Chapter 1

Finances of the State Government

Profile of the State

Karnataka is the eighth largest State in terms of geographical area and accounts for around five *per cent* of India's population. As indicated in **Appendix 1.1**, in the last ten years, the density of population in Karnataka has increased from 276 persons per sq km to 319 persons per sq km. However, the State still has lower density of population as compared to all India average.

The State has shown higher economic growth in the past decade as the compounded annual growth rate of its GSDP for the period 2002-03 to 2011-12 has been 15.59 *per cent against* 14.46 *per cent* of the General Category States. During this period, the population growth rate of the State (16.50 *per cent*) was higher than that of the General Category States (13.90 *per cent*) and higher *per capita* income in the State was on account of higher GSDP growth rate.

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

Gross State Domestic Product (GSDP)

GSDP is the market value of all officially recognized final goods and services produced within the State in a given period of time. The growth of GSDP of the State is an important indicator of the State's economy as it indicates the standard of living of the State's population. The trends in the annual growth rate of India's GDP and that of the State's GSDP at current prices are indicated below:

Annual growth rate of GDP and GSDP at current prices

Year	2007-08	2008-09	2009-10	2010-11 (QE)*	2011-12 (AE)*
India's GDP (**₹ in crore)**	45,82,086	53,03,567	60,91,485	71,57,412	82,79,975
Growth rate of GDP (*percentage*)	15.9	15.7	14.9	17.5	15.7
State's GSDP (**₹ in crore)**	2,70,628	3,10,312	3,45,235	4,05,123	4,65,552
Growth rate of GSDP (*percentage*)	19.1	14.7	11.3	17.3	14.9

Source: *Karnataka Economic Survey 2011-12*
**QE-Quick Estimates, AE-Advance Estimates*

In the years 2010-11 and 2011-12 Karnataka's GSDP growth rate at current prices were slightly lower than that of India's.

However, the GSDP amount conveyed by the Ministry of Finance, GOI with respect to State for the years 2010-11 and 2011-12 and accepted by the Government was ₹ 3,98,893 crore and ₹ 4,34,270 crore respectively. This varied from the figures released by Directorate of Economics and Statistics and adopted in the Karnataka Economic Survey- 2011-12.

1.1 Introduction

This chapter provides a broad perspective of the finances of the Government of Karnataka during 2011-12. It analyses important changes in the major fiscal indicators compared to the previous year and keeping in view the overall trends during the last five years. The analysis is based on the Finance Accounts and 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 the overall fiscal position, respectively, during 2011-12 *vis-à-vis* the previous year.

Table 1.1: Summary of fiscal transactions

(₹ in crore)

Receipts			Disbursements				
	2010-11	2011-12		2010-11	2011-12		
Section-A: Revenue				Total	Non Plan	Plan	Total
Revenue receipts	**58,206.22**	**69,806.27****	**Revenue expenditure**	**54,033.84**	**46,548.33**	**18,566.74**	**65,115.07**
Tax revenue	38,473.12	46,475.96	General services	14,055.09	16,292.44	153.04	16,445.48
Non-tax revenue	3,358.28	4,086.86	Social services	22,107.82	14,111.26	11,060.47	25,171.73
Share of union taxes/ duties	9,506.31	11,075.04	Economic services	14,892.44	13,374.74	5,779.16	19,153.90
Grants-in-aid & contributions from GOI	6,868.51	8,168.41	Grants-in-aid and contributions	2,978.49	2,769.89	1,574.07	4,343.96
Section-B: Capital and others							
Misc. Capital receipts	**71.81**	**89.19**	**Capital outlay**	**13,355.17**	**583.88**	**14,921.77**	**15,505.65**
			General services	465.46	24.62	600.87	625.49
			Social services	2,616.70	25.91	2,669.28	2,695.19
			Economic services	10,273.01	533.35	11,651.62	12,184.97
Recoveries of loans and advances	**161.37**	**240.40**	**Loans and advances disbursed**	**1,737.93**	**84.74**	**1,730.81**	**1,815.55**
Public debt receipts*	**6,713.74**	**9,357.95**	**Repayment of public debt***	**2,807.13**	**3,319.88**	**----**	**3,319.88**
Contingency Fund	**-**	**12.53**	**Contingency Fund**	**12.53**	**0.51**	**-----**	**0.51**
Public Account receipts	**80,313.64**	**94,408.53**	**Public Account disbursements**	**75,626.38**			**86,216.03**
Opening cash balance	**9,773.51**	**7,667.31**	**Closing cash balance**	**7,667.31**			**9,609.49**
Total	**1,55,240.29**	**1,81,582.18**	**Total**	**1,55,240.29**			**1,81,582.18**

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

*** Includes ₹ 170.14 crore (treated as non-tax revenue), the outstanding central loans under Central Plan Schemes and Centrally Sponsored Schemes advanced to State Governments by the Ministries other than Ministry of Finance written off as per the recommendation of the Thirteenth Finance Commission (XIII FC). The said amount has not been reckoned for arriving at fiscal indicators viz., revenue surplus, fiscal deficit, primary revenue surplus, primary deficit and their comparison with GSDP and interest payment to revenue receipts. It has been considered for calculation of other variables like revenue receipts and non-tax revenue receipts (to GSDP, total receipts, total expenditure, capital expenditure, revenue expenditure, budget estimate and MTFP), growth rate, buoyancy parameters and sufficiency of incremental non-debt receipts.*

Source: *Finance Accounts*

The following are the significant changes during 2011-12 over the previous year:

- Revenue receipts grew by ₹ 11,600.05 crore (20 *per cent*) due to increase in own tax revenue (₹ 8,002.84 crore), non-tax revenue (₹ 728.58 crore), share of Union taxes/duties (₹ 1,568.73 crore) and grants-in-aid and contributions from GOI (₹ 1,299.90 crore). The revenue receipts for the year 2011-12 exceeded the projection made in the Medium Term Fiscal Plan (MTFP) 2010-14 by ₹ 9,043 crore.

- Revenue expenditure increased by ₹ 11,081.23 crore (21 *per cent*). Increase was under economic services sector (₹ 4,261.46 crore), social services sector (₹ 3,063.91 crore), general services sector (₹ 2,390.39 crore) and grants-in-aid and contributions (₹ 1,365.47 crore). It exceeded the MTFP projections for the year by ₹ 5,468 crore.

- Capital outlay increased by ₹ 2,150.48 crore (16 *per cent*). Increase was mainly under economic services sector (₹ 1,911.96 crore). Increase under general services sector and social services sector was ₹ 160.03 crore and ₹ 78.49 crore, respectively.
- Public debt receipts (excluding ways and means advances) increased by ₹ 2,644.21 crore (39 *per cent*) while repayment of public debt increased by only ₹ 512.75 crore (18 *per cent*).
- Public Account receipts and disbursements increased by ₹ 14,094.89 crore (18 *per cent*) and ₹ 10,589.65 crore (14 *per cent*), respectively.
- Cash balance of the State Government increased by ₹ 1,942.18 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 on the basis of broad parameters of fiscal correction laid down by the Eleventh Finance Commission (EFC) and enacted (September 2002) and operated the Fiscal Responsibility Act (FRA) from 1 April, 2003 which provided statutory backup to MTFP.

The State Government has been on a fiscal consolidation path since passing the FRA and Karnataka Ceiling on Government Guarantees Act, 1999. It has recorded revenue surplus since 2004-05. During 2008-09 and 2009-10, as per the recommendations of GOI, the State deviated from the fiscal consolidation path and borrowed more money for public spending to tide over economic slowdown. The XIII FC suggested a roadmap for medium term fiscal correction to the State Government and assigned a new set of ceilings relating to fiscal deficit and outstanding debt as percentage of GSDP for the years 2010-15.

In accordance with the XIII FC recommendations the State Government, with an amendment to the FRA (May 2011), laid down the following fiscal targets.

- Ensuring that the outstanding debt (including off-budget borrowings) is gradually reduced and, at the end of 2014-15, be at 25.20 *per cent* of the estimated GSDP for the year. During 2011-12 the outstanding debt was to be at 26 *per cent*.
- Fiscal deficit during 2011-12 not to exceed more than 3 *per cent* of GSDP
- Constituting Fiscal Management Review Committee (FMRC) which shall meet at least twice a year to review fiscal and debt position of the State.

The FMRC, headed by Chief Secretary to Government, was constituted in July 2011 and had met twice in December 2011 and March 2012. The committee has to review fiscal and debt position of the State, the State's progress on the fiscal correction path and advise on corrective measures, if required. Some of the measures recommended by the committee, which are detailed below, were aimed at increasing the capital expenditure, lowering priority to revenue expenditure, increasing non tax revenue and pursuing prudent investment appraisal methods.

- No new additions to grants-in-aid commitments.
- Shifting from beneficiary orientation to capital investment (five *per cent* of GSDP) for mobilising more resources for power, roads and drinking water.
- Revision of user fee every alternate year.
- Setting up of a mechanism for ex-ante appraisal of new schemes and projects.

The outstanding debt and fiscal deficit during 2011-12 were 23.72 *per cent* and 2.87 *per cent*, respectively, of the GSDP which was well within the prescribed limit. However, inclusive of off-budget borrowings, the outstanding debt stood at 24.16 *per cent*.

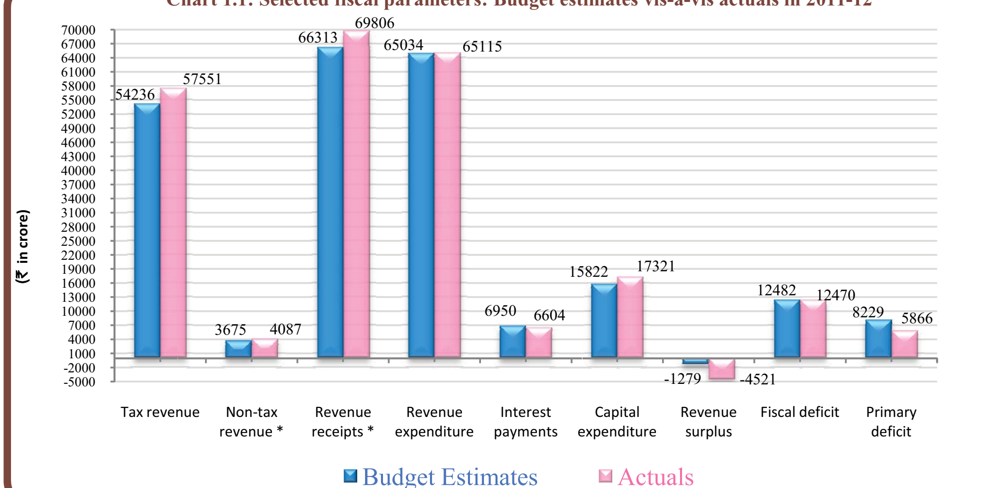
1.4 Budget 2011-12

1.4.1 Actuals vis-à-vis budget estimates

Budget papers presented by the State Government provide 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-optimization of desired fiscal objectives.

Chart 1.1 presents the budget estimates and actuals of some important fiscal parameters for the year 2011-12.

Chart 1.1: Selected fiscal parameters: Budget estimates vis-a-vis actuals in 2011-12



Source: *Annual Financial Statement and Finance Accounts*
**refer footnote below Table 1.1*

The State's revenue receipts during 2011-12, were estimated at ₹ 66,313 crore. In order to meet increasing developmental expenditure, tax collection efforts were improved during 2011-12 rather than increasing tax rates/proposing new rates. However, to raise additional resources, VAT on jewellery, articles of gold, noble metals, semi-precious stones were increased by one *per cent* and tax on goods increased by 0.5 *per cent* by taxing only on those who could afford to pay such increased tax. While the composition amount payable in respect of betting tax was increased from four *per cent* to eight *per cent*, the additional excise duty was doubled across all the 17 slabs. Further, stamp duty was revised in respect of various categories and additional revenue of ₹ 300 crore was expected to be realized. The efforts of the Government at mopping up increased tax revenue have been heartening.

The revenue expenditure was estimated at ₹ 65,034 crore. To bring about progress in the agriculture sector, allocation for the irrigation sector was increased by 50 *per cent* from that of previous year. Other top priority areas were education, energy and urban developmental infrastructure which play a decisive role in the State's growth. Further, since the peak electricity consumption per day increased drastically, the State Government planned to increase the quantum of per capita availability of electricity.

The State's revenue receipts were more than the budget estimate by ₹ 3,493 crore (five *per cent*) due to increase in tax as well as non tax revenue. The State's tax revenue (inclusive of State's share of Union taxes and duties) was more than the budget estimate by ₹ 3,315 crore (six *per cent*). Further, non-tax revenue exceeded the budget estimate by ₹ 412 crore (11 *per cent*). Revenue expenditure and capital expenditure were more than the budget estimate by ₹ 81 crore and ₹ 1,499 crore (nine *per cent*), respectively. Though the revenue and capital expenditure were inclusive of supplementary estimates, the expenditure was brought very close to the budget estimates (excluding supplementary estimates) by compression of expenditure etc. (as detailed in Chapter 2 and discussed in paragraph 1.12.1 – Revenue surplus). Interest payments were less than the budget estimate by ₹ 346 crore (five *per cent*). While revenue surplus was more than the budget estimate by ₹ 3,242 crore, the fiscal deficit had been contained within the budgeted level and primary deficit was less than the budget estimate by ₹ 2,363 crore. These are indeed praiseworthy efforts.

1.4.2 Gender Budgeting

Gender budget of the State discloses the 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 had created the Gender Budget Cell (January 2007) and gender budgeting was introduced in 2007-08. The year-wise allocations in the gender budget document are detailed in **Table 1.2**.

Table 1.2: Gender budgetary allocations during 2007-12

(₹ in crore)

Year	Outlay under			Expenditure under			Demands covered
	Category A*	Category B^	Total	Category A*	Category B^	Total	
2007-08	562.63	17,235.88	17,798.51	551.66	16,280.36	16,832.02	20
2008-09	661.77	20,764.82	21,426.59	637.92	19,470.44	20,108.36	25
2009-10	845.10	22,285.31	23,130.41	645.22	21,818.97	22,464.19	27
2010-11	870.70	25,417.95	26,288.65	924.30	25,700.05	26,624.35	27
2011-12	879.54	29,683.39	30,562.93	850.28	31,219.61	32,069.89	27

**Budgetary allocations to schemes designed to benefit women to the extent of 100 per cent of allocation.*
^*Budgetary allocations for schemes designed to benefit women to the extent of 30 per cent of allocations*

The Gender Budget Cell has been entrusted with implementation of the gender budget by coordinating between various departments, while the Department of Women and Child Development has been entrusted with the monitoring of the impact analysis. Study of the functioning of the above during 2009-10 had showed that while the Gender Budget Cell was not involved in assessing and working out budgetary requirement of category A and B, the Department of Women and Child Development had not conducted any impact analysis. This position continued in 2011-12 also.

State Government had informed (July 2011) that the Gender Budget Cell, in order to strengthen analysis and analytical inputs, had improved the format of the MPIC and a circular was issued to validate the categorization of schemes, assess the impact and analyse the allocation. Further, a study viz., 'Monograph on the Status of Women in Karnataka' had been commissioned (May 2011), which was to be carried out jointly by Institute of Social Economic Change, Bangalore and Institute of Social Studies Trust, Bangalore. The Department of Women and Child Development stated (June 2012) that the study report was yet to be received.

The Public Accounts Committee in its 13th report on CAG's Report on State Finances – 2009-10, (December 2011) (report) placed before the Legislative Assembly had recommended proper identification of schemes to be undertaken under both category A and B of the Gender Budget.

Gender Budget document (2011-12) stated that categorization was being fine-tuned every year in consultation with departments. Further, the document also stated that generation of gender disaggregated data through MPIC, during implementation of the scheme would further the cause of gender budgeting for deeper analysis. The Finance Department stated (October 2012) that the rationale for categorization was based on 'Ashok Lahiri Committee Report'.

Analysis of schemes of Gender Budget document (2011-12) under category A and B of Department of Forest and Tourism showed the following:

Forest:

The Gender Budget Document of 2011-12 reflected seven schemes with respect to Department of Forest under category B which is detailed in **Table 1.3**. However, no schemes were selected under category A.

Table 1.3: Schemes under category B of Department of Forest

(₹ in crore)

Schemes	Allocations	Expenditure#	30% Allocation	Actual allocation*	Expenditure *	Percentage to expenditure
Training institutions	4.16	4.13	---	---	---	--
Development of degraded forests	4.12	4.10	1.37	0.82	0.56	14
Greening of Urban areas	5.00	9.46	1.67	1.00	1.92	20
Development of Bio-fuel plantations	0.10	0.10	0.03	0.02	0.02	20
Raising of seedlings for Public distribution	5.00	4.98	1.67	1.00	1.00	20
Re-imbursement of medical expenses	0.52	0.04	---	---	---	--
Environment management & policy research institute	1.76	1.76	---	---	---	--

**as furnished by the Department of Women and Child Development*
#as per Appropriation Accounts

Against the minimum 30 *per cent* expenditure to be incurred under category B, the amount expended ranged between 14 *per cent* and 20 *per cent*. Also, the three schemes *viz.,* Training institutions, re-imbursement of medical expenses and Environment management and policy research institute, included under category B did not benefit women. It was seen that the expenditure under 3 schemes was even less than 30 *per cent* allocation and in respect of scheme of greening of urban areas, the expenditure exceeded 30 *per cent* allocation. The Department of Women and Child Development in their progress report for the year 2011-12 also did not reflect the said schemes. Hence, the Gender Budget allocation was overstated to this extent.

Further, the other four programmes *viz.,* development of degraded forests, greening of urban areas, development of bio-fuel plantation and raising of seedlings for public distribution also did neither empower women nor alleviated the position of women.

The department in its reply (July 2012) stated that there were no schemes meant specifically for women and since more than 30 *per cent* of the work force for watering the saplings, weeding, transplanting the saplings etc., were women, the schemes were categorized as falling under category 'B'. It also stated that as 40 *per cent* of allocation was incurred towards cost of materials, the allocation was less than 30 *per cent*.

However, the annual plan of the department for the year 2011-12 with respect to scheme 'Raising of seedlings for public distribution' and 'Greening of urban area' did not allocate 30 *per cent* of its manual work to women.

Tourism:

The Gender Budget Document of 2011-12 reflects only one scheme under category B with respect to Department of Tourism and the details of it are indicated in **Table 1.4**.

Table 1.4: Scheme under category B of Department of Tourism

(₹ in crore)

Schemes	Allocations	Expenditure	30% Allocation	Actual allocation	Expenditure	Percentage to expenditure
	(As per Appropriation Accounts)					
Tourist infrastructure at various places	115.43	133.44	38.48	---	---	--

Though the department incurred ₹ 133.44 crore as expenditure during 2011-12, which was in excess of ₹ 18.01 crore over provision, it did not take up any programmes which benefited women under Category B exclusively. The department in its reply (September 2012) stated that it had not planned any programme for the benefit of women. This indicated lack of effective co-ordination/ monitoring while preparing the estimates.

The Gender Budget Cell of Finance Department stated that a 'Gender Budget Monitoring Cell' was proposed to be set up by the Department of Women and Child Development. It also stated that nodal officers of Karnataka Mahila Abhivriddhi Yojane (KMAY) were expected to monitor the performance of the schemes shown in Gender Budget document. The reply of the Department of Women and Child Development (June 2012) also indicated that, while the schemes under category A were fully monitored, the schemes under category B were monitored only with respect to certain schemes identified by KMAY. Hence, against 759 schemes under category B in Gender Budget document, only 254 schemes were being monitored.

1.4.3 Major policy initiatives of Budget 2011-12

In 2011-12 for the first time an exclusive agriculture budget was presented to the Legislature along with the general budget. Agriculture and the related irrigation sectors were allocated ₹ 17,857 crore and other sectors were allocated ₹ 69,880 crore.

Some of the major initiatives announced in the budget are detailed in **Table 1.5**.

Table 1.5: Major initiatives as per budget 2011-12

Agriculture budget	General budget
₹ 1,000 crore earmarked for improvement of lives of 10 lakh agricultural families under the Suvarna Bhoomi Yojane.	Allocation to rural development increased to ₹ 4,385 crore with allocations of ₹ 1,000 crore for drinking water and ₹ 400 crore for Suvarna Gramodaya.
Agriculture loan made available for farmers at an interest of one per cent through co-operative societies.	Devolution of funds to local bodies increased to 42 per cent of Non Loan Net Own Revenue Receipts (NLNORR).
₹ 3,900 crore for supplying quality power to irrigation pumpsets.	₹ 500 crore as equity support to the ESCOMs for separation of the electricity feeders under Niranthara Jyothi project.
For taking up rejuvenation of tanks and for filling up dried tanks with water, earmarking an amount of ₹ 1,000 crore.	₹ 4,770 crore from various sources for infrastructure development and overall development of Bangalore.
₹ 100 crore provided for regularization of one lakh illegal pump sets.	₹ 750 crore provided in 2011-12 for improving urban infrastructure in urban areas under the three year Mukhya Mantri Nagarothana Yojane.
Organising Global Agro Investment Meet for the first time in the country and framing of Karnataka Agri-Business development policy.	₹ 400 crore for distribution of bonds to beneficiaries under Bhagyalakshmi scheme.
Providing ₹ 7,800 crore exclusively for irrigation sector.	Pooled funds for Special Component Plan / Tribal Sub Plan increased to ₹ 1,000 crore.

During 2011-12, the action taken by the Government to implement the said major initiatives, as enumerated in the Action Taken Report (2011-12), are summarized below:

Agriculture	: Total amount released under the scheme 'Suvarna Bhoomi Yojane' was ₹ 518.78 crore. Against this, ₹ 361.32 crore has been expended to 6.50 lakh beneficiaries. Further, interest subvention of ₹ 11.10 crore was re-imbursed in respect of two lakh farmers who availed crop loans at three per cent rate of interest. During 2011-12, Karnataka Agri-Business Development Policy has been brought out for Global Agro Investment Meet. Provision of ₹ 7,800 crore was made for implementation of 'Jala Kranthi' which included rejuvenation of tanks and filling dried tanks with water. While around 40,899 IP sets were regularized, ₹ 4,117 crore were released as subsidy to ESCOMs for providing power to irrigation pumpsets.
General	: Action plan for ongoing rural development schemes had been carried out. Government order for increase in devolutions to local bodies was issued during October 2011. Action plan has been initiated to speed up the work of both 1st and 2nd phase of Niranthara Jyothi project. As at the end of December 2011, 100 feeders have been charged and put to use. Further, action to provide basic infrastructure in Bangalore city, widening and upgrading of city roads and flyovers, construction of underpasses have been taken up by Government. Action plan in respect of 10 ULBs of North Karnataka has been approved in respect of 'Mukhya Manthri Nagarothana Yojane' where the administrative / technical approvals for these works were in various stages. ₹ 407.59 crore has been provided during 2011-12 for the Bhagyalakshmi scheme. Also, Government orders have been issued for various programmes under SCP / TSP.

