Kerala's Unprecedented Fiscal Crisis and the State Budget of 2023–24

B A PRAKASH

Kerala has been experiencing a persistent, acute and unprecedented fiscal crisis. The persistent failure of successive budgets to address the causes of the fiscal crisis mentioned in the white paper on state finances of 2016 on two fronts, namely expenditure control and resource mobilisation, are major reasons for the crisis. The huge increase in revenue expenditure due to the revision of salary and pension once in five years is another major reason. The other factors that contributed to the crisis are the fall in the share of central taxes due to the Fifteenth Finance Commission, the stoppage of goods and services tax compensation, the lack of clear norms about the items coming under borrowing within the budget and outside the budget and the lack of clarity on inclusion of items in the public account.

The author is grateful to the anonymous reviewer for valuable comments.

B A Prakash (*baprakash1948@gmail.com*) taught economics at the University of Kerala, and headed the Fifth State Finance Commission, Kerala.

Kerala Finance Minister K N Balagopal said in the state legislative assembly that the state is reeling under an unprecedented fiscal crisis and attributed it to the distorted fiscal policies of the central government, the outbreaks of the COVID-19 pandemic, and the recurring natural disasters (Niyama Sabha Question 2022). The crisis has led to an acute shortage of funds for all items of expenditure, except salary, pension, and certain essential administrative expenses. In the budget 2023–24, it is mentioned that the government is anticipating a more severe fiscal crisis in the coming fiscal year 2023–24 compared to the previous year. The reasons attributed to the crisis in the budget are the fall in revenue deficit grant, stoppage of goods and services tax (GST) compensation, restrictions in borrowing and treating certain items of off-budget borrowing as borrowing within the budget. In this context, the article examines the nature and magnitude of the fiscal crisis of Kerala, the causes of the crisis attributed in the state budget, and the factors contributing to the crisis.

Nature and Magnitude of the Fiscal Crisis

We can assess the crisis by using fiscal indicators, namely revenue deficit, gross state domestic product (GSDP) ratio, gross fiscal deficit (GFD) GSDP ratio and debt GSDP ratio. Revenue deficit or revenue surplus is the difference between revenue expenditure and revenue receipts. The revenue deficit has increased to ₹31,915 crore, denoting a revenue deficit/GSDP ratio of 3.5%, much higher than the national average (Table 1). Although the revenue deficit target set by the Fiscal Responsibility and Budget Management Act is zero, Kerala has not been able to achieve it so far. It may be noted that 12 states in India recorded a revenue surplus during 2021–22 (RBI 2023).

The data on GFD indicates that the deficit is at a higher level (5.1% of GSDP) (Table 2). Compared to the national average, the ratio is very high. A disturbing aspect is that almost 69% of the amount of borrowed funds is spent on meeting the revenue deficit. The persistent diversion of a major share of annual borrowing for routine revenue expenditure is an important issue. Due to this, the resources available for capital outlay have fallen to nearly one-fourth of the borrowing in 2021–22 (Table 3).

A major change was the steep fall in the development expenditure on the one hand and the spurt in non-development expenditure on the other between 2020–21 and 2021–22 (Table 4, p 28). The non-development expenditure increased by 42.9% during the year. This indicates that the fiscal crisis has emerged as a development crisis.

Another outcome of the crisis has been the substantial increase in the public debt of the state. The outstanding liabilities increased from ₹2,43,745 crore in 2019 to

Table 1: Revenue Deficit of Kerala (₹ crore)

Year	Revenue Receipts	Revenue Expenditure	Revenue Deficit	Revenue Deficit of Kerala as % of GSDP	Revenue Deficit of All States and UTs as % of GSDP
2018–19	92,854.5	1,10,316.4	17,461.9	2.2	0.1
2019–20	90,224.7	1,04,719.9	14,495.3	1.7	0.6
2020–21	97,616.8	1,23,446.3	25,829.5	3.2	1.9
2021–22 (RE)	1,17,888.2	1,49,803.2	31,915.0	3.5	0.9

Source: RBI (2020, 2021, 2023).

Table 2: Gross Fiscal Deficit of Kerala (₹ crore)

Year	Receipts	Expenditure	GFD	GFD of Kerala as % of GSDP	GFD of All States and UTs as % of GSDP
2018–19	92,901.0	1,19,859.3	26,958.3	3.4	2.4
2019–20	90,252.1	1,14,089.6	23,837.5	2.8	2.6
2020–21	97,651.0	1,38,620.7	40,969.7	5.1	4.1
2021–22 (RE)	1,17,931.9	1,64,326.4	46,395.5	5.1	3.7

Source: RBI (2020, 2021, 2023).

