Chapter 1

Finances of the State Government

Profile of Karnataka

Karnataka is the eighth largest State in terms of geographical area and accounts for around five *per cent* of India's population.

The economic growth of the State was on par with the other General Category States as the compounded annual growth rate of its GSDP for the year 2000-01 to 2008-09 was 12.71 *per cent* as against 12.54 *per cent* of the General Category States. However, the population growth rate of the State during 2000-2010 (10.57 *per cent*) was lower than that of the General Category States (13.42 *per cent*) which indicated higher *per capita* income growth in the State.

The social indicators *viz.*, literacy rate, infant mortality, life expectancy at birth etc., indicated that the State was better off than the all India average (**Appendix 1.1**).

1.1 Introduction

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 the Government Accounts and the layout of the Finance Accounts have been explained in **Appendix 1.2**.

1.2 Summary of fiscal transactions

Table 1.1 and Appendix.1.3 presents the summary of the State Government's fiscal transactions and provides details of receipts and disbursements as well as overall fiscal position respectively during the current year (2009-10) *vis-à-vis* the previous year.

Table 1.1: Summary of fiscal transactions

(₹ in crore)

Receipts			Disbursements				
	2008-09	2009-10		2008-09	2009-10		
Section-A: Revenue				Total	Non Plan	Plan	Total
Revenue receipts	**43,290.67**	**49,155.70**	**Revenue expenditure**	**41,659.29**	**35,234.23**	**12,302.69**	**47,536.92**
Tax revenue	27,645.66	30,578.60	General services	12,275.57	12,664.55	97.79	12,762.34
Non-tax revenue	3,158.99	3,333.80	Social services	15,872.99	11,873.61	7,245.25	19,118.86
Share of union taxes/ duties	7,153.77	7,359.98	Economic services	11,136.64	8,991.07	4,190.64	13,181.71
Grants-in-aid from Government of India	5,332.25	7,883.32	Grants-in-aid and contributions	2,374.09	1,705.00	769.01	2,474.01
Section-B: Capital and others							
Misc. Capital receipts	**181.14**	**69.79**	**Capital outlay**	**9,870.29**	**1,018.71**	**11,117.97**	**12,136.68**
			General services	475.37	56.46	433.39	489.85
			Social services	2,555.16	210.79	2,439.89	2,650.68
			Economic services	6,839.76	751.46	8,244.69	8,996.15
Recoveries of loans and advances	**56.65**	**555.36**	**Loans and advances disbursed**	**731.34**	**65.16**	**916.42**	**981.58**
Public debt receipts*	**8,592.16**	**7,990.86**	**Repayment of public debt***	**1,777.90**	**2,308.33**	**---**	**2,308.33**
Contingency Fund	**---**	**2.10**	**Contingency Fund**	**2.10**	**---**	**---**	**---**
Public Account receipts	**60,603.55**	**71,172.45**	**Public Account disbursements**	**54,782.85**	**---**	**---**	**64,029.09**
Opening cash balance	**3,919.45**	**7,819.85**	**Closing cash balance**	**7,819.85**	**---**	**---**	**9,773.51**
Total	**1,16,643.62**	**1,36,766.11**	**Total**	**1,16,643.62**			**1,36,766.11**

*Excluding net transactions under ways and means advances and overdraft.
Source : *Finance Accounts*

Following are the significant changes during 2009-10 over the previous year:

- Revenue receipts grew by ₹ 5,866 crore (14 *per cent*) due to increase in own tax revenue (₹ 2,934 crore), Government of India (GOI) grants (₹ 2,551 crore), State's share of Union taxes and duties (₹ 206 crore) and non-tax revenue (₹ 175 crore). However, revenue receipts during the current year fell short of projection in the Medium Term Fiscal Plan (MTFP) 2008-12 by ₹ 4,348 crore.

  The compounded annual growth rate of revenue receipts of the State during 2000-2009 was 14.34 per cent as against 14.40 per cent of General Category States. This was mainly due to the lower compounded growth rate of non-tax revenue which was at 8.38 per cent in the State as against 12.08 per cent with respect to General Category States.

- Revenue expenditure increased by ₹ 5,878 crore (14 *per cent*). Increase was under social services sector (₹ 3,246 crore), economic services sector (₹ 2,045 crore), general services sector (₹ 487 crore) and grants-in-aid (₹ 100 crore). It fell short of MTFP projection for the year by ₹ 1,445 crore.

  The compounded annual growth rate of revenue expenditure of the State under social sector such as education and health during 2000-2009 was at 11.78 per cent and 8.78 per cent respectively as against 9.33 per cent and 8.95 per cent of General Category States.

- Miscellaneous capital receipts (₹ 70 crore) represented the sale proceeds of Government land as in previous year. The projection made in MTFP for the year, however, was ₹ 3,377 crore.

- Capital outlay was more by ₹ 2,267 crore (23 *per cent*). Increase was under economic services sector (₹ 2,156 crore), social services sector (₹ 96 crore) and general services sector (15 crore).

  The compounded annual growth rate of capital expenditure of the State during 2000-2009 was 22.50 per cent as against 21.41 per cent of General Category States.

- Public debt receipts (excluding ways and means advances) decreased by ₹ 601 crore (seven *per cent*) while repayment of public debt increased by ₹ 530 crore (30 *per cent*).

- Public Accounts receipts and disbursements increased by ₹ 10,568 crore (17 *per cent*) and ₹ 9,246 crore (17 *per cent*) respectively.

- Cash balance of the State Government increased by ₹ 1,954 crore (25 *per cent*).

1.3 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 the 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) the 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 and greater transparency in fiscal operations by the use of medium-term fiscal framework. To give effect to the fiscal management principles, the Act prescribed the 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 on 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 1.4**

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. By an amendment to the FRA, the fiscal deficit limit of three *per cent* was enhanced to 3.5 *per cent* in 2008-09 and to four *per cent* in 2009-10 in order to over-come the impact of economic slow-down. During the period 2005-10 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 on Government Guarantees Act, 1999. The ratio of fiscal liabilities (excluding off-budget borrowings) to GSDP which continued to decline from 2004-05 to 2008-09 and was around 26 *per cent* in 2008-09, increased to 28 *per cent* in 2009-10. This was on account of increase in borrowings. 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 ₹ 1,252 crore for the period 2005-10 along with waiver of GOI loan of ₹ 1,792 crore as brought out in **Table 1.2.**

Table 1.2: Gains from debt consolidation and debt waiver as per the recommendations of Twelfth Finance Commission

(₹ in crore)

Year	Before DCRF		Post DCRF		Savings		Debt waiver
	Principal	Interest	Principal	Interest	Principal	Interest	
2005-06	371	829	358.3	538	13	291	358.3
2006-07	404	787	358.3	511	45	276	358.3
2007-08	472	740	358.3	484	114	256	358.3
2008-09	468	685	358.3	457	109	228	358.3
2009-10	506	631	358.3	430	148	201	358.3
	2,221	**3,672**	**1,791.5**	**2,420**	**429**	**1,252**	**1,791.5**

1.4 Budget 2009-10

1.4.1 Actuals vis-à-vis budget estimates

Budget papers presented by the State Government provide description about estimation 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 2009-10.

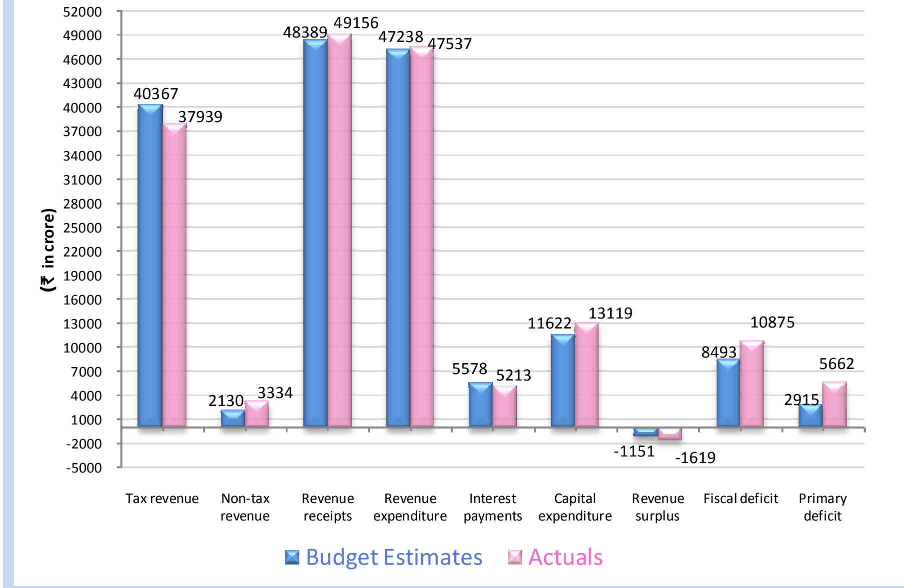


Chart 1.1: Selected fiscal parameters: Budget estimates vis-a-vis actuals

Source: *Annual Financial Statement and Finance Accounts*

During 2009-10, the State's revenue receipts were estimated at ₹ 48,389 crore. In order to give stimulus to the State's economy, the Government provided exemption from VAT on some food grain items. Luxury tax and profession tax exemption limit was raised. Entertainment tax on movies and stamp duty on sale transaction of all kinds of immovable properties were reduced. Revenue expenditure was estimated at ₹ 47,238 crore. After implementation of the State's Pay Commission award, as stated in MTFP 2008-12, salary burden and pension liabilities were expected to stabilize at normal growth rate of 2.75 *per cent* and 9.7 *per cent* respectively. It was proposed to give special emphasis on distributing food grains at subsidized prices to poor families through Public Distribution System (PDS). Agriculture and allied activities, rural development, irrigation, power generation, roads and education were the priority sectors of the Government. Capital expenditure was estimated at ₹ 11,622 crore.

The State's revenue receipts were more than the budget estimate by ₹ 767 crore (two *per cent*) mainly due to increase in non tax revenue. The State's tax revenue (inclusive of State's share of Union taxes and duties) was less than the budget estimate by ₹ 2,428 crore (six *per cent*), while non-tax revenue was more than the budget estimate by ₹ 1,204 crore (57 *per cent*). Revenue expenditure and capital expenditure were more than the budget estimate by ₹ 299 crore (one *per cent*) and ₹ 1,497 crore (13 *per cent*) respectively. Interest payments were less than the budget estimate by ₹ 365 crore (seven *per cent*). Revenue surplus, fiscal deficit and primary deficit were more than the budget estimate by ₹ 468 crore, ₹ 2,382 crore and ₹ 2,747 crore respectively.

1.4.2 Gender Budgeting

Gender budget of the State discloses expenditure proposed to be incurred within the overall budget on schemes which are designed to benefit women fully or partly. Based on the Finance Minister's proposal (Budget speech 2006-07), the State created the Gender Budget Cell (January 2007) and gender budgeting was introduced in 2007-08. The year-wise allocations in the gender budget document is detailed in **Table 1.3**.

Table 1.3: Gender budgetary allocations during 2007-10

(₹ in crore)

Year	Total Outlay	Outlay under			Demands covered	Percentage of total outlay
		Category A*	Category B^	Total		
2007-08	5,04,65.61	562.63	1,72,35.88	1,77,98.51	20	35
2008-09	6,04,97.19	661.77	2,07,64.82	2,14,26.59	25	35
2009-10	6,24,13.81	845.10	2,22,85.31	2,31,30.41	27	37

*Budgetary allocations to Schemes designed to benefit women- 100 *per cent*
^Budgetary allocations for Schemes designed to benefit women to the extent of 30 *per cent* of allocations

The Gender Budget Cell which had to implement gender budget effectively by coordinating between various departments, NGOs, experts and administrative departments, also, had to carry out activities like formulation of policies and other activities including publicity. The Department of Women and Child Development was entrusted with the monitoring of the impact analysis of the schemes on the socio-economic status of women in the State.

Study of the functioning of the above revealed the following:

- The Gender Budget Cell was entrusted only with the task of publishing / bringing out the budget document based on proposals / demand of various departments accepted by Government.
- The Cell was not involved in assessing and working out budgetary requirement of Category A and B schemes nor in policy decision on actual allotment of funds to the schemes under the Category A and B.
- The Department of Women and Child Development did not conduct any impact analysis study.
- The Department only collected statistical information and progressive expenditure from all departments with respect to the schemes under Category B.
- There were discrepancies between the statistical information furnished by the Department and gender budget document.

Analysis of the gender budget documents for the period 2007-10 revealed that:

- Gender budgeting exercise was based on certain assumptions relating to the proportion of allocations under a scheme that directly benefited women. Some of these assumptions were unrealistic and weakened the gender budgeting exercise. Schemes like National Family Benefit Scheme (Department of Revenue) and State Plan Schemes (Department of Commerce and Industries) benefited both men and women.

- There were no clear guidelines for identification of items in the gender budget under both Category A and B schemes. Routine expenditure of various departments, debt servicing of HUDCO loans, civil works such as construction of colleges, universities etc., allocation towards child welfare, grant-in-aids to Jain Piligrim Centres and Kannada Sahithya Parishad etc were included under Category B schemes.

1.5 Resources of the State

1.5.1. 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 2005-10, while **Chart 1.3** depicts the composition of resources of the State during the current year.

