C h a p t e r – I

Finances of the State Government

Chapter I

Finances of the State Government

Profile of the State

The State of Karnataka is the seventh largest State in terms of geographical area (1,91,791 Sq. Km) and the eighth largest by population. The State's population increased from 5.28 crore in 2001 to 6.11 crore in 2011, recording a decadal growth of about 16 *per cent*. The percentage of population below the poverty line was 20.90 compared to the All India Average of 21.90 during 2011-12. The State's Gross State Domestic Product (GSDP) in 2016-17 at market prices was ₹11,17,334 crore. The State's literacy rate increased from 66.60 *per cent* in 2001 to 75.40 *per cent* in 2011. The per-capita income of the State stood at ₹1,59,893 against the country average of ₹1,03,818 (As of March 2017 - Economic Survey Government of Karnataka, 2016-17). General data relating to the State is given in **Appendix 1.1**.

Gross State Domestic Product (GSDP)

GSDP is the market value of all officially recognised 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 of India's Gross Domestic Product (GDP) and that of the State, at current prices, are indicated in **Table 1.1**.

Table 1.1: Annual Growth Rate of GDP and GSDP at current prices

Year	2012-13	2013-14	2014-15	2015-16	2016-17
India's GDP@ (₹ in crore)	99,44,013	112,33,522	124,45,128	136,82,035	151,83,709
Growth rate of GDP (percentage)	13.82	12.97	10.79	9.94	10.98
State's GSDP# (₹ in crore)	6,91,700	8,17,886	9,21,788	10,27,068	11,17,334
Growth rate of GSDP (percentage)	14.56	18.24	12.70	11.42	8.79

@ All India GDP figures are from Ministry of Statistics and Programme Implementation (MoSPI) press release dated 01.08.2017.

 # GSDP figures for 2012-13 to 2015-16 are taken from Economic Survey of Karnataka 2016-17 with 2011-12 as base year and for 2016-17 as conveyed by Ministry of Finance, Government of India vide letter dated 29 March 2016 with 2011-12 as base year.

1.1 Introduction

This chapter provides a broad perspective of the finances of the Government of Karnataka during 2016-17. It analyses important changes in the major fiscal indicators compared to the previous year, 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 are explained in **Appendix 1.2**.

1.1.1 Summary of fiscal transaction in 2016-17

Table 1.2 and **Appendix 1.3** present the summary of the State Government fiscal transaction during 2016-17 *vis-à-vis* the previous year (2015-16), while **Appendix 1.4** provides the details of receipts and disbursement as well as the overall fiscal position during preceding four years.

Table 1.2: Summary of fiscal transactions in 2016-17

(₹ in crore)

Receipts				Disbursements			
	2015-16	**2016-17**		**2015-16**	**2016-17**		
Section-A Revenue				**Total**	**Non-Plan**	**Plan**	**Total**
Revenue Receipts	**1,18,817.31**	**1,33,213.79**	**Revenue Expenditure**	**1,17,028.58**	**83,958.99**	**47,961.76**	**1,31,920.75**
Tax revenue	75,550.18	82,956.13	General Services	30,799.28	31,152.93	111.63	31,264.56
Non-tax revenue	5,355.04	5,794.53	Social Services	46,307.08	24,653.32	29,895.92	54,549.24
Share of Union taxes/duties	23,983.34	28,759.94	Economic Services	33,846.17	23,840.45	16,580.92	40,421.37
Grants-in-aid and contributions from GOI	13,928.75	15,703.19	Grants-in-aid and contributions	6,076.05	4,312.29	1,373.29	5,685.58
Section-B: Capital and others:							
Misc. Capital receipts	**352.30**	**26.96**	**Capital Outlay**	**20,713.03**	**466.08**	**27,684.35**	**28,150.43**
			General Services	991.41	33.42	1,026.97	1,060.39
			Social Services	5,313.91	213.80	6,683.04	6,896.84
			Economic Services	14,407.71	218.86	19,974.34	20,193.20
Recoveries of Loans and Advances	**59.68**	**99.84**	**Loans and Advances disbursed**	**656.41**	**5.31**	**1,929.07**	**1,934.38**
Public debt receipts**	**21,072.33**	**31,155.92**	**Repayment of public debt****	**4,110.20**	**7,420.24**	**-**	**7,420.24**
Contingency Fund	**-**	**-**	**Contingency Fund**	**-**	**-**	**-**	**-**
Public Account Receipts	**1,60,518.76**	**1,79,318.45**	**Public Account disbursements**	**1,55,094.83**	**-**	**-**	**1,67,153.81**
Opening Cash Balance	**23,900.90**	**27,118.23**	**Closing Cash Balance**	**27,118.23**	**-**	**-**	**34,353.58**
Total	**3,24,721.28**	**3,70,933.19**	**Total**	**3,24,721.28**			**3,70,933.19**

Source: Finance Accounts 2016-17.

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

The following are the significant changes during 2016-17 over the previous year:

- Revenue receipts grew by ₹14,396.48 crore (12 *per cent*) due to increase in Share of Union Taxes/Duties (₹4,776.60 crore), Own Tax Revenue (₹7,405.95 crore), Non-Tax Revenue (₹439.49 crore) and Grants-in-aid and Contributions from Government of India (₹1,774.44 crore). The revenue receipts for the year 2016-17 fell short of the projection made in Medium Term Fiscal Plan (MTFP) 2013-17 by ₹17,061 crore;

- Revenue expenditure increased by ₹14,892.17 crore (13 *per cent*). Increase was under Social Services Sector (₹8,242.16 crore), Economic Services Sector (₹6,575.20 crore), General Services Sector (₹465.28 crore) and off-set by decrease under grants-in-aid and contributions (₹390.47 crore). The revenue expenditure for the year 2016-17 were short of the projection made in MTFP 2013-17 by ₹4,689 crore;

- Capital outlay increased by ₹7,437.40 crore (36 *per cent*), increase was mainly under Economic Services Sector (₹5,785.49 crore) and Social Services Sector (₹1,582.93 crore) and General Services Sector (₹68.98 crore);

- Recoveries of Loans and Advances increased by ₹40.16 crore (67 *per cent*) and Disbursement of Loans and Advances increased by ₹1,277.97 crore (195 *per cent*);

- Public Debt receipts (excluding ways and means advances) and repayments increased by ₹10,083.59 crore (48 *per cent*) and ₹3,310.04 crore (81 *per cent*), respectively;

- Public Account receipts and disbursement increased by ₹18,799.69 crore (12 *per cent*) and ₹12,058.98 crore (eight *per cent*), respectively; and

- Cash balance of the State Government increased by ₹7,235.35 crore (27 *per cent*).

1.1.2 Review of Fiscal situation

In Karnataka, fiscal reforms and consolidation were brought to the forefront with the State Government formulating the first Medium Term Fiscal Plan (MTFP) for the period 2000-05 on the basis of broad parameters of the fiscal correction path laid down by the Eleventh Finance Commission (EFC). Towards this end, the Karnataka Fiscal Responsibility Act (KFRA) was enacted (September 2002), which became operational from 1 April 2003 and provided statutory backup to MTFP.

The State Government was on a fiscal consolidation path since passing of KFRA and maintained the guarantees within the limits prescribed under the Karnataka ceiling on Government Guarantees Act, 1999. It recorded revenue surplus since 2004-05 and the fiscal deficit was within the limit of three *per cent* of GSDP as prescribed under the Act. However, during 2008-09 and 2009-10, as per the directives of Government of India (GOI), the State deviated from the fiscal consolidation path and borrowed more money for public spending to tide over economic slowdown, by amending the Act.

By an amendment to the Act in February 2014, the scope of the total liabilities as defined under Section-2(g) was amplified to include the borrowings by Public Sector Undertakings (PSU) and Special Purpose Vehicles (SPVs) and other equivalent instrument, where the principal and/or interest are to be serviced out of the State Budget. The State Government amended its KFRA from time to time keeping in view the parameters prescribed by the successive Finance Commissions.

XIV Finance Commission (XIV FC) recommended a set of rules for the States relating to fiscal deficit targets and annual borrowing limits of the State wherein the States are eligible for flexibility of fiscal deficit of 0.25 *per cent* of GSDP for any given year, for which, the borrowing limits are to be fixed if their debt GSDP ratio is less than or equal to 25 *per cent* in the preceding year and further eligible for an additional borrowing limit of 0.25 *per cent* of GSDP in a given year if the interest payments are less than or equal to 10 *per cent* of the revenue receipts in the preceding year. Thus, by availing this flexibility provisions either separately or simultaneously, a State can have a maximum fiscal deficit-GSDP limit of 3.5 *per cent* in any given year, provided there is no revenue deficit in the year, in which, borrowing limits are to be fixed and immediately preceding year.

If the State is not able to fully utilise its sanctioned borrowing limit of three *per cent* of GSDP in any particular year during the first four years of award period (2015-16 to 2018-19), it will have the option of availing this unutilised borrowing amount only in the following year but within the award period. Further, it recommended that the State Governments may amend their Fiscal Responsibility Budget Management (FRBM) Acts to provide for the statutory flexible limits on fiscal deficit.

However, KFRA was not amended to reflect the above recommendations. MTFP placed before the Legislature also did not contain the reasons behind the non-amendment.

The ratio of outstanding debt (inclusive of off-budget borrowings) and fiscal deficit to GSDP (₹11,17,334 crore) during 2016-17 were 19.81 *per cent* and 2.57 *per cent*, respectively, which were within the prescribed limit of 25 *per cent* and three *per cent* respectively.

The Fiscal Management Review Committee (FMRC), headed by Chief Secretary to Government was constituted in July, 2011. The Committee recommended (March 2017) remedial measures to be adopted to ensure adherence to the parameters stipulated in KFRA, which were as under:

- The economic effects of demonetisation were considered as primarily responsible for the reduction in tax collection in Stamps and Registration and Commercial Taxes. It was advised to review the stagnant volume of sales of Indian Made Liquor (IML), whereas the growth rates were better in neighbouring States;

- The revised arrangement for writing back of unspent balances in the local body funds in Public Account was noted and advised that a clear picture of balances in the bank accounts of the local bodies should be brought out for taking a suitable decision;

- Continuing the practice of resorting to budgetary borrowings only in the 3rd and 4th quarters as per the actual cash flow;

- Steps should be taken to increase the capital receipts by reviewing the status of repayment of loans extended to various sectors including Co-operative sector;

- Departments should strictly adhere to the detailed instructions issued by the Finance Department to manage deposits of Government money in banks;
- A system should be evolved to approve new capital projects so that the average budget multiplying factor remains around three years only. A proposal for creating a Public Investment Committee that scrutinises all new capital programmes accompanied by a financing plan above a certain size from their efficacy and sustainability point of view be prepared by Finance Department and Planning Department;
- Prioritisation needs to be done to use the available funds first for projects that are nearing completion so that immediate benefits accrue to the public;
- Continued efforts be made to improve own revenue receipts through increased efficiency in tax administration as well as monitoring and to make optimum use of central funds available under various schemes; and
- For non-tax revenues, a thorough exercise be made to review the rates and wherever possible, make these index linked.

Scrutiny of certain high end transaction during 2016-17 revealed that the fiscal deficit and the liabilities in the Public Account were affected more through certain accounting adjustments than through fiscal management. Such adjustments are discussed below in brief:

- The infrastructure cess collected on excise license fee, motor vehicle tax and non-judicial stamp duty were to be allocated to the Infrastructure Initiative Fund (IIF), Bangalore Metro Rail Corporation Limited (BMRCL) fund and Chief Minister's Rural Road Development (CMRRD) fund in the ratio of 57, 28 and 15 *per cent* respectively. The Infrastructure cess realised during 2016-17 amounting to ₹951.53 crore, initially booked under Consolidated Fund was adjusted to IIF (₹542.36 crore), BMRCL fund (₹266.43 crore) and CMRRD fund (₹142.74 crore) maintained in Public Account. Even though the expenditure for the infrastructure works was to be met out of the fund, the fund was not debited with the expenditure, thereby overstating the Revenue and Capital Expenditure;

  Further, on introduction of a uniform Value Added Tax (VAT) in 2005, levy of Infrastructure cess was dispensed with and the State Government decided to contribute from General Revenues of the State. During 2016-17, an amount of ₹3,670 crore was transferred from General Revenues of the State to Infrastructure Initiative Fund (₹2,092 crore), BMRCL Fund (₹1,027 crore) and CMRRD fund (₹551 crore) without any investment under the fund account in

Public Account. The transfers from general revenues has the effect of overstatement of Revenue Expenditure and fiscal deficit besides projecting reduced revenue surplus. Further details are available in **paragraph 1.9.4** of this report;

- Funds to State Urban Transport Fund (SUTF) would accrue from three sources *viz*., Budgetary Grant, Cess on Motor Vehicles Tax and Cess on Property Tax. During 2016-17, cess amount of ₹60.90 crore which includes ₹43.82 crore from motor vehicle tax, ₹13.49 crore, from General Reserves and ₹3.59 crore from Cess on Property tax was transferred from Consolidated Fund to SUTF. However, the expenditure was not met out of the fund resulting in overstatement of fiscal deficit during the year. Further details about the fund account is explained in **paragraph 1.9.4** of this report;

- The grants of Panchayat Raj Institutions (PRIs) are released from functional heads under the Consolidated Fund and accounted under Public Account. The balances under Zilla Panchayat (ZP) Fund II account and Taluk Panchayat (TP) Fund II at the end of March every year should be written back to the Consolidated Fund in the second succeeding financial year. Write back of ₹565.77 crore for the year 2014-15 under ZP Fund II and ₹520.51 crore under TP Fund II was made during 2016-17, which led to suppression of expenditure to the extent of ₹1,086.28 crore, treating the transactions as recovery of overpayment under respective service major heads. Write back of these amounts overstated the Revenue Surplus and understated the Fiscal Deficit to this extent. Also, the liabilities of the Government reduced by the equivalent amount in Public Account; and

- During 2016-17, a sum of ₹612.04 crore was credited to the Consolidated Fund under the Major Head 2515 – Water Supply and Sanitation by operating the authorised Minor Head – 911-Recovery of Overpayments of previous years. This amount includes the interest amount earned by the department on the amount kept in bank account. This amount was treated as expenditure during the year of release on the Consolidated Fund of the State. These releases had the effect of overstatement of revenue expenditure and fiscal deficit of those years. As the amount was remitted back in the current year to the Consolidated Fund, the expenditure stood compressed and the revenue surplus was overstated and fiscal deficit stood understated to the extent stated above. Further details are available in **paragraph 2.7.4**. of this report.

1.1.3 Major Fiscal Variables

Major fiscal variables provided in the budget and targeted in KFRA, are depicted in **Table 1.3**.

Table 1.3: Major Fiscal Variables

Fiscal Variables	2016-17			
	Targets as prescribed in KFRA	**Targets proposed in the Budget**	**Projections made in MTFP 2013-17**	**Actuals (2016-17)**
Revenue Deficit (-)/ Surplus (+) (₹ in crore)	-	522	13,665	1,293
Fiscal deficit/ GSDP (*per cent*)	3.00	2.12*	3.00	2.57
Ratio of total outstanding debt of the Government to GSDP (*per cent*)	25.00	17.22*	22.62	19.81

**GSDP figures adopted in the BE was ₹12,11,080 crore, which was revised to ₹11,17,334 crore as communicated by Ministry of Finance, GOI vide letter dt 29 March 2016.*

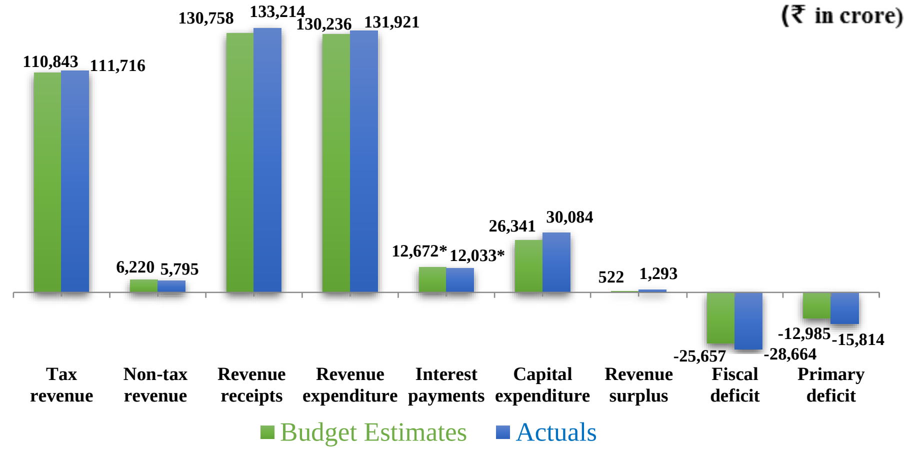
During 2016-17, there was a surplus on revenue account (₹1,293 crore), which exceeded budget projections by ₹771 crore and fell short of MTFP 2013-17 projections by ₹12,372 crore. The ratio of total outstanding debt to GSDP exceeded budget estimates by 2.59 percentage points and ratio of fiscal deficit to GSDP was 2.57 percentage points, which exceeded budget projections by 0.45 *per cent*. This was well within the prescribed target as per KFRA.

1.1.4 Budget Estimates and Actuals 2016-17

Budget papers presented by the State Government provide descriptions for projections or estimations of revenue and expenditure for a particular fiscal year. The importance of accuracy in the estimations 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/non-optimisation of desired fiscal objectives, due to a variety of factors, some of which are within the control of the Government while some are beyond its control.

Chart 1.1 presents the budget estimates and actuals of some important fiscal parameters for the year 2016-17.

Chart 1.1: Selected fiscal parameters: Budget estimates *vis-a-vis* Actuals in 2016-17



Source: Annual Financial Statement and Finance Accounts.

**excludes interest on off-budget borrowings.*

The budget estimates envisaged revenue receipts of ₹1,30,758 crore against which, the actual realisation was ₹1,33,214 crore, an increase of ₹2,456 crore (two *per cent*). The increase was mainly under Grants-in-aid and contributions from Government of India (GOI) (₹2,009 crore) and Central Tax transfers (₹1,781 crore), off-set by decrease in Own-tax revenue (₹908 crore) and Non-tax revenue (₹426 crore).

Revenue expenditure was estimated at ₹1,30,236 crore against which, the actual expenditure was ₹1,31,921 crore, an increase of ₹1,685 crore (one *per cent*). The increase in the actuals was noticed under social services (₹3,589 crore) and economic services (₹2,144 crore), off-set by decrease under general services (₹3,754 crore) and grant-in-aid and contributions (₹294 crore). Further details are available in **Chapter II** of this report.

Interest payments were estimated at ₹12,672 crore (excluding off-budget borrowings - Borrowings by PSUs and other Special Purpose Vehicles from financial institutions, where the responsibility of servicing the debt solely lies on the Government) shown against Major Head 2049-Interest payments. The actual payment was ₹12,033 crore, (exclusive of off-budget borrowings of ₹817 crore). According to KFRA, 2002 (as amended on 28.02.2014), the interest on off-budget borrowings recorded below various service heads are also to be treated as the interest liability of the State.

Major source of revenue receipts was the State's own tax revenue which constituted 62 *per cent*. Including the non-tax revenue, the State's own resources were around 67 *per cent* during 2016-17. The variations between budget estimates and actuals together with the reasons for the same under four major tax revenue heads and two non-tax revenue heads are brought out in **Table 1.4**.

Table 1.4: Variation between Budget and Actuals

(₹ in crore)

Source of revenue	Budget Estimates	Actuals	Increase (+) Decrease (-)	Reasons for variations as per MTFP 2017-21
Taxes on sales, trade etc.	46,504	46,105	(-) 399	The shortfall in the collections was attributed to economic effects of demonetisation during the year.
State Excise	16,510	16,484	(-) 26	State Excise is the second largest contributor to the States' own tax revenues. During 2016-17, the budgetary targets were almost met.
Stamps and Registration fees	9,100	7,806	(-) 1,294	Demonetisation had a major impact on the performance of Stamps and Registration revenue collections.
Taxes on vehicles	5,160	5,594	434	When compared to last year, there is a healthy increase in collections. The budgetary targets were exceeded.
Royalty on major and minor minerals	2,137	2,229	92	The budgetary targets are largely met.
Interest receipts	1,211	1,200	(-) 11	The interest are mainly from loans advanced and interest earned out of investment of surplus cash balance of the State in Government of India's T-bills.

Source: Budget documents-2016-17.

1.1.5 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. The State created the Gender Budget cell (January 2007) and gender budgeting was introduced in 2007-08. The year wise allocations in the gender budget document are detailed in **Table 1.5**.

Table 1.5: Gender budgetary allocations during 2012-13 to 2016-17

(₹ in crore)

Year	Outlay			Expenditure			
	Category A*	Category B^	Total	Category A*	Category B^	Total	Demands covered
2012-13	1,509.36	44,647.63	46,156.79	2,643.91	41,026.57	43,670.48	27
2013-14	1,915.30	55,032.21	56,947.51	2,541.78	47,679.24	50,221.02	28
2014-15	3,684.91	66,615.81	70,300.72	3,513.71	50,912.24	54,425.95	28
2015-16	5,617.10	55,834.26	61,451.36	5,135.04	58,119.33	63,254.37	27
2016-17	5,091.07	61,603.40	66,694.47	5,055.10#	61,031.79#	66,086.89#	27

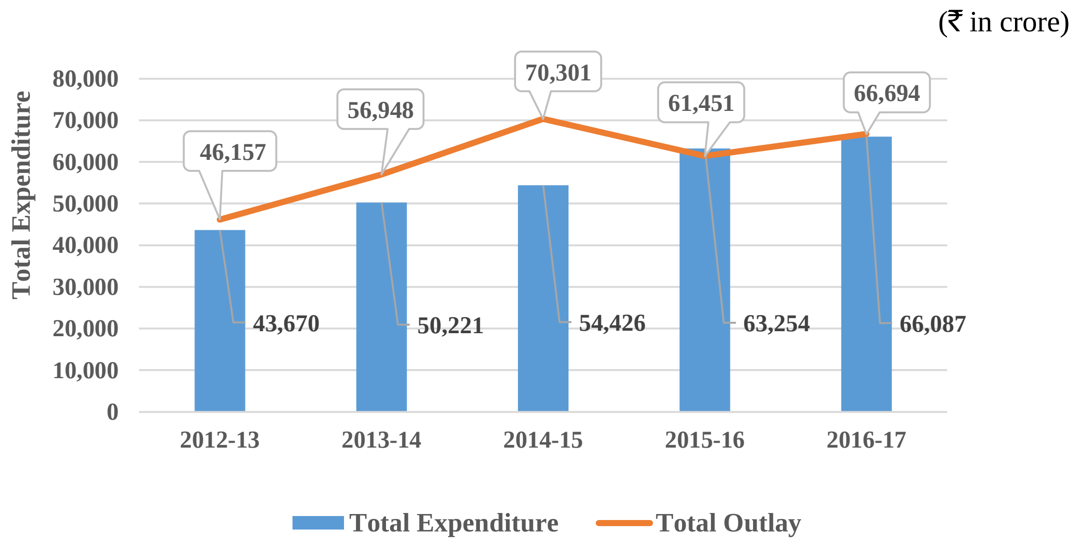
**Budgetary allocation to schemes designed covering 100 per cent women beneficiaries.*

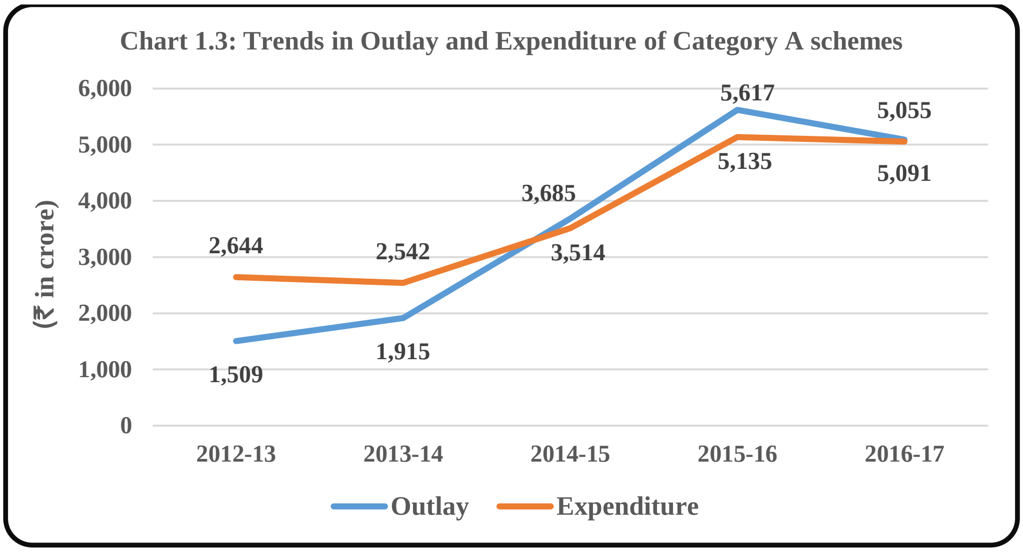
^Budgetary allocations to scheme designed for covering at least 30 per cent women beneficiaries.

