Chapter 1

Finances of the State Government

Profile of the State

Karnataka is the sixth largest State in terms of geographical area (1,91,791 Sq. km) and the eighth largest by population. The State's population recorded 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 (2011-12). The Gross State Domestic Product (GSDP) in 2017-18 at market prices was ₹13,10,879 crore. The State's literacy rate grew from 66.60 *per cent* to 75.40 *per cent* during the period 2001-11. The per-capita income of the State stands at ₹1,74,551 against the country average of ₹1,11,782 (As of March 2018 - Economic Survey Government of Karnataka, 2017-18). 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 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 **Appendix 1.1**. As seen from the appendix, in the years 2013-14 to 2017-18, Karnataka's GSDP growth rate at current prices, was more than that of the Nation's average growth rate.

1.1 Introduction

This chapter provides a broad perspective of the finances of the Government of Karnataka during 2017-18. It analyses important changes in 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 have been explained in **Appendix 1.2**.

1.1.1 Summary of fiscal transaction in 2017-18

Table 1.1 and **Appendix 1.3** present the summary of the State Government fiscal transaction during 2017-18 *vis-à-vis* the previous year (2016-17), while **Appendix 1.4** provides the details of receipts and disbursement as well as the overall fiscal position during preceding four years.

Table 1.1 Summary of fiscal transactions in 2017-18

(₹ in crore)

Receipts			Disbursements		
	2016-17	**2017-18**		**2016-17**	**2017-18**
Section A: Revenue					
Revenue Receipts	**1,33,213.79**	**1,46,999.65**	**Revenue Expenditure**	**1,31,920.75**	**1,42,482.33**
Tax revenue	82,956.13	87,130.38*	General Services	31,264.56	34,484.44
Non-tax revenue	5,794.53	6,476.53	Social Services	54,549.24	58,652.35
Share of Union taxes/duties	28,759.94	31,751.96^	Economic Services	40,421.37	42,855.78
Grants-in-aid and contributions from GOI	15,703.19	21,640.78#	Grants-in-aid and contributions	5,685.58	6,489.76
Section B: Capital and others:					
Misc. Capital receipts	**26.96**	**3.70**	**Capital Outlay**	**28,150.43**	**30,666.76**
			General Services	1,060.39	977.45
			Social Services	6,896.84	8,676.76
			Economic Services	20,193.20	21,012.55
Recoveries of Loans and Advances	**99.84**	**136.93**	**Loans and Advances disbursed**	**1,934.38**	**5,092.22**
Public debt receipts**	**31,155.92**	**25,121.86**	**Repayment of public debt****	**7,420.24**	**8,269.16**
Contingency Fund	-	-	**Contingency Fund**	-	-
Public Account Receipts	**1,79,318.45**	**2,00,615.43**	**Public Account disbursements**	**1,67,153.81**	**1,94,536.63**
Opening Cash Balance	**27,118.23**	**34,353.58**	**Closing Cash Balance**	**34,353.58**	**26,184.05**
Total	**3,70,933.19**	**4,07,231.15**	**Total**	**3,70,933.19**	**4,07,231.15**

Source: Finance Accounts 2017-18.

** includes SGST of ₹24,182 crore; ^ includes IGST of ₹3,204.72 crore and CGST of ₹447.56 crore.*
 # includes ₹6,246 crore towards Compensation for loss of revenue arising out of implementation of GST
*** Excluding net transaction under ways and means advances and overdraft.*

The following are the significant changes during 2017-18 over the previous year:

- Revenue receipts grew by ₹13,785.86 crore (10 *per cent*);
- Revenue expenditure increased by ₹10,561.58 crore (eight *per cent*);
- Miscellaneous capital receipts decreased by ₹23.26 crore (86 *per cent*);
- The State was able to increase the capital outlay by nine *per cent* over the previous year despite decrease in public debt receipts by 19 *per cent*; Increased capital expenditure, despite far lower debt receipts, if sustained, would be a good indicator of the State's financial health;
- Recoveries of Loans and Advances increased by ₹37.09 crore (37 *per cent*) and Disbursement of Loans and Advances increased by ₹3,157.84 crore (163 *per cent*) which includes loan waiver of ₹3,400.67 crore treated as capital expenditure;
- In Power Sector, the recovery of loans (₹14.44 crore) was adjusted against the Rural Energy Subsidy to be given to Karnataka Power Transmission Corporation Limited by Government of Karnataka;
- Public Debt receipts (excluding ways and means advances) decreased by ₹6,034.06 crore (19 *per cent*) and repayments increased by ₹848.92 crore (11 *per cent*);
- Public Account receipts increased by ₹21,296.98 crore (12 *per cent*) and disbursements by ₹27,382.82 crore (16 *per cent*); and
- Though the cash balance of ₹26,184 crore as on 31 March 2018 decreased by 24 *per cent* over the previous year, this level of cash balances does not appear to be financially prudent as it represents an unnecessary cost, equivalent to cost of borrowings of the State. The

GOK needs to examine whether this magnitude of cash balance is required and reduce its borrowings to meet requirements of capital expenditure/outlays.

1.1.2 Review of Fiscal situation

The Karnataka Fiscal Responsibility Act (KFRA) 2002 as amended from time to time was enacted with the objective of achieving inter-generational equity in fiscal management and long-term macro-economic stability. The KFRA envisaged sufficient revenue surplus and prudential debt management through limits on borrowings, debt and deficits. The State Government is on a fiscal consolidation path and has maintained guarantees within the limits prescribed under the Karnataka ceiling on Government Guarantees Act, 1999.

The State has 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. The targets for revenue and fiscal deficits and debt-GSDP ratio set for XIII FC and XIV FC periods along with their actual levels are given in **Table1.2**.

Table 1.2: Outcome vis-à-vis targets under KFRA

Period	Revenue Deficit/Surplus		Fiscal Deficit/GSDP (in *per cent*)		Debt/GSDP ratio (in *per cent*)	
	Ceiling as per KFRA	**Actual**	**Ceiling as per KFRA**	**Actual**	**Ceiling as per KFRA**	**Actual**
XIII FC (2010-15)						
2013-14	Maintain Revenue Surplus	Achieved the target	3.00	2.09	25.40	16.93
2014-15			3.00	2.14	25.20	18.00
XIV FC (2015-20)						
2015-16	Maintain Revenue Surplus	Achieved the target	3.00	1.89	25.00	18.10
2016-17			3.00	2.53	25.00	19.54
2017-18			3.00	2.37	25.00	18.78

By an amendment to KFRA, 2002 in February 2014, the scope of total liabilities as defined under Section-2(g) was amplified to include the borrowings by Public Sector Undertakings (PSU) and SPVs and other equivalent instruments, where the principal and/or interest are to be serviced out of the State Budget. The State Government has been amending the KFRA from time to time keeping in view the parameters prescribed by successive Finance Commissions.

The ratios of outstanding debt (inclusive of off-budget borrowings) and fiscal deficit to GSDP (₹13,10,879 crore) during 2017-18 were 18.78 *per cent* and 2.37 *per cent*, respectively, which were well within the prescribed limit of 25 *per cent* and three *per cent* respectively.

The Fiscal Management Review Committee (FMRC), headed by Chief Secretary was constituted in July, 2011. The Committee *inter alia* recommended (July, 2018) that all departments should initiate measures to increase non-tax revenues which has been discussed in **paragraph 1.3.1.2**.

Scrutiny of certain high end transactions during 2017-18

Scrutiny of certain high end transactions during 2017-18 revealed that the level of fiscal deficit and the liabilities in the Public Account were affected by certain accounting adjustments which are brought out in Notes to Accounts in Finance Accounts and detailed in **Table 1.3.** Further details are available in **paragraph 1.9.4**.

Table 1.3: Impact of high end transactions during 2017-18

(₹ in crore)

Sl. No.	Nature of transaction	Amount	Impact on fiscal indicators
1	Transfers from General Revenues to		
a	Infrastructure Initiative Fund (IIF)	1,578.00	In addition to the cess which was to be transferred to these funds additional funds amounting to ₹2,768 crore were transferred from general revenues to the fund accounts. The transfer had the effect of overstatement of revenue expenditure and fiscal deficit besides projecting reduced revenue surplus.
b	Bangalore Metro Rail Corporation Limited (BMRCL) Fund	775.00	
c	Chief Minister's Rural Road Development (CMRRD) fund	415.00	
2	Non-transfer of expenditure to State Urban Transport Fund (SUTF)	71.22	Transferring only cess without transferring expenditure resulted in overstatement of fiscal deficit to that extent.
3	Non-transfer of expenditure to Karnataka Forest Development Fund (KFDF)	299.09	Non-transfer of expenditure had the effect of overstatement of revenue expenditure and fiscal deficit and reduced revenue surplus.
4	Waiver of loans classified under Capital Expenditure instead of Revenue Expenditure	3,400.67	This resulted in inflating capital expenditure and reduced revenue expenditure and overstatement of revenue surplus.

Source: Notes to Accounts

1.1.3 Major Fiscal Variables

Major fiscal variables provided in the budget and targeted in KFRA, are depicted in **Table 1.4**.

Table 1.4: Major Fiscal variables

Fiscal variables	2017-18			
	Ceiling as prescribed in KFRA	Targets proposed in the Budget	Projections made in MTFP 2014-18	Actuals
Revenue Deficit (-) /Surplus (+) (₹ in crore)	-	137	1,538	4,518
Fiscal deficit/GSDP (*per cent*)	3.00	2.61*	2.86	2.37
Ratio of total outstanding debt of the Government to GSDP (*per cent*)	25.00	18.93*	23.03	18.78

**GSDP figures adopted in the BE were ₹12,80,465 crore (MTFP-2018-22) and were revised to ₹13,10,879 crore after the budget was presented.*

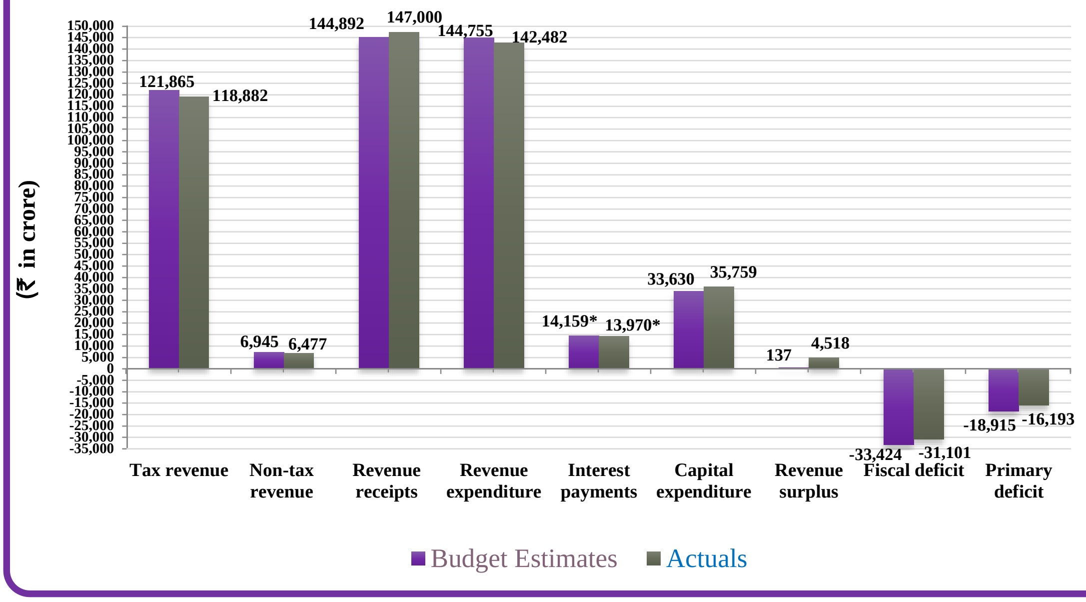
As evident from table above, all three parameters were well within the limits of KFRA.

1.1.4 Budget Estimates and Actuals 2017-18

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 2017-18.

Chart 1.1: Selected fiscal parameters: Budget estimates *vis-a-vis* Actuals in 2017-18



Source: Annual Financial Statement and Finance Accounts.

**excludes interest on off-budget borrowings.*

The budget estimates envisaged revenue receipts of ₹1,44,892 crore against which the actual realisation was ₹1,47,000 crore, an increase of ₹2,108 crore (one *per cent*). The increase was mainly under Grants-in-aid (GIA) and contributions from Government of India (GOI) (₹5,559 crore). The GIA includes ₹6,246 crore towards compensation for loss of revenue arising out of implementation of GST and off-set by decrease in Own-tax revenue (₹2,826 crore), Non-tax revenue (₹468 crore) and Central Tax transfers (₹156 crore).

Revenue expenditure was estimated at ₹1,44,755 crore against which the actual expenditure was ₹1,42,482 crore, a decrease of ₹2,273 crore (two *per cent*). The decrease in the actuals was noticed under general services (₹3,515 crore), economic services (₹825 crore) and grants-in-aid and contributions (₹697 crore) and off-set by increase under social services (₹2,765 crore).

The budget estimated interest payments at ₹14,159 crore (excluding off-budget borrowings - Borrowings by PSUs and other SPVs from financial institutions, where the responsibility of servicing the debt solely lies on the Government) against Major Head 2049. The actual payment was ₹13,970 crore (exclusive of off-budget borrowings of ₹1,043 crore). According to KFRA, 2002 (as amended on 28.02.2014), the interest on off-budget borrowings recorded below various service heads is also to be treated as the interest liability of the State.

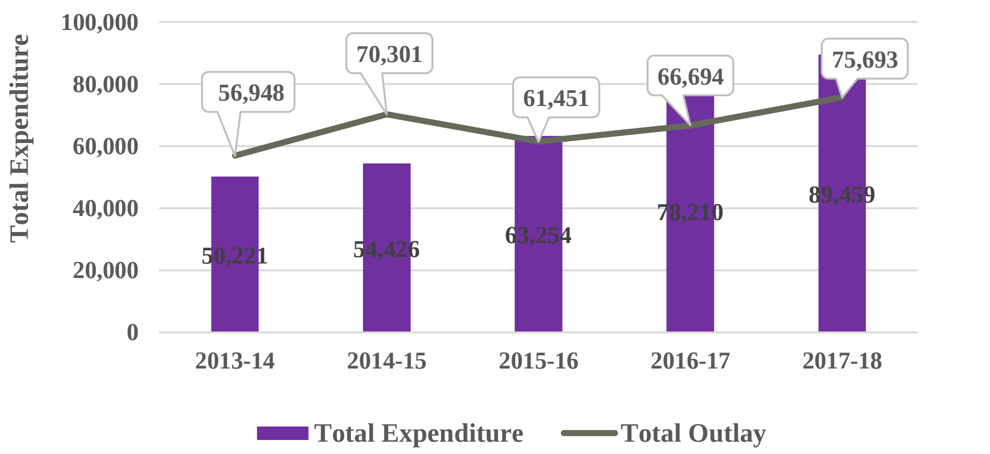
Major source of revenue receipts had been the State's own tax revenue which constituted 59 *per cent*. Including the non-tax revenue, the State's own resources were around 64 *per cent* during 2017-18.

1.1.5 Gender Budgeting

Gender budget discloses the expenditure proposed to be incurred within the overall budget on schemes which are designed to benefit women fully or partly. The State had created the Gender Budget cell (January 2007) and gender budgeting was introduced in 2007-08. The trends in total expenditure and total outlay under Gender Budgetary allocations during 2013-14 to 2017-18 are shown in **Chart 1.2.**

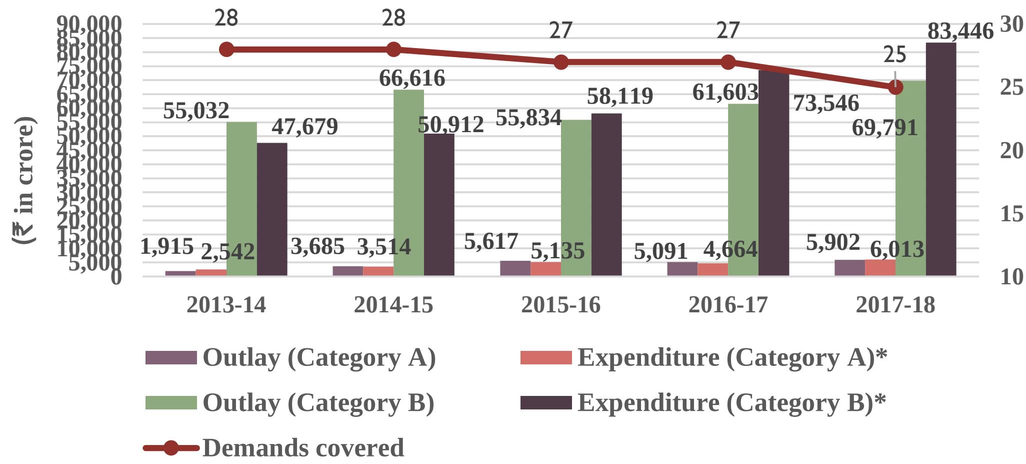
Chart 1.2 : Trends in Total Expenditure vs Total Outlay

(*₹in crore*)



As seen from the chart above, the total expenditure during 2013-14 and 2014-15 is less than the total outlay, whereas during 2015-16 to 2017-18 the expenditure is more than the outlay implying that the expenditure is not commensurate with the budget. The trends in the total outlay and total expenditure of Category A[1] and Category B[2] schemes under 28 demands covered during 2013-14 to 2017-18 are depicted in **Chart 1.3**.

