KERALA
PUBLIC EXPENDITURE
REVIEW COMMITTEE

Second Report

November 2006

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REVIEW COMMITTEE

[Constituted as per Gazette Notification No. 17950/FRC-2/04/FIN dated 25-11-2005 (S.R.O. No. 1033/2005) as prescribed under Section 6 of the Kerala Fiscal Responsibility Act, 2003(29 of 2003)]

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Foreword and Acknowledgements

We present the Second Report of the Public Expenditure Review Committee, constituted under section 6 of the Kerala Fiscal Responsibility Act of 2003 (Act 29 of 2003). The annual review report falls due in the month of November each year, by sections 8 and 9 of the Rules pertaining to the Committee. Since the Committee was notified only on 25 November 2005, the First Report was submitted in May 2006.

Before finalising this Second Report, the Committee met on 25 September and 23 October 2006, in Delhi.

We thank Mr. K. Jose Cyriac, Principal Secretary, Finance Department, Government of Kerala for lending the services of Mr. R. Venkitaramanan, Additional Secretary, Finance Department. Mr. R. Venkitaramanan served the Committee admirably. We also thank Mr. Satyajeet Rajan, Additional Resident Commissioner of the Government of Kerala in New Delhi, for hosting the meetings of the Committee. Last but by no means least, we thank Mrs. Promila Rajvanshi of the National Institute of Public Finance and Policy for word processing the First and Second Reports through their several drafts.

DR. N.J. KURIAN MEMBER	DR. K.P. KANNAN MEMB ER	DR. INDIRA RAJARAMAN CHAIRPERSON

29 November 2006
New Delhi

1. INTRODUCTION

The Kerala Public Expenditure Review Committee was constituted by the Government of Kerala on 25 November 2005 in exercise of the powers conferred by Section 6 of the Kerala Fiscal Responsibility Act, 2003. The Committee is required to submit to the Government of Kerala a review report in November every year on the fiscal performance of the State during the previous year. Since the Committee was constituted in November 2005, the first review report in respect of 2004-05 could be submitted only in May 2006. It covered the fiscal years 2003-04 and 2004-05.

This is the Second Report, covering the year 2005-06. Before finalising this report the Committee met on 25 September and 23 October 2006, in Delhi.

In the Revised Budget Speech for 2006-07, presented to the Legislature in June 2006, the Finance Minister of the newly elected Government stated that the KFR Act, 2003 would be amended in line with the recommendations of the Twelfth Finance Commission. The Committee therefore presumes that the Act and the Rules will be so amended before the close of the fiscal year.

There are seven Sections in this Second Report of the Committee. Section 2 on overall fiscal imbalance targets assesses the fiscal correction achieved in 2005-06 relative to the previous two years and contains details of the revenue deficit, primary revenue deficit, fiscal deficit and primary fiscal deficit. In Section 3 an attempt is made to construct a more realistic assessment of the revenue deficit and capital outlay by adjusting revenue expenditure to exclude expenditures incurred on creation of assets, out of devolutions to Local Bodies, and maintenance expenditure indistinguishable from asset creation, both of which are now entirely classified under the Revenue Account. Section 4 deals with the various items of revenue receipts of the State during the pre-FRA period and FRA period. Section 5 focuses on the major constituents of revenue expenditure during the above periods. Section 6 captures the debt profile of the State over 2000-01 to 2006-07. A summary of the main conclusions and recommendations of the Committee is given in Section 7.

The factors which have contributed to achieving the set targets and the reasons for slippages have been analysed in the respective sections. Wherever necessary, the budget estimates for 2006-07 have also been considered, fully realising that there can be substantial variation between actuals and budget estimates, as pointed out in the first report of the Committee.

2. OVERALL FISCAL IMBALANCE TARGETS

Revenue Deficit (RD) and Primary Revenue Deficit (PRD)

The Kerala Fiscal Responsibility Act in its present form targets a nil revenue deficit by the end of 2006-07. The Committee had in its first report recommended amending these targets in line with the Twelfth Finance Commission recommendations. It is presumed that the Act and Rules will be amended accordingly. In that case the State would be required to phase out the revenue deficit only by 2008-09.

The major fiscal indicators are given in table 2.1 and the Budget Estimates for 2004-05, 2005-06 and 2006-07 in table 2.2. The revenue deficit in 2004-05 was 3.65 percent of GSDP. In the absence of any structured reduction targets during the expected extended period, the annual target works out to a required reduction of 0.91 percent per year from 2005-06 to 2008-09. The revenue deficit stood at 2.80 percent of GSDP as against the required level of 2.74 percent in 2005-06. Thus the shortfall for the reporting period of 2005-06 is only a meagre 0.06 percent. The achieved decline by 0.85 percent in 2005-06 was mainly due to better realization of own tax revenue and increase in devolutions from the Centre, despite a 7.3 percent increase in revenue expenditure over the previous year.

The anticipated revenue deficit of 4.40 percent in 2006-07(BE) does not augur well for the State in terms of meeting the fiscal targets prescribed in the Act. The purpose of having a fiscal responsibility act in place is defeated, if the budget estimates repeatedly ignore the stated goals as legislated (table 2.2). The anticipated revenue deficit for 2005-06 was budgeted at 4.05 percent of GSDP, but came down to 2.80 percent (actuals).

The primary revenue deficit for 2005-06 recorded an impressive surplus of Rs. 670 crore compared to a deficit of Rs. 56 crore in 2004-05. Thus salary, pension and other non-interest items of revenue expenditure have been contained within total revenue receipts, and part of the interest liability has been discharged with the surplus so generated. This is a welcome change from the past. However, by the budgeted figures for 2006-07, this will switch back in sign to a large primary revenue deficit of Rs. 987 crore in 2006-07 principally on account of a large budgeted increase of 33 percent in revenue expenditure over actuals, in turn because of implementation of the pay and pension revision.

Fiscal Deficit (FD) and Primary Fiscal Deficit (PFD)

The fiscal deficit for 2004-05 was 4.43 percent GSDP. The existing provisions in the KFR Act and Rule require this to be brought down to 3.5 percent in 2005-06 and 2 percent in 2006-07. If amended, the State would be required to achieve the target of 3 percent fiscal deficit only by 2008-09. The required annual reduction pro-rated from 2004-05 thus becomes less than 0.36 percent over 2005-06 to 2008-09. In 2005-06 it has come down to 3.75 percent from 4.43 percent in 2004-05, which means the State has achieved a decline by 0.68 percent against the required 0.36 percent. The commendable decline in the fiscal deficit as a percent of GSDP was achieved despite a rise in capital outlay to Rs. 1053 crore from Rs. 783 crore in 2004-05. It would be recalled that capital outlay in 2004-05 declined by Rs.1076 crore, from Rs.1859 crore in 2003-04 to Rs.783 crore. The revenue deficit as a percent of the fiscal deficit declined from 82.41 percent in 2004-05 to 74.82 percent during 2005-06.

