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GOVERNMENT OF KERALA

REPORT OF THE KERALA PUBLIC EXPENDITURE REVIEW COMMITTEE

SIXTH COMMITTE

FIRST REPORT
2019-20 and 2020-21
JUNE 2024

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SIXTH COMMITTEE

[Appointed as per notification issued under G.O.(P) No. 108/2022/Fin. Dated 16.09.2022 and published as SRO No 892/2022 in the Kerala Gazette Extraordinary No.3162 Dated 16.09.2022]

FIRST REPORT

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Preface

This is the 1st report of the 6th Kerala Public Expenditure Review Committee (KPERC) (appointed as per notification issued under G.O.(P) No. 108/2022/Fin. Dated 16.09.2022 and published as SRO No 892/2022 in the Kerala Gazette Extraordinary No.3162 Dated 16.09.2022). This Report has examined Public Finance Management of the state for the financial year 2020-21 along with that of 2019-20 as mandated under Fiscal Responsibility Act (2003). The Committee is guided by Section 7 of the said Act:

7. Powers and functions of the Committee. - The Committee shall submit to the Government in such form and at such intervals as may be prescribed a review report giving full account of each item where the deviation from the fiscal target have occurred during the previous year.

The chapters are drafted by the members as follows: Chapters 1 and 2 are drafted by D Narayana, Chapter 3 by N Ramalingam, Chapter 4 by Siddik Rabiyath, and Chapter 5 by P L Beena. All the members reviewed all the chapters, discussed in detail and finalised the Report.

The Committee acknowledges the support and co-operation rendered by officials of the Finance Department, Government of Kerala.

Dr D Narayana
Chairperson

Dr N Ramalingam
Member

Dr P L Beena
Member

Siddik Rabiyath
Member

Glossary

AJ	–	Administration of Justice
AS	–	Administrative Services
CGST	–	Central Goods and Services Tax
CTD	–	Collection of Taxes, Duties, etc.,
FD	–	Fiscal Deficit
GA	–	General Administration
GDP	–	Gross Domestic Product
GSDP	–	Gross State Domestic Product
GST	–	Goods and Services Tax
HSN/SAC	–	Harmonized System Nomenclature/ Service Accounting Code
IGST	–	Integrated Goods and Services Tax
IP	–	Interest Payments
JS	–	Jails
MD	–	Miscellaneous Departments
P&L	–	Parliament and Legislature
P&V	–	Police and Vigilance
SGST	–	State Goods and Services Tax
SORR	–	State’s Own Revenue Receipts
SOTR	–	State’s Own Tax Revenue
RD	–	Revenue Deficit
RE	–	Revenue Expenditure
VAT	–	Value Added Tax

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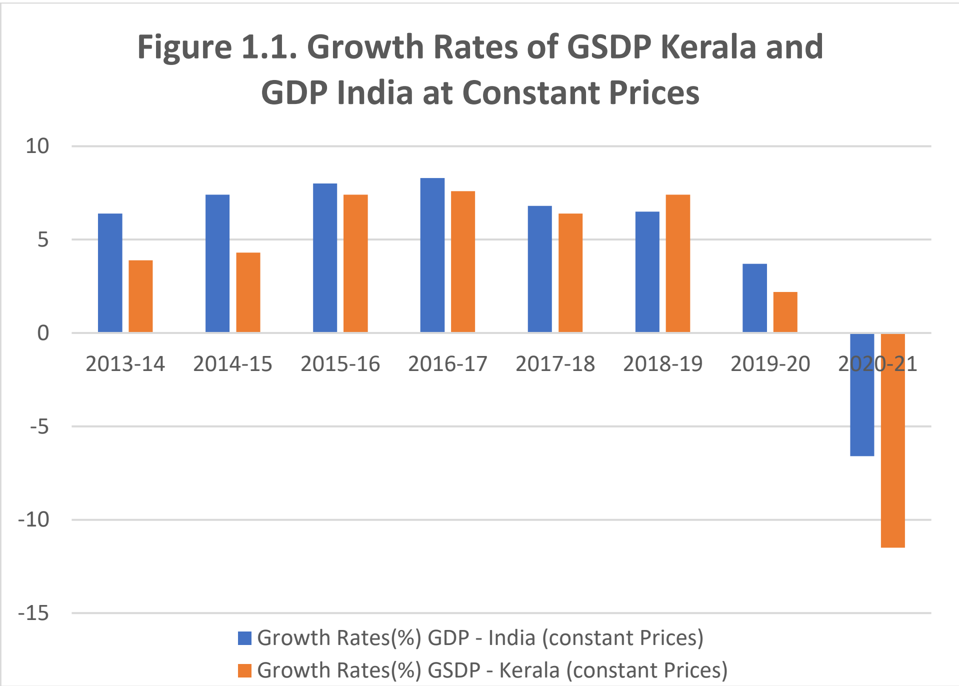
Chapter 1

Growth of Gross State Domestic Product, Kerala

Global economic growth took a huge hit struck by the COVID-19 pandemic in the year 2020-21. Indian economy, which was not doing too well since 2016-17, too took a hit of unimaginable proportions. The fall in economic growth affected personal incomes, expenditure, consumption and investment and by the end of the year when it was thought that the worst was over and the economy would recover the second wave hit the nation pulling the economy further down. The fall in incomes affected government revenues but government could not cut expenditures as support to get over the pandemic was absolutely essential.

1.1 GSDP of Kerala in Comparison with GDP Growth

It may be seen that (Figure 1.1) the Indian economy which was growing at a healthy rate of 8 per cent or more in 2015-16 and 2016-17 showed a decline of over 4.5 per cent points in the next three years following demonetization in 2016 and the introduction of Goods and Services Tax in 2017. The healthy growth of the previous four or five years vanished and the GDP growth rate fell to 3.7 per cent in 2019-20 - the pre-pandemic year. The already low growth rate took a severe beating with the lock-downs and the growth rate slumped to -6.6 per cent in 2020-21.

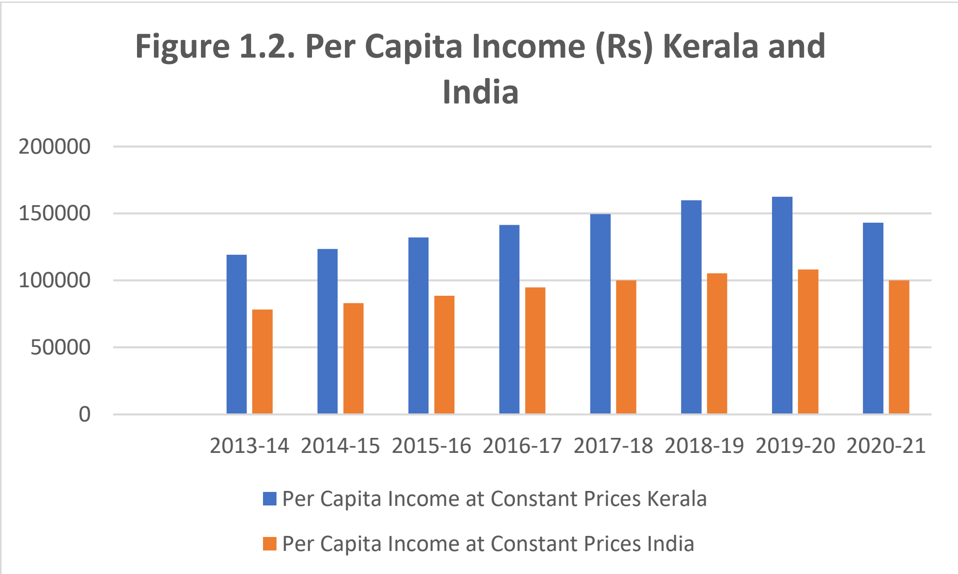


Source: https://mospi.gov.in accessed 28 October 2022; https://ecostat.kerala.gov.in/ accessed 28 October 2022.
Notes: 2011-12 Base year for Constant Prices; For Kerala, 2019-20 figures are provisional and 2020-21 are quick estimates; For India, 2020-21 estimates are provisional.

The Kerala economy was showing a healthy growth pick up from 2013-14 (Figure 1.1). The GSDP growth rate that averaged just around 4 per cent during 2013-14 and 2014-15 jumped by more than 3 per cent points to an average of 7.2 per cent during 2015-16 to 2018-19 but collapsed to 2.2 per cent in 2019-20 along with the collapse of the Indian GDP growth. The already low growth took a huge hit during the COVID 19 first wave with the GSDP of the state falling by a large 11.5 per cent. The low growth in 2019-20 and large de-growth in 2020-21 meant the volume of activity in the economy fell to Rs. 5.01 lakh crore in 2020-21 which was lower than the level achieved in 2017-18 of Rs 5.17 lakh crore. The economy was set back by four years!

1.2 Per Capita Income in the Covid 19 Year

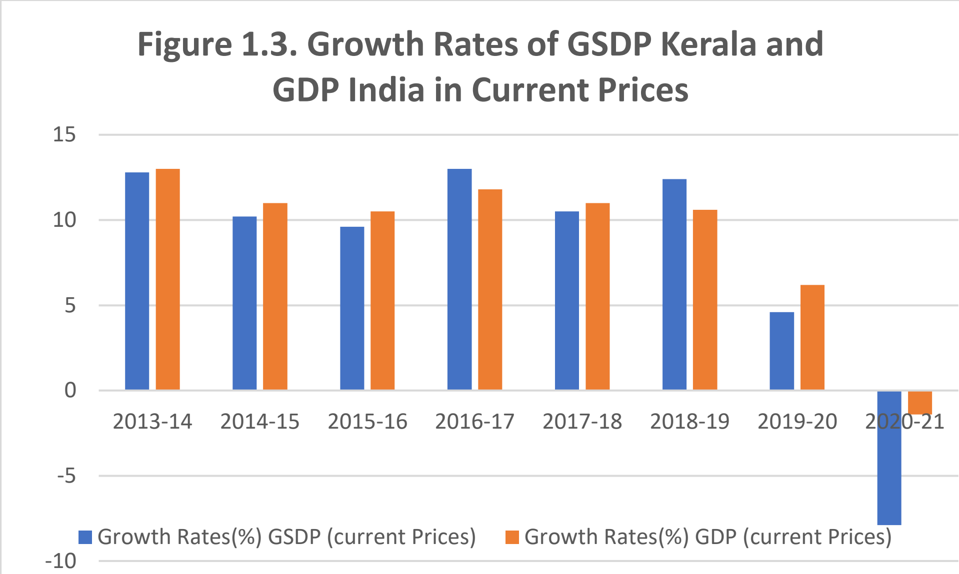
The low growth of the economy in the years preceding the pandemic and the de-growth during the pandemic year has implications for the trends in per capita income. As may be seen from Figure 1.2, per capita GDP of India in 2020-21 fell to the level below that in 2017-18. In Kerala, the fall was steeper; it fell to a level almost on par with that in 2016-17. This was a huge setback for the Kerala economy unheard of in recent times. Obviously, many population groups must have suffered deprivations unheard of in their lifetimes.



Source: https://mospi.gov.in accessed 28 October 2022; https://ecostat.kerala.gov.in/ accessed 28 October 2022.
Notes: 2011-12 Base year for Constant Prices; For Kerala, 2019-20 figures are provisional and 2020-21 are quick estimates; For India, 2020-21 estimates are provisional.

1.3 GSDP in Current Prices

An analysis of the trends in GDP/ GSDP in constant prices is essential for understanding the real economic activity, or the volume growth, but it may not be very helpful in the analysis of government revenue and expenditure which are in nominal money terms. Here it may be useful to turn to the time series in current prices. The data presented in Figure 1.3 suggests that till 2018-19, growth rate of GSDP in current prices was comparable to that of GDP in current prices. But the year 2019-20 and 2020-21 saw the GSDP grow at a significantly lower rate and the de-growth in 2020-21 too was higher. This would have serious implications to the tax revenue receipts of the state.