Detailed scrutiny of action taken by the Government as enumerated in the Action Taken Report 2011-12 with respect to Department of Energy and Housing was initiated in audit. The observations on the action taken by the Government are brought out in **Appendix 1.4.**

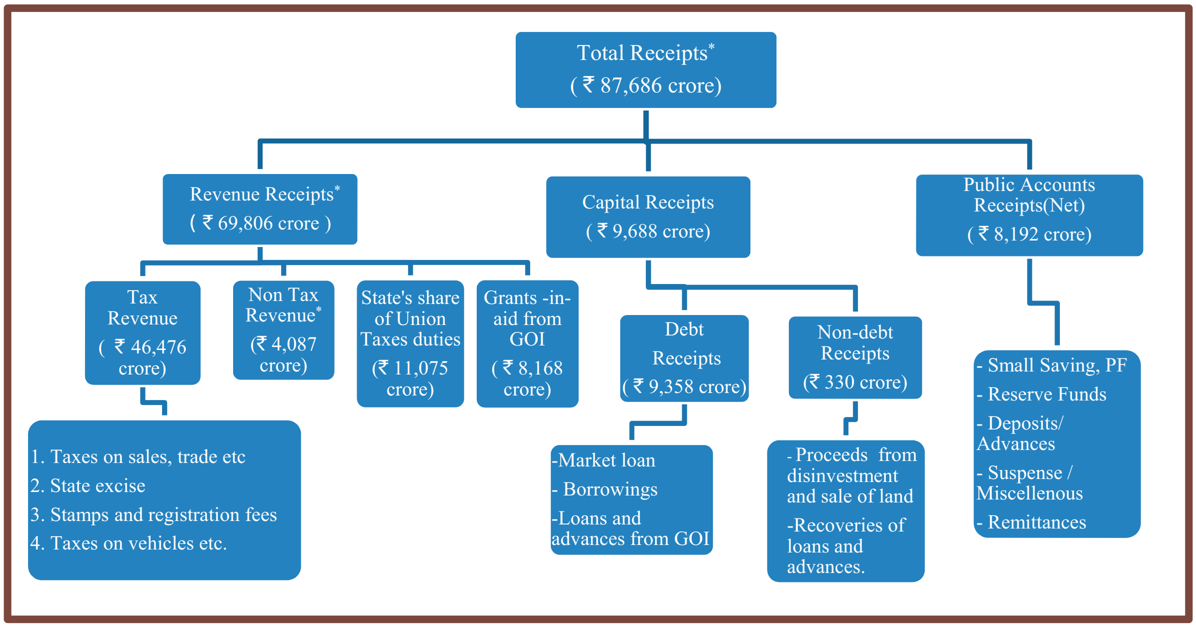
1.5 Resources of the State

1.5.1. Resources of the State as per Finance Accounts

The progress of the Government's programmes depends on its resources and the quantum of resources in any particular financial year determines the expenditure threshold of the Government.

The components of the State's receipts have been categorized in **Chart 1.2**

Chart 1.2: Components and sub-components of Resources

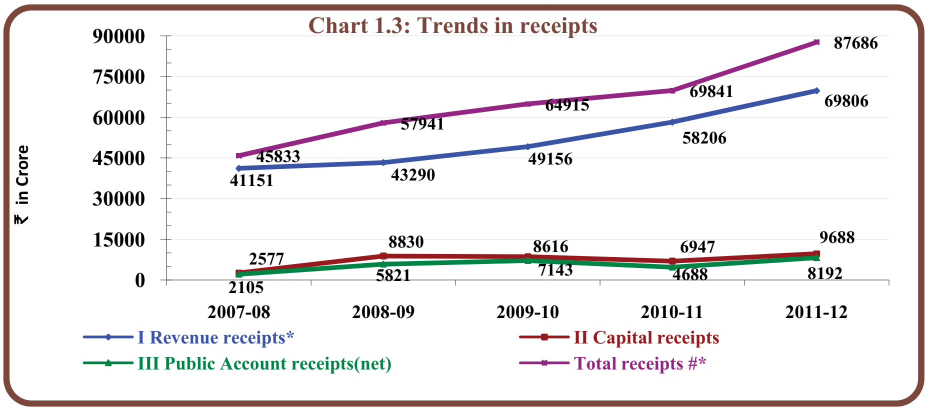


** refer note below Table 1.1*

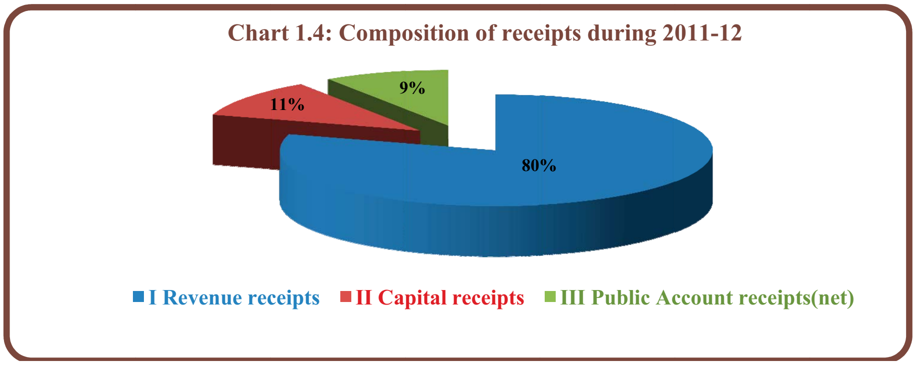
Table 1.1 depicting *inter-alia* the receipts of the State during 2011-12, as recorded in Finance Accounts, may also be referred to on page 2.

Chart 1.3 depicts the trends in various components of receipts during 2007-12, while **Chart 1.4** depicts the composition of resources of the State during the year 2011-12.

Total receipts (excluding contingency fund receipts) increased by 91 *per cent* from ₹ 45,833 crore in 2007-08 to ₹ 87,686 crore in 2011-12. Further, there was an increase of receipts over the previous year by ₹ 17,845 crore (26 *per cent* excluding contingency fund receipts).



 # Excluding Contingency Fund receipts
**refer note below Table 1.1*



Source: Finance Accounts

Public Account receipts refer to those receipts for which the Government acts as a banker/trustee for the public money. On an average, it constituted 8 *per cent* of the total receipts during 2007-2012. Net Public Account receipts which totaled ₹ 2,105 crore in 2007-08 increased to ₹ 8,192 crore in 2011-12. During 2011-12, there was 75 *per cent* growth in Public Account receipts compared to previous year. The growth was maximum in Reserve Fund (101 per cent). Analysis of Reserve Funds is provided in paragraph 1.10.3**.**

The share of revenue receipts in total receipts during 2011-12 was at 80 *per cent*. Further details are provided in paragraph 1.6.

Capital receipts increased by 276 *per cent* from ₹ 2,577 crore in 2007-08 to ₹ 9,688 crore in 2011-12. During 2011-12, the capital receipts accounted for 11 *per cent* of total receipts. Debt receipts, which was the main constituent of capital receipts, increased by ₹ 2,644 crore from the previous year. Internal Debt and Loans and Advances from GOI are the two components of debt receipts whose share was 86 *per cent* and 14 *per cent* of the total debt receipts respectively. In 2011-12, there was a growth of 55 *per cent* in internal debt over the previous year while there was a negative growth of 16 *per cent* in Loans and Advances over the previous year. This was due to short release of loans under State plan schemes.

Apart from debt receipts, capital receipts include non-debt receipts such as recovery of loans and advances and receipts through sale of land, etc. In the year 2011-12, non-debt capital receipts showed a growth of 42 *per cent* over the previous year.

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

Government of India transferred ₹ 7,140.32 crore during 2011-12 directly to the State implementing agencies[1] for implementation of various schemes/programmes in social and economic services sectors recognized as critical against the transfer of ₹ 7,594.32 crore and ₹ 7,342.27 crore during 2009-10 and 2010-11 respectively. There has been a decrease in transfer of such funds consistently since 2009-10. During 2011-12, the decrease was by three *per cent* over previous year. As these funds were not routed through the State budget/State treasury system, Finance Accounts did not capture the flow of these funds and to that extent State's receipts and expenditure as well as other fiscal variables/ parameters thereto could not be ensured. However, an appendix giving details of funds transferred directly to State implementing agencies outside State budget is included in Finance Accounts by capturing data from CGA website. Details in respect of major Central plan schemes are furnished in **Table 1.6**.

Table-1.6: Funds transferred directly to the State implementing agencies for major plan schemes

(₹ in crore)

Programme / scheme	Implementing agency in the State	2009-10	2010-11	2011-12
Pass/Equity /Sub-ordinate Debt to Metro Rail Corporation under MoHD	Bangalore Metro Rail Corporation Limited	386.01	101.21	1,480.00
National Rural Health Mission (NRHM) including hospitals and dispensaries	Karnataka State Health and Family Welfare Society	308.80	450.95	692.06
National Rural Drinking Water Programme	Karnataka Rural Water Supply and Sanitation Agency	467.46	703.80	667.78
Mahatma Gandhi National Rural Employment Guarantee Scheme	Zilla Panchayats	2,769.98	1,573.05	662.57
Sarva Shiksha Abhiyan (SSA)	Sarva Shiksha Abhiyan Samithi	442.21	669.03	627.88
Rural Housing (IAY)	Zilla Panchayats	356.27	448.80	294.03
Integrated Watershed Management Programme (IWMP)	Zilla Panchayats and State Level Nodal Agency	219.23	156.43	154.85
Member of Parliament Local Area Development Scheme (MPLADS)	Deputy Commissioners	88.50	90.93	120.07
Micro Irrigation	State Micro Irrigation Committee	63.81	92.54	109.65
National Horticulture Mission	Karnataka State Horticulture Mission Agency	80.02	93.25	99.96
Central Rural Sanitation Scheme	State Water and Sanitation Mission, Karnataka Rural Water Supply and Sanitation Agency	55.71	44.59	87.09
National AIDS Control Programme	Karnataka State AIDS Prevention Society	28.14	59.51	79.25
National Food Security Mission	State Agriculture Management Agency and Karnataka State Seeds Corporation Limited	47.71	72.64	73.31
Pradhan Mantri Gram Sadak Yojana (PMGSY)	Karnataka Rural Roads Development Agency	438.00	927.67	----

Source: *Finance Accounts.*

State Government in this context has decided (April 2012) to account for these direct releases by the GOI to implementing agencies by incorporating the same as 'receipts to' and 'expenditure out' of the Consolidated Fund in the budget for the financial year 2012-13. Further, a circular along with direction for the adjustment orders has been issued to all the administrative departments. The said accounting adjustments would have considerable effect on the fiscal parameters and also have a bearing on accounts. Further, though directions have been issued for such adjustment of data, no explicit instructions have been issued for validation of data which has a bearing on certification of accounts.

[1] State implementing agency includes any organization/institution including non-governmental organizations and central autonomous bodies 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 Sarva Shiksha Abhiyan.

State Government replied (November 2012) that since the adjustment orders would be issued both of receipt of GOI funds and its expenditure at the same time and as both receipt and expenditure would be similar in nature i.e., either revenue or capital, there would be no net effect on fiscal parameters like revenue surplus/fiscal deficit on account of such adjustments. However, for certain schemes like PMGSY, APDRP and RGGVY where receipts are budgeted as revenue grants and expenditure as capital in nature, these have been kept outside the scope of adjustments and the concerned administrative departments have been advised not to carry out adjustments. Regarding validation of data for adjustments, the administrative departments have been advised to issue adjustment orders after verifying the GOI release order.

In the present dispensation all the accounting transactions taking place in the treasury/account rendering authorities are reported with relevant documentation to Pr. AG (A&E) for compilation of accounts. Though the efforts of the State Government in bringing transparency in accounts are laudable, in the present case the accounting adjustment is to be done only on the basis of reporting by the Administrative departments without the backup of expenditure details. Therefore, a system should be put in place to take care of the accuracy of/responsibility for such accounting adjustments and its validation.

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 with proper documentation and timely reporting of expenditure, it is difficult to monitor the end use of these direct transfers. Malpractices and misuse of funds cannot also be ruled out.

1.6 Revenue receipts

The trends and composition of revenue receipts over the period 2007-12 are presented in **Appendix 1.5** and are also depicted in **Charts 1.5** and **1.6,** respectively.

Revenue receipts showed progressive increase from ₹ 41,151 crore in 2007-08 to ₹ 69,806 crore in 2011-12. On an average, 71 *per cent* of the revenue came from State's own resources during the period 2007-12. The balance was from transfers from GOI in the form of State's share of taxes and grants-in-aid and contributions.

State's own resources consist of tax revenue and non-tax revenue. The share of tax revenue in revenue receipts was between 62 and 66 *per cent* during 2007-12. Though, the State had already achieved a high tax to GSDP ratio the growth of tax revenue, which was 66 per cent in 2010-11, was maintained in 2011-12 also. Non-tax revenue as a *per cent* of revenue receipts had decreased from eight *per cent* in 2007-08 to six *per cent* in 2010-11. The percentage remained the same in the year 2011-12 also.

Chart 1.5: Trends in revenue receipts

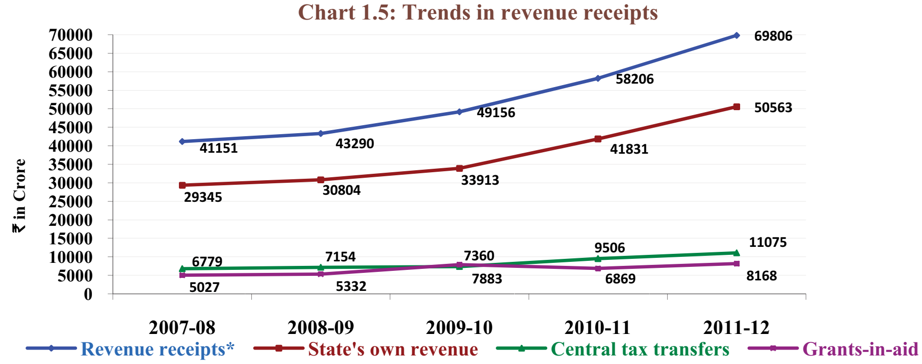
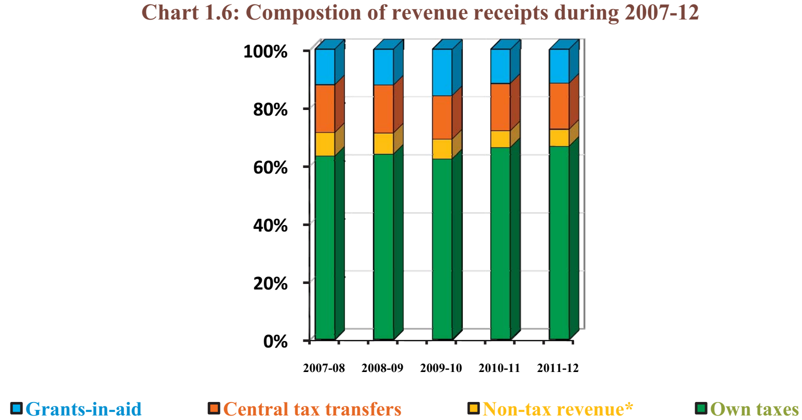


Chart 1.6: Compostion of revenue receipts during 2007-12



Source: *Finance Accounts*

**refer note below Table 1.1*

The trends in revenue receipts relative to GSDP are presented in **Table 1.7.**

Table 1.7: Trends in revenue receipts relative to GSDP

	2007-08	2008-09	2009-10	2010-11	2011-12
Revenue receipts (RR) (₹ in crore)	41,151	43,290	49,156	58,206	69,806*
Rate of growth of RR (*per cent)*	9.5	5.2	13.6	18.4	19.9
Rate of growth of State's own tax (*per cent*)	11.5	6.4	10.6	25.8	20.8
R R/GSDP (*per cent)*	15.2	14.0	14.2	14.6	16.1
Buoyancy ratios[2]					
Revenue buoyancy w.r.t GSDP	0.5	0.4	1.2	1.2	2.2
State's own tax buoyancy w.r.t GSDP	0.6	0.4	0.9	1.7	2.3
Revenue buoyancy with reference to State's own taxes	0.8	0.8	1.3	0.7	0.9
GSDP (₹ in crore)	2,70,628	3,10,312	3,45,235	3,98,893	4,34,270
Rate of growth of GSDP	19.1	14.7	11.3	15.5	8.9

Source: *Finance Accounts.*
GSDP: MTFP 2011-15
**Refer note below Table 1.1*

[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*.

Revenue buoyancy, which is directly proportionate to growth of revenue receipts and GSDP, widely fluctuated during the period due to fluctuations in the growth rate of revenue receipts. During 2007-09, the lower growth rate of revenue receipts relative to GSDP pushed the revenue buoyancy ratio down. Revenue buoyancy ratio, which was lowest at 0.4 in 2008-09, increased to 1.2 in 2009-11 due to high increase in the growth rate of revenue receipts. During 2011-12, the revenue buoyancy ratio increased exorbitantly and was at 2.2. This was on account of increase in growth rate of revenue receipts and decrease in growth rate of GSDP from that of previous year.

During 2007-12, the State's own tax revenue was the largest component of the revenue receipts and its growth trend influenced the trends in revenue receipts. During this period, rate of growth of own tax revenue was lowest in 2008-09. During 2011-12, there was decrease in growth rate of own tax revenue. However, due to decrease in growth rate of GSDP, the buoyancy ratio of own tax revenue with respect to GSDP increased to 2.3. The buoyancy ratio of own tax revenue with respect to GSDP was lowest in 2008-09 and highest in 2011-12. The growth rate of own tax revenue influenced the growth rate of revenue receipts, revenue buoyancy with respect to GSDP and the State's own tax buoyancy with respect to GSDP also. In 2011-12, the increase in growth rate of revenue receipts along with decrease in growth rate of GSDP over the previous year influenced the revenue buoyancy with respect to GSDP and the State's own tax revenue buoyancy with respect to GSDP.

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.

The State's actual tax and non-tax receipts for the year 2011-12 vis-à-vis assessment made by XIII FC and MTFP (2010-14) are given in **Table 1.8**

Table 1.8

(₹ in crore)

	XIII FC projection	Budget Estimates	MTFP projection	Actual
Tax revenue	46,974	43,817	41,120	46,476
Non-tax revenue	5,471	3,675	2,996	4,087*

**refer footnote below Table 1.1*

The tax revenue of the State in 2011-12 fell short of the projection made in the XIII FC by ₹ 498 crore. It exceeded the MTFP projection by ₹ 5,356 crore and budget estimates by ₹ 2,659 crore. Non-tax revenue was less than the XIII FC projection by ₹ 1,384 crore but exceeded the MTFP projection and budget estimates by ₹ 1,091 crore and ₹ 412 crore respectively.

Tax revenue as well as non-tax revenue of the State was overstated due to the following aspects:

- Pooling of cess
- Relief under DCRF / debt waiver

These issues are dealt with in detail in paragraph on non-tax revenue.

Tax revenue

Taxes on sales, trade, etc. were the main sources of the State's tax revenue with a contribution of 54 *per cent* followed by State excise (21 p*er cent*), stamps and registration fees (10 *per cent*) and taxes on vehicles (six *per cent*). The trends in the major constituents of tax revenue during the period 2007-12 are shown in **Table 1.9.**

Table 1.9: Tax revenue

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12
Taxes on sales, trade, etc.	13,894	14,623	15,833	20,235	25,020
Rate of growth	18.13	5.25	8.27	27.80	23.65
State excise	4,767	5,749	6,946	8,285	9,776
Rate of growth	6.05	20.60	20.82	19.28	18
Stamps and registration fees	3,409	2,927	2,628	3,531	4,623
Rate of growth	6.33	(-)14.14	(-)10.21	34.36	30.93
Taxes on vehicles	1,650	1,681	1,962	2,550	2,957
Rate of growth	20.00	1.88	16.72	29.97	15.96

Source: *Finance Accounts*

During the period 2007-12, the rate of growth of taxes on sales, trade, etc., which had decreased during 2008-10 due to general slowdown of economy revived in 2010-11 and was highest at 27.80 *per cent*. Even though, better tax monitoring and collection efforts undertaken by the Government by introducing 'Karsamadhan Scheme' was continued in 2011-12, the rate of growth was at 23.65 *per cent* in 2011-12. However, in the year 2011-12, against budget estimate of ₹ 24,170 crore, revenue realization was ₹ 25,020 crore. The excess collection of ₹ 850 crore was due to increase in VAT rate on goods currently taxed at 13.5 *per cent* to 14 *per cent* and one *per cent* increase on jewellery/article of gold, nobel metals, precious and semi-precious stones. Also, MTFP (2012-16) attributed the excess on account of positive response of the tax payers (80 *per cent* of realisation) to the extensive computerization programme, undertaken by the department.

The growth rate of State excise which was at its lowest in 2007-08 at 6.05*per cent* was 20.82 *per cent* during 2009-10. The increase was due to increase in the consumption of Indian made foreign liquor of lower price band. Since 2009-10, there has been a steady downfall in the growth rate and the rate of growth was 18 *per cent* in 2011-12. The revenue realization was estimated at ₹ 9,115 crore during 2011-12 by increasing the rates of additional excise duty by 10 *per cent* and declared price by ₹ 25 across all 17 slabs. With the increase and strict enforcement measure a revenue growth of 12 *per cent* was expected over the previous year. Against the said expectation, there was a welcome increase in growth rate of 18 *per cent*.

The economic slowdown in 2008-10 had resulted in fall in the number of registrations and negative growth in stamps and registration fees. In 2010-11, on account of an overall growth in economy and reforms initiated by GOI to allow direct investment by foreign players in the real estate sector, there was a huge increase in growth rate over the previous year. There was decrease in rate of growth by 3.46 *per cent* during 2011-12 over the previous year. However, against budget estimate of ₹ 4,030 crore, the revenue realized was ₹ 4,623 crore. The revision of guidance value (November 2011) in line with market rates along with significant improvement in the real estate sector, enhanced better revenue receipts.