The primary fiscal deficit continues to show a downward trend. In 2004-05 this was 0.89 percent[1] of GSDP, but it declined to 0.34 percent in 2005-06. The actual and primary fiscal deficits, as a percentage of GSDP, have been showing a declining trend throughout the FRA period. However, it must be noted that the primary fiscal deficit remains positive. The significance of the sign of the primary fiscal deficit is that, unless the nominal growth of GSDP exceeds the rate of

[1] This was erroneously recorded as 0.83 percent in table 2.1 in the First Report of this Committee.

interest on outstanding liabilities, the percent of debt to GSDP cannot get stabilized as long as the primary fiscal deficit remains positive (i.e., not a surplus).

Table 2.1: Overall Fiscal Indicators for FRA Period

	Actuals				Diff (percent/GSDP)			BE (revised)	Diff (percent/GSDP)
	2002-03	2003-04	2004-05	2005-06	03-04A/ 02-03A	04-05A/ 03-04A	05-06A/ 04-05A	2006-07	06-07BE/ 05-06A
Revenue Deficit in Rs. Cr.	4119	3680	3669	3129	-439	-11	-540	5415	2286
RD/GSDP (%)	5.09	4.08	3.65	2.80	-1.01	-0.43	-0.85	4.40	1.60
Fiscal Deficit in Rs.Cr.	4990	5539	4452	4182	549	-1087	-270	7535	3353
FD/GSDP (%)	5.53	6.14	4.43	3.75	0.61	-1.71	-0.68	6.13	2.38
RD/FD (%)	82.54	66.44	82.41	74.82	-16.09	15.97	-7.59	71.86	-2.96
Primary Revenue Deficit in Rs.Cr.	1172	352	56	-670	-820	-296	-726	987	1657
PRD/GSDP (%)	1.45	0.39	0.06	-0.60	-1.06	-0.33	-0.66	0.80	1.40
Primary Fiscal Deficit in Rs. Cr.	2043	2211	839	382	168	-1372	-457	3107	2725
PFD/GSDP (%)	2.53	2.45	0.89	0.34	-0.08	-1.56	-0.55	2.53	2.18
Cap. Exp./GSDP (%)	1.08	2.06	0.78	0.94	0.98	-1.28	0.16	1.72	0.78
Direct Capital Outlay/GSDP (%)	0.86	0.71	0.68	0.73	-0.15	-0.03	0.05	1.14	0.41
GSDP in Rs. Cr.	80844	90172	100531	111633	11.54	11.49	10.41	123000	10.18

	Actuals				*Changed (percent)*			BE (revised)	Changed (percent)
	2002-03	2003-04	2004-05	2005-06	03-04A/ 02-03A	04-05A/ 03-04A	05-06A/ 04-05A	2006-07	06-07BE/ 05-06A
Revenue Account in Rs.Cr.									
Revenue Receipts	10637	11815	13500	15295	11.07	14.26	13.30	19140	25.14
Revenue Expenditure	14756	15496	17169	18424	5.01	10.80	7.31	24555	33.28
Capital Expenditure in Rs. Cr.	871	1859	783	1053	113.31	-57.88	34.48	2120	101.33
Direct Capital Outlay	699	640	682	817	-8.44	6.57	19.79	1399	71.24
Net loan Disbursement	173	1219	101	236	605.79	-91.69	133.66	721	205.51
Total Expenditure in Rs. Cr.	15627	17354	17952	19477	11.05	3.45	8.49	26675	36.96
of which interest in Rs. Cr.	2947	3328	3613	3799	12.94	8.56	5.15	4428	16.56

Notes: Capital expenditure is obtained from the sum of direct capital outlay, and net loan disbursements (gross disbursements minus loans recoveries).

Table 2.2: Budgeted Fiscal Indicators for FRA Period

	Budget est.	Diff (%/ GSDP)	Budget est.	Diff (%/GSDP)	Budget est. (revised)	Diff (%/ GSDP)
	2004-05	**04-05BE/ 03-04A**	**2005-06**	**05-06BE/ 04-05A**	**2006-07**	**06-07BE/ 05-06A**
Revenue Deficit in Rs. Cr.	6093		4072		5415	
RD/GSDP (%)	6.06	1.98	4.05	0.40	4.40	1.60
Fiscal Deficit in Rs. Cr.	5343		5171		7535	
FD/GSDP (%)	5.31	-0.89	5.14	0.72	6.13	2.38
Direct Capital Outlay/ GSDP (%)	0.57	-0.14	0.53	-0.15	1.14	-0.41

Notes: Capital expenditure is obtained from the sum of direct capital outlay, and net loan disbursements (gross disbursements minus loans recoveries).

To conclude the fiscal correction required under the (to be amended) Act, was achieved during the period under review. The primary revenue surplus in 2005-06 is worth special mention. But, in view of the huge commitments on account of pay and pension revision, the impact of which will be felt only from 2006-07, concerted efforts will have to be made to substantially increase own revenues of the State.

3. ADJUSTMENTS REQUIRED TO REVENUE DEFICIT AND CAPITAL OUTLAY FIGURES

The necessity for adjustments in the revenue deficit was explained in detail in Section 3 of the first report. That report suggested reclassification of certain revenue items of expenditure into the capital account, such as maintenance works by Public Works Department, and annual devolutions to Local Self Governments.

No reliable official figures are available on the actual capital expenditure incurred by Local Bodies out of the revenue transfers from the State Government. But they are required to spend 30 percent of these funds for infrastructure and another 30 percent on the productive sector. Therefore 50 percent is a reasonably conservative estimate of the share of revenue transfers to Local Bodies going towards capital expenditure. A similar assumption is made with respect to maintenance expenditure by the PWD, that half of this is essentially indistinguishable from capital expenditure. These adjustments are exactly the same as those as in the first report. Until they are validated on the basis of detailed figures on expenditures by local bodies and the PWD, the adjustments so made will have to be treated with caution. The Committee urges the Government to make available the data required for further fine-tuning the adjustment procedure.

