TWELFTH FINANCE COMMISSION'S AWARD: WHAT IT FORETELLS FOR KERALA?

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ABSTRACT

This paper examines the award of the Twelfth Finance Commission with the specific objective of finding out the extent to which their recommendations, valid for the current year and the next four years, are going to affect the fiscal health of Kerala. The paper is written in the backdrop of the discussions on different agendas for Kerala's development floating around in the State today. Most of these agendas either overlook totally or just gloss over the contributory role of the Central government in general and the Finance Commissions in particular in heightening the fiscal crisis and consequently the development crisis of the State.

The paper begins with an examination of the Commission's scheme of sharing of Central government revenue between the Centre and the States. It then goes on to examine the inter-state distribution of Central revenue transfers to find out how Kerala has fared in comparison with all States. The paper discusses the impact of the Twelfth Finance Commission's award on Kerala in comparison with those of the Eleventh and the Tenth Finance Commissions. The study finds that Kerala has been losing more and more in the hands of successive Finance Commissions. The paper looks at the criteria of transfers which affect Kerala adversely. The implications of the Finance Commission's award for the State's Plan are also discussed. The paper notes that conflict in priorities between the State and the Central government, is emerging due to the difference in stages of social development between Kerala and other States. While the Centre's priority is to address the first generation problems of other States in literacy, primary education, primary healthcare, poverty, deprivation etc., Kerala's priority is to address the second-generation problem unique to the State. The paper argues that it is this conflicting priorities which is at the root of the steady decline in the role of Central transfers in general and those coming through the Finance Commissions in particular, deepening the State's fiscal crisis.
Key Words: India, Kerala, Federal Finance, Public Finance, State Finances, Fiscal Federalism, Centre-State Relations, Devolution, Finance Commission.

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Twelfth Finance Commission's Award: What it Foretells for Kerala?

A number of agendas for Kerala's development are floating around in the State today. But all these agendas either totally overlook or only make a cursory treatment of the issue of mobilizing resources to achieve the ambitious targets set. But the fact remains that without adequate resources, these ambitious targets will remain only pipe dreams. The State's kitty is almost exhausted and even the State's present hand to mouth existence is done by borrowing. The reason for the State's grave fiscal crisis, most often highlighted during the current discussions on the issue, is the mismanagement of the finances by the State government. The role of the Central government, pivotal under the existing Centre-State financial relationship, is seldom mentioned as a possible reason. It is not often realized that the share of Central government transfers in the total revenue of the State has been ranging between 25 to 36 per cent in recent years. Despite its decreasing role, the Finance Commission, the body constituted under the Indian Constitution still accounts for between 30 to 40 per cent of the total Central transfers to the States. It is in this context that this paper examines, the award of the Twelfth Finance Commission (TFC) with the objective of finding out to what extent this Commission's recommendations (2005-10) are going to affect the fiscal health of the State valid for the current year and the next four years, the award period of the Commission.

The award of the Eleventh Finance Commission (EFC) evoked strong criticism in Kerala. This is understandable, as, under its award, the share of Kerala in total Central transfers to all States had come down to 2.8 per cent from 3.4 per cent under the award of the Tenth Finance Commission. It was estimated then that for the entire five-year period covered by the award of the Eleventh Finance Commission (2000-2005), the State would get Rs.3664 Crores less than what it would have got as per the recommendations of the Tenth Finance Commission (XFC). The Twelfth Finance Commission reduced Kerala's share still further to 2.6 per cent. As a result, during the period, 2005-10 covered by its award, Kerala will be getting Rs.6088 crores less than what it would have got under the award of the Tenth Finance Commission. The loss per year will amount to Rs.1218 crores which will be much more than all the own non-tax revenue of the State (Rs.978 crores) put together, collected by way of revenue from the forests, user charges, dividends and interest. The amount of yearly loss will be six times more than the additional Central assistance of Rs.200 crores said to have been committed by the Planning Commission for implementing the specific 'Mission for Prosperity' for the State drawn up incorporating the 'Vision 2010', the ten point agenda of the President, Dr. A.P.J. Abdul Kalam. Thus, the TFC report will have tremendous adverse implications on the fiscal stability of the State and consequently on its development agenda during the coming years. Despite the much bigger loss to the State, the TFC's report, unlike the report of the EFC did not create much of a stir in Kerala for some inexplicable reasons.

Notes: The views expressed in this paper are those of the authors and do not necessarily represent the views of the Centre.

