

CHAPTER 1

FINANCES OF THE STATE GOVERNMENT

This chapter provides a broad perspective of the finances of the Government of Karnataka during the current year and analyses critical changes in the major fiscal aggregates relative to the previous year keeping in view the overall trends during the last five years. The analysis is based on the Finance Accounts and the information obtained from the State Government. The structure of Government accounts and the layout of Finance Accounts is shown in **Box -1.1**. **Appendix 1.1** gives methodology adopted for assessment of fiscal position.

1.1 Summary of fiscal transactions

Table 1.1 presents the summary of the State Government's fiscal transactions during the current year (2008-09) *vis-à-vis* the previous year, while **Appendix.1.2** provides details of receipts and disbursements as well as overall fiscal position during the current year.

Table 1.1: Summary of fiscal transactions

(Rupees in crore)

Receipts			Disbursements				
	2007-08	2008-09		2007-08	2008-09		
Section-A: Revenue					Non Plan	Plan	Total
Revenue receipts	41,151.14	43,290.67	Revenue expenditure	37,374.77	31,128.98	10,530.31	41,659.29
Tax revenue	25,986.76	27,645.66	General services	10,871.78	12,165.37	110.20	12,275.57
Non-tax revenue	3,357.66	3,158.99	Social services	13,123.68	9,947.55	5,925.44	15,872.99
Share of union taxes/ duties	6,779.23	7,153.77	Economic services	11,453.31	7,437.94	3,698.70	11,136.64
Grants-in-aid from Government of India	5,027.49	5,332.25	Grants-in-aid and contributions	1,926.00	1,578.12	795.97	2,374.09
Section-B: Capital and others							
Misc. Capital receipts	245.78	181.14	Capital outlay	8,648.94	735.02	9,135.27	9,870.29
			General services	339.02	52.63	422.74	475.37
			Social services	2,147.68	140.69	2,414.47	2,555.16
			Economic services	6,162.24	541.70	6,298.06	6,839.76
Recoveries of loans and advances	52.07	56.65	Loans and advances disbursed	756.74	507.76	223.58	731.34
Public debt receipts*	2,278.55	8,592.16	Repayment of public debt*	1,250.64	1,777.90	0	1,777.90
Contingency Fund	13.28	---	Contingency Fund	---	2.10	---	2.10
Public Account receipts	56,159.75	60,603.55	Public Account disbursements	54,054.80	0	0	54,782.85
Opening cash balance	6,104.77	3,919.45	Closing cash balance	3,919.45		0	7,819.85
Total	1,06,005.34	1,16,643.62	Total	1,06,005.34			1,16,643.62

*Excluding net transactions under ways and means advances and overdraft.

Source : Finance Accounts

Box – 1.1 Structure of Government accounts

The accounts of the State Government are kept in three parts viz., Consolidated Fund, Contingency Fund and Public Account.

Part I: Consolidated Fund : All revenues received by the State Government, all loans raised by issue of treasury bills, internal and external loans and all moneys received by the Government in repayment of loans shall form one Consolidated Fund entitled the Consolidated Fund of State established under Article 266(1) of the Constitution of India.

Part II: Contingency Fund: Contingency Fund of the State established under Article 267(2) of the Constitution is in the nature of an imprest placed at the disposal of the Governor to enable him to make advances to meet urgent unforeseen expenditure, pending authorisation by the Legislature. Approval of the Legislature for such expenditure and for withdrawal of an equivalent amount from the Consolidated Fund is subsequently obtained, whereupon the advances from the Contingency Fund are recouped to the fund.

Part III: Public Account: Receipts and disbursements in respect of certain transactions such as small savings, provident funds, reserve funds, deposits, suspense, remittances etc which do not form part of the Consolidated Fund, are kept in the Public Account set up under Article 266(2) of the Constitution and are not subject to vote by the State Legislature.

Layout of Finance Accounts

Statement number	Layout
1	Summary of transactions of the State Government – receipts and expenditure, revenue and capital, public debt receipts and disbursements etc in Consolidated Fund, Contingency Fund and Public Account of the State.
2	Summarised statement of capital outlay showing progressive expenditure to the end of 2008-09
3	Financial results of irrigation works, their revenue receipts, working expenses and maintenance charges, capital outlay, net profit or loss, etc.
4	Summary of debt position of the State including borrowing from internal debt, Government of India, other obligations and servicing of debt.
5	Summary of loans and advances given by the State Government during the year and repayments made, recoveries in arrears etc.
6	Summary of guarantees given by the Government for repayment of loans etc. raised by Statutory corporations, local bodies and other institutions.
7	Summary of cash balances and investments made out of such balances.
8	Summary of balances under Consolidated Fund, Contingency Fund and Public Account as on 31 March 2009.
9	Revenue and expenditure under different heads for the year 2008-09 as a percentage of total revenue/expenditure.
10	Distribution of expenditure between charged and voted categories.
11	Detailed account of revenue receipts by minor heads.
12	Accounts of revenue expenditure by minor heads under non-plan and plan separately and capital expenditure by major head wise.
13	Details of capital expenditure incurred during and to the end of 2008-09.
14	Details of investment of the State Government in Statutory corporations, Government companies, other joint stock companies, co-operative banks and societies etc up to the end of 2008-09.
15	Capital and other expenditure to the end of 2008-09 and the principal sources from which the funds were provided for that expenditure.
16	Detailed account of receipts disbursements and balances under heads of account relating to debt, Contingency Fund and Public Account.
17	Detailed account of debt and other interest bearing obligations of the Government of Karnataka.
18	Detailed account of loans and advances given by the Government of Karnataka, the amount of loan repaid during the year, the balance as on 31 March 2009.
19	Details of earmarked balances of reserve funds.

Following are the significant changes during 2008-09 over the previous year:

- Revenue receipts grew by Rs 2,139 crore (5 *per cent*) due to increase in own tax revenue (Rs 1,658 crore), State's share of Union taxes and duties (Rs 375 crore) and Government of India (GOI) grants (Rs 305 crore) off set by fall in non-tax revenue (Rs 199 crore). However, revenue receipts during the current year fell short of projection in the Medium Term Fiscal Plan (MTFP) 2007-11 by Rs 2,492 crore.
- Revenue expenditure increased by Rs 4,284 crore (11 *per cent*). Increase was mainly under social services sector (Rs 2,749 crore), general services sector (Rs 1,403 crore) and grants-in-aid (Rs 448 crore) off-set by decrease under economic services sector (Rs 316 crore). It fell short of MTFP projection for the year by Rs 3,109 crore.
- Miscellaneous capital receipts (Rs 181 crore) represented the sale proceeds of Government land as in previous year. The projection made in MTFP for the year, however, was Rs 3,000 crore.
- Capital outlay was more by Rs 1,221 crore (14 *per cent*). Increase was mainly under economic services sector (Rs 678 crore) and social services sector (Rs 407 crore).
- Public debt receipts (excluding ways and means advances) increased by Rs 6,313 crore (277 *per cent*) due to increase in internal debt receipts (Rs 6,523 crore) offset by decrease in loans and advances from GOI (Rs 210 crore).
- Cash balance of the State Government increased by Rs 3,900 crore (100 *per cent*).

Box – 1.2 Fiscal reforms path in Karnataka

In Karnataka, fiscal reforms and consolidation were brought to the forefront with the State Government formulating the first MTFP for the period 2000-05 based on broad parameters of fiscal correction laid down by the Eleventh Finance Commission (EFC). MTFP became a rolling annual document to report on the actual performance of the State against fiscal targets of the previous year and to put in place a multi-year medium term reform framework dovetailed to the budgetary exercise.

Karnataka was the first State to enact (September 2002) Fiscal Responsibility Act (FRA) providing statutory backing to MTFP. The Act aims to ensure fiscal stability and sustainability, enhance the scope for improving social and physical infrastructure and human development by achieving revenue surplus, reducing fiscal deficit, removing impediments to the effective conduct of fiscal policy and prudent debt management through limits on borrowings, debt and deficits, greater transparency in fiscal operations by the use of medium-term fiscal framework. To give effect to the fiscal management principles, the Act prescribed following fiscal targets for the State Government.

- Elimination of revenue deficit by the end of the financial year 2005-06.
- Reduction of fiscal deficit to not more than three per cent of the estimated GSDP by the end of the financial year 2005-06.
- Limiting the total liabilities to not more than 25 per cent of the estimated GSDP within a period of 13 financial years, i.e., by the end of the financial year 2014-15.
- Maintaining outstanding guarantees within the limit stipulated under the Karnataka Ceiling to Government Guarantees Act, 1999.

Revenue and fiscal deficits may exceed the specified limits due to unforeseen demands on the State finances on account of natural calamities to the extent of actual fiscal costs attributable to the situation.

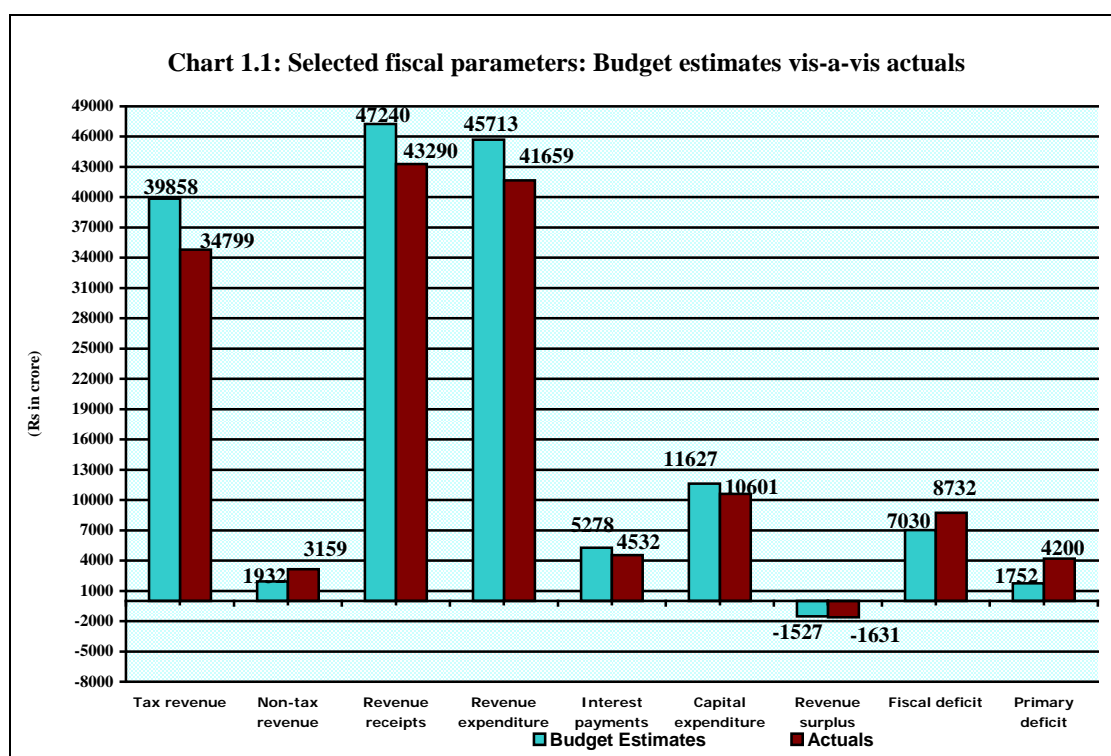
Outcome indicators for the period 2004-10 are given in **Appendix 1.3**

By adhering to the policy changes in revenue generation strategies and expenditure control envisaged in MTFPs, the State achieved the fiscal targets laid down in FRA one year ahead, with the year 2004-05 ending in revenue surplus and fiscal deficit for the year at less than three per cent of GSDP. During the period 2005-09 also, the State continued to maintain the revenue surplus and kept the fiscal deficit relative to GSDP below the limit laid down under FRA. Outstanding guarantees given by the Government were within the limit prescribed under the Karnataka Ceiling to Government Guarantees Act, 1999. The ratio of fiscal liabilities to GSDP continued to decline from 2004-05 and was around 27 per cent in 2008-09. As a result of these achievements, State received the full benefit of incentive grants of Rs 286 crore for the EFC award period. Under GOI's scheme of States' Debt Consolidation and Relief Facility (DCRF) recommended by the Twelfth Finance Commission (TFC), the State got the benefit of interest relief of Rs 1,051 crore for the period 2005-09 along with waiver of GOI loan of Rs 1,433 crore.

1.2 Actuals vis-à-vis budget estimates

Budget papers presented by the State Government provide description about estimations of revenue and expenditure for a particular fiscal year. The importance of accuracy in estimation of revenue and expenditure is widely accepted in the context of effective implementation of fiscal policies for overall economic management. Deviations from budget estimates are indicative of non-attainment and non-optimisation of desired fiscal objectives.

Chart 1.1 presents the budget estimates and actuals of some important fiscal parameters for the year 2008-09.



Source: Annual Financial Statement and Finance Accounts

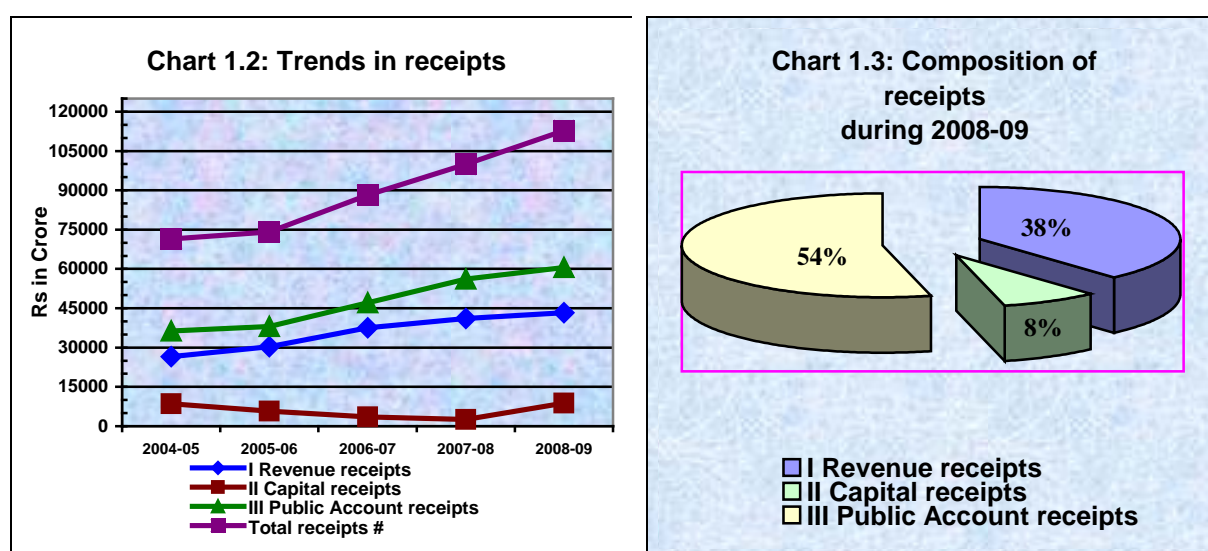
The State's revenue receipts fell short of the budget estimates by Rs 3,950 crore (8 per cent) mainly due to shortfall in tax revenue. The State's tax revenue (inclusive of State's share of Union taxes and duties) was less than the budget estimates by Rs 5,059 crore (13 per cent), while non-tax revenue was more than the budget estimates by Rs 1,227 crore (64 per cent). Revenue expenditure and capital expenditure were less than the budget estimates by Rs 4,054 crore (9 per cent) and Rs 1,026 crore (9 per cent) respectively. Interest payments were less than the budget estimates by Rs 746 crore (14 per cent). Revenue surplus, fiscal deficit and primary deficit were more than the budget estimates by Rs 104 crore, Rs 1,702 crore and Rs 2,448 crore respectively.

