Kerala's Financial Crisis

Why in news?

Kerala government has approached the Supreme Court claiming the Centre's borrowing limit restrictions violate
fiscal federalism.

How the State's borrowing is regulated in India?

- **Article 293**- It grants fiscal autonomy to states, allowing them to borrow only from within the territory of India on guarantee from the Consolidated Fund of the State.
- **7th Schedule-** Fiscal matters are delineated in the 7th Schedule of the Constitution, with "Public Debt of the State" falling under the State List, giving states exclusive jurisdiction over this matter.
- **FRBM Act 2003**- The Fiscal Responsibility and Budget Management Act 2003 was enacted to ensure intergenerational equity in fiscal management, it sets limit on fiscal deficit and borrowing for both the Central and State governments.
- **Finance Commission**- It periodically makes recommendations regarding fiscal matters, including borrowing limits for States, it is crucial for determining the borrowing ceilings for states, taking into account factors such as economic conditions, fiscal health, and developmental needs.
- **State Fiscal Responsibility Acts-**Each State may have its own Fiscal Responsibility Act, which further defines the limits and guidelines for borrowing and fiscal management within the State.
- **Role of Centre**- It plays a significant role in overseeing fiscal matters, including approving borrowing limits for States based on recommendations from bodies like Finance Commission.
- It can influence the State's borrowing limits through legislative changes, amendments to existing laws like the FRBM Act, or by exercising discretion in granting additional funds or relaxing borrowing constraints in exceptional circumstances.

Why Kerala is facing financial crisis?

- **Fiscal deficit-** Kerala has struggled to contain its fiscal deficit within the mandated limits.

  The average fiscal deficit of Indian States is 2.5%, in 2021-22 Kerala's fiscal deficit was 4.17%

- **Debt servicing-** The state's borrowing is used for ongoing expenses rather than profitable investments, affecting its credit rating.

- **Revenue generation**- The State's revenue generation may not be sufficient to meet its expenditure requirements, the State relies heavily on revenue from taxes including GST but fluctuations in economic activity and external factors impact tax collections.
- **Expenditure patterns**- There is high levels of recurrent expenditure on items like salaries, pensions and subsidies which contributes to financial strain.
- **Natural disasters**- Kerala is prone to natural disasters such as flood, landslides etc., which can cause widespread damage to infrastructure and disrupt economic activities.
- **Impact of pandemic-** COVID-19 pandemic has exacerbated Kerala's financial challenges, the economic slowdown resulting from lockdowns and restrictions has affected revenue streams while increasing healthcare and social welfare spending have added to expenditure pressures.

What is the stand of Kerala and Centre?

Kerala's stand	Centre's stand
• **Fiscal Autonomy**-Kerala claims the Centre's amendments to the FRBM Act, 2003, infringe upon its fiscal autonomy. • **Borrowing limit**- The Centre's amendments have reduced Kerala's borrowing limit significantly, impacting the state's financial crisis management. • **Constitutional violation**- Kerala argues that the Centre's actions encroach upon the state's legislative domain, violating the 7th Schedule of the Constitution. • **Financial crisis**-The state fears that without intervention, the imposed financial constraints could have long-lasting detrimental effects. • **One time package**- It was suggested by Supreme Court for Kerala to help with funds shortage while imposing stricter conditions for the next financial year. • The State rejected Rs 5000 crore loan as it would need around 10,000 crore rupees as loan.	• **State's financial crisis**-The Centre argues that Kerala's financial woes are due to the state's mismanagement and extravagance, not the borrowing limit. • **FRBM Act**-Fiscal transactions between states and the Centre are governed by the FRBM Act, 2003, with borrowing limits set as 3% of the Gross State Domestic Product (GSDP). • **15th Finance Commission**- It labeled Kerala as "highly debt stressed," with a history of breaching fiscal deficit targets and high expenditure on salaries. • The Centre has refused to relax borrowing limits citing 15th Finance Commission recommendations. • **Conditions**-The Centre said its one time package offer (Rs 5000 crore) comes with strict conditions to prevent it from setting a precedent for other states to approach courts for similar packages. • The borrowing in the first 9 months of FY25 would be issued quarterly, up to 25% of the eligible amount, after deducting the early special concession of Rs 5,000 crore.

References

1. Indian Express- Decoding Kerala's financial crisis
2. Indian Express- SC suggests one time package for Kerala