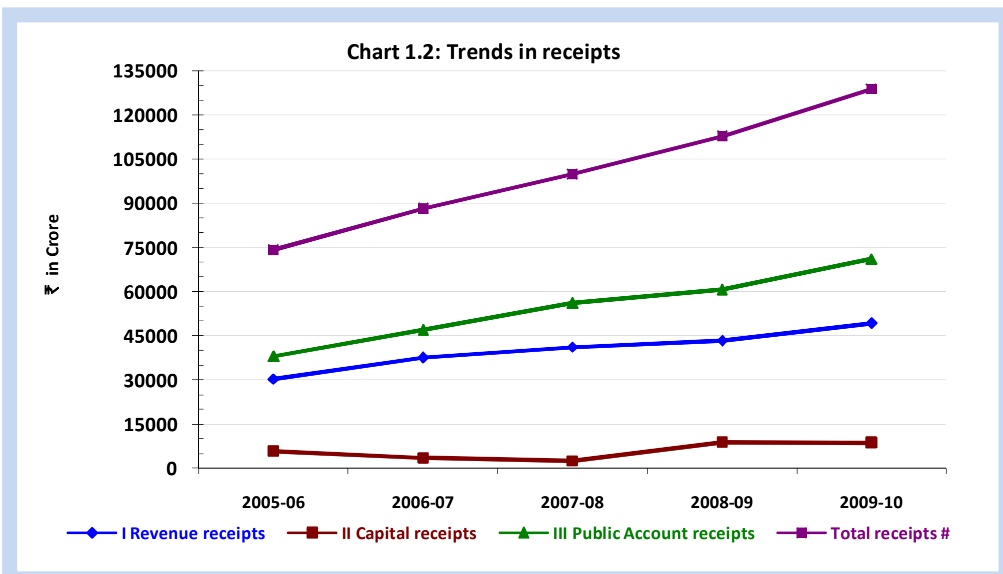
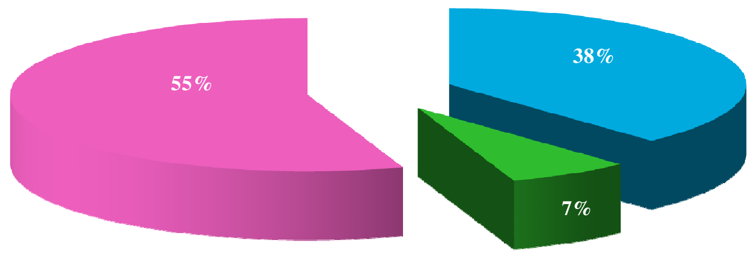


Chart 1.3: Composition of receipts during 2009-10



 # Excluding Contingency Fund receipts
Source : *Finance Accounts*

Total receipts increased by 74 *per cent* from ₹ 74,204 crore in 2005-06 to ₹ 1,28,946 crore in 2009-10, of which increase of revenue receipts was by 62 *per cent* from ₹ 30,352 crore to ₹ 49,156 crore during the period.

Capital receipts increased by 49 *per cent* from ₹ 5,788 crore to ₹ 8,616 crore. Public account receipts increased by 87 *per cent* from ₹ 38,025 crore to ₹ 71,172 crore.

During the current year, revenue receipts accounted for 38 *per cent* of total receipts while Capital and Public Account receipts accounted for seven and 55 *per cent* respectively. Public debt receipts which create future re-payment obligation were 93 *per cent* of total capital receipts.

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

The Central Government transferred ₹ 7,594.32 crore during 2009-10 directly to the State implementing agencies[1] for implementation of various schemes/programmes in social and economic services sectors recognized as critical as against transfer of ₹ 3,326.29 crore during 2008-09. There was an increase of transfer in 2009-10 by 128 *per cent*. 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. Details in respect of major Central plan schemes are furnished in **Table 1.4**.

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

Table-1.4: Funds transferred directly to the State implementing agencies

(₹ in crore)

Programme / scheme	Implementing agency in the State	2008-09	2009-10
National Rural Employment Guarantee Scheme	Zilla Panchayats	234.01	2769.98
Accelerated Rural Water Supply Scheme	Karnataka Rural Water Supply and Sanitation Agency	0.69	467.46
Sarva Shiksha Abhiyan (SSA)	Sarva Shiksha Abhiyan Samithi	515.78	442.21
Pradhan Mantri Gram Sadak Yojna (PMGSY)	Karnataka Rural Roads Development Agency	---	438.00
Rural Housing (IAY)	Zilla Panchayats	94.97	356.27
National Rural Health Mission (NRHM)	Karnataka State Health and Family Welfare Society	176.88	308.80
Integrated Watershed Management Programme (IWMP)	Zilla Panchayats and State Level Nodal Agency	17.83	219.23
Swaranjayanti Gram Swarozgar Yojana (SGSY)	Zilla Panchayats	40.99	90.97
Member of Parliament Local Area Development Scheme (MPLADS)	Deputy Commissioners	63.50	88.50
National Horticulture Mission	Karnataka State Horticulture Mission Agency	125.37	80.02

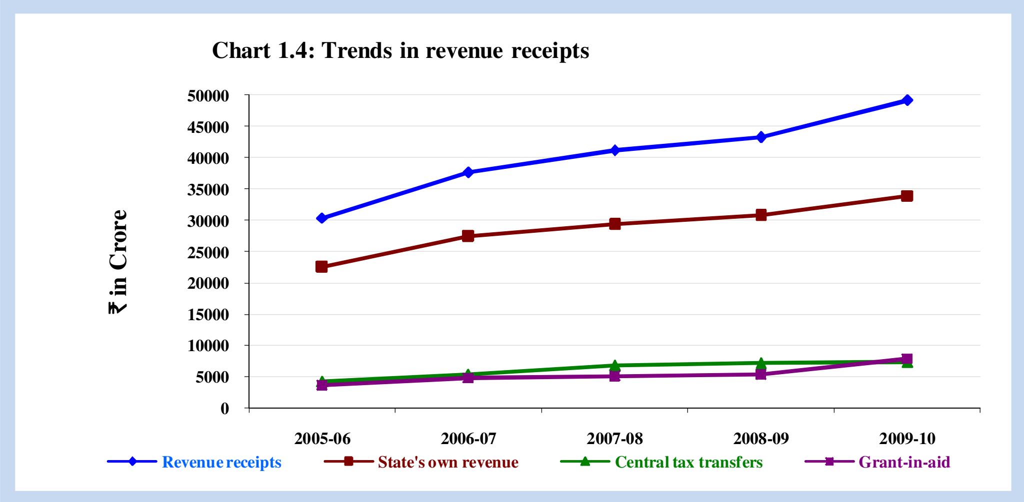
Source : *CGA's website.*

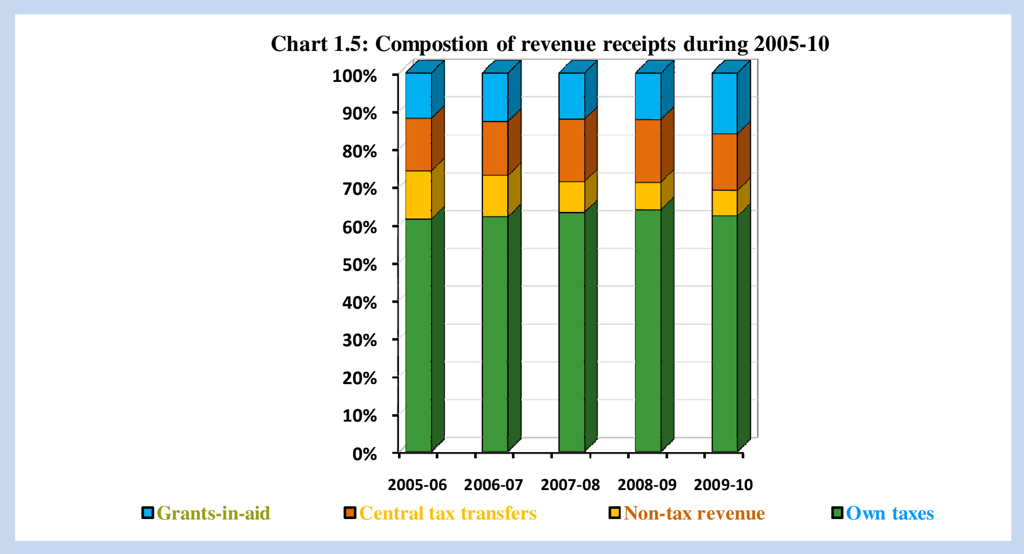
Direct transfer from the Union to the State implementing agencies runs the risk of poor oversight of utilisation of funds by these agencies. Unless uniform accounting practices are diligently followed by all these agencies and there is proper documentation and timely reporting of expenditure, it will be difficult to monitor the end use of these direct transfers.

In the memorandum submitted to the Thirteenth Finance Commission, the State Government stated that the direct transfers considerably eroded accountability and undermined the role of the State.

1.6 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 2005-10 are presented in **Appendix 1.5** and also depicted in **Charts 1.4 and 1.5** respectively.





Source: *Finance Accounts*

Revenue receipts showed progressive increase from ₹ 30,352 crore in 2005-06 to ₹ 49,156 crore in 2009-10 with inter-year fluctuations in the growth rate. On an average 72 *per cent* of the revenue came from State's own resources during the period 2005-10. The balance was from transfers from GOI in the form of State's share of taxes and grants-in-aid.

The share of tax revenue in revenue receipts was between 61 and 64 *per cent* during 2005-10. Non-tax revenue as a *per cent* of revenue receipts showed steady fall during the period 2005-10. It decreased from13 *per cent* in 2005-06 to seven *per cent* in 2009-10.

The trends in revenue receipts relative to GSDP are presented in **Table 1.5.**

Table 1.5: Trends in revenue receipts relative to GSDP

	2005-06	2006-07	2007-08	2008-09	2009-10
Revenue receipts (RR) (₹ in crore)	30,352	37,587	41,151	43,290	49,156
Rate of growth of RR (*per cent*)	14.2	23.8	9.5	5.2	13.6
R R/GSDP (*per cent*)	16.5	18.3	17.1	16.0	16.5
Buoyancy ratios[2]					
Revenue buoyancy w.r.t GSDP	0.8	2.0	0.6	0.4	1.3
State's own tax buoyancy w.r.t GSDP	0.9	2.09	0.7	0.5	1.04
Revenue buoyancy with reference to State's own taxes	0.9	0.9	0.8	0.8	1.3
GSDP (₹ in crore)	1,83,796	2,05,784	2,40,062	2,70,699	2,98,465
Rate of growth	17.6	12.0	16.6	12.8	10.2

Source: *Finance Accounts.*
GSDP : State's Economic Survey 2009-10

Revenue buoyancy widely fluctuated during the period due to fluctuations in the growth rate of revenue receipts. During 2005-10, the growth rate of revenue receipts was not only the highest in 2006-07 but it was also twice the growth rate of GSDP. In the next two years the lower growth rate of revenue receipts relative to GSDP pushed the revenue buoyancy ratio down. Revenue buoyancy ratio, which was at its lowest at 0.4 in 2008-09, increased to 1.3 in 2009-10 due to increase in the growth rate of revenue receipts.

During 2005-10, on an average own tax revenue constituted 62 *per cent* of the revenue receipts of the State and trends in own tax revenue receipts largely influenced the trends in revenue receipts. During this period, growth rate of own tax revenue and buoyancy ratio of own tax revenue w.r.t. GSDP was the highest in 2006-07 and so also was the growth rate of revenue receipts and revenue buoyancy w.r.t. GSDP. The next two years witnessed fall in the growth rate of own tax revenue and the buoyancy ratio of own tax revenue with GSDP. This influenced the growth rate of revenue receipts and revenue buoyancy w.r.t. GSDP. In 2009-10, the growth rate of own tax revenue, buoyancy ratio of own tax revenue with GSDP, and growth rate of revenue receipts increased over the previous year.

1.6.1 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.

State's actual tax and non-tax receipts for the year 2009-10 vis-à-vis assessment made by TFC and the State Government in FCP and MTFP (2008-12) are given in **Table 1.6.**

[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 0.4 implies that revenue receipts tend to increase by 0.4 percentage points, if the GSDP increases by one *per cent*.

Table 1.6

(₹ in crore)

	TFC projection	FCP projection	MTFP projection	Actual
Tax revenue	32,291	32,523	36,800	30,579
Non-tax revenue	4,620	6,318	2,070	3,334

The tax revenue of the State in 2009-10 was less than the projection made in the State's MTFP as well as the normative assessment made by TFC and the projection in FCP. Non-tax revenue was less than the TFC and FCP projections but exceeded the MTFP projection. Due to continuance of effects of economic slowdown during 2009-10, the actual tax revenue was less than the MTFP projection. Due to increase in mineral concession fees, rent and royalties, guarantees fees and other receipts under forestry and wild life, the actual non-tax revenue was more than MTFP projection.

Tax revenue

Taxes on sales, trade, etc. was the main source of State's tax revenue with a contribution of 52 *per cent* of the State's tax revenue followed by State excise (23 *per cent*) and stamps and registration fees (nine *per cent*). The trend in the major constituents of tax revenue during the period 2005-10 is shown in **Table 1.7.**

Table 1.7: Tax revenue

(₹ in crore)

	2005-06	2006-07	2007-08	2008-09	2009-10
Taxes on sales, trade, etc.	9,870	11,762	13,894	14,623	15,833
Rate of growth	13.45	19.17	18.13	5.25	8.27
State excise	3,397	4,495	4,767	5,749	6,946
Rate of growth	21.06	32.32	6.05	20.60	20.82
Stamps and registration fees	2,213	3,206	3,409	2,927	2,628
Rate of growth	25.74	44.87	6.33	(-)14.14	(-) 10.21
Taxes on vehicles	1,105	1,375	1,650	1,681	1,962
Rate of growth	12.41	24.43	20.00	1.88	16.72

Source : *Finance Accounts*

The rate of growth of taxes on sales, trade, etc which had witnessed a steep fall in 2005-06 from 31 *per cent* in 2004-05, following the introduction of value added tax with effect from April 2005, 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. During 2009-10, there was increase in rate of growth in taxes on sales, trade, etc by three *per cent* as the general slowdown of economy which had continued in the first half of 2009-10 reversed during the second half.

Due to ban on sale of arrack, the growth rate of State excise witnessed a 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. The growth rate was maintained in 2009-10.

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. Reduction of stamp duty from 7.5 to six *per cent* to stimulate the real estate market during 2009-10 resulted in the negative growth rate declining from 14 to 10 *per cent.*

The fall in the growth rate of tax on vehicles during 2008-09 was also due to fall in sale of vehicles on account of general economic slow-down. According to MTFP 2010-14, measures of GOI to stimulate the automobile industry by reducing excise duty and allocation of funds for purchase of buses under Jawaharlal Nehru National Urban Renewal Mission (JnNURM) resulted in higher rate of growth in taxes on vehicles during 2009-10.

