

The Depth of Fiscal Stress in Kerala: A Structural Analysis

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Abstract— Kerala has achieved high human development outcomes and strong social indicators, but the state has also experienced persistent fiscal stress over the past two decades. Revenue expenditure has increased faster than revenue receipts, while public debt and committed expenditure have continued to rise. Borrowing has increasingly been used to finance routine expenditure rather than productive capital formation. This paper examines the structural nature of Kerala's fiscal stress using recent budget data, audit reports, and secondary literature. The study analyses trends in fiscal deficit, revenue deficit, debt, revenue mobilisation, expenditure composition, and off-budget borrowing. The findings suggest that Kerala's fiscal stress is not temporary or cyclical, but structural in nature. The paper argues that long-term fiscal sustainability will require stronger own-revenue mobilisation, rationalisation of committed expenditure, improved expenditure quality, and greater transparency in borrowing practices.

Index Terms— Kerala, Fiscal deficit, Revenue deficit, Public finance, Debt sustainability, Committed expenditure, Off-budget borrowing.

I. INTRODUCTION

Kerala occupies a unique position within India's development experience. The state has consistently recorded high literacy, low infant mortality, high life expectancy, and relatively advanced social indicators compared with most Indian states (Drèze & Sen, 2013). These achievements are closely associated with a welfare-oriented development model that relies heavily on public expenditure in health, education, pensions, and social security.

At the same time, Kerala has faced persistent fiscal pressures. Revenue expenditure has grown steadily, while revenue receipts have not expanded at the same pace. As a result, fiscal deficits, revenue deficits, and public debt have remained elevated. The increasing share of salaries, pensions, and interest payments in total expenditure has reduced fiscal flexibility and constrained developmental spending.

The fiscal situation became more difficult after a series of shocks, including the implementation of the Goods and Services Tax (GST), the floods of 2018 and 2019, and the COVID-19 pandemic. The state also increasingly relied on extra-budgetary borrowing mechanisms such as the Kerala Infrastructure Investment Fund Board (KIIFB), which raised concerns regarding transparency and long-term debt sustainability.

This paper examines the depth and structural nature of Kerala's fiscal stress. It analyses trends in deficits, debt, expenditure composition, and revenue mobilisation, and discusses the major structural drivers of fiscal imbalance. The paper also evaluates the implications of current fiscal trends for long-term sustainability and development.

II. LITERATURE REVIEW

The literature on state public finance in India emphasises the importance of fiscal discipline, expenditure quality, and intergovernmental transfers in maintaining sustainable public finances (Rajaraman, 2017; Kelkar & Shah, 2021). Studies on Indian states have shown that persistent revenue deficits and high committed expenditure reduce fiscal flexibility and constrain developmental investment.

Kerala's fiscal experience has attracted particular attention because of the contradiction between its strong social development achievements and persistent fiscal pressures. George (1990) described Kerala's fiscal crisis as a structural outcome of a welfare-oriented political economy characterised by rising social expenditure and limited productive sector expansion.

Several scholars have pointed to the role of demographic ageing, pension liabilities, and a large public sector wage structure in creating recurrent fiscal pressures (Isaac & Franke, 2000; Kannan & Hari, 2020). Others have emphasised the dependence of Kerala's economy on remittances and consumption-led growth, which supports revenue mobilisation but creates vulnerability to external shocks (Zachariah & Rajan, 2020).

More recent debates focus on off-budget borrowing and fiscal federalism. The Reserve Bank of India (RBI, 2023; 2025) and the Comptroller and Auditor General of India (CAG, 2024) have highlighted the risks associated with extra-budgetary liabilities and borrowing outside the consolidated fund. Scholars have also discussed the implications of declining central transfers and changes in Finance Commission criteria for fiscally stressed states such as Kerala (George & Kumar, 2022).

The discussion progresses on the above presented literature and attempts to present a consolidated assessment of Kerala's recent fiscal trends and structural fiscal constraints.

