GOVERNMENT OF KERALA

MEDIUM TERM FISCAL POLICY & STRATEGY STATEMENT WITH MEDIUM TERM FISCAL PLAN FOR KERALA

2011-12 (Revised Budget Estimate) to 2013-14

FINANCE DEPARTMENT

2011

STATEMENT OF COMPLIANCE

- **This 2011-12 Medium Term Fiscal Policy and Strategy Statement is placed before the Legislature in compliance with Section 3 of the Kerala Fiscal Responsibility Act, 2003.**

- **Section 3 of the Act requires the Medium Term Fiscal Policy Statement to include the following elements all of which have been incorporated in the document:**

1. **A statement of recent economic trends and prospects for growth and development.**
2. **An assessment of sustainability relating to the revenue deficit and the use of capital receipts for generating productive assets.**
3. **An evaluation of the performance against targets for 2008-09 and 2009-10.**
4. **The medium term fiscal objectives of the Government.**
5. **Three year rolling targets for fiscal indicators with specification of underlying assumptions.**
6. **The strategic priorities and key policies of the Government.**
7. **Policies of Government for the ensuing financial year relating to taxation, expenditure, borrowings, other liabilities etc.**

FOREWORD

This Medium Term Fiscal Policy and Strategy Statement mandated under Kerala Fiscal Responsibility Act 2003 is based on the Revised Budget Estimate (2011-12), the newly elected Government is entitled to present before this august house. This reflects the policy shift of the new government in favour of growth and development with equity.

The reduction target in RD, FD and Debt stock given to the State by the 13^{th} FC can be complied within the targeted years, only with great effort, for which, Government will strive its best. But in 2011-12 there will be slippage in achieving the RD target of 1.40 percent of GSDP owing to the commitment on account implementation of pay /pension revision with effect from July 2009. From 2012-13 the Government will be right on track in achieving the fiscal consolidation path for which required taxation and expenditure policies are being put in place.

The task before the Government is very challenging, given the uncertain global economic scenario, the unabating inflationary trend and the inclusive environment within which the State Finances have to be managed. Nevertheless it is the duty of the government to put the state in high growth path taking bold steps.

I solicit the co-operation of all concerned to achieve the target set out in the Medium Term Fiscal Policy and Strategy Statement 2011-12 (Revised Budget Estimate);

08.07.2011 **K.M. Mani**
Finance Minister

MEDIUM TERM FISCAL POLICY AND STRATEGY STATEMENT

1. **Recent Economic Trends and Prospects for Growth and Development.**

1.1 Overview

1.1.1. Revision to the MTFP 2011 presented along with the budget in February 2011 has been necessitated in the wake of alterations in the budget estimates and policy shift of the new Government that took office after the recent election. Revenue receipts is increasing by R881 crore on account of increase in Central Transfers. Non-plan Revenue expenditure is going up to an extent of R395 crore. The plan expenditure has been retained at P 11030 crore with some sectoral deviations amply explained in the Alteration Memorandum. The increase in expenditure under capital outlay is R 905 crore taking into account additional resource availability and reprioritisation of schemes between capital outlay and Loans and Disbursements. Correspondingly disbursement of Loans and advances will come down by R 553 crore.

1.1.2. Due care has been taken to include committed expenditure arising out of the implementation of pay/pension revision 2009 and also to accommodate some expenditure for which sufficient provision has not been made in the Budget Estimate especially under subsidies.

1.1.3. The fiscal consolidation process will hinge on revenue mobilisation and expenditure control, by avoiding wasteful expenditure. The revised estimates show some improvement in major fiscal indicators. It becomes evident from the projection for forward estimates in 2012-13 and 2013-14 that the revised road map for fiscal consolidation drawn by the 13th FC can be achieved in the targeted years. But the year 2011-12 will be an aberration in respect of achieving RD/GSDP target, considering a more than normal growth in Revenue Expenditure emanating from Pay/Pension revision major portion of which is likely to be accounted in the current year. The other two indicators viz FD/GSDP and Debt/GSDP ratios are in compliance of the road map.

1.2. Global Scenario

1.2.1. The slide in the global economy as a result of mortgage led crisis in USA has started receding within a lesser time span than was thought, by the timely intervention with adequate monetary and fiscal policies globally. Advanced economies which were affected more had co-operated for this early recovery by not adopting protectionist policies to the detriment of international trade that would have left the global economy in a prolonged state of depression. Accommodative monetary and fiscal policies were put in place by nations to stem their respective economies. But resurfacing of some problems recently suggest that these temporary measures are not sufficient enough to unwind the global imbalances which are larger in dimension. There is uncertainty as to whether the global economy is on a revival phase or would witness another downturn. The happenings in USA and in some of the Euro Zone countries are major worries in this regard compounded by the devastating tsunami and its impact on Japanese economy which was already in a deflationary condition.

1.2.2. Meanwhile the interest rate being kept at low levels to combat recession in the advanced economies has created a situation in these countries that continuing these policies can have adverse impact on the inflationary front. Moreover measures taken to reimpose fiscal consolidation through spending cuts in these nations give worries not only to their citizen but also to the international community. It is feared that policy prescriptions in these nations to tackle inflation can result in shrinkage of demand thereby affecting employment and income internally. Trade volume is expected to contract because of this, affecting Emerging Market Economies (EMEs) in the export front.

