

PRE-BUDGET MEMORANDUM 2018

submitted to

**the Hon'ble Minister for Finance,
Government of Kerala**



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1.0 The State of the Macro Economy

The economy of Kerala clearly demonstrates a crisis situation, wherein the productive sectors show some degree of stagnancy. The macroeconomic figures brought out by the State Planning Board speak of a comparative picture of Kerala's growth rates in relation to that of other States. However, these macro figures, by themselves, cannot be useful in taking forward a strategy for the development of the State. Examined from the point of view of strategy, the picture emerging from the State, need to be analyzed in relation to the three aspects:

- 1) national policies that significantly limits the State's budgetary resources;
- 2) The state of the meso and subsectoral growth rates; and
- 3) The role of savings and investments as growth accelerators.

The major national policies that influenced the State's economic position, relating to income distribution and resource availability, during the current financial year are:

- 1) Demonetization and its distributional consequences; and
- 2) GST implementation and its fall-outs. The demonetization programme of the government of India, has had disastrous consequences on the industrial sector, and especially the micro sector, where, transactions take place largely through conventional method. While, the enhanced integration of this sector with the new economy is necessary, the particular nature of the sector itself is caught in a vicious circle of low productivity, low investment, small volume of output, and unwholesome financial transaction, with large dependence on the local market.

The savings and investment position in Kerala demonstrates the need for correction and improvement. While, on the one hand, foreign remittances have remained by and large constant, the changes in the pattern of investment still remains undesirable. The capital goods sector remains still weak. The limited investments that have come into the consumer goods sector, are not sufficient to trigger an income acceleration. As such, the production base of the States' economy still remains weak. While the productive sectors, by and large, remain stagnant, and most of the consumer goods come from outside the State, the growth potential of the services sector also remains doubtful.

While the production base remains weak, as mentioned above, the changes in the consumption pattern, as revealed by the NSSO figures, gives much room for alarm. A fundamental question that emerges is, whether Kerala could meet its expanding demand base, with an appropriate response on the production base. The experience need to be examined in relation to the commodity basket of consumption in Kerala. Most of the consumer goods enter into the State from outside. Besides, much of the items of daily consumption, such as vegetables, milk, eggs etc., find their way into the State from neighboring States, with obvious concerns relating to their quality and environmental hazards.

While the micro economic policy of the country is not adequately sympathetic to the rigidities of this sector, the political and ideological background of the government matters a lot in providing support to these enterprises. An area that has been badly neglected is,

business development services, where, governments , based on their imagination and conviction can evolve innovative programmes meant for promotion.

2.0.Public Policy and Business Sustainability

Public policy, in all countries, focus on employment promotion. Given the 'redundant labour' phenomenon seriously constrains employment opportunities in the formal sector, governments increasingly resort to 'enterprise development', development of micro, small and medium enterprises, as a Keynesian solution today.

Clarity on approaches to sustainable enterprise development is often limited. It demands a mutually reinforcing policy framework that operates both at the macro and micro-meso levels. The focus on catch-words often in vogue are, "development' and "Investment promotion". But, the dynamics of the process and its details are often missed out. Such integrated policy approach is often missing in most cases. Kerala also is no exception, despite's significant achievements on the decentralisation front.

3.0.Translating Hard core Economic Rationale into Budgetary Sense

n ILO's definition of forms of work. It gives a comprehensive definition of work , which can be used by to Finance Minister, as a beautiful operational tool. It says:

A "type of contract which a person's has with other persons or organizations when performing a particular job" when that is measured in a statistical survey or registered in other administrative files. The "type of contract" for a job is determined by the type of economic risks and authority which are involved when carrying out the tasks and duties of the job".

In the ILO's definition as above, out of the six categories, three constitute self employment. Based on such categorisation, the Budget need to act as a dynamic agent that triggers creative economic activity of the people(work).

4.0.Work and Work Process: Kerala's comparative Experience

The Budget simply does not speak Economics, it is more of a political document. Finance Ministers often fail to understand, what motivates the entrepreneur. It is something more than mere tax rates.

