Government of Kerala

Finance Department

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

2018-2019 to 2020-2021

Government of Kerala

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2018

FINANCE DEPARTMENT

STATEMENT OF COMPLIANCE

- This 2018-19 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.
    - A statement of recent economic trends and prospects for growth and development.
    - An assessment of sustainability relating to the revenue deficit and the use of capital receipts for generating productive assets.
    - An evaluation of the performance against targets for 2016-17 and 2017-18.
    - The medium term fiscal objectives of the Government.
    - Three year rolling targets for fiscal indicators with specification of underlying assumptions.
    - The strategic priorities and key policies of the Government.
    - Policies of Government for the ensuing financial year relating to taxation, expenditure, borrowing, other liabilities etc.

FOREWORD

The global economy has not yet fully recovered from the crisis of 2008-09. Nevertheless, the indicators are that the slow acceleration in the growth is taking place in advanced economies and emerging market and developing economies, lingering impact of demonetization coupled with issues in implementation of GST slowed down the growth of economy in India. The State's economy also had to face the impact of external headwinds and domestic macro-economic vulnerabilities. It is in this backdrop that the Medium Term Fiscal Policy and Strategy Statement 2018-19 is presented before the state legislature as mandated under the Kerala Fiscal Responsibility Act 2003.

We had outlined in the white paper released in early 2016 pointing to the severe erosion of fiscal consolidation that was taking place during the decade from 2001 to 2011. We had pointed out unless these trends are corrected there would be severe crisis. Our expectation that GST would enable us to move up to a new high level of revenue growth has not been realized, exacerbated with persisting ill effects of demonetization and faulty implementation of GST. The steady decline of rate of growth of state's own tax revenue after all-time high pick-up during 2006-2011 is also evident from the slippage in tax buoyancy- the ratio of increase in tax revenue to increase in GSDP, implying that tax revenue is growing at lesser rate than the growth of economy. With the roll-out of GST, the State lost its fiscal autonomy to levy tax on items other than which are covered under KGST, which used to be the mainstay for the State's economy. Another worry that affects the State's finances is recent decision of Central Government to make reduction in net borrowing ceiling in subsequent year based on the recommendation of 14th Finance Commission if fiscal deficit goes beyond 3% of GSDP, in any particular year.

The return migration from Middle East has darkened the horizons of remittance inflow. To add to the woes of the State, the recent Ockhi cyclone disaster hit the fisheries sector of the State badly and that drove many fishermen community to misery and distress. All these macro-economic factors are putting tremendous pressure on State's finances and reducing the fiscal space for its much needed development activities and widening revenue and fiscal deficits.

At this juncture, the State has to evolve a fiscal policy strategy to improve tax revenue and importantly, non-tax revenue and reprioritise revenue expenditure without impairing social security to the poor so as to reduce revenue deficit, which will, in turn, and provide more fiscal space for capital spending and infrastructure development. KIIFB is gearing up towards this direction. This policy strategy needs to be unveiled in the forthcoming budget.

I sincerely hope that there would be an upsurge in revenue receipts from GST in the forthcoming financial year, once effective monitoring system is in place at the national level, Kerala being a consumer State with more than 80% of products sold in the State coming from other states. This optimistic upturn in revenue from GST would dissipate clouds of financial crisis looming over the State's economy.

I am confident of the State's ability to move along a fiscal correction path. I earnestly seek the wholehearted support of all in this endeavor to bring back the State's economy into growth trajectory by achieving the fiscal targets laid down in the Medium Term Fiscal Policy and Strategy 2018.

02.02.2018

Dr.T.M.Thomas Issac
Minister for Finance and Coir

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

Introduction

1. Global economy witnessed green shoots towards the end of 2017, piggybacking on recent increases in investment and consumption. The momentum in the world economy built-up in the latter part of 2017 is likely to sustain in 2018 and 2019. The World Economic Outlook Update of the International Monetary Fund for January 2018 indicates that about 120 economies registered a momentum in growth in 2017. The acceleration in growth is broad-based across countries, driven by investment and trade. Global growth for 2017 has been estimated at 3. 7 percent in the January 2018 World Economic Update. This buoyancy is expected to be carried forward to 2018 and 2019 and is projected to be 3.9 percent for both years. Projected growth of the advanced economies would contribute substantially towards this. Emerging and developing Asia is expected to grow at 6.5 percent in 2018 and 2019, which is broadly the same level as in 2017. A mild pick-up has been projected for India, moderate growth for China and broadly stable growth has been projected for the ASEAN region.

2. The overall global growth prospects thus seem to be bright with stronger domestic demand growth in advanced economies and perceptible improvement in performance of other large emerging market and developing economies. Notwithstanding the overall positive projections, tightening of global financial norms, build-up of financial vulnerabilities, inward-looking policies of advanced economies and geo-political tensions do cloud the medium term global outlook. The lingering impact of the reckless demonetization measure of

2016 coupled with issues in implementation of GST continue to remain as downside risks to the growth of the Indian economy.

