Kerala's Alarming Fiscal Crisis

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Introduction

- The paper examines nature, magnitude and causes of the fiscal crisis
- Kerala’s fiscal crisis is not a temporary or a short term problem.
- It is a basic, structural and persistent problem
- The state faced the worst fiscal crisis during the period of 1998-2001
- Very high revenue deficit (RD, GSDP ratio) (3.5 to 5.2%)
- Very high fiscal deficit (FD, GSDP ratio) (4.8 to 6.6%)
- During the past three years the state has been facing acute crisis
- The crisis is some what similar to the worst crisis of 1998-2001

Fiscal crisis in 2016 (White Paper, June 2016)

- The State is facing an acute fiscal crisis
- Entire borrowing permitted by central government is just sufficient to meet the day to day expenditure
- No funds left for capital expenditure
- State budgets are highly unrealistic (inflated)
- Poor resource mobilisation
- Highly inflated annual plans (not based on resources availability)
- Fall in plan expenditure (actual plan expenditure 60-70%)
- Schemes in the budget had no resources to finance them
- The state has been living on a financial lie.

- **Two reasons for the crisis** :

1) Failure on expenditure control and
2) Poor resource mobilisation

- **Causes attributed to the crisis** :

1) Unsound fiscal policy
2) Poor fiscal management
3) Inefficiency in tax administration and
4) Corruption (of the UDF government for 3 years, 2013-16)

Prediction of White Paper 2016

- If the same fiscal situation continues, state would be in a fiscal anarchy in 2017-18.
- Development and growth of the state would come to a halt
- By 2021, the revenue deficit would exceed 3.25% of GSDP and gross fiscal deficit 6.25% of GSDP
- Will Result in default of payments on salaries, pensions and loan repayment obligations by 2021
- The state will move to fiscal collapse by 2021

Fiscal Situation Worsens Since 2015-16

- Available evidences suggests that the fiscal situation worsens since 2015-16
- The CAG report on state finances says that the fiscal crisis become more worse in 2016-17 (Table 1,2 & 3)
- There has been an increase in revenue deficit, fiscal deficit and debt GDP ratio.
- According to CAG’s Finance Account 2017-18 (Vol I), the actual revenue and fiscal deficit are higher due to distorted fiscal accounts
- During the year 2017-18 government imposed severe restrictions on treasury payments during the major part of the year

- Except salary, pensions and few establishment items, treasury payments of all other item were restricted between October and December 2017
- An amount of ₹ 12,000 crore deposited in government departments and 1200 LGs in treasury saving bank accounts was withdrawn by the governement.
- Expenditure control on non-plan revenue expenditure and additional treasury restrictions were announced in March 2018.
- In addition to the existing treasury restrictions, new restrictions were imposed in December 2018.
- The devastating flood during August 2018 also contributed to substantial fall in revenue receipts of state.
- Very severe treasury restrictions were imposed from February 15, 2019.

- The withdrawal ceiling amount of a bill from treasury is limited to Rs. 1 Lakh for all bills, except salary, pension, medical and dietary charges.
- The treasury restrictions continue even now with some modifications.
- During the month of November 2019, payment of almost all bills except salary and pensions were stopped during the entire month.
- This is to facilitate payment of salaries and pensions for the month of November 2019
- The acute crisis has paralysed the entire activities of the state government and 1200 local governments.

Table 1
Trends in Revenue Deficit (RD)

Year	Revenue deficit (Rs Crore)	RD as % of revenue expenditure	GSDP* (₹ crore)	RD as % of GSDP	RD as per KFR Act (%)
2010-11	3674	10.6	324513	1.13	
2011-12	8035	17.4	364048	2.21	1.4
2012-13	9352	17.5	412313	2.27	0.9
2013-14	11309	18.7	465041	2.43	0.5
2014-15	13796	19.2	512564	2.69	0.0
2015-16	9657	12.3	561994	1.72	0.0
2016-17	15484	17.0	616357	2.51	0.0
2017-18	16928	16.9	686764	2.46	0.0
2017-18 (Revised)	25820**	23.7	686764	3.75	0.0

Note: *The GSDP figures given in budget in brief 2019-20 issued for calculation of all GSDP fiscal indicators in the paper

** Revised revenue deficit as per CAG's Finance Accounts 2017-18 (Vol I) (16928 crore + 8892 crore)

Source: CAG (2016), Report of CAG on state finances for the year ended March 2015 and CAG (2018), Report for the year ended March 2017 and budget in brief 2019-2020.