1.3 Resources of the State

1.3.1. Resources of the State as per annual Finance Accounts

Revenue and capital are the two streams of receipts that constitute the resources of the State Government. Revenue receipts consist of tax revenue, non-tax revenue, State's share of Union taxes and duties and grants-in-aid from GOI. Capital receipts comprise miscellaneous capital receipts such as proceeds from disinvestments, recoveries of loans and advances, debt receipts from internal sources (market loans, borrowings from financial institutions/commercial banks) and loans and advances from GOI as well as accruals from Public Account. **Table 1.1** presents receipts and disbursements of the State during the current year as recorded in Finance Accounts.

Chart 1.2 depicts the trends in various components of receipts during 2004-09, while **Chart 1.3** depicts the composition of resources of the State during the current year.



Excluding Contingency Fund receipts

Source : Finance Accounts

Total receipts increased by 58 per cent from Rs 71,451 crore in 2004-05 to Rs 1,12,724 crore in 2008-09, of which increase of revenue receipts was by 63 per cent from Rs 26,570 crore to Rs 43,290 crore during the period.

Capital receipts increased by three *per cent* from Rs 8,556 crore to Rs 8,830 crore. Public Account receipts increased by 67 *per cent* from Rs 36,325 crore to Rs 60,604 crore.

During the current year, revenue receipts accounted for 38 *per cent* of total receipts while capital and Public Account receipts accounted for 8 and 54 *per cent* respectively. Public debt receipts which create future re-payment obligation were 97 *per cent* of total capital receipts.

1.3.2 Funds transferred by Central Government to the State implementing agencies outside the State budget

The Central Government transferred a sizeable quantum of funds directly to the State implementing agencies¹ for implementation of various schemes/programmes in social and economic services sectors recognized as critical. As these funds were not routed through the State budget/State treasury system, Finance Accounts do not capture the flow of these funds and to that extent State's receipts and expenditure as well as other fiscal variables/parameters derived from these are understated. Information available in respect of a few Central plan schemes where funds were directly transferred to the State implementing agencies is furnished in **Table 1.2**.

Table-1.2: Funds transferred directly to the State implementing agencies

Programme / scheme	Implementing agency in the State	(Rupees in crore)	
		2007-08	2008-09
National Rural Employment Guarantee Scheme (NREGA)	Zilla panchyats	246.41	434.58
Swarna Jayanthi Gram Swarozgar Yojana (SGSY)		71.02	101.30
Indira Awaz Yojana (IAY)		131.13	275.44
Administration grant to District Rural Development Authority (DRDA)		8.82	28.10
Western Ghat Development Programme (WGDP)		15.23	126.63
Sampoorna Grameen Rozgar Yojana (SGRY)		163.58	6.17
Swajaladhara		4.45	4.63
Drought Prone Areas Programme (DPAP)		46.88	58.62
Desert Development Programme (DDP)		35.07	51.36
Total Sanitation Campaign (TSC)		48.17	27.52
Integrated Wasteland Development Project (IWDP)		20.54	49.91
Sarva Siksha Abhiyan (SSA)		SSA Society	
Members of Parliament Local Area Development Scheme (MPLAD)	District authorities		62.00
National Rural Health Mission (NRHM)	State Health Society		436.00
Total		791.30	2437.23

Source : e-lekha portal of the Controller General of Accounts, Ministry of Finance, Government of India. The list is not exhaustive.

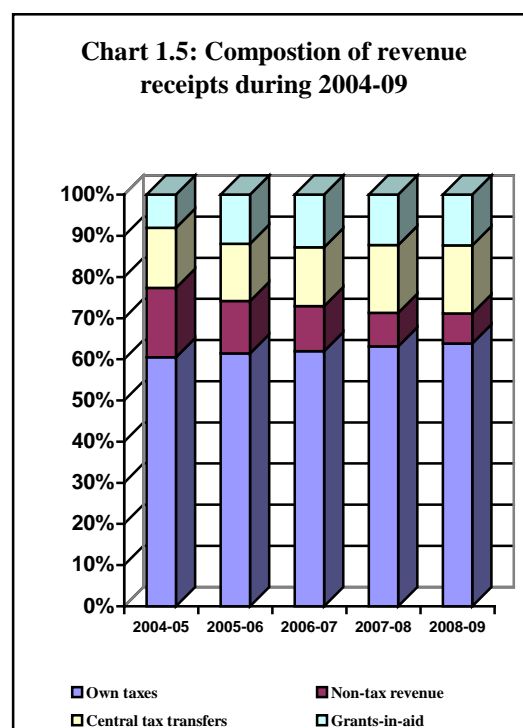
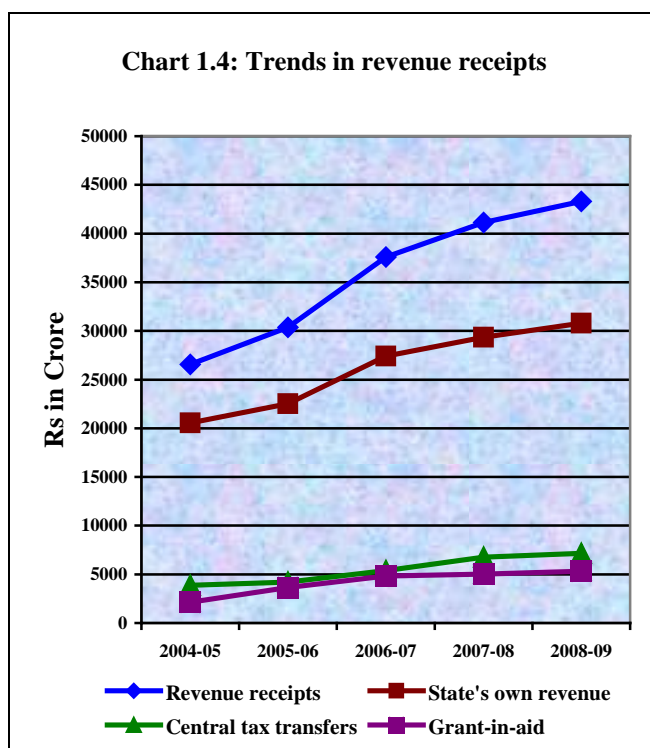
Direct transfer from the Union to the State implementing agencies runs the risk of poor oversight of utilisation of funds by these agencies. Unless

¹ State implementing agency includes any organization/institution including non-governmental organization which is authorized by the State Government to receive funds from GOI for implementing specific programmes in the State, e.g. State implementation society for SSA.

uniform accounting practices are diligently followed by all these agencies and there is proper documentation and timely reporting of expenditure, it will be difficult to monitor the end use of these direct transfers.

1.4 Revenue receipts

Revenue receipts consist of State's own tax and non-tax revenues, Central tax transfers and grants-in-aid from GOI. The trends and composition of revenue receipts over the period 2004-09 are presented in **Appendix 1.4** and also depicted in **Charts 1.4 and 1.5** respectively.



Source: Finance Accounts

Revenue showed progressive increase from Rs 26,570 crore in 2004-05 to Rs 43,290 crore in 2008-09 with inter-year fluctuations in the growth rate. On an average 73 per cent of the revenue came from State's own resources during the period 2004-09. The balance was from transfers from GOI in the form of State's share of taxes and grants-in-aid.

The trends in revenue receipts relative to GSDP are presented in **Table 1.3**.

Table 1.3: Trends in revenue receipts relative to GSDP

	2004-05	2005-06	2006-07	2007-08	2008-09
Revenue receipts (RR) (Rs in crore)	26,570	30,352	37,587	41,151	43,290
Rate of growth of RR (<i>per cent</i>)	28.0	14.2	23.8	9.5	5.2
GSDP (Rs in crore)	1,56,254	1,86,209	2,00,922	2,33,802	2,68,138
R R/GSDP (<i>per cent</i>)	17.0	16.3	18.7	17.6	16.1
Buoyancy ratios²					
Revenue buoyancy w.r.t GSDP	1.4	0.7	3.0	0.6	0.3
State's own tax buoyancy w.r.t GSDP	1.4	0.8	3.2	0.7	0.4
Revenue buoyancy with reference to State's own taxes	1.0	0.9	0.9	0.8	0.8

Source: Finance Accounts.

GSDP : State's Economic Survey 2008-09

Revenue buoyancy widely fluctuated during the period with reference to growth rate of GSDP. In 2006-07, the growth rate of revenue receipts was three times more than that of GSDP but in the next two years the low growth rate of revenue receipts relative to GSDP pushed the revenue buoyancy ratio down. The revenue buoyancy ratio was at its lowest at 0.3 in 2008-09.

1.4.1 State's own resources

As the State's share in Central taxes and grants-in-aid are determined on the basis of recommendations of the Finance Commission, collection of Central tax receipts and Central assistance for plan schemes etc, the State's performance in mobilization of additional resources should be assessed in terms of revenue from its own tax and non-tax sources.

Actual State's tax and non-tax receipts for the year 2008-09 vis-à-vis assessment made by TFC and the State Government in FCP and MTFP (2006-10) are given in **Table 1.4**

Table 1.4

(Rupees in crore)

	TFC projection	FCP projection	MTFP projection	Actual
Tax revenue	27,684	26,488	28,471	27,645
Non-tax revenue	3,846	5,491	5,765	3,159

The tax revenue of the State in 2008-09 was less than the projection made in the State's MTFP, marginally less than the normative assessment made by TFC, but exceeded the projection in FCP. Non-tax revenue was less than the TFC assessment as well as MTFP and FCP projections.

² Buoyancy ratio indicates the elasticity or degree of responsiveness of a fiscal variable with respect to a given change in the base variable. For instance, revenue buoyancy at 0.5 implies that revenue receipts tend to increase by 0.5 percentage points, if the GSDP increases by one *per cent*.

Tax revenue

Tax on sales, trade, etc. was the main source of State's tax revenue with a contribution of 53 *per cent* of the State's tax revenue followed by State excise (21 *per cent*) and stamps and registration fees (10 *per cent*). The trend in the major constituents of tax revenue during the period 2004-09 is shown in **Table 1.5**.

Table 1.5: Tax revenue
(Rupees in crore)

	2004-05	2005-06	2006-07	2007-08	2008-09
Taxes on sales, trade, etc.	8,700	9,870	11,762	13,894	14,623
<i>Rate of growth</i>	30.85	13.45	19.17	18.13	5.25
State excise	2,806	3,397	4,495	4,767	5,749
<i>Rate of growth</i>	20.22	21.06	32.32	6.05	20.60
Stamps and registration fees	1,760	2,213	3,206	3,409	2,927
<i>Rate of growth</i>	29.79	25.74	44.87	6.33	(-)14.14
Taxes on vehicles	983	1,105	1,375	1,650	1,681
<i>Rate of growth</i>	22.88	12.41	24.43	20.00	1.88

Source : Finance Accounts

The rate of growth of taxes on sales, trade, etc witnessed a steep fall in 2005-06 following the introduction of value added tax with effect from April 2005. Though the growth rate ranged between 18 and 19 *per cent* in the next two years, it again decreased to five *per cent* in 2008-09 due to reduction of Central sales tax from three to two *per cent* and fall in sale of industrial inputs and goods due to general slowdown of economy.

Due to ban on arrack, the growth rate of State excise witnessed steep fall from 32 *per cent* in 2006-07 to six *per cent* in 2007-08. The growth rate increased to 21 *per cent* in 2008-09 due to increase in the consumption of Indian made foreign liquor of lower price band.

Negative growth rate of stamps and registration fees in 2008-09 was due to economic slow down which stressed the real estate market and led to fall in the number of registrations.

The fall in the growth rate of tax on vehicles was also due to fall in sale of vehicles on account of general economic slow-down.

Non-tax revenue

During 2004-09, only 43 *per cent* of the non-tax revenue on an average was on account of interest receipts, dividends, fees and fines and user charges for socio-economic services. The balance 57 *per cent* on an average represented receipts (gross) from State lotteries, amount received from GOI under the scheme of DCRF, amounts written back from Public Account and pooling of cess collection under the head 1475 -Other General Economic Services. Thus non-tax revenue reflected in Finance Accounts stood inflated as revealed by the details of composition of non-tax revenue shown in **Table 1.6**.

Table 1.6: Composition of non-tax revenue

	2004-05	2005-06	2006-07	2007-08	2008-09	(Rupees in crore)	
						Average percentage composition during 2004-09	
						Interest, dividends, user charges, fees, fines	Others
Interest and dividends receipts	162 (4)	300 (8)	396 (10)	399 (12)	377 (12)	9	
General services	2,098 (47)	2,030 (52)	2,127 (52)	679 (20)	675 (21)		
Receipts (gross) from State lotteries	1,826 (41)	1,767 (46)	1,128 (28)	---	---		23
Relief under DCRF	---	---	716 (17)	358 (11)	358 (11)		8
Fees, fines etc,	272 (6)	263 (7)	283 (7)	321 (10)	317 (10)	8	
Economic services	2,066 (46)	1,416 (37)	1,428 (35)	2,099 (63)	1,921 (61)		
Write-back from Public Account	1,050 (23)	426 (11)	299 (7)	749 (22)	484 (15)		16
Pooling of cess collections	516 (12)	275 (7)	357 (9)	377 (11)	365 (12)		10
User charges	500 (11)	715 (18)	772 (19)	973 (29)	1,072 (34)	22	
Social services –user charges	147 (3)	129 (3)	148 (3)	181 (5)	186 (6)	4	
Total	4,473	3,875	4,099	3,358	3,159	43	57

Figures in parenthesis denote percentage composition in non-tax revenue

Source : Finance Accounts.

