KERALA'S UNPRECEDENTED FISCAL CRISIS

Collection of published articles

B A PRAKASH

Presents a review of Kerala's fiscal situation between 2016 and 2024

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Preface

I have experience as Chairman, Kerala Public Expenditure Review Committee for three years (2012-14) and prepared three reports on state finances. I was also Chairman, 5th State Finance Commission (2015-16), which recommends devolution of states taxes to local bodies consists of three tier panchayats, municipalities and municipal corporations. I wrote a book in Malayalam on state finances (ധനധൂർത്ത് രാഷ്ട്രീയവും രൂക്ഷ ധനപ്രതിസന്ധിയും, കറന്റ് ബുക്സ്, 2017) and a book on local finance (Local Finance, Fiscal Decentralisation and Decentralised Planning: A Kerala Experience, Sage Publications, New Delhi, 2020).

This book presents the recent articles of mine on state finances of Kerala published in The Times of India; The New Indian Express; The Hindu; and Economic and Political Weekly. The articles examine the causes for transformation of mild fiscal crisis to an unprecedented crisis in Kerala.

I take this opportunity to thank Shri. Bijil Babu R, who gave the research support for the book.

Thiruvananthapuram **B. A. Prakash**
August, 2024

ABOUT THE AUTHOR

B. A. Prakash was Professor and Head of the Department of Economics, University of Kerala, Kariavattom, Thiruvananthapuram and retired from service in 2008. Formerly, he was a Professor in the Department of Economics, University of Calicut, John Mathai Centre, Thrissur, where he had been teaching since 1976. He was a recipient of two prestigious fellowships – the Young Social Scientist Fellowship of the Indian Council of Social Science Research (1980-82) and the Career Award of the University Grants Commission (1986-89). During that period, he did post-doctoral research at the Centre for Development Studies, Thiruvananthapuram. Prof. Prakash has served as a member of a number of study groups/committees constituted by the Government of Kerala and the State Planning Board. He also held positions such as Chairman, Fifth State Finance Commission, Kerala; and Chairman, Kerala Public Expenditure Review Committee.

Areas of research of Prof. Prakash are migration to the Gulf, labour market, state finance, local finance, fiscal decentralization, economic reforms, development issues of the Indian and Kerala economies. He is the pioneer in Gulf migration studies in Kerala with the publication of his study in *Economic and Political Weekly* on July 8, 1978.

Besides publishing research papers in leading journals, working papers, research reports and articles in dailies, Prof Prakash has published books and edited books. **Book:** *Local Finance, Fiscal Decentralisation and Decentralised Planning: A Kerala Experience*, Sage Publications, 2020. **Edited books on Indian economy:** *The Indian Economy Since 1991: Economic Reforms and Performance*, Pearson, 2008; and a fully revised edition, Pearson, 2012. **Edited books on Kerala economy:** *Kerala's Economy: Performance, Problems, Prospects,* Sage Publications, 1994; *Kerala's Economic Development: Issues and Problems,* Sage Publications, 1999; *Kerala's Economic Development: Performance and Problems in the Post-Liberalisation Period*, Sage Publications, 2004; *Kerala's Economic development: Emerging Issues and Challenges,* Sage Publications, 2018; and *Kerala's Economic Development: COVID-19 Pandemic, Economic Crisis and Public Policy,* Pearson, 2023. Two books and a large number of articles are also published in Malayalam language.

An Overview

This note presents an overview of Kerala's unprecedented fiscal crisis based on my recent articles, interviews, and other publications presented in 16 items. The note contains an introduction, the state of finances given in the white paper 2016, an assessment of state finances by CAGs impact of hikes in the revision of salaries and pensions, the impact of natural disasters, etc. This note gives a picture of the transformation of mild fiscal crisis to an unprecedented crisis.

Introduction

Kerala's fiscal crisis has emerged as a structural and persistent state problem in recent years. Though it is a structural issue, the successive governments in Kerala treated this as a temporary problem relating to the tenure of one government. The white paper 2016 has considered this as a temporary problem arising out of fiscal mismanagement of previous UDF government. But there is not much difference in fiscal policy pursued by LDF and UDF governments in the state. Fiscal policies pursued in the state have given low priority for own resource mobilisation. Efforts are not made to improve the fiscal management or revenue collection. Fiscal policies promoted excessive increases in non-plan revenue expenditure, especially salary and pension. There is no change in fiscal extravagance to satisfy the powerful vested interests (trade unions in the public sector, private aided institutions, bureaucracy, social organisations etc).

The failure of successive governments to correct the unsound policies regarding resource mobilisation and restrict the excessive growth in non-plan revenue expenditure has resulted in deepening the crisis. Available evidences suggest that the fiscal situation worsened since the publication of the white paper in 2016 due to the inaction of the LDF government to address the issues raised by the white paper. The white paper 2016 predicted that a fiscal collapse will happen in 2021 if the issues raised are not addressed. This prediction has come true. Kerala finance minister K.N. Balagopal has declared in the Kerala Legislative Assembly that the state is facing an unprecedented fiscal crisis on December 6, 2022.

White Paper, 2016

According to the white paper on state finances, prepared by the Finance Department, the state faced an acute fiscal crisis in 2016. The entire borrowing permitted by the Central Government was just sufficient to meet the day-to-day expenditure of the State. The major cause was the failure on twin fronts, viz. expenditure control and resource mobilization. The failure on expenditure management included an inflated plan budget, giving administrative sanctions for projects without funds, a lack of matching resources for major projects announced in the budget, and a lack of control on revenue expenditure, particularly on salaries, interest, and pensions.

The failure in revenue mobilisation was the underperformance of the tax collection machinery in general, huge amounts of stays issued by the government, delay in disposal of arrear appeals and stay cases, non-realization 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 the major tax collection. A notable aspect is that the white paper has not attributed the fiscal crisis in Kerala to any policies or measures of the Central Government.

The white paper predicted that if the same fiscal behaviour continues, the state would face fiscal anarchy in 2017-18 and the state would default on its committed payment on salaries, pensions, and loan repayment obligations by 2020-21. The failure of the state government to take action on the findings of the white paper has worsened the fiscal crisis.

CAG's Audit Report, 2020-21

CAG's State Finances Audit Report of Kerala for 2020-21 presented a dismal picture about the state finances for the period from 2016-17 to 2020-21. The state was not able to achieve the revenue deficit, fiscal deficit, and debt Gross State Domestic Product (GSDP) targets stipulated as per the Kerala Fiscal Responsibility Act (KFR Act) for the five years. The only exception is the achievement of the fiscal deficit for 2019-20. The CAG has calculated the overall debt of Kerala including off-budget borrowing as Rs. 3,24,855 crore in 2020-21 (Debt GSDP ratio 39.87 percent). This is an excessive and unsustainable level of public debt of the state by any fiscal norms. As resources are not available to meet routine revenue expenditure like social security pensions, the state has resorted to off-budget borrowing.

Huge hike in Salary, Pension

A disturbing development in revenue expenditure during 2021-22 is the huge increase in salary and pension due to its revision every five years. The salary expenditure increased from Rs 28,763 crore in 2020-21 to Rs 45,585 crore in 2021-22 (58 percent increase) and pension expenditure increased from Rs 18,942 crore to Rs 26,899 crore (42 percent). The net additional financial commitment created was Rs 24,779 crore.

The salary and pension revision was implemented when the state faced the worst recession due to COVID-19. 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. Though the Kerala Public Expenditure Review Committee (KPERC) (2012) and Tenth State Pay Revision Commission have recommended revision of salary once in 10 years, the successive governments in Kerala have not accepted the recommendations.

Natural disasters, COVID-19

Natural disasters such as the devastating floods and landslides during 2018 and 2019 have resulted in unprecedented dislocation of people, destruction of houses, and loss of property. The spread of the COVID-19 pandemic in the state since March 2020 has also created an unprecedented health crisis and recession.

