CENTRE-STATE RELATIONS, FINANCE COMMISSIONS AND KERALA'S FISCAL CRISIS

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ABSTRACT

In the context of the ongoing work of the Twelfth Finance Commission chaired by Dr.C.Rangarajan, this paper examines, the record of the fiscal transfer mechanism in India particularly that of the Finance Commissions. The specific objective of the present enquiry is to find out to what extent the deficiencies of these mechanisms are responsible for accentuating the recurrent fiscal crisis of the States. The issue is examined with particular reference to Kerala.

The paper is divided into two sections. Section I takes a look at the past record of vertical transfers viz., transfers from the Centre to the States as a whole. Section II examines the trends in horizontal transfers, viz. interstate distribution of Central transfers. It examines, in particular, the flow of Central government funds to Kerala in comparison with that going to other States. It discusses in detail the different criteria for Central transfers adopted by recent Finance Commissions which led to Kerala receiving lower than All States average quantum of Central funds. It argues in favour of the Twelfth Finance Commission adopting altogether new criteria, taking into account the unique pattern of Kerala's development and the resulting problems which again are unique to the State.

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States in India are plagued by recurrent and severe fiscal crisis from the middle of the eighties. Mismanagement of the finances by the State governments is the reason for the crisis, most often highlighted during the current discussions on the issue. The role of the Central government, pivotal under the existing Centre-State financial relationship, is seldom mentioned as a possible reason. It requires reiteration in this context that India is a semi federal polity and the existing constitutional allocation of financial powers between the Centre and the States is heavily skewed in favour of the former. The Indian Constitution places considerable constraints on the States' capacity for resource mobilisation while saddling them with enormous expenditure responsibilies. The Constitution of India however envisaged a fiscal transfer mechanism to transfer adequate funds from the Central government to the States, taking into account the disproportion between the financial powers and responsibilities of the two tiers of the government. The Finance Commission to be appointed every five years under Article 280 of the Constitution is the main agency for effecting such transfers. It is a semi-judicial body and is entrusted with the twin responsibilities of apportioning Central Government revenues between the Centre and the States on the one hand and among the individual States on the other. The turf of this constitutional body had been encroached, upon to a large extent, by Planning Commission, an extra constitutional body and the Union Ministries. Despite this, the Finance Commissions account for more than fourty percent of the total Central transfers to the States (Table 1). In the context of the ongoing work of the Twelfth Finance Commission chaired by Dr.C.Rangarajan, this paper examines, the past record of the fiscal transfer mechanism in general and that of the Finance Commissions in particular. The specific objective of the present enquiry is to find out to what extent the deficiencies of these mechanisms are responsible for accentuating the recurrent fiscal crisis of the States. The issue is examined with particular reference to Kerala.

The paper is divided into two sections. Section I takes look at the past record of vertical transfers viz., transfers from the Centre to the States as a whole. Section II examines the trends in horizontal transfers, viz. interstate distribution of transfers. It examines in particular the flow of Central government funds to Kerala in comparison with that going to other States. It discusses in detail the different criteria for Central transfers adopted by recent Finance Commissions which led to Kerala receiving lower than All States average quantum of Central funds under their dispensation. It also argues for the Twelfth Finance Commission adopting altogether new criteria taking into account the unique pattern of Kerala's development and the resulting problems which are again unique to the State.

SECTION I

Vertical Transfers (Transfers from the Centre to the States)

The Tenth and the Eleventh Finance Commissions had tried to restore the fiscal balance of the Central government at the cost of the States by limiting the States' share in Central taxes to 29 percent. This is despite the strong plea made by all the States to raise the share at least to 33.3 percent. What is more, the stipulated 29 percent is not that of gross tax revenue but that of revenue after excluding Cesses and Surcharges and after deducting the cost of collection. During the five-year period ended 1999-2000, Cesses and Surcharges accounted for nearly 4 percent of the gross tax revenue. In 1999-2000, their share was as high as 6.7 percent.[1] *The Twelfth Finance Commission will be doing only justice to the States if Cesses and Surcharges are included in the divisible pool of Central taxes.*

The Eleventh Finance Commission, for the first time, had suggested capping the aggregate revenue transfers to States (Tax share + all grants including plan grants) at 37.5 percent of the Centre's total revenue. It appears that there was no need for such capping the Central Transfers since these transfers did not reach the ceiling of 37.5 percent in any year since 1995-96. (Table 2) Besides, there was steep decline in the ratio of total revenue transfers to gross Central revenues during the second half of the nineties covered by the award of the Tenth Finance Commission. During the first two years of the award period of the Eleventh Finance Commission, the ratio went up and hovered around the stipulated 37.5 percent. But it came down to 34.3 percent in 2002-03 and 36.3 percent in 2003-04. (These figures are those of Revised Estimates and Budget Estimates and therefore are subject to further revision.) In any case, the proposed ceiling is much lower than the actual States' share during the first five years of the nineties.

Other indicators also show the decreasing trend of revenue transfers from the Centre. The ratio of revenue transfers to GDP has been coming down steadily in the nineties. From 5.0 percent in 1990-91, the ratio came down to 3.7 percent in 1998-99 and stood at 4.3 percent in 2003-04. This decline is partly due to the decrease in the share of revenue transfers in gross revenue noted earlier. But the more important reason is the low revenue mobilisation effort of the Central government as may be seen from the Table 2. The tax-GDP ratio as well as the gross revenue (tax+non-tax) to GDP ratio showed declining trends. The mobilisation of commodity taxes was particularly poor.

While the Finance Commissions had been following a reward and punishment approach for disciplining the States, no such approach is followed in the case of the Central government. *The Twelfth Finance Commission will be paving a new trail in Indian federalism, if it can link the States' share to the estimates of revenue determined normatively by the Commission and not to what is actually collected by the Central government.* Such a decision will help in disciplining the Central government and in preventing leakages of revenue due to the States. Such an approach by the Commission will be then more even handed between the Centre and the States unlike in the past.

