Chapter 1

Finances of the State Government

Profile of the State

Karnataka is the eighth l e in terms of geographical area and accounts for around fiv of India's population. As indicated in Appe n the ars, the density of population in Karnataka has increased from 276 persons per sq km to 319 persons per sq km. However, the State still has lower density of population as compared to all India average.

The State has shown higher economic growth in th cade as the compounded annual growth rate of its Gross State Domestic Product (GSDP) for the period 2001-02 to 2010-11 has been 15.01 *per cent* as against 14.68 *per cent* of the General Category States. Dur riod, the population growth rate of the State (15.67 *per cent*) was lower than that of the General Category States (17.56 *per cent*) indicating higher *per capita* income in the State.

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

1.1 Introduction

This chapter provides a broad perspective of the finances of the Government of Karnataka dur rrent year. s important n the major fiscal indicators compared to the pr ing in view the overall trends during the last five years. The analysis is based on the Finance Accounts and information obtained from the State Government. The structure of the Government Accounts and the layout of the Finance Accounts have been explained in **Appendix 1.2**.

1.2 Summary of fiscal transactions

Table 1.1 and Appendix.1.3 presents the summary of the State Government's fiscal transactions and provides details of receipts and disbursements as well as the overall fiscal position, respectively, during the current year (2010-11) *vis-à-vis* the previous year.

Table 1.1:Summary of fiscal transactions

(₹ in crore)

Receipts			Disbursements				
	2009-10	2010-11		2009-10	2010-11		
Section-A: Revenue				**Total**	**Non Plan**	**Plan**	**Total**
Revenue receipts	**49,155.70**	**58,206.22**	**Revenue expenditure**	**47,536.92**	**38,846.41**	**15,187.43**	**54,033.84**
Tax revenue	30,578.60	38,473.12	General services	12,762.34	13,959.34	95.75	14,055.09
Non-tax revenue	3,333.80	3,358.28	Social services	19,118.86	12,301.06	9,806.76	22,107.82
Share of union taxes/ duties	7,359.98	9,506.31	Economic services	13,181.71	10,686.35	4,206.09	14,892.44
Grants-in-aid & contributions from GOI	7,883.32	6,868.51	Grants-in-aid and contributions	2,474.01	1,899.66	1,078.83	2,978.49
Section-B: Capital and others							
Misc. Capital receipts	**69.79**	**71.81**	**Capital outlay**	**12,136.68**	**773.44**	**12,581.73**	**13,355.17**
			General services	489.85	50.50	414.96	465.46
			Social services	2,650.68	66.74	2,549.96	2,616.70
			Economic services	8,996.15	656.20	9,616.81	10,273.01
Recoveries of loans and advances	**555.36**	**161.37**	**Loans and advances disbursed**	**981.58**	**1.52**	**1,736.41**	**1,737.93**
Public debt receipts*	**7,990.86**	**6,713.74**	**Repayment of public debt***	**2,308.33**	**2,807.13**	---	**2,807.13**
Contingency Fund	**2.10**	**-**	**Contingency Fund**	---	**12.00**	**0.53**	**12.53**
Public Account receipts	**71,172.45**	**80,313.64**	**Public Account disbursements**	**64,029.09**			**75,626.38**
Opening cash balance	**7,819.85**	**9,773.51**	**Closing cash balance**	**9,773.51**			**7,667.31**
Total	**1,36,766.11**	**1,55,240.29**	**Total**	**1,36,766.11**			**1,55,240.29**

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

Source: *Finance Accounts*

The following are the significant changes during 2010-11 over the previous year:

- Revenue receipts grew by ₹ 9,050 crore (18 *per cent*) due to increase in own tax revenue (₹ 7,894 crore) and State's share of Union taxes and duties (₹ 2,146 crore). This was offset by decrease in grants-in-aid and contributions from GOI (₹ 1,015 crore). The revenue receipts during the current year were more than the projection made in the Medium Term Fiscal Plan (MTFP) 2009-13 by ₹ 5,434 crore.
- Revenue expenditure increased by ₹ 6,497 crore (14 *per cent*). This increase was mainly in respect of social services sector (₹ 2,989 crore), economic services sector (₹ 1,710 crore), general services sector (₹ 1,293 crore) and grants-in-aid and contributions (₹ 504 crore). It over shot MTFP projection for the year by₹ 3,187 crore.
- Capital outlay increased by ₹ 1,218 crore (10 *per cent*). Increase was only under economic services sector (₹ 1,277 crore). This was offset by decrease in general service sector (₹ 24 crore) and social service sector (₹ 34 crore).
- Public debt receipts (excluding ways and means advances) decreased by ₹ 1,277 crore (16 *per cent*) while repayment of public debt increased by ₹ 499 crore (22 *per cent*).
- Public Account receipts and disbursements increased by ₹ 9,142 crore (13 *per cent*) and ₹ 11,597 crore (18 *per cent*), respectively.
- Cash balance of the State Government decreased by ₹ 2,106 crore (22 *per cent*).

1.3 Fiscal reforms path in Karnataka

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

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

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

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

The outcome indicators reflecting the State's fiscal correction path for the period 2011-15 are given in **Appendix 1.4**.

By adhering to the policy changes in revenue generation strategies and expenditure control envisaged in MTFPs, the State achieved the fiscal targets laid down in FRA one year ahead, with the year 2004-05 ending in revenue surplus and fiscal deficit for the year at less than three *per cent* of GSDP. By an amendment to the FRA, the fiscal deficit limit of three *per cent* was enhanced to 3.5 *per cent* in 2008-09 and to four *per cent* in 2009-10 in order to over-come the impact of economic slow-down. During the period 2005-10, the State continued to maintain revenue surplus and kept the fiscal deficit relative to GSDP below the limit laid down under FRA. Outstanding guarantees given by the Government were within the limit prescribed under the Karnataka Ceiling on Government Guarantees Act, 1999. The ratio of fiscal liabilities (excluding off-budget borrowings) to GSDP which was around 25 *per cent* in 2006-07 decreased to 22 *per cent* in 2007-08. Thereafter, there was an increase in the successive two years and was around 25 *per cent* in 2009-10. This was on account of increase in

borrowings. Under GOI's scheme of States' Debt Consolidation and Relief Facility (DCRF) recommended by the Twelfth Finance Commission (TFC), the State got the benefit of interest relief of ₹ 1,252 crore for the period 2005-10 along with waiver of GOI loan of ₹ 1,792 crore.

However, the Government of India (GOI), while re-evaluating, found that the ratio of fiscal deficit to GSDP (actual) for 2008-09 was more than the ratio of fiscal deficit to GSDP (BE) for 2008-09, thereby making the State ineligible for debt waiver. Hence, the entire debt waiver amount of ₹ 358.33 crore for the year 2008-09 was recovered during April 2011. Thus, the State got benefit of debt waiver of GOI loan of ₹ 1,434 crore only against a possible total waiver of ₹ 1,792 crore.

Revised fiscal roadmap for the State

With the overall macro economic slowdown during 2008-09 and 2009-10 the State, as per the recommendations of GOI, deviated from the fiscal consolidation path in the past two years and it was essential for the State to initiate steps towards fiscal correction in the succeeding years. In this context, the Thirteenth Finance Commission (XIII FC) suggested a roadmap for medium term fiscal correction for the State Government. The factors to have significant implications for fiscal consolidation include implementation of Goods and Service Tax (GST), higher devolutions to State, State's own efforts towards mobilizing non-tax revenues, amendment of FRA, review of tariff policies relating to power and irrigation sectors, rationalization of expenditure, effective cash management and strengthening of the State Finance Commission (SFC).

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

- Ensuring that the outstanding debt be gradually reduced and at the end of 2014-15 to be at 25.20 *per cent* of the estimated GSDP for the year. During 2010-11, the outstanding debt was to be at 26.20 *per cent.*
- Fiscal deficit during 2010-11 not to exceed more than 3.44 *per cent* of GSDP
- Constitute Fiscal Management Review Committee which shall meet at least twice a year to review fiscal and debt position of State.

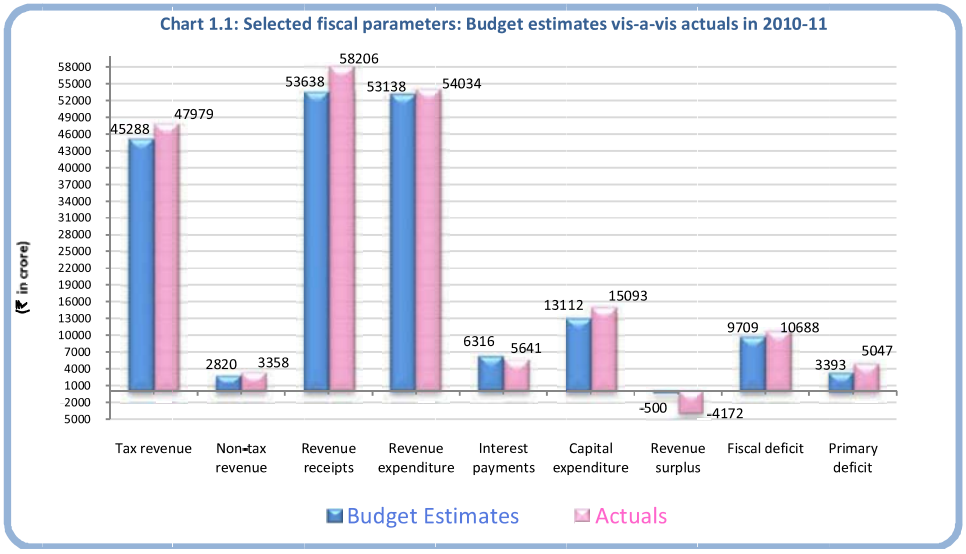
It is heartening to note that, the outstanding debt and fiscal deficit during 2010-11 was 24.14 *per cent* and 2.81 *per cent,* respectively, of the GSDP which was well within the prescribed limit.

1.4 Budget 2010-11

1.4.1 Actuals vis-à-vis budget estimates

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

Chart 1.1 presents the budget estimates and actuals of some important fiscal parameters for the year 2010-11.



Source: *Annual Financial Statement and Finance Accounts*

During 2010-1[illegible] e's revenue [illegible] ere estimated at ₹ 53,638 crore. In order to achieve development obj[illegible] ecial attention was gi[illegible] e government to resource mobilisation during 2010-11. This was r[illegible] e during 2008-0[illegible] 10 due to the adverse impact of global economic crisis. Value Added Tax (VAT) rates including lower [illegible] ax on tobac[illegible] s and luxury tax were increased. Motor vehicle taxes under various cate[illegible] e increased to collect additional resources. Further, toll on heavy vehicles was imposed during 2010-11 in order to achieve growth in non tax revenue.

Revenue expenditure was estimated at ₹ 53,138 crore. The Government proposed to give top priority to inc[illegible] ltural productivity by implementing various programmes in the agriculture sector. Providing right education, training opportunities [illegible] empowerment of weaker sections and development of backward areas, power generation and improvement of infrastructure for Bangalore were the other priority sectors of the Government. Capital expenditure was estimated at ₹ 13,112 crore.

The State's revenue receipts were more than the budget estimate by ₹ [illegible] e (nir[illegible]) due to increase in tax as well as non tax revenue. The State's tax rev[illegible] sive of State's share of Union taxes and dut[illegible] ore than the budget estimate by ₹ 2,691 crore (six *per* [illegible] rther, non-tax revenue exceeded the budget estimate by ₹ 538 crore (19 *per cent*). Revenue [illegible] e and [illegible] xpenditure were more than the [illegible] imate by ₹ 896 crore (tw[illegible]) and ₹ 1,981 crore (1[illegible]) [illegible] st payments were less than the budget estimate by ₹ 675 crore (11 *per c*[illegible] s, fiscal deficit [illegible] ary deficit were more than the budget estimate by ₹ 3,672 crore, ₹ 979 crore and ₹ 1,654 crore respectively.

1.4.2 Gender Budgeting

Gender budget of the State discloses the expenditure proposed to be incurred within the overall budget on schemes which are designed to benefit women fully or partly. Based on the Finance Minister's proposal (Budget speech 2006-07), the State had created the Gender Budget Cell (January 2007) and gender budgeting was introduced in 2007-08. The year-wise allocations in the gender budget document are detailed in **Table 1.2**.

Table 1.2: Gender budgetary allocations during 2007-11

(₹ in crore)

Year	Total Outlay	Outlay under			Demands covered	Percentage of total outlay
		Category A*	Category B^	Total		
2007-08	50,465.61	562.63	17,235.88	17,798.51	20	35
2008-09	60,497.19	661.77	20,764.82	21,426.59	25	35
2009-10	62,413.81	845.10	22,285.31	23,130.41	27	37
2010-11	70,033.39	873.20	25,417.93	26,291.13	27	38

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

The Gender Budget Cell was entrusted with implementation of the gender budget by coordinating between various departments and the Department of Women and Child Development was entrusted with the monitoring of the impact analysis. Study of the functioning of the above during 2009-10 had revealed that while the Gender Budget Cell was not involved in assessing and working out budgetary requirement of category A and B, the Department of Women and Child had not conducted any impact analysis study. Further, there were no clear guidelines for identification of items in the gender budget under both category A and B.

The State Government stated (May 2011) that the chief constraint in mainstreaming Gender Budget was the staff's inability to comprehend the process itself.

It was also informed that the Gender Budget Cell, in order to strengthen analysis and analytical inputs, had improved the format of the Monthly Programme Implementation Calendar and a circular was issued to validate the categorization of schemes, assess the impact and analyse the allocation. Further, a study on 'Monograph on the Status of Women in Karnataka' has been commissioned (May 2011), which is to be carried out jointly by Institute of Social Economic Change, Bangalore and Institute of Social Studies Trust, Bangalore. The study is in its nascent stage.

The Public Accounts Committee in its 13th report on CAG's Report on State Finances – 2009-10, (December 2011) placed before the Legislative Assembly recommended the following:

- The area of activity of the Gender Budget Cell should be expanded in order to achieve the purpose for which the cell was created.
- Priority to be given for the analysis of the data collected from various departments for their effective implementation.
- Proper identification of schemes are required to be made under both category A and B of the Gender Budget.

Analysis in audit during 2010-11of the gender budget document and internal audit observations of the Department of Women and Child Development revealed that:

- In the gender budget document for the year 2010-11, the gender budget allocation covered 25 demands with 42 schemes under Category A and 596 schemes under Category B. However, the document in the summary had claimed that the allocation covered 27 demands with 49 schemes under Category A and 737 schemes under Category B.
- The internal audit report of 'Stree Shakthi' scheme observed that the amounts drawn for implementation of the scheme were parked in the bank account accumulating interest and were not refunded back to the Government account. Also, it observed that the expenditure in many cases was not supported with requisite documents such as vouchers etc.

This has resulted in projecting greater coverage and overstatement of expenditure both under the gender budget as well as total expenditure.

1.4.3 Major policy initiatives of Budget 2010-11

In order to transform Karnataka into a prosperous State, major policy initiatives have been taken up in the Budget 2010-11 which are detailed in **Appendix 1.8**.

During 2010-11, the action taken by the Government to implement the said policy initiatives as enumerated in the action taken report (2010-11) are summarised below:

Sector	Action Taken
Social sector :	While the proposal for compulsory education was under examination, the project of developing Metro Rail was being implemented satisfactorily. Further, ₹ 233.08 crore was spent during 2010-11 for water and drainage facilities. Notification to bring a few districts under the jurisdiction of Shimoga University of Agricultural Sciences pending amendment to the University of Agricultural Sciences Act 2009 has been issued.
Economic Sector:	In order to increase agricultural productivity, Government order for providing special assistance for building check dams etc., has been issued in January 2011 and ₹ 400 crore has been utilised under Suvarna Gramodaya programme. Further, ₹ 179.26 crore has been released as first installment of assistance to co-operative Banks.
Fiscal Sector:	Notifications for modification of various taxes have been issued and the Acts amended accordingly.
Others:	Preliminary notification for acquisition of land, techno-economic pre-feasibility survey and impact study has been done for setting up a Special Economic Zone. Phase I, II and III of the Mukhyamanthri Nagarothana Yojane have been launched with a total outlay of ₹ 2,208 crore and is under progress. Selection of villages in two districts under Phase IV with outlay of ₹ 208 crore is also under progress.

Public Private Partner-ship (PPP):	To facilitate the process of economic growth the Government has encouraged PPP's in creating new infrastructure assets as well as in managing the assets created. The new Infrastructure Policy – 2007 was announced covering sectors like Agri-Infrastructure, Education, Energy, Transportation, Industrial Infrastructure, Urban and Municipal Infrastructure etc. The note prepared by the State Government (Infrastructure Development Department) in November 2010 stated that 90 projects were being developed through PPP route by various departments and agencies. The 90 projects which are in different stages are detailed in **Table 1.2A.**

Table 1.2A: Brief summary of the PPP projects in different stages

(₹ in crore)

Sl. No.	Sector	Under Planning/Pipeline		Under Implementation		Completed		Total	
		Nos	Cost	Nos	Cost	Nos	Cost	Nos	Cost
1	Agri-Infrastructure	8	855.75	0	0.00	0	0.00	8	855.75
2	Education	0	0.00	0	0.00	0	0.00	0	0.00
3	Energy	4	7,350.00	0	0.00	0	0.00	4	7,350.00
4	Healthcare	0	0.00	0	0.00	0	0.00	0	0.00
5	Industrial Infrastructure	15	24,346.00	0	0.00	0	0.00	15	24,346.00
6	Tourism	7	1,164.50	0	0.00	1	32.00	8	1,196.50
7	Transport and Logistics	39	29,398.59	7	1,383.33	3	3,006.29	49	33,788.21
8	Urban and Municipal Infrastructure	2	144.32	0	0.00	4	108.64	6	252.96
	Total	**75**	**63,259.16**	**7**	**1,383.33**	**8**	**3,146.93**	**90**	**67,789.42**

1.5 Resources of the State

1.5.1. Resources of the State as per Finance Accounts

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

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

Chart 1.2: Components and sub-components of Resources.

