GOVERNMENT OF KERALA

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

2012-13 to 2014-15

FINANCE DEPARTMENT

2012

STATEMENT OF COMPLIANCE

- **This 2012-13 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 2010-11 and 2011-12.**
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

As per stipulation in the Kerala Fiscal Responsibility Act 2003, a Medium Term Fiscal Policy and Strategy Statement is to be prepared and submitted along with the budget documents to the State Legislature. Accordingly I present the Medium Term Fiscal Policy and Strategy Statement for 2012-13 .

The State has resumed its fiscal consolidation efforts with the amendment to Kerala Fiscal Responsibility Act 2003 incorporating target put forth by the 13th Finance Commission in the revised roadmap for fiscal consolidation. Fiscal consolidation is the joint responsibility of the Centre and the States towards putting the nation in a sound macro economic footing for stable development. It is a common knowledge that in all economic downturns, the most affected are the working class and the poor. Hence at times of crisis there should be ample headroom for fiscal maneuver.

It is the right time for the State to forge ahead with fiscal consolidation, as our resources in 2011-12 are estimated to post an unprecedented growth of 27.74 percent. The revenue collection will be consolidated further in the coming years. Unlike in 2011-12, there will be moderation in revenue expenditure also from 2012-13 arising from the non-recurrence of arrear payments.

Even amidst a lot of pressure on the payment side in 2011-12, the capital expenditure is likely to book a growth of 43.58 Percent which is a positive development. I hope that this momentum will be sustained during the forward estimates period.

I know that the fiscal correction path is not easy to tread considering the uncertainties in the global economic environment and our interconnectedness to the rest of the world through trade and finances. But I have deep faith in the State's capabilities on the revenue front.

I solicit the whole hearted co-operation of all in attaining the objectives of this Medium Term Fiscal Policy and Strategy Statement

19th March 2012

K.M. Mani
Finance Minister

MEDIUM TERM FISCAL POLICY AND STRATEGY STATEMENT 2012

1. RECENT ECONOMIC TRENDS AND PROSPECTS FOR GROWTH AND DEVELOPMENT

1.1. OVERVIEW

1.1.1. In the Revised Medium Term Fiscal Policy and Strategy Statement 2011, confidence has been expressed that, fiscal consolidation would be achieved in the State as per roadmap of the 13th Finance Commission, even though slippages would be encountered in 2011-12 on account of implications of pay/pension revision on Revenue deficit. Subsequently efforts for fiscal consolidation have been resumed in the State with the amendment of Kerala Fiscal Responsibility Act 2003 incorporating fiscal targets to be achieved as per the revised roadmap for fiscal consolidation. As anticipated, except for slippages in achieving the target of Revenue deficit/GSDP, we are right on track in respect of Fiscal Deficit/GSDP and Debt/GSDP targets. We are hopeful of achieving targets in the respective years in respect of all the indicators from 2012-13 giving credibility to our efforts.

1.1.2. There are concerns, that the growth prospects of GDP may slip to levels below 7 percent in the current year. This is expected to be only temporary as the Indian economy had come out of the crisis of 2008, earlier than expected through better economic management and had exhibited its capabilities before the world. Notwithstanding a weak global economy and some setbacks in the Indian economy, the State economy and finances are putting up a brighter performance. The GSDP of the State at constant price is expected to grow 7.80 percent in 2011-12 and at current prices it is likely to post a growth of 17.94 percent.

1.1.3. The global economic crisis, which originated in the financial sector of advanced economies has not affected the Indian financial sector is a relief and giving rays of hope. Had this been the same as in developed countries; our economy would have been shattered in an unprecedented manner. The regulatory strength of monetary authority deserves to be patted in this respect. The outlook for the financial year 2012-13 is cautiously optimistic, given the positive development in the price front. The task ahead is to induce business confidence through policy measures both at the Centre and in the States. The policy pronouncements in the budget 2012-13 are towards addressing these issues, giving primacy to development and care with compassion.

1.1.4. As regards State finances, it requires special mention that, the huge commitment on account of the pay/pension revision, the increased subsidy payment, welfare payments at enhanced level for the vulnerable section of the society, the outstanding liabilities inherited from the past and scaling up of plan expenditure from ₹ 11,030 crore to ₹ 12,010 crore involving an additional commitment of ₹ 980 crore have been challenging. But impressive tax and non-tax collections have been a succor, and these payments have been met without resorting to Ways and Means Advances and Overdrafts.

1.1.5. Some shortfalls in the collection under the States Own Tax Revenue of Stamps and Registration and reduced non tax revenues from royalty on minerals as a consequence of an overambitious target of revenue from the desiltation in dams in the original budget apart, the revenue receipts as per Revised Estimates 2011-12 will surpass the estimates. A positive and creditable achievement is that the revenue from Sales Tax/VAT the main source of States Own Tax revenue, is buoyant on an already higher growth in 2010-11. A huge jump in the non-tax collection from lotteries became possible from the second half of 2011-12, by raising the number of weekly draws from one to seven. Efficient and effective spending under Centrally

Sponsored Schemes and other Central Schemes also has become possible this year causing an increase in the release of grants from the Centre. These developments give a sound base for achieving fiscal targets in the subsequent years.

1.2. GLOBAL SCENARIO

1.2.1. The global economic environment continued to be a grim one in 2011-12 also, except for some occasional positive signals in the growth front of United States and the Eurozone crisis not exploding into a full blown recession. The third quarter growth of 1.8 percent and last quarter projected growth of 3 percent in United States provides some glimmer of hope, the sustainability of which will largely depend on revival of private investment and consumption as well as fall in unemployment. But the fiscal deficit which already is higher at around 9 percent of GDP this year cannot be continued at such levels, as the American congress while consenting for raising the debt ceiling to avoid payment crisis this year, has imposed the condition that for the additional amount of debt ceiling allowed, the Government has to embark on a spending cut equal to the same amount, ending 2021. If the cut imposed could not be adhered to as mandated by the Congress, the US debt may be rated down, which can send shock waves across the globe. With limited scope for fiscal expansion, the Federal Reserve has been keeping the interest rate persistently down to near zero levels to stimulate private investment and consumption.