Role of the Finance Commissions

As is well known, India is only a semi federal polity and the existing Constitutional allocation of financial powers and responsibilities between the Centre and the States places considerable constraints on the States' capacity for resource mobilization while saddling them with enormous expenditure responsibilities. The Constitution, however envisaged a fiscal transfer mechanism to transfer adequate funds from the Central government to the States, taking into account the above disproportion between the two tiers of government. In fact, the provision for a Finance Commission to be appointed by the President, every five years under Article 280 is the only difference between the Government of India Act, 1935 and the Indian Constitution with regard to the distribution of financial powers between the Central and the State governments. Though the Planning Commission and the Union ministries have come to overshadow the working of the Finance Commission, the body still accounts for about two fifth of the total Central transfers to the States. The Finance Commission was conceived as an arbiter between the Central government and the State governments and to determine the share of Central revenues to be transferred to the States. This body also determines the inter-state allocation of these Central revenues to be transferred to the States. Sharing of Central tax revenue is the principal means of fiscal transfers from the Centre adopted by the Finance Commissions. The Commissions also determine the quantum of grants to the States "in need of assistance" under Article 275 of the Constitution. Of late, the Finance Commissions have increasingly resorted to grants for upgradation of different services of the State governments. They also have started giving grants for meeting the specific problems of States as also for meeting the expenditure for mitigating the effects of natural calamities. The recent Finance Commissions have been assigned by the Central government, the task of reviewing the debt position of States and to suggest debt relief measures.

Though funds through any channel, whether it is through Finance Commission or the Planning Commission or through the different Union ministries are welcomed by the funds-starved States, they prefer funds coming through the Finance Commission channel known as Statutory transfers. There are two main reasons for this. Firstly, the States consider the funds coming by way of Statutory transfers as their constitutional right as the Finance Commission unlike the Planning Commission is a constitutional body assigned the task of transferring funds from the Centre to the States. Secondly, the funds through the Finance Commission are intended to be transferred to the States unconditionally for the use by the States according to their own priorities. As will be seen later, these intentions of the Constitution makers are gradually being negated during the last fifty-five years. The recent Finance Commissions are making their transfers to the States more and more conditional and linking them to particular schemes.

The Context of the Twelfth Finance Commission

The Twelfth Finance Commission's award may be seen in the context of (1) the deteriorating financial position of the State and (2) the contributory role of the Central government in accentuating this crisis. The share of aggregate Central revenue transfers in the total revenue of Kerala came down steadily from 35.5 per cent in 1990-91 to 25.1 per cent in 2003-04. In regard to the share of Central taxes in total revenue of the State, there was almost a steady decline over the years from 20.2 per cent in 1990-91 to 15.2 per cent in 2003-04. In the share of grants from the Centre too, there was a sharp decrease from the mid-nineties. In respect of the share of Central transfers in both the revenue and expenditure, Kerala lagged behind all States as may be seen from

Table 1. The Table also brings out the decreasing role of Central transfers in financing State's expenditure. The share of Central transfers in expenditure has been coming down rather steeply from the mid nineties. It came down from 37.3 per cent in 1994-95 to 27.6 per cent in 2002-03**.**

The role of Central funds in the State's budget has been coming down on account of two reasons. Firstly, the share of States as a whole in the Central revenues has been coming down almost steadily. Secondly, Kerala's share in the total amount transferred to all the States is coming down. It will be relevant in this context to examine to what extent the TFC has been able to arrest these declining trends.

The TFC had stepped up the States' share in total Central taxes only marginally from the 29.5 per cent fixed by the Tenth and the Eleventh Finance Commissions to 30.5 per cent. This is despite the strong plea made by all the States unanimously to raise their share substantially in view of their vastly expanding commitments in the social sectors and the decreasing commitments of the Central government in economic sphere under the economic reforms policy. What is more, the stipulated 30.5 per cent is not that of gross tax revenue but that of revenue after excluding Cesses and Surcharges and after deducting the cost of collection. Consequently, despite fixing the share of States in total Central Taxes at 29.5 per cent by the Tenth and Eleventh Finance Commissions, the limit was touched only in one year (1997-98) during the entire ten-year period covered by their awards. The gap between the actual ratios and the stipulated ratio has been increasing in recent years as may be seen from Table 2. The exclusion of Cesses and Surcharges from the shareable pool of Central Taxes and the increasing resort to these measures by the Central government may be part of the reason for this shortfall. During the five-year period ended 1999-2000, Cesses and Surcharges accounted for nearly 3 per cent of the gross tax revenue. In the next two years, their share was 2.7 per cent.[1] According to the TFC's own estimate, the share of Cesses and Surcharges are likely to increase to 12 per cent during their award period[2]. The TFC does not appear to have taken any measure to arrest the increasing tendency of the Central government to keep a good portion of Central tax revenue out of the reach of the State government.