Chart 1.3: Trends in Outlay and Expenditure of Category A and Category B schemes



**Expenditure figures for 2017-18 are Revised Estimate figures and not actuals.*

As seen from the **Chart 1.3**, in respect of Category A schemes during the year 2013-14, the expenditure was more than outlay and during 2014-15 to 2016-17, the expenditure is less than outlay. However, during 2017-18, the expenditure is more than the outlay implying that the entire budget was utilised. In case of Category B schemes, during the years 2013-14 to 2014-15, the expenditure is less than outlay, whereas during 2015-16 to 2017-18, the expenditure is more than outlay. The total number of schemes under Category A and B in 2017-18 were 724, of which 58 schemes were under Category A and 666 schemes were under Category B. The gender document also gives a brief explanatory note about the schemes indicating the objective of such schemes.

An analysis of some of the Category A schemes is brought out in the following paragraphs.

a) Samruddhi

The objective of the scheme is to stop exploitation of women by preventing them from taking loans with very high interest rates and also to overcome unemployment. Under this scheme 10,000 women who are running road side business are to be provided with financial assistance of ₹10,000 each. The scheme is being implemented by Women's Development Corporation, Bengaluru from 2016-17 onwards. The physical and financial targets,

[1] Budgetary allocation to schemes designed covering 100 *per cent* women beneficiaries.
[2] Budgetary allocations to schemes designed for covering at least 30 *per cent* women beneficiaries.

achievement and shortfall of the scheme is brought out in **Table 1.5** and **Table 1.6**.

Table 1.5: Financial target

(₹in crore)

Year	Budget	Releases	Expenditure	Savings
2016-17	10.00	10.00	8.87	1.13
2017-18	10.02	10.02	9.81	0.21

Table 1.6: Physical target fixed and achieved

Year	Number of BPL women given financial assistance		Shortfall	Percentage of shortfall
	Target	Achievement		
2016-17	10,000	8871	1129	11
2017-18	10,520	9810	710	7

Even though, the financial targets have been achieved, the department attributed the shortfall in physical progress due to the delay in the selection of beneficiaries by the selection committee during 2016-17. It also stated that due to election code of conduct, the complete target could not be achieved at the end of March 2018 and proposals received after March 2018 are under consideration.

b) Girl Guides

The scheme is under department of Education and has been introduced to support the voluntary organisation Bharat Scouts and Guides. The objective of the organization is to inculcate discipline and service motto among boys and girls studying in primary, middle and high schools. The physical target, achievement and shortfall of the scheme is brought out in **Table 1.7**.

Table 1.7: Physical target fixed and achieved

Year	Number of girl guides to be trained		Shortfall	Percentage of shortfall
	Target	Achievement		
2012-13	1,85,700	1,38,878	46,822	25.21
2013-14	2,68,600	2,03,664	64,936	24.18
2014-15	2,52,000	2,03,685	48,315	19.17
2015-16	2,13,000	1,62,939	50,061	23.50
2016-17	2,45,000	1,73,542	71,458	29.17
2017-18	2,76,500	2,22,868	53,632	19.40

There was shortfall in the percentage of girl guides to be trained during the period 2012-13 to 2017-18 to the extent of 19.17 *per cent* to 29.17 *per cent*. The department stated that the shortfall was due to lack of teachers attending the training courses who impart training to girl guides. Concerted efforts need to be made so as to train more girl guides and inculcate discipline and service motto.

1.1.6 Major policy initiatives of Budget 2017-18

Audit undertook a study on the action taken by the Government to implement major policy initiatives announced in the budget 2017-18 covering various departments of the Government with reference to the action taken report brought out along with the budget documents for 2018-19.

For this purpose, the Department of Health and Family Welfare was selected whose budget was ₹7,071 crore on revenue account and ₹1,162 crore on capital account. The expenditure as per accounts was ₹6,667 crore on revenue account and ₹1,133 crore on capital account indicating unutilised provision of ₹404 crore and ₹30 crore on revenue and capital accounts respectively constituting six and three *per cent* of budget provision. Some of the issues are summarised below and in **Appendix 1.5**.

a) Karnataka Ayush Drugs Manufacturing Society (KADMS) was not established as it was not approved by the Cabinet;

b) Out of 54 mortuaries to be constructed in CHCs, two are completed, one is under progress, 13 are yet to be taken up and the remaining 38 are not approved by the Government;

c) Out of the proposed Ayush Treatment Centres in 116 taluk hospitals, 93 are functioning and 23 are non-functioning; and

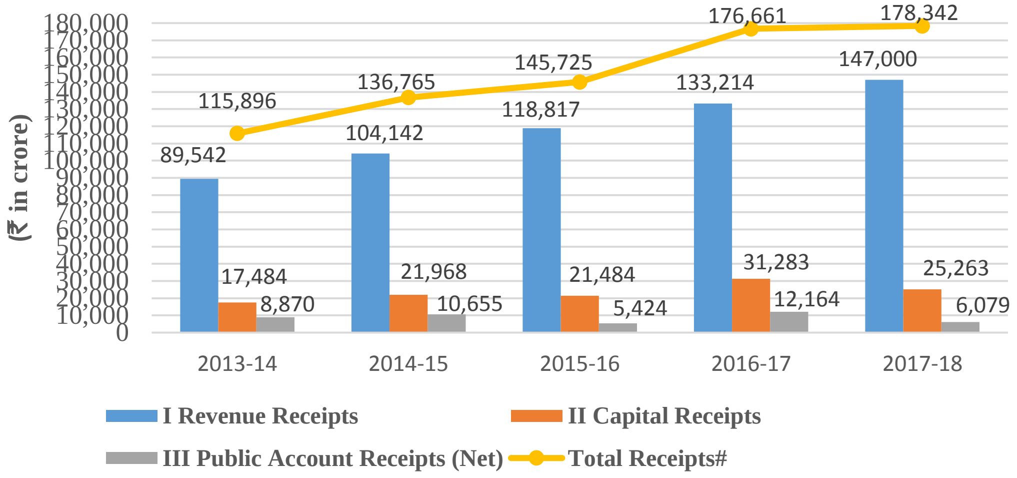
d) CT and MRI scan facility has been provided in 10 and 2 district hospitals against 14 and 6 district hospitals.

1.2 Resources of the State

1.2.1 Resources of the State as per the Annual Finance Accounts

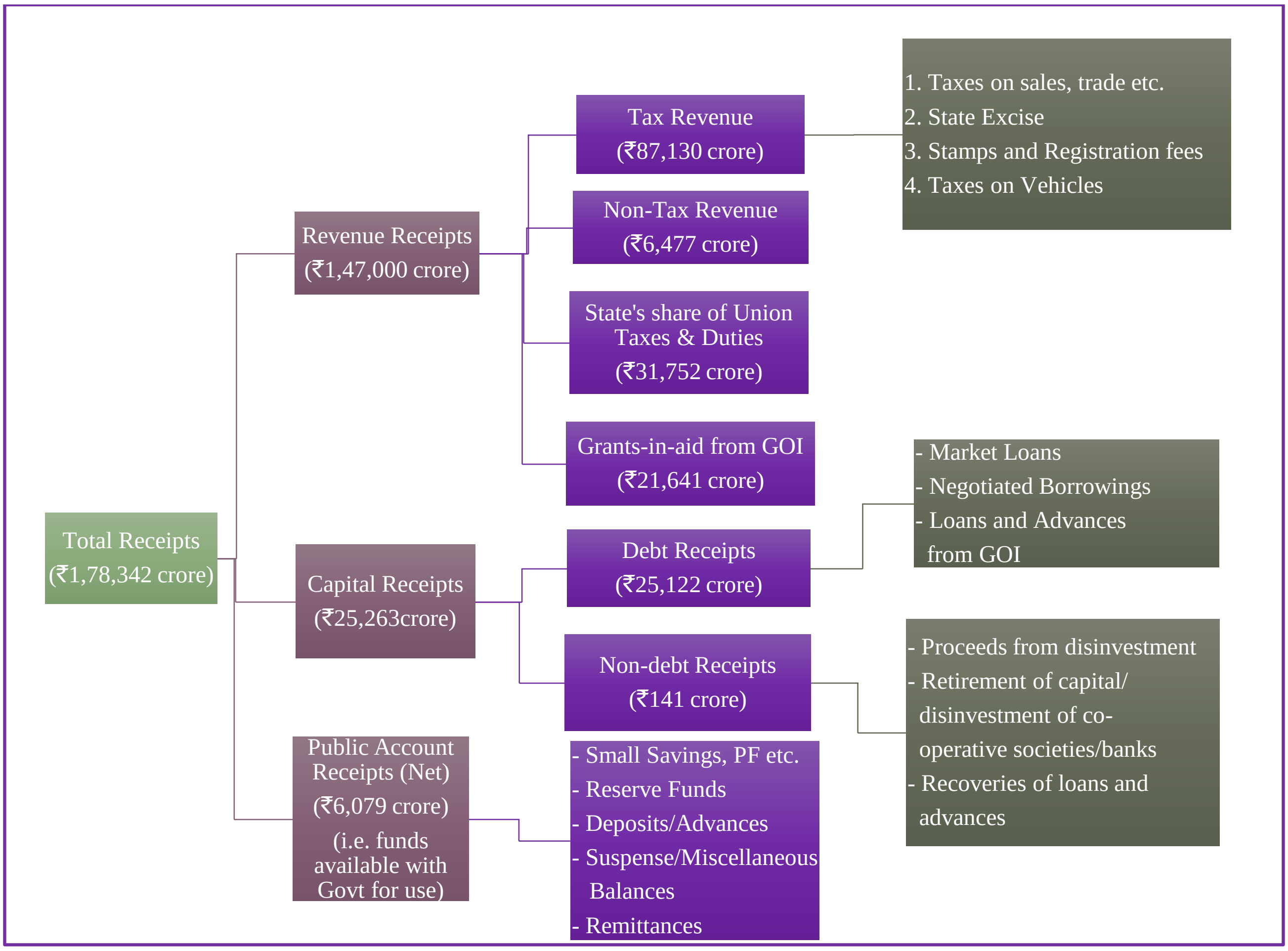
Revenue and Capital are the two streams of receipts that constitute the resources of the State Government. Revenue Receipts consist of tax revenue, non-tax revenues, States' share of Union taxes and duties and grants-in-aid and contributions from GOI. Capital receipts comprise miscellaneous capital receipts 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. 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 2013-14 to 2017-18. **Chart 1.5** depicts the components and sub-components of resources of the State during 2017-18.

Chart 1.4: Trends in receipts from 2013-14 to 2017-18



#excluding Contingency Fund receipts.

Chart 1.5: Components and sub-components of Resources



Source: Finance Accounts.

Total receipts (excluding Contingency Fund receipts) increased by 54 *per cent* from ₹1,15,896 crore in 2013-14 to ₹1,78,342 crore in 2017-18. Compared to the previous year (₹1,76,661 crore), there was an increase of ₹1,681 crore (less than one *per cent*) during 2017-18 (₹1,78,342 crore).

The share of revenue receipts in total receipts during 2017-18 was 82 *per cent*. Further details are provided in **paragraph 1.3**.

Capital receipts increased by 44 *per cent* from ₹17,484 crore in 2013-14 to ₹25,263 crore in 2017-18. During 2017-18, the capital receipts accounted for 14 *per cent* of total receipts. Debt receipts, the main constituent of capital receipts, decreased by ₹6,034 crore over the previous year. There was decrease in growth of internal debt receipts by 21 *per cent* and Loans and Advances increased by one *per cent* over the previous year. The non-debt capital receipts showed 11 *per cent* increase in growth during 2017-18 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, they constituted seven *per cent* of the total receipts during 2013-14 to 2017-18. Net Public Account receipts, which were ₹8,870 crore in 2013-14, increased to ₹12,164 crore in 2016-17, but decreased to ₹6,079 crore in 2017-18.

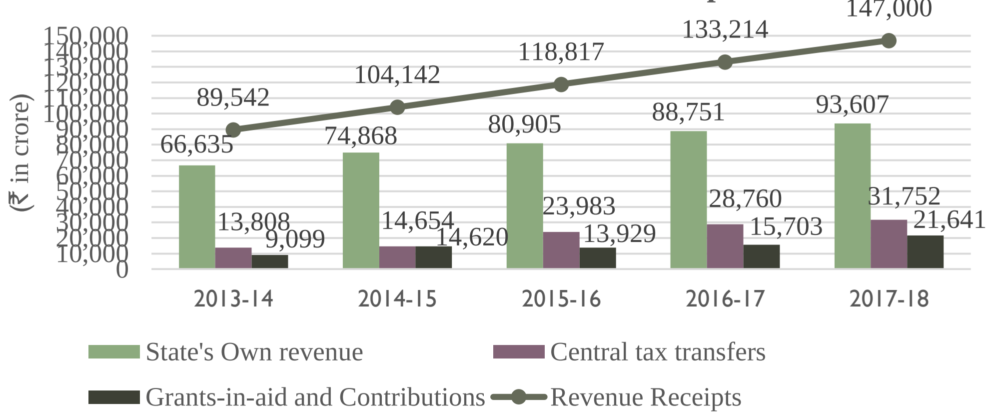
1.3 Revenue Receipts

The Government of Karnataka's fiscal position is largely influenced by the revenue side. On an average, 69 *per cent* of the revenue came from State's own resources during the period 2013-14 to 2017-18. 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 have been consistently growing, the Government of Karnataka has not improved revenues on the non-tax front, which was between four and five *per cent* of revenue receipts during 2013-14 to 2017-18 which is discussed in detail in **paragraph 1.3.1.2**.

The trends in revenue receipts relative to GSDP over the period 2013-14 to 2017-18 are presented in **Appendix 1.4** and its composition are also depicted in **Chart 1.6**.

Chart 1.6: Trends in Revenue Receipts



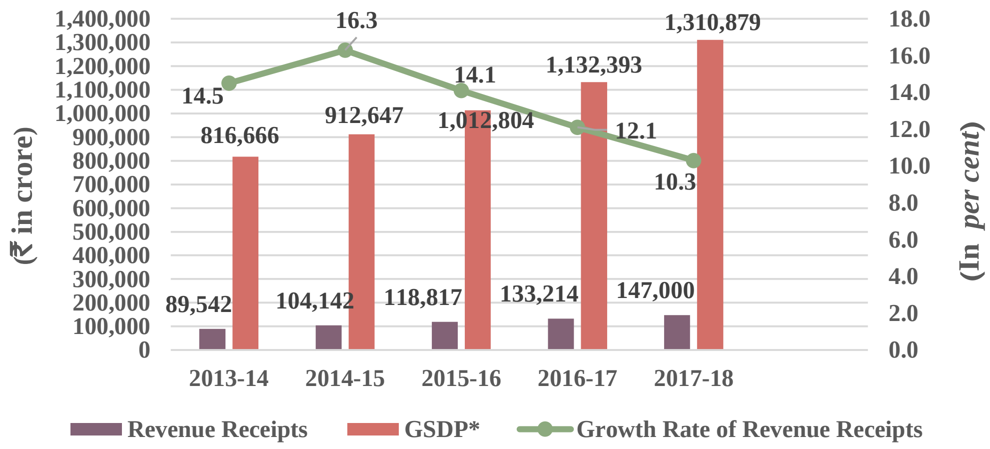
Source: Finance Accounts.

As seen from the appendix,

- Revenue buoyancy[3], which is directly proportionate to growth of revenue receipts and increase in GSDP, showed an oscillating trend and ranged between 0.83 and 1.39 during the five year period. The growth rate of Revenue Receipts decreased from 14.54 *per cent* in 2013-14 to 10.35 *per cent* in 2017-18; and
- Buoyancy of State's own tax revenue to GSDP showed an oscillating trend and recorded a sharp fall in the year 2017-18 due to fluctuation of growth of tax revenue. It was 0.94 in 2013-14, 0.70 in 2015-16, 0.83 during 2016-17 and was at its lowest of 0.32 during 2017-18.