1.2.2. The Eurozone continues to exhibit vulnerabilities even after the European Financial Stability Facility came to the rescue of those countries which were in the threat of sovereign debt default and a bail out package for Greece has been struck by European Commission, European Central Bank and IMF. With the overhang of debt afflicting almost all the countries of the Eurozone, the fear of default is looming large irrespective of whether it is a periphery country or a core country. A sense of urgency has pervaded almost all the European countries, to impose severe austerity measures. These austerity measures apart from inflicting pain on the people, can cause the economy to shrink further. Whether cut in public spending alone can achieve the desired results is doubtful as, opinion among economists are divided as to whether, austerity at this point would find a solution to problems or aggravate matters further by bringing down growth and revenue, which are already in a bad shape. The whole of Eurozone is mired as to how to emerge unhurt from the sovereign debt crisis. As if to compound matters, the growth numbers of the third quarter are negative from 7 percent in Greece, a periphery country to 0.2 percent in Germany, a core country. The United Kingdom, a major economy, outside the Eurozone also is showing negative growth for the latest quarter. Growth slippages and falling revenues can cause an upheaval in the whole of Europe the contagion of which can spread to other countries.

1.2.3. As the fiscal situation in dire straits and fiscal space for stimulating the economy shrinking, a loose monetary policy is being pursued by the European Central Bank in the hope of stimulating private investment and consumption. Such a policy has ensured liquidity to the financial and banking system avoiding credit crunch. The yield on sovereign debt also could be brought down. But in the absence of demand for credit, banks are investing this money in riskier bonds or parking back with European Central Bank which can hurt the balance sheet of these banks if the bonds are defaulted as happened to the bond holders of Greece. For the Governments of Eurozone countries also the worries are redemption of bonds in time or to face rollover risks. Business confidence level in the Eurozone is sagging.

1.2.4. It is saddening that, the kind of global cooperation evinced by the G-20 nations to dissipate the financial crisis of 2008 is not shown towards mitigating Eurozone crisis. Even at the World Economic Forum nobody exuded the confidence that, normalcy would return to the world economy because of the Eurozone crisis.

Since Eurozone only is a monetary union, and not a fiscal and political union, the sovereign debt crisis is difficult to resolve, as political opposition can erupt in the fiscally well off countries when they try to support fiscally profligate countries. A recent resolve by the countries of European Union to maintain budget discipline to contain debt is viewed with hope.

1.2.5. The export dependant economies like China and Korea are concerned from these developments, as fall in trade can affect output and growth in these nations rendering capacities built in industries and infrastructure excess. Under utilization of capacities can cause unemployment in these nations. These nations have considerable stake in the debt of Eurozone as well. The fallout would affect India also even though to a lesser extent. India has only a negligible stake in the Eurobond is comforting. But Emerging Market Economies including India, which are exporting raw materials, intermediary goods and finished goods directly to the advanced economies and to the export dependent economies also will be affected in the process. The efforts being made by our country to enter Free Trade Agreements with European Union, Canada along the lines of ASEAN to find new export markets are very encouraging. Progress has also been made in the talks with our neighbours, to have cordial trade relations setting aside other differences to the mutual benefit.

1.3. National Scenario

1.3.1. The GDP growth after remaining robust at 8.4 percent for the years 2009-10 and 2010-11 is showing signs of deceleration. A lower growth rate of only around 7 percent is projected by various agencies for 2011-12.This is not surprising, considering the weak global economic environment and the macro economic management required domestically to prevent the economy from overheating. The growth moderation in 2011-12 is largely expected from agriculture and industrial sectors. In the agricultural sector the growth has moderated around 2.5 percent from the previous years level of 7 percent. High base of the previous year is the reason for reduced growth numbers in agriculture. The vibrant performances of industrial sector in the last two years had been as if to make true the Indian growth story durable. But the slow down in the industrial sector in 2011-12 as evident from the IIP numbers is worrisome. The latest GDP numbers for 2011-12 suggest to an industrial sector growth of only 4 percent. A consistent decline in the numbers called for a reversal of monetary policy stance from Reserve Bank of India by the industry. But the RBI in its concern to make the growth sustainable in the long term is adopting a cautious monetary stance, on the apprehension that, premature easing of monetary policy at this stage can overturn the economy. It is estimated that the growth in 2012-13 will recover to 7.6 percent.

1.3.2. For the smooth conduct of monetary policy, the RBI, from March 2010, has raised repo rate 13 times to 8.50 percent. The CRR also has been raised to 6 percent to regulate money supply. The hard monetary stance has helped the economy by holding on price level and inflation not galloping to destructive zones. A normal monsoon both in the years 2010-11 and 2011-12 have increased the yield from crops and availability of food items in sufficient quantity. This has caused the food price to come down from November 2011 to a negative zone persistently. Record food grain production this year is expected to create sufficient buffer and tame prices of food articles. Inflation as a result is expected to enter into a comfort zone in the near proximity.

1.3.3. But what is giving concern is the deceleration in manufacturing especially capital goods and mining, both pointing towards fall in investment in the economy. The Gross Fixed Capital Formation which was as high as 36 percent of GDP in the pre-crisis period, has come down to the levels below 30 percent of GDP in 2011-12 does not augur well for the economy.

1.3.4. It is a solace that the financial and banking sector of the country is not exposed to the sovereign debt of Eurozone. But the rising NPA levels in some asset categories are giving anxiety to the banks. But the financial stability report of the RBI has not indexed vulnerabilities emanating from these issues as capital adequacy of Indian banks are capable enough to meet these risks. Liquidity management in the wake of higher borrowing programme of the Centre has been a ticklish issue of late. The RBI has eased some pressure on liquidity by reducing CRR by 1.25 percent point in two spells and injecting ₹ 80,000 crore into the banking system. The liquidity requirements have also been met through Open Market Operations especially when shortages were anticipated at the time of raising Open Market Borrowings by the Centre. As the Government borrowings are consistently at higher levels, the rate of interest also is staying high crowding out private investment. The non-food credit growth in the banking system has come down to 16 percent in the current year from 21 percent in the previous year is indicative of the shrinking credit demand for investment. The CD ratio also has come down this year.

