

CHAPTER I
FINANCES OF THE STATE
GOVERNMENT

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1.1 Introduction

The accounts of the State Government are kept in three parts (i) Consolidated Fund, (ii) Contingency Fund and (iii) Public Account (**Appendix 1.1-Part A**). The Finance Accounts of the Government of Karnataka are laid out in 19 statements, presenting receipts and expenditure, revenue as well as capital, in the Consolidated Fund, the Contingency Fund and the Public Account of the State. The layout of the Finance Accounts is depicted in **Appendix 1.1-Part B**.

1.1.1 Summary of receipts and disbursements

Table 1 summarises the finances of the Government of Karnataka for the year 2007-08 as compared to the previous year, covering revenue receipts and expenditure, capital receipts and expenditure, contingency fund transactions and public account receipts/disbursements as emerging from statement-1 and other detailed statements of Finance Accounts.

Table 1: Summary of receipts and disbursements

(Rupees in crore)

2006-07	Receipts	2007-08	2006-07	Disbursements	2007-08		
					Non-Plan	Plan	Total
Section-A: Revenue							
37,586.94	Revenue receipts	41,151.14	33,435.43	Revenue expenditure	29,061.95	8,312.82	37,374.77
23,301.03	Tax revenue	25,986.76	10,419.42	General services	10,786.54	85.24	10,871.78
4,098.41	Non-tax revenue	3,357.66	10,936.71	Social services	8,339.59	4,784.09	13,123.68
5,374.33	State's share of Union taxes and duties	6,779.23	10,440.24	Economic services	8,009.82	3,443.49	11,453.31
4,813.17	Grants from Central Government	5,027.49	1,639.06	Grants-in-aid/Contributions	1,926.00	-	1,926.00
Section-B: Capital and others							
--	Misc. capital receipts	245.78	8,542.57	Capital outlay	1,450.14	7,198.80	8,648.94
			320.94	General services	55.00	284.02	339.02
			1,292.62	Social services	190.89	1,956.79	2,147.68
			6,929.01	Economic services	1,204.25	4,957.99	6,162.24
59.97	Recoveries of loans and advances	52.07	357.23	Loans and advances disbursements	5.31	751.43	756.74
3,545.94	Public debt receipts	2,356.68	1,749.37	Repayment of public debt	1,328.77	-	1,328.77
--	Contingency fund (recoupment)	13.28	13.28	Contingency fund	-	-	-
47,040.04	Public account receipts	56,159.75	42,636.88	Public account disbursements	-	-	54,054.80
4,606.64	Opening cash balance	6,104.77	6,104.77	Closing cash balance	-	-	3,919.45
92,839.53	Total	1,06,083.47	92,839.53	Total	31,846.17	16,263.05	1,06,083.47

Following are the significant changes during 2007-08 over the previous year:

- Revenue receipts grew by Rs. 3,564 crore due to increase in tax revenue (Rs. 2,686 crore), State's share of union taxes and duties (Rs. 1,405 crore) and Government of India (GOI) grants (Rs. 214 crore) partly off set by fall in non-tax revenue (Rs. 741 crore).
- Revenue expenditure increased by Rs. 3,940 crore. Increase was mainly under social services sector (Rs. 2,187 crore) and economic services sector (Rs. 1,013 crore).
- Miscellaneous capital receipts (Rs. 246 crore) accrued for the first time during the six year period 2002-08 were on account of sale of Government land.
- Capital outlay was more by Rs. 855 crore in social services sector, while it was less by Rs. 767 crore in economic services sector.
- Public debt receipts (excluding ways and means advances) decreased by Rs. 1,267 crore due to reduction in internal debt receipts (Rs. 1,419 crore) and increase in loans and advances from GOI (Rs. 152 crore).
- Recovery of loans and advances was less by Rs. eight crore, while the disbursements were more by Rs. 400 crore.
- Public Account receipts and disbursements increased by Rs. 9,120 crore and Rs.11,418 crore respectively.
- Cash balance of the State Government decreased by Rs. 2,185 crore.

1.1.2 Fiscal position by key indicators

The fiscal position of the State Government as reflected by the key indicators during the current year as compared to the previous year is given in table 2:

Table : 2

(Rupees in crore)

2006-07	Serial number	Major aggregates		2007-08
37,587	1	Revenue receipts (2+3+4)		41,151
23,301	2	Tax revenue		25,987
4,099	3	Non-tax revenue		3,358
10,187	4	Other receipts		11,806
60	5	Non-debt capital receipts	246	298
		Loans and advances recovered	52	
37,647	6	Total receipts (1+5)		41,449
25,766	7	Non-plan expenditure (8+10+11)		30,517
25,583	8	on Revenue account		29,062
4,236	9	Interest payments		4,506
132	10	on Capital account		1,450
51	11	Loans and advances disbursed		5
16,569	12	Plan expenditure (13+14+15)		16,264
7,852	13	on Revenue account		8,313
8,411	14	on Capital account		7,199
306	15	Loans and Advances disbursed		752
42,335	16	Total expenditure (7+12)		46,781
- 4,688	17	Fiscal deficit [(1+5) – 16]		-5,332
4,152	18	Revenue surplus [1-(8+13)]		3,776
-452	19	Primary deficit (6-16+9)		- 826

During 2007-08, revenue expenditure grew by Rs. 3,940 crore (12 *per cent*) as against the increase in revenue receipts by Rs. 3,564 crore (9 *per cent*) resulting in decrease of surplus on revenue account. Given the decrease of Rs. 376 crore in revenue surplus, growth of Rs. 506 crore in capital expenditure (including loans and advances) and increase of Rs. 238 crore in non-debt capital receipts resulted in increase of fiscal deficit by Rs. 644 crore. The increase in fiscal deficit along with increase of Rs. 270 crore in interest payments was the reason for the increase of primary deficit by Rs. 374 crore.

1.2 Methodology adopted for the assessment of fiscal position

The trends in the major fiscal aggregates of receipts and expenditure as emerged from the statements of Finance Accounts were analysed over the period from 2002-03 to 2007-08. The norms/ceilings prescribed by the Twelfth Finance Commission (TFC) as well as its projections and projections made by the State Government in their Fiscal Responsibility Act and in other statements required to be laid before legislature under the Act are used to make assessment of the trends and pattern of major fiscal aggregates during the current year. Assuming that Gross State Domestic Product (GSDP)¹ as published by the Director of Economics and Statistics, Government of Karnataka (table 3) is the good indicator of the performance of the State's economy, major fiscal aggregates like tax and non-tax revenue, revenue and capital expenditure, internal debt and revenue and fiscal deficits have been presented as percentage of GSDP at current market prices. For revenue receipts, revenue expenditure, *etc.*, buoyancy projections are provided to estimate the range of fluctuations with reference to the base represented by GSDP. The key indicators adopted for the purpose are (i) trends in aggregate receipts, (ii) application of resources (iii) assets and liabilities and (iv) management of deficits. Observations made also take into account the cumulative impact of resource mobilisation efforts, debt servicing and corrective fiscal measures. The overall financial performance of the State Government as a body corporate has been presented by the application of a set of ratios commonly adopted for the relational interpretation of fiscal aggregates. In addition, selected indicators of financial performance of the Government are listed in this section; some of the terms used in this context are explained in **Appendix 1.1-Part C**. Summarised financial position of the State Government as on 31 March 2008, abstract of receipts and disbursement for the year 2007-08, sources and application of funds and the time series data on State Government finances are given in **Appendices 1.2 to 1.5**.

Table 3: Growth of GSDP

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
GSDP (Rupees in crore)	1,17,919	1,29,181	1,49,854	1,67,975	1,88,274 ϕ	2,15,282 μ
Rate of growth (<i>per cent</i>)	7.8	9.6	16.0	12.1	12.1	14.3

ϕ quick estimates, μ advance estimates

¹ GSDP is defined as the total income of the State or the marked value of goods and services produced using labour and all other factors of production.

1.2.1 Fiscal reforms path in Karnataka

In Karnataka, fiscal reforms and consolidation were brought to the forefront with the State Government formulating the first Medium Term Fiscal Plan (MTFP) for the period 2000-01 to 2004-05 based on broad parameters of fiscal correction laid down by the Eleventh Finance Commission (EFC). MTFP became a rolling annual document to report on the actual performance of the State against fiscal targets of the previous year and to put in place a multi-year medium term reform framework dovetailed to the budgetary exercise.