According to FRA, the State Government had to pursue non-tax revenue policies with due regard to cost recovery and equity. The ratio of non-tax revenue to non-plan revenue expenditure is considered as an indicator of cost-recovery from socio-economic services.

The details of recovery of current cost as ratio of non tax revenue receipts to non-plan revenue expenditure in respect of Education, Health and Family Welfare, Water Supply and Sanitation and Irrigation during 2008-09 are given in **Table 1.7**.

Table 1.7: Cost-recovery from socio-economic services

Service	Non tax revenue receipts (NTR)	Non plan revenue expenditure (NPRE)	(Rupees in crore)
			Cost recovery (ratio of NTR/ NPRE in per cent)
Education, sports, art and culture	73.56	6607.96	1
Health and family welfare	40.84	1,105.12	4
Water supply and sanitation	0.19	11.92	2
Irrigation	38.43	169.57	23

Source: Finance Accounts.

The State Government stated in MTFP (2007-11) that the condition and quality of public services made the task of making any appreciable changes in user charges difficult as a result of which user charges were yet to be rationalised.

Grants-in-aid from GOI

Grants-in-aid from GOI increased from Rs 2,147 crore in 2004-05 to Rs 5,332 crore in 2008-09 as shown in **Table 1.8**.

Table 1.8: Grant-in-aid from GOI
(Rupees in crore)

		2004-05	2005-06	2006-07	2007-08	2008-09
Non-plan		263	1,736	2,224	1,531	1,694
Plan	State	1,089	915	1,284	1,916	2,020
	Central	46	37	43	71	94
	Centrally sponsored	749	944	1,262	1,509	1,524
Total		2,147	3,632	4,813	5,027	5,332

Source : Finance Accounts.

The increase of GOI grants by Rs 305 crore in 2008-09 over the previous year was due to increase in non-plan grants (Rs 163 crore), grants for State plan schemes (Rs 104 crore), Central plan schemes (Rs 23 crore) and Centrally sponsored schemes (Rs 15 crore).

Central tax transfers

Increase of State's share of Union taxes by Rs 375 crore over the previous year was mainly under corporation tax (Rs 194 crore), taxes on income other than corporation tax (Rs 29 crore), customs (Rs 86 crore) and service tax (Rs 96 crore) partly off-set by decrease in share under Union excise duties (Rs 31 crore).

1.4.2 Arrears of revenue

As of March 2009, arrears of revenue pertaining to taxes on sales, trade, etc., entry tax, entertainment tax, agricultural income tax, profession tax and luxury tax, stamp duty and registration fees and tax and duties on electricity aggregated Rs 3,129 crore. Revenue of Rs 124 crore relating to taxes and duties on electricity (Rs 61 crore) and stamps duty and registration fees (Rs 63 crore) was outstanding for more than five years.

1.5 Application of resources

Analysis of the allocation of expenditure at the State Government level assumes significance since major expenditure responsibilities remained entrusted with them. Within the framework of fiscal responsibility legislations, there are budgetary constraints in raising public expenditure financed by deficit or borrowings. It is, therefore, important to ensure that the ongoing fiscal correction and consolidation process at the State level is not at the cost of expenditure, especially expenditure directed towards development and social sectors.

1.5.1 Growth and composition of expenditure

Growth rates of total expenditure during 2004-09, its ratio and buoyancy with reference to GSDP and revenue receipts are presented in **Table 1.9**.

Table 1.9: Total expenditure – Basic parameters
(Rupees in crore, ratio in per cent)

	2004-05	2005-06	2006-07	2007-08	2008-09
Total expenditure (TE)*	30,217	34,163	42,335	46,781	52,260
Rate of growth	19.3	13.1	23.9	10.5	11.7
TE/GSDP (ratio)	19.3	18.3	21.1	20.0	19.5
Revenue receipts / TE (ratio)	87.9	88.8	88.8	88.0	82.8
Buoyancy of total expenditure with					
GSDP(ratio)	1.0	0.7	3.0	0.6	0.8
Revenue receipts (ratio)	0.7	0.9	1.0	1.2	2.2

*Total expenditure includes revenue expenditure, capital expenditure including loans and advances

Source : Finances Accounts.

Total expenditure increased by 73 per cent from Rs 30,217 crore in 2004-05 to Rs 52,260 crore in 2008-09 due to increase in revenue expenditure (Rs 16,727 crore), capital outlay (Rs 5,196 crore) and increase in disbursement of loans and advances (Rs 120 crore).

During the period 2004-09, the growth rate of total expenditure was at the highest (24 per cent) in 2006-07 and at the lowest (11 per cent) in 2007-08. In 2008-09, the growth rate of total expenditure was 12 per cent.

During 2008-09, the growth rate of total expenditure was more than twice the growth rate of revenue receipts over the previous year. As a result, the buoyancy ratio of total expenditure with revenue receipts was more than two. This meant that the incremental total expenditure (Rs 5,479 crore) could not be met by the incremental revenue receipts (Rs 2,139 crore).

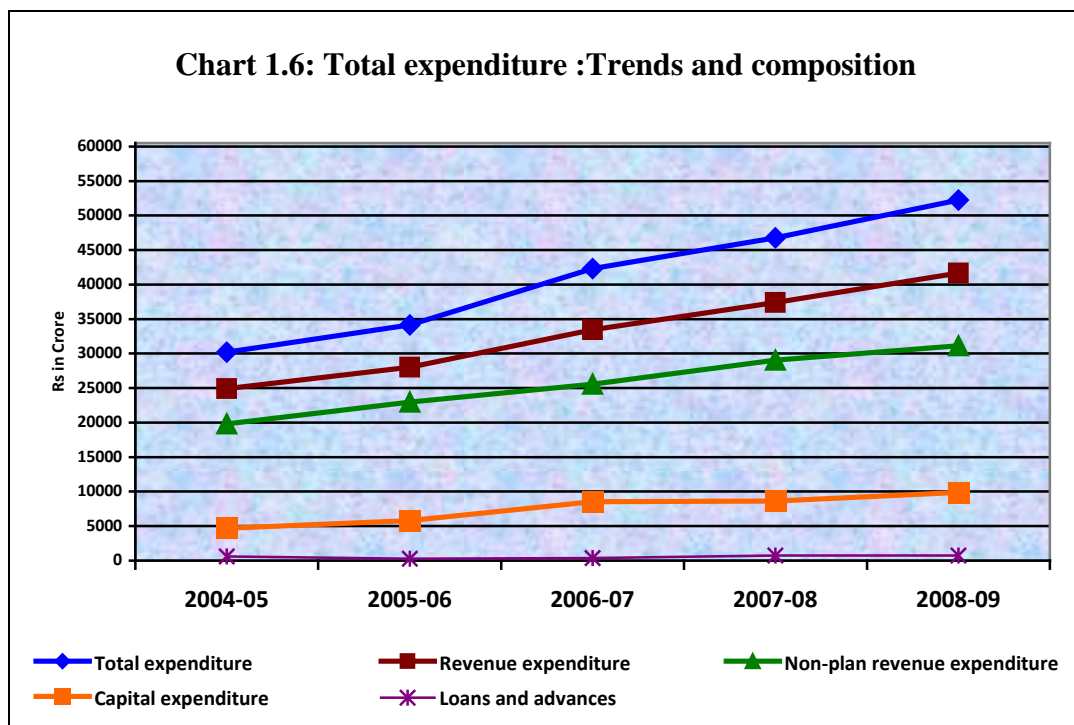
During the period 2004-09, revenue expenditure ranged between 79 and 83 per cent of the total expenditure. Decrease in committed expenditure, mainly expenditure on interest and subsidies helped in stabilizing revenue expenditure in the current year.

As a part of its expenditure strategy, the State identified agriculture, rural development, power, education and health as high priority sectors with greater capital outlay. Though capital outlay increased from Rs 4,674 crore in 2004-05 to Rs 9,870 crore in 2008-09, there was decrease (Rs 96 crore) in the capital outlay in the priority sectors of health and family welfare (Rs 54 crore), rural development (Rupees three crore) and agriculture and allied activities (Rs 39 crore) during 2008-09 relative to the previous year.

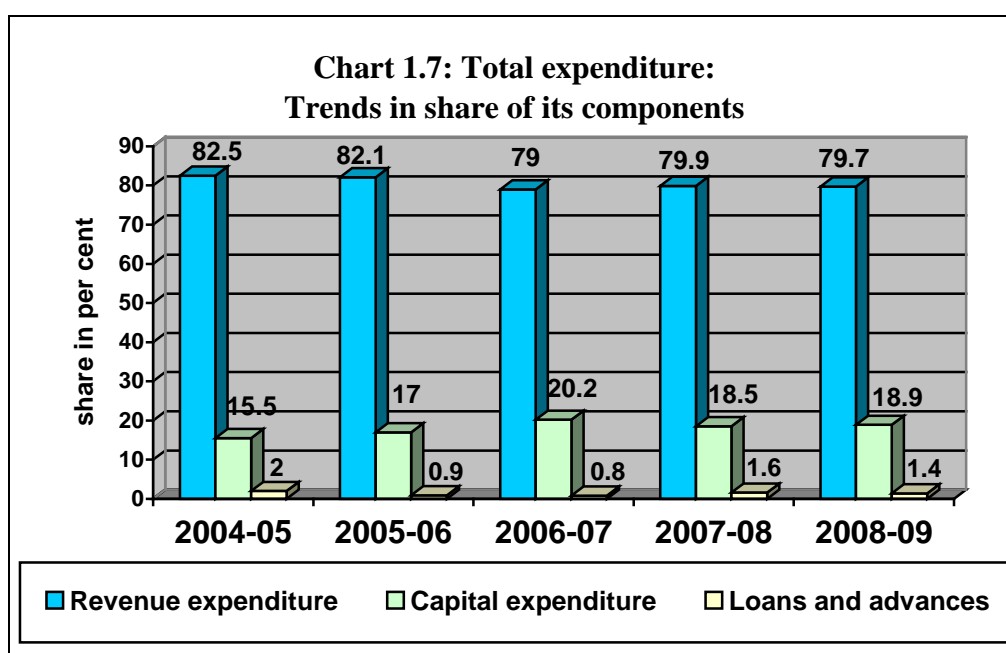
During the years 2005-06, 2007-08 and 2008-09, the growth rate of expenditure was less than that of GSDP and the buoyancy of total expenditure to GSDP was less than one.

Revenue receipts as a ratio of total expenditure stood at 83 per cent in 2008-09 which meant that 83 per cent of the total expenditure could be met out of revenue receipts.

Chart 1.6 presents the trends in total expenditure under revenue, capital and loans and advances, while **Chart 1.7** exhibits the share of these components in total expenditure.



Source: Finance Accounts.



Source: Finance Accounts.

1.5.2 Incidence of revenue expenditure

Revenue expenditure is incurred to maintain the current level of services and make payment for past obligations and as such does not result in any addition to the State's infrastructure and services network.

Revenue expenditure increased by 67 per cent from Rs 24,932 crore in 2004-05 to Rs 41,659 crore in 2008-09. While plan expenditure increased by 105 per cent from Rs 5,125 crore to Rs 10,530 crore, non-plan expenditure increased by 57 per cent from Rs 19,807 crore to Rs 31,129 crore.

Increase of plan revenue expenditure by Rs 2,217 crore over the previous year was mainly under Education, Sports, Arts and Culture (Rs 475 crore), Health and Family Welfare (Rs 211 crore), Social Welfare and Nutrition (Rs 504 crore) and Transport (Rs 224 crore). Plan revenue expenditure included devolutions (Rs 4,321 crore) to Panchayat Raj Institutions (PRI) and Urban Local Bodies (ULB), Subsidies (Rs 464 crore) and Salaries (Rs 658 crore).

Non-plan revenue expenditure (NPRE) was 75 per cent of revenue expenditure and 72 per cent of revenue receipts during 2008-09. It included devolutions to PRIs and ULBs (Rs 9,246 crore), interest payments (Rs 4,532 crore), subsidies (Rs 2,935 crore), pension payments (Rs 4,113 crore) salaries (Rs 9,254 crore) and maintenance expenditure (Rs 584 crore).

The trend in non-plan revenue expenditure *vis-à-vis* the normative assessment made by TFC about NPRE while estimating the pre-devolution non-plan revenue deficit/surplus for the State indicated that actual NPRE exceeded TFC's projections during 2005-09 as shown in **Table 1.10**.

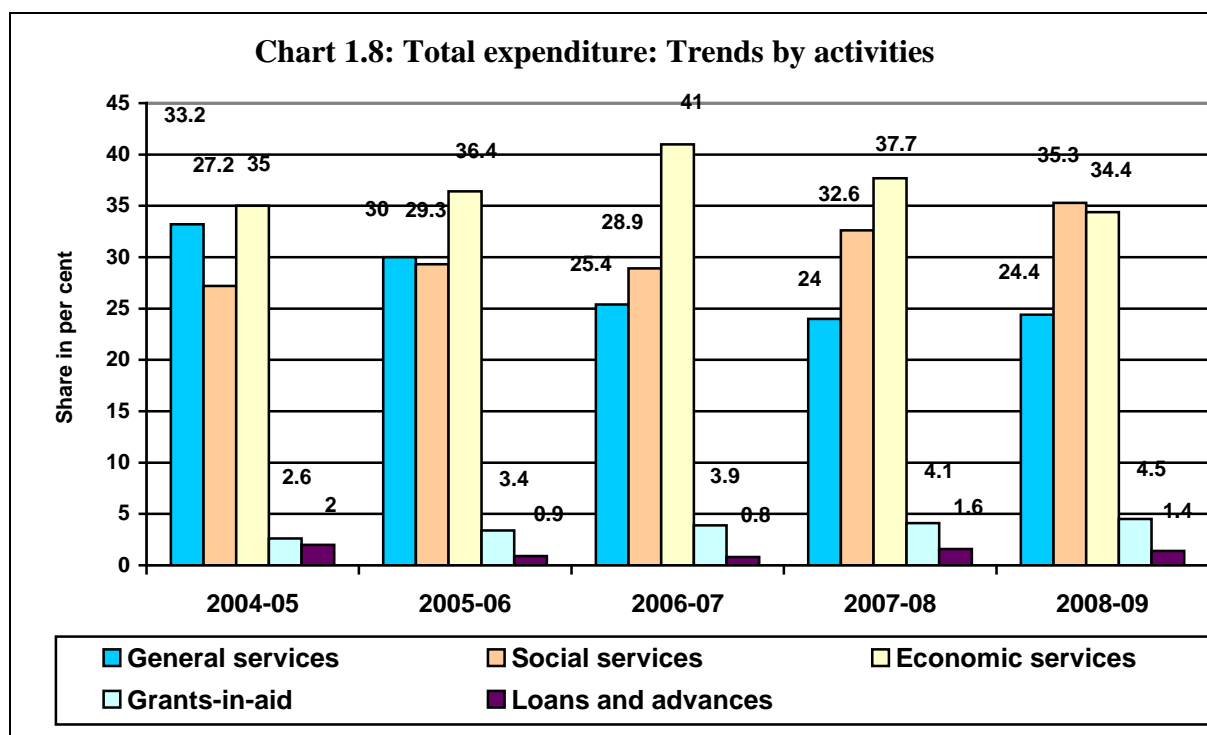
Table 1.10: Non-plan revenue expenditure- Actuals *vis-à-vis* TFC projection

Rupees in crore)			
	Normative assessment of TFC	Actual expenditure	Percentage variation
2005-06	17,001	22,972	35
2006-07	18,473	25,583	38
2007-08	21,735	29,062	34
2008-09	23,574	31,129	32

Source: TFC Report and Finance Accounts.