The Declining Role of Central Transfers in States' Expenditure

The growth rate in Central transfers to States shows a decline though marginal from the first half of the nineties to the second half (Table 3). The rate of growth of total Central revenue transfers has been much lower than the growth rate in State's own revenue both during the first and the second half of the nineties. As a result, the role played by Central transfers in financing the States' expenditure has been coming down rather steeply. This trend is more prominent from the second half of the nineties (Table 4).

There is a strong case for increasing the share of the States in the Central government's revenue. The Twelfth Finance Commission has to take cognisance of the changing role of the State implicit in the economic reforms being pushed through in the country. The reforms envisage the Governments to reduce their role in economic activities and concentrate on providing social services like education, health care, social security, food security etc. Under the constitutional dispensation, almost all these services come largely under the States' jurisdiction. This suggests the need for increasing the share of States in Centre's revenue.

[1] Based on Annexure VI.1, Eleventh Finance Commission Report, p.217.

SECTION II

Inter-State Transfers and Kerala

The discussion above shows that the decreasing flow of Central government funds to the States has aggravated the fiscal crisis of the States. This decline has accentuated the fiscal crisis of Kerala, which is much more severe than that of All States (CSES, 2003). The average growth rate in total Central transfers was lower for Kerala (8.3 percent) than for other States (12.5 percent) (Table 3). It has also been coming down rather steeply. The growth rate in Central transfers was lower than that of State's own tax revenue during both halves of the nineties. Consequently the role played by Central transfers in financing Kerala's expenditure, both revenue and aggregate was always smaller than the average for other States. Besides, the relative importance of Central transfers in financing State's aggregate expenditure has been coming down rather steeply from the mid nineties. It came down from 37.3 percent in 1994-95 to 32.8 percent in 2002-03.

Per Capita Central Transfers

A comparison of per capita aggregate Central transfers received by Kerala and All States shows that from the Sixth Plan onwards, Kerala was receiving less Central transfers than the average of All States (Table 5). During the Ninth Plan period, per capita Central transfers to the State was only Rs.4995 as against Rs.6159 for all States. The Table, which also gives the agency-wise data of Central transfers reveals that all the three agencies, viz., the Finance Commission, Planning Commission and various Union Ministries had contributed to Kerala receiving less Central transfers than other States.

Record of the Finance Commissions

Though all agencies had contributed to the lower quantum of funds flow to the State, it is the role of the Finance Commission which is particularly disturbing as it is this agency which is envisaged under the constitution to effect fiscal transfers judiciously and fairly. Except during the Fifth and the Sixth Plan periods, Kerala received less than All States average quantum of per capita statutory transfers (transfers effected on the recommendations of the Finance Commissions). (Table 5)

The award of the Eleventh Finance Commission evoked strong criticism in Kerala. This is not surprising as, under the award, the share of Kerala in total transfers to all States had come down to 2.83 percent from 3.88 percent under the award of its predecessor. (Table 6) For the entire five-year period covered by the award of the Eleventh Finance Commission (2000-2005), the State was to get Rs.3664 Crores less than what it would have got as per the recommendations of the Tenth Finance Commission.

Criteria for Devolution (Sharing of Central Taxes)

Kerala has not been getting its due share in Central taxes under the awards of the recent Finance Commissions because of four reasons. (1) The use of criteria inappropriate for the State. (2) Use of Inappropriate indicators for the criteria used (3) inappropriate weightages given for the different criteria (4) Failure to use criteria which are relevant to the State. In the section that follows, we examine the different criteria adopted by the recent Finance Commissions and assess their effects on the State. We also suggest some alternative criteria which are more appropriate for the State.

Population

One of the criteria adopted for devolution by all Finance Commissions is the size of population as it is an indicator of the budgetary needs of States. Besides, this is a neutral criterion. But the Eleventh Finance Commission had reduced the weightage of this factor to just 10 percent. *This weightage is too small and hurts the interest of populous states like Kerala. Therefore, population should get more weightage, at least 20 percent given by the Tenth Finance Commission.*

All the recent Finance Commissions had been enjoined under their terms of reference that "in making its recommendations on the various matters aforesaid, the Commission shall adopt the population figures of 1971 in all cases where population is regarded as a factor for determination of devolution of taxes and duties and grants in aid". In giving weightage to the criterion of population, all Finance Commissions use the 1971 population figures. But in calculating per capita income, it is the current population and not the 1971 population, which is being used by them. This tends to inflate the per capita income of States like Kerala, which are more successful in controlling population growth. This in turn has reduced its entitlement under the devolution package. *In order not to penalise States with better record of implementing national population policy, the Twelfth Finance Commission should use the 1971 population figures for working out the per capita income for operationalising the income criterion.*

Area and Density of Population

Area of the States is a relatively new criterion, which has come to be used by the Tenth and Eleventh Finance Commissions. The Eleventh Finance Commission had increased the weightage to area from 5 percent to 7.5 percent. Area is an indicator of states' budgetary needs. But the size of the area as a criterion for devolution adversely affects relatively smaller states but with high density of population. It can be argued that density of population also has fiscal implications. The density of population boosts the land prices as it has happened in Kerala and affects the capital expenditure needs of States. *The Twelfth Finance Commission should consider giving a combined weightage of 10 percent to the two factors-area and density of population (5 percent for each).*

Per Capita Income

Per capita income is one of the core criteria used by all Finance Commissions. The Eleventh Finance Commission had raised the weightage of per capita income by distance method from 60 percent to 62.5 percent. By doing so, the Commission claims that it has helped the cause of backward States. But per capita income can only be one of the indicators of the States' economic backwardness. The world over, regional economic backwardness is measured not only in terms of per capita income but also in terms of unemployment rates. Besides, data of major Indian States show that, there is only an insignificant correlation between per capita State income and States' unemployment rates (-0.014). *Kerala, therefore, should argue before the Twelfth Finance Commission that it should include unemployment as an additional criterion of backwardness and give it a weightage equal to that of per capita income.*

Table 7 shows that unemployment rate for the State (21.0 percent) is nearly three times higher than the national average (7.3 percent). It is the highest among the major States. What is more, unemployment rates have been increasing in the nineties. The employment elasticity of Kerala (0.013) during the period 1993-94 to 1999-2000 was the lowest among the fifteen major States in India; national average being 0.160.

