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BALANCE OF TRADE, REMITTANCES AND NET CAPITAL FLOWS : AN ANALYSIS OF ECONOMIC DEVELOPMENT IN KERALA SINCE INDEPENDENCE

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Introduction

A major draw back of the plethora of regional studies in India is that most of them tend to treat regional development as an autonomous process of regional productive forces and relations of production. The multifarious interregional relations that impinge on regional development are not given sufficient consideration. At best such a concern is confined to centre-state budgetary flows which are only one component of the overall regional balance of payments account.

The reasons for the above lacunae are both empirical as well as theoretical. Absence of relevant data is a serious stumbling block. No regional accounts of trade, factor payments or capital flows are maintained. At the level of theory many of the tools of analysis, particularly those related to interregional trade, have been refined in the context of international relations. Their transportation to the realm of regional analysis is beset with numerous problems. The present paper is an attempt to integrate external relations into the analysis of regional development of Kerala.

Kerala has a highly commercialised economy that specialises in export oriented cultivation of commercial crops and processing of their products. It exports around 55 per cent of the output of its primary and secondary sectors to the rest of India and foreign countries. An even greater proportion of the regional consumption is met through imports. [Thomas Isaac and Reddy, 1992] In terms of per capita state domestic product or its growth over time, Kerala is one of the backward states in the country. Modern industrial activity is yet to make any significant impact on the regional production structure. The agro-processing industries, which dominate the secondary sector production as well as employment, are characterised by labour intensive and low productivity techniques. Historically these industries played the role of residual sector accomodating the surplus labour [Thomas Isaac, 1992]. As a result, per capita output of the region has been relatively low even though a greater proportion of the regional workforce is employed in the non agricultural sector. [Centre for Development Studies, 1977] Despite the relatively backward production base, the regional development has been distinguished by significant social investment in education, health and other social infrastructures [Tharakan, 1992]. Consequently, the workforce in Kerala is better educated. The educational attainment of the workforce, the low labour absorption capacity of agriculture dominated by perennial crops and the high incidence of wage labour relations have resulted in more visible underemployment in the region. The above compounded by the slow growth of job opportunities in the modern sector has caused an open unemployment rate nearly three times that of the national average [Mukherjee and Thomas Isaac, 1992]. Migration to rest of India and to foreign countries can be considered as an important adjustment mechanism to the worsening employment situation in the state.

In short, trade and migration are two vital external relations that have to be explicitly considered in any attempt to explain the regional development of Kerala state. We have discussed elsewhere in detail the trend and pattern of external trade flows of Kerala [Thomas Isaac and Reddy, 1992]. A severe and growing imbalance in the external trade was seen as one of the most important features of Kerala's external trade in the recent period. The relevant data is summarised in Table 1.

Rs. 1224 crores and Rs. 2615 crores worth commodities were exported from Kerala during the years 1975-76 and 1980-81. The total imports in those years amounted to Rs. 1448 crores and Rs.3441 crores. The exports exceed the imports in the international trade while the imports exceed the exports in the interregional trade. Overall, the imports are higher than the exports.

Thus in both years, Kerala had a sizeable trade deficit. As the imports tended to grow faster than the exports, we find that the trade deficit of the region rose from Rs.223 crores to Rs.822 crores during the period under discussion. The domestic product of the region at factor cost was Rs.2228.24 crores in 1975-76 and Rs.3505.36 crores in 1980-81. The trade deficits have sharply increased relatively to the increase of domestic production within the state. The ratio was 10 per cent in 1975-76 and 23 per cent in 1980-81.

It was noted that it would be unrealistic to assume that the substantial volume of crude petroleum moved into and refined oils moved out as regional imports and exports. The Cochin refineries, a central public sector undertaking, could be treated as an enclave unit and the imports of crude petroleum and exports of processed mineral oils be ignored. Instead, the actual consumption of the mineral oils in Kerala could be considered to be its net imports. Accordingly the trade deficit, according to our second set of estimates, in 1975-76 was Rs.364 crores and 861 crores in 1980-81. The ratio of trade deficit to state domestic product rises from 16 per cent in 1975-76 to 24 percent in 1980-81.

Table. 1
Estimates of Regional Exports, Imports and Trade Deficit of Kerala

Rs.

	Year	Exports (crores)	Imports (crores)	Trade balance
1		2	3	4
Estimate 1	1975-76	1224.92 (54.9)	1448.08 (64.9)	-223.16 (10.0)
	1980-81	2615.35 (74.6)	3441.43 (98.2)	-826.08 (23.6)
Estimate 2	1975-76	1062.34 (47.7)	1427.14 (64.0)	-364.80 (16.3)
	1980-81	2193.20 (62.5)	3054.24 (87.1)	-861.04 (24.5)

Note: 1. Figures in parenthesis refers to the estimates as a percentage of SDP.

Source : [Thomas Isaac and Reddy, 1992].

What is the significance of the above adverse trade balance and changes therein to regional analysis? It is to this question that we address ourselves in Section 1. The Section 2 is devoted to a fairly detailed analysis of the massive inflow of remittances on regional consumption, savings and growth during the last one and half decades. In Section 3 we shall attempt to infer the broad trends in net capital flows into the region indirectly through examining the trends in the balance of trade since independence. We hope to periodise Kerala's development experience into distinct phases on the basis of behaviour of key macro-economic variables such as domestic product, consumption, investment, remittances, net capital flows and trade balance. In the concluding Section 4 we shall summarise our findings and emphasise certain broad policy implications of our discussion.