Due to economic slowdown, the growth rate of taxes on vehicles was the least in 2008-09. The various measures of GOI to stimulate the automobile industry resulted in higher rate of growth during 2009-10. The demand for motor vehicles which re-bounded strongly in 2010-11 resulted in a steep growth of 29.97 *per cent*. During 2011-12, due to economic slowdown once again there was decrease in sale of motor vehicles which resulted in decrease in growth rate by 14.01 *per cent*. However, against estimate of ₹ 2,630 crore the revenue realized was ₹ 2,957 crore. Against expected growth rate of motor vehicles taxes of 15 *per cent,* the growth rate during 2011-12 was 15.96 *per cent.*

Cost of collection

The gross collection of taxes on motor vehicles, taxes on sales, trade etc., stamp duty and registration and State excise, expenditure incurred on their collection and its percentage to gross collection during the years 2009-12 along with their all-India average cost of collection for the respective previous years are indicated in **Table 1.10.**

Table 1.10: 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	2009-10	1,962.62	36.81	1.87	2.93
	2010-11	2,551.40	41.45	1.62	3.07
	2011-12	2,958.43	47.50	1.61	3.71
Taxes on sales, trade etc.	2009-10	16,546.34	84.46	0.51	0.88
	2010-11	21,252.97	92.87	0.44	0.96
	2011-12	26,203.81	99.24	0.38	0.75
Stamp duty and registration	2009-10	2,650.17	53.18	2.01	2.77
	2010-11	3,554.48	53.52	1.51	2.47
	2011-12	4,644.46	58.75	1.26	1.60
State excise	2009-10	6,948.72	60.55	0.87	3.66
	2010-11	8,286.83	68.35	0.82	3.64
	2011-12	9,778.38	79.77	0.82	3.05

It is heartening to note that the percentage of cost of collection to the gross collection was significantly less than the all India average for the period 2009-11.

In MTFP (2011-15), State Government, while acknowledging the fact, had stated that in the coming years the State Government would continue with better enforcement measures for raising revenue, review and monitoring of tax efforts and intense use of information technology.

During 2011-12, while the percentage of cost of collection to the gross collection with respect to motor vehicles, taxes on sales, trade etc., and stamp duty / registration was less than the previous year, it was same as in the previous year with respect to State excise.

Non-tax revenue

During 2007-12, 72 *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 28 *per cent* on an average represented the amounts received from GOI under the scheme of DCRF, amounts written back from Public

Account[3] and pooling of cess collection under the head 1475-Other General Economic Services. These transactions had no cash realisation and also did not account for any services provided / user charges and fees levied by the State Government but only represented inter account adjustment. Thus non-tax revenue reflected in Finance Accounts stood inflated by 28 *per cent* as revealed by the details of composition of non-tax revenue shown in **Table 1.11.**

Table 1.11: Composition of non-tax revenue

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12	Average percentage composition during 2007-12	
						Interest, dividends, user charges, fees, fines	Others
Interest receipts, dividends and profits	**399 (12)**	**377 (12)**	**413 (12)**	**618 (18)**	**495 (12)**	**13**	
General services	**679 (20)**	**675 (21)**	**846 (26)**	**98 (3)**	**634 (16)**		
Relief under DCRF/debt waiver	358 (11)	358 (11)	358 (11)	---	170 (4)		**8**
Fees, fines etc,	321 (10)	317 (10)	488 (15)	98 (3)	464 (12)	**10**	
Economic services	**2,099 (63)**	**1,921 (61)**	**1,836 (55)**	**2,312 (69)**	**2,576 (63)**		
Write-back from Public Account	749 (22)	484 (15)	2 (-)	---	2 (-)		**7**
Pooling of cess collections	377 (11)	365 (12)	386 (12)	516 (15)	634 (16)		**13**
User charges	973 (29)	1,072 (34)	1,448 (43)	1,796 (53)	1,940 (47)	**41**	
Social services –user charges	**181 (5)**	**186 (6)**	**239 (7)**	**330 (10)**	**382 (9)**	**8**	
Total	**3,358**	**3,159**	**3,334**	**3,358**	**4,087 ***	**72**	**28**

Figures in brackets denote percentage composition in non-tax revenue

**refer footnote below Table 1.1*

***Source:** Finance Accounts.*

The State Government in its reply to PAC (July 2011) had stated that though relief under DCRF was not received in cash, it contributed to the total revenue receipts of the State and hence was accounted as non-tax revenue.

During the year 2011-12, 20 *per cent* of the non tax revenue was inflated on account of pooling of cess collection under the major head 1475 and relief under DCRF/debt waiver.

In this regard, the PAC in its report has proposed the following:

- To identify and bring out the non cash transactions separately for the purpose of transparency.
- Elimination of all non cash transactions for working out the fiscal indicators.
- Representatives of State Accountant's General and Finance Department to work towards strengthening the system.

[3] The Balance under the Zilla Panchayat Fund/Taluk Panchayat Fund under category II (in Public Account) which accounts receipts and expenditure in respect of all State plan schemes (other than matching share of CPS/CSS and all non-plan assistance received from State Government) as at the end of March each year have to be written back to the Consolidated Fund in the next financial year. During past three years, the balances have not been written back to the Consolidated Fund of the State resulting in over statement of expenditure to that extent.

It may be mentioned here that the XIII FC had opined that accounting of debt waiver as non-tax revenue was not desirable as it artificially overstated the non-tax revenue of the State. Further, accounting of debt-waiver as non-tax revenue allowed the State to spend more within the same fiscal deficit cap, artificially reducing the intended impact on the debt stock of the State. Hence the XIII FC had recommended accounting of such transactions in such a manner that it did not artificially affect the revenue/fiscal deficit of the State.

However, during 2011-12, cess collection of ₹ 634.28 crore continued to be pooled under non-tax receipt head 1475 as non-tax revenue even though the State Government had committed in the MTFP 2012-16 that in order to standardize accounting, cess would be classified as tax receipts instead of non-tax receipts. Further, central loans of ₹ 170 crore to the State Government for CSS/CPS, outstanding as at the end of 2009-10, was written off during 2011-12 based on the XIII FC recommendations, treating this adjustment as non tax revenue. However, this particular accounting adjustment has not been reckoned for working out the fiscal indicators like revenue surplus/fiscal deficit as per the instructions of the Government of India.

The State Government in its reply (November 2012) stated that the MTFP was the last document placed before the State Legislature while the supplementary estimates (final installment) for the year was placed much earlier resulting in non provision for giving effect to MTFP commitment. However, this has been taken care of in budget 2012-13. The reply is to be viewed in the light of the fact that the commitment for treating the cess as tax revenue existed in the MTFP (2012-16) and that the Finance Department should have adhered to this commitment while placing the supplementary estimates.

Total non tax revenue increased by ₹ 729 crore from ₹ 3,358 crore in 2010-11 to ₹ 4,087 crore in 2011-12. Out of ₹ 729 crore, the actual increase accounted for was only ₹ 58 crore. Remaining ₹ 671 crore was on account of loans written off, non-withdrawal of debt waiver and pooling of cess under non-tax receipt head 1475. During 2011-12, there was a growth of 16 and 11 *per cent* over the previous year in social services and economic services, respectively. However, there was a negative growth of 20 *per cent* over the previous year under interest receipts, dividend and profits. Huge increase (₹ 536 crore) of non-tax revenue under general services over the previous year was on account of the debt waiver amount of ₹ 358.33 crore pertaining to the year 2008-09 being recovered and deducted from the non-tax revenue of 2010-11. This had resulted in lower non-tax revenue under general services in that year. In 2011-12, the revenue realized (₹1,269.69 crore) in royalty receipts was higher by nine *per cent* than the previous year (₹ 1,161.70 crore). The decrease in the rate of growth was due to the ban imposed on mining in the State, which constituted 31 *per cent* of the total non-tax revenue of the State.

According to FRA, the State Government had to pursue non-tax revenue policies with due regard to cost recovery and equity. In MTFP (2011-15) and also in MTFP (2012-16), State Government has stated that apart from enforcement and monitoring of own tax efforts, special emphasis was required to be given on mobilizing non-tax revenues in the coming years. State Government further stated that it was committed to rationalize user charges and review the same regularly.

In this regard, Expenditure Reforms Commission (ERC) as well as FMRC has suggested remedial measures to check the slide in growth of non-tax revenue. The recommendations of ERC in its third and fourth reports are mainly on the revision of user charges. Some of the suggestions were in the following areas:

- The Government should articulate a clear policy on user charges and draft a detailed user charges policy.
- Government should expedite the constitution of a State Water Regulatory authority which could function as a regulator for water use in the State (drinking, irrigation and industrial projects).
- Government to review road related taxes/toll and to constitute State Road Regulatory Authority.

The State Government in MTFP (2012-16) has stated that the Department of Rural Development and Panchayat Raj would propose a water O&M policy which would look at tariff structure.

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 2011-12 are given in **Table 1.12.**

Table 1.12: 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	130.58	9,270.99	1.41
Health and family welfare	87.86	1,754.24	5.01
Water supply and sanitation	0.41	31.53	1.30
Irrigation	41.90	332.33	12.61

Source: *Finance Accounts.*

In this connection, the XIII FC had recommended to the States to increase power tariff rates to bridge the gap between cost and recovery. It also recommended water sector grants, in addition to maintenance expenditure grants, which were subject to stepping up of the above mentioned recovery rates.

In the irrigation sector, the receipts which were ₹ 28.32 crore during 2010-11 increased to ₹ 41.90 in 2011-12 (48 *per cent*).

1.6.2 Grants-in-aid from GOI

Grants-in-aid from GOI increased from ₹ 5,027 crore in 2007-08 to ₹ 8,168 crore in 2011-12 as shown in **Table 1.13**.

Table 1.13: Grant-in-aid from GOI

(₹ in crore)

		2007-08	2008-09	2009-10	2010-11	2011-12
Non-plan		1,531	1,694	3,429	2,257	2,129
Plan	State	1,916	2,020	2,973	2,839	3,626
	Central	71	94	61	145	76
	Centrally sponsored	1,509	1,524	1,420	1,628	2,337
Total		**5,027**	**5,332**	**7,883**	**6,869**	**8,168**

Source*: Finance Accounts.*

The increase of GOI grants by ₹ 1,299 crore in 2011-12 over the previous year was due to increase in State plan schemes (₹ 787 crore) and Centrally Sponsored Plan Scheme (₹ 709 crore), offset by decrease in mainly non plan scheme

(₹ 128 crore). The increase in State plan schemes was mainly under block grants and XIII FC grants while the decrease was under other grants.

1.6.3 Central tax transfers

The XIII FC had recommended the State's share of Central Taxes to be increased to 32 *per cent* from 30.50 *per cent* as recommended by Twelfth Finance Commission. The State's share in the net proceeds of Central Tax (excluding Service Tax) and net proceeds of Service Tax has been fixed at 4.33 and 4.40 *per cent,* respectively. The share of Union Taxes received during 2011-12 (₹ 11,075 crore) exceeded the estimate (₹ 10,419 crore) by ₹ 656 crore.

Increase of the State's share of Union Taxes and duties by ₹ 1,569 crore over the previous year was mainly under Corporation Tax (₹ 644 crore), Customs Duty (₹ 258 crore) and Taxes on Income other than Corporation Tax (₹ 251 crore) and Service Tax (₹ 374 crore).

1.6.4 Optimization of XIII FC grants

The Commission had recommended ₹ 2,039.96 crore as transfer to the State in the areas indicated in **Table 1.14** during 2011-12.

Table 1.14: Transfers recommended and actual release of Grants-in-aid

(₹ in crore)

Sl. No.	Transfers	Recommendation of FC	Actual Releases	Expenditure under relevant revenue heads of account	Unutilized amount
1	**Local Bodies**				
	(a)Grants to PRIs	486.40	464.73	4,342.24*	---
	(b)General Performance Grant to PRIs	166.27			
	(c)Grants to ULBs	215.10	653.99		
	(d)General Performance Grant to ULBs	73.53			
2	**Disaster Relief**				
	(i)Disaster Relief Fund	126.76	126.76	126.76	Nil
	(ii)Capacity Building	4.00	4.00	Nil	4.00
3	**Improving outcome grants**				
	(i) Improvement in Justice Delivery	53.94	26.98	16.50	10.48
	(ii) Incentive for issuing UIDs	27.78	Nil	Nil	Nil
	(iii) Statistical Systems Improvement	5.80	5.80	1.73	4.07
	(iv) Employee and Pension Data Base	2.50	Nil	Nil	Nil
	(v) District Innovation Fund	7.25	14.50	0.83	13.67
4	**Environment Related Grants**				
	a) Forest	27.63	27.63	27.14	0.49
	b) Water Sector Management	32.00	Nil	Nil	Nil
5	**Elementary Education**	**119.00**	**119.00**	**119.00**	**Nil**
6	**Roads and Bridges**	**367.00**	**367.00**	**256.47**	**110.53**
7	**State Specific grants**				
	a) Restoration of Tanks	87.50	87.50	17.79	69.71
	b) Drinking Water	75.00	60.91	166.27*	---
	c) Infrastructure in Bangalore - Solid waste and Traffic management	100.00	70.00	Nil	70.00
	d) Heritage	25.00	25.00	Nil	25.00
	e) Police Training	37.50	37.50	37.50	Nil
	Total	**2,039.96**	**2,091.30**	**5,112.23***	**307.95**

**inclusive of State's share as per the recommendations of Third State Finance Commission*

As of March 2012, the State Government had received grants aggregating ₹ 2,091.30 crore against recommendation of ₹ 2,039.96 crore. This was on account of excess release of ₹ 184.67 crore under Local Bodies (₹ 177.42 crore) and District Innovation Fund (₹ 7.25 crore) offset by short release of ₹ 133.33 crore under Pooling to improvement in Justice delivery (₹ 26.96 crore), Incentive for issuing UIDs (₹ 27.78 crore), Employee and Pension Data Base (₹ 2.50 crore), Water Sector Management (₹ 32.00 crore) and State Specific Grants (₹ 44.09 crore).

In the above cases where there were short releases, the first transfer/installment was to be released during 2010-11 without any condition and the subsequent installments were to be released on fulfillment of certain conditions as detailed against each in the **Table 1.15.** As the State did not fulfill the conditions stipulated by the XIII FC, subsequent installments were not released.

Table: 1.15: Conditions for release of XIII FC grants

Transfer	Condition for release of subsequent installment
Incentive grant for UID	To be released on a re-imbursement basis based on various criteria.
Improvement of Justice delivery	To be released after the State puts in place a State Litigation Policy.
Database for Government Employees and Pensioners	Database to be completed in three years. Balance to be released after the State certifies that it has created a database.
Water Sector Management*	State to set up the Water Regulatory Authority by 2011-12 which is to be notified latest by 31.03.2012.
State Specific grant	To be withheld for the period during which a State is in violation of the agreement. If a State is in violation for only the part of a year, its grants to be reduced to a proportionate extent.

** Condition for release of first installment*

Against the release of ₹ 2,091.30 crore, ₹ 307.95 crore remained unutilized. The unspent provision was mainly on account of delayed approval of action plan (₹ 4.07 crore and ₹ 69.71 crore), late release of fund (₹ 25 crore), non-approval of action plan (₹ 70 crore), non-commencement of morning and evening courts and non-recruitment of court managers (₹ 10.48 crore) and non-adherence to the guidelines of the Central Government (₹ 13.67 crore).

1.6.5 Foregone revenue

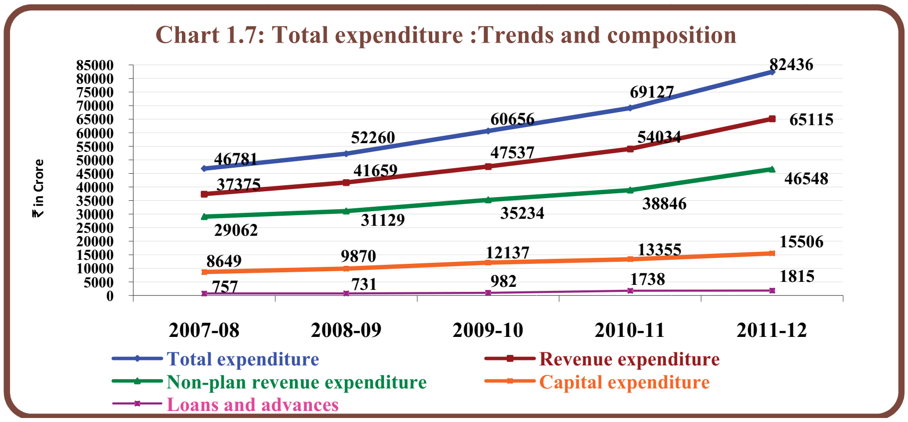
PAC in its report, while recommending a system to oversee the collection of revenue had suggested to the State Government to discontinue the practice of giving discounts, waivers and exemptions while collecting taxes. However, as per MTFP (2012-16), the revenue foregone during 2011-12 by way of stamp duty and entry tax exemptions, re-imbursement of CST etc., was ₹ 304.09 crore. Further, the amount of tax exemptions and tax deferments availed by industries were ₹ 307.21 crore and ₹ 325.89 crore respectively. Tax exemptions under industrial policy are discussed in detail in **Paragraph 1.7.6.**

1.7 Application of resources

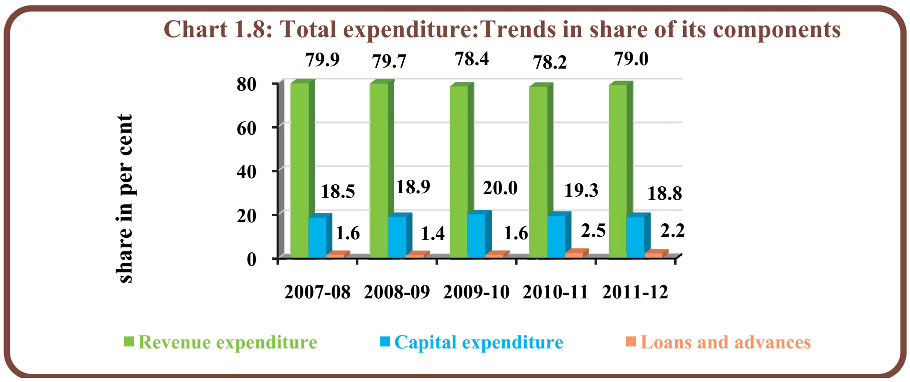
Analysis of the allocation of expenditure at the State Government level assumes significance as it is an important aspect of fiscal policy to achieve developmental goals. Within the framework of fiscal responsibility legislations, there are budgetary constraints on raising public expenditure financed by deficit or borrowings. At the same time, it is important to ensure that the ongoing fiscal correction and consolidation process at the State level is not at the cost of expenditure directed towards development and social sectors.

1.7.1 Growth and composition of expenditure

Chart 1.7 presents the trends in total expenditure under revenue, capital and loans and advances, while **Chart 1.8** exhibits the share of these components in total expenditure.



Source: *Finance Accounts*



Source: *Finance Accounts.*

Total expenditure increased by 76 *per cent* from ₹ 46,781 crore in 2007-08 to ₹ 82,436 crore in 2011-12 due to increase in revenue expenditure (₹ 27,740 crore), capital outlay (₹ 6,857 crore) and disbursement of loans and advances (₹ 1,058 crore).

During the period 2007-12, on an average, 79 *per cent* of the total expenditure was revenue expenditure. The share of revenue expenditure in the total expenditure, which had decreased from 80 *per cent* in 2008-09 to 78 *per cent* in 2009-11, increased to 79 *per cent* in 2011-12. However, the share of capital expenditure (including loans and advances) which had increased from 20 *per cent* in 2008-09 to 22 *per cent* in 2009-11 decreased marginally and was 21 *per cent* in 2011-12. ERC (Expenditure Reforms Commission) in their first report (February 2010) had recommended capital investments to be stepped up and protected from fiscal uncertainties through prudent allocations. It had also recommended maintaining the capital expenditure (excluding debt servicing) at five *per cent* of GSDP. However, the capital expenditure (excluding debt servicing) which was four *per cent* of GSDP in 2010-11 continued at that level in 2011-12 also.

The revenue expenditure during 2011-12 included ₹ 93.74 crore provided to Bangalore Metro Rail Corporation Limited (₹ 50 crore) as 'reimbursement of taxes and duties', Bharath Earth Movers Limited (₹ 40.99 crore) as 'reimbursement of sales tax to eligible industries' and cashew dealers (₹ 2.75 crore) as waiver of central sales tax. Also, the capital expenditure included ₹ 50 crore provided to Bangalore Metro Rail Corporation Limited as 'reimbursement of taxes and duties'. The State Government took the approval of legislature stating that neither the Karnataka Value Added Tax Act nor the Central Sales Tax Act had any proviso for re-imbursement / waiver of tax. This resulted in overstatement of revenue receipts and also revenue / capital expenditure to that extent.

State Government stated (November 2012) that once the Legislature's approval was obtained for any taxation provision, Executive had no authority to refund the tax collected in the absence of enabling provision. Therefore the payments were made under the prevailing development policies. It was generally felt that the reimbursement route for support to industries would be a better option than outright provision of tax exemption.

Though the concession by way of tax reliefs to promote industry is laudable, the treatment is technically incorrect. The proper recourse will be bringing in suitable legislation under the relevant Act before the Legislature for granting concession/exemption. Further, the absence of such a provision in the relevant Act does not give the Executive the authority to treat it as an item of expenditure requiring the approval of the Legislature.

1.7.2 Buoyancy of expenditure

Buoyancy of total expenditure

The trends in expenditure relative to GSDP and revenue receipts during 2007-12 are presented in **Table 1.16**.

Table 1.16: Total expenditure – Basic parameters

(₹ in crore, rate & ratio in *per cent*)

	2007-08	2008-09	2009-10	2010-11	2011-12
Total expenditure (TE)*	46,781	52,260	60,656	69,127	82,436
Rate of growth	10.5	11.7	16.1	14.0	19.2
GSDP	2,70,628	3,10,312	3,45,235	3,98,893	4,34,270
Rate of growth	19.1	14.7	11.2	15.5	8.9
TE/GSDP	17.3	16.8	17.6	17.3	19.0
Revenue receipts ** / TE	88.0	82.8	81.0	84.2	84.7
Revenue expenditure	37,375	41,655	47,527	54,034	65,115
Rate of growth	11.8	11.5	14.1	13.7	20.5
Capital expenditure	9,406	10,605	13,129	15,093	17,321
Rate of growth	5.7	12.7	23.8	15.0	14.8
Buoyancy of total expenditure with					
GSDP	0.5	0.8	1.4	0.9	2.1
Revenue receipts	1.1	2.2	1.2	0.8	1.0
Buoyancy of revenue expenditure with					
GSDP	0.6	0.8	1.2	0.9	2.3
Revenue receipts	1.2	2.2	1.0	0.7	1.0
Buoyancy of capital expenditure with					
GSDP	0.3	0.9	2.1	1.0	1.7
Revenue receipts	0.6	2.4	1.8	0.8	0.7

**Total expenditure includes revenue expenditure, capital expenditure including loans and advances*
***refer footnote below Table 1.1*
***Source:** Finances Accounts.*

The rate of growth of total expenditure which was 10.5 *per cent* in 2007-08 grew consistently and was 16.1 *per cent* in 2009-10. However, during 2010-11 there was a slight decrease in its growth and in 2011-12 the growth was maximum at 19.2 *per cent*.