Table 3: Decomposition of Gross Fiscal Deficit (share in %)

Year	Revenue Deficit	Capital Outlay	Net Lending	Non-debt Capital Receipts	GFD
2018–19	64.8	27.6	7.8	-0.2	100.0
2019–20	60.8	35.5	3.8	-0.1	100.0
2020–21	63.0	31.5	5.6	-0.1	100.0
2021–22 (RE)	68.8	26.4	4.9	-0.1	100.0

Source: RBI (2020, 2021, 2023).

Table 4: Development and Non-development Expenditure of Kerala

Year	Development Expenditure	Growth (%)	Non-development Expenditure	Growth (%)	Total	Share of Development Expenditure to Total
(1)	(2)	(3)	(4)	(5)	(2+4)	
2018–19	60,130.4	–	51,040.7	–	1,11,171.1	54.1
2019–20	52,645.6	-12.4	55,675.4	9.1	1,08,321.0	48.6
2020–21	78,761.5	49.6	50,630.5	-9.1	1,29,392.0	60.9
2021–22 (RE)	82,727.3	5.0	72,363.1	42.9	1,55,090.4	53.3

Source: RBI (2020, 2021, 2023).

Table 5: Total Outstanding Liabilities of Kerala

Year	Amount (₹ crore)	Growth (%)	Total of Kerala as % of GSDP	Total of All States and UTs as % of GSDP
2019	2,43,745.7	–	30.9	25.3
2020	2,67,585.4	9.8	32.5	26.7
2021	3,10,856.2	16.2	38.9	31.1
2022 (RE)	3,52,323.2	13.3	39.1	28.7
2023 (BE)	3,90,859.5	10.9	39.1	29.5

Source: RBI (2023).

₹3,90,859 crore in 2023 (Table 5). The total debt as the percentage of GSDP increased from 30.9% to 39.1%. The debt ratio is very high compared to the all-India average (10% difference). Thus, the review of the fiscal indicators suggests that Kerala has been experiencing a persistent, acute, and unprecedented fiscal crisis.

CAG's Audit Report, 2020–21

The Comptroller and Audit General's (CAG) audit report for 2020–21, which assessed the state finances based on fiscal indicators from 2016–17 to 2020–21, came to the conclusion that Kerala's fiscal situation is precarious (CAG 2022). The state was not able to achieve the revenue deficit, fiscal deficit, and debt GSDP targets stipulated as per the Kerala Fiscal Responsibility (KFR) Act for five years. The only exception is the achievement of fiscal deficit for 2019–20. The fiscal targets of the KFR Act for 2019–20 were as follows: revenue deficit (zero), GFD (3% of the GSDP) and debt GSDP ratio (29.67%).

Causes of the Crisis Attributed in the State Budget

The state budget attributes the following distorted fiscal policies of the central government for the crisis: (i) during the tenure of the Fifteenth Finance Commission (FFC), the share of Kerala in the divisible pool fell to 1.925% resulting in a huge fall in the share of central taxes to the state; (ii) as a result of the cessation of GST compensation, there is a shortfall of around ₹7,000 crore during fiscal year 2022–23; the anticipated loss in revenue in 2023–24 is ₹5,700 crore; (iii) due to the policy of the union government treating public account as debt liability, there is a revenue loss of around ₹10,000 crore per annum; (iv) the policy of treating off-budget borrowing of institutions, such as Kerala Infrastructure Investment Fund Board (KIIFB), Kerala Social Security Pension Ltd (KSSPL), etc, as borrowing within the budget and reducing the borrowing limit of the state. The estimated resource loss on these items is around ₹5,000 crore; and (v) the anticipated shortage of ₹8,400 crore in revenue deficit grant in 2023–24 compared to the previous year.

Let us examine these arguments. First, it is true that there was a fall in the share of central tax due to a decline in the share of the divisible pool to Kerala. But we do not have the facts to support that the FFC has followed discriminatory norms of devolution to favour or disfavour certain states. Second, it is a fact that the stoppage of GST compensation has affected the finances of Kerala. However, the continuation of GST compensation is a complex federal finance issue to be resolved by the GST Council taking into consideration positive and negative effects. Third, the lack of clear norms about the items coming under borrowing within and outside the budget is creating much confusion and problems for states. Clear norms are needed in this case. The solution lies in the enactment of appropriate legislation for the purpose by Parliament. Clarity is also needed regarding the treatment of items in the public account as debt liability within the budget. Fourth, the argument that the centre should give revenue deficit grants continuously is not a rational one. The post-devolution revenue deficit is a specific grant given to a state to correct the deficiency in fiscal capacity. The total revenue deficit grant recommended by FFC to Kerala was ₹53,137 crore between 2020–21 and 2023–24. Though there has been a fall in the share of the centre's taxes due to the FFC recommendations, the grants from the centre registered a substantial increase due to the receipt of the post-devolution revenue deficit grant (Table 6). All these suggest the need for a more state-friendly centre–state federal relation addressing the demands and requirements of states.