1.5.3 Trends in expenditure by activities

In terms of activities, total expenditure could be considered as being composed of expenditure on general services (including interest payments), social and economic services, grant in aid and loans and advances. Relative share of these components in total expenditure (including loans and advances) is indicated in **Chart 1.8**.



Source : Finance Accounts.

The movement of the relative share of these components indicates that the share of social services in total expenditure increased from 27 in 2004-05 to 35 per cent in 2008-09 and that of general services decreased from 33 to 24 per cent. The share of economic services increased from 35 in 2004-05 to 41 per cent in 2006-07 but showed declining trend thereafter and was 34 per cent in 2008-09.

1.5.4 Committed expenditure

Committed expenditure of the State Government on revenue account mainly consisted of interest payments, expenditure on salaries, pensions and subsidies. **Table 1.11** and **Chart 1.9** present the trends in the expenditure on these components during 2004-09.

Table 1.11: Committed expenditure

(Rupees in crore)

	2004-05	2005-06	2006-07	2007-08	2008-09
Salaries*, of which	5,392 (20.3)	5,932 (19.5)	6,426 (17.1)	8,169 (19.8)	9,912 (22.9)
Non-plan head	5,075	5,597	6,111	7,705	9,254
Plan head**	317	335	315	464	658
Interest payments	3,794 (14.3)	3,765 (12.4)	4,236 (11.3)	4,506 (10.9)	4,532 (10.5)
Expenditure on pensions	2,157 (8.1)	2,237 (7.4)	2,496 (6.6)	3,241 (7.9)	4,113 (9.5)
Subsidies	2,732 (10.3)	3,712 (12.2)	4,355 (11.6)	5,420 (13.2)	3,399 (7.8)
Total committed expenditure	14,075 (52.97)	15,646 (51.55)	17,513 (46.59)	21,336 (51.85)	21,956 (50.72)

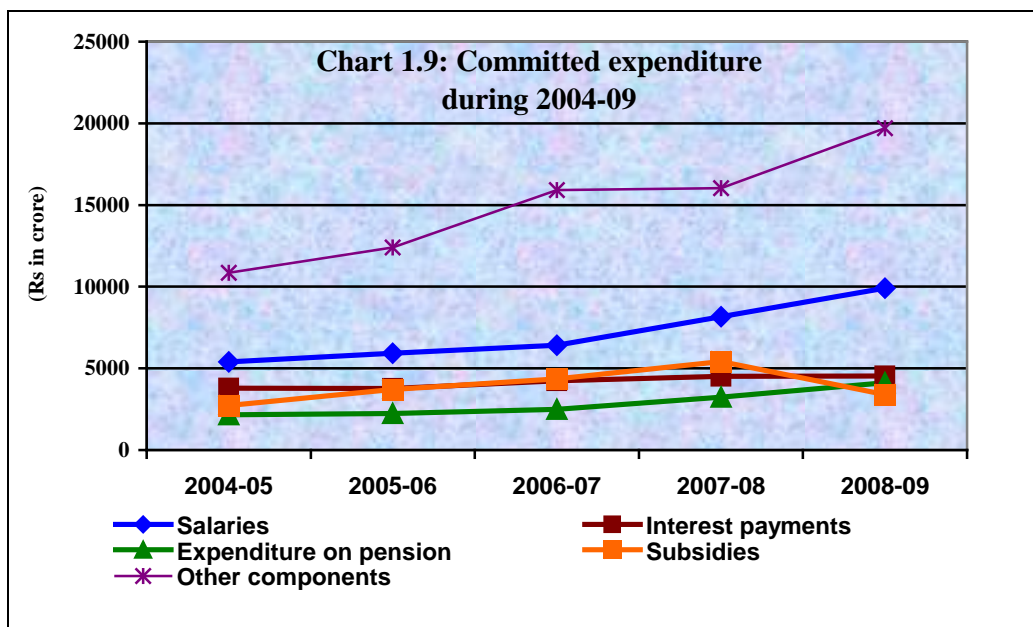
Other than committed expenditure ***	10,857 (40.9)	12,395 (40.8)	15,922 (42.4)	16,039 (39.0)	19,703 (45.5)
Total revenue expenditure	24,932	28,041	33,435	37,375	41,659
Revenue receipts	26,570	30,352	37,587	41,151	43,290

Figures in the parentheses indicate percentage to revenue receipts

* Includes salaries paid out of grants-in-aid released to PRIs and others

** Includes the salaries paid under Centrally sponsored schemes.

*** Included expenditure on administrative services (Rs 2,705 crore), Organs of State viz., Governor, Council of Ministers, Legislature, State Judiciary etc., (Rs 455 crore), fiscal services (Rs 444 crore), pensions under social services sector (Rs 982 crore), inter account transfers (Rs 2,214 crore) etc.,.



Source: Finance Accounts.

Expenditure on salaries

Expenditure on salaries as a percentage of revenue receipts increased from 20 in 2007-08 to 23 in 2008-09 due to implementation of fifth pay commission (FPC) award. It was, however, 30 per cent of revenue expenditure (net of pensions and interest payments), within the limit of 35 per cent recommended by TFC. The expenditure on salaries for 2008-09 was less than the MTFP-2007-11 projection of Rs 10,528 crore by Rs 616 crore.

Pension payments

Expenditure on pension (Rs 4,113 crore) pre-empted 10 per cent of total revenue receipts of the State during the year. The expenditure on pension during the year was less than MTFP (2007-11) projection by Rs 144 crore. Increase of Rs 872 crore over the previous year was due to implementation of FPC award.

Adopting budget estimates (Rs 2,214 crore) of pension expenditure for 2004-05 as base figure, TFC projected growth rate of 10 per cent per annum during the forecast period. The pension expenditure was less than TFC projection

during 2005-06 and 2006-07 while it was more than TFC projection during 2007-08 and 2008-09 as shown in **Table 1.12**.

Table 1.12: Pension expenditure vis-à-vis TFC projection

	(Rupees in crore)		
	TFC Projection	Actual expenditure	Percentage variation
2005-06	2,435	2,237	(-) 8
2006-07	2,679	2,496	(-) 9
2007-08	2,947	3,241	10
2008-09	3,242	4,113	27

Interest payments

Interest payments increased by Rs 738 crore from Rs 3,794 crore in 2004-05 to Rs 4,532 crore in 2008-09.

During 2004-05, interest payment on GOI loans was 34 *per cent* of total interest payments. The percentage of interest payments on GOI loans fell to 17 *per cent* on an average during 2005-09 as a result of implementation of DCRF scheme.

The ratio of interest payments to revenue receipts determines the debt sustainability of the State. During the year, interest payments pre-empted 10 *per cent* of total revenue receipts of the State *which was below the TFC norm of 15 per cent*.

Subsidies

In any welfare State, it is not uncommon to provide subsidies/subventions to disadvantaged sections of the society. Subsidies are dispensed not only explicitly but also implicitly by providing subsidised public service to the people. Budgetary support to financial institutions, inadequate returns on investments and poor recovery of user charges from social and economic services provided by the Government fall in the category of implicit subsidies. Finance Accounts (**Appendix V**) showed an explicit subsidy of Rs 3,399 crore during the year. Test check revealed implicit subsidies aggregating Rs 30 crore on electricity used by ice plants and cold storages (Rs 2 crore) and assistance to Karnataka State Financial Corporation towards waiver of interest due from small and marginal farmers (Rs 28 crore).

Subsidy provided by the State may also be classified as merit and non-merit subsidy. Subsidy (Rs 233 crore)³ on education, housing, health, social welfare and nutrition, rural and urban development, land reforms, non-conventional energy, agriculture and village and small industries considered to be merit

³ Education-Rs 4.43 crore, urban development-Rs 65.75 crore, social welfare and nutrition-Rs 1.63 crore, village and small industries-Rs 20.52 crore, agriculture-Rs 140.66 crore and non-conventional energy-Rs 0.03 crore

subsidy constituted around seven *per cent* of the total subsidy expenditure of the State during the year.

Subsidy payments during the year were mainly in the areas of power (Rs 1,943 crore), food (Rs 726 crore), co-operation (Rs 187 crore) and transport (Rs 143 crore). The details are given in **Box 1.3**.

Box – 1.3 Major subsidies

Power

During the year budgetary subsidy to power sector (Rs 1,943 crore) accounted for 57 *per cent* of the total subsidy (Rs 3,399 crore). It included financial assistance to electricity supply companies to cover loss due to rural electrification (Rs 1,743 crore) and contribution towards pension (Rs 200 crore).

Power subsidy on rural electrification during the year, however, did not include subsidy of Rs 87 crore given to the Karnataka Power Transmission Cooperation (KPTCL) for meeting the debt servicing obligations of Power Finance Corporation (PFC) and Rural Electrification Corporation (REC). Finance Accounts did not show this liability as these loans were not taken over by the Government. The State Government had also paid subsidy of Rs 243 crore in 2006-07 (Rs 130 crore) and 2007-08 (Rs 113 crore). The Government stated (November, 2007) that debt would be included on off-budget side in 2008-09. MTFPs 2007-11 to 2009-13, however, did not exhibit this liability on off-budget side.

Food

Food subsidy to meet the differential cost of food grains under Public Distribution System (PDS) increased from Rs 650 crore in 2007-08 to Rs 726 crore in 2008-09. Against annual food subsidy of Rs 53 crore recommended for Karnataka by TFC for the award period 2005-10, the amount of food subsidy was Rs 714 crore per annum, on an average during 2005-09, exceeding by 237 *per cent*.

Co-operation

Subsidy in the co-operative sector predominantly represented waiver of overdue loans (principal as well as interest) given to farmers. Such waiver of loans and interest aggregated Rs 3,511 crore in 2005-06 (Rs 917 crore), 2006-07 (Rs 801 crore) and 2007-08 (Rs 1,793 crore)

According to Vaidyanathan Committee Report (March 2008), the Governments both at the Centre and in the States should desist from the practices of waiver of recovery of loans and interest to prevent deterioration of co-operative credit system. The aggregate amount of loan and interest waived during 2008-09 decreased to Rs 186 crore, 90 *per cent* less than that of previous year.

Transport

Transport subsidy declined from Rs 230 crore in 2007-08 to Rs 143 crore in 2008-09. Fifty four *per cent* of the subsidy (Rs 77 crore) during 2008-09 was towards fare concession extended to students, freedom fighters, physically challenged, etc.

1.5.5 Financial assistance to local bodies

The quantum of assistance provided by way of grants to local bodies and others during the current year relative to the previous years is presented in **Table 1.13**.

Table 1.13: Financial assistance to local bodies and other institutions

	2004-05	2005-06	2006-07	2007-08	2008-09		
					Budget estimate	Actuals	Percentage variation
Panchayat Raj Institutions	4,956.93	6,088.61	7,767.93	9,122.39	11,297.12	10,949.27	3
Urban Local Bodies	1,169.85	1,605.85	2,113.48	2,468.20	3,370.89	2,618.59	22
Educational Institutions (including universities)	688.93	695.62	750.27	878.23	918.57	882.27	4
Co-operative societies and co-operative institutions	167.65	955.45	882.98	1,895.60	506.98	372.70	26
Other institutions and bodies (including statutory bodies)	1,745.28	1,837.43	2,400.54	2,361.00	2,449.26	1,979.32	19
Assistance as a percentage of revenue expenditure	35	40	42	45	40	40	
Total	8,728.64	11,182.96	13,915.20	16,725.42	18,542.82	16,802.15	9

Source : Finance Accounts.

The assistance to PRIs increased from Rs 4,957 crore in 2004-05 to Rs 10,949 crore in 2008-09 while the assistance to ULBs increased from Rs 1,170 crore to Rs 2,619 crore. Out of the total devolution of Rs 10,949 crore to PRIs during 2008-09, Rs 5,839 crore (53 per cent) were towards salaries as the State Government's functions viz., Education, Water Supply and Sanitation, Housing, Health and Family Welfare etc., were transferred to PRIs. Assistance to other institutions (Rs 1,979 crore) included subsidy of Rs 1,943 crore to electricity supply companies. The assistance to Urban Local Bodies, Co-operatives and other institutions was less than the budget estimates by 22 per cent, 26 per cent and 19 per cent respectively during the year 2008-09.

Sequel to the Second State Finance Commission's recommendation, the State Government decided (June 2006) to increase devolution of funds to ULBs from six to eight per cent of non loan net own revenue receipts (NLNORR) during the period 2005-10. The devolution to ULBs which was seven and eight per cent of NLNORR during 2005-08 increased to nine per cent in 2008-09.

1.6 Quality of expenditure

The availability of better social and physical infrastructure in the State generally reflects the quality of its expenditure. The improvement in the quality of expenditure basically involves three aspects, viz., adequacy of the expenditure (i.e. adequate provisions for providing public services); efficiency of expenditure use and the effectiveness (assessment of outlay-outcome relationship for select services).

1.6.1 Adequacy of public expenditure

The expenditure responsibilities relating to social sector and economic infrastructure are largely assigned to the State Governments. Enhancing human development levels requires the States to step up their expenditure on key social services like education, health, etc. The low level of spending on any sector by a particular State may be either due to low fiscal priority attached by the State Government or on account of the low fiscal capacity of the State Government or due to both working together. The low fiscal priority (ratio of expenditure category to aggregate expenditure) is attached to a particular sector if it is below the respective national average, while the low fiscal capacity would be reflected if the State's *per capita* expenditure is below the respective National average even after having a fiscal priority that is more than or equal to the National average. **Table 1.14** presents a comparison of fiscal priority given to different categories of expenditure and fiscal capacity of Karnataka in 2005-06 (the first year of TFC award period) and 2008-09.