The adjusted revenue and fiscal deficits are shown in table 3.1. While the reported RD/GSDP ratio is 2.80 percent in 2005-06, the adjusted RD works out to 1.71 percent against the required 2.74 percent. This is far in excess of the necessary fiscal correction towards meeting the R.D target in 2005-06. There is clearly a strong case for the State Government to persuade the Government of India to permit an adjustment of the revenue deficit, for use of revenue expenditures towards creation of physical assets.

Table 3.1: Unadjusted and Adjusted RD and FD: 2002-06

	Actuals				**Diff percent/ GSDP**		
Rs. crore	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**03-04A/ 02-03A**	**04-05A/ 03-04A**	**05-06A/ 04-05A**
RD	4119	3680	3669	3129			
Rev exp. on public works, roads & bridges	510	487	600	871			
Of which est. cap. component	255	243	300	436			
Devolution to local bodies	1458	1731	1783	1565			
Of which est. cap. component	729	866	892	783			
Adjusted RD	3135	2572	2478	1911			
Capital outlay	699	640	682	817			
Adjusted capital outlay	1683	1749	1873	2036			
(Percent/GSDP)							
RD/GSDP	5.09	4.08	3.65	2.80	-1.01	-0.43	-0.85
Adj RD/GSDP	3.88	2.85	2.46	1.71	-1.03	-0.39	-0.75
Cap outlay/GSDP	0.86	0.71	0.68	0.73	-0.15	-0.03	0.05
Adj capital outlay/GSDP	2.08	1.94	1.86	1.82	-0.14	-0.08	-0.04

The capital outlay as a percentage of GSDP also registers an increase of 1.09 percent from 0.73 percent to 1.82 percent on carrying out the adjustments outlined above. A mechanism to monitor the exact nature of maintenance works by departments like PWD, irrigation and other major departments which undertake such works needs to be set up. Similarly, accounting procedures of LBs have to be strengthened so as to identify the capital works done out of the revenue grants from the State Government.

These adjustments do not affect the fiscal deficit. However, there are some adjustments required for the fiscal deficit as well, pointed out in the first report. Unreported liabilities are accumulated over time owing to arrears in payments due to contractors for work done and to suppliers for goods delivered. In addition, land acquisition charges in respect of various projects and schemes, and other committed items of expenditure, are not recorded in any official budget document. These liabilities need to be fully reported.

4. REVENUE RECEIPTS

The total revenue receipts in 2005-06 stood at Rs.15296 crore, 13.8 percent of GSDP. The corresponding figure for 2004-05 was Rs.13500 crore including receipts of Rs.3718 crore from the Centre, representing 13.5 percent of GSDP during the year. Table 4.1 gives the figures of revenue receipts over the period 1999-00 to 2005-06 and the budget estimates for 2006-07.

Own tax revenue recorded a growth rate of 9.1 percent in 2005-06 against 10.8 percent during the previous year. In terms of GSDP also, the (annual) tax buoyancy dropped from 1 to 0.8. The average annual growth rate during the FRA period has registered a sharp fall from 12 percent over 2000-03 to 10.2 percent over 2003-06. This was in part a result of initial teething problems with the VAT, introduced from 1 April 2005. In the first year the department went slow in enforcing compliance to encourage traders to register themselves. As a result, revenue from sales tax, which registered an increase of 11.84 percent in 2004-05 over the previous year, could post only a much lower growth rate of 5.03 percent in 2005-06 (table 4.2).

Table 4.1: Revenue Receipts

Revenue Receipts	Pre-FRA Period					FRA Period					
	Annual				Average annual	Annual			Average annual	BE (revised)	Average annual
	1999-00	2000-01	2001-02	2002-03	2000-03	2003-04	2004-05	2005-06	2003-06	2006-07	2003-07
Total Revenue Receipts (Rs. Cr)	7944	8731	9056	10637		11815	13500	15296		19140	
Growth rate (%)		9.9	3.7	17.5	**10.2**	11.1	14.3	13.3	**9.0**	25.1	**17.4**
TRR/GSDP (%)	12.7	12.5	12.5	13.2		13.1	13.5	13.8		15.6	
Buoyancy		0.9	1.0	1.5	**1.1**	1.0	1.3	1.2	**1.2**	2.5	1.6
State's Own Taxes (Rs. Cr)	5194	5870	5923	7303		8089	8964	9779		11663	
Growth Rate (%)		13.0	0.9	23.3	**12.0**	10.8	10.8	9.1	**10.2**	19.3	**13.0**
Own taxes/GSDP (%)	8.3	8.4	8.2	9.0		9.0	8.9	8.8		9.5	
Buoyancy		1.1	0.2	2.0	**1.3**	0.9	1.0	0.8	**1.4**	1.9	1.2
State's Non Tax (Rs. Cr)	533	659	543	681		807	819	937		1113	
Growth Rate (%)		23.7	-17.6	25.4	**8.5**	18.5	1.5	14.4	**5.1**	18.8	**11.3**
Own non-tax/GSDP (%)		0.9	0.8	0.8		0.9	0.8	0.8		0.9	
Buoyancy		2.0	-4.7	2.2	**1.0**	1.6	0.1	1.3	**0.7**	1.8	1.0
Central Transfers (Rs. Cr)	2218	2202	2590	2654		2920	3718	4579		6365	
Growth Rate (%)		-0.7	17.6	2.5	**6.2**	10.0	27.3	23.2	**16.2**	39.08.9	**29.7**
GSDP (Rs. Cr)	62520	69770	72349	80844		90172	100327	111633		123000	
Growth rate (%)		11.6	3.7	11.7	**8.9**	11.5	11.3	11.3	**7.4**	10.2	**10.9**

Note: VAT was introduced in 2005-06. The State's Own Tax Revenue of Rs. 9779 crore in 2005-06 does not include Rs.456 crore received from Government of India as VAT Compensation which is included under Central Transfers.