1.2.3. The EMEs already are facing the twin problem of inflation and excessive capital flows. Taking advantage of the lower interest rates in the advanced economies speculative fund flows are boosting commodity prices world over. This is causing input cost to rise. In addition to this, in EMEs, the low cost global funds are moving in search of profits arising out of interest rate differentials. This in turn causes an appreciation in the exchange rate affecting exports. Increase in the fuel prices due to the unexpected events in the Middle East is another cause of worry. An orderly unwinding of imbalances is the need of the hour. The efforts being taken by G20 Countries and BRICS nations in this regard are positive and can fetch result in the near to long term.

1.3. National Scenario

1.3.1. It was with great care, and caution the Government of India put in place appropriate fiscal policies that arrested the tide in the growth rate witnessed in the economy in 2007-08 and 2008-09 consequent on the crisis that gripped the global economy. The fiscal sops in the form of a considerable reduction in Central Excise duties, even though dented the indirect tax collection in 2009-10 could stimulate the economy. The expenditure policies also were complementary. Debt relief to farmers and implementation of

NREGS were measures that induced confidence in the rural economy. A vibrant rural demand could compensate for the temporary demand shortfall witnessed in urban India. From the second half of 2009-10 there was perceptible change in the growth momentum. As a result the tax cuts introduced were withdrawn in 2010-11. Nature also was bountiful in 2010-11 and the growth in agriculture production boosted demand further. The corporate sector also became resilient after a period of lull raising employment level.

1.3.2. But a pervasive increase in income generated demand more than the supply especially of food articles and inflation emanating from this demand has been giving tough times in the management of economy. The trade-off between inflation and growth has been a challenge for the monetary authorities and the RBI increased policy rates 10 times from February 2010 with the aim of controlling inflation. Inflation meanwhile became genaralised as reflected by Wholesale Price Index. It is comforting that the increase in policy rates did not dampen the GDP growth rate severely and the economy in 2010-11 could register a growth of 8.5 percent and a growth at the same rate is expected to be repeated in 2011-12 also. On the strength of a more than enough food grain stock in the granaries supported by good Khariff as well as Rabi crops, the food inflation has come down gradually. It is hoped that the inflation especially of food articles will moderate further soon. Normal monsoon again in the current year can anchor inflationary expectations. The worrisome speculative price movement in commodities can also be tackled through adequate policy measures it is hoped.

1.3.3. Nevertheless the increase in fuel prices may put further pressure on the price front and the monetary policy measures to contain price rise may affect the growth rate temporarily. For some more time it is anticipated that the general inflation will stay at higher levels which will necessarily keep the market interest rate at higher levels. This will keep pressure on interest payments. Similar will be the effect on Salaries and Pension payments because of a possible upward movement of Consumer Price Index intermittently and consequent increase in the DA/DR rates. For the time being controlling inflation outweighs the concern of policy makers more than the growth momentum required in the economy. Unless price control is given due consideration now, it will have medium and longer term impact on growth.

1.3.4. Amidst these concerns the encouraging performance in the external sector is notable. The demand from traditional export markets continues to be tepid. A halting recovery in USA the crisis in some Euro zone countries is especially in the form of sovereign debt default and the already deflationary Japanese economy continue to hinder export demand from these traditional markets. Pre-emptive measures taken by the Centre to identify new markets through FTAs with blocks of nations and also the bilateral agreements entered to with some countries have yielded handsome gains when the growth in global trade is not so impressive. The astonishing growth rate witnessed in exports at about 31% for 2010-11 is laudable. In the year 2011-12 also, the export figures continue to be vibrant on an already higher growth in 2010-11. It is also heartening to note that in the recent months the current account deficit has narrowed on the back of improvement in trade balance and receipts from invisibles.

1.3.5. The improvement in the fiscal indicators of the Centre in 2009-10 and 2010-11 even amidst unfavourable economic condition globally is not a one to be overlooked. The Fiscal Deficit as a percentage of GDP in both these years were less than that estimated in the budget. The FD/GSDP at 4.68 percent in 2010-11 against the initial target of 5.1 percent is heartening. This improvement has created sufficient fiscal cushion so that any fresh rounds of economic crisis globally can be faced with confidence by providing fiscal impetus without the fear of fiscal deficit fuelling inflation and the sovereign debt liabilities not being defaulted as has been happening in some Euro zone economies. Dependence on multilateral lending institution for emergency funding accepting severe conditionallities is also a remote possibility now, considering the lower level of external liabilities in the composition of total debt and also on the strength of growing forex reserves.

1.3.6. India is now a major economic player in the international sphere. It is with anticipation that the international community is looking to India to unwind the global imbalances. Advance economies are mired by high level of current account deficit, fiscal deficit and is over laden with unmanageable debt/GDP ratios. The rebalancing has to happen by more spending in the EMEs. In realization of the need to steer the global economy out of troubled waters, India is in greater co-operation with global efforts to mitigate the ill effects of economic crisis. India is not practicing protectionism in these hard times and not resorting to currency manipulations as practised by some nations to boost exports. This approach will be mutually beneficial.