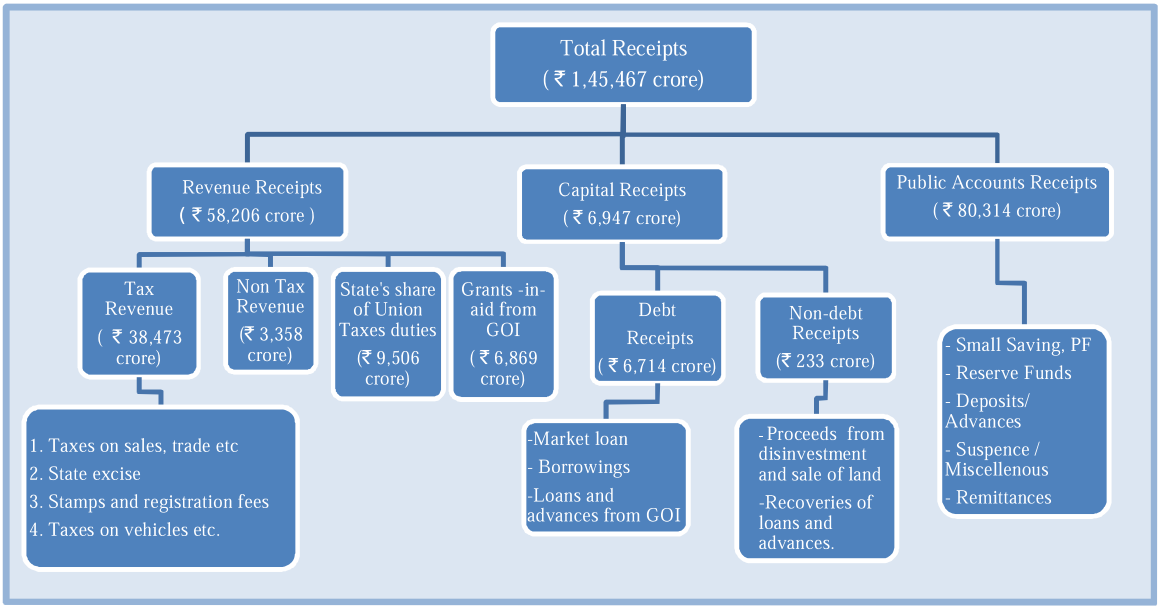
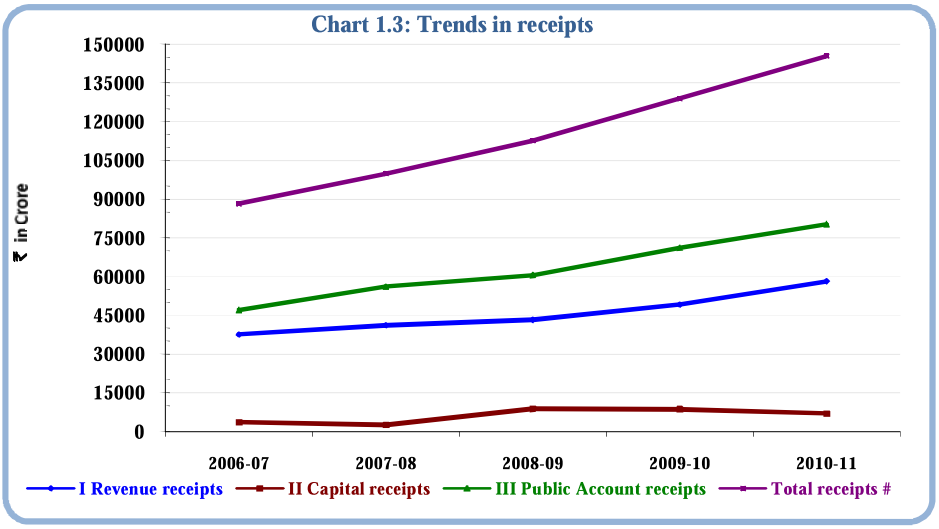


Table 1.1 depicting *inter-alia* the receipts of the State during the current year, as recorded in Finance Accounts, may also be referred to on page 2.

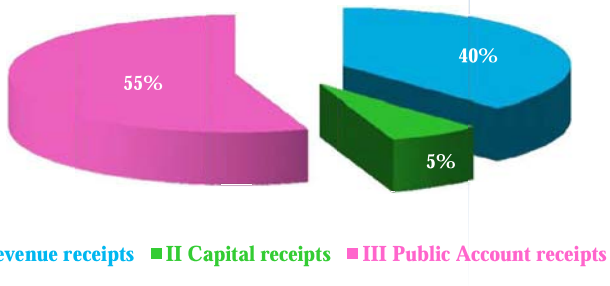
Chart 1.3 depicts the trends in various components of receipts during 2006-11, while **Chart 1.4** depicts the composition of resources of the State during the current year.

Chart 1.3: Trends in receipts



Excluding Contingency Fund receipts

Chart 1.4: Composition of receipts during 2010-11



Source: Finance Accounts

Tot l receipts increased by 65 *per cent* from ₹ 88,233 crore in 2006-07 to ₹ 1,45,467 crore in 2010-11. Furth as an increase of receipts over the previous year by ₹ 16,519 crore (13 *per cent* excluding contingency fund).

Public Account receipts refer to those receipts for which the Government acts as a banker/trustee for the public money. It constitutes the single largest component of total receipts. On an average it constituted 55 *per cent* of the total receipts during 2006-2011. Public Account receipts which totalled ₹ 47,040 crore in 2006-07 increased to ₹ re in 2010-11. In 2010-11, there was *13 per cent* growth in Public Account receipts compared to previou as maximum in Suspense and Miscellaneous (25 *per* owed by Remittances (18 per cent), Small Savi ent Fund etc (16 *per cent*) and Deposits and Advances (seven *per cent*). There was considerable negative growth in Remittances to Reserve F us 58 *per cent*). Analysis of Reserve funds is provided in paragraph 1.10.3.

The share of Revenue Receipts in total receipts which was 38 *per cent* during 2009-10 increased to 40 *per cent* in 2010-11. Further details are provided in paragraph 1.6.

Capital receipts increased by 93 per cent from ₹ 3,606 crore in 2006-07 to ₹ 6,947 crore in 2010-11. During the current year, the capital receipts accounted for nt of total r ch was less by two *per cent* from the previous year. Though debt receipts, which is the main constituent of capital receipts, decreased by ₹ 1,277 crore from the previous year, its share was 97 *per cent* of capital receipts which was higher by four *per cent* o vious year (93). Internal Debt and Loans and Advances from GOI are the two con ponents of debt receipts whose share is 78 *per cent* and 22 *per cent* of the total deb espectively. In 2010-1 a e growth of 29 *per cent* in internal debt over the previous year. Howev as a tremendous growth of 121 *per cent* in Loans and Advances from GOI. This was due to significantly increased borrowings from GOI under State Plan Schemes.

Apart from d t receipts include non-debt receipts such as rec ans and advances and of land. In the current year, non-deb owed considerable negative gro s 63 *per cent*) over the previous year due to less recovery of loan and advances.

The State Government in reply to Public Accounts Committee (PAC) (July 2011) had stated that the percentages of revenue and capital receipts were to be worked out based on receipts under Consolidated Fund excluding Public Account receipts. The reply is not acceptable as the State Government utilizes the Public account receipts for financing the Fiscal Deficit.

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

Government of India transferred ₹ 7,342.27 crore during 2010-11 directly to the State implementing agencies[1] for implementation of various schemes/programmes in social and economic services sectors, recognized as critical against the transfer of ₹ 3,326.29 crore and ₹ 7,594.32 crore during 2008-09 and 2009-10, respectively. There was a decrease of transfer in 2010-11 by three *per cent*. As these funds were not routed through the State budget/State treasury system, Finance Accounts do not capture the flow of these funds and to that the extent State's receipts and expenditure as well as other fiscal variables/ parameters derived from these are understated. Details in respect of major Central plan schemes are furnished in **Table 1.3**.

Table-1.3: Funds transferred directly to the State implementing agencies for major plan schemes

(₹ in crore)

Programme / scheme	Implementing agency in the State	2008-09	2009-10	2010-11
Mahatma Gandhi National Rural Employment Guarantee Scheme	Zilla Panchayats	234.01	2,769.98	1,573.05
Pradhan Mantri Gram Sadak Yojna (PMGSY)	Karnataka Rural Roads Development Agency	---	438.00	927.67
National Rural Drinking Water Programme	Karnataka Rural Water Supply and Sanitation Agency	0.69	467.46	703.80
Sarva Shiksha Abhiyan (SSA)	Sarva Shiksha Abhiyan Samithi	515.78	442.21	669.03
Rural Housing (IAY)	Zilla Panchayats	94.97	356.27	448.80
National Rural Health Mission (NRHM)	Karnataka State Health and Family Welfare Society	176.88	308.80	415.35
Integrated Watershed Management Programme (IWMP)	Zilla Panchayats and State Level Nodal Agency	17.83	219.23	156.43
Swaranjayanti Gram Swarozgar Yojana (SGSY)	Zilla Panchayats	40.99	90.97	99.73
National Horticulture Mission	Karnataka State Horticulture Mission Agency	125.37	80.02	93.25
National Mission on Micro Irrigation	State Micro Irrigation Committees	75.64	63.81	92.54
Member of Parliament Local Area Development Scheme (MPLADS)	Deputy Commissioners	63.50	88.50	90.93
National Food Security Mission	State Agriculture Management Agency and Karnataka State Seeds Corporation Limited	30.15	47.71	72.64

Source: *CGA's website.*

Direct transfer from the Union to the State implementing agencies runs the risk of poor oversight of utilisation of funds by these agencies. Unless uniform accounting practices are diligently followed by all these agencies with proper documentation and timely reporting of expenditure, it is difficult to monitor the end use of these direct transfers. An analysis of one such scheme i.e., MPLADS is indicated in **Box 1.1.**

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

Box – 1.1

The MPLADS, a plan scheme fully funded by the GOI, aims at enabling Members of Parliament (MPs), to cater to local requirements through the creation of assets in their constituency. The implementation of the scheme was marked by various shortcomings and lapses as there was no systemic arrangement to ensure the effective utilization of funds in the form of asset creation and maintenance thereafter. Since the State Government has a limited role in the implementation of the scheme, the entire responsibility for monitoring its execution by District Authorities (DAs) rested with the Ministry of GOI. However, DAs were not accountable to any immediate monitoring authority. The Ministry did not analyse basic records such as UCs and audited accounts furnished by DAs and based its releases of funds primarily on progress reflected in Monthly Progress Reports (MPRs) sent by DAs. Some of the lacunae in reporting financial progress were incorrect submission of UCs by DAs (UCs from implementing agencies not obtained), incorrect reporting of interest earned and unutilized balances, non timely submission of MPRs and discrepancies between figures of MPRs, UCs and annual accounts.

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

1.6 Revenue receipts

The trends and composition of revenue receipts over the period 2006-11 are presented in **Appendix 1.5** and are also depicted in **Charts 1.5** and **1.6,** respectively.

Revenue receipts showed progressive increase from ₹ 37,587 crore in 2006-07 to ₹ 58,206 crore in 2010-11 with drastic growth during 2009-11. On an average, 71 *per cent* of the revenue came from State's own resources during the period 2006-11. The balance was from transfers from GOI in the form of State's share of taxes and grants-in-aid and contributions.

State's own resources consist of tax revenue and non-tax revenue. The share of tax revenue in revenue receipts was between 62 and 66 *per cent* during 2006-11. In 2010-11, there was a spurt in growth of tax revenue which increased from 62 *per cent* in 2009-10 to 66 *per cent* in 2010-11. Non-tax revenue as a *per cent* of revenue receipts showed steady fall during the period 2006-11. It decreased from 11 *per cent* in 2006-07 to six *per cent* in 2010-11.

Chart 1.5: Trends in revenue receipts

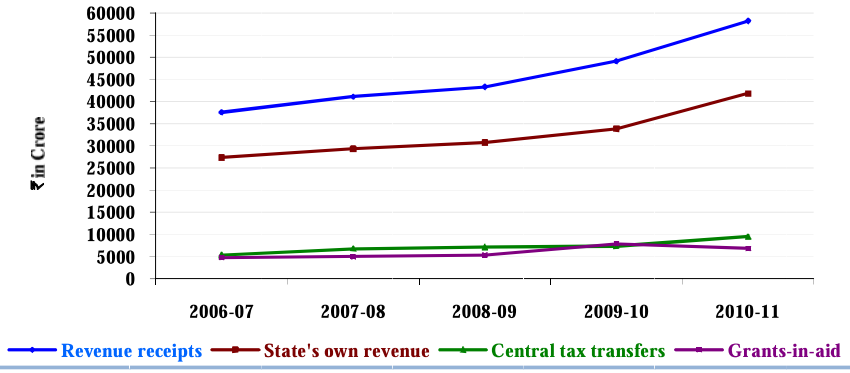
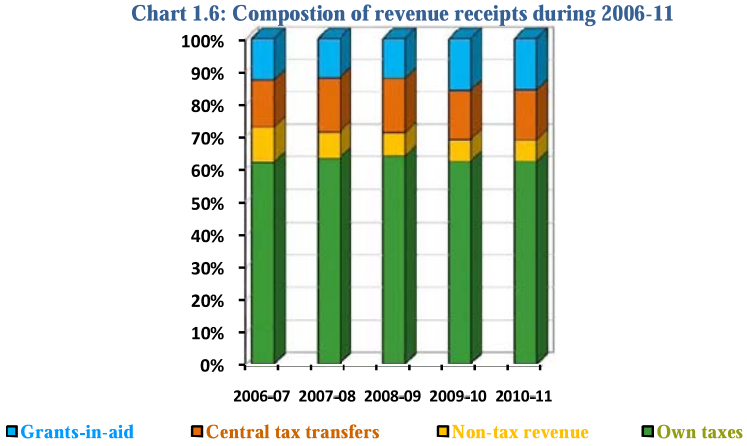


Chart 1.6: Compostion of revenue receipts during 2006-11



Source: *Finance Accounts*

The trends in revenue receipts relative to GSDP are presented in **Table 1.4.**

Table 1.4: Trends in revenue receipts relative to GSDP

	2006-07	2007-08	2008-09	2009-10	2010-11
Revenue receipts (RR) (₹ in crore)	37,587	41,151	43,290	49,156	58,206
Rate of growth of RR (*per cent*)	23.8	9.5	5.2	13.6	18.4
Rate of growth of State's own tax (*per cent*)	25.05	11.52	6.38	10.61	25.81
R R/GSDP (*per cent*)	16.5	15.2	14.3	14.6	15.3
Revenue buoyancy w.r.t GSDP	1.4	0.5	0.4	1.2	1.4
State's own tax buoyancy w.r.t GSDP	1.5	0.6	0.5	1.0	1.9
Revenue buoyancy with reference to State's own taxes	0.9	0.8	0.8	1.3	0.7
GSDP (₹ in crore)	2,27,831	2,70,843	3,03,058	3,35,747	3,80,872
Rate of growth of GSDP	16.4	18.9	11.9	10.8	13.4

Source: *Finance Accounts.*
GSDP: MTFP 2011-15

[2] Bu ... indicates the elasticity or degree of responsiveness of a fiscal variable with respect to a given change in the base variable. For instance, r ... ncy 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 widely fluctuated during the period due to fluctuations in the growth rate of revenue receipts. During 2007-09, the lower growth rate of revenue receipts relative to GSDP pushed the revenue buoyancy ratio down. Revenue buoyancy ratio, which was at its lowest at 0.4 in 2008-09, increased to 1.2 in 2009-10 and 1.4 in 2010-11, due to increase in the growth rate of revenue receipts.

During 2006-11, the State's own tax revenue was the largest component of the Revenue Receipts and its growth trend influenced the trends in revenue receipts. During this period, rate of growth of own tax revenue and buoyancy ratio of own tax revenue with respect to GSDP was also the lowest in 2008-09. The growth rate of own tax revenue, which increased in 2009-10, continued the trend in 2010-11 also and was highest at 25.81 per cent. This influenced the growth rate of revenue receipts, revenue buoyancy with respect to GSDP and the State's own tax buoyancy with respect to GSDP during 2009-10 and 2010-11 also. In 2010-11, all the factors increased over the previous year.

1.6.1 State's own resources

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

The State's actual tax and non-tax receipts for the year 2010-11 vis-à-vis assessment made by XIII FC and MTFP (2009-13) are given in **Table 1.5**

Table 1.5

(₹ in crore)

	XIII FC projection	Budget Estimates	MTFP projection	BE Actual
Tax revenue	41,199	36,228	38,252	38,473
Non-tax revenue	5,040	2,820	2,308	3,358

The tax revenue of the State in 2010-11 attained the projection made in the State's MTFP, Budget Estimates but was less than XIII FC projection. Non-tax revenue was less than the XIII FC projection but exceeded the MTFP projection and budget estimates. Due to sustained growth in the economy during 2010-11, the tax collection was expected at 10 *per cent* of GSDP and was projected at ₹ 38,252 crore and exceeded it by ₹ 221 crore. Due to increase in mineral concession fees, rents and royalties, interest receipts, introduction of toll on heavy vehicles etc., the actual non-tax revenue was more than the MTFP projection.

Tax revenue

Taxes on sales, trade, etc. was the main source of the State's tax revenue with a contribution of 53 *per cent* of the State's tax revenue followed by State Excise (21 p*er cent*), stamps and registration fees (nine *per cent*) and taxes on vehicles (seven *per cent*). The trends in the major constituents of tax revenue during the period 2006-11 are shown in **Table 1.6.**

Table 1.6: Tax revenue

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Taxes on sales, trade, etc.	11,762	13,894	14,623	15,833	20,235
Rate of growth	19.17	18.13	5.25	8.27	27.80
State excise	4,495	4,767	5,749	6,946	8,285
Rate of growth	32.32	6.05	20.60	20.82	19.28
Stamps and registration fees	3,206	3,409	2,927	2,628	3,531
Rate of growth	44.87	6.33	(-)14.14	(-) 10.21	34.36
Taxes on vehicles	1,375	1,650	1,681	1,962	2,550
Rate of growth	24.43	20.00	1.88	16.72	29.97

Source: *Finance Accounts*

The rate of growth of taxes on sales, trade, etc which ranged between 18 *per cent* to 19 *per cent* in 2006-08, has decreased to five *per cent* in 2008-09 on account of reduction of Central sales tax by one *per cent* and fall in sale of industrial inputs and goods, due to general slowdown of economy. During 2009-10, there was increase in rate of growth in taxes on sales, trade, etc by three *per cent* as the general slowdown of economy which had continued in the first half of 2009-10 reversed during the second half. It is heartening to note that in 2010-11, there was a steep rise by 19.53 *per cent* due to additional resource mobilization measures undertaken by the Government by way of revision of rate of VAT by one *per cent*. Apart from this, the increase was attributable to the general economic recovery and better tax monitoring and collection efforts undertaken by Government, such as introducing 'Karsamadhan Scheme' to provide relief to the tax payers who were unable to pay taxes.