According to the National Sample Survey, the rural unemployment rate in Kerala has shot up from 14.7 percent in 1993-94 to 21.7 percent in 1999-2000. The urban unemployment rate has gone up from 17.7 percent to 19.1 percent during this period (Prakash, 2003). Kerala's achievement in bringing about a demographic transition has resulted in a shift in the age pyramids which has implications for the dimension of unemployment in the State. The share of working age population is estimated to have increased from 53.9 percent in 1991 to 59.7 percent in 2001. It is expected to reach 67.0 percent by 2011 (Table 8).

The State's higher level of education also introduced a qualitative dimension to its unemployment problem. More than eighty percent of the unemployed registered with the Employment exchanges in the State are matriculates and above (Economic Review, 2002). Among the rural educated, one out of four is unemployed. Among the urban educated, one out of five is unemployed (Prakash, 2003). Because of this peculiarity of Kerala's unemployment problem, many of the national schemes for unemployment relief like 'food for work' programme are not relevant for Kerala. The State's growing unemployment problem has budgetary implications as the government operates an unemployment relief Scheme.

Index of Infrastructure

The Tenth and Eleventh Finance Commissions had used an index of infrastructure as a criterion for devolution and had given it a weightage of 5 percent and 7.5 percent respectively. Kerala should have strong reservation in accepting this index due to a number of reasons. Firstly, there is high correlation between per capita GSDP and index of social and economic infrastructure of States, both used by the Eleventh Finance Commission (0.76). By including both the criteria and giving large weightage to both (62.5 percent and 7.5 percent respectively), the Eleventh Finance Commission had compounded the effects of the criteria of backwardness adopted by them. Secondly, the infrastructure indices constructed for both the Tenth and Eleventh Finance Commissions give undue weightage to social indicators. Thirdly, some of the qualitative indicators of infrastructure development relevant to Kerala are not included in the indices.

According to the index of infrastructure used by the Eleventh Finance Commission, Kerala stands third among the States. This is because the Eleventh Finance Commission had included many indicators of social development in this index of infrastructure. Large weightage has also been given to quantitative indicators of financial, communication and road network in the State. But the Commission has overlooked some of the qualitative dimensions of the State's infrastructure development. For instance, the vehicle density of the State's roads is nearly three times higher than the national average. National Highways account for just 1.1 percent of the road length in the State. (Economic Review, 2002) Even State highways account for only about 2 percent of the road length in the State. The railway network per lakh of population is much below the country's average and the system requires thorough modernisation(CSES, 1997). Today infrastructure has become an important bottleneck, which prevents Kerala emerging as an investment destination. The importance of railways, National Highways and State Highways is all the more high for a State like Kerala, the economy of which has predominant export-import orientation.

Incentive for Tax Efforts, Fiscal Management and Fiscal Reforms

Kerala stands to benefit by restoring the weightage for tax efforts from the present 5 percent assigned by the Eleventh Finance Commission to 10 percent given by the Tenth Finance Commission. It would also benefit if the weightage for fiscal discipline is raised from 7.5 percent to 10 percent. The Tenth Finance Commission, had used the level and trend in the ratio of own revenue to total revenue as the indicator of fiscal management. In addition, the Twelfth Finance Commission, can think of other criteria for assessing the fiscal discipline. The share of administrative services in the aggregate expenditure and the share of salary in the total revenue expenditure are two such indicators of fiscal discipline of States. The share of administrative services in total expenditure of Kerala was only 8.8 percent as against 10.5 percent for all States. The total salary expenditure as percentage of total expenditure in Kerala has been brought down from 39.5 percent in 1991-92 to 35.3 percent in 2000-01. The Commission should also take note of the fact that the State is implementing a programme for modernising government (MGP), which involves administrative reforms, budgetary reforms, reforms in expenditure management and tax administration.

Statutory Grants

Table 9 shows that the share of grants in statutory transfers to Kerala was considerably lower than those to other States. (1.1 percent for Kerala and 14.5 percent for other States in 2000-01) In fact, it was negligible throughout the nineties. Table 10 shows that Kerala received, in per capita terms, much less grants than other States in the hands of the recent Finance Commissions. Kerala received much less of all types of grants- Article 275 grants, upgradation grants and special problem grants. Per capita statutory grants to Kerala under the award of the Eleventh Finance Commission was just Rs.9 as compared to Rs.282 for other States.

