Finance Department
Government of Kerala

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

2024-2025 to 2026-2027

Printed by the Superintendent of
Government Presses at the Government Press,
Mannanthala, Thiruvananthapuram-2024

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

2024-25 to 2026-27

FINANCE DEPARTMENT
2024

STATEMENT OF COMPLIANCE

- This 2024-25 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 2022-23 and 2023-24.

  - ✓ 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 is facing multiple challenges. Geo-political tensions remain elevated posing down side risk to growth. The Global growth is expected to slowdown in 2024 as per the recent report published by the World Bank. Inequality and unemployment are rising. Despite global headwinds, Indian economy has been resilient. As per the recent estimates published by NSO, Indian economy is projected to grow at 7.3% for the current year. However, the decline in consumption demand is a cause for concern.

The Kerala economy is on the path of recovery, the GSDP for 2023-24 and 2024-25 is expected to grow at 12.24% and 11.68% respectively. The Government is committed to continue the path of fiscal consolidation by enhancing revenue and reprioritisation of expenditure without compromising on welfare measures for the poor and vulnerable. The strategy of the Government is to increase investment in productive sectors to generate job and income thereby rejuvenate the economy and widen the Tax base. Capital expenditure will also be enhanced to bolster growth in the economy.

I present the Medium Term Fiscal Policy and Strategy Statement before the august house seeking co-operation of all.

K.N.Balagopal
05.02.2024 **Minister for Finance**

MEDIUM TERM FISCAL FRAMEWORK

WORLD ECONOMIC OUTLOOK

World economy faces divergent near term growth prospects. IMF in its January 2024 **World Economic Outlook update**, projected global growth at 3.1 percent in 2024 and 3.2 percent in 2025, the forecast for 2024 is 0.2 percentage higher than the one projected in the October 2023 report. However, the World Bank, in its January 2024 **Global Economic Prospect**, has projected global growth to decline to 2.4 percent in 2024 amid tight monetary policy, restrictive credit conditions, feeble global trade and investments. The growth in Advanced Economies (AEs) is expected to bottom out at 1.2 percent in 2024 from 1.5 percent in 2023 while Emerging Market and Developing Economies (EMDEs) are expected to grow at 3.9 percent. Global inflation is declining gradually due to tighter monetary policy aided by lower international commodity prices, but continues to remain above the targeted level. The downside risks to the outlook include an escalation of the ongoing conflict in the Middle East, Russia-Ukraine conflict and associated commodity market disruptions, financial stress amid elevated debt and high borrowing cost, trade fragmentation, persistent inflation and climate related disasters etc., Emerging Market and Developing Economies (EMDEs) need to have proper macroeconomic and structural policy actions and well functioning institutions in boosting investment for long-term growth prospects. Global level cooperation need to be strengthened to provide debt relief, facilitate trade integration, tackle climate change and alleviate food insecurity for economic growth and stability.

Indian Economy

Indian economy remained remarkably resilient amid global headwinds. Indian economy is now the fastest growing major economy in the world (Word Economic Outlook January 2024). As per the recent report of IMF, India will emerge as the third largest economy in the world by 2027 as its GDP will hit US$ 5 trillion. The RBI has projected a GDP growth rate of 7% for the current fiscal. The Ministry of Finance in its latest report pegged India's real GDP growth at closer to 7% in 2024-25.

As per ***the First Advance Estimate released by NSO*** in January 2024, real GDP growth is pegged at 7.3% in 2023-24 compared to 7.2% in 2022-23. On the demand side, the growth is driven up by investment aided by higher Government Capex. In fact, the rate of real fixed investment is at its historic high in 2023-24. On sectoral performance, the Industry sector is estimated to grow by 7.9% as compared to 4.4% in the previous financial year. The growth in Agriculture and Service sector is estimated to decelerate to 1.8% and 7.7% respectively as compared to 4 % and 9.5% recorded during 2022-23.

Among the Expenditure components of GDP, the growth of Gross Fixed Capital Formation (GFCF) is pegged at 10.3%, with its share in GDP reaching to a record 34.9%. On the other hand, Private Final Consumption Expenditure (PFCE) is estimated to moderate to 4.4% as compared to 7.5% in the previous year due to the drag in rural demand The share of PFCE in GDP is expected to drop to 56.9% from 58.5% recorded during the previous year. The private consumption, the largest component of GDP, is expected to show tepid growth this fiscal.

