CHAPTER V
CONCLUSIONS AND SUGGESTIONS

The present study ‘Public Borrowings - A Financial Management Perspective – A study with special reference to Government of Kerala’ is focused on the ever increasing debt obligations of the State of Kerala and is an attempt to sort out the important variables responsible for the alarming growth of public debt and also to find out the ways through which the Government of Kerala can escape from the worsening fiscal conditions and growing debt burdens. The study, carried out with this purpose, has the following specific objectives as stated at the outset.

Objectives of the study

The following are the specific objectives of the study.

1) To study the growth pattern and trends of change in the public borrowings of the Government of Kerala.

2) To analyse the variables influencing the growth of public borrowing in Kerala.

3) To analyse the cost of debt Vis- a-Vis public borrowing.

4) To analyse the mobilization and redemption of various components of public borrowings.

Important Conclusions

The preliminary part of the study was intended to have an overview of the present fiscal situation of the State of Kerala. The major observations obtained from the analysis of the data, with this perspective, can be briefed as follows.
1) The increase in fiscal deficit and revenue deficit over the years are primarily responsible for the ever worsening debt position of the State.

2) The growth rate of Net State Domestic Product is much less than the growth rate of outstanding debt of the State, which is not at all desirable for the healthy financial condition of the State.

3) Compared to other south Indian States and all States’ Average, the debt position of the State of Kerala is more alarming.

The objective-wise analysis of the data leads to the following important conclusions.

**Findings related to Growth and Composition of Public Debt**

4) Kerala’s public debt has been increasing by leaps and bounds since 1980-81. The total debt of the state which was just Rs. 1,041.58 crores mounted as high as Rs. 49,875.18 crores by the end of 2006-07.

5) Among the various components of public debt, internal debt is the most prominent with its gigantic growth in size, which was Rs. 166.67 crores in 1980-81 rose to Rs. 29,969.15 crores towards the end of the period under study.

6) The Loans and Advances from the Central Government, which constituted a very high proportion of the total debt earlier, came down drastically to 10.77 per cent, by the end of 2006-07 from 63.39 per cent in 1980-81.

7) Analysis of the debt composition of the State during the 27 years reveals that the major share of the total debt shifted from the Loans and Advances from the Central Government to Internal Debt. Of the three major components of public debt, Internal Debt exhibits the highest CAGR (22.1 %) while Loans and Advances from the Central Government shows the lowest (8.39 %). Similarly, the Small Savings and Provident Fund registered a CAGR of 17.6 per cent during the period.
8) The plan period wise analysis reveals that the total debt position of the State got aggravated especially during the ninth five year plan period. This was mainly because of the unprecedented growth of Internal Debt and loans from Small Savings and Provident Fund. The major reason for the above is the decline in the Loans and Advances from the Central Government.

9) The Market loans constitute about 42.87 per cent of Internal Debts of the State at present and hence any alarming growth of market loan will be a matter of much concern.

10) Loans from National Small Saving Fund of Central Government, which was Rs. 1,011.52 crores in 2001 increased to Rs.11,875.28 crores with an unreasonable and disturbing growth rate (CAGR 50.57%) may be a distressing component in the internal debt in the years to come.

11) The share of other internal debt remained in between 13 per cent and 16 per cent till 1996-97 but rose steadily to 25.10 per cent in 2003-04, the highest in the 27 year period. Thereafter it shows a slightly declining trend reaching 17.51 per cent towards the end of the period under study.

12) The Loans and Advances from the Central Government are mainly confined to plan schemes of the State at present. The proportion of loans for State plan schemes was only 16.68 per cent in 1980-81 which increased to 97.95 per cent of the total loans from the Central Government by the end of 2006-07.

