THE FISCAL CHALLENGE TO KERALA'S DEVELOPMENT

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

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Representational image

Kerala's development possibilities are being crippled by a fiscal crisis. While the critics allege extravagance in government operations, the State government blames the Centre for its troubles. In many ways, Kerala's problems are no different from the financial difficulties faced by several other States. One of the fundamental issues they all confront is the 'vertical fiscal imbalance': the power to raise most of the taxes is entrusted with the Union government while the bigger chunk of the spending is done by the State governments.

Other than State Goods and Services Tax (SGST), the only sources of revenue for the States are stamp duty and registration fee on property transactions and on vehicles; sales tax and excise duty on a few commodities such as alcohol; and revenue from mining leases, lotteries, and so on. The States bridge the excess of expenditures over their own revenues partly with fiscal transfers, grants, and loans from the Union government and partly with their borrowings, mainly from the market. A share of the taxes collected by the Centre is devolved to the States based on a formula recommended by the Finance Commission. While earlier the States could set tax rates independently, they surrendered that right when national uniform tax rates were introduced, notably the GST regime in 2017.

The States must bear 40% of the outlay for most of the centrally sponsored schemes (CSS) or they risk losing the funds allotted for these schemes altogether. But the projects under CSS may not always be the suitable ones for the individual States given their respective development priorities. The States have also disagreed with some of the norms prescribed for availing themselves of the CSS. Over the last decade, there has been an increase in the share of surcharges and cesses in taxes collected by the Union government, which do not have to be shared with the States as per constitutional provisions. All these have weakened the fiscal autonomy of the States.

In 2021-22, Kerala raised revenues amounting to 688 billion (1 billion = 100 crore), with major contributions from SGST, sales taxes, and income from lotteries. According to the Reserve Bank of India (RBI), Kerala is among the top performers in revenue mobilisation efforts. But it is also one of the biggest spenders of government money, on a per capita basis. The per capita revenue expenditures (for day-to-day operations) in Kerala were 1.3 times higher than the corresponding average for all the States in all developmental activities put together; 1.9 times higher in the case of health; and 3.7 times higher in social welfare. Kerala's revenue expenditures on social services alone came to 507 billion, which took up almost three-fourths of all the revenues the State mobilised on its own (all figures relate to 2021-22).

Kerala's share in the taxes devolved by the Union government to the States fell from 3.88% during the 10th Finance Commission period (1995 to 2000) to 1.93% during the 15th Finance Commission period (2021 to 2026). Notably, 1.93% is less than Kerala's share in India's population (2.6% in 2021).

Not having adequate financial resources is impairing Kerala's growth prospects. The educated youth are seeking opportunities outside the State. Translating Kerala's potential to emerge as a thriving region for knowledge-based industries requires big investments in infrastructure, research centres, and so on. However, capital expenditures undertaken by the State – equivalent to 1.87% of the State Domestic Product (SDP) – is hardly sufficient for this task.

There has been a lot of discussion about salaries and pensions to government employees, which accounted for 48.8% of all of revenue expenditures by the State. Kerala has 5,26,000 government employees, with nearly half of them employed in the fields of education or health. About half of all government employees are women compared to just one-sixth at the national level.

Public employment has been one of the prime movers of Kerala's social achievements. But the government requires many more professionals and analysts on its ranks, and much fewer 'attenders' and 'typists'. Higher education receives only a quarter of all funds allocated for education in the State. This must be reviewed given the large demand for high-quality higher education on the one hand and the absolute decline in the population of children in the school-going years on the other. Almost 30% of the expenditure on salaries is set aside for teachers in institutions run by private managements. It is time to revisit this arrangement.

Kerala will have to seek new sources of finance. One option is to borrow from the people — to begin with, mobilise savings within the State, much of which is frittered away in houses, vehicles, and jewellery. Commercial and cooperative banks and the Kerala Infrastructure Investment Fund Board could be deployed for this task. However, the hurdle to this is the general opposition to debt-financed government expenditures. The Centre has rejected Kerala's plans to seek more loans, citing that the State's debt level (38.6% of SDP) is already high. But fears of debt are unwarranted if the debt-financed expenditures can generate new incomes and jobs and savings that can pay off the debts. The State government must take the lead in preparing a detailed blueprint for Kerala's future economy, which should allay the fears about its financing plans.

Kerala / development

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