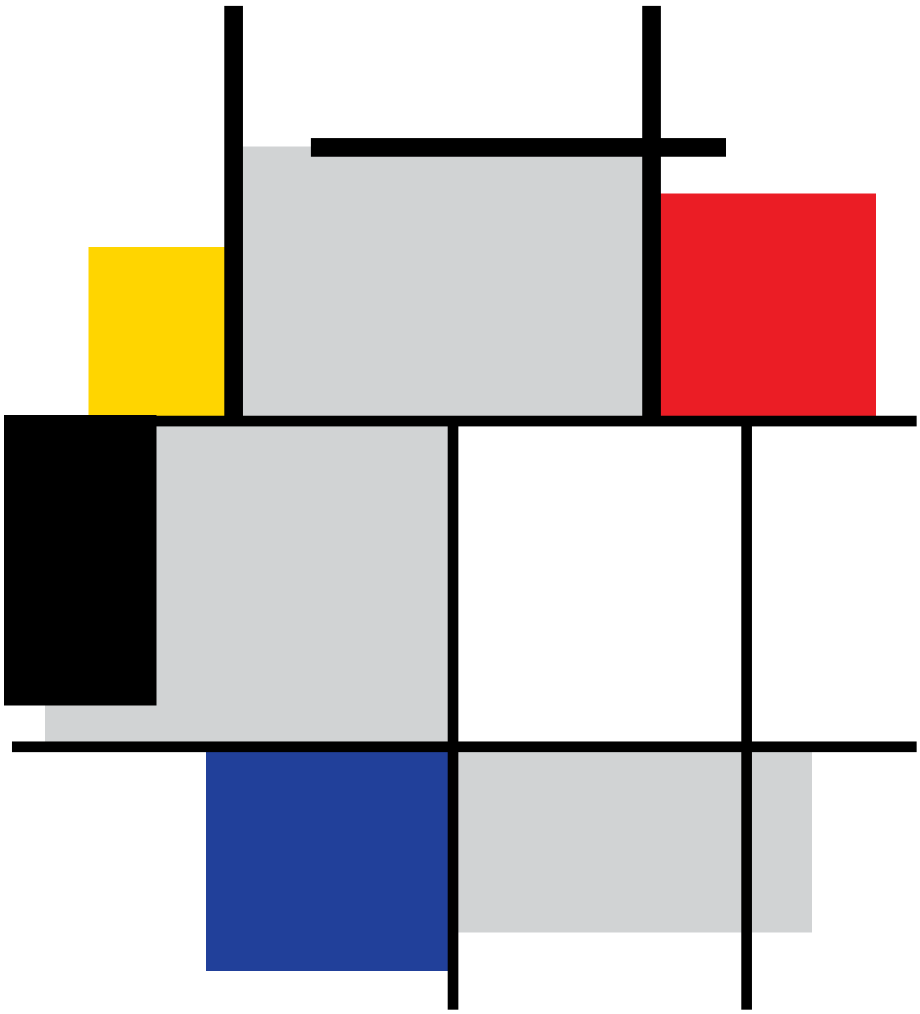
Government of Kerala



MEMORANDUM

presented to

The Fifteenth Finance Commission

Finance Department

MAY 2018

MEMORANDUM

presented to

The Fifteenth Finance Commission

Government of Kerala

Finance Department

MAY 2018

CONTENTS

Chapter 1

FEDERAL FISCAL RELATIONS IN INDIA – AN OVERVIEW

1.1 Background and Prevailing Context

According to the Constitution, India is a Union of States. Though the word federal does not find a mention in the Constitution, there is clear division of powers, especially in the domain of revenue collection and expenditure obligations. But the general view is that Indian Constitution is quasi federal in nature. This is due to the predominant unitary features like the power to dismiss an elected State government on the basis of the report of the Governor or otherwise and the exclusive power of the Union on Residuary subjects. Article 3 of the Constitution has empowered the Parliament to create new States and alter the areas, boundaries or names of existing States by making suitable law, for which approval by the Legislative Assembly of existing State is not necessary.

On the fiscal front, the expenditure obligations, especially in the social and economic sectors arise from the Directive Principles of the Constitution which are reflective of the National priorities. These are substantially in the domain of the State governments, as per the division of powers in the Seventh Schedule of the Constitution. Though there is no separate List assigning subjects to Local Self-governments, their empowerment has been attempted through the 73rd and 74th amendments to the Constitution during the early 1990s. In this three-tier federal structure, a major part of the revenues are collected by the Union. States in India collect around 39 per cent of national taxes and are responsible for spending 58 per cent of the combined expenditure of Union and States. This brings to the fore the issue of fiscal imbalance which is sought to be addressed through the Constitutional mechanism of Finance Commissions. Apart from States own revenue effort, decentralised spending would be sustainable only when there is a stable and predictable flow of resources predominantly based on the recommendations of a credible Constitutional body. This task has been performed admirably by the Finance Commissions in the past. The Finance Commission has the mandate of ameliorating vertical imbalance in revenue mobilisation between the Union and the States along with ensuring equalising fiscal capacities across the States for providing comparable levels of public services at comparable levels of taxation. The latter obligation is an act of delicate balancing especially, when the fiscal capacities of the States differ very widely across States in India.

In recent times, the discussion is veering around the concept of co-operative federalism. In economic literature, the implication of co– operative federalism is conceptualised as a situation in which the federation and the sub national units take a joint or consensual decision. Inmam and Rubinfield, in their paper "Rethinking Federalism (*Journal of Economic Perspectives, Vol 11, No 4, Fall 1997, Pp 43-64*), describe co-operative federalism as one "which prefers the most decentralised structure of government, capable of internalising all economic externalities, subject to the constitutional constraint that all central government policies are agreed to unanimously by elected representatives from each of the lower - tier governments".

In this definition, consensus is emphasised, so that the federal or the Union government is not considered the best judge under any circumstance and there is pooling together of experience from all tiers of the government. But the term 'lower tier' of governments, implying a pyramidal hierarchy among elected governments is not conducive for a consensus, which is to be arrived at after deliberations among equals.

Between democratically elected governments at various levels, the relationship should not be hierarchical, but akin to concentric circles. The sharing of resources between them is to enable each tier to discharge its Constitutional responsibility. The fact that there is imbalance between taxation powers and expenditure obligations between the Union and the States (or federation and the provinces) should not be the basis for placing the former at a higher hierarchical level than the latter. Federal relations are between political executives elected by the people in a democratic process and cannot be treated as higher and lower levels in a hierarchical set up of authority. At the outset, it is felt that there is a need for a basic change in the discourse on political federalism in academic as well as administrative domains.

Under this broad framework, we examine the context prevailing in our country at the time of formation of the 15th Finance Commission. The first and the foremost question that is to be addressed is the need for sharing of resources, especially taxes between the Union and the States. As already stated, there is imbalance in the taxing powers of the Union and the States. This imbalance is not the fallout of any non- implementation of policies, or lower revenue efforts by States but one which has been consciously made so through Constitutional division of powers. The domains of state intervention are broadly classified as Stabilisation, Distribution and Allocation. On efficiency grounds and considerations of economic prudence, the first two are in the domain of the Union and the third one in the domain of States or Local Self Governments. To elaborate a little, policies of macroeconomic stabilisation are with the Union. Distributive taxes like Personal and Corporate Income Tax are also Union subjects so as to avoid competition at the provincial level which would cause inefficiency due to shifting of tax bases. The allocation part of the state intervention is considered as best served by the level of government closest to the beneficiary. This principle is generally known as a subsidiarity principle. [1]

In the Indian context, the first two, stabilisation and distribution are with the Union. But in the allocation aspect also, Union is substantially involved. The Union enters the allocation domain through Centrally Sponsored Schemes (CSS) and the Central Sector Schemes. Under these, criteria for selection of beneficiaries, allocation of funds and norms for programme implementation are laid down at the Central Ministry level. The enabling provision in the Constitution which enlarges the space for the Union to intervene in subjects in the State List (which fall in the purview of allocation), is Article 282 of the Constitution, which reads as under:

"Expenditure defrayable by the Union or a State out of its revenues.- The Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not one with respect to which Parliament or the Legislature of the State, as the case may be, may make laws"

This article is under the head "Miscellaneous Financial Provisions of the Constitution, but has been used routinely by the Union to formulate schemes in social sector activities, which are in State or Concurrent List. Though States have no role in the formulation of the schemes or fixing the criteria, they are to share a part of the cost of the scheme. The contribution of the States to the CSS has increased since 2015-16. This is due to the fact that after the implementation of the Fourteenth Finance Commission award, recommending a higher sharing of Union tax revenues with the States, the share of the Centre in most CSS has come down. The Ninth Finance Commission report went into the routine resorting of Article 282 by the Union and the consequent encroachment into the fiscal space of the States. The discussion with legal experts was on whether Article 282, which comes under "Miscellaneous Financial Provisions", can be used in a routine manner and in the general course or it is meant to be used under exceptional

---

1 Wallace E Oates (in his book Fiscal Federalism, Hardcourt Brace Jovanovich, New York,1972) put forward the hypothesis, that given the absence of externalities, an activity that can be done cost effectively by the tier closest to the people, it should be left to be done by that part of the government (Decentralisation Theorem).

circumstances. It was opined by the legal experts (whose views have been stated in the Ninth Finance Commission Report) that Article 282 closely follows Section 150 of the Government of India Act 1935, which was also placed under 'Miscellaneous Financial Provisions". The main use which was made of this section was for granting special assistance by the Central government to Bengal in connection with the famine of 1943. *Ad hoc* grants were also later on given under this section for purposes like growing more food, post-war development and relief and rehabilitation. It is thus obvious that this provision, which is virtually repeated in Article 282, was always meant to serve the purpose of *ad hoc* grants which had to be made for contingencies and unforeseen requirements.

This view was the subject agitated before the Hon'ble Supreme Court in Bhim Singh vs Union of India (5 SCC 538 (2010), in which the validity of Member of Parliament Local Area Development Scheme (MPLAD) was questioned. While upholding the validity of MPLAD Scheme, the Apex Court adumbrated that:

1) Owing to the quasi-federal nature of the Constitution and the specific wording of Article 282, both the Union and the State have the power to make grants for a purpose irrespective of whether the subject matter of the purpose falls in the Seventh Schedule provided that the purpose is "public purpose" within the meaning of the Constitution.

2) The Scheme falls within the meaning of "public purpose" aiming for the fulfilment of the development and welfare of the State as reflected in the Directive Principles of State Policy.

3) Both Articles 275 and 282 are sources of spending funds/monies under the Constitution. Article 282 is normally meant for special, temporary or ad hoc schemes. However, the matter of expenditure for a "public purpose", is subject to fulfilment of the constitutional requirements. The power under Article 282 to sanction grant is not restricted.

4) "Laws" mentioned in Article 282 would also include Appropriation Acts. A specific or special law need not be enacted by the Parliament to resort to the provision. Thus, the MPLAD Scheme is valid as Appropriation Acts have been duly passed year after year.

5) Indian Constitution does not recognise strict separation of powers. The constitutional principle of separation of powers will only be violated if an essential function of one branch is taken over by another branch, leading to a removal of checks and balances."

Though the legal aspect has been settled by the Apex Court, the interpretation that Article 282 is normally meant for special, temporary and ad hoc schemes has been reiterated in the concluding part of the judgement. In view of this, grants under Article275 based on the recommendations of the Finance Commission need to be the prime source of grants-in-aid by the Union to the States. This would ensure the subsidiarity principle that the tier of the government closer to the beneficiaries should be doing the allocation function.

In sum, imbalance in the sources of revenue between the Union and the States exist in India and the expenditure burden of the States is larger in activities of social and economic sectors. The latter is in accordance with the subsidiarity principle. As the subsidiarity principle is being violated through one size fits all CSS on subjects in the State List. Presently, the States are to share a rising cost of implementation of these schemes, which accentuates the vertical fiscal imbalance between the Union and the States.

Over the last few years, there are other factors which have increased the vertical imbalance in India. To illustrate a few

a) The share of surcharges and cesses, which are not shareable with the States as per the provisions of Article 271 of the Constitution which reads as "*Surcharge on certain duties and taxes for purposes of the Union: Notwithstanding anything in Articles 269 and 270, Parliament may at any time increase any of the duties or taxes referred in those articles by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part the Consolidated Fund of India".*The share of surcharges and cesses are rising and are being increasingly resorted to (discussed in detail in Chapter 4 of this Memorandum)

b) The implementation of Goods and Services Tax (GST) (in which share of State taxes subsumed is much larger than that of the Central taxes) with equal apportionment of rates between Centre and the States instead of at a 60:40 ratio (discussed in detail in Chapter 4 of this Memorandum)

c) Additional expenditure burden on States consequent to Central pay revisions, which becomes a committed fiscal burden for the States.

The 15th Finance Commission has been constituted at a time when then vertical imbalance between the Union and the States is getting sharper due to structural policy changes like implementation of GST, measures resorted to by the Centre by increasing surcharges and cesses, not only as a means of raising revenues but also to shrink the divisible pool of taxes (**as is evident from reducing the lowest Income Tax slab from 10 to 5 percent and compensating the revenue loss by imposing a surcharge on incomes above ₹ 50 lakh and reducing basic Excise Duty of petroleum products and imposing an equivalent road cess**) and rising fiscal burden of States, due to their increased share in CSS since 2015-16.

Fundamental changes have also been introduced in the Union State Fiscal relations in recent years. First, the Fourteenth Finance Commission has considered both Plan and Non-Plan expenditure to cover the entire revenue expenditure gap, and recommended sharing of 42 per cent of the divisible pool of Union taxes to the States. I**t is important to note that this increase in devolution to 42 per cent is not an additionality but to cover both plan and non-plan revenue expenditure.** Second, this increase in tax devolution resulted in a restructuring of non-Finance Commission grants to the States by the Union Government. As already pointed out, this has resulted in an increase in the contribution of States' share of resources in CSS. Third, introduction of Goods and Services Tax (GST) has merged base of indirect taxes of Union and States. This requires a re-assessment of the vertical fiscal imbalance across both the levels of Governments. Government of Kerala believes that the 15th Finance Commission would factor in these circumstances and their impact on State finances while formulating its recommendations.

Table 1.1 Pre - Devolution Imbalance between Centre and the States

Year	All States' share in Total Revenue (%)	All States' share in Total Expenditure (%)	Expenditure - Revenue Gap (%)	Average Expenditure Revenue Gap (%)
2005-06	36.68	49.84	13.17	
2006-07	34.78	49.48	14.70	
2007-08	32.57	49.33	16.76	
2008-09	34.72	45.52	10.80	
2009-10	36.76	46.21	9.45	12th FC 12.97
2010-11	36.75	46.84	10.09	
2011-12	38.54	48.07	9.53	
2012-13	38.71	49.86	11.14	
2013-14	38.49	49.86	11.38	
2014-15	38.50	53.49	14.99	13th FC 11.43
2015-16	36.79	50.80	14.01	
2016-17	35.72	51.12	15.40	
2017-18RE	35.99	53.11	17.12	14th FC 15.51

Source: Budget Documents of the Union and the States

1.2. Prevailing Macroeconomic and Fiscal Context

Under this evolving framework of fast changing Union-State fiscal relation, it is important to look at the prevailing macroeconomic context in which 15th Finance Commission (15th FC) has been constituted. Further, the States are still recovering from the shock of demonetisation and an uncertain revenue environment after the introduction of GST.

The comparative revenue receipts and expenditure burden of the Union and the States would give a picture of rising imbalances between them. In the post – Fiscal Responsibility and Budget Management (FRBM) Act period, combined Revenue and Fiscal Deficits of the States have been lower than that of the Centre. But the pre devolution (taxes and grants) revenue expenditure gap between the Union and the States has gone up significantly during the award periods of 12th to part of 14th Finance Commissions (Table 1.1).

Besides rising imbalances between revenues and expenditure, overall macroeconomic slowdown in recent years has contributed to slower growth of revenue receipts, while expenditure continued to have an upward pressure. In the subdued growth environment, a counter cyclical fiscal policy could place more demands on expenditure. This needs to be considered by the 15th Finance Commission while making its recommendations, with regard to the FRBM framework since 2020-21.

Chapter 2

TERMS OF REFERENCE OF 15TH FINANCE COMMISSION – VIEWS OF KERALA

The Finance Commission has the Constitutional mandate to make recommendations to the President in regard to a) the distribution between the Union and the States of the net proceeds of taxes and duties, b) the allocation between the States of such proceeds and c) the grants-in-aid of the revenues of the States which are considered to be necessary. The Government of Kerala urges the Commission to consider the consequences of the significant changes that have been incorporated in the Terms of Reference (ToR) of this Commission compared to that of the previous Commissions. Table 2.1 is an illustrative list of ToR of 14th and 15th Finance Commissions which highlights the above mentioned changes in the latter.

Table 2.1: Comparison of ToRs of 14th and 15th Finance Commissions

Item Number in ToR	14th Finance Commission	15th Finance Commission	Remarks
5 (14th&15th)	The Commission shall review the state of the finances, deficit and debt levels of the Union and the States, keeping in view, in particular, the fiscal consolidation roadmap recommended by the Thirteenth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the Fiscal Responsibility and Budget Management Acts currently in force and while doing so, the Commission may consider the effect of the receipts and expenditure in the form of grants for creation of capital assets on the deficits; and the Commission shall also consider and recommend incentives and disincentives for States for observing the obligations laid down in the Fiscal Responsibility and Budget Management Acts.	The Commission shall review current status of finance, deficit, debt levels cash balance and fiscal discipline efforts of the Union and the States, and recommend a fiscal consolidation roadmap for sound fiscal management, taking into account the responsibility of the Central Government and State Governments to adhere to appropriate levels of general and consolidated government debt and deficit levels, while fostering higher inclusive growth in the country, guided by the principles of equity, efficiency and transparency. The Commission may also examine whether revenue deficit grants be provided at all.	The words "stable and sustainable fiscal environment consistent with equitable growth" is absent in the ToR of the 15th F.C. The mandate for making recommendations as to whether "Revenue Deficit grants should be provided at all "is making appearance in the ToR of 15th FC for the first time
6(vi) of 14th and 7 (iv) and (v)) of 15th	the level of subsidies that are required, having regard to the need for sustainable and inclusive growth, and equitable sharing of subsidies between the Central Government and State Governments;	(iv) Progress made in increasing capital expenditure, eliminating losses of power sector, and improving the quality of such expenditure in generating future income streams; (v) Progress made in increasing tax/non-tax revenues, promoting savings by adoption of Direct Benefit Transfers and Public Finance Management System, promoting digital economy and removing layers between the government and the beneficiaries;	The ToR of the 15th FC proposes to look at only States position for performance grant and Union is left out unlike in the ToR of 14th FC

Item Number in ToR	14th Finance Commission	15th Finance Commission	Remarks
6(vii) of 14th F.C. and 7(vii) of 15th FC	the need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions;	Control or lack of it in incurring expenditure on populist measures; and	Though both try to insulate certain budgetary decisions from the political domain, the scope of the ToR of 14th F.C. is far more limited than that of the 15th F.C. ToR which is directly in cursive into the domain of State governments and their legislative realm. The ToR of the 14th F.C. is not limited to the States only.
7 of 14th F.C. and 8 of 15th FC	In making its recommendations on various matters, the Commission shall generally take the base of population figures as of 1971 in all cases where population is a factor for determination of devolution of taxes and duties and grants-in-aid; however, the Commission may also take into account the demographic changes that have taken place subsequent to 1971.	The Commission shall use the population data of 2011 while making its recommendations.	The ToR of 15th F.C. is far more restrictive than that of 14th F.C. and the word "generally" is conspicuous by its absence in ToR of 15th FC
6(vi) of 15th FC	No comparable ToR	The impact on the fiscal situation of the Union Government of substantially enhanced tax devolution to States following recommendations of the 14thFinance Commission, coupled with the continuing imperative of the national development programme including New India – 2022;	The review of the recommendations of an earlier Finance Commission, accepted and implemented, is a new and unprecedented feature in ToR of 15th FC

Source: 14th Finance Commission Report and Notification constituting 15th Finance Commission

The legal view on the Constitutional status of the Finance Commission suggests that: "The Finance Commission would not be entitled to abdicate its function under the Articles of the Constitution because what binds them is the Constitution, and where the terms of reference to the Commission involve any repugnance, conflict or inconsistency, the Finance Commission would be bound to follow the Constitution as against the terms of reference. In such a case it is doubtful whether this is practicable or whether the Commission would go back to the Government and ask for reconsideration of the terms of reference. But to the extent that any of the terms of reference seek to deprive the Finance Commission of its powers which are constitutionally vested in it under Article 280, Clause 3, the terms would be invalid and unconstitutional".(views stated by Shri K K Venugopal in "The Ninth Finance Commission Issues and Recommendations", p.210).

This is the first Finance Commission, after the abolition of Planning Commission and the introduction of Goods and Service Tax (GST) on July 1st 2017. It is relevant, as with the abolition of planning process at the National level, States have lost formula based grants (Plan grants devolved under the modified Gadgil formula). Similarly, with the introduction of GST, States have also lost the right to alter tax rates in goods and services, which is the most important component of Own Tax Revenue of the States. In other words, the award period of the 15th Finance Commission, that is, 2020-2025, falls in the immediate aftermath of substantial structural changes in Central Devolution as well as in Own Tax Revenue sources of the States. These changes have to be kept in mind while recommending the size of the divisible pool taxes to be shared between the Union and the States, the methodology of sharing the taxes among the States, and distribution of grants to the States by the 15th Finance Commission. It is in this context that the Constitutional mandate of the Finance Commission mentioned above assumes high importance.

The ToR of the 15th Finance Commission are a reflection of the fiscal concerns of the Union much more than that of the States. Over a period of time, the ToR has tended to be expansionary in so far as it pertains to conditionalities regarding deficit targets for States and in proposing to assess performance of States in subjects of the State List of the Seventh Schedule of the Constitution. The Government of Kerala urges the 15th Finance Commission to take a balanced view as regards the changes in the ToR, which have made it skewed in favour of the Union.

We propose to divide our comments on ToR of the15th Finance Commission into two parts. The first part deals with issues which are of general concern to all the States and the second part deals with the needs of Kerala which are to be addressed by the Commission.

2.1 Issues Concerning States in General

In a federal set up, the Union and the States have separate taxing and expenditure powers, which are Constitutionally delineated. In the Indian context, the revenue raising powers of the Union are much wider than that of the States, while the latter have much larger responsibilities in the expenditure side, especially in social sectors like health and education.

In other words, there is imbalance, where more buoyant and income elastic taxes go to the Union and the rather inelastic taxes come to the States and being the tier of government closer to people, a larger share of social sector responsibilities accrue to the State governments. This results in what is called as Vertical Imbalance - the States burdened with more expenditure responsibilities and lesser own revenue raising powers. The primary requirement of Central devolution of resources is to ameliorate this vertical imbalance, which is the result of a conscious decision (due to inbuilt in the Constitutional allocation of powers) on division of revenue raising powers and expenditure obligations.

Besides the above, the fiscal capacity of the States differ due to inter - regional economic inequalities and there is need to ensure that citizens should get a minimum level of public services, irrespective of her/his place of residence. This necessitates the second step of distribution of resources across States to ameliorate what is called horizontal imbalance.

Under the Indian Constitution, Article 280 mandates constitution of FCs considering these primary fiscal needs, but has also authorised the President to call for recommendations in the interest of sound finance and augmenting States' resources for onward devolution to Local Self Governments (LSGs).

In this context, it needs to be mentioned that in the post -1990s, the FCs have become a vehicle for incentivising States to implement fiscal reforms like deficit targeting. The FCs, since the 11th have been consistently doing this by linking grant disbursement and debt relief packages to implementing Fiscal Responsibility and Budget Management Acts (FRBMA) and adhering to zero Revenue Deficits and 3 percentage Fiscal Deficit - GSDP ratio. 15th FC has also been mandated to deal with this issue in its ToR.

2.1.1 Deficits, Debt, Borrowings and Grants-in-Aid – Impacts on State finances.

Item 5 of the ToR states as under:

"The Commission shall review the current status of the finance, deficit , debt levels, cash balance and fiscal discipline efforts of the Union and the States, and recommend a fiscal consolidation roadmap for sound fiscal management, taking into account the responsibility of the Central Government and State Governments to adhere to appropriate levels of general and consolidated government debt and deficit levels, while fostering higher inclusive growth in the country, guided by the principles of equity, efficiency and transparency. The Commission may also examine whether revenue deficit grants be provided at all."(emphasis added).

Already, the FRBMA Review Committee, 2017, has recommended that instead of deficit targeting, Debt - GSDP ratio should be anchored to 60 percent level (40 percent for the Centre and 20 percent for the States), and accordingly Fiscal Deficit - GSDP ratio should be glided down to 2. 5 percent at the Central level and 1.7 percent for the States level. These are targeted to be achieved by 2022-23.