Real GDP grew by 7.7% in the first half of 2023-24. The slow pace of growth estimated in the second half relative to the first half is due to weaker private consumption, especially rural. Broad based recovery in consumption demand is vital for sustaining growth momentum by crowding in private investment and bolstering government spending.

Retail Inflation stands at 5.7 % in December 2023,which is still within the tolerance band fixed by RBI. However, food inflation remains high and volatile and is adversely impacting mass consumption.

GST collection remains buoyant with the average monthly collection in 2023-24 so far at 1.66 lakh crore. As per the latest report of CBDT, as on January 24, Net direct tax collection has witnessed a growth of 19.41% over the corresponding period of the 2022-23. The strong growth in tax collection needs to be used to step up government expenditure to spur growth in the economy.

Easing of Monetary Policy by US Fed Reserve, softening of commodity prices, higher profitability of corporate, healthy balance sheets of Financial Institutions, moderate inflation, strong macroeconomic fundamentals of the Indian economy etc, remain positive while ongoing geopolitical tensions and weaker global growth pose risk to growth .

Union Finances

Fiscal indicators

As per the Union Budget presented in parliament on 1 February 2024, the Revenue Deficit stands at 3.9% of GDP as per 2023-24 RE. Fiscal Deficit stands at 5.8% of GDP as against the Finance Commission target of 5% for 2023-24. The Debt outstanding is at 58.1% which is much higher compared to the debt level of States.

Kerala Economy and Finances

The rebound in economic activities has been sustained in 2023-24 and GSDP is expected to clock a growth rate of 12.24%. Despite robust growth in Own tax revenues, the state is facing liquidity crunch due **to *Vertical fiscal imbalance and arbitrary cut in the borrowing limit.*** States Own Tax revenue has increased from Rs.58340 crore in 2021-22 to Rs.71968 crore in 2022-2023. The central Transfer has declined from Rs.47837 crore in 2021-22 to Rs.45638 crore in 2022-23. The central transfers as a percentage of total Revenue receipts has declined from 41% in 2020-21 to 34% in 2022-23. As a percentage of total revenue receipts, this constitute only 25% as per RE 2023-24. The surge in States Own Revenue was not sufficient to offset the reduced central transfers.

The cut in borrowing limit of the state, the loss on account of withdrawal of GST compensation and reduction in Revenue Deficit Grant have substantially reduced the central transfer for the current financial year putting the state to financial stress. The share in divisible pool got reduced from 3.875 % during the 10th FC to 1.925 % during the 15th FC period. The Union Government's decision to reckon the guarantee provided to KIIFB and KSSP Ltd as borrowing of the State and treating the accruals in the Public Account as liabilities in the calculation of the OMB eligibility further aggravated the resource position of the State. The delayed transfer of central funds and imposing impractical conditionalities for release of the central share of CSS, which are difficult to implement immediately, are choking the state financially, creating liquidity management issues.

As per the report of 15thFC, the relative share of the states in the combined Revenue expenditure is 62.5% whereas it is 37.5% for the Centre. On the other hand, the relative share of states in the combined Revenue receipts is 37.5% and the remaining is with Centre. That is, the States bear 62 % of the public expenditure while they get only 37% of the tax revenue. This ***vertical fiscal imbalance*** has impacted the resources and thus the development priorities of the states are compromised.

The recent policies of the Union Government have *significantly* ***weakened the fiscal autonomy of the States.*** With the rationalisation of CSS, the fund sharing pattern of CSS which were in the ratio of 90:10, 80:20 and 75:25 were changed to 60:40, enhancing the states liability . Most of the CSS are not suitable to the states' developmental needs and the conditionalities are not favourable to the States' priorities. The cesses and surcharges which are not sharable with the

States have increased from 10.4 % in 2011-12 to 28.1% in 2020-21 as a percentage of Gross Tax Revenue (GTR) thereby shrinking the divisible pool as a percentage of GTR. The Central Government is providing Special Capital Assistance to States in the form of a 50 year interest free loan. However, the guidelines are very difficult to follow and are imposing impractical conditionalities in the name of ***branding*** for release of Central Share. This results in delayed transfer of both Capex and Central Share of CSS putting pressure on State finances. State is of the view that **co-branding** should be allowed by Government of India as the State is contributing 40% of the share in majority of the schemes. Despite taking up the matter at various levels, over Rs.600 crore under the National Health Mission and Rs.2500 crore under Special Assistance for CAPEX have not been released so far, further damaging the fiscal situation in the State.