13) The Non Plan Loans, one of the major components of the Loans and Advances from the Central Government up to 1999-2000 (44.55 %) declined to a negligible share of 0.75 per cent by the year 2006-07.
14) The share of loans from Small Saving Fund in total SSPF has increased from 33.52 per cent (1980-81) to 45.09 per cent towards the end of the period under study. The loans from the State Provident Fund show a fall from 57.75 per cent in 1980-81 to 46.63 per cent in 2006-07, though the amount in absolute terms rose from Rs. 123.96 crores in 1980-81 to Rs. 6,778.36 crores in 2006-07 with a CAGR of 16.63 per cent. These two items constitute about more than 90 per cent of the total loans out of small savings and provident fund.

15) Loans from Insurance and Pension Fund increased from Rs. 18.63 crores in 1980-81 to Rs. 1,201.33 crores in 2006-07 and recorded a CAGR of 17.38 per cent. Its proportion is only 8.27 per cent of the total Small Savings and Provident Fund.

**Findings Related to Variables influencing the Growth of Public Debt**

16) The proportion of the State’s non tax revenue in total revenue receipts declined from 15.51 per cent to 5.16 per cent during the period under study. The non tax revenue shows an abysmally low compound growth rate of 9.02 per cent and States’ tax revenue shows a growth rate of 14.71 per cent only during the period under study. This leads to dependence on borrowings for filling revenue gap which in turn causes debt accumulation of the State, year after year. Consequently, the total debt of the State shows a growth rate of 16.04 per cent, during the same period.

17) The share of Central Taxes in total revenue receipts declined from 23.67 per cent to 17.66 per cent during the period under study. Consequently the State is forced to depend more on borrowings for meeting its financial requirements.

18) It is obvious from the analysis that the debt trap faced by the State of Kerala during the ninth plan period was the outcome of the unprecedented decline in the non tax
revenue, share of central tax, tax revenue and grant-in-aid. This leads to the conclusion that non tax revenue, share of central tax, tax revenue and grant-in aid have significant influence on the total debt accumulation of the State.

19) It is observed from the comparison of growth of revenue components and debt that the States’ own non tax revenue is the most influencing factor responsible for the retarded growth of the total revenue and consequent debt accumulation of the State.

20) From the expenditure side, the major factors influencing debt are pension and interest payments. This inference emerges from the observation of the growth rates of pension (CGR 20.49%) and interest (CGR 19.24%). The data proves that interest and pension exert great pressure on the State finances as they are unproductive economically. In absolute terms, the most decisive factor is salary because it represents about 39 per cent of the total revenue expenditure of the State.

21) The proportion of capital expenditure out of annual debt additions is showing a declining trend year after year. The proportion was 38.29 per cent in 1980-81 while it is only a meager 4.59 per cent in 2006-07. This is really a dangerous situation from the point of view of economic prospects of the State. Public debt is desirable only when it is meant for developmental activities. But in the State of Kerala, only a negligible share of additional debt collection is spent for capital expenditure requirements.

**Findings Related to Cost of Public Borrowing**

22) The analysis of the composition of total interest payments reveals that the share of interest on internal debt in total interest payment, has been growing very fast towards the end of the period under study (56.98% in 2006-07). In contrast, the share of
interest on Loans and Advances from Central Government declined sharply during the same period.

23) The amount of interest on internal debt rose heavily since 2000-01 and this has put a heavy burden on the State’s exchequer, especially because of the reason that the internal debt carries a higher rate of interest than Loans and Advances from the Central Government or from the Small Savings and Provident Fund.

24) Among the various components of Internal Debt, market loans carry heavy interest burden (41.06%). The preponderance of interest on market loans is the most decisive factor in the total interest on internal debt of the State of Kerala.

25) The share of interest on National Small Saving Fund of the Central Government which was only a negligible component earlier (7.6% in 2000-01) has become a prominent one by the end of the period under study (40.84%). It is noticed that the National Small Saving Fund of the Central Government carries a relatively very high interest rate of 9.5%.

26) As the Loans and Advances from Central Government are centered around State plan loans, the interest on state plan loan is the greatest in the total interest payment on Loans and Advances from Central Government.