Self employment as the breeding ground of entrepreneurship-it is the lowest form of 'enterprise'(risk-taking). Look at the self-employment scene in India. At the national level here is a general tendency for the density of self employment to come down. Per Sq.km. self empty is very low in two States, via, Kerala and T. N. This is a pattern that is gradually catching up in other States as well. Why does it happen? Can the budgets do something to reverse this trend?

Table: Ranking of States According to Employment Categories

Region	Self Employed	RANK	Wage/ Salaried	RANK	Contract Workers	RANK	Casual Labour	RANK
Andaman and Nicobar Islands	25	36	35	6	4	15	37	7
Andhra Pradesh	38	30	13	31	6	7	48	1
Arunachal Pradesh	71	1	17	24	5	11	7	35
Assam	60	8	19	19	2	27	18	23
Bihar	51	16	7	37	4	16	38	6
Chandigarh	39	27	45	2	5	12	11	32
Chhattisgarh	57	12	12	32	3	20	28	16
Dadra and Nagar Haveli	28	34	25	12	36	2	11	31
Daman and Diu	29	32	23	14	46	1	3	37
Delhi	41	26	39	4	12	4	8	34
Goa	23	37	54	1	11	5	12	30
Gujarat	52	14	13	28	8	6	26	18
Haryana	51	17	24	13	5	13	20	22
Himachal Pradesh	62	5	19	20	2	28	17	25
India	51	19	16	25	3	19	30	14
Jharkhand	68	3	12	33	6	8	14	28
Karnataka	45	22	19	23	1	30	35	8
Kerala	29	31	23	15	3	21	46	2
Lakshadweep	38	29	36	5	16	3	10	33
Madhya Pradesh	60	9	10	36	1	32	29	15
Maharashtra	60	7	21	17	3	18	15	27
Manipur	69	2	12	34	1	34	18	24
Meghalaya	63	4	15	26	1	35	21	20
Mizoram	60	10	25	11	2	26	13	29
Nagaland	59	11	34	7	1	31	5	36
Odisha	51	18	15	27	2	25	32	11
Puducherry	26	35	43	3	0	37	31	13
Punjab	43	24	20	18	5	9	32	12
Rajasthan	61	6	13	30	5	10	21	21
Sikkim	52	15	28	9	3	17	17	26
Tamil Nadu	29	33	27	10	1	33	43	3
Tripura	42	25	19	21	0	36	39	5
Uttar Pradesh	56	13	13	29	3	22	28	17
Uttarakhand	48	20	28	8	2	29	22	19
West Bengal	44	23	11	35	3	23	43	4
Jammu and Kashmir	39	28	22	16	4	14	35	9
Telangana	46	21	19	22	2	24	33	10

Note: All figures are expressed in percentages per sq.kms

Source: Estimated by ISED Small Enterprise Observatory(based on Labour Bureau)

Public policy has a major role in giving the market signals for private investment at the bottom level. Much of the focus today- so called 'Investment approach,'(where focus is on top of the pyramid). While, it is assumed that large investors will get attracted to some of the incentives offered by the Government, and thereby will come with their large investments. Such large investments are expected to provide trickle down effects in the economy in two major forms; a) The creation of downstream link industries and self-employment activities; and b) Expansion of direct employment opportunities.

5.0.Budgeting Strategy: Need for Change

The more recent evidences on the investment scene indicate that , such a uni-linear process does not really happen to a significant extent. Therefore, there is need for a radical restructuring of the strategic approach to budgeting. Such a change involves a more broad-based initiative for building up business confidence. Experience so far, shows that, business confidence does not generally go up with respect to isolated fiscal incentives to particular sub-sectors. On the other hand, it is the predictability of business returns that influence investment decisions positively.

Investment decisions are made by INDIVIDUALS. Their achievement motivation(subjective) and expected rate of return(objective), lead to investment proposals. These aspects are often not factored into public policy(also not in Budgets).

More recently , two major policy initiatives of the Union Government have impacted the State's economy seriously:- great impact. a)Demonetization; and b) Introduction of GST. While additional resource mobilisation is critical, the options are limited. One option is the dependence on out of Budget sources, which also need to be done with extreme caution.