Table 2
Trends in Gross Fiscal Deficit (GFD)

Year	GFD (Rs crore)	GFD as % of total expenditure	GFD as % of GSDP	GFD Target as per KFR Act (%)
2010-11	7731	19.9	2.38	
2011-12	12815	25.2	3.52	3.5
2012-13	15002	25.3	3.64	3.5
2013-14	16944	25.5	3.64	3.0
2014-15	18642	24.2	3.64	3.0
2015-16	17818	20.5	3.17	3.0
2016-17	26448	25.8	4.29	3.0
2017-18	26837	24.3	3.91	3.0
2017-18 (Revised)	36215*	30.3	5.27	3.0

Note: * Revised fiscal deficit as per CAG's Finance Accounts 2017-18 (Vol I) (26837 crore + 9378 crore)

Source: Same as Table 1

Table 3
Trends in public debt

Year	Public debt (Rs Crore)	Rate of growth (%)	Debt/GSDP (%)	Target as per KFR Act (Debt-GSDP Ratio)
2010-11	78673	10.9	24.24	
2011-12	89418	13.7	24.56	32.2
2012-13	103561	15.8	25.12	31.7
2013-14	119009	14.9	25.59	30.7
2014-15	135440	13.8	26.42	29.8
2015-16	157370	16.2	28.00	31.3
2016-17	186453	18.5	30.25	30.8
2017-18	210762	13.03	30.69	30.4

Source: Same as Table 1

Causes of the Crisis

Revenue

- Slump in mobilisation of state taxes and non-tax revenue
- Mounting losses of public sector undertakings and state support to retain them.
- Inadequate resources to meet inflated annual plan outlays
- Imposition of ceiling limit on state's borrowings by central government

Expenditure

- Excessive growth in the government bureaucracy, institutions, public sector undertakings etc.
- Kerala has 122 depts, 1200 local governments (panchayat & municipalities) large number of private aided educational institutions and semi government institutions
- High growth in non-plan revenue expenditure (salaries, pensions, interest, grant-in-aid to private aided educational institutions, administration etc)
- Salary & pension revision once in five years resulting in spurt in the growth of salary and pension expenditure
- Mounting debt and increase in repayments of debt and interest payments.

Hypothesis to explain the crisis

- The following unsound fiscal policies pursued and poor fiscal management by successive governments have contributed to persistent fiscal crisis.

a) Neglect of own resource mobilisation

b) Excessive increase in non-plan revenue expenditure (NPRE)

c) Fiscal extravagance to satisfy the powerful vested interest groups

d) Failure to take prompt action on steady deterioration of state finances.

- The failure of successive governments to correct the unsound policies and fiscal imbalances have resulted in deepening the crisis and led the state to a fiscal crisis trap.

Total Receipts

- Revenue and Capital are the two streams of receipts
- Revenue receipts consists of tax revenue, non-tax revenue, State’s share of union taxes and duties and grant in aid from the GOI
- Capital receipts comprise of non-debt capital receipts such as miscellaneous capital receipts, recoveries of loans and advances, and public debt resources from internal sources
- There has been a growth in the share of public debt receipts to total receipts (Table 4).
- It indicates that the state is depending on borrowing to meet revenue expenditure

Table 4

Trends in Total Receipts in the Consolidated Fund*

(Rs crore)

Year	Total revenue receipts	Non-debt capital receipts	Public debt receipts	Total receipts	Share of public debt receipts to total receipts
2010-11	30991	69	7189	38249	18.8
2011-12	38010	71	9799	47880	20.5
2012-13	44137	89	13261	57487	23.1
2013-14	49177	123	14461	63761	22.7
2014-15	57950	152	18509	76611	24.2
2015-16	69033	181	19658	88872	22.1
2016-17	75612	322	23858	99792	23.9
2017-18	83020	380	30234	113634	26.6

*Excluding public account receipts: *Source:* Same as Table 1

Trends in Revenue Receipts

- There has been a steep decline in growth rate of own tax revenue since 2011-12 (Table 5)
- But there has been an increase in growth rate of central tax transfer
- The growth rate of revenue receipts was lower in 2016-17 and 2017-18
- The share of own taxes revenue receipts witness a steady fall
- The share of central tax transfer and grants-in-aid witnessed an increase
- Of the total revenue, the state’s share is 69% and centre 31% in 2017-18 (Table 6)
- The structure of total revenue receipts is given in the Table 6

Table 5
Total Revenue Receipts

Year	Own taxes	Non-tax revenue	Central tax transfer	Grant-in-aid	Total revenue receipts
	Amount ₹ crore				
2010-11	21722	1931	5142	2196	30991
2011-12	25719	2592	5990	3709	38010
2012-13	30077	4198	6841	3021	44137
2013-14	31995	5575	7469	4138	49177
2014-15	35232	7284	7926	7508	57950
2015-16	38995	8426	12691	8921	69033
2016-17	42177	9700	15225	8510	75612
2017-18	46459	11199	16833	8528	83020
	Growth in %				
2011-12	18.4	34.2	16.5	68.9	22.6
2012-13	16.9	62.0	14.2	-18.5	16.1
2013-14	6.4	32.8	9.2	37.0	11.4
2014-15	10.1	30.7	6.1	81.4	17.8
2015-16	10.7	15.7	60.1	18.8	19.1
2016-17	8.2	15.1	19.9	-4.6	9.5
2017-18	10.1	15.4	10.6	0.2	9.8