27) Interest on insurance and pension fund had only a negligible role in total interest payment in the earlier years of the period under study. However, the share of the interest payments on insurance and pension fund witnessed a heavy increase with a compound growth rate of 24.12 per cent towards the end of 2006-07. Interest on insurance and pension fund was just Rs. 0.29 crores in 1980-81 but the amount
alarmingly increased to Rs. 80.02 crores in the year 2006-07, which is about 5.87 per cent of the total interest payment.

28) Of the total interest payment on Small Savings and Provident Fund, the share of interest on Small Savings Fund as well as State Provident Fund are fast growing. The Interest on Small Savings Fund has been growing with a CGR of 22.12 per cent while interest on State Provident Fund shows a CGR of 16.04 per cent, during the period under study.

29) The interest on Insurance and Pension Fund is likely to be an alarming component in the total interest payment because it shows the highest growth rate of 24.12 per cent compared to other components.

30) The study reveals that the total interest on Small Savings and Provident Fund is a major contributory to the ever increasing interest burden and consequent growth of public debt.

31) It is also inferred that the interest payment is one of the prime contributory factors to the alarming growth of public debt.

32) The net borrowing is not sufficient enough to meet the ever rising interest payment obligations and it entails an inevitable debt deficit spiral leading to an imminent fiscal crisis. The very high proportion of interest on LACG and SSPF in total interest, necessitates more internal debt which again leads to huge increase of high cost debt.

33) Observing the average interest rates on various components of debt, it can be inferred that the average interest rate of internal debt is high mainly due to the high dependence on market loans. The average interest rate of Loans and Advances from Central Government, which remained low in the early eighties, began to rise steadily
since then and reached the level of internal debt. On the other hand, the average interest rate of Small Savings and Provident Fund remained on moderate levels, through out the period under study, without any significant fluctuations.

34) The rate of interest on internal debt is the highest when compared to LACG and SSPF, in different five year plan periods under study. One of the major reasons for the severe financial stringency experienced by the State in late nineties was the excessive interest burden of the Government which is evident from the unreasonable hike in the rate of interest on different sources of borrowing prevailed during that time.

35) The interest rate on internal debt is higher than the corresponding rate of interest on total debt. This definitely points to the conclusion that the interest burden of the State can be reduced only by controlling the rate of interest on internal debt. This is particularly significant from the fact that internal debt is the major source of borrowing of the State at present.

**Findings Related to Additions and Discharge of Debt**

36) The study brings out that the major portion of the addition to debt was in the form of internal debt and small savings and provident funds, during almost all the years under study. The proportion of additions to Loans and Advances from Central Government has been showing a sharp decline and this decline is compensated by an increased proportion of additions from internal debt and Small Savings and Provident fund.

37) The proportion of additions of internal debt to total debt additions was more than that of the proportion of discharge of internal debt, towards the end of the period under study. On the other hand, the repayment ratio of LACG is higher than that of
additions. Similarly in the case of SSPF also the repayment ratio is more than the debt addition ratio throughout the period under the study. This is the reason behind the over dependence on other sources of borrowing, particularly internal debts, to compensate the short fall in LACG and SSPF.

38) In many years the net retention was negative in the case of LACG, even though the gross retention was positive. It implies that the annual addition of debt was not enough even to discharge the debt already due and needless to say about the interest payments. A similar situation is seen in the case of loans from small savings and provident funds also. It follows that even to pay the interest, the Government is forced to resort to other sources of borrowings like internal debt.

39) The excess amount of internal debt in the form of net retention, is seemed to have been used for the unabsorbed interest payments and other fixed obligations under the debt sources of LACG and SSPF. This forces the Government to heavily bank on internal debt for raising more money. These factors together with consequential high rate of interest, are likely to cause the debt to get cycled and spiraled, eventually culminating in to an inevitable debt trap.