1.3.7. Globalisation as we know presents opportunities as well as challenges. Macro economy of the country has been managed well in the past few years so that the challenges can be boldly met to take advantage of the opportunities. The country’s position as one among those nations that can stem the global crisis has to be looked with pride. With the rural economy looking up in the face of good monsoon and improved wages and resultant increase in income of the households, the consumption rate, savings rate and investment rate of the country are in good stead and once the inflation reaches the comfort zone of 5-6 percent targeted by RBI, and the inflationary expectation is anchored, the nation can certainly tread the path of a 9 – 9.5 percent growth persistently that is being targeted for the 12th plan.

1.4. State Scenario

1.4.1. The state economy for long has been more dependent on the growth of service sector than on the growth of agriculture and industrial sector. Large scale remittances from abroad is another factor keeping the economy thriving. But it is still a dismay that in the agricultural and industrial sector the state is lagging behind even though fertile soil, skilled manpower and capital are in abundance. The productive sector is far behind the national trend. Long term prospectus of such a growth pattern is in peril. It is the right time to find out factors responsible for this backwardness and rectify the mistakes without losing further time.

1.4.2. It is the right time for introspection as the Centre has come out with a draft manufacturing policy to raise the share of manufacturing in GDP to 25 percent from 16 percent at present with the intention of generating employment. The policy brought out by the Centre can be adopted for the state as well with suitable modifications. If the state misses this opportunity it will have to face severe consequences on the employment front. Already the numbers of registered unemployed in the Employment exchange have swelled to a whopping 45 lakh persons

1.4.3. Industrial sector in the State needs rejuvenation. In addition to public sector, partnership is required to be struck with private sector for major investments. The State can no longer shy away from private capital. Infrastructure requirement in the State also call for huge investment.Seaport, airports and road transportation sector in the State is starving for funds. The micro, small and medium enterprises need to be promoted for employing the vast number of qualified skilled labour force which is searching its fortune outside the State.

1.4.4. Kerala is more affected by price rise than any other State because of its overdependence on other States for all the consumer products. Huge market intervention is required to soften the prices of essential commodities so that the poor is not hurt and inclusive growth agenda of the Government is not affected. The spending requirement for these interventions require revenue generation. The tax base of the Government is not growing commensurately to meet fund requirements because of the sagging industrial sector. Hence to industralise the State is the prime agenda of Government. The GST regime which would have brought some comfort to the State is yet to be implemented. Preparedness for its effective implementation will be put in place.

2. STATE FINANCES : SUSTAINABILITY, STRATEGIC PRICORITIES, KEY POLICIES AND MEDIUM TERM FISCAL OBJECTIVES

2.1. Fiscal Performance in 2009-10

2.1.1. From the BE level of 1.30 percent and 2.47 percent of GSDP, the RD and FD in 2009-10 has gone up considerably to 2.18 percent and 3.42 percent of GSDP respectively in the actuals. The reversal was caused by revenue shortfall that arose from the crisis. The Central Transfers fell in absolute terms by P 1834 crore and the States Own Tax Revenue (SOTR) item viz. stamps & Registration fell by P 833 crore .The spike in RD from P 3008 crore in the BE to P 5023 crore in the actuals, is mainly because of these shortfall in revenues. Thus the share of RD in the FD has risen to 63.8 percent. But the positive factor was that the revenue expenditure could be contained within the budgeted level. The shortfall in revenues and a hard budget constrain through a compressed borrowing ceiling of 4 percent of GSDP reckoning the GSDP figure computed by the Finance Commission setting aside the estimates of CSO did not deter the Government from incurring capital expenditure even though with a moderate growth. The growth in capital expenditure was 9.95 percent and within this direct spending (capital outlay) grew at a rate of 21.45 percent. The debt/ GSDP ratio was 30.81 compared to 31.47 percent in the previous year.

2.1.2. In 2009-10 some stimulus spending too was undertaken by the Government. Administrative sanctions have been issued for works totaling around P 4000 crore towards capital projects. Expenditure on account of this is anticipated to spill over to 2011-12 and 2012-13.

2.3. REVIEW OF MTFP 2010

2.3.1. The RE 2010-11 shows a growth of 24.38 percent in SOTR compared to actuals in 2009-10. The revision is based on current trend in collection witnessed in SOTR especially in Sales Tax/VAT and Stamps & Registration. The impact of a reduced horizontal share in the 13th FC award will weigh down heavily on Central Transfers, which otherwise would have contributed to reduction of the RD further. The revenue expenditure is expected to grow by an additional 3 percent in the RE over BE. This increase will be offset by the additional revenue arising out of States Own Tax revenue. Hence RD as a percentage of GSDP remains more or less the same as that of BE. The capital expenditure however is expected to post a decline of 19.8 percent from the budget estimate mainly under non-plan capital outlay and loan disbursement. The spending under plan capital is anticipated to increase by 34.38 percent. The FD/GSDP is likely to post a 0.33 percent drop because of this.

