GOVERNMENT OF KERALA

MEMORANDUM

PRESENTED
TO
THE FOURTEENTH FINANCE COMMISSION

FINANCE DEPARTMENT

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Chapter 1
Introduction

1.1 Indian States have come a long way in terms of income growth, distribution and well-being over the last 65 years. Along with growth the diversity among the States has also widened. The populations have increased at disparate rates bringing about diverse population structures. Educational and health achievements too have been diverse among the States calling for the provision of diverse public services. Human settlement has changed decisively with the level and pattern of urbanisation varying widely across the States. These diverse patterns of development of the States have not only increased the fiscal needs but also brought about severe cost disabilities in the provision of comparable public services.

1.2 The last two decades have seen India move in the direction of opening the economy to trade and commodity flows of unimaginable levels. While the opening has boosted economic growth, the country has also become more vulnerable to external factors such as the global financial crisis. The States which have a higher share of manufacturing in Gross State Domestic Product (GSDP) and higher share in exports did see their growth rates fall relatively more than the other States. Similarly, the localization in the Gulf affected the States with a higher number of migrant labour differently from the other States. The differentials in growth and composition of GSDP and employment have given rise to differing fiscal capacities and differing fiscal needs among the States calling for larger and equitable devolution of resources from the divisible pool.

1.3 Articles of the Constitution between 268 and 275 have designed a well-structured system whereby States can benefit from the Centre's taxation power to address the cost disabilities and fiscal capacities of the States. Aid to the States is what the makers of the Constitution had in mind. The Finance Commission has the authority to deal with the entire area where State's revenues are applied and not just the non-plan revenue expenditure as it is largely presumed. Often the Terms of Reference (TOR) of the Commission would bind it to exclude some parts. For instance, the XIII Finance Commission was mandated to adjudicate on the quantum of revenue transfer to States out

of what is left after the Centre meets plan expenditure commitments (TOR 6ii). Fortunately, the TORs of the XIV Commission are broad enough to deal with the entire area where State's revenues are applied.

1.4 The State of Kerala has some unique characteristics. It is a narrow strip of land sandwiched between the Western Ghat and the long coastal stretch with about four per cent of the geographical area of the State as wetlands. Wetlands are areas of critical ecological significance that support rich biodiversity calling for their identification and protection. The growing population pressure is a threat to these resources as wetlands are the first target of human interference. While India has less than 0.25% of the world coastline and 11% of the global population living in the coastal areas, the State accounts for nine per cent of the coastline of India and accounts for about 14% of the Indian coastal population. The fragile coastal zones have to be protected for the larger well-being of the nation which is a huge cost to the small State. About 29% of the State's geographical area falls under forests. The positive externalities of conservation of environment and forest taken up by the State since the last 30 years or more needs to be taken note of. The revenue foregone by the State on account of conservation of forests, projects foregone and the indirect benefit accruing to the country on account of environmental protection should not be ignored in any distributional schema.

1.5 The Madhav Gadgil Committee Report earlier and the Kasturi Rangan Panel Report have brought additional cost disabilities to the State. The notifications issued by the Union Ministry of Environment and Forests following the reports severely limit mining, quarrying and sand mining, building and construction projects, townships and area development projects and certain categories of industries. In the last thirty years the State has not been able to take up any hydro power projects though the potential does exist. Environmental concerns have overridden the immediate economic gains. Kerala was also one of the first States in the country to ban clear felling of forests in the 1980s forgoing the forest revenues that were a substantial component of non-tax revenue of the State. These are huge cost disabilities for a State with one of the highest population densities.

1.6 The State has been successful in converting the limitations posed by the long coastline, large wetland stretches and dense forests into assets by

investing large resources in human development over a long period. The consequent large outmigration has done much good to the country –positive externalities of remittances in terms of bridging part of the current account deficit and trained manpower akin to brain drain to rest of India – but has brought with it cost disabilities in the form of rehabilitation of the returnees. Similarly, the sustained control of population growth has left an ageing population with the heavy burden of health care costs.

1.7 The spread of health and educational services have raised the expectations of the marginalized. The State is obliged to uplift the marginalized and special population groups- Scheduled Tribe, fisher folk, disabled - who are still at relatively lower levels of human development. Each of these groups has their special problems and the State is making efforts to attend to them. They all have to be equipped to lead healthy long lives.

1.8 The State has made large and varied investments in physical and social infrastructure over a long period. To be able to provide efficient services there is need for regular maintenance and upgradation of all types of infrastructure. The State has been making efforts to maintain the infrastructure by devoting part of the revenues. But the running deficits have put a break on this process and a way has to be found out of this scenario for better upkeep of the infrastructure.

1.9 A literate and politically conscious society that is highly globalised, demands higher levels of services; their expectations run high. Keeping these in mind the State has developed a Perspective Plan 2030 envisaging Kerala to be a knowledge hub with distinctive world class expertise in the education sector, health care, bio- technology, ICT, bio diversity and environment related areas. The mission is to achieve “Sustainable Economic Prosperity”- prosperity for the present without compromising the prosperity of future generations. Quality of development rather than economic growth will continue to be the basis for the strategy.

1.10 While the finances of the State are severely stressed to meet the challenges, the formulae of the Commissions have often not been able to take care of the cost disabilities specific to the State. Despite the declining share in tax assignment and the absence of grants to bridge the revenue deficit, the State has made concerted efforts in mobilising resources, being one of the first

to implement the Value Added Tax (VAT) system. Despite the danger of a higher deficit, the State has borrowed to finance investment as the state has to meet the rising aspirations of the people and try to move towards a higher trajectory of development.

1.11 Needless to say, often the TORs have often restricted the scope of work of the Commissions. The TORs of the XIV Finance Commission have some distinct features which provided an opportunity to tread some new paths. With regard to TOR 7 on the population base, “the Commission may also take into account the demographic changes that have taken place subsequent to 1971”. Similarly, TOR 6 (iii) refers to the impact of the debt levels on resource availability. There are others too. These features of the TORs are an opportunity for the Commission to take a comprehensive view of the fiscal needs of the States, each with their own specificity. It is with this broad view that the memorandum has been conceived.

1.12 The memorandum is organised in eleven chapters including the introductory chapter. Chapter 2 titled, *Comments on the Terms of Reference* responds to some of the additions to the TOR of the Fourteenth Finance Commission compared to those of the earlier Finance Commissions. The general talk of incentives/disincentives in the context of budget management is questioned as it has often led to perverse behaviour. There is need to evaluate the fiscal situation of the State in the historical and structural context of its development rather than by any general yardsticks and not to burden it with additional subsidies on account of Central schemes. Also, if the TOR has laid down a specific measure (which has been questioned many times) for the evaluation of tax effort, we would urge the Commission to evaluate possible alternatives also so that the issue can be looked at with a comprehensive perspective.

1.13 Chapter 3 on the *Fiscal Situation of the State* presents an analysis of the recent efforts by the State to rein in the revenue and fiscal deficits and the pressures brought by the 9th Pay Commission awards and the higher allowances necessitated by inflationary pressures in the economy. The State has made successful efforts in mobilizing resources but the lower share of Central transfers has put pressure on the finances of the State. On the expenditure side the burden of interest payments, salaries, pension and

subsidies has been high. The large devolution to the local governments being classified as revenue expenditure too leads to a situation of higher revenue deficit and our suggestion is for developing alternative methods of assessing deficits. The realisation that capital expenditure has not been substantial led to the taking of steps to raise it despite the fears of widening deficits.

1.14 The next chapter titled *Forecasts of Receipts and Expenditure* presents details of Finance Commission projections of revenue and expenditure and deviations from the actuals. The unrealistic projections and the denial of non-plan post devolution grant to the State, the pay commission awards and the impact of inflation on salaries and pensions put lot of pressure on the finances of the State. Taking 30 per cent of the plan expenditure of the terminal year of the plan period as committed expenditure also puts pressure on the non-plan expenditure as the actuals surpass those numbers. The chapter argues for a realistic assessment of the trends rather than take a “one size fits all” approach.

1.15 In *Debt: A Picture of Sustainability* the fiscal deficits of Kerala are compared with that of Punjab and West Bengal as was done by the Thirteenth Finance Commission. Kerala did move well on the suggested fiscal road map, reduced the debt and improved the spending on capital formation to take the State on an investment trajectory. The State is, however, conscious of the need to tread a path of debt sustainability. Chapter 6 on *Fiscal Responsibility and Budget Management* discusses the quality of fiscal adjustments made by the States and argues that reaching sustainable deficits at the cost of growth and justice might aggravate regional inequalities. Devolution of larger resources would have partly solved the fiscal problems of the States but the approach of the Centre to impose cess and surcharges to deny a share to the States and the large tax foregone has made matters worse. This has to change.

1.16 Chapter 7: *Ecology, Environment and Climate Change* begins by highlighting the National Forest policy, 1988 where it is clearly stated that forests should not be looked upon as a source of revenue. While forests are national assets and public goods, the costs borne by the State are large. They become relatively larger for those States having relatively more geographical area under forests. Kerala falls in this group of States. In terms of carbon stock, Kerala stands ahead of most States except Arunachal Pradesh. Foregone

economic activity, hydel projects and lower non tax revenues are the costs borne by the State, in addition to incurring regular maintenance costs of forests. A new dimension to forest management has been added by the Kasturi Rangan report; the resources required to carry out the activities are beyond the means of the State. The suggestion is that the Commission should consider increasing the funds allotted by the Thirteenth Finance Commission for forest and environmental conservation. Like forest conservation, wetland and coastal preservation too needs the consideration of the Commission. A formula for the allocation of funds has been suggested. Environmental activities at the level of the local governments are rare but they need to be encouraged to address the mitigation of environmental risks.

1.17 Chapter 8 titled *System of Inter-Governmental Transfers* begins with the principle of inter-governmental transfers enunciated by the 11th Finance Commission. Transfers serve a two-fold purpose: one to address the vertical imbalance and two, to alleviate horizontal imbalances, the **disparities in the revenue capacities** of the constituent units of the federation- States and local bodies in our case - in order that all of them may be in a position to **provide basic public services to their citizens at a reasonable level.** As regards the vertical imbalance, the experience has been one of the States getting less and less with more restrictive conditions. Despite the fiscal stress the burden of fiscal adjustment has been put on the States. This has to change with more responsibility placed on the Centre for mobilising resources as well as sharing it with the States. Considering the facts of the matter our demand is for a share of 50% in the divisible pool. Turning to the inter se distribution the principle of equalization would call for the dropping of tax effort and fiscal discipline from the formula. The population and fiscal capacity distance should be related through weights generated by the devolution ratio starting with the principle of equalization. Population needs to be redefined incorporating the cost disabilities imposed by the share of aged population, level of urbanization, forest area and effective population density.

1.18 Chapter 9, *Grants in Aid to States under Article 275* argues that the economic logic of grants in a federal set up cannot be questioned altogether. The need to make realistic awards to fill the non-plan revenue account gaps so as to make adequate surplus available for capital investment is emphasized. The uniqueness of Kerala demands that specific problem grants be awarded in

addressing problems of aged population, disability, and that of marginalised groups. Funds need to be provided to protect the coastal zones, forests and conserve water sources. Many departments require resources for upgrading infrastructure and systems.

1.19 The chapter on *Local Self Governments* after describing the efforts made by Kerala in turning them into truly self-governing institutions by devolving functions, funds and functionaries presents data on devolution under various heads. Decentralisation has resulted in creditable outcomes in terms of reduction of poverty and the provision of public services. But decentralisation involves additional costs for capacity building of elected members, local government employees and additional staff at the State government level. The demand is for doubling the award from a share of 2.28 per cent of the divisible pool as recommended by the Thirteenth Finance Commission to five per cent.

1.20 In chapter 11, *Financing Disaster Management*, the issue raised is that of the diversity of disasters among the States of India. Kerala is vulnerable to coastal erosion, floods, droughts and lightning. Kerala has been awarded low sums by the last two Commissions which has been inadequate to meet the exigencies. The demand is for raising the award substantially. Chapter 12 is on the issue of *Goods and Services Tax*.

Chapter 2
Comments on the Terms of Reference

2.1 The Terms of Reference of the Finance Commissions fall into a standard set with some qualifications. The TORs of the Fourteenth Finance Commission too fall into the same pattern. However, there are some items of TOR which call for close scrutiny either because they are additions/modifications compared to the TOR of the Thirteenth Finance Commission or because they have not been changed despite close scrutiny by the preceding Commissions.

2.2 Item 5: 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 road map 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 FRBM Act currently in force. 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. The Commission shall also consider and recommend incentives and disincentives for States for observing the obligations laid down in the FRBM Acts****.*

2.3 The FRBM Acts had a role at the point, ten years ago, at which they were recommended as States were building revenue and fiscal deficits which raised doubts about the sustainability of the fiscal environment. The FRBM Acts served a useful purpose in bringing about some discipline in resource mobilisation and spending. However, the economic situation has changed drastically following the global turmoil and its impact on the economies of the States. In many States they have brought about compression of expenditures which were not in their best interests. Thus, the suggestions to amend the Act are a most welcome TOR.

2.4 The issue of amendments in the Act has arisen as some States are not able to meet the obligations laid down by the Act. In such a situation, the latter parts of the TOR where incentives and disincentives are talked about, we feel are not in the right direction. Such incentives may not result in optimizing the outcome. Too many conditionalities may not be in the best interests of the State.

2.5 Item 6. In making its recommendations, the Commission shall have regard, among other considerations to-

(ii) the demands on the resources of the Central Government, in particular, on account of the expenditure on civil administration, defence, internal and border security, debt servicing and other committed expenditure and liabilities;

2.6 One of the exercises every Finance Commission carries out is that of critically evaluating every rupee spent by the State Governments. The expenditure of the Central Government too should be subjected to the same yardstick. This has not been done for long and this Commission should take it up in all seriousness.

2.7 (iii) *the resources of the State Governments* ***and the demands on such resources under different heads including the impact of debt levels on resource availability in debt stressed states for the five years commencing on 1st April 2015****, …*

2.8 There could be historical and structural reasons for the accumulation of debt which in turn may influence resource availability. Kerala is a unique case as historically it put lot more resources into education and health that too in the form of public institutions. That was at a time when outsourcing of services to the private sector was unthinkable, or unheard of. The salary and pension outgo on that count was a heavy burden. The burden, in fact, increased as the public spending gave rise to high health and educational achievements and the resultant longevity and higher demand for health care. The longevity of the population and the higher pension outgo cannot easily be controlled leading to debt stress. The above TOR gives an opportunity for addressing such issues.

Kerala would face a special problem during the period 2015-16 to 2019-20, on account of a substantial amount of debt maturing, as well as the impact of pay revision which is due from 1.7.2014 for which a Pay Commission has recently been appointed. The increase in outflows would be 114% and the increase in revenue expenditure would be 119% during the above period.

2.9 (vi): *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;*

2.10 The first part of the TOR is a welcome step as the burden of subsidies has steadily increased over the years, especially with the high levels of inflation of the recent period. But the latter part of the TOR cannot be agreed to. Already in a number of Central schemes that have emerged in recent years the conditionalities force the States to devote resources. The Commission should in no way add to this list.

2.11 (v) the taxation efforts of the Central Government and each State Government and the potential for additional resource mobilisation to improve the tax- Gross Domestic Product ratio in the case of the Union and tax- Gross State Domestic Product ratio in the case of the States;

2.12 In the case of the Union Government, the tax-GDP ratio could be a reasonable measure of tax effort. But at the level of States tax-GSDP is not a reasonable measure of tax effort as its composition varies widely among the States and the incidence of tax varies across sectors of the economy. Further, GSDP is a measure of the incomes generated within a political boundary whereas the tax base has to include the net factor incomes as well. These aspects have been highlighted by the XII and the XIII Finance Commissions in great detail and it is surprising that the TOR is explicit about what measure of tax effort should be used. The Fourteenth Commission should make it absolutely clear that such a measure is not appropriate for the function it has to serve.

2.13 (viii) ***the need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions****;*

2.14 This TOR is too broad and general and may not adequately accommodate the specificities of the State. For instance, the composition of public transport is very different in Kerala from that in Tamil Nadu or Maharashtra. Without detailed studies how is it possible for the Commission to deal with this issue?

2.15 (ix) ***the need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and the relinquishing of non-priority enterprises****;*

2.16 This too is a subject where general solutions are hard to find. Even in the Central government listing and disinvestment has not been easy and hasn't had the desired results. So, this issue too needs careful handling by the Commission.

2.17 (xi) the impact of the proposed Goods and Services Tax on the finances of the Centre and States ***and the mechanism for compensation in case of any revenue loss****.*

2.18 The contours of the Goods and Services Tax are still quite hazy as the Constitutional amendment is not in sight and there are issues to be agreed upon by the States and the Centre. Similarly, there has not been an agreement on the rate structure. Given these factors, how would the Commission estimate the loss or arrive at compensating mechanisms? Further, the Revenue Neutral Rates arrived at by the Tax Turnover Method is subject to some serious flaws. In this method the tax base is estimated on the basis of the tax revenue and the tax rates. Such a method will seriously underestimate the base and may give rise to a situation of compensating inefficiency in tax collection. The Commission may make awards which go to strengthen the federal fabric of Indian polity.

2.19 Item 7. 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.***

2.20 The last four decades or so have seen drastic changes in the demographic structure of the population across the Indian States. The age composition of the population has changed with higher proportion of aged in some States that have achieved higher fertility reduction. Residence has also undergone a sea change with over 30% of the Indian population living in the urban areas with wide variation across the States. These demographic changes have implications for cost disabilities and hence the addition of the last part in the TOR is most welcome and is an opportunity to incorporate these cost disabilities in the devolution shares of the States.

Chapter 3
Fiscal Situation of the State

3.1 The last decade (2003-13) witnessed concerted efforts being made by the Centre and the States towards fiscal consolidation with specific focus on the reduction of deficits and improving debt sustainability. During this period, the Union Government and most of the States have enacted Fiscal Responsibility and Budget Management (FRBM) legislations aimed at prudence and transparency in the management of public finances. The period also marked the introduction of Value Added Tax (VAT) by most of the States paving the way for the enhancement of the tax base and the consequent increase in tax collections. The recommendations of the XII and XIII Finance Commissions governed the pattern and extent of sharing of resources between Centre and States during the period. The recommendations of the XII Finance Commission fixed the share of States in the net revenues of the Centre at 30.5 percent during the award period (2005-10). The XIII Finance Commission raised this share to 32 percent for the award period of 2010-2015 with an indicative ceiling of 39.5% of Gross Revenue Receipts of the Centre on overall transfers of States on the revenue account.

3.2 The fiscal consolidation at the Centre and the States has resulted in the decline of the combined Fiscal Deficit (FD) of Central and State Governments from 9.9% of GDP in 2001-2002 to 4% in 2007-2008. The fiscal stimulus package launched by the Union Government to combat the effects of global economic recession in the year 2008-09, however, pushed this deficit figure up to a high of 8.3% in 2008-09 and 9.4% in 2009-10. Since then the FD figures were reigning in the range of 7-8% of GDP.

3.3 Kerala enacted its Fiscal Responsibility Act in 2003 with the objective of bringing in transparency and accountability in the management of its finances. The Act primarily aimed at reduction of deficits – mainly the Revenue and Fiscal deficits. The XIII Finance Commission reviewed the status of fiscal consolidation efforts by the State Governments after the enactment of FRBM legislation and prescribed revised fiscal correction path to be followed by the States during the award period. Under the fiscal consolidation path prescribed by the XIII Finance Commission, Kerala had to reach zero revenue deficit level

by 2014-15 and restrict its fiscal deficit to a level of 3% of GSDP from 2013-14 onwards.

3.4 The Revenue Deficit of the State showed year to year variations during 2007-2012. The Revenue deficit of Rs.3785 crore in 2007-08 increased to Rs.5023 crore in 2009-10 and decreased to Rs. 3674 crore in 2010-11. Subsequently, in 2011-12, the Revenue Deficit increased substantially to Rs.8035 crore. The Fiscal Deficit of the State showed an increasing trend from Rs.6100 crore in 2007-08 to Rs.7872 crore in 2009-10, but increase was moderated to Rs.7731 crore in 2010-11. However, the Fiscal Deficit increased to the level of Rs.12815 crore in 2011-12 as a consequence of the increase in the Revenue Deficit. As a proportion of GSDP, the Revenue Deficit of 1.3% and Fiscal Deficit of 2.8% in 2010-11 were the lowest in recent years. This trend however reversed to 2.5% and 3.9% respectively in 2011-12 and to 2.57% and 4.13% respectively in 2012-13.

3.5 The sharp increase in the revenue and fiscal deficits in 2011-12 and 2012-13 can be attributed to the implementation of the recommendations of the 9th State Pay Commission, as well as those of the 4th State Finance Commission (SFC) on devolution of resources to local bodies and also the enhancement of rates of DA/DR to Government employees and pensioners owing to the inflationary pressures in the economy.

3.6 The annual growth rate of State's Revenue Receipts during the period from 2007-08 to 2012-13 was above 16% except during 2009-10. The revenue receipts recorded a growth rate of 16.15% each in 2007-08 and 2008-09, 6.5% in 2009-10, 18.7% in 2010-11, 22.6% in 2011-12 and 16.37% in 2012-13. The State's own tax revenue also recorded similar growth rate during this period. The revenue buoyancy with reference to GSDP remained above the level of 1 during the period from 2007-2008 to 2012-13 except in 2009-10. State's own tax revenue buoyancy with reference to GSDP too remained above one during the period, except in 2009-10 (Table 3.1).

Table 3.1. Trends in Revenue Receipts Relative to GSDP

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Revenue receipts (Rs.in crore)	21,107	24,512	26,109	30,991	38,010	44138
State's own taxes (Rs in crore)	13,669	15,990	17,625	21,722	25,719	30077
Rates of growth						
Revenue receipts (percent)	16.1	16.1	6.5	18.7	22.6	16.1
State's own taxes (percent)	14.5	17.0	10.2	23.2	18.4	16.9
RR/GSDP(per cent)	12.1	12.1	11.2	11.2	11.6	12.2
Buoyancy Ratios						
Revenue Buoyancy w.r.t GSDP	1.2	1.0	0.4	1.0	1.3	1.1
State's own tax Buoyancy w.r.t GSDP	1.0	1.1	0.7	1.2	1.0	1.1

3.7 The Revenue Receipts of the State increased by 80% during the five year period from 2007-08 to 2011-12. During the same period, State's own Revenue Receipts increased by 90 percent while the grant in aid from the Centre increased by 70 percent. The share of Central transfers accounted for 29 percent of state's total Revenue Receipts in 2007-08 and 2008-09. This share declined to 26% in 2009-10, 24 percent in 2010-11, 26% in 2011-12 and further to 22% in 2012-13.

3.8 The share of State's Non-Tax revenue in its total revenues is in the range of 6-7 percent. State's Non-Tax revenue sources mainly comprise receipts from State Lotteries, Forestry and Wild Life and Interest Receipts. In the case of State Lotteries, the increase in receipt has been matched by a corresponding increase in expenditure and hence the net revenue from this source is not sizeable. Though forests account for about 29% of the state's geographical area, the State has only limited scope for enhancing revenues from this source owing to the compelling need for conservation of ecology and preservation of bio diversity. The State also faces serious constraints in raising large volume of revenues from its social services sector. The main contributor to the State's economy is the tertiary sector (about 60% of the GSDP) on which the State does not have much power to levy taxes. As such the State has only very limited scope for enhancing its tax buoyancy substantially over its present level.

3.9 The revenue expenditure of the State continues to account for the major chunk of state's total expenditure, its share in State's total expenditure being in the range of 89 to 91 percent during the period from 2007-08 to 2012-13. The capital expenditure including loans and advances accounted for just 9 to 11% of the total expenditure during this period. The expenditure on General Services which mainly comprises of interest and pension payments accounts for almost 40 percent of the total expenditure. The relative shares of social and economic services are 33 percent and 18 percent respectively. The share of these sectors in the total expenditure has been consistently rising over the years. The Grants-in-aid representing transfer of resources by the State Government to LSG Institutions bears a share of about 7 percent in the total expenditure.