#Figures for 2016-17 are Revised Estimates figures and not actuals.

The total number of schemes under Category A and B in 2016-17 were 721, of which 57 schemes were under Category A and 664 schemes were under Category B. The gender document also gives a brief explanatory note about the schemes indicating the objective of such schemes. The trends in total expenditure and total outlay and in the Gender Budgetary allocations during 2012-13 to 2016-17 is shown in **Chart 1.2** and the trends in the total outlay and total expenditure of Category A schemes is depicted in **Chart 1.3**.

Chart 1.2 : Trends in Total Expenditure vs Total Outlay





As seen from the above chart, it was observed that in respect of Category A schemes, during the years 2012-13 and 2013-14, the expenditure was more when compared to the outlay and during 2015-16, the expenditure is less over the outlay. However, during the years 2014-15 and 2016-17, the outlay is equal to the expenditure implying that the entire budget was utilised. A review of some of the Category A schemes is brought out in the following paragraphs.

a) Pension to Anganwadi Workers/Helpers – NPS Lite/Swavalamban/ Atal Pension Yojana -

Anganwadi workers and helpers of Karnataka are performing a vital role in the development schemes of mother and child health care and supply of nutrition. Considering their contribution to the society, a Contributory Pension Scheme was announced for them in the 2010-11 Budget. This scheme was introduced to provide contributory pension benefits to Anganwadi Workers and Helpers, who retire from service at the age of 56-60 years as on 31.03.2011. This scheme "New Pension System (NPS) for Anganwadi Workers and Helpers" is called NPS-Lite/Swavalamban and is being implemented by the Department of Women and Child Development.

Government of Karnataka, vide GO No WCD 119 ICD 2010 Bangalore dated 18.03.2011 stated that the Anganwadi workers and helpers, who are born on or after 01-04-1955 are required to contribute ₹150 and ₹84 respectively as monthly instalment and an equal amount is contributed by Government of Karnataka.

Government of India notified (October 2015) a pension scheme namely Atal Pension Yojana (APY) w.e.f. 1 June 2015. The scheme is open to all citizens of age group of 18-40 years. Under the guidelines of the scheme, the existing subscribers of NPS-Lite/Swavalamban in the age group of 18-40 years shall be migrated to APY unless they exercise an option to opt-out.

In the light of this, the Pension Fund Regulatory and Development Authority (PFRDA) in its public notice (January 2016) stopped new/fresh enrolments under NPS-Lite/Swavalamban w.e.f. 1 April 2015 and only the subscribers already registered under the scheme prior to 01.04.2015 can continue to deposit their subsequent contributions. It directed all the aggregators to ensure migration of all the interested subscribers under the scheme of NPS-Lite/Swavalamban to the APY scheme.

In view of the above, the NPS-Lite scheme was discontinued from 01.04.2015 and 1,08,037 Anganwadi workers and helpers were enrolled and 5,925 applications were pending for enrolment as on the date of the closure of the scheme. The department replied (June 2017) that the migration of the NPS-Lite subscribers was not accepted, as it was applicable only to the people of the age group 18-40 years and with the consent of subscribers, they were continued under NPS scheme due to operational issues. It further stated that, the department was in contact with PFRDA to maintain the uniformity in operational and conditional issues under Atal Pension Yojana for Anganwadi workers and helpers.

The department replied (November 2017) that instructions were issued to district level officers (July 2017) to direct the 5,925 subscribers who were not enrolled under NPS-Lite scheme, to enrol themselves under the APY scheme. Further, it stated that the department discussed the operational system of implementation of Atal Pension Yojana with PFRDA, which was planning to introduce a module, where through a facilitator the Government contribution could be remitted to NPS trust. The department was awaiting for the scheme from PFRDA and as soon as the module was formulated, the 5,925 number of Anganwadi Workers and Helpers and also the newly recruited subscribers from 01.04.2015 would be included in APY scheme.

However, the fact remained that the decision to stop fresh enrolment under NPS-Lite scheme from 1 April 2015, denied the 5,925 subscribers and the newly recruited Anganwadi workers and helpers the benefits of pension schemes.

b) Blocking of funds relating to Training Programme for Women Entrepreneurs by the Karnataka State Women's Development Corporation – ₹12.92 crore

Karnataka State Women's Development Corporation was made the nodal agency for imparting training to women for development of skill under Computer programming, Call centre training, Accounting, Web design, Fashion designing, Hospitality etc. Out of a sum of ₹20.36 crore, which was budgeted and released to the corporation for the period from 2011-12 to 2016-17, only ₹7.44 crore was expended, leaving a balance of ₹12.92 crore in the bank account of the corporation. The reasons adduced for non-utilisation of the balance amount were:

1) Non submission of required documentation from the agencies entrusted with the task of imparting training; and

2) Non finalisation of tender procedure etc.

It was noticed in audit that the administrative department went on releasing the grants without ascertaining the position of previous grants released for the purpose and without verifying the utilisation of grants. The above action of the department resulted in unnecessary locking up of Government money of ₹12.92 crore without utilisation over the years.

1.1.6 Major policy initiatives of Budget 2016-17

The results of scrutiny of records of certain schemes, which were proposed for implementation in 2016-17 and the action taken on such proposals in the Departments of Social Welfare and Infrastructure Development are brought out in **Table 1.6.**

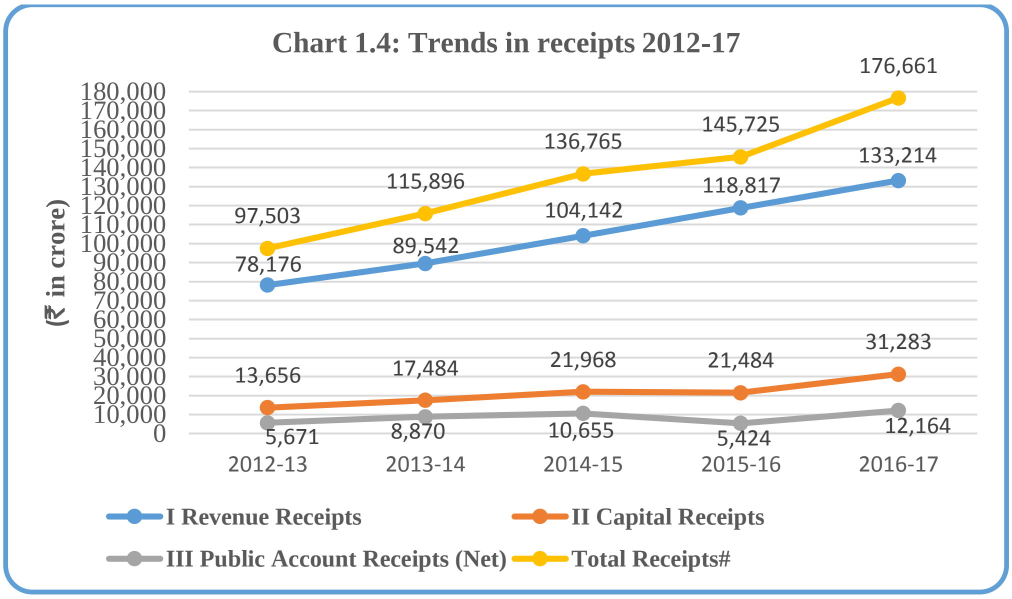
Table 1.6: Budget assurances and audit analysis thereon

Budget Assurance	Status as per Action Taken Report	Audit Observations
Shuchi Kits (Soaps, Tooth paste, oil etc.) to be provided to 75,000 post metric hostel inmates on the same lines as that for pre metric students	Government Order No. SWD 172 Pakavi 2016 dated 15.06.2016 was issued.	In Social Welfare Department, Shuchi Kits were released to districts for distribution to post metric hostel inmates. The Utilisation Certificates for ₹5.68 crore is yet to be received from district level officers.
Many welfare schemes are being implemented by various welfare Departments for the development of SC/STs under SCSP/TSP. A Social Audit Cell will be setup in Social Welfare Department to ensure that the benefits of the said schemes reach the target group.	Proposal is expected from Social Welfare Department. Reminder was sent on 04.01.2017.	Letter was addressed to Karnataka Evaluation Authority (KEA) (June 2017) by the department to identify agencies having network all over the State for conducting evaluation of the infrastructure works undertaken by various departments in SC/ST colonies. Reply from KEA is awaited.
Research and Training programmes will be taken up by establishing Dr. Babu Jagajivan Ram Research Institute at Destitutes' Rehabilitation Center, Magadi Road, Bangalore.	Finance Department gave in principle approval.	Construction of the research institute was approved at a cost of ₹88.25 crore. The proposal is yet to be approved by the Cabinet (October 2017).
Kalaburagi Airport is being developed by PWD and it will be completed during current year. Development of Shivamogga Airport will be taken up on PPP basis.	The completion of balance work of Kalaburagi Airport project was entrusted to State PWD. Administrative approval for the approximate cost of the project of ₹109,47,85,149/- was given on 27.04.2016. Government decided to develop Shivamogga Airport project under PPP model. Re-tender process is in progress.	The development work of Kalaburagi Airport which is stated to be completed during 2016-17 is still under progress as the PWD which was entrusted with the work was expected to complete the work in 18 months (July 2017). The department decided to take up the feasibility analysis, obstacle survey and topographical survey of the current location of Shivamogga Airport before going for rebidding process under PPP basis.

1.2 Resources of the State

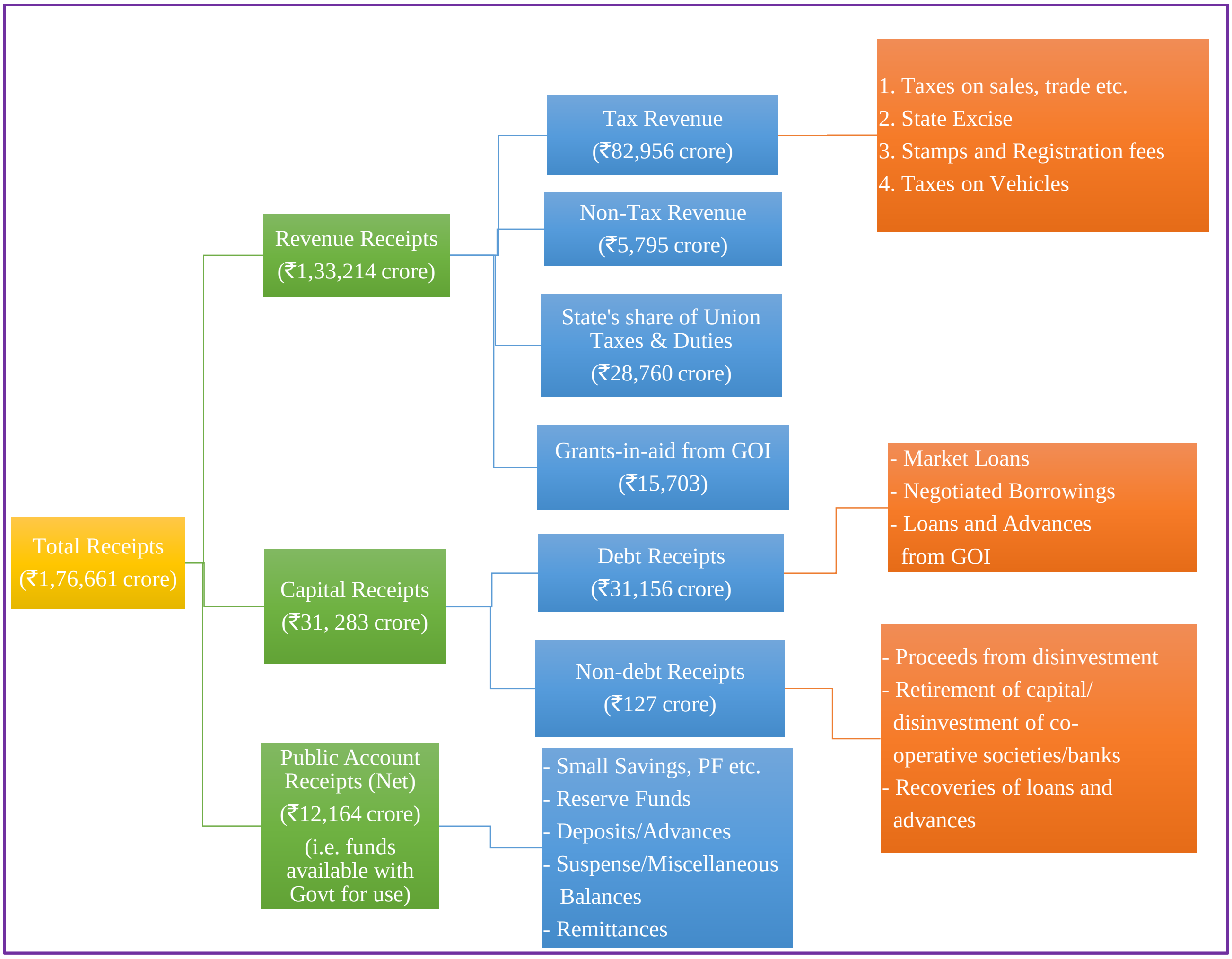
1.2.1 Resources of the State as per the Annual Finance Accounts

Revenue and Capital are the two streams of receipts that constitute the resources of the State Government. Revenue Receipts consist of tax revenue, non-tax revenues, States' share of Union taxes and duties and grants-in-aid and contributions from GOI. Capital receipts comprise miscellaneous capital receipts such as proceeds from disinvestment, recoveries of loans and advances, debt receipts from internal sources (market loans, negotiated loans from financial institutions/commercial banks) and loans and advances from GOI. Besides, the net Public Account receipts are also utilised by the Government to finance its deficit. **Chart 1.4** depicts the trends in various components of receipts during 2012-13 to 2016-17. **Chart 1.5** depicts the components and sub-components of resources of the State during 2016-17 while **Chart 1.6** depicts the composition of resources of the State during the year 2016-17.



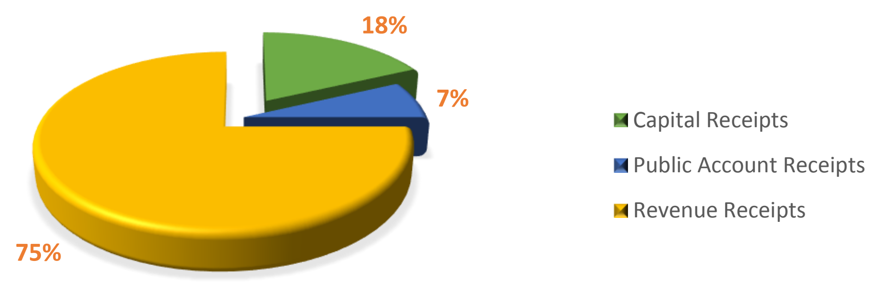
#excluding Contingency Fund receipts.

Chart 1.5: Components and sub-components of Resources



Source: Finance Accounts.

Chart 1.6: Composition of resources during 2016-17



Total receipts (excluding Contingency Fund receipts) increased by 81 *per cent* from ₹97,503 crore in 2012-13 to ₹1,76,661 crore in 2016-17. Compared to the previous year (₹1,45,725 crore), there was an increase by ₹30,936 crore (21 *per cent*) during 2016-17 (₹1,76,661 crore).

The share of revenue receipts in total receipts during 2016-17 was 75 *per cent*. Further details are provided in **paragraph 1.3**.

Capital receipts increased by 129 *per cent* from ₹13,656 crore in 2012-13 to ₹31,283 crore in 2016-17. During 2016-17, the capital receipts accounted for 18 *per cent* of total receipts. Debt receipts, the main constituent of capital receipts, increased by ₹10,084 crore. Internal debt and Loans and advances from GOI are the two components of debt receipts, whose share was 94 *per cent* (₹29,238 crore) and six *per cent* (₹1,918 crore) of the total debt receipts (₹31,156 crore) respectively. In 2016-17, there was a growth of 48 *per cent* in internal debt receipts. Loans and Advances increased by 51 *per cent* over the previous year.

Apart from debt receipts, capital receipts include non-debt receipts, such as recovery of loans and advances, miscellaneous capital receipts & retirement of capital/disinvestment of co-operative societies/banks etc. During 2016-17, non-debt capital receipts showed 69 *per cent* decrease in growth over the previous year.

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 six *per cent* of the total receipts during 2012-13 to 2016-17. Net Public Account receipts, which totalled to ₹5,671 crore in 2012-13, increased to ₹12,164 crore in 2016-17.

1.2.2 Direct transfer of Central Scheme Funds to Implementing Agencies in the State (Funds routed outside State Budget)

The Central Government is transferring funds directly to the State Implementing Agencies[1] for implementation of various schemes/programmes in social and economic sectors, which are recognised as critical. The practice was changed by Government of India from financial year 2014-15 and even central share has started flowing through the Consolidated Fund. Thus this source of revenue is also available for the State although the same is tied up towards Centrally Sponsored Schemes (CSSs).

However, during the year 2016-17, there was a deviation from the practice and central funds of ₹98.61 crore were transferred directly to the State Implementing Agencies. To present the holistic picture on the availability of aggregate resources, funds directly transferred to State Implementing Agencies, implementing seven major Government of India schemes are presented in **Table 1.7**. An Appendix giving details of funds transferred directly to State Implementing Agencies outside State Budget is included in Finance Accounts by capturing data from Controller General of Accounts (CGA) website (unaudited figures).

[1] State implementing agency includes any organisation/institution including non-governmental organisations and central autonomous bodies, which are authorised by the State Government to receive funds from GOI for implementing specific programmes in the State.

Table 1.7: Funds transferred directly to the State Implementing Agencies

(₹ in crore)

Sl. No.	Government of India Scheme	Implementing Agency/ Recipient in the State	Funds transferred directly by GOI during 2016-17
1	Schemes under Panchayati Raj	Seegehalli Grama Panchayath	0.10
2	Schemes under Urban Development	Town Municipal Council Badami	3.73
3	Schemes under Youth Affairs & Sports	Karnataka State NSS Cell	9.69
4	Schemes under Health & Family Welfare	YOGA Project-Kidwai Memorial Institute of Oncology	0.17
5	Panchayat Sashakthikarana Abhiyan (PSA)	Abdul Nazirsab Institute of Rural Development &Panchayat Raj, Mysore	15.08
6	National AIDS & Control Organization (NACO)	Karnataka State AIDS Prevention Society, Bengaluru	69.84
Total			**98.61**

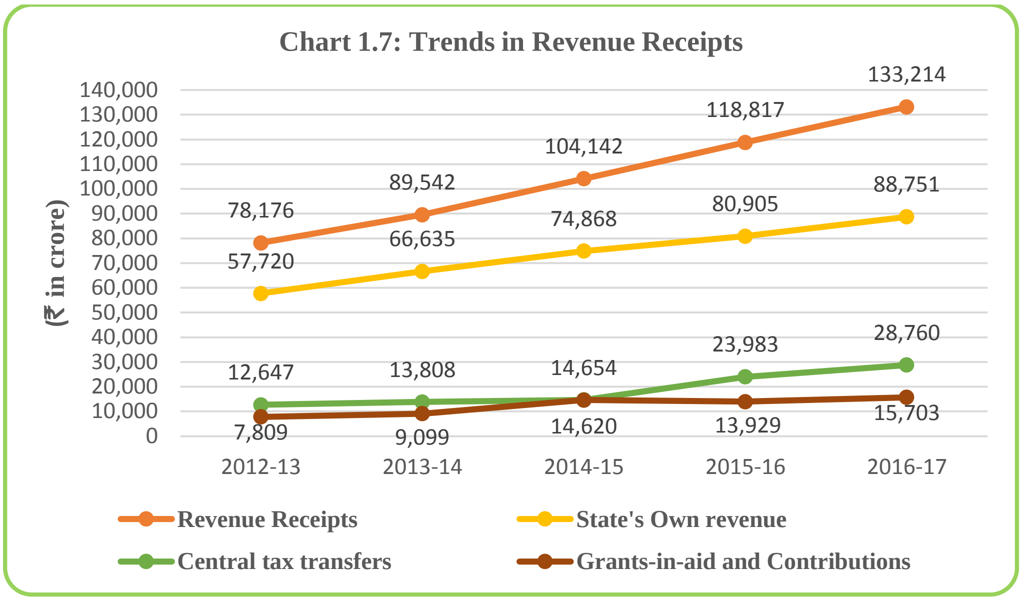
Source: Finance Accounts.

1.3 Revenue Receipts

The Government of Karnataka's fiscal position is largely influenced by the revenue side, as revenue receipts showed progressive increase from ₹78,176 crore in 2012-13 to ₹1,33,214 crore in 2016-17. On an average, 71 *per cent* of the revenue came from State's own resources during the period. The balance was transfers from GOI in the form of State's share of taxes and duties and grants-in-aid and contributions.

Simplification and rationalisation of tax structure, along with simplification of process of filing tax returns like e-payment of taxes and anywhere registration has ensured effective mobilisation of resources from various taxes, which reflected consistent performance on the tax front. Though tax revenues are consistently growing, Government of Karnataka did not improve revenues on the non-tax front, which was between four and five *per cent* during 2012-13 to 2016-17, which is discussed in detail in **paragraph 1.3.1.2**. The State's Fiscal Responsibility and Budget Management Committee (FRBMC) recognised this issue and advised departments to improve their non-tax revenue by regular revision of fees, user charges etc.

Statement No.14 of the Finance Accounts depicts the revenue receipts of the Government. The trends and composition of revenue receipts over the period 2012-13 to 2016-17 are presented in **Appendix 1.4** and are also depicted in **Chart 1.7**.



Source: Finance Accounts.

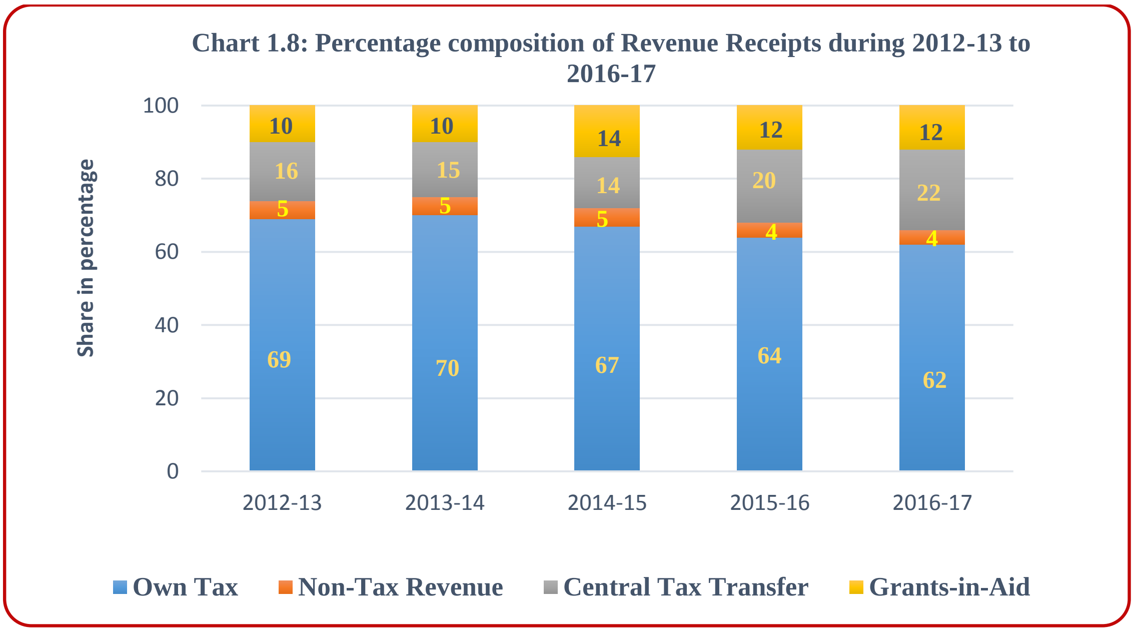


Chart 1.8 depicts that 66 *per cent* of revenue came from State's own resources during 2016-17 and the balance was from GOI in the form of State's share of taxes and Grants-in-aid. The share of own tax revenue increased from 69 *per cent* in 2012-13 to 70 *per cent* in 2013-14 and then decreased to 62 *per cent* in 2016-17 with inter-year variations. During 2016-17, there was increase under Central Tax transfers when compared to previous year. The trends in revenue receipts relative to GSDP are presented in **Table 1.8**.