Cost of collection

The gross collection of taxes on motor vehicles and taxes on sales, trade etc., expenditure incurred on their collection and its percentage to gross collection during the years 2007-10 along with their all India average cost of collection for the respective previous years are indicated in **Table 1.8.**

Table 1.8: Details of cost of collection

Receipt	Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
		(₹ in crore)			
Motor vehicles	2007-08	1,651.82	29.39	1.78	2.47
	2008-09	1,682.90	34.84	2.04	2.58
	2009-10	1,962.62	36.35	1.85	2.93
Taxes on Sales, Trade etc.,	2007-08	15,036.11	74.30	0.49	0.82
	2008-09	16,259.37	81.62	0.50	0.83
	2009-10	16,546.34	84.46	0.51	0.88

The percentage of cost of collection to the gross collection was less than the all India average for the period 2007-10.

Non-tax revenue

During 2005-10, 54 *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 46 *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 by 46 *per cent* as revealed by the details of composition of non-tax revenue shown in **Table 1.9.**

Table 1.9: Composition of non-tax revenue

(₹ in crore)

	2005-06	2006-07	2007-08	2008-09	2009-10	Average percentage composition during 2005-10	
						Interest, dividends, user charges, fees, fines	Others
Interest and dividends receipts	**300 (8)**	**396 (10)**	**399 (12)**	**377 (12)**	**413 (12)**	**11**	
General services	**2,030 (52)**	**2,127 (52)**	**679 (20)**	**675 (21)**	**846 (26)**		
Receipts (gross) from State lotteries	1,767 (46)	1,128 (28)	---	---	---		**15**
Relief under DCRF	---	716 (17)	358 (11)	358 (11)	358 (11)		**10**
Fees, fines etc,	263 (7)	283 (7)	321 (10)	317 (10)	488 (15)	**10**	
Economic services	**1,416 (37)**	**1,428 (35)**	**2,099 (63)**	**1,921 (61)**	**1,836 (55)**		
Write-back from Public Account	426 (11)	299 (7)	749 (22)	484 (15)	2 (-)		**11**
Pooling of cess collections	275 (7)	357 (9)	377 (11)	365 (12)	386 (12)		**10**
User charges	715 (18)	772 (19)	973 (29)	1,072 (34)	1448 (43)	**28**	
Social services –user charges	**129 (3)**	**148 (3)**	**181 (5)**	**186 (6)**	**239 (7)**	**5**	
Total	**3,875**	**4,099**	**3,358**	**3,159**	**3,334**	**54**	**46**

Figures in parenthesis denote percentage composition in non-tax revenue

Source : *Finance Accounts.*

Twenty six *per cent* of the total non-tax revenue of the State in 2009-10 was on account of royalty receipts which increased from ₹ 554 crore in 2008-09 to ₹ 858 crore in 2009-10 as a result of revision of royalty rates by the Central Government in August 2009.

According to FRA, the State Government had to pursue non-tax revenue policies with due regard to cost recovery and equity. During 2000-08, the compounded annual growth rate of non-tax revenue of the State (8.38 *per cent*) was less than that of the General Category States (12.08 *per cent*) and in 2000-10, the State's CAGR of non-tax revenue fell to 8.06 *per cent*. 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.

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 2009-10 are given in **Table 1.10.**

Table 1.10: Cost-recovery from socio-economic services

(₹ in crore)

Service	Non tax revenue receipts (NTR)	Non plan revenue expenditure (NPRE)	Cost recovery (ratio of NTR/ NPRE in *per cent*)
Education, sports, art and culture	95.85	6,657.52	1
Health and family welfare	54.98	1,164.66	5
Water supply and sanitation	0.34	11.30	3
Irrigation	28.09	173.25	16

Source: *Finance Accounts.*

However, bulk of user charges in respect of Health and Education is not credited to the Consolidated Fund of the State resulting in under-statement of non-tax revenue of the State. The cost-recovery ratio calculated in respect of Health and Family Welfare and Education is therefore, under-stated[3] to that extent.

Total non-tax revenue increased by ₹ 175 crore from ₹ 3,159 crore in 2008-09 to ₹ 3,334 crore in 2009-10 mainly due to increase in non-tax revenue from General Services (₹ 171 crore) partly off-set by decrease in non-tax revenue from Economic Services (₹ 85 crore).

Grants-in-aid from GOI

Grants-in-aid from GOI increased from ₹ 3,632 crore in 2005-06 to ₹ 7,883 crore in 2009-10 as shown in **Table 1.11**.

Table 1.11: Grant-in-aid from GOI

(₹ in crore)

		2005-06	2006-07	2007-08	2008-09	2009-10
Non-plan		1,736	2,224	1,531	1,694	3,429
Plan	State	915	1,284	1,916	2,020	2,973
	Central	37	43	71	94	61
	Centrally sponsored	944	1,262	1,509	1,524	1,420
Total		**3,632**	**4,813**	**5,027**	**5,332**	**7,883**

Source *: Finance Accounts.*

The increase of GOI grants by ₹ 2,551 crore in 2009-10 over the previous year was due to increase in non-plan grants (₹ 1,735 crore) and grants for State plan schemes (₹ 953 crore). The increase in non-plan grants was mainly under Grant for National Calamity Contingency Fund (₹ 1,405 crore), Grant for loss of revenue on account of phasing out of Central Sales Tax (₹ 555 crore) and Grants for State Specific needs (₹ 272 crore) and the increase in grants for State plan schemes was mainly under Accelerated Irrigation Benefit Programme (₹ 477 crore) and Crop Husbandry – other grants (₹ 253 crore).

[3] All district hospitals, PHCs, CHCs and THCs in the State have been authorized under order dated 22 August 2003 to retain user charges which were to form part of Arogya Raksha Samithi's fund. These receipts were to be utilized for development work of hospitals. Similarly, laboratory fee, library fee etc., collected by colleges are not remitted to treasury and form part of College Development Fund.

Central tax transfers

Increase of State's share of Union taxes by ₹ 206 crore over the previous year was mainly under corporation tax (₹ 683 crore) and taxes on income other than corporation tax (₹ 214 crore) partly offset by decrease in customs (₹ 338 crore) and Union excise duties (₹ 363 crore).

The share of Central taxes and duties received in the State during 2005-10 was ₹ 30,880 crore as against ₹ 27,362 crore recommended by TFC. During 2005-10, Central tax transfers were also more than the estimated tax transfers (₹ 30,296 crore) by ₹ 584 crore. Surplus devolution of ₹ 1,697 crore during 2005-08 was off-set by short devolution of ₹ 1,113 crore during 2008-10.

1.6.2 Optimization of TFC grants

TFC recommended amounts aggregating ₹ 4,054.40 crore as transfers to the State during 2005-10. The recommendations and the actual releases are detailed in **Table 1.12.**

Table 1.12: Transfers recommended and actual release of Grant-in-aid

(₹ in crore)

	Transfers recommended	Actual Releases	Shortfall
Maintenance (Public Works)	205.12	205.12	--
Maintenance (Forest)	55.00	55.00	--
Heritage & conservation	50.00	50.00	--
Local Bodies	1,211.00	1,211.00	--
Maintenance (Roads and Bridges)	1,458.12	1,275.85	182.27
State Specific needs	600.00	540.00	60.00
Calamity relief	475.16	475.16	--
Total	**4,054.40**	**3,812.13**	**242.27**

As of March 2010, the State Government received grants aggregating ₹ 3,812 crore. The balance (₹ 242.27 crore) pertaining to Maintenance –Roads and Bridges (₹ 182 crore) and State Specific Needs (₹ 60 crore) was not received. In respect of Maintenance –Roads and Bridges, the State lost ₹ 182 crore due to non-fulfillment of TFC conditions. Test check revealed the following irregularities in utilization of TFC grants received during 2005-10.

Improvement of Health Services

A grant of ₹ 150 crore was recommended by the TFC for improvement of health services in Karnataka. Detailed action plan which included up-gradation of 275 Community Health Centres (CHCs) as trauma care centres, 18 primary trauma care centres, 44 trauma care centres in district hospitals and Sanjay Gandhi hospital as Apex hospital, purchase of 550 ambulances, supply of equipments to trauma care centres and Sanjay Gandhi hospital, training etc., was drawn for utilizing the grant during 2006-10.

There was short-fall in the achievement of physical and financial progress as the State took up only civil works in respect of 175 CHCs, purchase of ambulance and up-gradation of Sanjay Gandhi hospital. Out of the first instalment of ₹ 54.88 crore released in 2006-07, the total expenditure incurred in 2006-07 was ₹4.97 crore on purchase of 44 ambulances. The State failed to achieve physical progress in respect of up-gradation of 175 CHCs which remained incomplete as on March 2010.

The State Government replied (November 2010) that based on a review of implementation of activities in 2007-08, the number of civil works was limited to 137. The reply cannot be accepted because as per the Utilization Certificate furnished to GOI, 175 civil works had been started and were in various stages of completion and as admitted by the State Government completion of the civil works will involve the State Government having to bear the necessary budgetary burden.

Due to short-fall in achievement of targets and under-utilisation of TFC grants, the State did not receive the instalments due in 2007-08 and 2008-09. GOI released ₹ 80.12 crore in 2009-10 as against ₹ 95.12 crore due. The State thus, lost TFC grant amounting to ₹ 15 crore.

Further, out of TFC grant amounting to ₹ 135 crore received from GOI, the State used ₹ 98.35 crore for its ongoing scheme Arogya Kavacha (implemented during 2008-09).

The State Government (November 2010) replied that the State Cabinet had approved the use of TFC grants towards Arogya Kavacha and that there was no deviation. However, the State Government had announced in 2008-09 (budget speech) that it had a commitment of providing ₹ 221 crore (regardless of TFC grants) during 2008-11 for implementation of Arogya Kavacha. Also, the infrastructure envisaged in the action plan for utilization of TFC grants was not fully created.

1.6.3 Arrears of revenue

As of March 2010, arrears of revenue pertaining to taxes on sales, trade, etc., (₹ 3,751 crore), State excise (₹ 738 crore), mineral receipts (₹ 241 crore), taxes and duties on electricity (₹ 73 crore), stamp duty and registration fees (₹ 60 crore) and taxes on motor vehicles (₹ four crore) aggregated ₹ 4,867 crore. Revenue of ₹ six crore relating to State excise was pending on account of litigation in courts.

1.7 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.

1.7.1 Growth and composition of expenditure

Growth rates of total expenditure during 2005-10, its ratio and buoyancy with reference to GSDP and revenue receipts are presented in **Table 1.13.**

Table 1.13: Total expenditure – Basic parameters

(₹ in crore, ratio in *per cent*)

	2005-06	2006-07	2007-08	2008-09	2009-10
Total expenditure (TE)*	34,163	42,335	46,781	52,260	60,656
Rate of growth	13.1	23.9	10.5	11.7	16.1
TE/GSDP (ratio)	18.6	20.6	19.5	19.3	20.3
Revenue receipts / TE (ratio)	88.8	88.8	88.0	82.8	81.0
Buoyancy of total expenditure with					
GSDP(ratio)	0.7	2.0	0.6	0.9	1.6
Revenue receipts (ratio)	0.9	1.0	1.1	2.2	1.2

**Total expenditure includes revenue expenditure, capital expenditure including loans and advances*
Source : *Finances Accounts.*

Total expenditure increased by 78 *per cent* from ₹ 34,163 crore in 2005-06 to ₹ 60,656 crore in 2009-10 due to increase in revenue expenditure (₹ 19,496 crore), capital outlay (₹ 6,315 crore) and disbursement of loans and advances (₹ 682 crore).

During the period 2005-10, the growth rate of total expenditure was at the highest (24 *per cent)* in 2006-07 and lowest (11 *per cent)* in 2007-08. The growth rate of total expenditure which was at 12 *per cent* in 2008-09 increased to 16 *per cent* in 2009-10.

In 2009-10, total expenditure was 1.2 times the revenue receipts. The buoyancy ratio of total expenditure to revenue receipts was around 1.2 *per cent* and the growth rate of total expenditure was more than the growth rate of revenue receipts by 1.2 times.

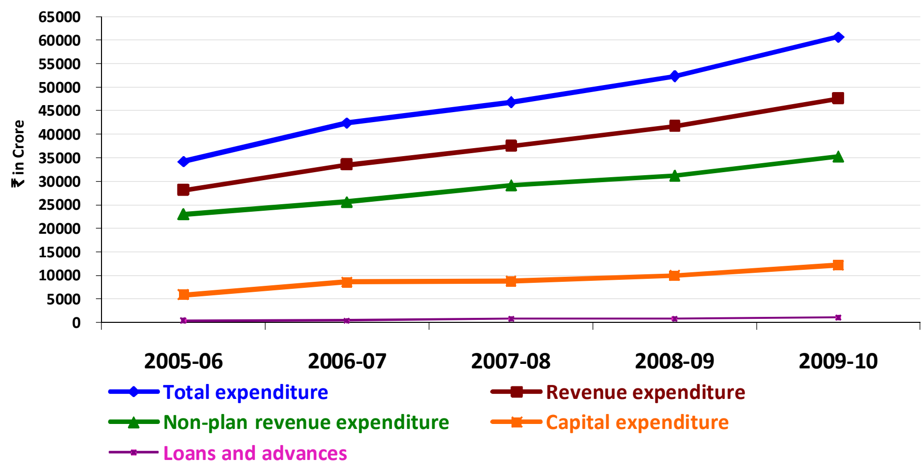
During the period 2005-10, on an average, 80 *per cent* of the total expenditure constituted revenue expenditure. While the share of revenue expenditure in the total expenditure decreased from 80 *per cent* in 2008-09 to 78 *per cent* in 2009-10, the share of capital expenditure increased from 20 *per cent* in 2008-09 to 22 *per cent* in 2009-10.

The State identified agriculture, rural development, power, education and health under socio-economic services as high priority sectors with greater capital outlay. Though capital outlay increased from ₹ 5,822 crore in 2005-06 to ₹ 12,137 crore in 2009-10 (108 *per cent*), there was minimal increase in the capital outlay in the priority sectors of health and family welfare (₹ 20 crore), education (₹ 16 crore) and agriculture and allied activities (₹ 24 crore) while there was decrease in capital outlay on rural development (₹ 60 crore) during 2009-10 relative to the previous year.