This is a sharp reduction from the present targeted level of 3 percent Fiscal Deficit -GSDP ratio, suggested by the 13th and 14th FCs. Even if the revenue position of the Centre as well as the States improves markedly, the cut suggested by the FRBMA Review Committee, would necessitate substantial expenditure compression. Under the present circumstances, when the economy is showing palpable signs of slowdown, a cutback in public expenditure is bound to have a second round contractionary effect. The impact of the cut suggested would lead to budget crises in the States, especially when initial GST revenues are not very encouraging. Compensation from Centre would also taper off in five financial years from 2017-18.

The logic stated in the report of the FRBMA Review Committee for reduction of debt and deficit ratios, can be summarised as under:

"The ratio of household financial savings to GDP is 7.6 percent and external borrowings are 2.3 percent, which takes the total to 10 percent approximately. Dividing this equally between the government and private sector, 5 percent each is apportioned. This 5 percent apportioned for the government sector is divided as 2.5 percent between the Centre and the States. But the committee set a lower target for the States at 1.7 percent citing relative larger primary imbalances of the States Vis-à-vis the Centre".

This is the same reason, which was advanced when the 3 percent target for Fiscal Deficit to GSDP ratio was fixed by the earlier FCs. It was assumed that the Centre and the States could borrow 6 percent with 3 percent each out of the savings pool of 10 percent, leaving the balance 4 percent for the non- government sectors. The FRBMA Review Committee has made an arbitrary reduction of 6 to 5 and based on Primary Deficit balances, suggested a lower Fiscal Deficit - GSDP ratio for the States. The following realities on the ground appear to have been ignored

1) When private investment growth is in the negative zone and borrowing demands are muted in the non-government sector, the assumption that government can sustainably borrow only 5 percent from the savings pool need not be realistic.

2) The fact that a larger government borrowing increases private spending which puts more income in the hands of people and thereby savings too can rise. In fact, there is omission to take note of the acknowledged multiplier effect of spending.

3) When the external debt ratio for India is safely low, the limit of 60 percent fixed based on study by Reinhart and Rogoff (2010),which suggests this limit for emerging market economies with a substantial external debt is of doubtful validity is the Indian context.

It is felt that the recommendations of the FRBMA committee should not guide the 15th FC, as reduction of FD - GSDP ratio by almost fifty percent (from 3 to 1.7 percent) for the States, would have deleterious impact on capital spending, critically needed to bridge the infrastructure deficit. The 15th Finance Commission should look into the State specific needs and suggest State specific fiscal paths. Across the board fiscal deficit reduction would result in abnormal compression of capital and development expenditure.

On the question of fiscal consolidation at the State level, one critical issues needs to be emphasised is the target of Zero Revenue Deficit suggested within a timeframe for the States by the 13th and the 14th Finance Commissions was attained by most States. In the Medium Term Fiscal Policy Statement (MTFP) of the Union, it has been stated that the Government of India is proposing an amendment to the FRBM Act and in the proposed FRBM architecture, debt and fiscal deficit will be simultaneously targeted not the revenue deficit. The fiscal deficit will be the operational target and it is proposed to do away with deficit targets on the revenue account, that is, Revenue Deficit. It has been stated that spending for maintenance of capital assets and for education and health is revenue expenditure and these expenditures are as crucial as that in physical capital.

The reasons stated in the MTFP, 2018 of the Government of India applies with more strength in the case of States as they have much larger obligations in social sector spending. Hence, the 15th Finance Commission should consider making Fiscal Deficit the operational target for States also and do away with the targeting of Zero Revenue Deficit. But States, which need investment in physical capital, will naturally rein in deficits in the revenue account for utilising more borrowed funds for capital expenditure. Considering the fact that States have large commitments in the revenue account, they should be encouraged to self-target Revenue Deficit, so that more borrowed funds can be utilised for capital expenditure.

The ToR also suggests a look at whether there should be Revenue Deficit (RD) grants at all. Till the 14th FC, post- tax devolution (under Article 275) grants were called Non - Plan Revenue Deficit (NPRD) Grants and was a very important source of flexible part of Central Devolution and a means for augmenting Consolidated Fund of the State. The 14th FC awarded Revenue Deficit (RD) grants taking a holistic view of plan and non-plan revenue expenditure.

When the State Finances are likely to be stressed in the immediate future due to a) Pay Commission Awards, b) Problems in implementation of GST c) Need for spending social and economic sectors and d) Interest liabilities on UDAY bonds etc., the ToR mandate on whether "there should be Revenue Deficit grants at all" is a retrograde step and if taken seriously by the Commission would severely strain the State Finances. In other words, it would result in severely impeding capital and development spending.

Besides the fiscal issues, there are important Constitutional issues arising here. The ToR mandating the review of Revenue Deficit grants to the States is requiring the Finance Commission to bypass the Article 275 of the Constitution, the provision under which Finance Commissions give grants to the States. This item in the ToR seemingly travels beyond the provisions of Article 280(3) (b) of the Constitution which empowers the Finance Commission to make recommendations to the President "*as to the principles* *which should govern the grants-in- aid of the revenues of the States out of the Consolidated Fund of India".* The unambiguous wordings of this provision in the Constitution do not appear to intend giving the power of review to the Finance Commission regarding giving grants-in-aid to the States.

ToR 6 (vi): Conditions that GOI may impose on States while providing consent under Article 293(3) of the Constitution (for borrowings)

Already, FRBM Acts are in operation and limits for borrowings are specified therein. Why further conditions should be specified? It would obviously become a move to restrain the borrowings and constrain the fiscal space of States. The FRBMA Review committee has already recommended a debt - GSDP limit of 60 percent (40 for the Centre and 20 for the States) (Overall, Centre has 49 percent and all States 21 percent now. But, States like Kerala have 27-28 percent of GSDP as Debt). For this to be achieved, the FRBM committee recommended that Centre's FD should be 2.5 percent by 2022-23 and all States at 1.7 percent by 2022-23. If this is sought to be achieved through the conditionalities, that are to be imposed by invoking provisions of Article 293(3) of the Constitution, fiscal space for capital and developmental expenditure of the States would be severely constrained and would have adverse consequences on economic growth.

2.1.2 Incursion into Policy Domain of Democratically Elected Governments

ToR 7 (viiii): Control of lack of it in incurring expenditure on Populist measures

This item in the ToR is open to wide interpretations. Through this ToR, 15th FC is mandated to restrain democratically elected governments from implementing promises made to people in the election manifestoes. Any measure from welfare pensions for the poor and weaker sections of the society to food subsidy can be termed as populist and recommended to be curtailed. This strikes at the root of democratic polity in which State governments should be free to implement welfare measures, under broad parameters of fiscal discipline. It should be remembered that States initiated and implemented successfully at the State level schemes like Mid Day Meal Scheme and Food for Work Programme, which later became national level schemes.

2.1.3 Change in Population from 1971 census to 2011 census

ToR 8 mandates the Commission use of Population based on 2011 census while making recommendations. This may penalise horizontal share of taxes to those States, which took successful initiatives to reach replacement rates of Population in accordance with the National Population Policy. States that achieved early demographic and health outcomes are now not able to reap the demographic dividend due to the sharp reduction in labour force (15-59 age group) and at the same time is faced with challenges of taking care of ageing population. It is yet another fact that they have also incurred huge fiscal cost to achieve a lower population growth and healthy demographic indicators. Kerala government is of the considered opinion that this ToR should be deleted. It is also suggested that the loss of the States including Kerala needs to be considered in the tax devolution formula, by introducing an appropriate indicator in the composite tax devolution formula '**Demographic Achievements**'.

2.1.4 Monitoring of Performance of States through Incentives

It is also our considered opinion that Finance Commission becoming a monitoring agency of policies does not befit its Constitutional role. Bodies like Inter-State Council (Article 263) can discuss how outcome of public policy be evaluated by the State governments. Any monitoring mechanism suggested by Finance Commission is likely to become Central officials' supervision over the State governments. The ToR 7 (i) to (ix) has provided for measurable performance based indicators, like widening of GST Net, population control, power transmission losses, utilisation of funds of Centrally Sponsored Schemes, promoting digital economy, ease of doing business, labour intensive growth, controlling populist measures etc. Further, when most of these schemes have multiple objectives, measurement of performance becomes difficult and often subjective. The ToR mandates measuring attributes such as behavioural change, which defies an easy quantification. Drawal of funds from flagship schemes is also made a base for providing performance based incentive. When States are at different levels of development, the drawal of funds will be at different levels for States, especially when the criteria in the flagship schemes are uniform across States. Making this a criterion for performance based incentive is a double whammy for States which are not able to avail of the schemes due to lack of flexible criteria. Besides these operational issues, the Government of Kerala is of the opinion that this ToR is not in accordance with treating Centre, States and LSGs as equal stakeholders in a federal set up with the primary job of providing public services.

In fact, conditional or tied grants have got chequered course in the recent past. The 11th FC recommended withholding of grants based on fiscal performance and there was strident criticism of that recommendation. The 12th FC went back on this and made debt relief linked to fiscal target achievement. The 13th FC suggested monitoring of grants to LSGs requiring presentation of utilisation certificates and the 14th FC relaxed it finding this of little use. In fact, 14th FC did away with the practice of tied grants itself. The ToR of the 15thFC seems to suggest a return to tied grants and monitoring of outcomes, which is moving away from the ideal of co-operative federalism.

It needs to be reiterated that such micro level monitoring assigned in the ToR 7 is stretching the scope of 'any other matter referred to the Commission by the President in the interests of sound finance', envisaged under Article 280 (3) (c) the Constitution, beyond reasonable limits and understanding.

Notwithstanding our clear opinion regarding ToR 7, which has been expressed above, Government of Kerala requests the 15th Finance Commission to take kind note of the efforts taken and the strides made by the State in the areas mentioned in ToR 7. The details are included as Annexure to this Memorandum

2.1.5 Fiscal Federalism and National Priorities

The part of ToR 6 (iv) that goes counter to fiscal federalism is "The impact of the fiscal situation of the Union Government of substantially enhanced tax devolution to the States following recommendation of the 14th Finance Commission, coupled with the coming imperative of national development programme including New India-2022"

In a framework of co-operative federalism, there has to be a consensual approach and States and the LSGs, being closer tiers to the people benefiting from the programmes, should have the prime role in implementing development projects. A substantially enhanced devolution would naturally ensure implementation of these programmes in a better way and there should not be any room for the apprehension expressed in the ToR 6 (iv). In fact, a larger untied allocation with defined outcomes should be better than the Centre spending from its own resources in the form of tied or conditional grants. This ToR is unprecedented that it seeks a review of the recommendations of the earlier Finance Commission which has been accepted by the President.

The basic principles of federalism will be adversely affected if the fiscal space of the States are sought to be unduly constrained in the name of sound finance. As already pointed out, ToR7 (viii) on "control or lack of control of populist policies", gives a wide latitude to the FC, to stride into the domain of electoral democracy and the freedom of State legislatures to formulate welfare policies in line with the election manifestos of the political parties. The trend of making the Constitutional body of Finance Commissions as a vehicle for implementing deficit targeting and expenditure cuts, which started since the beginning of economic reforms during the 1990s, appears to have gathered momentum in the ToR of 15th FC. It is earnestly hoped that the basic Constitutional mandate would be given precedence by the 15th Finance Commission and the additional ToR, in so far as they prejudice the basic tenets of fiscal federalism would not be followed to the detriment of the role of the States as equal stakeholders in implementing national priorities and their finances.

2.2 Kerala Specific Issues

Kerala's share in the divisible pool of Central taxes has consistently fallen since the 11th Finance Commission Award, before going up marginally in the 14th FC Award. It was 3.057 percent during 2000-2005 (11th FC). 2.665 percent during 2005-2010 (12th FC), 2.341 percent during 2010-2015 ;(13th FC) and 2.50 percent during 2015-2020 (14th FC).

All these FCs except, the 14th had used 1971 census for the population criterion in tax devolution formula, The 14th FC used 2011 population also by including a criterion, demographic change (It gave 17.5 percent for 1971 population and 10 percent for 2011 population). The ToR of the 15th FC has mandated the use of 2011 census data for population criterion.

For States like Kerala, which have incurred enormous fiscal costs over a long period of time, despite having lower fiscal capacity, this is a setback. The spread of education and health as a consequence of conscious public intervention required not only capital investment, but also recurring expenditure on the revenue front under the heads of salary and pension. In the recent past, Kerala has been facing the problem of slower own tax revenue growth (at 10 percent per annum as against the average growth rate of 17.5 percent during the period 2006-2012). The slowdown in the economy is affecting the revenue potential of the State. The implementation issues in GST has impeded faster growth of own tax revenue even in the new tax regime. The committed expenditure and slowdown in own tax revenues have together exacerbated the deficit position of the State. The relatively lower share in the divisible pool of Central taxes puts the State in a further disadvantageous position. Economic slowdown and consequential lower remittances from abroad is likely to adversely affect the Private Final Consumption Expenditure in the State and this would result in lesser buoyancy of consumption based taxes like GST. The nominal GSDP growth in Kerala has fallen to 8.5 percent in 2015-16 from an average of 12 percent in the last decade. Though final figures are not available, this trend is likely to continue in the immediate future.

Based on the circumstances elaborated above, there is an emergent need to prevent the decline in share of Kerala in the divisible pool of Central taxes. It is broadly suggested that

1. The ToR 8 should be deleted. A specific weight may be assigned to a criterion of "Demographic Goals Achievement", which should be introduced in the Tax Devolution formula. This should help the States which have achieved lower infant mortality, higher life expectancy and better female literacy.

2. A floor level may be set below which share of no State should fall in the divisible pool.

3. Post -tax devolution, Revenue Deficit grants should not be discontinued. If discontinued, it would be a retrograde step from all previous FCs and would go against the principle of co - operative federalism. This would also mean an unrealistic assessment of revenue and expenditure need of States.

4. In view of introduction of GST and the States having lost much of the space for fiscal manoeuvring and the rising share of surcharges and cesses in Central revenues resulting in the shrinking the divisible pool of the States, raising the share of divisible pool from 42 to 50 percent should be considered. This suggestion has

merit in view of the rising vertical imbalance in the pre-devolution revenues and expenditure of Union and the States the expected higher buoyancy in direct taxes by the Centre and higher anticipated non - tax revenues for the Centre. The non-tax revenues of the Centre are anyway, not shareable with the States

5. The Commission will have to seriously consider enhancing the size of State Level Disaster Response Fund (SDRF) for Kerala, as the State has a long coastline and vulnerable sections of population, who depend on the sea for livelihood. The unprecedented impact of Ockhi cyclone has necessitated a revamping of the mechanism of disaster management, which involves substantial fiscal burden.

6. The Commission may consider permitting an additional market borrowing limit over and above the Fiscal Deficit-GSDP ratio of 3 percent for exclusive investment in physical infrastructure projects, as they have medium and long run growth enhancing effects. This is suggested as the economy is showing signs of persistent slowdown.

Chapter 3

KERALA ECONOMY AND STATE FINANCES: AN OVERVIEW

3.1 Evolving Trends in Kerala Economy

Kerala up to the end of 1970s had a relatively low level of Per Capita income. By the end of the 1990s, the State's income started growing at a fast rate. As regards growth of GSDP, it was uneven across the sectors of the economy, with growth in primary sector stagnant or negative and that of the services sector robust. The decline of the share of agriculture and allied sectors in the economy was largely filled by the rising share of the services sector. The contribution of the services sector in GSDP has increased from 60.46 percent to 66 percent during the period 2013-14 to 2015-16. Trade, Hotels and Restaurants is the major sub sector in the service sector. Tourism constitutes 10 percent of the GSDP and is a major provider of employment in the State. Information Technology (IT) is also an upcoming sub sector in the state. Most of the employment for the educated, especially the technically educated, in the State is generated by the service sector. Currently, manufacturing sector constitutes only around 10 percent of the GSDP. Major portion of the industrial production in the state is from traditional industries like coir, cashew, khadi, handlooms and from Micro Small and Medium Enterprises (MSMEs). Construction industry remained buoyant for more than three decades since the 1980s, but is now facing deceleration in its growth.

The decline in overall economic growth of Kerala, since 2012-13, is in line with the all India trend, but the decline has been sharper for Kerala than at the all India level. Though migration from Kerala is across a broad spectrum of countries, large share of this migration is to the Gulf countries. Fall in the price of crude oil and consequent slowdown in economic activity in the Gulf countries have been adversely impacting the State economy in a major way. There has been a sharp decline in employment opportunities in the Gulf countries. Decline in real wages, and stringent labour laws have resulted in a decline in the growth of remittances. This coupled with fall in the prices of rubber and other cash crop produces in the State have had a bearing on the consumption expenditure of the State. The downturn in growth has contributed to the general fall in the revenue of the State and consequential fiscal stress. The situation has further worsened due to the shocks of demonetisation and early implementation of Goods and Services Tax (GST).

Though current economic scenario in the State is subdued, it needs to be mentioned that in the last four decades, the State has made rapid strides in effective family planning programme, education, public health and poverty alleviation through public intervention policies pursued by successive governments in Kerala. The government interventions in these areas have determined the composition of expenditure, especially, revenue expenditure. Large social sector spending dominated by health and education contributed to the increase in current or revenue expenditure and consequently constrained fiscal space for capital expenditure in the State. The State is at present facing the challenging task of not only maintaining the achievements made in the past, but also upgrading the quality of services provided by the government. Capital expenditure also has to be scaled up in order to attract critically needed private investment. The State is committed to safeguard the achievements made in the social sector, while simultaneously giving boost to capital investment in infrastructural sector. It is pertinent to note that capital expenditure to GSDP ratio which was 0.81 percent in 2005-06 has risen to 1.49 percent in 2018-19 BE.

The State has recently embarked on a Nava Keralam Karma Padhathi with the social welfare objectives in mind. For this, new initiatives are introduced through four innovative missions targeting vulnerable sections of the society. These initiatives are: a) Haritha Keralam, b) Aardram, c) LIFE and d) Education Rejuvenation. Haritha Keralam is an environment friendly approach focusing on organic farming, water conservation and waste management. The Mission Aardram aims to create people friendly health delivery system in the State through improving universal health care and addressing second generation health care issues. LIFE (Livelihood, Inclusion and Financial Empowerment) Mission aims to provide safe and secure houses to all landless and homeless families. Education rejuvenation mission aims to take forward the state from universalisation of education to modernisation of education with smart class rooms, digital libraries and IT enabled learning.

The State has embarked on a Public Education Rejuvenation Campaign with the aims of a) up-gradation of 10000 schools as centres of excellence, b) conversion of all classrooms of standards 9 to 12 as high tech classrooms, c) infrastructural improvement, d) improving proficiency in English language and e) special packages for renovation of schools which have completed 50 and 100 years. The mission for improving standard of public education would help the students from poorer sections of the society who are dependent on them. Kerala has achieved the distinction of having the lowest dropout rate of school students among the Indian States. In the year 2016-17, dropout ratio among school students in Kerala was 0.22 per cent. Besides initiatives in the formal education sector, the State has initiated the programme of Changathi (friend), a programme for reading and writing in Malayalam for migrant workers. This would enable them to assimilate better with the environment of the State.

The State has also formulated schemes in social and economic sectors aiming at achieving sustainable development goals. The efforts taken by the State to protect water bodies and paddy fields not only by framing legislation but ensuring its effective implementation through Local Self Governments is noteworthy. The long run impact on environment and climate is a policy priority of the State government. The commitment of the State in decentralised governance is much better than in all other States as can be seen from the Report of the Ministry of Panchayati Raj, 2015-16.

The flagship Centrally Sponsored Scheme under Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), 2005, is being implemented by the LSGs and all Gram Panchayats have implemented the scheme during 2014-15 to 2017-18. The average utilisation of Central releases during this period is almost 100 percent (nrega.nic.in). This illustrates that Kerala is implementing not only State level schemes but also Centrally Sponsored flagship schemes.

The expenditure incurred for all the above initiatives would fall in the category of revenue expenditure in the budget. As already mentioned, increased intervention of the government is required to enhance the capital expenditure in the State for building up critically needed infrastructure. This will have a crowding in impact on private investment and would lead to enhanced economic growth and more employment opportunities. Kerala Infrastructural Investment Fund Board (KIIFB) is conceived as a fund raising and implementing agency for the infrastructure works on a fast track. Implementation of projects under KIIFB has gained momentum. The condition of the State finances is the crucial determinant for the success of all the above mentioned efforts and in the next two parts of this chapter, the challenges facing Kerala's State finances and the renewed efforts taken by the government for fiscal consolidation are discussed.

3.2 An Overview of State Finances

One of the features of the finances of Kerala is the persistent Revenue Deficit (RD) from

1983-84. The RD of the state overwhelmingly is due to the higher growth in Revenue Expenditure despite significant revenue effort. As mentioned earlier, there had also been a consistent decline in the horizontal share of Central taxes to the State during the award period of Eleventh, Twelfth and Thirteenth Finance Commissions, i.e., from 2000-01 to 2014-15. Even though the state lagged much in per capita income almost up to the end of 1990s, its performance in the own revenue collection front was higher and even comparable to that of the high per capita income States. For much of the period the Tax/ GSDP ratio was between 7-8 percent. The recent trend, since 2013-14, however is below 7 percent, which can be traced to international, national and regional events as discussed above.

Table 3.1: Overview of State Finances (₹.crore)

Items	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18 RE	2018-19 BE
Revenue Receipts	38010	44137	49177	57950	69033	75612	88267	102801
% of GSDP	10.44	10.70	10.57	11.31	12.40	12.25	12.86	13.30
State Tax Revenue	25719	30077	31995	35233	38995	42176	48823	58588
% of GSDP	7.06	7.29	6.88	6.87	7.01	6.84	7.11	7.58
State Non-Tax Revenue (SNTR*)	2592	4199	5575	7284	8425	9700	11729	14271
SNTR as % of GSDP	0.71	1.02	1.20	1.42	1.51	1.57	1.71	1.85
Net receipts of Lotteries in SNTR	381	591	593	960	1149	1291	2064	3236
Central Govt. Transfers	9700	9862	11607	15434	21612	23735	27715	29942
% of GSDP	2.66	2.39	2.50	3.01	3.88	3.85	4.04	3.87
Capital Receipts	12284	15685	17050	18719	17965	26763	22392	24217
% of GSDP	3.37	3.80	3.67	3.65	3.23	4.34	3.26	3.13
Total Receipts	50295	59823	66227	76670	86998	102374	110659	127018

Items	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18 RE	2018-19 BE
% of GSDP	13.82	14.51	14.24	14.96	15.63	16.59	16.12	16.43
Total Expenditure	50896	59228	66244	76744	87032	102383	111352	127093
% of GSDP	13.98	14.36	14.24	14.97	15.64	16.59	16.22	16.44
Revenue Expenditure	46045	53489	60486	71746	78689	91096	101346	115661
RE as % of GSDP	12.65	12.97	13.01	14.00	14.14	14.76	14.76	14.96
Expenditure on Lotteries in RE	902	2083	3203	4485	5123	5992	6851	7874
Capital Outlay	3853	4603	4294	4255	7500	10126	8668	10330
% of GSDP	1.06	1.12	0.92	0.83	1.35	1.64	1.26	1.34
Loan Disbursements	999	1136	1464	743	842	1160	1337	1102
% of GSDP	0.27	0.28	0.31	0.14	0.15	0.19	0.19	0.14
Revenue Deficit	8034	9351	11309	13796	9657	15485	13080	12860
% of GSDP	2.21	2.27	2.43	2.69	1.73	2.51	1.91	1.66
Fiscal Deficit	12815	15002	16944	18642	17818	26448	22774	23957
% of GSDP	3.52	3.64	3.64	3.64	3.20	4.29	3.32	3.10
Primary Deficit	6521	7798	8679	8872	6708	14332	9248	9019
% of GSDP	1.79	1.89	1.87	1.73	1.21	2.32	1.35	1.17
Outstanding Debt	89418	103561	119009	135440	157370	186453	210789	237266
% of GSDP	24.56	25.12	25.59	26.42	28.27	30.22	30.71	30.70
GSDP (Current Prices)	364048	412313	465041	512564	556616	617035	686498	772894

Source: Budget Documents, Government of Kerala

The persistent RD that consumed much of the borrowings is an important aspect to be factored in while aiming at fiscal consolidation. The RD/ FD ratio remains high except for the period from 2006-07 to 2011-12. This is the period during which the tax collection was robust on the back of introduction of VAT and strong measures taken for tax compliance. Even the fall in growth in the economy from 2008-09 due to global financial crisis could not deter the State from achieving healthy tax collection. During the period from 2006-07 to 2010-11, the States witnessed a revenue led fiscal consolidation. Kerala also benefited from the effect of fiscal consolidation through better outlay for capital expenditure.

The period from 2013-14 to 2017-18 is one of the difficult phases in the fiscal history of the State for the reason that, the growth in the State's own revenue collection was falling and growth in revenue expenditure remained at higher levels. This caused widening of Revenue Deficit. However it has to be emphasised that the successive governments in office always strived for revenue led fiscal consolidation. But this could not be achieved to the extent desired due to lingering uncertainties and weaknesses in the global and national economy and other reasons like demonetisation and continued challenges in the implementation of GST. An important source which ameliorated the fiscal stress was the RD grant awarded by the 14th FC for 2015-16, 2016-17and 2017-18. Table 3.1 provides overview of fiscal situation of the state from 2011-12 to 2018-19 (BE).