Section 1

Significance of Balance of Trade to Regional Analysis

To the best of our knowledge the only serious attempt to grapple with the economic significance of inter-regional trade balance in the Indian context has been by B.N. Ganguli [1962]. Based on S.Sivasubramonian's [1962] estimates, Prof. Ganguli drew attention to the significant trade imbalance that exist between various regions in India and attempted to analyse it as a case of 'international trade involving a common currency'. He noted that in India the institutional arrangements had not yet developed to permit 'absentee capitalists participating actively in local investments' or for efficient 'equilibriating short term capital movements'. The banking net work was also regionally fragmented. "In India the payment position of at least certain states or regions is more like that of seperate nations and less like that of units in a fully integrated economy.... Payments from region X to non X reduce X reserves and deposits and increase those of non X. But banks in X cannot forestall any pressure towards multiple contraction by having enough government securities to sell or falling back on other secondary reserves. Thus the fall of bank reserves and deposits in X as the result of prolonged fall in prices of exports of X is more likely to set in motion a multiple contraction because the assets of X banks are not readily saleable outside X, and may even cause bank failures" [Ganguli 1962: 104]. Factors such as rapid integration of Indian economy and development of integrated banking network have proved such fears of regional imbalances unfounded. Further, such financial disequilibria were also unlikely because the trade deficit regions were likely to be the economically advanced regions while it was the backward regions that had trade surpluses. Prof. Ganguli himself hints of the above peculiar relationship in his discussion of the causes of regional trade imbalances.

Unilateral Transfers: Drain of Surplus

Unilateral transfers of capital and income was seen as the major cause for regional trade imbalances. Unilateral transfers may take the form of (a) drain of surplus from backward regions to advanced regions and (b) capital movements by private investors and transfer payments to the backward regions by the federal government. "Unilateral transfers must be made in kind. In this respect there is really no difference between domestic and foreign trade".

The first type of unilateral transfers is familiar in Indian development literature in the context of Indian foreign trade surplus during the colonial period. It was not a sign of Indian prosperity but counterpart of the net transfer of resources from colonial India. Similarly, "taxes, land revenue, irrigation dues, interest and amortization of loans originating in bigger commercial centres, interest on advances made by middlemen who transfer their earnings to bigger centres, remittances of profits of capitalistic enterprise in the hinterland are all forms of unilateral transfer of funds. Their counterpart in real terms is the export surplus taking the form of commodities in the long run" [Ganguli, 1962: 103]. The above hypothesis has not so far been verified empirically. But it is significant to note that even today many of the backward regions in India have export surplus while most of the advanced regions have import surplus. The trade defecit may be viewed as a process of net resource inflow and trade surplus as a process of net resource outflow to and from the region.

Table 2 drawn up by R. Mehta (1982) on the basis of RITES road and rail goods movement survey of 1978-79 is revealing. The data have many limitations. At least with respect to Kerala we have been able to show definitively that the incidence of the inter-state trade and the extent of trade deficit is severely under estimated. [Thomas Isaac and Duvvury, 1992]. Despite these limitations Table 2 may be taken as a broad indicator of inter-state trade balances prevalent today.

It shows that among the major states Punjab, Karnataka, Haryana, Andhra Pradesh, Maharashtra, Uttar Pradesh and Kerala had significant trade deficit relative to the state domestic product. In terms of per capita trade deficit, Punjab, Haryana and Maharashtra top the ranks. These states also enjoy high per capita incomes. A major exception is Uttar Pradesh, relatively one of the poorest states, but which has significant trade deficit. In contrast the poorest ranking states in terms of per capita state domestic product namely Bihar, Orissa and Madhya Pradesh have the highest trade surpluses among the major states. But Gujarat and West Bengal, two states with per capita income above the national average, also have trade surpluses.

Table 2

Distribution of Inter-state Exports, Imports and Trade Balance 1978-79 (Rs. Crores)

State/U.T.	Imports	Exports	Surplus/ Deficit(-)	Surplus/ Deficit percentage of SDP	Per capita as surplus/ deficit
(1)	(2)	(3)	(4)	(5)	(6)
I. Major States					
1. Maharashtra	2975	1938	(-)1037	(-) 18.46	(-) 171
2. Uttar Pradesh	2254	1300	(-) 954	(-) 9.76	(-) 91
3. Andhra Pradesh	1664	980	(-) 684	(-) 12.76	(-) 15
4. Karnataka	1210	659	(-) 551	(-) 14.23	(-) 154
5. Punjab	1682	1181	(-) 501	(-) 15.27	(-) 310
6. Haryana	911	635	(-) 276	(-) 12.73	(-) 224
7. Kerala	730	580	(-) 150	(-) 5.52	(-) 61
8. Rajasthan	876	803	(-) 73	(-) 2.26	(-) 22
9. West Bengal	2282	2290	8	0.13	2
10. Tamil Nadu	1542	1600	58	1.14	12
11. Gujarat	1282	1773	491	16.35	150
12. Orissa	691	1292	601	27.80	235
13. Madhya Pradesh	1363	3245	1882	43.40	373
14. Bihar	1112	3077	1965	39.08	300

(1)	(2)	(3)	(4)	(5)	(6)
II. Special Category States					
1. Assam	388	288	(-) 100	(-) 5.77	(-) 54
2. Jammu & Kashmir	191	110	(-) 81	(-) 12.67	(-) 141
3. Manipur	44	10	(-) 34	(-) 30.87	(-) 246
4. Himachal Pradesh	22	16	(-) 6	(-) 1.10	(-) 15
5. Tripura	5	0.5	(-) 5	(-) 2.55	(-) 26
6. Meghalaya	1	3	2	Neg.	16
7. Nagaland	10	17	7	Neg.	96
III. Union Territories					
1. Delhi	1553	923	(-) 631	46.24	(-) 1129
2. Mizoram	21	3	(-) 18	(-) Neg.	(-) 452
3. Arunachal Pradesh	1	0.1	(-) 1	(-) Neg.	(-) 19
4. Pondicherry	12	12	0	Neg.	6
5. Goa	68	153	85	39.40	833
Total	22689	22689	0	0	0

Source: [R. Mehta, 1983].

It is seen that most of the special category states despite their relative economic backwardness have trade deficits. Kerala also is a similar case. Its per capita state domestic product is lower than the national average. But it has an adverse trade balance. In this instance a modified version of the second type of disequilibriating unilateral transfers that Prof. Ganguli referred to becomes relevant.

<u>Unilateral Transfers: Investment Funds</u>

In the second model of adverse regional trade balance the relative acceleration of imports is initiated by large scale flow of investment funds by the central government or private capitalists into a backward region - say X. The funds are spent on local resources and on imports. To the extent the funds are expended on local resources, they would raise income and to a limited rise in the price of such commodities. Bank reserves also will increase to the extent of increase in demand deposits.

