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State of state finances:
Kerala’s turnaround in fiscal consolidation

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Introduction

Going by the available evidence, Indian economy is turning around post COVID-19. India's GDP at current prices in September 2022-23 is estimated at Rs 130.26 lakh crore as against Rs 107.47 lakh crores during the first half of the previous year. This implies a rate of growth of 21.2 per cent in H1 2022-23 as against 25.0 per cent during the same period last year. (NAS, 2022-23). Normally, economic turnaround gets translated to fiscal turnaround. But this need not necessarily be so at the subnational level in India because, given the existing fiscal federal relations in our country, the fiscal health of states is contingent on the decisions by the Centre. For instance, in the case of Kerala, along with indications of strong turnaround in the economy, certain decisions of the Centre for example, decision on GST compensation, could affect the fiscal health of the state. We also note that the implementation of pay revision, when the fiscal boat was confronted with wild waves, added fuel to the fire. Hence any turnaround in the fiscal situation would be possible only through the concerted effort by the state government towards fiscal consolidation.

Against this background this article examines the fiscal performance of Kerala during the first eight months of this fiscal to discern whether there are any indications of fiscal consolidation. We approach the problem, to begin with, by taking the first half of this fiscal, in comparison with other states. Subsequently, we present the picture of Kerala's fiscal performance till November 2022 since the data for all the other states is not available for the extended period.

To place the story in place

The states in India account for over 62.4 per cent of the combined expenditure (Centre and States) and their share in total revenue is only 37.6 per cent (15th Finance Commission, 2021). This could be termed as the great Vertical Fiscal Imbalance (VFI) which is perhaps the characteristic aspect of India's Fiscal Federalism. Addressing VFI inter alia through devolution remained the major challenge of Finance Commissions appointed in every five years since 1951. The task of Finance Commissions turned to be all the more challenging when the size of the divisible pool has been shrinking because of the smart moves by the Centre through increasingly resorting to cess and surcharges which are not be shared with the states. As per Union budget 2022-23, the share of cess and surcharges is as high as 19.00 per cent of the tax revenue 2021-22 (RE), up from 6.5 percent in 2009-10. Given the commitment of Finance Commissions to ensure horizontal equity (between states) the devolution criteria adopted is often inimical to the interests of better performing states like Kerala. Accordingly, Kerala's share in central taxes almost halved from about 3.875 per cent in 10th Finance Commission (1995-2000) to 1.925 per cent at present (15th Finance Commission, 2021-26). Although Kerala has new generation problems like ageing, it is yet to receive the attention that it deserves. The manner in which GST was introduced also turned out to be against the interest of the states as they had to forgo a larger proportion of their revenue as compared to the union. Above all, with the approach of one size fits all, severe restrictions are imposed on borrowing by states along with the inclusion of off-budget borrowing within the borrowing limit turning the fiscal situation from bad to worse.

In what follows we shall begin by an analysis of the key indicators of fiscal performance during first six months (April- September) of the current fiscal.

Revenue receipts

Half-yearly growth in total revenue receipts, comprising of state's own tax revenue, own non-tax revenue, share in central taxes and grants-in-aid, showed a remarkable growth rate of 35.5% during the first half of the current fiscal as compared to the corresponding period in the previous year. Given the base effect, we need to be careful in drawing definite inference. Hence, we compared performance of Kerala with that of other major states. It is evident that (see Table 1) the recorded growth rate of Kerala is lower only to Maharashtra (40.4 per cent) and Telangana (38.9 per cent). Kerala's performance with respect receipts during the first half of 2022-23 is found to be better when compared to all the major states average (25.0%) as well.

The performance of Kerala becomes all the more encouraging when it comes to tax revenue, with a growth rate of 42.2 per cent which is exceeded only by Maharashtra (45.5 per cent). The all states' average tax revenue growth being much lower at 30 per cent. The other states, which registered higher than all state average growth, are Tamil Nadu (38.2 per cent), West Bengal (37.6 per cent), Gujarat (32.7 per cent), Uttar Pradesh (33.5 per cent) and Telangana (30.5 per cent).

Table 1- Half yearly growth rates across in states 2022 over 2021

States	Revenue Receipts	Tax Revenue	Revenue Expenditure	Capital Expenditure
Andhra Pradesh	12.5	15.4	16.2	1.8
Bihar	12.1	17.5	18.6	2.7
Gujarat	27.9	32.7	11.3	40.0
Haryana	16.1	21.6	10.6	-31.8
Karnataka	20.8	27.0	8.9	4.0
Kerala	35.8	42.2	-5.6	5.0
Madhya Pradesh	28.5	30.0	18.8	-4.9
Maharashtra	40.4	45.5	22.1	36.2
Odisha	13.3	28.0	-3.7	33.6
Punjab	23.3	21.5	27.7	-42.6
Rajasthan	17.3	29.0	9.2	-23.8
Tamil Nadu	31.6	38.2	22.9	18.4
Telangana	38.9	30.5	26.3	-47.8
Uttar Pradesh	31.3	33.5	21.5	-3.8
West Bengal	25.8	37.6	12.3	96.7
All states average	25.0	30.0	14.5	5.6