Table 1.8: Trends in revenue receipts relative to GSDP

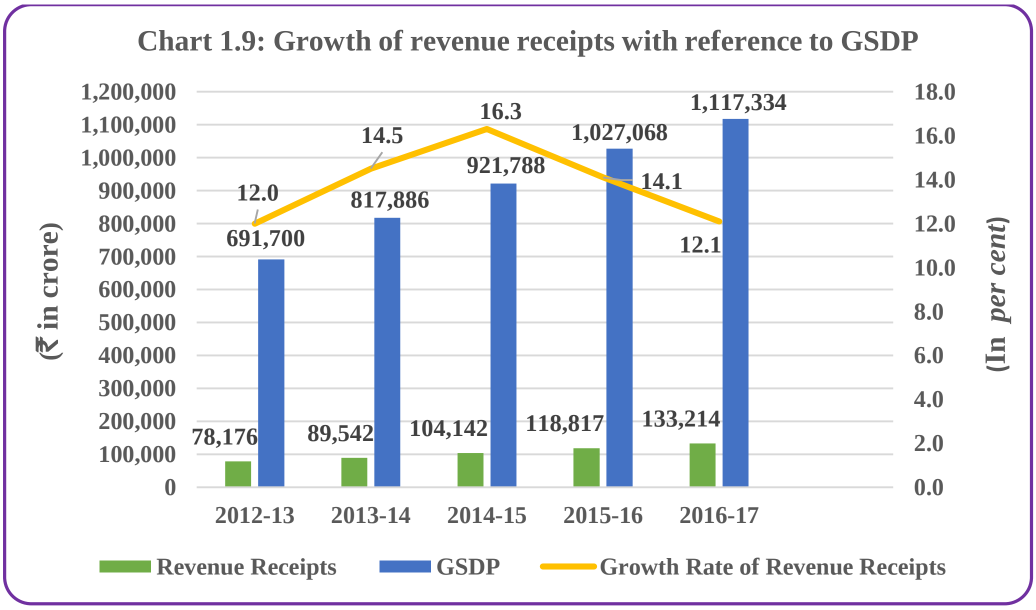
	2012-13	2013-14	2014-15	2015-16	2016-17
Revenue Receipts (RR) (₹ in crore)	78,176	89,542	1,04,142	1,18,817	1,33,214
Rate of growth of RR (*per cent)*	12.0	14.5	16.3	14.1	12.1
Rate of growth of State's own tax (*per cent*)	15.7	16.5	12.1	7.6	9.8
Own tax/GSDP (*per cent*)	7.8	7.6	7.6	7.3	7.4
Buoyancy ratios[2]					
RR/GSDP (*per cent*)	11.3	10.9	11.3	11.5	11.9
Revenue Buoyancy w.r.t GSDP	0.8	0.8	1.3	1.2	1.4
State's own tax Buoyancy w.r.t GSDP	1.1	0.9	1.0	0.7	1.1
Revenue buoyancy w.r.t States' own tax	0.8	0.9	1.3	1.8	1.2
GSDP (₹ in crore) @	6,91,700	8,17,886	9,21,788	10,27,068	11,17,334
Rate of growth of GSDP	14.56	18.24	12.70	11.42	8.79

Source: Finance Accounts.

@ GSDP figures for the years 2012-13 to 2015-16 are taken from Economic Survey of Karnataka, 2016-17 with 2011-12 base year. For 2016-17, the figures are as conveyed by Ministry of Finance, Government of India, vide letter dated 29 March 2016 with 2011-12 base year.

- State's own tax revenue buoyancy showed an oscillating trend due to fluctuation of growth of tax revenue and the buoyancy ratio, which was at its highest at 1.1 in 2012-13 and lower down to 0.7 in 2015-16 and thereafter increased to 1.1 during 2016-17; and
- Revenue buoyancy, which is directly proportionate to growth of revenue receipts and GSDP, showed an oscillating trend and ranged between 0.8 and 1.4. The growth of Revenue Receipts decreased from 14.1 in 2015-16 to 12.1 in 2016-17.

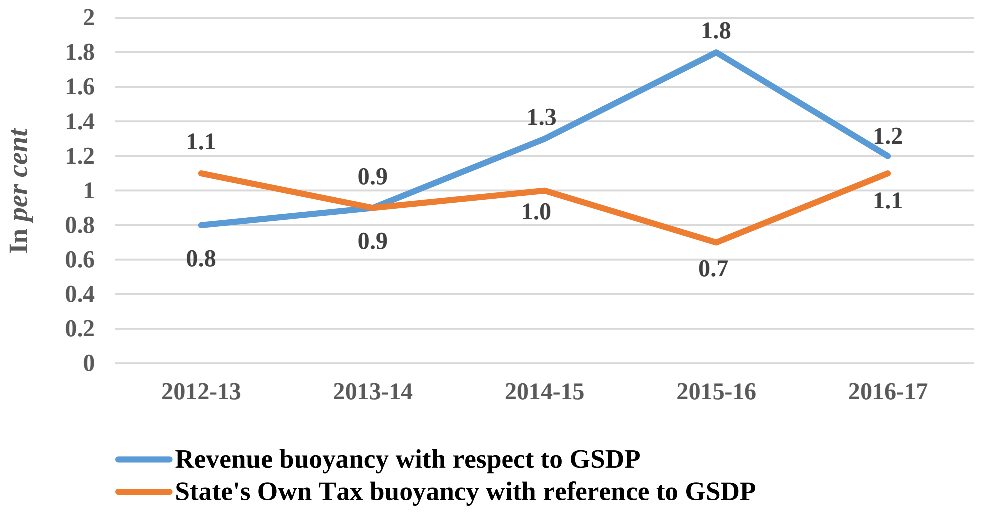
Chart 1.9 depicts the rate of growth of revenue receipts compared to GSDP and Total Revenue Receipts and **Chart 1.10** depicts the trends of buoyancy ratios.



Source: Finance Accounts and Economic Survey, GOK for 2016-17 and MOF, GOI letter dt 29 March 2016.

[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*.

Chart 1.10: Trend of Buoyancy of Revenue



Revenue buoyancy with respect to GSDP showed a steady growth till 2015-16 and decreased in 2016-17. The State's Own Tax Buoyancy with reference to GSDP decreased from 2012-13 to 2015-16 and increased during 2016-17.

In the Economic Survey for 2016-17, it was admitted that the ratio of non-tax revenue to total receipts was continuously declining over the years. Further, the State has one of the lowest non-tax revenues to GSDP ratios in the country **(Appendix 1.4)**. It was around the one *per cent* mark over the past five years. This is due to the low recovery of costs. A mention was also made in the earlier reports of State Finances, where departments like Hospitals, Horticulture etc., collected user charges/rent and utilised the same without remitting into Consolidated Fund of the State. In many departments, the revision of user charges, fees and fines and other such non-tax receipts did not take place for many years. Even with revision of rates and better collection mechanisms, the increase in revenues from this avenue may not be large due to existing low base.

Though Expenditure Reforms Commission has made a number of recommendations during 2010 to enhance revenues from user charges, the same was not accomplished. The Government in their reply reported in the previous report on the issue stated that instructions were issued to give information relating to user charges that were being collected. Further developments in this regard is awaited (December 2017).

1.3.1 State's own resources

The tax revenue of the State in 2016-17 was less than the projection made in MTFP by ₹15,507 crore and budget estimates by ₹908 crore. Non-tax revenue was significantly more than MTFP projections (₹870 crore) and less than budget estimates by ₹425 crore, as detailed in **Table 1.9**.

Table 1.9: Projections of Tax and Non-Tax Revenue for 2016-17

(₹ in crore)

	Budget estimates	MTFP projections	Actual
Tax revenue	83,864	98,463	82,956
Non-tax revenue	6,220	4,925	5,795

1.3.1.1 Tax revenue

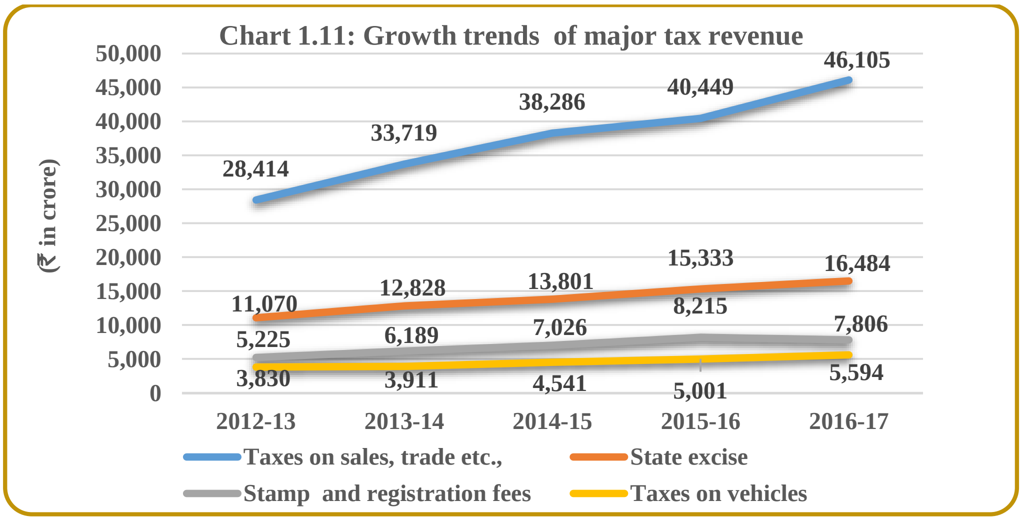
Taxes on sales, trade, etc., (56 *per cent*) were the main source of the State's tax revenue followed by State Excise (20 *per cent*), Stamps and Registration Fees (nine *per cent*) and Taxes on Vehicles (seven *per cent*) during 2016-17. The trends in the major constituents of tax revenue during the period 2012-13 to 2016-17 are shown in **Table 1.10** and **Chart 1.11** below.

Table 1.10: Components of State's own tax revenue

(₹ in crore and growth rate in *per cent*)

Revenue Head	2012-13	2013-14	2014-15	2015-16	2016-17
Taxes on sales, trade etc.,	28,414	33,719	38,286	40,449	46,105
Rate of growth	13.57	18.67	13.54	5.65	13.98
State excise	11,070	12,828	13,801	15,333	16,484
Rate of growth	13.24	15.88	7.58	11.10	7.51
Stamp and Registration fees	5,225	6,189	7,026	8,215	7,806
Rate of growth	13.02	18.45	13.52	16.92	(-) 4.98
Taxes on vehicles	3,830	3,911	4,541	5,001	5,594
Rate of growth	29.52	2.11	16.11	10.13	11.86
Land Revenue	205	199	186	181	209
Rate of growth	(-) 4.65	(-) 2.93	(-) 6.53	(-) 2.69	15.47
Taxes on goods and passengers	2,181	2,626	3,038	3,125	3,306
Rate of growth	29.05	20.40	15.69	2.86	5.79
Other taxes[3]	2,829	3,131	3,302	3,246	3,452
Rate of growth	28.88	10.68	5.46	(-) 1.70	6.35
Total	**53,754**	**62,603**	**70,180**	**75,550**	**82,956**

Source: Finance Accounts of the respective years.



[3] Other taxes include taxes on Agricultural Income (₹1.00 crore), Taxes and duties on Electricity (₹1,451 crore), Other taxes on Income and Expenditure (₹901 crore) and Other taxes and duties on Commodities and Services (₹1,099 crore).

During the period 2012-13 to 2016-17, the rate of growth of taxes on sales, trade, etc., was between 5.65 *per cent* and 18.67 *per cent*. During 2016-17, the growth rate was 14 *per cent*.

State Excise, was the second largest contributor to State's own tax revenues. The growth rate increased from 13.24 *per cent* in 2012-13 to 15.88 *per cent* in 2013-14 and reduced to 7.51 *per cent* during 2016-17.

Stamp and Registration fees also contributed to own tax revenues. There was a moderation in the growth rate during the years 2012-13 to 2016-17. During 2016-17, it stood at (-) 4.98 *per cent* and efforts need to be made to ensure that collections are improved. As per MTFP 2017-21, demonetisation had a major impact on the performance of Stamps and Registration revenue collections.

Motor vehicle taxes also contributed significantly to own tax revenues. The growth rate of revenue under the head was 2.11 *per cent* during 2013-14, which increased to 16.11 *per cent* during 2014-15 and reduced to 11.86 *per cent* during 2016-17.

Cost of Collection

The gross collection of taxes on motor vehicles, taxes on sales, trade etc., stamp and registration fees and state excise, expenditure incurred on their collection and its percentage to gross collection during the years 2014-15 to 2016-17 along with their All-India average cost of collection for the respective previous years are indicated in the **Table 1.11**.

Table 1.11: 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)			
Taxes on Motor Vehicles	2014-15	4,544.17	82.52	1.82	6.25
	2015-16	5,004.35	83.37	1.67	6.08
	2016-17	5,597.93	81.41	1.45	4.99
Taxes on sales, trade etc.,	2014-15	39,694.76	1,464.43*	3.69	0.88
	2015-16	41,891.72	250.47	0.60	0.91
	2016-17	48,034.12	259.35	0.54	0.66
Stamp and Registration fees	2014-15	7,063.35	68.28	0.96	3.37
	2015-16	8,241.07	126.03	1.53	3.59
	2016-17	7,884.29	92.73	1.18	2.87
State Excise	2014-15	13,805.75	130.11	0.94	1.81
	2015-16	15,337.11	132.61	0.86	2.09
	2016-17	16,488.94	146.25	0.89	3.21

@ The expenditure booked under the minor head, 001-Direction and Administration and 101 – Collection charges is considered as cost of collection.

**Expenditure on collection include ₹1,211.67 crore being the book adjustment entry of grants-in-aid in respect of M/s HAL brought under collection charges.*

The percentage of cost of collection to the gross collection was significantly less than the All India Average for the period 2014-17 except for taxes on sales, trade etc., in 2014-15.

1.3.1.2 Non-tax revenue

Non-tax receipts (fees, user charges, interest receipts, etc.) are generally raised through non-statutory mandates and usually a reciprocal benefit accrues to the citizens from whom such receipts are collected. The sources of non-tax receipts included receipts from fiscal services like interest receipts from outstanding advances, dividends and profits from equity investments, royalty fees for allowing use of assets held as custodian like minerals, forests and wild life, or other such services and user charges for various social and economic services provided through the apparatus of the Government. The trend in collection of non-tax revenue under certain important heads of accounts is given in **Table 1.12**.

Table 1.12: Trends in collections of non-tax revenues

(₹ in crore)

Revenue Head	2012-13	2013-14	2014-15	2015-16	2016-17	% increase (+)/ decrease (-) over previous year
Interest receipts	778.55	693.17	874.74	1,292.63	1,199.74	(-) 7.19
Dividend and profits	56.29	55.49	74.84	69.40	82.50	18.88
Nonferrous Mining and Metallurgical Industries	1,496.49	1,474.49	1,931.10	2,003.80	2,419.43	20.74
Medical and Public Health	100.70	207.54	224.00	260.74	152.90	(-) 41.36
Other Administrative Services	123.37	181.66	179.23	269.08	130.74	(-) 51.41
Forestry and Wild Life	171.54	161.14	178.21	168.15	291.94	73.62
Education, Sports and Culture	148.73	120.09	154.96	159.72	193.43	21.11
Police	110.84	150.71	152.07	171.87	176.47	2.68
Roads and Bridge	119.49	120.14	118.38	56.11	61.70	9.96
Other non-tax receipts	860.11	867.47	800.71	903.54	1,085.68	20.16
Total	**3,966.11**	**4,031.90**	**4,688.24**	**5,355.04**	**5,794.53**	**8.21**

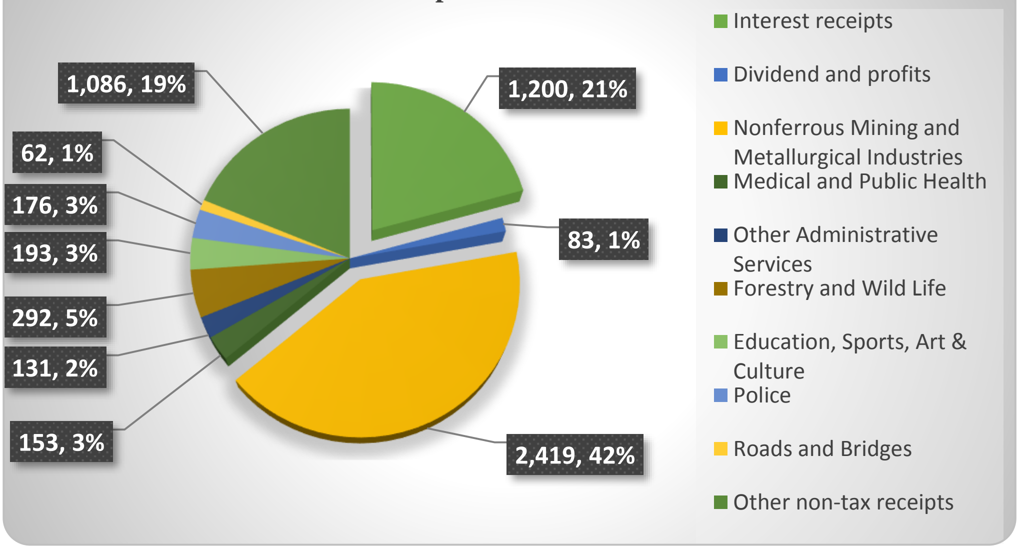
Source: Finance Accounts.

Incorrect Accounting under Non-tax revenue

As per paragraph 3.10 of List of Major and Minor Heads (LMMH), recoveries of overpayment, whether made in cash or by short drawal from a bill, during the same financial year in which, such overpayments were made, shall be recorded as reduction of expenditure under the Service Head. Recoveries of overpayments pertaining to previous years shall be recorded under the distinct minor head 'Deduct-Recoveries of Overpayments' below the concerned major/sub-major head without affecting the gross expenditure under the functional Major/Sub-Major Head in the Appropriation Accounts. During the year 2016-17, ₹3.87 crore was incorrectly accounted as receipt under major head 0515- Other Rural Development Programme-800-Other Receipts, whereas it is actually recovery of overpayments pertaining to previous years. Treating the transaction as a non-tax revenue was not in order as it inflated the non-tax revenue. The transaction was required to be recorded under the expenditure major head 2515-Other Rural Development Programme-911-Recoveries of Overpayment.

The components of non-tax revenue for the year 2016-17 are presented in **Chart 1.12**.

Chart 1.12: Components of non-tax revenue in 2016-17



Interest receipts, Dividends and Profits

Apart from the regular source of interest receipts on account of repayment of loans, the other major source is interest proceeds out of investment of surplus cash balance of the State. As per Reserve Bank of India's (RBI) regulations, the cash balance maintained by the State is invested in GOI's 14-day Treasury Bills (TBs). To improve cash management, excess cash balance (beyond the immediate requirement) is invested in GOI's 91 day TB's. Against the budgeted estimate of ₹1,097 crore during 2016-17, the revenue realised was ₹1,054.16 crore, of which, 14 day TBs yielded ₹349.51 crore and 91 day TBs yielded ₹704.65 crore.

The interest realised on loans and advances given by the Government to its Companies/Corporations etc., stood at ₹144.93 crore, working out to one *per cent* of the outstanding balances of loans at the end of the year. The receipts also included ₹0.67 crore, being the interest on capital of departmentally run commercial undertakings, such as Silk Filatures, the adjustments of which, were made through book transfer.

Substantial sums of money are held in banks by the Departmental Officers in contravention to the financial rules, which preclude the Departmental Officers from depositing the money in savings bank accounts. During 2016-17, a sum of ₹20.18 crore being the interest earned on deposits in banks was accounted under the Head of Account '0049-04-800-6-01 – Interest received from deposit accounts'. Unspent grants of ₹0.91 crore held in bank accounts was also remitted as interest receipts. Further, interest amount accumulated in the savings bank account pertaining to Finance Commission grants of ₹1.19 crore was also remitted under the above head of account as interest receipts, thus, indicating misclassification in the books of accounts relating to principal amount.

The return on investment in the form of dividends declared by the Companies/Corporations and credited to Government account during 2016-17 was ₹82.50 crore. Considering the magnitude of Government investment (₹63,115 crore), the return works out to a meagre 0.13 *per cent*.

Other Non-tax receipts

The other major non-tax revenue is royalty on major and minor minerals. Against the Budget estimates of ₹2,137 crore, the actual realisation was ₹2,229 crore. There was an increase of ₹317 crore compared to the previous year.

1.3.2 Grants-in-aid from GOI

Grants-in-aid and Contributions from GOI increased from ₹7,809 crore in 2012-13 to ₹15,703 crore in 2016-17 as shown in **Table 1.13**.

Table 1.13: Grants-in-aid from GOI

(₹ in crore)

Particulars	2012-13	2013-14	2014-15	2015-16	2016-17
Non-Plan grants	2,455.43	3,139.79	3,634.58	5,547.34	7,045.21
Grants for State Plan schemes	2,908.74	3,341.15	9,096.87	8,105.31	8,101.62
Grants for Central plan schemes	124.59	191.70	158.52	138.90	116.06
Grants for Centrally sponsored schemes	2,320.66	2,426.18	1,729.48	137.20	440.30
Grant for special plan schemes	-	-	-	-	-
Total	**7,809.42**	**9,098.82**	**14,619.45**	**13,928.75**	**15,703.19**
% of increase/decrease over previous year	(-) 4.39	16.51	60.67	(-) 4.72	12.74
Total grants as % of revenue receipts	10.00	10.16	14.04	11.72	11.79

Source: Finance Accounts.

As compared to the previous year, there was an increase of ₹1,774 crore during 2016-17. This was on account of increase in receipts under Non-plan grants (₹1,498 crore) and Centrally Sponsored Schemes (CSS) (₹303 crore), offset by decrease in Grants for State Plan Schemes (₹4 crore) and Grants for Central Plan schemes (₹23 crore).

The Union Government decided that from 1 April 2014, transfer of funds under Centrally Sponsored Schemes was through the Consolidated Fund of the State and not directly to the implementing agencies. Thus, these central shares were also available under State Budget. However, this practice of direct transfer of funds was discontinued during 2014-15 and 2015-16. But during 2016-17, the Union Government continued to transfer funds directly to State Implementing Agencies/Non-Government Organisations for implementation of various schemes/programmes. The details of these direct transfer of central scheme funds are explained in detail in **paragraph 1.2.2**.

1.3.3 Central tax transfers

Government of India transfers share of State Government in Union Taxes and Duties such as Corporation Tax, Income Tax, Service Tax, Union Excise Duties etc. The trends in these Central tax transfers during 2012-17 are given in **Table 1.14**.

Table 1.14: Trends in Central Tax transfers

(₹ in crore)

Particulars	2012-13	2013-14	2014-15	2015-16	2016-17
Corporation Tax	4,542.84	4,643.76	5,117.21	7,547.57	9,211.05
Taxes on Income other than Corporation Tax	2,719.73	3,057.77	3,654.18	5,252.47	6,401.72
Taxes on Wealth	7.66	12.75	13.81	1.65	21.08
Customs	2,101.59	2,252.90	2,369.95	3,830.22	3,962.25
Union Excise duties	1,428.25	1,591.16	1,338.24	3,181.60	4,524.54
Service Tax	1,847.07	2,249.93	2,160.75	4,153.56	4,639.22
Other Taxes on Income and Expenditure	-	-	0.12	0.15	-
Other taxes and duties on Commodities and Services	-	0.01	(-) 0.01	16.12	0.08
Total	**12,647.14**	**13,808.28**	**14,654.25**	**23,983.34**	**28,759.94**

Source: Finance Accounts of the respective years.

