Final Report

EVALUATION OF KARNATAKA STATE FINANCES

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EXECUTIVE SUMMARY

The fiscal implications of major policy changes affected during the last decade on the state finances need a careful study to initiate informed policy correctives if any required. Majorly these include the fiscal stimulus undertaken by the governments during global recession, followed by the changes in revenue sharing and the support extended under centrally sponsored schemes post 14 Finance Commission recommendations and the introduction of major indirect tax reform i.e. the Goods and Services Tax (GST). The evaluation of Karnataka state finances attempted in the present report examines the implications of these changes in addition to the state level fiscal measures initiated during the last decade i.e. 2006-07 onwards.

The state went through a fiscal roller coaster ride from one of severe fiscal stress in the decade of nineties to that of fiscal recovery following a series of reform initiatives. The state took stock of the fiscal situation by presenting a White paper on the State Finances in the financial year 2000. Karnataka has had the distinction of pioneering many reform initiatives. The fiscal consolidation path was initiated by the Karnataka state government with the framing of legislations such as Karnataka ceiling on government guarantee Act, Karnataka transparency in public procurement Act (KTPP) and the most important of all in the fiscal context being the Karnataka Fiscal Responsibility Act (KFRA) 2002. The fiscal principles laid down in the KFRA have guided the state through its fiscal consolidation process. The state had to encounter the challenges arising on account of the global recession which had hit the state quite hard as revealed by the rate of GSDP growth which dropped from 19.1 percent in 2007-08 to 14.66 percent in 2008-09 and further to 8.78 percent in 2009-10.Growth in revenue receipts dropped from 23.84 percent in 2006-07 to 5.2 percent in 2008-09. Enhancement in the share of state taxes in the divisible pool from 32 percent to 42 percent, provide greater resources and fiscal autonomy, however, reduction in resource support under the grants and centrally sponsored schemes to a large extent nullified the beneficial impact. There has been an increased expenditure commitments on the state on account of the changes effected. The state however, continues to have sound macro fiscal indicators as indicated by the fiscal and revenue deficits, albeit reduced revenue surplus caused by a higher growth in the revenue expenditure.

Chapter two pertains to an analysis of the state's resource performance. Trends and composition of state's resource position comprising of own tax and non-tax revenue, share in central taxes and grants are analyzed for the time period 2006-07 onwards. This analysis is aimed at capturing the impacts of major policy changes on the state's resource position. Performance of the tax resources in terms of their buoyancy and tax effort in comparison with major states has been analyzed. Karnataka state's own tax revenue performance continues to be much better than 'All states', all along as indicated by the own tax to GDP ratio during the reference period. On the contrary the state's non tax performance has been poor and been a cause for worry for long. While the own tax revenue continues to be the major source of revenue with its share in the total revenue resources increasing from 61.99 percent in 2006-07 to 63.55 percent in 2018-19 (B.E) that of non-tax revenue has dwindled to a little less than half. Share in central taxes has revealed a good increase from 14.3 percent to 22.5 percent during the above reference period. Grants on the contrary have declined considerably from 12.8 percent to 9.18 percent. The outcome of the 14 Finance Commission recommendations is a clear increase in the share of central taxes from 2.14 percent of GSDP in 2014-15 to 3.33 percent in 2017-18 (RE) an increase of 1.19 percent points. This rise is on account of the 14 Finance Commission's recommendation to enhance the states' share from 32 to 42 percent. On the contrary the share of grants has dropped from 2.13 percent to 1.65 percent, a decline by almost 0.48 percent points, a net increase of support only by 0.71 percent of GSDP. State's own tax revenue has declined from 10.24 percent to 9.62 percent and that of non-tax revenue has marginally increased from 0.68 percent to 0.72 percent. State's own tax revenue has continued to grow at impressive levels even after the state has got larger revenue support implying that the state's revenue efforts continue to be good.

Karnataka state's public spending in terms of broad trends and composition are presented in chapter three. The chapter discusses the trends in broad aggregates such as revenue and capital categories, functional categories- general, social and community and economic services; development and non-development; and plan and non-plan. The state's expenditure under the consolidated fund has increased from 19.4 percent of GSDP to 19.9 percent. Positive trends include the sharper growth in the expenditure on social and community services and development expenditure that tend to have favourable impacts on human development. Both the items have an increased share in the GSDP and total expenditure. Expenditure on economic services has the second largest share. The state has achieved a considerable decline in the share of non-development expenditure. However while the share of revenue expenditure has increased that of capital expenditure has had a declined share. Expenditure on both social and community and Economic services, i.e. the development expenditure has had an increased share in the total which is a welcome trend. Further it is heartening to note that Karnataka compares well with its neighbouring states with reference to capital spending and has much smaller non development expenditure among the southern states. In particular the increase in capital spending after the KFRA as compared to the pre reform phase is remarkable and it is all the more important to note that the state has had a relative improvement in infrastructure delivery. Research evidence bears out that Karnataka's performance in infrastructure delivery has improved over time from seventh rank among major Indian states in 2001 to number one position in 2011. (Mundle et.al, 2016) This gain should however not lead to complacency as the research has considered only two indicators i.e. standard state highways (in kms) per 100 sq.km of area and per capita consumption of electricity (kWh) The state has to insulate capital investments from fiscal adversities and sustain its growth and in fact further raise it to 5 percent of GSDP as recommended by the Expenditure Reforms Commission to address the infrastructure deficiencies in the state. The state's human development as indicated by the social service delivery has not been very encouraging. The state's relative performance has declined from seventh to eighth place, this is despite the fact that state's per capita social sector and development spending has been much larger than many other states. (Mundle,et.al, 2016 and Gayithri, 2017) Government subsidies have been an area of concern with the power sector subsidy posing a threat to the fiscal health of the state. Ironically, subsidy element is quite large in the category of economic services, the services that can be provided by the private sector on commercial basis as opposed to the social services that are associated with large-scale externalities and social benefits. This certainly narrows down the scope of cost recovery by way of user charges. Policy pronouncements such as loan waivers do not augur well for the state's development.

Analysis of deficits relating to fiscal and revenue and implementation of FRBM Act and commitment towards targets is presented in Chapter four and state's debt issues are discussed in chapter five. Karnataka has proved to be a fast reforming state that has been trying to implement reforms as and when mooted at the national level. The targets set in the KFRA 2002 have been achieved well within the timelines. The chapter has traced fiscal, revenue and primary deficit trends ever since the framing of FRBM Act and examines the status of KFRA target attainment. The target to achieve revenue surplus and 3 percent fiscal deficit by March 2006 has been achieved by the FY 2004-05 itself. The revenue surplus has given room for enhanced capital investments. Revenue surplus, however, has dropped significantly from 1.08 percent in 2011-12 to 0.03 percent in 2017-18 (RE). During this period the fiscal deficit has further declined from 2.83 percent 2.78 percent. Consequentially, there has been a decline in the capital expenditure, albeit, small. The general tendency to compress the capital expenditure in the wake of revenue shortfalls needs to be overcome in the interest of promoting social and economic infrastructure in the state. Expenditure Reforms Commission constituted by the Government of Karnataka had recommended that capital expenditure should be maintained at 5 percent of GSDP and insulated from such revenue shortfalls. An important policy challenge that the state government needs to address (also an issue for national level debate) has reference to the usefulness attached to the 3 percent fiscal deficit target, especially during the times when the state's demand/ requirement for infrastructure is large and until the time the much sought after adequate private investment takes place. Capital investments have greater potential to enhance growth and also help in crowding in of private investment.

Growth and composition of public debt of Karnataka presented in chapter five analyze the trends since 2006-07. According to the KFRA, total liabilities include those under Consolidated Fund and the Public Account, the former includes the internal debt and loans and advances from Government of India. It also includes off budget borrowings. Outstanding liability of GoK has sharply increased from Rs 57682 crore in 2006-07 to Rs 271144 crore in 2018-19 (BE), amounting to a 4 fold increase in absolute terms. The off budget borrowing has increased from Rs 4837 crore to Rs. 15646 crore during the above reference period. However, outstanding liability as percent of GSDP has declined from 33.21 percent to 20.36 percent and that of off budget borrowing has also declined from 2.57 percent to 1.11 percent during the reference period. This declining trend has been a feature of the Indian states caused by the debt relief linked to the rule based correction.

Thirteenth Finance Commission had stipulated that the debt/GSDP ratio should be restricted to 25.5 percent of GSDP by 2014.15. Karnataka state has amended section 4 of the FRA to incorporate the ceilings. The FRA ceilings for outstanding debt as percent of GSDP and the total liability to GSDP ratios reveal that the state government has been in a position to contain the debt to the prescribed levels.

Chapter six discusses the issues of power sector in Karnataka. Karnataka is one of the first Indian states to introduce power sector reforms in order to reduce power deficit and solve financial problems. Karnataka Electricity Reform Act, KERA, 1999, which mandated for unbundling of the Karnataka Electricity Board (KEB), and transferred the function of transmission and distribution to the newly corporatized Karnataka Power Transmission Corporation Limited (KPTCL), aimed to improve power accessibility in the state by solving the technical and financial problems. An independent regulatory commission called Karnataka Electricity Regulatory Commission (KERC) was also formed. A major issue with the power sector in Karnataka relates to the substantial increase in the revenue expenditure of the power sector under the head 'Assistance to Electricity Boards' which mainly relates to the subsidy element by the government on account of subsidies to power sector which continue to rise with time. Very often, the amount provided in the budget does not represent the entire subsidy dues from the government. The matter of subsidy to power sector is perhaps the most critical aspect in the context of its implications on the state finances. The subsidy released for electricity supply to irrigation pump sets (IPS) was to the tune of Rs 8143 crore in 2015-16. There have been various bailout schemes where the government has bailed out the loss-making distribution utilities. Such bail outs seem to serve merely short-term objectives, without any design or plan for long term solutions, nor an in-depth investigation of the real causes of the persisting problems in power sector. Prolonged crisis in financial health of power sector is and would continue to be very expensive for the state government in future, with no return whatsoever in terms of development or progress. Impact of the working of State Public Sector Undertakings (PSUs) on the state finances is analyzed in chapter seven. As of March 2017, there are 102 PSUs functioning in the state. Of these 102 PSUs, 90 are working and remaining 12 are non-working PSUs. Karnataka occupies third place among Indian states in terms of working PSUs are concerned. There has been overtime an increase of working government companies followed by gradual decrease of non-working PSUs. The total investment of PSUs over the years is increasing in current prices. It has almost doubled from Rs. 53,656.81 crore in 2009-10 to Rs. 1, 03,717.40 in the year 2016-17 (93% of growth rate) and is witnessing more than 10 percent of annual average growth rate during the same reference period.

It is important in the context of fiscal reforms to periodically review the need for the presence of the public sector by specific sectors and the quantum and nature of investment required. The state has in a welcome development witnessed a decline in the number of non-working PSUs, and a marginal decline in total investment, however, they still account for sizeable resource support from the state budget. There is every need to prevent further drain of resources to loss making and non-working units. Yet another positive feature refers to the fact that the PSU investment has a predominant share under the categories infrastructure and power, together they account for 92 percent of total investment and manufacturing sector is small and has declined over time. In the changing global economic scenario, state should ideally withdraw from manufacturing sector and Karnataka state seems to be adapting to the changing economic environment. Public sector participation in the infrastructure and power sector can be justified as is currently the case in Karnataka, as the multiplier effect of such capital investments on state income tends to be much larger and also enables crowding in of private investment. Such investments tend to positively contribute to state's economic growth in the long-run. Ironically, the recent trends reveal that, a larger share of budgetary resource support provided to the PSUs is in the nature grants and subsidies whose share has increased over time from 42 percent in 2007-08 to 70 percent in 2016-17 and on the contrary that of Equity Capital has come down from 49 percent to 29 percent during the above reference period. The PSU turnover as percent to GSDP has considerably shrunk from 11.23 percent in 2004-05 to 4, 99 percent in 2016-17. The mounting subsidies are a drag on state's resources and if they continue unabated the state's fiscal health can be at considerable risk. It is also disheartening to note that the contribution of PSUs to the state exchequer by way of profits and dividends is very meagre as opposed to the state's sizeable contribution to the PSUs in the form of share capital and grants. While the state has recognized the need to reform the performance of PSUs and formed Public Sector Restructuring Commission way back in 2000, and as a follow up 29 PSUs were identified for disinvestment and liquidation the progress seems to be lackluster.

Major decentralization initiatives and transfers to urban and rural local bodies are discussed in chapter eight. The Karnataka state has pioneered a number of reform initiatives and the state's decentralization efforts are also well recognized among Indian states. The state has largely honoured the requirement of appointing State Finance Commissions with four State Finance Commissions giving their recommendations till date, the chapter has analyzed the trends in actual transfers vis-à-vis the recommendations for the first three Finance Commissions as the Fourth Finance Commission has recently been submitted.

Transfers to local bodies in Karnataka from the state government have increased from Rs 3320.81 crore in 1997-98 to Rs 35538.62 crore in 2016-17 amounting to 9.7 times increase over the initial year. The distribution of the resources transferred between the urban and local bodies reveals that while the share of urban local bodies has doubled from 8.28 percent to 16.83 percent that of rural local bodies has declined from 91.72 percent to 83.17 percent. However, on an average rural local bodies account for a much larger share in the total with almost 85 percent share with the urban local bodies accounting for 15 percent share in the total. It can also be observed that while transfers to urban local bodies have increased by 21 times that of rural local bodies has increased by 8.7 times. The rates of growth too reveal that transfers to the urban local bodies have been by and large much larger than that of rural local bodies, however, the former has revealed considerable fluctuation over time and at times has even been negative. Per capita transfers to local bodies have revealed a fivefold increase in the transfers affected to the local bodies in Karnataka. Details of the SFC recommendations vis-à-vis the actual devolution by each of the SFC periods reveal that by and large there has been considerable deviation between the SFC recommendations and the actual assignment to the local bodies, there has been however larger flow of resources as compared to the recommended level. An important policy concern in this context is with reference to the fact that despite an absolute overall increase in the transfers provided over time, they are very often adversely affected by the state's overall fiscal position. The state's fiscal adversities get clearly reflected in the shared resources with the local bodies that have suffered a decline during 1997-98 until 2004-05 and once again from 2009-10.

Devolution to local bodies is observed to be highly vulnerable to State's overall fiscal position creating uncertainty in the flow of funds. This phenomenon is more predominant for the PRIs as the share of ULBs is observed to be by and large on the increase albeit it's smaller share in total. This is more with reference to plan/development funding than the non-plan funding which largely is towards salary. Uncertainty/unpredictability of fund support and hamper the developmental activities of the local bodies. The support provided by the Centre and states are not complementing each other rather they are substituting for one another, which once again raises the issue of predictability of assured funding.

Public Expenditure and Financial management reforms undertaken by Government of Karnataka are presented in chapter nine**.** One of the fiscal management principles laid down in the KFRA is to pursue expenditure policies that would provide impetus for economic growth, poverty reduction and improvement in human welfare. There has also been emphasis on expenditure reforms, stressing on the need to adopt a threefold approach of outcome linkage-program prioritization and designing and rationalization of schemes and programs on the basis of a medium term performance evaluation. The two important strategies that seem to have been pursued by Government of Karnataka to achieve these objectives a) is to enhance allocations for the high priority development sectors identified by the government year on year ever since the FRA, b) Introduce frameworks that enable the government to track the outputs and outcomes of the programs.

With reference to the first strategy, government has listed some sectors as high priority development sectors. These sectors (as listed in various MTFPs) include Agriculture, Rural development, Power among the Economic services category and Health and Education from the Social services category. The expenditure analysis presented in chapter three of the present report too highlights the increases that have occurred in select development sectors. This is a welcome development given the human and infrastructure development challenges of the state. Government also has constituted Expenditure Reforms Commission (ERC) in 2009, with wide terms of reference to tone up public expenditure in Karnataka. This is a major initiative, probably one of the few Indian states to examine the aspects of growing public expenditure and the corrective measures required. In all four reports were submitted by the ERC providing wide ranging recommendations (totaling 292 recommendations) pertaining to aspects of inter sectoral prioritization, organizational structure and review of departmental schemes. Many of these recommendations have been accepted and implemented by the GoK (MTFP, 2013-17). Among the measures that attempted to promote economy and ensure transparency was the introduction of e-procurement in all departments with effect from, 3-12-2012, by the e-governance department. Independent Directorate of Social Audit has been set up to ensure social audit of schemes identified by the Planning department. Karnataka evaluation policy has been announced and Karnataka Evaluation Authority (KEA) set up in 2011 to streamline program evaluation.

With reference to the second strategy too there has been a constant effort by the Government of Karnataka to put in place appropriate frame work that would enable systematic tracking of the performance of government programs and eventually help in toning up the quality of public spending. The frameworks attempted by GoK include Departmental Medium Term Framework; Program Performance budgets (PPBs); Monthly Program Implementation Calendar; Results Framework Document. While the first two frameworks have been at the instance of the international aid agencies, MPIC has been conceived by the Finance department, GoK. Government of Karnataka has adopted the Results framework of Government of India to track the results of government programs and ensure accountability. While the state has been very quick in adopting new initiatives, four varied approaches attempted in a span of eight years, they are also put to disuse fast. RFD also has been discontinued. There are also issues such as use of inappropriate outcome indicators, poor outcome database, multiple reporting formats and inadequate understanding of the new approaches. It is also important to note that the ultimate benefit of these frameworks lies in the use of outcome information in the expenditure planning for the ensuing financial year which has to be ensured by the Government of Karnataka. There are issues relating to bunching of expenditure more so for the plan expenditure which will adversely impact the service delivery.

The issue of sustaining the sound fiscal health in the long run needs immediate attention. The revenue led recovery achieved by the state in the present juncture may not continue for long in the absence of buoyant economic growth. The global recession impact has already revealed that the state’s resource position is very much dependent on the general economic condition. Creation of additional fiscal space required to address the social and economic development needs of the state is largely possible through a thorough review of public expenditure, framing of informed expenditure decisions, setting of right priorities and enhancing the technical efficiency of public spending.

CHAPTER 1
INTRODUCTION

The fiscal implications of major policy changes affected during the last decade on the state finances need a careful study to help initiate informed policy correctives if any required. Majorly these include the fiscal stimulus undertaken by the governments during global recession, followed by the changes in revenue sharing pattern and the paradigm shift in the centrally sponsored schemes following the 14 Finance Commission recommendations and the introduction of the major indirect tax reform i.e. the Goods and Services Tax (GST) from July, 2017. The evaluation of Karnataka state finances attempted in the present report examines the implications of these changes in addition to the state level fiscal measures initiated during the last decade of 2006-07 to 2016-17.

The state went through a fiscal roller coaster ride from one of the severe fiscal stress in the decade of nineties to that of fiscal recovery following a series of reform initiatives. The state took stock of the fiscal situation by presenting a White paper on the State Finances in the financial year 2000. Karnataka has the distinction of pioneering many reform initiatives. The fiscal consolidation path was initiated by the Karnataka state government with the framing of legislations such as Karnataka Ceiling on Government Guarantee Act, Karnataka Transparency in Public Procurement Act (KTPP) and the most significant of all in the fiscal context being the Karnataka Fiscal Responsibility Act (KFRA) 2002. The fiscal principles laid down in the KFRA have guided the state through its fiscal consolidation process. The state had to encounter the challenges arising on account of the global recession which had hit the state quite hard as revealed by the rate of GSDP growth which dropped from 19.1 percent in 2007-08 to 14.66 percent in 2008-09 and further to 8.78 percent in 2009-10. Growth in revenue receipts declined from 23.84 percent in 2006-07 to 5.2 percent in 2008-09.

Enhancement in the share of state taxes in the divisible pool from 32 percent to 42 percent, provided greater resources and fiscal autonomy. However, reduction in resource support under the grants and centrally sponsored schemes to a large extent nullified these beneficial impacts. There has been increased expenditure commitment on the state on account of the changes effected. The state however, continues to have sound macro fiscal indicators as indicated by the fiscal and revenue deficits, albeit reduced revenue surplus caused by a higher growth in the revenue expenditure.

The state’s expenditure growth is characterized by a huge chunk of committed expenditure leaving a little room for manoeuvrability for furthering the capital investment to meet the growing needs of social and economic infrastructure required to steer the economy to greater economic heights. The state has been increasingly resorting to Public Private Partnerships (PPPs) to fill the investment gaps; however, the infrastructure challenges remain large. There is also increasing demand on the public resources in the light of Right to Education, Food Security and Employment guarantee measures. These emerging concerns necessitate a review of the public resources for their allocative and technical efficiency.

It is also important to take stock of the state's achievements Vis-a- Vis the impending requirements. The state has experimented with frameworks such as Departmental Medium Term Fiscal Policy (DMTFP), Program Performance Budget (PPB), and Results framework Document (RFD)now has in place tools such as Monthly Program Implementation Calendar (MPIC) to track the expenditure management. Sakala initiative aims at guaranteed delivery of services in specified time frame. However, the frameworks used to track the results of the governmental programs on the social and economic wellbeing of the individuals needs further toning up as there is need to focus on outcomes rather than outputs. The processes also need a big change by way of using the outcome information in the expenditure planning for the ensuing financial year, which aids in reflecting the changing sectoral priories thus enhance allocative efficiency. The current incremental budgeting practices not only result in bloating of public expenditure but also fail to create the necessary fiscal space to accommodate the public spending arising out of the changing demands given the resource constraints of the governments. In the light of these developments it is essential to take stock of the status of state finances in Karnataka.

The present study at the behest of the Fifteenth Finance commission has the following terms of reference:

The study should provide an analysis of the State Finances over a period of 10 years starting from 1st April, 2006. Specifically, the study should include (and may not be restricted to) the following:

1. Estimation of revenue capacities of State and Measures to improve the tax-GDP ratio during last five years. Suggestions for enhancing the revenue productivity of the tax system in the State.
2. Analysis of the state's own non-tax revenues and suggestion to enhance revenues from user charges and profits from departmental enterprises and dividends from non-departmental commercial enterprises.
3. Expenditure pattern and trends separately for Revenue and Capital, and major components of expenditure there under. Measures to enhance allocative and technical efficiency in expenditures during the last 5 years. Suggestions for improving efficiency in public spending.
4. Analysis of Deficits – Fiscal and Revenue.
5. The level of Debt: GSDP ratio and the use of debt (i.e. whether it has been used for capital expenditure or otherwise). Composition of the state's debt in terms of market borrowing, Central government debt (including those from bilateral/multilateral lending agencies routed through the Central government), liabilities in public account (small savings, provident funds etc) and borrowings from agencies such as NABARD, LIC etc.
6. Implementation of FRBM Act and commitment towards targets. Analysis of MTFP of various departments and aggregate.
7. Analysis of the state's transfers to urban and rural local bodies in the State. Major decentralization initiatives.

8. Impact of State Public Enterprises finances on the State's financial health and measures taken to improve their performance and/or alternatives of closure, disinvestment etc.
9. Impact of Power Sector Reforms on States' fiscal health. In case reforms have not been implemented, the likely outcome on the States' fiscal health.
10. Analysis of contingent liabilities of the State.
11. Subsidies given by the States (Other than Central subsidies), its targeting and evaluation.
12. Outcome Evaluation of State Finances in the context of recommendations of the 14th Finance Commission.
13. Determination of a sustainable debt roadmap for 2020-25, taking into account impact of introduction of GST and other tax/non-tax trend forecasts.

The evaluation study is expected to critically analyse the overall States' finances over the ten-year period with reference to above and the ToR of the 15th Finance Commission. Suggestions for improved financial performance may also be given.

1.1 Data sources and Methodology

Karnataka state finances are evaluated in the present study based on the performance over time and also wherever possible using an inter-state perspective. The study uses secondary data from budget documents, Economic Survey, Finance department's computerized database, reports and existing studies. Time period covered for the study is from 2006-07 till 2018-19 (BE). This period is marked by important events that tend to have significant implications on state finances. These included global recession, the recovery phase, and the post Fourteenth Finance Commission, whose recommendations made major changes to transfer system. The study attempts comparisons with the pre Fiscal reforms, i.e. 1991-2002-03; and 2003-04 till 2006-07- the initial years of fiscal reform, involving framing of Karnataka Fiscal Responsibility Act, and introduction of major tax reforms. The rest of the time period is categorized into sub periods to include, (i) 2007-08 till 2009-10- the global recession phase, involving fiscal stimulation and relaxed fiscal deficit targets; (ii) 2010-11 till 2014-15- the recovery phase and (iii) post 2015-16- the outcome of Fourteenth Finance Commission recommendations. The analysis makes the necessary adjustments to prices and population to understand the real and per capita growth in the fiscal variables. The study uses GSDP implicit deflator for the purpose with 2004-05 as the base. In order to have meaningful comparisons of the fiscal variables over time the corresponding GSDP used is adjusted to the 2004-05 base by making the subsequent changes in the base using the splicing method. The GSDP data relating to both current and constant prices for different base year is collected from the Reserve Bank of India website. (https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=18136 & https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=18135) which is sourced from Central Statistical Organization (CSO) and the GSDP data for states (for all different base years) is in factor cost. The absolute values of GSDP from 1991-91 to 2017-18 are given in Appendix 2.1 (pg. 30). The study uses descriptive statistics and appropriate econometric methods to analyze the data.

1.2 STRUCTURE OF THE REPORT

The report is structured into ten chapters. Chapter one provides a brief introduction, terms of reference, methodology and outline of the report. Karnataka's resource position in terms of its growth, resource composition, tax effort and the status of non-tax revenue (pertaining to TOR 1 and 2) are discussed in chapter two. Trends and growth of public expenditure by important categories such as revenue and capital; development and non-development; plan and non-plan categories and the composite index of expenditure management in an interstate perspective are discussed in chapter three. This chapter also includes discussion relating to subsidies of the state (TOR 12) The state's fiscal position in terms of the various deficit variables (TOR 4) and the implementation of FRBM Act and commitment towards targets analysis of MTFP of various departments and aggregate (TOR 6) are analyzed in chapter 4. Karnataka's debt position, its composition and contingent liabilities (TOR 11) are discussed in chapter 5. Issues pertaining to the power sector and its implications on state's health are dealt with in chapter 6. Transfers to local bodies constitute the discussion of chapter 7. The impact of Public sector enterprises on state's health is analyzed in chapter 8. Public expenditure and finance management reforms are presented in chapter 9. The last chapter pertains to summary, conclusion and recommendations.

CHAPTER 2
STATE'S REVENUE EFFORTS

The macro policy changes introduced in India comprising of an enhanced devolution of Union government's net tax receipts to the states increasing from 32 percent to 42 percent based on the Fourteenth Finance Commission recommendations, a paradigm shift in the design of the centrally sponsored schemes, introduction of Goods and Services Tax (GST) tend to have substantial implications on the sub national fiscal scenario. The composition of state's revenue resources comprising of state's own revenue in the form of tax and non-tax revenue and that of transfer of resources from the Central government by way of tax and grants and the changes therein need a closer scrutiny from the point of view of state's fiscal sustainability given the macro policy changes.

Karnataka has been a forerunner with reference to many fiscal reform initiatives and the first state to launch the Karnataka Fiscal Responsibility Act (KFRA) in 2002 which came into effect from April 2003. Karnataka's own tax performance has played a key role in reviving the state's finances from severe stress experienced in the decade of nineties. The state's initiative to appoint the Tax Reforms Committee and the subsequent implementation of several of its recommendations has brought about a sea change in the revenue performance. Details of the state level-initiated revenue reforms are presented in Text box (Text Box 2.1).

This chapter presents a discussion of the revenue position of Karnataka state in the wake of the Fourteenth Finance Commission recommendations that have effected a substantial change in the transfer of resources of both the tax share and grants. The enhanced share in taxes tends to enhance the fiscal autonomy and is in line with the long-standing demand of the sub national governments in India. In addition, these resources can be used by the states to fulfil state expenditure priorities. Hence, this move has been widely welcomed. On the contrary while the reduction in grants and the paradigm shift in the centrally sponsored schemes is to be welcomed given the revenue compulsions of the central government, it remains a fact that states have adopted a number of centrally sponsored schemes and being implemented resulting in some commitments on expenditure that cannot be abruptly stopped.

Goods and Services Tax (GST) is another major tax reform introduced in the country which will have considerable implications on the state's resources. GST is a value-added tax at each stage of the supply of goods and services applied on the amount of value addition achieved. GST implemented from July 2017 helps eliminate inefficiencies in the tax system that result in 'tax on tax', known as cascading of taxes.

TEXT BOX 2.1: REVENUE REFORMS OF KARNATAKA

TAX REFORMS

MTFP 2007-11 has identified the following areas that needed focus to improve the commercial tax administration

- Increasing the tax base
- Commodity wise data analysis and intelligence
- Rigorous audit and enforcement
- Incorporating Computerization in not only database maintenance but also improving and simplifying taxpayer services.
- Strategy to be devised to ensure collection of arrears of taxes

The MTFP (2007-11) also suggested some explicit measures to improve individual taxes

- On excise duty, MTFP (2007-11) felt that the present excise duty structure is step based hence there is a need to rationalize the duty structure by replacing it with an advalorem duty structure. Also in modern excise administration, excise duties have been replaced with excise sales tax. This facilitates the refund of input tax credit and also ensures proper book keeping and accounting. It is envisaged to move in this direction in the medium term plan period.
- Suggested for periodical revision of the guidance value that forms the basis for recording registration to improve the stamps and registration tax.
- The rate of Motor Vehicle tax on public transport needs to be maintained at the same level however, there is a need for constant review of tax rate with regard to private transport and luxury brands in the market.

NON-TAX REFORMS

A Revenue Reform Commission (RRC) was constituted to go into the various non tax revenues, basis for their rate, fees, user charges etc. Based on the recommendations of the RRC the non tax revenue of some of the departments was revised suitably

- The RRC identified that the non revision of user charges, levies, fees and royalties is one the main reasons for declining contribution of Non Tax revenues. It felt that a *de novo* review of most of the rates of non-taxes is necessary to avoid arbitrary criteria while fixing the rates. Similarly the Fiscal Management Review Committee (FMRC) also suggested for revision of user charges levies, fees and royalties.

MTFP 2006-10 has recorded some concrete measures undertaken to improve individual non-tax revenue reforms. Accordingly,

- Royalty collection is aligned to the growth in mineral exploration and mining.
- Strict enforcement and modernization of mechanism of collection is envisaged to detect evasion.

Source: MTFP (2006-10, 2015-19 and 2007-11)

GST is a destination-based tax on consumption, as per which the state's share of taxes on inter-state commerce goes to the one that is home to the final consumer, rather than to the exporting state. Considerable long-run benefits are expected from the GST on the economic activities however, negative impacts are justifiably expected in the short to medium term due to transitional problems, and also because of the shift from origin-based taxation to destination-based taxation. MTFP, 2017-21, (p 43-44) gives an outline of the compensation arrangement, "…this loss is expected to be compensated by the Central Government for the first five years from the date of implementation of GST.4. As per the agreed compensation formula, States will be compensated for a 14%growth over 2015-16 base. From 2018-19 onwards, revenues from GST, along with the compensation are projected to grow at 14% over 2015-16 base as per the agreed compensation formula. However, in the year 2017-18, the projections have been modulated by two factors. (a) Firstly, since GST will be implemented from 1st July, 2017, revenue from existing taxes will continue for the first four months and they are projected to grow at the rate as in the last quarter of 2016-17. (b) Secondly, since the compensation will be released bimonthly, there will be a spill over in payment of compensation for loss of revenue in 2017-18 that will get paid in 2018-19. Therefore, the compensation will be available only for six months. For revenues not being subsumed in GST, namely, taxes on petroleum products and profession tax, historic growth rate has been presumed."

The revenue implications of GST at the state level are difficult to be captured due to non-availability of data. However, the revenue composition changes effected on account of the Fourteenth Finance Commission recommendations are clearly visible from the trends presented below in the distribution of state's revenue resources

DISTRIBUTION OF STATE'S REVENUE RESOURCES

Details of state's revenue resources, in nominal, real, per capita real and as a percent of GSDP are presented in table 2.1. The composition of revenue receipts by its major components own tax revenue, non-tax revenue, share in central taxes and grants are presented in 2.2. Phase wise rates of growth are presented in table 2.3. State's own tax revenue has increased from Rs 23301 crore in 2006-07 to Rs 70180 crore in 2014-15and further to Rs 91718 crore in 2017-18 (RE). In per capita real terms, State's Own Tax Revenue (OTR) has also significantly increased from Rs. 3694 to Rs 5868 in 2014-15 and further to Rs. 6774 in 2017-18 (RE) and it is constantly growing during 2006-07 to 2017-18 (RE) in real terms. Its share in GSDP marginally declined from 10.25 percent to 10.24 percent between 2006-07 to 2014-15 which had a further decline to 9.62 percent. Share in central taxes has increased from Rs 5374 crore to Rs 14654 in 2014-15 and further substantially increased to Rs 23983 crore in 2015-16, an absolute increase by Rs9329 crore as a result of the 14 Finance Commission recommendations. On the contrary grants have increased from Rs 4813 crore to Rs 14619 crore in 2014-15 but declined to Rs 13929 crore in 2015-16 resulting in absolute decline by Rs 690 crore.

In terms of the percentage composition of the individual items to total revenue receipts, own tax share had increased from 62 percent to 67.39 percent from 2006-07 to 2014-15, however declined to 63.55 percent by 2018-19 B.E (Table 2.2). State's own tax revenue continues to be the major source of revenue for the state. The percentage share of central taxes has increased from 14.07 percent in 2014-15 to 20.18 percent in 2015-16. Share of central grants in total revenue receipts had increased from 12.8 percent in 2006-07 to 14.04 percent in 2014-15 went on to decline to 11.72 percent in 2015-16 and further to 9.18 percent in 2018-19 (BE) Performance of non-tax revenue being the poorest, with the per capita Non tax Revenue going down from Rs. 650 to Rs. 504 and the share in total revenue receipts declining from 10.9 percent to 4.68 percent between 2006-07 and 2017-18 (R.E.) respectively. In summary, state's own taxes remain a predominant source of revenue followed by share in central taxes, grants with the non-tax revenue being small and on the decline. On an average while the states own taxes constituted 66 percent till 2014-15 which declined to 63 percent in 2018-19; that of central tax share was 16 percent and increased to 21 percent; grants has declined from 12.34 percent to 10.87 percent.

Broad trends in revenue receipts are discussed for the time period, 2006-07 onwards as per the Terms of reference of the study. However, wherever necessary to have a more meaningful understanding of the trends and composition, the study attempts comparisons with the pre-fiscal reforms, i.e. 1991-2002-03; and 2003-04 till 2006-07- the initial years of fiscal reform, involving framing of Karnataka Fiscal Responsibility Act, and introduction of major tax reforms. The rest of the time period is categorized into sub periods to include, (i) 2007-08 till 2009-10- the global recession phase, involving fiscal stimulation and relaxed fiscal deficit targets; (ii) 2010-11 till 2014-15- the recovery phase and (iii) post 2015-16- the outcome of Fourteenth Finance Commission recommendations. Growth rates by these phases are presented in 2.3. The positive impacts of the fiscal reforms on the growth in revenue receipts in particular that of own tax revenue can be perceived from the annual average rates of growth which in the case of revenue receipts has increased from 11.85 percent (1991-92 to 2002-03) to 23.61 percent (2003-04 to 2006-07) and for own tax revenue the increase is from 12.49 percent to 22.31 percent during the above reference period. Coincidentally the shares in central taxes and grants also have revealed a larger growth and also the non-tax revenue. The global recession phase was marked by a sharp decline in all the items of revenue receipts in particular that of state's own tax revenue and the non-tax revenue which revealed a negative growth. In fact, the state's own revenue resources have not achieved the annual average growth that was achieved immediately after the framing of KFRA during the subsequent phases and is even lower than the pre-reform phase in the post 2015-16 phase that captures the impacts of Fourteenth Finance commission recommendations. The last phase revealed a good hike in the AAGR of share in central taxes to the tune of 27.01 percent while that of grants has grown at 0.8 percent.

In summary, one can argue that the state's fiscal recovery is on account of the reforms initiated by the state government on the tax front, although the government has been hinting at the need to address the non-tax revenue issues the expected results are not forthcoming. The state's revenue reforms are guided by the following principles (MTFP 2007 p15)

- Rationalize rate of taxes so as to improve tax compliance
- Stepping up enforcement to detect evasion
- Simplification of procedure and payment to make tax computation &payment citizen friendly
- Building up of database of tax payers and returns information for the purposes of intelligence, monitoring and policy formulation
- Implementing an e-governance interface between tax payer and collecting authorities

REVENUE RECEIPTS AND GSDP
SHARE OF REVENUE RESOURCES IN GSDP

A well-designed tax system will automatically yield larger revenues with the growth in economy. It is important to examine the buoyancy of the tax system in Karnataka. While the data analyzed in this chapter pertains to the reference period suggested in the Terms of reference, i.e. 2006-07 onwards, comparisons are drawn with the previous period to understand the changes in the revenue efforts over time. This is true especially for the initial years of FRA wherein, considerable reform measures are introduced. State's revenue receipts as percent of GSDP has declined from 16.54 percent in 2006-07 to 15.32 percent in 2017-18 RE (Table 2.1) State Own Tax Revenue (STR) that constituted 10.25 percent share in 2006-07 has succumbed to the recessionary pressures and also state's tax concessions between 2007-08 till 2009-10 subsequently recovered until 2014-15 and declined subsequently to end up at 9.62 percent in 2017-18R.E. Since, STR accounts for highest share of Revenue resources of the state, the relative reduction in STR from 2007-08 to 2010-11 is reflected in reduction in the total revenue receipts of the state. On the contrary, increase in the share of STR during the period 2011-12 to 2014-15 is reflected in the higher percentage of revenue receipts in GSDP. On the other hand, NTR as a percentage of GSDP is continuously decreasing from 2006-07. The share of central taxes has more or less remain constant from 2006-07 to 2014-15. However, it has increased slightly more than one percentage point of GSDP after the implementation of 14th Finance Commission recommendations.

Table 2.1: Category wise revenue resources of Karnataka

Details		2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Revenue Receipts	Nominal	37587	41151	43291	49156	58206	69806	78176	89544	104142	118817	133214	146033
	Real	33522	34700	34099	36055	38651	43364	44924	48010	53300	59286	63900	67856
	PC (Rs.)	5859	6097	5925	6197	6 573	7298	7484	7919	8707	9594	10245	10786
	GSDP %	16.54	15.21	13.95	14.56	14.17	15.33	14.97	14.6	15.19	15.62	15.66	15.32
Own Tax Revenue	Nominal	23301	25987	27646	30578	38473	46475	53754	62604	70180	75550	82956	91718
	Real	20781	21913	21776	22428	25547	28871	30890	33566	35918	37697	39792	42618
	PC (Rs.)	3694	3851	3784	3855	4345	4859	5146	5537	5868	6100	6380	6774
	GSDP %	10.25	9.6	8.91	9.06	9.37	10.21	10.29	10.21	10.24	9.93	9.75	9.62
Non Tax Revenue	Nominal	4098	3358	3159	3333	3358	4086	3966	4032	4688	5355	5795	6828
	Real	3655	2832	2488	2445	2230	2538	2279	2162	2399	2672	2780	3173
	PC (Rs.)	650	498	432	420	379	427	380	357	392	432	446	504
	GSDP %	1.8	1.24	1.02	0.99	0.82	0.9	0.76	0.66	0.68	0.7	0.68	0.72
Share Central Tax	Nominal	5374	6779	7154	7360	9506	11075	12647	13809	14654	23983	28760	31752
	Real	4793	5716	5635	5398	6312	6880	7268	7404	7500	11967	13796	14754
	PC (Rs.)	852	1004	979	928	1073	1158	1211	1221	1225	1936	2212	2345
	GSDP %	2.36	2.5	2.31	2.18	2.31	2.43	2.42	2.25	2.14	3.15	3.38	3.33
Grants	Nominal	4813	5027	5332	7883	6869	8168	7809	9099	14619	13929	15703	15736
	Real	4292	4239	4200	5782	4561	5074	4487	4878	7482	6950	7532	7312
	PC (Rs.)	763	745	730	994	776	854	748	805	1222	1125	1208	1162
	GSDP %	2.12	1.86	1.72	2.34	1.67	1.79	1.49	1.48	2.13	1.83	1.85	1.65

Source: Finance Department-GOK

Note: Values in Nominal and Real Terms are in Rs. Crores, PC: Per Capita (INRs in real Terms) , data for 2017-18 is Revised Estimate

Table 2.2: Composition of revenue receipts (Percentage to total Revenue Receipts)

YEARS	Own-tax Revenue		Non Tax Revenue		Share Central Taxes		GRANTS	
	% to RR	Growth	% to RR	Growth	% to RR	Growth	% to RR	Growth
2006-07	61.99	25.06	10.9	3.09	14.3	27.56	12.8	32.52
2007-08	63.15	11.52	8.16	-18.06	16.47	26.14	12.22	4.45
2008-09	63.86	6.39	7.3	-5.93	16.53	5.53	12.32	6.07
2009-10	62.21	10.61	6.78	5.54	14.97	2.88	16.04	47.84
2010-11	66.1	25.82	5.77	0.72	16.33	29.16	11.8	-12.86
2011-12	66.58	20.8	5.85	21.71	15.87	16.51	11.7	18.91
2012-13	68.76	15.66	5.07	-2.96	16.18	14.19	9.99	-4.4
2013-14	69.91	16.46	4.5	1.66	15.42	9.19	10.16	16.52
2014-15	67.39	12.1	4.5	16.27	14.07	6.12	14.04	60.67
2015-16	63.59	7.65	4.51	14.23	20.18	63.66	11.72	-4.72
2016-17	62.27	9.8	4.35	8.22	21.59	19.92	11.79	12.74
2017-18 RE	62.81	10.56	4.68	17.83	21.74	10.4	10.78	0.21
2018-19 BE	63.55	12.78	5.02	19.55	22.25	14.06	9.18	-5.05

Source: Finance Department-GOK

Table 2.3: Annual Average Growth Rate of Revenue Receipts

Time Points	RR	OTR	NTR	SCT	Grants
1991-92 to 2002-03	11.85	12.49	8.76	12.80	13.96
2003-04 to 2006-07	23.61	22.31	43.78	18.04	32.27
2007-08 to 200910	9.56	9.51	-6.16	11.52	19.45
2010-11 to 2014-15	16.24	18.17	7.49	15.03	15.77
2015-16 to 2018-19BE	11.82	10.20	14.96	27.01	0.80

Source: Finance Department-GOK

RATES OF GROWTH - REVENUE RECEIPTS AND GSDP

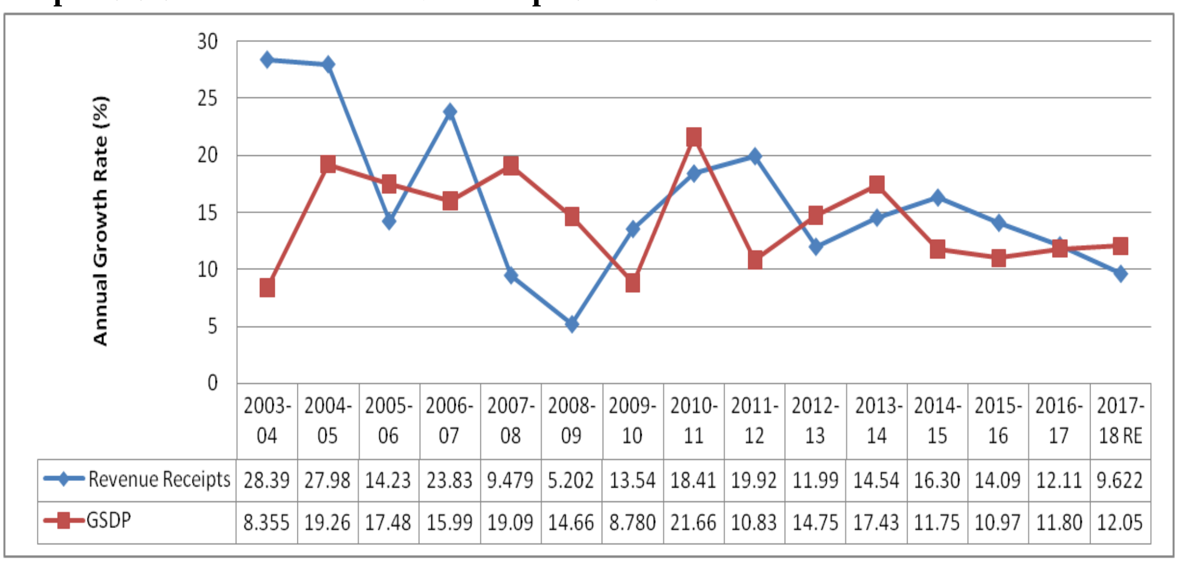
Revenue receipts of Karnataka have been growing at a lesser rate than that of GSDP for seven (7) years from 2003-04 to 2017-18 RE (Graph 2.1.1) which imply that the growth in collection of taxes has been growth in economy. Ideally, a buoyant tax revenue should grow with the growth of the economy. Especially, growth of receipts is significantly lesser with regard to the time period of 2006-07 to 2017-18 (RE) as six (6) out of twelve (12) years in this period reveal lesser growth than the GSDP. It is evident from the table 2.1 that the growth of revenue receipts has declined from 2007-08 to 2008-09 this was caused by the recessionary trends and also reduction in rates of taxes by the government to revive the economic activity. Hence, at the outset it is seems that there is no coherence between the growth rate of GSDP and Revenue Receipts. However, if the entire period is concerned the difference is marginal in terms of annual average growth rate of GSDP (14.33 %) and Revenue Receipts (15.98%).