Source: Estimates based on C&AG Data

Revenue expenditure

Increase in expenditure more than commensurate with revenue growth is at the root of fiscal stress of states. Given the predominance of revenue expenditure in total expenditure, fiscal consolidation perhaps should begin with containing revenue expenditure. If the available data for the first half of the current fiscal is any indication, a firm beginning in this direction has already been made since the revenue expenditure in Kerala declined with the recorded growth being - 5.6% (table 1). It is also evident that revenue expenditure for all states registered a growth of 14.5 per cent. The only state that recorded negative growth other than Kerala is Orissa (-3.7%). The highest growth in revenue expenditure was registered in Punjab (27.7 per cent), which is known to be confronted with a highly stressed fiscal situation. The containment of revenue expenditure growth, indeed, needs to be seen as yet another indicator of Kerala's path towards fiscal consolidation.

Capital expenditure

When it comes to capital expenditure, Kerala's recorded growth (5.0%) has been marginally lower than the all state average of 5.6%. To put this in perspective, we need to keep in mind the following. First, out of the 15 major states, six of them recorded negative growth rate, indicating an approach of apparent fiscal consolidation by compromising on capital expenditure which is bound to have its implications on future growth. Secondly, the recorded growth rate of 5.6%, however, conceals Kerala's actual capital investment. This is because much of Kerala's capital expenditure is being undertaken through KIIFB, Rebuild Kerala and such other initiatives as an alternative mode for financing capital investment over and above the budgeted capital expenditure. Thus viewed, Kerala's attempt at maintaining higher capital expenditure growth along with reduced revenue expenditure point towards the state's trajectory of fiscal consolidation.

Borrowing and deficit

Public debt in Kerala has always been an issue of public attention. Of late however, it appears to have emerged as the issue of heightened public discourse. However, the discussion, very often than not, ignores the fact that growing debt burden is not just a Kerala-specific phenomenon. IMF observed that in 2021, the Global debt (public and private) was 247 per cent of GDP, of which public debt accounted for 96%. The World Bank states that "Public debt reached record levels during the pandemic, in both advanced economies and low- and middle-income countries. For the poorest and most fragile countries, high fiscal and debt vulnerabilities undermined macroeconomic stability". It also to be noted that analysis of debt sustainability by GIFT based on Domar condition indicates that the excessive concern on debt sustainability is misplaced and our concern shall on the use of debt.

During the first half of the current fiscal, with a recorded growth of -53.4 per cent, there has been a drastic decline in the borrowing by Kerala (Table 2). This has to be compared with an all-state average decline of - 20.0%. In fact, all the states in India, except four, reduced their borrowing and hence recorded negative growth in borrowing and liabilities. This is indicative of the concerted efforts across states to keep borrowing within FRBM limits and debt under control. Thus viewed, the recorded negative growth in borrowing and liabilities of Kerala is another strong indication of the state being on path of fiscal consolidation. At this juncture we also note the Centre's move to include off Budget borrowing of the States with in the budgetary process.

The outcome of revenue mobilization and expenditure compression measures is evident from a remarkable decline in revenue deficit recording a growth rate of -67.3% during the first half of the current fiscal. It is also evident that five states registered a growth in revenue surplus during the period under consideration. These states are Gujarat, Karnataka, Punjab, Bihar and Andhra Pradesh. Yet when all the major states are taken into consideration, there has been only a marginal reduction in revenue deficit with the recorded growth being only -4.8%. On the whole, Kerala, with a drastic reduction in revenue deficit along with a corresponding reduction in other deficit indicators like fiscal deficit the (-53.4%) and primary deficit (-76.3%) could be rightly be termed as an indication of salutary fiscal consolidation in the state.

Table 2- Half yearly growth rates of borrowing and deficits across in states 2022 over 2021

States	Borrowings & Other Liabilities	Revenue Deficit	Fiscal Deficit	Primary Deficit
Andhra Pradesh	23.4	23.6	23.4	27.4
Bihar	27.4	37.6	27.4	20.0
Gujarat	-82.7	786.6	-82.7	288.9
Haryana	-13.7	-9.4	-13.7	-54.5
Karnataka	-86.0	310.8	-86.0	-1241.2
Kerala	-53.4	-67.3	-53.4	-76.3
Madhya Pradesh	-34.6	-311.1	-34.6	-60.0
Maharashtra	-135.8	-425.0	-135.8	763.5
Odisha	144.5	-3.4	79.3	144.5
Punjab	17.2	52.7	17.2	50.0
Rajasthan	-20.3	-22.3	-20.3	-40.5
Tamil Nadu	-15.9	-55.6	-15.9	-89.2
Telangana	-17.2	-56.7	-17.2	-34.0
Uttar Pradesh	-46.8	-304.7	-46.8	-131.4
West Bengal	-6.4	-27.4	-6.4	-36.7
All states average	-20.0	-4.8	-24.4	-31.3

Source: Estimates based on C&AG Data

Fiscal position beyond H1 in Kerala

The analysis so far in comparison with other states has been for the first six months. By now we have access to the data from CAG for the first eight months for Kerala and it is important to know where Kerala stands by November 2022; first eight months of 2022.