The statutory backing for MTFP was provided by the Karnataka Fiscal Responsibility Act, 2002 (Act), which came into force from 1 April 2003. The Act aims to ensure fiscal stability and sustainability, enhance the scope for improving social and physical infrastructure and human development by achieving revenue surplus, reducing fiscal deficit, removing impediments to the effective conduct of fiscal policy and prudent debt management through limits on borrowings, debt and deficits, greater transparency in fiscal operations by the use of medium-term fiscal framework.

To give effect to the fiscal management principles, the Act prescribed the following fiscal targets for the State Government.

- elimination of revenue deficit by the end of the financial year 2005-06.
- reduction of fiscal deficit to not more than three *per cent* of the estimated GSDP by the end of the financial year 2005-06.
- limiting the total liabilities to not more than 25 *per cent* of the estimated GSDP within a period of 13 financial years, i.e., by the end of the financial year 2014-15.
- maintaining outstanding guarantees within the limit stipulated under the Karnataka Ceiling to Government Guarantees Act, 1999.

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

1.2.2 Fiscal policy statements 2007-08

The State Government laid the MTFP for the period 2007-11 before the State Legislature along with the annual budget for the 2007-08, which *inter alia* contained:

- medium term fiscal objectives of the State Government.
- evaluation of the performance of the prescribed fiscal indicators in the previous year.
- recent economic trends and prospects for growth and development.
- strategic priorities and key fiscal policies of the Government and evaluation of their consistency.
- four year rolling targets.
- assessment of sustainability relating to the revenue deficit and the use of capital receipts for productive purposes.

1.2.3 Roadmap to achieve the fiscal targets as laid down in the Act

Keeping in view the fiscal targets laid down in the Act, the State Government developed its own Fiscal Correction Path (FCP) indicating the milestones of outcome indicators with target dates of implementation during the period from 2004-05 to 2008-09 (**Appendix 1.6**). The State's MTFP 2007-11 presented along with budget for 2007-08 contained budget estimates of outcome indicators. The variations between FCP and MTFP regarding significant indicators for the year 2007-08 were as given in the table 4:

Table 4 : Variations between FCP and MTFP

(Rupees in crore)

Outcome indicator	Projection vis-à-vis Actual for 2007-08		
	FCP projection	Budget estimates	Actual
Revenue receipts	36,282	40,762	41,151
Revenue expenditure	34,661	39,135	37,375
Expenditure on capital account	5,346	8,207	8,649
Revenue surplus	1,621	1,627	3,776
Fiscal deficit	5,875	6,305	5,332
Fiscal Liabilities / GSDP ratio (in per cent)	32	31	28

The State achieved the fiscal targets laid down in the Act one year ahead, with the year 2004-05 ending in revenue surplus of Rs. 1,638 crore and fiscal deficit for the year (Rs. 3,600 crore) at less than three *per cent* of GSDP. The revenue surplus increased to Rs. 4,152 crore in 2006-07 which although marginally declined to Rs. 3,776 crore in 2007-08. The fiscal deficit for the years 2005-06 to 2007-08 was also below three *per cent* of GSDP. Outstanding guarantees given by the Government (Rs. 10,786 crore) were within the prescribed limit of 80 *per cent* of the State's revenue receipts of the second preceding year. The ratio of fiscal liabilities to GSDP continued to decline from 2004-05 and was around 28 *per cent* in 2007-08. As a result, the State received the full benefit of incentive grants of Rs. 286 crore for the EFC award period. Under GOI's scheme of States' Debt Consolidation and Relief Facility (DCRF)², the State got the benefit of interest relief of Rs. 824 crore for the years 2005-06 (Rs. 292 crore), 2006-07 (Rs. 276 crore) and 2007-08 (Rs. 256 crore) along with waiver of GOI loan of Rs. 1,074 crore.

1.2.4 Mid-term review of fiscal situation

According to the half-yearly review report for the current year placed before the State Legislature in compliance with the provisions of the Act, realisation of revenues up to end of September 2007 was below target. Revenue receipts

² In pursuance of the recommendations of the TFC for fiscal consolidation and elimination of revenue deficit of the States, Government of India formulated a scheme of DCRF under which general debt relief is provided by consolidating and rescheduling at substantially reduced rates of interest on the Central loans granted to States enacting the Fiscal Responsibility Act and debt waiver is granted based on fiscal performance, linked to the reduction of revenue deficits of States.

at the year-end, however, exceeded the budget estimates. At the end of the year revenue expenditure was less than the budgeted estimates and capital expenditure was more than the budget estimates as stated in the mid term review. As forecast in the mid term review, the revenue surplus for the year exceeded the projection made in the mid term review by Rs. 1,627 crore, while the fiscal deficit was less by Rs. 754 crore.

1.3 Trends and composition of aggregate receipts

Resources of the State Government consist of revenue receipts and capital receipts. Revenue receipts consist of tax revenue, non-tax revenue, State's share of union taxes and duties and grants-in-aid from the GOI. Capital receipts comprise miscellaneous capital receipts such as proceeds from disinvestments, recovery of loans and advances, debt receipts from internal sources (market loans, borrowings from financial institutions/commercial banks) and loans and advances from GOI as well as accruals from public account. Sources of receipts under different heads during 2002-08 are indicated in table 5.

Table 5: Trends in growth and composition of aggregate receipts

(Rupees in crore)						
Sources of State's receipts	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
I. Revenue receipts	16,169	20,760	26,570	30,352	37,587	41,151
II. Capital receipts	6,361	8,052	8,556	5,788	3,606	2,577
Recovery of loans and advances	928	64	47	124	60	52
Public debt receipts	5,433	7,988	8,509	5,664	3,546	2,279
Miscellaneous capital receipts	Nil	Nil	Nil	Nil	Nil	246
III. Contingency fund	8	0	41	39	0	13
IV. Public account receipts	27,879	30,513	36,325	38,026	47,040	56,160
a. Small savings, Provident fund etc.	1,399	1,422	1,521	1,651	1,748	1,994
b. Reserve fund	338	396	570	1,289	1,656	1,034
c. Deposits and advances	13,428	14,686	17,211	15,926	19,073	19,899
d. Suspense and miscellaneous	10,606	11,308	14,390	16,393	20,772	30,714
e. Remittances	2,108	2,701	2,633	2,767	3,791	2,519
Total receipts	50,417	59,325	71,492	74,205	88,233	99,901

Total receipts increased by 98 per cent from Rs. 50,417 crore in 2002-03 to Rs. 99,901 crore in 2007-08, of which increase of revenue receipts was by 154 per cent from Rs. 16,169 crore to Rs. 41,151 crore during the period. While non debt receipts decreased by 68 per cent from Rs. 928 crore to Rs. 298 crore, public account receipts increased by 101 per cent from Rs. 27,879 crore to Rs. 56,160 crore during the period. Public debt receipts, which create future repayment obligations, decreased from Rs. 5,433 crore to Rs. 2,279 crore which might improve the fiscal position of the State. The share of revenue receipts as a percentage of total receipts increased steadily from 32 in 2002-03 to 43 in 2006-07 with marginal decline to 41 in 2007-08. The share of capital receipts witnessed a steep fall from 14 per cent in 2003-04 to three per cent in 2007-08. The percentage share of public account receipts was 55 in 2002-03, declined to 51 during the period 2003-06 which thereafter increased to 53 per cent in 2006-07 and further to 56 per cent in 2007-08.

