ADMINISTRATIVE REFORMS COMMISSION

GOVERNMENT OF KERALA

TWELFTH REPORT

Finance and Planning

REFORMS IN FINANCIAL MANAGEMENT AND PLANNING

FEBRUARY 2021

In Association With
Centre for Development Studies, Thiruvananthapuram.

Foreword

Ensuring economic and social justice to people is the primary concern of governments all over the world and is done through proper utilisation of resources raised from taxes and other sources of public finance. Proper and efficient management of financial resources is a prerequisite for governments to fulfill its obligations to the people. Resource generation, resource allocation and expenditure management (resource utilisation) are basic tenets of public financial management system. Financial management is a core function of Government. Reforms in the Financial sector is essential to generate positive impulses in other sectors. It will assist Government to revisit its priorities and ensure clarity of vision in adoption of programmes and policies, demystify perceptions about financial controls and promote responsible attitudes and behavior.

Historical evidence points to the existence of administrative system and financial management in ancient civilisations. It is from the Mauryan period that administration evolved concretely in India and 'Arthashastra' of Kautilya highlights the importance of public finance. Arthashastra states that all activities in the state depend on finances and primary attention should be given to state treasury, which form the vital part of economic activity of the state. Inscriptions and literature of the Gupta period, one of the most prominent dynasties in post Mauryan period lays stress on financial management and project a picture of healthy economic conditions built on the traditional norms of taxation and building up of strong treasury for the protection and welfare of the people.

Based on the 'Terms of Reference' (ToR) of the Commission and the approach paper delineating areas of study, ARC selected 'Finance and Planning' as one of the studies. Finance and planning are complementary processes which constitute two main pillars of Financial Management and is pivotal to governance and any change/reform of governance structures. The two sectors need to work in tandem for prudent allocation of resources resulting in creation of assets providing maximum benefits to the people and lead to financial stability, economic progress and all-round development of the state. Currently the huge investments made in programmes, projects and infrastructure are not translating into accelerated growth of the state. The report aims to recommend measures for adoption by government for improving economy of the state leading to social and economic development of the state.

Kerala has shown reasonable revenue growth over a period of time in line with national growth rate and States' GSDP growth rate. However, expenditure growth rate, especially for welfare projects and subsidies has seen 15 - 16 percent growth compared to 10 percent growth in revenue and 11 percent growth in GSDP (nominal terms) over the last 6-7 years, causing imbalance in the budget. A gap of around Rs. 15000 crores between revenue and expenditure in the budget has forced government to impose 'ways and means' restrictions leading to cuts in budgetary expenditure of Plan and Non Plan.

Committed liability of unfinished schemes gets carried over to succeeding financial years, adding more pressure on the limited resources available. Decision of Government of India to include public account borrowings through TSB to calculate State's borrowing limit at 3 percent of GSDP has restricted the borrowing power of the state. Thus, the restriction on borrowing, lower growth rate, launching of new schemes necessitating additional expenditure etc. has led to serious financial constraints to the state.A reasonable balance between inflow and outflow of funds needs to be ensured to maintain stability and sustain economic development.Issues arising from gap in the budget needs to be addressed as soon as the gap arise.Revenue projection needs to be realistic and expenditure planned methodically to create a strong economy, which ensures social and economic justice to the people.

The report recommends measures to increase revenue of the state, preparation of a more realistic budget, budget reforms, management of debt and rationalisation of expenditure, change of approach in planning and project management process, importance of outcome budgeting and social audit etc. The report is prepared in association with Centre for Development Studies (CDS), Thiruvananthapuram and with the assistance of persons with expertise and practical experience in Finance and Planning. I thank all who partnered in preparation of this report and made valuable contributions in conceiving the spirit of the report.

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28.01.2021
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CONTENTS

Abbreviations		
List of Tables		
List of Figures		
Executive Summary		1
Introduction		7
Chapter 1	Non-Tax Revenue	11
Chapter 2	Tax Revenue	29
Chapter 3	Preparation and Execution of Budget	45
Chapter 4	Rationalization of Expenditure and Debt Management	89
Chapter 5	Outcome Budget	103
Chapter 6	Planning Process in Kerala	110
Chapter 7	Project Planning and Implementation	124
Chapter 8	Mid-Term Review of Projects	143
Chapter 9	Social Audit	146
Chapter 10	Revisit of Codes and Manuals& Delegation of Financial Powers	152
	Annexure I	163
	Annexure II	189
	Annexure III	210
	Appendices	265
	References	279

ABBREVIATIONS

SONTR..States' Own Non Tax Revenue

CAG...Comptroller and Auditor General

KPERC...Kerala Public Expenditure Review Committee

NLRMP..National Land Records Modernisation Programme

KMSCL.. Kerala Medical Services Corporation Ltd.

CPSE..Central Public Sector Enterprises

MoU...Memorandum of Understanding

PPP...Public Private Partnership

ICT...Information and Communication Technology

GST...Goods and Services Tax

SGST...State Goods and Services Tax

IGST..Integrated Goods and Services Tax

GSTN...Goods and Services Tax Network

VAT..Value Added Tax

IMFL...India Manufactured Foreign Liqour

DITII...................................... State Directorate of Direct Taxes Intelligence and Investigation

MIS...Management Information System

IMF..International Monetary Fund

EBF...Extra Budgetary Finance

FRBMA... Fiscal Responsibility and Budget Management Act

GSDP.. Gross State Domestic Product

PSU...Public Sector Undertaking

ARM...Additional Resource Mobilisation

UNCDF...United Nations Capital Development Fund

NCAER...National Council of Applied Economic Research

OECD...Organisation for Economic Co-operation and Development

SDG...Sustainable Development Goals

PERT...Programme Evaluation Review Technique

CPM...Critical Path Method

ULB..Urban Local Bodies

PRI..Panchayat Raj Institutions

JV...Joint Venture

TP..Town Planning

TDR...Transfer of Development Rights

CRZ..Coastal Regulation Zone

MTR...Mid-Term Review

MGNREGS.........................Mahatma Gandhi National Rural Employment Guarantee Scheme

NGO..Non Government Organisation

KFC...Kerala Financial Code

KBM...Kerala Budget Manual

KTC...Kerala Treasury Code.

LIST OF TABLES

Table	Title	Page No
Table 1	Balance of Current Revenue (BCR)	50
Table 2	Miscellaneous Capital Receipts (MCR)	51
Table 3	Size Estimate of Annual Plan	51
Table 4	Budget Variance Summary (in percent)	52
Table 5	Budget Variance Analysis (as no. of years showing deviation)	55
Table 6	Percent Variation in accounts/Budget estimates	59
Table 7	Voted portion of SDG for the period 2018-19	60
Table 8	IT Apps controlled by Finance Department	76
Table 9	Item wise share of major Items of Expenditure	80
	Annexures	
Table 3.1	Potential weaknesses in Budget preparation	214
Table 3.2	Total Revenue receipts and growth of Revenue from different sources	251

LIST OF FIGURES

Figure	Title	Page No
	Annexures	
Figure 1.1	Average share of Non Tax Revenue to Total Revenue Receipts in Kerala	170
Figure 1.2	Pattern of Composition of Revenue in terms of GSDP	171
Figure 1.3	Trends in the composition of NTR in terms of GSDP	171
Figure 1.4	Composition of SONTR in Kerala over years	172
Figure 1.5	Composition of components within General Service	174
Figure 1.6	Share of Gross and Net Lottery Revenue to SONTR	175
Figure 1.7	Composition of components within social services	178
Figure 1.8	Composition of components within economic service	181
Figure 3.1	Revenue Performance of Kerala	235
Figure 3.2	Gross Fiscal deficit as percentage of total expenditure and GSDP	235
Figure 3.3(a)	Receipts, Expenditure-Interest and primary balance	236
Figure 3.3(b)	Kerala Primary Balance	236
Figure 3.4	Overall Financial State Burden of the State	238
Figure 3.5	Public Sector Return on Capital Return on Equity to state	239
Figure 3.6	Public Debt-year wise	240
Figure 3.7	Annual percentage rate of growth in debt	241
Figure 3.8	Public Debt Burden of the state	242
Figure 3.9	Debt to GDP ratio	242

Figure 3.10	Public Debt own tax ratio	243
Figure 3.10(a)	Maturity profile of outstanding state government securities	244
Figure 3.11	Return on Investment GOK	247
Figure 3.12	Pattern of total expenditure and capital expenditure	247
Figure 3.12(a)	Capital expenditure as percentage of total expenditure	248
Figure 3.13	Growth rate of Total expn., Capital expn. and Interest expn.	248
Figure 3.14	Total Revenue receipts and Revenue expn. as percentage of GSDP	249
Figure 3.15	Outcome based accountability	259

“Finance is not mere arithmetic;
Finance is a great policy; without sound
Finance no sound Government is possible:
and without sound Government no
sound Finance is possible.”

-James Wilson

EXECUTIVE SUMMARY

Finance and planning are complementary processes which need to work in tandem for prudent allocation of resources resulting in creation of assets providing maximum benefits to the people and lead to financial stability, economic progress and all round development. Collection of sufficient resources from the economy in an appropriate manner along with allocating and use of these resources efficiently and effectively constitute good Financial Management. Resource generation, resource allocation and expenditure management (resource utilization) are the essential components of a public Financial Management System. Attempt has been made in this study to identify possible avenues to increase revenue of the state, methods for preparation of a more realistic budget and its reforms, methods for rationalisation of expenditure and debt management, review present planning and project management process etc. The importance of outcome budgeting and relevance of social audit is also looked into. As a part of improving the efficiency of administrative matters in departments and to promote the speedy disposal of files, an attempt has been made in the area of Revision of Codal Provisions and Delegation of Financial Powers also. Chapter wise details are summarized below:

Chapter 1 - Non-Tax Revenue

Fiscal structure of an economy is based mainly on the revenue it collects and expenditure incurred. Since the state is a benevolent provider to the people, reducing public expenditure to reduce fiscal deficit will not be a right solution. So instead of reducing public expenditure focus needs to be in enhancing revenue receipts. Revenue receipts mainly come from two sources: tax revenue and non-tax revenue.

Division of Non-Tax revenue can be brought under two headings States' Own Non-Tax Revenue (SONTR) and Grants from centre. The state can raise its Non-tax revenue in variety of ways and mainly from six sources - 1. General Services; 2. Social Services; 3. Economic Services; 4. Fiscal Services; 5. Interest Receipts; 6. Dividends and Profits. It is observed that there is a shift in the contribution of non-tax revenue from economic services to general services during 1980 to 2018. General services emerged as a significant contributor to non-tax revenue in recent period due to introduction of the Karunya lottery and ban on selling lotteries from other states. Analysis indicates that expenditure is many times that of the revenue collected across all sources of non tax revenue - Economic, General and Social

services. Another important avenue that needs focus is reduction of fiscal burden due to non performing state owned enterprises using a mix of policy tools.

Regular maintenance of data records with the help of ICT by respective Departments related to non-tax revenue will help better governance and research. The study proposes conducting detailed surveys andsetting up of a Non-Tax Revenue Boardin order to examine the existing situation in various departments and thus exploring the possibility of eliminating inefficiencies and suggesting customized solution for mobilizing resources more effectively.

Chapter 2- Tax Revenue

This part covers structure of tax regime of the state and recommendations on improving tax revenue within the existing constraints. Tax Revenues include both Direct Taxes and Indirect Taxes.

Following observations are made in the analysis. There is not much of a scope to mobilise resources through Direct Tax Revenue. Therefore, resource mobilisation has to be explored through Indirect Taxes. Of the indirect taxes that the State of Kerala collects, the most prominent one is GST –both State GST (SGST) for intra-state trade and the State's share of Integrated GST (IGST) for inter –state trade. However, administrative reforms in respect of GST necessarily have to be restricted to administering of GST. There is maximum scope of revenue mobilization in GST through twin modes of strong Anti –Evasion (enforcement) measures to plug leakages of revenue and efficient audit of taxes paid, as reflected in Tax Returns and Tax Invoices. There is need for strong anti-evasion (enforcement) machinery that would work on development of strong human intelligence. The state may convert to model -2 states with full operationalisation of GSTN. Emphasis needs to be placed in having a modern Audit system as it is crucial in stopping leakages. Need of State **Directorate of Audit** for overseeing institutionalisation of a credible Audit System is also discussed.

Chapter 3 - Preparation and Execution of Budget

Fiscal discipline and financial propriety are basic principles that any government should aim at while formulating, implementing and monitoring the state budget.

The report recommends realistic preparation and presentation of the state budget, suggest measures for better performance and options to improve budgetary processes to arrive at transparent, efficient and realistic outlays and outcomes.

Avoiding ad-hoc, unplanned cuts in expenditures which create problems of reliability and deviations from budget principles is another recommendation. Excessive use of supplementary estimates causes difficulties, and usually indicates lack of budget discipline which has serious reflections on the economy and is an indication that budget preparation has been casual. It is also true that such exercises are not costless as they discourage effective expenditure planning and hence should be carried out with caution.

Chapter 4 - Rationalisation of Expenditure and Debt Management

Fiscal anatomy of the state carried out based on the accepted theoretical principles of public finance reveal structural deficiencies - high budgetary deficits, remarkably high public debt, unhealthy pattern of expenditure, limited resource base, excessive borrowings, no realistic attempt for resource generation and poorly focused and limited spending on Capital, combined with mounting liabilities resulting in unrewarding interest payments. Analysis shows that primary deficit of the state is negative, and its volume is continuously on the rise revealing a disturbing trend. Overall financial burden of the state - from budgetary sources and through public sector, is on the rise from 2010-11 onwards. Analysis of the working of the public sector undertakings needs to be carried out.

The state needs to have forecasts for its short term and long term borrowing and repayment calendar and monitor repayments of the public sector undertakings for which it stood guarantee. Government may venture into investments in public sector undertakings through equity participation, loans and guarantees, only after cost benefit analysis of each component of the projects.

State Government needs to take urgent measures to maximise tax collection through widening of tax base, plugging of tax leakages and scaling up tax compliance. Augmenting resources from Non-tax Revenue is another area which calls for focused attention from State Government. Efforts needs to be made for availing maximum central assistance for Centrally Sponsored Schemes by meticulously designing schemes in tune with the Government of India guidelines and through regular follow-up and timely submission of utilisation certificates etc.

Chapter 5 - Outcome Budget

Outcome Budget converts "outlays" into "outcome" by planning expenditure, fixing appropriate targets, quantifying deliverables in each scheme and bringing to the knowledge of all, "outcomes" of budget outlays provided for each scheme/programme. Outcome-based budgeting differs from traditional approaches as it focuses on results rather than input utilisation. Outcomes are harder to deliver than outputs and by their nature will be publicly communicated, requiring resolve from leaders to see the transition through. Two-way relationship between government and people is needed to make this work. Outcome based budgets is a necessity to put before people successes/ failures of government programmes/projects, and it is in sync with sustainable development goals of the UN.

Chapter 6 - Planning Process in Kerala

Kerala is the only State to continue planning process after it was discontinued by Central Government in 2015. Planning process as presently followed by Kerala consists of Five Year Plans and Annual Plan for each of the five years. A longer perspective of the sector is required to address critical needs of the economy. Universities and research institutions may be involved in the planning process. Departments and State Planning Board may guide universities and research institutes to study issues prevailing in the sector.

Plan proposals submitted by the departments often lack clarity and are not backed by adequate data. Proposals need to be made more concrete by clearly outlining objective, target, time period of implementation and mode of implementation. District Plans may be integrated with the State Plan and State Development Council needs to be strengthened.

Resource allocation needs to be flexible within the constraints of estimated resources. While preparing plans, the departments need to be sensitive about the cost of funds which they use. Present system of Working Group for Administrative Sanctions needs to be reviewed. Delegation of financial and administrative powers may also be suitably amended to speed up the implementation process. Single window monitoring system through Plan space needs to be encouraged. Capacity building in the planning board needs to be a priority.

Chapter 7 - Project Planning and Implementation

At present there is no mechanism to actively monitor projects and programmes at operational level. Monitoring is mostly done in terms of financial expenditure. Estimates and critical path of projects needs to be made accurately to avoid cost and time overrun which ultimately affect growth of the economy. Share of capital expenditure in both Plan and Non-Plan is noticeably small.

Effective "Management Information System" (MIS) is necessary for working out variances and taking corrective measures in implementation of projects. MIS should allow for "result based framework" of planning, reporting and oversight of departments. Bundling of projects, standardisation of format, design of meaningful query system etc., have to be part of the system. Government may consider public access to select items so that beneficiaries of funding can monitor and track their own projects/ other projects, and to improve accountability. Investments through PPPs and JVs needs to be experimented in lower order roads, smaller airports, sewerage and sanitation services etc.

To improve social value of government expenditure, a large part of which lies in gains in productive efficiency and consumer efficiency in the economy as a whole a more realistic approach need be taken in the selection and implementation of projects. Non - integrated investments have brought about ribbon-development along roads clobbering the value of internal land by blocking their access and congesting the road. To overcome these locational planning grids and near grid layouts needs to be considered. Land pooling and transfer of developmental rights can overcome current issues on road expansion. Land pooling can also be used to overcome issues associated with land acquisition, especially in getting land to expand public infrastructure in a densely populated economy.

For utilising the higher human capital development state needs to focus on investments in high technology and nonpolluting capital intensive sectors which generate higher employment potential. Planning department needs to create a model of growth for employment.

Government needs to review norms of coastal zone regulations and regulations on sand mining considering environmental control as well as development and socio-economic aspects of the state and take these up with Government of India.

Chapter 8 – Mid-Term Review of Projects

Mid-Term review is a comprehensive exercise generally held at project midpoint during which a project's original development objectives and likelihood of achieving them are reassessed. For effectiveness of the review planning wing in each department needs to be strengthened and a committee with members from Planning Board, officials from departments of finance and planning and subject experts in each field needs to be constituted in each department. Existing software application, "Plan Space" needs to be upgraded and integrated for mapping existing departmental resources and progressive physical data of ongoing projects by capturing actual images of a project with the help of Geo-tagging, GPS technology etc., for facilitating Midterm Review.

Chapter 9 - Social Audit.

Social audit refers to a legally mandated process where potential and existing beneficiaries evaluate implementation of a programme by comparing official records with ground realities. It is an audit conducted by the people; especially those affected by or are intended beneficiaries of the scheme being audited. It also examines whether money was spent properly and has made difference to peoples' lives. The report recommends need for adopting Social Audit in its letter and spirit.

Chapter 10 - Revisit of Codes and Manuals & Delegation of Financial Powers

Recommendations on revision of codes and manuals and delegation of financial powers for administrative convenience and to improve quality of service and speedy disposal of files is included in the chapter.

INTRODUCTION

Constant improvement in service delivery to provide quality service, on time to people based on their requirement is the primary responsibility of all government institutions. Government takes regular measures to fulfill this constitutional obligation. Apart from these governments institute various studies to accelerate the pace of reforms and bring in paradigm shift in governance structure enabling it to address challenges that emerge from rising aspirations of the people, and fast paced changes.

Government of Kerala constituted the 4th Administrative Reforms Commission (ARC) in August 2016, to recommend reforms in administration. ARC has taken up the study on "Finance and Planning" based on the "Terms of Reference" approved by State Government and 'Approach paper' adopted by the commission, delineating the areas of study.

In the present report, ARC has taken up study of Finance and Planning-complementary processes that needs to work in tandem to enable prudent allocation of resources, for creation of assets, achieving financial stability, economic progress and all-round development of the state. Financial management is a core function of government. Reforms in the financial sector are essential to generate positive impulses in other sectors and will assist government to revisit its priorities and ensure clarity of vision in adoption of programmes and policies. It will demystify perceptions about financial controls and promote responsible attitudes and behaviour. Reforms in this sector needs to move towards professional management from centralised control followed since the days of colonial rule leading to accelerated development of all sectors of the economy. ARC has reviewed the Existing rules/procedures followed in Finance and Planning Departments are reviewed in this study.

About the Report

In this report ARC has attempted to identify additional avenues to increase revenue of the state, methods for preparation of a more realistic budget and its reforms, rationalisation of expenditure and debt management, review of current planning and project management process etc. The importance of outcome budgeting and relevance of social audit is also looked into. As part of improving efficiency of administration and to promote speedy disposal of files, revision of Codes, delegation of financial authority, etc., is also examined.

Objectives

Budget is Government's most important economic policy tool to translate goals of government into plans to raise revenue, and for judicious devolution of resources to meet competing needs. Properly planned formulation and execution of budget is crucial for developing sustainable fiscal policies and economic growth. At present a system of incremental budgeting without any in-built provision for need analysis of budgetary allocations is followed by government. Gap between demand and supply of financial resources is constantly widening as rate of growth of expenditure exceeds rate growth of resources for meeting the expenditure resulting in inflated resource estimates and unmet targets. Committed liability towards unfinished schemes gets carried over to succeeding financial years, adding more pressure to the limited resources. Reasonable balance between inflow and outflow of funds needs to be ensured to maintain stability and robustness of economic development.

Revenue Receipts and Capital Receipts are the two streams of government resources. Revenue Receipts consist of state's own tax and non-tax revenue, share of central taxes and grant-in-aid from Government of India. Capital Receipts of the state include debt and non-debt receipts. Debt receipts consist of loans raised by the state from various sources (open market borrowings, loans from financial institutions etc.,) and loans received from Government of India. Non-debt receipts include Miscellaneous Capital Receipts and recoveries against loans advanced. Balance available in the Public Account after disbursements is also utilised by government to finance its deficit. Though the quantum of Revenue Receipts of the state has increased over the years, state's own receipts as a percentage of total receipts show a declining trend, more so in tax revenue. Share of central taxes and grants-in-aid is determined on the basis of recommendations of Central Finance Commission. Resource mobilisation by the state is assessed in terms of own tax and non-tax revenue. Post-GST states do not have room for manoeuvring tax rates, as the rates are decided by the GST Council in which role of Central Government is dominant. Downward revision of taxes and tax rates since introduction of GST has also affected state finances necessitating urgent measures to maximise tax collection through widening tax base, plugging tax leakages and scaling up tax compliance. Identification of new sources of non-

tax revenue, periodical revision/rationalisation of rates/user fees etc., are to be adopted to maximise resources from non-tax revenue sources.

Government enacted the Kerala Fiscal Responsibility Act, 2003, to ensure prudence and stability in fiscal management by progressive elimination of revenue deficit and sustainable management of debt, and greater transparency in fiscal operations of the government in tune with medium term fiscal policy of the State. Finance Commission has recommended a set of rules relating to fiscal targets and annual borrowing limits. As there are strict restrictions on borrowings, the state is compelled to meet its priorities with the limited resources available.

Kerala faces several issues in infrastructure development and provision of basic amenities to people. In many sectors the state lags behind in adoption of technological innovations. The annual plans focus mostly on fulfilling short-term and local needs. While this is necessary, importance of long-term plans aimed at accelerated development needs to be emphasised. This may entail an in-depth study of the conventional planning process and suggestion of reforms to evolve long term planning systems that have scientific basis, promote technology adoption and ensure ecological stability. The importance as well as relevance of Social audit is also examined in the study. Finally, as a part of improving the efficiency of administrative matters in departments and to promote speedy disposal of files, ARC has recommended reforms/changes/amendments to certain provisions in the Codes and on delegation of financial responsibilities/authority.
The study focuses on the following areas:

- Non-Tax- Revenue
- Tax Revenue
- Preparation and Execution of Budget
- Rationalisation of expenditure and Debt Management
- Outcome Budgeting
- Planning Process in Kerala
- Project Planning and implementation
- Mid-Term-Review of Projects
- Social Audit
- Revisit of Codes and Delegation of Financial Powers.

Methodology

Assistance of persons with expertise and practical experience in finance and planning was availed by the Commission in the study. Centre for Development Studies (CDS), Thiruvananthapuram assisted ARC in the study of specified areas/ topics.

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Secondary data from Handbook of Statistics on State Government Finances, Reserve Bank of India (RBI), annual studies of state finances published by the RBI, Budget documents and other documents of Government of Kerala and Handbook of Statistics on Indian Economy- RBI, are used in preparation of the report. Discussions were held with retired and serving Secretaries to Government, other senior officials of the state government and Finance Officers of Government Departments and various agencies of government, to obtain suggestions on changes required for effective implementation of schemes/projects. Websites of state and central government departments, national and international organisations relating to Finance and Planning were also reviewed periodically.

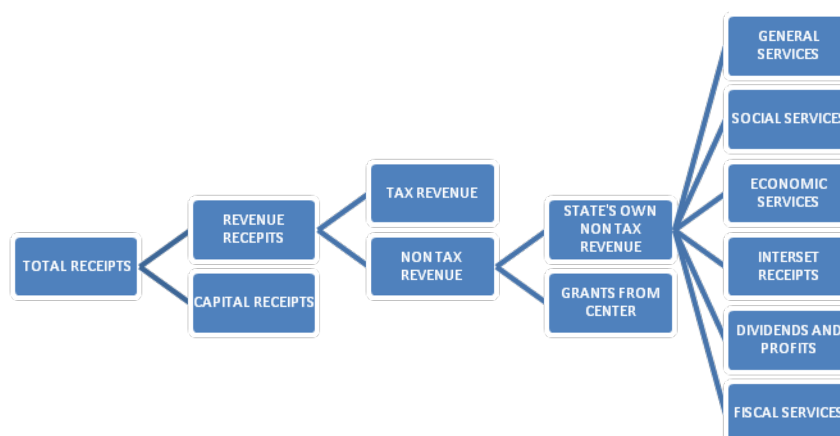
Chapter 1

NON- TAX REVENUE

1.1 Introduction

Fiscal structure of an economy is mainly based on the revenue it collects and the expenditure it incurs. Since a state, by its definition is a 'benevolent provider' of several public goods to the people, reducing public expenditure indiscriminately to reduce fiscal deficit at the risk of detrimentally affecting this role will clearly not be the right solution to achieve financial balance. Instead focus needs to be on enhancing revenue receipts. Revenue receipts are mainly from two sources: tax revenue and non-tax revenue. The report has attempted an analysis of potential sources of non-tax revenue. [Theoretical aspects are separately outlined in Annexure I]

Chart 1.1: Structure of Total Receipts of the State



1.2 States' Own Non-Tax Revenue

States' Own Non-Tax Revenue (SONTR) is the category of revenue which includes administrative receipts, profits of departmentally runs commercial undertakings, interest and dividend, receipts and royalties from mines and mineral concession fees etc. Non-Tax revenues is mainly from three sources (a) revenue from assets owned and managed by

government (b) revenue generated by government from sales of goods and services produced and managed by it, and (c) revenue from sale of licenses and permits to limited activities.

State raises its Non-tax revenue mainly from six sources, 1. General Services 2. Social Services 3. Economic Services 4. Fiscal Services 5. Interest Receipts 6. Dividends and Profits. The first three are non-tax revenue sources - General Services, Social Services, and Economic Services and is called administrative receipts of SONTR and constitutes the major portion of SONTR. Though administrative receipts contribute a major share to SONTR, the state can also collect non-tax revenue apart from administrative receipts from sources such as revenue from interest receipts and dividend and profits. Revenue from these two sources is also significant and should also augment the efficacy of that effort. Share of SONTR to total non-tax revenue is an indicator of the efficiency of government in raising its 'own non-tax revenue'.

States 'Own Non-Tax Revenue' is realised from resources owned by the state. A larger SONTR indicates more efficiency on the part of the government to raise revenue from non-tax sources. Administrative receipts and revenue earning resources under each of them is discussed below.

1. General Services

The revenue earned out of general services come from the following services provided by the state.

1. Public service Commission	2. Police
3. Jails	4. Stationery and Printing
5. Public Works Department	6. Supplies and disposals
7. Contributions and Recoveries towards Pension and Other Retirement Benefits	8. Other administrative sources
9.Miscellaneous General Services (including lotteries)	

2. Social Services

Social services provided by state governments come at a cost/charge – whether it is health, education, water supply etc. Revenue earned out of these sources is accounted under the non-tax revenue from social services.

Various components of social services are:

1. Education, Sports, Arts and Culture.	2. Medical and Public Health
3. Family Welfare	4. Water Supply and Sanitation
5. Housing	6. Urban Development
7. Information and Publicity	8. Labour and Employment
9. Social Security and Welfare	10. Other Social Services.

3. Economic Services

Economic Services include revenue earned from judicious exploitation of resources owned by government. Economic services are the major contributor of SONTR of most states.

Various resources contributing to revenue from economic services are:

1. Crop Husbandry	2. Animal husbandry
3. Dairy Development	4. Fisheries
5. Forestry and Wildlife	6. Co-operation
7. Other Agricultural and rural Programmes	8.Special Area programmes
9. Major and medium Irrigation	10. Minor Irrigation
11. Village and Small Industries	12. Industries
13. Nonferrous mining and Metallurgy	14. Roads and Bridges
15.Ports and Light houses	16. Tourism
17. Other Economic Services	

1.3 Major Components of General Services

1. Lotteries

Major contribution to general services is from lotteries. In the lottery policy of the state sale of other state lotteries was prohibited in Kerala and contributed to increase in revenue mobilisation from this source.[see Appendix 4].Empirical analysis reveals that revenue from lotteries increased steeply from a mere 3 percent to 78 percent of SONTR of Kerala during 1980 to 2018-19 [Appendix 5]. However, a reverse trend is expected due to policy changes on lotteries at the national level.

It can be noticed that there is a growing divergence between gross and net lottery revenues overtime, indicating burgeoning expenditure related to its administration. This expenditure arises mainly from a combination of social cost and economic cost. Social cost is from the expenditure incurred on social contribution of employment generation (including disabled persons) and using profit for medical services for the poor, especially cancer patients. Economic costs such as huge prize money for the lottery and administrative defects in management of the lottery system contribute to the widening gap between gross and net lottery revenue.

2. Motor Vehicles, Police and Prisons

Effective collection of fines and penalties for crimes under the New Motor Vehicles Act and setting these fines and penalties at suitably enhanced rates can be an effective method of mobilising resources for supplementing state finances. Recent spike in fines for violations in traffic rules may also have a positive impact on this. Government of Kerala has enhanced the fees/charges of all services rendered by government departments/public sector undertakings/grant in aid institutions by 5 percent, in April 2019.This is a definite step towards greater resource mobilisation through non-tax revenue, also suggested by earlier studies. Fourth KPECR (2012) suggested raising fees for services rendered by the Police department. Accountability needs to be ensured in handling financial resources generated through economic activities by Prisons department apart from ensuring market access to products of other government departments. Thus, expenditure incurred by one department can be compensated by income generated by another department through proper planning and good governance.

3. Construction Industry

Registration/Licensing fees can be charged against building and construction contractors at the time of sanctioning licenses for building construction. So far, there are no regulations specifically on quality of delivery and execution by contractors/builders engaged in construction. This needs special attention especially in the context of repeated occurrence of natural calamities and the need to ensure resilient construction practices in buildings and other structures in the State.

4. Land Revenue

Government of Kerala may consider the possibility of mobilising additional non-tax revenue by implementing Torrens system [see Annexure I] which was introduced by Government of India as part of the National Land Records Modernisation Programme (NLRMP). Kerala had made a feeble attempt to introduce Torrens system in 1995 in 13 villages under the principal sub-registrar offices of Kottayam and Angamaly. This initiative could not be scaled up due to strong opposition and litigations that ensued. However, it is still being followed in the selected villages. Introduction of the system helped in reducing boundary disputes and related court cases. If Government roll out Torrens system to the entire state, Rs. 755 per land transaction would accrue to the public exchequer. Average number of transactions on registration of sale deed per month in a Sub Registrar Office is calculated as 155 and total number of SROs in Kerala is 315. Thus, Rs.3,68,62,875/- per month can be reasonably expected as new revenue. This comes to Rs.44,23,54,500/- per annum. If government implements Torrens map preparation, without land transaction for individual land holdings as a proof of land records income for government would be much more. This might be possible without incurring high cost in the era of digital economy.

There is also considerable scope to revise the rates of rent of public land. Apart from this, land given to private sector (tea estates/plantations in Munnar, Nelliyampathy, Wayanad, etc.) decades ago need timely revision of lease rates and the asset should be resumed by Government if required to ensure accountability and avoid encroachment.

The issue of revision of rentals on public land has engaged the attention of Government on several occasions. In a recent study, the Report of the Committee appointed by the State Government titled “Covid 19 Pandemic and Kerala: A Response Strategy” suggests that a calibrated increase in fair value of land accompanied by a small reduction in the stamp duty rates, along with measures such as e-stamping for all documentation combined with the measures already announced in the budget will help augment Non-Tax Revenue significantly. The Committee recommended the constitution of a task force for collecting lease rent arrears along with re-assessment and resumption of land that is not being utilised as per the original lease terms. The report suggests fixing lease rentals based on market rate determined by usage of land as per the master plan in the urban areas. In addition,

it was also recommended that there is considerable scope for resumption of unutilised land with Public Sector Undertakings (PSUs) and other government institutions. There are practical problems associated with fixing market value. Hence it was recommended that instead of market value the lease rent may be fixed on an interim measure based on fair value of the area which is already notified. This can be adopted as an interim measure till the market value of various user categories of land in urban areas is ascertained and notified.

It is observed that there are small land parcels in bow shape (oxbow land) which are created as a result of straightening roads for development works. Such oxbow land parcels could be leased out for construction of roadside amenities for a specified period.

1.4 Major Components of Social and Community Services

Least contribution to administrative receipts is from social and community services. It has declined over the years and has remained between 10 percent and 16 percent from 1980-81 to 2011-12 (Appendix 6).

Education, Sports, Arts and Culture are the major contributors from social services to states' own non-tax revenue, followed by medical services and public health. In the case of education, major contribution is from tuition fees; charges collected from sale of textbooks, entrance examination fees etc., from secondary, higher, and technical education. Under Art and Culture, the contribution is from museums and zoos, rent from various theatres and halls etc. However, in the recent years there is marginal decline in contribution from the sector. Major component of Medical Services and Public health is revenue from education, training, and research in all streams of medicine – Allopathy, Ayurveda, Homeopathy etc.- through tuition fees and other charges. Receipts from hospitals for patient care and dispensary services, and receipts from Employees State Insurance Scheme also contribute significantly to this sector.

Medical and public health services can mobilise only 4 to 6 percent of the cost incurred in the sector indicating that the services are supported through huge implicit and explicit subsidies. There exists an evident trade-off between policies that curtail subsidies and those that aim at building or sustaining the image of the state as the benevolent provider of social security. A permanent and more viable solution is indexing charges for various treatments (dialysis, angioplasty, and so on) and surgeries to the existing inflation rates to combat inflationary pressures while rendering quality health services. This needs to be

viewed as correction in user charges instead of a hike. Higher revenues will assist in improving overall quality of public health services and enable people to shift from private to public services at affordable costs. Introducing individual medical insurance-based payment for above poverty line (APL) categories may help in improving revenue without affecting disposable income of people.

ARC recommends following a similar approach in education–subsidising eligible sections of the society and adoption of cross-subsidy/differential pricing/providing scholarships through an objective transparent system with the use of technology. Indexing fees for higher education, technical and medical education and other professional courses with current inflation rates will bring in correction in the fee structure. This will be an instrument for combating inflationary pressures and providing quality education.

Transportation facilities, entertainment facilities, (theatres, museum, recreational facilities, national parks, stadium) and information services are examples of quasi-public goods where user charges may be imposed to mobilise non-tax revenue.

1.5 Major Components of Economic Services

Economic services used to be the main source of non-tax revenue in Kerala in the 1980s (Appendix 7). Its share has declined from around 48 per cent in early 1980s to around 29 per cent in the late 2000s. There has been a shift in the revenue distribution on economic services away from forests towards other components such as co-operatives, nonferrous mining & metallurgical industries, roads & bridges and industries, tourism, irrigation, ports and so on. Economic services are one of the best available categories for mobilising resources through inflation indexing. Few specific suggestions on some subcategories are given below.

1. **Forests**

Fees collected for entry to protected areas and other ecotourism centres under the control of Forest Department needs to be enhanced. Provisions may be incorporated in the Kerala Captive Elephant (Management & Maintenance) Rules, 2013 for payment of fees by elephant owners for inter district transportation of captive elephants. Funds thus generated may be earmarked for schemes for the welfare of captive elephants across the state. Lease-rent realised by Kerala Forest Department for lands leased out to various agencies are very nominal and needs to be substantially enhanced. Rates for sale of seedlings by forest

department to public and other agencies can be hiked further. Annual inspection fee for sawmills, application fee for various wood based industrial units, film shooting charges, parking fee, hotel fee etc. may be reviewed

2. Quarrying/Mining

It observed by the Commission that the number of functional granite stone quarries has reduced to 728 from 3500 after issue of court order dated 27/2/2012 that made environmental clearance mandatory for all mining. Gadgil Committee report followed by Kasturirangan report on Western Ghats has also led to the closure of many quarries close to the Western Ghats. Similarly, implementation of the Forest and Wildlife Protection Act has compelled closure of 89 granite quarries within a radius of 10km of Wildlife Sanctuaries and National Parks. As per Mines and Minerals (Development and Regulations) Act-1957, State Government is authorised to fix royalty of minor minerals and revise the royalties once in three years. Present rate of royalty is Rs 24 per MT of granite stone while the market rate (selling price) of one MT of Granite Stone is disproportionately high. The present schedule for collecting royalty is based on various slabs, depending on the surface area of land from where mineral is to be exploited – an approach that is apparently quite unscientific. More scientific methods will have to be employed to realise royalty based on the quantity of minerals extracted. Government of Kerala has revised certain rules related to mining and quarrying like consolidated royalty payment scheme, stricter fines and penalties for illegal mining and quarrying to limit/eliminate corruption and for better mobilisation of resources.

3. Tourism

Tourism potentially offers a very good avenue for generation of funds. Obvious requirement for this should be that tourist spots are well managed and conducive to visits and stay of tourists. Government of Kerala needs to invest time in assessing *'willingness to pay'* of both domestic and foreign tourists. This can be done by conducting primary survey in selected tourist spots, heritage sites, amusement parks and museums. This needs to be compared with the total cost of maintenance and operations of each site. Based on these two factors, government needs to consider setting prices for tourists to avail these facilities. Once price rise is implemented for all tourist spots government may combine several sites and introduce online issue of tickets/passes making tourism more consumer friendly. To ensure sustainable long-term growth in tourism, government needs to make investments in the sector

and provide infrastructure support. Tourism is seasonal by its nature and hence revised pricing structure needs to allow a differentiated pricing model – one set of prices for the peak period at the one end of the spectrum and another other set for the lean period at the other end of the spectrum. A segmented pricing structure according to the type of tourist site (heritage/cultural sites, backwaters, beaches, hill stations, wildlife sanctuaries and Ayurveda), season (peak/lean), type of tourists (domestic/ foreign), type of relations that India/Kerala has with the country of origin of the tourists and above all, the pricing scheme must reflect cost and marginal willingness to pay of different categories of tourists. The pricing formula needs to be based on the number of tourists necessary to ensure sustainable growth of the tourist site. Other avenues for revenue generation include parking fees for private vehicles at tourist destinations, pay and use toilet and refreshment services, opening government guest houses for public at a higher rate, bundling various services for purposes of ticketing and issuing unified pass for visiting tourist destinations. Organising festivals and services to encourage more tourists and focus on pilgrim tourists will also be beneficial for additional revenue generation.

1.6 Interest Receipts, Dividends and Profits

Interest receipts include interest on loans on housing schemes, loans to government companies, treasury bills, and interest from departmental commercial undertakings etc. Revenue from dividends and profits arise from government's investment in the shares of co-operative societies, government commercial and industrial undertakings etc. Share of interest receipts and dividends in the total own non-tax revenue of the state is small –an average of 11 percent from 1980-81 to 2011-12. Kerala has the highest number of state level public sector enterprises in India. Improving profitability of these enterprises lies in planning for their long-term sustainability as vibrant and productive institutions. This requires critical analysis of technological capabilities and production efficiency. This also calls for shifting focus from merely focusing on profit generation to transforming production modes by making use of latest technology and deepening linkages with the economy by sustainable utilisation of available resources.

1.6.1 Recommendations:

1. Improving Corporate Governance in PSE

Improving corporate governance in PSEs is a sine qua non for any organisation to emerge as a healthy and well managed one. The principle- agent problem requires further reflection. To ensure accountability and transparency in the monitoring of these enterprises, government needs to include corporate governance disclosure reports with the annual report that is published by these enterprises. Having an effective corporate governance policy and framework also ensures re-organization of management and board of directors, and proper auditing by concerned committees of the Board.

2. Memorandum of Understanding (MoU)

MoU is a well-designed document drawn up after directed negotiations between the government and the managers of public sector enterprises specifying responsibilities, objectives, and obligations of the two parties. Such a document will equip government to assess performance of these enterprises in a nuanced manner.

3. Listing on Stock Market

Stock market acts as a regulatory mechanism to ensure that PSEs comply with guidelines of SEBI and other regulatory authorities, like any other private listed enterprise. State Government, for understandable reasons do not advocate divestment of PSEs in Kerala. This report does not recommend any wholesale disinvestment either. But, as in the case of Kochi International Airport Limited (CIAL), it would be a good strategy to divest PSEs to some extent that could be decided by government depending on the nature of goods or service dealt with by the PSE. Percentage of disinvestment should be such that government retains its strategic control over the PSE but at the same time large enough to bring in modern management practices through private sector participation. Listing on the stock market will also ensure more frequent and diligent scrutiny by investors and analysts leading to better functioning of the enterprises.

4. Public Private Partnership (PPP)

PPPs are effective tools available with the government for facilitating private sector investments in the State without giving up policy control over diffusion of new investment into any sector. It also serves to ease budgetary pressures and ensure effective provisioning of public services. However, a model of PPP requires careful scrutiny by considering critical factors of success – type of PPPs (Build-own-transfer,

Build-own-operate and its effectiveness according to the sector, age of the project, type of end users and so on), transparent and effective contractual agreements, suitable sectors where it can be used, timely and regular review.

5. **CIAL Model**

Cochin international airport is the first airport in India to be built under a new business model and is owned by Cochin International Airport Limited (CIAL) a public limited company floated by Government of Kerala in 1994. It is a pioneering and innovative example of a model and became operational in 1999. Envisaged source of funds were interest-free loans from non-resident Indians working overseas, donations from industrial undertakings, exporters, cooperative societies, and loans from the state government. Kerala's experience of CIAL model in financing infrastructure development is a success story, and is replicable.

In adopting the policy tools discussed above a one-size fits all approach is neither desirable nor practical. In fact, a more effective method for performance improvement would be a combination of these. Some basic issues also need to be addressed. Careful examination of existing long-term loans, arrears and payments and an institutional mechanism for settling the loans needs to be in place before attempting disinvestment. PSEs needs to focus on strengthening their network by, synergising relations with each other, effective utilisation of their presence across the state, investing in R&D activities, outsourcing innovation activities, improved use of technology and strategic tie-ups with each other and other CPSEs.

Another important aspect relates to utilisation of land, machinery, and other resources of sick/closed-down enterprises. Leasing of the land to private sector at market rates or using it for construction of government offices or for other pressing public needs may be an effective way of utilising these resources. These broad recommendations may help in increasing the technological capabilities and financial viability- thus rendering better profits and dividends.

1.7 Grants from Centre

Second component of states' non-tax revenue-grants from Government of India, includes various grants provided to state government under state plan schemes, central plan schemes, centrally sponsored schemes, special plan schemes and non-plan grants. Share of grants from the centre to total non-tax revenue in terms of various central-plans and supports may vary and is not a constant revenue source. Increasing share of grants from centre in the non-tax

revenue may be interpreted as inefficiency of government in mobilising own non-tax revenue from its resources.

1.8 A Cost Accounting Approach to Augmenting Non-Tax Revenue

A general thread that emerges out of the discussion above is that the State needs to cost services appropriately given the context if it has to augment Non-Tax Revenue. One of the limitations in enhancing nontax revenues is that governments in general do not have any clear idea of the actual cost it incurs on each service provided by it. There are types of goods and services provided by government, public, private and quasi-public. A pure public good or service is characterised by non-excludability (benefits derived from them cannot be confined to those who have paid for it), non-rival consumption (one person's consumption is not restricted by another person's) non-rejectable (collective supply means that it cannot be rejected by people).

On the other hand, a private good yields positive benefits to consumers that is excludable, the owner holds property rights over it and hence can exclude other users from consuming the same. In between public and private goods and services are the quasi-public good or service which is a near-public good viz. has many but not all the characteristics of a public good.

Theoretically, Governments could confine its provision of goods and services to public or quasi-public ones, but compulsions of social equity (e.g., education and health) and affirmative policies necessitate governments to extend their provision to private goods and services as well.

There are several considerations that apply for fixing the cost of any goods or service provided by government through its departments. Unlike the private sector, the goal is not to recover the full long-run cost of providing a service or to match income and expenditure. The question in government is to decide the services that should be provided free of cost, and what needs to be charged to meet expenditure incurred by government for partial provision of the service, and what are the services where entire charges incurred can be recovered on a cost or cost plus basis.

Costing of goods and services supplied by government is a scientific process that needs thorough understanding of the science of cost accounting and how the methodology is

practised. There are several classes of costs that one is likely to encounter in the process, Fixed costs (including depreciation, warranty costs and annual maintenance costs (AMC)), variable costs (including fuel and lubricants, other consumables (tyres, filters etc.), other maintenance costs, overheads (allocation of human resources costs – salaries, pension contribution etc, and other managerial costs involved specifically in providing the goods and services.

For systematically doing this, Cost Accountants often begin by listing out 'cost identifiers' to ensure that no data at the micro level is missed out for cost accounting. Systems and protocols will have to be developed for cost attribution wherein all costs, including indirect and overhead costs, are allocated to a function, activity, good or service consistently and correctly.

SETTING PRICES, FEES AND INTER-UNIT REIMBURSEMENTS

Cost is an important element of the decision-making process for setting prices and user fees for government-provided goods and services. Information about costs is relevant even when goods and services are provided at less than cost as a result of government policy decisions, or when prices and user fees are set on the basis of market prices. Cost is also frequently the basis for transfer pricing between government units. A number of governments have specific cost-related requirements for pricing.

When governments are engaged in commercial type activities, private sector concepts of pricing may be relevant and, as a result, market prices may be a more determining factor than cost recovery. For example, in the United States, unless otherwise specified by law, regulations require that prices charged to the public for government goods and services be based on market prices or the full costs incurred by the government. Nevertheless, determining costs remains important in these circumstances.

Canada has an initiative for cost recovery with respect to certain government goods and services provided to external users. This initiative is to give departments the impetus to maximize cost recovery where appropriate and to change attitudes and processes to meet higher cost-recovery expectations. Canada suggests that full cost is a good starting point for determining user fees.

New Zealand has expanded the concept of pricing services to all activities of the government, whether sold, transferred between government units or distributed free to the general public. All outputs are costed and the costs of those distributed free to the public represent the prices Ministers pay departments and agencies for the production of goods and services.

The United Kingdom encourages charging for services supplied between departments unless it is clear that the likely benefits would not justify the cost. The expected benefit from internal charging for support services is improvement in the "value for money" from exercising greater cost discipline upon the suppliers of services and their internal customers.

In 2001, Sri. C.P. Nair, then Chief Secretary to Government had submitted his Report on augmentation of Non-Tax Revenue in the State. Shortly after that the Non-Tax Revenue Cell was constituted in the Finance Department in Government. This new Administrative Unit was intended to keep track of various fees/user charges in connection with various

services/facilities rendered by government departments in the State and submit proposals to update them from time to time. Major Non-Tax Revenue items in government departments are various fees, fines, service charges, receipts under various acts, sale proceeds/cost of various form / applications/ documents/ publications/ manufactured/ agricultural products, rents, user charges for using government utilities/amenities, receipts from patients for hospital and dispensary services, hire charges, examination fee of Kerala Public Service Commission, traffic fee/ fine receipts, royalties and others. However, over the years this Unit has not gone beyond issuing orders on proposals submitted by other departments or at best propose some adhoc increases in these charges.

To mobilise revenues from non-tax revenue, it is imperative that a cost accounting perspective is built into the process of fixing charges for goods and services provided by government to people. The Non-Tax Revenue Cell needs to be administratively reorganised, professionally upgraded to take up these functions. Non-Tax Revenue Cell needs to be reconstituted as the Non-Tax Revenue Board (NTRB). It shall report to a Committee comprising of a senior Additional Chief Secretary (preferably the senior most) with the Finance Secretary and another Principal Secretary as members. It is advisable to position the NTRB outside the Finance Department for ensuring a greater degree of acceptability among all non-Finance Departments and for avoiding the ‘regulator’ vs. ‘regulated’ mentality that could thwart objective of this exercise.

The NTRB should have two Additional Secretaries, one each from the Finance and General Administration Departments with an officer of the rank of Deputy Secretary under each of these Additional Secretaries along with two Sections. The Deputy Secretaries and Sections also may be designated, one each from GAD and Finance, respectively. Finance Department can provide a small unit (an Under Secretary with one section) which serve as the servicing unit for the NTRB. Rest of the posts in the Finance Department may be redeployed to NTRB.

Officers posted to Non-Tax Revenue Board needs to acquire Cost and Accountancy (CWA) qualification from the Institute of Cost and Works Accountants of India (ICWA). If officers who possess this qualification are not available (more likely than not) then the officers posted to the NTB may be given three years to acquire the qualification.

To fulfil this criterion, candidates willing to acquire these qualifications may be selected and their entire enrolment, registration, and educational fees for acquiring the qualification may be sponsored by government. An additional incentive equivalent to 10 percent of the Basic Pay may be given to those who acquire these qualifications. Till such time as government can fill the posts with qualified persons, services of a third-party agency specialised in cost accounting may be availed by selection through a transparent bidding process.

NTRB needs to develop costing protocols for each department and each type of service. Every fee, fine or penalty fixation by any department in government or any PSU (to the extent that it does not relate to its own commercial operations) shall be referred to NTRB. A Web based application with the formats and online help facility and manuals for uploading a service request to fix a user charge or any item of Non-Tax Revenue needs to be developed and maintained by the Board.

1.9 Recommendations

1.9.1 General Services

1. Lotteries

General services emerged as a significant contributor to the non-tax revenue from 2011 after introduction of 'Karunya' lottery and banning sale of lotteries from other states. However, inclusion of lotteries in GST and judicial order setting aside ban on sales of lottery from other states is expected to increase competition from lotteries of other states. Proper monitoring of the sector can prevent fraudulent activities, multiple claims on prize money etc. and ensure better revenue mobilisation – of both gross and net revenues. Replacing single lottery of large prize money, with multiple lotteries of smaller prize money may attract larger number of buyers. An efficient mechanism for monitoring administrative aspects related to Kerala lottery system needs to be implemented. Shift towards e-lottery, at least for the price draw and disbursement will be an effective tool to reduce associated inefficiencies.

2. Motor Vehicles and Police

ARC recommends that the state government desist from diluting existing fines and penalties introduced by Government of India under various legislations. Fines are imposed for keeping violation of laws in check. Hence as a measure of deterrence, the fines need to be kept at the rates decided by Government of India (GoI) to reduce accidents and resultant loss of lives. It

will also be an additional source of income to government and needs to be invested for improving safety standards of the roads and create awareness about safety standards and the need to adhere to them. Government needs to take steps to reduce administrative cost of the departments through adoption of ICT enabled services.

3. Construction Industry

Differential fee structure needs to be introduced based on category of contractors in the construction industry.

4 Land revenue:

Introduction of Torrens system in land registration will improve security and transparency of land records and can be a source of improving non-tax revenue mobilisation. There needs to be an appropriate revision of the rates of rent of public land. Efforts needs to be initiated on a mission mode as referred above for the revision of lease rentals and for resuming land which do not comply with original conditions of issue. ARC recommends introduction of differential rates of rental based on the purpose for which land is rented. Oxbow land parcels maybe leased out for specific period.

1.9.2 Social Services

Expenditure under social services is approximately fifty times the revenue collected. This is mainly due to steady increase in expenditure in the sectors of Education, Sports, Art and Culture, and Health Services. Given the pure-public goods characteristic of health and education services, ARC recommends caution in implementing hike in user-fee in these sectors. User charges related to education and health services could be corrected for inflationary pressures by considering inflation prevailing at the time of previous revision/introduction of better-quality services. However, it is important to identify the population group which has the potential/capacity to pay marginally higher costs without being excluded from the service. An objective and observable parameter for that is the BPL card and SC/ST/Transgender/physically & visually challenged certificate. ARC recommends exclusion of BPL card holders and other marginalised sections from price related recommendations of this report except for fines/penalties for illegal/unlawful acts.

1.9.3 Economic Services

1. Forestry

ARC recommends hiking of rents/ rates/fees, inspection fee for sawmill, application fee for various wood based industrial units, charges for film shooting, parking fee, lease rent etc., by adopting inflation indexing method.

2. Quarrying/Mining

State needs to take urgent steps to revise royalties of minor minerals in a logical, reasonable and scientific manner and ensure implementation of an effective cost-linked price regulatory mechanism for quarry products. This shall be done with all due regard to environmental sustainability and avoid undue exploitation of national resources. Stringent penalties including hefty fines and other deterrent measures needs to be enforced to prevent illegal quarrying.

3. Tourism:

The Commission recommends formulating a pricing structure which could be segmented according to the type of tourist site (heritage/cultural sites, backwaters, beaches, hill stations, wildlife sanctuaries and Ayurveda), the season (peak/lean), type of tourists (domestic/ foreign), type of relations that India/Kerala has with the nation of origin of tourists. However, the pricing scheme needs to be reflective of the cost and marginal willingness to pay by different categories of tourists. Pricing formula needs to ensure the number of tourists necessary for sustainable growth of the tourist site and activities therein. Hence, the government needs to invest time in assessing 'willingness to pay' of both domestic and foreign tourists and accordingly recalibrate user fees/charges through continuous surveys in selected tourist spots, heritage sites, amusement parks and museums.

1.9.4 Interest Receipts, Dividends and Profits

ARC recommends combining MoUs, listing on stock market, improvement in corporate governance and PPP's for enhancing performance of PSEs. Additionally, some basic issues need to be addressed. Restructuring of long-term loans is a prerequisite for disinvestment. Careful examination of existing long-term loans and settlement of arrears and pending payments through an institutional mechanism needs to be done. The PSEs also need to focus on strengthening their operational and marketing network and improve synergy with other PSEs and effectively leverage their presence across the state, invest in R&D activities, outsource innovation activities, improve use of technology, and set up strategic ties with each other and other CPSEs. Another important

aspect is related to the usage of land, buildings, machine, and other resources of enterprises that are sick or are shut down. Leasing of this land to private sector enterprises at market rates or any other effective method of utilising the assets needs to be done. Reduction of fiscal burden of the state from non-performing state-owned enterprises needs to be carried out by using a mix of policy tools recommended in the previous section.

1.9.5 A Cost Accounting Approach to Augmenting Non-Tax Revenue

ARC recommends the setting up of a Non-Tax Revenue Board with sufficient number of qualified personnel. Till such time as qualified personnel are in position, services of a third-party cost accounting firm may be availed.

The NTRB needs to provide its services on an online web portal. All items of Non-Tax Revenue shall be fixed only after circulating the proposal thereof to the NTRB.

As part of its work, NTRB may need have to undertake in-depth studies to examine existing situation in various departments and explore the possibility of eliminating inefficiencies and suggest solutions for more effective mobilisation of resources. Regular maintenance of data records related to non-tax revenue with the help of ICT, by respective departments will ensure better governance and assist in research.

Chapter 2

TAX-REVENUE

2.1 Tax Revenue – Direct and Indirect

Important direct taxes like Income Tax, Corporate Taxes etc., are in the jurisdiction of Central government. The states are left with relatively insignificant direct taxes like Property Tax, Professional Tax etc. Therefore, the States are heavily dependent *on Indirect Taxes for resource mobilisation*. Prominent Indirect Taxes that the State of Kerala collects are as follows.

a) SGST - States GST (SGST) for intra- state transaction.

b) IGST - States share of GST in Integrated GST (IGST) for inter-state transaction, *as a Destination State.*

c) Kerala State VAT (Sales Tax) - Petroleum and Petroleum products not being within the ambit of GST, the states collect States VAT on these products.

d) State Excise and State VAT - These are imposed on Alcohol, both Imported Foreign Liquor and India Manufactured Foreign Liquor (IMFL)

e) Turnover Tax - This tax is imposed on Drinking Bars selling alcohol to their customers, at a certain percentage of the Turnover of a particular Bar.

f) Entertainment Tax - This tax is collected by the Local Bodies for for sustaining their local development and welfare work.

Constitutionally, Petroleum and its products are within the ambit of GST. However, effectively it has been kept outside GST until the GST Council representing both Centre and

the States decide to bring it within GST. Consequentially both Centre and States continue to collect Central Excise and State VAT respectively on Petroleum, as in the pre-GST era.

Alcohol for human consumption is kept out of GST, constitutionally. So, its taxation is entirely vested with the States. Centre continues to impose Customs Duty for imported alcohol. The distribution and marketing of alcohol in Kerala is as follows.

The Kerala State Beverages (Manufacturing & Marketing) Corporation Ltd (BEVCO) is a public sector company fully owned by Government of Kerala. BEVCO has monopoly over wholesale and retail vending of alcohol in the state. Besides, the Corporation also controls retail sale of Indian Made Foreign Liquor (IMFL) and Beer trade in the state. State Excise department levies State Excise Duties and a fee on foreign liquor, both IMFL and imported. These apart, as mentioned there is Turnover Tax for the Drinking Bars, at a certain percentage of the turnover of a particular bar.

Broadly, this is the picture of Indirect Tax levies in Kerala. From revenue point of view, the most important taxes are GST – both for intra-state and interstate trade, State VAT on Petroleum and its products, and State Excise on Alcohol.

2.2 Constitutional Provisions relating to GST

Constitutional provisions relating to policy formulation and implementation of GST, after the amendments are as follows:

Article 246A authorises Parliament and the State Assemblies to make law with respect to GST.

Article 269A authorises Centre to levy and collect GST in the course of interstate trade and get the collected tax apportioned between the Union and the States in a predetermined manner.

Article 279A provides for the constitution of GST Council chaired by the Union Finance Minister with Finance Ministers of all the States as its members. The Article also authorises the Council, inter alia, to take policy decisions and recommend the decisions to the Central government and the States for getting them cleared by Parliament and individual State Legislatures.

Hence no state can unilaterally change an existing position of GST policy like form, structure, rates, procedures etc. Any change sought by any State must be decided and approved by the GST Council, where there is a provision for voting.

Therefore, recommendation on administrative reforms in respect of GST has

necessarily to be restricted to the administering of GST or in simpler terms the recommendations will have to confine to improvement of GST implementation in respect of compliance and anti-evasion measures.

2.3 Revisiting the premises underlying the current GST framework

However, ARC opines that the deeper fissures revealed in the recent controversial decision of the Union Government to renege from its obligation to bear the financial burden of the compensation, and the unfortunate and evidently highhanded but successful attempt to saddle the States with additional debt in lieu of this might well reflect the shape of things to come.

Signs of fissures in the structure and disputes between States and Union are likely to get accentuated in the near future. The voting balance in the GST Council is now tilted in favour of the Union Government. This is so because the same political party ruling in the Centre holds power in several states giving it majority in the Council. This enables them to carry their wishes through, in the event of any voting. But, as in any democracy this balance will not be constant and is bound to reverse. It is felt that discordance in the smooth functioning of GST will emerge as major contention and dispute in the federal-state fiscal relationship in India.

That being so, Kerala which politically maintains a certain independence in its thinking and its refusal to identify with the current prevailing equations in national politics, might well examine an alternative strategy that might even need espousing a new paradigm fundamentally different to the GST structure, as known in the last two years of its implementation. In this context a different line of thinking for which the State Government may have to prepare itself is outlined in the Box .

Box

GST – An alternative view

Even though the GST regime is regarded as a settled and irreversible issue, it should be mentioned that there is considered view among some that the structure of GST brought about through the 101st Constitutional Amendment is not constitutional. This view holds that what has been put in place through the Constitutional Amendment is ultra vires of several judgements of the Hon. Supreme Court, in this regard, particularly the case law established clearly in landmark judgements of the Supreme Court in Kesavananda Bharati vs. State of Kerala and others.

The reasons adduced by those who hold the view is that the fiscal framework as envisaged in the Constitution regarding financial powers of State under the Constitution has been torn asunder by the 101st Constitutional Amendment that ushered in the GST regime in the country. This constitutional amendment, the view holds, has taken away the fiscal powers of the State on the revenue side. The Constitution invests the State with financial powers both on the revenue and expenditure side. Union and State Governments are conferred with full autonomy in the respective areas. Article 266 which defines the Consolidated Fund of a State and Article 202 that defines the Annual Financial Statement would make this clear. The view of some of the experts is that these powers define the basic structure of the Constitution in relation to the federal-state distribution of powers and these cannot be abrogated or repealed by any Constitutional Amendment.

In essence, the question is simple. When a State cedes all the financial powers of taxation to a new structure the GST Council, does it not imply that the independent financial powers of a State granted by the Constitution gets altered beyond recognition from what was contemplated by the makers of our Constitution? When the Centre and other States (!) get to decide on the taxes within the State in respect of items that fell squarely within the State's domain in the Constitution that was created by the makers of modern India, has it not mutilated the basic financial arrangement designed by the Constitution? Even if all this is brought into effect through a constitutional amendment by Parliament and even if all the States agree to such an amendment, it is till antithetical to the basic structure of the constitution that separates the federal-state financial arrangement.

Given the thrust of the argument above the State Government has to prepare an alternative strategy for the future – one which builds on the learning acquired from the experience of the GST Council over the last three years and which would address the fundamental loss of financial powers suffered by the States of India.

One solution for restoring the constitutional balance of financial powers envisaged therein would be to bring in dual taxation administered by the Union and the States with independent powers for each tier in government to decide on the rates on goods and services.

When States impose rates differently, it could be pointed out that complexity of administering such a system could make it regressive and a step backward. But such a criticism would ignore the fact that the CGST-SGST-IGST structure that has been

implemented now runs, albeit with its flaws, imperfections and red tape, sheerly because of the huge IT systems that have been put in place under the GST Network (GSTN). Thus, managing a tax system in which the States and the Union can decide on the tax rates is a matter of creating appropriate data processing systems to make it workable.

ARC recommends that the State Government may entrust the Gulati Institute of Finance and Taxation to visit the GST scheme afresh in the light of the remarks above and prepare a detailed architecture for a new approach. Kerala, with its relatively good tax administration set up should take the lead in building consensus among other states to press for a dual taxation system of GST where states will not have to sacrifice its financial powers originally envisaged in the Constitution.

The above recommendation is of course for the future. For the current, as mentioned above, the recommendations need to focus on what can be done best at present.

2.4 GST Compliance and Anti Evasion Measures

One of the main reasons for the GST collections not measuring up to expectations is that there has been huge tax evasion right from its introduction, through different methods and are continuing even today. Numerous cases of tax frauds and fake invoice scams have been detected so far. These involve large amounts, and even the projected figures are far too likely to be an underestimation. Be this as it may, these figures point to significant leakages. It is seen that the Central authorities registered over 6000 cases by November 2019, involving huge amounts.

2.5 Consequences of Unprepared GSTN

GST regime was introduced in July 2017 without making GST Net (GSTN) - the IT infrastructure that would be the bedrock for the implementation of this massive project - fully operational. Consequently, the GST regime suffered its biggest setback when at the beginning itself, the GSTN failed to deliver as was expected. To be specific, the GSTN was to ensure that all the transactions are documented and backed by invoices, and that appropriate Returns are filed periodically to facilitate matching of invoices and weeding out of all fake transactions. However, due to failure of GSTN in this matter, the GST Council- the decision-making body, was compelled to recommend one simple form - GSTR 3B, in place of the well thought out Return forms GSTR 2 and GSTR 3 that could have facilitated invoice matching.

Originally, invoice matching was so planned that invoices uploaded by the recipient (buyer) had to match with the invoice uploaded by the supplier (seller), for validating the claiming of credit by the buyer. But, as mentioned, the scheme of invoice matching that could have facilitated tallying of tax paid by seller and credit taken by the buyer was abandoned. Consequently, many used this loophole to claim input tax credit without payment of input tax and without any counter verification. [See **Annexure II**]

2.6 Fully Operational GSTN to Check Evasion

Most of the frauds could have been avoided if the Central Government had implemented GST by fully operationalising GSTN after pilot runs for all the modules of the GSTN, including those of filing of Returns and Invoice Matching. *Tax Invoice* is an important document in the scheme of GST. A registered person supplying taxable goods issue a Tax Invoice showing the description, quantity and value of the goods, the tax charged thereon and certain other particulars, before or at the time of removal of goods for supply to the recipient or for delivery of goods to the recipient.

A registered taxpayer also needs to file details of outward supply in *GSTR-1* about type of supplies made in a month- outward supplies to registered persons, outward supplies to unregistered persons (consumers), details of credit/debit notes, zero-rated, exempted and non-GST supplies, exports, and advances received in relation to future supply.

