in December 2008.

1.2 The first PERC in its Third Report had recommended extension of the period prescribed for submission of the Report from November to December every year in view of the delay in obtaining the audited accounts of the Comptroller and Auditor General. In view of the time lag between certification of accounts by the C&AG and the actual availability of the Finance Accounts for reference we recommend that this period may be extended to January of every year. The Committee also finds that though the Reports of the PERC are laid before the Legislative Assembly no further action is seen taken by the Government on the various recommendations of the Committee. Hence we recommend that necessary amendments may be made to the KFR Act/Rules prescribing tabling of the Reports of the Committee before the Legislative Assembly along with an Action Taken Report.

1.3 The Committee found that there was no single location in the Finance Department to collect various data required for preparing the Report. For instance, the department had to collect details of user charges from various Administrative and Line Departments. An ICT based system of information and networking in respect of many fiscal variables is required in the Finance Department. It is therefore recommended to establish an MIS located in the Finance Department for collection, processing and updating of all valuable fiscal variables. Such a system, the Committee believes, will be useful for efficient analysis of issues from time to time and for formulating appropriate policies.

1.4 This Report has 7 sections. In Section 2 we give an overview of the finances of the State of Kerala in recent years and the fiscal imbalance profile of the State and assess the State's fiscal performance for the year 2007-08 vis-à-vis earlier years. In section 3, we discuss the profile of revenue receipts and recent tax reform measures introduced by the Government. Broad trends and specific issues related to expenditure are discussed in Section 4. Debt Profile of the State is examined in Section 5. Some issues that we consider complex in nature, which are involved in the fiscal management of State finances, are analysed in section 6. A summary of findings and recommendations are given in section 7.

2. OVERVIEW OF STATE FINANCES AND FISCAL IMBALANCE

2.1 Kerala's fiscal profile shown in Table 2.1 can broadly be characterized as an improvement in revenue earnings by the State and also containment of revenue expenditures in recent years. However, as evident from the above mentioned Table, revenue expenditure to GSDP ratio has increased from 15.69 to 16.76 per cent between 2006-07 and 2007-08. The revenue receipts to GSDP ratio also has increased by 0.51 percentage point during the same period. There has been a significant step up in capital expenditure from 0.89 per cent of GSDP to 1.56 percent between 2006-07 and 2007-08 due to the increase in capital outlay and also due to the significant jump in net lending.

2.2 Based on the movement of the revenue and expenditure profiles of the State, it may be inferred that despite increase in revenues in relation to GSDP, faster increase in expenditure has resulted in an increase in fiscal imbalances in the year 2007-08. As evident from the Table 2.1, revenue deficit, fiscal deficit and the primary deficit in the year 2007-08 have shown an increase compared to 2006-07. This is primarily due to the full impact of implementation of the Pay Commission Award, clearance of arrears of contractors' bills and significant increase in development spending through higher capital expenditure.

2.3 However, it is important to note that the quality of fiscal deficit has also improved in the year 2007-08 compared to 2006-07. In the year 2006-07, revenue deficit was 69 per cent of fiscal deficit, which has declined to 62 per cent in 2007-08. In other words, the revenue expenditure intensity of the fiscal deficit has declined in the year 2007-08. If we compare intertemporally, the share of revenue deficit in total fiscal deficit continuously declined from 82.5 to 62 per cent between 2002-03 and 2007-08. In other words, there has been a continuous decline in the share of revenue deficit in total fiscal deficit. However, high revenue deficit still remains a major concern for the State of Kerala and requires attention so that the capital expenditure can be increased in the medium term.

2.4 The Medium Term Fiscal Plan of 2008-09 set the target year of elimination of revenue deficit as 2010-11 with heavy emphasis on additional revenue mobilization. As per the MTFP—2008-09, the aggregate revenue to GSDP ratio is expected to increase to 16.5 per cent of GSDP by the end of 2010-11 i.e., an increase of around 1.5 percentage point of GSDP from the present level and lot would depend on State's Own Tax effort as well as the quantum of Central transfers. Given the global financial meltdown and its impact on slowing down of growth in the economy, sluggishness in revenue growth is an expected outcome. If that happens, it may not be possible to mobilize additional resources to the order of 1.5 per cent of GSDP by the State in the medium term and in that case, the revenue deficit elimination may not be possible by 2010-11 unless there is substantial increase in Central transfers or a drastic cut in revenue expenditure. But one also needs to see what kind of rationalization of expenditure is possible so that expenditure efficiency is improved and unit cost of providing various public services comes down.

Table 2.1: Overview of State Finances and Fiscal Imbalances (In Rs. crore)

	2002-03	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*2008-09 BE*
1. Revenue Receipts	10637	11815	13500	15295	18187	21107	24935.72
2. Revenue Expenditure	14756	15496	17169	18424	20825	24892	28302.77
Interest Payment	2947	3328	3613	3799	4190	4330	5144.08
3. Capital Expenditure	872	1859	783	1053	1186	2315	2258.61
4. Capital Outlay	699	640	682	817	903	1475	1561.93
5. Net Lending	173	1219	101	236	283	840	696.68
6. Revenue Deficit	4119	3681	3669	3129	2638	3785	3367.04
7. Fiscal Deficit	4991	5540	4452	4182	3824	6100	5625.65
8. Primary Deficit	2044	2212	839	383	-366	1770	481.57
As per cent to GDP							
Revenue Receipts	12.33	12.31	12.61	12.85	13.70	14.21	15.04
Revenue Expenditure	17.10	16.14	16.04	15.48	15.69	16.76	17.08
Capital Expenditure	1.01	1.94	0.73	0.88	0.89	1.56	1.36
Capital Outlay	0.81	0.67	0.64	0.69	0.68	0.99	0.94
Net Lending	0.20	1.27	0.09	0.20	0.21	0.57	0.42
Revenue Deficit	4.77	3.83	3.43	2.63	1.99	2.55	2.03
Fiscal Deficit	5.78	5.77	4.16	3.51	2.88	4.11	3.40
Primary Deficit	2.37	2.30	0.78	0.32	-0.28	1.19	0.29

2.5 If we look at the year to year differences and the deviation of both actual revenues and expenditures vis-à-vis budget estimates of 2007-08, few important points emerge. On the revenue side, in the year 2007-08, even though the actual revenue mobilization has been marginally lower than the BE of 2007-08, aggregate revenues have shown a positive increase and this trend in increase in revenue mobilization is observed since 2004-05 with a significant increase in 2006-07. The increase in the revenue mobilization in the year 2007-08 compared to 2006-07 is 0.51 percentage point of GSDP.

2.6 Although the revenue expenditure has shown a contraction up to 2005-06, it has shown a positive increase in 2006-07 and 2007-08. However, if we compare the actual revenue expenditure of 2007-08 vis-à-vis its budget estimates, the contraction in revenue expenditure is to the order of 1.22 percentage points to GSDP. There has been a marginal increase in the capital expenditure compared to the budget estimates. In turn there has been a significant decline in the revenue deficits, fiscal deficits and primary deficits of the State compared to its budget estimates of 2007-08. So if we evaluate the fiscal performance of the Government for the fiscal year 2007-08, vis-à-vis its own budget estimates, the year of 2007-08 can be termed as a year of fiscal correction in the State towards improving the fiscal imbalance profile and also the quality of fiscal deficits. However, the State remains far from its own set deadlines of eliminating revenue deficits.

2.7 The Medium Term Fiscal Plan of the Government of Kerala for the year 2008-09 clearly mentions that the instruments of adjustment will be the revenue side of the State budget, not the cut in development spending. Thus, achieving these targets would primarily depend on how the revenues and expenditure profile of the State would behave given the overall lowering of growth prospects globally as well as in India and also in Kerala. Also, fiscal conservatism at the given point of time may be detrimental to growth in face of falling aggregate demand. However, it needs to be emphasized that the scope of a State Government in pulling up aggregate demand in the given context of macroeconomic crisis is limited because of their restricted borrowing power and very little independent tax handle within the overall inter-Governmental fiscal arrangements and Centre-State fiscal relations. However limited the scope is, if the crisis deepens and its adverse impact is equally felt in India, a State like Kerala may have to have a fiscal expansion to protect itself from the shock of the crisis. But the State needs to be careful, so that long run fiscal sustainability of State finances is not violated.

Table 2.2: Key Fiscal Indicators: Year -Wise Differences as Per cent of GSDP								
	03-04A/ 02-03A	*\04-05A/ 03-04A*	*05-06A/ 04-05A*	*06-07A/ 05-06A*	*07-08A/ 06-07A/*	*07-08A 07-08BE*	*08-09BE/ 07-08A*	*07-08 actual as % to BE*
Revenue Receipts	-0.02	0.30	0.24	0.85	0.51	-0.23	0.83	0.98
Revenue Expenditure	-0.96	-0.10	-0.56	0.21	1.08	-1.22	0.32	0.93
Capital Expenditure	0.93	-1.20	0.15	0.01	0.67	0.09	-0.19	1.06
Capital Outlay	-0.14	-0.03	0.05	-0.01	0.31	0.10	-0.05	1.12
Net Lending	1.07	-1.18	0.10	0.01	0.35	-0.01	-0.14	0.98
Revenue Deficit	-0.94	-0.41	-0.80	-0.64	0.56	-0.99	-0.51	0.72
Fiscal Deficit	-0.01	-1.61	-0.64	-0.63	1.23	-0.89	-0.71	0.82
Primary Deficit	-0.07	-1.52	-0.46	-0.60	1.47	-0.59	-0.90	0.67

3. REVENUE PROFILE

3.1 In this section, we discuss in detail the revenue profile of the State with special focus on the fiscal year 2007-08. As the major source of revenues at the State level is VAT, we will focus how the VAT has performed in the State since its introduction in 2005. Also it needs to be highlighted that improvements in all State fiscal situation has been contributed by the buoyant Central transfers especially due to the buoyant growth of Central revenues in a high growth phase of Indian economy. We need to see to what extent the State of Kerala has been benefited in this process.

3.2 As evident from Table 3.1, the revenue growth is periodized between pre-FRA and FRA period. In the pre-FRA period, growth of aggregate revenue was 10.2 per cent, Own Tax Revenue growth was 12.0 per cent, own non-tax revenue growth was 8.5 per cent and growth in Central transfers was 6.2 percent. If we compare this with the post FRA period, the growth of revenues has been significantly higher than the pre-FRA period. This is not to say that FRA has acted as an incentive or as hard budget constraints for higher revenue mobilization. Instead it also needs to be kept in mind that the period of 2003-04 to 2007-08 is a phase of high growth at the All India macro level and also for the State of Kerala, which definitely had a positive influence on revenues.