The States Own Tax Revenue has witnessed a robust growth of 22.41% and 23.36% respectively in 2021- 2022 and 2022-2023 as compared to the previous years, which is highest in the recent history, on the back of sustained economic recovery.

GST collections continues to be robust with monthly average growth hovering at 10% in 2023-24 compared to the previous year in tandem with post pandemic rebound in the economy The re-organisation of GST Department also contributed to the healthy performance in tax collection.

The RD as a percentage of GSDP stands at 0.88% in 2022-23 due to State's efforts to increase Own Revenue and curtail non productive expenditure. The total expenditure has decreased from 1.63 Lakh crore in 2021-22 to 1.59 Lakh crore in 2022-23. After the spike in debt in the pandemic period of 2020-21, Debt/GSDP has been progressively coming down from 38.51% in 2020-21 to 34.62% in 2022-23 which vindicates States commitment to fiscal consolidation.

Fiscal Performance 2022-23

States Own Tax Revenue rose by 23.36% in FY 2022-23 compared to the previous year. State's Non Tax Revenue grew by 44.50% in comparison to the previous year. Share of Central Taxes grew by 2.47%. Total Revenue Receipts grew only by 13.79% as against 19.49% in the previous year due to decline in central transfers, especially in Grant-in-aid. Revenue Expenditure and Capital Expenditure declined by 2.89 % & 1.51 % respectively. Revenue Deficit (RD) and Fiscal Deficit (FD) were at 0.88% & 2.44% of GSDP respectively as against 1.96% & 3.61% in the Revised Budget Estimates. The improvement in RD and FD is due to the increase in tax collections and reduction in expenditure, which is due to the sharp decline in Central share.

Review of 2023-24

State's Own Tax Revenue & Non Tax Revenue grew by 7.04% & 11.48% due to the high base effect. Total Revenue Receipts contracted by 4.44% mainly due to the decline in the Share of Central transfers by 27.81%. Revenue Expenditure and Capital Expenditure rose by 6.67% and 1.17% respectively. RD and FD as a percentage of GSDP are at 2.09% & 3.45 % respectively as against 2.11% & 3.50% in the Budget estimates for 2023-24 and MTFP target of 2.22% and 3.5% set in 2002-23. The improvement in RD and FD is due to the robust growth in own revenues of the State despite the cut in Central transfers. Debt /GSDP is at 34.29% as against 36.05% in the Budget estimates due to decline in the growth rate of Debt.

Three Year rolling targets and underlying assumptions

Budget Estimates 2024-25

Revenue Receipts

State's Own Tax Revenue is estimated to grow at 10.18% over RE 2023-24 due to the continued growth momentum in economic activities.

Share of Central Taxes is expected to grow at 12.20% on the back of higher growth in Direct Tax collection and GST mop up by the Union Government. However, the cessation of RD grant will offset the expected increase in Central tax receipts.

Revenue Expenditure

Revenue Expenditure is estimated to grow at 9.96% with thrust on Health and Education.

Gross State Domestic Product

GSDP is projected to grow at 11.68% on the back of the sustained growth momentum in the economy.

Revenue Deficit & Fiscal Deficit

RD is pegged at 2.12% as against the FC target of (-) 1.2% (-ve denotes Surplus). FD is estimated at 3.40% as against the FC target of 3.5%. The State is committed to continue the path of fiscal consolidation by gradual reduction of FD. Debt/GSDP is estimated at 34.15% as against the FC target of 32.8 %.

Taxation

GST department has been reorganised in tune with GST regime, with a three tier system of Tax Audit, Tax Payer Service and Intelligence for further leveraging GST revenues. With this, tax frauds have been unearthed. Special training is imparted to officers for Audit. Strengthening of the enforcement wing is expected to widen the tax base and improve the tax efficiency by plugging in leakages and evasion.

Strategic Priorities

- The fiscal strategy is to rejuvenate the economy by increasing investment in productive sectors with Public Private Participation

- Agriculture with thrust on value addition
- Tourism, MSME etc will be priority sectors
- Creation of Knowledge economy
- Capital Expenditure will be enhanced through Budget and SPV mode
- Welfare measures for the poor and vulnerable will be continued
- Sustainable development
- IT and Innovation including Start ups
- Health, Education and skill development

Forward Estimates and Underlying Assumptions

Gross State Domestic Product

GSDP is projected to grow at 13% in the forward estimate period.