"Since banks in X may not be able or willing to expand local loans, they will acquire short term assets through the Indian money market.. As imports rise, the Banks in X will sell their newly acquired short-term assets to meet the drain to non X ...... X and non-X are so linked with a common monetary system that the opposite price movements contemplated in classical theory do not occur, except in a small way as prices of non traded goods and services rise in X. Capital movement does raise money incomes in X, but a cummulative rise is quickly arrested by high marginal propensity to import. In the meantime since a large part of the capital inflow is spent on imported goods it produces no immediate income effect in X" [Ganguli, 1962: 103-4].

If we replace 'large scale investment fund inflow 'by 'large scale remittance inflow the above hypothetical description made three decades ago would be a broad statement of the contemporary experience in Kerala. It is to this aspect that we shall next turn our attention.

Section 2

Impact of Remittance Inflows

Despite the long history of foreign trade contacts dating to the ancient times, international migration from the region is a relatively new phenomenon. The decisive break came with the economic depression in the thirties that played havoc on the regional economy dominated by commercial cultivation. The pauperisation of the peasantry, worsening of land man ratio, breakdown of traditional family structures, spurt in open unemployment, etc. triggered off three streams of migration. Of these the first was the intra- regional migration by Christian peasant families from the south central parts of the state to the virgin lands at the foothills of northern Kerala [Tharakan, 1977]. This intraregional migration to the hilly tracts accelerated in the fifties and sixties. Interregional migration to the urban centres of India can be considered as the second stream of migration. Initially this stream was dominated by the educated members of the upper caste gentry families in search of clerical jobs. It became the most important outlet for the growing workforce during the fifties and sixties. The third stream was international migration to Ceylon, Malaysia and Burma (Mayammar) mostly by members of lower castes and communities along the coastal belt and pockets in south central Kerala [Joseph K.V., 1986].

The migration to Ceylon and Malaysia was short lived. But Kerala was a vigorous participant in the new phase of migration of skilled and professional personnel to the developed countries in the West during the post independence period. The migrants were mostly drawn from the younger generation of Christian commercial cultivators who had over the past decades made substantial investment of their surplus from commercial cultivation in improving human capital. However in terms of numbers, the migration to the West was not very substantial. Further it provided little scope for non professional and semi skilled sections of the workforce. The job opportunities for these sections in rest of India had also begun to dwindle during the seventies. The average net migration to rest of India declined from around 25000 in the 1960s to 5000 per annum by the end of the 1970s [Government of Kerala, Directorate of Economics and Statistics, 1982]. It was in the background of rapidly declining external job opportunities that the latest phase in the migration history of Kerala, viz. the Gulf migration, opened up.

The concentration of Gulf migrants in Kerala maybe linked to its prior experience in migration and the close ties the coastal pockets of the region have always had with the Arab countries.

There, incidentally, is a remarkable coincidence not only in the regional concentration but also in the pattern of Gulf migration to that of the earlier Ceylon-Malaysian migration. The average annual net migration to the Gulf countries, at the end of seventies was estimated to be around 70,000. The stock of migrants from Kerala in Gulf countries rapidly increased to around half a million by the middle of the eighties.

Trend in Remittances

In Table 3, we present a time series of the estimated remittance inflow into Kerala. We have updated the estimates of remittance inflow into India from Gulf and non Gulf countries by Nayyar [1989]. Following Gulati and Modi [1985], we assumed that 50 per cent of the remittences from Gulf countries and 5 per cent of that from non Gulf countries are destined to Kerala. The resultant estimate for remittance inflows into Kerala in per capita terms is presented in Table 3. The remittance inflow into the state surged upwards from 1975-76. It tends to plateau off from the early eighties. As a ratio of the domestic product of the region (SDP), the remittance inflow was negligible in 1970-71. In 1975-76 the ratio was 3.6 per cent and rose to a peak of 10.7 per cent in 1980-81. Our estimate of remittances does not include the unofficial inflows which could form 35 to 50 per cent of the official inflows depending upon factors such as exchange premium, etc.

Table 3

Per capita SDP, Consumer Expenditure, Bank Deposits and Remittances in Kerala 1971-89 (Rupees)

Year	Per Capita SDP in Kerala	SDP Ratio Kerala to India	Per Capita Conex. Kerala	Conex. Ratio Kerala to India	Ratio of Conex to SDP	Per Capita Bank Deposits in Kerala	Deposit Ratio Kerala to India	Per Capita Remittances	Ratio of Remittances to SDP
1	2	3	4	5	6	7	8	9	10
1970-71	594	0.94	455.52	0.95	0.77	182.38	0.77	2.69	0.005
1971-2	592	0.90	N.A	N.A	N.A	115.96	0.76	3.00	0.006
1972-3	682	0.97	533.44	0.93	0.81	138.50	0.81	3.30	0.005
1973-4	811	0.95	691.6	1.01	0.85	172.72	0.81	4.65	0.006
1974-5	910	0.91	N.A	N.A	N.A	207.20	0.83	9.89	0.011
1975-6	954	0.95	N.A	N.A	N.A	266.00	0.83	34.42	0.036
1976-7	1009	0.94	N.A	N.A	N.A	356.00	0.92	64.31	0.064
1977-8	1043	0.87	910.60	1.01	0.87	466.00	1.01	109.65	0.105
1978-9	1121	0.89	N.A	N.A	N.A	569.00	0.99	107.39	0.096
1979-80	1271	0.95	N.A	N.A	N.A	682.00	1.01	172.91	0.136
1980-1	1385	0.89	N.A	N.A	N.A	672.00	1.04	258.88	0.187
1981-2	1438	0.83	N.A	N.A	N.A	817.00	1.07	232.64	0.162
1982-3	1626	0.86	N.A	N.A	N.A	957.00	1.08	282.22	0.174
1983-4	1823	0.86	1816.44	1.21	0.96	1149.00	1.09	302.95	0.161
1984-5	2104	0.89	N.A	N.A	N.A	1347.00	1.07	339.01	0.161
1985-6	2140	0.82	N.A	N.A	N.A	1629.00	1.39	285.83	0.134
1986-7	2371	0.84	2445.48	1.25	1.03	1682.00	1.10	299.95	0.127
1987-8	2834		2673.46	1.25	0.94	N.A	N.A	351.33	0.124
1988-9	3146		2772.00	1.16	0.88	N.A	N.A	397.46	0.12[illegible]

Source: Col 4. NSS reports on consumer Expenditure, relevant issues.
Col 3. India Data Base, H.L.Chandhok and the Policy Group (1990).
Col 5. Basic Statistics Relating to Banks in India.