1.3.5. The external sector remained vibrant, till July 2011, witnessed by higher export growth rate than import growth rate which narrowed the current account deficit for sometime. But the export growth retarded from October 2011, without the import growth rate falling commensurately causing the current account deficit to widen alarmingly. The demand slackness in the traditional export destinations of US and Eurozone are not likely to turn around, unless the crisis in these countries are resolved and demand picks up. The widening current account deficit is required to be balanced by surplus in the capital account. But capital flows are either volatile or staying away fearing risks. The forex reserves remains stable around $300 billion. The forex reserves at the present import rate, is just sufficient enough to meet 8-9 months of import requirements which compared to the level when reserves could meet 12 months of import requirements is discomforting. The widening current account deficit is the main reason behind rupee depreciation and capital outflows, which makes the imports costlier, especially of fuel prices which is inflationary. However the recent measures to allow higher interest rate for NRE deposits, and direct investment in the Indian equity by qualified foreign investors etc are steps in the right direction to attract inflows of capital, to balance the external account.

1.3.6. The fiscal sector in 2010-11 was comfortable with buoyant revenues. While estimating budget for 2011-12, it gave the hope that buoyant revenues and expenditure compression would bring the fiscal deficit to 4.6 percent of GDP. But a spate of issues like fall in corporate margins, reduction in the tax rates of petroleum products, fall in investment and slippages in IIP numbers have impacted tax collection especially under Corporate Tax and Excise duties. However the major worry in the fiscal front is overshooting subsidy payments for fuel, food and fertilizers. Another reason for fiscal slippages is the non-achievement of disinvestment as planned in the budget. As a consequence of all these factors the fiscal slippages are expected to be high and can push up the Fiscal Deficit to around 6 percent of GDP which is disquieting.

1.4. State Scenario

1.4.1. The unique position that Kerala occupies in terms of high Human Development Indicators has been made possible due to early intervention in the areas of land reforms, elementary education, public provision for health care, gender equality etc. As an impact, poverty level in the State also has been reduced compared to other States. At the time of formation of the State, Kerala predominantly was an agrarian economy, with industrial activities in the absence of major industry were restricted largely to traditional sectors like coir, cashew and handloom. During the course of time the agricultural and industrial sector confronted problems like high wages, resistance to mechanization and a hostile attitude towards entrepreneurs. Low productivity and high cost led people to shun agriculture and industry, as staying in these sectors turned highly riskier. In the process, cash crops only were continued to be grown with food crops limited mainly to areas where cash crops could not be grown. Meanwhile the traditional industries also weakened in the face of stiff competition from mechanized units in other States. Displacement of labour from these sectors led to migration of workers both skilled and unskilled to other States/countries especially to the Middle East. This large scale migration and the remittances over a period of time has boosted the construction and tertiary sector.

1.4.2. The share of tertiary sector in the GSDP increased from 32% in 1970-71 to 58% in 2000-01,the share of secondary sector more or less remained the same at 21%.As per the advance estimates of GSDP for 2011-12 the real GSDP is expected to grow 7.80 percent. The growth projected for GSDP in 2012-13 is 9.60 percent. The share of agriculture, industrial and tertiary sectors as a percentage of GSDP in 2011-12 are anticipated to be 9.81, 20.44 and 69.75 percent respectively. This is suggesting to the weakening of agricultural sector further, while the share of industrial sector remains the same and tertiary sector continues to be the mainstay of Kerala economy. This when compared with the share of agriculture, industry and service as a percentage of GDP at 13.9, 27.1 and 59 percent respectively indicates low production and productivity in agriculture and industry in the State.

1.4.3. Thus, for agriculture and industrial products the State is dependent on other States. Even after the reforms in 1991, the State lagged far behind when many States made rapid strides in industry. The activities of the State has not gone beyond producing some high value agriculture products and some production in the traditional sector. Industrial production largely has been restricted to State level/Central Public Sector Undertakings where, competitiveness and efficiency has not gone up. Large scale unemployment of the educated thus has become the hall mark of Kerala.

1.4.4. Yet another problem, the State faces is the lack of infrastructure of international standard. Private participation in the infrastructure front is negligible in the State. With budgetary funds overwhelmingly allocated to the social sector, whatever is left only is used for capital formation which when compared to the requirement is meagre. Although State is a pioneer in venturing into a PPP project at CIAL, this model has not been sanctioned in sectors like roads, bridges, airports, seaports, inland waterways, water supply, sewage and solid waste management in a big way.

1.4.5. Whether the Kerala model economy, with high spending on social sectors, lack of infrastructure and excessive dependence on other States and countries for employment would stand the test of time is a question often faced by the administrators and policy makers. With the present global turmoil and the apprehension of inward migration almost a certainty, not in the distance of time, business as usual policies towards agriculture and industry would be disastrous and will be an enactment of a cruel joke on the youth of the State.

1.4.6. The year 2012-13 is the first year of the 12th Five Year plan and policy formulation has already taken shape with regard to the priorities. A paradigm shift has been envisaged during this plan period. Private sector also will play an equal role in the development initiatives of the State. The agriculture and industrial sector will be given a key role in respect of food security and job creation respectively. The Government will act as a key facilitator for providing state of the art infrastructure facilities like seaport, airport, inland waterways, road network of international standard etc.

1.4.7. The energy sector which is key to industrial development will be rejuvenated with the support of the Centre. Skill development and entrepreneurship developments are the other important areas in which Government will orient its efforts in, considering the national level manufacturing policy and the proposed National Investment and Manufacturing Zones ,along the Kochi-Coimbatore industrial corridor, which will throw open opportunities in abundance. A global investor meet named “Emerging Kerala” will be organized in 2012 to showcase opportunities, potential and capabilities that Kerala offer for the investors.

