Economic Crisis in Kerala

Current uncertainties around the world in terms of the COVID situation, spillover effects of the Russia-Ukraine war causing inflation of commodities, and monetary tightening by the central banks across the world are also causing major macroeconomic risks for the state governments in India. Besides these other reasons for the worsening financial crisis for states include declining own tax revenue, increased expenditure of freebies, the relaunch of the old pension scheme, increased natural disasters, the realization of government guarantees extended to state-owned enterprises, and rising overdue loss-making power distribution companies (DISCOMs).

States with the highest debt burden based on the debt-GSDP ratio in 2020-21 are Punjab, Rajasthan, Kerala, West Bengal, Bihar, Andhra Pradesh, Jharkhand, Madhya Pradesh, Uttar Pradesh, and Haryana. With the continuous decline in their tax revenue some of these 10 states, viz., Madhya Pradesh, Punjab, and Kerala are becoming more fiscally vulnerable. And the decline in own tax and non-tax revenue affects expenditure planning and increases their dependence on market vulnerability.

States like Rajasthan, West Bengal, Punjab, and Kerala spend 90% on revenue accounts resulting in poor expenditure quality. Investment expenditure on capital development lasts longer and is stronger bringing the positives after two-three years.

In these 10 most indebted states, 12.4 percent (Average of 2017-18 to 2021-22) of total revenue expenditure has been on pensions.

Over the last three years, the largest rise in subsidies has been observed by the states of Kerala, Odisha, Telangana, Uttar Pradesh, and Jharkhand.

Over the years, the state of Kerala has performed better in social indicators, even when compared to other states, overcoming gender and caste barriers and thus ensuring human development. It is a relatively high-income state with a per capita GSDP of Rupees 1,46,910 in 2020-21. The average income per person in Kerala is 1.5 times the Indian average in the fiscal year 2020-21. However, considering current stats, Kerala is moving towards a financial crisis. The cumulative public debt of the state is estimated to cross rupees 3.27 lakh crore by the end of this year.

A glimpse of expenditure and revenue trends for Kerala

The share of revenue expenditure is much more than capital expenditure for the state. Higher borrowings by the state government have not been used for capital expenditure. This in turn impacted capital formation in the state. The investment made by the state in Public Sector Undertakings, joint ventures, private corporations, and others also witnessed a decline which started improving slightly only after 2006-07. Comparing two areas of expenditure, developmental and non-developmental, a major portion of expenditure is incurred in non-developmental areas including debt services, pension, and salaries. It must be noted that employees receiving a major chunk of expenditure are only a small part of the population. Due to tax leakages and inadequate assessment of tax, there has been revenue reduction and revenue loss.

In Focus: Rising Committed Expenditure of Kerala

Committed expenditure by the government can be referred to as expenditure on salaries, pensions, and interest. More the expenditure on this side of the budget limits the ability of the government to spend on developmental areas.

- For the financial year, 2022-23 about 71 % (Rs 94,781 crore) of revenue receipts of the state will be incurred in the committed expenditure area. This includes 31.3% on salaries, 20% on pension, and 19.4 % on interest payments of total revenue expenditure.
- Experts have constantly argued how a continuous hike in salaries and pensions has constrained the ability of the state despite higher revenue capabilities.

• In 2020-21, the state spent 65% of its revenue receipts on committed expenditure.

• According to the Medium Fiscal Plan presented along with the budget, committed expenditure of that state will increase to about 72% by the financial year 2024-25.

• On the other hand, there has been a decline in expenditure on key sectors education, health, agriculture, rural development, policy, and energy as compared to the average allocation by the other states. For instance:

1. In 2022-23, 14. 8% of total expenditure has been allocated for education lower than the average allocation of 15.2% by other states.
2. In 2022-23, 5.8% of total expenditure has been allocated for health, marginally lower than the average allocation of 6% by other states.
3. In 2022-23, 4.5% of total expenditure has been allocated for agricultural and allied sector development, lower than the average allocation of 6.2% by other states.
4. In 2022-23, 4.0% of total expenditure has been allocated for rural development, lower than the average allocation of 5.7% by other states.
5. In 2022-23, 2.7% of total expenditure has been allocated for police, lower than the average allocation of 4.3% by other states.
6. In 2022-23, 0.3% of total expenditure has been allocated to the energy sector, a significant reduction from the average allocation of 4.4% by other states.

CAG Analysis :

- According to CAG reports, over the last five years revenue receipts of the state have recorded a growth of 31%. However, tax revenue for the state, a major source of revenue in revenue receipts, has increased by a mere 29% from the period 2015-16, and 2019-20.
- Considering the expenditure of the state, there has been an increase in revenue expenditure by the state from ₹78,690 crores in 2015-16 to ₹1,04,720 crore in 2019-20, a growth of 33%

during the period. CAG reports also made a point of the rising committed expenditure i.e. salaries, pensions, and interests by the state government.

- Capital Expenditure means the expenditure by the government on the development of assets through spending on education, health, infrastructure, etc. Such investments by the government bring in profits or dividends in the future. Capital expenditure of the state has increased from ₹7,500 crores in 2015-16 to ₹8,455 crores in 2019-20 indicating a meager growth of 12% during five years from 2015-16 and 2019-20.
- Average returns of the state's investment on statutory corporations, Government Companies, Joint Stock Companies, and Cooperatives were 1.39% in the last years while the average interest rate government incurred on its borrowings was 7.33% during the last five-year period of 2015-16 and 2019-2020.
- It must also be noted that the government has made huge allocations of funds for loss-making institutions.