In 2009-10, the growth rate of total expenditure (16.1 *per cent*) was 1.6 times more than the growth rate of GSDP (10.2 *per cent*) and the buoyancy of total expenditure to GSDP which was less than one *per cent* in 2008-09 increased to 1.6 *per cent* in 2009-10. Revenue receipts as a ratio of total expenditure stood at 81 *per cent* in 2009-10 which meant that 81 *per cent* of the total expenditure could be met out of revenue receipts.

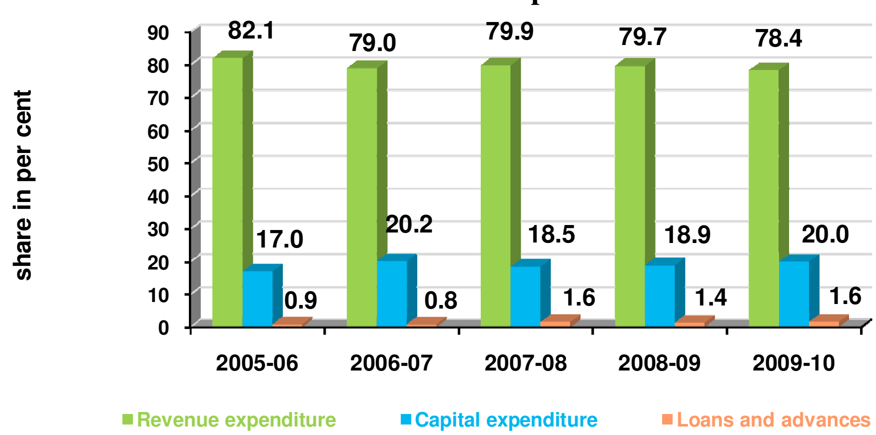
Chart 1.6 presents the trends in total expenditure under revenue, capital and loans and advances, while **Chart 1.7** exhibits the share of these components in total expenditure.

Chart 1.6: Total expenditure :Trends and composition



Source: *Finance Accounts.*

Chart 1.7: Total expenditure:Trends in share of its components



Source: *Finance Accounts.*

1.7.2 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 70 *per cent* from ₹ 28,041 crore in 2005-06 to ₹ 47,537 crore in 2009-10. While plan expenditure increased by 143 *per cent* from ₹ 5,069 crore to ₹ 12,303 crore, non-plan expenditure increased by 53 *per cent* from ₹ 22,972 crore to ₹ 35,234 crore.

Increase of plan revenue expenditure by ₹ 1,773 crore over the previous year was mainly under Social Welfare and Nutrition (₹ 639 crore), Welfare of SCs, STs and OBCs (₹ 377 crore), Agriculture (₹ 290 crore), Special Areas Programme (₹ 272 crore), Rural Development (₹ 151 crore) and Water Supply, Housing and Urban Development (₹ 111 crore). Plan revenue expenditure included devolutions to Panchayat Raj Institutions (PRI) (₹ 3,506 crore) and Urban Local Bodies (ULB) (₹ 769 crore), Subsidies (₹ 429 crore) and Salaries (₹ 841 crore).

Non-plan revenue expenditure (NPRE) was 74 *per cent* of revenue expenditure during 2009-10. It included devolutions to PRIs (₹ 7,901 crore) and ULBs (₹ 1,703 crore), interest payments (₹ 5,213 crore), subsidies (₹ 3,689 crore), pension payments (₹ 3,408 crore), salaries (₹ 9,501 crore) and maintenance expenditure (₹ 548 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 2005-10 as shown in **Table 1.14**.

Table 1.14: Non-plan revenue expenditure- Actuals *vis-à-vis* TFC projection

(₹ in crore)

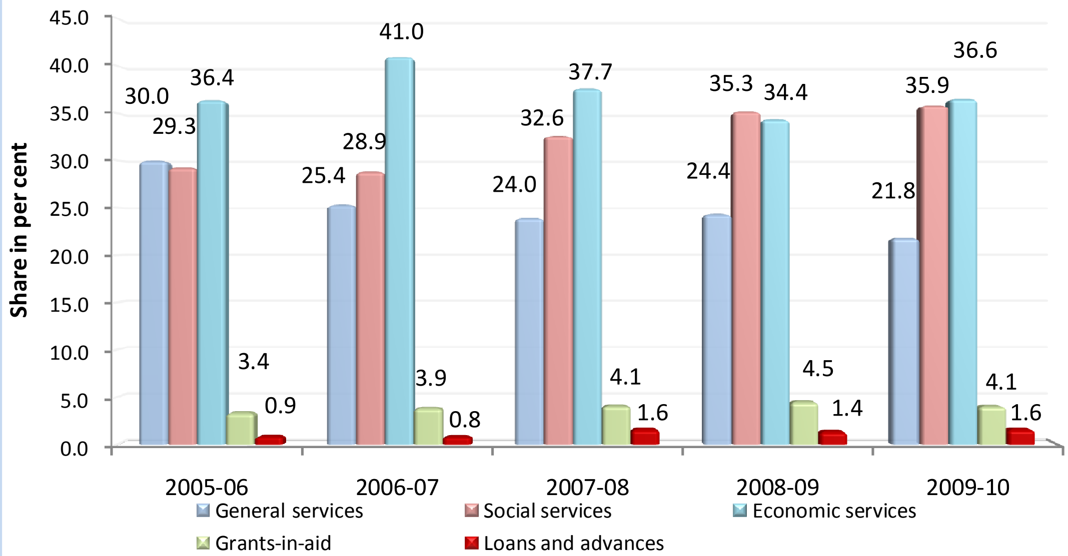
	Normative assessment of TFC	Actual expenditure	Percentage variation
2005-06	17,001	22,972	35
2006-07	18,473	25,583	38
2007-08	21,735	29,062	34
2008-09	23,574	31,129	32
2009-10	25,643	35,234	37

Source: *TFC Report and Finance Accounts.*

1.7.3 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.**

Chart 1.8: Total expenditure: Trends by activities



Source : *Finance Accounts.*

In the MTFP 2010-14, the Government stated that it has been enhancing outlays on social service and restricting expenditure on general services, as part of its strategy to improve structure of expenditure. The expenditure on social services which was at 29 *per cent* of total expenditure in 2005-06 increased to 36 *per cent* in 2009-10 while expenditure on general services decreased from 30 *per cent* in 2005-06 to 22 *per cent* in 2009-10.

The share of expenditure on economic services which had increased from 36 in 2005-06 to 41 *per cent* in 2006-07 decreased to 38 *per cent* in 2007-08. During 2008-09, the share of expenditure on economic services which had further decreased to 34 *per cent* increased to 37 *per cent* in 2009-10.

As stated in the MTFP-2010-14, the State had to incur expenditure on relief measures for flood which hit the State in 2009-10. This expenditure (₹ 1,750 crore accounted under the HOA 2245-05) was eight *per cent* of the total expenditure on social services.

1.7.4 Committed expenditure

Committed expenditure of the State Government on revenue account mainly consisted of interest payments, expenditure on salaries, pensions and subsidies. **Table 1.15** and **Chart 1.9** present the trends in the expenditure on these components during 2005-10.

Table 1.15: Committed expenditure

(₹ in crore)

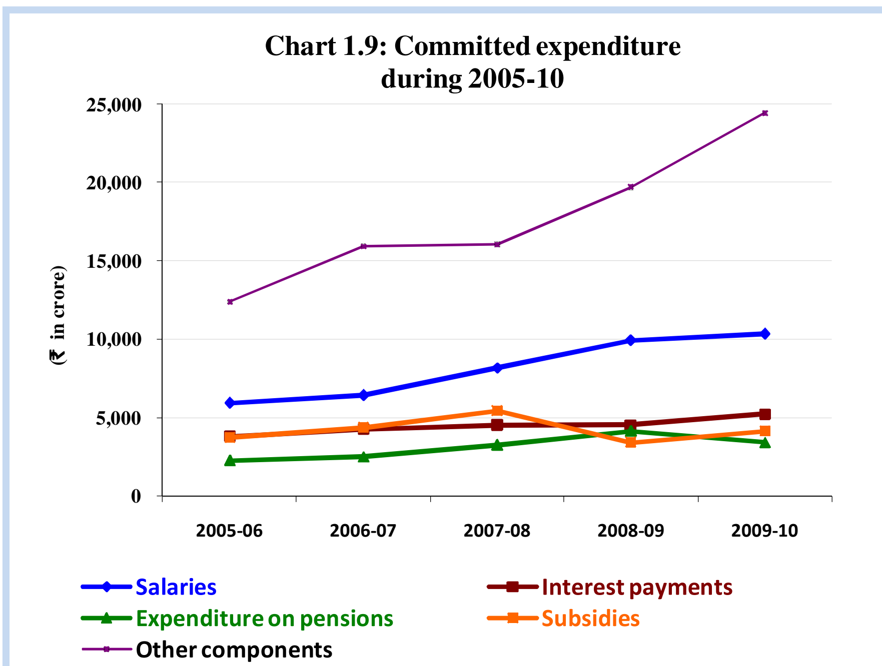
	2005-06	2006-07	2007-08	2008-09	2009-10
Salaries*, *of which*	5,932 (19.5)	6,426 (17.1)	8,169 (19.8)	9,912 (22.9)	10,342 (21.04)
Non-plan head	5,597	6,111	7,705	9,254	9,501
Plan head**	335	315	464	658	841
Interest payments	3,765 (12.4)	4,236 (11.3)	4,506 (10.9)	4,532 (10.5)	5,213 (10.6)
Expenditure on pensions	2,237 (7.4)	2,496 (6.6)	3,241 (7.9)	4,113 (9.5)	3,408 (6.9)
Subsidies	3,712 (12.2)	4,355 (11.6)	5,420 (13.2)	3,399 (7.8)	4,118 (8.4)
Total committed expenditure	**15,646 (51.55)**	**17,513 (46.59)**	**21,336 (51.85)**	**21,956 (50.72)**	**23,081 (46.9)**
Other than committed expenditure ***	12,395 (40.8)	15,922 (42.4)	16,039 (39.0)	19,703 (45.5)	24,456 (49.7)
Total revenue expenditure	**28,041**	**33,435**	**37,375**	**41,659**	**47,537**
Revenue receipts	**30,352**	**37,587**	**41,151**	**43,290**	**49,156**

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.*

*** *Includes expenditure on financial assistance / relief (₹ 4,935 crore), other expenses (₹ 3,722 crore), grants-in-aid (₹ 2,235 crore), special component plan (₹ 987 crore), maintenance (₹ 619 crore), pensions under social services sector (₹ 922 crore), inter account transfers (₹ 2,809 crore).*



Source : *Finance Accounts.*

Expenditure on salaries

Expenditure on salaries as a percentage of revenue receipts which had increased from 20 in 2007-08 to 23 in 2008-09 due to implementation of fifth pay commission (FPC) award reduced to 21 during 2009-10. *It was, however, 27 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 2009-10 was less than the MTFP-2008-12 projection of ₹ 10,990 crore by ₹ 648 crore.

Pension payments

Expenditure on pension (₹ 3,408 crore) was at seven *per cent* of total revenue receipts of the State during the year. The expenditure on pension during the year was less than MTFP (2008-12) projection by ₹ 430 crore. Decrease of ₹ 705 crore over the previous year was on account of increase in retirement age from 58 years to 60 years during 2008-09.

Adopting budget estimates (₹ 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 2005-07. It was more than TFC projection during 2007-08 and 2008-09 on account of FPC award. It once again was less than TFC projection during 2009-10 as shown in **Table 1.16**.

Table 1.16: Pension expenditure vis-à-vis TFC projection

(₹ 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
2009-10	3,566	3,408	(-) 4

Interest payments

Interest payments increased by ₹ 1,448 crore from ₹ 3,765 crore in 2005-06 to ₹ 5,213 crore in 2009-10. It constituted interest on internal debt (₹ 3,675 crore), interest on small savings, PF etc., (₹ 786 crore) and interest on loans and advances from Central Government (₹ 752 crore).

The interest on internal debt increased by 21 *per cent* from ₹ 3,038 crore in 2008-09 to ₹ 3,675 crore in 2009-10 on account of increase in payment of interest on markets loans and other internal debts by 58 *per cent* relative to previous year.

The interest on small savings, provident funds etc increased by seven *per cent* from ₹ 736 crore during 2008-09 to ₹ 786 crore in 2009-10 mainly on account of increase in interest on State provident funds and insurance and pension funds by 18 and 12 *per cent* respectively relative to previous year.

During 2005-10, interest payment on GOI loans fell to ₹ 745 crore on an average from ₹ 1,296 crore during 2004-05 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 11 *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 III**) showed an explicit subsidy of ₹ 4,118 crore during the year. Test check revealed implicit subsidy of ₹ seven crore provided as assistance to Karnataka State Financial Corporation (KSFC) towards waiver of interest due from small farmers and implicit subsidy of ₹ 122 crore provided as equity investment to KSFC to cover loss of earlier years.

Subsidy provided by the State may also be classified as merit and non-merit subsidy. Subsidy (₹ 276 crore)[34] on education, housing, health, social welfare and nutrition, rural and urban development, agriculture and village and small industries considered to be merit 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 (₹ 2,341 crore), food (₹ 1,164 crore), transport (₹ 157 crore) and co-operation (₹ 125 crore). The details are given in **Box 1.1.**

[4] Education - ₹ 7.03 crore, urban development - ₹ 66 crore, social welfare and nutrition - ₹ 2.00 crore, village and small industries - ₹ 15.00 crore, agriculture- ₹ 96.43 crore and housing - ₹ 89.75 crore.

Box – 1.1

Major subsidies

Power

During the year, subsidy to power sector (₹ 2,341 crore) accounted for 57 *per cent* of the total subsidy (₹ 4,118 crore). It included financial assistance to electricity supply companies to cover loss due to rural electrification (₹ 2,091 crore) and contribution towards pension (₹ 250 crore).

Subsidy on rural electrification during the year, however, did not include subsidy of ₹ 75 crore given to the Karnataka Power Transmission Corporation (KPTCL) for meeting its 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 ₹ 330 crore, in 2006-07 (₹ 130 crore), 2007-08 (₹ 113 crore) and 2008-09 (₹ 87 crore). Though the Government stated (November 2007) that debt would be included on off-budget side in 2008-09, neither did MTFPs 2007-11 to 2010-14 nor overview of budget 2009-10 and 2010-11 exhibited this liability on off-budget side.