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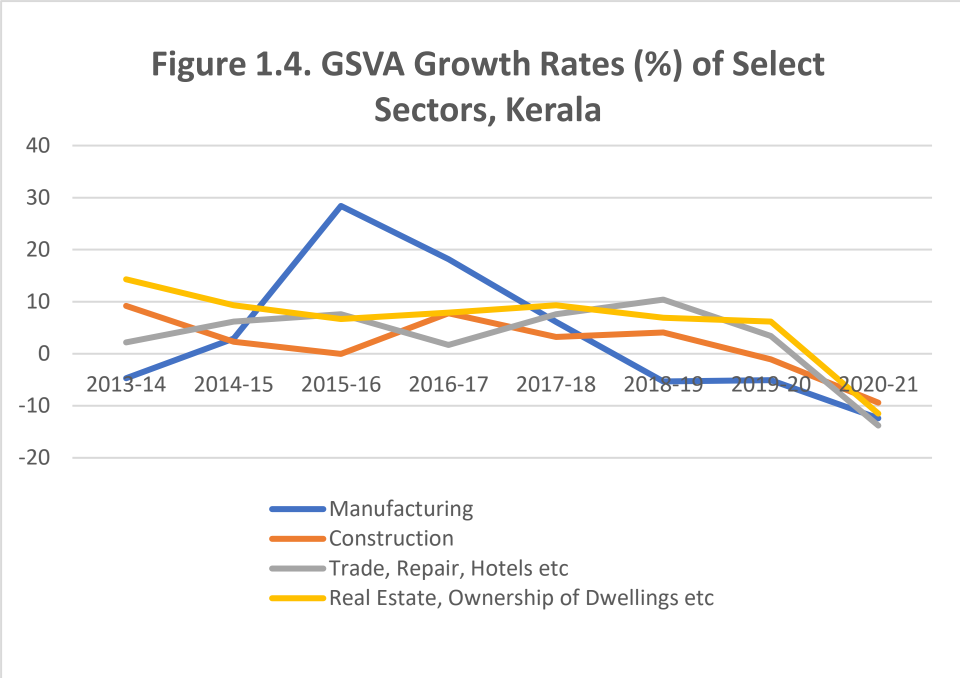
Notes: For Kerala, 2019-20 figures are provisional and 2020-21 are quick estimates; For India, 2020-21 estimates are provisional.

1.4 Sectoral Growth Trends

A look at the growth trends of some of the major sectors of the economy of the state may also be of some use in this context (Figure 1.4). Manufacturing accounting for about 10 per cent of the gross value added showed high growth in 2015-16 and 2016-17. Surprisingly, growth turned negative since 2018-19 much before the poor overall growth of 2019-20 and the pandemic of 2020-21.

Both construction and trade and hotel, restaurants were not doing too well since 2013-14. Construction growth turned negative in 2019-20 and became worse the next year. Trade, hotel and restaurants showed a huge dip in the Covid 19 year. Real estate, ownership of dwellings etc., which was showing average growth till 2019-20 too took a huge hit in 2020-21. Thus, overall all the major sectors were hit by the pandemic but some were already in bad shape before the Covid 19 arrived on the Kerala shores.



Source: https://ecostat.kerala.gov.in/ accessed 28 October 2022.
Notes: 2019-20 figures are provisional and 2020-21 are quick estimates.

In sum, the Indian economy was on a downward stride since 2016-17 but Kerala economy took a hard hit only by 2019-20. Covid 19 hit Kerala much harder than the Indian economy. Nominal growth trend that did not differ much between India and Kerala till 2018-19 took a harder hit both in 2019-20 and 2020-21 in Kerala. All the major economic sectors in Kerala were not performing well since 2013-14 and the lockdowns during the Covid 19 wave made matters worse.

Chapter 2

An Overview of the Public Finances of Kerala

The poor growth of the Kerala economy in 2019-20 and 2020-21 had its ramifications for the revenue receipts. They remained virtually stagnant during 2018-19, 2019-20 and 2020-21 (Table 2.1); the growth depicted by the revenue receipts till 2018-19 disappeared in the next two years along with the poor GSDP growth. In 2019-20, the revenue receipts were lower than that in 2018-19 and the growth in 2020-21 took it just above the level of 2018-19. State’s own revenue receipts saw no growth in 2019-20 and declined sharply in 2020-21. Both own tax revenue and non-tax revenue behaved more or less similarly depicting no growth in 2019-20 and sharp fall in 2020-21. Central transfers too declined in 2019-20 but witnessed a sharp rise in 2020-21 pushing the total revenue receipts of the State past the 2018-19 level. Between the central transfers, while tax assignment saw a sharp fall in 2020-21, grants increased by Rs 20,000 crore meeting the increased expenditure of the State in the Covid 19 year of 2020-21.

The poor growth of state’s own revenue receipts and central transfers in 2019-20 led to the total expenditure of the government taking a hit of close to Rs 6,000 crore. It was a slightly larger hit on revenue expenditure as interest payments increased by Rs 1,500 crore and capital expenditure was maintained. The next year, 2020-21, saw the total expenditure go up by close to Rs. 25,000 crore with Rs 20,000 crore covered by the central grants. Of the total increase of Rs. 25,000 crore, the bulk of it was accounted for by the increase on revenue account (Rs 19,000 crore) and the rest on capital account. While the management of Covid 19 pandemic in 2020-21 necessitated a higher revenue expenditure, the year turned out to be one of the best in terms of capital expenditure surpassing the previous maximum of Rs. 11,286 crore in 2016-17 by over Rs. 5,000 crore. The most productive aspect of capital spending in the two years is that in 2019-20, despite the fall in revenue receipts capital outlay was raised by Rs. 1,000 crore by curtailing loan disbursements by an equal amount. The year 2020-21 saw both go up, loan disbursements by over Rs 1,000 crore and capital outlay by Rs 4,500 crore. While capital outlay surpassed the previous maximum, loan disbursements reached the level of 2018-19.

In 2019-20, the falling revenue receipts did not lead to an increase in the revenue deficit; the revenue deficit was brought down by a tight leash on revenue expenditure. The maintenance of capital expenditure too did not lead to the fiscal deficit going up. In fact, fiscal deficit was brought down by Rs. 3,000 crore that was comparable to the revenue deficit of the year suggesting that additional borrowing was not resorted to maintain the capital expenditure, the hallmark of prudent fiscal behaviour. This was clearly reflected in the total borrowings of the year. The borrowings which were around Rs 27,000 crore in the three years preceding 2019-20 came down by Rs 3,000 crore that year before it went up sharply in the next year to meet the increased expenditure of Covid-19 management related activities. Thus, it is seen that the fiscal consolidation attempted in 2019-20 despite the falling revenue receipts took a big hit with the pandemic in 2020-21.

Table 2.1 : An Overview of State Finances 2011-12 to 2020-21 (Rs crore)

No	Items	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
A	**Revenue Receipts [A1+A2]**	**38010**	**44137**	**49177**	**57950**	**69032**	**75611**	**83020**	**92854**	**90225**	**97617**
A1	**State's Own Revenue [A1i+A1ii]**	**28311**	**34275**	**37570**	**42516**	**47420**	**51876**	**57659**	**62427**	**62589**	**54988**
A1i	State Own Tax Revenue	25719	30077	31995	35232	38995	42176	46460	50644	50324	47661
A1ii	State Own Non-Tax Revenue	2592	4198	5575	7284	8425	9700	11199	11783	12265	7327
A2	**Central Government Transfers [A2i+A2ii]**	**9699**	**9862**	**11607**	**15434**	**21612**	**23735**	**25361**	**30427**	**27636**	**42629**
A2i	Share of Central Taxes	5990	6841	7469	7926	12691	15225	16833	19038	16401	11561
A2ii	Grants from Central Government	3709	3021	4138	7508	8921	8510	8528	11389	11235	31068
B	**Capital Receipts [B1+B2+B3]**	**12285**	**15686**	**17050**	**18719**	**17966**	**26762**	**27221**	**27243**	**24160**	**41268**
B1	Recoveries of Loan	55	74	104	124	153	292	351	211	295	264
B2	Other Capital Receipts	16	15	19	28	28	30	29	47	28	34
B3	**Borrowings and other Liabilities [B3i+B3ii+B3iii]**	**12214**	**15597**	**16927**	**18567**	**17785**	**26440**	**26841**	**26985**	**23837**	**40970**
B3i	Public Debt (Net)	6906	10457	11216	12666	13598	16152	17102	15250	16405	30808
B3ii	Public Accounts (Net)	5308	5140	5711	5901	4187	10288	9739	11735	7340	10066
B3iii	Draw Down of cash balance	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	92	96
C	**Total Receipts [A+B]**	**50295**	**59823**	**66227**	**76669**	**86998**	**102373**	**110241**	**120097**	**114385**	**138885**
D	**Total Expenditure**	**50896**	**59228**	**66244**	**76744**	**87031**	**102382**	**110238**	**120070**	**114385**	**138885**
D1	**Revenue Expenditure**	46045	53489	60486	71746	78689	91096	99948	110316	104720	123446
D1i	***Interest payments***	***6294***	***7205***	***8265***	***9770***	***11111***	***12117***	***15120***	***16748***	***19215***	***20975***
D2	**Capital Expenditure [D2i+D2ii]**	**4851**	**5739**	**5758**	**4998**	**8342**	**11286**	**10290**	**9754**	**9665**	**15439**
D2i	Capital Outlay	3853	4603	4294	4255	7500	10126	8749	7431	8455	12890
D2ii	Loan Disbursements	998	1136	1464	743	842	1160	1541	2323	1210	2549
E	**Revenue Deficit (-) [A-D1]**	**-8035**	**-9352**	**-11309**	**-13796**	**-9657**	**-15485**	**-16928**	**-17462**	**-14495**	**-25829**
F	Loan against GST Compensation**	0	0	0	0	0	0	0	0	0	5766
G	**Revenue Deficit (-) [E-F]**	**-8035**	**-9352**	**-11309**	**-13796**	**-9657**	**-15485**	**-16928**	**-17462**	**-14495**	**-20063**
H	**Fiscal Deficit (-) [(A+B1+B2)-D]**	**-12815**	**-15002**	**-16944**	**-18642**	**-17818**	**-26449**	**-26838**	**-26958**	**-23837**	**-35204**
I	**Primary Deficit (-)[H-D1i]**	**-6521**	**-7797**	**-8679**	**-8872**	**-6707**	**-14332**	**-11718**	**-10210**	**-4622**	**-14229**
J	**Debt**	**89418**	**103561**	**119009**	**135440**	**157370**	**186454**	**210761**	**235631**	**260311**	**296901**
K	**Gross State Domestic Product (GSDP in current prices)**	**364048**	**412313**	**465041**	**512564**	**561994**	**634886**	**701588**	**788286**	**824374**	**799571**

***Loan received in lieu of GST Compensation of Rs. 5766 crore for the year 2020-21 is reckoned as Revenue Grant from Govt. of India and hence reduced from Revenue Deficit; it is also not included in the debt.*

Source: *Finance Accounts of C &AG of the respective years and Budget in Brief, GoK [GSDP: Budget in Brief 2021-22 (Table A10) and 22-23 (Table A8)]*

Table 2.2 : Major Indicators of State Finances 2011-12 to 2020-21 (as Percentage of GSDP)