Chart 1.7 depicts the rate of growth of revenue receipts compared to GSDP and total revenue receipts and **Chart 1.8** depicts the trends of buoyancy ratios.

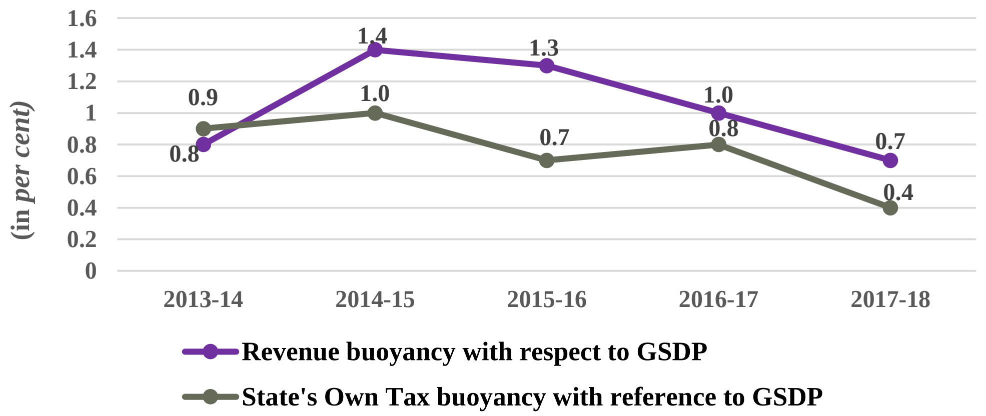
Chart 1.7: Growth revenue receipts with reference to GSDP



Source: Finance Accounts and Economic Survey, GOK for 2017-18 and MOF, GOI letter dt 28 August 2017.

For GSDP figures adopted in audit reports of previous years, refer* ***Appendix 1.4.*

Chart 1.8: Trend of Buoyancy of Revenue



[3] Buoyancy ratio indicates the elasticity or responsiveness of a fiscal variable with respect to a given change in the base variable. For instance, revenue buoyancy at 0.4 implies that revenue receipts tend to increase by 0.4 percentage points, if the GSDP increases by one *per cent*.

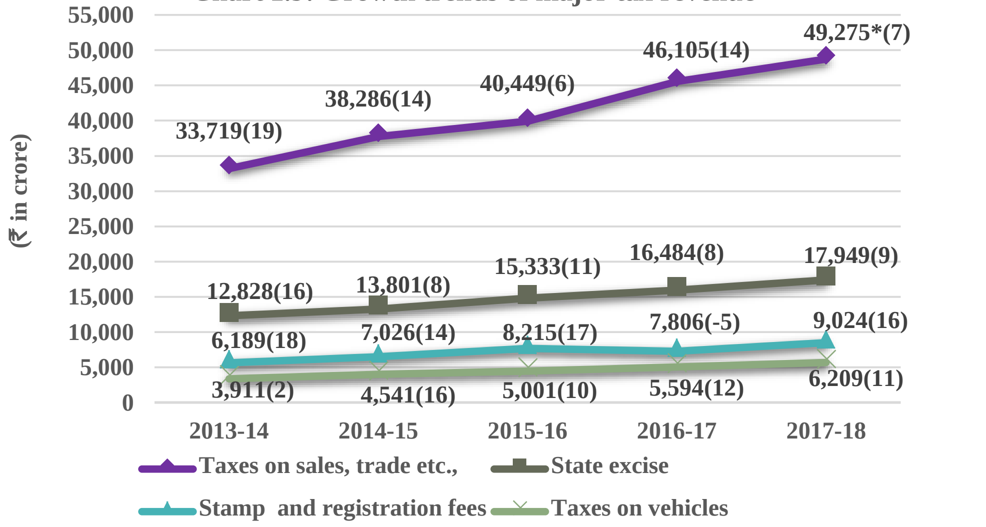
Revenue buoyancy with respect to GSDP showed growth till 2014-15 and a decline thereafter. The State's Own Tax Buoyancy with reference to GSDP increased marginally from 2013-14 to 2014-15 decreased thereafter with inter year variations.

1.3.1 State's Own Resources

1.3.1.1 Tax Revenue

Taxes on sales, trade, etc., (29 *per cent*) and State Goods and Service Tax (28 *per cent*) were the main source of the State's tax revenue followed by State Excise (21 *per cent*), Stamps and Registration Fees (ten *per cent*) and Taxes on Vehicles (seven *per cent*) during 2017-18. The components and trends of tax revenue during the period 2013-14 to 2017-18 are shown in **Appendix 1.4** and **Chart 1.9**.

Chart 1.9: Growth trends of major tax revenue



**includes SGST of ₹24,182 crore.*
figures in bracket denote rate of growth.

The taxes on sales, trade etc., increased from ₹33,719 crore in 2013-14 to ₹49,275 crore in 2017-18, an increase of 46 *per cent* (₹15,556 crore in terms of amount) which includes SGST of ₹24,182 crore also. State Excise, which was the second largest contributor to State's own tax revenues increased by 40 *per cent* during the same period. During the period 2013-14 to 2017-18, the Stamps and Registration fees increased from ₹6,189 crore to ₹9,024 crore, an increase of 46 *per cent*. The Motor vehicle taxes also contributed significantly to own tax revenues. It increased by 59 *per cent* (₹2,298 crore in terms of amount) during the period 2013-14 to 2017-18.

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 **Appendix 1.6**. As seen from the appendix, the percentage of cost of collection to the gross collection was significantly less than the All India Average for the period 2013-18 indicating that the expenditure on collection in Karnataka was significantly less than All India expenditure except for taxes on sales, trade etc., for 2013-14 and 2014-15.

Comparison of Own Tax Revenue to GSDP

A comparison of State's Own Tax Revenue to GSDP of Karnataka for 2017-18 with neighbouring States is given in **Table 1.8**.

Table 1.8: Comparison of Own Tax Revenue to GSDP with neighbouring States

(₹ in crore)

Sl. No.	Component	Karnataka	Kerala	Tamilnadu	Maharashtra
1	Own Tax revenue	87,130	46,460	93,737	1,67,932
2	GSDP	13,10,879	6,86,116	14,27,074	24,96,505
3	Own Tax/ GSDP (in *per cent*)	6.65	6.77	6.57	6.73

Own Tax Revenue as percentage of GSDP was better for Karnataka State (6.65 *per cent*) during 2017-18 when compared to the neighbouring State of Tamilnadu (6.57 *per cent*) but less than that of Maharashtra (6.73 *per cent*) and Kerala (6.77 *per cent*).

1.3.1.2 Non-tax revenue

Non-tax receipts (fees, user charges, interest receipts, etc.) are generally raised through non-statutory mandates. 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 State's Fiscal Reforms and Budget Management Committee (FRBMC) has recognised the fact that non-tax revenue needs to be increased and advised departments every year to take forward measures to increase non-tax revenues and to adopt auction route in order to increase revenues from the mines and minerals. The Budget circular issued by the Government (2017-18) in this regard also emphasized the need to step up collections under non-tax revenue over the present level of collections. All Administrative Departments should conduct a thorough review of all non-tax revenue sources and initiate action to revise the rates of non-tax revenue/user charges.

Similarly, efforts should be made to collect interest receipts, dividends and capital recoveries from various Public Undertakings, Co-operatives, Autonomous Institutions and other departmental loans based on the terms and conditions of the loans, investment made and periodicity of the repayments.

The trends in collection of non-tax revenue are given in **Appendix 1.4**. The components of non-tax revenue for 2017-18 are presented in **Chart 1.10** and the trends in non-tax revenue and its growth rate during the period 2013-14 to 2017-18 is shown in **Chart 1.11**.

Chart 1.10: Components of non-tax revenue in 2017-18

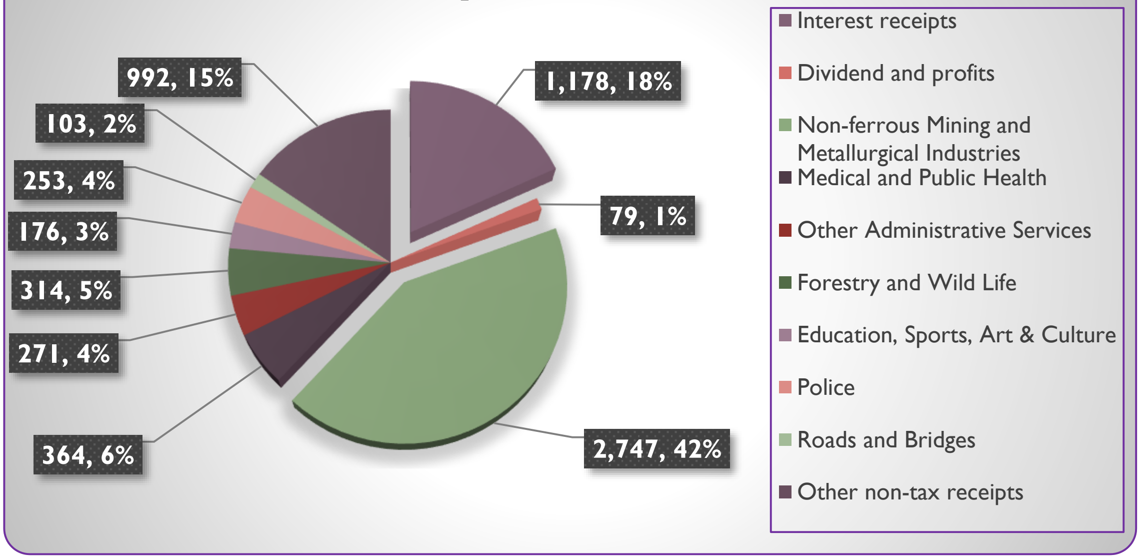
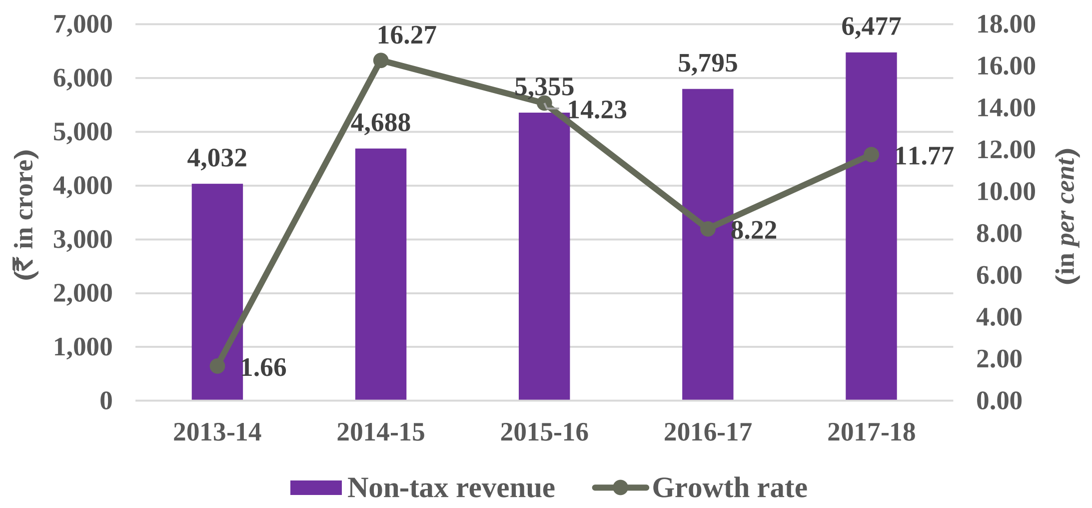


Chart 1.11: Non-tax revenue and its growth rate



As seen from the chart above, the growth rate of non-tax revenue increased from 1.7 *per cent* in 2013-14 to 11.8 *per cent* in 2017-18 with inter year variations.

In the Economic Survey for 2017-18, it was admitted that non-tax revenues are an important fiscal challenge faced by the State, which warrants necessary measures to recover user charges at optimal levels. The ratio of non-tax revenue to total receipts has been continuously low. This is due to low recovery of costs. In many departments, the revision of user charges, fees & fines and other such non-tax receipts has not taken place for many years.

The Finance Department stated that all administrative departments have been instructed to revise non-tax revenues. Based on the instructions, the Home department revised its user charges vide GO dated 27.10.2017 and 20.11.2017. Similarly, the Labour department has revised the fees payable for license and annual renewal fees by factories vide its notification dated 11.10.2017 and 24.03.2018. The Department of Personnel and Administrative Reforms has revised the user charges related to Karnataka Bhavan, New Delhi and Kumara

Krupa Guest House, Bengaluru in January 2018 and August 2018 respectively. All departments should review the revision of non-tax revenue/user charges from time to time based on the instructions/directions issued by the Finance Department.

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 the Consolidated Fund of the State. Even with revision of rates and better collection mechanisms, the increase in revenues from this avenue may not be large due to the existing low base. Though the Expenditure Reforms Commission has made a number of recommendations in 2010 to enhance revenues from user charges, the achievement is poor.

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 partly in 14-day intermediate Treasury bills of RBI with an average interest rate of 3.35 *per cent* per annum and partly in 91 day intermediate TB's of RBI with an average interest rate of 6.17 *per cent* against an average rate of 7.69 *per cent* per annum at which the borrowings are made. Against the budgeted estimate of ₹1,097 crore during 2017-18, the revenue realised was ₹1,078.30 crore, of which 14 day TBs yielded ₹331.14 crore and 91 day TBs yielded ₹747.16 crore.

The interest realised on loans and advances given by Government to its Companies/ Corporations etc., stood at ₹99.45 crore, working out to less than one *per cent* of the outstanding balances of loans at the end of the year. The receipts also included interest on capital of departmentally run commercial undertakings[4].

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 the savings bank accounts. The budgetary grants released to the departments in previous years that remain unutilised are kept in banks. The Finance Department initiated action by issuing directions/ instructions (May 2018) for remittance of these balances/interest on the balances. A sum of ₹62.62 crore, being the interest earned on the balances in savings bank during 2017-18, was accounted under the HOA '0049-04-800-6-01 – Interest received from deposit accounts'.

The return on investment in the form of dividends declared by the Companies/ Corporations and credited to Government account during 2017-18 was ₹78.83 crore. Considering the magnitude of Government investment (₹65,146 crore), the return works out to a meagre 0.12 *per cent*.

[4] Interest on Capital in Silk Filatures of ₹0.63 crore, the adjustments of which were made through book transfer.

Other non-tax receipts

The other major non-tax revenue is royalty on major and minor minerals. Against the budget estimate of ₹2,251 crore, the actual realisation was ₹2,590 crore. There was an increase of ₹361 crore compared to the previous year.

Non-remittance of user charges/fees into Consolidated fund of the State

Article 266 (1) of the Constitution of India provides that all revenues received by the State Government, all loans raised by the Government by issue of treasury bills, loans or ways and means advances and all moneys received by the Government in repayment of loans form one Consolidated Fund called 'the Consolidated Fund of the State'. No moneys out of the Consolidated Fund of the State shall be appropriated except in accordance with law and for the purposes and in the manner provided in the Constitution.

Two cases of Non-remittance of user charges/fees into Consolidated Fund of the State are given below.

a) Tiger Conservation Foundation

Government of Karnataka approved (December 2007), the establishment of three Tiger Conservation Foundations in Tiger Reserves of Bandipura, Bhadra and Anshi-Dandeli. The foundation earned income in the form of user charges, through collection of entry fees, parking fees and other charges at these tiger reserves.

A check of records of these tiger reserves, showed that the user fees assigned to the tiger conservation foundation is being deposited in the bank account. During the period from 2012-13 to 2017-18, ₹46.75 crore of user charges collected were deposited in various nationalised banks as detailed in the **Table 1.9**.

Table 1.9: Remittance of user fees in bank account

(₹ in crore)

Sl. No.	Name of the Foundation	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total
1	Bhadra	0.21	0.32	0.44	0.53	0.71	1.01	**3.22**
2	Anshi-Dandeli	1.00	0.92	1.51	2.10	1.91	2.09	**9.53**
3	Bandipur	3.08	4.50	5.52	6.69	7.14	7.07	**34.00**
	Total	**4.29**	**5.74**	**7.47**	**9.32**	**9.76**	**10.17**	**46.75**

These user charges/fees are not remitted into the Consolidated Fund of the State but are utilised by Tiger Reserve Foundations to facilitate ecological, economic, social and cultural development.

b) District Mineral Foundation (DMF) fund

As per Government of India Notification dated 17.09.2015, all recipients of mining leases executed before 12.01.2015 (the date on which the MMDR amendment Act came into force) will have to contribute an amount equal to 30 *per cent* of the royalty payable to the DMF fund. In the cases where mining leases are granted after 12.01.2015, the rate of contribution will be 10 *per cent* of the royalty payable.