3.3 Although, there has been a downward adjustment in the National GDP growth rate in 2007-08 at 8.7 per cent, the Kerala economy has shown a higher growth rate in that year. If we compare the Kerala GSDP growth rate with the national GDP, it is evident that Kerala economy is fast catching up. In real term, the GSDP of Kerala has grown at the rate of 6.77 per cent during the first half of decade of 2000, while the national economy has grown at the rate of 6.9 per cent. Kerala‘s GSDP growth in real term has increased further during the last two years. Sustained high growth in Kerala has contributed to the increase in real per-capita income of the State. The State economy is projected to grow at the rate of 11.9 percent in nominal terms during 2007-08, i.e., a real growth of more than 8 per cent. In other words, it is now certain that the average annual growth rate of the State economy will be more than 8 per cent during the 10th period. This phase of high growth must have contributed positively to the revenue mobilization of the State and the reverse may happen if growth slows down.

3.4 Also various tax reform measures, especially introduction of VAT has contributed positively to the revenues. Even though the Own Tax Revenue growth during the post FRA period is more than 14 per cent compared to pre-FRA period of 12 per cent, it needs to be highlighted that Own Tax Revenues have increased by 18.3 per cent between 2006-07 and 2007-08. This has happened primarily due to the introduction of VAT and various other tax reform measures introduced by the Government to check tax evasion/avoidance and also by providing incentives and campaign for payment of taxes in taxable purchases and sales in the State. The comparatively better performance of Kerala in tax effort in recent years is due to a series of measures taken by the Government especially in the area of sales tax and VAT. The measures taken to mobilize additional resources from VAT can be elaborated under the following heads: (a) Human Resource Development (b) Improving the Physical Infrastructure (c) Promoting Tax Compliance Culture (d) Rationalization and Simplification and (e) Measures to Arrest Tax Evasion. The details of each of these measures are given in Box 1.

BOX-1: MEASURES TO IMPROVE VAT COLLECTION IN THE STATE

(a) Human Resource Development

As part of the implementation of VAT, the State of Kerala invested in human resource development and physical infrastructure. Intensive training on VAT Laws and Procedure was imparted to officers at all levels. Special efforts have been made to impart computer training to officers and supporting staff.

(b) Improving the Physical Infrastructure

Investments have been made to improve the physical infrastructure. Sales tax complexes have been established in districts where the offices were functioning in rented premises. Three computer centres have been established with 25 computers in Thiruvananthapuram, Kochi and Kozhikkode. The Commercial Taxes Department has added to its vehicle fleet and this has considerably strengthened the intelligence work.

(c) Promoting Tax Compliance Culture

An emerging pattern in tax compliance the world over is the emphasis laid on voluntary tax compliance. In order to inculcate a habit of collecting sales bills while making purchases, the Commercial Taxes Department introduced Lucky VAT Scheme for the first time in the country. Schemes have been introduced to reward exemplary tax compliance behavior by giving awards to traders. It is proposed that honest dealers who comply with the procedures and formalities will be provided green channel facilities at the check-posts.

(d) Rationalization and Simplification

Measures have been taken to rationalize and simplify the procedures and formalities. Interest relief scheme, one time settlement, e-filing of returns, simplified procedure for registration are some of these measures. In order to complete the pending assessments under KGST, special adalaths have been organized.

(e) Measures to Arrest Evasion

An effective measure to arrest tax evasion is the single most important step towards additional resource mobilization. A major initiative in this direction was the Walayar Campaign. Social audit programme by eminent persons along with stake holders at Walayar was an important step towards eradication of corruption. Through the Walayar to Ernakulam Campaign, the declarations submitted at the check-posts are being processed properly and used as a tool for detecting tax evasion. More and more tax evasion prone commodities have been brought under the tax net by including those commodities in the notified goods list. Special efforts are now being taken to prevent tax evasion through railways. As part of this initiative, it is proposed to reward officers who detect evasion and penalize the offenders

Table 3.1: Revenue Receipts (Rs. in crore)

Revenue Receipts	*Pre-FRA Period*					*FRA Period*								*Average annual*
	Annual				*Average annual*	*Annual*					*Average annual*			
	1999-00	*2000-01*	*2001-02*	*2002-03*	*2000-03*	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*2003-07*	*2007-08BE*	*2008-09 BE*	*2003-08*
Total Revenue Receipts	7944	8731	9056	10637		11815	13500	15295	18187	21107		21446	24935.72	
Growth rate		9.9	3.7	17.5	10.2	11.1	14.3	13.3	18.9	16.1	15.7	17.9	18.1	12.7
TRR/GSDP	12.7	12.5	12.5	13.2		13.1	13.5	13.8	13.7	14.2		14.6	15.1	
Buoyancy		0.9	1.0	1.5	1.1	1.0	1.3	1.2	1.0	1.4	1.2	1.7	1.6	1.0
State's Own Taxes	5194	5870	5923	7303		8089	8964	9779	11942	13669		13790	15780.85	
Growth Rate		13.0	0.9	23.3	12.0	10.8	10.8	9.1	22.1	14.5	14.3	15.5	15.4	14.3
Own taxes/GSDP	8.3	8.4	8.2	9.0		9.0	8.9	8.8	9.0	9.2		9.4	9.6	
Buoyancy		1.1	0.2	2.0	1.3	0.9	1.0	0.8	1.2	1.2	1.0	1.4	1.4	1.1
State's Non Tax	533	659	543	681		807	819	937	938	1210		1133	1293.55	
Growth Rate		23.7	-17.6	25.4	8.5	18.5	1.5	14.4	0.1	29.0	9.9	20.8	6.9	8.9
Own Non-tax/GSDP		0.9	0.8	0.8		0.9	0.8	0.8	0.7	0.8		0.8	0.8	
Buoyancy		2.0	-4.7	2.2	1.0	1.6	0.1	1.3	0.0	2.4	0.7	1.9	0.6	0.7
Central Transfers	2218	2202	2590	2654		2920	3718	4579	5307	6229		6523	7861.32	
Growth Rate		-0.7	17.6	2.5	6.2	10.0	27.3	23.2	15.9	17.4	20.6	22.9	26.2	22.3
GSDP	62520	69770	72349	80844		90172	100327	111633	132739	148485		147000	165000	
Growth rate		11.6	3.7	11.7	8.9	11.5	11.3	11.3	18.9	11.9	13.6	10.7	11.1	13.0

3.5 The other major source of revenues in the State is stamp duty and registration fees. Its share in the total tax revenue has increased three fold between 1999-2000 and 2007-08. There are many factors that have contributed to this increase, especially the boom in housing sector in Kerala. However, it needs to be highlighted that there is a scope for rationalization of stamp duty with simultaneous fixation of fair value of land. Kerala has one of the highest stamp duty rates among the States in India, which requires to be brought down so that it helps broadening the base and thereby revenues.

3.6 The growth of Central transfers to Kerala has also been buoyant during recent years. If we look at the year wise growth rates of Central devolution to the State, it has increased sharply during the post-FRA period compared to the pre-FRA period and has been particularly buoyant during the year 2004-05 and 2005-06. However, compared to 2004-05 and 2005-06, the growth in Central devolution has been much lower at around 16 per cent during the last two years and even lower than the average rates of growth for the period between 2003-04 and 2007-08. This implies that improvement in the overall revenue situation in the State is primarily due to the increase in the State's Own Tax Revenues.

3.7 Now if we look at the structure of the Own Tax Revenues (Table 3.2), the share of VAT/Sales tax in total taxes has declined from 74 per cent in 1999-00 to 68 per cent in 2007-08 with a corresponding increase in the share of stamp duty and registration fees. The share of motor vehicle taxes has declined marginally over the years. If look at the buoyancy, VAT and stamp duty have been particularly buoyant in recent years including 2007-08. The expected revenue buoyancy in the year 2008-09 (BE) would be 1.35. The own tax to GSDP ratio, which was 8.35 per cent of GSDP for the period between 2002-03 and 2004-05 increased to 9 per cent in 2006-07 and thereafter in 2007-08 to 9.21 percent is expected to be more than 9.5 per cent as per the BE of 2008-09. Considering the limited scope for expenditure compression, the State has to maintain this upward growth in realisation of taxes. It is essential for Government to design a Management Information System in the Commercial Taxes Department for collecting commodity wise information of collectable taxes. This will help Government in estimating the leakages and to take appropriate corrective measures to check tax evasion.

Table 3.2: Structure of Own Tax Revenues (Rs. Crore)							
	1999-00	*2002-03*	*2003-04*	*2004-05*	*2006-07*	*2007-08*	*2008-09 BE*
a. Sales Tax	3854	5343	5991	6701	8563	9372	10616
b. Excise Duty	591	663	656	746	953	1169	1300
c. Motor Vehicle Tax	381	513	586	610	708	853	1009
d. Stamp Duty and Regn. Charges	280	487	550	775	1520	2028	2421
e. Electricity Duty	3	193	190	10	32	32	136
f. Others	85	104	116	121	166	214	299
Total (In Rs. Crore)	5194	7303	8089	8964	11942	13669	15781
Structure of Own Tax							
a. Sales Tax	74.2	73.2	74.1	74.8	71.7	68.6	67.3
b. Excise Duty	11.4	9.1	8.1	8.3	8.0	8.6	8.2
c. Motor Vehicle Tax	7.3	7.0	7.2	6.8	5.9	6.2	6.4
d. Stamp Duty & Regn. Charges	5.4	6.7	6.8	8.6	12.7	14.8	15.3
e. Electricity Duty	0.1	2.6	2.3	0.1	0.3	0.2	0.9
f. Others	1.6	1.4	1.4	1.3	1.4	1.6	1.9
Total	100	100	100	100	100	100	100
Growth of Own Taxes (% PA)	13.03	23.28	10.82	9.10	22.12	14.46	15.45
Own Tax to GSDP Ratio	8.41	8.46	8.37	8.22	9.00	9.21	9.54
Yearly Buoyancy of Taxes	1.12	1.21	0.94	0.82	1.92	1.22	1.358.8

3.8 When we look at the structure of the Non-Tax Revenues, it comes predominantly from the forest and lottery[1] and also recoveries from various publicly provided services. Between 1999-00 and 2008-09, the contribution of lottery has increased sharply from 18.9 to 26.9 percent on gross basis. The net contribution of lottery is also given in Table 3.3 and the net contribution is much lower than the gross and on an average it is almost one-tenth of the gross contribution. Non-Tax Revenue remains one of the major problem areas in the context of resource mobilization. The revenue mobilization from various non-tax sources is abysmally low and requires attention for improvements. In this context, the issue of revision of user charges for various publicly provided services becomes important. The growth of Non-Tax Revenues below unity. has also shown extreme volatility over the years. The Non-Tax Revenues to GSDP ratio remained much below unit.

