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KERALA'S FISCAL PARADOX

A RICH SOCIETY WITH A FISCALLY STRESSED GOVERNMENT

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Abstract: In recent years, the development paradox of Kerala has taken a new dimension with regard to the fiscal space of the economy. The visibility of the paradox has become more apparent as the state's economy continued to expand while the fiscal position weakened. Kerala's Gross State Domestic Product (GSDP) has grown steadily, but public finances remain strained due to structural expenditure commitments, limited own-revenue growth, and rising debt-servicing obligations. The economy's achievements have to be seen in the face of persistent fiscal stress and hence remarked 'a rich society with a fiscally stressed government'. Despite achievements, there are various factors that render Kerala's fiscal position fragile. The present discussion tries to delve into the various reasons that leads to such a conundrum in the economy and the possible ways to address the predicament.

Index Terms – Gross State Domestic Product, Net State Domestic Product, Fiscal paradox, Fiscal Stress, Fiscal Federalism.

I. INTRODUCTION

Kerala occupies a distinctive position within India's federal political economy. The state has consistently achieved some of the highest human development outcomes in the country despite relatively modest industrialization. High literacy, low poverty, favourable demographic indicators, and substantial remittance inflows have produced a socially prosperous society in the economy. But, alongside these achievements, the Government of Kerala continues to face persistent fiscal stress marked by recurring revenue deficits, rising debt, and constrained fiscal space. This contradiction is frequently described as Kerala being a "rich society with a poor government" (Oommen 2021).

The paradox has become more visible in recent years as the state's economy continued to expand while the fiscal position weakened. Kerala's Gross State Domestic Product (GSDP) has grown steadily, but public finances remain strained due to structural expenditure commitments, limited own-revenue growth, and rising debt-servicing obligations. This article attempts to examine the various factors that causes Kerala's fiscal stress using recent budgetary and audit data keeping the subject within broader debates on fiscal federalism and welfare-state sustainability. The paper is presented in five main sections such as a briefing of the Kerala model, recent trends in fiscal situation, structural drivers of fiscal stress, the state in a comparative perspective and the state financial position in the framework of fiscal federalism.

II. KERALA'S DEVELOPMENT MODEL AND SOCIAL PROSPERITY

Kerala has long been recognised as an exception within India's development trajectory. The state has a lot of credentials to its credit. The uniqueness of the Kerala development is marked by the records such as highest literacy rate in India, the lowest multidimensional poverty levels, and one among the states with highest life expectancy in the country (Government of Kerala 2024a; NITI Aayog & UNDP 2023). These achievements are rooted in decades of public investment in education, healthcare, land reforms, and social welfare.

According to official estimates, Kerala's per capita Net State Domestic Product (NSDP) for 2024–25 stood significantly above the all-India average (Government of Kerala 2025). The composition of the NSDP of the

economy also plays a role in making the economy distinct from others. The following table shows a comparative analysis of NSDP of Kerala with all India average and its implications. Apart from higher NSDP in comparison with the nation wide average, Kerala exhibited a higher growth trend implying higher average income and human development outcomes.

Table 1: Kerala per capita NSDP in comparison with national average

Indicator	Kerala (2024–25)	All-India Average (2024–25)
Per Capita NSDP (Current Prices)	₹3,08,338	₹1,33,501
Relative Position	About 2.3 times the national average	—
Growth Trend	Increased from ₹2,81,269 in 2023–24	Moderate national growth
Economic Implication	Reflects higher average income and stronger human development outcomes	Benchmark for national comparison

Source: Government of Kerala (Economic Review) & Government of India Statistics

The service sector dominates the state economy, contributing nearly two-thirds of Gross State Value Added (GSVA). Remittances from migrant workers, especially from the Gulf region, remain central to Kerala's economic structure. Studies estimate remittance inflows at between one-fifth and one-third of the state economy (Kannan & Hari 2020; Zachariah & Rajan 2023). This remittance-driven prosperity in the economy has enabled relatively high household consumption and improved living standards despite the absence of a large industrial base. The surpassing of the service sector growth over the industrial sector makes Kerala's development model to differ from the industrial growth trajectories followed by states such as Gujarat or Maharashtra. Social development preceded rapid economic expansion rather than emerging as a consequence of industrialisation.