40) The net retention of the total debt (additions of debt as reduced by discharge of debt and interest) is very low in most of the years and in some years, it has been negative. Every year the State is borrowing more and more amounts which are used only to repay previous debts and interest. Consequently, the debt as well as interest accumulate disturbingly and the State is forced to borrow again to meet the current obligations. This is a kind of financial vicious circle in to which the State has fallen.
41) Out of the total additions of debt, only a meager amount is available with the Government for developmental requirements. The disposable amount with the Government out of the borrowings after meeting debt repayment obligation and filling up the revenue deficit was above 20 per cent up to the year 1984-85. The financial condition of the State met a miserable fate by the end of the ninth plan period when the percentage dwindled to 2.69. It is really alarming that the disposable amount fell again, as low as -.04 during the year 2002-03.

42) The borrowings are neither sufficient to repay the ever rising debts of the State nor to meet the revenue deficits so that the State is pushed into such a difficult situation that only a little is left for the developmental requirements.

**Suggestions**

The significant suggestions based on the study are furnished below.

1. The growing share of internal debt in the total public debt should be reduced as far as possible since it carries high rate of interest. Loans and advances from the Central Government may be increased and more initiatives must be taken by the Government to mobilize more amounts from small savings and provident fund which has comparatively lesser rate of interest.

2. The impact of Market Loan component in the Internal Debt and consequently in the total debt is to be considered seriously. Steps must be taken to reduce the burden of market loans and also its share in the total debt as they carry high rates of interest.

3. The Central Government should contribute more to the welfare schemes in the form of non plan loans which would reduce the State’s dependence on high cost market loans for the implementation of welfare schemes.
4. The State Government must take appropriate measures to increase its non-tax revenue. As there is always an optimal limit for taxation, the way out for the State Government is to increase its non-tax revenue as much as possible by exploring untapped sources.

5. Pension being one of the dominant factors influencing the public debt, the burden of pension obligations of the State will have to be brought down substantially to reduce the total revenue expenditure. This is because pension is likely to exceed all other revenue expenditure in the immediate future itself. Pension, though an unproductive expenditure, is a social necessity. Therefore it is highly urgent to shift towards contributory pension system instead of the present system of statutory pension.

6. The Government can also consider raising the retirement age of employees, to defer the pension burden which will help to improve the financial position in the short run.

7. The State Government largely depends on internal borrowings to meet its financial requirements. But such internal borrowing is burdened with high rate of interest. Hence it will be better for the Government to take more loans from Small Savings and Provident Fund which has a comparatively low rate of interest.

8. The lion’s share of the total expenditure of the State goes towards the payment of interest, salary and pension. Only a negligible amount is available for capital expenditure. Unfortunately the State of Kerala is able to utilize only less than 10 per cent of the borrowings for developmental requirements. Since capital expenditure offers future revenue and in turn future relief from the debt problems, the Government should give due attention to raise the volume of capital expenditure.
9. The Central Government should reduce interest rates on Loans and Advances given to the states. This will help the State Government to reduce its dependence on high interest bearing market loans.

10. The Government should bring the additions and discharge of debt to an optimum balance. Public debt, as such is not an evil, but the only thing to be ensured is that amount of borrowings is used only for productive purposes of the State.

11. Strict control mechanism should be adopted to compress the growth of interest on internal debt so as to contain total interest payments and there by effectively manage the public debt of the Government of Kerala.

12. The existing debt swap schemes are to be revamped so that the high interest debt components can be replaced completely with lower interest rate components within a short span. This will give much relief to the interest burden of the State.

13. The legislative committee system should be further strengthened to ensure that money is borrowed only on the basis of need and affordability.

14. As far as possible public debt decision should be made in such a way that the inter-generational equity is maintained at an optimum level.

In short, there cannot be any disagreement on the need for fiscal adjustments and reforms aiming to contain expenditure and augment revenue. This process cannot be done overnight. The fiscal consolidation will, once implemented and strictly followed, take its own course to achieve financial robustness. Therefore the State government should prepare and implement a fiscal recovery plan very urgently. Only a determined implementation of such a recovery plan can save the State from future economic disasters.
Scope of Further Research

2. Expenditure management to contain revenue deficit.
3. Down sizing and re deployment of existing employees.
4. Further exploration and mobilization of non tax revenue of the State.
5. Paradox between finance commission awards and improving economic indicators of the State of Kerala.