ECONOMIC OUTLOOK

Global Economy

3. The gradual normalization of monetary policy initiated by the US Federal Reserve largely contributed to the improvement of global economy and global financial markets remain buoyant. Favourable financial conditions, tax reform measures and associated fiscal stimulus measures, hardening of the interest rate and strong business and consumer confidence have supported the growth of the US economy, which is now estimated to be 2.3 percent in 2017. The IMF has estimated the growth rate to be 2.7 percent in 2018 and 2.5 percent in 2019. Nevertheless, the US economy is vulnerable to downside risks of higher inflation pressures and Federal policy rate tightening measures. Besides, inward-looking policies and non -economic factors such as geopolitical tensions and weather conditions do pose a threat to global economic growth.

4. The European economies gathered strength in 2017 on account of accelerated exports due to upswing in global trade, continued strength in domestic demand growth supported by accommodative financial conditions and progress in addressing banking sector issues. The World Economic Outlook of IMF has estimated the growth rate of Euro zone as 2.4 percent in 2017 . However the growth rate projected for 2018 is 2.2 per cent and for 2019, 2 percent; a reflection of political uncertainties in the region, and the impact of Brexit related transition issues.

5. The World Economic Outlook's projection on the growth of the Chinese economy is pegged at 6.8 percent for 2017. However the rate is likely to decelerate to 6.6 percent in 2018 and further to 6.4 percent in 2019.Policy easing measures and supply side reforms have enabled enhanced public investment in Chinese economy in 2017.

6. Japan is projected to grow at 1.8 percent in 2017; its pace of growth is predicted to decelerate to 1.2 percent in 2018 and further to 0.9 percent in 2019. The slow pace projected for 2018 is attributed to faded fiscal support, moderated private consumption growth, and offsetting of the advantage expected from 2020 Olympics-related private investment by higher imports and slow growth in foreign demand.

7. The IMF has also reported that geopolitical tensions have a bearing on the medium-term global outlook. The decision of Organisation of Petroleum Exporting Countries (OPEC)to extend OPEC plus agreement to limit oil production and tensions in the Middle East caused crude oil prices to reach $60 per barrel, an increase of about 20 percent from August 2017 after the dip between February and August 2017. The upturn in oil price raised headline inflation in advanced economies, but wage and core inflation continue to be weak. At the same time, headline and core inflation have increased slightly in recent months in emerging market economies.

8. Besides political uncertainties in the advanced economies can derail the implementation of reforms and lead to reorientation of policy agenda, which in turn can impact the global economy. In addition the economic costs of certain climatic events such as hurricanes and droughts are devastating; these could further destabilise the global economy.

National Economy

9. The disruptive impact of the demonetisation drive of 2016 and hiccups in the rollout of the GST have undeniably caused a perceptible slowdown in the growth of Indian economy. As per the latest estimates of Gross Domestic Product (GDP) for the second quarter of 2017-18 released by CSO, growth of Indian economy is projected to slow down to 6.3 per cent in 2017-18 compared to 7.5 percent in the corresponding period of 2016-17. Against this, GVA growth rate is projected at 6.1 per cent over the 6.8 per cent in the corresponding period of previous year. The October 2017 Monetary Policy Report of RBI projected real GVA growth at 6.7 per cent for 2017-18 which is estimated to grow at 7.4 per cent in 2018-19.

10. The sector wise analysis reveals that economic activities in manufacturing, electricity, gas, water supply & other utility services and trade, hotels, transport & communication and services related to broadcasting recorded growth over 6 per cent; while agriculture, forestry and fishing, mining and quarrying, construction financial, insurance, real estate and professional services sectors grew at below 6 per cent and public administration, defence & other services grew at 6 per cent as against 9.5 per cent in the corresponding period of previous year. The sluggish growth of agriculture, forestry and fishing sector is mainly attributed to decline in the production of food grains during kharif season due to irregular and deficient south-west monsoon.

11. The domestic and global macroeconomic and financial conditions that led to the recent slowdown in economy can be broadly attributed to a number of reasons; the primary one being irregular and deficient south-west monsoon, which resulted in decline of kharif food grain production. Rise in crude oil

prices, moderated external demand and increases in international air freight and container port throughput have also contributed to the slow-down in the Indian economy.

12. The Monetary Policy Committee (MPC) of Reserve Bank of India has projected inflation in the range of 4.3 to 4.7 per cent in Q3 and Q4 of 2017-18 as against its October bi-monthly projection of 4.2 to 4.6 per cent in the Q2 of this year. The reversal of moderated core inflation, impact of HRA by the Central and various State governments and crude oil price rises are some major factors that contributed to the upward trajectory of headline inflation. However, seasonal moderation expected in price of vegetables and fruits in winter, and recent decision of the GST Council to bring several retail goods and services to lower tax brackets, resulting in lower retail price are likely to rein inflation to a certain extent.