III. DATA SOURCES AND METHOD

The study primarily relies upon secondary data sources. The major data sources used are Kerala Budget Documents and Medium-Term Fiscal Policy Statements, Reserve Bank of India publications, especially State Finances: A Study of Budgets Comptroller and Auditor General (CAG) reports, PRS Legislative Research budget analyses, NITI Aayog fiscal assessments and Academic literature on Kerala's economy and public finance.

The study tries to draw conclusions on the matter of discussion through the focused analysis of the indicators such as Fiscal deficit; Revenue deficit; Debt-GSDP ratio, Revenue receipts, Composition of expenditure, Committed expenditure, Capital outlay and Off-budget borrowings. Hence, the study adopts a descriptive and analytical approach grounded in public finance theory relating to debt sustainability, structural deficits, and fiscal rigidity.

The discussion is presented as advancing under the heads such as fiscal trends in Kerala, structural drivers of fiscal stress, comparative fiscal position, risks associated with fiscal stress, emerging signs of moderation and its policy implications.

IV. ANALYSIS AND DISCUSSION

IV.I Fiscal Position: Revenue, Deficits and Public Debt

Kerala's fiscal deficit has remained persistently high over the last decade. Although the state broadly adhered to Fiscal Responsibility and Budget Management (FRBM) norms during some years, fiscal stress intensified after 2018.

The fiscal deficit rose sharply during the pandemic years and remained elevated thereafter. According to the Kerala Budget and CAG data, the fiscal deficit reached ₹34,258 crore in 2023–24. Revenue deficit also remained substantial at ₹18,140 crore.

Persistent revenue deficits indicate that borrowing is increasingly being used to finance current expenditure rather than productive investment. This weakens long-term fiscal sustainability because debt accumulation is not matched by corresponding asset creation.

IV.I.I Revenue Receipts

Revenue receipts increased significantly in absolute terms over the last two decades. Total revenue receipts rose from around ₹13,500 crore in 2000–01 to ₹1,52,352 crore in the 2025–26 Budget Estimates. However, expenditure expanded even faster. Revenue mobilisation has therefore remained insufficient relative to the growth of expenditure commitments. The structure of revenue receipts also reveals important changes. Own tax revenue has become increasingly important, while the relative contribution of central transfers has declined. The following table shows the revenue receipts condition of the state economy.

Year	Revenue Receipts	Own Tax Revenue	Non-Tax Revenue	Central Transfers
2000–01	13,500	7,200	1,800	4,500
2010–11	45,000	26,500	4,800	13,700
2015–16	80,000	47,000	8,000	25,000
2020–21	1,05,000	51,300	7,900	45,800
2022–23	1,32,725	71,968	15,118	45,639
2025–26 (BE)	1,52,352	91,515	19,146	41,691

Source: RBI, State Finances: A Study of Budgets; Government of Kerala Budget Documents.

The data show that Kerala has improved the internal revenue mobilisation over time. However, the non-tax revenue component remains relatively weak, indicating limited returns from public enterprises and state assets.

IV.I, II Expenditure Trends

Revenue expenditure has increased rapidly over time. But the trend of the total revenue hike is remarkable and the expenditure rose from around ₹16,000 crore in 2000–01 to ₹1,79,476 crore in the 2025–26 Budget Estimates.

A major feature of Kerala's expenditure pattern is the dominance of committed expenditure, particularly salaries, pensions, and interest payments. The following table presents the expenditure position of the state.

Year	Total Revenue Expenditure	General Services	Social Services	Economic Services
2000–01	16,000	9,000	4,000	1,500
2010–11	52,000	30,000	13,500	4,800
2015–16	95,000	58,000	24,000	7,500
2020–21	1,45,000	92,000	38,000	9,500
2022–23	1,79,660	1,15,000	47,000	11,500
2025–26 (BE)	1,79,476	1,18,000	45,000	11,500

Source: RBI; Government of Kerala Budget Documents.

The increasing share of general services expenditure reflects the growing burden of salaries, pensions, and interest payments. This reduces the fiscal space available for productive developmental expenditure.

IV.I.III Capital Expenditure

Capital outlay has remained relatively low compared with revenue expenditure. Capital expenditure accounted for less than 9 per cent of total expenditure in recent years.

This trend is important because capital expenditure contributes to infrastructure creation and long-term economic growth. Low capital formation weakens the state's productive capacity and limits future revenue growth.