Table 3.3: Structure of Own Non-Tax Revenues (Rs. crore)								
	1999-00	*2002-03*	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*2008-09 BE*
a. Forests	109.88	149.57	187.18	199.69	189.63	174.56	154.45	191.21
b. Lottery (Gross)	100.82	131.69	147.80	151.38	237.28	236.15	325.26	420.00
b.1. Lottery (Net)	16.62	36.34	36.47	30.55	65.44	41.95	50.36	97.20
c. Interest Receipts	37.31	35.86	32.40	40.50	46.36	44.63	69.65	51.16
d. Education., Sports, Art & Culture	39.18	63.40	81.86	85.76	82.09	99.91	100.89	138.62
e. Other Admn Services	40.23	45.57	46.10	78.79	54.77	53.86	61.85	69.67
f. Contribn towards pension etc.	23.12	19.29	17.08	16.66	17.85	29.06	30.24	22.80
g. Medical & Public Health	18.82	28.16	27.61	27.51	29.80	32.99	36.92	42.11
h. Cooperation	23.49	24.49	27.32	29.38	35.78	35.75	36.52	43.19
i. Non-ferrous mining & inds.	14.57	18.76	18.37	21.46	25.09	28.32	32.81	37.56
j. Roads and Bridges	18.57	20.30	18.68	14.67	20.38	15.35	20.3	21.28
k. Other Genl. Economic Services	8.83	12.64	12.12	13.29	11.79	18.00	18.51	20.59
l. Others	97.95	131.53	190.46	139.99	185.96	168.99	322.15	235.36
Total Own Non-Tax Revenues	532.77	681.26	806.98	819.08	936.78	937.57	1209.55	1293.55
Structure of Own Tax Revenues								
a. Forests	20.6	22.0	23.2	24.4	20.2	18.6	12.8	14.8
b. Lottery (Gross)	18.9	19.3	18.3	18.5	25.3	25.2	26.9	32.5
c. Interest Receipts	7.0	5.3	4.0	4.9	4.9	4.8	5.8	4.0
d. Education, Sports, Art & Culture	7.4	9.3	10.1	10.5	8.8	10.7	8.3	10.7
e. Other Admn. Services	7.6	6.7	5.7	9.6	5.8	5.7	5.1	5.4
f. Contribn towards pension etc.	4.3	2.8	2.1	2.0	1.9	3.1	2.5	1.8
g. Medical and Public Health	3.5	4.1	3.4	3.4	3.2	3.5	3.1	3.3
h. Cooperation	4.4	3.6	3.4	3.6	3.8	3.8	3.0	3.3
i. Non-ferrous mining & inds.	2.7	2.8	2.3	2.6	2.7	3.0	2.7	2.9
j. Roads and Bridges	3.5	3.0	2.3	1.8	2.2	1.6	1.7	1.6
k. Other Genl. Economic Services	1.7	1.9	1.5	1.6	1.3	1.9	1.5	1.6
l. Others	18.4	19.3	23.6	17.1	19.9	18.0	26.6	18.2
Total Own Non-Tax Revenues	100	100	100	100	100	100	100	100
Growth Rate		25.37	18.45	1.50	14.37	0.08	29.01	6.94
Own non-tax/GSDP		0.8	0.8	0.8	0.8	0.7	0.8	0.8
Buoyancy		1.32	1.64	0.13	1.29	0.01	2.45	0.61

3.9 In order to look into the user charges, we further probe into the sources of user charges. As evident from the Table 3.4, the major source of user charges are Education, Health and Urban Affairs Departments and in that urban affairs department contributes almost one-third of the. User charges levied and collected by LSGs do not form part of the consolidated fund of the State. The total user charges excluding those collected by the LSGs contribute to less than 10 percent of the Non-Tax Revenues. The year wise growth of user charges has shown extreme volatility over the years (Table 3.5). The rates of various user charges have to be periodically adjusted for inflation and differential charges levied on the basis of ability to pay. At the same time it is imperative to enhance the quality of services so as to overcome resistance from the users. The Committee also recommends putting in place multiple channels for payment of various user charges by the public.

Table 3.4: Sources of User Charges & Its Structure (Per cent)

Department/Institutions	*2002-03*	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*
Education Department	23.83	32.94	37.82	20.41	31.42	26.26
Primary & Secondary Education Department	5.46	4.23	4.06	2.19	2.99	1.42
Higher Secondary Education Department	0.01	0.01	0.02	0.01	0.01	0.01
Higher Education Department	18.13	28.45	33.39	17.97	28.19	24.64
Technical Education Department	0.23	0.24	0.34	0.24	0.23	0.19
Health Department	10.31	9.24	16.16	19.00	13.20	11.63
Panchayats Department	10.35	9.93	15.05	9.93	9.67	7.60
Urban Affairs Department	44.91	36.67	4.38	39.66	33.96	30.80
Others	10.60	11.22	26.58	11.00	11.75	23.72
Total	100.00	100.00	100.00	100.00	100.00	100.00

Table 3.5: Year Wise Growth Rates of User Charges (Per cent per annum)

	2003-04	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*Trend Gr. Rate*
Education Department	52.84	—13.13	—13.28	67.92	7.32	12.79
Primary and Secondary Education Department	—14.36	—27.32	—13.21	48.37	—38.76	10.54
Higher Secondary Education Department	6.96	57.96	0.74	9.49	27.33	18.68
Higher Education Department	73.57	—11.20	—13.56	71.18	12.20	16.59
Technical Education Department	17.65	5.00	12.52	5.26	5.26	8.74
Health Department	—0.86	32.38	88.87	—24.25	13.17	19.79
Panchayat Department	6.18	14.68	5.93	6.30	0.83	7.23
Urban Affairs Department	—9.71	—90.96	1353.97	-6.58	16.43	13.95
Others	17.06	79.19	—33.49	16.47	159.25	24.84
Total	10.59	—24.34	60.66	9.09	28.41	13.674.

4. EXPENDITURE PROFILE

4.1 As mentioned earlier, the revenue expenditure tended to rise during the year 2006-07 and 2007-08 vis-à-vis earlier years. The growth of revenue expenditure was 19.5 per cent in the year 2007-08 over the previous year's growth of 13 per cent and this in turn contributed to the increase in revenue and fiscal deficit in the year 2007-08. The disaggregated profile of revenue expenditure and the growth of its various components shown in Table 4.1 reveal that the increase in the growth of revenue expenditure was primarily due to the increase in the growth of salary and pension expenditure, a common trend observed in earlier Reports of PERC as well. However, high growth in salary expenditure in recent years is not peculiar to Kerala. This is observed in many other States due to the pay revision induced increase in the salary after the implementation of the Fifth Central Pay Commission's recommendations by many States. As evident from the Table, the salary expenditure has grown at the rate of more than 17 per cent during the year 2006-07 and 2007-08. The growth of pension expenditure was 49.5 per cent in 2007-08 over the previous year. The salaries and pensions are aggregated across Government employees, staff of Government aided private educational institutions and those transferred to Local Self Governments. This rapid salary driven increase in revenue expenditure was due to the implementation of the Pay Revision award recommended by the Eighth Pay Commission of Kerala.

4.2 The other important point is that the growth of interest payment has been only 3.3 per cent in the year 2007-08 over the previous year and is the lowest ever growth during recent years. The share of interest payment in total revenue expenditure has also declined sharply from more than 20 per cent in 2006-07 to 17.4 percent in 2007-08. Although this means release of fiscal space for other expenditures, the increase in salary and pension in turn may have absorbed this fiscal space. There is another important point that emerges from the Table 4.1; although, Kerala has a very high incidence of committed expenditures, viz., interest payment, salaries and pension, the combined share of these three in total expenditure is declining over the years.

Table 4.1: Revenue Expenditure Profile (Rs. Crore)									
	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 BE
Total (In Rs. Crore)	11878	11662	14756	15496	17169	18424	20825	24892	28303
Salaries	4492	4201	4679	5147	5346	5581	6560	7693	9220
Pensions	1930	1838	2283	2409	2601	2861	3295	4925	4569
Interest	2258	2489	2947	3328	3613	3779	4190	4330	5144
Sal.+Pensions+Int.	8680	8528	9909	10884	11560	12221	14045	16948	18934
Discretionary Exp.	3198	3134	4847	4612	5609	6203	6780	7944	9369
Committed Exp. Intensity	73.1	73.1	67.2	70.2	63.4	66.3	67.4	68.1	66.9
Growth in Expenditure (percent per annum)									
Total Expenditure	2.7	—1.8	26.5	5.0	10.8	7.3	13.0	19.5	13.7
Salaries	—0.2	—6.5	11.4	10.0	3.9	4.4	17.5	17.3	19.8
Pensions	6.7	—4.8	24.2	5.5	8.0	10.0	15.2	49.5	—7.2
Interest	15.7	10.2	18.4	12.9	8.6	4.6	10.9	3.3	18.8
Discretionary Exp.	5.0	—1.8	16.2	9.8	6.2	5.7	14.9	20.7	11.7
Sal.+Pensions+Int.	5.0	—1.8	16.2	9.8	6.2	5.7	14.9	20.7	11.7
Structure of Expenditure (in per cent)									
Total Expenditure	100	100	100	100	100	100	100	100	100
Salaries	37.8	36.0	31.7	33.2	31.1	30.3	31.5	30.9	32.6
Pensions	16.2	15.8	15.5	15.5	15.1	15.5	15.8	19.8	16.1
Interest	19.0	21.3	20.0	21.5	21.0	20.5	20.1	17.4	18.2
Sal.+Pensions+Int.	73.1	73.1	67.2	70.2	67.3	66.3	67.4	68.1	66.9
Discretionary Exp.	26.9	26.9	32.8	29.8	32.7	33.7	32.6	31.9	33.1

4.3 As salary and pension expenditure together constituted on an average around 50 per cent of the total revenue expenditure and the salary expenditure constituting more than one-third of the revenue expenditure, it is important to contain the aggregate growth of these two components so that more resources could be released for the provision of various public services. However, it is important to understand that given Kerala's pro-social sector fiscal policy stance, especially added emphasis on public provisioning of health and education, any cut in salary expenditure must be calibrated in such a way that, it does not adversely affect the provisioning of these services as salary is the major input component for these services.

4.4 The other issue in the expenditure side of the budget is the increase in capital expenditure of the State in recent years and especially during 2007-08. One needs to explore a bit more to examine the nature of the increase and the changing structure of various components of capital expenditure to understand what has accounted for this increase. We examine this looking into both capital outlay and net lending separately. As evident from Table 4.2, more than half of the total capital outlay is accounted for 'Roads and Bridges' with 52 per cent of the total allocation, followed by telecommunication and industries with 9.4 per cent and major and medium irrigation with 8.62 per cent. The rest of the capital outlay is spent under various other heads and major departments among them are public works, education, medical and public health, welfare of SC/ST/OBCs etc. If we look at the growth of the sectoral capital spending, it varies from 68.17 percent in tourism to as high as 16878.99 per cent in co-operation. The overall growth in capital outlay in 2007-08 over 2006-07 was 63.37 per cent.