Table 4.2: Composition of States Own Tax Revenue and Non Tax Revenue

	Pre-FRA Period					FRA Period					
	Annual				Average annual	Annual			Average annual	BE (revised)	Average annual
	1999-00	2000-01	2001-02	2002-03	2000-03	2003-04	2004-05	2005-06	2003-06	2006-07	2003-07
State's Own Taxes (Rs. Cr)											
a. Sales Tax	3853.54	4344.33	4440.85	5343.15		5991.43	6701.05	7037.97		8129.56	
b. Excise Duty	591.10	688.94	541.46	663.07		655.91	746.45	841.00		944.73	
c. Motor Vehicle Tax	380.83	394.85	452.18	513.20		585.77	610.47	628.51		760.00	
d. Stamp Duty & Regn Charges	279.65	341.10	394.28	486.53		549.81	775.35	1101.42		1400.37	
e. Electricity Duty	3.33	14.92	5.18	192.62		189.97	9.62	31.52		265.69	
f. Others	85.06	86.12	89.47	103.97		115.89	120.71	138.20		162.50	
Total SOTR	**5194**	**5870**	**5923**	**7303**		**8089**	**8964**	**9779**		**11663**	
Growth Rate (%)		13.0	0.9	23.3	**12.0**	10.8	10.8	9.1	**10.2**	19.3	**13.0**
Own taxes/GSDP (%)	8.3	8.4	8.2	9.0		9.0	8.9	8.8		9.5	
Buoyancy (%)		1.1	0.2	2.0	**1.3**	0.9	1.0	0.8	**1.4**	1.8	1.2
State's Own Non Tax (Rs. Cr)											
a. Forests	109.88	141.24	113.70	149.57		187.18	199.69	189.63		250.32	
b. Lottery (Gross)	100.82	134.17	121.59	131.69		147.80	151.38	237.28		251.00	
c. Interest Receipts	37.31	36.81	31.08	35.86		32.40	40.50	46.36		49.51	
d. Educatn., Sports, Art & Culture	39.18	44.98	53.56	63.40		81.86	85.76	82.09		114.93	
e. Other Admn Services	40.23	150.86	32.41	45.57		46.10	78.79	54.77		105.42	
f. Contribn towards Pension etc.	23.12	18.87	17.17	19.29		17.08	16.66	17.85		18.11	
g. Medical & Public Health	18.82	20.66	19.85	28.16		27.61	27.51	29.80		33.22	
h. Cooperation	23.49	23.46	21.12	24.49		27.32	29.38	35.78		35.39	
i. Non-ferrous Mining & Inds.	14.57	16.94	16.29	18.76		18.37	21.46	25.09		31.66	
j. Roads & Bridges	18.57	16.91	14.15	20.30		18.68	14.67	20.38		18.17	
k. Other Genl. Economic Services	8.83	11.00	11.25	12.64		12.12	13.29	11.79		16.75	
l. Others	97.95	43.19	91.21	131.53		190.46	139.99	185.96		188.14	
Total SONTR	**533**	**659**	**543**	**681**		**807**	**819**	**937**		**1113**	
Growth Rate (%)		23.7	-17.6	25.4	**8.5**	18.5	1.5	14.4	**5.1**	18.8	**11.3**
Own non-tax/GSDP (%)		0.9	0.8	0.8		0.9	0.8	0.8		0.9	
Buoyancy (%)		2.0	-4.7	2.2	**1.0**	1.6	0.1	1.3	**0.7**	1.7	1.0
GSDP (Rs. Cr)	62520	69770	72349	80844		90172	100327	111633		123000	
Growth rate (%)		11.6	3.7	11.7	**8.9**	11.5	11.3	11.3	**7.4**	10.8	**10.9**

However while the VAT collection during the first half of 2005-06 was only Rs.1250 crore, the corresponding figure for the same period of 2006-07 was Rs.2106 crore, an increase of 68 percent. New initiatives responsible for this upsurge include scrutiny of records and raids conducted regularly to detect evasion. Special squads drawn up from different districts are deployed for surprise inspections at major check posts. These efforts are expected to be intensified in the coming months. Targets of collection are given for each ward and circle office. Revenue collection is reviewed at the level of Chief Secretary every month.

The introduction of the 'Lucky VAT' scheme in the last week of August 2006 encourages customers to insist on proper bills from traders, since each purchase for 1000 or more carries a lottery coupon. This is for the first time that such a novel scheme has been introduced in any State in India and is a model for other States to emulate. There is a provision to assign one percent of revenue realization in excess of targets to a traders welfare fund. Thus, there are positive incentives for both consumers and traders. However, there is at present no scheme for cash incentives to staff. Along with this additional positive incentive, the Government may consider introducing disincentives for defaulters.

The revenue from stamp duty and registration charges increased by 42 percent in 2005-06 over 2004-05 (table 4.2). Rates of conveyance (consisting of stamp duty, surcharge and registration fee) were slashed by 50 percent from December 2003. But a closer look at the monthly figures of accounts revealed that collection was indeed relatively low till November 2004, when the Government announced in advance that from the next year the rates would be revised to restore the old rates since the fair value fixation did not come through as expected. There was a consequent rush to register documents during December 2004-March 2005, with the result that collections during the year registered an increase of Rs.226 crore over the previous year. Had the Revenue Department issued notification on fair value fixation of land after complying with all necessary statutory regulations, simultaneously with the reduction of rates of conveyance as originally planned, the revenues in 2004-05 would have been much higher. As a result of the failure to notify the fair value, the pre-December 2003 rates were restored with effect from 31 March 2005.The Committee suggests redoing this exercise of simultaneous reduction of rates of conveyance and fixation of fair value after careful planning and co-ordination between the Taxes Department and the Revenue Department.

The revenue from excise duty and tax on motor vehicles has been steadily increasing during the FRA period.

Non-Tax Revenue also registered a higher growth rate of 14.4 percent in 2005-06 as against just 1.5 percent during the previous year. The major component, lottery receipts, generated Rs. 86 crore more than in 2004-05. All lotteries, including sale of tickets of other States and on-line lotteries, were banned on 27 January 2005, but on 22 April 2005, the lottery scheme of Kerala State alone was reintroduced. The ban on on-line lotteries still continues. This has increased the sale of Kerala State lotteries. Of late, paper lotteries of a few other States which have registered with the commercial taxes department, have started operating in Kerala following court intervention, the effect of which will be known only at the end of fiscal 2006-07.

Following the introduction of the Kerala Ceiling on Government Guarantees Act 2003, the State has been insisting on payment of guarantee commission for new guarantees and extension of expired guarantees. This has also helped the State in raising the Non Tax Revenue. Though fresh guarantees are very limited the collection has gone up by 46 percent from Rs.44 crore in 2004-05 to Rs.65 crore in 2005-06.

Central transfers to State accounted for Rs. 3718 crore in 2004-05, and grew by 23 percent in 2005-06 to record a total transfer of Rs. 4579 crore (table 4.1). The share in central taxes and grants from the Centre increased by Rs.113 crore and Rs. 748 crore respectively in 2005-06 relative to 2004-05. This includes a VAT compensation of Rs. 457 crore received from Government of India by the terms of the agreement reached between the Centre and the States on introduction of VAT with effect from 1 April 2005. The anticipated increase in transfers from the Centre, from Rs. 4579 crore in 2005-06 to Rs.6365 crore in 2006-07, is mainly on VAT compensation estimated at Rs.1067 crore. However, if the VAT performance is good, this compensation will not be realized. The additional Rs. 800 crore from the Center includes Rs 318 crore in respect of some transfers which begin only in 2006-07, and Rs 319 in respect of externally aided projects.