The TFC like its predecessor had suggested capping of the aggregate revenue transfers to States (Tax share + all grants including plan grants) from the Centre's total revenue. It fixed the States' share to 38 per cent, an increase of just half a per cent from the share stipulated by the Eleventh Finance Commission. It appears that there was no need for such capping as Central revenue transfers rarely reached the ceiling of 37.5 per cent during the years since 1995-96 (see 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 covered by the Eleventh Finance Commission, the ratio went up and hovered around the stipulated 37.5 per cent. But it came down in the remaining three years. The ceiling of 38 per cent proposed by the TFC is much lower than the actual States' share during the first five years of the nineties covered by the Ninth Finance Commission's Award. Central revenue transfers expressed in relation to Gross Domestic Product (GDP) also was coming down. The TFC does not appear to have taken cognizance of this trend detrimental to the interest of the States.

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[1] Based on Annexure VII.3, Twelfth Finance Commission Report, p.409.
[2] Based on Annexure V.2, Twelfth Finance Commission Report, p.381.

While the Finance Commissions had been wielding a big stick for disciplining the States by limiting the volume of grants just enough to meet their deficits in non-plan revenue account determined normatively by them, no such stick is used in the case of the Central government. The TFC, like all its predecessors, had failed to discipline the Centre by linking the States' share to the Central revenue determined normatively by the Commission for the next five years and not to what is actually collected by the Centre. As a result, laxity of the Centre in resource mobilization leads to States loosing heavily the revenue due to them. This is evident from Table 3, which shows the revenue normatively estimated by the Eleventh Finance Commission and the actual revenue collected by the Centre. There was considerable shortfall in actual revenue mobilization by the Centre from what was envisaged by the Finance Commission in its normative estimates. The States lost heavily as a result of this laxity of the Central government.

The Criteria which Affects Kerala Adversely

The share of Kerala in total Statutory transfers had been coming down progressively with every Finance Commission as may be seen from Table 4. The TFC's award reduced Kerala's share further. The reasons for this situation have to be looked for in the criteria employed by the Finance Commissions for their inter-state distribution under different types of transfers. The share of Central taxes is the most important component of Statutory transfers. Its share for Kerala was as high as 99 per cent during the period 1991-92 to 2000-01. During the next three years the share of taxes increased slightly, but it still ranged from 93 to 96 per cent. The TFC, in tune with their general policy had reduced the share of Central taxes in its total transfers considerably, but it still accounts for 81.1 per cent of the total. If Kerala is not getting its due share in Finance Commissions' transfers, the fault lies largely in the criteria used by them in their inter-state distribution of the Centre's tax shares. Kerala has not been getting its due share in Central taxes 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 and, (4) Failure to use criteria, which are most relevant to the State.

The criteria adopted by the Finance Commissions included population, area, contribution, revenue equalization, non-plan deficit, tax effort, fiscal efficiency, per capita income, index of backwardness, index of infrastructure, index of deprivation and the poverty ratio. The indices of backwardness and infrastructure due to their excessive weightage to social indicators had been adversely affecting Kerala, which had been in the forefront of social development despite low levels of per capita income in the past. Similarly, the criteria of poverty and deprivation had been hitting Kerala badly for doing the right thing much ahead of time. The Twelfth Finance Commission had given the following weightage to the five criteria used by them.

Criteria and Weights

(In Per cent)

Criteria	Twelfth Finance Commission	Eleventh Finance Commission
Population	25	10
Income Distance	50	62.5
Area	10	7.5
Index of Infrastructure	-	7.5
Tax Effort	7.5	5
Fiscal Discipline	7.5	7.5
Total	**100**	**100**

The Twelfth Finance Commission, like all its predecessors, adopted the size of population as a major criterion for the purpose of sharing Central tax revenues among the States. It had stepped up the weightage of population to 25 per cent from 10 per cent assigned by the Eleventh Finance Commission. It had also assigned a weightage of 40 per cent to population while distributing grants for local bodies. The criterion of population is used by all the Finance Commissions right from the first, as it is considered to be a good indicator of the budgetary needs of the States. Besides, this criterion has the advantage of being a neutral one.

All the recent Finance Commissions since 1971 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". This requirement is being made so that States which control population, do not suffer financially. In giving weightage to the criterion of population for tax sharing, all Finance Commissions including the Twelfth used the 1971 population figures. But the Twelfth Commission has made a deviation from the past while allocating grants to local bodies amounting to Rs.25000 crores. The Commission for reasons which are not made clear, has used the 2001 census population figures. This affects a state like Kerala, which had been the most successful State in controlling population growth. The State's success in controlling population growth has hit Kerala in an indirect way also. In calculating per capita income, it is the current population and not the 1971 population, which is being used by all Finance Commissions including the Twelfth. This tends to inflate the relative position of Kerala in per capita income. This in turn reduces its entitlement wherever distance from per capita income is taken as a criterion.