Table 4.2: Major Head wise Capital Outlay Structure: 2006-07 and 2007-08

	2006-07 (Rs. Lakh)	*% Distribution*	*2007-08 (Rs. Lakh)*	*% Distribution*	*% change over previous year*
Public Works	3920.47	4.34	5706.03	3.87	45.54
Education, Sports Art and Culture	3628.04	4.02	3422.81	2.32	—5.66
Medical and Public Health	2986.06	3.31	4665.03	3.16	56.23
Housing	303.82	0.34	894.43	0.61	194.39
Welfare of SCs, STs and OBCs	2941.65	3.26	3761.54	2.55	27.87
Soil and Water Conservation	1586.52	1.76	1000.14	0.68	—36.96
Fisheries	2401.31	2.66	2730.62	1.85	13.71
Forestry and Wildlife	457.31	0.51	1101.24	0.75	140.81
Food, Storage and Warehousing	1090.26	1.21	2098.77	1.42	92.50
Co-operation	16.85	0.02	2860.96	1.94	*16878.99
Major and Medium Irrigation	11928.30	13.22	12704.34	8.62	6.51
Capital Outlay on Minor Irrigation	646.60	0.72	1605.25	1.09	148.26
Flood Control Projects	1201.88	1.33	4177.66	2.83	247.59
Telecommunications and Electronic Industries	3571.59	3.96	13882.00	9.41	288.68
Ports and Lighthouses	1370.24	1.52	2523.13	1.71	84.14
Roads and Bridges	39210.60	43.44	76809.05	52.09	95.89
Inland Water Transport	95.36	0.11	427.68	0.29	348.49
Other Transport Services	258.74	0.29	1974.55	1.34	663.14
Tourism	3262.95	3.62	1038.76	0.70	—68.17
Others	9379.84	10.39	4073.96	2.76	—56.57
Total	90258.40	100	147458.00	100	63.37

* *Note :* —This is due to increased NCDC assistance to primary agricultural co-operative societies through Government.

Table 4.3: Loans & Advances (Net): 2006-07 & 2007-08

	2006-07	*% Distribution*	*2007-08*	*% Distribution*	*% increase*
Loans for Social Services of which	162.58	57.39	666.04	78.51	309.67
Water Supply, Sanitation, Housing and Urban Development	155.61	54.93	666.61	78.58	328.39
Loans for Economic Services	142.41	50.27	199.12	23.47	39.82
Loans for Government Servants	—21.70	—7.66	—16.85	—1.99	—22.35
Total	283.29	100	848.31	100	199.45

4.5 As mentioned earlier, one of the major reasons for the increase in capital expenditure during 2007-08 was the increase in net lending by the State Government. Table 4.3 provides a disaggregated analysis of the pattern of net lending by the State in the year 2007-08 vis-à-vis 2006-07. As evident, there has been more than 309 per cent growth in net lending for the social services and the share of lending under social services increased from 57.9 to 78.51 per cent of total lending. This is due to the loans to Kerala Water Authority to the order of Rs. 662.18 crore for implementing JBIC assisted water supply projects.

5. DEBT MANAGEMENT

5.1 Debt as a percentage of GSDP started declining gradually from 2005-06 from a peak of 39.1 per cent in 2004-05. In 2007-08 the debt GSDP ratio declined to 37.3 per cent. The effective rates of interest on debt also declined during recent years, which in turn is reflected in lower interest payment obligations.

5.2 The composition of debt has tilted towards internal debt by increasing its share in the total debt stock to 61.4 per cent by the end of 2007-08. Within internal debt, the share of NSSF has increased from 2.8 per cent in 1999-00 to 21.6 per cent in 2007-08. The share of Central loans declined sharply from 29.3 per cent to 10 per cent during the same period. This is primarily due to the changes in the accounting classification of Small Savings to NSSF and also due to the recommendations of the Twelfth Finance Commission, according to which States need not borrow from the Centre starting from 2005-06.

Table 5.1: Debt Profile: Structure, Magnitude, Interest Rate

	1999-00	*2000-01*	*2001-02*	*2002-03*	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*2007-08*	*2008-09*
Internal Debt	5735	7627	9342	11747	17421	21676	25671	29969	34019	38590
Of which NSSF	571	1012	1475	2306	4577	7048	9698	11876	11982	14432
Loans from Centre	5903	6102	6347	6535	5628	5410.8	5417	5372	5533	5928
PF, Fixed Deposits	8538	10190	11262	12778	14403	14791	14841	14534	15858	17135
Total (Rs. Crore)	20176	23919	26951	31060	37452	41878	45929	49875	55410	61654
Structure of Debt (In Per cent)										
Internal Debt	28.4	31.9	34.7	37.8	46.5	51.8	55.9	60.1	61.4	62.6
of which NSSF	2.8	4.2	5.5	7.4	12.2	16.8	21.1	23.8	21.6	23.4
Loans from Centre	29.3	25.5	23.6	21.0	15.0	12.9	11.8	10.8	10.0	9.6
PF, Fixed Deposits	42.3	42.6	41.8	41.1	38.5	35.3	32.3	29.1	28.6	27.8
Total debt	100	100	100	100	100	100	100	100	100	100
Debt/GSDP (%)	32.3	34.3	37.3	36.0	39.0	39.1	38.6	37.6	37.3	37.3
Interest Rate(%)	10.88	10.24	9.79	10.16	9.72	9.11	8.67	8.75	8.22	8.34
GSDP	62520	69770	72349	86275	96012	107054	118998	132739	148485	165477

5.3 It is to be noted that the debt structure has to a significant extent become high cost in nature because of the high cost NSSF debt, which carries a rate of interest of 9.5 percent. The decline in average cost of State debt, as we see in recent years, would have been more had the share of NSSF borrowing been lower. As the provident fund has a high share in the total stock of debt and the interest rate is now 8 percent, this would also help in softening the average interest rate releasing resources for discretionary developmental expenditure.

Table 5.2 : Instrument Specific Rates of Interest (percent)

	2004-2005	2005-2006	2006-2007	2007-2008
Provident Fund	8.50	8.50	8.00	8.00
Market Borrowings (Average)	6.40	7.51	7.96	8.29
NABARD-RIDF	6.50	6.50	6.50	6.50
LIC	8.50	8.50	8.50	9.10
NCDC	8.50	8.50	9.12	9.75
GIC & Others	9.00	9.00	9.00	9.10
Govt. of India Loans	9.00	9.00	9.00	9.00
NSSF	9.50	9.50	9.50	9.50
Treasury Fixed Deposits (Average)	7.33	6.67	6.86	8.34
Treasury Savings Bank	5.50	4.50	4.58	5.00

5.4 The maturity period of market loans as seen in Table 5.3 reveals that although average cost of market loans is 8.1 per cent in the shorter end of the maturity, Kerala still has some high cost debt. But overall bunching securities seems to be on the longer end of the maturity profile in the year 2015-16, 2016-17, 2017-18 and 2018-19. This is indicative of the lengthening of the maturity profile of debt and is a sign of better debt management. On the other hand, the rate of interest on the lower end of the maturity period is higher than the longer end of the maturity profile. This requires correction so that average cost of debt declines further. This also indicates the fact that upon redemption of the debt with shorter maturity in 2009-10 and 2011-12 should substantially bring down the average cost of debt, provided new market loans are such that it does not distort the interest rate term structure providing higher rates of interest on shorter dated securities.

Table 5.3: Maturity Period of Market Loans (Percent)

	Maturity Period of Market Loans	*Weighted Average Rates of Interest*	*Distribution of Loans against Maturity Period*
2009-10	746	12.0	4.3
2010-11	802	11.2	4.6
2011-12	966	9.1	5.5
2012-13	1005	7.3	5.7
2013-14	1205	6.2	6.9
2014-15	1423	6.1	8.1
2015-16	2114	7.3	12.1
2016-17	2614	7.8	14.9
2017-18	4297	8.3	24.5
2018-19	2335	8.6	13.3
Total	17507	8.1	100.0

5.5 Finally, the achievement of the State in bringing down contingent liabilities has been remarkable throughout the FRA period. The statutory guarantee limit still remains at Rs.14,000 crore. The total outstanding guarantees of both principal and interest, which stood at Rs.12316 crore as on 31-3-2005 declined to Rs. 11935 crore as on 31-3-2006 and Rs. 9496 crore as on 31.3.2007. This has been further brought down to Rs. 8317 crore by the end of 2007-08.

6. SOME COMPLEX ISSUES IN FISCAL MANAGEMENT

6.1 In Kerala, the Fiscal Responsibility Act (Act of 2003) came into effect from 5th December 2003 and Kerala Fiscal Responsibility Rules were framed in 2005 for operationalisation of fiscal management principles, which *inter-alia* required revenue deficit to be brought to 'nil' and fiscal deficit to 2 per cent of GSDP by 31st March 2007. The Rules have also prescribed year-wise targets for phasing out revenue deficit and reducing fiscal deficit. The review of the situation for 2007-08 attempted in Section 2 of this Report puts the revenue deficit at 2.55 per cent of GSDP and fiscal deficit at 4.1 per cent. Looking strictly in terms of the Fiscal Responsibility Act of 2003, and Rules of 2005, there are thus clear deviations from the prescribed fiscal targets.

6.2 In the matter of sound fiscal management, the Committee is of the opinion that Kerala has to eliminate revenue deficit by introducing revenue enhancing measures and restructuring expenditures. The State, however, requires augmenting its fiscal resources through borrowing to ensure adequate rate of capital formation for achieving the desired levels of income growth though it has to be cautious not to get caught in a debt-trap. At the same time, prescribing year-by-year targets for reducing deficits is rather arbitrary and may turn to be difficult to achieve due to some complex issues involved in expenditure reduction. Obviously, the focus has to be on expenditure restructuring and improving the expenditure efficiency (quality of spending) rather than on arbitrary cuts in the levels of expenditure (spending). In this section some complex issues in fiscal management through expenditure compression is highlighted by illustrative cases relating to (a) devolution of funds to Local Self-Governments (b) impact of public sector undertakings (PSUs) on fiscal imbalance, and (c) fiscal burden of the prevailing Civil Service pension scheme.

6.3 Before examining the complex issues in expenditure management, the Committee would like to underline that the deviation of revenue deficits from targets laid down by fiscal responsibility legislation has to be evaluated in a proper perspective taking into consideration some methodological limitations of working out deficit ratios, particularly for Kerala.

6.4 The first Expenditure Review Committee's First as well as Second Reports had recommended that the Kerala Act could be amended to extend the deficit horizon as permissible under the conditionalities accompanying the interest concession and debt consolidation offer of the Twelfth Finance Commission. In the Budget Speech for 2006-07 the Finance Minister had stated that the KFR Act 2003 would be amended in line with the recommendation of the Twelfth Finance Commission. For some reason, the Act of 2003 is not yet amended on the above lines. If the Act were amended, there would be some time space to achieve the target of zero revenue deficit. The Committee therefore recommends amendment of the Fiscal Responsibility Act suitably.

6.5 The first two Reports of the first PERC had also emphasised the need for re-classification of expenditure of some departments so as to separate out the capital component from revenue expenditures. The first Committee argued that the "ultimate purpose of having separate targets for revenue and fiscal deficits in FRA legislation is to have separate controls on revenue expenditure and thereby to provide larger permissible margin for growth promoting capital expenditure" The present Committee endorses the above view and recommends the Government to re-classify the revenue and capital expenditure data and prepare adjusted revenue/capital expenditure statements to provide the right perspective for evaluating the deficit ratios - revenue deficit and fiscal deficit - in the context of Kerala. This is particularly important, when Kerala's revenue deficit ratio is very high compared to many major States in India.