Efforts to step up the own revenue of the State, rather than reliance on Central assistance, will place the fiscal position of the State on a sound footing.

5. REVENUE EXPENDITURE

The major items of revenue expenditure are salary, pension and interest. The details are given in table 5.1. These three components together constitute 66.5 percent of the total revenue expenditure and 80.09 percent of the total revenue receipts for 2005-06. The corresponding figures for 2004-05 were 67.32 percent and 85.62 percent respectively.

The Pay Revision ordered in March 2006 prescribes arrears payable from 1 April 2005. The arrears for 1 April 2005 to 28 February 2006 will be credited to the Provident Fund account. Payments in cash are to be made only from March 2006. In the case of the pension revision, the arrears are payable in cash from 1 April 2005 itself. The estimated expenditure for 2006-07 in respect of salary and pension, without arrears, is Rs.1556 crore. The arrears including credit to P.F come to Rs.1366 crore. The total financial commitment during 2006-07 on account of salary and pension thus sums to Rs.2922 crore.

The salary bill which stood at 33.2 percent of total revenue expenditure in 2003-04, dropped to 31.1 percent in 2004-05 and to 30.4 percent in 2005-06. But with the pay and pension revision, this is expected to go up to 32.8 percent of total revenue expenditure in 2006-07. The average annual increase in salary over the previous year is 3.85 percent in 2004-05, 4.94 percent in 2005-06, and the estimated increase in 2006-07 relative to 2005-06 is 44.33 percent. This increase includes arrears.

Table 5.1: Revenue Expenditure

	Pre-FRA Period					FRA Period					
Revenue Expenditure	**Annual**				**Average annual**	**Annual**			**Average annual**	**BE (revised)**	**Average annual**
Composition	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2000-03**	**2003-04**	**2004-05**	**2005-06**	**2003-06**	**2006-07**	**2003-07**
Total Expenditure (Rs. Cr.)	11563	11878	11662	14756		15496	17169	18424		24555	
(%)	100.0	100.0	100.0	100.0		100.0	100.0	100.0		100.0	
Salaries (Rs. Cr.)	4503	4492	4201	4679		5147	5346	5610		8055	
(%)	38.9	37.8	36.0	31.7		33.2	31.1	30.4		32.8	
Pensions (Rs. Cr.)	1808	1930	1838	2283		2409	2601	2861		4055	
(%)	15.6	16.2	15.8	15.5		15.5	15.1	15.5		16.5	
Salaries+Pensions (Rs. Cr.)	6311	6422	6039	6962		7556	7946	8471		12110	
(%)	54.6	54.1	51.8	47.2		48.8	46.3	46		49.3	
Interest (Rs. Cr.)	1952	2258	2489	2947		3328	3613	3779		4428	
(%)	16.9	19.0	21.3	20.0		21.5	21.0	20.5		18.0	
Sal.+Pensions+Int. (Rs. Cr.)	8263	8680	8528	9909		10885	11559	12250		16538	
(%)	71.5	73.1	73.1	67.2		70.2	67.3	66.5		67.3	
Annual Increase (%)											
Total Expenditure (Rs. Cr.)	11563	11878	11662	14756		15496	17169	18424		24555	
(%)		2.7	-1.8	26.5	**8.5**	5.0	10.8	7.3	**5.9**	33.3	16.6
Salaries (Rs. Cr.)	4503	4492	4201	4679		5147	5346	5610		8055	
(%)		-0.2	-6.5	11.4	**1.3**	10.0	3.8	4.94	**2.7**	44.3	16.1
Pensions (Rs. Cr.)	1808	1930	1838	2283		2409	2601	2861		4055	
(%)		6.7	-4.8	24.2	**8.1**	5.5	8.0	10.0	**5.9**	41.7	19.0
Salaries+Pensions (Rs. Cr.)	6311	6422	6039	6962		7556	7946	8471		12110	
(%)		1.8	-6.0	15.3	**3.3**	8.5	5.2	6.6	**3.9**	43.4	17.0
Interest (Rs. Cr.)	1952	2258	2489	2947		3328	3613	3779		4428	
(%)		15.7	10.2	18.4	**14.7**	12.9	8.6	4.6	**4.3**	17.2	10.0
Sal.+Pensions+Int. (Rs. Cr.)	8263	8680	8528	9909		10885	11559	12250		16538	
(%)		5.0	-1.7	16.2	**6.2**	9.8	6.2	6	**4**	35.3	15.0
GSDP (Rs. Cr)	62520	69770	72349	80844		90172	100327	111633		123000	
GSDP Growth Rate (%)		11.6	3.7	11.7	**8.9**	11.5	11.3	11.3	**11.4**	10.2	11.1

Pensions stood at 15.5 percent of total revenue expenditure in 2003-04, 15.1 percent in 2004-05 and 15.5 percent in 2005-06. The rise in 2005-06 was owing to payments of two instalments of dearness relief. The budget estimates for 2006-07 project the pension bill at 16.5 percent of the total revenue expenditure. The average annual increase in pension over the previous year is 7.97 percent in 2004-05, and 10.01 percent in 2005-06. The estimated increase in 2006-07 relative to 2005-06 is 41.72 percent in view of the revision in pension.

Nothing can be done at this juncture with respect to the Pay Revision, which is a fait accompli. However, the problems arising from the demographic transition in Kerala and the problem of surplus posts for teachers dealt with in the first report of the Committee are now more valid than ever. The ban on creation of new posts introduced in 2001-02 still remains in place. However, the ban on recruitment to existing vacancies was lifted in 2004-05. The latter policy needs to be reviewed. No fiscal restructuring can take place in Kerala until it is recognized that public servants can be paid only for a service performed. There are many States in desperate need of trained teachers. A teacher exchange scheme can be visualized, whereby all three parties, the teacher, Kerala State, and the State buying the services of the teacher, are better off.