13. The RBI in its Monetary Policy Committee meeting held in December 2017 decided to keep repo rate unchanged at 6 per cent and reverse repo rate at 5.75 per cent under the liquidity adjustment facility (LAF) and the marginal standing facility (MSF) rate and the Bank Rate at 6.25 per cent. The decision of the Monetary Policy Committee to shift monetary policy stance to neutral is mainly with the objective of containing target for consumer price index (CPI) based inflation at 4 per cent in 2017-18. Despite downside risks of recent increase in crude oil prices, shortfalls in kharif food grain production and rabi sowing, RBI retained the projection of real GVA growth at 6.7 per cent for 2017-18. Upside factors considered by the RBI include recent pickup in growth of credit flows from primary capital market for new projects with scope for further improvement due to recapitalization of public sector banks, improvement in the

ease of doing business ranking which helps attract foreign direct investment and expected improvement in the service and infrastructure sectors.

DEMONETISATION AND ITS IMPACT

14. The Central Government demonetised high value currency notes of Rs.500 and Rs.1000 on November 08, 2016 with the aim of eliminating counterfeit notes, tackling black money, curbing corruption and tax evasion, preventing terror financing and promoting digitization and non-cash payments. Demonetisation of high value currency notes, which accounted for 86.9 per cent of currency in circulation, had caused immeasurable distress to people, especially farmers, traders and small and medium industries. The rural and informal sector, which are mainly based on cash transactions suffered heavily. Those in rural areas, where access to banking and internet facility is quite inadequate were the worst –hit. The Central Government, in its Economic Survey 2016-17, had spelt out that demonetisation had short-term costs but was optimistic of its benefits in the long run and that short-term costs could be mitigated through fast, demand-driven remonetisation and tax reforms. A year later, achievement on all stated aims of demonetisation seems to be very modest. Further questions emerge as to whether this onetime measure was needed at all to reach its avowed aims. Those who argue in favour of demonetisation undeniably admit that there have been shocks in the short run. As far as containment of black money was concerned, actual results have been quite disappointing. Volume of seized counterfeit notes has not recorded a substantial increase in the aftermath of demonetisation exercise, while counterfeits of the freshly issued note of Rs.500 have already appeared in the money circulation. The contraction of the economy post demonetisation continue to linger; and the corrective measures and tax reforms have not put the economy back on steam.

STATE SCENARIO

15. The State economy which had been experiencing downturn due to macroeconomic factors of external and domestic headwinds, showed a marginal turnaround in 2016-17. As per the quick estimates of GSDP at current price, State's economy, despite disruptive impact of demonetisation, recorded a growth of 10.59 per cent in 2016-17 as against the growth of 8.85 per cent in 2015-16. At constant price, growth rate of State' economy is estimated to be 7.41 per cent as against the provisional estimated growth of 6.60 per cent in 2015-16. The contribution of primary sector, consisting of agriculture, forestry and fishing, mining etc to GSVA at current price, increased to 13.25% from -4.06 % in 2015-16. Although the agricultural sector showed a positive upturn in 2016-17, downside risks still exist. Secondary and tertiary sectors recorded lower growth of 3.74 % and 9.72 % respectively in 2016-17 compared to the previous year. The lower growth of these sectors was mainly because of the negative impact of demonetisation.

16. The State's ability to sustain a moderate growth in the current fiscal is inhibited by external and domestic macroeconomic vulnerabilities. On the external front, the economy of Kerala is mainly dependent on exports of agricultural products and other primary goods and its service sector too has high level of dependence on international tourism. Any macroeconomic swings in the global economy will have its repercussions on Kerala's economy too. The dwindled absorption of exports from developing countries, by the advanced economies in view of low growth and their inward looking policies has adversely affected the prospects of Kerala's export oriented agriculture sector. The growth of deposits from NRIs declined to 10 per cent in September 2017 against the 18 per cent growth achieved in September 2016, which is mainly

due to the diplomatic rift in the Gulf region and consequent sluggish growth of the Gulf economy.

17. On the domestic front, the persisting disruptive effects of demonetisation coupled with problems in the implementation of GST and resultant fall in growth of State's own tax revenue slowed down the State's economy in the current fiscal. The state finances have been facing a liquidity crunch from the beginning of third quarter. The State's own tax revenue started falling after the all-time high growth during 2006-2011. Roadblocks in the smooth roll out of GST include inter-alia problems associated with matching of returns, e-way bill and reverse charge mechanism, poor tax compliance by trader community due to complex nature of tax structure and tax evasion, besides the high dependence of state's economy on service sector.