In a context where, there are serious constraints on resource mobilisation, the State Budget this year cannot think of such major incentives for attracting large private investments. The only option available is to broad-base such incentives, in such a way that it ignites the market sentiments in general. This essentially involves, streamlining economic governance in general, on a more rational footing. The initiatives taken on public sector companies like the KSRTC, is a good beginning. It is possible that in the industrial sector, all the existing schemes are reviewed and reorganized on a rational footing, on the basis of clear evidences on past performance.

Kerala's challenge, today, is on how to use the Budget as a tool for addressing the adverse impacts of several macro-economic policies: On the employment front,low 'self employment' and high 'casual labour' per sq. Km are Kerala's striking features today. This would naturally imply that, any unfair practice by the traders and manufacturers are likely to affect the consumers more seriously, than in any other State.

6.0.A Vision & Direction for the Budget

Kerala must, undoubtedly, build up on its achievements of the past. The question is one of sustainability strategies. It has to continue with the ongoing broad based Welfare Programmes. But the State has to also ensure that the money does not leak out of the Kerala economy. The mechanism need to be buttressing local investor confidence. The preparation of an Annual Business Sustainability Report (to be tabled in the Legislative Assembly), needs to be initiated immediately.

7.0.Key Challenges Before the Budget 2018

The forthcoming State Budget faces a vicious circle involving five inter-related problems: 1.Tax revenue squeeze; 2.Mounting non-plan expenditure; 3.Price- rise of essential commodities; 4.Limited base of PDS; and 5.Drastic fall in investor confidence, and a standstill in infrastructure sectors. Solutions to these problems are not that easy. They belong, broadly, to three areas: a)enhancement of revenue base(tax and non-tax); b)improving economic governance system in general-not only tax regime-less of "administration", and more of 'evidence- base'; c)proper targeting of Plan funds- rationalize all enterprise related programmes and schemes of various departments.

8.0.Critical Constraints

While seeking such solutions, there are 3 three critical constraints that stand out: a)Widespread price manipulation by traders, following the GST roll- out; b)High adulteration of essential commodities; c)Inadequate coverage and weaknesses of PDS; and d) A fall in investor confidence at the grass root level.

Of these, from the angle of sustainability, the critical factor is, the fall in the investor confidence itself, a scientific measure of which is the TEA rate. Despite the usual claims of the line-Department, the district-wise TEA rate indicates a rather confusing picture of what the routine programmes of the Government of Kerala achieve, in terms of investment promotion and employment. The Total Early Age Entrepreneurship(TEA) rate show a tendency to fall further. Monitoring the impact of the routine schemes of investment promotion and employment creation, on scientific lines,, need to be a major thrust of the Budget hereafter.

Total Early Age Entrepreneurial Activity (TEA) for Kerala (2013-2014)						
District Name	2011-2012	2012-2013	2013-2014	Total	As on	%
Alappuzha	510	1116	1091	2717	17456	16%
Ernakulam	1977	1949	2444	6370	30851	21%
Idukky	260	192	268	720	5124	14%
Kannur	655	656	966	2277	12070	19%
Kasaragod	313	440	505	1258	6731	19%
Kollam	484	1199	1307	2990	16249	18%
Kottayam	743	881	716	2340	23747	10%
Kozhikode	779	1058	940	2777	18271	15%
Malappuram	682	896	1185	2763	12702	22%
Palakkad	523	742	1274	2539	15917	16%
Pathanamthitta	626	868	903	2397	9764	25%
Thiruvananthapuram	1378	1679	1817	4874	31365	16%
Trissur	1177	1458	1564	4199	30461	14%
Wynadu	322	369	331	1022	3543	29%
Total	10429	13503	15311	39243	234251	17%
E II	11071	13551	14997			

Source: Computation by ISED Small Enterprise Observatory, Institute of Small Enterprises and Development.

Unless the issues, as above, are addressed meticulously through strong administrative and political steps, they are likely to affect consumers and producers alike. Naturally, the exiting businesses will open another window of imports from China, a trend that has already been in motion. Market manipulations and unfair practices cannot be checked by regulatory measures alone. There is a need to explore new voluntary and motivational tools.