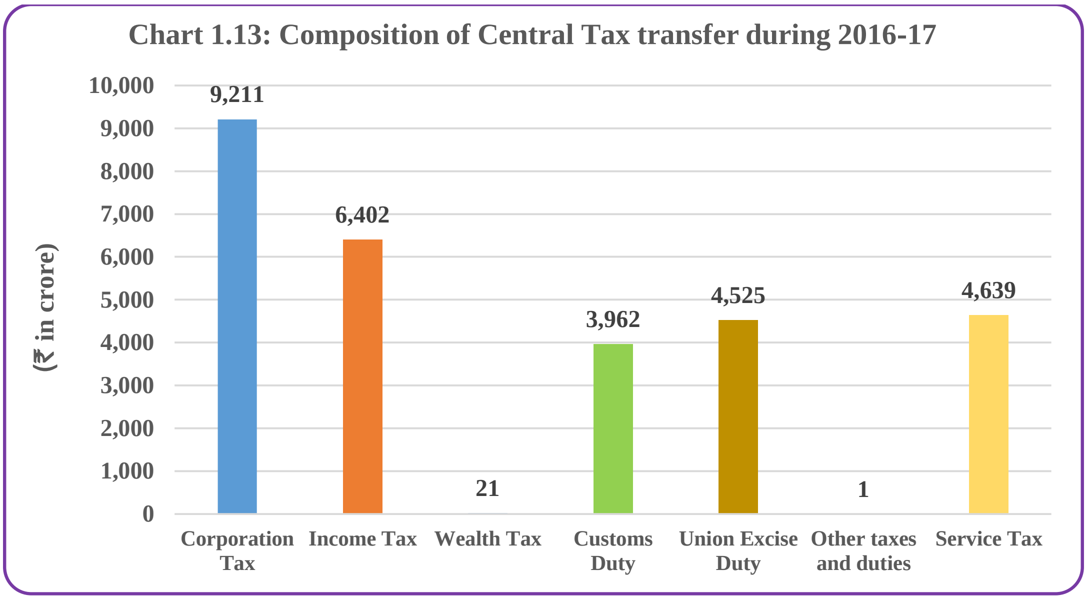
There is an increase of ₹4,777 crore over the previous year under Corporation Tax (₹1,663 crore), Service Tax (₹486 crore), Union Excise duties (₹1,343 crore), Taxes on Income other than Corporation Tax (₹1,149 crore), Customs Duty (₹132 crore) and Wealth Tax (₹20 crore) offset by decrease in share of Other taxes and duties on Commodities and Services (₹16 crore) and Other taxes on Income and Expenditure (₹0.15 crore). The Central Tax transfers constituted 22 *per cent* of Revenue Receipts of the State during 2016-17. The major component of Central Tax transfers during 2016-17 was Corporation Tax (32 *per cent*) followed by Taxes on Income other than Corporation Tax (22 *per cent*) and Service Tax (16 *per cent*) as reflected in **Chart 1.13**.

Further, XIV FC recommended that the State's share in the net proceeds of Central Taxes (excluding Service Tax) and net proceeds of Service Tax be fixed at 4.713 *per cent* and 4.822 *per cent*, respectively. The net collection of Union taxes during 2016-17 and the State's share in it is shown in **Table 1.15** and the composition during the year is given in **Chart 1.13**.

Table 1.15: Share of net proceeds of Union taxes during 2016-17

(₹ in crore)

Sl. No.	Nature of the Tax	Share of the State	All India Total (Net)	Percentage
1	Corporation Tax	9,211.05	1,95,439.24	4.713
2	Taxes on Income other than Corporation Tax	6,401.72	1,35,830.86	4.713
3	Taxes on Wealth	21.08	447.43	4.711
4	Customs	3,962.25	84,070.39	4.713
5	Union Excise Duties	4,524.54	96,001.18	4.713
6	Other Taxes and Duties on Commodities and Services	0.08	1.78	4.494
7	Service Tax	4,639.22	96,209.43	4.822
	Total	**28,759.94**	**6,08,000.31**	



Source: Finance Accounts of 2016-17.

1.3.4 Optimisation of XIV Finance Commission (XIV FC) Grants

1.3.4.1 Introduction

XIV FC was constituted by the President under Article 280 of the Constitution on 2 January 2013 to make recommendations on specified aspects of Centre - State fiscal relations for the period from 2015-16 to 2019-20 (award period). As per the terms of reference, the Commission shall make recommendations in the matter of distribution of net proceeds of taxes between the Union and the States, principles which should govern the grants-in-aid of the revenues of the States and measures needed to augment the Consolidated Fund of the State to supplement the resources of the Panchayat and Municipalities in the State.

1.3.4.2 Release of Grants

The Commission recommended ₹2,839.76 crore as transfer to the State in the areas indicated in **Table 1.16** during 2016-17.

Table 1.16: Transfers recommended and actual release of grants during 2015-16 and 2016-17

(₹ in crore)

Sl. No.	Transfers	2016-17			Release for 2015-16	Increase/ Decrease over previous year	Percentage of increase (+)/ decrease(-)
		Recommended amount	Actual release	Short fall			
1	Local Bodies						
	(a) Basic Grants to PRIs	1,388.62	1,368.21	20.41	972.36	395.85	41
	(b) Performance Grants to PRIs	182.15	179.45	2.70	-	179.45	-
	(c) Basic Grants to ULBs	778.29	778.29	-	562.08	216.21	38
	(d) Performance Grants to ULBs	229.70	229.70	-	-	229.70	-
2	Disaster Relief	261.00	217.50	43.50	207.00	10.50	5
	Total	**2,839.76**	**2,773.15**	**66.61**	**1,741.44**	**1,031.71**	**-**

As of March 2017, the State Government received ₹1,368.21 crore of Basic Grants for Panchayat Raj Institutions(PRIs) against the recommendation of ₹1,388.62 crore, which was ₹395.85 crore (41 *per cent*) more over the previous year leaving a shortfall of ₹20.41 crore. The Rural Development and Panchayat Raj (RD&PR) department in its reply (June 2017) stated that the grants were released on pro-rata basis for the duly constituted local bodies only. The same procedure is being followed uniformly across the States and in consonance with the recommendations of the XIV FC. Similarly, the recommended amount of ₹778.29 crore towards Basic Grants to Urban Local Bodies (ULBs) were released, which showed an increase of ₹216.21 crore over the previous year, an increase of 38 *per cent*.

XIV FC recommended that to be eligible for Performance Grants, the gram panchayats will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year, in which the gram panchayat seeks to claim the Performance Grant. It will also have to show an increase in the own revenues of the local body over the preceding year, as reflected in the audited accounts. The release of Performance Grants to PRIs and ULBs commenced from 2016-17. The State Government {RDPR department and Urban Development Department (UDD)} issued guidelines to arrive at entitlement of PRIs and ULBs with regard to the operational criteria to obtain Performance Grants under XIV Finance Commission.

During 2016-17, against the recommended amount of ₹182.15 crore towards Performance Grants to PRIs, ₹179.45 crore was released leaving a shortfall of ₹2.70 crore. RDPR department attributed (June 2017) this to releasing of grants on pro-rata basis only for duly constituted local bodies. For ULBs, the entire recommended amount of ₹229.70 crore towards Performance Grants was released during 2016-17. For the year 2016-17, Performance Grants were released to 191 ULBs out of 213 ULBs, which submitted audited accounts

Similarly, against the recommended amount of ₹ 261 crore towards State Disaster Relief Fund (SDRF), only ₹217.50 crore was released, an increase of ₹10.50 crore (five *per cent*) over the previous year. XIV FC recommended that the contribution to the fund is in the ratio of 90:10 between GOI and State Government. GOI accepted this recommendation with the modification that the percentage share of the States will continue to be as before in the ratio of 75:25 and that the flows will also be of the same order as in the existing system and that, once GST is in place, the recommendations of XIV FC on disaster relief would be fully implemented. The contributions from GOI together with the State's contribution are transferred to SDRF account in Public Account of the State.

1.3.4.3 Other Recommendations

XIV FC made number of recommendations relating to devolution of grants to local bodies, disaster relief etc. In addition to this the commission made many other recommendations like increasing professions tax, transactions under National Small Savings Fund (NSSF), setting up of Water Regulatory Authority (WRA) etc. These recommendations are brought out in detail below.

Tax on professions, trades, callings and employments

Article 276 of the Constitution provides for the levy of a tax on professions, trades, callings and employments for the benefit of the State or local bodies at a rate not exceeding ₹2,500 per tax payer per annum. The States, State Finance Commissions (SFCs) and local bodies expressed the view that this tax can be a major source of income for the local bodies if the ceiling can be raised periodically and the tax can be collected efficiently.

The Commission having considered the pleas of the State Governments, recommended for raising the ceiling on this professions tax from ₹2,500 per annum to ₹12,000 per annum by bringing amendment to Article 276(2) of the Constitution by increasing the limits on the imposition of professions tax by States. The amendment may also vest the power to impose limits on Parliament with the caveat that the limits would adhere to the Finance Commission's recommendations and the Union Government should prescribe a uniform limit for all the States.

Finance Department replied (June 2017) that Government of India was requested by State Government in this regard to consider bringing amendment to the Constitution at the earliest.

Transactions under National Small Savings Fund (NSSF)

XIV FC recommended that State Governments be excluded from the operations of the NSSF, with effect from 1 April, 2015. This exclusion will not hamper the overall borrowing programme of the States in any manner, as they will continue to have access to open market borrowings. As for the fiscal burden incurred in the course of the operations of NSSF, prior to 1 April, 2015, since the scheme was administered almost in its entirety by the Union Government, no part of this fiscal burden, incurred till that date, should be passed on to the States. It further recommended that the involvement of the States in NSSF scheme with effect from 1 April, 2015, may be limited solely to discharging the debt obligations already incurred by them until that date. However, during 2015-16, ₹2,738 crore was accounted under the head 6003-111 towards NSSF loans.

Finance Department replied (July 2017) that Government of India (GOI) vide letter dated 16 February 2017 communicated that Union Cabinet decided to exclude all the States and UTs (with Legislature) from NSSF investments, w.e.f 1 April 2016 and that the investments of the State will be limited solely in discharging the debt obligations already incurred by them. The delay in implementation of XIV FC recommendations by GOI of excluding the State Governments from NSSF loans led to the receipts of ₹2,738 crore under NSSF in the FY 2015-16. Further, the State Government did not receive any loans under NSSF from GOI in the financial year 2016-17 and the Government did not anticipate any loans under NSSF from GOI for financial year 2017-18.

On account of delay in implementation of the recommendations, the State Government is subject to unnecessary burden towards interest payment due to delayed decision on the part of GOI. The State Government had to incur the burden of liability to the extent cited above, apart from the increased interest liability (nine *per cent* on NSSF loans) instead of tapping the market directly, whose interest rates was between 7.98 *per cent* and 8.67 *per cent*.

Template for collating of extended Public Debt

For any evaluation of public finances to be meaningful, it should consider the Government's risk exposure to its public sector in the form of guarantees, off-budget borrowings and accumulated losses of financially weak public sector enterprises. In this context XIV FC explored the concept of extended debt, analyzing different indicators, including the debt of public sector enterprises (PSEs), guarantees to PSEs and a risk weighted combination of guarantees. Keeping in mind the importance of risks arising from guarantees, off-budget borrowings and accumulated losses of financially weak public sector enterprises when assessing the debt position of States, FC recommended that both Union and State Governments adopt a template for collating, analyzing and annually reporting the total extended public debt in their respective budgets as a supplement to the budget document.

Finance Department in its reply (July 2017) stated that the State Government was reporting the total extended Public Debt in the Budget documents. The same is published in the over view of budget every year.

The reply of the department is not satisfactory as the State Government is reporting the liabilities of the Government which are captured in accounts, whereas Finance Commission recommended for drawing up a template for collating of extended public debt, which in effect mean the budgetary support given by the State Government to entities under Off-budget borrowings, various ULBs/Corporations. These data are required to be brought out for the purpose of transparency. A note in the budget document to indicate that the liabilities mentioned do not include the ones stated above whose borrowings up to the end of March, can be considered.

Sanction of New Capital Works in the Budget

To curb the scope for perverse allocation of available funds among competing projects and to ensure that the economy benefits from investments in capital works, XIV FC recommended both Union and States to amend their respective Fiscal Responsibility Acts to provide a statutory ceiling on the sanction of new capital works to an appropriate multiple of the annual budget provision. An amendment on the lines as suggested by the Commission, if given a statutory backup, would eventually result in healthy fiscal management and spread of resources to capital works in a regulated manner.

Irrigation – Setting up of Water Regulatory Authority (WRA)

The fixation and rationalisation of water charges should be guided by the basic consideration of generating sufficient revenue to recover recurring O&M costs essential for the maintenance of the system initially, and a fixed percentage of the capital cost subsequently. Nevertheless, a balance needs to be maintained, keeping in view the paying capacity of farmers. Appropriate fixation and rationalisation of water charges demands basic information, which requires measurement of water consumption through meters. The advantage of metering is that it encourages farmers to limit their water use, adopt the cropping pattern best suited to the area and avoid over-irrigation, as well as wasteful use of water. For this purpose, meters are required, which have to be honestly read and reported. Therefore, XIV FC, while reiterating the recommendations of XIII FC in setting up of Water Regulatory Authority urged the States to setup the authority for pricing of water for domestic, irrigation and other uses independently and in a judicious manner. It further recommended that WRAs already established be made fully functional at the earliest.

The Water Resources Department in its reply (December 2017) stated that Government of India asked Government of Karnataka to consider setting up of a Regulatory Authority in the State on the lines of Maharashtra Water Resources Regulatory Authority Act, 2005 (MHWRRA Act 2005). The MHWRRA Act, among its various other functions, provides for fixing water tariff for various category of users. The views of all the Nigams under Water Resources Department, GOK is being sought on this Act and further action would be taken after receipt of the said views.

Power – Setting up of State Electricity Regulatory Commission (SERC) Fund

A key issue in the functioning of SERCs is their financial independence and autonomy. SERC's primary sources of income include grant from State Governments and their own revenue generated through fees for annual licenses and the filing of applications. XIV FC recommended all States to constitute a State Electricity Regulatory Commission Fund in order to provide financial autonomy to SERCs, as regulated under Section 103 of the Electricity Act, 2003, to enable SERCs to perform their responsibilities. The Commission reiterated the importance of financial independence of SERCs and urged all States to constitute a SERC Fund, as statutorily provided for. However, the fund was not established.

Energy Department replied (August 2017) that AG (E&RSA) was requested for concurrence to the revised draft amendment to the Karnataka Electricity Regulatory Commission (Annual Statement of Accounts) Rules, 2014, for enabling creation of SERC fund. As this amendment is in contravention to the provisions of the Karnataka Electricity Reforms Act, 1999, and Section 103 of the Electricity Act, 2003, the office of AG (E&RSA) suggested for a relook into the matter (November 2017).

Road Transport – Setting up of independent regulator

At present, there is no independent regulatory authority for the road transportation sector. Current arrangements, both at the Union and State level, give rise to a potential conflict, as the rule-making body is also the implementing body. Consequently, there is no independent assessment of the performance of the State Road Transport Undertakings (SRTUs) across various parameters. Therefore, XIV FC recommended the setting up of independent regulators for the passenger road sector, whose key functions should include tariff setting, regulation of service quality, assessment of concessionaire claims, collection and dissemination of sector information, service-level benchmarks and monitoring compliance of concession agreements.

In its reply, the Karnataka State Road Transport Corporation (KSRTC) (November 2017) stated that no proposal was sent to Transport Department, Government of Karnataka with regard to Setting up of Independent Regulator for the Passenger Road Transport Sector.

1.3.5 Foregone revenue

As per the requirements under Section 5(2) (c) of KFRA, additional statements are brought out in MTFP 2017-21, detailing the tax expenditure/revenue foregone by exemption or deferment of VAT, CST and Entry Tax. The details of such exemptions/revenue foregone during the years 2015-16 to 2016-17 are indicated in **Table 1.17**.

Table 1.17: Details of exemptions/revenue foregone

(₹ in crore)

Particulars	2015-16	2016-17#
Tax expenditure/ revenue foregone under deferment of purchase tax on sugarcane	28.53	45.50
Exemption/ deferment/ re-imbursement of tax	576.02	635.61
Total	**604.55**	**681.11**

Source: MTFP – 2017-21.

#for the first three quarters of 2016-17.

Though the Public Accounts Committee (PAC) in its 13th Report, while recommending a system to oversee the collection of revenue suggested to the State Government to discontinue the practice of giving discounts, waivers and exemptions while collecting taxes, the State Government had failed to adhere to the same.

However, Government contended that the tax concessions in the form of waiver/discount/exemptions are conscious decisions taken by the State as a matter of policy for promoting certain sectors of the economy. Such concessions are provided with the objective of enabling a conducive environment to attract more industries to the State. It has other benefits of providing employment to locals and boosting the economy. It is expected that it will ultimately compensate the revenue foregone by way of improvements in overall tax collection and faster growth of GSDP.

1.4 Capital Receipts

Capital receipts of the State Government include non-debt and debt receipts, whose composition is discussed in **paragraph 1.2.1**. The Public Debt receipts during 2016-17 (₹31,156 crore) comprised internal debt of ₹29,238 crore (94 *per cent*) and Loans and Advances from GOI ₹1,918 crore (six *per cent*). Market borrowings had a major share under internal debt, comprising 82 *per cent* followed by NSSF loans (15 *per cent*) and negotiated loans (three *per cent*). Loans from GOI comprised Plan loans only. The trends in composition of capital receipts during the period 2012-13 to 2016-17 are indicated in **Table 1.18**.

Table 1.18: Trends in growth and composition of capital receipts

(₹ in crore and growth rate in *per cent*)

Sources of State Capital receipts	2012-13	2013-14	2014-15	2015-16	2016-17
Capital Receipts (CR)	13,656	17,484	21,968	21,484	31,283
Misc. Capital Receipts	33	88	10	352	27
Recovery of Loans and Advances	158	109	84	60	100
Public Debt receipts	13,465	17,287	21,874	21,072	31,156
Percentage of Public Debt receipts to total capital receipts	98.60	98.87	99.57	98.08	99.59
Rate of growth of debt capital receipts	43.89	28.38	26.53	(-) 3.67	47.85
Rate of growth of non-debt capital receipts	(-) 42.12	3.14	(-) 52.28	338.30	(-) 69.17
Rate of growth of GSDP	14.56	18.24	12.70	11.42	8.79
Rate of growth of capital receipts (%)	40.96	28.03	25.65	(-) 2.20	45.61

Overall, capital receipts increased from ₹13,656 crore in 2012-13 to ₹31,283 crore in 2016-17. Debt receipts had a predominant share in capital receipts which ranged between 98 and 100 *per cent* during 2012-13 to 2016-17. The recovery towards loans and advances was very meagre during the period. Recovery amounted to less than one *per cent* of the outstanding loans and advances as at the end of 2016-17. It also included book adjustment of ₹9.50 crore being the dues of Electricity Supply Companies (ESCOMs), treated as subsidy on revenue account.

1.5 Public Account Receipts

Receipts and disbursements in respect of certain transactions, such as Small Savings, Provident Fund, Reserve Funds, Deposits, Suspense, Remittances etc., which do not form part of the Consolidated Fund are kept in the Public Account set up under Article 266(2) of the Constitution and are not subject to vote by the State Legislature. Here, the Government acts as a banker/trustee for custody of public money, since these transactions are mere pass through transactions. The net transactions under Public Account covering the period 2012-13 to 2016-17 are indicated in **Table 1.19**.

Table 1.19: Net transaction under Public Account

(₹ in crore)

Resources under sectors of Public Account (Net)	2012-13	2013-14	2014-15	2015-16	2016-17
I. Small Savings, PF etc.,	1,732	3,107	2,156	2,086	2,657
J. Reserve Funds	1,362	1,264	1,547	2,081	6,013
K. Deposits and Advances	2,511	2,840	3,702	284	3,041
L. Suspense and Misc.	98	2,671	3,282	990	491
M. Remittances	(-) 32	(-) 12	(-) 32	(-) 17	(-) 38
Total	**5,671**	**8,870**	**10,655**	**5,424**	**12,164**

The net receipts from Public Account increased from ₹5,671 crore in 2012-13 to ₹12,164 crore (114 *per cent*) in 2016-17. This includes transfer of ₹3,670 crore from General Revenues of the State and ₹952 crore from the Consolidated Fund out of the cess collections to Infrastructure Funds in Public Account. Similarly, an amount of ₹43.82 crore out of cess collections of motor vehicle tax and ₹13.49 crore out of General Revenues of the State was transferred to SUTF in Public Account. Net availability of funds under Reserve Funds, Small

Savings and Provident Fund had a major share in financing the fiscal deficit. The receipts under Deposits and Advances include ₹1,265 crore deposits made in Panchayat Bodies Fund. Under Suspense and Miscellaneous, there was decrease in transactions relating to un-encashed cheques, which amounted to ₹404 crore during 2016-17. An analysis of the transaction is brought out in **paragraph 1.8.6**.

1.6 Applications of resources

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

Prudent fiscal management should aim at creating savings by raising revenue receipts in excess of revenue expenditures. The revenue balance is called Government's saving, which is used to finance capital expenditure. Use of borrowed funds for either directly revenue yielding activities or indirectly productive uses creates returns by way of tax or non-tax revenues, which can be used for debt servicing and repayment of loans.

1.6.1 Growth and composition of expenditure

The basic parameters of total expenditure, growth rate and comparison with GSDP etc., are furnished in the **Table 1.20**.

Table 1.20: Total Expenditure- Basic parameters

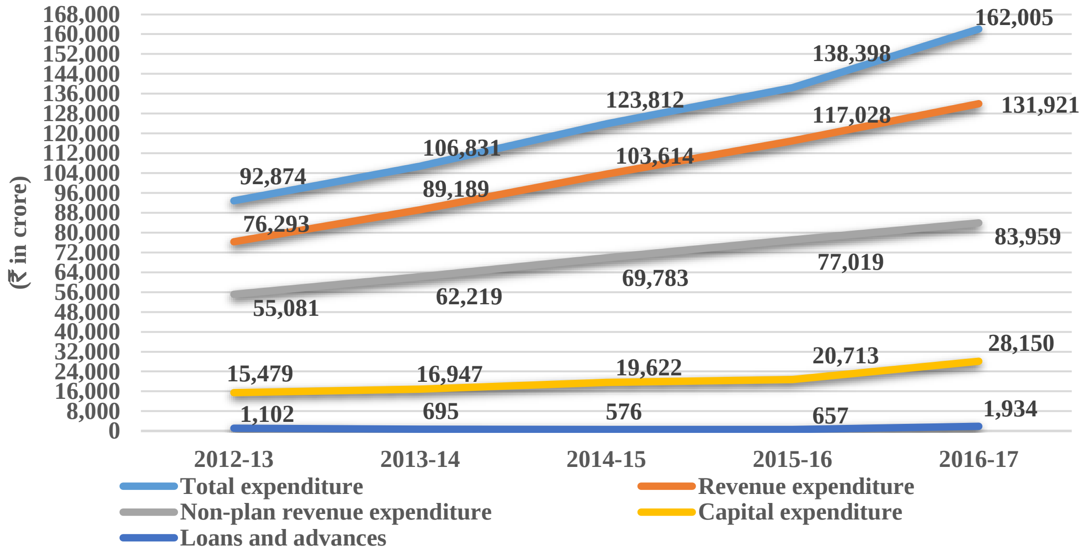
(₹ in crore and growth rate in *per cent*)

	2012-13	2013-14	2014-15	2015-16	2016-17
Total Expenditure (TE)*	92,874	1,06,831	1,23,812	1,38,398	1,62,005
Rate of growth	12.7	15.0	15.9	11.8	17.1
GSDP	6,91,700	8,17,886	9,21,788	10,27,068	11,17,334
Rate of growth	14.56	18.24	12.70	11.42	8.79
TE/GSDP	13.43	13.06	13.43	13.47	14.50
Revenue receipts/TE	84.20	83.80	84.11	85.85	82.23
Revenue expenditure	76,293	89,189	1,03,614	1,17,028	1,31,921
Rate of growth	17.2	16.9	16.2	12.9	12.7
Capital expenditure (including loans and advances)	16,581	17,642	20,198	21,370	30,084
Rate of growth	(-) 4.3	6.4	14.5	5.8	40.8
Buoyancy of total expenditure with					
GSDP	0.9	0.8	1.3	1.0	1.9
Revenue receipts	1.1	1.0	1.0	0.8	1.4
Buoyancy of revenue expenditure with					
GSDP	1.2	0.9	1.3	1.1	1.4
Revenue receipts	1.4	1.2	1.0	1.0	1.0

Source: Finance Accounts.