Table 2.4: Revenue Receipts and GSDP: Growth Rate

Year	Revenue Receipts		GSDP	
	Value in Rs. Crore	Growth %	Value in Rs. Crore	Growth %
2006-07	37587	23.84	227237	15.99
2007-08	41150	9.48	270629	19.10
2008-09	43291	5.20	310312	14.66
2009-10	49156	13.55	337559	8.78
2010-11	58206	18.41	410703	21.67
2011-12	69806	19.93	455212	10.84
2012-13	78176	11.99	522369	14.75
2013-14	89544	14.54	613450	17.44
2014-15	104142	16.30	685547	11.75
2015-16	118817	14.09	760781	10.97
2016-17	133214	12.12	850612	11.81
2017-18 RE	146033	9.62	953137	12.05

***Source*: Finance Department-GOK, GSDP has taken from CSO**

Graph 2.1.1: GSDP and Revenue Receipts: Annual Growth Rate



Source: Same as Table 2.4

REVENUE BUOYANCY

Tax buoyancy is a key indicator to assess the performance of taxes. Buoyancy for own tax revenue is above unity in the post KFRA period. The buoyancy of revenue receipts was lesser than to unity in the pre KFRA period however, it performed well after the reforms. Non-Tax revenue is less buoyant in almost all the time points except for the recent period. The buoyant own tax and revenue resources in the post KFRA period is a good trend for state finances and the state should sustain this in the long run to achieve fiscal sustainability, however, the sustainability is subject to prudent spending of these resources. Buoyancy of Revenue receipts and own tax revenue after the implementation of 14th Finance Commission is below the unity.

Table 2.5: Buoyancy of State's Revenue Receipts

Time Points	Revenue Receipts	Own Tax Revenue	Non-Tax Revenue
1991-92 to 2002-03	0.93	1.06	0.11
2003-04 to 2006-07	1.45	1.56	0.41
2007-08 to 2009-10	1.59	0.28	-1.61
2010-11 to 2014-15	1.32	1.42	0.27
2015-16 to 2017-18	0.87	0.78	1.12

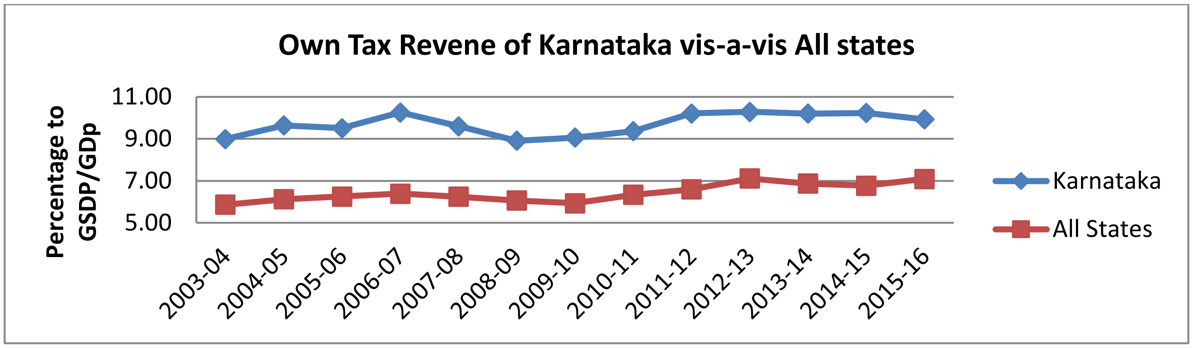
Source: Authors' computation based data from Finance Department, GoK

TRENDS IN TAX AND NON-TAX RESOURCES IN KARNATAKA: VIS-A-VIS ALL STATES

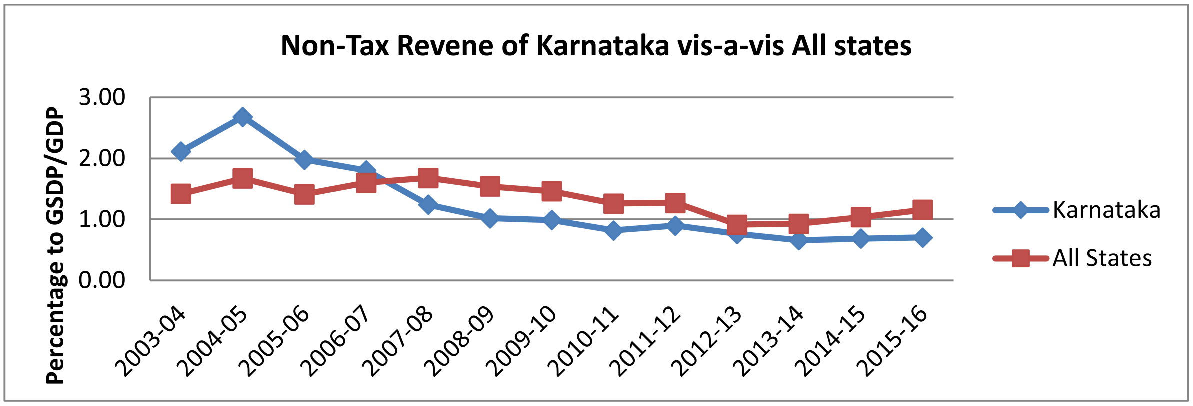
State's own resources constitute a major share in the total revenue resources- the share of state's own tax being 63.55 percent and that of non-tax revenue being 5.02 percent in 2018-19 (BE). While the state's performance with reference to own taxes as compared to that of all states have been exemplary that of non-tax revenue has deteriorated over time. The small and declining share of the non-tax revenue has been an area of concern for the state government. The non-tax revenue has in absolute terms increased from Rs 2958 crore in 2003-04 to Rs 8163 crore in 2018-19 (BE). Its share in GSDP has declined from 2.12 percent in 2003-04 to 0.72 percent in 2017-18 (RE). These trends are depicted in Graph 2.1.2. A more detailed analysis of non-tax revenue is presented later in the chapter after providing an analysis of tax revenue in Karnataka.

In terms of Own Tax Revenue (OTR) though the state of Karnataka possessing higher share of GSDP compared to that of all states put together its trend across time points seems to be similar. The share of OTR for both the cases declined 2007-08 to 2010-11 and this phenomenon may be partly due to recessionary trends prevailing at that point of time.

Graph 2.1.2: Tax and Non-tax performance: Karnataka-vis-à-vis All States



Source: RBI, State Finances (Various Years)



Source: RBI, State Finances (Various Years)

Karnataka government has very well recognized the poor performance on account of non-tax revenues (NTR) and has acknowledged the need to revise it from time to time. It is stated "The ratio of non-tax revenues (NTR) to the GSDP has declined over time and this is a matter of great concern. While Non Tax resources accounted for 30% of state's resources in 1976, now after 30 years they account for only 11.63% of the resources of the state. One of the main reasons for the declining contribution of Non Tax revenues is non revision of user charges, levies, fees and royalties." (MTFP, 2006-10, p24)

TRENDS IN MAJOR TAXES

Revenue from major taxes as percent to GSDP, its compound growth rates and buoyancy details are presented in tables 2.6 and 2.7. The performance of major taxes in Karnataka as percent of GSDP to that of all states is presented in Graph 2.1.6.

Table 2.6: Revenue performance of Karnataka (percent to GSDP)

Year	Own tax revenue	Land Revenue	Sales Tax	State Excise	Stamp, Reg Fee	Taxes on Motor Vehicles
2006-07	10.25	0.05	5.18	1.98	1.41	0.60
2007-08	9.60	0.05	5.13	1.76	1.26	0.61
2008-09	8.91	0.08	4.71	1.85	0.94	0.54
2009-10	9.06	0.04	4.69	2.06	0.78	0.58
2010-11	9.37	0.04	4.93	2.02	0.86	0.62
2011-12	10.21	0.05	5.50	2.15	1.02	0.65
2012-13	10.29	0.04	5.44	2.12	1.00	0.73
2013-14	10.21	0.03	5.50	2.09	1.01	0.64
2014-15	10.24	0.03	5.58	2.01	1.02	0.66
2015-16	9.93	0.02	5.32	2.02	1.08	0.66
2016-17	9.75	0.02	5.42	1.94	0.92	0.66
2017-18 RE	9.62	0.03	5.89	1.85	0.94	0.63

Source: Finance Department-GOK

SALES TAX

Sales tax: Sales tax revenue has increased from Rs 11, 762 crore in 2006-07 to Rs 67, 006 crore in 2018-19 BE which is subsumed in GST from July 2017-18. It constitutes the largest share in the own tax revenue of the state. Its share in the GSDP has increased from 5.18 percent to 5.42 percent from 2006-07 to 2016-17 after reaching its peak in 2011-12 at 5.50 percent. The share of sales tax was above 5 percent of GSDP during the period 2005-06 to 2016-17 barring three years in between. However, it has witnessed a sudden fall in the year 2017-18 (RE).

Sales tax has become more buoyant after the launch of reform initiatives except the period of economic recession (2007-08 to 2009-10). It has increased from 0.88 percent (1991-92 to 2002-03) to 1.35 after 2002-03 till 2006-07 (Table 2.8). However, it was negatively buoyant during 2007-08 to 2009-10 and this is mainly due to a steep decline of tax buoyancy after the year 2006-07.The sales tax in Karnataka has also performed better than that of 'All states', the share of which in GDP has ranged between 4.24 percent (2002-03) and 5.89 percent (2017-18RE). Annual average growth (Table 2.7) of sales tax also depicts that the growth is substantially higher during 2003-04 to 2006-07 at 21.23 percent i.e. during the initial years of KFRA and tax reforms than that of pre KFRA(1991-92 to 2002-03) which had revealed 11.76 percent increase. The reforms were attempted with the following objectives (MTFP, 2007-11, p 22):

- Increasing the tax base
- Commodity wise data analysis and intelligence
- Rigorous audit and enforcement

- Incorporating Computerization in not only database maintenance but also improving and simplifying taxpayer services.
- Devising appropriate strategy to ensure collection of arrears of taxes

Growth in the sales tax revenue can be largely attributed to the Information Technology initiatives that the Commercial taxes department has introduced for providing most of the services. More than 80 percent of the revenue is mobilized through electronic mode. There are however issues such as the loss of revenue on account of various incentives and concessions announced by the government and also cases of non-recovery of arrears pertaining to deferred tax amounts given by way of industry concessions. CAG reports also raise issues such as under assessment, non/ short levy of taxes, excess input tax credit claims etc., Tax administration has been of late strengthened by the government through the e-initiatives, however, it is very important to set right the issues of input tax credit as this can become a more serious issue with the introduction of GST.

Table 2.7: Annual Average growth rates: own tax categories

Year	Sales Tax	State Excise	Taxes on Motor	Stamps &Regn	Land Revenue	OTR
1991-92 to 2002-03	11.76	14.11	13.00	18.29	13.88	12.49
2003-04 to 2006-07	21.23	21.27	19.52	30.50	19.92	22.31
2007-08 to 2009-10	10.55	15.82	12.87	-6.01	19.85	9.51
2010-11 to 2014-15	19.45	14.79	18.74	22.06	9.13	18.17
2015-16 to 2018-19 BE	15.18	7.98	7.33	10.70	11.67	10.20

Source: Finance Department-GoK, OTR: Own Tax Revenue

STATE EXCISE

Revenue from State Excise has increased from Rs 4, 495 crore in 2006-07 to Rs 18, 750 crore in 2018-19 (BE). Its share in the GSDP has increased significantly from 1.98 percent to 2.02 percent during 2006-07 to 2015-16 however, reduced marginally in recent two years. The share of state excise in GSDP is relatively larger in during 2009-10 to 2015-16.State Excise too has become more buoyant after the KFRA as it has increased from 0.83 (1980-81- 2001-02) percent to 1.09 percent (2002-03 to 2017-18 RE). The department has intensified patrolling and surveillance on manufacturing and selling units. There are also proposals to use Information Technology to enhance growth of revenue.

STAMPS AND REGISTRATION

Revenue from the Stamps and Registration has increased from Rs 3, 206 crore in 2006-07 to Rs 10, 400 crore 2018-19 (BE).As a percent of GSDP, it has been fluctuating. There has been an increase until 2007-08 followed by a gradual decline until 2008-09 followed by a marginal increase till 2015-16 which declined gradually further. Unlike Sales tax and Excise Duty, the Stamps and

Registration buoyancy which was less than unity prior to reforms has declined further during the post reform period. This is definitely a cause for concern and there is need for more reform initiatives. Some measures of department include anywhere registration facility, it has facilitated registration with any Sub Registrar office within a district. It is a citizen friendly move. The department is contemplating to create a dedicated cell as started by Government of Maharashtra to regularly advise on guidance value revision.

MOTOR VEHICLES TAX

State's revenue from Motor Vehicles source has increased from Rs 1, 374 crore in 2006-07 to Rs 6, 600 crore in 2018-19 (BE). Its share in the GSDP has increased from 0.60 percent to 0.63 percent during the reference period. Motor vehicle tax too has become more buoyant after the reforms improving from 0.57 percent to 1.09 percent. Motor Vehicles department too has been extensively resorting to use of Information Technology in the provision of its services such as issuance of driving licenses, issue of permits, registration certificates etc.

Table 2.8: Buoyancy of State Major Taxes

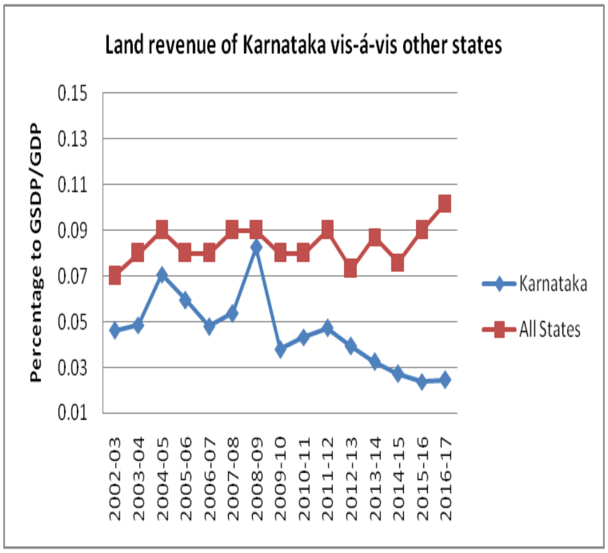
Time Points	Own Tax Revenue	Sales Tax	State Excise	Stamps and Registration	Tax on Motor
1991-92 to 2002-03	1.06	0.88	1.37	2.17	0.67
2003-04 to 2006-07	1.56	1.35	1.74	2.81	1.23
2006-07 to 2009-10	0.28	-0.10	3.15	-3.88	0.40
2010-11 to 2014-15	1.42	1.60	0.99	1.86	1.30
2015-16 to 2017-18	0.78	1.76	0.41	0.12	0.71

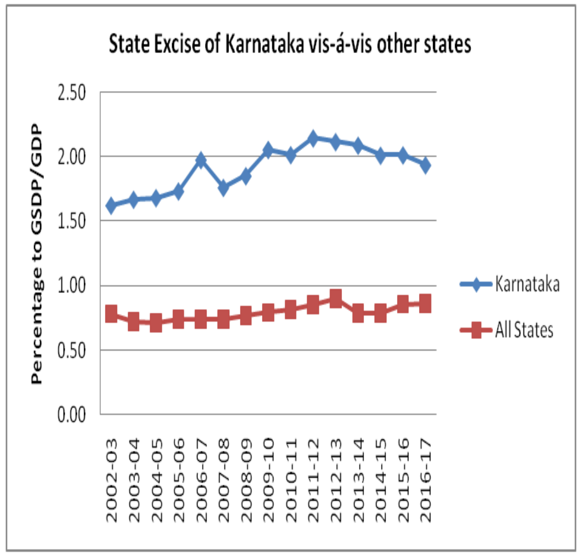
Source: Author's computation based data from Finance Department, GoK

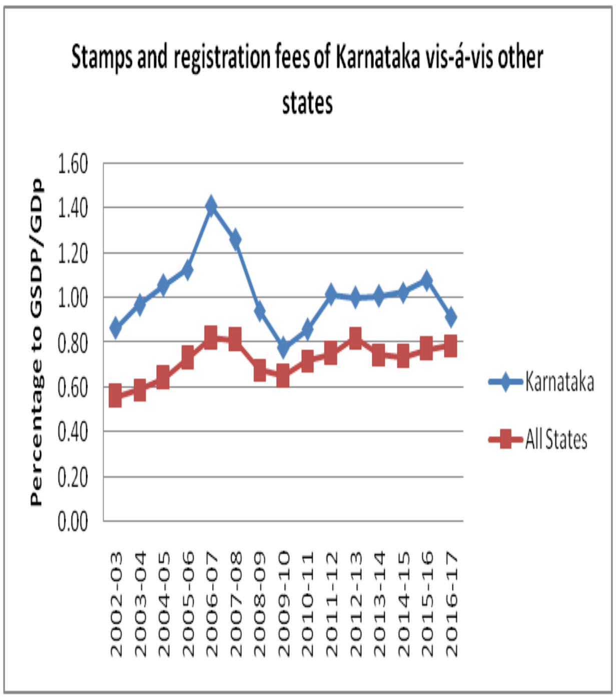
MAJOR TAXES- KARNATAKA VIS-À-VIS OTHER STATES

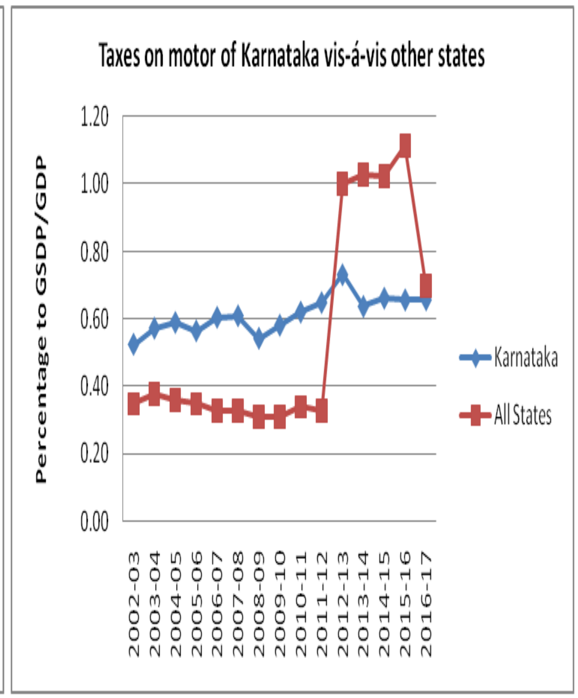
Performance of major taxes as percent to GSDP as presented in Graph 2.1.6 is much better in Karnataka as compared to 'All states', with the exception of land revenue that had a very small share in the total and also on the decline. The 'All states' major taxes have improved their performance especially that of Stamps and Registration, Sales tax and Motor Vehicles, thus reducing the gap.

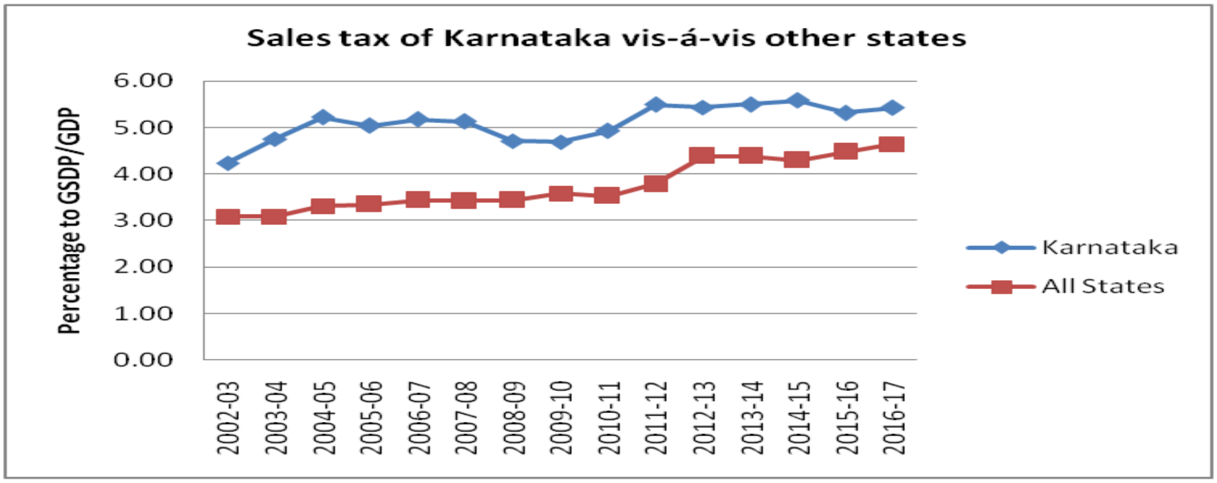
Graph 2.1.6: Major taxes as percent to GSDP: Karnataka visa-vis other states (source: RBI)


Land revenue of Karnataka vis-á-vis other states
Percentage to GSDP/GDP
0.15
0.13
0.11
0.09
0.07
0.05
0.03
0.01
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
Karnataka
All States


State Excise of Karnataka vis-á-vis other states
Percentage to GSDP/GDP
2.50
2.00
1.50
1.00
0.50
0.00
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
Karnataka
All States


Stamps and registration fees of Karnataka vis-á-vis other states
Percentage to GSDP/GDp
1.60
1.40
1.20
1.00
0.80
0.60
0.40
0.20
0.00
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
Karnataka
All States


Taxes on motor of Karnataka vis-á-vis other states
Percentage to GSDP/GDP
1.20
1.00
0.80
0.60
0.40
0.20
0.00
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
Karnataka
All States



NON TAX REVENUE IN KARNATAKA

Karnataka's non tax performance has not been satisfactory, it has not only deteriorated over time but also has trailed behind that of all states. Karnataka's non tax revenue as percent of GSDP has declined from 2.12 (higher than that of all states) in 2003-04 to 0.70 percent in 2015-16, where as that of all states has declined from 1.42 percent to 1.16 percent during the above reference period (Table 2.9). The non-tax revenue was higher than that of all states till 2006-07. A reversal in the trend is seen after that. Steady decline of revenues from the general services may be one of the reasons for the state of Karnataka to lag behind in collecting non tax revenue.

Table 2.9: Non tax revenue Karnataka Vis a Vis all states (Percent of GDP)

Items/Years	Non tax revenue (K)	Non tax revenue (AS)	Interest Receipts (K)	Interest Receipts (AS)	Dividends and profits (K)	Dividends and profits (AS)	General Services (K)	General Services (AS)	Social Services (K)	Social Services (AS)	Economic Services (K)	Economic Services (AS)
2002-03	0.99	1.5	0.03	0.37	0.01	0.01	0.27	0.37	0.14	0.12	0.54	0.61
2003-04	2.12	1.42	0.08	0.3	0.01	0.01	1.28	0.36	0.09	0.12	0.66	0.63
2004-05	2.68	1.57	0.09	0.29	0.01	0.01	1.26	0.37	0.09	0.12	1.24	0.77
2005-06	1.98	1.41	0.14	0.28	0.01	0.02	1.04	0.35	0.07	0.13	0.72	0.64
2006-07	1.80	1.6	0.17	0.3	0.01	0.02	0.94	0.47	0.06	0.18	0.63	0.64
2007-08	1.24	1.68	0.14	0.28	0.01	0.01	0.25	0.58	0.07	0.17	0.78	0.65
2008-09	1.02	1.54	0.11	0.31	0.01	0.02	0.22	0.42	0.06	0.15	0.62	0.65
2009-10	0.99	1.46	0.11	0.25	0.01	0.01	0.25	0.39	0.07	0.15	0.54	0.65
2010-11	0.82	1.26	0.14	0.22	0.01	0.01	0.02	0.26	0.08	0.16	0.56	0.61
2011-12	0.90	1.27	0.10	0.02	0.01	0.01	0.14	0.2	0.08	0.19	0.57	0.64
2012-13	0.76	0.91	0.15	0.27	0.01	0.01	0.10	0.2	0.07	0.2	0.43	0.21
2013-14	0.66	0.93	0.11	0.27	0.01	0.02	0.10	0.19	0.08	0.22	0.36	0.24
2014-15	0.68	1.04	0.11	0.22	0.01	0.01	0.09	0.3	0.08	0.23	0.04	0.26
2015-16	0.70	1.16	0.10	0.16	0.01	0.01	0.11	0.34	0.07	0.27	0.34	0.26

Source: Department of Finance, GoK and RBI, State Finances

Non tax revenue as percent of respective functional heads of expenditure reveals (Table 2.10) that there has been a decline during the reference period. The share of economic services has dwindled to 9.59 from 13.68 percent in 2006-07 to 2018-19 B.E and that of General services has declined from 20.41 percent to 2.72 percent during the reference period. This is despite a sharp increase in the functional categories of expenditure. While one of the reasons is the retention of user charges by departments concerned, the cost recovery has been abysmally low and does not even cover the operation and maintenance charges incurred by the government in the provision of these services. Government has acknowledged this issue and states, “The collection from several Non-tax sources is so low that even doubling of user charges or fees in one stroke may not lead to immediate generation of appreciable resources, but for the end user it might mean a sudden and high revision, causing a disincentive to comply. When the user charges are revised the fixation of rates is often on the basis of arbitrary criteria. A *de novo* review of most of these rates is necessary. A policy will be formulated to fix the user charges and other rates of non-tax revenues based on factors such as nature of the levy (i.e. whether it is regulatory or service charge etc.), cost of provisioning of services, cost of collection etc. A committee will be constituted to take a fresh look at the revision of user charges. While the first problem relates to appropriateness of the rates of non-tax revenues, the second problem lies in their collection. There is at present, no proper practice in place at the level of field departments for review of recovery of user charges. Regular monitoring of recovery will have to be made part of regular departmental and State level reviews.” MTFP, 2006-10 p 24) Government also recognises that, “The condition and quality of public services has made the task of making any appreciable changes in user fees difficult.” (MTFP, 2007-11, p 16)Further this issue was addressed by the Expenditure Reforms Commission (ERC) which had recommended that government should articulate a policy on user charges so that it is firmly on the agenda of every department (GoK, ERC, 2011, 41)..The hard data however does not reflect much of improvement indicating that non-tax continues to be a major issue in Karnataka.

Table 2.10: Non Tax Revenue as (% of Expenditure of Functional Categories)

Years/Items	General Services		Social Services		Economic Services	
	Receipt	% to Exp (GS)	Rev Receipt	% to Exp (SS)	Rev Receipt	% to Exp (ES)
2006-07	2126.8	20.41	147.56	1.35	1428.36	13.68
2007-08	679.09	6.25	181.39	1.38	2098.52	18.32
2008-09	675.81	5.51	185.7	1.17	1920.16	17.24
2009-10	845.87	6.63	238.6	1.25	1835.98	13.93
2010-11	97.52	0.69	330.47	1.49	2311.78	15.52
2011-12	634.46	3.86	381.92	1.52	2575.70	13.45
2012-13	503.97	2.50	383.19	1.26	2244.10	10.35
2013-14	611.66	2.45	491.49	1.51	2180.08	8.20
2014-15	618.69	2.19	533.37	1.35	2586.60	8.63
2015-16	844.27	2.74	548.84	1.19	2599.90	7.68
2016-17	728.64	2.33	485.90	0.89	3297.75	8.16
2017-18 RE	1028.60	2.85	808.30	1.40	3591.22	8.06
2018-19 BE	1224.35	2.72	889.50	1.39	4553.18	9.59

Source: Finance Department, Gok

DEPARTMENTAL ENTERPRISES

Huge investment has been made by Government of Karnataka to the tune of Rs 63115 crore (as of March 31 2016) in 68 government companies (Rs 57606.01 crore), 16 non-working government companies (67crore) 9 statutory corporations (Rs 2520.36 crore) 43 Joint Stock Companies (Rs 2523.85 crore) and Cooperative institutions, local bodies and regional rural banks (Rs 652.29 crore), financial return, however has been very meagre. (CAG, 2016) The Department of Disinvestment and Public Enterprises Reform has been vested with the responsibility in the matters of disinvestment, restructuring and amalgamation and the department has been accorded independent status and named as Department of Public Enterprises. Thirteenth Finance Commission had recommended that state government should draw up a road map for closure of non working companies by March 2011; however, it is not clear as to what action has been initiated by the government in this regard. The Department of Public Enterprises has very recently (2014) initiated a number of studies through professional institutions to study the working of these enterprises and to locate the remedial measures for their sickness.

ENHANCING REVENUE PRODUCTIVITY: ISSUES AND OPTIONS

State's revenue resources have proved to be more buoyant during post FRA period as compared to the pre FRA phase. However, this is largely due to the own tax revenue whose buoyancy increased from 1.001 to 1.05 as compared to the non tax revenue whose buoyancy has turned negative at – 0.439 during the post reform phase as compared to 0.238 during the pre FRA phase. Hence, the state needs to tone up the non-tax revenue in a significant manner by framing a clear policy on user charges. The IT initiatives of the Commercial Taxes Department with 80 percent of revenue realized through electronic mode and Any where registration in Stamps and Registration department have helped in substantially improving the tax administration and yield of revenue. Similar initiatives can be introduced in the other tax departments too to improve tax administration and generate more revenue. It is often argued that the state's tax performance has been commendable, but the state has almost reached the tax plateau and further enhancement is largely possible only through higher economic growth. Sales tax, the major component in state's own tax revenue has however has experienced a negative growth after 2015-16.The sharp reduction in the rate of growth of tax revenue during the recent recession reveals that rate of growth of economy impacts the tax revenues in a significant manner. Managing the tempo of economic growth remains a major challenge with the state government by way of enhancing productive capital investments to generate social and economic infrastructure that helps in crowding in private investments in a big way.

Appendix 2.1A: GSDP of Karnataka (Rs. in crore)

GSDP Factor Cost				GSDP 2004-05 Series		
Base		**Current Prices**	**Constant Prices**	**Year**	**Current**	**Constant**
Base: 1980-81	**1990-91**	23300	10260	**1990-91**	28481	70086
	1991-92	30092	11494	**1991-92**	36782	78519
	1992-93	33036	11810	**1992-93**	40380	80678
	1993-94	38241		**1993-94**	46743	86598
Base: 1993-94	**1993-94**	41079	41079	**1994-95**	54521	91463
	1994-95	47915	43387	**1995-96**	63965	97323
	1995-96	56215	46167	**1996-97**	74162	106041
	1996-97	65176	50302	**1997-98**	83117	113368
	1997-98	73046	53778	**1998-99**	99952	127791
	1998-99	87841	60620	**1999-00**	108066	134603
	1999-00	94972	63851	**2000-01**	115660	136516
Base: 1999-00	**1999-00**	101247	101247	**2001-02**	120446	140336
	2000-01	108362	102687	**2002-03**	129030	146717
	2001-02	112847	105560	**2003-04**	139812	151787
	2002-03	120889	110360	**2004-05**	166747	166747
	2003-04	130990	114174	**2005-06**	195904	184277
	2004-05	156226	125426	**2006-07**	227237	202660
Base: 2004-05	**2004-05**	166747	166747	**2007-08**	270629	228202
	2005-06	195904	184277	**2008-09**	310312	244421
	2006-07	227237	202660	**2009-10**	337559	247590
	2007-08	270629	228202	**2010-11**	410703	272721
	2008-09	310312	244421	**2011-12**	455212	282784
	2009-10	337559	247590	**2012-13**	522369	300181
	2010-11	410703	272721	**2013-14**	613450	328905
	2011-12	455212	282784	**2014-15**	685547	350865
Base: 2011-12	**2011-12**	606010	606010	**2015-16**	760781	379605
	2012-13	695413	643292	**2016-17**	850612	408021
	2013-14	816666	704849	**2017-18**	953137	442886
	2014-15	912647	751908			
	2015-16	1012804	813497			
	2016-17	1132393	874395			
	2017-18	1268881	949111			

Source: RBI

CHAPTER 3
PUBLIC EXPENDITURE REVIEW OF KARNATAKA

The steady fiscal reform path pursued by the Karnataka state government and the revenue reform efforts have resulted in a drastic improvement in state's fiscal health over the decade of nineties as indicated by the macro fiscal indicators."Sustaining this fiscal prudence in the long run and creation of fiscal space however is possible only by introducing well thought-out reforms in public expenditure planning and management. The public expenditure planning has to be guided by the current achievements and the felt needs of the public in the respective sectors. This requires a complete review of the governmental schemes and programs implemented by each department vis-à-vis their impact on the sector's development in the light of the changing 'Role of State'. (Gayithri, 2014).

PUBLIC EXPENDITURE REVIEW: BROAD CATEGORIES

Public expenditure is broadly categorized under accounting classification, comprising of 'Revenue' and Capital disbursements', the latter is further divided under ' capital outlays', Public debt repayment' and 'loans and advances'. Expenditure incurred under both the revenue and capital accounts is further categorized by functional categories, 'General Services' Social and Community services' and Economic services', indicating the purpose or function, for which the expenditure is incurred. The latter two categories together are considered as 'Development expenditure' and the former as 'non-development expenditure. Another important category used for long in Indian context related to 'plan' and 'non-plan' expenditure, which however has been given up from 2017-18 FY. In the conduct of analysis of the huge amount of expenditure, it becomes imperative to scrutinize appropriate forms of aggregation to derive the corrective measures based on the directional changes occurring in the public expenditure.

This chapter begins by discussing the expenditure reforms undertaken/proposed after 2006-07 followed by the discussion of few trends and composition in the above mentioned expenditure aggregates. An attempt is also made to compare Karnataka's trends with those in the other Southern states to have a better understanding of the Karnataka's public spending pattern.. While these kinds of analysis may provide a broad summary of the nature of government expenditure the ultimate test to the spending lies in the end service delivery to the citizens and the efficiency and effectiveness with which these services are delivered. In this connection, the existing research evidence is used to indicate the state's performance in service delivery.

EXPENDITURE REFORMS IN KARNATAKA

Karnataka is one of the progressive states to implement early fiscal reforms. The state is one the first to implement Fiscal Responsibility Act (FRA). Karnataka has initiated many expenditure reforms to contain deficits, debt within the permissible limits and to achieve the desired level of outcomes. The Expenditure reforms undertaken and proposed are briefly discussed in the following text box (Text Box 3.1).

TEXT BOX 3.1: EXPENDITURE REFORMS EVIDENT IN MTFP, GoK.

As per the mandate, Fiscal Management Review Committee (FMRC) was formed and it has met in the month of March 2015 to review the current fiscal situation. After detailed deliberations the committee noted that only an incremental growth is possible as far as tax revenues as the state has the highest tax to GSDP ratio among all States in the country. Hence, the focus of FMRC discussions remained on the expenditure re-prioritization. The committee suggested the following recommendations to improve the expenditure management in Karnataka:

- Critically examine expenditure requirements and priorities them with a focus on capital expenditure in order to generate productive assets that will help the economy to expand in the longer run.
- To minimize necessity of supplementary estimates, Administrative departments to make appropriate estimations of their expenditure requirements in the ensuing year at the time of budgeting itself. This would also help to maintain the integrity of Budget Estimates.
- While putting up additional requirement of funds, if any, for inclusion in supplementary estimates, departments to identify corresponding surrenders in their overall budgetary provisions by identifying low priority expenditures.
- For effective usage of available resources as against burgeoning expenditure demands, departments to move over to Medium Term (3 to 5 years) planning and implementation cycle. Departments to also explore possibility of PPP model wherever feasible.
- To critically assess the existing subsidies' net from the point of their effectiveness and to prune down non-merit subsidies in a phased manner to keep expenditure under sustainable levels. Hence expenditure on subsidies needs to be moderated in the medium to long term to make them fiscally sustainable.
- For effective utilization of available resources as well as to increase transparency, Departments to curtail usage of bank accounts and/or Personal Deposit Accounts for implementation of schemes and programs.
- Focus on consolidating existing institutions and improving their effectiveness.
- Regulation on creation of new posts, and filling up vacancies in noncore mandate areas.
- FMRC also re-iterated its earlier recommendation that all approvals for new initiatives and works requiring implementation over multiple years to be specifically based on fiscal sustainability of the total expenditure rather than expenditure during the year of approval only.

Linking outlays to outcomes is a major budgetary reform undertaken in Karnataka in order to improve the efficiency of expenditure. A new concept of presenting "Program Performance Budget (PPB)" by the departments is being formulated. These PPBs in addition to indicating the program wise outlays on a 7 year time frame will provide information on linked outputs and outcomes (MTFP, 2006-10)

Source: MTFP (2015-19), GoK

PUBLIC EXPENDITURE UNDER THE CONSOLIDATED FUND

Broad trends in expenditure are discussed for the time period, 2006-07 onwards as per the Terms of reference of the study. However, wherever necessary to have a more meaningful understanding of the trends and composition, the study attempts comparisons with the pre Fiscal reforms, i.e. 1991-2002-03; and 2003-04 till 2006-07- the initial years of fiscal reform, involving framing of Karnataka Fiscal Responsibility Act, and introduction of major tax reforms. The rest of the time period is categorised into sub periods to include, (i) 2007-08 till 2009-10- the global recession phase, involving fiscal stimulus and relaxed fiscal deficit targets; (ii) 2010-11 till 2014-15- the recovery phase and (iii) post 2015-16- the outcome of Fourteenth Finance Commission recommendations.

MAJOR EXPENDITURE INDICATORS AS A PERCENT OF GSDP

During the time period under consideration, total expenditure under the consolidated fund has reflected a 0.5 percent point increase, increasing from 19.4 percent of GSDP to 19.90 percent. By and large this increase is under the Revenue Expenditure (RE) accounting to the tune of 0.47 percent increase, the share of RE has increased from 14.71 percent to 15.28 percent. The revenue receipts (RR) on the contrary have declined from 16.54 percent to 15.32 percent, thus reducing the revenue surplus from 1.83 percent to 0.04 percent of GSDP, shrinking the space significantly for capital investments.

Table 3.1: Expenditure Indicators in Karnataka (Percent to GSDP)

Year	RR	RE	CE	GS	SS	ES	DE	NDE	PE	NPE	TE	TEC
2006-07	16.54	14.71	3.76	4.73	5.53	7.66	13.18	4.73	7.28	12.12	18.47	19.40
2007-08	15.21	13.81	3.20	4.14	5.86	6.57	12.43	4.14	6.01	11.74	17.01	17.78
2008-09	13.95	13.42	3.18	4.11	5.99	5.97	11.97	4.11	6.41	11.01	16.61	17.41
2009-10	14.56	14.08	3.60	3.93	6.69	6.62	13.31	3.93	7.22	11.43	17.68	18.65
2010-11	14.17	13.16	3.25	3.54	6.38	6.19	12.57	3.54	7.18	10.34	16.41	17.51
2011-12	15.33	14.30	3.41	3.75	6.46	6.94	13.40	3.75	7.74	11.10	17.71	18.84
2012-13	14.97	14.61	2.96	3.98	6.54	6.50	13.03	3.98	7.17	11.32	17.57	18.49
2013-14	14.60	14.54	2.76	4.15	5.89	6.56	12.45	4.15	7.21	10.82	17.30	18.04
2014-15	15.19	15.11	2.86	4.21	6.41	6.56	12.97	4.21	8.40	11.73	17.98	18.76
2015-16	15.62	15.38	2.72	4.18	6.83	6.39	13.21	4.18	7.48	9.98	18.11	18.73
2016-17	15.66	15.51	3.31	3.80	7.42	7.16	14.58	3.80	NA	NA	18.82	19.92
2017-18RE	15.32	15.28	3.28	3.90	7.07	7.33	14.40	3.90	NA	NA	18.56	19.90

Source: Author's Computation based GoK-Finance Department, and CSO (GSDP)
Note:RR: Revenue Receipts, RE: Revenue Expenditure CE: Capital Expenditure DE: Development Expenditure, NDE: Non-Development Expenditure, SS: Social Services, ES: Economic Services, GS: General Services, PE: Plan Expenditure, NPE: Non-Plan Expenditure, TE: Total Expenditure, TEC: Total Expenditure on Consolidated Fund.

Revenue surplus aids in augmenting capital investments which is a dire need of the state now to build the social and economic infrastructure of the state. Capital expenditure has had a decline from 3.76 percent in 2006-07 to 3.28 percent of GSDP in 2017-18 (RE) after reaching the lowest level of 2.72 percent in 2015-16. On a very positive note, the state has substantially been able to contain the non-development expenditure by 0.83 percent points and that of Social services significantly enhanced by 2.34 percent points. The share of Economic services has had a decline by 0.33 percent points. (Table 3.1) Thus the expenditure priority is in favour of Social and Community services comprising of expenditure that helps in human development. Prima facie this trend in expenditure reflecting priority to the building of state's human development is very important in the context of state's human development concerns (Gayithri, 2017). A more detailed discussion of the trends by major categories is presented in a subsequent section.

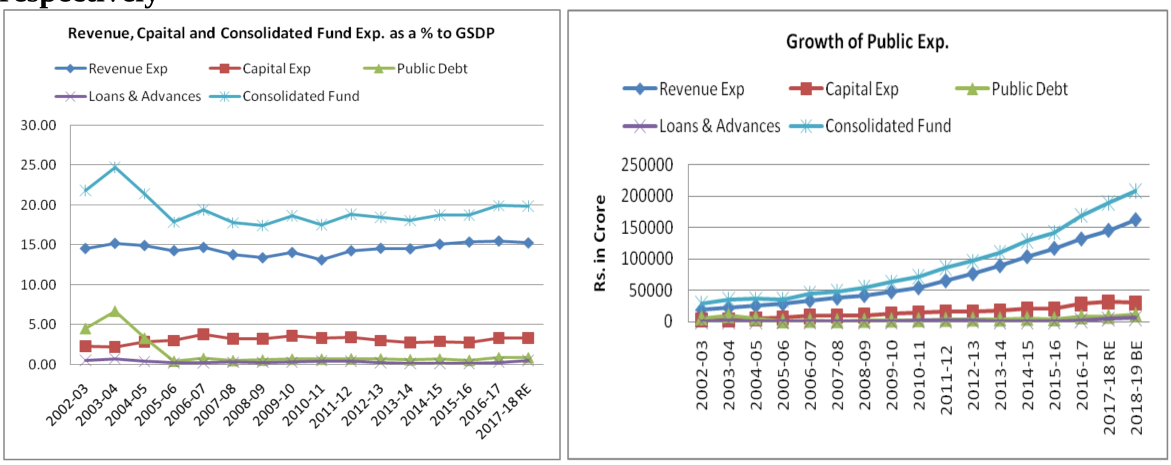
PUBLIC EXPENDITURE RATIO

To facilitate interstate/ country comparisons and the growth over time UNDP (1991) has proposed some ratios, one of them being public expenditure ratio. The norm in the context of state's participation in the human development suggests that public expenditure ratio should be in the range of 25 percent of the national income. The share of public expenditure in GSDP was 24.78 percent in 2003-04, the year in which FRA was operationalised declined to 19.4 percent in 2006-07 and increased to 19.90 percent in 2017-18RE (Graph 3.1.1a). The share has ranged between 17.41 percent (the lowest in 2008-09) and 24.78 percent (the highest in 2003-04). However, the public expenditure ratio to GSDP has remained considerably low for many years after 2006-07. On an average the total expenditure under Consolidated Fund constitutes 19.33 percent of GSDP with revenue and capital expenditure accounting for at 14.56 and 3.23 percent respectively since 2002-03. The total expenditure on consolidated fund as a share of GSDP has declined to 18.62 percent during 2006-07 to 2017-18RE as against 21.47 percent during 2002-03 to 2005-06(17.83, 20.86, 17.94, 18.32 and 19.51 respectively for the five time points).

GROWTH OF PUBLIC EXPENDITURE IN KARNATAKA

Total government expenditure under consolidated fund has increased from Rs 44084 crore in 2006-07 to Rs 209181 crore in 2018-19 (BE), an increase by 4.75 times. It has been mentioned earlier, this represents expenditure comprising the broad categories of revenue account and capital disbursements (consisting of capital account, public debt repayment and loans and advances).

Graph 3.1.1a and 3.1.1b: Public Expenditure in Karnataka: Percent to GSDP and growth respectively



Source: Author's Computation based on FD, GoK

The total expenditure has grown at 15.01 percent per annum during 1991-92 to 2002-03 and is highest during 2010-11 to 2014-15. As can be observed from Graph3.1.1b reveals that the rapid growth is largely governed by the growth in revenue expenditure. Public debt repayment and loans and advances category have a much smaller share.

Table 3.2: Annual Average Growth Rate of Select Fiscal Indicators

Time Points	RR	RE	CE	TE	ECF	PD	L &A	GSDP
1991-92 to 2002-03	11.85	13.05	14.27	12.96	15.01	88.12	26.60	12.20
2003-04 to 2006-07	23.61	15.49	32.19	17.97	12.52	12.60	-2.54	15.28
2007-08 to 2009-10	9.41	12.45	12.78	12.47	12.66	13.21	47.51	14.18
2010-11 to 2014-15	16.23	16.88	10.25	15.63	15.38	16.13	-2.36	15.29
2015-16 to 2018-19BE	11.82	11.94	11.87	11.80	12.98	27.93	93.12	11.61

Source: Author's Computation based of GoK, Finance Department

GROWTH IN PUBLIC EXPENDITURE: REVENUE AND CAPITAL CATEGORIES

Growth and composition of total Karnataka government expenditure by revenue and capital heads- the former denoting recurring and maintenance expenditure and the latter capital investments incurred by the government is discussed in the following. While the conventional public finance analysis supports growth in capital investments in view of the possible income and asset generation that are generally associated with such investments, the current thinking is that growth in revenue expenditure cannot be denounced either. This is in view of the fact that social sectors such as Education, Health etc. are man power intensive, hence largely get accounted under the revenue account. However, this manpower needs to be supplemented with adequate infrastructures such as schools and hospital buildings and other equipment to produce these services. In fact many studies have established that investments in education and health yield high social and economic returns.