Policies to address the fiscal crisis

Kerala’s fiscal crisis came to unmanageable level due to persistent increases in revenue deficit, fiscal deficit, and borrowing to meet routine revenue expenditure. Treat Kerala’s crisis as a structural issue and make drastic changes in all aspects of fiscal policy to solve the problem. Structural changes in revenue expenditures and revenue receipts are needed to achieve this. A drastic cut in the existing pattern of revenue expenditure is needed. Take urgent steps to rationalise the tax and non-tax rates collected by state governments and local governments. Strengthen the administrative machinery to increase the efficiency of collection. Collect arrears of tax and non-tax revenue. Salary and pension revisions once every five years are a basic cause of the persistent fiscal crisis of state governments, autonomous bodies, universities, public sector undertakings, and other semi-government organizations in Kerala. So implement salary and pension revision once in every 10 years.

The size of the bureaucracy in Kerala is very large compared to other similar states in terms of population in India. Reduce it. Identify and cut down the fiscal extravagance type of revenue expenditure of state governments, state government departments, autonomous bodies, universities, semi-government organizations, etc. Too many welfare schemes beyond the fiscal capacity of the state are creating a chaotic situation. Reduce the number of schemes. Utilise the entire borrowed funds for capital and plan expenditure. The current practice of using it for meeting revenue expenditure should be stopped. Instead of starting new higher educational institutions such as universities, private-aided colleges, autonomous colleges, and other institutions using public funds, they shall be started in the private sector using private funds. The issue of borrowing, fiscal disputes, etc. between state and union government should be settled within the fiscal framework of the Indian Constitution.

1 Isaac a proponent of fiscal extravaganza: Economist Pre-Budget Debate Turns 'Ugly'

The pre-budget consultations initiated by finance minister T. M. Thomas Isaac has spurred a debate on the necessity to control fiscal extravaganza fuelled by political considerations to save the state's exchequer. Economist B A Prakash who spoke about fiscal extravaganza as the worst vice that plagued our economy was criticised sharply by minister Isaac.

The argument between Isaac, an economist-turned politician and Prakash, the former chairman of the Kerala public expenditure review committee and fifth finance commission, during Monday's consultations spilled out of the discussion room on Tuesday when Isaac posted on Facebook his disagreement with Prakash's arguments. Prakash, on Wednesday, retorted with a detailed reply.

For long, Prakash has been cautioning about the fiscal extravaganza in the state. Cost cutting should begin at the top and trickle down to bottom, he has argued. The huge cost incurred by the government in the form of jumbo personal staff of ministers, luxury vehicles and limitless re-imbursement of bills by ministers and MLAs were part of the work 'Dhana dhoorthu rashtreeyavum rooksha dhana prathisandhiyum' (Fiscal extravagant politics and deep fiscal crisis) penned by Prakash last year.

According to Prakash, he pointed out key arguments against fiscal extravaganza and urged the minister to announce drastic cost-cutting measures in the next budget. "Take our public service commission. There are 21 members making it the biggest in the country. Personal staff of ministers who had worked just two years would get lifelong pensions. During the last assembly, an MLA claimed Rs 1.90 crore as medical reimbursement," Prakash listed out examples to support his argument.

Isaac said Prakash always took a stand opposite to that of his on almost all issues. "He is against KIIFB. He says such initiatives should wait till the exchequer gets back to perfect health. My argument is that such a long wait would be bad for the state. Similarly, he demanded to reduce non-plan expenditure. He suggested that pay revision should be once in

10 years and loss-making PSUs should be privatized. None of these suggestions are appealing to me," Isaac posted.

Prakash retorted saying that Isaac was a proponent of fiscal extravaganza. "Such policies will drive our state into a debt trap and anarchy. Government says Rs 30,000 crore worth projects under KIIFB have been sanctioned. It is not possible to levy user fee from KIIFB projects. That means government will have to pay principal and interest of this loan from tax collection. This will be disastrous," Prakash replied on his FB page

(Report published in *The Times of India* on January 4, 2018)

2 He's building castles in the air

When finance minister T M Thomas Isaac left for the assembly on Thursday morning to present the budget, he said the state was facing an acute fiscal crisis. While presenting the budget, he said despite issuing a white paper, there had been no improvement in fiscal situation during last three years. There has been no increase in annual revenue receipts.

The government wants to improve the fiscal situation through reduction in revenue deficit and fiscal deficit, but it is not prepared to cut down the revenue expenditure, especially the non-plan revenue expenditure. It seems the budget has taken a contradictory position.

It proposes to increase GST revenue by 30% in 2019-20 from the current 10%. It is an unrealistic and unattainable target. The government has failed to present an economically sensible solution to improve the fiscal situation.

The budget criticizes the central government for its 'negative attitude' towards the state's efforts to mobilise funds for rebuilding Kerala after the devastating floods. It says the Centre has allotted only a paltry sum as relief and prevented the state from getting funds from foreign countries and NRKs. It says the Centre has taken a hostile attitude towards the state and its people. At the same time, the state has spent only a small amount of funds it received. The chief minister's distress relief fund (CMDRF) has spent only Rs 1,733 crore of the Rs 3,229 crore it received. Moreover, no clear proposal has been put forward to help people who lost their houses, properties and livelihoods or to the trade and commerce, which suffered in the devastating floods.

The finance minister announced a large number of development schemes, which require huge funds for implementation. But he relies on the Kerala Infrastructure Investment Fund Board (KIIFB) to run most of these schemes. I feel that the KIIFB is an unreliable source of funds.

Besides, several schemes like the parallel rail line from Thiruvananthapuram to Kasaragod, estimated at Rs 55,000 crore, has been announced with no resource support. The budget says the government will begin the rail project in 2020. Currently, there's a treasury restriction on bills above Rs 50 lakh, which reveals the state's fiscal position. Most of the projects proposed are just ‘dream projects’ without any resource support.

So, the finance minister has totally failed to give any rational or practical solution to address the acute fiscal crisis. He has not made any serious attempt to rehabilitate or give assistance to lakhs of people who were affected by the floods. And, a large number of projects proposed are not for implementation as they don’t have any resource support.

(Article of B. A. Prakash published in The Times of India on February 1, 2019)

3 Kerala heading towards a fiscal collapse

Due to acute fiscal crisis, the state government has implemented stringent treasury restrictions on February 15, 2019 in addition to the restrictions in force. For payment to contractors, accredited agencies, suppliers, the withdrawal ceiling is limited to ₹ one lakh for each treasury bill or cheque. This has paralysed all plan, development activities of states including the rebuild activities for the rehabilitation of flood victims.

Now, disbursal from state treasuries is limited to salary, pension and certain items on medical and dietary charges. Persistent fiscal crisis forced the state government to effect large cut in the share of state taxes transferred to LGs (local self-government) as per 5th state finance commission, non-spending of allotted funds due to treasury restrictions and acute shortage of funds to 1200 LGs in Kerala. Available evidences suggest Kerala is heading for a fiscal collapse.

The white paper on state finances published in June 2016 said that Kerala was facing an acute fiscal crisis. It predicted that if the same trend continued, it would face a virtual fiscal anarchy in 2017-18 and by 2021 the state would default on its committed payments on salaries, pensions, loan repayment obligations etc. The fiscal situation has been worsening. The CAG report on state finances said that the fiscal situation worsened in 2016-17 compared to previous year. A review of the fiscal indicators shows that the fiscal situation worsened in 2016-17 and 2017-18 compared to 2015-16 (Table).

Fiscal Indicators of State

Sl. No.	**Indicators**	**2015-16 (Accounts)**	**2016-17 (Accounts)**	**2017-18 (Accounts)**
		Amount ₹ crore		
1	Revenue Deficit (RD)	9657	15484	16928
2	Fiscal Deficit (FD)	17818	26448	26837
3	Public Debt (PD)	157370	186453	210762
		Indicators (%)		
1	RD as % of GSDP	1.72	2.51	2.46
2	FD as % of GSDP	3.17	4.29	3.91
3	PD as % of GSDP	28.00	30.25	30.69
4	RD as % of Revenue Expenditure	12.27	16.99	16.94
5	FD as % of Total Expenditure	20.47	25.83	24.34

Source: Report of CAG (2018) on State Finances ended March 2017 and Budget in Brief 2019-20

The revenue mobilisation measures taken by the LDF government failed to increase the growth rate of revenue receipts. The experiment to mobilise resources through Kerala Infrastructure Investment Fund Board (KIIFB), an agency outside the budget to finance many projects within the budget failed miserably. The annual growth in revenue receipts fell from 19.1 percent in 2015-16 to 9.5 and 9.8 in the subsequent two years.