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

Chart 1.14 presents the trends in total expenditure over a period of five years (2012-13 to 2016-17) and its composition under revenue, capital and loans and advances.



Total expenditure increased by 74 *per cent* from ₹92,874 crore in 2012-13 to ₹1,62,005 crore in 2016-17 due to increase in revenue expenditure (₹55,628 crore), capital outlay (₹12,671 crore) and disbursement of loans and advances (₹832 crore).

During the period 2012-13 to 2016-17, on an average, 83 *per cent* of the total expenditure was on revenue account. During 2016-17, it was 81 *per cent*. The share of capital expenditure (including loans and advances) was 19 *per cent*.

The share of Revenue Expenditure, Capital Expenditure and Loans and Advances for the years 2012-13 to 2016-17 is given in **Table 1.21**.

Table 1.21: Total Expenditure- Trends of Share of its components

(figures in *per cent*)

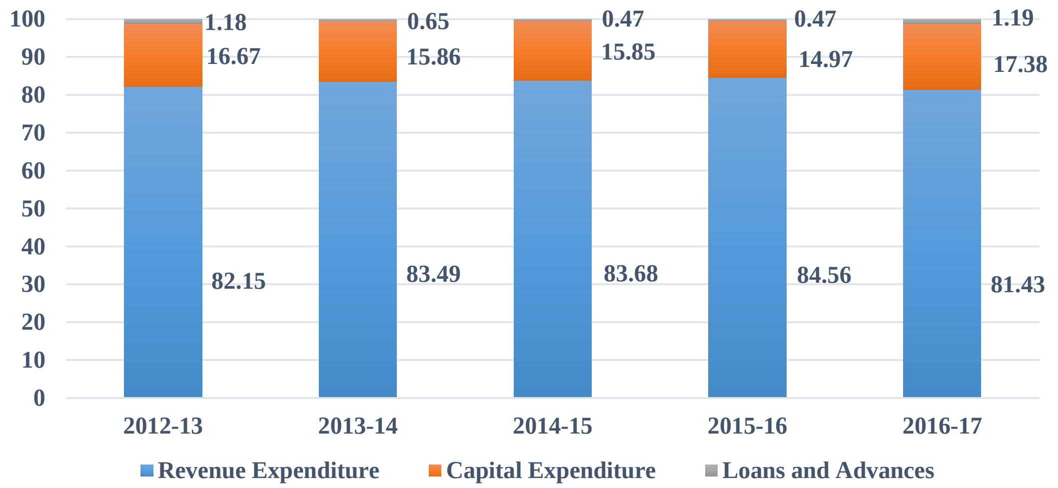
Expenditure	2012-13	2013-14	2014-15	2015-16	2016-17
Revenue Expenditure	82.15	83.49	83.68	84.56	81.43
Capital Expenditure	16.67	15.86	15.85	14.97	17.38
Loans and Advances	1.18	0.65	0.47	0.47	1.19

Source: Finance Accounts of respective years.

Chart 1.15 presents composition of total expenditure over a period of five years (2012-13 to 2016-17).

Chart 1.15: Total expenditure - Trends in share of its components

(share in *per cent)*



Revenue expenditure had a predominant share in total expenditure as around 80 *per cent* of the expenditure was committed expenditure thus leaving little scope for increase in capital expenditure. The trends of total expenditure by activities under General, Social, Economic, Loans and Advances and Grants-in-aid are given in **Table 1.22.**

Table 1.22: Total Expenditure – Trends by activities

(Share in *per cent*)

	2012-13	2013-14	2014-15	2015-16	2016-17
General Services	22.36	23.83	23.33	22.97	19.95
Social Services	35.89	33.39	35.17	37.30	37.93
Economic Services	36.23	37.43	36.17	34.87	37.42
Loan and Advances	1.18	0.65	0.47	0.47	1.19
Grants-in-aid and contributions	4.34	4.70	4.86	4.39	3.51

Source: Finance Accounts of the respective years.

The movement of relative share of these components exhibited relative stability during the period from 2012-13 to 2016-17 with marginal inter-year variations. The share of General Services decreased marginally while the share of Social and Economic Services increased in 2016-17. The share of loans and advances declined sharply from 2012-13 to 2015-16 and increased to 1.19 *per cent* in 2016-17.

The Expenditure Reforms Commission (ERC) in its first report (February 2010) recommended capital investments to be stepped up and protected from fiscal uncertainties through prudent allocations. It also recommended maintaining the capital expenditure (excluding debt servicing) at five *per cent* of GSDP. The ratio of capital expenditure to GSDP, which was at two *per cent* during 2012-13 to 2015-16, however, increased to three *per cent* during 2016-17.

1.6.2 Revenue Expenditure

Revenue expenditure comprises of day-to-day expenditure of the Government, wages and salaries, interest payments, pensions, expenditure on operation and maintenance of capital works, subsidies and transfers to local bodies, co-operatives, Non-Government Organizations (NGO) and others. Expenditure can also be classified into various functional categories such as administrative services, social services and economic services. Expenditure on social and economic services is incurred to create physical infrastructure and human resource development and, therefore, is considered productive, whereas expenditure on general administration and debt servicing are considered unproductive.

Revenue expenditure increased from ₹76,293 crore in 2012-13 to ₹1,31,921 crore in 2016-17, an increase of 73 *per cent*. The revenue expenditure buoyancy during 2016-17 was 1.4 times compared to GSDP. Compared to the previous year, the increase was 13 *per cent*, due to increase in salary expenditure (₹934 crore), interest payments (₹1,507 crore), pensions (₹44 crore) and devolution to local bodies (₹2,303 crore) etc.

The revenue expenditure during 2016-17 also included ₹4,204.65 crore provided as Guarantee Commission[4] (₹52.91 crore), Adjustment of interest on Fund/GP Fund balances (₹1,164.21 crore), Adjustment of interest on fund balances under Karnataka Government Insurance Schemes (₹739.58 crore), Adjustment of interest on GP Fund balances under Karnataka General Provident Fund (₹988.28 crore), ESCOMs (₹1,259 crore) being the dues of electricity tax etc., treated as subsidy and adjustment of interest on Capital invested in Government Commercial Undertakings (GCU's) (₹0.67 crore) through book adjustment.

1.6.3 Committed Expenditure

Most of the revenue expenditure is in the nature of committed expenditure on salaries, interest, pension, subsidy etc., which affects the maneuverability of the State in prioritising expenditure and in meeting capital investments to meet growing needs of social and economic infrastructure. The expenditure on these components and also certain other expenses such as pensions under social security schemes, implicit subsidies arising under various schemes of the Government, Grant-in-aid & financial assistance, administrative expenses, devolution to local bodies etc., which are treated as committed expenditure from time to time in MTFP 2017-21 covering the period 2012-13 to 2016-17 is depicted in **Table 1.23** and **Chart 1.16**.

Table 1.23: Trends in Committed Expenditure

(₹ in crore)

Sl. No.	Particulars	2012-13	2013-14	2014-15	2015-16	2016-17 BE	2016-17 Actuals
1	Salaries* of which	16,308	18,027	19,952	20,774	23,779	21,708
	Non-plan head	8,324	15,211	16,733	17,342		18,366
	Plan Head**	7,984	2,816	3,219	3,432		3,342
2	Interest payments#	7,454	8,027	9,804	11,343	12,672$^{@}$	12,850
3	Expenditure on pensions	7,227	9,152	10,118	11,251	12,123	11,295
4	Social Security Pensions	1,880	1,870	2,322	2,247	3,966	2,503

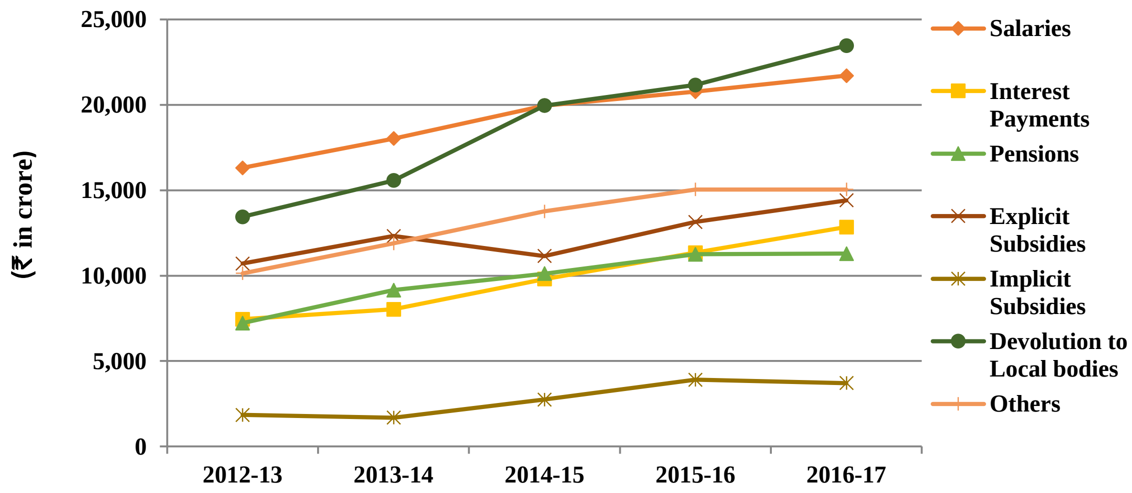
[4] Rajiv Gandhi Rural Housing Corporation Ltd., (₹24.22 crore), Karnataka Slum Development Board (₹0.04 crore), Karnataka State Co-operative Marketing Federation Limited (₹22.64 crore), Karnataka Road Development Corporation Limited (₹5.08 crore) and Karnataka Police Housing Corporation (₹0.93 crore).

Sl. No.	Particulars	2012-13	2013-14	2014-15	2015-16	2016-17	
						BE	Actuals
5	Subsides of which						
	Explicit	10,709	13,323	11,153	13,149	18,492	14,387
	Implicit	1,849	1,690	2,973	3,913		3,714^
6	Grants-in-aid and financial assistance	6,898	8,471	9,737	10,840	9,580	13,163
7	Administrative Expenses	1,358	1,549	1,708	1,958	2,412	1,966
8	Devolution of Local Bodies	13,445	15,570	19,952	21,163	22,676	23,466
9	**Total Committed Expenditure**	**67,128**	**77,679**	**87,719**	**96,638**	**1,05,700**	**1,05,052**
10	**Revenue receipts**	**78,176**	**89,542**	**1,04,142**	**1,18,817**	**1,30,758**	**1,33,214**
11	Revenue receipts of which, committed expenditure as % of revenue receipts (9/10)	86	87	84	81	81	79

** Includes salaries paid out of grants-in-aid released to PRIs and others.*
*** Includes the salaries paid under centrally sponsored schemes.*
 # Includes interest on off-budget borrowings.
@ includes interest pertaining to 2049 only.
^ Excludes subsidy under Indira Awas Yojana, which was released as financial assistance.

The ratio of committed expenditure to revenue receipts was steadily increasing from 2012-13 to 2013-14 and there was decreasing trend from 2014-15 onwards. The high percentage of committed expenditure to revenue receipts indicates that the State has limited flexibility in allocation of its resources for new schemes. Medium term correction on the expenditure side is required to moderate such committed expenditure. There is also increasing demand on the public resources in the light of statutory legislation like Right to Education, Food Security Act and Employment Guarantee measures. These emerging concerns necessitate a review of public resources as a whole to assess their allocative and technical efficiency.

Chart 1.16: Committed expenditure during 2012-17



Expenditure on salaries

Expenditure on salaries increased from ₹16,308 crore in 2012-13 to ₹21,708 crore in 2016-17. It grew by four *per cent* over the previous year. It was noticed that the Finance Accounts captured data on salaries only in respect of State Sector, whereas the salary expenditure in case of PRIs (to the tune of ₹11,918 crore) was not captured. Since the salaries in respect of PRIs are released as grant-in-aid, the total salary expenditure is not reflected in the accounts. The salary expenditure excluding the salary grant relating to Urban Local Bodies (ULBs) of the State was 20 *per cent* of the revenue expenditure net of interest payment and pensions, which was within the norm of 35 *per cent* fixed by the Twelfth Finance Commission (TFC).

Finance Department replied (November 2014) that grants to PRIs/ULBs are released as lump sum grants as per constitutional requirement. Further, scheme wise breakup of salary and non-salary items is available in the link volumes. As such, the information is already being captured as part of PRI/ULB accounts.

PAC in its 5th Report (July 2015) reiterated its recommendation that the data of the district sector, relating to details of salary be consolidated for exhibition in the Appendix of Finance Accounts.

Also, the salary expenditure relating to the employees of ULBs overlapped with those under the State sector (Constitutional dignitaries). This is discussed in **paragraph 2.4.1.6**.

Misclassification of salary expenditure under capital section amounting to ₹13.23 crore instead of under revenue during 2016-17 is discussed in **paragraph 2.4.1.1**.

Pension Payments

The expenditure on pension (₹11,295 crore) during 2016-17 was short of MTFP (2013-17) projections by ₹1,494 crore. There was a moderate increase in expenditure over the previous year (₹44 crore).

Defined Contribution Pension Scheme known as New Pension Scheme (NPS), for all employees who joined the State Government service on or after 01 April 2006, became fully operational from 01 April 2010. A dedicated NPS Cell was created under the Directorate of Treasuries to operationalise NPS in the State. The State Government adopted NPS architecture designed by the Pension Fund Regulatory Development Authority (PFRDA) and appointed the National Securities Depository Limited (NSDL) as the Central Record Keeping Agency (CRA) for NPS. Bank of India is the Trustee Bank in charge of operation of Pension Funds. The security of investment of the pension corpus is also given primacy by mandating that 85 *per cent* of corpus be invested in bonds and fixed maturity investments and the remaining 15 *per cent* in equity and equity related instruments. The employees are given an option to pay their backlog either in lump sum outside salary or in multiple installments through salary deductions.

The New Pension Implementation Cell (NPIC) stated that (June 2017) there were 1,77,962 officials registered in the State and allotted Permanent Retirement Account Number (PRAN) as on 31 March 2017. An amount of ₹460.94 crore was contributed towards the scheme by the Government through revenue account. Employees' contribution of ₹565.97 crore (Regular + Backlog contribution) for the current year was also accounted against the scheme. The employee recoveries and backlog[5] contribution as on 31 March 2017 was ₹2,239.16 crore and the matching contributions made by State Government since inception of the scheme was ₹1,978.00 crore.

From fund balance, ₹900.08 crore was transferred to NSDL/Trustee bank, leaving net balance of ₹37.64 crore (Employees' contribution, Government's contribution and backlog/interest) under Major Head 8342 and Minor head 117-Defined Contribution Pension Scheme for Government Employees. The discrepancy was due to misclassification by the Director of Treasuries and needs to be reconciled. Un-transferred amounts with accrued interest represent outstanding liabilities of the Government. During 2016-17, ₹4.61 crore was paid from the Consolidated Fund as 'New Contributory Pension Schemes – Extension of benefit to the cases of persons/families who retire/died while in service' and were covered under NPS.

As per List of Major and Minor Heads (LMMH), the interest paid on Government backlog contributions in respect of New Pension Scheme recovery should be accounted under separate Major Head 2049-Interest Payments-03-117-Interest on Defined Contribution Pension Scheme (DCPS). During 2016-17, ₹6.35 crore was accounted under 2071-117 instead of under 2049-117 as interest. The progressive interest paid on the Government backlog contribution till 31-03-2017 was ₹70.21 crore. Finance Department replied (September 2017) that there was no Head of Account 2049-03-117-0-01 created in the database yet. As such for the year 2017-18, for the expenditure incurred under 2071-01-101-3-01 and 2071-01-117-0-01 towards interest on Government backlog contributions in respect of NPS will be transferred to the Head of Account 2049-03-117-0-01 by making a suitable provision in Supplementary Estimates-II of 2017-18. Thus, during 2016-17 the expenditure stood overstated under 2071 and stood understated under 2049 due to not carrying out of correction slip issued to List of Major and Minor Head (LMMH) by CGA.

Vide correction slip No. 793 effective from 2015-16 issued to LMMH a new minor head '119' below the functional Major head "2071 – Pension & Retirement benefits" was opened to account the expenditure towards service charges paid to NSDL. Accordingly, for the year 2016-17, ₹4.50 crore was paid to NSDL towards service charges under NPS and accounted under HOA '2071-01-119-0-01-NP'.

Government in its GO dated 30.01.2014 issued the detailed procedure for effecting NPS deductions of Government employees on foreign services to Boards/Corporations/Societies/Universities/State Aided Institutions/State Autonomous Bodies under all Ministries and Departments of State Government. For effecting NPS deductions, NPS cell stated that (July 2017), a unique Non-Treasury PAO/DDO code was allocated to 40 organisations, of which 20 organisations were registered by CRA as on 31.03.2017 and allotted PAO and DDO registration numbers.

[5]Refers to the contribution, the employee has to make from the date of his entry into service to the date of implementation of the scheme.

The payment of pension and other retirement benefits to All India Service (AIS) officers prior to 01 April 2008, was a liability to be borne by the State Government. The liability on account of pension payments that are to be borne by GOI from April 2008 are to be booked under suspense head – 8658 and a demand raised for reimbursement. At the end of March 2017, ₹50.65 crore was outstanding for settlement, when compared to ₹9.12 crore (March 2016), implying that the State Government was yet to receive amount due to it.

Out of outstanding amount of ₹50.65 crore for the year 2016-17, ₹3.63 crore was cleared in the accounts for August 2017 and the demand draft for ₹4.36 crore received from Central Pension Accounts Office (CPAO) was remitted into State Bank of India, Treasury branch, Bengaluru on 31 October 2017.

Interest Payments

Interest payments increased by ₹5,396 crore from ₹7,454 crore in 2012-13 to ₹12,850 crore in 2016-17. Interest payments during 2016-17 constituted interest on internal debt (₹9,578 crore), interest on small savings, provident fund etc., (₹1,904 crore), interest on loans and advances from the Central Government (₹659 crore) and interest on off-budget borrowings (₹817 crore).

The interest on internal debt increased by 17 *per cent* from ₹8,221 crore in 2015-16 to ₹9,578 crore in 2016-17 on account of increase in payment of interest on market loans by ₹1,198 crore (20 *per cent*), interest on special securities by ₹144 crore (seven *per cent*) issued to NSSF of the Central Government by the State Government and management of debt by ₹15 crore (94 *per cent*).

The interest on small savings, provident funds etc. increased by ₹60 crore (three *per cent*) from ₹1,844 crore during 2015-16 to ₹1,904 crore in 2016-17, mainly on account of increase in interest on State Provident funds and insurance and pension funds by three *per cent*.

Due to non-effecting of correction slip issued by CGA by booking the interest on DCPS under 2071 instead of under 2049, it stood understated and the interest payments to revenue receipts ratio was very close to 10 *per cent* as prescribed by XIV FC.

Subsidies

Subsidy expenditure increased from ₹10,709 crore in 2012-13 to ₹14,387 crore during 2016-17, which was 11 *per cent* of revenue receipts.

Explicit Subsidies

In MTFP (2013-17), the Government stated that subsidies provided by the State is of two kinds – explicit and implicit subsidies. Explicit subsidy provides for expenditure in the form of a subsidy or interest subvention for certain schemes of the Government. It was stressed that the challenge lies in ensuring that these subsidies do not become a permanent source of additional support and thereby deter these sectors from undertaking reforms. The three largest explicit subsidy outgoes for the State were power subsidy provided for supply of free electricity to farmers for usage of agricultural pump sets, food subsidy and interest subsidy for crop loans. Finance Accounts (Appendix-II) showed an explicit subsidy of ₹14,387 crore during 2016-17, which was ₹1,238 crore more than the previous year. The increase was nine *per cent* over the previous year. The details are given below.

Power

During 2016-17, subsidy to the power sector (₹8,647 crore) accounted for 60 *per cent* of the total subsidy (₹14,387 crore). It included financial assistance to electricity supply companies towards subsidy for supply to Irrigation Pump (IP) sets, Bhagya Jyothi (BJ)/Kutira Jyothi (KJ) consumers (₹8,647 crore). The power subsidy included book adjustment of ₹1,268.26 crore, of which, ₹1,218.83 crore was the tax dues retained by ESCOMs against power subsidy due.

Though Government stated (November 2007) that the Karnataka Power Transmission Corporation Limited (KPTCL) would be reflected as an off-budget entity in the budget documents, this was not complied with. Also subsidy of ₹8.95 crore given to KPTCL for meeting its debt servicing obligations to the Power Finance Corporation (PFC) and Rural Electrification Corporation (REC), was not captured under revenue account.

Food

Food subsidy to meet the differential cost of food grains in 2016-17 is ₹1,854 crore, which includes subsidy towards Annabhagya for BPL beneficiaries towards subsidies for food grains (₹1,171 crore), Annabhagya for BPL beneficiaries towards subsidies for other items (₹620 crore) and Annabhagya for Above Poverty Line (APL) beneficiaries towards subsidies for food grains (₹9 crore) and Sugar (₹54 crore).

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 to ₹6,234 crore (₹1,323 crore in 2012-13, ₹2,704 crore in 2013-14, ₹624 crore in 2014-15, ₹765 crore in 2015-16 and ₹818 crore in 2016-17).

According to the Vaidyanathan Committee Report (March 2008), and as reiterated by PAC, the Government 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 the health of the co-operative credit system.

Transport

Transport subsidy increased from ₹748 crore in 2015-16 to ₹799 crore in 2016-17. This subsidy was mainly towards fare concession extended to students, freedom fighters, physically challenged, etc. It also included book adjustment of ₹291.39 crore being the motor vehicle tax dues of transport corporations, adjusted as subsidy towards concession value of bus passes issued to students, senior citizens, blind, handicapped and free bus passes provided to ex-MLAs and MLCs.

Implicit Subsidies

Implicit subsidies *inter alia* arise when the Government is unable to recover the costs it incurs on the provision of social and economic goods/services, even though sometimes these may have extended benefits. They can be indirect, in kind or take the shape of tax concessions. Some of the implicit subsidies extended during 2016-17 are detailed in **Appendix 1.5**.

The implicit subsidies increased from ₹1,849 crore in 2012-13 to ₹3,714 crore during 2016-17. They mainly include financial assistance for supply of seeds, weaver's package, Ashraya scheme, micro/drip irrigation, minimum floor price scheme, housing for weaker sections, house site for landless etc.

During 2016-17 also, the subsidy under Indira Awas Yojana (₹962.99 crore) was accounted for under HOA '2216-80-198-6-02-300(P)' as financial assistance/block grant to ZPs instead of for under HOA '2216-80-103-0-21' (Indira Awas Yojana) & '2216-80-800-0-04' (Indira Awas Yojana – State share).

1.6.4 Financial assistance to local bodies and other institutions

The quantum of assistance provided by way of grants to local bodies and other institutions during 2016-17, relative to the previous years, is presented in **Table 1.24**.

Table 1.24: Financial assistance to local bodies and other institutions

(₹ in crore)

	2012-13	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Panchayat Raj Institutions	18,532.58	20,512.71	24,991.27	26,694.94	29,697.94
Urban Local Bodies*	4,018.42	5,020.43	6,011.45	6,076.05	5,685.58
Educational Institutions (including Universities)	738.69	961.62	1,145.04	1,406.50	1,449.75
Co-operative societies and co-operative institutions	47.04	849.85	818.09	1,023.13	1,009.47
Other institutions and bodies (including statutory bodies)	3,850.11	5,267.90	5,782.63	4,820.87	6,656.29
Assistance as a percentage of revenue expenditure	36	37	37	34	34
Total	**27,186.84**	**32,612.51**	**38,748.48**	**40,021.49**	**44,499.03**

Source: Finance Accounts.

**the figures under assistance to Urban Local Bodies differs from those shown in the earlier reports on account of inclusion of devolutions under the Minor Head 200 – Other compensations and assignment.*

As a sequel to the recommendations of the Eleventh Finance Commission, grants are released to PRIs under three distinct programme minor heads namely 196, 197 and 198. The assistance to PRIs increased from ₹18,533 crore in 2012-13 to ₹29,698 crore in 2016-17, while the assistance to ULBs increased from ₹4,018 crore in 2012-13 to ₹5,686 crore in 2016-17.