TRENDS IN REVENUE AND CAPITAL HEADS OF EXPENDITURE

An analysis of the broad trends by the revenue and capital expenditure in Karnataka reveals that revenue expenditure has increased sharply from INR 33434crore in 2006-07 to INR 162637crore in 2018-19 (BE), an increase by 4.86 times. On the other hand, capital expenditure has increased from INR 8543 crore to INR 29691 crore, an increase by 3.47 times during the above reference period (Table 3.3). Growth in real terms has been of a much lesser order i.e. just about one-third of the nominal increase. In per capita real terms while revenue expenditure has slightly more than doubled from Rs 5300 to Rs 10757 that of capital expenditure has increased from Rs 1354 to Rs 2307 during the above reference period. The ratio has further tilted in favour of revenue expenditure.

REVENUE AND CAPITAL EXPENDITURE: PRE AND POST KFRA

It is essential to understand the changes in the quality of public spending after the introduction fiscal reforms and the framing of KFRA. The state has witnessed an improvement in the quality of spending as assessed by the composition of revenue and capital spending before and after the launch of KFRA. The ratio of revenue and capital spending to the total was 87.88 percent and 12.12 percent for the period 1991-92 to 2002-03. There has been a considerable increase in the share of capital spending immediately after the framing of KFRA to 16.45 percent 2003-04 to 2007-08, which further increased to 19.43 percent during 2007-08 till 2010-11, i.e. the recession phase. It has since dropped to 16.43 percent for the period 2015-16 till 2018-19 BE (Graph3.1.2a and b). On an average revenue and capital heads constitute 82.14 and 17.86 percent share in total expenditure; 14.49 and 3.19 percent share in GSDP during 2006-07 to 2018-19 BE.

In terms of Annual Average rate of growth Capital expenditure reveals a higher rate at 32.19percent during 2003-04 to 2006-07 and registered lowest during 2010-11 to 2014-15. The sharper growth in capital expenditure has largely occurred during the after 2002-03 caused by the recovery experienced by the state government finances following pronouncement of FRA and sound revenue position. Rates of growth of capital expenditure after 2007-08 is lower than pre KFRA period (1991-92 to 2001-02).(Table 3.2)

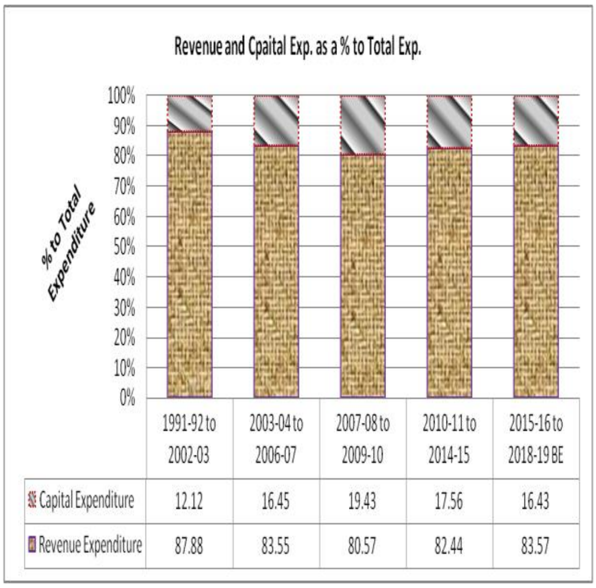
These are positive trends given the capital investment inadequacy in the past, however, it is important to note that the larger increase in capital spending that occurred after the KFRA until 2009-10 is not sustained in the subsequent period. The state should sustain these investments and even step it up further to not only address the infrastructure deficit in the state, but also to boost the economic growth further in view of the larger multiplier effects that capital spending tends to possess. (Bose, Sukanya and Bhanumurthy, 2016) The state should aim at further stepping it up to at least 5 percent of the GSDP and insulated from any kind of future fiscal adversities as recommended by the Expenditure Reforms Commission.

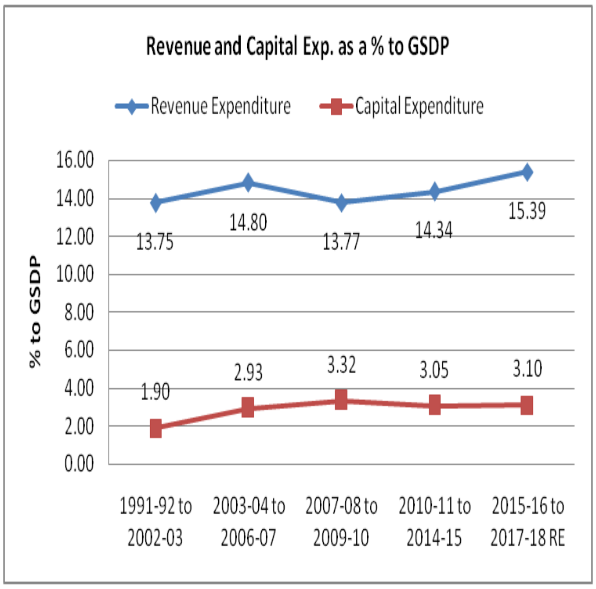
Table 3.3: Trends in Revenue and Capital Expenditure

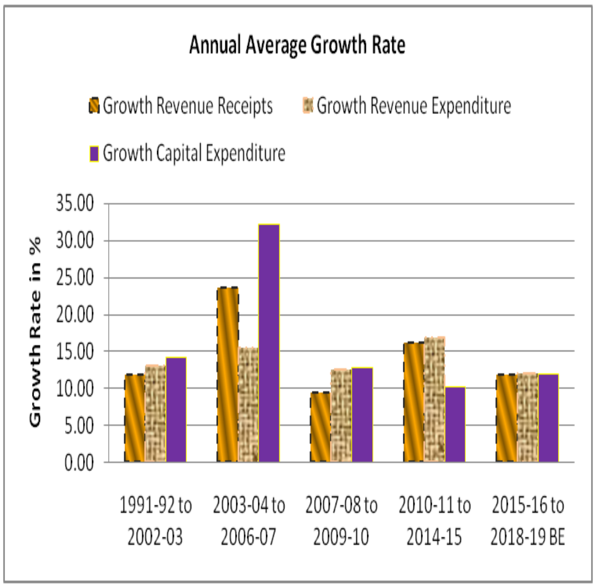
Year/ Particulars	Rvenue Expenditure					Capital Expenditure				
	Nominal	Real	PC (Rs.)	TE %	GSDP %	Nominal	Real	PC (Rs.)	TE %	GSDP %
2006-07	33435	29819	5300	79.65	14.71	8543	7619	1354	20.35	3.76
2007-08	37375	31516	5538	81.21	13.81	8649	7293	1282	18.79	3.20
2008-09	41659	32813	5702	80.85	13.42	9870	7774	1351	19.15	3.18
2009-10	47537	34867	5993	79.66	14.08	12137	8902	1530	20.34	3.60
2010-11	54034	35880	6102	80.18	13.16	13355	8868	1508	19.82	3.25
2011-12	65115	40450	6808	80.77	14.30	15506	9632	1621	19.23	3.41
2012-13	76293	43842	7304	83.13	14.61	15478	8895	1482	16.87	2.96
2013-14	89190	47820	7888	84.03	14.54	16947	9086	1499	15.97	2.76
2014-15	103614	53030	8663	84.08	15.11	19622	10043	1641	15.92	2.86
2015-16	117029	58394	9449	84.96	15.38	20713	10335	1672	15.04	2.72
2016-17	131921	63280	10145	82.41	15.51	28150	13503	2165	17.59	3.31
2017-18 RE	145649	67678	10757	82.34	15.28	31231	14512	2307	17.66	3.28
2018-19 BE	162637			84.56		29691			15.44	

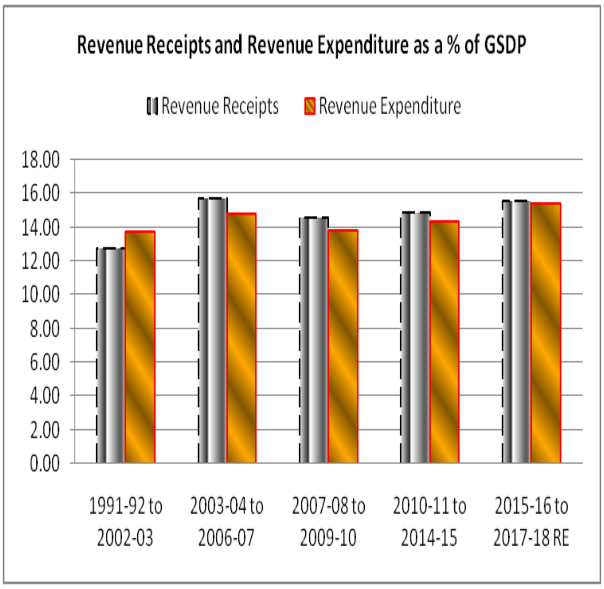
Source: FD, GoK,

Graph3.1.2a, b, c and d: Phase wise trends in revenue and capital spending







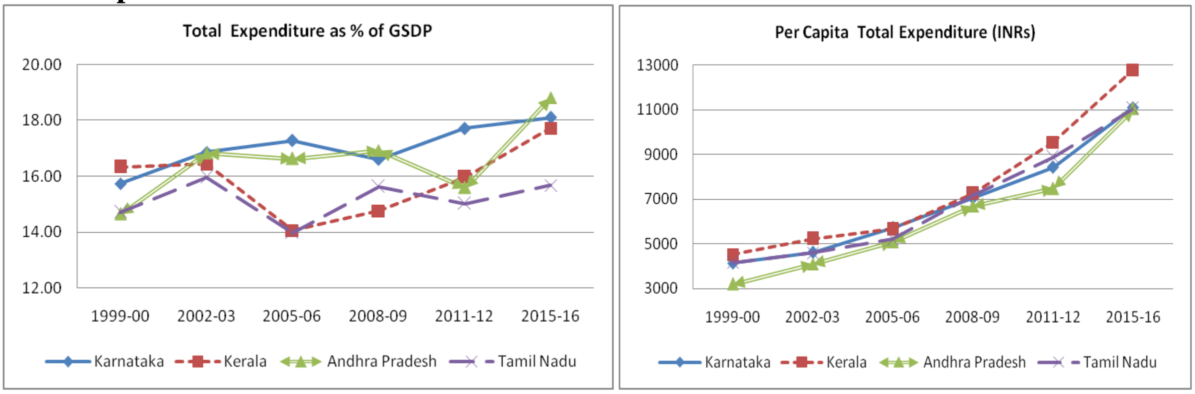


Source: Author's Computation Based on FD, GoK

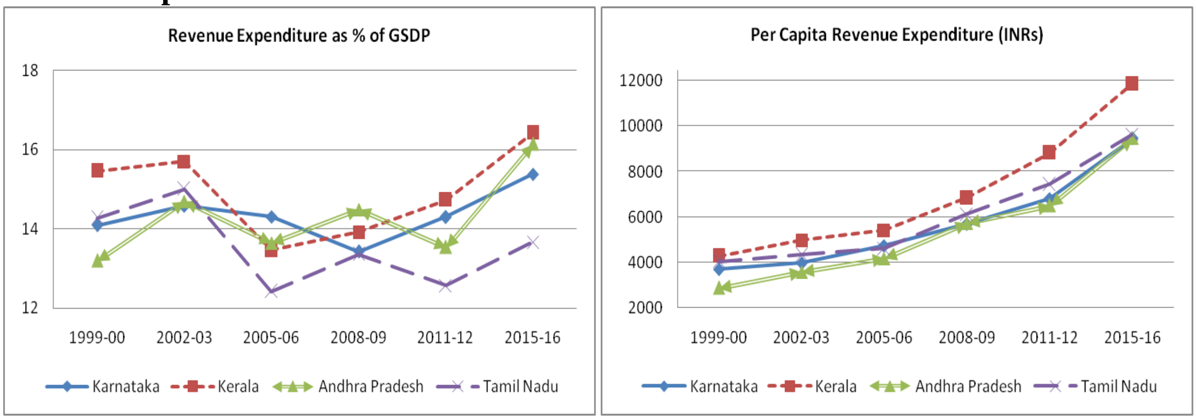
REVENUE AND CAPITAL EXPENDITURE TRENDS IN SOUTHERN STATES

A comparative trend analysis of revenue and capital expenditure in four southern states is presented in graphs 3.1.3a to 3.1.3f (please refer Appendix table 3.5A for details). Important observations from this analysis are that Karnataka's public expenditure ratio (Total Expenditure (Revenue +Capital) as percent of GSDP) is largely higher than all other southern states. (Kerala exceeds that of Karnataka in 1999-00 and AP exceeds in 2008-09 and 2015-16) By and large all the four states have an increased share in 2015-16, AP has the largest share followed by Karnataka. It can also be observed that Karnataka has higher share in capital expenditure to GSDP than all the states. Andhra Pradesh however has a higher share than Karnataka in the year 2005-06. In terms of per capita capital expenditure also Karnataka and Andhra Pradesh have higher levels; this has further increased after 2008-09. From these trends it can be inferred that while Karnataka's performance in terms of its allocation to capital investments in comparison with the revenue expenditure may not have been very satisfactory, these trends compare well with the other southern states.

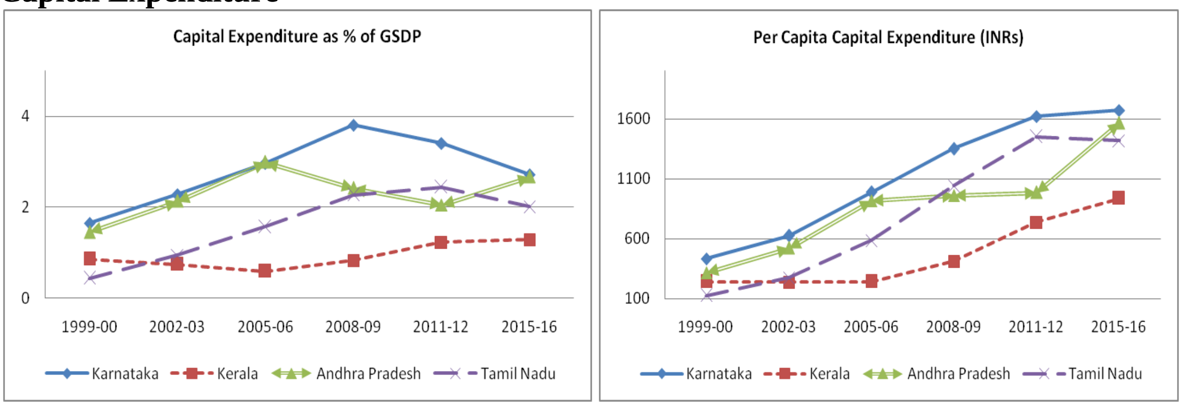
Graph 3.1.3a and 3.1.3b: Four Southern States Percentage of GSDP and Per Capita of Total Expenditure



Graph 3.1.3c and 3.1.3d: Four Southern States Percentage of GSDP and Per Capita of Revenue Expenditure



Graph 3.1.3e and 3.1.3f: Four Southern States Percentage of GSDP and Per Capita of Capital Expenditure



Source: Author's Computation based on FD, GoK

Karnataka's infrastructure performance:

It is important to examine the performance of the state on infrastructure delivery given the increased capital spending both in terms of relative share and also per capita spending over time, especially after the framing of KFRA. The state has also by and large performed better than the other southern states in per capita capital spending and also the relative share of capital spending in total. The infrastructure delivery composite scores and ranks developed by Sudipto Mundle et.al for two time points i.e. 2001 and 2011 (table 3.4) reveals that Karnataka has performed better than 19 other major Indian states and its relative rank has improved from 7 to 1 and there has been a considerable increase in the score from 0.5 to 0.7. These scores certainly account for an improved performance in Karnataka in a relative sense, however, the infrastructure delivery improvement is in the context of two variables i.e. 'State highways per 100 sq km of area' and 'per capita consumption of electricity consumption kWh' included in the study. A similar analysis by including more relevant infrastructure variables can provide a comprehensive understanding of infrastructure delivery performance in the state.

Table3.4: Infrastructure Delivery Ranks

2001		2011			DAG^{Infra} 2011		
Rank	**States**	**Rank**	**States**		**Rank**	**States**	
1	Gujarat	1	Gujarat	0	1	Karnataka	(+2)
2	Maharashtra	2	Maharashtra	0	2	Gujarat	(-1)
3	Punjab	3	Karnataka	(+4)	3	Bihar	(+15)
4	Kerala	4	Tamil Nadu	(+2)	4	Maharashtra	(-2)
5	Haryana	5	Kerala	(-1)	5	Tamil Nadu	(-1)
6	Tamil Nadu	6	Haryana	(-1)	6	Punjab	(+1)
7	Karnataka	7	Punjab	(-4)	7	Uttar Pradesh	(+10)
8	Himachal Pradesh	8	Uttarakhand	(+9)	8	Madhya Pradesh	(+6)
9	Andhra Pradesh	9	Himachal Pradesh	(-1)	9	Kerala	(-4)
10	Jharkhand	10	Andhra Pradesh	(-1)	10	Haryana	(-4)
11	Odisha	11	West Bengal	(+5)	11	Jharkhand	(+5)
12	Rajasthan	12	Chhattisgarh	(+2)	12	Chhattisgarh	0
13	Madhya Pradesh	13	Rajasthan	(-1)	13	Odisha	(+2)
14	Chhattisgarh	14	Madhya Pradesh	(-1)	14	Rajasthan	(-1)
15	Uttar Pradesh	15	Odisha	(-4)	15	West Bengal	(-4)
16	West Bengal	16	Jharkhand	(-6)	16	Andhra Pradesh	(-6)
17	Uttarakhand	17	Uttar Pradesh	(-2)	17	Assam	(+2)
18	Assam	18	Bihar	(+1)	18	Uttarakhand	(-10)
19	Bihar	19	Assam	(-1)	19	Himachal Pradesh	(-10)

Source: Mundle Sudipto, et.al, 2016

Note: Figures in parenthesis indicate the change in ranks in 2011 with respect to 2001 and the change in ranks in DAG^{infra} 2011 with respect to 2001. Functional distribution of public expenditure:

Distribution of expenditure by the functions performed by the government which generally depicts government expenditure as under 'General Services' 'Social and Community Services' and 'Economic Services' is discussed below. Generally, in government parlance the latter two categories are treated as 'development' expenditure while the former is treated as 'non-development' expenditure. This categorization is also a subject of important ongoing debates.

This is in view of the fact that items of expenditure falling under the General Services are essential support services, thus cannot strictly be treated as non-development expenditure. For that matter any wasteful or inefficient spending under the so-called development expenditure under social and economic services should be treated as unproductive expenditure and inefficient way of using state resources.

GROWTH OF EXPENDITURE UNDER FUNCTIONAL CATEGORIES

Absolute expenditure incurred under each of the functional categories for the time period 2006-07 to 2018-19 (BE) are presented in table 3.5 which has generally revealed an increasing trend. An important trend to be noticed relates to the sharper growth in the per capita real expenditure on social and community services followed by the economic services reflecting the thrust sector status provided by the government for the components of social services like Education, health, social welfare, roads, irrigation and power sector in the economic services. Per capita real expenditure on general services has the least growth of all the three services. This order of importance is also reflected in the share of these services to the total expenditure and GSDP. On an average from 2006-07 to 20017-18 RE, Economic services expenditure has the largest share in total and to GSDP, 37.88 and 6.70 percent respectively, closely followed by the Social services with 36.31 and 6.42 percent respectively. General services have a much smaller share with 22.82 and 4.03 percent respectively. Moreover, in the recent past allocation towards economic and social services are consistently increasing while that of general services is decreasing. These trends are highly welcome to the state's development.

FUNCTIONAL CATEGORIES OF EXPENDITURE: PRE AND POST KFRA

Many studies have empirically verified Wagner's theory of 'increasing state activity" which states that ratio of public expenditure to Gross domestic product (especially for social sectors like education, health and infrastructure) increases with increasing levels of development. The average share of general, social and economic services in GSDP have had 4.04, 6.42 and 6.70 percent share respectively during 2006-07 to 2017-18RE. Distribution of expenditure by functional categories has experienced a positive shift as there has been a good hike in the share of economic services and a clear decline in the share of general services over the 1991-92 to 2002-03. Percentage composition during 1991-92 till 2002-03 was 4.53, 5.45 and 5.88 percent share in the GSDP respectively for general, social and community and economic services (refer Appendix 3.1A for details). The trends in these three functional categories reveals that (Graph 3.1.4b) the share of general services has declined from 4.53 percent from the pre KFRA phase to 3.96 percent in the period 2015-16 to 2017-18RE, that of social services has increased from 5.45 percent to 7.11percent and that of economic services has increased from 5.88 percent to 6.96 percent respectively during the reference period. The share of economic services was the highest in the year 2006-07 and probably the highest in the last two decades (7.66 % of GSDP).

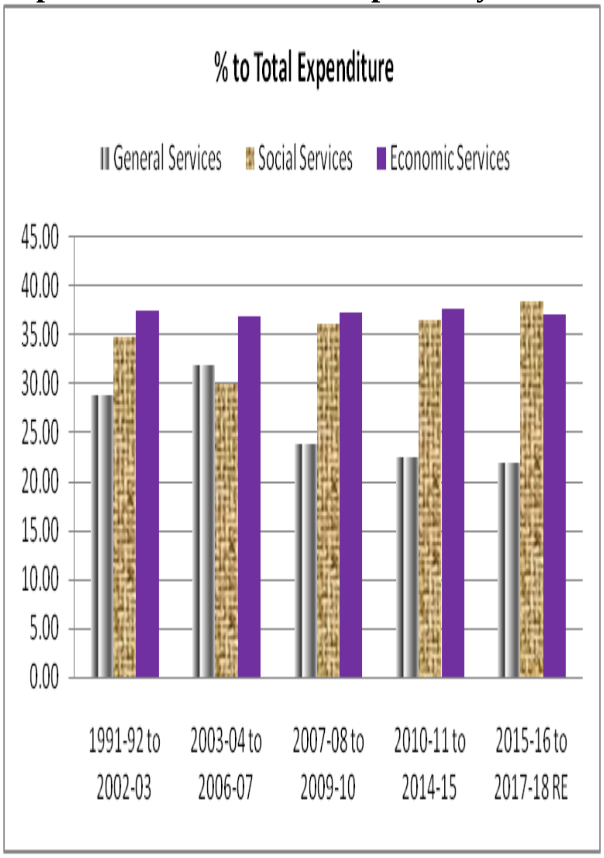
Table 3.5: Expenditure by Functional Categories (Rupees in crores)

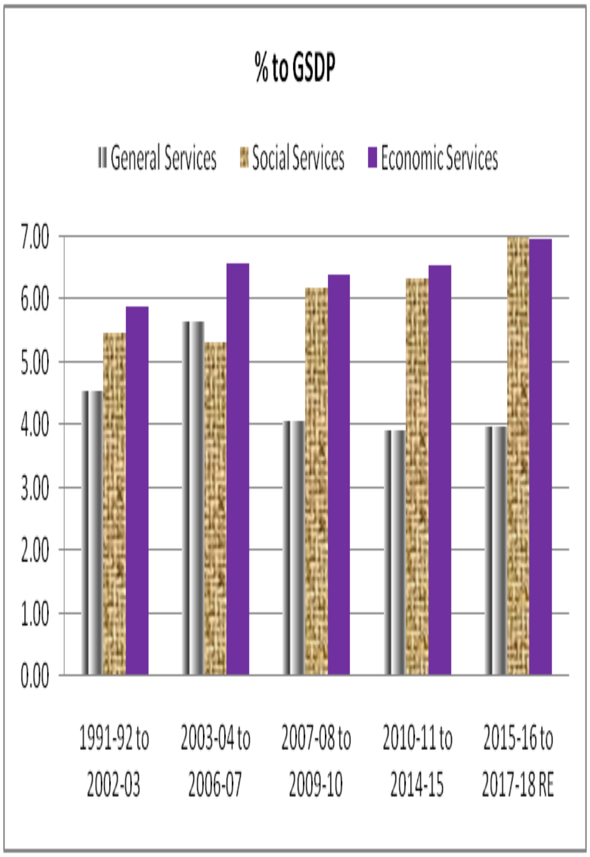
Year/ Details	General Services					Social Services					Economic Services				
	Nominal	Real	PC (Rs.)	% to Total Exp	GSDP %	Nominal	Real	PC (Rs.)	% to Total Exp	GSDP %	Nominal	Real	PC (Rs.)	% to Total Exp	GSDP %
2006-07	10740	9579	1703	25.59	4.73	12555	11197	1990	29.91	5.53	17401	15519	2758	41.45	7.66
2007-08	11211	9453	1661	24.36	4.14	15866	13379	2351	34.47	5.86	17778	14991	2634	38.63	6.57
2008-09	12751	10043	1745	24.75	4.11	18601	14652	2546	36.10	5.99	18534	14598	2537	35.97	5.97
2009-10	13252	9720	1671	22.21	3.93	22575	16558	2846	37.83	6.69	22354	16396	2818	37.46	6.62
2010-11	14521	9642	1640	21.55	3.54	26214	17407	2960	38.90	6.38	25413	16875	2870	37.71	6.19
2011-12	17071	10605	1785	21.17	3.75	29413	18272	3075	36.48	6.46	31608	19635	3305	39.21	6.94
2012-13	20770	11936	1988	22.63	3.98	34151	19625	3269	37.21	6.54	33934	19500	3249	36.98	6.50
2013-14	25455	13648	2251	23.98	4.15	36103	19357	3193	34.02	5.89	40254	21582	3560	37.93	6.56
2014-15	28884	14783	2415	23.44	4.21	43917	22477	3672	35.64	6.41	45001	23032	3762	36.52	6.56
2015-16	31791	15863	2567	23.08	4.18	51948	25920	4194	37.71	6.83	48583	24241	3923	35.27	6.39
2016-17	32325	15506	2486	20.19	3.80	63120	30277	4854	39.43	7.42	60875	29200	4682	38.03	7.16
2017-18 RE	37137	17256	2743	21.00	3.90	67407	31321	4979	38.11	7.07	69828	32446	5157	39.48	7.33

Source: Government of Karnataka, Accounts at a glance for 1960-2009 and Finance Department Nov-09, MTFP, GoK for rest of the years
Note: Total Functional categories of expenditure include Revenue, Capital expenditure and Loans & Advances.

Distinct changes in the distribution of functional categories of expenditure are visible from the graph 3.1.4a and b wherein the percent share of social and community services which was the second highest during the pre-reform phase (1991-91 to 2002-03) declined to third place immediately after the framing of KFRA till 2006-07, however subsequently increased to reach the highest place. This is despite the revenue shortfall during the global recession phase and also after 2014-15 wherein owing to 14 FC recommendations, there was a considerable decline in the share of funds under the centrally sponsored schemes. Considerable increase is also observed in per capita real expenditure of the social and economic services (Graph 3.1.1c). These trends are an outcome of the priority assigned to sectors like Education, health and Social welfare by the government during the reform phase. MTFP, 2006 states, "The first task before the Government is to ensure that the essential public services in the area of education and health are provided to the poor without loss of quality. Unless gaps in literacy and health are addressed at the earliest, fiscal correction may not mean anything to the poorer sections of the state. This is not only an issue related to allocation of resources but also a Governance issue." (GoK, MTFP, 2006-10, P 25)Although the share of Economic services has marginally declined, it still retains the second largest share and two services together constitute major share in the total expenditure. However, as stated earlier, employee related and interest payments are on the rise, given their rigidity downwards, they need to be closely monitored.

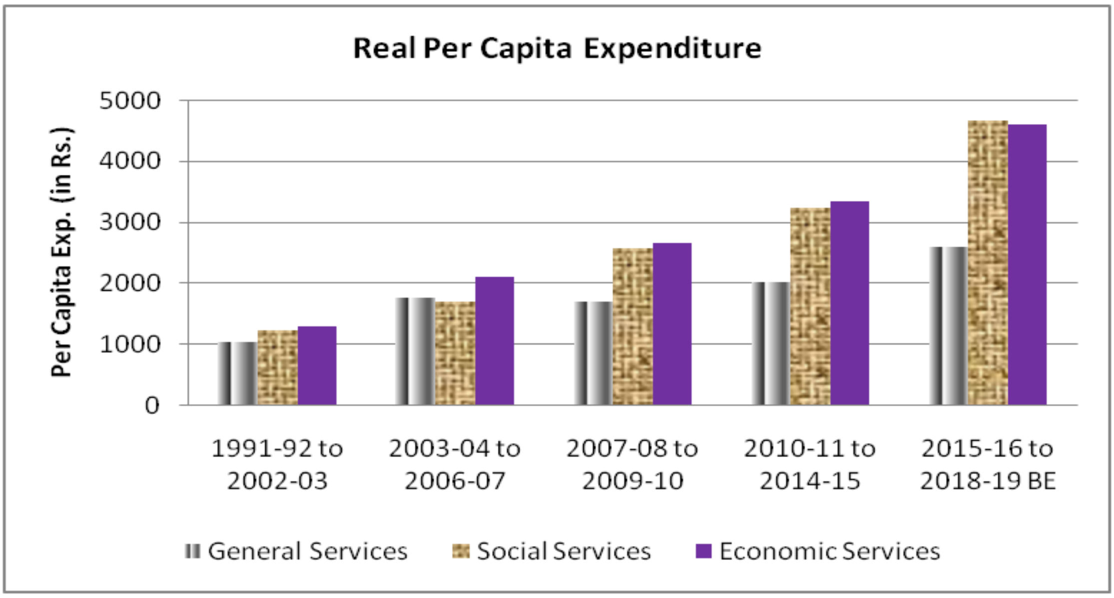
Graph 3.1.4a and b: Functional Categories of Expenditure as a Percentage of Total Expenditure and GSDP respectively





Source: Author's Computation based on FD, GoK

Graph 3.1.4c: Functional Categories: Growth in Per Capita Expenditure



Source: Author's Computation based on FD, GoK

The compound annual rates of growth presented in table 3.6 reveals that economic services on average have experienced the highest annual average growth rate from 1991-92 to 2018-19 BE (16.71 %) as opposed to social and community services (15.16 %) and general services (12.42). The period after FRA has seen a good gain in the social and community and economic services as opposed to the highest rate of growth revealed by the general services expenditure in the decade of nineties. This accounts for an increased focus on the social and economic services by the Government of Karnataka which certainly a very welcome trend given the slow improvement in the Human Development Index (HDI) of the state.

Table 3.6: Compound Annual Growth Rate (in Percentage)

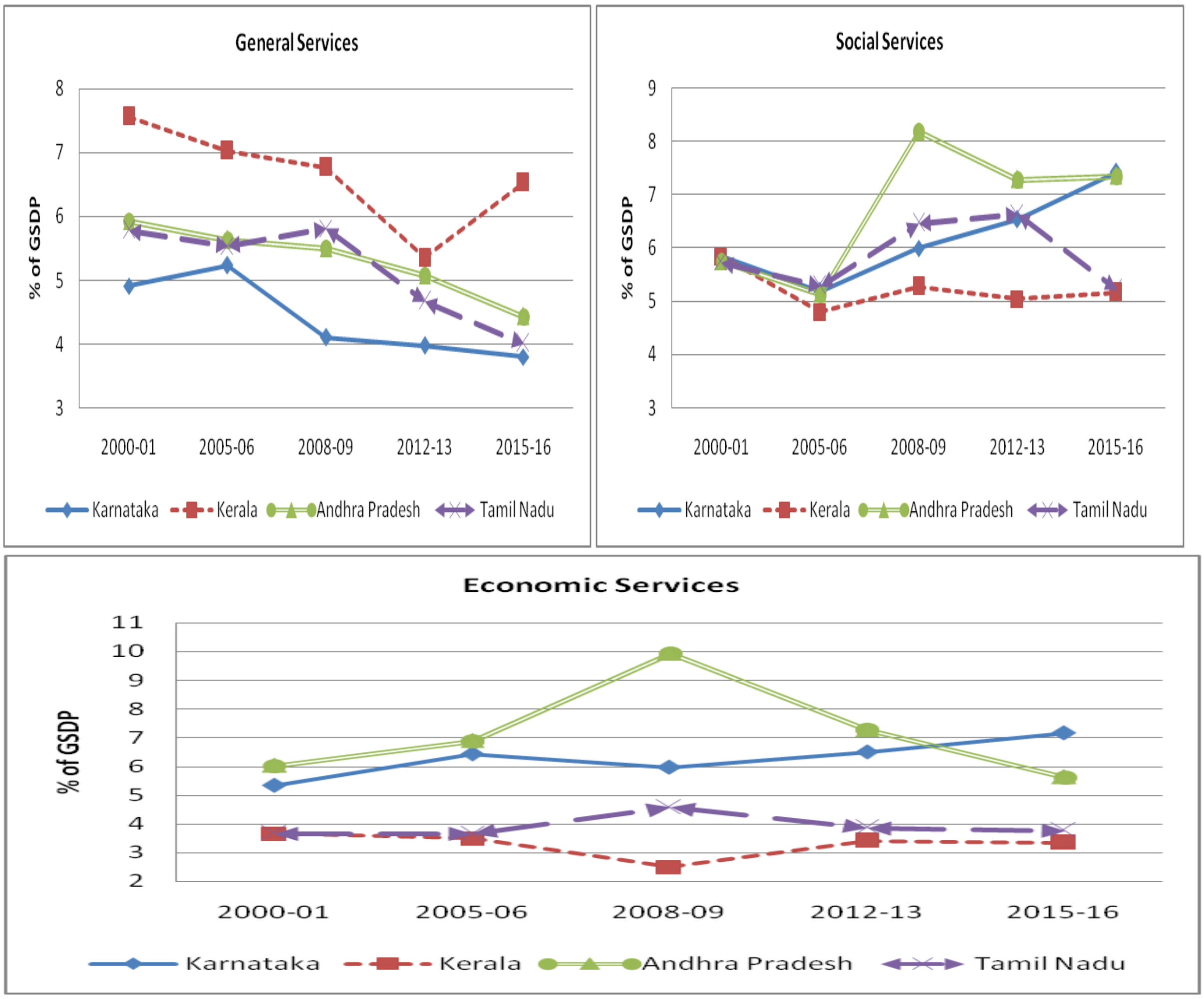
Year	General Services	Social Services	Economic Services
1991-92 to 2002-03	15.76	11.95	12.03
2003-04 to 2006-07	5.46	18.10	30.70
2007-08 to 2009-10	8.83	19.30	12.43
2010-11 to 2014-15	18.81	13.92	15.54
2015-16 to 2018-19 BE	13.23	12.54	12.85

Source: Author's Computation based on FD, GoK

KARNATAKA COMPARED WITH SOUTHERN STATES: FUNCTIONAL CATEGORIES

Southern states' share of functional categories of expenditure as percent of GSDP is presented in graphs 3.1.5 a, b and c. Karnataka state compared favourably with other states in general services expenditure during all the time points. The share has been lesser in Karnataka compared to all southern states from 2000-01 to 2015-16. Share of social services was highest during 2000-01 and 2005-06. However, it dipped down to third place for next two time points mentioned in the graph 3.1.5b. The state's share of social services has again reached to first place in the year 2015-16 (7.42 % to GSDP). On the other hand, Karnataka occupies second position after Andhra Pradesh in terms of share of Economic Services in GSDP from 2000-01 to 2012-13. The state is spending the highest in terms of share in GSDP on economic services among the southern states in 2015-16.

Graph 3.1.5.a, 3.1.5b and 3.1.5c: General Services, Social Services and Economic Services as a percentage of GSDP respectively



Source: Author's Computations based on RBI state Finances**.**

Karnataka spends very less for general services compared to all other southern states even in terms of per capita expenditure (table 3.7). However the state of Tamil Nadu is spending highest per person for all years with reference to social services except for the years 2008-09 and 2015-16 where Andhra Pradesh had the highest. Karnataka though it ranked first in terms share of GSDP of social services for the years 2000-01, 2005-06 and 2015-16 its per capita spending largely remained in second or third place for all the years. On the contrary, the state is spending higher per person with reference to economic services except for the year 2008-09.

Table 3.7: Per Capita Expenditure of Functional Categories of Expenditure across southern states

Year	Services	Karnataka	Kerala	Andhra Pradesh	Tamil Nadu
2000-01	General Services	1092	1731	1129	1368
	Social Services	1300	1337	1094	1355
	Economic Services	1187	837	1148	867
2005-06	General Services	1844	2662	1682	2005
	Social Services	1825	1819	1532	1915
	Economic Services	2267	1323	2056	1321
2008-09	General Services	2216	3783	2466	2974
	Social Services	3232	2945	3663	3304
	Economic Services	3220	1399	4456	2338
2012-13	General Services	3460	5436	3254	4486
	Social Services	5689	5120	4673	6351
	Economic Services	5653	3462	4666	3722
2015-16	General Services	5144	10245	5963	6746
	Social Services	8406	8098	9876	8808
	Economic Services	7862	5034	7562	6365

Source: Author's Computations based on RBI state Finances.

Social service delivery performance:

Table 3.8: Social service delivery ranks

2001		2011			DAG^{social}2011		
Rank	States	Rank	States		Rank	States	
1	Kerala	1	Kerala	0	1	Kerala	0
2	Himachal Pradesh	2	Tamil Nadu	(+2)	2	Bihar	(+16)
3	Maharashtra	3	Maharashtra	0	3	West Bengal	(+3)
4	Tamil Nadu	4	Himachal Pradesh	(-2)	4	Tamil Nadu	(-2)
5	Gujarat	5	Punjab	(+1)	5	Himachal Pradesh	(-1)
6	Punjab	6	West Bengal	(+3)	6	Maharashtra	(-3)
7	Karnataka	7	Karnataka	0	7	Punjab	(-2)
8	Haryana	8	Uttarakhand	(+6)	8	Karnataka	(-1)
9	West Bengal	9	Gujarat	(-4)	9	Uttar Pradesh	(+8)
10	Assam	10	Haryana	(-2)	10	Madhya Pradesh	(+2)
11	Andhra Pradesh	11	Andhra Pradesh	0	11	Jharkhand	(+5)
12	Chhattisgarh	12	Madhya Pradesh	(+4)	12	Andhra Pradesh	(-1)
13	Odisha	13	Rajasthan	(+2)	13	Rajasthan	0
14	Uttarakhand	14	Chhattisgarh	(-2)	14	Uttarakhand	(-6)
15	Rajasthan	15	Odisha	(-2)	15	Chhattisgarh	(-1)
16	Madhya Pradesh	16	Jharkhand	(+1)	16	Odisha	(-1)
17	Jharkhand	17	Uttar Pradesh	(+2)	17	Gujarat	(-8)
18	Bihar	18	Bihar	0	18	Assam	(+1)
19	Uttar Pradesh	19	Assam	(-9)	19	Haryana	(-9)

Source: Mundle, Sudipto et.al, 2016

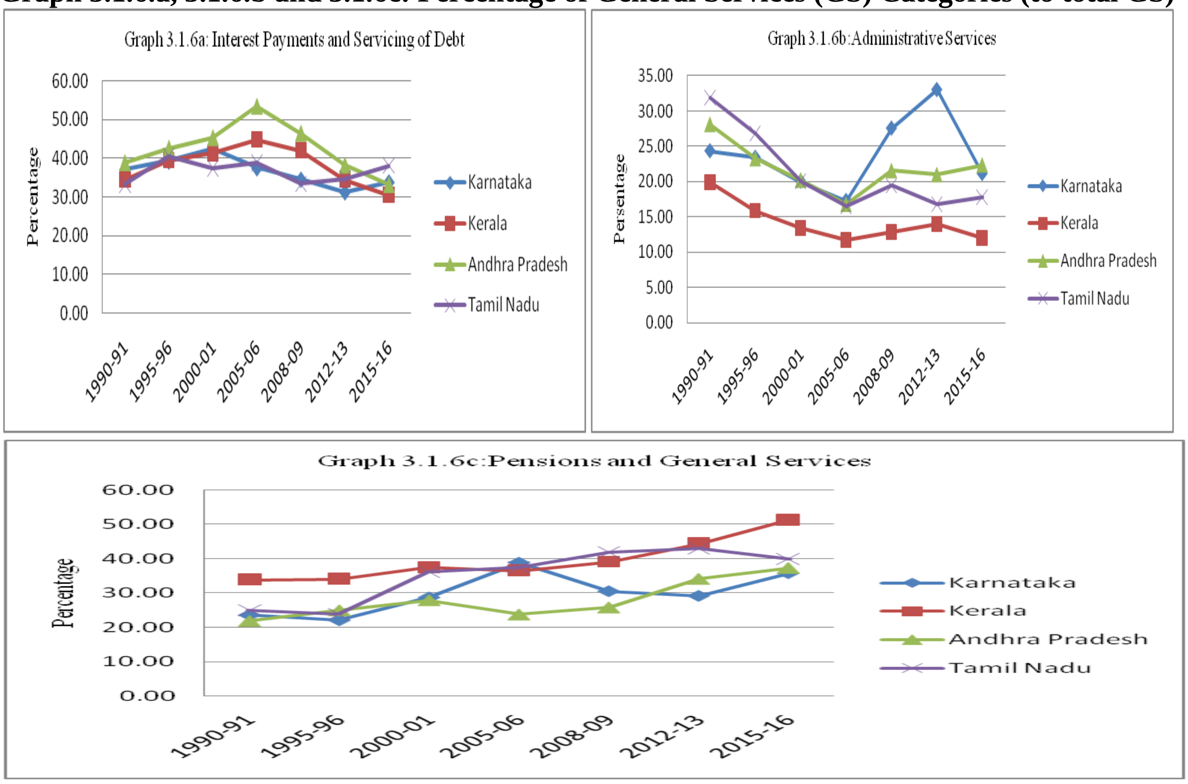
Social services delivery performance assessed in the context of 19 major states using the health sector variables- Infant Mortality Rate, Maternal Mortality Rate, Life Expectancy at Birth and Education variables- Literacy rate, Gross enrolment rate and Average years of schooling for two time points 2001 and 2011 revealed that Karnataka constitutes seventh rank for both the time points and Eighth place with reference to Development Adjusted Governance ranking.(Mundle, Sudipto et.al.2016) (Table 3.8).

In addition, Karnataka is one among the five states that experienced deterioration in its relative position along with AP, Assam, Gujarat and Maharashtra. Tamil Nadu along with Madhya Pradesh and Rajasthan has managed to improve their relative position. (Ghosh, 2011) This is despite the fact that Karnataka's fiscal performance with reference to share of development expenditure and state's own tax effort indicated by ratio of state's own tax to GSDP has been exemplary with top rank during both the time points.(Mundle, Sudipto et.al.2016) It is of great policy importance to recognize that it is crucial to have public spending on social sectors get effectively translated to human development.

GENERAL SERVICES

Percentage distribution of General services expenditure in the four southern states presented in graphs 3.1.6a to 3.1.6c clearly reveals that Karnataka is much better placed in terms of the committed expenditure such as pension payments and interest payments. The interest payments is comparatively lesser than its counterparts from 2005-06 and pension payments are lesser than all the four southern states from 2008-09. Administrative services however seem to be high and on the increase since 2005-06 as compared to other states, the reasons for this need to be probed into.

Graph 3.1.6.a, 3.1.6.b and 3.1.6c: Percentage of General Services (GS) Categories (to total GS)

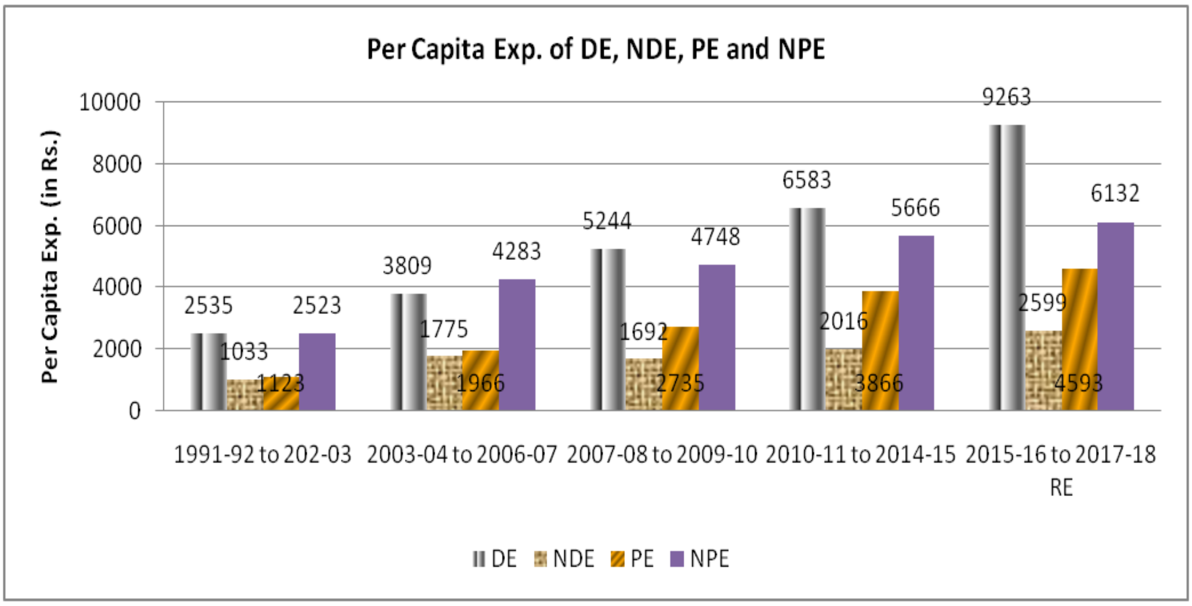


Source: RBI, State Finances

DEVELOPMENT AND NON- DEVELOPMENT EXPENDITURE

The distribution of development and non-development expenditure and plan and non-plan categories is presented in Graph 3.1.7reiterates the earlier findings that Karnataka's performance has improved substantially after the launch of KFRA as revealed by the sharper increase in the per capita real expenditure. The state's per capita development expenditures the second highest in the country with Rs 17413 next to Andhra Pradesh.