3.10 Kerala's revenue expenditure mainly comprises of interest payments, expenditure on wages and salaries, pensions and subsidies and also transfers to LSG Institutions. The expenditure on salaries, interest payments, pension and subsidies constitute almost 70 percent of revenue expenditure and account for 85 percent of the revenue receipts of the state. Apart from this, state government regularly devolves a portion of its resources to the LSGs based on the recommendations of the State Finance Commissions. The State also provides grants to meet salaries and pension liabilities of employees in Universities and State Autonomous Bodies and also pension payments of the employees of Municipalities/Corporations, etc (Table 3.2).

Table 3.2 Financial Assistance to Local bodies, Educational Institutions, and Others (Rs. crore)

Institutional Category	**2007-2008**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Educational Institutions (Aided Schools, Colleges, Universities, etc.	2812.88	3306.81	3546.61	4087.83	5605.77
Municipal Corporations and Municipalities	485.85	966.99	834.46	901.87	1073.78
District Panchayats and Other Panchayati Raj Institutions	2421.93	2600.11	2996.66	3411.65	4203.98
Development Agencies	1.36	1.95	2.04	5.25	5.50
Hospital and Other Charitable Institutions	53.98	56.66	76.40	139.02	144.46
Other Institutions	468.50	658.83	1159.47	1252.58	1065.96
Total	6244.50	7591.35	8615.65	9798.20	12099.45
Assistance as % of revenue expenditure	25	27	28	28	26

3.11 The State Government provides substantial amounts of grants to Local Bodies, Autonomous institutions, Universities, etc. for creation of capital assets. Such expenditure is, however, classified as Revenue Expenditure at present, which in turn enhances the volume of State's Revenue Deficits to that extent. The State Government is of the view that expenditure by way of such grants made for the creation of capital assets should be excluded from the purview of Revenue Expenditure for the purpose of determining Revenue Deficit. The Effective Revenue Deficit so determined shall be reckoned as a fiscal parameter to measure the quality of financial performance of the State Government.

3.12 The present status of social and physical infrastructure available in the State reflects the quality of its expenditure. The State has to perform a large number of responsibilities relating to the development of social and economic infrastructure in the State to provide quality living conditions to the people. For enhancing the human development levels of the people in the State, it is necessary to step up the expenditure on key social services like education, health, etc. The development expenditure is usually expressed as an aggregate of expenditure under the social and economic sectors. Development expenditure of the State based on this classification is relatively less as a proportion of GSDP compared to that of the general category States. This, however, does not include the expenditure incurred by the State Government on account of funds devolved to local bodies for maintenance of assets, extension and development and traditional functions. When a portion of such transfers to local bodies which is spent on development needs are also reckoned, the pattern becomes different. Though the developmental expenditure in general is lower than that of the general category States, Kerala's average expenditure in respect to education and health sectors is higher than those of the general category States.

3.13 Due to the heavy pressure of revenue expenditure on the available resources, the proportion of State's capital expenditure has not been substantial over the years. However, the State could achieve marginal improvement in the share of capital expenditure during the last three years (2010-11 to 2012-13) when it accounted for 10% of the total expenditure. While the State Government is committed to continue with enhanced support for key social services like education, health, etc, it has also

the responsibility to enhance the proportion of expenditure on economic services and capital outlay in order to create much needed assets to stimulate economic growth.

3.14 The fiscal liabilities (as percent of GSDP) of the State Government have been showing a declining trend over the years. The State's fiscal liabilities which were as high as 33.2% of GSDP in 2007-2008 have dropped substantially to the level of 28.5% in 2011-12, which is less than the target of 32.3% fixed in the Kerala Fiscal Responsibility (Amendment) Act 2011.As per the Act enacted on the lines of the fiscal correction path proposed by the XIII Finance commission, State Government is bound to reduce its Revenue and Fiscal Deficits substantially and to reach a Zero Revenue Deficit level by 2014-15. The Fiscal Deficit is to be restricted to 3% of GSDP from 2013-14 onwards. As Government will not be able to achieve these targets through compression of expenditure or through additional taxation, it is likely that State's fiscal imbalances measured in terms of the three fiscal parameters – Revenue, Fiscal and primary deficits – will persist in future also. The medium term fiscal correction path may have to be reset on a realistic basis with reference to the fiscal situation specific to the state. Achievement of the targets so fixed will largely depend on the extent of Central funds being made available to the State in the future years. With a rational devolution of resources from the Centre, the State will be able to correct its fiscal imbalances and consolidate its developmental and fiscal targets further.

Chapter 4
Forecast of Receipts and Expenditure

4.1 Kerala set out on a fiscal consolidation path different from that of many other States, which was mostly revenue led. Even during the worst of the fiscal crisis that the State faced from 1997-98 to 2002-03, it could maintain a healthier tax/GSDP ratio, comparable either to that of the better performing States or even a shade higher and it continues to do so. However, the NPRE continued to be at higher levels as many committed expenditures could not be contained owing to certain historical legacies causing the Non Plan Revenue Deficit (NPRD) to widen. In addition, the 73rd and 74th amendments to the Constitution which were designed to empower the Local Self Government Institutions required devolutions in conformity with the recommendations of the State Finance Commissions. Consequently, with rising interest payments the debt levels of the State soared.

4.2 Kerala's achievement in terms of the human development index is well known. Most of the investments made in the social sectors were with own resources of the State. This development tag, along with increase in Gross State Domestic Product and per capita income meanwhile, began to hit the State from another front as the Finance Commissions began giving higher weight to the income distance. Norms for expenditure reduction suggested by successive Commissions could not be implemented owing to various historical legacies. For sustaining the achievements made, the State had to incur expenditure through borrowings at higher levels of interest rate. The opportunity cost of the achievements in the social sector is the lower level of capital formation. Increased capital formation in the state will be possible only through increased Constitutional transfers under the Finance Commission awards lest the debt burden increases.

4.3 A realistic assessment of expenditure by the XIII Finance Commission would have made the State eligible for non-plan post devolution revenue deficit grant. Table 4.1presents a comparison of our projections, XIII Finance Commission projections and the actuals.

Table 4.1. XIII Finance Commission Revenue and Expenditure Projections (Rs crore)

No.	Particulars	2010-11	2011-12	2012-13	Total 2010-13	2013-14 #	2014-15 #	Total 2010-15
A	**Revenue Receipts**							
1	**Own Tax Revenue**							
	Projections of Government of Kerala	19619.37	22293.83	25351.66	**67264.86**	28850.06	32855.04	**128969.96**
	XIII FC Projection	21725.63	24765.06	28355.99	**74846.68**	32467.61	37175.42	**144489.71**
	Actual	21721.69	25718.60	30076.61	**77516.90**	34737.30	40149.39	**152403.59**
2	**Own Non Tax Revenue**							
	Projections of Government of Kerala	1479.83	1644.18	1828.08	**4952.09**	2033.98	2264.61	**9250.68**
	XIII FC Projection	1918.93	2043.80	2187.16	**6149.89**	2360.10	2554.22	**11064.21**
	Actual	1930.79	2592.18	4205.41	**8728.38**	4572.63	4975.32	**18276.33**
3	**Total Revenue Receipts (1+2)**							
	Projections of Government of Kerala	**21099.20**	**23938.01**	**27179.74**	**72216.95**	**30884.04**	**35119.65**	**138220.64**
	XIII FC Projection	**23644.56**	**26808.86**	**30543.15**	**80996.57**	**34827.71**	**39729.64**	**155553.92**
	Actual	**23652.48**	**28310.78**	**34282.02**	**86245.28**	**39309.93**	**45124.71**	**170679.92**
B	**Non-Plan Revenue Expenditure**							
	Salary							
	Projections of Government of Kerala	**2865.59**	**2963.31**	**3065.54**	**8894.44**	3172.53	3284.41	**15351.38**
	XIII FC Projection	**6421.75**	**6805.29**	**7211.71**	**20438.75**	7642.36	8098.69	**36179.80**
	Actual	**10677.91**	**15483.33**	**16697.50**	**42858.74**	20419.68	22784.74	**86063.16**
1	**General Services**							
(i)	**Interest payments**							
	Projections of Government of Kerala	5756.92	6278.23	6765.14	**18800.29**	7256.01	7809.01	**33865.31**
	XIII FC Projection	5866.54	6581.57	7400.27	**19848.38**	8203.77	9123.77	**37175.92**
	Actual	5689.66	6293.60	7211.71	**19194.97**	8231.95	9229.16	**36656.08**
(ii)	**Pension**							
	Projections of Government of Kerala	5508.10	6169.07	6909.35	**18586.52**	7738.48	8667.09	**34992.09**
	XIII FC Projection	5500.65	6050.71	6655.78	**18207.14**	7321.36	8053.50	**33582.00**
	Actual	5767.49	8700.30	8866.89	**23334.68**	9930.92	11122.63	**44388.23**
(iii)	**Elections**							
	Projections of Government of Kerala	95.02	55.04	29.05	**179.11**	31.86	35.05	**246.02**

	XIII FC Projection							
	Actual	93.31	99.37	32.32	**225.00**	39.20	45.16	**309.36**
(iv)	**Other General Services**							
	Projections of Government of Kerala	1543.86	1776.86	2167.00	**5487.72**	2491.72	2856.81	**10836.25**
	XIII FC Projection	1060.35	1111.69	1172.82	**3344.86**	1264.76	1386.93	**5996.55**
	Actual	1394.30	1688.10	2819.41	**5901.81**	3344.33	4015.15	**13261.29**
	Total General Services (i to iv)	**(excluding Salary)**						
	Projections of Government of Kerala	**12903.90**	**14279.20**	**15870.54**	**43053.64**	**17518.07**	**19367.96**	**79939.67**
	XIII FC Projection	**12427.54**	**13743.97**	**15228.87**	**41400.38**	**16789.89**	**18564.20**	**76754.47**
	Actual	**12944.76**	**16781.37**	**18930.33**	**48656.46**	**21546.40**	**24412.10**	**94614.96**
2	**Social Services**							
	Projections of Government of Kerala	8283.40	8807.83	10264.58	**27355.81**	10933.95	11706.25	**49996.01**
	XIII FC Projection	5126.32	5536.42	5979.34	**16642.08**	6457.68	6974.30	**30074.06**
	Actual	2460.49	2586.26	3493.53	**8540.28**	4226.77	5114.17	**46951.79**
3	**Economic Services**							
	Projections of Government of Kerala	5337.11	5908.07	6908.25	**18153.43**	7596.21	8301.63	**34051.27**
	XIII FC Projection	1679.82	1780.66	1888.17	**5348.65**	2002.80	2125.05	**9476.50**
	Actual	1701.28	2576.74	3551.10	**7829.12**	4376.21	5221.89	**17427.22**
4	**Compensation and Assignments to Local Bodies**							
	Projections of Government of Kerala	2805.46	3156.14	3550.66	**9512.26**	3994.49	4493.80	**18000.55**
	XIII FC Projection	2693.94	2909.46	3142.21	**8745.61**	3393.59	3665.08	**15804.28**
	Actual	2778.17	3389.08	4016.22	**10183.46**	5344.31	5993.18	**21520.95**
5	**Committed Liabilities**							
	Projections of Government of Kerala	0.00	0.00	1434.65	**1434.65**	1542.25	1657.92	**4634.82**
	XIII FC Projection	0.00	0.00	1302.57	**1302.57**	1367.69	1436.08	**4106.34**
	Actual							
6	**Commitment on DA**							
	Projections of Government of Kerala	1875.65	2742.08	3658.81	**8276.54**	4628.08	5652.20	**18556.82**
	XIII FC Projection							
	Actual							
7	**Commitment on DR**							
	Projections of Government of Kerala							

	XIII FC Projection							
	Actual							
8	**Fresh Expenditure**							
	Projections of Government of Kerala	2459.51	1570.46	1735.40	**5765.37**	1854.09	1984.33	**9603.79**
	XIII FC Projection							
	Actual							
9	**Total Non-Plan Revenue Expenditure (1 to 8)**							
	Projections of Government of Kerala	**36530.62**	**39427.09**	**45053.78**	**121011.49**	**49697.42**	**54790.58**	**225499.49**
	XIII FC Projection	**28349.37**	**30775.80**	**33450.30**	**92575.47**	**36286.32**	**39427.32**	**168289.11**
	Actual	**30562.61**	**40816.78**	**46688.68**	**118068.06**	**55913.37**	**63526.08**	**237507.51**
10	**Pre-devolution Non-Plan Revenue Deficit/Surplus**							
	Projections of Government of Kerala	**-15431.42**	**-15489.08**	**-17874.04**	**-48794.54**	**-18813.38**	**-19670.93**	**-87278.85**
	XIII FC Projection	**-4704.81**	**-3966.94**	**-2907.15**	**-11578.90**	**-1458.61**	**302.32**	**-12735.19**
	Actual	**-6910.12**	**-12506.00**	**-12406.66**	**-31822.78**	**-16603.44**	**-18401.37**	**-66827.59**
11	**Tax Share**	5141.85	5990.36	6840.65	**17972.86**	8143.79	8958.17	**35074.82**
12	**Post Devolution NPRD**	-1768.27	-6515.64	-5566.01	**-13849.92**	-8459.65	-9443.20	**-31752.77**

Note:-# Actual figures are not available for years 2013-14 and 2014-15 and hence, estimates submitted to the XIV Finance Commission are shown under the respective heads for these years.

4.4 As can be seen from the Table, the Finance Commission's projection of revenue has been considerably higher than that of Government of Kerala but the actuals have surpassed such projections by a margin showing our efforts at mobilising resources. It is with regard to expenditures that actuals have far surpassed our projections as well as those of the Commission: while actual salary disbursed was more than double the Commission's projections, the actual pension payments were 30 to 40% higher. Transfers to local bodies too showed a similar trend. The net result has been that the actual pre devolution non plan revenue deficit turned out to be three and four times the Commission's projections for 2011-12 and 2012-13. As the share of the State in tax assignment from the Centre has been declining the post devolution NPRD too turned out to be really large.

4.5 The gross underestimation of expenditure by the XIII Finance Commission across general, social, economic sectors and in the devolution to Local Self Government Institutions made the state ineligible for non-plan post devolution revenue deficit grant. The XIV Finance Commission has the opportunity to adopt realistic norms. The State would suggest that impact of inflation on salaries, pensions, interest payments and on subsidies is to be factored in full. Reasonable degree of expansion in the existing services needs to be provided for. Provision for implementing new services that the people are expecting from a responsible government should be made. The State has projected its revenues and Non Plan Revenue Expenditure with the above objectives in mind. The basis of projections is given below.

4.6 For projecting revenue and expenditure up to the base year of 2014-15 pre-actuals in 2012-13 would be a better starting point than the budget estimates of 2013-14. This is because, the budget estimates for 2013-14 require adjustments taking into account the slowdown in the economy and lower tax collections concomitant to that and the likely overshooting of expenditure because of the pre actuals 2012-13 surpassing the RE 2012-13 by a huge amount. The Commission needs to recognise these factors.

4.7 The State has assumed a Gross State Domestic Product growth rate of 14.5% for the 12th plan period. While the growth of the nominal Gross State Domestic Product would reach this level, the buoyancy in tax revenues seen in the previous years is not likely to be sustained in 2013-14 as consumption spending in the State has come down sharply. This is evident from the lower tax collection under major tax items like Sales Tax, Excise, Motor Vehicle and Stamps and Registration. The growth for the first half of the financial year 2013-14 under state's own tax revenue is only 6% which, when compared with the 22% adopted for the BE 2013-14 over RE 2012-13,presents a worrisome scenario. The Gross State Domestic Product growth rate assumed is 14.5% from 2013-14 up to the end of the forecast period. The projection of revenue is based on CAGR for the 5 years commencing from 2007-08 up to 2012-13 adjusting individual tax items to reflect the current trend of tax collection in the state. Nevertheless, projection of individual items taken together give a growth rate of around 15.50%. This is the same as the average buoyancy based growth rate for the period from 2008 to 2013 at 15.54%. The basis for the projection of individual items of tax revenues are sufficiently explained in

the explanatory notes on the estimates separately submitted to the Commission. The growth rates assumed are applied on the pre-actuals 2012-13 to arrive at the base year estimate of 2014-15. For the forecast period also the same growth rates have been applied for arriving at the tax revenues.

4.8 A major development under the non-tax revenue collection is the spurt in the revenue from lotteries beginning from the year 2011-12, the trend of which has kept pace even amidst the present slowdown affecting major tax revenues. Long term sustenance of the trend on the higher base, however, is doubtful for the forecast period. Hence a moderate projection of only 7% is taken. Moreover net availability from the collection under lotteries will be meagre considering the welfare programme directly linked to the revenue from lotteries. In respect of the other non-tax items government could revise almost all items of non-tax revenues and that also will give higher base for the forecast period. Various non-tax revenue items are projected in the range of 5 to 15 % depending upon factors impacting collection. These projections incorporate revenue from additional resource mobilisation as well. After adjusting for eventualities arising out of the current slowdown the revenue projected is realistic and the maximum achievable.

4.9 Salaries constitute the single largest item in the Non Plan Revenue Expenditure. The pre actuals under salaries for the year 2012-13 was Rs 11,784 crore towards basic pay and Rs 4914 crore in respect of dearness and other allowances totalling Rs 16698 crore. As against this the XIII Finance Commission assessed a salary payment of only Rs 7212 crore for the year 2012-13. The Finance Commission estimate was not even sufficient to cover the basic pay component. The gross under assessment to the tune of Rs 9486 crore which is 132% higher than that assessed by the Commission requires to be noted specifically for guidance while computing salary commitments for the XIV Finance Commission period. A detailed projection factoring an annual increase of 2.50% in the basic pay, two instalments of dearness allowance each year @ 7%, and growth provided for other allowances are given along with the estimates separately.

4.10 In addition to this, the commitment in respect of the 10th Pay Commission awards which will become due from 2015-16 is given separately in the estimates. These estimates are based on projection of basic pay from the

pre actuals in 2012-13. Kerala does not follow the central pay scales and allowances. Pay revision is allowed once in 5 years to the State Government employees. The point to be taken note of is that, even after pay revision once in five years, scales of pay are well below that of comparable posts in the Government of India and in many other states. An amount of Rs 17300.77 crore is computed for the five year period from 2015-16 for the next pay revision anticipating a moderate increase in pay scales. These figures need to be fully factored into the estimates.

4.11 Non salary non plan revenue expenditure during the last five years has witnessed an inconsistent growth pattern. In order to even out these variations, compound average growth rate for the five years from 2008-09 has been taken and adjusted suitably. Accordingly, growth rates of 20%, 21%, 20% are assumed under the general, social and economic sectors respectively. For computing interest payments in 2013-14 and up to the forecast period, the debt stock as per 2012-13 pre actuals, is taken as the base figure. To this amount is added, incremental debt to be contracted annually at the rate of 3% of the assumed Gross State Domestic Product growing at 14.5%. An effective interest rate of 7.5% is applied on the mid-year debt, taking the average of the opening and closing debt stock of the particular year.

4.12 Expenditure on pension estimated by the XIII Finance Commission was well below the requirement of the state. The payment of pension as per pre actual 2012-13 was Rs 8867 crore as against the estimates of XIII Finance Commission at Rs 6656 crore, which was 33% below the requirement. The growth rate adopted for projecting pensions is 12% in the successive years on the pre actual of 2012-13. The pension to state government pensioners would be revised along with pay revision for employees in 2015-16. An amount of Rs 9480.31 crore is worked out towards this, for the projection period, which the Commission may reckon in their estimates. It is brought to the notice of the Commission that the age of retirement in the state has been enhanced to 56 years with effect from April 2011 and new pension scheme has been introduced for new entrants in service with effect from April 2013.

4.13 In respect of assignment to local bodies, the XIII Finance Commission reckoned a sum of Rs 3142 crore for the year 2012-13 in their assessment, whereas the actual devolution was Rs 4729.28 crore. The devolution to local

bodies is clearly set out in the Fourth State Finance Commission report. Funds beyond the 4th State Finance Commission period are reckoned at the same level as recommended by the Commission even though larger devolution would be due to the Local Self Government Institutions by the year 2016-17, going by the trends of State Finance Commission awards. The predictable fund flows the state is providing to Local Self Government Institutions can act as a guide for the XIV Finance Commission while assessing the requirement of the State from its consolidated fund.

4.14 Non plan expenditure at the end of a plan period increases because of the committed liabilities that arise on continuation of some plan schemes as non-plan schemes in the next plan period. Difficulty in the assessment of transfer of such schemes has been continuing. In the absence of a system for exact assessment, 30% of the plan revenue expenditure of the terminal year of the plan period is taken as committed expenditure. This has no sound basis. Experience of the State Government is that there has been a spike in the non-plan expenditure immediately after the terminal year of the plan period. In fact an increase of 35% in the non-plan non salary expenditure under the social sector and an increase of 38% under the economic sector in 2012-13, which is the first year of the 12th plan period, suggest that an increase of more than 30% would be attributable as committed liability than the 30% now reckoned. In view of the huge liability that falls as non-plan expenditure of the state government, an objective criterion may be suggested by the Finance Commission which shall form the basis for estimating committed liability. Only 30% of plan revenue expenditure projected in the year 2016-17 is taken as committed expenditure in 2017-18 with an annual increase of 7.5% in the subsequent years.

4.15 The total plan outlay for the 12th plan at current prices is Rs 1,02,000 crore out of which Rs 5228.78 crore is from the contribution of power sector to state plan, Rs 22546.98 crore from contributions of Local Self Governments and the remaining Rs 74224.64 crore is through state budget. Out of Rs 74224.64 crore for the state plan, an amount of Rs 46152.71 crore is estimated as plan revenue expenditure for the period from 2012-13 to 2016-17 by taking an annual growth rate of 20% over 2012-13 figures.

4.16 The pay/pension revision in 2015-16 will result in a huge spike in the Non Plan Revenue Expenditure in 2015-16 making the pre-devolution revenue deficit very large and unsustainable without increased devolution. Projections for the forecast period, based on realistic assessment gives a total own revenue of Rs 350635.21 crore and a total non-plan revenue expenditure of Rs 519923.82 crore. The pre devolution non plan revenue deficit for the XIV Finance Commission period would be Rs 169288.61 crore.

4.17 We wish to draw the attention of the Commission to the fact that only Rs 470.37 crore was provided as non-plan revenue deficit grant to fill the gap in 2005-06 even though gap grant was eligible to the State in all the years from 2005-06 had the Finance Commission considered the projections of the State. A large gap has emerged already in the first three years of the XIII Finance Commission award period totalling Rs 13849.92 crore against the post devolution revenue surplus as estimated by the XIII Finance Commission. The financial situation in 2013-14 is raising fears of the reappearance of the financial difficulties in the State. In these circumstances, the right course for the Finance Commission would be to address the gap in resources by raising the vertical devolution and decide on a horizontal devolution which would fill the gaps. If on the other hand, the XIV Finance Commission intends to recommend a gap filling arrangement under Article 275, the state would request that the norms for the assessment of expenditure be realistic. As the fiscal problems vary widely across states, a “one size fits all” approach cannot do justice to Kerala which has one of the highest human development achievements. The state would request the Commission to reduce the burden of the State so that it could sustain its achievements.

Chapter 5
Debt Position : A Picture of Sustainability

5.1 A major portion of the debt outstanding of States is the accumulated borrowings to finance fiscal deficits over the years. Rising levels of debt and commitments on interest payments reduce the capacity of States to widen the much needed fiscal space for improving the quality of public services and invest in development infrastructure. Keeping the debt stock at manageable levels is therefore crucial from the point of view of achieving budgetary control and attracting more private investment to accelerate and sustain economic growth. Recognising the importance of this, successive Finance Commissions have been stressing the need to bring the debt position of states to manageable levels by prescribing target levels of revenue deficit (RD), gross fiscal deficit (GFD) and debt as a percentage of Gross State Domestic Product (GSDP).