The State Government vide GO dated 05.11.2015 notified the establishment of District Mineral Foundation (DMF) fund in each district of Karnataka with effect from 12.01.2015 and accorded sanction (January 2016) for opening of Deposit account of DMF fund under HOA 8449-00-120-9-45 – District Mineral Foundation Fund in Public Account in each district treasury, where mining activities takes place. It is utilised for specific purposes to implement activities and welfare programmes[5].

As per notification dated 11.01.2016, DMF fund shall be kept in non-interest bearing deposit account under Public Account, one in each district and with the approval of the State Government, can be kept in interest bearing account in the treasury or designated bank as the State Government may in general or special guidelines permit. However, vide notification dated 08.03.2018 DMF trust shall open a bank account in any of the nationalised bank and shall operate the account as per the provisions of the trust guidelines. The balance in the fund was ₹909.96 crore as on 31 March 2018.

The contribution to the DMF fund is a percentage of royalty paid by the miners and in the nature of non-tax revenue of the State. Therefore, the contribution to the DMF fund should form a part of the Consolidated Fund of the State. Hence, directly accounting in the Public Account in treasuries till 07.03.2018 and then in the bank accounts thereafter is not correct.

When the issue was brought to the notice of the department that the percentage of royalty realised were not remitted to the Consolidated Fund of the State and it was in contravention to the provisions of Article 266(1) of the Constitution of India, Secretary to the Government of Karnataka (MSMEM), Commerce and Industries Department replied (August 2018) that contributions towards DMF is being collected from the miners and is to be spent in the mining affected area of the district only. Therefore, the contribution will not be part of the Consolidated Fund of the State but is part of the mineral wealth of that region, to be utilised for their benefit only.

The reply of the department is not acceptable as audit is commenting on the accounting of the receipts collected into DMF and not the utilisation of the amount. Further, non-remittance of user charges/fees escapes the scrutiny of the Legislature. Therefore, a system for remittance/release of such money needs to be put in place for tracking the revenues/expenditure.

[5] Like drinking water supply, healthcare, education, sanitary work etc., in the mining affected areas, to alleviate the adverse impact of mining on the people and environment and create long term sustainable livelihood opportunities for mining affected people.

1.3.2 Grants-in-aid from GOI

Grants-in-aid and Contributions from GOI increased from ₹9,099 crore in 2013-14 to ₹21,641 crore in 2017-18 as shown in **Appendix 1.4**. As compared to the previous year, there was an increase of ₹5,938 crore during 2017-18. As the distinction between plan and non-plan has been removed from 2017-18 onwards, the increase in receipts is mainly under Centrally Sponsored Schemes (CSS) (₹11,177 crore), Other transfers/Grants to States (₹7,316 crore) which includes ₹6,246 crore towards compensation for loss of revenue arising out of implementation of GST and Finance Commission Grants (₹2,708 crore).

1.3.3 Central tax transfers

The Government of India transfers share of the 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 2013-18 are given in **Table 1.10**.

Table 1.10: Trends in Central Tax transfers

(₹ in crore)

Particulars	2013-14	2014-15	2015-16	2016-17	2017-18
Corporation Tax	4,643.76	5,117.21	7,547.57	9,211.05	9,721.29
Taxes on Income other than Corporation Tax	3,057.77	3,654.18	5,252.47	6,401.72	8,208.94
Taxes on Wealth	12.75	13.81	1.65	21.08	(-) 0.29
Customs	2,252.90	2,369.95	3,830.22	3,962.25	3,203.80
Union Excise duties	1,591.16	1,338.24	3,181.60	4,524.54	3,348.80
Service Tax	2,249.93	2,160.75	4,153.56	4,639.22	3,617.15
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	(-) 0.01
Integrated Goods and Service Tax (IGST)	-	-	-	-	3,204.72
Central Goods and Service Tax (CGST)	-	-	-	-	447.56
Total	**13,808.28**	**14,654.25**	**23,983.34**	**28,759.94**	**31,751.96**

Source: Finance Accounts of the respective years.

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. During 2017-18, out of total net collection of Union taxes of ₹6,73,012 crore, the net devolution of State's share is ₹31,751.96 crore and the share of Corporation tax, Taxes on income other than Corporation tax, Customs and IGST was 4.713 *per cent*, Union Excise duties was 4.666 *per cent*, CGST was 4.628 *per cent* and Service tax was 4.812 *per cent*.

1.3.4 XIV Finance Commission Grants

1.3.4.1 Introduction

As per the terms of reference of the XIV FC constituted by the President under Article 280 of the Constitution on 2 January 2013, the Commission shall make recommendations in respect of measures needed to augment the Consolidated

Fund of the State to supplement the resources of the Panchayats and Municipalities in the State.

1.3.4.2 Grants to PRIs/ULBs

The Commission recommended ₹2,969.74 crore during 2017-18 as transfer to the State in the areas indicated in **Table 1.11**.

Table 1.11: Transfer of recommended and actual release of grants during 2017-18

(₹in crore)

	Transfers	Recommended amount	Actual release	Short fall
a	Basic Grants to PRIs	1,604.42	1,580.18	24.24
b	Performance Grants to PRIs	206.13	-	206.13
c	Basic Grants to ULBs	899.25	899.25	-
d	Performance Grants to ULBs	259.94	-	259.94
	Total	**2,969.74**	**2,479.43**	**490.31**

As of March 2018, the State Government received ₹1,580.18 crore of Basic Grants[6] for Panchayat Raj Institutions(PRIs) against the recommendation of ₹1,604.42 crore and received the entire recommended amount of ₹899.25 crore towards Basic Grants to Urban Local Bodies(ULBs).

The 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.

For the year 2017-18, the Performance Grants[7] to PRIs and ULBs were not released till the end of March 2018. Rural Development and Panchayatraj department in its reply (November 2018) stated that the claim for 2017-18 Performance Grants pertaining to PRIs has been submitted to Government of India (February 2018) after attending to compliance as suggested by GOI. Reply from ULBs is yet to be received.

1.3.5 Releases under Disaster Relief

Against the recommended amount of ₹305.00 crore towards State Disaster Relief Fund (SDRF), only ₹228.75 crore (75 *per cent*) was released, an increase of ₹11.25 crore (five *per cent*) over the previous year. The 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

[6] The basic grants to PRIs and ULBs for 2016-17 was ₹1,368.21 crore and ₹778.29 crore respectively.

[7] The performance grants to PRIs and ULBs for 2016-17 was ₹179.45 crore and ₹229.70 crore respectively.

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.

Even though GST has been implemented from 2017-18 onwards, the contributions from GOI towards SDRF for 2017-18 was at 75 *per cent* only instead of 90 *per cent*. Failure on the part of the State Government to pursue the matter with Government of India, resulted in the State Government losing grants to the extent of ₹45.75 crore.

1.3.6 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 2016-17 to 2017-18 are indicated in **Table 1.12**.

Table 1.12: Details of exemptions/revenue foregone

(₹ in crore)

Particulars	2016-17	2017-18#
Tax expenditure/ revenue foregone under deferment of purchase tax on sugarcane	78.20	29.10
Entry Tax Exemption/ VAT deferment/ CST deferment	712.00	137.38
Total	**790.20**	**166.48**

Source: MTFP – 2018-22.

#for the first three quarters of 2017-18.

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

The 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.

1.3.7 Implementation of Goods and Service Tax (GST) in Karnataka

The State Government implemented the Goods and Services Tax (GST) Act which became effective from 1 July 2017. According to GST (Compensation to the States) Act 2017, the Central Government will compensate the States for loss of revenue arising on account of implementation of GST for a period of five years. The compensation payable to the State shall be calculated for every financial year after the receipt of final revenue figures, as audited by the CAG of India. A base year (2015-16) revenue figure of taxes subsumed under GST was finalised under the GST Act. In case of Karnataka State, the revenue was ₹36,144.15 crore during the base year (2015-16). The projected revenue for any year in a State shall be calculated by applying the projected growth rate (14 *per cent* per annum) over the base year revenue of that State. Therefore, the projected revenue for the year 2017-18 shall be ₹46,972.94 crore at 14 *per cent* growth rate.

The projected revenue for the period from 1st July 2017 to 31st March 2018 in accordance with the base year figure was ₹35,229.69 crore (₹3,914.41 crore X 9 months). Revenue figures under GST for the year 2017-18 have been depicted in Finance Accounts as per the nature of receipts i.e. State Goods and Services Tax (SGST), Input Tax Credit cross utilisation of SGST and IGST (Integrated Goods and Services Tax), Apportionment of IGST-Transfer-in of Tax component to SGST and Advance apportionment from IGST.

Against the projected revenue of ₹35,229.69 crore for the period from 1st July 2017 to 31st March 2018, taxes collected by the State (pre-GST taxes & SGST), IGST portion (including provisional/advance apportionment of IGST) received from the Central Government and GST compensation received aggregating to ₹35,095.12 crore and balance GST compensation receivable was ₹134.57 crore as detailed in **Appendix 1.7**.

1.4 Capital Receipts

Capital receipts of the State Government include non-debt (miscellaneous capital receipts and recovery of loans and advances) and debt receipts. The Public Debt receipts during 2017-18 (₹25,122 crore) comprised internal debt of ₹23,179 crore (92 *per cent*) and Loans and Advances from GOI ₹1,943 crore (eight *per cent*). Market borrowings had a major share under internal debt, comprising 95 *per cent* followed by negotiated loans (five *per cent*). Loans from GOI comprised other loans only. The composition of capital receipts during the period 2013-14 to 2017-18 are indicated in **Appendix 1.4**.

Overall, capital receipts increased from ₹17,484 crore in 2013-14 to ₹25,263 crore in 2017-18. Debt receipts had a predominant share in capital receipts which were between 98 and 99 *per cent* during 2013-14 to 2017-18. 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 2017-18. It also included book adjustment of ₹14.44 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 2013-14 to 2017-18 are indicated in **Table 1.13**.

Table 1.13: Net transaction under Public Account

(₹ in crore)

Resources under sectors of Public Account (Net)	2013-14	2014-15	2015-16	2016-17	2017-18
I. Small Savings, PF etc.,	3,107	2,156	2,086	2,657	2,811
J. Reserve Funds	1,264	1,547	2,081	6,013	3,019
K. Deposits and Advances	2,840	3,702	284	3,041	1,834
L. Suspense and Misc.	2,671	3,282	990	491	(-) 1,509
M. Remittances	(-) 12	(-) 32	(-) 17	(-) 38	(-) 76
Total	**8,870**	**10,655**	**5,424**	**12,164**	**6,079**

The net receipts from Public Account increased from ₹8,870 crore in 2013-14 to ₹12,164 crore in 2016-17 and reduced to ₹6,080 crore in 2017-18. This includes transfer of ₹2,768 crore from General Revenues of the State to Infrastructure Funds in Public Account. Similarly, an amount of ₹71.22 crore 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 ₹1,807 crore deposits made in Panchayat Bodies Fund. Under Suspense and Miscellaneous, there was increase in transactions relating to un-encashed cheques which amounted to ₹1,521 crore during 2017-18. An analysis of the transaction is brought out in **paragraph 1.8.6**.

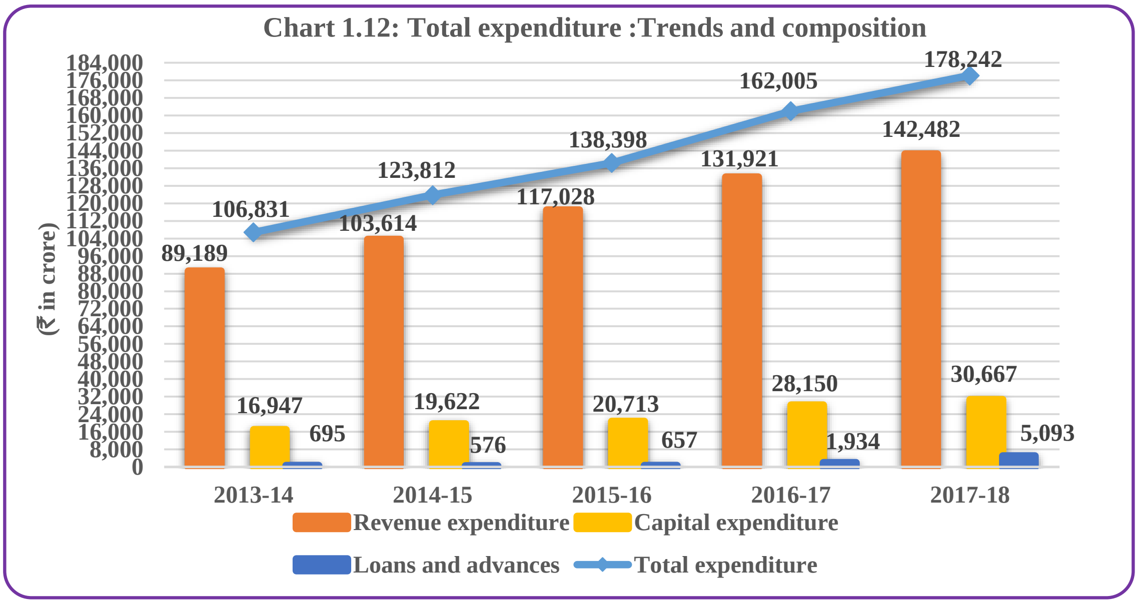
1.6 Applications of resources

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

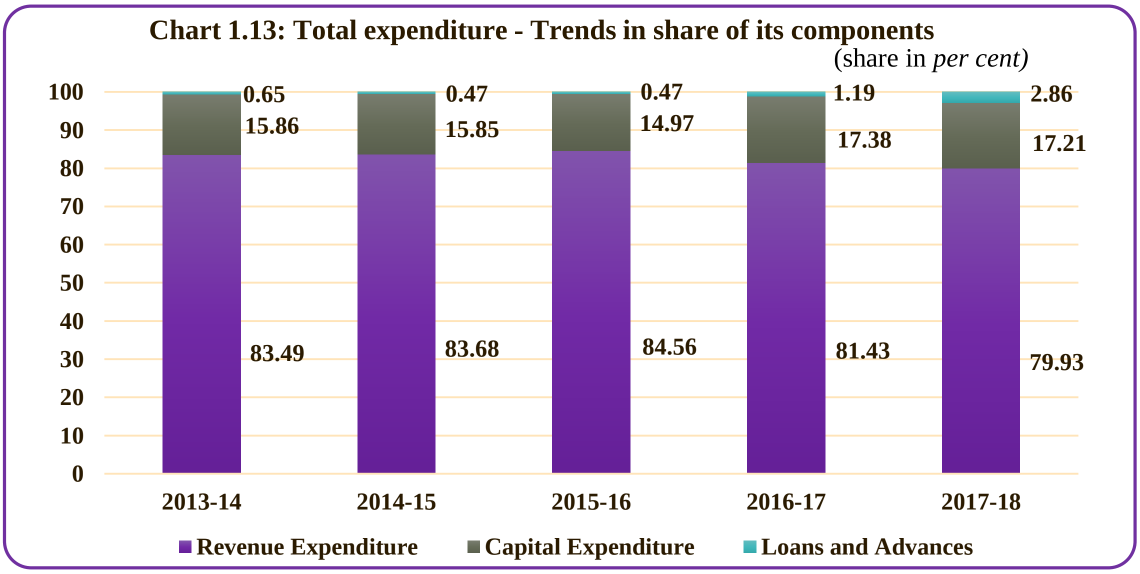
The basic parameters of total expenditure, growth rate and comparison with GSDP etc., are furnished in the **Appendix 1.4**. **Chart 1.12** presents the trends in total expenditure over a period of five years (2013-14 to 2017-18) and its composition under revenue, capital and loan and advances.



Total expenditure increased by 67 *per cent* from ₹1,06,831 crore in 2013-14 to ₹1,78,242 crore in 2017-18 due to increase in revenue expenditure (₹53,293 crore), capital outlay (₹13,720 crore) and disbursement of loans and advances (₹4,398 crore).

During the period 2013-14 to 2017-18, on an average, 83 *per cent* of the total expenditure was on revenue account. During 2017-18, it was 80 *per cent*. The share of capital expenditure (including loans and advances) was 20 *per cent*.

The share of Revenue Expenditure, Capital Expenditure and Loans and Advances for the years 2013-14 to 2017-18 is given in **Chart 1.13**.



Revenue expenditure had a predominant share in total expenditure as around 62 *per cent* of the expenditure was committed expenditure alone 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 1.14**.

Table 1.14: Total Expenditure – Trends by activities

(share in per cent)

	2013-14	2014-15	2015-16	2016-17	2017-18
General Services	23.83	23.33	22.97	19.95	19.90
Social Services	33.39	35.17	37.30	37.93	37.77
Economic Services	37.43	36.17	34.87	37.42	35.83
Loan and Advances	0.65	0.47	0.47	1.19	2.86
Grants-in-aid and contributions	4.70	4.86	4.39	3.51	3.64

Source: Finance Accounts of the respective years.