1.3.1 Revenue receipts

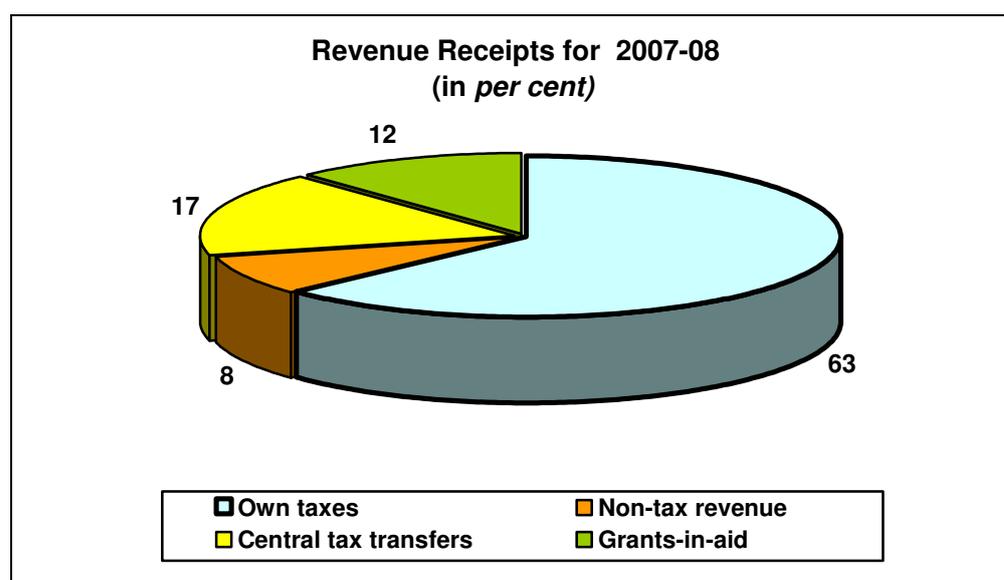
Statement-11 of the Finance Accounts details the revenue receipts of the Government. Revenue receipts are linked to economic activity and GSDP is its natural base. Apart from the quantum and rate of growth of revenue receipts, it is equally important to look at these receipts relative to this base and its expansion over time. Overall revenue receipts, their annual rate of growth, ratio of these receipts to GSDP and their buoyancy are indicated in table 6.

Table 6: Revenue receipts – Basic parameters

	(Rupees in crore)					
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Revenue receipts (RR)	16,169	20,760	26,570	30,352	37,587	41,151
State's own taxes	10,440(65)	12,570 (61)	16,072(60)	18,632(61)	23,301(62)	25,987 (63)
Non-tax revenue	1,278 (8)	2,958 (14)	4,473(17)	3,875(13)	4,099(11)	3,358 (8)
Central tax transfers	2,786 (17)	3,245 (15)	3,878(15)	4,213(14)	5,374(14)	6,779 (17)
Grants-in-aid	1,665 (10)	1,987 (10)	2,147(8)	3,632(12)	4,813(13)	5,027 (12)
Rate of growth of RR (per cent)	5.5	28.4	27.9	14.2	23.8	9.0
RR-GSDP (per cent)	13.7	16.1	17.7	18.1	20.0	19.1
Revenue buoyancy w.r.t GSDP (ratio)	0.7	3.0	1.7	1.2	2.0	0.6
State's own taxes buoyancy w.r.t GSDP (ratio)	0.8	2.1	1.7	1.3	2.1	0.8
Revenue buoyancy w.r.t State's own taxes (ratio)	0.9	1.4	1.0	0.9	0.9	0.8
GSDP growth (per cent)	7.8	9.6	16.0	12.1	12.1	14.3

Note: Figures in parenthesis represent percentage composition of revenue receipts.

Revenue receipts showed progressive increase from Rs. 16,169 crore in 2002-03 to Rs. 41,151 crore in 2007-08. On an average 74 per cent of the revenue came from State's own resources and the balance was from transfers from GOI in the form of State's share of taxes and grants-in-aid during the period 2002-08. The Composition of revenue receipts during 2007-08 is indicated graphically below:



Revenue buoyancy widely fluctuated varying from 0.6 to 3.0 depending upon the rates of growth of revenue receipts and the GSDP during the period 2002-08. Given the increase by two percentage points in GSDP growth relative to the previous year and steep fall in growth rate of revenue receipts by 15 percentage points led to a sharp deterioration in their buoyancy ratio with reference to GSDP in 2007-08. The trends in revenue buoyancy not only moved in tandem with state's own tax buoyancy ratios with respect to GSDP during the period 2002-08 but the trends in the latter determined the former as more than 70 per cent of revenue receipts are contributed by the State's own resources.

Tax revenue

Taxes on sales, trade *etc.*, was the main source of State's own tax revenue which contributed 53 per cent followed by state excise (18 per cent), stamps and registration fees (13 per cent) and taxes on vehicles (6 per cent). Table 7 below shows the trends in major constituents of tax revenue during 2002-08

Table 7: Tax revenue

	(Rupees in crore)					
Tax revenue	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Taxes on sales, trade, <i>etc.</i>	5,474	6,649	8,700	9,870	11,762	13,894
<i>Rate of growth</i>	3.89	21.47	30.85	13.45	19.17	18.13
State excise	2,094	2,334	2,806	3,397	4,495	4,767
<i>Rate of growth</i>	5.92	11.46	20.22	21.06	32.32	6.05
Stamps and registration fees	1,115	1,356	1,760	2,213	3,206	3,409
<i>Rate of growth</i>	30.41	21.61	29.79	25.74	44.87	6.33
Taxes on vehicles	676	800	983	1,105	1,374	1,650
<i>Rate of growth</i>	-5.06	18.34	22.88	12.41	24.34	20.09

The marginal reduction in growth rate of taxes on sales, trade, *etc.*, by one percentage point during 2007-08 over the previous year was, as stated by the State Government in its MTFP 2008-12, was due to non revision of administered price of petrol and diesel, reduced collections of central sales tax on account of reduction of rate of taxation and abolition of special entry tax. A steep decline in rate of growth of state excise from 32 per cent to 6 per cent during the year was mainly on account of ban on sale of arrack from July, 2007 and low overall rate of tax on liquor. Fall in number of documents registered due to slow down in the real estate market led to a reduced growth rate of stamps and registration fees.

Non-tax revenue

Non-tax revenue of the Government included interest on loans and advances made by the Government, dividends and interest on equity investments and lending, fees and fines and user charges for socio-economic services. A decline in non-tax revenue by Rs. 741 crore from Rs. 4,099 crore in 2006-07 to Rs. 3,358 crore in 2007-08 was mainly due to reduction of receipts from State lotteries over the previous year on account of their ban from April, 2007. This loss in non tax revenue was partly offset by more revenue by way of royalty charges (Rs. 100 crore) and increase (Rs. 468 crore) in the amount representing unspent balance in the panchyati raj bodies fund in public account written back to consolidated fund .

Non tax revenue of Rs. 2,099 crore (63 *per cent*) from agriculture, forestry, fisheries, irrigation, *etc.*, accounted for major share of total non tax revenue during the year. While general services like police, jails, public works, miscellaneous general services contributed Rs. 679 crore (20 *per cent*), the share of social services was Rs. 181 crore (five *per cent*). Revenue in the form of dividend and interest was Rs. 399 crore (12 *per cent*).

Collection of user charges as ratio of revenue receipts to revenue expenditure under education, medical and public health, water supply and sanitation, irrigation and power during the period 2002-08 was negligible at less than one *per cent*.

Grants-in-aid from GOI

Grants-in-aid from GOI increased from Rs. 1,665 crore in 2002-03 to Rs. 5,027 crore in 2007-08 as detailed in the table below:

Table 8 : Grants-in-aid from GOI

		(Rupees in crore)					
		2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Non-plan		421	530	263	1,736	2,224	1,531
Plan	State	570	796	1,089	915	1,284	1,916
	Central	45	42	46	37	43	71
	Centrally sponsored	629	619	749	944	1,262	1,509
Total		1,665	1,987	2,147	3,632	4,813	5,027

The increase of GOI grants by Rs. 214 crore in 2007-08 was due to increase in plan grants by Rs. 907 crore offset by decrease in non-plan grants by Rs. 693 crore. Increase of plan grants was mainly under block grants (Rs. 385 crore), grants for agriculture (Rs. 154 crore) and grants for other rural development programmes (Rs. 102 crore). Decrease of non-plan grants by Rs. 693 crore over the previous year was due to reduction in National Calamity Contingency Fund grants (Rs. 316 crore) and grants for other rural development programmes (Rs. 246 crore)

Central tax transfers

Increase of state's share of union taxes by Rs. 1,405 crore over the previous year was mainly under corporation tax (Rs. 474 crore), taxes on income other than corporation tax (Rs. 425 crore), customs (Rs. 233 crore) and service tax (Rs. 161 crore) and union excise duties (Rs. 110 crore).