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

2.1. FISCAL PERFORMANCE IN 2010-11

2.1.1. The year 2010-11 was the first year of the 13^{th} Finance Commission award period. Contrary to expectations that the State would be a looser because of the fall in horizontal share, the Share of Central Taxes exceeded BE by ₹ 316.09 crore on the back of the buoyant revenue collections of the Centre. In respect of State tax revenues, the collection exceeded estimates on the impact of nominal GSDP growth. However total revenue receipts was less than that estimated in the BE because of the reduced receipts of grants from the Centre. The revenue expenditure more or less remained the same as that of the BE. As against the Revenue deficit of ₹ 3629.55 crore in the BE the actuals turned out to be higher at ₹ 3673.87 crore. The Revenue deficit as a proportion of GSDP was 1.33 percent.

2.1.2. As per the revised roadmap for fiscal consolidation drawn up by the 13^{th} Finance Commission, no target was given for Revenue deficit. The target given for Fiscal Deficit and debt as a percentage of GSDP were at 3.33 and 32.80 percent respectively. These indicators could be achieved as the Fiscal Deficit and Debt were 2.79 percent and 28.40 percent respectively of GSDP.

2.2. REVIEW OF MTFP 2011

2.2.1. The highlight of the performance in 2011-12 is the achievement of revenue receipts targeted at higher level on a higher base already in 2010-11.It is anticipated that, the total revenue receipts in 2011-12 would be a shade higher at ₹ 39587.85 crore than the one estimated for revised budget at ₹39427.51 crore. The growth in revenue receipts over actuals 2010-11 is higher at 27.74 percent as against 27.22 percent in the revised budget estimates. This stands as testimony to the performance of the Government in the revenue front. Despite a slight shortfall of ₹ 195.25 crore in the SOTR mainly on account of lesser collection than budgeted under Stamps and Registration, the non-tax revenue and transfers from the Centre would go beyond budget estimates. Not withstanding a fall in collection under royalty on minerals arising from desiltation of dams, the non-tax revenue is posting a robust growth of 42.47 percent which is unprecedented. The grants grow by 91.83 percent on the back of a prudent financial planning as per which spending on Central scheme have been augmented and the dues claimed in time. A noticeable feature is the amendment of Kerala Fiscal Responsibility Act 2003 incorporating targets set out by the 13th Finance Commission by which an amount of ₹ 340 crore has accrued to the State which otherwise would have been denied to the State.

2.2.2. On the revenue expenditure side spending has gone up beyond budget estimates on account of increased subsidy payments, welfare pension payments at enhanced levels as well as increase in pensionary payments. From the actuals of ₹ 34664.82 crore in 2010-11 the Revenue Expenditure is going upto ₹ 45059.51 crore in 2011-12, recording a growth of 30 percent. The revenue deficit is increasing by a sum of ₹ 1797.80 crore. It is comforting that the revenue deficit as a percentage of GSDP has come down despite this increase. The Revenue deficit at 1.67 percent of GSDP is showing improvement over the Revenue deficit of 1.81 percent estimated for revised budget 2011-12.

2.2.3. The Fiscal Deficit/GSDP and Debt/GSDP at 3.46 and 27.33 percent are in compliance of the roadmap for fiscal consolidation. The Capital Expenditure going up from ₹ 3363.69

crore in 2010-11 to ₹ 4949.15 crore even amidst payment pressures arising on the revenue expenditure side in 2011-12 is notable. This represents an increase of 47.13 percent.

Table 1

STATE FINANCES

₹ Crore

	2009-10 Accounts	2010-11 Accounts	2011-12 BE	2011-12 RE	2012-13 BE
A. Revenue Receipts	**26109.40**	**30990.95**	**39427.51**	**39587.85**	**48141.59**
1. State Tax Revenue	17625.02	21721.69	26641.53	26446.28	32122.21
2. State Non-Tax Revenue	1852.22	1930.79	2530.94	2750.81	3495.41
3. Central Government Transfers	6632.16	7338.47	10255.04	10390.76	12523.97
i. Share of Central Taxes	4398.78	5141.85	6176.97	6176.98	7103.46
ii. Grant in aid	2233.38	2196.62	4078.07	4213.78	5420.51
B. Capital Receipts	**7999.74**	**7807.42**	**10438.67**	**10917.78**	**11099.85**
1. Recoveries of Loans	38.47	44.23	70.75	75.19	87.81
2. Other Receipts	48.96	24.61	20.00	20.00	20.02
3. Borrowings and other liabilities	7912.31	7738.58	10347.92	10822.59	10992.02
a. Public Debt (Net)	4850.46	5213.87	7793.76	8062.45	10815.76
b. Public Account (Net)	3061.84	2524.71	2554.15	2760.14	176.26
C. Total Receipts (A+B)	**34109.14**	**38798.37**	**49866.17**	**50505.63**	**59241.44**
D. Non Plan Expenditure	**27283.03**	**31509.53**	**41070.00**	**41410.36**	**47101.62**
1. On Revenue Account	26953.32	30469.07	39177.19	39471.66	43118.18
a. of which interest payments	5292.48	5689.66	6254.56	6358.43	7234.33
2. On Capital Account	157.23	598.03	1344.46	1351.85	3679.87
3. On Loan Disbursements	172.48	442.43	548.35	586.85	303.57
E. Plan Expenditure (including CSS)	**6785.41**	**7280.71**	**8955.24**	**9572.75**	**11874.59**
1. On Revenue Account	4179.05	4195.74	5784.22	5587.85	8487.18
2. On Capital Account	1902.16	2765.66	2490.24	3597.30	2875.03
3. On Loan Disbursements	704.20	319.31	680.78	387.60	512.38
F. Total Expenditure (D+E)	**34068.44**	**38790.24**	**50025.25**	**50983.11**	**58976.21**
1. Revenue Expenditure	31132.38	34664.82	44961.42	45059.51	51605.36
2. Capital Expenditure	2059.39	3363.69	3834.69	4949.15	6554.90
3. On Loan Disbursements	876.68	761.74	1229.13	974.45	815.95
G. Revenue Surplus/Deficit (A-F(1))	**-5022.98**	**-3673.87**	**-5533.91**	**-5471.66**	**-3463.77**
H. Fiscal Deficit (A+B(1)+B(2))-F)	**-7871.62**	**-7730.46**	**-10507.00**	**-11300.07**	**-10726.79**
I. Primary Deficit (H-D(1a))	**-2579.14**	**-2040.80**	**-4252.45**	**-4941.64**	**-3492.45**