The movement of relative share of these components exhibited relative stability during the period from 2013-14 to 2017-18 with marginal inter year variations. The share of General Services decreased gradually while the share of Social and Economic Services decreased in 2017-18 when compared to the previous years. The share of loans and advances declined sharply from 2013-14 to 2015-16 and increased to 2.86 *per cent* in 2017-18.

The Expenditure Reforms Commission (ERC) in its First Report (February 2010) had recommended capital investments to be stepped up and protected from fiscal uncertainties through prudent allocations. It had also recommended maintaining the capital expenditure (excluding debt servicing) at five *per cent* of GSDP. However, the ratio of capital expenditure to GSDP which was at two *per cent* during 2013-14 to 2015-16, increased to three *per cent* during 2016-17 and 2017-18.

1.6.2 Revenue Expenditure

Revenue expenditure comprises 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 (NGOs) 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 ₹89,189 crore in 2013-14 to ₹1,42,482 crore in 2017-18, an increase of 60 *per cent*. Compared to the previous year, the increase was eight *per cent*, due to increase in salary expenditure (₹1,250 crore), interest payments (₹2,057 crore), pensions (₹389 crore) and devolution to local bodies (₹1,665 crore) etc.

The revenue expenditure during 2017-18 also included ₹3,382.21 crore provided as Guarantee Commission[8] (₹13.80 crore), Adjustment of interest on Karnataka Government Insurance Fund (₹190.48 crore), Adjustment of interest on fund balances under Karnataka Government Insurance Schemes (₹832.37 crore), Adjustment of interest on GP Fund balances under Karnataka General Provident Fund (₹1,054.67 crore), ESCOMs (₹1,290.24 crore) being the dues of electricity tax etc., treated as subsidy and adjustment of interest on Capital invested in Government Commercial Undertakings (GCU's) (₹0.65 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 as indicated in MTFP 2018-22 covering the period 2013-14 to 2017-18 is depicted in **Table 1.15** and **Chart 1.14**.

Table 1.15: Trends in Committed Expenditure

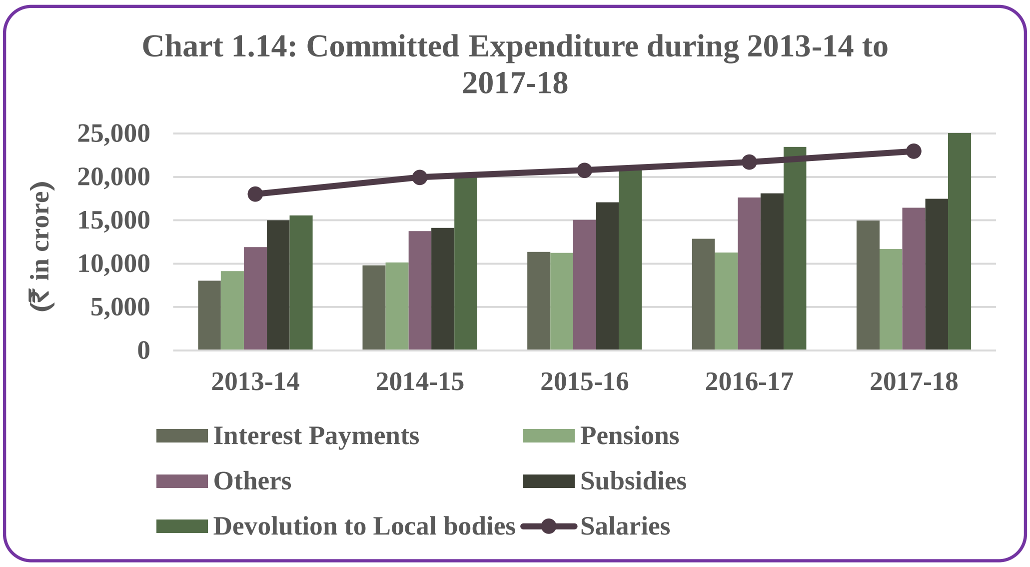
(₹ in crore)

Sl. No.	Particulars	2013-14	2014-15	2015-16	2016-17	2017-18	
						BE	Actuals
1	Salaries* of which	18,027	19,952	20,774	21,708	25,405	22,958
	Non-plan head	15,211	16,733	17,342	18,366		
	Plan Head**	2,816	3,219	3,432	3,342		
2	Interest payments#	8,027	9,804	11,343	12,850	14,159@	14,973
3	Expenditure on pensions	9,152	10,118	11,251	11,295	13,183	11,684
4	Social Security Pensions	1,870	2,322	2,247	2,503	3,992	4,055
5	a) Subsidies	13,323	11,153	13,149	14,387	23,328	14,148
	b) Subsidies in the form of financial assistance etc.	1,690	2,973	3,913	3,714		3,318^
6	Grants-in-aid and financial assistance	8,471	9,737	10,840	13,163	9,534	11,812
7	Administrative Expenses	1,549	1,708	1,958	1,966	1,077	2,404
8	Devolution to Local Bodies	15,570	19,952	21,163	23,466	26,452	25,131
9	**Total Committed Expenditure**	**77,679**	**87,719**	**96,638**	**1,05,052**	**1,17,040**	**1,10,483**
10	**Revenue expenditure**	**89,189**	**1,03,614**	**1,17,028**	**1,31,921**	**1,44,755**	**1,42,482**
11	**Revenue receipts**	**89,542**	**1,04,142**	**1,18,817**	**1,33,214**	**1,44,893**	**1,47,000**
12	Committed expenditure as % of revenue receipts	**87**	**84**	**81**	**79**	**81**	**75**
13	Committed expenditure as % of revenue expenditure	**87**	**85**	**83**	**80**	**81**	**78**

** Includes salaries paid out of grants-in-aid released to PRIs and others.*
*** Includes the salaries paid under centrally sponsored schemes.*

8 Rajiv Gandhi Rural Housing Corporation Ltd., (₹11.63 crore), Karnataka Slum Development Board (₹0.01 crore), Karnataka State Khadi & Village Industries Board (₹0.52 crore) and Karnataka Road Development Corporation Limited (₹1.64 crore).

 # Includes interest on off-budget borrowings.
@ includes interest pertaining to 2049 only.
^Excludes subsidy under Indira Awas Yojana which was released as financial assistance.



Though, the ratio of committed expenditure to revenue expenditure has decreased from 87 *per cent* in 2013-14 to 78 *per cent* in 2017-18 and the ratio of committed expenditure to revenue receipts has also been decreasing during 2013-14 to 2017-18, the high proportion 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 legislations 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.

Expenditure on salaries

Expenditure on salaries increased from ₹18,027 crore in 2013-14 to ₹22,958 crore in 2017-18. It grew by six *per cent* over the previous year. It was noticed that the Finance Accounts captured data on salaries only in respect of the State Sector, whereas the salary expenditure in case of PRIs (₹12,412 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 of Urban Local Bodies (ULBs) of the State (₹524.21 crore) excluding the salary grant 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).

The 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.

The 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 the Finance Accounts.

Also, the salary expenditure relating to the employees of ULBs overlapped with those under the State sector (Constitutional dignitaries). This has been discussed in **paragraph 2.4.5**.

In spite of PAC recommendations, no efforts have been made by the State Government to exhibit the salary details of district sector in the Appendix of the Finance Accounts.

Pension Payments

The expenditure on pension during 2017-18 was ₹11,684 crore. There was a moderate increase in expenditure over the previous year (₹389 crore).

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. From April 2008, the liability on account of pension payments that is to be borne by GOI is to be booked under suspense head – 8658 and a demand raised for reimbursement. At the end of March 2018, ₹92.18 crore was outstanding for settlement, compared to ₹50.65 crore (March 2017), implying that the State Government was yet to receive amount due to it.

New Pension Scheme (NPS)

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 has been created under the Directorate of Treasuries to operationalise NPS in the State. The State Government has adopted NPS architecture designed by the Pension Fund Regulatory Development Authority (PFRDA) and has appointed the National Securities Depository Limited (NSDL) as the Central Record Keeping Agency (CRA) for NPS. Axis Bank is the Trustee Bank in charge of operation of Pension Funds.

The details of the scheme and contributions made by State Government and employees as furnished by Director of Treasuries (October 2018) are given below.

- The number of officials allotted Permanent Retirement Account Number (PRAN) was 1,99,316 as against 2,00,433 officials who joined service between 01.04.2006 and 31.03.2018;
- The employee contribution (regular and backlog[9]) till 31 March 2018 is ₹2,369.29 crore and the matching contributions made by State Government since inception of the scheme is ₹2,358.99 crore. This includes the Governments contribution of ₹581.70 crore and employees' contribution of ₹462.18 crore during the current year;

[9]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.

- Out of 1,18,995 employees eligible to receive Government backlog contribution, 25,959 employees were yet to receive due to non-receipt of employee wise details of schedules from DDOs;
- From the accretions during the year, ₹1,173.30 crore which included an opening balance of ₹37.64 crore was transferred to Trustee bank, (Employees' and Employer's contribution) leaving a closing balance of ₹6.23 crore under the deposit account as at the end of 31 March 2018;
- During 2017-18, ₹5.20 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 are covered under New Defined Pension Scheme;
- The Government has been paying compound interest at eight *per cent* on Government backlog contribution of NPS employees with effect from 01.04.2010. The interest paid on the Government backlog contribution up to the end of 31.03.2018 is ₹73.86 crore and for the current year it was ₹3.65 crore. However, the State Government has issued orders for stoppage of interest on the Government backlog contribution from 01.07.2016 due to non-submission of schedules by DDOs;
- The Human Resources Management System (HRMS) package was to incorporate a modification in the software to restrict the interest up to 30.06.2016 while generating the schedule for backlog payable to the employee. The modification is yet to be incorporated and payment of Government backlog had been put on hold from January 2018, which adds to the liability of the Government; and
- For effecting NPS deductions of Government employees on foreign services to Boards/ Corporations/ Societies/ Universities/ State Aided Institutions/ State Autonomous Bodies under various Departments of State Government, a unique Non-Treasury PAO/ DDO code has been allocated to 113 organisations, of which 104 organisations have been registered by CRA as on 31.03.2018 and allotted PAO and DDO registration numbers.

Interest Payments

Interest payments increased by ₹6,946 crore from ₹8,027 crore in 2013-14 to ₹14,973 crore in 2017-18. Interest payments during 2017-18 constituted interest on internal debt (₹11,196 crore), interest on small savings, provident fund etc., (₹2,081 crore), interest on loans and advances from the Central Government (₹652 crore) and interest on off-budget borrowings (₹1,043 crore).

The interest on internal debt increased by 18 *per cent* from ₹9,468 crore in 2016-17 to ₹11,196 crore in 2017-18, on account of increase in payment of interest on market loans by ₹1,765 crore (25 *per cent*), Interest on other Internal Debts by ₹9 crore (three *per cent*). The interest on small savings, provident funds etc. increased by ₹177 crore from ₹1,904 crore during 2016-17 to ₹2,081 crore in 2017-18, mainly on account of increase under interest on State Provident funds, Insurance and Pension funds and interest on Defined Contribution Pension Scheme by nine *per cent*.

Subsidies

Subsidy expenditure increased from ₹13,323 crore in 2013-14 to ₹14,148 crore during 2017-18, which was 10 *per cent* of revenue receipts. The four largest subsidy outgoes for the State were power subsidy provided for supply of free electricity to farmers for usage of agricultural pump sets, food subsidy, interest subsidy for crop loans and transport. The Finance Accounts (Appendix-II) showed subsidy of ₹14,148 crore during 2017-18 which was ₹240 crore less than the previous year. The decrease was two *per cent* over the previous year. The details of different subsidies are given in **Appendix 1.8**.

According to the Vaidyanathan Committee Report (March 2008), and as reiterated by PAC, the Governments both at the Centre and in the States should desist from the practice of waiver of recovery of loans and interest to prevent deterioration of the health of the co-operative credit system. However, during 2017-18, the waiver of loans accounted to ₹3,400.67 crore which has been discussed in detail in **paragraph 3.10.2**.

Subsidies in the form of financial assistance, incentives etc.

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 these subsidies extended during 2017-18 are detailed in **Appendix 1.9**.

These subsidies increased from ₹1,690 crore in 2013-14 to ₹3,318 crore during 2017-18. 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 2017-18 also, the subsidy under Indira Awas Yojana (₹1,219 crore) was accounted for under HOA '2216-80-198-6-02-300' as financial assistance/ block grant to GPs instead of for under HOA '2216-80-103-0-21' (Indira Awas Yojana) & '2216-80-800-0-04' (Indira Awas Yojana – State share).

Financial assistance to local bodies and other institutions

The quantum of assistance provided by way of grants to local bodies and other institutions during 2017-18, relative to the previous years, is presented in **Table 1.16**.

Table 1.16: Financial assistance to local bodies and other institutions

(₹ in crore)

	Name of the Institution	2013-14	2014-15	2015-16	2016-17	2017-18
a	**Panchayat Raj Institutions**	20,512.71	24,991.27	26,694.94	29,697.94	31,054.63
b	**Urban Local Bodies**	5,020.43*	6,011.45*	6,076.05	5,685.58	6,489.76
c	**Educational Institutions (including Universities)**	961.62	1,145.04	1,406.50	1,449.75	1,293.70
d	**Co-operative societies and co-operative institutions**	849.85	818.09	1,023.13	1,009.47	1,191.32
e	**Other institutions and bodies (including statutory bodies)**	5,267.90	5,782.63	4,820.87	6,656.29	7,067.08
	Assistance as a percentage of revenue expenditure	37	37	34	34	33
	Total	**32,612.51**	**38,748.48**	**40,021.49**	**44,499.03**	**47,096.49**

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 ₹20,513 crore in 2013-14 to ₹31,055 crore in 2017-18, while the assistance to ULBs increased from ₹5,020 crore in 2013-14 to ₹6,490 crore in 2017-18.

Out of the total devolution of ₹31,055 crore to PRIs during 2017-18, ₹12,412 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 (₹1,580.18 crore).

The assistance to ULBs increased by ₹804 crore over the previous year. The assistance to ULBs included ₹1,971 crore towards creation of capital assets. It also included XIV FC grants released to the State Government (₹899.25 crore).

Assistance to other institutions (₹7,067 crore) included assistance to Statutory bodies and Development Authorities (₹2,340 crore), NGOs (₹1,762 crore), PSUs (₹75 crore) and others (₹2,890 crore). The assistance to Co-operatives increased by ₹182 crore and for other institutions by ₹411 crore as compared to the previous year. It decreased for educational institutions by ₹156 crore during 2017-18.

1.6.4. Entry tax devolution to Urban Local Bodies (ULBs)

The grants to ULBs are released pursuant to the recommendations of the State Finance Commission. Based on the recommendations of the Third State Finance Commission (December 2008), orders were issued in 2011 for release of grants to ULBs. Due to the extension of time for the Fourth State Finance Commission to submit its report, the recommendations of the Third SFC were extended till 2017-18. According to the operative portion of the GO dated 31 October 2011, grants to ULBs (including devolution of entry tax) for the period from 2011-12 to 2015-16 were made as shown in **Table 1.17**.

Table 1.17: Devolution under entry tax and other devolution

Devolution to ULBs	2011-12	2012-13	2013-14	2014-15	2015-16
Entry Tax Devolution (in ₹crore)	1,510 (3.3%)	As per actual collection			
Other Devolution (% of NLNORR[10])	5.2%	5.7%	6.2%	6.7%	6.7%

With regard to Entry Tax devolution, it was noticed in audit that the entry tax collected under tax revenue has not been completely devolved to ULBs during the period from 2011-12 to 2016-17 as indicated in **Table 1.18**.

Table 1.18: Collection of entry tax and its devolution

(₹ in crore)

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Entry Tax collection (0042-106)	1,690	2,181	2,626	3,038	3,125	3,306	1,279
Entry Tax devolution (3604 - 191,192,193)	1,538	1,830	1,972	2,175	2,490	2,566	2,987

However, during 2017-18, the entry tax devolution was more when compared to the entry tax collection. Also, the devolution is made by taking expenditure route for obtaining the approval of the Legislature through Appropriation Acts under Demand for Grants. But on central side, the devolution to State of net proceeds of Union Taxes and Duties on the recommendations of the Finance Commission is made through the tax revenue head of account only (tax expenditure) without subjecting the transfer to Parliamentary approval.

1.6.5 Fourth State Finance Commission

The Fourth State Finance Commission was constituted by the Governor of Karnataka under Article 243 (I) and (Y) of the Constitution of India vide notification dated 21 December 2015.