Note: 1.Figures are at current prices.
2.Per capita SDP for Kerala in 1988 and 1989 are taken from Economic Review-1991.
3.Conex = Consumer Expenditure; SDP = State Domestic Product

A general equilibrium analysis of the impact of migration has so far not yet been undertaken in the absence of the required input/output framework and relevant coefficients for the regional economy. However, micro level studies on migration from Kerala provide important insights into the possible macro economic consequences of remittance inflow for regional development [Commerce Research Bureau, 1978; Mathew E.T. and Nair, P.R.G. 1978; Prakash B.A., 1978; Radhakrishnan C and Ibrahim, 1981 and Ravindran A.M. 1987]. After all, the decisions regarding the utilisation of the domestic money resource counterpart of foreign remittances are individually taken by the migrant families themselves. But there are two caveats that have to be borne in mind.

Firstly, the macro level impact on development will not be merely a summation of the first round impact of spending or saving decisions reached by the migrant households. Equally important are successive rounds of expenditure and saving from remittance income. The benefits of remittance inflow are not confined to migrant households alone given the strong redistributive mechanisms in operation, especially the traditions of collective bargaining in the region and nearly universal practice of gifts that the migrant has to give his/her kith and kin. It is unlikely that migration has led to a worsening of the income distribution in the state. The Lorentz ratio of consumer expenditure was virtually the same in both 1973-74 and 1986-87 at 0.303 and 0.307 respectively. The fact that a majority of the Gulf migrants belonged to the relatively lower income groups, even if not the lowest, also contributed to the above outcome.

Secondly, even the micro data that have been generated with respect to household level income, expenditure and saving have to be taken with caution. The income estimates are universally underestimated partly due to deliberate underreporting by the respondents or due to the lack of knowledge of the savings directly deposited or personally brought back by the migrant workers. Consequently there is a tendency to overstate the marginal propensity to consume out of the remittance income. Further, the reluctance to divulge information regarding financial savings also tends to exaggerate the proportion of savings devoted to the formation of non productive assets.

An evidence of such a possibility of understating productive utilisation of assets is indicated in a large survey of Gulf returnees which reveals that the majority of migrant returnees enjoyed improvement in their current income over that prior to migration (Nair P R G,1986). Higher current income flows is not consistent with the picture of unproductive utilisation of remittances during the period of migration.

Impact on Consumption

Even though the micro level studies conducted so far are not useful for drawing definite ratios of marginal or average propensity to consume from remittance income, the universal conclusion reached regarding substantial improvement in consumption levels of the migrant households is an eminently acceptable one. It is only understandable why for most of the Gulf migrants who are drawn from relatively poorer strata of society, consumption expenditure should be the first claimant on increased income. Improvement in consumption has been the most visible economic impact of migration.

The above observation is justified by the available data on the trends in per capita consumption expenditure given in Table 3. The per capita consumer expenditure in Kerala was lower than the national average till the early seventies. Since then the relative consumer expenditure level in Kerala has improved rapidly and is seen to be significantly above the national average for 1983-84 and 1986-87 to 1988-89, the years in the Gulf boom phase for which data are available. The rank order of Kerala among the major states in India in terms of per capita expenditure improved from 10 in 1970-71 to 4 in 1980s. Even more impressively, as can be seen from Table 5, the ratio of consumer expenditure to SDP has tended to rise in the eighties exceeding unity in 1986-87.

Migration which caused remarkable increase in per capita consumption expenditure, seems to have also effected significant changes in the composition of consumption. The food basket of the state has been transformed from one dominated by cheap carbohydrate substitutes like tapioca and relatively cheap protein source like sea fish to one predominantly consisting of costlier cereals, milk,meat, imported vegetables and processed foods [Duvvury,1990]. The share of non-food items in consumption expenditure has increased from 26 per cent to 38 per cent in rural areas and from 29 per cent to 41 per cent in urban areas of Kerala between 1967 and 1983. The share of consumption of durable goods is 5.0 and 3.7 per cent in rural and urban areas of Kerala against an all India average of 2.3 per cent [Sunny K.P., 1988].

Another important point that may be noted in this context is the escalation of import content of the consumer expenditure in the state. The food dependency of the state has expanded from grain imports to even items such as meat, egg, fruit and vegetables. The import of manufactured consumables and intermediate products such as construction materials have also phenomenaly expanded. The import of cement increased from 7 lakh tonnes between 1975-76 and 1980-81. Similarly there was 8 fold increase in the value of imports of sanitary wares [Thomas Isaac and Reddy, 1992]. The increase in the import intensity of the regional economy has been reflected in the ballooning of the trade deficit of the region vis a vis India and the rest of the world.

Impact in Savings

We shall take up the implications of this import leakage a little later. Before that let us examine the available evidence on the trends in the savings in the state. There are no reliable estimates of regional savings or savings rate. But there are two sources of information that indicate a definite increase in the physical and financial saving in the region consequent upon inflow of remittances from the Gulf.

The first is the decennial All-India Rural and Debt and Investment Surveys. They reveal that in 1960-61 and 1970-71, the average assets of rural households in Kerala was only around the national average and Kerala's rank order among the Indian states remained unchanged at 8. But in 1980-81, the average value of assets of rural households in Kerala was Rs. 77,479 compared to the national average of Rs. 36,097. Kerala's rank order improved dramatically from 8 to 2, next only to Punjab. Kerala's ranking is not affected even if value of land is excluded. A final point may also be noted regarding asset distribution. Kerala reveals a distinct tendency for the inequality ratio in asset distribution to decline from 0.71 in 1960-61 to 0.65 in 1970-71 and further to 0.63 in 1980-81 [Narayana, 1991].