The interest payment was 21.5 percent of revenue expenditure in 2003-04, 21 percent in 2004-05 and 20.5 percent in 2005-06. Because of the increase in salary and pension in the revenue expenditure, interest is estimated to be only 18 percent in 2006-07. The annual increase in interest over the previous year is 8.56 percent in 2004-05, 4.6 percent in 2005-06 and a staggering 17.2 percent in 2006-07. The reasons for this emerge in the next section. There is also a cumulative interest of Rs 421 crore in respect of the 6 years Treasury Small Savings Fixed Deposit Certificate taken in 2000-01 on behalf of the Co-operative Academy for Professional Education. This is a bullet payment due in 2006-07, on maturity, as per the terms and conditions of the Scheme. It is a special stand-alone scheme like the Indira Vikas Patra.

6. DEBT

The closing stock of debt throughout the FRA period of 2003-06 stabilized at around the 41.5 percent of GSDP mark registered at the end of 2003-04 (table 6.1). This rose to 41.7 percent in 2004-05

Table 6.1: Composition of Debt

	Pre-FRA Period					FRA Period					
Debt	**Annual**				**Average annual**	**Annual**			**Average annual**	**BE (revised)**	**Average annual**
Composition	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2000-03**	**2003-04**	**2004-05**	**2005-06**	**2003-06**	**2006-07**	**2003-07**
Total (Rs. Cr.)	20176	23919	26951	31060		37452	41878	45929		53459	
(%)	100.0	100.0	100.0	100.0		100.0	100.0	100.0		100	
Internal Debt (Rs. Cr.)	5735	7627	9342	11747		17421	21676	25671		30665	
(%)	28.4	31.9	34.7	37.8		46.5	51.8	55.9		57.4	
of which NSSF (Rs. Cr.)	571	1012	1475	2306		4577	7048	9698		12381	
(%)	2.8	4.2	5.5	7.4		12.2	16.8	21.1		23.2	
Loans from Center (Rs. Cr.)	5903	6102	6347	6535		5628	5411	5417		6101	
(%)	29.3	25.5	23.6	21.0		15.0	12.9	11.8		11.4	
PF, Fixed Deposits (Rs. Cr.)	8538	10190	11262	12778		14403	14791	14841		16692	
(%)	42.3	42.6	41.8	41.1		38.5	35.3	32.3		31.2	
Annual Increase (%)											
Total debt (Rs. Cr.)	20176	23919	26951	31060		37452	41878	45929		53459	
(%)		18.6	12.7	15.2	**15.5**	20.6	11.8	9.7	**14**	16.4	**14.6**
Internal Debt (Rs. Cr.)	5735	7627	9342	11747		17421	21676	25671		30665	
(%)		33.0	22.5	25.7	**27.1**	48.3	24.4	18.4	**29.8**	19.5	**27.7**
of which NSSF (Rs. Cr.)	571	1012	1475	2306		4577	7048.3	9879		12381	
(%)		77.2	45.8	56.3	**59.8**	98.5	54.0	40.2	**64.23**	25.3	**54.5**
Loans from Center (Rs. Cr.)	5903	6102	6347	6535		5628	5411	5417		6101	
(%)		3.4	4.0	3.0	**3.4**	-13.9	-3.9	0.1	**-6.1**	12.6	**-1.2**
PF, Fixed Deposits (Rs. Cr.)	8538	10190	11262	12778		14403	14791	14841		16692	
(%)		19.3	10.5	13.5	**14.4**	12.7	2.7	0.3	**5.1**	12.5	**7.0**
GSDP (Rs. Cr)	62520	69770	72349	80844		90172	100327	111633		123000	
(%)		11.6	3.7	11.7	**9.00**	11.5	11.3	11.3	**11.4**	10.8	**11.2**
Debt/GSDP (%)	**32.3**	**34.3**	**37.3**	**38.4**		**41.5**	**41.7**	**41.1**		**43.5**	

Interest Rate(%)	10.88	10.24	9.79	10.16	**10.27**	9.72	9.11	8.7	**9.17**	8.91	**9.1**

and decreased to 41.1 percent in 2005-06. What helped secure this stabilization in the debt/GSDP ratio has been the higher rate of GSDP growth, at 11.4 percent over 2003-06 as compared to 9.0 percent over 2000-03, at a time when the average rate of interest declined to 9.17 percent over 2003-06 from 10.27 percent over 2000-03. In part this was a result of the debt swap scheme offered by the Centre over 2002-05. The average annual growth in debt of 15.5 percent during the pre-FRA period has dropped to 14 percent during the FRA period, and within the FRA period, from 20.6 percent in 2003-04 to just 9.7 percent in 2005-06.

While loans from the Centre continue to show a declining trend there is a more than compensatory increase in loans from the NSSF which in 2005-06 has become the highest cost source of borrowing (9.5 percent; see table 6.2).

Table 6.2 : Instrument Specific Rates of Interest

(percent)

	2004-2005	**2005-2006**
Provident Fund	8.50	8.50
Market Borrowings (Average)	6.40	7.51
NABARD-RIDF	6.50	6.50
LIC	8.50	8.50
NCDC	8.50	8.50
GIC & Others	9.00	9.00
Govt. of India Loans	9.00	9.00
NSSF	9.50	9.50
Treasury Fixed Deposits (Average)	7.33	6.67
Treasury Savings Bank	5.50	4.50

Fixed deposits in Treasuries and Provident Fund deposits have come down from 42.3 percent of the total debt in 1999-2000 to 35.3 percent in 2004-05, and further to 32.3 percent in 2005-06. This is an outcome of the gradual reduction in rates of interest on Treasury Savings Bank (TSB) and fixed deposits. The average rate of interest on fixed deposits has been reduced from 7.33 percent in 2004-05 to 6.77 percent in 2005-06. The total outstanding fixed deposits declined from Rs.4560 crore to Rs.4173 crore during the above period. The rate of interest on TSB was reduced from 5.5 percent in 2004-05 to 4.5 percent in 2005-06. Now even though the Bank rates have gone up slightly the treasury rates remain the same.

It is difficult for the Government to dispense with the deposits in treasuries completely as many Government officers and pensioners encash their salaries/pensions through TSB accounts. Pensioners also deposit their pensionary benefits in treasury fixed deposits. There are also deposits from the public and institutions though Government does not solicit deposits. The treasury deposit system now prevailing in Kerala is a legacy of the past from the pre-Independence era, when the princely State of Travancore had a system called "Anchal", akin to the present Post Offices. When, after Independence, the Government of India took over the post and telegraphs, the old system in Kerala gradually evolved into the treasuries.

Loans from the NSSF are the most rapidly rising component of total debt in the FRA period rising at 64.23 percent annually as against the overall rise in debt of 14 percent. This, in conjunction with the fact that the NSSF is the highest cost source of borrowing, is what poses the great challenge for debt stabilization in Kerala.