2.3. *Review of Medium Term Fiscal Policy Targets*

2.3.1 As an impact of pay/pension revision, the revenue expenditure has grown beyond normal levels. Better tax, non-tax collections came as a relief in addition to higher transfers from the Centre. But, the revenue deficit estimated in the RE 2011-12 is going up to 1.67 percent of GSDP as against the targeted Revenue deficit of 1.40 percent. The slippage is a foreseen one. In respect of the other two indicators of Fiscal Deficit/GSDP and Debt/GSDP the compliance may be noted.

The Fiscal Targets for 2011-12 were	Outcome as per RE 2011-12
A Revenue Deficit of 1.4 % of GSDP	A Revenue Deficit of 1.67 % of GSDP
A Fiscal Deficit of 3.5 % of GSDP	A Fiscal Deficit of 3.46 % of GSDP
A Debt of 32.3 % of GSDP	A Debt of 27.33 % of GSDP

2.4. *Projections for BE 2012-13*

2.4.1. Revenue Receipts

2.4.1.1. A consistent growth in SOTR for the last two years is giving rise to the confidence that there is more tax compliance and the tax administration has turned effective and we are on the move towards achieving the potential tax collection in the State over a few years. It is with this optimism, the SOTRs are projected. The major source of tax revenues is Sales Tax/VAT which is contributing 48.71 percent of the total Revenue Receipts and 73.01 percent of SOTR. In 2011-12 the growth anticipated is 22.71 percent over actual 2010-11. For 2012-13 the projection applied is 20.71 percent anticipating buoyant collection and better compliance. In respect of the other major taxes of Stamps and Registration, Excise and Motor Vehicle tax the growth rates applied are 21.03, 22.17 and 19.38 percent respectively.

2.4.1.2. Under non-tax revenues, the growth projected is 27.07 percent anticipating revision of fees and user charges and better collection under lotteries. Effective implementation of Central schemes may lead to receipts of grant at higher level. The increase in the receipt of grant is expected at 28.63 percent. Share of Central taxes is expected to grow by 15 percent anticipating buoyancy in the tax revenues of the Centre.

Table 2

STRUCTURE OF OWN TAX REVENUES

₹ Crore

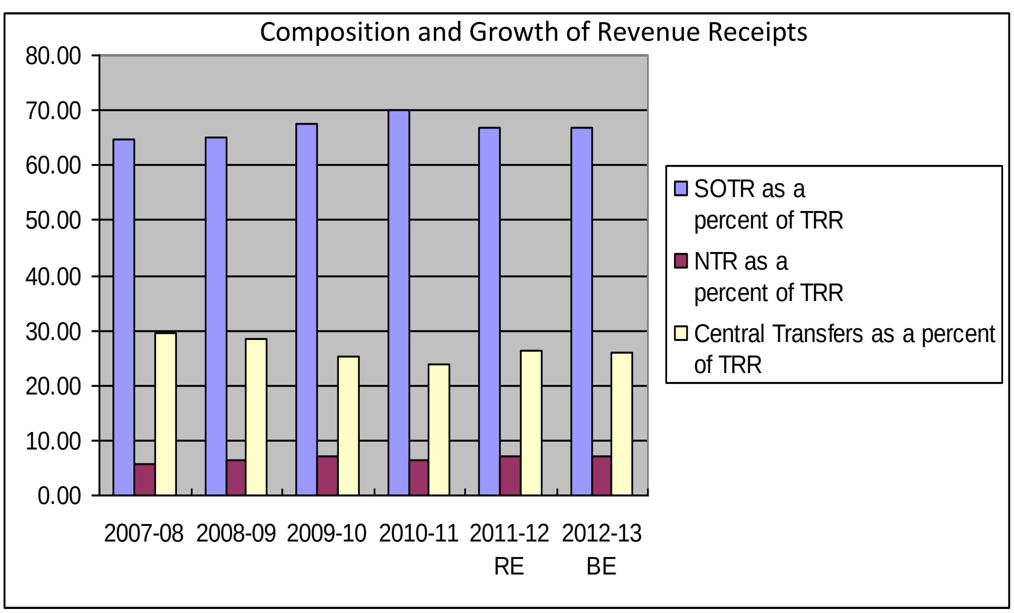
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12 RE	2012-13 BE
SOTR *of which*	11942	13669	15990	17625	21722	26446	32122
a. Sales Tax/VAT	8563	9372	11377	12771	15833	19428	23451
Growth Rate	21.67	9.45	21.39	12.25	23.98	22.71	20.71
b. Excise Duty	953	1169	1398	1515	1700	2088	2551
Growth Rate	13.32	22.67	19.59	8.37	12.21	22.82	22.17
c. Motor Vehicle Tax	708	853	937	1131	1331	1419	1694
Growth Rate	12.56	20.48	9.85	20.70	17.68	6.61	19.38
d. Stamp Duty & Regn.	1520	2028	2003	1896	2553	3120	3776
Growth Rate	38.06	33.42	-1.23	-5.34	34.65	22.21	21.03
Percentage to Total							
a. Sales Tax	71.70	68.56	71.15	72.46	72.89	73.46	73.01
b. Excise Duty	7.98	8.55	8.74	8.60	7.83	7.90	7.94
c. Motor Vehicle Tax	5.93	6.24	5.86	6.42	6.13	5.37	5.27
d. Stamp Duty & Regn.	12.73	14.84	12.53	10.76	11.75	11.80	11.76