The second set of evidence relates to the trend in per capita deposits in commercial banks given in Table 43. The per capita bank deposits in Kerala were significantly lower than the national average till the mid seventies. But with the onset of Gulf migration, the position of Kerala improved in relation to the national average. Thus the ratio of per capita bank deposits to the national average which was 0.77 in 1970-71 becomes greater than unity in the year 1977-78 and plateaus off a nearly 10 per cent higher level from 1983-84. The expansion of deposits in the cooperative sector (Sunanda, 1991) and the informal financial sector, popularly known as "blade companies", has been equally impressive. [Prakash B.A., 1984]

Section 3

Direction of Net Capital Flows and Phases of Growth

Kerala has not been channelising the above abundance of savings into productive investments within the state. It is seen that the extension of credit to firms and households in the state by the financial intermediaries has not kept pace with the growth of deposits. The credit deposit ratio for the state is not only lower than the neighbouring states but has also been declining over time [Government of Kerala, State Planning Board, 1991]. This is an indicator of the savings outflow from Kerala through institutional channels. Without any claim of attempting to quantify the savings outflow we shall undertake a simple illustrative exercise using some of the key variables in Kerala's regional balance of payments. Despite the many limitations of the data used, the figures arrived at will give a broad dimension of the regional economic reality and some significant insights.

Savings Outflows: 1975-76 and 1980-81

In order that the external payments may balance, the net of other items in the current and capital accounts has to equal balance of trade. On the assumption that the net payment on externally owned assets and other items on current account are negligible, the balance of payments identity may be expressed as follows:

$$(X - M) + FR + IR = PL + OL \qquad (1)$$

where IR stands for the remittances from rest of India, FR for remittances from foreign countries, PL for private short and long term loans and other items on the capital account and OL for similar items on the public account. The estimate of remittances in Table 5 is an underestimate to the extent the remittances sent through illegal/non formal channels are excluded from the calculation. It may be noted that the entire 'pipe money', as the above is popularly known, is not a redistributive transfer payment as far as the regional economy is concerned. A significant proportion of this is transferred from the Bombay black money market and thus a net addition to the financial flows to the state. It is assumed that at least an amount equal to 20 per cent of the foreign remittances through official channels is so transferred from other states via 'pipe money' channels. Substituting the available data for 1980-81 in (1), we get the following:

$$(2193 - 3054) + 786 + IR = PL + OL \qquad (2)$$

$$-861 + 786 + IR = PL + OL \qquad (3)$$

$$-75 + IR = PL + OL \qquad (4)$$

We do not have the value for IR but given the large number of inter regional migrants from Kerala to the rest of India, it must have been a significant and positive sum. Similarly the capital movement on official lending must have also been a net inflow into Kerala. Therefore, the net private loans and other private account items must have been a significant outflow from Kerala. The quantum of outflows would be determined by the size of IR and OL. An important conclusion that can be drawn from the above discussion is that there was a significant outflow of funds from Kerala in 1980-81.

A similar exercise may be undertaken for the year 1975-76. The foreign remittances for 1975-76 is Rs. 96 crores. Substituting the relevant figures in the balance of payments identity, we get the following:

$$(1062 - 1427) + 96 + IR = PL + OL \quad (1)$$

$$- 364 + 96 + IR = PL + OL \quad (2)$$

$$- 288 + IR = PL + OL \quad (3)$$

The situation in the mid-seventies appears to be significantly different from 1980-81 in one respect. It is unlikely that IR would have been such a magnitude as to offset the trade deficit in (3). Consequently, it is probable that there must have been a net inflow of funds in the capital account from rest of India in 1975-76. Even if it was an outflow, undoubtedly, it would have been much smaller in scope than for 1980-81. It enables us to draw yet another important conclusion, viz. that the outflow of funds from Kerala has tended to increase during the Gulf boom.

Between 1975-76 and 1980-81 there was a significant change in the direction of the net capital flows from the region. While in 1975-76 there was a net inflow in 1980-81 reverse was the case. It underlines the fact that the interregional relations are not unilinear but shift in response to interplay of economic factors. These shifts are significant in understanding the regional development.

<u>Fifties and Early Sixties</u>

We do not have regional trade accounts for Kerala for any point of time before the mid- seventies. But extrapolating the trend in trade balance between 1975-76 and 1980-81 backwards and observing the trends in consumption expenditure provided by NSS surveys it may be safely said that the import surplus of the region must have been much lower during the early seventies and 'sixties. And probably there was an export surplus on trade account during the 'fifties. The latter inference is reinforced by the data on trade balance of Travancore during the pre independence period. Travancore had significant trade surplus for most of the colonial period. It may be noted that in the foreign trade sector Kerala has always enjoyed a significant export surplus even in the post independence period. The trade deficit has been with respect to the inter regional trade. As we have noted elsewhere the weight of inter regional trade in the overall trade was significantly lower in the earlier years [Thomas Isaac and Reddy, 1992] and what little information we have points to the possibility of export surplus on the inter regional trade account also in the earlier years. Throughout the sixties the originating rail traffic exceeded the terminating rail traffic of Kerala. [Thomas Isaac and Duvoury, 1992]

Counterpart of this physical outflow of resources through trade must have been a net outflow of fiscal funds out of Kerala during this first phase of post independence development. For obvious reasons no quantitative estimates of the funds outflow from the region can be given. But from the following evidences suggest such an outflow. Firstly, the initial decade and half of independence was a period of rapid withdrawal of European capital from the plantations and foreign trade sectors of Kerala which they had dominated during the colonial period and from industrial sectors like coir weaving. Secondly, the investment flows from the central government was relatively lower for the region during this period in comparison to later years as well as to the share received by other regions. It is exemplified by the relatively lower plan allocations for the region during the first two five year plans and virtual absence of any major direct central investment during this period. The devolution by the Finance Commissions also paid little attention to the special problems of the region. The loss of elastic customs revenues to the princely states of Travancore and Cochin was also not adequately compensated. Thirdly, it would appear that private Indian investment inflow from the rest of India to the region also decelerated when compared to the two decades preceeding the independence. [Thomas Isaac and Tharakan, 1986].

The consequence of the relatively low investment is reflected relatively the low growth rate the regional economy during 1950 to 1965 period. [see Table 4] The rate of growth of state domestic product during this period was only 3.37 per cent per annum while the national income of India at large grew at 3.91 per cent per annum. The rate of growth of the secondary sector was nearly half the national average. Kerala failed to partake bouyancy of the national economy in the immediate independence period.