Similarly, she must file inward supply details in *GSTR-2*on types of supplies received in a month. The details of inward supplies of goods and/or services to be furnished in *GSTR-2*should include invoice-wise details of all inter-State and intra-State supplies received from registered persons and unregistered persons. The details of inward supply furnished by the recipient in GSTR-2 are to be matched with the corresponding details of outward supply furnished by the counterparty supplier in her GSTR-1. If invoices in GSTR-2 do not match with invoices in counterparty GSTR-1, then the mismatch is to be intimated to the supplier. In such a case, ITC availed by the recipient is to be added to her output tax liability. In short, all mismatches are to lead to proceedings if the supplier had made a supply but not paid tax on it.

There was legislative support for carrying out this important and onerous job. Section 42(1) of the CGST Act stipulates that details of *every Inward Supply* furnished *by the Recipient* of supply for a tax period will be matched with the *corresponding 'Outward*

Supply' furnished by the counterparty *supplier* in his valid Return or with the IGST paid in respect of imported goods. The matching was also to be done to check duplication of claims of ITC.

Thus, a system of ensuring compliance through invoice matching was planned. But dispensing with invoice matching opened the pandora's box of fraudulent modus operandi, leading to large scale evasion of GST.

It was clear from the very beginning that administration of GST would depend heavily on proper functioning of the IT infrastructure, the GST Net. It was therefore expected that the GST Net will be fully operational and well-tested before starting implementation of GST. But that did not happen.

2.7 Proposed New Return Formats & Invoice Matching

By the later part of 2019, the GST Council decided to introduce simplified Return Filing System together with e-filing of invoices in a phased manner. The introduction of e-invoices will also facilitate Invoice Matching. There will be two simplified Return Forms, one named '*Sahaj*' (Form GSTR 2) meant for Business supplies to the Consumers (B2C transactions), and the other '*Sugam'* (Form GSTR 3) for the Business making supplies to both Business to Consumer (B2C) and Business to Business (B2B transaction). Besides these two simplified formats for specific types of taxpayers GSTR 1 (Normal) for normal taxpayers will also continue. Two Annexures of Outward Supplies (GST ANX-1) and Inward Supplies (GST ANX-2) will be filed as part of the aforesaid returns. Further, the e-invoicing system would force the tax-filers to push transactional level details on the GSTN portal for every Business to Business (B2B) transaction to ensure seamless flow of legitimate tax credit. This will eliminate bogus taxpayers from the supply/value chain as tax credits will be matched digitally by the government portal itself without any need for manual intervention, thus ensuring a balanced, reasonable, and impartial credit mechanism.

2.8 Other Ways of Preventing Evasion

Another efficient way to check evasion is proper use of the e-way bill facility for movement of goods from one place to another. To increase compliance under GST and minimise tax frauds, the Central government has come forward with a new rule to block the facility to generate e-way bill for the taxpayers who have not filed their GSTR-3B Returns

for two consecutive months. E-way Bill is an electronic document required to be carried for transportation of goods. So, once blocked, the E-way Bill generation for such defaulters will not happen on the E-Way Bill portal, either as supplier, recipient or even as a transporter. This will help in arresting tax-evasion if the tax personnel use the facility diligently.

Another effective move to curb tax evasion and increase compliance by the GST authorities is cancelling registration of taxpayers who have not filed GSTR-3B Returns for three consecutive months. This is a good move to ensure compliance.

With the help of technology, like introduction of e-invoice, invoice matching, e-way bill etc. the tax personnel can take care of goods moving with documents – fake or otherwise. But technology (read GSTN) will be of little help where there is movement of goods from the stage of raw materials and components to the stage of finished goods and thereafter from production of finished goods to the consumers, without any payment of GST at any stage. Here, there is a complete system of parallel economy in as much as the entire supply chain is out of the purview of the GST system.

Then, there are cases of non-billed cash purchases by consumers from the shops. Quite a few shops offer an option to the consumer that if the bill is not insisted, she will not have to pay GST. There lies the importance of keeping a check on B2C (Business to Consumer) transactions.

Development of Human Intelligence is the only answer to tackle these kinds of evasion. For this purpose, informers who give information about the evasions needs to be developed. **There will have to be an efficient system of paying rewards to the informers, as a percentage of the recovered amount of tax evasion.**

It is reported that GST leakages through the above two methods, if stopped is estimated to additionally add 15-20% of GST revenue to the government coffers.

2.9 Way Forward

It is clear that the most important way to enhance GST collection is through administrative actions. This will necessitate undertaking administrative reforms. While all facilities will have to be provided in respect of administration of GST to enhance ‘ease of doing business’, strict measures will have to be undertaken simultaneously to ensure compliance and action against fraudulent actions.

Along with facilitating trade and industry on 'ease of doing business', strong compliance mechanism needs to be enforced. Compliance can be enforced effectively through strong anti-evasion steps and intelligent and incisive audits.

Once the new return system and the scheme of Invoice Matching is put in place, major part of tax evasion by availing input tax credit based on fake invoices can be curbed through use of technology. But it will not curb other ways of tax evasion like having a complete supply chain (from manufacturing to the consumer) outside the ambit of GST, where transactions take place amongst a group of fraudsters without payment of GST at any stage. It will also not curb the tax evasion in cases where non-existing firms were fraudulently registered by a single person generated invoice and took credit without movement of any goods, and then generated e-way bills. The fraudulent credits were then passed on to a range of buyers who availed it to discharge their GST liability on outward supplies.

2.10 Need for Human Intelligence

Reliance on Invoice Matching alone will not stop evasion of tax. Besides, it will take quite a long time to have a settled Invoice Matching system, and one cannot wait for that. For these reasons, there needs to be a strong anti-evasion machinery, which will collect *human intelligence,* develop the intelligence to get an actionable intelligence and then take action followed by thorough and incisive investigation.

All these activities demand a rehaul in the administrative setup. First, it must be understood that ***in post-GST era, human resources will have to be engaged more in intelligence, investigation, enforcement together with a modern and efficient*** **Audit setup to match this.**

Increased use of technology will reduce the need for officers in supervising assessment and in any case, it is now self-assessment by the taxpayers. Role of officials in pre –assessment and assessment stages are minimal enabling their shift from assessment related functions. Their services need to be utilised more in Anti –Evasion (Enforcement) and Audits.

2.11 Enforcement relating to Alcohol, Petroleum and its Products

Alcohol being a State subject, the State levies state excise duty according to need. As

it is a demerit good, Alcohol is a favourite item with the tax personnel for increasing tax. While an increase in excise duty rate on Alcohol will no doubt be one way of enhancing revenue collection, it is also to be remembered that too much increase in tax will lead to increased illicit traffic of Alcohol and non-payment of any tax. Besides, high variance in the rates of tax on Alcohol with the taxes levied by bordering states of Tamil Nadu, Karnataka and Mahe will lead to inter-state illicit trade (smuggling) through land borders in the north and east and through the sea route in the west and south. So, a balanced view will have to be taken.

As for Petroleum, there is scope for increasing the State VAT rate. But it is to be remembered that an increase in State VAT on Petroleum, Diesel etc., will increase the cost of transportation of all items including essential items, and that may not be acceptable. Therefore, in respect of these items too, the main mode of mobilisation of taxes needs to be through tightening of enforcement measures with the help of a State Directorate of Intelligences, as discussed.

2.11.1 State Directorate of Indirect Taxes Intelligence and Investigation (DITII)

It is recommended that a *State Directorate of Indirect Taxes Intelligence and Investigation (DITII)* be set up with headquarters in Thiruvananthapuram and branches in all the District Headquarters, with varying strength based on need. For illustration, one at Kochi may be the largest District Branch and that at Waynand may be of much less strength. The directorate may have jurisdiction over not only GST items (goods and services) but also over Non-GST items like Alcohol, Petroleum and Petroleum Products. It may also have jurisdiction over action against smuggling of goods, particularly Alcohol, across the State borders with Tamil Nadu, Karnataka and Mahe.

2.11.2 Duties and Functions of the Officers in the proposed Directorate may include:

i. Applying GST *Data Analytics* to identify potential GST frauds. For this purpose, ways and means of utilising data from the GSTN will have to be put in place. This aspect of GSTN will be discussed below.

ii. Collection, collation, and dissemination of *human intelligence* relating to evasion of GST and other indirect taxes.

iii. Studying the *modus operandi* of evasion of GST across the country, (some of the illustrative cases have been discussed in the earlier part of the

chapter) Modus Operandi of important cases needs to be circulated confidentially to all field formations.

iv. Studying aspects of *valuation* and *classification* of goods and services particularly those at the high end of the GST Rate Structure.

v. Coordinating with field formations in intelligence collection and investigation of cases detected for evasion of tax.

vi. Maintaining and updating laws and rules relating to GST.

vii. Sharing important methods used for tax evasion with inter –state ramifications with the Directorate General of Central GST Intelligence posted in Kerala.

viii. Maintaining liaison with other State and Central agencies in all matters of GST evasion and inter –state smuggling of taxable goods.

ix. The intelligence and investigation work may cover other indirect taxes like that on Alcohol, Petroleum & its products etc.

The Director of the Directorate of Indirect Taxes Intelligence (DITI) may be in the rank of Joint Secretary to the Government of India and may be assisted by Additional Directors of DITII, in each district, who may be in the rank of Director/Deputy Secretary to Government of India.

Besides the aforesaid specialised Intelligence and Investigation Directorate, Commissionerate of State GST may have an Anti-Evasion Wing whose functions will be more or less same as the DITII in respect of functions at serial numbers (i) to (iv) above. In addition, it will also work in co-ordination with the DITII to supplement each other’s work.

2.12 Use of GSTN Reports and Data

GSTN provides shared IT infrastructure and services to Central and State governments, taxpayers, and other stakeholders. Front-end services of Registration, Returns, Payments, etc. to all taxpayers are provided by GSTN. It is the interface between the government and the taxpayers.

The GST Portal services (frontend) are provided by GSTN. The *backend services* (the modules for processing the applications/returns etc.) are developed independently by a few states ***(Model 1)*** and Central Government themselves. However, most of the states (termed as ***Model-2 states)*** are dependent on GSTN to develop, maintain and upgrade their *backend modules.*

Model -2 states take *backend services (the modules for processing the applications/returns etc.) from GSTN. After* every module (enforcement etc.) is unrolled, there is no necessity for Model-2 states to develop back end modules individually. Once GSTN develops the same, it may be utilised by all Model-2 states.

Kerala is a Model-1 state and therefore, its modules for backend services are developed by themselves, independent of GSTN. As Model -1 state, Kerala must get API for transmission of data and populate its backend modules. Many times, there are issues of mismatch of data and non-transmission of data to Model 1 State from GTSN.

Instead of each Model-1 State developing its own MIS reports, the GSTN has developed MIS reports using Big data, Data analytics and Artificial Intelligence. *The advantage of Kerala becoming a Model-2 state is that the Kerala State would get access to all these reports.* These reports can be used by officials of the state for GST related work in the state.

GST portal (www.gst.gov.in) is one single common portal for all GST related services - Tax payer registration (new, surrender, cancelation, amendment etc.), Invoice upload, auto-drafting of Purchase details of buyer, GST Returns filing on stipulated dates for each type of return, Tax payment by creation of Challan and integration with agency Banks, Electronic Credit Ledger, Cash Ledger and Liability Register MIS reporting for tax payers, tax officials and other stakeholders and Business Intelligence /Analytics for Tax officials. GSTN will be accessible over internet (for taxpayers and their CAs/Tax Advocates etc.) and intranet for Tax Officials etc.

A common GST system provides linkage to all State/UT Commercial Tax departments, Central Tax authorities, Taxpayers, Banks, and other stakeholders. The GST system will include all stakeholders – taxpayers, tax professionals, tax officials, Banks, and accounting authorities.

Considering all factors discussed above ***it is recommended that the state of Kerala may switch over to Model -2 State from Model -1 State*** and will give the state government all the advantages of Model -2 state.

It is understood that the State Government has entered into an agreement with the *Indian Institute of Information Technology and Management, Kerala (IIITMK),* an autonomous premier educational institution established by Government of Kerala for data analytics for the purpose of identifying risky files for audit selection, classification of dealers, widening the tax base and tackling evasion through effective use of third party data.

This fact may not come in the way of getting the State converted in to Model -2 states. Rather, a continued back-end specialised work planned with the help of IIITMK will complement the efforts of the state of Kerala as Model -2 State in having an efficient and effective administration in tackling Anti-Evasion and Audit efforts.

2.13 Audit in GST Administration

Besides the field Commissionerates or Audit Commissionerates, there is a need to have a State Directorate of Audit following the basic principles laid down in the functioning of the Central Directorate General of Audit. Directorate of audit will *not* conduct primary audits in the Commissionerates, on its own. *Its basic purpose would be overseeing the creation and institutionalisation of a credible Audit System in coordination with the Directorate General of Audit of the Central Government.*

2.13.1 Responsibilities may include:

(i) develop and provide policy direction to the internal audit of taxpayers by the Audit officers of the Commissionerates.

(ii) ensure its effective implementation through periodic review of the functioning of the Commissionerate Audit.

(iii) prepare Audit Manual for the State based on inputs from the Draft Audit Manual of CBIC and to update the same regularly.

(iv) review GST Audit program of the Commissionerates.

(v) associate with Central organisations like Directorate General of Systems and Data Management, Directorate of Analytics and Risk Management etc. for functional direction to the Audit Department of the Commissionerate in

effective conduct of Audit on intelligent selection basis, and help it in conducting meaningful and focused audit.

(vi) interact with National Academy of Customs, Indirect Taxes and Narcotics (NACIN) to develop strategies for timely training of Auditors including refresher courses for them.

(vii) study the level of compliance including recoveries of taxes relating to important Audit objections.

(viii) collect and disseminate information having a bearing on tax evasion/compliance and having revenue ramification, which are noted during the conduct of audit. In this context, Monthly Audit Bulletins and compilation of important Audit Objections may be circulated regularly.

(ix) enhance tax compliance by the taxpayers through planned interactions with Trade Associations and chambers of Commerce & Industries to explain benefits of Self–compliance. Nuances of Audit functions may also be explained during the interactions.

(x) conduct regular studies based on audit experiences and make recommendations to State Finance department to remove procedural and legal impediments and to plug revenue leakages that discourage quick compliance.

(xi) coordinate with the State GST (SGST) formations and other agencies as deemed fit by the State Director of Audit for exchange of information on new methods to ensure tax compliance.

2.14 Recommendations

1. ***ARC finds merit in the alternative view that the present GST Regime has significantly altered the basic structure of the Constitution which provides and affirms certain financial powers to both the Union and the States. The Commission also feels that differences could be deep-seated and the mechanisms of resolving it through majority votes in the GST Council will not be adequate to find solutions. ARC recommends that the State Government should entrust the Gulati Institute of Finance and Taxation (GIFT) to draw up an alternate strategy which respects taxation and financial powers of both the Union and the States and to come out with detailed recommendations, administrative, legal and technological, to implement the same. Thereafter, the State Government should take the lead to build consensus among States to move towards a***

more equitable structure that does not fundamentally alter the fiscal balance provided for by the founding fathers of the Constitution.

2. ***Given the fact that revenue mobilisation is to be done mainly through Indirect Taxes and that GST is the main source of revenue collection, together with Alcohol and Petroleum & its products, it is recommended that a separate state Directorate of Indirect Taxes Intelligence and Investigation (DITII) is set up with headquarters at Thiruvananthapuram and offices in all the District Headquarters with varying strength based on need. (For illustration, one at Kochi may be the largest district unit while the one at Wayanad may be of much less strength.)***
3. ***The Directorate may have jurisdiction over items covered by GST and over non-GST items like alcohol, petroleum, and petroleum products.***
4. ***The Directorate also needs to be given the responsibility of taking action against smuggling/illicit movement of goods like alcohol and any other indigenously manufactured goods across the state borders with Tamil Nadu, Karnataka and Mahe either by land or sea route. There will be no jurisdiction over action against smuggling across the country which is in the exclusive domain of Central Government.***
5. ***Duties and functions of DITII have been recommended on the body of this report under the heading 'State Directorate of Indirect Taxes Intelligence and Investigation (DITII)'.***
6. ***Independent of DITII, the Commissionerates may have an anti–evasion wing whose functions may be more or less the same as those of DITII in respect of functions at Serial Number (i) to (iv). Theanti-evasion units of the Commissionerates may work in coordination with DITII and supplement each other's work.***
7. ***Till the time GSTN is fully functional, and even after that DITII needs to give adequate importance on the use of human intelligence.***
8. ***For the reasons explained on the body of the Report under the heading 'use of GSTN Reports and Data', it is recommended that the Kerala switches over to Model -2 State for utilisation of backend service from GSTN.***
9. ***ARC recommends that the current specialised work planned for backend support with the help of Indian Institute to Information Technology and Management Kerala (IIITMK) may continue as it will complement efforts of the state as Model -2 States.***
10. ***Anti-Evasion and auditing of GST revenue collection are the two pillars on which the success of GST and the State's efforts for revenue mobilisation rests.ARC recommends that auditing of all matters related to GST, alcohol, petroleum, and petroleum products are done based on the draft Audit Manual of CBIC. This will provide uniformity, besides other advantages.***

ARC recommends setting up of a State Directorate of Audit for the purposes explained in foregoing pages. It may have Headquarters at Thiruvananthapuram and two branch offices –one at Kochi and the other at Kannur. This Directorate will not conduct primary audit which will remain as the responsibility of the audit wing in the Commissionerates.

Chapter 3

PREPARATION AND EXECUTION OF BUDGET

3.1 Introduction

For Governments across the world, budget is the most important economic and fiscal policy tool. Essentially, it translates the aspirations of the people as seen through the lens of political and policy framework of the government of the time, into a concrete action plan with funds allocated duly to each item in it. The financial allocations cumulatively are balanced within the constraint of affordability viz. the limits to how much a government can mobilise resources for what it budgets. It proposes the plans to raise estimated revenue from various sources and its use among various competing needs. Traditionally the budget is viewed as a statement of receipt and expenditure in terms of financial outlays. Budgets in any democracy, approved by the elected bodies (Parliament, Legislative Assembly, Elected Councils) representing the electorate directly. In one sense, Budgets reflects the challenge posed by the classical problem in economics of scarcity – viz: - matching the demand for goods and services – which invariably is limitless - against the supply of funds/resources to accommodate that – which is generally constrained. Therefore, the budget in essence also becomes an expression of the will and commitment of a government to fiscal prudence.

The study (______________ et. al.) (Annexure III) commissioned by ARC brings out various approaches to planning, preparation, execution and monitoring of Budget prevalent across various governments of the world and shed some light into the general weaknesses observed in the current approach to budget preparation. There is no one yardstick to measure quality of a government budget. In most jurisdictions, budget characteristics mirror the historical context in which that society has evolved. For example, countries which were under the British Empire prior to gaining independence all show some similarity – though some of these differences have become diluted over the years with indigenous practices settling in.

However, fiscal policy makers have generally recognized three virtues of a good budget viz.-:

1. Comprehensiveness
2. Transparency
3. Realism

Comprehensiveness of budget refers to how inclusive the budget is in terms of its coverage. Do all activities in government find a place in the budget attached with the necessary financial allocation? No activity important to government in its assessment should be orphaned and fall by the wayside – just because there was some serious omission whereby the activity got ignored at the stage of budget preparation.

Transparency of a budget has several dimensions, both in the preparation of the budget as well as the implementation/execution of the budget. Allocations need to be normative and not *adhoc* to the extent possible, though by the very nature of government functioning, certain arbitrariness in responding to emergencies or unforeseen situations must be accommodated. If one unit of government with a set of objectives and priority has set apart a specified sum in the budget, a similar unit with the same size, form and identical objectives and priority should also be treated on par in this regard. The second aspect is the transparency in budget execution. This translates into whether incurring expenditure by the spending units from funds allocated in the budget (i.e., access to funds) is uniformly easy or smooth. On the revenue side of the budget, transparency equates to the fairness with which revenue (tax and other revenues) and its incidence are structured. There is also a less talked about dimension of transparency – and this relates to how much of trust lies at the base of the budget execution framework. On one side of the spectrum there are systems where any significant expenditure from the budget needs active or even concurrent authorisation, and on the other side are systems where after the budget is approved by the competent authority, spending units have full powers to spend the amounts with all the flexibility necessary for smooth implementation and even incidental corrections in the allocations. Often, the former has to do with a trust deficit in the system – when historically or for other reasons, spending units are not trusted with the funds or the controlling authority (Finance Departments in India) feels that spending units are more than likely to breach guidelines that regulate or govern expenditure from the budget.

Realism relates to the degree of 'over budgeting' or 'under budgeting' in the budget. At the time of budget preparation, it is unlikely that cost data or price data are readily available on the expenditure side. Hence, a certain amount of deviation of actual fund requirement from what is budgeted is natural and is tolerable. But over the years in almost all the States demands of populism have made short shrift of the rigors of budget preparation. Instances are not unusual in which absurd allocations of Rs. 5 crores for building five

medium sized hospitals have been proposed in the Budget, when the actual requirement is not likely to be less than Rs. 150 crores!

On the revenue side, too, there is a valid reason why estimates could miss actual figures realised at the end of the year. The incidence of taxes, the number of taxpayers affected by a revenue measure in the budget may not always be accurate – both for lack of data or for incorrect estimation and forecasting methodologies adopted. But beyond this, State Governments and the Union Government as well boost their revenue estimates to unattainable levels – to accommodate unworkable and inflated schemes to give a populist colour to the budget. Thus, in short, budget variances could arise for legitimate reasons as well as for reasons that compromise integrity and transparency of the budget itself. Beyond this and at a deeper level, knowingly designing an unrealistic Budget is tantamount to deluding concerned legislature and by implication, is a fraud on the people who have elected the government. However in India, where budgetary exactness or rigour is not seen as much of an acclaimed virtue and does not come in for any meaningful review once the budget is approved, realism in the budget will continue to be compromised.

Annexure III, as mentioned earlier, takes a deeper look at diverse aspects of budgets. The scope for discussion, as would be evident on a perusal of the material therein, is too vast. Therefore only selected topics where there is scope for improvement in the short or medium term are discussed, along with brief background, rationale for changes and intended positive outcome. Each recommendation presented in this Chapter, is weighed against the three touchstones of **comprehensiveness**, **transparency** and **realism**.

3.2 Kerala Budget Manual

Budgeting and expenditure control in the State were governed by provisions of the Travancore-Cochin Budget Manual before it was replaced by the Kerala Budget Manual (KBM) in 1966. Thereafter, the provisions have been amended occasionally and in 1977 and 1986two editions of the Manual incorporating the amendments as on date, were published.

There are four distinct areas covered in KBM which are as follows:

1. Preparation of the Budget
2. Passing of the Budget
3. Execution of the Budget
4. Review of the Budget

Of these four, this Chapter focuses mostly on the first and third viz. the Preparation and Execution of the Budget. One obvious reason for this is because the second in the list above viz. ‘Passing of the budget’ is an area under the purview of the Legislative Assembly and the fourth -‘Review of the Budget’ involves multiple players that are part of the framework for financial audit in the State. There are not many changes that be made – and the suggestions that could possibly be made are far too intertwined with processes set in the Constitution or expenditure and audit codes of both the State Government as well as the Comptroller and Auditor General. But the main reason that the Commission has confined its focus to the ‘preparation’ and ‘execution’ of the budget is because these are the two areas where the processes and procedures fail the most when measured against the three yardsticks used to measure the qualities of a good budget.

3.3 Budget Preparation

Before the financial estimates are consolidated and submitted to the Legislature, there are three distinct stages:

In the first stage, estimates are prepared by the Heads of Departments based on estimates submitted by the Regional/District Officers. In the second stage, estimates are scrutinised by the Administrative Department. In the third and final stage, these estimates are scrutinised by the Finance Department. Usually, departmental estimates start coming in September-October, Non-plan Estimates by the September-November and the Plan and Revenue Estimates by the December of each year. Both Non Plan and Plan Estimate preparation are discussed briefly below.

3.3.1 Preparation of Non Plan Estimates

Non Plan estimates prepared by Heads of Departments (often based on consolidation of field or subordinate offices report) in actual practice has become a new set of figures derived by adding a percentage increase to the previous year’s budget. The general assumption on which non plan estimates are prepared by departments or their subordinate units is that the estimates should be projected sufficiently higher than what is required, so that Finance Department will at least allocate an amount that is closer to what they require! Therefore, there is no actual attempt or incentive to identify the real requirements or to pay attention to optimal use of public funds. The Finance Department too, uses a broad standard

approach to work out allocations for the succeeding year based on expected inflation and actual figures spent in the previous years, without taking effort to understand real nature of the requirements, or to differentiate those items of expenditure which need greater emphasis and prioritisation, and those that can be paired down or even dispensed with. Departments have treated preparation of non-plan estimates almost like a game in which the goal is to outwit the Finance Department and maximise its allocations. This goal of procuring the best deal from Finance Department, by itself, is neither unnatural nor undesirable. In fact, it may even be healthy to some extent as it builds up certain competitiveness between departments. But what certainly runs contrary to best practices in the world is the way this has evolved in States in India, Kerala being no exception. Departments hardly develop any real ownership of allocations in the budget heads that they operate – allowing the entire process to regress into a mechanical and mindless bargain.

3.3.2 Preparation of Plan Estimates

Kerala is one of the States that has not given up the Plan–Non Plan distinction in terms of planning. It did not follow the lead of the Central Government in 2014 when it abolished the Planning Commission and replaced it with NITI AAYOG. In hindsight, Kerala did well in keeping its independence of approach. Today practically, the nation has no unified architecture for development or a defined development goal. Beyond a compilation of allocations for schemes in the Union Budget, some (often exaggerated) pronouncements in the Budget Speech, and occasional musings of the NITI AAYOG itself in the form of position papers which finds its way into the media, there is no document which reflects what the development vision of the country is or a single source to which one can turn to for guidance in this regard. In contrast, the preparation of Plan Estimates continues in Kerala within the broad contours of development that the State Government has drawn up through its Five Year Plan documents.

The process adopted for preparation of plan estimates is different. Almost simultaneously along with the preparation Non Plan estimates, the State Planning Board seeks proposals from the departments on new schemes and allocations needed for continuing schemes under the Plan. These are first discussed by Divisions of the Board with the Heads of Departments, sometimes through multiple rounds of meetings. The Divisions in the State Planning Board often armed with the actual progress in the field, proceed to make their

recommendations to the next higher level viz. the Vice Chairperson and Members of the State Planning Board.

While this process of discussions and negotiations between the Departments and the State Planning Board happens, another secret round of discussions progresses between the State Planning Department and the Finance Department. The discussions are done at different levels, but invariably involve Vice Chairperson of the Board, Finance Secretary and finally Finance Minister and sometimes the Chief Minister too. Outcome of these discussions is that the size of the resource envelope available to the State Planning Board is arrived at. Naturally, Finance Department tries to (and not without reason) be realistic/conservative about the size of the resource envelope that it agrees with the State Planning Board. The State Planning Board on the other hand, in the face of challenges and expectations placed on it to meet development aspirations of departments/agencies of government argues for a more liberal dispensation from the Finance Department.

The mechanism adopted in fixing this envelope is the following: (For simplifying the discussion, several insignificant items have been omitted from this analysis, without sacrificing the generalities.)

TABLE 1:	**BALANCE OF CURENT REVENUE (BCR)**
A.	**NON PLAN REVENUE RECEIPTS**
A.1	Share of Central Taxes
A.2	State's Own Tax Revenue
A.3	State's Own Non Tax Revenues
B.	**Grants from Centre**
B.1	Revenue Deficit Grant
B.2	Central Share of Calamity Relief Fund
B.3	Grants for Local Bodies
B.4	Other Non- Plan Grants
C.	**NON PLAN REVENUE EXPENDITURE**
C.1	Interest Payments
C.2	Pension Payments
C.3	Salaries (including pay revision)
C.4	Local Self Government Grants
BALANCE OF CURRENT REVENUE (BCR) = A+B-C	

1. Firstly, the Balance of Current Revenue (BCR) is computed as the amount left after Government meets essential and unavoidable expenditure. This is computed as Non-Plan Revenue Receipts plus Grants Received from Government of India minus Non-Plan Revenue Expenditure. Key components of each of these are shown in Table 1 below.

2. The second step is to calculate Net Capital Receipts of government referred to as Miscellaneous Capital Receipts (MCR). Key components are shown in Table 2 below.

TABLE 2:	MISCELLANEOUS CAPITAL RECEIPTS (MCR)
D.	**Receipts**
D.1	Recoveries of Loans & Advances
D.2	Public Account (net) (does not include Provident Fund and such items)
E.	**Disbursements**
E.1	Non-Plan Capital Outlay
E.2	Disbursement of non-plan loans & advances
F.	**Miscellaneous Capital Receipts (net) (D–E)**

3. Once the BCR and MCR are computed (together they constitute the State Government's Own Fund), added to the Net Borrowings (that the State Government makes i.e., Borrowing minus Repayments) and Assistance received from the Central Government to arrive at the **size of the Annual Plan** as shown in Table 3.

TABLE 3:	SIZE ESTIMATE OF ANNUAL PLAN
G.	**State Government's Own Funds (BCR + MCR)**
G.1	BCR
G.2	MCR (excluding deductions for repayment of loans)
H.	**State Government's Budgetary Borrowings**
H.1	Gross Borrowings (State Provident Fund, Small Savings, Market Borrowings, Loans from NABARD, HUDCO etc. and Loans from Externally Aided Projects)
minus	
H.2	Repayments (Withdrawal from State Provident Fund, Small Savings, Market Borrowings, Loans etc.)
I.	**Central Assistance**
I.1	Grants
STATE GOVERNMENT RESOURCES = (G + H + I)	
(Add) ADDITIONAL RESOURCE MOBILISATION (ARM)	

While this computed figure worked out in Table 3 will be the realistic plan size for the year, government can add any fresh Additional Resource Mobilisation (ARM) at the time of Budget discussions in the Assembly. This too gets added to the State Government Resources that will determine effective size of the Annual Plan. [The rest of additions made to the

Annual Plan size e.g., Extra Budgetary Resources of the Kerala State Electricity Board are only notional as they do not impact the budget in any real sense.]

3.3.3 Budget Accuracy or Budget Variance

Table 4 and 5 shows the results of budget variance analysis for the period 2002-03 to 2018-19 based on data from the study of State Finances (Reserve Bank of India). Both these tables contain the data for all the major subgroups of Capital Receipts and Disbursements, Total Revenue Expenditure and Total Revenue Receipts.

Col 2 in Table 4 shows the average annual deviation for the period of study (2002-2019) of the Accounts figure from the Budget Estimate of the corresponding year.

Col 3 in Table 4 shows the average annual deviation for the period of study (2002-2019) of the Accounts figure from the Revised Estimate of the corresponding year.

Col 4 and 5 in Table 4 shows the maximum and minimum annual deviation for the period of study (2002-2019) of the Accounts figure from the Budget Estimate of the corresponding year.

Col 6 and 7 in Table 4 shows the maximum and minimum annual deviation for the period of study (2002-2019) of the Accounts figure from the Revised Estimate of the corresponding year.

TABLE 4: BUDGET VARIANCE SUMMARY (in per cent)

ITEM	AVG. DEVIATION (Actuals to BE)	AVG. DEVIATION (Actuals to RE)	Max. Devn. (BE)	Min. Devn. (BE)	Max. Devn. (RE)	Min. Devn. (RE)
1	2	3	4	5	6	7
CAPITAL RECEIPTS AND DISBURSEMENTS						
TOTAL CAPITAL DISBURSEMENTS (Excluding Public Accounts)	-10.35	-5.14	8.79	-35.95	12.12	-39.70
TOTAL CAPITAL RECEIPTS (Includes Public Accounts on a net basis)	8.33	7.37	38.12	-35.20	30.86	-37.12
EXPENDITURE						
TOTAL EXPENDITURE (I+II+III)	-3.41	-2.94	6.21	-15.19	10.53	-16.31

I.DEVELOPMENTAL EXPENDITURE (A + B)	**-7.67**	**-5.26**	**0.62**	**-20.60**	**10.26**	**-21.69**
A. Social Services	-7.11	-4.50	2.71	-21.98	10.99	-22.66
B. Economic Services	-7.46	-6.82	16.31	-28.22	11.00	-19.29
II.NON-DEVELOPMENTAL EXPENDITURE (A to F)	**2.30**	**-0.06**	**18.71**	**-12.16**	**11.15**	**-13.47**
A. Organs of State	3.53	-0.17	22.89	-7.22	30.39	-9.20
B. Fiscal Services	0.15	-0.93	15.63	-9.18	14.85	-14.82
C. Interest Payments, Servicing of Debt	2.13	0.59	21.92	-8.48	11.78	-8.90
D. Administrative Services	-5.20	-3.16	6.00	-17.88	15.10	-16.15
E. Pensions	4.00	0.88	25.47	-18.75	16.84	-18.78
F. Miscellaneous General Services	44.76	8.54	315.77	-69.08	69.97	-68.21
III. Grants-in-Aid and Contributions	**-6.27**	**-3.15**	**3.03**	**-39.89**	**19.69**	**-39.89**
Local Bodies	-6.18	-3.48	3.74	-39.89	19.69	-39.89
REVENUE						
TOTAL REVENUE (I+II)	**-7.40**	**-5.52**	**-0.61**	**-15.30**	**-1.57**	**-10.53**
I. TAX REVENUE (A+B)	**-6.49**	**-3.16**	**4.49**	**-16.73**	**1.07**	**-9.67**
A. State's Own Tax Revenue	-6.99	-3.48	4.01	-17.48	1.27	-9.98
B. Share in Central Taxes	-4.26	-1.64	12.35	-19.24	5.28	-10.41
II. NON-TAX REVENUE (C+D)	**-10.74**	**-14.68**	**19.25**	**-31.85**	**-3.46**	**-30.53**
C. State's Own Non-Tax Revenue	0.17	-2.23	26.90	-25.07	20.24	-13.63
D. Grants from the Centre	-16.52	-22.25	23.36	-44.26	-2.02	-42.64

Table 5 shows the margin of error that has crept into budget estimates and the revised estimates.

Under budgeting [denoted by ‘BE (-)’] is when the budgeted allocation is lower than the actual figure revealed by the Accounts approved by the C&AG.

Over budgeting [denoted by ‘BE (+)’] is when the budgeted allocation is higher than the actual figure revealed by the Accounts approved by the C&AG.

Under revising [denoted by ‘RE (-)’] is when the revised allocation is lower than the actual figure revealed by the Accounts approved by the C&AG.

Over revising [denoted by ‘RE (+)’] is when the revised allocation is higher than the actual figure revealed by the Accounts approved by the C&AG.

The data presented in Table 5 shows the level of inaccuracy for three margins of error - 20%, 10% and 5%. It shows the number of years (out of 17 years in the period of study adopted)

where the budget estimate or the revised estimate is overstated or understated in comparison with the corresponding margin of error.

E.g., In Column 3 in Table 5 [BE (+)] against the item Development Expenditure, (pertaining to a margin of error of 20%), the figure 1 indicates that in ONE of the 17 years in the period of study, the Budgeted Estimate was higher than the Actual amount spent as development expenditure by more than 20%. (In other words, the expenditure target could not be achieved in one year by a margin of 20% error.)

E.g., In Column 8 in Table 5 [RE (-)] against the item C. Interest Payments, Servicing of Debt, (pertaining to a margin of error of 10%), the figure 2 indicates that in TWO of the 17 years in the period of study, the Actual amount spent toward interest payments and servicing of debt exceeded Revised Estimate by more than 10%. (In other words, the revised estimate of interest payment was insufficient to meet the actual amount needed for interest payments in two years by a margin of error of 10%).

TABLE 5: BUDGET VARIANCE ANALYSIS (as no. of years showing deviation)												
	Margin of Error: 20%				Margin of Error: 10%				Margin of Error: 5%			
	Budget Estimates		Revised Estimates		Budget Estimates		Revised Estimates		Budget Estimates		Revised Estimates	
ITEM	BE (-)	BE (+)	RE (-)	RE (+)	BE (-)	BE (+)	RE (-)	RE (+)	BE (-)	BE (+)	RE (-)	RE (+)
1	2	3	4	5	6	7	8	9	10	11	12	13
CAPITAL RECEIPTS AND DISBURSEMENTS												
TOTAL CAPITAL DISBURSEMENTS (Excluding Public Accounts)	0	3	0	2	0	6	2	4	1	8	2	6
TOTAL CAPITAL RECEIPTS (Includes Public Accounts on a net basis)	3	1	3	1	7	2	7	1	9	2	9	2
EXPENDITURE												
TOTAL EXPENDITURE (I+II+III)	0	0	0	0	0	2	1	2	1	7	1	3
I.DEVELOPMENTAL EXPENDITURE (A + B)	0	1	0	1	0	5	1	3	0	10	1	7
A. Social Services	0	1	0	1	0	3	1	2	0	10	1	6
B. Economic Services	0	4	0	0	2	7	1	7	5	9	2	12
II.NON-DEVELOPMENTAL EXPENDITURE (A to F)	0	0	0	0	3	1	1	1	5	1	3	3
A. Organs of State	1	0	1	0	4	0	1	0	7	1	1	3
B. Fiscal Services	0	0	0	0	1	0	1	2	5	4	2	4
C. Interest Payments, Servicing of Debt	2	0	0	0	4	0	2	0	5	3	3	2
D. Administrative Services	0	0	0	0	0	4	1	3	1	8	2	7
E. Pensions	1	0	0	0	3	2	3	2	8	3	5	3
F. Miscellaneous General Services	10	2	6	2	12	3	8	3	13	3	8	3
III. Grants-in-Aid and Contributions	0	2	0	2	0	3	2	2	0	3	2	3
Local Bodies	0	2	0	2	0	3	2	2	0	3	2	3
REVENUE												

TABLE 5: BUDGET VARIANCE ANALYSIS (as no. of years showing deviation)												
	Margin of Error: 20%				Margin of Error: 10%				Margin of Error: 5%			
	Budget Estimates		Revised Estimates		Budget Estimates		Revised Estimates		Budget Estimates		Revised Estimates	
ITEM	BE (-)	BE (+)	RE (-)	RE (+)	BE (-)	BE (+)	RE (-)	RE (+)	BE (-)	BE (+)	RE (-)	RE (+)
1	2	3	4	5	6	7	8	9	10	11	12	13
TOTAL REVENUE (I+II)	0	0	0	0	0	5	0	1	0	12	0	10
I. TAX REVENUE (A+B)	0	0	0	0	0	5	0	0	0	11	0	2
A. State's Own Tax Revenue	0	0	0	0	0	6	0	0	0	10	0	6
B. Share in Central Taxes	0	0	0	0	1	5	0	1	5	8	1	3
II. NON-TAX REVENUE (C+D)	0	3	0	4	2	10	0	13	2	12	0	14
C. State's Own Non-Tax Revenue	3	1	1	0	6	6	2	2	8	8	3	8
D. Grants from the Centre	1	9	0	11	3	12	0	16	3	14	0	16

3.3.4 Inferences drawn from Table 4 and Table 5

1. There is considerable inaccuracy in budget estimation in all the major groups of expenditure and receipt. This variation from the final figures in the Accounts of the State, is in a very wide range of -69.08% to +315.77%.

2. Revised estimates (as part of the Budget Preparation) are prepared towards November-December based generally on 5-7 months of actual expenditure. Even these revisions show considerable inaccuracy with the variation from the final figures in the Accounts of the State, ranging between -68.21% to 69.97% across the major groups of expenditure and receipts.

3. What it means is that this degree of inaccuracy and mismatch between the budgeted estimates and the final figures affects the entire process of budget preparation and plan estimation outlined in Tables 1 to 3.

3.3.5 Inaccuracy in Budget Estimates

4. From a count of items with positive entries in Columns 2 and 3 in Table 5, there are 18 cells (out of 44 cells) which show either over budgeting or under budgeting with a margin of error of 20%. These wide margins of error occur, in some sub-groups of revenue/expenditure even as many as in 10 out of 17 years studied.

5. From a count of items with positive entries in Columns 6 and 7 in Table 5, there are 31 cells (out of 44 cells) which show either over budgeting or under budgeting with a margin of error of 10%. 10% errors are seen in as many as 12 out of 17 years studied, in some sub-groups of revenue/expenditure.

6. From a count of items with positive entries in Columns 10 and 11 in Table 5, there are 37 cells (out of 44 cells) which show either over budgeting or under budgeting with a margin of error of 5%. 5% plus errors are seen in as many as 14 out of 17 years studied, in some sub-groups of revenue/expenditure. Most of the revenue/expenditure groups reveal this level of inaccuracy.

3.3.6 Inaccuracy in Revised Estimates

7. From a count of items with positive entries in Columns 4 and 5 in Table 5, there are 13
8. cells (out of 44 cells) which show either overestimated revisions or underestimated revisions with a margin of error of 20%. These wide errors of 20% plus, occur in the revised estimates, in some sub-groups of revenue/expenditure even as many as in 11 out of 17 years studied.
9. From a count of items with positive entries in Columns 8 and 9 in Table 5, there are 34 cells (out of 44 cells) which show either overestimated revisions or underestimated revisions with a margin of error of 10%. 10% plus errors in the revised estimates are seen in as many as in 16 out of 17 years studied, in some sub-groups of revenue/expenditure.
10. From a count of items with positive entries in Columns 12 and 13 in Table 5, there are 39 cells (out of 44 cells) which show either overestimated revisions or underestimated revisions with a margin of error of 5%. 5% plus errors are seen in as many as 16 out of 17 years studied, in the revised estimates of some sub-groups of revenue/expenditure. Most of the revenue/expenditure groups reveal this level of inaccuracy.
11. Revised Estimates are expected to be a better estimate of the actual figures of receipts and expenditures than what was approved in the Budget Estimates. This is indeed true in the case of all financial institutions universally. But overall data above suggests that in several cases, revised estimated failed to live up to this expectation and in a few instances show that they are more inaccurate than the budget estimates themselves.

12. These lead to a conclusion that Budget Preparation is neither realistic nor scientifically done and as such violates one of the cardinal principles of budgeting discussed above viz. **realism**. So, any suggestion on budgetary reform should start with making budgetary processes more realistic and predictable.

3.3.7 Cause analysis of excessive budget variance

Budget variance significantly affects the realism expected of a good budget, in budget preparation in Kerala as can be seen from a study of the budgets of 17 years for the period 2002-03 to 2018-19. This is not to suggest that the problem of inaccuracy in budgeting is unique to Kerala. [For a more complete exposition on the subject, please refer to the publication, “Budget Credibility

of Sub national Governments: Analyzing the Fiscal Forecasting Errors of 28 States in India" by Lekha Chakraborty, Pinaki Chakraborty and Ruzel Shrestha.]

This budget variance is also not a new phenomenon. Data available on Revenue Receipts and Expenditure as well as Capital Receipts and Expenditure (Source: RBI Study of State Finances – 2002), show significant under budgeting or over budgeting that was observed during the period 1995-96 to 1999-2000.

TABLE 6: PER CENT VARIATION IN ACCOUNTS/BUDGET ESTIMATES

ITEM	1995-96	1996-97	1997-98	1998-99	1999-2000
Rev. Receipts	10.0	2.4	5.8	-20.0	-19.4
Rev. Exp.	0.9	-5.0	-6.3	-4.1	-1.
Capital Receipts	-8.9	4.2	6.7	25.3	54.2
Capital Exp.	16.9	-2.9	27.6	2.6	2.5

The Commission feels that regardless of the extent of budget variance it is essential to look at the causes that primarily contribute to this and devise methods to mitigate the same. As mentioned earlier, budget variance is a characteristic of almost all organisations and is not untypical or unusual.

Without a detailed discussion of the proximate sources of the variance, the following reasons evidently stand out as the primary causative factors for the same.

1. Inadequate use of modern statistical methods and tools for expenditure and revenue projections
2. Unrealistic expenditure estimations for schemes/projects, which are not linked to actual cost schedules. Professionalism required for detailed planning of a project/scheme is often seen lacking in Departments/Agencies in government. Even for Capital Projects (PWD etc.), where estimates are prepared based on Government approved schedule of rates, there is no methodology adopted to capture the project execution schedules and link them to the cash flow requirements from the budget. Capital Works therefore get included as rough cost estimates, which in most cases undergo significant upward revision during execution and significantly affect execution of the budget.
3. New budget announcements or new schemes of government finalised after the Budgets are approved crowd out budgetary allocations, cause budget failure, and disrupts budget implementation and its efficiency. New budget announcements either made through the

budget speech or based on post-budget decisions are allocated funds in compliance with the 'New Service Procedures' laid down in the Kerala Budget Manual (Appendix XIII) as amended from time to time.

4. Carried over commitments into a year from expenditure commitments of the past years was more prevalent in the case of capital works in the past. Capital works by their very nature have project timelines which stretch beyond one or even more years. Hence cash flows of a project are met from budgetary allocations from the next year, through a system called 'Letter of Credit' in the case of few departments, or directly from the budgetary allocations for that year. The system of Letter of Credit is dealt with in detail in the Kerala Budget Manual (Appendix XII).
5. Under Article 204 of the Constitution no money shall be withdrawn from the Consolidated Fund of the State except under appropriation made by law. Article 205 of the Constitution provides that when a need arises during the current financial year for supplementary or additional expenditure upon some 'New Service' not contemplated in the Annual Financial Statement for the year, funds will have to be first voted by the Legislature prior to incurring expenditure out of the Consolidated Fund. These too must be placed before the Legislature in the form of Demand for Grants before expenditure can be incurred. Typically, every year there are two Supplementary Demand for Grants (SDGs).

TABLE 7: Voted Portion of SDG for the period 2018-2020	
Year and Month of SDG	Voted portion of SDG (Rs. crore)
August 2020	2178.26
February 2020	5254.39
October 2019	152.67
June 2019	657.59
January 2019	11405.43
December 2018	3416.72
June 2018	1690.47

Table 7 shows figures from SDGs for the period 2018-2020 of the voted portion of the Supplementary Demands. [Charged portions often include the 'gross' of the transactions of settlement of Ways and Means Advances and may not convey a real picture of the impact on the exchequer.] As may be seen from the Table above the size of these transactions outside the original budgeted estimates are by no means small, every year. However, what is unscientific is that SDGs are not preceded by a resource availability check as is done prior to the Annual Budget.

Thus SDGs (or in other words additional expenditure outside the original Demands for Grants) are without observing prudent budget principles and add to the budget distortions in no small measure.

3.3.8 Recommendations

Recommendations listed below relating to the Budget Preparation process are often complementary in nature and are inter-dependent. To achieve desired results of budget optimisation, increasing budget accuracy (or marksmanship) must be taken together as a package. Isolating individual components for ease of implementation will fail to deliver required results.

1. Use of sophisticated forecasting methodologies for budget estimation

Presently a system of incremental budgeting is followed by government without any in-built provision for proper need analysis of budgetary allocations. Incremental budgeting relies on the belief that the next period's budget can best be developed by making some marginal tweaking or corrections to the current period's budget. Not only is this method of budgeting conservative in its approach, but it also discourages the introduction of innovative or progressive ideas into the budget, promotes unnecessary spending of the amount allocated – regardless of any compelling need for the same, fails to account for need for change and upgradation in view of changes in external and internal factors and above all discourages comprehensive review to analyse savings and reallocating it in line with changed policy priorities.

Within the Finance Department, budget provisions are worked out typically on a 'per cent' addition to the existing provisions. For macroeconomic analysis e.g., working out the Medium Term Fiscal Framework, three-year (say) moving average forecasting methodology is used.

The Commission recommends that a professional unit comprising of statisticians, experts in newer technological tools of Machine Learning and Artificial Intelligence needs to be set up in the Budget/Planning Divisions of the Finance Department. Alternatively, such a unit may be recruited in the Kerala Statistical Institute and placed exclusively at the disposal of the Budget/Planning Division in the Finance Department. The service of this Unit shall be made available to other departments for preparing estimates of their budgets too.

2. Decentralising and delegating budget allocation process to owner departments and institutions

In current practice, Budget Officers in charge of departments/institutions submit a 'wishlist' of what they would like to receive as allocations for the next year. In doing so, they are required to comply with the Budget Circular issued by the Finance Department, or instructions issued by the State Planning Board in the case of Plan Schemes. Many a time these circulars may generally require Departments/Institutions to peg their requirements to a certain percentage over the previous year, or during difficult years to the current year's allocation itself.

Finance Department/Planning Board then aggregates the requirements and prunes them depending on the availability of finances. This scaling down of the allocations in the Finance Department is often a mechanistic computation, done on a spreadsheet. The only real guide that Finance Department/State Planning Board uses is expenditure in the previous year. This seriously affects delivery of the project/scheme as contemplated originally.

The Commission recommends an alternative approach that will improve realism in the budget significantly. The approach, as mentioned earlier would work only if the package of recommendations is considered and adopted holistically without severing the package into its individual recommendations for selective implementation. For example, this recommendation, as will be seen further, is linked directly to the Commission's recommendation on budget secrecy.

The Commission recommends that Finance Department/State Planning Board needs to communicate a definite allocation that a department can receive against a major/minor Head of Account. It will be for the department/institutions to develop spending plans and draw up the targets to be achieved within this 'firm' amount. The firm gross allocations can be pegged at (say) 90% of the Budget Estimate in the current year or at a specified level determined by the Finance Department. The 'firm' amounts, or allocations shall be specified by the Finance Department at the MINOR head in the hierarchy of Major Head-Sub Head-Minor Head-Detailed Head-Object Head. Departments/Institutions preparing the budget shall be given complete autonomy to allocate the 'firm' amounts at the Minor Head level across lower levels heads (Detailed and Object Heads).

These estimates within the indicated allocations are aggregated to be included in the Budget. Finance Department/State Planning Board needs to confine its role to minimal pruning/fine tuning of allocations. The success of this bottom-up approach in budget preparation will depend on the quality of tools, particularly scheduling tools and capacity building that is imparted to the departments/agencies. (This is discussed below as part of the

recommendations of the Commission on Web Portal for Estimation and Scheduling.) It will also call for making modifications in the IT Platforms (BOUGETTE and BAMS) currently used by Finance Department and open these up with a Module for the Administrative Departments/Institutions to directly feed in their estimates based on the firm allocations.

3. Link budgetary allocations to a suitably designed cost estimation software linked project/scheme scheduler

Every Chief Controlling Officer or officer responsible for furnishing budget estimates for schemes needs to be liable to develop a project/scheme schedule for the twelve months in the financial year. This schedule should show, with a reasonable but high degree of accuracy cash flows that will be required over the twelve months. To reiterate this idea, the PRICE software helps estimate capital cost of an infrastructure (capital) project, but it does not capture the schedule of completion of the project or the cash flows required along the project completion period.

However, for revenue expenditure (generally reckoned in finance as those with a life of one year or less), the basis of pricing of the various components is quite arbitrary and is not captured till much later - after the budget proposal is approved. In fact, cost estimates are prepared at the time of seeking Administrative Sanctions (i.e., at the time of placing it before the Working Group/Special Working Group as the case may be, for Plan Schemes or when AS is issued by the department in other cases).

Even though Government of Kerala can be proud of an arsenal of IT tools developed in the departments of Finance /Information Technology to control different aspects of Budgeting/Planning, no effort has been made to develop a planning and scheduling tool, as outlined above. As discussed subsequently, such a tool will become a sine qua non for budgetary reform and improving budgeting practices in the State Government.

The Commission recommends that an IT based, Web Based solution needs to be developed for planning and scheduling. Such a platform (Web Portal for Estimation and Scheduling) needs to contain provisions for estimating the cost of various components of a scheme/project, as required.

The following items should invariably be covered under the platform designed for the above:

- *Infrastructure*
- *Human Resources*
- *Establishment Charges*

- *Beneficiary Schemes (e.g., welfare payments, unemployment assistance etc.)*

This platform should be linked to a Scheduling Software to capture timelines of cash flows required for the project/scheme. A host of choices of Scheduling Software are available ranging from Open Source to Proprietary tools (e.g., ZOHO, Microsoft Projects, Primavera etc.) in the market.

4. Resource assessment for Supplementary Demand for Grants (SDG)

As mentioned earlier, supplementary demand for grants are channels provided in the Constitution to 'supplement' the budget estimates approved in the Annual Financial Statement under Article 202 of the Constitution. However, while budget estimates are preceded by an estimation of resources as discussed under the sections – preparation of Non Plan and Plan Estimates, no such exercise is seen done prior to each Supplementary Demand for Grants.

Supplementary Demands for Grants generally, like any Budget Demand contains amounts allocated under Voted for expenditure from the Consolidated Fund and Charged to the Consolidated Fund. In general, on the charged side the large amounts are on account of interest repayments of government as well as treasury adjustments with the Reserve Bank of India or Ways and Means advances. On the voted side, SDG serves two purposes viz:

(1) to regularise additional expenditure authorised

(2) to satisfy "New Service" procedure

The latter (New Service) mostly is curtailed to providing token allocations (Re.1 to Rs.1000 or as appropriate) that authorises the Finance Department to make additional allocations as and when need arises subsequently. The former (regularisation of additional expenditure) also does not impact the exchequer as the financial transaction precedes the SDG itself. In short, a substantial portion of the amount contained in the SDGs do not pose any additional burden on the exchequer as they often merely present a fait accompli in terms of expenditure already incurred.

Therefore, to ensure that SDGs themselves do not distort the budgetary balance contained in the original budget it is necessary to bring in rigor (and rectitude) to the process of authorising additional allocation itself, for meeting expenditure. Currently what happens is that resource availability for funding the SDG is taken for granted. Ironically, it is the very existence

of the budget variance (read inaccuracy and poorly designed budgets) that gives the cushion – so much so that a few thousand crores of additional allocation can be easily set off without posing any pressure on the budget implementation!

But if the package of budgetary reforms recommended by the Commission is implemented by government in right earnest and all seriousness, then it would logically follow that budget variance or inaccuracy should vanish or become almost non-existent. This is only to be expected when the marksmanship in estimating budget/revised figures improves. Should this desirable target be achieved in due course, then the Commission proposes that government publish a resource computation monthly (to begin with). Later, after the system matures this can be done dynamically on a continuous real-time basis and made available in the public portal of Finance Department. This is to suggest that the resource computation exercises (adopted in Plan and Non Plan Estimation) needs to be repeatedly done based on actual expenditure incurred to date and updated expected cash flow requirement extracted from the Planning and Scheduler Portal described earlier.

If net funds available at any given point of time (current resources estimated minus current expenditure estimated over the rest of the year) is insufficient, then government needs to desist from making any significant additional allocation (say over a certain threshold - Rs.1 crore or more) or make specific cuts in the expenditure before doing this. The threshold can be calibrated. It needs to be set at the right size: too small a figure will cripple government's availability to authorise additional allocations needed in due course of administration to meet exigencies or unforeseen contingencies, while too high a threshold will defeat the purpose of the exercise and the distortion in budget implementation will persist.

5. Transparency in budget making

Budget has been traditionally the most secret public document till it is prepared and presented by the Finance Minister before the Legislative Body. Is this age-old practice justified anymore? Can such secrecy in the budget-making process be considered legal or rational in this age of transparency? Traditionally three justifications are given for the extreme degree of confidentiality attached to budget preparation and its secrecy till it is placed before the Legislature or Parliament as the case may be. Firstly, Budget proposals include tax proposals. If tax proposals are known beforehand to few selectively, scheming merchants/traders may resort to hoarding or off-loading inventory or resort to playing the market that would be detrimental to customers and the public in general. So also, in the case of income or other tax proposals

favouring certain class of investments or financial instruments, if a few become privy to the same, it could lead to market manipulation or unbalanced offloading or buying dynamics that would be unfair to other investors. All the proverbial ills of 'insider trading' could also surface in different forms and shapes. Secondly, the Budget documents and the Budget presentation is a solemn opportunity for any Government to make policy announcements and declare its development or regulatory strategy in respect of one or more aspects of governance. Dispersed announcements take away from the focus and sanctity associated with such decisions of the government. Thirdly, (though a much less substantive objection – and hence not discussed herein) is motivated by the thinking that it would be nothing short of sacrilege to make the budget public without first placing this before the representatives of the people themselves (i.e., in the Legislature or Parliament)

The Commission feels that the first argument might have some merit. However, after GST implementation, states have ceded their sovereign authority and autonomy in the federal structure to determine taxes independently (discussed in Chapter II), there is very little left for the State to be secretive about. Therefore, there might not arguably be much need to apply the same yardsticks of secrecy when tax rates were inordinately (and often unconscionably) high – calling for a safeguard to prevent manipulation of transactions by leveraging the tax proposals and the legal amendments related to them. However, as a sovereign prerogative, it may be conceded that the State has a solemn duty to prevent even the remotest of such possibility – and hence keeping the tax/non-tax revenue proposals of the budget under wraps till it is placed before the Legislature might still have merit. But clearly should this secrecy extend beyond the revenue proposals (tax/non-tax mobilisation)?

This brings us to the second argument, that the Budget is an instrument where government traditionally announces changes in its strategy and policy or sets new policy goals for itself. Clearly there is some merit in this argument also. The Commission does not recommend a radical departure from tradition – though it feels that in the not so long future – with information so easily accessible and dissemination of the same becoming much faster with advances in Information Technology - strategy setting, and policy announcements of government may not have to wait for a single day in the year viz. for Budget day – to be made public!

Most governments follow an incremental budgeting system – where a very large part of the Budget (say even as much as 90-95% of the budget) is a continuation of the previous budget. With 60-70% of revenues (on an average) in the budgets of state governments being spent on Salaries, Interest and Pensions, it is clearly impossible for to make any radical and substantial departure from the previous year's budget.

In the light of this, the Commission is of opinion that except for new policy announcements or strategy declarations and their financial allocations there is absolutely no argument that can justify attaching any secrecy to the lion share of the budget. Hence, except for tax/non-tax revenue proposals and new policy announcements, nothing in the Budget needs to be kept secret. This will enhance transparency and will make budget preparation a more democratic, consultative and collaborative process among the parties involved (viz: between the Finance Department/State Planning Board and the Departments/Agencies). The Commission expects that over time, giving up this archaic vestige of secrecy inherited from the past will substantially improve the realism and accuracy of the Budget itself.

6. Passing the full budget before the start of the financial year

A trend that has been observed in the last few decades is for governments to present the budget usually in January-February of the year and then defer passing of the budget to July-August. In the interim, government uses the Vote on Account procedure envisaged in the Constitution. Article 206 (1) of the Constitution provides that the State Legislature may make an advance grant, as a "Vote on Account" (VoA), to meet estimated expenditure for a part of the new financial year. Funds thus voted on account are spent only on services already approved by the Legislature. Legislature of the State is armed with the power to authorise by law withdrawal of money from the Consolidated Fund of the State for the purposes for which the said grants are made.

Typically, a vote on account is rushed through as a formality and passed with no discussion on the matter. In the past, VoAs were taken recourse to generally during the final year of the elected government to meet short-term (3-4 months at most) expenses to keep the administration moving and meet essential expenditure after the new government approves the full Budget. Over the years, despite several recommendations to the contrary, the practice of 'interim' budgets or 'vote on account' has become the rule rather than the exception.

The Commission is of the view that this practice seriously affects efficiency of implementation for several reasons and even detracts from the constitutional sanctity attached to budgets:

1. This militates against the scheme and order of budget approvals by the State Legislatures. Once, the VoA for the months [say April-July (4 months)] is approved, expenditure on the Heads of Accounts can be incurred for the first four months. This means that the Legislature has agreed to the required expenditure in a specific Head of Account. Thereafter, ratification or

approval of the expenditure for the rest of the months in that year becomes a mere formality. So, the entire long drawn out process of discussion and debate attached to final approval (lasting for weeks), once the VoA has been approved and set in motion, is merely a formality (almost meaningless in its outcome). This detracts from the spirit of the constitutional scheme regarding State Budgets, whereby budgets need to be seriously reviewed by the Legislature before the approval of each Demand for Grants.

2. Each Demand for Grant has a 'shelf life' of 12 months viz. the approval of the Legislature is valid only for the financial year. Budget discussions leading to the approval of the Appropriation Act for the full Budget takes weeks of preparation. No insignificant work and time (on the part of the Minister, the Secretary and the Heads of Departments/Agencies) goes into preparation for the Subject Committee discussions, debate on the floor of the House and reply of the concerned Minister in charge of the Demand (or whose sector the Demand corresponds to). Effectively, that leaves the departments only eight months (if the VoA is for say April to July) for budget execution and implementation. This discontinuity is costly and detrimental to the process of budget implementation.

3. The VoA based implementation also involves significant administrative overheads and lets in adhocism and arbitrariness into the expenditure control as discussed further. Each Head of Department (Controlling Officer) is expected to issue Letters of Allotment to the sub officers (Drawing and Disbursing Officers) and thereafter downward to the spending unit. HoDs/Controlling Officers typically issue one Letter of Allotment for the expenditure for the period of the VoA. Thereafter, additional letter(s) of Allotment are issued for the rest of the year, either at one go or in stages, as per extant guidelines. This often leads to a punctuation or pause in the flow of budget execution.

VoA pegs or limits expenditure to the amount authorised in the Demand for Grant approved as part of the VoA under Article 206(1) of the Constitution. To ensure that Departments do not exceed the approved grants under VoA, Finance Department advises proportionate expenditure in all heads of accounts up to the last level. So, for a 4-month VoA, all HoDs and spending units are advised to limit their expenditure to a third (4/12) of each head. But the VoA itself is approval for a gross amount in the Demand presented. So, in reality, this (1/3rd limit on expenditure) imposes an artificial constraint on expenditure which is not there in the VoA itself. To clarify, while in the VoA the cap is at the Demand Level, in actual practice the limit is applied at the Minor Head or Detailed Head level itself.

At the same time, departments which are in urgent need to spend more than the proportionate amount in the period of the VoA either do it and then get the expenditure ratified or seek approval from Finance Department to get over this limit. Either way, this contradicts 'transparency' principle that should characterise good budgets.

4. Finally, this can seriously compromise efficiency of budget execution. For instance, where the expenditure needs to substantially incurred in the early months of the year (e.g., expenditure of a seasonal nature as in the agriculture sector) or where bulk procurement needs to be made under the scheme (e.g., purchase of life-saving and costly equipment in a hospital) or where the training programmes for a scheme must precede implementation of the scheme itself, the rule of one-third or one-fourth limit of expenditure can setback implementation by four months.

The Commission therefore recommends that government (Finance Department and State Planning Board) needs to rework the budget cycle (published annually) so that all deliberations in the Legislature is completed in time and the Appropriation Act envisaged under Article 204(1) of the Constitution approved before the 15th of March annually.[As discussed under the section on Budget Implementation below, the Commission feels that last fortnight of the month of March should be made available to all Departments to issue necessary Administrative Sanctions, so that Government Agencies will have the full benefit of twelve months for implementing the schemes or completing the activities for which funds have been allocated in the Budget.]

7. Budgeting for carried over expenditure (or spill-over expenditure)

One of the serious flaws in budget design (both in the Union Government and the State Governments) is that the Budget (in most cases) do not reveal spill-over (or unpaid liability) in any head of account. Unless a Ministry at the Centre or a Department in the State has an explicit provision in the budget allocated for meeting accumulated liabilities, there is no design element in the preparation of the budget itself that will ensure that the extent of liabilities carried over from previous years are provided for and captured explicitly in the Budget. For instance, in the Union Budget (2020-2021) the allocation of Rs. 61500.00 crore in the Demand for Grants set apart for the Mahatma Gandhi National Rural Employment Guarantee Program does not offer a clue as to how much of it is for meeting the accumulated liabilities for meeting bills/claims of the previous year (2019-2020) of the State Governments. This is true for the State Government budgets as well. Thus, in any Budget in the Union or State Government a high degree of opacity is inherent in the process itself.

One reason for this is the manner in which Governments maintain their accounts. Governments in India follow cash basis accounting. This means that Revenue is reported only when cash is received, and expenditure is only recorded when cash is paid out. In the alternative method, viz. accrual based accounting, revenue is accounted for when it is earned (and not necessarily received). Similarly, expenditure of goods and services are recorded despite no cash being paid out against those expenses and classified as accounts/liabilities payable. But the switch over to an accrual based system falls in the domain of the C&AG, the Union Parliament and the Union Government – and hence is outside the scope of this Chapter.

Government of Kerala, like any other State Government has to contend with this inherent difficulty or limitation. In the first 25 years of independence, government faced the difficulty of budgeting for spill-over works in capital projects, which had a completion period that extended beyond a year. The system of cheque drawing departments (PWD, Public Health (present Kerala Water Authority), Forests, was brought in to smoothen cash flows for works. But that was still not a solution to address root cause of the issue - the indeterminacy of payment schedules and poor information on the exact cash outflows required. In 1974, government brought in the system of Letter of Credit to make payments on account of capital works more efficient. As the years went by, (without addressing the problem of identification of exact liabilities on account of capital works, and budgeting for it), pendency of bills increased to as high as 18-24 months for some sectors (e.g., roads where contractors have to wait as long as two years to get their bills paid). In almost all sectors (buildings, forest, irrigation etc.) unpaid bills began to pile up inordinately. What this translated into is that the current year allocation in the Demand for Grants approved by the Legislature is in fact used to defray bills that date back two years – and not spent on the schemes or projects approved by the Legislature that year! Contractors would factor in this delay into the tenders – consequently leading to significant wastage of resources from the public exchequer.