Due to ban on sale of arrack, the growth rate of State excise had witnessed a steep fall from 32 *per cent* in 2006-07 to six *per cent* in 2007-08. The growth rate increased to 21 *per cent* in 2008-09 due to increase in the consumption of Indian Made Foreign Liquor of lower price band. Though the growth rate was maintained in 2009-10, there was a slight decrease in growth rate during 2010-11 by two *per cent*. In MTFP 2010-14, the year 2010-11 had been contemplated to be the year of consolidation and only a moderate increase of revenue of about 10 *per cent* was anticipated.

The economic slowdown in 2008-10 resulted in fall in the number of registrations and negative growth in stamps and registration fees. Reduction of stamp duty from 7.5 to six *per cent* to stimulate the real estate market during 2009-10 resulted in containing the negative growth rate. In 2010-11 there was a huge increase in growth rate by 35 *per cent* over the previous year. According to MTFP (2011-15), this was on account of an overall growth in economy and reforms initiated by GOI to allow direct investment by foreign players in the real estate sector.

The fall in the growth rate of taxes on vehicles during 2008-09 was also due to fall in sale of vehicles on account of general economic slow-down. According to MTFP 2010-14, measures of GOI to stimulate the automobile industry by reducing excise duty and allocation of funds for purchase of buses under Jawaharlal Nehru National Urban Renewal Mission (JnNURM) resulted in higher rate of growth in taxes on vehicles during 2009-10. In 2010-11 the State witnessed a growth rate of 29.97 *per cent* of revenue by way of taxes on vehicles. Due to growth in economy, the demand for motor vehicles rebounded strongly which resulted in significant growth in tax revenue also.

Cost of collection

The gross collection of taxes on motor vehicles, taxes on sales, trade etc., stamp duty and registration and State excise, expenditure incurred on their collection and its percentage to gross collection during the years 2008-11 along with their all India average cost of collection for the respective previous years are indicated in **Table 1.7.**

Table 1.7: Details of cost of collection

Receipt	Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceeding year
		(₹ in crore)			
Motor vehicles	2008-09	1,682.03	34.84	2.07	2.58
	2009-10	1,962.62	36.81	1.87	2.93
	2010-11	2,551.40	41.45	1.62	3.07
Taxes on sales, trade etc.,	2008-09	16,259.37	81.62	0.50	0.83
	2009-10	16,546.34	84.46	0.51	0.88
	2010-11	21,252.97	92.87	0.44	0.96
Stamp duty and registration	2008-09	2,946.37	41.01	1.39	2.09
	2009-10	2,650.17	53.18	2.01	2.77
	2010-11	3,554.48	53.52	1.51	2.47
State excise	2008-09	5,754.42	55.78	0.97	3.27
	2009-10	6,948.72	60.55	0.87	3.66
	2010-11	8,286.83	68.35	0.82	3.64

The percentage of cost of collection to the gross collection was less than the all India average for the period 2008-11.

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

Non-tax revenue

During 2006-11, 63 *per cent* of the non-tax revenue on an average was on account of interest receipts, dividends, fees and fines and user charges for socio-economic services. The balance 37 *per cent* on an average represented receipts (gross) from State lotteries, amount received from GOI under the scheme of DCRF, amounts written back from Public Account[3] and pooling of cess collection under the head 1475-Other General Economic Services. These transactions had no cash realisation and also it did not account for any services/user charges provided by the State Government but only represented inter account adjustment. Thus non-tax revenue reflected in Finance Accounts stood inflated by 37 *per cent* as revealed by the details of composition of non-tax revenue shown in **Table 1.8.**

[3] The Balance under the Zilla Panchayat Fund/Taluk Panchayat Fund under category II (in Public Account) which accounts receipts and expenditure in respect of all State plan schemes (other than matching share of CPS/CSS and all non-plan assistance received from State Government) as at the end of March each year have to be written back to the Consolidated Fund in the next financial year. During 2009-10 and 2010-11, the balances have not been written back to the Consolidated Fund of the State resulting in over statement of expenditure to that extent.

Table 1.8: Composition of non-tax revenue

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11	Average percentage composition during 2007-11	
						Interest, dividends, user charges, fees, fines	Others
Interest receipts, dividends and profits	**396 (10)**	**399 (12)**	**377 (12)**	**413 (12)**	**618 (18)**	**13**	
General services	**2,127 (52)**	**679 (20)**	**675 (21)**	**846 (26)**	**98 (3)**		
Receipts (gross) from State lotteries	1,128 (28)	---	---	---	---		**7**
Relief under DCRF	716 (17)	358 (11)	358 (11)	358 (11)	---		**10**
Fees, fines etc,	283 (7)	321 (10)	317 (10)	488 (15)	98 (3)	**9**	
Economic services	**1,428 (35)**	**2,099 (63)**	**1,921 (61)**	**1,836 (55)**	**2,312 (69)**		
Write-back from Public Account	299 (7)	749 (22)	484 (15)	2 (-)	---		**8**
Pooling of cess collections	357 (9)	377 (11)	365 (12)	386 (12)	516 (15)		**12**
User charges	772 (19)	973 (29)	1,072 (34)	1,448 (43)	1,796 (53)	**35**	
Social services –user charges	**148 (3)**	**181 (5)**	**186 (6)**	**239 (7)**	**330 (10)**	**6**	
Total	**4,099**	**3,358**	**3,159**	**3,334**	**3,358**	**63**	**37**

Figures in brackets denote percentage composition in non-tax revenue

Source: *Finance Accounts.*

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

During the current year 15 per cent of the non tax revenue was inflated on account of pooling of cess collection under the major head 1475.

The State Government in its reply (November 2011), stated that accounting has been done as per the norms prescribed by the Comptroller and Auditor General of India and also Controller General of Accounts from time to time. However, the facts remains that there is no cash realization under the said transactions and also the revenue has not been received by way of providing any services/goods.

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

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

It may be mentioned here that the XIII FC had opined that accounting of debt waiver as non-tax revenue was not desirable as it artificially overstated the non-tax revenue of the State. Further, accounting of debt-waiver as non-tax revenue

allowed the State to spend more within the same fiscal deficit cap, artificially reducing the intended impact on the debt stock of the State. Hence the XIII FC had recommended accounting of such transactions in such a manner that it did not artificially affect the revenue/fiscal deficit of the State.

Total non tax revenue increased marginally by ₹ 24 crore from ₹ 3,334 crore in 2009-10 to ₹ 3,358 crore in 2010-11. While there was a negative growth of 88 *per cent* over the previous year in general service, there was a growth of 50, 38 and 26 *per cent* over the previous year in interest receipts, dividend and profits, social services and economic services, respectively.

During 2009-10, as a result of revision of royalty rates by GOI in August 2009, there was an increase in royalty receipts by 55 *per cent* over the previous year. In 2010-11, due to firming up of iron prices and on account of revision of royalty rates on major minerals, the revenue realized (₹ 1,161.70 crore) was more by 38 *per cent* over the previous year (₹ 839.01 crore). This constituted 35 *per cent* of the total non-tax revenue of the State.

According to FRA, the State Government had to pursue non-tax revenue policies with due regard to cost recovery and equity. In MTFP (2011-15), State Government stated that apart from enforcement and monitoring of own tax efforts, special emphasis was required to be given on mobilizing non-tax revenues in the coming years. It was further stated that for improving the performance of the State entities, greater transparency, and infusion of technology were some of the interventions required in this direction.

The ratio of non-tax revenue to non-plan revenue expenditure is considered as an indicator of cost-recovery from socio-economic services. The details of recovery of current cost as ratio of non-tax revenue receipts to non-plan revenue expenditure in respect of Education, Health and Family Welfare, Water Supply and Sanitation and Irrigation during 2010-11 are given in **Table 1.9.**

Table 1.9: Cost-recovery from socio-economic services

(₹ in crore)

Service	Non tax revenue receipts (NTR)	Non plan revenue expenditure (NPRE)	Cost recovery (ratio of NTR/ NPRE in *per cent*)
Education, sports, art and culture	127.83	7,939.95	1.61
Health and family welfare	121.42	1,361.25	8.92
Water supply and sanitation	0.73	11.90	6.13
Irrigation	28.32	285.73	9.91

Source: *Finance Accounts.*

However, the bulk of user charges in respect of Health and Education are not credited to the Consolidated Fund of the State resulting in under-statement of non-tax revenue of the State. The cost-recovery ratio calculated in respect of Health and Family Welfare and Education is therefore, under-stated[4] to that extent.

In this regard, PAC in its report recommended the Municipalities coming under the control of Karnataka Urban Water Supply and Drainage Board and Irrigation Department to put in place a system for collection of all user charges without fail.

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

The XIII FC had also observed that the practice of maintaining the receipts of the States outside the Consolidated Fund was not transparent and was to be discouraged.

The State Government in its reply to PAC (July 2011) stated that the user charges in respect of Health was not credited to the Consolidated Fund of the State on account of government decision to incentivise the district level hospitals, PHCs and CHCs thereby making them self sufficient. Further, it was stated that user charges in respect of education was insignificant and was used to meet the immediate operational expenditure.

PAC in its report proposed to account all user charges under Consolidated Fund of the State as per the Article 266 (1) of the Constitution of India and further to allot the same to respective organizations through normal budgetary process. It also recommended the Finance Department to put in place a proper system to track the allotment and utilization of user charges.

The XIII FC in its study stated that the poor recovery levels in the power sector were due to irrational power tariffs and high transmission and distribution losses. Further, it also stated that the receipts from irrigation sector did not even cover the expenditure on operation and maintenance of irrigation projects. As the cost of recovery on account of public services was a critical issue, the XIII FC had recommended the States to increase power tariff rates to bridge the gap between cost and recovery. In this connection, XIII FC recommended water sector grants, in addition to maintenance expenditure grants, which was subject to stepping up of the above mentioned recovery rates.

Grants-in-aid from GOI

Grants-in-aid from GOI increased from ₹ 4,813 crore in 2006-07 to ₹ 6,869 crore in 2010-11 as shown in **Table 1.10**.

Table 1.10: Grant-in-aid from GOI

(₹ in crore)

		2006-07	2007-08	2008-09	2009-10	2010-11
Non-plan		2,224	1,531	1,694	3,429	2,257
Plan	State	1,284	1,916	2,020	2,973	2,839
	Central	43	71	94	61	145
	Centrally sponsored	1,262	1,509	1,524	1,420	1,628
Total		**4,813**	**5,027**	**5,332**	**7,883**	**6,869**

***Source**: Finance Accounts.*

The decrease of GOI grants by ₹ 1,014 crore in 2010-11 over the previous year was due to decrease in non-plan grants (₹ 1,172 crore) and grants for State plan schemes (₹ 134 crore), offset by increase in Centrally Sponsored Plan Scheme (₹ 208 crore). The decrease in non-plan grants was mainly under the grant from National Calamity Contingency Fund (₹ 1,594 crore). During 2009-10, the excess release was towards flood relief in the State. The decrease in State plan grant was under block grants (₹ 280.19 crore).

During 2010-11, grants-in-aid included TFC grants of ₹ 42.31 crore towards the State's specific needs withheld in the previous year.

Central tax transfers

The XIII FC had recommended the State's share of Central taxes to be increased to 32 *per cent* from 30.50 *per cent* as recommended by Twelfth Finance Commission. The State's share in the net proceeds of Central tax (excluding service tax) and net proceeds of Service Tax has been fixed at 4.33 and 4.40 *per cent,* respectively. The share of Union taxes received during 2010-11 (₹ 9,506 crore) exceeded the estimate (₹ 9,060 crore) by ₹ 446 crore.

Increase of the State's share of Union taxes and duties by ₹ 2,146 crore over the previous year was mainly under corporation tax (₹ 687 crore), customs (₹ 632 crore) and Union excise duties (₹ 380 crore), taxes on income other than corporation tax (₹ 276 crore) and service tax (₹ 171 crore).

1.6.2 Optimization of XIII FC grants

The Commission had recommended ₹ 951.24 crore as transfer to the State in the areas indicated in **Table 1.11** during 2010-11.

Table 1.11: Transfers recommended and actual release of Grants-in-aid

(₹ in crore)

Sl. No.	Transfers	Recommendation of FC	Actual Releases	Expenditure under relevant revenue heads of account	Unutilized amount
1	Local Bodies	604.87	604.84	604.84	Nil
2	Disaster Relief	124.72	124.72	124.72	Nil
3	**Improving outcome grants**				
	(i) Improvement in Justice Delivery	53.94	53.95	20.91	33.04
	(ii) Incentive for issuing UIDs	27.78	13.89	13.89	Nil
	(iii) Statistical Systems Improvement	5.80	Nil	Nil	Nil
	(iv) Employee and Pension Data Base	2.50	2.50	Nil	2.50
4	**Environment Related Grants**				
	Forest	27.63	27.63	27.41	0.22
5	Elementary Education	104.00	104.00	104.00	Nil
	Total	**951.24**	**931.53**	**895.77**	**35.76**

As of March 2011, the State Government had received grants aggregating ₹ 931.53 crore against recommendation of ₹ 951.24 crore. The balance (₹ 19.71 crore), pertaining to incentives for issuing UIDs (₹ 13.89 crore) and Statistical Systems Improvement (₹ 5.80 crore) was not received. Against the said release, ₹ 35.76 crore remained unutilized due to delay in execution of approved activities on account of administrative reasons (₹ 33.04 crore), non compilation of action plan for employee and pension database (₹ 2.50 crore) and grant for forest activities being received at the fag end of the year (₹ 0.22 crore).

1.6.3 Arrears of revenue

As of March 2011, arrears of revenue pertaining to taxes on sales, trade, etc., (₹ 3,193 crore), State excise (₹ 738 crore) and stamp duty and registration fees (₹ 78 crore) aggregated ₹ 4,009 crore. Revenue of ₹ 2,168 crore relating to taxes on sales, trade, etc., was pending on account of stay orders (₹ 393 crore), BIFR/AAIFR (₹ 108 crore), liquidation process (₹ 176 crore), revenue recovery (₹ 82 crore), court recovery (₹ 184 crore), departmental recovery (₹ 1,024 crore), payment verification (₹ 161 crore) and proposal under write off (₹ 40 crore). The

closing balance of arrears of revenue pertaining to stamps and registration was under reconciliation. Also, entire arrears of revenue relating to state excise were pending for more than five years. Out of this, revenue of ₹ six crore was pending on account of stay by courts.

PAC in its report recommended for putting in place a system to oversee the collection /non recovery of revenue by various departments on a monthly basis. It has also recommended discontinuing the practice of giving discounts, waiver and exemptions in collection of taxes.

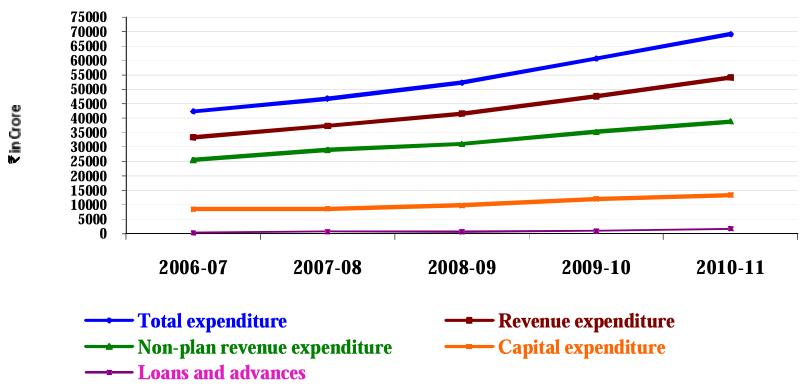
1.7 Application of resources

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

1.7.1 Growth and composition of expenditure

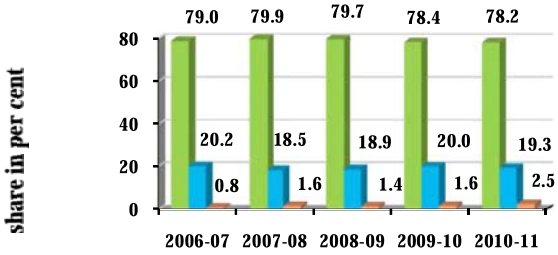
Chart 1.7 presents the trends in total expenditure under revenue, capital and loans and advances, while **Chart 1.8** exhibits the share of these components in total expenditure.

Chart 1.7: Total expenditure :Trends and composition



Source: *Finance Accounts*

Chart 1.8: Total expenditure:Trends in share of its components



Source: Finance Accounts.

Total expenditure increased by 63 *per cent* from ₹ 42,335 crore in 2006-07 to ₹ [illegible] rore in 2010-11 due to increase in revenue [illegible] e (₹ 20,599 crore), capital outlay (₹ 4,812 crore) and disbursement of loans and advances (₹ 1,381 crore).

Du[illegible]iod 2007-11, on an av[illegible]rage, 79 *per cent* of the total expenditure was revenue expenditure. While the share of revenue expenditure in the total expenditure decreased from 80 *per cent* in 2008-09 to 78 *per cent* in 2009-11, the share of capital expenditure (including loans and advances) increased from 20 *per cent* in 2008-09 to 22 *per cent* in 2009-11. [illegible]ure Reforms Commission constituted during 2008-09 in thei[illegible]rt (February 2010) had recommended [illegible]vestments to be stepped up and protected from fiscal uncertainties through prudent allocations. It had also recommended maintaining the capital expenditure (excluding debt servi[illegible]ve *per cent* of GSDP. Ho[illegible]ng 2010-11, the capital expenditure (excluding debt servicing) was four *per cent* of GSDP.

1.7.2 Buoyancy of expenditure

Buoyancy of total expenditure

Growth rates of total expenditure during 2007-11, its ratio and buoyancy with reference to GSDP and revenue receipts are presented in **Table 1.12.**

Table 1.12: Total expenditure – Basic parameters

(₹ in crore, ratio in *per cent*)

Total expenditure (TE)*	42,335	46,781	52,260	60,656	69,127
Rate of growth	23.9	10.5	11.7	16.1	14.0
GSDP	2,27,831	2,70,843	3,03,058	3,35,747	3,80,872
TE/GSDP (ratio)	18.6	17.3	17.2	18.1	18.1
Revenue receipts / TE (ratio)	88.8	88.0	82.8	81.0	84.2
Revenue expenditure	33,435	37,375	41,659	47,537	54,034
Rate of growth	19.24	11.78	11.46	14.11	13.67
Capital expenditure	8,900	9,406	10,601	13,119	15,093
Rate of growth	45.38	5.68	12.70	23.75	15.05
[illegible]					
GSDP(ratio)	1.4	0.5	1.0	1.5	1.0
Revenue receipts (ratio)	1.0	1.1	2.2	1.2	0.8
Buoyancy of revenue expenditure with					
GSDP	1.17	0.62	0.96	1.31	1.02
Revenue receipts	0.81	1.24	2.20	1.04	0.74
Buoyancy of capital expenditure with					
GSDP	2.77	0.30	1.07	2.20	1.12
Revenue receipts	1.91	0.60	2.44	1.75	0.82

[illegible]re includes revenue expenditure, capital expenditure including loans and advances

Source: Finances Accounts.