Table 3

COMPOSITION AND GROWTH OF REVENUE RECEIPTS

₹ 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
2007-08	**13669**	**1210**	**6228**	**21107**	**14.46**	**29.00**	**17.35**	**16.06**
2008-09	**15990**	**1559**	**6963**	**24512**	**16.98**	**28.84**	**11.80**	**16.13**
2009-10	**17625**	**1852**	**6632**	**26109**	**10.23**	**18.79**	**-4.75**	**6.52**
2010-11	**21722**	**1931**	**7338**	**30991**	**23.24**	**4.25**	**10.65**	**18.70**
2011-12 RE	**26446**	**2751**	**10391**	**39588**	**21.75**	**42.47**	**41.59**	**27.74**
2012-13 BE	**32122**	**3495**	**12524**	**48142**	**21.46**	**27.07**	**20.53**	**21.61**



2.5. EXPENDITURE

2.5.1. Out of the total expenditure in 2011-12, the share of revenue expenditure is estimated to be 88.38 percent and that of the capital expenditure 11.62 percent. The higher share of revenue expenditure in 2011-12 is because of the implementation of pay/pension revision and payment of past arrears.

2.5.2. In 2012-13 the situation would improve as the one time commitment on account of pay revision would be absorbed in 2011-12.The total expenditure in 2012-13 is estimated to grow by 15.68 percent. The growth of revenue expenditure and capital expenditure is expected to be 14.53 and 24.43 percent respectively. It can also be seen that the share of revenue expenditure as a percentage of total expenditure is going down to 87.5 percent whereas that of capital expenditure going up to 12.50 percent. The upward shift in capital expenditure from the first year of the 12th Five Year Plan will facilitate development of critical infrastructure which can spur growth in the State.

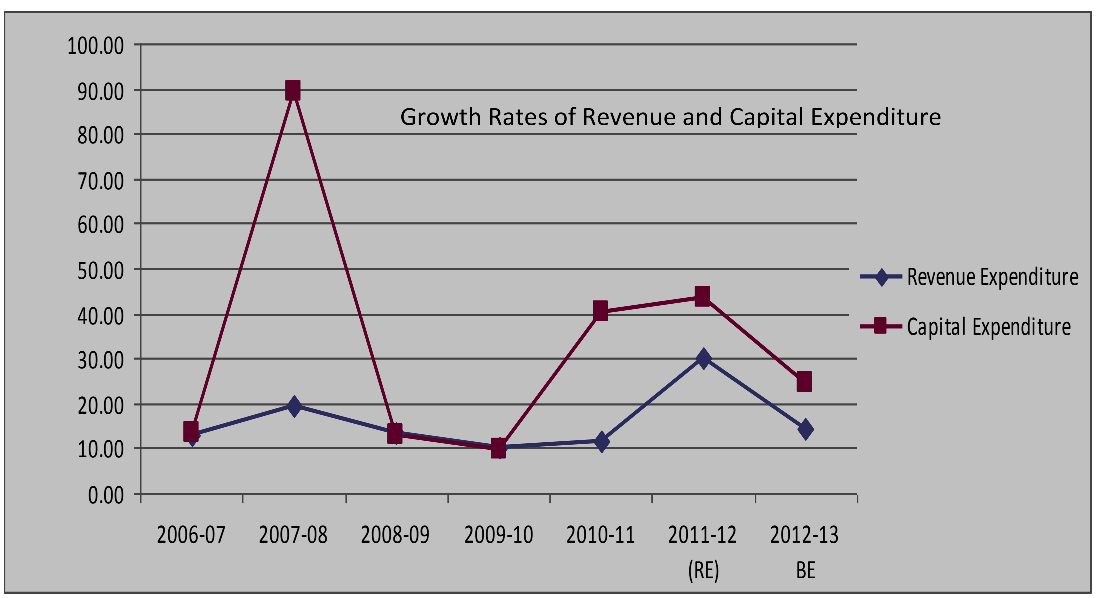


Table 4

EXPENDITURE PATTERN

₹ Crore

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12 RE	2012-13 BE
Revenue Expenditure	**20825**	**24892**	**28224**	**31132**	**34665**	**45060**	**51605**
Plan	2308	2277	3212	4179	4196	5588	8487
Non Plan	18516	22614	25012	26953	30469	39472	43118
of which							
i) Interest payments	4190	4330	4660	5292	5690	6358	7234
ii) Pensions	3295	4925	4686	4706	5767	7731	8178
iii) Salaries	6317	7367	8801	9799	11032	15763	16724
vi) Others	7024	8270	10077	11335	12176	15207	19469
Capital Expenditure	**1252**	**2368**	**2679**	**2936**	**4125**	**5924**	**7371**
of which							
i) Capital Outlay	903	1475	1696	2059	3364	4949	6555
ii) Loans & Advances	349	893	984	877	762	974	816
Total Expenditure	**22077**	**27259**	**30903**	**34068**	**38790**	**50983**	**58976**

2.6. STRATEGIC PRIORITIES

2.6.1. ‘Development and care with compassion’ is the dictum of the Government. The State has planned several projects and programmes on priority basis to give impetus to the total development of the State. The fruits of development should be enjoyed by every section of society and no one should be excluded from the benefits of development. The vulnerable section of the society need to be provided care and compassion. The Government cannot turn a blind eye towards the needs of the vulnerable section of the society as it is the duty of the State to protect the weak.

2.6.2. The policy formulation of the Government and resource allocations are keeping in mind the strategic priorities. The aim is that the current revenues should be able to meet all the current expenditure which is inclusive of the social sector interventions like welfare payments, subsidies etc. The golden rule is that borrowings should be utilized only for capital expenditure to facilitate a conducive environment for the development of agriculture, industry and service sectors. Hence Revenue deficit has to be brought down to nil by 2014-15 as envisaged in the 13th Finance Commission roadmap for achieving fiscal stability and economic progress.