18. Kerala being a welfare state also has growing expenditure commitments due to increased spending in the social and health sectors, and high level of salary and pension commitments. Not only the increased cost of borrowings, but also uncertainty regarding borrowings from open market due to insufficient borrowing space because of net accretion in the Public Account is a matter of concern to the state. The state nevertheless managed to tide over this borrowing uncertainty through Public Account led fiscal consolidation measures. The change in policy of the Central Government to devolve share of Central taxes on the 15th of every month instead of the first of every month, bi-monthly release of GST compensation and practice of devolving IGST credit after 20th of every month have also strained the state's already stressed financial sector. To add to the woes of the State, the recent Ockhi cyclone disaster hit the fisheries sector badly and drove many fishermen to misery and distress. The fishermen community needs to be rehabilitated with adequate social security coverage.

Besides the state needs to set up an advanced cyclone warning system, which would obviously strain the already constrained fiscal situation of the State.

19. The persisting ill effects of demonetization and RBI's policy to increase capital-risk-weighted assets ratio(CRAR), which treats co-operative banks at par with commercial banks, have driven the functioning of co-operatives in the State into a major crisis. It is in this backdrop that Government of Kerala has decided to go ahead with the formation of Kerala Bank by merging DCBs and State co-operative banks. As per the vital banking statistics as on September,2017 released by SLBC, CD ratio declined to 64 percent in September,2017 as against 66 per cent of the corresponding period of previous year. Total agricultural advances by Commercial Banks which stood at Rs.58,495 crore in September 2016 increased to Rs.63,867 crore in September 2017 recording a growth of 9 %. The buoyant agricultural advances mirror the modest performance of agriculture sector in the economy. At the same time, MSME advances declined to Rs.41,462 crore in September,2017 as against Rs.42,910 crore in the corresponding period of 2016. Total industrial advances decreased to Rs.50,134 crore in September 2017 from the total advances of Rs.57,215 crore made in September 2016.The decline in MSME and industrial advances can also be ascribed to the contraction of economic activities under these sectors.

20. These macro-economic factors put tremendous pressure on State's finances and reduced the fiscal space for its much needed development activities, and further led to widening of revenue and fiscal deficits. However these factors would not deter the state from keeping its avowed pro-poor policy commitment, which includes, inter alia, disbursement of social security pensions and mitigation of distress of farmers from declining price of crops through price

stabilization fund/crop incentive schemes, etc. The State is also committed to fiscal consolidation measures as recommended by the 14th Finance Commission. This is manifested by the measures taken by the State government to amend the Fiscal Responsibility Act,2003 in accordance with the recommendation of the 14th Finance Commission. Also, several measures aimed at effective fiscal management on resources and expenditure such as Integrated Financial Management System (IFMS), Centralized system for accounting and monitoring of Government guarantees and payment of guarantee commissions (GIMS) , Bill Information and Management System(BIMS), Budget Allocation and Monitoring System(BAMS) Ways and Means Clearance system (WAMS) aimed for ensuring effective cash management, e-Treasury –Revenue management, Core-TIS for expenditure management, etc have been initiated.

GST IMPACT IN KERALA

21. The Goods and Service Tax (GST) is a destination based taxation system and the consumer States are expected to benefit higher as compared to manufacturing states. There was general perception that the State will achieve rise at more than 20% per year in revenue collection given the fact that Kerala being a consumption State. It was expected that the Integrated Goods and Services Tax (IGST) charged on inter-state sales will increase considerably since more than 80% consumption needs are met from other States. However the IGST is hovering around only 1.25 to 1.5 times that of State Goods and Services Tax (SGST) which is charged on intra-State sales. In reality, revenue collection from GST has not been as buoyant as expected. Kerala is getting compensation from Central Government for the revenue loss.

22. There is reduction in registration of dealers as well in the GST regime than dealers registered in the pre GST period as dealers with annual turnover below Rs.20 lakhs are not required to register. The initial glitches associated with GST network and frequent change in dates of return filing has resulted in shortfall in filing of returns by dealers.

23. After introduction of GST, check posts of Taxes Department across the country have been closed in order to facilitate free movement of goods and services. This could have resulted in evasion of taxes as there was no means to check movement of goods and services. It is also pointed out that tax compliance has not reached at the desired level thanks to delay in implementation of some of the main features of GST, viz matching of returns, e-way bill and reverse charge mechanism, which in turn also resulted in the shortfall of revenue collection under GST. Now, GST Council has decided to implement e-way bill system for movement of goods and services, Inter State from 1st February,2018 and intra-State from 1st June 2018. This will have the effect to bring down tax evasion. With all these pro-active measures, it is expected that GST collection would pick up in the near future and the State of Kerala will no longer need compensation from Central Government.