During the period 2007-11, the growth rate of total expenditure was highest (24 *per cent)* in 2006-07 and lowest (11 *per cent)* in 2007-08. The growth rate of total expenditure which was at 16 *per cent* in 2009-10 decreased to 14 *per cent* in 2010-11.

In 2010-11, total expenditure was 1.2 times the revenue receipts. The buoyancy ratio of total expenditure to revenue receipts was around 0.8 *per cent* and the growth rate of total expenditure was less than the growth rate of revenue receipts by 0.8 times.

The growth rate of total expenditure (14 *per cent*) in 2010-11 was almost equal to the growth rate of GSDP (13.4 *per cent*) and the buoyancy of total expenditure to GSDP which had increased to 1.5 *per cent* in 2009-10 once again attained the buoyancy of one *per cent* of 2008-09 in the current year. Revenue receipts as a ratio of total expenditure stood at 84 *per cent* in 2010-11 which meant that 84 *per cent* of the total expenditure could be met out of revenue receipts.

Buoyancy of revenue expenditure

The growth in revenue expenditure, which was higher than the growth of revenue receipts during 2007-10, decreased in 2010-11. Also, the growth of revenue expenditure which was less than the growth of GSDP, increased during 2008-10 period. For every one *per cent* growth in GSDP during 2008-09, revenue expenditure grew only by 0.96 *per cent.* However, during 2010-11, revenue expenditure growth was 1.02 times the growth of GSDP. This trend was reverse with respect to buoyancy of revenue expenditure to revenue receipts as the rate of growth of revenue receipts was least in 2008-09 due to economic slowdown and highest in 2010-11. Hence, for every one *per cent* growth in revenue receipts during 2008-09, the growth of revenue expenditure, which was 2.20 times the growth of the revenue receipts, decreased to 0.74 *per cent* during 2010-11.

Buoyancy of capital expenditure

During 2008-10 the growth in capital expenditure was higher than the growth of both GSDP as well as revenue receipts. In 2010-11, while the growth of capital expenditure was more than the growth of GSDP, it was less than the growth of revenue receipts. During 2010-11, while the capital expenditure growth was 1.12 times the growth of GSDP, its growth was only 0.82 *per cent* for every one *per cent* growth of revenue receipts.

1.7.3 Plan and non-plan expenditure

Finance Accounts provide a further classification of expenditure into plan and non-plan. Plan expenditure normally relates to incremental developmental expenditure on new projects or schemes and involves both revenue and capital expenditure. In order to maintain the level of services already achieved, non-plan expenditure is normally utilized. **Table 1.13** presents the growth and composition of plan and non-plan expenditure over the last five years.

Table 1.13 Growth in plan and non-plan expenditure

(₹ in crore)

		2006-07	2007-08	2008-09	2009-10	2010-11
Plan	Revenue	7,852	8,313	10,530	12,303	15,188
	Capital	8,411	7,199	9,135	11,118	12,582
	Loan	306	751	224	916	1,736
	Total	**16,569**	**16,263**	**19,889**	**24,337**	**29,506**
	Percentage of plan to total expenditure	**39**	**35**	**38**	**40**	**43**
Non-plan	Revenue	25,583	29,062	31,129	35,234	38,846
	Capital	132	1,450	735	1,019	773
	Loan	51	6	507	66	2
	Total	**25,766**	**30,517**	**32,371**	**36,319**	**39,621**
	Percentage of non-plan to total expenditure	**61**	**65**	**62**	**60**	**57**
Total expenditure		**42,335**	**46,780**	**52,260**	**60,656**	**69,127**

The share of plan expenditure in the total expenditure, exhibiting increasing trend since 2007-08, indicates productive quality of expenditure.

During the period 2007-11, while plan expenditure increased 78 *per cent* from ₹ 16,569 crore in 2006-07 to ₹ 29,506 crore in 2010-11, non-plan expenditure increased by 54 *per cent* from ₹ 25,766 crore to ₹ 39,621 crore.

Increase of plan revenue expenditure by ₹ 2,885 crore over the previous year indicated that more emphasis was given towards developmental expenditure and schemes/programmes. The increase was mainly under Education, Sports, Art and Culture (₹ 931 crore), Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes (₹ 763 crore), Social Welfare and Nutrition (₹ 384 crore), Water Supply and Sanitation, Housing and Urban Development (₹ 249 crore), Health and Family Welfare (₹ 236 crore) and Agriculture (₹ 175 crore). Plan revenue expenditure included devolutions to Panchayat Raj Institutions (PRIs) (₹ 4,083 crore) and Urban Local Bodies (ULBs) (₹ 1,079 crore), Subsidies (₹ 529 crore) and Salaries (₹ 1,355 crore).

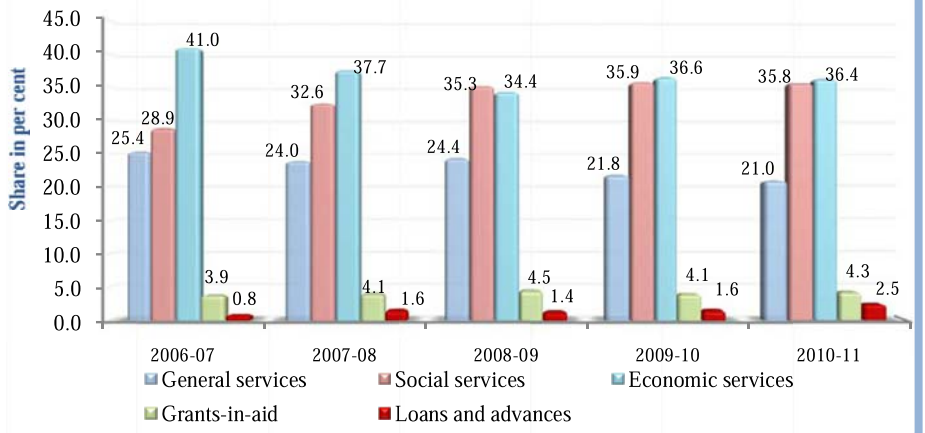
Non-plan revenue expenditure (NPRE) was 72 *per cent* of revenue expenditure during 2010-11. It included devolutions to PRIs (₹ 8,472 crore), ULBs (₹ 1,897 crore), Interest payment (₹ 5,641 crore), Subsidies (₹ 5,775 crore), Pension payments (₹ 4,070 crore), Salaries (₹ 10,593 crore) and maintenance expenditure (₹ 648 crore).

Non-plan revenue expenditure (₹ 38,846 crore) exceeded projections made by XIII FC for 2010-11 (₹ 35,140 crore) by ₹ 3,706 crore.

1.7.4 Trends in expenditure by activities

In terms of activities, total expenditure could be considered as being composed of expenditure on general services (including interest payments), social and economic services, grants-in-aid and loans and advances. Relative shares of these components in total expenditure (including loans and advances) are indicated in **Chart 1.9.**

Chart 1.9: Total expenditure: Trends by activities



Source: *Finance Accounts.*

In the MTFP 2011-15, the Government stated that to hav expenditure, outlays for social and economic services were to be enhanced while e on general services was to be contained. The State Government also assured to giv e in social sectors which would have a direc n human development and economic infrastructure that would accelerate growth. The re on social services which was at 29 *per cent* of total expenditure in 2006-07 increased to 36 *per cent* in 2010-11 while expenditure on general services decreased from 25 *per cent* in 2006-07 to 21 *per cent* in 2010-11.

The share of economic services to total expenditure which was at 41 *per cent* in 2006-07, decreased to 34 *per cent* in 2008-09. The share which had increased to 36 *per cent* in 2009-10, has been maintained in 2010-11 also.

MTFP 2011-15 envisaged increase of 16.60 *per cent* during 2010-11 over the pre on social services (including loans and adva st which the increase was 16.12 *per cent*. This was on account of substantially higher expenditure on Education, Welfare of SCs/STs/OBCs, Welfare Schemes, Urban Development and Health, which was a welcome development.

1.7.5 Incidence of revenue expenditure

The bulk of total expenditure goes towards revenue expenditure. Revenue expenditure is incurred to maintain the current level of services and make payment for ations and as such does not result in any addition to the State's infrastructure and services network.

Revenue expenditure increased by 62 *per cent* from ₹ 33,435 crore in 2006-07 to ₹ 5 e in 2010-11. The predominance of revenue expenditure has been prir ccount of a conscious n priorities and systematic rigidity in evenue expenditure in the short term, particularly a m committed expenditure such as salaries, pensions, interest payments and subsidies. Also, the gran o various b nizations are classified as revenue exp regardless of the purpose for which it is used by the bodies/organizations.

The revenue expenditure during 2010-11 included ₹ 60.59 crore provided to M/s Bharath Earth Movers Limited, as 'Reimbursement of Central Sales Tax to export oriented units'. The State Government replied (November 2011) that the reimbursement was done as an industrial promotion measure and specific approval of the Legislature was obtained in this regard.

1.7.6 Committed expenditure

Committed expenditure of the State Government on revenue account mainly consisted of interest payments, expenditure on salaries, pensions and subsidies. **Table 1.14** and **Chart 1.10** present the trends in the expenditure on these components during 2007-11.

Table 1.14: Committed expenditure

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Salaries*, *of which*	6,426 (17.1)	8,169 (19.8)	9,912 (22.9)	10,342 (21.04)	11,948 (20.52)
Non-plan head	6,111	7,705	9,254	9,501	10,593
Plan head**	315	464	658	841	1,355
Interest payments	4,236 (11.3)	4,506 (10.9)	4,532 (10.5)	5,213 (10.6)	5,641 (9.70)
Expenditure on pensions	2,496 (6.6)	3,241 (7.9)	4,113 (9.5)	3,408 (6.9)	4,070 (7)
Subsidies	4,355 (11.6)	5,420 (13.2)	3,399 (7.8)	4,118 (8.4)	6,303 (10.82)
Total committed expenditure	**17,513 (46.59)**	**21,336 (51.85)**	**21,956 (50.72)**	**23,081 (46.9)**	**27,962 (48.04)**
Other than committed expenditure ***	15,922 (42.4)	16,039 (39.0)	19,703 (45.5)	24,456 (49.7)	26,072 (44.8)
Total revenue expenditure	**33,435**	**37,375**	**41,659**	**47,537**	**54,034**
Revenue receipts	**37,587**	**41,151**	**43,290**	**49,156**	**58,206**

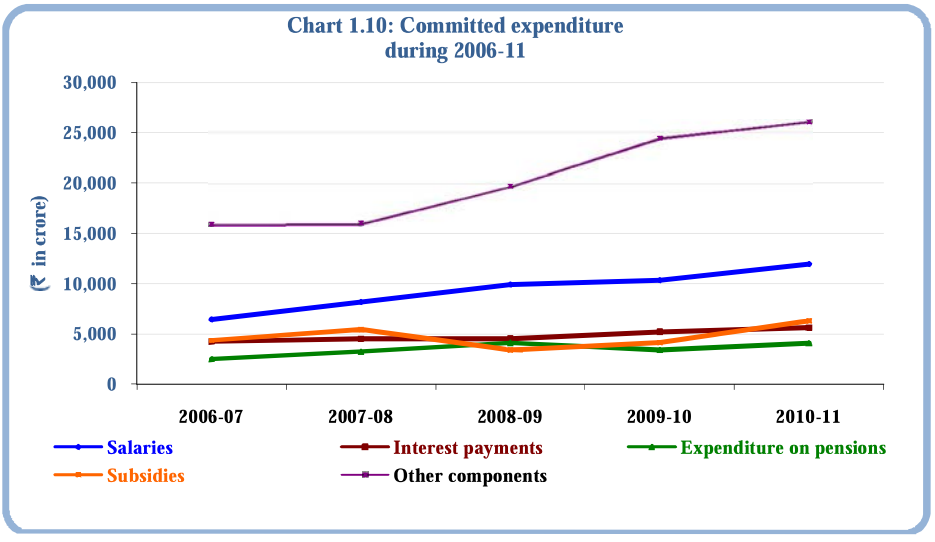
Figures in the brackets indicate percentage to revenue receipts

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

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

*** *Includes expenditure on financial assistance / relief (₹ 3,958 crore), special component plan (₹ 1,533 crore), other expenses (₹ 3,839 crore), grants-in-aid (₹ 3,147 crore), maintenance (₹ 713 crore), pensions under social services sector (₹ 956 crore), inter account transfers (₹ 1,074 crore).*

Chart 1.10: Committed expenditure during 2006-11



Source: *Finance Accounts.*

Expenditure on salaries

Expenditure on salaries as a percentage of revenue receipts which had increased from 20 in 2007-08 to 23 in 2008-09 due to implementation of fifth pay commission (FPC) award decreased to 21 during 2009-10 and was maintained in 2010-11 also. The expenditure on salaries for 2010-11 exceeded the MTFP (2009-13) projection of ₹ 11,456 crore by ₹ 492 crore. The salary expenditure in the Finance Accounts captured data in respect of State sector only. The salary data in respect of district sector (Employees of PR Institutions) are released as grants-in-aid to said bodies. Thus the total salary expenditure is not captured in accounts.

The State Government in its reply (November 2011) indicated its inability to furnish the salary details of district sector accounts in the absence of any mechanism at present for consolidation of such details. However, the PAC in its report has recommended the Finance Department to depict salaries in total, taking into account the district sector also, if possible by opening a separate sub-head to capture the data.

Pension payments

Expenditure on pension (₹ 4,070 crore) was seven *per cent* of total revenue receipts of the State during the year. The expenditure on pension during the year was less than MTFP (2009-13) projection by ₹ 1,167 crore. Increase of ₹ 662 crore over the previous year was on account of superannuation retirements becoming due in 2010-11 on account of revision of retirement age from 58 to 60 years during 2008-09.

Pension payments post 2009-10 have been projected by XIII FC to grow at 10 *per cent* and the estimated pension payment for 2010-11 was ₹ 4,782 crore. The pension expenditure fell short of the projection by ₹ 712 crore.

Defined Contribution Pension Scheme for all employees who joined the State Government service on or after April 1, 2006 was to be implemented from April 1, 2010 as per Pension Fund Regulatory and Development Authority. According to the scheme, the monthly contribution would be 10 *per cent* of Basic Pay and Dearness Allowance thereon to be paid by the employee and matched by the Government in equal proportion. In 2010-11, though a provision of ₹ 175 crore was made to meet the State Government's contribution, expenditure of ₹ 0.48 crore only was incurred which was towards payment of service charges to Central Record Keeping Agency and not as Government's contribution. Further, list of Major and Minor Heads of account prescribes opening of minor head 117 under 8342 – Other deposits for the said scheme. However, the Public Account in Finance Accounts reflects the scheme under Minor head 120 with three tiers for Employee's contribution, Government's contribution and Interest on Government contribution respectively. While the fund reflects, both debit and credit under the three tiers, no investment out of the scheme has been made.

Interest payments

Interest payments increased by ₹ 1,405 crore from ₹ 4,236 crore in 2006-07 to ₹ 5,641 crore in 2010-11. Interest payments during 2010-11 constituted interest on internal debt (₹ 3,928 crore), interest on small savings, provident fund etc., (₹ 962 crore) and interest on loans and advances from Central Government (₹ 751 crore).

The interest on internal debt increased by seven *per cent* from ₹ 3,675 crore in 2009-10 to ₹ 3,928 crore in 2010-11 on account of increase in payment of interest on market loans and on special securities issued to NSSF of the Central Government by the State Government by 18 and one *per cent* respectively with respect to the previous year.

The interest on small savings, provident funds etc increased by 22 *per cent* from ₹ 786 crore during 2009-10 to ₹ 962 crore in 2010-11 mainly on account of increase in interest on State provident funds and insurance and pension funds by 17 and 11 *per cent* respectively relative to the previous year.

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

The PAC in its report observed that the borrowings based on availability rather than necessity also contributed to the increase in the interest payments.

Subsidies

In any welfare State, it is not uncommon to provide subsidies/subventions to disadvantaged sections of the society. Subsidies are dispensed not only explicitly but also implicitly by providing subsidised public service to the people. Budgetary support to financial institutions, inadequate returns on investments and poor recovery of user charges from social and economic services provided by the Government fall in the category of implicit subsidies.

Finance Accounts (**Appendix III**) showed an explicit subsidy of ₹ 6,303 crore during the year which was ₹ 2,185 crore more than the previous year. Subsidy payments during the year were mainly in the areas of power (₹ 4,442 crore), food (₹ 926 crore), transport (₹ 316 crore) and co-operation (₹ 334 crore). The details are given in **Box 1.2.**

In MTFP (2011-15), Government stated that expenditure on subsidies had shown enormous increase primarily due to rural electrification. The State Government accepted the fact that certain immediate steps were needed to be taken in order to prevent the subsidy from reaching unsustainable levels in the future.

Box – 1.2

Major subsidies

Power

During the year, subsidy to power sector (₹ 4,442 crore) accounted for 70 *per cent* of the total subsidy (₹ 6,303 crore). It included financial assistance to electricity supply companies to cover loss due to rural electrification (₹ 4,117 crore) and contribution towards pension (₹ 325 crore).

Subsidy on rural electrification during the year, however, did not include subsidy of ₹ 16 crore (Net) given to the Karnataka Power Transmission Corporation (KPTCL) for meeting its debt servicing obligations to Power Finance Corporation (PFC) and Rural Electrification Corporation (REC). Finance Accounts did not show this liability as these loans were not taken over by the Government. The State Government had also paid subsidy of ₹ 405 crore in 2006-07 (₹ 130 crore) 2007-08 (₹ 113 crore), 2008-09 (₹ 87 crore) and 2009-10 (₹ 75 crore). Though the Government had stated (November 2007) that debt would be included on off-budget side in 2008-09, neither did MTFPs 2007-11 to 2011-15 nor overview of budget 2009-10, 2010-11 and 2011-12 exhibited this liability on off-budget side. The State Government in reply (July 2011) to PAC had accepted the fact and promised to include the same on off-budget side in the next MTFP.

