ലോക കേരള സഭ

കേരള സർക്കാർ

ലോക കേരള സഭ 2024

നാലാം സമ്മേളനം

2024 ജൂൺ 14, 15

നിയമസഭാ മന്ദിരം, തിരുവനന്തപുരം

Concept Note

ENVISIONING KERALA AS AN UPPER MIDDLE-INCOME ECONOMY

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Preface: Kerala's rising per capita income

The World Bank classifies a "lower middle-income economy" as one with a per capita gross national income (GNI) between $1,136 and $4,465, and an "upper middle-income economy" as one with a per capita GNI between $4,466 and $13,845. As per this classification, India was at the lower end of the list of lower middle-income economies with a per capita GNI of US$ 2390 in 2022. But Kerala (if it were a country) was at the upper end of the list of lower middle-income economies with a per capita GSDP of US$ 3873 in 2022-23. My estimates show that even if the Kerala economy grows at a moderate 5 per cent per year, it would become one of the few States in India to achieve the status of an upper middle-income economy by 2026-27. Its actual rates of economic growth are higher, and it may achieve this status earlier too.

If we consider purchasing power parity (PPP) adjusted estimates of per capita income, India was ranked 166th among 246 countries in 2022 – with a per capita gross domestic product (GDP) of US$ 9172 at current prices. In the same year, Kerala's corresponding per capita gross state domestic product (GSDP) was US$ 12,860. Kerala was closest to Indonesia's per capita GDP, which was US$ 12,893. Again, if Kerala were a country, it would have been ranked 142nd.

In fact, Kerala has consistently been in the top five (most populous) Indian States in per capita income for a while. However, given recurrent natural disasters, the slowing down of the global economy and the fall in commodity prices over the last decade, its rank among all Indian States in per capita income slipped from 4th in 2011-12 to 6th in 2021-22. Nevertheless, even if Kerala continues to grow moderately in the next few years, its graduation into an upper middle-income economy would continue.

The higher per capita income in Kerala also translates into higher per capita consumption expenditure. In 2022-23, Kerala ranked 1st in rural per capita expenditure and 5th in urban per capita expenditure among all Indian States. These numbers show the extent to which a large domestic market has historically been built up in Kerala.

In short, Kerala is no more an economy that it was globally known for in the 1970s i.e., with low per capita incomes and low levels of consumption expenditure. Particularly after the 1980s, it recorded economic growth rates higher than the national average for a prolonged period. Here again, however, there are reasons why we must be worried. Our per capita incomes are not anymore growing at the rates that it grew till the first decade of the 21st century. Over the past decade, these growth rates have slowed down even though Kerala's status as an economy with high levels of per capita income and consumption remains a reality.

There are two issues that must matter to us here. One, is it obvious that Kerala would make this transition seamlessly? Some economists may point to what is called the "middle-income trap", where an economy enters the middle-income club but gets stuck there without no graduation into a high-income economy. Two, how do we envision the future of Kerala's economy in the face of such potential constraints? What must be done to address the factors that lead to the underdevelopment of the productive sectors, and align Kerala's economic strategy with the future needs of its people and society?

Kerala is an economy that already possesses several pre-requisites to the transition discussed above. First, its structural transformation has been one the fastest in India in terms of the share of workers moved out of agriculture, and into industries and services. While the non-agricultural sector of Kerala's economy was larger than in other States from the 1950s itself, the shift out of agriculture was also aided by the land reform from the 1960s. Thus, in 2022-23, the share of workers employed in the primary sector was 23.5 per cent in Kerala and 43 per cent in India. Secondly, Kerala's workforce is almost universally literate, and "educated" to a significant extent. In 2021-22, the gross enrolment ratio in the tertiary sector (among those age 18-23 years) was 41.3 per cent in Kerala and 28.4 per cent in India. The gross enrolment ratio was even higher among women in Kerala at 49 per cent, as opposed to 28.5 per cent in India. This educated workforce makes Kerala a potential reservoir of talent, which could be skilled and employed in a knowledge-based economy.

But these are only necessary pre-requisites, and not sufficient conditions to make the economic transition smooth. Globally, the fragilities and uncertainties fostered by free market economics, rapidly rising inequalities, and the challenges of climate change are forcing policy makers to return to planning – to tame the anarchic market systems, to enhance the capacities of governments, and to reprioritise resource allocations. Given such a global context, Kerala must design sectoral strategies and goals and work towards ensuring a move of resources towards them.