Revenue Receipts

State's Own Tax Revenue is estimate to grow at 13% in the forward estimate period. Non Tax Revenue is projected to grow at 15%.

Central Transfers

Share of Central Taxes is projected to grow at 22% and 20% in 2025-26 and 2026-27 respectively. Grant in Aid is estimated to taper off in the forward estimates period due to the discontinuation of RD grant.

Revenue Expenditure

Revenue expenditure is projected to grow at 10% in the forward estimates period.

Borrowing, Public Debt and Other Liabilities

The borrowing ceiling is fixed at 3% in the forward estimate period as per the recommendation of 15th FC as the additional borrowing in respect of power sector reforms will cease after 2024-25 The

Debt/GSDP is estimated at 33.22% in 2025-26 and 32.40% in 2026-27 respectively in line with State's commitment to fiscal consolidation.

Salaries & Pension

Salaries & Pension are projected to grow at 7% and 5% respectively to cover the incremental growth.

Interest

Interest is calculated by applying effective interest on outstanding debt. Effective interest rate is worked out to be 7%.

Subsidies

The provision for subsidy is normalizing on account of the reduced need post pandemic.

Devolution to LSG's

The 6th State Finance Commission will cover the forward estimate period. General Purpose Fund and Maintenance fund are projected at 4% and 6.5% of Net State's Own Tax Revenue (t-2) respectively for the year 2025-26 and 2026-27. Development fund is provided at 28% and 28.5% of Plan outlay for 2025-26 and 2026-27 respectively.

Capital Expenditure

Capital Outlay is projected to grow at 7% and 12% for 2025-26 and 2026-27 respectively. In addition to this, investment in infrastructure by KIIFB and asset creation through local bodies are supplementing Capital Expenditure.