The failure to curtail excessive growth in non-plan revenue expenditure led to the unmanageable level of expenditure. The expenditure on salaries and pension increased from ₹ 36820 crore in 2015-16 to ₹ 52188 crore in 2017-18 (42% increase). It is disturbing to note that 63% of the total revenue receipts is spent on salaries and pensions in 2017-18. The creations of 20,000 new posts over the last three years have increased salary expenditure. There has been an alarming growth in interest payments due to mounting public debt.

Kerala experienced a fiscal collapse from 1998-2001, due to huge growth in non-plan revenue expenditure (especially salary and pension) and stagnation of state's own tax and non-tax resources. Just like that, Kerala is experiencing an alarming growth in non-plan revenue expenditure especially salary, pension and stagnation of state own resources now. The state treasury cannot withstand the financial burden due to the pay and pension revision announced in the budget and future repayment obligation of KIIFB from state taxes. All these indicate Kerala is heading towards a fiscal collapse by 2021.

(Article of B. A. Prakash published in *The Times of India* on March 1, 2019)

4 Distorted fin accounts hurt Kerala

The annual borrowing limit of the State is 3 percent of the Gross State Domestic Product (GSDP) according to fiscal norms. The State can borrow money coming under the heads viz. consolidated fund of the State and public accounts such as treasury savings bank deposits and provident fund.

The treasury savings bank accounts falls in to two categories: treasury savings bank in which government accepts deposits from public, and second, special treasury savings bank (STSB) account of departments, State owned PSUs, autonomous institutions etc. where unspent budgetary amount are kept for a short period. The STSBs are non-interest bearing and will be closed immediately after the implementation of the scheme.

Available evidences suggest that huge amounts of unspent budgetary provision of Departments, PSUs, autonomous institutions etc. are transferred to their STSB accounts without backing of resources. This has resulted in substantial increase in the deposits of STSB accounts. The central government began to treat this amount as a surplus fund parked in the accounts and can be used as loans.

The State government has resumed an amount of Rs. 8298.22 crore in 2017-18 from STSB accounts to the consolidated fund after the central curtail the borrowing limit. According to the Comptroller and Auditor General (CAG), the amount resumed could not be shown against the original heads of accounts, against which the expenditure stand booked and put in the category of incorrect accounting.

The CAG found that the amount resumed to the consolidated fund has resulted in understatement of revenue deficit (Rs. 7812.58 crore) capital and loan (Rs. 485.64 crore) and fiscal deficit (Rs. 8292.22 crore). The liabilities of the government have also reduced by Rs. 8292.22 crore in public account.

The CAG's observations indicated that the State government has deliberately manipulated the STSB accounts to distort the actual receipts and expenditure. If we correct the understatement of revenue deficit based on the observation of CAG, the revenue deficit will increase to Rs. 25820 crore and fiscal deficit to Rs. 36215 crore in 2017-18. This means that the revenue deficit will increase to 3.75 percent of GSDP and fiscal deficit to 5.27

percent of GSDP. And the fiscal situation prevailed was like the worst fiscal crisis of 2000-01.

Due to the incorrect accounting of the STSB accounts, the State government had lost the opportunity to borrow Rs. 6000 crore in 2016-17 and Rs. 5550 crore this year.

(Article of B. A. Prakash published in *The Times of India* on August 24, 2019)

5 KIIFB : A dream project with high expectations and poor results

In the context of persistent fiscal crisis and recessionary situation in Kerala, the LDF government announced an out of budget financing scheme for implementing development projects in the revised budget (2016-17). It declared a second anti-recession package worth ₹20,000 crore with an anticipated expenditure of ₹2500 crore in FY 2016-17. It was proposed that the amount would be mobilised through Kerala Infrastructure Investment Fund Board (KIIFB) by making necessary amendments in the KIIFB Act, 1999. This article examines the performance of the KIIFB.

Regarding the mobilisation of resources and execution of the development projects, KIIFB's performance was very poor during the past three years. Though KIIFB projects are visualised as anti-recessionary spending, not a single rupee was spent in 2016-17. Things did not improve in 2017-18.

According to Comptroller and Auditor General (CAG), ₹1,042.64 crore was released to KIIFB as tax transfer from Motor Vehicle Tax and Cess on Petroleum products during 2017-18 period. As per CAG, ₹100.80 crore has been borrowed through off-budget borrowings in 2017-18. Despite of the widespread publicity given to KIIFB, the amount borrowed through off-budget borrowing during the first two years was meagre.

An answer given in the state Legislative Assembly, had clarified that ₹54,000 crore would be invested through KIIFB for development in five years. The actual expenditure for execution of KIIFB projects, till July 1, 2019 was ₹1859 crore (3.4% of total proposed investment). But KIIFB said it approved 555 projects and the estimated amount was ₹43,730 crore (as on July 2019).

This gives wide disparity in the amount approved and actual expenditure. Based on the expenditure pattern of KIIFB projects for the past three years, we can predict that the actual total expenditure of KIIFB projects during the five years will be less than 10% of the total proposed outlay.

KIIFB scheme has many contradictory and confusing ideas. Government says KIIFB is an outside the budget scheme. But practically entire projects come within its annual plans and budgets. Another contradiction is the repayment of the future liabilities. The entire repayment is met from state revenue. Total confusion prevails over who should audit accounts, CAG or private auditors.

The poor performance of KIIFB projects can be attributed to following factors: (1) KIIFB is not a self-sustaining scheme aiming resource mobilisation and generation of revenue for repayment of loans outside the budget like build, operate and transfer (BOT) or private investment projects collecting tolls to cover the cost etc. (2) The BOT and private investment projects can be executed efficiently and quickly by private parties compared to projects implemented by government departments and agencies. (3) KIIFB projects are coming under the state budget and implemented by government departments and agencies within the bureaucratic framework observing rigid rules and formalities. (4) Due to the stringent treasury restrictions in the payment of bills the contractors and suppliers won't be willing to take up projects of government departments and agencies. (5) Due to the persistent fiscal crisis, domestic and foreign investors will not be willing to provide loans to the KIIFB. (6) Barring a few, most of the projects started by the present government will remain incomplete or discarded when a new government assumes office. In conclusion, we can say that KIIFB is a dream project with high expectations and poor outcomes.

(Article of B. A. Prakash published in *The Times of India* on September 23, 2019)

6 Pay Revision : State will be pushed to fiscal trap

A pre-condition for good administration, effective implementation of annual plans and major development projects, providing good quality public services, implementation of social welfare programs, transfer of funds to 1200 local governments and providing relief and assistance to natural disasters such as flood etc is sound finances of state government. But due to mismanagement of state finances by the successive governments, the state has been facing persistent fiscal crisis.

Though the LDF government published a white paper in June 2016 and declared that they were going to improve finances, nothing happened. Available data on state finances and review by CAG suggest that the fiscal situation has deteriorated since 2016. Due to acute shortage of funds, the state government was not able to pay much relief to lakhs of people affected in two major floods. In this context, the article examines the impact of 11th pay revision commission on state finances.

The fiscal crisis is linked with the expansion of bureaucracy and pay and pension revision once in five years. During 1950's and 1960's the political philosophy in Kerala was socialism and state intervention in market in all economic fronts. For this, huge bureaucratic institutions were created viz. government departments, public sector undertakings, autonomous bodies, semi government institutions, aided educational institutions etc. Expansion of public sector jobs and job reservations for various communities were the core objectives of political process. But due to political considerations and appeasing powerful vested interest groups, the successive governments have retained these institutions.

Salary and pension are the major items of expenditure of the state. It accounts for about 63 per cent of the total revenue receipts, consisting of own taxes, non-tax revenue, share of tax and grants in aid from central government. There is a close relationship between the salary and pension revision and fiscal crisis. The worst fiscal crisis in state's history between 1999 and 2001 was due to pay revision and the additional financial liability created due to it. Trends in salary and pension growth are given in table. A major cause for the persistent fiscal crisis since 2016-17 has been due to pay and pension revision implemented from January 2016. The annual additional financial commitment of the pay revision was estimated as Rs. 7700 crore.