Kerala's primary sector

To begin with, Kerala's agricultural sector needs a radical re-envisioning. Presently, the sector is bogged down by a series of structural, technological and socioeconomic constraints. Its effort in agriculture must be based on three pillars. First, we must look towards agricultural science to ensure a marriage of higher crop productivity and improved climate resilience. Along with focusing on scientific methods of cultivation and traditional methods of breeding, we must explore new innovations in agricultural science – including in genetic engineering and gene editing – to achieve this goal.

Secondly, Kerala must take urgent steps to improve aggregation of its scattered agricultural produce. For this purpose, it must harvest the historical strength of its cooperative movement and the administrative power of local self-governments. These institutions must also create storage and warehousing facilities in the panchayats, including cold storages, and emerge in the future as common facility centres.

Thirdly, aggregated products must be effectively linked with industries in processing and value addition. Industrial investors prefer purchases in large quantum, and aggregation must aim to fill this prevailing gap. The state must also facilitate investment of private capital in food parks and industrial parks. Kerala needs private investments in the value addition of coconut, spices, tubers and to lesser extent in vegetables and fruits. KINFRA is establishing a new spices park in Muttam spread over 15 acres. An announcement has already been made to establish a coconut industrial park in Kuttyadi in about 115 acres of land belonging to the KSIDC. In paddy, three integrated rice technology parks are being built in Palakkad, Thrissur and Kuttanad. Work is progressing on establishing an integrated coffee and agri-produce processing park in Wayanad in about 103 acres. Finally, there is the plan to establish a rubber company with a total investment of Rs 1050 crore and a 26 per cent ownership to the Government of Kerala.

But these interventions are not enough. Kerala also needs a programme to ensure the ease of agribusiness in crops, animal husbandry and fisheries. Only then would private investment flow into the facilities that we meticulously create. I shall provide just two examples.

In coconut, the production of neera is heavily constrained by the provisions in the excise laws. At present, a license to produce neera is given only to seven institutions: bonafide jaggery tappers, Kerala State Beverages Corporation Ltd., the Coconut Producers Society Committee and the Coconut Producers Federation (both registered with the Coconut Development Board), Kerala Agricultural University (KAU), Kerala Agro Industries Corporation Ltd. (KAIC) and Kerala State Coconut Development Corporation Ltd (KSCDC). Such stringent license conditions are a hindrance to the inflow of private investment in neera.

Similarly, in dairy, Kerala should popularise the establishment of larger commercially run dairy farms. But many existing regulations under the Kerala Municipal Building Rules 1999 to set up big dairy units (i.e., with 6 animals or more) discourage entrepreneurs. The presence of more than 5 cattle (or for that matter, more than 5 pigs and more than 20 goats) implies that the unit would be considered "hazardous" under the 2012 rules of the Kerala Panchayati Raj Act. It then requires approvals or NOCs from the panchayat/municipality, from the Fire and Rescue Services, from the Pollution Control Board and so on.

In all these cases, we need discussions to simplify rules and deregulate the sectors to ensure the flow of private and cooperative capital and promote rural entrepreneurship. In their absence, agriculture risks remaining a low-productivity and low-income sector – and a drag on the overall economy.

Kerala's secondary sectors

But it is in sectors outside agriculture that the real impetus for the future economic growth in Kerala lies. Indeed, there are several constraints in this path. On the one hand, Kerala bears the burden of a large class of poorly productive producers in traditional industries. To add, there are plantations and specific industrial sub-sectors that were previously engines of export but have now lost competitiveness due to cost disadvantages. On the other hand, Kerala faces the challenge of not losing the race in skilling its workers, upgrading its innovation ecosystem and attract quality private investments in the knowledge economy. Kerala must concurrently address both the above concerns. Failure would inevitably lead to higher levels of educated unemployment among the youth, as well as poor levels of economic growth.

Experience across middle-income countries show that it is neither necessary to prematurely exit from traditional industries nor advisable to hold on to policies that may have been successful in the past. In many cases, traditionally accumulated specialisations could be platforms for future innovations, even if they remain niche in scope. An example in the context of Kerala may be coir. What is important is to urgently reform our interventions in the traditional sectors, modernise them, and provide them support vis-à-vis market access, inputs, technology, and product design.