Table 1

STATE FINANCES

P Crore

	2008-09 Accounts	2009-10 Accounts	2010-11 BE	2010-11 RE	2011-12 Revised BE
A. Revenue Receipts	**24512.18**	**26109.40**	**31180.82**	**32127.01**	**39427.50**
1. State Tax Revenue	15990.18	17625.02	20884.23	21922.51	26641.53
2. State Non-Tax Revenue	1559.29	1852.22	2314.31	2235.57	2530.94
3. Central Government Transfers	6962.71	6632.16	7982.28	7968.93	10255.03
i. Share of Central Taxes	4275.52	4398.78	4825.76	4900.50	6176.97
ii. Grant in aid	2687.19	2233.38	3156.52	3068.43	4078.06
B. Capital Receipts	**6231.67**	**7999.74**	**8201.89**	**7845.56**	**10438.66**
1. Recoveries of Loans	35.64	38.47	56.24	58.55	70.75
2. Other Receipts	9.11	48.96	9.50	9.50	20.00
3. Borrowings and other liabilities	6186.92	7912.31	8136.15	7777.51	10347.91
a. Public Debt (Net)	5271.05	4850.46	7723.21	6279.08	7793.76
b. Public Account (Net)	915.87	3061.84	412.94	1498.43	2554.15
C. Total Receipts (A+B)	**30743.85**	**34109.14**	**39382.73**	**39972.57**	**49866.16**
D. Non Plan Expenditure	**25441.27**	**27283.03**	**31726.63**	**31471.86**	**41070.00**
1. On Revenue Account	25012.00	26953.32	29376.97	30513.23	39177.19
a. of which interest payments	4659.69	5292.48	5786.48	5517.92	6254.56
2. On Capital Account	24.84	157.23	2250.00	646.56	1344.46
3. On Loan Disbursements	404.44	172.48	99.67	312.07	548.35
E. Plan Expenditure (including CSS)	**5461.87**	**6785.41**	**8063.21**	**8383.32**	**8955.24**
1. On Revenue Account	3211.86	4179.05	5433.41	5349.90	5784.22
2. On Capital Account	1670.76	1902.16	1895.38	2547.12	2490.24
3. On Loan Disbursements	579.25	704.20	734.42	486.30	680.78
F. Total Expenditure (D+E)	**30903.14**	**34068.44**	**39789.84**	**39855.19**	**50025.26**

1. Revenue Expenditure	28223.85	31132.38	34810.37	35863.13	44961.42
2. Capital Expenditure	1695.60	2059.39	4145.38	3193.69	3834.70
3. On Loan Disbursements	983.69	876.68	834.09	798.37	1229.13
G. Revenue Surplus/Deficit (A-F(1))	**-3711.68**	**-5022.98**	**-3629.55**	**-3736.12**	**-5533.92**
H. Fiscal Deficit (A+B(1)+B(2))-F)	**-6346.22**	**-7871.62**	**-8543.28**	**-7660.13**	**-10507.00**
I. Primary Deficit (H-D(1a))	**-1686.52**	**-2579.14**	**-2756.80**	**-2142.21**	**-4252.44**

The Fiscal Targets for 2010-11 were	**Actual outcome of 2010-11 RE**
➢ **A Revenue Deficit of 1.37% of GSDP**	✓ A Revenue Deficit of 1.41 % of GSDP
➢ **A Fiscal Deficit of 3.22 % of GSDP**	✓ A Fiscal Deficit of 2.89 % of GSDP
➢ **A Primary Deficit of 1.04 % of GSDP**	✓ A Primary Deficit of 0.81% of GSDP

2.4. REVIEW OF MEDIUM TERM FISCAL POLICY TARGETS

2.4.1. The fiscal targets fixed for the year 2010-11 as a percentage of GSDP and the actual outcome are given below. Except Revenue Deficit, all other indicators have improved as can be seen below. The main reason for Revenue Deficit exceeding the target fixed was the result of pension payments exceeding the estimates.

➢ **A Primary Deficit of 1.04 % of GSDP**	✓ A Primary Deficit of 0.81% of GSDP
➢ **A Debt of 29.52 % of GSDP**	✓ A Debt of 29.52 % of GSDP

2.5. PROJECTIONS FOR BE 2011-12

2.5.1. Revenue Receipts

2.5.1.1. There has been realisation that the Sales Tax/VAT collection in the State is below the potential collection. Various measures already taken to ensure tax compliance and strengthening of tax administration will be augmented further. Hence Government is anticipating higher tax buoyancy in 2011-12 as in the previous year. With this optimism in mind, the growth rate adopted for the year 2011-12 is 22.68 percent. Projection of 24.26 percent provided for Stamps and Registration is on the anticipation of spur in real estate activities ancillary to some newly conceived projects in the State. Other SOTR items also are likely to post good growth over RE 2010-11. Only a normal growth rate of 13 percent is anticipated in respect of non-tax revenue. Share of Central Taxes is reckoned at the level provided in the Union Budget. The overall growth in Revenue Receipts for 2011-12 is thus anticipated to be around 23 percent. The estimates are achievable, unless unexpected upheavals happen in the economy.