Food

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

Co-operation

Subsidy in the co-operative sector predominantly represented waiver of overdue loans (principal as well as interest) given to farmers. Such waiver of loans and interest aggregated ₹ 3,239 crore in 2006-07 (₹ 801 crore), 2007-08 (₹ 1,793 crore), 2008-09 (₹ 186 crore), 2009-10 (₹ 124 crore) and 2010-11 (₹ 335 crore).

According to Vaidyanathan Committee Report (March 2008) and as reiterated by the PAC, the Governments both at the Centre and in the States should desist from the practice of waiver of recovery of loans and interest to prevent deterioration of co-operative credit system. The aggregate amount of loan and interest waived during 2009-10, which had decreased to ₹ 124 crore, increased to ₹ 335 crore in 2010-11 (170 *per cent* more than that of previous year).

Transport

Transport subsidy increased from ₹ 157 crore in 2009-10 to ₹ 316 crore in 2010-11. This was towards fare concession extended to students, freedom fighters, physically challenged, etc.

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

The subsidies present a partial picture as these are exclusive of the implicit subsidy. Implicit subsidies *inter-alia* arise when the government is unable to recover the costs it incurs in the provision of social and economic goods/services, which are mainly private goods/services in nature, even though sometimes these may have extended benefits. Some of the implicit subsidies extended during 2010-11 are detailed in **Table 1.14A**.

Table: 1.14A Details of some of the implicit subsidy

Sl. No.	Schemes/Subsidy	Amount in crore
1	Bhagya Lakshmi	557.64
2	Milk Subsidy	294.45
3	Bicycle to School Children	91.73
4	Social Security Pension	955.57
5	Crop Loans	277.00
6	Krishna Bhagya Jala Nigam	93.00
7	Karnataka Neeravari Nigam Limited	4.00
8	Failed Well Compensation Fund Scheme	6.57
9	Capitative Assistance to Rural Banks	Discussed below
10	Subsidies to Statutory Corporations/Government Companies	

Two of these implicit subsidies are discussed below by way of illustration.

Subsidies to regional rural banks

To strengthen the capital base of regional rural banks, State Government has released capital through budgetary allocations. Against cumulative investment of ₹ 19.42 crore in rural banks no dividend has accrued to the Government till date (2010-11).

Subsidies to Statutory Corporations/Government companies

Table 1.15 presents the trend of investment made in the Statutory Corporations and Government Companies for the last 10 years. The return on investments is dismal, implying large implicit subsidisation.

Table: 1.15 Subsidies to SCs/GCs

(₹ in crore)

Year	Investment during the year	Up to date investment	Interest /Dividend received	Per cent of Interest / Dividend to investment	Rate of interest	Implicit Subsidy
2001-02	612.19	4,499.59	3.54	0.08	5 %*	190.83
2002-03	1,296.29	5,795.88	13.57	0.23		211.41
2003-04	1,831.64	7,627.52	15.18	0.20		274.61
2004-05	2,712.36	10,348.88	15.38	0.15		365.99
2005-06	3,315.50	13,664.38	14.99	0.11		502.45
2006-07	4,642.84	18,307.22	16.79	0.09		666.43
2007-08	3,580.81	21,888.03	20.93	0.10		894.43
2008-09	3,891.73	25,779.76	37.78	0.15		1,056.62
2009-10	5,735.20	31,514.96	27.73	0.09		1,261.26
2010-11	4,978.16	36,493.12	41.08	0.11		1,534.67

**To enhance financial viability of State public sector's undertaking, XIII FC recommended a minimum of five per cent dividend from all such enterprises. The same has been adopted for government companies/statutory corporations.*

The State Government in its reply (November 2011) has stated that there were no specific norm for classifying an expenditure as implicit subsidy. However, the TFC in November 2004 itself recommended the States to identify the expenditure forming implicit subsidy and bring out the same in Finance Accounts for transparency.

Further, subsidy provided by the State may also be classified as merit and non-merit subsidy. Subsidy (₹ 264 crore)[5] on education, housing, health, social welfare and nutrition, rural and urban development, agriculture and village and small scale industries, considered to be merit subsidy constituted around four *per cent* of the total explicit subsidy expenditure of the State during the current year.

1.7.7 Financial assistance to local bodies and others

The quantum of assistance provided by way of grants to local bodies and others during the current year, relative to the previous years, is presented in **Table 1.16.**

Table 1.16: Financial assistance to local bodies and other institutions

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Panchayat Raj Institutions	7,767.93	9,122.39	10,804.46	11,406.81	12,554.65
Urban Local Bodies	2,113.48	2,468.20	2,339.11	2,471.69	2,976.02
Educational Institutions (including universities)	750.27	878.23	379.23	387.57	501.69
Co-operative societies and co-operative institutions	882.98	1,895.60	119.00	239.41	304.43
Other institutions and bodies (including statutory bodies)	2,400.54	2,361.00	1,620.24	1,914.55	2,704.11*
Assistance as a percentage of revenue expenditure	42	45	37	35	35
Total	**13,915.20**	**16,725.42**	**15,262.04**	**16,420.03**	**19,040.90**

Source: *Finance Accounts*

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

The assistance to PRIs increased from ₹ 7,768 crore in 2006-07 to ₹ 12,555 crore in 2010-11 while the assistance to ULBs increased from ₹ 2,113 crore to ₹ 2,976 crore.

Out of the total devolution of ₹ 12,555 crore to PRIs during 2010-11, ₹ 6,667 crore (53 *per cent*) were towards salaries as the State Government's functions viz., education, water supply and sanitation, housing, health and family welfare etc., were transferred to PRIs.

The assistance to ULBs, co-operatives and other institutions increased by ₹ 504 crore, ₹ 65 crore and ₹ 790 crore respectively during the year 2010-11 from the previous year. The increase of ₹ 449 crore in 2010-11 for ULBs was towards developmental works.

Assistance to other institutions (₹ 2,704 crore) included *inter-alia* assistance to Development Authorities (₹ 484 crore), NGOs (₹ 967 crore) and various other boards and institutions (₹ 922 crore).

The other assistance (₹ 301 crore) included *inter-alia* assistance to elections to urban local bodies (₹ 3 crore), temples and other religious institutions (₹ 116 crore), schemes such as Rashtriya Krishi Vikasa Yojane – Animal Husbandry (₹ 22 crore), subsidy scheme of ₹ 6.57 crore under failed well compensation fund and grants under XIII FC for issuing unique identification (₹ 13.89 crore).

[5] Education - ₹ 3.98 crore, housing - ₹ 23.55 crore, urban development - ₹ 90.53 crore, social welfare -₹ 25.34 crore, village and small scale industries - ₹ 42.55 crore, agriculture- ₹ 78.50 crore.

As a sequel to the Second State Finance Commission's recommendation, the State Government had decided (June 2006) to increase devolution of funds to ULBs from six to eight *per cent* of non loan net own revenue receipts (NLNORR) during the period 2005-10. The Third State Finance Commission recommended the devolutions to the local bodies to be 33 *per cent* of State's net own revenue receipts (NORR). The recommendation of Third State Finance Commission on allocation of funds from State Government to PRIs at 23 *per cent* and ULBs at 10 *per cent* of NORR to be implemented from 2010-11 onwards. However, as stated in the budget speech, the recommendations were being examined and hence the devolutions continued at the old rate. Though the devolutions, to ULBs increased from ₹ 2,113 crore in 2006-07 to ₹ 2,976 crore in 2010-11, the devolution to ULBs which was eight *per cent* of NLNORR during 2006-09, decreased to seven per cent during 2009-10 and continued at the same rate during 2010-11 also.

1.8 Quality of expenditure

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

1.8.1 Adequacy of public expenditure

The expenditure responsibilities relating to social sector and economic infrastructure assigned to the State Governments are largely State subjects. Enhancing human development levels requires the States to step up their expenditure on key social services like education, health, etc. Low fiscal priority (ratio of expenditure category to aggregate expenditure) can be stated to have been attached to a particular sector if the priority given to that particular head of expenditure is below the General Category States average for that year.

Table 1.17 analyses the fiscal priority of the State Government with regard to development expenditure, social expenditure and capital expenditure relative to General Category States in 2007-08 and the current year 2010-11.

Table-1.17 Fiscal priority of the State in 2007-08 and 2010-11

(in *per cent*)

Fiscal Priority by the State	AE/ GSDP	DE/ AE	SSE/ AE	CE/ AE	Education/ AE	Health/ AE
General Category States Average (Ratio) 2007-08	16.85	64.28	32.54	16.14	14.62	3.98
Karnataka State's Average (Ratio) 2007-08	17.25	71.91	33.92	18.49	14.82	3.92
General Category States Average (Ratio) 2010-11	16.65	64.42	36.75	13.27	17.42	4.35
Karnataka State's Average (Ratio) 2010-11	17.37	74.68	37.92	19.32	16.22	4.05

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

Comparative analysis reveals the following:

- The State is spending marginally higher proportion of its GSDP on aggregate expenditure as compared to General Category States.
- Development expenditure as a proportion of aggregate expenditure in the State has also been higher than the General Category States' average. Development expenditure consists of both economic and social service sector expenditure. Though social sector expenditure as a proportion of aggregate expenditure in the State has been higher than that of the General Category States, inadequate priority has been given to health sector as well as education sector in the current year. As observed from the Table 1.17, small proportion of expenditure has been spent on health sector during 2007-08 as well as in the current year; while adequate priority was given to education sector in 2007-08, smaller proportion has been spent on this sector in the current year as compared to General Category States.
- Adequate priority to capital expenditure has been given by the State Government in 2007-08 and 2010-11, as the ratio of capital expenditure to aggregate expenditure has been higher than the average ratio of General Category States.

The State Government in its reply to PAC (July 2011) stated that the audit conclusion 'that low priority was given by the State towards expenditure on education and health than the General Category States' was over generalised statement, as comment was made keeping in mind only the outlays and not upon the outcomes. It also stated that since there was an improvement in literacy rate, infant mortality rate and life expectancy at birth, current expenditure itself was not the sole benchmark for assessment.

Though the literacy rate of the State increased from 66.64 *per cent* in 2001 to 75.60 *per cent* in 2011, the ranking of the State which was 21 in 2001 came down to 23 in 2011. Further, the Expenditure Reforms Commission in their first report submitted during February 2010 also observed that the development of health and education sectors needed to be addressed not by merely earmarking increased allocations, but also by insisting on performance attainments against a set of pre-determined targets for expected outcomes in each sectors, with a clear timeline for the talukas identified as backward, more backward and the most backward.

1.8.2 Efficiency of expenditure use

In view of the importance of public expenditure on development heads for social and economic development, it is imperative for the State Governments to take appropriate expenditure rationalization measures and lay emphasis on provision of core public and merit goods[6]. Apart from improving the allocation towards development expenditure[7], particularly in view of the fiscal space being created on

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

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

account of decline in debt servicing in recent years, the efficiency of expenditure use is also reflected by the ratio of capital expenditure to total expenditure and proportion of revenue expenditure being spent on operation and maintenance of the existing social and economic services. The higher the ratio of these components to total expenditure, the better would be the quality of expenditure. While **Table 1.18** presents the trends in development expenditure relative to the aggregate expenditure of the State during the current year *vis-à-vis* that of previous years, **Table 1.19** provides the details of capital expenditure and the components of revenue expenditure incurred on the maintenance of the selected social and economic services.

Table-1.18: Development expenditure

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Development expenditure (DE)	**29,953**	**33,642**	**37,134**	**44,930**	**51,628**
Percentage of DE to total expenditure	**71**	**72**	**71**	**74**	**75**
Components of DE					
Revenue	21,377	24,577	27,010	32,301	37,000
	(71)	(73)	(73)	(72)	(72)
Capital	8,222	8,310	9,395	11,647	12,890
	(27)	(25)	(25)	(26)	(25)
Loans and advances	354	755	729	982	1,738
	(1)	(2)	(2)	(2)	(3)

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

Development expenditure comprising revenue expenditure, capital outlay and loans and advances on socio-economic services increased from ₹ 29,953 crore in 2006-07 to ₹ 51,628 crore in 2010-11. As a *percentage* of total expenditure, it increased from 71 in 2006-07 to 75 in 2010-11. In the current year, development expenditure as a percentage of aggregate expenditure, increased by one *per cent* relative to the previous year due to increase in development loans disbursed. On an average, 72 *per cent* of the development expenditure was on revenue account while capital expenditure including loans and advances accounted for the balance during 2006-11.

In 2010-11, development revenue expenditure included, *inter alia*, expenditure on salary (₹ 8,817 crore), subsidy (₹ 6,290 crore) and financial assistance to local bodies and other institutions (₹ 10,517 crore).

Table 1.19: Efficiency of expenditure use in selected social and economic services

(ratios in *per cent*)

	2009-10		2010-11	
	Ratio of CE to TE	Share of salaries (excluding wages and O&M) in RE	Ratio of CE to TE	Share of salaries (excluding wages and O&M) in RE
Social services (SS)				
Education, sports, art and culture	0.35	10.33	0.61	10.27
Health and family welfare	0.53	2.05	0.63	2.20
Water supply, sanitation, housing and urban development	4.31	0.05	4.21	0.04
Others	0.50	0.86	0.49	1.25
Total (SS)	**5.70**	**13.29**	**5.94**	**13.78**
Economic services (ES)				
Agriculture & allied activities	0.15	1.46	0.18	1.44
Irrigation and flood control	6.50	0.22	6.90	0.21
Power & energy	2.89	---	2.04	0
Transport	4.43	0.05	4.44	0.08
Others	1.14	0.87	1.66	0.81
Total (ES)	**15.11**	**2.60**	**15.22**	**2.54**
Total (SS+ES)	**20.81**	**15.89**	**21.16**	**16.32**

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

Expenditure on social services

Capital expenditure on social services increased from ₹ 3,456 crore in 2009-10 to ₹ 4,106 crore in 2010-11 while there was no increase in ratio of capital expenditure to total expenditure as compared to the previous year.

Capital expenditure on social services during 2010-11 included ₹ 77 crore (two *per cent*) on account of repayment of off budget borrowings.

The share of salary expenditure (under social services) in total revenue expenditure increased from 13 *per cent* in 2009-10 to 14 *per cent* in 2010-11.

Expenditure on economic services

Capital expenditure on economic services increased from ₹ 9,167 crore in 2009-10 to ₹ 10,520 crore in 2010-11 with a growth rate of 15 *per cent*.

The priority sectors identified by the Government in respect of economic services were agriculture, rural development, special area programmes, irrigation and flood control and transport. In 2010-11, Capital outlay on special area programme, irrigation and flood control and transport was more by ₹ 377 crore, ₹ 823 crore and ₹ 422 crore respectively compared to previous year

The share of salary expenditure (under economic services) in total revenue expenditure remained at three *per cent* in 2009-11.

Capital expenditure on economic services in 2010-11 included expenditure of ₹ 752 crore (seven *per cent*) on repayment of off budget borrowings.

1.9 Analysis of Government expenditure and investments

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

1.9.1 Incomplete projects

Blocking of funds on incomplete works which include works stopped due to reasons like litigation, etc. impinge negatively on the quality of expenditure. The department-wise information pertaining to incomplete projects as of March 2011 is given in **Table 1.20**.

Table 1.20: Incomplete projects

(₹ in crore)

Department	Incomplete projects					Cumulative expenditure as of March 2011
	Number	Budgeted cost	Revised cost	Cost over run[8]		
				Number	Amount	
Public works						
Buildings	148	659.69	706.16	17	16.37	546.91
Roads & bridges	199	667.19	670.81	30	10.65	510.63
Irrigation	41	151.20	167.41	3	0.37	145.27
Total	**388**	**1,478.08**	**1,544.38**	**50**	**27.39**	**1,202.81**

Source: *Finance Accounts*

Against the initial budgeted cost of ₹ 1,478 crore in respect of 388 works, stipulated to be completed on or before March 2011, the progressive expenditure was ₹ 1,203 crore as of March 2011. Out of which, in 50 cases, the cost overrun aggregated ₹ 27.39 crore.

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

1.9.2 Investment and returns

As of March 2011, Government had invested ₹ 38,421 crore in 89 Government companies (₹ 34,716 crore) including investment of ₹ 52 crore in 17 non-working Government companies, nine statutory corporations (₹ 1,777 crore), 45 joint stock companies (₹ 1,557 crore) and co-operative institutions, local bodies and regional rural banks (₹ 371 crore). The return from investment was negligible (**Table 1.21**).

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

Table-1.21: Return on investment

	2006-07	2007-08	2008-09	2009-10	2010-11
Investment at the end of the year (₹ in crore)	18,698.37	22,279.35	26,672.11	32,483.28	38,420.75
Return (₹ in crore)	19.5	23.4	40.2	29.48	43.47
Return *(per cent)*	0.1	0.1	0.1	0.1	0.11
Average rate of interest on Government borrowings *(per cent)*	7.7	7.6	6.9	6.7	6.4
Difference between interest rate and return *(per cent)*	7.6	7.5	6.8	6.6	6.3

Source: *Finance Accounts.*

Government in its reply to PAC (July 2011) stated that investment in irrigation, transport, infrastructure, power, housing etc., enabled economic growth in the long run and was not expected to yield returns in the short time.

Investments in the said sectors have been made from time immemorial and most of these institutions are earning profits without giving any returns to the Government. Further, no study has been made with regard to their contribution to the economic growth.

In addition, investment of ₹ 2,793.69 crore in respect of six[9] Companies/ Corporations has been lying in Public Account to the end of March 2011 without actual release to the institutions. This has resulted in locking up of funds in the Public Account.

The State in its reply to PAC (July 2011) stated that the releases from Consolidated Fund were deposited in the Deposit Account to carry out capital works and the funds utilized for Company's/Corporation's immediate needs.

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

Out of the total investment of ₹ 38,421 crore up to the end of 2010-11, investment of ₹ 36,393 crore (95 *per cent*) was in 64 Government companies and statutory corporations under irrigation sector (₹ 21,923 crore), transport sector (₹ 1,004 crore), infrastructure sector (₹ 5,604 crore), power sector (₹ 5,081 crore), industries sector (₹ 360 crore), housing sector (₹ 1,245 crore), financing sector (₹ 451 crore), construction sector (₹ 283 crore) and social sector (₹ 442 crore).