Salary and pension expenditure

Year	Salary (S) (Rs. crore)	Growth (%)	Pension (P) (Rs. crore)	Growth (%)	Total (S+P) As % of revenue receipts
2010-11	11178	13.0	5767	22.5	54.7
2011-12	16229	45.2	8700	50.9	65.6
2012-13	17505	7.9	8867	1.9	59.8
2013-14	19554	11.7	9971	12.5	60.0
2014-15	21621	10.6	11253	12.9	56.7
2015-16	23526	8.8	13126	16.6	51.6
2016-17	28373	20.6	15277	16.9	57.7
2017-18	32349	14.0	19938	30.5	63.0

Source: Report of CAG of India on State Finances, Kerala (for various years) and Budget in brief 2019-20

The expert committees, which examined the salary revision and its fiscal consequences, recommended the revision once in 10 years. They are Kerala Public Expenditure Review Committees (KPERC) (2nd committee, first report 2007-08 and third committee, first report 2010-11) and the 10th pay revision commission, Kerala. Though the 10th pay revision commission revised the pay scales for 10 years, the government implemented it for five years.

Though the state has several options to solve the fiscal crisis – steep increase in taxes and non-tax rates; closing non-priority departments, public sector under takings and autonomous bodies; substantial cut in number of posts; vigorous implementation of e-governance; reduction of fiscal assistance to private aided educational institutions; substantial increase in the rate of fees and user charges of public health and education – the most desirable measure will be moving from five to ten yearly salary revision.

(Article of B. A. Prakash published in *The Times of India* on November 2, 2019)

7 State’s fiscal crisis: Issues and challenges

Kerala is experiencing an unprecedented fiscal crisis that is more severe than the one it experienced from 1998-2001. The crisis has four dimensions: slowdown of own resource mobilisation, excessive increase in non-plan revenue expenditure, steep fall in development expenditure and increased burden on debt repayments. Also, two deluges in successive years (2018 and 2019) have hit all sectors of the economy and adversely affected mobilisation of own source of revenue.

Kerala’s fiscal crisis is a basic, structural and persistent problem. But, LDF government treated this as a temporary one arising from the mismanagement of finances by UDF regime. The government has a distorted view on the causes of fiscal crisis and steps required to address it.

The pre-conditions required to improve the state’s finances are increasing own resources mobilisation through various measures, effecting a drastic cut in non-plan revenue expenditure and restrict borrowings to a desired level and preparing the budget based on realistic appraisal of revenue receipts. But the government is doing just the opposite.

It felt that the problem could be resolved through GST implementation which would subsequently increase revenue collection. In the previous budget, it proposed a 30% increase in GST revenue, which is unattainable. Moreover, there is laxity on the part of finance department to collect tax and non-tax revenue and its arrears. Also there is considerable scope for increasing tax and non-tax revenue collected by local governments as they have not been revised for more than a decade. But the government has not exercised the option to insure a periodical revision in these cases.

Government did not go for a drastic cut in non-plan revenue expenditure and no steps were taken to curtail spending in unnecessary government establishments, bureaucracy, semi-government institutions, loss making PSUs, private aided institutions etc. The LDF government created over 50,000 new posts, which includes nearly 25,000 posts in private aided schools.

The root cause of the present crisis is the additional financial burden that came in to effect after the last pay revision in 2014. The annual additional financial commitment was ₹ 7700 crore. Though the 10th pay commission recommended for pay revision once in five years, the LDF government did not accept the same.

Spending money based on budget heads in each financial year is the healthy practice. But this is not done and funds are spent in the subsequent years through the system of treasury queues, e-lams, shifting funds to STSB accounts etc.

Government must address the above mentioned issues and make appropriate changes in the fiscal policy. History shows that political parties in power and opposition are unwilling to make a radical change in fiscal policies and practices. The question before us is whether the present government will address these issues and save Kerala from total financial collapse.

(Article of B. A. Prakash published in *The Times of India* on February 6, 2020)

8 An Election Manifesto disguised as Budget

The budget presented by finance minister Thomas Isaac can't be termed a 'budget' in strict sense. You may rather describe it an early election manifesto or a series of announcements that makes you feel good.

The economy of the state has been going through an unprecedented crisis owing to Covid-19 pandemic. A sensible budget should have given priority for steps to address the crisis. Unfortunately, what we only heard from Isaac is about the adept handling of Covid-19 treatment by the health department. In fact, we need to congratulate the government for that. But state budget could have done better things rather than merely acknowledging the good works of the health department. Lakhs of jobs have been lost and reverse migration is turning out to be a big economic crisis. However, the finance minister turned a blind eye to such burning issues.

The highlight of this budget is the open bid to lure organised vote banks and influencer groups ahead of the assembly poll. Announcement of pay revision for government employees even without a proper recommendation for the same, hike in honorarium of local body members and CDS chairpersons and the second hike in three months in the social welfare pensions are all clear attempts to win votes. Even while making such ambitious announcements, the finance minister is not giving us a plan from where he would find resources for this.

Earlier, budgets used to announce development projects based on the studies by state planning board. There is no new major infrastructure announcement in this budget. In fact, all projects are now executed by KIIFB. The government has passed the responsibility for development to a 'company', thus evading its responsibility.

Another irony which I found was the contrasting claims made in the budget. Soon after claiming that Kerala has witnessed unprecedented development in the last five years, Isaac says the problem of unemployment is haunting the state's youth. The direct impact of any development is creation of jobs! The government now promises 20 lakh jobs in five years and skill training for 50 lakh in five years. I wonder whether the FM thinks that he can waver his magic wand and create jobs at will.

Apart from peripheral announcements, there is nothing concrete to help lakhs of Keralites who had returned from Gulf. Remittance from gulf countries has been the back bone of our economy and when that is affected badly, there should be concrete plans to replace that.

The mounting debt problem of the state also remains unaddressed. The habit of spending the money availed as loan for non-plan revenue expenditure will continue. The dangerous proposition of taking more loans and managing state's finances with that will eventually land us in a serious debt trap.

(Article of B. A. Prakash published in *The Times of India* on January 16, 2021)

9 Budget turns a blind eye to the deep financial crisis

Kerala has landed in a financial crisis much before the outbreak of Covid-19. In the last 15 months, the crisis deepened as pandemic has gripped the state. The financial crisis now faced by the state is the worst since its formation. The latest analysis of CAG reveals that revenue and fiscal deficit of the state increased by 60% and the state's annual borrowing soared by 60% in the last fiscal. The new finance minister, KN Balagopal ventured out to present his maiden budget in this background.

Sadly, the budget doesn't give us any idea how the government plans to come out of this crisis. The practice followed by Balagopal's predecessor was to borrow large sums and use that for routine expenditure. If we analyse the Rs. 38,000 Cr the state borrowed last year, around 70% of that is seen to be spent for revenue expenditure. There is no hint that this practice will stop soon and that means our debt burden will get worsen in the coming months.

In the last report of CAG, there were some serious observations against KIIFB. The borrowings by KIIFB needed to be within the state's statutory borrowing limit. Though the state has contented these curbs, chances are high that the unbridled borrowing by the outside agency will have to be stopped. The budget is silent on this though the right step would have been to start addressing this issue and find solutions.

The covid-19 package of Rs. 20,000 Cr sounded good in the speech. Sadly, there is no mention at all from where the additional resources will be mobilised. Later, Balagopal clarified that this package is drawn from allocations already made in the budget. If so, how that can be called a special package? The worst hit sectors during this pandemic are trade and tourism. Traders and tourism promoters were expecting some bailout packages. There is nothing for them. Transport sector is another worst hit area. There are seven lakh auto rickshaw drivers in the state and all of them badly need support. It is true that the budget allotted money to continue supply of free grocery kits. There should have been some schemes to transfer money directly to those who have been affected badly.

Reverse migration, especially from the Middle East, has developed into a major social crisis. The estimate is that 14 lakh people returned to Kerala following covid-19 crisis and 60% of them had returned after losing their jobs. There is no concrete plan in the budget to help them.

The only silver lining I see in the Ministers admission that our economy is facing a serious crisis owing to covid-19 impact. He speaks about the need to revive economy and he has plans to pump money to revive economy. That is a positive sign. The one factor that differentiates Balagopal from his Thomas Isaac is that former is more pragmatic and believes in a disciplined fiscal approach. Rather than following dream projects, let him handle the finances with the time tested, conventional approach.