2.7. DEBT MANAGEMENT AND SUSTAINABILITY

2.7.1. The debt sustainability indicators have improved a lot since the State has rolled on the fiscal consolidation process. The Debt/GSDP ratio has come down to 27.33 percent and FD/GSDP to 3.46 percent in the RE 2011-12 which are below the target fixed by the 13th Finance Commission. In 2012-13 also the FD/GSDP target has been coming down to 2.74 percent, while as per roadmap it is required to be brought down to 3 percent, only in 2013-14. Lower FD in 2012-13 will reduce the debt stock which will lead to lesser interest payments as a proportion of TRR. The Interest Payments/TRR is coming down to 15.03 percent in 2012-13 from 16.06 percent in 2011-12. The RD/FD ratio reflects the quality of fiscal deficit. The RD/FD which was as high as 63.81 percent in 2009-10 is coming down to 32.29 percent in 2012-13. The Debt/TRR which was above the benchmark of 300 percent in 2005-06 is also coming down to 210.17 percent in 2012-13. With interest rate well below the nominal GSDP the Domar gap has become positive further. All these indicators depict the sustainable debt position of the State.

TARGETS AND POLICIES

2.8. FISCAL POLICY FRAME WORK

2.8.1. 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 fiscal policy framework of the Government is summarized below.

2.9. MEDIUM TERM FISCAL POLICY PLAN FROM 2012-13 TO 2014-15

- The Agriculture sector will be rejuvenated in a high tech environment.
- A vision document for the long term development perspective of State will be formulated under the banner 'VISION 2030' to leverage sectors in which the State has competitive advantage.
- Infrastructure investment in critical sectors like Airport, Seaport, railways, Inland Waterways and Road sector will be expedited for the faster economic development of State.
- Qualitative improvement of all the sectors will be envisaged.
- Employability of the educated unemployed as well as students will be ensured through skill development and developing their entrepreneurial abilities.
- Scientific and Technological innovation will be inducted into products and processes.
- Capital investment will be augmented through Public Private Partnership.
- In solid waste management, priority will be attached to large scale solid waste processing and also to source level processing.
- A centre will be setup to formulate public policy in tune with changing requirements and trends.

2.10. TAX POLICY

2.10.1. 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.

2.11. Contingent Liabilities

2.11.1. As against a legislative ceiling of ₹ 14000 crore in respect of contingent liabilities, the outstanding liabilities is ₹ 7426 crore. The space available for providing guarantee will be used prudently for viable projects for the faster development of State.

3. THREE YEAR ROLLING TARGETS AND UNDERLYING ASSUMPTIONS

3.1. GSDP

3.1.1. The Economic and Statistics Department has estimated advance GSDP at ₹ 326693 crore in 2011-12 and projected further with a growth of 19.77 percent to arrive at the nominal GSDP in 2012-13 at ₹ 391293 crore. The projections for the year 2013-14 and 2014-15 are with a nominal growth rate of 14.50 percent which is in conformity with the growth rate assumed by the 13th Finance Commission. The 12th Five Year Plan also has assumed a real growth rate of 9 percent, which, with GDP deflator added, would be somewhere in the range of 14.50 percent.

3.2. Revenue

3.2.1. State's Own Tax Revenue

3.2.1.1. The buoyancy of SOTR for the last five years gives an average of 1.17. The GSDP growth rate assumed for 2013-14 and 2014-15 is 14.50 percent to conform to the growth rate assumed by 13th Finance Commission. It will end higher ultimately, as has been the experience. The buoyancy worked out on a higher GSDP growth rate of around 15 percent will give rise to a tax growth rate of 17.5 percent.

3.3. Non-tax Revenues

4.3.1. Non-Tax revenue in 2012-13 are projected at a higher level because of the impact of the increase in the number of draws in Lotteries. Other than this, almost all the non tax revenue items that have not been revised for the last few years are likely to be revised in 2012-13. On a higher non tax revenue that would be derived in 2012-13 normal growth only can be expected in the subsequent years. Thus, for forward estimates growth rate applied is only 12 percent.

3.4. RESOURCES FROM THE CENTRE

3.4.1. The transfers from the Centre are guided by several factors like buoyancy of Central Taxes, compliance of fiscal targets for eligibility of Finance Commission grants, allocation for the State, spending abilities etc. Taking into all these factors, only a conservative growth rate of 15 percent is applied

3.4.2. Overall growth in revenue receipts thus would be 16.45 Percent, for the forward estimates.

3.5. REVENUE EXPENDITURE

3.5.1. Salaries

3.5.1.1. The increase in basic pay is taken as 3 percent considering the past trend. In addition to the DA installments sanctioned up to the previous years, two more installments of DAs at 5 percent each is reckoned on the assumption of moderation in Consumer Price Index. Other allowances are projected with 12 percent.

3.6. PENSION

3.6.1. Forward Estimates projected with 12 percent considering the moderation in growth that could be witnessed after the impact of pension revision that will be fully absorbed in 2012-13.

3.7. INTEREST

3.7.1. Interest is calculated on the midyear debt, reckoning effective interest rate at 7.60 percent annually for the forward estimates period.

3.7.2. Subsidies, administrative expenditure and other revenue expenditures are projected with a growth of 10 percent in view of the likely moderation of food price and normalization of expenditure in 2012-13, after committed expenditure arising out of the 11th plan is incurred at higher levels from 2012-13. For maintenance and repairs the growth applied is 15 percent considering the requirement for maintenance of assets created in the past.

3.8. Devolution to LSGIs

3.8.1. Figures are calculated on the basis of the recommendations made by the 4th State Finance Commission and the likely plan size in the forward estimates period.