5.2 The Thirteenth Finance Commission reviewed the progress achieved by states on reaching targeted deficit levels during the award period of the Twelfth Finance Commission, and identified Kerala, Punjab and West Bengal as states which could not achieve the targets. The Commission recommended an adjustment path for these states commencing 2011-12 to eliminate the revenue deficit by 2014-15. Based on the fiscal road map set forth by the Commission, Kerala has been making earnest efforts to bring the debt position under control. As required by the Thirteenth Finance Commission, Kerala amended the Fiscal Responsibility and Budget Management (FRBM) Act and prepared the Medium Term Fiscal Policy (MTFP) in line with the suggested fiscal road map. The efforts by the Government could bring the debt within the targets in 2011-12 and 2012-13.

Table 5.1. Debt Position: Targets and Achievements

Year	Debt/GSDP Ratio (%)	
	Thirteenth FC Targets	Achievements
2011-12	32.3	28.37
2012-13*	31.7	28.69
2013-14	30.7	28.06
2014-15	29.8	27.51

*Pre-actual

5.3 Kerala has been able to bring the debt- GSDP ratio well below the targets set by the Thirteenth Finance Commission (Table 5.1). While the rising GSDP growth has helped the State, concerted efforts have been made to mobilise tax resources to control borrowing. The result has been a reduction in the debt position of the State. To be in line with the comparison made by the Thirteenth Finance Commission the experience of Punjab and West Bengal, the other two debt stressed states, has been presented (Table 5. 2). It may be seen that compared to Punjab and West Bengal, Kerala was at a better position in 2004-08. The debt –GSDP ratio of the State was significantly lower than that of the other two States. While both Punjab and West Bengal showed significant reductions in debt by 2008-09, Kerala could not do so. But the reduction since 2010-11 has been significant for Kerala and West Bengal but not for Punjab.

Table 5.2 Debt- GSDP Ratio of Debt Stressed States

States	Average for 2004-08	2008-09	2009-10	2010-11	2011-12 RE	2012-13 BE
Kerala	34.80	33.30	32.50	30.30	28.90	27.00
Punjab	43.10	35.40	34.20	33.20	32.70	32.00
West Bengal	47.30	44.00	44.00	40.70	38.60	36.30

RE - Revised estimates; BE - Budget Estimates

Source: *State Finances: A Study of Budgets, 2012-13*, Reserve Bank India.

5.4 States could take two approaches to bring down debt, either by reducing capital expenditure or by not compromising on capital spending and mobilising more revenue resources. A sense of the approach may be obtained by analysing the use of debt. It may be seen that Kerala and West Bengal brought down the Revenue Deficit as a proportion of GFD whereas Punjab has not been able to do it (Table 5.3). It implies that financing revenue deficit from borrowings has come down in Kerala. It is important to note that compared to Punjab and West Bengal, Kerala has been utilising an increasing proportion of the borrowed funds for investment purposes. Note the contrast between Kerala and West Bengal; whereas both the States brought down RD/GFD, Kerala did it along with boosting capital outlay (CO/GFD) by almost 20 per cent and West Bengal brought down capital outlay by about 10 per cent. We request the Commission to appreciate our concerted effort to take the State to a higher level of growth by devoting resources for investment. The larger

capital outlay cannot wait till we bring down our deficits as we have to move towards a higher investment trajectory.

5.5 The expectations of the population of an enlightened State which has already achieved Millennium Development Goals are very different from that of others at lower levels of development. The priorities in such a State will be different. Resources will have to be found to make such investments as well as for efficient utilization of the resources. We may also add that any mechanical reduction in revenue deficit and fiscal deficit to the targeted levels would amount to denigrating these achievements. In order to consolidate and sustain these achievements, the State has to continue expenditures in the non-plan account. Under these circumstances, the Commission may have to view the debt position of Kerala in a different light.

5.6 There could be no disagreement that capital outlay may need larger borrowing. But there are limits to debt as well lest the capacity to repay, or service the debt gets affected. An often raised question in this context is the sustainability of debt. Some of the major indicators of debt sustainability are presented in Table 5.4. As is evident most of the debt sustainability indicators exhibit a positive trend. Debt-TRR ratio registered a decrease from 258 per cent in 2008-09 to 234 per cent in 2012-13. Interest payments-TRR ratio too exhibits a falling trend. But RD-TRR ratio and rate of growth of debt do not show a clear trend. Thus, it may safely be said that Kerala is not treading a path of unsustainability of debt.

Table 5.3 Proportion of Gross Fiscal Deficit by Use (%)

Year	Kerala				Punjab				West Bengal			
	RD/ GFD	CO/ GFD	NL/ GFD	CO+NL/ GFD	RD/ GFD	CO/ GFD	NL/ GFD	CO+NL/ GFD	RD/ GFD	CO/ GFD	NL/ GFD	CO+NL/ GFD
2008-09	58.50	26.73	14.94	41.66	57.60	42.72	-0.36	42.36	108.50	27.33	-35.82	-8.49
2009-10	63.80	26.18	10.67	36.85	85.10	35.17	-20.26	14.91	86.50	12.06	1.48	13.55
2010-11	47.50	43.51	9.31	52.83	74.00	33.39	-7.42	25.97	88.40	11.40	0.20	11.60
2011-12(R.E)	48.40	43.80	7.96	51.76	58.00	41.12	0.93	42.05	79.70	17.92	2.40	20.32

Note: CO-capital outlay; NL-Net lending

Source: Worked out using data from *State Finances: A study of Budgets* by Reserve Bank of India, relevant issues.

Table 5.4 Indicators of Debt Sustainability of Kerala (%)

Indicators	2008-09	2009-10	2010-11	2011-12	2012-13*
RD/GSDP	1.83	2.16	1.36	2.55	2.59
GFD/GSDP	3.13	3.39	2.87	4.07	4.16
Effective RD/GSDP		1.28	0.49	1.67	1.74
Debt outstanding/TRR	258.12	271.82	253.83	233.25	234.60
Interest payments/TRR	19.01	20.27	18.36	16.56	16.34
RD/TRR	15.14	19.24	11.86	21.14	21.21
Growth rate of debt	14.19	12.17	10.86	13.66	15.82

*Pre-actual

5.7 One widely used indicator of the sustainability of debt is the Domar Gap i.e. the difference between the rate of growth of GSDP at current prices and the average rate of interest. Domar gap for Kerala is presented in Table 5.5. It is evident that Kerala's debt position is sustainable as the gap is positive and widening. Considering the rate at which Kerala's economy is growing, it appears that setting artificial borrowing limits would be counterproductive. Some sectors of Kerala economy like tourism, bio-technology and information technology hold considerable promise. These are the sectors where Kerala's strength lies. But they require substantial investment in infrastructure. As we have pointed out elsewhere, these investments are lumpy in nature. The private sector is unlikely to come forward to invest in these sectors. If the State can commit a critical mass of resources in infrastructure, then growth will be boosted and the tax base substantially widened besides supplementing the foreign exchange earnings of the country.

Table 5.5 Domar Gap of Kerala

Year	Rate of growth of GSDP at current prices	Interest rate	Domar gap
2005-06	14.74	8.30	6.44
2006-07	12.38	8.40	3.98
2007-08	13.89	7.90	5.99
2008-09	15.78	7.50	8.28
2009-10	14.41	7.50	6.91
2010-11	15.06	7.30	7.76
2011-12	16.97	7.20	9.77

Source: Latest CSO figures for GSDP; C&AG Report for interest rate.

5.8 Table 5.6 presents the composition of Kerala's debt for the last five years. Though the share of internal debt has remained the same, the market borrowings have shown an upward trend during these years. The share of loans and advances from the Centre in total debt has decreased from 9.5 per cent in 2009 to 6.39 per cent in 2013. As a consequence, the share of open market borrowings has registered a sharp increase from 33.61% in 2009 to 47.13% in 2013. The securities issued to the National Small Savings Fund (NSSF) has registered sharp decline over the years due to negative net NSS collections. The share of small savings and provident fund constitutes nearly 30% of total debt.

Table5.6 Composition of Kerala's Debt (Rs in crores)

	Items	2009	% share	2010	% share	2011	% share	2012	% share	2013	% share
1	Internal Debt	38814	61.35	43368	61.11	48528	61.68	55397	61.95	65628	63.37
	of which (i) Market borrowings	21263	33.61	25973	36.60	30744	39.08	38239	42.76	48809	47.13
	(ii) Special securities issued to NSSF	11880	18.78	11740	16.54	11781	14.97	11290	12.63	11322	10.93
	(iii) Loans from banks and Fis	5671	8.96	5655	7.97	6003	7.63	5867	6.56	5496	5.31
2	Loans and advances from the Centre	6009	9.50	6305	8.88	6359	8.08	6396	7.15	6622	6.39
3	Small saving, Provident fund etc	18447	29.16	21296	30.01	23786	30.23	27625	30.89	31310	30.23
4	Total Debt	63270	100.00	70969	100.00	78673	100.00	89418	100.00	103560	100.00

Source: Worked out using data from *State finances: A study of budgets* by Reserve Bank of India, relevant issues.

5.9 The level of debt which might cross the targets set by the Thirteenth Finance Commission by a few percentage points may not be alarming considering the fact that Kerala economy is one of the fastest growing economies in the country. It may be noted that while urging the states to bring the fiscal position within the targets, the Thirteenth Finance Commission had emphasized the importance of capital expenditure. The Commission had noted:

> "…..in these state's memoranda their willingness to attempt a fiscal correction exercise that would allow them to maintain and even increase their fiscal space for capital expenditure. Thus in the case of these states, the

fiscal adjustment path requires them to have capital expenditure less than the states that have already carried out fiscal correction, but with a slightly relaxed fiscal deficit target in the years 2011-12 and 2012-13, so that capital expenditure is not compressed to undesirable levels"(Chapter 9, para 9.76).

It may be noted that the capital outlay plus net lending as a percentage of gross fiscal deficit (GFD) was only 24.96% during the Tenth Plan period which increased to 41.34% during the Eleventh Plan period. This shows that an increasing proportion of the borrowed funds are being utilized for investment purposes in the State.

5.10 A large number of infrastructure projects are being implemented in the state now. Some of them are the Vizhinjam port, Kochi metro, monorail in Trivandrum and Kozhikode, Kannur international airport and techno-cities in various parts of the state. These projects require substantial investments which will have to come from borrowings. Moreover, nearly one-fourth of the Plan funds are devolved on local bodies, a major portion of which is used for the creation of capital assets at the local level.

5.11 The previous Finance Commissions have recommended various measures to reduce the debt burden of States but relief to States on this account has not been significant. The outstanding debt of all States which stood at Rs.1,09,650crore in 1991 had risen to Rs19,40,340 crores at the end of March, 2013. The Thirteenth Finance Commission broadly followed the approach of the Twelfth Finance Commission with regard to the debt position of states. Borrowing limits for states were to be worked out by Ministry of Finance using the reform path which required all general category states to attain zero revenue deficit target and 3 per cent fiscal deficit-GSDP target by 2011-12. States were required to amend/enact FRBM Acts to build in the proposed fiscal reform path. The fiscal reform path thus acted as an enforcement mechanism for fiscal correction by States. Apart from the recommendations relating to National Small Savings Fund, National Small Savings Scheme and loans from Government of India to States and administered by ministries/departments other than Ministry of Finance, the Commission did not recommend any significant debt relief to States.

5.12 In the context of Kerala, a significant portion of grants provided to local Self Government institutions and other autonomous institutions are meant to create capital assets. However, the present accounting standards prevent the government from classifying these expenditures as capital expenditure. It may be noted that a similar accounting procedure is followed by the Centre and therefore this is a problem faced by the Centre also. Recognising this, the Ministry of Finance has evolved a system to compute and incorporate Effective Revenue Deficit after separating grants of capital nature and deducting it from the revenue expenditure. Following this practice, the State budget 2012-13 also adopted such a procedure to incorporate Effective Revenue Deficit. Had the real revenue deficit after factoring in the capital nature of grants been taken, Kerala's target of revenue deficit in the road map for fiscal consolidation would have been achieved. We urge the Commission to look into this and give proper recognition to this concept.

5.13 So long as fiscal deficit is kept within manageable limits and the borrowed funds are utilized for capital investments, States' share in Open Market Borrowings (OMB) may be enhanced appropriately subject to prudent levels of sustainable debt. At present, States' share of OMBs comes to only about 20 per cent while Centre retains the other 80 per cent. Since this is often the cheapest source of funds, there is a strong case to raise the share of the States to at least 50 per cent.

5.14 The prevailing grant-loan ratio of 30:70 in the Central assistance to State plan schemes was fixed long ago when the revenue component of plan schemes was 30 per cent. But now the proportion of revenue relative to capital in plan expenditure of both Centre and States has increased considerably. Hence, it is time that the ratio is re-fixed. It may be recalled that the Twelfth Finance Commission recommended that the Central Government should not act as an intermediary for raising loans for the States in respect of the loan component of the Central plan assistance to States but instead should allow them to approach the market directly. The Fourteenth Finance Commission may take the next logical step and recommend enhancing the grant portion of Normal Central Assistance from 30 percent to 50 percent which will also help States to reduce the debt burden to that extent.

5.15 As stated earlier, the Thirteenth Finance Commission broadly followed the approach of the general scheme of debt relief through debt consolidation and re-scheduling recommended by the Twelfth Finance Commission. While this is a useful initiative and has helped many States to improve their debt position, some of the States continue to have huge negative borrowings in terms of net receipts from Centre mainly due to past Central loans and accumulated interest thereon. The Central loans are now a relic of the past as Centre no longer gives loans to States as recommended by the Finance Commission. Kerala's position on net receipts on account of the borrowings from Centre had turned negative as early as 2000-01. Therefore, the Commission may take the next logical step to recommend waiver of all past Central loans and interest thereon. If this is not possible, at least 50 percent of this liability should be waived. This will help States with high debt stock to further improve their debt position.

Chapter 6
Fiscal Responsibility and Budget Management Act

6.1 The finances of State governments deteriorated consistently in the post-reform period. A corrective was imposed in the form of FRBM Acts. States were compelled to enact the legislation and adhere to it lest they lose considerable resources. During the past decade, the fiscal indicators of states have begun to show favourable changes. Aggregate states' fiscal deficit has declined and revenue deficit has turned to a marginal surplus. While in general, state finances have shown a marked improvement, the situation is not very comfortable. Many of the states have reduced their deficit targets, complying with the fiscal responsibility legislations by compressing developmental expenditures. One is drawn to question the quality of fiscal adjustments that have been made in this period. Thus, the attempt at reaching sustainable deficit levels has been at the cost of economic growth and justice. Such a trend would be costly and would in fact aggravate regional inequalities, especially in this period of turbulence in the global economy when governments ought to adopt a counter-cyclical fiscal policy. Therefore, these achievements in the fiscal space need to be viewed from a larger perspective.

6.2 The last decade has seen Central devolution to States through a share in taxes decline as a consequence of increasing share of cess and surcharges in Central revenue (which are not part of the divisible pool as stated in Article 279 of the Constitution of India). As the so-called fiscal consolidation by States (in General Category except, Punjab, Kerala and West Bengal) has been merely reducing deficit targets through expenditure cuts in the face of stagnant revenues (a fact specifically mentioned in "State Finances- A Study of the Budgets- Reserve Bank of India), the question of higher devolution of taxes to States cannot be left unaddressed. This is especially so when at the all- States' level there has not been a significant improvement in tax buoyancy since 2005-06, that is after the introduction of the Value Added Tax (VAT was introduced for intra-State sales of commodities except alcoholic liquor for human consumption and petroleum products).

6.3 This period has not seen any large devolution of resources from the divisible pool. Though Finance Commissions since the Eleventh (which started devolving a share of all Central taxes after the Eightieth Constitutional amendment) recommended token increases from 29.5 to 30.5 to 32 actual shares devolved have been less due to increasing share of surcharges in Central taxes. A large devolution would have definitely made things better.The argument that larger devolution would have an adverse impact on the finances of the Central Government does not seem to be valid. The total deficit of Central and State governments is a more reliable indicator of deficit and if one goes by the argument that government borrowings will crowd out private investments, then larger devolution by cutting down the deficits of the States would have a favourable impact. Further, as the States will rely much less on cuts of development expenditure and social sector spending for achieving deficit targets, it will have a favourable impact on overall economic growth.

6.4 The larger devolution will provide greater incentive for the Centre to tap more revenues, and measures of targeting “Tax Expenditure”, that is, tax foregone due to various tax deductions and exemptions in the Central taxes, should improve revenue mobilisation. At present, tax foregone is about 6 per cent of the GDP and even a small reduction in it would make a large difference to the revenues of the Centre and States. The higher tax-GDP ratio of the Centre would enlarge the size of the divisible pool of taxes. Much of the revenue foregone through tax concessions is not part of any stimulus package in the wake of slowdown in economic growth. The total revenue foregone at more than 6 per cent of GDP is approximately Rs 5.8 lakh crore. Much of these concessions which reduce the effective tax rate do not have any link with the stimulus efforts, but have brought down the Tax-GDP ratio at the Central level. If these could be targeted at 3 per cent of GDP, Tax-GDP ratios can be raised to 13 to 14 per cent of GDP and more fiscal space would be available for expansionary spending (without further enlarging revenue and fiscal deficits), which is necessary in the wake of the fall in economic growth.

6.5 As per the Acts the State governments have to reduce the Revenue Deficit (RD), the Fiscal Deficit (FD) and Debt to target levels within specified dates. Kerala too passed the FRBM Act and has been attempting to adhere to the targets. The Revenue Deficit was set to be brought down from over four per cent in 2002 – 03 to 0.94 per cent in 2012 – 13 (RE) and to 0.54 per cent in

2013 – 14 (BE). The Fiscal Deficit too has been set to be brought down from over five per cent in 2002 – 03 to 3.12 per cent in 2012 – 13(RE) and to 2.82 per cent in 2013 – 14(BE). As per the Kerala Fiscal Responsibility (Amendment) Act, 2011 the State has to reduce the total debt liabilities to 29.8 per cent of the estimated GSDP by 31 March 2015. But the State has already crossed the target by 2011 – 12 as its debt liabilities have dropped to 28.5 per cent.

6.6 The State, however, is caught in a difficult situation as Non – Plan Revenue Expenditure (NPRE) is growing owing to three major factors specific to the State, namely interest payments, salary and pensions. The state is making concerted efforts to bring down all the three components but with large historical legacies. Both interest payments and pension are difficult to bring down in the short term: interest payments owing to the debt stream (which the State is addressing as indicated below) and pension owing to the trajectory of the number of retirements and the longevity of the population. For instance, the interest payments is projected to increase by 58 per cent and salary by 80 per cent during the period from 2012 – 13 to 2016 – 17. Pension payments during the same period are projected to grow by 109 per cent. The huge outgo on account of pension is too evident.

6.7 On the pension front, realizing the enormous burden arising due to the payments towards pension, Government of India introduced a contribution based New Pension Scheme for Government servants recruited after 1 January 2004. The Government of Kerala could not adopt the scheme for various reasons. But the State has now succeeded in overcoming the hurdles and has implemented the Scheme from 1 April 2013. However, the effect of the new Scheme on the pension payments will not be immediate and hence the outgo on this account will continue to be an area of stress. A major reason for the inability of the State to achieve revenue surplus is, the huge lumpy expenditure incurred at a frequency of five years in respect of pay/pension revision when the finances are reaching the threshold level of stabilization and consolidation. Another reason is the consistent fall in the devolution through successive Union Finance Commissions. The State Finance Commission recommendations too are liberally accepted to provide increased devolution to Local Self Government Institutions in the true spirit of 73rd and 74th amendment of the Constitution. Growing number of grant-in-aid institutions, welfare schemes

and subsidies are also adding to the revenue expenditure stream and exerting pressure on the revenue account.

6.8 A large chunk of the grants provided to Local Self Government Institutions and other autonomous institutions is meant to create capital assets and the present accounting standards deter the Government to classify grants as capital expenditure. A similar accounting pattern is followed by the Centre and the same issue is faced by the Centre as well. This has been rightly recognized by the Ministry of Finance and from the Budget 2012-13, a system has been evolved to compute and incorporate Effective Revenue Deficit after segregating grants of capital nature and deducting it from the revenue expenditure. Taking a cue from the Centre, the State Budget 2012-13 also adopted such a system to incorporate Effective Revenue Deficit. It has been brought down from 1.67 per cent in 2011 – 12 to 1.74 per cent in 2012 – 13 (pre actuals) and to -0.29 per cent in 2013 – 14(BE). Our submission to the Commission is that a proper recognition of the concept of Effective Revenue Deficit be given as the real Revenue Deficit after factoring in the capital nature of grants. As regards the targets of Revenue Deficit in the roadmap for Fiscal consolidation fixed by the Thirteenth Finance Commission, it can be seen that Effective Revenue Deficit as proxy would satisfy the targets in 2012-13.

6.9 In addition to the factors mentioned above, Kerala faces a difficult situation regarding debt servicing. Close to 60 per cent of the debt outstanding as by April 2013 will be maturing in the five years since 2015 – 16. Such high outgo over a short period will be putting enormous pressure on the finances of the State and adhering to the FRBM Act would leave little room for raising resources for development. The State would also not be able to reduce revenue expenditure beyond a point, because of its commitments in the social sectors and increasing salary and pension commitments. We would therefore urge the Commission to revise the FRBM targets for the State in such a way that while the fiscal deficit target can remain the same, a ceiling of 1.5% may be stipulated for the revenue deficit, instead of insisting that revenue deficit may be eliminated. The position could be reviewed after five years for appropriate changes.

Chapter 7
Ecology, Environment and Climate Change

7.1 One of the terms of reference of the Fourteenth Finance Commission is to consider the need to balance management of ecology, environment and climate change consistent with sustainable economic development. In this context, the management of forests becomes an important priority. States have a predominant role in enlarging and maintaining the forest cover. As per the National Forest Policy of 1988, forests should not be looked upon as a source of revenue. Forests are a renewable national resource. They are national assets to be protected and enhanced for the wellbeing of the people and the nation. All this takes note of the fact that the States which have a large forest area have an opportunity cost in terms of the foregone economic activity and lower tax revenues. Hence, such States need to be compensated for this cost disability borne by them. As the devolution formula is inadequate to handle such compensations other methods have to be adopted.

7.2 The extent of forests in Kerala is 29 percent of its geographical area providing a forest cover of 40.13 percent. Concerted steps have been taken to maintain and protect the forests. The total recorded forest area of the State in 2005 was 11,265 sq. km. This has now increased to 11,305 sq. km. These forests are very rich in biodiversity. The State has stopped the clear felling and selection felling of the natural forests from the mid-1980s and thereby has been suffering substantial loss of revenue from timber and other forest produce. Further, in order to maintain the biodiversity and the environmental stability of the region, the State is not harnessing the hydel energy potential. Kerala is poorly endowed with natural resources suitable for commercial power generation. The only resource available is water running along the Western Ghats. However, during the last two decades, ten hydel projects at various stages of investigation with a capacity of about 1400 MW could not be taken up with the concerns regarding the entire Western Ghats as a hotspot of biodiversity. The Commission should consider these factors also while providing grant to the State for the maintenance of forests.

7.3 Receipts from forest as percentage of total non-tax revenue of Kerala have been coming down from about 10 per cent to 2.95 percent (Table

7.1).Forest revenue as a percentage of revenue expenditure on forest has also been coming down. The Forest revenue in 2013-14 is estimated to meet only 0.78 percent of the receipts from forest showing the need for massive support from the Finance Commission for the conservation of this national public good with great implication for climate change.

7.4 Kerala is a state with low carbon emission of green gases (GHG) and high carbon sequestration. Scientific studies show that the emission of GHG from Kerala is one of the lowest among the states in India. While the emission of GHG from the state is quite low, its carbon sequestration potential is quite high. This is due to the large area under forest as well as under other tree crops. The proportion of recorded forest area to geographical area in Kerala was 29 percent as against 23.4 per cent for the country. In addition to the forest spread over 11265 sqkms, Kerala accounts for more than four fifth of the area under Rubber Plantation in India which act as an excellent terrestrial carbon sink.