A. Devolution of funds to Local Self Governments (LSGs)

6.6 The rationale of the above recommendation is illustrated here with respect to devolution of funds to Local Self-Governments for the year 2007-08. As per the Third State Finance Commission Report, each LSG is to be given a pre-determined fixed sum as devolution. This amount when aggregated is shown as the devolution of grants to LSGs under Revenue head of the State's budget as per the accounting principle adopted by Government. Thus, the fiscal devolution funds to LSGs are treated as revenue expenditure of the State Government though a good part of it is used by the LSGs for asset creation or capital expenditure. Clearly there is an over-estimation of the revenue expenditure (and hence revenue-deficit) in the State's Finance Accounts on account of the methodological complexity in the devolution of funds to LSGs. This needs to be corrected to get a proper perspective for evaluating the deviation of revenue deficit from the target prescribed by the fiscal responsibility legislation.

6.7 Information Mission for Kerala (IKM) collects, collates, codifies and put on computer the sanctioned amount for each micro-sector project of each LSG. viz., Grama Panchayat, Block Panchayat, District Panchayat, Municipality and Municipal Corporation. The Committee requested IKM for helping it with estimates of capital and revenue components of micro sector projects in aggregate. The IKM was requested to identify by looking at the nature of these micro-sector projects the sanctioned outlay that can be classified as of capital and revenue types. In the case of maintenance of roads, the expenditure excluding ordinary and special repairs was treated as capital expenditure. Components like subsidy given for construction of houses were also treated as capital expenditure. Using a computer programme, the IKM then quickly estimated the capital and revenue shares in the total project outlay and arrived at a figure of about 40 percent of State's contribution (i.e. excluding LSGs' Own Funds, and Other Funds (beneficiary contribution) etc. from the total outlay) towards micro sector projects sanctioned as revenue expenditure. (*See* Table 6.A.1)

Table: 6.A.1: % Share of States' devolution to LSGs that can be treated as revenue

LB Type	*Gen Plan*	*SCP Plan*	*TSP Plan*	*State Fund*
Block Panchayat	49.12	11.25	18.06	31.97
Municipal Corporation	34.03	15.46		29.00
District Panchayat	35.90	18.38	10.38	26.42
Grama Panchayat	57.65	18.87	16.76	44.35
Municipality	44.20	18.42	29.33	37.93
Grand Total	50.75	17.17	15.31	38.29

6.8 It would thus appear that around 40 percent of the State's devolution to LSGs should only be treated as revenue expenditure (and the balance as capital expenditure) in the readjusted estimate of the State Government's revenue expenditure. The State Government's revenue deficit in 2007-08 then would appear much less than what is estimated in Section 2 of this Report on conventional lines. In this connection it may be recalled that the Third State Finance Commission had prepared a summary financial profile, with all components of revenue as well as expenditure, of each and every LSG in the State and the voluminous data, from which these statements have been compiled, is now lying idle in the Finance Department without being put to any use. This may be computerised and updated periodically so that the real capital and revenue components in LSG accounts can be identified accurately, which would enable to understand the impact of transfers on capital expenditure at local level and its impact in improving local social and physical infrastructure and in turn on growth.

6.9 The Committee is of the view that attempts for re-adjusting the revenue expenditure by separating out capital expenditure elements from maintenance and repairs funds of the major spending departments/institutions is required to make a proper assessment of aggregate revenue deficit of the State. In particular, an exercise of the type attempted here in relation to LSGs could be carried out for P.W.D. The Committee could not get readily access to the required data on the details of maintenance expenditure enabling the separation of expenditure as capital and revenue items in the case of PWD. However discussions with officials put a conservative figure of 40 percent of the total allocation for repairs and maintenance etc. as the revenue component.

6.10 Using a thumb-rule of 40 percent as revenue component and the remaining 60 percent as capital component of the expenditure now incurred by the PWD on repairs and maintenance, and devolution to LSGs, a re-adjustment exercise can be made of the total revenue expenditure of the State Government for 2007-08 as illustrated in the Table 6A.2. Then the real revenue deficit would appear to be much less than what is worked out using conventional methodology.

Table 6.A.2: Readjusted revenue expenditure and revenue deficit for 2007-08 (Rs. crore)

Revenue Deficit	3785
Rev exp. on public works, roads and bridges	854
of which estimated capital Component	512
Devolution to Local Bodies	2099
of which estimated capital Component	1259
Adjusted RD (Percent/GSDP)	2013
RD/GSDP	2.55
Adj. RD/GSDP	1.36

6.11 The Committee recommends that a system for reclassification of expenditure as capital and revenue in respect of PWD, LSGS and similar major spending departments may be set up for a proper assessment of revenue deficit and other deficit variables and for evaluating the improvement in the quality (efficiency) of public expenditure.

6.12 From the view point of expenditure efficiency (spending quality), there is room for examining the issue of redeployment of technical staff from the State Government departments like PWD, education and health for carrying out the functions transferred to LSGs under the new dispensation of decentralisation process. The Expenditure Review Committee is informed that the plan of staff re-deployment from the State Government department (especially from Irrigation) to Panchayat Raj Institutions (PRIs) under the control of LSGs remains to be fully completed. This is a complex issue but it, however, impairs the efficiency of project completion and hence the public expenditure.

6.13 As for the personnel who have been working in the schools and other educational institutions, health centres and hospitals, and Plan projects/schemes of various types, there is the system of dual control of LSGs and Departments. This to a large extent has meant indiscipline, dereliction of duty etc. of the staff as their functional control is by the elected representative - more often less qualified than the redeployed civil servants - who have no control or even say in the salary, promotion and other benefits. The parent departments of the State Government directly control the latter aspects. The dual control is a complex issue that tends to depress the efficiency of public expenditure. It is necessary that Government takes effective steps to complete the process of staff transfer or otherwise it will impair the efficiency of administration.

6.14 At present the salary and other benefits of the redeployed staff as well as newly appointed personnel in the LSGs are fully met and directly paid by the State Government departments. The LSGs are therefore not in an effective position to exercise functional control over the personnel for completing the execution or monitoring the development projects and utilise the funds with efficiency.

6.15 The Committee feels that the Government should examine the feasibility of transferring the funds on account of salary and other service benefits of the redeployed or newly appointed personnel to the concerned LSGs, which in turn can administer the disbursal and payments to these personnel and thereby establish the psychological environment required for improved discipline and work commitment of the staff working in the institutions transferred to LSGs under the new dispensation of decentralisation. As the process of computerisation of LSGs is now complete, the administrative burden on account of this shift over should not be problematic. Of course, there is no saving to the State Government in its expenditure but there is scope for improving the overall public expenditure efficiency, which is also important as introducing measures for correcting fiscal imbalance, in the principles of fiscal management.

B. Impact of Public Sector Undertakings (PSUs) on the State's fiscal imbalance

6.16 In the context of Kerala, a State with the largest number of State Level Public Enterprises (SLPEs) in the country, concerns have been vociferously expressed about the flow of budgetary funds in the forms of grants, subscription to equity capital (investment), long-term loans, and Government guarantees to the SLPEs that generally do not pay back to the Government any substantial amount in terms of dividends. Thus the fund flow to PSUs becomes a burden on the State finances and adds to the fiscal imbalance. And various reform measures like restructuring, modernization, disinvestments, privatisation and closures have been suggested in the past. The Committee therefore decided to take stock of the flow of funds from the exchequer to the SLPEs and make an assessment of its impact on fiscal imbalance.

6.17 Today, there are 114 Public Sector Undertakings, of which 9 are statutory bodies and the remaining 105 are corporations/companies registered under Indian Companies Act. Of the 105 companies, 69 are wholly owned Government companies, 9 under joint ownership of the State and Central Government, and the remaining ones under the joint ownership of the State, Financial Institutions, Public and Foreign firms. These companies and statutory bodies are engaged in various activity sectors like infrastructure, manufacturing, traditional industries, trading, welfare of targeted groups, and public utilities. The overall performance records of these SLPEs differ by types of organisations (company vs. statutory body) and across activity sectors. A summary picture of the movement of some selected performance indicators for the last five years (latest year for which balance sheet and profit and loss accounts are made available is related to 2006-07) of Government companies and statutory bodies is presented in the Table 6.B.1.)

Table 6.B.1: A summary picture of selected performance indicators (Rs. crore)											
Year	*No.of Units*	*Paid-up capital*	*Capital invested*	*Profit making units*		*Loss making units*		*Net annual profit/loss*	*Dividend declared*		*Employ-ment No.*
				No.	*Amount*	*No.*	*Amount*		*Units*	*Amount*	
Government Companies											
2002-03	95	1441.24	4716.71	31	203.50	51	232.15	-28.65	14	6.13	53960
2003-04	95	1491.35	5790.41	38	194.56	45	244.15	-49.60	12	12.82	54625
2004-05	95	1525.72	5982.14	37	186.83	45	229.62	-42.79	14	14.07	50505
2005-06	95	1535.35	6121.62	30	215.48	51	185.68	29.80	9	6.68	51339
2006-07	96	1562.44	6149.59	48	597.79	33	640.45	518.12	13	13.27	50596
Statutory Bodies											
2002-03	9	3694.97	13043.72	2	74.48	5	267.05	-192.57			56922
2003-04	9	3864.48	13664.40	2	93.63	6	271.20	-177.56			57721
2004-05	9	4018.34	13070.67	2	103.62	5	269.05	-165.23			60751
2005-06	9	4175.22	12368.25	2	101.37	5	245.35	-143.98			60724
2006-07	9	4361.75	11715.20	2	218.33	5	-280.39	-62.06			59338
Total PSUs											
2002-03	104	5136.21	17760.43	33	269.04	56	499.20	-221.22	14	6.13	110882
2003-04	104	5355.83	19454.81	40	280.46	51	515.35	-227.16	12	12.82	112346
2004-05	104	5544.06	19052.81	39	319.10	50	498.67	-208.02	14	14.07	111256
2005-06	104	5710.57	18489.87	32	699.16	56	431.03	-114.18	9	6.68	112063
2006-07	105	5924.19	17864.79	50	218.33	38	360.06	456.06	13	13.27	109934

6.18 It appears that there has not been much addition to the equity capital of PSUs during the last five years. The tradition has been for PSUs by and large to be in red with increasing levels of annual net losses until recently. Since 2005-06, however, the performance in terms of annual profit/loss has improved with the last two years (2005-06 and 2006-07) witnessing net annual profit by the Government companies as a group. As compared to Government companies, the performance of statutory bodies has been more depressing.

6.19 It is but encouraging to note that PSUs taken together has made an investment of Rs.17864 crore and earned net annual profit of Rs. 456 crore in 2006-07. The Government companies as a group declared dividend of Rs.13 crore. Of course, Units, which declared dividend, numbered only 13 and that too confined to Government companies; none of the statutory bodies ever declared dividend during the period under review. Interestingly, the level of State Government's investment and the long-term loans in statutory bodies is quite high and much larger than in Government companies but the Government does not earn any financial return from that investment. Thus viewed, the flow of funds to PSUs (Government companies and statutory bodies) especially to the statutory bodies is a heavy burden to the State's exchequer and adds to the fiscal imbalances of the State.