Table 2

STRUCTURE OF OWN TAX REVENUES

P Crore

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 RE	2011-12 Revised BE
SOTR ***of which***	9779	11942	13669	15990	17625	21923	26642
a. Sales Tax/VAT	7038	8563	9372	11377	12771	15836	19428
Growth Rate		21.67	9.45	21.39	12.25	24.00	22.68
b. Excise Duty	841	953	1169	1398	1515	1800	2059
Growth Rate		13.32	22.67	19.59	8.37	18.81	14.39
c. Motor Vehicle Tax	629	708	853	937	1131	1233	1411

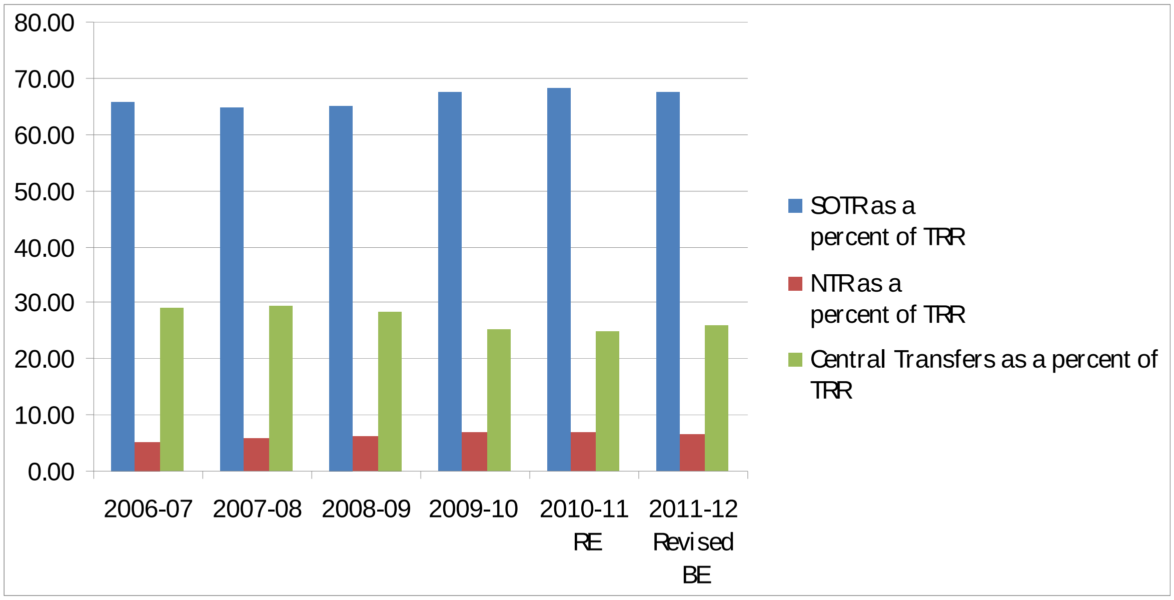
Growth Rate		12.56	20.48	9.85	20.70	9.02	14.44
d. Stamp Duty & Regn.	1101	1520	2028	2003	1896	2617	3252
Growth Rate		38.06	33.42	-1.23	-5.34	38.03	24.26
Percentage to Total							
a. Sales Tax	71.97	71.70	68.56	71.15	72.46	72.23	72.92
b. Excise Duty	8.60	7.98	8.55	8.74	8.60	8.21	7.73
c. Motor Vehicle Tax	6.43	5.93	6.24	5.86	6.42	5.62	5.30
d. Stamp Duty & Regn.	11.26	12.73	14.84	12.53	10.76	11.94	12.21

Table 3

COMPOSITION AND GROWTH OF REVENUE RECEIPTS

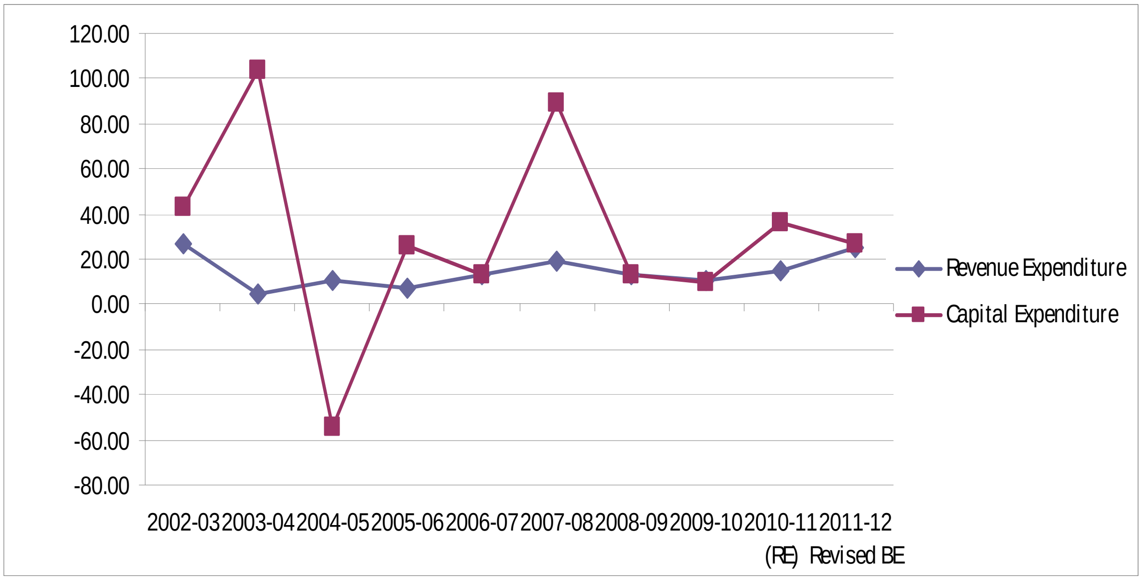
P Crore

Year	SOTR	NTR	Central Transfers	Total Revenue Receipts	Growth rate of SOTR	Growth rate of NTR	Growth rate of Central Transfers	Growth rate of TRR
2006-07	11942	938	5307	18187				
2007-08	13669	1210	6228	21107	14.46	29.00	17.35	16.06
2008-09	15990	1559	6963	24512	16.98	28.87	11.80	16.13
2009-10	17625	1852	6632	26109	10.22	18.77	-4.75	6.52
2010-11 RE	21923	2236	7969	32127	24.38	20.71	20.16	23.05
2011-12 Revised BE	26642	2531	10255	39427	21.53	13.21	28.69	22.72