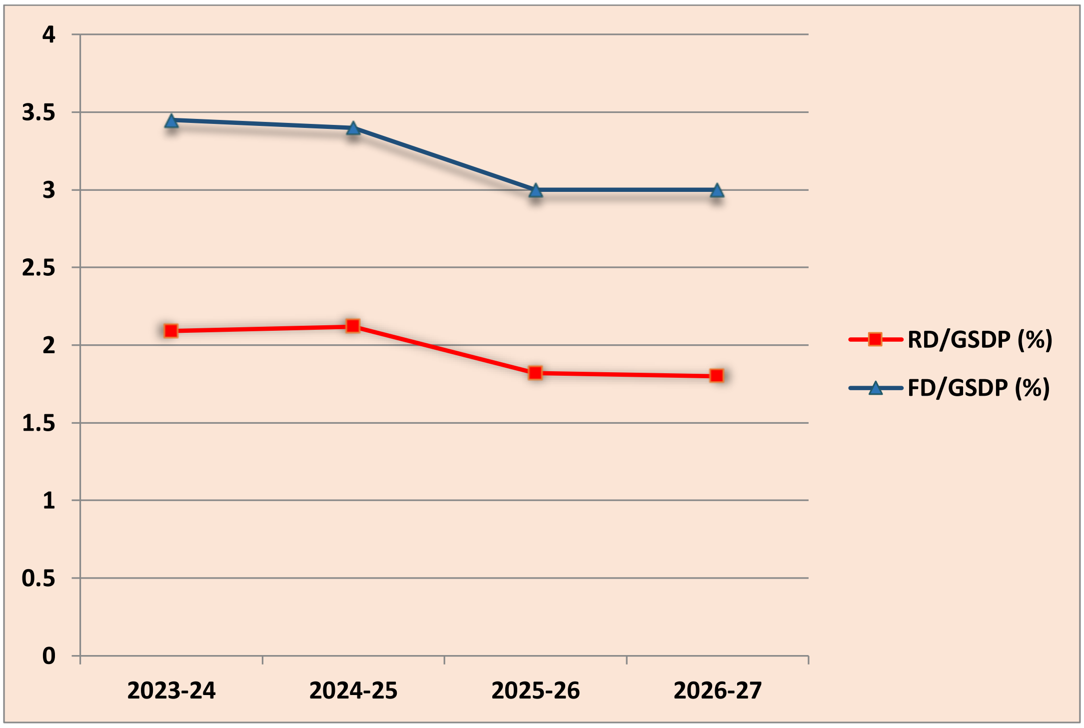
Revenue Deficit and Fiscal Deficit

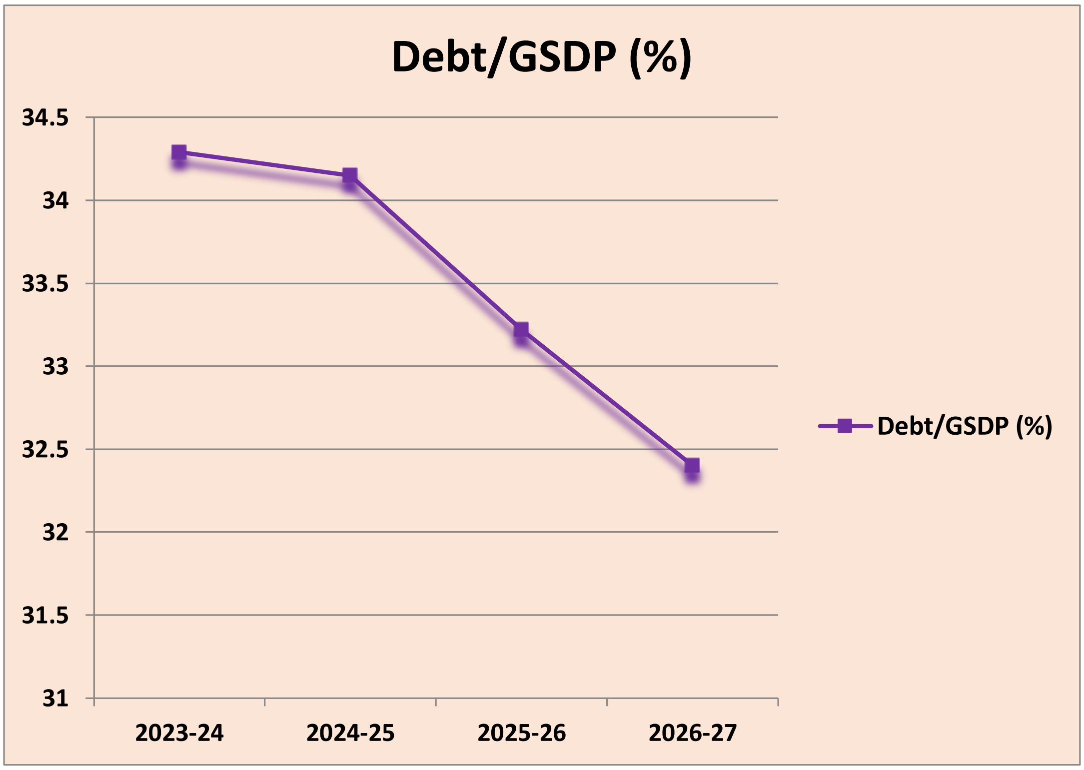
The State is committed to continue to the path of fiscal consolidation by gradual reduction of RD, FD and Debt/GSDP by mobilization of revenue and rationalization of expenditure. The State is of the view that fiscal consolidation should not be at the cost of Welfare measures for poor and vulnerable. The fiscal strategy is to augment capital spending to spur economic growth. RD is projected at 1.82% for 2025-26 and 1.80% for 2026-27 as against the FC target of (-) 2.5% (-ve denotes surplus) for 2025-26 (2025-26 being the last year of the 15th FC). FD is projected at 3% for 2025-26 and 2026-27 for the forward estimate period as against FC target of 3% for 2025-26. Debt/GSDP is projected at 33.22 % for 2025-26 and 32.40% for 2025-26 for 2026-27 period as against the FC target of 32.5% for 2025-26. There will be a reduction of 0.32% in RD /GSDP in the 2026-27 over the level in 2024 -25BE. In respect of Debt/GSDP, the reduction would be 1.75 % during the same period.