In 2011-12 as in 2010-11, total expenditure was 1.2 times the revenue receipts. The buoyancy ratio of total expenditure to revenue receipts was around 1.0 *per cent* and the growth rate of total expenditure was almost the same as the growth rate of revenue receipts.

The growth rate of total expenditure (19.2 *per cent*) in 2011-12 was 2.1 times the growth rate of GSDP (8.9 *per cent*) and the buoyancy of total expenditure to GSDP which was 0.5 *per cent* in 2007-08 fluctuated during the period 2009-12. The buoyancy of total expenditure to GSDP which had decreased to 0.9 in 2010-11 increased to 2.1 on account of increase in growth rate of total expenditure and decrease in growth rate of GSDP. During 2011-12, 85 *per cent* of the total expenditure could be met out of revenue receipts.

Buoyancy of revenue expenditure

The growth in revenue expenditure, which was higher than the growth of revenue receipts during 2007-10, had decreased in 2010-11. During 2011-12, once again the growth of revenue expenditure was highest at 20.5 *per cent*. Also, the growth of revenue expenditure, which was less than the growth of GSDP in 2007-09 and 2010-11, increased during 2009-10 and 2011-12. For every one *per cent* growth in GSDP during 2008-09, revenue expenditure grew only by 0.8 *per cent*. However, during 2011-12, revenue expenditure growth was 2.3 times the growth of GSDP. This trend was reverse with respect to buoyancy of revenue expenditure to revenue receipts as the rate of growth of revenue receipts was least in 2008-09 due to economic slowdown and highest in 2011-12. Hence, for every one *per cent* growth in revenue receipts during 2008-09, the growth of revenue expenditure was 2.20 times. During 2011-12, growth of the revenue receipts was almost the same as growth of revenue expenditure and hence its ratio was 1.0 *per cent*.

Buoyancy of capital expenditure

During 2009-10, the rate of growth in capital expenditure which was highest at 23.8 *per cent* was also higher than the rate of growth of GSDP as well as revenue receipts. In 2011-12, while the rate of growth capital expenditure (14.8 *per cent*) was more than the growth of GSDP, it was less than the growth of revenue receipts. The buoyancy of capital expenditure with respect to revenue receipts has shown decreasing trend during 2008-12 and was least at 0.7 *per cent* in 2011-12. The buoyancy of capital expenditure with respect to GSDP which was highest at 2.1 in 2009-10 had decreased to 1.0 in 2010-11. During 2011-12, it once again increased to 1.7 due to decrease in growth rate of GSDP.

1.7.3 Plan and non-plan expenditure

Finance Accounts provide a further classification of expenditure into plan and non-plan. Plan expenditure normally relates to incremental developmental expenditure on new projects or schemes and involves both revenue and capital expenditure. In order to maintain the level of services already achieved, non-plan expenditure is normally utilized. **Table 1.17** presents the growth and composition of plan and non-plan expenditure over the last five years.

Table 1.17 Growth in plan and non-plan expenditure

(₹ in crore)

		2007-08	2008-09	2009-10	2010-11	2011-12
Plan	Revenue	8,313	10,526	12,293	15,188	18,567
	Capital	7,199	9,139	11,128	12,582	14,922
	Loan	751	224	916	1,736	1,731
	Total	**16,263**	**19,889**	**24,337**	**29,506**	**35,220**
	Percentage of plan to total expenditure	**35**	**38**	**40**	**43**	**43**
Non-plan	Revenue	29,062	31,129	35,234	38,846	46,548
	Capital	1,450	735	1,019	773	584
	Loan	6	507	66	2	84
	Total	**30,518**	**32,371**	**36,319**	**39,621**	**47,216**
	Percentage of non-plan to total expenditure	**65**	**62**	**60**	**57**	**57**
Total expenditure		**46,781**	**52,260**	**60,656**	**69,127**	**82,436**

Source: *Finance Accounts*

The share of plan expenditure in the total expenditure had exhibited increasing trend during 2007-11, which indicated the productive quality of expenditure. During 2011-12, however, the share of plan expenditure was the same as in the previous year.

During the period 2007-12, while plan expenditure increased by 117 *per cent* from ₹ 16,263 crore in 2007-08 to ₹ 35,220 crore in 2011-12, non-plan expenditure increased by 55 *per cent* from ₹ 30,518 crore to ₹ 47,216 crore.

Increase of plan revenue expenditure by ₹ 3,379 crore over the previous year indicated that more emphasis was given on developmental expenditure and schemes/programmes. The increase was mainly under Education, Sports, Art and Culture (₹ 119 crore), Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes (₹ 344 crore), Social Welfare and Nutrition (₹ 577 crore), Health and Family Welfare (₹ 206 crore) and Agriculture (₹ 1,162 crore) offset by decrease in Transport (₹ 136 crore). Plan revenue expenditure included devolutions to Panchayat Raj Institutions (PRIs) (₹ 4,944 crore) and Urban Local Bodies (ULBs) (₹ 1,480 crore), Subsidies (₹ 635 crore) and Salaries (₹ 1,550 crore).

Non-plan revenue expenditure (NPRE) was 71 *per cent* of revenue expenditure during 2011-12. It included devolutions to PRIs (₹ 10,268 crore), ULBs (₹ 2,768 crore), interest payment (₹ 6,604 crore), subsidies (₹ 6,478 crore), pension payments (₹ 5,436 crore), salaries (₹ 11,446 crore) and maintenance expenditure (₹ 1,056 crore).

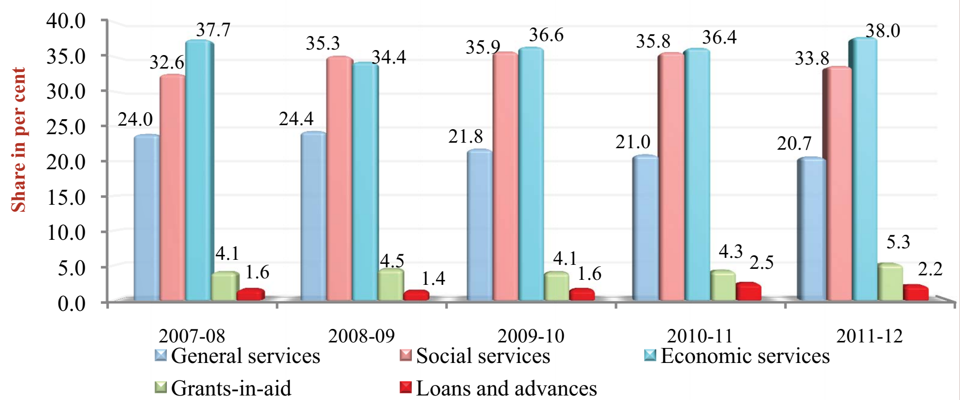
Non-plan revenue expenditure (₹ 46,548 crore) exceeded projections made by XIII FC for 2011-12 (₹ 38,040 crore) by ₹ 8,508 crore.

In the year 2011-12, plan expenditure included conversion of equity of ₹ 2.99 crore into capital grant (₹ 1.68 crore) and subsidy (₹ 1.31 crore). The said equity, which was released under plan in earlier years, was converted into capital/revenue in the current year by withdrawing the debit under non-plan. Thus, while the non-plan was understated, the plan expenditure was overstated.

1.7.4 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, grants-in-aid and loans and advances. Relative shares of these components in total expenditure are indicated in **Chart 1.9.**

Chart 1.9: Total expenditure: Trends by activities



Source: *Finance Accounts.*

In the MTFP 2011-15 and 2012-16, the Government stated that to have quality expenditure, outlays for social and economic services (including loans and advances) were to be enhanced while expenditure on general services were to be moderated. The State Government also stated that during the last three years, expenditure on social services accounted for the largest expenditure. The expenditure on social services, which was at 34 *per cent* of total expenditure in 2007-08, had increased to 38 *per cent* in 2010-11. However, during the year 2011-12, it decreased by two *per cent* and was at 36 *per cent*. Meanwhile expenditure on general services decreased from 24 *per cent* in 2007-08 to 21 *per cent* in 2011-12.

The share of economic services to total expenditure which was at 38 *per cent* in 2007-08 decreased to 35 *per cent* in 2008-09. However, it once again increased to 38 *per cent* in 2011-12.

MTFP 2012-16 envisaged increase of 15 *per cent* during 2011-12 over the previous year on social services (including loans and advances) against which the increase was 12.20 *per cent*. The increase was on account of higher expenditure in critical sectors such as Education, Welfare of SCs/STs/OBCs, Medical and Public Health, Woman and Child Development.

1.7.5 Incidence of revenue expenditure

The bulk of total expenditure goes towards 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 74 *per cent* from ₹ 37,375 crore in 2007-08 to ₹ 65,115 crore in 2011-12. The predominance of revenue expenditure has been primarily on account of a conscious shift in plan priorities on programmes under education, social welfare and nutrition, agriculture etc., and systematic rigidity in non-plan revenue expenditure in the short term, particularly arising from committed expenditure such as salaries, pensions, interest payments and subsidies. Further, the grants given to various bodies/organizations are classified as revenue expenditure, regardless of the purpose for which it is used by the bodies/organizations.

In this regard, the High Level Expert Committee on Efficient Management of Public Expenditure in its report recommended revenue-capital classification to be continued. Further, it recommended that while all transfers were to be treated as revenue expenditure in accounts, the merit of classifying revenue expenditure by end-use may also be considered for FRA compliance and grants for creating assets may be classified as capital grant. Also an adjusted revenue deficit was recommended only for the purpose of FRA compliance and it opined that the FRA would require some amendments to allow for adjusted revenue deficit.

Karnataka Legislators' Local Area Development Scheme was introduced (2001-02) for asset creation, infrastructure development and employment generation for the benefit of the poor and weaker sections. The scheme aimed to follow a participatory demand responsive development approach to address infrastructure development requirements of the local area within a Legislator's constituency. While the expenditure for the period 2001-2010 was classified as revenue, the expenditure for 2010-11 (₹ 377.39 crore) and 2011-12 (₹ 298.63 crore) was classified as capital. The unspent balance as on March 2012 lying in personal deposit account was ₹ 499.25 crore. The State Government in its reply (July 2012) stated that classification of expenditure was not dependent on the source of financing, but determined by ownership criteria. Since, the scheme created assets owned by State Government, classification of expenditure was appropriate as per the accounting norms.

The reply is not acceptable as the fund provided to the Legislator's was a grant as per the XIII FC report and as per the Indian Government Accounting Standard-2, the expenditure on grants for the purpose of creating assets shall not, except in cases specifically authorized by the President on the advice of the C&AG of India, be debited to a capital head of account. Further, since it is part of the operating expenditure of the grantor, it has to be accounted for as revenue irrespective of its ultimate application.

The revenue expenditure also included ₹ two crore being the contribution of Government to the State Energy Conservation Fund kept outside the Government Account. The fund, which consisted of all grants and loans made by Government of Karnataka or Central Government or any other State Government or Quasi Central/State Government organizations or Central / State PSUs etc., was to be administered and operated by the State designated agency through Personal Deposit account. However, during March 2010, contrary to the above, a savings bank account in a nationalized bank was opened for the said purpose.

1.7.6 Committed expenditure

Committed expenditure of the State Government on revenue account traditionally consisted of interest payments, expenditure on salaries, pensions and subsidies. **Table 1.18** and **Chart 1.10** present the trends in the expenditure on these components during 2007-12.

Table 1.18: Committed expenditure

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12
Salaries*, *of which*	8,169 (19.8)	9,912 (22.9)	10,342 (21.04)	11,948 (20.52)	12,996 (18.6)
Non-plan head	7,705	9,254	9,501	10,593	11,446
Plan head**	464	658	841	1,355	1,550
Interest payments	4,506 (10.9)	4,532 (10.5)	5,213 (10.6)	5,641 (9.70)	6,604 # (9.5)
Expenditure on pensions	3,241 (7.9)	4,113 (9.5)	3,408 (6.9)	4,070 (7)	5,436 (7.8)
Subsidies	5,420 (13.2)	3,399 (7.8)	4,118 (8.4)	6,303 (10.82)	7,390 (10.6)
Total committed expenditure	**21,336 (51.85)**	**21,956 (50.72)**	**23,081 (46.9)**	**27,962 (48.04)**	**32,426 (46.4)**
Other than committed expenditure ***	16,039 (39.0)	19,703 (45.5)	24,456 (49.7)	26,072 (44.8)	32,689 (46.8)
Total revenue expenditure	**37,375**	**41,659**	**47,537**	**54,034**	**65,115**
Revenue receipts	**41,151**	**43,290**	**49,156**	**58,206**	**69,806 @**

Figures in the brackets indicate percentage to revenue receipts

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

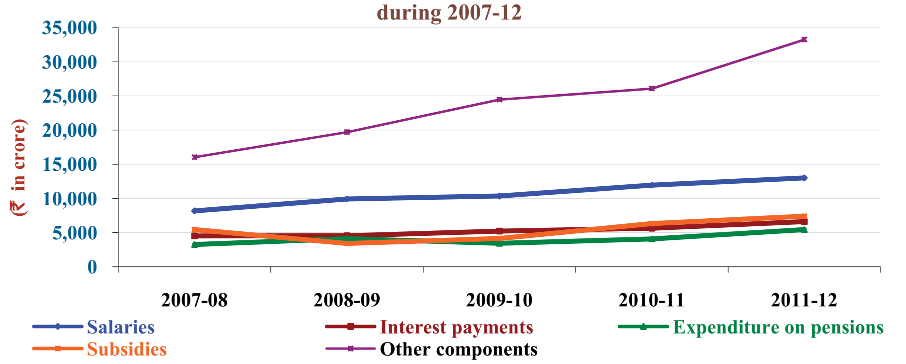
** *Includes the salaries paid under centrally sponsored schemes.*

****Includes expenditure on financial assistance/relief (₹ 1,177 crore), special component plan (₹ 1,845 crore), other expenses(₹ 5,193 crore), grants-in-aid (₹ 4,132 crore), maintenance (₹ 1,233 crore), pensions under social sector(₹1,067 crore), inter account transfer (₹ 890 crore)*

 # includes (₹ 542 crore interest payments in respect of off-budget borrowings)

@ refer foot note below Table 1.1

Chart 1.10: Committed expenditure during 2007-12



Source: *Finance Accounts.*

The MTFP (2011-15), in order to provide a realistic picture, envisaged committed expenditure to comprise expenditure on salaries, interest, pension, subsidies, grants-in-aid which included devolutions to PRIs and ULBs, expenditure on operation and maintenance of assets, administrative expenditure and State's share of Centrally sponsored schemes and Centrally planned schemes. It was further envisaged that until a major policy intervention was made, this committed expenditure would be in excess of 90 *per cent* of the uncommitted revenue receipts. In 2011-12, this committed expenditure amounted to ₹ 59,048 crore, which formed 91 *per cent* and 85 *per cent* of revenue expenditure and revenue receipts, respectively. The committed expenditure exceeded the projection and was 117 *per cent* of the uncommitted revenue receipts (State's tax and non-tax receipts). This indicated that the State's own revenue was insufficient to take care of the committed expenditure.

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 decreased to 19 during 2011-12. The expenditure on salaries for 2011-12 exceeded the MTFP (2010-14) projection of ₹ 12,858 crore by margin of ₹ 138 crore. The salary expenditure in the Finance Accounts captured data in respect of State sector only. The salaries in respect of district sector (Employees of PR Institutions) are released as grants-in-aid to those bodies. Thus, the total salary expenditure is not captured in accounts.

The State Government in its reply to the earlier reports had indicated its inability to furnish the salary details of district sector accounts in the absence of any mechanism for consolidation of such details. However, the PAC in its report has recommended to the Finance Department to depict total salaries, taking into account the district sector also, if possible, by opening a separate sub-head to capture the data. On the basis of XIII FC recommendations, the State Government brought out a separate budget document during 2011-12 which indicated allocations to ULBs. However, the document indicated the transfers to the object head with the same classification numbers given to various heads at the State level. For example, the object head for payment of salaries of staff of ULBs overlapped with payment of salary of constitutional dignitaries. Further, the expenditure data captured were the releases made to ULBs and not the actual expenditure. Thus, the understatement of salary expenditure continued even during 2011-12.

Pension payments

Expenditure on pension (₹ 5,436 crore) was eight *per cent* of total revenue receipts of the State during the year. The expenditure on pension during the year exceeded MTFP (2010-14) projection by ₹ 261 crore. Increase of ₹ 1,366 crore over the previous year was on account of pay revision for the State Government employees.

Pension payments post 2009-10 have been projected by XIII FC to grow at 10 *per cent* and the estimated pension payment for 2011-12 was ₹ 5,260 crore. The pension expenditure overshot the projection by ₹ 176 crore.

Defined Contribution Pension Scheme for all employees who joined the State Government service on or after April 1, 2006 was to be implemented from April 1, 2010 as per Pension Fund Regulatory and Development Authority. According to the scheme, the monthly contribution would be 10 *per cent* of basic pay and dearness allowance thereon to be paid by the employee and matched by the Government in equal proportion. In MTFP (2012-16), Government stated that a separate New Pension Scheme Cell was been created for implementation of the Scheme. It also stated that regular Government matching share was around ₹ 185 crore and the Government was committed to pay its share of backlog contribution with a compound interest of eight *per cent*. Further, it stated that the Government had already contributed ₹ 125 crore as its backlog share. However, in 2011-12, though a provision of ₹ 250 crore was made to meet the State Government's contribution, expenditure of ₹ 4.13 crore only was incurred which was also not towards the Government matching contribution. Further, List of Major and Minor Heads of account prescribed opening of minor head 117 under 8342 – Other deposits for the said scheme. The Public Account in Finance Accounts reflected the scheme under Minor head 120 with three tiers for

Employee's contribution, Government's contribution and Interest on Government contribution respectively. While the fund reflected both debit and credit under the three tiers, no investment out of the scheme was made.

XIII FC recommended a grant of ₹ 10 crore for setting up a database for Government employees and pensioners. An amount of ₹ 2.50 crore was released during 2010-11 without any precondition. However, for release of balance of ₹ 7.50 crore, the State was required to certify that it had created a database and integrated it with the treasury on a transactional basis. This database would enable speedier implementation of the New Pension Scheme and also provide the basis for payroll linked deduction and transfer of contribution to the service providers. As at the end of March 2012, the State was yet to complete setting up of the database.

The payment of pension and other retirement benefits to All India Service officers prior to 1 April 2008 was a liability which was to be borne by the State Government. As per the new procedure introduced from 1 April 2008, the payments made to the officers were to be booked under suspense head 8658 and a demand raised for re-imbursement from GOI. During 2011-12, a demand for ₹ 5.22 crore, being the pensionary benefits disbursed to All India Service officers for the year 2010-11, was raised and hence the suspense head included the dues from the GOI for the years 2010-11 and 2011-12. However, as the amount authorized for the years 2008-10, which was part of revenue expenditure in those years, were yet to be assessed, the suspense head 8568 was understated to that extent.

Interest payments

Interest payments increased by ₹ 2,098 crore from ₹ 4,506 crore in 2007-08 to ₹ 6,604 crore in 2011-12. Interest payments during 2011-12 constituted interest on internal debt (₹ 4,186 crore), interest on small savings, provident fund etc., (₹ 1,100 crore), interest on loans and advances from Central Government (₹ 776 crore) and interest on off-budget borrowings (₹ 542 crore).

The interest on internal debt increased by seven *per cent* from ₹ 3,928 crore in 2010-11 to ₹ 4,186 crore in 2011-12 on account of increase in payment of interest on market loans and on special securities issued to NSSF of the Central Government by the State Government by four and nine *per cent* respectively with respect to the previous year.

The interest on small savings, provident funds etc increased by 14 *per cent* from ₹ 962 crore during 2010-11 to ₹ 1,100 crore in 2011-12 mainly on account of increase in interest on State provident funds and insurance and pension funds by 18 and 10 *per cent,* respectively, relative to the previous year.

The interest payment of ₹ 542 crore towards off budget borrowings which was being classified as capital expenditure was classified as revenue expenditure for the first time in 2011-12 in terms of section 2(f) of FRA. The PAC in its report had observed that borrowings based on availability rather than necessity also contributed to the increase in the interest payments.

The ratio of interest payments to revenue receipts determines the debt sustainability of the State. It was heartening to note that during the year, ratio of interest payments to total revenue receipts of the State was nine *per cent,* which was well within 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 ₹ 7,390 crore during the year which was ₹ 1,087 crore more than the previous year. The increase in its growth rate was 17 *per cent*. Subsidy payments during the year were mainly in the areas of power (₹ 5,303 crore), food (₹ 791 crore), transport (₹ 309 crore) and co-operation (₹ 447 crore). The details are given in **Box 1.1.**

In MTFP (2012-16) Government stated that subsidy scheme in the energy sector consistently required higher allocation in budget every year. It also stated that there has been large increase in the number of beneficiaries under schemes such as social security pensions and Bhagyalakshmi scheme.

In MTFP (2011-15) the State Government had averred that certain immediate steps were needed to be taken in order to prevent the subsidy from reaching unsustainable levels in the future. In the MTFP (2012-16) it was once again reiterated and it was felt that subsidies needed to be moderated in the medium term. Further, Government opined that the Resident Data Hub scheme and UID scheme would help in better identification of beneficiaries and targeting of subsidies directly, which meant that the ineligible and bogus beneficiaries under various schemes would be weeded out.

Box – 1.1

Major subsidies

Power

During the year, subsidy to power sector (₹ 5,303 crore) accounted for 72 *per cent* of the total subsidy (₹ 7,390 crore). It included financial assistance to electricity supply companies to cover loss due to rural electrification (₹ 4,853 crore) and contribution towards pension (₹ 450 crore).