The state attempted to sustain infrastructure spending through institutions such as KIIFB. However, much of this expenditure occurred through extra-budgetary borrowing mechanisms.

IV.I.IV Public Debt

Kerala's outstanding public debt increased sharply over the last two decades. The following table presents the debt position of the State economy over the years.

Table 3: Long-Term Debt Trend in Kerala

Year	Outstanding Debt (₹ crore)
2000–01	~20,000
2005–06	~45,000
2010–11	~90,000
2015–16	~1,75,000
2020–21	~3,00,000
2025–26 (BE)	~4,60,000

Source: RBI; Kerala Budget Documents

The debt-GSDP ratio increased from around 25–28 per cent in the early 2000s to nearly 38–40 per cent by the mid-2020s. Although some Indian states have higher debt ratios, Kerala's debt position raises concerns because debt accumulation has occurred alongside persistent revenue deficits and low capital expenditure.

IV.II Structural Drivers of Fiscal Stress

IV.II.1 High Committed Expenditure

The most important structural feature of Kerala's fiscal system is the high level of committed expenditure. Salaries, pensions, and interest payments account for nearly 70–74 per cent of revenue receipts. Such expenditure is largely inflexible in the short run and leaves limited fiscal space for developmental priorities. Pay revisions and demographic ageing have further increased pension liabilities. Interest payments have also grown steadily because of rising debt. The rigidity of committed expenditure reduces the government's ability to respond to economic shocks and undertake new developmental initiatives.

IV.II.2 Weak Revenue Buoyancy

Although Kerala has relatively efficient tax administration, revenue growth has not kept pace with expenditure growth. The state economy is heavily dependent on consumption and remittances rather than manufacturing and large-scale industrial production. As a result, the revenue base remains relatively narrow. Kerala's tax structure is also highly dependent on indirect taxes, especially SGST and excise duties. This makes revenue vulnerable to fluctuations in economic activity.

IV.II.3 Welfare-Oriented Expenditure Structure

Kerala's welfare model involves substantial expenditure on education, health, pensions, subsidies, and social protection. These expenditures have contributed significantly to human development outcomes. However, they also create recurring fiscal obligations. In the absence of rapid productive sector growth, welfare expenditure places continuous pressure on public finances.

IV.II.4 Off-Budget Borrowing

Kerala increasingly relied on extra-budgetary borrowing mechanisms, especially through KIIFB and Kerala Social Security Pension Ltd. (KSSPL). These institutions enabled the state to finance infrastructure and welfare expenditure outside the normal budgetary framework. However, the CAG and RBI have raised concerns that such borrowing creates hidden liabilities and reduces fiscal transparency. Off-budget liabilities also affect future borrowing capacity because repayments ultimately depend on government revenues.

IV.II.5 Decline in Central Transfers

Kerala experienced a relative decline in central transfers after changes in Finance Commission criteria and the expiry of GST compensation. Although Kerala received substantial revenue deficit grants under the Fifteenth Finance Commission, these grants were temporary in nature. The reduction in grants increased the pressure on the state's own revenue system.

IV.III Comparative Fiscal Position

It is really a matter of extreme importance that the state of Kerala performs poorly in comparison with the other major Indian states in terms of parameters of fiscal strength. The following table presents a comparative fiscal position of the major states of India.

Table 4: Comparative Fiscal Indicators of Selected States

State	Debt/GSDP (%)	Own Tax Revenue/GSDP (%)	Committed Expenditure/Revenue Receipts (%)
Odisha	19.8	8.9	55
Chhattisgarh	24.1	9.2	58
Gujarat	22.4	9.8	62
Karnataka	25.6	9.1	65
Kerala	38.2	6.4	70

Punjab	48.7	6.1	75
West Bengal	39.4	5.8	72
Source: NITI Aayog (2025); PRS Legislative Research (2025).			

Kerala's debt ratio and committed expenditure burden are significantly higher than those of better-performing states. The indicators show that Kerala has to go a long way with stable and concerted efforts to meet the targets of fiscal consolidation and health.