Food

Food subsidy to meet the differential cost of food grains under Public Distribution System (PDS) increased from ₹ 650 crore in 2007-08 to ₹ 1,164 crore in 2009-10. Against food subsidy of ₹ 264 crore recommended for Karnataka by TFC for the award period 2005-10, the amount of food subsidy was ₹ 804 crore per annum, on an average, during 2005-10.

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 ₹ 3,795 crore in 2005-06 (₹ 917 crore), 2006-07 (₹ 801 crore), 2007-08 (₹ 1,793 crore), 2008-09 (₹ 186 crore) and 2009-10 (₹ 98 crore).

According to Vaidyanathan Committee Report (March 2008), the Governments both at the Centre and in the States should desist from the practice 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 which had decreased to ₹ 186 crore further decreased to ₹ 98 crore in 2009-10 (50 *per cent* less than that of previous year).

Transport

Transport subsidy increased from ₹ 143 crore in 2008-09 to ₹ 157 crore in 2009-10. Forty nine *per cent* of the subsidy (₹ 66.66 crore) during 2009-10 was towards fare concession extended to students, freedom fighters, physically challenged, etc.

1.7.5 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 1.17.**

Table 1.17: Financial assistance to local bodies and other institutions

(₹ in crore)

	2005-06	2006-07	2007-08	2008-09	2009-10
Panchayat Raj Institutions	6,088.61	7,767.93	9,122.39	10,804.46	11,406.81
Urban Local Bodies	1,605.85	2,113.48	2,468.20	2,339.11	2,471.69
Educational Institutions (including universities)	695.62	750.27	878.23	379.23	387.57
Co-operative societies and co-operative institutions	955.45	882.98	1,895.60	119.00	239.41
Other institutions and bodies (including statutory bodies)	1,837.43	2,400.54	2,361.00	1,620.24	1,914.55*
Assistance as a percentage of revenue expenditure	40	42	45	37	35
Total	**11,182.96**	**13,915.20**	**16,725.42**	**15,262.04**	**16,420.03**

Source : *Finance Accounts*

**Includes assistance to ULBs for urban local election (₹ 25 crore) and grants to ULBs under FC recommendation (₹ 97 crore).*

The assistance to PRIs increased from ₹ 6,089 crore in 2005-06 to ₹ 11,407 crore in 2009-10 while the assistance to ULBs increased from ₹ 1,606 crore to ₹ 2,472 crore.

Out of the total devolution of ₹ 11,407 crore to PRIs during 2009-10, ₹ 5,886 crore (52 *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.

The assistance to ULBs, Co-operatives and other institutions increased by ₹ 133 crore, ₹ 120 crore and ₹ 295 crore respectively during the year 2009-10 from previous year. Assistance to other institutions (₹ 1,915 crore) included assistance to Development Authorities (₹ 252 crore), NGOs (₹ 617 crore) and various boards and institutions (₹ 358 crore). It also included assistance to schemes such as Modernization of Police (₹ 48 crore) and Rashtriya Krishi Vikasa Yojane – Animal Husbandry (₹ 33 crore).

As a 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 *per cent* of NLNORR during 2005-06 increased to eight *per cent* in 2006-09. It once again decreased to seven *per cent* during 2009-10. However, taking into account, assistance of ₹ 122 crore to ULBs accounted for as assistance to other institutions in Finance Accounts, assistance to ULBs would be eight *per cent* of NLNORR.

1.8 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 of expenditure.

1.8.1 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 said to be due to low fiscal priority attached by the State Government. Low fiscal priority (ratio of expenditure category to aggregate expenditure) is attached to a particular sector if the priority given to that particular head of expenditure is below the General Category States average for that year.

Table 1.18 brings out the fiscal priority given to different categories of expenditure of the State relative to General Category States in 2005-06 and the current year 2009-10.

Table-1.18 Fiscal Priority of the State in 2005-06 and 2009-10

(In *per cent*)

Fiscal Priority by the State	AE/GSDP	DE/AE	SSE/AE	CE/AE	Education/ AE	Health/ AE
General Category States Average (Ratio) 2005-06	17.75	61.76	30.76	13.97	14.95	4.05
Karnataka State's Average (Ratio) 2005-06	18.59	66.44	29.68	17.04	14.34	3.37
General Category States Average (Ratio) 2009-10	18.24	66.05	35.76	14.85	16.21	4.28
Karnataka State's Average (Ratio) 2009-10	20.32	74.06	37.22	20.01	14.50	3.71

AE: Aggregate Expenditure, DE: Development Expenditure, SSE: Social Sector Expenditure
CE: Capital Expenditure
Development expenditure includes Development Revenue Expenditure, Development Capital Expenditure and Loans and Advances disbursed.
Source : For GSDP, the information was collected from the State's Directorate of Economics and Statistics

Comparative analysis reveals the following:

- The ratio of AE to GSDP in 2005-06 and 2009-10 (18.59 and 20.32 *per cent*) were above the average ratios of General Category States (17.75 and 18.24 *per cent*). Hence, Government of Karnataka is spending more proportion of GSDP compared to General Category States.

- Adequate fiscal priority to DE and CE was given by the State Government in 2005-06 and 2009-10 as the ratio of DE to AE and CE to AE was higher than the average ratio of General Category States.

- Low priority to social sector was given by the State during 2005-06 as the ratio of SSE to AE (29.68 *per cent*) was less than the average ratio of General Category States (30.76 *per cent*). However, during 2009-10 adequate priority was given to the sector as the State's average of SSE to AE was 37.22 *per cent* as against the ratio of 35.76 *per cent* of General Category States.

- The State's average ratio of expenditure on education was less than the average ratio of General Category States in 2005-06 and 2009-10 which implied that there was low priority by the State in the said area. However, as per the census of 2001, the State had a literacy rate of 67 *per cent.*

- The State also gave low priority to health as the State's average ratio of expenditure on health was less than the average ratio of General Category States in 2005-06 and 2009-10. However, as per census of 2001, two parameters viz., infant mortality rate and life expectancy at birth of the State was at 45 per 1000 live births and 65 years which was better than the national average.

1.8.2 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 goods[4]. Apart from improving the allocation towards development expenditure[5], 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 1.19** presents the trends in development expenditure relative to the aggregate expenditure of the State during the current year *vis-à-vis* that of

---

[4] *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.

[5] 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.

previous years, **Table 1.20** provides the details of capital expenditure and the components of revenue expenditure incurred on the maintenance of the selected social and economic services.

Table-1.19: Development expenditure

(₹ in crore)

	2005-06	2006-07	2007-08	2008-09	2009-10
Development expenditure (DE)	**22,734**	**29,953**	**33,642**	**37,134**	**44,930**
Percentage of DE to total expenditure	**67**	**71**	**72**	**71**	**74**
Components of DE					
Revenue	16,846	21,377	24,577	27,010	32,301
	(74)	(71)	(73)	(73)	(72)
Capital	5,604	8,222	8,310	9,395	11,647
	(25)	(27)	(25)	(25)	(26)
Loans and advances	284	354	755	729	982
	(1)	(1)	(2)	(2)	(2)

Figures in parentheses indicate percentage to development expenditure
Source: *Finance Accounts.*

Development expenditure comprising revenue expenditure, capital outlay and loans and advances on socio-economic services increased from ₹ 22,734 crore in 2005-06 to ₹ 44,930 crore in 2009-10. As a *percentage* of total expenditure, it increased from 67 in 2005-06 to 74 in 2009-10. In the current year, development expenditure as a percentage of aggregate expenditure, increased by three *per cent* relative to the previous year due to increase in development capital 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 2005-10.

In 2009-10, development revenue expenditure included, *inter alia*, expenditure on salary (₹ 7,550 crore), subsidy (₹ 4,106 crore) and financial assistance to local bodies and other institutions (₹ 10,517 crore).

Table 1.20: Efficiency of expenditure use in selected social and economic services

(Ratios in *per cent*)

	2008-09		2009-10	
	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	0.38	11.40	0.35	10.33
Health and family welfare	0.58	2.35	0.53	2.05
Water supply, sanitation, housing and urban development	3.72	0.05	4.31	0.05
Others	0.54	1.00	0.50	0.86
Total (SS)	**5.22**	**14.80**	**5.70**	**13.29**
Economic services (ES)				
Agriculture & allied activities	0.14	1.61	0.15	1.46
Irrigation and flood control	5.71	0.24	6.50	0.22
Power & energy	2.75	---	2.89	---
Transport	4.30	0.06	4.43	0.05
Others	1.25	0.98	1.14	0.87
Total (ES)	**14.15**	**2.89**	**15.11**	**2.60**
Total (SS+ES)	**19.37**	**17.69**	**20.81**	**15.89**

TE: Total expenditure; CE: Capital expenditure; RE: Revenue expenditure

Expenditure on social services

Capital expenditure on social services increased from ₹ 2,728 crore in 2008-09 to ₹ 3,456 crore in 2009-10 and there was a corresponding marginal increase in ratio of capital expenditure to total expenditure.

Capital expenditure on social services during 2009-10 included ₹ 226 crore (seven *per cent*) on account of repayment of off budget borrowings.

The share of salary expenditure (under social services) in total revenue expenditure decreased from 15 *per cent* in 2008-09 to 13 *per cent* in 2009-10.

Expenditure on economic services

Capital expenditure on economic services increased from ₹ 7,395 crore in 2008-09 to ₹ 9,167 crore in 2009-10 with a growth rate of 24 *per cent*.

The priority sectors identified by the Government in respect of economic services were agriculture, power and rural development. In 2009-10, the capital outlay on power (₹ 1,750 crore) was 87 *per cent* more than the outlay in 2008-09. Capital outlay on power (₹ 1,750 crore) in 2009-10 included expenditure of ₹ 75 crore on REC and PFC loans of KPTCL taken over by the Government. In 2009-10, capital outlay on agriculture and rural development was more by ₹ 1,122 crore compared to 2008-09.

The share of salary expenditure (under economic services) in total revenue expenditure remained at three *per cent* in 2008-10.

Capital expenditure on economic services in 2009-10 included expenditure of ₹ 759 crore (eight *per cent*) on repayment of off budget borrowings.

1.9 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.

1.9.1 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 2010 is given in **Table 1.21**.

Table 1.21: Incomplete projects

(₹ in crore)

Department	Incomplete projects					Cumulative expenditure as of March 2010
	Number	Budgeted cost	Revised cost	Cost over run[6]		
				Number	Amount	
Public works						
Buildings	109	581.82	591.13	12	157.90	495.76
Roads & bridges	121	590.31	593.84	29	99.08	411.06
Irrigation	31	104.06	120.26	3	24.24	107.78
Total	**261**	**1,276.19**	**1,305.23**	**44**	**281.22**	**1,014.60**

Source: *Finance Accounts*

As against the initial budgeted cost of ₹ 1,276 crore in respect of 261 works stipulated to be completed on or before March 2010, the progressive expenditure was ₹ 1,015 crore as of March 2010. In 44 cases, the cost over run aggregated ₹ 281.22 crore.

No reasons for delay in completion of the works were given by the Public Works and Irrigation Departments.

1.9.2 Investment and returns

As of March 2010, Government had invested ₹ 32,483 crore in 88 Government companies (₹ 29,341 crore) including investment of ₹ 52 crore in 17 non-working Government companies, nine statutory corporations (₹ 1,674 crore), 45 joint stock companies (₹ 1,106 crore) and 15 co-operative societies/banks including regional rural banks (₹ 362 crore). The return from investment was negligible (**Table 1.22**).

Negligible returns from the investment were partly on account of locking up of funds in the Public Account without actual release to the institutions. Investment of ₹ 981.40 crore[7] in respect of five Companies / Corporations was lying in Public Account to the end of March 2010.

Table-1.22: Return on investment

	2005-06	2006-07	2007-08	2008-09	2009-10
Investment at the end of the year (₹ in crore)	14,052.53	18,698.37	22,279.35	26,672.11	32,483.28
Return (₹ in crore)	16.9	19.5	23.4	40.2	29.48
Return *(per cent)*	0.1	0.1	0.1	0.1	0.1
Average rate of interest on Government borrowings *(per cent)*	7.6	7.7	7.6	6.9	6.7
Difference between interest rate and return *(per cent)*	7.5	7.6	7.5	6.8	6.6

Source: *Finance Accounts.*

[6] Includes four cases where expenditure exceeded the revised cost and the cost overrun aggregated to ₹ 3.08 crore.

[7] Krisha Bhagya Jala Nigama (₹ 131.28 crore), Karnataka Infrastructure Development and Finance Corporation (₹ 283.35 crore), Karnataka Neeravari Nigam Limited (₹ 30.33 crore), Karnataka Rural Infrastructure Development Corporation Ltd (₹245.70 crore) and Mega Area Development (₹ 290.74 crore)

Out of the total investment of ₹ 32,483 crore upto the end of 2009-10, investment of ₹ 30,925 crore (95 *per cent*) during 2005-10 was in 63 Government companies and Statutory corporations under irrigation sector (₹ 19,084 crore), transport sector (₹ 924 crore), infrastructure sector (₹ 4,595 crore), power sector (₹ 3,717 crore), industries sector(₹ 316 crore), housing sector (₹ 1,220 crore), financing sector (₹ 427 crore), construction sector (₹ 261 crore) and social sector (₹ 381 crore).

The investment included ₹ 16,993 crore (52 *per cent*) in the following companies/corporations under perennial loss (**Table 1.23**).

Table 1.23: Investment in companies/corporations under perennial loss

(₹ in crore)

Company/Corporation	Investment during 2005-10	Cumulative loss as at 2008-09
Krishna Bhagya Jala Nigam Limited	14,267	156
Karnataka Road Development Corporation Ltd	2,505	85
North Western Karnataka Road Transport Corporation	137	334
North Eastern Karnataka Road Transport Corporation	84	293
Total	**16,993**	**868**

Source : *Finance Accounts.*

During the year, Government invested ₹ 5,039 crore in Government companies, ₹ 572 crore in Joint stock companies, ₹ 196 crore in Statutory corporations and ₹ four crore in Co-operative societies. This included;

- ₹ 122 crore invested in KSFC for removal of negative net-worth (₹ 110 crore) and for reimbursement of amount paid by loanees as equity (₹ 12 crore).
- Conversion of interest dues (₹ 4 crore) of Mysore Sales International Limited as equity.
- Conversion of interest free loans (₹ 500 crore) released to Electricity Supply Company (ESCOM) during 2008-09 as equity in 2009-10.