Kerala Model of Development

- Since the beginning, the market intervention has been the key feature of the Kerala model. Till the 1980s economic controls and regulations using measures like state ownership of sectors like communication, water, infrastructure, irrigation, water, and power supply, policies detrimental for private players to expand, less scope for modernization and mechanization and limited public investment with limited resources have been in play.
- Remittances from the workers who migrated to Gulf countries have played a major role in the economic growth of the state beginning in 1975. This large-scale migration improved parameters like poverty, consumption, savings, investment, income distribution, and regional development.

- As globalization and privatization policies came in the 1990s, there has been an increase in private investments, emigrations, the flow of remittances, and improved public expenditure on infrastructure and the social sector.
- However, the state witnessed recession challenges with the COVID-19 pandemic. With the imposition of lockdown came higher levels of unemployment, impacted production and movement of goods and services, imposition of lockdowns, fall in emigration and remittances, and fiscal crisis at the state and local government levels. Severely impacted industries include mining and quarrying, construction, trade, tourism and hospitality, real estate, and commercial and financial services.
- Several reasons pointed for the fiscal crisis of the states are poor resource mobilization, populist policies of the government leading to less revenue earning, inefficient management of taxation, inadequate development of the industrial and manufacturing sector, high dependence on remittances and the tourism sector, and unsound fiscal policies, and high expenditures.
- Revenue deficit increased from Rs 9657 crore in 2015-16 to Rs 24,206 crore in 2020-21. In 2017-18, Kerala among the 28 states had the highest revenue deficit. And in 2018-19 the state of Kerala ranked in the third position concerning the highest revenue deficit.
- The inability of the government to mobilize its tax and non-tax revenue has significantly contributed to the grave fiscal situation and mounting public debt.
- This year's annual budget has also failed to meet the challenges of the ongoing fiscal crisis, inflation, high educational unemployment, and sectoral growth in areas like infrastructure, trade, tourism, agriculture, education, small and marginal industries, and services.

Labor Relations and Industrial Backwardness in Kerala:

- For a long period, labor unrest and the growth of active trade union movements have disrupted or slowed the industrial development in the state. As informal workers into the fold, there has been a constant demand for better wages and improved working conditions leading to a higher number of strikes and diminishing labor productivity.

- These factors pushed industries like cashew processing that depends on cheap and unskilled labor to relocate to different parts of the country.
- Apart from labor issues, the lack of industrial diversification has also impacted revenue generation for the state and its people.
- When considering social parameters, Kerala has performed better than the national average owing to public policies of the government and social, political, and labor movements.
- However major stimulus to this growth has been from the services and construction sector and not major industries and agriculture. The state has made large investments solely in the chemical industry and the inability to develop its linkages with the rest of the economy has hurdled the growth process.
- Besides, environmental problems, unavailability of land, and power shortage are also the underlying concerns.

Exports and Trade in Kerala:

- Detailed research by EXIM Bank suggests that Kerala has the potential to reach an export target of `3.67 trillion by 2024-25.
- At present, Kerala's share in merchandise exports in its GSDP stands at 12% and in overall India's merchandise exports it is 2.9%. This value is much lower than other coastal states of the region. As per EXIM Bank research, Kerala has an untapped potential of US$ 6.7 billion in merchandise exports. Reaping the potential, the value of merchandise exports from the state can increase to nearly US$ 16.5 billion.
- The State's policies must focus on increasing the share of exports, both merchandise and services from the current level of 14.5% to match the national average of 19% and in the future at 25%, lining with future targets for 2024-25.
- Major export destinations for the state are UAE, USA, China, Japan, and Vietnam.

- Challenges that the state is facing currently include low agricultural productivity, concentration in export basket and export markets, a nascent and low-performing industrial sector, and stagnating growth in foreign exchange earnings by key services verticals.
- Apart from these, exporters and traders face marketing constraints in terms of difficulty in finding buyers, cost of marketing & packaging of exports, competition and risk associated with exports to international markets, issues related to standards, rules, and regulations, difficulty adhering to quality norms, domestic regulations, and getting certifications in international market access. Several other constraints include infrastructural, financial, and technology-related constraints.

Way Forward:

CAG Recommendations:

- Measures need to be adopted for increasing and improving own tax revenue.
- Focus on improving capital expenditure that will bring in long-run growth and development.
- Investments in loss-making institutions need to be reviewed and a proper strategy must be implemented for the same.
- Debt sustainability must be monitored closely by bringing in positive measures to maintain a healthy debt-GSDP ratio.
- CAG reports recommend the government make realistic budgetary assumptions while bringing efficient measures to improve savings and control excess expenditures.
- For the overall development of the state in all sectors, improved implementation and financial management of schemes and projects are suggested.
- The state government must attend to revenue and fiscal deficit on an urgent basis achieving the targets as stated in Kerala Fiscal Responsibility Act.
- Increased borrowing by the state government contributes to higher debt. Higher debt and rising interest payments hamper capital formation and development of the region.

• The report also suggests healthy expenditure on infrastructure and social security pension schemes are required. Such expenditure must be covered within the budget constraints.

Another measure:

• One long-term way to expand states' revenues and income generation would be to develop and diversify the industrial sector for Kerala.

• Kerala has a high potential in the agro-based and food processing industries. The state can bring in policies to boost export-based growth utilizing agriculture and natural resources. Promoting the production of coconut, rubber, wood, and bamboo will bring in great revenues. It must be noted that many South Asian nations like Malaysia and Thailand developed rapidly by tapping the potential in these areas.

• Government must focus on increasing agricultural productivity and diversification of crops along with value addition and marketing of the same.

• Large-scale investments from both public and private players are also required.

• Apart from agriculture, Kerala carries potential in the area of biotechnology, health- care, and educational services.

• The savings of the migrants from remittances has largely gone into construction, real estate, and some service sectors.

• Policies must be brought in to promote the culture of entrepreneurship, something that never really flourished in the state.

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