(Article of B. A. Prakash published in *The New Indian Express* on June 5, 2021)

10 No solution in sight for fiscal crisis

Kerala has been experiencing an acute fiscal crisis somewhat similar to the worst crisis experienced in state's history during 1999-2000.

The crisis has four dimensions: decline in own resource mobilization, excessive increase in salary, pension and other items of non-plan revenue expenditure, steep fall in plan expenditure and increased burden on interest and debt repayments.

During the first 10 months of the current fiscal year 2021-22, the ratio of gross fiscal deficit to total expenditure went up to 34 per cent, the highest rate of increase since 1999-2000. But the budget has not addressed the above issues or proposed measures to improve the fiscal situation.

The pay revision factor

The root cause of the current crisis is the implementation of pay revision of February 2021 with retrospective effect from 1st July 2014. The additional financial commitment for paying the revision with arrears is estimated at Rs.12,000 crore. A good part of the amount is yet to be paid. The government has no idea about solving this issue and the budget has not proposed anything to address it. It is proposed to finance the new schemes announced in the budget through Kerala Infrastructure Investment Fund Board (KIIFB). But KIIFB do not have funds to meet the expenditure for the projects as it has committed huge amount for the existing schemes.

The COVID-19 induced economic crisis has rendered lakhs of self-employed and casual labours in the state jobless.

It may be noted that of the total workers in the state, 37.8 per cent are self-employed and 29.3 per cent are casual labourers.

Lakhs of Keralite emigrant workers were forced to return to Kerala from Gulf. It is estimated that 14.71 lakh Keralite emigrants returned due to COVID-19 crisis, mostly from GCC countries. But the budget has no proposal to provide relief to these categories.

Many projects

The budget has a number of sound proposals for the development such as IT sector, road sector, start-ups.

It is proposed to start a new IT park at Kannur, four IT corridors and other IT infrastructure schemes.

Expansion of knowledge economy mission for skill development and measures to increase the quality of higher education are other notable projects.

Roads and Bridges

A number of new roads, bridges and national highway projects are also proposed. In the context of fall in rubber price, the proposal for Rs. 500 crore subsidy will help the farmers.

The proposals to allot Rs 250 crore for medical college in the state, Rs. 100 crore for medical innovation lab, Rs 50 crore for Institute of Virology, and Rs 88 crore for regional cancer center are sound projects.

In sum, the budget totally failed to address the acute fiscal crisis.

On the other hand, it has sound projects and schemes for development of some sectors.

(Article of B. A. Prakash published in *The Hindu* on March 12, 2022)

11 Kerala’s Unprecedented Fiscal Crisis: What are the causes?

Kerala has been experiencing a persistent, acute and unprecedented fiscal crisis. Kerala Finance Minister K.N. Balagopal said that it is an unprecedented fiscal crisis and attributed the distorted fiscal policies of Union Government, the COVID-19 pandemic and recurring natural disasters. It is true that the floods of 2018 and 2019; the unprecedented health crisis created by COVID-19 and the pandemic induced recession have adversely affected the finances of the state. But available evidences suggest that unsound fiscal policies and poor fiscal management by successive governments in the State are the major causes for the persistent fiscal crisis.

White Paper, 2016

According to white paper on state finances, prepared by the Finance Department, the state had faced acute fiscal crisis in 2016. The entire borrowing permitted by the Central Government was just sufficient to meet the day to day expenditure of the State. The government was faced with the stark reality that there was no funds left for capital expenditure like construction of roads, bridges and so on. The major cause was the failure on twin fronts, viz. expenditure control and resource mobilization. The failure on expenditure management included inflated plan budget, giving administrative sanctions for 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 failure in revenue mobilisation was underperformance of the tax collection machinery in general, huge amounts of stays issued by government, delay in disposal of arrear appeals and stay cases, non-realization of additional resource measures announced in the budget, undue concessions offered to certain groups of tax payers, corruption and nepotism in the tax administration and failure to implement technology support in the major tax collection. A notable aspect is that the white paper has not attributed the fiscal crisis in Kerala any policies or measures of the Central Government.

The white paper predicted that if the same fiscal behaviour continues, the state would face a fiscal anarchy in 2017-18 and the state would default its committed payment on salaries, pensions and loan repayment obligations by 2020-21. The failure of the state government to take action on the findings of the white paper has worsened the fiscal crisis prior to the spread of COVID-19.

CAG's Audit Report, 2020-21

CAG's State Finances Audit Report of Kerala for 2020-21 presented a dismal picture about the state finances for the period from 2016-17 to 2020-21. The state was not able to achieve the revenue deficit, fiscal deficit, debt Gross State Domestic Product (GSDP) targets stipulated as per Kerala Fiscal Responsibility Act (KFR Act) for the five years. The only exception is the achievement of fiscal deficit for 2019-20. The CAG has calculated the overall debt of Kerala including off budget borrowing as Rs. 3,24,855 crore in 2020-21 (Debt GSDP ratio 39.87 percent). This is an excessive and unsustainable level of public debt of the state by any fiscal norms. As resources are not available to meet routine revenue expenditure like social security pensions, the state has resorted to off budget borrowing.

Huge hike in Salary, Pension

A disturbing development in revenue expenditure during 2021-22 is the huge increase in salary and pension due to its revision every five years. The salary expenditure increased from Rs 28,763 crore in 2020-21 to Rs 45,585 crore in 2021-22 (58 percent increase) and pension expenditure increased from Rs 18,942 crore to Rs 26,899 crore (42 percent). The net additional financial commitment created was Rs 24,779 crore. This is the result of the implementations of the 11th State pay revision commission recommendations.

The commission's recommendations were implemented when the state faced the worst recession due to COVID-19. Due to this, the revenue deficit increased to Rs 26582 crore in 2021-22 (RD/GSDP ratio 2.9%) and fiscal deficit to Rs 42785 (FD/GSDP ratio 4.7%). This is an unsustainable deficit by any fiscal norms. The most important cause for the current unprecedented crisis is this.

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. Though the Kerala Public Expenditure Review Committee (KPERC) (2012) and tenth state pay revision commission have recommended revision of salary once in 10 years, the successive governments in Kerala have not accepted the recommendations.

Natural disasters, COVID-19

Natural disasters such as the devastating floods and landslides during 2018 and 2019 have resulted in unprecedented dislocation of people, destruction of houses, loss of property, damage of public infrastructure such as roads and bridges and loss of livelihood of lakhs of people. The state was forced to spend a lot of funds for rehabilitation, relief, repair of damaged assets, compensation of damaged properties and reconstruction of infrastructure.

The spread of COVID-19 pandemic in the state since March 2020 has also created unprecedented health crisis and recession. Even after three years, the state's economy has not returned to the pre-COVID level.

The pandemic has resulted in a huge fall in state own taxes, non-tax revenue and state's share of union taxes during 2020-21. The state was forced to spend a lot of funds for measures related to contain spread of pandemic, improving public medical facilities, treatment of COVID-19 patients, COVID-19 testing and so on. But the revenue position improved in 2021-22.

We do not have facts to support the argument that the current fiscal crisis of Kerala is due to the distorted policies of Central Government. The white paper 2016 has not mentioned anything on the issue.

The 15^{th} Union Finance Commission has recommended a revenue deficit grant of Rs 53,137 crore to Kerala, the largest amount given to a state. We can conclude that the unsound fiscal policies, poor fiscal management and revision of salaries and pension once in five years, diverting major share of annual borrowing for routine revenue expenditure and failure to achieve fiscal targets as per Fiscal Responsibility Act are the major causes of present fiscal crisis. Taking corrective measures based on the findings of the white paper 2016 and other changes suggested above and implementation of pay and pension revision once in 10 years are required.

There is a need to curtail, the size of unnecessary government establishments and departments, staff strength, outsource some of the activities and services, closing down the public sector under taking incurring continuous losses and improve the efficiency of tax collections. The fiscal extravaganza nature of spending to satisfy the demand of powerful vested interest and pressure groups should be strictly curtailed.