Graph 3.1.7: Per Capita Expenditure of Select Expenditure Indicators



Source: FD, GoK

Table 3.9: Per Capita Development Expenditure (in Nominal terms) in selected States (INRs)

States	2014-15 (A/C)	2015-16 (RE)	2016-17 (BE)
Andhra Pradesh	19288	15517	17445
Assam	9073	15662	15499
Bihar	5668	8272	8741
Gujarat	12546	14259	14954
Karnataka	**13928**	**15591**	**17413**
Kerala	11483	13553	16762
Madhya Pradesh	10433	12673	15003
Maharashtra	11450	13534	14045
Odisha	10741	14015	15567
Punjab	9053	11067	11696
Rajasthan	11407	19366	16777
Tamil Nadu	13036	14505	15576
All States	**10437**	**13545**	**14404**

Source: Economic Survey of Karnataka (2017-18)

COMPOSITE INDEX OF EXPENDITURE MANAGEMENT AND FISCAL SPACE
COMPOSITE INDEX OF EXPENDITURE MANAGEMENT

A summary measure to understand the efficacy with which the government expenditure is managed enables comparison across regional governments and over time. Fiscal health of the state governments has been assessed by International Centre for Information systems and Audit (ICISA, 2004) using four major components of state finances:

1. Resource Mobilization
2. Expenditure Management
3. Management of Fiscal Imbalances
4. Management of Fiscal Liabilities

The present study has applied this methodology in estimating the Composite Expenditure Management Index (CEMI) in a slightly modified manner. The parameters used for the estimation of CEMI include:

1. Development expenditure (DE)/ Total expenditure
2. Capital Expenditure (CE)/ Total expenditure
3. Own resources (Tax +Non tax rev,(OR)/ Revenue expenditure (RE)
4. Interest payments(IP)/Revenue Receipts (RR)
5. Interest payments(IP)/Revenue expenditure (RE)
6. Capital expenditure and loans disbursed (CEL)/ Total expenditure including loans and advances.
7. Plan expenditure (PE)/Total expenditure

Table 3.10: Composite Expenditure Management Index of Major States in India

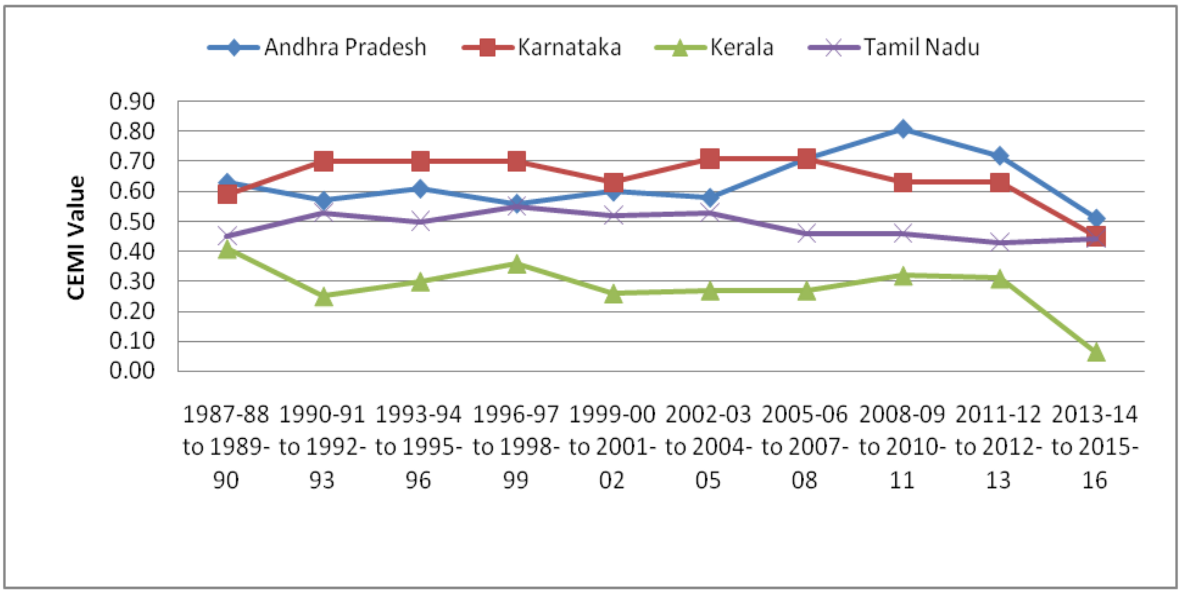
Composite Expenditure Management Index (CEMI) of Major States														
Years	AP	BHR	GUJ	HAR	KAR	KRL	MP	MAH	ORS	PJB	RAJ	TND	UP	WB
1987-88 to 1989-90	0.63	0.51	0.48	0.65	0.59	0.41	0.53	0.46	42.00	0.37	0.31	0.45	0.24	0.32
1990-91 to 1992-93	0.57	0.33	0.55	0.64	0.70	0.25	0.56	0.50	0.48	0.44	0.46	0.53	0.33	0.29
1993-94 to 1995-96	0.61	0.32	0.52	0.59	0.70	0.30	0.48	0.63	0.42	0.28	0.44	0.50	0.30	0.36
1996-97 to 1998-99	0.56	0.27	0.56	0.69	0.70	0.36	0.58	0.49	0.45	0.29	0.45	0.55	0.24	0.34
1999-00 to 2001-02	0.60	0.41	0.56	0.74	0.63	0.26	0.52	0.53	0.40	0.34	0.34	0.52	0.26	0.23
2002-03 to 2004-05	0.58	0.44	0.50	0.54	0.71	0.27	0.65	0.64	0.41	0.40	0.38	0.53	0.46	0.15
2005-06 to 2007-08	0.71	0.49	0.42	0.47	0.71	0.27	0.56	0.69	0.30	0.42	0.41	0.46	0.42	0.13
2008-09 to 2010-11	0.81	0.52	0.43	0.73	0.63	0.32	0.56	0.59	0.46	0.46	0.38	0.46	0.45	0.15
2011-12 to 2012-13	0.72	0.86	0.45	0.43	0.63	0.31	0.43	0.37	0.39	0.39	0.40	0.43	0.48	0.08
2013-14 to 2015-16	0.51	0.62	0.48	0.44	0.40	0.06	0.70	0.33	0.81	0.02	0.65	0.44	0.59	0.08

Source: Author's Computation

Methodology adopted by the study (ICISA, 2004) is same as that of Human Development Index of UNDP (Please refer Appendix 3.9A). The present study has analyzed the expenditure management index and the results for Karnataka and other major states are presented in the following table 3.10.

The results reveal that Karnataka's expenditure management has been exemplary (as revealed by the broad expenditure parameters included in the analysis) over time and across states (except for the recent time point). The index has improved from 0.59 levels during the late eighties to 0.70 during decade of nineties, further improving to 0.71 during 2002-03 to 2007-08, declining to 0.63 from 2008-09 to 2012-13 and it has reached its lowest in the recent time point. States like Andhra Pradesh, Bihar, Madhya Pradesh, Odisha, Rajasthan and Uttar Pradesh have better index than Karnataka for the period 2013-14 and 2015-16. Most of the backward states have improved in the index as they have high potential left for spending compared the developed states. A comparison of CEMI for four southern states is presented in the following graph 3.1.8.

Graph 3.1.8: Movement of CEMI overtime of Southern States



Source: Author's Computation

FISCAL SPACE

'Fiscal space' can be enhanced by governments through alternative means such as enhancement of tax and non tax resources; reprioritizing expenditure, enhancing allocative and technical efficiency; increasing Official Development assistance including grants, loans and debt relief; financing public expenditure by borrowing from domestic and international sources. (Heller, 2005) An important source in addition to the tax and non tax resources that is completely under the control of the state governments is the option to create fiscal space by reprioritizing expenditure to reduce low priority expenditure and enhance the cost effectiveness of spending. This helps in providing additional cushion to enhance productive expenditure by retaining the tax and debt burden unchanged.

Large-scale committed expenditures of various kinds such as wages and salaries, pension payments, interest payments restrict the government's fiscal capability to enhance productive expenditure. In addition, MTFP argues that the committed grants-in-aid and the stipulated transfers to the local bodies too reduce the scope for expenditure by the state government. With the exception of devolution to PRIs the other committed items (there has been an under provision for the subsidy heads, the details of which are not readily available to us) have had a reduced share in the total revenue resources, expenditure, GSDP and Own tax Revenue as presented below in a significant manner. However, the employee related expenditure has a large increase in 2018-19 BE and is consuming close to a half of state own tax revenue (48.52 percent) that of interest payments has been on the increase since 2014-15, and has reached 9.97 percent, if the state's interest payments cross 10 percent mark, the state's eligibility to avail higher fiscal deficit benefit to the tune of 0.25 percent will be lost. a benefit recommended by the Fourteenth Finance Commission for the states that manage to contain interest payments within 10 percent of the revenue receipts of the previous year.

In addition to gaining of fiscal space by way of reducing expenditure on committed items, efficiency gains can be achieved by way of effective implementation of programs, reprioritization of expenditure. Heller aptly states that "It is also important to note that not spending an adequate amount in a sector (say, health) may weaken the sector to the extent that it would in the future be costly and time consuming to 'rebuild' the sector." (Heller, 2004, 8) This applies to many other sectors in Indian context such as capital expenditure and maintenance of assets created.

Table 3.11a: Committed Items of Expenditure as a Percentage of Revenue Expenditure

Years	Empl. related	Interest	Subsidy	Grants -in-Aid	Devolution to PRIs	Committed Exp.	Balance
2006-07	27.00	12.67	13.04	5.33	11.94	89.17	10.83
2007-08	31.13	12.06	15.15	5.54	11.04	90.60	9.40
2008-09	33.71	10.88	8.16	4.48	11.91	89.27	10.73
2009-10	28.80	10.97	8.66	4.70	11.54	79.70	20.30
2010-11	28.05	10.44	11.67	5.51	10.94	79.43	20.57
2011-12	26.58	9.31	11.35	6.67	10.60	76.65	12.15
2012-13	30.05	8.96	14.04	5.27	12.43	85.28	14.54
2013-14	30.23	8.79	15.81	5.63	11.97	85.58	13.16
2014-15	28.81	9.08	11.41	5.80	13.57	81.58	12.91
2015-16	27.11	9.18	12.00	5.19	13.03	84.18	17.67
2016-17	24.85	9.12	11.56	4.31	13.55	79.39	15.99
2017-18 RE	24.93	9.73	13.15	4.90	13.45	80.76	14.60
2018-19 BE	30.86	9.97	12.35	3.71	NA	NA	NA

Source: Gayithri, K, 2011 (from 2001-02 to 2009-10), MTFP for other years

Table 3.11b: Committed Items of Expenditure as a Percentage of Own Tax Revenue

Year	Empt. related	Interest	Subsidy	Grants-in-Aid	Devolution to PRIs	Committed Exp	Balance
2005-06	43.59	20.21	19.96	8.77	17.69	135.84	14.66
2006-07	38.74	18.18	18.71	7.66	17.13	127.95	15.55
2007-08	44.77	17.34	21.78	7.97	15.88	130.31	13.51
2008-09	50.79	16.39	12.35	6.75	17.95	134.52	16.17
2009-10	45.14	17.05	13.47	7.62	18.71	129.13	32.90
2010-11	39.39	14.66	16.38	7.74	16.05	116.51	30.17
2011-12	37.24	13.04	15.90	9.35	14.85	107.39	17.02
2012-13	42.65	12.71	19.92	7.48	17.64	121.04	20.64
2013-14	43.06	12.52	22.52	8.02	17.05	121.92	18.74
2014-15	42.54	13.40	16.85	8.57	20.03	120.45	19.06
2015-16	41.99	14.22	18.58	8.04	20.19	130.39	27.36
2016-17	39.52	14.51	18.39	6.85	21.55	126.25	25.43
2017-18 RE	39.60	15.45	20.88	7.78	21.37	128.25	23.18
2018-19 BE	48.52	15.67	19.42	5.83	NA	NA	NA

Source: Same as Table 3.10a

SUBSIDIES IN KARNATAKA

Subsidy bill of GoK has increased over years, despite its intentions to contain it from time to time. Explicit subsidy has increased around three and half a times from Rs 4355 crore in 2006-07 to Rs 14388 crore in 2016-17 (please refer Appendix 3.8A for details). Of particular concern are the subsidies relating to power sector towards free supply of power to farmers for irrigation pump sets, food and interest subsidy for concessional crop loan. Power subsidy has increased from Rs 2371 crore in 2006-07 to Rs 8646 crore in 2016-17 constituting around 60 percent of the total subsidy bill. Very often, the power subsidy bill is underprovided. Data presented in table 3.12 accounts for the subsidy bill as percent of revenue expenditure. Subsidy bill as percent of revenue expenditure has also shown a decline (Table 3.12) some of the subsidies have been under provided for which would be partly responsible for this

Table 3.12: Subsidies as percent of Revenue Expenditure

Year	Food	Transport	Power	Industries	Housing	Cooperation	Agriculture	Others	Total
2005-06	2.60	0.35	6.49	0.05	0.01	3.30	5.95	0.43	13.24
2006-07	2.24	0.82	7.09	0.00	0.00	2.45	4.89	0.41	13.03
2007-08	1.74	0.62	6.15	0.19	0.00	4.80	6.87	1.00	14.50
2008-09	1.74	0.34	4.66	0.11	0.22	0.45	2.53	0.64	8.16
2009-10	2.45	0.33	4.93	0.05	0.19	0.26	2.92	0.46	8.66
2010-11	1.71	0.58	8.22	0.02	0.04	0.62	2.48	0.47	11.67
2011-12	1.22	0.47	8.14	0.02	0.04	0.69	2.16	0.76	11.35
2012-13	1.30	0.51	9.24	0.01	0.37	1.73	3.61	0.88	14.04
2013-14	3.42	0.77	6.68	0.11	0.50	3.03	6.76	0.12	14.94
2014-15	2.44	0.63	6.47	0.25	0.23	0.60	3.07	0.13	10.76
2015-16	1.88	0.64	7.43	0.24	0.19	0.68	2.58	0.16	11.24
2016-17	1.41	0.61	6.55	0.23	0.30	0.62	3.04	0.19	10.91

Source: State Finance Accounts, CAG, GoI

Table 3.13: Subsidies as a percentage of Revenue Expenditure and GSDP

Subsidies as % of GSDP									
Time Points	Food	Transport	Power	Industry	Housing	Cooperation	Agri	Others	Total
2007-08 to 2009-10	0.27	0.06	0.72	0.02	0.02	0.25	0.57	0.10	1.44
2010-11 to 2014-15	0.29	0.09	1.11	0.01	0.03	0.19	0.52	0.07	1.80
2015-16 to 2016-17	0.25	0.10	1.08	0.04	0.04	0.10	0.43	0.03	1.71
Subsidies as % of Revenue Expenditure									
2007-08 to 2009-10	1.98	0.43	5.25	0.12	0.14	1.84	4.11	0.70	10.44
2010-11 to 2014-15	2.02	0.59	7.75	0.08	0.24	1.33	3.62	0.47	12.55
2015-16 to 2016-17	1.64	0.62	6.99	0.24	0.25	0.65	2.81	0.17	11.07

Source: Author's Calculation based on Finance Accounts, CAG (Various Years)

However, an important observation from the subsidy element under the three important functional categories is the fact that subsidy element is quite large in the category of economic services, the services that can be provided by the private sector on commercial basis as opposed to the social services that are associated with large-scale externalities and social benefits. The share of explicit subsidy under economic services was as high as 46.38 percent in 2005-06 and has declined to 22.71 percent (table 3.14) in 2016-17. The decline is partly due to under provision in certain sectors like power etc.; On the contrary the share of explicit subsidy element is small in the total of general services and has declined from 0.11 percent in 2005-06 to 0.07 percent in 2016-17. The share of social services is also small but has increased from 0.16 percent to 0.97 percent. However, one has to carefully examine if this database has captured all the explicit subsidy items from all these heads.

Table 3.14: Subsidies by Functional Categories

Year		Social Services						Economic Services				
	GS	ESAC	WSHU	IB	SC/ST/ OBC	SWN	Total SS	Agri	Energy	IM	TRNSP	Total ES
2005-06	0.11	0.01	0.03	0.03	0.05	0.03	0.16	21.00	22.91	1.24	1.24	46.38
2006-07	0.12	0.02	0.13	0.03	0.07	0.02	0.30	15.67	22.71	0.30	2.61	41.29
2007-08	0.10	0.03	0.57	0.03	0.13	0.02	0.78	22.42	20.08	1.82	2.01	46.33
2008-09	0.12	0.03	0.98	0.01	0.10	0.01	1.13	9.38	17.44	0.59	1.29	28.70
2009-10	0.10	0.04	0.81	0.02	0.07	0.01	0.95	10.47	17.76	0.30	1.19	29.77
2010-11	0.09	0.02	0.52	0.03	0.10	0.01	0.68	8.85	29.83	0.28	2.12	41.08
2011-12	0.10	0.01	0.53	0.02	0.10	0.00	0.66	7.14	27.69	0.48	1.61	36.92
2012-13	0.09	NA	1.10	0.02	0.10	0.00	1.22	8.19	20.95	0.25	1.15	30.54
2013-14	0.08	NA	1.26	0.02	0.19	0.00	1.47	15.08	NA	0.25	1.73	31.96
2014-15	0.13	NA	0.56	0.02	0.12	0.00	0.70	7.09	14.96	0.58	1.45	24.13
2015-16	0.13	NA	0.43	0.01	0.25	0.00	0.70	9.50	18.02	0.59	1.55	26.41
2016-17	0.07	NA	0.65	0.01	0.30	0.00	0.97	6.62	14.27	0.51	1.32	22.71

Source: Finance Accounts, CAG, GoI

OUTCOMES OF THE 14 FINANCE COMMISSION: ISSUES
CHANGES IN THE CENTRALLY SPONSORED SCHEME (CSS) FUNDING

There have been significant changes brought in the resource support extended to the state governments in the wake of Fourteenth Finance Commission recommendations. This has resulted in drastic reduction in allocation of various Centrally Sponsored Schemes (CSS); especially for 'Category B' schemes where the central share has been reduced below 50 percent (MTFP, 2015-19). The delinking of schemes and the change in sharing pattern for certain centrally sponsored programs has added to the state's commitments by way of enhanced state support. Trends in the CSS support to the state are presented in table 3.15. It can be observed that funding support under the CSS received by the state has increased from Rs 941.53 crore in 2005-06 to Rs 4234.16 crore in 2013-14 and has declined to Rs 854.98 crore in 2016-17. In the past, it has been observed that state support has increased with every instance of decline in the central support, it is expected that the state government would assume these commitments.

Table 3.15: Trends in CSS (Rs in crores)

Year	CSS	CSS Burden to State (Projected)
2005-06	941.53	
2006-07	1122.53	
2007-08	1487.05	
2008-09	1829.19	
2009-10	1477.68	
2010-11	1572.35	
2011-12	1620.5	
2012-13	3208	
2013-14	4234.16	
2014-15	1142.99	4514.41
2015-16	838.22	4745.91
2016-17(RE)	854.98	4934.78
2017-18 (BE)		5131.15
2018-19		5335.35

Source: GoK, MTFP (Various Years**)**

OTHER COMMITMENTS

The announcement made by the Chief Minister in June 2017 waiving farmers crop loans up to Rs 50,000 which is estimated to cost the exchequer Rs 8,165 crore. Government of Karnataka has also constituted the Sixth Pay Commission to suggest possible pay hike to six lakh employees. The Commission has submitted its report on 01/06/2017 and state government has accepted to recommendations and implemented the pay revision for Master Scale and 25 revised pay Scales with effect from 1st July, 2017. This revision of pay, allowances and pension is set to cost the state exchequer an estimated Rs 10,508 crore annually which is in turn to result in an increase in state's committed expenditure. It has been observed earlier that large-scale committed expenditures of various kinds such as wages and salaries, pension payments, interest payments restrict the government's fiscal capability in undertaking new programs or extend larger support to the local bodies.

In addition to the state's commitments on account of farmers' loan waiver and sixth pay commission, costs on account of state's ongoing capital works also need to be taken into account in taking stock of the state's commitments.

Subsidies have been a concern, not merely because of the quantum of increase but also due to the issues of targeting, multiple and duplicative schemes, absence of sunset clauses, poor monitoring of use of such benefits. Power sector subsidy has been of serious concern. Subsidy studies have highlighted varied kinds of problems. The social housing subsidies reveal excess provisioning of houses over and above the need as indicated by the houseless population in districts of Yadgir and Uttar Kannada, a typical fallout of duplicative interventions by Central and state governments with individual targets. (GayithriK, 2011). In the context of credit subsidy field level evidence indicated that loans were taken at low interest rate from Co-operatives and lent to other villagers at higher rate. (Kannan, Elumalai, 2011). Regarding industrial incentives and concessions, CAG has observed non-recovery of the deferred tax arrears. As a part of the transparency, while some concession related revenue loss is reported in the MTFP, there is need to track all the revenue losses arising on account of concessions. These are only select instances; there is a need to comprehensively evaluate all the major subsidies periodically. Regarding the user charges, ERC urges the need to have a clear policy. Field based studies on electricity and fertilizer subsidies in Karnataka examining the willingness to pay for services, observe that users are willing to pay for these services provided uninterrupted and quality services are made available to them. (Kannan, Elumalai, 2011).

APPENDICES

Appendix 3. 1A: Expenditure Indicators of Karnataka (Rs. in Crore)

Details		2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
RR	Nominal	16169	20760	26570	30352	37587	41151	43291	49156	58206	69806	78176	89544	104142	118817	133214	146033
	Real	18385	22538	26570	28551	33522	34700	34099	36055	38651	43364	44924	48010	53300	59286	63900	67856
	PC (Rs.)	3429	4155	4837	5135	5959	6097	5925	6197	6573	7298	7484	7919	8707	9594	10245	10786
	GSDP %	12.53	14.85	15.93	15.49	16.54	15.21	13.95	14.56	14.17	15.33	14.97	14.60	15.19	15.62	15.66	15.32
RE	Nominal	18814	21285	24932	28041	33435	37375	41659	47537	54034	65115	76293	89190	103614	117029	131921	145649
	Real	21393	23108	24932	26377	29819	31516	32813	34867	35880	40450	43842	47820	53030	58394	63280	67678
	PC (Rs.)	3990	4260	4539	4744	5300	5538	5702	5993	6102	6808	7304	7888	8663	9449	10145	10757
	GSDP %	14.58	15.22	14.95	14.31	14.71	13.81	13.42	14.08	13.16	14.30	14.61	14.54	15.11	15.38	15.51	15.28
CE	Nominal	2936	4674	5822	8543	8543	8649	9870	12137	13355	15506	15478	16947	19622	20713	28150	31231
	Real	3338	5074	5822	8036	7619	7293	7774	8902	8868	9632	8895	9086	10043	10335	13503	14512
	PC (Rs.)	623	935	1060	1445	1354	1282	1351	1530	1508	1621	1482	1499	1641	1672	2165	2307
	GSDP %	2.28	3.34	3.49	4.36	3.76	3.20	3.18	3.60	3.25	3.41	2.96	2.76	2.86	2.72	3.31	3.28
GS	Nominal	7188	9168	10036	10254	10740	11211	12751	13252	14521	17071	20770	25455	28884	31791	32325	37137
	Real	8173	9953	10036	9645	9579	9453	10043	9720	9642	10605	11936	13648	14783	15863	15506	17256
	PC (Rs.)	1524	1835	1827	1735	1703	1661	1745	1671	1640	1785	1988	2251	2415	2567	2486	2743
	GSDP %	5.57	6.56	6.02	5.23	4.73	4.14	4.11	3.93	3.54	3.75	3.98	4.15	4.21	4.18	3.80	3.90
SS	Nominal	6852	7649	8448	10147	12555	15866	18601	22575	26214	29413	34151	36103	43917	51948	63120	67407
	Real	7791	8304	8448	9545	11197	13379	14652	16558	17407	18272	19625	19357	22477	25920	30277	31321
	PC (Rs.)	1453	1531	1538	1717	1990	2351	2546	2846	2960	3075	3269	3193	3672	4194	4854	4979
	GSDP %	5.31	5.47	5.07	5.18	5.53	5.86	5.99	6.69	6.38	6.46	6.54	5.89	6.41	6.83	7.42	7.07
ES	Nominal	7765	7880	10935	12603	17401	17778	18534	22354	25413	31608	33934	40254	45001	48583	60875	69828
	Real	8829	8555	10935	11855	15519	14991	14598	16396	16875	19635	19500	21582	23032	24241	29200	32446
	PC (Rs.)	1647	1577	1991	2132	2758	2634	2537	2818	2870	3305	3249	3560	3762	3923	4682	5157
	GSDP %	6.02	5.64	6.56	6.43	7.66	6.57	5.97	6.62	6.19	6.94	6.50	6.56	6.56	6.39	7.16	7.33
DE	Nominal	14616	15529	19382	22750	29956	33644	37135	44929	51627	61021	68085	76357	88918	100531	123995	137235
	Real	16620	16859	19382	21400	26716	28369	29250	32954	34282	37907	39125	40939	45508	50162	59478	63768
	PC (Rs.)	3099	3108	3529	3849	4749	4985	5083	5664	5830	6380	6518	6753	7434	8117	9536	10136
	GSDP %	11.33	11.11	11.62	11.61	13.18	12.43	11.97	13.31	12.57	13.40	13.03	12.45	12.97	13.21	14.58	14.40

Details		2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
NDE	Nominal	7188	9168	10036	10254	10740	11211	12751	13252	14521	17071	20770	25455	28884	31791	32325	37137
	Real	8173	9953	10036	9645	9579	9453	10043	9720	9642	10605	11936	13648	14783	15863	15506	17256
	PC (Rs.)	1524	1835	1827	1735	1703	1661	1745	1671	1640	1785	1988	2251	2415	2567	2486	2743
	GSDP %	5.57	6.56	6.02	5.23	4.73	4.14	4.11	3.93	3.54	3.75	3.98	4.15	4.21	4.18	3.80	3.90
PE	Nominal	6369	7380	10340	11131	16540	16263	19889	24380	29490	35219	37453	44260	57618	56886	NA	NA
	Real	7242	8012	10340	10470	14751	13713	15666	17882	19582	21879	21523	23730	29489	28384	NA	NA
	PC (Rs.)	1351	1477	1883	1883	2622	2410	2722	3074	3330	3682	3586	3914	4817	4593	NA	NA
	GSDP %	4.94	5.28	6.20	5.68	7.28	6.01	6.41	7.22	7.18	7.74	7.17	7.21	8.40	7.48	NA	NA
NPE	Nominal	16009	21887	23906	23842	27545	31768	34150	38580	42450	50537	59148	66389	80390	75949	NA	NA
	Real	18204	23762	23906	22427	24566	26788	26899	28297	28188	31394	33990	35595	41144	37896	NA	NA
	PC (Rs.)	12	4380	4352	4034	4367	4707	4674	4864	4794	5284	5662	5871	6721	6132	NA	NA
	GSDP %	395.00	15.65	14.34	12.17	12.12	11.74	11.01	11.43	10.34	11.10	11.32	10.82	11.73	9.98	NA	NA
TE	Nominal	21750	24314	29606	33863	41978	46024	51529	59674	67389	80621	91771	106137	123236	137742	160071	176880
	Real	24731	26397	29606	31853	37438	38809	40587	43769	44749	50083	52737	56906	63073	68729	76783	82189
	PC (Rs.)	4612	4866	5390	5729	6655	6819	7053	7523	7610	8429	8786	9387	10304	11122	12310	13064
	GSDP %	16.86	17.39	17.76	17.29	18.47	17.01	16.61	17.68	16.41	17.71	17.57	17.30	17.98	18.11	18.82	18.56
TEC	Nominal	28167	34648	35709	34973	44085	48109	54039	62964	71934	85756	96601	110649	128625	142508	169426	189679
	Real	32028	37616	35709	32898	39317	40567	42564	46182	47767	53273	55512	59325	65831	71107	81270	88137
	PC (Rs.)	5973	6934	6501	5917	6989	7128	7396	7938	8123	8966	9248	9786	10754	11507	13029	14010
	GSDP %	21.83	24.78	21.42	17.85	19.40	17.78	17.41	18.65	17.51	18.84	18.49	18.04	18.76	18.73	19.92	19.90

Source: CAG, Finance Accounts (Various Years), GoK, Finance Department (only 2017-18 RE), RBI State Finances (Plan and Non-Plan Exp) GSDP: GoI, CSO, Data Pertaining to 2017-18 is the Revised Estimates.

Appendix 3.2A: Expenditure Indicators for different Time Points

Time Periods	Revenue Receipts	Revenue Expenditure	Capital Exp	General Services	Social Services	Economic Services	Developement Exp	Non Development	Plan Exp	Non Plan Exp
Percentage to Total Expenditure										
1991-92 to 2002-03	81.66	87.88	12.12	28.93	34.88	37.57	72.46	28.93	32.26	71.26
2003-04 to 2006-07	88.57	83.55	16.45	31.87	29.97	37.00	66.97	31.87	34.39	76.70
2007-08 to 2009-10	85.27	80.57	19.43	23.77	36.13	37.35	73.49	23.77	38.26	66.65
2010-11 to 2014-15	85.40	82.44	17.56	22.56	36.45	37.67	74.12	22.56	43.34	63.58
2015-16 to 2018-19 BE	84.17	83.57	16.43	22.01	38.39	37.14	75.53	22.01	41.30	55.14
Percentage to Total Expenditure on Consolidated Fund										
1991-92 to 2002-03	72.17	77.78	10.63	25.59	30.90	33.06	63.97	25.59	28.38	63.07
2003-04 to 2006-07	76.59	71.82	14.46	27.06	25.81	32.22	58.02	27.06	29.90	65.19
2007-08 to 2009-10	81.24	76.76	18.51	22.65	34.42	35.58	70.00	22.65	36.44	63.50
2010-11 to 2014-15	81.03	78.24	16.65	21.41	34.57	35.74	70.31	21.41	41.13	60.33
2015-16 to 2018-19 BE	79.20	78.63	15.45	20.71	36.12	34.93	71.05	20.71	39.92	53.29
Percentage to GSDP										
1991-92 to 2002-03	12.76	13.75	1.90	4.53	5.45	5.88	11.33	4.53	5.05	11.15
2003-04 to 2006-07	15.70	14.80	2.93	5.63	5.31	6.57	11.88	5.63	6.11	13.57
2007-08 to 2009-10	14.57	13.77	3.32	4.06	6.18	6.39	12.57	4.06	6.55	11.39
2010-11 to 2014-15	14.85	14.34	3.05	3.92	6.33	6.55	12.89	3.92	7.54	11.06
2015-16 to 2017-18 RE	15.53	15.39	3.10	3.96	7.11	6.96	14.06	3.96	7.48	9.98
Per Capita Expenditure (INRs)										
1991-92 to 2002-03	2854	3107	422	1033	1228	1307	2535	1033	1123	2523
2003-04 to 2006-07	5022	4711	949	1775	1694	2115	3809	1775	1966	4283
2007-08 to 2009-10	6073	5744	1387	1692	2581	2663	5244	1692	2735	4748
2010-11 to 2014-15	7596	7353	1550	2016	3234	3349	6583	2016	3866	5666
2015-16 to 2017-18 RE	10208	10117	2048	2599	4676	4587	9263	2599	4593	6132

Source: Author's Computation based on FD, GoK

Appendix 3.3A: Revenue Indicators for Different Time Points

Time Points	Own tax revenue	Non-tax revenue	Share in Central Taxes	Grants	Total Revenue Receipts
Revenue Receipts as a Percentage to Total Expenditure					
1991-92 to 2002-03	49.27	9.10	13.86	7.78	80.01
2003-04 to 2006-07	54.39	11.87	12.88	9.69	88.83
2007-08 to 2009-10	53.56	6.27	13.54	11.60	82.75
2010-11 to 2014-15	57.87	4.29	13.15	9.92	85.23
2015-16 to 2018-19 BE	53.02	3.92	18.10	9.04	84.08
Revenue Receipts as a Percentage to Total Expenditure on Consolidated Fund					
1991-92 to 2002-03	43.53	8.04	12.24	6.87	70.69
2003-04 to 2006-07	47.24	10.31	11.19	8.42	77.16
2007-08 to 2009-10	51.00	5.97	12.90	11.05	78.80
2010-11 to 2014-15	55.01	4.08	12.50	9.43	81.02
2015-16 to 2018-19 BE	49.76	3.68	16.98	8.48	78.90
Categories Reveneu Receipts as a % to Reveneu Receipts					
1991-92 to 2002-03	61.58	11.38	17.32	9.72	100
2003-04 to 2006-07	61.23	13.36	14.50	10.91	100.00
2007-08 to 2009-10	64.73	7.57	16.37	14.02	100.00
2010-11 to 2014-15	67.89	5.03	15.43	11.64	100.00
2015-16 to 2018-19 BE	63.06	4.66	21.52	10.75	100.00
Real Per Capita Revenue Receipts (in Rs.)					
1991-92 to 2002-03	1764	335	497	279	2875
2003-04 to 2006-07	3078	678	731	544	5030
2007-08 to 2009-10	3830	450	970	824	6074
2010-11 to 2014-15	5158	387	1178	882	7606
2015-16 to 2018-19 BE	6420	461	2166	1165	10212
Revenue Receipts as a Percentage to GSDP					
1991-92 to 2002-03	7.77	1.43	2.19	1.23	12.61
2003-04 to 2006-07	9.67	2.11	2.29	1.72	15.80
2007-08 to 2009-10	9.17	1.07	2.32	1.99	14.16
2010-11 to 2014-15	10.10	0.75	2.30	1.73	14.88
2015-16 to 2017-18 RE	9.76	0.70	3.29	1.77	15.52

Source: Author's Computation based on FD, GoK

Appendix 3.4A: Sources of Financing Revenue Expenditure (Rs. in Crore)

Year	OTR	OTR as a % RE	NTR	NTR As a % RE	SCT	SCT as a % RE	Grants	Grants % RE	RR	RR as a % RE	RE
2006-07	23301	69.70	4098	12.30	5374	16.10	4813	14.40	37587	112.00	33435
2007-08	25987	69.50	3358	9.00	6779	18.10	5027	13.35	37655	101.00	37375
2008-09	27646	66.40	3159	7.60	7154	17.20	5332	12.80	43291	104.00	41659
2009-10	30579	64.30	3333	7.01	7360	15.48	7883	16.60	49155	103.00	47536
2010-11	38473	71.20	3358	6.22	9506	17.59	6868	12.70	58206	108.00	54034
2011-12	46476	71.40	4086	6.28	11075	17.01	8168	12.50	69806	107.00	65115
2012-13	53754	70.46	3966	5.20	12647	16.58	7809	10.24	78176	102.47	76293
2013-14	62604	70.19	4032	4.52	13809	15.48	9099	10.20	89544	100.40	89190
2014-15	70180	67.73	4688	4.52	14654	14.14	14619	14.11	104142	100.51	103614
2015-16	75550	64.56	5355	4.58	23983	20.49	13929	11.90	118817	101.53	117029
2016-17	82956	62.88	5795	4.39	28760	21.80	15703	11.90	133214	100.98	131921
2017-18 RE	91718	62.97	6828	4.69	31752	21.80	15736	10.80	146033	100.26	145649
2018-19 BE	103444	63.60	8163	5.02	36215	22.27	14942	9.19	162765	100.08	162637

Source:Government of Karnataka, Finance Department, Accounts at a Glance and Medium Term Fiscal Plan, different issues

Appendix 3.5A: Trends in Revenue and Capital Expenditure in Southern States

Year	States	Revenue Expenditure			Capital Expenditure			Total Expenditure	
		% to TE	% to GSDP	PC (in Rs.)	% to TE	% to GSDP	PC (in Rs.)	% to GSDP	PC (in Rs.)
1999-00	KAR	89.54	14.09	3707	10.46	1.65	433	15.74	4141
	KRL	94.69	15.46	4280	5.31	0.87	240	16.33	4520
	AP	90.05	13.20	2881	9.95	1.46	318	14.66	3199
	TN	96.98	14.27	4044	3.02	0.44	126	14.72	4169
2002-03	KAR	86.5	14.58	3990	13.5	2.28	623	16.86	4612
	KRL	95.48	15.70	4985	4.52	0.74	236	16.44	5221
	AP	87.28	14.70	3589	12.72	2.14	523	16.84	4112
	TN	94.04	15.01	4331	5.96	0.95	274	15.96	4606
2005-06	KAR	82.81	14.31	4744	17.19	2.97	985	17.28	5729
	KRL	95.75	13.46	5420	4.25	0.60	240	14.06	5660
	AP	82.01	13.64	4183	17.99	2.99	918	16.64	5102
	TN	88.76	12.41	4617	11.24	1.57	585	13.99	5202
2008-09	KAR	80.85	13.42	5702	19.15	3.81	1351	16.6	70.53
	KRL	94.33	13.92	6842	5.67	0.84	411	14.75	7253
	AP	85.65	14.49	5734	14.35	2.43	961	16.92	6695
	TN	85.48	13.35	6131	14.52	2.27	1042	15.62	7173
2011-12	KAR	80.77	14.3	6808	19.23	3.41	1621	17.71	8429
	KRL	92.28	14.73	8816	7.72	1.23	738	15.96	9554
	AP	86.82	13.54	6503	13.18	2.05	987	15.59	7490
	TN	83.69	12.57	7437	16.31	2.45	1449	15.01	8886
2015 - 16	KAR	84.96	15.38	9449	15.04	2.72	1672	18.1	11121
	KRL	92.69	16.42	11860	7.31	1.30	935	17.72	12795
	AP	85.82	16.14	9486	14.18	2.67	1568	18.81	11054
	TN	87.16	13.67	9636	12.84	2.01	1419	15.68	11055

Source: Finance Department, GoK, Note: PC = Per Capita Expenditure. GSDP (current) is in different series.

Appendix 3.6A: Functional Categories of Expenditure in the Southern States

Year	Name of the State	General Services		Social Services		Economic Services	
		% to GSDP	Per Capita (Rs)	% to GSDP	Per Capita (Rs)	% to GSDP	Per Capita (Rs)
2000-01	KAR	4.91	1092	5.84	1300	5.34	1187
	KRL	7.56	1731	5.84	1337	3.66	837
	AP	5.93	1129	5.75	1094	6.03	1148
	TN	5.79	1368	5.74	1355	3.67	867
2005-06	KAR	5.23	1844	5.18	1825	6.43	2267
	KRL	7.03	2662	4.8	1819	3.49	1323
	AP	5.64	1682	5.14	1532	6.89	2056
	TN	5.54	2005	5.3	1915	3.65	1321
2008-09	KAR	4.11	2216	5.99	3232	5.97	3220
	KRL	6.77	3783	5.27	2945	2.5	1399
	AP	5.5	2466	8.18	3663	9.94	4456
	TN	5.82	2974	6.47	3304	4.58	2338
2012-13	KAR	3.98	3460	6.54	5689	6.5	5653
	KRL	5.35	5436	5.04	5120	3.41	3462
	AP	5.08	3254	7.29	4673	7.28	4666
	TN	4.68	4486	6.63	6351	3.88	3722
2015-16	KAR	3.8	5144	7.42	8406	7.16	7862
	KRL	6.53	10245	5.16	8098	3.34	5034
	AP	4.44	5963	7.35	9876	5.63	7562
	TN	4.01	6746	5.23	8808	3.78	6365

Source: Expenditure on functional categories of other than Karnataka State Finance Accounts. Population data is drawn from Registrar of Census, India. GSDP (current) in different series

Appendix 3.7A: Composition of General Services (Rs. in Crore)

Year	Name of The State	Organs of States	Fiscal Services	Interest Payments and servicing of debt	Administrative Services	Pensions and General Services
1990-91	Karnataka	3.82	7.29	37.09	24.3	23.61
	Kerala	3.58	8.34	34.41	19.88	33.8
	Andhra Pradesh	2.98	8.25	38.93	28.04	21.81
	Tamil Nadu	3.10	6.78	33.24	31.85	25.02
1995-96	Karnataka	4.17	7.28	39.23	23.38	22.08
	Kerala	3.08	7.5	39.51	15.84	34.07
	Andhra Pradesh	3.70	5.55	42.64	23.2	24.9
	Tamil Nadu	3.14	5.71	40.49	26.78	23.88
2000-01	Karnataka	3.31	5.6	42.38	19.99	28.71
	Kerala	2.68	5.14	41.38	13.39	37.41
	Andhra Pradesh	2.46	4.16	45.34	20.17	27.86
	Tamil Nadu	2.26	4.07	37.39	20.03	36.24
2005-06	Karnataka	2.47	3.95	37.51	17.26	38.81
	Kerala	2.48	4.48	44.88	11.69	36.47
	Andhra Pradesh	2.15	4.00	53.42	16.73	23.7
	Tamil Nadu	1.90	5.25	38.86	16.52	37.48
2008-09	Karnataka	3.65	3.82	34.5	27.51	30.52
	Kerala	2.00	4.08	42.05	12.86	39.01
	Andhra Pradesh	2.27	4	46.5	21.5	25.73
	Tamil Nadu	2.07	3.27	33.4	19.44	41.83
2012-13	Karnataka	3.26	3.39	31.20	32.98	29.17
	Kerala	2.50	4.53	34.63	13.99	44.36
	Andhra Pradesh	2.90	3.83	38.30	20.93	34.04
	Tamil Nadu	2.77	2.81	34.60	16.81	43.01
2015-16	Karnataka	2.97	6.39	33.80	21.08	35.75
	Kerala	2.39	3.75	30.57	12.04	51.26
	Andhra Pradesh	2.32	4.86	33.30	22.30	37.22
	Tamil Nadu	2.18	2.01	38.10	17.76	39.94

Source: State Finance Accounts CAG, GoI

Appendix 3.8A: Subsidies in Karnataka (Rs. Crore)

Year	Food (b)	Transport (c)	Power (d)	Industries (e)	Housing (f)	Cooperation (g)	Agriculture(g)	Total (b to h)	Others	Grand Total
2005-06	730	98	1821	14	3	924	1669	3590	121	3712
2006-07	750	273	2371	1	1	821	1636	4217	138	4355
2007-08	650	230	2300	71	1	1793	2568	5044	375	5420
2008-09	726	143	1943	45	90	187	1054	3134	265	3399
2009-10	1164	157	2341	25	89	125	1386	3901	217	4118
2010-11	926	316	4442	11	24	334	1340	6052	251	6303
2011-12	791	309	5303	16	26	447	1407	6893	496	7390
2012-13	991	385	7050	9	280	1323	2755	10038	671	10709
2013-14	3046	691	5960	99	448	2705	6028	12949	111	13323
2014-15	2533	651	6700	262	243	624	3177	11014	133	11153
2015-16	2196	748	8693	285	223	792	3019	12938	187	13149
2016-17	1854	799	8647	308	402	824	4013	12833	244	14388

Source: Finance Accounts, CAG. (Various Years)

Appendix 3.9A: Methodology of Composite Expenditure Management Index (CEMI)

Various expenditure rations are calculated from 2013-14 to 2015-16. The average ration from these three years is obtained to compute the dimension indices for each expenditure category.

Methodology followed to compute the dimension indices is explained below

$$DI_i = \frac{Actual_i - Minimum_i}{Maximum_i - Minimum_i}$$

DI= Dimension Index, 'i' represent various expenditure ratios

The Following Dimension Indices are obtained using above formula

DE_{TE}: Development Expenditure, CE_{TE}: Capital Expenditure, OTR_{RE}: Own Tax Revenue, IP_{RR}: Interest Payments to Revenue Receipts, IP_{RE}: Interest Payments to Revenue Expenditure, $CELA_{TELA}$: Capital Expenditure including Loans & Advances, PE_{TE}: Plan Expenditure

The Geometric Mean of All the Dimension Indices is considered as the Composite Expenditure Management Index (CMIE)

$$CMIE_{2013-14\ to\ 2015-16} = \sqrt{DE_{TE} * CE_{TE} * OTR_{RE} * IP_{RR} * IP_{RE} * CELA_{TELA} * PE_{TE}}$$

CHAPTER 4
TRENDS IN DEFICITS IN KARNATAKA

State finances in India had experienced severe fiscal stress during the decade of nineties and Karnataka state was no exception despite being a fiscally better administered state. The state prepared a white paper on State Finances in March 2000 to take stock of the fiscal issues and the measures required. Karnataka launched its fiscal reforms program in 2000-01 with the first Medium Term Fiscal Plan (MTFP) framed for the period 2000-01 to 2004-05, and the state has since then continued the practice of preparing a rolling MTFP. A major fiscal landmark is the framing of Karnataka State Fiscal Responsibility Act (KFRA) in 2002 which came into force from April 2003. KFRA features are presented in Box (Text Box 4.1).

KFRA was mended in 2011 to accommodate the suggestions made by the Thirteenth Finance Commission. These included:

1. Outstanding debt inclusive of the off budget borrowings is gradually reduced. The target is to reduce it to 25.2 percent of GSDP by 2014-15
2. Fiscal deficit not to exceed the 3 percent level of GSDP
3. Constitution of Fiscal management review committee (FMRC) which will meet at least twice a year to review the fiscal and debt position of the state.

As per the CAG state finances report (2012, 4) the FMRC was constituted in July 2011 and since then has resolved the following.

