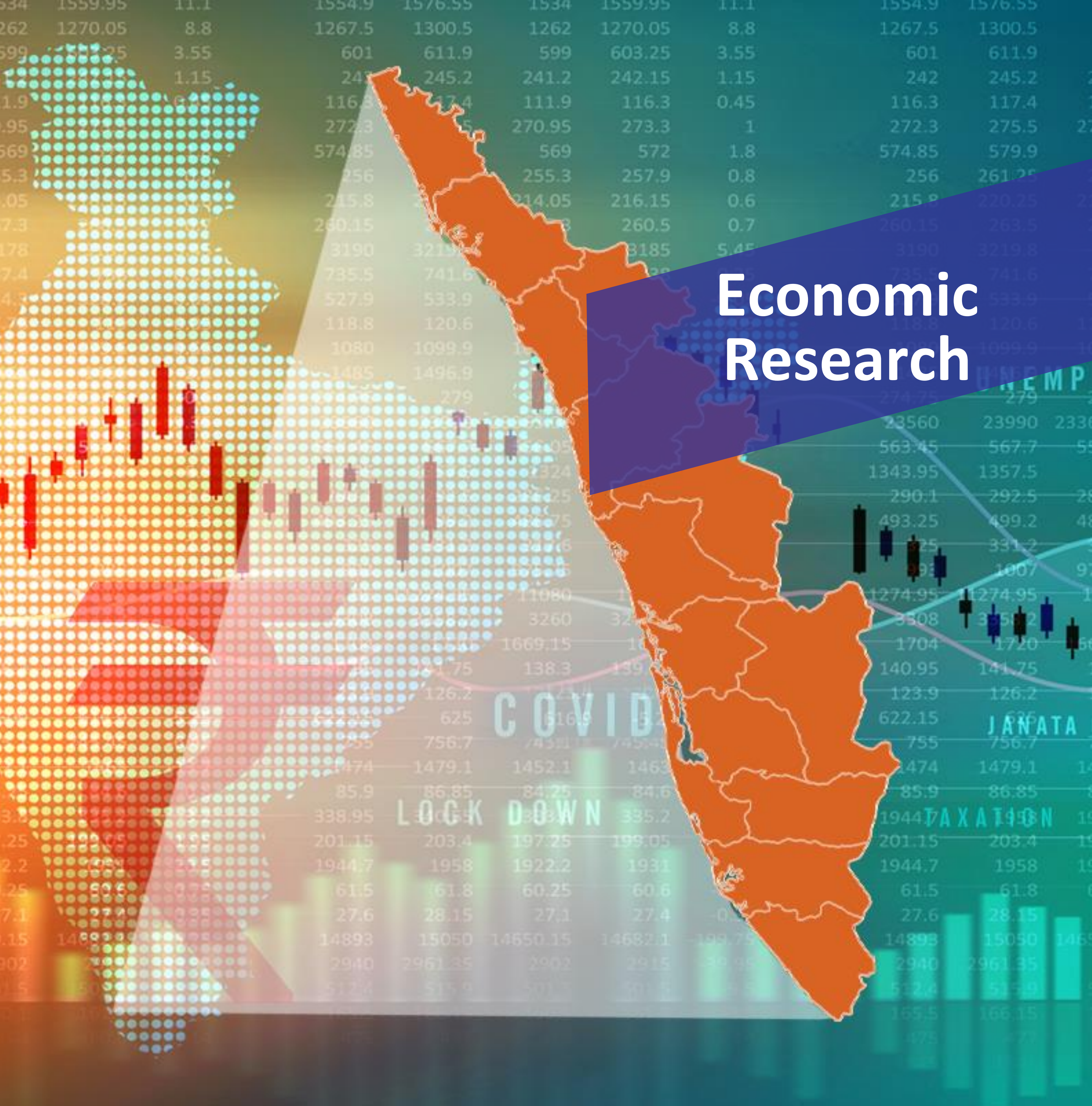

Economic Research

Kerala State Finances

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Kerala State Budget 2021-22: Fiscal situation demands a credible fiscal consolidation plan and its careful calibration

June 2021

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Kerala's performance in containing the first wave of the Covid-19 pandemic was exemplary, and it was the first state to unveil a Rs 20,000 crore financial package in March 2020 to tide over the pandemic crisis. The impact of the pandemic on this state's fiscal health was disastrous, as in the case of other states. Due to the lockdown and closure of economic activities the GSDP in current prices for 2020-21 contracted by 3.8% over the previous year. Apparently, the state missed its FY21 budget targets by a substantial gap.