The Table 3.1 illustrates the recent weaknesses in States Own Revenues, increasing revenue expenditure, low capital expenditure and higher deficit indicators. It can also be seen from the estimates of budget for 2018-19 that there is renewed effort for fiscal consolidation targeting States Own Revenues at higher levels and bringing down deficits to lower levels.

3.3. Kerala's Public Finances – Renewed Efforts at Fiscal Consolidation

Kerala Government is committed to achieving fiscal consolidation. In the second half of the 1990s, Kerala's fiscal slippage, as was the case with all States in India, was marked. But during the second half of the first decades of the 2000s, Kerala embarked on a path of revenue led fiscal consolidation and not a mere fiscal correction based in expenditure compression. Though the State did not achieve zero Revenue Deficit, the proportion of Revenue Deficit to Fiscal Deficit was brought down substantially and the growth rate of Own Tax Revenue was significant during the period 2006-07 to 2010-11.

The implementation of Value Added Tax (VAT) along with administrative measures to improve compliance by modernising enforcement, making check posts corruption free and significant steps taken towards building a digital data base were taken during the period 2006-07 to 2010-11. The outcomes were achievement of significant growth rate in Own Tax Revenue and a move towards revenue led fiscal consolidation.

But, as can be seen from Table 3.2, the growth rates of Own Tax Revenue fell in the first half of the second decade, especially since 2013-14. One major reason for this is the slowdown in the economic growth of the State (Table 3.3). But it needs mention that despite the slowdown, Kerala's Own Tax -GSDP ratio has remained higher than that of the all States in India (Table 3.5). It can be seen from Table 3.3 that the slowdown in economic growth is discernible at all India level and in Kerala, but it is more marked in Kerala during 2012-13 to 2015-16.

Table 3.2: Component wise Growth Rate of Own Tax Revenues (%)

Period	Sales Tax/Value Added Tax	Excise duty	Motor Vehicle Tax	Stamp duty and Registration
2006-07 to 2010-11	17.75	15.22	16.26	19.91
2011-12 to2015-16	14.26	3.93	16.24	2.88
Decrease (-) / Increase (+) (%)	(-) 3.49	(-)11.29	(-) 0.02	(-)17.03

Source: Finance Accounts, Kerala, C&AG

Table 3.3: GSDP and GDP Growth Rates (in current prices) – Kerala and All-India (%)

Year	Kerala GSDP Growth Rate	All India GDP Growth Rate
2012-13	13.26	13.82
2013-14	12.79	12.82
2014-15	10.22	10.79
2015-16	8.59	9.94

Source: Central Statistics Office, mospi.gov.in

Table 3.4: Growth Rates of GSDP (current prices) Construction and Trade Hotels and Restaurants (%)

Year	Construction	Trade, Hotels and Restaurants
2012-13	4.43 (9.02)	22.19 (19.35)
2013-14	16.10 (8.46)	13.32 (12.10)
2014-15	8.97 (6.46)	14.00 (10.72)
2015-16	0.95 (2.29)	8.20 (8.72)

Source: Central Statistics Office, mospi.gov.in, Figures in parentheses are all India growth rates.

Table 3.5: Own Tax Revenue-GSDP Ratio- Kerala and all States

Year	Kerala	All States
2011-12	7.06	6.4
2012-13	7.29	6.8
2013-14	6.88	6.3
2014-15	6.70	6.3
2015-16	6.63	6.5

Source: Finance Accounts, Kerala, C&AG, State Finances – A Study of the Budgets, RBI

Major contributors of economic growth in the State are Construction and Trade, Hotels and Restaurants. Slowdown in construction activity is an all India phenomenon in recent years. By 2015-16, there was a significant fall in growth rates for Kerala and it became below all India growth rates (Table 3.4), primarily due to a decline in growth rate of construction sector.

One of the factors that sustained the relatively high growth of the Construction and Trade, Hotels and Restaurants sub-sectors in Kerala for a long period of time was the large inflow of remittances. According to the Development and Migration Brief (2017) published by the World Bank, inward remittances to India dropped by 9 per cent from $ 67 billion in 2015 to $62.7 billion in 2016. While State- wise break up of remittances is not available, Kerala is the State which would have taken a large hit due to this fall.

Kerala's economy which had started witnessing signs of slowdown since 2012-13, had faced a major blow due to demonetisation. The impact of withdrawal of ₹500/- and ₹ 1000/-notes from circulation on November 8, 2016 and the subsequent cash crunch adversely affected every sector of the State's economy. This resulted in a sharp fall in tax collection in the months following demonetisation as compared to the months preceding the same. The impact has been severe on Commercial Taxes that is, VAT and Sales Tax and on revenues from Stamp Duty and Registration (Table 3.6).

For the year 2016-17, the overall growth rate of Own Tax Revenue was at a low rate of 8.16 percent, due to sluggish economic growth which further compounded due to demonetisation. It is in this background that GST was implemented during financial year 2017-18, with effect from 1st July, 2017. Kerala, as a prominent destination State of consumption had high expectation of a buoyant revenue growth from intra and more from inter State trade. Besides, inclusion of services in the tax base was expected to result in an expansion of the tax base of the State.

Table 3.6: Growth Rate in Collection of components of Own Tax Revenue – Pre and Post Demonetisation (%)

Component	July-October 2016	November -December 2016
Commercial Taxes	1.94	-8.5
Excise	5.3	3.63
Registration	5.9	-7.48
Motor Vehicles	4.4	2.46
Total	2.1	-7.63

Source: Table 19, Report of the Committee to Study the impact of Demonetisation on the Economy of Kerala

However, there were several unforeseen challenges. As observed by the Fourth Kerala Public Expenditure Committee in its second Report (February 2018), the tax base of goods as well as the tax rates were reduced after introduction of GST. As observed by the Committee:

"2.3.3 Since the implementation of GST from 1st July 2017, the standard rate on goods, which was 14.5 percent under the Value Added Tax (VAT) regime, has come down to 9 percent (SGST component of 18 percent GST). This implies that there has been a fall in the rate of tax by 5.5 percentage points for a majority of commodities (14.5 - 9), as 75 percent of the taxable commodities were at 14.5 per cent under the VAT."

In addition to the fall in rate, the tax base of goods also got reduced. Earlier, on a good received on inter State trade, priced at ₹100 had levy of ₹ 12.50 as Central Excise Duty, taking the total to ₹ 112.50, On this, a profit margin of 10 percent is added, taking the price to ₹ 123.75. On this price, 2 percent Central Sales Tax is levied and collected by the exporting State, taking the price to ₹ 126.23. It is on this price 14.5 percent VAT was levied, which amounted to ₹18.30. Under GST, tax is levied on ₹ 110, (₹100+ 10 percent profit margin), say at 18 percent. The States' share in GST is ₹ 9.9. If the GST rate is at 28 percent (which is the case only with a very few commodities), States' share would be ₹ 15.4. Due to equal apportioning of rates, along with the fall in standard rate from 14.5 to 9 percent, there has been substantial revenue loss for a high consumption State like Kerala. This is increasingly becoming a challenge for cash management due to the slow movement of flow of States' share in IGST from the Union government. This issue is discussed in Chapter 4 of this Memorandum. The late implementation of 'e-Way bill' much after abolition of check posts has adversely affected the effectiveness of enforcement. These have severely impacted the revenues from GST for all States. The impact has been even more serious for a consumer State like Kerala.

Due to the factors mentioned above, Kerala has experienced a significant shortfall in growth of own tax revenue during 2017-18. Though compensation with an assured growth rate of 14 percent for the State taxes subsumed in GST on the base of actual collections for 2015-16, would be paid, it will taper off by 2021-22.

Unless the uncertainties in implementation of GST, the increased Vertical Imbalance due to fall in standard rate on 75 percent of taxable commodities from 14.5 percent to 9 percent and loss resulting from equal apportionment of GST rates between the Union and the State are factored in while determining the States' share of the divisible pool of the Union taxes, the fiscal situation of Kerala would further deteriorate.

The above discussion also underscores the fact that Kerala economy and State's Own Tax Revenues are slowing down, impeding the process of fiscal consolidation (Table 3.7).

Table 3.7: Deficit Indicators – 2011-12 to 2018-19 BE

Year	Revenue Deficit/ GSDP (%)	Fiscal Deficit /GSDP (%)	Primary Deficit /GSDP
2011-12	2.21	3.52	1.79
2012-13	2.27	3.64	1.89
2013-14	2.43	3.64	1.87
2014-15	2.69	3.64	1.73
2015-16	1.73	3.18	1.21
2016-17	2.51	4.28	2.32
2017-18 (BE)	2.14	3.43	1.62
2017-18 (RE)	1.91	3.31	1.35
2018-19 (BE)	1.66	3.10	1.17

Source: Budget Documents, Government of Kerala

Even under these unenviable circumstances, there is a renewed effort for fiscal consolidation by the Government of Kerala, as can be seen from the targeted reduction of all major deficit indicators. The Revenue Deficit ratio for 2015-16 declined sharply. The implementation of the recommendations of the Tenth State Pay Commission in the financial year 2016-17 resulted in a rise in Revenue Deficit ratio during 2016-17. Renewed fiscal consolidation process has started since 2017-18 (RE) and the government is committed to continue this as is evident from the targets in the Medium Term Fiscal Policy (MTFP) Statement, 2018 (Table 3.8).

Table 3.8: Deficit Indicators Targets as per MTFP Statement, 2018

Year	Revenue Deficit/ GSDP (%)	Fiscal Deficit /GSDP (%)	Primary Deficit /GSDP (%)
2019-20	1.51	3.01	0.88
2020-21	1.33	2.91	0.81

Source: MTFP Statement. 2018Government of Kerala.

In paragraph 39 page 20 of the MTFP Statement, 2018, reproduced below, the Government of Kerala makes its commitment to fiscal consolidation very clear.

"The State is committed to reduce RD/GSDP ratio and FD/GSDP ratio over the next three years so as to reduce RD/GSDP ratio to 1.33 % in 2020-21. FD/GSDP ratio could be brought down below 3% to 2.91 % in 2020-21. Debt to GSDP ratio is expected to decline to 29.70 per cent by 2020-21 and IP/RR ratio to below 15 per cent."

As can be seen from the targets for Revenue Deficits and Fiscal Deficits as a proportion of GSDP, the government is committed to increase Capital Expenditure and reduce the preponderance of revenue expenditure in total expenditure. Capital Expenditure as a proportion of GSDP has been rising and by bringing down Revenue Deficits in a phased manner, Capital Expenditure – GSDP ratio will further go up (Table 3.9).

The Debt- Revenue Receipt ratio which is at 247 as per 2016-17 actuals is proposed to be brought down to 201.83 by 2012-22 as per the MTFP Statement, 2018. This would require both expenditure rationalisation and buoyant revenues and for achieving this, the State is making conscious efforts on a continued basis.

The MTFP Statement, 2018, has projected committed expenditure on Salary+ Pension +Interest as a proportion of Revenue Expenditure to decline to 52.88 percent by 2020-

21 from 60.76 percent in 2016-17. This will give more fiscal space for other necessary revenue expenditure as well for Capital Expenditure. The MTFP Statement, 2018 aims for revenue led fiscal consolidation and expects Own Tax Revenue to grow at 20 percent per annum once the implementation of GST stabilises and the economic environment turns more robust. This reveals the commitment of the State to fiscal consolidation.

Table 3.9: Capital Expenditure- GSDP Ratio (%)

Year	Capital Expenditure- GSDP Ratio
2005-06	0.81
2006-07	0.81
2007-08	1.35
2008-09	1.32
2009-10	1.26
2010-11	1.56
2011-12	1.33
2012-13	1.4
2013-14	1.23
2014-15	0.97
2015-16	1.50
2016-17	1.83
201718 (RE)	1.46
2018-19 (BE)	1.48

Source: Table 1.5 in KPERC Report, February 2018, MTFP Statement 2018

Though Kerala could not meet the targets as per the FRBM Act, it needs to be recognised that it is taking efforts towards fiscal consolidation. The other impediments like lower growth of the economy and impacts of polices like demonetisation and issues in GST implementation have also created slowdown in revenue mobilisation efforts. In this situation, the Central resources to Kerala have a crucial role in maintaining fiscal balance and sustainability, while ensuring the much needed fiscal space for public services.

Table 3.10: Share of Salary, Pension and Interest in Revenue Expenditure

Year	Revenue Expenditure (₹ crore)	Salary + Pension+ Interest (₹ crore)	(3) As a proportion of (2) (%)
(1)	(2)	(3)	(4)
2012-13	53489	33329	62.31
2013-14	60486	37516	62.02
2014-15	71746	42366	59.05
2015-16	78689	47624	60.52
2016-17	91096	55347	60.76
2017-18 (RE)	101436	61938	61.06
2018-19 (BE)	115661	66088	57.04
2019-20	135323	74915	55.36
2020-21	158328	83716	52.88

Source: MTFP Statement, 2018, Government of Kerala

Chapter 4

ISSUES IN ADDRESSING VERTICAL IMBALANCE: VIEWS OF KERALA

Prior to the implementation of GST on 1st July 2017, tax bases of the Union and States were separate. Major taxes of the Union were Excise Duty on manufacture of goods other than alcoholic liquor for human consumption, Customs Duty on imports, Personal Income Tax on non- corporate incomes and Corporate Income Tax on profits of companies. Initially, Services were not taxed either by the Union or the States. But the Finance Act, 1994, started taxing of a limited number of services, which were widened until all services, except those in the negative list were brought in the tax net. The States were taxing purchase and sale of goods within their jurisdiction and inter State trade (a subject in the Union List) was taxed through the Sixth Constitutional amendment, 1956. Though the Central Sales Tax (CST) was a Central tax, it was levied and collected by the State in which the transaction originated. Given the Constitutional division of power to tax, the more buoyant taxes are with the Union. As a share of Gross Domestic Product, the share of a Union and State taxes are shown in Table 4.1.

It is evident from Table 4.1, that since 2015-16, Centre's GTR to GDP ratio is increasing, while the OTR to GDP ratio of all States remained stagnant. This indicates that Vertical Imbalance in the revenue side has been increasing since 2015-16. This has resulted in an increase in the gap between buoyancies of Gross Tax Revenue of the Union and Own Tax Revenues of the States (Table 4.2).

Table 4.1: Union and State Taxes to GDP Ratio (%)

Year	GTR of the Union	OTR of the States	OTR as a percentage of OTR+GTR
2011-12	10.17	6.38	38.54
2012-13	10.42	6.58	38.71
2013-14	10.14	6.34	38.49
2014-15	9.98	6.25	38.50
2015-16	10.58	6.15	36.79
2016-17	11.25	6.25	35.72
2017-18(RE)	11.52	6.53	35.99

Source: Budget Documents of the Union and the States
Note: GTR - Gross Tax Revenue, OTR - Own Tax Revenue

The improvement in Union government's revenue buoyancy can be attributed to the following factors:

(a) In the fiscal year 2010-11, Union government was taxing 104 selected services. The Union Budget 2012-13 introduced the concept of negative list in service taxation. Introduction of negative list rendered tax base comprehensive and removed selectivity in taxation of services. Subsequently, negative list was further pruned. The service tax rate was subsequently increased to 14 percent from 1st June 2015. Since 15th November 2015, Swachh Bharat Cess @ 0.5 percent was also added to it. Therefore the effective rate of Service Tax became 14.5 percent with effect from 15th November 2015.

(b) Steep decline in the crude oil prices offered an opportunity to the Union to increase price of petroleum products by imposing cess in Excise Duty, which is not shareable with the States. This turned out to be a windfall gain of revenues to Government of India. Since this was primarily done by imposing cess and revenue collected through cess is not sharable with the States, increase in Central revenue did not result in an increase in the quantum of tax shares to the States. This also reduced States' fiscal space for revenue increase in petroleum products through an increase in taxation.

Table 4.2: Buoyancy of Union and State Taxes

Year	Buoyancy of Union GTR	Buoyancy of States OTR	Gap between Buoyancies GTR - OTR
2012-13	1.20	1.26	-0.06
2013-14	0.76	0.68	0.08
2014-15	0.85	0.85	0.00
2015-16	1.63	0.84	0.79
2016-17	1.65	1.16	0.49

Source: Budget Documents of the Union, States and mospi.gov.in

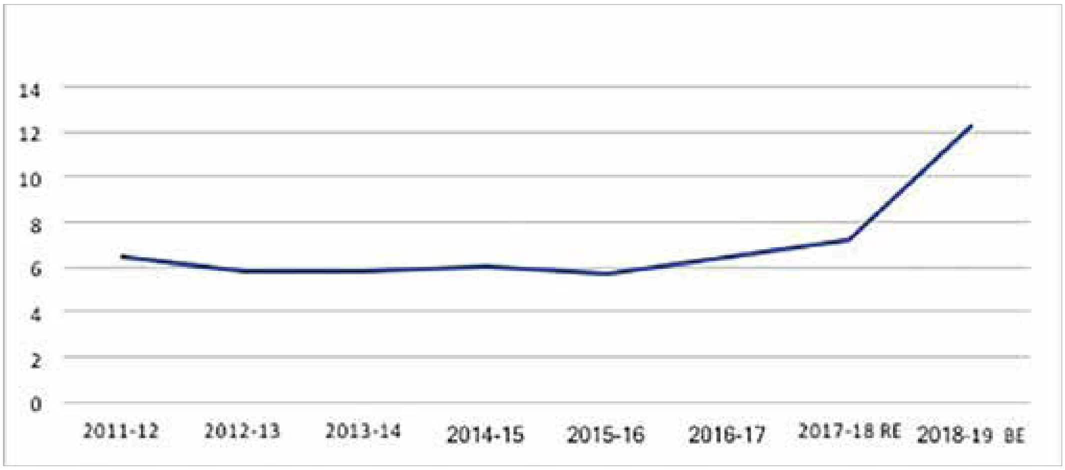
Besides the above, general increase in surcharges and cesses in Gross Tax Revenue is reducing the Divisible Pool of Union Taxes shareable with the States. This is one of the key factors accentuating the Vertical Imbalance between the Centre and the States. As evident from Table 4.3, the share of surcharges and cesses to Gross Tax Revenue of the Union during 2011-12 to 2018-19 (BE) (Table 4.3 and Figure 4.1) has increased from 6.47 per cent to 12.59 per cent.

Table 4.3: Surcharges and Cesses as a proportion of GTR of the Union

Year	Gross Tax Revenue (GTR) (₹ crore)	Surcharges & Cesses (₹ crore)	Surcharge & Cess as a % of GTR
2011-12	889176	57500	6.47
2012-13	1026234	59572	5.80
2013-14	1138733	70518	6.19
2014-15	1244884	74401	5.98
2015-16	1455648	78509	5.39
2016-17	1715822	123318	7.19
2017-18 RE	1946119	137510	7.07
2018-19 BE	2271242	285917	12.59

Source: Budget Documents of the Union

Figure 4.1: Surcharges and Cesses as a proportion of GTR of the Union



Source: Table 4.3

It may be taken note of that since 2015-16, when the share of the States in the divisible pool of Union Taxes was increased to 42 percent from 32 percent, the proportion of surcharges and cesses has been increasing making the size of the divisible pool smaller. Loss to the Sates due to the rising share of surcharges and cesses by the Union are presented in Tables 4.4 and 4.5 respectively.

Table 4.4: States' loss from Surcharges and Cesses (₹ crore)

Year	GTR	Cost of collection	GTR-Cost of Collection	Divisible Pool at 42 percent of (4)	Actual Divisible Pool	Loss due to surcharges and cesses	Tax Devolution as a percentage of Gross Tax Revenue
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2015-16	1455648	9260	1446388	607483	506192	101291	34.77
2016-17	1715822	11472	1704350	715827	608000	107827	35.43
2017-18 RE	1946119	14350	1931769	811343	673005	138338	34.58
2018-19 BE	2271242	14805	2256437	947704	768412	179292	33.83
						526747	

Source: Budget Documents of the Union

From Table 4.4, it can be seen that, the proportion of surcharges and Cesses to Gross Tax Revenue of the Union has been rising since 2015-16. Let us look at a scenario, where States' loss would have been minimised, had the proportion of surcharges and cesses to Gross Tax Revenue remained at the median level of 2011-12 to 2015-16, that is, at 5.83 percent during the period 2015-16 to 2018-19 (during the first period, States' share in divisible pool of Union Taxes was 32 percent and in the second period, it was 42 percent) (Table 4.5). As a proportion of Gross Tax Revenue, share of the Divisible Pool has shrunk from 34.77 percent to 33.83 percent during 2015 - 16 to 2018-19 BE. This is due to increasing share of surcharges and cesses and non-transparent computation of Net Proceeds, as explained later.

Table 4.5: Loss to States from rising share of Surcharges and Cesses in GTR (₹ crore)

Year	Net Proceeds of assumed GTR with Surcharges at 5.83 percent of GTR	Divisible Pool at 42% of (2)	Actual Divisible Pool	Loss to States from increase in surcharges and cesses
(1)	(2)	(3)	(4)	(5) = (3)- (4)
2015-16	1372188	576319	506192	70127
2016-17	1616917	679105	608000	71105
2017-18 RE	1832669	769721	673005	96716
2018-19 BE	2140682	899086	768412	130676
				368623

Source: Budget Documents of the Union

In the first scenario, without surcharges and cesses (as in Table 4.4), the States would have had a divisible pool larger by ₹ 526747 crore and in the second scenario (as in Table 4.5), the divisible pool would have been larger by ₹ 368623 crore.

The rising proportion of surcharges and cesses in Gross Tax Revenue (which will have an impact on Net Proceeds also) substantially neutralises the higher share to the States in the divisible pool of the Union taxes. This is a crucial factor in increasing Vertical fiscal imbalance between the tax revenues of the Union and the States, In short, even after the percentage of Union taxes shareable with the States has been raised to 42 percent of the Net Proceeds by the 14th Finance Commission as against 32 percent recommended by the 13th Finance Commission, the Vertical Imbalance between the revenues of the Union and the States has increased predominantly due to proliferation of surcharges and cesses.

Even though GST seeks to eliminate surcharges and cesses, it is still retained for providing compensation to the States. As regards other taxes, the Union can still levy surcharges and cesses. Recently, the loss of revenue by reduction of Income Tax rates for incomes up to ₹ 5 lakh from 10 to 5 percent was sought to be compensated by levy of surcharge on incomes above ₹ 50 lakh. This in effect reduces the size of divisible pool. It is felt that the 15th FC needs to take a view on surcharges and cesses neutralising higher devolution. It is our considered opinion that levy of surcharges and cesses should be avoided to the maximum extent possible and if levied and are continued for more than a medium period, say, beyond three financial years, they should be made part of the divisible pool. This would require a Constitutional amendment. As an interim measure the FC should consider increasing the share of taxes in the divisible pool proportionately to reduce the loss of revenue rightfully due to the States. In this context, the observations of the Justice. M M Punchhi Committee on Centre-State Relations (volume III, Pp 55 - 56) are pertinent. The relevant portion of the report is extracted below:

"6.3.01 The 80th Amendment of the Constitution provided for the sharing of all Union taxes between the Centre and the States except the proceeds of taxes referred to in Articles 268 and 269 and the cesses and surcharges levied on Union taxes. This has met the long standing demand of the States for the enlargement of the divisible pool of Central taxes. But the extension of the scope of cesses and surcharges imposed on Central taxes has greatly reduced the divisible pool over the years. The share of cesses and surcharges witnessed a sharp increase from 4.9 per cent of the Gross Tax Revenue of the Centre in the award period of FC-VIII to 11.34 per cent in the award period of FC-XII.

6.3.02 The introduction of new cesses and surcharges has neutralised the higher tax devolution recommended by the successive Finance Commissions. FC-XI and FC-XII recommended States' shares in net Central taxes at 29.5 and 30.5 per cent, respectively. But because of large scale resort to the levy of cesses and surcharges, actual tax devolution to States were lower at 25.95 per cent of Gross Tax Revenue in the award period of FC-XII as compared with tax devolution amounting to 26.57 per cent in the award period of FC-XI. Thus, the increase of States' share in Central taxes by one percentage point by FC-XII was more than neutralised. The Finance Commissions' recommendations are based on the assessment of the resource position of the Centre and the States and their needs. Extension of cesses and surcharges amounts to dilution of the recommendations of the Finance Commissions and deprives the States of their due share in Central tax revenue."

It also needs to be mentioned here that due to the lack of transparency in calculation of Net Proceeds (which is not published by the Union), States are not in a position to understand the size of the divisible pool. It is relevant to point out here that C&AG in Report 27 of 2016 (Pp 28-29) has observed as under:

"In terms of Article 279 of the Constitution, the Comptroller and Auditor General of India is required to ascertain and certify the 'net proceeds' (any tax or duty the proceeds thereof reduced by the cost of collection), whose certificate shall be final. During the certification of 'net proceeds' by the CAG, based on the recommendations of the successive Finance Commissions, it was noticed that during the period 1996-97 to 2014-15 an aggregated amount of ₹81,647.70 crore was short devolved to the States."