Article 275 Grants

No Finance Commission from the seventh had given any grants to Kerala under the substantive provisions of Article 275 of the Constitution meant for States "in need of assistance". The State was not receiving Article 275 grants because of the surpluses in the non-plan revenue account assumed by the Finance Commissions in their normative estimates of States' budgets. But the State actually had continuous deficits on non-plan account ever since 1985-86, even after including all additional resources mobilised in the non-plan account. At least part of the blame for this situation may have to be borne by the unrealistic forecasts made by the Finance Commissions based on wrong assumptions. (George, 1999)

Non-Plan deficits/surpluses assumed by the Sixth Finance Commission onwards and the actuals are given in Table 11. The Table shows that the actual Non-Plan revenue deficits of Kerala, before and after devolution, were higher than those assumed by the recent Finance Commissions. During the award period of the Eighth Commission (1984-89), the volume of actual deficits, before devolution turned out to be far bigger than its forecasts despite massive additional resource mobilisation made during the Seventh Plan. The surplus after devolution forecasted by them turned out to be deficits in the case of Kerala. There was substantial divergence between the non-plan deficits for 1989-90 assumed by the Ninth Finance Commission in its First Report and the actuals for the year. The actual non-plan revenue deficit before devolution exceeded the deficit assumed by the Commission by a wide margin. The surplus of Rs.90 crores after devolution forecasted for Kerala turned out to be a deficit of Rs.117 crores even after taking into account the effects of additional resource mobilisation in 1989-90. The same pattern of divergence between the forecasts and actuals was noticed during the award periods of the Ninth (Second Report), Tenth and the Eleventh Commissions.

The non-plan surpluses even after all statutory transfers (share in central taxes + statutory grants) envisaged by the Finance Commissions also turned out to be a mirage. For instance, the Eleventh Finance Commission had forecasted a surplus of Rs.2157 crores for Kerala for the first three years. But the actuals turned out to be a whopping deficit of Rs.3182 crores.

No doubt, the lack of financial discipline of the State governments has contributed its share to the phenomenon of large surpluses assumed by the Finance Commissions turning into large deficits. But faulty methodologies for forecasting adopted by the successive Finance Commissions cannot be totally absolved of the blame for these large variations which are prevalent in the case of almost all States.

Upgradation Grants

With regard to grants for upgradation of social and administrative services too, Kerala received only marginal sums (Table 12). Of the total upgradation grants dispensed by the Seventh, Eighth and the Ninth (First and Final) Finance Commissions, Kerala received only 0.8 percent to 1.4 per cent. Under the award of the Tenth Finance Commission, Kerala's share was only 2.2 percent. Under the award of the Eleventh Commission, Kerala received slightly less. For upgradation of social services, Kerala received no funds at all from the Seventh and the Eighth Finance Commissions. It received just 0.1 percent and 0.3 percent respectively from the Ninth and the Tenth Commissions. Eleventh Finance Commission provided slightly more. But it was not more than 1.5 percent of the total grants meant for upgradation of the social services. The State obviously is penalised for its success in attaining above average standards in social services like education and health care. But the successive Finance Commissions took cognisance of Kerala's major achievements only in quantitative terms.

Need for Upgradation Grants for Education

While looking at the educational development of the State, all Finance Commissions failed to take into account some of the major deficiencies of the education sector. The quantitative expansion in educational sector has been at the expense of quality at all levels. A study by the NCERT showed that Kerala ranked very low among the Indian States in terms of learning achievement of primary school children (Jangira N.K 1994). About 30 percent of the children who complete primary schools do not reach the necessary achievement levels in literacy and numeracy. The situation in the secondary schools is not very different. The drop-out rates in secondary schools especially in the 9th and 10th standards are quite high. This is particularly true for SC/ST students (Kerala Education Commission, 1999). Another major indicator of the inefficiency of Kerala's school education system is the large-scale failure of the students in the matriculation examination. Only about 50 percent of the students who appear for the examination get through in spite of liberal valuation and provision of grace marks. Only one-third of the children who join the 1st standard manage to pass the matriculation examination.

An analysis of the average marks for various subjects in the 10th standard examination further illustrates the poor quality of Kerala's secondary education system. The average marks are: Malayalam -26 percent, Mathematics -18 percent, English -15 percent, Hindi -22 percent, General Science -26.5 percent, Social Science -20.5 percent (Vijayakumar.B, 1998). A recent study has shown that 44 percent of the students in the 9th standard get less than 40 percent in Malayalam, their mother tongue. More than 70 percent get less than 40 percent for Mathematics and English (Ramakrishnan.C, 1998)

The large-scale drop-outs in the secondary schools as also the high percentage of failures at the matriculation level, the low average marks scored etc. are manifestations of the low-level of preparation of students and their consequent inability to cope with even the modest sifting procedures. The State thus faces the problem of a large number of children being rejected by the school system (Kerala Education Commission, 1999).

The poor academic standards are understandable in view of the poor infrastructure and other facilities which in turn is a reflection of the low level of investment. It is true that the State is spending more on education than most other States on a per-capita basis. But a recent study has brought out that the per pupil expenditure on secondary education is very low compared to that of other States. The per-pupil expenditure on secondary education in Kerala was only Rs 4659, as against the all-India average of Rs 5668. In this respect, Kerala's position is only 20th among the 26 States in India (George *et.al*, 2003). This apparent contradiction is due to the larger enrolment in schools in Kerala as compared to other States. The butter seems to be spread too thinly.

The above discussion suggests that there is a strong case for Kerala getting upgradation grants for education for improving the quality standards in Kerala's school system.

Special Problem Grants

The Ninth Finance Commission in its first report had provided Rs.552 crores as grants for solving 'special problems'. Kerala was one of the four States, which in the Commission's opinion did not have any special problem to merit special problem grants. The Tenth Finance Commission provided Rs.52 crores as special problem grants- Rs.50 crores to tackle the problem of sea erosion and Rs.2 crores for the conservation shola forests. What Kerala received was about Rs.50 crores less than what was received by Maharashtra. The Eleventh Finance Commission provided just Rs.50 crores by way of special problem grants. This amount was meant for preventing coastal sea erosion, the only special problem that it could identify.

The Kerala model of development has thrown up a large number and variety of special problems unique to the State. It is often claimed that some of Kerala's achievements are comparable to those of advanced countries. But these have also brought in its wake some of the advanced countries' problems. The State does not have the financial ability to tackle them all by itself. Since these problems are unique to the State, they have not received the national attention and priority that they deserve. While the federal agencies are still grappling with first generation problems in education, health care and social security, Kerala is saddled with second generation problems resulting from the very success in attaining higher levels of social development (eg: the problems of old age, unemployment of the educated, larger demand for higher education etc.). The State should press the Twelfth Finance Commission to take cognisance of these special problems of the State.