2.6. EXPENDITURE

2.6.1. Revenue expenditure as a percentage of total expenditure was as high as 94 percent in 2002-03 and almost remained the same throughout the period 2002-2007. Since 2007-08 a marked shift in the pattern of expenditure in favour of capital expenditure is visible as can be seen from the table below. A major contributory towards this achievement is the higher tax buoyancy attained from 2006-07. For 2010-11 it is estimated that the share of capital expenditure in total expenditure would be 10 percent. Even in the face of fresh commitments anticipated in the revenue expenditure in 2011-12 this tempo can be maintained with improved vigour and capital expenditure is estimated to grow by a whopping 27 percent.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2002-03
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2007-08
2008-09
2009-10
2010-11 (RE)
2011-12 Revised BE
Revenue Expenditure
Capital Expenditure

Table 4

EXPENDITURE PATTERN

P Crore

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 RE	2011-12 Revised BE
Revenue Expenditure	**18424**	**20825**	**24892**	**28224**	**31132**	**35863**	**44961**
Plan	3223	2308	2277	3212	4179	5350	5784
Non Plan	15201	18516	22614	25012	26953	30513	39177
Revenue Expenditure of which							
i) Interest payments	3799	4190	4330	4660	5292	5518	6255
ii) Pensions	2861	3295	4925	4686	4706	5788	7311
iii) Salaries	5369	6317	7367	8801	9799	11332	16326
vi) Others	3171	4715	5993	6865	7156	13225	15069
Capital Expenditure	**1104**	**1252**	**2368**	**2679**	**2936**	**3992**	**5064**
Capital Expenditure of which							
i) Capital Outlay	817	903	1475	1696	2059	3194	3835
ii) Loans & Advances	287	349	893	984	877	798	1229
Total Expenditure	**19528**	**22077**	**27259**	**30903**	**34068**	**39855**	**50025**

2.6.2. The implementation of 9th pay/ pension revision will take effect from July 2009. Arrear in respect of salary for 19 months in the revised scale, in addition to regular salary payments for 2011-12 and two installments of DA are factored into in respect of salary expenditure estimates. Pension revision arrears for 20 months in the revised pension and regular pension payment for 2011-12 with other pensionery benefits at enhanced rates are also factored in. The 4th SFC has submitted the recommendation as per which 25 percent of the State plan outlay will be devolved for developmental expenditure. In addition, general purpose grant and maintenance grants also are estimated as per recommendations.The enhanced devolution formula envisages higher outgoes to LSGIs.

2.6.3. The revenue expenditure thus records an increase of 24 percent over RE 2010-11.

2.7. STRATEGIC PRIORITIES

2.7.1. The State realize the need for managing the finances in tandem with the targets set by the 13th Finance Commission in the larger macro economic management of the country. The State will strive to achieve fiscal consolidation targets within the time frame fixed as per roadmap of the 13th Finance Commission. Confrontationist attitude with Centre will not bring any gains to the State economy. Conciliatory steps would be taken to remove difficulties specific to the State arising out of conditionalities attached to the schemes which in the context of State may not be feasible. Fiscal consolidation in the States context cannot be achieved by compressing social sector expenditure, and denying much needed public goods to the needy and the deserved. Compression of expenditure has thus to be limited to those sectors where public spending will be a waste or will not fetch the desired results. Augmentation of revenue alone would not result in fiscal consolidation as economic turmoil can pull down revenue occasionally. The twin pronged approach of revenue augmentation and avoiding wasteful and inefficient expenditure can bring consistency to the fiscal consolidation effort.

2.7.2. Outstanding dues of all kinds would be cleared in a phased manner so that budgetary planning and MTFP targets are not vitiated. The Kerala Fiscal Reforms Act 2003 would be amended in compliance of the 13th Finance Commission recommendations so that the Fiscal consolidation process will be rolled on in the State and the benefits recommended in the 13th FC will be availed as far as possible.

