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BUDGETING FOR A BETTER KERALA

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

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Kerala Governor Arif Mohammad Khan gives a policy address on the first day of Budget Session of State Assembly, in Thiruvananthapuram on January 23, 2023. | Photo Credit: ANI

As the Budget process for the financial year 2023-24 begins, many challenges await the Finance Ministers of various States in India. The economy which was picking up after COVID-19 pandemic is facing the threat of another wave of the virus. Shocks from a looming recession in advanced economies, continuing supply chain disruptions following a new wave of COVID-19 in China, the war in Ukraine and rising interest rates are reaching Indian shores too. Kerala's economy, which was already facing several challenges, has to weather the storm caused by these new developments and much more.

The return of more than 1.7 million expatriates following the pandemic poses a big challenge for Kerala, which has been haunted by the spectre of unemployment for long. Outflow of students from the State is a fresh challenge. And the issue of recurring natural calamities demands urgent attention.

The State's economy and government finances have been in the doldrums for some time now. Kerala's economy had slowed down significantly from 2013-14 when the GSDP (gross State domestic product) growth rate dipped to 3.9% compared to GDP growth rate of 6.39%. This trend continued till 2017-18 to revive for a year in 2018-19 (GSDP 7.5%, GDP 6.12%). The GSDP slowed down again in 2019-20 and contracted due to the pandemic in 2020-21. Naturally, the fiscal fallout was serious, with revenue dwindling and expenditure continuing to rise. This raised the public debt of the State, further affecting the fiscal space. The tapering off of the revenue deficit grants awarded by the 15th Finance Commission is also going to add to the woes.

While it is important to address each of these issues specifically, the underlying approach has to necessarily pay attention to two aspects. First, to the growth rate of the economy; and second, to fiscal consolidation.

The foremost challenge before Kerala's Finance Minister will be to take immediate steps to take the economy to a higher growth trajectory. Economics 101 tells us that the only way to achieve this is by raising investment, which will ensure more employment too. When government finances are in the red, and when capital expenditure by the government is a measly 7% of budget with most of it going to the public works department, the only way to achieve this is by attracting private investment.

Urgent steps are needed to encourage private investment in green infrastructure and productive sectors instead of remaining locked in commerce, trade and retail business. Tourism, education, health and IT are probable areas of investment as identified by experts long back. Such investments will have significant backward and forward linkages.

This approach will address the issues which emanate from the return of expatriates and the fresh outflow of students, although it is going to be a long road. Students go out looking for better education and a better standard of living. Steps to improve the quality of existing universities and educational institutions are essential, but that may not suffice. What the Budget can immediately do as a policy document is to announce a decision to allow private and foreign universities in the State in a phased manner.

Kerala will have to pay increasing attention to environmental aspects in the context of recent extreme weather events. Against the backdrop of COP27 at Sharm el-Sheikh, India has prepared its first national adaptation communication. State governments will have a significant role to play in this area. Given the multi-sectoral significance of adaptation, the Department of Finance may start publishing a 'climate change related budget statement' as a Public Financial Management (PFM) tool of accountability. We hope the forthcoming Budget will act on it.

Fiscal consolidation is going to be a laborious task for Kerala. The public debt of the State is close to 40% of GSDP. With interest payments to revenue receipts ratio — an important parameter to analyse 'fiscal risks' — high at 18%, the debt servicing burden of the State is mounting. The fiscal deficit is above 4% and the revenue deficit approximately 2%. As general services (non-developmental expenditure) — with significant components of interest payments and pensions — continue to crowd out social and economic services (developmental expenditure), there is an urgent need to review the quality of fiscal deficit. The Budget will have to articulate a roadmap for fiscal consolidation in the medium term.

In short, Kerala is in dire need of a climate-resilient growth Budget. While faster growth can improve the fiscal health in the medium term, a move towards fiscal consolidation is essential to beat the fiscal blues. This will prove to be good economics. That will be good politics too for a ministry in its second year.

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