



GOVERNMENT OF KERALA



WHITE PAPER

ON

STATE FINANCES

JUNE 2016

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PREFACE

Any major crisis strikes those who are affected with great intensity. The distress is felt for protracted periods of time. While the effects are perceptible and often agonizingly painful, most crisis defy quick or simple prognosis. A crisis most often does not respond to easy solutions either.

The financial crisis that has affected the State currently is no exception to this rule. The attempt in this White Paper has been to critically analyse data and evidence available in the accounts and budget documents and correlate it with the reality on the ground. Hence, this starts necessarily, by looking at broad sources of the fiscal worry - viz. the unsustainable increase in some of the components of public expenditures and the failure of the receipts, particularly State taxes to keep pace with the requirements to meet this expenditure. It is through juxtaposing these alongside that will help give some insight into the causative factors that triggered the crisis and give useful pointers to practical solutions, however demanding they be. The analysis would point to a strategy that would ensure greater fiscal consolidation at the same time, greater social security to the poor and a major step-up in capital expenditure. This strategy will be unveiled in the forthcoming budget.

We want to look forward and not dwell on exposing the past misdeeds. But the latter cannot be completely avoided because there are many who do not understand the gravity of the fiscal situation or even refuse to accept the reality of the fiscal crisis. Further, it is important to understand what went wrong, so that we can learn the proper lessons and correct the future course of events. I want to make it clear that the intention of the White Paper is not to malign anyone personally. I sincerely hope it will generate a public discussion which would contribute and enrich the process of correction.

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CHAPTER I

DIMENSIONS OF THE CURRENT FISCAL CRISIS

1. INTRODUCTION

1.1. Immediate need for a White Paper

- 1.1.1. The finances of Kerala are in dire straits. Apart from meeting the day-to-day challenge of keeping the Treasury afloat for meeting routine expenditure of the administrative machinery, the State is constantly facing grave paucity of resources for financing all its other plan and capital expenditure. The situation is alarming and has been succinctly brought out by His Excellency, the Governor of Kerala in his first address to the 14th Legislative Assembly on June 24, 2016.

“The State is facing an acute financial crisis. My Government is today facing the unenviable task of steering the State out of this. For the last three years (2013-2016), the implementation of the Annual Plan approved by the people of Kerala through the Legislative Assembly has virtually stagnated. Against the large number of schemes announced in the annual plan budgets of the three years, actual expenditure has been only 60-70% of the budget approved by the Legislature. This, in particular, has had a debilitating impact on public investments in Kerala, and has adversely hit poorer sections of the society the most. The flow of funds to beneficiaries and workers in the coir, fisheries and other traditional sectors have suffered the most in the aftermath of the crisis. This has also severely impeded the overall economic growth, income and employment generation of the State. The entire borrowing ceiling now permitted by the Central Government is just sufficient to meet the day to day expenditure of the State Government. Consequently, my Government is faced with the stark reality that there are no funds left for capital expenditure like construction of roads, bridges and other major infrastructure projects.”

- 1.1.2. For the last three years, budgets placed before the State Legislature have not had much of reality with either the resources to finance them or with the actual expenditure incurred at the end of the year. Schemes and projects were announced without the funds to back them up. Additional Resource Measures (ARM) were proposed in the budgets for bridging the gap between budgeted figures and announced projects - but tax and non-tax efforts were not stepped up in line with them. The actual revenue realised through ARM was only a portion of what is announced in the budget speeches year after year. Out of approximately Rs.2400 cr. of ARM announced in the last two budgets, only Rs.1800 cr. has been collected. Every budget in the last five years has had an additional expenditure implication of a few thousand arising

from new pronouncements in the Budget Speech. However, very few of these pronouncements were actually implemented.

1.1.3. Each year, before the Annual Plan Size is fixed an estimate of the Balance in Current Revenues (BCR) is made. This is what the State can contribute to the Plan after meeting its inevitable and routine expenditures. If it is a negative figure, it means that the State has to devote some of its borrowing to first meet its routine expenditure first, and correspondingly less is available for financing the Plan. The State has been persistently running huge negative BCR in both 2013-2014 and 2014-2015 of (-) Rs.6916 cr. and (-) Rs.9533 cr. However, what exacerbated this was that for the last three years, the Annual Plan Size has been fixed about 10-15% even beyond the State's estimated capacity – all done to announce an artificially bloated plan size each year.

1.1.4. Thus three dimensions of the Annual Plan that has in no small measure, contributed to this fiscal situation are the following:

- **The original Plan Size itself was fixed beyond what the State could afford each year.**
- **Schemes were announced in the Budget that had no resources to finance them. The expenditure incurred on them place enormous strains on the budget.**
- **ARM measures announced in the last two years were only achieved to the tune of 75% leaving huge uncovered gaps in meeting plan expenditures.**

1.1.5. In the process, unfortunately, budgets have lost their sanctity and budget speeches have become exercises in conjuring up unachievable visions of schemes and projects. The divergence between the reality and what is professed, has reduced the annual budgets to a ritual of proclaiming a slew of real or imagined dreams and intentions. Thus unfortunately, the State has been living on a financial lie.

1.1.6. It is in this background that the relevance of a White Paper lies. The people of Kerala have the right to know where their State stands in terms of its financial position and what it holds for them and for their future generations.

1.2. CASH BALANCES IN THE TREASURY

1.2.1. Nothing conveys the unpardonable deterioration in the quality of financial management over the past five years more poignantly than the status of cash reserves of the State. The figure below illustrates the mindless depletion of the cash reserves of the State during the last five years. The vital tax collection machinery, be it in commercial taxes, or excise was pawned away for private gains ignoring public interest.