Arrears of revenue

As of March, 2008 arrears of revenue pertaining to taxes on sales, trade, *etc.*, entry tax, entertainment tax, agricultural income tax, profession tax, luxury tax, state excise and taxes and duties on electricity aggregated Rs. 4,729 crore. Revenue of Rs. 682 crore (pertaining to taxes and duties on electricity: Rs. Seven crore and state excise: Rs.675 crore) were outstanding for more than five years.

1.4 Application of resources

1.4.1 Growth of expenditure

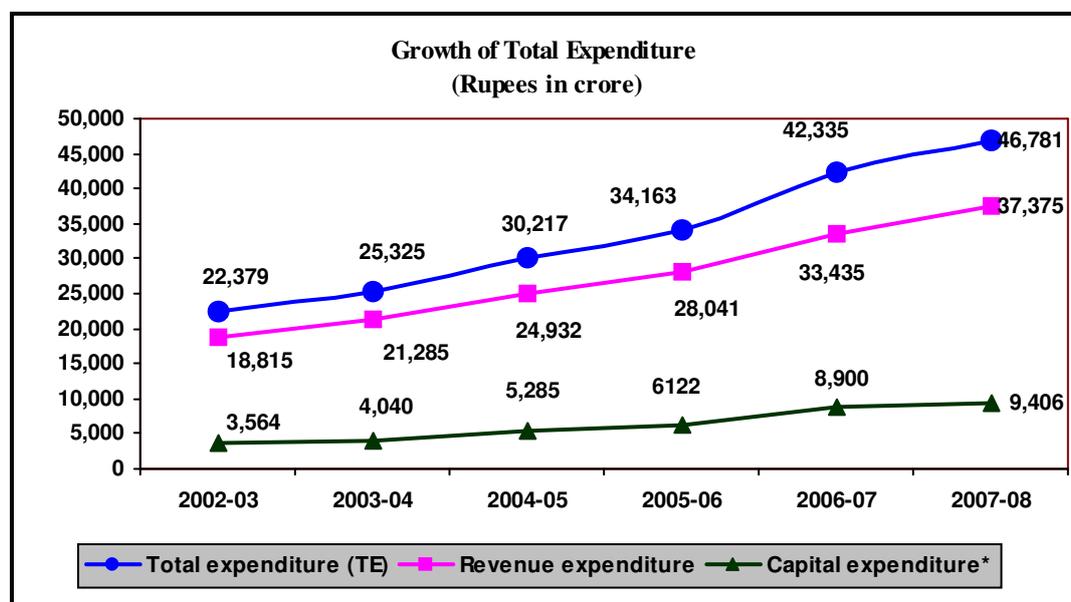
Statement 12 of the Finance Accounts depicts the detailed revenue expenditure by minor heads and capital expenditure by major heads. States raise resources to perform their sovereign functions, maintain their existing nature of delivery of social and economic services, extend the network of these services through capital expenditure and investments and discharge their debt servicing obligations.

Total expenditure, its annual growth rate and ratio of expenditure to GSDP and to revenue receipts and its buoyancy in relation to GSDP and revenue receipts are indicated in table 9 followed by its graphic representation.

Table 9 : Total expenditure – Basic parameters

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Total expenditure (TE)* (Rupees in crore)	22,379	25,325	30,217	34,163	42,335	46,781
Rate of growth (Per cent)	5.4	13.2	19.3	13.1	23.9	10.5
TE/GSDP ratio (Per cent)	19.0	19.6	20.2	20.3	22.5	21.7
Revenue receipts/TE ratio (Per cent)	72.2	82.0	87.9	88.8	88.8	88.0
Buoyancy of total expenditure with						
GSDP(Ratio)	0.7	1.4	1.2	1.1	2.0	0.7
Revenue receipts (ratio)	1.0	0.5	0.7	0.9	1.0	1.2

* Total expenditure includes revenue expenditure, capital expenditure & loans and advances



* includes disbursement of loans and advances

Total expenditure increased from Rs. 22,379 crore in 2002-03 to Rs. 46,781 crore in 2007-08 (109 per cent). Revenue expenditure which constituted 84 per cent of total expenditure in 2002-03 decreased to 80 per cent in 2007-08. Capital expenditure (including loans and advances) increased by 164 per cent from Rs. 3,564 crore in 2002-03 to Rs. 9,406 crore in 2007-08. It constituted 20 per cent of total expenditure in 2007-08 as against 16 per cent in 2002-03. During 2007-08, plan capital expenditure constituted 85 per cent of total capital expenditure. Of this, 17 per cent (Rs. 1,507 crore) was towards repayment of off-budget borrowings.

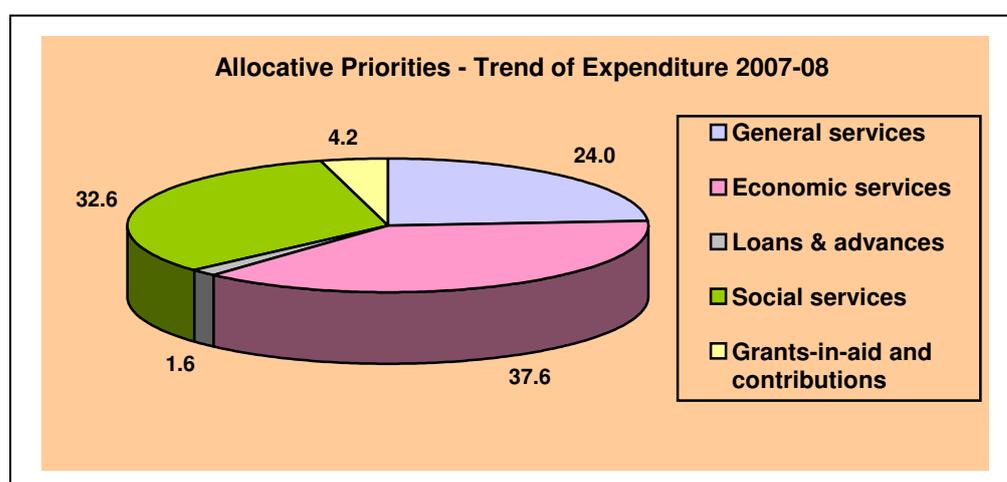
The buoyancy ratio of total expenditure with respect to revenue receipts was around one during the last three years indicating that fact incremental total expenditure was solely determined by availability of revenue receipts. As a result, the ratio of revenue receipts to total expenditure remained at 88 and 89 per cent during the period 2004-08.

1.4.2 Trends in total expenditure by activities:

In terms of activities, total expenditure could be considered as being composed of expenditure on general services including interest payments, social and economic services, grants-in-aid and loans and advances. Relative share of these components in total expenditure (including disbursements of loans and advances) is indicated in table 10 followed by its graphic representation.

Table 10: Components of expenditure – Relative share

	<i>(in per cent)</i>					
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
General services	32.1	36.2	33.2	30.0	25.4	24.0
<i>Of which interest payments</i>	45.8	40.5	37.8	36.7	39.4	40.2
Social services	29.6	29.2	27.2	29.3	28.9	32.6
Economic services	32.9	28.1	35.0	36.4	41.0	37.6
Grants-in-aid	2.6	2.5	2.6	3.4	3.9	4.2
Loans and advances	2.8	4.0	2.0	0.9	0.8	1.6



The movement of relative share of these components indicates that while the share of social services in total expenditure increased from 30 *per cent* in 2002-03 to 33 *per cent* in 2007-08, the relative share of general services, considered as non-developmental declined from 32 *per cent* in 2002-03 to 24 *per cent* in 2007-08. The share of economic services expenditure increased from 33 *per cent* in 2002-03 to 38 *per cent* in 2007-08 with inter-year variations. While the share of grants in aid indicated an increasing trend, the loans and advances revealed fluctuations during the period 2002-08.