KIIFB - IMPACT ON STATE'S FINANCES

24. Kerala Infrastructure Investment Fund Board (KIIFB), an appropriate choice for major infrastructure projects, has been restructured with the optimistic aim of sustainable infrastructure development of the State. KIIFB will act as an institutional mechanism for appraising including approving and funding large infrastructure projects in the State through various means of borrowings and advanced financial instruments such as AIF,IDF,InVIT,etc. approved by SEBI and RBI. It has also been decided to mobilise funds from NRI chitty floated by

KSFE for investment in infrastructure projects. The State Government has provided Rs.1624.57 crores to KIIFB as seed capital corpus in addition to tax devolution from Motor vehicle tax and cess on petroleum products so as to leverage the mobilization of funds from the financial market. Projects for total outlay of Rs.54,000 crore are proposed to be implemented. KIIFB has given administrative approval for projects with a total outlay of Rs.18,939 crore so far. It is expected that altogether administrative approval for projects with a total outlay of Rs.20,000 crore could be given by February, 2018. Various projects approved in the field of Health, Industries, Education, Tourism, Information Technology, etc. are expected to take off soon. Administrative approval for another set of projects worth Rs.30,000 crore will also be cleared by the Board in the next financial year 2018-19. The A+' credit rating assigned to KIIFB by CRISIL and ICRA will augur well for the mobilisation of funds from financial market. Since bridging the infrastructure deficit is one of the key priorities of Government, this institutional framework would give an impetus to the implementation of major infrastructure projects on a massive scale in the State.

KERALA BANK

25. As part of reforming the federal structure of credit co-operatives societies of the State from the existing three tier to a two tier system, State Government have given in principle approval for the formation of Kerala Co-operative Bank by merging all the 14 District Cooperative Banks with the Kerala State Cooperative Bank as announced in the Hon'ble Governors' address to the State Assembly on 24 June 2016. A Task Force has been constituted by the Government to examine the recommendations made by the Expert Committee on the formation of Kerala Co-operative Bank and prepare a road map for the formation of the Kerala Bank. The new bank would play a pivotal role in

extending adequate as well as timely credit to the small & marginal farmers and other weaker sections of the society through PACS by accessing concessional finance from refinancing agencies like NABARD in addition to ensuring credit support to the SME sector and the service sector. The new bank could tap the huge potential in mobilising NRI deposits. It can attract deposits from State Government Departments, Local bodies, Government owned Corporations, Boards etc. and channelise such resources to increase credit flow to the core sectors of the State's economy. It is sanguinely hoped that the Kerala Co-operative Bank would become the most preferred bank for the people of Kerala within a short span. The Kerala Co-operative Bank is expected to take off in the next financial year.

EXPENDITURE REFORMS

26. Government have been implementing wide-ranging reforms of the State's budgetary architecture. Expenditure reforms will improve management of scarce public resources. Integrated Financial Management System (IFMS) was launched in February 2017 for efficient monitoring and control of State finances. IFMS helps monitoring of cash position, captures online real time transaction details, ensures automated consolidated of accounts and provides MIS for decision making.

27. In the past, various Government Departments and Institutions have been parking funds in Treasury Savings Bank (TSB) Account near the end of financial year which used to be spent in subsequent year. This has resulted in increase in Public Account balances and higher figures of fiscal and revenue deficit. This affected ways and means position and resulted in poor financial management.

28. Government have started implementing Direct Benefit Transfer (DBT) so that funds are directly transferred from Consolidated Fund of the State to end beneficiaries. Parking of funds in TSB Account has been severally restricted and a big chunk of funds parked earlier have been extinguished. Payments are to be made on real time basis as and when the actual demand arises. Additional authorization over and above budget provision is being minimized and wasteful expenditure are being cut.

BORROWINGS AND OTHER LIABILITIES

29. Debt liability of the State mainly consists of public debt (i.e., borrowings from internal sources and loans and advances from Government of India) and net accretion in Public Account (i.e. State provident fund, small savings, etc.) Over the last few years, State has been dependent on market borrowings and Public Account accruals to finance its fiscal deficit. Since the State is highly dependent on borrowed funds for financing the fiscal deficit, i.e. total resource gap, for the sake of capital expenditure and infrastructure development, it assumes significance to ensure the sustainability of debt liability in terms of growth of debt liability, Debt-GSDP ratio, Debt-Revenue receipts and Interest payment to Revenue receipts.

30. The debt liability started showing increasing trend from 2015-16 and it increased to 15.60 % in 2016-17 from 13.94 % in 2015-16. As per the accounts of Accountant General for 2016-17, outstanding debt liability of the State is Rs.1,86,453.84 crore recording an increase of Rs.29,083.51 crore (15.60%) which indicates higher dependence on borrowed funds by the State for financing its developmental expenditure on account of insufficient non-debt receipts. Debt-GSDP ratio increased to 30.22% in 2016-17 from 26.75 % in

2015-16. The percentage of interest payments to revenue receipts was in the range of 16-17 percent during the last five years. The interest payments as a percentage of revenue expenditure also declined to 13.30 % in 2016-17 from 14.12 % in 2015-16.