Per Capita Income

Distance of per capita income of a State from the average per capita income of the three States having highest per capita income, is one of the core criteria used by the TFC. In this, the Commission was only following its predecessors' footsteps. The TFC had given maximum weightage of 50 per cent to this criterion. Besides, this criterion was assigned a weightage of 20 per cent while allocating grants meant for local bodies. This criterion certainly imparts progressivity in inter-state distribution. Per capita income is used as a measure of economic development and fiscal capacity of a State. But per capita income can be only one of the indicators of a States' economic development. The world over, regional development is measured not only in terms of per capita income but also in terms of employment rates. But none of the Finance Commissions had used employment as an indicator and instead relied solely on per capita income. Data of major Indian States shows that, there is no significant correlation between per capita State income and States' unemployment. The refusal of the Finance Commissions to consider employment as an indicator of backwardness hurts a State like Kerala with unemployment rate nearly three times the national average. In fact, the State has the highest unemployment rate in the country.

Finance Commission's Grants

As seen earlier, the earlier Finance commissions had relied on tax sharing rather than on grants for distribution of Central revenue. But the TFC raised the share of grants in their total transfers to all States to an all-time high of 18.9 per cent. The share of grants in total Statutory transfers to Kerala was pegged up to 16.6 per cent. Table 4 shows that Kerala had received much less grants than other States in the hands of the TFC. Kerala's share in total grants will be just 2.3 per cent of the total grants to all States. The per capita grants, given to the State under the award of the TFC for the five years will be only Rs.1022 as against Rs.1392 for all States.

Article 275 Grants

None of the Finance Commissions from the seventh had given any grant to Kerala under the substantive provisions of Article 275 of the Constitution meant for States "in need of assistance". The State was not receiving Article 275 grants because the Finance Commissions assumed surpluses in the non-plan revenue account of the State in their normative estimates. But the State actually had continuous deficits on non-plan account ever since 1985-86, even if one includes all additional resources mobilised in the non-plan account. Non-Plan deficits/surpluses assumed by the Sixth Finance Commission onwards and the actuals are given in Table 5. 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. When surpluses were assumed by the Finance Commissions, they turned out to be just mirages.

The same pattern of divergence between the forecasts and actuals is most likely to occur during the award period of the TFC. For example, the Commission for the current year (2005-06) had envisaged a non-plan deficit of only Rs.470 crores. Accordingly, they had limited the grants just to the amount of deficit. But the current year's Kerala budget shows a non-plan revenue deficit of Rs.1345 crores even after devolution of tax shares from the Centre. In this respect, Kerala's experience is no different from that of all States. This implies that 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.

Upgradation Grants

The TFC provides no grant at all for upgrading the State's health or education services. Kerala's share in grants for upgradation of all social services put together was just 0.1 per cent. The State obviously is penalised for its success in attaining above average standards in social services like education and health care. In dispensing grants for upgradation of social and economic services to Kerala, TFC had only been following the pattern of the past Commissions (Table 6). Of the total upgradation grants dispensed by the Seventh, Eighth and the Ninth Finance Commissions, Kerala received only 0.8 per cent to 1.4 per cent. Under the award of the Tenth

Finance Commission, Kerala's share was only 2.2 per cent. 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 per cent and 0.3 per cent respectively from the Ninth and the Tenth Commissions. Eleventh Finance Commission provided only slightly more (1.5 per cent).

The TFC like its predecessors took cognizance of Kerala's major achievements only. For instance, while looking at the educational development of the State, the Commission had failed to appreciate that there is a flip side to Kerala's much lauded achievements. Most of Kerala's achievements in education had been in literacy and school education. The Commission failed to take into account both the qualitative and quantitative backwardness of Kerala's higher education, technical education and research[3]. In fact, the Commission based its estimates for grants for education solely on the budget category under the major head 2202, which does not cover technical education at all.

In making zero allocation of upgradation grants for the health sector of Kerala, the TFC like the previous ones failed to take note of the increasing demand for expenditure on health services as a result of the aging of the State's population, which is changing the disease profile of the State (Panikar and Soman, 1985). A new category of diseases comprising of degenerative, neo-plastic, and lifestyle diseases have begun to emerge in the State. These diseases of the old, unlike those of children and youth, call for higher investment in diagnostic equipment, hospitalization, treatment, recovery and rehabilitation.