The investment included ₹ 20,085 crore (52 *per cent*) in the following Companies/Corporations under perennial loss (**Table 1.22)**.

[9] Krishna Bhagya Jala Nigam (₹ 131.28 crore), Karnataka Infrastructure Development and Finance Corporation (₹ 457.98 crore), Bangalore City Corporation (₹ 237.98 crore), Karnataka Rural Infrastructure Development Corporation Limited (₹ 246.93 crore), Mega Area Development Board (₹ 290.74 crore) and Department of Floods and Development of merged areas (₹ 1,428.78 crore).

Table 1.22: Investment in companies/corporations under perennial loss

(₹ in crore)

Company/Corporation	Investment Up to 2006-11	Cumulative loss as at 2009-10
North Western Karnataka Road Transport Corporation	167	325.11
North Eastern Karnataka Road Transport Corporation	109	326.85
Karnataka State Agro Corn Products Limited, Bangalore	1	9.83
The Karnataka Minorities Development Corporation Limited, Bangalore	151	24.27
Karnataka Urban Infrastructure Development and Finance Corporation	6	0.67
Rajeev Gandhi Rural Housing Corporation Limited	130	52.59
Karnataka Road Development Corporation Ltd	2,924	94.38
Krishna Bhagya Jala Nigam Limited	15,891	199.59
Karnataka Silk Marketing Board Limited, Bangalore	3	24.40
The Mysore Sugar Company Limited, Bangalore	114	266.73
Hubli Electricity Supply Company Limited	396	659.08
Chamundeswari Electricity Supply Company Limited	190	285.15
Thungabadra Steel Products Limited	1	26.76*
Karnataka Inland Fisheries Development Corporation Limited, Bangalore	2	1.68
Total	**20,085**	**2,297.09**

Source: *Finance Accounts.*
**the cumulative loss is as at 2008-09*

The State Government in its reply to PAC (July 2011) stated that as the Companies/Corporations were established for creation of infrastructure needs of the State and providing public service, investments in these Companies/Corporations could not be viewed in terms of financial gain.

Against 81 Companies /Corporations (working) wherein Government had invested ₹ 36,440.85 crore, 23 were profit earning companies. It may be mentioned here that XIII FC, while recommending measures to enhance financial viability of State Public sector undertakings, had stated that a minimum dividend of five per cent on Government equity should be paid by all such enterprises. Since, most of the Government Companies/Statutory Corporations are working on commercial basis (though some are under utility and welfare sectors), the same analogy could be applied and a return of five *per cent* on government investment should be expected.

During the year, Government invested ₹ 104 crore in statutory corporations, ₹ 5,369 crore in Government companies and ₹ 450 crore in joint stock companies. The investment included;

- ₹ 5.55 crore released for Mysore Sugar Company for repayment of HUDCO loan.
- Conversion of Government State support and Government deposits with KSIIDC (₹ 25 crore) and lease rental received from BIAL but retained with KSIIDC (₹ 20 crore) into equity.

XIII FC while reviewing the performance of State Public Sector undertakings with respect to Government investments had recommended that the State Government should draw up a road map by March 2011 for closure of non-working companies in consultation with the Accountant General. Presently, in Karnataka, the Government has invested ₹ 52.22 crore in 17 non-working Government Companies.

1.9.3 Departmental undertakings

Nineteen undertakings of certain Government departments performed activities of quasi-commercial nature. According to the latest accounts furnished by six undertakings, the State Government's investment was ₹ 10.28 crore. The total loss incurred by these undertakings was ₹ 5.30 crore. Details are furnished in **Appendix 1.7.**

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

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

1.9.4 Loans and advances by the State Government

In addition to investments in companies, corporations and co-operative institutions, Government also provided loans and advances to many institutions/organizations. **Table 1.23** presents the position of outstanding loans and advances as of March 2011 and interest receipts *vis-à-vis* interest payments during the last five years.

Table-1.23: Average interest received on loans advanced by the State Government

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Opening balance	**5,944**	**6,241**	**6,946**	**7,620**	**8,047**
Amount advanced during the year	357	757	731	982	1,737*
Amount repaid during the year	60	52	57	555	161
Closing balance	**6,241**	**6,946**	**7,620**	**8,047**	**9,623**
Net addition	297	705	674	427	1,576
Interest receipts	38	58	103	74	180
Interest receipts as *per cent* to outstanding loans and advances	0.6	0.8	1.3	0.9	1.9
Interest payments as *per cent* to outstanding fiscal liabilities of the State Government.	7.3	7.5	6.3	6.2	6.1
Difference between interest payments and interest receipts (*per cent*)	-6.7	-6.7	-5.0	-5.3	-4.2

Source: *Finance Accounts.*

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

Loans outstanding as of March 2011 aggregated ₹ 9,623 crore. Interest spread of Government borrowings was negative during 2007-11 which meant that the State's borrowings were more expensive than the loans advanced by it.

Loans aggregating ₹ 1,737 crore were disbursed during 2010-11 which included

- ₹ 31 crore provided to Infrastructure Development Corporation of Karnataka (iDeck) for conversion of capital investment into interest free loan.
- ₹ 101.59 crore to sugar cane industry for conversion of purchase tax on sugar cane into interest free loan.

During 2010-11, terms and conditions of repayment were not received for loans amounting to ₹ 1,761 crore.

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

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

Recovery of loans and advances aggregating ₹ 1,861 crore (principal: ₹ 970 crore and interest: ₹ 891 crore) was overdue as of March 2011 from 23 institutions [detailed accounts of which were kept by the Accountant General, (Accounts and Entitlements)]. However, the State Government is yet to reconcile the balances maintained against these 23 institutions. Around 96 *per cent* of this pertained to five major defaulters viz., Karnataka Urban Water Supply and Drainage Board, Bangalore Water Supply and Sewerage Board, New Government Electric Factory, Karnataka Housing Board and Bangalore Development Authority. In these cases the overdue interest and principal for recovery was ₹ 942 crore and ₹ 842 crore, respectively.

The controlling officers maintaining loans are required to furnish details of arrears in recovery of loan installments and interest to the Accountant General every year. Out of 928 statements from 842 bodies /organizations due, only 55 statements with 23 nil statements were received. Further, recovery of loans and advances aggregating ₹ 376 crore (principal: ₹ 245 crore and interest: ₹ 131 crore) was overdue as of March 2011 from 32 institutions (detailed accounts of which were kept by the State Government).

Around 64 *per cent* of this pertained to three major defaulters viz., Mysore Electrical Industries Limited, Mysore Lamp Works and KASKARD Bank Limited. In these cases, the overdue interest and principal for recovery was ₹ 148 crore and ₹ 93 crore, respectively.

The PAC in its recommendation stated that the actual amount due for recovery be brought in the budget estimates.

1.9.5 Cash balances and investment of cash balances

Table 1.24 depicts the cash balances and investments made therefrom by the State Government during the year.

Table-1.24: Cash balances and investment of cash balances

(₹ in crore)

	As of March 2010	As of March 2011	Increase(+)/ Decrease (-)
Cash balances	9,773.51	7,667.31	- 2,106.20
Investments from cash balances	**8,889.98**	**6,971.51**	**-2,018.47**
GOI treasury bills	8,889.67	6,871.18	-2,018.49
GOI securities	0.20	0.32	+0.12
Other securities	---	---	---
Other investments	0.11	0.01	-0.10
Funds-wise break-up of investment from earmarked balances	**980.45**	**1,444.24**	**+463.79**
Sinking fund	-0.21	-0.26	-0.05
Industrial development fund	0.01	0.01	---
Co-operative development fund	0.49	0.49	---
Other development and welfare fund	980.15	1,443.99	+463.84
Miscellaneous deposits	0.01	0.01	---
Interest realized	**309.04**	**400.28**	**91.24**

Source: *Finance Accounts.*

The cash balance of the State at the end of the year was ₹ 7,667 crore. The decrease in cash balances was 22 *per cent* over the previous year. The analysis of the surplus cash balances is brought out in **Box 1.3**.

Box – 1.3

Analysis of cash management

Surplus cash balance was mainly due to market borrowings of ₹ 2,000 crore raised during 2010-11 in November 2010 (₹ 1,000 crore at 8.42 *per cent*) and December 2010 (₹ 1,000 crore at 8.43 *per cent*).

The entire loan amount was invested in fourteen day intermediate treasury bills of RBI with an interest rate of five *per cent* per annum against an average rate of six *per cent* per annum at which the borrowings were made.

In view of the comfortable position of cash balances, revenue surplus of ₹ 4,172 crore and a very low fiscal deficit of 2.81 *per cent* of GSDP, the open market borrowings could have been avoided.

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

Following the advice of GOI and RBI, the State Government in MTFP (2011-15) has proposed to utilize part of the cash balance pertaining to various Reserve Funds for financing the fiscal deficit. In other words, the State Government has committed to borrow funds on need basis rather than on availability.

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

1.10 Assets and liabilities

1.10.1 Growth and composition of assets and liabilities

In the existing Government accounting system, comprehensive accounting of fixed assets like lands and buildings owned by the Government is not done. However, the Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure incurred. **Appendix 1.6** gives an abstract of such liabilities and assets as on 31 March 2011 compared with the corresponding position as on 31 March 2010.

Total liabilities, as defined in the Karnataka Fiscal Responsibility Act, 2002 are the liabilities under the Consolidated Fund and the Public Account of the State. Consolidated Fund liabilities consist of Internal Debt and Loans and Advances from GOI.

Further, the internal debt includes market loans, special securities issued to RBI and other negotiated loans. The Constitution of India provides that States may borrow within the territory of India upon the security of their Consolidated Funds, within such limits, as may from time to time, be fixed by an Act of the Legislature and give guarantees within such limits as may be fixed. The Public Account liability includes small savings, provident funds, etc., reserve funds and other deposits. The liabilities of the State as depicted in Finance Accounts, however, did not include pension, other retirement benefits payable to retired/retiring State Government employees/guarantees/letters of comfort issued by the State Government and borrowings through special purpose vehicles, termed off-budget borrowings.

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

The growth rate of components of assets and liabilities are summarized in the **Table 1.25.**

Table 1.25 Summarised position of Assets and Liabilities

(₹ in crore)

Liabilities				Assets			
	2009-10	2010-11	(*per cent*)		2009-10	2010-11	(*per cent*)
Consolidated Fund	***55,370***	***59,277***	***7***	***Consolidated Fund***	***83,216***	***98,148***	***18***
a. Internal Debt	45,468	48,762	7	i. Capital outlay	75,170	88,525	18
b. Loans and advances from GOI	9,902	10,515	6	ii. Loans and advances	8,046	9,623	20
Public Account*	***28,112***	***32,666***	***12***	***Cash***	***9,774***	***7,667***	***(-)22***
a. Small savings, Provident funds, etc	11,177	12,784	14				
b. Reserve Funds	9,274	10,184	13				
c. Deposits	7,661	9,698	8				

*the liabilities are on net basis. It does not include investments from out of ear marked funds of ₹ 980 crore (2009-10) and ₹ 1,444 crore (2010-11).

The growth rate of assets was maintained at 18 *per cent* in 2010-11as in 2009-10, and that of liabilities decreased from 17 *per cent* in 2009-10 to 10 *per cent* in 2010-11.

1.10.2 Fiscal liabilities

The trends in outstanding fiscal liabilities of the State are presented in **Appendix 1.5**. The composition of fiscal liabilities during the current year *vis-à-vis* the previous year, is presented in **Charts 1.11 and 1.12.**

Chart 1.11: Composition of outstanding Fiscal Liabilities as on 01.04.2010

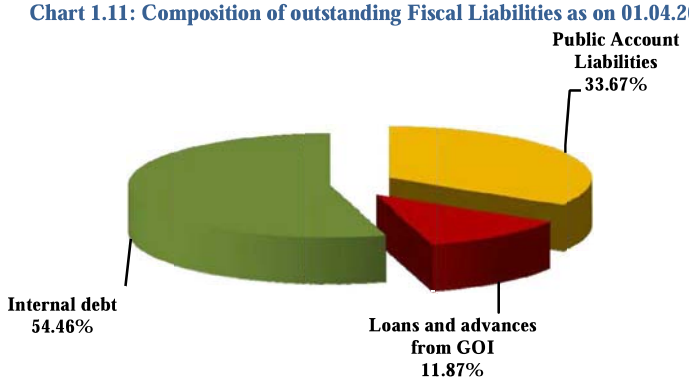
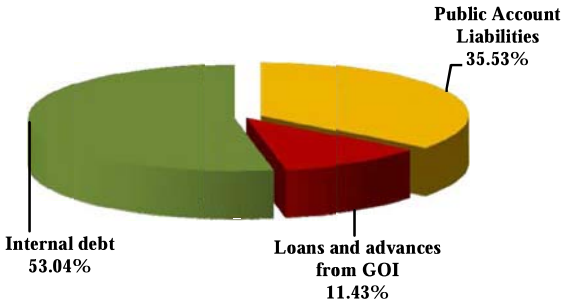


Chart 1.12: Composition of outstanding Fiscal Liabilities as on 01.04.2011



Source: *Finance Accounts.*

Fiscal liabilities of the State, their rate of growth, ratio of these liabilities to GSDP, revenue receipts and own resources as well as buoyancy of fiscal liabilities with respect to these parameters are brought out in **Table 1.26.**

Table 1.26: Fiscal liabilities –basic p ers

(₹ in crore and ratios in *per cent*)

Fiscal liabilities	57,682	60,142	71,550	83,482	91,943
Rate of growth (*per cent*)	10.4	4.3	19.0	16.7	10.1
Ratio of fiscal liabilities to					
GSDP	25.32	22.20	23.61	24.86	24.14
Revenue receipts	153.5	146.1	165.3	169.8	157.9
Own resources	210.5	204.9	232.3	246.2	219.8
Buoyancy ratio of fiscal liabilities to					
GSDP	0.6	0.2	1.6	1.5	0.7
Revenue receipts	0.4	0.5	3.6	1.0	0.5
Own resources	0.5	0.6	3.8	1.6	0.4

Source: *Finance Accounts.*

Fiscal liabilities of the State increased by 59 *per cent* from ₹ 57,682 crore in 2006-07 to ₹ 91,943 crore in 2010-11 comprising Consolidated Fund liabilities (₹ 59,277 crore) and Public Account liabilities (₹ 32,666 crore).

Consequent upon the implementation of FRA and restriction on borrowings (fiscal deficit) to three *per cent* of GSDP, the rate of growth of fiscal liabilities of the State decreased from 12 *per cent* in 2004-05 to four *per cent* in 2007-08. With the announcement of the economic stimulus package by GOI and consequent amendment to FRA, fiscal deficit limit was raised to 3.5 and four *per cent* of GSDP during the year 2008-09 and 2009-10, respectively. As recommended by XIII FC and the subsequent amendment to FRA, fiscal deficit limit of three *per cent* is to be attained by 2011-12 with the year 2010-11 being the year of consolidation. The fiscal deficit during 2010-11 was not to be more than 3.44 *per cent* of GSDP and was 2.81 *per cen*t. The growth rate of fiscal liabilities which was 17 *per cent* during 2009-10 decreased to 10 *per cent* during2010-11. As a result, buoyancy of fiscal liabilities to GSDP which was more than one in 2008-10 decreased to 0.7 in the current year. The ratio of fiscal liabilities to GSDP was 24 *per cent* at the end of 2010-11.

1.10.3 Transactions under Reserve Fund

Reserve and Reserve funds are created for specific and well defined purposes under the Sector 'J' in the accounts of the State Government. 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 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 the Fund (Public Account) through an operation of deduct entry in accounts. The funds may be further classified as 'Funds carrying interest' and 'Funds not carrying interest'. Generally, the Reserve Funds are classified under the following three categories based on the sources from which they are fed.

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

Sixty four reserve funds have been created and maintained in the accounts of the State Government. Out of the said 64 funds, 42 are dormant for periods ranging from 10 to over 30 years. Positions of these funds are detailed in **Table 1.27.**

Table: 1.27 Details of dormant Reserve Funds

(₹ in crore)

Sl. No.	No. of Funds	Status of Funds	Balance in the fund
1	20	Depreciation funds of commercial undertakings	11.01
2	02	Funds with respect to which investments have been made	0.35
3	17	The purposes for which the funds were created do not exist.	36.94
4	03	Adverse balances	(-)7.02

Failed Well Compensation Fund,[10] which was inoperative since 2001-02, had a balance of ₹ 2.41 crore. An expenditure of ₹ 6.57 crore was incurred in 2010-11 to settle claims received till November 2006 but the same was not debited to the fund.

Remaining twenty two funds with a balance of ₹ 9,232.82 crore are operative, out of this, four funds have adverse balances. Analysis of transactions of Consumer Welfare Fund, Infrastructure Initiative Fund, State Disaster Response Fund, Central Road Fund and Fiscal Management Fund are detailed in the subsequent paragraphs. Transactions with respect to Guarantee Reserve Fund and Sinking Fund have been detailed in paragraphs 1.10.4 and 1.11.4 respectively.

Consumer Welfare Fund

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

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

The expenditures of ₹ 0.93 crore and ₹ 1.33 crore incurred towards consumer welfare activities during 2009-10 and 2010-11 respectively, have not been met out of the Consumer Welfare Fund.

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

Further, a fund with the balance of ₹ 0.67 lakh was dormant since 1999-2000, which may be considered by the State for winding up or merging with the Corpus Fund yet to be created.

[10] Included in Sl. No. 3 of Table No 1.27.

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 vehicle 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 to be allocated between IIF, BMRCL and CMRRD Fund in the ratio of 57, 28 and15 *per cent,* respectively. On the introduction of a uniform value added tax (VAT) in 2005 levy of infrastructure cess was dispensed with and the Government decided to contribute to the fund out of general reserves of the State. In 2010-11, the cess realized through motor vehicle, stamps and registration and state excise (₹ 516.49 crore) was allocated to IIF, BMRCL Fund and CMRRD Fund. The sum transferred was ₹ 294.10 crore, ₹ 144.62 crore and ₹ 77.47 crore respectively. Further, as the road works and maintenance there on were being financed from Central Road Fund, Finance Commission grants and budget allocations, the Government decided during 2010-11 to augment IIF and BMRCL Fund in the ratio of 50:50. Though a provision of ₹ 2,000 crore was made for this purpose, sanction for transfer of ₹ 1,300 crore at the rate of ₹ 650 crore each to IIF and BMRCL Fund was made (31 March 2011) which was later modified and limited to ₹ 650 crore towards BMRCL Fund on the same day. This was stated to be made considering the overall fiscal balance of the State.