6.20 The evidence is sharper when the analysis is made of the funds flow to PSUs for 2007-08 based on the relevant data from Finance Accounts (see Table 6.B.2). A total amount of Rs.1978.79 crore as on 31st March 2008 is due to Government in arrears of repayment of principal and interest from the PSUs, particularly the statutory bodies. Besides, the terms and conditions of loans aggregating Rs. 1789.89 crore, sanctioned from 1990 to 2008 have not been stipulated by Government so far. Therefore the Committee recommends that immediate steps may be taken to recover the arrears of repayment of principal and interest from the concerned PSUs. Government may also issue strict instructions to the concerned administrative department to fix the terms and conditions of all the loans sanctioned to the PSUs without delay. Fixing of the terms and conditions of the loans may be done in the same order sanctioning the loan.

Table 6.B.2 : Details of Fund Flow to PSUs (Rs. crore)						
Items	*2006-07 Accounts*		*Total*	*2007-08 Accounts*		*Total*
	Plan	*Non Plan*		*Plan*	*Non Plan*	
Grant	68.85	118.14	186.99	34.75	141.5	176.25
Share Capital	91.76	0	91.76	82.13	3.31	85.44
Loan	196.01	92.55	288.56	773.98	66.5	840.48 *
Total	356.62	210.69	567.31	890.86	211.31	1102.17

* includes loan of Rs.662.18 crore to the statutory body, Kerala Water Authority from externally funded project assistance.

6.21 It is obvious that the burden of fund-flows to PSUs arises due to their poor financial performance. Some key indicators of overall financial performance of all operating PSUs (Government companies and statutory bodies) shown in Table 6.B.3 clearly point out the dismal performance of PSUs until recently. The growth (14.5 percent) in turnover is impressive but the profitability record is poor. Overall, the PSUs taken as a whole have been operating on loses and not adding the value of net worth through reserves and surplus generation. In fact, the PSUs as a whole were marked by negative net worth, which was less than one third of the value of the paid-up capital. In 2006-07 there appeared to have taken place a change in the performance trend of the PSUs as a whole by earning a profit of Rs.456 crore.

Table 6-B.3 : Trend in Overall Performance: Some key indicators (Rs. crore)					
				3 year average	
Indicators	*2004-05*	*2005-06*	*2006-07*	*Amount*	*Growth rate (%)*
Paid up capital	5537.48	5715.78	5924.00	5725.75	3.43
Capital invested	19100.02	18701.07	17852.80	18551.30	-3.31
Capital employed	15205.39	14756.79	12725.42	14229.20	-8.36
Net worth	2490.85	2522.81	1518.92	2177.53	-19.25
Net asset	9713.25	10042.92	10744.77	10166.98	5.19
Turnover	8302.00	9282.95	10885.37	9490.11	14.54
Profit(+)/Loss(-)	-244.42	-191.78	456.06		
Net worth as % of paid-up capital	44.98	44.14	25.64		

6.22 It is instructive to note that the Government has been taking some measures for modernization and revitalisation of SLPEs and help improve the financial operation of SLPEs under the control of Industries Department.

6.23 The notable efforts made by the Industries Department included:

* Comprehensive restructuring packages as being implemented in the following PSUs.
  - Ø Kerala State Electronics Development Corporation Ltd (KSEDC).
  - Ø Steel Complex Ltd.
  - Ø Steel Industrials Kerala Ltd.
  - Ø Autokast Ltd.
  - Ø Kerala State Textile Corporation Ltd.
* Many SLPEs had availed of term loans as well as working capital loans from banks and failed to service the same promptly. That has resulted in classification of these accounts by banks as NPAs and bank operations stalled in certain cases. Due to the above, there was dearth of capital support from the FIs/Banks. To overcome this shortcoming, the Government extended budgetary assistance to conclude " One Time Settlements" with Banks / FIs in respect of some PSUs (e.g. Kerala State Detergent & Chemicals Ltd., Kerala State Electronic Development Corporation, Autokast Ltd. and Steel Complex.) during 2006-07.
* The Government identified around 20 CEOs through a transparent procedure to improve the professional management in PSUs,
* The Government, while remaining committed to keep the companies in Public Sector, has also embarked upon strategic tie-ups with the Central Government Undertakings. Steps are initiated for inter PSU tie-ups on marketing of products among themselves and strategic tie-ups with State/Central PSUs or agencies. The following are typical examples:
  - Ø Kerala State Electronics Development Corporation Ltd (KSEDC).
  - Ø TELK entered strategic tie-up with NTPC.
  - Ø Takeover of KELTEC by M/s. Brahmos, DRDA.
  - Ø Manufacture of railway wagon for Indian Railway using the facilities of SILK in Autokast & SFU, Cherthala.
  - Ø Tie-up with SAIL being worked out in Steel Complex.
  - Ø Steps are being taken for availing orders from KSEB for UEI, KEL and from Health Department of Kerala Government for KSDP.
  - Ø Availed orders from VSSC for SIFL, KELTRON units, Autokast and KAL.
  - Ø Steps are being initiated for availing work orders from Defence Department for KEL, KELTRON units and SIFL.
* The Government is exploring the possibility of merging PSUs having the same lines of business. (KSIPTC with TTP, Sitaram Textiles and TSM with KSTC).
  * Financial assistance is provided to PSUs for settlement of PF dues.
  * Initiated plan for implementation of comprehensive Capacity Building Programme in PSUs.
  * RIAB conducts a Training Need Assessment programme as part of the Capacity Building Programme in PSUs.

  Hon. Minister for Industries makes monthly review of the performance of PSUs and quarterly newsletter named "*Resurgence*" published by RIAB helps disseminating best practices.

6.24 During 2007-08, Rs. 48.53 crore was provided to PSUs under the Industries Department. Out of this, Rs. 23.72 crore was sanctioned for OTS, Rs. 15.22 crore for revival and rejuvenation and Rs. 9.59 crore for clearing the VRS dues. Around 19 companies have been assisted during 2007-08 and the assistance amounted to Rs.49.14 crore. As a result of the reform measures on the lines indicated earlier and the release of funds for modernization and rejuvenation there has been improvement in the financial performance of SLPEs. To illustrate the number of profit making units increased from 11 in 2005-06 to 23 in 2006-07 and further to 27 in 2007-08.

6.25 The profit made by these units increased from Rs. 56.38 lakh to Rs. 126.08 lakh and 122.24 lakh respectively for these years. The total of loss-making units declined from 31 to 19 and 15 during 2005-06, 2006-07 and 2007-08 with gradual reduction in quantum of loss from (-) Rs. 125.87 lakh, (-) Rs. 34.65 lakh and (-) 41.93 lakh respectively. Overall, these reform measures helped transforming net loss of (-) Rs. 69.49 lakh in 2005-06 to profit of (+) Rs. 91.43 lakh and (+) Rs. 80.31 lakh in 2006-07 and 2007-08 respectively of SLPEs under the Department of Industries.

6.26 To conclude, the fund flow to PSUs has been putting pressure on the State's fiscal imbalance essentially because of their poor financial performance though some degree of improvement is observed when reform measures for modernization, restructuring and rejuvenation are effectively introduced as illustrated by some SLPEs under the control of the Industries department. Earlier, PSU reform measures had placed greater emphasis on disinvestments, privatisation and closure of loss making units, but those measures proved infeasible and ineffective. The PER Committee feels that lessening the burden of the fund flow to PSUs by such measures as disinvestments or closure of loss making units and thereby to reduce the fiscal deficits and correct fiscal imbalance is a complex issue. For, PSUs provide employment to more than one lakh people in total. The feasible option therefore would be to take effective measures for improving the profitability and financial performance of PSUs. The PER Committee therefore recommends to get the performance of SLPEs including statutory bodies (e.g. KSRTC, KSEB, KWA) thoroughly evaluated by professional experts and get their suggestions/recommendations for improving the financial performance of PSUs keeping in perspective the political commitment on the rationale, in the Kerala context.

C. The Complex Issue of Civil Service Pension

6.27 Another complex issue, which is more severe than fund-flows to PSUs, in fiscal management from the viewpoint of reducing the revenue deficit is the increasing amount of revenue expenditure on account of civil service pension. The Committee notes that Kerala has been emphasizing the importance of universal social security schemes of various types for enhancing the welfare of the people. The variety of forms, the extensive coverage, and the larger quantum of benefits provided in Kerala make its social security/welfare experience a unique one as compared to that of other Indian States though its fiscal implications on the State's budgets are larger and more significantly increasing and thereby make the task of reducing deficits – revenue as well as fiscal – a complex issue. The Committee would like to go deep into the characteristics of various social security/welfare schemes and their fiscal implications in connection with its review of public expenditure from the viewpoint of reducing budget deficits in Kerala. Owing to shortage of time, however, a study of the complex issue of evaluating and if necessary reforming the universal social security/welfare system in Kerala is not feasible to be included in the present Report. Perhaps, the Committee would include a detailed discussion in its next Report. Nevertheless, the present Report cannot ignore the subject totally and hence it shows concerns with the increasing fiscal burden of the prevailing scheme of Civil Service Pension, which is regarded as a constituent of the Universal Social Security system.

6.28 Although the Civil Service Pension is an integral part of Universal Social Security system, the Committee recognises that the service pension differs vastly from social security in many respects. It refers to periodic money payments to a person who retires at a certain age considered as the age of disability or a phase starting the fall in the incumbents' productivity of service work. The payments are designed to meet the requirements of an individual when he is made to leave the service due to ageing. In fact it is part of a contract that an individual enters into with the employer at the time joining the service. Therefore, the employee has to receive retirement pension in one form or another. The State as an employer of the civil servants has the legal obligation to provide for pension payments to the retired civil servants and dependent family members whatever be the impact of the pension payment on its fiscal sustainability.

6.29 There are however many types of civil service pension schemes that prevail across the States in India and different countries in the world. In some cases the prevailing schemes are voluntary; in others these are mandatory. In some cases, choices are made between defined benefits Vs. defined contribution. In some cases the pension funds are managed by the private sector and in others these are publicly managed. The risks and the fiscal liability of the Government would vary with the type of scheme in vogue.

6.30 In a larger number of cases, pensions are made mandatory and re-distributive in principle and the pensioners are offered defined benefits that are largely financed on "pay-as-you-go" (PAYG) basis and are publicly managed. Kerala has been following the above mentioned PAYG Scheme, which imposes relatively higher risks and fiscal liability on the State Government as compared to other schemes or their combinations. The increasing liability of its Civil Service Pension Scheme is clearly evident from the data on the increasing outgo on account of Civil Service Pension.

6.31 As highlighted in section 3 of this Report, in 2007-08 the service pension accounted for nearly 20 percent of the total revenue expenditure in Kerala. All States average figure is reportedly below 10 per cent. More significantly, the fiscal liability has been growing at a faster rate in the recent years. During the post FRA period, the outgo on account of Civil Service Pension has been growing at an average rate of around 19 per cent per year (See the Table 6.C.1).