Subsidy on rural electrification during the year, however, did not include subsidy of ₹ 17 crore (net) given to the Karnataka Power Transmission Corporation Limited (KPTCL) for meeting its debt servicing obligations to 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 ₹ 421 crore in 2007-11. Though the Government had stated (November 2007) that borrowings would be included on off-budget side in 2008-09, neither did MTFPs 2007-11 to 2012-16 nor overview of budget 2009-10 to 2011-12 exhibited this liability on off-budget side. The State Government in reply (July 2011) to PAC, had accepted the fact and promised to include it on off-budget side, in the next MTFP. The reply is not acceptable as the KPTCL is not a Special Purpose Vehicle and its borrowings cannot be termed as 'off budget borrowings'.

Food

Food subsidy to meet the differential cost of food grains under Public Distribution System (PDS), which had decreased to ₹ 926 crore in 2010-11 from ₹ 1,164 crore in 2009-10, further decreased to ₹ 791 crore during the current year.

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 ₹ 2,885 crore in 2007-08 (₹ 1,793 crore), 2008-09 (₹ 186 crore), 2009-10 (₹ 124 crore), 2010-11 (₹ 335 crore) and 2011-12 (₹ 447 crore).

According to Vaidyanathan Committee Report (March 2008) and as reiterated by the PAC, 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.

Transport

Transport subsidy which had increased from ₹ 157 crore in 2009-10 to ₹ 316 crore in 2010-11 decreased marginally and was ₹ 309 crore during the current year. This was towards fare concession extended to students, freedom fighters, physically challenged, etc.

The PAC had recommended that the said subsidy be borne by the corporations with-in their resources as these were earning profits and were working on commercial lines.

The State Government in its reply (August 2012) stated that Transport Corporations were incurring heavy expenditure on account of the above bus passes and also stated that if the Corporations had to bear the entire subsidy expenditure, then they would incur heavy losses.

The subsidies present a partial picture as these are exclusive of the implicit subsidies. Implicit subsidies *inter-alia* arise when the Government is unable to recover the costs it incurs in the provision of social and economic goods/services, which are mainly private goods/services in nature, even though sometimes these may have extended benefits. It can be indirect, can also be in kind or take the shape of tax concessions. Some of the implicit subsidies extended during 2011-12 are detailed in **Table 1.19**.

Table: 1.19 Details of some of the implicit subsidy

Sl. No.	Schemes/Subsidy	Amount in crore
1	Bhagya Lakshmi	486.09
2	Milk Subsidy	334.78
3	Bicycle to School Children	296.63
4	Social Security Pension	1,067.14
5	Interest subsidy on Crop Loans	450.00
6	Failed Well Compensation Fund Scheme	1.00
7	Weavers' Package	33.82
8	Capitative Assistance to Rural Banks	1,534.67
9	Subsidies to Statutory Corporations/Government Companies	**(Appendix 1.8)**
10	Tax concession to industries	Discussed below

Subsidies to Industries by way of tax concession

The State Government relies on concession as an instrument to promote industry. Karnataka has also been announcing various industrial policies since 1968. In 2009 the State had brought out 'New Industrial Policy 2009-14', where the incentives and concessions offered for investment were a mix of fiscal and financial incentives. Some of the major incentives / concessions were:

a. Exemption from stamp duty
b. Concessional registration charges
c. Waiver of conversion fine
d. Exemption from entry tax
e. Interest free loan on VAT
f. Interest subsidy
g. Support to sugar sector

Most of the incentives are in the nature of tax concessions and hence is not budgeted. Incentives *viz*., interest free loan on VAT, interest subsidy, support to sugar sector etc., are budgeted. Apart from the above refund of Sales Tax and re-imbursement of Central Sales Tax, which are not part of the industrial policy, has also been given, and also budgeted.

The various types of revenue which have been foregone by the State on account of industrial policies or otherwise in the past three years are detailed in **Table 1.20.**

Table 1.20: Revenue foregone on account of industrial policies

(₹ in crore)

Type of concession	2009-10	2010-11	2011-12
Conversion of MVT due as interest free loan	42.00	29.04	NA
Support to sugar sector – conversion of purchase tax to interest free loans	43.56	100.99	27.73
Re-imbursement of CST	93.73	60.59	40.99
Waiver of CST	NA	NA	2.40
Re-imbursement of taxes and duties	NA	NA	100.00
Interest free loan on VAT	NA	NA	14.91
Exemption from stamp duty / concessional registration charges	NA	NA	6.86
Exemption from entry tax	NA	NA	85.19

***Source**: Appropriation Accounts and MTFP (2012-16)*
NA – Not available

The financial incentives – interest free loan on VAT/purchase tax/MVT dues-given by Government is fraught with a number of risks, such as, reduction of future VAT inflows, foregone interest and also failure of repayment of principal starting between five years to 12 years range. Further, 50 *per cent* of fixed assets are provided by Government as loan and in case of default, the Government has to fall back upon assets which are depreciated from time to time. Also, in respect of sugar industries the Government, apart from interest free loan, has been providing loans to co-operatives / companies consistently every year for repayment of their other loans from various banks.

Reflecting upon the huge fiscal burden, the Tax Reforms Commission, Government of Karnataka, way back in 2001 had recommended to the State Government to discontinue all forms of incentives and, instead, to strengthen infrastructure, streamline administration and create an investor friendly climate to attract investment.

The State Government has not undertaken any study on the impact of the 'New Industrial Policy' in terms of employment generation, upliftment of economy of the district in which the industry is located, contribution to exports etc.

The ERC has recommended the following with respect to industrial concessions:

- Interest free loans to be provided only for small and medium industries.
- If the Government wants to attract large industries by giving incentives, it should be some selected industry, for which the State does not bestow any special advantage such as availability of raw materials i.e. it should not give incentives for cement and steel industries.
- State Government should strengthen the infrastructure in the State – particularly power and road network, as it plays a greater role in the industrial development of a region rather than incentives and concessions.

The State Government in its earlier reply had stated that there were no specific norms for classifying expenditure as implicit subsidy. However, the XII FC in November 2004 itself had recommended to the States to identify the expenditure forming implicit subsidy and bring out the same in Finance Accounts for transparency. Further, the ERC in its fourth report has identified some of the implicit subsidies given by the State. However, during the year 2011-12 also implicit subsidies have not been identified.

ERC in its report submitted to the State Government gave recommendations in respect of various subsidies sanctioned by the State Government. Some of the major recommendations are:

- Efforts to streamline the identification of below poverty line household through proper verification and computerization to be expediated.
- Government should comprehensively evaluate various subsidies offered in the agriculture sector on their cost effectiveness and impact on relieving distress of farmers.
- Government to examine alternative options such as insurance to farmers.
- Government to identify all subsidies other than budget head '106' and report total subsidy bill.
- Government to target housing subsidy to districts where there is need and not in all the districts.
- Government to provide subsidized medical treatment only to below poverty line households.
- Government to review all the subsidies from the standpoint of alternative delivery mechanism to optimize their outcomes.

Subsidy provided by the State may also be classified as merit and non-merit subsidy. Subsidy (₹ 395 crore)[4] on education, housing, health, social welfare and nutrition, rural and urban development, agriculture and village and small scale industries, considered to be merit subsidy, constituted around five *per cent* of the total explicit subsidy expenditure of the State during 2011-12.

1.7.7 Financial assistance to local bodies and others

The quantum of assistance provided by way of grants to local bodies and others during the year 2011-12, relative to the previous years, is presented in **Table 1.21.**

Table 1.21: Financial assistance to local bodies and other institutions

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12
Panchayat Raj Institutions	9,122.39	10,804.46	11,406.81	12,554.65	15,211.83
Urban Local Bodies	2,468.20	2,339.11	2,471.69	2,976.02	4,247.90
Educational Institutions (including universities)	878.23	379.23	387.57	501.69	630.47
Co-operative societies and co-operative institutions	1,895.60	119.00	239.41	304.43	357.79
Other institutions and bodies (including statutory bodies)	2,361.00	1,620.24	1,914.55	2,704.11*	3,486.31
Assistance as a percentage of revenue expenditure	45	37	35	35	37
Total	**16,725.42**	**15,262.04**	**16,420.03**	**19,040.90**	**23,934.30**

Source: *Finance Accounts*

**includes assistance to ULBs for urban local election (₹ 3 crore) and XIII FC grants – incentive for issuing unique identification (₹ 13.89 crore)*

The assistance to PRIs increased from ₹ 9,122 crore in 2007- 08 to ₹ 15,212 crore in 2011-12 while the assistance to ULBs increased from ₹ 2,468 crore to ₹ 4,248 crore.

Out of the total devolution of ₹ 15,212 crore to PRIs during 2011-12, ₹ 6,928 crore (46 *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 ₹ 1,272 crore, ₹ 53 crore and ₹ 782 crore, respectively, during the year 2011-12 from the previous year. The increase in respect of ULBs was 43 *per cent* over the previous year and was towards schemes such as 'Mukhya Manthri Nagarothana Yojane' and 'Swarna Jayanti Shahari Rozgar Yojana'. It also included XIII FC grants of ₹ 308 crore. The assistance to ULBs included ₹ 2,498 crore towards creation of capital assets. However, the nature of assets created out of grants released was not available.

Assistance to other institutions (₹ 3,486 crore) included *inter-alia* assistance to Development Authorities (₹ 481 crore), NGOs (₹ 1,268 crore) and various other boards and institutions (₹ 1,737 crore).

Government in MTFP (2011-15) stated that with the revision of UGC, AICTC pay scales, the assistance to other institutions would increase in 2011-12. It also stated

[4] Education - ₹ 2.39 crore, housing - ₹ 25.69 crore, urban development - ₹ 106.50 crore, social welfare -₹ 26.90 crore, village and small scale industries - ₹ 76.40 crore, agriculture- ₹ 156.88 crore.

that with such huge amounts of Government money being spent outside the Government sector, it was important for better enforcement mechanisms to be created to regulate and monitor the aided institutions.

The other assistance (₹ 389 crore) included *inter-alia* assistance to temples and other religious institutions (₹ 137 crore), schemes such as Rashtriya Krishi Vikasa Yojane – Animal Husbandry (₹ 38 crore), Integrated Child Protection Scheme (₹ Seven crore), subsidy scheme of ₹ one crore under failed well compensation fund and grants under XIII FC for roads and bridges (₹ 44.42 crore).

1.7.8 Local bodies

The position of major issues related to Local Bodies i.e. Panchayat Raj Institutions (PRIs) and Urban Local Bodies (ULBs) are summarized in following paragraphs.

1.7.8.1 Panchayat Raj Institutions (PRIs)

(i) Introduction: There are 30 Zilla Panchayats (ZPs), 176 Taluk Panchayats (TPs), 5628 Gram Panchayats (GPs) in the State as on 31 March 2012. At the State level, Rural Development and Panchayat Raj Departments (RDPR) are presently headed by the Principal Secretary and the Secretary (PR) to the Government, respectively.

(ii) Audit: State Accounts Department (SAD) is the statutory external auditor for GPs. Its duty *inter-alia* is to certify correctness of accounts, assess internal control system and report cases of loss, theft and fraud to audit entities and to the State Government. The State Government entrusted (May 2011) the audit of GPs under Technical Guidance and Support (TGS) Module to the Comptroller and Auditor General of India (C&AG) up to the year 2014-15.

The C&AG audits and certifies the accounts of ZPs and TPs as entrusted under Section 19(3) of the C&AG's (Duties, Powers and Conditions of Service) Act, 1971.

(iii)Accounting: Financial reporting in the PRIs is a key element of accountability. The matters relating to drawal of funds, incurring of expenditure, maintenance of accounts, rendering of accounts by the ZPs and TPs are governed by the provisions of the KPR Act, Karnataka ZPs (Finance and Accounts) (KZP(F&A)) Rules, 1996, KPR-TP(F&A) Rules,1996.

Annual Accounts of ZPs and TPs are prepared in five statements for Revenue, Capital and Debt, Deposit and Remittance(DDR) heads as prescribed in Rule 33&30(4) of KZP(F&A) and KPR TP(F&A) Rules, 1996. GP accounts are prepared on accrual basis by adopting Double Entry Accounting System (DEAS) as prescribed under KPR GPs (Budgeting and Accounting) Rules, 2006. From 2011-12, the ZPs and TPs adopted Model Accounting system as prescribed by the C&AG of India.

(iv)Devolution: The 73rd amendment to the Constitution of India, envisaged transfer of 29 functions listed in the Eleventh Schedule to the PRIs. The State Government, however, devolved functions under 26 subjects and the remaining three subjects were yet to be transferred. Of these, 'Public Distribution System' is implemented by the Food and Civil Supplies Department. 'Social Welfare' and 'Welfare of the weaker sections' are implemented by both the State Government and PRIs.

(v) Reporting: The audit of accounts of Panchayat Raj Institutions (PRIs) in the State is conducted by the C&AG of India under Section 19(3) of the Duties, Powers and Conditions of Service Act 1971. The report of the C&AG of India is submitted to the Government as envisaged in Section 19A (1) of the DPC Act, 1971 and the State Government places the report before the State Legislature, as per section 19A(3) of the CAG's DPC Act 1971.

As per section 262 and section 253 of the KPR Act, 1993 the accounts of the ZPs and TPs are to be audited by the C&AG of India and the Audit report is to be laid before the State Legislature.

1.7.8.2 Urban Local Bodies (ULBs)

(i) Introduction: In Karnataka, there are eight City Corporations (CCs), 44 City Municipal Councils (CMCs), 94 Town Municipal Councils (TMCs), 68 Town Panchayats (TPs) and four Notified Area Committees (NACs). The CCs are governed by the Karnataka Municipal Corporations Act (KMC Act), 1976 and the other ULBs are governed by the Karnataka Municipalities Act (KM Act), 1964 which specify the obligatory, special and discretionary functions to be discharged by these ULBs. At the State level, Urban Development Department is headed by the Principal Secretary to the Government.

(ii) Audit: The Controller, State Accounts Department (SAD) is the statutory auditor of ULBs in terms of KMC and KM Acts.

The State Government entrusted (May 2010) the audit of accounts of all ULBs (except NACs) to the Comptroller and Auditor General of India (C&AG) under Section 14(2) of C&AG's DPC Act, 1971 from 2008-09 to 2010-11. Subsequently, audit of all ULBs was entrusted (October 2011) to the C&AG based on TGS module from the year 2011-12.

(iii) Accounting: On the recommendations of Eleventh Finance Commission, GOI had entrusted the responsibility of prescribing appropriate accounting formats for the ULBs to the CAG of India.

The Ministry of Urban Development, GOI developed the National Municipal Accounts Manual (NMAM) as recommended by the CAGs Task Force. The State Government brought out the Karnataka Municipal Accounting and Budgeting Rules (KMABR), 2006 based on the NMAM with effect from 1 April 2006. KMABR was introduced in a phased manner in all the ULBs except Bruhat Bangalore Mahanagara Palike (BBMP). As of 31 March 2012, all the ULBs were preparing the fund based accounts in double entry system.

The BBMP has adopted Fund Based Accounting System (FBAS) as per the Bangalore Mahanagara Palike (Accounts) Regulations, 2001 and the funds of BBMP are classified into three categories viz., Governmental Funds, Proprietary Funds and Fiduciary Funds based on the objectives, policies and activities.

(iv)Devolution: The 74th Constitutional amendment envisaged devolution of 18 functions to ULBs. Out of 18 functions, 14 functions were transferred to ULBs and two functions were being implemented by ULBs and State Government. The other two functions, namely, Urban Planning and Fire Services have not been transferred to ULBs.

Devolution of funds to ULBs is a natural corollary to the implementation of transferred functions. The State Government releases funds directly through budget to the ULBs to implement the devolved functions. In addition, grants are released to implement State and Centrally Sponsored Schemes.

(v) Reporting: Under Sections 150 and 295 of the Karnataka Municipal Corporations Act, 1976 and the Karnataka Municipalities Act, 1964 as amended the C&AG is to forward the annual technical inspection report of Corporations/Municipalities to the State Government for being placed before the State Legislature.

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 assigned to the State Governments are largely State subjects. Enhancing human development levels requires the States to step up their expenditure on key social services like education, health, etc. Low fiscal priority (ratio of expenditure category to aggregate expenditure) can be stated to have been 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 1.22 analyses the fiscal priority of the State Government with regard to development expenditure, social expenditure and capital expenditure relative to General Category States in 2008-09 and the current year 2011-12.

Table-1.22 Fiscal priority of the State in 2008-09 and 2011-12

(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) 2008-09	17.00	67.09	34.28	16.47	15.41	3.97
Karnataka State's Average (Ratio) 2008-09	16.84	71.05	35.60	20.29	16.63	3.97
*General Category States Average (Ratio) 2011-12	16.09	66.44	36.57	13.25	17.18	4.30
Karnataka State's Average (Ratio) 2011-12	18.98	73.91	35.68	21.01	15.24	4.02

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.
*General category States excludes three States i.e., Delhi, Goa and Puducherry

Comparative analysis reveals the following:

- The State's spending ratio of aggregate expenditure to GSDP which was marginally lower in 2008-09 increased considerably in 2011-12.

- Development expenditure as a proportion of aggregate expenditure in the State has also been higher than the General Category States' average. Development expenditure consists of both economic and social service sector expenditure. The social sector expenditure as a proportion of aggregate expenditure in the State which was higher than that of the General Category States in 2008-09 has decreased marginally in 2011-12. As observed from the **Table 1.22**, adequate priority needs to be given to both education and health sectors as the ratio under both these sectors are well below the General Category States' average during 2011-12.

- Priority to capital expenditure has been given by the State Government in 2008-09 and 2011-12, as the ratio of capital expenditure to aggregate expenditure has been higher than the average ratio of General Category States.

The State Government in MTFP (2012-16) acknowledged that the State had a huge challenge in matching the Human Development Indices of neighbouring States. It also stated that in the Education and Health Sectors, the scope for improvement in provision of services and translating the services into desired outcomes was large. Further, it emphasized that there was a need for focused investment in these sectors.

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[5]. Apart from improving the allocation towards development expenditure[6], 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 1.23** presents the trends in development expenditure relative to the aggregate expenditure of the State during the year 2011-12 *vis-à-vis* that of previous years, **Table 1.24** provides the details of capital expenditure and the components of revenue expenditure incurred on the maintenance of the selected social and economic services.

[5] *Core public* goods are those which all citizens enjoy in common in the sense that each individual's consumption of such goods leads to no subtractions from any other individual's consumption of those goods, e.g. enforcement of law and order, security and protection of citizen's rights; pollution free air and other environmental goods and road infrastructure etc.
Merit goods are commodities that the public sector provides free or at subsidized rates because an individual or society should have them on the basis of some concept of need, rather than ability and willingness to pay the Government and therefore wishes to encourage their consumption. Examples of such goods include the provision of free or subsidized food for the poor to support nutrition, delivery of health services to improve quality of life and reduce morbidity, providing basic education to all, drinking water and sanitation etc.

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

Table-1.23: Development expenditure

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12
Development expenditure (DE)	**33,642**	**37,134**	**44,925**	**51,628**	**60,930**
Percentage of DE to total expenditure	**72**	**71**	**74**	**75**	**74**
Components of DE					
Revenue	24,577	27,006	32,291	37,000	44,326
	(73)	(73)	(72)	(72)	(73)
Capital	8,310	9,399	11,657	12,890	14,880
	(25)	(25)	(26)	(25)	(24)
Loans and advances	755	729	977	1,738	1,724
	(2)	(2)	(2)	(3)	(3)

Figures in brackets 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 ₹ 33,642 crore in 2007-08 to ₹ 60,930 crore in 2011-12. As a *percentage* of total expenditure, it increased from 72 in 2007-08 to 75 in 2010-11. In 2011-12, development expenditure as a percentage of aggregate expenditure decreased by one *per cent* relative to the previous year, due to decrease in development 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 2007-12.

In 2011-12 expenditure on salary (₹ 9,548 crore) and subsidy (₹ 7,279 crore) formed two major components of development revenue expenditure.

Table 1.24: Efficiency of expenditure use in selected social and economic services

(ratios in *per cent*)

	2010-11		2011-12	
	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
Education, sports, art and culture	0.61	10.27	0.40	8.90
Health and family welfare	0.63	2.20	0.43	2.39
Water supply, sanitation, housing and urban development	4.21	0.04	3.84	0.04
Others	0.49	1.25	0.48	0.68
Total (SS)	**5.94**	**13.78**	**5.15**	**12.01**
Agriculture & allied activities	0.18	1.44	0.27	1.11
Irrigation and flood control	6.90	0.21	6.90	0.20
Power & energy	2.04	0	1.38	0
Transport	4.44	0.08	4.89	0
Others	1.66	0.81	1.56	1.10
Total (ES)	**15.22**	**2.54**	**15.00**	**2.41**
Total (SS+ES)	**21.16**	**16.32**	**20.15**	**14.42**

Source: *Finance Accounts*

Expenditure on social services

Capital expenditure on social services increased from ₹ 4,106 crore in 2010-11 to ₹ 4,241 crore in 2011-12 while there was decrease in the ratio of capital expenditure to total expenditure from six per cent in 2010-11 to five per cent 2011-12.

The share of salary expenditure (under social services) in total revenue expenditure decreased from 14 *per cent* in 2010-11 to 12 *per cent* in 2011-12.

Expenditure on economic services

Capital expenditure on economic services increased from ₹ 10,520 crore in 2010-11 to ₹ 12,363 crore in 2011-12 with a growth rate of 18 *per cent*.

The priority sectors identified by the Government in respect of economic services were agriculture, rural development, special area programmes, irrigation and flood control and transport. In 2011-12, capital outlay on irrigation and flood control, industries and minerals and transport was higher by ₹ 925 crore, ₹ 268 crore and ₹ 962 crore respectively, compared to the previous year.

The share of salary expenditure (under economic services) in total revenue expenditure remained same in 2010-12.

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, 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 in 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 2011-12 *vis-à-vis* previous years.

1.9.1 Incomplete projects

Blocking of funds, on incomplete works 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 2012 is given in **Table 1.25**.

Table 1.25: Incomplete projects

(₹ in crore)

Department	Incomplete projects					Cumulative expenditure as of March 2012
	Number	Budgeted cost	Revised cost	Cost over run[7]		
				Number	Amount	
Public works						
Buildings	137	520.48	541.89	22	47.14	424.79
Roads & bridges	147	591.14	591.47	19	3.73	470.22
Irrigation	60	171.26	176.01	28	6.61	151.86
Total	**344**	**1,282.88**	**1,309.37**	**69**	**57.48**	**1,046.87**

Source: *Finance Accounts*

Against the initial budgeted cost of ₹ 1,283 crore in respect of 344 works, stipulated to be completed on or before March 2012, the progressive expenditure was ₹ 1,047 crore as of March 2012, out of which, in 69 cases, the cost overrun aggregated ₹ 57 crore.