2.8. DEBT MANAGEMENT AND SUSTAINABILITY

2.8.1. Improvement in the debt sustainability indicators will be achieved through prudent measures. The composition of debt remains almost unchanged during the last five years. The internal debt as a percent of total debt stock is 63.46 percent while the loan from the Centre is at 8.56 percent in 2011-12 and PF, Small savings etc constitute 28.28 percent of debt stock. The debt as a percentage of GSDP comes down from 29.52 in 2010-11 RE to 28.99 percent in 2011-12(Alt).The Debt/GSDP limit proposed by the 13th Finance Commission for 2011-12 is 32.3 percent. The FD/GSDP and RD/GSDP ratios allowed by the 13th Finance Commission for 2011-12 are 3.5 percent and 1.4 percent respectively. But for 2011-12, the RD/GSDP ratio will be at an increased level of 1.81 percent whereas FD/GSDP ratio will remain within the limit. The non achievement of RD/GSDP target is due to the provisioning of pay/pension revision arrears in 2011-12.The RD/FD ratio shows that the quality of Fiscal Deficit has been improving. The RD/FD ratio which was as high as 74.82 percent is coming down to 52.66 percent in 2011-12(Alt). Another important indicator is the Debt/TRR ratio. From 2006-07 this ratio has been within the benchmark level of 300 percent. The ratio in 2011-12 is coming down to 225 percent. The improvement in the current year against huge pay/pension revision commitments is commendable. Domar Gap, which has also been positive throughout these periods, indicates the sustainable debt position of the Government.

TARGETS AND POLICIES

2.9. FISCAL POLICY FRAME WORK

2.9.1. The State would move towards fiscal consolidation in a policy environment conducive to growth with inclusion by augmenting revenues further and avoiding wasteful and inefficient expenditure. The Governments fiscal policy frameworks are summarized below.

2.10. MEDIUM TERM FISCAL POLICY PLAN FROM 2011-12 TO 2012-13

- Corruption free and transparent governance will ensure that Government spends efficiently and effectively.
- The bane of administration for the past several years was lethargy. Quick decisions and fast implementation will be the hallmark of Government.
- Inadequate infrastructure of international standard hinders Kerala's image as an attractive investment destination. Given the resource constraints of Government, infrastructure will be built up with private participation. Major infrastructure projects will be put in a fast track mode.
- Measures will be taken to focus Kerala as an attractive investment destination.
- Agriculture and industry will be the thrust areas for creating employment opportunities.
- Cordial Centre-State relations will be restored to derive maximum resources from the Centre for development.
- Growth and development with equity without sacrificing the interest of the poor is the motto of Government.
- Kerala will be made a knowledge hub for higher education.
- Public Transportation System will be strengthened to reduce pressure on road.
- Power generation capacity will be increased to foster industralisation.
- Conservation and Preservation of environment will be ensured.

- Support for solid waste management will be given to make Kerala clean.

2.10.1. Tax Policy

2.10.1.1. Strong growth in the State's own tax revenues is essential to reduce fiscal imbalances. Tax administration would be strengthened further and essential preparedness will be put in place to reap gains from the GST to be introduced .

2.10.2. Contingent Liabilities

2.10.2.1. As against a legislative ceiling of P14000 crore in respect of contingent liabilities ,the outstanding liabilities is P7495 crore.

3. THREE YEAR ROLLING TARGETS AND UNDERLYING ASSUMPTIONS

3.1. GSDP

3.1.1. The 13th FC has estimated GSDP growth rates of 13.99 and 14.50 percents respectively for 2011-12 and 2012-14. As against this the Economics & Statistics Department has estimated a GSDP growth of 15.40 percent for 2011-12. The growth of GSDP a shade higher than GDP growth rate has been a trend for the past several years. Even though for computation of borrowing ceiling the State has to settle for the figures worked out by MOF, for working out indicators the figure will be that of

CSO, based on the figures of Economics and Statistics Department. For forward estimates the figures reckoned are that of 13th FC.

3.2. REVENUE

3.2.1. STATE'S OWN TAX REVENUE

3.2.1.1. The high tax buoyancy obtainable in 2011-12 cannot be taken as trend growth rate and projected into the future. Government is hoping for a buoyancy of around one in future. Hence for forward estimates, the States Own tax revenues are projected at 15 percent against the GSDP growth rate of 14.50 percent.

3.2.2. NON-TAX REVENUES

3.2.2.1. A conservative growth rate of only 13 percent is projected, which the Government consider is realistic on the reckoning that annual increase of fees and user charges are not feasible.

3.2.3. RESOURCES FROM THE CENTRE

3.2.3.1. A definitive pattern is not visible to give a growth rate that is feasible in the medium term. BE 2011-12 is estimated on the basis of figures in the Union Budget and grants receivable under various items. For forward estimates 15 percent projections seems realistic.

3.2.3.2. Overall growth in revenue receipts thus derived is 15 percent for the forward estimates.

3.3. REVENUE EXPENDITURE

3.3.1. SALARIES

3.3.1.1. For the forward estimates in 2012-13 one time arrears (July 2009 to March 2010) has been removed and projected further providing for normal increase of pay and two installments of DAs. Projection for 2013-14 includes normal growth on pay as well as provision for two additional installments of DAs.

3.4. PENSION

3.4.1. Arrears payable on account of pension revision is removed from BE 2011-12 and forward estimates projected further with 12 percent annually.

3.5. INTEREST

3.5.1. Interest is calculated on the midyear debt reckoning effective interest rates 7.55 percent annually for the forward estimates period.

3.5.2. While subsidies, maintenance and repair, and administrative expenditure are projected with 10 percent increase, other revenue expenditure is projected with 15 percent for 2012-13 and 10 percent for 2013-14.The higher provisioning for other revenue expenditure in 2012-13 is considering the committed expenditure that would be required for maintaining the assets created in the 11^{th} Plan period which would end in 2011-12.