Given the importance of the issue and lack of fiscal transparency on the part of the Union resulting in revenue loss to the states, it is submitted that the Finance Commission consider making a specific recommendation requiring the Centre to publish along with budget documents as to how Net Proceeds are computed so that unseen losses to States as pointed out by C& AG do not occur in future. Given the observations of the C&AG, Finance Commission is also requested to give appropriate recommendations to compensate the revenue loss to the States just due to the practice followed by the Union to keep its own budgetary account non-transparent.

If we consider the aggregate transfers, though tax share has increased consequent upon the recommendations of the 14th Finance Commission, the, Central grants to States as a proportion of GDP and Revenue Expenditure of the Union stagnated and declined from the level of 2014-15. It is expected to be 2.80 per cent of GDP in the year 2017-18 (RE). The increase in grants during 2014-15 is due to the change in procedure of giving grants to the States. Earlier, the big ticket centrally sponsored schemes were transferred directly to the implementing agencies bypassing the State budgets. From 2014-15, all grants are routed through the state budgets. This makes figures prior to 2014-15 not comparable with that of figures subsequent to 2014-15 (Table 4.6).

Table 4.6: Share of Central Grants to States 2011-12 to 2017-18 (%)

Year	Union Revenue Expenditure GDP Ratio	Central Grants – GDP Ratio	Central Grants-Union Revenue Expenditure Ratio
2011-12	13.12	2.13	16.27
2012-13	12.51	1.90	15.17
2013-14	12.21	1.83	15.01
2014-15	11.77	2.65	22.55
2015-16	11.17	2.39	21.37
2016-17	11.08	2.45	22.07
2017-18 (RE)	11.52	2.80	24.32

Source: Budget Documents, Government of India

4.1 Vertical Fiscal Imbalance post GST

If we consider combined indirect tax to GDP ratio for the year 2013-14, it was 11.39 per cent of which Union government's indirect tax to GDP ratio was 4.65 per cent. In other words, States on an average was collecting around 60 per cent of the total indirect taxes in the country and that was roughly the entire own tax revenues of States, as they do not have any major direct tax sources. Since the predominant source of this indirect tax revenue was VAT on goods, it was expected that post GST, this revenue would be protected through appropriate rate structure in which standard rates for State revenues would be fixed appropriately.

As India has gone for a dual GST in an overlapping tax base and single rate across the country, substantial fiscal autonomy has been surrendered by both levels of governments. A unified GST not only has implications for trade and business but also on the basic federal structure, particularly the fiscal structure and resultant vertical and horizontal imbalances. In this context, protecting state level fiscal autonomy is critical. One of the key aspects of fiscal autonomy is the ability to fix rate. Since a consensus was reached to have single rates across the country, apportionment of rate should have been such that States were able to protect their revenues even if they gave up their ability to fix rate to ensure harmonisation of tax rate for common market.

In a multi-level fiscal system, fiscal autonomy is just not independent financial power of sub-national governments. It is critical for accountability. Going a step forward it may not be wrong to argue that GST council should have apportioned the rate structure in such a way that it reduced the existing vertical fiscal imbalance and provided appropriate fiscal space for greater accountability of all levels of governments.

In future, the vertical imbalance in tax revenue of the Union and the States is going to increase due to the way GST has been implemented. The GST rates of 3, 5, 12, 18 and 28 percent are shared between the Centre and the States equally as 1.5, 2.5, 6,9and 14 percent respectively. The equal apportionment of GST rates between the Union and the States is iniquitous. As viewed by many, including the Task Force appointed by the 13th Finance Commission, the rates should have been apportioned in 60:40 between the States and the Union. On distribution of Revenue Neutral Rate between the Union and states, Report of the Committee on RNR headed by Chief Economic Advisor noted that allocation of rate *"must reflect the revenue requirements of the Centre and states so that revenues are protected. For example, a standard rate of 17 percent would lead to rates at the Centre and states of say 8 percent and 9 percent, respectively because that is roughly the ratio of GST revenues that would have to be generated by the Centre and states assuming that the 2013-14 data on which these estimates are calculated remain valid. According to the Committee it would be preferable to keep all other rates identical between the Centre and states to minimise distortions and facilitate compliance."* (Pp 30-31).The 50:50 ratio when the proportion of State taxes subsumed is twice that of the Union would undoubtedly exacerbate the Vertical Imbalance between the Centre and the States. The major commodities on which Central Excise is leviable, other than Petroleum and Tobacco products are Iron and Steel, Cement, Chemicals, Motor Vehicles and Plastics and Machinery. Along with Petroleum and Tobacco products, they contributed 80 percent of the Central Excise collections. Petroleum and Tobacco products alone comprised 60 to 70 percent of Central Excise collection.

As observed by C & AG (Report: 2, 2016) growth rate of commodities other than Petroleum and Tobacco products have either been stagnant or negative. It is this part of Central Excise that is getting subsumed in GST. The Union still has the right to levy excise duty on Tobacco products and hence Tobacco cannot be taken as subsumed in GST. The share of Central taxes subsumed in GST is only 26.92 percent as per the budget figures for 2015-16, when worked out on the basis of the following formula.

Central Share subsumed in GST = (Gross Revenue from Non-Petroleum and Tobacco Products in Central Excise + Service Tax+ Additional Countervailing Duty + Special Additional Countervailing Duty) / Gross Tax Revenue of the Union

As can be seen from Table 4.7, the percentage of Gross Tax Revenue of the Union subsumed in GST is an average of 23.11 percent for the period 2011-12 to 2015-16. Prior to GST, the Union could levy Excise Duty on manufacturers with an annual turnover of above ₹ 1.5 crores. After GST, the Union can tax up to the retail sales level above the turnover limit of ₹ 20 lakh per annum (though the traders with a turnover limit of ₹ 1.5 Crore per annum can opt for a compounding levy)

Table 4.7: Share of Central Taxes subsumed in GST – 2011-12 to 2015-16

Year	Central Excise Duty other than from Petro-leum and Tobacco.(.₹ crore)	Service Tax (₹crore)	Additional and special countervailing duty (part of Customs Duty) (₹ crore)	Gross Tax Revenue of the Centre (₹ crore)	Percentage of GTR subsumed in GST
2011-12	40038	97508	86097	1145785	19.52
2012-13	52043	132600	106942	1243513	23.45
2013-14	48917	154778	111832	1371771	23.00
2014-15	48048	167969	122542	1469991	23.08
2015-16	66257	211414	136282	1537761	26.92

Source: Budget Documents of the Union and C&AG Reports on Union Indirect Taxes

As far as the States are concerned, the expansion of base is due to inclusion of service tax, which was levied by the Centre. The part of State Taxes subsumed in GST is 41.34 percent (Sales Tax/VAT is 78 percent of Own Tax Revenue and VAT is 53 percent of Sales Tax + VAT. Hence share of overall State taxes subsumed in GST is 41.34 percent).This is based on Kerala's finances but the situation in other States may be more or less similar. It is also to be taken note of that, States do not have any buoyant source left after the VAT leviable commodities has been subsumed under GST. In this context, the apportionment of rates between CGST and SGST and the States' necessity for a higher share than that of the Centre assumed significance, but when GST came into effect from 1st July, 2017, apportionment of rates was equal between the Union and the States. This has truncated the tax base of the States in contrast to the earlier VAT regime when VAT was levied in addition to Central Excise, Service Tax and Central Sales Tax in case of inter-State trade. Besides these, the standard rate on 75 percent of the taxable commodities has fallen from 14.5 percent under the VAT regime to 9 percent after the implementation of GST.

It is worth mentioning here that though under a different rate structure (of uniform 12 percent and more commodities being subsumed), the Task Force constituted by the Thirteenth Finance Commission suggested that SGST rate should be higher by 2 per cent than CGST rate. The above discussion and the illustration in the footnote makes it abundantly clear that the Vertical Imbalance in the Indian context has increased and is likely to increase further due to the equal apportionment of GST rates between the Centre and the States.

The GST levy has also brought in the problem of liquidity crunch for the States in addition to contributing further to Vertical Imbalance. The levies of tax on inter- State trade is a subject in the Union List. After implementations of the GST, the Central Sales Tax (CST) levied on inter State trade by the State where the transaction originates has been subsumed and Integrated Goods and Services Tax (IGST) is levied and collected by the Centre. IGST is paid at the time of inter- State purchase and the IGST rate is the combination of Central GST (CGST) and State GST (SGST) rates. One half of IGST rate is due to the Union as CGST and the other one half is due to the destination State, where the good or service is finally sold or delivered, as SGST. In short, the Union acts as a clearing house by collecting entire IGST and releasing the destination state's share subsequently, as and when the good is sold or service is delivered and in proportion to the output tax paid.

This trickle of destination States' share in IGST gives rise to liquidity problems to consumer States like Kerala, which have a large proportion of inter State purchases. To tide over the liquidity crisis, the State is forced to borrow which creates interest liabilities, when its share in IGST is held up with the Union. For the Union, the additional resource available is interest free funds for ways and means. It is also pertinent to note that the entire IGST collected has been taken as revenue receipts by the Union in the 2017-18

Revised Estimates, whereas only 50 percent of this would be CGST and the balance would be the share of the State where the final consumption takes place.

This proportionate release of States' share in IGST is due to the provisions of Section 18 of the IGST Act, 2017. This needs an amendment and provisional allocation of the SGST share to the State to which the dealer making the inter-State purchase is located is necessary. (If adjustments are needed due to further inter-state sales by the dealer, this needs to be made). The present system of Union keeping the SGST share in IGST deprives the States of it timely availability of tax revenue and forces them to take recourse to interest bearing borrowings. But the Union gets interest free resources for ways and means. This is another way in which Vertical Imbalance has increased after implementation of GST.

4.2 Why higher shares of Union taxes need to be devolved to the States?

The 14th Finance Commission had recommended a share of 42 percent of the net proceeds of the Union taxes to be shared with the States. As per the 2018-19 Budget Estimates of the Union government, tax devolution as a percentage of Union Taxes is 34 percent of Gross Tax Revenue. This indicates 8 percentage point gap between the share of the States in net proceeds and in Gross Tax Revenue of the Union. As evident from Table 4.1, there is a declining trend in OTR of the States as a percentage of total tax revenues (OTR+GTR), during the first two years of the 14th Finance Commission award due to the continuous proliferation of cess and surcharges. The OTR as a percentage of total tax revenue of the Union has declined from 38.54 per cent in 2011-2016 to 35.99 per cent in 2017-18 RE. It needs to be emphasised that this has happened in a situation when States' tax effort remained at around 6.15 to 6.5 per cent of GDP. Thus, the decline in the share of OTR + GTR is not due to the decline in States' tax effort. It is primarily due to the increase in the share of non-divisible part of the GTR in total.

To compensate for the 2 percentage point drop in tax shares due to the increase in non-sharable component of the GTR, i.e., cess and surcharges, an increase in the vertical devolution to a level higher than 42 per cent of the divisible pool is absolutely critical. Apart from this, vertical fiscal imbalance has further accentuated due to the introduction of GST through equal apportionment of rates of various tax slabs under GST, the rising expenditure- revenue imbalance and the gap between post devolution Union and State resources. How much should tax devolution go up taking these three factors into consideration is the critical question.

As evident from Table 4.8, though Own Tax Revenues of the States constitute roughly 55 per cent of the Gross Tax Revenue of the Union, post-tax devolution and grants, this ratio goes up to 93 per cent. We propose that complete elimination of vertical fiscal imbalance would mean States' tax resources post devolution and Article 275 Revenue

Deficit grants should be equal to the Gross Tax Revenue of Union. By this formulation, which is presented in Table 4.9 and explained below, the vertical devolution should go up from existing 42 per cent to 50.9 percent of the Net Proceeds of Union taxes.

The gap between the all States Own Tax Revenues, Tax Devolution and Deficit Grants under Article 275 and the Gross Tax Revenue of the Union is presented in column 6 of Table 4.9. Net Proceeds is estimated in column 7 from the actual Tax Devolution figures in column 4. For 2011-12, it is (253022/32)*100 and for 2015-16, it is 506192/42)*100. In other words, Net Proceeds is estimated by (Actual Tax Devolution to States / Share of the Proceeds recommended by the Finance Commission) X 100. The gap between States' Own Tax Revenues, Tax Devolution and Revenue Deficit grants under Article 275 and Gross Tax Revenue of the Union is estimated as a percentage of Net Proceeds in column 8. This is added to the share recommended by the 14th Finance Commission to reduce the gap to zero, which is the closest proxy for Vertical Equity (column 9). Based on this estimate, we propose vertical devolution of 50 percent of Net Proceeds of Union Taxes to the States.

Table 4.8: States Tax Revenues and RD Grants as a percentage of GTR of the Union

	Own Tax Revenue	Tax Devolution	RD Grants	Total Untied Transfers
2011-12	62.7	28.5	1.2	92.4
2012-13	63.8	28.4	1.1	93.3
2013-14	62.6	27.9	0.9	91.4
2014-15	62.6	27.1	0.6	90.3
2015-16	58.2	34.8	3.4	96.3
2016-17	55.6	35.4	2.4	93.4
2017-18 RE	56.2	34.6	1.8	92.6

Source: Budget Documents of the Union

Table 4.9: Increase in Tax Devolution for Vertical Equity

Year	GTR-Centre₹ crore)	OTR - All States(₹ crore)	Tax Devolution(₹ crore)	OTR+ Tax+ Deficit Grants(₹ crore)	GTR-Total States(₹ crore)	Net Proceeds(₹ crore)	Share of 7 in 8 (%j	Estimated Total Share in Net Proceeds (%)
1	2	3	4	5	6	7	8	9
2011-12	889175	557400	253022	821230	67945	790694	8.6	40.6
2012-13	1026324	654550	291546	957812	68512	911081	7.5	39.5
2013-14	1138733	712420	318229	1040723	98010	994466	9.9	41.9
2014-15	1244884	779280	337808	1124638	120246	1055650	11.4	43.4
2015-16	1455648	847143	506192	1402241	53407	1205219	4.4	46.4
2016-17	1715822	953307	608000	1602615	113207	1447619	7.8	49.8
2017-18 RE	1946119	1094225	673005	1803050	143069	1602393	8.9	50.9

Source: Budget Documents of the Union

Last but not the least, it deserves reiteration that the flow of resources to the States should be stable and predictable. The calendar of devolution of taxes to the States should not be subject to sudden changes, like from 1st of a month to the 15th or made bimonthly. This would create liquidity management problems for the States. Government of Kerala urges the 15th Finance Commission to recommend a calendar of devolution of taxes and to the States so that stability and predictability of resource transfer, which are crucial for the States, are ensured.

Chapter 5

SHARING OF DIVISIBLE POOL AMONG STATES – ISSUES AND SUGGESTIONS

The most challenging task of the Finance Commissions in India is to arrive at a formula for sharing proceeds of taxes of the divisible pool among the States. Though there would be agreement among States in India that the share of the divisible pool of taxes from the Union needs to be larger, there would be marked difference of opinion on any formula for distributing the share of Union taxes among the States. So far, the formula for dividing taxes in the divisible pool among the States has given considerable weightage for Population and Income Distance, with the latter having almost twice the weight of the former. The combined weight of these two criteria has varied between 72.5 to 77 percent of the overall weights since the 11th Finance Commission recommendations.

The 15th Finance Commission's ToR 8 mandates use of population based on 2011 census instead of population based on 1971 census. This is contrary to the ToR of earlier Finance Commissions. Since the population levels and its growth rates across States in India are vastly different, the opinions of the States on the weight to be given to the Population criterion will not converge. The States like Kerala which have achieved replacement rates of population and made considerable progress in human development indicators would prefer use of Population based on 1971 census as a criterion, not only because their share in all States' population has gone down since then, but also due to the fact that States have incurred substantial fiscal costs to adhere to the aims of the National Population Policy, 1977. Likewise, the suggestions for weight to be given to Income Distance criterion would also be markedly different, as the divergence in levels of per capita income between Indian States is high.

The weights assigned by Finance Commissions since the 11^{th} for horizontal distribution is reported in Table 5.1. The Constitutional provisions for sharing Union taxes, until the 11^{th} Finance Commission, were different. Previously, Personal Income Tax was shareable as per Article 270 and Central Excise was shareable under Article 272 as per law enacted by the Parliament. The Corporation Income Tax and Customs Duties (and surcharges and cesses) were not shareable with the States. But after the 80^{th} Constitutional amendment, all taxes of the Union, except surcharges and cesses, are part of the divisible pool and this came into effect with the award of the 11^{th} Finance Commission.

From Table 5.1, it can be seen that Population and Income Distance comprised about 75 percent in the recommendations of the Finance Commissions from the 11^{th} to the 14^{th}. As per the ToR of the pervious Finance Commissions, Population based on 1971 Census was used. But the 14^{th} Finance Commission gave 10 percent weight to Population based on 2011 census to consider demographic changes. The ToR 8 of the 15^{th} Finance Commission requires it to take into consideration Population based on 2011 census.

While taking Population based on 2011 census would be helpful to the States whose Population share has increased between 1971 and 2011, this has the potential to reduce the share of States like Kerala, whose share in total population based on 2011 census has declined as against its share in population based on 1971 census. Along with Kerala, population share has declined for Karnataka, Tamil Nadu, Andhra Pradesh, Assam, Chhattisgarh, Goa, Himachal Pradesh, Punjab and West Bengal between 1971 and 2011 Census.

It should be noted that this reduction in growth rate of population has come at a substantial fiscal cost to the State of Kerala. The expenditure on health and educational sectors are the prime determinants of the better human development index and consequent reduction in rate of population growth. The present stage of population profile in Kerala, has a rising proportion of ageing population, a situation similar to that of advanced countries. When rest of India is reaping the benefit of demographic dividend, Kerala is not able to have this benefit, though it has a longer life expectancy, higher female literacy, and lower infant mortality rates. It must be taken note of that merely because of the fact that the State has reached replacement rates in population growth, its spending needs have not decreased. Providing health care for ageing population, giving welfare pensions as part of the social commitment, providing housing to homeless and numerous pro-poor redistributive programmes impose huge fiscal cost to the State. Besides, the State cannot rest on its laurels after having achieved these progresses in indicators of human development. Maintaining them also is a commitment to achieve

Sustainable Development Goals. Government of Kerala is committed to provide affordable health care and education in the public institutions and this is an activity as per the Directive Principles of the Constitution. Without taking these into account, a mechanical application of ToR 8 of the 15th Finance Commission would constrain the capacity of the State to intervene to sustain the achievement in social development. Kerala is facing the challenge of allocating a higher share of its shrinking fiscal space for sustaining these indicators. Hence, any formula which ignores the demographic transition and the cost of maintenance of the achievements would be highly retrograde. This is the reason why Kerala along with other States facing similar issues has demanded deletion of ToR 8.

Substantial part of the spending on social sectors like education and health is salary payment for the personnel. This contributes to high revenue expenditure. Though the salary expenditure in Social sector is classified as Development Expenditure at present, the pension payments for these personnel at a later stage is classified as Non-Development Expenditure. To state in brief, Kerala is at present in a difficult situation, where sustaining the present achievements demand a higher fiscal space and this adversely affects the capacity of the State to intervene and spend in capital projects and higher social sector spending. The inability of the State to make investment in social and economic sector can have a negative consequence on economic growth. Given the uncertainties in getting higher revenues from GST and the issue of increasing Vertical Imbalance, as highlighted in Chapter 4 of this Memorandum, any loss of share from divisible pool of Union taxes will have deleterious fiscal and social consequences. It is in this context that Kerala's views on formula for sharing of divisible pool of Union taxes among the States needs to be considered.

Table 5.1: Criteria for sharing Taxes between States -11th to 14th Finance Commissions

Criteria and Weight (%)	11th FC	12th FC	13th FC	14th FC
Population	10	25	25	17.5
Demographic Change				10
Income Distance	62.5	50	47.5	50
Area	7.5	10	10	15
Index of Infrastructure	7.5	0	0	0
Tax Effort	5	7.5	0	0
Fiscal Discipline	7.5	7.5	17.5	0
Forest Cover				7.5

Source: Reports of the Finance Commissions

As can be seen from Table 5.1, Population and Income Distance comprise more than 75 percent of the weights in criteria for distribution of shared taxes among the States. The change in the ToR of the 15th Finance Commission is that Population based on 2011 census is to be used. Government of Kerala is of the considered opinion that this ToR should be deleted and Population based on 1971 census be given due weightage for devolution of taxes.

Population based on 1971 census, should get a weightage based on item ToR 7 (ii). TOR 7 states that the Commission may consider *"proposing measurable performance based incentives for States, at the appropriate level of government, in following areas (ii) Efforts and Progress made in moving towards replacement rate of population growth".*

It is our view that instead of making this forward incentives of additional sector specific grants, States should be given tax devolution based on tangible achievement of lowering the rate of growth of population between 1971 and 2011, as this is the first Finance Commission, which has been mandated to recommend tax shares based on Population of 2011 census. The tangible achievements can be proxied by giving a weight to Population based on 1971 Census in the devolution formula itself.

The 14th Finance Commission had used Population based on 2011 census as a proxy for Demographic Changes. Population is a neutral indicator of needs and the basis for using this as a criterion in tax devolution is that a citizen irrespective of her/his place of residence should have access to basic essential public services and for that the fiscal capacity of the States needs to be augmented. On this basis, there could be logic in using Population based on 2011 census, but the fiscal cost of the States, which achieved lower population growth and human development indicators cannot be overlooked. This would be equally iniquitous. The task of the Finance Commission being balancing the interests of States at different levels of per capita income, the Population based on 1971 census cannot be done away with. It is to be taken note of that current population is the denominator in calculating the average per capita incomes, which is the basis for the Income Distance criterion. Hence, doing away with Population based on 1971 census will have disproportionate adverse effect on States whose share in population has come down between 1971and 2011. The Government of Kerala is of the opinion that instead of considering progress made towards replacement rates of population as a condition for performance based grants, the substantial achievements made in this regard by the States like Kerala, should be considered as a criterion in tax devolution, which is the most important untied flow of resources to the States. The formula suggested by us (Table 5.3) is based on this.

There are possible alternatives like considering the inverse of the of difference in shares of Population based on 2011 and 1971 censuses or considering the profile of populations of the States based on the factors like age profile etc. But it is felt that in the larger interests of a political federation, an equity criterion like Population should be used in such a way so that a delicate balance is struck between the States. Simulation exercises reveal that the best possible option is to consider Population based on 1971 census as a proxy for the demographic achievements of States like Kerala, by giving it an equal weightage along with Population based on 2011 census. This is stated without prejudice to our opinion that ToR 8 of the 15th Finance. Commission mandating use of 2011 Population shall be deleted. In a simulation exercise done assuming that 14th Finance Commission had used Population based on 2011 census fully, the inter se share of Kerala in the divisible pool would have been 1.988 percent instead of 2.501 percent. The Table 5.2 illustrates the loss 12 States would have suffered had 14th Finance Commission adopted Population based on 2011 census. The fall is not merely due to adoption of Population based on 2011 census as an explicit criterion, but also due to scaling of Income Distance with Population based on 2011 census instead of that based in 1971 census. This would cause shares of States like Kerala in the divisible pool of Union taxes fall more than proportionally to their share in all States' population based on 2011 census.

Table 5.2: States' Losses had 14th FC adopted 2011 Population (%)

State	Inter-se share as per 14th FC Award	Inter-se share had 14th FC adopted 2011 population fully	Loss (-)
Andhra Pradesh	4.308	3.692	-0.616
Assam	3.313	3.182	-0.130
Chhattisgarh	3.081	3.044	-0.037
Goa	0.374	0.367	-0.07
Himachal Pradesh	0.713	0.695	-0.018
Karnataka	4.715	4.503	-0.212
Kerala	2.501	1.988	-0.513
Odisha	4.645	4.176	-0.469
Punjab	1.577	1.499	-0.086
Tamil Nadu	4.024	3.455	-0.569
Telangana	2.438	2.429	-0.009
West Bengal	7.33	6.823	-0.507

Source: Report of the 14th Finance Commission and computations with 2011 Population replacing 1971 Population.

By way of reiteration, it is submitted that as a Constitutional body, Finance Commission is required to achieve a delicate balance in devising a horizontal distribution formula which provided appropriate fiscal resources to all the States according to fiscal needs. As can be seen from the Table 5.2, the use of Population based on 2011 census, would cause loss to many States, in low, middle and high income categories. Highly populous States, which are already getting high shares would get still higher shares. Equity demands that their relative shares in the divisible pool should be higher. But exacerbating the imbalance between higher and lower shares, by reducing the share of States which have made achievements in human development and moved towards replacement rates in accordance with the National Population Policy, is an equally anti equity proposition. Government of Kerala is of the considered opinion that ToR 8 should be deleted and flexibility should be given to the Commission on the appropriate combination of choice of population to strike a balance between need, equity and efficiency.

Table 5.3: Suggested Relative weights and Criteria

Criteria	Suggested Relative Weight (%)
2011 Population	30
Demographic Achievement (Proxied by 1971 Population)	30
Income Distance	20
Area	10
Forest Cover	10

The suggested criteria and their proposed weights for horizontal sharing between the States is presented in Table 5.3. The Government of Kerala suggests that along with giving a weight to population based on 2011 census, 15th Finance Commission should consider giving an equal weight for Demographic Achievement Indicator, which can be proxied by population based on 1971 census. It is also suggested that since Population based on 2011 census is being used, it would be fair to reduce the present weight for Income Distance from the present 50 percent to 20 percent as the scaling factor also gives an advantage to highly populous States. The combined weight of Population and Income Distance is suggested at 80 percent which is higher than the 77. 5 percent adopted by the 14th Finance Commission. Other criteria like Area and Forest Cover can be retained as the reasons for which they have been introduced, hold good even now.