(Article of B. A. Prakash published in *The Hindu* on February 1, 2023)

12 'The state's fiscal crisis is not the result of anything new…'

About 50 years ago economist BA Prakash published his first research paper in which he predicted that KSRTC would face a crisis unless it reorients its focus away from city services. He was also the first to identify the impact of Gulf migration on Kerala's economy. He had to face stiff resistance when he held militant trade unionism and blind opposition to technology responsible for the collapse of traditional industries. The CPM often criticized him for taking sides with globalization/liberalization. His recommendation to put an end to the practice of salary and pension revision every five years earned him more enemies than friends across the political spectrum. Prakash spoke to TOI about his work, what ails the state's finances & how he became an avid critic of CPM's policies, among other things. Excerpts:

Can you briefly describe your academic experience?

I did my graduation and post-graduation in Economics at the University College in the late 1960s and early 70s. Many people discouraged me from pursuing PhD as the majority of people who joined the course failed to clear it. There was a practice to send the thesis to foreign universities as part of the evaluation. But, with the support of my teacher Prof G Ramachandran Nair, I joined for PhD in 1972 and could submit the thesis in 1976. Soon, I was selected as a research fellow at the Indian Institute of Management, Bangalore, and after a few months, I joined as a lecturer at Calicut University.

You were the first to study the impact of Gulf migration in Kerala. What was the trigger?

By the late 1970s, the impact of Gulf money was visible in Kerala. But there was no authentic study. However, the real trigger was the experience some of my colleagues had when they tried to purchase some land in Thrissur where our economics department was functioning. To our surprise, the price of land was going up in the Chavakkad area like anything. I thought of carrying out a sample study at every panchayat in the Chavakkad area. Though a majority of people who went to Gulf countries at that time were illiterate, their families back home flourished economically. Once land emerged as a speculative asset, economic activities increased. When I attributed Gulf remittance as the single major reason for the increased economic activities in the late 70s nobody, not many, including academics and politicians, were willing to believe. But the findings were later published in Economic & Political Weekly, and it attracted wide attention in and outside Kerala.

Your PhD thesis was about the economic performance of KSRTC. What did you find out about KSRTC in your thesis?

In those times, the public transport system was part and parcel of everyday life. There were enough indications that KSRTC was plying on the wrong route, though the crisis was not acute. It was found that more than 50% of the loss of the KSRTC was the contribution of the Thiruvananthapuram city service. I had recommended the management to focus on long-distance service routes and privatize city routes. But it was unimaginable for them.

You were often identified as an economist with right-wing moorings. You were also blunt in criticizing the CPM…

Due to socio-political reasons, the apathy towards the market economy and capital were the hallmarks of Kerala even since independence and before. Blind opposition to technology and militant trade unionism destroyed our traditional industries. The Left wanted the industries to be owned and run by the government and cooperatives. Their only focus was the welfare of labourers. The practice of treating even small shopowners as enemies of labour discouraged the business culture and drove away investors to other states. Who would now believe that Kerala had legally prohibited the mechanization of traditional industry? There was even a Husk Control Act. The political atmosphere in the state created a strong dislike towards private capital. When I carried out a study on the plight of the coir industry in Alappuzha and presented this anti-technology attitude and militant unionization as major factors for its downfall, there was huge criticism. Yes, Kerala's economic growth would have been much better if the CPM was willing to change its attitude towards private capital and investment as it did in 2005. The 50 years of relentless attack on private capital, and technology intervention, coupled with the promotion and protection of militant trade unionism by the CPM contributed heavily towards the poor economic performance and position of Kerala.

You still face criticism for your argument that the practice of implementing salary and pension revision every five years should go. Your views on it?

I am not against government servants and pensioners getting better financial returns. As the chairman of the Kerala public expenditure review committee during the 2012-14 period, we recommended that salary and pension should be revised in 10 years instead of five, as the state can no longer bear it. A disproportionate portion of the government revenue is spent on salary and pension, and society in general suffers. But no government is willing to face the ire of organized government employees. The state's fiscal crisis is not the result of anything new. When Thomas Isaac published a white paper on the state economy in 2016, he said the state finances would be on the verge of collapse by 2021 due to the callous manner the finances were managed by the state. There was no mention of the Centre's role.

What do you consider as the most valuable contributions you made in the last 50 years?

I consider the series of books on Kerala's economic development edited by me as my major contribution. Everything else hinges on the academic success of these books published between 1994 to 2023. When I joined Calicut University, the study of Kerala's economy was not part of the PG or UG syllabus. When I took the initiative and included the Kerala economy as a paper, there were not many authentic books available for reference. It was to fill that vacuum that I first published the book on the state's economic development. Till now, the series remains the bedrock for the university level study of Kerala's economic development.

(Interview of B. A. Prakash by B. S. Anil Kumar published in *The Times of India* on August 12, 2023)

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

Abstract

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.

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).

Table 1
Revenue Deficit (RD) of Kerala (Rs. Crore)

Year	Revenue Receipts	Revenue Expenditure	RD	RD of Kerala as % of GSDP	RD 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), RBI (2021), 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).

Table 2
Gross Fiscal Deficit (GFD) of Kerala (Rs. 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), RBI (2021), RBI (2023).

Table 3
Decomposition of Gross Fiscal Deficit (Share in %)

Year	RD	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), RBI (2021), RBI (2023).

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.

Table 4
Development and Non Development Expenditure of Kerala

Year (1)	Development Expenditure (2)	Growth (%) (3)	Non Development Expenditure (4)	Growth (%) (5)	Total (2+4)	Share of development expenditure to total
2018-19	60130.4	-	51040.7	-	111171.1	54.1
2019-20	52645.6	-12.4	55675.4	9.1	108321.0	48.6
2020-21	78761.5	49.6	50630.5	-9.1	129392.0	60.9
2021-22 (RE)	82727.3	5.0	72363.1	42.9	155090.4	53.3

Source: RBI (2020), RBI (2021), RBI (2023).

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 `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.

Table 5
Total Outstanding Liabilities of Kerala

Year	Amount (Rs 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).

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.

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 (Rs Crore)			
2018-19	18663.2	11388.9	30052.1	32.4
2019-20	16401.1	11235.3	27636.4	30.6
2020-21	11560.4	31068.3	42628.7	43.7
2021-22 (RE)	17332.1	31650.1	48982.2	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), RBI (2021), RBI (2023).

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 Rs 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 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).

Table 7
Expenditure on salary and pension (Rs Crore)

Year	Salary and wages	Pension	Total	Growth (%)	Share of total to revenue receipts (%)
2018-19	32697.8	19011.9	51709.7	-	55.7
2019-20	33043.6	19064.3	52107.9	0.8	57.8
2020-21	28852.4	18942.8	47795.2	-8.3	49.0
2021-22 (RE)	45619.9	26959.2	72579.1	51.8	61.6

Source: RBI (2020), RBI (2021), RBI (2023).

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.

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.

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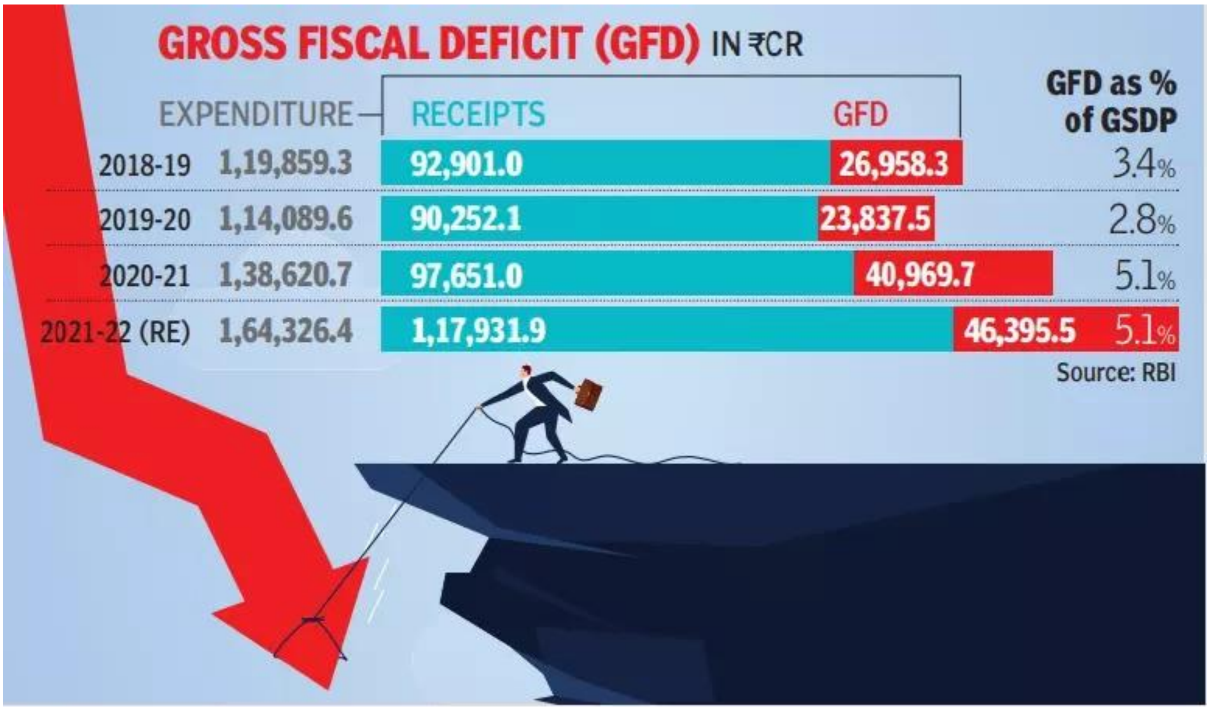
14 'Centre's role in fin crisis [is] a newly invented political reason to deflect focus..'