Table-1.14: Fiscal priority and fiscal capacity of the State in 2005-06 and 2008-09
(Amount in rupees, ratio in per cent)

Fiscal priority by the State	AE/GSDP	DE/AE	SSE/AE	CE/AE
2005-06				
All States/National average* (ratio)	19.50	61.44	30.41	14.13
Karnataka's average (ratio)	20.41	66.54	29.66	17.92
2008-09				
All States/National average* (ratio)	19.16	67.68	33.90	16.87
Karnataka Average (ratio)*	19.49	71.05	35.58	20.29
Fiscal capacity of the State	DE#	SSE	CE	
2005-06				
All States average per capita expenditure	3,010	1,490	692	
Karnataka's per capita expenditure	4,070	1,790	1,042	
Adjusted per capita** expenditure	NR	1,859	NR	
2008-09				
All States' average per capita expenditure	5,030	2,520	1,250	
Karnataka's per capita expenditure	6,425	3,188	1,708	
* As per cent to GSDP				
** Calculated as per the methodology explained in Box 1.4				
AE: Aggregate Expenditure DE: Development Expenditure SSE: Social Sector Expenditure				
CE: Capital Expenditure.				
Population of Karnataka: 5.59 crore in 2005-06 and 5.78 crore in 2008-09.				
# Development expenditure includes development revenue expenditure, development capital expenditure and development loans and advances disbursed.				
Source : (1) <i>GSDP : State's economic survey 2008-09</i>				
(2) Population figures: Projection 2001-2026 of the Registrar General & Census Commissioner, India				
Data of Arunachal Pradesh has not been included in All States average.				
NR: Not required				

Box –1.4 Methodology adopted.

For working out the fiscal capacity of the State Government, the following methodology given in TFC report is adopted.

Step 1: Calculate the National average of AE-GSDP and CE/DE/ SSE–AE.

Step 2: Based on the National average of AE-GSDP ratio, derive the aggregate expenditure so that no State is having a ratio AEGSDP less than the National average, *i.e.*, if

$$\begin{aligned} \text{AE/GSDP} &= x \\ \text{AE} &= x * \text{GSDP} \dots\dots\dots(1) \end{aligned}$$

where x is the National average of AE-GSDP ratio.

Wherever the States are having AE-GSDP ratio higher than National average, no adjustments were made. Wherever this ratio was less than average, it was made equal to the National average.

Step 3: Based on the National average of DE-AE, SSE-AE and CE-AE, derive the respective DE, SSE and CE, so that no State is having these ratios less than National average, *i.e.*, if

$$\begin{aligned} \text{DE/AE} &= y \\ \text{DE} &= y * \text{AE} \dots\dots\dots(2) \end{aligned}$$

where y is the National average of DE-AE ratio

Substituting (1) in (2), we get

$$\text{DE} = y * x * \text{GSDP} \dots\dots\dots(3)$$

Wherever the States are having DE-AE, SSE-AE and CE-AE ratio higher than National average, no adjustments have been made. Wherever these ratios were less than average, it was made equal to the National average.

Step 4: Based on the derived DE, SSE and CE as per equation (3), respective *per capita* expenditure is calculated, *i.e.*,

$$\text{PCDE} = \text{DE/P} \dots\dots\dots(4)$$

where PCDE is the *per capita* development expenditure and P is the population.

Substituting (3) in (4), we get

$$\text{PDE} = (y * x * \text{GSDP})/P \dots\dots\dots(5)$$

Equation (5) provides the adjusted *per capita* expenditure. If the adjusted *per capita* expenditure is less than the National average of *per capita* expenditure, then the States' low level of spending is due to the low fiscal capacity. This gives a picture of actual level of expenditure when all the State Governments are attaching fiscal priority to these sectors equivalent to the National average.

In 2005-06, Karnataka Government gave adequate fiscal priority to AE, DE and CE as AE/GSDP, DE/AE and CE/AE was higher than the National average. The priority given to SSE was, however, not adequate as the SSE/AE ratio (29.66 *per cent*) was marginally lower than the all States average of 30.41 *per cent*. In 2008-09, however, there was adequate priority for all categories of expenditure compared to the National average including SSE.

In 2005-06, *per capita* DE (Rs 4,070), SSE (Rs 1,790) and CE (Rs 1,042) were higher than the National average *per capita* expenditure in these categories (Rs 3,010, Rs 1,490 and Rs 692 respectively). This means that the absorptive capacity⁴ was relatively high and that effective systems were in place to benefit people. Had the Government spent as much on SS as the

⁴ Absorptive capacity in this case refers to the ability of a State to implement a development scheme in such a way that with given resources, there is maximum benefit to the people. This is usually achieved when the design of schemes are well planned with careful risk mitigation strategy in place, administrative costs are low, operation maintenance, monitoring and control mechanisms are in place etc., so that the State is able to effectively achieve targeted outcomes.

National average, then the adjusted *per capita* expenditure on SS (calculated as per methodology given in **Box 1.4**) would have been even higher at Rs 1,859. In 2008-09, it was observed that the *per capita* expenditure in all categories viz DE, SSE and CE continued to be higher than the National average.

As the AE/GSDP ratio was lower in 2008-09 than the National average, an adjustment factor was applied to increase AE/GSDP ratio at least to the National average. *Per capita* expenditure in all categories viz., DE, SSE and CE was higher than the National average in 2008-09, once again indicating continued higher absorptive fiscal capacity of the State.

1.6.2 Efficiency of expenditure use

In view of the importance of public expenditure on development heads for social and economic development, it is imperative for the State Governments to take appropriate expenditure rationalization measures and lay emphasis on provision of core public and merit goods⁵. Apart from improving the allocation towards development expenditure⁶, particularly in view of the fiscal space being created on account of decline in debt servicing in recent years, the efficiency of expenditure use is also reflected by the ratio of capital expenditure to total expenditure and proportion of revenue expenditure being spent on operation and maintenance of the existing social and economic services. The higher the ratio of these components to total expenditure, the better would be the quality of expenditure. While **Table 1.15** presents the trends in development expenditure relative to the aggregate expenditure of the State during the current year *vis-à-vis* that of previous years, **Table 1.16** provides the details of capital expenditure and the components of revenue expenditure incurred on the maintenance of the selected social and economic services.

⁵ *Core public goods* are which all citizens enjoy in common in the sense that each individual's consumption of such a good leads to no subtractions from any other individual's consumption of that good, e.g. enforcement of law and order, security and protection of citizen's rights; pollution free air and other environmental goods and road infrastructure etc.

Merit goods are commodities that the public sector provides free or at subsidized rates because an individual or society should have them on the basis of some concept of need, rather than ability and willingness to pay the Government and therefore wishes to encourage their consumption. Examples of such goods include the provision of free or subsidized food for the poor to support nutrition, delivery of health services to improve quality of life and reduce morbidity, providing basic education to all, drinking water and sanitation etc.

⁶ The analysis of expenditure data is disaggregated into development and non development expenditure. All expenditure relating to revenue account, capital outlay and loans and advances is categorized into social, economic and general services. Broadly, the social and economic services constitute development expenditure, while expenditure on general services is treated as non-development expenditure.

Table-1.15: Development expenditure**(Rupees in crore)**

	2004-05	2005-06	2006-07	2007-08	2008-09
Development expenditure (DE)	19,323	22,734	29,953	33,642	37,134
Percentage of DE to total expenditure	64	67	71	72	71
Components of DE					
Revenue	14,234 (74)	16,846 (74)	21,377 (71)	24,577 (73)	27,010 (73)
Capital	4,538 (23)	5,604 (25)	8,222 (27)	8,310 (25)	9,395 (25)
Loans and advances	551 (3)	284 (1)	354 (1)	755 (2)	729 (2)

Figures in parentheses indicate percentage to development expenditure

Source: Finance Accounts.

Development expenditure comprising revenue, capital and expenditure on loans and advances on socio-economic services increased from Rs 19,323 crore in 2004-05 to Rs 37,134 crore in 2008-09. As a *percentage* of total expenditure, it increased from 64 in 2004-05 to 71 in 2008-09. In the current year, development expenditure as a percentage of aggregate expenditure, decreased by one *per cent* relative to the previous year due to decrease in development revenue expenditure and loans disbursed. On an average, 73 *per cent* of the development expenditure was on revenue account while capital expenditure including loans and advances accounted for the balance during 2004-09.

In 2008-09, development revenue expenditure included, *inter alia*, expenditure on salary (Rs 7,367 crore), subsidy (Rs 3,384 crore) and financial assistance to local bodies and other institutions (Rs 9,142 crore).

Table 1.16: Efficiency of expenditure use in selected social and economic services**(Ratios in per cent)**

	2007-08		2008-09	
	Ratio of CE to TE	Share of salaries (excluding wages and O&M) in RE	Ratio of CE to TE	Share of salaries (excluding wages and O&M) in RE
Social services (SS)				
Education, sports, art and culture	0.26	10.01	0.38	11.40
Health and family welfare	0.77	2.29	0.58	2.35
Water supply, sanitation, housing and urban development	4.32	0.05	3.72	0.05
Others	0.52	0.85	0.54	1.00
Total (SS)	5.87	13.20	5.22	14.80
Economic services (ES)				
Agriculture & allied activities	0.22	1.57	0.14	1.61
Irrigation and flood control	7.36	0.24	5.71	0.24
Power & energy	0.94	--	2.75	---

Transport	3.23	0.06	4.30	0.06
Others	1.77	0.94	1.25	0.98
Total (ES)	13.52	2.81	14.15	2.89
Total (SS+ES)	19.39	16.01	19.37	17.69
TE: Total expenditure; CE: Capital expenditure; RE: Revenue expenditure				

Expenditure on social services

Capital expenditure on social services decreased from Rs 2,743 crore in 2007-08 to Rs 2,728 crore in 2008-09 and there was a corresponding decrease in ratio of capital expenditure to total expenditure by about one *per cent*.

Capital expenditure on social services during 2008-09 included Rs 331 crore (13 *per cent*) on account of repayment of off budget borrowings.

The share of salary expenditure (under social services) in total revenue expenditure increased from 13 *per cent* in 2007-08 to 15 *per cent* in 2008-09.

While projecting the expenditure requirements for estimating the pre-devolution non-plan revenue deficit/surplus of the States during its award period 2005-10, TFC assigned different growth rates to NPRES in various sectors implicitly suggesting the changes in the expenditure pattern of the States. *Trends emerging from Finance Accounts, however, revealed that salary expenditure under NPRES in education and health and family welfare sectors increased by 25 and 9 per cent respectively as against six per cent and five per cent recommended by TFC. Non-salary component increased only by 16 per cent and 6 per cent respectively as against 30 per cent recommended for both these sectors.*

Expenditure on economic services

Capital expenditure on economic services increased from Rs 6,323 crore in 2007-08 to Rs 7,395 crore in 2008-09 with a growth rate of 17 *per cent*.

The priority sectors identified by the Government in respect of economic services were agriculture, power and rural development. In 2008-09, the capital outlay on power (Rs 937 crore) was more than twice the outlay in 2007-08. Capital outlay on power (Rs 937 crore) in 2008-09 included expenditure of Rs 87 crore on REC and PFC loans of KPTCL taken over by the Government. In 2008-09, capital outlay on agriculture and rural development was less by Rs 42 crore compared to 2007-08.

The share of salary expenditure (under economic services) in total revenue expenditure remained at three *per cent* in 2007-09.

Capital expenditure on economic services in 2008-09 included expenditure of Rs 557 crore (08 *per cent*) on repayment of off budget borrowings. It also included Rs 750 crore released to Karnataka Power Corporation (Rs 500 crore) and Karnataka Road Development Corporation (Rs 250 crore) which remained parked in public sector banks/Public Account as of March, 2009.

1.6.3 Effectiveness of expenditure, i.e., outlay-outcome relationship

Besides stepping up expenditure on key social and economic services, enhancing human development required the Government to improve the delivery mechanism to obtain the desired outcomes. To assess the effectiveness of the expenditure in terms of output/outcome, a critical analysis of two programmes is given at **Box 1.5**

Box –1.5

PDS aimed at ensuring availability of adequate food grains to public at affordable prices as well as enhancing food security to the poor. An expenditure of Rs 3,452.44 crore was incurred during 2004-09. Non-observance of GOI guidelines for identification of families living Below Poverty Line (BPL) resulted in inclusion of 75.40 lakh extra families in the BPL list over and above the 31.29 lakh families identified by GOI. Besides, lack of basic infrastructure in the wholesale godowns, non-viability of Fair Price Shops and weak monitoring of transportation and distribution of food grains affected the implementation of PDS.

NRHM aimed at carrying out necessary architectural corrections in the basic health care delivery system. An expenditure of Rs 1,065.56 crore was incurred on the programme. There were gaps in community participation in planning and preparation of village and block plans. Upgradation and construction of health care centres was delayed, centres lacked essential equipment and medical/para-medical staff affecting the service delivery at primary health centre and community health centre levels.

1.7 Analysis of Government expenditure and investments

In the post-FRA framework, the Government is expected to keep its fiscal deficit (borrowing) not only at low levels but also meet its capital expenditure/investment (including loans and advances) requirements. In addition, in a transition to complete dependence on market based resources, the State Government needs to initiate measures to earn adequate return on its investments and recover cost of borrowed funds rather than bearing the same on its budget in the form of implicit subsidy and take requisite steps to infuse transparency in financial operations. This section presents the broad financial analysis of investments and other capital expenditure undertaken by the Government during the current year *vis-à-vis* previous years.

1.7.1 Incomplete projects

Blocking of funds on incomplete works which include works stopped due to reasons like litigation, etc. impinge negatively on the quality of expenditure. The department-wise information pertaining to incomplete projects as of March 2009 is given in **Table 1.17**.

Table 1.17: Incomplete projects

(Rupees in crore)

Department	Incomplete projects					Cumulative expenditure as of March 2009
	Number	Budgeted cost	Revised cost	Cost over run [♦]		
				Number	Amount	
Public works						
Buildings	96	529.79	582.06	11	59.00	467.77
Roads & bridges	79	773.54	779.87	17	13.58	581.23
Irrigation	22	60.06	72.25	7	12.54	57.82
Total	197	1,363.39	1,434.18	35	85.12	1,106.82

Source: Finance Accounts

The initial budgeted cost of 197 works stipulated to be completed on or before March 2009 was Rs 1,363 crore and the progressive expenditure was Rs 1,107 crore. In 35 cases, the cost over run aggregated Rs 85.12 crore. No reasons for delay in completion of the works were given by the Public Works and Irrigation Departments.