The Commission was asked to review the financial positions of the Zilla Panchayats, Taluk Panchayats, Grama Panchayats, Municipal Corporations, City Municipal Councils, Town Municipal Councils and Town Panchayats and make recommendations as to

a) Distribution between the State Government and the local bodies of the net proceeds of the taxes, duties, tolls and fees leviable by the Government which may be divided between them and allocation between them the shares of such proceeds;

b) The Grants-in-Aid to the local bodies from the Consolidated Fund of the State;

c) Measures to improve the financial position of the local bodies;

[10] As against 10 *per cent* (₹9,360.69 crore) of Non-Loan Net Own Revenue Receipts (NLNORR) to be released to ULBs during 2017-18, the State Government had released only 6.93 *per cent* (₹6,489.76 crore) of NLNORR (₹93,606.91 crore) resulting in short release of ₹2,870 crore.

d) Determination of taxes, duties, tolls and fees which may be assigned to or appropriated by the local bodies;

e) Make a detailed analysis on repayment of loans and advances extended by Government from time to time to the local bodies; and

f) Examine and make suggestion on the extent to which and the manner in which the resources available to the local bodies could best be utilized for meeting the expenditure of these bodies.

The Commission was required to submit its report in six months. However, the Government of Karnataka vide notification dated 1 September 2016 stated that consequent on extension of the period of Fourth State Finance Commission for submission of its report up to 30.09.2017, the period of applicability of the Third State Finance Commission recommendations is extended till 2017-18. Since the work of the Commission could not be completed in time, the State Government extended its tenure till 31 May 2018. As such the recommendations of the Commission will be applicable from 2018-19 to 2022-23. The Commission submitted its recommendations in May 2018 and some of recommendations are highlighted below.

i) The relative share of the State and local bodies which are in the ratio of 58:42 in NLNORR is changed to 52:48;

ii) The Bruhat Bengaluru Mahanagara Palike (BBMP) gets one *per cent* of NLNORR as additional devolution, apart from its share as a part of ULBs. The remaining 47 *per cent* is the share of local bodies (PRIs and ULBs). As a result, the share of PRIs increased from the present 32 *per cent* to 35 *per cent* and in case of ULBs from 10 *per cent* to 12 *per cent* of NLNORR;

iii) Performance grants are recommended to each tier of PRIs and ULBs based on two criteria namely collection of tax revenue/property tax by 95 *per cent* and submission of audited accounts for the immediate preceding year;

iv) Establishment grant is recommended to newly formed PRIs and ULBs as a onetime measure; and

v) Assigned grants to local bodies from two/three *per cent* of surcharge on stamp duty collected for taluk panchayats/municipalities shall be distributed within a quarter to the TPs and Municipalities as per respective Acts.

The Government in its order dated 7 December 2018 accepted the following recommendations.

a) The recommendations would be implemented from financial year 2018-19 for a period of five years up to 2022-23;

b) Total funds to be devolved to local bodies will be increased from the current 42 *per cent* to 48 *per cent* of the NLNORR of the State in a phased manner depending on the availability of the resources;

c) The Central Finance Commission grants would be considered as part of State devolution;

d) GST compensation will be excluded from NLNORR calculation, as it is only a temporary measure;

e) Budget allocations to parastatal bodies like BWSSB, KUWS&DB, BMRCL would be considered as part of devolution to ULBs; and

f) 12% of total devolution to be passed on as untied devolution for ULB's, will be achieved in a phased manner from 2018-19 to 2022-23.

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) can be stated to have been attached to a particular sector if the priority given to that particular head of expenditure is below the General Category States (GCS) average for that year. **Table 1.19** 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 2017-18.

Table 1.19: Fiscal priority of the State in 2013-14 and 2017-18

Fiscal priority by the State	AE/ GSDP	DE#/ AE	SSE/ AE	CE/ AE	Education/ AE	Health/ AE
General Category States* Average (Ratio) 2013-14	14.70	66.50	37.60	13.60	17.20	4.50
Karnataka (Ratio) 2013-14	13.08	71.45	33.79	16.51	15.50	4.24
General Category States* Average (Ratio) 2017-18	16.10	67.90	36.70	14.40	15.50	4.90
Karnataka (Ratio) 2017-18	13.60	76.46	38.43	20.06	12.60	4.55

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 marginally during 2017-18 compared to 2013-14. However, ratio is less than that of GCS;
- Development expenditure as a proportion of aggregate expenditure in the State has been markedly 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 2017-18;
- As observed from the **Table 1.19**, adequate priority needs to be given to education sector as the ratio of expenditure under this sector is well below GCS average during 2013-14 and 2017-18*;* and
- The ratio under health sector is less during 2013-14 as well as 2017-18 than that of GCS.

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 would be the quality of expenditure. **Table 1.20** presents the trends in development expenditure relative to the aggregate expenditure of the State during 2017-18 *vis-à-vis* that of previous years.

Table 1.20: Development expenditure

(₹in crore)

	2013-14	2014-15	2015-16	2016-17	2017-18
Development Expenditure (DE)	76,328	88,904	1,00,441	1,23,988	1,36,286
Percentage of DE to total expenditure	71	72	73	77	76
Components of DE					
Revenue	59,215 (77)	69,337 (78)	80,153 (80)	94,970 (76)	1,01,508 (74)
Capital	16,446 (22)	19,004 (21)	19,722 (20)	27,090 (22)	29,690 (22)
Loans and Advances	667(1)	563(1)	566(-)	1,928(2)	5,088(4)

Source: Finance Accounts.

Figures in brackets indicate percentage to development expenditure.

Development expenditure increased from ₹76,328 crore in 2013-14 to ₹1,36,286 crore in 2017-18. As a percentage of total expenditure, it increased from 71 *per cent* in 2013-14 to 77 *per cent* in 2016-17 and decreased to 76 *per cent* during 2017-18. 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 2013-14 to 2017-18. In 2017-18, expenditure on salary (₹16,764 crore) and subsidy (₹14,145 crore) formed two major components of development revenue expenditure.

Table 1.21 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 1.21: Efficiency of expenditure in selected social and economic services

(ratio in per cent)

Sector	2016-17			2017-18		
	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	0.68	8.25	0.01	0.64	7.94	0.03
Health and family welfare	0.50	1.63	0.01	0.64	1.61	0.01
Water Supply, sanitation, housing and urban development	2.61	0.09	0.11	1.75	0.09	0.09
Others	1.54	0.51	0.02	1.84	0.49	0.02
Total (SS)	**5.29**	**10.48**	**0.15**	**4.87**	**10.13**	**0.15**
Economic Services						
Agriculture and allied activities	0.34	0.94	0.04	0.13	0.74	0.04
Irrigation and flood control	5.33	0.10	0.26	5.83	0.09	0.26
Power and energy	0.57	-	-	0.46	0.02	-
Transport	4.71	0.05	0.56	4.14	0.05	0.57
Others	1.69	0.67	0.03	1.23	0.67	0.03
Total (ES)	**12.62**	**1.76**	**0.89**	**11.79**	**1.57**	**0.90**
Total (SS+ES)	**17.91**	**12.24**	**1.04**	**16.66**	**11.70**	**1.05**

Source: Finance Accounts.

Expenditure on Social Services

Capital expenditure on social services increased from ₹8,571 crore in 2016-17 to ₹9,855 crore in 2017-18 and the ratio of capital expenditure to total expenditure decreased from 5.29 *per cent* in 2016-17 to 4.87 *per cent* in 2017-18. The share of salary expenditure (under social services) in revenue expenditure was ten *per cent* in 2017-18 (**Table 1.21**).

Expenditure on Economic Services

Capital expenditure on economic services increased from ₹20,447 crore in 2016-17 to ₹24,923 crore in 2017-18 and its ratio to total expenditure decreased from 12.62 *per cent* in 2016-17 to 11.79 *per cent* in 2017-18. The share of salary expenditure (under economic services) in revenue expenditure was two *per cent* during 2017-18 (**Table 1.21**).

The priority sectors identified by the Government in respect of economic services were agriculture, rural development, irrigation and flood control, energy, industries and minerals, transport. In 2017-18, capital outlay was higher by ₹1,757 crore, ₹381 crore, ₹64 crore, ₹30 under irrigation and flood control, industry and minerals, rural development, special area programme and under agriculture, transport, energy it was lower by ₹276 crore, ₹245 crore, ₹34 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 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 2017-18 *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 of 31 March 2018 is given in **Table 1.22**.

Table 1.22: Incomplete projects

(₹in crore)

Department	Incomplete Projects*				Cumulative expenditure as of March 2018
	Number	Budgeted Cost	Cost over run		
			Number	Amount	
Public Works					
Buildings	46	214.80	6	2.61	174.26
Roads and Bridges	124	757.51	17	12.24	699.06
Irrigation	66	123.81	8	20.31	94.13
Total	**236**	**1,096.12**	**31**	**35.16**	**967.45**

Source: Finance Accounts.

**projects scheduled to be completed on or before 31 March 2018 have been included.*

Against the initial budgeted cost of ₹1,096.12 crore in respect of 236 works, stipulated to be completed on or before March 2018, the progressive expenditure was ₹967.45 crore as of 31 March 2018, out of which, in 31 cases, the cost overrun aggregated ₹35.16 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.

As of 31 March 2018, the Government had invested ₹65,146 crore, in 85 Government Companies (₹59,355 crore including investment of ₹68 crore in 16 non-working Government Companies), Nine Statutory Corporations

(₹2,595 crore), 43 Joint Stock Companies (₹2,733 crore) and Co-operative Institutions, Local bodies and Regional Rural Banks (₹441 crore). The return from investment was negligible **(Table 1.23)**.

Table 1.23: Return on investment

	2013-14	2014-15	2015-16	2016-17	2017-18
Investments at the end of the year (₹ in crore)	55,048.00	61,726.92	61,335.89	63,115.06	65,145.88
Return (₹ in crore)	55.49	74.84	69.40	82.50	78.83
Return (*per cent*)	0.1	0.1	0.1	0.1	0.1
Average rate of interest on Government borrowings (*per cent*)	6.2	6.5	6.5	6.3	7.7
Difference between interest rate and return (*per cent*)	6.1	6.4	6.4	6.2	7.6

Though the State Government had 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 would 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.

Out of the total investment of ₹65,146 crore up to the end of March 2018, ₹61,883 crore (95 *per cent*) were invested in 78 Government Companies and Statutory Corporations under various sectors[11]. The investment included ₹38,912 crore (60 *per cent*) in the following Companies/ Corporations, which have significant losses and where the investments were substantial (**Table 1.24**).

Table 1.24: Investment in Companies/Corporations under loss

(₹ in crore)

Company/Corporation	Investment up to 2017-18	Cumulative loss	Cumulative loss to the end of
North Western Karnataka Road Transport Corporation	266.85	720.50	2016-17
North Eastern Karnataka Road Transport Corporation	183.43	509.11	2016-17
Karnataka Road Development Corporation Limited	1,145.70	130.41	2016-17
Krishna Bhagya Jala Nigam Limited	23,745.34	2,448.13	2016-17
Karnataka Neeravari Nigam Limited	13,034.03	2,971.09	2016-17
The Mysore Sugar Company Limited	298.78	416.67	2012-13
Mysore Paper Mills Limited	237.37	425.94	2013-14
Total	**38,911.50**	**7,621.85**	

Source: Finance Accounts.

[11] Irrigation (₹36,779 crore), Power (₹10,751 crore), Infrastructure (₹4,664 crore), Financing (₹3,155 crore), Transport (₹2,399 crore), Social (₹1,647 crore), Housing (₹1,451 crore), Industries (₹936 crore), Construction (₹2 crore) and Other sectors (₹98 crore).

Up to 2017-18, Government invested ₹38,911.50 crore in these companies and the cumulative loss accounted for is ₹7,621.85 crore. However, during 2017-18, no investment was made in these companies.

During 2017-18, the Government invested ₹1,963.61 crore in Government Companies (working) (₹1,659.38 crore), Joint Stock Companies (₹209.44 crore), Statutory Corporations (₹75.00 crore) and Co-operative institutions (₹19.79 crore).

The transactions under investment account includes certain non-cash transactions like conversion of loans into equity and reconciling the investment of the Government with the books of the companies. Loans amounting to ₹22.00 crore in respect of Karnataka Silk Industries Corporation and ₹47.91 crore in respect of Co-operative Spinning Mills were converted into equity in order to increase the capital base of the company.

During 2017-18, the investment account was reduced proforma due to decrease in the progressive capital expenditure under '4425-Capital Outlay on Co-operation' by ₹2.70 crore, due to retirement of Government investments in share capital institutions, the proceeds of which stand accounted under 'Miscellaneous Capital Receipts'.

Deposit Account in Public Sector Undertakings (PSU)

Investment in respect of Companies/Corporations were lying in the deposit account in Public Account. These investments are accounted under HOA '8449-00-120-9 – Investment Account'. The balances outstanding in this deposit account at the end of March 2018 as available in DDR Ledger and as furnished by the entities in respect of few PSUs is furnished in **Table 1.25**.

Table 1.25: Balances in Deposit Accounts of PSUs as of March 2018

(₹ in crore)

Sl. No.	Name of the Entity	Head of Account	Closing Balance as per Accounts	Closing Balance as per entity
1	Karnataka Slum Development Board	8449-00-120-9-52	7.13	Nil
2	Karnataka Rural Infrastructure Development Corporation Limited (KRIDCL)	8449-00-120-9-36*	62.90	Nil
3	Karnataka Urban Infrastructure Development and Finance Corporation Limited (KUIDFC)	8449-00-120-9-14	267.41	281.00
4	Krishna Bhagya Jala Nigam Limited (KBJNL)	8449-00-120-9-10	128.70	Nil
5	Karnataka Neeravari Nigam Limited (KNNL)	8449-00-120-9-16	0.33	0.0077

Source: DDR Ledger and information as furnished by entities

**being operated by three different authorities namely (1) Director, Department of Tourism, Bengaluru, (2) Special Secretary, Bhoomi Monitoring Cell, Revenue Department and (3) KRIDCL*

As seen from the above table, there are differences in balances as appearing in DDR Ledger and as furnished by the entities. The administrators are to reconcile the accounts with treasury/office of AG (A&E) to depict correct balances. Further, KUIDFC stated (January 2019) that the closing balance reflects the amount released from Government of Karnataka during the end of the financial year and also due to delay in obtaining clearances from line departments/land acquisition issues and change in scope of work.

1.8.3 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 1.26** presents the position of outstanding loans and advances as on 31 March 2018 and interest receipts *vis-à-vis* interest payments during the last five years.

Table 1.26: Average interest received on loans advanced by the State Government

(₹ in crore)

	2013-14	2014-15	2015-16	2016-17	2017-18
Opening balance	12,142	12,724*	13,216	13,813	15,578^
Amount advanced during the year	695	576	657	1,934	5,092
Amount repaid during the year	109	84	60	100	137
Closing balance	12,729	13,216	13,813	15,648	20,533
Net addition	586	492	597	1,835	4,955
Interest receipts	235	127	264	145	99
Interest receipts as *per cent* to outstanding loans and advances	1.9	1.0	1.9	0.9	0.5
Interest payments as *per cent* to outstanding fiscal liabilities of the State Government	5.8	6.0	6.2	5.8	6.1
Difference between interest receipts and interest payments (*per cent*)	(-)3.9	(-)5.0	(-)4.3	(-)4.9	(-)5.6

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*.

^differs by ₹70 crore on account of conversion of loans into equity during 2017-18.

Loans outstanding as on 31 March 2018 aggregated ₹20,533 crore. Interest spread of Government borrowings was negative during 2013-17 to 2017-18, which meant that the State's borrowings were more expensive than the loans advanced by it.

The amount advanced during 2017-18 was ₹5,092 crore which includes ₹3,401 crore released to Credit Co-operatives (6425-00-107-05) towards loan waiver scheme. Repayment of loans during 2017-18 aggregated to ₹137 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 ₹7,772 crore (Principal: ₹4,402 crore and Interest: ₹3,370 crore) were overdue as on 31 March 2018 from 21 institutions (**Appendix 1.10**).

Information in respect of overdue principal and interest contained in Statement No.7 of Finance Accounts of 2017-18 is incomplete, as only 18[12] 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, have 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 103 loans valued at ₹5,092.22 crore sanctioned by the State Government in 2017-18, 39 loans valued at ₹3,807.87 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 in its circular (August 2018) has stated that the State Government has revised the terms and conditions and other procedural aspects that has to be followed by departments relating to loans sanction vide G.O dated November 2013. All departments are instructed to adhere to the instructions delineated in general loan GO issued by the Finance Department in November 2013. Audit observed that the compliance was poor.