1.9.3 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 ₹ 12.36 crore. The total loss incurred by these undertakings was ₹ 5.82 crore. Details are furnished in **Appendix 1.7.**

In view of the continued losses sustained by 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.

1.9.4 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 1.24** presents the position of outstanding loans and advances as of March 2010 and interest receipts *vis-à-vis* interest payments during the last five years.

Table-1.24: Average interest received on loans advanced by the State Government

(₹ in crore)

	2005-06	2006-07	2007-08	2008-09	2009-10
Opening balance	**5,768**	**5,944**	**6,241**	**6,946**	**7,620**
Amount advanced during the year	300	357	757	731	982
Amount repaid during the year	124	60	52	57	555
Closing balance	**5,944**	**6,241**	**6,946**	**7,620**	**8,047**
Net addition	176	297	705	674	427
Interest receipts	95	38	58	103	74
Interest receipts as *per cent* to outstanding loans and advances	1.6	0.6	0.8	1.3	0.9
Interest payments as *per cent* to outstanding fiscal liabilities of the State Government.	7.2	7.3	7.5	6.3	6.2
Difference between interest payments and interest receipts (*per cent*)	-5.6	-6.7	-6.7	-5.0	-5.3

Source: *Finance Accounts.*

Loans outstanding as of March 2010 aggregated ₹ 8,047 crore. Interest spread of Government borrowings was negative during 2005-10 which meant that the State's borrowings were more expensive than the loans advanced by it.

Loans aggregating ₹ 982 crore were disbursed during 2009-10 which included ₹ 26 crore to sugar cane industry for conversion of purchase tax on sugar cane and ₹ 42 crore to Karnataka State Road Transport Corporation for conversion of motor vehicle tax due into interest free loan respectively. Terms and conditions of repayment were not received for loans amounting to ₹ 928 crore.

Recovery of loans and advances aggregating ₹ 1,315 crore (principal: ₹ 469 crore and interest: ₹ 846 crore) was overdue as of March 2010 from 23 institutions [detailed accounts of which were kept by the Accountant General, (Accounts and Entitlements)]. Around 94 *per cent* of this pertained to five major defaulters viz., Karnataka Urban Water Supply and Drainage Board, Bangalore Water Supply and Sewerage Board, New Government Electric Factory, Karnataka Housing Board and Bangalore Development Authority. In these cases the overdue interest and principal for recovery was ₹ 798 crore and ₹ 442 crore respectively.

Further, recovery of loans and advances aggregating ₹ 321 crore (principal: ₹ 201 crore and interest: ₹ 120 crore) was overdue as of March 2010 from 14 institutions (detailed accounts of which were kept by the State Government).

Around 61 *per cent* of this pertained to only two major defaulters viz., Mysore Electrical Industries Limited and Mysore Lamp Works. In these cases, the overdue interest and principal for recovery was ₹ 80 crore and ₹ 122 crore respectively.

1.9.5 Cash balances and investment of cash balances

Table 1.25 depicts the cash balances and investments made there from by the State Government during the year.

Table-1.25: Cash balances and investment of cash balances

(₹ in crore)

	As of March 2009	As of March 2010	Increase(+)/ Decrease (-)
Cash balances	7,819.85	9,773.51	1,953.66
Investments from cash balances	**7,519.31**	**8,889.98**	**1,370.67**
GOI treasury bills	7,518.98	8,889.67	1,370.69
GOI securities	0.32	0.20	-0.12
Other securities	---	---	---
Other investments	0.01	0.11	0.10
Funds-wise break-up of investment from earmarked balances	**652.92**	**980.45**	**327.53**
Sinking fund	-0.06	-0.21	-0.15
Industrial development fund	0.01	0.01	---
Co-operative development fund	0.49	0.49	---
Other development and welfare fund	652.47	980.15	327.68
Miscellaneous deposits	0.01	0.01	---
Interest realized	**232.53**	**309.04**	**76.51**

Source : *Finance Accounts.*

The cash balance of the State at the end of the year was ₹ 9,774 crore, an increase of 25 *per cent* over the previous year. The position of holding the surplus balances is brought out in **Box 1.2**.

Box – 1.2

Position of holding surplus cash balances

Surplus cash balance was mainly due to market borrowings of ₹ 6,000 crore raised during 2009-10 on 30 July (₹ 1,000 crore at 7.76 *per cent*), 04 August (₹ 1,000 crore at 7.95 *per cent*), 09 September (₹ 750 crore at 8.25 *per cent*), 25 November (₹ 2,000 crore at 8.05 *per cent* and 09 March (₹ 1,250 crore at 8.52 *per cent*).

The entire loan amount was invested in fourteen days intermediate treasury bills of RBI with an interest rate of five *per cent* per annum as against an average rate of seven *per cent* per annum at which the borrowings were made. The amount of investments at the year end was ₹ 8,890 crore. The balance of investments in April, May and June 2010 was ₹ 6,019 crore, ₹ 6,998 crore and ₹ 7,590 crore respectively. The balance at the end of June 2010 after meeting all short term liabilities of the State Government was ₹ 1,590 crore.

In view of the comfortable position of cash balances, the open market borrowings, could have been limited to ₹ 4,410 crore to meet the short term liabilities of the Government.

The State Government replied that the entire borrowings were required to meet short time liabilities of 2009-10. Audit conclusion was however drawn on the basis of surplus cash balance during the first quarter of 2009-10 after meeting all short term commitments.

Maintaining idle cash balance is not prudent cash management. A shelf of projects should be ready so that mismatch between timing of borrowings and channeling it towards productive investment is considerably reduced.

1.10 Assets and liabilities

1.10.1 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 1.6** gives an abstract of such liabilities and assets as on 31 March 2010 compared with the corresponding position as on 31 March 2009.

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. Consolidated Fund liabilities consist of Internal Debt and Loans and Advances from GOI.

Further, the internal debt includes market loans, special securities issued to RBI and other negotiated loans. 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. The Public Account liability includes small savings, provident funds, etc., reserve funds and other deposits. 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.

Assets comprise, assets under Consolidated Fund and cash. The assets under Consolidated Fund consists of capital outlay on fixed assets – investments in shares of companies and corporations and loans and advances which in turn consist of loans for power projects and other development loans.

The growth rate of composition of assets and liabilities are summarized in the **Table 1.26.**

Table 1.26 Summarised position of Assets and Liabilities

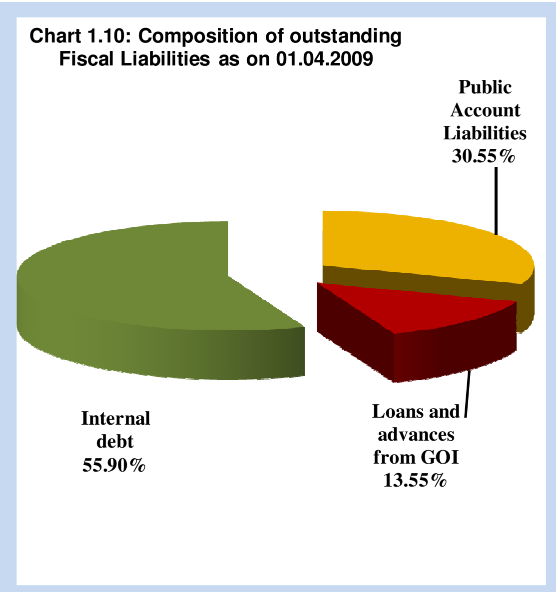
(₹ in crore)

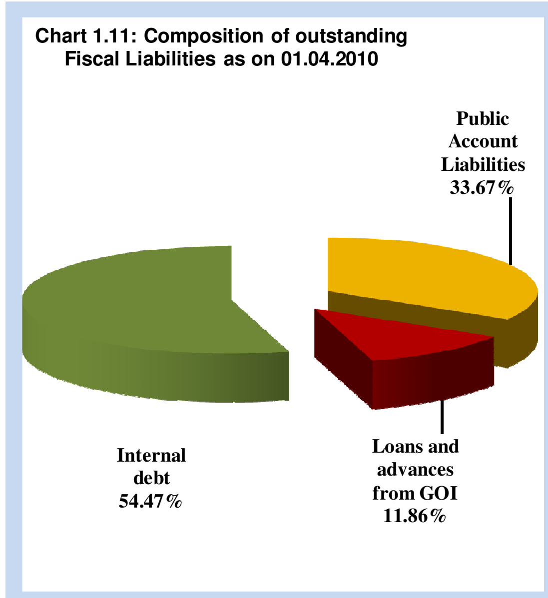
Liabilities				**Assets**			
	2008-09	**2009-10**	***(per cent)***		**2008-09**	**2009-10**	***(per cent)***
Consolidated Fund	***49,688***	***55,370***	***11***	***Consolidated Fund***	***70,643***	***83,206***	***18***
a. Internal Debt	39,996	45,468	14	i. Capital outlay	63,023	75,160	19
b. Loans and advances from GOI	9,692	9,902	2	ii. Loans and advances	7,620	8,046	6
Public Account	***22,515***	***29,092***	***29***	***Cash***	***7,820***	***9,774***	***25***
a. Small savings, Provident funds, etc	9,710	11,177	15				
b. Reserve Funds	7,053	10,254	45				
c. Deposits	5,752	7,661	33				

The growth rate of assets decreased from 23 *per cent* in 2008-09 to 18 *per cent* in 2009-10, and that of liabilities decreased from 19 *per cent* in 2008-09 to 17 *per cent* in 2009-10.

1.10.2 Fiscal liabilities

The trends in outstanding fiscal liabilities of the State are presented in **Appendix 1.5**. 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.*

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 1.27**.

Table 1.27: Fiscal liabilities –basic parameters

(₹ in crore and ratios in *per cent*)

	2005-06	2006-07	2007-08	2008-09	2009-10
Fiscal liabilities	52,236	57,682	60,142	71,550	83,482
Rate of growth (*per cent*)	11.3	10.4	4.3	19.0	17.0
Ratio of fiscal liabilities to					
GSDP	28.42	28.03	25.05	26.43	27.97
Revenue receipts	172.1	153.5	146.1	165.3	171.4
Own resources	232.1	210.5	204.9	232.3	246.2
Buoyancy ratio of fiscal liabilities to					
GSDP	0.64	0.87	0.26	1.48	1.67
Revenue receipts	0.8	0.4	0.5	3.6	1.0
Own resources	1.2	0.5	0.6	3.8	1.7

Source: *Finance Accounts.*

Fiscal liabilities of the State increased by 60 *per cent* from ₹ 52,236 crore in 2005-06 to ₹ 83,482 crore in 2009-10 comprising Consolidated Fund liabilities (₹ 55,370 crore) and Public Account liabilities (₹ 28,112 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 four *per cent* in 2007-08. With the announcement of economic stimulus package by GOI and consequent amendment to FRA, fiscal deficit limit was raised to 3.5 and four *per cent* of GSDP during the year 2008-09 and 2009-10 respectively. The growth rate of fiscal liabilities which had increased to 19 *per cent* during 2008-09 decreased to 17 *per cent* during 2009-10. 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 and 2009-10. The ratio of fiscal liabilities to GSDP was 28 *per cent* at the end of 2009-10.

1.10.3 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 four years are given in **Table 1.28**.

Table-1.28: Guarantees given by the State Government

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10
Maximum amount guaranteed	19,793	23,109	18,732	18,420
Outstanding amount of guarantees (including interest)	9,879	10,786	8,693	7,203
Percentage of outstanding amount guaranteed to total revenue receipts of the second preceding year	37	36	23	18

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 2006-10 were within the prescribed limit.

The outstanding guarantees of ₹ 7,203 crore at the end of the year 2009-10 included guarantees extended to 35 institutions/companies under irrigation (₹ 1,467 crore), co-operative (₹ 2,122 crore), finance (₹ 782 crore), power (₹ 469 crore), housing (₹ 457 crore), transport (₹ 391 crore) and water supply and urban development (₹ 874 crore) sectors.

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.

Off - budget borrowings

The borrowings of the State Government are governed under Article 293 (1) of the Constitution of India. In addition to the contingent liabilities shown in **Table 1.28**, 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 of ₹ 569 crore on off-budget borrowings, even though there is no corresponding built up of assets in Accounts. This further resulted in under-statement of interest expenditure and revenue surplus and overstatement of capital expenditure.

Table 1.29 captures the trend in the off-budget borrowings of the State during 2005-10 while **Table 1.30** gives the entity-wise position of borrowings to the end of 2009-10.

Table 1.29: Trend in off-budget borrowings

(₹ in crore)

Year	2005-06	2006-07	2007-08	2008-09	2009-10
Amount as per MTFP 2007-11♠	1,078	242	103	---Nil---	---Nil---

♠ Figures are yet to be reconciled with those of the financial institutions.

Table 1.30: Entity-wise position of off-budget borrowings

(₹ in crore)

Company/Corporation/Board	Outstanding Off-budget borrowings	Repayment during the year	
		Principal	Interest
Krishna Bhagya Jala Nigam Limited	514.9	141.5	29.53
Karnataka Neeravari Nigam Limited	607.00	109.00	49.84
Karnataka Road Development Corporation	805.63	414.84	346.89
Rajiv Gandhi Rural Housing Corporation	592.01	70.78	48.47
Karnataka Slum Clearance Board	79.86	20.11	6.16
Karnataka Rural Infrastructure Development Corporation Limited	84.67	12.52	9.12
Karnataka Renewable Energy Development Limited	19.40	19.40	2.04
Cauvery Neeravari Nigam Limited	789.55	185.37	55.04
Karnataka Residential Education Institution Society	36.52	5.45	3.43
Karnataka State Industrial Investment Development Corporation	207.15	2.75	17.22
Sarva Siksha Abhiyan Samithi	10.68	2.21	1.05
Total	**3,747.37**	**983.93**	**568.79**

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 2010 worked out to ₹ 86,245 crore[8] as against ₹ 83,482 crore shown in **Table 1.27** and the ratio of fiscal liabilities (inclusive of off-budget borrowings) to GSDP remained at 29 *per cent* at the end of the year as in the previous year.