Out of the total devolution of ₹29,698 crore to PRIs during 2016-17, ₹11,918 crore (40 *per cent*) was towards salaries as the State Government's functions *viz*., education, water supply and sanitation, housing, health and family welfare etc., were transferred to PRIs. It also included XIV FC grants released to the State Government (₹1,547.66 crore).

The assistance to ULBs decreased by ₹390 crore and to Co-operatives by ₹14 crore respectively, as compared to the previous year. It increased for educational institutions by ₹43 crore and by ₹1,835 crore during 2016-17 for other institutions. The assistance to ULBs included ₹2,190 crore towards creation of capital assets. It also included XIV FC grants released to the State Government (₹1,007.99 crore).

Assistance to other institutions (₹6,656 crore) included assistance to Development Authorities (₹1,853 crore), NGOs (₹1,772 crore), PSUs (₹25 crore) and others (₹3,006 crore).

1.7 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 public expenditure (i.e., adequate provisions for providing public services), efficiency of expenditure, and its effectiveness.

1.7.1 Adequacy of public expenditure

The expenditure responsibilities relating to the 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) is attached to a particular sector if the priority given to that particular head of expenditure is below the General Category States' (GCS) average for that year.

Table 1.25 analyses the fiscal priority of the State Government with regard to development expenditure, social expenditure and capital expenditure relative to GCS in 2013-14 and the current year 2016-17.

Table 1.25: Fiscal priority of the State in 2013-14 and 2016-17

Fiscal priority by the State	AE/ GSDP	DE#/ AE	SSE/ AE	CE/ AE	Education/ AE	Health/ AE
General Category States* Average (Ratio) 2013-14	14.80	70.00	38.20	13.70	17.70	4.60
Karnataka (Ratio) 2013-14	13.06	71.45	33.79	16.51	15.49	4.24
General Category States* Average (Ratio) 2016-17	16.70	70.90	32.20	19.70	15.20	4.80
Karnataka (Ratio) 2016-17	14.50	76.53	38.96	18.57	13.08	4.25

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, data is as per the Government of India conveyed figures, adopted by the State Government in its budget documents.
**refer note in Appendix 1.1.*

Comparative analysis reveals the following:

- The State's spending ratio of aggregate expenditure to GSDP increased during 2016-17 compared to 2013-14. However, ratio is less than that of GCS;

- Development expenditure as a proportion of aggregate expenditure in the State was higher than GCS 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, was lower than that of GCS in 2013-14 and higher in 2016-17. As observed from the **Table 1.25**, adequate priority needs to be given to both education and health sectors as the ratio under both these sectors was well below GCS average during 2013-14 and 2016-17; and
- The State's ratio of expenditure on education was less than the average ratio of General Category State in 2013-14 and 2016-17, which implied that there was low priority by the State in the said area. However, as per the census of 2011, the State had a literacy rate of 75.40 *per cent*.

1.7.2 Efficiency of expenditure

In view of the importance of public expenditure on social and economic development, it is imperative for the State Government to take appropriate expenditure rationalisation measures with more emphasis on development expenditure. The higher the ratio of these components to total expenditure, the better will be the quality of expenditure. **Table 1.26** presents the trends in development expenditure relative to the aggregate expenditure of the State during 2016-17 *vis-à-vis* that of previous years.

Table 1.26: Development expenditure

(₹ in crore)

	2012-13	2013-14	2014-15	2015-16	2016-17
Development Expenditure (DE)	68,067	76,328	88,904	1,00,441	1,23,988
Percentage of DE to total expenditure	73	71	72	73	77
Components of DE					
Revenue	52,094 (76)	59,215 (77)	69,337 (78)	80,153 (80)	94,970 (76)
Capital	14,889 (22)	16,446 (22)	19,004 (21)	19,722 (20)	27,090 (22)
Loans and Advances	1,084(2)	667(1)	563(1)	566(-)	1,928(2)

Source: Finance Accounts.

Figures in brackets indicate percentage to development expenditure.

Development expenditure increased from ₹68,067 crore in 2012-13 to ₹1,23,988 crore in 2016-17. As a percentage of total expenditure, it decreased from 73 in 2012-13 to 71 in 2013-14 and thereafter increased to 77 *per cent* during 2016-17. On an average, 77 *per cent* of the development expenditure was on revenue account while capital expenditure, including loans and advances accounted for the balance during 2012-13 to 2016-17. In 2016-17, expenditure on salary (₹16,149 crore) and subsidy (₹14,364 crore) formed two major components of development revenue expenditure.

Table 1.27 provides the details of capital expenditure and the components of revenue expenditure incurred on salaries and maintenance of the selected social and economic services.

Table 1.27: Efficiency of expenditure in selected social and economic services

(ratio in *per cent*)

Sector	2015-16			2016-17		
	Ratio of capital expenditure to total expenditure	Revenue expenditure		Ratio of capital expenditure to total expenditure	Revenue expenditure	
		Salaries and wages	Operation and Maintenance		Salaries and wages	Operation and Maintenance
Social Services						
Education, sports, art and culture	0.52	8.68	0.01	0.68	8.25	0.01
Health and family welfare	0.59	1.96	0.01	0.50	1.63	0.01
Water Supply, sanitation, housing and urban development	1.42	0.08	0.12	2.61	0.09	0.11
Others	1.55	0.55	0.02	1.54	0.51	0.02
Total (SS)	**4.08**	**11.27**	**0.16**	**5.29**	**10.48**	**0.15**
Economic Services						
Agriculture and allied activities	0.14	1.04	0.04	0.34	0.94	0.04
Irrigation and flood control	5.02	0.12	0.29	5.33	0.10	0.26
Power and energy	0.06	-	-	0.57	-	-
Transport	3.90	0.07	0.62	4.71	0.05	0.56
Others	1.46	0.74	0.02	1.69	0.67	0.03
Total (ES)	**10.58**	**1.97**	**0.97**	**12.62**	**1.76**	**0.89**
Total (SS+ES)	**14.66**	**13.24**	**1.13**	**17.91**	**12.24**	**1.04**

Source: Finance Accounts.

Expenditure on Social Services

Capital expenditure on social services increased from ₹5,641 crore in 2015-16 to ₹8,571 crore in 2016-17 and the ratio of capital expenditure to total expenditure increased from 4.08 *per cent* in 2015-16 to 5.29 *per cent* in 2016-17. The share of salary expenditure (under social services) in total revenue expenditure was 10 *per cent* in 2016-17 (**Table 1.27**).

Expenditure on Economic Services

Capital expenditure on economic services increased from ₹14,647 crore in 2015-16 to ₹20,447 crore in 2016-17. The share of salary expenditure (under economic services) in total revenue expenditure was two *per cent* during 2016-17 (**Table 1.28**).

The priority sectors identified by the Government in respect of economic services were agriculture, rural development, irrigation and flood control, transport, industries and minerals. In 2016-17, capital outlay was higher by ₹2,224 crore, ₹1,680 crore, ₹812 crore, ₹319 and ₹43 crore under transport, irrigation and flood control, energy, agriculture and rural development respectively, while under industries and minerals and special areas programmes it was lower by ₹238 crore, and ₹10 crore, respectively compared to the previous year.

1.8 Financial Analysis of Government expenditure and investments

In the post KFRA framework, the Government is expected to keep its fiscal deficit (borrowing) at low levels and still 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 rather than bearing the same in the form of implicit subsidy, recover cost of borrowed funds 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 2016-17 *vis-à-vis* previous years.

1.8.1 Incomplete projects

Locking up of funds in incomplete works, which includes works stopped due to reasons like litigation, etc., impinge negatively on the quality of expenditure. The department-wise information pertaining to incomplete projects as on 31 March 2017 is given in **Table 1.28**.

Table 1.28: Incomplete projects

(₹ in crore)

Department	Incomplete Projects*				Cumulative expenditure as of March 2017
	Number	Budgeted Cost	Cost over run		
			Number	Amount	
Public Works					
Buildings	67	353.81	9	10.75	282.83
Roads and Bridges	232	1,798.08	74	68.93	1,682.66
Irrigation	42	76.19	5	0.62	61.12
Total	**341**	**2,228.08**	**88**	**80.30**	**2,026.61**

Source: Finance Accounts.

**Projects scheduled to be completed on or before 31 March 2017 are included.*

Against the initial budgeted cost of ₹2,228.08 crore in respect of 341 works, stipulated to be completed on or before March 2017, the progressive expenditure was ₹2,026.61 crore as on 31 March 2017, out of which, in 88 cases, the cost overrun aggregated ₹80.30 crore. No reasons for delay in completion of the works was given by the Public Works and Irrigation Departments.

1.8.2 Investment and returns

The investment of the Government in the share capital of Companies/Corporations etc., as brought out in Finance Accounts include the expenditure under the heads of account 4225-107 - Investment in Credit Co-operatives, 4225-108 - Investment in other Co-operatives, 4405-00-191 - Fishermen Co-operatives, and 4851-00-108-01 - Share Capital Assistance to Power Loom Co-operative Societies and the minor heads 190 – Investments in Public Sector and Other undertakings and 195 - Investment in Co-operatives under the various Capital Outlay heads.

Sick /non-working PSUs/Departmentally managed organisations

As on 31 March 2017, the Government invested ₹63,115 crore, in 84 Government Companies (₹57,674 crore including investment of ₹68 crore in 16 non-working Government Companies), Nine Statutory Corporations (₹2,520 crore), 43 Joint Stock Companies (₹2,524 crore), and Co-operative Institutions, Local bodies and Regional Rural Banks (₹397 crore). The return from investment was negligible **(Table 1.29)**.

Table 1.29: Return on investment

	2012-13	2013-14	2014-15	2015-16	2016-17
Investments at the end of the year (₹ in crore)	49,463.80	55,048.00	61,726.92	61,335.89	63,115.06
Return(₹ in crore)	56.29	55.49	74.84	69.40	82.50
Return(*per cent*)	0.1	0.1	0.1	0.1	0.1
Average rate of interest on Government borrowings (*per cent*)	6.6	6.2	6.5	6.5	6.3
Difference between interest rate and return (*per cent*)	6.5	6.1	6.4	6.4	6.2

Though the State Government accepted that the return on these investments was meager, it stated that it would not shy away from investing in social infrastructure involving long gestation and pay back periods. The Government further stated that efforts will be made to ensure due returns. Audit found that MTFPs placed before the Legislatures did not contain a road map for ensuring proper return on investments.

In addition, investment of ₹916.61 crore in respect of five[6] Companies/ Corporations was lying in Public Account as at the end of March 2017 without actual utilisation by the institutions. This resulted in locking up of funds in the Public Account. Efforts should be made for proper utilisation of these funds and a system should be put in place for scrutiny of proposals received from the companies seeking funds before releasing further money from the Consolidated Fund.

With regard to large sums remaining unutilised by certain entities, the Finance Department replied (October 2015) that a committee called Off Budget Borrowing Monitoring Committee (OMC) was constituted under the chairmanship of the Principal Secretary to Government, Finance Department, that has the power to review the status of the existing loan or bond and suggest action as may be required in the overall interest of the finances of the Board /Corporation. The Finance Department also stated (October 2015) that before releasing the amount towards payment of principal and interest, the utilisation of previous year's principal repayment and interest was also being ensured.

Out of the total investment of ₹63,115 crore upto the end of March 2017, ₹60,139 crore (95 *per cent*) were invested in 77 Government Companies and Statutory Corporations under irrigation sector (₹36,779 crore), transport sector (₹2,399 crore), infrastructure sector (₹4,251 crore), power sector (₹10,120 crore), industries sector (₹850 crore), housing sector (₹1,451 crore), financing sector (₹2,932 crore), construction sector (₹2 crore), social sector (₹1,267 crore) and other sectors (₹88 crore). The investment included ₹24,474 crore (39 *per cent*) in the following Companies/Corporations, which were running under losses and where the investments were substantial (**Table 1.30**).

[6] Krishna Bhagya Jala Nigam (₹629.26 crore), Karnataka Urban Infrastructure Development and Finance Corporation (₹177.83 crore), Karnataka Neeravari Nigam Limited (₹49.09 crore), Karnataka Rural Infrastructure Corporation Limited (₹53.30 crore), Karnataka Slum Development Board (₹7.13 crore).

Table 1.30: Investment in Companies/Corporation under loss

(₹ in crore)

Company/Corporation	Investment up to 2016-17	Cumulative loss	Cumulative loss to the end of
North Western Karnataka Road Transport Corporation	266.85	562.17	2014-15
North Eastern Karnataka Road Transport Corporation	183.43	432.74	2014-15
Krishna Bhagya Jala Nigam Limited	23,745.34	564.64	2015-16
The Mysore Sugar Company Limited	278.78	289.42	2012-13
Total	**24,474.40**	**1,848.97**	

Source: Finance Accounts.

During 2016-17, the Government invested ₹123 crore in these companies and the cumulative loss decreased by ₹45 crore over the previous year. During 2016-17 the Government invested ₹1,558.57 crore, in Statutory Corporations (₹75.00 crore), Government Companies (working) (₹1,466.52 crore) and co-operative institutions (₹17.05 crore).

1.8.3 Investment in Public Private Partnership (PPP) Projects

Recourse to 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 are in the sectors of transport, agri-infrastructure, education, health, tourism, urban and municipal infrastructure and energy. The Infrastructure Development Department was established to play a significant role in the areas of developing air, train and maritime connectivity for the State and in promoting increased private investment in public infrastructure through PPP.

The summary of PPP projects that are completed, under implementation/ construction and in operation/planning/pipeline as on 31 March 2017 are detailed in **Table 1.31**.

Table 1.31: Sector and stage-wise 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	105.90	12	5,439.00	13	5,544.90
Education	-	-	-	-	-	-	-	-
Energy	-	-	-	-	1	20.00	1	20.00
Health	-	-	-	-	1	0.00	1	0.00
Industrial Infrastructure (including IT Parks and Telecommunications)	-	-	-	-	10	61,851.50	10	61,851.50
Roads and Bridges	6	983.34	3	1,085.35	28	41,438.00	37	43,506.69
Tourism	1	32.00	1	108.00	20	1,982.00	22	2,122.00
Transportation & Logistics excluding Roads and Bridges	2	2,763.29	3	60.82	19	23,483.00	24	26,307.11
Urban & Municipal Infrastructure	7	325.00	1	40.00	54	34,284.00	62	34,649.00
Total	**16**	**4,103.63**	**9**	**1,400.07**	**145**	**1,68,497.50**	**170**	**1,74,001.20**

Source: PPP Cell of Infrastructure Development Department.

From the table it is seen that as on 31 March 2017, 16 projects were completed at a cost of ₹4,103.63 crore. Another nine projects of ₹1,400 crore are under implementation and 145 projects of ₹1,68,498 crore were under pipeline/ planning.

1.8.4 Departmental Undertakings

Nineteen undertakings of certain Government departments performed activities of a quasi-commercial nature. According to the latest accounts furnished by six undertakings, the State Government's investment in these undertakings was ₹9.64 crore. The total loss incurred by these undertakings was ₹6.09 crore. Details are furnished in **Appendix 1.6**.

In view of the continued losses sustained by these undertakings, there is a need for reviewing their working so as to wipe out their losses in the short term and make them self-sustaining in the medium to long term.

State Government assured PAC in December 2013 that the departments would be advised to expedite the conduct of review on the working of these undertakings and submit the findings of the review to FD and PAC. The outcome of the review is yet to be received.

1.8.5 Loans and advances by the State Government

In addition to investments in Companies, Corporations and Co-operative Institutions, the Government also provided loans and advances to many institutions. **Table 1.32** presents the position of outstanding loans and advances as on 31 March 2017 and interest receipts *vis-à-vis* interest payments during the last five years.

Table 1.32: Average interest received on loans advanced by the State Government

(₹ in crore)

	2012-13	2013-14	2014-15	2015-16	2016-17
Opening balance	11,198	12,142	12,724*	13,216	13,813
Amount advanced during the year	1,102	695	576	657	1,934
Amount repaid during the year	158	109	84	60	100
Closing balance	12,142	12,729	13,216	13,813	15,648
Net addition	944	586	492	597	1,835
Interest receipts	247	235	127	264	145
Interest receipts as *per cent* to outstanding loans and advances	2.2	1.9	1.0	1.9	0.9
Interest payments as *per cent* to outstanding fiscal liabilities of the State Government	6.2	5.8	6.0	6.2	5.8
Difference between interest receipts and interest	-4.0	-3.9	-5.0	-4.3	-4.9

Source: Finance Accounts.

**differs by ₹5 crore on account of conversion of outstanding loans into equity in respect of M/s MSIL during 2014-15.*

Loans outstanding as on 31 March 2017 aggregated to ₹15,648 crore. Interest spread of Government borrowings was negative during 2012-13 to 2016-17, which meant that the State's borrowings were more expensive than the loans advanced by it.

The amount advanced during 2016-17 was ₹1,934 crore. Repayment of loans during 2016-17 aggregated ₹100 crore.

Detailed accounts of recovery of loans which are maintained in the office of the AG (A&E) indicated that arrears in recovery of loans and advances aggregating ₹6,973 crore (Principal: ₹4,069 crore and Interest: ₹2,904 crore) were overdue as on 31 March 2017 from 21 institutions (**Appendix 1.7**).

Information in respect of overdue principal and interest contained in Statement No.7 of Finance Accounts is incomplete, as only 16 out of 842 institutions in respect of whom the detailed accounts are maintained by the Heads of Departments/Chief Controlling Officers of the Government of Karnataka, furnished the required information. Indian Government Accounting Standards (IGAS)-3 requires disclosure of loans that were sanctioned without specific terms and conditions governing such loans. Out of the 53 loans valued at ₹1,934.38 crore sanctioned by the State Government in 2016-17, 29 loans valued at ₹1,777.42 crore were sanctioned without specifying any terms and conditions. Details are available as additional disclosures under Statement No.18 of the Finance Accounts.

The Finance Department stated (November 2014) that the department of treasuries will be directed to categorically check whether GOs pertaining to release of loan amounts adhere to the instructions delineated in general loan GO issued by the Finance Department in November 2013. It was observed in audit that even after the issue of instructions, compliance was poor.

1.8.6 Cash balances and investment of cash balances

Table 1.33 depicts the cash balances and investments made by the State Government during 2016-17.

Table 1.33: Cash balances and their investments

(₹ in crore)

	Opening Balance on 01-04-2016	**Closing Balance on 31-03-2017**	**Increase (+)/ Decrease (-)**
a) General cash balance			
Cash in treasuries	-	-	-
Deposits with RBI	(-) 74.90	100.05	174.95
Deposits with other banks	-	-	-
Remittance in transit- Local	0.01	0.01	-
Sub Total	(-) 74.89	100.06	174.95
Investments held in cash balance investment account	16,917.13	23,977.48	7,060.35
Total (a)	**16,842.24**	**24,077.54**	**7,235.30**
b) Other cash balances and investments			
Cash with departmental officers viz. PWD officers, Forest Department, DCs	2.09	2.09	-
Permanent Advances for contingent expenditure with departmental officers	1.69	1.74	0.05
Investment of earmarked funds	10,272.21	10,272.21	-
Total (b)	**10,275.99**	**10,276.04**	**0.05**
Grand Total (a+b)	**27,118.23**	**34,353.58**	**7,235.35**

Source: Finance Accounts.

Claims against Government are settled by preferring bills at treasuries, against which cheques are issued (by debit to the Consolidated Fund) to the claimants. The Major Head 8670 – Cheques and Bills is credited with the amount of each cheques and paired off with its encashment at the Agency Banks. Thus, credit balances under this head indicate the value of cheques that remained un-encashed. Article 75(1) of the Karnataka Financial Code, 1958, prescribes that the Treasury Officer should propose an Alteration Memorandum for the value of cheques outstanding for more than 12 months from the date of issue on the 15th of May each year. Due to non-compliance with these instructions by the treasury officers, the credit balance under this head increased from ₹13,752 crore in 2015-16 to ₹14,156 crore during 2016-17, which includes un-encashed cheques issued during January to March 2017.

Audit observed that the net credit under the account during 2016-17 was ₹404 crore. Action is required to be taken for analysis of data for cleaning up of the balances.

The cash balance of the State at the end of the year was ₹34,354 crore. The increase in the cash balance was 27 *per cent* over the previous year. The surplus cash was on account of release of funds by the Government of India to the State Government during 2016-17, which remained un-utilised and were released during 2017-18 through supplementary estimates to the extent of ₹1,235.52 crore.

Surplus cash balance was due to market borrowings of ₹28,007 crore raised during 2016-17. There was an increase of ₹7,060 crore in the investments held in cash balance investment account with RBI at the end of the year.

The surplus cash balance was invested partly in 14-day intermediate Treasury Bills of RBI with an average interest rate of 3.90 *per cent* per annum and partly in 91-day intermediate Treasury Bills of RBI with an average interest rate of 6.49 *per cent* against an average rate of 7.34 *per cent* per annum at which the borrowings were made. The interest received from investment in 91-day Treasury Bills during 2016-17 was ₹704.65 crore.

1.9 Assets and Liabilities

1.9.1 Growth and composition of assets and liabilities

In the existing Government accounting system, comprehensive accounting of fixed assets like land and buildings owned by the Government is not done. However, Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure incurred. **Appendix 1.8** gives an abstract of such liabilities and assets as on 31 March 2017 compared with the corresponding position as on 31 March 2016.

Total liabilities, as defined in KFRA, 2002, are the liabilities under the Consolidated Fund and the Public Account of the State. By an amendment to section 2(g) of KFRA, 2002, brought out in February 2014, the scope of the total liabilities was enlarged to include borrowings by PSUs and SPVs and other equivalent instruments where the principal and /or interest are to be serviced out of the budget of the Government of Karnataka.

The internal debt includes market loans, special securities issued to RBI and other negotiated loans. 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 SPVs, termed off-budget borrowings.

Assets comprise assets under the Consolidated Fund and cash. The assets under the Consolidated Fund consist of capital outlay on fixed assets – investments in shares of companies and corporations and loans and advances, which consist of loans for power projects and other development loans. The growth rate of components of assets and liabilities is summarised in **Table 1.34**.

Table 1.34: Summarised position of Assets and Liabilities

(₹ in crore)

Liabilities				**Assets**			
	2015-16	**2016-17**	***per cent***		**2015-16**	**2016-17**	***per cent***
Consolidated Fund	**1,22,547**	**1,46,283**	**19**	***Consolidated Fund***	**1,90,566**	**2,20,527**	**16**
a. Internal Debt	1,09,545	1,32,489	21	Capital Outlay	1,76,753	2,04,880	16
b. Loans and advances from GOI	13,002	13,794	6	Loans and Advances	13,813	15,647	13
Off-budget borrowings	**7,699**	**10,248**	**33**	**Cash**	**27,118**	**34,354**	**27**
Public Account*	**53,076**	**64,788**	**22**				
a. Small savings, Provident Funds etc.,	22,262	24,920	12				
b. Reserve Funds	10,371	16,384	58				
c. Deposits	20,443	23,484	15				

**The liabilities are on net basis. It does not include investments from earmarked funds of ₹10,272 crore (2015-16 and 2016-17).*

The growth rate of assets increased from 13 *per cent* in 2015-16 to 16 *per cent* during 2016-17, while that of liabilities inclusive of off-budget borrowings, increased from 16 *per cent* in 2015-16 to 19 *per cent* in 2016-17.

The Finance Accounts reflected an amount of ₹1,32,489 crore as internal debt outstanding at the end of 2016-17 after taking into account the difference of ₹558.50 crore in the accounts of LIC, GIC, NABARD, NCDC etc. Further, the Reserve Bank of India in its quarterly statement of outstanding balances of the Government of Karnataka as on 31 March 2017 reflected closing balance of Market Loans – not bearing interest as ₹0.15 crore. However, the Finance Accounts reflected an amount of ₹0.70 crore, indicating that reconciliation of loan balances (capital account) was required. It was also observed that certain loan balances, which figure in the Finance Accounts, were not reckoned in RBI books (four cases). In respect of seven cases, there were differences, which require reconciliation. In respect of four cases, the balances as per the books of accounts of AG (A&E) tallied with those of RBI. Further, as per the communication from the Reserve Bank of India, there still exists a balance of ₹0.40 crore to be discharged in respect of compensation bonds, the transactions of which, are accounted under the minor head 106. However, these loans do not figure in the outstanding balances in the Finance Accounts. The loans and advances from GOI reflected an amount of ₹13,794 crore at the end of 2016-17.