MTFP Targets

Item	2023-24	2024-25	2025-26	2026-27
	RE	BE	Forward Estimates	
RD/GSDP (%)	2.09	2.12	1.82	1.80
FD/GSDP (%)	3.45	3.40	3.00	3.00
Debt/GSDP (%)	34.29	34.15	33.22	32.40

Fiscal Consolidation Path





States Fiscal Plan 2024-2025							(Rs. in crores)
Item	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	Accounts	Accounts	Accounts	RE	BE	Forward Estimate	
Revenue Receipts	97616.83	116640.24	132724.66	126837.06	138655.16	156164.82	171294.71
State's own tax revenue	47660.84	58340.52	71968.16	77038.25	84883.51	95918.37	108387.75
Non Tax Revenue	7327.31	10462.51	15117.96	16853.05	18356.46	21109.93	23643.12
Resources from Centre	42628.68	47837.21	45638.54	32945.76	35415.20	39136.53	39263.83
Revenue Expenditure	123446.33	146179.51	141950.94	151422.37	166501.21	183151.33	201466.46
Non-Interest Revenue Expenditure	102470.97	122876.69	116774.58	124579.19	137806.97	150245.30	165246.11
Interest	20975.36	23302.82	25176.36	26843.18	28694.24	32906.03	36220.35
Salaries	27810.86	44494.16	37902.84	38178.81	40674.56	43521.78	46568.30
Pensions	18942.85	26898.69	26090.04	26182.89	28609.04	30039.49	31541.47
Non SPI Revenue Expenditure	55717.26	51483.84	52781.70	60217.49	68523.37	76684.03	87136.34
Subsidies	6300.41	3892.87	1542.50	1512.19	2009.11	2109.57	2215.04
Devolution to LSGs	11399.78	11185.01	9562.52	12313.15	15205.46	17018.09	18001.29
Revenue Expenditure excld SPI,subsidies & Devol.to LSGIs	38017.07	36405.96	41676.68	46392.15	51308.80	57556.38	66920.01
Revenue Surplus/Deficit	**-20063.51**	**-20799.96**	**-9226.29**	**-24585.31**	**-27846.05**	**-26986.51**	**-30171.76**
Capital Expenditure	**15438.16**	**17046.02**	**16787.49**	**16984.74**	**17826.12**	**19030.69**	**21268.95**
Capital Outlay	12889.65	14191.73	13996.56	14398.19	15663.22	16759.65	18770.80
Loan disbursements	2548.51	2854.29	2790.93	2586.55	2162.90	2271.05	2498.15
Non Debt Capital Receipts	*297.97*	*539.51*	*459.23*	*1108.67*	*1143.20*	*1500.00*	*1200.00*
Fiscal Deficit/Surplus	**-35203.69**	**-37306.47**	**-25554.54**	**-40461.37**	**-44528.96**	**-44517.20**	**-50240.71**
Primary Deficit/Surplus	-14228.33	-14003.65	-378.18	-13618.19	-15834.72	-11611.17	-14020.36
End of the period Debt	278606.11	316271.00	348916.52	382412.97	425245.65	470086.11	517433.57
Debt Service	20975.36	23302.82	25176.36	26843.18	28694.24	32906.03	36220.35
Salary+Pension+Interest	67729.07	94695.67	89169.24	91204.88	97977.84	106467.30	114330.12
Debt Stock	296900.85	335641.15	362191.89	402634.04	447857.25	492314.96	542552.18
Government Guarantees	31714.27	44361.39	50374.49				
Interest/Revenue Receipts (%)	**21.49**	**19.98**	**18.97**	**21.16**	**20.69**	**21.07**	**21.15**
Debt/Revenue (%)	304.15	287.76	272.89	317.44	323.00	315.25	316.74
(Salary+Pen+Interest)/Revenue(%)	69.38	81.19	67.18	71.91	70.66	68.18	66.74
(Salary+Pen+Interest)/GSDP(%)	8.78	10.13	8.52	7.77	7.47	7.18	6.83
(Salary+Pen)/GSDP (%)	6.06	7.64	6.12	5.48	5.28	4.96	4.66
Rev Deficit/Rev Receipt (%)	20.55	17.83	6.95	19.38	20.08	17.28	17.61
RD/GSDP (%)	2.60	2.23	0.88	2.09	2.12	1.82	1.80
FD/GSDP (%)	4.57	3.99	2.44	3.45	3.40	3.00	3.00
Debt Stock/GSDP (%)	38.51	35.92	34.62	34.29	34.15	33.22	32.40
GSDP	**771009**	**934542**	**1046188**	**1174244**	**1311437**	**1481924**	**1674574**
Nominal GSDP Growth Rate(%)	-5.16	21.21	11.95	12.24	11.68	13.00	13.00
Average Interest Rate (%)	7.53	7.37	7.22	7.02	6.75	7.00	7.00