Table7.1 Forest Revenue in Kerala

Year	Receipts from forest as percentage to total non- tax revenue	Forest revenue receipts as a % of forest revenue expenditure
2000-01	11.08	1.06
2004-05	9.37	6.45
2005-06	6.33	1.39
2006-07	5.75	1.13
2007-08	4.55	0.97
2008-09	5.26	1.16
2009-10	6.68	1.32
2010-11	6.64	1.30
2011-12	3.50	0.76
2012-13 (RE)	3.33	0.94
2013-14 (BE)	2.95	0.78
Source:RBI State Finances and Budget in Brief Govt. of Kerala. 2011-12, 2012-13, 2013-14 [Table A-18, A-22]		

7.5 The tropical forests of Kerala are valuable not only for their Carbon sequestration ability but also for its water holding capacity. It is this capacity of the forest ecosystem which makes the flow of the 44 rivers of Kerala perennial. Water in these rivers is used not only by Kerala but also by neighbouring States like Tamil Nadu and Karnataka. Kerala represents an epitome of the biodiversity profile of the Western Ghats in India.

Table 7.2 Carbon Stock

State	Carbon stock Ton/hectare
Arunachal Pradesh	142.07
Kerala	**127.95**
Karnataka	124.66
Sikkim	121.8
Uttarakhand	116.88
Jammu &Kashmir	113.62
Himachal Pradesh	112.2
Maharashtra	100.8
Chhattisgarh	98.85
West Bengal	96.48
Jharkhand	94.7
Nagaland	94.67
Tamilnadu	91.77
India	**89.976**
Madhya Pradesh	89.79
Andhra Pradesh	89.7
Punjab	88.85
Meghalaya	87.77
Orissa	87.46
Bihar	84.23
Manipur	80.86
Uttar Pradesh	80.42
Haryana	79.91
Goa	77.52
Gujarat	77.14
Tripura	72.25
Assam	61.1
Rajasthan	56.22
Mizoram	52.41
Delhi	46.5

Source: Kerala's Development Experience: Its Implications for Finance Commissions,K K George, K KKrishnakumar, WP No 21,2009, CSES

7.6 The facts presented above suggest that Kerala has a strong case to be rewarded financially for managing ecology, environment and climate change for the benefit of the whole country. It is only fair that the State is compensated adequately by the Finance Commission for 1) revenue loss, 2) funds spent for maintenance of forests and 3) compensation for acting as a net carbon sequestration area of the country incurring opportunity cost of economic growth and food security at least in the short run. The compensatory green dividend needs to bear a relationship with the energy requirements of the State. We propose that the Commission set apart Rs 10,000 crore for compensating the States. The allocation criterion may be the distance of the carbon stock (shown in Table 7.2) from the average and the quantum arrived at by the total carbon stock of the State.

7.7 A new dimension to conservation is added with the recommendations of the Western Ghats Ecology Expert Panel (WGEEP). Western Ghats is a magnificent mountain range next only to Himalayas and is a biological treasure trove with a high degree of endemism (11% to 78%) and scenic beauty. This unique eco-system has been threatened by the increasing habitat pressures and declared as one of the world's hottest hotspots of biodiversity. Realizing the need to protect and rejuvenate the ecology of and for sustainable development in Western Ghats, the Ministry of Environment and Forests (MoEF) constituted a Western Ghats Ecology Expert Panel (WGEEP). The mandate of WGEEP was to demarcate ecologically sensitive zones and suggest measures to conserve protect and rejuvenate the ecology of Western Ghats region. Taking into account the wide ranging comments of the stakeholders on WGEEP Report, the MoEF constituted a High Level Working Group (HLWG) to suggest an all-round and holistic approach for sustainable and equitable development while keeping in focus the preservation and conservation of ecological systems in Western Ghats.

7.8 The Working Group, after careful examination of the different approaches available for characterizing the Western Ghats System and after extensive discussions with experts, has defined the extent of Western Ghats as an area of 1,64,280 km^2 and extending from North to South over a distance of 1500 km traversing Six States. It was revealed that already close to 60 per cent of the Western Ghats region is under cultural landscape - human dominated

land use of settlements, agriculture and plantations (other than forest plantations) - and only 41 per cent of the land area can be currently classified as natural landscape. Of the natural landscape, the biologically rich area, with some measure of contiguity is roughly 37 per cent of the Western Ghats which is about 60,000 km^2. The HLWG has identified this 37% of natural landscape having very high biological richness and low fragmentation and low population density and containing Protected Areas (PAs), World Heritage Sites (WHSs) and Tiger and Elephant corridors as Ecologically Sensitive Area (ESA) and recommended it for notification.

7.9 The HLWG has noted the unprecedented threats to natural landscape of Western Ghats region by development projects and urban growth, and has recommended a non-tolerance policy with respect to highly interventionist and environmentally damaging activities like mining or polluting industries and made specific recommendations about prohibited activities and those that require high level of scrutiny and assessment before clearance within ESA. While Kerala is fully sensitive to the issue of preservation of our rich natural heritage, it recognizes that the long history of human habitation in the Ghats owing to the extremely high population pressure cannot be erased in the short run. Incentives change behavior only gradually and call for careful calibration and higher levels of participation of the people. We agree that the future lies in working on green growth strategies that build on the natural endowment of the Western Ghats region to create a vibrant economy, while preserving, conserving and rejuvenating the ecology. This entails a huge responsibility on the State Government.

7.10 What does it entail?

i. Constant updating and improving our understanding of the multi-dimensional Mountain Systems; this is an area of research that can be carried out for several years involving some of our best minds;
ii. Data monitoring systems and the participation and involvement of local communities in decision-making;

iii. To promote sustainable agriculture, growers in Western Ghat need to move towards organic cultivation and build a unique brand of premium products;

iv. Incentivize forest production on private lands; and

v. Developmental projects and activities to be undertaken within an overarching environmental and ecological framework.

Each of the activities calls for resources beyond the means of the State and we submit that the Commission has to allocate substantial resources on comparable basis. We would like to remind the Commission that it is only in Kerala that almost all the districts of the State fall under the Western Ghat.

7.11 The XII Finance Commission considered this combination of benefit externalities and internalized costs and provided a grant of Rs. 1000 crore to States, distributed between them in accordance with the share accounted for by each in the total forested acreage in the country. The Thirteenth Finance Commission improved the formula for *inter se* allocation and increased the amount. The amount was increased from Rs. 1000 crores to Rs. 5000 crores. The formula determining the forest grants of the Finance Commission takes into account three factors. Firstly, the share of the total forest area in the country falling in any particular state. This has been further enhanced for those states where the share of forested area in the total area of the state is greater than the national average. A further compensation is given to those states where the enhancement is done on account of the economic disability posed by forest cover. The entitlement of each state thus obtained is further weighted by the quality of the forest in each state which is measured by the forest density in terms of moderately dense and dense forest cover. Our submission is that the formula adopted by the XIII Finance Commission be adopted by the XIV Commission and the grant amount be enhanced substantially. We wish to remind the Commission the words of the High Level Working Group, "…the XIV Finance Commission should consider substantially increasing the fund allotted to States by the XIII Finance Commission for forest and environmental conservation" (para 19).

Table 7.3The Share of Wetland Allocation for the States

State	Share of Inland Wetland Area	Share of Coastal Population*	Share of Wetland Allocation
Andhra Pradesh	9.341	18.681	14.01
Arunachal Pradesh	1.400		0.70
Assam	6.874		3.44
Bihar	3.626		1.81
Chhattisgarh	3.039		1.52
Goa	0.116	0.796	0.46
Gujarat	6.006	22.916	14.46
Haryana	0.382		0.19
Himachal Pradesh	0.886		0.44
Jammu and Kashmir	3.521		1.76
Jharkhand	1.529		0.76
Karnataka	5.713	2.566	4.14
Kerala	1.077	13.919	7.50
Madhya Pradesh	7.357		3.68
Maharashtra	8.163	10.542	9.35
Manipur	0.548		0.27
Meghalaya	0.270		0.13
Mizoram	0.126		0.06
Nagaland	0.194		0.10
Orissa	4.723	7.575	6.15
Punjab	0.776		0.39
Rajasthan	6.865		3.43
Sikkim	0.067		0.03
Tamil Nadu	7.016	16.814	11.92
Tripura	0.158		0.08
Uttar Pradesh	11.173		0.47
Uttarakhand	0.934		5.59
West Bengal	7.968	6.187	7.08
India	100.000	100.000	100.000

*Population is taken as a proxy for the coastal wetland and the coastline

7.12 Turning to the issue of wetland and coastal preservation, the Ramsar Convention defines it as, 'Wetlands are area of marsh, fen, peatland or water, whether natural or artificial, permanent or temporary, with water that is static or flowing, fresh, brackish or salt, including areas of marine water, the depth of which at low tide does not exceed six metres.' The National Environment Policy has emphasized the need for a holistic view of wetlands: 'India's freshwater resources comprise the single most important class of natural endowments enabling its economy and its human settlement patterns. The fresh water resources comprise the river systems, groundwater and wetlands. Each of these has a unique role, and characteristic linkages to other environmental entities … A holistic view of Wetlands is necessary which looks at each

identified Wetlands in terms of its causal linkages with other natural entities, human needs, and its own attributes'.

7.13 Like the forest area, the allocation for wetland and coastal preservation cannot be accommodated in the devolution formula. Hence, a grant under Article 275 is the appropriate mode of transfer of resources. The wetland and coastal preservation requires an amount equal to or more than what is required for the preservation of forests. The amount may be distributed among the States by taking the share of inland wetland area for each state by taking the wetland as a proportion of the total inland wetland. As regards the coastal wetland and coastal preservation the share of coastal population in the total coastal population of the nation may be taken. The two are combined to arrive at the allocation share by taking a simple average (Table 7.3).

7.14 Primary Environment Care (PEC) at the level of the local bodies, or environmental activities as local initiatives as per the plan programmes of the three tier Local Self Government institutions are rare. Such initiatives have certainly been weakened because of poor institutional abilities to assess environmental status, and inadequate environmental awareness of local communities. Pressure for popular programmes like infrastructure facilities and poor monitoring of the stipulated conditions for environment management, especially pollution control with popular participation, too play a role. In para 12.42 of the report of the XIII Finance Commission, it has been stated that "We have recommended a substantial increase in the grants to the local bodies, linking these grants to a share of the previous year's divisible pool" (Chapter 10). One of the reasons for the enhanced level of funding is to enable the local bodies to address mitigation of environmental risks. There should not be any usage conditionalities attached to local grants, since certification of usage has been found to act as an obstruction to the regular flow of funds awarded by previous commissions.

7.15 It is requested that the grants to local bodies may be awarded with a special component exclusively for Primary Environmental Care (PEC) activities at Local Self Government Institution level. All the 978 Grama Panchayats in the state have duly constituted Biodiversity Management Committees (BMC). Documentation of the biological assets in all the Panchayats and thus the state is in the last leg through the statutory programme of preparation of Peoples'

Biodiversity Register (PBR). The State Government has designated the BMCs as environmental sentinels at Grama Panchayat level so as to interfere timely and effectively in all cases of environmentally disagreeable activities and to find remedies. A legally sanctioned and effective institutional arrangement is in existence in all the Grama Panchayats of the state but in the absence of conservation programmes and funds the desired environmental improvement in the fast urbanising state is not discernible. On the other hand the overall economic and social development has taken its environmental toll in the form of excessive sand mining leaving the rivers dead and rock quarrying making hillocks aesthetically mutilated and ecologically dysfunctional. Primary Environment Care programmes at Grama Panchayat level is in the long-term interest of the protection and conservation of natural environment. The added advantage of Primary Environment Care projects at Panchayat level is that it can facilitate the constitutional obligations of the local bodies in the sectors of sanitation, public health, prevention of dangerous and objectionable activities as well. Setting up of waste management facilities, abattoirs, conservation of water bodies, organic farming, bio restoration of canals and ponds etc., would propagate environmental conservation at the grass root level at the same time fulfilling the constituent obligations of the local bodies.

Chapter 8
System of Inter-Governmental Transfers

8.1 The fundamental principle of inter-governmental transfers is discussed in clear terms in the opening paragraph of the 11th Finance Commission Report:

> "A sound system of inter- governmental fiscal transfers constitutes the cornerstone of a strong and stable federal polity. Transfers serve a two-fold purpose: one, to address the vertical imbalance- the inadequacy of revenues of subnational governments to meet their expenditure liabilities, arising from the assignment of asymmetrical functional responsibilities and financial powers among different levels of government, and two, to alleviate horizontal imbalances, the **disparities in the revenue capacities** of the constituent units of the federation- States and local bodies in our case - in order that all of them may be in a position to **provide basic public services to their citizens at a reasonable level**" (11th Finance Commission Report, p.6). (emphasis added)

8.2 As regards vertical imbalance, the recommendations of the Tenth Finance Commission was a watershed in fiscal transfers in India as it recommended an alternative scheme of global sharing of tax receipts. Since then the Commissions have followed this pattern and the share of transfers in the Centre's tax receipts awarded by the Commissions have risen from 26% (Tenth Finance Commission) to 32% (Thirteenth Finance Commission). The spirit of such larger transfers have, however, been not honoured as the Centre has been collecting resources through cesses and surcharges which are not part of the divisible pool. The share of cess and surcharge in the Centre's gross receipts has been increasing from around 3% during the award period of the Tenth Finance Commission to over 12% by the period of the Thirteenth Finance Commission. In effect, the share of the States in the gross tax receipts of the Centre has remained more or less at the level of the Tenth Finance Commission's award till the Thirteenth Finance Commission's award period with a dip in between. It is requested, therefore, that the Fourteenth Finance Commission consider enlarging the divisible pool by including the revenue from cesses and surcharges which have been in existence for over three years.

8.3 A related issue is that of compensating the States for the shortfall of the actual share from the award percentage. As indicated above if the award is 32% and the actual is only 28%, then the shortfall of four per cent has to be compensated. Not compensating the States amounts to the Centre taking away what is due to the States and spending it on schemes of Centre's choice. A compensating mechanism would not only strengthen the State's finances but also will become a disincentive for the Centre to splurge on funds not due to it. Fiscal responsibility should apply equally to the Centre and the States.

8.4 Every Commission chastises the States for not meeting the targets of Revenue Deficit and Fiscal Deficit; and often it extends to penalising the States such as Kerala. It may be seen that the Central Government regularly exceeds the Revenue Deficit and Fiscal Deficit targets. Whereas the Thirteenth Finance Commission estimated the Fiscal Deficit (as per cent of GDP) of the Centre at 5.7%, 4.8% and 4.2% for the years 2010-11, 2011-12, 2012-13 respectively, the actuals were 4.9%, 5.7% and 5.2% respectively. The Revenue Deficit estimated and actuals (shown in brackets) were 3.2% (3.3%), 2.3% (4.4%) and 1.2% (3.9%) respectively. The Centre has exceeded the revenue deficit by two per cent and fiscal deficit by about one per cent in two of the years. One wonders why no penalties are imposed on the Centre? The Commission has a duty to take up this issue.

8.5 The fundamental issue of federal fiscal transfers in India is the larger taxation powers in the hands of the Central Government and higher expenditure responsibilities of the States. In order to achieve higher expenditure levels the gross tax collection by the Centre has to improve. Over the recent period the ratio of Gross Tax Revenue to Gross Domestic Product (GDP) has shown a tendency to fall. We are not one of the highly taxed countries in the world and one wonders why nothing is done by the Centre to arrest such a fall. Related to the mobilisation of taxes is the issue of revenue foregone, which is of the order of around six per cent of GDP. It is not clear why the States should forego revenue because the Centre on its volition has chosen to forego revenue. Ideally, the share of the State's should be computed on the basis of the larger divisible pool including the revenue foregone and the deficit should fall on the Centre's spending powers.

8.6 The share of States in the net proceeds of Union taxes is the predominant channel of resource transfer. While arriving at the net proceeds the Commission makes an assumption regarding the cost of collection. The Thirteenth Finance Commission assumed that 14% is the cost of collection. This assumption is arbitrary and it is time a clear explanation is offered on it. Any improvement in the efficiency of the tax collection system is a gain for both the Centre and the States and it is a subject which should not be assumed away.

8.7 Another imbalance that has become too glaring in recent years is the centralization of the allocation of plan funds and a secular decline in the share of State plans; the share of the States declining from a high of 64% in the First Five Year Plan to 44% by the Twelfth Plan. In recent years such reduction has come about owing to the proliferation of high ticket centrally sponsored schemes (CSS). There is also the disturbing tendency of the Central Government treading over State subjects and subjects in the concurrent list in their expenditure responsibilities. And in the case of many of the CSS, the funds are transferred to implementing agencies directly. The Commission has to take a view on this to curb these tendencies. Further, as recommended by the Expert Committee on Expenditure Management, the Commission is urged to recommend transfers to be routed through the treasury for efficient monitoring and assessment of outcomes.

8.8 Considering the facts mentioned above, our view is that the Commission should devolve 50 per cent of the net proceeds of the enlarged divisible pool to the States. The liberalised economic environment, private investment led growth and the diversity of challenges faced by the States call for the strengthening of the hands of the States which would only be possible with a larger flow of resources from the Centre. The raise in the vertical devolution is a necessity because the higher weight to income distance in the formula for horizontal distribution is tantamount to a lower devolution ratio (which depends on the share of the States in the divisible pool) as is shown later. If we go strictly by the principle of equalization in the horizontal distribution, then the vertical share is not independent of it. As practiced currently, both the vertical share as well as the weights of the different indicators in the devolution formula has a large element of arbitrariness. This could be done away with.

8.9 Turning to the issue of *inter se* distribution the Canadian constitution puts the concern of alleviating horizontal imbalances effectively as follows: "making Equalization payments to ensure that provincial governments have sufficient revenues to provide **reasonably comparable levels of public services at reasonably comparable levels of taxation.**" (Equalization Report[1], p.86)(emphasis added). An important proviso of the fiscal capacity of the constituent units is that it be taken at reasonably comparable levels of taxation. Some constituent units might be collecting taxes at higher rates than the average but that cannot be a ground for offering them a lower share. Then, it is not the actual revenue realized which should be taken into account but the hypothetical at comparable levels of taxation. This immediately obviates the need to include tax effort as an indicator in the devolution formula.

8.10 In very broad terms, horizontal fiscal equalization (HFE) is designed to correct for economic disabilities experienced by some subnational governments. The economic disabilities are a result of horizontal fiscal imbalances, a situation in which there exists differences between subnational jurisdictions in their ability to provide comparable levels of government services while imposing comparable tax burdens. These differences may arise from tax raising disabilities (for example, from lower per capita tax payer incomes, or a larger share of agriculture in GSDP) and/or cost disabilities in the provision of government services (for example, from different population age structures). HFE is fundamentally based on the principle of equity between subnational jurisdictions and this principle has been accepted by all the Indian Finance Commissions. HFE is the equalization of the fiscal capacity of the states. State governments should then receive funds from the pool such that if each made the same effort to raise revenues from its own sources and operated at the same level of efficiency each would have the same capacity to provide services at the same standard. The revenue bases of states taken for comparison should, however, reflect the range of activities, transactions and assets the states actually tax, as such bases capture the revenue raising advantages and disadvantages ("disabilities") that states face.

[1]ACHIEVING A NATIONAL PURPOSE: Putting Equalization Back on Track Expert Panel on Equalization and Territorial Formula Financing, 2006.

8.11 Countries do not often include expenditure in HFE. But cost differences associated with expenditure needs can influence the capacity of a region to provide a comparable level of services across jurisdictions. Canada does not include any consideration of cost differences nor Germany. Australia has put in place an explicit and ambitious equalization scheme that aims at full budget equalization:

> "Australia does not only attempt to evaluate standardized taxing powers of her states, but also standardized expenditures adjusted for needs and cost differentials among jurisdictions"(Spahn[2], 2001: p.9).

8.12 In India too public finance experts have emphasized equalization: "For transfers to be based on rational principles, the focus should be **only on equalisation of revenue capacity to meet normatively assessed expenditure needs"** (Bagchi, p.35) (emphasis added). Bagchi goes on to say that equalisation transfers based on norms should provide the signals required for good fiscal conduct. The emphasis on the need for a normative approach is evident in thereport of the 12th Commission: "In a normative approach, fiscal efficiency is implicit because requirements are assessed taking into account only the average revenue effort" (p. 16). Thus, there is general acceptance that inter-governmental fiscal transfers should be guided by the principle of equalization and that fiscal efficiency is implicit in the normative approach.

8.13 The test of the adherence of the Finance Commissions to the principle of equalization is the formulae and indicators used for devolution. Population and collection/assessment were the only two criteria used for determining the *inter se* shares of the States in the case of Income Tax up to the VIIth Finance Commission. In respect of Union excise duties, the criteria, as these evolved over time, had placed greater and greater emphasis on factors relating to economic backwardness and fiscal weakness of the States. However, population continued to be the largest determining factor up to the VI Finance Commission, although its weight went down from 100 to 75 percent. This weight was further reduced to 25 percent by the VII Finance Commission.

[2]Spahn, Paul Bernd. "Maintaining fiscal equilibrium in a federation: Germany'."*Texts Submitted for the International Symposium on Fiscal Imbalance*. 2001.

8.14 Corresponding to the reduction of the weight of population there has been an increase in the weight of income distance criterion in various forms. In using the income distance criterion, the Fifth Finance Commission sought to close a part of the gap between the fiscal capacities of states whose per capita income was below the average per capita income of all states. The Sixth Finance Commission allowed a positive share to accrue to all states, the value of which was determined by the difference between the per capita income of the respective state and that of the state with the highest per capita income, scaled to population of that state. The Eighth and Ninth Finance Commissions also used the same method. Until the Ninth Finance Commission, two formulae supposed to reflect differentials in revenue capacities of states, namely, income distance and inverse income were being used. The Tenth Finance Commission discarded the inverse income formula due to some inherent procedural difficulties.

8.15 While estimating the distance based shares of states, the Ninth and Tenth Finance Commissions, as noted above, considered the distance of the state's per capita income from that of the state with the highest per capita income. Noting some inconsistencies, the Eleventh Finance Commission modified this procedure of using the highest income state as the representative benchmark from which such distances are measured. Instead, the Commission arrived at the shares by calculating distances from the weighted average of the per capita GSDPs (PCGSDP) of the three highest ranking states in terms of PCGSD, with the weights being the respective populations of these top three states. The income distances of these three states were arrived at as a fraction of that of Haryana, where the fraction was the ratio of the PCGSDP of Haryana to that of the respective state.

8.16 Population and area have been adopted by the different Commissions with varying weights as measures of fiscal need. Some Commissions have added poverty ratio, index of backwardness and index of infrastructure as well to better reflect the fiscal need. Income distance and inverse income have been adopted by the Commissions as measures of fiscal capacity. As is evident, the pendulum has shifted from the end of fiscal need- almost the entire weight placed on population by the Commissions in the early years- to the fiscal capacity – the bulk of the weight placed on income distance by the Seventh

Commission onwards. In recent years some weight has been placed on tax effort and fiscal discipline as well (Table 8.1).

8.17 The devolution formulae used by the XI, XII and the XIII Finance Commissions combine the fiscal capacity and expenditure side variables without adequately clarifying the logic behind the weights. The Eleventh Finance Commission went largely by the fiscal capacity side variables (Income Distance, Tax Effort, and Fiscal Discipline together having a weight of 75 per cent). The next two Commissions brought it down to 65 per cent, still tilting the balance largely to the fiscal capacity side. The only expenditure side variable is area that carried 10 per cent weight. Population is anyway an essential standardizing variable thereby suggesting that the Finance Commissions have largely gone by the fiscal capacity variables.

Table 8.1.Horizontal sharing- criteria and weights, Finance Commissions – XI, XII, XIII

Criteria	Weights		
	XI	XII	XIII
Population	10	25.0	25.0
Income Distance / Fiscal Capacity Distance*	62.5	50.0	47.5
Index of Infrastructure	7.5	0	0
Tax Effort	5.0	7.5	0
Fiscal Discipline	7.5	7.5	17.5
Area	7.5	10	10
Tax revenue devolution	29.5% of Net proceeds of all shareable Union taxes and duties	30.5%	32.0%

Note: * XIII FC used the concept of fiscal capacity distance

8.18 As regards the criteria, the Thirteenth Finance Commission had the following to say regarding population: “Population is an indicator of the expenditure needs of a state. It is a simple, objective and transparent indicator that ensures predictability. The criterion ensures equal per capita transfers to all states, not taking into account cost disabilities across states because of

differences in the geographic spread of population" (p.119). Such cost disabilities were addressed by taking area in the formula. Area as a criterion was first introduced by the Xth Commission to accommodate differential administrative costs to provide the same level of services and the XIIth Commission continues with the logic but increasing the weight to 10%.