1.11 Public Debt Management

Public Debt management is the process of establishing and ensuring a strategy for managing Government's debt portfolio to meet the funding requirements of the Government, achieve objective of cost and risk and meet any other objectives of debt such as ensuring that both the levels and growth of debt are fiscally sustainable.

The basic principles of sound debt-management lay stress on the importance of well-defined institutional arrangements for managing public debt, importance of transparency in debt-management objectives and policies, importance of accountability on matters related to public debt and importance of risk-evaluation / risk-assessment of public-debt.

1.11.1 Institutional frame-work for public debt management

In the Budget Speech of 2005-06, the Finance Minister proposed formation of a Fiscal Policy Analysis Cell (Cell) to act as the analytical brain to provide inputs and analytical support to the fiscal responsibility programme of the Government and an order was passed by the Government in June 2005 which provided for the creation of the Cell and laid down the responsibilities of the various units of the Cell.

The Debt Management Unit of the Cell is responsible for tracking, managing and planning government debts, loans, guarantees, cash flow plans, risk management strategies and other debt related information. The Unit was to be manned by staff drawn from the Finance Department, Reserve Bank of India, O/o the Accountant General, State Public Sector Undertakings (PSUs) and a person drawn from the Economics and Statistics Department. Details of staff strength of the Debt Management Unit and the nature of inputs provided by the Debt Management Unit to the Expenditure Planning Unit were not furnished by the Finance Department (FD).

[8] Total fiscal liabilities: ₹ 83,482 crore plus balance of off-budget borrowings; ₹ 2,763 crore.

1.11.2 Tracking and monitoring of Government borrowings

Public debt management strategy is said to be efficient when debt-servicing and repayment take place in time without the burden of payment of penal interest, compound interest, etc. This can be done by tracking and monitoring all borrowings of the Government. This implies that the public debt-management authority should have a data-base which is complete and reliable as an incomplete data-base may result in non-servicing/non-repayment of such chunks of borrowings of the Government not captured in the debt profile. To improve the data-base on debt, the Government proposed the introduction of Commonwealth Secretaries Software in the MTFP-2007-11. The software was expected to help in the monitoring and supervision of debt and generation of Management Information Reports (MIRs). The Finance Department stated that the software was used for building data-base on market loans, LIC, GIC, NSSF and GOI loans and generation of MIRs.

The following instances disclosed inadequacies in the data-base on public debt;

- The internal debt of the State includes loans from LIC drawn mainly by the Department of Housing towards its housing projects. Two identical loans amounting to ₹ 159.99 crore were drawn by the Department of Housing in 2000-01 and 2001-02 and the latter, in respect of which interest payments had to be made half-yearly on 15 May and November every year commencing from 2002 and principal repayment had to be made on 15 May every year from 2003 onwards was not serviced from the beginning (i.e., 15 May 2002 to 15 November 2008) as it had not entered the register/debt-profile of the Housing Department and consequently the data-base of the DMU. The amount due to LIC from 15 May 2002 to 15 May 2008 was finally settled by payment of ₹ 186.72 crore (principal: ₹ 121.24 crore and interest: ₹ 65.48 crore) under one-time settlement of dues in 2009-10. In the normal course the outflow would have been ₹ 151.14 crore.

- The data base on National Co-operative Development Corporation (NCDC) loans which is also part of internal borrowings of the Government is also inadequate and unreliable to the extent that the closing balance of the NCDC loans as depicted in the Finance Accounts of the Government is adverse with re-payments exceeding the outstanding balance of loans. The Finance Department replied (October 2010) that adverse balance in respect of NCDC loans was on account of direct release of loans by NCDC through Apex Bank as a result of which such loans not routed through the Consolidated Fund of the State were not reflected in the Finance Accounts and that the Department had built a data-base of NCDC loans based on information obtained from NCDC in 2003-04. It was also stated that re-payment of principal and interest was being made by the Government based on the debt profile so developed. Despite obtaining complete details of outstanding NCDC loans in 2003-04 itself, the Finance Department had not taken action for bringing within Finance Accounts such loans hitherto not reflected in Accounts. Instead it continued to make re-payments to NCDC on the loan balance not reflected in the Finance Accounts.

- Recovery/adjustment of outstanding dues payable by the borrowing departments from new loans sanctioned by financial institutions is also a reflection of inadequate debt management.
  - In respect of a loan amount of ₹ 170 crore released by LIC on 28 March 2003 to Housing Department, an amount of ₹ 21.11 crore was recovered by LIC towards over-dues on that date.
  - In respect of a loan amount of ₹ 159.99 crore released by LIC in May 2001 to Housing Department, continuous delay in remittance of dues by the Housing Department during 2002-08, resulted in LIC adjusting ₹ 59.15 crore towards compound interest (₹ 48.43 crore), penal interest (₹ 9.77 crore) and withdrawal of rebate (₹ 0.95 crore), from out of ₹ 817.55 crore paid by the Government during this period to LIC towards repayment.

The Finance Department accepted (October 2010) the fact of non-remittance and delay in remittance and stated that debt re-payments are now being monitored more professionally by creating the data base of each instrument.

- The Government is incurring expenditure towards payment of debt-management charges to RBI on account of Urban Land Ceiling Bonds raised in 1976, while the books of AG (A&E) do not reflect this liability as it has been discharged. The Finance Department stated (October 2010) that action would be taken to write-off the balance as per books of RBI (₹ 10 lakh) which would save payment of management charges.
- As public debt includes even the contingent liabilities of the Government, it is important that the Government/debt-management authority has a reliable data-base on all guarantees extended by the Government. As part of debt reforms, the Government proposed in the MTFP 2007-11 the creation of a central data-base on all guarantees extended by the Government. The Finance Department stated that the data-base on guarantees extended by Government was under creation.

1.11.3 Transparency

Effectiveness of public debt management operations and policies can be ensured if the objectives, strategies and instruments of borrowing are known to public. Sound practice in the area of transparency includes publicly disclosing the objectives of debt management, the cost-risk measures of these objectives, publishing all material aspects of public-debt and publishing all available information on public debt - budget allocation, debt-servicing flows, timing of raising loans, size of loans required to meet the funding requirements of the Government and the financial position of the Government.

Debt-servicing expenditure on the off-budget borrowings of the State Government is passed off in the budget documents as capital expenditure.

The State Government replied (November 2010) that the SPVs create public assets on behalf of the State and the borrowings of the SPVs serviced by the State are treated as part of State's fiscal deficit as per KFR Act norms. However, KFR

Act stipulates that interest payments on SPV borrowings are to be treated as revenue expenditure. The off-budget borrowings by SPVs are amortised through the budget and classified under the sectoral head under which the SPV falls, while interest on the SPV borrowings is capitalised and serviced through capital outlay, against which there is no build-up of State assets.

In 2008-09 and 2009-10, the Government incurred an expenditure of ₹ 8.14 crore and ₹ 12.67 crore towards interest dues of 2009-10 and 2010-11 in respect of NABARD loans which was accounted as (current year) revenue expenditure of 2008-09 and 2009-10, thereby resulting in under-statement of revenue surplus of the State. This also meant that revenue receipts of the Government were used to meet future commitments whereas the scope of the annual budget placed in the Legislature by the State is to meet current year's expenditure out of current year's receipts.

The State Government replied (November 2010) that debt-servicing of NABARD loans due on April 2010 (2010-11) was done in March 2010 (2009-10) at the insistence of NABARD as First of April was a bank holiday. However, any payment by cheque/DD is deemed to have been made on the date of issue of cheque/DD subject to availability of balance on that date. Further, under Section 10 of General Causes Act, 1897, if due date of payment falls on a holiday, the next working day is reckoned as the due date of payment.

1.11.4 Accountability and Risk management

Debt management strategy can be said to be effective only if there is allocation of responsibilities among all entities involved in various aspects of debt management.

Discharge of guarantees by the Government, one-time settlement of dues to LIC in respect of housing loan dues, payment of penal interest on delayed servicing of loans, etc., are instances of failure of debt management. Information as to action taken by the Government to fix accountability among the various entities involved was not furnished to Audit.

In the MTFP 2007-11, the Government announced that it was working on prescription of a protocol to be followed with regard to extension of guarantees and that all guarantees would be rated through a professional agency to assess the associated risk and take corrective action.

The Government had not taken any action in this regard and the FD stated that risk analysis being complex and technical in nature, it did not have the capacity for risk assessment.

The Government had created the guarantee reserve fund in 1999-2000 but the fund is not operational as guarantee commission receipts and expenditure on account of discharge of obligations is not transferred to the Fund. The Government had not evolved a risk management strategy to default/possible default by the entities which had raised loans under Government guarantee.

Stipulation of guidelines for extension of guarantees, periodic evaluation of financial position of PSUs backed by the Government guarantees and rating of guarantees for assessment of risk are to be considered actively by the Government in view of the announcement in MTFP 2009-13 that off-budget borrowings would be rooted out and only such organisations would be allowed to borrow (under Government guarantee) which can service the debt out of their resources without depending on State budget.

1.11.5 Assessment of budget requirement

Effective debt management of the Government implies assessment of funds required for scheduling payments. As per GO dated 15 June 2005, an Expenditure Planning, Analysis and Project Evaluation Unit was to be set-up to formulate budget through analytical work in the area of base-line spending, estimates, expenditure prioritisation, etc. and linkages between the Debt Management unit and the Expenditure Planning Unit will be critically important for resource planning efforts of the Government.

Correct estimation of budget requirement under the debt servicing heads is important since surrenders may be misinterpreted by the general public as failure to use funds provided. Realistic cash-flow estimate must be prepared and taken into account while working out the over draft (OD) and ways and means requirements. Owing to the comfortable cash balance position in the recent years, the Government is not availing either ways and means advances or over-draft and the huge budget provision made under 6003-110-1&2-ways and Means Advances and OD is being surrendered. Huge surrender of appropriations of meant for debt-servicing/loan re-payment is indicative of incorrect estimation of fund requirements.

1.11.6 Excess market borrowings

The total market borrowings raised by the Government of Karnataka during 2009-10 amounted to ₹ 6,000 crore.

Though the borrowings were stated to finance the fiscal deficit, the fiscal deficit of the State was over-stated by at-least ₹ 2,100 crore in 2009-10 on account of non-transfer of expenditure from the Consolidated Fund to the Public Account even though deduct entries were provided in the supplementary estimates for carrying out the adjustment. The capital expenditure of the State also included certain items of expenditure which did not involve any cash outflow -loan to KPTCL in 2008-09 accounted as equity in 2009-10 (₹ 500 crore) and adjustment of ₹ 110 crore due from sugar factories, MSIL, KSFC, KSIIDC and KLAC as investments/loan in 2009-10.

Thus, on account of non-transfer of capital expenditure (₹ 2,100 crore) from the Consolidated Fund to the Public Account and inclusion of items of expenditure which did not involve cash out-flow (₹ 610 crore), the fiscal deficit of the State was over-stated resulting in over-borrowings by the State.

The State Government replied (November 2010) that items of expenditure not involving cash out-flow are deficit neutral as these are backed by non-debt receipts. These items of expenditure, however, would have been deficit neutral had these not been taken into account for working out borrowing requirement.

1.12 Debt sustainability

Apart from the magnitude of debt of the State Government, it is important to analyze various indicators that determine the debt sustainability[9] of the State. This section assesses the sustainability of debt of the State Government in terms of debt stabilization[10]; sufficiency of non-debt receipts[11]; net availability of borrowed funds[12]; burden of interest payments (measured by interest payments to revenue receipts ratio) and maturity profile of the State Government securities. **Table 1.31** analyzes the debt sustainability of the State according to these indicators for the period 2005-10.

Table 1.31: Debt sustainability: Indicators and trends

Debt sustainability indicators	2005-06	2006-07	2007-08	2008-09	2009-10
Debt stabilization (₹ in crore) (Quantum spread -/+ Primary deficit/ surplus)	6,137	-337	4,466	1,381	- 2,740
Sufficiency of incremental non-debt receipts (resource gap) (₹ in crore)	750	1,777	-138	-2,205	375
Net availability of borrowed Funds (in *per cent*)	6	5	---	21	18
Burden of interest payments (IP/RR Ratio)	12.4	11.3	10.9	10.5	10.6
Maturity profile of State debt (in years)					
0 – 1					963 (4)
1 – 3					4,494 (19)
3 – 5					3,902 (17)
5 – 7					8,167 (35)
7 and above					6,000 (25)

Figures in parenthesis denote the percentage to market borrowings of ₹ 23,526 crore.
Source: *Finance Accounts.*

[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 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.

1.12.1 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 2005-10 the primary revenue balance was positive and sufficient to meet interest expenditure.

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). The interest spread and quantum spread will be positive/negative depending on whether the GSDP growth rate is more or less than the growth rate of interest payments. When the quantum spread and primary deficit are negative, debt-GSDP ratio will be high indicating unsustainable levels of public debt and when the quantum spread and primary deficit are positive, debt-GSDP ratio will be low indicating sustainable levels of public debt. In 2009-10, both interest and quantum spread were positive.

Stabilization of debt is understood to mean debt as a constant *per cent* of GSDP which is a measure of the debt carrying capacity of the State. Even though the GSDP growth rate was more than the average interest rate on the debt stock of the State in 2009-10, the debt-GSDP ratio was higher than in 2008-09. The State can stabilize debt-GSDP ratio by containing/reducing primary deficit by at least ₹ 2,740 crore, i.e. from ₹ 5,662 crore to ₹ 2,922 crore. This can be done by corrections in the sub-components of primary deficit-primary expenditure as well as own revenue. Then the State can honour the FRA fiscal deficit cap (normal) of three *per cent* of GSDP.

1.12.2 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 was negative during 2007-09, turned positive in 2009-10. This meant that the State did not depend on borrowed funds for meeting current revenue and capital expenditure.

1.12.3 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 continued to be less than one *per cent* (0.8) in 2009-10 as in the previous year as debt redemption was lower than debt receipts. Eighteen *per cent* of debt receipts were available for productive/capital expenditure.