Table 6.C.1: Trend in the number of pensioners and expenditure on their pension

Year			*Expenditure incurred (Rs. in crore)*				
	No. of Pensioners	*% yearly change*	*Pension*	*Other Retirement Benefits*	*Family Pension*	*Total*	*% yearly change*
2000-01	339000		1444.02	308.57	176.89	1929.48	
2001-02	346500	2.21	1374.60	296.86	166.47	1837.93	-4.745
2002-03	353200	1.93	1688.43	397.59	196.88	2282.90	24.210
2003-04	358245	1.43	1787.21	410.11	211.51	2408.83	5.516
2004-05	381156	6.40	1963.89	411.97	224.91	2600.77	7.968
2005-06	398007	4.42	2219.73	396.85	244.60	2861.18	10.013
2006-07	416815	4.73	2517.89	487.50	289.19	3294.58	15.148
2007-08	441011	5.80	3783.62	737.06	403.85	4924.53	49.474

6.32 An exercise made by the Government towards giving a projection of the growth of Civil Service Pensioners revealed an alarming picture of the growing number of pensioners. (see Table 6.C.2) Naturally, with the faster rate of growth of retirement among the civil servants, the forecast of the pension benefit liability of the Government also presents an alarming situation. (see Table 6.C.3) According to Government estimates, by 2015 the pension payment to the retired civil servants is projected to be 87 per cent of the salary payments to the civil servants working in the Government then.

Table 6.C.2: Anticipated number of Retirees during 2009-10 to 2014-15

Year	*Anticipated number of retirees*
2009-10	11264
2010-11	12216
2011-12	11639
2012-13	10645
2013-14	10733
2014-15	13294

Table 6.C.3 : Forecast of Salary & Pension payment liability (Rs. in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Item	Actual	Estimate		Forecast				
Salary	7351.16	8945.65	8465.27	10178.14	9959.31	10357.16	10713.21	11085.19
Pension	4924.53	4783.02	4917.94	6540.86	6830.04	7649.63	8567.60	9595.70

6.33 The actual outgo is likely to be higher than the projected figure if Pay Commissions offer more liberal conditions of pension. To illustrate, the Government of India has recently decided, on the recommendation of the Sixth Central Pay Commission, that full pension can be sanctioned irrespective of the length of service rendered by employees, once they reach the minimum pensionable service. This means that an employee in a particular grade with just 20 years of service and another with 33 years of service will get the full pension in that grade. Moreover, instead of reckoning the average pay for the last 10 months for calculating pension, now the last pay or the former, which ever is advantageous to the pensioner, is taken into account. These modifications are likely to be adopted in Kerala also as the State generally follows the Central rules in such matters. Needless to say, this will result in further increase in pension expenditure for the State Government.

6.34 Obviously, Kerala has reached a stage when it has to take measures in the form of modifying the prevailing pension scheme in order to improve the quality of expenditure and to find the fiscal space to enhance capital investment. What are the options available to the State Government for introducing modifications or reforms to the existing pension scheme? Broadly, two approaches or a combination thereof, can be adopted. One is parametric reforms (modifications) and the other structural reforms. The latter category includes Defined Contribution Scheme (DC Pension Scheme).

6.35 The Government of India has announced the introduction of a DC scheme for new civil servants and several State Governments (including Kerala) showed willingness to that structural reform. As yet, however, Kerala has not introduced the new DC scheme in place of the old PAYG pension scheme whereas other State Governments have switched over to it. Even if the new DC Scheme is introduced for new recruits, there will not have any immediate fiscal gain, as it is a long-term (structural) reform. The concern of the Committee in this Report could therefore be confined to some parametric modification (reform) to the existing PAYG scheme managed by the Government.

6.36 The aim of parametric modifications (reforms) is to minimise the outgo or bring about savings by tinkering with some aspects of the existing pension scheme. These generally include:

- Use of longer averaging periods for calculation of pension benefits.
- Use of a lower limit for maximum amount of pension.
- Use of higher discount rate and a more realistic set of life tables to calculate the value of (commuted) pension.
- Reduction in leave encashment limit, and more importantly.
- Indexing pensions only to prices and not to real wages.

6.37 The above mentioned types of parametric reforms have been introduced in some State Governments (e.g. Karnataka and Tamilnadu) and have reduced fiscal burden of the civil service pension, although there have been protests and strikes by the pensioners and Government employees. The point for emphasis is this: even the parametric modification (reform) of tinkering with the existing PAYG Scheme is a complex issue. Therefore, the State Government should initiate steps for collection and computerisation of the relevant data and making an in-depth study of the alternative profiles of pension outgo so as to arrive at some feasible parametric modifications (reforms) in consultation with the major political parties, employees and pensioners' unions.

6.38 The Committee is of the view that the rapidly increasing outgo of civil service pension in Kerala is attributable to a number of factors among which the increase in the number of Government employees during the earlier decades, period of their services, and improvement in the life expectancy are significant ones. It follows that the age of entry into and of the retirement from the civil service are important parameters that determine the quantum of pension benefits outflow from the existing PAYG Scheme. Therefore one of the ways to minimise the fiscal liability in a somewhat longer time perspective is by allowing employees to have lengthier service and reducing the number of pensioners which in turn points, inter alias, to the inevitability of enhancing the age of superannuation in Kerala.

6.39 Due to the sporadic nature of recruitment through the Kerala Public Service Commission and the relatively high maximum age limit for first appointment in Government service, the number of employees retiring is increasing and at the same time the longevity of people is also increasing because of the high Human Development Indices the State has achieved, particularly in the health sector. But there has been no change in Government's policy of retiring employees at 55 years of age. The maximum age limit prescribed for first appointment in Government service for the general category candidates is 35 years with the usual relaxation of 5 years for SC/ST candidates and 3 years for Backward Communities. (In certain cases relaxation even up to 50 years is allowed!) Considering that life expectancy in Kerala is about 75 years now and that it can reach 80 or 85 years in another 20 years, this means that even for 10 or 15 years of service, Government will have to pay pension for double the years the employees serve it or even more. As mentioned earlier the remedy lies in giving a lengthier service period to its employees for which a two-pronged approach is necessary. First is to enhance the age of superannuation of employees and the second is to lower the age limit for initial appointment to service. These two steps can be done in a phased manner to avoid any serious hardship to candidates in general.

6.40 Kerala is the only State in India where the age of superannuation is 55 years. In Government of India it is 60 years and in most other States it is 60 or 58 years. Why should a Government retire its physically and mentally healthy, experienced employees at 55 years—an age at which they can perform their duties very efficiently—and continue to pay them pension for another 25 or 30 years for doing nothing, leaving a heavy drain on the exchequer? If we think about the reasons for Government's indecision in this crucial area it is easy to find that the hesitation is only because of a lack of political consensus on the issue. One stated reason against enhancement of retirement age is unemployment of the educated youth. Admittedly employment opportunities for the educated youth are limited in Kerala. It is also true that Government and Government agencies constitute the largest provider of employment in Kerala. However, it is also a basic fact that the Government alone simply cannot solve the problem. Here private enterprises have a much larger role to play. The State Government should be able to provide an investor friendly climate and adequate infrastructure facilities to attract private investment to the State. But that needs resources and takes time. However, the remedy to the problem of unemployment is definitely not in keeping a rather low retirement age.

6.41 The probable loss of job opportunities on account of extending retirement age is purely temporary. Once the employees reach the new retirement age there will again be vacant posts to be filled by fresh candidates. The temporary loss can easily be partly set off against those vacancies that remain unfilled due to the failure of appointing authorities to fill up all the vacancies through the PSC because of various reasons. It is a fact that despite periodic circular instructions by Government, not all appointing authorities report all vacancies promptly to PSC. In certain categories, like Drivers for instance, appointing authorities are known to prefer provisional hands to regular recruits. All such temporary hands may be replaced with regular PSC recruits. The recruitment process has also to be speeded up significantly.

6.42 Yet another step to ameliorate the situation is to create exclusive, temporary training posts for fresh entrants in service. At present in most departments fresh candidates, on advice from PSC, are directly appointed to vacant posts without any training at all. Since they do not have any previous exposure to the job they are going to do, they cannot obviously perform the duties attached to the post efficiently until, after a long time, they slowly and painfully gain experience. Instead of this, they can be first accommodated in the newly created training posts for a prescribed period during which they will undergo training in Government recognised institutions like the Institute of Management in Government. During this training period the full salary attached to the posts need not be given. Only after successful completion of training, the new recruits, now professionally trained to perform their duties, need be posted against regular vacancies in the concerned departments.

6.43 The retirement age can be enhanced to 60 years in two stages. First it may be fixed as 58 years. This has the added advantage that during this period the PSC can clear its backlog in completing the recruitment process for various posts, which is in heavy arrears now. After the new system stabilises, the retirement age can then be further enhanced to 60 years. It has to be emphasised that due to the delay of about three years in the recruitment process by the PSC, enhancement of retirement age will not cause loss of even a single job opportunity for the first three years atleast. The PSC will continue to advise candidates during this period against vacancies already reported. The impact of losing new job opportunities in later years can be absorbed to a large extent by adopting the measures outlined above. And the money thus saved can be utilised for investment in infrastructure development, which in turn will attract more private investment to the State. This alone can tackle the high unemployment problem in Kerala.

6.44 As for the second part of the remedy i.e. lowering the age limit for recruitment, naturally this should have been the first step or a simultaneous course of action along with extension of retirement age. But as stated earlier, in order to obviate any undue hardship to the job seekers the Committee suggests that this may be attempted only after completing the process of raising the superannuation age when new job opportunities will be available in full. In the normal course students complete their studies and start looking for jobs from 20 to 25 years of age. Therefore the upper age limit for applying for jobs can be reduced from the present 35 years to 33 years first, of course with the usual relaxations. The delay in the recruitment process would be drastically reduced by this time as PSC gets sufficient time to clear its entire backlog in the recruitment process. This will ensure that people get reasonably good number of chances to apply for jobs before they become overage. Later, when people are accustomed to the new arrangement, the maximum age limit can further be reduced to 30 years, with the usual relaxations.

6.45 The suggestions made in this Report on "lowering the age of entry" into and "extending the age of retirement " from the civil service are not new. In fact, the Report of the Third Administrative Reform Committee of Kerala did recommend these measures in the context of introducing personnel reforms in the State though no serious attempts were seen made towards implementing those reforms. What the PER Committee has done here is to emphasise the rationale of the same reforms from the view point of minimising the fiscal burden of the existing PAYG Pension Scheme and thereby ensure fiscal sustainability. At least, Government, which has all the relevant statistical data with it, can make a small beginning by instituting a study by an expert committee on the feasibility of reducing the age of entry and extending the age of retirement and also make recommendations based on informed discussions among the various stake holders to remove apprehensions of all sorts, as a prelude to arriving at a consensus on a matter of such great importance as phasing out revenue as well as fiscal deficits and maintaining fiscal sustainability.