1.7.2 Investment and returns

As of March 2009, Government had invested Rs 26,672 crore in 82 Government companies (Rs 24,052 crore); 17 statutory corporations (Rs 1,747 crore); 45 joint stock companies (Rs 534 crore) and co-operative societies (Rs 339 crore). The return from investment was negligible (Table 1.18).

Table-1.18: Return on investment

	2004-05	2005-06	2006-07	2007-08	2008-09
Investment at the end of the year (Rs in crore)	10,741.40	14,052.53	18,698.37	22,279.35	26,672.11
Return (Rs in crore)	16.7	16.9	19.5	23.4	40.2
Return (per cent)	0.2	0.1	0.1	0.1	0.1
Average rate of interest on Government borrowings (per cent)	8.5	7.6	7.7	7.6	6.9
Difference between interest rate and return (per cent)	8.3	7.5	7.6	7.5	6.8

Source: Finance Accounts.

Out of the total investment of Rs 26,672 crore to end of 2008-09, investment of Rs 18,498 crore (69 per cent) during 2004-09 was in 19 Government companies and Statutory corporations under irrigation sector (Rs 12,264 crore), transport sector (Rs 1,964 crore), infrastructure sector (Rs 1,072 crore), power sector (Rs 1,050 crore), industries sector (Rs 854 crore), housing sector (Rs 758 crore), financing sector (Rs 224 crore), construction sector (Rs 182 crore) and social security sector (Rs 130 crore).

[♦] includes 22 cases where expenditure over run of Rs 14.33 crore was on the budgeted cost (buildings Rs 6.71 crore in nine cases ; roads and bridges Rs 7.26 crore in 12 cases ; irrigation Rs 0.36 crore in one case).

The investment included Rs 10,820 crore (58 per cent) to the following companies/corporations under perennial loss (**Table 1.19**).

Table 1.19: Investment in companies/corporations under perennial loss
(Rupees in crore)

Company/Corporation	Investment during 2004-09	Cumulative loss
Krishna Bhagya Jala Nigam Limited	8,822	65
Karnataka Road Development Corporation Ltd	1,664	79
Karnataka State Road Transport Corporation, Bangalore	132	125
North Western Karnataka Road Transport Corporation	112	265
North Eastern Karnataka Road Transport Corporation	56	264
D.Devraj Urs Backward Classes Development Corporation Ltd, Bangalore	34	27
Total	10,820	825

Source : Finance Accounts.

During the year, Government invested Rs 4,393 crore in Government companies (Rs 3,317 crore), Statutory corporations (Rs 575 crore), joint stock companies (Rs 500 crore) and (Rupees one crore) in co-operative institutions. This included

- Rs 224 crore invested in Karnataka State Financial Corporation which had a negative net-worth (Rs 200 crore) and for conversion of corporation's dividend liability to the Government into equity (Rs 24 crore).
- Repayment of off-budget borrowings aggregating Rs 635 crore of seven companies/corporations.

1.7.3 Departmental undertakings

Nineteen undertakings of certain Government departments performed activities of quasi-commercial nature. According to the latest accounts furnished by six undertakings, the State Government's investment was Rs 12.81 crore. The total loss incurred by these undertakings was Rs 5.42 crore. Details are furnished in **Appendix 1.6**.

In view of the continued loss of these undertakings, the Government should review their working so as to wipe out their losses in the short term and make these self sustaining in medium to long term.

1.7.4 Loans and advances by the State Government

In addition to investments in companies, corporations and co-operative institutions, Government also provided loans and advances to many institutions/organizations. **Table 1.20** presents the position of outstanding loans and advances as of March 2009 and interest receipts *vis-à-vis* interest payments during the last five years.

**Table-1.20: Average interest received on loans advanced by the State Government
(Rupees in crore)**

	2004-05	2005-06	2006-07	2007-08	2008-09
Opening balance	5,203	5,768	5,944	6,241	6,946
Amount advanced during the year	611	300	357	757	731
Amount repaid during the year	46	124	60	52	57
Closing balance	5,768	5,944	6,241	6,946	7,620
Net addition	565	176	297	705	674
Interest receipts	88	95	38	58	103
Interest receipts as <i>per cent</i> to outstanding loans and advances	1.5	1.6	0.6	0.8	1.3
Interest payments as <i>per cent</i> to outstanding fiscal liabilities of the State Government.	8.1	7.2	7.3	7.5	6.3
Difference between interest payments and interest receipts (<i>per cent</i>)	-6.6	-5.6	-6.7	-6.7	-5.0

Source: Finance Accounts.

Total loans outstanding as of March 2009 aggregated Rs 7,620 crore. Interest spread of government borrowings was negative during 2004-09 which meant that the State's borrowings were more expensive than the loans advanced by it.

Loans aggregating Rs 731 crore were disbursed during 2008-09 which included interest free loan of Rs 500 crore to KPTCL. Terms and conditions of repayment were not received for loans amounting to Rs 728 crore.

Recovery of loans and advances aggregating Rs 1,579 crore (principal: Rs 629 crore and interest: Rs 950 crore) was overdue as of March 2009, from 34 institutions (detailed accounts of which were kept by the Accountant General, (Accounts and Entitlements). Around 71 *per cent* of this pertained to five major defaulters viz., Karnataka Urban Water Supply and Drainage Board, Bangalore Water Supply and Sewerage Board, Karnataka Housing Board, New Government Electric Factory and Mysore Sugar Company. In these cases the overdue interest (Rs 763 crore) was more than twice the amount of the principal (Rs 363 crore) due for recovery.

1.7.5 Cash balances and investment of cash balances

Table 1.21 depicts the cash balances and investments made there from by the State Government during the year.

Table-1.21: Cash balances and investment of cash balances**(Rupees in crore)**

	As of March 2008	As of March 2009	Increase(+/ Decrease (-)
Cash balances	3,919.45	7,819.85	3,900.40
Investments from cash balances	3,480.49	7,519.31	4,038.82
GOI treasury bills	3,480.16	7,518.98	4,038.82
GOI securities	0.21	0.32	0.11
Other securities	0.11	---	-0.11
Other investments	0.01	0.01	---
Funds-wise break-up of investment from earmarked balances	343.15	652.92	309.77
Sinking fund	0.09	-0.06	-0.15
Industrial development fund	0.01	0.01	---
Co-operative development fund	0.49	0.49	---
Other development and welfare fund	342.55	652.47	309.92
Miscellaneous deposits	0.01	0.01	---
Interest realized	315.87	232.53	-83.34

Source : Finance Accounts.

The efficiency of handling cash balances by the State Government can also be assessed by monitoring the trends in monthly average daily cash balances held to meet normal banking transactions. **Table 1.22** presents the trends in monthly average daily cash balances and the investments in treasury bills for the last three years (2006-09).

Table 1.22: Trends in monthly average daily cash balances and the investments in treasury bills**(Rupees in crore)**

Month	Monthly average daily cash balances			Investment in 14 days treasury bills		
	2006-07	2007-08	2008-09	2006-07	2007-08	2008-09
April	35.83	416.71	877.76	451.82	479.28	447.76
May	43.06	334.29	721.55	338.96	410.45	346.96
June	37.30	334.47	729.43	282.95	452.19	287.18
July	34.62	341.07	734.67	323.60	280.22	238.25
August	40.37	381.10	814.56	358.90	415.95	384.51
September	54.89	443.90	836.56	359.40	438.90	295.59
October	77.97	452.91	959.49	448.21	156.48	347.01
November	71.08	488.56	910.38	446.13	291.17	344.50
December	111.39	499.26	984.06	515.24	559.18	246.06
January	129.20	569.21	955.82	414.49	349.17	479.88
February	152.33	541.82	1048.98	696.32	348.44	542.49
March	233.72	645.40	1,004.47	1,341.00	530.90	1,123.77

Source: Statement of daily transactions from Reserve Bank of India(RBI)

Except for 2004-05 and 2007-08, when the Government availed of ways and means advances for 61 and four days respectively, the cash-balance position of the Government during the period 2004-09 improved relative to the pre-FRA period. The improved position was reflected by its ways and means and overdraft position as these are resorted to when the Government daily balance with

the RBI was below the prescribed limit. The State did not avail of over-draft facility in any year during this period.

The cash surplus of the State at the end of the year was Rs 7,820 crore, an increase of 100 *per cent* over the previous year. The cost of holding the surplus balances is brought out in the **Box 1.6**.

Box – 1.6 Cost of holding surplus cash balances

Surplus cash balance was mainly due to market borrowings of Rs 7,417 crore raised during 2008-09 on 14 January (Rs 1,500 crore), 2 March (Rs 3,000 crore) and 18 March (Rs 2,917 crore).

The entire loan amount was invested in fourteen days intermediate treasury bills of RBI with an interest rate of 5 *per cent* per annum as against an average rate of 7 *per cent* per annum on market borrowings. The amount of investments at the year end was Rs 7,533 crore. The average balance of investments in April, May and June 2009 was Rs 4,802 crore, Rs 5,116 crore and Rs 4,886 crore respectively. The balance at the end of June 2009 after meeting all short term liabilities of the State Government was Rs4,277 crore.

In view of the comfortable position of cash balances, the open market borrowings, could have been limited to Rs 3,140 crore to meet the short term liabilities of the Government. Additional borrowings of Rs 4,277 crore at the close of the financial year resulted in net interest burden of Rs 41.85 crore up to the end of June 2009.

1.8 Assets and liabilities

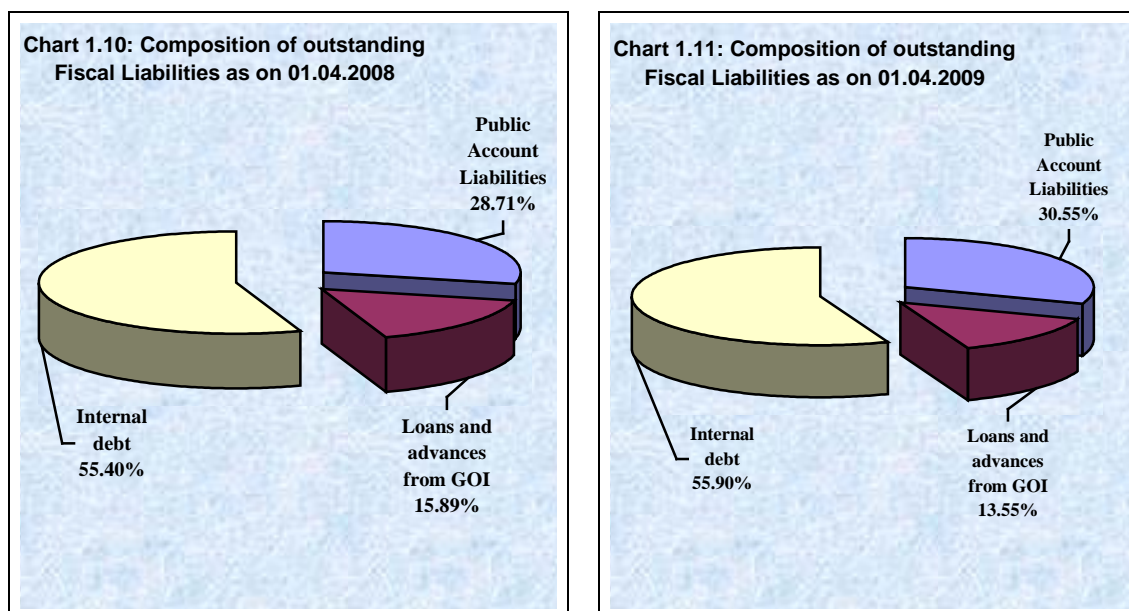
1.8.1 Growth and composition of assets and liabilities

In the existing Government accounting system, comprehensive accounting of fixed assets like land and buildings owned by the Government is not done. However, the Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure incurred. **Appendix 1.5** gives an abstract of such liabilities and assets as on 31 March 2009 compared with the corresponding position as on 31 March 2008. While liabilities consist mainly of internal borrowings, loans and advances from GOI, receipts from Public Account and Reserve funds, the assets comprise mainly the capital outlay, loans and advances given by the State Government and cash balances. Total liabilities, as defined in the Karnataka Fiscal Responsibility Act, 2002 are the liabilities under the Consolidated Fund and the Public Account of the State. The liabilities of the State as depicted in Finance Accounts, however, did not include pension, other retirement benefits payable to retired/retiring State Government employees/guarantees/letters of comfort issued by the State Government and borrowings through special purpose vehicles, termed off-budget borrowings.

The growth rate of assets increased from 12 per cent in 2007-08 to 23 per cent in 2008-09, while that of liabilities increased from six per cent in 2007-08 to 20 per cent in 2008-09.

1.8.2 Fiscal liabilities

The trends in outstanding fiscal liabilities of the State are presented in **Appendix 1.4**. The composition of fiscal liabilities during the current year *vis-à-vis* the previous year, are presented in **Charts 1.10 and 1.11**.



Source: Finance Accounts.

There are two sets of liabilities namely, public debt and other liabilities. Public debt consists of internal debt of the State and is reported in the annual financial statements under the Consolidated Fund – capital account. It includes market loans, special securities issued to RBI and loans and advances from GOI. The Constitution of India provides that State may borrow within the territory of India upon the security of its Consolidated Fund, within such limits, as may from time to time, be fixed by an Act of the Legislature and give guarantees within such limits as may be fixed. Other liabilities which are a part of Public Account include deposits under small savings scheme, provident funds, and other deposits.

Fiscal liabilities of the State, their rate of growth, ratio of these liabilities to GSDP, revenue receipts and own resources as well as buoyancy of fiscal liabilities with respect to these parameters is brought out in **Table 1.23**.

Table 1.23: Fiscal liabilities –basic parameters

(Rupees in crore and ratios in per cent)					
	2004-05	2005-06	2006-07	2007-08	2008-09
Fiscal liabilities	46,940	52,236	57,682	60,142	71,550
Rate of growth (<i>per cent</i>)	11.8	11.3	10.4	4.3	19.0
Ratio of fiscal liabilities to					
GSDP	30.04	28.05	28.71	25.72	26.68
Revenue receipts	176.7	172.1	153.5	146.1	165.3
Own resources	228.5	232.1	210.5	204.9	232.3
Buoyancy ratio of fiscal liabilities to					
GSDP	0.61	0.59	1.32	0.26	1.29
Revenue receipts	0.4	0.8	0.4	0.5	3.6
Own resources	0.4	1.2	0.5	0.6	3.8

Source: Finance Accounts.