1.4.3 Incidence of revenue expenditure

Revenue expenditure has the predominant share in the total expenditure. Revenue expenditure is incurred to maintain the current level of services and make payment for the past obligations and as such does not result in any addition to the State's infrastructure and service network. The overall revenue expenditure, its rate of growth, ratio of revenue expenditure to GSDP and to revenue receipts and its buoyancy are indicated in table 11.

Table 11: Revenue expenditure – Basic parameters

(Rupees in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Revenue expenditure (RE)	18,815	21,285	24,932	28,041	33,435	37,375
Non-plan revenue expenditure (NPRE)	15,570	17,732	19,807	22,972	25,583	29,062
Plan revenue expenditure (PRE)	3,245	3,553	5,125	5,069	7,852	8,313
Rate of growth (Per cent)						
NPRE	6.2	13.9	11.7	16.0	11.4	13.6
PRE	-17.7	9.5	44.2	-1.1	54.9	5.9
NPRE/ GSDP (Per cent)	13.2	13.7	13.2	13.7	13.6	13.5
NPRE as <i>per cent</i> of TE	69.6	70.0	65.5	67.2	60.4	62.1
NPRE as <i>per cent</i> to revenue receipts	96.3	85.4	74.5	75.7	68.1	70.6
Buoyancy of revenue expenditure with						
GSDP (ratio)	0.1	1.4	1.1	1.0	1.6	0.8
Revenue receipts (ratio)	0.2	0.5	0.6	0.9	0.8	1.2

Revenue expenditure increased by 99 *per cent* from Rs. 18,815 crore in 2002-03 to Rs. 37,375 crore in 2007-08. While plan revenue expenditure increased by 156 *per cent* from Rs. 3,245 crore to Rs. 8,313 crore, non-plan revenue expenditure increased by 87 *per cent* from Rs. 15,570 crore to Rs. 29,062 crore. The non plan revenue expenditure was 78 *per cent* of revenue expenditure and 71 *per cent* of revenue receipts during 2007-08. The increase of Rs. 3,479 crore in 2007-08 over the previous year was mainly due to increase in subsidy payments (Rs. 451 crore), salaries (Rs. 1594 crore), pension payments (Rs. 745 crore) and interest payments (Rs. 270 crore). The trends in non plan revenue expenditure vis-à-vis the normative assessment made by TFC about NPRE while estimating the pre-devolution non-plan revenue deficit/surplus for the State indicated that actual NPRE exceeded TFC's projections during the period 2005-08 as shown in the table below:

(Rupees in crore)

	Normative assessment of TFC	Actual expenditure
2005-06	17,001	22,972
2006-07	18,473	25,583
2007-08	21,735	29,062

The increase in plan revenue expenditure by Rs. 461 crore was mainly under water supply, sanitation, housing and urban development (Rs. 252 crore), education, sports, art and culture (Rs. 69 crore) and health and family welfare (Rs. 45 crore).

1.4.4 Committed expenditure

Expenditure on salaries

Salary expenditure increased from Rs. 4,941 crore in 2002-03 to Rs. 8,169 crore in 2007-08 as indicated in table below:

Table 12 : Expenditure on salaries

(Rupees in crore)

Heads	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 ³
Expenditure on salaries ⁴	4,940.70	5,322.76	5,392.15	5,932.49	6,526.52	8,168.73
Non-plan	4,634.00	5,007.07	5,074.62	5,597.59	6,110.82	7,705.26
Plan ⁵	297.70	315.69	317.53	334.90	315.70	463.47
As percentage of GSDP	4.2	4.1	3.6	3.5	3.5	3.8
As percentage of Revenue receipts	30.6	25.6	20.3	19.5	17.4	19.8

Expenditure on salaries as a percentage of revenue receipts increased from 17 per cent in 2006-07 to 20 per cent during the year due to implementation of pay commission award. It was, however, around 28 per cent of revenue expenditure (net of pensions and interest payments), within the limit of 35 per cent recommended by TFC. The expenditure on salaries for 2007-08 exceeded FCP projection of Rs. 6,907 crore by Rs. 1,262 crore but was below the budget estimate (MTFP) by Rs. 378 crore.

Pension payments

Year-wise break-up of expenditure incurred on pension during the years 2002-03 to 2007-08 was as under:

Table 13 – Expenditure on pensions

(Rupees in crore)

Head	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Expenditure on pension	1,773	1,901	2,157	2,237	2,496	3,241
As per cent of GSDP	1.5	1.5	1.4	1.3	1.3	1.5
As per cent of revenue receipts	11.0	9.2	8.1	7.4	6.6	7.9

Expenditure on pension payments (Rs. 3,241 crore) constituted eight per cent of the total revenue receipts of the State during 2007-08. The increase (Rs. 745 crore) of expenditure on pension during the current year was due to the State's pay commission award. The expenditure on pensions for 2007-08 exceeded FCP projection by Rs. 32 crore but was below the budget estimate (MTFP) by Rs. 175 crore.

³ Actual expenditure in state sector (Rs.3,511.43 crore) plus expenditure (revised estimates) in district sector (Rs.4,657.30 crore)

⁴ Includes salary expenditure of panchayat raj institutions. Source : Finance department

⁵ Includes salaries under centrally sponsored schemes.

Interest payments

The details of interest payments of the State Government for the period 2002-08 and its percentage with reference to revenue receipts and revenue expenditure are given in table 14.

Table 14: Interest payments

Year	Revenue receipts	Revenue expenditure	Interest payment	Percentage of interest payment with reference to	
	(Rupees in crore)			Revenue receipts	Revenue expenditure
2002-2003	16,169	18,815	3,292	20.4	17.5
2003-2004	20,760	21,285	3,710	17.9	17.4
2004-2005	26,570	24,932	3,794	14.3	15.2
2005-2006	30,352	28,041	3,765	12.4	13.4
2006-2007	37,587	33,435	4,236	11.3	12.7
2007-2008	41,151	37,375	4,506	10.9	12.1

Interest payments increased by Rs. 1,214 crore from Rs. 3,292 crore in 2002-03 to Rs. 4,506 crore in 2007-08. Interest payments aggregating Rs. 1,961 crore (44 per cent) were on NSSF loans, the interest rate of which was hiked by 100 basis points from April 2007.

The ratio of interest payments to revenue receipts determines the sustainability of debt of the State. The interest payments relative to revenue receipts at 11 per cent in 2007-08 were below the norm of 15 per cent prescribed by TFC.

Subsidies

In any welfare State it is not uncommon to provide subsidies/subventions to disadvantaged sections of the society and making provision for merit goods – education, housing, health, etc. at subsidised prices. Subsidies are dispensed not only explicitly but also implicitly by providing subsidised public service to the people. Budgetary support to financial institutions, inadequate returns on investments and poor recovery of user charges from the social and economic services provided by the Government fall in the category of implicit subsidies. The trends in the explicit subsidies given by the State Government are given in table 15.

Table 15 : Subsidies

Year	Amount (Rs. in crore)	Percentage increase (+)/ decrease (-) over previous year	Percentage of subsidy to revenue expenditure
2002-03	2,230	(-) 22	12
2003-04	2,066	(-) 07	10
2004-05	2,732	32	11
2005-06	3,712	36	13
2006-07	4,355	17	13
2007-08	5,420	24	14

Subsidy payments during 2007-08 were mainly in the areas of power (Rs. 2,300 crore), co-operation (Rs. 1,793 crore), food (Rs. 651 crore) and transport (Rs. 230 crore) as detailed below:

Power

Power sector continued to be highly subsidised in the form of financial assistance being extended to electricity supply companies to cover loss due to rural electrification (Rs. 1,650 crore), pension payment contribution (Rs. 589 crore), irrigation pump set regularisation (Rs. 45 crore), fixed meter connection (Rs. 13 crore).

The power subsidy during the year included Rs. 1.82 crore paid to M/s. Mysore Cements Limited for using alternative source of energy. There was delay in refunding sales tax paid by the company on diesel used for captive generation of power. On the directions of High Court of Karnataka for the payment of interest for the delay in accordance with law, expenditure on this avoidable payment of interest (Rs. 1.82 crore) was accounted for as subsidy in accounts of the Government.