Pandemic-led shortage in revenue collections in 2020-21

The shortfall in the total revenue receipts in the revised estimate compared to the budget estimate was Rs 21,521 crore in FY21. As a ratio of the GSDP, the revised estimate of revenue receipts stood at 11.3%, which is lower than the budgeted by almost 0.4 percentage point, and yet, it was higher than the previous year's actual collection by 0.8 percentage point, mainly due to decline in the GSDP. The revised estimate of the state's own tax revenues in 2020-21 was lower than the budget estimate by Rs 22,148 crore, and the tax devolution was lower by Rs 11,091 crore partly due to lower central tax collections and partly due to the lower tax devolution resulting from the Fifteenth Finance Commission's (FFC's) award. It's share from the divisible pool of the central tax revenue has decreased from 3.057% in 2000-2005 to 2.5% in 2015-20 and further to 1.925% in 2021-26. As per the revised budget, the share of central taxes for 2021-22 is fixed at Rs 12,812 crore, which is Rs 3,748 crore less than the amount already provided in the budget presented in January 2021.

On the other hand, the state received Rs 17,184 crore more as grants in 2020-21 due to its huge debt and deficits, coupled with a higher interest outgo. Kerala is the second highest to receive revenue deficit grants for 2021-26 by the FFC. For 2021-22, Rs 19,891 crore with respect to the revenue deficit grant is recommended, which would help moderate the impact on lower revenue due to a declining share of central taxes to some extent; however, it should be noted that revenue deficit gets reduced in successive years and would taper off in 2023-24.

As stated above, the pandemic situation has disrupted economic activities at large for the most part of the year; hence, to manage the additional expenditure on the back of the revenue shortfall, the central government allowed states to borrow an additional 2% of their GSDP from the market, in addition to the prescribed limit of 3% of the GSDP, subject to compliance with four specific state-level reforms. Kerala completed these reforms in 2020-21 itself, and it therefore availed the additional borrowing facilities to meet the revenue shortfall and additional expenditure liability. The state borrowed Rs 6,000 crore in April 2020 from the market even at a high cost of 7.9% to 8.9%. Overall, the state government borrowed Rs 25,819 crore more than budgeted to compensate for the revenue deficit, which crossed 2.9% of the GSDP, as against the budget estimate of 1.55% in FY21. The irony is that most of these borrowings are being used to meet its revenue expenditure, which constitutes nearly 67% of the total expenditure in FY21, mainly due to very high committed expenditures (8.0% of the GSDP). Although the state curtailed its revenue expenditure by 9.6% (Rs 12,516 crore) during FY21 as against the budget estimates, it still remained 12% more than the amount spent in FY20. The total capital expenditure too increased by 3.9% year-on-year, and the state spent 41.8% (Rs 16,444 crore) more than what was budgeted for FY21. With an inevitable additional burden, the state again missed its deficit and debt targets. The fiscal deficit of 4.25% of the GSDP as against the targeted 3% and the debt to GSDP ratio of 36.1% for FY21 would have adverse effects on the state's medium and long-term economic growth (Table 1 and 2).

Table 1: Budget at a glance (Rs crore)

	2019-20	2020-21 BE	2020-21 RE	2021-22 RBE
Revenue Receipts				
State's Own Tax Revenue	50,323	67,420	45,272	71,833
State's Own Non-tax Revenue	12,265	14,587	9,121	14,336
Total State's Own Revenue	**62,588**	**82,007**	**54,393**	**86,169**
Tax Devolution	16,401	20,935	9,844	12,812
Grants	11,235	11,694	28,878	32,000
Central Transfers	**27,636**	**32,629**	**38,722**	**44,812**
Total Revenue Receipts	**90,224**	**114,636**	**93,115**	**130,981**
Expenditures				
Revenue Expenditures, of which	104,720	129,837	117,322	147,891
Interest Payments	19,215	19,850	20,286	21,940
Capital Expenditures	53,666	39,306	55,750	66,587
Total Expenditures	**158,386**	**169,143**	**173,071**	**214,479**
Revenue Deficit	-14,495	-15,201	-24,207	-16,910
Fiscal Deficit	-23,838	-29,295	-34,950	-30,698
Primary Deficit	-4,623	-9,445	-14,663	-8,757
Debt Outstanding	**260,311**	**292,087**	**296,818**	**327,655**

