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Editorial
Financing development: Need for a dialogue

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The role of the state and public investment in social overhead capital in economic development has been highlighted by development economists of repute like Albert Hirschman. Active role of state by way of public investment in reviving an economy in recession is at the core of Keynesian economics. Yet, with globalization, the states across the developing world were pushed to the backseat under the influence of Washington consensus. However, based on the outcomes of globalization, scholars of eminence, like Dani Rodrik, have argued that the Washington consensus has become Washington confusion and in the early years of the new millennium we witnessed a renewed interest in the role of state in development. Influential economists of younger generation too argue that role of the state cannot be reduced to mere facilitation and fixing market failures. (Reference is to a book - Entrepreneurial State by Mariana Mazzucato). Since the recipe for "development without investment" is yet to be made, the states are constrained in this regard.

The role of state needs no elaboration in the current juncture wherein the Indian economy is confronted with an unprecedented recession resulting from negative growth in the first two quarters of the current fiscal (-23.9% in Q1 and -7.5% in Q2). The recessionary trend on account of the COVID is expected to continue and the projected growth for the current fiscal is around -10 per cent calling for public spending to boost demand. In a period of poor revenue growth, while different options are open for the Central government, the State governments are constrained especially by the FRBM Act and the nature of federal fiscal relationship. While the combined revenue of States accounts only for about 8.6 percent of the GDP their combined expenditure is shown to be as high as over 17 percent. The imbalance appears to have intensified with the roll out of the GST. While the States have surrendered nearly 51.8 percent of the total tax revenue, the corresponding sacrifice by the Centre was only 28.8 percent.

Perhaps, the problem is more pronounced in the case of Kerala. Thanks to the heavy expenditure in the social sector, including health and education, the State is known for its high Human Development Index apart from being in the highest rank among Indian States with respect to the U N Agenda 2030. This, however, has come at a cost. Out of the budgeted expenditure of Rs. 1.44 lakh crore for the year 2021, for example, revenue expenditure including salary, pension and other committed expenditure accounts for as high as Rs. 1.29 lakh crore (90.1%). The state is hardly left with 0.14 lakh crore - not even 0.9 percent of GSDP - for capital expenditure for growth recovery. The option for the State Governments is to borrow. However, the strict implementation of the FRBM Act, which stipulates the states to limit their borrowing to three percent of the GDP, acts as a major barrier.

The State governments are left with hardly any option other than to search for innovative financing options including the harnessing of global financial markets. The Kerala Infrastructure Investment Fund Board (KIIFB) needs to be seen in this context. There are, however, a number of issues arise here. To what extent the existing institutional arrangements enable the states to resort to innovative financing options for development? What are the downsides of innovative financing like off budget borrowing? To what extent India has been successful in exploiting the global financial market for development? Whether investment by the State governments by harnessing the external financial market is superior to FDI, wherein investment is driven by global profit maximizing considerations of MNC's instead of local development priorities? Are there reasons to believe that there exists institutional inertia for change according to changing needs of time and harnessing new opportunities opened by globalization? Implications of public debt on development are yet another issue of much public concern. All of these are matters on which more informed discussion is needed. This issue of the Kerala Economy opens up this subject for discussion.

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