The power subsidy on rural electrification during the year did not include subsidy of Rs. 113 crore given to KPTCL for meeting the debt servicing obligations of Power Finance Corporation and Rural Electrification Corporations loans. The Finance accounts did not show this liability as the loans were not taken over by the Government. The State Government had similarly released Rs. 130 crore in 2006-07 and had stated (November, 2007) that debt would be included on off-budget side in 2008-09. This was however, against the State's commitment in MTFP 2007-11 to phase out off-budget borrowings from 2008-09. MTFP 2007-11, however, did not exhibit this liability on off-budget side.

Co-operation

Subsidy of Rs. 1,793 crore in the co-operative sector represented Rs. 1,250 crore on crop loans waiver and Rs. 542 crore on interest waiver. The subsidy on co-operation increased by Rs. 972 crore over the previous year mainly due to increase in crop loan waiver by Rs. 750 crore.

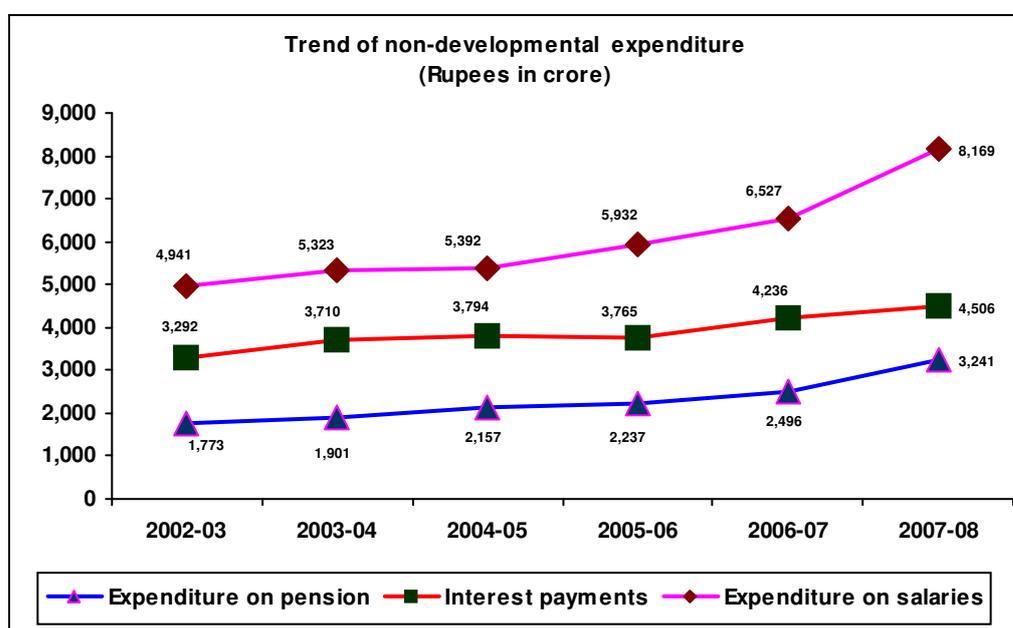
Food

Food subsidy to meet the difference between the cost price of food grains and issue price from the public distribution system declined from Rs. 750 crore in 2006-07 to Rs. 650 crore in 2007-08. Subsidy of rupees one crore was for providing food security to senior citizens under the centrally sponsored 'Annapoorna' scheme.

Transport

Transport subsidy declined from Rs. 273 crore in 2006-07 to Rs. 230 crore in 2007-08. Forty *per cent* of subsidy (Rs. 92 crore) was towards free/concessional facility extended to students, freedom fighters, physically challenged, *etc.*

Trends in expenditure on pension, interest payments and salaries are graphically depicted below:



1.5 Expenditure by allocative priorities

1.5.1 Quality of expenditure

The availability of better social and physical infrastructure in the State reflects its quality of expenditure. Therefore ratio of capital expenditure to total expenditure as well as to GSDP and proportion of revenue expenditure being spent on running efficiently and effectively the existing social and economic services would determine the quality of expenditure. Higher the ratio of these components to total expenditure and GSDP better is the quality of expenditure. table 16 gives these ratios during 2002-08.

Table 16 : Indicators of quality of expenditure

(Rupees. in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Capital expenditure	2,936	3,029	4,674	5,822	8,543	8,649
Revenue expenditure, of which	18,815	21,285	24,932	28,041	33,435	37,375
Social & Economic services						
<i>Salary component</i>	3,589.85	3,796.47	3,887.09	4,315.20	4,791.43	5,982.91
<i>Non-salary component</i>	7,538.82	7,820.27	10,346.18	12,530.91	16,585.52	18,594.08
As per cent of total expenditure (excluding loans and advances)						
Capital expenditure	13.50	12.46	15.79	17.19	20.35	18.79
Revenue expenditure	86.50	87.54	84.21	82.81	79.65	81.21
As per cent of GSDP						
Capital expenditure	2.50	2.34	3.12	3.47	4.54	4.02
Revenue expenditure	16.00	16.50	16.60	16.70	17.80	17.36

The trends presented in table 16 revealed that capital expenditure increased by Rs. 5,713 crore during 2002-08. Capital expenditure as a percentage of total expenditure remained on an average around 17 per cent during the period 2003-08 with inter-year variations. As a percentage of GSDP too, it exhibited relative stability around an average of three per cent with inter-year variations during the period 2003-08. As salary component of revenue expenditure did not include the corresponding grants-in-aid component, it is difficult to draw a definite inference from the trends in expenditure on salary but expenditure on non-salary component (net of subsidy) picked up since 2003-04.

1.5.2 Expenditure on social services

Given the fact that human development indicators such as access to basic education, health services and drinking water and sanitation facilities *etc.*, have a strong linkage with eradication of poverty and economic progress, it would be prudent to make an assessment with regard to the expansion and efficient provision of these services in the State. Table 17 summarises the expenditure incurred by the State Government in expanding and strengthening social services in the State during 2002-08.

Table 17 : Expenditure on social services

(Rupees in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Education, sports, art and culture						
<i>Revenue expenditure, of which</i>	3,564.01	3,766.02	4,357.91	4,837.40	5,703.21	6,811.21
<i>Salary component⁶</i>	2,017.82	2,142.56	2,292.74	2,606.79	3,019.53	3,742.21
<i>Non-salary component</i>	1,546.19	1,623.46	2,065.17	2,230.61	2,683.68	3,069.00
Capital expenditure	6.71	5.31	4.92	52.67	54.98	120.77
Total	3,570.72	3,771.33	4,362.83	4,890.07	5,758.19	6,931.98
Health and family welfare						
<i>Revenue expenditure, of which</i>	953.65	958.93	1,035.61	1,138.50	1,206.66	1,477.94
<i>Salary component⁶</i>	570.10	581.78	573.95	616.03	651.87	855.75
<i>Non-salary component</i>	383.55	377.15	461.66	522.47	554.79	622.19
Capital expenditure	50.47	36.77	8.30	7.69	142.95	354.24
Total	1,004.12	995.70	1,043.91	1,146.19	1,349.61	1,832.18
Water supply, sanitation, housing and urban Development						
<i>Revenue expenditure, of which</i>	576.04	794.22	857.89	911.77	1,205.44	1,493.06
<i>Salary component</i>	12.02	13.34	12.86	14.69	14.54	17.30
<i>Non-salary component</i>	564.02	780.88	845.03	897.08	1,190.90	1,475.76
Capital expenditure	167.32	288.81	411.38	969.78	925.48	1,431.53
Total	743.36	1,083.03	1,269.27	1,881.55	2,130.92	2,924.59
Other social services						
<i>Revenue expenditure, of which</i>	1,232.55	1,445.87	1,471.34	2,011.12	2,821.40	3,341.47
<i>Salary component⁶</i>	189.40	207.16	216.59	214.12	249.89	318.35
<i>Non-salary component</i>	1,043.15	1,238.71	1,254.75	1,797.00	2,571.51	3,023.12
Capital expenditure	70.80	96.32	61.44	75.16	169.21	241.14
Total	1,303.35	1,542.19	1,532.78	2,086.28	2,990.61	3,582.61
Social services						
<i>Revenue expenditure, of which</i>	6,326.25	6,965.04	7,722.75	8,898.79	10,936.71	13,123.68
<i>Salary component⁶</i>	2,789.34	2,944.84	3,096.14	3,451.63	3,935.83	4,933.61
<i>Non-salary component</i>	3,536.91	4,020.20	4,626.61	5,447.16	7,000.88	8,190.07
Capital expenditure	295.30	427.21	486.04	1,105.30	1,292.62	2,147.68
Grant Total	6,621.55	7,392.25	8,208.79	10,004.09	12,229.33	15,271.36

⁶ Includes salary expenditure of panchayat raj institutions. Source: Finance Department

Expenditure on social services increased from Rs. 6,622 crore in 2002-03 to Rs. 15,271 crore in 2007-08. Out of total developmental expenditure of Rs.32,887 crore, expenditure on social services accounted for 46 *per cent* during the year.