Aging of Population – A Special Problem of Kerala

The aging of population is one of the emerging special problems of Kerala. The percentage of aged population in the total population was 10.6 percent in 1990-91 as against 7.5 percent in 1981. The corresponding percentage for the country as a whole was 6.7 percent in 1990-91 and 6.5 percent in 1981. The projections of the old age population in Kerala are given in Table 8. The proportion of old people in the population is expected to reach 13.6 percent in 2011. The large greying population has several implications in relation to health needs, work participation rate, dependency rate, service pension requirements and social security system.

Kerala's success in extending life expectancy has been burdening the government with a high-volume of service pension payments. The problem is likely to be aggravated in future as death rates are likely to fall further among senior citizens in the State. Already, these pensions account for 16.2 percent of the State's revenue expenditure as against the average of 8.7 percent for all States.

The changing population profile is straining the State's social security system. The majority of the social security schemes are targeted at senior citizens. The burden of these schemes is likely to increase in view of the demographic changes taking place. Already, the State is unable to revise the rates of welfare payments in time to compensate for the increase in cost of living. Besides, these payments to the elderly are effected only after considerable time lags.

The changing demographic profile is also likely to increase the demand for expenditure on health services. The increasing proportion of the aged in the State's population is changing the disease profile in the State (Panikar and Soman, 1985). A new category of diseases comprising degenerative and neo-plastic diseases like hyper-tension, cardio-vascular diseases and cancer have begun to emerge in the State. The proportion of these diseases which is already quite high is likely to increase further. These diseases of the old call for higher investment in diagnostic equipment, hospitalisation, treatment, recovery and rehabilitation. At a time when the expenditure requirements on health are rising, the State is finding it increasingly difficult to meet these requirements. As a result, the quality of services in the government health services has come down. Consequently, there has been an increase in the demand for private medical care services offered very often on commercial terms. This, in turn, has boosted the average private expenditure on medical care. The State seems to be loosing its gains on the health front.

It is necessary that the Twelfth Finance Commission should consider aging of population of Kerala as a special problem and provide Special Problem and Upgradation Grants to meet the manifold expenditure needs of the government.

Special Problems in Higher Education

In the field of higher education, Kerala lags behind other States not only in qualitative terms but also in quantitative terms. This is yet another success induced second generation problem of the State's social development. The demand for tertiary enrolment in absolute terms is much higher in Kerala due to large scale enrolment in schools. But the State is not able to meet this demand due to financial constraints. As a result, the number of higher educational institutions per million population was only 7.96 in Kerala as against 9.87 in the country. The ratio of enrolment in higher education to enrolment in higher secondary education shows that Kerala (67.4 percent) lags behind the national average (76.2 percent) (Tilak, 2001).

The Twelfth Finance Commission should treat the problem of insufficient capacity in higher and technical education in the State as a special problem arising out of the State's very success in attaining universal schooling.

Compensation for Centre induced Fiscal Disabilities

Compensating the States for their fiscal disabilities resulting from national policies has not been considered by any Finance Commission in India except the First. But this practice is being followed in many other federations. As is well known, the impact of national policies differs among different States. The commitments of the country under WTO, SAARC, Indo-Sri-Lanka Trade Agreement, Free Trade Area Framework under ASEAN+, Bilateral agreements with Malaysia and Thailand etc. have opened the flood gates of competition and have adversely affected the agricultural sector of the State, dominated by cash crops. Due to declining prices of some of the major plantation crops, misery, destitution and starvation are widely prevalent in the once prosperous plantation regions of Kerala. This has increased the expenditure commitments of the State government, while the severe decline in agricultural income has affected tax mobilisation by the State during the second half of the nineties (Table 13). The average annual growth rate of State's own tax revenue came down from 20.4 percent during the first half of the nineties to 11.7 percent during the second half. The Twelfth Finance Commission must take cognisance of the woes of Kerala's plantation sector following the opening up of the national economy, and its impact on both the revenue and expenditure fronts.

Postscript

The award of the Eleventh Finance Commission evoked loud hue and cry in Kerala. There were vehement protests against 'injustice' meted out to Kerala and the 'discrimination' shown against the State. Much of the criticisms was legitimate. The composition and the style of functioning of the Commission was not such as to inspire much confidence. However, one has to admit that there was also a failure of civil society to present Kerala's case. Unlike the Planning Commission, FC is a semi-judicial body, which collects evidence from the public and conducts open hearings. But, only six out of a dozen and a half political parties had appeared before the Commission. None of the major Chambers of Commerce presented memoranda. Only a lone trade union submitted a memorandum and argued its case before this body. Besides, most of the memoranda and presentations were not backed by any solid research on Kerala's unique problems arising from its unique pattern of development. If the State's case is not to be lost before the Twelfth Finance Commission, it is high time that informed discussions are initiated by all sections of Kerala society including the media on the State's case.