1. There will be no new additions to grant-in-aid commitments
2. Shifting from beneficiary orientation to capital investments for mobilizing more resources for power, roads and drinking water. ERC recommendation of 5 percent (to GSDP) level of capital investment is the guiding factor.
3. Revision of user fee every alternate year.
4. Setting up of a mechanism for ex-ante appraisal of new schemes and projects

TEXT BOX 4.1: FEATURES OF KARNATAKA'S FISCAL RESPONSIBILITY ACT

FISCAL TARGETS

1. The fiscal deficit to be reduced to 3% of Gross State Domestic Product (GSDP), and the revenue (current) deficit to 0 in 4 years (by 2005-06). In each intervening year, these deficits are required to be reduced as percentages of GSDP from their previous year's levels.
2. The debt/GSDP ratio to fall to 25% in 13 years (by 2014-15).
3. Let-out clauses are provided in relation to these targets if there is a natural calamity, with a rider that the excess above targets cannot exceed the estimated fiscal costs of the calamity (this clause is required since GSDP is highly volatile in Karnataka on account of fluctuations in agriculture, largely rain-fall related).

FISCAL TRANSPARENCY

1. Government to ensure greater transparency in its fiscal operations.
2. Government to publish a half-yearly review report on progress in achieving the fiscal targets and remedial measures proposed to off-set slippages.
3. Government to disclose key fiscal information - e.g. contingent liabilities from guarantees, off-budget borrowings through Special Purpose Vehicles, tax arrears; tax expenditures; losses through public sector entities; expenditure arrears of major works and contracts; and subsidy payments. Significant changes in the accounting standards, policies or practices that affect the computation of fiscal indicators would also be disclosed.

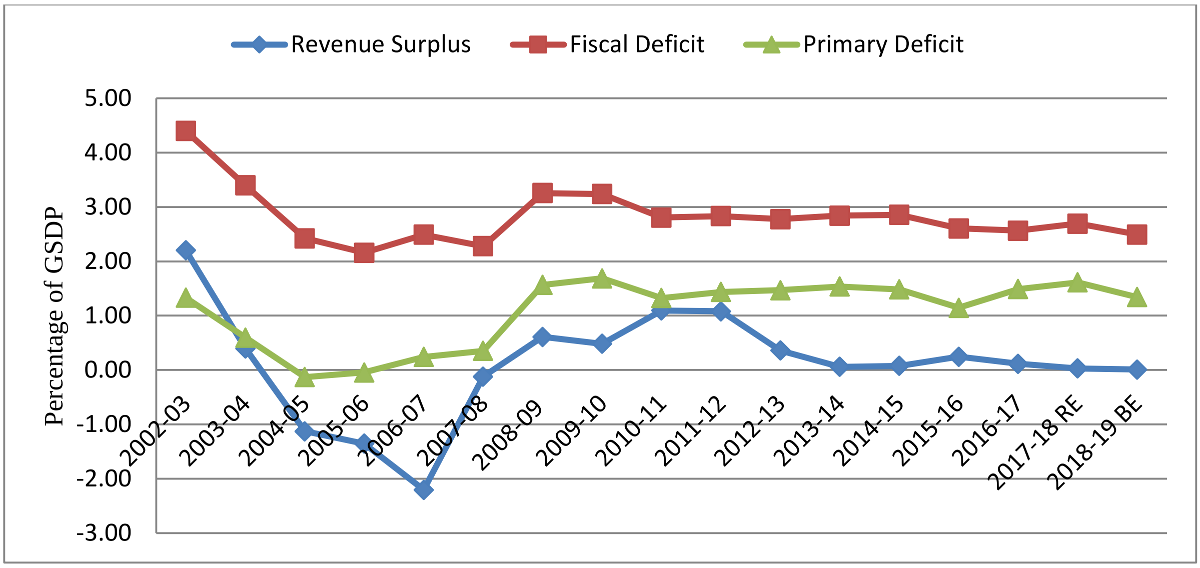
FISCAL POLICY IMPLEMENTATION

1. Government to publish every year a Medium Term Fiscal Plan (MTFP)
2. Obligation to ensure off-setting measures for the adverse fiscal impact of any new policy decision.

Source: MTFP, 2003, p 7

Karnataka has proved to be a fast reforming state that has been trying to implement reforms as and when mooted at the national level. The targets set in the KFRA 2002 have been achieved well within the timelines. The fiscal, revenue and primary deficit trends from 2002-03 till 2017-18(RE) are presented in Graph 4.1.1. The targets as per the KFRA and the status of their achievements are presented in table 4.1. The target to achieve revenue surplus and 3 percent fiscal deficit by March 2006 has been achieved by the FY 2004-05 itself. The revenue surplus has given room for enhanced capital investments. Revenue surplus, however, has dropped significantly from 1.08 percent in 2011-12 to 0.03 percent in 2017-18 (RE). During this period the fiscal deficit has further declined from 2.83 percent 2.78 percent. Consequentially, there has been a decline in the capital expenditure, albeit, small. The general tendency to compress the capital expenditure in the wake of revenue shortfalls needs to be overcome in the interest of promoting social and economic infrastructure in the state. Expenditure Reforms Commission constituted by the Government of Karnataka had recommended that capital expenditure should be maintained at 5 percent of GSDP and insulated from such revenue shortfalls. An important policy challenge that the state government needs to address (also an issue for national level debate) has reference to the usefulness attached to the 3 percent fiscal deficit target, especially during the times when the state's demand/requirement for infrastructure is large and until the time the much sought after adequate private investment takes place. Capital investments have greater potential to enhance growth and also help in crowding in of private investment.

Graph 4.1.1: Trends in Deficit-Karnataka (as % of GSDP)



Source: RBI, State Finances various issues

Table 4.1: Fiscal Targets and Achievements

Particulars	Statutory norm	Compliance by State
Revenue Deficit (RD)	Reduce RD to Nil by 31st March, 2006	Achieved in FY04-05 Itself Maintained adequate Revenue Surplus thereafter.
Fiscal Deficit (FD)	Reduce FD to not more than 3% of estimated GSDP by 31st March, 2006.	Maintained FD below 3% since FY04-05*
Total Liabilities to GSDP (TL/GSDP)	To ensure that TL/GSDP does not exceed 25.2% of GSDP by 31st March, 2015.	Already achieved this in FY10-11 much ahead of timeline prescribed.
Outstanding Guarantees (OG)	OG on 1st April of any year should not exceed 80% of Revenue Receipts of second preceding year.	Since enactment of Karnataka Guarantee of Ceiling Act, 1999 this limit has not been breached.

* Except in the FY 2008-11 where it was fixed based on the advice of the Central Government.
Source: MTFP 2013-2017, Government of Karnataka.

KARNATAKA'S PERFORMANCE COMPARED WITH ALL STATES

The fiscal position in the state compares well with the southern states as well as all states average both at the times when Karnataka was experiencing severe fiscal stress as well as the current decade when the state's fiscal health has substantially improved. This gets very well depicted from the information on various fiscal indicators presented in table 4.2. Revenue deficit as a proportion of Gross Fiscal Deficit (GFD) is smaller than all states average for all the time points presented and the surplus in the recent years has been larger than the other states except for the recent year (2017-18RE). Further, the state has a better capital outlay level in the GFD. The other important expenditure indicators such as the proportion of interest payments in the revenue expenditure and that of non-development expenditure in the aggregate disbursements also place Karnataka in a better position. On the resource front, while Karnataka has all along performed better than the other states in terms of tax revenue as a proportion to revenue expenditure, that of non-tax revenue does not compare favorably with other states. Yet another cause for concern is that its contribution to revenue expenditure has been constantly on a decline, reflecting the poor recovery of user charges from the services provided by the government. A comparative profile of fiscal deficit in southern states is presented in Graph 4.1.2 which reveals that Karnataka has made a steady progress in the reduction of fiscal deficits during the study period and also compares well with Andhra Pradesh and Kerala; Tamil Nadu however, has largely revealed lesser deficit levels than Karnataka.

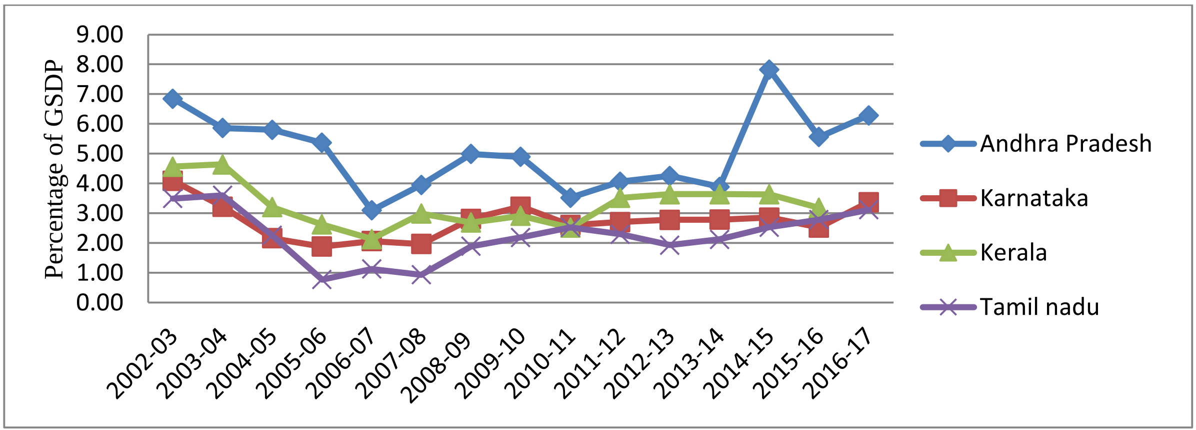
Table 4.2: Karnataka's fiscal indicators vis-à-vis all states

Years	Region	RD/GFD	CO/GFD	NDE/ AD	IP/RE	STR/RE	SNTR/RE
2004-05	Karnataka	-45.50	129.80	29.50	15.20	64.50	17.90
	All States	33.30	56.30	33.30	21.50	46.30	11.60
2006-06	Karnataka	-88.60	182.20	24.40	12.70	69.70	12.30
	All States	-32.10	126.50	32.20	18.40	49.90	12.50
2008-09	Karnataka	-18.70	113.00	23.60	10.90	66.40	7.60
	All States	-9.40	106.00	28.90	15.10	47.20	12.00
2010-11	Karnataka	-39.00	125.00	20.20	10.40	71.20	6.20
	All States	-1.90	94.10	30.80	13.40	49.40	9.80
2012-13	Karnataka	-13.00	106.70	21.50	9.00	87.00	15.40
	All States	-10.40	98.80	32.20	10.00	76.80	24.80
2014-15	Karnataka	-2.70	100.20	22.50	9.10	81.88	18.60
	All States	14.00	83.10	28.00	11.60	68.20	29.00
2015-16	Karnataka	-4.90	102.80	22.00	9.40	85.28	15.60
	All States	6.30	77.50	25.70	10.90	70.80	27.70
2016-17	Karnataka	-2.00	100.20	22.10	9.70	85.11	15.30
	All States	-4.60	98.70	27.40	11.40	71.30	29.60

Source: RBI State Finances - Various Issues

Note: RD: Revenue Deficit, GFD: Gross Fiscal Deficit, CO-Capital Outlay, NDE- Non development Expenditure; AD- Aggregate disbursement; RE: Revenue Expenditure, IP-Interest Payments, STR: State's Own Tax Revenue; SNTR: State's Own Non-Tax Revenue

Graph 4.1.2: Trends in Fiscal Deficit of Southern States

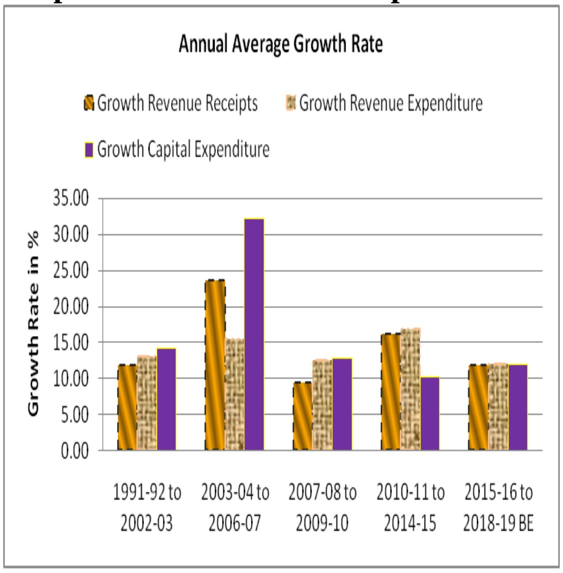


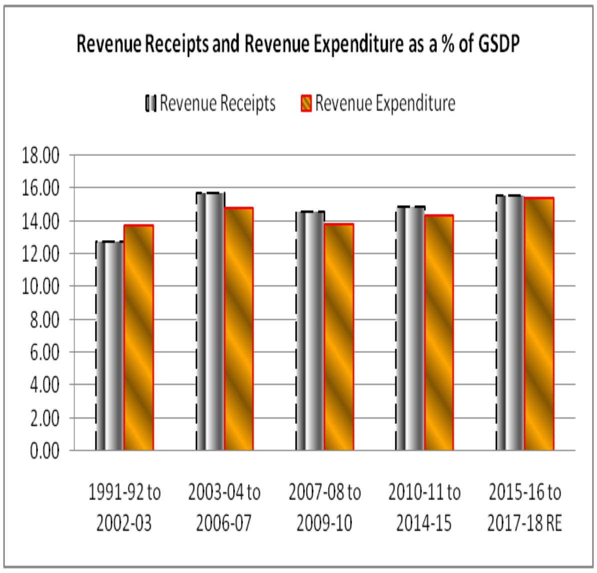
Source: RBI, State Finances various issues

IMPENDING CHALLENGES IN FISCAL SUSTAINABILITY

The Karnataka state's ability to meet all the stipulated fiscal targets and also its better fiscal performance in comparison with the major states is laudable. The trends in expenditure discussed in chapter three have clearly indicated a more rapid growth of revenue expenditure since 2010-11 causing the revenue surplus to decline in a significant manner. The phase wise annual average growth rate of revenue receipts revenue expenditure and capital expenditure presented in Graph 4.1.3 a clearly reveals that the state had significant gains in containing the rate of growth of revenue expenditure within revenue receipts after the launch of KFRA i.e.2003-04 to 2007-08 which continued during the global recession period also. However, from the FY 2010 onwards the rate of growth of revenue expenditure has been much higher. Revenue receipts and expenditure as percent of GSDP presented in 4.1.3 b also reveal this.

Graph 4.1.3a and 4.1.3 b: Expenditure and Revenue Indicators of Karnataka





Source: Finance Department, GoK

In the event, these trends continue very soon the state may end up with revenue deficits once again given the fact that revenue expenditure tends be largely committed in nature. However, since the legislative requirements under the KFRA do not allow revenue deficits to prevail, the state will be forced to resort to cuts in development spending in view of difficulties associated in cutting down committed expenditure in view of its downward rigidity. Details of committed expenditure are presented in chapter three.

CHAPTER 5
PUBLIC DEBT IN KARNATAKA

The present chapter analyzes the growth and composition of public debt of Karnataka since 2006-07. According to the FRA, total liabilities include those under Consolidated Fund and the Public Account, the former includes the internal debt and loans and advances from Government of India. It also includes off budget borrowings. Outstanding liability of GoK has sharply increased by more than doubling from Rs 57682 crore in 2006-07 to Rs 271144 crore in 2018-19 (BE), amounting to a 4 fold increase in absolute terms. The total outstanding liability inclusive of off budget borrowing has increased from Rs 4837 crore to Rs. 15646 crore during the above reference period. However, outstanding liability as percent of GSDP has declined from 33.21 percent to 26.44 percent and that of off budget borrowing has also declined from 2.57 percent to 1.38 percent during the reference period. (Table 5.1) This declining trend has been a feature of the Indian states caused by the debt relief linked to the rule based correction. Thirteenth Finance Commission had stipulated that the debt/GSDP ratio should be restricted to 25.5 percent of GSDP by 2014.15. Karnataka state has amended section 4 of the FRA to incorporate the ceilings. The FRA ceilings for outstanding debt as percent of GSDP and the total liability to GSDP ratios provided in table 5.2 reveal that the state government has been in a position to contain the debt to the prescribed levels except for the recent two years.

Table 5.1: Karnataka's fiscal liability (Rs in crores)

Year	Outstanding Liabilities (Year End)	Off Budget Borrowings	Total Outstanding Liabilities (Year End)
2006-07	57682 (25.38)	4837 (2.13)	62519 (27.51)
2007-08	60143 (22.22)	3701 (1.37)	63844 (23.59)
2008-09	71550 (23.06)	3736 (1.20)	75286 (24.26)
2009-10	83482 (24.73)	3249 (0.96)	86731 (25.69)
2010-11	91943 (22.39)	2349 (0.57)	95192 (23.18)
2011-12	103030 (22.63)	3249 (0.71)	106279 (23.35)
2012-13	116767 (22.35)	1388 (0.27)	118155 (22.62)
2013-14	135318 (22.06)	2942 (0.48)	138261 (22.54)
2014-15	158553 (23.13)	5726 (0.84)	164279 (23.96)
2015-16	175623 (23.08)	7697 (1.01)	183320 (24.10)
2016-17	211071 (24.81)	10249 (1.20)	221320 (26.02)
2017-18 RE	238778 (25.05)	13197 (1.38)	251976 (26.44)

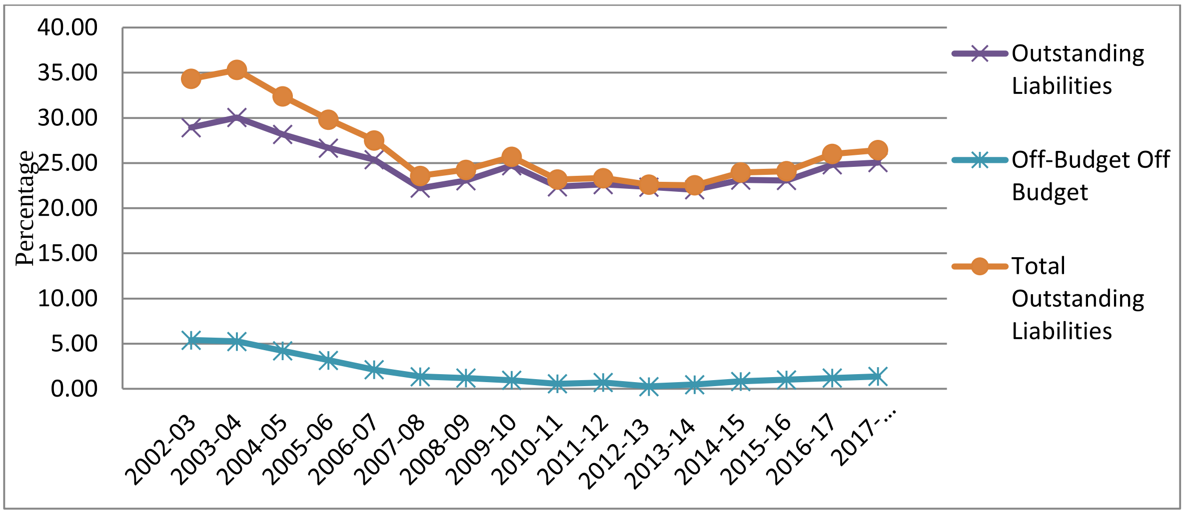
Source: Finance Department-GOK Note: Figures in parenthesis indicate % to GSDP

Table 5.2: FRA ceiling and outstanding liability to GSDP

Year	FRA Ceiling	Outstanding to GSDP
2011-12	26.0	23.35
2012-13	25.7	22.62
2013-14	25.4	22.54
2014-15	25.2	23.96
2015-16	25 #	24.10
2016-17	25 *	26.02
2017-18		26.44

Source: GoK, MTFP, 2013-17. # Budget Estimates, * Revised Estimates

Graph 5.1.1: Total Liabilities as % GSDP



Source: Finance Department-GOK

COMPOSITION OF DEBT

Public debt in Karnataka has increased by 250 percent points increasing from Rs 40048crore in 2006-07 to Rs 147360 crore in 2018-19 (BE). Karnataka's public debt is largely sourced from NSSF and market borrowings, the former has had a smaller increase of 19 percentage points from Rs 19305 crore in 2006-07 to Rs 23040 crore in 2016-17 where as that of latter has revealed the largest increase of 804 percent points from Rs 11702 crore to Rs 105890 crore and its share in total public debt has radically increased from 27.96 in 2006-07 to 71.86 percentage in the recent year. Although loans from financial institutions have had the second largest increase of 104 percent points among all the major components, its share in the total is quite small. Loans from Government of India has increased from Rs 9199 crore to Rs 14480 crore revealing a 56 percent increase.(Table 5.3) The annual growth of public debt (table 5.4) reveals that there has been a sharp increase in debt during 2008-09, 2009-10, 2013-14 as compared to the other years. Market loans revealed a very sharp hike in 2008-09 to the tune of 54.92 percent and 65.83 percent in 2013-14.

Table 5.3: Composition of Debt in Karnataka

Years	Market Borrowings	Loans from Financial Institutions	NSSF	GOI Loans	Total
2005-06	11934 (29.8)	1932 (4.83)	16827 (42.02)	9282 (23.18)	40048
2006-07	11702 (27.96)	1639 (3.92)	19305 (46.13)	9199 (21.98)	41845
2007-08	11989 (27.96)	1852 (4.32)	19514 (45.52)	9557 (22.29)	42873
2008-09	18573 (37.38)	2072 (4.17)	19351 (38.95)	9692 (19.51)	49688
2009-10	23527 (42.49)	2343 (4.23)	19597 (35.39)	9902 (17.88)	55370
2010-11	24564 (41.44)	2762 (4.66)	21435 (36.16)	10514 (17.74)	59276
2011-12	30771 (47.11)	2969 (4.55)	20591 (31.53)	10981 (16.81)	65314
2012-13	32160 (47.78)	3420 (5.08)	20070 (29.82)	11660 (17.32)	67310
2013-14	53330 (60.23)	3370 (3.81)	19730 (22.28)	12110 (13.68)	88540
2014-15	69420 (65.73)	3320 (3.14)	20170 (19.10)	12700 (12.03)	105610
2015-16	84330 (68.47)	3460 (2.81)	21730 (17.64)	13650 (11.08)	123170
2016-17	105890 (71.86)	3950 (2.68)	23040 (15.64)	14480 (9.83)	147360

Source: Finance Department-GOK Note: Figures in parenthesis indicate % to Total Public Debt

For 2005-2008 Loans from financial institution=loans from LIC + GIC + NABARD+ Loans from other institutions+ loans from state bank and other banks and Market loans include=Market Loans bearing interest +Market loans not bearing interest.

Table 5.4: Annual Growth Rate

Years	Market Borrowings	Loans from Financial Institutions	NSSF	GOI Loans	Total
2006-07	-1.95	-15.2	14.73	-0.89	4.49
2007-08	2.45	13	1.08	3.88	2.46
2008-09	54.92	11.88	-0.84	1.41	15.9
2009-10	26.67	13.09	1.27	2.17	11.44
2010-11	4.41	17.87	9.38	6.19	7.06
2011-12	25.27	7.52	-3.94	4.44	10.19
2012-13	4.51	15.15	-2.53	6.18	3.05
2013-14	65.83	-1.46	-1.69	3.86	31.54
2014-15	30.17	-1.48	2.23	4.87	19.28
2015-16	21.48	4.22	7.73	7.48	16.63
2016-17	25.57	14.16	6.03	6.08	19.64

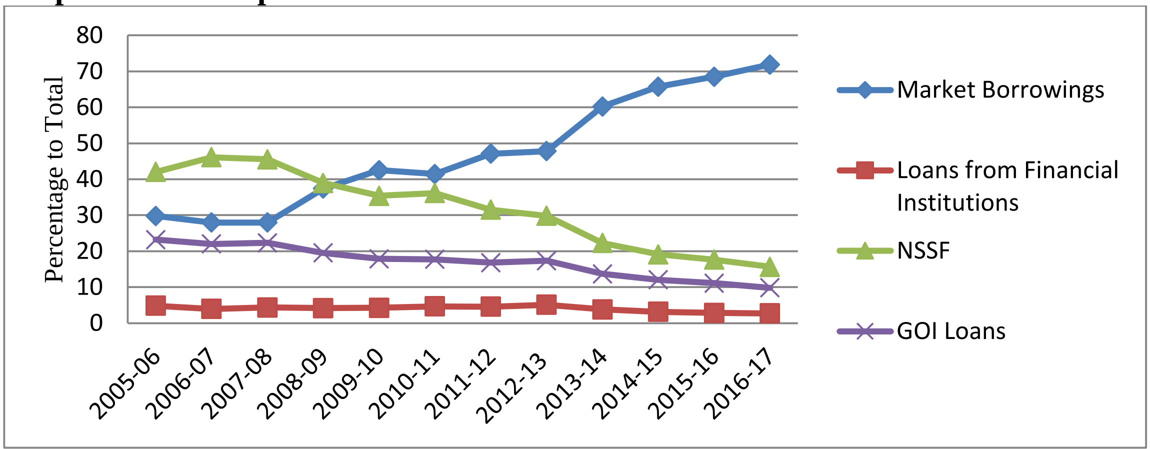
Source: Finance Department-GOK

Table 5.5: Percentage composition of debt

Years	Market Borrowings	Loans from Financial Institutions	NSSF	GOI Loans
2005-06	29.80	4.83	42.02	23.18
2006-07	27.96	3.92	46.13	21.98
2007-08	27.96	4.32	45.52	22.29
2008-09	37.38	4.17	38.95	19.51
2009-10	42.49	4.23	35.39	17.88
2010-11	41.44	4.66	36.16	17.74
2011-12	47.11	4.55	31.53	16.81
2012-13	47.78	5.08	29.82	17.32
2013-14	60.23	3.81	22.28	13.68
2014-15	65.73	3.14	19.10	12.03
2015-16	68.47	2.81	17.64	11.08
2016-17	71.86	2.68	15.64	9.83

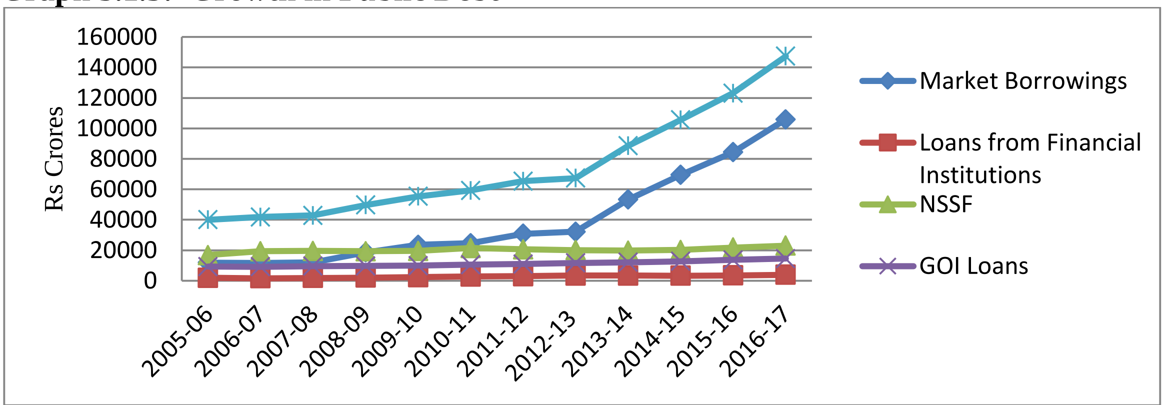
Source: Finance Department-GOK

Graph: 5.1.2: Composition of Debt



Source: Finance Department-GOK

Graph 5.1.3: Growth in Public Debt



Source: MTFP, various issues

CONTINGENT LIABILITY

Guarantee extended by governments become liability in the event of default by the borrower. Government of Karnataka's Ceiling on Government Guarantee Act of 1999 prescribes a cap on the guarantees extended by the government, at the end of any year, at 80 percent of state's revenue receipts of the second preceding year. Details regarding guarantees given by Karnataka provided in table 5.6 reveal that they have remained within the stipulated levels during all the time points. Karnataka government has also recognized the importance of exercising due diligence while providing guarantees.

Table 5.6: Guarantees given by the Karnataka government (Rs in crores)

Details/Years	Maximum amount guaranteed	Outstanding amount of guarantees (Including interest)	Percentage of outstanding amount Guaranteed to total revenue receipts of preceding year
2008-09	18732	8693	23
2009-10	18420	7203	18
2010-11	19150	6618	15
2011-12	13262	6515	13
2012-13	14306	6688	10
2013-14	16145	7783	11.2
2014-15	16869	11033	14.1
2015-16	18358	13324	14.9
2016-17	21115	15392	14.8

Source: Report of the Comptroller and Auditor General of India on State finances (2016-17)

FISCAL SUSTAINABILITY INDICATORS

Fiscal sustainability has been an important issue of debate in the current literature. A number of indicators have been used to assess the fiscal health of governments. The study by Dholakia, et al, 2004 identifies indicators such as public debt to GSDP ratio; fiscal deficit to GSDP; primary deficit/GSDP; interest payments/revenue receipts; interest payments/state's own revenue receipts; interest payments/total expenditure; state's own revenue/ revenue receipts; revenue deficit/gross fiscal deficit to assess the fiscal health of state governments. In the context of debt sustainability it is argued that debt/state's own revenue ratio as a more critical indicator than that of debt/GDP ratio.

These indicators have been analyzed earlier on in various chapters. These are put together in table 5.7 for the time period 2006-07 till 2018-19 (BE) to understand the fiscal health of Karnataka. The debt/GSDP ratio of Karnataka has declined from 33.21 percent in 2006-07 to 20.36 percent in 2018-19 (BE). Interest payments as percent GSDP, has declined from 1.86 percent to 1.49 percent (from 2006-07 to 2017-18 RE); interest payments to revenue receipts and own tax revenue has drastically declined. All these indicators and many other expenditure indicators such as per capita development expenditure, per capita plan expenditure discussed elsewhere in the report reveal that Karnataka's fiscal performance has been sound.

Table 5.7: Select Fiscal Sustainability Indicators

Years	Interest payments/GSDP	Interest payments/Rev Exp	Interest payments/Rev Rec	Interest payments/Own Tax Rev
2006-07	1.86	12.67	11.27	18.18
2007-08	1.67	12.06	11.97	17.34
2008-09	1.46	10.88	10.47	16.39
2009-10	1.54	10.97	11.23	17.05
2010-11	1.37	11.89	11.78	14.59
2011-12	1.33	9.31	8.68	13.04
2012-13	1.31	8.96	8.74	12.71
2013-14	1.28	8.79	8.75	12.52
2014-15	1.37	9.08	9.03	13.40
2015-16	1.41	9.18	9.04	14.22
2016-17	1.41	9.12	9.03	14.51
2017-18 RE	1.49	9.73	9.70	15.45
2018-19 BE		9.97	9.96	15.67

Source: Gok, Finance Department

While it is gratifying to note that the overall debt position in terms of GSDP and the interest payments are well within the stipulated levels, an important area of concern is the huge impending debt repayment, which are expected by grow almost ten times during 2018-22. Government borrowings are expected to be productively used such that the debt servicing and repayments are made possible through the returns of the capital investments made with such resources. In the present context it is not very clear as to how these resources are used, the available evidence suggests that as on March 2012 GoK had invested INR 44295 crore in government companies, corporations etc., and the return from these investments, although on increase from INR 23.4 crore in 2007-08 to INR 60.56 crore constitutes hardly 0.1 percent of the investment. (CAG, 2013) Given these current trends in the returns from investments, the government will be forced to raise fresh loans to repay the old loans and there is every possibility that such practices can result in debt spiral and the government has to take early precautionary measures to prevent such fiscal crisis in future times.

Table 5.8: Contingent Liabilities

Contingent Liabilities				% of GSDP	
Years	Maximum amount guaranteed	Outstanding amount of guarantees (Including Interest)	GSDP	Maximum amount guaranteed	Outstanding amount of guarantees (Including Interest)
2007-08	23109	10786	270629	8.54	3.99
2008-09	18732	8693	310312	6.04	2.8
2009-10	18420	7203	337559	5.46	2.13
2010-11	19150	6618	410703	4.66	1.61
2011-12	13262	6640	455212	2.91	1.46
2012-13	14306	6668	522369	2.74	1.28
2013-14	16145	7783	613450	2.63	1.27
2014-15	16869	11033	685547	2.46	1.61
2015-16	18358	13324	760781	2.41	1.75
2016-17	21115	15392	850612	2.48	1.81

Source: Finance Department –MTFP (Various years), GoK.

CHAPTER 6

POWER SECTOR IN KARNATAKA

Power sector development has been majorly government's responsibility since the beginning of Plan era, private sector participation is highly encouraged ever since the introduction of reforms. Government's participation through the budgetary support extended to the power sector's development will have direct implications on the state finances. State objectives in promoting power sector's development cannot be limited to economic reasons of enhancing growth but also to serve a number of social objectives of enhancing the standard of living of weak and the downtrodden. Power sector is highly essential for economic growth, being an important input in all the sectors of an economy. Power shortage leads to economic loss of industries and agriculture, besides lowering the overall standard of living in the economy, hence the state has a major role to play in ensuring adequate power supply.

Karnataka is one of the first Indian states to introduce power sector reforms in order to reduce power deficit and solve financial problems. Karnataka Electricity Reform Act, KERA, 1999, which mandated for unbundling of the Karnataka Electricity Board (KEB), and transferred the function of transmission and distribution to the newly corporatized Karnataka Power Transmission Corporation Limited (KPTCL), aimed to improve power accessibility in the state by solving the technical and financial problems. An independent regulatory commission called Karnataka Electricity Regulatory Commission (KERC) was also formed. At present, electricity supply in the state comes mainly from the generating stations of Karnataka Power Corporation Limited (KPCL), private players/Independent Power Producers (IPPs), allocation from Central generating stations, and procurement from other states. Majority of the public sector generation is from thermal source, while the main modes of private sector generation are thermal and renewable sources (RES).

Electricity transmission in Karnataka is handled by KPTCL, while the five Electricity Supply Companies (ESCOMs) are responsible for distribution of electricity to the entire state. The end-consumers comprise of many categories, including industries, agriculture, domestic, commercial, public lighting and others, which pay differential tariffs for electricity.

POWER SECTOR DEVELOPMENT AND BUDGETARY IMPLICATIONS

There are a number of ways that government participation in power sector development can impact on the state finances. The financial performance of power sector direct investments, the pricing policy, the costs associated with fiscal instruments used in promoting private sector investment, subsidies extended to promote consumption, cost of production etc. The fiscal implications of the policies could also range from short term to long term. It is essential to understand the fiscal implications of power sector development pursuits of the state government.

To do so, some important indicators are considered which are listed in Table 6.1.

Table 6.1: Major indicators of power sector development

Indicators	Explanation
Investment in power sector	The flow of funds from the state government to power sector
Revenue expenditure and Loans and advances by the state government on power sector	Flow of expenditure of state government on power supply
Cost recovery from electricity supply	Measured by the percentage of receipts to revenue expenditure on power sector
Subsidy	Indicates the amount of funds inflow to power sector from the state government as subsidy
Revenue realization, Cross subsidization and Commercial losses	Reflects the differential revenue realization from different categories and its trend over time. The losses show the financial condition of the utilities
Installed capacity addition	Addition of capacity through various modes indicates inflow of investment and progress in power sector
Electricity generation growth	Indicates the utilization of existing capacity for power supply
Capacity utilization	Indicates the utilization of capacity, better utilization can reduce the need for additional investment

INVESTMENT IN POWER SECTOR

There are outlay and expenditure components in the state finances specifically for power sector development. Planned outlays have been much higher than the actual investment, the issue that arises is if the planned outlays are based on a scientific need assessment and any shortfall amounts to underinvestment. After the unbundling of KEB, KPTCL and subsequently, the ESCOMs were expected to function as corporations working on commercial principles. Thus, the government contribution was bound to decline over time, as the major expenditures were supposed to be undertaken by the utilities from their own revenues. These utilities however, do obtain loans and advances from the state government to power sector remained quite high, due to several financial issues. Some figures of the power sector investment by the state government is presented in Table 6.2.

Table 6.2: Investment in power sector (Rs crore)

	Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
KPCL	**Plan Outlay**	1861.18	2439.65	2808	2850	2685	2526.51	1822
	Expenditure	1206	2363	2339.26	2588.55	2343.76	1535.32	714.85
KPTCL & ESCOMs	**Plan Outlay**	1376.28	1200	1250	1200	1200	2476.8	2000
	Expenditure	1132	747	1250	1200	1200	2476.8	2000
Capital Outlay for Power Projects	**Plan Outlay**	800	300	820	820	869.02	861.29	827
	Expenditure	1065	1162	820	770	869.02	861.29	620.22

Source: Finance Department, Government of Karnataka

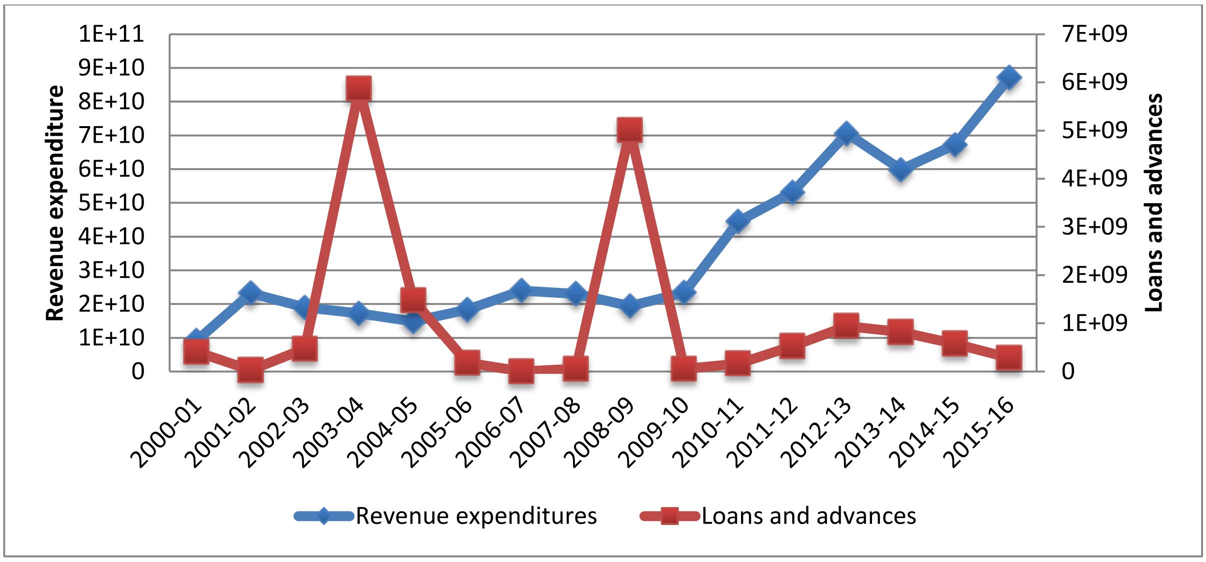
Table 6.3: Revenue expenditure and Loans and advances by the state government on power sector in Karnataka (Rs in crore)

Year	Revenue expenditures	Loans and advances
2000-01	920	408
2001-02	2321	29
2002-03	1901	472
2003-04	1722	5868
2004-05	1483	1478
2005-06	1833	181
2006-07	2399	0
2007-08	2304	56
2008-09	1945	5000
2009-10	2343	53
2010-11	4449	164
2011-12	5309	526
2012-13	7054	940
2013-14	5983	817
2014-15	6723	576
2015-16	8716	282

Source: Finance Accounts of Karnataka, various years

There has been a substantial increase in the revenue expenditure of the power sector under the head 'Assistance to Electricity Boards' which mainly relates to the subsidy element by the government on account of subsidies to power sector continue to rise with time (Graph 6.1.1). Very often, the amount provided in the budget does not represent the entire subsidy dues from the government.

Graph 6.1.1: Trend of Revenue expenditure and Loans and advances by the state government on power sector in Karnataka (Rs)



Source: Finance Accounts of Karnataka, various years

The loans and advances by the state government fluctuate substantially with high intermittent values, while the revenue expenditures seem to be rising in recent years. While the revenue expenditure is high and rising, the recovery rate is declining, as shown in Table 6.4. The percentage of cost recovery to expenditure declined from 3.8 in 2007-08 to 0.4 in 2015-16.

Table 6.4: Percentage of Revenue receipts to revenue expenditure on Karnataka power sector (%)

Year	Revenue receipts	Total Revenue expenditure	Receipts/ Expenditure percentage	Non-plan revenue expenditure	Receipts/ non-plan expenditure percentage
2007-08	87.52	2304.26	3.8	2299.03	3.81
2008-09	82.82	1945.09	4.26	1944.56	4.26
2009-10	60.12	234.337	2.57	234.295	2.57
2010-11	47.57	4448.53	1.07	4444.06	1.07
2011-12	5.31	5309.36	0.1	5307.36	0.1
2012-13	90.65	722.95	1.25	322.07	2.81
2013-14	39.54	5982.98	0.66	5962.98	0.66
2014-15	62.53	6723.01	0.93	6703.01	0.93
2015-16	32.22	8716.41	0.37		

Source: Computed by the author from RBI State Finances and Finance accounts

The revenue receipts for some major Indian states are shown in Table 6.5. Gujarat, Maharashtra, Odisha and Tamil Nadu witnessed decline in all the components of revenue receipts in terms of GSDP. Especially, Gujarat's Own Non-Tax Revenue has declined substantially during 2004-05 to 2010-11. It was 1.5 percent during 2004-05 to 2008-09 and came down to 1.3 percent of GSDP in 2009-10. Further it has fell down to 1 percent of GSDP in 2010-11. At the same time, cost recovery of the power sector an average for all states (ratio of Non Tax Revenue to Non-Plan Expenditure) has also decreased from 18.1 in 2008-10 to

13.4 in 2010-11 and further plunged to 12.0 in 2011-12 (RBI State Finances, 2012-13 and 2013-14). The above mentioned trends probably reduce the revenue receipts in states like Gujarat and Karnataka for the corresponding years.

Table 6.5: Revenue receipts for power sector of major Indian states (Rs lakh)

Year	Karnataka	Gujarat	Maharashtra	Andhra Pradesh	Himachal Pradesh
2007-08	8752	658	34407	2513	141452
2008-09	8282	7752	41328	1577	125543
2009-10	6012	2	45661	2612	121480
2010-11	4757	1	48542	2761	101321
2011-12	531	10500	72501	3843	114570
2012-13	9065	10593	45141	2812	63715
2013-14	3954	868	61750	4156	69629
2014-15	6253	3	69118	135075	112151
2015-16	3222	401	61998	1245	92368

Source: RBI State Finances

SUBSIDY TO POWER SECTOR

The matter of subsidy to power sector is perhaps the most critical aspect in the context of its implications on the state finances. The subsidy released for electricity supply to irrigation pump sets (IPS) was to the tune of Rs 8143 crore in 2015-16 (Table 6.6).

Table 6.6: Subsidy for Irrigation pump sets (Rs crore)

Year	Subsidy released (Rs. Crore)
2007-08	1650.0
2008-09	1742.7
2009-10	2091.1
2010-11	3776.3
2011-12	4851.3
2012-13	6500.0
2013-14	5460.0
2014-15	6200.0
2015-16	8143.3
2016-17 (Upto Dec-2016)	4280.0

Source: Economic Survey of Karnataka

It is a significant amount flowing into one sector, given the fact that it is not being utilised for capital formation or further investment. It was supposed to be for the benefit of the poor farmers and to boost agricultural growth. However, the low quality and erratic power supply to IPS defeats the purpose of the subsidy thereby leading to insignificant outcome in production. In addition, the subsidy is found to be regressive, in the sense that the rich farmers owning land and IPS could reap the benefits of the subsidy, while the poorer farmers remain out of the beneficiary net. The state government is investing huge amount of funds as subsidy when it is not producing the desired results. It seems to be a loss-loss situation, nonetheless, there have been hardly any bold policy interventions to resolve this issue, which is the need of the hour.

Despite the subvention from the state and cross subsidization, the utilities continue to have 'Uncovered Subsidy[1]', which remains a crucial loophole for the utilities' finances. This component has increased to about Rs 538.6 crore in 2012-13; nonetheless, it is lower than other major Indian states (Table 6.7)

Table 6.7: Uncovered subsidy of power utilities of major Indian states (Rs crore)

	Uncovered subsidy (Rs crore)	
States	**2009-10**	**2012-13**
Andhra Pradesh	1417.2	2001.9
Gujarat	207	913.4
Karnataka	473.3	538.6
Kerala	1423.5	2120.8
Rajasthan	11291.5	14053.3
Tamil Nadu	10705.3	8465.6
West Bengal	890.1	1085.6

Source: Annual Report on the Working of State Power Utilities & Electricity Departments, Planning Commission, 2014

REVENUE REALISATION, CROSS SUBSIDIZATION AND COMMERCIAL LOSSES

There are different consumer categories of electricity who pay varying tariff rates for their consumption. Ideally, the pricing of any commodity should be based on economic/financial grounds of breaking even, if not making profits. However, power sector has been experiencing government interference in its tariff policies since the late 1970s due to the decision of de-metering IPS and charging zero/ minimal tariffs for electricity. This opened the flood gate to numerous problems and issues in the sector which are still persisting till date. The electricity consumption by the IP sets is the highest (33.5% of the total in 2017-18) followed by domestic consumers (24.6%) (Table 6.8).

High electricity use by agriculture should ideally contribute to higher sector growth and production, however, the issue lies with the faulty measurement of the electricity use by the IPS, because the de-metering of the IPS made it difficult to segregate and measure the agricultural consumption accurately. Moreover, the quality and duration of power supply to IPS is extremely poor, thereby failing to translate to higher agricultural output.

One of the most important effects of the differential tariff policy is the cross-subsidization, where industries and commercial consumers pay higher tariffs to compensate for the subsidised power supply to IPS and other consumers. This has led to industries resorting to establishing their own captive power plants for more reliable power, which implies loss of revenue-

1 Uncovered subsidy = Gross subsidy - Subvention from state - surplus from other users

generating customers for the utilities. Thus, the reforms aimed to reduce the cross-subsidization over time.