8.19 It is surprising that the Thirteenth Finance Commission which did mention cost disabilities owing to urbanization earlier did not think it necessary to include it. On para 8.13, the Commission had the following to say on urbanization, "The states have a major responsibility in terms of provision of both rural and urban infrastructure. The proportion of urban population of the country is projected to increase from 28 per cent of the total population to about 38 per cent in 2026. Further, the projected growth of urban population will account for two-thirds of the total population increase. The current state of supply of core services in the urban areas, viz. water supply, sewerage, solid waste management and street lighting, is inadequate by any standards. The higher growth of urban population will add further pressure on provision of these services" (p.116). The urban growth has indeed been high and the level has already been crossed 30% in 2011. More importantly, the variation across the States has widened: the South, West and the Punjab-Haryana belt has been urbanizing rapidly- Gujarat (42.58%), Haryana (34.79%), Punjab (37.49%), Maharashtra (45.23%), Andhra Pradesh (33.49%), Karnataka (38.57%), Kerala (47.72%), and Tamil Nadu (48.45%). We believe it is not proper to ignore the cost disabilities brought about by urbanisation.

8.20 Turning to the fiscal capacity, the XIIIth Finance Commission had the following to say, "The income distance criterion used by Finance Commission - XII, measured by per capita GSDP, is a proxy for the distance between states in tax capacity. When so proxied, the procedure implicitly applies a single average tax-to-GSDP ratio to determine fiscal capacity distance between states. This Commission recommends, instead, the use of separate averages for measuring tax capacity, one for general category states and another for special category states. The justification for doing this is that between the two categories, a single average applied (implicitly) to GSDP does not accurately capture the fiscal distance between the two groups. This is because overall base **GSDP does not accurately capture the taxable income** for two reasons. The first is that the sectoral composition of GSDP varies across states and the sectors are

not uniform in their taxability" (p. 120). The Commission recognizes the deficiency of the measure and says, "Ideally, tax frontiers specific to each state should be estimated, but an exercise of this kind was constrained due to lack of the necessary data" (p.120).

8.21 More or less similar views had been expressed by the XII Finance Commission too, "Revenue capacity is often measured, as was done also by some of the previous finance commissions, by GSDP at factor cost even though it is recognized that GSDP is not a perfect correlate of income or fiscal capacity. The Central Statistical Organization (CSO) has furnished to us the comparable estimates of GSDP at factor cost at current prices. The question has been raised from time to time whether GSDP at market prices would serve as a better proxy for income or revenue capacity than GSDP at factor cost. In our view it does. Further, GSDP is an indicator of the domestic product and not of income or consumption. With a view to developing a more suitable macro indicator of fiscal capacity, we also had discussions with the CSO. However, a practical alternative is not readily available. We have, therefore, decided to continue to use the comparable estimates of GSDP as provided by the CSO" (p.13).

8.22 The issue is whether the GSDP truly reflects the tax base. For the reasons mentioned by the XII and XIII Finance Commissions it is not. Especially, in a world of consumption taxes (value added tax or VAT, Service Tax etc.,), what is the sanctity of taking GSDP as a measure of tax base? With VAT, tax falls on consumption that too excluding services (services are taxed by the Union and the States getting a share of it). Consumption expenditure depends on disposable income. Income accruing to persons is conditioned not so much by 'domestic production' in the GSDP measure but the 'national income' which has to take into account factor incomes. In the current Indian context, both labour incomes and capital incomes flow across states and are large. Not having proper estimates is no reason for ignoring them. On labour migration a recent study says, "… there has been a high level of migration persistence in many parts of India across the twentieth century and that these migrations have been associated with substantial remittance flows to the source regions" (Tumbe[3], 2012: p.88). These migrations are circular and usually semi-

[3]Tumbe, Chinmay, Remittances in India: Facts & Issues, Working Paper 331, Indian Institute of Management Bangalore, 2011.

permanent in nature. The migrants spend large part of their working lives away from home and they differ from permanent migration. The study referred above puts the largely male dominated streams directly affecting 17% of Indian households and provides an estimate of the domestic household remittance "to be nearly $10 billion in 2007-2008, 60% of the flows being inter-state transfers and 80% directed towards rural households" (p. 89).

8.23 The domestic remittance in 2007-08 would only be about one percent of the Gross National Income but their concentration in a few states makes a huge difference. About six district and dense clusters have high remittance receiving propensities where over 25% of the households receive remittances. These clusters are: (a) Most parts of the West Coast (b) Parts of the East Coast barring coastal Andhra Pradesh (c) Eastern Uttar Pradesh and Bihar (d) Himalayan region (e) Jalandhar area of Punjab and (f) parts of Rajasthan. Together these regions cover roughly 20 per cent of the Indian population. Hence, remittances as a share of GSDP could easily be over five per cent for many of the states involved.

8.24 It is often said that Kerala receives large amount of Gulf remittances that do not get counted in the state's GSDP and the Tax-GSDP ratio is overestimated. What is forgotten is that Kerala has larger number of domestic migrant labourers- largely from Assam, Bengal, UP and Bihar- estimated to be over 2.5 million in early 2013 that too growing at the rate of 8 per cent a year. Their annual remittances to their homes is around Rs. 17,000 crore a year which is over 5 per cent of Kerala's GSDP. The tax base of Kerala will be lesser than the GSDP to that extent. The outflow from Kerala will be the inflow for some other states. In recent years Kerala has attracted migrant labour from Bihar, Orissa, West Bengal, Assam, Uttar Pradesh and so on. These states also send a large number of migrants to Gujarat, Mumbai, Karnataka and other rapidly growing Indian states. The large inflow of remittances would raise their tax base. The fiscal capacity distance will come down as a result of these remittance flows. States like Kerala will move down the scale and states like UP and Bihar will go up the scale.

8.25 What would be a proper measure of tax base? Can the per capita consumption expenditure be used as a proxy for the tax base? Our submission is that it too is not an appropriate measure owing to some well-known

reasons. Firstly, the consumption expenditure data available from the National Sample Survey rounds deviate from the CSO estimates of consumption and the deviations are not uniform across the States. Secondly, Consumption suffers from the same compositional problem as that of GSDP. Services account for a larger share of the consumption basket between the rural and urban areas and urbanisation levels vary across the Indian States. Thirdly, the composition of the services basket in consumption varies between States. Hence, per capita consumption expenditure too would be an inappropriate measure of tax base.

8.26 One of the indicators used by the Eleventh Finance Commission in the devolution formula is the index of fiscal discipline defined as the relative improvement in the ratio of the own revenue to the State's revenue expenditure from a base period. It gave a weight of 7.5 per cent to it. Both the Twelfth and Thirteenth Finance Commissions adopted the same methodology but the latter raised its weight to 17.5 per cent. There is a basic flaw in this index. The flaw might be discerned by a comparison of the performance of the States in terms of the index of fiscal discipline between the two time periods, 2001-03 to 2005-08 and 2005-08 to 2010-2013 (Appendix Table A.1). The top panel presents the performance between 2001-03 and 2005-08, when the growth rate of the economy was one of the highest and the tax buoyancy was improving for the States. It is seen that on an average change in the ratio was positive and higher for those States that had higher levels of the ratio initially (there are only one or two exceptions). The inference is that the States with better 'discipline' were doing better. Turning to the lower panel, the comparison is for the period 2005-08 to 2010-2013 when the growth of the economy was slipping. The change in the ratio had turned negative and the States with better 'discipline' were doing much worse, with hardly any exception. Thus, the performance in terms of the index did not have much to do with 'discipline' but the growth of the economy. It seems the index fails to incentivise factors within the control of the States. What good does such an index serve?

8.27 Turning to the devolution formula, if the principle of horizontal fiscal equalization is adhered to, then the formula could be thought of in the following terms. Suppose a_i is the population share (1971) of State i; b_i is the share of the ith State in the all state's tax revenue (which is also equal to the share of GSDP and tax base as used in the computations of the Commissions).

x is the ratio of devolution (Centre's taxes devolved to the States) to all state's tax revenue, which has been coming down over the years. Suppose β_i is the share of State i in the divisible pool. Horizontal fiscal equalization calls for the equalization of the share of State i in the sum of all state's tax revenue and the divisible pool with the population share. In notations,

$$a_i = [b_i \sum(b_i) + \beta_i x \sum(b_i)]/[\sum(b_i) + x\sum(b_i)]$$

This could be simplified as $a_i = [b_i + \beta_i x]/(1+x)$, or $[a_i (1+x) - b_i]/x = \beta_i$, which can be rewritten as

$$\beta_i = a_i + (a_i - b_i)/x$$

Let us call $(a_i - b_i)$ the tax capacity distance. The equation can then be described as the share of State i in the divisible pool is the sum of the share of the State in the population and the difference of the share of the State in the all state's tax revenue from its share in the population multiplied by the inverse of the devolution ratio. The equation suggests that for fiscal equalization to happen the tax capacity distance has to get a weight of (1/x) and the population share a weight of '1'. The equation has some interesting interpretations: lower is the tax capacity distance of a State relative to its population share larger will be $(a_i - b_i)$ and it will get a larger boost being divided by x, a value lower than 1. Thus, a low devolution ratio is implicitly a larger weight for the tax capacity distance.

8.28 The relationship between devolution ratio and the share of the poorer States in devolution while adhering to the principle of fiscal equalization is shown in Appendix Table A2. It is seen that a relatively poorer State (such as C in the example) gets almost the entire divisible pool when the devolution ratio is low. As devolution ratio increases the shares of other States start improving. The need for raising the devolution ratio is thus absolutely critical when the disparity among the States is wide and the Centre has such large taxation powers.

8.29 Turning to the devolution formula of the Thirteenth Finance Commission with the new light of the equation presented above the following issues need to be highlighted. In the devolution formula of the Thirteenth Finance Commission, we may take the population and area together as corresponding to *a* and the rest corresponding to *(a-b)*. It follows that the devolution ratio needs to be thought of through the horizontal shares and not independent of

it. The low devolution ratio of about 0.4 implies a higher implicit weight for the tax capacity distance of the order of 70%. The explicit lower weight of the population share in the devolution formula means additional weight to the tax capacity distance. Further, the factor within the bracket, namely *(a-b),* has a tendency to increase for the poorer States as the tax capacity distance widens. This gets further aggravated by taking the income distance as it is the distance from the income of the State with the highest income rather than the population share. In effect, the devolution formula as applied by the Thirteenth Finance Commission is a three-fold hit to the States like Kerala. We suggest that this be corrected by adhering to the principle of horizontal fiscal equalization and deriving weights by applying a proper methodology.

8.30 In sum, our submission regarding the devolution formula is the following. Raise the devolution ratio by raising the share of the States in the divisible pool. In the devolution formula, drop tax effort and fiscal discipline on the fiscal capacity side for the reasons mentioned earlier. Income distance should be modified as the distance from the population share called tax capacity distance above. The weight of tax capacity distance be brought down. The population share be reworked to incorporate cost disabilities and its weight raised accordingly.

8.31 Assessing expenditure needs would require comparable approaches across the provinces to measure disparities, not only in the volume of services provided but also in a number of factors that affect the costs of delivering services (e.g., composition of the population, health and education status, dispersion of the population, wage rates, etc.). This is highly data demanding. However, that in itself is not a ground for ignoring it and the ToR of the XIV Finance Commission provides an opportunity for incorporating these factors. A simple procedure for incorporating some cost disabilities worked out in the following paragraphs.

8.32 Population is one of the basic indicators which should get into any formula for devolution. But just the number or share is a very crude measure: (a) Age composition does make a difference; larger proportion of elderly needs to be taken into account; (b) Area is taken in the formula because it brings in cost differences. But instead of taking area as a separate indicator, we submit that forest area be taken and integrated with the population measure; (c)

Effective density should also appear as extremely low densities and high densities bring about cost disabilities in addition to and independent of the effect of forest cover; and (d) Bring the urbanization factor into the weighing of population.

8.33 We submit that the following weighing procedure be adopted. Take the difference between the proportion for the state and the national average. If it is negative assign the value of zero; otherwise retain the difference. Enhance the 1971 population share by the proportion thus arrived at. Carry it out for all the factors indicated above. The enhanced population shares are shown in Table 8. 2. Our submission is that the Commission should use these population shares or refined population shares following the method indicated above.

Table 8.2: Population Shares of States Enhanced with the Cost Disability Factors

State	Population Share (1971)	Enhanced Population Share (aged, forest, urbanization)	Enhanced Population Share (aged, forest, urbanization, effective density)
Andhra Pradesh	8.010	7.576	7.572
Arunachal Pradesh	0.086	0.109	0.110
Assam	2.693	2.754	2.753
Bihar	7.757	7.159	7.167
Chhattisgarh	2.143	2.389	2.388
Goa	0.146	0.195	0.195
Gujarat	4.916	5.055	5.053
Haryana	1.848	1.763	1.762
Himachal Pradesh	0.637	0.854	0.854
Jammu and Kashmir	0.850	0.784	0.787
Jharkhand	2.620	2.568	2.567
Karnataka	5.395	5.361	5.359
Kerala	3.931	4.600	4.605
Madhya Pradesh	5.527	5.474	5.472
Maharashtra	9.283	9.898	9.894
Manipur	0.198	0.282	0.282
Meghalaya	0.186	0.204	0.204
Mizoram	0.061	0.105	0.106
Nagaland	0.095	0.115	0.116
Orissa	4.041	4.283	4.281
Punjab	2.495	2.486	2.485
Rajasthan	4.744	4.378	4.382
Sikkim	0.039	0.057	0.057
Tamil Nadu	7.586	8.259	8.256
Tripura	0.287	0.361	0.362
Uttar Pradesh	15.439	14.250	14.257
Uttarakhand	0.827	1.081	1.081
West Bengal	8.159	7.585	7.593
India	100.000	99.999	100

Source: (1) The 1971 population shares are taken from the Report of the XIIIth Finance Commission; (2) Both urbanization and the proportion of elderly is taken from the Population Census, 2011; (3) India State of Forest Report, 2011.

Appendix

Table 8A.1 Distribution of States by the Ratio of Own Revenue to Revenue Expenditure

Change between 2001-04 and 2005-08(All State =12%)	**Level of the Ratio in 2001-04**			
	Below 20	**20-39**	**40-59**	**60 +**
	Between 2001-04 and 2005-08			
Above 12%	Aru P	HP, Ori, UP	Chh, Raj, MP	Guj, Har, Kar, Maha, Punj, TN
9-12%		Assam UttaraKhand		AP
Below 9%	Mani, Mizo, Naga, Tri	Bi, JK, Megh, Sikkim, WB	Jh, Ke	Go
Change between 2005-08 and 2010-13 (All State = -3.5%)	**Level of the Ratio in 2005-08**			
	Below 20	**20-39**	**40-59**	**60 +**
Below -3.5		Aru P, Megh	Assam, Jh	Chh, Go,Har, Kar, Maha, Punj, TN
+3.5 to -3.5	Mani, Naga, Mizo, Tri		HP, Ori, UP, Raj, MP, UK	AP, Guj,
Above +3.5		Bi, JK, Sikki, WB		Kerala

Source: Report of the 12th and XIII Finance Commission Reports and RBI's Study of State Budgets.

Table 8A.2 Relationship between Devolution ratio and the share of the States

State	Population Share (a)	Tax Share (b)	Devolution ratio 20:80			Devolution ratio 30:70			Devolution ratio 40:60		
			Tax share	Tax Amount	Devolution*	Tax share	Tax Amount	Devolution*	Tax share	Tax Amount	Devolution*
1	2	3	4	5	6	7	8	9	10	11	12
A	30	40	40	32	0	40	28	2 (6)	40	24	6 (15)
B	40	40	40	32	8 (40)	40	28	12 (40)	40	24	16 (40)
C	30	20	20	16	14 (70)	20	14	16 (54)	20	12	18 (45)

*Amount (share within brackets)

Computation with a devolution ratio of 20:80

Share of C= a + (80/20) (a-b) = 30 +(80/20)*(30-20) = 70. As 20 is the devolution, 70% of 20 is 14 which goes to State C. Similar computations may be carried out for other States and for other devolution ratios.

It is clear from the Table that as devolution ratio improves the share of the States move closer to their population shares. Just note the progressive decline of the share of State C from 70% to 45% (column 6 and 12) as devolution ratio improves from 20 to 40.

Chapter 9
Grants-in-aid to States under Article 275

9.1 Though devolution constitutes the largest component of statutory transfers to states, its importance has come down in the recent Finance Commission awards and the share of grants has increased. While this is an undesirable trend from the point of view of the finances and fiscal autonomy of states, the economic logic of grants in a federal set up cannot be questioned altogether. At the same time, it will also be prudent to fix a ceiling for the level of Article 275 grants keeping in view the primacy of the share of Central taxes as the vehicle for resource transfer to states.

9.2 Kerala is of the considered view that grants-in-aid under Article 275 should serve the following two purposes: (i) it should fill the gap in availability of revenue account resources on the non-plan side, after a rigorous but realistic assessment of the State's efforts; (ii) It should fill the gap if any, in the revenue account on the plan side at the existing level. As we have argued elsewhere, there is absolutely no constitutional or other reason to exclude the gap on the plan side to be left unattended by Finance Commissions.

9.3 When such an exercise is undertaken, it is clear that there are two categories of states. One would have substantial surplus on the revenue account, the other would have either no per capita surplus or only meagre surpluses. The latter group of states may be given additional grants under Article 275 to augment their revenue account in order to ensure that adequate surplus is available for capital investment. Such a second stage utilization(after the first stage of filling non-plan and plan revenue account gaps, as rigorously and realistically assessed by the Finance Commission) of grants under Article 275 should be norm based. Tied grants under Article 275 should be mainly limited to calamity relief grants and grants for augmenting State's consolidated fund to give assistance to local self-governments.

9.4 As in the case of tax sharing, in the case of grants also, Kerala's experience has not been very encouraging. Kerala had been getting lower share of grants in the hands of the recent Commissions. Kerala's share in total grants was just 2.5 percent of the total grants to all states (Table 9.1). Under

the award of the XIII Finance Commission, the per capita grants, given to the State for the five years will be only Rs.1908 as against Rs.2137 for all states.

9.5 What is more, none of the Finance Commissions from the seventh except the 12th had given any grant to Kerala under the substantive provisions of Article 275 of the Constitution meant for States "in need of assistance". The State was not receiving Article 275grants, usually referred to as deficit grants because the Finance Commissions assumed surpluses in the non-plan revenue account of the State in their normative estimates. But the State actually had continuous deficits on non-plan account ever since 1985-86, even if one includes all additional resources mobilized (ARM) in the non-plan revenue account. The actual Non-Plan revenue deficits, before and after devolution, were much higher than those assumed by the recent Finance Commissions not only for Kerala but also for All States. When surplus after devolution was assumed by the 12th Finance Commission for Kerala, it turned out to be much lower than the forecasts by the Commission.

Table 9.1 Share of Kerala in the Total Finance Commission Transfers to States (Rs core)

		Finance Commission			
		Tenth	Eleventh	Twelfth	Thirteenth
1. Share in Central Taxes and Duties		7217.00 (3.5)	11504.00`(3.1)	16353.21(2.7)	33954.3(2.34)
2. Non-Plan Revenue Deficit Grants		0(0.0)	0(0.0)	470.37(0.8)	0(0.0)
3. Special Problem Grants		52.00(4.2)	50.00(4.4)	500.00(7.04)	1500.00(5.4)
4. Upgradation Grants		29.83(2.2)	79.14 (2.1)	795.82(2.1)	1632.2(2.6)
Grant to Local Bodies	5. Panchayat	178.81(4.1)	330(4.1)	985(4.9)	1950.2(3.1)
	6. Municipalities	25.43(2.5)	75(3.8)	149(3.0)	725.9(3.1)
	7. Total	204.24(3.8)	405(4.0)	1134(4.5)	2676.1(3.1)
8. Grants for Relief Expenditure		218.74(4.6)	279(3.4)	354.32(2.2)	563.2(2.1)
9. Performance Incentive					0(0.0)
10. Total Grants (2+3+4+7+8+9)		504.81 (2.5)	813(1.4)	3254.51(2.3)	6371.5(2.5)
11. Total Transfers (1+10)		7721.81(3.4)	12317(2.8)	19607.72(2.6)	40325.8(2.4)

9.6 A major source of such lapses is the projections relating to salary and pensions. The Twelfth Finance Commission had recommended that the states should follow a recruitment policy such that salary expenditure does not exceed 35 per cent of the revenue expenditure net of interest payment and pensions. The Commission limited the impact of pay revision to salary expenditure within this normative ceiling and the expenditure over and above the ceiling has been successively reduced by 10 per cent of the amount every year. But with the implementation of the Pay Commissions' recommendations, the salary expenditure increased by 76.4% over the XIII Commission's projections. The variation was 140 per cent in 2011-12.

9.7 The Thirteenth Finance Commission projects that the pensions will increase by 10 percent between 2010-11 and 2014-15 as against 6 per cent for salaries. Finance Commission has estimated the pension payments for the base at 21 percent over the 2008-09 pension payment, arrived at by applying total growth rate over the actual figure for 2007-08. According to the Commission, for states having their own Pay Commission, a procedure similar to that adopted for salaries has been adopted. The actual growth rates of state's pension payments prior to 2009-10, the base year for the Finance Commission, itself was quite at variance with the projected figures of the Finance Commission. The difference in pension in 2011-12 from the projections of the Commission comes to Rs.1260 crore (20.8 percent) in 2011-12.

9.8 All Finance Commissions as also other central government agencies like the Planning Commission seem to be under a mistaken impression that all salaries paid by the state government are on account of administrative services. As may be seen from Table 9.2 social services account for nearly two-thirds of the total salaries during the year 2011-12. General Education and Technical Education account for 50.6 percent. Salary bill under medical and public health account for 10.8 per cent of the total salary bill of the State. The payment of pensions may appear quite high in comparison with other states, but they are on account of personnel retired from education and medical services.

Table 9.2. Proportion of each head in Expenditure on Salaries during the year 2011-12

Head	Rs. Lakhs	% of Total
Secretariat - Social Services	2997.72	0.19
Other Social Services	0.02	0.00
General Education	781166.83	48.57
Technical Education	32016.77	1.99
Sports and Youth Services	2492.69	0.15
Art and Culture	2570.19	0.16
Medical and Public Health	173016.45	10.76
Family Welfare	30101.99	1.87
Social Security and Welfare	28475.31	1.77
Total Expenditure on Salaries	1608193.08	65.46

9.9 The influence of the Finance Commission in determining the size of the States' plan is not often appreciated. It is the balance in the current revenue account (non-plan revenue account) that forms the seed money of plan funds for the States. What is often not realized is that it is the policy of the Finance Commission with regard to tax sharing and grants that to a large extent, determines this surplus in the non-plan account. Kerala's share in the non-plan surplus of all States after devolution of tax shares and all types of statutory grants was 4.1 percent under the Tenth Finance Commission's award. It came down to 3.2 percent under the award of the Eleventh Finance Commission. Kerala's share fell steeply to just one per cent under the award of the 12th Finance Commission. The 13thFinance Commission increased the state's share marginally to 1.4 percent. The per capita non-plan revenue surplus of Kerala under the award of the XIII Finance Commission was only Rs.7034 as against the all States average of Rs.14125. Even the minimum surplus estimated for Kerala as in the past will turn out to be negative or has already turned out for some of the reasons mentioned earlier. Already the state's per capita state plan outlay and expenditure is one of the lowest among the states (Table 9.3). Thus the State faces a major handicap with respect to its 12th plan financing.

Table 9.3 State-wise per capita plan expenditure (Rs.)