1.8.4 Cash balances and investment of cash balances

Table 1.27 depicts the cash balances and investments made by the State Government during 2017-18.

Table 1.27: Cash balances and their investments

(₹in crore)

	Opening Balance on 01-04-2017	Closing Balance on 31-03-2018	Increase (+)/ Decrease (-)
a) General cash balance			
Cash in treasuries	-	-	
Deposits with RBI	100.05	723.77	623.72
Deposits with other banks	-	-	-
Remittance in transit- Local	0.01	0.01	-
Sub Total	100.06	723.78	623.72
Investments held in cash balance investment account	23,977.48	12,655.49	(-)11,321.99
Total (a)	**24,077.54**	**13,379.27**	**(-)10,698.27**
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	1.74	1.75	0.01
Investment of earmarked funds	10,272.21	12,800.94	2,528.73
Total (b)	**10,276.04**	**12,804.78**	**2,528.74**
Grand Total (a+b)	**34,353.58**	**26,184.05**	**(-)8,169.53**

Source: Finance Accounts.

Claims against due of 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 cheque and paired off with its encashment at the Agency Banks. Thus, credit balances under this head indicate the value of cheques that

[12] In 2016-17, 16 out of 842 institutions have furnished the information.

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. The opening balance of un-encashed cheques at the beginning of the year was ₹14,158.60 crore. Against issue of cheques worth ₹1,36,077.97 crore during 2017-18, cheques worth ₹1,37,599.39 crore were encashed. The balance of un-encashed cheques amounts to ₹12,637.18 crore as on 31 March 2018.

Audit observed that the net credit under the account during 2017-18 was ₹1,526 crore. Action is required to be taken for analysis of data for clearing of the balances.

The cash balance of the State at the end of the year was ₹26,184 crore. The decrease in the cash balance was 24 *per cent* over the previous year. The reduction in cash was on account of decrease in cash balance investment of 14-day and 91-day intermediate treasury bills of RBI during 2017-18 to the extent of ₹11,321.99 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 lands 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 1.11** gives an abstract of such liabilities and assets as on 31 March 2018 compared with the corresponding position as on 31 March 2017.

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 1.28**.

Table 1.28: Summarised position of Assets and Liabilities

(₹ in crore)

Liabilities				Assets			
	2016-17	**2017-18**	***Growth rate (per cent)***		**2016-17**	**2017-18**	***Growth rate (per cent)***
Consolidated Fund	**1,46,283**	**1,63,135**	**12**	***Consolidated Fund***	**2,20,528**	**2,56,146**	**16**
a. Internal Debt	1,32,489	1,48,581	12	Capital Outlay	2,04,950	2,35,614	15
b. Loans and advances from GOI	13,794	14,555	6	Loans and Advances	15,578	20,533	32
Off-budget borrowings	**10,248**	**13,173**	**29**	**Cash**	**34,354**	**26,184**	**(-)24**
Public Account*	**64,788**	**69,923**	**8**				
a. Small savings, Provident Funds etc.,	24,920	27,731	11				
b. Reserve Funds	16,384	16,874	3				
c. Deposits	23,484	25,318	8				

**The liabilities are on net basis. It does not include investments from earmarked funds of ₹10,272 crore (2016-17) and ₹12,801 crore (2017-18).*

The growth rate of assets remained same at 16 *per cent* during 2016-17 and 2017-18 while that of liabilities inclusive of off-budget borrowings, decreased from 19 *per cent* in 2016-17 to 12 *per cent* in 2017-18.

The Finance Accounts reflected an amount of ₹1,48,581 crore as internal debt outstanding at the end of 2017-18 after taking into account the difference of ₹588.44 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 2018 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 had not been reckoned in RBI books (two 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.

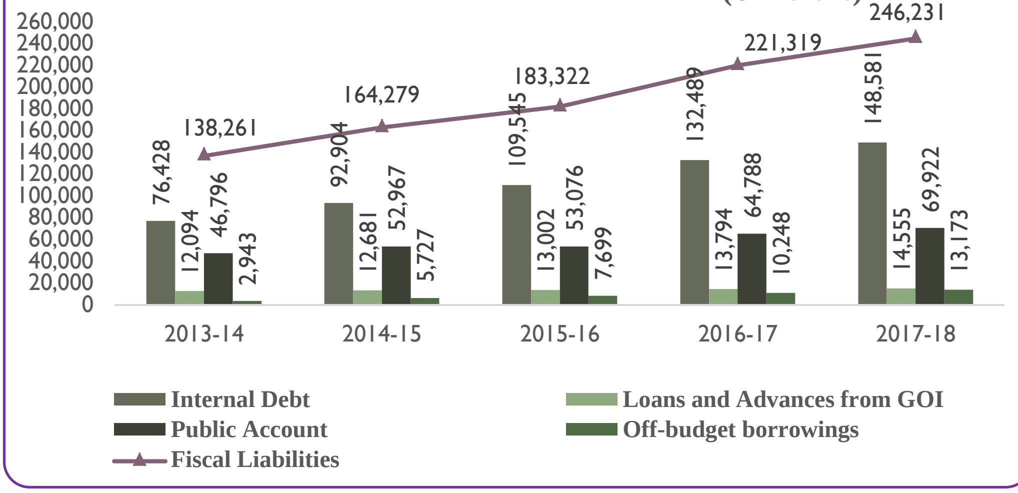
Further, as per the communication from the Reserve Bank of India, there still exists a balance of ₹0.40 crore to be discharged in respect of compensation bonds, the transactions of which are accounted under the minor head 106. However, these loans do not figure in the outstanding balances in the Finance Accounts. The loans and advances from GOI reflected an amount of ₹14,555 crore as at the end of 2017-18.

The assets shown in the Finance Accounts (Statement No. 1 - Investment from earmarked funds - ₹12,801 crore) were understated to the extent of ₹484.36 crore. This is on account of the interest accrued on the investment of Consolidated Sinking Fund account made during 2012-13 and 2015-16, which had not passed 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 2013-14 to 2017-18 is presented in **Chart 1.15**.

Chart 1.15: 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 **Appendix 1.4**. The fiscal liabilities of the State increased by 78 *per cent* from ₹1,38,261 crore in 2013-14 to ₹2,46,231 crore in 2017-18.

1.9.2.1 Internal Debt

The internal debt which is a part of Consolidated Fund liabilities increased from ₹76,428 crore in 2013-14 to ₹1,48,581 crore in 2017-18, an increase of 94 *per cent*.

1.9.2.2 Loans and Advances from Government of India

The loans and advances from GOI showed an increase of 20 *per cent* from ₹12,094 crore in 2013-14 to ₹14,555 crore.

Due to increased borrowings in 2016-17 and decreased borrowings in 2017-18, the growth rate of fiscal liabilities was 21 *per cent* and 11 *per cent* respectively. Further the buoyancy of fiscal liabilities to revenue receipts was at 1.71 *per cent* and 1.10 *per cent* in 2016-17 and 2017-18 respectively. Also, the buoyancy ratio of fiscal liabilities to own resources gradually increased from 1.03 *per cent* in 2013-14 to 2.07 *per cent* in 2017-18.

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' (OBB) and the Government had been repaying the loans availed of by these Companies/ Corporations/ Societies including interest through regular budget provision under capital/revenue account.

During 2017-18, capital expenditure of ₹35,760 crore included ₹575.92 crore towards servicing of principal amount of off-budget borrowings. However, the accounts of the entities for the year show disbursement as ₹575.12 crore towards off budget borrowings. **Table 1.29** captures the trend in the off-budget borrowings of the State during 2013-14 to 2017-18 while **Table 1.30** gives the entity-wise position of borrowings till the end of 2017-18.

Table 1.29: Trend in off-budget borrowings

(₹ in crore)

Year	2013-14	2014-15	2015-16	2016-17	2017-18
Amount as furnished by entities*	1,914.50	3,081.50	2,372.00	3,005.16	3,500.23

Source: As reported by the concerned entities.

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

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

(₹ in crore)

Company/Corporation/Board	Outstanding off budget borrowing*	Borrowings during 2017-18	Repayment during 2017-18		Closing Balance
			Principal	Interest	
Krishna Bhagya Jala Nigam Limited	5,111.58	1,498.23	0.58	699.97	6,609.23
Karnataka Neeravari Nigam Limited	2,174.12	765.00	302.50	208.89	2,636.62
Karnataka Road Development Corporation Limited	147.17	2.00	26.01	18.00	123.16
Rajiv Gandhi Rural Housing Corporation Limited	1,255.76	-	186.98	90.00	1,068.78
Karnataka Slum Development Board	1.60	-	1.60	0.08	-
Karnataka State Police Housing and Infrastructure Development Corporation	23.05	-	14.59	1.66	8.46
Cauvery Neeravari Nigam Limited	1,235.00	500.00	-	-	1,735.00
Visvesvaraya Jala Nigam Limited	300.00	735.00	42.86	24.60	992.14
Total	**10,248.28**	**3,500.23**	**575.12**	**1,043.20**	**13,173.39**

**as there were differences in the closing balances of these entities (2016-17), the principal repayments have been adjusted to bring them in concordance with the closing balances of 2017-18.*

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2018 worked out to ₹2,46,231 crore.

1.9.3.1 Borrowings by Bangalore Metropolitan Transport Corporation (BMTC)

During 2017-18, Bangalore Metropolitan Transport Corporation (BMTC) obtained loan to the extent of ₹359.31 crore from M/s Karnataka Urban Infrastructure and Finance Corporation for the purchase of 1,500 new buses. The servicing of debt including interest of the Corporation has been taken over by the Government by providing budgetary support under HOA 3055-00-190-0-03-240-Debt servicing. The borrowings of BMTC during 2017-18 forms part of the State debt obligations as the borrowings by Public Sector Undertakings (PSUs) and Special Purpose Vehicles (SPVs), where the principal and or interest are to be serviced out of the State Budget as per Karnataka Fiscal Responsibility Act. These borrowings form the off-budget borrowings of the State Government.

Annexure to Statement No 17 in Finance Accounts which covers Off-budget borrowings, does not show the borrowings by BMTC, thus under stating the off-budget borrowings. The budget overview which gives the details of the extended public debt liability in the form of off-budget borrowings, also, did not contain the borrowings of the corporation, thus, affecting the transparency of the Budget document.

1.9.4 Public Account transactions

1.9.4.1 Reserve Funds

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' of Finance Accounts for the year, out of the total outstanding balance of ₹29,674.61 crore available in various reserve funds as on 31 March 2018, the Government of Karnataka invested ₹12,800.93 crore (43 *per cent*). This is mainly in the form of Capital Outlay on infrastructure projects (₹10,731 crore) and investment from Consolidated Sinking Fund of ₹2,070 crore. In addition, AG(A&E) had requested (June 2011) the State Government to review the necessity to continue two reserve funds, namely

- State Renewable Fund which has not recorded 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.

Analysis of certain major reserve funds having a bearing on the liability position of the Government, its funding and expenditure are detailed 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 (excluding off-budget borrowings) at the end of the previous financial year. During 2017-18, against the requirement of ₹1,055 crore, the State Government has made provision of ₹350 crore under Major Head 2048 – Contribution to Consolidated Sinking Fund. However, no investment has been made, despite the fact that the State Government had a surplus cash balance of ₹26,184 crore as at the end of 31 March 2018.

Even, XIV FC in its report has 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 ₹484.36 crore accrued (2014-15 to 2017-18) 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 has resulted in compression of revenue expenditure and also revenue/ fiscal deficit to the extent of ₹1,055 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. 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.

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, on 'Improper accounting and Non-utilisation of Green Tax Cess collections', it was stated that 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[13] collected is opened under Development and Welfare Funds – '8229-00-200-0-63 – Green Tax'.

During the year 2017-18, ₹4.36 crore has been collected under the revenue receipt head apart from the amount of ₹57.89 crore collected from 2006-07 to 2016-17. Hence the total green tax cess collected up to 2017-18 i.e. ₹62.25 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 has been transferred to the Public Account. This has resulted in overstatement of revenue receipts/ expenditure.

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 2017-18, the Infrastructure Cess realised (₹1,100.49 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 ₹627.28 crore, ₹308.14 crore and ₹165.07 crore respectively. The related expenditure of ₹2,693.80 crore which includes the expenditure of ₹240.72 crore pertaining to earlier year was booked to the fund. These transfer transactions has been utilized twice – once to show excess fiscal deficit and again to finance deficit.

[13] Green Tax Cess is cess on old vehicles which have 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 at the rates specified for the purpose of implementation of various measures to control air pollution.

Further, an amount of ₹2,768 crore available under General Revenues were transferred to Infrastructure Initiative Fund which included ₹1,578 crore to IIF, ₹775 crore to BMRCL fund and ₹415 crore to CMRRD fund respectively. This transfer of funds from general revenues had the effect of artificially inflating the revenue expenditure as also the fiscal deficit. Further, this has resulted in increased liability in the Public Account also and the same amount is used again for financing the fiscal deficit through surplus from Public Account.

d) State Disaster Response Fund

The State Disaster Response Fund (SDRF) constituted under Disaster Management Act, 2005, is operative from 2010-11 under Reserve Fund bearing interest. As per the guidelines the accretions to the SDRF together with the income earned on the investment of the SDRF are to be invested in one or more of instruments viz., Central Government dated securities, auctioned treasury bills and interest earning deposits and certificates of deposits with Scheduled Commercial Banks. Natural Calamities such as drought, flood, cyclone, earthquake, fire, etc., qualify for relief under this scheme.

While 75 *per cent* of the contribution was to be from GOI, the balance 25 *per cent* was to come from the State Government, the XIV Finance Commission has however recommended that the contribution to the fund is to be in the ratio of 90:10 between Government of India and State Government respectively. Government of India accepted this recommendation with the modification that the percentage share of the States will continue to be as before (75:25) and 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 Finance Commission on disaster relief would be fully implemented. However, despite the implementation of the GST with effect from July 2017, the contribution to the fund continued in the ratio of 75:25 during 2017-18.

During 2017-18, an aggregate amount of ₹1,218.04 crore was transferred to the fund account (contribution from GOI ₹228.75 crore and the State's contribution of ₹76.25 crore to the SDRF and the GOI contribution from National Disaster Response Fund ₹913.04 crore). Out of total fund balance of ₹2,453.56 crore, expenditure of ₹2,411.58 crore was released to the Deputy Commissioners of the Districts under the Major Head '2245-Relief on account of Natural Calamities' and was shown as met out of the SDRF. The amount released to Deputy Commissioners were kept in Personal Deposit accounts. Further, the unspent balance in the Personal Deposit accounts of the Deputy Commissioners for SDRF was not reflected in the accounts but merged with the general balances. However, these unspent balances resulted in understatement of the fund account in Public Account to that extent. This also resulted in overstatement of expenditure towards calamity relief in the Consolidated Fund. The balance in the fund as on 31 March 2018 was ₹41.98 crore.

Further, the State Government had to pay interest to the SDRF at the rate applicable to overdrafts and credit the same on a half yearly basis by a charge to Major Head '2049-Interest Payments'. However, no interest was paid on the fund balances during 2017-18.

e) 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 ₹101.38 crore, was credited with ₹45.27 crore from cess on motor vehicle tax, ₹5.95 crore from cess on property tax and ₹20.00 crore from general revenues during the year 2017-18. Thus, an amount of ₹71.22 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 ₹172.60 crore as on 31 March 2018. This has resulted in overstatement of capital expenditure and fiscal deficit to that extent.

f) Forest Development Fund

Revenue realized from Forest Development Tax is credited as revenue of the Government and an equal amount is transferred to the Karnataka Forest Development Fund (KFDF) maintained under the Public Account. Actual expenditure incurred on certain works related to conservation and development of forest is transferred to KFDF under the head of account 8229-00-200-0-04 through accounting adjustments.

There was a balance of ₹2,565.94 crore as on 1 April 2017 and during the year 2017-18, an amount of ₹381.15 crore was credited to the fund. However, expenditure of ₹299.09 crore incurred during the year had not been transferred to the fund. The balance in the fund was ₹2,947.09 crore at the end of March 2018. Transferring only the revenue receipts to the fund, without transferring the corresponding expenditure has resulted in overstatement of revenue expenditure and fiscal deficit to the extent stated above. This has also resulted in increased liabilities in the Public Account.

Inoperative Reserve Funds

As at the end of 31 March 2018, out of 127 Reserve Funds, 108 funds remained inoperative. Of these 108 inoperative reserve funds, 83 reserve funds had zero balance, 14 reserve funds had a credit balance of ₹5,282.77 crore and 11 reserve funds had debit balance of ₹4,539.89 crore as on 31 March 2018. The impact on accounts is that the liability of the Government has increased by ₹742.88 crore (net) under reserve funds.