However, for a large part of the nineties and till 2015, the problem outlined above of spill-over payments met against the current year's was confined to capital expenditure. But as budget mismatches coupled with populist and inflated budgets (a trend that can be traced back to the mid-eighties in Kerala) put liquidity pressures on the exchequer governments were unable to honour all the bills raised on the revenue side of the Budget also. These bills which could not be paid on presentation to the Treasury were cancelled as unpaid and fresh bills had to be issued in the next financial year. This proved to be cumbersome – and therefore some quick fixes were again attempted by Finance Department to make this less burdensome (e.g., ELAMS – Electronic Ledger Accounting and Monitoring System). However, the problem of designing realistic

budgets - with accurate estimation of current year's requirements as well as accumulated liabilities – remained unaddressed and still remains so.

While the diagnosis of the problem of budget variance and mismatches might look straightforward, the problem is more deceptive than what meets the eye. If for instance, the annual outlay on Roads under the Major Head (5054) for Major District Roads is Rs.1000 crore and the bills unpaid (accumulated liability) to contractors from works taken up in previous years is itself Rs.500 crore (say), and the bills in the pipeline (i.e., undertaken for completed portion of the works in progress) also amount to Rs.500 crore (say), then cash flow scheduling for new works initiated against the allocation in the Budget (i.e., of Rs.1000 crore) will not resolve the problem of budget inaccuracy and mismatch. Evidently, the solution cannot be attempted at one go as (in this example) the entire budgetary provision for the current year is just sufficient to meet unpaid liabilities from the past years – in which context there is little scope for cash flow scheduling for any new works in the current year.

A pragmatic and feasible approach therefore needs to be devised to correct the distortion (over budgeting) over a definite period. One option would be to make a one-time additional allocation for the current year to defray all unpaid liabilities. The current allocation can then be used to provide for more accurately defined budget estimates. This is where, the IT solution proposed above (Web Portal for Estimation and Scheduling) referred to in the earlier recommendations) needs to be harnessed to correctly estimate cash flow requirements for the new works.

If resources availability does not allow government the luxury of making such a substantial additional allocation (which is likely to be the case), then government needs to separate allocation into two (for accumulated liabilities and for new works). Government needs to enforce budgetary discipline and permit commencement of new works to the extent that cash flow (now correctly estimated) can be accommodated within the amount allocated for new works. As regards accumulated or unpaid liabilities, payments towards that will get delayed – and hence Government needs to decide to give interest compensation for the extra wait or bring in a Special Bill Discounting Scheme to pay them off.

The Commission recommends that government needs to enforce budgetary discipline for restricting commencement of works as estimated by the Web Portal for Estimation and Scheduling within the specific provision for new works earmarked as discussed above. This approach, with less difficulty can be adopted for the Revenue Expenditure side of the budget

also. Once the cash flow estimation and implementation scheduling is done correctly, quick fixes like ELAMS (referred to above) can be dispensed with.

8. Budgetary pressures from new announcements in the Budget Speech

Needless to say, Budget Speeches are used by governments to set strategy, announce major initiatives, lay out tax and non-tax revenue proposals and communicate to people what their governments are doing for them. Governments also use Budget Speeches to make a statement about their performance. However, over the last three to four decades (in particular), Budget Speeches have become over-ambitious with Finance Ministers at the Centre and the States showing a greater propensity to over-exaggerate claims both on schemes and policies. In the process, budget realism is given the goby. It may not be untrue to say that in the last three decades in particular, Budget Speeches reveal a greater number of unfulfilled promises made eloquently by successive Finance Ministers than the number of fulfilled promises. However, it is not the announcements perse that pose the problem. The real ill effect of this unbridled propensity to declare more and more schemes and projects in Budget Speeches is visible when some or all of this (depending on the degree of hyperbole), are translated into budgetary allocations and finally get regularised through additional allocations in existing budget heads or through Supplementary Demand for Grants. These new schemes compete for funds with existing schemes – creating liquidity pressures that compromise integrity of the Budget itself. In the process, allocations that are properly voted and approved by the Legislature get underfunded and crowded out – while the schemes that laterally enters through the budget speech (and not voted on by the Legislature even at the time the Appropriation Act is passed and final consent of the Legislature to incur expenditure is received) corner its share of the budgetary allocation.

It would be wishful thinking that the tendency to flood the Budget Speech with new announcements, without examining their realistic fund requirement or resource availability will vanish on its own one day. Pressures of running a government and the burgeoning demands from the electorate for newer public interventions and schemes is only likely to make this even more difficult. Ultimately, the rectitude and transparency practiced in Budget Announcements has its roots in social attitudes and mores - how demanding a society is in its standard of fidelity that it expects from its government and its threshold of tolerance of exaggerated or false promises. But at the same time, no budgetary reform in the State will become meaningful, *unless it tackles this problem posed by governments overusing the Budget as an instrument for announcing far too many measures that are unfunded or underfunded.*

The Commission does not perceive (notwithstanding how sound or logical the arguments to the contrary are), that Governments will give up its freedom to be expressive about new policies, schemes and strategies through the Budget and the Budget Speeches. However, the Commission observes that this needs to be controlled lest budgets themselves lose their meaning. The Commission recommends the following approach and budgetary discipline to ameliorate this problem:

Firstly, a portion of the resource estimated as State's Resources (say 5-10%) should be set apart as a buffer to accommodate budgetary announcements (Table 3 above). In other words, budget allocations should be restricted to the rest of the amount alone. This is a discipline which Finance Ministers alone can enforce with the support of the Council of Ministers.

Secondly, Additional Resource Mobilisation (ARM) in the Budget speech needs to be computed realistically (which is now not the case often) and added to the portion set apart as buffer (as outlined above). The sum of these two amounts should be the resource envelope available to the Finance Minister to announce new schemes.

Itemised computation of this resource envelope and the schemes announced against it also needs to be included in the Budget Speech to bring in the required element of transparency and discipline needed.

3.4 Budget Execution

Having outlined key deficiencies in the preparation of the Budget and suggested reform measures to align budgets on the three principles that distinguish a good budget, it is proposed to examine the process of budget execution itself. A few basic facts underlying the process of budget execution are briefly explained.

3.4.1 Demands for Grants

Every year the State Government must place before legislature a statement of estimated receipts and expenditure of the State for that year, called the "Annual Financial Statement" under Article 202(1) of the Constitution of India. However, the term Budget has come to denote the Annual Financial Statement with all its accompanying and explanatory material along with the other documents which any requirement of law or code should accompany the same.

Article 203(2) provides that the estimates as relates to other expenditure, which are not charged to the Consolidated Fund shall be submitted in the form of demands for grants to the Legislative Assembly, and the Legislative Assembly shall have power to assent or to refuse to assent to any demand, or to assent to any demand subject to a reduction of the amount specified therein.

Thus, it would follow that the atomic unit at which level the Legislature approves the budget is the 'Demand'. Within a Demand, the estimates themselves are arranged against a hierarchy of Major Heads, Sub Major Heads, Minor Heads. Below the Minor Heads are the finer classification in terms of Sub Heads and Detailed Heads. Up to the Minor Heads, the classification is prescribed and issued by the Controller General of Accounts, Ministry of Finance with the concurrence of Comptroller and Auditor General of India.

Typically, a Demand corresponds to a function. Expenditure on Revenue Account, Capital Account and Loans and Advances relating to the function are brought under the same Demand. Thus, under Demand No. XXV WELFARE OF SCHEDULED CASTES / SCHEDULED TRIBES / OTHER BACKWARD CLASSES AND MINORITIES, the revenue expenditure under 2225-Welfare of Scheduled Castes / Scheduled Tribes / Other Backward Classes and Minorities, the capital expenditure under 4225-Capital Outlay on Welfare Of Scheduled Castes / Scheduled Tribes / Other Backward Classes And Minorities and the loan expenditure under 6225- Loans for Welfare of Scheduled Castes, Scheduled Tribes, Other Backward Classes and Minorities are brought together.

Generally, each Demand corresponds to the portfolio of a Minister in the Council. The real 'owner' of the Demand is the concerned Minister and the Ministry. This ownership is passed on to her department in the Secretariat and the department(s)/agency(s) executing the activities envisaged through that Demand for Grants. As explained in what follows, over the years this 'ownership' of the Departments has eroded. While they still perfunctorily go through the Legislative motions in getting their Demands approved in the Legislature, to most Ministers, Secretaries and Heads of Departments, the allocations are viewed as 'control barriers' that are used by Finance Department to keep a check on them!

3.4.2 Appropriation and Appropriation Control

After the Demands for Grants are passed by the Legislature, a Bill - the Appropriation Bill,

is introduced in the Assembly. This Bill provides for appropriation out of the Consolidated Fund of the State of all moneys required to meet the demands approved by the Assembly as well as expenditure charged on the Consolidated Fund of the State, but not exceeding in any case the amount shown in the statement previously before the Assembly. The term 'appropriation' thus refers to the permission that the Legislature gives to government to incur expenditure. Finance Department introduced the system of Appropriation Control with effect from 1st April 1974 in 15 selected departments (Para 67 of the Kerala Budget Manual).

The simple objective of 'appropriation control' as envisaged by government (Finance Department) was solely to control expenditure and make it impossible for the departments concerned to draw on treasuries in excess of the appropriation. In fact, the Kerala Budget Manual (Para 73) in respect of the role of Administrative Department notes "As already pointed out, the responsibility for the control of expenditure against the sanctioned appropriation is mostly that of the Administrative Departments, and all that the Finance Department can do is to take steps for the rectification of any defect in the system of control that comes to its notice. It is, however, open to the Administrative Departments to seek the advice of the Finance Departments on matter affecting the control of expenditure."

But over the years, what financial governance and appropriation control has witnessed is a steady deviation from the democratic 'appropriation control' envisaged in Para 73 of the KBM! The steady 'administrative creep' of the Finance Department into the legitimate scope of work of Administrative Departments has resulted in a vice-like grip over their working by the Finance Department. On the other hand, Administrative Departments too do not systematically resist attempts to force them to cede the turf to Finance Departments but gently acquiesce to these moves. Evidently one reason for such a cultivated indifference to their loss of territory is that such an approach is far less risky and gives them a sense of comfort and security that they are spared of any future allegation (by say occasionally hyper-active Vigilance or Finance Inspection Wings or the audit teams of the Comptroller and Auditor General). But this over-centralisation and concentration of expenditure control in Finance Department has serious consequences. One is of course, the entire process of budget execution becomes inefficient. Secondly, the budget loses its ownership or proper stewardship. Today, the budget is recognised as the sole property of the Finance Department. For Administrative Departments, the allocations and estimates provided therein are merely figures that tell them how far they can spend. The idea of Administrative

Departments owning the budget and becoming its stewards and making the best of the budgetary allocation has got diluted somewhere down the line.

To understand, the extent of takeover of functions of Administrative Departments over the years it is instructive to look at the different IT applications that are designed and management by Finance Department. Today Finance Department administers nearly twenty three Web Applications. These have been grouped into five categories for the purpose of the discussion in Table 8.

TABLE 8 (IT Apps controlled by Finance Department)

I. Applications related to Budget and Treasury Management

1. **Budget System (BOUGETTE)**
2. **Budget Allocation and Monitoring System (BAMS)**
3. **Budget Monitoring System (BMS)**
4. **Integrated Financial Management System (IFMS)**
5. **Bill Information and Management System (BIMS)**

II. Applications related to Liquidity Management

1. **Ways and Means System (WAMS)**
2. **Electronic Management of Ledger Accounts and Administrative Sanction (e-ledger) (ELAMS)**
3. **Bill Discounting System (BDS)**
4. **Effective Management of Letter of Credit Issuance (EMLI)**

III. Payroll functions and benefits management

1. **Pension Information System (PRISM)**
2. **House Building Advance (State Eligibility List) (HBA-SEL)**
3. **Service and Payroll Administrative Repository of Kerala (SPARK)**

IV. Functions that fall exclusively in the domain of Administrative Departments

1. **Legislative Assembly Constituency – Asset Development Scheme (LAC-ADS)**
2. **Vehicle Management and Location Tracking System (VEELS)**
3. **Education Loan Repayment Support Scheme (ELRSS)**
4. **State Confidential Reporting and Reviewing system (SCORE)**
5. **Medical Insurance for State Employees and Pensioners (MEDISEP)**
6. **Chief Minister's Distress Relief Fund (FUNDS)**

V. Functions that are in the sole purview of Finance Departments and internal to it

1. **Financial Administrators' Information Repository (FAIR)**
2. **Government Aided Institutions' PF System (GAINPF)**
3. **Centralized system for accounting and monitoring of Government guarantees and payment of guarantee commissions (GIMS)**
4. **Meeting Information System (MIST)**
5. **Financial Inspection Management Systems (FIMS)**

This over-concentration of powers and function seriously affects efficiency of budget execution, besides setting up budget execution as an 'adversarial' exchange between the spending department (Administrative Department) and the controlling department (Finance Department).

Whether it is in the area of liquidity control, or in the area of administrative functions, the reasons ostensibly used to justify the same in the Finance Department is the need to control and coordinate expenditure functions of other departments. But often what is conveniently forgotten or overlooked or unexpressed is that the root cause of the administrative creep referred to above is that government does not design and execute a 'realistic' budget, where the amounts voted by the people (Legislature) will be treated as sacrosanct and made available to the spending units, no matter what. Not long ago, lapsing funds by a department was viewed with a sense of justifiable horror and a sign of its inefficiency! Instances were not rare when officers who have lapsed funds through their negligence have been punished for such infractions. **But today, the fact that sizable funds get lapsed every year offers the much needed relief to the Finance Department – and**

helps them in tiding over the liquidity pressures especially in the last week of March every year, when maximum piling up of expenditure bills in the Treasury takes place.

But what is pertinent in this regressive decline of budget quality is that the more 'unrealistic' the budget is, the greater the need for Finance Department to exercise control over expenditure functions of other Departments. It is a vicious cycle that keeps reinforcing itself. If the inability to design realistic budgets lies at the heart of budget inefficiency, logically the blame for that should be shared by the Budget formulating functions in government viz. the departments of Finance and Planning (State Planning Board). It is the fault that should be rectified and remedied first. The solution clearly does not lie in bringing in more controls on Administrative Departments and using the whip to make them conform to ineptly designed budgets in the first place.

Out of the five Categories in Table 8 viz:

I. Applications related to Budget and Treasury Management
II. Applications related to Liquidity Control
III. Payroll functions and benefits management
IV. Functions that fall exclusively in the domain of Administrative Departments
V. Functions that are in the sole purview of Finance Departments and internal to it

The six items shown in Category IV Table 8 (marked in red) [Functions that fall exclusively in the domain of Administrative Departments], have no business to be retained in the functional domain of the Finance Department. The Commission recommends that these software need to be transferred to Information Technology Department for maintenance and the concerned Administrative Department(s) for using them without delay..

In Category III (Payroll functions and benefits management), Service Functions (marked in red) need not be administered by Finance Department. In fact, these should be handed over to the concerned Administrative Departments or the General Administration/Personnel Departments. This is also required for development of good personnel management practices over time with capacity building. The approach to bring personnel functions of the State under Finance Department is certainly wrong and bad administrative practice.

In Category II (Applications related to Liquidity Management), the last two viz. Bill Discounting and the Letter of Credit System, Finance Department need to confine their role to providing funds and the necessary system for accounting only. At present, Finance Department has a system of making other departments issue their Administrative Sanction on the portal maintained by Finance Department. The Commission recommends that the module on Administrative Sanction system (in ELAMS) needs to be delinked from the ELAMS system and put fully in the domain of Administrative Departments. The Commission also recommends maintenance of the module itself be handed over to Information Technology Department.

Taken together with the range of functions of Finance Department and the nature of files that are sent to Finance Department for advice, it can be easily surmised that the IT Apps discussed above reveal only a small view of the over-concentration of powers in Finance Department. Administrative Departments enjoy little or no freedom in making the slightest deviation from norms prescribed by Finance Department – although marginal deviations could often facilitate faster programme/project implementation.

The Commission recommends that Finance Department need to withdraw from the systematic appropriation of administrative functions and reverse, without delay the administrative creep that has happened over the decades.

3.4.3 Actual effectiveness of financial control exercised by Finance Department

As brought out above, appropriation control has a simple objective viz. to prevent excess expenditure that exceeds the ‘appropriation’ made by the Legislature when it approved the Demand for Grants. But today, appropriation control buoyed by pressures of liquidity management – and all of that to run a poorly designed and badly balanced budget created by the Finance Department – has resulted in total loss of freedom and autonomy to the Administrative Departments.

For a small deviation needed for hiring a rented building (because it exceeded the rent that was calculated by PWD), or for the regularisation of the travel beyond the ceiling limit, or for ratifying a spike in petrol expenses because of an exigency, files keep travelling to the Finance Department. In fact, many a time, files reach the Finance Department for no real reason – except

that an endorsement by Finance Department gives the officer in the Administrative Department a vague sense of comfort and freedom from risk. The concerned officer in the Finance Department (at the appropriate level of delegated authority) either agrees to the deviation or rejects it. Either way, the officer rejecting or accepting it adds little or no value – but merely substitutes her intelligence for that of the officer in the Administrative Department. Most of the 'exception' or 'exemption' files referred to the Finance Department fall in the area of Wages, Materials and Supplies, Rents-rates-taxes, POL and Travelling Expenses. While some of them are for seeking exemptions in the application of extant guidelines, many of them also seek additional allocation to meet exigencies or requirements in the ordinary course of business.

But the relevant question is whether this labyrinth of administrative procedures results in any real benefit? How significant are they in the larger scheme of the Budget approved by the Legislature?

Table 9 (compiled from the latest Budget Documents 2021-2022) shows the Item wise share of some of the items of expenditure. Both figures from the latest audited accounts (2019-20) and the latest Budget Estimates for 2021-22, are shown in the Table

TABLE 9 - Item wise share of major items of expenditure				
Item	**2019-20 Accounts**	**% share**	**2021-22 BE**	**% share**
1 Salaries	₹ 31,774.87	27.78%	₹ 39,845.75	24.99%
2 Pensions	₹ 19,064.29	16.67%	₹ 23,105.98	14.49%
3 Interest	₹ 19,214.70	16.80%	₹ 21,940.20	13.76%
TOTAL OF 1 to 3	**₹ 70,053.86**	**61.24%**	**₹ 84,891.93**	**53.25%**
4 Grant-in-aid	₹ 2,824.58	2.47%	₹ 3,217.63	2.02%
5 Subsidies	₹ 1,378.19	1.20%	₹ 2,084.55	1.31%
TOTAL OF 1 to 6	**₹ 74,256.63**	**64.92%**	**₹ 90,194.11**	**56.57%**
6 Minor Works	₹ 71.27	0.06%	₹ 127.17	0.08%
7 Major works	₹ 317.92	0.28%	₹ 750.02	0.47%
8 Scholarships and Stipends	₹ 930.65	0.81%	₹ 1,181.24	0.74%
9 Contributions	₹ 428.82	0.37%	₹ 814.93	0.51%
10 Wages	₹ 1,268.68	**1.11%**	₹ 1,375.02	**0.86%**

11 Materials & Supplies	₹	163.99	**0.14%**	₹	175.29	**0.11%**
12 Machinery & Equipment	₹	52.48	0.05%	₹	92.90	0.06%
13 Travel Expenses	₹	143.44	**0.13%**	₹	154.13	**0.10%**
14 Maintenance	₹	84.37	**0.07%**	₹	125.80	**0.08%**
15 Petroleum, Oil & Lubricant	₹	103.89	**0.09%**	₹	101.42	**0.06%**
16 Motor Vehicles	₹	27.22	0.02%	₹	20.89	0.01%
17 Rent Rates and Taxes	₹	43.67	**0.04%**	₹	50.38	**0.03%**
TOTAL EXPENDITURE	**₹**	**1,14,384.94**		**₹**	**1,59,427.21**	

Table 9 shows that Salaries, Pension and Interest accounted for 61.24% of Total Expenditure (Capital and Revenue included) in the latest accounts audited by the C&AG. In the BE for the year 2021-22, these items together are expected to be 53.25% of the total Expenditure. If subsidies and grant-in-aid (both are items which are largely normative and hence offer little scope for modifications), the five items - Salary, Pensions, Interest, Grant-in-aid (mostly to Local Bodies) and Subsidies accounted for 65% of the Total Expenditure in 2019-20 and has been estimated at 57% for 2021-2022.

The items - Wages, Materials and Supplies, Travelling Expenses, Maintenance, POL &Rents-rates-taxes accounted for a miniscule 1.11%, 0.14%, 0.13%, 0.07%, 0.09% and 0.04% respectively in 2019-2020 as per the audited figures (cumulatively 1.58% of the expenditure in the budget!!). In the next year's budget (2021-22) these items are 0.86%, 0.11%, 0.10%, 0.08%, 0.06% and 0.03% (cumulatively 1.24% of the total expenditure in the Budget!!) respectively. For all the due diligence that Finance Department might exercise on controlling these items and the red tape and administrative delay the very process of referring files to Finance Department entails, these efforts on such miniscule items clearly are hardly significant when measured against the size of the budget, and in reality contribute very little to efficiency. The only good that comes out of these virtually meaningless controls (arguably) is that a general message conveying a scare and urgency that everyone should be 'fiscally' disciplined permeates to the Government Departments. But at what price?

3.4.4 Approach to Financial Regulation and oversight in Budget Execution – a shift from Rule-based approach to Principle-based approach

Modern regulatory practices are rapidly moving away from **Rules-based regulation** (based on detailed rules that set out specific standards and requirements and is generally highly prescriptive, making clear what is permissible and what is not) to **Principle-based regulation** (where only fundamental principles or guidelines are laid out, leaving the exact details of implementation to individual agencies relying on their wisdom to interpret the broad principles). Of late, regulatory processes are witnessing an even more radical move to **Outcomes-based regulation** where the focus is for the regulated entity and its management (read Secretaries/Heads of Departments/CEOs) to deliver the desired outcomes for its clients (viz. the people of the State/stakeholders).

The Commission recommends that one crucial element of budgetary reform is to restore the autonomy of the Administrative Department in appropriation control. In this age and time, when regulatory regimes are becoming more open and flexible, the kind of control exercised by Finance Department on Administrative Departments and the level of consequent inflexibility is regressive. It is inimical to modern regulatory practices as indicated above.

Reappropriation is defined as the transfer of funds from one unit of appropriation to another. From 1974-75 the detailed heads of account, wherever they occur in the Budget Estimates are treated as distinct units of appropriation. General restriction on any reappropriation is provided in Rule 84(2) of the KBM which reads as follows:

> Rule 84(2) *No reappropriation is permissible between grants, or between the charged and voted sections or the revenue and capital sections of the same grant or for meeting expenditure on a 'new service' not contemplated in the budget estimates for the year.*

The Budget Manual (Rule 84) delegated the power to reappropriate between heads subordinate to a minor head to the Administrative Department of the Secretariat and the Chief Controlling Officers of that unit of appropriation. So technically, Administrative Departments/Chief Controlling Officers can reappropriate on their own between detailed heads of accounts (i.e., those that fall under a minor head) – but even such proposals nowadays are referred to Finance Department for approval. The Budget Allocation and Monitoring System of Finance

Department (BAMS) disallow reappropriation by Administrative Departments without the specific concurrence of Finance Departments, despite the provisions in the KBM.

The above authority of the Administrative Department, in disuse now for the most part could be exercised at the level or unit of appropriation - the detailed head. Rule 84(1) brought in an explicit restriction on reappropriation between minor heads. This Rule is to the effect that ***"the power to reappropriate between MINOR heads within a grant is exclusively that of the Finance Department, and its reserve power to refuse reappropriation is a check on overspending, and it should encourage the departments to be watchful about potential excesses."*** However, going back even further, before 1974 there was a time when Administrative Departments exercised the power to reappropriate between two minor heads within the same demand. The ostensible reason for this restriction brought in Rule 84(1), as mentioned above, is that if the authority to reappropriate between Minor Heads is granted to Administrative Departments there would not be any automatic check on overspending and would not encourage the departments to be watchful about potential excesses. Whatever be the merit of this argument when it was written in 1974, in this age of Information Technology and the availability of sophisticated control mechanisms in the battery of IT tools developed by Finance Department this argument has certainly no merit. The Treasury IT portal (Integrated Financial Management System – IFMS) coupled with BAMS can be programmed to disallow potential excesses and to automatically reject bills drawn in excess of the limits. Thus, the raison d'etre for restricting the right of Administrative Departments to reappropriate between minor heads no longer exists.

The golden rule that the Commission has borne in mind in addressing reforms needed in budget execution is that each Demand for Grant represents a 'function' assigned to the Administrative Department. The Legislature has authorised the Demand for specific achievement of this 'function'. This 'function' itself corresponds to the portfolio assigned to one or more of the Ministers in the Council of Ministers and as such is the exclusive domain of the concerned Administrative Department(s) or Agency(s) under that Minister(s).

Therefore, it follows that the Administrative Department needs to have sufficient flexibility and autonomy to determine how best to deploy resources approved by the Legislature within a Demand, in furtherance of the 'function'. This freedom should not be taken away by the Finance Department in the guise of appropriation control. Taking away autonomy of the Administrative

Department is antithetical to the constitutional arrangement envisaged in the scheme of approval of Demands for Grants by the State Legislature. Furthermore, in an age where payment in excess of the Demands approved by the Legislature is easily prevented by technological tools available, the arguments that controls by Finance Department are necessary to prevent breaching the provisions of the Budget is quite specious.

3.4.5 Recommendations

In the light of the above discussion, the Commission recommends the following.

1. ***As an immediate step, all restrictions on the exercise of the authority of the Administrative Departments envisaged in the KBM on reappropriation at the level of the detailed head needs to be removed. Circulation of files to Finance Department shall not be insisted to issue orders.***

   Budget Allocation & Monitoring System (BAMS) is an online computerised system to distribute budget and authorise expenditure. BAMs need to be slightly re-engineered to make it accessible to the Administrative Departments and Chief Controlling Officers, for effecting re-appropriations (without having to wait for concurrence of Finance Department). In other words, control of the reappropriation procedure needs to vest completely with the Administrative Secretariat.

2. ***Rule 84(2) of KBM needs to be removed and Administrative Departments and Chief Controlling Officers given powers to reappropriate funds between Minor Heads, within one year of implementing Recommendation 1.***
3. ***Progressively, this power of reappropriation needs to be extended to level of Sub-Major Heads under a Demand, within one year of implementing Recommendation 2.***
4. ***Finally, this power of reappropriation shall be extended to the level of Major Headunder Demand within one year of implementing Recommendation 3.***

   For ensuring that Plan priorities of the State Government are not distorted, where this reappropriation affects components of a Plan Scheme the concurrence of the State Planning Board/Planning Department should be obtained where such reappropriation is over 25% of the item that is being reduced or Rs.10 crore, whichever is lower.

   For ensuring that Finance Department will not have to contend with any unexpected challenges to maintain liquidity, to begin with, for Non Plan components prior concurrence of the Finance Department needs to be obtained where reappropriation is more than 25% of the total allocation in that Major Head or the amount reappropriated from a single Major Head

exceeds Rs.10 crore. [<u>Note:</u> In a properly designed budget, where the entire amount is made available for unhindered withdrawals (i.e., without liquidity restrictions), this should not pose a problem and such a restriction would be unwarranted. This recommendation is therefore only for a limited period, till Finance Department can design and implement budgets accurately with reasonable variances and mismatches.]

5. ***In consonance with the transition recommended by the Commission to Principle-based Regulation (away from Rule-based Regulation), and the fact that those items account only for a miniscule portion of the Expenditure Budget of the State, total flexibility needs to be given to the Secretaries of the Administrative Departments in the following items:***
    - ***a) Wages***
    - ***b) Materials and Supplies***
    - ***c) Travelling Expenses***
    - ***d) Maintenance***
    - ***e) POL***
    - ***f) Rents-rates-taxes***

    Secretaries of the Administrative Departments need to be able to justify deviations made and its reasonableness. These deviations need to be noted and recorded in the portal for issue of Administrative Sanction (See earlier recommendation). Needless to say, autonomy given to the Administrative Departments will impose a higher degree of accountability from them.

6. ***The Commission recommends that in line with the modern and democratic approach to regulation viz. a shift to principle-based regulation, the Kerala Budget Manual needs to be rewritten to reflect this spirit and make it progressive in tune with the times. This will restore a sense of ownership of the Administrative Departments over the Budget and their respective Demands. It will also be a panacea to the trust-deficit that distinctly characterises the oversight of the Finance Departments over the Administrative Departments.***

3.5 Budget Execution Cycle

Legislature grants approval to a Demand for Grant for incurring expenditure over the whole of the financial year. But for two reasons - (1) the Vote on Account system that artificially introduces a pause in the budget execution cycle and (2) Preparing estimates/Detailed Project Reports/Action Plans and issuing Administrative Sanctions consumes time, leaving only a few months for actual commencement of the expenditure. The need for passing the full budget,

without recourse to the Vote on Account has already been touched upon. The discussion here is confined to the second – viz. saving time on preparatory work (Estimates/DPR/Issue of AS) leading to actual expenditure.

For efficient and optimal utilisation of resources and for avoiding wastage of resources through hurried execution, it is best to utilise the entire financial year for planned execution of expenditure. However due to capacity constraints in preparing these estimates with reasonable degree of accuracy both on the costs as well as on the project implementation/expenditure schedule, considerable time is lost at the pre-project stage itself. The Web Portal for Estimation and Scheduling (described in the recommendations above) would provide a handy tool to resolve this issue. If the personnel in the Planning Divisions of the various Departments are adequately trained in project management and on the use of the software, they would be able to prepare cost and time schedules quite easily for most of the schemes and expenditure items. In the case of more complex projects, a special allocation needs to be provided in the budget for hiring good resource consultants. The Commission recommends that resource consultants need to be empanelled by Administrative Departments for this purpose.

This will also require that, as briefly mentioned earlier, the Finance Department/State Planning Board need to intimate Major Head Wise firm allocations that will be included in the Annual Budget, so that Administrative Departments can prepare their cost estimates and time schedules with high degree of accuracy.

Using the Web Portal for Estimation and Scheduling, all Administrative Departments should be required to complete preparation of their schemes and projects within the specified 'firm' allocations that are intimated to them. The process of preparation of these cost estimates and time schedule needs to be completed before November 30 of the financial year. These cost estimates are then accumulated Major Head-Sub Head-Minor Head-Detailed Head-Object Head through the Budget Allocation & Monitoring System (BAMS) and the BOUGETTE (the software used by Finance (Budget) Department to prepare various documents) which then become part of the Annual Budget.

As mentioned in an earlier recommendation, budget preparation and approval schedule need to be carried out by the Legislature in such a way that, ideally final Appropriation Act is approved before the 15th of March every year. This leaves the last fortnight to all Administrative

Departments to issue necessary Administrative Sanctions. Such a well planned and executed budgetary cycle will ensure that Administrative Departments will have the entire twelve months in the financial year for budget execution.

3.6 Recommendations

1) ***Detailed scheduling of the projects/expenditure items needs to be done prior to the start of the Financial Year. Necessary changes should be made in the relevant IT tools that are used by the Finance Department as mentioned above.***
2) ***Firm allocations need to be communicated in advance to administrative departments for allowing preparation of estimates and implementation time schedules.***
3) ***Specific attention needs to be given to capacity building of planning divisions in the departments and institutions under it. Departments need to be provided with adequate funds to hire expert resources in the preparation of DPRs for more complex projects.***
4) ***A new Budget Cycle specifying revised timelines to reflect the recommendations in this Chapter should be drawn up for proper implementation of the package of measures suggested here.***

3.7 Adopting International Best Practices in Budgetary Reforms in the State

The host of measures suggested for Budgetary Reform requires careful design and planning. While doing so, best international practices need to be adopted. Several governments (New Zealand, Australia, United Kingdom etc.) have done extensive work in reforms in their own budgetary processes. When the State Government decides to address budgetary reforms seriously, it will be a tremendous loss of opportunity if reforms in Kerala were to miss out on the work done internationally.

3.8 Recommendations

Hence, the Commission recommends that government needs to take steps to appoint an Expert Group comprising of both national and international experts – particularly those who have worked in the area of budget reform and design. To get the best talent available, the Commission would suggest that Government go in for an international bid for the aforesaid procurement.

The process of budgetary reforms needs to start immediately and should not wait for appointment of consultants or completion of their study. The problem created by poorly designed budgets is so grave, that budgetary reforms cannot brook any further delay.

Chapter 4

RATIONALISATION OF EXPENDITURE AND DEBT MANAGEMENT

4.1 Introduction

The State Government enacted the Kerala Fiscal Responsibility Act, 2003 to ensure, prudence and stability in fiscal management, and by progressive elimination of revenue deficit and sustainable debt management greater transparency in fiscal operations of the government in tune with the medium-term fiscal policy of the state.

Fourteenth Finance Commission recommended the following set of rules relating to fiscal targets and annual borrowing limits for the states:

(1) Fiscal deficit of the state should not go beyond an annual limit of 3 percent of GSDP (2) state will be eligible for flexibility of 0.25 percent of GSDP over and above this for any given year if its debt-GSDP ratio is less than 25 percent in the preceding year (3) state will be eligible for an additional borrowing limit of 0.25 percent of GSDP in a given year if the interest payments are less than 10 percent of the revenue receipts in the preceding year etc.

Thus, a state can have a maximum fiscal deficit-GSDP limit of 3.50 percent in any given year if the above criteria are fulfilled. If any state is not able to utilise the sanctioned limit of 3 percent of GSDP in any particular year it will have the option of availing the unutilised borrowing amount in the following year, but within the award period. In the previous years, the state could not achieve the deficit indicators presented in the budget and thus became ineligible for availing increased borrowing limits. As there is restriction on borrowings the state is compelled to incur expenditure within what is permitted by the borrowing limit and what is available from revenues raised by it or funds from the Central Government (on account of the State's entitlements under the Finance Commission Awards) or by way of grants/loans from the Centre and what is available from Externally Aided Funding. Hence the Government must order its priorities with the limited resources available. A sizeable amount of funds is necessarily to be spent on committed expenditure, and hence the allocable funds for

Plan schemes need to be utilised sensibly. It is high time the state initiate measures to contain debt.

4.2 Current practice - Need for reforms in Rationalisation of Expenditure

Matters concerning the entire nation such as control over currency, coinage, defence, international affairs etc. are responsibilities of the Central Government, while the States bear the main responsibility to deliver public services that are of more immediate concern to the people, like public order, public health and sanitation, agriculture, water supply and irrigation. The States also have concurrent jurisdiction in several areas like education, electricity, economic and social planning, population control and family planning. **Powers to levy broad based resources (income tax, corporation tax, customs and excise, GST) are vested in the Centre, while the States can levy a few other taxes with limited revenue potential -duties of excise on liquor, motor vehicle tax and taxes on agricultural land and income. Revenue from state's own sources meet on an average only about fifty to sixty percent of state's current expenditure, necessitating transfers from Government of India on a large scale thereby weakening the Wicksellian connection between spending and taxing decisions and raising the possibility of opportunistic fiscal behaviour among recipient governments.** These are supplemented with the devolutions of the Finance Commissions from time to time and through borrowings, which too has a limit now.

State finances have certain special features worthy of mention. Despite interventions and participation by the private sector in the health and education sectors, government is constrained to continue with higher investments in the sectors to ensure quality of service and access to health and education by all sections of the society, and for inclusive development. Combined with this, investments in primary and secondary sectors are considerably less and private participation and investments in these sectors are not adequate to give fillip to the economy leading to a scenario of heavy expenditure burden on the states despite low level of budgetary resources. Historically, finances of Kerala have gone through large fiscal deficits, high revenue expenditure, and resultant revenue deficits, high debt, and low capital expenditure.

The fiscal stress faced by the state to maintain its achievements in human development and fund capital infrastructure formation given the 'fiscal space' due to rule based fiscal

framework is increasingly getting attention. Recent reports of the Kerala Public Expenditure Committee highlighted that revenue led fiscal consolidation is what the state attempts to do. However, volatility of revenue - both of own revenue and devolution of central shares of taxes and grants – remain a matter of concern.

It can be seen that revenue is over projected in the budget to match expenditure leading to a gap of about Rs15,000 Crore in the budget. Identifying innovative policy tools in strengthening Additional Resource Mobilisation programmes or reduction in public expenditures are significant at least to maintain the current level of growth -inducing capital formation in Kerala. This persistent imbalance between revenue and expenditures affects growth of the state as there is very little funds available for any capital formation. Another recent development is that Government of India now includes public account borrowings through the Treasury Savings Bank (TSB) system to calculate the State's borrowing limit at 3 percent of GSDP. This has considerably taken away the leeway that the State Government had in leveraging the Public Account for mobilising resources to meet its expenditure. [There is an argument however by some critics that this action of the Government of India will not stand the constitutional test and goes beyond what is permitted by Article 293]. Thus, restriction on over borrowing, lower growth rate, increased tendency to launch new schemes on the expenditure side and continued post creation has led to creation of serious financial issues to Government of Kerala. Although creation of posts is a necessity in all governments, in the case of projects of both long and short duration it is observed that these posts once filled in continues even after completion of the project/ period for which it is created. Annual approval for continuance is taken up by the implementing agencies for one reason or the other. These expenditures and continuance of posts even after the period for which it is sanctioned leads to heavy burden on state's financial system. Necessity for continuance of posts should be examined carefully. Onetime works audit needs to be conducted to optimise the number of employees in organisations and departments of the government.

It is often observed that the present practice of budget preparation has the following deficiencies (major issues are addressed in Chapter 3):

- system of incremental budgeting without any in-built provision for need based analysis of budgetary allocations.

- gap between demand and supply of funds is constantly widening as rate of growth of expenditure exceeds rate growth of resources for meeting the expenditure.

- expenditure demand is large compared to available resources. Budgets are formulated quite often to meet demands, resulting at least partially in inflated resource estimates.

- realisation of resources falls short of projected estimates and expenditure targets remain unattainable. This is further exacerbated through cutting short of actual releases by Government of India.

- committed liability of unfinished schemes gets carried over to succeeding financial years, adding more pressure on the limited resources available.

- distribution of limited budgetary resources among large number of schemes with token provision to satisfy demands of political entities and the people also give rise to frittering away of resources without achieving desired results.

- Although the rules set forth in the Budget Manual is looked in-toto, quite often other regulations and international and national norms set forth in the realms of budget preparation are not keenly observed.

4.3 To understand the fiscal scenario of the state following parameters may be looked into:

1) Revenue Performance of the state:

Revenue deficit as percentage of revenue expenditure continuously hovers between 16 to 19 percentage for almost a decade except in 2015-16 (12.3%). This accumulated deficit is a serious issue in the long run distorting total fiscal balance of the state and contributes to increased unproductive debt. Revenue deficit as percentage of GSDP also show a similar pattern and it hovers between 2 and 3 for the period from 2011-12 to 2017-18.

2) **Gross Fiscal deficit as percentage of total expenditure and GSDP:**

During most of last decade gross fiscal deficit as percentage of total expenditure hovered around 25 percent. These deficits impact the 'fiscal space' of government. Gross fiscal deficit as percentage of GSDP is also on the rise since 2010-11. High fiscal deficit over long periods could imperil savings rate of the state and thereby affect its investments, particularly on infrastructure. It could also lead to outflows from the state economy. These risks, unless carefully addressed can lead the economy to a debt trap.

3) **Primary Balance:**

Primary fiscal balance is defined as the difference between total revenue and grants, and the total noninterest expenditures. Since primary balance excludes interest payments, it is expected to have some surplus even if the conventional fiscal balance shows deficit. In other words, primary balance is expected to show positive balance even if the government has high debt burden and thereby large interest payments. It is observed that for the period from 2011-12 to 2017-18, non-interest expenditure is higher than that of the revenue i.e., the primary balance is negative for the period. This shows the fiscal health of the state during the period. It is found to be quite precarious as the phenomenon is not for some years but has persisted continuously, and there is phenomenal increase in deficits which is detrimental to the economy at large. Moreover, the primary deficit will be used mainly for consumption rather than for investments. Government needs to find ways to immediately plug such lapses, failure to do so could be catastrophic to the economy and lead to fall into a debt trap.

4) **Overall financial burden for the state:**

Overall financial burden for the state, from budgetary sources and through public sector undertakings together is Rs 28603.17 crore in 2016-17. It can be observed that financial burden is on the rise from 2010-11 onwards. While it was of Rs 7260 cr. during 2010-11 it reached to Rs. 28603 cr. during 2016-17, a rise of 400 percent over a period of 5 years. Investments in public enterprises are intended to contribute to the state from its profits, but the contrary happens.

In this connection it is suggested that an analysis of the functioning of public sector undertakings needs to be done. Based on the analysis, restructuring/reengineering of the undertakings need to be taken up. Possible options including infusion of private capital through public-private participation shall be considered. Many of these undertakings are maintained by the state only to prevent loss of jobs and undertake a welfare role. Government needs to invest in reskilling employees for improving productivity and employability. Options including voluntary retirement and employment to children/relatives also need to be considered. Private sector investments should be channelized into enterprises that can be opened up for private investment. Another major issue faced by these undertakings is inadequacies in technical efficiency and obsolescence of plant and machinery. Wherever technology infusion/replacement with modern machinery can assist in improving their functioning, government may make one time investment for adoption of technology/replacement of plant and machinery and provide necessary skills to the employees to handle it. Government also needs to give autonomy to the enterprises in taking business decisions. These steps can assist the state in reducing its debt burden and resultant savings can be channelised for development purposes.

5) **Return on Capital and Return on equity*:***

Both, public sector returns on capital employed and return on equity by the state shows a declining trend. Return on equity is negative from 2013-14 and has increased manifold in the last 2-3 years.

For these reasons, the State Government finds itself struggling to mobilise resources for day to day management of finances and for meeting its developmental objectives. One possible source is to incur additional debt and find resources to finance and the other is to shift developmental objectives to other entities and finance them through extra budgetary sources.

4.4 Debt Management and Servicing of Debt

In the absence of adequate resources from its revenues, governments resort to borrowing funds to finance its development goals. However, the real issue is that a considerable part of the

debt of the state is incurred to meet even revenue expenditure, given the revenue deficits. If done prudently, borrowed funds can foster development of the economy. Even in the portion of debt that actually goes to finance projects, it would appear that they are spent on projects/schemes without direct returns or any significant economic impact. This would naturally overburden the state in the long run and eventually cripple the economy. Recent studies show that the state runs the risk of becoming insolvent if the present trend in debt accumulation continues. This finding needs to be given the attention it deserves as it is backed by some empirical evidence.

4.5 Following observations based on available empirical analysis may be examined:

1) Public debt

It can be seen that public debt has risen rapidly over the period 2000-01 to 2017-18 from Rs 23919 crores to 210762 crores and during 2017-18 to almost 18.5 percent whereas growth over a period of almost half a decade is at the rate of half of that i.e., 9.7 percent. The analysis also suggests that this is due to serious shortfalls in revenue resource mobilisation. Another reason is that some of this debt goes as subsidies which do not contribute to enhancing welfare – and is merely deployed to keep the related interest groups satisfied.

2) Annual Rate of growth

It is also seen that trends in the rate of growth in debt was less than 10 percent on an average during the decade from 2000-01 to 2010, whereas from 2010-11 onwards it began to increase and has shown a significantly upward trend.

3) Public debt burden of the state

It is also seen that the percentage of interest payments invariably overshoot estimates of the Finance Commissions for all the years from 2010-11 and is at its peak during 2017-18. It is also observed that the percentage of interest burden to that of total revenue is also similarly higher to the tune of more than 50percent of the level anticipated by the Finance Commissions. The state has to rein in its debt lest the additional borrowing result in debt insolvency. It is pertinent that the figures discussed above are the burden of direct borrowings of the state alone, if

borrowings of public sector undertakings and that of extra budgetary financial institutions are added the extent of indebtedness of the State will go up further.

4) Debt to GDP Ratio

It is observed that although the ratio was higher than the normality assumed by the Finance Commission up to the period 2010-11, it is seen that efforts are made to bring it down to 25 percent in the subsequent two years, but it began to rise gradually since then to reach almost 31percent during the end of the period of the Finance Commission award, around 6percent higher than the stipulated mark.

5) Public debt to own tax revenue of the state

This ratio is increasing over the years from 2010-11 to 2017-18, indicating that both aspects need to be monitored carefully. The current trend is that the gap is widening. All this suggests that a radical restructuring of the entire budget process is inevitable.

6) Maturity profile of outstanding state government securities

An examination of the future debt burden and repayment schedules suggests that debt management may become even more of a challenge going forward. The state government is obliged to pay back the securities on a higher, interest rate, at almost double the current average rate from 2021-22 onwards. This will have detrimental effect on the resources position. The State is likely to be left with meagre resources to finance development expenditure. Suitable measures need to be adopted for revenue enhancement to tide over this. Government needs to take urgent measures to increase revenue and limit debt for productive purposes.

The debt burden has not had a high negative impact on growth of the economy possibly due to the high rate of inflow of remittances to the economy from migrant workers. This in turn has generated higher demand for goods and services along with a higher level of savings. But with the return migration predicted by experts the scenario is likely to change, gradually first and then at an accelerated price. The impact of lock down/restrictions implemented to contain COVID-19 is yet to be assessed.

Government needs to conduct an in-depth study of its debt and rate of interest including debts of public undertakings for which the government has given guarantees and appropriate measures evolved to reduce spending of borrowed funds for revenue expenditures, as it may not yield any return.

Debt profile of the state needs to be developed and updated regularly. The state needs to have forecasts of its borrowing and repayment calendar for short term and long term. It should also monitor and keep watch of repayments of public sector undertakings for which it has stood guarantee.

Analysis on the return from investments that the government has made in the past on public sector undertakings also conveys a grim picture. It needs to be emphasised that for the period from 2012-13 to 2016-17 the total percentage of interest payments are far higher than the returns received from the investments.

All these lead to a situation of revenue deficit and fiscal deficit. The state's borrowing limits specified in the FRBM Act is breached and simultaneously revenue expenditure of the State has surpassed revenue receipts. On an average, during each year there is a gap of 2 to 3 percent of growth in expenditure above that of revenue.

Almost throughout the decade revenue expenditures have exceeded revenue receipts forcing government to borrow from time to time to meet revenue expenditure, leaving less room for utilising borrowed funds for capitalisation and at the same time has led to higher interest and principal payments. These factors have forced government to find alternatives for financing capital expenditure through Extra Budgetary Finances. **[See Annexure III]**

4.6 Share of Union Taxes and Grants-in-Aid

As per the recommendation of the Fourteenth Finance Commission, 42 percent of the divisible pool of Union taxes is shared among states, ensuring a reasonable transfer of funds from the Centre. Post-Devolution Revenue Deficit Grant was also passed on to the state governments to cover its Revenue Deficit. This enhanced share was partly offset by reduced outlay on Centrally Sponsored Schemes, lowering the percentage of central support for these schemes. The 15th Finance Commission on the other hand has reduced the divisible pool to 41 percent and share of Kerala share is reduced to 0.8 percent from 1.05 percent of 14th FC. Similarly, the share of 2.5 percent from the divisible pool in the 14th FC is reduced to 1.94 percent in the

15th FC. Although a revenue deficit grants of Rs. 15323 crores is allocated for the current year there is no indication whether this will be continued in the main report.

Criteria for **Performance-based grants laid down by the 15th Finance Commission include**: (i) implementation of agricultural reforms, (ii) development of aspirational districts and blocks, (iii) power sector reforms, (iv) enhancing trade including exports, (v) incentives for education, and (vi) promotion of domestic and international tourism. The grant amount will be provided in the final report. The state may not be able to leverage these criteria to its advantage in any significant manner. In all probability, the share is only likely to fall.

Resource mobilisation under Centrally Sponsored Schemes needs to be systematically tracked using a centralised mechanism. Efforts shall be made for tapping maximum central assistance for Centrally Sponsored Schemes by proper designing of the schemes adhering to Government of India guidelines and through regular follow-up and timely submission of utilisation certificates etc.

4.7 Recommendations

1. ***Government needs to maintain up-to-date record of its external liabilities and the timing of foreign inflows due. They should also be aware of the system of repayment, its scheduling and current status.***
2. ***Fiscal attainment should be objectively assessed for more reliable forecasting errors in the budgetary system. Component wise magnitude of errors in forecasting and errors has to analysed. Results of the analysis show that the magnitude of fiscal forecasting errors is relatively higher for tax revenue, which is generally overestimated to plug lapses in resource mobilisation.***
3. ***This has several policy implications. Volatility in intergovernmental transfers can affect stability of sub-state public finances. Identifying innovative policy tools in strengthening Additional Resource Mobilisation programmes or reduction in public expenditure is significant and inevitable at least to maintain current level of growth inducing capital formation in the state.***
4. ***The persistent pattern of revenue and expenditure can affect growth of the state as savings and remittances are not transformed into capital but are being used only for consumption expenditure.***
5. ***The practice of allowing project staff recruited on ad-hoc basis to continue despite completion of the project on the plea that finalisation of the project needs to be carried out needs to be discouraged. Posts created for projects needs to be discontinued once the project is completed. It***

also needs to be mandated that the implementing agency shall obtain prior sanction for continuing employees in the succeeding year. Committee consisting of Heads of Departments, Secretaries of respective administrative departments and finance department shall be constituted to review the need for continuance of posts before formulation of the budget, for scrutiny and decisions.

6 *ARC recommends that government needs to conduct onetime works audit to settle issues of excess/deficiency of employees in all organisations and departments of the government. It is recommended that comments from watchdog/regulatory institutions need to be complied with by the state without further delay for its own financial health.*

7 *The budget exercise is mostly incremental in nature and may not reflect actual need of the state and the people. ARC recommends that careful and in-depth study of the resources, need and utilisation needs to be done by the authorities before formulation of the budget making allocations. Prioritisation of projects and its benefits also needs be studied before finalising allocations. (This aspect is discussed in Chapter 3)*

8 *Another important tool to adjudge financial performance of the state is the 'Primary balance'. Primary fiscal balance is considered to be an important measure in public finance for determining fiscal sustainability. Based on 'primary balance' government needs to arrive at a prudent and pragmatic path to rein in debt without crippling its development objectives. Failure to do so will be catastrophic to the economy and lead to the State falling into a probable debt trap.*

9 *Analysis of data from 2010-11 to 2017-18 show that the fiscal burden on account of public sector units of the state is continuously on the rise. The increase is to the tune of 400 percent within half a decade. ARC recommends that an analysis of the functioning of public sector undertakings needs to be done. Based on professional analysis, restructuring/reengineering of the undertakings needs to be taken up. Possible options including infusion of private capital through public-private participation shall be considered. Many of these undertakings are maintained by the state to prevent job loss. Government needs to invest in reskilling employees for improving productivity and employability. Options including voluntary retirement and employment to children/relatives also need to be considered. Enterprises that can be privatised maybe opened up for private investment. In cases where the employees are willing to take over and run the undertakings, these may be handed over to them, with infusion of funds required for modernisation and technical back up to ensure improved productivity and profits.*

10 *To overcome the issues of technological inefficiency the Commission recommends that wherever feasible technology infusion/replacement with modern machinery needs to be done to assist in improving the functioning of PSEs. Government may make one time investment for adoption of technology/ replacement of plant and machinery and provide necessary skills to the employees to*

handle it. Government also needs to give autonomy to the enterprises in taking business decisions. These steps can assist the state in reducing its debt burden and savings can be channelised for development purposes.

11 *Return on capital and return on equity participation of the state in public sector enterprises are also analysed by the Commission and the results are worrying. ARC recommends that government may refrain from this unproductive expenditure till it achieves positive primary balance. If at all the state desires on equity participation in PSEs, it needs to be done only after careful cost benefit analysis and ensuring minimum financial and economic return of 10 percent.*

12 *The state resort to borrowing of funds from outside for execution of developmental projects. It is observed that a part of the debt is allocated even to meet revenue expenditures, in the context of the states' revenue deficits. Debt of the state has already reached high levels, and any additional borrowing may even lead to debt insolvency. If the current pattern and policy of fund management is pursued there is a risk that government may not be able to service, its debt in the long run. This finding needs to be considered seriously.*

13 *ARC recommends that government institute an in-depth study of the debt and rate of interest including that of the debts of public undertakings for which the government have stood guaranteed and take appropriate measures to reduce use of borrowed funds to meet revenue expenditures that may not give any return*

14 *Debt profile of the state needs to be worked out and updated regularly. The state needs to have forecasts of its borrowing and repayment calendar for short term and long term. The state also needs to monitor repayments of the public sector undertakings where government is the guarantee.*

15 *ARC recommends constituting a regulatory body to evolve mechanisms to arrive at appropriate rates and prices for public utilities and other infrastructure generating resources, to finance the loan and interest. Another area that needs attention is improvement in the standards and quality of education and appropriate pricing for the institutions.*

16 *In all the years less than 10 percent of expenditure is on capitalisation, which signify that 90 percent of expenditure is towards unproductive revenue expenditure. This is a matter of serious concern. ARC recommends that an in depth analysis is to be made before proceeding further and concrete steps taken to contain revenue expenditure to ensure sustained development.*

17 *It is reiterated that projection of budget estimates of both resources and expenditure requires a more systematic approach to ensure sanctity and accuracy of the budget. Projection of revised estimates needs to be fixed as close as possible to the actuals as a clear monitoring system of the expenditures already exists in the state.*

18 State Government needs to initiate urgent measures to optimise tax collection through widening of tax base, plugging of tax leakages and scaling up tax compliance. Resource mobilisation under Centrally Sponsored Schemes needs to be carried out more systematically under a centralised mechanism. Efforts needs to be taken for tapping maximum central assistance for Centrally Sponsored Schemes by meticulously designing the schemes in consonance with guidelines of Government of India and through regular follow-up and timely submission of utilisation certificates etc.

19 Resource envelope indicating the size of allocable resources needs to be intimated in advance to each spending department to equip them to formulate realistic projections of expenditure, after proper prioritisation of items. A deeper reform of the budget along this line is included in Chapter 3.

20 An attempt to draw up a balance between developmental and non-developmental expenditure needs to be made as part of annual budget exercise. Obsolete non-plan schemes that are continuing for long needs to be closed/restructured to ensure better quality of expenditure. Evaluation of plan schemes/projects for which expenditure for the last 3 to 5 years is less than 30 percent needs to be done and relevance of such schemes needs to be evaluated.

21 Critical review of over lapping functions of organisations in the same sector or field needs to be undertaken. There needs to be clear demarcation of rules and functions of organisations.

22 Token provisions in the annual budgets needs to be avoided as far as possible or be minimal, to curb the tendency to incur additional expenditure during the course of the financial year. Government needs to develop a shelf of projects, with clear prioritisation that can be considered for developmental investments in the state. Supplementary demands for grants needs to be preceded by full scale and transparent resource estimation.

23 Welfare programs implemented by Government needs to be targeted appropriately to ensure that only eligible beneficiaries receive the benefits.

24 "One Department - One Head of account" principle is to be adopted for allocating resources for administrative expenses of individual departments to avoid spreading thin resources across multiple heads.

25 Issuing of administrative sanctions for schemes and projects need to be a pre-budget exercise. Administrative sanctions need to be issued in a standardised format, clearly indicating objectives, phasing, physical and financial targets, performance indicators, review mechanism etc.

26 It is suggested that an expert committee consisting of eminent economists and administrators need to be constituted in the state so that resource requirements, mobilisation of measures and effective

transformation of resources through budgets on a year on year basis can be suggested in consonance with broad policies of governments.

Chapter 5

OUTCOME BUDGET

5.1 Introduction

Outcome budget is a pre-expenditure instrument to realise government's vision through clearly defined outcomes, which will lend greater transparency to the budgetary process. The process of outcome budget needs to be built-in at the time of formulation of plans, where the output and outcome of schemes and projects are clearly stated. An Outcome Budget converts "outlays" into "outcome" by planning expenditure, fixing appropriate targets, quantifying deliverables in each scheme and bringing to the knowledge of all, 'outcomes' of budget outlays for each scheme/programme.

5.2 Need for Outcome based Budget System

Reforms in budgetary systems are a key issue in the content of 'good (enough) governance' and New Public Management (NPM). Good governance focuses on budgetary transparency and participation of people in the budgetary process. Outcome based budgeting requires a shift in thought processes/outlook, from short term 'outputs' to medium term focus on economic and social outcomes. Leadership from political executives/senior officials of government is crucial in driving the change. Outcomes are harder to deliver than outputs and by their nature will be publicly communicated, requiring resolve from leaders to see the transition through. To gain the interest and acceptance of leaders and those involved in the governance of transition of budget from output to outcome, it is necessary that they are aware of the benefits and drawbacks of the system. It also requires a two-way relationship between government and people to make this work. Government will attempt to hold itself to outcomes valued by the public, but the corollary is that the public needs to provide feedback on the utility of outcome based budgeting and allow time for the government to get the concept and its tracking, right.

In outcome-focused management and budgeting government defines what a particular programme or function is to achieve in terms of public good, welfare or security-for example, outcomes to reduce incidence of disease or ensure a certain level of educational attainment for most students, or specified standards. After defining outcomes indicators to assess performance of the system in achieving these outcomes are defined. In principle outcome-focused budgeting and

management involves greater internalisation of information needed for formulating, implementing and evaluating policies, considering the need to establish linkages between the five elements - costs, inputs, process, outputs, outcomes.

Outcome budgeting system requires (1) strategic plan, 2) annual performance plan, (3) annual performance report, and (4) programme evaluation.

Preparation of outcome budget involves:

- Defining measurable outcomes,
- Standardising unit costs of delivery,
- Benchmarking standards,
- Capacity building for attaining requisite administrative capacity,
- Ensuring necessary funding,
- Effective monitoring and evaluation,
- Making the system more inclusive through participation of the community and stakeholders.

During the processes of pre-budget transactions needs of the people gets channelised through representatives of the people and are placed before the government for consideration. Government, based on the availability of resources and consensus of views of those involved in the governance process, and policies for ensuring welfare and rights of the people places it before democratic institutions for further prioritisation of the needs, commensurate with its policies. These considered initiatives are transferred to the policy formulation processes, either making full provision of funds or channelises funds from multiple sources to the implementing agencies, through the budgetary process. Resource flows supplementary to the budgetary sources may also be channelised to the implementing entities through extra budgetary processes. Usually, only allocation from government is budgeted, the balance flow could be harnessed from other sources supplementary to budget as complementary resources and utilised. These inputs are left to the implementing agencies, using their transfer and operational methods, which are often termed as Outlays.

In the long process of conversion of outlays into outcomes several intermediate stages and complementary resources are required in achieving intended outcomes.

1) **Outlays:**

Outlays imply total financial resources deployed for achieving outcomes. Part of the resources may come directly from budget and part may be contributed by other stakeholders like Government of India, Public Sector Undertakings, or even private sector through Public Private Partnerships. As far as possible, total resource commitment needs to be brought out in the Outcome Budget with clear segregation of State Government budgetary support. Outlays need to be segregated scheme-wise, covering both Plan/Non Plan budget (as in the Expenditure Budget Vol II) for the respective financial year in monetary terms. In case of projects (whether government or parastatal) spanning multi-year time frames, total sanctioned cost of the project and planned annual expenditure needs to be included as both are relevant 'outlays' for effecting linkage with outcomes.

2) **Inputs of Implementing Agencies:**

After observing rules, regulations, and formalities the implementing agencies, depending on efficiency of the management and observing processes and activities physically execute the program to benefit originators of the project.

3) **Monitoring:**

The process of implementation needs to be monitored using technology tools at each stage of financial flow. For each stage of financial flow, be it from budgetary or auxiliary sources appropriate physical outputs are expected and it needs to be ensured and measured. Final stage is the expected outputs. Output is viewed as one though expenditure towards this might reflect use of funds from multiple sources.

4) **Outputs:**

Outputs are a measure of the physical quantity of goods/services produced through an activity under a scheme or programme. They are usually an intermediate stage between 'outlays' and 'outcomes.' For example, construction/completion of a school building is the 'output', whereas increase in the literacy rate will be the 'outcome'. Enrolment would be an "intermediate outcome". Similarly, for a social sector programme/scheme, the intermediate results before identifying, measuring, and arriving at the 'final outcome' as per the objectives of the programme/scheme, may be treated as 'output'. The purpose is to capture intermediate 'outputs' before identifying and measuring the 'final outcome'. The crucial issue is to what extend the expenditures and output are effective and can lead to delivery of

the expected outcome. In effect, it is the impact of the output and expenditure that is measured through the outcome process.

5) **Outcomes:**

Outcomes are the end products/results of various government initiatives and interventions including those involving partnership with the central government, public sector undertakings, autonomous bodies, private sector and the community. It involves more than mere 'outputs' as it includes quality and effectiveness of the goods or services produced because of an activity under a scheme/programme. 'Outcomes' will be measured considering objectives of the programme/scheme by following appropriate methodology. Both outputs and outcomes need to be in measurable terms. This would be in terms of movement of absolute numbers and/or percentages over a certain time frame. The percentages may be in terms of annual growth or share in certain broader aggregates. Focus on outcome makes a substantial demand on the part of implementing agencies and departments as they plan their budgets and action plans starting from the outcomes specified.

5.3 Sustainable Development Goals

A realistic achievement of outcomes in all the sectors in the budget can contribute at a faster rate to the achievement of sustainable development goals aimed for 2030. The core functions of government are - 'provision of social services such as health care and education, provision of infrastructure such as roads, ports, and power, protection of individuals from crime and violence, promotion of basic science and new technologies, and the implementation of regulations to protect the environment.' All these are possible only if outcomes and outputs in the budgets are carefully balanced/adjusted to achieve the goal in a structured manner. Properly defined aims and objectives have to be first set to achieve outputs and outcome in a carefully considered and planned framework and span of time.

Collecting and evaluating data on achievement of outcomes is usually more difficult than data collection and analysis of outputs. Difficulties arise from, time lags in reporting, ability to gauge effects of an outcome on society, economy, environment or similar aspects, and uncertainty about how much of the outcome-effect can be attributed to individual programmes in a multi-programme effort. To what extent does, (or should), the potential difficulty and expense of

collecting and evaluating data on outcomes influence the choice of outcomes or how they are defined. Techniques have been developed to overcome and evaluate the success and failures of a programme (or combinations of programmes) by the government.

5.4 Accountability

Officials need to be given more flexibility in managing and administering programmes considering the greater responsibility and accountability required for outcomes. They should also be held accountable for achieving outputs and outcomes. Government also needs to ensure individual/organisational accountability of the people. Another aspect corollary to the attainment of outcomes is that governments need to consider external factors that influence outcomes for coherent cross cutting achievements. Achievement of some outcomes requires different programmes or organisations to work together. Such outcomes can often be across ministries/departments/organisations. Defining and achieving inter agency outcomes is challenging and presents an opportunity to optimise the use of resources. Opportunity arises from getting related programmes across the government to communicate with each other and agree to work in mutually supportive way toward a common objective. This can increase effectiveness and efficiency of individual programmes. Challenge stems from the difficulty often experienced in forging these agreements, and coordinating the tasks, especially when no ministry/department is given lead responsibility for the outcome. Failure in one programme can be detrimental to the outcome as complementarities are not attained.

5.5 Limitations

It is equally important to stress that managerial accountability needs to be based on outputs rather than outcomes. The outcomes themselves are beyond the direct control of managers, difficult to define and quantify, and not possible to use as a basis for costing.

Main Limitations of outcome-based accountability are:

(1) It is difficult to link outcomes directly with managerial actions and decisions as outcomes are remote in time and space from what the program does/interact with other factors. The extent of a manager's direct control over outputs is usually more substantial than outcomes.

(2) Outcomes are difficult to identify and difficult to quantify on an annual basis but is definitely quantifiable on the basis of programme or interventions. Timescale for measuring

outcomes is normally after completion of the program/intervention, and usually do not synchronise with the same budgeting cycle, and

(3) Calculating cost of the effort to achieve outcomes can be more difficult than costing outputs. Outcomes are achieved not as the result of a single intervention of a program in isolation, but by interaction of a number of different planned/unplanned factors and interventions. Hence, it is inappropriate and unrealistic to hold public managers accountable for outcomes.

However, all these limitations can be resolved through careful and proper planning and strategic moves with calculated aims and budget outlays. Managers and others responsible for success of outcome budget needs to be given appropriate training and skills to achieve desired results.