Outstanding contingent liabilities of the State by way of guarantees (including interest) have been reduced from Rs.13,996 crore in 2003-04 to Rs.12,316 crore in 2004-05 and again to Rs.11,935 crore at the end of 2005-06 well within the mandatory ceiling of Rs.14,000 crore.

7. CONCLUDING ASSESSMENTS AND RECOMMENDATIONS

7.1 ***Amendment of KFR Act Targets:*** This second report of the Kerala Public Expenditure Revenue Committee covers the fiscal year 2005-06. The assumption in the first Report that the KFRA will be amended in conformity with the stipulations of the Twelfth Finance Commission (TFC), further reinforced by the Revised Budget Speech for 2006-07 presented to the Legislature in June 2006, underlies the paras that follow. It is assumed that the final targets are a fiscal deficit at 3 percent of GSDP, and a zero revenue deficit, by 2008-09.

7.2 ***The Revenue Deficit 2005-06:*** In the absence of any structured reduction targets during the expected extended period, the annual target works out to a required reduction of 0.91 percent per year over 2005-06 to 2008-09, from a starting revenue deficit at 3.65 percent of

GSDP in 2004-05. The revenue deficit stood at 2.80 percent of GSDP in 2005-06 as against the required level of 2.74 percent in 2005-06. Thus the shortfall for the reporting period of 2005-06 is only a meagre 0.06 percent. The achieved decline by 0.85 percent in 2005-06 was mainly due to better realization of own tax revenue and increase in devolutions from the Centre, despite a 7.3 percent increase in revenue expenditure over the previous year.

7.3 ***Budgeted Revenue Deficits:*** In the first Report (recommendation 8.23) the Committee pointed out the wide discrepancy between budget estimates and actuals. This problem persists. The anticipated revenue deficit of 4.40 percent in 2006-07(BE) does not augur well for the State in terms of meeting the fiscal targets prescribed in the Act. The credibility of a budget depends largely on the degree of achievement of the targets set forth therein - both fiscal and physical. For instance, the revenue deficit for 2005-06 was budgeted at 4.05 percent of GSDP in 2005-06, but came down to 2.80 percent (actuals). The purpose of having a fiscal responsibility act in place is defeated, if budgeted estimates repeatedly ignore the stated goals as legislated.

7.4 ***The Primary Revenue Deficit 2005-06:*** There has been an impressive sign switch in the primary revenue deficit, from a deficit of Rs. 56 crore in 2004-005 to a surplus of Rs. 670 crore in 2005-06. However, by the budgeted figures for 2006-07, this will switch back in sign to a large primary revenue deficit of Rs. 987 crore in 2006-07 principally on account of a large budgeted increase of 33 percent in revenue expenditure over actuals, in turn because of implementation of the pay and pension revision.

7.5 ***The Fiscal Deficit and Capital Outlay:*** The fiscal deficit in 2005-06 came down to 3.75 percent from 4.43 percent in 2004-05, by 0.68 percent against the required 0.36 percent. The commendable decline in the fiscal deficit as a percent of GSDP was achieved despite a rise in capital outlay to Rs. 1053 crore from Rs. 783 crore in 2004-05. It would be recalled that capital outlay in 2004-05 declined by Rs.1076 crore from Rs.1859 crore in 2003-04 to Rs.783 crore. The revenue deficit as a percent of the fiscal deficit declined from 82.41 percent in 2004-05 to 74.82 percent during 2005-06.

7.6 ***The Primary Fiscal Deficit:*** This declined from 0.89 percent of GSDP to 0.34 percent in 2005-06. Both the fiscal deficit and primary fiscal deficit have been showing a declining trend throughout the FRA period as a percent of GSDP. However, it must be noted that the primary fiscal deficit remains positive. The significance of the sign of the primary fiscal deficit is that, unless the nominal growth of GSDP exceeds the rate of interest on outstanding liabilities, the percent of debt to GSDP cannot get stabilized as long as the primary fiscal deficit remains positive (i.e., not a surplus).

7.7 ***Summary of Fiscal Indicators for 2005-06:*** The fiscal correction required under the (to be amended) Act, in terms of revenue and fiscal deficits, were achieved during the period under review. The achievement of a primary revenue surplus is worth special mention. But, in view of the huge commitments on account of pay and pension revision, the impact of which will be felt only from 2006-07, concerted efforts will have to be made to substantially increase own tax revenues of the State.

7.8 ***The Adjusted Revenue Deficit:*** The first report estimated an adjusted revenue deficit after reclassification of certain revenue items of expenditure into the capital account, such as maintenance works by Public Works Department, and annual devolutions to Local Self Governments, portions of each of which go towards capital expenditure. On the basis of the same assumptions as those in the first report, the adjusted RD works out to 1.71 percent, against the required 2.74 percent. This is far in excess of the fiscal correction required. Until the underlying assumptions are validated on the basis of detailed figures on expenditures by local bodies and the PWD, the adjustments so made will have to be treated with caution. The Committee urges the Government of Kerala to make available the data required for further fine-tuning the adjustment procedure. There is a strong case for the State Government to persuade the Government of India to permit adjustment of the revenue deficit to exclude revenue expenditures towards creation of physical assets.

7.9 ***Unreported Liabilities:*** Unreported liabilities are accumulated over time owing to arrears in payments due to contractors for work done and to suppliers for goods delivered. In addition, land acquisition charges in respect of various projects and schemes, and other committed items of expenditure, are not recorded in any official budget document. These liabilities need to be fully reported. The Committee urges the Government to provide information on the opening and closing stocks of such unreported liabilities for the year 2006-07 with the budget documents for the fiscal year 2007-08.

7.10 ***Poor Performance of Own Tax Revenue:*** The average annual growth rate during the FRA period has registered a sharp fall from 12 percent over 2000-03 to 10.2 percent over 2003-06. This was in part a result of initial teething problems with the VAT, introduced from 1 April 2005. In the first year the department went slow in enforcing compliance to encourage traders to register under the VAT. As a result, revenue from sales tax which registered an increase of 11.84 percent in 2004-05 over the previous year, could post only a much lower growth rate of 5.03 percent in 2005-06.

7.11 ***Commendable VAT Initiatives:*** Preliminary estimates for VAT collections during the first half of 2006-07 show an increase of 68 percent over the corresponding period in 2005-06. New initiatives responsible for this upsurge include inspections, scrutiny of records and raids conducted regularly to detect evasion. Special squads drawn up from different districts are deployed for surprise inspections at major check posts. These efforts are expected to be intensified in the coming months. The Lucky VAT Scheme encourages customers to insist on proper bills from traders, since each purchase for Rs.1000 or more carries a lottery coupon. This is the first time that such a novel scheme has been introduced in any State in India and is a model for other States to emulate. One percent of revenue realization in excess of targets is marked to a traders' welfare fund. Thus, there are positive incentives for both consumers and traders. However, there is at present no scheme for cash incentives to staff. Along with this additional positive incentive, the government may consider introducing disincentives for defaulters.