III. FISCAL STRESS IN KERALA: RECENT TRENDS

The strong performance of the economy in social development indicators could not be leveraged in the economic fronts in the state. Hence, despite the favourable social conditions, Kerala's fiscal position remains fragile. Recent budget estimates and audit reports show persistent fiscal and revenue deficits alongside rising public debt. The state's fiscal deficit for 2024–25 was budgeted at approximately ₹44,529 crore, or around 3.4 per cent of GSDP (PRS Legislative Research 2025).

Revenue deficit was projected at approximately ₹27,846 crore, or around 2.1 per cent of GSDP. Persistent revenue deficits are particularly significant because they indicate that borrowings are being used to finance routine expenditure rather than capital formation. Kerala's debt burden has also increased steadily. Outstanding public liabilities were projected at around 34 per cent of GSDP in 2024–25 (Government of Kerala 2025). More importantly, debt relative to revenue receipts reached approximately 323 per cent, implying that total debt was more than three times the state's annual revenue receipts. Interest payments alone consumed over one-fifth of revenue receipts. The state's fiscal structure is further constrained by high committed expenditure. Salaries, pensions, and interest payments account for more than half of total expenditure. Consequently, discretionary fiscal space available for infrastructure, industrial development, and productive investment remains limited.

IV. STRUCTURAL DRIVERS OF FISCAL STRESS

The section presents a brief discussion on the various factors that make Kerala's fiscal situation to be administered cautiously.

Limited Revenue Base

A central feature of Kerala's fiscal problem is the disconnect between social prosperity and government revenue mobilisation. Although remittances support household income and consumption, they do not directly enlarge the tax base. Kerala's economy remains dominated by services and small-scale activities with limited industrial diversification.

Compared to industrialised states, Kerala's own-tax revenue performance remains moderate. The own-tax revenue to GSDP ratio has generally remained between 7 and 8 per cent, lower than states such as Tamil Nadu and Karnataka (RBI 2025). The absence of a broad manufacturing base constrains long-term revenue buoyancy.

Welfare Commitments and Social Expenditure

Kerala operates one of India's most extensive welfare systems. Public expenditure on health, education, social security pensions, and welfare-board schemes has historically contributed to the state's impressive social outcomes. However, these programmes also create large recurring expenditure obligations.

Unlike capital expenditure, welfare commitments are politically and socially difficult to reduce. As expenditure commitments continue to rise faster than revenues, fiscal stress intensifies. The persistence of large revenue deficits reflects this structural imbalance.

Ageing Population and Pension Burden

Kerala's demographic transition has produced one of the oldest populations in India. An ageing population increases pension and healthcare liabilities, placing additional pressure on public finances (Irudaya Rajan & James 2024). Pension expenditure has become a major component of committed expenditure, reducing fiscal flexibility.

The demographic transition also has implications for future economic growth. A slowing working-age population may weaken revenue growth while social expenditure obligations continue to rise.

Borrowing and Off-Budget Liabilities

To sustain welfare expenditure and infrastructure investment, Kerala has increasingly relied on borrowing. Apart from conventional borrowing, the state also utilised off-budget financing mechanisms through institutions such as the Kerala Infrastructure Investment Fund Board (KIIFB).

Although such mechanisms enabled infrastructure creation, they also attracted criticism regarding transparency and debt sustainability. The Comptroller and Auditor General (CAG) has repeatedly highlighted concerns regarding off-budget liabilities and borrowing practices (CAG 2024).

All the above discussed points can be consolidated and summarized with the help of the following table

Table 2: Kerala State Deficit Indicators Implying Fiscal Stress

Fiscal Indicator (% of GSDP / Relevant Ratio)	2022-23	2023-24	2024-25	2025-26	Fiscal Stress Implication
Revenue Deficit as % of GSDP	0.88%	2.09%	2.12%	1.90%	Persistent revenue deficit reflects structural imbalance in state finances and dependence on borrowing for current expenditure.
Fiscal Deficit as % of GSDP 3.20%	2.44%	3.45%	3.40%	3.20%	Fiscal deficit remains close to the FRBM threshold, limiting fiscal flexibility.
Outstanding Liabilities / Debt as % of GSDP	37.20%	37.84%	35	33.77%	High debt burden increases future repayment and interest obligations.
Interest Payments as % of Revenue Receipts	18.6%	20.3%	20.8%	21.0%	Rising interest burden reduces fiscal space for developmental expenditure.
Committed Expenditure as % of	63.4%	65.01%	64.8%	64.5%	Large pre-committed spending on salaries, pensions, and