No	Items	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
A	Revenue Receipts [A1+A2]	10.44	10.7	10.57	11.31	12.28	11.91	11.83	11.78	10.94	12.21
A1	State's Own Revenue [A1i+A1ii]	7.78	8.31	8.08	8.29	8.44	8.17	8.22	7.92	7.59	6.88
A1i	State Own Tax Revenue	7.06	7.29	6.88	6.87	6.94	6.64	6.62	6.42	6.1	5.96
A1ii	State Own Non-Tax Revenue	0.71	1.02	1.2	1.42	1.5	1.53	1.6	1.49	1.49	0.92
A2	Central Government Transfers [A2i+A2ii]	2.66	2.39	2.5	3.01	3.85	3.74	3.61	3.86	3.35	5.33
A2i	Share of Central Taxes	1.65	1.66	1.61	1.55	2.26	2.4	2.4	2.42	1.99	1.45
A2ii	Grants from Central Government	1.02	0.73	0.89	1.46	1.59	1.34	1.22	1.44	1.36	3.89
B	Capital Receipts [B1+B2+B3]	3.37	3.8	3.67	3.65	3.2	4.22	3.88	3.46	2.93	5.16
B1	Recoveries of Loan	0.02	0.02	0.02	0.02	0.03	0.05	0.05	0.03	0.04	0.03
B2	Other Capital Receipts	0	0	0	0.01	0	0	0	0.01	0	0
B3	Borrowings and other Liabilities [B3i+B3ii+B3iii]	3.36	3.78	3.64	3.62	3.16	4.16	3.83	3.42	2.89	5.12
B3i	Public Debt (Net)	1.9	2.54	2.41	2.47	2.42	2.54	2.44	1.93	1.99	3.85
B3ii	Public Accounts (Net)	1.46	1.25	1.23	1.15	0.75	1.62	1.39	1.49	0.89	1.26
B3iii	Draw Down of cash balance	0	0	0	0	0	0	0	0	0.01	0.01
C	Total Receipts [A+B]	13.82	14.51	14.24	14.96	15.48	16.12	15.71	15.24	13.88	17.37
D	Total Expenditure	13.98	14.36	14.24	14.97	15.49	16.13	15.71	15.23	13.88	17.37
D1	Revenue Expenditure	12.65	12.97	13.01	14	14	14.35	14.25	13.99	12.7	15.44
D1i	*Interest payments*	1.73	1.75	1.78	1.91	1.98	1.91	2.16	2.12	2.33	2.62
D2	Capital Expenditure [D2i+D2ii]	1.33	1.39	1.24	0.98	1.48	1.78	1.47	1.24	1.17	1.93
D2i	Capital Outlay	1.06	1.12	0.92	0.83	1.33	1.59	1.25	0.94	1.03	1.61
D2ii	Loan Disbursements	0.27	0.28	0.31	0.14	0.15	0.18	0.22	0.29	0.15	0.32
E	Revenue Deficit (-) [A-D1]	-2.21	-2.27	-2.43	-2.69	-1.72	-2.44	-2.41	-2.22	-1.76	-3.23
F	Loan against GST Compensation**	0	0	0	0	0	0	0	0	0	0.72
G	Revenue Deficit (-) [E-F]	-2.21	-2.27	-2.43	-2.69	-1.72	-2.44	-2.41	-2.22	-1.76	-2.51
H	Fiscal Deficit (-) [(A+B1+B2)-D]	-3.52	-3.64	-3.64	-3.64	-3.17	-4.17	-3.83	-3.42	-2.89	-4.4
I	Primary Deficit (-)[H-D1i]	-1.79	-1.89	-1.87	-1.73	-1.19	-2.26	-1.67	-1.3	-0.56	-1.78
J	Debt	24.56	25.12	25.59	26.42	28	29.37	30.04	29.89	31.58	37.13

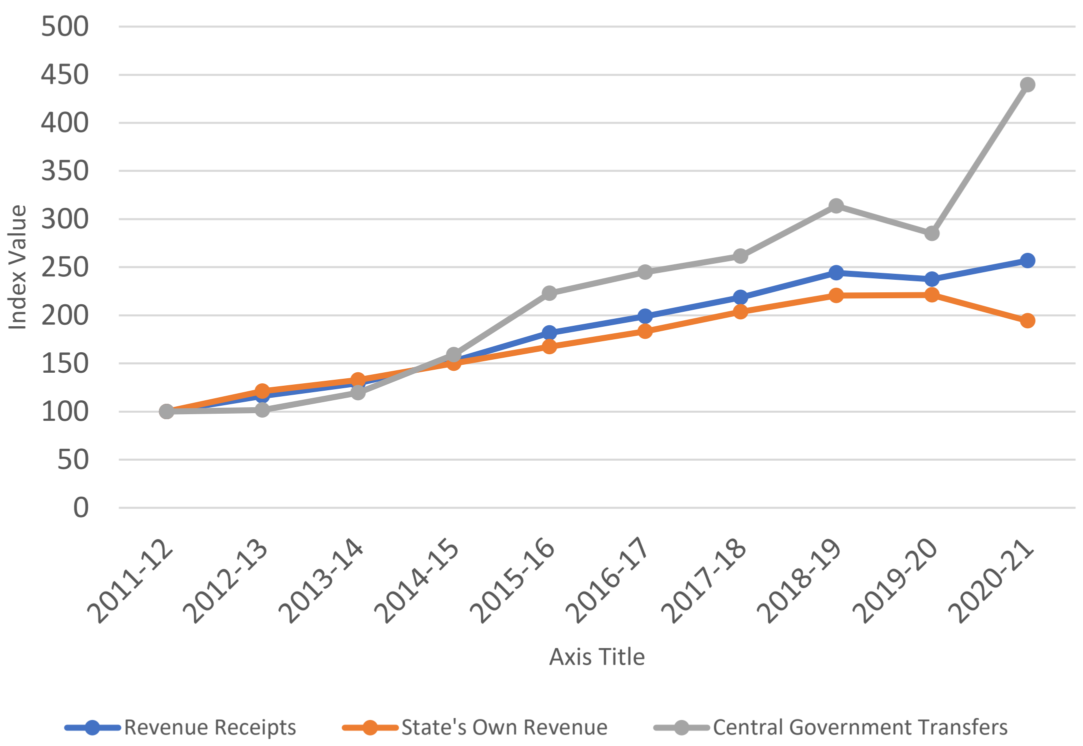
***Loan received in lieu of GST Compensation of Rs. 5766 crore for the year 2020-21 is reckoned as Revenue Grant from Govt. of India and hence reduced*

Source: *Finance Accounts of C &AG of the respective years and Budget in Brief, GoK [GSDP: Budget in Brief 2021-22 (Table A10) and 22-23 (Table A8)]*

2.1 Movement of Revenue Receipts

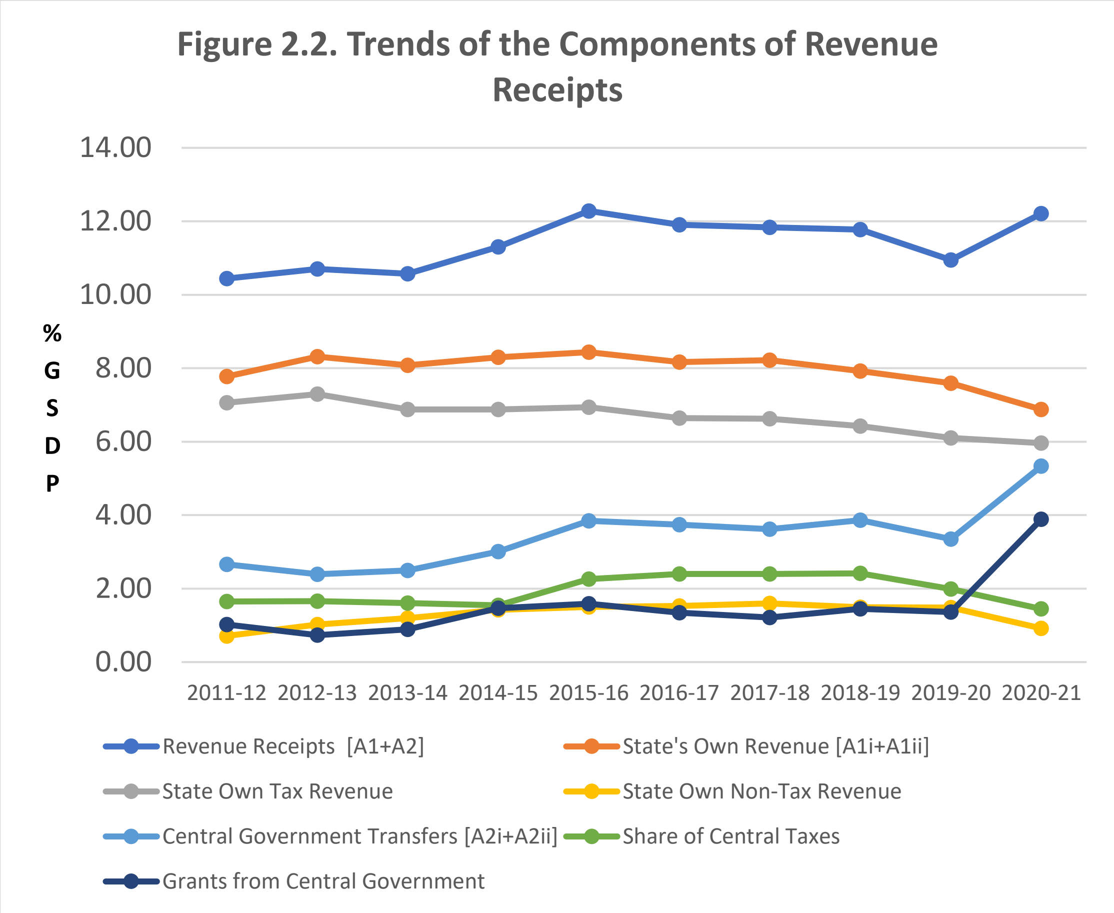
State's total revenue receipts is a sum of state's own revenue receipts and central transfers. The revenue receipts of Kerala increased by 144 percent between 2011-12 and 2018-19 (Figure 2.1). It dipped in 2019-20 and then moved up in 2020-21 crossing the level reached in 2018-19. The dip in 2019-20 was contributed by the double dip of both SORR and Central transfers. But the pull back is owing to the large uptick in central transfers as the dip in SORR continued well into 2020-21. More importantly, state's revenue receipts were a tad below the SORR line till 2014-15, but crossed over and lay above it since then. The central transfers have become larger and have continued to move up. Despite the dip in 2019-20, it has continued to remain high above the SORR line. Thus, the last seven years have seen the central transfers play a key role in the upward movement of the revenue receipts of the State when the State's own revenue receipts were losing steam.

Figure 2.1. Trends of Revenue Receipts, SOR, and Central Transfers



Source: Table 2.1

Total revenue receipts of the State that was hovering around 10.50 per cent of GSDP through 2011-12 to 2014-15 showed an increase of 1.5 per cent point in 2015-16 (Figure 2.2). It continued to be close to 12 per cent of GSDP since then but for the dip in 2019-20. In the Covid-19 year of 2020-21, it reached the maximum, closer to the level reached in 2015-16. State's own revenue receipts remained above 8 per cent of GSDP from 2012-13 to 2017-18. It dropped below 8 per cent in 2018-19 and has been steadily falling. The Covid 19 year saw it fall below 7 per cent. Thus during the decade of the 2010s Kerala's own revenue receipts have dropped by 1.5 per cent points. This trend does not have much to do with the pandemic and the fall in the GSDP in 2020-21. It had begun earlier and the trend continued during the Covid 19 year.



Source: Table 2.2.

State's own revenue receipts are constituted by tax revenue and non - tax revenue with the former accounting for more than 80 per cent of the total. The tax revenue of the State (as a percent of GSDP) has steadily been falling from over 7 per cent in 2011-12 and 2012-13 to below 6 per cent by 2020-21. Till 2017-18 this fall in tax revenue was more or less made up by the increase in non-tax revenue, but since then both has been falling. And the total has also been falling steeply.