31. In 2016-17, State had to utilize 83.59 % of annual net borrowing of Rs.18,524 crore for bridging the gap in the revenue account (revenue deficit) compared to 61.88 % in 2015-16. This higher ratio of revenue deficit to net borrowings elucidates that present fiscal condition and growing expenditure commitments forced the State to spend major chunk of the borrowed funds for non productive revenue expenditure rather than much needed capital expenditure. Besides, the practice of departments and State owned PSUs to park their unutilised plan funds in the Spl.TSB accounts, resulted in accumulation of huge funds in the Public Account. This accumulation of funds in the Public Account, which is notional in nature, leads to breach of State's annual net borrowing ceiling fixed by GOI. This adversely affects the open market borrowings by the State as Central Government has decided to adjust over borrowed amount from annual borrowing ceiling in subsequent year. State needs to put in place a monitoring mechanism to check unnecessary parking of funds in the Public Account on a regular basis so as to ensure that the open market borrowings by the State are not adversely affected by accumulation of funds in the Public Account.

Fiscal Performance in 2016-17

32. State's fiscal situation for the period from 2011-12 to 2015-16 witnessed increase in fiscal imbalances. Between 2011-12 and 2014-15, revenue deficit as a percentage of GSDP increased from 2.36 per cent to 2.62 per cent of GSDP. During the same period fiscal deficit to GSDP ratio remained above 3.5 per cent

of GSDP. Debt to GSDP ratio increased sharply and reached at 26.75 per cent of GSDP.

33. In 2016-17, revenue receipts growth has been at 9.53 % compared to 19.12% in 2015-16. This is mainly due to decline in revenue collection and reduction in the growth of central transfers from 40. 03 per cent in 2015-16 to 9.82 per cent in 2016-17. As per the budget estimate 2016-17, total receipts (other than borrowings) of Rs.84,856.70 crore and borrowings of Rs.18,524 crore were estimated. Against the estimated receipts, total expenditure commitment was estimated at Rs 1,07,996.60 crore. But total receipt of Rs.75,934.20 crore only could be realized by the State. The fall in total receipts was mainly owing to slippage in state's own tax revenue, exacerbated with ill effects of demonetisation. Due to this yawning gap between total receipts and expenditure, State had to depend more on borrowings.In the year 2016-17, committed expenditure viz. pension and interest payments and salary was 73.39 per cent of total revenue receipts. During the fiscal year 2016-17 capital expenditure was 1.82 per cent of GDP as against 1.42 per cent in 2015-16. Fiscal consolidation measures such as posting of imprudent expenditure to Electronic Ledger Account Monitoring System (e-LAMS) and switching over to incurring LSG expenditure against revenue account instead of public account for avoiding unnecessary transfer credit to TSB account at the fag end of the financial year were taken. However higher level of non-plan expenditure including additional commitment due to 10th pay and pension revision and falling state's own tax revenue resulted in higher borrowings and other liabilities in Public Account. It also led to a situation where significant portion of revenue and borrowings is consumed for meeting the committed non-plan revenue expenditure, leaving a little for capital spending. These macro-

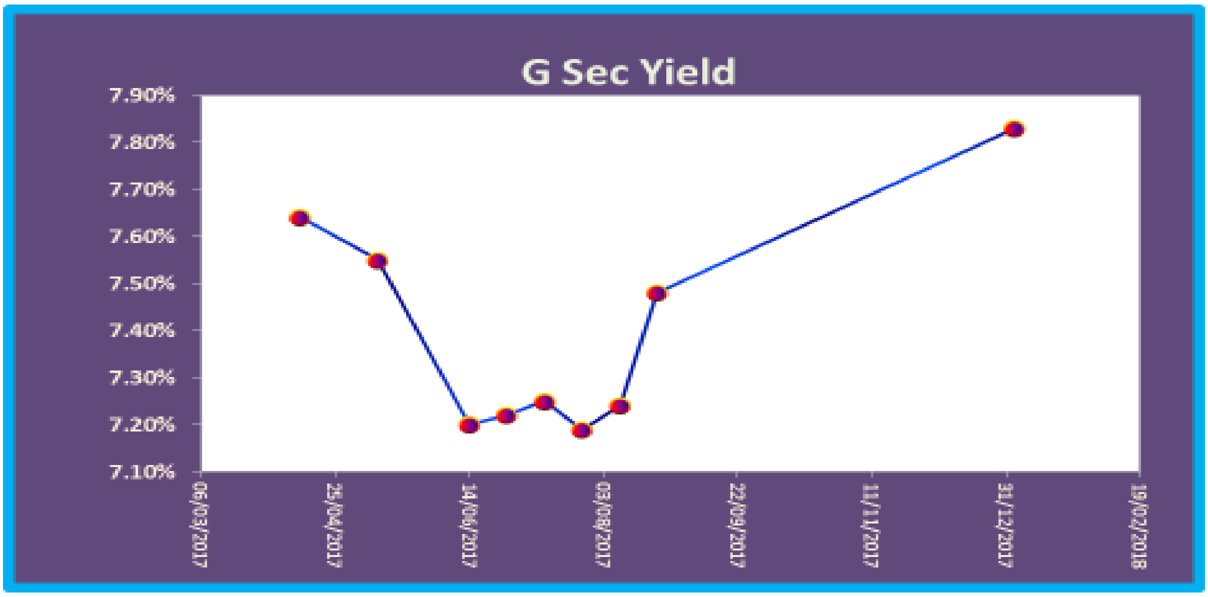
economic factors led to actual revenue deficit of Rs.15,484.59 crore and fiscal deficit of Rs.26,448.35 crore in 2016-17