Table 3- Fiscal position of Kerala up to November 2022 compared to November 2021

Description	2021-22 (RE)	2022-23 (BE)	Nov-22	Nov-21	Growth rate Nov 2022 over Nov 2021
Revenue Receipts	117888.2	134097.8	81736.6	64292.0	27.13
Tax Revenue	76200.0	91818.3	55751.8	41349.5	34.83
Non-Tax Revenue	10038.0	11769.6	6634.7	4133.7	60.50
Grants-in-aid	31650.0	30509.9	19350.1	18808.8	2.88
Capital Receipts	46912.0	39489.7	20053.3	42180.0	-54.13
Borrowings & Other Liabilities	46395.5	39144.9	19887.8	41772.5	-52.39
Total Receipts	164800.2	173587.5	101789.9	106472.0	-4.40
Revenue Expenditure	149803.2	157065.9	92115.7	96591.8	-4.63
Expenditure on Interest Payment	22115.4	25965.9	14850.0	12706.6	16.87
Expenditure on salaries and wages	45585.4	43305.0	26632.7	32370.0	-17.72
Expenditure on Pension	26898.7	26834.0	18588.5	19002.1	-2.18
Expenditure on Subsidy	3889.5	2170.5	1278.9	2960.7	-56.81
Capital Expenditure	14996.9	16521.6	8009.0	7558.9	5.95
Expenditure on Capital outlay	12226.3	14890.8	7931.3	7463.1	6.27
Total Expenditure	164800.1	173587.5	100124.7	104150.8	-3.87
Revenue Surplus (+)/Deficit (-) *	-23176.1	-22968.1	-10379.1	-32299.9	-67.87
Fiscal Surplus/Deficit*	-37656.5	-39116.6	-19887.8	-41772.5	-52.39
Primary Deficit	-15541.0	-13150.6	-5037.9	-29065.9	-82.67

* GST compensation balance and balance from Revenue Deficit grant excluded from revenue deficit.
Note: 2021-22 and 2022-23 figures are taken from Budget in Brief, 2022-23, Government of Kerala

In the case of revenue receipts, Kerala recorded a growth rate of 27.13 per cent which is lower than the 35.8 per cent growth recorded during the first half of 2022. When it comes the tax revenue the recorded growth rate is 35 per cent as compared to 42 per cent during the first half. Even with this lower growth compared to first six months, Kerala would be able to reach almost the budgeted revenue receipts of Rs 91,818.3 crore. The increase in revenue receipts by increasing state's own tax and non-tax revenue is to been seen as an outcome of the rebound of the economy after COVID-19. Overall, on the revenue front, our performance is highly satisfying.

However, the negligible growth (2.9%) in grants-in-aid from the Centre indeed affects the fiscal space of the state to meet the committed expenditure and also infrastructure development. What is important from the fiscal consolidation is the continued decline in borrowing at the same pace (-52.4%) and the decline in revenue expenditure (-4.63%) backed by the decline in salary and pension at -17.7 per cent and -2.2 per cent respectively. As a result, decline in revenue deficit, (-67.3%) and Fiscal deficit (-53.4%) was at the same pace as the first six months while the decline in primary deficit (-82.7%) was at a still higher pace than the first six months (-76.3%). On the whole, the empirical evidence suggests that the impressive fiscal consolidation during the first six months as compared to other states, backed by significant revenue growth and expenditure compression, continued till November 2022. The challenge for the state is to keep up the trend so far in the coming months. This will call for more initiatives towards further hike in revenue including GST, which the state has already undertaken, while sustaining the success in expenditure compression.

Conclusion

Given the Vertical Fiscal Imbalance inherent in India's fiscal federalism along with criteria of devolution adopted by the Finance Commission which is inimical to the interest of Kerala, the state's fiscal health is very much contingent on its own initiatives in fiscal consolidation. Given the commitment of the state towards saving the lives and livelihood of people during the once in a century pandemic, there were serious limits for the state in resorting to such efforts. GIFT (2022) observed that the social sector expenditure by the state during the pandemic recorded the highest growth among Indian states (163%). The second highest growth of 60% recorded by Gujarat was not even half of that of Kerala.

The evidence presented in the study confirms that there are strong indications of fiscal turn around in the state and Kerala has been way ahead of other states in this respect. This is manifested in significant increase in revenue growth coupled with moderation in expenditure and borrowing leading to a significant decline in all indicators of deficit; revenue deficit, fiscal deficit and primary deficit. More importantly, the trend towards fiscal consolidation observed during the first half of the current fiscal has been continued till November 2022. Despite the substantial reduction in borrowing, the public concern on public debt continues. But it is important to note that increasing debt is not a Kerala specific phenomenon. As observed by IMF in the aftermath of Covid-19 pandemic, the Global debt (public and private) was 247 per cent of GDP in 2021, of which public debt accounted for 96%. Perhaps, it is high time for a shift in our public concern from the quantity of public debt to quality of debt utilization. On the whole, we note a salutary effort towards fiscal consolidation which needs be sustained by continued efforts towards revenue mobilization and expenditure rationalization.

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