Table 6.8: Trend and composition of Electricity consumption in Karnataka

	Consumer-Categories	Industries	IP Sets	Domestic	LT Industries	Water Works & Sewage Pumping	Commercial Lighting	Public Lighting	Others	Total
Consumption (MU)	2012-13	7,609	16,995	9,105	2,541	2,172	5,778	801	656	45,657
	2013-14	8472.43	16788.31	9535.375	1834.75	2383.36	5724.16	812.28	1304.51	46855.18
	2014-15	8352.78	17889.17	10592.76	1889.14	2476.88	5812.56	876.34	1511.02	49400.64
	2015-16	7946.74	19239.49	11044.9	1905.67	2559.89	6128.7	870.56	1374.89	51070.83
	2016-17	7677.34	21504.19	11762.18	1925.96	2901.31	6539.15	923.23	950.11	54183.47
	2017-18*	5326.96	11636.63	8544.7	1284.26	2054	4406.86	655.03	864.8	34773.24
Percentage of sales (%)	2012-13	16.66	37.22	19.94	5.56	4.76	12.65	1.76	1.45	100
	2013-14	18.08	35.83	20.35	3.92	5.09	12.22	1.73	2.78	100
	2014-15	16.91	36.21	21.44	3.82	5.01	11.77	1.77	3.06	100
	2015-16	15.56	37.67	21.63	3.73	5.01	12	1.7	1.88	100
	2016-17	14.17	39.69	21.71	3.55	5.35	12.07	1.7	1.75	100
	2017-18*	15.32	**33.46**	24.57	3.69	5.91	12.67	1.88	2.49	100

Source: Economic Survey of Karnataka

The average revenue realisation (ARR) from different categories is widely different. Table 6.9 shows that the ARR from the IPS has risen from Rs 3/kWh to Rs 5/kWh in 2017-18, while that of the industries has grown from Rs. 5.9 to Rs 8.7/kWh. The coefficient of variation (CV) and the ratio of maximum to minimum value are used to observe the variation of ARR among the consumer categories. From 2012-13 to 2017-18, the CV and the Max/Min ratio have declined, albeit marginally. This indicates that the cross subsidy has fallen slightly over time, which reflects that the reforms might have helped in improving the situation to a certain extent (Table 6.9).

A corporation should run on the basis of commercial principles in order to re-invest and contribute in capital formation, which is imperative in all the sectors of an economy to achieve economic growth. The financial health of power is assessed through some indicators like revenue to cost ratio, and commercial profit/ loss[2] of the sector.

Table 6.9: Average revenue realization (Rs/kWh) and cross-subsidization among different consumer categories

Category of Consumers	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18*
Industries	5.9	6.0	6.7	7.4	7.6	8.7
IP Sets	3.0	3.2	3.7	4.1	4.4	5.0
Domestic	4.1	4.3	4.7	5.3	5.1	5.8

[2] Commercial profit/loss = Total revenue - Revenue expenditure - Depreciation - Interest payable (Source: Planning Commission)

LT Industries	5.8	5.9	6.3	6.8	6.8	7.6
Water Works & Sewage Pumping	4.7	5.0	5.4	6.0	5.8	6.4
Commercial Lighting	7.6	8.0	8.2	9.1	9.1	9.8
Public Lighting	5.4	6.2	7.0	7.7	8.0	8.6
Others	6.9	7.9	6.6	10.5	9.3	9.0
Total	4.6	4.9	5.3	5.9	5.9	6.7
Coefficient of Variation (CV)	0.27	0.28	0.24	0.29	0.26	0.23
Maximum/Minimum ratio	2.53	2.45	2.23	2.57	2.13	1.97

* Upto Nov 2017

Source: Computed from Economic Survey of Karnataka, various years

Table 6.10: Sales revenue to cost ratio and commercial profit (with subsidy) (Rs crore) of major Indian states

	Sales revenue as a ratio of cost		Commercial profit (with subsidy)	
States	**2009-10**	**2012-13**	**2009-10**	**2012-13**
Andhra Pradesh	66.3	76.1	38.5	-2878.7
Gujarat	92.5	92.9	91	48.1
Karnataka	**85.9**	**91.3**	**-257.9**	**171.4**
Kerala	76.9	67.5	-986.8	-3323.7
Maharashtra	92.2	99.6	40.1	1043
Tamil Nadu	57.5	63.9	-10294.3	-9239.7
West Bengal	89.8	92.9	100.8	104.8

Source: Annual Report on the Working of State Power Utilities & Electricity Departments, Planning Commission, 2014

The sales revenue to cost ratio in Karnataka increased from 85.9 to 91.3 during 2009-2013, nonetheless, was exceeded by states like Gujarat, Maharashtra, and West Bengal. On the other hand, the commercial loss in Karnataka in 2009-10 changed to profit in 2012-13, which reflects a better scenario compared to other states, except, Maharashtra.

The losses accrue mainly to the distribution segment, due to the subsidy policy. Despite the cross-subsidization, and re-imbursement from the state government, the cost of power supply was not completely recovered by the ESCOMs. Thus, the State government bridged the difference by giving further financial support called gap subsidy, which was about Rs.1696 crore in 2006-07 and Rs.433 crore in 2010-11 (CAG, 2011). It is of tremendous concern that major financial support to the ESCOMs comes via government subsidy, which would have been better utilised for capital formation or other areas of greater priority.

After considering all the subsidies, the ESCOMs still faced a net loss of about Rs 281.4 crore in 2010-11 (Table 6.11), which is a matter of critical concern for the power sector as well as state finances. The state did spend substantial amount of funds on power sector, nonetheless, it appears to be going to a bottomless pit which does not contribute to development purposes, nor capital formation.

Table 6.11: Profit before tax and subsidy in respect of the ESCOMs (Rs crore)

Detail	2006-07	2010-11
Profit/loss(-) of ESCOMs	-1671.3	-4534.1
Subsidy for KJ/BJ and IPS	87.27	3819.66
Net profit/loss (-)	-1584.0	-714.4
Gap subsidy	1696.38	433
Net profit/loss (-) after all subsidies	112.4	-281.4

Source: Commercial Audit, Comptroller and Auditor General, 2011

KPCL handles the public sector electricity generation in the state. The ESCOMs purchase power from KPCL for which they often fail to make timely and adequate payment, due to poor revenue realisation. The dues receivable from the ESCOMs increased from about Rs.2525 crore by March 2006 to Rs.4032 crore by March 2010. This led to higher dependence on short term loans to meet operational requirements. The borrowings increased from Rs.4552.4 crore in 2006 to Rs.7381.9 crore in 2010 (CAG, 2010). The State government infused capital to KPTCL as well. The details are given in Table 6.12.

Table 6.12: Financial position of KPTCL (Rs crore)

Details	2007-08	2011-12
Paid-up capital	690.3	1675.3
Borrowings	3236.1	5587.8
Profit before tax	124.9	8.7

Source: Audit report, CAG, 2012

The government had stipulated the Company to design and monitor framework for capital expenditure for each project with investment above Rs.5 crore and obtain cabinet approval, however, the guidelines were not adhered to. The Return on Capital (RoC) which indicate efficiency and profitability in capital investment, declined from 8.9 % in 2007-08 to 6.2% in 2011-12 due to decrease in profit and rise in net fixed assets. The profit before tax fell to about Rs.8.7 crore in 2011-12, nevertheless it remains positive.

INSTALLED CAPACITY AND ELECTRICITY GENERATION

The overall progress of Karnataka power sector in terms of installed capacity and generation is highlighted in Table 6.13.

Table 6.13: Installed capacity and electricity generation in Karnataka

	Installed capacity (MW)								
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18*
1. Public Sector									
Hydel	3637	3652	3652	3,652	3,652	3,652	3,667	3,667	3,680
Wind energy	5	5	5	5	5	5	5	5	5
Thermal	1970	2220	2240	2,720	2,720	2720	2720	4,220	5,020
Diesel plants	108	108	108	108	108	108	108	0	0
Solar PV plant	6	6	9	14.00	14.00	14	24	24	34
Total	5726	5991	6014	6,499	6,499	6,499	6,524	7,916	8,739
Jurala Hydro						117	117	117	117
2. Private Sector									
IPP Thermal	109	709	709	1,550	1550	1200	1200	1,200	1,200
Mini Hydel	572	656	656	701	742.06	785	835.46	843.5	851.9
Wind energy	1513	1670	1976	2,177	2,365.3	2,677	2,911.3	3,798.7	3,840.4
Co-generation & Biomass	766	744	1001	1,171	1,247.58	1286	1,386.1	1,451.1	1,519.6
Solar					31	84	110	1,059.3	1,697.9
Total	2960	3779	4342	5,599	5,935.9	6,032	6,442.9	8,352.5	9109.8
Central generating station		1596	1700	1,836.00	1,921.00	2169	2,677.00	2,898	3,222
Total Installed capacity	**8686**	**11366**	**12056**	**13,934**	**14,355.9**	**14,817**	**15,760.9**	**19,283.5**	**21187.8**
	Electricity generation (MU)								
Hydel (KPCL)	12249	11366	14024.05	9,863.78	12,178.80	12,775.61	6,972.66	6,564.42	4,334.10
Thermal (KPCL)	13263	10434	12856.55	12,414.98	14,978.20	15,428.83	15,443.51	16,491.36	8,615.95
Private Sector	5546	8984	14920.85	23,328.29	19,008.95	17,999.75	18,940.59	8,158.59	5,500.00
Central projects	10974	11041	11571.81	11,443.54	12,617.30	14,340.31	15,203.77	23,267.00	10,918.69
Total electricity generation	42575	47272	53373.26	57,050.59	58,783.25	60,544.50	61,602.02	65,392.54	39,946.95

* Up to November 2017

Source: KTPCL, Economic Survey of Karnataka

As of November 2017, the share of private sector (42.9% of the total) exceeded that of public sector (41.8%) and Central generation plants (15.2%). This is perhaps because the AAGR of the public sector installed capacity (5.6%) is much lower than that of private capacity (15.6%) during 2010-2017. Out of the total installed capacity of 211878 MW in 2017, the share of renewable energy is as high as 37.5%, while the hydro-thermal mix in public sector capacity including central generating allocation is in the ratio of about 1:2, as the hydro capacity has stagnated over the years.

There has been a tremendous hike in RES capacity, especially in recent years, mainly wind and solar capacity. It is doubtlessly the most sustainable and environmentally friendly source of electricity generation which is abundantly available and renewable in nature. Nevertheless, the cost of solar generation remains on the higher side. For instance, the average purchase cost by BESCOM from solar mode is the highest at Rs.7.3/ kWh, followed by biomass at Rs.5.2/kWh and wind at Rs.3.6/kWh, as compared to hydro at Rs.0.9/kWh and thermal in the range of Rs.2.8 to 4.8/kWh (BESCOM, 2016)

CAPACITY UTILISATION

Adequate investment flows into power sector for installing capacities. However, the existing capacity should be optimally utilized in order to reap the full benefit of the investment. The Plant Load Factor (PLF) of a power station signifies the percentage of actual generation out of the maximum output that can be generated from the particular plant, thereby indicating the capacity utilization rate. The PLFs of some major power stations in Karnataka are presented in Table 6.14. The hydro power plants in general, have lower PLFs because they are used to meet peak demand, while the thermal power plants are used to meet the base load, as they cannot be immediately switched off and on as and when needed.

Table 6.14: Plant Load Factor (PLF) of some major power stations in Karnataka (%)

	Plant Load Factor (%)		
Power Stations	**Model**	**2010-11**	**2016-17**
Sharavathy	Hydro	49.7	29.6
Nagjhari	Hydro	28.1	16.9
Supa	Hydro	41.5	27.3
Varahi	Hydro	24.5	17.9
Raichur Thermal Power station (RTPS) Unit 1 to 8	Thermal	46.2-82.0	75.7-79.7
Bellary Thermal Power station (BTPS)	Thermal	60.2	56.5-78.1

Source: Economic Survey of Karnataka

The PLF of the thermal plants have come down in 2016-17 to lower than 80%, implying sub-optimal utilization of the existing power capacities, and sub-optimal electricity generation, which prompts for further investment in the sector. Therefore, the capacity utilisation of existing plants should be further enhanced to avoid unnecessary investment in the future.

ROLE OF PRIVATE SECTOR IN POWER DISTRIBUTION IN KARNATAKA

POWER DISTRIBUTION SYSTEM IN THE STATE

The Distribution of electricity, including retail electricity sale in the state is undertaken by five government sector distribution companies (ESCOMs), one rural electricity cooperative society and two Special Economic Zones (SEZs). The three non-government sector distribution units are operating under license provided/renewed by Karnataka Electricity Regulator Commission (KERC).

The distributions entities and their jurisdiction is specified below,

1. Bangalore Electricity Supply Company (BESCOM): Bangalore Urban, Bangalore Rural, Chikkaballapura, Chitradurga, Davanagere, Kolar, Ramanagara and Tumkur.
2. Mangalore Electricity Supply Company (MESCOM): Dakshina Kannada, Udupi, Shivamogga and Chikkamagaluru..
3. Chamundeswari Electricity Supply Company (CESC): Mysuru, Hasana, Mandya, Chamarajanagara and Kodagu.
4. Hubli Electricity Supply Company (HESCOM); Bagalakote, Belagavi, Vijayapura, Dharwad, Gadag, Haveri and Uttara Kannada.
5. Gulbarga Electricity Supply Company (GESCOM): Bellary, Bidar, Kalaburagi, Koppala, Raichur and Yadgir.
6. Hukkeri Rural Electricity Cooperation Society Limited (HRECS): Hukkeri Taluk of Belagavi district, Sutagatti and Maranahole villages of Belagavi taluk and Kamatyanahatti of Chikkodi taluk.
7. Mangalore SEZ (MSEZ): Exclusive area under Dakshina Kannada Distinct.
8. AEQUS SEZ: Exclusive area under Belagavi Distinct.

HRECS amongst the private distribution companies (Sl. No. 6 to 8), has playing considerable role in power distribution of the state.

HUKKERI RURAL ELECTRICITY COOPERATIVE SOCIETY LIMITED (HRECS)

HRECS was established through Rural Electrification Corporation Limited (RECS) in 1969 as a cooperative society under the Karnataka Cooperative Societies Act, 1959. The society is engaged in power distribution after initial license granted by Government of Karnataka since 1970. Later the society was granted license initially for five years after the formation of KERC from 2001. Thereafter, the KERC has extended the license for the society for another 25 years in 2006 via its order No. L/1/06 dated 14th November 2006.

The society has six zones. They are Hukkeri Urban Hukkeri Rural, Sankeshwar Urban, Sankeshwar Rural, Yamakanmaradi and Hidkal Dam. HRECS operates in 991.49 sq.km and serves about 1.2 lakh consumers in Hukkeri Taluk and other villages of Belagavi and Chikkodi taluk (KERC, 2018). The society's energy sale for the recent years is portrayed in the following table (Table 6.15).

Table: 6.15 Energy Sale, Average Tariff and Average Cost of HRECS

Year	Energy Sales (MU)	Average Tariff (Rs/KWh)	Average Cost (Rs/KWh)

2014-15	238.21	4.78	5.44
2015-16	264.36	4.96	5.59
2016-17	245.80	5.98	5.98
2017-18	275.10	5.92	5.92

Source: Economic Survey of Karnataka (various years)

Mangalore Special Economic Zone (MSEZ) is a multi-product SEZ jointly promoted by Oil and Natural Gas Company (ONGC), Fortune 500 Company, Infrastructure Leasing and Finance Services (ILFS), Karnataka Industrial Area Development Board (KIADB) and Karnataka Chamber of Commerce and Industry (KCCI). Sale of Power is one its principal business activities. Sale of Power of this organization has increased from 10.62 percent of its total turnover in 2015-16 to 17 percent in 2017-18 (Annual Report MSEZ, various years). At present, sale of power is its second major business activity with reference to total turnover of the company.

TREND OF AT&C LOSSES IN KARNATAKA

Table 6.16: AT&C (%) losses of DISCOMs in Karnataka

Year	BESCOM	GESCOM	HESCOM	MESCOM	CESC	Karnataka
2005-06	35.80	52.70	40.40	20.80	46.00	38.00
2006-07	26.90	47.00	37.40	12.10	40.60	31.20
2007-08	26.60	41.30	40.70	21.70	37.70	29.50
2008-09	19.20	38.80	33.90	14.00	25.30	23.20
2009-10	21.10	38.10	28.50	18.40	28.20	23.00
2010-11	22.80	25.80	26.20	13.80	28.70	22.00
2011-12	22.60	24.00	23.60	17.90	29.00	21.50
2012-13	20.50	18.30	20.40	14.60	30.40	19.50
2013-14	18.90	30.50	20.40	14.80	33.90	18.25
2014-15	NA	NA	NA	NA	NA	17.08
2015-16	NA	NA	NA	NA	NA	17.10
2016-17	NA	NA	NA	NA	NA	15.01
As of 12th December 2018	13.86	18.63	13.44	12.97	11.06	14.05

Source: Laxmi Rajkumari and K Gayithri (2017) from 2005-06 to 2013-14 for DISCOMs, Aggregate (Karnataka) AT&C losses data drawn from Economic Survey, 2017-18. The recent data is drawn from UDAY Website https://www.uday.gov.in/bond-issued-all.php?id=9&parameter_name=2

The tripartite MoU amongst Ministry of Power, GoI, Government of Karnataka (June, 2016) and all the five electricity distribution companies in Karnataka fixed the target to achieve 14.20% of AT& C losses by all the DISCOMs by FY of 2018-19. The state has achieved the target fixed by the MoU, as of December 2018. The MoU also specifies the trajectory of reduction in AT&C losses for each DISCOM and entire state. Though the state has not necessarily followed the path specified by the MoU, it has achieved the target within the fiscal year 2018-19 albeit, the GESCOM amongst the DICOMs has not yet achieved the target reduction and it has reported highest AT&C losses from 2005-06 to 2009-10. In general, the performance of MESCOM is exceptional as it has reported the lowest AT&C losses during 2005-06 to 2014-15.

SCHEMES

Innumerable schemes have been initiated by the government at the central and state level in power sector over time, some retaining the same components under new names, while some with minor changes. A prominent example of such initiative is **Ujwal DISCOM Assurance Yojana (**UDAY), which was launched by the Central Government in 2015, aiming for operational and financial turnaround of state-owned Power Distribution Companies (DISCOMs). The main objectives were to improve operational efficiency of DISCOMs, reduce cost of power, and financial turnaround (reduction in interest cost of DISCOMs).

Under this scheme, the States shall take over 75% of DISCOM debt as on 30th September, 2015 over two years (50% in 2015-16 and 25% in 2016-17).Government of India will not include the debt taken over by the States as per the above scheme in the calculation of fiscal deficit (FRBM Limit) of respective States in the financial years 2015-16 and 2016-17. DISCOM debt that is not taken over by the State would be converted by the Banks /financial institutions into loans or bonds with interest rate not more than the bank's base rate plus 0.1%. The state of Karnataka has signed MOU only for operational parameters (Economic Survey, 2017-18). Hence, the state of Karnataka has not takeover DISCOM debt. Therefore, Revenue and Fiscal deficits and public debt of the state has not influenced by the UDAY. However, there is a decrease in the gap between ACS and ARR in recent times. The table below present the details of gap between ACS and ARR across different power supply companies in Karnataka.

Table 6.17: The Gap between ACS and ARR

Companies	BESCOM	CESC	MESCOM	GESCOM	HESCOM	Karnataka
Rs/Unit	(-) 0.10	(-) 0.13	0.077	(-) 0.01	0.15	0.03

Source:https://www.uday.gov.in/bondissuedall.php?id=9&parameter_name=2

Note: BESCOM: Bangalore Electricity Supply Company, CESC: Chamundeshwari Electricity Supply Company, MESCOM: Mangalore Electricity Supply Company, GESCOM: Gulbarga Electricity Supply Company, HESCOM: Hubli Electricity Supply Company

The state also performed well and ranked in third place in overall performance of power sector according to UDAY.

There have been various such schemes where the government has bailed out the loss-making distribution utilities. However, such bail outs seem to serve merely short-term objectives, without any design or plan for long term solutions, nor an in-depth investigation of the real causes of the persisting problems in power sector. Prolonged crisis in financial health of power sector is and would continue to be very expensive for the state government in future, with no return whatsoever in terms of development or progress.

The electricity supply to agricultural irrigation pump sets (IPS), domestic and certain consumer groups are subsidized by the government since the late 1970s, claimed to be due to the political motive of gaining vote banks.

Such a policy has a large scale effect on the state finances, because the government is obligated to compensate the utilities for the subsidized supply of power to certain groups. The reforms aimed to resolve the financial issues that stemmed from the subsidization. In this regard, it is crucial to examine the impact of the power sector reforms on the finances of the state.

CHAPTER 7

KARNATAKA STATE PUBLIC SECTOR ENTERPRISES AND STATE'S FISCAL HEALTH

INTRODUCTION

Traditionally governments across the Globe have shouldered the responsibility of providing public utilities involving initial huge fixed costs with declining average and marginal costs which tend to render a natural advantage to the firms that make initial entry to have the cost advantage and thus attain natural monopoly status. Large scale investment by the government enterprises in public infrastructure spanning road and rail network, power and telecom networks was a predominant development strategy. With the onset of the neoliberal economic thinking most of the economists believe that market do a better job of resources allocation. Competitive markets augment the economic growth by providing incentives to the economic agents to be more productive, efficient and innovative. They also significantly enhance the welfare of the consumer through greater choice, lower prices and superior quality of goods and services(Crown, 2009). However, if left to their own choices and devices markets may not necessarily always generate desirable outcomes. Markets can be perfectly competitive if only several stringent regulations/conditions on the functioning of them is satisfactory (Rajeev, 2004). Consequently, Public intervention is justifiable in the presence of natural monopoly, free-rider problem (in case public goods), under investment/consumption of merit goods and asymmetry of information. Markets on their own cannot function efficiently in the above-mentioned conditions.

Governments can intervene in the markets by (a) direct provision of goods and services and/or (b) through regulations, taxation, subsidy and other forms of directives. In India, foundations for industrialization were begun by direct participation of government through Public Sector Undertakings (PSUs) due to inadequate private sector just after the independence. The state of Karnataka was also no exception in this regard. In fact, the state industrialization process has begun in early 1800s through direct efforts of the state to utilize its abundant of natural resource, minerals and human resource (Rajeev, 2004).

STATUS OF PUBLIC UNDERTAKINGS IN KARNATAKA

Karnataka state's Public Sector Undertakings (PSUs) consist of Government Companies (GCs) and Statutory Corporations (SCs). The state PSUs are established to carry out commercial activities specially by considering the two important views i.e. (1) Welfare of the people and (2) To play a significant role in the state's economy (CAG, 2017).   The above two types of PSUs are again grouped as (a) Working and (b) Non-Working PSUs. As of March 2017, there are 102 PSUs functioning in the state. Of these 102 PSUs, 90 are working and remaining 12 are non-working PSUs (Table 7.1). Karnataka occupies third place among Indian states in terms of working PSUs are concerned. There has been overtime an increase of working government companies followed by gradual decrease of non-working PSUs. On the other hand, the size of statutory corporations has remained the same over time.

Table 7.1: Status of Public Sector Undertakings in Karnataka

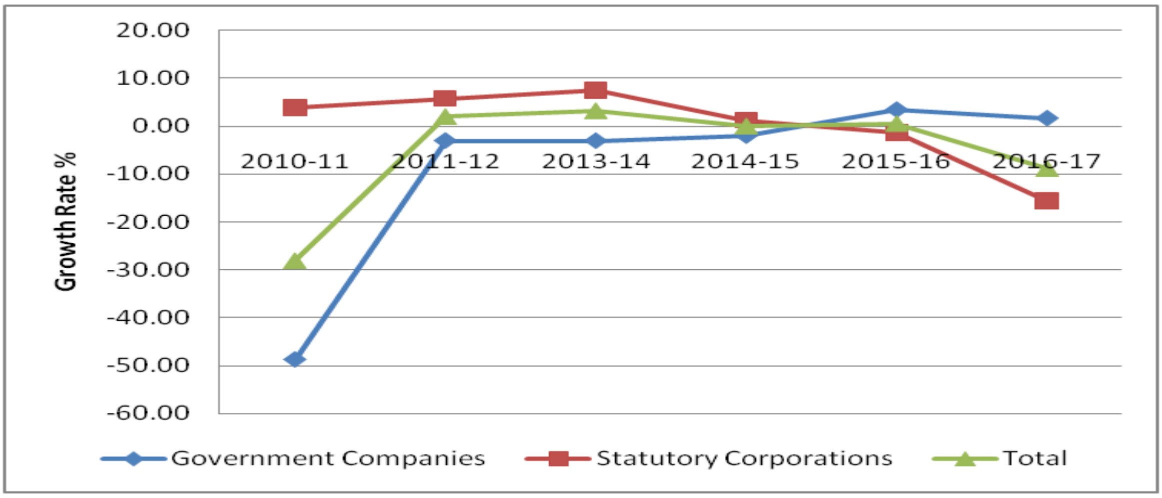
Year	Type of PSUs	Working PSUs		Non-working PSUs		Total	
		No. of PSUs	Manpower	No. of PSUs	Manpower	No. of PSUs	Manpower
2005-06	GCs	59		17		76	
	SCs	6				6	
	Total	65		17		82	
2009-10	GCs	69	153336	15	256	84	153592
	SCs	6	99890			6	99890
	Total	75	253226	15	256	90	253482
2010-11	GCs	69	78382	14	259	83	78641
	SCs	6	103788			6	103788
	Total	75	182170	14	259	89	182429
2011-12	GCs	70	76003	14	259	84	76262
	SCs	6	109743			6	109743
	Total	76	185746	14	259	90	186005
2013-14	GCs	75	73679	14	261	89	73940
	SCs	6	117942			6	117942
	Total	81	191621	14	261	95	191882
2014-15	GCs	75	72465	12	2	87	72467
	SCs	6	119365			6	119365
	Total	81	191830	12	2	93	191832
2015-16	GCs	75	74957	12	2	87	74959
	SCs	6	117823			6	117823
	Total	81	192780	12	2	93	192782
2016-17	GCs	84	76206	12	1	96	76207
	SCs	6	99478			6	99478
	Total	90	175684	12	1	102	175685

Source: CAG (Commercial), GoK.

Note: GCs- Government Companies, SCs-Statutory Corporations.

By the end of March 2017, the state PSUs in Karnataka accounts for around 1.75 million employees. Statutory corporations though are less in number account for 56.62 percent employment and it is significantly larger than that of government companies. Growth rate of manpower (Graph 7.1.1) in statutory corporations was positive from 2010-11 to 2014-15 and turned into negative in the subsequent year and plunged to all time low of (-) 15.57 percent in the year 2016-17. On the contrary, employment growth of Government Companies has suddenly declined from 1, 53,593 to 78,641 (almost 51 percent) in the year 2011-12 and it has gradually decreased over time.

Graph 7.1.1: Growth rate of Manpower in PSUs (%)



Source: Computed based on CAG (Commercial), GoK

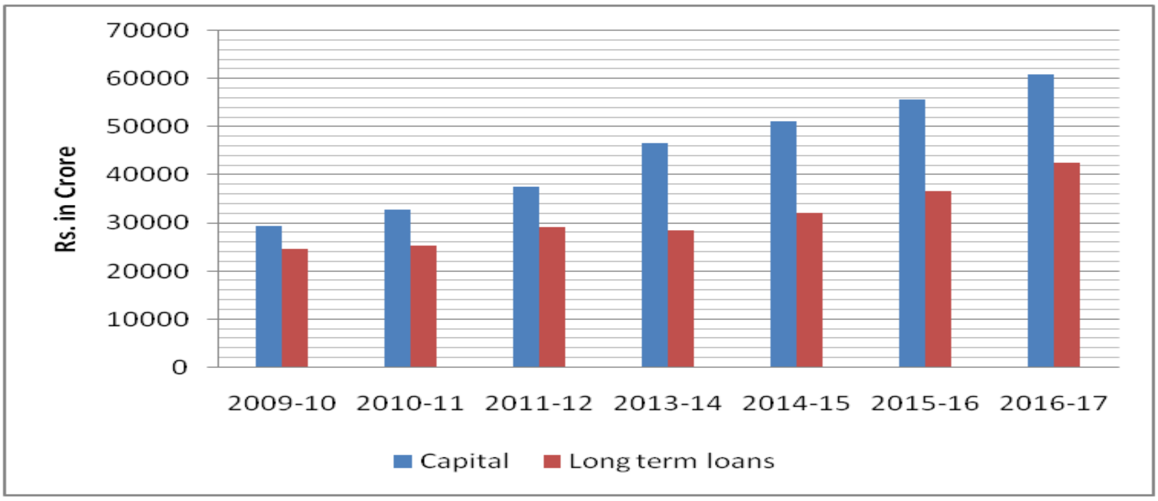
Table 7.2: Investment in PSUs (Rs. in Crore)

Year	Type of PSUs	Capital	Long Term Loans	Total
2009-10	Working PSUs	29364.19	24292.62	53656.81
	Nonworking PSUs	163.06	411.43	574.49
	Total	29527.25	24704.05	54231.3
2010-11	Working PSUs	32611.53	24935.67	57547.2
	Nonworking PSUs	161.35	428.71	590.06
	Total	32772.88	25364.38	58137.26
2011-12	Working PSUs	37354.21	28762.5	66116.71
	Nonworking PSUs	161.35	434.81	596.16
	Total	37515.56	29197.31	66712.87
2013-14	Working PSUs	46456.11	27994.79	74450.9
	Nonworking PSUs	161.35	439.21	600.56
	Total	46617.46	28434	75051.46
2014-15	Working PSUs	51034.96	31664.63	82699.59
	Nonworking PSUs	160.21	422.31	582.52
	Total	51195.17	32086.94	83282.11
2015-16	Working PSUs	55639.23	36343.09	91982.32
	Nonworking PSUs	160.21	431.09	591.3
	Total	55799.44	36774.18	92573.62
2016-17	Working PSUs	60921.33	42251.59	103172.9
	Nonworking PSUs	111.85	432.63	544.48
	Total	61033.18	42684.22	103717.4

Source: CAG (Commercial), GoK

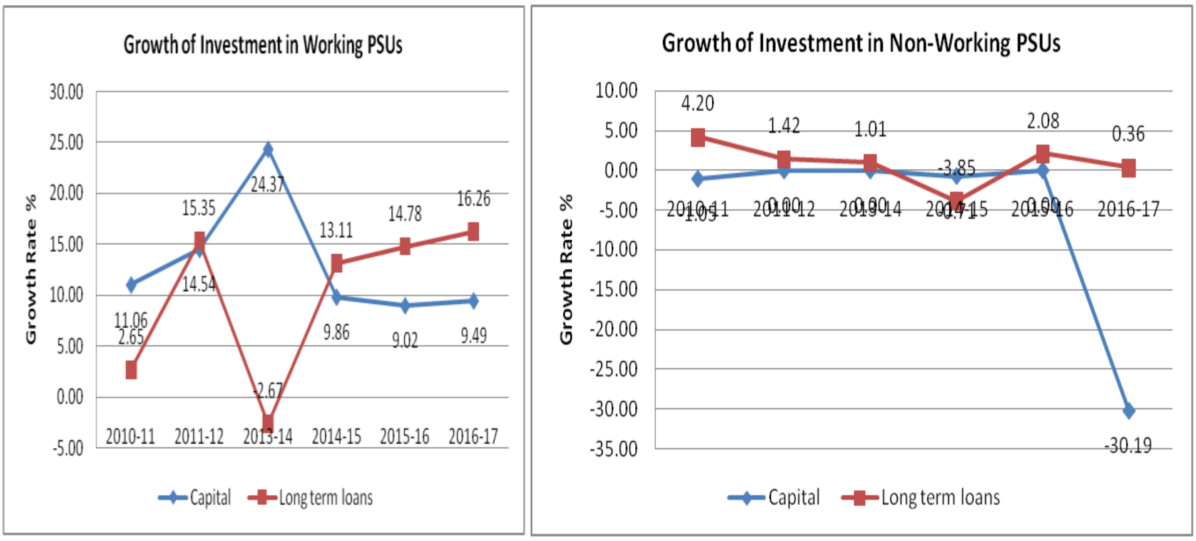
Investment is a necessary pre-requisite for the growth of enterprises. The total investment of PSUs over the years is increasing in current prices. It has almost doubled from Rs.53, 656.81 crore in 2009-10 to Rs.1, 03,717.40 in the year 2016-17 (93% of growth rate) and is witnessing more than 10 percent of annual average growth rate during the same reference period. Investment with regard to public sector undertakings includes two important components *viz*, Share Capital and Long-Term Loans. In 2009-10 around 55 percent of total investment is funded by the share capital and remaining is taken care by term loans. Observation with regard to composition of investment over the year indicate that share of long-term loans is gradually decreasing and is contained at lesser than 40 percent for the recent three years. This trend is desirable as it may bring down the total outstanding loan of the PSUs. Government of Karnataka contributes to the investment of PSUs through equity capital and loans both are incurred form annual budgets of the state. The state government has contributed Rs.4375.47 crore (8.07%) to the total investment in 2009-10 and the contribution has gone up to Rs.6843.92 crore in 2016-17 however, it has declined in terms of share of the government in total investment from 8.07 to 6.60 percent during the same time period.

Graph 7.1.2: Investments in PSUs



Source: CAG (Commercial), GoK

Graph 7.1.3: Growth of Investment in Working and Non-Working PSUs



Source: CAG (Commercial), GoK

By the end of 2016-17 financial year 99.48 percent of total investment was in working PSUs and remaining only 0.52 percent was invested on non-working PSUs. In a welcome development, government has reduced its investment in the non-working units from 1.06

percent in 2009-10 to 0.52 percent in 2016-17. In absolute terms, total investment in the non-working units is as high as Rs 544.48 crore in 2016-17. On the other side, share capital of non-working enterprises remained the same across the years till 2015-16 whereas the growth of long terms loans registered a positive growth for almost all the years except for 2014-15. Investment in non-working enterprises is in fact is a matter of concern though its share in total investment is too little as these enterprises do not contribute in any ways either for the welfare of consumers or to the growth of state's economy.

PSUs are classified and grouped on the basis of commodities and services they deal with, into the following broad categories:

1. Infrastructure
2. Power
3. Financing
4. Miscellaneous

The investment pattern by major sector is depicted in table 7.3. Accordingly, both Infrastructure and Power sectors account for around 92 percent of total investment and remaining 8 percent of investment is shared among the rest all sectors. Share of infrastructure has remained the highest compared to all other sectors however; there is a gradual decrease in its share over the years. Among all the sectors only the share of Power sector investment over the years is consistently increasing and it has gained an enormous importance over the years. These trends wherein the state PSUs are predominantly investing in infrastructure and power is a welcome feature in view of the fact that despite the opening up of some infrastructure sectors to the private sector, the investments have not adequately flown in, and the government should step in to fill the gap. The investment in manufacturing sector has justifiably come down given the changing role of state.

Table 7.3: Sector wise Investment on PSUs (Rs. in Crore)

Year	Infrastructure	Power	Financing	Miscellaneous	Total
2004-05	24770.41 (64.74)	7365.24 (19.25)	3747.83 (9.80)	2377.31 (6.21)	38260.79
2009-10	31581.89 (58.24)	15166.88 (27.97)	3956.77 (7.30)	3526 (6.50)	54231.54
2013-14	36398.10 (48.50)	29468.78 (39.26)	4862.42 (6.48)	4322.16 (5.76)	75051.46
2014-15	41707.22 (50.08)	33385.63 (40.09)	4762.27 (5.72)	3426.99 (4.11)	83282.11
2015-16	46532.29 (50.27)	37822.7 (40.86)	4679.88 (5.06)	3538.75 (3.82)	92573.62
2016-17	53558.57 (51.64)	42192.96 (40.68)	4835.46 (4.66)	3130.41 (3.02)	103717.40

Source: CAG (Commercial), GoK
Note: Miscellaneous includes Agriculture and Allied, Manufacturing, and Service sectors

PERFORMANCE OF PSUs IN KARNATAKA

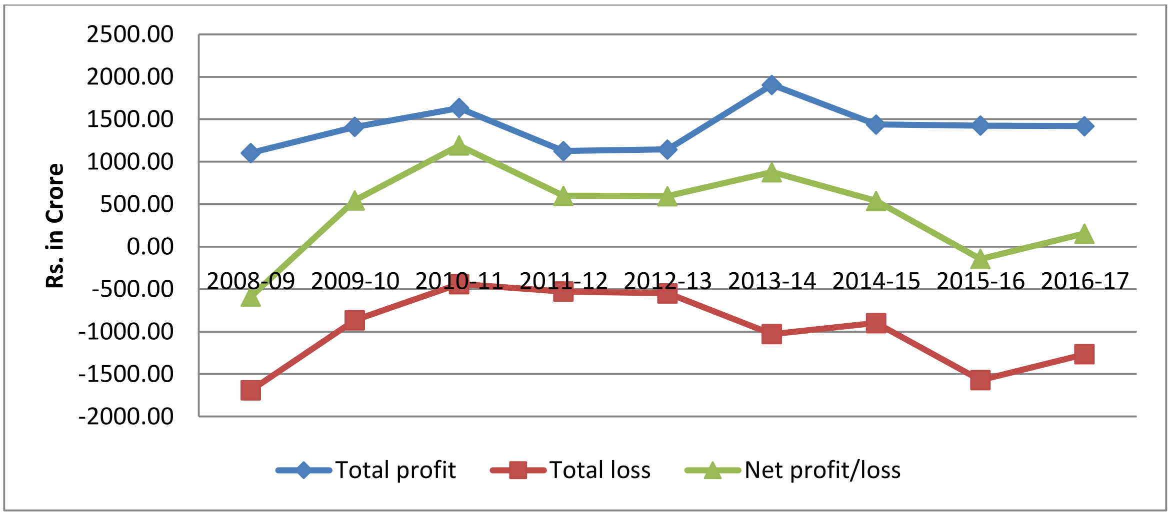
The working Public Sector Undertakings in Karnataka have registered 56, 478 crore of turnover that is equal to around 5 percent of total GSDP of the state during the latest finalized accounts i.e. 2016-17. Though the turnover indicates an important role played by the PSUs in the state's economy its proportion to GSDP over the years has drastically come down (table 7.4). It was 11.23 percent in 2004-05, suddenly dipped to 8.01 percent in the very next year and kept on to shrink thereafter to reach its lowest for the recent year. Hence, the turnover of the state PSUs has never been restored to earlier levels since 2005-06.

Table 7.4: Select Performance Indicators of PSUs in Karnataka (Rs. in Crore)

Year	Debt	Turnover	Turnover as a Percentage to GSDP	Debt-Turnover ratio	Interest payments	Return on capital employed (per cent)	Net profit/loss	Accumulated profits/ losses (-)
2004-05	22499.07	24935.75	11.23	0.90:1	1400.97	3.13	566.05	808.52
2005-06	22736.05	20883.70	8.01	1.09:1	1625.19	3.26	590.17	1209.00
2006-07	23234.20	25284.68	8.36	0.92:1	1593.24	4.60	934.73	935.94
2007-08	24078.32	28218.05	7.83	0.85:1	1607.58	4.58	996.02	1248.48
2008-09	24087.55	32627.68	7.90	0.74:1	1556.95	1.88	-587.97	(-) 39.93
2009-10	24704.05	36369.48	8.09	0.68:1	1901.19	3.47	545.78	(-) 197.93
2010-11	25364.38	41493.51	7.59	0.61:1	2269.00	4.40	1192.92	1007.36
2011-12	29197.31	34490.58	5.69	0.85:1	2555.79	4.22	598.58	1368.93
2012-13	27434.29	37867.13	5.45	0.72:1	2557.69	4.77	595.29	1388.01
2013-14	28434.00	44908.32	5.50	0.63:1	3038.67	5.46	877.82	1894.94
2014-15	32086.94	48765.18	5.34	0.66:1	4090.73	5.16	538.94	731.66
2015-16	36774.18	53787.89	5.31	0.68:1	4592.09	4.80	-144.71	861.65
2016-17	42613.76	56478.00	4.99	0.75:1	3807.07	4.92	155.12	299.26

Source: CAG (Commercial), GoK. Note: Turnover Percentage to GSDP is Author's calculation.

Graph 7.1.4: Profit and Loss of PSUs (Rs. in Crore)



Source: CAG (Commercial), GoK

The working PSUs of the state for the year ended on March 2017 have accounted for Rs.155.12 crore of net profit which is the result of Rs.1420.49 crore of profit earned by 52 PSUs and Rs.1265.37 crore of loss caused by 22 PSUs**.** Karnataka Rural Infrastructure Development Corporation Limited is the first among the major contributors of profit. On the other hand, PSUs such as Karnataka Neeravari Nigama Limited, Hubli Electricity Supply Company Limited, and Gulbarga Electricity Supply Company Limited have jointly contributed a huge loss to the tune of Rs.980. 86 crore (around 77 percent of total loss for the year 2016-17).The Net profit/loss over time is highly volatile and at the outset it seems to be related with return on capital employed. As it is observed from the table 7.4 that the PSUs earn higher profit when there is a higher return to capital employed and vis versa. The annual audit report (Commercial) of the CAG observed that PSUs such as Karnataka Power Corporation Limited, Mysore Minerals Limited, and Hutti Gold Mines Limited are mostly accruing profit since 2004-05.

Table7.5: Sector wise Performance (only for Working PSUs)

Year	Agriculture and Allied	Financing	Infrastructure	Manufacturing	Power	Service	Miscellaneous
Turnover							
2009-10	179.64	243.31	409.41	11376.67	18088.52	1516.96	NA
2010-11	337.69	195.12	431.77	13661.65	21225.53	808.14	NA
2011-12	336.55	199.08	660.68	3077.52	24507.99	817.79	NA
2013-14	513.43	255.89	1145.78	3433.97	31244.30	1842.68	1.50
2014-15	529.88	267.45	1385.00	3780.26	34887.37	665.74	2.21
2015-16	592.25	256.51	1884.74	3492.53	38372.81	955.14	2.42
2016-17	483.08	258.66	1940.91	3656.61	41284.65	806.77	3.37
Accumulated Profit/Loss (-)							
2009-10	23.67	-502.06	-254.99	496.24	1412.29	115.39	0.15
2010-11	50.63	-476.56	-270.98	979.54	2140.88	35.36	0.15
2011-12	70.29	-475.55	-577.87	1464.82	2337.59	62.11	0.40
2013-14	162.25	-254.60	-908.42	2703.04	1905.09	38.48	4.07
2014-15	175.22	-64.70	-1291.10	2029.69	1744.89	36.77	4.95
2015-16	232.13	-6.56	-2265.01	2869.63	2065.20	37.05	5.84
2016-17	236.39	49.32	-2717.41	3092.89	1615.90	49.19	8.55
Net Profit							
2009-10	3.06	17.58	9.11	384.96	135.65	12.29	0.21
2010-11	34.27	16.25	-1.61	464.47	593.43	4.53	0.21
2011-12	17.97	33.67	-231.12	397.78	262.28	9.00	0.26
2013-14	79.50	186.83	-94.29	573.41	331.95	-1.63	3.53
2014-15	51.64	117.94	-304.31	502.85	372.60	61.82	0.59
2015-16	59.14	167.27	-992.13	288.50	422.87	7.54	0.50
2016-17	9.44	158.15	-423.91	321.09	19.25	9.67	1.20
Return to Capital Employed							
2009-10	2.19	1.96	0.15	21.01	6.35	5.16	0.52
2010-11	14.07	2.29	0.10	23.76	7.61	4.01	0.33
2011-12	5.74	2.86	-0.65	16.37	7.69	5.73	0.36
2013-14	20.68	12.33	-0.01	22.84	9.84	0.18	4.86
2014-15	10.56	6.78	-0.81	19.72	8.39	78.12	0.80
2015-16	14.96	8.55	-1.84	11.08	10.01	23.05	0.58
2016-17	5.24	10.47	0.16	16.28	8.15	20.95	22.38

Source: CAG (Commercial), GoK, Returns to Capital Employed is computed by Author based on CAG

On the contrary, Karnataka Neeravari Nigama Limited, Hubli Electricity Supply Company Limited and Gulbarga Electricity Supply Company Limited are accounting for huge losses over the years. CAG in its annual reports made a note of amount of loss and in-fructuous investment that would have been controlled with higher efficiency and better management of resources. It also expressed its severe concerns on the professionalism and accountability mechanisms in the functioning of state PSUs.

We can observe from the table 7.5that the turnover, accumulated profit and net profit of power sector is notably increasing over the years in current prices. Though the turnover of manufacturing sector is decreasing its return to capital employed is the highest among all the sectors. As a result, the accumulated profit is mounting up as the sector accumulates considerable net profit every year. The accumulated loss of infrastructure sector is drastically increasing year on year as its returns to capital employed is negative for most of the years and hence it accumulates loss every year. In the same way financing sector also accumulate loss over the year. The performance of PSUs differs across the sectors because few of the sectors and enterprises may not operate purely on commercial basis.

The Seventh Finance Commission (1977-82) for the first time has recognized the need to prescribe a stipulated rate of return on capital employed for the non-departmental State Level Public Enterprises (SLEPs). Following the tradition of Seventh Finance Commission the Ninth Finance Commission (1987-92) suggested a five-fold categorization of SLEPs based on the optimal rate of returns (De, 2014). Accordingly, a highest potential annual return on capital is assigned to manufacturing sector (12%) followed by service sector (10 %). Trading, Financing and Promotional & Welfare sector assigned the target of 9, 8, and 5 percent respectively. Later, due to practical constrains the rate of returns are revised by re-classifying the entire SLEPs into three groups (*Ibid)*. The first is commercial sector usually undertake manufacturing activities suggested to realize 7.5 percent of returns on capital. The second category comprises of enterprises that undertake commercial and promotional activities obtained 5 percent as their rate of return. The final category includes the promotional enterprises that are set up to fulfil the social obligations, hence suggested the least rate of return (2.5%).