State	Tenth Plan	Eleventh Plan *
Andhra Pradesh	7873.20	15399.02
Bihar	2398.43	5952.90
Chhattisgarh	7111.03	16318.22
Goa	26870.12	46827.79
Gujarat	8627.32	15829.47
Haryana	5781.74	16879.70
Jharkhand	5467.80	9804.32
Karnataka	10834.76	16562.45
Kerala	5944.64	8845.86
Madhya Pradesh	5312.31	8627.27
Maharashtra	5520.25	10122.68
Orissa	3702.24	8271.08
Punjab	5863.93	10980.11
Rajasthan	5624.00	10668.70
Tamil Nadu	6658.14	10221.13
Uttar Pradesh	3106.92	7032.92
West Bengal	2687.96	5850.48
All States	5491.45	10257.97

Note: Mid-year population has been used for the calculation.
*Only the first four years are included under the eleventh plan.
Figures for 2009-10 of Revised Outlay and for 2010-11 of Budget Outlay.
Source: Government of Kerala, *Budget in Brief*, 2011-12.

9.10 **Special problem grants:** Right from independence, Kerala pursued a development path different from most Indian states committing a lion's share of public resources in health and education. This was done at the expense of much needed investments in agriculture, industry and infrastructure. This development strategy not only benefitted the state but the whole country. Kerala's investments had an 'externality effect' on the human development process of the whole nation through the hundreds of teachers and nurses who took up employment in other states.

9.11 It is often acclaimed that some of Kerala's achievements are comparable to those of developed countries. But these successes have also brought in its wake some of the developed countries' problems. Unlike these countries, the State does not have the financial ability to tackle them all by itself. Since these problems are unique to the State, they have not received the national

attention and priority that they deserve. While the Central agencies like the Planning Commission and the Finance Commissions are still grappling with first generation problems in education, health care and social security in other parts of the country, Kerala is saddled with second-generation problems resulting from its very success in attaining higher levels of social development.

9.12 Instead of recognizing and rewarding the state's achievements, the successive Finance Commissions have been finding it as an excuse to deny financial assistance to Kerala. The 13thFinance Commission's award in respect of State specific needs is much worse than its immediate predecessor. It reduced Kerala's share in special problem grants to 5.4 percent from 7.1 percent by the 12thFinance Commission. The 13thFinance Commission too did not take cognizance of the large number and variety of special problems of the State. Our earnest plea to the Fourteenth Finance Commission is to take note of some of these problems outlined below.

9.13 **Registration:** The Department of Registration has completed computerization of all the 311 Sub Registry offices (SRO) as part of the upgradation. Extending the process, centralization of database was initiated during the year 2011-12 with access to the database through internet media from SRO locations. With the advent of this various levels of information can be made available to different target groups. The pilot project has been started in 2011 to be extended to all the SROs. In the long run the functionality of the Department might involve delivering service via internet, telephone, SMS, community centers, wireless devises or other communication systems.

9.14 The consolidated database can be put to use for implementing online mutation with the co-operation of Revenue and Survey Departments. The outcome of the project would be that the ownership details of a particular property can be viewed or verified through the internet along with the map, facilitating banking and other financial institutions to confirm the ownership status of a land record and also provide authenticity and transparency in land transactions. During the period 2015-2020, the Department plans to undertake the following activities in connection with e-governance initiatives in the Department.

1. The project for Integration with Revenue and Survey Departments for online mutation.
2. E-Stamping for deed registration
3. Digitization of legacy records
4. Modernization of Record Rooms

The expected expenditure for carrying out these activities during 2015-20 is, Rs. 310.00 crore (See Annexure for details).

9.15 **Police:** The Police establishment is primarily a citizen centric and service centric entity. Citizens have started demanding better and more efficient security for their lives and property and policing services at their doorsteps. Coupled with these expectations, the problems of Terrorism, Cybercrimes, Financial frauds, Intellectual property rights, Environmental crimes etc has brought into focus the need for urgent modernization of the Police establishment. We have begun some such as Community Policing (Janamaithri Suraksha Programme) since 2008. Student Police Cadet Centre, Coastal Security Training and Cyber Forensic Training etc are some of the other activities taken up. **The expected expenditure is Rs. 258.90 crore** (See Annexure for details).

9.16 **Prisons:** State Government have formulated various schemes aiming at upgradation of infrastructure and other facilities in the jails in the State. In order to improve the living conditions of the inmates in prisons, State Government is taking up various initiatives as detailed below:

1. Installation of solar Energy devices in jails has been completed in 5 jails in the State. Government proposes to extend the initiative to the other jails also.
2. Installation of solar water heaters.
3. Cots to all prisoners.
4. Sanitation, sewage, health care and hygiene improvements.
5. Improved medical facilities in the jail hospitals.
6. Setting up of Bio gas plants in jail premises.
7. Installation of rainwater harvesting system in jails.

In order to tighten the security measures in jails, Government proposes to install diversified safeguards, such as electric powered fencing, heavy guarded and protected entrances, sniper guard towers, illuminating movement

detectors, CCTV digital surveillance, Metal detectors, Walky talky sets, body scanners, mobile phone jammers, automatic alarms, sensors etc.

Commission may consider recommending a grant of Rs. 190 crore for taking up these activities by the State. (See Annexure for details).

9.17 **Maintenance of Roads and Bridges:** Kerala has a well- developed road net- work compared to the other States of India. Almost all the road traffic is plying through the P.W.D. roads and rural roads of the state. The vehicular density in the State is very high. In addition to the spurt in the number of vehicles on the roads the axle load on these roads has also increased by over six times during the past decade. The other factors such as round the year rainfall, abundance of coastal and hilly regions are causing hindrance to the maintenance of the roads in Kerala.

9.18 The Public Works Department maintains the State Highways (4341.65 Km) and Major District Roads (27469.95 Km) making a total road length of 31811.600 Km. The rural roads of Kerala are maintained by the Grama Panchayat, Block Panchayath , Municipal bodies and District Panchayath. The rural roads are of two types namely, Other District Roads (59499.43 Kms.) and Village roads (111927.22Kms.) adding to a total road length of 171426.646 Kms.

9.19 There are 627 bridges on State High Ways, and 2179 on Major District Roads (MDR). There are 11512 culverts on State Highways and 39910 on MDR. Of these 2240 bridges, 85 numbers are to be reconstructed / renovated. The high traffic density in the roads of Kerala is causing lateral pressure on the bridge structure. The heavy tonnage of the new generation heavy vehicles such as container lorries is making the matters worse. The need to reconstruct/ renovate the existing weak bridges is being given top priority by the State Government.

9.20 The hilly regions of Kerala do not have a well-integrated road network as in the case of coastal and midland regions. The damages caused on the existing hill roads due to land slips; torrential rainfall and natural calamity have made traveling on these roads arduous and risky. The poor transportation facility is the major handicap faced by the people living in the hilly regions. The cost of transportation per kilometer in the hilly region is very high when

compared with coastal and midland regions. The proper maintenance of hill roads will ensure savings in vehicle operating costs and will increase revenue earnings of the State by way of quick movement of farm products.

9.21 The development of coastal region is the most essential component in the marine fisheries and ports sector policy initiatives of the state. The State of Kerala provides 19% of the total marine product exports of the country. There is one major port and 17 non major ports in the state to facilitate coastal development. In addition there are 13 fishing harbours and 15 fish landing centers. Therefore, for facilitating achievement of optimal multi modal transport and logistics inter nodal chain connectivity development and providing special maintenance package for coastal roads is the most important necessity.

We would urge the Commission to enhance the grants for maintenance of roads and bridges by 25 per cent over the award of the Thirteenth FC.

9.22 **Maintenance of Irrigation Works:** Most of the irrigation projects were completed in the sixties and seventies. These projects require maintenance for their head works as well as canal systems. Three projects-Malampuzha, Kanhirapuzha and Chitturpuzha received AIBP assistance for ERM and the work has been completed. Water use efficiency is given thrust in the 12th Five Year Plan. Therefore, an earnest attempt to modernize the canal as well as head works of the projects is given top priority by the State. The proposal envisages modernizing the distribution system of selected projects through digital controls and monitoring, taking up special repairs to prevent loss of water due to leakage, reforming deformed canal sections, lining the entire canal system, and regenerating waterlogged lands etc.

9.23 The role of minor irrigation occupies a prominent position in the Irrigation map of Kerala, due to its advantages over the other types of Irrigation. Minor irrigation schemes are intended for irrigating command areas under 2000 hectares by way of diversion of water from rivers and channels and also by effecting proper drainage by constructing sidewalls, sluices, crossbars etc.The cumulative physical achievement of 281,866 hectares (net) has been achieved until the XIth plan period (2007-2012) by execution of minor irrigation schemes in the State. Further, ayacut of around 15,000

hectares is proposed to be created during 2012-13 to 2014-15. Regular maintenance of minor irrigation schemes is necessary for improving and maintaining the total ayacut in the State.(See Annexure for details)

Proposal during the award period:

A. Maintenance of Major & Medium Irrigation schemes	**: Rs.300 crore**
B. Maintenance of Minor Irrigation schemes	**: Rs.150crore**
Total	**: Rs.450crore**

9.24 **Inland Waterways:** The total length of Inland waterway in the state is about 1687 km. The main arterial waterway in the state is the West Coast Canal (W C C), which connects Neeleswaram in the north to Kovalam in the south. As part of a programme for developing the water ways in the country, a portion of WCC from Kollam to Kottappuram (168 km) and Champakkara and Udyogamandal canals were declared as National Water way No: III (NW III). Now, the canal from Kovalam to Kollam and Kottappuram to Neeleswaram is being developed for the movement of bulk carriages and passenger transport.

9.25 State Government is utilizing the award under XIII Finance Commission for developing the waterways. However, this work has to be continued to make the entire West Coast Canal navigable. As the waterways were left unused, several structures like bridges have come up across the canals, over the past several years, without sufficient clearances for water transport. Re-construction of these structures is being done in several stretches in a phased manner to make the canal navigable. **A length of 237Km is to be covered during the 14thFinance Commission award period to complete the work, the proposed cost is, Rs.151 crore**(See Annexure for details).

9.26 **Protection of the Coast:** Out of the total coastal length of 560Km, the length which is vulnerable to erosion and which requires protection is 478.14 Km as assessed by the Directorate of Central Water Commission and Coastal Erosion Studies, Kerala. Out of the total of 331.80 Km of existing sea wall, reformation is required at different locations. The length which needs new seawall is 118.22 Km., out of which a length of 30 Km needs immediate protection and is proposed for the construction of new seawall. The maintenance and reformation works of sea walls also require urgent attention, failing which the newly formed and existing sea walls will get totally damaged

by severity of waves during the monsoon. A length of 40 Km is proposed for reformation work. Also, the maintenance of seawall constructed under the Twelfth Finance Commission and Tsunami Rehabilitation Programme has to be done at least once in every two years. A length of 41 Km is proposed for the maintenance work. **The total cost of these works is Rs 455 crore.**

9.27 **Conservation of Water:** The average annual rainfall in Kerala is 3070mm. As most of the rainfall occurs in a short period, and as the terrain is very steep, the runoffis very high. About 2/3 of runoff water directly flows into the sea, and 1/3 is used for various purposes. It is obvious that the lion's share of runoff water is not used. If this water could be stored or diverted and recharged, to increase the ground water storage, the acute scarcity of water during the summer season could be reduced considerably.

9.28 Many of the tanks are now in a damaged condition with heavy silting, slippage of sides, vegetation, broken steps, accumulation of waste, and improper maintenance and management, and encroachment. The coverage area is much reduced and the capacity of the tanks/ ponds is greatly reduced.Strengthening of surrounding walls by providing retaining structures wherever necessary, replacement/repair of sluices, desilting, providing field canals etc can supplement the irrigation facilities and increase the irrigation potential. Paucity of funds is the main constraint to accomplish the maintenance works. The Government has made some efforts to renovate the tanks and ponds in the State. However, only a small number could be covered. Funds made available during the XIII Finance Commission award has been utilized well and the results are promising. **Proposed outlay expected during the award period is Rs.200 crore.**

9.29 **Construction of Mini Reservoirs and Check Dams to Conserve Water:** Studies have revealed that mini reservoirs can be built in at least four of the West flowing reservoirs, taking advantage of the bank height and topography of the area. These mini reservoirs can store water and can be let off through the river course itself and small tanks/storage facility can be created near agricultural areas on the downstream. This would also ensure minimum environment flow during lean season, facilitating eco preservation. Kerala Government has already undertaken a project to construct check dams at ideal locations in all the 44 rivers of the State to conserve water and assure

environment flow and ground water recharge to rejuvenate the river system. However, more check dams are required for effective water conservation. It is proposed to take up construction of 4 numbers of mini reservoirs and 25 check dams. **Expected outlay during the award period is Rs.155crore** (See Annexure for details).

9.30 **Comprehensive Plan for the Upliftment of Vulnerable Adivasi Groups:** Kerala reports high human development index but there is considerable variation among social groups and adivasis are at the low end. The Government has been making a concerted effort for their upliftment. Government of India has allotted Rs. 148 crore for the overall development of five Particularly Vulnerable Tribal Groups, namely Kattunaikan, Cholanaikan, Kadar, Kurumbar, and Koraga. The period of implementation is from 2011-12 to 2014-15. An amount of Rs. 73.97 crores has already been expended by the end of 2013 and the balance will be expended before March 2015.Houselessness, protection from wild animals, reducing alcoholism, lack of road access are still the major problems faced by them. A comprehensive plan has been drawn up to change this situationat **an estimated outlay of Rs.445.08 crores**. We request the Commission to consider this case (See Annexure for details)

9.31 **The National Food Security Act, 2013:** The Act mandates creation and maintenance of scientific storage facilities at the State, District and Block levels sufficient to accommodate food grains required under Targeted Public Distribution System (TPDS)and other food related welfare schemes. As on date the intermediary storage space is only 0.39 lakh MT and ideally it is necessary to have storage space for three months' supplies, additional storage space needs to be created **at a cost of Rs 320.62 crore**.

9.32 The State Governments is implementing computerization of TPDS on top priority basis in a time bound manner. For achieving end to end computerization of TPDS, the Department of Food and Civil Supplies has identified four key components- digitized beneficiary database, supply chain management, sale of TPDS commodities with proper identification, and transparency and grievance redressal mechanism- the implementation of which would cost Rs 193 crore. The Act mandates door to door delivery of foodgrains with a recurring cost of Rs 256.18 crore. **The financial requirement**

for creating additional storage, computerization and door to door supply during the Fourteenth Finance Commission award period would be Rs 1794.52 crore(See Annexure for details).

9.33 **Fisheries:** The fisheries sector of the State is an important contributor to the export economy of India. But the fishing community is one of the most marginalized communities being resident of the coastal zone with all its uncertainties and restrictions. Two important problems have attracted our attention but yet remained unsolved: proper housing for the fisherfolk and post-harvest infrastructure.A project ensuring safe dwelling to the landless fishermen of the state has been conceived. Construction cost for individual houses and flats along with land acquisition cost are included in the project. **Rs.360 crore is required for providing individual safe dwelling home to the 6000 landless and homeless fisher folk families of the State**.

9.34 One of the long standing problems in the fisheries sector is wastage of caught fish to the tune of 20-30%. The challenge is to transform the waste into an opportunity by ensuring proper storage, handling and distribution and exploring the possibility for value addition, thereby increasing the income of fisher folk and augmenting the availability of nutritional food to the fish eaters. Proper storage of fish can be ensured by issuing insulated boxes to the fishermen, establishing plant for the production of clean ice (free from microorganisms), and constructing cold storages at the fish landing centres. Fish spoilage during transportation can be minimized through the use of insulated trucks. **An amount of Rs.50 crore will be required for addressing these issues**(See Annexure for details).

9.35 **The Health Sector:** Kerala is known for high health achievements but recent years have thrown up major challenges in the areas of communicable diseases with higher incidence of water and vector borne diseases. Emergence/re-emergence of communicable diseases, including Dengue fever, Leptospirosis and Chikungunia have also been reported from many parts of the State. With the ageing population higher prevalence of non-communicable diseases like diabetes, hypertension and cancer further complicate the epidemiological scenario of the State. Similarly, higher prevalence of mental illnesses, suicides, road traffic accidents and resultant trauma care necessitate a different frame of public health interventions in the state.

9.36 Recognising the importance of the problem the XIII Finance Commission supported the department for strengthening the diagnostic facilities, trauma care centres, bio medical management and for providing elderly health care services. Effective utilisation of these schemes is being done for strengthening the health services and for providing better patient care. Sustainable efforts are to be made in this area and it is in this context that the following schemes are proposed for financial assistance.

A. Strengthening the secondary health care services in Kerala: Rs 645 crore.
B. Developing a Public Health protection Agency: Rs 155 crore.

9.37 Medical education has to be transformed to equip the doctors to face the new challenges. An effort has been made during the last five years. Directorate of Medical Education, Government of Kerala was beneficiary of the Thirteenth Finance Commission award in which the focus areas were development of Trauma care, setting up of Geriatric Departments, improvement of Diagnostic Facilities and Bio waste Management. An amount of Rs. 73.75 Crores was allocated between 2011- 2015 (four year period). The support has been extremely useful in developing the infrastructure of all the Government Medical Colleges in the State. Continued support by the XIV Finance Commission will help to develop other focus areas and priority has been given to Non Communicable Diseases – Cardiac and Diabetic Care, Cancer Care - setting up of Mini RCCs, Quality and Patient Safety (health promotion initiatives) including the setting up of Skills lab and Faculty Improvement programme. **The estimated cost of all the initiatives mentioned above: Rs 545 crore.**

9.38 Kerala is one of the largest per capita drug consumers of a wide spectra of allopathic drugs exceeding a turnover of Rupees 6000 crore per annum. But Kerala has only one Drugs Testing Laboratory (DTL) at Thiruvananthapuram under the Drugs Control Department. This has been found totally inadequate. In the circumstances, the State Government has proposed to set up three more Drugs Testing Laboratories at Thrissur, Kozhikode and Pathanamthitta. **The estimated cost is, Rs 100 crore** (See Annexure for details).

9.39 **State Disability Initiative:** To achieve the development prospects envisaged in the 2015 Millennium Development Goals, it is necessary to empower people living with disabilities and to remove their barriers and their

marginalization. This requires focused intervention through awareness creation and training on the part of health workers, doctors, teachers and parents. The acute shortage of specialized rehabilitation professionals and other support staff also has to be addressed. The initiatives called for in this area will require financial interventions that are beyond the capacity of the State. These interventions call for special grants under Article 275 for support from the Fourteenth Finance Commission for State Initiative on Disability.

9.40 The Government of Kerala is planning the following intervention strategies during the next five years: Prevention of Disability through awareness programmes; vaccinations; vitamin supplements; developmental screening and early detection at birth by health workers; medical officers, mothers, etc. Early intervention by establishing Early Intervention Centres, by formation of mobile teams for early detection and intervention, providing assistive aids and equipment, education support and capacity building programmes, employment and separate skill improvement training centre for the persons with disabilities, rehabilitation measures, accessibility by providing barrier-free physical and psychological environment at all levels.

9.41 The State is planning a project, **Assisted Living for Adults with Disabilities** that focuses on enabling adults with disabilities to live within the community with minimal assistance. The project will be implemented through identified NGOs from the State selected as per the NGO policy approved by the Government of Kerala. The building for this purpose will be provided by the LSGD/NGO. In the first phase, there will be one house per community development block that accommodates a maximum of 10 adults with disabilities. **The two projects together are estimated to cost Rs. 454.24 crore**(See Annexure for details).

9.42 **National University for Disabilities and Rehabilitation Sciences**: India has a significant proportion of population with various disabilities who need to be integrated into the mainstream society. Efforts towards this are being made with India’s participation in the UN Convention on the Rights of Persons with Disabilities. These efforts require massive human resources trained with the skill sets necessary to address the issue of disabilities ranging from prevention of disabilities, early detection and screening, early intervention, to education and research. Traditional Universities focus on a variety of courses and

research that are considered attractive in terms of income potential and career advancement in the market place. Special Education, Rehabilitation and Disability studies do not come in the forefront of human resource development needs in the market place and hence needs to be addressed separately in a focused mode. Given the complexities and the scale of efforts required, only an institution of the status of a University can help address the problems of the disabled.

9.43 Over the past 16 years National Institute of Speech and Hearing (NISH) has acquired significant domain knowledge and competencies in the area of detection and diagnosis, intervention and education, rehabilitation and integration of hearing impaired population. NISH has the unique status of an institution that has the expertise to conduct all three aspects – professional preparation, education and research. Transforming NISH into a University is the natural process of growth to have greater impact and wider reach in serving India's population segment with disabilities. The four important goals of the University shall be:

- Higher Education for the person with disabilities;
- Preparing professionals with the appropriate skill sets to address the challenges facing the disabled;
- Undertaking applied research relating to disabilities and integration;
- Rehabilitation studies to help the process of integration

The financial requirement of the University to set up infrastructure and operate for the first five years **is estimated as Rs. 188 crore.** (See Annexure for details).

9.44 **Elder Care in the State:** The State today has one of the lowest population growth rates in India. A paper on the unique ageing scenario in Kerala estimates that the size of the population in the age group of 60 years and above in the State is expected to increase from 33 lakh in 2001 to 57 lakh in 2021 and to 120 lakh in 2061. Living in old age homes has also become common among the elderly in Kerala. As per the Kerala Aging Survey done in 2009, Kerala topped the country with 204 old age homes, and one out of every five old age institutions in India is located in the state. Kerala's longer life span (74 for men and 78 for women against an average of 68 for men and women in India) implies that the old live longer with morbidity.

9.45 The State Government's revised Policy on Senior Citizens, declared in 2012, envisages a number of programmes for its senior citizens. As part of the unique response strategy, the first project is the VAYOMITHRAM PROJECT – which provides free medical consultation and check up, free medicines, Palliative care through mobile clinic for bed-ridden patients and Help desk to elderly, eye camp, and entertainment programmes at old age homes. The project is implemented with the support of Municipality/Corporation. This has been started in Kerala in 25 municipalities and this year nine more are to be started. The project has received very encouraging responses from the elderly population. Total number of beneficiaries has been 99,732.

The proposal seeks funds for extending the Vayomithram project to 60 Municipalities and 152 Block Panchayats of the State. Expenditure envisaged (on account of salary, medicine, office, vehicle) is Rs 169.60 crore (See Annexure for details).

9.46 **e- Governance and IT Services**: Kerala has made rapid progress in the field of e-Governance over the years. Kerala has been in the fore-front of setting up of the core IT infrastructure much before the National e-Governance Plan was formulated by the Government of India. Kerala has two State Data Centres, Kerala State Wide Area Network (KSWAN) covering 3100 offices and 2300 Akshaya Common Service Centres covering length and breadth of Kerala. Government of Kerala is determined to take the IT initiative forward by digitizing all the government offices, transforming them into paperless offices using electronic file systems and ensuring electronic citizen service delivery. To enable this, Government of Kerala is committed to strengthen Network super highways with high speed bandwidth within all the districts of Kerala. Government of Kerala shall be implementing "e-Office" software of NIC in all its government offices – State Secretariat, Directorates, Collectorates, RDO offices, Taluk offices and other District offices. Kerala will be setting up the e-Office with 100,000 users for the entire state in the State Data Centre. **The e-Office implementation would require an estimate of Rs. 50 crore** for training and deployment, apart from the recurring network costs. The implementation agency shall be Kerala State IT Mission and the development partner will be NIC.

9.47 **Networking Kerala**: National Knowledge Network (NKN) and National Optical Fibre Network (NOFN) are two important projects of Government of India. However, it has to be integrated to the state network to fully utilize the bandwidth potential and to give seamless connectivity till the last mile. This is intended to be done using the NKN-KSWAN integration and NOFN last mile connectivity. **An amount of Rs. 112 crore is needed to execute both the projects** for providing high-quality bandwidth for the entire state of Kerala.