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Table 1

Share of Different types of Transfers in Aggregate Transfers

(Figures in Percentages)

Year	Statutory Transfers(1)		Plan Transfers(2)		Non-plan Non-statutory Transfers(3)		Total	
	Kerala	Other States	Kerala	Other States	Kerala	Other States	Kerala	Other States
1990-91	43.6	40.2	36.0	37.4	20.4	22.4	100.0	100.0
1991-92	38.3	42.1	35.9	41.0	25.9	16.9	100.0	100.0
1992-93	41.2	44.2	41.3	42.6	17.6	13.2	100.0	100.0
1993-94	40.9	41.9	44.0	46.1	15.0	12.0	100.0	100.0
1994-95	38.0	41.8	42.7	45.2	19.3	13.0	100.0	100.0
1995-96	48.6	47.4	32.6	34.1	18.7	18.5	100.0	100.0
1996-97	55.3	46.9	35.5	38.2	9.2	14.9	100.0	100.0
1997-98	48.9	44.0	30.4	35.0	20.7	21.0	100.0	100.0
1998-99	48.9	39.1	34.8	34.6	16.4	26.3	100.0	100.0
1999-2000	47.1	37.3	30.4	34.2	22.5	28.5	100.0	100.0
2000-01	51.3	42.0	30.9	30.1	17.8	28.0	100.0	100.0
2001-02*	47.5	38.8	29.7	36.4	22.8	24.8	100.0	100.0
2002-03+	42.2	38.0	41.8	38.3	15.9	23.7	100.0	100.0

* Revised Estimates

+Budget Estimates

Notes: 1. Effected by the Finance Commissions.

2. Effected by the Planning Commission. Includes transfers for financing State plans and Central and Centrally sponsored schemes.

3. Effected by different Union Government ministries.

Source: Computed from Reserve Bank of India, *State Finances* for various years.

Table 2

Financial Management of Central Government

(Figures in percentages)

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03+	2003-04*
Ratio of Revenue Expenditure to GDP	--	--	12.4	12.6	12.1	11.8	11.6	11.8	12.5	12.9	13.2	13.1	13.9	13.4
Ratio of Gross Tax Revenue to GDP	10.12	10.31	9.97	8.82	9.11	9.36	9.41	9.14	8.26	8.87	8.96	8.15	9.05	9.22
Ratio of Taxes on Income, Property and Capital Transactions to GDP	1.94	2.33	2.42	2.36	2.66	2.83	2.84	3.17	2.68	2.99	3.25	3.01	3.36	3.51
Ratio of Taxes on Commodities and Services to GDP	8.19	7.99	7.55	6.45	6.45	6.54	6.57	5.97	5.58	5.87	5.72	5.13	5.69	5.71
Ratio of Total Central Government's Gross Revenue to GDP	12.23	12.76	12.66	11.38	11.45	11.74	11.79	11.65	10.83	11.61	11.62	11.10	12.02	11.77
Ratio of Total Revenue Transfers to States to GDP	5.03	5.21	5.12	4.99	4.46	4.30	4.31	4.38	3.74	3.79	4.33	4.17	4.12	4.25
Ratio of Total Revenue Transfers to Gross Revenue of Centre	41.10	40.84	40.46	43.85	38.95	36.65	36.51	37.57	34.56	32.62	37.27	37.59	34.32	36.08
Ratio of Tax Share to Gross Tax Revenue of Centre	25.35	25.67	27.50	29.36	26.91	26.33	27.23	31.28	27.22	25.32	27.41	28.25	25.30	25.35

\+ Revised Estimates

* Budget Estimates

Source: EPW Research Foundation, "Finances of Government of India", *Economic and Political Weekly(EPW)* , May 10, 2003

Table 3

Average Annual Growth of Own Revenue and Central Revenue Transfers

	1991-92 to 1995-96		1996-97 to 2000-01	
	Kerala	Other States	Kerala	Other States
Own Tax Revenue	20.4	15.9	11.7	13.2
Own Non-Tax Revenue	20.9	21.0	4.8	7.0
Own Revenue-Total	20.4	17.0	10.8	11.6
Share in Central taxes	16.5	15.4	9.0	12.2
Grants from the Centre	6.9	11.3	9.1	13.2
Total Central Revenue Transfers	12.2	13.4	8.3	12.5

Source: Computed from *State Finances* op.cit.

Table 4
Share of Gross Central Transfers in States' Expenditure

(Figures in Percentages)

Year	Revenue Expenditure		Capital Expenditure		Total Expenditure	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	38.0	37.3	55.0	42.1	42.0	38.7
1975-76	36.3	40.4	44.4	39.4	38.2	40.1
1976-77	33.9	40.1	51.3	37.8	38.3	39.4
1977-78	36.3	40.9	51.6	44.6	40.3	42.1
1978-79	36.7	42.1	76.0	62.8	45.8	48.9
1979-80	33.5	45.4	41.7	46.2	35.5	45.7
1980-81	30.5	43.4	39.8	41.5	32.6	42.7
1981-82	32.3	40.9	28.2	43.5	31.1	41.7
1982-83	32.6	39.6	50.9	50.5	36.5	42.9
1983-84	33.2	36.7	61.9	51.8	40.2	41.0
1984-85	32.5	37.4	49.2	52.8	37.1	41.8
1985-86	34.5	41.2	81.4	69.2	47.0	48.8
1986-87	31.7	39.9	56.2	56.2	37.4	44.2
1987-88	26.5	39.2	64.2	61.2	34.4	44.6
1988-89	30.3	38.9	61.8	63.8	36.1	44.7
1989-90	30.3	36.8	56.7	65.6	35.2	43.1
1990-91	30.2	37.5	74.1	72.4	37.4	44.9
1991-92	29.3	37.2	72.9	60.1	37.9	41.8
1992-93	31.5	39.9	74.9	56.6	38.6	43.1
1993-94	29.2	39.8	70.5	57.0	36.0	43.1
1994-95	29.0	34.9	84.9	58.1	37.3	39.7
1995-96	25.8	34.5	59.8	60.2	31.2	39.2
1996-97	25.5	34.4	46.8	70.3	28.6	40.4
1997-98	25.1	34.6	36.0	16.5	26.8	25.6
1998-99	21.6	28.8	62.9	87.2	27.0	38.9
1999-2000	19.2	28.6	80.4	90.7	25.5	39.1
2000-01	18.5	30.4	72.7	92.6	23.8	40.3
2001-02*	22.5	32.0	75.7	89.7	29.3	42.1
2002-03+	23.5	32.8	121.0	93.8	32.8	43.5

* Revised Estimates
+Budget Estimates

Source: 1. George K.K., *Limits to Kerala Model of Development,* Centre for Development Studies, Thiruvananthapuram, 1999.
2. Computed from *State Finances* op.cit.