Source: Same as Table 1

Table 6
Percentage share of Total revenue receipts

Year	Own taxes	Non-tax revenue	Central tax transfer	Grant-in-aid	Total revenue receipts
2010-11	70.09	6.23	16.59	7.08	100
2011-12	67.66	6.81	15.75	9.75	100
2012-13	68.14	9.51	15.49	6.84	100
2013-14	65.06	11.33	15.18	8.41	100
2014-15	60.79	12.56	13.67	12.95	100
2015-16	56.49	12.21	18.38	12.92	100
2016-17	55.78	12.83	20.14	11.25	100
2017-18	55.96	13.49	20.28	10.27	100

Source: Same as Table 1

Arrears of Tax and Non-tax items

- According to CAG, the total arrear in March 2017 is ₹ 12591 crore
- Of this, the amount of arrears for more than five years is ₹ 5183 crore (41 per cent)
- Major share of arrears and from sales tax and VAT (61 per cent in March 2015)
- Land revenue arrears accounts for 20 per cent (March, 2015)
- Motor vehicles tax accounts for 12 per cent (March 2015)
- A major reason is stay orders issued by courts, state government and appellate bodies.
- Most public sector undertakings failed to pay dues in time
- Government also fail to take prompt action in collection of arrears due to political factors/corruption

Fiscal policies on Expenditure

- State sponsored and funded development strategy since the formation of the state.
- Major political parties in Kerala believed in the ideology of socialism and expansion of bureaucracy
- The policy was to achieve development in all sectors through public investment
- Little priority was given to private investment till 1991 especially in non-agricultural sectors
- A large number of regulatory measures were implemented till 1991
- Salaries and pensions were revised once in five years and the same pattern was followed in autonomous bodies, in semi government institutions.

- Fiscal extravagance to satisfy the powerful vested interest groups-trade unions in public sector, private aided institutions, bureaucracy, social oraganisations, other vested interest groups etc.
- Unnecessary public sector undertakings were started in tourism, hotels, housing, trade, production of consumer goods etc.
- Expansion of public sector employment by expanding bureaucracy and public sector
- Liberal grants-in-aid to private educational institutions (which are in excess)

Total Expenditure (TE)

- Total Expenditure is classified as revenue and capital
- The growth rate was 31.2% in 2011-12. This was mainly due to the pay revision (Table 7).
- During last five years the annual growth rate of total expenditure ranged between 17.6 & 11.8 except 2017-18
- The total expenditure-GSDP ratio in the last three years was about 16%
- The resource gap between revenue receipts and TE was about 25% for six years (out of 8 years)
- This means that nearly one fourth of the expenditure has been met through borrowing

Revenue Expenditure (RE)

- RE accounts for about 89 to 93% of TE (Table 7)
- Annual Growth rate of RE range between 10 & 33 %
- Pay revisions ones in five years is the major factor which determine the growth of RE
- During 2011-12 the growth rate in RE was 32.8% mainly due to pay revision
- Only a small share of TE is spends for Capital Expenditure
- To find resources for RE, a cut in Capital Expenditure are effected
- The fall in RE in 2017-18 is due to severe restrictions imposed on treasury payments for major part of the year.

Table 7
Total expenditure – Basic Parameters

Year	Total expenditure(TE) (Rs crore)	Rate of growth (%)	Revenue expenditure (RE)	Growth rate of RE (%)
2010-11	38791	-	34665	-
2011-12	50896	31.2	46045	32.8
2012-13	59228	16.4	53489	16.2
2013-14	66244	11.8	60486	13.1
2014-15	76744	15.9	71746	18.6
2015-16	87032	13.4	78690	9.7
2016-17	102382	17.6	91096	15.7
2017-18	110238	7.7	99948	9.7

* GSDP figures given in the table 1 is used to estimate TE/GSDP ratio
Source: Same as Table 1

Non Plan Revenue Expenditure (NPRE)

- The NPRE is to meet items like salaries, pension, interest, subsidies, establishment, administration, grants-in-aid, etc.
- NPRE accounts for 76-81% of total expenditure (Table 8)
- NPRE as percent of revenue receipts was more than 100% in seven years except 2015-16
- This suggest that the entire revenue receipts is not sufficient to meet NPRE
- For meeting NPRE, government resort to continuous borrowing.
- The major factor which influence NPRE is salary, pension and DA revisions
- Rapid rise in NPRE is the root cause of the fiscal crisis