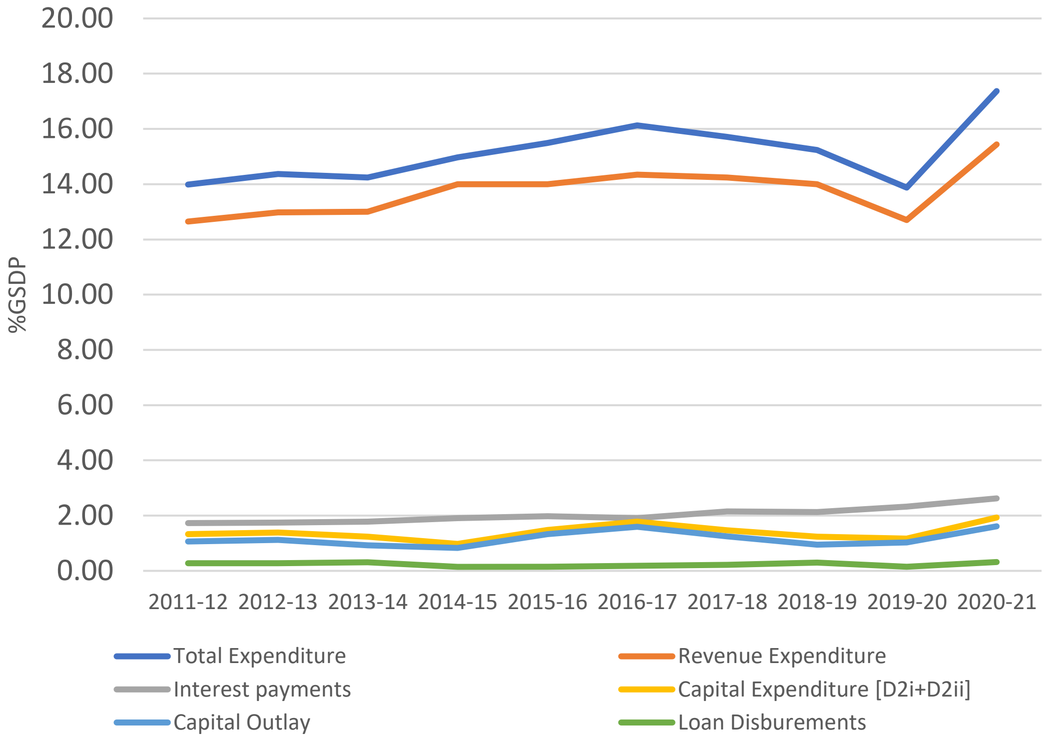
In sharp contrast is the movement of central transfers. After remaining stagnant for the first three years, it showed a sharp jump in 2015-16 and continued to remain at that level for the next four years before showing a dip in 2019-20. The next year witnessed a sharp jump to meet the Covid-19 management related expenses. 2015-16 was a turning point for both central government tax share as well as grants. Both showed a jump and continued to remain at that level for the next three years before falling in 2019-20. While tax share continued to fall in 2020-21 as well, grants moved up. The upward movement since 2015-16 was on account of the XIV Finance Commission awards and the next jump in 2020-21 was on account of XV Finance Commission awards.

Overall, the significant rise in total revenue receipts of the State during the second half of the decade is largely owing to the Finance Commission awards. The awards of tax share and grants have offset the decline in state's own revenue which has been on a steady decline for the most part of the decade.

2.2 Expenditure Trends

Total expenditure as a percentage of GSDP has shown a sharp fall in 2019-20 reaching a level below the minimum reached in 2011-12 (Figure 2.3). The sharp fall in State's own revenue receipts and also the central transfers hardly left a choice for the government but to cut the expenditure. Despite such a fall in revenue receipts capital expenditure was maintained in 2019-20 by restraining revenue expenditure. The next year saw sharp increases in capital expenditure, revenue expenditure and total expenditure as the revenue receipts increased.

Figure 2.3. Expenditure Trends in the Economy

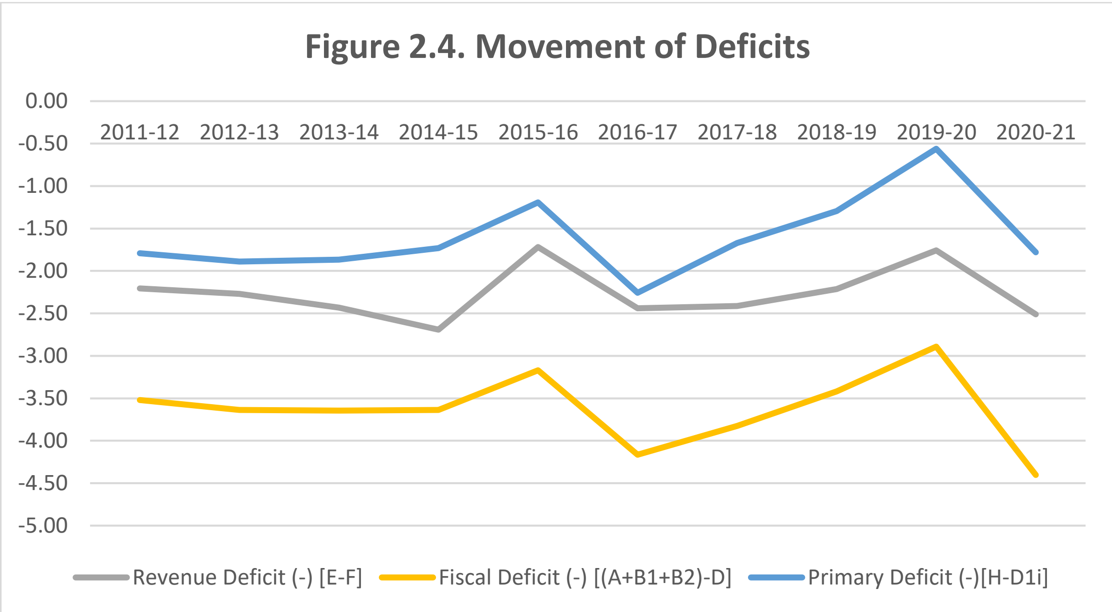


Source: Table 2.2.

Taking a longer view of the trends in expenditure it may be seen that the sharpest increase in total expenditure took place in 2016-17 with both revenue expenditure and capital expenditure rising. Since then it has gradually declined. The total expenditure trend is largely led by the revenue expenditure both rising and falling together. The residual is the capital expenditure which has remained below 1.5 per cent of GSDP most of the years in recent decades. The performance of capital expenditure peaked in 2016-17 but started coming down the next year hitting a low of 1.7 per cent of GSDP in 2019-20. But 2020-21, despite the Covid 19 year showed the best performance reaching a level of close to 2 per cent of GSDP. Capital expenditure has two components, namely capital outlay and loan disbursements, the latter hovering around 0.3 per cent of GSDP in the initial years and falling in later years. Again, the peak of loan disbursements at 0.32 per cent is reached in 2020-21. While both revenue expenditure and capital expenditure have been fluctuating, one major component of revenue expenditure, namely interest payments has been steadily rising. The increase during the last ten years has been from 1.73 per cent in 2011-12 to 2.62 per cent in 2020-21, an almost one percent point increase in nine years. If we exclude interest payments from the total expenditure, then the discretionary component of total expenditure has increased from about 12 per cent in the initial years by over one percent point over the period but such an increase has not been observed for capital expenditure. This is a disturbing aspect of the public finances of the State.

2.3 Movement of Deficits

Despite the Fiscal Responsibility and Budget Management Act and the periodic setting of targets for Revenue and Capital Deficits and Debt Kerala has not been able to bring down the revenue deficit (RD) below 2 per cent of GSDP (Figure 2.4). It is only in 2015-16, it fell below 2 per cent owing to the large central transfers that year. The large transfer was on account of the XIV Finance Commission awards. But the very next year saw it rise to the levels prevailing earlier of about 2.4 per cent to meet the Pay Commission awards the arrears of which were staggered over that year and the next.



Source: Table 2.2.

The next four years, however saw a concerted effort made to bring down the revenue deficit. It was brought down from 2.44 per cent of GSDP in 2016-17 to 1.76 per cent in 2019-20, reflecting a conscious effort of fiscal consolidation. But Covid 19 scuttled such an effort as the RD doubled in 2020-21. The fiscal deficit (FD) too remained high, above 3.5 per cent of GSDP, in the initial years of the decade and peaking in 2016-17. But the conscious effort of fiscal consolidation was able to bring it down in the subsequent years. It reached below 3 per cent in 2019-20. Again the Covid 19 put a stop to the fiscal consolidation journey, which now has to re-begin after the scars of the pandemic are erased.

2.4 The Debt Build Up

The fall in revenue receipts and the reduction in borrowings and liabilities in 2019-20 had not resulted in the usual squeezing of capital expenditure. The capital expenditure was, in fact, maintained at the previous year's level by exercising a tight control on revenue expenditure. Capital outlay (as a proportion of GSDP) saw a rise of 0.09 percent point in that year. The next year, despite the impact of Covid 19 and the resultant massive rise in revenue expenditure (of Rs 19,000 crore), witnessed the capital expenditure rise by (Rs 6,000 crore) 50 per cent which is what Keynesian theory would advocate in a crisis year. This was a huge increase in capital outlay (as a proportion of GSDP) from 1.03 per cent in 2019-20 to 1.61 per cent in 2020-21. This thrust on capital outlay was showing the government's commitment to fill the large infrastructure deficit of the State. The Central government's emphasis on capital spending in the Covid 19 year too helped the State.

The stable capital expenditure in 2019-20 and the large increase in 2020-21 in the face of running revenue deficits meant rising debt of the State. Debt that increased by around Rs 25,000 crore in 2019-20 went up by over Rs 35,000 crore in 2020-21. As a proportion of GSDP, debt became 31.58 per cent in 2019-20 and 37.23 per cent in 2020-21. These are huge increases scuttling the fiscal consolidation path by large margins. It would take great efforts in the coming years to return to the path of consolidation.

It may be instructive here to take a look at the debt path of the last ten years. Debt was hovering around 25 per cent of GSDP in the initial years of the last decade. It rose by around one percentage point in 2014-15 and another 1.5 percentage point in 2015-16. Compared to the 2.5 percentage points in these two years, despite the large payout on account of the Pay Commission awards in 2016-17 and 2017-18 the debt went up by only around 2 percentage points. Further, this ratio was maintained till 2018-19. It was the special circumstances of 2019-20 and the crisis of 2020-21 which pushed the debt to the highs of 30s.

Chapter 3
State's Own Tax Revenue

3.1 The Components of SOTR

The State's Own Tax Revenue (SOTR) of Kerala comes from Goods and Services Tax, Sales Tax & Value Added Tax, Excise Duty, Motor Vehicles Tax, Stamp Duty and Registration and others. The 'others' comprise of Agricultural Income Tax, Land Revenue, taxes on property other than agricultural land, tax on goods and passengers, taxes and duties on electricity and other taxes and duties.

The sales tax, after the introduction of GST, covers tax from the sale of petroleum crude, high speed diesel, motor spirit (petrol), aviation turbine fuel and alcoholic liquor for human consumption. Currently, the value added tax falls only on natural gas.

State's Own Tax Revenue in 2019-20 is the same as that in the previous year reflecting the poor GSDP growth in the year (Table 3.1). Almost all the seven components of SOTR have also showed the revenue for 2019-20 to be almost the same as that in the previous year. In the Covid 19 year of 2020-21, GST revenue remained almost the same as the previous year but Sales Tax/VAT fell by Rs 2,000 crore and motor vehicles tax by Rs 400 crore. The other components too showed minor falls and the total fell by close to Rs 3,000 crore. The more or less similar fall in all the components of SOTR resulted in the share of each remaining the same as the previous year (Table 3.2).

Turning to the long-term trend of SOTR, it may be seen that after the high growth in 2012-13, the annual increase has been around Rs 3000 crore till 2016-17. The next two years saw increases of Rs 4000 crore each. Then came the stagnation of 2019-20 and the fall in 2020-21. In the net, the nine-year period hardly recorded a doubling of the own tax revenue. Similar was the trend in almost all the components, except Sales Tax/VAT/GST and motor vehicles tax. Some components hardly showed an increase during this long period, for example excise duty (Table 3.1).

Among the seven components of SOTR, the Sales Tax/VAT/GST accounted for close to 80 per cent of the total. When GST was introduced in 2017 it could be seen that it accounted for slightly more than the share of Sales Tax/VAT, with each accounting for around 40 per cent. The only component of SOTR which showed a steady rise in the share was motor vehicles tax. Steady fall was recorded in stamp duty and registration (Table 3.2).