Special Problem Grants

Though TFC's award in respect of State specific needs is much better than those of its predecessors. The TFC too did not take cognizance of the large number and variety of special problems in the State arising out of the much eulogised and unique Kerala Model of Development. It is often acclaimed that some of Kerala's achievements are comparable to those of developed countries. But these successes have also brought in its wake some of the developed countries' problems. Unlike these countries, the State does not have the financial ability to tackle them all by itself. Since these problems are unique to the State, they have not received the national attention and priority that they deserve. While the Central agencies like the Finance Commissions are still grappling with first generation problems in education, health care and social security in other parts of the country, Kerala is saddled with second-generation problems resulting from its very success in attaining higher levels of social development. For instance, the lengthening life expectancy has resulted in the aging of population, which has tremendous implications on the State's budget. Aging tends to inflate the volume of social security payments and healthcare expenditure. It also has implications on the quantum of service pensions, which today account for nearly 17 per cent of State's revenue expenditure. Similarly, the universalisation of school education has boosted the demand for tertiary education. None of the Finance

[3] a) George.K.K. and Ajith Kumar.N., *What is wrong with Kerala's Education System?*, Journal of Educational Planning and Administration, January 2001.
b) Jangira N.K, *Learning Achievements of Primary School Children in Reading and Mathematics: Research based Interventions in Primary Education*, NCERT, New Delhi, 1994
c) Kerala Sasthra Sahitya Parishad, *Report of the Kerala Education Commission*, Kochi, 1999.
d) Tilak.J.B.G., *Higher Education and Development in Kerala*, Working Paper No.5, CSES. Kochi, 2001.

Commissions including the Twelfth had treated 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. Higher school level education has also changed the character of unemployment in the State to that of the educated.

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, Bilateral agreements with Malaysia and Thailand etc. have opened the floodgates of competition and have adversely affected the agricultural sector of the State, dominated by cash crops. Income originating from agricultural sector has shown negative growth in four years during the period 1994-95 to 2003-04. Even when they showed positive growth rates, they ranged only between 1.23 to 1.92 per cent. The state of Kerala's agricultural sector in recent years can be judged by the fact that income from agriculture sector had registered an absolute decline, from Rs.7402 crores in 1996-97 to Rs.5475 crores in 2003-04. Due to declining prices of some of the major plantation crops, misery, destitution, starvation and suicides are widely prevalent in the once prosperous plantation regions of Kerala. In the predominantly agricultural district of Wayanad, more than 480 suicides were reported during the last four years[4]. The farm crisis has increased the expenditure commitments of the State government, even while the severe decline in agricultural income has affected tax mobilisation by the State during the second half of the nineties. The TFC had failed to take cognizance of the woes of Kerala's agricultural sector following the opening up of the national economy, and its impact on both the revenue and expenditure sides of the State's budget.

Debt Relief

The Twelfth Finance Commission like its predecessors had tried to ease the debt-servicing burden of States by giving interest relief and by consolidating and rescheduling of the debt. The interest relief granted by the Twelfth Finance Commission for Kerala for the five-year period amounted to Rs.715 crores. Relief in repayment obligation amounted to Rs.379 crores. The debt relief granted by the Commission was irrespective of the level of economic development or the fiscal situation of the State. Kerala got in per capita terms only Rs.344 by way of debt relief. While its per capita non-plan revenue surplus after devolution of Central taxes was Rs.1222. Andhra Pradesh with a per capita revenue surplus of Rs.4958 got a debt relief of Rs.449. Gujarat one of the richest States in India with per capita surplus of Rs.7029 received Rs.530 as debt relief. The neighboring state of Karnataka with a per capita surplus of Rs.11136 received a debt relief of Rs.370 per head. It may also be noted that these States had much less debt burden than Kerala as indicated by the ratio of interest payment to total revenue receipts calculated by the Finance Commission itself.

Debt relief recommended by the TFC is conditional and is linked to fiscal reforms. The rescheduling of loans is subject to the enactment of the Fiscal Responsibility Act (Kerala has already enacted this legislation). The

[4] The New Indian Express, Kochi, 19th December 2005.

quantum of write off is linked to the absolute amount by which revenue deficit is reduced during the award period. Going by the track record of most of the States including Kerala in containing revenue deficit despite accepting the Medium Term Fiscal Reform Programme, it is quite unlikely that Kerala will be able to gain substantially from the debt relief schemes of the TFC. It may be noted that Kerala had been able to avail of only two yearly installments of the Incentive Fund constituted as per the recommendations of the Eleventh Finance Commission. Kerala had not been able to avail of remaining three installments because it could not meet the deficit reduction requirement of the Eleventh Finance Commission.

Increasing Conditionalities of Statutory Transfers

States prefer finance flowing through the Finance Commission route as this is unconditional and the States are free to make use of the funds according to their own priorities. But in their debt relief recommendations TFC had violated the spirit of the Constitution as noted above. This violation is more evident in the way the grants were provided by the TFC.

As indicated earlier, TFC had raised the share of grants in total transfers to 19 per cent from 13.5 per cent under the Eleventh Finance Commission and 9 per cent under the award of the Tenth Finance Commission. Of the grants, the normatively determined unconditional deficit grants formed only 40 per cent. The remaining 60 per cent were grants given for specific purposes, most of them conditional and some of them very discretionary. In some cases, as in the case of grants for meeting State specific needs, the Commission's discretion bordered on arbitrariness.