Chapter 6

LOCAL BODIES – SUGGESTED PRINCIPLES FOR GRANTS-IN-AID

6.1 Grants-in-aid to Local Bodies - from 10th to14th Finance Commissions

Award of grants to the Local Bodies, generally called Local Governments and Local Self Governments (LSGs), through Union Finance Commissions began with the 10th Finance Commission. The 10th FC has allocated grants to the States for the Local Bodies even without a stipulation in its ToR. From the 11th Finance Commission onwards, there has been a specific ToR concerning the Local Governments as to recommend "*…the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State*", as mandated in Article 280 (3) [bb] and [c] of the Constitution, which was amended consequent to the 73rd and 74th amendments.

The 11th FC stipulated that the grant has to be used for maintaining core service and should not be used for payment of salaries and wages. The 12th FC also recommended that the grants are to be used for improving service delivery, creation of database on local body finances and maintenance of accounts through the use of modern technology and management systems. The 13th and 14th FCs bifurcated the grants as basic and performance based ones.

While the former is unconditional, the latter carries several conditions. The conditions also varied between those for the Panchayats Raj Institutions (PRIs) and Urban Local Bodies (ULBs). The 13th FC further stipulated furnishing of utilisation certificates and the maintenance of accounts of local bodies as a condition for the award of performance grants. The 14th FC did away with the need to furnish utilisation certificates, but made audited accounts of the year two years prior to the current financial year as a condition for performance grants. The grants allocated by the various Finance Commissions and the criteria for horizontal devolution are presented in Tables 6.1 and 6.2

Table 6.1: Amount of Grants (in ₹ crores) Devolved to Local Bodies –10th to 14th FCs

Finance Commissions Rural		All States		Kerala	
		Urban	**Rural**	**urban**	
10th FC		4380.93	1000	178.81	25.43
11th FC		8000	2000	65.93	15.05
12th FC		20000	5000	985	149
13th FC	Basic Service Grant	39712.33	13971.03	1291.8	481.23
	Performance Grant	17471.83	5009.28	670.27	288.85
14th FC	Basic Service Grant	180262.98	69715.04	3615.85	2931.48
	Performance Grant	20029.22	17428.76	401.76	732.87

Source: Reports of the Finance Commissions

In accordance with their ToR, the Finance Commissions since 11th also have proposed measures to augment the Consolidated Funds of the States. The proposed measures include both increasing the efficiency of tax collection by the local bodies, periodic revisions in taxes, introduction of new revenue sources such as service charges from State and Union Governments to the Local bodies for civic services and also matching grants from the State governments.

Table 6.2: Criteria for Horizontal Distribution of Grants to Local Bodies among States – 10th to 14th FCs

Criteria	10th FC	11thFC	12thFC	13thFC		14thFC
				PRI	ULB	
Index of Decentralisation		20				
Index of Deprivation			10			
Distance from Highest per capita Income		20	20			
Revenue Effort		10	20			
Of which a) w.r.t. own revenue of states			10			
b) w.r.t. GSDP			10			
Geographical Area		10	10	10	10	10
Population	100 (1971)*	40 (1991)	40 (2001)	50 (2001)	50 (2001)	90 (2011)
Index of Devolution				15	15	
Distance from Highest per-capita Sectoral Income				10	20	
SC/ST proportion in the Population				10	-	
FC Local Body Grant utilisation index				5	5	

Source: Reports of the Finance Commissions

Note: Figures in Paranthesis represent Census year

Note: * For the PRIs. For ULBs, the distribution criteria is based on inter-state ratio of slum population derived from the Urban population figures of 1971 Census.

6.2 Local Bodies and Kerala Specific Initiatives

Kerala took initiatives in the area of decentralisation, even prior to the Constitutional amendments. These included formation of District Councils in 1990. After the Constitutional amendments and formation of local governments, decentralisation has been implemented on a mission mode in Kerala through Peoples' plan campaign. Kerala had assigned the collection of Profession Tax to Local bodies much before the 73rd and 74th Constitution amendments. It has also devolved substantial powers to LSGs much beyond what is expected in the traditional realm. Early on, Peoples' plan campaign sensitised people to the possibilities opened up by the local self governments. The Government of Kerala has carried on this and the State has been the best performer in devolving funds, functions, functionaries and in empowering LSGs, (see the Report of the Ministry of Panchayat Raj, Government of India and Tata Institute of Social Sciences, ("*Devolution Report 2015-16: Where Local Democracy and Devolution in India is heading towards?"*).

Kerala devolves 24 percent of plan fund and 9.25 percent Net Own Tax Revenue of the state government to Local bodies under Development, General Purpose Funds and Maintenance heads. Kerala is one among the very few states which has been regular in appointing the State Finance Commissions and preparing the Action Taken Reports. The State is far ahead in terms of representation of women and persons from marginalised communities in local bodies through fair elections. The best performance of the Local Bodies in Kerala is, therefore, be viewed as the result of substantial budgetary efforts of the State government. Kerala's lead in democratic decentralisation by devolving between one-fourth and one-third share of the plan funds to the local self governments made possible the 'development with social justice' and the aspirations of the weak and marginalised could be addressed. Plans could be formulated to improve the living environment of vast segments of population and improve their capabilities.

Due to the higher devolution of funds, functions and functionaries to Local Bodies, States like Kerala, which have taken a lead in this regard suffer on account of lack of achievement of deficit targeting, especially in the revenue account. To elucidate this, we have to take note of the fact that revenue expenditure has General, Social and Economic Services and Grants–in-Aid components. A major part of the grants-in-aid given to the Local Bodies is spent for developmental and capital expenditure, whereas in the State Budget, it forms part of the non-development revenue expenditure. In other words, a State which has made rapid strides in devolution of funds and functions to Local bodies cannot reflect in its Budget the developmental and capital expenditure fully due to the current government accounting mandates.

As a necessary condition for facilitating decentralised governance, the Government of Kerala took the lead in transferring the institutions such as *Krishi* Bhavans, Veterinary Services, Primary Health Centres, Primary Schools and hostels for Scheduled Caste and Scheduled Tribes. These initiatives are specific to Kerala, by which, the State could progress in delivering basic services to the citizens as well as addressing the issue of inclusive development. The quality of participatory governance has been ensured in Kerala through the District Planning Committee which is instituted to consolidate the development planning of the local bodies.

For Kerala, a number of websites initiated and made possible by the State Government such as *Sulekha* for annual plan, *Sanchaya* for property tax and other taxes and licenses, *Subhadra* for Annual Budget and *Saankhya* for accounting are examples (e-initiatives) of best performance for the digitalisation and disseminating of information related to local bodies. To sustain these e-initiatives and to facilitate the state for furthering the performance, special grants may be provisioned.

The lack of audited accounts has always been a concern of various Union Finance Commissions while studying the performance of Local Bodies. It is to be noted in this context that Kerala State is remarkable in keeping a timely auditing of local body accounts and even the recent audited figures are available with the Government. The State, therefore, deserves a performances based incentive for these initiatives which are signs of transparency and accountability of public accounts.

6.3 ToR of Fifteenth Finance Commission on Local Bodies: Suggestions by Kerala

The ToR of the 15th Finance Commission contains two items regarding grants-in-aid to Local Self Governments (LSGs):

ToR 4 (iii) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.

ToR 7 (vii) proposing measurable performance based incentives for States for provision of grants in aid to Local Bodies for basic services, including quality human resources, and implementation of performance grant system in improving delivery of services.

In the spirit of the federal framework, the Finance Commission should incentivise a State government which devolves more functions, functionaries and funds to the Local Bodies. The closest and the most transparent proxy for this is the proportion of devolution to LSGs to Revenue Expenditure of the State. This can be used as the criterion and given an appropriate weightage in the grants for augmenting Consolidated Fund of the States for empowering the LSGs.

Since most of the Union Finance Commissions starting from the Tenth and the Fourth State Finance Commission of Kerala have highlighted the issue of the lack of reliable data on financial statements of local governments, the improvement in this aspect may be considered as a criterion for allocating grants by the 15th Finance Commission under performance grant part. The 14th FC has already made auditing of accounts (two years prior to the current financial year), a condition for award of grants. The devolution of functionaries of accounting to local governments, steps taken to digitalise the financial accounts and prepare digital/online database, regularity of audit are important indicators to be considered for assessing the improvement of respective LSGs in terms of the availability of financial data. This would carry forward the initiatives in the recommendations of the 14^{th} FC.

The 14^{th} FC provided performance grants to address the issues related to i) making available reliable data on local bodies' receipts and expenditure through audited accounts; and ii) improvement in own revenues. The ULBs were asked to measure and publish service level benchmarks for basic services. This can be extended to PRIs also in a gradual manner. The State Finance Commissions can be entrusted with the task of suggesting suitable criteria for this.

In addition to the above, environmental friendly initiatives by the LSGs should be incentivised through part of the performance-grants. It is suggested that steps taken for decentralised waste management and observance of green protocol like bringing down use of non-biodegradable substances shall be made the criteria for this.

The 14^{th} FC recommended 90 percent of the grants as basic grants (which are to be used for civic services) and 10 percent as performance grants. These grants are then advised to distribute among the local bodies based on two criteria such as population (with a weight of 90 percent for PRIs and 80 percent for ULBs) and Area (with a weight of 10 percent for PRIs and 20 percent for ULBs).

Unlike the 14^{th} Finance Commission's recommendation of earmarking 90 percent as basic grants and 10 percent as performance grants, it is suggested that 60 percent may be categorised as basic grants and 10 percent as performance grants. The balance 30 percent may be categorised as devolution based grants. For this, it is suggested to consider the devolution of functions, functionaries and funds to LSGs, proxied by the proportion of transfers to LSGs to Revenue Expenditure of the State for the latest two years for which budget actuals are available.

The 10 percent performance grants can be based on auditing, e-initiatives in accounting and environment-friendly measures adopted.

The 60 percent earmarked as basic grants may be allowed to use not only for civic services as recommended by the 14^{th} FC, but also for the economic, social and general services.

The Government of Kerala is of the considered opinion that LSGs also should be able to share the rising buoyancy of taxes coming under the divisible pool of Union taxes. It is suggested that a proportion of the divisible pool may be converted as grants-in-aid to augment the Consolidated Fund of the States as done by the previous two Finance Commissions.

The 15^{th} Finance Commission may also suggest Constitutional Amendment for increasing the present ceiling of Profession Tax, because the present limit was fixed in 1988.

Chapter 7

FINANCING OF DISASTER MANAGEMENT

Natural disasters are events of nature which cause sudden disruptions to the normal life of a society, resulting in substantial damage to life and property. Consequentially, normal social and economic mechanisms that are usually available to the society become inadequate to restore normalcy. Disaster management systems need to be put in place to meet such eventualities. This primarily becomes a responsibility of the government, albeit with whole hearted participation of social organisations and other stake holders.

In the Indian context, there is wide diversity in the type and extent of natural disasters faced by different States. While the States in the Himalayan belt are prone to earth quakes and major landslides, those in the eastern coast are prone to frequent cyclones. The States in the western coast are prone to rare but devastating cyclones. The most recent example is the cyclone 'Ockhi', which ravaged Kerala also in December 2017.

The State of Kerala, which has a coastline of 590 kilometres is vulnerable to a number of natural calamities such as coastal erosion, floods, cloudbursts, droughts, lightning, landslides etc. Disaster management systems should be able to take these variations into account. Disaster management occupies an important place in the State's policy framework, as it is the poor and the under-privileged sections of the population who are worst affected on account of calamities/disasters. A paradigm shift in the approach to disaster management from response to preparedness is necessary because investments in mitigation are much more cost effective than expenditure on relief and rehabilitation. Disaster management is to be considered a multi-disciplinary function and integrated into all sectors of development.

The Second Union Finance Commission acknowledged that financing expenditure on relief was an unforeseen expenditure and may have a destabilising impact on State finances. A margin money scheme was initiated by it envisaging the setting apart by the States, a specific amount each year to meet the expenditure for relief work consequent to disaster. Setting up of a Calamity Relief Fund was recommended by the Ninth Finance Commission placing generous funds at the disposal of the States. This scheme was replaced by the Disaster Relief Fund (National Disaster Relief Fund and State Disaster Relief Fund). As per sub-section (1) of section 48 of the Disaster Management Act 2005, the Central and the State Governments are required to establish the Disaster Response Fund and the Disaster Mitigation Fund at the National and State Level respectively. Besides the above, Response and Mitigation funds are required to be established at the Districts Level also. After establishing these funds, the National, State and District levels, they will have to be adequately funded for capacity building efforts and managing the consequence of various disasters.

At present, the State Government has the State Disaster Response Fund (SDRF) for the natural calamity relief activities in the State. It consists of 75 per cent Central share and 25 per cent State share. Experience has shown that the funds available for calamity relief operations have been quite insufficient given the frequency of occurrence and magnitude of the natural calamities in Kerala. The fund earmarked for the period 2005 - 2010 to Kerala is of the order of ₹ 472.42 crore out of which the Central contribution is ₹ 354.32 crore; the amount increased to ₹ 724.3 crore (Central share of ₹543.23 crore) during 2010-15, the award period of the Thirteenth Finance Commission. The Central share recommended by the 14th Finance Commission was ₹ 919 crore and the State's share was ₹ 102 crore. In real terms this marks hardly any increase. In per capita terms the allocations for the State of Kerala at ₹ 149 and ₹ 228 during the award periods of the Twelfth and Thirteenth Finance Commissions respectively was very low among the States.

For a State like Kerala which faces multiple calamities almost every year, the corpus of the Fund is very meagre. The SDRF now available with the State is so inadequate that there is no money left for constituting the Mitigation Fund at the State level and Response and Mitigation Funds at the District Level. Hence, the funds available for disaster management activities need to be enhanced for Kerala. Under the facts and circumstances discussed above, Government of Kerala urges the Finance Commission to increase the corpus of the SDRF to ₹ 3000 crore, as Kerala has a long coastline and densely populated and vulnerable sections living in that area. It is also requested that i the contribution of the Centre to the Fund shall be increased to 90 per cent, as recommended by the 14th Finance Commission. The Centre has stated this would be done as soon as GST is in place. In case of severe calamities, advance drawal up to 100 per cent of next year's provision may be allowed.

In view of the regional disparities in terms of costs on account of labour, materials, terrain etc., States may be permitted to fix their own norms for utilisation of the SDRF. Additional grants may also be provided to set up Mitigation Fund at the State level and Response and Mitigation Funds at the District level.

The coast line of Kerala (590 km) is one of the most densely populated land areas in the country. This coastline is exposed to high waves, rogue wave (Kallakadal) and Tsunami. Sea erosion is one of the recurring natural hazards affecting the coastline in the State. Generally, it occurs as part of erosion - accretion cycle. It is feared that with the predicted rise in sea level, as a result of the greenhouse gas effect, the rate of beach erosion and loss of coastal properties are going to increase. Coastal erosion results in the loss of life and property of the coastal fisher-population who are among the most economically backward communities in the State. Every year, several of their lives are lost due to natural disasters of various magnitudes. Apart from loss of lives, hundreds of houses are damaged due to the fury of the sea. Almost all fisher families prefer to live along the coast and very few of them tend to have landed property or houses further inland. The waves damage livelihood of the fishermen community and their properties. The affected families have to be accommodated in relief camps at a substantial cost to the exchequer. The recent Ockhi cyclone which had cross country and cross State impact, had caused severe human and financial loses. The State provided compensation affects families at ₹ 20 lakh per household in which there were losses of lives. The State Memorandum requested relief from the Centre to the tune of ₹ 7340.45 crore for Recovery, Rehabilitation and Reconstruction. But the Centre hasn't released any amount on this account except statutory NDRF allocation of ₹ 133 crore. The state has single handedly collected around ₹.107 crore in CMDRF for giving assistance to Ockhi victims.

In the State budget 2018-19, it has been stated that a long term Coastal Disaster Mitigation Plan should be formulated. The budget speech declares that the 2018-19 Budget marks the beginning of a comprehensive Coastal Development Package even while awaiting a decision from the Central Government in this regard.

The Government of Kerala announced a package of ₹ 2000 crore in the 2018-19 Budget for a package which includes a) formulating a mechanism for giving timely warning and providing emergency aid to fishing villages and to those who are engaged in fishing. The Disaster Management Authority has developed a satellite information and communication system, linking all fishing vessels and coastal villages. This is expected to cost ₹ 100 crore, b) providing free Wi-Fi connectivity in every public centre in coastal villages, c) provision of ₹ 10 lakh to each family with habitation within 50 meters of coastline and planting mangroves and trees in these areas. The cost of the Scheme is expected to be ₹ 150 crore, d) preparation of a detailed project Report for Coastal Area Development Package by an internationally recognised agency at an estimated cost of ₹ 10 crore, e) developing fish markets and fish landing centres, f) seeking assistance from NCDC for creating a cold storage chain to preserve fish under the aegis of Matsyafed g) for producing value added products by earmarking a fund of ₹ 3 crore (An amount of ₹ 240 crore is earmarked as part of the annual plan outlay for fisheries sector including inland fishing and ₹ 238 crore for coastal development. The total outlay of fisheries sector including coastal roads comes to ₹ 600 crore).

Besides the above, the budget speech also mentions the following:

"The construction of fishing harbours is in crisis due to the considerable reduction of Central assistance. An amount of ₹ 584 crore is required for the completion of construction of the following harbours. Arthunkal (₹ 61 crore), Thanoor (₹ 36 crore), Vellayil (₹ 22 crore), Manjeswaram(₹ 30 crore), Thottapally (₹ 80 crore), Kasargode (₹ 59 crore), Chethy (₹ 111crore), Parappanangadi (₹ 133 crore), Kayamkulam (₹ 36 crore), Munambam (₹ 8 crore), Neendakara (₹ 10 crore). NABARD has agreed in principle, to provide these amount as loan. The harbours which haven't started the work or yet to start the 2nd phase like Chethi and Parappanangadi will be included in KIIFB. Priority will be given to the coastal hospitals under the Hospital Renovation Scheme, which is implemented with the assistance of KIIFB. Priority will be given to the coastal hospitals under the Hospital Renovation Scheme, which is implemented with the assistance of KIIFB. Kozhikode beach hospital, General Hospitals in Kollam and Alappuzha, Taluk Hospitals in Faroke, Ponnani, Chavakkadu, Karuvelippadi, Chettikad, Karunagappally, Neendakara and Chirayinkeezhu. In the selection of Family Health Centres, priority will be given to coastal areas. Health micro plans for each family in coastal areas will be prepared and Family Health Scheme will be implemented. All the schools in coastal area, where more than 250 students are studying, will be included in this year's school renovation package. Sanction has already been given for urgent coastal protection measures in regions such as Chellanam, Edavanakkadu, Ponnani and Alappuzha where coastal erosion is severe. Based on a comprehensive study, a final shape will be given to the protective measures to be adopted along the entire coastal belt of Kerala. For this an amount of Rs.300 crore has already been sanctioned from KIIFB. An investment of Rs.900 crore will be made from KIIFB in coastal areas. This does not include coastal highways or other roads."

The measures proposed clearly reveal the seriousness with which the State addresses the issue of disaster mitigation and response in a comprehensive manner. More than half of the area of the State is only 4 meters above sea-level and encroachment by the sea severely affects the economy of the State. The State has the second largest density of population after West Bengal. A substantial part of population not only lives close to the coastline but also lives off it and they belong to the vulnerable sections of the society. With high density of population and major establishments along the sea coasts, large investments have to be made to erect shore protection structures and take up other mitigating measures.

Similarly, lightning strikes also cause heavy loss of lives in the State. Looking at the Statistics, Kerala has high lightning incidence compared to nearby regions. On an average, 188 such incidents occur every year in which 71 people die and 112 people are injured. These statistics were obtained through an investigation conducted by the Centre for Earth Science Studies, Thiruvananthapuram. Lightning is a natural phenomenon where the charge generated gets down to the earth with disastrous direct and indirect effects and prevention of its occurrence is beyond human control. The amount of loss of human life and properties due to lightning is significantly high in Kerala. In addition to the high frequency of lightning the State has higher population density which increases the probability of more people getting hit by lightning resulting in more death and injury. Knowing that lightning cannot be prevented, the obvious choice for reducing personal injury is to find ways to avoid it or take protective measures. It is clear that the people in the State bounded by the Western Ghats have a problem different from elsewhere in regard to lightning and so we have to take special efforts to combat this hazard. In the last 20 years, 4000 deaths have occurred in the State due to lightning and sea-erosion. The State has recently witnessed a new phenomenon of heavy unseasonal rains causing massive water logging and extensive damage to crops. Therefore, the State earnestly urges the Finance Commission to consider all these vulnerabilities and increase the size of SDRF during the period 2020-2025 to ₹3000 crore, considering all these and not an incremental growth from that of the previous allocations. The latter have been totally inadequate to meet the special needs of the State to respond and mitigate the impact of natural calamities. The State also should be allowed complete flexibility in spending funds from SDRF in response to any natural disaster and there should not be any restriction on this.

a) Public Calamity Insurance Scheme

Hazards are unprecedented and random. Many natural and anthropogenic catastrophic events occur in the country which do not come under the list of calamities entitled for claims under NDRF/SDRF. Hence, it is recommended that a Public Calamity Insurance Scheme may be funded by Govt. of India. An initial grant-in-aid for premium payment for 5 years may be allotted which may subsequently be taken up by the State Government through a suitable funding mechanism. A separate additional share may be recommended for SDRF to meet this expenditure.

b) Ward level Calamity Response Fund

An ambitious proposal that the Department of Disaster Management, Govt. of Kerala put forth in the State Pre-monsoon meeting of the Relief Commissioner held in Kerala on 27th May 2013, the LSGs were urged to create a Ward Level Calamity Response Fund utilising their own funds (₹ 5000/- for Panchayat wards, ₹ 10000/- for municipal wards, ₹ 25000/- for city corporation wards). The suggestion was well received by many LSGs. However, many LSGs, which did not have their own funding, although wanted to setup the fund could not do so. Hence, to make the initiative successful and to inculcate disaster risk reduction responsibility consciousness in the grass root level, it is proposed that grant-in-aid for setting up ward level calamity response fund may be made available to the State Government along with the Basic and Performance grants given by the Union Finance Commission for LSGs.

c) Gender-sensitive Disaster Risk Reduction

Gender sensitiveness in Disaster Risk Reduction (DRR) is an emerging domain. At present, although gender bias is not consciously prevailing in risk reduction, response and relief actions, often in the response and relief phase, gender constrains prevail. A gender sensitive DRR effort should ideally ensure equitable facilities for the affected females and males. In order to ensure gender sensitivity and gender budgeting in DRR efforts, a seed funding may be allotted for ensuring sufficient facilities in identified relief camps and shelters such that equitable facilities are available for both men and women. Further, to sensitise and ensure consciousness of gender sensitivity in grass root level, grant in aid may also be allotted to advertise gender sensitivity in disaster risk reduction. This also could be part of the grants to augment the State resources for LSGs.

It is important to note that the Commission, like the past Commissions has been asked to "…review the prevailing arrangements on financing Disaster Management initiatives, with reference to the funds constituted under the Disaster Management Act, 2005 (53 of 2005), and make appropriate recommendations thereon". The Disaster Management Act, 2005 envisages that funds should be constituted not only to respond to the calamities but also to undertake steps to mitigate them. However, presently the funds are constituted to respond to the disasters at National and State levels as National Disaster Response Funds (NDRF) and State Disaster Response Fund (SDRF). However, Mitigation Funds have not been constituted at both National and State levels. The ToR of the 15th Finance Commission requires it to review and make recommendations only on the funds already constituted. In this regard, following from the recommendation of the Fourteenth Finance Commission, we would like to underline two important issues. First is regarding the determination of the funds required and its distribution among the States. With increasing recurrence and intensity of different types of disasters- Ockhi is the best example to measure the intensity, Kerala has not witnessed such intensity for over 70 years- determination of the volume of funds to be constituted and their distribution based on the past trends may not be adequate. This is particularly true of a State like Kerala which has a history of severe sea erosion. Therefore, the 14th Finance Commission had recommended that a Hazard Vulnerability Risk Index must be scientifically constructed and validated for the future and use the index in determining the shares of different States. We hope, the Commission will use such an index. Second, the 14th Finance Commission had recommended that the shares of the Centre and States in contributing to the SDRF should be 90:10 keeping in view States' low availability of fiscal space. However, the government has not implemented this recommendation and the States are required to contribute 25 per cent to the SDRF. In our view, the entire cost of the SDRF should be contributed by the Central government through grants because, the States, after meeting their spending obligations have hardly any fiscal space left to make a contribution to disaster relief. We would urge the Commission to revisit the issue and at least reiterate the recommendation made by the 14th Finance Commission.