REVIEW OF MTFP 2017

34. Over the last few years, the rate of growth of State's own tax revenue is recording decline which has reduced state's fiscal space. Tax collection from Commercial tax constituted major share of State's own tax revenue. With the roll out of GST from 1st July 2017, State's own tax revenue did not pickup due to transitional bottlenecks in GST implementation. The declining rate of growth of State's own tax revenue and growing expenditure commitments are major concern for the State. The objective of the MTFP 2018 is to move towards larger fiscal consolidation

35. However, there are challenges in the medium term. The yield on Government securities (G-Sec) for the current fiscal showed a decreasing trend till the second quarter but it started increasing thereafter **(Chart 1)**. This upturn in the yield of Government Securities would result in increasing cost for SDL and increase the cost in the medium as well as in the long term.

Chart 1



Projections of BE 2018-19

Revenue Receipts

36. The steady decline in the growth of State's Own Tax Revenue started since 2012-13 continues to be a major fiscal challenge for the State. The State government proposes to evolve a strategy to improve non-tax revenue and reprioritise revenue expenditure without compromising on pro-poor fiscal policy stance of Government of Kerala. Budget estimate of State's Own Tax Revenue in 2018-19 is projected to increase at 20 % over the revised estimate 2017-18. The major components of State' Own Tax Revenue viz. Sales Tax/VAT/GST, Registration, Motor vehicles, State Excise, etc are estimated to grow at 20.16 %, 13.07 % and 24.67 % respectively in budget estimate 2018-19. The central transfers have been projected to grow at a nominal growth odf 8.04 per cent. State' Own Non-Tax Revenue is projected to grow at 21.67% over the revised estimate of 2017-18. The receipt from lotteries, which is the major revenue under non-tax revenue, is estimated to grow at 24.67 % over RE 2017-18.

Expenditure

37. Given the overall resource envelope described above, Government would focus on rationalization of non-plan revenue expenditure while taking forward social sector initiatives and major infrastructure projects. The Annual Plan outlay has been fixed at Rs.29,150 crore for 2018-19 by allowing 10% annual growth. The arrears on account of the 10th Pay and Pension Revision will have to be disbursed along with interest in two installments during the year 2018-19. Taking into account all these fiscal factors, total expenditure is projected to grow at 14.13 % in the budget estimate 2018-19, over the revised estimate 2017-18. Out of the total expenditure, revenue expenditure is estimated to grow

at 14.12% over the RE of 2017-18. In budget estimate 2018-19, capital expenditure is projected to grow at 14.27 % in the budget estimate over the RE 2017-18. Government proposes to finance its major infrastructure projects through KIIFB - an SPV created under the State Government. Revenue Deficit (RD) and Fiscal Deficit (FD) as a percentage to GSDP, are projected to be 1.66% and 3.10% respectively in 2018-19 (BE).

THREE YEAR ROLLING TARGETS AND UNDERLYING ASSUMPTIONS

38. The objective of the MTFP 2018 is fiscal consolidation by reducuing revenue and fiscal deficit of the State. This will be done through a combination of both receipts and expenditure side adjustments. On the revenue side the focus would be revenue enhancement. On the expenditure side, rationalization of expenditure and improvement in financial management practices would help reduce expenditure. Although, the State was unable to eliminate Revenue Deficit and bring down the Fiscal Deficit at 3% in 2015-16 and 2016-17, our objective would be to bring down the RD to 1.33 per cent of GSDP by the end of 2020-21 and fiscal deficit to 2.91 per cent. For the purpose of projection, nominal GSDP is projected at an average growth rate of 12.59 % for 2018-19. The forward estimates of GSDP are arrived at by applying a growth rate of 13% for the year 2019-20 and 2020-21.