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 available in **Appendix 1.4**.

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 1 April of each year were within the prescribed limit. The outstanding guarantees amounting to ₹18,416 crore at the end of the year 2017-18 (principal + interest) included guarantees extended to 161 institutions/ companies under irrigation (₹11,496 crore), co-operation (₹1,796 crore), finance (₹1,395 crore), power (₹605 crore), housing (₹2,316 crore), transport (₹200 crore) and other sectors (₹608 crore).

Against the total estimated guarantee commission of ₹355.83 crore receivable as reported by the State Government, only ₹148.04 crore was received during 2017-18. The guarantee commission received includes book adjustment made by the State Government towards the guarantee commission payable to it by Karnataka Slum Development Board (₹0.01 crore), Rajiv Gandhi Rural Housing Corporation Limited (₹11.63 crore), Karnataka State Khadi and Village Industries Board (₹0.52 crore) and Karnataka Road Development Corporation Limited (₹1.64 crore) by way of subsidies / grants-in-aid/ financial assistance. Consequently, the net shortfall in guarantee commission received was ₹221.59 crore (₹355.83 crore minus ₹134.24 crore, excluding book adjustment of ₹13.80 crore).

In MTFP (2016-20) presented before the Legislatures, the Government had 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.

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

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 ₹1,416 crore during 2017-18. These transactions had the impact of showing the tax/non-tax revenues without actual cash flow. Such revenue, adjusted through book adjustment was ₹1,362 crore (tax revenues) and ₹54 crore (non-tax revenues) constituting one *per cent* of revenue receipts.

Table 1.31 gives details of outstanding fiscal liabilities of the Government under Consolidated Fund and Public Account compared with the per capita liability.

Table 1.31: Debt Profile of the State

(₹in crore)

Borrowings through	2013-14	2014-15	2015-16	2016-17	2017-18
Open market loans	53,326	69,419	84,334	1,08,359	1,25,708
Negotiated loans	3,372	3,318	3,482	3,973	4,289
NSSF loans	19,730	20,167	21,729	20,157	18,584
GOI loans	12,094	12,681	13,002	13,794	14,555
Public Account borrowings	46,796	52,968	53,076	64,788	69,922
Off budget borrowings	2,943	5,726	7,699	10,248	13,173
Total Fiscal Liabilities	**1,38,261**	**1,64,279**	**1,83,322**	**2,21,319**	**2,46,231**
Population (in crore)	6.28	6.35	6.42	6.49	6.56
Per capita debt ratio (in ₹)	22,016	25,871	28,555	34,102	37,535

Source: Finance Accounts and Economic Survey of GOK 2017-18.

During the period 2013-14 to 2017-18, the Open Market Loans increased by 136 *per cent* and the Government of India loans by 20 *per cent*. The Public Account borrowings increased from ₹46,796 crore in 2013-14 to ₹69,922 crore in 2017-18, an increase of 49 *per cent*. The off-budget borrowings increased from ₹2,943 crore in 2013-14 to ₹13,173 crore in 2017-18, an increase of 29 *per cent* over the previous year. The per capita debt ratio has significantly increased from ₹22,016 in 2013-14 to ₹37,535 in 2017-18, an increase of 70 *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 1.32** analyses the debt sustainability of the State according to these indicators for the period from 2013-14 to 2017-18.

Table 1.32: Debt Sustainability indicators and trends

(in per cent)

Debt Sustainability indicators	2013-14	2014-15	2015-16	2016-17	2017-18
Debt*/GSDP	10.84	11.57	12.10	12.92	12.44
Rate of growth of Outstanding Debt*	17.95	19.28	16.06	19.37	11.52
Rate of growth of GSDP	18.06	11.75	10.97	11.81	15.76
Average interest rate of Outstanding Debt (Interest payments/(opening balance of Public Debt +closing balance of Public Debt/2)	9.81	10.10	9.94	9.56	9.68
Interest Payment/Revenue Receipts	8.96	9.41	9.55	9.65	10.18
Net availability of borrowed funds (₹in crore)	7,117	9,324	8,060	13,609	5,005
Debt Repayment/ Debt Receipts**	58.83	57.37	61.75	56.32	80.08

Source: Finance Accounts.

**Excluding Public Account liabilities and Off Budget Borrowings.*
*** The figures differ from those of earlier reports due to inclusion of interest payments.*

- The rate of growth of outstanding debt was 11.52 *per cent* during 2017-18, being six *percentage points* decrease over the year 2013-14 (17.95 *per cent*);
- Though there was increase in Debt Repayment/Debt Receipts ratio, there was decrease in total debt receipts by ₹6,034 crore due to decrease in market loans during 2017-18 as compared to debt repayment which increased by ₹849 crore; and
- Decrease in net debt available to the State was mainly due to decrease in receipt under internal debt from ₹29,238 crore in 2016-17 to ₹23,179 crore in 2017-18 (**Appendix 1.4**) and off-set by increase of ₹25 crore under Loans and Advances from Government of India.

1.10.2.1 Interest on off-budget borrowings

The ratio of interest payment to revenue receipts (IP/RR) determines the debt sustainability of the State. During 2017-18, the IP/RR ratio of the State was 10.18 *per cent*, which was well within the TFC norm of 15 *per cent*. During 2013-14 to 2017-18, the ratio was between 8.96 *per cent* and 10.18 *per cent* on account of buoyancy in revenue receipts. By an amendment to KFRA in February 2014, the scope of the total liabilities was amplified to include the borrowings by PSU and SPVs and other equivalent instruments, where the principal and /or interest are to be serviced out of the State Budget. Thus, the off-budget borrowings are part of the State's own liabilities for working out the total liabilities of the State.

The State Government in its MTFP 2018-22 on the ratio of IP/RR had included the interest payment serviced under the HOA 2049 only. But the interest on off-budget borrowings which are serviced through other heads of account is not part of this ratio of IP/RR. Due to non-inclusion of interest on off-budget borrowings, the IP/RR ratio was between 8.75 *per cent* and 9.48 *per cent* during the period 2013-14 to 2017-18. Even though the ratio of IP/RR is within the norms, the inclusion of interest on off-budget borrowings should also be considered for working out this ratio, in the MTFP by the State Government.

1.10.2.2 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 2013-14 to 2017-18, the primary revenue balance was positive and sufficient to meet incremental interest expenditure.

1.10.2.3 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 have been indicated in **Table 1.33**.

Table 1.33: Sufficiency of incremental non-debit receipts

(₹ in crore)

Sl. No.		2013-14	2014-15	2015-16	2016-17	2017-18
1	Incremental Non-Debt Receipts	11,372	14,497	14,993	14,112	13,800
2	Incremental Interest Payments	573	1,777	1,539	1,507	2,123
3	Incremental Primary Expenditure	13,384	15,204	13,047	22,101	14,114
4	Resources gap	(-) 2,585	(-) 2,484	407	(-) 9,496	(-) 2,437

The resource gap, which was negative from 2013-14 to 2014-15 turned positive during 2015-16 and again turned negative from 2016-17 to 2017-18. 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.

1.10.2.4 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 56.32 *per cent* and 80.08 *per cent* during 2013-14 to 2017-18. During 2017-18, the debt redemption ratio increased by 23.76 *per cent* compared to the previous year.

1.11 Fiscal Parameters

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.

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 2017-18.

1.11.1 Trends in deficits

a) Revenue Surplus

Revenue surplus represents the difference between revenue receipts and revenue expenditure. Revenue surplus helps to decrease the borrowings. The revenue surplus had increased from ₹353 crore in 2013-14 to ₹1,789 crore in 2015-16, but decreased by ₹496 crore during 2016-17 and again increased to ₹4,518 crore in 2017-18, due to increase in net proceeds of State share of Union Taxes and duties and grants-in-aid from GOI which helped the Government to maintain surplus.

The growth rate of revenue receipts and revenue expenditure was 10 *per cent* and eight *per cent* respectively during 2017-18, as a result of which there was considerable increase in revenue surplus. The factors responsible for the surplus on revenue account have been discussed in **paragraph 1.1.2**.

The State Government in MTFP (2016-20) had stated that 'though the size of budget has gone up over the years, it is characterised by a substantial portion being in the nature of committed expenditure. This reduces maneuverability around expenditure decision and that the State has 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.

b) Fiscal Deficit

Fiscal deficit represents the net incremental liabilities of the Government or its additional borrowings. The shortfall could be met either by additional public debt (internal or external) or by the use of surplus funds from Public Account. Fiscal deficit trends along with the trends of the deficit relative to key components are indicated in **Table 1.34**.

Table 1.34: 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
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	2.14	18.78	15.81
2015-16	1,19,229	1,38,398	19,169	1.89	16.08	13.85
2016-17	1,33,341	1,62,005	28,664	2.53	21.50	17.69
2017-18	1,47,141	1,78,241	31,101	2.37	21.14	17.45

Source: Finance Accounts.

During the period from 2013-14 to 2017-18, fiscal deficit as a percentage of GSDP increased from 2.09 *per cent* to 2.37 *per cent*, with marginal variations in between. The fiscal deficit as *per cent* of GSDP, Non-debt receipts and Total expenditure decreased during 2017-18 over the previous year, on account of decreased borrowing/increased revenue surplus.

c) 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 1.35**.

Table 1.35: Primary deficit and its parameters

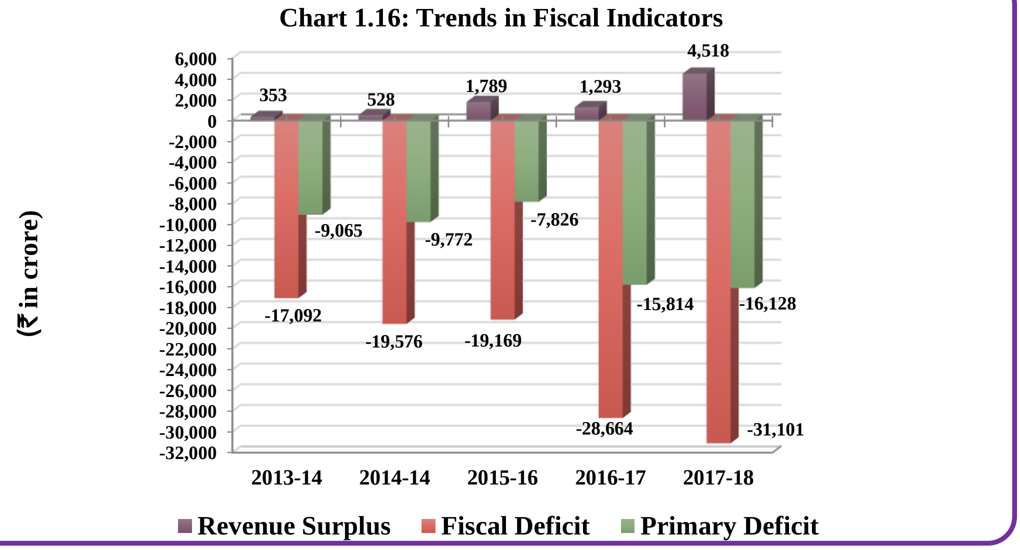
(₹ in crore)

Period	Fiscal Deficit	Interest Payments	Primary Deficit
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
2017-18	31,101	14,973*	16,128

Source: Finance Accounts.

**includes interest payments of ₹190 crore, ₹400 crore, ₹597 crore, ₹817 crore and ₹1,043 crore towards off-budget borrowings during 2013-14, 2014-15, 2015-16 2016-17 and 2017-18 respectively.*

During 2013-14 to 2017-18, the fiscal deficit was almost twice the amount of interest payments. Containing the committed expenditure, which constitutes the major chunk of the revenue expenditure, would 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. The trends in deficit indicators over the period from 2013-14 to 2017-18 is shown in **Chart 1.16**.



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 **Appendix 1.12**. 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.

The components of fiscal deficit are Deduct Revenue Surplus, Net Capital Expenditure and Net Loans and Advances. Since the State had attained revenue surplus in 2004-05 itself, the surplus on revenue account along with market borrowings, loans from GOI etc., were utilised to finance capital expenditure. As seen from the appendix, the capital expenditure could be financed by revenue surplus to the extent of two, three and nine *per cent* in 2013-14, 2014-15 and 2015-16 respectively. In 2016-17 and 2017-18 revenue surplus could finance five and 15 *per cent* of capital expenditure.

In 2017-18, there was decrease in market borrowings and its share in financing fiscal deficit increased to 56 *per cent*. There was decrease in Deposits and Advances, loans from financial institutions and 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 over the previous year. There was increase in Small Savings, Provident Fund marginally over the previous year. As per recommendations of the XIV FC, the State Governments are excluded from the operations of NSSF with effect from 1 April 2015. As such there were no receipts under NSSF from GOI from the financial year 2016-17 onwards.

1.11.3 Quality of deficit/surplus

The position of primary deficit with bifurcation of factors are given in **Table 1.36**.

Table 1.36: 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)**
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
2017-18	1,47,141	1,27,509	30,667	5,093	1,63,269	19,632	(-) 16,128

Source: Finance Accounts.

Primary deficit which was ₹9,065 crore during 2013-14 increased to ₹16,128 crore during 2017-18. The interest payment with respect to fiscal deficit was 48 *per cent* during 2017-18. A shrinking primary deficit indicates progress towards fiscal health. It also indicates how much of the Government borrowings are going to meet expenses other than the interest payments. The interest payments during the year was ₹14,973 crore, an increase of 17 *per cent* over previous year (₹12,850 crore).

1.12 Follow up

The Report of C&AG of India on State Finances for the year 2009-10 was discussed by the 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 the PAC, the Action Taken Note was placed before the PAC for its consideration during September 2014. The PAC discussed the Action Taken Note furnished by the Government and made further recommendations which were placed before the Legislature in July 2015.

Important issues meriting attention of the PAC on the State Finances have been brought to the knowledge of the august body for their consideration.

1.13 Conclusion and Recommendations

Fiscal Position

The State continued to maintain revenue surplus during 2013-14 to 2017-18 and kept fiscal deficit relative to GSDP below the limit prescribed under KFRA.

During 2017-18, revenue surplus was ₹4,518 crore which was partly on account of loan waiver of ₹3,401 crore booked under capital expenditure instead of under revenue account. Failure to carry out the adjustments to Consolidated Sinking Fund (₹1,055 crore) contributed in maintaining surplus of Revenue Account. The fiscal deficit during 2017-18 was 2.37 *per cent* of GSDP (₹13,10,879 crore), which was within the limit laid down under KFRA.

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

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 7.67 *per cent* in 2013-14 to 6.65 *per cent* in 2017-18. 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 2013-14 to 2017-18 also.

Recommendation: Revision of user charges/fees etc., of the sources for Non-tax revenues is required to be considered from time to time as recommended by FMRC (MTFP 2018-22) and Expenditure Reforms Commission.

Revenue expenditure

During 2017-18 there was eight *per cent* growth under social sector over the previous year and the share of expenditure on social services to total revenue expenditure remained at 41 *per cent* in 2016-17 and in 2017-18. The growth in expenditure on economic services was at 19 *per cent* during 2016-17 where as it was six *per cent* in 2017-18.

Seventy-eight *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 ₹17,466 crore contained subsidy amounting to ₹3,318 crore which was in the form of financial assistance under various schemes of socio-economic services.

Recommendations: Adequate priority needs to be given to both education and health sectors as the ratios under both these sectors are below GCS average during 2017-18.

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 Subsidies in committed expenditure, would enable the State Government to attain surplus on revenue account to a considerable extent.

Quality of expenditure

The share of capital expenditure to total expenditure during 2017-18 (20 *per cent*) increased by one *per cent* from that of previous year. The percentage of developmental expenditure to total expenditure decreased to 76 *per cent* in 2017-18 from 77 *per cent* in 2016-17. Funds aggregating ₹967 crore were locked up in incomplete projects at the end of 2017-18.

The return from investment of ₹65,146 crore as of 31 March 2018 in Companies/ Corporations was negligible (₹78.83 crore). The investment included ₹38,912 crore (60 *per cent*) to Companies/ Corporations which were under perennial loss.

Recommendations: 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 huge 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. During 2017-18, there was no investment in the Consolidated Sinking Fund and the interest of ₹484.36 crore accrued on re-investment made on fund balances by RBI did not pass through the accounts. During the year, Green Tax collections of ₹62.25 crore were not transferred to fund account.

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

Debt sustainability

Open Market Loans had a major share (51 *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 8.96 *per cent* and 10.19 *per cent* during 2013-14 to 2017-18. The net debt available to the State during 2017-18 (₹5,005 crore) decreased by 63 *per cent* when compared to the previous year. The State has limited revenue space available after accounting for its committed expenditure needs.

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

The State Government needs to make medium term corrections on the expenditure side to moderate committed expenditures.