Assessment of Rate of return to capital employed in the state's PSUs following the above guidelines reveals that the manufacturing sector comes under category one and exceeds the targeted returns for all the years. Infrastructure even considered under third category had not able to achieve least targeted rate of return and the financing sector also failed to achieve lowest returns on its capital from 2009-10 to 2010-11.

PSUs AND STATE'S FISCAL HEALTH

The state governments exercise their control in the affairs of PSUs through their administrative departments. The executive heads of these departments are appointed by the government. State government is one of the major stake holders in terms of financial resources for the smooth functioning of PSUs. State provides the financial support to the PSUs in the following ways:

1. Share Capital and Loans
2. Special Financial Assistance through Grants and Subsidies to the PSUs as and when required

3. The state government also guarantees the repayment of loans by the PSUs from financial institutions.

Table 7.6: State Government Budget Support to PSUs

Year	Equity Capital from Budget	Loans from Budget	Grants/Subsidy from Budget	Total Budget outgo	Guarantees issued	Accumulated Guarantees
2007-08	2610.65 (48.84)	481.89 (9.02)	2252.79 (42.15)	5345.33	158.02	4800.02
2008-09	3400.36 (49.45)	500.55 (7.28)	2975.23 (43.27)	6876.14	393.11	4202.18
2009-10	4026.78 (49.63)	348.69 (4.30)	3738.14 (46.07)	8113.61	262	3615.88
2010-11	5126.76 (57.73)	58 (0.65)	3695.96 (41.62)	8880.72	517.3	3802.38
2011-12	4442.57 (37.48)	46.6 (0.39)	7364.64 (62.13)	11853.81	920.72	3353.86
2012-13	4660.59 (30.95)	11.08 (0.07)	10387.06 (68.98)	15058.73	557.19	3500.88
2013-14	4078.15 (30.18)	67.55 (0.50)	9365.95 (69.32)	13511.65	1775.65	4542.73
2014-15	3990.66 (28.59)	38.88 (0.28)	9927.99 (71.13)	13957.53	3736.46	7251.35
2015-16	4528.88 (25.84)	241.47 (1.38)	12756.15 (72.78)	17526.50	2434.04	10477.08
2016-17	6715.21 (29.05)	128.71 (0.56)	16271.49 (70.39)	23115.41	2120.35	8286.40
AAGR	**12.74**	**81.76**	**27.68**	**18.57**	**59.19**	**9.37**

Source: CAG (Commercial), GoK

The summary of the state financial support is listed in the table 7.6. In addition to the items listed in the table the government also occasionally write-off the loans/interest given for PSUs. However, the size of such written-offs is very negligible. The state is allocating large resources to PUSs. The total budget outgo has increased at the Annual Average Growth Rate of 18.57 from 2007-08 to 2016-17.Among the items listed in the table Equity Capital, Loans and Subsidies are allocated through annual budgets of state government, Hence, expenses under these items clearly depicts the burden on state budgets due to PSUs. In the year 2007-08, Equity Capital accounts for the highest share out of total budget outgo followed by Grant/Subsidies and its share was increasing until 2010-11. In the subsequent year share of Grants/Subsidies overtook that of Equity capital and forms around 70 percent of total budget outgo in 2016-17 and proportion of share capital dropped down to 29 in the year 2016-17 percent from 48.84 percent in 2007-08. Hence, there is clear indication that PSUs are highly dependent on the Grants/Subsidies of the state government. Mounting up of subsidies is a matter of concern as these subsidies may cause severe damage to the fiscal health of state.

Comparison of State's contribution towards PSUs with certain fiscal indicators helps to understand the impact on state's resource position (Table 7.7). The total budget outgo as a percentage to the GSDP indicates that state government is spending nearly three percent of its state income on PSUs it is almost equal to expenditure on education and health put together (these are major components in social services). Grants/Subsidies alone accounts for nearly 2 percent of GSDP and that is more than one percent (to GSDP) increase since 2007-08. Regular increase of budget outgo as a percentage of these major indicators may cause genuine threat to the fiscal space of state budget over time. At the same time, the growth rate of state government guarantees to financial institutions on behalf of PSUs is also an added element to the severity.

Table 7.7: Budget Support as a % of Major Fiscal Indicators

Details of Financial Support to PSUs	% to RR		% to TE.		% to GSDP		% to DE	
	2007-08	**2016-17**	**2007-08**	**2016-17**	**2007-08**	**2016-17**	**2007-08**	**2016-17**
Equity capital	6.34	5.04	5.53	4.15	0.96	0.79	7.94	5.50
Loans Budget	1.17	0.10	1.02	0.08	0.18	0.02	1.47	0.11
Grants/Subsidy	5.47	12.21	4.77	10.04	0.83	1.91	6.85	13.33
Total Budget Outgo	**12.99**	**17.35**	**11.31**	**14.27**	**1.98**	**2.72**	**16.25**	**18.94**
Guarantees	0.38	1.59	0.33	1.31	0.06	0.25	0.48	1.74
Accumulated Guarantees	11.66	6.22	10.16	5.11	1.77	0.97	14.6	6.79

Source: Author's Computation based on CAG (Commercial), GoK
Note: RR-Revenue Receipts, TE- Total Expenditure, DE-Development Expenditure

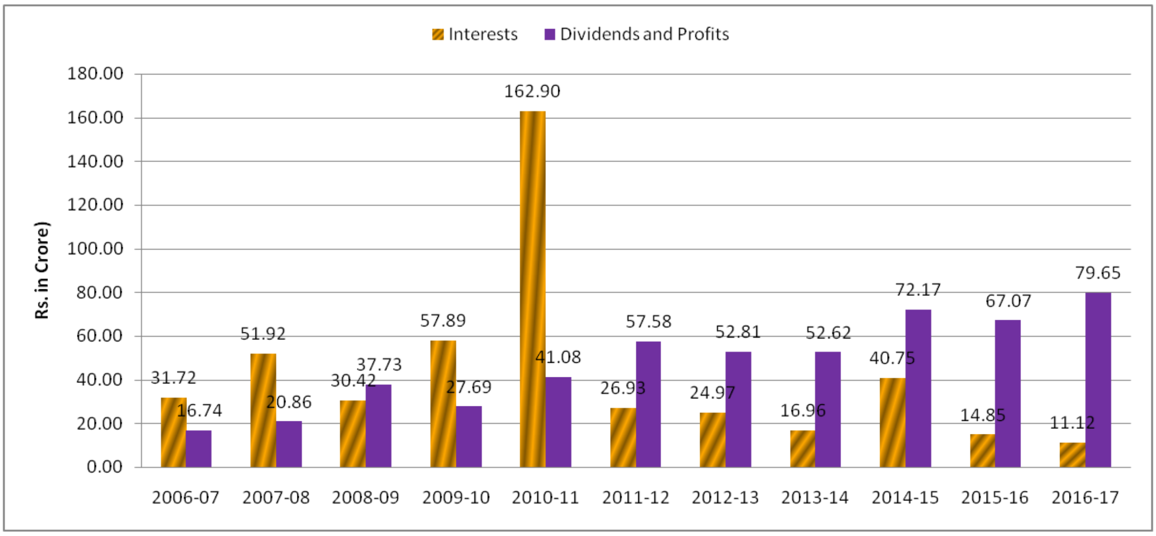
CONTRIBUTION PSUs TO STATE EXCHEQUER

The contribution made by the public enterprises to the state exchequer adds to the government revenue. Higher the enterprise contribution to the exchequer the better is it for the state's revenue. However, not all enterprises contribute to the state exchequer. Thus, the PSEs which fail to contribute to the state become an unnecessary burden and an added cost to the government. In other words, the state fails to receive returns made on the investment. Graph7.1.5 shows the average contribution made by PSEs between the years 2006-07 to 2016-17.

The state of Karnataka has formulated new guidelines by overriding the earlier Guidelines (1997) for dividend payment by the PSUs via its order No. DDPER 50 ARU 2003 dated 22.05.2003. The 2003 guidelines clearly specify that the Government nominees on the boards of Public Enterprises or Joint Ventures where the State Government has equity holding should insist on the declaration of minimum dividend of 20% on share holding. In case payment of dividend to this extent was not possible, dividend payout must constitute at least 20% of post tax profit. Further, it also specifies that in case the capital base is narrow, bonus shares should be issued depending on the reserve of the PSE concerned. And these guidelines are not revised further till date.

However, the profits and dividends are very meagre as compared to the state's contribution to PSUs in the form of share capital and Grants. Hence, they do not seem comparable with state's financial assistance. The recent evidence from the CAG audit report (2018) indicates that 55 PSUs that include three non-working companies reported profit worth of Rs. 1420.61 crore, but only 13 PSUs declared the dividends.

Graph 7.1.5: Interest and Dividends and Profits by PSUs to state exchequer



Source: Finance Accounts, CAG, (Karnataka State Various Years)

DISINVESTMENT, PRIVATIZATION AND RESTRUCTURING OF PSUs IN KARNATAKA

Karnataka is one of the first states to take measure to improve the performance of PSUs even before the advent of economic reforms. In 1988 a committee was set up to evaluate the state government policies towards PSUs (Rajeev, 2004). The state of Karnataka in its Medium-Term Fiscal Plan (MTFP-2001-02 to 2004-05) recognized reduction of budgetary support to the public enterprises and curtailing revenue expenditure are the key measures to phase out the revenue deficit and reducing fiscal deficit (Ram Kumar Mishra, 2014).

In order to evaluate and suggest measures for restructuring through rationalization, disinvestment, merger and privatization of under-performing PSUs the state government has formed Public Sector Restructuring Commission (PSRC) in March 2000 under the chairmanship of Mr. Padmanabha. In February 2001 a High-Power Committee is set up to monitor and oversee the successful implementation of policy relating to PSUs headed by Chief Secretary of Karnataka. The following functions are allotted to the High-Power Committee (State level Public Enterprises Survey, 2001-02).

1. To examine the recommendations of PSRC and evolve comprehensive proposals for decision of the government, there on.
2. To ensure that on receipt of the government decision, the concerned administrative department in close collaboration with Karnataka State Bureau of Public Enterprises (KSBPE) takes timely action to implement the decision.
3. To periodically review the progress of Restructuring/Privatization or closure process
4. To make arrangements for the management of Rationalization Fund that may be established for Voluntary Retirement Scheme (VRS).

Accordingly, in 2002, 29 PSUs out of 82 were identified for disinvestment and liquidation. Out of 29 PSUs 17 non-working and 4 working companies are listed for closure and the remaining eight working PSUs were to be privatized (Gowda, 2013). However, no significant move has made to reform the PSUs thereafter.

With view to minimize the procedural delays Karnataka state has gone up a step further to create a separate department under a Cabinet Minister. As a result, KSBPE was merged into new Department of Disinvestment and Public Sector Reforms in 2002. In the year 2006, around 30 PSUs were included in the list of disinvestment and liquidation. Out 30 PSUs 17 non-working enterprises are listed, 3 working companies are slated for closure and one on them got the closure Government Order (GO). Similarly, 2 out of 8 working companies listed for privatization got the GO.

Table 7.8:Progress of Disinvestment, Privatization and Restructuring of PSUs in Karnataka

Year	PSUs	Non-Working Government Companies Decided for Closure	Working Government Companies Decided for Closure	Working Government Companies Decided for Privatization	Restructuring of Working Government Companies
2006	No.of Companies	17	3	8	2
	GO Issued	17	1	6	2
	GO Not Issued		2	2	
2010	No.of Companies	15	3	8	1
	GO Issued	15	1	6	1
	GO Not Issued	1	1		
2011	No.of Companies	14	3	8	1
	GO Issued	14	1	6	1
	GO Not Issued		2	2	
2012	No.of Companies	14	3	8	1
	GO Issued	14	1	6	1
	GO Not Issued		2	2	
2014	No.of Companies	14	3	8	1
	GO Issued	14	1	6	1
	GO Not Issued		2	2	
2015	No.of Companies	12	3	8	1
	GO Issued	12	1	6	1
	GO Not Issued		2	2	
2016	No.of Companies	12	3	8	1
	GO Issued	12	1	6	1
	GO Not Issued		2	2	
2017	No.of Companies	12	3	8	1
	GO Issued	12	1	6	1
	GO Not Issued		2	2	

Source: CAG (Commercial), GoK

The table 7.8 reveals the details of action taken by the government for 30 companies that are identified for closure, restructuring and privatization. As of now all the 17 companies listed for closures have been issued GO. They include Karnataka Textile Ltd, Karnataka Agro Proteins Ltd, Chamundi Machine Tools Ltd, Karnataka Small Industries marketing Corporation Ltd, Vijayanagara Steel Ltd, Karnataka Telecom Ltd, Karnataka Tungsten Moly Ltd, The Mysore Acetate and Chemicals Company Ltd, Mysore Cosmetics Ltd, Mysore Chrome Training Company Ltd, Mysore Lamp Works Ltd, Mysore Match Company Ltd, NGEF Ltd, Karnataka Agro Industries Corporation Ltd, Karnataka State Veeners Ltd, Karnataka Pulp Ltd, Karnataka State Construction Corporation Ltd, and Karnataka Film Industry Development Corporation Ltd. Though the liquidation process is on none of the above companies are completely shut down (Gowda, 2013. The public sector reforms in Karnataka are delayed due to several impediments such as lack of attractive private bids to purchase the PSUs set for privatization, disputes with regard to VRS and most importantly lack of clear approach from the government side.

CONCLUSION

It is important in the context of fiscal reforms to periodically review the need for the presence of the public sector by specific sectors and the quantum and nature of investment required. The state has in a welcome development witnessed a decline in the number of non-working PSUs, and a marginal decline in total investment, however, they still account for sizeable resource support from the state budget. There is every need to prevent further drain of resources to loss making and non-working units. Yet another positive feature refers to the fact that the PSU investment has a predominant share under the categories infrastructure and power, together they account for 92 percent of total investment and manufacturing sector is small and has declined over time. In the changing global economic scenario, state should ideally withdraw from manufacturing sector and Karnataka state seems to be adapting to the changing economic environment. Public sector participation in the infrastructure and power sector can be justified as is currently the case in Karnataka, as the multiplier effect of such capital investments on state income tends to be much larger and also enables crowding in of private investment. Such investments tend to positively contribute to state’s economic growth in the long-run. Ironically, the recent trends reveal that, a larger share of budgetary resource support provided to the PSUs is in the nature grants and subsidies whose share has increased over time from 42 percent in 2007-08 to 70 percent in 2016-17 and on the contrary that of Equity Capital has come down from 49 percent to 29 percent during the above reference period. The PSU turnover as percent to GSDP has considerable shrunk from 11.23 percent in 2004-05 to 4, 99 percent in 2016-17. The mounting subsidies are a drag on state’s resources and if they continue unabated the state’s fiscal health can be at considerable risk. It is also disheartening to note that the contribution of PSUs to the state exchequer by way of profits and dividends is very meagre as opposed to the state’s sizeable contribution to the PSUs in the form of share capital and grants. While the state has recognized the need to reform the performance of PSUs and formed Public Sector Restructuring Commission way back in 2000, and as a follow up 29 PSUs were identified for disinvestment and liquidation the progress seems to be lack luster.

CHAPTER 8
FISCAL TRANSFERS TO LOCAL BODIES IN KARNATAKA

INTRODUCTION

Local governments in India in general and Karnataka in particular have depicted a large-scale dependence on state government's financial support in discharging their functions and provision of services. The importance of fiscal autonomy in the decentralization process is amply highlighted in the literature. "A critical factor in improving fiscal autonomy of rural local bodies is to enhance their own revenues. Improving own revenues is important also to strengthen the link between revenue and expenditure decisions of the rural local bodies at the margin, which is extremely important to promote both efficiency and accountability in the provision of services. At present, the rural local bodies at district and block levels do not have worthwhile own revenue sources." (Rao, et.al, 2011). The excessive dependence of the local bodies on transfers leads to a situation where in the decentralization process tends to get vitiated and the performance of local bodies becomes vulnerable to any adverse changes in the resource transfer. In addition, the acclaimed advantages of decentralization in toning up the service delivery by reflecting the local needs get nullified in the event the transfers are made from the higher levels of government with strings attached to it. Further the extent and nature of transfers tend to largely depend on the fiscal capacity of the state government supporting the local bodies, which invariably happen after providing adequate resources for the state's own commitments. Hence, the resource transfers to the local bodies are largely determined by the fiscal space available with the state government that gets created by augmenting the revenue resources and attaining allocative efficiency in expenditure.

Fiscal performance of Karnataka state has been observed to be sound as evident from the trends in broad fiscal indicators such as fiscal and revenue deficits, development and non-development expenditure and own tax resource generation. This has been especially the case since the enactment of Fiscal Responsibility Act by the state government in 2002. The state's performance on account of non-tax revenue however has been very weak. The state's committed expenditure which includes state commitments with reference to expenditure items such as salaries, pensions, interest payments subsidies, administrative expenditure and devolution to PRIs and ULBs has increased from 89 percent of uncommitted revenue receipts to 95 percent in 2012-13 which has further decreased to 82 percent. (GoK, Economic survey, 2015-16)

In this background, the present paper makes an attempt to understand the trends in the resources of the local bodies in Karnataka and examine if the fiscal dependency of the local bodies has significantly reduced. The Karnataka state has pioneered a number of reform initiatives and the state's decentralization efforts are also well recognized among Indian states. The state has largely honoured the requirement of appointing State Finance Commissions with four State Finance Commissions giving their recommendations till date, the paper analyses the trends in actual transfers vis-à-vis the recommendations for the first three Finance Commissions as the Fourth Finance Commission has recently been submitted. State's fiscal condition also tends to influence the transfers to local governments, uncertainties in revenue flows and revenue shortfalls that result in higher levels of deficit could be a potential threat to transfers to the lower levels of government. Here too, while the non-plan transfers tend to get sticky due to its committed nature, the plan funding could get adversely affected. The present chapter has made an attempt to track the status of transfers along the Karnataka state government's fiscal deficit path. The World Bank (2004) observes that, "Local plan allocation is also vulnerable to another feature of the intergovernmental arrangement in Karnataka; the devolution to sub-state bodies is vulnerable to expenditure compression. When budgets are tight, state transfers to local governments can be under-funded, or postponed."

The present paper is based largely on secondary sources of data. Data relating to state own resources and expenditure have been collected from the state budget documents. Data bases of rural development and Panchayat raj and urban development departments and Link documents have been used to collect details on the state support to the local bodies. In the data collection process, it has been observed that data availability is poor and the data discrepancies between different sources add to the complications in the conduct of professional studies and these needs to be rectified on a priority basis.

DEVOLUTION OF FUNCTIONS TO LOCAL SELF-GOVERNMENT INSTITUTIONS IN KARNATAKA

Functions of ULBs: The 74th Constitutional Amendment envisaged devolution of 18 functions listed in Schedule Twelfth (12th) of the constitution. The state government of Karnataka has transferred 17 functions to ULBs as on March 2017. The remaining function i.e. Fire service function has not been transferred to ULBs till date (CAG, 2017).

Functions of PRIs: The state of Karnataka has transferred all the 29 subjects listed in 11th Schedule of the constitutions. Consequently, Karnataka is the first to attempt state activity mapping to allot the subjects among the three tiers of Panchayat Raj institution in the state. Accordingly, out of 29 subjects state has assigned 25 to Gram Panchayts, 27 to Taluk Panchayts and 26 subjects to Zilla Panchayats.

Karnataka Panchayat Raj Act (PR Act 1993) has specified the functions for all the three tiers of rural local bodies.

Gram Panchayats: 31 functions listed in Schedule I of PR Act of Karnataka (1993)

Taluk Panchayats: 28 functions listed in Schedule II of PR Act of Karnataka (1993)

Zilla Panchayats: 29 functions listed in Schedule II of PR Act of Karnataka (1993).

PREVAILING MECHANISM OF AUDITING AND ACCOUNTING OF PRIs AND ULBs IN KARNATAKA

AUDIT AND ACCOUNTING OF PRIs

The Karnataka State Audit and Accounts Department (KSAD) is the external auditor for Gram Panchayats. KSAD undertake the following responsibilities,

(i) Certifying the correctness of accounts

(ii) Assessment of internal control system and report cases of loss, theft and fraud to audited entities and to the State Government.

The state government entrusted (May, 2011) the audit of Gram Panchayats under Technical Guidance and Supervision (TGS) module to by CAG by amending KPR Act, 1993 (CAG, 2017).

Auditing and certification of the accounts of Zilla Panchayats (ZPs) and Taluk Panchayts (TPs) is done by the Comptroller and Audit General (CAG) under the section 19 (3) of CAGs duties

AUDIT AND ACCOUNTING OF ULBs

The Principal Director, KSAD is the primary auditor of ULBs as per the Karnataka Municipal Corporation and Karnataka Municipal Acts. The audits and accounts of all the ULBs except NACs is entrusted to CAG by the State Government. The CAG performs its duties under its Duties, Powers and Conditions of Services (DPC) Act, 1971 implemented from 2008-09 and under Technical Guidance and Supervision with effect from 2011-12 onwards. However, there is no Internal Audit Wing in the state Karnataka for ULBs. The Directorate of Municipal Administration (DMA) has submitted a proposal to the government to establish an Internal Audit Wing in the state (CAG, 2017).

PROPERTY TAX RATE AND STRUCTURE IN THE STATE.

PROPERTY TAX RATES OF PRIs

Schedule IV of Karnataka Panchayat Raj Act (1993, pp 174-175) specifies the maximum tax chargeable on certain items that comes under the jurisdiction of the local self governing bodies. Subsequently, the state of Karnataka has introduced a new Policy in May 2003 to standardise the rules to fix property tax for Gram Panchayats. The new guidelines intend to bring transparency in measurement of property and valuation of property tax. Hence, the new policy has specified certain guidelines as follow (V K Nataraj et al 2014),

a) Classification of property based on the kind of construction. The policy suggested classifying the property as concrete or slabbing roofed, tile roofed and thatched. This would help to measure the extent of area under each kind of construction.

b) Classification of property based on the end use i.e. commercial, residential

c) Committee headed by the Chief Executive officer (CEO) suggest the band of maximum and minimum of After Repair Value (AVR), based on that the Gram Panchayat has to fix the rate for each square foot for each category of property. This rate is extrapolated to arrive at annual letting value.

d) The Gram Panchayats in Karnataka apply up to 10 percent to the total annual letting value in order to arrive property tax leviable on each property (Raghunandan, 2006)

PROPERTY TAX OF ULBs:

The Karnataka Municipalities (Amendment) Ordinance (2003) has formulated the tax rate s levied on property within the jurisdiction of urban local government institutions.

i. Commercial Buildings: Not less than 0.5 and 1.5 percent of taxable capital value of the building
ii. Residential Buildings/Other than Commercial Buildings: Not less than 0.3 and 0.6 percent of taxable capital value of the building
iii. Vacant Land
   a. Up to 1000 square meters: Not less than 0.1 and 0.2 percent of taxable capital value of the land.
   b. 1000 to 4000 square meters: Not less than 0.025 and 0.05 percent of taxable capital value of the land.
   c. Above 4000 square meters: Not less than 0.01 and 0.02 percent of taxable capital value of the land.

TRENDS IN RESOURCES AND EXPENDITURE OF THE LOCAL BODIES

Resource base of the PRIs consist of own revenue and assigned revenue, the latter comprising of State Finance Commission (SFC) grants, Central Finance Commission (CFC) grants, the state and central government grants for maintenance and development. Distribution of PRI by major sources reveals that the share of resources that the PRIs are getting from the state grants is not only high but on the increase. Its share has increased from 77 percent to 92 percent during the reference period. The sharp increase observed in 2015-16 is on account of the restructuring of centrally sponsored schemes and consequential reduction in transfers under the CSS schemes. The own resource mobilization by the PRIS has had an absolute increase from Rs. 111.96 crore in 2004-05 to Rs 228.84 crore in 2015-16, however its share in the total resources has not only been abysmally low but also declined further from 1.14 percent to 0.89 percent. **(Table 8.1)**

Table 8.1: Resources of Panchayat Raj Institutions (PRIs)

Year / Details	2005-06	2006-07	2007-08	2008-09	2009-10	2011-12	2012-13	2013-14	2014-15	2015-16
Own Revenue	111.96 (1.14)	138.64 (1.28)	133.64 (1.06)	144.74 (1.07)	NA	312.08 (1.80)	269.09 (1.29)	176.93 (0.69)	228.84 (0.89)	NA
CFC transfers (12th Finance Commission)	177.6 (1.81)	177.6 (1.64)	177.6 (1.41)	177.6 (1.31)	177.6 (1.14)	769.58 (4.43)	1036.49 (4.96)	1350.87 (5.26)	977.85 (3.79)	NA
Grants from State Govt and assigned Revenue	7580.47 (77.39)	7962.34 (73.57)	9488.13 (75.43)	9841.85 (72.73)	10380.7 (66.53)	13340.83 (76.76)	16622.14 (79.46)	19669.19 (6.64)	21004.52 (81.36)	21385.43 (92.55)
GOI grants for CSS/State Schemes	1815.33 (18.53)	2372.98 (21.93)	2680.4 (21.31)	3285.09 (24.28)	5032.2 (32.25)	2764.62 (15.91)	2837 (13.56)	4243.92 (16.54)	3426.05 (13.27)	1573.58 (6.81)
Other Receipts	109.74 (1.12)	171.24 (1.58)	99.57 (0.79)	82.29 (0.61)	13.28 (0.09)	192.66 (1.11)	153 (0.73)	224.12 (0.87)	179.2 (0.69)	146.94 (0.64)
Total	9795.1	10822.5	12579.34	13531.57	15603.78	17379.77	20917.72	25665.03	25816.43	23105.95

Source: Economic Survey of Karnataka (2015-16 and 2016-17)

URBAN LOCAL BODIES

Resource support to urban local bodies by each of the sources is presented in table 8.2. While the tax devolution has the largest and increased share from 50.88 percent in 2013-14 to 60.31 percent in 2016-17 that of grants for state and centre schemes has significantly come down from 36.7 percent to 22.83 percent. Owing to the absolute decline under this component from Rs 2380 crore in 2013-14 to Rs 1366 crore, the aggregate resource support to the ULBs under all the components has declined from Rs 6486 crore to Rs 5980 crore. It is important to note that data of the ULBs are not available; hence the analysis was possible only for the recent years unlike the PRIs that are available for much longer time period.

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Table 8.2: Resources of Urban Local Bodies (ULBs)

Particulars	Transfers to Urban Local bodies (Rs. in Crore)				Share in %			
	2013-14	2014-15	2015-16	2016-17	2013-14	2014-15	2015-16	2016-17
Tax Devolution	3300	3346	3588	3607	50.88	49.39	55.76	60.31
Grants from Finance commission	806	985	562	1008	12.42	14.54	8.73	16.86
Grants for State and centre Schemes	2380	2443	2285	1366	36.70	36.06	35.50	22.83
Total	**6486**	**6773**	**6435**	**5980**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Department of Urban Development, GoK

In addition to the Finance Commission recommended transfers provided to the ULBs, there is additional support provided by the state government to the parastatals which include KUWS&DB, BWSSB, KUIDFC etc., While these details are difficult to obtain, data for 2011-12 are presented in table 3 revealing that Finance Commission grants constitute 30 percent share in the total plan support for urban development, 42 percent of the resources are by way of plan support to the parastatals

Table 8.3: Summary of Plan Allocation to Urban Development Department for the Year 2011-12 (Rs. in Crore)

Sl. No	Name of the Scheme	Plan	SCP	TSP	SDP	Total Plan	% to Total
A	Total KUWS&DB Allocation	244	19	8	0	271	
B	Total BWSSB Allocation	1150	0	0	0	1150	
C	Total KUIDFC	474	7	3	100	584	
Total I	Total (A+B+C)	1868	26	11	100	2005	42.02
Total II	Total State Govt. Finance grants	1448	0	0	0	1448	30.35
Total III	Total 13th FCG	100	0	0	0	100	2.10
Total IV	Total Others*	1118	100	0	0	1218	25.53
Total V	Total Plan Allocation to UDD (I+II+III+IV)	4534	126	11	100	4771	100

Source: Department of Urban Development, GoK

DISTRIBUTION OF EXPENDITURE BY SALARY AND NON-SALARY

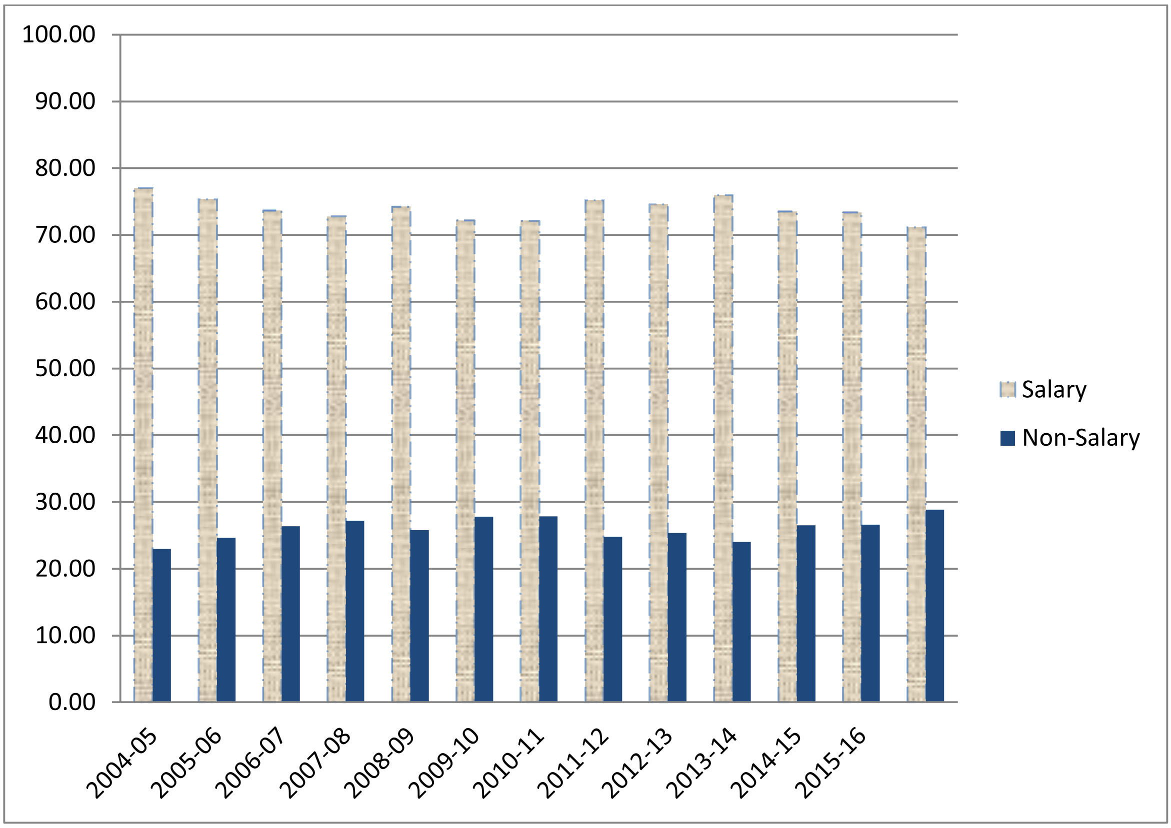
The share of salary component in the total PRI allocation is over 70 percent all along, with the share marginally declining from 77 percent to 71 percent (Table 8.4). On the contrary the non-salary component, although on the increase its share in the total is very small.

Table 8.4: Percentage Share of Salary and non-Salary Allocation to PRIs (Rs. In crore)

Year	Salary	Non-salary	Total	Salary	Non-salary
2004-05	2661	793	3454	77.04	22.96
2007-08	4362	1629	5991	72.81	27.19
2010-11	5983	2312	8295	72.13	27.87
2013-14	8989	2840	11829	75.99	24.01
2015-16	9919	3601	13520	73.37	26.63
2016-17	10161	4119	14280	71.16	28.84

Source: GoK, Link Documents to Budget: Various Years

Graph 8.1.1: Percentage Share of Salary and non-Salary Allocation to PRIs



TRANSFERS TO LOCAL BODIES: LONG TERM TRENDS AND ISSUES

The resource base of the local bodies comprises of State Finance Commission (SFC) grants, Central Finance Commission (CFC) grants, state government and central government grants for maintenance and development purpose. An analysis of the trends in local bodies from the state government over time is presented below.

Transfers to local bodies in Karnataka from the state government have increased from Rs 3320.81 crore in 1997-98 to Rs 35538.62 crore in 2016-17 amounting to 9.7 times increase over the initial year. (Table 8.5) The distribution of the resources transferred between the urban and local bodies reveals that while the share of urban local bodies has doubled from 8.28 percent to 16.83 percent that of rural local bodies has declined from 91.72 percent to 83.17 percent. However, on an average rural local bodies account for a much larger share in the total with almost 85 percent share with the urban local bodies accounting for 15 percent share in the total. It can also be observed that while transfers to urban local bodies have increased by 21 times that of rural local bodies has increased by 8.7 times.

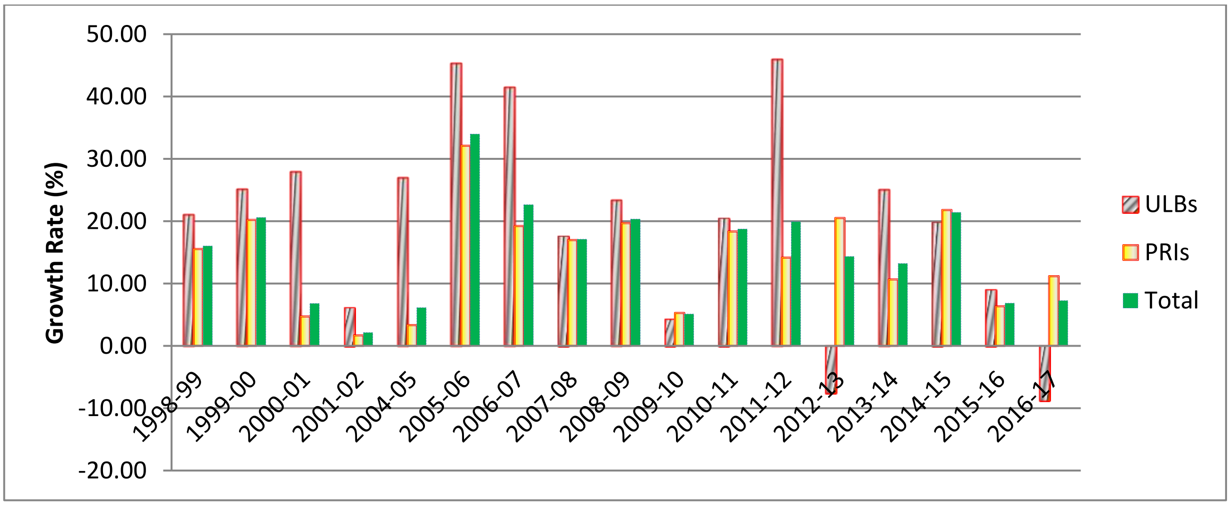
Table 8.5: Trends in transfers to Local Bodies (Rs. Crore)

Transfers to Local Bodies				% share to total		
Year	ULBs	PRIs	Total	ULBs	PRIs	Total
1997-98	274.81	3046.00	3320.81	8.28	91.72	100.00
2000-01	531.43	4432.20	4963.63	10.71	89.29	100.00
2004-05	798.00	4893.41	5691.41	14.02	85.98	100.00
2007-08	1926.00	9024.13	10950.13	17.59	82.41	100.00
2010-11	2978.00	13464.97	16442.97	18.11	81.89	100.00
2013-14	5020.44	20510.18	25530.62	19.66	80.34	100.00
2016-17	5980.31	29558.31	35538.62	16.83	83.17	100.00

Note: Data on allocation to ULBs from 2002-03 to 2004-05 and 2010-11 is taken from MTFP rest of the years is from GoK, Finance Department. Data on allocation to PRIs from 2002-03 to 2004-05 and 2010-11 is taken from GoK, Link Documents; rest of the years is from GoK, Finance Department

The rates of growth too reveal that transfers to the urban local bodies have been by and large much larger than that of rural local bodies, however, the former has revealed considerable fluctuation over time and at times has even been negative.

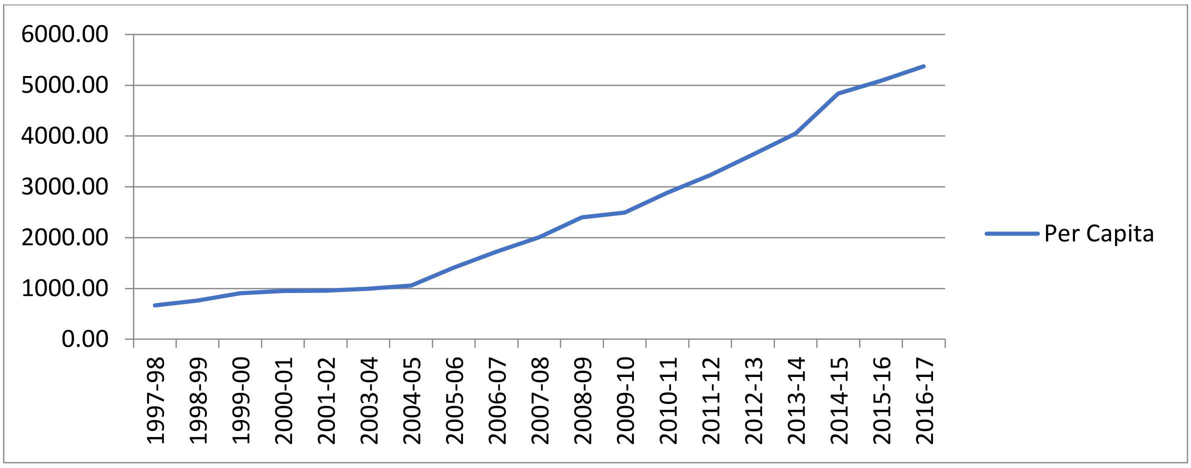
Graph 8.1.2: Growth of Allocation to Local Bodies



Source: Finance Department, GoK

Per capita transfers to local bodies are depicted in graph 8.1.3 which reveals that there is a fivefold increase in the transfers effected to the local bodies in Karnataka.

Graph 8.1.3: Per capita transfers to the local bodies



STATE FINANCE COMMISSIONS' RECOMMENDATIONS VIS-À-VIS ACTUAL ALLOCATION OF FUNDS

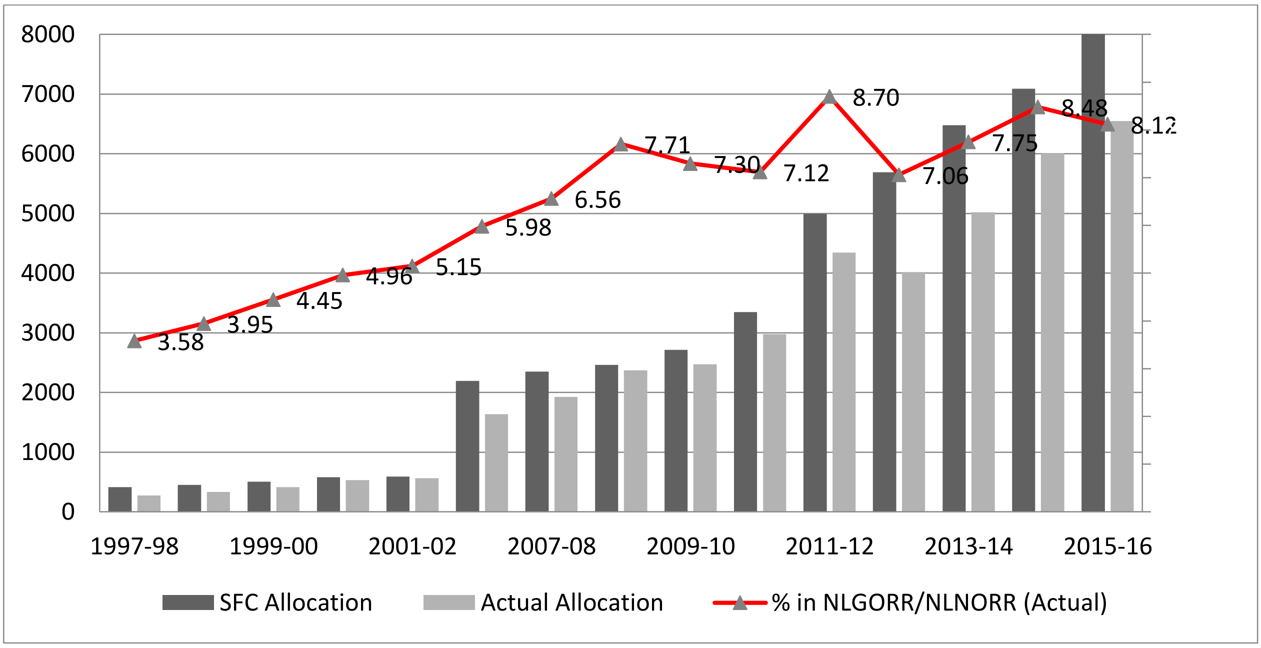
As per the Karnataka Panchayat Act state government has to constitute a State Finance Commission once in five years to make recommendations on the sharing of proceeds of taxes between the state and the local bodies, grants to be given from the state's Consolidated Fund and the share of Urban and Rural local bodies. Karnataka has appointed four SFC s till date with the first SFC award covering the period 1997-98 to 2001-02; second SFC award covering 2006-07 to 2010-11 and third SFC award covering 2010-11 to 2015-16. The Fourth SFC has recently submitted its report. While the first two commissions have used Non-Loan Gross Own Revenue Resources (NLGORR) the third one has used Non-Loan Net Own Revenue Resources (NLNORR). Details of the SFC recommendations vis-à-vis the actual devolution by each of the SFC periods are presented in table 8.6 and graphs 8.1.2 to 8.1.4. It can be observed that by and large there has been considerable deviation between the SFC recommendations and the actual assignment to the local bodies, there has been however larger flow of resources as compared to the recommended level. While the urban local bodies have largely had an underfunding thus having lesser resource availability as opposed to the recommended level, PRIs have had larger absolute allocations during most of the years with the exception of two years during the Second SFC period. An important aspect to be remembered is that as discussed earlier urban development is supported by the state government by way of funds provided to various parastatals, PRIs' support is on the contrary largely limited to the SFC funds. Graphs 4 to 6 also depict the percent share of allocations to ULBs, PRIs and total to the respective base used by the various SFCs i.e. NLNGORR in the case of first two SFCs and NLNORR in the case of third SFC. While the recommended share to the urban local bodies has increased over each SFC the recommended share has not been assigned. Rural local bodies share on the contrary has declined from 30.6 percent in first SFC to 32 in second and 23 percent in the third SFC.