1.12.4 Maturity profile

In terms of maturity profile, around 38 *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 nearly five times in 2018-19 compared to 2017-18 due to huge market borrowings in 2008-09 as the State was allowed to borrow at 3.5*per cent* of GSDP under the Fiscal Stimulus Package. Due to huge market borrowings in 2009-10 also, 85 *per cent* of the total re-payment obligation of ₹ 7,072 crore in 2019-20, will be in respect of market borrowings.

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.*

1.12.5 Burden of interest payments

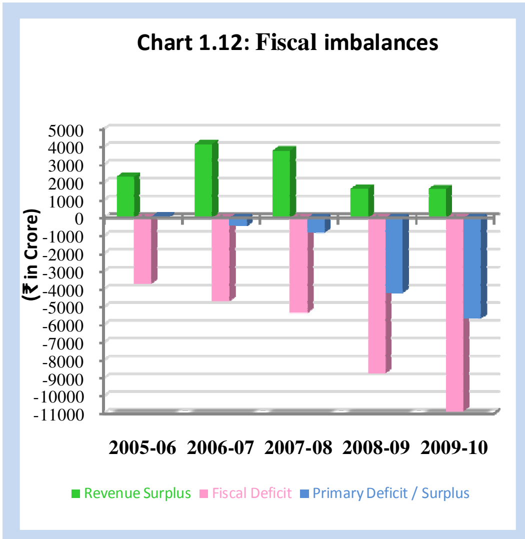
The ratio of interest payments to revenue determines the debt sustainability of the State. *During the year, interest payments pre-empted 11 per cent of the total revenue receipts of the State which was below the norm of 15 per cent prescribed by TFC.* On account of achievement of targets under FRA, the State benefited in terms of interest relief (₹ 1,252 crore) under DCRF scheme during 2005-10 which helped in stabilization of interest payments as a ratio of revenue receipts.

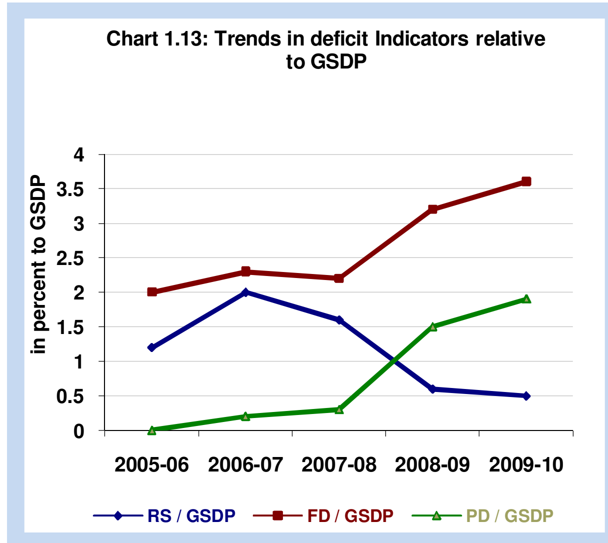
1.13 Fiscal imbalances

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 2009-10.

1.13.1 Trends in deficits

Charts 1.12 and 1.13 present the trends in deficit indicators over the period 2005-10





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 2009-10 with inter-year variation. Decrease in the amount of revenue surplus began in 2007-08. In 2008-09, revenue surplus of the State decreased by ₹ 2,145 crore due to increase in revenue expenditure by ₹ 4,215 crore (11 *per cent*) as against increase in revenue receipts by ₹ 2,140 crore (five *per cent*). In 2009-10, revenue surplus continued to decrease and was ₹ 1,619 crore.

FRA target of reducing fiscal deficit –GSDP ratio to less than three *per cent* was also achieved one year ahead in 2004-05 and in 2008-09 the State continued to maintain fiscal deficit as a ratio of GSDP within the revised FRA limit of 3.5 *per cent*.

In 2009-10, decrease in revenue surplus (₹ 12 crore), increase in non-debt capital receipts (₹ 387 crore) and increase in capital expenditure (₹ 2,517 crore) increased the fiscal deficit by ₹ 2,143 crore over the previous year, but fiscal deficit was within the revised FRA limit of four *per cent* of GSDP.

Despite increase in revenue and non-debt receipts by ₹ 6,253 crore in 2009-10 over the previous year, primary deficit increased by ₹ 1,462 crore as the incremental non-debt receipts were short of incremental primary expenditure by ₹ 1,462 crore.

Primary deficit of ₹ 5,622 crore at the end of the year implied that non-debt receipts were sufficient for meeting primary revenue expenditure and that the State had to depend on borrowed funds for meeting 10 *per cent* (₹ 5,622 crore) of its primary expenditure. This underlined the need for augmentation of own revenue for fiscal correction and consolidation.

In 2009-10, the State was on the road to recovery from the effects of economic slow-down. Decrease in revenue surplus was contained, if not reversed, and in 2009-10 revenue surplus decreased by only ₹ 12 crore over the previous year. This was possible because the growth rate of revenue receipts (13.5 *per cent*) more or less matched the growth rate of revenue expenditure (14.1 *per cent*) in 2009-10, unlike in 2008-09 when the growth rate of revenue expenditure was twice the growth rate of revenue receipts. In 2009-10, the growth rate of revenue receipts improved over the previous year because of increase in the growth rate of revenue from Motor Vehicle Tax and Sales, Trade, etc.

The increase in fiscal deficit in 2009-10 was less pronounced than the increase in fiscal deficit in 2008-09 mainly because of increase in non-debt capital receipts by ₹ 387 crore and containment of decrease in revenue surplus (₹ 2,133 crore).

Primary deficit increased by ₹ 1,462 crore in 2009-10 as against an increase by ₹ 3,374 crore in 2008-09. The increase in primary deficit was also contained in 2009-10 because of improvement in the growth rate of non-debt receipts also.

1.13.2 Components of fiscal deficit and its financing pattern

The financing pattern of fiscal deficit has undergone a compositional shift as reflected in the **Table 1.32**.

Table 1.32: Components of fiscal deficit and its financing pattern

(₹ in crore)

		2005-06		2006-07		2007-08		2008-09		2009-10	
		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		**-3,687**	**-2.0**	**-4,688**	**-2.3**	**-5,332**	**-2.2**	**-8,732**	**-3.2**	**-10,875**	**-3.6**
1	Revenue surplus	2,311	1.3	4,152	2.0	3,776	1.6	1,631	0.6	1,619	0.5
2	Net capital expenditure	5,822	3.2	8,543	4.2	8,403	3.5	9,689	3.6	12,067	4.0
3	Net loans and advances	176	0.1	297	0.1	705	0.3	674	0.2	427	0.1
Financing pattern of fiscal deficit*											
1	Market borrowings	165	**0.1**	-233	**-0.1**	287	**0.1**	6,583	**2.4**	4,954	**1.7**
2	Loans from GOI	251	**0.1**	-83	**0.0**	357	**0.1**	135	**0.0**	211	**0.1**
3	Special securities issued to NSSF	4,272	**2.3**	2,478	**1.2**	209	**0.1**	-164	**-0.1**	247	**0.1**
4	Loans from financial institutions	164	**0.1**	-366	**-0.2**	174	**0.1**	260	**0.1**	272	**0.1**
5	Small savings, PF etc	656	**0.4**	659	**0.3**	749	**0.3**	1,176	**0.4**	1,468	**0.5**
6	Deposits and advances	-368	**-0.2**	1,805	**0.9**	-62	**0.0**	1,554	**0.6**	1,908	**0.6**
7	Suspense and misc	523	**0.3**	237	**0.1**	1,498	**0.6**	968	**0.4**	602	**0.2**
8	Remittances	40	**0.0**	514	**0.2**	-828	**-0.3**	-52	**0.0**	-36	**0.0**

		2005-06		2006-07		2007-08		2008-09		2009-10	
		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
9	Reserve funds	473	**0.3**	1,188	**0.6**	750	**0.3**	2,174	**0.8**	3,201	**1.1**
10	Increase (-) / decrease (+) in cash balance	-2,528	**-1.4**	-1,498	**-0.7**	2,185	**0.9**	-3,900	**-1.4**	-1,954	**-0.7**
11	Net of Contingency Fund transactions	39		-13		13		-2		2	
	Total	**3,687**	**2.0**	**4,688**	**2.3**	**5,332**	**2.2**	**8,732**	**3.2**	**10,875**	**3.6**

* 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 downward trend of revenue surplus which commenced in 2007-08 continued in 2008-09 and 2009-10 there-by affecting the extent of fiscal deficit which could be financed by revenue surplus. 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. In 2009-10, surplus in revenue account financed 15 *per cent* of the fiscal deficit of the State, the lowest during 2007-10.

Declining revenue surplus reduced the ability of the Government to increase its capital outlay significantly. While capital outlay as a *per cent* of GSDP ranged between 3.2 and 4.2 *per cent* during 2005-10, there was no significant increase in capital outlay as a *per cent* of GSDP in 2009-10 over the previous year.

Net loans and advances was a very insignificant component of gross fiscal deficit expenditure due to restricted lending by the State Government.

As in 2008-09, market borrowings by the State Government continued to finance a major portion of fiscal deficit but its share in financing fiscal deficit decreased from 75 *per cent* in 2008-09 to 46 *per cent* in 2009-10. Despite TFC recommendation that loans from Centre be phased out, there was a marginal increase in loans from Govt. of India in 2009-10 relative to 2008-09. The share of NSSF loans, loans from financial institutions, small savings, Provident Fund, etc., in financing fiscal deficit was slightly higher in 2009-10 than in 2008-09.

1.13.3 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 1.33**) 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 1.33: Primary deficit/surplus – Bifurcation of factors

(₹ 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)
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
2009-10	49,781	42,324	12,137	982	55,443	7,457	-5,662

Source : *Finance Accounts.*

Primary surplus showed declining trend in 2005-06 and turned negative in 2006-07 as 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. Primary deficit showed increasing trend thereafter. 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 other items of expenditure which did not result in asset creation.

In 2009-10, the growth rate of non-debt receipts of the State increased to 14 *per cent* from five *per cent* in 2008-09 and the gap between growth rate of non-debt receipts and growth rate of primary expenditure was also bridged. While in 2008-09, the growth rate of primary expenditure (13 *per cent*) surpassed the growth rate of non-debt receipts (five *per cent*), in 2009-10 the growth rate of non-debt receipts fell short of the growth rate of primary expenditure (16 *per cent*) by two *per cent*. Thus, increase in primary deficit was ₹ 3,374 crore in 2008-09 while it was ₹ 1,462 crore in 2009-10.

1.14 Conclusion and recommendations

Fiscal position

The State continued to maintain revenue surplus during 2005-10 and kept fiscal deficit relative to GSDP below the limit laid down under FRA.

In 2009-10, the State was on the road to recovery from the effects of economic slow-down. Decrease in revenue surplus was contained, if not reversed. The increase in fiscal deficit in 2009-10 was less pronounced than the increase in fiscal deficit in 2008-09. The increase in primary deficit was also contained in 2009-10. Despite increase in revenue and non-debt receipts by ₹ 6,253 crore in 2009-10 over the previous year, primary deficit increased by ₹ 1,462 crore as the incremental non-debt receipts were short of incremental primary expenditure by ₹ 1,462 crore.

Recommendations: Primary deficit of ₹ 5,622 crore at the end of the year implied that non-debt receipts were sufficient for meeting primary revenue expenditure and that the State had to depend on borrowed funds for meeting 10 *per cent* (₹ 5,622 crore) of its primary expenditure. This underlined the need for augmentation of own revenue for fiscal correction and consolidation.

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 78 *per cent* of the total expenditure in 2009-10.

Non-plan revenue expenditure (NPRE) was 74 *per cent* of revenue expenditure during 2009-10. It included devolutions to PRIs and ULBs, interest payments, subsidies, pension payments, salaries and maintenance expenditure.

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

Recommendations: Subsidies will not meet the aims of social policy unless the beneficiaries are properly identified and targeted. The delivery of product or service at subsidized price results in large scale corruption, diversion and misuse. The Government should take action to implement the purchaser-provider model proposed in 2005 and ensure that beneficiaries are properly identified and targeted.

Quality of capital expenditure

Capital expenditure of the State included certain items of expenditure which did not involve any cash outflow and also subvention to a loss making PSU.

Funds aggregating ₹ 1,015 crore were blocked in incomplete projects as at the end of 2009-10.

Investment to the end of 2009-10 included ₹ 16,993 crore (52 *per cent*) to companies/corporations under perennial loss. Investment of ₹ 981.40 crore in respect of five Companies / Corporations was lying in Public Account to the end of March 2010.

Recommendations: 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.

Position of Cash Balance

The cash balance of the State at the end of the year increased by 25 *per cent* over the previous year.

Recommendations: Since, maintaining idle cash balance is not prudent cash management, a shelf of projects should be ready and techno-economic feasibility should have been appraised and approved so that mismatch between timing of borrowings and channeling it towards productive investment is considerably reduced.

Oversight of funds transferred directly from the Union to the State implementing agencies

The Central Government transferred a sizeable quantum of funds (₹ 7,594 crore during 2009-10) directly to the State implementing agencies for implementation of Central plan schemes. Funds flowing directly to the implementing agencies through off-budget routing inhibits FRA requirements of transparency and therefore, escape accountability. There is no single agency monitoring its use and there is no readily available data on the amounts spent in any particular year on major flagship and other important schemes. *A system has to be put in place to ensure proper accounting of these funds and the updated information should be validated by the State Government as well as the Accountant General (Accounts & Entitlement).*

Debt management

Public debt management strategy is said to be efficient when debt-servicing and repayment take place in time without the burden of payment of penal interest, compound interest, etc.

Recovery/adjustment of outstanding dues payable by the borrowing Departments from new loans sanctioned to the departments by financial institutions is a reflection of inadequate debt management.

Effective debt management of the Government implies assessment of funds required for scheduling payments. Correct estimation of budget requirement under the debt servicing heads is important since surrenders may be misinterpreted by the general public as failure to use funds provided.

Recommendations: The data base on Government borrowing should be complete, reliable and transparent in all respects. Realistic cash flow statement should form the basis of budgeting.