Under the spirit of Article 275 of the Constitution captured by the First and the Second Finance Commissions, the Statutory grants through the Finance Commissions should be residuary and should be mostly automatic and unconditional. No doubt, it was envisaged that in exceptional cases the grants could be directed to broad but well-defined purposes. But the TFC had distorted the spirit of this constitutional scheme and allotted more than half of the grants on conditional basis. The TFC had imposed its own priorities on the States. Sometimes it goes overboard and goes into minor details regarding how the schemes financed by the grants should be utilised. Take this sample-

> *"In the case of the urban local bodies we have already stressed the importance of public-private partnership to enhance the service delivery in respect of solid waste management. The Municipalities should concentrate on collection, segregation and transportation of solid waste. The State governments may require the Municipalities…to prepare a comprehensive scheme including composting and waste to energy programmes to be undertaken in the private sector for appropriate funding from the grants-in-aid recommended by us. Grants-in-aid shall, however be available to support the cost of collection, segregation and transportation only, as the activities to be taken up by the private sector should be commercially viable once the Municipality is able to discharge its role effectively."*

The largesses of the TFC can be seen in the sanctioning of a zoological park in one State and a botanical garden in another. In fact, TFC went to the extent of providing for multi-gym complexes and sports complexes at *Taluk* headquarters in Karnataka by no means a fiscally disabled State. Such schemes involve capital expenditure. In these matters, the TFC was making provision for new schemes, which should normally have found a place under the State plans. Besides, such 'one size fits all' schemes applicable to all parts of the country, which do not take the local specificities, distorts the States' priorities. Perhaps the Commission could have learnt from the pre-1969 experience of linking Central plan financing to Centrally designed individual schemes. This practice of linking plan finance to individual plan schemes was replaced by the Gadgil formula only because of its complexity, cumbersomeness, red-tapeism, inefficiency and arbitrariness.

Twelfth Finance Commission Award and the State Plan-2005-06 to 2009-10

The influence of the Finance Commission in determining the size of the States' plan is not often appreciated. It is the balance in the current revenue account (non-plan account) that forms the nucleus of plan funds for the States. It is the policy of the Finance Commission with regard to tax sharing and grants that largely determines this surplus in the non-plan account. Kerala's share in the non-plan surplus of all States after devolution of tax shares and all types of grants was 4.1 per cent under the Tenth Finance Commission's award. It came down to 3.2 per cent under the award of the Eleventh Finance Commission. Kerala's share will go down steeply to just 1 per cent under the award of the TFC. As a result, the per capita non-plan revenue surplus of Kerala under the award of the awarded by the Finance Commission will be only Rs.2245 as against the all States average of Rs.5238. The State's per capita surplus will be much less than that of the neighboring states of Andhra Pradesh (Rs.5642), Tamil Nadu (Rs.7475) and Karnataka (Rs.11903). It is also much lower than that of other developed States like Gujarat (Rs.7760), Haryana (Rs.12714) and Maharashtra (Rs.6554). Thus the State faces a major handicap with respect to its plan financing during the current year and the next four years as a result of the TFC's award.

Common Minimum Programme (CMP) and Kerala's Finances

As may be seen from Table 7, Kerala was receiving less Central transfers than the average of all States from the Sixth Five Year Plan onwards. The Table reveals that it was not only the Finance Commission but also the other two agencies viz., Planning Commission and Union Ministries that had contributed to Kerala receiving less Central transfers than other States in almost all the periods covered by our study.

The fate of the State in the matter of Central funds under the aegis of the Planning Commission and the various Union ministries during the next four years may not be much different than in the past. The transfers from these agencies are likely to be influenced by the Common Minimum Programme (CMP) of the United Progressive Alliance (UPA) and the Central government's international commitments for achieving the Millennium Goals. While the CMP may augur well for the country as a whole, it need not necessarily augur well for Kerala's finances. There is every likelihood that the Central plan and Centrally Sponsored Schemes as well as other non-plan, non-Statutory schemes for transfers under various Union Ministries will proliferate as instruments for achieving national priorities and millennium goals of the UPA government. Most of these schemes are likely to address only the first-generation problems and millennium goals in literacy, primary education, primary healthcare etc. Reduction of poverty and deprivation may also get importance. But these schemes may not be very relevant for Kerala, as they may not address the second-generation problems unique to the State. Besides, some of the schemes like Food for Work, Employment Guarantee etc. in their present formulation may not be benefiting the State due to the higher minimum wages already prevailing in the State and the peculiarity of the State's unemployment problem. The State's priorities may also be in conflict with the priorities of the international funding agencies, the dependence on whom in Central budget is increasing steadily. In a way, it is this conflict of priorities with those of the Central government and the international funding agencies including Non-Governmental Organisations, arising out of the different stages of social development of States and the resultant problems, which are at the root of the steady decline in the role of Central transfers to the State, accentuating its fiscal crisis.