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

[7] Includes only one case where expenditure exceeded the revised cost and the cost overrun was ₹ 2.39 crore.

The ERC in its report has recommended that infrastructure projects above ₹10 crore should be subjected to detailed social cost benefit analysis. Further, it recommended that projects in progress required to be subjected to effective monitoring and evaluation for timely course correction. It also proposed to introduce investment appraisal mechanism for all large projects in a phased manner.

1.9.2 Investment and returns

As of March 2012, Government had invested ₹ 44,295 crore in 87 Government companies (₹ 40,313 crore) including investment of ₹ 52 crore in 17 non-working Government companies, nine statutory corporations (₹ 2,032 crore), 43 joint stock companies (₹ 1,562 crore) and co-operative institutions, local bodies and regional rural banks (₹388 crore). The return from investment was negligible (**Table 1.26**).

Table-1.26: Return on investment

	2007-08	2008-09	2009-10	2010-11	2011-12
Investment at the end of the year (₹ in crore)	22,279.35	26,672.11	32,483.28	38,420.70	44,294.86
Return (₹ in crore)	23.4	40.2	29.48	43.47	60.56
Return *(per cent)*	0.1	0.1	0.1	0.1	0.1
Average rate of interest on Government borrowings*(per cent)*	7.6	6.9	6.7	6.4	6.8
Difference between interest rate and return *(per cent)*	7.5	6.8	6.6	6.3	6.7

Source: *Finance Accounts.*

The State Government in MTFP (2012-16) has accepted the fact that the return on these investments was negligible. It was also stated that though the efforts of Government to get due returns out of its investments did not yield satisfactory results, it could not shy away from investing in social infrastructure involving long gestation and pay back periods. It further stated that Government would continue to make efforts to ensure due returns.

In addition, investment of ₹ 1,007.34 crore in respect of four[8] Companies/ Corporations has been lying in Public Account to the end of March 2012 without actual release to the institutions. This has resulted in locking up of funds in the Public Account.

The State in its reply to PAC (July 2011) had stated that the releases from Consolidated Fund were deposited in the Deposit Account to carry out capital works. It had also stated that the said amount enabled the Companies/Corporations to utilize the funds as per their immediate needs.

The reply of the State Government is not acceptable for the reason that while the Appropriation Accounts show the money as expended in a particular year, in reality the amount still remains in the Government account (Public account) without being spent for the purpose for which it was intended.

Though generally borrowings (with interest liability) are utilized for capital expenditure, the amounts released as investments in these cases were parked in Public Account without any returns (both financial and physical).

[8] Krishna Bhagya Jala Nigam (₹ 128.78 crore), Karnataka Infrastructure Development and Finance Corporation (₹ 362.55 crore), Bangalore City Corporation (₹ 225.27 crore) and Mega Area Development Board (₹ 290.74 crore).

Out of the total investment of ₹ 44,295 crore up to the end of 2011-12, investment of ₹ 42,223 crore (95 *per cent*) was in 60 Government companies and statutory corporations under irrigation sector (₹ 25,076 crore), transport sector (₹ 4,550 crore), infrastructure sector (₹ 1,790 crore), power sector (₹ 6,133 crore), industries sector (₹ 542 crore), housing sector (₹ 1,321 crore), financing sector (₹ 2,297 crore), construction sector (₹ 2 crore) and social sector (₹ 512 crore).

The investment included ₹ 18,924 crore (43 *per cent*) in the following Companies/Corporations under perennial loss (**Table 1.27**).

Table 1.27:Investment in companies/corporations under perennial loss

(₹ in crore)

Company/Corporation	Investment Up to 2011-12	Cumulative loss as at 2010-11
North Western Karnataka Road Transport Corporation	209	355.55
North Eastern Karnataka Road Transport Corporation	134	338.90
Karnataka State Agro Corn Products Limited, Bangalore	1	12.98
The Karnataka Minorities Development Corporation Limited, Bangalore	185	28.18
Karnataka Urban Infrastructure Development and Finance Corporation	6	0.67*
Rajiv Gandhi Rural Housing Corporation Limited	130	55.59
Krishna Bhagya Jala Nigam Limited	17,619	251.04
Karnataka Silk Marketing Board Limited, Bangalore	3	28.40
The Mysore Sugar Company Limited, Bangalore	165	266.73*
Hubli Electricity Supply Company Limited	472	723.79
Thungabadra Steel Products Limited	- #	26.76*
Total	**18,924**	**2,088.59**

Source: *Finance Accounts.*

**the cumulative loss is as at 2009-10 in respect of KUIDFC and at 2008-09 in respect of TMSCL and TSPL*

 # Amount is less than ₹ 10,000, hence not indicated.

During the year, Government invested ₹ 255 crore in statutory corporations and ₹ 5,594 crore in Government companies (working). The investment included;

- ₹ 144 crore loan amount converted as equity and details of the same is discussed in paragraph 1.9.4.
- ₹ 4.91 crore released for Mysore Sugar Company Limited for repayment of HUDCO loan.
- ₹ 150 crore provided as support to Karnataka State Finance Corporation in order to facilitate refinance from SIDBI.

During 2011-12 investment of ₹ 2.99 crore made earlier to Karnataka Dairy Development Corporation Limited was partly converted as subsidies (₹ 1.31 crore) and partly as capital expenses (₹ 1.68 crore) under investments, thereby increasing the plan expenditure of both revenue and capital. Further, the expenditure of earlier years was shown as investment (capital expenses) of the current year. The trend in this regard for the last three years is detailed in **Table 1.28**.

Table 1.28: Conversion details

(₹ in crore)

Type of conversion	2009-10	2010-11	2011-12
Loan to equity	516	Nil	144
Equity to loan	Nil	31	Nil

Source*: Finance Accounts*

XIII FC, while reviewing the performance of State Public Sector undertakings with respect to Government investments, had recommended that the State Government should draw up a road map by March 2011 for closure of non-working companies in consultation with the Accountant General. To the end of 2011-12, in Karnataka, the Government has invested ₹ 52.17 crore in 17 non-working Government Companies.

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 ₹ 9.46 crore. The total loss incurred by these undertakings was ₹ 7.56 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.

State Government in its reply to PAC (July 2011) had stated that the Department of Commerce and Industries would be advised to conduct a review of the working of the said undertakings. The outcome of the review is yet to be received.

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 1.29** presents the position of outstanding loans and advances as of March 2012 and interest receipts *vis-à-vis* interest payments during the last five years.

Table-1.29: Average interest received on loans advanced by the State Government

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12
Opening balance	**6,241**	**6,946**	**7,620**	**8,047**	**9,623**
Amount advanced during the year	757	731	982	1,737	1,816
Amount repaid during the year	52	57	555	161	241*
Closing balance	**6,946**	**7,620**	**8,047**	**9,623**	**11,198**
Net addition	705	674	427	1,576	1,575
Interest receipts	58	103	74	180	52
Interest receipts as *per cent* to outstanding loans and advances	0.8	1.3	0.9	1.9	0.5
Interest payments as *per cent* to outstanding fiscal liabilities of the State Government.	7.5	6.3	6.2	6.1	6.4
Difference between interest payments and interest receipts (*per cent*)	-6.7	-5.0	-5.3	-4.2	-5.9

Source: *Finance Accounts.*

**the amount disbursed differs by ₹ one crore with that shown in appendix 1.3 and 1.6 due to rounding.*

Loans outstanding as of March 2012 aggregated ₹ 11,198 crore. Interest spread of Government borrowings was negative during 2007-12 which meant that the State's borrowings were more expensive than the loans advanced by it.

The amount advanced during 2011-12 (₹ 1,816 crore) did not include ₹ 0.15 crore advanced to Karnataka State Forest Industries Corporation under revenue head of account 2406.

Repayment of loans during 2011-12 aggregated to ₹ 241 crore. This included ₹ 144 crore loan converted into equity (60 *per cent*). The details are brought out below:

- ₹ 13.91 crore of loan provided to Karnataka Pulpwood company.
- ₹ 1.16 crore of loan provided to Karnataka State Forest Industries Corporation Limited.
- ₹ 3.00 crore of term loan provided to Karnataka Cashew Development Corporation Limited.
- ₹ 10.00 crore loan provided to Karnataka State Warehousing Corporation for construction of godowns.
- ₹ 15.00 crore loan provided to power utilities.
- ₹ 101.03 crore loan provided to Mysore Paper Mills Limited.

During 2011-12, terms and conditions of repayment were not received for loans amounting to ₹ 1,983 crore.

The Government order of July 2003 indicated the revised interest rate on all the loans sanctioned by the Government on or after 1st April 2003. Further, it stated that all sanction orders should invariably be accompanied by the essential details and the standard terms and conditions of loans appended to the said order. However, the Finance Accounts, since 2006-07, have been including a statement where terms and conditions of repayments have not been received.

The PAC in its recommendation (December 2011) had stated that terms and conditions of repayment have to be invariably issued with respect to all loans and advances sanctioned.

Recovery of loans and advances aggregating ₹ 2,694 crore (principal: ₹ 1,690 crore and interest: ₹ 1,004 crore) was overdue as of March 2012 from 22 institutions[9] **(Appendix 1.9)**. However, the State Government had not reconciled the balances maintained against these 22 institutions.

The controlling officers maintaining loans are required to furnish details of arrears in recovery of loan installments and interest to the Principal Accountant General (Accounts and Entitlement) every year. However, the statements are received from respective bodies / organizations instead of controlling officers. Out of 928 statements from 842 bodies /organizations due, only 70 statements with 27 nil statements were received. Further, recovery of loans and advances aggregating ₹ 567 crore (principal: ₹ 283 crore and interest: ₹ 284 crore) was overdue as of March 2012 from 43 institutions[10].

Around 68 *per cent* of this pertained to three major defaulters viz., Karnataka Agro Industries Corporation, Mysore Lamp Works and Mysore Electrical Industries Limited. In these cases, the overdue interest and principal for recovery aggregated ₹ 192 crore.

The PAC in its recommendation had held that the actual amount due for recovery should be incorporated in the budget estimates.

[9] Source: Finance Accounts 2011-12
[10] Details accounts kept by State Government.

Test check of records with respect to three companies showed the following:

- The Finance Accounts reflected the arrears of principal and interest as ₹ 0.30 crore and ₹ 0.86 crore, respectively, with respect to M/s. Hutti Gold Mines Company Limited. The outstanding loan against the company was ₹ 3.05 crore. However, at the time of closure of the company in 1997, the State Government took over the assets of the company in lieu of writing off outstanding loan of ₹ 1.38 crore.
- The outstanding loan of ₹ 101.03 crore against M/s. Mysore Paper Mills Limited was converted as equity. This included ₹ 56.69 crore of interest bearing loan released between 1994 and 2007. Terms and conditions have not been issued by Government in respect of these loans till date. Further, the Government order converting the loan into equity was silent on the treatment of the interest due on the said loans.
- The outstanding loan as at the end of March 2012 with respect to M/s. Mysore Lamp Works reflected an amount of ₹ 49.06 crore against major head 6858 and ₹ 52.96 crore against major head 6852, given towards State Renewal Fund, VRS and other relief in Finance Accounts. Against this, the company reflected combined loan of ₹ 96.89 crore. On analysis it was observed that during 1998-99, the State Government had converted the outstanding loan of ₹ 8.06 crore and interest of ₹ 2.38 crore into equity. Further, a sum of ₹ 3.02 crore was sanctioned as loan during 2001-02 for the payment of commercial tax dues by the company, which was not acted upon and hence was not reflected in Finance accounts. Evidently, the data on loan recoveries in arrears required reconciliation. Further, terms and conditions with respect to loans and advances sanctioned during 2009-10 were issued during 2011-12 only.

1.9.5 Cash balances and investment of cash balances

Table 1.30 depicts the cash balances and investments made there from by the State Government during the year.

Table-1.30: Cash balances and investment of cash balances

(₹ in crore)

	As of March 2011	As of March 2012	Increase(+)/ Decrease (-)
Cash balances	7,667.31	9,609.49	1,942.18
Investments from cash balances	**6,971.51**	**7,640.61**	**669.10**
GOI treasury bills	6,871.18	7,640.28	769.10
GOI securities	0.32	0.32	---
Other securities	---	---	---
Other investments	0.01	0.01	---
Funds-wise break-up of investment from earmarked balances	**1,444.24**	**1,961.98**	**517.74**
Sinking fund	-0.26	-0.41	0.15
Industrial development fund	0.01	0.01	---
Co-operative development fund	0.49	0.48	-0.01
Other development and welfare fund	1,443.99	1,961.89	517.90
Miscellaneous deposits	0.01	0.01	---
Interest realized	**400.28**	**381.69**	**-18.59**

Source: *Finance Accounts.*

The cash balance of the State at the end of the year was ₹ 9,609 crore. The increase in cash balances was 25 *per cent* over the previous year.

Surplus cash balance was mainly due to market borrowings of ₹ 7,500 crore raised during 2011-12.[11] Further, there was an increase of ₹ 2,579 crore (net) in suspense and miscellaneous which contributed to the surplus cash balance. The increase was mainly on account of un-encashed treasury cheques.

The PAC in its report has also emphasized the need for revisiting the investment policy of the Government.

In MTFP (2012-16), the State Government has stated that it has invested its surplus cash balance in 91 days' treasury bills and around ₹ 163 crore was expected as interest revenue out of the investment. It further stated that efforts would have to be made for better forecasting of exact requirement and timely release of funds so as to maintain prudent level of cash balance. It also emphasized that it followed the policy of need-based borrowings and kept basic minimum surplus cash balance as buffer.

The surplus cash balance was invested partly in fourteen day intermediate treasury bills of RBI with an average interest rate of five *per cent* per annum and partly in ninety one day intermediate treasury bills of RBI with an average interest rate of 8.3 *per cent* against an average rate of 8.8 *per cent* per annum at which the borrowings were made.

The interest received from investment in ninety one day treasury bill during the current year was ₹ 1, 63.64 crore.

In view of the comfortable position of cash balances, revenue surplus of ₹ 4,521 crore and a low fiscal deficit of 2.87 *per cent* of GSDP, the open market borrowings could have been restricted to ₹ 3,800 crore (approximately).

The XIII FC has also suggested that there should be a directed effort by States with large balances towards utilizing their existing cash balances before resorting to fresh borrowings. Further, it has suggested to consider utilizing their surplus cash balances for bullet repayment of market borrowings raised for debt swap during the period 2002-05, which was likely to become due during the next few years. The Reserve Bank of India also has reiterated the fact and advised the States to manage their cash balance more efficiently.

Following the advice of GOI and RBI, the State Government in MTFP (2011-15) had proposed to utilize part of the cash balance pertaining to various Reserve Funds for financing the fiscal deficit. In other words, the State Government had committed to borrow funds on need basis rather than on availability. Further, it stated that whenever there was a demand on respective reserve funds and Fiscal Management Fund, the GOI would be approached to allow additional borrowings. In the current year, while no expenditure was met out of the Fiscal Management Fund, the balance in the reserve funds increased by ₹ 2,761 crore over the previous year. Also, the statement of State Government clearly indicated that it could approach GOI for additional borrowings in future on the expenditures which were not transferred to public account during 2008-12 but could be adjusted in coming years through more borrowings.

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[11] November 2011 (₹ 1,500 crore at 9.19 *per cent*), January 2012 (₹ 1,250 crore at 8.69 *per cent* and ₹ 1,250 crore at 8.65 *per cent*), February 2012 (₹ 1,500 crore at 8.69 *per cent* and ₹ 500 crore at 8.74 *per cent*) and March 2012 (₹ 1,500 crore at 8.92 *per cent*).

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 lands 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 2012 compared with the corresponding position as on 31 March 2011.

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. It also include borrowings by Public Sector Undertakings and Special Purpose Vehicles and other equivalent instruments where liability for repayment is of the State Government.

Further, the internal debt includes market loans, special securities issued to RBI and other negotiated loans. The Constitution of India provides that States may borrow within the territory of India upon the security of their Consolidated Funds, 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 consist 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 components of assets and liabilities are summarized in the **Table 1.31.**

Table 1.31: Summarised position of Assets and Liabilities

(₹ in crore)

Liabilities				Assets			
	2010-11	2011-12	*(per cent)*		2010-11	2011-12	*(per cent)*
Consolidated Fund	***59,277***	***65,315***	***10***	***Consolidated Fund***	***98,152#***	***1,15,233***	***17***
a. Internal Debt	48,762	54,333	11	i. Capital outlay	88,529	1,04,035	18
b. Loans and advances from GOI	10,515	10,982	4	ii. Loans and advances	9,623	11,198	16
Public Account*	***32,666***	***37,715***	***15***	***Cash***	***7,667***	***9,609***	***25***
a. Small savings, Provident funds, etc	12,784	14,182	11				
b. Reserve Funds	10,184	12,427	22				
c. Deposits	9,698	11,106	15				

**The liabilities are on net basis. It does not include investments from out of ear marked funds of ₹ 1,444 crore (2010-11) and ₹ 1,962 crore (2011-12).*

 # Assistance of rupees four crore of previous year treated as investment which has been corrected proforma.

The growth rate of assets which was 14 *per cent* during 2010-11, increased to 18 *per cent* during 2011-12, while that of liabilities also increased from 10 *per cent* in 2010-11 to 12 *per cent* in 2011-12.

The Finance Accounts reflected an amount of ₹ 54,333 crore as internal debt outstanding as at the end of 2011-12 after taking into account the difference of ₹ 505.081 crore in the accounts of LIC, GIC, NABARD, NCDC etc. Further, Reserve Bank of India in its quarterly statement of outstanding balances of Government of Karnataka as on 31 March 2012 reflected closing balance of Market loans – not bearing interest as ₹ 0.18 crore. However, the Finance Accounts reflected an amount of ₹ 1.58 crore. This clearly indicated that reconciliation between the revenue and capital accounts was required.

The loans and advances from GOI reflected an amount of ₹ 10,982 crore as at the end of 2011-12. Loans amounting to ₹ 170.14 crore outstanding as per Finance Accounts under Central plan schemes and Centrally sponsored schemes with respect to all Ministries other than Finance Department has been written off on the basis of recommendation of XIII FC. However, as per the Ministries' records, the outstanding balances worked out to ₹ 144.89 crore and the difference amount of ₹ 25.25 crore required reconciliation.

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 year 2011-12 *vis-à-vis* the previous year is presented in **Charts 1.11 and 1.12**.

Chart 1.11: Composition of outstanding Fiscal Liabilities as on 01.04.2012

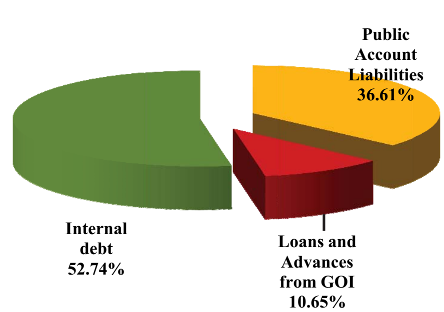
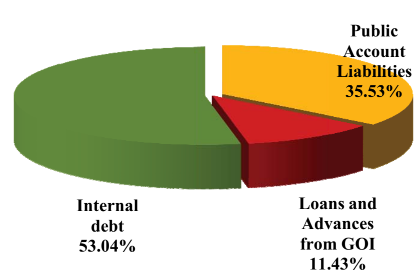


Chart 1.12: Composition of outstanding Fiscal Liabilities as on 01.04.2011



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 are brought out in **Table 1.32**.

Table 1.32: Fiscal liabilities –basic parameters

(₹ in crore and ratios in *per cent*)

	2007-08	2008-09	2009-10	2010-11	2011-12
Fiscal liabilities	60,142	71,550	83,482	91,943	1,03,030
Rate of growth (*per cent*)	4.3	19.0	16.7	10.1	12.0
Ratio of fiscal liabilities to					
GSDP	22.20	23.06	24.18	23.04	23.72
Revenue receipts	146.1	165.3	169.8	157.9	147.9*
Own resources	204.9	232.3	246.2	219.8	203.8
Buoyancy ratio of fiscal liabilities to					
GSDP	0.2	1.3	1.5	0.6	1.3
Revenue receipts	0.5	3.6	1.2	0.5	0.6
Own resources	0.6	3.8	1.6	0.4	0.6

Source: *Finance Accounts.*
**refer footnote below Table 1.1*

Fiscal liabilities of the State increased by 71 *per cent* from ₹ 60,142 crore in 2007-08 to ₹ 1,03,030 crore in 2011-12 comprising Consolidated Fund liabilities (₹ 65,315 crore) and Public Account liabilities (₹ 37,715 crore).

With the announcement of the 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 years 2008-09 and 2009-10 respectively. This resulted in rate of growth of fiscal liabilities at 19 and 16.7 *per cent* respectively. As recommended by XIII FC and the subsequent amendment to FRA, fiscal deficit limit of three *per cent* was to be attained by 2011-12 with the year 2010-11 being the year of consolidation. The growth rate of fiscal liabilities which was 16.7 *per cent* during 2009-10 decreased to 10.1 *per cent* during 2010-11. In 2011-12, due to increased borrowings, the growth rate of fiscal liabilities once again increased to 12 per cent. As a result, buoyancy of fiscal liabilities to GSDP was 1.3 during the year 2011-12. Further, the ratio of fiscal liabilities to GSDP during 2011-12 increased to 24 *per cent* from 23 per cent in 2010-11, and also buoyancy of fiscal liabilities to revenue receipts increased from 0.5 *per cent* in 2010-11 to 0.6 *per cent* in 2011-12.

1.10.3 Transactions under Reserve Fund

Reserves and Reserve Funds are created for specific and well defined purposes under the Sector 'J' in the accounts of the State Government (Public Account). These funds are fed by contributions or grants from the Consolidated Fund of India or State or from outside agencies. The contributions are treated as expenditure under the Consolidated Fund. These form debits to the Consolidated Fund. The expenditure relating to the fund is initially accounted under the Consolidated Fund itself for which the vote of the legislature is obtained. At the end of the year, at the time of closure of accounts, the expenditure relating to the fund is transferred to Public Account under the concept of gross budgeting through an operation of deduct entry in accounts. This forms credit to the Fund. The funds may be further classified as 'Funds carrying interest' and 'Funds not carrying interest'. Generally, the Reserve Funds are classified under the following three categories based on the sources from which they are fed.

- Funds accumulated from grants made by another government and at times aided by public subscriptions, example: Fund formed from subventions from the Central Road Fund.

- Funds accumulated from sums set aside by the Union/State from the Consolidated Fund of India or Consolidated Fund of State, as the case may be, to provide reserves for expenditure to be incurred by them for particular purposes, e.g: Depreciation Fund.
- Funds accumulated from contributions made by outside agencies to the State Government.

