State Budget, 2007-08: Kerala

New Development Agenda
Will the State Overcome Obstacles?

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The Budget for 2007-08, the year being the first year of the Eleventh Plan, has done reasonable justice to support the Plan and take Kerala on a higher growth path. However, there are external constraints to the implementation of these policies that have to be resolved.

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The year 2007-08 is indeed one to remember with great nostalgia. This is the 50th anniversary of the formation of the Kerala State and the first elected popular Communist ministry led by the veteran E.M.S. Namboodiripad. Kerala's political history saw unprecedented turbulence during the short period of this ministry. The dynamic policy initiatives taken by the EMS ministry in the field of land reforms, social control of education sector, tripartite industrial relation institutions, Public Distribution System ensuring food security, etc brought an alliance of communal forces under the Anti Communist Front (ACF). ACF spearheaded a violent struggle against the ministry prompting the central government to invoke relevant provisions in the Constitution to order the dismissal of the elected government. This was a great watershed in the history of modern Kerala. Pro-people good governance was under serious threat. Today Kerala faces another set of problems, besides the ones that emerged in 1959.

In his speech, Thomas Isaac, the present State Finance Minister noted:

> Kerala State is at the cross roads of history…From a past era of socio-economic justice with its emphasis on redistribution, Kerala is moving towards a future of rapid economic growth and modernisation. A bridge has to be built between these two worlds. A new Kerala model is to be evolved, combining economic justice and rapid economic growth. The achievements of the 20th century have to be closely guarded while conquering the heights of the 21st century. [Budget Speech 2007-08, pp.70-71. See http://www.esocialsciences.com/articles/displayArticles.asp?Article_ID=883]

Let us see how he is going to do it.

The finance minister has clearly spelt out the state's New Development Agenda and the obstacles before it. The main components of the New Agenda are:

- Protection of agriculture and traditional industries.
- Upgradation of standards of public amenities in education and health.
- Switching over to sectors like IT, tourism, light engineering, etc.
- Providing infrastructure for the above growth sectors.
- Removing the backwardness of outliers such as scheduled tribes, fishermen, etc and ensuring gender justice and protection of the environment.
- Democratic decentralisation of power, administrative reforms and eradication of corruption.

This looks like a comprehensive agenda. But when it comes to its implementation the finance minister anticipated two major obstacles. These are: Rusty administrative machinery, and, the financial constraints of the government. Which one of these acts as the bigger obstacle is a matter of debate.

Most of the departments have been able to spend, on an average, only a little less than one-third of the plan outlay sanctioned to them during 2006-07. The performance of the local bodies is no better. The departments have their own explanations for this under-spending. One among them is the financial constraint of the government. This constraint forces the finance department to delay release of funds for spending. So ultimately the obstacle is fixed on the 'financial constraints' facing the government. This is a 'fiscal issue'.

Impact of Central Policies

There are two dimensions to this. One is the impact of the central government policies on the state finances. The second is the inability of the state to mobilise enough revenue to meet development and non-development expenditure. In a sense, they are inter-connected.

The impact of the central government policies is manifold. The policy of liberalisation, particularly with regard to imports, has hit Kerala farmers very hard on account of the crash in crop prices and the consequent fall in farm incomes. The large number of suicides by farmers is a reflection of this. The acute agrarian crisis in the state has led to an increase in unemployment and underemployment among the agricultural labour class.

The centre has been putting pressure on the states to implement the Fiscal Responsibility and Budget Management (FRBM) Act. This would force states to reduce their revenue and fiscal deficits as per a given time frame. Many states are trying to achieve the stipulated targets by cutting down development expenditure. Should Kerala also follow this practice?

The Kerala finance minister admits that the state has a certain amount of fiscal stress. He has clearly stated that Kerala has "no intention of reducing the deficit, either by weakening interventions in developmental areas or by curtailing expenditure on social welfare". In fact, he told the Assembly that "the deficit this year will be higher than that of the previous year", and, a "plan cut is not going to be resorted to as a short cut to tide over financial crisis". Perhaps no other state finance minister would have been so bold as that of Kerala in declaring that a sovereign government need not downsize the public domain and make the life of the poor and the vulnerable more critical by just following the central government directive under FRBM law. In fact, according to him, there is a strong case for amending or scrapping the FRBM Act. The views of Kerala government led by the Left Democratic Front (LDF) are very clear on this.

In the recent past Kerala has registered its protests against the Awards given by the Finance Commissions. These have not taken into consideration the second-generation problems arising from the social and economic development in the past. Indeed, the sustainability of the Kerala Model of Development has been questioned. Unless greater state support is given, the high Human Development Index achieved by the state so far may decline. This requires revenue mobilisation by the state.