Revenue Expenditure					interest constrains discretionary spending.
Own Tax Revenue Growth Rate	14.3%	7.8%	9.5%	10.2%	Slower revenue growth affects the state's ability to finance expenditure sustainably

Source: Kerala Budget Analysis, 2025-26.

The table clearly shows that all the fiscal indicators are showing deficit, which turns out to be a fundamental factor for caution. At the same time, the table presents the rate of growth of own tax revenue generation which is seen as tortoise crawls whereas the expenditure side witnesses swifter movements. Source: Government of Kerala (Economic Review) & Government of India Statistics

V. COMPARATIVE PERSPECTIVE

Kerala's fiscal indicators remains at an unfavourable position at comparisons with fiscally stronger Indian states. Debt-to-GSDP ratios in Gujarat and Maharashtra remain significantly lower than that of Kerala. Kerala's fiscal deficit also remains relatively high compared to states with diversified industrial economies. However, Kerala's position is not as severe as that of highly indebted states such as Punjab. Kerala occupies an intermediate position characterised by relatively high social development combined with structural fiscal vulnerability. The NITI Aayog Fiscal Health Index 2025 placed Kerala among the weaker-performing major states on indicators such as debt sustainability and fiscal space (NITI Aayog 2025). High committed expenditure and low revenue buoyancy were identified as key concerns.

VI. FISCAL FEDERALISM AND CENTRAL TRANSFERS

Kerala's fiscal stress cannot be understood entirely in isolation from India's federal fiscal architecture. The state government has consistently argued that changes in Finance Commission devolution criteria have disadvantaged states with lower population growth and higher human development achievements.

The Fifteenth Finance Commission placed greater emphasis on population and income-distance criteria, reducing the relative share of southern states in central tax devolution (Finance Commission of India 2021). Kerala has argued that this effectively penalises states that successfully controlled population growth and invested in human development.

At the same time, Union government borrowing restrictions and limits imposed under fiscal responsibility frameworks have constrained Kerala's ability to borrow for developmental expenditure. The conflict between state-level welfare commitments and central fiscal constraints has become a recurring feature of Centre-State fiscal relations.

VII. THE "RICH SOCIETY, POOR GOVERNMENT" PARADOX

The phrase "rich society, poor government" captures a real structural contradiction in Kerala's political economy. Household prosperity, supported by remittances and human development, coexists with a fiscally constrained state apparatus.

Kerala resembles a welfare-oriented middle-income society without the industrial and tax base typically associated with such welfare systems. In many respects, the state exhibits social outcomes comparable to upper-middle-income economies, but without equivalent fiscal capacity.

This contradiction creates a long-term sustainability challenge. Welfare commitments continue to expand while revenue growth remains constrained. Borrowing temporarily bridges the gap, but rising debt-servicing obligations reduce future fiscal flexibility. As a result, the state increasingly faces a situation in which maintaining the welfare model itself becomes fiscally difficult.

VIII. CONCLUSION

Kerala's fiscal stress is not a temporary phenomenon caused solely by cyclical slowdown or short-term shocks. Rather, it reflects deep structural contradictions within the state's development model. A narrow production base, dependence on remittances, high welfare commitments, demographic ageing, and constrained fiscal autonomy together produce persistent fiscal imbalance.

The Kerala experience demonstrates that high human development can be achieved even without large-scale industrialisation. However, sustaining such achievements requires adequate fiscal capacity. Kerala's challenge today is therefore not merely one of debt management but of reconciling social commitments with long-term fiscal sustainability.

Addressing the imbalance will require a combination of stronger revenue mobilisation, expansion of productive sectors, rationalisation of committed expenditure, and reforms in federal fiscal relations. Without such adjustments, the state risks gradual erosion of the very welfare achievements that distinguish the Kerala model.

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