Table 8.6: SFC recommendations vis-a vis Actual transfers

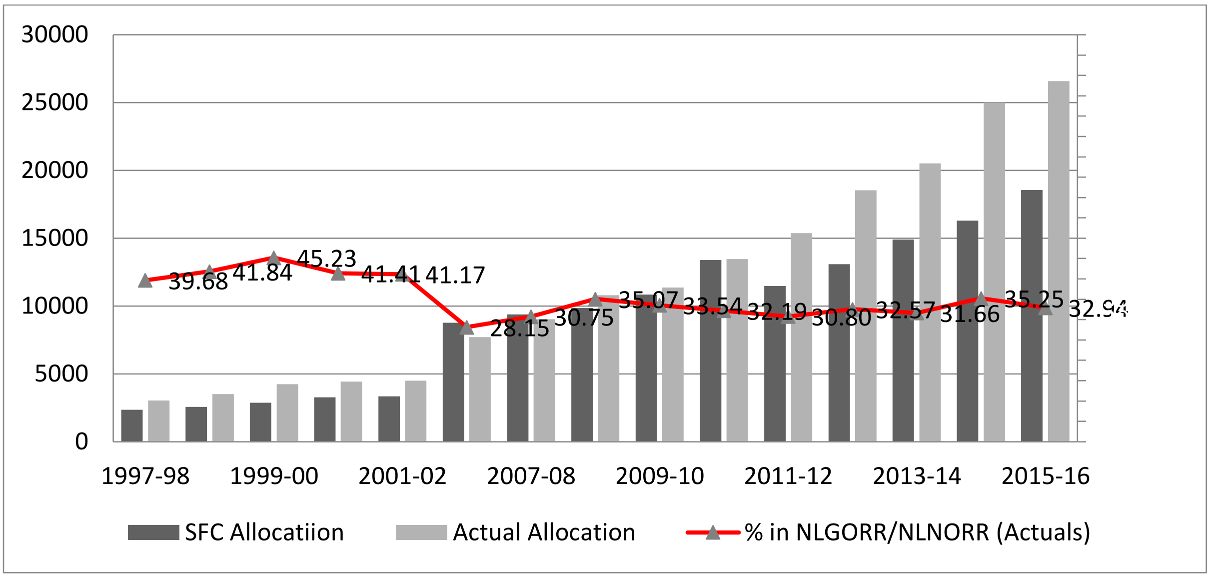
Year	Actual Transfers to Local Bodies (Rs. in crore)			Allocation Recommended by SFC (crore)			Difference b/w Actual and SFC Allocation (Rs. in crore)		
	ULBs	PRIs	Total	ULBs	PRIs	Total	ULBs	PRIs	Total
First State Finance Commission									
1997-98	275	3046	3321	415	2349	2763	-140	697	558
1998-99	332	3520	3853	454	2574	3029	-122	946	824
1999-00	416	4232	4648	505	2863	3368	-89	1369	1280
2000-01	531	4432	4964	578	3275	3853	-47	1157	1111
2001-02	564	4507	5071	591	3350	3941	-27	1157	1130
Second State Finance Commission									
2006-07	1639	7712	9351	2192	8768	10960	-553	-1056	-1609
2007-08	1926	9024	10950	2348	9390	11738	-422	-366	-788
2008-09	2374	10802	13176	2464	9857	12322	-90	945	854
2009-10	2474	11374	13848	2713	10852	13565	-239	522	283
2010-11	2978	13465	16443	3347	13386	16733	-369	79	-290
Third State Finance Commission									
2011-12	4344	15375	19719	4992	11483	16475	-648	3892	3244
2012-13	4018	18531	22550	5690	13087	18777	-1672	5444	3773
2013-14	5020	20510	25531	6478	14898	21376	-1458	5612	4155
2014-15	6011	24988	30999	7089	16305	23395	-1078	8683	7604
2015-16	6549	26576	33125	8069	18559	26628	-1520	8017	6497

Source: GoK, Finance Department

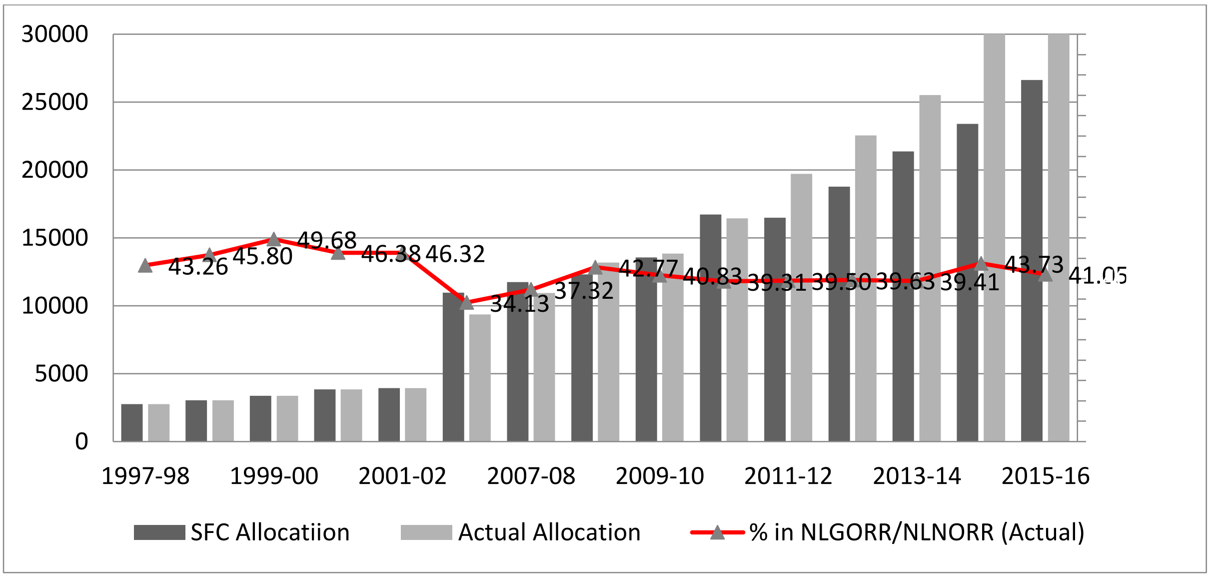
Graph 8.1.4: State Finance Commissions' Recommendations and Actual Allocation to ULBs (Rs in crores)



Graph 8.1.5: State Finance Commissions' Recommendations and Actual Allocation for PRIs (Rs in crores)



Graph 8.1.6: State Finance Commissions' Recommendations and Actual Allocation for LBs (Rs in crores)



TRANSFERS VIS-À-VIS STATE'S FISCAL POSITION

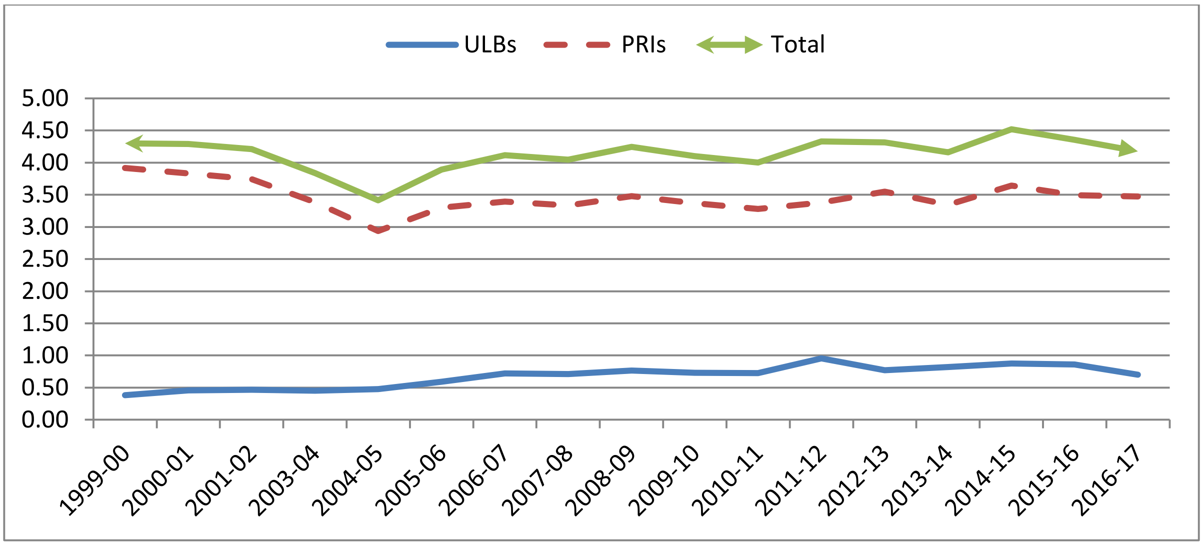
Analysis of the share of allocation to the local bodies in the state's aggregate expenditure (Revenue and capital account) over time reveals that there has been an overall decline from 1997-98. The variations in the share clearly reveal that the allocations are largely reflecting the overall state's fiscal situation. The share declined during 1997-98 till 2004-05, subsequent to which there has been some increase until 2008-09, the decline that has occurred in 2009-10 has more or less continued at the reduced level for the rest of the reference period. Karnataka's fiscal situation was precarious until 2003-04, substantially improved with the framing of Fiscal

Responsibility Act in 2002-03 resulting in a significant improvement in the resource position. The global recession that occurred in 2008-09 adversely affected the state's resource position once again due to the tax concessions that were provided and stimulus measures in the form of enhanced spending.

An important policy concern in this context is with reference to the fact that despite an absolute overall increase in the transfers provided over time, they are very often adversely affected by the state's overall fiscal position. The state's fiscal adversities get clearly reflected in the shared resources with the local bodies that have suffered a decline during 1997-98 until 2004-05 and once again from 2009-10.

The allocation to local bodies as a percent share in GSDP is small and overall the share declined from 4.30 percent in 1998-99 to 3.41 percent in 2004-05 however, it increased to 4.18 percent in 2016-17.

Graph 8.1.7: Allocation to Local Bodies: Share of GSDP



Source: MTFP (various years), GoK

TRANSFERS IN RELATION TO NLNORR

It is important to examine the trends in share of transfers in the Non- Loan Net Own Revenue Resources (NLNORR) which basically comprises of state's own revenue inclusive of both tax and non-tax sources after netting out the cost of collection charges. The third State Finance Commission appointed by the Government of Karnataka had recommended that NLNORR be used as the divisible pool as opposed to the first and second State finance commission that had recommended Non-Loan Gross Own Revenue Receipts (NLGORR). The divisible pool should consist of net proceeds of taxes, tolls, duties, fees levied and collected by the state government.

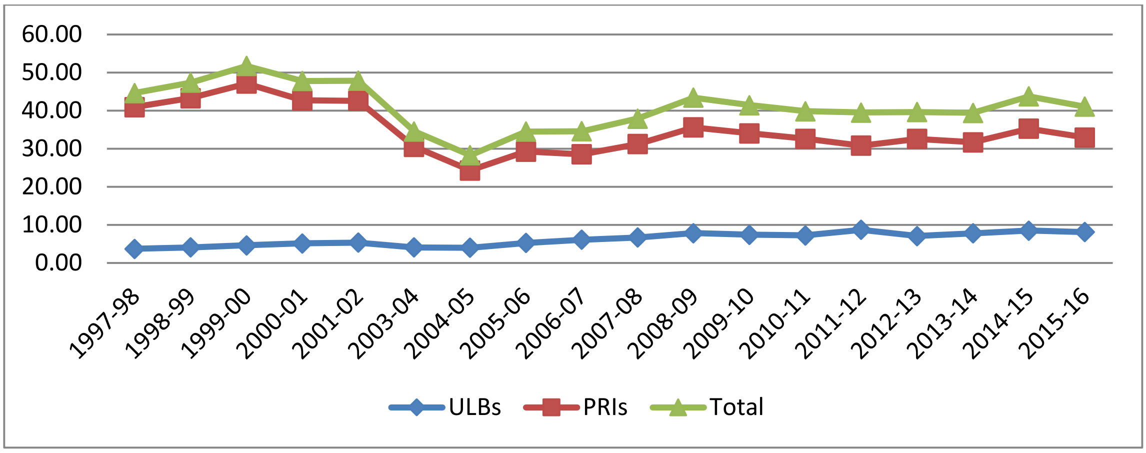
In order to make the long-run comparison meaningful, the overall trends in the transfers to the local bodies have been traced as a percent to NLNORR.

These trends have revealed that the share of total transfers to the NLNORR has declined from 44.62 percent in 1997-98 to 40.28 percent in 2016-17. In addition, there is no uniform trend i.e. either a gradual increase/decrease revealed during the reference period, on the contrary considerable fluctuations have been observed. The share was at the highest in 1999-00 at 51.71 percent and at the lowest in 2004-05 with 28.25 percent share (Table 8.7). On an average, the total transfers account for 40.93 percent share in NLNORR; while the average share of urban local bodies share is 6.16, rural local bodies account for 34.71 percent. The paths of increase/ decrease are clearly discernible in graph 7. The fiscal stress experienced by the government of Karnataka in late nineties and early years of the last decade had resulted in a declining share to the local bodies in the NLNORR, the improved state’s fiscal health had resulted in a considerable increase in its share from 2005-6 till 2008-09. There has been a decline after that owing to the set back to the state’s resource position caused by the global melt down. PRIs seem to be more vulnerable to the fiscal stress of the state as the fluctuations are more in the case of PRIs and the ULBs continue to have a steady increase albeit a much smaller share as compared to the PRIs. Yet another important observation from the trends is that the transfers effected to the local bodies do not seem to be in total compliance with the recommendations of State finance commissions constituted from time to time. For instance, transfers observed during 2011-12 to 2015-16, the period applicable for Third State Finance Commission, have exceeded the recommended level of 33 percent. Similar trends prevailed for the earlier periods too. These trends by and large account for adhocism in the transfers effected to the local bodies albeit enhanced allocations over time and is an important matter of policy concern from the point of view of assured and predictable support received by the local bodies in the discharge of their development function.

Table 8.7: Transfers to Local Bodies (Rs. In crore)

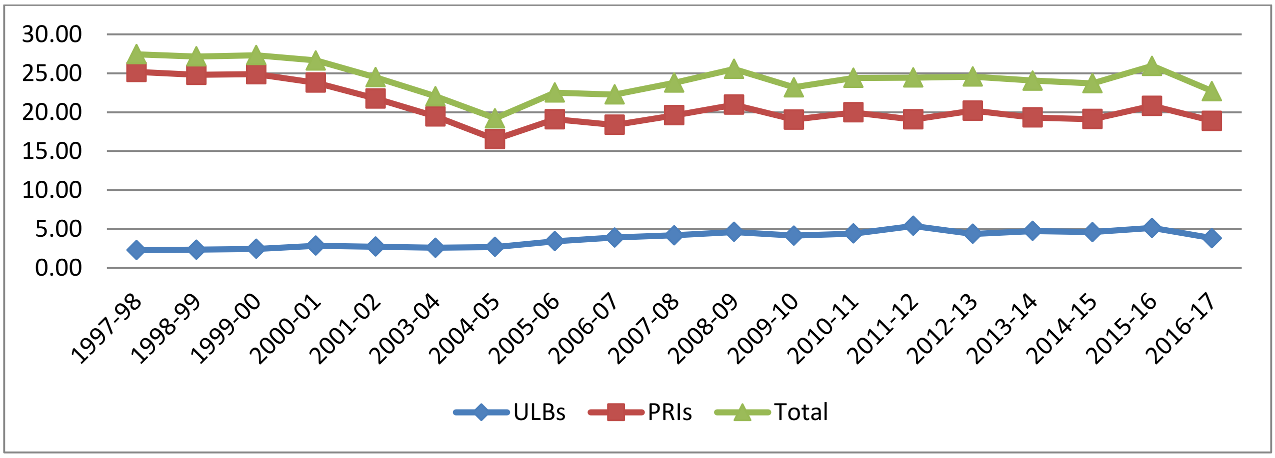
Transfers to Local Bodies				NLNORR (Rs. in Crore)	Ratio of Transfers to NLNORR		
Year	ULBs	PRIs	Total		ULBs	PRIs	Total
1997-98	274.81	3046.00	3320.81	7441.63	3.69	40.93	44.62
2000-01	531.43	4432.20	4963.63	10386.94	5.12	42.67	47.79
2004-05	798.00	4893.41	5691.41	20143.69	3.96	24.29	28.25
2007-08	1926.00	9024.13	10950.13	28895.33	6.67	31.23	37.90
2010-11	2978.00	13464.97	16442.97	41286.49	7.21	32.61	39.83
2013-14	5020.44	20510.18	25530.62	64775.78	7.75	31.66	39.41
2015-16	6548.92	26575.81	33124.73	80690.68	8.12	32.94	41.05
Source: State's Own Tax and Non Tax Revenue GoK, Accounts at a Glance 1960-2015, Data on Total Fiscal Services from both Annual Financial Statments (Gok) and Finace Accounts (CAG, GoI).							

Graph 8.1.8: Allocation to Local Bodies: Share in NLNORR



It is also important to examine the trends in the share of allocation to the local bodies in the state's total expenditure. The long-run trends reveal a clear decline as depicted in graph 8.1.9 from 1998-99 till 2004-05 after which it increased until 2008-09 followed by a decline that continued till the end of the reference period. This decline is more for PRIs than ULBs as the share of ULBs continued to increase. The share of the budget allocation to the local bodies in state's total expenditure well above 25 percent in late nineties had dropped to 20 percent in 2004-05, the increase in the subsequent period however never reached the level prevailing in late nineties.

Graph 8.1.9: Allocation to Local Bodies: Share in Total Expenditure



ALLOCATION TO PRIs BY LEVELS

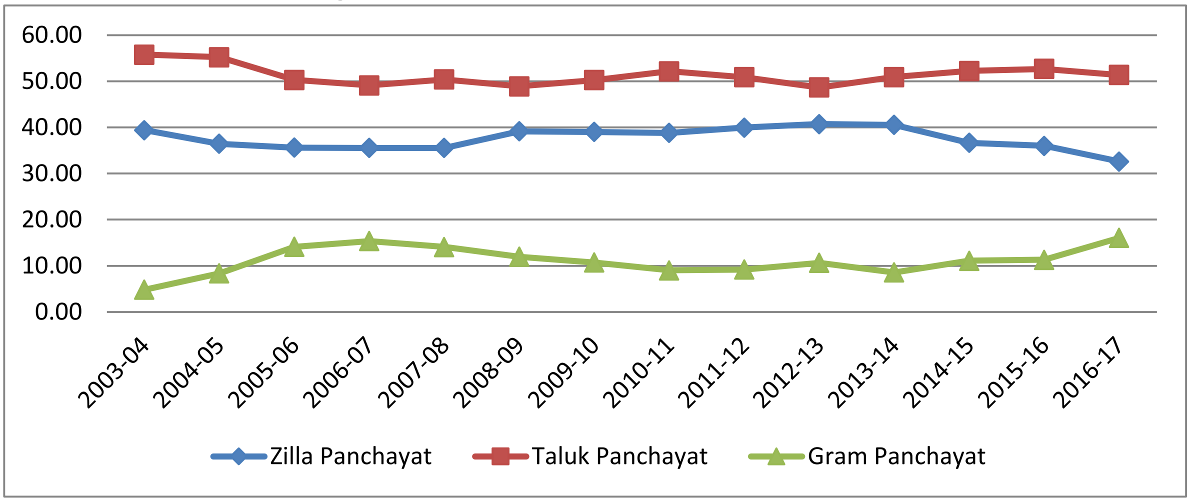
Distribution of the resources allocated to the three tiers of local bodies i.e. ZillaPanchayat(ZP), Taluk Panchayat (TP) and Gram Panchayat (GP) are presented in table 8.8 and graph 8.1.10. The largest share accrues to the TPs followed by the ZPs and lastly the GPs. While the share of the former two tiers has declined during the reference period that of the third tier i.e. GPs has increased significantly from 4.84 percent in 2003-04 to 16.06 percent in 2016-17. However, ZPs and TPs together constituted over 80 percent share throughout the reference period.

Table 8.8: Transfers to Local Bodies by each level

Year	Total Allocation in Rs. in Crore				Share of Total Allocation (in %)		
	ZP	TP	GP	Total	ZP	TP	GP
2004-05	1784	2701	409	4893	36.45	55.19	8.36
2007-08	3422	4848	1355	9625	35.55	50.37	14.08
2010-11	5227	7023	1215	13465	38.82	52.16	9.02
2013-14	9141	11476	1930	22547	40.54	50.90	8.56
2015-16	9568	14002	3006	26576	36.00	52.69	11.31
2016-17	9633	15178	4748	29558	32.59	51.35	16.06

Source: Government of Karnataka, Link Documents: various years

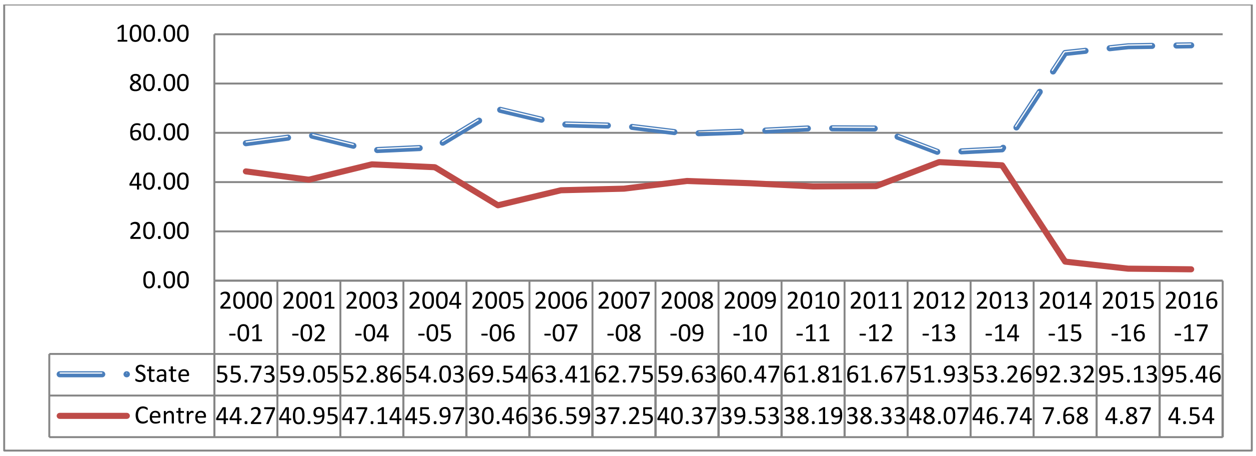
Graph 8.1.10: Percentage Share of ZPs, TPs, and GPs in Total Allocation to PRIs



DISTRICT SECTOR PLAN OUTLAY IN THE STATE'S PLAN OUTLAY

Devolution of plan funds to the rural local bodies as a percentage of the state's total plan outlay has reduced by more than half from 34.85 percent in 1991-92 to 15. 43 percent in 2015-16. This decline has occurred both in the state plan outlay and also the allocations under central schemes. While that of state's plan outlay has declined from 18.43 to 14.68 percent that of centrally sponsored schemes has declined in a much more significantly from 16.42 percent to 1.2 percent. The decline has been very sharp for both state plan and central plan between 2002-03 to 2004-05 and 2008-09 onwards. The state plan has more or less supplemented the significant central plan support that has occurred after 2014-15. Two key issues that concern the rural local bodies development relates to first a significant decline in the support to the development spending, which is a serious of concern as the dependence of the local bodies on higher levels of government is high due to very small size of their own resources. Secondly, the plan funding support is not steady and is subjected to considerable variations depending on the state's fiscal position. This leads to unpredictability of funding support and thus hampers developmental activities in a significant manner.

Graph 8.1.11: Percentage Share of State and Centre in the plan Allocation to PRIs



PLAN AND NON-PLAN ALLOCATION

The plan and non-plan breakup of the resources allocated to the PRIs (table 8.9) reveals that plan has had a larger increase and thus has an increased share in the total.

Table 8.9: Plan and non- plan allocation to PRIs:

Year	Allocation in Rs. Crore			% Share of Allocation	
	Plan	Non-Plan	Total	Plan	Non-Plan
2004-05	1425	3468	4893	29.13	70.87
2007-08	3571	6054	9625	37.10	62.90
2010-11	4870	8595	13465	36.17	63.83
2013-14	8730	13817	22547	38.72	61.28
2015-16	11328	15248	26576	42.62	57.38
2016-17	12513	17046	29558	42.33	57.67

Source: GoK, Link Documents: Various Years

However, when one analyses the PRI plan outlay share in the state's plan outlay it can be observed that (Graph 8.1.12) it has declined from a little over 25 percent in 1993-94 to a little less than 15 percent. The recent decrease is largely on account of the central plan schemes.

Graph 8.1.12: Percentage Share of PRIs Plan Outlay to the Total State Plan Outlay

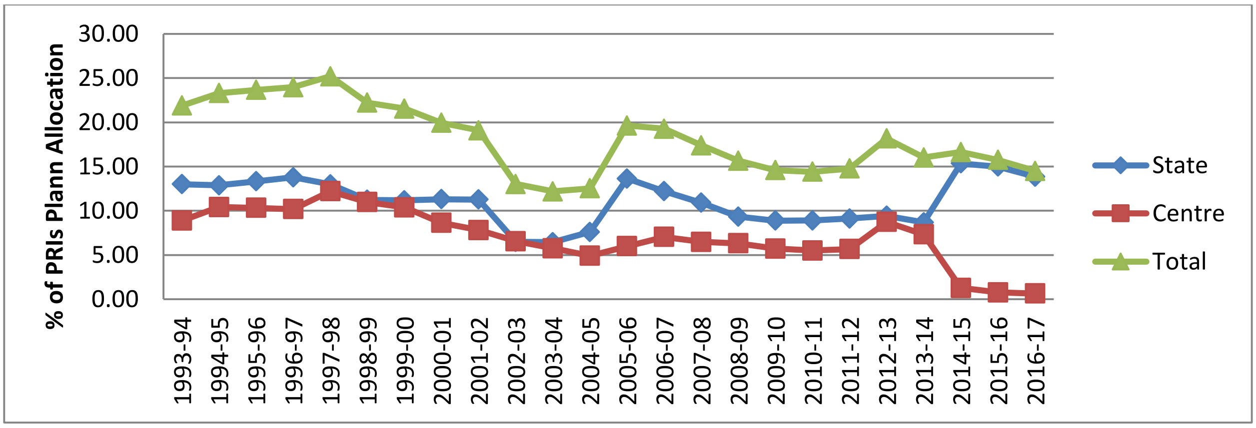


Table 8.10: Percentage Share of State and Centre in the total Plan outlay to PRIs

Year	**State**	**Centre**
1994-95	55.29	44.71
1997-98	51.55	48.45
2000-01	56.69	43.31
2004-05	60.73	39.27
2007-08	62.76	37.24
2010-11	61.81	38.19
2013-14	54.27	45.73
2015-16	95.13	4.87

Source: Economic Survey of Karnataka (2016-17)

KEY ISSUES

Devolution to local bodies is observed to be highly vulnerable to State's overall fiscal position creating uncertainty in the flow of funds. This phenomenon is more predominant for the PRIs as the share of ULBs is observed to be by and large on the increase albeit its smaller share in total. This is more with reference to plan/development funding than the non-plan funding which largely is towards salary. Uncertainty/unpredictability of fund support and hamper the developmental activities of the local bodies.

There has been a sharp decline in plan funding from the state's plan outlay from both the state and centre sources reiterating the fact that while development funding is receiving a setback, the salary component continues to be on the rise. It remains a debatable issue if salary expenditure has to be relegated to secondary importance, especially with reference to services such as Health and Education wherein the services of Doctors and teachers are the most important inputs in the service delivery.

The support provided by the Centre and states are not complementing each other rather they are substituting for one another, which once again raises the issue of predictability of assured funding.

CHAPTER 9

FOURTEENTH FINANCE COMMISSION'S (FFC) OUTCOME EVALUATION

This chapter presents a discussion of the fiscal position of Karnataka state in the wake of the Fourteenth Finance Commission recommendations that have effected a substantial change in the transfer of resources in terms of both the central tax share and grants. The enhanced share in taxes tends to increase the fiscal autonomy and is in line with the long-standing demand of the sub national governments in India. In addition, these resources can be used by the states to fulfil the state specific expenditure priorities. Hence, this move has been widely welcomed. On the contrary while the reduction in grants and the paradigm shift in the centrally sponsored schemes is a relief to the Central government given its own expenditure compulsions, it remains a fact that states have adopted a number of centrally sponsored schemes and have been implementing them which has resulted in some commitments on expenditure that cannot be abruptly stopped. State's assumption of these expenditure responsibilities tends to add to the state's committed expenditure on items that may not have been its priority area.

IMPACT ON REVENUE

Recommendation with regard to share of tax devolution to the states from the divisible pool of Union taxes and its horizontal distribution (inter se) are the significant developments which caught the attention of policy thinkers. The FFC recommended transferring 42 percent of the total divisible taxes to the states against 32 percent of Thirteenth Finance Commission (2010-11to 2014-15) and 30.50 percent of Twelfth Finance Commission (2005-06 to 2009-10). This has resulted in an increased share of tax devolution from 50.50 in 2014-15 to 61.04 in the very subsequent year (2015-16) and it remained more than 60 percent in the total central transfers to the states. Hence, the share of central taxes from the divisible pool has increased by 10 percent points when compared to the previous finance commission. While increasing the pie of share of central taxes, the FFC also has modified the 13th FFC formula for inter se (horizontal) distribution of shared tax net. The criterion adopted by Thirteenth and Fourteenth Finance Commissions is explained in table 9.1

Table 9.1: Horizontal Devolution Formula

Variables	**Weights Accorded**	
	13th FC	**14th FC**
Population (1971)	25	17.5
Population (2011)	0	10
Fiscal Capacity Distance	47.5	50
Area	10	15
Forest Cover	0	7.5
Fiscal Discipline	17.5	0
Total	100	100

Source: Ministry of Finance, GoI

The state of Karnataka is one among the significant gainers due to the new criteria adopted by the FC for tax devolution. Inclusion of forest cover area as one of the variables in the formula by awarding 7.5 percent weight made the state to gain from the horizontal distribution as the state's forest cover area is around 5.5 percent of its total area (Pranay Kotasthane, 2015). According to the new formula the state of Karnataka was awarded 4.713 percent in total share of sharable taxes excluding service tax as against of 4.328 of Thirteenth Finance commission. In the same way, its share in services taxes has increased from 4.397 during Thirteenth Finance commission's award to 4.822 in the new criteria. Hence, the state witnessed a 63 percent increase in the share of central taxes in 2015-16 when compared to its previous year and it has grown at the rate of 27.01 percent Annual Average Growth Rate during 2015-16 to 2018-19 BE (Please refer table 2.3). Share in central taxes has increased from Rs 5,374 crore in 2006-07 to Rs 14,654 in 2014-15 and has further substantially increased to Rs 23,983 crore in 2015-16, an absolute increase by Rs 9,329 crore as a result of the 14 Finance Commission recommendations. Its share in total Revenue receipts increased from 14.07 in 2014-15 to 20.18 in 2015-16 and continued to increase to 22. 25 in 2018-19 BE.

Despite the increase in shared tax revenue, the Revenue receipts of Karnataka as a percentage share of GSDP after 2015-16 is relatively smaller as compared to the previous years. Its annual average growth rate between 2015-16 to 2018-19 BE is lower than that of 2010-11 to 2014-15. Reduction in the Own Tax Revenue (OTR) is one of the major reasons for the short fall in revenue receipts. The percentage share of Own Tax revenue in total revenue receipts during the post FFC has declined to 63.05 percent (average for 2015-16 to 2018-19BE) from 67.74 during 2010-11 to 2014-15 (average). Similarly, the growth of OTR has declined from 18.16 percent of pre FFC to 10.19 percent after 2015-16 (please refer table 2.2 and 2.3). Growth of major taxes under Own Tax Revenue like Sales tax, State Excise Duty, Taxes on Motor and Stamps and Registration Taxes has registered lesser Annual Average Growth Rate (AAGR) during 2015-16 to 2018-19BE than that of 2010-11 to 2014-15 (table 2.7).

The share of Non Tax Revenue of the state in total revenue receipts is very low and has been further on the decline from 2006-07 (please refer table 2.2). The share of NTR was higher than that of all the states till 2006-07. It has got reduced after that. The major reason for the decline in the NTR is the reduction in the returns from general and economic services. Non tax revenue as percent of respective functional heads of expenditure reveals (Table 2.10) that there has been a decline during the reference period. The share of economic services NTR to its total expenditure has declined to 9.59 from 13.68 percent during 2006-07 to 2018-19 BE and that of General services has declined from 20.41 percent to 2.72 percent during the same period. This is despite a sharp increase in the functional categories of expenditure. While one of the reasons is the retention of user charges by departments concerned, the cost recovery has been abysmally low and does not even cover the operation and maintenance charges incurred by the government in the provision of these services. Hence, the performance of NTR in Karnataka is not satisfactory condition since 2006-07 and has marginally increased in the last three years.

IMPACT ON EXPENDITURE

OUTCOMES OF THE 14 FINANCE COMMISSION: ISSUES
CHANGES IN THE CENTRALLY SPONSORED SCHEME (CSS) FUNDING

FFC has suggested compositional shift from grants to tax devolution mainly to enhance the share of unconditional fund flow to the state governments to enable the state governments to spend according state's priorities. As a result of that, the expenditure on consolidated fund for the state of Karnataka has significantly increased after 2015-16. The total expenditure on consolidated fund as a percentage GSDP has increased from 18.76 in 2014-15 to 19.90 in 2018-19BE. Analysis of expenditure on functional categories of the state indicates that the compositional shift in expenditure is favourable to the state's development as the General Services has substantially decreased whereas the share of Social and Economic Services which had a considerable gain after the state's fiscal reform in 2002-03, has further continued to increase after FFC. The state of Karnataka was spending 4.21 percent of its GSDP towards General services in 2014-15 and it has came down to 3.90 percent in 2018-19 BE. On the contrary, expenditure on Social and Economic services was 6.41 and 6.56 percent to state's GSDP in 2014-15 respectively and has witnessed a substantial increase to 7.07 percent for Social services and 7.33 percent of GSDP in case of Economic Services (Table 3.5). The annual average growth rate of functional categories (Table 9.2) indicates that the state substantially reduced its expenditure on general services and increased spending on social and economic services after implementation of the FFC. Comparison of Karnataka with other southern states with reference to expenditure on functional categories also depicts the further advantageous position of Karnataka after 2015-16 (Graph 3.15a, b and c) though the state's spending on functional head was already in an ideal situation. According to the graphical description the state is spending the least on General services and spending the highest on Social and Economic services especially after 2015-16 among all the southern states. This certainly indicates that increased tax devolution has increased the fiscal space to accommodate expenditure needs of the state. This is also partially due to the additional commitment that the state had to undertake on account of reduction in the support extended under the centrally sponsored schemes. The details are discussed below.

Table 9.2 : Annual Average Growth Rate of Expenditure on Functional Categories

Time Points	General Services	Social Services	Economic Services
2010-11 to 2014-15	16.96	14.35	15.16
2015-16 to 2017-18 RE	8.87	15.52	15.98

Source: Authors' Computation based on GoK

As stated earlier the FFC gives more importance to tax devolution over grants in inter-governmental transfers. As a result of that the FFC has desisted to recommend sector and state specific grants. Consequently, the Union government of India has restructured the schemes that clearly altered the funding pattern. The first list consists of 31 schemes whose pattern of funding is unchanged. The second list consists of 24 schemes whose funding pattern is altered and third consist of delinked schemes (8 Schemes). The Union Government will not finance these 8 delinked schemes. These 8 schemes are,

i. National e-Governance Plan
ii. Backward Regions Grant Fund
iii. Modernization of Police Forces
iv. Rajiv Gandhi Panchayat Sashaktikaran Abhiyan (RGPSA)
v. Scheme for central Assistance to the States for Developing export infrastructure
vi. Scheme for setting up of 6000 Model schools
vii. National Mission on Food Processing
viii. Tourist Infrastructure

The state government has spent Rs. 146.37 crore on account these de-linked schemes. These developments have brought a significant change in the resource support extended to the state governments. This has resulted in a drastic reduction in allocation of various Centrally Sponsored Schemes (CSS); especially for 'Category B' schemes where the central share has been reduced below 50 percent (MTFP, 2015-19). The delinking of schemes and the change in sharing pattern for certain centrally sponsored programs has added to the state's commitments by way of enhanced state support. The Fiscal Management Review Committee headed by the Chief Secretary of the state expressed that the receipts from the central government for some of the major CSS has shown a decreasing trend and is a major concern for the state government (MTFP, 2018-22). Table 9.3 compares the allocation of central grants to major schemes for the years 2015-16 and 2016-17 with that of 2014-15. The data shows that there is a reduction in the grants an account most of the major schemes after 2014-15. It can also be noted from the table 9.3 that reduction on the allocation of grants has not only happened in the case of altered funding but also in case of the schemes whose funding pattern is unchanged such as MGNREGA.

Table 9.3: Allocation of Central Grants for Major Schemes (Rs. in Crore)

Name of the Scheme	2014-15	2015-16	2016-17	Difference b/w 2014-15 and 2016-17
Rashtriya Krishi Vikas Yojana	637.46	370.6	242.31	-395.15
Accelerated Irrigation Benefit and Flood Management	173.44	260.17	-	-173.44
National Health Mission	316.63	10.57	-	- 316.63
Mid Day Meals and SSA	1141.85	983.66	984.34	-157.51
Indira Awaas Yojana	285.24	604.06	117.43	-167.81
National Urban Renewal Mission	239.07	129.84	687.73	448.66
Integrated Child Development Services	553.54	965.57	559.27	5.73
MGNREGA	1277.3	991.55	953.33	-323.97
RMSA	176	209.68	81.04	-94.96
PMAGY	22.88	40	0.31	-22.57

Source: Budget Documents (Various years), GoK.

The reduction of support has forced the state government to spend additionally from its own resources. Trends in the CSS support to the state are presented in table 3.15. It can be observed that funding support under the CSS received by the state has increased from Rs 941.53 crore in 2005-06 to Rs 4234.16 crore in 2013-14 and has declined to Rs 854.98 crore in 2016-17. In the past, it has been observed that state support has increased with every instance of decline in the central support, it is expected that the state government would assume these commitments.

Table 9.4: Trends in CSS (Rs in crores)

Year	CSS	CSS Burden to State (Projected)
2005-06	941.53	
2006-07	1122.53	
2007-08	1487.05	
2008-09	1829.19	
2009-10	1477.68	
2010-11	1572.35	
2011-12	1620.5	
2012-13	3208	
2013-14	4234.16	
2014-15	1142.99	4514.41
2015-16	838.22	4745.91
2016-17(RE)	854.98	4934.78
2017-18 (BE)		5131.15
2018-19 (projected)		5335.35

Source: GoK, MTFP (Various Years**)**

IMPACT ON FISCAL DEFICIT AND PUBLIC DEBT

The Fourteenth Finance Commission has specified the limits for Fiscal Deficit and Borrowing limits as follows,

i. Fiscal deficit of all States will be anchored to an annual limit of 3 per cent of GSDP. The States will be eligible for flexibility of 0.25 per cent over and above this for any given year for which the borrowing limits are to be fixed if their debt-GSDP ratio is less than or equal to 25 per cent in the preceding year.

ii. States will be further eligible for an additional borrowing limit of 0.25 per cent of GSDP in a given year for which the borrowing limits are to be fixed if the interest payments are less than or equal to 10 per cent of the revenue receipts in the preceding year.

iii. The two options under these flexibility provisions can be availed of by a State either separately, if any of the above criteria is fulfilled, or simultaneously if both the above stated criteria are fulfilled. Thus, a State can have a maximum fiscal deficit-GSDP limit of 3.5 per cent in any given year.

iv. The flexibility in availing the additional limit under either of the two options or both will be available to a State only if there is no revenue deficit in the year in which borrowing limits are to be fixed and the immediately preceding year.

If a State is not able to fully utilize its sanctioned borrowing limit of 3 per cent of GSDP in any particular year during the first four years of the award period (2015-16 to 2018-19), it will have the option of availing this un-utilized borrowing amount (calculated in rupees) only in the following year but within the award period.

Karnataka is one of the fiscally prudent states. The state has contained the Fiscal Deficit within 3 percent of GSDP in March 2006 itself. The state has contained the fiscal deficit below 3 percent of the GSDP for all the years with the exception of 2008-09 and 2009-10 where the fiscal deficit limit itself was hiked on account of the recession. During these years the fiscal deficit has remained at 3.26 and 3.24 percent to the GSDP respectively, and the state has continued to remain within the targeted level. After these two years the fiscal deficit has come down and stood lesser than 3 percent of GSDP. Both Fiscal and Primary deficits have further come down after 2015-16. Fiscal and Primacy deficits during 2015-16 to 2018-19BE (on an average) are to some extent lower than that of 2010-11 to 2014-15. Fiscal deficit of the state during 2015-16 to 2018-19BE has remained on an average 2.59 against 2.82 during 2010-11 to 2014-15. Similarly, the primary deficit of the state also is lower after 2015-16 than 2010-11 to 2014-15 (graph 4.1.1). the recent evidence suggests that the state is eligible to enhance its Fiscal Deficit to the tune of 0.25 percent of GSDP above the ceiling limit as its borrowing limits are well below the FFC guidelines. In addition to this, the state has controlled both its borrowing limit and interest payment within the specified levels of FFC since 2015-16 (its Debt GSDP ratio is below 25 percent of GSDP and its interest payments are lesser that 10 percent of its total Revenue receipts). Hence, the state has fulfilled both criteria to avail an extra 0.5 percent of enhanced fiscal deficit. However, the state of Karnataka has never utilized the above provisions.

CHAPTER 10

CONCLUSIONS

Karnataka state's overall fiscal performance has been exemplary ever since the state has launched the fiscal reform process as indicated by the broad fiscal indicators like fiscal and revenue deficits that have been all along managed within the stipulated levels albeit with a reduced level of revenue surplus leaving lesser margin for capital investments. The state also compares very well with other states and has outperformed with reference to tax effort as indicated by tax to GSDP ratio and per capita development expenditure. The state's performance in mobilising non-tax revenue, however, has not been very satisfactory. The state took stock of the fiscal situation by presenting a White paper on the State Finances in the financial year 2000. The fiscal consolidation path was initiated by the Karnataka state government with the framing of legislations such as Karnataka ceiling on government guarantee Act, Karnataka transparency in public procurement Act (KTPP) and the most important of all in the fiscal context being the Karnataka Fiscal Responsibility Act (KFRA) 2002. The fiscal principles laid down in the KFRA have guided the state through its fiscal consolidation process.

State's tax performance has improved as it has tended to be more buoyant during post FRA period as compared to the pre FRA phase. However, this is largely due to the own tax revenue whose buoyancy increased from 1.001 to 1.05 as compared to the non-tax revenue whose buoyancy has turned negative at – 0.439 during the post reform phase as compared to 0.238 during the pre FRA phase. Hence, the state needs to tone up the non-tax revenue in a significant manner by framing a clear policy on user charges. The need to improve non-tax performance has been recognised and reiterated time and again in the policy statements by the government albeit with little success. The IT initiatives of the Commercial Taxes Department with 80 percent of revenue realized through electronic mode and 'Anywhere' registration in Stamps and Registration department have helped in substantially improving the tax administration and yield of revenue. Similar initiatives can be introduced in the other tax departments too to improve tax administration and generate more revenue. It is often argued that the state's tax performance has been commendable, but the state has almost reached the tax plateau and further enhancement is largely possible only through higher economic growth. The sharp reduction in the rate of growth of tax revenue during the recent recession reveals that rate of growth of economy impacts the tax revenues in a significant manner. Managing the tempo of economic growth remains a major challenge with the state government by way of enhancing productive capital investments to generate social and economic infrastructure that helps in crowding in private investments in a big way.

The state's expenditure performance too is quite impressive with a large-scale increase in the share of expenditure on Social and Community services during the post FRA period and a substantial increase in per capita real expenditure. The state's inclusive focus is clearly revealed in the sharp increase in spending in the social welfare sector. The second largest component in the functional categories is that of Economic services. Social and economic services expenditure together denoted as development expenditure account for a major share in the total expenditure and the state has had the distinction of having the highest per capita development spending among Indian states for a number of years. On the contrary, the state's spending on non- development category is small and has declined during the reform phase and has tended to be much smaller than many other Indian states. Karnataka has also enhanced its capital investment during the reform phase, however is not consistent, the state's revenue expenditure has had much larger growth than capital expenditure in the recent years. In the event these trends continue the state may have issues of containing revenue expenditure within revenue resources, already the state has experienced a reduced revenue surplus. The state has had a very large increase in the interest payments and employee related expenditure in the last couple of years. Farmers' loan waiver, pay commission and the reduced support extended by the central government under many of the centrally sponsored schemes are likely to have a huge dent on state's resources in the years to come.

Regarding the behaviour of deficits it is gratifying to note that Karnataka state was one of the first Indian states to formulate the Medium term fiscal plan based on the broad parameters suggested by the Eleventh Finance Commission for fiscal correction. A statutory back up to MTFP was provided with the framing of KFRA in September 2002. The fiscal and revenue deficit targets were achieved well within the stipulated time frame. State achieved revenue surplus by 2004-05 itself thus generating more resources for capital investment. However, from the FY 2010 onwards the rate of growth of revenue expenditure has been much higher. In the event, these trends continue very soon the state may end up with revenue deficits once again given the fact that revenue expenditure tends be largely committed in nature. However, since the legislative requirements under the KFRA do not allow revenue deficits to prevail, the state will be forced to resort to cuts in development spending in view of difficulties associated in cutting down committed expenditure in view of its downward rigidity which will have severe implications on state's future development.

Regarding the public debt in the state, while it is gratifying to note that the overall debt position in terms of GSDP and the interest payments are well within the stipulated levels, an important area of concern is the huge impending debt repayment, which are expected by grow almost ten times during 2018-22. Government borrowings are expected to be productively used such that the debt servicing and repayments are made possible through the returns of the capital investments made with such resources. Given these current trends in the returns from investments, the government will be forced to raise fresh loans to repay the old loans and there is every possibility that such practices can result in debt spiral and the government has to take early precautionary measures to prevent such fiscal crisis in future times.

The matter of subsidy to power sector has been the most critical aspect in the context of its implications on the state finances. In addition, there have been various bailout schemes where the government has bailed out the loss-making distribution utilities. Such bail outs seem to serve merely short-term objectives, without any design or plan for long term solutions, nor an in-depth investigation of the real causes of the persisting problems in power sector. Prolonged crisis in financial health of power sector is and would continue to be very expensive for the state government in future, with no return whatsoever in terms of development or progress.

Public sector undertakings contribution to the state exchequer by way of profits and dividends is very meagre as opposed to the state's sizeable contribution to the PSUs in the form of share capital and grants. While the state has recognized the need to reform the performance of PSUs and formed Public Sector Restructuring Commission way back in 2000, and as a follow up 29 PSUs were identified for disinvestment and liquidation the progress seems to be lacklustre. The state has to act fast on reviving the performance of state PSUs.

Karnataka's decentralisation efforts are appreciated. However, devolution to local bodies is observed to be highly vulnerable to State's overall fiscal position creating uncertainty in the flow of funds. This phenomenon is more predominant for the PRIs as the share of ULBs is observed to be by and large on the increase albeit its smaller share in total. This is more with reference to plan/development funding than the non-plan funding which largely is towards salary. Uncertainty/unpredictability of fund support and hamper the developmental activities of the local bodies. The support provided by the Centre and states are not complementing each other rather they are substituting for one another, which once again raises the issue of predictability of assured funding.

The state's pro-reform orientation gets reflected in its adoption of frameworks like Departmental Medium Term Framework; Program Performance budgets (PPBs); Monthly Program Implementation Calendar; Results Framework Document. While the first two frameworks have been at the instance of the international aid agencies, MPIC has been conceived by the Finance department, GoK. Government of Karnataka has adopted the Results framework of Government of India to track the results of government programs and ensure accountability. While the state has been very quick in adopting new initiatives, four varied approaches attempted in a span of eight years, they are also put to disuse fast. RFD also has been discontinued. There are also issues such as use of inappropriate outcome indicators, poor outcome database, multiple reporting formats and inadequate understanding of the new approaches. It is also important to note that the ultimate benefit of these frameworks lies in the use of outcome information in the expenditure planning for the ensuing financial year which has to be ensured by the Government of Karnataka.

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