It is, however, instructive to analyse the trends in the component of tax as a ratio of GSDP. It may be seen from Figure 3.1 that SOTR has steadily fallen from above 7 per cent in 2011-12 to below 6 per cent in 2020-21. It was expected that there would be a sharp drop in 2017-18 if GST was making a major difference, or a drop in 2020-21 because of Covid 19. But the graph shows no such dips; it is more of a continuous fall. Obviously, there are deep rooted

Table 3.1: Trends in States Own Tax Revenue: 2011-12 to 2020-21 (Rs crore)

No.	Item	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017- 18	2018- 19	2019-20	2020-21
1	Goods and Services Tax*							12008	21015	20446	20028
2	Sales Tax/VAT	18939	22511	24885	27908	30737	33453	24578	19226	19650	17689
3	Excise Duty	1883	2314	1942	1777	1964	2019	2240	2521	2255	2329
4	Motor Vehicle Tax	1587	1925	2161	2365	2814	3107	3663	3709	3721	3386
5	Stamp Duty and Registration	2987	2938	2593	2659	2878	3007	3453	3693	3615	3490
6	Others**	323	389	414	523	602	590	518	480	636	738
7	Total (SOTR) (1 to 6)	25719	30077	31995	35232	38995	42176	46460	50644	50323	47661
8	GSDP	364048	412313	465041	512564	561994	634886	701588	788286	824374	799571

*** GST was implemented w.e.f 1 July 2017. Hence the GST revenue for 2017-18 is for 9 months only**

**** Others consist of (i)Taxes on Agricultural Income, (ii) Land Revenue (iii) Other taxes on property other than agricultural Land (iv) Taxes on goods and Passengers (v) Taxes and duties on electricity and (vi) other taxes and duties**

Source: Finance Accounts of C &AG of the respective years and Budget in Brief, GoK

Table 3.2: Trends in States Own Tax Revenue: 2011-12 to 2020-21 (Share on Total)

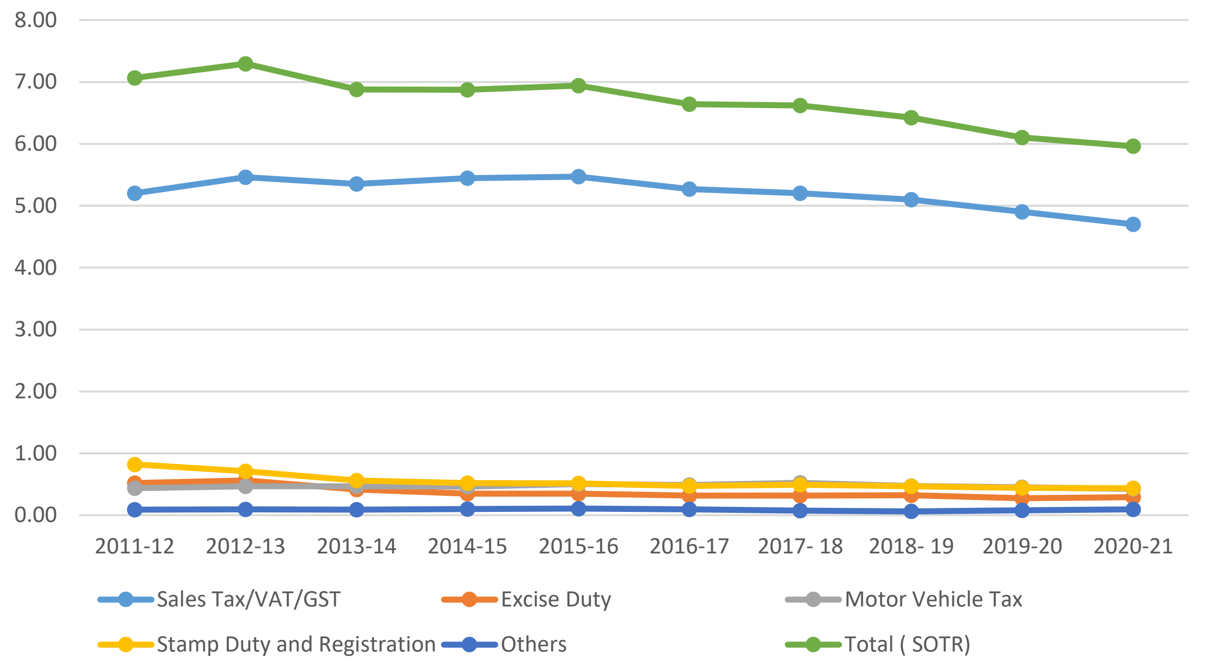
No.	Item	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017- 18	2018- 19	2019-20	2020-21
1	Goods and Services Tax*							25.85	41.49	40.63	42.02
2	Sales Tax/VAT	73.64	74.84	77.78	79.21	78.82	79.32	52.90	37.96	39.05	37.11
3	Excise Duty	7.32	7.69	6.07	5.04	5.04	4.79	4.82	4.98	4.48	4.89
4	Motor Vehicle Tax	6.17	6.40	6.75	6.71	7.22	7.37	7.88	7.32	7.39	7.10
5	Stamp Duty and Registration	11.61	9.77	8.10	7.55	7.38	7.13	7.43	7.29	7.18	7.32
6	Others**	1.26	1.29	1.29	1.48	1.54	1.40	1.12	0.95	1.26	1.55
7	Total (SOTR) (1 to 6)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Same as Table 3.1
Notes: Same as Table 3.1

structural reasons which were affecting resource mobilization in the state economy. This gets further confirmed when we look at the components of SOTR.

The major component of SOTR, namely Sales Tax/VAT/GST shows a trend very similar to that of SOTR. It is a smooth fall all the way with no sharp dip or abrupt rise despite many major events taking place during these years. The trends of the other components are no different. The simultaneous fall in all the components, except motor vehicles tax, definitely suggests deep rooted factors affecting the economy of the State.

Figure 3.1 Trends in the Components of SOTR (%GSDP)



Source: Table 3.1.
Notes: Others consist of (i) Taxes on Agricultural Income, (ii) Land Revenue (iii) Other taxes on property other than agricultural Land (iv) Taxes on goods and Passengers

3.2 The Components of GST

Since GST contributes more than 40 percent of the SOTR, this chapter takes up a detailed discussion of the sub-components of GST. The GST revenue of Kerala comprises of:

(a) **State Goods and Services Tax (SGST)** – the taxes from intra-state (within the state) supply of goods and services remitted to the Government of Kerala by the registered persons after utilizing the eligible input tax credits of SGST on intra-state inward supply (if any) and the balance (if any) paid in cash.

(b) **(i)Integrated Goods and Services Tax (IGST) through the settlement from Central Government on B2B (registered person to registered person) inter-state supply inwards** - SGST (State GST) output tax on all the intra-state supply outward (goods/services or both) remitted by the registered person after utilising the eligible input tax credits of IGST on inter-state inward supply or from IGST of imports made by him/her (Section 18 of the IGST Act 2017). The IGST input tax credits so utilised by the registered persons will be transferred to State Government from the IGST Account maintained by the Government of India.

(ii) Integrated Goods and Services Tax (IGST) through the settlement from Central Government on other than B2B intra-state supply inwards - Share (50%) of the IGST on all Inter-state supply inward of goods/services or both in eight different situations mentioned in section 17 of the IGST Act 2017.

(c) Compensation Cess – If the revenue from (a) +(b) mentioned above of a State does not achieve the yearly projected growth rate of 14 percent (with the base year of 2015-16), then the revenue gap is compensated by Government of India as per the Goods and Services Tax (Compensation to States) Act 2017 for five years i.e., till June 2022. This amount is transferred to states under the head of Grants-in-aid from the Government of India.

There is not much confusion as regards (a) and (c) above. But (b) is not easy to understand and the available database does not help us derive the tax due and the amount paid to the State. Hence, an attempt is made to illustrate with certain assumptions and therefore needs to be taken with much caution.

3.3 Revenue flow through IGST to the State

The working of the supply chain of inter-state transactions and the flow of tax revenue under IGST is depicted in three tables (Tables 3.3, 3.4 & 3.5) assuming for simplicity that the supply of goods is from Tamil Nadu into Kerala and the final sale is in Kerala.

It is assumed that in the inter-state supply of goods, the value addition within Kerala is not more than 20 percent of the value addition occurs within Kerala of the goods sold here. It means that the tax on 80 percent of the goods or services supplied to Kerala would reach the Kerala treasury through the IGST route i.e., monthly settlement from the Government of India. The calculations of Tables 3.3 to 3.5 show the same. The three tables map the flow of GST revenue from the sale of raw materials, goods manufactured in Tamil Nadu and subsequent sale to Kerala.

Table 3.3 Tamil Nadu

1. Raw Material Supplier (First Registered Person)

No.	Particulars	Rs.
1	Raw materials	500.0
2	Expenses & Profits/losses (value added)	300.0
3	Total	800.0
4	Central GST (2.5 %) *(Output Tax)*	20.0
5	State GST (2.5 %) *(Output Tax)*	20.0
6	Sale Value [3+4+5]	840.0
7	Remittance to Central Govt. **CGST (cash)**	20.0
8	Remittance to TN Govt. **SGST (Cash)**	20.0

The registered person (purchaser) of the purchasing state (Kerala) has to pay the full IGST to the Supplier of the selling state (Tamil Nadu). The registered person of Kerala will subsequently utilize the credit of IGST after supplying the goods/service within Kerala for paying the amount of CGST and SGST (Table 3.4). The IGST input tax availed for paying the SGST amount will be transferred to Kerala from the IGST account maintained by the Government of India as per the credit utilization provisions of the GST laws. The GSTN system by default settles the IGST utilization against the CGST first followed by that against the SGST of the respective state.

Table 3.4 - Tamil Nadu		
2. Manufacturer (Second Registered Person)		
No.	**Particulars**	**Rs.**
1	Purchases (Basic Price)	800.0
2	Central GST (2.5%) *(Input Tax)*	20.0
3	State GST (2.5 %) *(Input Tax)*	20.0
4	Purchase Value *(without tax)*	800.0
5	Expenses & Profits / losses (value added)	500.0
6	Total [4+5]	1300.0
7	IGST 18 % *(output tax)*	234.0
8	**Sale to Kerala [6+7]**	1534.0
9	Remittance to IGST A/C (cash)	194.0
10	Remittance to IGST A/c from CGST A/C (Credit)	20.0
11	Remittance to IGST A/c from TN GST A/C (Credit)	20.0

Table 3.5 -Kerala		
3. Kerala Registered Person		
No.	**Particulars**	***Rs.***
1	Purchases (Basic Price)	1300.0
2	IGST 18 % (Input Tax)	234.0
4	Purchase value	1300.0
5	Expenses & Profits / losses (value added) (20% Value Addition in Kerala)	200.0
6	Total	1500.0
7	Central GST (9 %) (Output Tax)	135.0
8	State GST (9%) (Output Tax)	135.0
9	Sale Value [6+7+ 8]	1770.0
10	Remittance to Central GST A/C from IGST A/C (Credit)	135.0
11	Remittance to Central GST A/C (cash)	0
	Remittance to (Kerala) State GST A/C from IGST A/C (Credit) IGST Settlement to Kerala from Govt. of India	**99**
10	Remittance to Kerala GST A/C (cash) SGST Remittance to Kerala	**36**

It is evident from Tables 3.4 and 3.5 that IGST a/c gets Rs. 234 as the goods leave Tamil Nadu for Kerala. After the value addition of Rs 200 in Kerala when it is sold by the trader in Kerala the consumer pays tax of Rs 270 (18% of 1500). The trader collects it but remits only Rs 36 to the Kerala SGST a/c as he has already paid Rs 234 to the Tamil Nadu seller (Table 3.5). Out of the Rs 234 in the IGST a/c, the CGST a/c receives Rs. 135 (9% of 1500) as its share leaving Rs 99 which should ideally go to the GST a/c of Kerala. Whether it goes to Kerala depends on the proper filing of returns by all the parties concerned.

As is well known, Kerala is a consumer state with an estimated import of about 1.5 Lakh Crore per annum (Sushil Khanna, 2020). Hence, a destination-based GST was welcomed by Kerala with great expectations. As we have illustrated above how IGST has been designed and implemented in the country is such that it doesn't provide any room for benefitting a consumer state like Kerala.