3.9. Capital Expenditure

3.9.1. As the fiscal indicators improve, and revenue deficit comes down, borrowing will be utilized more for capital expenditure. In 2014-15,when revenue deficit becomes zero, the borrowings and surplus from the revenue account will be utilized entirely for capital creation. Hence the increase in the capital expenditure for forward estimates.

3.10. Outcomes in Major Indicators in 2013-14 and 2014-15

3.10.1. The MTFP forward estimates for 2013-14 and 2014-15 are in accordance with the targets proposed by the 13th Finance Commission.

Indicators	Proposed by 13th FC		MTFP Targets	
	2013-14	2014-15	2013-14	2014-15
RD/GSDP	0.50	0.00	0.40	-0.02
FD/GSDP	3.00	3.00	3.00	3.00
Debt/GSDP	30.70	29.80	25.58	25.34

3.10.2. In 2011-12 target in respect of RD/GSDP has been missed on the impact of pay/pension revision. But in 2012-13, the State is on the path of achieving targets set out by the 13th Finance Commission. In respect of FD/GSDP and Debt/GSDP the State not only has achieved the target already, but also will be on the reduction path continuously.

3.11. EFFECTIVE REVENUE DEFICIT

3.11.1 As per accounting practice of Government as streamlined by the Comptroller and Audit General of India it is a standard practice across States that grants to autonomous institutions and devolution to local governments are to be treated as revenue expenditure, even if the grants are utilized for capital creation. Since this practice tantamount to under reporting of capital expenditure, the Government of India from the year 2011-12 is excluding grants to States for capital creation from revenue deficit to arrive at the effective revenue deficit. The State Government already has made a request to Ministry of Finance, Government of India in this regard, as the State is providing grants to Local Self Government Institutions for development purpose, which almost entirely are utilized by them for creation of capital assets. In order to avoid this under reporting of capital expenditure, the State also is adopting the concept of effective revenue deficit from 2012-13. The State would seek release of State specific grants reckoning effective revenue deficit. For the year 2012-13 revenue deficit as a percentage of GSDP is 0.89 percent and effective revenue deficit as a percent of GSDP is 0.05 percent.

Table 5

MEDIUM TERM FISCAL PLAN 2012-13

₹ Crore

Item	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**
	Accounts	Accounts	Accounts	RE	BE	Forward Estimates	
Revenue Receipts	24512	26109	30991	39588	48142	56061	65296
State's own tax revenue	15990	17625	21722	26446	32122	37744	44349
Non Tax Revenue	1559	1852	1931	2751	3495	3915	4385
Resources from Centre	6963	6632	7338	10391	12524	14403	16563
Revenue Expenditure	28224	31132	34665	45060	51605	57864	65204
Non -Interest Revenue Expenditure	23564	25840	28975	38701	44371	49664	55908
Interest	4660	5292	5690	6358	7234	8200	9296
Salaries	9064	9799	11032	15763	16724	18152	20028
Pensions	4686	4706	5767	7731	8178	9159	10259
Non SPI Revenue Expenditure	9814	11335	12176	15207	19469	22352	25622
Subsidies	329	441	624	851	769	845	930
Power subsidy	0	0	0	0	0	0	0
Maintenance & repair	858	734	734	791	748	860	989
Devolution to LSGs	2426	2083	2971	3953	4845	6228	7843
Administrative Expenditure	1620	1154	1315	1553	2119	2331	2564
Other Revenue Expenditure	4581	6924	6533	8059	10988	12087	13296
Revenue Surplus/Deficit	-3712	-5023	-3674	-5472	-3464	-1803	92
Effective Revenue Surplus/Deficit		-2972.13	-1325.65	-2726.58	-189.51		
Capital Expenditure	2680	2936	4126	5924	7371	11757	15612
Capital Outlay	1696	2059	3364	4949	6555	10859	14625
Loan disbursements(net)	984	877	762	974	816	898	987
Non Debt Capital Receipts	45	87	69	95	108	119	130
Fiscal Deficit/Surplus	-6347	-7872	-7731	-11300	-10727	-13441	-15390
Primary Fiscal Deficit/Surplus	-1687	-2579	-2041	-4942	-3493	-5241	-6094
End of the period Debt	59340	67120	67120	74821	95232	107900	122315
Debt Service	5004	5569	5965	6368	7234	8200	9296
Salary+Pension+Interest	18410	19797	22489	29852	32136	35512	39582
Explicit Power subsidy	0	0	0	0	0	0	0
Debt Stock	63270	70969	78673	89284	101179	114620	130010
Government Guarantees	7992	7496	7426				
Interest/Revenue (%)	19.01	20.27	18.36	16.06	15.03	14.63	14.24
Debt/Revenue (%)	258.12	271.81	253.86	225.53	210.17	204.46	199.11
(Salary+Pen+Interest)/Revenue(%)	75.11	75.82	72.57	75.41	66.75	63.35	60.62
(Salary+Pen+Interest)/GSDP(%)	9.08	8.52	8.12	9.14	8.21	7.93	7.72
(Salary+Pen)/GSDP (%)	6.78	6.24	6.06	7.19	6.36	6.10	5.90
Rev Deficit/Rev Receipt (%)	15.14	19.24	11.86	13.82	7.19	3.22	-0.14
RD/GSDP (%)	1.83	2.16	1.33	1.67	0.89	0.40	-0.02
FD/GSDP (%)	3.13	3.39	2.79	3.46	2.74	3.00	3.00
Effective RD as percentage of GSDP		1.28	0.48	0.83	0.05		
Debt Stock/GSDP (%)	31.20	30.54	28.40	27.33	25.86	25.58	25.34
GSDP	202783	232381	276997	326693	391293	448030	512995
Nominal GSDP Growth Rate(%)	15.78	14.60	19.20	17.94	19.77	14.50	14.50
Average Interest Rate (%)	7.85	7.89	7.60	7.57	7.60	7.60	7.60
Domar Gap	14.51	6.71	11.59	10.37	12.18	6.90	6.90