5.6 Recommendations

1. ***Government needs to initiate measures to implement outcome budgets to ensure transparency and proper accounting in the utilisation of scarce resources of the state. Some of the procedures for the implementation of outcome-based budget is given in the report.***
2. ***Introduction of outcome budget of selected schemes/ projects can facilitate regular review of progress of implementation of the schemes vis-à-vis defined objectives. The process needs to be built-in at the time of formulation of plans, where the output and outcome of schemes and projects are clearly stated.***
3. ***To start with it can be implemented on a pilot basis in some departments like Scheduled Castes Development and Scheduled Tribes development, where many projects and schemes implemented by other departments also find a place. It can also be implemented in departments such as PWD, Agriculture, Health etc., on a trial basis, and depending on the experience gained can be extended to all the departments.***
4. ***ARC recommends that it is essential to conduct a vertical trial among the local bodies. As of now many of the local bodies does not report physical progress of plan expenditure through the web portal despite iterated instructions from the Information Kerala Mission. To begin with outcome budgeting shall be introduced in Local Self Government Institutions (LSGIs) in selected Community Development Blocks and Municipalities as 30 percent of the budgetary***

resources flow to the local bodies. Once the system stabilise it can be extended to all the local bodies.

5. ***The Commission recommends to Government to constitute a technical committee consisting of experts in the selected area and officials for implementation of outcome budgeting, to ensure availability of technical competence and problem solving skills. Outcome based budgeting is implemented in many states in India. If required experiences of these states may be studied while implementing the pilot system. Methodologies for evaluation of outcome budgets and its implementation already exist.***

6. ***Government may initiate a separate study on an ongoing basis for measuring the impact of outcome budget on the economy, both at the aggregate and disaggregate levels.***

Chapter 6

PLANNING PROCESS IN KERALA

6.1 Introduction

Kerala is an example in India of the power of public action in improving well-being of the people and transforming social, political and cultural conditions in a State. Kerala is among the few States to continue the five-year planning process when it was discontinued in 2015 by Government of India. Social and economic development in the state is in most parts an outcome of interventions made through the planning process. It has been and continues to be the means of structuring aspirations of the people into workable economic policy.

6.2 Role of Planning Board

Planning continues to have an important role in Kerala. Planning at central and state levels, is neither constitutional nor statutory. But the planning processes assist in integration of all sectors and provide holistic view of the economy. Planning process needs to continue with the same vigour to meet the challenges that have been evolving with changing times. 73rd and 74th amendments gave decentralised governance a role in the planning process of the state. With the participation of private sector in the development process of the state, indicative planning[1]has also assumed greater importance.

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[1]Indicative Planning is a form of economic planning implemented by a state in an effort to solve the problem of imperfect information in market economies by co-ordination of private and public investment through forecast and output targets. The resulting plans aim to supply economically valuable information as a public good that the market by itself cannot disseminate, or where forward markets are nonexistent. However, indicative planning takes only endogenous market uncertainty into account, plans the economy accordingly, and does not look into exogenous uncertainty like technology, foreign trade etc. Indicative plans serve to complement and enhance the market, as opposed to replace the market mechanism, hence they are adopted in market-based and mixed economies and were most widely practiced in France and Japan before the 1980s.When utilizing indicative planning the state employs "influence, subsidies, grants and taxes(to affect the economy), but does not compel."

Perspective planning needs to give direction to the economy. This has to be done collaboratively with the participation of public sector enterprises, LSGIs and private sector. Planning Board needs to be more professionally equipped to undertake this task.

6.3 Plan and Non Plan

Though planning as a process is considered important for the economy, the purpose of distinguishing between Plan and non-Plan expenditure of government is questioned in recent times. Government of India has discontinued the practice and classifies all expenditure as either revenue or capital. It may be seen that the classification of expenditure into Plan and non-Plan has evolved over the years through the planning process. But the distinction between Plan and non-Plan has blurred over the years as developmental character of non-plan expenditure, especially under social sectors has gained greater acceptance and recognition. It is necessary to streamline the process of planning by defining the contours of Plan expenditure. Planning involves a process of conceptualising activities to achieve a desired goal.

6.4 Preparatory Stage of Plans — Five Year and Annual Plans:

Planning process in the public sector, as presently followed by Kerala consists of the preparation of Five Year Plans and Annual Plans for periods of five years. Five Year Plan lays out the objectives/ goals that government strives to achieve during the five year period. It provides the strategies that government seeks to adopt to achieve the goals. The targets and objectives for five years are thereafter achieved through annual plans for each year.

Prior to formulation of the Five Year Plan broad policy of government is outlined through Approach Paper of the Plan. Approach Paper is based on the vision of government and inputs provided by experts and stakeholders. It describes overall policy direction of government. Detailed sectoral interventions and policies are then formulated by the Working Groups. Working Groups are constituted for each sector and consists of representatives from government, academia, experts, and stakeholders. Working Groups hold detailed deliberations before finalisation of the report.

Five Year Plan process generally commences six to eight months prior to the first year of the five year Plan. It is suggested that the base for the next five year Plan should be laid after the mid- term review of the current five year Plan. Mid-term review of the Plan gives an idea about the areas where the policy must focus to achieve goals laid out in the Plan and course corrections to be

adopted. Only short and medium-term interventions can be made at that time. Long term interventions required can be incorporated in the next Five Year Plan. Hence, preparatory work of a Five Year Plan (formulation of Approach Paper and Working Groups) needs to begin one to one and a half years prior to commencement of the Plan.

Planning process is undertaken to decide short, medium and long-term objectives and activities to be undertaken as per the needs of the economy and availability of resources. At present this process is limited to a five year period. A longer perspective of the sector is required to address critical needs of the economy. Long term vision document covering a longer period needs to be prepared for public sector and private sector by the State Planning Board, under the perspective planning division. Capacity building/skilling to take up the task needs to be imparted to the concerned personnel in the Planning board.

As stated above, reports of the Working Group form an important source of input for the Five Year Plan. The usual time taken for preparation of reports by the Working Group is around 3 to 4 months. This seems insufficient considering the importance attached to the report. It is suggested that the time given to Working Groups must be sufficient, at least 6 to 8 months to enable them to understand the sector comprehensively and review all the schemes under implementation. This will help in improving the quality of Working Group Reports and help in critical examination of all schemes and generate ideas for new schemes to be adopted in the Plans.

Universities and research institutions in different sectors needs to be involved in the planning process. Link shall be established among departments, university/research institutes, industry, and State Planning Board. The departments and State Planning Board can guide the universities and research institutes to study issues prevailing in the sector. Needs of the industry can also be studied to frame appropriate policies.

Annual Plan process usually begins eight months prior to commencement of the financial year. Departments formulate their Plans based on the Approach Paper to the Five Year Plan and suggestions emanating from reports of the Working Group.

6.5 Integration of District Plan with State Plan

District Plans are formulated in all the districts of the State as mandated by the Constitution. So far Kerala is the only State to have taken significant efforts in this direction. The

District Plan is a comprehensive document and lays down suggestions for implementation by lower tiers of government- the three tier panchayats or urban local government, and higher tiers of government - the departments. It is suggested that District Plans needs to be integrated with the State Plan. Section 53 of the Kerala Municipality Act, 1994 stipulates that chairperson of District Planning Committee shall forward the District Plan, as recommended by the District Planning Committee to the government for approval and that government shall, while preparing the State Plan consider the proposal and priorities included in the District Plan. Section 55 of the Act in fact lays down that one of the functions of the State Development Council (SDC) is to co-ordinate the District Plans and State Plan. It is suggested that the SDC should be strengthened.

6.6 Plan Formulation

A critical review of the Plan raises lot of questions about the quality of Plans. Plan preparation is taken as a routine activity. Any substantial change in the nature of schemes or the approach does not seem to happen resulting in the continuation of same schemes or with minor modifications, over the years. Plans need to be dynamic and adopt fresh approach, innovative thinking, and based on abroad vision. Plan preparation needs to be viewed as a serious activity. Departments need to be equipped to formulate plans for their sector taking cue from the perspective plan and approach paper. A repository of good schemes/ programmes /projects needs to be readily available with the departments. Schemes/ programmes /projects needs to be conceived in consultation with government and the Planning Board including the perspective plan division. Responsibility of formulation, implementation, and monitoring of Plans of a sector shall be entrusted to a senior officer (Additional Director or Joint Director) of the department. This officer needs to be responsible for all matters related to Plan and liaise with the State Planning Board.

Role of State Planning Board is important in the formulation of schemes. Technical officers of the Board need to have multidimensional expertise in their sectors enabling them to guide the departments. The officers need to continuously review schemes in their sector, analyse current developments and needs of the sector, study relevant reports, and critically examine efficacy of schemes in the sector. Based on this, the officers need to generate internal review reports that will serve as a base for Plan discussions.

Plan proposals submitted by the departments often lack clarity and may not be backed by adequate data. Proposals need to be made more concrete by clearly outlining objectives, target, and time period of implementation and mode of implementation. Plans are mostly prepared using available datasets that gives the macro picture. Data collection, generation and analysis needs to be designed by concerned departments or by the department of Economics and Statistics. Schemes shall be formulated after identifying needs of the sector as reflected by the data.

6.7 Planning for employment generation

Kerala needs to start planning for employment and jobs in the public and private sectors, including self-employment. This would include, among other things mapping of human resources, particularly, skills, study of job markets, etc. The budget speech of 2020-21 has given several pointers that need to be detailed into action. These could be incorporated into a system for planning.

6.8 Planning for inclusion

Despite best efforts it is a shame that there are still outliers in the Kerala model of development which is praised for its inclusive nature. It is widely accepted that the Scheduled Tribes and traditional fisher-folk have not made significant development gains. Even if there has been improvement in the living conditions of Scheduled Castes they fare badly in access to better jobs in the economy within and outside the country. This calls for concerted effort which should include:

(i) A bottom-up planning process covering resources of local governments and the state government, done after detailed preparation and using both participatory and conventional data should be put in place. Young professionals could be used to facilitate the process which should be transparent.

(ii) Scheduled Caste/Scheduled Tribes Development Act moulded on the line of the SCSP/TSP legislation of Andhra Pradesh may be enacted, covering areas like planning process, protection of resources, penalty for violations, performance indicators, especially on development gaps and inequalities, periodic status reports presented to the Assembly, and so on.

(iii) The State has already a gender plan, child plan and an elderly plan. To this, a plan for differently abled needs to be added. The gender plans are of reasonably good quality, others need to be fleshed out to enable discussion and debate.

6.9 Plan Finance

As mentioned earlier, Plan Process for a financial year begins eight months prior to the start of the financial year. Departments submit plan proposals to the State Planning Board by the month of October. Around this time tentative information on estimate of resources is available. Departments prepare plans based on the tentative estimates. Plan proposals are first discussed with members of the Planning Board. Schemes are reviewed in detail, given a concrete shape, and new ideas are discussed and based on the discussions the proposals are revised by the departments. After the revision and finalisation of draft proposals by the departments detailed discussions are held by Vice Chairperson of the Planning Board and Ministers of the departments. Draft Plan proposals are finalised after several rounds of discussions in the State Planning Board. During this process, the departments often resort to significant hike in allocation to meet requirements of their sectors and include proposals beyond the availability of resources indicated. This makes planning process unrealistic, laborious and difficult. Usually, a clearer idea of resources may be available only by November. Hence, the departments along with the State Planning Board need to formulate plans based on resource availability indicated by the Finance Department. Some pointers as to how best this can be done is included in the Chapter III on Budgetary Reforms.

Shortage of resources is one of the main issues faced by the state. Resource availability in the recent times is seeing high fluctuation. Demand for resources by the Planning Board in its zeal to implement developmental projects/programmes required by the state without giving adequate consideration to availability of resources result eventually in adverse impact on fund flow for all projects, including priority projects. Resource allocation needs to be flexible within the constraints of estimated resources and where there is resource squeeze, programs need to be reprioritised.

While preparing plans the departments need to be sensitive about the cost of funds used, which is mostly borrowed funds and at a cost and hence must aim at optimising public expenditure. Departments need to estimate the return that the schemes will generate. This implies that when investment decisions are taken sufficient care needs to be taken to ensure that there shall be adequate returns to the economy over a period of time which facilitate not only repayment of

the loans but also generate enough resources for proper maintenance of the assets and for enhanced investment in the future. Departments need to be conscious of the cost of resources and their scarcity while taking any spending decision. This aspect needs to be taken into consideration while devising schemes. Effort needs to be taken to formulate growth oriented schemes. Departments need to be sensitised about this aspect.

There are projects which will be implemented over a period of few years. Multi-year projects need to be formulated with cost and time projections. Yearly commitment of the project shall be listed. While allocating funds for the project each year, spill over commitments needs to be taken into account.

An important fact to be noted is that recent changes taken by the State to address resource constraints have implications on Plan finances, especially the revamping of Kerala Infrastructure Investment Fund Board (KIIFB). A portion of motor vehicle tax and petroleum cess is earmarked to KIIFB. This is now escrowed into the account of KIIFB on a daily basis. KIIFB has the mandate to raise funds through off budget borrowings for infrastructure development. The borrowed funds have to be repaid using the funds escrowed. Since KIIFB depends on the funds escrowed from the Budget, the projects executed with KIIFB financing also needs to be included into reckoning total plan size of the state.

6.10 Scheme/ Project Approval:

The present system of constituting Working Groups (WG) for issuing Administrative Sanction (AS) needs to be reviewed. There is inordinate delay in implementation of schemes due to delay in getting administrative sanction. There is also lack of clarity in administrative sanctions, as to whether it pertains to the scheme or components of the scheme or for total outlay of the scheme. Most of the times, departments have to obtain AS for the same schemes if there is change in components/ outlay or is not implemented during the year. This results in review of the whole scheme and consumes time. To address these issue guidelines, need to be prepared for all schemes as done for Central schemes. Guidelines for schemes needs to convey details of the scheme including objective, target, mode of implementation, selection criteria of beneficiaries, time-period of implementation and district wise break ups. These guidelines shall be prepared by a team consisting of officers from the concerned department, State Planning Board and Finance Department. It should be prepared by March 31st of the year preceding the plan year to ensure

implementation from April onwards. Revised guidelines can be issued if there is any change in a scheme. Guidelines may be incorporated into Part Il of Plan document. Part I of Plan document provides details of the scheme and allocation in brief. This will make the entire process transparent. Working Group may examine only new schemes. Existing schemes needs to be brought to the WG for approval only when there is change in components and cost. The existing process of the Working Groups may be followed. Any change in the functioning of working group shall be decided by Finance Department in consultation with Administrative Departments according to requirement of changing scenarios and time.

6.11 Plan Implementation:

Substantial effort goes into the plan process. The process ranges over several aspects and includes analysing of needs of the economy, conceptualising, formulating, approving, implementing, monitoring and reviewing programmes and projects. Ensuring timely fund flows is a critical problem hindering progress of the plan program and projects. In this process the responsibility of the Finance Department is to report availability of resource and to ensure unfettered fund flows for implementation of schemes and projects. Implementation schedule should be programmed by the department ensuring spread throughout the year in a phased manner. Rush for implementing and preparing bills towards the end of the financial year needs to be avoided to reduce pressure on Finance Department for funds towards the end of the financial year. Finance Department on its part needs to report resource availability without any overestimation and ensure fund flow. Whenever unforeseen resource constraint is felt the extend of resource shortage needs to be brought before the Council of Ministers to prioritise schemes/ programmes/ projects in order to ensure fund flows for priority projects, and completion at the scheduled time to avoid cost overrun and delays in implementing critical projects benefitting economy of the state.

The e-lams facility was implemented by finance department in 2015 as a measure to address liquidity issues of government. The facility enables a department to carry over expenditure of a scheme to the ensuing financial year and avoid last minute rush at the end of a financial year. Expenditure for the scheme is met from current year budget allocation. Once the department fully expends the amount allocated for a scheme, amount under e-lams can be claimed in the current year itself as additional budget provision. However, it is observed that it has affected timely implementation of schemes. It has brought about a laxity in scheme implementation as

departments gets additional time for implementation. This also raises issues about financial propriety as the concept of financial year itself gets blurred.

Delegation of financial and administrative powers may also be suitably amended to speed up the implementation process.

6.12 Plan Monitoring

Plan monitoring through Plan space needs to be strengthened. Monitoring of outcomes and impact needs to be done. Single window monitoring system through Plan space needs to be encouraged. This system should be able to track all stages of planning from plan formulation, issuing of Administrative Sanction, monitoring of physical and financial achievements and evaluate impact of schemes and projects. Shortcomings in plan monitoring needs to be rectified. There shall be adequate capacity building/training of personnel in the Planning Board. Monitoring to be done at different levels need specific stipulation. Monitoring at various levels can be demarcated for monitoring by HODs, Secretaries, Principal Secretaries, Chief Secretary, Ministers and Chief Minister. This will improve quality of monitoring and only critical issues need to be brought to the notice of Ministers and Chief Minister.

6.13 Training

As stated earlier, planning is the process of conceptualising activities required to achieve a desired goal. Planning requires expertise in various sectors. It shall not turn into routine activity of planning department. A more systematic and focussed approach needs to be adopted. This requires building capacity of officers involved in the process. There is however no training institution at present which imparts training for this purpose at the State level. Kerala Institute of Local Administration (KILA) conducts training for local level planning. Existing facility at Institute of Management in Government, Kerala or Centre for Technical and Financial Management, Kerala may be upgraded and guest faculty with required experience and expertise invited for training. Modules may be formulated by experts for online courses.

6.14 Outcome Budgeting

Outcome based budgeting needs to be adopted in the departments. An Outcome Budget converts the "outlays" into "outcome" by planning expenditure, fixing appropriate targets,

quantifying the deliverables in each scheme, and bringing to the knowledge of all "outcomes" of Budget outlays for each scheme/programme. Outcome-based budgeting differs from traditional approaches because it focuses on results rather than on input utilisation and enables to understand long term impact of schemes and projects. When a plan programme / project is conceptualised benefits which it brings to the community are identified and deliverables determined. But when the project is implemented review is usually confined to the physical and financial targets achieved ignoring the purpose for which the programme/project is implemented. In order to measure the efficiency and effectiveness of a project outcome budgeting and desired outcome needs to be assessed. [see chapter 5 for more details]

6.15 Decentralised planning.

1) Voluntary Technical Corps (VTC).

One of the important innovations of the People's Plan when it started was the concept of Voluntary Technical Corps (VTC). The idea was to mobilise topmost experts in different sectors through a normative process and then formally request them, some of them by the Chief Minister himself and others by the Ministers concerned, Chief Secretary, etc. to involve themselves in local development initiatives. At local levels, the appeal could be from the District Collector, the head of the DPC or even the elected head of the local government. These experts should be given a formal role in project ideation and development, project vetting and in project monitoring. The services would be voluntary, in the sense they would not be paid for their services except meeting out of pocket expenses like travel, food, stationery, etc. Over the years, mainly due to bureaucratic apathy this system has fallen into disuse and formally put an end to in 2012.

Now with the popularity and acceptance of video conferencing, the potential for using even experts outside the country is very high. Many of them would be happy to do some service to their native land. All that is required is fair identification, courteous invitation, treatment with respect and serious consideration of suggestions.

2) Unnat Bharat Abhyan (UBA).

The Ministry of Human Resource Development initiated a scheme called "Unnat Bharat Abhyan" in 2015. Though it enjoys strong support of the Prime Minister himself, has not really taken off. It envisages that every institution of higher education - from a graduate college to IITs

and IIMs has to mandatorily do something for areas especially for the villages in their vicinity. In Kerala, this has a fascinating potential, particularly for village and block panchayats. Therefore, the following suggestions are made:

(i) A meeting of the Vice Chancellors and the heads of national institutions like IIT and IIM may be held by the Chief Minister based on concept note and approval taken.

(ii) A workshop of NSS Programme Officers along with People's Plan activists and selected leaders of local government could be held and draft guidelines developed.

(iii) Draft guidelines need to be vetted by a high level team and approved and action plan developed.

(iv) KILA may be entrusted with conduct of training for key resource persons on operationalising the scheme.

(v) At the district level, chairperson of the DPC and the District Collector who is the Member Secretary of the DPC and District Planning Officer needs to work out the modalities and detailed action plan for each of the educational institution and facilitate its implementation, particularly in sorting out teething problems and monitoring progress.

3) Planning from below.

Though local governments have been preparing plans for the last twenty five years, there is no system for using them as inputs for the preparation of the State plan, particularly, for those sectors which have a strong element of district level action. This can be operationalised through a simple mechanism. All the local governments while preparing their plan need to include a chapter containing suggestions to the State Government. These would be consolidated at the block level and district level and a formal proposal made by the DPC in consultation with the district level officers, with adequate justification for each suggestion. These may then be sent to the State Planning Board and district level officers needs to extract suggestions in respect of their departments and send to the head of department. These should be formally discussed during the Annual Plan deliberations.

At the local level, there are plans implemented with resources of local governments and resources of departments including centrally sponsored schemes. There is lot of duplication and

wastage of effort. Therefore, at least for sectors like agriculture, animal husbandry, fisheries, women and child development, social justice, SC/ST development and health, there should be a single document at the level of each local government. In due course the planning process could coalesce. To start with, by June a document should be prepared at the level of each LSGI, detailing what will be done during the financial year by the State and local governments. This will ensure that people know what is being spent from the public exchequer for different development activities in their locality.

6.16 Others:

There are instances, where the budget announces new schemes with insufficient allocation. Announcements of new schemes in the budget should not undermine the planning process. Such schemes need to be subjected to scrutiny by the Planning Board before implementation.

Frequent appropriation through Supplementary Demand for Grants (SDG) is another issue which reduces leeway for plan implementation. Departments often take recourse to the SDG route to realise funds for the schemes not approved by the Planning Board. SDG needs to be limited to essential purposes and to a maximum of two in a year for the smooth implementation of Annual Plans. Formation of new organisations with overlapping mandate needs to be avoided as this leads to wastage of funds and duplication in function leading to inefficiency.

It is observed that over the years administrative cost of implementing a project or scheme is met through Plan. This can be allowed only during initial period of implementation of a project. There needs to be a limit on meeting administrative cost, mainly salary from Plan. Staff strength needs to be reduced immediately on completion of a project. Format of Plan documents remain unchanged from Planning Commission days. The formats need to be changed to incorporate changes in classification and terminologies, especially related to central assistance.

6.17 Recommendations

These recommendations pertain to Planning at State level and do not include local level planning.

1. ***Process of formulating Five Year Plan generally commences six to eight months prior to the first year of the Plan. It is recommended that the base for the next five year Plan needs to be laid after mid- term review of the current five year so that the time for preparatory work of a Five Year***

Plan (formulation of Approach Paper and Working Groups) should commence almost one to one and a half years prior to the commencement of the Plan.

2. ***Despite limiting the planning process within five years, a longer term vision document to address critical need of the economy covering a longer period needs to be prepared. The time given to Working Groups must be sufficient, at least 6 to 8 months, to understand the sector comprehensively and review all schemes under implementation. Universities and research institutions may be involved in various sectors of the planning process. The departments and State Planning Board may collaborate with universities and research institutes to study issues prevailing in the sector and suggest required reforms.***
3. ***Plan preparation is taken as a routine activity. Fresh approach, innovative thinking, and a broad vision are required to prepare Plans. Plan proposals submitted by the departments often lack clarity and are not backed by adequate data. Proposals need to be concrete by outlining the objective, target, time-period of implementation and mode of implementation. District Plans shall be integrated with the State Plan. State Development Council needs to be strengthened.***
4. ***During Plan formulation, adequate attention has to be given to the generation and analysis of data. This requires close coordination between the departments and department of Economics and Statistics. Schemes need to be formulated after identifying needs of the sector as reflected in the data.***
5. ***While preparing plans, the departments must be extremely sensitive about the cost of funds they are using. Departments should be conscious of the cost of resources and their scarcity while taking any spending decision. This aspect needs to be taken into consideration while devising schemes. Efforts need to be taken to formulate growth oriented schemes. Proposals need to be more concrete and clearly define the objective, target, time-period of completion and mode of implementation.***
6. ***Present system of Working Group for issuing Administrative Sanctions needs to be reviewed. Guidelines shall be prepared for all schemes and must convey details of the scheme including objective, target, mode of implementation, selection criteria*** of beneficiaries, time period of ***implementation and district wise break up etc. Working Group may examine only new schemes and existing schemes with change in components and cost.***
7. ***Implementation schedule shall be programmed by the department to ensure phased spread throughout the year.***
8. ***Delegation of financial and administrative powers needs to be enhanced to speed up the implementation process.***
9. ***Single window monitoring through 'Plan space' of physical and financial progress needs to be encouraged.***

10. ***Planning requires expertise in various sectors. Capacity building/training of personnel in the Planning Board needs to be given priority.***
11. ***Outcome based budgeting needs to be adopted in the departments.***

Chapter 7

PROJECT PLANNING AND IMPLEMENTATION

7.1 Expenditure Processes

Government of Kerala retained planning and the distinction between Plan and Non-Plan Expenditure, even as Government of India abolished this distinction and replaced Planning Commission with Niti Aayog. The change at the centre is not merely in name. Control of the executive over Niti Aayog is more than what it had over Planning Commission. It can be argued that the distinction between Plan and Non-Plan funds might have become dysfunctional to some extent, since states exploited the financial process to get more Plan funds from the centre for projects without making adequate follow through arrangements/provision for maintenance and operational expenses of the projects/ assets created out of Plan funds. Yet, the distinction between plan and non-plan expenditure continues to be meaningful as Plan expenditure creates new capacities or adds to capacities for production and provision of social and economic services. As much of the expenditures moved significantly towards programmes and away from projects that created assets of social and economic value, even on the aspect of Plan versus Non-Plan expenditure the distinction was less between projects and their maintenance /operations.

There are valid reasons to distinguish between expenditures that create capacity and those that are in the nature of pure consumption or pure transfers for consumption by government (subsidies) that are not captured by the usual and widely used categories of revenue and capital expenditure

However, the positive role of the Planning Commission arose out of its role to craft projects and programmes, carry out social cost benefit analysis, and monitor projects and programmes, to take corrective measures and redesign the same, even if these strengths have been lower than what was desired. With the abolition of the Planning Commission, the aspect of allocative efficiency, i.e., the role of critically examining proposals and programmes that come from the executive at the highest levels is weakened, since Niti Aayog's mandate to support the government would override such a role. Planning Commission's analysis including the critique that happened within the government under the earlier structure while very weak still existed, as examples of the studies on

food subsidies, NREGS, evaluation of IRDP etc., would show. Kerala with a strong state planning department is one of the few state level planning organisations with sufficient capacity to take planning forward.

7.2 Fiscal Perversity

There is enthusiasm on the part of the governments to go in for plan size bigger than their fiscal capacity. Resulting underfunding for maintenance and other operational expenditure is a fiscal perversity that characterised the Indian system of Planning. Handling the same through highly standardised projects and programmes (as was done by the Central government) is only a partial answer. The answer to the problem is hardly overcome by abolishing the distinction between Plan and Non-plan expenditures. It is better done by ensuring that as part of the approval process of Plan funds, provision of funds for operational and maintenance expenditures (at least for projects and programmes involving investments) are made upfront as commitment over future resources of the recipient entity.

7.3 Projects

Since the Plans seek to add to productive assets / or improve the wellbeing of people through, for instance a subsidy programme, direct outcomes /impacts are always to be expected for all planned expenditures. However, the focus is on projects and programmes of a sustained nature that improve productive capacity including through improvement of factors (including human capital), and direct capital formation. Many of these are social factors and directed at overcoming market and endowment failures may not be appropriable, however all are intended to add to social value.

7.4 Absence of operational monitoring

There is no mechanism to actively monitor projects and programmes of a project type at the operational level since the information generated on progress of the projects /programmes is outside the cycle time for the government to be able to take corrective action. However, basic information on financial shortfalls in expenditure is generated (essentially through the deviation between budgeted expenditure, revised expenditure, and the actual expenditures). Since there is no readily available information on physical progress of the projects with reference to ex-ante milestones (in most cases no such milestones are laid at the time of approvals/ sanctions), control and monitoring of projects is outside the ability of the government / planning department.

However, in the case of projects of high visibility there could be monitoring and control on a case by case basis.

7.5 Need for Milestones

Regular monitoring would involve information of milestones, critical activities, contingencies and how these could change activities on the critical path. These naturally would have to be with the implementing agency (panchayat, a public enterprise, an autonomous agency, or a line department of the government). While it is possible that such tools and associated information would be available with a few of the PSUs and autonomous institutions of Government of Kerala, which are recipients of plan funds from the Planning Department there is no general availability of such information to enable the Planning Department to take corrective action or to forecast future requirements of funds (and coordinate across line departments) in a scientific way.

7.6 Handling Revisions

Projects go through multiple revisions. While some are justified in view of the change in the scope of the project, most may only be arising out of unit cost variations, and cost increases caused due to delays in mobilisation, and in receipt of funds from the Government. There is little or no ability to distinguish between these factors.

7.7 Adhocism

There is little prioritisation and ranking of projects especially when cuts in expenditure have to be made. Across the board cuts, and ad-hocism are more likely which could adversely affect the social and public value created when compared to a funding/ funding cuts that are based on closeness to completion, expenditure already incurred, changes in the cost/benefit assessment, that would have been possible had the proper systems of monitoring projects been in place.

7.8 Specific cuts difficult

It is the lack of systems which gives the ability to the Planning Department or the Finance Department of the Government to justify its cuts on particular projects, (more than the political pressures which emanate from regions and panchayats) that makes for adhocism or across the board cuts.

7.9 Weak cross department coordination

Monitoring involves project variance analysis for the sponsors, and changing activities on the critical path so that the financial and coordination implications of the project are recognised early enough to avoid cascading adverse effects. For this and other reasons, there is almost no coordination across departments in the execution of projects, and little coordination across regions.

7.10 Rampant over budgeting

There is over budgeting in the sense that many more projects and programmes are taken up in the plan than what could have been ideally feasible. This makes cuts inevitable, which thinly spreads the available resources. As a result, cost overruns and delays are common. These could not be estimated since the relevant information on original costs, and physical progress is not available, (expenditure trajectories could be approximately estimated). Yet, it is important to recognise that a50 percent cost overrun, and a 50 percent time overrun takes away significantly from the growth process. Assuming no positive externalities of publicly funded projects, at 50 percent of the gross capital formation in an economy, this delay and cost overrun can easily take away about 1.5 percent from the growth rate of the economy. With large expected positive externalities from public investments, as is usually the case, even at 20 percent of gross capital formation delays and cost overruns of the order considered can result in large shavings from the growth rate. Since over budgeting, and associated "spreading thin" of financial resources is controllable by the state, the same is an avoidable dead weight loss.

7.11 Falling share of capital expenditures

There has been falling share of capital in government expenditure over the nineties which has stabilised at low levels in the current decade. In both Plan and Non-Plan, the share of capital expenditure has been small.[2]

7.12 REQUIRED PROCESS INITIATIVES

1. Strengthening capability of agencies

Projects sponsored by the Planning Department take place in line departments of government, public enterprises, other statutory bodies, autonomous institutions and at lower levels

[2] See footnote 4 later.

of government – PRIs and ULBs. The approach to monitoring and feedback for corrective action has to be different for the line departments – since these are directly implemented by the government. The need to strengthen the implementation and monitoring mechanisms at the level of the agencies (including line departments) would be the first aspect of strengthening the institutional framework. Only if this takes place is there scope for the Planning Department to contribute meaningfully to the efficacy and efficiency of implementation. Without such capability at the agency level, including within the line departments efforts of the Planning or Finance department to monitor projects and programmes would be counterproductive, and would add to the administrative burden of the agencies.

2. Periodic report generation

Periodic progress reports and completion reports that arise in the regular course of implementation at the level of the agency is not a general practice. Completion reports have to be forced out of the agencies, and the progress reports tend to be sketchy and lack physical progress measure, or a measure against budgets in terms of time and progress, though in terms of expenditure there usually is a comparator with the budget but with no ability to break down the difference into meaningful variances for diagnosis.

3. Sui generis system required

A sui generis system for monitoring and assessing project implementation that has use for the agency and for the sponsor is an important need. Some of the larger public enterprises are likely to have PERT/CPM systems for project management, in which case the monitoring system of the Planning Department would have to be integrated with the same. Essentially all entities need to have project accounting systems which lie on top of their traditional accounting system. For agencies following the double entry enterprise systems (autonomous bodies, public enterprises) the overlay of project /programme accounting is one of low level implementation. However, for line departments, ULBs and PRIs which continue to use the single entry cash basis of accounting, the overlay would have to be actively developed.

4. MIS

Even as the accounting systems for project implementation and reporting/monitoring are strengthened the associated MIS that goes well beyond the same would be necessary for working out variances and taking corrective measures. Such systems would also allow for the forecast of

funds since fund flow analysis would be part of the design. MIS or "Management Information System" constitutes the core repository and acquisition process of all relevant information in large organisations to carry out their transactions including for oversight and monitoring besides reporting to stakeholders. Over time the power of these systems and their granularity has gone up immeasurably with the use of IT. At the core they support "Management Control", which is the accounting system to map expenditures against budgets to bring about the variances which then become the focus of attention to initiate corrections. In commercial organisations these processes are incomparably better developed. But even in government and public systems their increased use is evident by the increased penetration of ERP systems, more suited to commercial organisations, even when only marginally tweaked to suit public service oriented organisations.

5. Results based framework

The MIS should allow for a "results based framework" of planning, reporting and oversight of departments, especially the line departments. More detailed MIS is driven by the needs of operational managers /officers of the line departments who need to have the information to take corrective action. The information in the MIS needs to be integrated with operations (arising out of the need of operations) allocations, disbursement, spending, milestones etc. Results Based Framework (originally promoted by the Government of India) if sufficiently granular could benefit from such an MIS.

6. Accountability

Besides the requirements in terms of implementation and monitoring/reporting systems, an approach that recognises the considerations below would be very useful in ease of implementation.

7. Appropriate bundling

A large number of projects are not easy to monitor and assess. Bundling the number of projects taking advantage of the decentralised system of governance that Kerala has pioneered is important for ease of monitoring by the Finance /Planning Department, when the projects are repeated in each PRI or ULB. For the larger ULBs direct dealing with the same as an agency may be called for. In every case the Planning Department needs to know the designate on and contact within the agency/District level for each distinct project/programme that is under implementation. Standardisation of format, design of the query system to generate meaningful MIS, accounting and statistical/economic reports, all have to be part of the system. Bundling has to take advantage of

the logic of implementation, more than funding. Thus, a dam project funded by different agencies is still a project and primarily needs to be managed and monitored as such.

8. Contracts

Even in contract awards appropriateness of bundling is important for success. Thus, a road project on EPC basis when broken up into a large number of contracts as is the usual case with most PWDs of the country, results in weaknesses in coordination, risk and blame shifting, and in dodging accountability by putting the blame on other contractors. The PWD then bears the task of coordination. A power project when awarded as a few (around 4/5) packages will have a higher probability of being completed than when awarded as scores of packages. Turnkey projects while least risky can be quite expensive, but still would be far better than what is the current practice in most PWDs.

9. Public access

Government also needs to consider public access to select items from the data base, so that people, PRIs, ULBs, PSUs and autonomous institutions - beneficiaries of funding, can monitor and track their own projects, as also other projects. In this case the agencies implementing the projects would have a strong reason to keep the data base updated and correct. Finance and Planning Department can make releases on the project account conditional on the completeness of information in the database and on the performance/ achievement that is evident to all from it. The benefit of such public access (reading) in an active decentralised and democratic system is obvious – it can improve accountability of public agencies.

10. Extensive use of MIS

A lot will depend on MIS report formats that can be designed to bring out in various summary forms the status of implementation at various levels. Thus, MIS reports could bring out the status of all projects of an agency to be one element in the assessment of project implementation performance. Similarly, the performance / status of projects of a particular line department or in a sector can be brought out. Period wise analysis is also useful. These reports can take the form of end of accounting year reports for an ex-post diagnostic or can even be used, when more frequent for managerial actions. If variances are also analysed and cause/s for delays and cost overruns listed, they can constitute a powerful tool for feedback to all organisations involved in design and implementation to improve the efficacy and efficiency of public projects.

Diagnostic discussions and decision making at the top can be more perceptive and less adhoc than what it is today. Consequences of controllable factors such as underfunding, delays in land acquisition/assignment, in contract and procurement design, can all be brought to the fore. A process which can converge to better embedding of project management in government would then begin.

7.13 PUBLIC AND SOCIAL VALUE IN PROJECTS[3]

1. Declining social value

The need to improve social value of government expenditure cannot be overstated. The social value of government expenditure at the state level, all over the country, has been declining. It is unlikely that Kerala would have been able to avoid this decline.

Among the well-known reasons for the same are:

(1) lack of a holistic consistency i.e., the absence of strategy in the choice of projects,

(2) missed synergies across projects, as departments pursue their own objectives without an acute sense of how projects impact / and depend upon domains other than their own,

(3) little recourse to a spatial strategy and design that is concerned about locational efficiency. These along with delays and cost overruns –resulting from problems with land acquisition, underfunding, and poor coordination across departments and agencies in implementation have greatly reduced the public and social value in projects. There is little systematic evidence to bring out the rate of this decline, though there is much anecdotal and scattered evidence.[4]

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[3] Society is interested, or ought to be interested, in maximizing social value (benefits) while taking due account of social costs, pareto optimally. Thus, when there is divergence between private and social costs and benefits due to market and endowment failures, it is the job of the government to correct the same, through regulation, taxation, setting the right prices, creating markets, direct action and investments. Moreover, the aspect of human rights gives to governments a role in the economy independent of the divergence between social and private valuation of costs and benefits. Public value may be looked upon as that part of social value, which governments are responsible for. Thus, while households can keep their interiors clean, streets and public places are clean when governments can efficiently provide or arrange for the street cleaning services. Then the public value (or benefit) is maximized. Given the usually positive interaction between public and private value (benefit), then private value is also enhanced. One notable aspect of the poor capacity of the governments in India is that little public value is created. Public value is understood to be that part of social value, which is necessarily on government action, and hence weaknesses within government greatly reduces the social value that people derive in their existence.

[4] The Ministry of Programme Implementation brings out delays and cost overruns of the order of 30% on large projects under implementation of the central government all over the country. (Govt of India, 2020). Earlier in the 80s these were as high as 60%. (Morris, 1990) Factors underlying these delays tend to be the same across the regions – land acquisition, underfunding, political opposition, besides general lack of professionalism in project management, except in the case of a few entities like the NTPC. Some like Railways and Irrigation have large delays. NHAI's roads, have fewer delays and cost overruns today. They have no doubt come down significantly from the back- breaking levels of 60+ % that they used to be in the nineties.

2. Revenue, capital, and consumption

The small share in public spending of capital expenditure in Kerala as in many other states is indicative.[5] Thus, subsidies to support unviable agriculture can at best do a holding out operation in terms of employment. In contrast the potential of expenditure in infrastructure and related services to create public goods, which are then provided to productive entities can attract economic activities that can absorb labour, at much better value and in larger numbers for the same public expenditure.

3. Leveraging private capital and expenditures

This is not only because of the leverage aspect as when public expenditures help to attract private and commercially oriented investments through PPPs and JVs, but also because, public service in question often could never have been provided by the private sector given the many market failures, and it becomes necessary for commercial investments in the economy in general. This is, for example true of articulation infrastructure, public health, and education investments, where the market failures are known to be deep, and requiring state's efforts not only in regulation but in direct and indirect investments as well.

4. Recognising type of market failure/s

In areas like electricity, some arterial highways, major airports it is conceivable that regulation and frameworks for private participation through PPPs alone could have worked. But in areas where there are problems of appropriation- lower order roads, smaller airports, sewerage and sanitation services besides other public services like conservancy and inoculation, school education, most of higher education, intra-city connectivity, besides regulation, subsidisation and often direct production by the state, amounting to significant part of the overall supply would be necessary as well.

5. Sub Optimality

As in many of the states, public expenditures in Kerala are also nowhere near optimal [6]in

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[5] The share of "Development"expenditure in Kerala has declined from 55.9% to 51.5% from 2012-13 to 2018-19. (p.33 Table 1.5.4 of Economic Review 2018-19, Vol 1). Similarly, the share of capital expenditure fell marginally from 7.9 to 7.5% over the same period. (Tables 1.5.4 and 1.5.5 pg. 33 and 35, op.cit.). The extremely low share is worrying. Most other states are similarly placed.

[6] There is significant divergence between outlays and the actual expenditures that take place in any year. Besides funds availability, the pressures of actual spending, delays in gearing up, dependence of a project/ programme on other projects/programmes are the reasons. In many more cases there is underspending. The tendency to budget for more programmes and projects than what is possible given the resources of the state, and the erratic availability of capital from the centre, would have resulted in this deviation. This would along with other issues (mostly related to land, coordination and local factors) have in turn resulted in large delays and

their allocative aspect. Steps required to improve project implementation and management which is an aspect of internal efficiency conditional on the allocative choices made, have already been considered.

Reasons for the same in the case of transport infrastructure in India are many - little attention to network optimality as in the case of roads, ignoring multimodality in communication infrastructure, absence of land use change and alignments being interlinked, and generally ignoring spatial dynamics in both locational choices of economic activities and in construction, are the more important reasons for the low benefits created out of public infrastructure. Inappropriate procurement models also result in poor quality. This is especially true in relation to East Asia. Some of these are considered in the discussion that follows.

7.14 STRATEGISING PUBLIC EXPENDITURE FOR SOCIAL VALUE

Key orientations/strategies required for positive impact on efficacy and efficiency of public investments is discussed here though a large part of their overall impact on public and social value lies in gains in productive efficiency and consumer efficiencies in the economy as a whole.

1. **Reducing the frictional costs and times**

There is a need to take in transportation projects that can reduce the time and cost of movement of people and goods across the state. Kerala has awfully slow movement between its principal cities. Despite a near linear aspect which is conducive to quicker movement with efficient design of corridors, the state has much slower movement than many other states in its income class. Thus, in comparison to Gujarat the average time taken in Kerala is more than 20 percent in relation to similar distances, using sample measures from Google Maps for movement by car. From town to country, it is even higher when reckoned on a per km basis.

2. **Attracting high labour productivity industries**

Kerala is a money order economy with remittances amounting to almost 40 percent of its per capita SDP. Since the remittances arise from vast out migration of people as workers, there is a greater equality of income that the remittances engender contributing to high social development. However, the same results in a reservation wage much higher than in neighbouring Tamil Nadu or

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cost overruns, which reduce the value created per unit of expenditure especially in the case of capital expenditures. It is important to recognize that the fiscal capital expenditure multiplier is as high as 2.45 in the short run and cumulative is 4.80. In contrast the transfer multiplier is only 0.98 and 0.95 respectively, and the revenue expenditure multiplier 0,99 and 0.96. Bose and Bhanumurthy (2013).

Karnataka making it difficult for industries in Kerala with similar overall labour productivity as in the rest of India, to be competitive. Additionally, the remarkably high effective cost of land adds to the debilities of location in Kerala.

As a result, Kerala today has a tiny share of the country's manufacturing even though it was the region with the highest levels of industrialisation at the time of independence, outside the regions with the three metros[7]. Thus, it is almost axiomatic that Kerala needs to focus on attracting manufacturing and tradable services that are intrinsically high in labour productivity. These would necessarily be those that are either capital intensive or technology and human capital intensive or both. The potential of the first is much lower since many of the capital intensive industries are ruled out on account of high land cost. However, level of human development and especially of local availability of educated people make the potential for high technology and human capital intensive industries high. Besides IT and related sectors, design and development in a wide variety of electronics, systems development, hardware manufacturing and assembly, robotics, higher education, technical education, high quality tourism, aerospace, aircraft fabrication, defence and professional electronics, advertising and publishing, high value agriculture, industrial R&D on contract, medical services, entertainment production, are some examples.[8]

3. Clusters and coordination efforts

Yet these industries thrive in clusters; have strong agglomeration effects arising out of shared information making a graduated progression difficult. Strategic initiatives on multiple fronts –demarcating specific locations, greatly improving people movement speeds, investing habitat formation functions, tariff and investment policies, besides direct efforts to attract pioneering and leading firms, top-quality estate management are required.

4. Migrant labour integral to development process

Migration of lower cost construction and other manual labour into Kerala from Orissa, Bengal and Bihar, has over the last quinquennium allowed Kerala to overcome the unskilled labour constraint that had restricted its local output. This labour has found employment in construction, restaurant and related services, as unskilled labourers. Strategy to make efficient use of such labour in productive industries is required. It is important that investments and actions by the state

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[7] See Albin, Alice (1990)

[8] Kerala has many of these industries, but the scale and scope remain small, due to limitations arising inter alia out of macroeconomic and trade policies of the country being orthogonal to rapid growth. Local factors that constrain are locational in optimality, and low scale of clusters, and high frictional costs in interaction. The political pressures to support activities?

overcome the debilities that such labour suffers in their application to industries and tradable services.

5. **Locational considerations**

Locational aspects would be particularly important. Indeed, strategies that jointly address the communication and locational issues to push the economy (both production and habitat) demand a considerable coordination and design on the part of the government. A high speed corridor between two largish cities provides the opportunity to plan for activity along the corridor which uses the corridor –typically the hierarchically planned road system.

6. **Integration of land use and transport systems**

The above point needs emphasis since all over India and especially in Kerala non-integrated investments in roads have brought about 'ribbon-development' along roads, significantly depressing the value of internal lands by blocking their access and congesting the roads. Indeed, if one aspect that has greatly reduced the social value of investments in transportation and connectivity it is the fact of ribbon 'development' as the norm.

Besides integration of investments between locational planning and roads, imposing hierarchical structure in road networks, grids and near grid layouts are important. Along with tools like land-pooling, transfer of developmental rights (TDRs) and the important mechanisms of planning, projectisation of investments that are taken up at various levels and their derivation from an overall strategy of regional articulation, the state can overcome the current bind on road expansion.

7. **Land acquisition issues**

The problem of land acquisition for public projects is most acute in Kerala. While a large part of this is natural given the high population density and the space density of economic activity, certain approaches to land acquisition and in space and infrastructure planning have compounded the problem. These may be listed as:

a) compensation, which is well below the market value, not to speak of the market value in the new use for land since the acquisition often values the land at the official recorded transaction in the neighbourhood which would be understated by at least half, if not more and may not have taken into account special features like access.

b) general tendency to build on the old network structure (which tends to be point-to-point) instead of a movement to a grid greatly reducing the efficacy. This is because of incrementalism in road development without a prior strategy. This further limits access of lands and makes the value of those with access (typically these are to be acquired for infrastructure development), expensive.
c) similarly, ribbon development makes widening of roads nearly impossible because the value of the properties adjacent to a road are far too high. Again, the reason is the highly restricted general access to lands.
d) original highly chaotic local walkways and bullock cart pathways have slowly been expanded to become motorised highways. The general approach has been to widen/ improve the network wherever congestion /increased demand has manifested itself, moderated by some foresight based investments especially when linking roads have to be provided for large projects. However, this approach of accepting the original network structure (valid for an economy with weak articulation) instead of laying out – modifying the existing geometry – into the more efficient grid like pattern – which is optimal for an emerging economy with the need for increased articulation, besides contributing to the inefficiency also makes the price of land very high since the land that is sought to be acquired is around the roads with the highest traffic/ congestion.

8. The base in skilled and semi-skilled labour

In public spending on education and public health services, Kerala leads most states by a wide margin. In part this is reflected by the higher human capital development in the state. But it is also important to realise that by not spending on investments that create local productive industries, the local absorption of this skilled and semi-skilled labour is extremely low. Focusing this capability of the state on investments with high labour productivity potential –high technology and non-polluting capital intensive sectors- can immensely enhance the social value creation through enhanced public value that such investments can create.

9. Need for regional growth model

In this context it is suggested that the Planning Department creates a model of growth and investments with sufficient detailing of the public, and private investments across broad sectors valid in the regional context, and parameterise the same with reference to national growth, choices made in terms of focus on particular sectors. The model should have its own consumption and

household investments sub-model, as well as export and import and taxes that can be collected. The model would have the merit of giving results that are consistent across public and private investments and across sectors. With greater detail it can also generate employment opportunities created at various levels of skills and wages, to allow for anticipation of immigration. [9]

10. Skilled and semiskilled job creation the key

The need to sharply focus on job creation (skilled and semi-skilled) in Kerala cannot be overemphasised. The easy option of exporting labour to the Gulf and other regions at the same rate as in the last several decades may not be possible anymore with oil hovering around US$30-45 a barrel, and the exuberance of Dubai having reduced. In short, the factor (labour) side of development as in Philippines has been good, but the engine of growth has all but given away. Even then Kerala has witnessed high growth owing to the spending multiplier effects of the remittances. At even 35 percent of SDP, and a locally embedding multiplier of 1.5 as much as 50percent of Kerala's SDP owes its dynamism to internal remittances![10] This exposes Kerala to a high degree of vulnerability. Moreover, a path of growth that is dependent on remittances can take an economy only to low middle income status.

7.15 INVESTMENT AND FISCAL STRATEGIES

Kerala being a consumption oriented region (with a great amount of investments in the tradable goods and services repelled over the 80s and the 90s) is favourably placed with regard to

[9] A regional growth model would have to start with an SNA (System of National Accounts), which is then given a spatial aspect through the embedding of production locations, to make for a regional SNA. This would allow the economist to develop regional input-output relations (coefficients) for the more important industries and activities. To date such can be developed only with heroic assumptions. See Dholakia, Ravindra (2020) A simpler way would be to develop production functions for the core productive activities in the state, and have data on the labour, capital, skilled labour, material and infrastructure requirements of other industries/activities that the state wishes to consider promoting locally. These can recursively have solved together to provide a base model of production, which when subject to planned investment increases can tell the planner the expected output increases overall, and the labour and infrastructural requirements. Today even such modeling is possible only for the secondary and primary activities but not readily for the service industries, for which the requisite data would have to be generated from sample surveys. Such a model could even when approximate give reasonable estimates to how a certain local growth could be achieved, and bring out the associated changes in capital stock, savings, public services, local export and import, besides labour use and possible migration. Assumptions regarding the national growth strategy and rate would be inputs to such a regional model. Morris and Pandey developed such a model for the state of AP as part of the exercise of making a vision 2029-30 for the state. Now with detailed location ally valid invoice data being available from the GSTIN, a far more ambitious model, closer to the regional SNA can be constructed which can be used in regional planning.

[10] A long-term multiplier of 2.0 for autonomous consumption expenditures would not be too far from the reality, given the savings estimate for the country as a whole, out of disposable income. Leakages to nearby states (which can be changed with initiatives to embed production locally) would reduce this to about 1.5. Hence with remittances being as high as 35% (in relation to SDP) or even higher, the demand created due to the spending multiplier effect is considerable and would account for a large part of the demand side of the state's SDP. Kannan and Hari (2002) estimate the Gulf remittances to be around 22-24% in relation to SDP. Tumbe (2010) estimates the international remittances to be 35% of SDP for Kerala. Albin, Alice (1995) estimates the remittances to be around 35% of SDP. For long Kerala has essentially been a money-order economy with efficient human capital development, but without a substantial engine of growth.

its share of GST. GST being designation oriented, ultimately the tax on account of GST would accrue to the regions from where consumption arises. Delhi of course would be most favourably placed in this regard. Kerala has the benefit of the consumption arising out of its high per capita income (about 35 percent of which is due to the remittances). Only Delhi and Goa have higher per capita incomes. However, the recent decision of the Finance Commission in proposing to change the date for population numbers to a later date from 1972, in its fiscal devolution, will heavily penalise Kerala which has had the sharpest decline in the growth of population since that date and even before, thanks to its investments in human capital and the early social movements that were modern in character, and the land reforms in late 50s and in the 60s.

1. Need for non-tax resources

Therefore, for Kerala to have an ambitious programme to build its own engine of growth, would place large demands on fiscal resource if the problem is addressed conventionally.

Few of the implicit resources that are available, and which are closely related to the approach of spending and strategy outlined in the previous sections are considered here.

2. JVs and PPPs can leverage public resources

Joint ventures with private capital where the government has only limited participation, with the objective of giving comfort to local middle level entrepreneurs including NRI entrepreneurs in Kerala willing to play a pioneering role in innovative industries, industries that help to re-establish itself as an important destination, is important in leveraging its own capital resources. These units in turn can attract many other industries. Attracting and supporting potential mother units, key units to a cluster need to be considered and implemented.

Joint ventures and PPPs are suggested in areas of dual market failure, where the government through viability gap funding can attract a larger volume of investments than what it could do on its own. Models that are functional have emerged in India only in roads and ports and airports, and in little else. The Planning Department by developing frameworks, model concession agreements (MCAs), and state support agreements for sewerage and water, solid waste, inland water transport, multimodal switches in urban areas, public amenities in tourist centres, market yards, ports and harbours, agriculture processing centres, industrial estates, can greatly reduce its own fiscal outlay.

Roads, port, industrial parks, water and sewerage systems, airports, electricity, waste treatment, bus terminals, inland water transport, are all amenable to JVs/PPPs, where future revenues arising out of better and quality service can finance current capital expenditures.

3. New alignments and networks

Land and control over use of land is an important hidden resource. At present the government goes through the inefficient and long drawn out process of acquiring land adjacent to existing roads for expansion of roads. The market price (at about three times the last traded price)is very high (on account of intrinsically higher value, high population density, higher alternative use –especially homestead, and because of extreme ribbon development) in the state especially around national and state highways, that constructing roads in the state becomes far too expensive. As a result, even the national highways of Kerala remain a poor shadow of the speedy highways that have been built not only in the land abundant regions of India, but also in Punjab, Tamil Nadu, etc.

However, the very factors that keep the land price around roads remarkably high tells that the social value of expanding and improving roads will also be extremely high and immeasurably greater than the social cost of road construction. It is important to understand that the cost of land perse is not part of the relevant cost in social cost benefit analyses, only value loss in the alternative use of land. By using new alignments (rather than widening) at some distance (usually a km or more away from the current alignment), laying the same more as a grid which is connected by spurs to the current road, and making the current road hierarchically lower, large savings in acquisition cost with larger increase in social and public value is possible. If additional land required for the spurs for interconnect and for wayside facilities are also acquired net cost can be greatly reduced while enhancing the value. Models for such approaches do not exist in India, and Kerala will have to look to Thailand, China and Vietnam for such approaches.[11]

4. TP and land aggregation

An approach that is vital to getting land to expand public infrastructure, in a densely populated economy is almost unknown in India. This approach does not involve any acquisition,

[11] Such an approach has been common in these countries as may be seen by the geometrics of interconnect, which is grid like in character. A look through Google Earth would reveal the difference between Indian and these countries wherein the approach has been to integrate layouts and align properties with roads (and canals) to provide access to every farm and household. India in contrast has built on the alignment of old footpaths and animal carts, often almost unchanged with their curves, to create highways. As a result, roads have a fractal and point to point character and ribbon development is common. Similarly, multimodality is conspicuous by its absence in India and Kerala is no exception. (Morris, 2017) In Maharashtra the new planned second Mumbai-Nagpur highway is planned as a corridor on fresh alignment with spurs to urban places and towns . This would not only reduce the cost of construction but also greatly improve the public and social value created.

only land pooling. The method is akin to the TP Schemes under the Gujarat Town Planning Act, Mumbai Town Planning Act (used in a limited way in Gujarat). This essentially involves, implicit "acquisition" by shrinking all properties within a zone, where the positive benefits of the infrastructure (road, jetty, network, rail) are likely to accrue, issuing transfer of development rights (TDRs), compensating for real assets in areas where the public assets are laid, reworking the layout to make for oblong private properties, all in a way that the take of each landowner is proportional to their contribution in terms of land, its current locational value and real assets on the land. Acceptance by 70 percent of the property owners implies acceptance by all. The exceptionally large social value that can be released and which would accrue as private value to the property owner will ensure that the entire process with the right approach can be carried out very quickly. By breaking a proposed corridor into successive zones, the government will be able to quickly create high speed corridors which not only give value to longer distance movement, but also to the shorter distance local movements through a hierarchy of connectivity. No financial outlay is required, since this approach is self-financing and often government can generate net resources.

5. Role for PRIs and ULBs

The approach can be used by PRIs and ULB institutions, to improve access of homesteads releasing enormous private value through a social process that is mediated and facilitated by the PRI. A large number of households in the state are entrapped in the old foot paths which have evolved into roads with extremely poor access. The contrast with China, Vietnam, and Thailand where local coordination has resulted in vastly improved access for almost all properties is stark. Indeed, the activity can become especially important given the existence of great amount of cooperation, and decentralised government in the state.

6. Overcoming the bind of CRZ

At present a great extent of the areas adjacent to the coast and water bodies are prohibited from undertaking any kind of construction under the Central Government's coastal zone regulations. This approach of imposing blanket banks to solve environmental issues comes out of an inability or unwillingness to painstakingly resolve issues and find out appropriate interventions. In contrast most of East Asia and the advanced countries use lands adjacent to the sea and water bodies in ways that are functional and contribute to their environmental resources. CRZ by placing an outright ban on construction prevents even construction that could have protected and enhanced the marine ecosystem. India is completely unique in having an emotional rather than a scientific

approach to regulation of the environment. The instruments of control and regulation have also been dysfunctional especially in environmental control[12]

Another ban is that of sand mining. This has hurt all coastal states, especially Kerala with its vast potential for tourism, and use of water. In Kerala unlike in a state like Gujarat using the sea and living next to it has been part of the tradition as in East Asia and elsewhere in the world. There is a great deal that Kerala can learn by looking to China and East Asia in the exploitation of its water bodies and coastal zones.

7. "Monetising" zoned development

If the government can identify lands and zones for coastal development (infrastructure, housing, hotels, entertainment) and develop environmentally sound projects, then the transfer of developmental rights (TDRs) to these areas of development can be granted to owners of coastal lands and to the government itself by which the cost of such infrastructure can be internalised and result in no net fiscal cost.

7.16. Recommendations

1. ***Regular monitoring involving information of milestones, critical activities, contingencies and how these could change the activities on the critical path needs to be part of the implementation of projects.ARC recommends that when a contingency arises for revising a project it needs to be done only after critical analysis of the project.***
2. ***When cuts in expenditure are made by prioritising, social and public value created by the project also needs to be considered. Estimates and critical path of the projects shall be done accurately to avoid cost overrun and time overrun which ultimately affect the economy.***
3. ***The study reveals that proper mechanisms for implementation of projects/programmes and for monitoring is absent in most of the departments. Capacity building of personnel needs to be taken up on priority to improve efficiency in implementation. A distinctive system for monitoring and assessing project implementation is an important need. Government needs to ensure that departments develop technology based and efficient monitoring mechanisms to eliminate time and cost overruns.***
4. ***ARC recommends that government needs to ensure submission of periodic reports that contains information on measure of physical progress, measure against budgets in terms of time and***

[12] See for instance Curmally, Atiyah (2001). A simple consideration would tell us that the load of industrial pollution is probably about 10 times per unit of value added than in China since their absolute load is about as much as India's, but falling rapidly, with an industrial output in India that is probably as low as one fifteenth that of China. Perhaps so incompetent is the state machinery on environment control that nothing other than the ban has a remote chance of preventing large scale environmental and pollution damage. See Morris (2002).

progress and expenditure with the ability to break down the differences into meaningful variances for diagnosis. Some of the larger public enterprises are likely to have PERT/CPM systems for project management, in which case the monitoring system of the Planning Department needs to be integrated with it.

5. ***Effective "Management Information System" (MIS) is essential for working out variances and taking corrective measures in implementation of projects. MIS needs to include "result based framework" of planning, reporting and oversight of departments especially in line departments.***
6. ***Government needs to consider bundling of projects of similar nature, especially in LSGIs through standardisation of format, design of query system to generate meaningful MIS, generation of accounting and statistical/economic reports etc., to ensure efficiency in monitoring and assessment. Bundling needs to take advantage of the logic of implementation, more than funding.***
7. ***ARC recommends that to improve accountability government needs to allow public access to items from the database, so that beneficiaries of funding can monitor and track their own projects as also other projects. To begin with select items may be given access. Public access of the information will improve accountability of public agencies.***
8. ***To improve the social value of Government Expenditure, a large part of which lies in gains in productive efficiency and consumer efficiency in the economy, a more realistic approach need be taken in the selection and implementation of projects.***
9. ***State can focus on investment with high labour productivity potential- high technology and non-polluting capital intensive sectors- so that social value creation can be enhanced immensely owing to the higher human capital development in the state.***
10. ***Non -integrated investments in roads have brought about ribbon-development along roads depressing the value of internal land by blocking their access and congesting the road. To overcome this, in locational planning grids and near grid layouts needs to be given importance along with tools like land-pooling, transfer of developmental rights (TDRs), mechanisms of planning, projectisation of investments at various levels and their derivation from an overall strategy of regional articulation, can assist the state to overcome issues in expansion/development of roads and other public infrastructure in densely populated/built up areas.***
11. ***Government may consider impressing on the Government of India the need to review coastal zone regulations and the regulations on sand mining. The instruments of control and regulation have not shown to be effective in environmental control and have affected socio-economic development of the state. Government needs to argue for rational amendment of these laws, to ensure rights of the people living in the coastal area and protection of the environment.***

Chapter 8

MID TERM REVIEW OF PROJECTS

Mid-Term review is a comprehensive exercise generally held at or around the midpoint of the project execution cycle, during which a project's original development objectives and the likelihood of achieving them are reassessed. These reviews are carried out mainly as a means of verifying whether, the projects themselves or their design are still relevant or the project needs to be modified, recast or abandoned, and whether when completed the project will meet the initial objectives set at the design stage.

8.1 Objective

The purpose of Mid Term review is to assess project performance and progress, to establish the distance travelled and direction taken in implementing the project, the extent to which the project is achieving its goals and objectives and producing expected outcomes / impacts on target beneficiaries. Methodology includes analysing the project using a combination of quantitative and qualitative evaluation techniques. Main objectives of Mid Term Review are:

1. Independent and holistic assessment.
2. Obtain fresh, unbiased views of projects.
3. Identify potential for improvement.
4. Produce actionable, realistic, result oriented and concrete recommendations.
5. Presenting learning opportunity for all involved.
6. Review of project design/ assumptions in the light of changed circumstances and adjusting design accordingly.
7. Inspiring the project team and partners through recognition of project's relevance.
8. Proposing concrete and actionable recommendations.
9. Outline how the recommended changes have the potential to improve the project's result.
10. Assess progress against goals and outcomes of the strategic plan, including what has/has not worked well in the delivery of the plan so far.

After approval of the Plan Budget, the usual procedure is to issue Administrative Sanction and start implementation. Thereafter, reviews focus almost exclusively on expenditure targets. Usually there is no review of physical progress at government level. Review of expenditure is practically the only tool now used for review and measuring achievements. Though this will capture the financial progress, actual progress in implementation will be entirely different. For example, some of the departments which have no engineering wings deposit funds with the implementing department or agency and show 100percent progress. A project completed in all respects may not possess all the requisites essential for commissioning or functioning due to pending work like electrification, plumbing and obtaining statutory clearances. Hence a comprehensive exercise is to be necessarily held at the project midway for monitoring and evaluating the progress and recommending further guidance and expediting implementation.

Start of implementation and project completion is significantly delayed due to several reasons that might even include the existence of adverse policies and regulatory framework of each sector. Certain innovative projects lag in implementation due to sectoral constraints. Plan projects are conceived and prepared at its elementary stage by departmental officers without sufficient technical knowledge/expertise or professionalism. Projects with their working components are submitted to Planning Board, and the Planning Board after holding high level meetings, finalises and consolidate the plan budget. Thus, distortions at the stage of the formation of a project persist throughout its lifecycle.

Most projects face several hurdles before and during different stages of implementation. Periodical monitoring of achievements and progress towards objectives will help in proper planning of remaining phases of the project and ensure timely implementation of project. Many projects are terminated even before starting for several vital reasons such as non-availability of land, litigation, pending environment clearances, sanctions from LSGI's etc.

Time and cost overruns, which impede the process of smooth implementation of projects necessitates cost revision and leads to revision of estimate resulting in significant losses to government. Professional skills are essential for reviewing physical progress, identifying defects, if any at each stage, recommending remedial measures and collecting valuable data for future planning and guidance. Such tasks call for the expertise and professional competence of professionals in project management.

Periodical review and collection of data and proper reporting mechanism is necessary for monitoring projects. Periodical expenditure reporting mechanism by the planning CPMU department is currently used for monitoring progress of projects. This by itself is not sufficient for undertaking mid-term reviews. Physical achievement as envisaged in the original timeline and project phasing also needs to be monitored and reviewed.

Physical and financial achievements need to be reviewed simultaneously and monitored to assess whether the expenditure and the physical achievements are progressing *pari passu*. Conventional method of review only captures the percentage of expenditure. This underscores the need of medium term review of projects for evaluating physical achievements and outcomes. For achieving this objective, proper project monitoring and reporting structures needs to be created. Modern technology such as geo tagging and GPS can be used for the purpose so that all projects and departmental resources can be mapped, and relevant information is made easily available and accessible. A robust monitoring system will ensure that there is no duplication in works sanctioned and help in quality assurance.