The provision of ₹ 2,000 crore for augmenting the said funds was made with the budget estimate of ₹ 1,500 crore as revenue surplus. However, with the revenue surplus of ₹ 4,172 crore, limiting the transfer to ₹ 650 crore based on the overall fiscal balance resulted in bringing down the fiscal deficit.

The State Government in its reply (November 2011) stated that the actual contribution to the fund was kept lower to ensure adherence to the fiscal discipline mandated by FRA. The reply is not acceptable for the reason that during 2009-10, with the revenue surplus of ₹ 1,619 crore the fund was fed with ₹ 2,100 crore. While in 2010-11, with a revenue surplus of ₹ 4,172 crore, only ₹ 650 crore was transferred to the fund. Further, this indicated that the accounts were adjusted to attain the ratio of fiscal indicators to GSDP prescribed in the FRA.

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

Central Road Fund

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

transferred to the Central Road Fund account. The amount reimbursed by GOI was ₹ 110.97 crore. This resulted in wiping out the adverse balance of the previous year. This was contrary to the reply given by the State Government earlier. Hence, the expenditure of ₹ 90 crore remained in the Consolidated Fund itself.

Fiscal Management Fund

The Fiscal Management Fund was created during 2006-07 in terms of Section 4(p) of the Fiscal Responsibility Act, 2002, to discharge the liabilities arising during the course of the year out of general revenue of the State. However, no rules had been framed regarding its administration. A sum of ₹ 150 crore had been transferred from the Consolidated Fund during the year and expenditure of ₹ 24.84 crore incurred towards discharge of guarantee obligations has also been debited to the fund. The balance at the end of the year was ₹ 982 crore.

The State Government in its reply to PAC (July 2011) stated that the fund was created to take care of demands arising due to contingent liabilities on account of Government guarantees, contribution to pension scheme etc.

However, the Government had created the guarantee redemption fund for discharging liabilities arising on account of Government guarantees which is inoperative and also during 2010-11, a provision of ₹ 175 crore was made to meet the pension contribution liability which is yet to be implemented.

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 issued, the accretions to the SDRF together with the income earned on the investment of the SDRF are to be invested in one or more of instruments viz., Central Government dated securities, auctioned treasury bills and interest earning deposits and certificates of deposits with Scheduled Commercial Banks. Further, the State Government had to pay interest to the SDRF at the rate applicable to overdrafts and credit the same on a half yearly basis. While 75 *per cent* of the contribution was to be from GOI, the balance 25 *per cent* was to come from the State Government. Further, the balance as on 31 March 2010 in the Calamity Relief Fund (CRF) was to be transferred to the SDRF. The contributions to the fund for the year 2010-11, included GOI contribution of ₹ 120.72 crore, State's contribution of ₹ 40.24 crore and balance CRF transferred ₹ one crore. However, no interest was credited to the fund. An expenditure of ₹ 158.80 crore, released to District Commissioners for relief expenditure to deal with natural calamities was shown as met out of the SDRF. However, the Personal Deposit accounts of the District Commissioner for SDRF reflect a positive unspent balance of ₹ 8.63 crore resulting 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.

1.10.4 Contingent liabilities

Status of guarantees

Guarantees are contingent liabilities on the Consolidated Fund of the State in case of default by the borrower for whom the guarantee was extended. The details of last five years are given in **Table 1.28**.

Table-1.28: Guarantees given by the State Government

(₹ in crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Maximum amount guaranteed	19,793	23,109	18,732	18,420	19,150
Outstanding amount of guarantees (including interest)	9,879	10,786	8,693	7,203	6,618
Percentage of outstanding amount guaranteed to total revenue receipts of the second preceding year	37	36	23	18	15

Source: *Finance Accounts.*

The Karnataka Ceiling on Government Guarantees Act, 1999 provides for a cap on outstanding guarantees extended by the Government at the end of any year at 80 *per cent* of the State's revenue receipts of the second preceding year. It is heartening to note the outstanding guarantees at the end of the years 2007-11 were within the prescribed limit.

The outstanding guarantees amounting to ₹ 6,618 crore at the end of the year 2010-11 included guarantees extended to 52 institutions/companies under irrigation (₹ 974 crore), co-operative (₹ 2,142 crore), finance (₹ 714 crore), power (₹ 330 crore), housing (₹ 559 crore), transport (₹ 305 crore), water supply (₹ 583 crore), urban development (₹ 79 crore) and industrial (₹ 457 crore) sectors.

The Act further provides for a levy of one *per cent* as guarantee commission which is not to be waived under any circumstances. However, four[11] institutes/companies have been exempted from paying the Guarantee Commission in contradiction of the Act.

To provide for sudden discharge of State's obligations on guarantees, TFC had recommended that States should set up Guarantee Redemption Fund through earmarked guarantee fees. The State had set up a Guarantee Reserve Fund in 1999-2000 with a corpus of ₹ one crore. However, there was no transaction though there were guarantee commission receipts and expenditures on account of discharge of guarantee obligation. In 2010-11, ₹ 24.84 crore provided to three Sugar Co-operatives[12] for repayment of loan, required to be met through Guarantee Redemption Fund was met out of Fiscal Management Fund. Also, the guarantee fees of ₹ 465.42 crore received since 2000 have not been transferred to the fund. In current year, the commission fees of ₹ 8.16 crore received from three institutions have been utilised for revenue expenses such as building expense, internal subsidy and establishment charges.

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

[12] Vanivilas Sahakara Sakkare Kharkane (₹ 6.22 crore), Karnataka Sahakar Sakkare Kharkane (₹ 12.28 crore), Pandavapura Sahakar Sakkare Kharkane (₹ 6.34 crore).

The State Government in its reply to PAC (July 2011) stated that transfer of receipts and expenditure pertaining to the fund would be considered at the appropriate time. Further, it stated (July 2011) that government was meeting the obligations of payment out of budgetary allocations every year with the expenditure being shown as loan against the institution. Also, as per the Indian Government Accounting Standards (IGAS), when guarantees are invoked and payment made, the payment is to be treated as loan to the beneficiary. However, the State Government in order to take care of the said liability had constituted Guarantee Redemption Fund during 1999 itself. Further, expenditure of the Public Account has been debited to the Consolidated Fund resulting in overstatement of expenditure which is detailed in the following case.

M/s Mysore Sugar Limited, Mandya availed of a loan of ₹ 57.26 crore from HUDCO during 2001-02 for which the Government stood guarantor. As the company failed to repay the said loan amount, HUDCO offered a one time settlement scheme (OTS) under which the principal and the interest were to be paid within seven years. During 2009-10 and 2010-11 the Government sanctioned ₹ 37.04 crore and ₹ 14.57 crore (principal and interest) towards the same. However, the said amounts were released as investments, contrary to the IGAS standards and also the reply of State Government to PAC. Further, Government guarantee has also not been invoked.

The State Government in its reply stated that government guarantee was not invoked by HUDCO and hence there was no necessity for Government to release the defaulted amount as loan to the company. Further, it also stated that the releasing the OTS amount as loan would have added to the financial burden of the company which was not in a position to meet debt servicing of HUDCO loan. Hence, the OTS amount was released as equity in order to improve the financial position of the company.

The order (March 2010) sanctioning the OTS amount stated that separate guidelines would be issued with respect to repayment of the said amount along with interest. However, in the subsequent orders, government has been releasing the amount to HUDCO both towards repayment of principal and payment of interest.

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

Off - budget borrowings

The borrowings of the State Government are governed by Article 293 (1) of the Constitution of India. In addition to the contingent liabilities shown in **Table 1.28**, the State guaranteed loans availed of by Government companies/corporations. These companies/corporations borrowed funds from the market/financial institutions for implementation of various State plan programmes projected outside the State budget. Funds for these programmes were to be met out of resources mobilized by these companies/corporations outside the State budget but in reality the borrowings of these concerns ultimately turn out to be the liabilities of the State Government termed 'off-budget borrowings' and the Government had been repaying the loans availed of by these companies/corporations including interest through regular budget provision under

capital account. Thus, the capital expenditure of the State during 2010-11 included interest expenditure of ₹ 202 crore on off-budget borrowings, even though there was no corresponding built up of assets in Accounts. This further resulted in under-statement of interest expenditure and overstatement of capital expenditure / revenue surplus. State Government in its reply to PAC (July 2011) stated that the interest expenditure on off-budget borrowings would be treated as revenue expenditure from 2011-12 onwards.

Table 1.29 captures the trend in the off-budget borrowings of the State during 2006-11 while **Table 1.30** gives the entity-wise position of borrowings to the end of 2010-11.

Table 1.29: Trend in off-budget borrowings

(₹ in crore)

Year	2006-07	2007-08	2008-09	2009-10	2010-11
Amount as per MTFP 2007-11♠	242	103	Nil	Nil	Nil

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

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

(₹ in crore)

Company/Corporation/Board	Outstanding Off-budget borrowings	Repayment during the year	
		Principal	Interest
Krishna Bhagya Jala Nigam Limited	373.35	102.28	26.68
Karnataka Neeravari Nigam Limited	498.00	166.25	36.56
Karnataka Road Development Corporation	390.79	85.44	3.37
Rajiv Gandhi Rural Housing Corporation	457.06	65.44	43.90
Karnataka Slum Clearance Board	59.21	10.57	5.32
Karnataka Rural Infrastructure Development Corporation Limited	72.15	13.00	6.72
Karnataka State Police Housing	193.92	26.66	21.20
Karnataka Housing Board, NGV	49.26	17.91	6.81
Cauvery Neeravari Nigam Limited	555.82	182.62	42.76
Karnataka Residential Education Institution Society	31.07	5.45	2.91
Karnataka State Industrial Investment Development Corporation	60.05	10.90	4.63
Sarva Siksha Abhiyan Samithi	8.46	2.22	0.90
Total	**2,749.14**	**688.74**	**201.76**

Source: *As reported by the concerned entities.*

In compliance with the commitment made in MTFP 2009-13, off-budget borrowings were eliminated from 2008-09 to ensure transparency in fiscal performance. In MTFP 2011-15, it has been stated that as the State Government was well advanced on the fiscal consolidation road map set in the FRA and recommended by XIII FC, the Government has decided in future to allow off-budget borrowings in a limited manner. Further, it has been stated that the quantum of the borrowing would be limited to the repayments of the previous off -budget borrowings.

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2011 worked out to ₹ 94,003 crore[13] against ₹ 91,943 crore shown in **Table 1.26.** The ratio of fiscal liabilities (inclusive of off-budget borrowings) to GSDP remained at 25 *per cent* at the end of the year as in the previous year.

1.11 Debt sustainability

Apart from the magnitude of the debt of the State Government, it is important to analyze various indicators that determine the debt sustainability of the State. The debt sustainability is defined as the ability of the State to maintain a constant debt-GDP ratio over a period of time and also embodies the concern about the ability to service its debt. Sustainability of debt therefore also refers to sufficiency of liquid assets to meet current or committed obligations and the capacity to keep a balance between costs of additional borrowings and returns from such borrowings. It means that rise in fiscal deficit should match the increase in capacity to service the debt. This section assesses the sustainability of debt of the State Government in terms of debt stabilization, sufficiency of non-debt receipts, net availability of borrowed funds, burden of interest payments (measured by interest payments to revenue receipts ratio) and maturity profile of the State Government securities. **Table 1.31** analyses the debt sustainability of the State according to these indicators for the period 2006-11.

Table 1.31: Debt sustainability: Indicators and trends

Debt sustainability indicators	2006-07	2007-08	2008-09	2009-10	2010-11
Debt stabilization (₹ in crore) (Quantum spread -/+ Primary deficit/ surplus)	4,560	5,940	-608	-2,239	1,389
Sufficiency of incremental non-debt receipts (resource gap) (₹ in crore)	-1,001	-644	-3,400	-2,143	187
Net availability of borrowed Funds (in *per cent*)	5	---	21	18	9
Burden of interest payments (IP/RR Ratio)	11.3	10.9	10.5	10.6	9.7
Maturity profile of State debt (in years)					
0 – 1					1,293 (05)
1 – 3					5,609 (23)
3 – 5					1,494 (06)
5 – 7					8,167 (33)
7 and above					8,000 (33)

Figures in brackets denote the percentage to market borrowings of ₹ 24,563 crore.
Source: *Finance Accounts.*

1.11.1 Debt stability

Fiscal liabilities are considered sustainable if the Government is able to service these liabilities over the foreseeable future and the debt – GSDP ratio does not grow to unmanageable proportions. A necessary condition for stability is the Domar's Debt Stability Equation**.** It states that if the rate of growth of economy exceeds the cost of borrowings, the debt-GSDP ratio is likely to be stable provided primary balances are positive /zero/moderately negative. Primary revenue balance is the difference between revenue receipts and primary revenue expenditure and indicates whether the balance of revenue receipts left out after meeting current

[13] Total fiscal liabilities: ₹ 91,943 crore plus balance of off-budget borrowings; ₹ 2,060 crore.

revenue expenditure is sufficient for meeting the interest expenditure. During 2006-11 the primary revenue balance was positive and sufficient to meet interest expenditure.

Interest spread is the difference between average lending rate and average borrowing rate. Quantum spread is product of debt stock and interest spread. The interest spread and quantum spread will be positive/negative depending on whether the GSDP growth rate is more or less than the growth rate of interest payments. When the quantum spread and primary deficit are negative, debt-GSDP ratio will be high indicating unsustainable levels of public debt and when the quantum spread and primary deficit are positive, debt-GSDP ratio will be low indicating sustainable levels of public debt. In 2010-11, both interest and quantum spread were positive.

Stabilization of debt is understood to mean debt as a constant *per cent* of GSDP which is a measure of the debt carrying capacity of the State. Even though the interest paid in 2010-11 was more than in the previous year, debt-GSDP ratio was lower than in 2009-10. The stabilization has resulted in the State honouring the FRA fiscal deficit cap (normal) of three *per cent* of GSDP.

1.11.2 Sufficiency of incremental non-debt receipts

Another indicator of debt sustainability is the adequacy of incremental non-debt receipts of the State to cover the incremental interest liabilities and incremental primary expenditure. Debt sustainability could be facilitated if the incremental non-debt receipts could meet the incremental interest burden and the incremental primary expenditure. Negative resource gap indicates non-sustainability of debt while positive resource gap indicates sustainability of debt. The details for the last five years has been indicated in **Table 1.32**.

Table 1.32: Sufficiency of incremental non-debt receipts

(₹ in crore)

Sl. No.		2006-07	2007-08	2008-09	2009-10	2010-11
1	Incremental Non debt Receipt	7,171	3,802	2,079	6,253	8,658
2	Incremental Interest Payments	471	270	26	681	428
3	Incremental Primary expenditure	7,701	4,176	5,453	7,715	8,043
Resource Gap		-1,001	-644	-3,400	-2,143	187

The resource gap, which was negative during 2006-10, turned positive in 2010-11 on account of increase in revenue receipts during the year by 18 *per cent* over previous year. This meant that the State did not depend on borrowed funds for meeting current revenue and capital expenditure.

1.11.3 Net availability of borrowed funds

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

Debt redemption ratio continued to be less than one (0.9) in 2010-11 as in the previous two years as debt redemption was lower than debt receipts. Nine *per cent* of debt receipts were available for productive/capital expenditure.

1.11.4 Maturity profile

In terms of maturity profile, around 33 *per cent* of the outstanding stock of Government securities (market borrowings) at the end of the year belonged to maturity bracket of seven years and above. Repayment obligation of the State would increase from 2012-13 due to huge market borrowings during 2002-03 and 2004-05 under Debt Swap Scheme. This is worrisome.

Repayment obligations would increase ten times in 2018-19 compared to 2017-18 due to huge market borrowings in 2008-09 as the State was allowed to borrow at 3.5 *per cent* of GSDP under the Fiscal Stimulus Package. Due to huge market borrowings in 2009-10, 24 *per cent* of the total re-payment obligation of market loans (₹ 24,563 crore) would be in 2019-22.

The Government created a sinking fund for open-market loans and the fund consists of two components-sinking fund (amortisation) and sinking fund (depreciation). The amortisation fund was to accommodate contributions from revenue for repayment of loans on maturity while the depreciation fund was to be fed annually by loans. However, there had been no accretion to the sinking fund since 1999-2000. The Government needs to consider reviving the fund in compliance with the recommendation of TFC which would help the State to meet the sudden increase in the amount of debt-servicing from 2013 onwards when huge chunk of market borrowings starts maturing. The balance in the sinking fund (investment account) had become adverse during 2008-09 which increased during 2009-10 also. In the current year, the adverse balance increased by ₹ 0.05 crore. In reply (November 2011), Government stated that as the investment policy of State Government did not allow the sinking funds to be invested in dated securities other than GOI and Reserve Bank return on investment would be very less and hence creation of Sinking Fund was not considered by State Government. The reply is not acceptable for the reason that the surplus cash balance of the Government stands automatically invested in fourteen days treasury bills of RBI. The return/yield on these investments is around five per cent per annum. Hence, government should think of revisiting the investment policy to get return on cash balances instead of investing in low yielding treasury bills.

The State Government further stated that investment in dated securities was not practicable as the investments depended on easy liquidity for carrying out day to day administration and discharging liabilities as and when they arise. The reply is not acceptable as the TFC in its report stated that all the State Government would be in a tight situation during 2013-15 when all the additional open market borrowings raised during debt swap scheme (2002-05) would be maturing. Hence, it had suggested for setting up of a sinking fund, with contributions from general revenues/ further investments, thereon to take care of these liabilities. The State which had attained revenue surplus in 2004 itself, could have contributed towards the setting up of fund. Further, RBI in their report on Public Debt Management (August 2011) has emphasized on setting up of the fund (Conference of Secretaries of State Finances held during May 2011 at Mumbai).

The PAC in its report has also recommended for setting up of a sinking fund for taking care of the loan discharges arising in future through suitable contributions from revenues.