Kerala's economy is facing a grave crisis. For several days, the treasury was running on an overdraft. There are restrictions on the clearance of government bills above Rs 1 lakh. The crisis, which is fast assuming the proportions of a catastrophe, is the inevitable result of the basic structural flaw in the fiscal policy pursued by successive state governments, and the Central government's role in it is very limited, says Prof Prakash. Excerpts from an interview:



For more than two decades now, the Kerala government has been grappling with financial turmoil off and on. Has the state ever been in the pink of health?

I doubt it. The state finances were under stress even when C Achutha Menon was the chief minister in the 1970s. But crises in those times were not as severe as we face them now. Loss-making PSUs and slackness in revenue mobilization were the major factors that contributed to the financial stress in the old times too. The stress developed into a lingering crisis as salaries and pensions were revised every five years and governments failed to improve tax revenue but indulged in extravagance and continued to increase the size of bureaucracy.

How did the periodic revision of salaries and pensions contribute to the collapse of state finance?

The state cannot afford to revise salaries and pensions once every five years. More than 60% of the state's revenue is now used to meet the expenses of salary and pension. Several committees have recommended the government to increase the revision gap to 10 or at least seven years. But the system is in the hands of bureaucracy, and politicians can't antagonize them.

In your opinion, what makes the present financial crisis a more acute and unprecedented one?

The government has admitted that it is on the brink of a financial catastrophe. If it was not for the Rs 45,000 crore revenue deficit grant it received from the Centre, the highest among states, Kerala would have hit penury long before. The state faced an almost similar crisis when A K Antony's government came to power in 2001 after he inherited an empty treasury from his predecessor E K Nayanar. Antony's attempts to cut the expenditure drastically invited the wrath of government employees and teachers. But, unlike in the past, there is no talk about any curtailment of expenditure this time. Instead, there is a deliberate attempt to shift the responsibility and put up a fight with the Centre citing half-truths and lies.

So, the unprecedented crisis is not an unexpected one?

It is not at all unexpected. The successive governments and every financial body associated with it were well aware of the looming crisis. Take for example the findings in the white paper brought out by former finance minister Thomas Isaac way back in 2016. He had rightly predicted how bad the state finances would be by 2021. He said that 'the state was living on a financial lie'. It also predicted that the state's revenue deficit would exceed 3.25% of the GSDP. All these predictions came true as the promises made by Isaac to drive the finances to new heights remained only on paper. Successive governments grossly overlooked the fundamental principles of finance. Instead, they indulged in reckless spending of public money.

What do you mean by structural flaws in the fiscal policies? What is wrong with the system?

There is not much difference in the fiscal policy pursued by the LDF and UDF. Both indulge in financial extravagance to satisfy the interest of the powerful. They don't have plans to improve resource mobilization andare always interested in the promotion of excessive increases in non-plan revenue expenditure. They promote the politics of extravagance. Politicians in power and those who are part of the government and trade unions consider government money as something that they can splurge on with zero accountability and guilt. They believe that it would keep on running on its own perpetually. Trader union leaders used to boast in the past that KSRTC will never face salary and pension problems as long as there is a government in the state. When there isreckless spending, the system is bound to fail.

What is the role of bureaucracy in it?

What contributes to this financial anarchy is an incompetent bureaucracy. If the bureaucracy is professionally competent and committed, it would be able to project a real picture of the state's financial position and flag its gravity to political leadership. It would certainly deter the political leadership from reckless spending. Unfortunately, people in our finance department are not even competent to calculate the real impact of a pay revision on state finance. They prepare plans without understanding resource availability, leading to inflated annual plans and ultimate chaos, and get away scot-free.

What is the Centre's role in this unprecedented financial crisis?

I don't think there is any financial reason to say that the Centre contributed to the crisis. It's a newly invented political reason to deflect the focus from an unaddressed, age-old malady. If the Centre contributed to the crisis,why did the three white papers brought out by the UDF and LDF fail to mention it, even remotely? They all held the incompetence of the state machinery, extravagance, and huge liability on account of pay revision as the major contributing factors to the crisis from time to time. The cascading effect of the Centre's policies might haveaggravated the crisis, but that's not the root cause.

What is the way forward to tackle the crisis?

To resolve the crisis, first, there should be a political consensus. They should understand it not as the failure of one government or the other, or even the Centre. Political parties that come to power should adopt a responsible and realistic fiscal policy that would ensure a steady growth of revenue mobilization and a drastic cut in extravagance. The bureaucracy should understand the state's inability to effect pay revision once in five years. Candidates with professional competency in finance should be recruited in the financial department. The governments should also dump the concept that the expansion of bureaucracy by setting up new institutions means the development of the state. Instead, we should be able to restructure or shut down PSUs and organizations that not only leave a hole in the state's purse but also make no contribution at all.

(Interview of B. A. Prakash by B. S. Anil Kumar published in *The Times of India* on December 16, 2023)

15 How the state stumbled into a deep debt trap

Despite dire warnings, the state executed a revision of pay and pension, ramping us spending on them from Rs 47,710 crore in 2020-21 to 72,678 crore in 2021-22. This destabilized the state's finances, pushing it into a debt trap.

Available fiscal data on the state finances of the Kerala government, the Comptroller and Audit General, and the Reserve Bank of India indicate that Kerala's fiscal crisis has reached the phase of the deep debt trap. A debt trap is a circumstance where you are compelled to take out more loans than you can afford to pay off. Over time, you find yourself trapped in a scenario where your debt starts to spiral out of control and surpass your ability to repay it, ultimately trapping you in a cycle of debt. Severe payment restrictions have been in force in state treasuries during the entire year of 2023–24. It is reported that the total number of bills pending for payment in treasuries in Kerala is 76,805 at present. This is the context of the article.

Let us examine the major factors which led to the debt trap. First, the 2016 white paper, published by the state government, predicted that if the same fiscal situation continues, the state will go into fiscal collapse by 2021. However, the state implemented pay and pension revision, and expenditure of these items increased from Rs 47,710 crore in 2020–21 to Rs 72,678 crore in 2021–22. The net increase was Rs 24,968 crore in one year. This measure has destabilized the state's finances and pushed the state into a debt trap.

Second, off-budget borrowing for the Kerala Infrastructure Investment Fund Board (KIIFB) and Kerala Social Security Pension Limited (KSSPL), resulted in over borrowing and reduced borrowing capacity. An amount of Rs26,620 crore was over-borrowed, which was adjusted in the borrowing of subsequent years between 2021–22 and 2023–24.

Third, the state began to propagate that the anti-state policies of the Union govt relating to the transfer of funds, stoppage of GST compensation, fall in revenue deficit grants, fall in the rate of devolution of central taxes, restrictions on borrowing and treating off-budget borrowing as borrowing, etc. are the causes of Kerala's fiscal crisis. In the budget speech of the state for 2024–25, it is alleged that the state lost about Rs 57,400 crore due to the above items.