The National Calamity Contingency Fund (NCCF) was set up with an initial corpus of ₹ 500 crore on the recommendation of the 11th Finance Commission. In view of the magnitude of the severe calamities faced by various States, often at the same time, the corpus has proved to be inadequate. Hence, there is a need to enhance the corpus. An annual increase in the corpus needs to be done so as to maintain the real value of the corpus. The 15th Finance Commission may consider suggesting a one time increase in this and a suitable annual increase during the period 2020-21to 2024-25. The Government of Kerala also urges the Commission to recommend suitable measures to avoid delay in providing assistance by Centre from the NDRF to the States.

Chapter 8

REVENUE AND EXPENDITURE PROJECTIONS OF KERALA- 2020-21 TO 2024-25

State's projections of Revenue Receipts (pre-devolution) and Revenue Expenditure for the period from 2020-21 to 2024-25 are presented in this Chapter. The projections have been made after taking into consideration the State level macro fiscal scenario in totality and the past trends in each component of the Own Revenue Receipts and Revenue Expenditure. The trends during the period 2011-12 to 2016-17, the latest year for which budget actuals are available are used for the purpose of future projections. The pre-devolution Revenue Deficits are also projected accordingly for this period.

At the outset, the Government of Kerala wishes to point out that the Revenue Expenditure projections include the expenditure on Centrally Sponsored Schemes (CSS) for the period 2020-21 to 2024-25 as well. When Revenue Deficit is considered as a whole (without plan and non-plan distinction), the expected spending on CSS against both the Central and state shares is projected. The State share is a consequence of the Central share and unless the Central estimate on CSS for the State is known, the State share cannot be realistically projected. Since there is lack of information on the likely central spending on CSS for the future period, the projections of Revenue Expenditure and Revenue Deficit of the States will be ones which cannot be factored in this. It would be in the fitness of things, if the Union Government is asked to furnish at the earliest a projection of CSS for the period from 2020-21 to 2024-25, so that States can project or revise their already submitted projections, without asymmetry of information in this regard. It is also our view that in the event of Union making a substantial cut in spending on CSS, States would still have to discharge their Constitutional obligations in the Social and Economic sectors through their own spending. While considering the estimates of revenues and expenditure, the 15th Finance Commission needs to factor in this aspect also.

The Own Revenue Receipts of Kerala for the period 2020-21 to 2024-25 are projected in a most realistic manner. There is a general trend of decline in growth rate in all the States with regard to the major items of tax revenues since 2013-14. This is in tandem with the deceleration in GSDP growth rate also. As already elaborated in Chapter 3 of this Memorandum, the apportionment of GST at 50:50 ratio between the Union and the States and the sudden shock from demonetisation have been additional unfavourable factors affecting the growth of Own Tax Revenue of the States. Still, taking a holistic view of the future economic circumstances, we expect that the growth rate of GST during the five year period commencing from 2020-21 would be 14 percent per annum. At present, the growth rate before compensation is practically nil due to the hasty implementation of GST. The buoyancy of taxes is reasonably expected at 1.21, which is above the immediate past trend of less than unity.

The Sales Tax (on Petroleum products and Alcoholic Liquor for human consumption) is projected to grow at a rate higher than the CAGR for the reference period (2011-12 to 2016-17). For other major tax revenue items like Excise and Stamps and Registration, growth rates adopted are more than the CAGR of the reference period considering the fact that, additional resource mobilisation measures have been introduced in the State budget for 2018-19. Motor Vehicle Tax has been projected on the same trend as in the CAGR. The Own Tax Receipts projected based on a detailed component-wise analysis gives a realistically achievable target considering the revenue raising capacity of the State based on the norms discussed above.

Under Non-Tax revenues, growth rates of revenues from items under General Services excluding Miscellaneous General service have been projected at 15 percent. For revenues from lotteries, growth rate adopted is 12 percent. Revenues from Social Services and Economic Services have been projected with 12 and 10 percent growth rates respectively. These are higher than the CAGR of the reference period.

As regards Revenue Expenditure, projection has been made by factoring in actual requirements in the five year period including the quinquennial pay revision. The road map to fiscal consolidation laid down and emphasised by the Government of Kerala in the budget for 2018-19 has been kept in mind while making realistic projections of Revenue Expenditure for 2020-21 to 2024-25. But expenditure in Social and Economic sectors needs to be sustained in order to maintain the better social indices the state has achieved over the years and make improvements on that. The programmes *under Navakeralam Karma Padhathi,* mentioned in Chapter 3 of this Memorandum are part of this effort.

While projecting the Revenue Expenditure, the past trend of both salary and non - salary components have been analysed. Salary, Pension and interest payments are three largest components of Revenue Expenditure. The salary component has been projected taking into account the fact that this is the single largest item of expenditure so as to avoid any overestimation. Annual provisions for Dearness Allowance (DA) increase are taken at a lower level on the assumption that the inflation will be stabilised. Projection in respect of pension also is based on the assumption that there will be stability in the growth rate due to reduced Dearness Relief (DR) component. As far as interest payments are concerned, effective rate of interest is applied on the assumed debt annually adding borrowing equivalent to projected Fiscal Deficit. Expenditure on General Services other than salary has been reasonably projected at 15 percent. This is part of the rationalisation of expenditure proposed for the achievement of fiscal consolidation. Government of Kerala is committed to rationalise and prioritise expenditure in such a way that the needs of the poor and vulnerable sections of the population are not adversely affected.

Another major item of revenue expenditure in Kerala is the devolution to the LSGs. Kerala is the pioneer among Indian states which empowered the LSGs through the transfer of functions, functionaries and funds. The State tops the Indian States in this regard as per the Report of the Ministry of Panchayati Raj, Government of India, and 2015-16, as already cited in Chapter 6 of this Memorandum. The State Finance Commissions are constituted regularly and their recommendations are considered for making devolution. It has to be given due consideration that, the LSGs in Kerala spent significant amount of funds received by them through devolution for development purposes and for creation of capital assets. But in the State budget and accounts, this expenditure gets reflected as grants-in- aid forming part of Revenue Expenditure. This is to be taken note of as a major part of this expenditure classified as non-developmental Revenue Expenditure is actually spent for developmental and capital formation.

Taking into consideration the projected Own Revenue Receipts and Revenue Expenditure (subject to the asymmetry of information on Central spending on CSS, as already pointed out) the pre-devolution Revenue Deficit is arrived at. The pre-devolution Revenue Deficit estimated for the period 2020-21 to 2024-25 will be ₹ 3,11,296 crore. It can be seen that over the years, the pre-devolution RD, as a proportion of GSDP would come down substantially by 2024-25, as a result of our efforts for achieving fiscal consolidation. The Effective Revenue Deficit after deducting the revenue grants provided for creation of capital assets will be ₹ 2,48,831 crore. But we reiterate here that the success of our efforts in achieving fiscal consolidation critically depends upon enhanced transfers by way of taxes and grants by the 15th Finance Commission.

Table 8.1: Estimate of Revenue Receipts and Expenditure by Finance Commissions and the Actual Figures- For Kerala (₹ crore)

Period		Revenue Receipts			Non Plan Revenue Expenditure			Revenue Receipts		Non-plan Revenue Expenditure	
		Estimation by the State	Estimation by FC	Actuals	Estimation by State	Estimation by FC	Actuals	Actual as % of State Estimation.	Actual as % of FC. Estimation	Actual as % of State Estimation	Actual as % of FC Estimation
1		2	3	4	5	6	7	8	9	10	11
11th FC	2000-05	41029	49606	39376	61528	53979	58136	96.0	79.4	94.5	107.7
	2000-01	6587	7056	6435	9298	8419	9834	97.7	91.2	105.8	116.8
	2001-02	7252	8266	6360	10261	9287	9780	87.7	76.9	95.3	105.3
	2002-03	8066	9674	7880	12463	10960	11588	97.7	81.5	93.0	105.7
	2003-04	9000	11313	8806	13911	12028	12989	97.9	77.8	93.4	108.0
	2004-05	10123	13294	9893	15594	13283	13943	97.7	74.4	89.4	105.0
12thFC	2005-10	71910	81555	73983	106415	94024	106781	102.9	90.7	100.3	113.6
	2005-06	11143	12205	10543	17758	15113	15029	94.6	86.4	84.6	99.4
	2006-07	12564	13987	12685	19596	16403	18321	101.0	90.7	93.5	111.7
	2007-08	14171	16020	14603	21240	19158	22339	103.0	91.2	105.2	116.6
	2008-09	15988	18343	17177	22926	20788	24639.	107.4	93.6	107.5	118.5
	2009-10	18042	20998	18974	24891	22561	26450	105.2	90.4	106.3	117.2

Period		Revenue Receipts			Non Plan Revenue Expenditure			Revenue Receipts		Non-plan Revenue Expenditure	
		Estimation by the State	Estimation by FC	Actuals	Estimation by State	Estimation by FC	Actuals	Actual as % of State Estimation.	Actual as % of FC. Estimation	Actual as % of State Estimation	Actual as % of FC Estimation
1		2	3	4	5	6	7	8	9	10	11
13thFC	2010-15	138221	155554	155192	225499	172395	221569	112.3	99.8	98.3	128.5
	2010-11	21099	23644	23192	36530	28349	30008	109.9	98.1	82.1	105.9
	2011-12	23938	26808	27409	39427	30775	39815.	114.5	102.2	101.0	129.4
	2012-13	27179	30543	32192	45053	34752	44556	118.4	105.4	98.9	128.2
	2013-14	30884	34827	34367	49697	37654	50209	111.3	98.7	101.0	133.3
	2014-15	35119	39729	38030	54790	40863	56978	108.3	95.7	104.0	139.4
14th FC	2015-20	350635	349129	88181.6	613988	452250	158670				
	2015-16	51854	52851	42297	93418	72002	73566	81.6	80.0	78.7	102.2
	2016-17	59647	60114	45883	102397	80209	85103	76.9	76.3	83.1	106.1
	2017-18 RE	68679	68498		121247	89375					
	2018-19 BE	79151	78199		138492	99613					
	2019-20	91302	89467		158431	111051					

Source: Finance Commission Reports and State Budgets

The compelling reasons for a higher share of resources in the divisible pool have been elaborated in Chapter 4 of this Memorandum.

It is pertinent to point out the actual figures of Own Revenue Receipts (Own Tax +Own Non-Tax) and Revenue Expenditure have varied much more from the normative estimates made by successive Finance Commissions than the State's projections. It is worth pointing out that the State's revenue effort has been quite high as can be seen from the actual exceeding the State's projections during the 12^{th} and 13^{th} Finance Commission periods. They have been quite close to the Finance Commission's estimates during the 13^{th} Finance Commission award period. On the other hand, the normative estimates by the successive Finance Commissions have substantially under-assessed the expenditure needs of the State, where as the State's own projections have presented a much more realistic picture. (Table 8.1)

It has been found that the Revenue Deficit Estimates by the 14^{th} Finance Commission and the actuals of many States have widely varied. Haryana, Maharashtra, Punjab, Rajasthan, Tamil Nadu and Uttarakhand for whom no Revenue Deficit grants were estimated have reported significant Revenue Deficits in the last three financial years.("Challenges before the Fifteenth Finance Commission' by V Bhaskar, *Economic and Political Weekly,* March 10, 2018, Vol LII, No. 10, Pp 39-46). Table 8.2 illustrates the gap between actual Revenue Deficits and what was estimated by the 14^{th} Finance Commission for several States.

Table 8.2: Revenue Deficits–14th Finance Commission Estimates and Estimates in State Budgets - 2017-18 (₹ crore)

State	14th FC Revenue Deficit grants	Revenue Deficit reported in State Budgets
Andhra Pradesh	4430	415
Haryana	0	11124
Kerala	1529	16043
Maharashtra	0	40119
Punjab	0	14784
Rajasthan	0	13528
Tamil Nadu	0	15930

Source: Table 1, 'Challenges before Fifteenth Finance Commission', Economic and Political Weekly, March 10, 2018, page 40

It is requested that the constraints in fiscal capacity of Kerala in realising higher revenues should not be disregarded and its essential expenditure requirements should not be underestimated. The Government of Kerala urges the 15th Finance Commission to take a realistic view of Own Revenue and Expenditure needs of the States on the basis of past trends and requirements of the future.

The detailed projections of component wise Own Revenue Receipts and Revenue Expenditure of the State for the period 2020-21 to 2024-25 will be furnished separately.

Chapter 9

GRANTS-IN AID - SUGGESTIONS AND NEEDS

As regards grants-in-aids recommended by the Finance Commissions, the position of Government of Kerala is that it should not impinge on the flexibility of the State governments in discharging their assigned Constitutional responsibilities. Targeted grants with rigidly laid down criteria often falls in what is called as 'one size fits all'. Even otherwise, Sector specific grants restrict the expenditure priorities of the States. Untied and predictable resource flows will the best course that can be adopted in a set up with co-operative federalism as the stated aim. In the previous Chapters of this Memorandum, this view has been iterated.

Notwithstanding the reasoned stand of the Government of Kerala in this regard, it is submitted that in the event of 15th Finance Commission deciding to make Sector specific grants, it would be in the fitness of things to consider the sectoral needs of Kerala also. Keeping this in mind, the following pressing sectoral needs of Kerala are presented for consideration. These issues would be relevant for other States also for grant of special financial assistance under Article 275 of the Constitution.

9.1 Coastal Erosion and Coastal Protection

India has a very long coastline of 8414 km, which is shared by 10 Indian States and 4 Union Territories. Of this, 5778 km constitutes mainland coastline; while 2636 km constitutes coastline of islands.

The coastal plains provide rich resources for agriculture, industries, tourism and livelihood related activities and thereby make significant contributions to the economies of the coastal states in particular and the country in general. Hence protection of coastal lines is of vital importance and has to be treated as a priority area for providing strategic and financial support by the Union Government.

The long stretch of coastline on either side of the Indian peninsula is subjected to various coastal processes and anthropogenic pressures, which makes the coast vulnerable to erosion. A recent study based on satellite data over 15 years undertaken by the Scientists from Space Application Centre (SAC), Ahmedabad and Central Water Commission, Ministry of Water Resources reveals that as much as 45 percent of India's 8,414-km long Indian coastline is facing erosion. The results of the study also show that 3004 km of the coastal line (35.7 percent) is getting accreted, while 1581 km (18.8 percent) of the coast is more or less stable in nature. **In the case of Kerala, out of its 590 km long coastal line, 516 km is vulnerable to either erosion or accretion, while just 73.6 km is considered as stable.**

Coastal erosion, which is an escalating environment threat, could create severe impact on the environment and the ecosystem. It could also cause severe damages to life and property and have its social and economic impacts as well. The intensity of the impact will be much high in the areas like Kerala, where the density of coastal population is high.

The measures to counter erosion could include either structural or non-structural measures or a combination of both, based on proper investigations and analysis. It needs to be ensured that such measures do not result in shifting of erosion from one location to another. Therefore a scientific and coordinated approach needs to be taken to counter the impact of coastal erosion in the country, for which specific funds are to be earmarked and allocated to the coastal States and Union Territories. This being an issue common to all coastal States and Union territories and one requiring focused attention, the State strongly urges the 15th Finance Commission to consider this as a priority area if it decides to recommend specific grants under Article 275 to such states for countering coastal erosion problems.

In Chapter 7 of this Memorandum, the comprehensive policy for disaster mitigation management for coastal areas mentioned in the Kerala budget. 2018-19 has been highlighted. Taking the financial commitment involved, the State requests a specific grant of ₹ 1500 crore mitigation and response of disasters in coastal areas, which is inhabited by the most vulnerable segments of population.

9.2 Forest Conservation

The Western Ghats, though it occupies just 6 percent of the land area of the country, plays a crucial role in maintaining ecology, bio diversity and mitigating impact on climate change in the country. Stretching across 6 States, it occupies a land area of 1600 kilometres. Indian Monsoon weather pattern is guided by this ecosystem, which is rich in bio-diversity of rare flora and fauna. Hence, the protection and preservation of this site is an obligation mandated by national priority. The States including Kerala, cannot utilise this area for any economic and commercial activities, lest there should be damage to the fragile eco zone.

The issue of opportunity cost in preserving the forest land has been in the discussions of different Finance Commissions on the realisation that these are unique national assets to be conserved and protected in the larger national interest and compensation to be provided to states in economic disadvantage. The XII Finance Commission awarded a grant of Rs.1000 crore to the states, to be distributed among them in accordance with the share of the forest area with them. During XIII Finance Commission period, the award was increased to Rs.5000 crore considering factors like proportion of forest area falling in a state, the forest area in a state exceeding the national average, and the economic disability on account of forest cover. The entitlement, considering these three factors was further weighted by the quality of the forest in each state, measured by the forest density in terms of moderately dense and dense forest cover. The XIV Finance Commission also gave due consideration for the protection of forest area in national interest by providing the weightage of 7.5 percentage in the horizontal formula for tax sharing. This is purely for the opportunity cost forgone by the states for not utilising forest area for economic and commercial activities.

In a state like Kerala, where the land available for economic activities has been further constrained by the Coastal Zone Regulation Act, the opportunity cost will be relatively higher. The State has requested in chapter 5 of this. Memorandum, 10 percentage weightage for Forest Cover in horizontal sharing of taxes between the States. Besides this compensatory criterion for opportunity cost of not being able to utilise the forest cover for commercial purposes, the specific expenditure gap in preserving forests cover needs to be compensated through specific grants, if sectoral grants are recommended. As can be seen from Table 9.1, expenditure for forest conservation exceeds the revenue from forests.

Table 9.1

Gap in Receipt and Expenditure under Forests							
Year	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Receipt	274.10	220.52	237.33	329.95	300.40	283.04	296.85
Expenditure	210.11	291.12	344.48	378.34	428.70	418.60	518.98
Difference	63.99	-70.60	-107.15	-48.39	-128.30	-135.56	-222.13

In the past, the revenue from forest was higher than expenditure due to higher economic exploitation of the forests. But the subsequent policies followed by the State in national interest, gave more importance to conservation and protection than economic exploitation. This entailed incremental costs annually. Besides there are expenditure needs for a) controlling forest fires, b) restricting encroachments and c) regulated use of forests for getting optimum forest produce and d) utilising forest for eco tourism purposes. An amount of ₹ 1000 crore is requested as grants under Article 275 of the Constitution for this purpose.

9.3. Skill Up-gradation for Improved Employability Abroad

India, with its wide pool of talented and energetic human resources is recognised worldwide as a hub of dynamic, educated and skilled workforce. In fact, India has the largest population of people living abroad. Kerala is one of States with a substantial part of its population living abroad. With 2 million Keralites working in diverse sectors across the globe, Kerala's contribution in driving the world forward is highly significant.

Realising the large potential of job opportunities available to skilled workers abroad, the State has taken several initiatives towards focused skill development for different industrial domains with the objectives of development of core employability skills, building competence standards and for promoting technology catering to the demands of various job requirements within the country and abroad.

As part of its initiatives the State has set up Kerala Academy for Skills Excellence (KASE), under the Department of Labour & Skills, Government of Kerala and the State Skill Development Mission (SSDM) of Ministry of Skill Development & Enterprises, Government of India. KASE is envisaged to act as the apex entity to initiate, regulate and co-ordinate focused skill development activities for different industrial domains.

As part of promoting skill development activities, KASE has launched an international outreach initiative – iSTEP (International Skill Training and Employability Program), a single window web based approval system envisaged for faster, simpler and efficient processing. KASE would identify modified skill sets, impart international level skill trainings – sector skills and soft skills – and provide comprehensive certification requirements.

KASE has established Centres of Excellence (CoEs) in various sectors viz., Nursing, Oil and Rig, Security, Teaching, Entrepreneurship, Water & Waste Water Treatment. Currently, KASE has 7CoEs, in the aforementioned sectors with job placement training programmes. To create a vibrant design community and workforce KASE has established Kerala State Institute of Design (KSID) through a synergistic partnership between the artisan community, professional designers and the general public. In addition to these customised training and academic programs, KASE provides accreditation to the reputed skill training institutions to enhance their reach and acceptance in gaining the finest candidates. Special mechanisms in the delivery of training such as mobile training units, flexible batches, training based on the local needs of the area, are proposed to be introduced to ensure participation and mobilisation of women. Training in non-traditional fields for women is to be promoted through the establishment of specific training programmes that focus on life skills training modules and literacy training.

With a view to meet the skill requirement of jobs in foreign countries, programmes/ initiatives, as listed below are proposed to be taken up soon:

a) Indian Institute of Infrastructure and Construction (IIIC): The objective of IIIC is to conduct courses for the skill development of workers and managers in infrastructure and construction sectors and to ensure maximum employment through linking the courses vide industrial tie-up and collaboration with international institutes.

b) Skill Centres across the State: For Kerala to continue as the resource hub for skilled work force for UAE, skill centres are proposed to be established in the state.

c) UAE Driving Institute – Kerala State Industrial Development Corporation and Transport Department jointly envisions setting up a driving institute that will train Keralites as per the International driving standards, especially for the middle-east.

d) Aviation Academy: Aviation Academy is conceived to meet the ever growing demand for aviation technical and maintenance personal across the globe. As part of this initiative, KASE is planning to set up a full-fledged Aviation Training Academy, with an aim to provide EASA (European Aviation Safety Agency) license to the candidates undergoing the training in the center with the objective to establish a word class Centre of Excellence for imparting international quality skill sets to the personnel of all cadre in Aviation industry. It also propose to introduce EASA training in India and thereby exploring job opportunities available in India and abroad in the Aviation Industry.

e) World Skill Lyceum: In line with the national objective to be the resource hub for skilled work force across the globe, there is a need for dedicated execution plan and timeline for the Department of Labour and Skills of the State. A university with all the regulatory authority that can take up the vision of crafting globally competent skilled workforce is being envisaged as a model institution for the country catering to the global skill requirement which can fill the gap of formal education. The primary focus of this Lyceum is to complement the roles of SSDM in promoting, establishing, monitoring, governing and regulating institutions and academies for skill excellence and thereby to enhance core employability skills and competency standards to meet the demand of various industries globally. Futuristic sectors can be identified through the R&D wing. Analytical studies on the skill gap can also be conducted for each sector. The Lyceum focuses on:-

- Research and Development in Skilling
- Skill policy and projection for the State based on data pooled through R&D
- Development of courses in line with skill policy and demand
- Resource pooling from Government agencies
- Quality assurance
- Promoting entrepreneurship

The activities as outlined above will provide enhanced employability skills to the work force of Kerala, whereby their acceptability will further improve world-wide. All these initiatives would necessarily involve substantial fiscal cost to the State government. Considering these facts, the Government of Kerala urges the Commission to consider recommending a specific grant for skill upgradation initiatives, if sectoral grants are recommended by the 15th Finance Commission. Under Article 275 of the Constitution. Kerala requests an amount of ₹750 crores for the ongoing and proposed skill up-gradation initiatives.

9.4 Rehabilitation of Return Kerala Emigrants

Currently, over 24 lakh Keralites work outside the Country. Their number was around 12 lakhs in the mid-1990's (8 percent of the adult population) which increased to around 20 lakhs in the mid 2000's and to 24 lakh by 2014 (11 percent of the adult population). As over 80 percent of them work in the Middle East, a steady stream of workers returns to Kerala. Their number too has increased from around 7 lakhs in the mid— 1990's to around 10 lakhs in the mid - 2000's to 11 lakhs by mid-2010's.

The return emigrants are characterised by distinct features. Some come back after long years of employment, others come back after a short stint, yet another group come back with illness and so on. A sizable proportion of them are in dire need of various kinds of support to sustain themselves. The Non-Resident Keralites Affairs Department (NORKA) was set up by the Government of Kerala in 1996 to redress their grievances and safeguard their rights. Norka-Roots is the field agency of the Department of NORKA, set up in 2002.

The Government of Kerala has launched a number of schemes for the welfare of Non-Resident Keralites. Issuing of photo ID cards, Karunyam or Repatriation of dead bodies of Non Resident Keralites (NRK), and Swanthwana the Relief Fund Scheme. The beneficiaries of Santhwana are returnees living below poverty line and similarly placed dependents of deceased NRK's. The scheme meets with the financial requirements for marriages, medical treatment etc. and posthumous aid to provide social security to and their family or dependents. All these schemes, which are part of the social commitment of the State, put a pressure on its revenue expenditure.

Over the years, migration has become an extremely complex process and the migrant labourers of Kerala, as elsewhere, experience hardships and exploitation at every stage of migration. Past experience suggests that legal steps are only effective when the necessary information is made available to potential migrants, their families and common people. The Government has been launching awareness campaigns to sensitise potential emigrants and their families.

The protection of migrant workers can be enhanced through better training programmes and information dissemination about migration. 'Pre-departure' for migrant workers begins long before the actual journey. 'Pre-departure orientation training' aims to provide practical knowledge and protection skills to those who are in the middle of processing migration. It seeks to sensitise the migrants about the cultural milieu and legal rights and obligations in the destination country. NORKA-ROOTS has launched Pre-Departure Orientation Programmes for emigrants.

In the early years, after the oil boom, the emigrants from Kerala were largely unskilled labourers. But the composition of emigrants is changing rapidly and skill upgradation is of great benefit to many. Skill Upgradation Programmes have been launched by NORKA Roots that focus on upgrading the skill of young Keralite workforce to meet the challenges in the overseas employment markets. The programme aims to bring knowledge, deep functional expertise, and a practical approach to building capabilities and delivering real impact.