The committee based on certain assumptions regarding value addition within the state and the return filing behaviour of traders estimated the gross loss on account of IGST from 1-7-2017 to till date could be about Rs. 20,000 to Rs.25,000 crore. The net loss would be considerably lower if we account for GST compensation availed by the state till June 2022. With the cessation of GST Compensation, the loss could be higher in the years to come. This is because the design and implementation of GST is such that much of its advantages go to the producing states with higher production than consumption.

The committee is of the view that the gains from GST to a state like Kerala will accrue if and only if the principle of destination-based consumption tax becomes operational through the disaggregated and transparent system of the IGST settlement mechanism. As of now, this system works towards revenue loss through IGST which should addressed sooner rather than later.

The State Government is constrained by the lack of detailed and disaggregated data on the functioning of the IGST clearing mechanism that stands in the way of the state Government monitoring of the tax revenue.

To articulate Kerala's case in an informed manner, the Committee recommends the Government of Kerala to commission a detailed study that should examine, among others, the following.

1. IGST paid on Inter-State Supply inward (Eligible Input Tax only) is utilised to pay the SGST Output Tax on intra-state supply outwards made by the Registered Person in Kerala [Section 18(c) of IGST Act 2017];

2. IGST paid on imports (Eligible Input Tax only) is utilised to pay the SGST Output Tax on intra State supply outwards made by the Registered Person in Kerala [Section 18(c) of IGST Act 2017];

3. IGST paid on Inter-state supply inwards to Kerala made by an unregistered person [Section 17 (1)(a) of IGST Act 2017];
4. IGST paid on Inter-state supply inwards to Kerala made by a composition scheme registered person [Section 17 (1)(a) of IGST Act 2017];
5. IGST paid on Inter-state supply inwards to Kerala made by a registered person not eligible to input tax credit [Section 17 (1)(b) of IGST Act 2017];
6. IGST paid on Inter-state supply inwards to Kerala made by a registered person who does not avail the eligible Input Tax Credit within a Specified Period and expires after it the prescribed time limit [Section 17 (1)(c) of IGST Act 2017];
7. IGST paid on imports to Kerala made by an unregistered person [Section 17 (1)(d) of IGST Act 2017];
8. IGST paid on imports to Kerala made by a composition scheme registered person [Section 17 (1)(d) of IGST Act 2017];
9. IGST paid on imports to Kerala made by a registered person not eligible to input tax credit [Section 17 (1)(e) of IGST Act 2017];
10. IGST paid on imports to Kerala made by a registered person who does not avail the eligible Input Tax Credit within a Specified Period and expires after it the prescribed time limit [Section 17 (1)(f) of IGST Act 2017];
11. Supplier (Taxable person) (Origin State) are identifiable but Place of Supply (Destination state) are not identifiable - State's IGST portion transferred to all states based on proportion taxes collected by the States as SGST during the immediately preceding financial year [Second Proviso of Section 17(2) of IGST Act 2017]; and
12. Supplier (Taxable person) (Origin State) are not identifiable - State's IGST portion transferred to all based on proportion taxes collected by the States as SGST during the immediately preceding financial year [Second Proviso of Section 17(2) of IGST Act 2017]

It is to be noted that even after many years of its introduction in countries like Canada, GST is said to be in work in progress. Hence the observed issues related to IGST need to be seen in this context. The Committee is of the view that the issue could be resolved by the collective action of consumer states like Kerala with the GST Council and the Central Government.

Chapter 4
Patterns of Expenditure

4.1 Size of Government: The Theory

Adolph Wagner, the German economist, conducted an in-depth study of the rise in government expenditure in the late 19th century, called "the law of increasing state activity". Wagner's hypothesis states that "as the output of the economy increases over time, the activities and functions of the government increase", which include the increase in revenue and expenditure of the state; refers to the income and expenditure of the state a consequence of higher output than the cause (Wagner 1883). Peacock and Wiseman studied public spending from 1891 to 1955 in the United Kingdom and found that Wagner's hypothesis is still valid (Peacock and Wiseman 1979). Peacock and Wiseman stated, "The rise in public expenditure greatly depends on revenue collection. Over the years, economic development results in substantial revenue to the governments, enabling an increase in public expenditure". Also, they found that "there exists a gap between the expectations of the people about public expenditure and the tolerance level of taxation. Therefore, governments cannot ignore the demands made by people regarding various services, especially when the revenue collection is increasing at a constant rate of taxation. They further stated that during times of war, the government increases the tax rates and enlarges the tax structure to generate more funds to meet the increase in defence expenditure. After the war, the new tax rates and structure may remain the same as people get used to them. Therefore, the increase in revenue results in a rise in government expenditure.

Both hypotheses emphasize that public spending tends to increase over time, i.e. government expenditure increases due to the growth of the state's output. The consequential neutrality perhaps due to the economy is always at full employment, wage rates and interest rates self-adjust, and the budget should always balance since savings always equal investment, which is a classical economists' presumption. In contrast, Keynes is of the view that state activity drives the growth of the economy (Keynes 1936). That is, expenditure is a cause of the growth of the economy. Keynes thought that the government needed to step in to treat depression temporarily. Saving more won't help; spending will. Government expenditure will rise, providing people more purchasing power and encouraging manufacturers to produce more, which will lead to more jobs being created. This multiplier effect demonstrates the link between governmental spending and national revenue. Given the two opposing views on public finance and its rationalisation based on a rule based fiscal management begs a careful evaluation of state financing over the period.

4.2 The Drivers of Expenditure

To understand whether expenditure growth is *a la* Wagner, we need to examine the trend in terms of GSDP. It is clear from Table 2.1 of Chapter 2 that the expenditure increases during a normal expansion of the economy but falls in abnormal economic situations. After the demonetisation, the total expenditure started to fall, but the fall was much evident since 2018-19. The great deluge in the state, especially the central and southern parts of Kerala devastated the entire economy for a while due to an unprecedented spread and volume of flood. In order to rebuild Kerala, it demanded a higher expenditure but in the post deluge scenario, the state's own tax revenue had stagnated from its natural growth, which curbed the spending to grow at a larger pace. The Covid19 pandemic subsequently added to the slower growth of receipts and expenditures.

The testing of expenditure growth *a la* Wagner is a difficult exercise in the Kerala context as the periodic revision of salary and pension based on Pay Commission awards adds a new dimension to it. The three major components of revenue expenditure are Salary, Interest and Pension, together forming a total of Rs. 67,646 crores during 2020-21 (Table 4.1), and it accounted for 62.14 per cent of the total revenue expenditure of the year (Table. 4.2). The ten year (2011-12 - 2020-21) average expenditures are on Salary 30.22, Pension 17.77, and Interest payment 14.75 per cent respectively. The components of Salary and Pension growth are interestingly falling whereas the interest payment is increasing, which demands a careful evaluation.

There is a conceptual problem in comparing the time series of proportion of salary and pension in total expenditure as the denominator increases because of the increase in the numerator. The more apt comparison, hence, would be salary and pension as a proportion of total revenue receipts. Before attempting such a comparison, a careful look at the absolute value of salary and pension payments shown in Table 4.1, suggest that till 2015-16 there was only a gradual increase in both. In 2016-17 there was, however, a quantum jump and again a similar jump the next year as the Commission awards were staggered over these two years. The next award was in 2021-22 (which this report does not cover). Hence, the period from 2017-18 to 2020-21 is not expected to show much of an increase in salary and Pension. The next large increase will occur in 2021-22.

Table: 4.1
Trends in Salary, Interest, Pension, 2011-12 to 2020-21 (Rs crore)

Year	Salary	Interest	Pension	Total	Revenue Expenditure	Revenue Receipts
2011-12	16029	6294	8700	31023	46045	38010
2012-13	17257	7205	8867	33329	53489	44137
2013-14	19280	8265	9971	37516	60486	49177
2014-15	21334	9770	11253	42357	71746	57950
2015-16	23450	11111	13063	47624	78690	69033
2016-17	27954	12117	15277	55348	91096	75612
2017-18	31802	15120	19938	66860	99948	83020
2018-19	31406	16748	19012	67166	110316	92854
2019-20	31676	19215	19064	69955	104720	90225
2020-21	27728	20975	18943	67646	123446	97617

Source: Finance Accounts of C &AG of the respective years

The trend in the share of salary, interest and pension in total revenue receipts is unmistakable as is shown in Table 4.2. It comes down from the high of 2011-12 during the next four years and reaches 69 per cent. Then there is a jump of four per cent points in the next year followed by a jump of over seven percentage points in the succeeding year and it is back to the peak reached in 2011-12. The slide begins the next year and it has reached 69 per cent in 2020-21. A sharp escalation is expected in 2021-22. The cyclical pattern engineered by the Pay Commission awards does not leave any room for any other analysis as it over rides all other patterns in the data.

Table: 4.2
Percentage Share of Salary, Pension and Interest Payment to Revenue Expenditure and Receipt

Year	Percentage on Revenue Expenditure				Percentage on Revenue Receipt			
	Salary	Interest	Pension	Total	Salary	Interest	Pension	Total
2011-12	34.81	13.67	18.89	67.38	42.17	16.56	22.89	81.62
2012-13	32.26	13.47	16.58	62.31	39.10	16.32	20.09	75.51
2013-14	31.88	13.66	16.48	62.02	39.21	16.81	20.28	76.29
2014-15	29.74	13.62	15.68	59.04	36.81	16.86	19.42	73.09
2015-16	29.80	14.12	16.60	60.52	33.97	16.10	18.92	68.99
2016-17	30.69	13.30	16.77	60.76	36.97	16.03	20.20	73.20
2017-18	31.82	15.13	19.95	66.89	38.31	18.21	24.02	80.53
2018-19	28.47	15.18	17.23	60.89	33.82	18.04	20.48	72.34
2019-20	30.25	18.35	18.20	66.80	35.11	21.30	21.13	77.53
2020-21	22.46	16.99	15.35	54.80	28.40	21.49	19.41	69.30

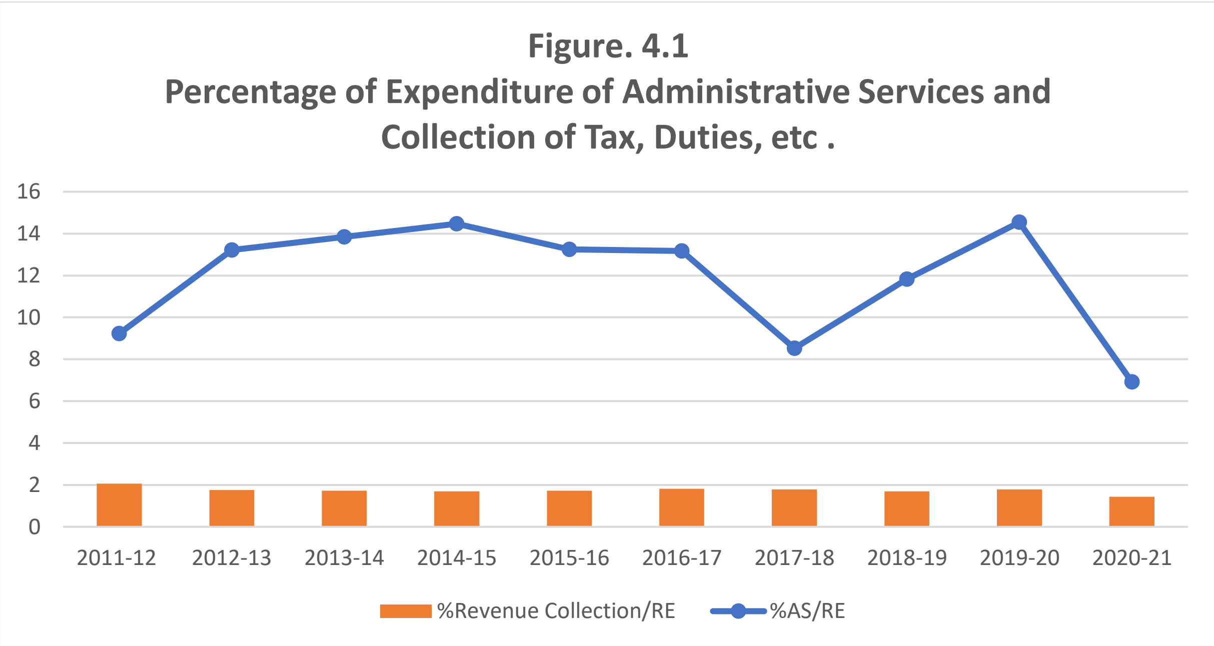
Source: Finance Accounts of C &AG of the respective years

The same Pay Commission award affects individual departmental expenditure too as may be seen in Table 4.3. The revenue expenditure the state incurs in the administrative services, which includes general administration, parliament and state legislature, administration of justice, jails, police and vigilance, and miscellaneous departments also show the steep increases in 2016-17 and 2017-18 when the XI Pay Commission awards were implemented. Due to demonetisation, the expenditure in 2017-18 dropped considerably and was restored to the original expenditure parity in 2019-2020. The Covid19 situation brought the expenditure to 6.9 per cent, an all-time low since 2011-12 (Figure 4.1). The spending on the collection of taxes, duties, etc. shows a secular decline over the period, which shows that a tightening of expenditure as warranted elsewhere in the wake of decreased revenue.