As per Finance Accounts, 33 reserve funds have been created and maintained in the accounts of the State Government. Out of the 33 funds, 20 are dormant for over 30 years. Out of this, two funds require further analysis and 17 funds could be considered for winding up. Further, the Government during March 2008, had issued directions to operate the Price Stabilization Fund under the Consolidated Fund. However, the fund continued to be operated under the Public Account and its closing balance as on March 2012 was ₹ 127.46 crore. The Commerce and Industries Department in March 2008 had clearly stated that the unused cheque books/documents etc., should be surrendered after reconciliation.

Failed Well Compensation Fund, which was inoperative since 2001-02, had a balance of ₹ 2.41 crore. Expenditures of ₹ 6.57 crore and ₹ 1.00 crore were incurred in 2010-11 and 2011-12. However, the same was not debited to the fund.

The remaining 13 funds with a balance of ₹ 12,300.39 crore are operative. Analysis of transactions of Consumer Welfare Fund, Infrastructure Initiative Fund, State Disaster Response Fund, Central Road Fund, Fiscal Management Fund, Port Development Fund and State Urban Transport Fund are detailed in the subsequent paragraphs. Transactions with respect to Guarantee Reserve Fund and Sinking Fund have been detailed in paragraphs 1.10.4 and 1.11.4 respectively**.**

Consumer Welfare Fund

The Consumer Welfare Fund (CWF), created for the welfare of the consumers during September 2006, was credited with the following:

- Seed money from Central Consumer Welfare Fund from GOI.
- Assistance provided by Central Government for strengthening consumer movement in the State.
- Matching grants or any assistance by the State Government and court fee accrued with the district and state consumer forum.
- Penalty paid by manufacturers of consumer products or service provider.
- Returns from the investment out of the accumulation in the fund.
- Any amount received by the State Government for the purpose of the fund.

The expenditures of ₹ 0.93 crore and ₹ 1.33 crore incurred towards consumer welfare activities during 2009-10 and 2010-11 respectively, were allowed to remain in the Consolidated Fund and have not been shown as met out of the Consumer Welfare Fund Account.

In order to strengthen the Consumer Welfare Fund in all states, revised Central Consumer Welfare Fund Guidelines, notified in 2007-08, envisaged establishing a corpus of ₹ 10.00 crore as State Consumer Welfare Fund supported by the Central Government with 75 *per cent* of the corpus as Central share. Though the State Government made a provision of ₹ 2.50 crore towards the establishment of Corpus Fund as State Share in 2010-11, the fund was not established as the account was not opened in the treasury. Thus, the State had to forego ₹ 7.50 crore, the Central Share of the Corpus Fund.

During 2011-12, ₹ 2.50 crore being the State's contribution towards setting up of consumer clubs in schools have not been shown as credit to the fund. However, the same has been adjusted against Deposit which does not form part of Consumer Welfare Fund. The central share of ₹ 7.50 crore is yet to be received.

Further, another fund with the same nomenclature of 'Consumer Welfare Fund' with the balance of ₹ 0.67 lakh has been dormant since 1999-2000, which may be considered by the State for winding up or merging with the Corpus Fund yet to be created.

Infrastructure Initiative Fund (IIF), Bangalore Metro Rail Corporation Limited (BMRCL) Fund and Chief Minister's Rural Road Development (CMRRD) Fund

Karnataka Act of 1998 provided for levy of infrastructure cess on taxes on sales, trade etc., excise license fee, motor vehicles tax and non-judicial stamp duty in the State. The cess collected was to be allocated to IIF and BMRCL Fund in the ratio of 2:1 of the total collections which was subsequently revised in 2004. The total infrastructure cess collected was to be allocated between IIF, BMRCL and CMRRD Fund in the ratio of 57, 28 and15 *per cent,* respectively. On the introduction of a uniform value added tax (VAT) in 2005 levy of infrastructure cess was dispensed with and the Government decided to contribute to the fund out of general revenues of the State.

In 2011-12, the infrastructure cess realized (₹ 609.28 crore) through taxes on motor vehicles, stamp and registration and State excise was allocated to IIF, BMRCL fund and CMRRD fund. The sum transferred to the said funds were ₹ 347.29 crore, ₹ 170.60 crore and ₹ 91.39 crore, respectively. Further, a provision of ₹ 1,000 crore was made for augmenting IIF out of general revenues. In view of requirement of funds for Bangalore Metro – Phase II, Government re-appropriated unspent provision of ₹ 1,100 crore under various heads and decided to transfer a total provision of ₹ 2,100 crore to BMRCL fund. The expenditure incurred under various plan schemes under major heads 5465, 6217 and 3054 are to be met out of the respective funds. During 2011-12, additional provisions amounting to ₹ 2,080.75 crore were provided for meeting the expenditure out of the IIF. The expenditure incurred in various plan schemes under the Major heads 5465, 6217 and 3054 were ₹ 510.76 crore, ₹ 933.00 crore and ₹ 166.90 crore respectively. However, expenditure amounting to ₹ 347.29 crore, ₹ 170.60 crore and ₹ 66.91 crore only was transferred to IIF, BMRCL and CMRRD fund respectively and expenditure against additional provision made was not transferred to the IIF fund. This resulted in understatement of revenue surplus and overstatement of fiscal deficit.

The PAC also, in its recommendation have stated that the directions contained in the List of Major and Minor Heads of account should be followed for accounting such transactions as the adjustments adopted by the Government were not in accordance with the instructions contained therein.

Central Road Fund

Central Road Fund is a fund constituted by the GOI. Subventions are paid from this fund to the State for road developmental works approved by GOI. Actual expenditures are also transferred to the fund. During 2009-10, expenditure of ₹ 205.30 crore was transferred from Consolidated Fund to the Central Road Fund in Public Account against the balance of ₹ 165.30 crore at its credit. This resulted in adverse balance of ₹ 40 crore. State Government in its reply (November 2010), reiterated in July 2011, had stated that initially expenditure was met out of State funds which were reimbursed subsequently by GOI, and hence, limiting the expenditure to the extent of the grant was not possible. However, in 2010-11, against expenditure of ₹ 149.98 crore incurred, ₹ 70.97 crore alone was transferred to the Central Road Fund account. The amount reimbursed by GOI was ₹ 110.97 crore. This resulted in wiping out the adverse balance of the previous year. This was contrary to the reply given by the State Government earlier. Hence, the expenditure of ₹ 80 crore had remained in the Consolidated Fund itself.

In 2011-12, against expenditure of ₹ 172.53 crore, ₹ 136.92 crore was transferred to the fund thereby limiting the expenditure to the extent of grant received. The Union Government in reply (August 2011) to the State Government's request for release of balance amount of ₹ 212.24 crore (pertaining to last 11 years) stated that the sanction amount was worked out as per the annual accrual for the year in which the schemes were sanctioned and the present liabilities, and not by considering the accumulated accrual of earlier periods. This clearly indicates that the State Government may not be in a position to receive the balance amount due. Hence, the reply of the Government given earlier that the excess expenditure would be reimbursed subsequently is not acceptable.

Fiscal Management Fund

The Fiscal Management Fund was created during 2006-07 in terms of Section 4(p) of the Fiscal Responsibility Act, 2002 to discharge the liabilities arising during the course of the year out of general revenue of the State. However, no rules had been framed regarding its administration.

During 2011-12, provision of ₹ 150 crore was made for the purpose of transfer to the fund. An order in this regard was issued on 31 March 2012 which was later modified on the same day and the amount of contribution to the fund was limited to ₹ 50 crore without citing any reasons. It may be mentioned here that the provision of ₹ 150 crore as contribution to Fiscal Management Fund was made with budget estimate for revenue surplus of ₹ 1,279 crore. However, since the revenue surplus actually amounted to ₹ 4,521 crore, the State could have met the promise made to the Legislature.

State Disaster Response Fund

The State Disaster Response Fund (SDRF), constituted under Disaster Management Act, 2005, is operative from 2010-11 under Reserve Fund bearing interest. As per the guidelines the accretions to the SDRF together with the income earned on the investment of the SDRF are to be invested in one or more of instruments viz., Central Government dated securities, auctioned treasury bills and interest earning deposits and certificates of deposits with Scheduled Commercial Banks. Further, the State Government had to pay interest to the SDRF at the rate applicable to overdrafts and credit the same on a half yearly basis. While 75 *per cent* of the contribution was to be from GOI, the balance 25 *per cent* was to come from the State Government. Further, the balance as on 31 March 2010 in the Calamity Relief Fund (CRF) was to be transferred to the SDRF. The contributions to the fund for the year 2011-12 included GOI contribution of ₹ 126.76 crore, State's contribution of ₹ 42.25 crore and balance CRF transferred ₹ one crore. It also included GOI contribution of ₹ 70.23 crore from National Disaster Relief Fund. However, no interest was credited to the fund. An expenditure of ₹ 168.93 crore, released to Deputy Commissioners for relief expenditure to deal with natural calamities was shown as met out of the SDRF. This excluded ₹ 0.08 crore of expenditure incurred against training in disaster preparedness. The amounts released to Deputy Commissioners were kept in Personal Deposit accounts which were in violation of the act. Further, the unspent balance in the Personal Deposit accounts of the Deputy Commissioners for SDRF was not reflected in the accounts but merged with the general balances. However, these unspent balances resulted in understatement of the fund account in Public Account to that extent. This also resulted in overstatement of expenditure towards calamity relief in the Consolidated Fund.

Port Development Fund

Under the provision of Sec 3 of the Indian Ports Act 1908, section 8 of Karnataka Ports (landing and shipping fees) Act 1961 and Rules 23 and 24 of Karnataka Ports (landing and shipping fees) Rules 1964, Port Development Fund was established during 2007-08. While all the receipts received under the head of account 1051 and 1052 are credited to the fund, the expenditure incurred towards various Port Development Schemes factoring out the establishment costs were to be met out of the fund.

In 2011-12, while the receipt under the head of account 1051 and 1052 were ₹ 8.58 crore, the expenditure on Port Development Schemes (Revenue and Capital) was ₹ 32.02 crore. Government decided to meet expenditure only to the extent of receipts received, despite having credit balance of Rs.63.50 crore in the fund to take care of the entire expenditure amounting to ₹ 32.02 crore. This resulted in understatement of revenue surplus and overstatement of fiscal deficit.

State Urban Transport Fund (SUTF)

Based on the Ministry of Urban Development, GOI recommendations, Government of Karnataka created SUTF with a corpus of ₹ 10 crore from the State Finance Commission grants during November 2010. The fund was created initially under Deposit bearing interest for funding urban transport initiatives. During March 2012, one more fund was created under Reserve Fund (not bearing interest) with accruals from budgetary grants, cess on motor vehicles registration (one *per cent*) and cess on property tax.

During 2011-12, provision of ₹ 12.50 crore under general revenues and ₹ 25 crore towards transfer of cess was made for crediting the same to the fund. In the year 2011-12, the cess on motor vehicles registration collected was ₹ 25.01 crore. However, the amount transferred to the fund was ₹ 25 crore (₹ 10 crore to the Deposit head and ₹ 15 crore to the Reserve Fund). An amount of ₹ 12.50 crore was also transferred to the SUTF under Reserve Fund out of general revenues. Hence, the total amount in the SUTF was ₹ 20 crore under Deposit head and

₹ 27.50 crore under Reserve Funds. Meanwhile, expenditure of ₹ 2.64 crore was met out of the Deposit head without routing it through the Consolidated Fund. Also, expenditure incurred (₹ 15 crore) under the head 4217 was met out of the Reserve Fund. As at the end of March 2012, the balance amount of ₹ 17.36 crore under Deposit head was not transferred to Reserve Fund and no interest also was credited to the fund. Operation of the fund, both under Deposit head as well as Reserve Fund, was not in order.

State Government replied (November 2012) that the anomaly would be set right during 2012-13.

1.10.4 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 five years are given in **Table 1.33**.

Table-1.33: Guarantees given by the State Government

(₹ in crore)

	2007-08	2008-09	2009-10	2010-11	2011-12
Maximum amount guaranteed	23,109	18,732	18,420	19,150	13,262
Outstanding amount of guarantees (including interest)	10,786	8,693	7,203	6,618	6,640
Percentage of outstanding amount guaranteed to total revenue receipts of the second preceding year	36	23	18	15	14

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. It is heartening to note that the outstanding guarantees at the end of the years 2007-12 were within the prescribed limit.

The outstanding guarantees amounting to ₹ 6,640 crore at the end of the year 2011-12 included guarantees extended to 55 institutions/companies under irrigation (₹ 1,061 crore), co-operative (₹ 2,224 crore), finance (₹ 822 crore), power (₹ 302 crore), housing (₹ 1,029 crore), transport (₹ 220 crore), industries (₹ 414 crore), infrastructure (₹ 46 crore) and other sectors (₹ 337 crore).

The outstanding amount of guarantees excludes the power sector utilities of the Government of Karnataka *viz.*, BESCOM, GESCOM and CESC who have obtained PFC loans. The guarantee commission payable by the organizations was ₹ 0.02 crore. Thus the statement on guarantees, prepared on the basis of the material from Finance Department, was incomplete and not fully reliable.

Further, the maximum amount guaranteed as at the end of March 2012 was reduced by ₹ 5,888 crore from that of the previous year. As stated by the Finance Department (August 2012) this was mainly on account of deletion of guaranteed amount repaid in full and also on account of recasting of the amount , based on the information furnished by the Public Sector Undertakings / organizations. This clearly indicated that no database was being maintained in the State Government in this regard.

The Act further provides for a levy of one *per cent* as guarantee commission which is not to be waived under any circumstances. However, four[12] institutes/companies have been exempted from paying the Guarantee Commission in contradiction of the Act.

To provide for sudden discharge of State's obligations on guarantees, TFC had 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 expenditures on account of discharge of guarantee obligation. The guarantee fees of ₹ 564.93 crore received since 2000 have not been transferred to the fund. In 2011-12, the commission/ fees of ₹ 67.16 crore, received from three institutions, have been utilised for revenue/capital expenses such as payment of subsidies, establishment charges and investments instead of transferring the amount to the guarantee redemption fund.

The State Government in its reply to PAC (July 2011) had stated that transfer of receipts and expenditure pertaining to the fund would be considered at the appropriate time. Further, it had stated (July 2011) that government was meeting the obligations of payment out of budgetary allocations every year with the expenditure being shown as loan against the institution.

The PAC in its report had recommended to the State to adhere to the advice of the TFC and operationalize the Guarantee Redemption Fund by transferring the guarantee fee received as also amount discharged on revocation of guarantee.

Off - budget borrowings

The borrowings of the State Government are governed by Article 293 (1) of the Constitution of India. In addition to the contingent liabilities shown in **Table 1.33**, 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 hitherto 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 till 2010-11 included interest expenditure on off-budget borrowings, even though there was no corresponding build-up of assets in Accounts. This had resulted in under-statement of interest expenditure and overstatement of capital expenditure / revenue surplus. State Government in its reply to PAC (July 2011) had stated that the interest expenditure on off-budget borrowings would be treated as revenue expenditure from 2011-12 onwards.

During 2011-12, the revenue expenditure included interest payment of ₹ 542.38 crore towards off-budget borrowings.

[12] The Coorg orange Growers Co-operative Society, Hukkeri Taluk Co-operative Rural Electrical Society Limited, Raibagh Sahakara Sakkare Kharkhane Limited and Karnataka Milk Federation Limited.

Table 1.34 captures the trend in the off-budget borrowings of the State during 2007-12 while **Table 1.35** gives the entity-wise position of borrowings to the end of 2011-12.

Table 1.34: Trend in off-budget borrowings

(₹ in crore)

Year	2007-08	2008-09	2009-10	2010-11	2011-12
Amount as furnished by entity♠	103	Nil	Nil	Nil	512

Source: *As reported by the concerned entities*

♠ Figures are yet to be reconciled with those indicated in Budget overview.

Table 1.35: Entity-wise position of off-budget borrowings

(₹ in crore)

Company/Corporation/Board	Outstanding Off-budget borrowings	Borrowings during the year	Repayment during the year	
			Principal	Interest
Krishna Bhagya Jala Nigam Limited	271.07	512.00	49.98	20.55
Karnataka Neeravari Nigam Limited	331.75	---	206.75	18.25
Karnataka Road Development Corporation	305.35	---	88.91	58.41
Rajiv Gandhi Rural Housing Corporation	394.45	---	65.94	31.96
Karnataka Slum Development Board	48.65	---	9.22	4.56
Karnataka Rural Infrastructure Development Corporation Limited	58.95	---	12.55	5.43
Karnataka State Police Housing Corporation	167.26	---	24.76	17.66
Karnataka Housing Board, NGV	27.01	---	20.45	1.62
Cauvery Neeravari Nigam Limited	370.20	---	167.70	19.06
Karnataka Residential Education Institution Society	25.62	---	5.45	2.40
Karnataka State Industrial Infrastructure Development Corporation Limited	49.15	---	10.90	3.73
Sarva Shiksha Abhiyan Samithi	6.25	---	2.22	0.59
Total	**2,055.71**	**512.00**	**664.83**	**184.22**

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. In MTFP 2011-15 it has been stated that as the State Government was well advanced on the fiscal consolidation road map set in the FRA and as recommended by XIII FC, the Government has decided in future to allow off-budget borrowings in a limited manner. Further, it has been stated that the quantum of the borrowing would be limited to the repayments of the previous off budget borrowings i.e., stock of off-budget borrowings would be maintained at the same level as it was at the end of financial year 2009-10. The limit projected as per MTFP 2012-16 is ₹ 3,249 crore.

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2012 worked out to ₹ 1, 04,933 crore[13] against ₹ 1, 03,030 crore shown in **Table 1.32.** The ratio of fiscal liabilities (inclusive of off-budget borrowings) to GSDP worked out to 24.16 *per cent* at the end of the year.

Public Private Partnership (PPP) Projects

Recourse to the PPP mode for project financing is encouraged because it frees valuable fiscal space for the provision of public goods in areas where such financing may not be forthcoming. PPP projects in sectors that come under the purview of Government of Karnataka are transport, agro-infrastructure, education, health, tourism, urban and municipal infrastructure and energy.

[13] Total fiscal liabilities: ₹ 1,03,030 crore plus balance of off-budget borrowings; ₹ 1,903 crore.

The summary of PPP projects under pipeline, implementation and operation are detailed in **Table 1.36.**

Table 1.36: Sector and stagewise status of PPP projects in the State

(₹ in crore)

Sector	Completed		Under implementation / construction		Under planning / pipeline		Grand Total	
	No	Cost	No	Cost	No	Cost	No	Cost
Agri Infrastructure			1	17.02	7	264.63	8	281.65
Education	2	85.00			7	5,450.00	9	5,535.00
Energy					12	16,400.00	12	16,400.00
Healthcare			3	3.27	13	84.40	16	87.67
Industrial Infrastructure					14	45,358.00	14	45,358.00
Tourism	1	32.00			23	1,531.50	24	1,563.50
Transportation & Logistics	4	3,046.29	12	2,023.26	81	1,26,388.75	97	1,31,458.30
Urban and Municipal Infrastructure	5	113.14	5	156.25	32	5,179.82	42	5,449.21
Total	**12**	**3,276.43**	**21**	**2,199.80**	**189**	**2,00,657.10**	**222**	**2,06,133.33**

***Source**: Department of Infrastructure Development*

The State Government in MTFP 2012-16 has disclosed a statement on contingent liability of Government for 2011-12 relating to the PPP projects in compliance to XIII FC recommendations. Apart from the five works indicated in the MTFP, the Government has incurred expenditure on the projects indicated in **Table 1.37** under PPP mode.

Table 1.37: Additional projects under PPP mode during 2011-12

(₹ in crore)

Sl. No.	Name of work	Estimated project cost	Expenditure incurred during 2011-12
1	Improvements to Chikkanayakanahalli – Tiptur – Hassan Road	241.76	5.00
2	Improvements to Dharwad – Alnawar – Ramanagara road	237.60	0.48
3	Improvements to State Highway from Maharashtra border to Andhra Pradesh border	242.75	1.76
4	Upgradation of ITI through PPP	42.00	3.75
5	Development of silk farms under PPP	NA	0.61

NA – Not available

1.11 Debt sustainability

Apart from the magnitude of the debt of the State Government, it is important to analyze various indicators that determine the debt sustainability of the State. 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 a balance between costs of additional borrowings and returns from such borrowings. It means that rise in fiscal deficit should match the increase in capacity to service the debt. This section assesses the sustainability of debt of the State Government in terms of debt stabilization, sufficiency of non-debt receipts, net availability of borrowed funds, burden of interest payments (measured by interest payments to revenue receipts ratio) and maturity profile of the State Government securities. **Table 1.38** analyses the debt sustainability of the State according to these indicators for the period 2007-12.

Table 1.38: Debt sustainability: Indicators and trends

Debt sustainability indicators	2007-08	2008-09	2009-10	2010-11	2011-12
Debt stabilization (₹ in crore) (Quantum spread -/+ Primary deficit/ surplus)	6,060	1,395	(-)1,922	3,292	(-)3,671
Sufficiency of incremental non-debt receipts (resource gap) (₹ in crore)	(-)644	(-)3,400	(-)2,143	187	(-)1,612
Net availability of borrowed Funds (in *per cent*)	---	21	18	9	13
Burden of interest payments (IP/RR Ratio)	10.9	10.5	10.6	9.7	9.5 *

Maturity profile of State debt (in years)	(₹ in crore)
0 - 1	2(00)
1 – 3	3,201(10)
3 – 5	3,681(12)
5 – 7	971(03)
7 and above	22,917(75)

Figures in brackets denote the percentage to market borrowings of ₹ 30,772crore.
** refer footnote below Table 1.1*
***Source:** Finance Accounts.*

1.11.1 Debt stability

Fiscal liabilities are considered sustainable if the Government is able to service these liabilities over the foreseeable future and the debt – GSDP ratio does not grow to unmanageable proportions. A necessary condition for stability is the Domar's Debt Stability Equation**.** It states that 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 2007-12 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. Quantum spread is the product of debt stock and interest spread. 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 (excluding off-budget borrowings) will be low indicating sustainable levels of public debt. In 2011-12, both interest and quantum spread were positive.

1.11.2 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 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 details for the last five years have been indicated in **Table 1.39**.