Table 8
Non Plan Revenue Expenditure (NPRE)

Year	NPRE (₹ in crore)	Rate of Growth (%)	NPRE as % of revenue receipts
2010-11	30469	-	98.3
2011-12	40718	33.6	107.1
2012-13	46640	14.5	105.7
2013-14	53412	14.5	108.6
2014-15	61462	15.1	106.1
2015-16	66611	8.4	96.5
2016-17	77604	16.5	102.6
2017-18	83767	7.9	100.9

Source: Same as Table 1

Salary and Pension Expenditure

- Kerala has a total staff strength of 5.15 lakh including private aided educational institutions in 2019.
- A major cause of the fiscal crisis has been the revision of salary and pensions once in five years
- Revision of salary results in an increase in expenditure of about 45 per cent in 2011-12 (Table 9)
- The revision of pension results in 50 per cent increase in expenditure in 2011-12 (Table 10)
- Salaries and pensions account for 63% of the total revenue receipts in 2017-18
- It accounts for 52% of the revenue expenditure
- The root cause of the present fiscal crisis is the additional financial commitment created due to 10th pay Revision commission, Kerala (annual Rs. 7700 crore)

Table 9
Salary Expenditure

Year	Salary Expenditure (₹ in crore)	Growth (%)	Share of revenue expenditure (%)	Salary as % of revenue Receipts (%)
2010-11	11178	-	32.2	36.1
2011-12	16229	45.1	35.2	42.7
2012-13	17505	7.8	32.7	39.7
2013-14	19554	11.7	32.3	39.8
2014-15	21621	10.5	30.1	37.3
2015-16	23757	9.9	30.2	34.4
2016-17	28373	19.4	31.1	37.5
2017-18	32349	14.0	32.4	38.9

Source: Same as Table 1

Table 10
Pension Expenditure

Year	Pension Expenditure (₹ in crore)	Growth (%)	Share of revenue expenditure (%)	Pension as % of revenue Receipts (%)
2010-11	5767	-	16.6	18.6
2011-12	8700	50.8	18.9	22.9
2012-13	8867	1.9	16.6	20.1
2013-14	9971	12.4	16.5	20.3
2014-15	11253	12.8	15.7	19.4
2015-16	13063	16.1	16.6	18.9
2016-17	15277	16.9	16.7	20.2
2017-18	19938	30.5	19.9	24.0

Source: Same as Table 1

Expenditure on Interest

- Expenditure on interest is emerging as a major item of expenditure.
- During 2017-18, interest expenditure was Rs 15,120 crore (Table 11)
- The growth rate was 24.8%
- It accounts for 15.1% of the revenue expenditure
- This is due to rapid growth in the public debt of the state

Table 11
Expenditure on interest

Year	Interest (₹ in crore)	Growth rate (%)	Interest as % of revenue expenditure	Interest as % of revenue receipts
2010-11	5690	-	16.4	18.4
2011-12	6294	10.6	13.7	16.6
2012-13	7205	14.5	13.5	16.4
2013-14	8265	14.7	13.7	16.8
2014-15	9770	18.2	13.6	16.9
2015-16	11111	13.7	14.1	16.1
2016-17	12117	9.1	13.3	16.0
2017-18	15120	24.8	15.1	18.2

Source: Same as Table 1

Three Major Items of NPRE

- The root cause of the present fiscal crisis is the rapid growth in three items of NPRE
- They are salaries, pensions and interest
- During 2017-18, the three items accounts for 81% of the revenue receipts (Table 12)
- There has been an increase in the share of the three items to total receipts
- Salaries accounts for 39% of the revenue receipts
- Pensions account for 24%
- Interest accounts for 18%
- There has been a spurt in growth of pension and interest during 2017-18.
- The above analysis support the hypothesis mentioned earlier to explain the acute fiscal crisis.

Table 12
Expenditure on Salaries, Interest and Pension

Sl. No	Item	2013-14	2014-15	2015-16	2016-17	2017-18
I	Amount (Rs. Crore)					
1	Salaries & wages	19,554	21,621	23,757	28,373	32,243
2	Pension	9,971	11,253	13,063	15,277	19,938
3	Interest	8,265	9,770	11,111	12,117	15,120
	Total	37,790	42,644	47,931	55,767	67,301
II	Percentage to Revenue Receipts					
1	Salaries & wages	39.76	37.31	34.41	37.52	38.84
2	Pension	20.28	19.42	18.92	20.20	24.02
3	Interest	16.81	16.86	16.10	16.02	18.21
	Total	76.85	73.59	69.43	73.74	81.07

Source: CAG (2019). State finance audit report of the CAG of India for the year ended March 2018.

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Thank You