3.6. DEVOLUTION TO LSGI's

3.6.1. Figures are provided based on the recommendations made by the 4th SFC towards developmental expenditure, general purpose grant and maintenance grant.

3.7. CAPITAL EXPENDITURE

3.7.1. Taken as a residuary item. With improvements in the fiscal indicators in 2012-13 a sharp increase from the previous year is anticipated. In 2013-14, the FD will only be 3 percent of GSDP according to the revised road map for fiscal consolidation and hence an increase as that in the previous year will not be available because of borrowings at reduced level.

3.8. OUTCOMES IN MAJOR INDICATORS IN 2012-13 AND 2013-14

3.8.1. The MTFP forward estimates for 2012-13 and 2013-14 are in accordance with the targets proposed by the 13th Finance Commission.

Indicators	Proposed by 13th FC		MTFP Targets	
	2012-13	2013-14	2012-13	2013-14
RD/GSDP	0.90	0.50	0.89	0.48
FD/GSDP	3.50	3.00	3.50	2.98
Debt/GSDP	31.70	30.7	28.82	28.08

3.8.2. The major improvement is in the Debt-GSDP ratio. The targets proposed by the 13th FC for the years 2012-13 and 2013-14 are 31.70 and 30.70 respectively. But as per the Medium Term Fiscal Plan for these years they are likely to come down to

28.82 and 28.08 percent respectively which will ease debt servicing cost in the coming years.

Table 5

MEDIUM TERM FISCAL PLAN 2011-12

P Crore

Item	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
	Accounts	Accounts	Accounts	RE	Revised BE	Forward Estimates	
Revenue Receipts	21107	24512	26109	32127	39428	44983	51329
State's own tax revenue	13669	15990	17625	21923	26642	30638	35233
Non Tax Revenue	1210	1559	1852	2236	2531	2860	3232
Resources from Centre	6228	6963	6632	7969	10255	11486	12864
Revenue Expenditure	24892	28224	31132	35863	44961	48111	53274
Non -Interest Revenue Expenditure	20562	23564	25840	30345	38706	40947	45205
Interest	4330	4660	5292	5518	6255	7164	8069
Salaries	7693.66	9064	9799	11332	16326	16533	18050
Pensions	4925	4686	4706	5788	7311	6668	7468
Non SPI Revenue Expenditure	7943.34	9814	11335	13225	15069	17747	19687
Subsidies	219	329	441	506	647	657	722
Power subsidy	0	0	0	0		0	0
Maintenance & repair	633	858	734	614	527	580	638
Devolution to LSGs	2273	2426	2083	2880	3839	5025	5403
Administrative Expenditure	1473	1620	1154	1461	1598	1758	1934
Other Revenue Expenditure	3376	4581	6924	7764	8458	9727	10991
Revenue Surplus/Deficit	**-3784.8**	**-3712**	**-5023**	**-3736**	**-5533**	**-3127**	**-1945**
Capital Expenditure	1475	2680	2936	3992	5064	9227	10150
Capital Outlay		1696	2059	3194	3835	7267	7993
Loan disbursements(net)	848	984	877	798	1229	1960	2156
Non Debt Capital Receipts		45	87	68	91	100	110
Fiscal Deficit/Surplus	**-6100.2**	**-6347**	**-7872**	**-7660**	**-10506**	**-12254**	**-11985**
Primary Fiscal Deficit/Surplus	-1770.6	-1687	-2579	-2142	-4251	-5091	-3916
End of the period Debt	55410	59340	67120	74643	83532	94882	106871
Debt Service	4330	5004	5569	5842	6616	7573	8533
Salary+Pension+Interest	16948.7	18410	19797	22638	29892	30364	33586
Explicit Power subsidy	0	0	0	0	0	0	0
Debt Stock	55410	63270	70969	78317	88747	101017	112724
Government Guarantees	8317	7992	7496	7193	7495	7495	7495
Interest/Revenue (%)	20.51	19.01	20.27	17.18	15.86	15.92	15.72
Debt/Revenue (%)	262.52	258.12	271.81	243.77	225.09	224.57	219.61
(Salary+Pen+Interest)/Revenue(%)	80.30	75.11	75.82	70.46	75.81	67.50	65.43
(Salary+Pen+Interest)/GSDP(%)	10.23	9.16	8.60	8.53	9.76	8.66	8.37

(Salary+Pen)/GSDP (%)	7.61	6.84	6.30	6.45	7.72	6.62	6.36
Rev Deficit/Rev Receipt (%)	17.93	15.14	19.24	11.63	14.03	6.95	3.79
RD/GSDP (%)	2.28	1.85	2.18	1.41	1.81	0.89	0.48
FD/GSDP (%)	3.68	3.16	3.42	2.89	3.43	3.50	2.99
Debt Stock/GSDP (%)	33.44	31.47	30.81	29.52	28.99	28.82	28.08
GSDP	165722	201020	230316	265322	306172	350567	401399
Nominal GSDP Growth Rate(%)		21.30	14.57	15.20	15.40	14.50	14.50
Average Interest Rate (%)		7.85	7.89	7.39	7.04	7.55	7.55
Domar Gap		13.45	6.69	7.81	8.36	6.95	6.95