Expenditure on interest waiver was required to be classified under the major head '2235- Social Security and Welfare' in social services sector. The expenditure of Rs. 542 crore on this account in 2007-08 was, however, accounted for under major head '2425-Co-operation' in economic services sector according to budget provision made by the State Government. Thus the expenditure under social services sector was under stated by Rs. 542 crore. Taking this into account, share of social services sector in the developmental expenditure would be 48 *per cent*.

The revenue expenditure under social services sector increased by 107 *per cent* from Rs. 6,326 crore in 2002-03 to Rs. 13,124 crore in 2007-08 while the capital expenditure registered an increase from Rs. 295 crore to Rs. 2,148 crore. A steep increase of capital expenditure by Rs.855 crore (66 *per cent*) during the current year was mainly due to an increase of Rs. 411 crore under water supply and Rs. 148 crore under urban development. Capital expenditure on social services during the year, however, included Rs. 237 crore (11 *per cent*) on repayment of off-budget borrowings comprising mainly of Rs 120 crore given to Karnataka Housing Board; Rs 34 crore to Karnataka Land Army Corporation; Rs 30 crore to Slum Clearance Board for repayment of HUDCO loans.

While the salary component in revenue expenditure on social services decreased from 44 *per cent* in 2002-03 to 37 *per cent* in 2007-08, the share of non salary component increased from 56 to 63 *per cent*.

While projecting the expenditure requirements for estimating the pre-devolution non-plan revenue deficit/surplus of the States during its award period 2005-10, which formed the basis of NPPE deficit grants and restructuring plan of state finances, TFC assigned different growth rates to NPPE in various sectors implicitly suggesting the changes in the expenditure pattern of the States during its award period. Recognising the need to improve quality of education and health services in states, TFC recommended that non-plan expenditure under education and health and family welfare should increase by five to six *per cent* while non-salary expenditure under non-plan heads should increase by 30 *per cent* per annum. The trends emerging from finance accounts for the current year, however, revealed that the non-plan salary expenditure increased by 27 *per cent* and 28 *per cent* under education and health and family welfare respectively, while the non-salary component increased in these sectors respectively by 17 and 29 *per cent*.

1.5.3 Expenditure on economic services

The expenditure on economic services includes all such expenditures as to promote directly or indirectly, productive capacity within the State's economy. The expenditure on economic services (Rs. 17,616 crore) accounted for 54 *per cent* of total developmental expenditure of Rs. 32,887 crore. The actual share of economic services expenditure would be 52 *per cent* as the expenditure is overstated to the extent of Rs. 542 crore (*see para 1.5.2*).

In the economic services sector, expenditure on priority sectors like agriculture and allied activities (Rs. 4,597 crore), irrigation and flood control, (Rs. 3,720 crore) and energy (Rs. 2,741 crore) consumed 63 per cent of the total expenditure on economic services. Major trends during 2002-08 were as follows:

Table 18: Economic services sector expenditure

(Rupees in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Agriculture and allied activities						
Revenue expenditure, of which	1,077.10	1,348.92	2,064.90	2,866.65	3,140.84	4,518.05
Salary component ⁷	413.68	430.70	420.01	459.07	467.08	585.37
Non-salary component	663.42	918.22	1,644.89	2,407.58	2,673.76	3,932.68
Capital expenditure	22.95	7.45	18.80	17.17	33.15	78.93
Total	1,100.05	1,356.37	2,083.71	2,883.82	3,173.99	4,596.98
Irrigation and flood control						
Revenue expenditure, of which	206.73	179.06	213.91	215.81	294.42	278.52
Salary component ⁷	128.48	140.36	92.42	89.40	76.66	88.58
Non-salary component	78.25	38.70	121.49	126.41	217.76	189.94
Capital expenditure	2,028.46	1,881.46	3,009.73	3,329.69	4,115.74	3,441.50
Total	2,235.19	2,060.52	3,223.64	3,545.50	4,410.16	3,720.02
Power & energy						
Revenue expenditure, of which	1,906.92	1,733.05	1,896.71	1,836.93	2,402.01	2,307.76
Salary component	0.09	0.09	0.13	0.25	0.13	0.18
Non-salary component	1,906.83	1,732.96	1,896.58	1,836.68	2,401.88	2,307.58
Capital expenditure	---	---	---	50.00	430.47	432.90
Total	1,906.92	1,733.05	1,896.71	1,886.93	2,832.48	2,740.66
Transport						
Revenue expenditure, of which	395.79	311.43	617.60	756.10	1,563.98	1,325.53
Salary component	16.21	17.80	15.01	18.27	19.21	22.27
Non-salary component	379.58	293.63	602.59	737.83	1,544.77	1,303.26
Capital expenditure	423.08	510.21	895.82	1,030.45	1,823.50	1,511.62
Total	818.87	821.64	1,513.42	1,786.55	3,387.48	2,837.15
Other economic services						
Revenue expenditure, of which	1,215.88	1,079.24	1,717.39	2,271.83	3,038.99	3,023.45
Salary component ⁷	242.04	262.68	263.37	296.58	292.52	352.90
Non-salary component	973.84	816.56	1,454.02	1,975.25	2,746.47	2,670.55
Capital expenditure	90.36	74.63	127.08	71.40	526.15	697.29
Total	1,306.24	1,153.87	1,844.47	2,343.23	3,565.14	3,720.74
Economic services						
Revenue expenditure, of which	4,802.42	4,651.70	6,510.52	7,947.32	10,440.24	11,453.31
Salary component ⁷	800.51	851.63	790.95	863.57	855.60	1,049.30
Non-salary component	4,001.91	3,800.07	5,719.57	7,083.75	9,584.64	10,404.01
Capital expenditure	2,564.85	2,473.75	4,051.43	4,498.71	6,929.01	6,162.24
Total	7,367.27	7,125.45	10,561.95	12,446.03	17,369.25	17,615.55

The revenue expenditure under economic services sector increased by 138 per cent from Rs. 4,802 crore in 2002-03 to Rs. 11,453 crore in 2007-08 while the capital expenditure grew by 140 per cent from Rs. 2,565 crore to Rs. 6,162 crore. The capital expenditure on economic services declined by Rs 767 crore (11 per cent) during the current year mainly due to fall in expenditure of Rs.657 crore under major and medium irrigation. Capital expenditure on economic services, however, included Rs. 1,215 crore

⁷ Includes salary expenditure of Panchayat Raj Institutions. Source: Finance Department

(20 per cent) on repayment of off-budget borrowings comprising mainly of Rs. 913 crore given to Krishna Bhagya Jala Nigam Limited and Karnataka Neeravari Nigam Limited for repayment of borrowings made by these special purpose vehicles.

While the salary component in revenue expenditure on economic services decreased from 17 per cent in 2002-03 to nine per cent in 2007-08, the share of non salary component increased from 83 to 91 per cent. Non salary component in revenue expenditure during the year showed an increase of Rs.819 crore over the previous year. However, taking into account subsidy component of Rs. 4,311 crore and Rs.5,307 crore in 2006-07 and 2007-08 (included in the non-salary component of revenue expenditure), the actual increase was only Rs. 177 crore. Since capital expenditure is inclusive of expenditure on repayment of off-budget borrowings and non-salary component of revenue expenditure is inclusive of subsidy component, it is difficult to make comments on the quality of expenditure based on the trends revealed in table 18.