Fiscal liabilities of the State increased by 52 *per cent* from Rs 46,940 crore in 2004-05 to Rs 71,550 crore in 2008-09 comprising Consolidated Fund liabilities (Rs 49,688 crore) and Public Account liabilities (Rs 21,862 crore).

Consequent upon the implementation of FRA and restriction on borrowings (fiscal deficit) to three *per cent* of GSDP, the rate of growth of fiscal liabilities of the State decreased from 12 *per cent* in 2004-05 to 4 *per cent* in 2007-08. With the announcement of economic stimulus package by GOI and consequent amendment to FRA raising the limit of fiscal deficit to 3.5 *per cent* of GSDP during the year 2008-09, the growth rate of fiscal liabilities increased to 19 *per cent*. As a result, buoyancy of fiscal liabilities to GSDP which was less than one during 2007-08, increased to more than one in 2008-09. The ratio of fiscal liabilities to GSDP was 27 *per cent* at the end of 2008-09.

1.8.3 Contingent liabilities -status of guarantees

Guarantees are contingent liabilities on the Consolidated Fund of the State in case of default by the borrower for whom the guarantee was extended. The details of last three years are given in **Table 1.24**.

Table-1.24: Guarantees given by the State Government

(Rupees in crore)			
	2006-07	2007-08	2008-09
Maximum amount guaranteed	19,793	23,109	18,732
Outstanding amount of guarantees (including interest)	9,879	10,786	8,693
Percentage of outstanding amount guaranteed to total revenue receipts of the second preceding year	37	36	23

Source: Finance Accounts.

The Karnataka Ceiling on Government Guarantees Act, 1999 provides for a cap on outstanding guarantees extended by the Government at the end of any year at 80 *per cent* of the State's revenue receipts of the second preceding year. The outstanding guarantees at the end of the years 2006-07, 2007-08 and 2008-09 were within the prescribed limit.

The outstanding guarantees of Rs 8,693 crore at the end of the year 2008-09 included guarantees extended to 18 institutions/companies under irrigation sector (Rs 1,863 crore), co-operative sector (Rs 1,818 crore), financing sector (Rs 852 crore), power sector (Rs 845 crore), housing sector (Rs 739 crore), transport sector (Rs 684 crore) and water supply and urban development sector (Rs 567 crore). Outstanding guarantees extended to institutions⁷ which were either closed or sick/liquidated/under liquidation amounted to Rs 59.33 crore.

Outstanding guarantees as reported by the Government included liability of Rs 7.77 crore pertaining to Malaprabha co-operative spinning mill discharged by the Government.

To provide for sudden discharge of States' obligations on guarantees, TFC recommended that States should set up Guarantee Redemption Fund through earmarked guarantee fees. The State had set up a Guarantee Reserve Fund in 1999-2000 with a corpus of one crore. However, there was no transaction though there were guarantee commission receipts and expenditure on account of discharge of guarantee obligation. The State Government stated (April 2009) that transfer of receipts and expenditure pertaining to the fund would be considered at the appropriate time.

1.8.4 Off - budget borrowings

The borrowings of the State Government are governed under Article 293 of the Constitution of India. In addition to the contingent liabilities shown in **Table 1.25**, the State guaranteed loans availed of by Government companies/corporations. These companies/corporations borrowed funds from the market/financial institutions for implementation of various State plan programmes projected outside the State budget. Funds for these programmes were to be met out of resources mobilized by these companies/corporations outside the State budget but in reality the borrowings of these concerns ultimately turn out to be the liabilities of the State Government termed 'off-budget borrowings' and the Government had been repaying the loans availed of by these companies/corporations including interest through regular budget provision under capital account. Thus, the capital expenditure of the State during the current year included interest expenditure (Rs 595 crore) which was revenue in nature.

Table 1.25 captures the trend in the off-budget borrowings of the State during 2004-09 while **Table 1.26** gives the entity-wise position of borrowings to the end of 2008-09.

Table 1.25: Trend in off-budget borrowings

Year	(Rupees in crore)				
	2004-05	2005-06	2006-07	2007-08	2008-09
Amount as per MTFP 2007-11 [*]	838	1,078	242	103	---Nil---

^{*} figures are yet to be reconciled with those of the financial institutions.

⁷ Raibagh Sahakara Sakkare Kharkhane -liquidated (Rs 53.88 crore), Coorg Orange Growers Society Ltd.-Sick(Rs 0.14 crore), KAIC- closed(Rs 0.91 crore), Gangavati Sugars- under liquidation (Rs 4.40 crore)

Table 1.26: Entity-wise position of off-budget borrowings
(Rupees in crore)

Company/Corporation/Board	Off-budget borrowings	Repayment	
		Principal	Interest
Krishna Bhagya Jala Nigam Limited	2,483.17	1.94	0.51
Karnataka Neeravari Nigam Limited	638.00	31.00	44.80
Karnataka Road Development Corporation	805.63	318.23	300.68
Rajiv Gandhi Rural Housing Corporation	588.34	70.40	46.87
Karnataka Slum Clearance Board	250.55	41.23	17.21
Karnataka Police Housing Corporation	280.93	30.55	0.39
Karnataka Land Army Corporation	160.00	75.33	113.63
Karnataka Renewable Energy Development Limited	0.39	0.19	0.05
Cauvery Neeravari Nigam Limited	789.55	51.00	61.41
Karnataka Residential Education Institution Society	76.30	10.87	8.10
Karnataka State Industrial Investment Development Corporation	7.39	7.39	0.23
Karnataka State Electronics Development Corporation Limited	61.35	0	-
Mahithi bonds	60.00	0	-
Sarva Siksha Abhiyan Samithi	20.00	2.22	1.03
Total	6,221.60	640.35	594.91

Source: As reported by the concerned entities.

In compliance with the commitment made in MTFP 2009-13, off-budget borrowings were eliminated from 2008-09 to ensure transparency in fiscal performance.

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2009 worked out to Rs 77,131 crore⁸ as against Rs 71,550 crore shown in **Table 1.23** and the ratio of fiscal liabilities (inclusive of off-budget borrowings) to GSDP would increase to 29 per cent at the end of the year as against 28 per cent in the previous year

1.9 Debt sustainability

Apart from the magnitude of debt of the State Government, it is important to analyze various indicators that determine the debt sustainability⁹ of the State. This section assesses the sustainability of debt of the State Government in terms of debt stabilization¹⁰; sufficiency of non-debt receipts¹¹; net availability

⁸ Total fiscal liabilities: Rs 71,550 crore plus balance of off-budget borrowings; Rs 5,581 crore.

⁹ The Debt sustainability is defined as the ability of the State to maintain a constant debt-GDP ratio over a period of time and also embodies the concern about the ability to service its debt. Sustainability of debt therefore also refers to sufficiency of liquid assets to meet current or committed obligations and the capacity to keep balance between costs of additional borrowings with returns from such borrowings. It means that rise in fiscal deficit should match with the increase in capacity to service the debt.

¹⁰ A necessary condition for stability states that if the rate of growth of economy exceeds the interest rate or cost of public borrowings, the debt-GDP ratio is likely to be stable provided

of borrowed funds¹²; burden of interest payments (measured by interest payments to revenue receipts ratio) and maturity profile of the State Government securities. **Table 1.27** analyzes the debt sustainability of the State according to these indicators for the period 2004-09.

Table 1.27: Debt sustainability: Indicators and trends

Debt sustainability indicators	2004-05	2005-06	2006-07	2007-08	2008-09
Debt stabilization (Rs in crore) (Quantum spread +/- Primary deficit/ surplus)	5,264	6,137	-337	4,466	1,381
Sufficiency of incremental non-debt receipts (resource gap) (Rs in crore)	2,146	750	1,777	-138	-2,205
Net availability of borrowed Funds	4	6	5	---	21
Burden of interest payments (IP/RR Ratio)	14.3	12.4	11.3	10.9	10.5
Maturity profile of State debt (in years)					
0 – 1					1,046 (6)
1 – 3					3,866 (21)
3 – 5					3,998 (21)
5 – 7					1,494 (8)
7 and above					8,168 (44)

Figures in parenthesis denote the percentage to market borrowings of Rs 18,573 crore

Source: Finance Accounts.

1.9.1 Debt stability

An important condition for debt sustainability is stabilization in terms of debt/GSDP ratio. According to Domar's debt stability equation, if the rate of growth of economy exceeds the cost of borrowings, the debt-GSDP ratio is likely to be stable provided primary balances are positive /zero/moderately negative. Primary revenue balance is the difference between revenue receipts and primary revenue expenditure and indicates whether the balance of revenue receipts left out after meeting current revenue expenditure is sufficient for meeting the interest expenditure. During 2004-09, the primary revenue balance was positive and sufficient to meet interest expenditure and the debt-GSDP ratio was less than one.

When the quantum spread and primary deficit are negative, debt-GSDP ratio will be high indicating unsustainable levels of public debt and when the

primary balances are either zero or positive or are moderately negative. Given the rate spread (GSDP growth rate – interest rate) and quantum spread (Debt*rate spread), debt sustainability condition states that if quantum spread together with primary deficit is zero, debt-GSDP ratio would be constant or debt would stabilize eventually. On the other hand, if primary deficit together with quantum spread turns out to be negative, debt-GSDP ratio would be rising and in case it is positive, debt-GSDP ratio would eventually be falling.

¹¹ Adequacy of incremental non-debt receipts of the State to cover the incremental interest liabilities and incremental primary expenditure. The debt sustainability could be significantly facilitated if the incremental non-debt receipts could meet the incremental interest burden and the incremental primary expenditure.

¹² Defined as the ratio of the debt redemption (principal + interest payments) to total debt receipts and indicates the extent to which the debt receipts are used in debt redemption indicating the net availability of borrowed funds.

quantum spread and primary deficit are positive, debt-GSDP ratio will be low indicating sustainable levels of public debt.

Interest spread is the difference between average lending rate and average borrowing rate. In terms of GSDP growth rate, it is the difference between the growth rate of economy and the average interest rate (Domar's gap). When GSDP growth rate exceeds the average interest rate, the interest spread and quantum spread will be positive and when it is less than the average interest rate, the interest spread and quantum spread will be negative.

During the period 2004-06, the GSDP growth rate was more than the average interest rate and the State had a positive interest spread and quantum spread.

In 2006-07, slow down in the growth rate of GSDP and shift to primary deficit brought down debt sustainability though the interest spread and quantum spread remained positive. In the current year, GSDP growth rate as well as the interest rate decreased over the previous year and the quantum spread was Rs 5,581 crore and this positive gap absorbed the primary deficit of Rs 4,200 crore.

1.9.2 Sufficiency of incremental non-debt receipts

Another indicator of debt sustainability is the adequacy of incremental non-debt receipts of the State to cover the incremental interest liabilities and incremental primary revenue expenditure. Debt sustainability could be facilitated if the incremental non-debt receipts could meet the incremental interest burden and the incremental primary expenditure. Negative resource gap indicates non-sustainability of debt while positive resource gap indicates sustainability of debt. The resource gap which turned negative in 2007-08 continued to be negative in 2008-09 and the amount of negative resource gap increased due to fall in incremental non-debt receipts and increase in primary expenditure.

1.9.3 Net availability of borrowed funds

Debt sustainability also depends on the ratio of debt redemption (principal + interest payments) to total debt receipts and application of available borrowed funds. The ratio of debt redemption to debt receipts indicates the extent to which the debt receipts are used in debt redemption indicating the net availability of borrowed funds.

Debt redemption ratio which was more than one in 2007-08 reduced to less than one (0.79) in 2008-09 as debt redemption was lower than debt receipts indicating availability of 21 *per cent* of debt receipts for productive expenditure.

1.9.4 Maturity profile

In terms of maturity profile, around 44 *per cent* of the outstanding stock of Government securities at the end of the year belonged to maturity bracket of seven years and above. Repayment obligation of the State would increase from 2012-13 due to huge market borrowings during 2002-03 and 2004-05 under Debt Swap Scheme. Repayment obligations would increase more than two-fold in 2018-19 compared to 2017-18 due to huge market borrowings in 2008-09.

The Government created a sinking fund for open-market loans and the fund consists of two components-sinking fund (amortisation) and sinking fund (depreciation). The amortisation fund was to accommodate contributions from revenue for repayment of loans on maturity while the depreciation fund was to be fed annually by loans. However, there had been no accretion to the sinking fund since 1999-2000. *The Government should revive the fund in compliance to the recommendation of TFC which would help the State to meet the sudden increase in the amount of debt-servicing from 2013 onwards when huge chunk of market borrowings starts maturing.*

1.9.5 Burden of interest payments

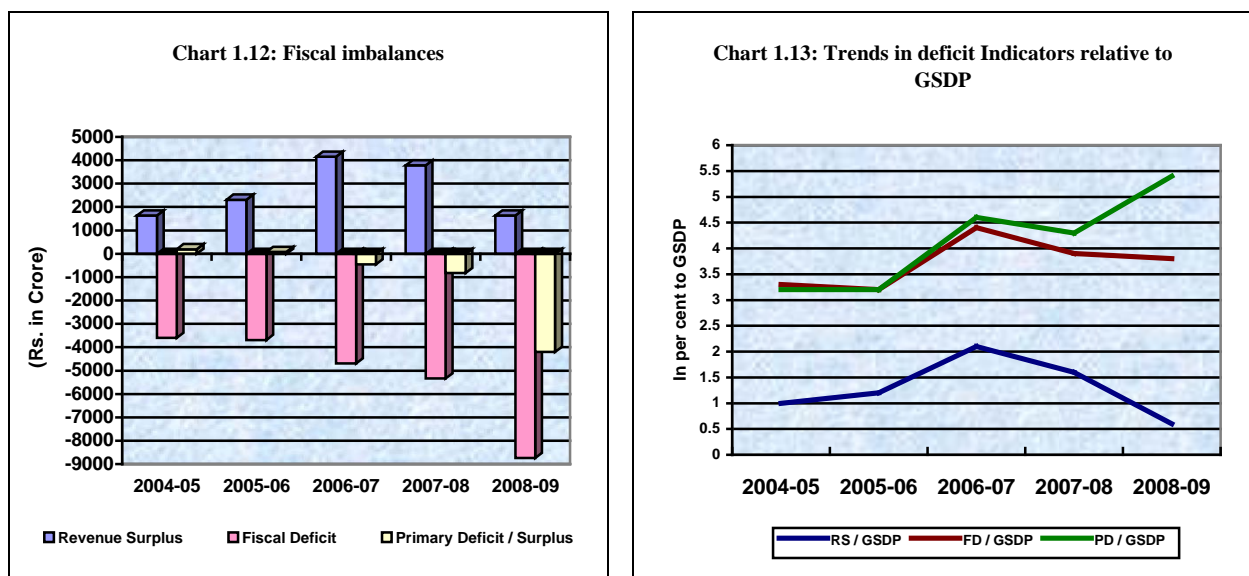
The ratio of interest payments to revenue determines the debt sustainability of the State. *During the year, interest payments pre-empted 10 per cent of the total revenue receipts of the State which was below the norm of 15 per cent prescribed by TFC.* On account of achievement of targets under FRA, the State benefited in terms of interest relief (Rs 1,051 crore) under DCRF scheme during 2005-09 which helped in stabilization of interest payments as a ratio of revenue receipts.