Table: 4.3 Component Wise Major Administrative Expenditure 2011-12 to 2020-21 (Rs crore)									
1	**2**	**3**	**4**	**5**	**6**	**7**	**8 (2 to 7)**	**9**	**10**
Year	**GA**	**P&L**	**AJ**	**JS**	**P&V**	**MD**	**AS**	**CTD**	**RE**
2011-12	787.88	164.74	384.11	64.65	1721.09	1126.99	4249.47	947.85	46045
2012-13	799.28	123.62	487.15	79.58	2070.44	3505.71	7065.78	936.01	53489
2013-14	950.87	222.07	542.45	91.57	2340.05	4827.83	8374.84	1046.54	60486
2014-15	1051.27	250.52	616.41	102.96	2636.92	5725.47	10383.55	1213.48	71746
2015-16	1091.49	250.52	616.41	102.96	2636.92	5725.47	10423.78	1361.24	78690
2016-17	1305.80	251.70	703.4	120.51	3188.03	6421.27	11990.71	1651.58	91096
2017-18	1421.04	188.10	801.31	136.62	3585.68	2384.14	8516.88	1792.10	99948
2018-19	1518.47	206.05	858.00	145.12	3653.10	6663.09	13043.83	1868.67	110316
2019-20	1494.32	338.76	892.94	139.44	3610.13	8747.43	15223.03	1866.02	104720
2020-21	1373.37	466.63	826.74	154.35	3327.23	2390.27	8538.6	1774.35	123446

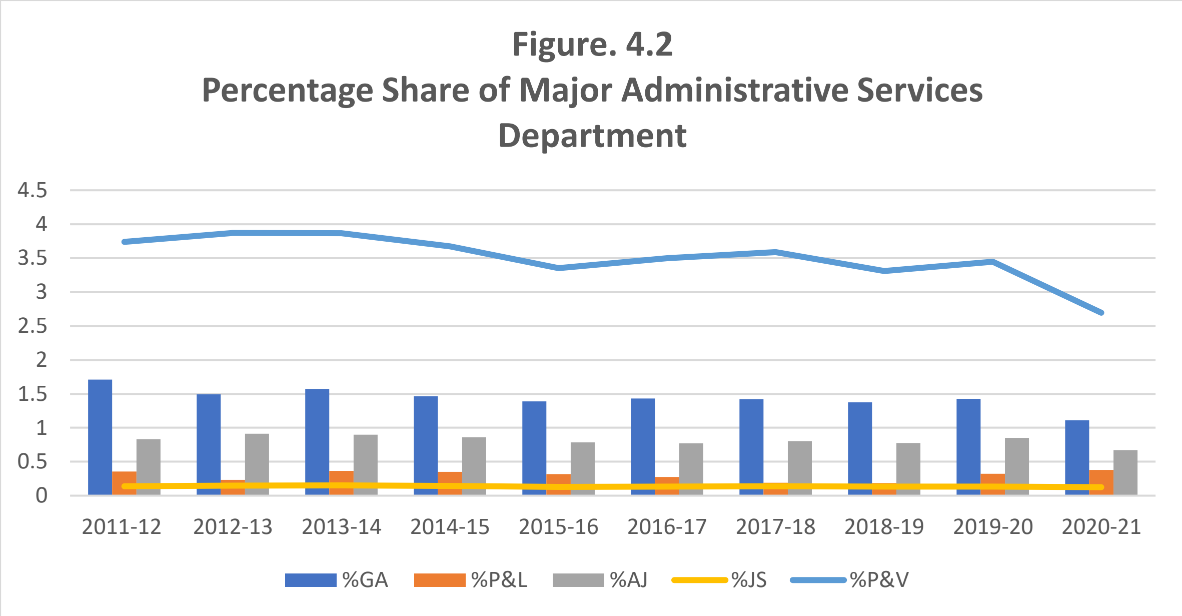
GA=General Administration, P&L=Parliament and Legislature, AJ=Administration of Justice, JS=Jails, P&V=Police and Vigilance, MD=Miscellaneous Departments, AS=Administrative Services, CTD=Collection of Taxes, Duties, Etc., and RE=Total Revenue Expenditure

Source: *Finance Accounts of C &AG of the respective years and Budget in Brief, GoK*



Source: *Finance Accounts of C &AG of the respective years and Budget in Brief, GoK*

The head wise share of administrative services expenditure needs some attention to understand the contribution of the fall (Figure. 4.2). It is a common notion that the policing expenses of the state is increasing over the years. Nonetheless, the expenditure share of police and vigilance (%P&V) is falling, and the same is the case with general administration (GA) and Jails (JS). The expenditure on the administration of justice is oscillating, but the spending on parliament and legislature shows a marginal increase in the last few years. The sum of falls in the administrative services contributed by the fall in expenditure in the miscellaneous departments (Table. 4.3).



GA=General Administration, P&L=Parliament and Legislature, AJ=Administration of Justice, JS=Jails, and P&V=Police and Vigilance

Source: *Finance Accounts of C &AG of the respective years and Budget in Brief, GoK*

The important observation from the graph and elsewhere, the expenditure in the state is proportionally linked with the revenue of the state, though spending is greater than the revenue. A sustainable mechanism of bridging the gap between expenditure in accordance with income is the need of having a prudent financial management. Though Covid19 had adversely affected the income of the state there is a possibility of tightening the expenditure in the administrative and other fronts, specifically possible through the all miscellaneous departments. At the same time, the periodic revision of payments through pay commission recommendation increase the burden of the economy without due priority of whether it is a lean or fat year. The size of the government and expenditure theory hence validate that as the economy get bigger, its expenditure too increase. Hence, the increased expenditure and revenue, though having mismatch, is in congruent of what Peacock and Wiseman pointed or a la Wagner.

Chapter 5

Debt Management

It was argued until the Keynesian revolution (1936) that Budget deficits and accumulation of debt would lead to bankruptcy of the government. With the advent of Keynesian economics, budget deficits were considered essential for macro stabilisation. Domar (1944) claimed that even if the government mobilises its expenditure through borrowing, the public debt and the proportion of debt to GDP could be stable in the long run provided the growth rate of the output of the economy exceeds interest rate. This understanding guides the discussion of the chapter that deals with the debt management aspects of Kerala economy as mandated by the Fiscal Responsibility Act, 2003. The chapter examines whether the debt and interest payments met the targets set by the XIV Finance Commission. For this purpose, the structural distribution of debt, its growth and composition, and interest payments is examined for the period 2011-12 to 2020-21. The decomposition exercise of the total interest payments in terms of volume of debt and price or effective rate of interest is examined. Such an exercise has been carried out to analyse the cost of borrowings through different instruments. An attempt has also been made to analyse the sustainability of state finance, the impact of cost of finance with the repo rate going up and its implications on the budget deficits with the theoretical insights given above.

5.1 Structure, Growth and Composition of Debt

The following section analyses the debt composition and its growth pattern. The total debt is defined as the sum of internal debt, loans and advances from the central government and public account which includes small savings, Provident fund etc. As already observed in Chapter 2, Kerala economy raised resources through loans from the Centre in order to meet the expenditure during Covid 19 crisis in 2020-21(Table 5.1). The debt mobilized from the Centre grew by 72.5 per cent from Rs. 8,680 crore in 2019-20 to Rs. 14,973 crore in 2020-21. And thus the total debt during the Covid 19 year 2020-21 witnessed an increase of 16.27 per cent and the debt outstanding reached Rs. 2,96,901crore (Table 5.1). The debt to GSDP ratio in 2020-21 stood at 37.13 per cent which is extremely high as compared to the level of 25 per cent set by the XIV Finance Commission.

Table 5.1: Growth of Public Debt of Kerala, 2011-12 to 2020-21 (Rs crore)

Year	Internal Debt				PF	Total Debt	GSDP	Debt/GSDP %
	Debt	Of which Market loan	*of which NSSF*	*Loans from the Centre*	Small Savings			
2011-12	55397	38239	11290	6396	27625	89418	364048	24.56
2012-13	65628	48810	11323	6622	31311	103561	412313	25.12
2013-14	76804	60183	11281	6662	35543	119009	465041	25.59
2014-15	89068	71960	11806	7065	39307	135440	512564	26.42
2015-16	102496	84846	12537	7235	47639	157370	561994	28.00
2016-17	118269	99532	13509	7614	60571	186454	634886	29.37
2017-18	135500	115735	14557	7484	67777	210761	701588	30.04
2018-19	150991	129719	15608	7243	77397	235631	788286	29.89
2019-20	165960	142336	17396	8680	85671	260311	824374	31.58
2020-21	190474	165402	19833	14973	97219	296901	799571	37.13

Source: Source: Finance Accounts, Volume 1, various issues; Table 2.1, Chapter 2.

Further, Table 5.1 reveals that the total debt in the fiscal year ending March 2011-12 was Rs. 89,418 crore which has increased to Rs 260311 crore in 2019-20, just before the year of Covid 19. It is further observed that, the total debt during 2016-17 has sharply increased from Rs.157370 crore to Rs. 186454 as the arrears of salary and pension as part of the pay commission award was disbursed during the year. The major component of this incremental growth in debt has come from the provident funds. The rate of growth of debt mobilized from provident funds for that particular year grew at the rate of 27% as compared to the total debt growth of 18 per cent (Table 5.1). While the borrowing from the provident funds grew at the rate of 15.32 per cent during 2011-12 to 2019-20, the market borrowing grew with an annual average growth of 17.98 per cent during 2011-12 to 2019-20. Thus, salary arrears flow into the provident fund accounts of employees as book entries. And from 2017-18 they also get counted in the total borrowing of the state.

Table 5.2: Distribution of Debt by Components (%)

	Internal Debt	of which Market loan	*of which NSSF*	Loans from the centre	PF and Small savings	Total Debt	IP/RR
2011-12	61.95	42.76	12.63	7.15	30.89	100	16.54
2012-13	63.37	47.13	10.93	6.39	30.23	100	16.31
2013-14	64.54	50.57	9.48	5.60	29.87	100	16.85
2014-15	65.76	53.13	8.72	5.22	29.02	100	16.87
2015-16	65.13	53.91	7.97	4.60	30.27	100	16.07
2016-17	63.43	53.38	7.25	4.08	32.49	100	16.00
2017-18	64.29	54.91	6.91	3.55	32.16	100	18.18
2018-19	64.08	55.05	6.62	3.07	32.85	100	18.18
2019-20	63.75	54.68	6.68	3.33	32.91	100	21.24
2020-21	62.93	54.65	6.55	4.95	32.12	100	21.28

Source: Finance Accounts, vol.1, various issues; IP=Interest Payments; RR=Revenue Receipt.

The distribution of the debt components of Table 5.2 reveals that the debt is mainly mobilized through internal sources as on 2011-12 (61.95%) and through public accounts (30.89%) such as small savings and provident funds (Table 5.3). The share of internal borrowings especially through market borrowings had increased from 42.76 to 54.68 during 2011-12 to 2019-20 (Table 5.2). It is noted that the share of debt mobilized through public funds has increased to the level of 32.49% during 2016-17 and such mobilization was done for the purpose of disbursing arrears of salary and pension.