The dysfunction of the regional economic growth from broad trends in the national economic performence - a phenomenon that we shall continue to observe during the subsequent phases also - is to a great extent explained by the structural specificities of the regional economy that are significantly different from the national pattern. Thus, for example, while foodgrain crops alone account for more than 75 per cent of the gross cropped area in India, all the short duration crops including the cereals and cereal substitutes would come to only around 45 per cent of the gross cropped area in Kerala. The specialisation in commercial perennial crops was the most important economic transformation that occurred in the region during the colonial period. Given the population pressure and the possibility of unrestricted import of food grains at favourable terms of trade there was rapid expansion of commercial crops into waste lands as well as reallocation of cultivated land to commercial crops [P.G.K. Panikar, et.al., 1978]. These broad trends in the cropping pattern continued into the post independence period. A break with the colonial pattern was that, due to the emphasis to given regional food self sufficiency in the five year Plan schemes, the gross cropped area under paddy began to increase, reversing the earlier trend in the reduction in area observable during the first half of the century. But the area under commercial crops rose even more rapidly so that latter's share in the total gross cropped area continued to rise. [Narayana, D. et.al. 1991] The tree/perennial crops have long gestation period and price cycle induced investment swings which need not be correlated to the trends in the short duration crops which dominated the national agrarian economy [Narayana, D. 1991].

Similarly, the regional industrial sector has also distinctive features when compared to the national pattern. The industrial evolution in the state during the colonial period was largely incidental to the commercialisation process in agriculture. The products of various commercial crops such as coconut, tea, coffee and cashew required certain elementary processing before they could be exported. Non agro based industries of notable importance in the early decades of the century were ceramic and rare mineral mining. A small number of chemical and metal factories also came up in Travancore during the thirties and the forties. However their presence was insufficient to make any significant change in the overall predominance foreign export oriented agroprocessing industries. On the one hand, the export oriented regional industries could draw only limited stimulus from the import substitution strategy of planned development adopted at the national level. On the other hand, the public sector investment in the industrial sector within the region was very meagre during the period. The absence of public sector investment reflected the financial constraints of the state government and the failure of regional social and political pressure groups in ensuring adequate central investment. The regional capital was more lured to the plantation and trade sectors from which the Europeans were exiting. The net result was that hardly any new modern large scale factories came up in the state during the period.

As a result, it has been argued that there was deceleration in the industrial growth when compared to the preceeding two decades, particularly, in the southern Kerala consisting of erstwhile Travancore - Cochin region (Thomas Isaac and Tharakan, 1990). As can be seen from table 4 the secondary sector grew at a relatively slower rate and its share in the state domestic product declined. Further, within the secondary sector share of the registered manufacture declined. Thus Kerala economy during the fifties and early sixties could be characterised as a backward economy with low consumption, low investment, slow economic growth, significant trade surplus and net outflow of financial resources.

Table 4

The Average Annual Growth of Kerala's State Domestic Product and Net National Product

(Per cent)

	India				Kerala			
	NDP	Primary	Secondary	Tertiary	NDP	Primary	Secondary	Tertiary
1950-51 to 1964-65	3.91	2.79	5.93	5.03	3.37	2.66	3.06	4.76
1964-65 to 1975-76	3.00	2.07	3.22	4.23	3.55	2.24	4.97	4.87
1975-76 to 1988-89	4.49	2.34	5.28	6.31	2.39	-0.32	3.78	4.43

Source: Kerala SDP growth rate for 1950-51 to 1964-65 calculated from the data provided by Department of Economics and Statistics, GOK; for the others AL Chandok and Policy Group (1990) and Economic Survey 1992.

Mid-Sixties to Mid-Seventies

The growth of the regional economy begins to accelerate from around mid-sixties. It is certainly a contrast to the experience national economy. Kerala is one of the few regions in India that was immune to the deceleration of the Indian economy from the mid-'sixties. As the data in Table 4 shows the growth of state domestic product of Kerala rises to 3.55 per cent per annum during 1964-65 to 1974-75 period while the national income growth rate declines to 3.0 per cent per annum.

The regional agricultural growth largely maintained the momentum even in the new phase. There was significant expansion of gross cropped area in the state from 2349 thousand hectares to 3026 thousand hectares between 1960-61 and 1974-75. The increase in the cropping intensity and net sown area contributed to the expansion of gross cropped area. The trend of area under both commercial crops and cereals to expand, but the former at a faster rate, continued to persist in the new phase also. [Sivanandan P.K. 1984]

A more remarkable phenomenon, that was sharply divergent from the national experience, was the significant step up of regional industrial production from mid-sixties. It has been pionted out that industries such as engineering that contributed significantly to the industrial deceleration in India have very little weightage in Kerala and that the divergence from the national experience may be explained with reference to the specificities of regional industrial structure. [Subrahmanian, K.K. and Mohanan Pillai, P. 1985]. Further, two more points may also be noted in this context. Firstly, the traditional agro based export industries grew at a faster rate than the national averages for their product groups. Secondly, there was a bunching of public investment and a number of new industrial sectors were opened up. New resource based product groups like rubber and paper products grew into prominence.

It would appear that the decade from mid sixties, the second phase was also one of significant step up of the rate of investment in the region. The direct central investment in Kerala increased and the regions share in the central public sector rose to 3.24 per cent of the total by 1975. The per capita state plan expenditure which was below the all India average during the first two plan periods exceeded the latter in the third and fourth plan periods. As we noted, infering from the balance of payments position of Kerala in 1975-76, the preceeding years must have been one with net inflow investible funds into the region.

Stagnation since Mid-seventies

The bouyancy in the productive activities of the economy was rather short lived. The growth of SDP began to decelerate from around mid-'seventies. The rate of growth of SDP during 1975-76 to 1988-89 is only 2.39 per cent perannum - much lower than in the previous phase of growth as well as the national income growth which averaged 4.49 per cent per annum during the same period. The decline is evident both in the primary and secondary sectors of the economy. There was an absolute decline in production of most of the agricultural crops and output of the traditional industries. The per capita output of agriculture, other primary activities and industry declined from Rs.385 in 1970-71 to Rs.348 in 1980-87. Only in the tertiary sectors did there occured an acceleration in the growth - particularly construction and social services. Despite the acceleration in the growth of the service sector, the per capita output has virtually stagnated during the Gulf boom decade from 1975-76 to 1985-86. Evidently, given the outflow of funds and import leakages, which we have discussed earlier, the impact of remittances on domestic employment and output in the region has been minimal.