Table 5
Agency-wise Per Capita Transfers, 1974-2002

(Figures in Rs.)

Plan Periods	Statutory Transfers		Plan Transfers		Non-Plan Non-Statutory Transfers		Total Transfers	
	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States
V (1974-75 to 1978-79)	253	202	187	185	49	80	489	467
AP (1979-80)	64	68	49	54	5	29	118	151
VI(1980-81 to 1984-85)	375	370	315	368	132	187	822	925
VII (1985-86 to 1989-90)	670	768	750	814	319	379	1739	1961
AP (1990-91)	189	197	156	183	89	109	434	489
AP (1991-92)	200	227	187	221	135	93	522	541
VIII (1992-93 to 1996-97)	1581	1741	1364	1587	555	567	3500	3895
IX (1997-98 to 2001-2002*)	2430	2480	1553	2092	1012	1586	4995	6159
2002-03+	669	698	662	703	252	430	1584	1832

* 2001-02 figures are revised estimates
+ Budget estimates

Source: 1. George K.K., *Limits to Kerala Model of Development,* op.cit.
2. Computed from *State Finances* op.cit.

Table 6

Share of Kerala in the Total Transfers to States : 2000 – 2005

(Rs. Crores)

1. Share in Central Taxes and Duties		11504 (3.1)
2. Non-Plan Revenue Deficit Grants		0 (0.0)
3. Upgradation and Special Problem Grants		129 (2.6)
Grant in Aid to Local Bodies	4. Panchayat	330 (4.1)
	5. Municipalities	75 (3.8)
	6. Total	405 (4.0)
7. Grants for Relief Expenditure		279 (3.4)
8. Total Grants (Col. 2 to 7)		813 (1.4)
9. Total Transfers (Col.1 & 8)		12317 (2.8)

Note: Figures in brackets indicate the percentage share in total EFC transfers to States.

Source: Government of India, *Report of the Eleventh Finance Commission,* 2000

Table 7

Unemployment in States

Selected States	Unemployment rate		Employment Elasticity 1993-94 to 1999-00
	1999-00	1993-94	
Andhrapradesh	8.03	6.69	0.067
Assam	8.03	8.03	0.737
Bihar	7.32	6.34	0.353
Gujarat	4.55	5.70	0.316
Haryana	4.77	6.51	0.420
Karnataka	4.57	4.94	0.188
Kerala	20.97	15.51	0.013
Madhyapradesh	4.45	3.56	0.272
Maharashtra	7.16	5.09	0.216
Orissa	7.34	7.30	0.262
Punjab	4.03	3.10	0.426
Rajasthan	3.13	1.31	0.104
Tamil Nadu	11.78	11.41	0.052
Uttarparadesh	4.08	3.45	0.185
West Bengal	14.99	10.06	0.056
All India	**7.32**	**5.99**	**0.160**

Source: Government of India, *Economic Survey-2002 -03*.

Table 8
Age wise Composition of Population in Kerala

(Figures in Percentages)

Year	Total	Under 20	Working Ages (20- 64	Old		
				60-74	75+	Total
1961	100.00	48.97	45.19	4.69	1.14	5.83
1971	100.00	48.96	44.82	4.97	1.25	6.22
1981	100.00	44.12	48.38	5.97	1.54	7.50
1991	100.00	37.28	53.87	6.90	1.95	8.85
2001	100.00	29.51	59.65	8.09	2.74	10.83
2011	100.00	19.45	66.97	9.81	3.76	13.57

Source: S.Irudaya Rajan, K.C.Zachariah, *Long Term Implications of Low Fertility in Kerala,* Working Paper No.282, October 1997, Centre for Develoment Studies , Thiruvananthapuram

Table 9
Share of Grants in Total Statutory Transfers

(Figures in Percentages)

Year	Kerala	Other States
1990-91	11.6	13.6
1991-92	0.8	11.5
1992-93	0.8	9.6
1993-94	0.8	7.9
1994-95	0.8	7.1
1995-96	1.3	12.4
1996-97	1.1	9.6
1997-98	1.3	4.1
1998-99	1.1	3.6
1999-2000	0.9	4.4
2000-01	1.1	14.5
2001-02*	0.2	16.4
2002-03+	0.3	13.1

* Revised Estimates

+Budget Estimates

Source:Computed from *State Finances* op.cit.

Table 10

Per Capita Tax Share and Grants, 1974-2002

(Figures in Rupees)

Plan Periods	Tax Share		Grants	
	Kerala	Other States	Kerala	Other States
AP (1990-91)	167	171	22	27
AP (1991-92)	198	202	2	26
VIII (1992-93 to 1996-97)	1566	1581	16	166
IX (1997-98 to 2001-2002*)	2409	2241	21	241
2002-03+	667	608	2	92
Finance Commision-wise				
IX FC (1990-91- 1994-95)	1148	1187	30	125
X FC (1995-96 to 1999-2000)	2223	2253	25	156
XI FC (2000-01 to 2002-03)	1760	1642	9	282

* 2001-02 figures are revised estimates

+Budget estimates

Source: 1. George K.K., *Limits to Kerala Model of Development,* op.cit.