8.2 Recommendations

Midterm review is an effective tool in project management, project progress monitoring and evaluation. To achieve intended goal of the review, the following measures needs to be adopted.

1. ***Strengthen the Planning Wing in each department and constitute a committee in each department supported by trained officials from the State Planning Board with the technical assistance of IT professionals and experts from respective fields. Members of the committee need to be skilled/trained on project management with special reference to the sector in which the projects are being undertaken.***
2. ***The software application, "Plan Space" may be upgraded and integrated for mapping existing departmental resources and physical data of ongoing projects by capturing actual images of a project with the help of Geo-tagging/ GPS for facilitating Midterm review mechanism.***

Chapter 9

SOCIAL AUDIT

9.1 Introduction

Social audit refers to a legally mandated process where potential and existing beneficiaries evaluate implementation of a programme by comparing official records with ground realities. It is an audit conducted by the people, especially those affected by, or are intended beneficiaries of the scheme being audited and facilitated by the government. It also examines whether money was spent properly and has made any difference to the lives of peoples.

Social audit includes audit of the quality of works executed at different levels along with, details of disbursements made, number of labourers employed, and the quantum of materials used. Generally, in social audit practice the people themselves in coordination with the local administration in charge of the project/policy conduct social audit. Basic objective of social audit is to ensure public accountability in the implementation of projects, laws and policies. Social audit is based on the principle that democratic local governance should be carried out, as far as possible with the consent and understanding of all stakeholders.

Social Audit is often misinterpreted as another form of audit to determine the accuracy of financial or statistical statement or reports and fairness of the facts they present. Conventional financial audit focuses on financial records and their scrutiny by an external auditor following accounting principles whereas social audit is more holistic with greater scope for measuring, understanding and improving social performance of an activity. In short, social audit focuses on the often neglected issues related to the social impact of the project or policy.

9.2 Objectives of Social Audit

Objectives of Social Audit are: -

1. promotes transparency and accountability in the implementation of programmes.

2. informs and educates people about their rights and entitlements under the relevant laws in the course of conducting audit.
3. provides a collective platform for people to express their needs and grievances.
4. promotes peoples' participation at all stages of implementation.
5. strengthens participation in the groups and makes it an inclusive and participatory institution and a platform for positive collective action.
6. improves capacity of local stake holders who participate in the programme.
7. strengthens the scheme by deterring corruption and improving implementation.
8. helps to assess physical and financial gaps between needs and resources available for local development.
9. helps to create awareness among beneficiaries and providers of local, social and productive services.
10. helps to increase efficiency and effectiveness of local development programmes.
11. scrutinise policy decisions, considering the interests and priorities of stake holders, particularly the rural poor.

9.3 Implications of Social Audit

1. Creates an impact on governance by lending a collective voice to the stake holders including marginalised/ poor groups whose views are rarely heard.

2. Enhances local governance, particularly by strengthening accountability and transparency in functioning of local bodies.

3. Ensures that responsibilities entrusted to decision makers areperformed, as far as possible with the participation, consent and understanding of stakeholders.

9.4 Benefits of Social Audit

Involvement of people in developmental activities ensures that money is spent where it is needed. Social auditing helps to reduce wastages and corruption and create awareness among people on schemes/programmes implemented by government.

Other benefits of social audit are: -

1. trains the community on participatory local planning.
2. encourages local democracy.
3. encourages community participation.
4. benefits disadvantaged groups.
5. promotes collective decision making and sharing of responsibilities.
6. develops human resources and social capital.

9.5 Public documents for Social Audit

1. All budget allocations, beneficiary lists, muster rolls, bills, vouchers, accounts, etc. needs to be available for public scrutiny.

2. All applications for licenses/permits and certificates issued by local self-government institutions shall have a serial number.

3. Registers indicating date of application and date of clearance in each case shall be available for reference by any applicant. If possible, copies should be publicly displayed.

4. Public assessment of tax, exemptions, grants, etc., to ensure there are no complaints of undue preferential treatment.

Several states have declared all Gram Panchayat plan documents related to beneficiary selection, budget cost estimates, etc. to be public documents. Notice is to be posted daily at the site of all development works that include lists of names of workers, wages paid, cost and quantities of material, transport charges, etc.

9.6 Social Audit in India

Social Audit in India is usually targeted at public works by government and mostly follows the methodology of involving public through physical verification of works, records assessment, public hearing and mass mobilisation, etc.

Social Audit was made statutory in India in the Rural Employment Act, 2005. Section 17 of the Act provides for regular "Social Audits" to ensure transparency and accountability in the scheme. It is the responsibility of the State Governments to conduct Social Audit. State Governments needs to conduct Social Audit based on pre-designed "Schedule of Social Audit". Government has established an independent Social Audit Society for carrying out Social Auditing of NREGA in the State - "Society for Social Audit". The above Act states that the Gram Sabha would monitor execution of works within the Gram Panchayat and would conduct regular social audit of all projects under the scheme taken up within a Gram Panchayat. Gram Panchayats shall make available all records to the Gram Sabha for the purpose of social audit.

9.7 Need for Social Audit in India

The fraction of public money spent on public projects or schemes that is frittered away through leakages – be it wasteful expenditure or corrupt practices, is significant. Even after 75 years of independence, the situation with respect to government/public schemes has not changed a great deal. Even today there is crisis of credibility, confidence and trust persists. Economic growth is threatened by corruption at all levels. Leakage of funds in public programmes and misuse of resources of shareholders and stakeholders is widely observed. This has adverse impact on vulnerable sections of the society, as they are most often the intended beneficiaries of public projects/programmes.

Social audit helps to narrow gaps between vision/goal and reality, and between efficiency and effectiveness. It is a technique to understand, measure, verify, report and improve social performance of an organisation. It creates an impact on governance and values the voice of stakeholders, including marginalised/poor groups whose voices are rarely heard. Social auditing is taken up for the purpose of enhancing local governance and strengthening accountability and transparency in local bodies.

Since more than 50 percent of government's budget goes towards welfare schemes, it is important to track how, and how much money is diverted away from intended recipients. Social audits serve as a better monitoring tool for these schemes. The impact of continuous cycles of social audit in deterring potential corruption is invaluable. Social audit process was recently endorsed by the public finance watchdog, the Comptroller and Auditor General of India. The

CAG said: "All over the world, there is a growing perception among the supreme audit institutions that it is important to partner with civil society to ensure the latter's participation in service delivery and public accountability."

9.8 MGNREGA Social Audit Society, Kerala

Government of India requested all States to expedite setting up of independent society tasked with exclusive responsibility of conducting social audit of MGNREGA. In this regard, all State Governments were also advised to refrain from setting up Social Audit Units (SAU) within their respective State Institute of Rural Development or engaging Non-Government Organizations (NGOs) and it was pointed out that this would violate the fundamental provision of independent Social Audits as mandated in the Social Audit Rules. Accordingly, Government of Kerala set up an independent Social Audit Society in the State in December 2015, for the conduct of Social Audit of MGNREGA. The Social Audit Unit (MGNREGA Social Audit Society, Kerala) is a facilitating unit for conducting Social Audits, provides training, evaluation, monitoring and regulatory support to Social Audit as envisaged in the MGNREGA and the MGNRE Social Audit Rules of 2011.

Main objectives are: -

1. ensures involvement of stake holders in the planning, decision making, implementation, monitoring and evaluation of MGNREGS.
2. ensures public accountability and transparency in the implementation of projects under MGNREGS and the laws and policies related to MGNREGA.
3. deepens the fact-finding process by investigating through cross verification of facts at worksites and duties and responsibilities of labourers involved in the scheme.
4. ensures peoples' participation for community development through MGNREG.

9.9 Conclusion

Social audit is emerging as a new democratic tool to plug leaks in public expenditure and gives the intended beneficiaries of public projects, particularly the poor and the vulnerable, an opportunity to seek justice in ensuring that money allocated for their welfare are fully and efficiently spent. Today social audit is no longer a matter of choice. Along with other

transparency and accountability platforms, it is a legal, moral, and democratic necessity. In short, Social Audit is a slow but sure way to fight corruption.

9.10 Recommendations

1. ***Social Audit (a comprehensive Grievance Redressal Mechanism) needs to be strengthened and periodical reviews conducted for timely follow-up.***
2. ***Mass campaigns needs to be organised to increase public awareness about the meaning, scope, purpose and objectives of social audit. This shall be given publicity through social media.***
3. ***A team of social audit experts responsible for training social audit committee members (stakeholders)needs to be established in each district. Training programmes on social auditing methods, preparation of social audit reports, and presentation at Gram Sabha meetings shall be conducted periodically.***
4. ***Guidelines shall be issued for proper conduct of social audit. It needs to be ensured that auditing is done while implementation of a work/project is in progress.***
5. ***Social auditing needs to be a continuous process to act as a constant check on wrong or corrupt practices.***
6. ***In addition to the institutional level for social audit, people need to be given opportunity to respond. To facilitate this, details of the work/ project including total estimate amount, date-of commencement of work, date on which it is to be completed, name and address of the implementing officer, name of contractor/ agency to whom the work is awarded, dimensions etc. shall be exhibited at the work/ project site with contact numbers of officials at different levels for reporting defects/ irregularities noticed during the course of implementation of the work/ project.***

Chapter 10

Revisit of Codes and Manuals
&
Delegation of Financial Powers

A. Codes and Manuals - Revisit

10.1 Introduction

After the formation of Kerala State rules contained in the Travancore Financial and Account Code, the Travancore Treasury Code and Madras Financial Code and Madras Treasury Code continued to be in force in the respective areas of the State in which they were applicable prior to the formation of the State. There was no uniformity in procedure relating to financial and accounting matters. To bring in uniformity in such matters revised rules were issued in three Codes, the Kerala Treasury Code, Kerala Financial Code and Kerala Account Code. The unified rules are framed in conformity with constitutional requirements. The Kerala Financial Code lays down general financial principles and rules of procedure in respect of all financial matters which are common to all departments of the Government. Rules and instructions pertaining to subjects which are specific to particular departments are contained in the Departmental Manuals. The Kerala Treasury Code contains the unified rules and procedures related to monetary transactions of government. The Kerala Account Code contains the rules issued in the Account Code of Comptroller and Auditor General of India. Provisions in the Central account Code which are not applicable to the State are omitted. The Code mainly describes functions of the Comptroller and Auditor General of India in relation to government accounts and general outline of the system of accounts. It also describes the main directions issued by Comptroller and Auditor General of India, with the approval of the President.

In the matter of budgeting, control of expenditure etc., provisions in the Travancore-Cochin Budget Manual were being followed. The Kerala Budget Manual was issued by incorporating not only the amendments made to the Travancore-Cochin Budget Manual but also several modifications to suit present day requirements of administration. The present version of the Kerala Budget Manual available in the official website of the Finance Department is the third edition and contains all amendments issued by the government up to 30-06-1982. But in the

recent times, the entire process of budgeting, especially submission of budget proposals, distribution/ allotment of funds etc. has undergone many changes, which are not reflected in the Manual.

10.2 Need for revision of Codes

All financial and accounting transactions of the State Government should conform to the provisions in the Codes and Manuals. Indian Accounts and Audit Department headed by the Comptroller and Auditor General of India audits financial transactions of the State and verifies whether the initial accounts rendered by departmental officers are maintained in accordance with the financial rules contained in the Codes and Manuals and existing orders. Hence it is imperative that all government departments, grant-in-aid institutions, public sector undertakings etc., adhere to the rules and instructions contained in the Codes and Manuals. Absence of periodical revision of the Codes and Manuals result in retention of certain outdated provisions/ rules in them. Amendments(deletions, modifications etc.) issued through various executive orders of government from time are not reflected in the relevant Codes and Manuals. Most often this creates confusion. It may not be possible to revise the Codes as and when an executive order is issued by the government. But there needs to be a mechanism for periodic revision, at least once in a year. A permanent system needs to be in place for timely revision of the existing Codes and Manuals- the Kerala Financial Code, the Kerala Treasury Code, the Kerala Account Code, the Kerala Budget Manual and other Departmental Manuals and Codes.

The Kerala Financial Code-Vol. 1 was amended in December 2008 incorporating all amendments, rulings and decisions ordered by government up to 19-04-2008. Since then, a number of amendments, rulings and decisions have been ordered by the government. But these changes are not incorporated in the Code. The same is the status of the Kerala Treasury Code and Kerala Budget Manual. Kerala Treasury Code was last revised in 2013 incorporating amendments up to 31-12-2012. Amendments/modifications issued since then have not been incorporated in the Code. Few discrepancies noticed in the Kerala Treasury Code, Volume-l, the Kerala Financial Code, Volume-l and the Stores Purchase Manual are given below:

1. Note-2 below Rule 90 (a) KTC Volume-l states that the Receipt Book in Form T.R.5 will

be printed with interleaved perforated copies to be taken by carbon process. The rule also states that copying pencils and double faced carbon papers should be used for this purpose. It is a fact that copying pencils are not in use at present. Instead, ball point pens are in use. Some of these rules are almost anachronistic in this age of technology and needs to be revised or replaced/outdated provisions removed.

2. (i) As per G.O (P) No. 77/2010/Fin Dated 18-02-2010, government introduced centralised numbering system for T.R.5 receipts. With the introduction of this system, each T.R.5 receipt will have 6 digit number prefixed by an English alphabet Code starting with AA which will be changed after every 999999 receipts and there will be 10000 books in one series. The new system was introduced as it was felt that there is scope for malpractice in the existing system. The new system also aimed to avoid duplication and forgery.

   (ii) In G.O (P) No. 96/2019/Fin Dated 26-07-2019, it was ordered that the use of TR-5 receipts bearing centralised serial number including year of printing, book number and receipt number on each leaf of the TR-5 receipt book will be mandatory with effect from 01-10-2019 on condition that all unused TR-5 receipts till that date (30-09-2019) are surrendered and a centralised system to monitor the return and record keeping of the old unused books is to be ensured. All Heads of Departments were directed to ensure that all the unused TR-5 receipts issued till 30-09-2019 are surrendered with proper register entries and are not in use. It was also ordered that the old TR-5 receipts will not be valid after 01-10-2019.

   (iii) In G.O (P) No. 172/2019/Fin dated 19-12-2019, it was ordered that the existing manual TR-5 receipts without unique serial numbers would be dispensed with effect from 01-01-2020 and instead new system of e-TR-5 receipts will be in place. It was also ordered that the physical TR-5 receipts with unique numbering would be limited to field collections by Police/Motor Vehicles etc. and Director of Treasuries was directed to instruct all treasury to comply with the order. Introduction of the new system of e-TR-5 receipts has subsequently been postponed to the financial year 2020-21, i.e., from 01-04-2020 onwards and later extended up to 30-06-2020. It was ordered in the Government orders that necessary amendments to Kerala Treasury Code Volumes-l & Il will be issued separately. But the Codal provision remains without any change.

3. Government have introduced e-bill book system dispensing with the physical bill book system with effect from 01-07-2019. Operational guidelines were issued in G.O (P) No. 69/2019/Fin Dated 20-06-2019. This is in modification of the existing provisions under Rule 223 Kerala Treasury Code Vol-1. But the Code has not been revised accordingly.

4. (i) As per Rule 432. (a) Kerala Treasury Code, Volume-l, the head of an office is personally responsible for all money drawn as pay, leave salary, allowances, etc., on an establishment bill signed by her or on her behalf until she has paid them to the persons who are entitled to receive them and has obtained their dated acknowledgments, duly stamped when necessary. These acknowledgments are to be taken on office copy of the bill. When the head of office concerned considers that an establishment is large or scattered that the payee's acknowledgments cannot be obtained on the office copy of the bill without undue inconvenience, she shall maintain a separate acquittance roll in Form T.R. 95 and obtain the payees' acknowledgment in it. Since the practice of obtaining acknowledgements in separate acquittance rolls stands discontinued consequent on the introduction of transfer credit of personal emoluments of employees to the bank accounts of the concerned, the above provisions and the sub rules under Rule 432 (b), (c), (d) and (e) have to be omitted. But the basic rules remain unchanged.

   (ii) The same Rule also states that if a government servant who is entitled to receive any money drawn from the treasury on her behalf fails to claim payment in person or otherwise before the end of the month in which they are so drawn, the money drawn for her shall ordinarily be refunded by short drawal in the next bill and drawn afresh when she claims it if rules regarding arrear claims permit it. At present claims of government employees are transferred to their bank accounts. Hence, the question of not claiming payment does not arise and there is no provision in SPARK for refund by short drawal in the next bill. This provision in the Code needs to be deleted.

5. As per G.O (P) No. 138/2016/Fin dated 23-09-2016, treasuries have to furnish credit confirmation data received from Reserve Bank of India to SPARK and keep a print of the same as proof of payment for audit purpose. In the case of cash payments, existing acquittance roll system will continue. All employees shall also be given login facility during

10th to 20th of every month in SPARK to view details of their pay and allowances. But this provision is not incorporated in the Kerala Treasury Code.

6. Article 99 of Kerala Financial Code Volume-1only stipulates that temporary advances should be adjusted by detailed bills and vouchers as soon as possible. Detailed guidelines on settlement of advances including charging of penal interest @ 18 percent in case of default have been issued by the Government in G.O (P) No. 1035/2000/Fin dated 19-07-2000, G.O (P) No. 419/2011/Fin Dated 04-10-2011 and G.O (P) No. 05/2020/Fin Dated 09-01-2020.These changes are also not incorporated under Article 99 of Kerala Financial Code, Vol-1.

7. As per Article 245 (a), Kerala Financial Code, Volume-l, government servants (Gazetted or Non Gazetted) are eligible for advances for the purchase of bicycles and as per Article 254 government servants are eligible for advance for the purchase of mosquito nets. The advance amounts are enhanced by Government in 2016. Government issued orders stopping these advances as per G.O (P) No. 100/2019/Fin Dated 13/08/2019. It was ordered in the G.O that formal amendments in the Kerala Financial Code will be issued separately. But the provision in the Kerala Financial Code remains without change.

8. Stores Purchase Manual was revised in 2013 as per G.O (P) No. 3/2013/SPD dated 21-06-2013. Orders on the revision were issued after getting the draft vetted by the Committee constituted by government for the purpose. Draft Manual was published in the official website for eliciting views/suggestions from the public, government departments, public sector undertakings, local self-government institutions, autonomous bodies and universities. Revised Stores Purchase Manual was approved by government considering views and suggestions received. Modifications to the Manual were issued as per G.O (P) No. 7/2014/SPD Dated 28-08-2014. As per G.O (P) No. 35/2018/Fin dated 09-03-2018, orders were issued on the amendments to the Kerala Financial Code, Vol-1 to ensure conformity with the revised monetary limits in the Stores Purchase Manual. But the Financial Code has not been revised accordingly. Following are a few discrepancies: -

(a) Article 126 (b) of Kerala Financial Code Volume-l stipulates that tenders should be invited if the estimated value of the stores to be purchased is Rs. 10,000/- or above. But, as per the revised Stores Purchased Manual (2013), tenders need be invited if the estimated value of stores to be purchased is above Rs. 15,000/- and up to Rs. 1 lakh. Also, in the Stores

Purchase Manual, there is provision for purchase of stores up to a value of Rs. 15,000/- on each occasion without quotation/tenders. Procurement rules are contained in the Kerala Financial Code. Provision of the Code needs to be modified to be in conformity with government order dated 09-03-2018.

(b). Article 126 (a) (i) KFC Vol-l states that a Purchasing Officer should obtain stores by calling for tenders in all cases except the following:-

(i) Purchase of uniform for nurses in all hospitals in the State. This is omitted in the revised Stores Purchase Manual. But basic provision in the Kerala Financial Code, Volume-l remains without any change.

(ii) Article 126 (a) (i) KFC Volume-l pertains to purchase of books and periodicals in all departments involving less than Rs. 1,000/- at a time. The Note there under states that for purchase of books and periodicals for any amount above Rs. 1,000/-, simple quotations from leading book houses and book dealers may be called for and orders placed on the basis of those competitive quotations. Written undertaking should be obtained from selected firms to the effect that they shall supply the books and periodicals ordered in time and in satisfactory condition. (iii) Petty purchases of less than Rs. 500/- at a time. The KFC has to be modified to be in conformity with the modifications in the Stores Purchase Manual.

(iii). Article 126 (a) (vii) KFC Volume-l- Quotations may be invited if the estimated value of stores is below Rs. 10,000/-. As per the Stores Purchase Manual quotations have to be invited if the estimated value of the stores to be purchased is above Rs. 15,000/- and up to Rs.1,00,000 on each occasion. Certain additional conditions are also incorporated in the Stores Purchase Manual. The Kerala Financial Code, Volume-l requires modification/ revision to be in sync with the changes.

(iv) Article 126 (b) KFC Vol-1-tenders should be invited if estimated value of the stores to be purchased is Rs. 10,000/- or above.

As per the Stores Purchase Manual tenders have to be invited if the estimated value of the stores to be purchased is above Rs. 1,00,000/-. The Kerala Financial Code has to be modified/ revised to reflect the change.

(v) Article 126 (b) 1. KFC Volume-l- Open Tender- (a) The open tender system i.e., invitation to tender by public advertisement, should be used as a general rule and must be adopted, subject to the exceptions mentioned in paragraphs under 'Limited Tender' and 'Single Tender', whenever the estimated value of the contract is Rs. 10,000 or more. As per the Stores Purchase Manual invitation to tender by public advertisement, should be used as a general rule and must be adopted whenever the estimated value of the contract is Rs. 1,00,000/- or more. The Kerala Financial Code requires modification/ revision to be in conformity with the Stores Purchase Manual.

(vi) Article 126 (b) 11.KFC Volume-l- Limited Tender: - The limited tender system may be adopted whenever the estimated value of the order to be given is less than Rs. 10,000/-. The limited tender system may also be adopted instead of the open tender system even when the estimated value of the stores to be purchased is above Rs. 10,000/-.As per the Stores Purchase Manual, the limited tender system may be adopted whenever the estimated value of the order to be given is above Rs. 1,00,000/- and up to Rs. 10,00,000/-. The limited tender system may also be adopted instead of the open tender system even when the estimated value of the stores to be purchased is above Rs.10,00,000/-

(vii) Article 126 (b) 111 .KFC Volume-l Single Tender: - (a) The single tender system may be adopted:-

(i) in the case of a small order when the articles required are of a proprietary character and competition is not expected to be advantageous. For this purpose, a small order means an order, the value of which does not exceed Rs. 250/- or, if more than one kind of article is ordered at one time the total value of which does not exceed Rs. 500/-.

(ii) When owing to the greater promptitude of supply by particular agencies of the special manufacture of some articles by certain firms, substantial economy can be effected by deviating from the tender system, officers may purchase direct such articles from the firms or agencies concerned.

Para 7.20 of the Stores Purchase Manual states as follows:-

(i) when the articles required are of a proprietary character and competition is not expected to be advantageous.

Note: The word proprietary is defined as an item which is manufactured by only one manufacturer and/ or which is a patent or specialty to which tender system cannot be applied with advantage.

(ii) When owing to greater promptitude of supply by particular agencies of the special manufacturer of some articles by certain firms, substantial economy can be effected by deviating from the tender system, purchasing officers may purchase such articles directly from the firms or agencies concerned on the advice of an expert committee after considering reasonableness of the cost fixed. Provisions in the Kerala Financial Code, Volume-l have to be revised to be in conformity with the amendments issued in G.O (P) No. 35/2018/Fin Dated 09-03-2018.

9. Article 130 KFC Volume-l- Form of tenders: - Every Officer who proposes to purchase materials by open tender system should obtain tenders in a prescribed form issued by her or on commercial letter papers of the tendering firms. For all purchases involving Rs. 10,000/- or more, tender forms should ordinarily be prescribed and issued by the purchasing officer at prices according to the scale approved by Government. As per Paragraph 7.22 of the Stores Purchase Manual, the amount (Rs. 10,000/-) stands modified as above Rs. 1,00,000/.

10. Article 131 (j) (i) KFC Volume-l: For ordinary stores which can be procured from the Indian market- One month. As per Paragraph 7.33 (ix) (a) of the Stores Purchase Manual, the minimum period to be given for ordinary stores which can be procured from the Indian market is 15 days. The provision in the Kerala Financial Code needs to be revised.

These are only few examples to illustrate the need for revision/replacement of the codes and manuals.

10.3 Recommendations

1. ***The Codes and Manuals needs to be simplified. It should be made easy to understand and user friendly.***
2. ***Since Malayalam is the official language of the state, Codes and Manuals needs to be translated at least to Malayalam. Government may take steps to ensure that the Codes and Manuals are available in Malayalam.***

3. *A number of amendments including modification of the existing rules, additions and deletions etc. are issued from time to time. It may not be feasible to revise the Codes and Manuals whenever an amendment is issued. But government needs to consider periodical revision of Codes by incorporating modifications/amendments issued by government from time to time, at least once in a year.*
4. *Work pertaining to timely revision of Codes and Manuals may be entrusted to a separate Section/ Wing constituted for the purpose. The system needs to be of permanent nature.*

B. Delegation of Financial Powers

The delegation of financial powers ordered in G.O (P) No. 110/2013/Fin Dated 01-03-2013 were revised/ enhanced as per G.O (P) No. 102/2017/Fin Dated 07-08-2017.

10.4 Recommendations

1. *Delegation of financial powers needs to be on the basis of annual financial transaction carried out by a department, nature of duties and functions to be performed, number of vehicles owned by it etc. There is no justification in giving the same delegation to departments irrespective of budgetary support available. A department having a total budget provision of Rs. 1 crore (both Plan and Non Plan) and a department having a total budget provision of Rs. 5 crore cannot be treated alike. The delegation to be given to the Director of Public Instruction and the Director General of Police may not be the same as the duties and functions of these two Departments differ. Delegation for the repairs and maintenance of vehicles to be provided to the departments like Police, Excise, Forest, Public Works, Health and family Welfare etc. may need to be higher than those of other departments considering special nature of duties of these departments. The number of vehicles owned by these Departments is comparativelyhigh. Delegation given for purchase of plant and machinery, equipment etc. need not be same for all the Departments. Most often Medical and Public Health department have to procure high end equipments on emergency basis. If the Department is not given proper delegation, procurement of life saving equipments will be delayed. Hence, delegation to be given to departments of like nature should be sufficient to meet emergency requirements. Departments like Chief Chemical Examiner, Drugs Controller, and State Forensic Laboratory etc. needs to be included*

in the orders on delegation of financial powers and they should be given separate delegation considering the special nature of works to be performed by them.

2. ***Separate delegation may be given to Major and Minor Departments. Segregation of Major and Minor Departments may be on the basis of the annual financial transaction of a Department. In the matter of purchase of stores, Heads of Departments are classified into 3 Groups:***

   Group I- Heads of Departments who usually purchase stores worth Rs. 1 crore or more in a year.

   Group- II- Heads of Departments who usually purchase stores worth between Rs. 20 lakh to Rs. 1 crore a year.

   Group-III- Heads of Departments who usually purchase stores worth below Rs. 20 lakh a year.

   In the same manner, all the Heads of Departments may be classified into separate groups on the basis of the annual financial transaction of each Department, considering budgetary support (Plan & Non Plan).

3. ***A question that is normally raised is whether there is any need for taking up proposals before Government or the Departmental Purchase Committee for issuing Administrative Sanction when sufficient provision is available in the Budget. The fact is that the budget estimates are prepared on the basis of rough cost estimates. At the time of preparation of Budget Estimates, detailed project report and detailed estimates of a scheme or project may not be available. Administrative Sanction for a project is normally issued after considering Detailed Project Report and detailed estimates of the implementing year. This aspect is discussed in detail in Chapter 3.***

4. ***As per the Rules of Business, Finance Department is the authority to issue orders on delegation of financial powers. But the present practice is that the Finance Department issues delegation of financial powers of the Heads of Departments whereas the delegation of powers to the subordinate officers are issued by the Administrative Department concerned on the basis of the decision taken in the meeting of the Empowered Committee consisting of the nominee of the Finance Department. Many Administrative Departments issue delegation of financial powers contrary to general orders issued by the Finance Department. This needs to be avoided. The procedure proposed in Government Circular No. 8/94/Fin. Dated 3 1-01-1994 needs to be followed and orders issued by the Finance Department should be in supersession of all orders in force on the subject.***

5. ***A comprehensive booklet on Financial powers may be issued for the use of all departments and it***

may be revised periodically considering money value, for ease of business. It shall contain financial delegation applicable to all departments.

6. ***In the interest of facilitating expeditious decision making and implementation of schemes, government needs to consider substantial enhancement in financial powers of Administrative Departments and Heads of Departments. This is essential for speedier implementation of schemes at the beginning of the financial year itself.***

ANNEXURES

Annexure I

AN ASSESSMENT ON NON- TAX REVENUE IN KERALA

I.1 Introduction

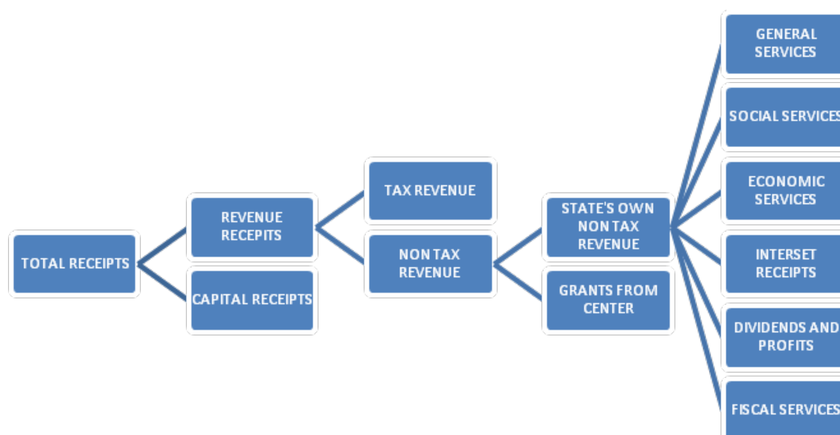
Fiscal structure of an economy is mainly based on revenue it collects and expenditure incurred. Since state is a benevolent provider to the people, reducing public expenditure to reduce fiscal deficit may not be a right solution. Instead focus needs to be on enhancing revenue receipts. Revenue receipts are mainly from two sources: tax revenue and non-tax revenue. About 39 per cent of revenue in 166 countries – including those which are not resource-rich – is from non-tax revenue sources (World Development Indicators, World Bank 2003). There are some countries within Asia where non-tax revenue constitutes major share of total revenue of the government. Singapore is an example. (Chia1998). Revenue generation from non-tax sources is quite low in India. Kerala sets apart sizable portion of its revenue for providing social and community services. But state's revenue from non-tax resources including user charges and other fees remain insignificant. In absolute terms, total revenue receipts of Kerala for 2018-19 is estimated to be Rs 1, 02,801 crore, an increase of 16.5 per cent over the revised estimates of 2017-18. Of this, Rs 72,860 crore (71 per cent of the revenue receipts) is expected to be raised by the state through its own resources and Rs 29,942 crore (29 per cent of the revenue receipts) as devolution from the centre in the form of grants and state's share in taxes. The report has attempted an analysis of potential sources of non-tax revenue. Chapter on "Non-Tax Revenue" is presented in four sections. First section is on concepts, definition and analytical framework and is based on review of empirical studies and theoretical literature. Second section looks at structure and pattern of non-tax revenue in Kerala in the last four decades. Analysis of the composition of major components of non-tax revenue is included in the third section. Fourth section sums up the findings and includes recommendations on raising financial resources through non-tax revenue.

I.2 Concepts, Definitions and Analytical Framework

Government can earn its revenue from taxes, user charges and through borrowings (Musgrave and Musgrave 1984). Of this, user charges constitute non-tax revenue. Unlike

borrowings, user charges do not result in monetary liability on the part of the government to the payee and unlike taxes, non-tax revenues are not compulsory taxes. They are raised out of voluntary transactions while taxes are compulsory unrequited payments, in cash or kind, made by institutional units - individuals or other institutions - to government units (System of National Accounts 1993). According to this argument, non-tax revenues can be considered as payments that are made to the government, which are *compulsory and requited* or *voluntary* - whether requited or not. It is argued that the importance of raising non-tax revenue needs to be viewed in the context of globalisation too. Since globalisation and economic integration can erode a country's ability to raise tax revenues, revenue from non-tax sources gains importance (Tanzi 2000). In addition to this, deficit financing by the states necessitates collection of revenue from both the sources of tax as well as non-tax (Dalton, Hugh, 1949). While setting up targets to raise non-tax revenue, the feasibility of raising the rates of these revenue sources is also significant as un-realistic objectives may negatively affect the targets. Therefore, the objectives of equity, efficiency and its impact on the economic growth of the economy are to be kept in mind (Purohit and Purohit, 2009). Welfare state program needs to mobilise resources in order to meet the objectives such as right to food, employment, access to health, education and old age pension.

Chart 1.1: Structure of Total Receipts



I.2.1 States' Own Non-Tax Revenue

Das Gupta (2008) defines non-tax revenues as all receipts other than taxes. Rao (1981) considers States' Own Non-Tax Revenue (SONTR) as one category of revenue which includes administrative receipts, profits of departmentally run commercial undertakings, interest and dividend, receipts and royalties from mines and mineral concession fees. Penalties and fines for

non-compliance of law comes under compulsory and requited payments while donations, gifts and contributions voluntarily made to the government by the people is considered as voluntary and unrequited payments. Das Gupta (2008) defines that Non-Tax revenues come from three main sources (a)revenue from the assets owned and managed by the government (b) revenue generated by government from the sales of goods and services produced and managed by government, and (c)revenue from the sales of licenses and permits to limited activities. Gupta further argues that government needs to look in to all the possibilities to expand its Non-Tax revenue base from all areas under each category explained above. Based on the above definitions, non-tax revenue can be of three types: a) compulsory and requited payments; b) voluntary and unrequited payments; c) voluntary and requited payments.

(a) ***Compulsory and requited payments***: These include penalties and fines demanded for non-compliance with the law (other than penalties on non-compliance of taxes). This contributes to a downward bias in the scope of non-tax revenue in government statistics.

(b) ***Voluntary and unrequited payments***: These include donations, gifts and voluntary contributions made to the government and unclaimed funds or excess payments for services. Such contributions are encouraged by making some of them tax deductible like contributions made to Prime Minister's/ Chief Minister's Relief Fund.

(c) ***Voluntary and requited payments***: Voluntary and requited payments form the major source of non-tax revenue in states. These involve three types of revenues, i) *from assets, ii) from sale of goods and services, iii) from the sale of licenses and permits for regulated activities.*

(i) *Revenue from assets*: This include three categories of assets- common property resources, exhaustible/renewable resources to which private property rights are not assigned, Assets created from government investments or which have earlier been nationalised. Revenue earned from common property resources include returns earned from those assets that are possessed by government, i.e. forests, flora, fauna, marine and riparian habitats etc. Revenue can be in the form of entry fees, pollution permits, royalty from the right to trade or reap naturally occurring produce etc. One example is royalty received from mineral exploitation. This forms a major source of non-tax revenue worldwide and in many Indian states. It is considered to be the fifth largest source of revenue from tax and non-tax sources in the country. Assets created from government investments mainly provide government dividends and interest receipts, which form part of total non-tax

revenue of states, e.g. equity investments in private concerns or public private partnerships, loans provided by the government, capital of public sector enterprises etc.

(ii) ***Revenue from the sale of goods***

Revenue from the sale of goods mainly include user charges- Toll for road usage, direct sale of forest produces like honey, medicinal plants etc.

(iii) ***Revenue from licenses for regulated activity***

It includes revenue obtained by providing business and shop licenses, construction and land use permits, examination and inspection fees etc. However, most of the registration fees, stamp duties etc. go under tax revenue. Indian states are still not efficient in acquiring revenue from non-tax sources. Singapore is one country where non-tax revenue forms a major source of government revenue, obtained from the sale of vehicle purchase permits (Chia 1998).

Non-tax revenue constitutes a major portion to the total revenue sources of the country. The division of Non-Tax revenue can be brought under two headings, States' Own Non-Tax Revenue (SONTR) and Grants from centre (Das-Gupta, 2008). The state can raise its Non-tax revenue in variety of ways and mainly from six sources, 1. General Services 2. Social Services 3. Economic Services 4. Fiscal Services 5. Interest Receipts 6. Dividends and Profits. First three categories of non-tax revenue sources - General Services, Social Services, Economic Services, is called administrative receipts of SONTR and it constitutes the major portion of SONTR. Though the administrative receipts contribute a major share to SONTR, the state can also collect non-tax revenue apart from administrative receipts from sources such as revenue from interest receipts and dividend and profits. Revenue from these two sources is also significant and should augment the efficacy of that effort too. Share of SONTR to total non-tax revenue is an indicator of the efficiency of government in raising its 'own non-tax revenue'.

States 'Own Non-tax revenue is realised out of the resources solely owned by the state. A larger SONTR indicates more efficiency on the part of the government to raise revenue from non-tax sources. The first three components of non-tax revenue - *Administrative receipts,* form two-thirds to three-fourth of SONTR in many states. Interest receipts include interest on loans that are

given to various investments like loans on housing schemes, agricultural loans, loans to government companies, treasury bills etc. Revenue from dividends and profits arise from the government's investment in the shares of co-operative societies, public undertakings and others. The contribution from fiscal services is insignificant in most states. The administrative receipts and the various revenue earning resources under each of them is discussed in detail below.

a. General Services

The revenue earned out of general services come from the following services provided by the state.

1. Public service Commission	2. Police
3. Jails	4. Stationery and Printing
5. Public Works Department	6. Supplies and disposals
7. Contributions and Recoveries towards Pension and Other Retirement Benefits	8. Other administrative sources
9. Miscellaneous General Services (including lotteries)	

b. Social Services

Social services provided by state governments come with a cost/charge – whether it is health, education, water supply etc. Revenue earned out of these sources is accounted under the non-tax revenue from social services.

Various components of social services are:

1. Education, Sports, Arts and Culture.	2. Medical and Public Health
3. Family Welfare	4. Water Supply and Sanitation
5. Housing	6. Urban Development
7. Information and Publicity	8. Labour and Employment
9. Social Security and Welfare	10. Other Social Services.

c. Economic Services

Economic Services include revenue earned from judicious exploitation of resources owned by government. Economic services are the major contributor of SONTR of most states.

Various resources contributing to revenue from economic services are:

1. Crop Husbandry	2. Animal husbandry
3. Dairy Development	4. Fisheries
5. Forestry and Wildlife	6. Co-operation
7. Other Agricultural and rural Programmes	8.Special Area programmes
9. Major and medium Irrigation	10. Minor Irrigation
11. Village and Small Industries	12. Industries
13. Nonferrous mining and Metallurgy	14. Roads and Bridges
15.Ports and Light houses	16. Tourism
17. Other Economic Services	

d. Grants from Centre

Second component of states' non-tax revenue- grants from Government of India includes various grants provided to state government under state plan schemes, central plan schemes, centrally sponsored schemes, special plan schemes and non-plan grants. Share of the grants from the centre to total non-tax revenue in terms of various central-plans and supports may vary and is not a constant revenue source. Increasing share of grants from centre in the non-tax revenue can be interpreted as inefficiency of government in mobilising own non-tax revenue from its resources.

I.2.2 Economic Principles behind Non-Tax Revenue

It is important to discuss the economic principles behind non-tax revenue. When people violate rules and regulations set for general well –being, government impose fines and penalties for breaking the laws. Increase in non-tax revenue from fines and penalties include social negative externality which appreciates the concept of Pigouvian taxes. In the collection of fines and penalties, the idea of marginal deterrence is important because the fines and penalties needs to be based on severity of crimes committed by public. (George and Krishnakumar, 2012). According to

Oliver Oldman (1965), penalties should increase under the following situations a expected loss in revenue due to breaking of the law, b) cost involved and difficulty in detecting the offence, c) depending on effect of the offence on other tax payers, d) state of mind of the offender, (higher penalty, if deliberate) e) when offence is repeated. There are no special economic principles to assess collection of non-tax revenue from gifts and donations. In most of the cases share of this revenue to total non-tax revenue is minimal.

Non-tax revenues are defined as payments made to the government for which there is a *quid pro quo*. This is in contrast to the definition of taxes as a compulsory payment for which there is no *quid pro quo* between government and the people. Prices charged by government for particular services and commodities provided by it, forms a major source of income for the government. These prices are of voluntary nature paid by individuals entering into an explicit or implicit contract with government for the use of these services. Taxes, on the other hand, are of compulsory nature (Dalton 1949).

Voluntary requited non-tax revenue is earned out of user charges and fees for the goods and services which the government provides. Often, the goods would be public goods and pure merit goods over which government has a monopoly. The design for such charges is similar to public sector pricing theory. For increasing cost, industries like public utilities can adopt marginal cost pricing in provision of a single product and Ramsey- Boiteux pricing when prices are set so that percentage mark-ups over marginal cost is proportional to inverse price elasticity of demand for the goods, thus minimising dead weight losses. However, the rationale for full cost recovery from non-tax revenue is strongest for pure private goods with market failure other than externalities. Greater reliance on user charges is found optimal for congestible public goods and those with negative external effects. However, theoretical foundations have little impact on the charging practices in developing countries. There is sharp contrast between economic theory of pricing and its practical application.

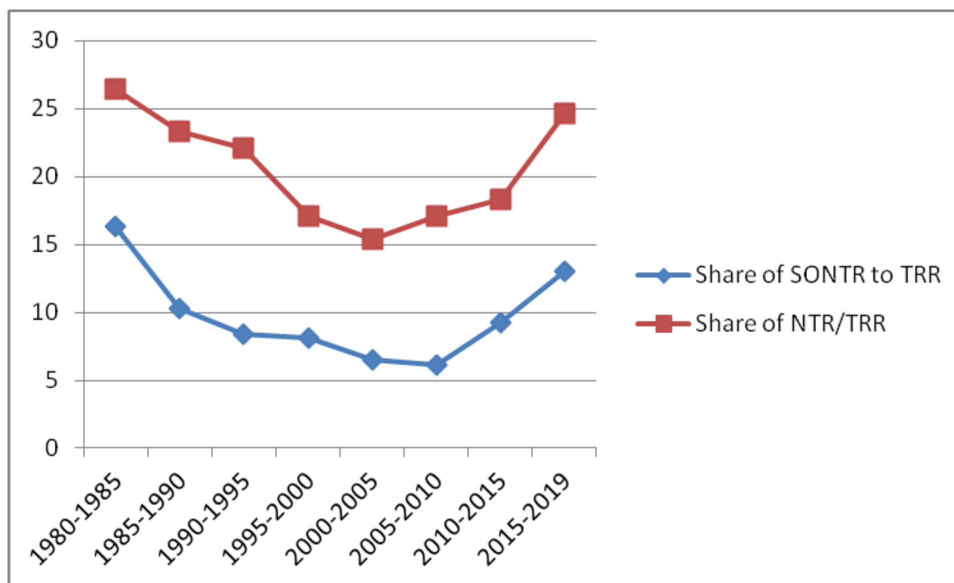
I.3 Structure and Growth Pattern of Non-Tax Revenue in Kerala

This section tries to analyse the structure and pattern of total revenue especially Non-tax revenue in Kerala in the last four decades. Non-tax revenue is considered to be by products of government activity. Kerala has estimated to generate Rs 14,271 crore through non-tax sources in 2018-19. Estimated increase of 21.7 per cent in non-tax revenue is expected to be driven by

receipts from state lotteries. In 2018-19, gross contribution by state lotteries to non-tax revenue was Rs 11,110 crore.

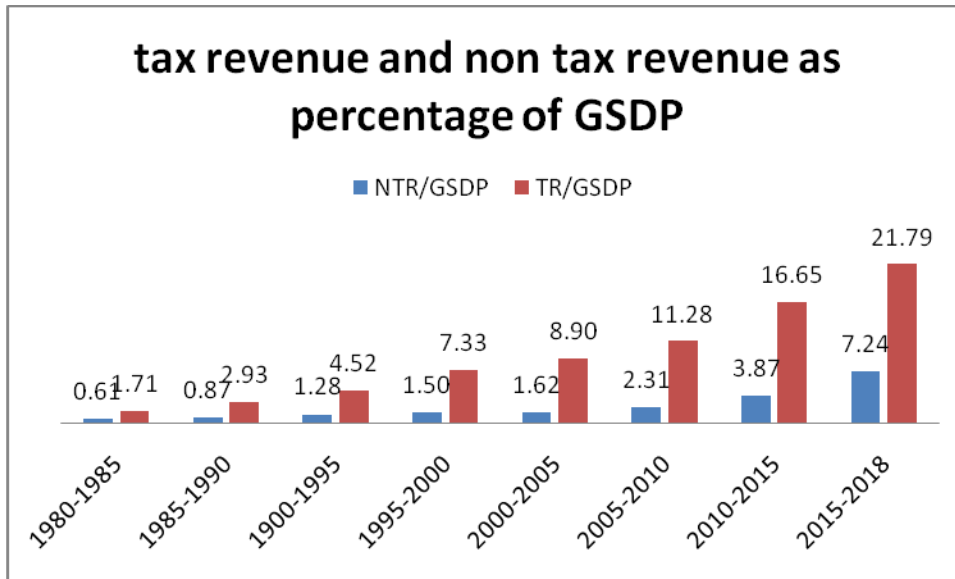
According to the Budget Estimate of 2017-18, States' Own Non-Tax Revenue accounts for 12.86 per cent of the revenue receipts of the state (Appendix 1). This share, which was relatively high during 1980-81 declined to 6.8 per cent during 2010-11 which is lower than all India level (9.32 percent) and the world level (See Figure 1.1).

Figure 1.1: Average share of Non-tax Revenue to Total Revenue Receipts in Kerala



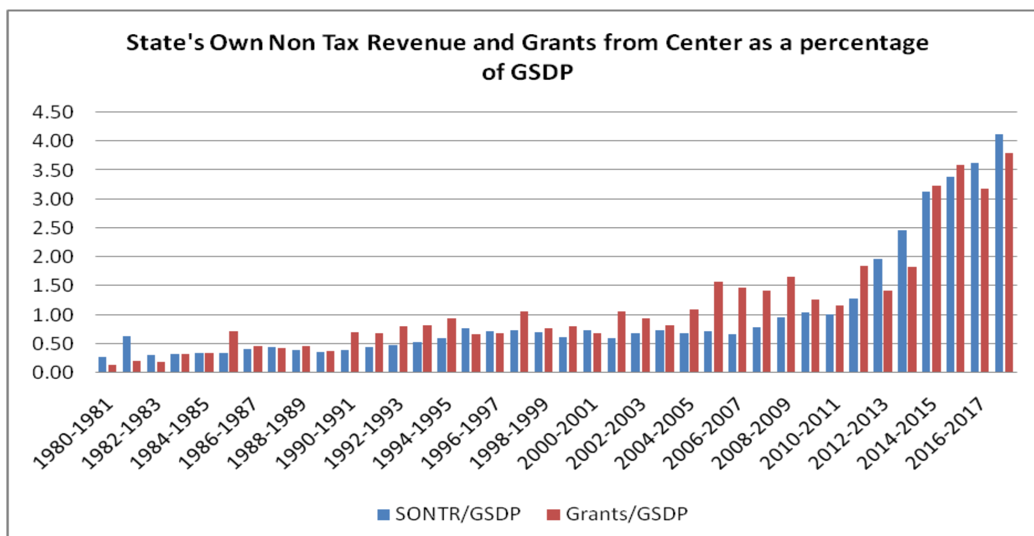
However, a revival is visible since then and this could be due to the collection under lotteries (gross) which grew at CAGR of 31 percent during 2010-11 to 2018-19 as compared to 16 percent for the period 2005-06 to 2010-11. Instead of gross receipts, if net receipts from lotteries are considered, the CAGR of non-tax revenue falls to 19 percent for the period 2011-12 to 2016-17 as against 14 percent for the period 2005-06 to 2010-11 (KPERC, Fourth Committee, 2017).

Figure 1.2 Pattern of composition of revenue in terms of GSDP



From 1980 to 2018, share of tax revenue and NTR has been increasing (Figure1.2) though the rate of tax revenue grew much faster as compared to non-tax revenue. In 2011, average non-tax collection of the states is to 1.23 per cent of GSDP while the same for Kerala is only 0.77 per cent, lowest among all states, except West Bengal. Per capita collection of non-tax revenue of Kerala is only Rs. 829 compared to national average of Rs. 879. (Expenditure Committee Report, Second report, 2011). However, in State's own tax revenue, Kerala is ahead of all States except Tamil Nadu and Haryana as Kerala receives less grant from the centre.

Figure 1.3: Trends in the composition of Non-tax Revenue in terms of GSDP



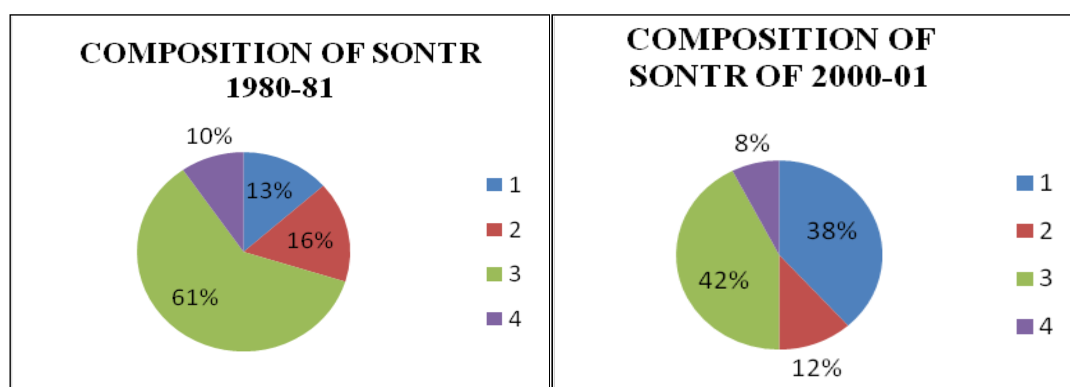
Improvement in the Non-Tax Revenue is mainly due to higher revenue from State Own Non-Tax Revenue (SONTR). In 1980-81 the share of SONTR was higher than centre grants. It is because State was able to raise more revenue from its own resources than depending on grants from Government of India. After 1985 grants from centre is a significant contributor to GSDP of the state. From 1980-81 to 2010-11 the centre share is higher than the state's Own Non-Tax Revenue in GSDP. This is partly due to an increase in the share of tax devolution and also due to e revenue deficit grants received by Kerala during the award period of Fourth State Finance Commission. (4th KPERC, 2017). A reverse trend is observed during 2011-12 to 2017-18 as it reveals that the share of SONTR is higher than the grants received from the centre (Figure1.3).

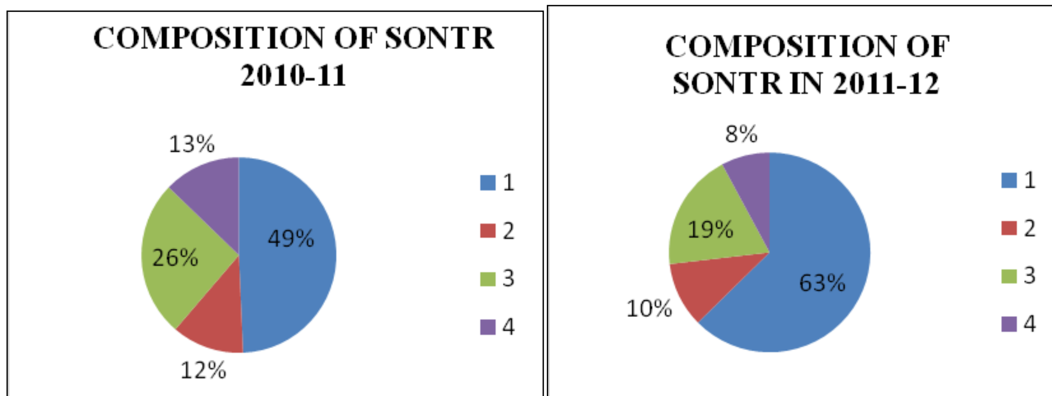
I.4 Sectoral Composition of State-Own Non-Tax Revenue

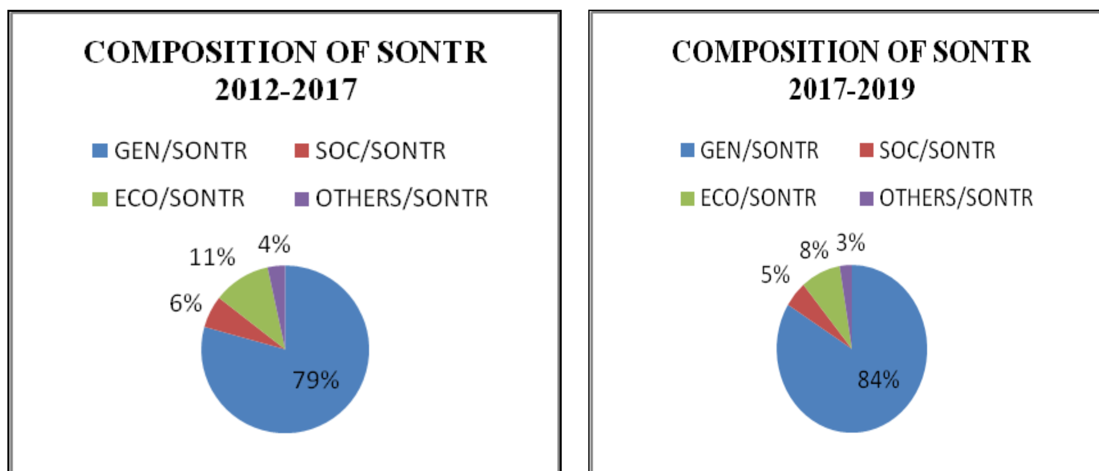
From the following chart, it is can be seen that economic services contributed around half of SONTR in early 1980s. Over time this has declined, except for an increase in early 1990s to an all-time low of around 9 percent in 2017-19 (See Appendix 2). On the other hand, share of general services in SONTR increased in the opposite manner. Share of social services also declined and has remained low during 2017 to 2019. Figure 1.4 shows that there is shift in composition pattern of non-tax revenue from economic services as the dominant contributor in the eighties towards general services since 2010.

Figure 1.4: Composition of SONTR in Kerala over the years

(1-General services, 2- social services, 3- economic services, 4-others)







An important aspect of various components of non tax revenue is the expenditure to revenue ratio. It is observed that, in the recent years expenditure under economic and general services are roughly 9 and 3 times the revenue collected respectively. This problem is exacerbated for the social service category where the expenditure incurred is fifty times of revenue collected (Appendix 3)[13].

I.4.1 Major Components of General Services

As seen in Figure 1.5, major contribution to general services is from lotteries. Sharp increase in revenue in 2011-12 is due to the introduction of Karunya lottery and ban on the sale of lottery from other states (Appendix 4). Empirical analysis reveals that revenue from lotteries

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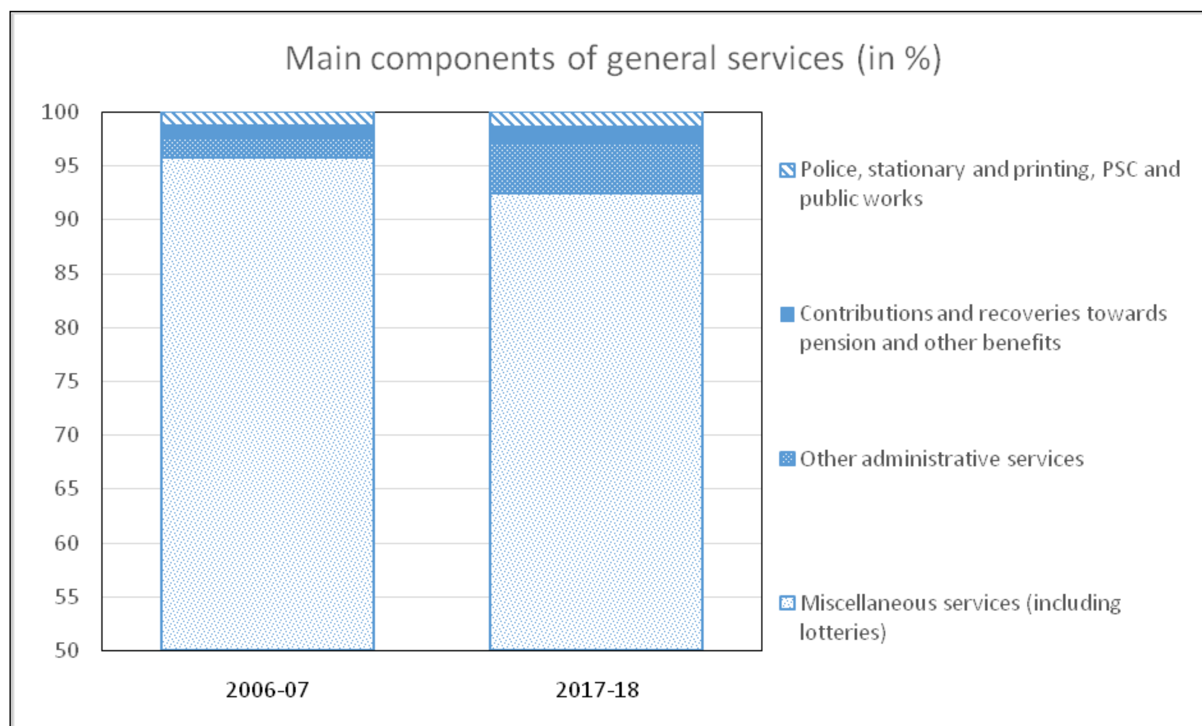
[13]Since detailed item wise data on expenditure is not readily available, the current report focuses only on the revenue aspect at the detailed level. The cost analysis is limited to the aggregate level.

increased steeply from a mere 3 percent to 78 percent of SONTR of Kerala during 1980 to 2018-19 (Appendix 5). However, a reverse trend could be expected due to the policy changes[14]. According to the Central Lotteries (Regulation) Rules 2010, "*The State Government under whose jurisdiction the lottery tickets are being sold shall be entitled to charge a minimum amount of Rs. 2000 per draw from the organising state but the maximum amount chargeable shall not be more than what is being charged by the state Government from its own lotteries*". This provision will no more be applicable as charge/fee per draw by the State on the lotteries of own or by other states sold within a state is struck down by Supreme Court Order dated 05-09-2016.

In addition to that GST council has recommended single rate of 28% as against present differential rate of GST for lotteries which ultimately attract the sale of other State lottery in Kerala[15].

Figure 1.5: Composition of components within general services



[14]Ramalingam and George (2019) predicted a fall in revenue from State run lottery at the rate of 40 % -45%.
[15]The introduction of GST is a respite for the government since in contrast to the previous 90% of the money being given to the winners, now they get a maximum of 80-82% as 12% is collected under GST.

Figure 1.6: Share of Gross and Net Lottery revenue to SONTR

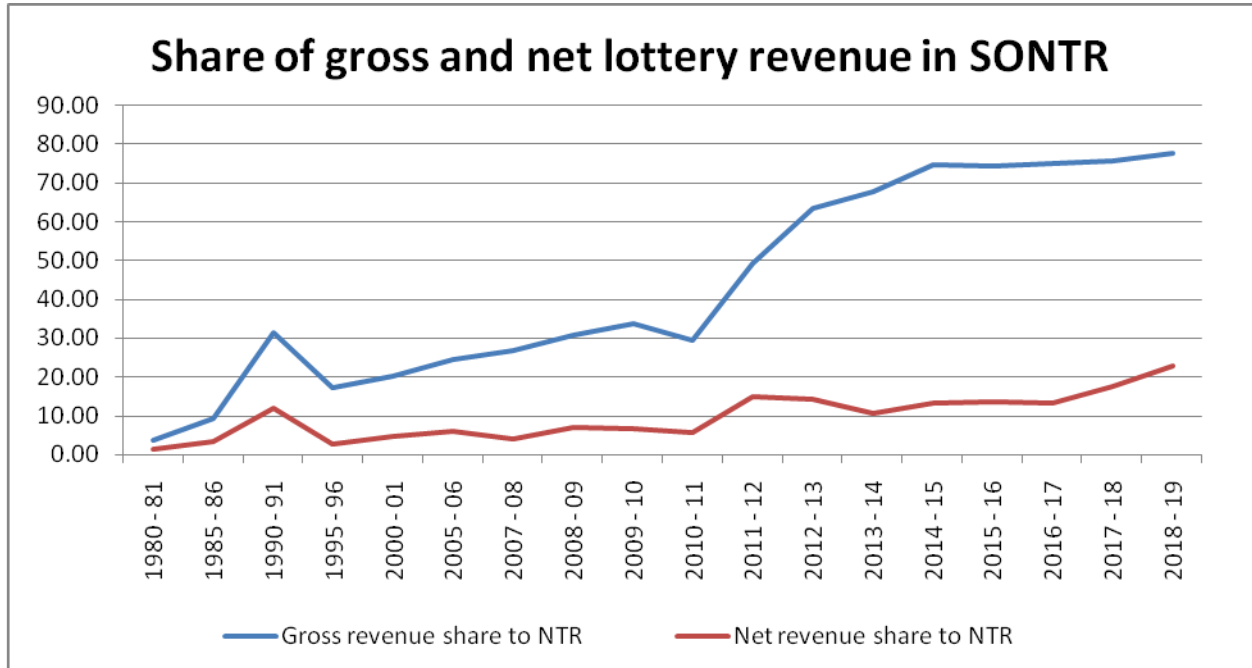


Figure 1.6 shows a diverging trend between gross and net lottery revenues overtime indicating burgeoning expenditure. This expenditure is mainly from a combination of social cost and economic cost. Social cost is from social contribution of employment generation (including disabled persons) and using profit for medical services for the poor, especially cancer patients. Economic costs such as huge prize money for the lottery and administrative defects in the management of the lottery system contribute to the widening gap. For instance, e Comptroller Auditor General of India detected 118 multiple claims against 91 prize winning lotteries in 2008-11 due to forged tickets. CAG observed absence of ticket validation and effective monitoring, leading to distribution of more than 30,000 excess prizes worth of Rs. 25.80 lakhs. Inefficiencies have also led to widespread corruption in the functioning of the system. Repeated winning of prizes by people from the same address indicate probability of fraudulent practices in the way the lotteries are conducted, as cited by KPERC, 2012.

a. *Motor Vehicles, Police and Prisons*

Increasing fines and penalties for crimes under the New Motor Vehicles Act is an effective method of mobilising resources for state finances. Recent spike in fines for violations in traffic rules may be a step towards this. According to the proceedings, issued in April 2019, govt. of Kerala has enhanced the fees/charges of all services rendered by Government department/public sector undertakings/grant in aid institutions, by 5 percent. This is also a major step towards greater resource mobilisation as part of non-tax revenue which was also suggested by earlier studies. Fourth KPECR (2012) suggested raising fees for services rendered by the Police department[16]. Accountability needs to be ensured in handling financial resources generated through economic activities by Prisons department apart from ensuring market access to products of other government departments. Thus, expenditure incurred by one department can be compensated by the income generated by another department through proper planning and good governance.

b. Construction Industry

Registration/Licensing fees[17] can be charged against building and construction contractors at the time of sanctioning licenses for building construction. So far there are no regulations concerning contractor/builder who manages construction, and this needs special attention especially in the current context of the state experiencing repeated occurrence of natural calamities.

c. Torrens System and Land Revenue:

Government of Kerala needs to consider the possibility of mobilising additional non-tax revenue by implementing Torrens system[18] which was introduced by Government of India as part

[16]KPECR (2012) has carried out a systematic primary survey of 79 state government departments with the help of a set of comprehensive questions focusing on the type and nature of non-tax revenue that each department is entitled to collect, year of first implementation, current rate of collection per unit, date of last revision of the rates, amount collected in 2011-12 etc. It is important to conduct such surveys before implementing any concrete policies regarding the user charges across different departments.

[17]There are approximately 8000-10000 such builder/contractors available in the state and certain amount shall be prescribed as license fee which is renewable after the expiry of a period of 5 years. Similarly written contractual agreement between the contractor/ builder and the owner of the building need be insisted for house and commercial buildings construction which are not covered under RERA.

[18]Torrens system envisages reduction of land related disputes in future through provision of conclusive title to land. The system envisages presentation of survey map along with the registration deed in respect of any

of the National Land Records Modernisation Programme (NLRMP). Kerala had made a feeble attempt to introduce Torrens system in in 1995 in 13 villages under the principal sub-registrar offices of Kottayam & Angamaly. Due to strong opposition and court cases, this initiative could not be scaled up but is still being followed in these villages. Introduction of the system has helped in reducing boundary disputes and related court cases[19]. If Government roll out Torrens system to the entire state, a total of Rs. 755 per land transaction would come to the public exchequer. Average number of transactions on registration of sale deed per month in a Sub Registrar Office is calculated as 155 and total number of SROs in Kerala is 315. Thus Rs.3,68,62,875/- per month could be expected as new revenue. This comes to Rs. 44,23,54,500/- per annum. If government implements Torrens map preparation, without land transaction for individual land holdings as a proof of land records income for government would be much more. This might be possible without incurring high cost in the era of digital economy.