Constraints to Revenue Mobilisation

According to the Budget statements, the revenue receipts for 2007-08 will be Rs.21,446 crore and the revenue expenditure will be Rs.26,697 crore. Kerala is reluctant to compress public expenditure in an anti-people manner. This is a unique feature of the Kerala Budget 2007-08. However, the finance minister has given more attention to raise additional resources through some bold moves. [http://www.esocialsciences.com/articles/displayArticles.asp?Article_ID=879]

In 2006-07 revenue receipts of the state were only 13.5 pr cent of the State Domestic Product. This is proposed to be raised to 16 per cent by 2010-11. The finance minister has plans to eliminate revenue deficit by 2010-11. The Planning Commission has come out openly in favour of extending the period for achieving the target for eliminating revenue deficit by two or three years. But they are not in favour of taking such a stand in the case of fiscal deficit. Finance minister Isaac strongly objects to the fixing of a mechanical ceiling on all kinds of deficits. There is, it may be recalled, a divergence of views between the Planning Commission and the Union ministry of finance on this matter of deficits.

Isaac has also challenged the policy of the Central Government on fixing a ceiling on market borrowings by states. Originally the state was made to understand that it could borrow up to Rs.7,500 crore. But the Union ministry of finance has now informed the state that its eligibility is only Rs.4,500 crore. After protracted discussions, the Planning Commission was willing to allow Rs.7,200 crore for 2007-08. But the Union Government does not accept this, and, on the contrary, has threatened the State with a further reduction of the limit.

The Union Government is adopting a new strategy by fixing not only the limit on market borrowing, but also stipulating the sources from which such borrowing had to done by the states. As such, the state has no right to borrow any amount from any source of its choice. Kerala is thus demanding the freedom to borrow and to utilise the funds according to its own priorities. The Union Government’s policy needs to be urgently corrected.

There are many other controversial issues like this. We have the issue of Value Added Tax (VAT) and the revenue loss caused by replacement of the state sales tax. Kerala has complained that the Centre does not consult the states when important decisions that affect the states are taken. The non-functioning of Inter State Council, the absence of any serious debate and discussion in the National Development Council, the blatant deviation from the agreed Common Minimum Programme (CMP), and the pressure applied on states to go in for Externally Aided Projects (EAPs) instead of locally designed programmes are a few other issues on which a consensus among states is urgently called for. Isaac has announced that he would take the initiative to organise a national-level workshop and invite all state finance ministers to Kerala to deliberate on all issues that affect the states. This seems to be a welcome initiative.

Fiscal Health

A look at the trend in Kerala's fiscal scenario would suggest that the State had been passing through difficult times. The following data in Table 1 reveals this.

Table 1

ITEM	1995-96 (Rs.cr.)	2006-07 (BE)
1. Total Revenue Expenditure	5826.38	24554.82
2. Development Expenditure	3412.16	13626.33
3. Non-Development Expenditure	2414.22	10928.82
4. Capital Expenditure	563.47	2213.25
5. Non-Plan Expenditure		
(a) Interest	924.20	4427.81
(b) Pension	716.90	4054.83
(c) Salary	2230.40	16537.64
6. Own Tax revenue	3382.68	11662.86
7. Non Tax Revenue	534.49	1112.60
8. Central Transfers	1505.39	6364.57
9.Gross Fiscal Deficit	31426.00	110070.00*
10. Revenue Deficit	8201.00	24770.00*

*Refers to Budget Estimate for 2005-06

The statement above indicates that the fiscal health of the Kerala State has deteriorated sharply since the late 1990s. In the Budget for 2007-08, though revenue receipts registered an increase to the level of Rs.21,445.76 crore, capital expenditure proposed is lower at Rs.13,19.61 crore.

Though the productive sectors have stagnated, Kerala's economy has been growing with extraordinary rapidity with the services sector driving it from behind. But this pattern does not seem to be sustainable in the long run. The threat to food security is also alarming. Unemployment and underemployment are very acute. The out-migrants outside Kerala as well as outside the country are sending in huge remittances, but they are not mobilised for productive investment.

The State Planning Board in its Draft Approach Paper for State's Eleventh Plan had stated:

> There is a paradox at the heart of Kerala's economic performance. During the years prior to 1987-88, when the state's growth rate was unimpressive and its material commodity producing sectors virtually stagnated, Kerala received world-wide acclaim on account of its remarkable achievements in the sphere of human development, which were celebrated as the 'Kerala Model'. Since the latter half of the eighties, however, when the growth rate began to pick up, Kerala's economic woes have increased, notwithstanding the emergence of certain new growth sectors.

It went on to say that the per capita foodgrain absorption and the per capita calorie intake have stagnated and there has been an acute agrarian crisis. There was a decline in plan outlay even in the midst of apparently impressive growth over 6 per cent. This is intriguing and instruments like the State budget and State Plan should find a solution for that. Kerala's Eleventh Plan (2007-12) aims to correct the past mistakes to some extent and create conditions for a sustainable development of the economy and ensure adequate social protection to the poor and vulnerable sections of the population.

The basic thrust of the Eleventh Plan is:

> Government must play a proactive role not just in defending, promoting and nurturing the petty and small scale producing sectors of agriculture and traditional industry, but also in providing social security to unprotected workers, and in strengthening social sector schemes through larger expenditure on education, health, nutrition and housing for the poor.

The Budget for 2007-08, the year being the first year of the Eleventh Plan, has done reasonable justice to support the Plan. The tax and expenditure policies and the various development programmes proposed by Thomas Isaac will definitely take Kerala on a higher growth path as well raise level and quality of Human Development in the coming years.