9.48 **e-Citizen Services of various Departments:** Government of Kerala has enacted Right to Service Act to ensure timely services to the citizens. The main focus of e-Governance applications and computerization of departments is the electronic citizen service delivery. There are many services of various departments which are still given manually even though computerization is done at various levels. Many departments of state governments have developed their own software to provide services to citizens. This multitude of sites offering services is making the life of the Citizen miserable as he is required to go from one web-site to another to avail different services. Service Plus of NIC attempts to address these issues by providing a single, unified, metadata-based portal to citizen and government alike where any service can be defined, accessed, delivered and monitored. Government of Kerala has decided that the services numbering around 500 under Right to Service Act will mandatorily be given electronically. To implement the same, the Government of Kerala would be requiring Rs. 50 crore for total implementation of 500 services (See Annexure for details).

9.49 **Taking Care of the Migrant Workers:** It is a fact the Indian growth trajectory of recent decades, though impressive and rapid, leaves behind some concerns to policy makers for at least two reasons: the rapid urbanization which goes hand - in- hand with the growth story and the large intra – state as well as inter – state migration. The level of urbanization is reported to be higher in states with high GDP growth and the two together acts as a catalyzing pull factor attracting large scale migrant labourers, mostly non - permanent. Provision of public services for this large work force is a responsibility of the host State. This is a factor aggravating the cost disability.

9.50 The Commission needs to take note of labour migration because of its regional dimensions. The percentage of households sending migrant labourers

is high for Bihar, Orissa, Uttar Pradesh and some other states. These migrants are received by Gujarat, Maharashtra, Karnataka, Andhra Pradesh and Kerala. As these are large numbers (the estimate for Kerala at 2.5 million is about eight per cent of the state's population, as per the study conducted by Gulati Institute of Finance and Taxation), some compensation mechanism needs to be worked out.

9.51 Kerala needs to provide decent sanitation and health facility to the migrant labour who have become the State's wealth creators. Kerala already has the Interstate Migrant Workmen (Regulation of Employment and Conditions of Service) Act 1979. But it requires a huge machinery to enforce this legislation in view of the scattered nature of their work and living. The Kerala Government has a scheme titled Inter State Migration Workers Welfare Scheme which is implemented through the Kerala Construction Workers Welfare Fund Board. Kerala has initiated a registration for the migrant labour to reach them some form of social security. There is an attempt to provide them health care services. We urge the Finance Commission to grant Rs 150 crore for providing shelter, sanitation and health care for the migrant labour.

9.52 **Tourism**: Tourism in Kerala is growing at a sustainable pace bringing earnings of over Rs 21,000 crore a year. The number of domestic and international visitors is increasing at over 8% every year, and in 2012, the total number of tourists who came to God's own country crossed 100 lakhs. Kerala leads other Indian states in many innovative initiatives in the tourism sector. A latest example is the Muziris Heritage Project. Muziris, a small port town near Kodungalloor was the capital of spice trade in the past. There are more than 20 heritage sites in and around Muziris which have remnants of Kerala's connections with Europe highlighting the legacy of spice trade. The Government is launching an international tourism project named 'Spice Route' centering Muziris heritage sites and connecting the 31 countries through which spices were traded from Kerala to Europe. The project is the first of its kind international project taken up by any tourism board in the country. This project, connecting history, culture, heritage and lives of millions of people around the world would result in more research, communal harmony, exchange of thought and culture, and will cement many bilateral/multilateral connections. State/ Central funding is available for some of the infrastructure for the project. But, national and international marketing and research for the

Spice Route project requires considerable financing, and it is requested **that an amount of Rs 200 crore be made available.**

9.53 Kerala focuses on responsible and sustainable tourism. The Government has launched and implemented a responsible tourism project for the state, to ensure that destinations/ hotels/ resorts are responsible to the society and environment. Tourism will grow sustainably only if the society is benefitted with the tourism growth. The responsible tourism campaign that the department is implementing resulted in declaration of Kumarakom as the first responsible tourism destination in the country. Of the 17 hotels in Kumarakom 14 are in the responsible tourism classification scheme. With active involvement of women self-help groups, Gram Panchayats, community and Tourism Department, the concept of responsible tourism is expanding to other places too. Financial assistance is requested for expansion and implementation of responsible tourism in the state. **An assistance of Rs 100 crore is requested**.

9.54 **Youth Affairs and Sports**: Kerala has been able to carve a niche for itself in the field of sports, thanks to the achievements of its talented sportspersons, who fighting the odds have been able to bring glory to both the State and the country. But the findings of the State Sports Commission, appointed in 2008, had established that growth of sports in Kerala could be sustained only with proper investment in building sufficient infrastructure across its 14 districts. Kerala's decision to host the 35th National Games in 2008- now likely to be held during the end of next year owing to the delay in holding the 34th National games- was with a view to boost the facilities in the State. The Games are to be held across seven districts of the State – Thiruvananthapuram, Kollam, Alappuzha, Kochi, Thrissur, Kozhikode and Kannur – where construction activity in 24 identified locations either have been completed or are nearing completion. A separate programme for the people of non-National Games districts -Pathanamthitta, Kottayam, Idukki, Palakkad, Malappuram, Wayanad and Kasaragod – to establish new sporting infrastructure or for upgrading the existing infrastructure suitably has been drawn up. **An assistance of Rs. 185 crore is requested**.

9.55 **Heritage Conservation:** Like the preservation of natural heritage, the preservation of the cultural heritage is also a major issue. Some states are sensitive to this issue whereas others are not. In a situation of rapid changes in

land use pattern some of our cultural heritage sites have already been lost and others are in the process of disappearing. The XIII Finance Commission had made a beginning by recommending grants for the preservation of cultural heritage sites of some of the states on request. This is a good beginning and we submit that this be continued.

9.56 The XIII Finance Commission made grants on request of states. The purpose of grants varied from specific activities such as the Nalanda Heritage Development Plan in Bihar to general activities like protecting the large number of monuments and buildings reflecting the State's heritage in Karnataka. It also included activities like survey, research and documentation. The amount allocated too varied from Rs. 10 crores to Arunachal Pradesh to Rs. 175 crores to Madhya Pradesh. There was no allocation for a number of states in the absence of requests. As is evident, the requests from states are not based on comparable criteria or an assessment of the need. Hence it is our submission that the allocations made for heritage conservation be founded on a proper base.

9.57 Preservation of cultural heritage is a common good. Many states with poor fiscal capacity but with large number of heritage sites might not have the resources to preserve them all. Our submission is that the Finance Commission is duty bound to support the states' efforts in the conservation of heritage sites. We submit that the Commission create a Fund for this purpose and frame rules of allocation.

9.58 **Agriculture:** The agriculture scenario of Kerala is unique and different from the rest of the country, characterised by a rich diversity of crops and multiplicity of cropping and farming situations. Kerala agriculture has been declining but still a sizeable proportion of the rural population is dependent on it. The State has a substantial share in the plantation crops of rubber, tea, coffee and cardamom. These four crops together occupy 7.02 lakh hectares accounting for 34.40 per cent of the net cropped area in the state. With the aim of overall productivity improvement and income generation, the following programmes are being implemented: Fallow land cultivation; Waste management through bio degradation; Promotion of integrated farm models; Promotion of tubers as an alternative to cereals or augmenting food security; Establishment of bio pesticide lab; Soil testing and bio fertilizer lab; Improving

marketing of agriculture produce; and Development of farms. The **schemes are estimated to cost Rs 387.1 crore.**

9.59 **Revenue**: As part of implementation of the State's policy of 'One Village one Panchayat' 30 new villages have been formed in the State. Adopting a model of Smart Villages construction of one village office and a staff quarter is envisaged in each village costing Rs 2 crore. The construction of buildings (Mini Civil stations) for the newly created 12 Taluk offices at the rate of Rs.15 croreper Taluk office is also required. The total outlay is Rs. 240 crore.

9.60 **Nurturing Innovation and fostering entrepreneurship in the youth of Kerala:** Jobs that are socially, economically and environmentally sustainable is a challenge of the 21st century. The Kerala IT Policy 2012 lays down specific growth directives for the creation of 3000 start ups in the state by 2020. The Government of Kerala, with its Technology Incubator in Technopark, TBI, has successfully promoted entrepreneurship in the state in the past 6 years by incubating close to 200 companies, thus creating 4500 jobs and generating annual revenue of around Rs. 150 Crore. Start-up Village, a new technology incubator in PPP model established in March 2012 has successfully incubated over 150 start-ups, including product start-ups, within a short span of time and receiving more than 1000 applications for start-up assistance within the first six months. The Government of Kerala's strategy for entrepreneurial development and innovation is a two tier process. Tier 1 which involves a set of educational programmes aimed at the creation of a talent pipeline in schools and colleges across the state. Tier 2 which involves support to young entrepreneurs in the form of infrastructure creation, funding, mentor support, creating market access.

9.61 As part of infrastructure creation, Government of Kerala with the help of Department of Science and Technology has already started the construction of the 3.75 lakh sqft Technology Innovation Zone in 13.2 acres of land, which will have individual incubators in various sectors like agriculture, IT/ITES, mobile communication, electronics, traditional industries etc. To achieve the vision of 3000 startups from the state by 2020, the Government of Kerala is setting up a Seed Support Scheme which will provide financial support to young enterprising entrepreneurs.

In total, an amount of Rs. 500 Crore is required for implementation of the Tier-1 and Tier-2 programmes aimed at nurturing Innovation and fostering entrepreneurship in the youth of Kerala.

9.62 **Infrastructure creation at IT Parks:** The State Government envisages expansion of the IT industry in the state with a hub and spoke model that benefits all districts. Thiruvananthapuram, Kochi and Kozhikode will act as hubs and the remaining districts will act as its spokes. Such a development model is possible as the highly skilled human resources are available throughout the State. As Kerala is a fully wired-up State internet connectivity is available everywhere. Currently, around 1200 acres of land is available with the IT Department in the various IT Parks in the State. Activities are under progress, though in a small way, for the creation of requisite infrastructure in these IT parks. However due to financial constraints, infrastructure development in the IT parks is not proceeding in the desired pace. The Government proposes to create basic infrastructure including road access, water, electricity and sewage in the upcoming IT Parks in the State as well addition of infrastructure in the existing ones. **An amount of Rs. 500 crore is required for creation of infrastructure at the various IT Parks.**

9.63 **Modernization of Manufacturing Public Sector Undertakings (PSU)**: There are about 40 manufacturing PSUs in Kerala functioning under the Industries Department. These encompass sectors like engineering, chemical, electrical equipment manufacturing, electronics, textiles, ceramics & refractories, and wood & agro based units. Most of these PSUs were commissioned during the1960's and early 70's, and had contributed immensely to the manufacturing sector of the State. However, investment in modernising them has been slack, and are still operating with out-dated technology, plant & machinery and manufacturing processes. The manufacturing PSUs also provide employment to around 50,000 persons. Hence, to improve the productivity and make them competitive, it is essential to modernise these PSU's and convert them into viable, self-sustaining entities. An amount of Rs.500 crore may be provided for this purpose.

9.64 **Strengthening and sustaining traditional sector Industries:** A very large segment of workers in the State is employed in the traditional industries, mainly coir, handloom and cashew. As regards the cashew sector, Kerala has a

long tradition both in cultivation and nut processing. The production of raw cashew nuts in the State has always shown an upward trend, constituting around 11% of the total cashew production in the country. These traditional industries need to be strengthened through introduction of technologies to reduce drudgery and increase the productivity of labour. Efforts need to be made for higher value addition to realise better prices. This involves modernising and diversifying production, ensuring adequate supply of raw material and strengthening marketing. An amount of Rs.250 Crore may be provided for strengthening the traditional industrial sector of the State.

9.65 **Coir Industry**: Coir industry is an agro based export and employment oriented traditional industry of Kerala. It is next only to agriculture in terms of employment. Only ten per cent of coir workers are employed in fully mechanised units, thirty per cent in partially mechanised and the rest in non-mechanised units. The key capability that must be developed for the global and domestic competitiveness of the industry is through focussing on standardisation and quality. The three components of coir industry in Kerala are the fibre, yarn and product sectors, the controlled mechanisation with effective measures to transfer technology will enhance the standard of living of workers. The immediate intervention envisaged is that of modernising the de-fibering, coir spinning, weaving and training programmes. The total outlay for the purpose is Rs 52 crore.

9.66 **Industrial infrastructure creation**: The National Manufacturing Zone of the Kochi –Palakkad belt is about to take off which calls for infrastructure building. Similar is the case with the petrochemical industrial area around the Kochi refinery, which is expanding its refining capacity by 70%, creating scope for many downstream units. Government is also promoting manufacture of electronic hardware in different industrial parks. The SSI sector continues to have a high rate of growth in the State which needs to be given a boost.

9.67 To fulfil the infrastructure requirements of the growing segments of industry we need to construct several standard design factories, provide utilities such as power, water, sanitation and effluent disposal. Government is also promoting development of industry and trade near the airports, which would require construction of roads and other infrastructure. We seek an assistance of Rs 500 crore for development of industrial infrastructure.

9.68 **Modernisation of Fire and Rescue Services**: Kerala is undergoing transformation with massive urbanization and modernization in the housing and industrial infrastructure. The fire and rescue services required to meet the demands of a changing environment is large. It is essential to modernize the functioning of the department by upgrading equipment for fire- fighting and rescue operations and by training the personnel in modern techniques. We seek assistance from the Commission for equipping the department. The projected demand for funds is Rs 212 crore.

9.69 **Fire and Rescue Services Academy**: The department does not have sufficient training facilities. The firemen are still being given basic training in the Kerala Police Academy. The Fire and Rescue Services Academy needs to be strengthened and equipped with modern facilities to enable the department to carry out fire-fighting and rescue services efficiently. There is a need for constructing a barrack building with all the facilities for the accommodation of minimum 300 trainees as the present facility for their accommodation is not sufficient. The academy possesses only limited number of equipment and appliances. Appliances and equipment are being shifted from various Fire & Rescue Stations on temporary basis for the purpose of training of trainees adversely affecting the normal functioning of Stations. The Academy requires all the advanced equipment and vehicles for demonstration and practical training purpose. The estimated cost is Rs 13 crore.

9.70 **Renewal Energy Initiatives:** The State government has formulated a project, under which the roof area and surrounding space in tribal and poor urban colonies will be utilized to generate grid tied solar energy to ensure affordable energy availability to the people in such locale. The day time generation from these solar plants will be exported without storage to the utility grid to be banked with, and the same will be imported for consumption during the night. However it is realised that, more than 35% of the targeted households do not have roofs with sufficient strength to hold solar panels. Hence, provision of proper roofs wherever needed, shall also form part of the scheme. This scheme shall be framed as a community participative program with the community having some role to play in the management of the plant. It shall act as a driver in further penetration of solar energy through better awareness in the society and shall also address the issue of power thefts and pilferage of plant components. The tribal colonies in the Western Ghats and

the urban poor colonies in the district headquarters, together covering 12,000 dwellings are targeted under this scheme. **A total solar PV capacity of 35 MW at a total cost of Rs. 400 crore**, including the cost of strengthening the roofs of houses is proposed.

9.71 **Coastal Shipping Development**: Nature has provided Kerala with a long coastline of about 580 km which harbors one major port and 17 minor ports. There is an elaborate system of inland canal system as well. From time immemorial, coastal shipping was a major means of transport in this part of the country. But with the ascendency of road transport, with its speed and convenience, coastal shipping declined but with the rising cost of fuel and increasing vehicle pollution it has again become relevant. It is in this background that the State has undertaken an ambitious coastal shipping promotion project. A deep sea port, ten non major ports, two cruise terminals and a marina area under construction/renovation are being proposed. The water transport of goods is sought to be encouraged by subsidizing greener and safer water transport. A vessel construction subsidy scheme is also under consideration. Further, coastal shipping promotion revolving fund for implementing the above scheme is proposed. The constitution of maritime board is in the final stage.

An assistance of Rs 300 crore for creating a Coastal Shipping promotion fund and Rs 893 crore for the development of port infrastructure are sought. A separate request for the ambitious Deep Sea Vizhinjam project is also submitted.

9.72 **Vizhinjam International Deep Water Multipurpose Seaport:** Shipping is the backbone of any globalised economy and Government of India is giving a lot of importance to port development. Yet 40% of Indian transhipment cargos are handled by Colombo Port. If we have to attract cargo, then we have to build ports of high standard in the southern tip of the nation. The best site feasible for (this purpose) is Vizhinjam located near Trivandrum, the capital city of Kerala. Vizhinjam is located close to the international sea route and Southern West tip of India, protruding into the Indian Ocean. The project received Environment Impact Assessment clearance from the Ministry of Environment and Forests in December, 2013 and the State Government is planning to issue tender documents for the Breakwater construction and for

the selection of Public Private Partner. Since this project is very crucial for the infrastructure development of the nation, **an amount of Rs.1500Crore may be provided as assistance**.

9.73 **Mitigation of Man- Animal Conflict**: Crop destruction, killing of human beings and cattle by wild animals in forest fringes is a serious problem in the State. The high density of population has led to the forest fringes being inhabited a large number leading to serious man-animal conflicts. Wild animals, especially elephants, boars, deer, porcupine etc., frequently cause destruction to life and property necessitating payment of compensation. Agitated public often turn against the forest department officials adversely affecting conservation activities. Relocation and rehabilitation of people living in settlements inside forests, construction of barriers such as solar power fences, rubble walls etc are the methods to reduce the conflicts. Paucity of fund is a major constraint for taking up mitigation measures. We seek assistance to take up schemes for resettlement and putting up fencing and barricades with an outlay of Rs 213 crore (For details see Annexure).

Chapter 10
Local Self Governments

10.1 Recent decades have shown that decentralised form of governance, *inter alia*, deepens democracy and provides efficient delivery of local public goods. As a result, more and more political, fiscal and administrative responsibilities are being devolved on the local units of government. There has also been a realization that fiscal decentralisation can help mobilise resources by introducing local solutions and promoting equitable growth by mainstreaming the poor in development—thus enmeshing welfare and development concerns together and making the process of governance more participatory. India too moved in that direction amending the constitution to institute local governments. By giving a legal status to the rural (Panchayat) and urban (Municipal) local bodies it aimed to enable them to function as effective democratic self-government institutions. This ensured people's participation in local level planning and enabled them to be part of the development process. The effective functioning of local governments was, however, subject to the devolution of larger functions, funds and functionaries.

10.2 The last two decades have seen the enactment of Conformity Acts by all the States. Elections are being held regularly; State Finance Commissions have been constituted and many states have accepted the recommendations of the Commissions. Large number of functions has been devolved on the local bodies. Finances and functionaries are also being devolved. In addition to the provision of civic services, the local bodies have increasingly taken up agency functions of Central and State Governments for the implementation of Centrally Sponsored Schemes.

10.3 Kerala transferred almost all functions enumerated in the amendment Acts of the Constitution. These include primary and secondary health, pre-primary, primary and secondary education, basic technical education, nutrition security, social security and welfare, poverty reduction, women and child development, connectivity other than major district roads and highways, water supply, agriculture development and social justice. Funds matching the expenditure responsibilities have been devolved that too largely untied. Staff

have been transferred to discharge the functions devolved; but their cadre control rested with the Line Departments. Local Governments have full freedom in supervising their function, reviewing performance and imposing minor penalties wherever required. Independent institutions, such as Ombudsman, Appellate Tribunal and performance audit, have been set up to bring about accountability while reducing executive control over local governments.

10.4 The local governments in Kerala- Grama Panchayats, Municipalities and Corporations- have very strong own tax domains consisting of property tax, profession tax, entertainment tax and advertisement tax. As regards own resource mobilisation, Kerala stands at the top collecting over three times the all- States average at over Rs 100 per capita. Only Goa, Haryana, Maharashtra and Meghalaya rank above Kerala[4].Kerala has set up four State Finance Commissions which have submitted their reports. Most of the recommendations were accepted and implemented in full and the recommended proportion of the state finance is devolved on the local governments. In recent years, Kerala has been transferring funds to local governments under three streams – Development Fund, Maintenance Fund and General Purpose Fund. Development Fund could be expended on activities of their choice for the social and economic development of the people of the locality. Maintenance Fund has to be spent for the maintenance of the assets under the administrative control of the local governments. General Purpose Fund is generally meant for meeting the establishment expenses of local governments.

10.5 The Fourth State Finance Commission, the recommendations of which were operationalized from 1 April, 2011, recommended the transfer of 3.5% of State's own tax revenue to the local governments as general purpose fund and 5.5% as maintenance fund. In the case of Development Fund, the Commission recommended 25% of the State Plan Fund to the local governments which should be gradually increased to 30% by 2015-16. The amount transferred to the local governments under the three streams mentioned above during the last five years is presented in Table 10.1. The funds transferred under the three streams are totally investible and are practically untied. Further, unlike in

[4]Alok, V. N. Strengthening of Panchayats in India: Comparing Devolution across States: Empirical Assessment 2012-13, The Indian Institute of Public Administration, New Delhi.

most other States, salaries and pensions of transferred staff like Teachers, Doctors, Engineers, etc. are paid directly by Government and do not constitute a charge on the transferred resources.

Table 10.1. Resources Transferred to the Local Bodies, 2008-09 to 2012-13 (Rs crore)

Year	Development Fund	Maintenance Fund	General Purpose Fund
2008-09	1670.24	397.51	363.98
2009-10	1842.29	448.05	399.31
2010-11	2097.87	440.55	440.44
2011-12	2549.30	713.94	643.19
2012-13	3070.42	1039.44	759.54
2013-14	3988.62	1387.04	900.15

Table 10.2. Devolution Formulae Adopted by the State Finance Commission

Criteria	Weights (%)			
	Gram Panchayat	BP Panchayat	DP Panchayat	Urban Local Bodies
Population (Excluding SC/ST)	50	50	50	50
Deprivation Index	30	30	30	30
Tax effort	10	-	-	10
Area	10	20	20	10

10.6 The amount transferred to the local bodies is governed by a formula with weightage for backwardness ensuring fairness and equity (Table 10.2). Transparency in the transfer is ensured by indicating Local Government wise allocation in a separate Budget Document – Appendix IV of the Budget presented to the Legislature. The smoothness of the fund flow is ensured by following the Government order issued in 2006. Development Fund and Maintenance Fund are transferred in ten equal monthly instalments and General Purpose Fund in 12 equal monthly instalments at the beginning of every month. The funds transferred are non-lapsable.

10.7 The larger fund devolution and the participatory planning followed by the local bodies have resulted in creditable outcomes in terms of reduction of poverty and the provision of public services. The Multi – Dimensional Poverty Index (MDPI) constructed in terms of lack of access to education, health and other basic services has shown a remarkable reduction in the recent past in the State. For instance, the Adjusted Headcount Ratio for the state of Kerala indicating the percentage deprivation in terms of the MPI indicators is 0.136

being the third lowest among the States in 1999 which fell to 0.038 by 2006, which is the lowest (Alkire and Seth[5], 2013). Similar is the case with the Multi – dimensional Headcount Ratio too. This is especially noteworthy for a state like Kerala where the deprivation levels were comparably low by the 1990s and it is generally difficult to bring it down further. Population Census, 2011 confirms the findings of Alkire and Seth as the state of Kerala is reported to have the largest proportion of households with latrines and *pucca* houses. These achievements are largely attributable to the experience of the past two decades of decentralization ensuring local planning and people's participation. The achievements of Kerala in the provision of public services indicate that resources transferred to the local governments are more efficiently spent as they yield better results. This links up with ToR 9 which explicitly states the need to link outlays to outputs and outcomes:

"The Commission may review the present Public Expenditure Management systems in place including the budgeting and accounting standards and practices; the existing system of classification of receipts and expenditure; ***linking outlays to outputs and outcomes****; best practices within the country and internationally, and make appropriate recommendations thereon."*

The mechanism of efficient public expenditure management needs to be viewed in a broader sense including decentralized governance. Hence our submission is that more resources be devolved to the local governments for better public expenditure management.

10.8 The experience of Kerala shows that decentralization involves additional costs. Though the personnel working in the Departments are transferred along with the responsibilities, new technical posts had to be created to cater to the requirements of local governments. A separate Engineering Wing was created for servicing the requirements of local governments and their cost is met entirely by the Government, the annual cost being Rs 116.80 crore. The supporting institutions like Kerala Institute of Local Administration (KILA), Information Kerala Mission (During the current year a budget provision is made for Rs.7 crores as assistance to Information Kerala Mission), etc. have to be strengthened to provide necessary support to the local governments.