1.10 Fiscal imbalances

Three key fiscal parameters - revenue, fiscal and primary deficits, indicate the extent of overall fiscal imbalances in the State finances during a specified period. The deficit in the Government account represents the gap between receipts and expenditure. The nature of deficit is an indicator of the prudence of fiscal management of the Government. Further, the ways in which the deficit is financed and the resources raised are applied are important pointers to fiscal health. This section presents trends, nature, magnitude and the manner of financing these deficits and also the assessment of actual levels of revenue and fiscal deficits *vis-à-vis* targets set under FRA for the financial year 2008-09.

1.10.1 Trends in deficits

Charts 1.12 and 1.13 present the trends in deficit indicators over the period 2004-09



The fiscal target of wiping out revenue deficit by March 2006 as laid down in FRA was achieved by the State one year ahead in 2004-05. Thereafter the State maintained revenue surplus till 2008-09 with inter-year variation. The decrease in the amount of revenue surplus began in 2007-08 and in 2008-09 revenue surplus further decreased by Rs 2,145 crore over the previous year.

The deterioration in revenue account of the State in 2008-09 was due to growth of revenue expenditure by Rs 4,285 crore (11 per cent) as against increase in revenue receipts by Rs 2,140 crore (five per cent). The low growth rate of own tax revenue (six per cent) and negative growth rate of non-tax revenue reduced the revenue surplus of the State.

FRA target of reducing fiscal deficit –GSDP ratio to less than three per cent was also achieved one year ahead in 2004-05. Buoyant revenue receipts during 2004-07, realisation of capital receipts from sale of land in 2007-08 and restricted borrowings were some factors that helped in reducing fiscal deficit-GSDP ratio to less than three per cent.

In 2008-09, decrease in revenue surplus (Rs 2,145 crore), decrease in non-debt capital receipts (Rs 60 crore) and increase in capital expenditure including loans and advances (Rs 1,195 crore) increased the fiscal deficit by Rs 3,400 crore over the previous year. During the year, fiscal deficit of Rs 8,732 crore as a ratio of GSDP was more than the previous year but was within the revised FRA limit of 3.5 per cent.

Increase in fiscal deficit by Rs 3,400 crore and a marginal increase in interest payments by Rs 26 crore during the year increased the primary deficit by Rs 3,374 crore. Primary deficit of Rs 4,200 crore at the end of the year implied that revenue and non-debt receipts were sufficient for meeting only

primary revenue expenditure and underlined the need for augmentation of own revenue for fiscal correction and consolidation.

1.10.2 Components of fiscal deficit and its financing pattern

The financing pattern of fiscal deficit has undergone a compositional shift as reflected in the **Table 1.28**.

Table 1.28: Components of fiscal deficit and its financing pattern

(Rupees in crore)

		2004-05		2005-06		2006-07		2007-08		2008-09	
		Amount	per cent of GSDP	Amount	per cent of GSDP	Amount	per cent of GSDP	Amount	per cent of GSDP	Amount	Per cent of GSDP
Decomposition of fiscal deficit		-3,600	2.4	-3,687	2.0	-4,688	2.3	-5,332	2.2	-8,732	3.3
1	Revenue surplus	1,638	1.0	2,311	1.2	4,152	2.1	3,776	1.6	1,631	0.6
2	Net capital expenditure	4,674	3.0	5,822	3.1	8,543	4.3	8,403	3.5	9,689	3.6
3	Net loans and advances	564	0.4	176	0.1	297	0.1	705	0.3	674	0.3
Financing pattern of fiscal deficit*											
1	Market borrowings	2,116	1.4	165	0.1	-233	-0.1	287	0.1	6,583	2.5
2	Loans from GOI	-1,851	-1.2	251	0.1	-83	0	357	0.2	135	0.1
3	Special securities issued to NSSF	4,386	2.8	4,272	2.3	2,478	1.2	209	0.1	-164	-0.1
4	Loans from financial institutions	-171	-0.1	164	0.1	-366	-0.2	174	0.1	260	0.1
5	Small savings, PF etc	585	0.4	656	0.4	659	0.3	749	0.3	1,176	0.4
6	Deposits and advances	-562	-0.4	-368	-0.2	1,805	0.9	-62	0	1,554	0.6
7	Suspense and misc	265	0.2	523	0.3	237	0.1	1,498	0.6	968	0.4
8	Remittances	109	0.1	40	0	514	0.2	-828	-0.4	-52	0
9	Reserve funds	465	0.3	473	0.3	1,188	0.6	750	0.3	2,174	0.8
10	Increase (-) / decrease (+) in cash balance	-1,744	-1.1	-2,528	-1.4	-1,498	-0.7	2,185	0.9	-3,900	-1.5
11	Net of Contingency Fund transactions	2		39		-13		13		-2	
Total		3,600	2.4	3,687	2.0	4,688	2.3	5,332	2.2	8,732	3.3

* All these figures are net disbursements/outflows during the year

Source: Finance Accounts.

Fiscal deficit is the total borrowing requirement of the State and is the excess of revenue expenditure and capital expenditure including loans and advances over revenue and non-debt capital receipts. Decomposition of fiscal deficit reveals the extent of various borrowings resorted to by the State to meet its requirement of funds over and above revenue and non-debt receipts.

The extent to which revenue surplus of the State financed its fiscal deficit decreased with the declining trend of revenue surplus from 2007-08. While the percentage of fiscal deficit financed by surplus revenue was 89 in 2006-07, it was 71 and 19 in 2007-08 and 2008-09 respectively.

There was also a compositional shift in the pattern of financing fiscal deficit in 2008-09 relative to the previous years. The role of market borrowings and NSSF loans in financing fiscal deficit underwent significant change in the current year.

NSSF loans were the major player in financing fiscal deficit during 2004-05 and 2005-06. Market borrowings by the State Government based on necessity rather than availability during 2005-08 resulted in these borrowings financing less than five *per cent* of the fiscal deficit of the State during that period. In contrast, in 2008-09 market borrowings emerged as the main source of financing fiscal deficit.

On account of build-up of funds in Public Account - debts, deposits and advances, small savings, provident fund, etc. 67 *per cent* of the fiscal deficit was financed by Public Account receipts. These are receipts in respect of which the Government has a liability in future.

Loans from GOI financed a small portion of fiscal deficit on account of phasing out of GOI loans in accordance with the recommendations of TFC.

1.10.3 Quality of deficit/surplus

The ratio of revenue deficit to fiscal deficit and the decomposition of primary deficit into primary revenue deficit and capital expenditure (including loans and advances) indicate the quality of deficit in the States' finances. The ratio of revenue deficit to fiscal deficit indicates the extent to which borrowed funds were used for current consumption. Further, persistently high ratio of revenue deficit to fiscal deficit also indicates that the asset base of the State was continuously shrinking and a part of borrowings (fiscal liabilities) were not having any asset backup. The bifurcation of the primary deficit (**Table 1.29**) indicates the extent to which the deficit was on account of enhancement in capital expenditure which might be desirable to improve the productive capacity of the State's economy.

Table 1.29: Primary deficit/surplus – Bifurcation of factors

(Rupees in crore)

Year	Non-debt receipts	Primary revenue expenditure	Capital expenditure	Loans and advances	Primary expenditure	Primary revenue deficit (-) /surplus (+)	Primary deficit (-) /surplus (+)
1	2	3	4	5	6 (3+4+5)	7 (2-3)	8 (2-6)
2004-05	26,617	21,138	4,674	611	26,423	5,479	194
2005-06	30,476	24,276	5,822	300	30,398	6,200	78
2006-07	37,647	29,199	8,543	357	38,099	8,448	-452
2007-08	41,449	32,869	8,649	757	42,275	8,580	-826
2008-09	43,528	37,127	9,870	731	47,728	6,401	-4,200

Source : Finance Accounts.

Primary surplus showed declining trend in 2005-06 and turned negative in 2006-07 and primary deficit showed increasing trend thereafter.

During the period 2006-09, non-debt receipts of the State were sufficient to meet only primary revenue expenditure but were not sufficient to meet the expenditure on capital account including loans and advances. In 2008-09, primary deficit was Rs 4,200 crore which was the extent of gap between non-debt receipts and primary expenditure of the State arising on account of capital expenditure and disbursement of loans and advances.

Deficit arising on account of capital expenditure and loans and advances implied that capital expenditure was not always productive or healthy as it included debt-servicing expenditure and disbursement of interest free loans.

1.10.4 State's own revenue and deficit correction

It is worthwhile to observe the extent to which the deficit correction is achieved by the State on account of improvement in its own resources which is an indicator of the durability of the correction in deficit indicators

Table 1.30 presents receipts and expenditure on revenue account of the State as a *per cent* of GSDP to examine the source of fiscal imbalance, revenue and deficit correction.

Table 1.30: Change in revenue receipts and correction of deficit
(*per cent* of GSDP)

	2006-07	2007-08	2008-09	
			BE	Actual
Revenue receipts	18.7	17.6	19.4	16.1
State's own tax revenue	11.6	11.1	13.1	10.3
State's own non- tax revenue	2.0	1.4	0.8	1.2
State's share in Central taxes and duties	2.7	2.9	3.3	2.6
Grants-in-aid	2.4	2.2	2.2	2.0
Revenue expenditure	16.6	16.0	18.7	15.5
Revenue surplus	2.1	1.6	0.6	0.6
Fiscal deficit	2.3	2.3	2.9	3.2

Total revenue receipts of the State as a *per cent* of GSDP was on declining trend from 2006-07 onwards. The ratio fell from 19 *per cent* of GSDP in 2006-07 to 16 *per cent* in 2008-09 mainly due to deceleration in the growth rate of State's own tax revenue and non-tax revenue.

Tax revenue was 10 *per cent* of GSDP in 2008-09 as against estimated 13 *per cent* on account of reduced buoyancy of taxes on sales, trade, etc, motor vehicles tax and stamps and registration fee.

Negligible returns from investments coupled with non-revision of user charges pertaining to socio-economic services resulted in fall in non-tax revenue from two *per cent* of GSDP in 2006-07 to one *per cent* in 2008-09.

Revenue expenditure decreased from 17 *per cent* GSDP in 2006-07 to 16 *per cent* in 2008-09 while there was no increase in capital expenditure, including loans and advances, as a *per cent* of GSDP.

There was a decrease in the revenue surplus of the State by Rs 2,521 crore from Rs 4,152 crore in 2006-07 to Rs 1,631 crore in 2008-09. It came down from two *per cent* of GSDP in 2006-07 to one *per cent* in 2008-09.

Fiscal deficit increased from 2.3 *per cent* of GSDP in 2006-07 to 3.2 *per cent* in 2008-09 but was within the FRA limit of 3.5 *per cent*.

1.11 Conclusion and recommendations

● **Fiscal position**

The State continued to maintain revenue surplus during 2004-09 and kept fiscal deficit relative to GSDP below the limit laid down under FRA. The fiscal position of the State viewed in terms of trends in deficit indicators revealed deterioration in 2007-08 and 2008-09 relative to 2006-07 as revenue surplus declined and fiscal and primary deficits increased. The deterioration in fiscal performance during the current year was primarily on account of a relatively lower growth rate in the State's own resources.

Recommendations: The State Government should mobilize additional resources both through tax and non-tax sources by expanding the tax base and rationalising the user charges. It should also make efforts to collect revenue arrears.

● **Revenue expenditure**

The expenditure pattern of the State revealed that the revenue expenditure as a *per cent* to total expenditure continued to dominate with around 80 *per cent* of the total expenditure in 2008-09.

Non-plan revenue expenditure exceeded the normative projection of TFC for the State for the year.

Expenditure on salary, pension, interest and subsidies together constituted around 71 *per cent* of non-plan revenue expenditure.

The expenditure on salaries during 2008-09 was within the ceiling of 35 *per cent* recommended by TFC.

Interest payments on GOI loans constituted 34 *per cent* of the total interest payments in 2004-05. With the benefit the State got under DCRF, the percentage, however, came down to 17 on an average, during 2005-09.

Recommendations: Expenditure on salaries and pensions witnessed substantial increase during 2007-09 due to implementation of the pay commission award. As the expenditure on these is expected to stabilize in the coming years as stated in the State's MTFP, the State should take action to restrict the other components of non-plan revenue expenditure by phasing out implicit subsidies and resort to need based borrowings to cut down interest payments.

- **Quality of capital expenditure**

Repayment of off-budget borrowings (Rs 8,595 crore) during 2004-09 was treated as capital expenditure. The State Government in compliance with the commitment in MTFP gradually phased out off-budget borrowings resulting in their complete elimination in 2008-09.

Funds aggregating Rs 1,107 crore were blocked in incomplete projects as at the end of 2008-09.

The State Government invested Rs 10,820 crore during 2004-09 in Government companies/Statutory corporations incurring losses continuously. Return on Government investments during the period was negligible.

Recommendations: The State Government should ensure better value for money in investments otherwise, high cost borrowed funds will continue to be invested in projects with low financial return. The State Government should also review the working of State public sector undertakings incurring huge losses and work out either a revival strategy or close down such units.

The State Government should formulate guidelines for quick completion of incomplete projects and strictly monitor reasons for time and cost over runs with a view to take corrective action.

- **Financial management**

The State Government paid interest at an average rate of 6.9 *per cent* on borrowings as against 0.1 *per cent* of return on investments made in Government companies / statutory corporations / co-operative societies etc.

Interest payments constituted six *per cent* of the total fiscal liabilities while interest receipts constituted only one *per cent* of total outstanding loans and advances disbursed by the State Government.

Surplus cash balance, mainly due to market borrowings of Rs 7,417 crore raised during 2008-09 was invested in fourteen days treasury bills at an interest rate of five *per cent* per annum as against interest paid at an average rate of seven *per cent* per annum on market borrowings.

Recommendations: The State Government should resort to borrowings based on necessity and affordability rather than availability in compliance with the commitment made in State's MTFPs.

The above points were referred (December 2009) to the Government; reply had not been received (January 2010).