Promotion of 'Responsible Business' practices(bringing in a voluntary standards regime)could be explored. Of course, scientific studies are needed on the subject. Implementation of National Voluntary Guidelines(NVGS) for MSMEs, legislation need to get the importance it deserves .For example, think of a 'Collective Efficiency' model for small hotels.

9.0.Bridging the Big Gap; Some Measures

To quote the Finance Minister: 'Revenue comes down , but expenditure goes up drastically. How to bridge this gap? The direct interventions by the Government have only limited scope in the present context. There need to be a meticulous effort to build up business confidence at the base of the business pyramid.

The thrust of the Budget need to be three pronged: First, Introduction of a Business Sustainability Policy-Manufacturing on an Enclave Model (eg: Industrial Corridor) which should work along with a decentralised LED model. Secondly, while there should be an effort to question Kerala's unique welfare schemes, wrapping such welfare schemes with sustainability-a Social Enterprise Policy& Social Enterprise Fund. Improving governance

through a strong social audit system need to be the *sine qua non* for ensuring that hard-earned resources are productively used. Thirdly, strengthening of consumer movement can play a big role. Activating Consumer Grievances Redressal Forums, and support to Consumer Guidance Societies can play a big role in cultivating responsible business practices. Broadbasing and strengthening PDS is vital. Support to CSR Hubs, having a clear programme at LSGI level, need to be explored as a new initiative.

Improvement of economic governance through evidence-based policy making is important in the present juncture. While the quality of public services are enhanced, making people willing to pay more as taxes, there is an opportunity of enhancement of basic taxes and fees: for example, meticulous e-governance at LSGI level, effective collection of professional tax and fees, are some steps that can be easily attempted at. Rationalisation of electricity and water charges need to be explored, and many of the exemptions given to particular consumer categories can be re-examined, and abolished, if needed. Kerala Start-up Policy to be restructured, into an Integrated Business Start-up Policy, with specific focus on key components, and specific Budgetary allocations. In this context, it would be advisable to examine the Tamil Nadu experience.

10.0. Tax Proposals (Indicative)

10.1. Negative Externalities Taxes (Pigouvian Taxes)

The following sources of reference

- 1) Landfill Tax (on LSGIs, Individuals, corporate entities) (objective: zero-waste economy)
- 2) Plastic tax (on all shops and establishments - higher rate on jewellery and textile shops)
- 3) NPA Tax (on LSGIs)
- 4) Congestion Tax (congestion pricing) on all vehicle users. (cross subsidized to Metro fares in Cochin).
- 5) Pet Dog Tax
- 6) Discretionary Freight Tax (on heavy vehicles in 5 city corporations)
- 7) Vehicle Excise Duty (UK model)
- 8) Public sector contracts tax
- 9) Business Devpt. Services Cess (on each GST account in the State - progressive rate on the basis of turnover)

10.2. Positive Externalities Subsidies

- 1) Social Enterprise Subsidy(based on State Social Enterprise Policy) eg: Cochin Social Enterprise Policy-by Kochi Municipal Corporation.
- 2) Healthcare subsidy/broad basing insurance
- 3) Skill Development subsidy(to private institutions)
- 4) Skill twinning subsidy(Fostering Partnerships)
- 5) Budget contribution to State CSR Pool(Corporate, PSUs, &State Government).
- 6) LED-CSR Pool(LSGIs, MSMEs, Corporate, State Government)
- 7) Employee Volunteering Subsidy
- 8) Introduction of a BDS Voucher Scheme

11.0.Conclusion

The more recent changes in the Centre-State financial relations, in addition to the many complexities, as outlined by various expert committees in the past, drastically reduces the financial resources of the States. However, the challenge today, is to strive for translating such constraints into opportunities. A major opportunity relates to enhancing productivity in Government, which is the largest employer in Kerala. Enhanced efficiency in economic governance would have a far reaching impact on confidence building at the grass root level. By now, the people understand the constraints of the State Government. Though, aspirations are always high in a society where the size of the middle-class is swelling day by day, it is such sincerity of the Government, as reflected through a properly stream-lined economic governance system that can show the way forward for Kerala.