Outside the traditional sphere, manufacturing must remain Kerala's focus with special emphasis on MSMEs. Our manufacturing sector has seen several successes in the recent past. The share of manufacturing in Kerala's GSVA rose from 9.78 per cent in 2014-15 to 13.1 per cent in 2022-23. The new areas that see growth are chemicals, refined petroleum products, rubber and plastic products, electronic products, and pharmaceuticals and medicinal botanical products. The number of workers employed is also seeing a rise in electronics, and medical devices and supplies. In the coming years, improved performance is expected in IT hardware, pharmaceuticals, biotechnology, life sciences, and medical-equipment manufacturing.

The recent improvement in industrial growth shows the success of our industrial promotion and investment facilitation activities – particularly, the initiatives and incentives for fostering entrepreneurship, developing enabling infrastructure, developing high-tech industries, building futuristic employment skillsets for employment, nurturing business environment, creating sectoral ecosystem and enhancing 'Kerala' brand equity. These must continue.

Three core areas of focus

If Kerala must rapidly develop modern industries (as well as in the services sector, particularly those services that are witnessing rapid globalisation and can be digitized and traded), it must concurrently focus on three more spheres. First, it must invest intelligently in its tertiary education system. Kerala can emerge as a hub of higher education if it is able to restructure the sector with focus on applied sciences and mathematics, with industry linkages, and aligned to the growing needs of its domestic sectors. At the same time, attention must remain on building core strengths in basic sciences and humanities. Kerala must continue to look at higher education as a nursery for rational and critical thinking, creativity, and compassion, and strive for excellence. Together, these constitute the foundation of a progressive and humane society built on core social values of equity, democracy, constitutional morality, and secularism. Here again, investment in education must primarily be a social investment and must be qualitatively distinct from other forms of industrial investment.

Secondly, societies with high tertiary gross enrolment ratio are also societies with improved skill acquisition in the workforce. Kerala must build cutting-edge skills in its workforce not just for better employability in the labour market but also to enhance domestic growth in agriculture, allied activities, modern industry, infrastructure-building, and income-bearing services like tourism. For this, we need a significant scaling up of our skill development schemes, entrepreneurship development programmes and career guidance facilities – allowing us to be a hub of skilled labour in India – with focus on women and persons from disadvantaged socioeconomic backgrounds.

Thirdly, the availability of physical infrastructure is yet another pre-condition. Kerala has seen considerable progress in this sphere in the recent years – examples are the Kerala Fibre Optic Network, Petrochemical and Pharma Park in Kochi, National Highways, Coastal and Hill Highways, Transgrid 2.0, Life Science Park in Thiruvananthapuram, and the Hi-Tech School Programme. These are in addition to the world-class IT parks, start-up parks, development of tourism destinations, and public hospitals. Yet, we need more investment in high-speed, multimodal transport infrastructure within the State, which would reduce regional imbalances, promote growth in tourism, and expand linkages across supply chains. We also need major investments in freight logistics, particularly with two large ports and container terminals. Ensuring uninterrupted power to non-domestic consumers must be another area of focus. Finally, we must also be able to harness the advances in modern science and technology to build climate-resilient infrastructure in the present era of climate change.

In conclusion

Without doubt, there are multiple challenges in the realisation of these goals. The most important challenge is the availability of fiscal space to finance the necessary investments. The conservative fiscal stance of the Government of India is not helpful. Here, Kerala must explore new and innovative forms of resource mobilisation – including collaborations with the investment capacities of non-resident Keralites.

A second challenge is the efficiency of implementation and coordination across different arms of the government. The Berlin Summit Declaration of May 2024, signed by 223 global thinkers, calls for "investing in an effective innovative state". In Kerala, expanding the capacity of the government – particularly the departments – is an absolute necessity if it is to undertake a task as complex as listed above. We have had some successes in the recent past, but we must also build on them to prepare ourselves for harsher challenges of the future.

I am sure that the vast knowledge base of Keralites living and working across the world can be effectively harnessed to achieve these goals. They have enormous technical and professional abilities that could be effectively invested in the State to prepare our economy for a better future.