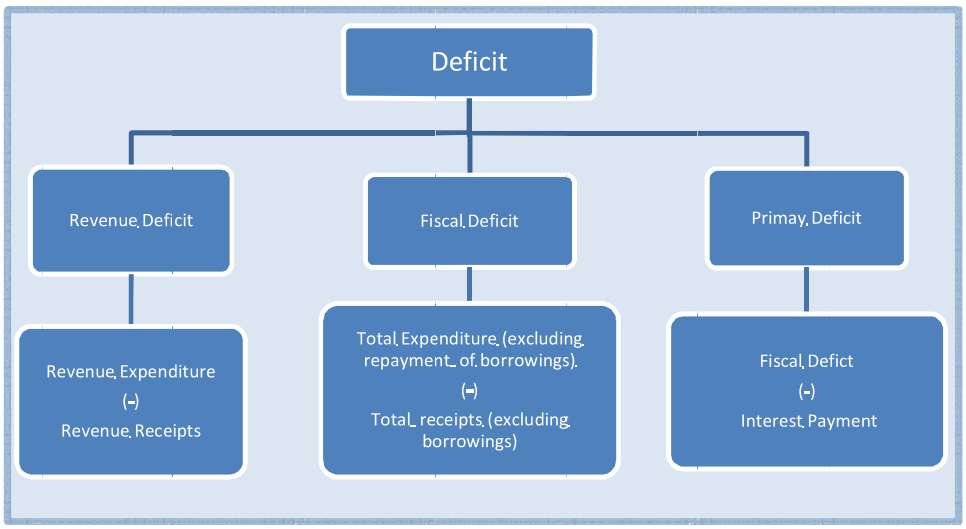
1.11.5 Burden of interest payments

The ratio of interest payments to revenue determines the debt sustainability of the State. During the year, interest payments pre-empted 10 per cent of the total revenue receipts of the State which was below the norm of 15 per cent prescribed by TFC. The NSSF accounts for around 23 *per cent* of the total outstanding liabilities of the State as at end of March 2011. Considerin[illegible]en arising as a result of the high effective rate of interest on NSSF loans till 2[illegible]e XIII FC recommended interest relief on those loans with a precondition to the enactment of the FRA. The loans contracted till 2006-07 and outstanding at the end of 2009-10 has been reset at an interest rate of 9 *per cent* in place of 10.5 or 9.5 *per cent*. According to the reset rates, inte[illegible]ent of ₹ 1,602.56 crore was due to be paid by the State during 2010-11 and the indirect relief to be ₹ 132.77 crore. The Finance Accounts, however, reflect ₹ 1,908.28 crore towards inte[illegible]ecial securities issued to NSSF. This was on account of interest payment of ₹ 305.72 crore on the NSSF loans availed of since 2007-08 onwards which did not attract interest relief.

1.12 Fiscal imbalances

In an emerging economy, a balanced budget is perhaps nex[illegible]sible and the Government has to resort to borrowings to bridge the gap between spiralling expenditure requirement and inadequate non-debt receipts. The gap between rece[illegible]xpenditure represents deficit. **Cha**[illegible]ves an indication of the various kinds of deficits that occur if the Government borrows excessively to balance the budget.

Chart 1.13: Type of deficits



The nature of deficit is an indicator of the prudence of fiscal management of the Government. Further, the ways in which the deficit is financed and the resources raised are applied are important pointers to fiscal health. This section [illegible]e trends, nature, magnitude and the manner of fi[illegible]se deficits and also the assessment of actual levels of revenue and fiscal deficits *vis-à-vis* targets set under FRA for the financial year 2010-11.

1.12.1 Trends in deficits

Charts 1.14 and 1.15 present the trends in deficit indicators over the period 2006-11.

Chart 1.14: Fiscal imbalances

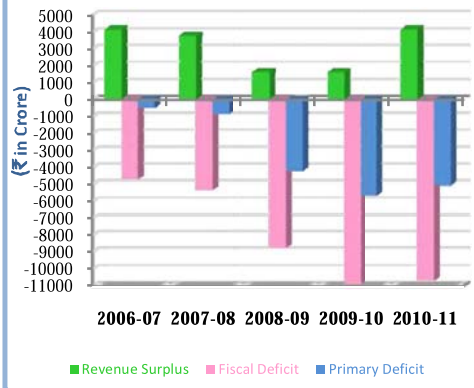
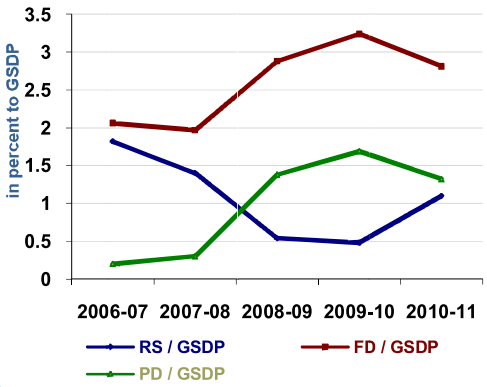


Chart 1.15: Trends in deficit Indicators relative to GSDP



The [illegible] revenue and fiscal deficits set for the TFC and XIII FC periods along with their actual levels are given in **Table 1.33.**

Table 1.33: Outcome vis-à-vis targets under FRA

Period	Revenue deficit		Fiscal deficit	
	Targets as per FRA	Actual	Targets as per FRA	Actual
TFC (2005-10)				
2005-06	Attain Revenue Surplus	Achieved the target in 2004-05 itself	3.0	2.00
2006-07	Maintain Revenue Surplus		3.0	2.06
2007-08			3.0	1.97
2008-09			3.5	2.88
2009-10			4.0	3.24
XIII FC (2010-15)				
2010-11	Maintain Revenue Surplus	Achieved the target	3.44	2.81

***Source:** Finance Accounts*

The fiscal target of wiping out revenue deficit by March 2006, as laid down in FRA, was ach[illegible]e State one year ahead in 2004-05. Thereafter the State maintained revenue surplus till 2010-11 with inter-year variations. In 2010-11, there was an increase in revenue surplus of ₹ 2,553 crore over the previous year and was ₹ 4,172 crore.

FRA target of reducing fiscal deficit –GSDP ratio to less than three *per cent* was also achieved one year ahead. In 2008-09 and 2009-10, the State continued to maintain fiscal deficit as a ratio of GSDP within the revised FRA limit of 3.5 *per cent* and 4.0 *per cent* respectively.

In 2010-11, the State initiated steps towards fiscal correction in the coming years as recommended by XIII FC revised the fiscal deficit limit to 3.44 *per cent* of GSDP. The State's fiscal deficit was 2.81 *per cent* thereby attaining the target of 2011-12 of three *per cent* also.

Revenue Surplus

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

The State attained revenue surplus in 2004-05 itself. The revenue surplus which was ₹ 4,152 crore in 2006-07 was in a decreasing trend during 2007-10. In 2010-11, revenue surplus increased by ₹ 2,553 crore and was ₹ 4,172 crore on account of the increase in revenue receipts by 18 *per cent* over previous year and increase in revenue expenditure by 14 *per cent*. Further, the compression of expenditure on account of delay in government sanctions, limiting transfers to fund accounts etc., resulted in unspent provision of ₹ 7,816 crore and an increase in revenue surplus.

Fiscal Deficit

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

Table 1.34: Fiscal deficit and its parameters

(₹ in crore)

Period	Non-debt Receipts	Total expenditure	Fiscal Deficit	Fiscal Deficit as percent to		
				GSDP	Non-debt receipt	Total expenditure
2006-07	37,647	42,335	4,688	2.06	12.45	11.07
2007-08	41,449	46,781	5,332	1.97	12.86	11.40
2008-09	43,528	52,260	8,732	2.88	20.06	16.71
2009-10	49,781	60,656	10,875	3.24	21.84	17.93
2010-11	58,439	69,127	10,688	2.81	18.29	15.46

Source: *Finance Accounts*

Fiscal deficit as a percentage of GSDP, non-debt receipts and total expenditure was the least in 2007-08. In 2008-10, these ratios were maximum due to enhancement of fiscal deficit limit based on the advice of the GOI. In the current year, there was a marginal improvement.

Primary Deficit

While fiscal deficit represents the need for additional resources in general, a part of such resources may be needed to finance interest payments. Interest payments represent the expenditure of past obligations and are independent of current allocative priorities. To look out at the imbalances of the current nature, these payments need to be separated and deducted from the total imbalances. The primary deficit and its parameters for the last five years is indicated in **Table 1.35.**

Table: 1.35 Primary deficit and its parameters

(₹ in crore)

Period	Fiscal Deficit	Interest Payments	Primary Deficit
2006-07	4,688	4,236	452
2007-08	5,332	4,506	826
2008-09	8,732	4,532	4,200
2009-10	10,875	5,213	5,662
2010-11	10,688	5,641	5,047

Source: *Finance Accounts*

During 2006-08, the primary deficit was less compared to 2008-11. In 2008-11, the fiscal deficit was almost twice the interest payments. This meant that during these three years, around 50 *per cent* of the fiscal deficits were due to revenue expenditure other than interest payments. Hence, prudent reduction of revenue expenditure could enable the State Government to attain primary surplus. Hence, containing the committed expenditure which constituted major chunk of the revenue expenditure would enable the State Government attaining the said goal. Since the costs of salary, pension and interest are inflexible, the expenditure on subsidies which is increasing steadily requires utmost attention by the State Government.

1.12.2 Components of fiscal deficit and its financing pattern

The financing pattern of fiscal deficit has undergone a compositional shift as reflected in the **Table 1.36**. Decomposition of fiscal deficit reveals the extent of various borrowings resorted to by the State to meet its requirement of funds over and above revenue and non-debt receipts.

Table 1.36: Components of fiscal deficit and its financing pattern

(₹ in crore)

		2006-07		2007-08		2008-09		2009-10		2010-11	
		Amount	*per cent* of GSDP	Amount	*per cent* of GSDP	Amount	*per cent* of GSDP	Amount	*per cent* of GSDP	Amount	*per cent* of GSDP
Decomposition of fiscal deficit		**-4,688**	**-2.06**	**-5,332**	**-1.97**	**-8,732**	**-2.88**	**-10,875**	**-3.24**	**-10,688**	**-2.81**
1	Revenue surplus	4,152	1.82	3,776	1.39	1,631	0.54	1,619	0.48	4,172	1.10
2	Net capital expenditure	8,543	3.75	8,403	3.10	9,689	3.20	12,067	3.59	13,283	3.49
3	Net loans and advances	297	0.13	705	0.26	674	0.22	427	0.13	1,577	0.41
Financing pattern of fiscal deficit*											
1	Market borrowings	-233	-0.10	287	0.11	6,583	2.17	4,954	1.48	1,037	0.27
2	Loans from GOI	-83	-0.04	357	0.13	135	0.04	211	0.06	613	0.16
3	Special securities issued to NSSF	2,478	1.09	209	0.08	-164	-0.05	247	0.07	1,838	0.48
4	Loans from financial institutions	-366	-0.16	174	0.06	260	0.09	272	0.08	419	0.11
5	Small savings, PF etc	659	0.29	749	0.28	1,176	0.39	1,468	0.44	1,607	0.42
6	Deposits and advances	1,805	0.79	-62	-0.02	1,554	0.51	1,908	0.57	2,037	0.53
7	Suspense and misc.	237	0.10	1,498	0.55	968	0.32	602	0.18	-296	-0.08
8	Remittances	514	0.23	-828	-0.31	-52	-0.02	-36	-0.01	-35	-0.01
9	Reserve funds	1,188	0.52	750	0.28	2,174	0.72	3,201	0.95	1,374	0.36
10	Increase (-) / decrease (+) in cash balance	-1,498	-0.66	2,185	0.81	-3,900	-1.29	-1,954	-0.58	2,106	0.55
11	Net of Contingency Fund transactions	-13	-0.01	13	0.00	-2	0.00	2	0.00	-12	0.00
	Total	**4,688**		**5,332**		**8,732**		**10,875**		**10,688**	

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

Source: *Finance Accounts.*

The components of fiscal deficit are Revenue surplus, Net Capital Expenditure and Net Loans and Advances. Since the State had attained revenue surplus in 2004-05 itself, it financed the fiscal deficit alongwith market borrowings, loans from GOI etc. The downward trend of revenue surplus during 2007-10 affected the extent of fiscal deficit which could be financed by revenue surplus. While 89 *per cent* of fiscal deficit could be financed by revenue surplus in 2006-07, it was 71, 19 and 15 *per cent* in 2007-08, 2008-09 and 2009-10. In 2010-11, revenue surplus could finance 39 *per cent* of fiscal deficit.

Also, capital expenditure suffered a set back due to declining trend of revenue surplus during 2007-10. Net loan and advances was a very insignificant component of gross fiscal deficit.

Due to limited market borrowings by the State Government in 2010-11, its share in financing fiscal deficit decreased from 75 *per cent* in 2008-09 to 10 *per cent* in 2010-11. However, there was considerable increase in loans from GOI, special securities issued to NSSF, loans from financial institutions and small savings, PF etc. in 2010-11 than in previous year. Further, based on the advice of the GOI and RBI with respect to cash management, the State Government utilised part of cash balances viz, investment in various reserve funds, fiscal management funds and local bodies funds maintained in the Public Account for financing the fiscal deficit. Hence, the cash balance utilised for financing fiscal deficit increased to ₹ 2,106 crore.

1.12.3 Quality of deficit/surplus

The ratio of revenue deficit to fiscal deficit and the decomposition of primary deficit into primary revenue deficit and capital expenditure (including loans and advances) indicate the quality of deficit in the State's finances. The ratio of revenue deficit to fiscal deficit indicates the extent to which borrowed funds were used for current consumption. Further, persistently high ratio of revenue deficit to fiscal deficit also indicates that the asset base of the State was continuously shrinking and a part of borrowings (fiscal liabilities) were not having any asset backup. The bifurcation of the primary deficit (**Table 1.37**) indicates the extent to which the deficit was on account of enhancement in capital expenditure which might be desirable to improve the productive capacity of the State's economy.

Table 1.37: 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)
2006-07	37,647	29,199	8,543	357	38,099	8,448	-452
2007-08	41,449	32,869	8,649	757	42,275	8,580	-826
2008-09	43,528	37,127	9,870	731	47,728	6,401	-4,200
2009-10	49,781	42,324	12,137	982	55,443	7,457	-5,662
2010-11	58,439	48,393	13,355	1,738	63,486	10,046	-5,047

Source: *Finance Accounts.*

Primary deficit which had occurred in 2006-07 showed an increasing trend thereafter. During 2010-11, the primary deficit was contained and was ₹ 5,047 crore. During the period 2006-11, non-debt receipts of the State were sufficient to meet only primary revenue expenditure. Thus deficit arising on

account of capital expenditure and loan and advances implied that capital expenditure was not always healthy and productive as it included debt-servicing expenditure and disbursement of interest free loans which did not result in asset creation.

The State Government replied (November 2011) that capital expenditure included loans to various boards/corporations which create infrastructure assets and also debt servicing pertaining to borrowings made in earlier years for creation of assets. As stated in the reply, capital expenditure though included loans/investments to various boards/corporations creating infrastructure assets, it included investments/loans to organizations under perennial loss without receiving any returns (discussed in paragraph no. 1.9.2). Also the debt servicing included interest payment which was capitalized.

1.13 Conclusion and recommendation

- ***Fiscal Position***

The state continued to maintain revenue surplus during 2006-11 and kept fiscal deficit relative to GSDP below the limit laid down under FRA.

The State which was on the road to recovery from the effects of economic slowdown in 2009-10, was expected to consolidate its position in the year 2010-11. During 2010-11, the State attained huge revenue surplus of ₹ 4,172 crore. This was on account of increase in revenue receipts by 18 *per cent* over previous year and increase in revenue expenditure by 14 *per cent*. Further, the compression of expenditure on account of delay in government sanctions, limiting transfers to fund accounts etc., also contributed to increase in revenue surplus.

For the first time, incremental non-debt receipts was higher than the incremental primary expenditure by ₹ 615 crore which could cover the incremental interest burden.

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

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

The ratio of State's tax revenue to GSDP which had shown declining trend since 2006-07 revived itself and was 10.10 *per cent*. However, the ratio of non-tax revenue to GSDP continued its declining trend.

Recommendation: Special emphasis needs to be given for mobilizing non-tax revenue in the coming years. The State Government also has to pursue non-tax revenue policies with due regard to cost recovery of public services.

- ***Revenue expenditure***

There was 16 and 13 *per cent* growth under social sector and economic sector of revenue expenditure over the previous year, while the growth in expenditure on general services was 10 *per cent.*

The share of plan expenditure to total expenditure increased from 26 *per cent* in 2009-10 to 28 *per cent* in 2010-11.

Fifty two *per cent* of revenue expenditure constituted committed expenditure on salaries, pensions, interest payments and subsidies. Total subsidy of ₹ 6,303 crore was partial as it excluded implicit subsidy of around ₹ 2,280 crore during 2010-11.

Recommendation: Though the macro parameters upon which the quality of expenditure of the Government assessed show an improvement in quality, more focus is required on improving the outcomes of expenditure.

Since most of the subsidies are beneficiary orientated, screening of beneficiary is required to weed out ineligible and bogus beneficiaries so as to control the expenditure on subsidy reaching unsustainable level. Further, as per the recommendations of TFC, expenditure forming implicit subsidy may be brought out in Finance Accounts for transparency.

➢ *Quality of expenditure*

The share of capital expenditure to total expenditure during the current year (22 *per cent*) remained same as in the previous year. It included interest expenditure of ₹ 202 crore on off budget borrowings.

Funds aggregating ₹ 1,203 crore were blocked in incomplete projects as at the end of 2010-11.

The return from investment of ₹ 38,421 crore as of March 2011 in companies / corporations was negligible (₹ 43.47 crore). The investment included ₹ 20,085 crore (52 *per cent*) to companies/ corporations under perennial loss.

***Recommendation*:** The State Government should also review the working of State public sector undertakings incurring huge losses and work out either a revival strategy or close down such units.

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

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

The Central Government transferred a sizeable quantum of funds (₹ 7,342 crore during 2010-11) directly to the State implementing agencies for implementation of Central plan schemes. Funds flowing directly to the implementing agencies through off-budget routing inhibit FRA requirements of transparency and therefore, escape accountability. There is no single agency monitoring its use and there is no readily available data on the amounts spent in any particular year on major flagship and other important schemes.

Recommendation: A system has to be put in place to ensure proper accounting of these funds and the updated information should be validated by the State Government as well as the Accountant General (Accounts & Entitlement).

- ***Assets and Liabilities***

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

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

- ***Debt sustainability***

The repayment obligation of the State would increase from 2012-13 due to huge market borrowings under debt swap scheme during 2002-03 and 2004-05. Further, repayment would increase enormously in 2017-18 onwards also, due to huge market borrowings in 2008-10.

Recommendation: The Government should consider reviving the sinking fund as it would help the State to meet the sudden increase in the amount of debt servicing from 2013 onwards.