As already mentioned, a large proportion of the early emigrants to the Gulf countries were unskilled labourers with low literacy. The last two decades has seen them returning to their home land. The tendency among the emigrants to spend on conspicuous consumption like spending large amounts on building houses and in the education of their children hardly left them with any savings for their later in life. As a consequence, has been that a sizable number of them have entered the welfare pension schemes of the Government of Kerala.

Similarly, a number of return emigrants are suffering from illnesses of various kinds and they have enrolled in Rashtriya Swasthya Bima Yojana (RSBY) and Comprehensive Health Insurance Scheme (CHIS) of the government. The expenditure on these schemes has been mounting and had crossed Rs.200 crore in 2015-16. The Karunya Benevolent Scheme designed to provide financial assistance for tertiary care treatment is also coming to the aid of return emigrants. The expenditure on Karunya Benevolent Scheme has been around ₹350 crores per year during the last four years. State Government is committed to provide continued social security cover and health insurance cover to this section of society who have substantially contributed towards the economic development of the country

Considering the social commitment of the Government if Kerala in supporting the return migrants, who for a long time contributed in a substantial manner to the foreign exchange kitty, when the nation needed it so badly, it is urged that the fiscal cost incurred by the Government of Kerala in this regard needs to be considered for grants under Article 275 of the Constitution, if the 15th Finance Commission recommends sector specific grants. The Government of Kerala requests a grant of ₹ 1500 crore for the purpose of welfare schemes for return migrants.

9.1.5 Farm Sector Crisis – Relief for Rubber growers

As is the case with all States, Kerala too is facing a crisis in farm sector. Its main cash crop, natural rubber is having fluctuating prices and a low demand from the major customers, the tyre industry. The market experts have views that the demand is low even while there is a supply crunch. The rubber growers in Kerala are facing fall in prices and the fallout of this along with return migration can be deleterious for the fragile economic base of Kerala. The State is several attempts to give support to rubber framers, but the forward demand from the industries also is dependent upon the import policy of the Union Government. Considering the vital link of the Kerala economy and its rubber plantation sector, the State has to make ongoing efforts to provide income support to rubber farmers. The fiscal cost to the State deserves support in the form of grants -in-aid under Article 275 of the Constitution, if the 15th Finance Commission recommends sector specific grants. The Eco diversity, paddy cultivation, ecologically significant Pokkali, Kaippadu and Kole wetlands need special attention. The Government of Kerala requests an amount of ₹ 250 crore for this sector as grants.

Chapter 10

SUMMARY AND CONCLUSIONS

Despite prominent unitary features of Indian Constitution, Indian Union is de-facto highly decentralised country where subnational governments play a predominant role in provisioning of public services, ensuring property rights, maintaining law and order and in creating an enabling environment for the functioning of the market. States together account for more than 58 per cent of the combined expenditure of Union and States. Finance Commissions constituted every quinquennium, recommends sharing of taxes of the Union to correct the vertical fiscal imbalance. This enables the States to discharge their Constitutional obligations in Social and Economic sectors in spite of their limited revenue mobilising powers vis-a-vis the Union. It is in this context that, the Government of Kerala considers the Finance Commission as one of the main pillars of fiscal federalism. Government of Kerala believes that to strengthen federalism in this vastly diverse country, the 15thFinance Commission would give precedence to its Constitutional mandate. We are concerned with the added roles, the Finance Commissions are required to perform through the expanding items in their Terms of Reference (ToR). These include fiscal reforms, making constitutionally mandated grants conditional, and proposals for monitoring the activities that are pre-dominantly in the domain of elected State governments. .

In the ToR of the 15th Finance Commission, there are many such items which are matters of serious concern to the States and these have been discussed in detail in Chapter 2 of this Memorandum. A major highlight that runs counter to the grain of co-operative federalism, which is a stated national goal is the ToR 6(iv) which requires the Finance Commission to review the "The *impact of the fiscal situation of the Union Government* *of substantially enhanced tax devolution to the States following recommendation of the 14th Finance Commission, coupled with the coming imperative of national development programme including New India-2022".*

The achievement of national goals is not the exclusive concern of the Union Government. It is the shared and joint responsibility of all tiers of democratically elected governments, namely, the Union, the States and the Local Self Governments. Yet another anti federal feature is the requirement to review the recommendations of the previous Finance Commission which have already been accepted and implemented. It is to be taken note of that the "enhanced devolution "is being stated without taking ground realities into consideration. The pre and post devolution vertical imbalance between the Union and the States have gone up during the period when this "enhanced devolution" is claimed to have taken place (Tables 1.1 of this Memorandum).The cost sharing by the Union in many Centrally Sponsored Schemes, have gone down from 75 to 60 percent. The plan grants which were given to the States under the Gadgil formula have ceased. The share of surcharges and cesses in the Union Budget have gone up and resulted in reduced size of the Net Proceeds. As a share of Gross Tax Revenue of the Union, devolution to the States have been coming down and is at 33.83 percent in 2018-19 BE (Table 4.4) Besides, C&AG has pointed out discrepancies in Union Finance Accounts, which have resulted in loss of devolved shares to the States. Considering all these, the Government of Kerala is of the considered opinion that the share of the divisible pool should be enhanced from 42 to 50 percent in order to factor in the leakages and losses to the States. Finally and most importantly, 32 per cent tax devolution recommended by the 13th Finance Commission is not comparable with the 42 per cent recommended by the 14th Finance Commission. Devolution recommended by the 13th Finance Commission was to cover the non-plan revenue expenditure gap, while 42 per cent recommended by the 14th Finance Commission was to cover the plan and non-plan revenue expenditure. Thus, the effective increase in devolution is insignificant.

A major area of concern is the item 8 in the ToR which requires the 15thFinance Commission to use Population based on 2011 census. Till now, Population based on 1971 census was used by the Finance Commissions for Population as an explicit factor in tax devolution formula. The weights for Population as an explicit criterion and income distance where it is an implicit criterion is as per Table 10.1

In the Income Distance criterion, where population is an implicit criterion in the calculation of per capita GSDP, it is the current population that is used. In other words, in the criterion with the largest weightage, it is the current population that has been used. This is to take care of the needs of the more populous States. While giving grants to augment the Consolidated Funds of the States for transferring resources to LSGs also, Population based on 2011 census has been used by the Finance Commissions. The ToR 8 seeks to make the explicit criterion of Population also to be based on 2011 census. This would result in disrupting the partial balance sought to be achieved in the ToR of the previous Finance Commissions. This puts the States which have achieved replacement rates of population in accordance with the National Population Policy of 1977, by taking successful initiatives and incurring substantial fiscal costs, in a disadvantageous position. The government of Kerala is of the opinion that ToR 8 should be deleted.

Table 10.1 Relative Weights for Population and Income Distance -11th to 14thFCs

Finance Commission	Weight for Population (1971) as an explicit it Criterion (%)	Weight for Income Distance based on three year average per capita GSDP (%)
Eleventh	10	62.5
Twelfth	25	50
Thirteenth	25	47.5 (it was fiscal capacity distance where income distance was weighted by average tax-GSDP ratios)
Fourteenth	17.5 (10 percent weightage was given to. 2011 Population for Demographic Changes since 1971)	50

Source: Reports of the Finance Commissions

The interests of the more populous States are already been adequately taken care of by use of current population and 2011 population in income distance and grants to LSGs respectively. Removing Population based on 1971 census, which had an average weight of 20 percent is putting States which have achieved replacement rates of population to greater disadvantage and would stress their finances and adversely affect their continued efforts to sustain past achievements in social sector. This would be against the stated policy of Sustainable Development Goals. A suitable criterion in tax devolution should be introduced so that the share of States like Kerala does not fall below that of what it was in the 14th Finance Commission recommendations. Our concerns and opinions on ToR 5 which seeks review of Revenue Deficit grants and ToR 7 to give performance based incentives and attempts to control welfare schemes launched by the States dubbing them as 'populist' have been discussed in detail in Chapter 2 of this Memorandum. We are of the firm opinion of that doing away with Revenue Deficit grant is against the constitutional scheme of fiscal federalism and also would have severe adverse consequence for state finances. As regards control of populist measures, it would be incursion into the domain of democratically elected State Government

The Government of Kerala's specific suggestions on principles for giving grants -in-aid to Local Self Governments and financing of Disaster Management have been elaborated in Chapters 6 and 7 of this Memorandum.

As regards, grants-in-aid to Local Self Governments, the Government of Kerala's is of the opinion that the devolution of funds, functions and functionaries to Local Self Governments is the most crucial indicator of their empowerment. Hence, it has been suggested that in addition to criteria like Area and Population, devolution of functions, functionaries and funds should be a criterion for basic grants. It is suggested that 90 percent of the total grants should be basic grants and out of this, 60 percent would be based on Population and Area (90:10 and 80:20 for PRIS and ULBs respectively) and 30 percent based on transfers to LSGs as a proportion of the State's Revenue Expenditure. The remaining 10 percent can be performance based grants as is the practice now.

The funds for SDRF should go up for Kerala, considering the long coastline and vulnerable sections of population being densely populated there. The State is facing the fall out of the Ockhi cyclone and a higher size of SDRF with the Union giving grants up to 90 percent (as recommended by the 14th Finance Commission and accepted by the Centre in the Action Taken Report before the Parliament, but yet to be implemented). The States should have more flexibility to spend from this fund, at least 25 percent as against the present 10 percent. The past expenditure trends and a Hazard Vulnerability Index for ranking of States would be the ideal determinant for grants-in-aid for SDRF. But the latter needs to be drawn up after detail d consultation with the States.

Coming to Kerala specific issues, the State is on a renewed path of fiscal consolidation, the movement towards fiscal consolidation was visible in the first six years after implementation of Value Added Tax (VAT). Later, since 2013-14, the economic slowdown and adverse fall out of national and global trends, resulted in slowing down of own tax revenues. The impact of demonetisation and initial problems in implementation of GST are causes of this continued slow growth of own tax revenues. But the State has taken administrative measures for raising the growth rate of own tax revenues and rationalising revenue expenditure. There are conscious efforts to raise capital expenditure. The State is committed to the Fiscal Deficit target of 3 percent of GSDP. But any attempt to implement the FRBM Review committee's target of 1.7 percent Fiscal Deficit -GDP ratio would be deleterious for the State finances and the economy, as development and capital expenditure would be compressed with further contractionary effects on the economy. It is hoped that the 15th Finance Commission would not suggest any change in the existing FRBM Act. For a sub national government, sustained and predictable resource flow from the Centre is critical to maintain fiscal balance. We urge the 15th Finance Commission to make recommendations which would make Union government's fiscal responsibility path a credible one. Any fiscal rebalancing efforts towards fiscal consolidation should not be asymmetric and adverse on its impact on fiscal space of States, especially when major expenditure responsibilities particularly on social and economic development are at the State level.

ANNEXURE

KERALA'S EFFORTS IN AREAS COVERED UNDER TOR 7 OF 15TH FINANCE COMMISSION

The ToR of the 15th Finance Commission is as follows

7. The commission may consider proposing measurable performance-based incentives for States, at the appropriate level of government in following areas:

(i) Efforts made by the States in expansion and deepening of tax net under GST;

(ii) Efforts and Progress made in moving towards replacement rate of population growth;

(iii) Achievements in implementation of flagship schemes of Government of India, disaster resilient infrastructure, sustainable development goals, and quality of expenditure,

(iv) Progress made in increasing capital expenditure, eliminating losses of power sector, and improving the quality of such expenditure in generating future income streams;

(v) Progress made in increasing tax/non-tax revenues, promoting savings by adoption of Direct Benefit Transfers and Public Finance Management System, promoting digital economy and removing layers between the government and the beneficiaries;

(vi) Progress made in promoting ease of doing business by effecting related policy and regulatory changes and promoting labour intensive growth;

(vii) Provision of grants in aid to local bodies for basic services, including quality human resources, and implementation of performance grant system in improving delivery of services;

(viii) Control or lack of it in incurring expenditure on populist measure; and

(ix) Progress made in sanitation, solid waste management and bringing in behavioural change to end open defecation.

The sectors indicated in this term of reference come under the State List in the Seventh Schedule of the Constitution. We believe that it is not part of the Constitutional mandate of the Finance Commission to propose "measurable performance-based indicators for States," and that such an effort is contrary to the federal principle. We believe that it is not the task of the Finance Commission to venture into the realm of day-to-day governance. It is for the elected governments of States to decide the policies that are appropriate for our people.

We also submit that it is not for the Finance Commission to declare this or that policy "populist." Any measure, from welfare pensions for the poor and weaker sections of the society to food assistance can be termed as "populist" and recommended to be curtailed. This strikes at the root of a democratic polity in which State Governments are free to implement welfare measures, albeit within conditions of fiscal responsibility.

Without prejudice to this position on the letter and spirit of term of reference no. 7, the Government of Kerala wishes to present the efforts taken by it in the sectors mentioned in the TOR.

At the outset, we note that the engine of economic change for which Kerala is justly famous in India and the world is the investment that it has made in its people. Kerala's achievements in human development are the basis of its national and international fame. With respect to education, Kerala has the highest levels in India of literacy, school enrolment, and retention for all children and separately for boy and girl pupils, pupils from the Scheduled Castes and Tribes, and rural and urban pupils. In respect of the main indicators of health outcomes – for example, life expectancy at birth, infant mortality, and maternal mortality – Kerala's achievements are the best in India and drew international attention. Kerala leads the States with respect to the achievement of the United Nations Sustainable Development Goals that are to be achieved by 2030. The State is entering a new phase with respect to the demands on its educational and health systems, and the role that public institutions must play with respect to the changing educational and health needs of a modern society and a population characterised by a new demographic structure. If the early phase of human development required resources on a vast scale, so also do our present and future efforts.

7 (ii) Efforts and progress made in moving towards replacement rate of population growth;

1. Kerala has incurred huge fiscal costs in order to achieve a lower population growth and healthy demographic indicators. The State has made substantial investments on education, health, and directly on family welfare programmes. Bringing down the rate of growth of population does not mean less expenditure. On the contrary, it creates new commitments by the State to those in the labour force and to senior citizens.

2. As a result of its efforts with respect to health, school education, and direct demographic interventions, Kerala achieved replacement levels of fertility as early as 1988 (2.2 in 1987 and 2.0 in 1988). At that time, the total fertility rate in India was 4.0

3. Kerala has the highest life expectancy at birth in India: 71.8 years for males and 77.8 years for females.

4. Since people now lead longer lives, there has been a sharp rise in the proportion of elderly population in the State. The care of the elderly is the responsibility of State Governments. The enhanced costs of such care should be considered by the Commission in making its awards and in deciding the population criterion to be used.

5. The old age dependency ratio of India was 12.2 at the Census of 1991 and 14.2 at the Census of 2011. The corresponding ratios for Kerala are 14.4 and 19.6, the highest among Indian States. Kerala is ageing faster than the rest of the country.

6. Kerala was one of the early States of India to introduce an Old Age Policy. Various social security schemes for the welfare of the elderly are given below
   - (i) Vayomithram project provides health care and support to the elderly above the age of 65 years.
   - (ii) VayoAmrutham – for the treatment of inmates of old age homes. As part of it, Ayurvedic treatment is being provided to the inmates belonging to old age homes functioning under the Social Justice Department.
   - (iii) Mandahasam – to provide free denture sets for senior citizens.
   - (iv) Sayamprabha is another comprehensive scheme for the welfare of Senior Citizens
   - (v) Kerala has established several old age homes and day care centres across the State.

(iii) Achievements in implementation of flagship schemes of Government of India, disaster resilient infrastructure, sustainable development goals, and quality of expenditure,

The achievements of Kerala in some of the flagship schemes of the Government of India are given below.

1. *National Urban Livelihood Mission (NULM).* NULM was introduced in Kerala as a continuation of the erstwhile Swarna Jayanti Shahari Rozgar Yojana (SJSRY) to alleviate poverty and vulnerability of the urban poor. The financial performance of NULM in 2017-18 is given in Table 1.

Table 1 Financial performance of NULM, 2017-18, in ₹ lakh

NULM components	Allocation	Expenditure	% of expenditure
Social Mobilisation and Institution Development	273.663	735.63	268.81
Employment through skill training and placement	1489.943	605.24	40.62
Self-employment programmes	334.477	860.25	257.19
Capacity building and training	364.884	533.85	146.31
Shelter for urban homeless	273.663	143.44	52.41
Support for urban street vendors	152.035	27.25	17.92
A & OE	60.814	59.47	97.79
IEC	91.221	74.90	82.11
Total	3040.70	3040.03	99.98

Source: Kudumbashree

2. *Pradhan Mantri Awas Yojana – Urban (PMAY-U).*

The Government of Kerala has started a comprehensive housing and livelihoods programme, LIFE Mission, to provide houses for all the landless and homeless in the State. The target of the mission is to provide safe housing to nearly 4.30 lakh homeless in the State within 5 years. Among the homeless, about 1.60 lakh landless families have been historically excluded from various housing schemes of the past. The mission will also help those who received assistance from other schemes but could not complete the construction and move into a safe house.

Priority will be given to coastal population, plantation workers and those who stay in temporary shelters in government land.

PMAY-U is a centrally sponsored scheme jointly implemented by State Government and urban local bodies to address the housing requirement of urban poor including slum dwellers. It aims to provide housing for all by 2022 through various programme verticals such as beneficiary-led individual house construction (BLC) (new houses) and enhancement, affordable housing in partnership with public and private sectors, slum rehabilitation, and credit linked subsidy scheme (CLSS). The financial performance of PMAY-U is given in Table 2.

Table 2 Financial performance of PMAY (Urban), 2016-17 to 2017-18, in ₹ lakh

Year	Project cost	Approved Central Share	40% of approved (1st instalment) Central Share	Fund received by GOK (Central share)	Balance to be received from GoI	Fund received by Kudumabshree			Balance to be received from GOK		
						Central	State	Total	Central	State	Total
2016-17	87816.0	37516.5	15006.60	15007.41	-0.81	5069.4	1689.8	6759.2	-0.81	-	-0.81
2017-18	229904.0	86214.0	34485.60	13556.80	20928.80	23494.8	3367.0	26861.8	20928.8	5000.0	25928.8
Total	317720.0	123730.5	49492.20	28564.21		28564.2	5056.8	33621.0	20927.99	5000.0	25927.9

Source: Kudumbashree

3. *Pradhan Manthri Awaas Yojana – Gramin (PMAY-G)*. PMAY-G, erstwhile Indira Awaas Yojana is a centrally sponsored programme of the Ministry of Rural Development. It aims at providing a pucca house with basic amenities to all houseless and those households living in kutcha and dilapidated house. The unit assistance under this scheme is ₹ 1.20 lakh in plain areas and ₹ 1.30 lakh in hilly/ difficult areas. This amount is shared by Central and State Governments in the ratio of 60:40. Allocation under the scheme are important for Kerala's ambitious plans for housing and livelihoods for all.

Table 3 Physical targets and achievements of PMAY (G) including General, SCSP and TSP

Year	Target	New Houses Constructed	Percentage of Achievement against Target
2015-16	59060	41567	70.38
2016-17	32559	45530	139.84
2017-18	9872	8506	86.16

Source: Commissionerate of Rural Development

4. *Mahatma Gandhi National Rural Employment Guarantee Programme.* MGNREGP is implemented through Centre and State on a cost sharing basis of 90:10 ratio. The financial performance and physical performance of MGNREGP from 2015-16 to 2017-18 are given in Table 4 and Table 5 respectively.

Table 4 Financial performance of MGNREGP during 2015-16 to 2017-18, in ₹ lakh

Year	Budget Provision		Total Release		Opening Balance & Miscellaneous Receipt	Total Fund Available	Expenditure	% of expenditure
	State share	Central Share	Central Release	State Release				
2015-16	5000	159000	152633.9	2500.4	241.2	155375.6	149221.2	96
2016-17	5000	219720	158248.9	3138.9	8737.6	170125.5	242685.3	142.6
2017-18	8000	291400	185413.2	5111.1	2703.2	193227.7	266733.4	138

Source: Commissionerate of Rural Development

Table 5 Physical performance of MGNREGP during 2015-16 to 2017-18

Year	Number of Job Cards issued (Cumulative)	Employment generated (person days)
2015-16	1,76,849	7,40,75,922
2016-17	31,98,466	6,84,44,643
2017-18	33,18,294	6,10,60,298

Source: Commissionerate of Rural Development

5. Pradhan Mantri Gram Sadak Yojana (PMGSY). PMGSY was launched in 2000-01 to establish rural connectivity by connecting unconnected habitats with all-weather resistant roads of high quality. PMGSY-I was a 100 per cent CSS and PMGSY-II is 60 per cent CSS. In Kerala, PMGSY-II was started from 2016-17 onwards, and is important in extending rural connectivity in the State.

6. *Deendayal Antyodaya Yojana – National Rural Livelihoods Mission (DAY-NRLM)*

The nodal agency for the implementation of the DAY-NRLM in Kerala is Kudumbashree. Kudumbashree is an organisation in the State that has earned repute in the implementation of several schemes for the benefit of people. Ministry of Rural Development (MoRD), Government of India recognised Kudumbashree as a National Resource Organisation (KS-NRO) under the National Rural Livelihoods Mission (NRLM) in 2013. NRO is working in seven States each on the convergence and enterprises project. Assam and Odisha has convergence project only while Bihar and Gujarat have only enterprises project. Five States have both the projects.

Kudumbashree has also been selected as one of the partners for the Feed the Future – International training programme. Feed the Future programme is Indo-US joint programme, aimed at helping developing countries of Africa and Asia to emulate the successful model adopted by India in agriculture and poverty reduction. Through this programme, 25 developing countries has been identified across the two continents.

Deendayal Antyodaya Yojana – National Rural Livelihoods Mission (DAY - NRLM) is the restructured SGSY Programme to provide self/wage employment opportunities for the rural poor through Self Help Groups. The sub components of DAY - NRLM are Deendayal Upadhyaya Grameen Kaushalya Yojana (DDU GKY), Start-up Village Entrepreneurship Programme (SVEP) and Mahila Kissan Sasakthikaran Pariyojana (MKSP).

From 2015-16 onwards, the funding pattern between Central and State Government has been changed to the ratio 60:40 instead of 75:25. Government of Kerala designated Kudumbashree mission as the state level nodal agency for implementing NRLM. The financial performance of DAY – NRLM from 2015-16 to 2017-18 is given in Table 6.

Table 6 Financial performance of DAY – NRLM from 2015-16 to 2017-18, in ₹ lakh

Year	Allocation		Fund Release		Utilization	
	Central	State	Central	State	Central	State
2015-16	849.05	566.03	621.44	545.65	802.21	534.80
2016-17	688.00	460.00	163.75	1482.83	1074.22	716.15
2017-18	5400.00	3600.00	1804.87	601.63	1920.60	1280.40

Source: Kudumbashree

7. *Rashtriya Swasthya Bima Yojana (RSBY)* – GoI launched the programme in 2007 as a 5-year rollout scheme beginning with 20 per cent districts of each State in the first year and adding 20 per cent each in the subsequent years.

Kerala was the 1st State to set up a separate Nodal Agency, CHIAK (Comprehensive Health Insurance Agency of Kerala), for implementation of RSBY under the Department of Labour and Rehabilitation. After getting approval from GoI, all the 14 districts of the State were brought under RSBY in 2008.

RSBY was applicable to 11.79 lakh BPL families in the State identified by erstwhile Planning Commission. The State re-engineered the central scheme by implementing CHIS (Comprehensive Health Insurance Scheme) as a 100 per cent State funded programme to cover poor people other than BPL families identified by GoI. Central government also permitted State to use RSBY technology platform and to issue RSBY cards to these families after enrolment. In order to help families from sudden burden from heart attack or cancer treatment, CHIS Plus was introduced in 2010-11. CHIS Plus is also 100 per cent State funded programme that gives ₹ 70,000 in addition to ₹ 30,000 provisioned under RSBY.

From 2008-09 to 2017-18 (July 2017), 34.84 lakh families were enrolled in RSBY/ CHIS. (RSBY – 20.54 lakh and CHIS 14.3 lakh). For CHIS Plus 1.02 lakh families benefitted from 2010-11 to 2016-17. In the initial stage, beneficiaries highly relied on private hospitals and the utilization ratio for private-public hospital was 75-25 in the 1st year that has been reversed. The private-public hospitals utilisation ratio was 36-64 in 2017. Amount received by public hospitals as part of claim is utilised for infrastructure and human resource purposes.

8. *National Rural Drinking Water Programme (NRDWP)* – The State has decided that the criterion for full coverage under the NRDWP in the State of Kerala will be 100 litre per capita per day (lpcd) of piped water. As per the guidelines, the provision of drinking water under this scheme is 70 lpcd from any source of water whatsoever.

It is because the State has adhered to these stringent targets that achievement appears low. Nevertheless, the present government has almost doubled the achievement percentages as compared to the achievements of 2014-15. The State requires greater resources in order to achieve full coverage with these rigorous criteria.