Based on exploratory analysis, it is observed that, as on March 2013 rent, per cent of prime land for commercial/industrial/ private purpose, in Trivandrum Corporation is lower (Rs. 0.05) than for land used for public purpose (Rs. 269.72), while rent for communal and religious organizations is Rs. 3.69 and that for secular organisations is Rs. 70.72 (Table 8.1, p. 111 of GIFT, 2017). Given this context there is scope to revise the rates of rent of public land. Apart from this, land given to private sectors (tea estates/plantations in Munnar, Nelliyampathy, Wayanad, etc.) decades ago needs timely revision of lease rates, and taken back if required to ensure accountability and avoid encroachment (Sebastian 2019).

It is observed that there are small land parcels in bow shape (oxbow land) which are created as a result of straightening roads for development works. Such oxbow land parcels[20] could be leased out for construction of roadside amenities for a particular period.

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transfer or sale of land. The survey map shall be prepared by a licensed surveyor or by an officer authorised by the Government. Under this system, the people have to get approval for the survey map from the Torrens office. At the time of land registration, this sketch is to be submitted along with other documents.

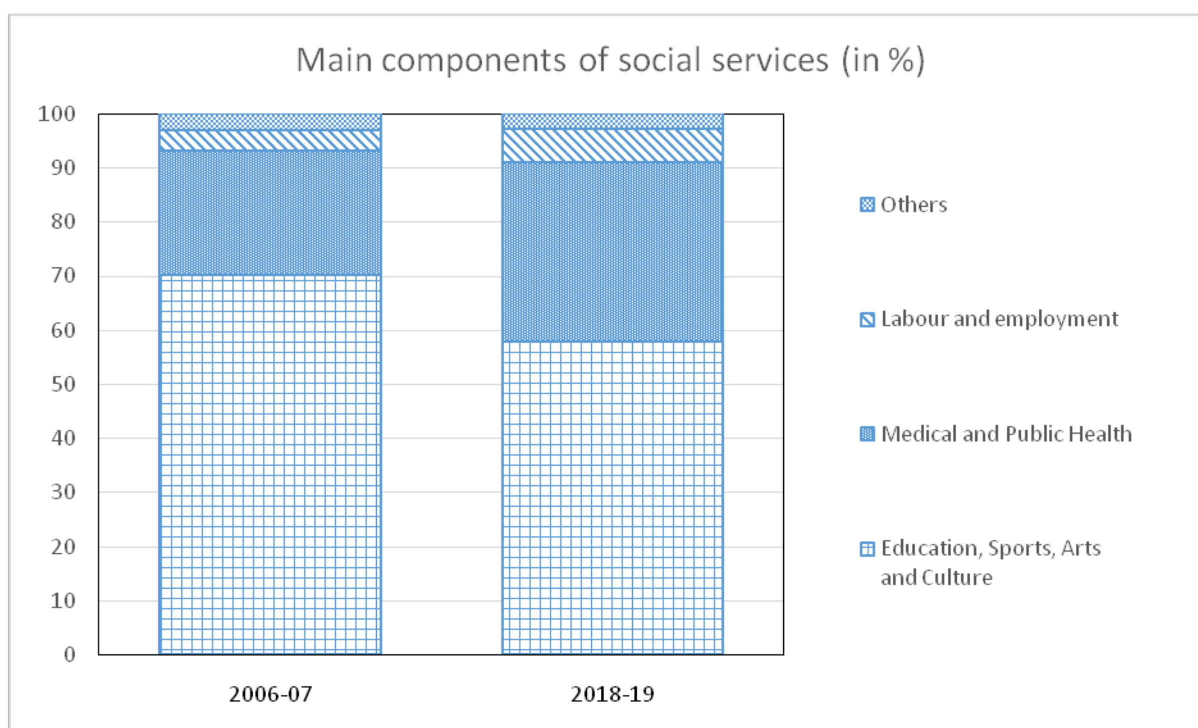
[19] The response to this policy initiative in these two villages is positive though this does not mean that a conclusive titling system is in place in these villages. Only difference in the present system and the form in which Torrens system is implemented in the state is that an approved survey sketch forms part of the title deed.

[20] There are number of road development works undertaken as part of KSTP, KIIFB, and the like. For instance, approximately 36 hectors of oxbow land is available along the sides of MC road from Thycaud to Chengannur stretches.

I.4.2 Major Components of Social and Community Services

Least contribution to administrative receipts is from social and community services. Contribution has declined over the years and has remained between 10 percent and 16 percent from 1980-81 to 2011-12 (Appendix 6). Components of social and community services and contribution to own non-tax revenue is presented in Figure1. 7.

Figure 1.7: Composition of components within social services



Education, Sports, Arts and Culture are the major contributors from social services to states' own non-tax revenue, followed by medical services and public health (see Figure1. 7). In the case of education, major contribution is from tuition fees, charges collected from sale of textbooks, entrance examination fees etc., from secondary, higher, and technical education. Under Art and Culture, contribution is from museums and zoos, rent from various theatres and halls etc. However, in the recent years there is marginal decline in contribution from the sector. Major component of Medical Services and Public health is revenue from education, training, and research in all streams of medicine – Allopathy, Ayurveda, Homeopathy etc.- through tuition fees and other charges. Receipts from hospitals for patient care and dispensary services, and receipts from Employees State Insurance Scheme also contribute significantly to this sector.

Revenue receipts as percentage of revenue expenditure reflects the actual cost recovered from these services. Above analysis reveals that recovery rate of social services as a percentage of revenue expenditure is marginally higher for Kerala (2.40) among major states (2.35) during 1993-96. This ratio has declined to 2.22 during 2001-04 which is lower than the average of fifteen major states (2.8). It is also lower than that of the neighbouring states of Tamil Nadu (3.7) and Karnataka (2.3) (Purohit and Purohit, 2009).

Medical and public health services are able to mobilise only 4 percent to 6 percent of the cost incurred in the sector indicating that the services are offered with huge implicit subsidies. There exists an evident trade off – between policies that curtail subsidies and those that aim at restoring the image of the state as the benevolent provider of social security[21]. From an interview with an official from Kerala Medical Service Corporation Ltd (KMSCL), it is observed that there is a growing population dependence on public health services. From around 28 per cent people visiting government hospitals in Kerala in 2015 the percentage has risen to 44 per cent in 2019[22].

During discussions with officials of KMSCL, it was reported that around 20,000 OP tickets are issued per day at Medical College, Trivandrum. Approximately 2 lakh OP tickets are issued every day by the government run hospitals in Kerala. Potential revenue generation by hiking the price to Rs. 10 per/ OP ticket will be around Rs. 600 crores[23] per year. This may mobilise sufficient funds for procurement of drugs every year (which is currently Rs. 450 crores). A permanent and more viable solution is indexing charges for various treatments (dialysis, angioplasty, and so on) and surgeries to the existing inflation rates to combat inflationary pressures

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[21] Based on the nature of public utilities/goods theory, social services may be further divided into two major categories- pure public, and quasi- public or mixed goods/services. Pure public goods have the dual feature of non-excludability and non-rivalry and hence universal provision of these services are better provided by the State (through taxes) given market imperfections and profit driven objectives of private players. These include mainly education and health services.

[22] The government official suggested that the main reason for this was an improvement in health services. This is also reflected in the rise in investment related to new purchases of state-of-the-art medical equipments, installation of new machines in health centers and government hospitals across the state and opening of new medical centers. For instance, between 2015-16 and 2018-19, the government of Kerala has spent Rs. 2.27 billion (approximately) on purchases of latest medical equipment such as X-ray machines, CT scanners and so on (based on the data provided by KMCL, 2019).

[23] If the number of patients visiting per day is 2 lakhs and paying Rs. 10 per ticket, then per year the potential revenue generated in a year 2 lakhs*10*25days (number of working days in a month) = 50crores*12 months leads to 600crores/ year

while rendering quality health services[24]. This needs to be viewed as correction in user charges instead of a hike. Higher revenues will assist in improving overall quality of public health services and enable people to shift from private to public services at affordable costs. Introducing individual medical insurance-based payment for above poverty line (APL) categories may help in improving revenue without affecting disposable income of people.

ARC recommends following a similar approach needs to be followed in education – subsidising eligible sections of the society and adoption of cross-subsidy/ differential pricing/providing scholarships through an objective transparent system with the use of technology. Indexing fees for higher education, technical and medical education and other professional courses with current inflation rates will bring in *correction* in the fee structure. This will be an instrument for combating inflationary pressures and providing quality education.

Transportation facilities, entertainment facilities, (theatres, museum, recreational facilities, national parks, stadium) and information services are examples of quasi-public goods where user charges may be imposed in order to mobilise non-tax revenue.[25]

I.4.3 Major components of Economic Services

Economic services used to be the main source of non-tax revenue in Kerala in the 1980s (Appendix 7). Its share has declined from around 48 per cent in early 1980s to around 29 per cent in the late 2000s. As Figure 1.8 suggests, there has been a shift in the revenue distribution on economic services away from forests towards other components such as co-operatives, nonferrous mining & metallurgical industries, roads & bridges and industries, tourism, irrigation, ports and so on.

Revenue from forest formed three-fourth of the total revenue from economic services during 1980-81 which has declined to less than half in 2011-12 and has further declined to 34 per cent (Appendix 7). As a component of SONTR, it fell from a high of 45 percent in the 80s to 8.5 percent during 2011-12 and declined further to 2.79 per cent. One reason cited for the same is that environmental regulations have curtailed felling of trees and sale of timber, exploitation of other

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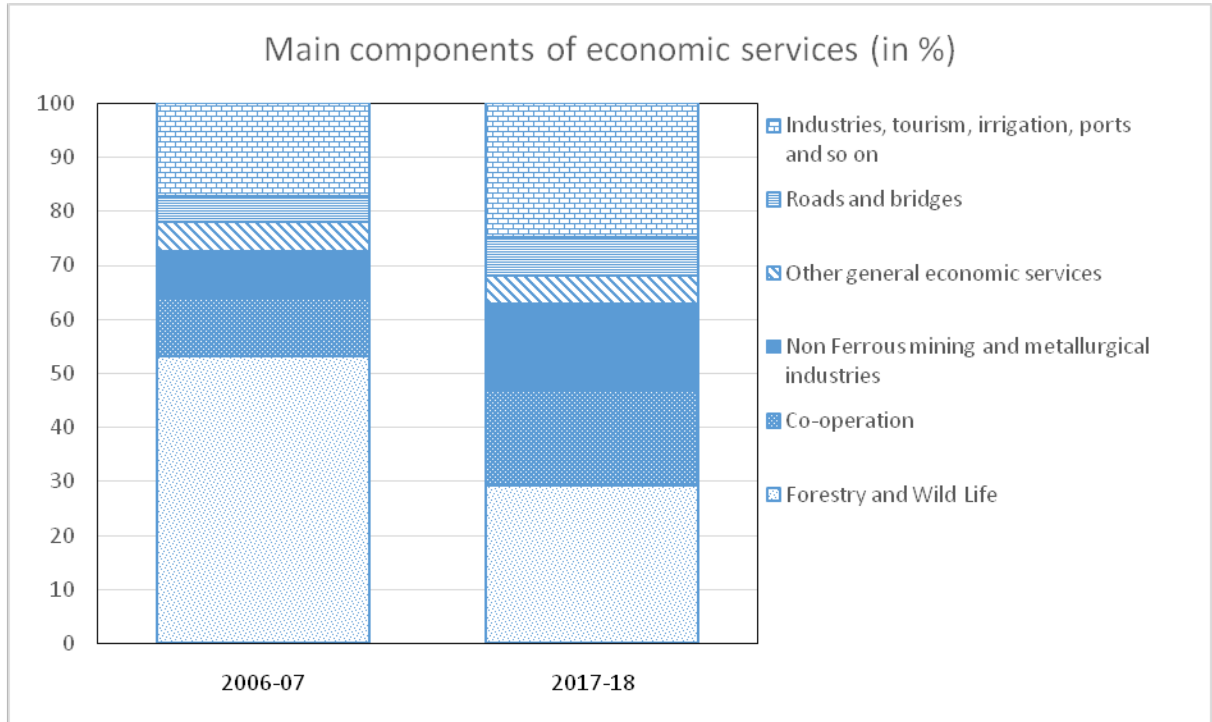
[24] Public hospitals charge Rs. 300 for a single dialysis session as opposed to Rs. 3500 in private hospitals. Similarly, the difference in angioplasty charge between the public and private hospitals is Rs. 1.35 lakhs (Rs. 1.5 lakhs in a private hospital where as Rs. 15000 in a public hospital)

[25] Quasi public goods are goods provided by the government which may be excludable based on prices (Burns and Walsh 1981) where the pricing can be managed through a user charge.

Figure 1.8: Composition of components within economic services



resources in buffer zones etc., reducing collection and sale of forest resources (White Paper on State Finances 2011). However, ensuring higher mobilisation of revenue within permissible parameters is essential in raising collection of non-tax revenue. The White Paper on State Finances estimated that an additional Rs. 50 crore can be mobilised from forest resource if efficiently exploited (Government of Kerala 2001). Economic services are one of the best available categories for mobilising resources through inflation indexing. Few specific suggestions on some subcategories are mentioned below.

a. Forests

Fees collected for entry to protected areas and other ecotourism centres under the control of Forest Department needs to be enhanced. Provisions may be incorporated in the Kerala Captive Elephant (Management & Maintenance) Rules, 2013 for payment of fees by elephant owners for inter district transportation of captive elephants. Funds thus generated may be earmarked for schemes for the welfare of captive elephants across the state. Lease-rent realised by Kerala Forest Department for lands leased out to various agencies are very nominal and needs to be substantially enhanced. At present seedlings are sold by forest department to the public and other agencies @ Rs.7/- for teak stump, Rs.17/- for small basketed seedlings and Rs.45/- for big basketed seedlings. These

rates need to be enhanced. As per office order issued in April 2018, Government increased rates for various services by 5 percent. Major items included in the order are annual inspection fee for sawmills, application fee for various wood based industrial units, film shooting charges, parking fee, hotel fee etc.

b. Quarrying/Mining

It observed by the Commission that the number of functional granite stone quarries has reduced to 728 from 3500 after issue of court order dated 27/2/2012 that made environmental clearance mandatory for all mining. Gadgil Committee report followed by Kasturirangan report on Western Ghats has also led to the closure of many quarries close to the Western Ghats. Similarly, Forest and wildlife protection act has compelled closure of 89 granite quarries within a radius of 10km of Wildlife Sanctuaries and National Parks.

As per Mines and Minerals (Development and Regulations) Act-1957, State Government is authorised to fix royalty of minor minerals and revise the royalties once in three years. Rates are not revised since 04.01.2018. Revision of rates cannot be done with retrospective effect. Present rate of royalty is Rs 24 per MT of granite stone while the market rate (selling price) of one MT of Granite Stone is incomparably high.

Schedule for collecting royalty is based on various slabs, depending on the surface area of land from where mineral is to be exploited. This seems to be an unscientific method. More scientific method will be to realise royalty based on the quantity of minerals extracted. Government of Kerala has revised certain rules related to mining and quarrying like consolidated royalty payment scheme, stricter fines and penalties for illegal mining and quarrying to limit/eliminate corruption and for better mobilisation of resources[26]. However, it is noted that the new rates are yet to be implemented though scientific mining has commenced with the introduction of approved mining plan vide G.O. (P) No. 16/2015/ID (SRO No.72/2015) dated 07.02.2015. This has resulted in heavy loss of royalty to the Government. According to report of C&AG, Government of Kerala did not conduct auctions for the right to quarry land in 2017 indicating lack of transparency that exists in the business.[27]

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[26] http://www.dmg.kerala.gov.in/docs/pdf/notification/draftkmmcr.pdf

[27] https://cag.gov.in/sites/default/files/audit_report_files/Chapter_2_Performance_Audit_of_Report_No.6_of_2017_-_Economic_Sector_Government_of_Kerala.pdf

c. *Tourism*

Kerala, well known for its backwaters, houseboats, waterfalls, hill-stations, tea gardens, beaches, forests, snake boat races and rich cultural heritage is an attractive tourist destination. Tourism is a suitable avenue for generation of funds provided tourist spots are well managed. Santhakumar (2009) presents a theoretical model and an empirical exposition to analyse management of the objectives of tourism in a Wildlife park and an important inference of the paper is the effect of differential pricing on the objective. Primary survey of domestic and overseas tourists (who pay a higher price) was conducted to collect data on the '*willingness to pay'* for tourist services. The theoretical model suggests that the cost of maintaining and conserving the forest and tourist spots will increase with rise in tourist flow. As long as cost is compensated by the revenue received from domestic and foreign tourists, it is feasible for the government to spend on maintenance of the spots. However, if the cost is higher than the benefit to the domestic tourist category but lower than the foreign tourist category, then the number of domestic tourists and foreign tourists become critical in the pricing decision. He further indicates that with a huge number of domestic tourists (due to extremely low entry fee) will increase the cost of maintenance sharply. Findings of the study is validated by using empirical data and finds that there would be a reduction in the number of tourists without drop in the potential revenue if the entry fee is raised to the average '*willingness to pay'* levels. Recently, in an attempt to encourage foreign tourists, Niti Aayog has proposed streamlining purchase of tickets by allowing online purchase, making availability of foreign exchange service easier and within reach, creating common passes for multiple sites etc.

It is difficult to assess willingness of consumers to pay from a survey using available data. Government of Kerala needs to invest time in assessing the *'willingness to pay'* of both domestic and foreign tourists in conducting a primary survey in selected tourist spots, heritage sites, amusement parks and museums. This needs to be compared with the total cost of maintenance and operations of each site. Based on these two factors, government can consider raising prices. Once the price rise is implemented for all tourist spots, the government may combine several sites and introduce online issue of tickets/passes making tourism more consumer friendly.

According to a Kerala Tourism Report prepared by Tata Consultancy Service (2018), the state's tourism sites can be divided into the following categories/activities- heritage/cultural sites,

backwaters, beaches, hill stations, wildlife sanctuaries and Ayurveda. To ensure a sustainable long term growth in tourism, government needs to make investments in the sector and provide infrastructure support. Tourism is season related and hence the revised pricing structure needs to allow a two part pricing system – one set of prices for the peak period and the other set for the lean period. A segmented pricing structure according to the type of tourist site (heritage/cultural sites, backwaters, beaches, hill stations, wild life sanctuaries and Ayurveda), the seasonality involved (peak/lean), type of tourists (domestic/ foreign), type of relations that India/Kerala has with the country of origin of the tourists and above all, the pricing scheme must reflect the cost and marginal willingness to pay of different categories of tourists. The pricing formula needs to be based on the number of tourists necessary to ensure sustainable growth of the tourist site.

Recently, Government of Kerala has declared a new Tourism policy 2017 which intends to double international tourist arrivals by 2021. Kerala has received 15.6 million domestic tourists and 1.09 million foreign tourists in 2018. After the devastating floods of 2018, Kerala Tourism has designed a 12-point strategy and has taken robust promotion and marketing initiatives, which resulted in Kerala tourism bouncing back in 2019 from the brink of heavy losses in 2018. In the first three quarters of 2019(Jan – Sep 2019), Kerala Tourism has registered an overall growth of 15.73% (Domestic – 16.48%; International – 4.84%). Overall revenue from the tourism sector is around 36500 crores during 2018 of which about 8500 crores is from foreign exchange earnings[28]. Positive recognition on Kerala's tourism opens up scope for investment opportunities by the private sector in Kerala in hotels, resorts, cruises and amusement parks. Other avenues for revenue generation include parking fees for private vehicles at tourist destinations, pay and use toilet and refreshment services, opening government guest houses for general public at a higher rate, bundling various services to tickets and generating common pass for visiting tourist destinations. Organising festivals and services to encourage more tourists and focus on pilgrim tourists will also be beneficial for additional revenue generation.

[28]On the digital marketing front, Kerala Tourism is a world leader in Facebook (3.56 million followers - 4th in the world), website (7th in the world), Twitter (1.85 million), Instagram (256K) and You tube (121 K). Kerala Tourism has won numerous awards in this period – 9 National Tourism Awards, 5 PATA awards, 2 WTM award etc. World famous tourism magazines have declared Kerala as must-see destination and we are the only south Asian destination to be featured so. Travel portals such as Lonely Planet and Travel CNN also rank Kerala as a tourist destination.

I.4.4 Interest Receipts, Dividends and Profits

The final category within own non-tax revenue to be analyzed comprises of interest receipts, dividends, and profits. Interest receipts include interest on loans on housing schemes, loans to government companies, treasury bills, and interest from departmental commercial undertakings etc. Revenue from dividends and profits arise from government's investment in the shares of co-operative societies, government commercial and industrial undertakings etc. Share of interest receipts and dividends in the total own non-tax revenue of the state is small – average of 11 percent from 1980-81 to 2011-12.

Dividends and profits remain as an unsteady element in the non-tax revenue. More revenue can be raised out of these two sources. Recommendations by committees for setting up of a centralised control mechanism in the Finance department for active monitoring of retrieval of loans and interest was never adopted (PAC 2001-04, 47th report cited in KPERC report 2012). An amount equal to Rs. 206.58 crores are considered unsettled due to non-recovery of loans given to various public sector undertakings (CAG 2012).

Kerala has the highest number of state level public sector enterprises in India (GIFT, 2014). Despite this, the contribution of profits and dividends from these enterprises is negligible (IIM-K, 2016). The share has slightly risen from 4.8 percent in the seventies to a little over 5 percent in 2018 (as a share of the total non-tax revenue). According to Sebastian (2019), the increase is mainly attributable to the exceedingly high dividends paid by the Kerala State Beverages Corporation (KSBC) Substantial amount is pumped into other state level public sector enterprises in Kerala in the form of subsidies and loans. An effective tool for improving profitability of these enterprises lies in planning for long term revival which requires critical analysis of technological capabilities and production efficiency. This requires shifting focus from a mere rise in profits to transforming production modes by making use of latest technology, deepening linkages with the economy by sustainable utilisation of available resources. According to the Kerala Economic Review Report, 2018, there is a modest improvement in the performance of these enterprises. The number and scale of profit of profit making enterprises have risen while that of loss making enterprises has declined thus narrowing the burden gap. Some of the policy recommendations are

as follows:

1. **Improving corporate governance in PSE:**

   Corporate governance is one of the most effective tools to ensure transparent governance in enterprises that have a dispersed ownership. In the case of public sector enterprises (PSE), the gap between ownership and control widens since people elect the government which assigns/ appoints persons to manage these enterprises. Thus, the principle- agent problem requires careful scrutiny. In 2009, the Department of Public Enterprises (DPE) under the Ministry of Heavy Industries and Public Enterprises, Government of India made it mandatory for Central PSEs to submit corporate governance report at the end of each financial year. Guidelines in this regard covered composition of Board of Directors, composition, and function of Committees of the Board (Audit Committee, Remuneration Committee, details on subsidiary companies, disclosures). It is also mandatory for all CPSEs to submit self-evaluation reports to the concerned ministries who would compile the information and submit it to DPE. Although, it started with only 60 percent of the enterprises submitting self-evaluation reports in 2010, there is a modest rise in the recent few years. To ensure accountability and transparency in the monitoring of these enterprises, the government needs to include corporate governance disclosure report with the annual report that is published by these enterprises. Having an effective corporate governance mechanism also ensures re-organization of management and board of directors, and proper auditing by the concerned committees of the Board.
2. **Memorandum of understanding (MoU)**:

   MoU is a well-negotiated document between the government and the managers of public sector enterprises specifying the responsibilities, objectives, and obligations of the two parties. MoU system was introduced for CPSEs in the late eighties and now spans across eighty percent of these enterprises. It is aimed at providing greater autonomy to these enterprises, reducing extraneous interference, and providing the CPSEs a level-playing field with their private counterparts. The MoU system links the level of financial support from the government for the succeeding year to the MoU score of the preceding year. Government of Kerala may consider introducing the MoU system at the SLPE level to reduce inefficiencies, restrict extraneous interference and also make the enterprises

financially accountable. The wide coverage of financial and non-financial parameters will also equip the government to gauge performance of these enterprises in a nuanced manner.

3. **Listing on stock market**:

   Listing on stock market requires disinvesting existing enterprises by miniscule amounts so that control of the enterprise continues to be with the government. Stock market acts as a regulatory mechanism which ensures that the PSEs also have to comply with all the guidelines of SEBI and other regulatory authorities, similar to the private listed enterprises. Listing on the stock market will also ensure more frequent and careful scrutiny by investors and analysts leading to better functioning of the enterprises.

4. **Public private partnership (PPP):**

   PPPs are effective tools available with the government for facilitating private sector to ease budgetary pressures and ensure effective provisioning of public services. PPP models are widely used in the infrastructure sector in India. Between December 2005 and August 2019, there have been approximately 10 PPP projects in Kerala, including those under construction. Most of these projects are in the road sub-sector. PPP based models may be a viable alternative in addressing financial crunch in public sector enterprises. However, a model of PPP requires careful scrutiny by considering critical factors of success – type of PPPs (Build-own-transfer, Build-own-operate and its effectiveness according to the sector, age of the project, type of end users and so on), transparent and effective contractual agreements, suitable sectors where it can be used, timely and regular review.

5. **CIAL Model**

   Cochin international airport is the first airport in India to be built under a new business model and is owned by a public limited company called Cochin International Airport Limited (CIAL) floated by Government of Kerala in 1994. Envisaged source of funds were interest-free loans from non-resident Indians working overseas, donations from industrial undertakings, exporters, cooperative societies, and loans from the state government.

CIAL model have significant differences with the Public-Private Partnership (PPP) model of infrastructure and public services financing. Government of Kerala holds 33.36% stake, making it the single largest investor in the project. Central PSUs like Air India, BPCL and Airport Authority of India hold 8.74 percent share, while foreign companies holds 5.42 percent share. Other Indian

companies hold 8.57 percent, while scheduled commercial banks like Federal Bank, SBI and Canara Bank hold 5.91 percent. Remaining 38.03 percent of shares is held by more than 10,000 individual investors from 29 countries, mostly non-resident Indians. The company subsequently went for public offering and gave 10 million shares to HUDCO as part of debt settlement, which gave HUDCO 3.37 percent share in the company and reduction in shareholding of others. Government of Kerala continues to be the single largest shareholder. Kannur International Airport Limited (KIAL) is implemented based on this model

Kerala's experience of CIAL model in infrastructure development financing is a success story and is replicable.

Instead of choosing one of the four policy tools discussed above, a more effective method for performance improvement would be a combination of these. Some basic issues also need to be addressed. Careful examination of existing long term loans, arrears and payments and an institutional mechanism for settling the loans needs to be done before attempting disinvestment. PSEs also needs to focus on strengthening their network by synergising relations with each other, effective utilisation of their presence across the state, investing in R&D activities, outsourcing innovation activities, improved use of technology and strategic tie ups with each other and other CPSEs.

Another important aspect relates to utilisation of land, machinery, and other resources of sick/closed down enterprises. Leasing out of the land to private players at market rates or using it for construction of government offices may be an effective way of utilising these resources. These broad recommendations may help in increasing the technological capabilities and financial viability- thus rendering better profits and dividends.

Annexure II

RESOURCE MOBILIZATION THROUGH TAX-REVENUE

II.1 Tax Revenue –Direct and Indirect

Important direct taxes like Income Tax, Wealth Tax, Corporate Taxes etc., are in the jurisdiction of Central government. The states are left with in significant direct taxes like Property Tax, Professional Tax etc. Therefore, the States are heavily dependent *on Indirect Taxes for resource mobilisation*. Prominent Indirect Taxes that the State of Kerala collects or go to its coffers, as the case may be, are as follows.

a) SGST - States GST (SGST) for intra- state transaction.

b) IGST - States share of GST in Integrated GST (IGST) for inter-state transaction, *as a Destination State.*

c) Kerala State VAT (Sales Tax) - Petroleum and Petroleum products not being within the ambit of GST, the states collect States VAT on these products.

d) State Excise and State VAT - These are imposed on Alcohol, both Imported Foreign Liquor and India Manufactured Foreign Liquor (IMFL)

e) Turnover Tax - This tax is imposed on Drinking Bars selling alcohol to their customers, at a certain percentage of the Turnover of a particular Bar.

f) Entertainment Tax - This tax is collected by the Local Bodies for for sustaining their local development and welfare work.

Constitutionally, Petroleum and its products are within the ambit of GST. However,

effectively it has been kept outside GST until the GST Council representing both Centre and the States decides to bring it within GST. Consequentially both Centre and States continue to collect Central Excise and State VAT respectively on Petroleum, as in the pre-GST era.

Alcohol for human consumption is kept out of GST, constitutionally. So, its taxation is entirely vested with the States. Centre continues to impose Customs Duty for imported alcohol. The alcohol scene in Kerala is as follows.

The Kerala State Beverages (Manufacturing & Marketing) Corporation Ltd (BEVCO) is a public sector company fully owned by Government of Kerala. BEVCO has monopoly over wholesale and retail vending of Alcohol in the state. Besides, the corporation also controls retail sale of Indian Made Foreign Liquor (IMFL) and Beer trade in the state. The State Excise Department levies State Excise Duties and a fee on foreign liquor, both IMFL and imported. These apart, as mentioned, there is a Turnover Tax for the Drinking Bars, at a certain percentage of the turnover of a particular Bar.

Broadly, this is the picture of Indirect Tax levies in Kerala. From revenue point of view, the most important taxes are GST – both for intra-state and interstate trade, State VAT on Petroleum and its products, and State Excise on Alcohol.

II.2 Constitutional Provisions relating to GST

Article 246 of the Constitution deals with laws framed by the Parliament and the State Legislatures. List I in the Seventh Schedule, the Union List, enumerates matters on which Parliament has exclusive authority to frame laws. List II of the Seventh Schedule, the State List' enumerates matters on which the States have the exclusive authority for making laws.

During the Pre-GST era, List I authorised the Central Government to levy, inter alia following taxes:

(1) Central Excise Duty.

(2) Duties of Excise (Medicinal and Toilet Preparations)

(3) Additional Duties of Excise (Goods of Special Importance)

(4) Additional Duties of Excise (Textiles and Textile Articles)

(5) Additional Duties of Customs (commonly known as CV Duty)

(6) Special Additional Duty of Customs (SAD)

(7) Service Tax

(8) Central Surcharges and Cesses so far as they relate to supply of goods and services.

(9) Duties of Customs including export duties,

(10) Taxes on Income other than Agricultural Income,

(11) Corporation Tax

(12) Estate Duty on property other than Agricultural Lad.

On the other hand, List II authorised the States to levy inter alia, following taxes in the Pre-GST era:

i. State VAT
ii. Central Sales Tax
iii. Luxury Tax
iv. Entry Tax (all forms)
v. Entertainment and Amusement tax (except when levied by the local bodies)
vi. Taxes on advertisements
vii. Purchase Tax
viii. Taxes on lotteries, betting and gambling
ix. State Surcharges and Cesses, so far as they relate to supply of goods and services.
x. Duties of Excise on Alcoholic liquors for human consumption and opium, Indian hemp and other narcotic drugs
xi. Stamp Duty and Land Registration charges relating to transactions in Real Estate
xii. Taxes on the consumption or sale of electricity
xiii. Taxes on professions, trades, callings and employments
xiv. Tools
xv. Taxes on lands and buildings.

On introduction of GST, eight Central taxes, Sl. No.(1) to (8) and nine State taxes at Sl. No. (i) to (ix) were subsumed in Goods and Services Tax (GST)

Constitutional provisions relating to policy formulation and implementation of GST, after the amendments are as follows:

Article 246A authorises Parliament and the State Assemblies to make law with respect to

GST.

Article 269A authorises Centre to levy and collect GST in the course of interstate trade and get the collected tax apportioned between the Union and the States in a predetermined manner.

Article 279A provides for the constitution of GST Council chaired by the Union Finance Minister with Finance Ministers of all the States as its members. The Article also authorises the Council, inter alia, to take policy decisions and recommend the decisions to the Central government and the States for getting them cleared by Parliament and individual State Legislatures.

A reading of these provisions of the Constitution as applicable to the States, leads one to infer that no *state can unilaterally change an existing position of GST policy like form, structure, rates, procedures etc. Any change sought by any State has to be decided and approved by the GST Council, where there is a provision for voting*.

Therefore, recommendation on administrative reforms in respect of GST has necessarily to be **restricted to the administering of GST** or in simpler terms the **recommendations will have to confine to improvement of GST implementation in respect of compliance and anti-evasion measures.**

II.3 GST Compliance and Anti Evasion Measures

One of the main reasons for the GST collections not measuring up to expectations is that there is huge tax evasion right from its introduction, through different methods and is still continuing. While it is difficult to arrive at a firm estimate of the scale of the problem, there are some indications of its enormity. In May 2018, it was estimated that the value of goods (July 2017 to March 2018) entering a state appeared to be under-reported by around Rs 50,000 crore in the case of West Bengal, Rs 60,000 crore in Madhya Pradesh, and Rs 1,50,000 crore in Maharashtra. Numerous cases of tax frauds and fake invoice scams have also been detected since then. These are large amounts, and they are likely to be an underestimation, nonetheless it points to significant leakages. Another set of statistics shows that in 2018 -19, the Central GST authorities registered over 1600 cases involving an amount of Rs. 11,251 crores, as against 5 cases involving an amount of merely Rs 13 crore in the nine months ending 31 March 2018. By November 2019, the number of detected cases swelled to over 6,000 cases.

II.4 Consequences of Unprepared GSTN

GST regime was introduced in July 2017 without making GST Net- the IT infrastructure, fully operational. Consequently, the regime suffered its biggest setback when at the beginning itself, the GSTN failed to deliver as was expected. To be specific, the GSTN was to ensure that all the transactions are documented and backed by invoices, and that appropriate Returns are filed periodically to facilitate matching of invoices and weeding out of all fake transactions. However, due to failure of GSTN in this matter, the GST Council, the decision making body was compelled to recommend one simple form - GSTR 3B, in place of the well thought out Return forms GSTR 2 and GSTR 3 that could have facilitated invoice matching. Originally, invoice matching was so planned that invoices uploaded by the recipient (buyer) had to match with the invoice uploaded by the supplier (seller), for validating the claiming of credit by the buyer. But, as mentioned, the scheme of invoice matching that could have facilitated tallying of tax paid by seller and credit taken by the buyer was abandoned.

Consequently, many used this loophole to claim input tax credit without payment of input tax and without any counter verification. Some of the evasion cases, detected mostly by the Central GST administrations and their intelligence wing, is briefly discussed below, together with the modus operandi.

II.5 Evasion Cases

In one case, bogus firm were registered by taking advantage of prevailing practice of registration without any physical verification. Many non –identifiable entities got themselves registered under GST, using PAN of random people. Thereafter, fake invoices were produced without actual movement of goods and these invoices were then used to claim input tax credit, fraudulently. For instance, in 2019, the Directorate General of GST Intelligence unearthed a fraud where one individual had created 90 fake firms and issued bogus invoices worth over Rs. 7,000 Crore involving GST of around Rs. 700 Crore. These fake invoices and resultant fraudulent input tax credits were then utilised by some bigger firms in the cotton yarn spinning industry to offset their tax liabilities.

In 2019, a similar case of fake invoices was detected by the Central GST officers where a tax fraud of Rs. 224 crores were carried out using fake invoices worth Rs. 1,289 Crores by a group of eight companies involved in the trade of iron and steel products. The companies generated fake

invoices without actual supply of TMT bars, MS bars, MS flat products etc., and passed on the input tax credit based on these fake invoices to other taxpayers within the same group, right from the introduction of GST in July, 2017. It was also found that five out of the above eight taxpayers were operating from the same address and many of the Directors/Partners/Proprietors of these companies were common.

Another similar case was detected in 2019 in Central GST officers in Delhi. The accused was operating 10 fake firms which were created for rotation of money and fraudulent Input Tax Credit. Fraudulent Credit of about Rs. 140 Crore was passed on using fake invoices involving an amount of Rs. 1040 Crore. The modus operandi involved obtaining GST registration of fake firms using documents of certain individuals and generating invoice without any movement of goods and then generating e-way bills too for these firms from a premise in Tilak Bazar, Delhi. There was also no link between inward and outward supplies of the errant firms. The fake firms passed on the fraudulent credits to a range of buyers who availed the same to discharge their GST liability on outward supplies, thus defrauding the exchequer.

Some of the exporters including so-called star exporters have also been taking advantage of flaws in the GST system that ran without the help of a fully operational GST Net. Besides claiming input tax credit and adjusting them against tax liability, as cited above, there have also been instances where the exporters used fake Input Tax Credit to pay duty and then claim cash refund. The investigation authorities found in such cases that the so-called 'star exporters' were non-traceable in their registered addresses.

In at least 9 such cases, investigations pointed out the fake invoicing and fraudulent tax credits which were cashed through the facility of Integrated GST (IGST) refunds. It may be recalled that IGST is applicable to interstate transactions, including those involving import of goods.

Another way was claiming of cash refunds are against input tax credits in case of 'inverted duty structure'. In cases where the tax paid on inputs is more than the tax applicable on the final output, the balance of input tax amount, after deducting the tax paid on final output becomes a tax burden on the taxpayer and is known as 'inverted duty' structure. GST law allows for cash refund in the case of inverted duty structure. Some among the taxpayers took advantage of the system and evaded tax fraudulently. In a case detected in 2019 by the investigating officers, it was found that a group of people created a network of 500 firms, including fake manufacturers of 'Hawai

Chappals', other intermediary firms and fake retailers to claim and encash fake credit. In this case, the raw materials had an applicable tax rate of 18 percent whereas the chappals were taxed at 5 percent. This network had created fake credit amounting to Rs. 600 crores when the investigating Central GST officers cracked down.

Similar GST evasion was detected by the CGST officers of Delhi in 2019 where over 120 entities were involved in producing fake invoices worth Rs. 1,600 Crore which was misused in exploiting the facility of refunds given for inverted duty structure. The tax evasion was of Rs. 241 Crore.

Another modus operandi was revealed when the Central GST officers in Mumbai unearthed a multi-crore tax evasion racket where gold and precious stones jewellery were transported without paying GST.

The jewellery belonging to various jewellers in the cities of Hyderabad, Chennai, Delhi, and Kolkata were being transported by an aggregator as a Courier Agent. The aggregator used to collect the said items and carry it on behalf of the jewellers. In declaration to the airlines, the aggregator acted as both consignor and consignee, in order to conceal names of actual suppliers and receivers. Investigation revealed that most of the precious jewellery was without proper documents on payment of GST. Even in cases where the consignment was accompanied by documents the jewellery was found to be mis declared and undervalued. Actual value of the jewellery was found to be Rs. 26 Crores.

Another method that involved misuse of large amount of credit by a group of fraudsters is as follows. First, a number of fake firms were registered taking advantage of lenient registration procedure without physical verification, these firms were then integrated in a chain and they undertook sale and purchase of fake invoices and created credits available in the chain. These fake firms then passed on the credit created out of the fake invoices first to other fake firms in the chain, and then ultimately to one actual, existing business firm after many layers, as explained above. This existing business firm then utilised this credit (for which actually no tax was paid). In this kind of cases, there was no actual movement of goods, no sale of goods, but only trading of fake invoices was carried out and on the basis of these fake invoices, input tax credit was availed and passed on. This process of availing of ineligible credit is also known as 'credit laundering'.

There is a similar case where a complete 'parallel economy' in which the entire supply chain functioned without payment of GST at different stages. Here, there was actual supply of

goods, but without payment of GST, like the clandestine removal of goods without payment Central Excise in the pre-GST regime. These non-GST paid goods moved along the supply-chain of a group of fraudsters without payment of GST at any stage.

In some cases, the goods were grossly undervalued, and GST was paid on the undervalued goods. Three or four players shown in the supply chain were often labourer/driver/clerk of the actual players. Thus, the transactions at different stages of the supply chain are layered to mislead investigating officers.

From a statement of the Union Ministry of finance, it is found that a large number of fake firms have been caught by different anti-evasion agencies which has an *estimated tax implication of at least Rs. Fifteen Thousand Crore.*

II.6 Fully Operational GSTN to Check Evasion

Most of the frauds described above could have been avoided if the Central Government implemented GST by fully operationalising GSTN after pilot runs for all the modules of the GSTN, including those of filing of Returns and Invoice Matching. *Tax Invoice* is an important document in the scheme of GST. Based on Tax Invoice issued by the supplier, the recipient takes credit. Again, it is on the basis of matching of tax invoices of input supplies and corresponding output supplies that the tax officials confirm whether credit is availed lawfully. To elaborate further, a registered person supplying taxable goods issue a Tax Invoice showing the description, quantity and value of the goods, the tax charged thereon and certain other particulars, before or at the time of removal of goods for supply to the recipient or for delivery of goods to the recipient.

A registered taxpayer also needs to file details of outward supply in *GSTR-1* about type of supplies made in a month- outward supplies to registered persons, outward supplies to unregistered persons (consumers), details of credit/debit notes, zero-rated, exempted and non-GST supplies, exports, and advances received in relation to future supply.

Similarly, she has to file inward supply details in *GSTR-2*on types of supplies received in a month. The details of inward supplies of goods and/or services to be furnished in *GSTR-2*should include invoice-wise details of all inter-State and intra-State supplies received from registered persons and unregistered persons. The details of inward supply furnished by the recipient in GSTR-2 are to be matched with the corresponding details of outward supply furnished by the counterparty supplier in her GSTR-1. If invoices in GSTR-2 do not match with invoices in

counterparty GSTR-1, then the mismatch is to be intimated to the supplier. In such a case, ITC availed by the recipient is to be added to her output tax liability. In short, all mismatches are to lead to proceedings if the supplier had made a supply but not paid tax on it.

There was legislative support for carrying out this important and onerous job. Section 42(1) of the CGST Act stipulates that details of *every Inward Supply* furnished *by the Recipient* of supply for a tax period will be matched with the *corresponding 'Outward Supply'* furnished by the counterparty *supplier* in his valid Return or with the IGST paid in respect of imported goods. The matching was also to be done to check duplication of claims of ITC.

Thus, a system of ensuring compliance through invoice matching was planned. But dispensing with invoice matching opened the pandora's box of fraudulent modus operandi, as illustrated, leading to large scale evasion of GST.

It was clear from the very beginning that administration of GST would depend heavily on proper functioning of the IT infrastructure, the GST Net. It was therefore expected that the GST Net will be fully operational and well-tested before starting implementation of GST. But that did not happen. However, the GST Net cannot be blamed for this. To be fair to them, the entire law and procedure through Acts and Rules were finalised by the June-end, leaving little time for the GSTN to be fully operational on 1st of July. It is believed that if they were given two more months after the rules were finalised, they could have done the required test-runs and delivered a fully operational GST Net by 1st of September. The call from some quarters for deferring implementation to 1st of September was not accepted.

Thus, when the GST implementation started on 1st of July, the GST Net was not fully operational. There was chaos. Finally, to get the things moving, the GST Council decided on having a simple system of Return Filing and postponed the implementation of Invoice Matching. As explained, that facilitated GST evasion. A fully operational GSTN along with the invoice matching system may have led to better acceptance of GST, prevented leakage of revenue and improved tax revenue from the second year itself.

II.7 Proposed New Return Formats & Invoice Matching

By the later part of 2019, the GST Council decided to introduce simplified Return Filing

System together with e-filing of invoices in a phased manner. The introduction of e-invoices will also facilitate Invoice Matching. There will be two simplified Return Forms, one named '*Sahaj*' (Form GSTR 2) meant for Business supplies to the Consumers (B2C transactions), and the other '*Sugam'* (Form GSTR 3) for the Business making supplies to both Business to Consumer (B2C) and Business to Business (B2B transaction). Besides these two simplified formats for particular types of taxpayers GSTR 1 (Normal) for normal taxpayers will also continue. Two Annexures of Outward Supplies (GST ANX-1) and Inward Supplies (GST ANX-2) will be filed as part of the aforesaid returns. Further, the e-invoicing system would force the tax-filers to push transactional level details on the GSTN portal for every Business to Business (B2B) transaction so as to ensure seamless flow of legitimate tax credit. This will eliminate bogus taxpayers from the supply/value chain as tax credits will be matched digitally by the Government portal itself without any need for manual intervention, thus ensuring a balanced, reasonable and impartial credit mechanism.

II.8 Other Ways of Preventing Evasion

Another efficient way to check evasion is proper use of the e-way bill facility for movement of goods from one place to another. In order to increase compliance under GST and minimise tax frauds, the Central government has come forward with a new rule to block the facility to generate e-way bill for the taxpayers who have not filed their GST R-3B Returns for two consecutive months. E-way Bill is an electronic document required to be carried for transportation of goods. So, once blocked, the E-way Bill generation for such defaulters will not happen on the E-Way Bill portal, either as supplier, recipient or even as a transporter. This will help in arresting tax-evasion if the tax personnel use the facility diligently.

Another effective move to curb tax evasion and increase compliance by the GST authorities is cancelling registration of tax payers who have not filed GSTR-3B Returns for three consecutive months. This is a good move to ensure compliance.

With the help of technology like introduction of e-invoice, invoice matching, e-way bill etc. the tax personnel can take care of goods moving with documents – fake or otherwise. But technology (read GSTN) will be of little help where there is movement of goods from the stage of raw materials and components to the stage of finished goods and thereafter from production of finished goods to the consumers, without any payment of GST at any stage. Here, there is a

complete system of parallel economy in as much as the entire supply chain is out of the purview of the GST system.

Development of Human Intelligence is the only answer to tackle these kinds of evasion. For this purpose, informers who give information about the evasions needs to be developed. **There will have to be an efficient system of paying rewards to the informers, as a percentage of the recovered amount of tax evasion.**

It is reported that GST leakages through the above two methods, if stopped, is estimated to additionally add 15-20% of GST revenue to the government coffers.

II.9 Way Forward

The illustrative instances of GST evasion enumerated above will make it clear that the *most important way to enhance GST collection is through administrative actions.* This will necessitate undertaking of administrative reforms. While all facilities will have to be provided in respect of administration of GST to enhance 'ease of doing business', *strict measures will have to be undertaken simultaneously to ensure compliance and action against fraudulent actions.*

As explained, the states are not empowered to take any unilateral policy decisions on GST but the *states can have their own independent administrative structures for ensuring compliance.*

Based on the findings and observations, the following important points emerge.

- Along with facilitating trade and industry on 'ease of doing business', strong compliance mechanism needs to be enforced. Compliance can be enforced effectively through strong anti-evasion steps and intelligent and incisive audits.
- Once the new return system and the scheme of Invoice Matching is put in place, major part of tax evasion by availing input tax credit based on fake invoices can be curbed through use of technology. But it will not curb other ways of tax evasion like having a complete supply chain (from manufacturing to the consumer) outside the ambit of GST, where transactions take place amongst a group of fraudsters without payment of GST at any stage.
- It will also not curb the tax evasion in cases similar to the one discussed before, where 10 fake (non-existing) firms were fraudulently registered by a single person generated invoice and took credit without movement of any goods, and then generated e-way bills. The

fraudulent credits were then passed on to a range of buyers who availed it to discharge their GST liability on outward supplies.

There are quite a few similar other cases where invoice matching will not help.

II.10 Need for Human Intelligence

Reliance on Invoice Matching alone will not stop evasion of tax. Besides, it will take quite a long time to have a settled Invoice Matching system, and one cannot wait for that. For these reasons, there needs to be strong anti-evasion machinery, which will collect *human intelligence,* develop the intelligence to get an actionable intelligence and then take action followed by thorough and incisive investigation.

All these activities demand a rehaul in the Administrative Set up. First, it must be understood that ***in post-GST era, human resources will have to be engaged more in intelligence, investigation, enforcement together with a modern and efficient*** **Audit set-up.**

Increased use of technology will reduce the need for officers in supervising assessment and in any case, it is now self-assessment by the taxpayers. Role of officials in pre –assessment and assessment stages are minimal enabling their shift from assessment related functions. Their services need to be utilised more in Anti –Evasion (Enforcement) and Audits.

II.11 Enforcement relating to Alcohol, Petroleum and its Products

Alcohol being a State subject, the State levies state excise duty according to need. As it is a demerit good, Alcohol is a favourite item with the tax personnel for increasing tax. While an increase in excise duty rate on Alcohol will no doubt be one way of enhancing revenue collection, it is also to be remembered that too much increase in tax will lead to increased illicit traffic of Alcohol and nonpayment of any tax. Besides, high variance in the rates of tax on Alcohol with the taxes levied by bordering states of Tamil Nadu, Karnataka and Mahe will lead to inter-state illicit trade (smuggling) through land borders in the north and east and through the sea route in the west and south. So, a balanced view will have to be taken.

As for Petroleum, there is scope for increasing the State VAT rate. But it is to be remembered that an increase in State VAT on Petroleum, Diesel etc., will increase the cost of

transportation of all items including essential items, and that may not be acceptable. Therefore, in respect of these items too main way of mobilisation of taxes needs to be through tightening of enforcement measures with the help of a State Directorate of Intelligences, as discussed.

II.11.1 State Directorate of Indirect Taxes Intelligence and Investigation (DITII)

It is recommended that a *State Directorate of Indirect Taxes Intelligence and Investigation (DITII)* needs to be set up with headquarters in Thiruvananthapuram and branches in all the District Headquarters, with varying strength based on need. For illustration, one at Kochi may be the largest District Branch and that at Waynand may be of much less strength. The directorate may have jurisdiction over not only GST items (goods and services) but also over Non-GST items like Alcohol, Petroleum and Petroleum Products. It may also have jurisdiction over action against smuggling of goods, particularly Alcohol, across the State borders with Tamil Nadu, Karnataka and Mahe.

II.11.2 *Duties and functions of the officers in the proposed Directorate may include:*

i. Applying GST *Data Analytics* to identify potential GST frauds. For this purpose, ways and means of utilising data from the GSTN will have to be put in place. This aspect of GSTN will be discussed soon.

ii. Collection, collation, and dissemination of *human intelligence* relating to evasion of GST and other indirect taxes.

iii. Studying the *modus operandi* of evasion of GST across the country, (some of the illustrative cases have been discussed in the earlier part of the chapter) Modus Operandi of important cases needs to be circulated confidentially to all field formations.

iv. Studying aspects of *valuation* and *classification* of goods and services particularly those at the high end of the GST Rate Structure.

v. Coordinating with field formations in intelligence collection and investigation of cases detected for evasion of tax.

vi. Maintaining and updating laws and rules relating to GST.

vii. Sharing important methods used for tax evasion with inter –state ramifications with the Directorate General of Central GST Intelligence posted in Kerala.

viii. Maintaining liaison with other State and Central agencies in all matters of GST evasion and inter – state smuggling of taxable goods.

ix. The intelligence and investigation work may cover other indirect taxes like that on Alcohol, Petroleum & its products etc.

The Director of the Directorate of Indirect Taxes Intelligence (DITI) may be in the rank of Joint Secretary to the Government of India and may be assisted by Additional Directors of DITII, in each district, who may be in the rank of Director/Deputy Secretary to Government of India.

Besides the aforesaid specialised Intelligence & Investigation Directorate, Commissionerate of State GST may have an Anti-Evasion Wing whose functions will be more or less same as the DITII in respect of functions at serial numbers (i) to (iv) above. In addition, it will also work in co-ordination with the DITII to supplement each other's work.

II.12 Use of GSTN Reports and Data

GSTN provides shared IT infrastructure and services to Central and State governments, taxpayers and other stakeholders. Front-end services of Registration, Returns, Payments, etc. to all taxpayers are provided by GSTN. It is the interface between the government and the taxpayers.

GSTN provides the following services through the Common GST Portal:

a) Registration (including existing taxpayer migration);
b) Payment management including payment Gateways and integration with banking systems;
c) Return filing and processing;
d) ITC (Input Tax Credit) matching, reversal of ITC
e) IGST settlement
f) Taxpayer management, including account management, notifications, information, and status tracking;
g) Tax authority account and ledger Management;

h) Computation of settlement (including IGST Settlement) between the Centre and States; Clearing house for IGST;
i) Processing and reconciliation of GST on import and integration with EDI systems of Customs;
j) MIS including need based information and business intelligence;
k) Maintenance of interfaces between the Common GST Portal and tax administration systems;
l) Provide training to stakeholders
m) Provide Analytics and Business Intelligence to tax authorities;
n) Carry out research and study best practices.

In the GST regime, core services required by taxpayers - applying for registration, uploading of invoices, filing of return, making tax payments, are hosted on GSTN. However, all the statutory functions (such as approval of registration, assessment of return, conducting investigation and audit etc.) are done by the tax authorities of State and Central governments. GSTN also provides the facility of generating Summary Reports for the Management. Centralisation of filing on GST portal has enabled generation of MIS of required information for the top management of Central and State tax departments. Statistics pertaining to various Modules like Registration, Returns, Payments, Refund, ITC blocked / unblocked etc. are generated for States and Centre. Management level summary reports are shared by GSTN with the States, Centre and Department of Revenue, Union Ministry of Finance etc.

Apart from summary reports, taxpayer-wise data of registration and returns are also shared with the states and the Centre. These detailed reports are transferred through SFTP (Secure file transfer protocol). States and Central Board of Indirect Taxes and Customs (CBIC) can download the data using their credentials by logging in to GSTN SFTP server.

GSTN also generates mismatch reports based on data contained in GSTR-1 and GSTR3B returns every quarter/month and shares the same with respective tax authorities.

Thus, the GST Portal services (frontend) are provided by GSTN. The *backend services* (the modules for processing the applications/returns etc.) are developed independently by a few states

(Model 1) and Central Government themselves. However, most of the states (termed as ***Model-2 states)*** are dependent on GSTN to develop, maintain and upgrade their *backend modules.*

Model -2 states take *backend services (the modules for processing the applications/returns etc.) from GSTN. After* every module (enforcement etc.) is unrolled, there is no necessity for Model -2 states to develop back end modules individually. Once GSTN develops the same, it may be utilised by all Model-2 states.

Kerala is a Model-1 state and therefore, its modules for backend services are developed by themselves, independent of GSTN. As Model -1 state, Kerala has to get API for transmission of data and populate its backend modules. Many times, there are issues of mismatch of data and non-transmission of data to Model 1 State from GTSN

Instead of each Model-1 State developing its own MIS reports, the GSTN has developed MIS reports using Big data, Data analytics and Artificial Intelligence. *The advantage of Kerala becoming a Model-2 state is that the Kerala State would get access to all these reports.* These reports can be used by officials of the state for GST related work in the state.

GST portal (www.gst.gov.in) is one single common portal for all GST related services - Tax payer registration (new, surrender, cancelation, amendment etc.), Invoice upload, auto-drafting of Purchase details of buyer, GST Returns filing on stipulated dates for each type of return, Tax payment by creation of Challan and integration with agency Banks, Electronic Credit Ledger, Cash Ledger and Liability Register MIS reporting for tax payers, tax officials and other stakeholders and Business Intelligence /Analytics for Tax officials. GSTN will be accessible over internet (for taxpayers and their CAs/Tax Advocates etc.) and intranet for Tax Officials etc.

A common GST system provides linkage to all State/UT Commercial Tax departments, Central Tax authorities, Taxpayers, Banks, and other stakeholders. The GST system will include all stakeholders – taxpayers, tax professionals, tax officials, Banks, and accounting authorities.

Considering all factors discussed above ***it is recommended that the state of Kerala may switch over to Model -2 State from Model -1 State.*** This will give the State Government all the advantages of Model -2 state.

It is understood that the State Government has entered into an agreement with the *Indian Institute of Information Technology and Management, Kerala (IIITMK),* an autonomous premier educational Institution established by the Government of Kerala for data analytics for the purpose of identifying risky files for audit selection, classification of dealers, widening the tax base and tackling evasion through effective use of third party data.

This fact may not come in the way of getting the State of Kerala converted in to Model -2 state. Rather, *a continued back - end specialised work planned with the help of IIITMK will complement the efforts of the state of Kerala as Model -2 State* in having an efficient and effective administration in tackling Anti-Evasion and Audit efforts.

II.13 Audit in GST Administration

As we have seen in foregoing pages, administration of GST is based on the principle of 'Trust the Trade', and so the taxpayers make the assessment themselves (Self-Assessment), pay the tax and continue the supply of goods and services. Then they submit Returns which are accounts of all their transactions- supplies received and supplies delivered.

It's on receipt of the Returns together with Tax Invoices that the real work of officers starts- when they undertake scrutiny and later audit in appropriate cases. Thus, audit becomes crucial in the context of stopping leakages of revenue. *Anti-evasion and Audit are the two pillars on which GST administration's revenue resource mobilization effort rests.*

As per Sec 6 of CGST Act, audit is to done by Centre and individual States for their respective taxpayers and there is no cross empowerment. Audit by tax authorities is to be done as per Sec 65 of CGST Act 2017andRule 101 of CGST Rules 2017 gives details of Audit to be done. Similar Section and rule are available in Kerala GST Act 2017 and Kerala SGST Rules 2017. The forms prescribed ADT-1 and ADT-2 are the same for CGST and SGST. Thus, the process adopted or being adopted shall be same for audit by Kerala Tax authorities and by CGST Authorities.

The CBIC has developed a *draft **Audit manual*** and it is being followed by CGST officers while planning/conducting GST audit. The CBIC has been following the basic principles of the EA-200- audit in central Excise regime and in-service tax regime. On the basis of the rich experience, they have developed a GST ***Audit process.***

As mentioned, the CBIC draft Audit Manual is being followed by the Central GST (CGST) officers in planning and conducting GST Audit. GST Audit process flow starts with selection process of the Taxpayer to be audited. Based on Risk Parameters and other selection criteria preferred by the authorised officer, Taxpayers are selected for Audit and report is generated at GST system. Based on the parameters, which sets the risk rules and other criteria of selection as prescribed in GST system and the other sources like assessment, enforcement, intelligence etc., the officer authorised for selection for audit will select GSTINs for audit.

The Audit Business flow comprise of the following major functions:

A. Selection & Allocation of Taxpayer to Zonal Audit Head

B. Assignment &, Team Formation

C. Desk Review and Audit Plan

D. Conducting Audit

E. Audit Report & Recovery

F. Closure of Audit

The draft Audit Manual developed by the CBIC is available in its website. The Audit Manual gives an idea about the importance, enormity, criticality and sensitivity of GST Audit.

Conducting Audit for the taxpayers spread across the state of Kerala will have to be done by officers of the Commissionerate or Divisions within a Commissionerate, following prescribed procedure. If necessary, there could be separate Audit Commissionerate independent of field Commissionerate. Either way, they would do the auditing as per the prescribed procedures. I**t would be advantageous if the State GST officers are instructed to follow the draft Audit Manual of the CBIC.** Besides uniformity, it will also facilitate ease of exchange of information between the audit officers of Centre and the State.

Besides the field Commissionerates or Audit Commissionerates, there is a need to have a State Directorate of Audit, following the basic principles laid down in the functioning of the Central Directorate General of Audit. Directorate of audit will *not* conduct primary audits in the Commissionerates, on its own. *Its basic purpose would be overseeing the creation and*

institutionalisation of a credible Audit System in coordination with the Directorate General of Audit of the Central Government.

II.13.1 Responsibilities may include:

(i) develop and provide policy direction to the internal audit of taxpayers by the Audit officers of the Commissionerates.

(ii) ensure its effective implementation through periodic review of the functioning of the Commissionerate Audit.

(iii) prepare Audit Manual for the State based on inputs from the Draft Audit Manual of CBIC and to update the same regularly.

(iv) review GST Audit program of the Commissionerates.

(v) associate with Central organisations like Directorate General of Systems and Data Management, Directorate of Analytics and Risk Management etc. for functional direction to the Audit Department of the Commissionerate in effective conduct of Audit on intelligent selection basis, and also help it in conducting meaningful and focused audit.

(vi) interact with National Academy of Customs, Indirect Taxes and Narcotics (NACIN) to develop strategies for timely training of Auditors including refresher courses for them.

(vii) study the level of compliance including recoveries of taxes relating to important Audit objections.

(viii) collect and disseminate information having a bearing on tax evasion/compliance and having revenue ramification, which are noted during the conduct of audit. In this context, Monthly Audit Bulletins and compilation of important Audit Objections may be circulated regularly.

(ix) enhance tax compliance by the taxpayers through planned interactions with Trade Associations and chambers of Commerce & Industries to explain benefits of Self–compliance. Nuances of Audit functions may also be explained during the interactions.

(x) conduct regular studies based on audit experiences and make recommendations to State Finance department to remove procedural and legal impediments and to plug revenue leakages that discourage quick compliance.

(xi) coordinate with the State GST (SGST) formations and other agencies as deemed fit by the State Director of Audit for exchange of information on new methods to ensure tax compliance.

II.14 Concluding Observations

In the light of the foregoing discussions, the following broad observations are made on resource mobilisation through Tax Revenue.

(i) Scope to mobilise resources through Direct Tax Revenue is limited. Therefore, resource mobilization needs to concentrate more on Indirect Taxes.

(ii) Of the indirect taxes that the State collects, the most prominent is GST – both State GST (SGST) for intra-state trade and the State's share of Integrated GST (IGST) for inter –state trade.

(iii) However, it has to be kept in mind that, the State cannot make unilateral changes on GST policy matters etc.

(iv) Administrative Reforms in respect of GST needs to be restricted to the administering of GST.

(v) Maximum scope of revenue mobilization in GST through twin modes of strong Anti –Evasion (enforcement) measures to plug leakages of revenue and efficient audit of taxes paid, as reflected in Tax Returns and Tax Invoices.

(vi) Based on study of few illustrative cases of GST evasion, as explained before, it is observed that implementation of GST on July 1, 2017 before a fully functional GSTN facilitated tax evasion, mainly through wrong availing of Input Tax Credit. So, there is an urgent need for a fully operational GSTN to be in place.

(vii) Till that time technology is made ready, and even thereafter, there is an urgent need for strong anti-evasion (enforcement) machinery that would work on development of strong human intelligence.

(viii) There is also a need for a state level Intelligence and Investigation Directorate for enforcement of checking evasion of all taxes, GST as well as taxes on Alcohol and Petroleum.

(ix) Besides the above said State Directorate, Commissionerate need to have a separate Anti Evasion (enforcement) wing doing only 'anti-evasion' work.

(x) GSTN is expected to be fully operational with all its modules including those of filing of Returns in new formats and of matching of invoices and of Data Sharing with States and Centre. Hence there is scope for the State to be more closely connected to the backend services from the GSTN, and get it converted to model -2 states.

(xi) Audit is crucial for stopping leakages of revenue and hence emphasis needs to be placed in having a modern Audit system. After all, Anti-Evasion work and Auditing of GST revenue collection efforts are the two pillars on which rest the GST administration's revenue resource mobilisation efforts.

(xii) Draft Audit Manual developed by the CBIC covers GST Audit Process Flow and will be a good document to be followed by the state GST Audit officers

(xiii) A need is felt to have in place a small **State Directorate of Audit** for the purpose of overseeing the creation and institutionalisation of a credible Audit System.

(xiv) The aforesaid Directorate will **not** conduct primary audits which will be the responsibility of the GST Commissionerates which will have their own separate Audit Wings.

(xv) Similar audit mechanism will have to put in place for taxation of Alcohol and Petroleum & its products.

Annexure III

BUDGET REFORMS

III.1 Introduction

According to Article 202 of the constitution of India, a statement of estimated receipts and expenditure of the state for each financial year is to be laid before the legislature, as Annual Financial Statement (Budget). The budget is Government's most important economic policy tool that translates the needs of the people and aims of the government into decisions. It proposes the plans to raise the estimated revenue from various sources and its use among various competing needs. Traditionally the budget is viewed as a statement of receipt and expenditure in terms of financial outlays. On the expenditure side projected expenditure on different sectors and programmes are often used to analyse and decide on priorities. Variations in outlays are analysed in terms of percentage increase or decrease relative to competing sectors/programmes. The budget in essence is an expression of the will and commitment of the government to fiscal prudence.

Fiscal institutions that determine budget performance of states broadly are (i) adequacy of revenue raising powers assigned to them relative to their expenditure responsibilities (ii) the system of intergovernmental transfers and signals emanating from them influencing fiscal behaviour of recipient governments, and (iii) the States' space for maneuver when under stress. Fiscal institutions work within a given socio political milieu and it is the political institutions that exert influence on the functioning of fiscal institutions.

A budget system that functions well and according to the desired needs and appropriations is crucial in developing sustainable fiscal policies and economic growth. Budgetary reforms and generation of adequate resources to finance the development process is an urgent need. The country is facing slowdown in the growth process and in this context improper management/utilisation of available resources will have serious consequences. The study aims to explore how best to channelise the budget for improved utilisation and obtain best possible results.