Fourth, the CAG, in the audit report ending March 31, 2022, has pointed out that the large off-budget borrowing will lead to a debt trap. The estimated total amount was Rs 25,874.39 crore in 2021–22. The report concluded that the fiscal performance based on fiscal indicators such as revenue deficit, fiscal deficit, and debt-GSDP ratio for five years between 2017–18 and 2021–22 was poor.

The report also said that of the total public debt receipts of Rs 64,934 crore in 2021–22, 79% was needed for debt repayment and interest payments.

Fifth, a study on the finances of states by the RBI identified five states as heavily indebted: Bihar, Kerala, Punjab, Rajasthan, and West Bengal. The findings of the study suggest that Kerala has become a highly debt-distressed state in India even by 2020–21.

This is the context in which Kerala filed a suit against the Union govt in the Supreme Court, demanding permission for additional borrowing. Observing that Kerala's fiscal crisis is the result of its fiscal mismanagement, the division bench refused to grant interim relief to allow the state to borrow more money and referred its petition against the Centre's decision to limit the borrowing capacity of states to the Constitution bench of five judges for adjudication.

To conclude, Kerala is in a deep debt trap and faces an acute shortage of resources and borrowed funds to meet expenditures on administration, development, and welfare activities. The situation is likely to continue. Structural reforms in fiscal administration, resource mobilization, borrowing, cutting revenue expenditure, downsizing government bureaucracy, digitalization of administration, winding up or restructuring loss-making public sector under takings, and prudent fiscal management are needed to revive the state from the deep debt trap.

(Article of B. A. Prakash published in *The Times of India* on April 6, 2024)

16 Fiscal Reforms on Public Expenditure to Overcome Kerala's Unprecedented Fiscal Crisis

Introduction

- Kerala's fiscal crisis is a structural, persistent, and unprecedented one.
- In December 2022, Kerala's finance minister said that the fiscal crisis had changed to the extent of an unprecedented crisis.
- The fiscal situation deteriorated further during the last year (December 2022–December 2023).
- The current fiscal data indicate that the state is heading towards a total fiscal collapse.
- Here I propose fiscal reforms on public expenditure to avert the fiscal collapse.

Fiscal reforms proposed.

- Reduce the revenue deficit with an objective to achieve zero deficit as stipulated in the Kerala Fiscal Responsibility Act (KFRA) in a phased manner.
- This is to be achieved by effecting a cut in non-plan revenue expenditure and by raising the own resources of state governments and local governments.
- Reduce the gross fiscal deficit of the state as stipulated in the KFRA.
- Limit the annual borrowing of the state to the limit prescribed by the KFRA in a phased manner.
- The issue of borrowing, fiscal disputes, etc. should be settled within the fiscal framework of the central state financial relations of the Indian Constitution.

Reduce the persistently high revenue deficit.

- As per the KFRA, the target is to achieve a zero revenue deficit.
- At present, 16 states in India are revenue surplus states.
- Achieving a zero revenue deficit is a precondition for improving state finances.
- Structural changes in revenue expenditures and revenue receipts are needed to achieve this.
- A drastic cut in the existing pattern of revenue expenditure is needed.

- The items of expenditure may be classified into (1) high priority, (2) priority, and (3) low priority. Effect a substantial cut in item 3.

Change the pattern of utilization of borrowing.

- Nearly 64 percent of the total annual borrowing is spent to meet the revenue deficit items.
- Reduce the share of borrowing used for items of revenue expenditure (from 64% to 33%).
- Spend at least two-thirds of total annual borrowing on meeting capital outlays and net lending.
- A structural change in finance (gross fiscal deficit) is required.
- Regarding borrowing, reduce the share of provident funds and increase the share of market borrowing.

Reduce the outstanding liabilities.

- The ratio of total liabilities as a percent of gross state domestic product (GSDP) increased from 30.9% in 2019 to 38.6% in 2022.
- This trend is not a healthy change. Try to reduce the debt-to-GDP ratio to about one-third (33.3%).
- Increase the share of gross market borrowing and reduce the share of other items.

Expenditure on salaries and pensions

- A basic issue in state finances is the excessive level of salary, pension, and committed expenditure in Kerala.
- The annual salary and pension expenditure increased by 52.3 percent in 2021–22 compared to the previous year (a net increase of Rs 25,017 crore).
- Salary and pension revisions once every five years are a basic cause of the persistent fiscal crisis of state governments, autonomous bodies, universities, public sector undertakings, and other semi-government organizations in Kerala.
- So implement salary and revision once every 10 years instead of once every five years, with immediate effect.

Size of bureaucracy

- The size of the bureaucracy in Kerala is very large compared to other similar states in terms of population in India. Kerala has 122 departments under state government and had a total staff strength of 5,26,169 as of March 2023 (permanent staff: 5,15,024; temporary staff: 11,145).
- In the pre-liberalization period, the concept was the expansion of bureaucratic organizations and the strength of staff. The perspective was expansion, which means development.
- The bureaucratic structure created in the pre-1991 period has been kept without much change.
- It is suggested to effect a cut of at least 10 percent of the staff in government departments and semi-government organizations in a phased manner.

Other measures to reduce revenue expenditure

- Identify and cut down on the fiscal extravagance type of revenue expenditure of state governments, state government departments, autonomous bodies, universities, semi-government organizations, etc.
- Example: luxurious cars for officers; misuse of government vehicles; unlimited medical reimbursement given to MLAs, ex-MLAs, and other categories; large size of personal staff of ministers; the practice of giving lifelong pensions to the private staff of ministers who completed two years of service; excessive staff of government departments, autonomous bodies, semi-government organizations, etc.
- Too many welfare schemes beyond the fiscal capacity of the state are creating a chaotic situation. Reduce the number of schemes.
- Reduce the number of market intervention types of schemes aiming for price stabilization using state funds (other than public distribution systems).
- The policy of expanding higher educational institutions by giving grants and state funds for private-aided educational institutions, universities, autonomous colleges, and other categories of post-plus two institutions instead of ensuring the contribution of the own funds of the above institutions.
- Excessive financial support given to loss-making public sector undertakings from state funds results in a huge financial burden for the state. The undertaking should be asked to mobilize their own finances for their activities.

- Too many cash support schemes give support to farmers, small-scale institutions, and other categories without considering the availability of state funds.
- Reduce the heavy dependence of state funds on grant-receiving agencies and institutions by generating their own funds.
- Stop giving state funds to public sector undertakings, semi-government institutions, etc. for their routine activities.

Some specific suggestions

- It is reported that the dues of DA, pension, and salary revision arrears are estimated at Rs 25,000 crores. In the context of an acute fiscal crisis, the payment of arrears shall be withheld. The payments may be resumed only after improving the fiscal situation.
- Instead of starting higher educational institutions such as universities, private-aided colleges, autonomous colleges, and other institutions using public funds, they shall be started in the private sector using private funds.
- Privately aided educational institutions, government institutions, and universities should increase the share of their own resources to total resources through periodical revision of fees, user charges, starting self-financing courses, and other measures.
- Recruitment of teachers in government institutions, universities, private-aided institutions, cooperative institutions, etc. should be done on a temporary or short-term contract basis till the state recovers from the fiscal crisis.
- Measures shall be taken to curb the number of official vehicles and the misuse of official vehicles in government departments and all public institutions.
- Currently, the rules on medical expenses for different categories of government staff, judicial officers, MLAs, and pensioners are different. Extend the medical insurance scheme for state government employees and pensioners (MEDISEP) to all categories of government staff, judicial officers, MLAs, ex-MLAs, and pensioners in the above categories with immediate effect.

(Proposals presented by B.A. Prakash in Kerala Finance Minister’s pre-budget consultation of Budget 2024-25)

KERALA'S UNPRECEDENTED FISCAL CRISIS

Collection of published articles

B. A. Prakash

"Kerala has been experiencing a persistent, acute and unprecedented fiscal crisis. I have experience as Chairman of the Kerala Public Expenditure Review Committee (KPERC) and 5th State Finance Commission to examine states finance and local finance of Kerala since 2012. I have been closely watching the development of state finances since then. I do not find any evidence to show that the state will recover from the present deep fiscal crisis and debt trap in the near future."

–B A Prakash