5.2. Trends and Pattern of Interest payments

Subsequently the interest payment has also increased from the level of Rs. 6288.65 crore to Rs. 12096 crore during 2011-12 to 2016-17 and then increased significantly to Rs.19161 crore during 2019-20, following the year which was hit by flood. The average annual rate of growth of interest payments during 2011-12 to 2019-20 was 15 per cent. The rate of growth of interest payment during 2016-17 has jumped to 24.8 per cent from 9 per cent as on 2015-16. However, the large component of the interest payment is used for the purpose of paying back the interest of market borrowings. The share of interest payment to the market borrowings has increased from the level of 65.39 per cent to 68 per cent during 2011-12 to 2019-20 whereas the share of provident funds has increased from 28 per cent to 31 per cent during the corresponding year. Now let us see how the implementation of new pay revision has had an impact on the interest payment during 2016-17 to 2019-20 and on the cost of finance (Table 5.3).

Table 5.3: Composition of Interest Payments

Percentage share of Interest Payments							
Year	Internal Debt	of which Market Loans	*of which NSSF*	*Loans from the Centre*	PF Small Savings	Total Interest Payments	Interest Payments (Cr)
2011-12	65.39	39.51	18.08	6.67	27.94	100	6288.654
2012-13	67.52	45.78	15.13	5.55	26.92	100	7199.246
2013-14	69.67	51.12	13.18	4.67	25.66	100	8281.106
2014-15	71.09	55.43	11.13	3.59	25.32	100	9775.825
2015-16	72.32	58.09	10.24	3.02	24.65	100	11093.01
2016-17	75.08	62.46	9.10	2.77	22.15	100	12096.01
2017-18	70.37	58.46	9.25	2.09	27.54	100	15095.69
2018-19	69.68	59.22	8.20	1.92	28.40	100	16879.45
2019-20	67.65	58.24	7.45	1.63	30.72	100	19160.99
2020-21	68.01	58.76	7.61	1.37	30.62	100	20769.12

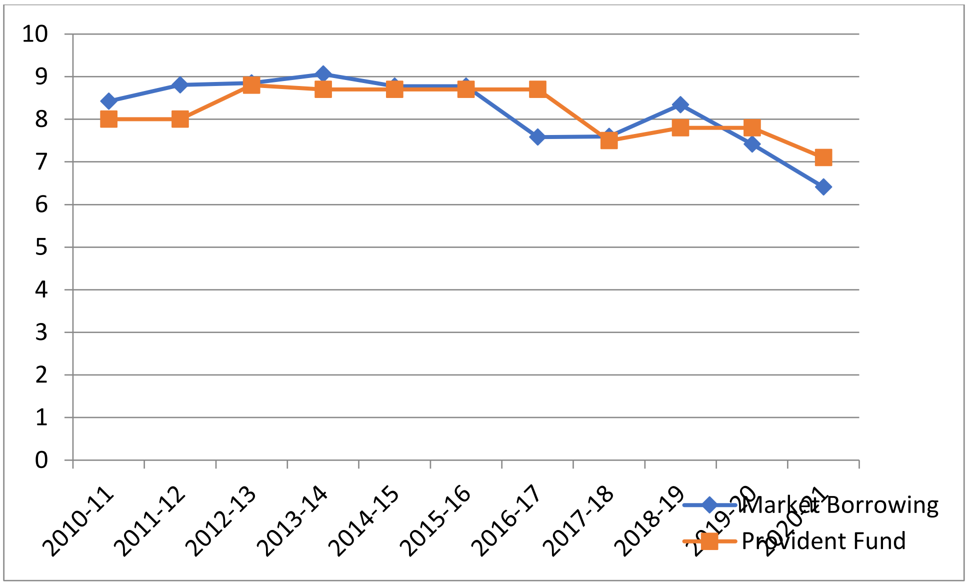
Table 5.4: Weighted average interest rate of major components of debt and the Effective Interest Rate of Total Debt

Year	Market Interest Rate%	PF Interest Rate%	Effective Interest Rate of Total Debt%
2011-12	8.81	8	7.03
2012-13	8.85	8.8	6.95
2013-14	9.06	8.7	6.96
2014-15	8.78	8.7	7.22
2015-16	8.78	8.7	7.05
2016-17	7.58	8.7	6.49
2017-18	7.6	7.5	7.16
2018-19	8.34	7.8	7.16
2019-20	7.42	7.8	7.36
2020-21	6.41	7.1	6.86

Source: Finance Accounts, vol.1, various issues

The decomposition of interest payments for the period of 2016-17 to 2019-20 reveals that 32 per cent of the interest payments made due to the change in the effective interest rates and another 68 per cent payment is made due to the change in borrowings. The exercise further reveals that if we had raised fund through market borrowings instead of public accounts, the share or component of interest payments due to change in interest rates during 2016-2020 could have maintained as a level of 7 per cent instead of 27 per cent (Table 5.1 and Table 5.4). This indicates that government could have saved money and used the same for the development expenditure if the state could raise funds through market borrowings with an interest rate of 7.58 per cent during 2016-17 instead of raising funds from public accounts which had relatively high interest rate of 8.7 per cent (Figure 5.1).

Figure 5.1: Weighted average interest rate of major debt instruments

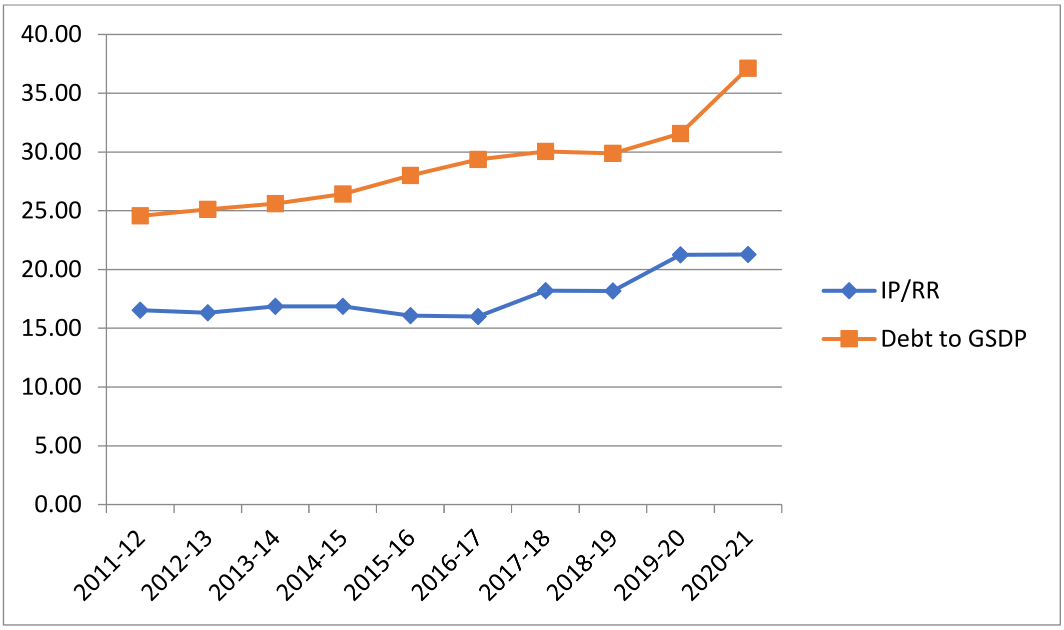


Source: Budget Documents, Various years

5.3. Debt Sustainability of the State

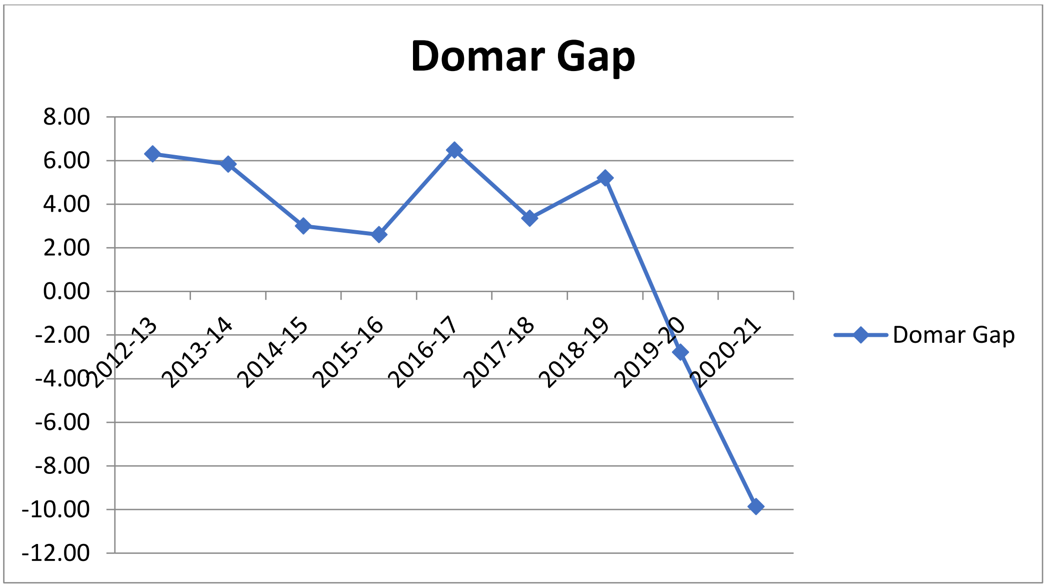
The analysis of growth of debt shows that the annual growth rate at 14.53 per cent of total debt for the period 2011-12 to 2019-20 is much higher than the growth rate of GSDP i.e., 9.26 per cent. Similarly, the ratio of debt to GSDP has increased from the level of 24.56 to 28 per cent during 2011-12 to 2015-16 which is above the target of 25 per cent set by the XIV Finance Commission. This ratio has further increased to 30 per cent during 2018-19 and then to the level of 31.58 per cent during 2019-20. It is quite evident that the GSDP did not grow proportionately as compared to the growth of total debt during 2018-19 to 2019-20. And this could be due to the historic flood that hit Kerala economy during 2018.

Figure 5.2: Debt Sustainability Ratios



Source: Budget Documents, Various years
Note: IP/RR; IP=Interest Payments; RR=Revenue Receipts.

Figure 5.3: Domar Gap



Source: Budget Documents, Various years

The ratio of interest payment to revenue receipts for Kerala is much above the level fixed by the XIV Finance Commission at 10 per cent. This ratio has been increasing significantly during 2011-12 to 2019-20 from the level of 16.54 per cent to 21.24 per cent (Figure 5.2). The larger the burden of interest payments, lesser would be the availability of borrowed funds for spending on capital formation. Further, the Domar gap (the gap between the rate of growth of GSDP and the effective interest rate) which is positive during 2012-13 (Figure 5.3) has narrowed down significantly during 2019-20 and turned negative during 2020-21, immediately after the economy hit by the Covid 19. And this gap is likely to be reduced further with the repo rate and the borrowing cost going up. The narrowing down of Domar gap is not a good sign as far as the public finance of the state is concerned.

The fall in the Domar gap, however, is found to be largely associated with the fall in the rate of growth of GSDP. The sharp fall in the GSDP registered especially during 2019-20 and 2020-21 could be partly due to the floods that hit Kerala economy and also due to the impact of Covid 19. Any government which does not generate enough revenue to service its debt must either default on its obligations, or would have to borrow more in order to pay off past debt through various debt instruments which is known as a Ponzi game (Rajaraman and Mukhopadhyay, 2005, p.320). Although it is believed that large fiscal deficit through expansionary policy and unsustainable public debt can have crowding-out effect, it is argued that an increase in capacity utilisation, public investment in infrastructure and social sector can crowd in private investment (Rakshit,2015, p.377). And therefore, it is the need of the hour for the Kerala government to adapt any kind of less expensive debt instruments in order to meet the capital and revenue expenditure for boosting the growth of the economy.

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