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4) *Tenth, Eleventh and Twelfth Finance Commission Reports*, Government of India.

5) *Economic Review*, Government of Kerala, Various years.

6) *State Finances*, Reserve Bank of India, Various years.

7) *An Agenda for Kerala's Development: 2006-2015*, AKG Centre for Research and Studies, Thiruvananthapuram, 2005.

8) Various Papers presented in *National Seminar on Governance and Development: Lessons and Experiences of Kerala* organized by C. Achutha Menon Foundation held on 8-10 December 2005.

9) *Missions for Kerala's Prosperity,* Address of A.P.J. Abdul Kalam, President of India, to the Members of the Kerala Legislative Assembly, Thiruvananthapuram, 28th July 2005.

Table 1
The Share of Revenue transferred from the Centre in States' Total Revenue and Expenditure

(Figures in Percentages)

Year	Share in Total Revenue						Share in Revenue Expenditure	
	Central Taxes Devolved		Grants from the Centre		Total Central Revenue Transfers			
	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States
1990-91	20.2	21.4	15.3	19.0	35.5	40.4	30.2	37.5
1991-92	20.2	20.9	12.9	18.9	33.1	39.8	29.3	37.2
1992-93	20.7	22.6	14.0	19.5	34.7	42.1	31.5	39.9
1993-94	19.2	21.2	12.8	20.1	32.0	41.3	29.2	39.8
1994-95	18.0	20.3	13.6	16.4	31.5	36.7	29.0	34.9
1995-96	19.1	21.2	8.6	15.3	27.8	36.6	25.8	34.5
1996-97	20.2	22.9	8.0	15.1	28.2	38.1	25.5	34.4
1997-98	17.9	23.7	11.1	14.2	29.0	38.0	25.1	34.6
1998-99	19.2	22.3	8.5	13.5	27.7	35.9	21.6	28.8
1999-2000	19.3	21.3	8.6	14.8	27.9	36.1	19.2	28.6
2000-01	18.2	21.3	7.1	15.9	25.2	37.2	18.5	30.4
2001-02	17.8	20.4	10.8	16.9	28.6	37.3	22.2	30.3
2002-03	16.1	20.2	8.8	16.3	25.0	36.5	18.0	30.5
2003-04*	15.2	19.8	9.9	18.5	25.1	38.2	19.4	31.4

* Revised Estimates

Source: 1. Computed from *State Finances*, Reserve Bank of India (RBI), for various years
2. George K.K., *Limits to Kerala Model of Development,* Centre for Development Studies, Thiruvananthapuram, 1999.

Table 2
Financial Management of Central Government

(Figures in percentages)

	1989-90	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	2004-05*
Ratio of Gross Tax Revenue to GDP	10.62	10.12	10.31	9.97	8.82	9.11	9.36	9.41	9.14	8.26	8.87	9.03	8.2	8.78	9.22	9.84
Ratio of Total 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	11.71	12.00	12.26
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	4.10	4.14	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	37.60	35.04	34.47	34.65
Ratio of Tax Share of States to Gross Tax Revenue of Centre	25.73	25.35	25.67	27.50	29.36	26.91	26.33	27.23	31.28	27.22	25.32	27.41	28.25	25.95	25.86	25.69

* Revised Estimates

Source: EPW Research Foundation, "Finances of Government of India", *Economic and Political Weekly (EPW)*, Different Issues.

Table 3

Central Finances as per Eleventh Finance Commission's Assessment and Actuals

		2000-01	2001-01	2002-03	2003-04	2004-05
Tax Revenue	FC Estimate	198226	230961	269185	313833	366002
	Actual	188603	187060	216266	254348	306021
	Difference	**9623**	**43901**	**52919**	**59485**	**59981**
Non-tax Revenue	FC Estimate	57464	67201	78499	91599	106778
	Actual	55947	67774	72290	76896	75100
	Difference	**1756**	**-586**	**6176**	**14703**	**31678**
Total Revenue Receipts	FC Estimate	255690	298162	347684	405432	472780
	Actual	244550	254834	288556	331244	381121
	Difference	**11140**	**43328**	**59128**	**74188**	**91659**
Non-plan Revenue Expenditure	FC Estimate	228768	248788	270718	294732	321018
	Actual	226782	239954	268074	283502	296396
	Difference	**1986**	**8834**	**2644**	**11230**	**24622**
Revenue Deficit	FC Estimate	77425	71785	63369	51552	35593
	Actual	85234	100162	107880	98262	85165
	Difference	**-7809**	**-28377**	**-44511**	**-46710**	**-49572**
Fiscal Deficit	FC Estimate	112275	122904	134399	146805	160166
	Actual	118816	140955	145072	123272	139231
	Difference	**-6541**	**-18051**	**-10673**	**23533**	**20935**
Primary Deficit	FC Estimate	11009	10702	10217	9514	8546
	Actual	19502	33495	27268	-816	13326
	Difference	**-8493**	**-22793**	**-17051**	**10330**	**-4780**

Source: 1. Eleventh Finance commission Report.