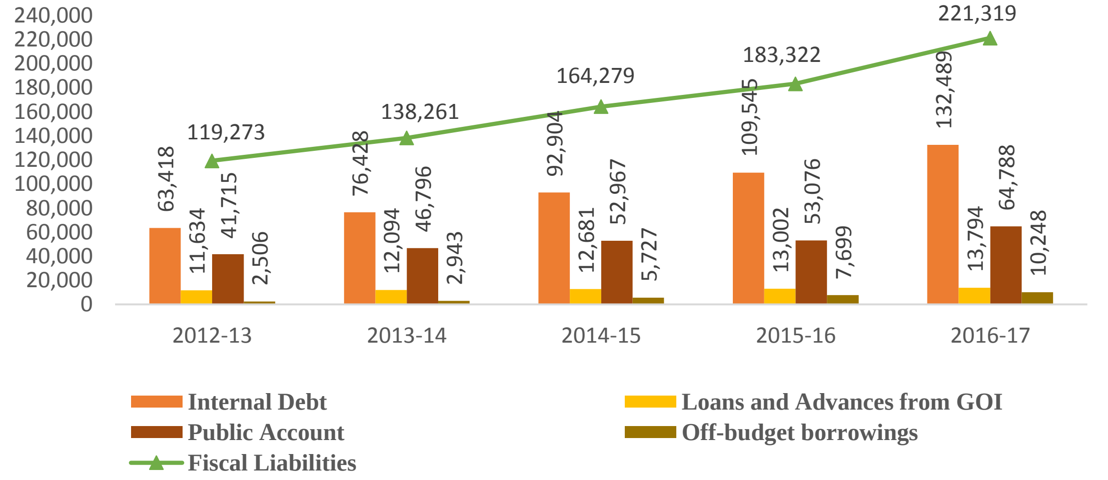
In the furtherance of the recommendations of XIII FC, the Ministry of Finance, GOI, in a series of orders (29 February 2012), wrote off loans advanced to the State Government by various Ministries (except those advanced by the Ministry of Finance itself) as on 31 March 2010 (limited to current balances outstanding in the records of the Ministries) towards Central Plan and Centrally Sponsored Schemes. The Ministry of Finance permitted the State Governments to adjust the excess repayments of principal and interest made from the effective date of the order (31 March 2010) and its implementation against future repayments to the Ministry of Finance. In respect of the Government of Karnataka, this excess payment amounted to ₹68.66 crore, of which, the Ministry of Finance adjusted ₹22.79 crore (June 2013) and ₹5.48 crore (May 2014) against the dues payable by the end of March 2013 and 2014. The balance amount pending for adjustment was ₹45.86 crore (Principal ₹23.66 crore and Interest ₹22.20 crore). This resulted in adverse balance (net debit) of ₹23.66 crore against the loans of the Ministries other than the Ministry of Finance in the books of the State Government.

The assets shown in the Finance Accounts (Statement No. 1 - Investment from earmarked funds - ₹10,272.21 crore) were understated to the extent of ₹317.45 crore. This is on account of the interest accrued on the investment of Consolidated Sinking Fund account made during 2012-13, which did not pass through the Government books.

1.9.2 Fiscal Liabilities

The trends in outstanding fiscal liabilities of the State are presented in **Appendix 1.4**. The composition of fiscal liabilities during the year 2012-13 to 2016-17 is presented in **Chart 1.17**.

Chart 1.17: Composition of outstanding Fiscal Liabilities
(₹ in crore)



Source: Finance Accounts.

The 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 1.35**.

Table 1.35: Fiscal Liabilities – basic parameters

	2012-13	2013-14	2014-15	2015-16	2016-17
Fiscal Liabilities (₹ in crore)	1,19,273	1,38,261	1,64,279	1,83,322	2,21,319
Rate of growth (*per cent*)	13.7	15.9	18.8	11.6	20.7
Percentage of fiscal liabilities to					
GSDP	17.24	16.90	17.82	17.85	19.81
Revenue Receipts	152.57	154.41	157.75	154.29	166.14
Own resources	206.64	207.49	219.42	226.59	249.37
Buoyancy ratio of fiscal liabilities to					
GSDP	0.94	0.87	1.48	1.02	2.35
Revenue Receipts	1.14	1.10	1.15	0.82	1.71
Own resources	0.96	1.03	1.52	1.44	2.13

Source: Finance Accounts.

The Fiscal liabilities of the State increased by 86 *per cent* from ₹1,19,273 crore in 2012-13 to ₹2,21,319 crore in 2016-17 comprising Consolidated Fund liabilities (₹1,46,283 crore), Public Account liabilities (₹64,788 crore) and off-budget borrowings (₹10,248 crore). In 2015-16 and 2016-17, due to increased borrowings, the growth rate of fiscal liabilities was 12 *per cent* and 21 *per cent* respectively. Further, the ratio of fiscal liabilities to GSDP during 2016-17 remained at 19.81 *per cent* and the buoyancy of fiscal liabilities to revenue receipts was at 0.82 *per cent* and 1.71 *per cent* in 2015-16 and 2016-17 respectively. Also, the buoyancy ratio of fiscal liabilities to own resources gradually increased from 0.96 *per cent* in 2012-13 to 2.13 *per cent* in 2016-17.

1.9.3 Off-budget borrowings

The borrowings of the State Government are governed by Article 293 (1) of the Constitution of India. The State stood as guarantor for loans availed by Government Companies /Corporations/ Societies. These Companies/ Corporations/ Societies borrowed funds from the market/financial institutions for implementation of various State Plan programmes projected outside the State budget. The borrowings of these concerns ultimately turn out to be the liabilities of the State Government termed 'off-budget borrowings' and the Government was repaying the loans availed of by these Companies/ Corporations/Societies including interest through regular budget provision under capital account.

During 2016-17, capital expenditure of ₹28,150 crore included ₹455.57 crore towards servicing of principal amount of off-budget borrowings. However, the accounts of the entities for the year show disbursement as ₹453.43 crore towards off budget borrowings. **Table 1.36** captures the trend in the off-budget borrowings of the State during 2012-13 to 2016-17 while **Table 1.37** gives the entity-wise position of borrowings to the end of 2016-17.

Table 1.36: Trend in off-budget borrowings

(₹ in crore)

Year	2012-13	2013-14	2014-15	2015-16	2016-17
Amount as furnished by entities*	18.16	1,914.50	3,081.50	2,372.00	3,005.16

Source: As reported by the concerned entities.

**Figures are yet to be reconciled with those indicated in Budget Overview.*

Table 1.37: Entity-wise position of off-budget borrowings

(₹ in crore)

Company/Corporation/Board	Outstanding off budget borrowing*	Borrowings during 2016-17	Repayment during 2016-17	
			Principal	Interest
Krishna Bhagya Jala Nigam Limited	3,880.85	1,232.36	1.63	406.64
Karnataka Neeravari Nigam Limited	1,562.32	800.00	188.20	162.78
Karnataka Road Development Corporation Limited	182.36	1.00	36.19	17.92
Rajiv Gandhi Rural Housing Corporation Limited	1,185.32	271.80	201.36	108.92
Karnataka Slum Development Board	5.71	-	4.11	0.38
Karnataka State Police Housing and Infrastructure Development Corporation	44.90	-	21.85	3.97
Cauvery Neeravari Nigam Limited	835.00	400.00	-	107.06
Visvesvaraya Jala Nigam Limited	-	300.00	-	0.07
Karnataka Power Transmission Corporation Limited	0.09	0.00	0.09	0.00
Total	**7,696.55**	**3,005.16**	**453.43**	**807.74**

**as there were differences in the closing balances of these entities (2015-16), the principal repayments are adjusted to bring them in concordance with the closing balances of 2016-17.*

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2017 worked out to ₹2,21,319 crore. The ratio of fiscal liabilities (inclusive of off-budget borrowings) to GSDP, thus, worked out to 19.81 *per cent* at the end of the year.

1.9.4 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. The expenditure relating to the fund is initially accounted for 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. The funds may further be classified as 'Funds carrying interest' or '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;
- 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; and
- Funds accumulated from contributions made by outside agencies to the State Government.

As given in 'Notes to Accounts' for the year, out of the total outstanding balance of ₹26,656.09 crore available in various reserve funds as on 31 March 2017, the

Government of Karnataka invested ₹10,272.21 crore (39 *per cent*). In addition, AG (A&E) requested (June 2011) the State Government to review the necessity to continue two reserve funds, namely

- State Renewable Fund, which did not record any transaction under it since 1999-2000; and
- Guarantee Reserve Fund, which needs to be replaced by Guarantee Redemption Fund in the light of recommendations of the TFC.

The operation of certain major reserve funds having a bearing on the liability position of the Government, its funding and expenditure are brought out below.

a) Consolidated Sinking Fund

The Government of Karnataka constituted a Consolidated Sinking Fund (CSF) in 2012-13 for the amortisation of all loans as recommended by the Twelfth Finance Commission and transferred ₹1,000 crore towards its corpus in 2012-13. The fund is administered by the Reserve Bank of India, which has invested the corpus in Government of India Securities. As per Government notification (February 2013), the State Government is required to make minimum annual contributions to the fund at 0.50 *per cent* of the outstanding liabilities at the end of the previous financial year. During 2016-17, against the requirement of ₹878.12 crore, the State Government made provision of ₹535 crore under Major Head 2048 – Contribution to Consolidated Sinking Fund. However, no investment was made, despite the fact that the State Government had a surplus cash balance of ₹23,997 crore at the end of 31 March 2017.

Even, XIV FC in its report analysed that Consolidated Sinking Fund is an integral part of prudent fiscal management. CSF creates a cushion to meet repayment obligations in times of fiscal/market stress, as it boosts investor confidence and thereby facilitates borrowings in the primary market at a reasonable cost even in normal times. The balance under the fund at the end of the year remained at ₹2,070 crore. However, the interest of ₹317.45 crore accrued (2016-17) on re-investment made by RBI from the fund did not pass through the accounts. Failure to comply with the instructions contained in notification dated 28.02.2013 and non-investment resulted in compression of revenue expenditure and also revenue/fiscal deficit to the extent of ₹878 crore.

Finance Department in its reply (July 2017 and December 2017) stated that transfer to CSF & investment thereof is contingent on the State being able to balance all its fiscal needs. The commitment to contribute certain percentage of outstanding liabilities is dependent on available revenue/fiscal space. The provision to the fund during budgeting depends on the fiscal space available then and investment also depends on the cash balance and that the Government cannot fund its contribution from out of borrowings.

The reply of the Finance Department is not satisfactory as the commitment on account of investment should form part of the budgetary exercise at the beginning of the year itself. Further, prudent financial management requires that the fund is built up through regular contribution on a year to year basis so as to reach a minimum corpus of three to five *per cent* of outstanding liabilities within a time frame of three to five years as recommended by RBI through investments.

b) Green Tax

Government of Karnataka, vide the Karnataka Motor Vehicles Taxation (Amendment) Act, 2002, introduced collection of a Cess called ‘Green Tax’ to control air pollution. There shall be levied green tax cess on old vehicles, which had completed fifteen years in respect of two wheelers and non-transport vehicles and seven years in respect of transport vehicles at the time of renewal of Certificate of Registration in addition to the tax levied under this act at the rates specified for the purpose of implementation of various measures to control air pollution.

A mention was made vide para 1.3.1.1 of the Report of the Comptroller and Auditor General of India on State Finances for the year ending 31 March 2016, regarding ‘Improper accounting and Non-utilisation of Green Tax Cess collections of ₹45.90 crore’. The green tax cess collected is to be accounted under revenue receipt head ‘0041-00-102-0-11 – Green Tax’. A Reserve Fund to transfer the Green tax cess collected is opened under Development and Welfare Funds – ‘8229-00-200-0-63 – Green Tax’.

During the year 2016-17, ₹4.37 crore was collected under the revenue receipt head apart from the amount of ₹53.52 crore collected from 2006-07 to 2015-16. Hence the total green tax cess collected up to 2016-17 i.e. ₹57.89 crore along with the relevant expenditure needs to be transferred to fund account in Public Account. However, neither the revenue receipts of green tax cess collections nor its corresponding expenditure was transferred to the Public Account. This resulted in overstatement of revenue receipts/expenditure.

Finance Department replied (December 2017) that a UO note was sent to Transport Department on 16.10.2017 and the matter would be taken up with the department once again.

c) 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 fund and CMRRD fund in the ratio of 57, 28 and 15 *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 2016-17, the Infrastructure Cess realised (₹951.53 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 ₹542.36 crore, ₹266.43 crore and ₹142.74 crore respectively. However, the related expenditure under revenue and capital were not debited to the fund, but remained under the Consolidated Fund only resulting in overstatement of revenue and capital expenditure.

Further, an amount of ₹3,670 crore available under General Revenues were transferred to Infrastructure Initiative Fund, which included ₹2,092 crore to IIF, ₹1,027 crore to BMRCL fund and ₹551 crore to CMRRD fund respectively. However, the expenditure for infrastructure works, which had to be met out of the fund, were not transferred to IIF, BMRCL fund and CMRRD fund. This transfer of funds from general revenues had the effect of inflating the revenue expenditure as also the fiscal deficit. Further, this has resulted in increased liability in the Public Account also the same amount was used again for financing the fiscal deficit through surplus from Public Account.

d) 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) under Major Head of Account '8229 – Development and Welfare Funds' with accruals from budgetary grants, cess on motor vehicles registration (one *per cent*) and cess on property tax.

The fund, which had an opening credit balance of ₹40.48 crore, was credited with ₹43.82 crore from cess on motor vehicle tax, ₹3.59 crore from cess on property tax and ₹13.49 crore from general revenues during the year 2016-17. Thus, an amount of ₹60.90 crore was transferred to fund account. However, the relevant expenditure incurred under the capital head was not transferred to the fund account, leaving a balance of ₹101.38 crore as on 31 March 2017. This resulted in overstatement of capital expenditure and fiscal deficit.

Finance Department replied (December 2017) that transfer or otherwise to a fund is a decision of State Government which is taken based on prevailing fiscal conditions. It is incorrect to state that the expenditure was overstated or understated to the extent that the expenditure was not met out of a fund account. The reply of the FD is not satisfactory as in the present case budget was made both for transfer of revenue and the related expenditure. By only transferring the revenues, the liability under the Public Account had only increased in the absence of any investment transactions carried out. As the budget was made for transfer of related expenditure also, by not transferring, expenditure relating to the fund remained under the Consolidated Fund only, thus, overstating the expenditure.

Inoperative Reserve Funds

At the end of 31 March 2017, out of 43 Reserve Funds, 33 funds remained inoperative with a balance of ₹7,784.40 crore.

1.9.5 Contingent liabilities

1.9.5.1 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 1.38**.

Table 1.38: Guarantees given by the State Government

(₹ in crore)

	2012-13	2013-14	2014-15	2015-16	2016-17
Maximum amount guaranteed	14,306	16,145	16,869	18,358	21,115
Outstanding amount of guarantees as on 1 April (including interest)	6,688	7,783	11,033	11,327	13,310
Percentage of outstanding amount guaranteed to total revenue receipts of the second preceding year	11	11	14	13	13

Source: Finance Accounts.

The Karnataka Ceiling on Government Guarantees Act, 1999, provides for a cap on outstanding guarantees extended by the Government at the end of any year at 80 *per cent* of the State's revenue receipts of the second preceding year. The outstanding guarantees on 1st April of each year were within the prescribed limit.

The outstanding guarantees amounting to ₹15,392 crore at the end of the year 2016-17 (principal + interest) included guarantees extended to 169 institutions/companies under irrigation (₹8,522 crore), co-operative (₹1,476 crore), finance (₹1,489 crore), power (₹564 crore), housing (₹2,493 crore), transport (₹147 crore) and other sectors (₹701 crore).

Against the total estimated guarantee commission of ₹362.52 crore receivable as reported by the State Government, only ₹166.32 crore was received during 2016-17. The guarantee commission received includes book adjustment made by the State Government towards the guarantee commission payable to it by Karnataka Slum Development Board (₹0.04 crore), Rajiv Gandhi Rural Housing Corporation Limited (₹24.22 crore), Karnataka State Co-operative Marketing Federation Limited (₹22.64 crore) and Karnataka State Police Housing and Infrastructure Development Corporation (₹0.93 crore) by way of subsidies /grants-in-aid/financial assistance. Consequently, the net shortfall in guarantee commission received was ₹244.03 crore (₹362.52 crore *minus* ₹118.49 crore, excluding book adjustment of ₹47.83 crore).

In MTFP (2016-20) presented before the Legislatures, the Government stated that since the guarantees result in increase in contingent liability, they should be examined in the same manner as a proposal for a loan, taking into account, *inter alia*, the credit-worthiness of the borrower, the amount and risks sought to be covered by a sovereign guarantee, the terms of the borrowing, the justification and public purpose to be served, probabilities that various commitments will become due and possible costs of such liabilities, etc. The utility of having a functional Guarantee Reserve Fund and Guarantee Policy is under consideration with the State Government.

PAC also recommended (July 2015) that suitable efforts should be made to operate and continue the Guarantee Reserve Fund.

1.9.5.2 Adequacy of disclosure about Guarantees

The Government of India notified "IGAS - 1 – Guarantees given by Governments" standard required disclosure of information relating to Guarantees as part of financial statement and provided formats for disclosure. During 2016-17, a perusal of the Statement No 9 of the Finance Accounts, it was observed that in respect of Other Infrastructure Sector, one entity namely Karnataka Rural Infrastructure Development Corporation Limited (KRIDCL), the maximum amount guaranteed and the guarantee commission receivable only has been disclosed.

Finance Department (September 2017) replied that KRIDCL cleared the loan availed from Housing and Urban Development Corporation (HUDCO) Limited on Government Guarantee. No Due Certificate from HUDCO was awaited. The Guarantee Commission receivable is rectified by the Corporation which was reduced when compared to previous year. The status of guarantee extended is retained by disclosing only the maximum guaranteed amount, even though the principal and interest was zero, during the period under report. As seen from the above, the report on guarantees as furnished by the department is not accurate.

1.10 Debt Management

1.10.1 Debt Profile

The revenues of the Government are of two types *viz*. current revenues, which are termed as revenue receipts, realised through administration of taxes, user charges and grants received from GOI and capital receipts that comprise of borrowings, non-debt receipts and surplus from Public Account. For working out the borrowings, certain book adjustments are also reckoned as if these are cash transactions. Such transactions are in the nature of subsidy dues of electricity supply companies, student/elderly concession passes etc., which on one side are shown as expenditure and on the other, as revenues, under relevant receipt heads (tax/non-tax). Such accounting amounted to ₹1,620 crore during 2016-17. These transactions had the impact of showing the tax/non-tax revenues without actual cash flow. Such revenue, adjusted through book adjustment was ₹1,516 crore (tax revenues) and ₹94 crore (non-tax revenues) constituting 1.2 *per cent* of revenue receipts.

Table 1.39 gives details of outstanding fiscal liabilities of the Government under Consolidated Fund and Public Account compared with the per capita liability.

Table 1.39: Debt Profile of the State

(₹ in crore)

Borrowings through	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Open market loans	39,920	53,326	69,419	84,334	1,08,359
Negotiated loans	3,425	3,372	3,318	3,482	3,973
NSSF loans	20,074	19,730	20,167	21,729	20,157
GOI loans	11,634	12,094	12,681	13,002	13,794
Public Account borrowings	41,714	46,796	52,968	53,076	64,788
Off budget borrowings	2,506	2,943	5,726	7,699	10,248
Total Fiscal Liabilities	**1,19,273**	**1,38,261**	**1,64,279**	**1,83,322**	**2,21,319**
Population (in crore)	6.11	6.11	6.11	6.11	6.11
Per capita debt ratio (in ₹)	19,521	22,629	26,887	30,004	36,222

Source: Finance Accounts.

The per capita debt ratio increased significantly from ₹19,521 in 2012-13 to ₹36,222 in 2016-17 (an increase of 86 *per cent).*

1.10.2 Debt Sustainability

Apart from the magnitude of the debt of the State Government, it is important to analyse various indicators that determine the debt sustainability of the State. 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. This section assesses the sustainability of debt of the State Government in terms of debt as a percentage of GSDP, rate of growth of outstanding debt, interest payments/ revenue receipts ratio and net debt available to the State. **Table 1.40** analyses the debt sustainability of the State according to these indicators for the period from 2012-13 to 2016-17.

Table 1.40: Debt sustainability indicators and trends

(in *per cent*)

Debt sustainability indicators	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Debt*/GSDP	10.85	10.82	11.45	11.93	13.09
Rate of growth of Outstanding Debt*	14.91	17.95	19.28	16.06	19.37
Rate of growth of GSDP	14.56	18.24	12.70	11.42	8.79
Average interest rate of Outstanding Debt (Interest payments/(opening balance of Public Debt +closing balance of Public Debt/2)	10.62	9.81	10.10	9.94	9.56
Interest/Revenue Receipts	9.53	8.96	9.41	9.55	9.65
Debt Repayment/ Debt Receipts	27.68	22.08	22.00	19.50	23.82
Net Debt available to the State (₹ in crore)	9,738	13,470	17,062	16,962	23,736

Source: Finance Accounts.

**Excluding Public Account liabilities and Off Budget Borrowings.*

- The rate of growth of outstanding debt was 19.37 *per cent* during 2016-17, being four percentage points increase over the year 2012-13 (14.91 *per cent*);

- Interest payments on debt and other liabilities totaling ₹12,850 crore constituted 9.6 *per cent* of revenue receipts during 2016-17, being 0.09 percentage points increase over previous year. The interest payment/Revenue Receipt ratio remained same in 2015-16 and in 2016-17, which was at 9.6 *per cent* due to increased interest payments (by

13.29 *per cent*) as compared to revenue receipts (12.11 *per cent*) during 2016-17;

- The increase in Debt Repayment/Debt Receipts ratio was mainly due to increase in total debt receipts by ₹10,084 crore as compared to debt repayment made during 2016-17, which increased by ₹3,310 crore; and
- Increase in net debt available to the State was mainly due to increase in receipt under internal debt from ₹19,801 crore in 2015-16 to ₹29,238 crore in 2016-17 (**Appendix 1.4**) and by ₹647 crore under Loans and Advances from Government of India.

1.10.3 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 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 2012-13 to 2016-17, the primary revenue balance was positive and sufficient to meet incremental interest expenditure.

1.10.4 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 is facilitated if the incremental non-debt receipts 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 are indicated in **Table 1.41**.

Table 1.41: Sufficiency of incremental non-debt receipts

(₹ in crore)

Sl. No.		2012-13	2013-14	2014-15	2015-16	2016-17
1	Incremental Non-Debt Receipts	8,231	11,372	14,497	14,993	14,112
2	Incremental Interest Payments	850	573	1,777	1,539	1,507
3	Incremental Primary Expenditure	9,588	13,384	15,204	13,047	22,101
4	Resources gap	(-) 2,207	(-) 2,585	(-) 2,484	407	(-) 9,496

The resource gap, which was negative from 2012-13 to 2014-15 turned positive during 2015-16 and again turned negative during 2016-17. This was mainly on account of growth of revenue receipts being 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.

1.10.5 Net availability of borrowed funds

Debt sustainability also depends on the ratio of debt redemption (principal *plus* 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 for capital spending. The debt redemption to debt receipts ranged between 19.5 *per cent* and 27.68 *per cent* during 2012-13 to 2016-17. During 2016-17, the debt redemption ratio increased by 4.3 *per cent* points compared to the previous year.

1.10.5.1 Short receipt of interest relief on NSSF loans as per the award of the XIII Finance Commission - ₹192.42 crore

The National Small Saving Funds (NSSF) was created in Public Account of India with effect from April 1999 with the Central Government taking on the responsibility of servicing the small savings deposits outstanding as on the date of creation of the fund. Since loans against the deposits outstanding on April 1999 were extended to State Government from the Consolidated Fund of India prior to creation of NSSF, interest from States on these loans was also credited to Consolidated Fund of India and accounted as a non-tax receipt of GOI.

Till 2001-02, the net Small Savings collection in a State (Gross collection *minus* repayments to depositors) were being shared between the Central and State Governments, with the share of State Government being progressively increased from 66.66 *per cent* to 75 *per cent* from 1 April 1987 and to 80 *per cent* from April 2000. From 01.04.2002 to 31.03.2007, the entire net collections in a State were being invested in special securities issued by the State Governments. However, with effect from 2007-08, the mandatory share of State Governments was reduced to 80 *per cent* with the option to go up to 100 *per cent*. The administration of the fund rests with the Reserve Bank of India.