7.12 ***Stamp Duty:*** Stamp duty rates have exhibited unfortunate volatility resulting from failure to follow up the halving of rates in December 2003 with fair value fixation, leading to a subsequent restoration of the earlier rates. The Committee suggests redoing the earlier aborted exercise, with simultaneous reduction of rates of conveyance and fixation of fair value, after careful planning and co-ordination between the Taxes Department and the Revenue Department.

7.13 ***Excise Duty and Motor Vehicles Tax:*** The revenue from excise duty and tax on motor vehicles has been steadily increasing during the FRA period.

7.14 ***State's Own Non Tax Revenue:*** Non-Tax Revenue also registered a higher growth rate of 14.4 percent in 2005-06 as against just 1.5 percent during the previous year. The major component, lottery receipts, generated Rs. 86 crore more than in 2004-05. All lotteries, including sale of tickets of other States and on-line lotteries, were banned on 27 January 2005, but on 22 April 2005, the lottery scheme of Kerala State alone was reintroduced. The ban on on-line lotteries still continues. This has increased the sale of Kerala State lotteries. Of late, paper lotteries of a few other States which have registered with the commercial taxes department, have started operating in Kerala following court intervention, the effect of which will be known only at the end of fiscal 2006-07.

7.15 ***Central Transfers:*** Central transfers in the revenues of the State accounted for Rs. 3718 crore in 2004-05, and grew by 23.2 percent in 2005-06 to record a total transfer of Rs. 4579 crore. The anticipated increase in transfers from the Centre, from Rs.4579 crore in 2005-06 to Rs.6365 crore in 2006-07, is mainly on VAT compensation estimated at Rs.1067crore. However, if the VAT performance is good, this compensation will not be realized. Further, it is unclear as to how an additional Rs. 800 crore from the Centre has been budgeted, when the deficit grant from the TFC, which applied to 2005-06 alone, will not be available in 2006-07. Efforts to step up the own revenue of the State, rather than reliance on Central assistance, will place the fiscal position of the State on a sound footing.

7.16 ***Salaries:*** The salary bill dropped from 33.2 percent of total revenue expenditure in 2003-04 to 31.1 percent in 2004-05 and to 30.4 percent in 2005-06. But when the full impact of the pay and pension revision ordered in March 2006 is felt in 2006-07, this is expected to go up to 32.8 percent of the revenue expenditure. The average annual increase in salary over the previous year was 3.85 percent in 2004-05, 4.94 percent in 2005-06. But the estimated increase in 2006-07 relative to 2005-06 is 44.33 percent. This increase includes arrears on account of the pay and pension revision.

7.17 ***Posts and Vacancies:*** The ban on creation of new posts introduced in 2001-02 still remains in place. However, the ban on recruitment to existing vacancies was lifted in 2004-05. The present policy with respect to existing vacancies needs to be reviewed in light of the problems arising from the demographic transition in Kerala and the problem of surplus posts for teachers. No restructuring of public expenditure can take place in Kerala without the recognition that public servants must be paid for some recognizable service. There are many States in desperate need of trained teachers. A teacher exchange scheme can be visualized, whereby all three parties, the teacher, Kerala State, and the State buying the services of the teacher, are better off.

7.18 ***Pensions:*** The average annual increase in pension over the previous year is 7.97 percent in 2004-05, and 10.01 percent in 2005-06. The estimated increase in 2006-07 relative to 2005-06 is 41.72 percent in view of the revision in pension. The recommendation in para 8.21 of the first report of this Committee , that Kerala should join the sixteen other States that have moved away from a defined benefit system to a defined contribution system, is strongly reiterated here.

7.19 ***Debt:*** Fiscal responsibility ultimately gets reflected in the ratio of public debt to GSDP, and thereby in the rating of the State by financial markets. The closing stock of debt throughout the FRA period of 2003-06 stabilized at around the 41.5 percent of GSDP mark registered at the end of 2003-04. This rose to 41.7 percent in 2004-05 and decreased to 41.1 percent in 2005-06. What helped secure this stabilization in the debt/GSDP ratio has been the higher rate of GSDP growth, at 11.4 percent over 2003-06 as compared to 9.0 percent over 2000-03. At the same time, the average rate of interest declined to 9.17 percent over 2003-06 from 10.27 percent over 2000-03. In part this was a result of the debt swap scheme offered by the Centre over 2002-05.

7.20 ***The Public Account:*** Kerala's unique system of savings bank and fixed deposits held by the Treasury is a vestigial remnant from the pre-independent era, when the princely State of Travancore had a system called "Anchal", akin to the present Post Offices. When, after Independence, the Government of India took over the post and telegraphs, the old system in Kerala gradually evolved into the treasuries. It is difficult for the Government to dispense with these deposits completely, as many Government officers and pensioners encash their salaries/pensions through TSB accounts. Pensioners deposit their pensionary benefits in treasury fixed deposits. There are also deposits from the public and institutions though Government does not solicit deposits. Fixed deposits in Treasuries and Provident Fund deposits have come down from 42.3 percent of the total debt in 1999-2000 to 35.3 percent in 2004-05, and further to 32.3 percent in 2005-06. This is an outcome of the gradual reduction in deposit rates. The average deposit rate on fixed deposits was reduced from 7.33 percent in 2004-05 to 6.77 percent in 2005-06, and the deposit rate on TSB was reduced from 5.5 percent in 2004-05 to 4.5 percent in 2005-06. Now even though the Bank rates have gone up slightly the treasury rates remain the same.

7.21 ***Debt Stabilisation Prospects:*** Loans from the NSSF are the most rapidly rising component of total debt in the FRA period, rising at 64.23 percent annually as against the overall rise in debt of 14 percent. This, in conjunction with the fact that the NSSF is the highest cost source of borrowing, is what poses the great challenge for debt stabilization in Kerala.

7.22 ***Contingent Liabilities:*** Outstanding contingent liabilities of the State by way of guarantees (including interest) have been reduced from Rs.13,996 crore in 2003-04 to Rs.12,316 crore in 2004-05 and again to Rs.11,935 crore at the end of 2005-06, well within the mandatory ceiling of Rs.14,000 crore