III.2 Theoretical base

"A full understanding of the budget planning and preparation system is essential, not just to derive expenditure projections but to be able to advise policymakers on the feasibility and desirability of specific budget proposals, from a macroeconomic or microeconomic perspective. It is much easier to control government expenditures at the "upstream" point of budget preparation than later during the execution of the budget" says the IMF guidelines for Public Expenditure Management (1999). Hence the formulators of the budget is expected to have a deep and thorough understanding of the framework in which budget decisions are made, persons responsible for planning and preparing the budget and its basic premise and steps required, weaknesses in procedures and how can these be overcome, required changes in budget plans be programmed and targeted.

Budget planning and preparation are (or should be) at the heart of good public expenditure management. To be fully effective, public expenditure management systems require four forms of fiscal and financial discipline: (1) control of aggregate expenditure to ensure affordability (2) effective means for achieving resource allocation (3) efficient delivery of public services and (4) minimising financial costs of budgetary management.

Each of the steps is equally important in the success of the total financial system of the state. To understand the budget preparation process in a given country, it is important to:

• Assess the basic soundness by judging the budget preparation system against certain internationally accepted standards or "budget principles";

• Know where to find the rules governing the process of budget preparation, and

• From those rules, identify responsibility for each element of the budget preparation process.

The soundness of budget systems can be judged by the following:

Comprehensiveness – By comprehensiveness it is meant that coverage of operations of government must be complete, and the estimates made are gross or net.

Transparency **-** A second aspect is the transparency of the budget. By transparency it is meant that the budget classification should be comprehensive with separate economic and functional

classifications that meet international standards. It should be easy to make a chain of policies, expenditures, and program structure in one thread.

Realism – There should be a clear and realistic macroeconomic framework in which it is based with reasonable projections of revenue, and the financing provisions. It is also a prerequisite to have a realistic costing of the components in the policies, programmes and expenditure, along with future implication on costs, with clear demarcation of present and new policies. It should also be laid down clearly the priorities of spending. All the above principles are achieved by designing budgets that satisfy the following criteria.

a) **Annuality -** A budget is prepared every year, covering only one year; voted every year; and executed over one year. While maintaining the core concept of annual authorization, it becomes inevitable quite often to *develop the annual budget within a multiyear perspective,* through the preparation of medium-term revenue and expenditure frameworks in order to have a better perspective.
b) **Unity -** Revenue and expenditure (as well as borrowing constraints) should be considered together to determine annual budget targets. The budget should cover all government agencies and other institutions – including extra budgetary institutions - undertaking government operations, so that the budget presents a consolidated picture of these operations and is voted on, as a whole, in the legislature which can reflect the true state of the economy.
c) **Universality** - All resources should be directed to a common pool or fund, to be allocated and used for expenditures according to the current priorities of the government. In general, earmarking of resources for specific purposes is thus to be discouraged; but the case of ***extra budgetary*** **funds** is to be considered separately. These three characteristics are essential to ensure that, in budget preparation, all policy proposals for undertaking government expenditure will be forced to compete for resources, and that priorities will be established across the whole range of government operations. These characteristics should be typically enshrined in a legal and administrative framework regulating the budget process.

The basic principles and steps involved in the standard budget preparation system comprise (i) determination of a macroeconomic framework for the budget year (and ideally at least the next

two years) to determine the global level of expenditure that can be afforded without adverse macroeconomic implications, *given expected revenues and the level of deficit that can be safely financed* ; (ii) of this global total among line ministries with some reserves; (iii) Budget circular with instructions to line ministries indicating the spending ceiling and a guideline for preparing the budget; (iv) forwarding of these to the budget department, and the budget department vet the proposals (v) negotiations under different levels; (vi) cabinet endorsement of the draft proposals that has to go to the legislature.

It needs to be re-emphasised that, if there is an assured resource flow to the line departments based on a medium term forecast, the line departments would restrict their demands to it. In the absence of that the line departments usually would try to inflate and extrapolate its proposals presuming that they would ultimately get what they desired. This sort of proposals is a headache to the personae involved in the budget preparation, since they can't be able to make any arbitrary reductions also. Hence it is desirable to have an understanding and medium term perspective of allocations to each of the programmes and projects.

While the principles should be broadly familiar in most ministries of finance, actual practices may fall a long way short. *For example, in many countries and states the budget department does not prepare a macro framework or even a first outline of the budget, let alone indicative ceilings by line ministry, before sending out the budget circular*. In such cases, when preparing their budget requests, the ministries often merely add percentages, guided by an inflation projection in the circular, to their previous year's budget. With this "bottom-up approach," line ministries are able to overstate their needs, exerting upward pressure on overall spending. This is what by and large happens in the state too.

There are often **weaknesses in budget preparation systems**: their nature, scale, and significance need to be understood, both to assess the value of the data produced and, where there are separate projections to be made, to accommodate such weaknesses. Eight common problems that usually occur are identified in the literature. The common weaknesses and their resulting problems are summarised in Table 3.1.

Table 3. 1 Potential weaknesses in Budget preparation		
Ideal Situation	**Common Weakness**	**Resulting problems for those preparing budgets**
Unified budget with full coverage	Dual budget (separate development and recurrent budgets- Revenue and Capital budgets) many extra budgetary funds	Difficulty in developing a consolidated budget. Blurring of capital and current expenditure concepts. With two different budgets it is more difficult to enforce expenditure limits or develop a fiscal adjustment program.
Universality: all revenues go into one fund for financing government activities	Earmarked funds, especially common for financing extra budgetary funds.	Rigidity in spending priorities leading to inefficient allocation of public resources. Again, this makes fiscal adjustment a more difficult task.
Knowledge and analysis of previous year's projected out turn expenditures; availability of volume indicators.	Lack of data; data not communicated to budget office, or data are not analysed.	Data in the budget office may be misleading. For example, actual expenditures are usually different from budgeted expenditures, and the actual number of persons employed may be very different from the original budget projection.
Use of macroeconomic framework. Separate price indices by category of expenditure.	Inadequate knowledge (or incorporation) of macroeconomic constraints. Poor estimates of program costs.	Leads to a bottom up approach where the budget is determined more by spending – agency requests. This and inadequate program provision generally lead to overspending.
Multilayer planning	Focus on current year only; no anticipation of future circumstances.	May have a negative impact n fiscal sustainability: short-sighted policies often cannot be maintained in the long term. Alternatively, a lack of planning means imminent problems or recurrent consequences of capital spending are not foreseen.
Procedures for resource prioritisation implemented early in budget preparation	No direction in priority setting, or attempt to prioritise until too late in the budget preparation	Procedures for prioritisation are especially important for meeting deficit targets or spending targets. If priorities are not communicated in a top-down approach early in the budget preparation process, overspending relative to budget is a likely outcome.

Budget classification according to implementing institution (administrative) purpose of expenditure (functional) and use of expenditure (economic)	Inconsistent nomenclature – for example, mixing functional and economic or budget nomenclature is not consistent with the chart of accounts nomenclature.	An economic classification is most useful when designing a fiscal adjustment program. Sometimes the only classification available is administrative—by budget institution—so that reducing the budget requires cuts by institution, and the quality of the fiscal adjustment suffers. Nor is it possible to understand how expenditures are distributed among different items or for what purpose.

Source: potter and Diamond, 1999.

Having examined the potential weaknesses that are likely to occur in a budget system, there are also certain typical instances that need mention. These are cautions that need to be taken by those who attempt to formulate the budget in the budget wing of the Finance Ministry.

One aspect is that whether the government's budget is really Unified. It is plausible that the budget document presented in the legislature may appear to be unified but in reality, the revenue and capital budgets are prepared following different procedures, resulting in deviations from the macro objectives. In many instances the development budget (plan budget) quite often includes a combination of capital and revenue (current) programmes. Such a system can also lead to an inefficient use of funds because the same item of expenditure may be included in the two budgets, or, more typically, investment projects may be included in the budget, without providing for the necessary corresponding current expenditure. It is also possible that the capital expenditure might have been completed and the project is commissioned, still the revenue part of the expenditures are met from the plan account itself, which also adversely affect the future capital investments and alternative use of capital.

Information on planned capital expenditures may be partial, where donor-financed expenditure is significant and coordination with the donors is inadequate. It is important to check the extent to which the budget is unified in the above sense of ensuring the internal consistency of different components. Quite apart from checking whether the economic assumptions are common and consistent, it is also essential to ascertain whether there has been policy agreement (e.g., on start dates for new policies, on levels of staffing for new development projects when completed, or whether the ministry of finance has ensured that the recurrent cost implications of capital spending

in future years have been taken into account). If there is inconsistency, the coordination between the two budgets should be strengthened by whatever means available.

A second aspect that is likely to be confronted is that the macroeconomic constraints may not be explicitly taken into account and the underlying economic assumptions of the budget preparation in accurate and inconsistent. Absence of proper macroeconomic analysis is particularly common in many states that follow a "dual-budget" system - separate development and recurrent budgets. Inadequacies in macroeconomic analysis, could possibly render ways to overlook the principles of budget discipline and thereby to limit the size of the sustainable budget deficit. As a consequence, the budget preparation procedure can be principally driven by the requests from the ministries for increased spending (i.e., the bottom-up approach). Without a firm top-down limit, the ministry of finance can only challenge proposals on technical or policy grounds, rather than in terms of affordability constraints and priorities within a fixed total.

Fiscal adjustment will be easier if the macroeconomic constraint and the acceptable deficit are defined first (i.e., a top-down approach). From this, spending departments can be given some guidelines to limit their requests. However, even if a macro constraint on aggregate expenditure is set, the fiscal economist needs to probe their validity. *Since many states have proven to be perennially optimistic in revenue forecasting, realistic revenue projections and the financeable fiscal deficit must be decided before the budget preparation procedure begins,* not at some late stage just before or, worst of all, after, its completion. (In the worst examples, the revenue forecast can become a residual derived from line ministries' aggregated spending plans less external financing and "acceptable" domestic borrowing.) Those preparing the budget need to ensure that the budget preparation timetable is sufficiently long, and the process transparent and comprehensive, so that there is no need for arbitrary expenditure cuts late in the process, when revenue or borrowing constraints become clear. It seems that this aspect has a wider application in the present context of the state.

Another source of weakness is that the economic assumptions to be used in estimating the cost of present and new policies may not be accurate, consistent across line ministries, or sufficiently discriminatory between different economic categories of expenditure. Poor unit cost estimates are one of the most common weaknesses in budget preparation. Fiscal economists need to urge the budget department to specify by category different price factors before budget estimates are prepared.

A third aspect that needs to be carefully handled is the problems of **inflation**, which is quite true in the case of Kerala in the recent past. If there is economic instability - for example, in times of high inflation—the budget preparation exercise can become seriously unrealistic. Uncertainty about likely price levels can also "excuse" and thereby perpetuate a lax attitude to budget preparation: when the budget is subsequently executed, the results may include wasted administrative efforts spent switching resources from one budget line to another (**virement)**; excessive use of supplementary appropriations; loss of macroeconomic control over the total; poor allocation of resources among programs; and expenditure arrears.

At the preparation stage of the budget, when discussing the budget figures, in addition to the budget department and planning ministry, and the budget execution department should also be fully involved. In particular, the execution department should provide estimates of spending in the previous year and the spending to date in the current year, as well as its forecast of the likely outturn for the current year. It is highly doubtful whether such a process is on in the state of Kerala. In this context prioritization of available and allowable resources is also important.

III.3 Resource Prioritization

An efficient budget preparation procedure should aim at making the government's priorities clear and at selecting from the many budget requests by spending ministries, those which are really important to the government. In principle this requires two elements. First, a budget strategy needs to be determined at a political level, which determines (1) the affordable total, (2) new policies to be accommodated, and (3) any changes in existing policy provision. The second element is that, each spending ministry and the budget department/planning authorities should meet to discuss each ministry's estimates. To accommodate new policies, the budget /planning department must require each spending ministry to prioritize its requests.

But this ideal is rarely matched by the practices in the state many times. Quite apart from weaknesses in the institutional arrangements, decisions on priorities at the budget preparation stage can be wholly artificial because (1) subsequent cash allocations or supplementary will render them redundant; (2) amounts given by line item are deliberately loose and inflated or unclear, in anticipation of a *real* allocation during budget execution; and/or (3) in practice, the priorities are set outside the formal budget framework.

Whenever possible, the cost of all new policies that a line ministry wishes to pursue should be estimated separately from the estimates of the costs of ongoing programmes. As supporting information, the spending ministry should provide data on expected results/performance from such new programmes/projects and incremental spending (ideally, outputs and outcomes) and preferably in a format that enables the requests across ministries to be compared, followed by a review and comment by the government. Very stringent control on staffing levels is a pre requisite in the context of rising revenue expenditures. Another aspect is the prospects for multiyear planning.

III.4 Multiyear Planning

It is prerequisite to follow a medium term planning rather than focussing on the current or the year after. For a state with multiyear Project Implementation Plans, such plans need to be reintegrated with recurrent expenditures and into a multiyear expenditure plan that provides the basis for establishing a realistic budget in the long run. Although the introduction of a regular procedure of medium-term planning frameworks by function, by ministry, and (ideally) by program takes time to develop, those analysing and preparing the budget should begin this process by preparing medium-term fiscal scenarios. Another aspect that needs to be further investigated is the role of extra budgetary funds.

III.5 Extra-Budgetary Funds

Extra budgetary funds (as defined in the Global Financial Statistics manual) 1996, generally refer to accounts of government transactions that are not included/ partially included in budget totals or documents and typically do not operate through normal budgetary execution procedures. Such transactions may, for example, be financed through foreign aid or earmarked revenues and or resources generates sometimes from market borrowings or combination of earmarked revenues with other sources of mobilisation of funds not included in the budget.

The Kerala infrastructure Investment Fund Board is a classic example of such an institution in the state, which has funds from most of the above sources cited.

Potter and Diamond (IMF, 1999) and Allen and Radev (IMF,2006) suggests that it is the responsibility of the fiscal economist in such cases to aim and identify all such funds and then ensure that they are consolidated on a gross basis in fiscal tables. When consolidated, however, and when the political authorities can be persuaded to consider them as a legitimate component of the published budget, at some point those preparing the budget may be able to close these accounts or at least to reduce their number. **The affected expenditures should then follow regular budgetary procedures and appear in the relevant heading in the consolidated budget.**

It is suggested that the Budget authorities should think of clearly bringing statements about such EBF institutions, its past performance and current and future programmes before the public in a transparent way so as to ensure the legislature processes are compulsorily met with as they are dealing with public funds and borrowed funds for a common cause of the public at large.

Another reason to create this kind of account, suggests (IMF, 1999) ,may be to earmark revenue for a particular purpose. In this case, a specific kind of revenue is transferred to this account when collected, and whatever funds are available must be spent on a given item. This is true in the case of KIIFB in Kerala, the extra petroleum cess is meant for harnessing resources to flow to the account of KIIFB. While there are advantages and disadvantages in operating such funds in many countries and states, in many cases the disadvantages far outweigh the advantages (see Box below on the pros and cons of extra budgetary funds). **Box.1 Pros and Cons of Extra-budgetary Funds**

Pros

- It can increase efficiency by simulating private market conditions where levels and standards of service are **linked directly to fees or charges**.
- Can provide more consistent source of funds for expenditures that yield high benefits yet do not get much recognition (road maintenance expenditures are a primary example).
- **Cons**
- Can result in a loss of aggregate expenditure control; such expenditure may be outside the control of ministry of finance.
- Can distort allocation of resources by circumventing the budget process and review of priorities.
- Earmarked revenues can become entrenched so that funding is no longer based on priority needs.
- Less transparency may lead to inefficiency and/or misuse of funds.
- Can facilitate rent-seeking and abuse of monopoly power.
- Leads to less flexibility at the margin to reallocate when budget is under stress.
- Is incompatible with good cash management practices.

Source : Potter and Diamond (IMF,1999)

Potter and Diamond (1999) and Allen and Radev (2006) are of the view that in some circumstances, extra budgetary funds may be established specifically to divert expenditures out of the budget, ***sometimes with the aim of publishing a lower fiscal deficit, rather this may pave way to escape from the Fiscal Responsibility and Budget Management (FRBM) Act.***. They also opine that the practice of opening such accounts is often an indication that the budget process is not functioning properly, and that resources for priority tasks must be allocated through other mechanisms. Unfortunately, this practice gives rise to rigidities in the short and long term. In the short term, financial management will be impaired because resources transferred to a special account are typically not available to the treasury for cash management purposes--for example, to relieve short-term cash shortages. In the medium term, a shift in government priorities may be impeded by the fact that a part of the available resources is set aside for a special task.

It is also emphasised that having too many extra budgetary funds needs to be discouraged, there can be a case for selective use of such funds, quite apart from separate social security funds that are a feature of many countries--for example, for earmarking resources for infrastructure maintenance. If it is apparent that a lack of maintenance is leading to higher capital expenditures in the long term, for example, earmarking may prevent the diversion of resources needed for road maintenance (often seen as not politically attractive) to other purposes. But the use of earmarked revenues should be accompanied by either administrative mechanisms or market-like incentives that promote accountability and efficiency (sometimes referred to as the "agency model")--something that is rarely achievable in developing countries opines Potter and Diamond (IMF, 1999). Box 2 provides a list of diagnostic questions for assessing the legitimacy of using extra-budgetary funds.

Box 2. Key Questions Concerning Extra budgetary Funds

What is the purpose of the extra budgetary fund? What is the rationale for keeping such a fund off-budget?

Financing Issues

What is the source of funding? Does the source of funding make sense; does it help to relate marginal benefits to marginal costs--for example, user fees? How user fees are determined; are there limits to prevent abuse of monopoly power (especially if demand is inelastic)? Are there general benefits (positive or negative externalities, public goods arguments) in addition to user benefits that justify support from general budget revenues? If there is a split, how is the share of financing determined? Is the source of financing an important government revenue, and can the government afford to lose the associated degree of flexibility in prioritizing expenditures? Do earmarked revenues detract from the government's capacity to collect traditional revenues?

Expenditure Decisions

How are expenditure decisions made by the extra budgetary fund? What use is made of cost effectiveness or cost-benefit analysis? Does the management of the extra budgetary fund promote efficiency, for example through quasi-market mechanisms or through mission statements, objectives, performance measures? How is consumer interests represented and taken into account in expenditure decisions? If governed by a board, is membership of the board biased towards certain needs--for example, regional needs?

Management Issues

Does the management of the extra budgetary fund meet good governance requirements? Is it free of political interference or unduly influenced by suppliers or trade unions? Is it possible for funds to be diverted to other uses? Can these accounts be "raided" for other uses? Is the extra budgetary fund independently audited?

How are the cash resources of the extra budgetary fund handled? Does the government have access to these funds for overnight borrowing to minimize government borrowing needs? Does the treasury or ministry of finance have the legal right to reduce funds available for expenditure in extra budgetary funds if the budget is under severe pressure?

All the aspects narrated in Box 2 should be carefully analysed by the budget economists before finalising the allocations to EBF bodies.

III.6 Accounting quasi-fiscal activities and contingent liabilities

Some operations of a fiscal nature are not conducted through the budget. Examples of such quasi-fiscal expenditures include interest subsidies paid or grants released on loans to public enterprises and special support operations for public or private sector enterprises. Quasi-fiscal expenditures also include spending by nonfinancial public enterprises that represents the provision (or subsidisation) of public goods (e.g., schools or hospitals). By definition, such expenditures do not pass through the budget and cannot be easily consolidated with the statement of general government operations.

In general, it is difficult to extract information on, let alone estimate the cost of quasi-fiscal activities and consolidate the data in the general government tables. But to gain an overall assessment of the fiscal position, **it may be necessary to assess the size of such operations and to notionally add the figures to the information on general government operations.** Kerala too has quasi fiscal operations. It is perturbing that the state does not undertake analysis of its quasi fiscal operations.

Another aspect that needs to be looked into is targeting of changes in expenditure plans, which has a bearing on execution of the budget.

III.7 Targeting of changes in Expenditure Plans

Whatever be the weakness of the budget preparation system the fiscal economist/policy advisor needs to be requested/ obligated to advise on options for changing expenditure plans (typically, but not always, for reductions in spending). In the past, fiscal adjustment through reductions in planned expenditures has often proved challenging. Changes in expenditure plans, relative to the original intent, are often implemented in ways that are disruptive to budget execution or are unsustainable in the long run. Expenditure reductions at times produce short-run savings at long-run cost--for example, failure in planned expenditure reductions (in the sense that outturn expenditure is above the revised budget) lead to payment arrears, and/or excess spending above appropriations. This damages the private sector economy by pendency in payment of bills and affects credibility of the government in financial markets.

This is what happens repeatedly in the state. Bills are not paid on leading to arrears and accumulation. This also indirectly increases the cost of government expenditure in the long run as many of the private agencies will be forced to make offers that include coverage of such risks.

Another fundamental problem is that changes in the budget are often proposed at a late stage in budget preparation. Yet, whatever the time constraints, proper evaluation of expenditure policy options is vital. Those preparing the budget may be tempted to grasp quick solutions. However, budgets must represent an objective estimate of the costs of stated and agreed (within government) expenditure policies. Correspondingly, the only sustained (and sustainable) changes in expenditure plans are those rooted in changed expenditure policies.

Expenditure reductions planned under revised annual budget in conformity with IMF 1999 are not likely to be successful where:

1. reductions are made in appropriations without accompanying changes in underlying expenditure policies. Changing only estimates make provisions in the budget less objective and can result in overspending against appropriation and/or the emergence of arrears in payment
2. estimates for open-ended, demand-led programs are revised downward, typically the triumph of hope over past experience
3. inconsistent agreements are made between the ministry of finance and line ministries to reduce the budget provision for certain line items, but with a "nod and wink" that access will be granted in-year to the contingency reserve, making the reserve overcommitted when contingencies arise
4. overoptimistic assumptions are made on "efficiency savings" through reductions in the number of civil servants and cuts in equipment purchases, utility charges, or fuel bills and
5. reductions are made in transfers to lower-tier governments-- only passes on the problem.

Many of the statements above are true for the state.

Planned expenditure reductions are also not likely to be successful, if they are essentially reliant on administrative actions in the budget execution process, where:

1. they are imposed by the ministry of finance through cutbacks in planned appropriations as it is happening in the state, without the concurrence/ ignoring line departments

2. the appropriations are not themselves changed but ministry of finance undertakes to control total spending within the appropriated sum--for example, through controls in-year on monthly cash allocations to line ministries and
3. they are to be accomplished by creative accounting measures--greater use of suspense accounts, establishment of new or additional extra budgetary funds, etc.

While there are no hard and fast rules about best ways to adjust planned public expenditure, Potter and Diamond suggests some guidelines (1) changes by program and policy, (2) changes by individual ministry, and (3) changes by economic category.

1. *Changes to budget plans by policy or program* is the optimal (though not always achievable) approach. Governments need to use--or develop--mechanisms for identifying the most and least efficient and effective expenditure policies and programs, and target expenditure changes accordingly. It is suggested by the authors that outside such agreed priority (or non priority) areas, the ministry of finance should, in principle assess the costs and benefits of alternative policy packages.

2. *Changes in expenditure plans by an individual ministry* may be considered, for example, where there is lack of information by economic category (see next item). A common variant of this approach is "across-the-board" reductions by ministries, in response to a call for lower than planned expenditures. Each ministry is allowed to decide how to cut a fixed percentage of its planned expenditure. But there are many drawbacks to this approach. Despite the apparent fairness in toto, in reality across-the-board reductions avoid consideration of priorities and leave individual ministries to allocate among line items, resulting in, apart from uncertain economic and social impact potential damage to efficient delivery of services. Often such reductions may be seen as temporary and so line ministries apply them in areas that allow payment arrears to build up.

3. *Changes in expenditure plans by economic category* may have to be made where budgetary pressures emerge at a late stage in budget preparation. Adjustments based on this economic classification enable *economic* analyses of expenditure patterns and prescriptions. Moreover, they can be targeted at wider expenditure policy objectives, such as reducing the wage bill or the number of civil servants, reining in travel costs, or cutting back generalised price subsidies to consumers or subsidies to industry, without caring for priorities between programmes.

Against this background, and with the renewed warning that there are no hard-and-fast rules, budget formulators are best advised to consider the following:

- make any revisions to emerging budget plans as soon as possible (last-minute changes tend to be ineffective)
- seek, as a starting point expenditure changes that are in line with previously agreed decisions or views on expenditure policy priorities--this is especially important where there is room for additional spending
- be sure that cost estimates for new expenditure proposals are realistic and accurate, not just for the year ahead but over the medium term
- be wary of the individual ministry or agency approach, except where this is consistent with pre-agreed policy priorities or to address glaring past failures to exercise proper control
- avoid "across-the-board" cuts
- where expenditure plans need to be scaled back, use reductions by economic category if fundamental policy changes cannot be achieved. The first target should be reductions consistent with the pursuit of outstanding policy goals, and ideally within the context of ongoing wider reforms--for example, measures to reduce number of civil servants or changes in wage policies to improve the alignment of public and private sector wages and
- be cautious in reaching for the obvious but superficial targets, like freezes in new or ongoing public sector capital projects or in public sector wages, or percentage reductions in the purchase of goods and services, unless and until the longer-term damage to the economy or to overall government operations is assessed as bearable.

Having examined the principles of budget preparation and the precautions to be taken during course budget preparation, it is equally important to implement what is envisaged and mapped in the budget documents for which the legislature has given the mandate. Some of the principles that need to be followed are noted below.

III.8 Budget Execution

For fiscal economists, the key issues on budget execution are always whether deficit targets are likely to be met, and whether any budget adjustments (both on revenue and expenditure) agreed at the preparation stage (or in-year) are being implemented as planned. On the expenditure side of

the budget, key issues are whether the outturn is likely to be within the budget , whether any changes in expenditure priorities (as against past patterns) are being implemented in specific areas as planned, and whether any issues are being encountered in budget execution- for example, build-up of payment arrears.

Hence fiscal economists have to go deep and understand weaknesses in the process of execution of the state budget. The first issue is transparency and accountability. Accuracy in information on execution of the budget and its timeliness and reliability are also equally important. Based on this understanding, it is desirable to explore areas where issues are likely to arise, and initiate measures to avoid such contingencies. In some instances, action may be needed through budget execution procedures to bring expenditures back on track to the budget provision, hold expenditures below budget, in response to below-target revenue collection or bring irregularities to the attention of the decision makers.

Thus, for fiscal economists and general budget advisors, the key questions can be summarised under the following categories. The first is the different stages of budget execution, followed by the responsibility. The next is the issue of budget appropriations in a year and the fourth is the information on outturn of expenditure. Issues encountered by the functionaries at the time of execution and its remedial measures are the next to be looked into. Adjustments of expenditure and governance issues are also pertinent at the time of execution of the budget.

IMF guideline (1999) also cautions that although some revisions and appropriations are necessary and desirable in many states and in many circumstances, excessive switching of budgetary provision between items of expenditure (virement) and excessive use of supplementary estimates cause difficulties, *and usually indicates a lack of budget discipline which has serious reflections on the economy.*

Further excessive ‘virement’ is linked to the issue of too great a use of supplementary estimates. Essentially a supplementary estimate is necessary under the law in most systems if expenditure on a line item is to exceed the amount provided for in the budget appropriation approved by legislature and the necessary additional amount cannot be accommodated by ‘virement’. *The basic principle, of course, is that supplementary should not be necessary, as long*

as the budget is well prepared and any unexpected spending is covered from a contingency reserve. But, in many states supplementary budget does arise to regularise the final accounts.

The principles to observe in the use of supplementary budget needs to be strictly adhered to. It has become a practice among some of the departments to raise their outlays consciously during each year as observed in the analysis of state budgets on a time series. In such circumstances it is the responsibility of ministry of finance to exhort line ministries and spending agencies to live within the budget resources allocated to them--the "hard" budget constraint, not giving supplementary too readily but encouraging the switching of resources from lower-priority expenditures to provide for expenditures above budget provision elsewhere, wherever possible during the fiscal year. This seems to be specifically true in the case of departments that execute public works. Spending above provision without an agreed drawing on a contingency reserve, 'virement', or a specific supplementary for that item, is an illegal act that should be subject of disciplinary action. Another question corollary to this is the adequacies in the provision for projects with foreign aid.

III.9 Foreign Aid Management

For many states and countries, the degree of their reliance on external foreign assistance has increased over the years. As long as the donors require separate accounting and banking of their grants and loans, there can be no generalised accounting solutions. In countries highly dependent on foreign aid, the fiscal economist needs to make special efforts to understand how commodity and project aid is handled on a case-by-case basis, so that consolidation of all government expenditures can be achieved. IMF guideline (1999) suggests that states and fiscal economists responsible should encourage government to maintain up-to-date record of both its external liabilities and the timing of foreign inflows. They should also be fully aware of the system of repayment and its scheduling and current status.

III.10 Expenditure adjustments within-year

On executing the budget there can be instances to consider additional expenditure in-year, or may be asked to look at scope for cutting back spending in-year- -for example, when revenue

inflows prove disappointing, as it is happening in the state now. Such schemes for “cutting” expenditures need to be eschewed as they typically involve:

- building up payment arrears
- recording expenditures in suspense accounts
- reductions in cash availability not matched by reduced appropriations and appropriate policy changes to reduce commitments or
- delayed submission of bills (particularly at the end of the year).

They are creative accounting devices that misrepresent and understate economic impact of government sector and often cause financial damage to the private sector. Basic principle must be that, in seeking to introduce expenditure reductions in-year, any attempt to reduce or slow down the rate of spending must be directed toward the commitment stage--that is, before a liability is incurred. It follows that the scope and targeting for such measures is restricted both by timing and by the critical need to alter expenditure policy on discretionary expenditures, so that commitment can be avoided. There are real constraints on the adjustments that can be made to the planned budget during budget execution during the year. Large components of spending--usually termed nondiscretionary--are usually fixed in the short term. These nondiscretionary expenditures include commitments made in prior years that cannot be changed, such as servicing debt, spending mandated by other legislations, such as indexation laws, pension and wage legislation, or other social benefits/ entitlements, wages and salaries for existing employees, and many transfers, like those to other tiers of government.

Thus, any proposed actions need to be carefully crafted, says Potter and Diamond, 1999, and suggest that more imaginative approaches to holding down expenditure can sometimes be found, such as delaying introduction of a planned wage increase or the start date of a new policy, or placing a freeze on hiring or prohibitions on external travel. The key point is that those executing the budget should be encouraged to look for opportunities to pursue pre-existing expenditure policy goals when reductions or increases are to be made. The scope for "consolidating" an in-year emergency action as a new policy in the next year's budget should also be an important consideration.

III.11 Conclusions

A fundamental role for those advising on budgetary matters is to support public sector reforms and policies that promote the efficient use of resources and sustainable economic growth. In recent years, greater awareness of governance issues has focused attention on fostering public sector efficiency, transparency, and accountability. Well-functioning budgetary system ensures accountability and transparency. Each individual shall be held accountable, each action should be properly documented and reported, and each action should be subject to unbiased independent audit, thereby ensuring sound governance practices by the budget advisors. In this context, the following points are important, as a means to foster/ maintain sound governing practices.

Define the government sector clearly and comprehensively. This means not only that central government, state/local governments, and government financial and nonfinancial operations should be separately identifiable, but also that respective roles of the executive, legislative, and judiciary should be clearly defined and widely understood. Also, the true extent of government quasi-fiscal activities and the contingent liabilities of government should be identified and monitored by governments.

View the budget as a complete process. Interference in any one element of the budget process may have repercussions on the system as a whole.

Adjust spending at the earliest stage possible. Indeed, the aim should be to have inputs at the policymaking stage of budget preparation, when existing expenditure policies are confirmed, or new policies adopted.

Minimise disruptions to the expenditure process. The budget system fulfils more functions than that of ensuring macroeconomic stability. Its original function is to ensure compliance with the budget appropriation law, the basis of sound governance. The budget system needs to promote efficient allocation of resources among programs, effectiveness of government operations, and efficient financial management of government resources. Care must be taken, therefore, that stabilisation objectives are not pursued at the expense of other objectives.

Respect the budget system's internal and external controls. At each stage of the expenditure process there are controls in place. In periods of fiscal stress there is a tendency to bypass regular

budgetary procedures and circumvent controls. Often the result is an increase in corruption. This can have macroeconomic impact and may be indicative of limited commitment to adjustment and reform

Poor governance can undermine fiscal adjustment. Governance issues affect the ability to deliver fiscal objectives. Countries successful in fiscal reform initiated the process by adoption of sound public expenditure management system or began their effort improving a deficient one, says IMF (IMF, 1997).

III.12.Current practice- Need for reforms in Rationalisation of Expenditure

Matters concerning the country as a whole such as control over currency, coinage, defense, international affairs etc. are responsibilities of the Central Government, while the States bear the main responsibility to deliver public services that are of more immediate concern to the people, like public order, public health and sanitation, agriculture, water supply and irrigation. The States also have concurrent jurisdiction in several areas like education, electricity, economic and social planning, population control and family planning. ***Powers to levy broad based resources (income tax, corporation tax, customs and excise, GST) are vested in the Centre, while the States can levy a few other taxes with some revenue potential, like duties of excise on liquor, motor vehicle tax and taxes on agricultural land and income. Revenue from state's own sources meet on an average only about fifty to sixty percent of their current expenditure, necessitating transfers from Government of India on a large scale, thereby weakening the Wicksellian connection between spending and taxing decisions and raising the possibility of opportunistic fiscal behaviour among recipient governments.*** These are supplemented with the devolutions of the Finance Commissions from time to time and through borrowings, which too has a limit now.

State finances have certain special features worthy of mention. Despite interventions and participation by the private sector in the health and education sectors government is constrained to continue with higher investments in the sectors to ensure quality of service and access to health and education by all sections of the society, and for inclusive development. Combined with this investments in primary and secondary sectors are considerably less and private participation and investments in these sectors are not adequate to give fillip to the economy, leading to a scenario of heavy expenditure burden on the states despite low level of budgetary resources. Historically, finances of Kerala have gone through large fiscal deficits,

high revenue expenditure and resultant revenue deficits, high debt, and low capital expenditure.

The fiscal stress faced by the state to maintain its achievements in human development and fund capital infrastructure formation given the 'fiscal space' due to rule based fiscal framework is increasingly getting attention. Recent reports of the Kerala Public Expenditure Committee highlighted that revenue led fiscal consolidation is what the state attempts to do. However, volatility of revenue - both of own revenue and devolution of central shares of taxes and grants –remain a matter of concern.

It can be seen that revenue is over projected in the budget to match the expenditure leading to a gap of about Rs15,000 Crore in the budget, even while it is formulated. Study by Shrestha and Chakraborthy (2019) suggests that realistic forecasting of revenue and expenditure is essential for budgeting of any entity. Under estimation of forecasts of budgetary resources can lead to undesirable deficits / debt levels in the economy. Overestimating of the forecasts on the other hand would mean unnecessary surplus which could have been spend for other productive purposes. In cases where the predicted values are under-estimated and the economy runs on a deficit, alternative source of financing these deficits may not be available and can cause problems during execution of the budget. This points to the need for accurate forecasting of governmental revenue and expenditures as pointed out by Allen (1965) and Marshall (1966). Fiscal marksmanship is an exercise to assess forecasting errors in the budgetary system, basically pointing to the magnitude of errors in forecasting and also errors in various components. Results of the analysis shows that the magnitude of fiscal forecasting errors is found relatively higher for tax revenue, which is usually overestimated to plug lapses in resource mobilisation. Source of errors – further decomposed into biasedness, unequal variation and random components - are analysed and results show that the proportion of error due to random component is significantly higher than the systematic bias for all the macro-fiscal variables, except for grants, own revenue (both own tax and own nontax) and capital expenditure. This is also pointed out by Shrestha and Chakraborthy (2019). This finding has policy implications as volatility in intergovernmental transfers can affect the stability of sub-state public finances. Identifying innovative policy tools in strengthening Additional Resource Mobilisation programmes or reduction in public expenditures are significant at least to maintain the current level of growth -inducing capital formation in Kerala.

This continuous persistent pattern of revenue and expenditures affects the growth of the state as savings are not transformed into capital but only to consumption expenditure.

Another development is Government of India considering public account borrowings through TSB to calculate State's borrowing limit at 3 percent of GSDP. Thus, restriction on over borrowing, lower growth rate, increased tendency to launch new schemes on the expenditure side and continued post creation has led to creation of serious financial issues to Government of Kerala. Although creation of posts is a necessity in all governments, specifically in the case of projects of both long and short duration, it is observed that these posts once filled in continues even after completion of the project/ period for which it is created. Annual approvals for continuance are taken up by the implementing agencies for one reason or the other. These expenditures and continuance of posts even after the period for which it is sanctioned leads to heavy burden in the state's financial system.

It needs to be ensured that posts created for projects are discontinued/redeployed once the project is complete. It needs to be enforced that prior sanction is obtained in the current year by the implementing agency for continuation of personnel in the next year. A committee consisting of Heads of Departments, Secretaries of respective administrative departments and Finance department needs to be constituted to review the need for continuance of posts well ahead of the financial year and before formulation of the budget. If need for continuance of posts is not established the personnel needs to be either redeployed to other projects/ similar organisations that require their services or may be terminated.

Onetime works audit needs to be conducted to optimise the number of employees in organisations and departments of the government.

Preparation of Budget is an important function of the Finance Department in all governments (union and state). Perusal of the budgets of Kerala Government in the previous years and analysis by Shreshtra and Chakraborthy (2019), Shyamala Gopinath (2009) Mukherjee S (2019) shows that budget preparation and its execution are not in conformity with principles . Receipts of the state is often overestimated, and expenditure underestimated resulting in widening gap of income and expenditure resulting in adverse comments from watchdog institutions and lead the State to precarious financial situation. Efforts to minimise the gap are nominal among the budget economists, though there are comments from watch dog institutions to do so. Widening gap

between receipts and expenditure and resultant alarming rise in debt needs to be addressed at appropriate level and corrective steps suggested for revival of State's economy.

It is often observed that the present practice of budget preparation has the following deficiencies:

- system of incremental budgeting without any in-built provision for need based analysis of budgetary allocations.

- gap between demand and supply of funds is constantly widening as the rate of growth of expenditure exceeds the rate growth of resources for meeting the expenditure

- expenditure demand is large compared to available resources. Budgets are formulated quite often to meet the demands resulting at least partially in inflated resource estimates.

- realisation of resources falls short of projected estimates and the expenditure targets remain unattainable. This is further exacerbated through cutting short of actual releases by Government of India

- committed liability of unfinished schemes gets carried over to the succeeding financial years, adding more pressure on the limited resources available.

- distribution of limited budgetary resources among large number of schemes with token provision to satisfy demands of political entities and the people also give rise to frittering away of resources without achieving desired results.

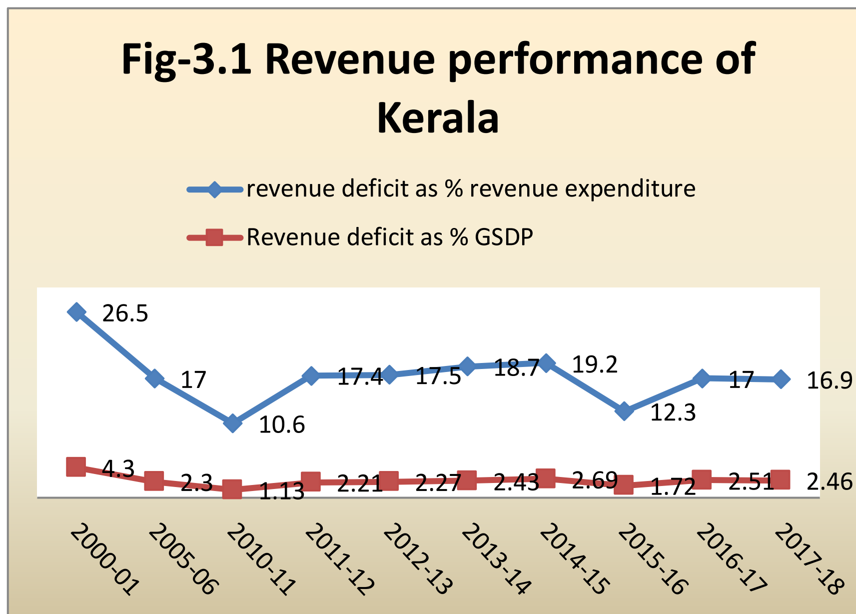
- Although the rules set forth in the Budget Manual is looked in-toto quite often other regulations and international and national norms set forth in the realms of budget preparation are not keenly observed.

Fiscal policy of any government involves the use of budgets – revenues, expenditures, budget balance, and budget financing – to reflect and impact on the macro economic activity. Theoretical writings and experience of other states and countries demonstrates that changes in any of these can

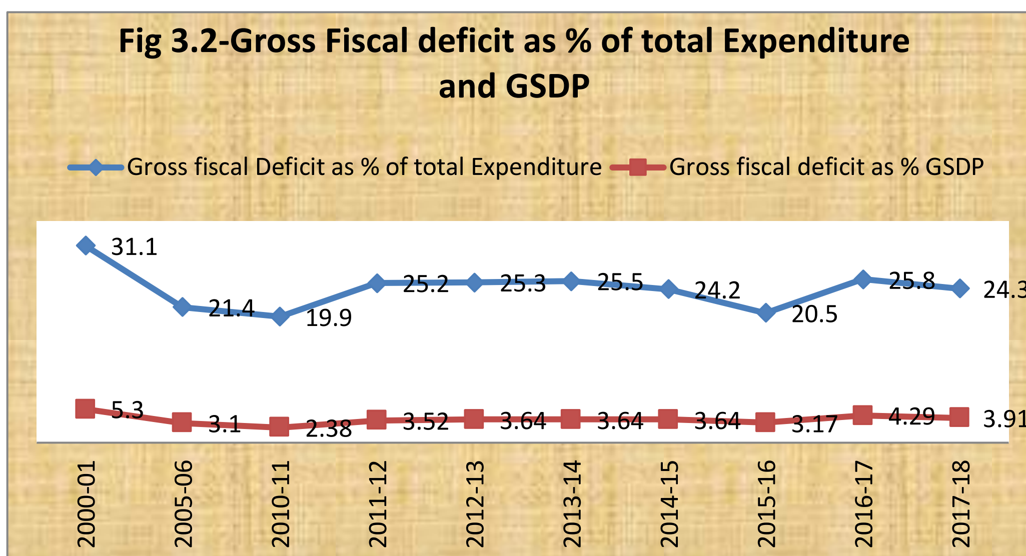
influence the real level of economic activity (Greene, 2018, 2012). In this context it is important to examine each of the components of the budget and bring in reforms for optimal realisation of its benefits to the people.

One of the conventional measures of performance in the macro context is revenue performance over periods. In the absence of long time series data, ARC could analyse only few data points. In Fig 3.1, although the revenue deficit as percentage of revenue expenditure shows some decline from that of 2000-01, it is continuously hovering between 16 to 19 percentage points for almost a decade except in 2015-16. This accumulated deficit is a serious issue in the long run distorting total fiscal balance of the state and contributes to increased unproductive debt. Revenue deficit as percentage of GSDP also show a similar pattern and is hovers between 2 and 3 for the period from 2011-12 to 2017-18.

Serious efforts are required to curtail government expenditures wherever possible or to raise revenue substantially to cope with the recovery of deficit. If not, it is going to be a serious issue in the long run. In this regard it is suggested by Williams that "Actual revenues and expenditures are compared with their budgeted values in the form of variance reports, which aretypically then used by analysts to examine the causes of significant deviations from appropriations based on prior forecasts. As variance analyses are performed midyear, governments need predictions of how much revenue or expenditure to expect within the remaining part of the year." Thus, it is suggested that appropriate analysis and instantaneous corrective measures, if resorted to can save performance of the government.



Another indicator of performance is the gross fiscal deficit as percentage of total expenditure as shown in Fig3. 2. During most of last decade the deficit hovers around 25 percent. These deficits impact the 'fiscal space' of government. Gross fiscal deficit as percentage of GSDP is also on the rise since 2010-11. High fiscal deficit over long periods could imperil savings rate of the state and thereby affect its investments, particularly on infrastructure. It could also lead to outflows from the state economy. These risks, unless carefully addressed can lead the economy to a debt trap.



An important measure that is used to adjudge performance of the state is the 'Primary balance'. Primary fiscal balance is defined as the difference between total revenue and grants, and the total noninterest expenditures. Greene (2018) is of the view that it has two main purposes. By excluding interest payments of the state, it identifies fiscal impact of "new" government activities-activities currently undertaken, without reference to the interest cost from past deficits. Secondly, primary balance turns out to be the crucial variable for determining fiscal sustainability i.e. the ratio of government's debt to GDP is stable or tends to rise. Since primary balance excludes interest payments, it is expected to have some surplus even if the conventional fiscal balance shows deficit. In short, primary balance is expected to show positive balance even if the government has high debt burden and thereby large interest payments. This is analysed in figures 3.3 (a) and 3.3(b).

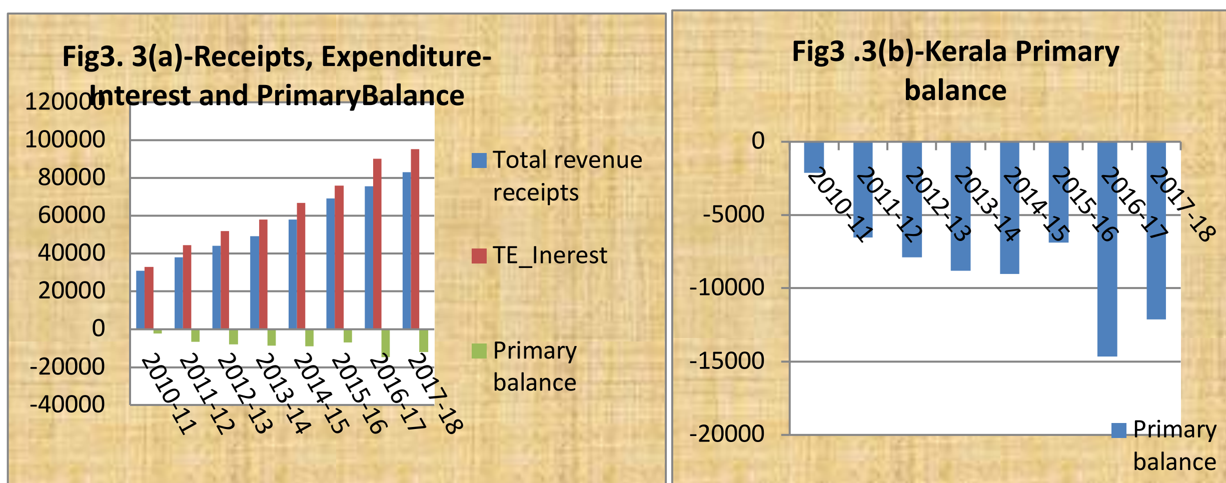


Figure 3. 3 (a) depicts total revenue and total non-interest payments of the state for the period from 2011-12 to 2017-18. For all the years, non interest expenditure is higher than that of the revenue. This shows the fiscal health of the state during the period as depicted in Fig 3.3(a). It is found to be quite precarious as the phenomenon is not for some years but on a continuous series Fig.3.3 (b) also shows that over periods, although short there is phenomenal increase in the deficits and takes a linear negative trend, which is detrimental to the economy at large. Moreover, the primary deficit will be used mainly for consumption rather than for investments. Deficit in primary balance has grown 300 percent over half a decade. This shows that the state has not initiated any measures to either reduce its expenditures to possible extent nor initiated measures to

improve its revenue. Government needs to find ways to immediately plug such lapses, failing which it could be catastrophic to the economy, falling to a debt trap. It is also to be considered that it is not only activities of government but also of its subordinate quasi undertakings that add to the burden.

Greene (2018, 2012) is of the view that apart from regular fiscal activities many economies conduct quasi fiscal operations as part of their budgetary transactions. These are activities that look like regular budgetary programs but take place outside the regular budget, or rather the budget controlling authorities have only limited control over the financial activities of these quasi fiscal entities. Quasi fiscal operations are less transparent than regular budgetary activities and are not subject to normal rules and procedures governing programs in the budget. Thus, they are often having limited control. Since the activities take place off budget and may not be having any limitations. Hence, they are to be considered as quasi fiscal operations. It affects the regular budget of the state as it quite often reduces resources available to the state to conduct its activities.

Fiscal sector of the economy hence comprises of economic activities of government and state owned enterprises as laid down in Greene(2018), Blejer and Cheasty (1991).

Hence another aspect that needs to be considered is the **overall financial burden of the state, or in other words the Public Sector Borrowing Requirement.** Greene (2018) defines it as "the Public sector borrowing requirement combines the conventional fiscal balance with the overall balance of the state enterprise sector: the combined surplus or deficit of state owned non-financial enterprises. Thus, it measures overall financing burden that the public sector imposes on the economy's financial system. "Kerala has around 130 public sector undertakings as on end of 2017" according to the Controller and Auditor General of India with a total investment amounting to Rs 27106.88 crores, by way of share capital contributions and loans. Besides the above many public undertaking has availed grants in aid from the government from time to time, for the last 3 years alone it amounts to Rs 5007. 68 crores. An additional guarantee commitment to the tune of Rs 7549.92 crores also exist at the end of March 2017 in respect of these public sector undertakings, according to the CAG report. Bearing such huge burden from these public sector undertaking adds to the load on the fiscal system of the state. This is measured in figure 3.4.

Overall financial burden for the state, from budgetary sources and through public sector undertakings together is Rs 28603.17 crore in 2016-17. From the figure shown below it can be

observed that financial burden is on the rise from 2010-11 onwards. While it was of Rs 7260 during 2010-11 it reached to 28603 during 2016-17, a rise of 400 percent over a period of 5 years.

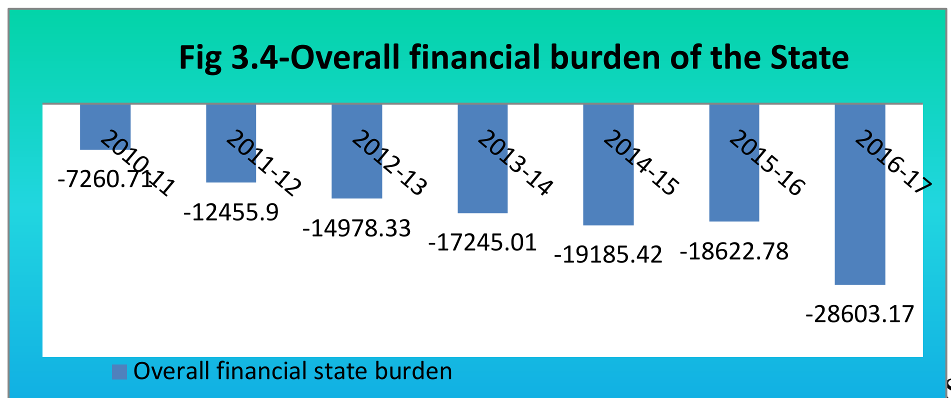


Fig 3.4-Overall financial burden of the State

S

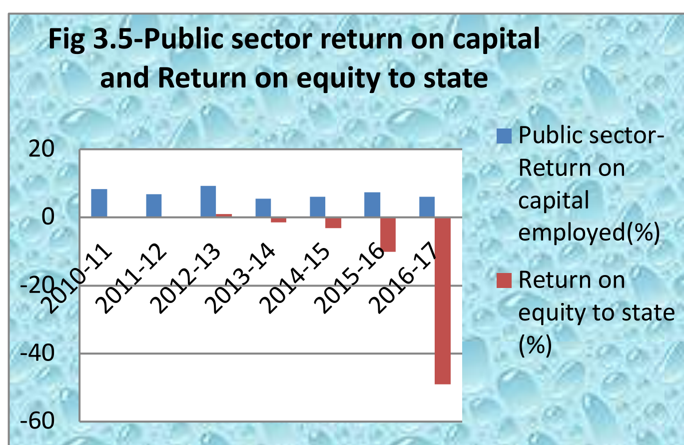
CAG and many of the Expenditure commissions have from time to time pointed out the risks of allowing the financial burden to continue without addressing the issues that cause it. Investments in public enterprises are intended to contribute to the state from its profits, but the contrary happens.

In this connection it is suggested that an analysis of the functioning of public sector undertakings needs to be done. Based on the analysis restructuring/reengineering of the undertakings shall be taken up. Possible options including infusion of private capital through public-private participation shall be considered. Many of these undertakings are maintained by the state to prevent job loss. Negotiations shall include take over with the employees. Government needs to invest in reskilling employees for improving productivity and employability. Options including benefits of voluntary retirement and employment to children/relatives also need to be considered. Enterprises that can be privatised maybe opened up for private investment.

Another major issue faced by these undertakings is inadequacies in technical efficiency and obsolescence of plant and machinery. Wherever technology infusion/replacement with modern machinery can assist in improving their functioning, government may make one time investment for adoption of technology/ replacement of plant and machinery and provide necessary skills to the employees to handle it. Government also needs to give autonomy to the enterprises in taking business decisions. These steps can assist the state in reducing its debt burden and savings can be channelised for development purposes.

Figure 3.5 depict return accrued to government from investments in public sector enterprises from 2010-11 to 2016-17. Both Public sector returns on capital employed and return on equity by the state is analysed. The figure shows a declining trend, in percentages of return on the capital employed signifying inefficiencies in governmental production process. Return on equity is negative from 2013-14 and has increased manifold in the last 2-3 years.

The scenarios cited, has led the state to a situation of finding resources for day to day management of finances and for developmental purposes from time to time. One possible source is to incur debt and find resources to finance and the other is to raise resources through extra budgetary sources of finance.

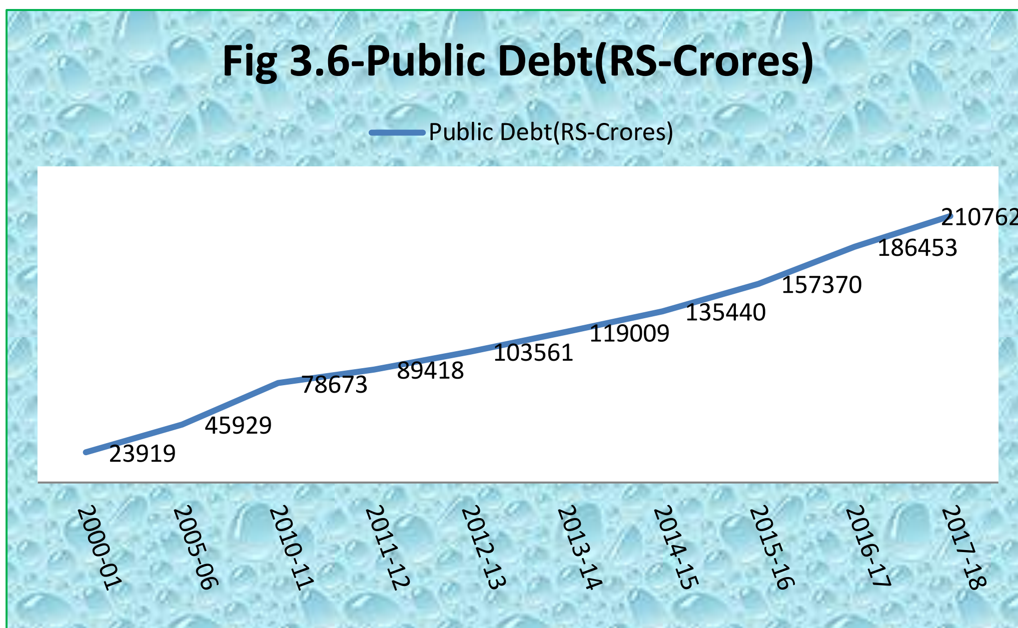


III.13 Debt Management and Servicing of Debt

In the absence of adequate resources from its revenue sources, Government resort to borrowing funds in order to enable execution of projects. It could be observed that a part of the debt of the state is incurred to meet even revenue expenditure, in the context of revenue deficiency. If done prudently, borrowed funds can foster development of the economy. But most often, borrowed funds are spent on projects/schemes without direct returns or economic impact. This would overburden the state in the long run and eventually cripple the economy. Recent studies by Lakshmanan Liji(2018) using scientific analysis for the periods from 1980-

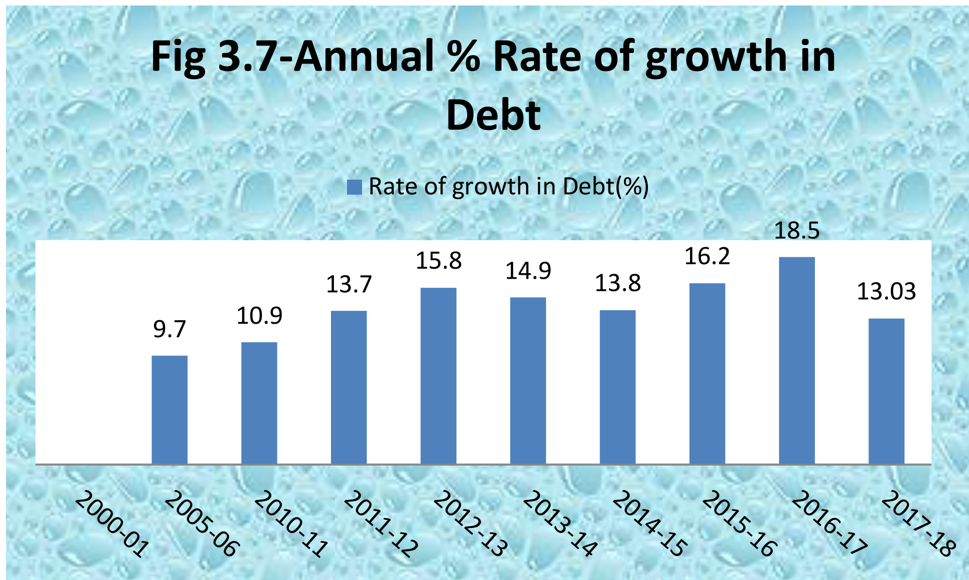
81 to 2016-17 shows that public debt of the state will be insolvent if the present trend continues. This finding needs to be given the attention it deserves as it is based on sufficient empirical evidence.

Public debt of the state is for the periods 2000-01 to 2017-18 in Fig 3.6 is as given in audit reports of CAG. It can be seen that public debt has risen rapidly over the period from Rs 23919 crores to 210762.crores and during 2017-18 to almost 18.5 percent whereas growth over a period of almost half a decade is at the rate of half of that i.e. 9.7 percent. Rise of annual growth in Public debt over years itself shows that successive governments have not taken any measures to contain/manage or reduce debt. Although this report is not venturing to explore the reasons, it is evident from the analysis that it is partly lapses in revenue resources mobilisation that widens the gap and partly untoward subsidies, which do not enhance welfare.

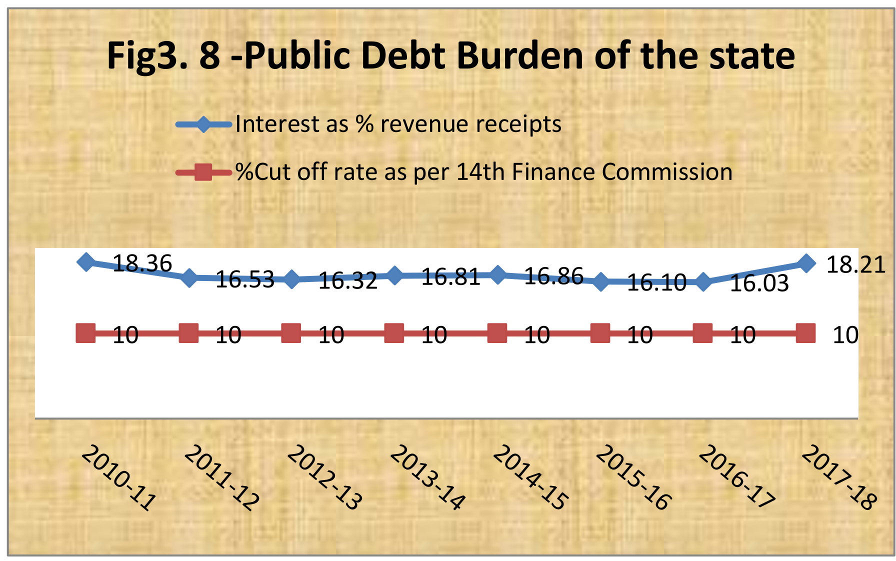


It may be seen that the trends in the rate of growth in debt (Fig 3.7) was less than 10 percent on an average during the decade from 2000-01 to 2010, whereas from 2010-11 onwards it began to increase and has overshot the trend in previous years by a wide margin. Interestingly

despite recommendations of the 14th Finance commission no effort is seen to be taken by government to check the debt situation.



Fourteenth Finance Commission evolved strategy for the states based on few criteria to make them eligible for extra borrowing. These include zero revenue deficits, fiscal deficit – GSDP ratio at 3 percent, public debt-GSDP ratio at 25 percent and interest payments-revenue receipts ratio at 10 percent. Kerala has not been able to meet all the criteria for extra-borrowing powers permitted by the Fourteenth Finance Commission. The point to be noted here is that the States which have cleared all four criteria and are eligible for extra-borrowing requirements have also not availed that provision and prefer to get "over-adjusted" to the fiscal rules at the cost of capital expenditure. 14th Finance Commission recommendation as stated supra is that interest payments of the state should be less than or equal to 10 percent of total revenue of the state to qualify for borrowings. The status of Kerala from 2010-11 to 2017-18 is shown in figure 3.8.



It can be seen that the percentage of interest payments are invariably on the higher side than the stipulated mark of the finance commission for all the years from 2010-11 and is at its peak during 2017-18. It also shows that the percentage of interest burden to that of total revenue is invariably higher to the tune of more than 50 percent of the level prescribed by the finance commission. The state has already borrowed more funds than it can afford, and any additional borrowing can result in debt insolvency. It also needs to be noted that it is the burden of direct borrowings of the state alone, if other borrowings of public sector undertakings and that of extra budgetary financial institutions are added it will go up further.

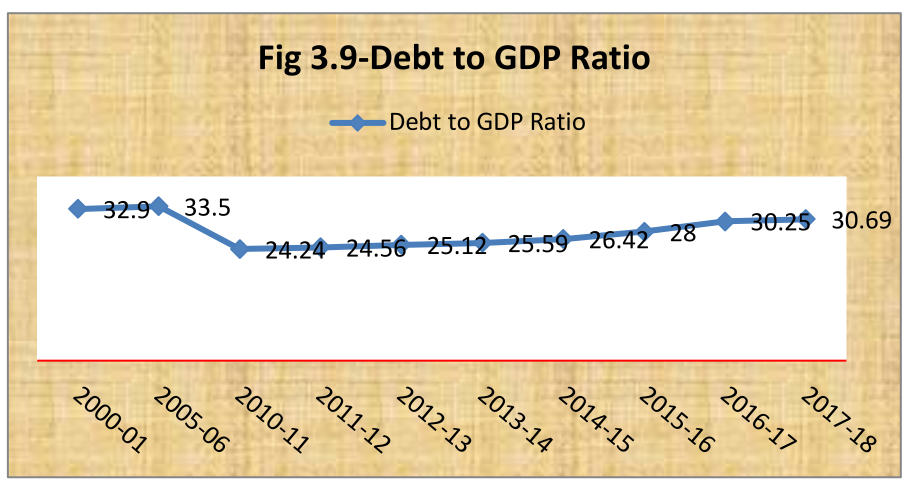


Fig 3.9 shows the debt to GDP ratio from 2000-01 to 2017-18. It shows that although the ratio was higher than the normality fixed by the finance commission up to the period 2010-11, earnest efforts are made to bring it down to 25 percent in the subsequent two years, but it began to rise gradually since then to reach almost 31 percent during the end of the period, around 6 percent higher than the stipulated mark.

Another aspect i.e. the ratio of Public debt to own tax revenue of the state is examined. This is depicted in figure 3.10 below.