9. *Integrated Child Development Scheme*

As per the National Family Health Survey-4 (2005-06), the following indicators show positive improvement in the integrated development of children:

(i) In Kerala, the proportion of children under 5 years who are stunted have been decreased from 24.5 in 2005-06 to 19.7 in 2015-16. The corresponding figures for India are 48.0 and 38.4

(ii) In Kerala, the proportion children under 5 years who are wasted have been decreased from 15.9 in 2005-06 to 15.7 in 2015-16. The corresponding figures for India are 19.8 and 21.0.

(iii) In Kerala, the proportion children under 5 years who are underweight have been decreased from 22.9 in 2005-06 to 16.4 in 2015-16. The corresponding figures for India are 42.5 and 35.7.

(iv) In Kerala, the proportion children age 6-59 months who are anaemic have been decreased from 44.5 in 2005-06 to 35.6 in 2015-16. The corresponding figures for India are 69.4 and 58.5.

Outcome indicators on child nutrition from the Fourth National Family Health Survey-4 (2005-06) indicate that Kerala's performance has been better than all-India achievement. Kerala's performance must be supported with resources for consolidation and following through:

ICDS is one of the flagship programmes of GOI aims at early childhood development. In 2016-17, the number of Anganwadi centres operational across the State were 33,114, covering 11.16 lakh beneficiaries under supplementary nutrition programme and 4.32 lakh children in the age group 3-6 years. Of the beneficiaries of supplementary nutrition programme, 2.57 lakh were pregnant and lactating women.

10. *Sarva Shiksha Abhiyan:* Kerala's achievements in universalising school education are well known. It has consistently worked to implement the guidelines of Sarva Shiksha Abhiyan to promote free, universal, equitable, and quality education to all children.

The dropout rate in Kerala is 0.2 per cent in primary school and 0.1 per cent in upper primary school. These rates are the lowest in the country. Of all government schools, 98.6 per cent have access to drinking water and 99.95 percent have toilets. Subjects in which children are weak are identified by the National Achievement Survey, and three unique programmes, Malayalathilakam (for the promotion of the mother tongue), Hello English, and Ganithavijayam (for Mathematics) have been put in place. During the summer vacation, 100 per cent of teachers in the State receive training.

Considering the special context of a large number of migrant workers in the State, special programme known as ROSHNI has been introduced for the children of migrant workers. Kerala's efforts in this regard should be supported with increased resources.

11. *Mid Day Meal Programme* – With a view to enhance enrolment, retention and attendance, and simultaneously improving the nutritional levels among children, the programme was launched as a Centrally Sponsored Scheme in 1995. In Kerala, the Midday Meal Scheme has been in existence in same form since 1984. Cooks are given an additional honorarium by the State to increase the efficiency of the programme.

Kerala also provides 150 ml milk twice a week to each child who eats mid day meals in school. The expenditure incurred for it is borne by the State Government. The State also provides boiled egg/banana to each child once in a week along with the meal served.

12. *National Rural Health Mission* – The achievements of Kerala in NRHM are given below.

    (i) Under Palliative care programme, more than 50,000 cases have been followed up with assistance from voluntary organisations.

    (ii) The setting up of palliative care mechanisms, gender-based violence management centres have been identified as some of the important innovations in the State under NRHM.

    (iii) Kerala is among the first States to implement quality assurance programme in hospitals. National Accreditation Board for Hospitals and Healthcare (NABH) standards were initially implemented in hospitals in Kerala.

    (iv) Kerala has been able to promote research and rehabilitation activities in a number of major specialised health research institutions in the State including Institute of Communicative and cognitive neuro sciences, Institute of mental health and neuro sciences, Institute of palliative medicine, Indian Institute of Diabetes, Child Development Centre, State Health System Resource Centre, Tribal Specialty Hospital etc.

    (v) As part of the scheme to distribute generic medicines free of cost to all patients irrespective of APL/BPL status, Kerala has started free distribution of generic drugs in 5 medical colleges to with the general hospitals in Trivandrum, Ernakulam, and Kozhikkode. Through this scheme 852 branded generic drugs are available.

    (vi) The modified school health programme is started in Kerala as a joint venture of Directorate of Health Services (DHS) and education with the aid of the

National Rural Health Mission in around 10 per cent of selected schools. The programme is scaled up to all the government and government aided schools in Kerala.

(vii) Rashtriya Bal Swasthya Karyakram, a new initiative under NRHM, is a child health screening and early intervention services programme to provide comprehensive care to all the children in the community. A new innovation of this project is the District early intervention centres set up as first referral point for further investigation, treatment, and management.

(viii) A geriatric health care programme in Kollam district named Ayurarogyam has started with the support of NRHM. The scheme is mainly aimed at improving the health status and quality of life of elderly people.

(ix) A total of 26 institutions in the State have been accredited with Kerala Accreditation Standards for Hospitals (KASH) till date. Seven more institutions in the state have completed state level assessment for KASH and are awaiting accreditation.

In 2017-18, the State had anticipated ₹ 8,038.95 crore as central share for implementation of centrally sponsored schemes. The expenditure under these schemes in 2017-18 was ₹ 5,782.39 crore, 72 per cent of the total anticipated amount. The State often does not receive funds as anticipated for the schemes. For example, for blue revolution scheme, the State had anticipated ₹ 82.5 crore and instead was allocated only ₹ 11.5 core; for PMAY-rural, the State had anticipated ₹ 299.86 crore and was allocated only ₹ 71.07 crore, for National Rural Drinking Water Programme ₹ 56.88 crore was allocated against the anticipated amount of ₹ 99.94 crore. For National Health Mission, the shortfall in allocation was more than ₹ 200 crore. In case of Sarva Shiksha Abhiyaan, the fund allocated was only ₹ 135 core against an anticipated amount of ₹ 495 crore.

Disaster resilient infrastructure

The State Government has taken the following initiatives for disaster resilient infrastructure.

1. Kerala State Disaster Management Authority (KSDMA) constituted a committee in 2011 (reconstituted in 2015) to evaluate techno-legal regime in light of Arya Committee Report and the National Building Code. In 2015, the Committee submitted the report to the State Executive Committee (SEC) of KSDMA and the SEC directed the Local Self Government under Section 64 of the Disaster Management Act, 2005 to consider the report of the Techno-legal Regime Committee and amend the Kerala Municipal Building Rules and Kerala Panchayat Building Rules accordingly.

2. Kerala State Disaster Management Authority is supporting the initiative of the

Coir Department and the National Coir Research and Management Institute for developing coir-based geotextile tube for coastal protection. The technology is indigenously developed and is experimentally tested at the coast of Alappuzha district.

3. The headquarters of KSDMA, which is under construction, will house the State Emergency Operations Centre. The building is designed to resist earthquakes and has facilities to sustain itself of 2 weeks without external power and water. Further, the building is the first Faraday's cage in the State that has conductivity plates running through its internal super structure to prevent lightning and electromagnetic pulse (EMP) hits affecting the internal servers and electrical gadgets.

4. Kerala is the first State in the country to release the hazard foot print maps of the State in digital query format for public use. The digital Geographic Information Systems files are available in KML format for use in any GIS platform including Google Earth with which potential land owners and house and infrastructure owners can plan their development structures with respect to the potential hazards that the area is prone to. This is a first of its kind disclosure in the whole country and the maps are available at http://sdma.kerala.gov.in/maps/. This ensures transparency and provides a priori information to public regarding potential hazards when planning for infrastructure development.

Sustainable Development Goals

Achievements in SDGs

SDG 1: According to a study on Global Multi-Dimensional Poverty, Kerala has registered the fastest decline in multi-dimensional poverty from 12 per cent in 2005-06 to 1 per cent in 2015-16. (Source: Southern comfort: India's global poverty rank improves, Suvojit Bagchi, The HINDU, May 13, 2018)

Further, Kerala has the largest network of Neighbourhood Groups (NHGs) or SHGs in the country with more than half the total households covered by it. The number of NHGs (or SHGs) formed increased to 2.7 lakhs in 2018 covering 39 lakh households. The special focus in 2017 was on NHGs of vulnerable groups (almost 50,000 such groups being formed between 2017 and 2018). The number of NHGs linked to bank credit (cumulative) is 1.82 lakhs, that is, over two-thirds of the NHGs.

In 2017-18, the State Government for the first time, published a Gender Budget Statement (GBS). As per the GBS, 11.4 per cent of total Plan Budget outlay was allocated for girls/women. In the 2018-19, the number of Departments/Agencies increased to 20 from 15 and the proportion of allocations for girls/women increased to 14.6 per cent. This included allocation for gender specific schemes or those in which a proportion is allocated to women as per the gender disaggregated beneficiary data provided by the departments.

SDG 8: Of a total population of about 7.94 lakhs disabled persons in the State, physically and intellectually (as per Kerala Disability Census in 2015), 3.79 lakhs are getting pension, that is almost 50 per cent; ₹ 1800 for people with more than 80 per cent disability and Rs.1300 for those < 80 per cent disability.

7 (iv) Progress made in increasing capital expenditure, eliminating losses of power sector, and improving the quality of such expenditure in generating future income streams;

1. *Total electrification.* Kerala has achieved total electrification of not only villages but all households. KSEB has provided electricity connection to all families except 1,000 families. This includes 150 families belonging to tribal communities living in dense forest area. Reasons behind this are pending court cases and denial of permission from forest department.

2. *Capital Expenditure*. The State aims to invest in strengthening of the transmission lines. The mission of the transmission sector is to limit the transmission losses by utilising the Transgrid 2.0 scheme under Kerala Infrastructure Investment Fund Board (KIIFB). Transgrid 2.0 is an innovative two-tier transmission system in 400 kv and 220 kv levels with an investment of ₹ 9,425 crore over a period of five years to bring transmission losses within the benchmark limits.

3. *Joining UDAY*. This provides an opportunity for KSEBL to critically analyse and correct its own performance in the technical as well as commercial spheres. The yearly target of AT&C loss is 11.2 per cent.

4. *Renewable energy (Solar)*. KSEB is going to set up 500 MW of solar power as it is mandatory for States to purchase a certain portion of their electricity needs from solar power plants

5. Renewable energy (biogas). In 2017-18, 2199 biogas plants (capacity 0.75 and 1 cubic metre per day) were installed.

7 (v) Progress made in increasing tax/non-tax revenues, promoting savings by adoption of Direct Benefit Transfers and Public Finance Management System, promoting digital economy and removing layers between the government and the beneficiaries;

The State has taken steps to mobilise Non Tax revenues by gradually increasing the user charges for services provided at 5 percent a year. Steps for improving collection efficiency is already in place through electronic payments of utility bills like that of electricity, water and registration fees. The welfare pensions are disbursed through the bank accounts of the beneficiaries. There is online mechanism for paying salaries to government employees. The Government of a Kerala has also taken steps to put in place a Financial Management System and expenditure flow is being closely monitored. It has been ensured that bill system of expenditure is strictly follows by the government departments and LSGs. The Government of Kerala has undertaken a programme to provide Internet facility to all people through a network of optical fibre cable. Connectivity has already been provided to all LSGs. This would go a long way in more efficient mobilisation of Non Tax revenues and provision of services

With regard to digital economy, the State has taken following steps to improve governance using information technology.

1. *Akshaya Centres* There are 2,670 Akshaya Centres across the State employing 7,335 persons enabling 255 services.

2. *FRIENDS.* Fast Reliable Instant Efficient Network for Disbursement of Services (FRIENDS) is a single window integrated remittance canter in each District enabling all digital services. In 2016-17, 16.31 lakh transactions worth ₹ 183.48 crores were carried out.

3. *Kerala Fiber Optic Network (KFON). KFON* is a project costing ₹. 823 crore to build a highly scalable and resilient core network creating access network to connect 30,000 plus Government institutions. It provides free internet access to 20 lakh economically backward households.

Government of Kerala has taken steps to develop a DBT single common platform for channelising all Central and State sponsored schemes. Public Finance Management System has been adopted in the State.

7 (vi) Progress made in promoting ease of doing business by effecting related policy and regulatory changes and promoting labour intensive growth;

Kerala has taken various steps to improve the ease of doing business and to promote labour-intensive economic growth in the State.

With respect to the ease of doing business, the State has identified the following areas for improvement: i) registration, ii) revenue, iii) municipality building rules, iv) panchayat building rules, and v) survey and land records. Based on a study coordinated by the Kerala State Industrial Development Corporation (KSIDC), Government of Kerala has approved specific changes in Acts and Rules in the above-mentioned areas (in October 2017) to make them more friendly for entrepreneurs. The State Government is also implementing an online single window clearance mechanism (SWIFT) to give faster clearances to industrial projects.

Kerala is committed to encouraging labour-intensive economic growth through promotion of specific areas of manufacturing and services. Within the manufacturing sector, the State Government is making efforts to develop agro and food-based industries, garments and textiles, and electronics industries. Given the specific conditions of the State, the above-referred industries have high potential for employment generation in

Kerala. The Industrial and Commercial Policy of the Government of Kerala announced in June 2017 lays out a clear roadmap for the promotion of labour-intensive manufacturing in the State.

First, the roadmap emphasises the building of modern infrastructure facilities for industrial growth. KSIDC, Kerala Industrial Infrastructure Development Corporation (KINFRA) and the Department of Industries and Commerce, Government of Kerala have set up a number of industrial parks across various districts of the State. Some of the existing and upcoming industrial parks include a Mega Food Park in Kozhikode, Ernakulam, Alappuzha, Palakkad, Wayanad and Idukki; an electronics hardware park and an electronic manufacturing cluster in Ernakulam; a park for high-end defence and aerospace electronics in Palakkad; a Life Sciences Park in Thiruvananthapuram; and textile and garment parks in various districts of the State.

Secondly, Kerala is taking steps to promote entrepreneurship in manufacturing and other areas. State planning is to encourage entrepreneurship particularly among women, students, and professionals who return to the State after working abroad. Kerala Startup Mission, an agency of the State Government, promotes entrepreneurship and incubation activities in Kerala. KSIDC conducts a highly successful annual event called *Young Entrepreneurs Summit*. Kerala Technology Startup Policy, 2014 aims to create a world-class scientific and technology ecosystem that can nurture technology-based startups. Micro, small and medium enterprises have a special place in Kerala's economy. Recent policy initiatives to promote this sector include the "Kerala MSME Revival Trust Fund," which is a comprehensive scheme to revive micro, small and medium enterprises in Kerala that suffer due to stressed assets.

Thirdly, the Labour Policy announced by the Government of Kerala in July 2017 is aimed to ensure fair wages, decent working conditions, and social security for various sections of the State's workforce. Notably, the policy also aims to create women-friendly work environments across the State. The objective is to significantly boost women's participation in the workforce. Another noteworthy feature of the Labour Policy relates to welfare schemes that target migrant workers in the State. Kerala is planning a major programme to upgrade the skills of various sections of its workforce by modernising the infrastructure and other facilities in Industrial Training Institutes (ITIs).

7 (vii) Provision of grants in aid to local bodies for basic services, including quality human resources, and implementation of performance grant system in improving delivery of services;

The major achievements of the state in the area of decentralized governance are given below.

1. Local level participatory planning has been an indispensable part of the development discourses in Kerala over the last two decades and its contributions to decentralised governance has been widely acknowledged. In fact, the Ministry

of Panchayati Raj, Government of India has adopted the participatory planning methodology of the state for preparing the guidelines of Grama Panchayat Development Plan (GPDP) for other states.

2. Kerala's fiscal decentralisation is unique, that the state has been able to assign well defined development responsibilities and revenue assignments to local governments. Since the beginning of decentralised planning, on an average 25 per cent of the State's investible resources have been devolved to local governments as development fund. In addition, the State transfers 3.5 per cent of its own tax revenue as general purpose fund and 5.5 per cent of own tax revenue as maintenance fund every year. During 2018-19, state devolved an amount of ₹ 10,770.59 crore as budget provision to local governments. Although the development fund is given in three streams namely- Special Component plan, Tribal Sub plan and General Sector fund, the government insists to earmark5 per cent for disabled and children, 5 per cent for old age &palliative population, 10 per cent for women component plan.

3. The LSGIs have also get performance-based grant from the Central Finance Commission and the World Bank scheme. The devolution from Central finance commission is directly assigned to local governments for activities related to public service delivery and infrastructure development. The World Bank assisted Kerala Local Government Service Delivery Project (KLGSDP) launched in 2011 has helped to revamp the institutional and financial potential of local governments by enhancing and strengthening the institutional capacity of the Local Government System in Kerala to deliver services and undertake basic governance functions more effectively and in a sustainable manner. Even though the local governments in Kerala depends on devolution from higher tiers of governments for developmental activities, their own sources of revenue is showing an increasing trend.

4. Kerala is the first State preparing comprehensive District Plans for the entire districts of the State in order to promote multilevel planning and to ensure greater integration between various development agencies and different tiers of local governments at district level. The District plan identifies the development gaps, addresses the priorities and evolves with integrated projects for comprehensive development of the districts.

5. The government was able to establish a whole set of support mechanism to sustain and streamline the functioning of local governments. The government instituted the State Election Commission, State Finance Commission, Ombudsman, Information Kerala Mission for ICT monitoring, Kerala Institute of Local Administration for quality human resource and mandated Citizen charter and social audit.

6. The State has ensured equity and inclusiveness in representation and developmental activities. There has been an increase in the participation of women and the members of SCs and STs in the local public sphere and as such there is big scope for further empowerment.

7. The State uses modern ICT methods for effective local governance. Sulekha Plan monitoring software developed by Information Kerala Mission is used for the formulation, appraisal, approval, monitoring, and expenditure tracking of the nearly 2 lakh annual decentralized plan projects of local governments. On the other hand, the government developed the Plan Space, a major e-governance initiative for monitoring the State plan schemes and projects. It enables real time Plan monitoring and integrated with Treasury Information System and Sulekha. These software capture real time information and serve as effective tools for monitoring total Plan activities of the State. The local governments disburse social security pensions through direct beneficiary transfer system.

7 (viii) Control or lack of it in incurring expenditure on populist measure

As written, we take exception to the categorisation of development schemes as "populist" or "non-populist."

We submit that the policy of universal school meals was one characterised as "populist"; today it is national policy.

When Kerala first introduced Comprehensive Agriculture Workers' Pension Scheme for agricultural workers, many policymakers called the effort "populist." Pensions for the poor and informal-sector workers are now widely accepted policy.

Among Indian states, Kerala was the first state to have introduced a comprehensive Agriculture Workers' Pension Scheme which came into effect in 1980 benefiting a major segment of the state's workforce in the unorganised sector (other pension schemes depending on the occupational category came to be modified around it). In terms of wages, working conditions and provisions for retired life, these workers were the most disadvantaged and hence most deserving of a pension however small which entitled them to half the food grain requirement of an adult and enhanced their acceptability within the family and society.

Another example is the Rashtriya Swasthya Bima Yojana (RSBY) – Comprehensive Health insurance Scheme (CHIS). RSBY was introduced by Government of India in 2007. It was introduced in all districts of Kerala in 2008. Kerala was the first State to set up a separate nodal agency namely CHIAK (Comprehensive Health Insurance Agency of Kerala) under the Department of Labour and Rehabilitation for the implementation of this scheme. RSBY was applicable to 11.79 lakh BPL families in the State identified by erstwhile Planning Commission.

To provide health care to the poorest segment of its population, the State, has in fact, re-engineered the central scheme by implementing CHIS (Comprehensive Health Insurance Scheme) as a 100 per cent State funded programme for covering poor people other than BPL families identified by GoI. Central government also permitted State to use the same RSBY technology platform and to issue RSBY cards to these families after enrolment. In order to provide tertiary care services for critical illness like cancer, cardiac and renal failure CHIS Plus was introduced in 2010-11. CHIS Plus is also 100 per cent state funded programme which gives ₹ 70,000 addition to ₹ 30,000 allowed under RSBY. Kerala has been the most successful State in implementing this scheme. Its efforts must be seen as constituting a welfare measure, not "populist."

7 (ix) Progress made in sanitation, solid waste management and bringing in behavioural change to end open defecation.

From 2016, the State has been active in implementing, in letter and spirit, the "Prohibition of Employment as Manual Scavengers and their Rehabilitation Act, 2013."

Kerala has been a pioneer in developing new technologies and ideas in the field of eliminating manual scavenging. A group of engineers from Kerala have designed a spider-shaped robot that cleans manholes and sewers with precision. Called Bandicoot, it has successfully completed a trial run in Thiruvananthapuram, unclogging five manholes filled with plastic, filth, medical waste and sediments. The robot, which takes 15 minutes to clean small sewers and around 45 minutes to unclog bigger ones, was developed by Genrobotics, a company founded by nine young engineers in Thiruvananthapuram two years ago.

Some significant achievements with respect to this term of reference are given below.

1. As part of Swachh Bharat Mission (Gramin) 1,74,720 Individual Household Latrines (IHHLs) and 10 Community Toilets were constructed and the State achieved 100 per cent coverage. Rural Kerala was declared ODF on November 1, 2016.

2. As part of Swachh Bharat Mission (Urban), all the beneficiaries in Urban Local Body (ULB) areas who did not have toilets have completed the construction of Individual Household Latrines (IHHL). The target for construction in the State was 29,578. Community Toilet units were provided to urban households wherever IHHL could not be provided. 1,650 community toilets and public toilets seats have been constructed in municipal areas across the State.

3. Out of 93 urban local bodies in the State, 92 are ODF (Open Defecation Free). 44 urban local bodies have been certified as ODF by Ministry of Housing and Urban Affairs and the process of third party inspection of the remaining urban local bodies for ODF certification is being carried out.

4. Action has been taken to construct another 2,445 Public Toilets in 87 ULBs in

the State. These will be constructed in public offices, bus stations, markets, tourist places, wayside of NH/SH/ODR, parks etc before September 2018.

5. The State Government has e introduced the "Haritha Keralam Mission", which covers areas of waste management, organic vegetable cultivation, and effective water resource management. During 2017-18, waste management activities began in a campaign mode with the active participation of the people.

6. In order to collect, segregate and transfer dry waste from households and institutions and to facilitate composting at source, a trained volunteer group called the Haritha Karma Sena (Green Task Force) has been deployed in enterprise mode. The services of Haritha Karma Sena (Green Task Force) are deployed for the collection of non-biodegredable waste from household and institutions. Presently there are 869 Haritha Karma Senas at Grama Panchayat and ULB levels. For the last 2 years, it has been made mandatory for the GPs to earmark 10 per cent of their plan fund (General) and for ULBs to earmark 15 per cent of their plan fund (General) for sanitation related projects.

7. The State promotes waste management by providing subsidy for domestic and decentralized bio degradable treatment plants like bio gas plants, pipe composting, ring composting, bucket composting, and bio-bin composting. as per the requirement of the area/dwelling unit. The Urban Local Governments have taken up projects for installing 48,559 bio gas plants, 3,57,934 community level composting devices, and 528 aerobic composting units during 2011-12 to 2016-17. Grama Panchayats have taken up 66, 250 bio gas plants and 6, 24, 212 household level composting units during the same period.

8. Material Recovery Facility (MRF) for managing dry waste are being set up by all tiers of Local Self Government Institutions. One hundred and twenty five Material Collection Facility Centres have been set up in Grama Panchayats. Another 129 MRF are being constructed. Thirteen Resource Recovery Facilities (RRF) have also been established at Block Panchayat level and another 29 RRF are nearing completion. Around 94 Material Collection Facilities (MCF), 37 Resource Recovery Facilities (RRF) and 7 plastic shredding units are being set up in municipalities across State. Most of the ULBs have decentralised waste management systems. Large cities such as Kochi and Kozhikode have centralised composting plants.

9. The State is also paying attention to enforcement and monitoring of waste management rules. Brand owners, manufactures and producers are motivated to take responsibility in creating systems for the proper collection and handling of their products.

10. People are motivated to organise all the public and private functions in accordance with a Green Protocol and to promote the Reduce–Reuse–Recycle principle.

Before concluding this chapter, we call attention to three tourism projects that have relevance to our national heritage. They are as follows:

Kshetra Nagrari: The Kshetra Nagari project aims to renovate and enhance facility in 15 temples across Kerala. It proposes construction and development of facilities such as dormitory for pilgrims, biogas plants, sewage treatment plants, bio-toilets, water supply treatment, CCTVs, landscaping, and parking facilities in the temples. The proposal includes a pilot project named "Harithakshetram", that involves planting aromatic plants, flowering plants, and medicinal plants. These plants can be used for pooja activities and for the preparation of ayurveda drugs.

Kochi Muziris Biennale project: The Kochi-Muziris Biennale seeks to establish itself as a centre for artistic engagement in India by drawing from the rich tradition of public action and public engagement in Kerala. The first Kochi-Muzris Biennale was held in 2012. The third edition was held in 2016-17. The biennale has evolved as a pilgrimage to art and culture enthusiasts and puts Kerala and India on global cultural platform.

Muziris Heritage Project: The Government of Kerala has initiated the Muziris Heritage Project to reinstate the historical and cultural significance of the legendary port of Muziris. The region is dotted with numerous monuments. The entire project is designed to involve and integrate the local community in all developmental initiatives. It is one of the largest heritage conservation project in India.

Government of Kerala