Building a New Kerala

Ideas and Reflections

Financing the Rebuild: Suggestions for Meeting the Challenges Ahead

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Present Fiscal Scenario

The natural disaster in the form of recent heavy floods could not have come at a worse time in so far as Kerala's public finances are concerned. The State was trying to bring its fiscal situation from the brink to back. The unprecedented natural disaster has pushed the State finances off the brink. Now, the challenge is the arduous uphill journey. How do we attempt this, is the question we address here.

Kerala's own tax revenues have been experiencing a growth sclerosis since 2013-14. After a robust annual growth rate of 18-20 percent per annum during 2006-07 to 2012-13(it had reached even 23-24 percent during 201-11 to 2012-13), the growth rate since 2013-14 fell to around 10 percent per annum and declined to 8.16 percent during 2016-17 (the latest year for which budget actuals are available).

Being a State which topped in Private Final Consumption Expenditure (PFCE), according to the last quinquennial survey conducted by the National Sample Survey Organisation (NSSO) during 2011-12, the State expected a robust annual growth rate of 20 percent in own tax revenue during 2017-18 and in the following years [1], consequent to the implementation destination based Goods and Services Tax (GST) . But the implementation problems in the GST and non - adoption of revenue neutral apportionment of rates between Centre and the States (on 50:50 basis instead of 40:60 basis) have resulted in a much lower rate of growth in own tax revenue at 12.89 percent during 2017-18. Though the 14 percent growth rate over 2015-16 base is assured for taxes subsumed in GST till 2021-22, this is hardly sufficient to meet the revenue expenditure, which is growing at 17-18 percent annum. The result would be resorting to borrowing to finance revenue expenditure.The Government of Kerala was taking steps to mobilise more own tax and

[1]As per the Medium Term Fiscal Policy Statement (MTFP), 2017 and 2018 of Government of Kerala, available in finance.kerala.gov.in

non-tax revenues and rationalise revenue expenditure and rein in revenue deficits, which is about two-thirds of our annual borrowing. It is at this time that the natural disaster has struck the State, placing the huge burden of building a new Kerala, besides resources required for immediate relief and rehabilitation.

Mobilising Resources

a) Borrowings from the Market

With the State's economy badly hit by the floods, an immediate pick up in the growth of commodity taxes is unlikely. At the same time, the State would have to spend on revenue and capital expenditure in the relief, rehabilitation and rebuilding exercise. The present borrowing limit of the State is 3 percent of the Gross State Domestic Product (GSDP) per annum as per the Fiscal Responsibility and Budget Management (FRBM) Act, which also stipulates that revenue deficit should be brought to zero.

The huge burden placed by the natural calamity would require a relaxation in the deficit targets. We need to have an enhanced borrowing limit of 4.5 percent of GSDP per annum to mobilise an additional ₹ 10000 crore approximately. But, it should be specifically for floating Rebuilding Bonds and should be exclusively utilised for this expenditure and not for meeting any other routine expenditure. The central government should be requested to give permission for this, as required under Article 293(3) of the Constitution.

b) Supplementary Memorandum to 15th Finance Commission for Grants under Article 275

The aspect that needs to be factored in is the additional inserts burden this enhanced borrowing would bring in. This would preempt the development spending in future. In order to avoid this, the State would have to present a supplementary memorandum to the 15th Finance Commission, requesting for additional statutory block revenue deficit grants under Article 275 of the Constitution. For this, we would have to present a revised revenue receipts and expenditure statement to

the 15th Finance Commission at the earliest. A specific request would have to be made for relaxing fiscal, revenue deficit and debt-GSDP ratio targets during 2018-19 to 2022-23.

Government of Kerala has already requested the 15th Finance Commission to enhance the size of the. State Disaster Response Fund (SDRF) to ₹ 3000 crore from the present ₹ 919.19 crore determined by the 14th Finance Commission. This needs to be reiterated and the central share of SDRF be enhanced to 90 percent as recommended by the 14th Finance Commission instead of the present 75 percent.

c) Memorandum to Central Government for Grants under Article 282

An alternate route is to request the central government to give a specific package. Grants under Article 282 of the Constitution under the heading "Miscellaneous Financial Provisions" is specifically meant for meeting exigencies like natural disasters. But experience so far has been that such packages have not become a reality for Kerala.

d) Revenue Mobilisation

Article 279A (4) (f) provides for special rates of GST for a specific period when there are natural calamities. Several States in India have been affected by floods and imposing a special rate for a period of one year to help these States is worth considering. A special rate, say, 24 percent instead of the standard rate of 18 percent can be imposed. This would need approval of the GST Council. An alternative scheme is that for the flood affected States, the apportionment of present GST rates between centre and them can be in 30:70 ratio for a specific period, say, two years.

Additional ad valorem increase in all charges for services provided, except, those directly connected with flood relief and rehabilitation can be considered by the State for augmenting non-tax revenues. The lease rent for government land should be aligned with market rates.

Economy in Expenditure

The State has to focus both on revenue mobilisation and bringing about an economy in expenditure also. Under normal circumstances, there are interest groups which would resist these measures. But under extra ordinary circumstances after the natural disaster, these would have to be considered, as effecting economy in expenditure is an absolute necessity.

a) Expenditure including purchase of vehicles, building and hiring of new offices (except under pressing circumstances) should not be incurred. Vehicles should be be hired on necessity and office spaces should be moderated based on need.

b) Filling up vacancies by redeployment of staff from departments having surplus instead of new recruitment.

c) Raising retirement age at least by two years to postpone the payment of pension burden. The present retirement age in Kerala is 56, where as in Government of India, it is 60 years.

d) Reemployment of all retired officials to be reviewed and done away with unless there is specific technical expertise which is not available with the existing officials.

e) The number of welfare boards and government corporations should be reduced on an immediate basis.

f) Align State pay Commissions with that of Government of India, that is, once in ten years.

g) Existing departmental programmes need to be reviewed and incremental budget allocation should be stopped. Each year, the feasibility of programmes should be considered afresh and zero based budgeting should be effected.

h) Road construction and maintenance by Public Works Department should be done under social audit by competent local persons who should check quality of materials also. Roads built with poor quality materials get damaged very fast resulting in avoidable maintenance and repair expenditure.

In short, we should aim to get borrowing limits raised for a specific period to 4.5 percent of GSDP, submit a supplementary memorandum to 15thFinance Commission seeking additional grants under Article 275 of the Constitution, attempt to mobilise more own resources and effect economy measures in expenditure, so that resources can be mobilised for financing the rebuild and building a more sustainable Kerala.

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