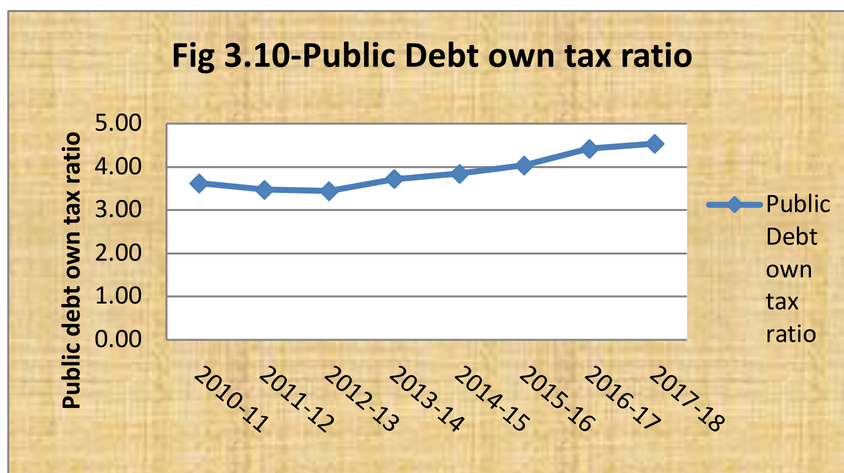
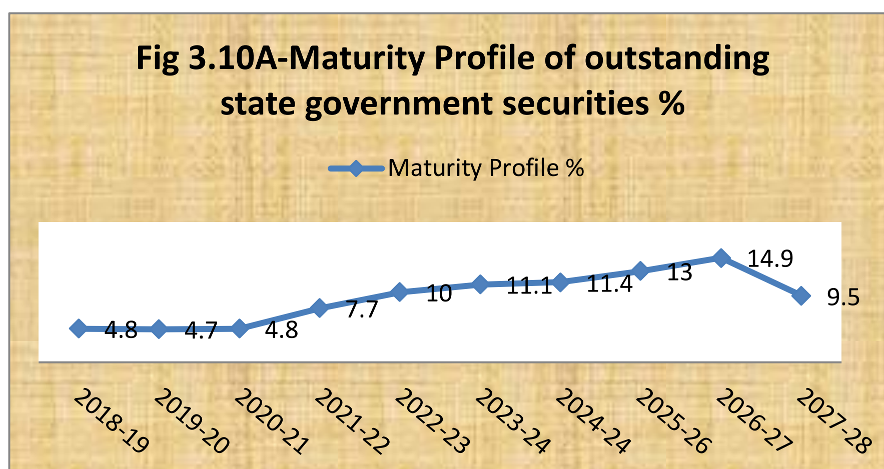


Fig 3.10 revels that this aspect also is not favourable to the state. The ratio gap is widening over the years from 2010-11 to 2017-18, indicating that both aspects need to be monitored carefully. The current trend is that the gap is widening.

An examination of the future debt burden and repayment schedules makes debt management more cumbersome. An analysis of debt pattern of scheduling maturity of securities is analysed and is shown in figure 3.10 A.



The figures reveal that an imminent peril is waiting to strike the economy in the near future- from 2021-22 onwards unless suitable measures are adopted for revenue enhancement. The state government is obliged to pay back the securities on a higher, almost double the rate than at present from 2021-22 onwards, affecting the resources and will be left with meagre resources to finance development expenditure.

Considering all these aspects the government needs to take urgent measures to increase revenue and limit debt for productive purposes. So far debt burden is not having a high negative impact on growth of the economy possibly due to the high rate of inflow of remittances to the economy from migrant workers, keeping the demand for commodities, and savings, on a higher level. But the scenario is changing gradually and may be accelerated in the coming years. The impact of lock down/restrictions implemented to contain COVID-19 is yet to be assessed. A move to chaos needs to be feared/expected.

Throughout history poorly structured debt portfolios, in terms of maturity, currency, or interest rate composition, and large contingent liabilities are important factors in inducing or generating economic crises in many countries. For example, irrespective of exchange rate regime, or whether domestic or foreign currency debt is involved, crises have often arisen because of an excessive focus by governments on possible cost savings associated with short-term or floating rate debt. Issuance of large volumes of such debt instruments has left government budgets seriously exposed to changing growth and financial market conditions, including changes in the country's creditworthiness, when the debt has to be refinanced. Excessive reliance on foreign currency debt poses particular risks as it can lead to exchange rate and/or monetary pressures if

investors become reluctant to refinance government debt. Reducing the risk of government's own debt portfolio will become a source of instability for the private sector. Prudent management of government, along with sound policies for managing contingent liabilities, can make nations/ sub nations less susceptible to the contagion of financial risk. A debt portfolio that is robust against shocks enables government in to manage financial crisis effectively. It is an issue of serious concern that Kerala, at present does not satisfy many of the conditions for debt sustainability.

Government needs to conduct an in-depth study of its debt and rate of interest including debts of public undertakings for which the government has given guarantees, and appropriate measures evolved to reduce spending of borrowed funds for revenue expenditures as it may not yield any return.

Debt profile of the state needs to be developed and updated regularly. The state needs to have forecasts of its borrowing and repayment calendar for short term and long term. It should also monitor and keep watch of repayments of public sector undertakings for which it has stood guarantee.

The unforeseen growth in public debt combined with continuous unhealthy performance of public undertakings exacerbate debt trap of the economy and seems to be dangerous. Measures suggested by various studies and in this report, for enhancing/improving nontax revenues and tax revenues needs to be implemented to enable the economy to escape from debt trap.

On this point it is worth mentioning the paper by Issac and Mohan (2016), which suggest that fiscal consolidation in the state is possible. They opine that "…we intend that the state should be more fiscally empowered to intervene in social sector, by raising more own tax revenue as well as its ability to use borrowed funds mainly for capital outlay."

Issac and Mohan (2016) further suggest that the state is bearing the burden of past public intervention. They go on saying that "Instead of a reversal of the role of the state, fiscal consolidation has to be revenue led by intensive tapping of own revenue potential and increasing capital outlay substantially so that further economic growth generates more revenue in a self sustaining process". There are many areas and services where previous investments have not yielded any returns. Take the case of drinking water supply in the urban areas of the state. Though borrowed capital is invested in the sector there is no functional regulatory mechanism to fix the water charges or to measure the efficiency and productivity of the system. Similar is the case with Sewerage, irrigation, and road to a great extent.

By constituting a regulatory mechanism appropriate scientific methods can be adopted with appropriate rates so that resources can be generated to finance the loan and interest. Another area is improvement in the standards and quality of education and appropriate pricing for the institutions. There are many similar areas that require careful attention to make revenue consolidation (Pushpangadan and Murugan, 1994, 1998, 2008 and Brown and Silby, 1986).

Analysis of some data on the return from investments that the government has made in the past on public sector undertakings also gives a grim picture. This is shown in the figure below. Percentage of return on investments is indicated in the first bar of Y axis and corresponding percentage of average interest is shown in the second bar. It needs to be emphasised that for the period from 2012-13 to 2016-17 the total percentage of interest payments are far higher than the returns received from the investments. Percentage of net losses is indicated in the bars below 0. The losses are invariably on the higher side.

These findings bring out the need to focus on investments by government and the need to address the question whether government should venture into investments that are not economically or socially productive. Most of these investments are in government owned enterprises, and those too using borrowed funds. If at all government has to invest in such ventures prior cost benefit analysis of the investments shall be carried out and only if the economic Internal Rate of Return is at least greater than 9 to 10 percent government should venture into it. As suggested earlier it is high time to arrive at decisions to either promote public private participation in such enterprises or decision taken to on unbundling of these units to the private sector. Although the percentage of loss is hovering around - 5.5 percent the effective monitory loss runs to crores with benefit to none.

In Fig.3.11 total expenditure and capital expenditure of the state is analysed. It may be noticed that total expenditure is on the rise over the years at a rapid pace as shown in the Fig. But capital expenditure and its pattern is more or less is crawling up to the fifth year and from the fifth year on wards marginal increase is visible for the next two years but came down in the terminal year. The pattern depicted in the graph shows that only a small fraction of the total expenditure is capitalised or in other words real investments are very low.

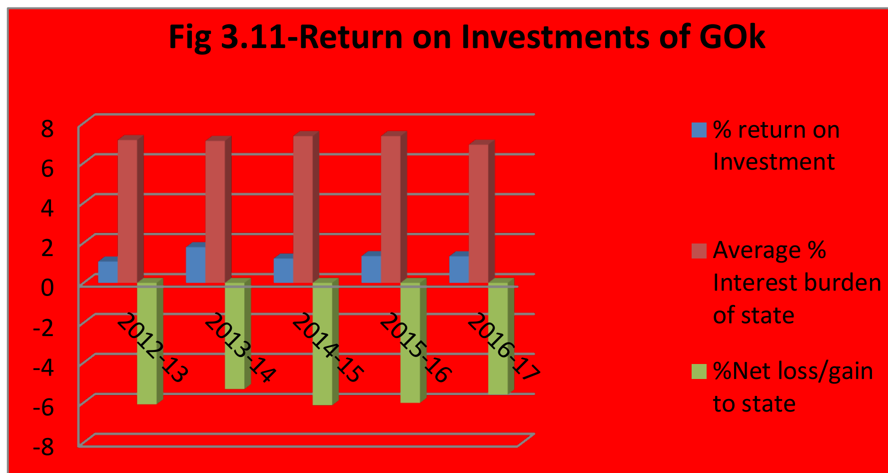
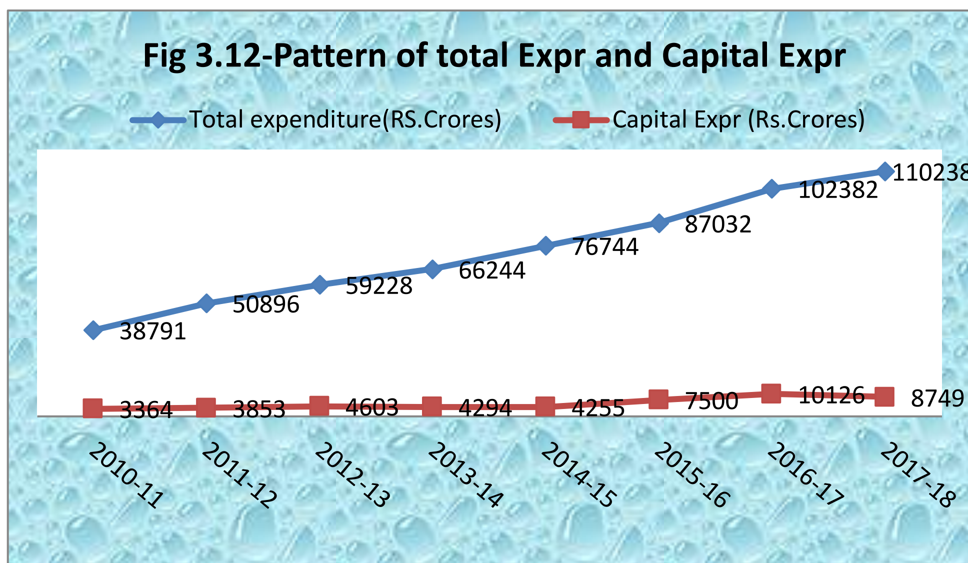


Fig 3.12 shows the percentage of capitalization from total expenditure of the state from 2010-11 to 2017-18. Although total expenditure was on the rise percentage of capitalisation fell during the period, except in two years, showing that a large percentage is flowing towards unproductive expenditures. This is an alarming situation that needs to be studied by the administrators and budget economists. This is all the more important in a context where private investments and investment by migrants are not taking place at a fast pace and even remittance flow is likely to decline as seen in the recent past.



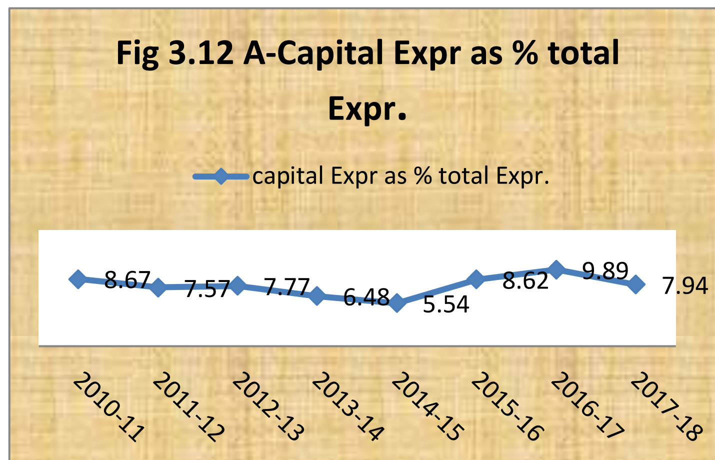


Fig 3.12 A-Capital Expr as % total Expr.

This is further explored in the Fig3.12A .The graph ascertains growth pattern of these expenditures. Growth rate in total expenditure does not exhibit much of an increase over periods except at the beginning. This suggests that after adjusting for inflation there is no significant increase in total spending of the state, rather it was almost on a constant pace. The rate of growth in capital expenditure shows an oscillating trend. It shows some growth only in two years, whereas it has more of negative growth for three years- less than 0 percent.

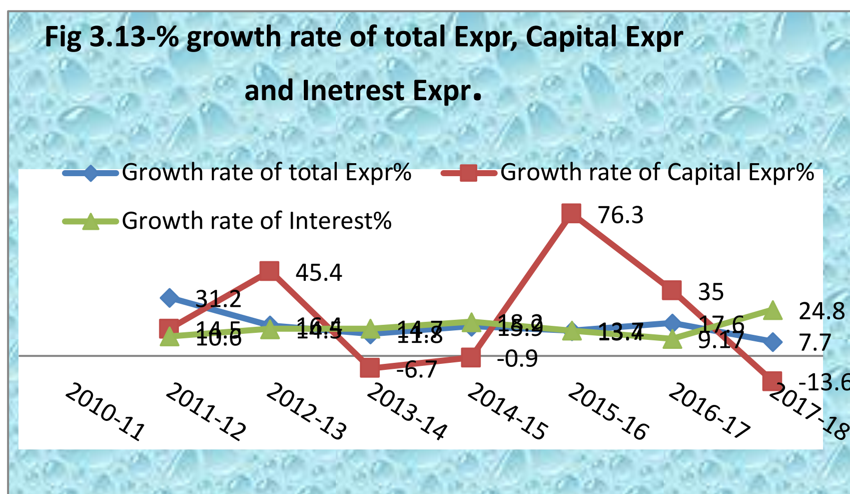


Fig 3.13-% growth rate of total Expr, Capital Expr and Inetrest Expr.

This peculiar phenomena call for specific analysis on the underlying factors that led to negative trend in capital investments. However, rate of growth of interest expenditures is on the rise, except in the pre terminal year, followed by a jump in the terminal year. This peculiar behavior of interest shows that borrowed funds are available but is not being utilised for capitalisation in the state which is a serious lapse, when options for resource generation exist. It could also be because of the loading of interests accrued from previous borrowings.

This calls for gradual easing out of the state from more investments in public sector undertakings, and the need for a regulatory mechanism that can device and implements rate structures and rationalise revenue for many of the public utilities.

All these lead to a situation of revenue deficits and fiscal deficits in the state. States borrowing limits also have saturated owing to the BMRA and simultaneously revenue expenditures of the State has surpassed revenue receipts, as can be seen from the fig 3.14. On an average, during each year, between 2 to 3 percent of expenditure is incurred above revenue of the year. When accumulated this overburdens the debt position of the state and weakens developmental activities.

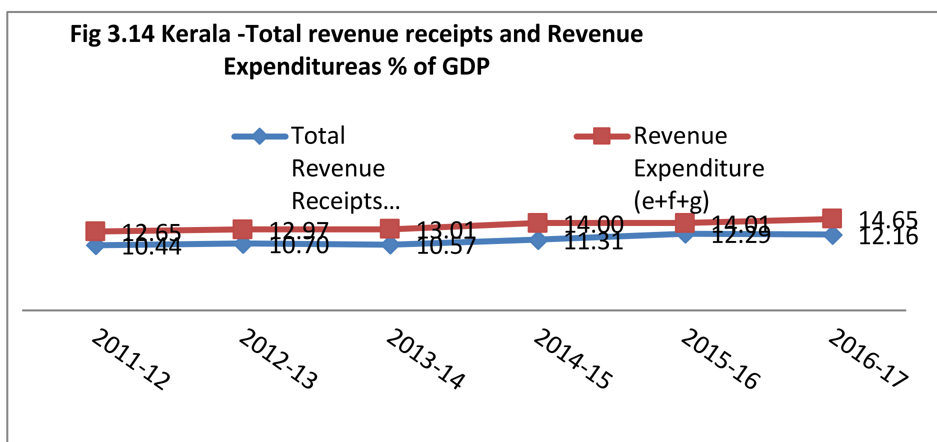


Fig 3.14 Kerala -Total revenue receipts and Revenue Expenditureas % of GDP

Almost throughout the decade revenue expenditures surpass revenue receipts, forcing government to borrow from time to time and meet revenue expenditure, leaving less room for utilising borrowed funds for capitalisation and at the same time pay interest and principal. These factors forced government to find alternatives for financing capital expenditure through extra budgetary finances as laid down by IMF (2006).

III.14 Extra Budgetary Finance (EBF)

Extra budgetary funds should be assessed against the three key levels of good public financial management - fiscal discipline (overall expenditure control), allocation of resources consistent with policy priorities (strategic allocation of resources), and good operational and cash management of expenditure (economy, efficiency, and effectiveness). IMF's Guidelines for Public Expenditure Management summarises the potential drawbacks of EBFs as follows: "EBFs can

result in a loss of aggregate expenditure control, because such expenditure may be outside the control of the ministry of finance; EBFs can distort the allocation of resources by circumventing the budget process and review of priorities; earmarked revenues can become entrenched so funding is no longer based on priority needs; less transparency may lead to inefficiency and/or misuse of funds; EBFs can facilitate rent-seeking and abuse of monopoly power; and EBFs are incompatible with good cash management practices." These issues, however, may often be mitigated by appropriate features in the design of EBFs and by establishing a strong interface between these bodies and the budget process. Extra budgetary funds are also sometimes associated with the dilution of accountability and control, problems in reporting and consolidating fiscal data, diversion of limited administrative capacity and restrictions on modifying taxes that are earmarked for financing EBFs.

It is recommended that the central and state governments need to make full disclosure of extra budgetary borrowings. Outstanding extra-budgetary liabilities need to be clearly identified and eliminated in a time-bound manner.

III.15 Need for a realistic budget and measures to achieve this goal

Budget preparation is essentially preceded by a resource estimation exercise. Reasonable balance between inflow and outflow of funds has to be ensured to maintain stability and economic development. Hence, realistic assessment of available resources and prioritisation of expenditure are essential pre-requisites for realistic budgeting. The basic paradigms in which a budget becomes ideal is explained in the earlier chapter. It should ideally be comprehensive, transparent, and realistic in the best possible way. Budget economists needs to make sincere efforts to satisfy the conditions put forth and explained earlier to make the budget of the state a true reflection of the policy of the government and of the resources available to government and what is the optimal allocation that the government desires to make within the given resources.

From a review of the budget estimates *vis-a-vis* accounts for the past few years, one could easily find that variation between the budget estimates and the actual for the respective year are substantial, indicating unrealistic projection of estimates of both receipts and expenditure as enunciated by Shreshta and Chakraborthy.

Hence it is again reiterated that ***Projection of budget estimates of both resources and expenditure requires a more systematic approach, to ensure sanctity and accuracy of budget. Projection of revised estimates needs to be as close as possible with the actual as a monitoring system of expenditures already exists in the state.***

III.16 Resources of the State Government

Revenue receipts and Capital receipts constitute the two streams of resources of the state. Of these Revenue Receipts consist of the state's own tax and non-tax revenues, share of central taxes and grants-in-aid from the Centre. Capital Receipts include Debt and Non-Debt receipts. Debt receipts consist of loans raised by the state from various sources (such as open market borrowings and loans from financial institutions) and loans received from Government of

Table 3.2

Total Revenue Receipts (Rs Crores) and growth of Revenue from different sources in Kerala

Year	Own tax	Growth rate of own tax%	Non tax revenue	Growth rate of Non tax%	Central tax transfer	Growth in Central tax transfer %	grant in aid	Growth in Grand in aid %	Total revenue receipts	Growth in total revenue %
2010-11	21722		1931		5142		2196		30991	
2011-12	25719	18.4	2592	34.2	5990	16.5	3709	68.9	38010	22.6
2012-13	30077	16.9	4198	62	6841	14.2	3021	-18.5	44137	16.1
2013-14	31995	6.4	5575	32.8	7469	9.2	4138	37	49177	11.4
2014-15	35232	10.1	7284	30.7	7926	6.1	7508	81.4	57950	17.8
2015-16	38995	10.7	8426	15.7	12691	60.1	8921	18.8	69033	19.1
2016-17	42177	8.2	9700	15.1	15225	19.9	8510	-4.6	75612	9.5
2017-18	46459	10.1	11199	15.4	16833	10.6	8528	0.2	83020	9.8

Source: Computed by the author

India. Non-Debt receipts include Miscellaneous Capital Receipts and recoveries against loans advanced. Balances available in the Public Account after disbursement is also utilised by the Government to finance its deficit.

Though the quantum of Revenue Receipts of the state has increased over the years, state's own receipts as a percentage of total receipts show a declining trend, more so in tax revenue. The rate of growth of own tax revenue does not show any increase, rather it has reduced to almost half by the end of 2017-18. Rate of growth in non tax revenue hovered around 30 percent till the end of 2014-15 but has halved during the subsequent period. Growth in the central tax transfer also show a dismal picture since it is quite volatile and cyclical in nature. Similar is the nature of grand in aid from the centre. It is almost nil during the last two years of the analysis and is negative in some years. As the share of central taxes and grants-in-aid is determined on the basis of the recommendations of Central Finance Commission, the state's performance in resource mobilisation is assessed in terms of own tax and non-tax revenue. In effect the growth in total revenue itself is less than half of that of 2011-12, leading the state to a precarious fiscal situation.

The state's own Tax Revenue as percentage of GSDP has dropped from 7.06 percent in 2011-12 to 6.77 percent in 2017-18. Taxes on sales, trade etc. was the single largest source of the state's own tax revenue all along. Post-GST introduction, states do not have much room for manoeuvring tax rates, as these are decided at the level of GST Council, in which the Centre plays the dominant role. Moreover, tax bases as well as tax rates of several items have undergone downward revision since introduction of GST. State Government needs to initiate urgent measures to maximise tax collection through widening of tax base, plugging tax leakages and scaling up tax compliance.

Augmenting resources from Non-tax Revenue is another area which calls for focused attention from State Government. Identification of new avenues of non-tax revenue, periodical revision of rates of user fees etc. and rationalisation of rates are to be attempted to maximise mobilization of resources from the Non-tax revenue.

III.17 Share of Union Taxes and Grants-in-Aid

As per the recommendation of the Fourteenth Finance Commission, 42 percent of the divisible pool of Union taxes is shared among states, ensuring a reasonable transfer of funds from the Centre. Post-Devolution Revenue Deficit Grant was also passed on to the state governments to cover its Revenue Deficit. This enhanced share was partly offset by reduced outlay on Centrally Sponsored Schemes, lowering the percentage of central support for these schemes. **The 15th Finance Commission** on the other hand has reduced the divisible pool to 41 percent and share of Kerala share is reduced to 0.8 percent from 1.05 percent of 14th FC. Similarly, from the divisible pool the share of 2.5 percent in the 14th FC is reduced to 1.94 percent in the 15th FC. Although revenue deficits grant of Rs. 15323 crores is allocated for the current year there is no indication whether this will be continued in the main report.

Criteria for **Performance-based grants laid down by the 15th Finance Commission include**: (i) implementation of agricultural reforms, (ii) development of aspirational districts and blocks, (iii) power sector reforms, (iv)Enhancing trade including exports, (v) incentives for education, and (vi) promotion of domestic and international tourism. The grant amount will be provided in the final report. The state can have only limited hope on favourable use of the criteria. In all probability the share is likely to fall.

Resource mobilisation under Centrally Sponsored Schemes needs to be carried out more systematically under a centralised mechanism. Efforts shall be made for tapping maximum central assistance for Centrally Sponsored Schemes by proper designing of the schemes adhering to Government of India guidelines and through regular follow-up and timely submission of utilisation certificates etc.

As there is strict restriction on borrowings, the state is compelled to incur expenditure by setting priorities, with the limited resources available with it. A sizeable amount of funds is necessarily to be spent on committed expenditure, the allocable funds for Plan schemes should be utilised in a very sensible manner. Also, there are certain non-plan schemes continuing unnecessarily for long without any result. This should also be taken into account while incurring expenditure.

A resource envelope indicating the size of allocable resources needs to be intimated to each spending department in advance to enable them formulate realistic projections of expenditure after proper prioritisation of programmes.

Balance between developmental and non-developmental expenditure needs to be attempted as part of annual budget exercise. Obsolete non-plan schemes that are continuing for long needs to be closed to ensure better quality of expenditure. There shall be a provision for evaluation of plan schemes with less than 30 percent expenditure for the last 3 to 5 years. However, relevance of such schemes needs to be evaluated.

Critical review of functions of organisations in the same sector or field, overlapping one another, has to be undertaken by planning authorities. There needs to be clear demarcation of rules and functions of organisations.

Token provisions in the annual budgets should, as far as possible be avoided or be minimal to curb the tendency to increase expenditure during the course of the financial year.

As far as possible, schemes incorporated in the budget should alone be part of the budget speech. New plan schemes having non-plan implications need to be critically evaluated before including in the budget.

Welfare programs implemented by Government needs to be appropriately targeted to ensure that only eligible beneficiaries receive the benefits of such schemes.

III.18 Need for Outcome based Budget System

Reforms in budgetary systems are a key issue in the content of ‘good (enough) governance’ and New Public Management (NPM). The political right's interest in NPM was on using it to get state finances right through different styles in public management, while the good governance theme focuses on budgetary transparency and citizen participation in the budgetary process. Both are driven by an obsession with adopting performance management (PM) in the government sector and moving away from the traditional inputs- to-outputs model towards outcomes in measuring

organisational performance in public budgeting. Outcome based budgeting requires a shift in mindset, from a short term 'outputs' mentality to a medium term focus on economic and social outcomes. Achieving that mindset shift requires strong leadership from parliamentary officeholders/senior executives of government departments to help drive the change. Outcomes are harder to deliver than outputs, and by their nature will be publicly communicated, requiring resolve from leaders to see the transition through. To gain the interest and acceptance of leaders and those involved in the governance of new forms of budget transition from output to outcome, it is necessary that they are aware of the benefits and drawbacks of the system. It also requires a two-way relationship between government and people to make this work. Government will attempt to hold itself to outcomes valued by the public, but the corollary is that the public needs to provide feedback on the utility of outcome based budgeting and allow time for the government to get the concept, and its tracking, right.[29]

Recommendation of the second Administrative Reforms Commission of Government of India (2008), chapter 9 on state finances states that "Efforts aimed at improving the efficiency, responsiveness and accountability of Government organizations have to be complemented by reforms in financial management system in order to deliver the desired outcome." The commission further states that " A paradigm shift from the traditional bottom up approach to budgeting to a top down technique focusing on broader resource allocations as well as on outcomes rather than processes has also been recommended."

The 15th Finance Commission appointed by Government of India, in its terms of reference (item 4 of the terms of reference) and in the recommendations (2019, 2020) re-emphasised by World bank, (2012) and UNCDF (2017) point out the need, and measurement yard sticks to be followed by governments in allocating resources based on outcomes. This shows the need for states to incorporate outcome measures as one of the targets in the formulation and implementation of state budgets. The study by NCAER, indicates deficiencies of the current data base and systems of measurement, and points out the need for collection of relevant data, that can be used for measuring outcomes. Thus, it becomes imperative for states to follow the same principles and criteria of outcomes while it allocates resources to local self-governments.

Outputs do not forge a strong link between government policies (whose purpose is likely to be phrased in terms of outcomes) and their implementation. With output focus, little information is

[29] Outcome budget is completely different from social auditing as laid down in the processes of local self government administration.

obtained or "learned" by the government for subsequent use in formulating policies or examining what programmes are actually accomplish. Outcome-focused management and budgeting brings together organisations involved in policy formulation, policy execution and audit or evaluative institutions, as well as connections between the three. It involves a movement beyond inputs and outputs towards outcomes, concerning a macro analysis of results, accomplishments, and impact. Outcome based budgeting is objective driven, provides accountability, enhances transparency, and is enabled by technology whilst supporting strategic goals of government.

Outcome budget is designed to rise above traditional line item system to define outcomes for all government programmes and is defined by the Ministry of Finance, (2007-08) , "the Outcome Budget is an endeavour of the Government to convert the "Outlays" into "Outcome" by planning the expenditure, fixing appropriate targets, quantifying the deliverables in each scheme and bring to the knowledge of all, the "Outcomes" of the Budget outlays provided for each scheme/programme." Many countries and some states in India have taken up these reforms. Many of the countries and some of the states face significant political, cultural, technical and legal challenges in adopting outcomes-based approach, significant among them are:

- (i) Lack of political ownership
- (ii) Implementing departments and Ministry of Finance approaching outcome based budgeting as a technical, theoretical exercise without due consideration for organisational structure impacts and wider public sector reform, e.g. driving policy through legislation
- (iii) Cultural and technical change required in state budget office and other agencies to move from compliance based management to outcome based management
- (iv) Unpreparedness for the enhanced accountability among line departments
- (v) Poor accounting and IT systems that do not support the reform
- (vi) Poor implementation and unwillingness on the part of the implementing departments to adhere to the principles of outcome budgets, on the fear of pointing out leakages in the system is also another reason for the slow adoption.

In outcome-focused management and budgeting, government defines what a particular programme or function is to achieve in terms of public good, welfare or security, for example, outcomes to reduce the incidence of disease or ensure for most students a certain level of educational attainment or specified standards. Having defined the outcomes, an outcome system

defines indicators to assess how the system performs in achieving these outcomes. In principle, outcome-focused budgeting and management involves greater internalisation of information needed for formulating, implementing and evaluating policies, considering the need to establish linkages between the five elements - costs, inputs, process, outputs, outcomes.

Performance budgeting on the other hand considers the mutual relationship between flow of financial resources and physical targets and thereby reflects organisational structure of the institution implementing the budget. It represents blending of three techniques, - management by objectives (MBO), "financial and cost control" and "physical performance control".

Outcome budget can be seen as an advanced form of budgetary scrutiny, which provide detailed information about progress towards meeting the executive's spending priorities. Outcomes can be seen as benefits resulting from outputs, which correspond to the ultimate aims of a government. For example, the output of health expenditure may be more doctors, number of patients treated or hospitals per geographical units etc. but the outcome of that expenditure may be to improve the overall health of the nation, or improvements in primary health care. Converting outlays into outcomes will require ensuring flow of right amount of money at the right time to the right level with neither delays nor parking of funds and effective monitoring and evaluation systems. Outcome budgeting system requires (1) a strategic plan, 2) an annual performance plan, (3) an annual performance report, and (4) programme evaluation.

Preparation of outcome budget involves –

Defining measurable outcomes,

Standardising unit costs of delivery,

Benchmarking standards,

Capacity building for attaining requisite administrative capacity,

Ensuring necessary funding,

Effective monitoring and evaluation, and

Making the system far more intrusive through the participation of the community and stakeholders.

The diagram shown in Fig 3.15 depicts the model on processes through which resource flows and measuring its effects in the administrative entity. It could be a country, state, district or even a local body and it can be departments within state or local body or country. It can have multi-dimensional and multidirectional flow of resources, processes, outputs, and outcome. In

short one can say that they are canonical in nature as in the case of 'capabilities and functioning' described in Sen (1985, 1986, 1999, 2004).

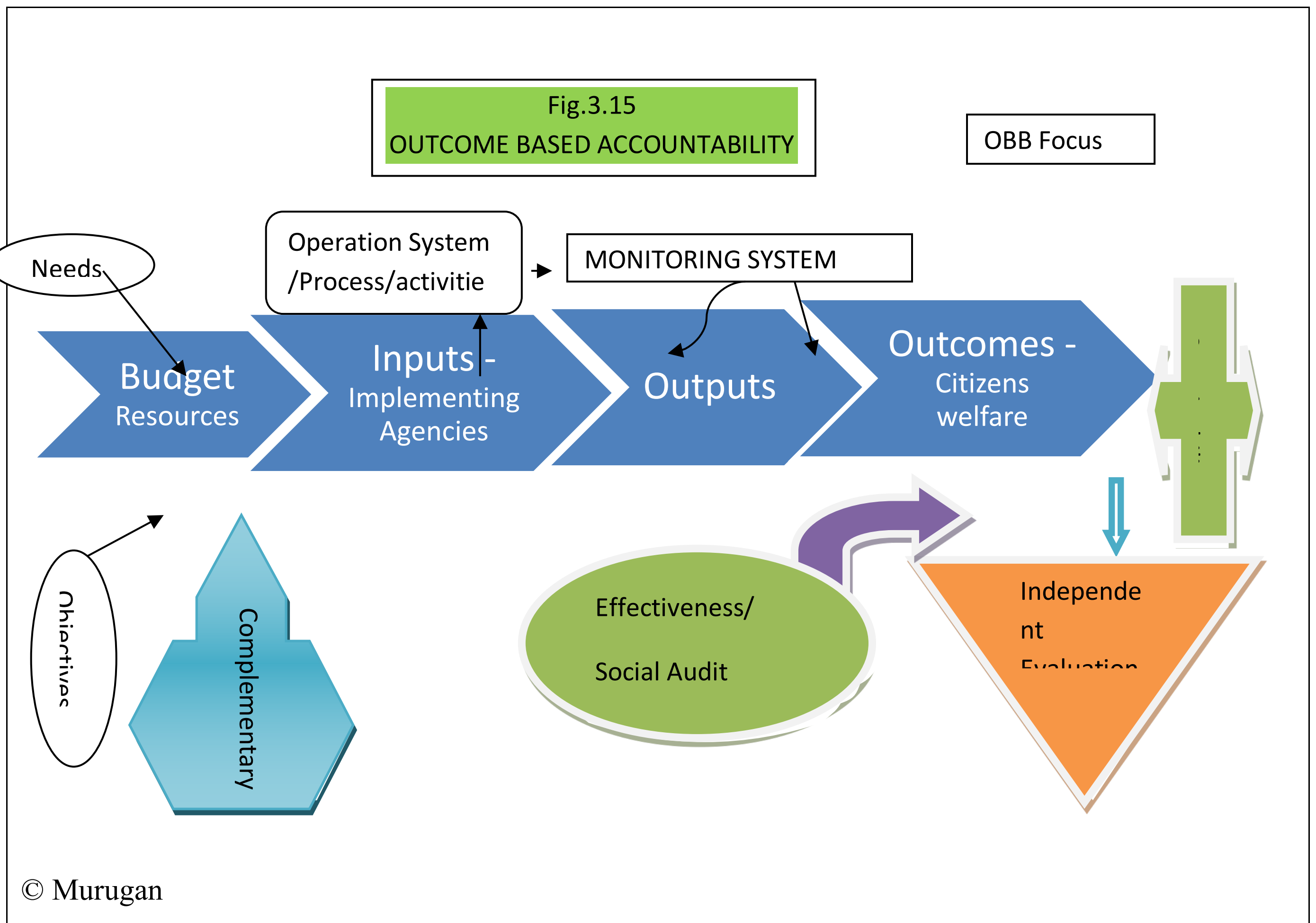
Needs and wants of the people in general and the objectives through which it can be achieved is depicted in stage 1 of the diagram. Many questions need to be answered for the need to have an outcome based budget. The probable questions include, what is the purpose of adopting an outcome-focused approach to management? Is it the government's fiscal outlook? Is it pressure from the public to make the budget more informative? Is it following naturally from observations of the limits of an output approach? Or has the outcome focus become a possible governance option with enhanced availability and decreasing price of information? Synthesis of answers to these questions demonstrates the need and purpose for outcome based budget. It may be right to say it is the interaction of all these that motivate fiscal authorities to decide on following an outcome based approach.

There can be several initiating and driving forces behind outcome-focused management - legislature (through enacting law), executive (utilising internal directives). Outcome-focused management needs to have a legal framework for institutionalising and running it.

During the processes of pre-budget transactions needs of the people is transferred to the representative of the people, whatever level it be and is put before the government for consideration. Government, based on its resources and consensus of views of those involved in the governance process and policies for ensuring welfare and rights of the people places it before democratic institutions for further prioritisation of the needs, commensurate with policies. These considered initiatives is transformed to the policy formulation processes, either making full provision of funds, or channelises funds from multiple sources to the implementing agencies, through the budgetary process. Resource flows supplementary to the budgetary sources may also be channelised to the implementing entities through extra budgetary processes. Usually, only allocation from government is budgeted, the balance flow could be harnessed from other sources supplementary to budget as complementary resources and utilised. These inputs are left to the implementing agencies, using their transfer and operational methods, which are quite often termed as Outlays.

In the long process of conversion of outlays into outcomes, several intermediate stages and complementary resources are required in achieving intended outcomes. Cause and effect chain is not always direct and apart from earmarked outlays the outcomes are influenced by several

environmental factors. Broad understandings of these factors are helpful in finalising the contents of Outcome Budget.



1. **Outlays** imply total financial resources deployed for achieving outcomes. Part of the resources may come directly from Government budget and part may be contributed by other stakeholders like Government of India, Public Sector Undertakings, or even private sector through Public Private Partnerships. *As far as possible, total resource commitment needs to be brought out in the Outcome Budget with clear segregation of State Government budgetary support*. The outlays need to be segregated scheme-wise, covering both Plan/ Non Plan budget (as in the Expenditure Budget Vol II) for the respective financial year in monetary terms. In case of projects (whether Government or parastatal) spanning multi-year time frames, total sanctioned cost of the project and planned annual expenditure needs to be included as both are relevant 'outlays' for effecting linkage with outcomes.

2. **Inputs of Implementing Agencies**: After observing the rules, regulations, and formalities the implementing agencies, depending on the efficiency of the management, and observing processes and activities physically execute the program to benefit the originators of the project.
3. **Monitoring:** The process of implementation needs to be monitored using technology tools, at each stage of financial flow. For each stage of financial flow, be it from budgetary or auxiliary sources, appropriate physical outputs are expected, and it needs to be ensured and measured. Final stage is the expected outputs .Output is one though expenditures are in combination.
4. **Outputs** are a measure of the physical quantity of the goods/services produced through an activity under a scheme or programme. They are usually an intermediate stage between 'outlays' and 'outcomes.' For example, construction/completion of a school building is the 'output', whereas increase in the literacy rate will be the 'final outcome'. Enrolment would be an "intermediate outcome". Similarly, for a social sector programme/scheme, the intermediate results before identifying, measuring, and arriving at the 'final outcome' as per the objectives of the programme/scheme, may be treated as 'output'. The purpose is to capture intermediate 'outputs' before identifying and measuring the 'final outcome'. Now the question is to what extend the expenditures and output are effective and can transform to the outcome process. In effect, it is the impact of the output and expenditure that is measured through the outcome process. There are well defined and conclusive ways through which it is measurable (World Bank, 2016).

Along with the monitoring systems that provide review of the progress of output, it is also desirable to have social audit. It shall be done by observing the principles and guidelines of social audit. Effectiveness of social audit can, to a great extent contributes to the formation of realistic outcomes. Thus, there are also some effective processes and institutions that matter in reaching the desired final outcome of the allocations in the budget.

Another issue in formulation and implementation of outcome budgeting is who defines and approves outcomes. Within the government, it is a synthesis of sharing, who is or should be responsible for defining outcomes and identifying indicators and who gives assurance on quality. It can be collective responsibility through discussions and debates in the legislature, the head of state,

the council of ministers, minister responsible for the programme, programme's executive or manager, government officials, or the outcomes defined jointly by several of these parties and institutions. Once an outcome is defined, there should also be a schedule for subsequent review of outcomes and for its revision or re-affirming. In order to ensure transparency participation or involvement of the people, stakeholders, recipients, users and beneficiaries of a programme needs to be included in the definition of outcome budgeting . If non-governmental organisations are involved, they also need to be included. Another issue is should outcome targets be publicised – and if so how? In order to ensure transparency publicising, public reporting on government's progress and success in achieving the outcomes is a essential.

There are two perceptions of what constitutes an "outcome". For some, an outcome is seen as the intended consequences of government action on society. This is how the Office of Management and Budgeting in the United States use the term. For others, "outcomes" are perceived as the actual impact – whether intended or not. The Department of Finance and Administration in Australia use "outcomes" this way.

III.19 Sustainable Development Goals

According to Brundtland Commission Report (BCR, 1987), "...Sustainable development is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations". Jeffry Sachs (2015) views sustainable development as a means to set off global extreme poverty and should take the challenge of ending it. A realistic achievement of outcomes in all the sectors in the budget can contribute at a faster rate to the achievement of sustainable development goals aimed for 2030. The SDGs call for socially inclusive and environmentally sustainable economic growth. To achieve the economic, social, and environmental objectives of the SDGs, a fourth objective must also be achieved: good governance. Among the core functions of government are the provision of social services such as health care and education; the provision of infrastructure such as roads, ports, and power; the protection of individuals from crime and violence; the promotion of basic science and new technologies; and the implementation of regulations to protect the environment." All these are possible only if the outcomes and output in the budgets are carefully

balanced/adjusted to achieve the goal in a non ad hoc manner, with properly defined aims and objectives to reach the output and outcome in a carefully considered and planned framework and span of time. Output and outcomes can be transformed into sustainable development process only if the objectives are set to reach the outcome.

Government of India has been preparing outcome based budgets since 2006-2007 and guidelines are issued for each budget preparation. A consolidation of these guidelines would be fruitful for the state to make its own guideline for preparation of outcome budget. As Miller, Hildreth, and Rabin (2001, 3) indicate, focus on inputs, outputs, and outcomes, along with citizen participation in assessing and resolving issues of their concern, are the characteristics of outcome budgeting, a potential major budgetary reform of the 21st century.

III.20 Difficulties in the processing and implementation of outcome budgets

There are multiple difficulties associated with outcome budgeting. There are difficulties in measuring outcomes as compared to outputs and ensuring managerial accountability to link funds to outcomes for public programmes. Outcomes could be influenced by many external factors (Shah and Shen, 2007). In addition, establishing a direct link between the level of funding and performance may not be possible due to the role of political concerns and value judgments involved in trade-offs in budgetary decisions (Kelly 2003). Since regular budget presented in the council of ministers is a separate process from ministry wise outcome budgets tabled later in the budget session, relationship between departmental outcome budget and the general budget decisions needs to be strengthened to improve performance orientation of the budgeting system.

Collecting and evaluating data on the achievement of outcomes is usually more difficult than data collection and analysis of outputs. Difficulties arise from time lags in reporting, ability to gauge effects of an outcome on society, the economy, the environment or similar sphere, and uncertainty about how much outcome-effect can be attributed to individual programmes in a multi-programme effort. To what extent does, or should, the potential difficulty and expense of collecting and evaluating data on outcomes influence the choice of outcomes or how they are

defined? Techniques have been evolved to overcome and evaluate the success and failures of a programme and also combinations of programmes by the government.

III.21 Accountability

Officials need to be given more flexibility in managing and administering programmes considering the greater responsibility and accountability required for outcomes and held accountable for achieving outputs and outcomes. Government also needs to ensure individual/organisational accountability of the people.

Another aspect corollary to the attainment of outcomes is that governments needs to consider external factors that influence outcomes for coherent cross cutting achievements. Achievement of some outcomes requires different programmes or organisations to work together. Such outcomes can often be across ministries/departments/organisations. Defining and achieving inter agency outcomes are challenging and an opportunity. The opportunity arises from getting related programmes across the government to communicate with each other and agree to work in mutually supportive way toward a common objective. This can increase effectiveness and efficiency of individual programmes. Challenge stems from the difficulty often experienced in forging these agreements, and coordinating the tasks, especially when no ministry is given lead responsibility for the outcome. Failure in one programme can pull down results of the outcome as the complementarities are not attained. Research and review is required to localise such externalities and bring out results in a consensus manner.

III.22 Limitations

It is equally important to stress that managerial accountability needs to be based on outputs rather than outcomes as the latter is beyond direct control of managers, is difficult to define and quantify, and impossible to use as a basis for costing.

Main justifications for output-based accountability is:

(1) It is difficult to link outcomes directly with managerial actions and decisions as outcomes are remote in time and space from what the program does/ interact with other factors. The extent of a manager's direct control over outputs is usually more substantial than outcomes

(2) Outcomes are difficult to identify and difficult to quantify on an annual basis, but is definitely quantifiable on the basis of programme or interventions. The timescale for measuring

outcomes is normally after completion of the program/intervention, and normally do not synchronise with the same budgeting cycle, and

(3) Calculating cost of the effort to achieve outcomes can be more difficult than costing outputs (Kristiansen, et al. 2002, 16). Outcomes are achieved not as the result of a single intervention of a program in isolation, but by interaction of a number of different planned/unplanned factors and interventions. Hence, it is inappropriate and unrealistic to hold public managers accountable for outcomes. However it is the only best form of measuring whether the real output has reached the desired targeted population.

Another important step in the execution of outcome budget is the need for careful implementation to achieve the outcome and not the output alone. Role of organisations implementing the budget is more important for this. Unless the managers are skilled and have the initiative to achieve the outcome along with the output, success rate would be minimal. This is the case with many of Government of India schemes that are implemented by the states, without an understanding the vision of the budget.

However, all these limitations can be resolved through careful and proper planning and strategic move with calculated aims and budget outlays. Managers and others responsible for success of outcome budget needs to be given appropriate training and skills to achieve desired results. This also calls for budget discipline in its true sense.

III.23 Conclusion

A comparison of the experiences of various countries on out come and output budgeting is described in Flynn, 2001 and in Webber David, 2004. These experiences and the experiences of some of the states in India and the Central government can guide the state in adopting outcome budgets. It would be advisable to start with the process of introduction of outcome budgets either in some departments like Scheduled Caste Development/ Scheduled Tribe Development departments, where the outcome can be clearly monitored. It is also desirable to start on a pilot basis the system of outcome budgeting in selected local bodies. Local bodies may be selected based on the size and categorisation and needs to include rural and urban local governments. Experience of this pilot can be extended to other departments and organisations. It is also essential to conduct periodic evaluation of the outcomes based on accepted methodologies and principles.

APPENDICES

Chapter I

Appendix 1: Non – tax and State own tax revenue in the Total Revenue Receipts (TRR) (%)

Years	Share of SONTR to TRR	Share of SONTR to NTR	Share of GRANTS to NTR	Share of NTR to TRR
1980-1985	16.37	60.68	39.32	26.43
1985-1990	10.24	44.99	55.01	23.31
1990-1995	8.41	38.08	61.92	22.13
1995-2000	8.08	47.42	52.58	17.04
2000-2005	6.5	42.98	57.02	15.37
2005-2010	6.09	38.27	64.01	17.06
2010-2015	9.29	50.54	49.46	18.31
2015-2019	13.05	53.16	46.84	24.60

Source: Computed based on data from Study of State Finances, RBI, Various Issues.

Appendix 2: Shares of general, social and economic services in SONTR of Kerala (%)

Years	**GEN/SONTR**	**SOC/SONTR**	**ECO/SONTR**	**OTHERS/SONTR**
1980-1985	24.70	16.78	47.92	10.60
1985-1990	26.21	16.65	39.83	17.31
1990-1995	32.32	12.95	44.44	10.30
1995-2000	32.65	11.27	43.06	13.02
2000-2005	38.46	14.70	39.67	7.18
2005-2012	49.77	12.16	29.37	8.70
2012-2017	79.33	6.20	11.08	3.39
2017-2019	83.60	5	8.58	2.62

Appendix 3: Ratio of expenditure to revenue across sectors

Year	General Services	Social services	Economic services
2014-15	3.18	48.88	8.87
2015-16	3.18	56.04	7.66
2016-17	3.16	55.20	8.72
2017-18	2.77	64.82	10.33
2018-19	3.34	48.46	9.35

Source: Computed based on inputs from Finance Department, 2020

Appendix 4: General services in Kerala and its major components

GENERAL SERVICES - REVENUE EARNED (In Rs. Lakhs.)	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
PSC	397.38	310.87	169.42	203.98	192.13	170.48
POLICE	2481.39	3711.42	5798.68	3570.87	2438.50	2354.21
JAILS	148.15	104.31	85.25	128.87	188.98	205.53
STATIONERY AND PRINTING	477.11	611.17	608.30	867.83	768.53	1075.27
PUBLIC WORKS	256.14	328.36	380.02	654.10	659.34	410.07
OTHER ADMINISTRATIVE SERVICES	5385.09	6185.02	8822.13	9946.14	13366.52	14679.52
CONTRIBUTIONS AND RECOVERIES TOWARDS PENSION AND OTHER BENEFITS	2906.06	3024.11	3108.63	3289.75	3445.20	6041.25
MISCELLANEOUS GENERAL SERVICES (including lotteries)	275019.86	38333.46	62801.16	81727.12	74174.04	137516.76
GENERAL SERVICES - TOTAL	287071.19	52608.72	81773.59	100388.64	95233.24	162453.09

CONTRIBUTION OF EACH COMPONENT TO THE TOTAL REVENEU EARNED OUT OF GENERAL SERVICES (%)						
PSC	0.14	0.59	0.21	0.20	0.20	0.10
POLICE	0.86	7.05	7.09	3.56	2.56	1.45
JAILS	0.05	0.20	0.10	0.13	0.20	0.13
STATIONERY AND PRINTING	0.17	1.16	0.74	0.86	0.81	0.66
PUBLIC WORKS	0.09	0.62	0.46	0.65	0.69	0.25
OTHER ADMINISTRATIVE SERVICES	1.88	11.76	10.79	9.91	14.04	9.04
CONTRIBUTIONS AND RECOVERIES TOWARDS PENSION AND OTHER BENEFITS	1.01	5.75	3.80	3.28	3.62	3.72
MISCELLANEOUS GENERAL SERVICES (including lotteries)	95.80	72.87	76.80	81.41	77.89	84.65

GENERAL SERVICES - REVENUE EARNED (In Rs. Lakhs.)	***2012-2013***	***2013-2014***	***2014-2015***	***2015-2016***	***2016-2017***	***2017-2018 Revised estimates***	***2018-2019 Budget estimate***
PSC	*166.73*	*190.25*	*245.86*	*244.01*	*299.56*	*166.73*	*190.25*
POLICE	*2,665.46*	*3,084.54*	*4,480.43*	*7,025.67*	*5,481.68*	*2,665.46*	*3,084.54*
JAILS	*293.31*	*391.74*	*730.53*	*260.29*	*301.49*	*293.31*	*391.74*
STATIONERY AND PRINTING	*1,778.84*	*1,710.11*	*2,101.81*	*2,047.92*	*2,213.13*	*1,778.84*	*1,710.11*
PUBLIC WORKS	*519.81*	*542.74*	*580.18*	*1,382.13*	*764.63*	*519.81*	*542.74*

OTHER ADMINISTRATIVE SERVICES	*16,466.36*	*19,531.57*	*22,626.37*	*30,972.10*	*36,362.91*	*16,466.36*	*19,531.57*
CONTRIBUTIONS AND RECOVERIES TOWARDS PENSION AND OTHER BENEFITS	*7,350.82*	*6,600.66*	*6,063.39*	*6,427.52*	*13,181.27*	*7,350.82*	*6,600.66*
MISCELLANEOUS GENERAL SERVICES (including lotteries)	*2,81,357.18*	*3,90,833.23*	*5,60,018.01*	*6,40,499.79*	*7,47,793.04*	*2,81,357.18*	*3,90,833.23*
GENERAL SERVICES – TOTAL	*3,10,598.50*	*4,22,884.84*	*5,96,846.58*	*6,88,859.44*	*8,06,397.70*	*3,10,598.50*	*4,22,884.84*

CONTRIBUTION OF EACH COMPONENT TO THE TOTAL REVENEU EARNED OUT OF GENERAL SERVICES (%)

GENERAL SERVICES - REVENUE EARNED	**2012-2013**	**2013-2014**	**2014-2015**	**2015-2016**	**2016-2017**	**2017-2018 Revised estimates**	**2018-2019 Budget estimate**
PSC	0.05	0.04	0.04	0.035	0.04	0.05	0.04
POLICE	0.86	0.73	0.75	1.020	0.68	0.86	0.73
JAILS	0.09	0.09	0.12	0.038	0.04	0.09	0.09
STATIONERY AND	0.57	0.40	0.35	0.297	0.27	0.57	0.40

PRINTING							
PUBLIC WORKS	0.17	0.13	0.10	0.201	0.09	0.17	0.13
OTHER ADMINISTRATIVE SERVICES	5.30	4.62	3.79	4.496	4.51	5.30	4.62
CONTRIBUTIONS AND RECOVERIES TOWARDS PENSION AND OTHER BENEFITS	2.37	1.56	1.02	0.933	1.63	2.37	1.56
MISCELLANEOUS GENERAL SERVICES (including lotteries)	90.59	92.42	93.83	92.980	92.73	90.59	92.42

Appendix 5: Gross and net revenue from lotteries

Year	Gross lottery revenue (Rs. Lakhs)	Net lottery revenue (Rs. Lakhs)
1980-81	374	144
1985-86	1315	503
1990-91	6556	2470
1995-96	9258	1467
2000-01	13417	3151
2005-06	22957	5773
2007-08	32525	5035
2008-09	48139	10913
2009-10	62407	12128

2010-11	57146	11122
2011-12	128274	38101
2012-13	267377	59126
2013-14	379570	59304
2014-15	544488	95966
2015-16	627141	114851
2016-17	728329	129084
2017-18	891450	206394
2018-19	1111000	323585

Source: Computed based on data from Study of State Finances, RBI, Various Issues

Appendix 6: Social services in Kerala and its major components

SOCIAL SERVICES (Rs. Lakhs)	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Education, Sports, Arts and Culture	9990.94	10088.96	13024.36	13061.66	15083.39	16496.01
Medical and Public Health	3298.81	3692.00	3858.06	3443.05	6345.96	6519.40
Family Welfare	5.82	13.97	5.26	5.62	3.27	2.07
Housing	102.64	76.16	31.84	98.99	180.48	140.45
Urban Development	124.31	118.35	99.27	559.52	164.98	146.38
Labour and employment	516.38	525.05	628.09	1106.34	900.08	3576.41
Social Security and Welfare	103.63	147.37	84.05	126.88	261.33	17.80

Water supply and sanitation	0.36	0.40	316.16	0.24	0.26	0.35
Information and publicity	9.60	7.85	20.76	24.35	21.83	27.87
Others	9.33	109.09	430.89	320.99	160.58	228.99
Total Revenue from Social services	14247.84	14779.19	18498.75	18747.64	23122.16	27155.73

CONTRIBUTION OF EACH COMPONENT TO THE TOTAL REVENUE EARNED OUT OF SOCIAL SERVICES (%)

Education, Sports, Arts and Culture	70.12	68.26	70.41	69.67	65.23	60.75
Medical and Public Health	23.15	24.98	20.86	18.37	27.45	24.01
Family Welfare	0.04	0.09	0.03	0.03	0.01	0.01
Housing	0.72	0.52	0.17	0.53	0.78	0.52
Urban Development	0.87	0.80	0.54	2.98	0.71	0.54
Labour and employment	3.62	3.55	3.40	5.90	3.89	13.17
Social Security and Welfare	0.73	1.00	0.45	0.68	1.13	0.07
Water supply and sanitation	0.00	0.00	1.71	0.00	0.00	0.00
Information and publicity	0.07	0.05	0.11	0.13	0.09	0.10
Others	0.07	0.74	2.33	1.71	0.69	0.84

SOCIAL SERVICES (Rs. Lakhs)	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018 Revised estimates	2018-2019 Budget estimates
Education, Sports, Arts and Culture	18,277.58	30,812.65	24,640.97	24,363.11	28,234.55	34942.75	41834.40
Medical and Public Health	8,689.88	9,176.16	13,932.65	15,111.76	21,822.01	21900.44	24058.51
Family Welfare	4.03	16.99	3.83	3.80	28.03	21.02	31.02
Housing	137.96	146.29	172.58	184.22	265.87	333.45	343.30
Urban Development	510.31	204.58	216.60	475.84	370.24	602.30	662.29
Labour and employment	1,197.34	1,649.02	2,067.16	2,459.93	2,521.75	3849.53	4425.78
Social Security and Welfare	150.15	106.28	1,357.90	154.33	617.68	824.09	833.72
Water supply and sanitation	0.25	0.48	0.41	0.19	0.59	.41	.86
Information and publicity	20.48	37.98	34.60	29.65	38.77	45.85	51.90
Others	119.11	77.10	72.73	73.49	56.90	58.72	69.22
Total Revenue from Social services	29,107.10	42,227.54	42,499.43	42,856.31	53,956.39	62578.56	72311.00

Appendix 7: Revenue from Economic Services in Kerala and its major components

ECONOMIC SERVICES (Rs. Lakhs)	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Crop Husbandry	1233.06	1091.19	1503.86	787.65	1003.35	1155.04
Animal Husbandry	643.39	526.27	296.23	310.57	397.14	405.54
Dairy Development	84.33	101.11	96.68	84.94	81.35	86.28
Fisheries	295.60	347.18	408.97	436.72	599.79	631.91
Forestry and Wild Life	17455.80	15445.22	22370.51	27279.94	27409.59	22052.42
Co-operation	3575.47	3652.41	4201.51	4938.73	5910.57	6832.78
Other Agricultural Programmes	3.54	10.60	7.47	14.37	6.93	9.88
Other Rural Development Programmes	15.67	15.57	24.41	32.36	38.71	136.36
Other Special Area Programmes	0.02	0.00	0.00	0.00	0.10	0.00
Major irrigation	462.16	488.10	542.65	446.81	322.69	653.85
medium irrigation	25.32	25.04	306.96	450.15	504.74	720.55
Minor irrigation	187.93	199.99	293.29	389.17	422.84	497.00
Petroleum	0.81	0.68	0.89	0.92	0.76	1.06
village and small industries	839.53	583.62	486.14	284.66	588.90	81.88
Industries	497.15	12582.66	1693.53	165.19	474.80	89.87
Non Ferrous mining and metallurgical industries	2831.65	3280.76	4031.67	3926.43	4579.48	4790.04
Ports and light houses	233.13	212.08	456.11	607.19	1019.42	4406.24
Roads and bridges	1534.98	2030.21	3316.65	4612.68	2977.61	2971.51
Inland water transport	449.05	439.39	506.21	486.40	483.45	517.50
Other transport services	2.87	36.90	10.50	17.30	13.94	12.15
Other scientific research	24.69	31.83	21.40	17.00	56.36	80.41
Tourism	501.09	441.86	527.33	436.65	471.69	553.34
Civil supplies	135.93	344.71	469.62	319.77	314.11	313.17

Other general economic services	1800.40	1851.45	2361.70	2061.88	2352.32	2217.04
other industries	0.00	753.37	0.00	0.00	0.0**0	0.00
Total	32833.57	44492.20	43934.30	48107.48	50030.63	49215.80

CONTRIBUTION OF EACH COMPONENT TO THE TOTAL REVENEU EARNED OUT OF ECONOMIC SERVICES (%)

Crop Husbandry	3.76	2.45	3.42	1.64	2.01	2.35
Animal Husbandry	1.96	1.18	0.67	0.65	0.79	0.82
Dairy Development	0.26	0.23	0.22	0.18	0.16	0.18
Fisheries	0.90	0.78	0.93	0.91	1.20	1.28
Forestry and Wild Life	53.16	34.71	50.92	56.71	54.79	44.81
Co-operation	10.89	8.21	9.56	10.27	11.81	13.88
Other Agricultural Programmes	0.01	0.02	0.02	0.03	0.01	0.02
Other Rural Development Programmes	0.05	0.03	0.06	0.07	0.08	0.28
Other Special Area Programmes	0.00	0.00	0.00	0.00	0.00	0.00
Major irrigation	1.41	1.10	1.24	0.93	0.64	1.33
medium irrigation	0.08	0.06	0.70	0.94	1.01	1.46
Minor irrigation	0.57	0.45	0.67	0.81	0.85	1.01
Petroleum	0.00	0.00	0.00	0.00	0.00	0.00
Village and small industries	2.56	1.31	1.11	0.59	1.18	0.17
Industries	1.51	28.28	3.85	0.34	0.95	0.18
Non Ferrous mining and metallurgical industries	8.62	7.37	9.18	8.16	9.15	9.73
Ports and light houses	0.71	0.48	1.04	1.26	2.04	8.95
Roads and bridges	4.68	4.56	7.55	9.59	5.95	6.04
Inland water transport	1.37	0.99	1.15	1.01	0.97	1.05
Other transport services	0.01	0.08	0.02	0.04	0.03	0.02
Other scientific research	0.08	0.07	0.05	0.04	0.11	0.16

Tourism	1.53	0.99	1.20	0.91	0.94	1.12
Civil supplies	0.41	0.77	1.07	0.66	0.63	0.64
Other general economic services	5.48	4.16	5.38	4.29	4.70	4.50
other industries	0.00	1.69	0.00	0.00	0.00	0.00

ECONOMIC SERVICES (Rs. Lakhs)	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018 Revised estimates	2018-2019 Budget estimate
Crop Husbandry	1,081.16	1,150.25	1,503.31	931.02	948.13	1580.10	1425.51
Animal Husbandry	460.41	594.16	584.43	548.72	636.97	773.37	833.92
Dairy Development	84.01	86.45	100.27	98.99	127.91	156.81	166.81
Fisheries	686.79	775.24	1,356.85	1,109.67	1,272.47	1646.96	1820.66
Forestry and Wild Life	23,733.27	32,994.85	30,040.15	28,303.97	29,684.89	34131.60	34131.60
Co-operation	9,998.52	11,235.77	12,141.22	15,950.04	14,663.95	19795.00	20616.00
Other Agricultural Programmes	5.54	36.54	25.48	11.78	11.15	20.25	20.26
Other Rural Development Programmes	168.28	203.61	235.49	331.15	363.69	580.23	677.23
Other Special Area Programmes	0.00	0.00	0.07	0.00	0.00	.11	.11
Major irrigation	691.92	555.57	386.92	586.58	534.98	964.38	1114.73
medium	781.98	632.02	558.68	680.04	568.10	1542.66	1670.91

irrigation							
Minor irrigation	541.40	635.96	471.15	602.92	574.87	845.31	920.16
Petroleum	0.71	0.77	1.16	0.76	0.70	1.10	1.25
village and small industries	352.88	416.78	761.76	424.61	453.87	776.99	806.14
Industries	53.63	13.67	66.11	72.89	75.76	127.04	149.04
Non Ferrous mining and metallurgical industries	5,387.46	5,982.26	7,952.97	14,954.00	14,424.88	17710.75	18541.00
Ports and light houses	5,191.02	2,073.06	4,530.37	6,310.96	7,443.48	8355.57	9093.27
Roads and bridges	4,547.75	4,994.49	4,342.06	10,340.89	6,567.14	7135.01	8320.01
Inland water transport	502.47	727.60	766.11	765.89	675.72	942.31	942.36
Other transport services	143.95	7.70	81.49	89.90	43.92	66.06	77.02
Other scientific research	79.30	9.37	89.97	673.68	260.34	742.00	1079.00
Tourism	562.70	618.63	748.25	615.55	514.96	945.48	1055.48
Civil supplies	422.99	507.02	496.78	515.37	805.29	1275.60	1335.60
Other general economic services	562.70	3,134.60	4,148.98	7,387.67	5,002.49	5412.50	6020.50

Other industries	0.30	0.00	0.00	0.00	0.00	.01	.01
Total	58,089.58	67,386.38	71,390.03	91,307.05	85,655.66	105527.20	116454.82

CONTRIBUTION OF EACH COMPONENT TO THE TOTAL REVENEU EARNED OUT OF ECONOMIC SERVICES (%)

ECONOMIC SERVICES (Rs. Lakhs)	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019
Crop Husbandry	1.86	1.71	2.11	1.02	1.11	1.50	1.22
Animal Husbandry	0.79	0.88	0.82	0.60	0.74	0.73	0.72
Dairy Development	0.14	0.13	0.14	0.11	0.15	0.15	0.14
Fisheries	1.18	1.15	1.90	1.22	1.49	1.56	1.56
Forestry and Wild Life	40.86	48.96	42.08	31.00	34.66	32.34	29.31
Co-operation	17.21	16.67	17.01	17.47	17.12	18.76	17.70
Other Agricultural Programmes	0.01	0.05	0.04	0.01	0.01	0.02	0.02
Other Rural Development Programmes	0.29	0.30	0.33	0.36	0.42	0.55	0.58
Other Special Area Programmes	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Major irrigation	1.19	0.82	0.54	0.64	0.62	0.91	0.96
medium irrigation	1.35	0.94	0.78	0.74	0.66	1.46	1.43
Minor irrigation	0.93	0.94	0.66	0.66	0.67	0.80	0.79
Petroleum	0.00	0.00	0.00	0.00	0.00	0.00	0.00
village and small industries	0.61	0.62	1.07	0.47	0.53	0.74	0.69
Industries	0.09	0.02	0.09	0.08	0.09	0.12	0.13
Non Ferrous	9.27	8.88	11.14	16.38	16.84	16.78	15.92

mining and metallurgical industries							
Ports and light houses	8.94	3.08	6.35	6.91	8.69	7.92	7.81
Roads and bridges	7.83	7.41	6.08	11.33	7.67	6.76	7.14
Inland water transport	0.86	1.08	1.07	0.84	0.79	0.89	0.81
Other transport services	0.25	0.01	0.11	0.10	0.05	0.06	0.07
Other scientific research	0.14	0.01	0.13	0.74	0.30	0.70	0.93
Tourism	0.97	0.92	1.05	0.67	0.60	0.90	0.91
Civil supplies	0.73	0.75	0.70	0.56	0.94	1.21	1.15
Other general economic services	0.97	4.65	5.81	8.09	5.84	5.13	5.17
Other industries	0.00	0.00	0.00	0.00	0.00	0.00	0.00

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