In the agricultural sector possibilities of expansion at the extensive margin seems to have been exhausted by the mid-sixties.

In fact, the gross cropped area declined to around 2870 thousand hectares by 1986-87. Both decline in net sown area and cropping intensity contributed to the above outcome. Unlike the trend so far, in the new phase the expansion of the commercial crops was at the expense of the food crops. The latters share in the gross cropped area declined from 41 per cent in 1974-75 to 31 per cent in 1986-87. Within the commercial crops the area under coconut and arecanut declined mildly while there was a phenomenal expansion of area under rubber. The expansion of coconuts into the paddy lands has not been sufficient to compensate for the formers loss to rubber. The net sown area under paddy declined as much as by 20 per cent, a part of which has gone fallow. [Narayana, D. et.al. 1991]

In the industrial sector the new sunrise industries on which the national industrial recovery was riding have yet to make their presence felt in Kerala. Meanwhile traditional resource based, export oriented industries like marine products, coir, cashew. wood, ceramic etc. are experiencing a phase stagnation due to constraints on the supply of raw materials and adverse market conditions for their products. The performance of public sector lagged behind expectations and there has been a significant deceleration in new public sector investment.

Why the plentiful savings did not flow into productive investments in the domestic economy in order to cater to the fast growing consumption requirements of the people in the region is the central question of the contemporary development crisis in Kerala. An answer would require examination of historically evolved structures of regional underdevelopment, problems of resource depletion and environmental degradation, inappropriate development policies, centre-state relations, and so on - a task beyond the scope of our present paper. All that we shall do further in this direction is to draw attention to the direct impact of migration on the labour and land markets, the perverse effects of which may be argued to have reinforced the tendency towards regional economic stagnation.

Perverse effect of migration?

Asset preference for land and buildings among the migrant households is an aspect of which all the micro level studies are in agreement. Even though the estimates of expenditure on the above two vary, in all studies they account for the preponderant proportion of the migrant households' income after meeting the current consumption expenditure. The marked difference between the migrant and non migrant households with respect to housing conditions, land and gold acquisition has been well documented.

The above asset preference which has been widely decried should be understood in a better perspective. For a majority of the migrants, who owned only small parcels of land prior to migration [Prakash, 1978], acquisition of a medium sized household plot and a good house was a ladder to gain social respectability comsensurate with their enhanced income. The non financial assets like land, building and jewellery with possibilities of significant capital gains was also a rational choice given their limited financial resources and entrepreneurial talents which were often insufficient for successful self employment ventures. There is no doubt that the Gulf migration contributed significantly to a construction boom in Kerala. Average number of housing plans sanctioned annually in Kerala doubled between 1975 and 1980. The expansion of the construction sector is also reflected in the rapid expansion of income originating from this sector [G. Gopikuttan, 1990].

The increased demand for construction labour within Kerala, coupled with the migration of skilled construction workers, resulted in relative scarcity of these workers and escalation of their wage rates [Harilal, K.N. 1986]. It has been forcefully argued that the autonomous increase in the wage rates in the construction sector triggered off sympathetic increase in wage rates in other sectors given the inter related labour market structures that exist in Kerala [Krishnan, T.N. 1991]. It will be highly unrealistic to attribute the wage escalation in Kerala to the remittance induced construction boom alone but there is no need to dispute that it did play an important role and that the construction sector acted as a wage leader. The increase in real wages faster than increase in productivity in the agricultural sector is claimed to have had a deleterious impact on output and employment in this sector [Kannan and Pushpangadan, 1990; Krishnan,1991]. Cropping intensity and gross cultivated land declined and agricultural output stagnated. Despite the declining profitability of agriculture, land continued to be a preferred asset holding due to possibilities of speculative profit that could be made in a period of rising land prices.

Phenomenal increase in land prices for residential sites, even in the rural areas, has been widely commented upon by the micro level studies mentioned earlier. These observations are collaborated by the available time series data on land prices for selected villages [Nair, P R G 1989; Varghese,T.A. 1987]. The data provided by the All India Debt and Investment Surveys reveal that the value of land owned by a rural household in Kerala increased by around 600 per cent between 1971 and 1981. During the previous decade, the increase has been only on the order of 100 per cent. The above escalation in value of land holdings can be only explained by a phenomenal explosion in land prices. Even a land owner who is not keen on maximising current income from the land would hold onto the land for speculative reasons in the above situation. Thus the extraordinarily high land prices may have acted as a barrier to investment flows into agriculture.

The above discussion would apparently seem to support views that have been sceptical of the development impact of the remittances [see for issues involved C.Keely and Tran B.N. 1989 and Stahl, C. 1986]. On the contrary we wish to emphasize that the developmental outcome need not necessarily have been as it has occurred in Kerala had the macro environment in the state been conducive to increasing agricultural productivity. At worst what could be raised as a criticism against the developmental consequence of the remittances is that they have tended to reinforce the pre existing structures of underdevelopment rather than break them down. At any rate the above discussion on land and labour markets has little relevance in an explanation of the low investment in the large scale industrial sector.

Section 4

Regional Economic Crisis and Need for a Policy Reorientation

The various strands of discussions in the previous section on the regional domestic product, consumption, investment, remittances, capital flows and trade balance in the various sections can be periodised into three distinct phases as is presented in the chart below. The phase I extends through the 'fifties and the early sixties, phase II ranges between mid-'sixties and mid-'seventies and phase III the period thereafter.

During Phase 1, consisting of the first one and a half decades of the post independence period, Kerala was a typical backward export oriented economy with low per capita production, and low consumption. The low investment resulted in relatively slow growth. Unilateral payments out of the economy in the form repatriation of profits and capital had as its shadow an export surplus on trade account. In the Phase II there is a step up of investment, partly financed by inflow of public sector investment and the growth rate accelerates in contrast to rest of India.