[5] Sabina Alkireand Suman Seth, Multidimensional Poverty Reduction in India between 1999 and 2006: Where and How? OPHI Working Paper No. 60, March 2013

Additional staff had to be recruited and trained and also infrastructure had to be created which has resulted in additional salary burden.

10.9 In the coming years the Information Kerala Mission will have to be converted into a permanent organization from the mission mode so that it can give continued support to the local governments in their computerization activities. The expenditure in this regard may increase many fold as a result of this. Due to the transfer of huge sums to the local governments, proper upkeep of accounts became unavoidable. In all the Grama Panchayats and Block Panchayats a separate cadre of accountants was created. Along with it additional posts of clerical and supervisory cadre were created- 864 Assistant Secretaries 1988 Lower Division clerks and 999 Accountants were appointed in the Grama Panchayats - involving an annual cost of Rs 79.06 crore.

10.10 Seats are reserved on rotation basis for women, scheduled castes and scheduled tribes in the election to the local governments. Large number of new faces gets elected to these posts, who require intensive training for capacity building to enable them to carry out their functions as elected representatives. In the same way the capacity of the staff of the local governments has to be built to handle the additional responsibilities. Every year sizable sum is spent by the Government through KILA for capacity building. Annual expenditure in this regard is Rs 25 crore. In order to strengthen the GramaSabha, KILA has appointed paid volunteers called GramaSabha Facilitators. Their training and honorarium is also met by the Government. Annual expenditure in this regard is Rs 3.6 crore.

10.11 The X Finance Commission felt obliged to make recommendations regarding measures to augment the Consolidated Funds of the States for the purpose of empowering the local governments, despite the absence of references to it in its Terms of Reference. It could only recommend *ad hoc* grants in the absence of State Finance Commission Reports. Since then the ToRs of Finance Commissions has specific reference to local bodies and they have all made recommendations for grants. The X Finance Commission recommended aggregate grant of Rs. 5380.93 crore representing 1.38 per cent of the divisible pool; the XI Finance Commission recommended a grant of Rs.10,000 crore representing 0.78 per cent of the divisible pool as estimated by them; the next Commission recommended Rs.25,000 crore (1.24 per cent of

the divisible pool); and the XIII Finance Commission recommended Rs. 87500 crore (2.28 per cent of the divisible pool).

10.12 The XIII Finance Commission recommended a split in the grant into two components – a basic component and a performance based component. The basic grant was equivalent to 1.50 per cent of the previous year's divisible pool to which all the states have access to. The performance grant, effective from 2011 – 12, of 0.50 per cent for 2011 – 12 and 1 per cent thereafter up to 2014 – 15, will become accessible to those States satisfying certain stipulations. The stipulations or conditions were nine, four to be met by the end of the fiscal year for the State to become eligible for the performance grant for the succeeding fiscal year. Kerala has received XIII Finance Commission Award in the form of General Basic Grant and General Performance Grant during the previous years as shown in Table 10. 3. The amount received was directly transferred to the accounts of the Local Governments through e-transfer as stipulated by the previous Commission.

Table 10. 3. XIII Finance Commission Award, Kerala (Rs crore)

Year	General Basic Grant	Performance Grant
2010-11	246.16	-
2011-12	315.34	148.07
2012-13	354.80	145.34

10.13 The view taken by the Finance Commission X to XIII is that the amount provided as Finance Commission Grants would be additional to the normal devolution by the State Governments. Same principle should be followed by the XIV Finance Commission also. The Commission need not stipulate the core services which it would support. The development areas where the Finance Commission Grant is to be utilized shall be left to the wisdom of the local governments. Splitting of the total grants into Basic Grant and Performance Grant by the XIII Finance Commission shall be followed as such by the XIV Finance Commission also.

10.14 The criteria and weightage for calculation of Basic Grant for Local Governments shall be as follows:

1.	Population	-	50
2.	Index of Devolution.	-	30
3.	Deprivation Index.	-	10
4.	Area.	-	5
5.	Revenue effort criteria.	-	5
	Total.	**-**	**100**

The release of Finance Commission Grants shall be monthly or quarterly.

10.15 Finance Commission may incentivise local governments by:

(i) Devolving more tax avenues;
(ii) Permitting levy of fees on infrastructures created from the Government funds;
(iii) Introducing Social Audit and strengthening of GramaSabha;
(iv) Computerisation of the functions of Panchayats.

10.16 The local bodies by providing basic services at the grass roots level have become the primary interface of the citizen's interaction with the government. They have also become the frontline implementing agencies of numerous Centrally Sponsored Schemes fulfilling their agency role. They face huge challenges as mentioned by the XIII Finance Commission: "We recognize the criticality of supporting all local bodies through adequate levels of devolution. They are increasingly being called upon to meet the challenges of environmental degradation, population pressure, exhaustion of resources and revenue constraints" (p.181, Report of the Thirteenth Finance Commission). The last four Finance Commissions have recognized the challenges faced by them, the principle of subsidiarity and made grants to the local bodies to empower them. The quantum of grants has steadily increased and has become 2.28 per cent of the divisible pool by the XIII Finance Commission. We urge this Commission to double it to about 5 per cent of the divisible pool.

10.17 There are special problems faced by the local bodies. Ten per cent of the Panchayaths and 20 Municipalities in Kerala are not able to meet their establishment expenses with their own income and the General Purpose Fund given to them. Their own resources are very limited due to their geographical remoteness, cultural backwardness and lack of sources to generate tax and non-tax revenue. Special assistance has to be provided to such local bodies to

take up income generating projects to enable them to stand on their own feet so that they may also become local governments in the true sense. **The Finance Commission may consider providing a grant of Rs.500 crore to these local bodies.**

Chapter11
Financing of Disaster Management

11.1 Natural disasters are events of nature which cause sudden disruptions to the normal life of a society. They also invariably cause damage to property and life to such an extent that normal social and economic mechanisms that are locally available to the society become inadequate to restore normalcy. Disaster management systems have to be put in place to face such eventualities. However, there is considerable variation in the natural disasters across the Indian States. While the Himalayan belt is prone to earth quakes and major land slides, the Eastern Coast is prone to cyclones. The State of Kerala is vulnerable to a number of natural calamities such as coastal erosion, floods, cloudbursts, droughts, lightning, landslides etc. with locational and geographical features contributing to them. Almost all the districts in the State are multi-hazard prone. Most of the 560 km coastline of Kerala is frequently subjected to coastal erosion of varying degrees. Disaster management systems should be able to take these variations into account to address the problems.

11.2 Disaster management occupies an important place in the State's policy framework as it is the poor and the under-privileged who are often the worst affected. A paradigm shift in the approach to disaster management from response to preparedness is necessary because investments in mitigation are 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 Finance Commission acknowledged that financing expenditure on relief was an unforeseen expenditure and may have a destabilizing impact on state finances. A margin money scheme was initiated envisaging setting apart by the States specific amount each year to meet the expenditure on relief. 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 (State Disaster Relief Fund and National Disaster Relief Fund). As per sub-section (1) of section 48 of the Disaster Management Act 2005, the State Government is required to establish the Disaster Response Fund and the Disaster Mitigation Fund at the level of the State and each District. After establishing these funds, the State Disaster Management

Authority and the District Authority will have to avail of sufficient funds for managing the various disasters.

11.3 At present, the Disaster Response Fund (DRF) meets the expenses of activities of natural calamity relief 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 insufficient given the occurrence and magnitude of the natural calamities in Kerala. The DRF earmarked for Kerala for the period 2005 - 2010 was of the order of Rs.472.42 crore out of which the Central contribution was Rs.354.32 crore; the amount was increased to Rs 724.3 crore (Central share of Rs 543.23 crore) during 2010-15, the award period of the Thirteenth Finance Commission. In real terms this marks hardly any increase. In per capita terms the allocations under the Calamity Relief Fund for the State of Kerala at Rs 149 and Rs 228 during the award periods of the Twelfth and Thirteenth Finance Commissions respectively are one of the lowest with only two other States placed below Kerala. As explained in the chapter on Ecology and Environment the burden of Kerala is not very small.

11.4 For a State like Kerala which faces multiple calamities almost every year, the corpus of the Fund is meagre. It is so small that there is hardly any money left for constituting the Response and Mitigation Funds at the level of the State and Districts. Hence, the funds available for relief activities need necessarily be enhanced considering the natural calamities frequently occurring in Kerala and the need for special attention to preventive and mitigating measures. In this backdrop, the State will urge the Commission to enhance the corpus of the SDRF by 30 per cent and also increase the contribution of the Centre to the Fund to 90 per cent. In the 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 the Response Fund and the Mitigation Fund at State and District levels.

11.5 The coast line of Kerala (~590 km) is one of the most densely populated land areas in the country. Sea erosion is one of the recurring natural hazards affecting the coastline in the State. Generally, it occurs as part of erosion -

accretion cycle. Coastal erosion results in the loss of life and property of the coastal fisher-population who are the most economically backward communities in the State. Every year several lives are lost due to the effects of the sea and hundreds of houses are damaged due to the fury of the sea. The affected families have to be accommodated in relief camps at a substantial cost to the exchequer.

11.6 **Capacity building fund for Disaster Management:** The State proposes to take up the following steps to manage disaster risk reduction. The capacity building grant in aid for the disaster management sector may continue with a 10% increase in the allocated amount. The State Government may also be given absolute freedom in deciding on the heads of allocation and preparing the financial utilization plan without any specific restrictions imposed.

11.7 **National Disaster Mitigation Fund:** As per the Disaster Management Act 2005, the State Governments were directed to establish State Disaster Mitigation Fund and District Disaster Mitigation Fund immediately after the notifications are issued. The Govt. of Kerala has constituted a State Disaster Mitigation Fund with its own meagre resources considering the directions in the DM Act 2005. However, it is unfortunate that the National Disaster Mitigation Fund is yet to be setup. Burden on the State Exchequer can be reduced substantially if appropriate financial provisions are made for disaster mitigation activities. Hence, the Government of Kerala requests the XIV Finance Commission for setting up a National Disaster Mitigation Fund similar to the National Disaster Response Fund and the fund may be shared in a manner similar to that of the NDRF.

11.8 The National Disaster Response Fund (NDRF) was set up with an initial corpus of Rs 500 crore on the recommendation of the Eleventh 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 rate of inflation of 8 percent may be added for each year since the constitution of the Fund to peg the corpus at Rs.1000 crore during the award period of the Thirteenth Finance Commission. The Commission may also recommend suitable measures to avoid delay in providing assistance by Centre from the NDRF to the needy States.

11.9 Lightning strikes cause heavy loss of lives in the State. Data on lightning damage in the State suggests that Kerala reports high incidence compared to other States. On an average, 183 such incidents occur every year in which 71 people die and 112 suffer injuries. The data were obtained from the Centre for Earth Sciences Studies, Thiruvananthapuram. Since this is not included in the list of natural disasters under calamity relief, neither ex gratia to the families affected nor assistance for loss of property can be given. Non-inclusion of coastal erosion and lightning as natural calamities entails a huge cost on the State to rehabilitate the victims. In the last 20 years 4000 deaths have occurred in the State due to lighting and coastal erosion, for which no financial assistance under calamity relief has been given. The State earnestly urges the Commission to recommend including sea erosion, lightning among natural calamities.

Chapter 12
Goods and Services Tax

12.1 A transformation of the indirect tax system at the level of the States in India was initiated with the implementation of value added tax (VAT) that resulted in some major gains in revenue collection. Kerala was one of the first States to move in the direction of inducting the system with major gains. However, some residual issues, vis-a-vis, compensation claims on VAT and CST as per the offers of the Central Government are yet to be honoured. In the case of Kerala, VAT compensation claim amounting to Rs.365.26 crores is still pending with the Government of India for release. In short, implementation of VAT has proved successful in reforming the indirect tax system of the State.

12.2 Goods and Services Tax (GST) is the next logical step towards comprehensive reform of the indirect tax system. This integrated Value Added Tax on Goods and Services is expected to eliminate the present system of cascading of tax in the manufacturing and distribution network, ensuring smooth transfer of input credit mechanism from the manufacturing stage right down to the last point of distribution mechanism, expanding the tax base and scaling up revenue resources of the State and the Centre resulting in the growth of the economy. The environment for the introduction of GST has been set up.

12.3 The Thirteenth Finance Commission appointed a task force, which comprehensively analysed all GST related issues and made a number of recommendations, outlying the design and modalities of a model GST law. The Empowered Committee of the State Finance Ministers carried forward the design of GST through consultative process among the States and the Centre. The Constitutional Amendment (115th) Bill was tabled in the Parliament in 2011 which was referred to the Parliamentary Standing Committee on Finance for detailed study and recommendations. After due deliberations the Standing Committee submitted its report (73rd report of Parliamentary Standing Committee on Finance) and based on the recommendation of the Committee, and the views of the member States, a revised Constitutional Amendment Bill was sent to the Empowered Committee for views, which is being deliberated by the Committee.

12.4 Kerala has all along supported the implementation of GST but there are certain issues of concern which need to be addressed on the revised draft Constitutional Amendment. By virtue of the amendments, the Central Government may get additional stream of revenue by imposing CGST on alcohol products. The States can also levy SGST and sales tax simultaneously on petroleum products and alcohol on intra-state sales. If the SGST is levied, in the case of inter-state transaction, input tax credit should be charged to these commodities which would result in revenue loss. If the present sales tax system is continued, no input tax credit is applicable and the revenue stream is protected. Also, if the present levy is divided and levied with SGST and sales tax, there could be revenue loss on the SGST components.

12.5 With regard to the States, the subsuming of alcohol and petrol under GST does not bring any benefit as with respect to prices of these sensitive products, the State Governments can only seek to protect the current revenue and cannot impose any additional burden on the consumers. The Central Government would get a vast revenue source by getting the power to impose CGST on alcohol products in addition to preserving the current taxation level. This trade-off is not in the interests of the States. Apart from this, there has been a clear understanding in the Empowered Committee that alcohol and petroleum products will be kept out of the purview of GST. Kerala has been advocating that exclusion of alcohol and petroleum products in GST should find a place in the Constitutional Amendment itself. Otherwise, by virtue of the Constitutional provisions, no extra Constitutional agreements in the Empowered Committee or the GST Council can alleviate disputes regarding these commodities, which are important for the revenue considerations of the State.

12.6 Kerala opposes the subsuming of betting and gambling in GST as it is an activity where taxation, regulation and prohibition converge and the States should retain the powers in controlling the same with regard to the conditions prevailing in the respective States.

12.7 We are of the view that the principles of determination as to when a supply of goods and services takes place in the course of interstate trade or commerce should be based on the destination principle. We suggest that the proviso to this effect is to be incorporated in the newly inserted Article 269A

whereby it shall be mandated that the guiding principle of such determination shall be that the tax shall accrue to the State where the ultimate consumer is located.

12.8 The newly inserted Article 246A, along with Entries 92D in the Union List and 54A in the State List, deleting the operation of Article 246, would be against the concept of federalism envisaged in the basic structure of the Constitution. This aspect needs to be examined and the possibility of reference to Hon'ble Supreme Court under Article 143 within the ambit of advisory jurisdiction may be explored.

12.9 We also suggested that the net proceeds of IGST should be assigned to the State in a manner as may be prescribed by the President by order after considering the recommendation of the Finance Commission and appropriate amendments be made in Article 270 in the Amendment Bill.

12.10 We also suggest that the provision for declared goods, as per Article 286(3) be deleted. In this context, it may be pointed out that the Empowered Committee had come out with the first discussion paper on GST in 2009. In view of the major improvements and significant policy perspectives that have emerged, it is an opportune time for a second discussion paper with a specific roadmap which is to be drafted to include the details on Constitutional Amendments, GST Design, IGST mechanism, IT infrastructure, critical issues relating to the GST compensation mechanism and its dispensation modalities.

12.11 The States are not in a position to quantify the exact revenue implications of GST for the following reasons:

First of all the Central Government has not been playing a pro-active role in providing reliable data to the State to calculate revenue benefits of services. Kerala has indicated its reservation about the methodology adopted by NIPFP (National Institute of Public Finance & Policy) projecting revenue neutral rate of 6% whereas the Gulati Institute of Finance and Taxation, Thiruvananthapuram has calculated the same as roughly about 15.5% during the year 2011-12. Further, the presence of large number of small scale service providers, peculiar to Kerala, has also its impact in the generation of tax revenue. The State specific RNR can be arrived at authentically only if the State specific service tax collection is fully disclosed by the Centre, which is not

forthcoming till now. Further, the issue of RNR is also referred to one of the Sub Committees of the Empowered Committee and the report is still awaited.

12.12 Another critical issue in this regard is the place of supply rules, which is yet to be finalized. The place of supply rules will essentially determine the place of supply and consequently the place of taxation. This has got vital implication with respect to telecommunication sector, financial sector, works contracts etc having inter-state ramifications.

12.13 IGST mechanism is also under consideration of one of the sub committees of the Empowered Committee which is entrusted with the design of the system for transfer of IGST, with its financial implications. Apart from the above, the details of Dual Control Mechanism, threshold level for taxation, the negative list of services, the list of exempted items etc are still under the consideration of the Empowered Committee. A clear picture on the revenue implications on implementation of GST can be formulated after the above issues are firmed up and model GST law framed.

12.14 We suggest that unlike VAT compensation system, there should be a structured compensation mechanism in GST. There should be clear guidelines and institutional mechanism, under the aegis of Empowered Committee and Government of India to disburse the GST compensation at least for a minimum period of 5 years. This issue has to be viewed in the backdrop of the experience of the State with respect to the compensation for VAT. Arbitrary grant of Rs.50,000 crores for GST compensation of the States as recommended by the Thirteenth Finance Commission may have to be replaced by a system of built in compensation package based on definite parameters. While deciding the compensation package the net revenue growth rate of 25% need be protected.

12.15 Apart from this, until the specifics of the Constitutional Amendments, GST compensation, IGST mechanism, exemption list of goods and services etc are clearly delineated, it is not possible to quantify the exact amount under the terms of revenue flows and make confident projections. The inability of the State Government to quantify the exact quantum of compensation in the transition to GST needs to be comprehended by the Fourteenth Finance Commission during allocation of grants/resources.

ANNEXURE

Summary of outlays of items proposed under State specific needs

Sl. No.	Item	Outlay proposed (Rs Crore)
1	**REGISTRATION**	
	i. The project for Integration with Revenue and Survey Departments for online mutation.	10.00
	ii. E-Stamping for deed Registration	5.00
	iii. Digitization of legacy records	250.00
	iv. Modernization of Record Rooms	45.00
	TOTAL	**310.00**
2	**POLICE DEPARTMENT**	
	i. Community Police Resource Centres	9.00
	ii. Construction of Dormitories	16.80
	iii. Security Embankments & Surveillance Systems	26.50
	iv. Cyber Dome- A Cyber Research and Development Centre	10.00
	v. Non Conventional Green Building Project	58.50
	vi. Community Oriented Policing System	11.50
	vii. Student Police Cadet Centre	20.00
	viii. State Police Response & Rescue System	10.70
	ix. District Training Centre Project	6.25
	x. Coastal Security Training Facility	1.00
	xi. Police Computer and Monitoring Centre	5.00
	xii. Cyber Forensic Training School *	30.65
	xiii. Ariel Crowd Management System	3.00
	xiv. Town Agglomeration CCTV Project	50.00
	TOTAL	**258.90**

3	**PRISONS**	
	i. Improving the conditions of the inmates	
	• Installation of solar energy devices	100.00
	• Installation of solar water heaters	5.00
	• Providing cots to all prisoners	5.00
	• Sanitation, Sewage, Health care & Hygenic Improvement	15.00
	• Improved Medical facilities in Jail Hospitals	5.00
	• Biogas Plants in Jails	5.00
	• Installation of Rainwater Harvesting Systems	10.00
	ii. Improving the security of prisons	45.00
	TOTAL (I+II)	**190.00**
4	**MAINTENANCE OF IRRIGATION WORKS**	
	i. Maintenance and Special Repairs to Major Medium and Minor Irrigation Projects	**450.00**
	ii. Modernization of Inland Waterways	**151.00**
	iii. Coastal Zone Management	**455.00**
	iv. Conservation of Water	**200.00**
	v. Construction of Mini Reservoirs and Check Dams to conserve Water.	**155.00**
	TOTAL	**1411.00**
5	**COMPREHENSIVE PLAN FOR THE UPLIFTMENT OF VULNERABLE ADIVASI GROUPS**	
	Development of backward Scheduled Tribe Communities	**445.08**
6	**NATIONAL FOOD SECURITY ACT 2013**	
	Creating Additional Storage Facility, Computerisation ,Door to door supply of food grains	**1794.52**
7	**FISHERIES SECTOR**	
	Safe Dwelling to Landless & Homeless fisher folk	360.00
	Scientific Preservation of fish(Proper storage, cold storages, insulated trucks etc.)	50.00
	TOTAL	**410.00**

8	**HEALTH SECTOR**	
	i. Strengthening the secondary Health care services of Kerala	645.00
	ii. Developing a Public Health Protection Agency for Kerala	155.00
	iii. Drugs testing laboratory under Drugs Control Dept.	100.00
	iv. Non Communicable Diseases- Cardiac & Diabetic Care, Cancer Care-Setting up of Mini RCCs, Quality and Patient Safety	545.00
	TOTAL	**1445.00**
9	**STATE DISABILITY INITIATIVE**	
	State Initiative on Disabilities	360.00
	Assisted Living Adults with Disabilities	94.24
	TOTAL	**454.24**
10	**NATIONAL UNIVERSITY FOR DISABILITIES & REHABILITATION SCIENCES**	
	National university for disabilities & rehabilitation sciences	188.00
11	**ELDER CARE IN THE STATE**	
	The proposal seeks funds for extending the Vayomithram project to 60 Municipalities and 152 Block Panchayats of the State. Expenditure envisaged (on account of salary, medicine, office, vehicle)	**Rs.169.60**
12	**E-CITIZEN SERVICES OF VARIOUS DEPARTMENTS**	
	E-citizen services of various departments	50.00
13	**Mitigation of Man - Animal Conflict**	**213.00**

Glossary

ARM	Additional Resource Mobilisation
BMC	Biodiversity Management Committee
CGST	Central Goods and Services Tax
CSO	Central Statistical Organisation
CSS	Centrally Sponsored Scheme
SDRF	State Disaster Response Fund
DTL	Drugs Testing Laboratory
EIA	Environment Impact Assessment
ESA	Ecologically Sensitive Area
FD	Fiscal Deficit
FRBM Act	Fiscal Responsibility & Budget Management Act
GDP	Gross Domestic Product
GFD	Gross Fiscal Deficit
GSDP	Gross State Domestic Product
HFE	Horizontal Fiscal Equalization
HLWG	High Level Working Group
KILA	Kerala Institute of Local Administration
LI	Lift Irrigation
MDR	Major District Road
MoEF	Ministry of Environment and Forests
MDPI	Multi - Dimensional Poverty Index
MTFP	Medium Term Fiscal Policy
NDRF	National Disaster Relief Fund
NGO	Non- Government Organisation
NL	Net Lending
NPRD	Non-Plan Revenue Deficit
NPRE	Non- Plan Revenue Expenditure
OMB	Open Market Borrowing
PAs	Protected Areas
PBR	People's Biodiversity Register
PCGSDP	Per Capita Gross State Domestic Product
PEC	Primary Environment Care
RCC	Regional Cancer Centre
RD	Revenue Deficit

RR	Revenue Receipt
SFC	State Finance Commission
SGST	State Goods and Services Tax
SRO	Sub Registry Office
TFR	Total Fertility Rate
ToR	Terms of Reference
TPDS	Targeted Public Distribution System
TRR	Total Revenue Receipt
VAT	Value Added Tax
WCC	West Coast Canal
WGEEP	Western Ghats Ecology Expert Panel
WHS	World Heritage Sites