Resource Mobilisation in the Budget

The budget proposed an additional resource mobilisation of ₹2,955 crore through proposals such as social security cess on the sale of petrol and diesel at the rate of ₹2 per litre, cess on Indian-made foreign liquor, increase in fair value of land by 20%, increase in one-time tax on newly purchased motor vehicles, motor cars, etc, increase in electricity duty, enhancement of royalty and fees in minor minerals, etc. Though additional resource mobilisation is a positive measure, it is too meagre to cover the huge revenue deficit. But the ₹2 cess on petrol and diesel is a regressive levy that creates more social cost than social benefit to the 155.65 lakh motor vehicle owners, including 101.51 lakh motorcycles/scooters in Kerala (KSPB 2023).

Failure of the Budget

During a previous fiscal crisis in 2016, the state government published a white paper on state finances, which found that the major cause was the failure on twin fronts, namely expenditure control and

Table 6: Share of Central Taxes and Grants from the Centre

Year	Share of Central Taxes	Grants from the Centre	Total	Share of Total to Total Revenue Receipts (%)
Amount (₹ crore)				
2018–19	18,663.2	11,388.9	30,052.1	32.4
2019–20	16,401.1	11,235.3	27,636.4	30.6
2020–21	11,560.4	31,068.3	42,628.7	43.7
2021–22 (RE)	17,332.1	31,650.1	48,982.2	41.5
Growth (%)				
2018–19	–	–	–	–
2019–20	-12.1	-1.3	-8.0	–
2020–21	-29.5	176.5	54.2	–
2021–22 (RE)	49.9	1.9	14.9	–

Source: RBI (2020, 2021, 2023).

resource mobilisation. The failures in expenditure management were inflated plan budget, giving administrative sanctions to projects without funds, lack of matching resources for major projects announced in the budget and lack of control on revenue expenditure, particularly on salaries, interest and pensions. The failures in revenue mobilisation were underperformance of the tax collection machinery in general, huge amounts of stays issued by the government, delays to expedite the disposal of arrear appeals and stay cases, non-realisation of additional resource measures announced in the budget, undue concessions offered to certain groups of taxpayers, corruption and nepotism in the tax administration and failure to implement technology support in major tax collection. A notable aspect is that the white paper has not attributed any policies or measures of the central government to the fiscal crisis. The persistent failure of the state government on expenditure control and resource mobilisation are the major causes of the current fiscal crisis.

Huge Increase in Salary and Pension Expenditure

Rejecting the recommendations of two Kerala public expenditure review committees and the Tenth Pay Revision Commission to switch over salary and pension revision to once in 10 years, the state government implemented it once in five years. The implementation of the Eleventh Pay Revision Commission recommendations in February 2021 has resulted in a huge increase in expenditure and pushed the state to an unmanageable fiscal crisis. It may be noted that the central government and most of the state governments in India are implementing pay and pension revision once in 10 years. Due to the revision of salary and pensions, the expenditure on the item increased by 51.8% in one year (Table 7).

This is the most important cause of the current crisis. A review of the past fiscal crisis of the state shows that there had been a correlation between fiscal crisis and salary and pension revisions. Kerala has 122 departments and a total staff of 5,26,169, including 11,145 temporary staff as on February 2023 (GoK 2023c). Of this, a sizeable number of staff may be put in the category of surplus staff in the context of digitalisation of office work.

The revision of salaries of the public enterprises once in five years also pushed them to fiscal problems. According to the latest statistics, Kerala has 131 active state-level public enterprises either wholly or jointly owned by the Government of Kerala with a total of 1,33,369 employees. Of these public sector enterprises, 60 are earning profits and 61 are incurring losses (data available) (CMD 2023). And the state government gives fiscal support to sustain the loss-making units.