Chart 1

Phases of Kerala's Economic Development since Independence

	Phase I 50s and early '60s	Phase II mid-'60s to mid-'70s	Phase III mid-'70s through '80s
Per capita SDP (relative to Indian average)	lower	lower	lower
Growth of Domestic Production	SDP: slower (lower than national average)	SDP: acceleration (higher than national average)	SDP: deceleration (lower than national average)
Investment	low	rises	falls
Consumption	low	low	high
Remittance inflows	mainly interregional	mainly interregional	foreign remittance remittance/SDP ratio sharply rise
Trade Balance	surplus	relatively small deficits	sharp increase in deficits
Capital flow	Net outflow	Net inflow	Net outflow

During Phase III the growth of the regional economy sharply decelerates but consumption rises. The paradox of low output - high consumption economy is facilitated by inflow of remittances. Due to the high import propensity the multiplier effect on regional income is low. Further the excess funds are channalised not for home invesment but for net lending outside the region. Thus we have yet another paradox, that of trade defecit backward region lending to rest of India.

The result has been the emergence of a high consumption economy with a backward production base. As can be seen from the following exercise the total expenditure in the state, that is consumption and investment, has been significantly in excess of state domestic product.

$$Y = D + R \qquad (1)$$

where Y is income, D domestic product and R net income flows from outside on account of foreign assets or remittances.

$$D = C + I + (X - M) \qquad (2)$$

where C is consumption, I investment, X exports and M imports.

$$E = C + I = D - (X - M) \qquad (3)$$

where E is expenditure. Substituting data for 1980-81, we have:

$$E = 3505 - 2193 + 3054 = 4366 \qquad (4)$$

The total expenditure for the year 1980-81 is Rs. 4366 crores - nearly 25 per cent higher than the state domestic product of Rs. 3505 crores. The situation reveals the fragility of the regional economy. In case of a serious decline in the remittance inflow from Middle East either due to political instability or any other factor, the present expenditure levels in the regional economy can be maintained only through substantial borrowing or disinvestment from outside the region. In the absence of any compensatory inflow of funds to the decline in remittances, consumption and investment would have to be curtailed, the latter leading to reverse multiplier contraction of the state domestic product.

Terms of Trade

The present path of development is clearly unsustainable. The recent developments in the national economy has added a poignancy to the situation. We have argued elsewhere that the regional terms of trade for the state is likely to move in adverse direction. [Thomas Isaac, Reddy, and Duvvury, 1992] Unlike the other primary commodity exporters, Kerala did not suffer from adverse terms of trade in the last four decades. The mild decline during 1960-75 was more than compensated by the significant increase in the terms of trade since mid-'70s. And unlike most of the primary export commodities the prices of commodities from Kerala did not crash after the boom of mid-'70s. The latter enjoyed buoyant and relatively stable demand conditions in the international market and the protected market for rubber and coconut, within India. A number of factors affecting the supply of Kerala's foreign export commodities had kept up the prices through the first half of the '80s. But given the history of cyclical pattern of output growth and prices of the perennial crops it is unlikely that these conditions will survive indefinitely. A downward trend in the prices of many of the commodities are already visible. In the longer term competition to Kerala's exports is likely to intensify from alternative sources of supply. In the national market it is unlikely that the present level of protection and high prices for rubber and coconuts divorced from the international prices can continue indefinitely given the new liberalisation policy regime. In contrast, the prices of the main import commodities of Kerala such as grains, sugar, cement, steel and petroleum are likely to rise faster than the general price level as in the past. The policy of curtailing the subsidies is going to force Kerala to increasingly rely on open market purchases. The net result is the likelihood of adverse movement in the terms of trade which would be a further drag on the improvement of the real income of the region.

Yet another disturbing trend has been the mounting evidence of growing supply constraints on the regional exports during the eighties. Unlike the period before mid-seventies regional exports have tended to stagnate during the eighties. The unregulated trade generated compulsions and incentives have caused resource depletion and ecological degradation which today are leading to a downturn of the exports but also affecting the other sectors of the economy through water scarcity, depletion of local food availability, raw material shortages to cottage industries, etc. It is difficult to ease these constraints in the short run. In the sixties the real income effect of the mild deterioration in barter terms to a great extent was mitigated by the rapid expansion of the quantity of exports. This is not the case today. It would appear that Kerala is also going to face a deterioration in the income terms of trade in the new phase.

Towards a new Development Strategy

There is an urgent need for reorientation of the development policies of the state towards emphasis on the protection of common property resources and ecological regeneration; priority for increasing the agricultural productivity by creating the externalities through scientific land-water management and appropriate facilitating organisational structures; improvement and diversification of products of traditional industries; encouragement to promote value addition in the available resources particularly further processing activities in rubber, aluminium, wood products etc; and diversification of the industrial production to new non resource based industrial sectors that are skill intensive and high value adding in which Kerala could have comparative advantage.

Left to itself the trade will only reinforce the existing structures and therefore there is paramount need for a concious social intervention to give a new direction to the development process. Rather than initiating any new ventures for direct production the government has got to utilise its limited funds for providing infrastructures and incentives for the productive investment of the funds that today flow into luxury consumption or out of the state. Apart from the inefficiency of the state machinery, the major handicap of the state government in fulfilling this task is the severe fiscal crisis it faces [K.K. George, 1992]. The continuous deficits in the revenue account and the failure to fund even the modest plan allocations have been the recurring feature of Kerala's budgets for more than a decade now. The scope for significantly curtailing the administrative or social expenditures is very limited. The prospects of the Federal Finance Commissions taking a generous view of the special problems are also not bright.

The financial constraints of the state strengthen the arguments for review of the present investment pattern and refixation of the priorities. It also increases the relevance of a more decentralised participatory development strategy that can tap the local resources and the unutilised man power for the creation of externalities in agriculture and ecological regeneration.

To go beyond the above general outlines of a new strategy of development is outside the scope of the present paper. As a concluding sentence we shall only reemphasise that the present trade led specialisation based on harvesting of natural resources or processing of agricultural products has reached a dead end and that if the present drift of the Kerala economy continues the prospects for future are rather bleak.

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