The XIII Finance Commission (XIII FC) in paragraph 9.106 had recommended that loans to States from NSSF contracted till 2006-07 and outstanding at the end of 2009-10 to be reset at nine *per cent* rate of interest subject to the State with FRBM acts already in place, amend the same as indicated by the Commission in terms of paragraph 9.82. No further conditionality with regard to compliance with the target were set as the Finance Commission believed that the mechanism mentioned in paragraph 9.85 for setting borrowing limits and allowing open market borrowing to States can act as an effective tool.

In the explanatory memorandum as to the action on the recommendations made by XIII FC in its report submitted to the President on December 30, 2009, Government of India, Ministry of Finance, Department of Economic Affairs, stated that with regard to the recommendations relating to interest rate reset on NSSF loan to the States, the Government accepted it in principle. However, since the recommendations were comprehensive, and cover other structural aspects like interest rate mis-match, tenor mis-match and other administrative matters, the Ministry of Finance will constitute a Committee to work out detailed modalities for implementation of its recommendations.

According to the data on the interest relief that the State Government of Karnataka received on the recommendations of XIII FC, as made available by the Reserve Bank of India and verified from accounts, a sum of ₹397.54 crore only was received by the State Government towards interest relief as against the recommended amount of ₹589.96 crore, indicating a short fall of ₹192.42 crore as detailed in **Table 1.42**.

Table 1.42: Short receipt of interest relief from 2010-11 to 2014-15

(₹ in crore)

Year	Interest relief as recommended by XIII FC	Interest relief received	Interest relief to be received
1	**2**	**3**	**2 - 3 = 4**
2010-11	132.77	45.17	87.60
2011-12	125.77	123.78	1.99
2012-13	118.12	118.12	0.00
2013-14	110.47	110.47	0.00
2014-15	102.83	0.00	102.83
Total	**589.96**	**397.54**	**192.42**

There was less interest relief extended for the period 2010-11 and 2011-12, as the amount of relief did not match the amount recommended by the Commission. Government of Karnataka amended its Fiscal Responsibility Act as per the recommendations of XIII FC and adhered to the provisions of the Act during the award period and that there were no deviations from the fiscal consolidation path as set out by the FC and the amendments brought out to KFRA.

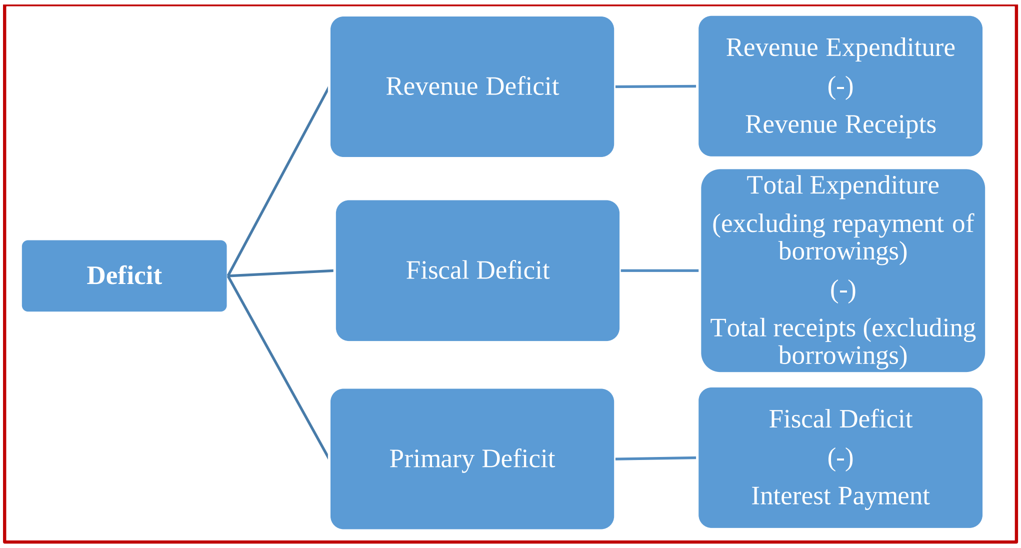
The matter was brought to the notice of the State Government (April 2017) for their remarks. The Finance Department while referring the matter to Ministry of Finance, Department of Economic Affairs, GOI, and endorsing a copy to audit (July 2017) stated that the award of interest relief started to flow from January 2013 onwards only i.e., after a gap of nearly two years of the recommendations. This resulted in extending the benefit of interest relief belatedly. Also, the interest relief of ₹397.54 crore covered the period (financial year only up to 2013-14). The interest relief of ₹102.83 crore worked out by the Commission for the year 2014-15 was not extended.

The Ministry of Finance, Department of Economic Affairs (Budget Division), Government of India replied (July 2017) that the interest relief actually due, was to be calculated on a yearly basis, starting from the day on which the amount was released to the State. That is why there was a difference in amount of interest relief calculated by XIII FC and amount of interest relief received by Karnataka. Further, Reserve Bank of India was asked to extend interest relief to Karnataka for the year 2014-15 also.

1.11 Fiscal Imbalances

Three key fiscal parameters – revenue, fiscal and primary deficits – indicate the extent of overall fiscal imbalances in the finances of the State Government during a specified period. The deficit in the Government accounts represents the gap between its receipts and expenditure. **Chart 1.18** gives an indication of the various kinds of deficits that occur if the Government borrows to balance the budget.

Chart 1.18: Type of deficits



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 application of resources raised are important pointers to its fiscal health. This section presents trends, nature and 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 KFRA for the financial year 2016-17.

1.11.1 Trends in deficits

Chart 1.19 and **Chart 1.20** present the trends in deficit indicators over the period 2012-13 to 2016-17.

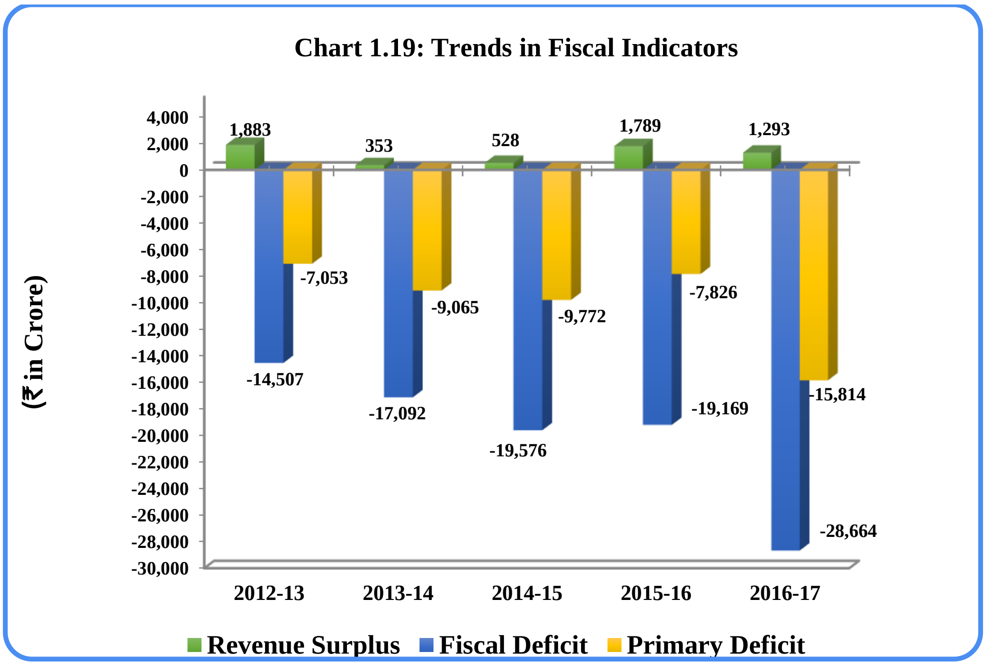
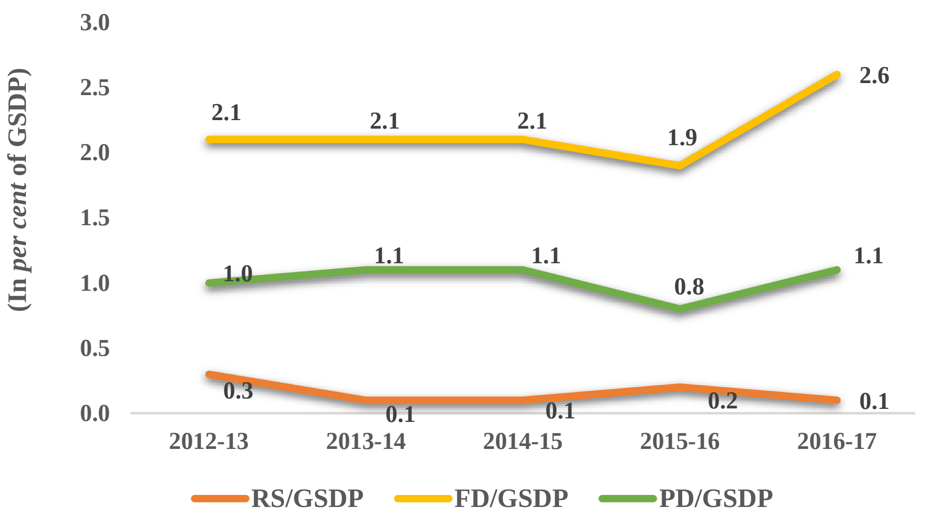


Chart 1.20: Trends in Deficit indicators relative to GSDP



The targets for revenue and fiscal deficits set for XIII FC and XIV FC periods along with their actual levels are given in **Table 1.43**.

Table 1.43: Outcome vis-à-vis targets under KFRA

Period	Revenue Deficit/Surplus		Fiscal Deficit (in *per cent*)	
	Targets as per KFRA	Actual	Targets as per KFRA	Actual
XIII FC (2010-15)				
2012-13	Maintain Revenue Surplus	Achieved the target	3.00	2.10
2013-14			3.00	2.09
2014-15			3.00	2.12
XIV FC (2015-20)				
2015-16	Maintain Revenue Surplus	Maintained Revenue Surplus	3.00	1.87
2016-17			3.00	2.57

The Government was able to maintain revenue surplus during 2012-13 to 2016-17. The fiscal target of wiping out revenue deficit by March 2006, as laid down in KFRA, was achieved by the State one year ahead in 2004-05, which was appreciable. Thereafter, the State maintained revenue surplus till 2016-17 with inter-year variations. In 2015-16, the revenue surplus increased by ₹1,261 crore over previous year and was ₹1,789 crore. However, during 2016-17 there was a decrease in revenue surplus and it was ₹1,293 crore.

KFRA target of reducing fiscal deficit to GSDP ratio to less than three *per cent* was also achieved. In 2016-17, there was increase in the ratio of fiscal deficit to GSDP as compared to the previous year and was 2.57 *per cent* considering the figure of GSDP as communicated by the State Government (₹11,17,334 crore), which was well within the target of three *per cent*.

Revenue Surplus

Revenue surplus represents the difference between revenue receipts and revenue expenditure. Revenue surplus helps to decrease the borrowings. The revenue surplus drastically reduced from ₹1,883 crore in 2012-13 to ₹353 crore in 2013-14, on account of increased expenditure (committed) on revenue account under salaries, pensions, interest, subsidies and devolutions affecting the fiscal space, but increased by ₹940 crore to ₹1,293 crore during 2016-17, due to increase in net proceeds of State share of Union Taxes and duties and increase in respect of devolutions to local bodies (₹1,031.71 crore) which helped the Government to maintain surplus.

The growth rate of revenue receipts and revenue expenditure was 12 *per cent* and 13 *per cent* respectively during 2016-17, as a result of which, there was considerable increase in revenue surplus. The factors responsible for the surplus on revenue account are discussed in **paragraph 1.1.2**.

The State Government in MTFP (2016-20) stated that though the size of budget went up over the years, it was characterised by a substantial portion being in the nature of committed expenditure. This reduced maneuverability around expenditure decision and that the State had limited revenue space available after accounting for its committed expenditure needs. Hence, the State Government needs to make medium term corrections on the expenditure side to moderate such committed expenditures.

Fiscal Deficit

Fiscal deficit represents the net incremental liabilities of the Government or its additional borrowings. The shortfall is 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 1.44**.

Table 1.44: Fiscal deficit and its parameters

(₹ in crore)

Period	Non-Debt Receipts	Total Expenditure	Fiscal deficit	Fiscal Deficit as *per cent* of		
				GSDP	Non-debt receipts	Total expenditure
2012-13	78,367	92,874	14,507	2.10	18.51	15.62
2013-14	89,739	1,06,831	17,092	2.09	19.50	16.00
2014-15	1,04,236	1,23,812	19,576	2.12	18.78	15.81
2015-16	1,19,229	1,38,398	19,169	1.87	16.08	13.85
2016-17	1,33,341	1,62,005	28,664	2.57	21.50	17.69

Source: Finance Accounts.

During 2012-13 to 2016-17, fiscal deficit as a percentage of GSDP increased from 2.10 *per cent* to 2.57 *per cent*, with marginal variations in between. The fiscal deficit as *per cent* of GSDP, Non-debt receipts and Total expenditure increased during 2016-17 over the previous year, on account of increased borrowing/reduced revenue surplus.

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 in respect of States having deficit on revenue account. Interest payments represent the expenditure of past obligations and are independent of ongoing expenditure. To look at the imbalances of 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 1.45**.

Table 1.45: Primary deficit and its parameters

(₹ in crore)

Period	Fiscal Deficit	Interest Payments	Primary Deficit
2012-13	14,507	7,454*	7,053
2013-14	17,092	8,027*	9,065
2014-15	19,576	9,804*	9,772
2015-16	19,169	11,343*	7,826
2016-17	28,664	12,850*	15,814

Source: Finance Accounts.

**includes interest payments of ₹621 crore, ₹190 crore, ₹400 crore, ₹597 crore and ₹817 crore towards off-budget borrowings during 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17 respectively.*

During 2012-13 to 2016-17, the fiscal deficit was almost twice the amount of interest payments. Containing the committed expenditure, which constitutes the major chunk of the revenue expenditure, will enable the State Government to attain surplus on revenue account to a considerable extent. Since the costs of salary, pension and interest are inflexible, the expenditure on subsidies and grants-in-aid other than to local bodies, which are increasing steadily, requires utmost attention from the State Government.

1.11.2 Composition of fiscal deficit and its financing pattern

The financing pattern of fiscal deficit has undergone a compositional shift as reflected in the **Table 1.46**. Breakdown 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 1.46: Components of fiscal deficit and its financing pattern

(₹ in crore)

Breakdown of fiscal deficit		2012-13		2013-14		2014-15		2015-16		2016-17	
		Amount	% of GSDP	Amount	% of GSDP	Amount	% of GSDP	Amount	% of GSDP	Amount	% of GSDP
		(-) 14,507	**2.10**	**(-) 17,092**	**2.09**	**(-) 19,576**	**2.12**	**(-) 19,169**	**1.87**	**(-) 28,664**	**2.57**
1	Revenue surplus	1,883	0.27	353	0.04	528	0.06	1,789	0.17	1,293	0.11
2	Net capital expenditure	15,446	2.23	16,859	2.06	19,612	2.13	20,361	1.98	28,123	2.52
3	Net loans and advances	944	0.14	586	0.07	492	0.05	597	0.06	1,834	0.16
Financing pattern of fiscal deficit*											
1	Market borrowings	9,149	1.32	13,406	1.64	16,093	1.74	14,914	1.45	24,026	2.15
2	Loans from GOI	652	0.09	461	0.05	586	0.06	321	0.03	791	0.07
3	Special securities issued to NSSF	(-) 517	(-) 0.07	(-) 344	(-) 0.04	437	0.05	1,563	0.15	(-) 1,573	(-) 0.14
4	Loans from financial institutions	454	0.07	(-) 53	(-) 0.01	(-) 54	-	164	0.02	491	0.04
5	Small savings, PF etc.,	1,732	0.25	2,107	0.26	2,156	0.23	2,086	0.20	2,657	0.24
6	Deposits and advances	2,511	0.36	2,840	0.35	3,702	0.40	284	0.03	3,041	0.27
7	Suspense and Miscellaneous	98	0.01	2,671	0.33	3,282	0.35	990	0.10	491	0.04
8	Remittances	(-) 32	-	(-) 12	-	(-) 32	-	(-) 17	-	(-) 38	-
9	Reserve Funds	1,362	0.20	135	0.01	1,547	0.17	2,081	0.20	6,013	0.54

Breakdown of fiscal deficit		2012-13		2013-14		2014-15		2015-16		2016-17	
		Amount	% of GSDP	Amount	% of GSDP	Amount	% of GSDP	Amount	% of GSDP	Amount	% of GSDP
		(-) 14,507	2.10	(-) 17,092	2.09	(-) 19,576	2.12	(-) 19,169	1.87	(-) 28,664	2.57
10	Increase (-)/ decrease (+) in cash balance	(-) 902	(-) 0.13	(-) 4,119	(-) 0.50	(-) 8,141	(-) 0.88	(-) 3,217	(-) 0.31	(-) 7,235	(-) 0.64
11	Net of Contingency Fund transactions	-	-	-	-	-	-	-	-	-	-
	Total	**14,507**	**2.10**	**17,092**	**2.09**	**19,576**	**2.12**	**19,169**	**1.87**	**28,664**	**2.57**

Source: Finance Accounts.

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

The components of fiscal deficit are Deduct Revenue Surplus, Net Capital Expenditure and Net Loans and Advances. Since the State attained revenue surplus in 2004-05 itself, the surplus on revenue account along with market borrowings, loans from GOI etc., were utilised to finance capital expenditure. The capital expenditure was financed by revenue surplus to the extent of 12, 2 and 3 *per cent* in 2012-13, 2013-14 and 2014-15 respectively. In 2015-16 and 2016-17, revenue surplus financed nine and five *per cent* of capital expenditure.

In 2016-17, there was substantial increase in market borrowings and its share in financing fiscal deficit increased to 84 *per cent*. There was increase in Small Savings, Provident Fund and Deposits and Advances over the previous year and increase in loans from financial institutions. There was decrease in suspense and miscellaneous balances which comprised transactions, relating mainly to cheques and bills, the net transactions, of which, were added for financing the fiscal deficit. There was a considerable decrease in the receipts during 2016-17 under special securities issued to NSSF.

1.11.3 Quality of deficit/surplus

The position of primary deficit with bifurcation of factors are given in **Table 1.47**.

Table 1.47: 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)**
2012-13	78,367	68,839	15,479	1,102	85,420	9,528	(-) 7,053
2013-14	89,739	81,162	16,947	695	98,804	8,577	(-) 9,065
2014-15	1,04,236	93,810	19,622	576	1,14,008	10,426	(-) 9,772
2015-16	1,19,229	1,05,686	20,713	657	1,27,054	13,544	(-) 7,826
2016-17	1,33,341	1,19,071	28,150	1,934	1,49,155	14,270	(-) 15,814

Source: Finance Accounts.

Primary deficit, which was ₹7,053 crore during 2012-13 increased to ₹15,814 crore during 2016-17. The interest payment with respect to fiscal deficit was 45 *per cent* during 2016-17.

1.12 Follow up

The Report of C&AG of India on State Finances for the year 2009-10 was discussed by PAC during the period May 2011 to August 2011. The report containing the recommendations was placed before the Legislature in December 2011. Compliance to the recommendations of PAC, the Action Taken Note were placed before PAC for its consideration during September 2014. PAC discussed the Action Taken Note submitted by the Government in five sittings and submitted its report on the Action Taken Note of the Government on 20-07-2015.

1.13 Conclusion and recommendations

Fiscal Position

The State continued to maintain revenue surplus during 2012-13 to 2016-17 and kept fiscal deficit relative to GSDP below the limit prescribed under KFRA.

Non adjustment of budget proposals to the Consolidated Sinking Fund (₹878 crore) in Public Account contributed to maintaining surplus on revenue account.

The fiscal deficit during 2016-17 was 2.57 *per cent* of GSDP (₹11,17,334 crore), which was within the limit laid down under KFRA.

Recommendation: Timely and proper accounting adjustments need to be carried out to reflect the true and fair picture of the fiscal parameters.

The proposals made in the budget are to be implemented so that unspent provisions by way of non-adjustments are avoided.

The accounting adjustments should be in accordance with the principles governing the adjustments and partial accounting adjustments should be done away with.

State's own resources

The ratio of State's tax revenue to GSDP showed a declining trend from 7.80 *per cent* in 2012-13 to 7.42 *per cent* in 2016-17. However, there was no improvement in the ratio of non-tax revenue to GSDP and it continued to be less than one *per cent* of GSDP during 2012-13 to 2016-17 also.

Recommendation: Non-tax revenues require significant thrust by rationalising user charges and reviewing the same regularly as recommended by FMRC (MTFP 2017-21) and Expenditure Reforms Commission.

Revenue expenditure

During 2016-17, there was 18 *per cent* growth under social sector over the previous year and the share of expenditure on social services to total revenue expenditure increased by two *per cent* over the previous year and was at 41 *per cent* in 2016-17. The growth in expenditure on economic services was at 13 *per cent* during 2015-16 whereas it was 19 *per cent* in 2016-17.

The share of plan revenue expenditure to total revenue expenditure increased from 34 *per cent* in 2015-16 to 36 *per cent* in 2016-17.

Eighty *per cent* of revenue expenditure constituted of committed expenditure on salaries, interest payments, pensions, subsidies, grants-in-aid and financial assistance, administrative expenditure and devolution to local bodies. Expenditure on subsidy of ₹18,101 crore contained implicit subsidy amounting to ₹3,714 crore, which was in the form of financial assistance under various schemes of socio-economic services. The release of money from the Consolidated Fund to corporations should be based on requirement of funds.

Recommendation: Adequate priority needs to be given to both education and health sectors as the ratio under both these sectors are below General Category States average during 2016-17.

Since the costs of salary, pension and interest are inflexible, the expenditure on subsidies, grants-in-aid other than to local bodies, which are increasing steadily, requires utmost attention from the State Government.

Containing the Committed expenditure, which constitutes the major chunk of the revenue expenditure, will enable the State Government to attain surplus on revenue account to a considerable extent.

Parking of funds especially with reference to developmental schemes either in nationalised banks/deposit account should be avoided.

Quality of expenditure

The share of capital expenditure to total expenditure during 2016-17 (19 *per cent*) increased by four *per cent* from that of previous year. The percentage of developmental expenditure to total expenditure increased to 77 *per cent* in 2016-17 from 73 *per cent* in 2015-16.

Funds aggregating ₹2,027 crore were locked up in incomplete projects at the end of 2016-17.

The return from investment of ₹63,115 crore as on 31 March 2017 in Companies/Corporations was 0.1 *per cent* (₹82.50 crore). The investment included ₹24,474 crore (39 *per cent*) to Companies/Corporations which were under perennial loss.

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

The State Government should review the working of State Public Sector Undertakings incurring losses and take appropriate action for their closure/revival.

Funds and other Liabilities

Reserve funds of the State *viz.*, corpus fund of Guarantee Redemption Fund was not created/revived. During 2016-17, the transactions relating to the Consolidated Sinking Fund included interest of ₹317.45 crore accrued on re-investment made by RBI, which did not pass through the accounts and non-investment in Consolidated Sinking Fund (₹878.12 crore) and Green Tax collections of ₹57.89 crore and corresponding expenditure was not transferred to fund account. Efforts should be made for liquidating Public Account balances under fund account by making suitable provision and incurring expenditure.

Recommendation: Rules with regard to administration and investment pattern of various reserve funds are required to be framed.

Also, expenditure should match the revenues so as to liquidate the balances within a reasonable period of time.

Debt sustainability

Open Market Loans had a major share (49 *per cent*) in the total fiscal liabilities of the State. The burden of interest payments measured by interest payments to revenue receipts ratio (IP/RR) was between 9.0 *per cent* and 9.6 *per cent* during 2012-13 to 2016-17. The net debt available to the State during 2016-17 (₹23,736 crore) increased by 40 *per cent* when compared to the previous year. The interest relief on NSSF loans as recommended by XIII FC was short to the extent of ₹192.42 crore.

Recommendation: Interest on Off-budget borrowings should form part of calculation of IP/RR ratio.