RE: Revised Estimates, BE: Budget Estimates, RBE: Revised Budget Estimates

Source: Kerala Revised Budget Documents 2021-22, BWR Research

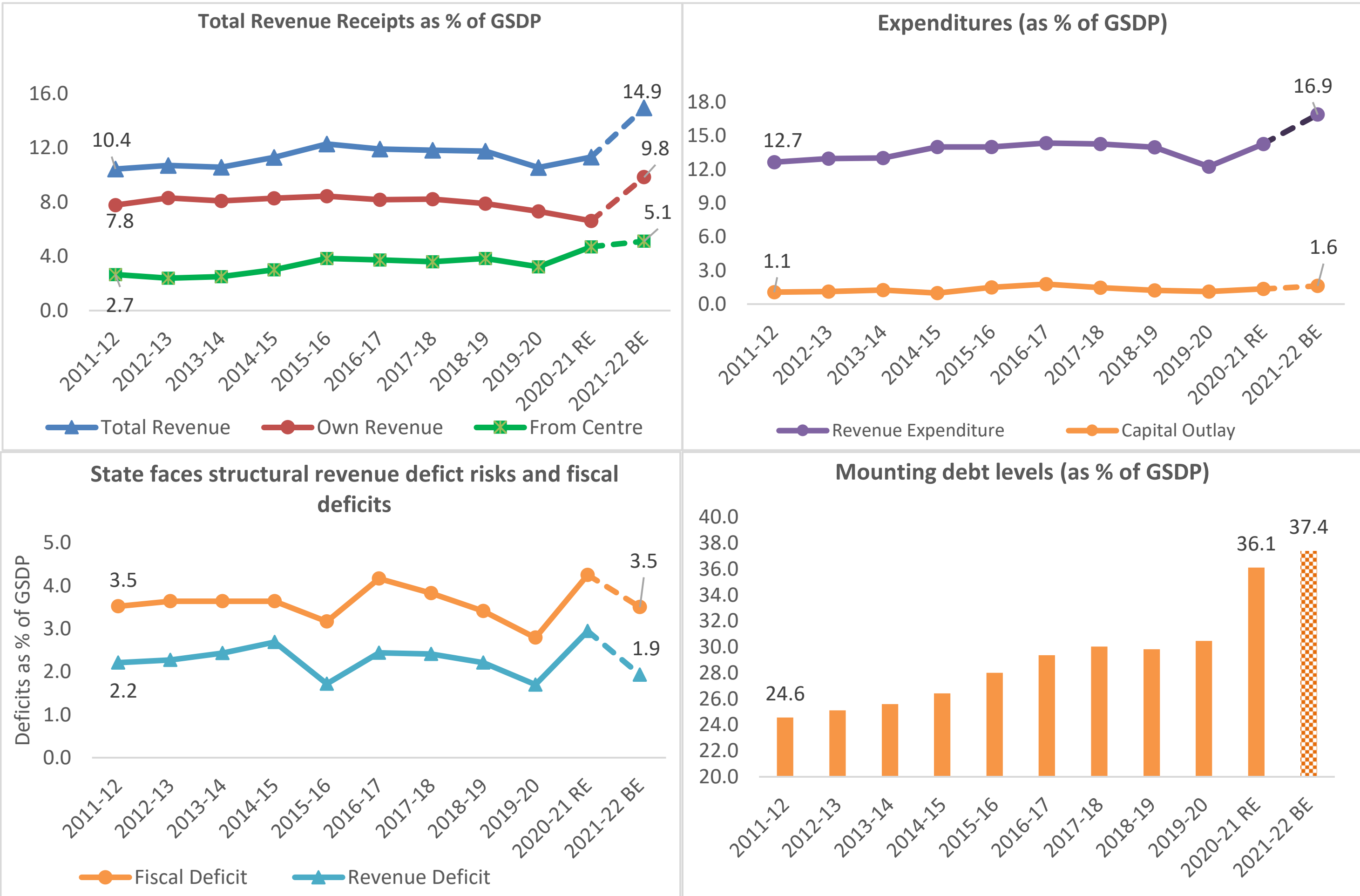
Budgeting for FY22 amid pandemic ambiguity

The interim budget presented in January 2021 by the previous Finance Minister Dr. T. M. Thomas Issac, made comprehensive proposals to uplift the Covid-19-hit economy. However, the rapid transmission of the virus in the second wave, and lockdowns/ restrictions imposed by the state beginning April 2021 once again have slowed down the economic recovery progress. The new Finance Minister K N Balagopal made some changes to the interim budget as the second wave of Covid-19 necessitated certain changes to the earlier estimates.