Table 7: Expenditure on Salary and Pension (₹ crore)

Year	Salary and Wages	Pension	Total	Growth (%)	Share of Total to Revenue Receipts (%)
2018–19	32,697.8	19,011.9	51,709.7	–	55.7
2019–20	33,043.6	19,064.3	52,107.9	0.8	57.8
2020–21	28,852.4	18,942.8	47,795.2	-8.3	49.0
2021–22 (RE)	45,619.9	26,959.2	72,579.1	51.8	61.6

Source: RBI (2020, 2021, 2023).

Neglect on Collection of Tax Arrears

The CAG's annual reports on the revenue sector point out an alarming increase in tax arrears in the state. The total arrears of revenue in the state were estimated as ₹21,798 crore, of which ₹7,100 crore was outstanding for more than five years as on March 2021 (CAG 2023b). An interesting aspect is that, of the total arrears, ₹6,422 crore is pending from the government and local bodies. The total amount under stay with both judicial authorities and government was ₹6,143 crore. The report also points out several cases of tax evasion. Despite the repeated observations of CAG on tax arrears, not many attempts have been made to improve the collection of tax and tax arrears.

In Conclusion

Kerala has been experiencing a persistent, acute and unprecedented fiscal crisis. The persistent failure of successive budgets to address the causes of the fiscal crisis mentioned in the white paper on state finances of 2016 on two fronts, namely expenditure control and resource mobilisation, are the major reasons for the crisis. A huge increase in revenue expenditure due to the revision of salary and pension once in five years in 2020 implemented in February 2021 is another major reason. The fall in the share of central taxes due to the FFC, the stoppage of GST compensation, the lack of clear norms about the items coming under borrowing within and outside the budget and the lack of clarity on the inclusion of items in the public account as debt liability also contributed to the fiscal crisis. Urgent measures are needed from the state as well as central government to address the current fiscal crisis of Kerala.

REFERENCES

CAG (2022): *State Finances Audit Report of the CAG for the Year Ended 31 March 2021*, Government of Kerala, Comptroller and Auditor General of India, Report No 1 of 2022.

— (2023a): *Accounts At a Glance 2021–22*, Comptroller and Auditor General of India, Thiruvananthapuram: Government of Kerala.

— (2023b): *Combined Compliance Audit Report of the CAG on Revenue Sector for the Period 2019–2021,* Comptroller and Auditor General of India, Report No 6 of the Year 2022.

CMD (2023): *A Review of Public Enterprises in Kerala 2021–22*, Thiruvananthapuram: Centre for Management Development.

GoK (2016): *White Paper on State Finances, June 2016*, Thiruvananthapuram: Government of Kerala.

— (2023a): *Budget Speech 2023–24, 3rd February 2023*, Thiruvananthapuram: Government of Kerala.

— (2023b): *Budget in Brief 2023–24*, Thiruvananthapuram: Government of Kerala.

— (2023c): *Appendix I to the Detailed Budget Estimates 2023–24: Details of Staff*, Thiruvananthapuram: Government of Kerala.

— (2023d): *Medium Term Fiscal Policy and Strategy Statement with Medium Term Fiscal Plan for Kerala 2023–24 to 2025–26*, Thiruvananthapuram: Government of Kerala.

Jose Sebastian (2019): "Kerala's Persistent Fiscal Stress: A Failure in Public Resource Mobilisation?" *Economic & Political Weekly*, Vol 54, No 22, pp 32–39.

KSPB (2023): *Economic Review 2022, Volume I and II*, Thiruvananthapuram: Kerala State Planning Board.

Niyama Sabha Question (2022): 15th Kerala Legislative Assembly, unstarred question No 450, 6 December.

Prakash, B A and Jerry Alwin (2018). "Kerala's Acute Fiscal Crisis: An Analysis of Causes," *Kerala's Economic Development: Emerging Issues and Challenges*, Prakash, B A and Jerry Alwin (eds), New Delhi: Sage Publications.

Prakash, B A (2022): "Fiscal Decentralisation and Finances of Gram Panchayats and Municipalities: A Kerala Experience," *Economic & Political Weekly*, Vol 57, No 36, pp 57–64.

RBI (2020): *State Finance: A Study of Budgets of 2020–21*, Mumbai: Reserve Bank of India.

— (2021): *State Finance: A Study of Budgets of 2021–22*, Mumbai: Reserve Bank of India.

— (2023): *State Finance: A Study of Budgets of 2022–23*, Mumbai: Reserve Bank of India.

Union Finance Commission (2020): *Finance Commission in COVID Times: Report for 2021–26, Fifteenth Finance Commission Report, Volume 1, Main Report*, October.