Year	2016-17	2017-18	2018-19	2019-20	2020-21
GSDP at Market Price (Rs. in Cr.)	617035	686498	772894	873370	986908
% Growth of GSDP	4.88	11.26	12.59	13	13

Outcomes in the Major indicators in 2019-20 and 2020-21

39. The State is committed to reduce RD/GSDP ratio and FD/GSDP ratio over the next three years so as to reduce RD/GSDP ratio to 1.33 % in 2020-21. FD/GSDP ratio could be brought down below 3% to 2.91 % in 2020-21. Debt to GSDP ratio is expected to decline to 29.70 per cent by 2020-21 and IP/RR ratio to below 15 per cent.

Indicators	MTFP Targets			
	2017-18 RE	2018-19 BE	2019-20	2020-21
RD/GSDP	1.91	1.66	1.51	1.33
FD/GSDP	3.31	3.10	3.01	2.91
Debt/GSDP	30.71	30.70	30.17	29.70
IP/RR	15.32	14.53	15.27	14.28

Medium Term Fiscal Plan 2017-18									
Item	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
			Accounts			RE	BE	Forward Estimates	
Revenue Receipts	44138	49177	57950	69033	75612	88267	102801	122164	145207
State's own tax revenue	30077	31995	35233	38995	42176	48823	58588	70306	84367
Non Tax Revenue	4199	5575	7284	8425	9700	11729	14271	17125	20550
Resources from Centre	9862	11607	15434	21612	23735	27715	29942	34732	40289
Revenue Expenditure	53489	60486	71746	78689	91096	101346	115661	135323	158328
Non-Interest Revenue Expenditure	46284	52220	61977	67579	78980	87820	100723	116671	137597
Interest	7205	8265	9770	11111	12117	13526	14938	18652	20731
Salaries	17257	19280	21344	23450	27954	31347	32929	35640	39643
Pensions	8867	9971	11253	13063	15277	17065	18221	20623	23342
Non SPI Revenue Expenditure	20160	22969	29381	31066	35749	39409	45859	60408	74613
Subsidies	1265	1252	1248	1343	1634	1867	1869	2194	2577
Devolution to LSGs	4739	5926	7454	5029	6060	7052	10771	12943	15111
Other Revenue Expenditure	14156	15791	20679	24694	28055	30490	33219	45270	56925
Revenue Deficit(-)/Surplus(+)	-9351	-11309	-13796	-9657	-15485	-13080	-12860	-13160	-13121
Capital Expenditure	5739	5759	4998	8342	11286	10005	11432	13595	16183
Capital Outlay	4603	4294	4255	7500	10126	8668	10330	12413	14916
Loan disbursements	1136	1464	743	842	1160	1337	1102	1182	1268
Non Debt Capital Receipts	88	123	152	181	322	310	335	434	561
Fiscal Deficit(-)/Surplus(+)	-15002	-16944	-18642	-17818	-26448	-22774	-23957	-26321	-28744
Primary Fiscal Deficit/Surplus	-7797	-8679	-8872	-6708	-14332	-9248	-9019	-7669	-8013
End of the period Debt	96490	111285	127225	146405	171912	184080	224028	250366	278271
Debt Service	7205	8265	9770	11111	12117	13526	14938	18652	20731
Salary+Pension+Interest	33329	37516	42366	47624	55347	61938	66088	74915	83716
Debt Stock	103561	119009	135440	157370	186454	210789	237266	263467	293074
Interest/Revenue Receipts (%)	16	17	17	16	16	15	15	15.27	14.28
Debt/Revenue (%)	235	242	234	228	247	239	231	215.67	201.83
(Salary+Pen+Interest)/Revenue(%)	75.51	76.29	73.11	68.99	73.20	70.17	64.29	61.32	57.65
(Salary+Pen+Interest)/GSDP(%)	8.08	8.07	8.05	8.09	8.97	9.02	8.55	8.58	8.48
(Salary+Pen)/GSDP (%)	6.34	6.29	6.20	6.21	7.01	7.05	6.62	6.44	6.38
Rev Deficit/Rev Receipt (%)	21.19	23.00	23.81	13.99	20.48	14.82	12.51	10.77	9.04
RD/GSDP (%)	2.27	2.43	2.62	1.64	2.51	1.91	1.66	1.51	1.33
FD/GSDP (%)	3.64	3.64	3.54	3.02	4.29	3.32	3.10	3.01	2.91
Debt Stock/GSDP (%)	25.12	25.59	25.75	26.75	30.22	30.71	30.70	30.17	29.7
GSDP	412313	465041	526002	588337	617035	686498	772894	873370	986908
Nominal GSDP Growth Rate(%)	13.26	12.79	13.11	11.85	4.88	11.26	12.59	13	13
Average Interest Rate (%)	7.47	7.43	7.68	7.59	7.05	6.81	6.67	7.45	7.45
Domar Gap	5.79	5.36	5.43	4.26	-2.17	4.45	5.92	5.55	5.55

Cover painting - **Sreevidya Subramanian** 'Dissociation'
Cover design - Godfrey Das

Printed by the Superintendent of Government Presses
at the Government Press, Mannanthala, Thiruvananthapuram-2018