As per the revised budget estimates for 2021-22, the tax revenue (own) is estimated to be higher than 2020-21(RE) by Rs 26,561 crore. This would require significant year-on-year growth of 58.7%. The estimated tax to GSDP ratio at

8.2% is the highest in the recent years and higher than the previous year by 2.7 percentage points; it is also higher than the 2019-20 actuals by around 2.3 percentage points. This looks ambitious, almost unrealistic, particularly because with the continued spread of the pandemic, many sectors requiring social distancing continue to stagnate or decline. The second wave has been much more severe, and its adverse impact on economic activity has been widespread. Although the severity of lockdowns this year was milder than in the last year, with most businesses allowed to operate, but travel and tourism continue to suffer. Tourism is a crucial contributor to the GSDP in Kerala, accounting for nearly 10% of the state's GSDP. The second wave of the pandemic and repeated restrictions have ruined the tourism business and it would take a longer time to revert to normalcy.

On the expenditure side, the State's total expenditure is estimated to increase by 23.9% over 2020-21(RE). The state continued with a high committed expenditure of 55.3% of the total revenue expenditure. Revenue expenditure is estimated to increase by 26.1%, and capital expenditure by 19.4% in 2021-22. In the last fiscal, the state's total expenditure stood at 21.05% of the GSDP, which is estimated to cross 24.4% in the current fiscal, given the rise in both revenue and capital expenditure.



RE: Revised Estimates, BE: Budget Estimates (revised)
Source: Kerala Revised Budget Documents 2021-22, BWR Research

Table 2: Fiscal Position of Kerala				
	2019-20	2020-21 BE	2020-21 RE	2021-22 BE
State's Own Tax Revenue (% of GSDP)	5.89	6.89	5.51	8.20
State's Own revenue (% of GSDP)	7.32	8.38	6.62	9.83
State's Revenue Expenditure (% of GSDP)	12.25	13.27	14.27	16.88
State's Capital Expenditure (% of GSDP)	6.28	4.02	6.78	7.60
Committed Exp/ Total revenue expenditure (%)	63.5	55.3	56.2	55.3
Development Exp as % of GSDP	6.0	7.5	7.8	9.5
Social Sector Exp as % of Total Exp	65.5	113.9	73.2	80.4
Interest Payment to total revenue (Tax+ non-Tax)	30.7	24.2	37.3	25.5
Revenue Deficit (% of GSDP)	-1.7	-1.6	-2.9	-1.9
Fiscal Deficit (% of GSDP)	-2.8	-3.0	-4.3	-3.5
Outstanding liabilities (% of GSDP)	30.46	29.86	36.11	37.39
Source: Kerala Revised Budget Documents 2021-22, BWR Research				

Conclusion

Kerala is one of the most progressive states in India in terms of social indicators. The state has retained its rank as the top state in the SDG Index of the NITI Aayog, with a score of 75 in 2020, released on 3 June 2021. Despite passing the legislation, the state has not been adhering to its FRBM limit in recent years. Containing revenue deficit has always been a problem, particularly in the recent years due to very high level of revenue expenditures. The revised estimate for the current fiscal, as well as in the last fiscal, displays the state's precarious fiscal position. Not surprisingly, very high revenue deficits have not only crowded out capital expenditures, but also forced the state to miss its fiscal targets. Revenue deficit remained consistently above 2% of the GSDP, with an exception in 2015-16, while its fiscal deficit crossed the prescribed limit of 3% of the GSDP, except for 2019-20. The Debt to GSDP ratio also reached its highest level of 36.1% in 2020-21 and is estimated to cross 37% in 2021-22. Thus, the state needs a credible fiscal consolidation plan and its careful calibration. The medium term looks very challenging as the revenue deficit grants are phased out. The FFC report has also highlighted this challenge.

As mentioned above, despite the looming pandemic, the state has set unrealistic revenue targets for the current fiscal, and the actual fiscal position is likely to be worse than presented. Due to the pandemic, the GSDP in current prices for 2020-21 contracted by 3.8% over the previous year and is estimated to grow at a rate of 6.6% in the current fiscal. The recent restrictions already have had a significant impact on tax and non-tax revenue collections so far. Along with decline in own tax revenue, there could also be decline in central tax devolution, particularly as the tax revenue collections of the union government may also be dented due to the pandemic. The increased financing of fiscal deficits with market borrowings has pushed up debt levels, which may lead to the tightening of debt servicing constraints. The state needs to implement a credible fiscal consolidation strategy to reduce revenue expenditures. As per Medium-Term Fiscal Plan 2021-2022, the state has estimated to bring down the debt level to 35.2% by 2023-24, which looks challenging in the prevailing situation in the state.

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