Table 1.39: Sufficiency of incremental non-debt receipts

(₹ in crore)

Sl. No.		2007-08	2008-09	2009-10	2010-11	2011-12
1	Incremental Non debt Receipts	3,802	2,079	6,253	8,658	11,697*
2	Incremental Interest Payments	270	26	681	428	963
3	Incremental Primary expenditure	4,176	5,453	7,715	8,043	12,346
Resource Gap		(-)644	(-)3,400	(-)2,143	187	(-)1,612

**refer footnote below Table 1.1*

The resource gap, which was negative during 2007-10, turned positive in 2010-11. However, in 2011-12, it once again was negative. This was mainly on account of growth of revenue receipts being the same as that of growth of total expenditure. This meant that the State had to depend on borrowed funds for meeting current revenue and capital expenditure.

1.11.3 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 (0.9) in 2011-12 as in the previous two years as debt redemption was lower than debt receipts. Thirteen *per cent* of debt receipts were available for productive/capital expenditure.

1.11.4 Maturity profile

In terms of maturity profile, around 75 *per cent* of the outstanding stock of Government securities (market borrowings) at the end of the year belonged to a 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. This is worrisome.

Repayment obligations would increase ten 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, 19 *per cent* of the total re-payment obligation of market loans (₹ 30,772 crore) would be in 2019-22 which the Government acknowledged in MTFP (2012-16). In 2011-12, Government borrowed ₹ 7,500 crore as market loans which constituted 24 per cent of the total outstanding market loans (₹ 30,772 crore) whose obligation would be in 2021-22. The State Government in MTFP 2012-16 stated that in a high interest rate regime, borrowings have to be scheduled in a prudent manner so as not to burden future generations with high debt costs. It also ensured that fiscal prudence would be followed while scheduling its borrowing needs in ensuing years. Contrary to this, the State made huge borrowings in the year 2011-12.

The Government created a sinking fund for open-market loans and the fund consisted of two components viz. 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 needs to consider reviving the fund in compliance with 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. Further, RBI in their report on Public Debt Management (August 2011) has emphasized on setting up of the fund. The PAC in its report has also recommended setting up of a sinking fund for taking care of the loan discharges arising in future through suitable contributions from revenues.

The balance in the sinking fund (investment account) had become adverse during 2008-09 which has been increasing since then and its balance in 2011-12 is (-) ₹ 0.40 crore.

The State Government in an earlier reply had stated that investments in dated securities were not practicable as funds are required for carrying out day to day administration and discharging liabilities as and when they arose. The reply is not acceptable as the State which had attained revenue surplus in 2004 itself, could have contributed from general revenues towards setting up of the fund.

1.11.5 Burden of interest payments

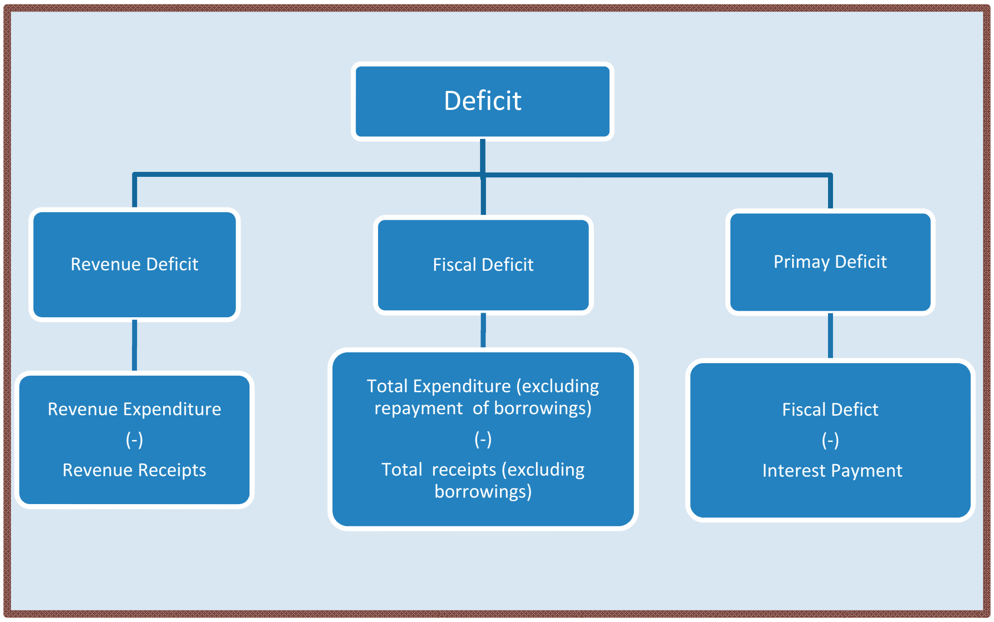
The ratio of interest payments to revenue determines the debt sustainability of the State. During the year, interest payments (including interest paid on account of debt servicing) pre-empted nine *per cent* of the total revenue receipts of the State which was below the norm of 15 *per cent* prescribed by TFC. The NSSF accounts for around 20 *per cent* of the total outstanding liabilities of the State as at end of March 2012. Considering the burden arising as a result of the high effective rate of interest on NSSF loans till 2006-07, the XIII FC recommended interest relief on those loans only if the State brought about necessary amendments to FRA.

Since the State did not receive any receipts under NSSF, its share in the total outstanding liabilities came down from 23 *per cent* in 2010-11 to 20 *per cent* in 2011-12.

1.12 Fiscal imbalances

In an emerging economy a balanced budget is perhaps next to impossible and the Government has to resort to borrowings to bridge the gap between spiralling expenditure requirement and inadequate non-debt receipts. The gap between receipts and expenditure represents deficit. **Chart 1.13** gives an indication of the various kinds of deficits that occur if the Government borrows excessively to balance the budget.

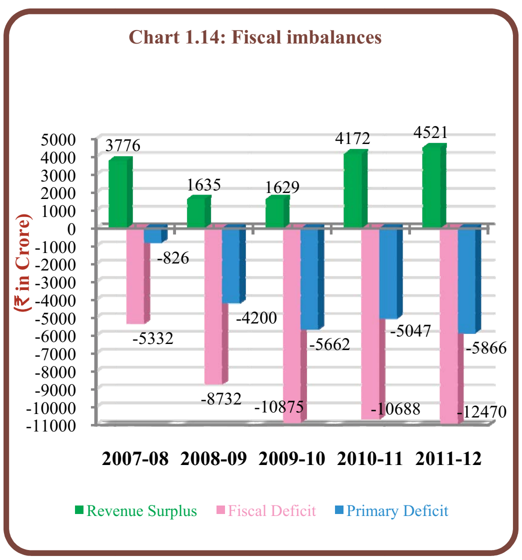
Chart 1.13: Type of defícits

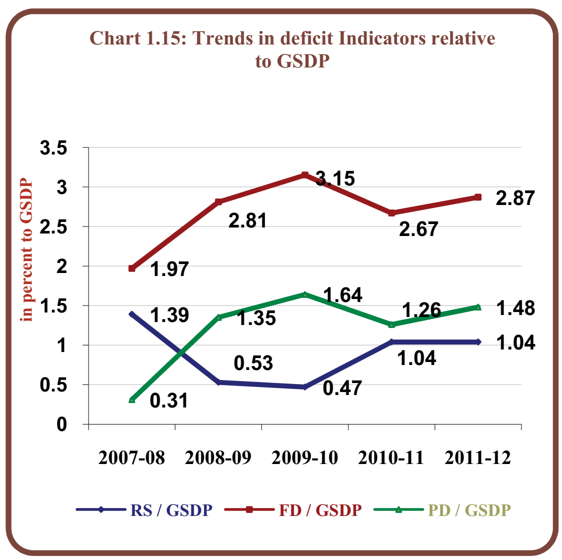


The nature of deficit is an indicator of the prudence of fiscal management of the Government. Further, the ways in which the deficit is financed and the resources raised are applied are important pointers to fiscal health. This section presents the trends, nature, magnitude and the manner of financing 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 2011-12.

1.12.1 Trends in deficits

Charts 1.14 and 1.15 present the trends in deficit indicators over the period 2007-12.





The targets for revenue and fiscal deficits set for the TFC and XIII FC periods along with their actual levels are given in **Table 1.40.**

Table 1.40: Outcome vis-à-vis targets under FRA

Period	Revenue deficit		Fiscal deficit (in percentage)	
	Targets as per FRA	Actual	Targets as per FRA	Actual
TFC (2005-10)				
2005-06	Attain Revenue Surplus	Achieved the target in 2004-05 itself	3.0	1.88
2006-07	Maintain Revenue Surplus		3.0	2.06
2007-08			3.0	1.97
2008-09			3.5	2.81
2009-10			4.0	3.15
XIII FC (2010-15)				
2010-11	Maintain Revenue Surplus	Achieved the target	3.44	2.67
2011-12			3.00	2.87

Source: *Finance Accounts*

The Government's achievements in the area of maintaining revenue surplus has been heartening. 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 2010-11 with inter-year variations. In 2011-12, the revenue surplus increased by ₹ 349 crore over previous year and was ₹ 4,521 crore.

The FRA target of reducing fiscal deficit –GSDP ratio to less than three *per cent* was also achieved one year ahead.

In 2011-12, there was increase in the rate of fiscal deficit to GSDP as compared to previous year and was 2.87 *per cent*. But it was well within the target of three *per cent*.

However, the following transactions affected the fiscal indicators of the State:

(i) Non transfer of expenditure/ limiting transfer of expenditure to IIF, CMRRD, BMRCL and Port Development Fund for which the approval of the Legislature was obtained resulted in understatement of Revenue Surplus and overstatement of Fiscal Deficit.

(ii) Limiting the transfer to FM Fund and increased augmenting to IIF from general revenues resulted in understatement of Revenue Surplus.

(iii)Utilizing / bringing the earlier years transaction to current year's books of account viz., conversion of loan to equity (₹ 144 crore), conversion of investment into revenue / capital expenditure (₹ Three crore) etc., resulted in boosting of capital expenditure and revenue expenditure of current year, thereby allowing the State to borrow more.

Revenue Surplus

Revenue surplus represents the difference between revenue receipts and revenue expenditure. Revenue surplus helps to decrease the borrowings.

Against the growth rate of 20 per cent of revenue receipts, the growth rate of revenue expenditure was 21 per cent. This resulted in bringing down the revenue surplus during 2011-12. This is to be viewed in the context that there was compression of expenditure of ₹ 1,071.41 crore on account of non/short/late release of funds and non/late receipt of sanctions from Government, limiting transfers to fund accounts, classifying revenue expenditure as capital expenditure etc.

The State Government in MTFP (2012-16) stated that the high tax effort of the State and curtailing of lower priority revenue expenditure resulted in a larger than anticipated revenue surplus. This reiterates the fact already stated above.

Fiscal Deficit

Fiscal deficit normally represents the net incremental liabilities of the Government or its additional borrowings. The shortfall could be met either by additional public debt (internal or external) or by the use of surplus funds from Public Account. Fiscal deficit trends along with the trends of the deficit relative to key components are indicated in **Table 1.41.**

Table 1.41: Fiscal deficit and its parameters

(₹ in crore)

Period	Non-debt Receipts	Total expenditure	Fiscal Deficit	Fiscal Deficit as percent of		
				GSDP	Non-debt receipt	Total expenditure
2007-08	41,449	46,781	5,332	1.97	12.86	11.40
2008-09	43,528	52,260	8,732	2.81	20.06	16.71
2009-10	49,781	60,656	10,875	3.15	21.84	17.93
2010-11	58,439	69,127	10,688	2.67	18.29	15.46
2011-12	70,136*	82,436	12,470	2.87	17.78	15.13

Source: *Finance Accounts*

**refer footnote below Table 1.1*

Fiscal deficit as a percentage of GSDP, non-debt receipts and total expenditure was the least in 2007-08. In 2009-10, these ratios were at the highest due to enhancement of fiscal deficit limit based on the advice of the GOI and in 2010-11 there was a marginal improvement. During 2011-12, fiscal deficit as a per cent of GSDP once again increased, mainly on account of increase in borrowings.

Primary Deficit

While fiscal deficit represents the need for additional resources in general, a part of such resources may be needed to finance interest payments. Interest payments represent the expenditure of past obligations and are independent of current allocative priorities. To look at the imbalances of the current nature, these payments need to be separated and deducted from the total imbalances. The primary deficit and its parameters for the last five years are indicated in **Table 1.42.**

Table: 1.42 Primary deficit and its parameters

(₹ in crore)

Period	Fiscal Deficit	Interest Payments	Primary Deficit
2007-08	5,332	4,506	826
2008-09	8,732	4,532	4,200
2009-10	10,875	5,213	5,662
2010-11	10,688	5,641	5,047
2011-12	12,470	6,604*	5,866

Source: *Finance Accounts*

**includes interest payment of ₹542 crore towards off-budget borrowings.*

During 2007-08 the primary deficit was the least. In 2008-12 the fiscal deficit was almost twice the interest payments. This meant that during these four years around 50 *per cent* of the fiscal deficits were due to revenue expenditure other than interest payments. Hence, prudent reduction of revenue expenditure could enable the State Government to attain primary surplus. Containing the committed expenditure, which constituted the major chunk of the revenue expenditure, would enable the State Government to attain the goal. Since the costs of salary, pension and interest are inflexible, the expenditure on subsidies, grants-in-aid other than to local bodies, which is increasing steadily, requires utmost attention by the State Government.

1.12.2 Components of fiscal deficit and its financing pattern

The financing pattern of fiscal deficit has undergone a compositional shift as reflected in the **Table 1.43**. 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.

Table 1.43: Components of fiscal deficit and its financing pattern

(₹ in crore)

		2007-08		2008-09		2009-10		2010-11		2011-11	
		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		**-5,332**	**1.97**	**-8,732**	**2.81**	**-10,875**	**3.15**	**-10,688**	**2.67**	**-12,470**	**2.87**
1	Revenue surplus	3,776	1.39	1,635	0.53	1,629	0.47	4,172	1.04	4,521	1.04
2	Net capital expenditure	8,403	3.10	9,693	3.12	12,077	3.50	13,283	3.32	15,417	3.55
3	Net loans and advances	705	0.26	674	0.22	427	0.12	1,577	0.39	1,574	0.36
Financing pattern of fiscal deficit*											
1	Market borrowings	287	0.11	6,583	2.12	4,954	1.43	1,037	0.25	6,207	1.43
2	Loans from GOI	357	0.13	135	0.04	211	0.06	613	0.15	637	0.14
3	Special securities issued to NSSF	209	0.08	-164	-0.05	247	0.07	1,838	0.46	-844	-0.19
4	Loans from financial institutions	174	0.06	260	0.08	272	0.08	419	0.10	208	0.05
5	Small savings, PF etc	749	0.28	1,176	0.38	1,468	0.43	1,607	0.40	1,398	0.32
6	Deposits and advances	-62	-0.02	1,554	0.50	1,908	0.55	2,037	0.51	1,410	0.32
7	Suspense and misc.	1,498	0.55	968	0.31	602	0.17	-296	-0.07	2,634	0.61
8	Remittances	-828	-0.31	-52	-0.01	-36	-0.01	-35	0.00	-11	0.00
9	Reserve funds	750	0.28	2,174	0.70	3,201	0.93	1,374	0.34	2,761	0.64
10	Increase (-) / decrease (+) in cash balance	2,185	0.81	-3,900	-1.26	-1,954	-0.56	2,106	0.53	-1,942	-0.45
11	Net of Contingency Fund transactions	13	0.00	-2	0.00	2	0.00	-12	0.00	12	0.00
	Total	**5,332**		**8,732**		**10,875**		**10,688**		**12,470**	

** All these figures are net disbursements/outflows during the year*
Source: *Finance Accounts.*

The components of fiscal deficit are Revenue surplus, Net Capital Expenditure and Net Loans and Advances. Since the State had attained revenue surplus in 2004-05 itself, the surplus on revenue account along with market borrowings, loans from GOI etc., were utilized to finance capital expenditure. The downward trend of revenue surplus during 2008-10 affected the extent of capital expenditure which could be financed by revenue surplus. While 41 *per cent* of capital expenditure could be financed by revenue surplus in 2007-08, it was 16,13 and 28 *per cent* in 2008-09, 2009-10 and 2010-11 respectively. Hence, capital expenditure suffered a setback due to declining trend of revenue surplus during 2008-10. In 2011-12, revenue surplus could finance 27 *per cent* of capital expenditure. There was one per cent decrease in the extent to which the revenue surplus could finance the capital expenditure over previous year. This was mainly on account of tremendous increase in the revenue expenditure when compared to that of previous year.

Due to limited market borrowings by the State Government in 2010-11, its share in financing fiscal deficit was limited to 10 *per cent.* In 2011-12, there was substantial increase in market borrowings and its share in financing fiscal deficit increased to 50 per cent. Hence, there was decrease in loans from financial institutions, small savings, PF etc., deposits and advances over the previous year. However, there was considerable increase in suspense and miscellaneous and reserve funds during 2011-12 over the previous year. There were also no receipts during 2011-12 under special securities issued to NSSF. Further, based on the advice of the GOI and RBI with respect to cash management, the State Government had utilised part of cash balances viz., investments in various reserve funds, fiscal management funds and local bodies funds maintained in the Public Account for financing the fiscal deficit during 2010-11. In MTFP (2011-15), it was stated that whenever there was a demand on respective reserve funds and fiscal management fund, the GOI would be approached for allowing additional borrowings. In 2011-12, however no such demands were noticed.

1.12.3 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 State's 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) was not having any asset backup. The bifurcation of the primary deficit (**Table 1.44**) 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 1.44: 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)
2007-08	41,449	32,869	8,649	757	42,275	8,580	-826
2008-09	43,528	37,123	9,874	731	47,728	6,405	-4,200
2009-10	49,781	42,314	12,147	982	55,443	7,467	-5,662
2010-11	58,439	48,393	13,355	1,738	63,486	10,046	-5,047
2011-12	70,136	58,511	15,506	1,815	75,823	11,455*	-5,866*

Source: *Finance Accounts*
** refer footnote at Table 1.1*

Primary deficit which was ₹ 826 crore during 2007-08 increased to ₹ 5,866 crore during 2011-12. The percentage of interest payment to fiscal deficit was at 53 during the year.

1.13 Conclusions and recommendations

- ***Fiscal Position***

The state continued to maintain revenue surplus during 2007-12 and kept fiscal deficit relative to GSDP below the limit laid down under FRA.

During 2011-12, the State attained revenue surplus of ₹ 4,521 crore. This was on account of increase in revenue receipts by 20 *per cent* over previous year. The fiscal deficit during 2011-12 was 2.87 *per cent* of GSDP. The compression of expenditure on account of delay in government sanctions, limiting transfers to fund accounts etc., contributed to increase in revenue surplus and limiting the fiscal deficit within target of three *per cent* of GSDP.

Recommendation: The proposals made in the budget are to be implemented diligently so that the unspent provisions by way of non-release of sanction / funds could be avoided.

- ***State's own resources***

The ratio of State's tax revenue to GSDP which had shown declining trend since 2006-07 had revived itself in 2010-11, increased further and was 10.70 *per cent.* However, there was no improvement in the ratio of non-tax revenue to GSDP and it continued to be around one in 2011-12 also.

Recommendation: Special emphasis needs to be given to mobilizing non-tax revenue by revising user charges in the coming years. The recommendation of ERC should be used as a tool for revising the user charges in the coming years.

- ***Revenue expenditure***

Though there was 14 *per cent* growth under social sector over the previous year, the share of expenditure on social services to total expenditure, which was 41 *per cent* in 2010-11, decreased to 39 *per cent* in 2011-12. However, the expenditure on economic services increased marginally from 28 *per cent* in 2010-11 to 29 *per cent* in 2011-12.

The share of plan revenue expenditure to total revenue expenditure increased from 28 *per cent* in 2010-11 to 29 *per cent* in 2011-12.

Ninety one *per cent* of revenue expenditure constituted committed expenditure on salaries, pensions, interest payments, subsidies, grants-in-aid, expenditure on operation and maintenance of assets, administrative expenditure and State share of centrally sponsored schemes and centrally planned schemes. Though the New Pension Scheme Cell has been created, Government's matching contribution was yet to be transferred to the fund account. Total subsidy of ₹ 7,390 crore reflected in the accounts is not complete as it excluded implicit subsidy of around ₹ 4,204 crore during 2011-12.

Recommendation: Defined contribution pension scheme is required to be operated by contributing the State's matching share along with interest.

As per the recommendations of XII FC and EFC, a statement on implicit subsidies may be brought out preferably as part of budget documents.

- ***Quality of expenditure***

The share of capital expenditure to total expenditure during 2011-12 (21 *per cent*) decreased by one *per cent* from that of previous year. The percentage of developmental expenditure to total expenditure decreased to 74 *per cent* in 2011-12 from 75 *per cent* in 2010-11.

Funds aggregating ₹ 1,047 crore were blocked in incomplete projects as at the end of 2011-12.

The return from investment of ₹ 44,295 crore as of March 2012 in companies/ corporations was negligible (₹ 60.56 crore). The investment included ₹ 18,924 crore (43 *per cent*) to companies/ corporations under perennial loss.

Recommendation: 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.

The State Government should review the working of State public sector undertakings incurring huge losses and take suitable decisions.

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

The Central Government transferred a sizeable quantum of funds (₹ 7,140 crore during 2011-12) directly to the State implementing agencies for implementation of Central plan schemes. Funds flowing directly to the implementing agencies through off-budget routing inhibit 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. Hence, the State Government decided to account these transfers and corresponding expenditure in Consolidated Fund from 2012-13.

Recommendation: Though a system has been proposed to ensure accounting of these funds, a system is required to validate this information by the State Government.

- ***Funds and other Liabilities***

Reserve funds of the State viz., corpus fund of Consumer Welfare Fund, Guarantee Redemption Fund etc., were not created / revived. No rules have been framed regarding administration of Fiscal Management Fund.

The outstanding amount of guarantees including interest (₹ 6,640 crore) excludes some of the power sector utilities of the State and hence the statement on guarantees is not complete and reliable.

Recommendation: Rules with regard to administration and investment pattern of various reserve funds requires to be framed. Also, schemes / programmes are required to be formulated for utilizing the balances.

The State is required to build up a data bank on guarantees given by the Government, guarantee fee/commission, guarantee invoked/discharged etc.

- ***Debt sustainability***

The repayment obligation of the State would increase enormously from 2018-19 onwards, due to huge market borrowings in 2008-10. Further, repayment obligations of the borrowings made in 2011-12 (₹ 7,500 crore) would become due from 2021-22.

Recommendation: The Government should consider reviving the sinking fund as it would help the State to meet the sudden increase in the amount of debt servicing from 2017-18 onwards. Also, the State Government has to schedule its borrowings in a prudent manner so as not to burden future generations with high cost debts.