2. Table 2, EPW Research Foundation, "Finances of Government of India", *Economic and* Political Weekly (EPW), July 30-August 5, 2005.

Table 4

Share of Kerala in the Total FC Transfers to States

(Rs. in Crores)

		Tenth Finance Commission	Eleventh Finance Commission	Twelfth finance Commission
1. Share in Central Taxes and Duties		7217 (3.5)	11504 (3.1)	16353.21 (2.7)
2. Non-Plan Revenue Deficit Grants		0 (0.0)	0 (0.0)	470.37 (0.8)
3. Upgradation and Special Problem Grants		81.83 (3.1)	129 (2.6)	1295.82 (2.9)
Grant to Local Bodies	4. Panchayat	178.81 (4.1)	330 (4.1)	985 (4.9)
	5. Municipalities	25.43 (2.5)	75 (3.8)	149 (3.0)
	6. Total	204.24 (3.8)	405 (4.0)	1134 (4.5)
7. Grants for Relief Expenditure		218.74 (4.6)	279 (3.4)	354.32 (2.2)
8. Total Grants (2+3+6+7)		504.81 (2.5)	813 (1.4)	3254.51 (2.3)
9. Total Transfers (1+8)		7721.81 (3.4)	12317 (2.8)	19607.72 (2.6)

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

Source: Tenth, Eleventh and Twelfth Finance Commission's Reports.

Table 5
Non-Plan Revenue Surplus/Deficit of Kerala and All States (1978-2004)
Finance Commission's Forecasts and Actuals

(Rs. in Crores)

Finance Commissions	Non-Plan Revenue Surplus(+)/Deficit(-) before devolution of tax shares						Non-Plan Revenue Surplus(+)/Deficit(-) after devolution 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	-202.4		-128.7	505	2734.7	-2229.7
VII	-531.1	-475.1	-56	-6823.8	-13457	6633.6	235.1	379.1	-144	12409	7264	5145.3
VIII	-635.4	-1872.1	1236.7	-10421	-36385	25964.2	623.5	-427	1050.3	25262	1858.6	23403.1
IX (1989-90)	-314.6	-572.9	258.3	-5567.6	-13543	7975.5	89.8	-117	206.8	6218	-455.8	6673.8
IX (1990-95)	-2917	-4845.4	1928.4	-55866	-121548	65682	2.3	-1506	1508.4	32016	-22599	54614.9
X (1995-2000)	-3734.5	-9231.7	5497.2	-122326	-290723	168397	3482.5	-2763	6245.3	84018	-102684	186701
XI (2000-04)	-4384.1	-14713	10328.5	-151052	-450923	299872	4062.6	-7886	11949	125253	-226022	351275
XII (2005-10)	-12468			-225638			3884.9			387474		

* Figures for 2003-04 are Revised Estimates

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

Table 6
Share of Kerala in Total Upgradation Grants

(Figures in percentages)

Service	Finance Commission						
	VII	VIII	IX (Interim Report)	IX (Final Report)	X	XI	XII
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	0.0
Medical			2.7	0.4		2.1	0.0
Other Social Services*						1.6	4.0
Total Social Services			0.6	0.1	0.7	1.5	0.1
Maintenance of Roads & Bridges							4.3
Maintenance of Buildings							2.1
Maintenance of Forests							2.5
Total	0.8	1.0	1.4	1.3	2.2	2.1	2.1

* Other Social Services include Public Libraries, Heritage Protection &Augmentation of Traditional Water Sources

\+ Other Admin. Services include Fire Services

$ Education includes Elementary Education & Computer Training in XI FC

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

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

Table 7
Agency-wise Per Capita Transfers, 1974-2004

(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
Annual Plan (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
Annual Plan (1990-91)	189	197	156	183	89	109	434	489
Annual Plan (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)	2362	2440	1607	1988	1082	1600	5051	6028
X (2002-03 to 2003-04*)	1206	1359	1286	1236	909	1322	3401	3918
Finance Commission Award Period-wise								
IX FC (1990-91- 1994-95)	1177	1307	1187	1332	568	470	2932	3109
X FC (1995-96 to 1999-2000)	2248	2404	1480	1987	814	1279	4542	5670
XI FC (2000-01 to 2003-04*)	2238	2540	2016	2141	1439	2124	5693	6804

* 2003-04 figures are revised estimates

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

2. Computed from Reserve Bank of India (RBI), *State Finances*, for various years.