2 Computed from *State Finances* op.cit.

Table 11

Non-Plan Revenue Surplus/Deficit of Kerala and All States (1978-2003)

Finance Commission's Forecasts and Actuals

(Rs. in Crores

Finance Commissions	Non-Plan Revenue Surplus(+)/Deficit(-) before devloution of tax shares						Non-Plan Revenue Surplus(+)/Deficit(-) after devloution of tax shares					
	Kerala			All States			Kerala			All States		
	F.C.Est.	Actual	Variance	F.C.Est.	Actual	Variance	F.C.Est.	Actual	Variance	F.C.Est.	Actual	Variance
VI	-473.4	-391.8	-81.6	-6594.3	-5531.3	-1063.0	-202.4	-73.7	-128.7	505.0	2734.7	-2229.7
VII	-531.1	-475.1	-56.0	-6823.8	-13457.4	6633.6	235.1	379.1	-144.0	12409.3	7264.0	5145.3
VIII	-635.4	-1872.1	1236.7	-10420.8	-36385.0	25964.2	623.5	-426.8	1050.3	25261.7	1858.6	23403.1
IX (1989-90)	-314.6	-572.9	258.3	-5567.6	-13543.1	7975.5	89.8	-117.0	206.8	6218.0	-455.8	6673.8
IX (1990-95)	-2917.0	-4845.4	1928.4	-55866.0	-121548.0	65682.0	2.3	-1506.1	1508.4	32016.0	-22598.9	54614.9
X (1995-98)	-2761.0	-4051.3	1290.3	-80092.0	-124427.0	44335.0	1005.6	-396.0	1401.6	27628.5	-20638.6	48267.1
XI (2000-03)	-6391.2	-8815.3	2424.1	-122797.5	-323802.2	201004.6	2156.8	-3210.4	5367.2	67782.5	-155210.7	222993.1

* Figures for 2001-02 are of Revised Estimates and 2002-03 are of Budget Estimates.

Source: 1. George K.K., *Limits to Kerala Model of Development,* op.cit.

2. Computed from *State Finances* op.cit.

Table 12
Share of Kerala in Total Upgradation Grants

(Figures in percentages)

Services	VII	VIII	IX (Interim)	IX (Final)	X	XI
Police	2.6	1.4	1.9	2.4	3.5	4.5
Jail	5.3		0.5	0.6	3.4	2.6
Tribal Administration			0.5	0.1		
Judicial		0.5	5.3	5.3		2.2
District & Revenue Administration	1.9	0.6	1.4	0.5	4.5	
Training			6.4	9.3		
Treasury Administration			1.8	1.1		5.5
Other Administrative Services						1.5
Total Administrative Services	2.3	1.0	1.9	2.1	3.5	2.7
Education					0.7	0.9
Medical			2.7	0.4		2.1
Other Social Services						1.6
Total Social Services			0.6	0.1	0.7	1.5
Total	0.8	1.0	1.4	1.3	2.2	2.1

Source: 1. George K.K., *Limits to Kerala Model of Development,* op.cit.
2. Computed from *State Finances* op.cit.

Table 13
Annual Growth Rates of Different Types of Taxes - Kerala & Other States

(Figures in Percentages)

Year		Total Own Tax Revenue	Taxes on Income	Taxes on Property and Capital Transactions	Taxes on Commodities and Services	*of which:* i) Sales Tax	ii) State Excise	iii) Taxes on Vehicles	iv) Taxes and Duties on Electricity
1991-92	Kerala	24.9	46.7	22.4	24.7	25.0	19.9	27.8	34.7
	Other States	17.5	0.0	20.8	17.6	18.9	13.2	16.8	34.7
1992-93	Kerala	12.7	-64.4	24.7	13.2	16.4	5.7	18.1	-46.2
	Other States	11.4	-3.3	8.6	12.0	10.5	15.6	19.5	11.0
1993-94	Kerala	24.3	66.8	23.7	24.0	17.4	48.9	35.0	100.7
	Other States	16.1	6.6	19.0	15.9	18.4	12.1	16.8	-2.5
1994-95	Kerala	19.4	-17.4	25.9	18.9	21.6	6.7	21.7	12.4
	Other States	20.1	11.3	46.7	17.5	19.9	9.1	19.2	30.3
1995-96	Kerala	20.8	51.3	18.3	21.0	22.6	27.2	21.2	-85.0
	Other States	14.3	15.6	15.5	14.1	6.1	9.1	20.9	8.1
1996-97	Kerala	15.2	-53.6	1.7	17.6	21.3	-6.8	11.1	522.6
	Other States	11.1	23.4	2.0	12.1	24.0	4.0	10.5	12.7
1997-98	Kerala	15.5	76.7	-5.8	17.6	11.2	29.8	21.8	260.5
	Other States	14.2	6.6	13.0	14.4	11.2	27.9	17.6	13.3
1998-99	Kerala	3.3	26.4	-5.2	3.9	9.2	-2.5	7.2	-76.8
	Other States	9.9	31.0	3.0	10.4	8.7	19.9	3.3	23.4
1999-2000	Kerala	11.7	-47.5	-4.4	13.4	14.5	11.6	17.8	-91.4
	Other States	15.5	25.9	14.5	15.4	17.5	12.3	22.8	-1.9
2000-01	Kerala	13.0	-73.0	21.2	12.7	12.7	16.6	3.7	347.0
	All States	15.1	12.0	15.1	15.2	18.1	6.3	8.6	20.5
Average Annual Growth-1991-1995	Kerala	**20.4**	**16.6**	**23.0**	**20.4**	**20.6**	**21.7**	**24.8**	**3.3**
	Other States	**15.9**	**6.1**	**22.1**	**15.4**	**14.8**	**11.8**	**18.6**	**16.3**
Average Annual Growth-1996-2001	**Kerala**	**11.7**	**-14.2**	**1.5**	**13.1**	**13.8**	**16.3**	**21.4**	**100.9**
	Other States	**13.2**	**19.8**	**9.5**	**13.5**	**15.9**	**10.0**	**17.4**	**11.9**

Source: Computed from *State Finances* op.cit.