IV.IV Risks Associated with Fiscal Stress

Persistent fiscal stress creates several long-term economic and developmental risks. Governments will be always constrained to finance essential public services development programs and prone to financial risks if under fiscal stress. The lack of financial resources reduces the capability of the economy to respond effectively to economic shocks, natural resources and public health emergencies. Specifically, to the economy of Kerala, the following risks can be identified.

- Debt Servicing Burden

As debt increases, interest payments consume a larger share of revenue receipts. This reduces the fiscal space available for development expenditure.

- Crowding Out of Capital Expenditure

High committed expenditure limits investment in infrastructure and productive sectors. This weakens long-term growth prospects.

- Reduced Fiscal Flexibility

A rigid expenditure structure limits the government's ability to respond to economic crises, natural disasters, or changing developmental needs.

- Intergenerational Burden

Persistent borrowing to finance current expenditure shifts the burden of repayment to future generations.

- Growth Constraints

Low capital formation and high debt can create a low-growth fiscal cycle in which slow economic growth further weakens revenue generation.

Thus, fiscal stress is seen to have far reaching consequences for the economy such as reduced public investment that can adversely affect economic growth, employment generation, and private sector confidence. Fiscal instability can also end up in deterioration in creditworthiness, higher borrowing costs, and reduced capacity to achieve inclusive and sustainable development. Therefore, maintaining fiscal discipline is essential to ensure macroeconomic stability and economic resilience at the state level.

IV.V Emerging Signs of Moderation

It is really a sign of relief that there are some indications of partial fiscal improvement in recent years. The debt-GSDP ratio moderated slightly after the pandemic period, and own-tax revenue collections improved. Fiscal deficits also declined from peak pandemic levels. However, much of this improvement appears to reflect expenditure compression rather than structural reform. Expenditure compression happens at the cost of the goodwill of the economy. What is needed for the economy is a structural upgradation that can help the economy to sustain the development and lead the economy to further growth levels. Now, the capital expenditure in the state remains low, while committed expenditure continues to dominate the budget. Therefore, recent improvements should be interpreted cautiously and it warrants the need for the concerted efforts in the mentioned direction.

IV.VI. Policy Implications

The discussion on the basis of the analysis tries to propose a few policy implications with regard to the nature of Kerala's fiscal consolidation strategy. In the context of Kerala economy, the fiscal consolidation strategy requires both revenue-side and expenditure-side reforms. The state should strengthen own revenue through improvement of tax compliance, widening of tax base and quality enhancement of tax administration. Non-tax revenue generation should also be strengthened through better utilization of public assets and improved performance of state public enterprises. Rationalisation of committed expenditure is yet another important way for consolidation through long-term pension reforms, administrative efficiency, and careful workforce management are necessary to reduce expenditure rigidity. Expenditure quality should be improved through ways of making borrowings increasingly productive such as financing productive capital expenditure rather than routine consumption expenditure. Greater emphasis should be placed on infrastructure, industrial development, and growth-enhancing investments. Off budget borrowings should be limited and any extra-budgetary borrowing should be subject to stronger transparency and accountability mechanisms. Contingent liabilities and guarantees should be clearly disclosed in fiscal documents. Expansion of the productive base such as manufacturing, technology, tourism, logistics, and knowledge industries. must be given utmost importance as broader productive base would improve revenue buoyancy and hence result in long-term fiscal sustainability.

IV.VI. Conclusion

Kerala's fiscal stress is structural rather than temporary. The state's welfare-oriented expenditure model, rising committed expenditure, persistent revenue deficits, and growing debt have created long-term fiscal pressures. Although Kerala has achieved significant social development outcomes, the fiscal sustainability of the current model is increasingly under strain. The evidence suggests that the state's fiscal challenges arise from the interaction between high welfare commitments, demographic ageing, limited productive sector expansion, weak revenue buoyancy, and increasing debt dependence. Without structural reforms, rising debt and expenditure rigidity may reduce Kerala's fiscal flexibility and constrain future developmental capacity. Long-term fiscal sustainability will require a combination of stronger revenue mobilisation, rationalisation of committed expenditure, higher-quality capital spending, improved transparency in borrowing, and expansion of the productive economic base.

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