7. SUMMARY AND RECOMMENDATIONS

7.1 In view of the time lag between certification of accounts by the C&AG and the actual availability of the Finance Accounts for reference, the Committee recommends that the time limit prescribed for submission of Reports to Government may be extended to January of every fiscal year, instead of November.

7.2 Though the Reports of the PERC are laid before the Legislative Assembly no further action is seen taken by the Government on the various recommendations of the Committee. Hence necessary amendment may be made to the KFR Act/Rules prescribing tabling of the Reports of the Committee before the Legislative Assembly along with an Action Taken Report.

7.3 The Committee found that there was no single location in the Finance Department to collect various data required for preparing the Report. An ICT based system of information and networking in respect of many fiscal variables is required in the Finance Department. It is therefore recommended to establish an MIS located in the Finance Department for collection, processing and updating of all valuable fiscal variables.

7.4 The movement of the revenue and expenditure profiles of the State shows that despite increase in revenues in relation to GSDP, faster increase in expenditure has resulted in an increase in fiscal imbalances in the year 2007-08.

7.5 There has been a continuous decline in the share of revenue deficit in total fiscal deficit. However, high revenue deficit still remains a major concern for the State of Kerala and requires attention so that the capital expenditure can be increased in the medium term.

7.6 If we assess the fiscal performance of the Government for the fiscal year 2007-08, vis-à-vis its own budget estimates, the year of 2007-08 can be termed as a year of fiscal correction in the State towards improving the fiscal imbalance profile and also the quality of fiscal deficits. But it needs to be emphasized that the scope of a State Government in pulling up aggregate demand in the given context of macroeconomic crisis is limited because of their restricted borrowing power and very little independent tax handle within the overall inter-Governmental fiscal arrangements and Centre-State fiscal relations. However limited the scope is, if the crisis deepens and its adverse impact is felt, Kerala may have to have a fiscal expansion policy to protect itself from the shock of the crisis. But the State needs to be careful so that long term fiscal sustainability of the State finances is not violated.

7.7 The average annual growth rate of the State economy will be more than 8 per cent during the 10th plan period. This phase of high growth must have contributed positively to the revenue mobilization of the State and the reverse may happen if growth slows down.

7.8 The comparatively better performance of Kerala in tax effort in recent years is due to a series of measures taken by the Government especially in the area of sales tax and VAT. However, it needs to be highlighted that there is a scope for rationalization of stamp duty with simultaneous fixation of fair value of land. Kerala has one of the highest stamp duty rates among the States in India.

7.9 Compared to 2004-05 and 2005-06, the growth in Central devolutions has been much lower at around 16 per cent during the last two years and even lower than the average rates of growth for the period between 2003-04 and 2007-08. This implies that improvement in the overall revenue situation in the State is primarily due to the increase in the State's Own Tax Revenues.

7.10 Considering the limited scope for expenditure compression, the State has to maintain this upward growth in realisation of taxes. It is essential for Government to design a Management Information System in the Commercial Taxes Department for collecting commoditywise information of collectable taxes. This will help Government in estimating the leakages and to take appropriate corrective measures for collection of taxes in full.

7.11 The revenue mobilization from various Non-Tax Revenue sources is abysmally low and requires attention for improvements. The rates of various user charges have to be periodically adjusted for inflation and differential charges levied on the basis of ability to pay. At the same time it is imperative to enhance the quality of services so as to overcome resistance from the users. The Committee also recommends putting in place multiple channels for payment of various user charges by the public.

7.12 As salary and pension expenditure together constitutes on an average around 50 per cent of the total revenue expenditure, with the salary expenditure alone constituting more than one-third of the revenue expenditure, it is important to contain the aggregate growth of these two components so that more resources can be released for the provision of various public services. However, it is important to understand that given Kerala's pro-social sector fiscal policy stance, especially added emphasis on public provisioning of health and education, any cut in salary expenditure must be calibrated in such a way that, it does not adversely affect the provisioning of these services as salary is the major input component for these services.

7.13 A positive development in the expenditure side of the budget is the increase in capital expenditure of the State in recent years and especially during 2007-08.

7.14 The achievement of the State in bringing down contingent liabilities has been remarkable throughout the FRA period. The statutory guarantee limit still remains at Rs.14,000 crore. The total outstanding guarantees of both principal and interest, which stood at Rs.12316 crore as on 31.3.2005 declined to Rs. 11935 crore as on 31.3 2006 and Rs.9496 crore as on 31.3.2007. This has been further brought down to Rs.8317 crore by the end of 2007-08.

7.15 The State, however, requires augmenting its fiscal resources through borrowing to ensure adequate rate of capital formation for achieving the desired levels of income growth though it has to be cautious not get caught in a debt-trap. At the same time, prescribing year-by-year targets for reducing deficits is rather arbitrary and may turn to be difficult to achieve due to some complex issues involved in expenditure reduction. Obviously, the focus has to be on expenditure restructuring and improving the expenditure efficiency (quality of spending) rather than on arbitrary cuts in the levels of expenditure (spending).

7.16 For some reason, the Fiscal Responsibility Act of 2003 is not yet amended to revise the target dates for balancing the revenue account and reducing the fiscal deficit to 3% of GSDP at the end of March 2007. If the Act were amended, there would be enough time span for achieving revenue deficit of zero. The Committee therefore recommends amendment of the Fiscal Responsibility Act suitably.

7.17 The Third State Finance Commission had compiled the summary financial profile, with all components of revenue as well as expenditure, of each and every LSG in the State and the voluminous data from which the above profile had been compiled is now lying idle in the Finance Department without being put to any use. This may be computerised and updated periodically so that the real capital and revenue components in LSG accounts can be identified accurately.

7.18 The Committee recommends that a system for reclassification of expenditure as capital and revenue and preparation of adjusted revenue/capital expenditure statements in respect of PWD, LSG and similar major spending departments may be set up for a proper assessment of revenue deficit and other deficit variables to provide the right perspective for assessing the deficit ratios - revenue deficit and fiscal deficit - and for evaluating the improvement in the quality (efficiency) of public expenditure, in the context of Kerala.

7.19 At present the salary and other benefits of the redeployed staff, as well as newly appointed personnel, to the LSGs are fully met and directly paid by the State Government Departments. The LSGs are therefore not in an effective position to exercise control over the personnel for completing the execution or monitoring the development projects and utilise the funds with efficiency.

7.20 The Committee feels that the Government should examine the feasibility of transferring the funds on account of salary and other service benefits of the redeployed or newly appointed personnel to the concerned LSGs, which in turn can administer the disbursal and payments to these personnel and thereby establish the psychological environment required for improved discipline and work commitment of the staff working in the institutions transferred to LSGs under the new dispensation of decentralisation. The process of redeployment of staff to LSGs may also be completed at the earliest.

7.21 The flow of funds to PSUs especially to the statutory bodies is a heavy burden on the State's exchequer and adds to the fiscal imbalances of the State. As compared to Government companies, the performance of statutory bodies has been more depressing. The burden of fund-flows to PSUs arises due to their poor financial performance.

7.22 The repayment of principal and interest to Government by the PSUs, particularly the statutory bodies, in respect of loans availed of by them is in heavy arrears. Besides, the terms and conditions of loans aggregating Rs. 1789.89 crore sanctioned from 1992 to 2008 have not been fixed by Government so far. Therefore the Committee recommends that immediate steps may be taken to recover the arrears of repayment of principal and interest from the concerned PSUs. Government may also issue strict instructions to the concerned administrative department to fix the terms and conditions of all the loans sanctioned to the PSUs without delay. Fixing of the terms and conditions of the loans may be done in the same order sanctioning the loan.

7.23 Since 2005-06 the performance of PSUs in terms of annual profit/loss has improved with the last two years (2005-06 and 2006-07) witnessing net annual profit by the Government companies as a group. Some degree of improvement is observed when reform measures for modernisation, restructuring and rejuvenation are effectively introduced as illustrated by some SLPEs under the control of the Industries Department. The PER Committee therefore recommends the Government to get the performance of SLPEs including statutory bodies (e.g. KSRTC, KSEB, KWA) thoroughly evaluated by professional experts and get their suggestions/ recommendations for improving the financial performance of PSUs keeping in perspective the political commitment on the rationale, in the Kerala context.

7.24 The State as an employer of the civil servants has the legal obligation to provide for pension payments to the retired civil servants and dependent family members whatever be the impact of the pension payment on its fiscal sustainability. There are however many types of civil service pension schemes that prevail across the States in India and different countries in the world. Kerala has been following the PAYG scheme, which imposes relatively higher risks and fiscal liability on the State Government as compared to other schemes or their combinations.

7.25 The increasing liability of its civil service pension scheme is clearly evident from the data on the increasing outgo on account of civil service pension. By 2015, the pension payment to the retired civil servants is projected to be nearly ninety per cent of the salary payments to the civil servants working in Government then. The actual outgo is likely to be higher than the projected figure if Pay Commissions offer more liberal conditions of pension.

7.26 `Kerala has not introduced the new DC scheme in place of the old PAYG pension scheme. Even if the new DC scheme is introduced for new recruits, there will not have any immediate fiscal gain, as it is a long-term (structural) reform. Parametric reforms have been introduced in some State Governments (e.g. Karnataka and Tamilnadu) and have reduced fiscal burden of the civil service pension. Therefore, the State Government should initiate steps for collection and computerisation of the relevant data and making an in-depth study of the alternative profiles of pension outgo so as to arrive at some feasible parametric modifications (reforms) in consultation with the major political parties and employees and pensioners' unions.

7.27 The number of employees retiring is increasing and at the same time the longevity of people is also increasing because of the high Human Development Indices the State has achieved. Government should not retire its physically and mentally healthy, experienced employees at 55 years – an age at which they can perform their duties very efficiently – and continue to pay them pension for another 25 or 30 years for doing nothing, leaving a heavy drain on the exchequer.

7.28 The remedy lies in giving a lengthier service period to its employees for which a two-pronged approach is necessary. First is to enhance the age of superannuation of employees and the second is to lower the age limit for initial appointment to service. These two steps can be done in a phased manner to avoid any serious hardship to candidates in general.

7.29 The retirement age may be enhanced from 55 to 58 years to begin with and finally to 60 years in the second step. It has to be emphasised that due to the delay of about three years in the recruitment process by the PSC, enhancement of retirement age will not cause loss of even a single job opportunity for the first three years atleast. The PSC will continue to advise candidates during this period against vacancies already reported.

7.30 The impact of enhancing retirement age on job seekers after the three year period can be lessened by creating new temporary training posts, speeding up recruitment process and enforcing reporting of all vacancies to PSC promptly.

7.31 The maximum age limit for applying for jobs can be reduced from the present 35 years to 33 years first, of course with the usual relaxations and then finally to 30 years. Since the delay in the recruitment process would be drastically reduced by this time people will get more chances to apply for jobs before they become overage.

7.32 Government may institute a study on the feasibility of reducing the age of entry into service and extending the age of retirement, to remove apprehensions of all sorts, as a prelude to arriving at a consensus.