1.5.4 Financial assistance to local bodies and other institutions

The quantum of assistance provided by way of grants to local bodies and others during 2002-08 was as presented in table 19.

Table 19: Financial assistance to local bodies and other institutions

(Rupees in crore)						
Description	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Panchayat raj institutions	4,515.66	4,524.31	4,956.93	6,088.61	7,767.93	9,122.39
Urban local bodies	644.42	892.48	1,169.85	1,605.85	2,113.48	2,468.20
Educational institutions (including universities)	646.99	603.16	688.93	695.62	750.27	878.23
Co-operative societies and co- operative institutions	5.00	57.62	167.65	955.45	882.98	1,895.60
Other institutions and bodies (including statutory bodies)	1,863.28	1,702.81	1,745.28	1,837.43	2,400.54	2,361.00
Total	7,675.35	7,780.38	8,728.64	11,182.96	13,915.20	16,725.42
Percentage growth over previous year	3	1	12	28	24	20
Revenue receipts	16,168.76	20,759.88	26,569.66	30,352.05	37,586.94	41,151.14
Assistance as a percentage of revenue receipts	47	37	33	37	37	41
Revenue expenditure	18,814.50	21,284.71	24,931.85	28,040.89	33,435.43	37,374.77
Percentage of assistance to revenue expenditure	41	37	35	40	42	45
Percentage of assistance to panchayat raj institutions to total assistance	59	58	57	54	56	55

The assistance to Panchayat Raj Institutions (PRI) increased from Rs. 4,516 crore in 2002-03 to Rs. 9,122 crore in 2007-08 while the assistance to Urban Local Bodies (ULB) increased from Rs. 644 crore to Rs. 2,468 crore. Out of the total devolution of Rs. 9,122 crore to PRIs, Rs. 4,657 crore (51 per cent) were towards salaries during 2007-08 as the State Government's functions viz., education, water supply and sanitation, housing, health and

family welfare *etc.*, remained transferred to PRIs. Assistance (Rs. 2,361 crore) to other institutions and bodies included expenditure of Rs. 2,300 crore on subsidy paid to electricity supply companies.

1.5.5 Delay in furnishing utilisation certificates

Of the 2,290 utilisation certificates (UC) due in respect of grants and loans aggregating Rs. 938 crore paid upto 2007-08, 2005 UCs for an aggregate amount of Rs. 834 crore were in arrears. Department-wise break-up of outstanding UCs was as given in **Appendix 1.7**.

1.5.6 Non-submission of accounts

To identify the institutions which attract audit under sections 14 and 15 of the Comptroller and Auditor General's (Duties, Powers and Conditions of service) Act, 1971, the Government/heads of the department are required to furnish to audit every year detailed information about the financial assistance given to various institutions, the purpose of assistance granted and the total expenditure of the institutions. As of March 2008, 16 departments of the Government have not furnished details for the year 2007-08 as shown in **Appendix 1.8**.

1.5.7 Audit of performance of the autonomous bodies

The audit of accounts of eight bodies in the State has been entrusted to the Comptroller and Auditor General of India. The details of entrustment, rendering of accounts to audit, issuance of separate audit report and its placement in the Legislature is indicated in **Appendix 1.9**.

1.5.8 Misappropriations, losses, defalcations, etc.,

The State Government reported 216 cases of misappropriation, defalcation, *etc.*, involving Government money amounting to Rs. 10.02 crore upto the period 31 March 2008 on which final action was pending. The department-wise breakup of pending cases is given in **Appendix 1.10**.

1.5.9 Write-off of losses, etc.

In nine cases pertaining to five departments Rs. 15.06 crore were written off during the year. Details are in **Appendix 1.11**

1.6 Assets & Liabilities

In the existing Government accounting system, comprehensive accounting of fixed assets like land and buildings owned by the Government is not done. However, Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure incurred. Appendix 1.2 gives an abstract of such liabilities and assets as on 31 March 2008, compared with the corresponding position on 31 March 2007. While liabilities shown in this statement consist mainly of internal borrowings, loans and advances from GOI, receipts from the public account and reserve funds; assets comprise mainly of capital outlay and loans and advances given by the State Government and the cash balances. The liabilities of the State depicted in the Finance Accounts, however, do not include pension, other retirement

benefits payable to retired / retiring State employees, guarantees/letters of comfort issued by State Government and borrowings through special purpose vehicles termed off-budget borrowings. Appendix 1.2 shows that the growth rate of assets fell from 22 in 2006-07 to 12 *per cent* in 2007-08, while that of liabilities decreased from 11 to 6 *per cent*.

1.6.1 Incomplete projects

Incomplete projects/works reflect failure on part of the State to prioritise expenditure and to spread its resources adequately over these projects. Additional statement of Finance Accounts gives the details of these works. As reported by the departments of the State Government, there were 429 incomplete projects/works. Expenditure incurred upto end of 2007-08 was Rs. 1,480.29 crore which represented an increase of 29 *per cent* over the sanctioned cost (Rs. 1,144.64 crore) of the incomplete works.

1.6.2 Investments and returns

As of March 2008, Government had invested Rs. 22,279 crore in 84 Government companies (Rs. 20,735 crore), 17 statutory corporations (Rs. 1,172 crore), 44 joint stock companies (Rs. 34 crore) and cooperative institutions (Rs. 338 crore). (table 20).

Table 20 : Return on investment

(Rupees in crore)

Year	Investment at the end of the year	Amount of return	Percentage of return	Average interest rate on Government borrowing – market loans (<i>per cent</i>)	Difference between interest rate and return
2002-2003	6,150.37	21.3	0.4	9.4	9.0
2003-2004	7,984.19	18.0	0.2	9.4	9.2
2004-2005	10,741.40	16.7	0.2	8.5	8.3
2005-2006	14,052.53	16.9	0.1	7.6	7.5
2006-2007	18,698.37	19.5	0.1	7.7	7.6
2007-2008	22,279.35	23.4	0.1	7.6	7.5

During the current year the Government's investment was Rs. 3,581 crore in Government companies (Rs. 3,479 crore), Statutory corporations (Rs. 100 crore) and one crore each in joint stock companies and cooperative institutions. The return from investment was 0.1 to 0.4 *per cent* during 2002-08 while the Government paid interest on its borrowing at an average rate of eight to nine *per cent*. The aggregate cumulative loss was Rs. 3,319 crore against the total investment of Rs. 3,421 crore made by the Government in 27 companies which included the following major companies under economic services sector.

Table : 21

(Rupees in crore)

Sl. No.	Company	Investment	Cumulative loss	
			Amount	to end of
1.	Karnataka State Road Development Corporation	1,217.37	71.45	2006-07
2.	Karnataka State Industrial Investment and Development Corporation, Bangalore	920.55	504.86	2006-07
3.	Karnataka State Road Transport Corporation	468.67	166.09	2006-07
Total		2,606.59	742.4	

1.6.3 Loans and advances by State Government

In addition to investment in corporations, companies and cooperative societies, Government has also been providing loans and advances to many of these institutions/organisations. Total outstanding loans and advances as of March 2008 were Rs. 6,946 crore (table 22).

Table 22 : Average interest received on loans advanced by the State Government

(Rupees in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Opening balance	4,556.46	4,256.04	5,202.95	5,767.53	5,943.58	6,240.83
Amount advanced during the year	627.58	1,011.20	611.43	299.60	357.23	756.74
Amount repaid during the year	928.00	64.29	46.85	123.55	59.97	52.07
Closing balance	4,256.04	5,202.95	5,767.53	5,943.58	6,240.83	6,945.50
Net addition (+) / reduction (-)	-300.42	946.91	564.58	176.05	297.26	704.67
Interest received (Rupees in crore)	19.98	96.27	88.18	94.95	38.49	58.46
Interest received as <i>per cent</i> to outstanding loans and advances	0.4	2.0	1.6	1.6	0.6	0.8
Average interest	9.4	9.4	8.5	7.6	7.7	7.6
Difference between weighted interest and interest received (<i>per cent</i>)	9.0	7.4	6.9	6.0	7.1	6.8

During the current year loans amounting to Rs. 757 crore were advanced by the Government. Terms and conditions of repayment were not specified in respect of loans amounting to Rs. 751 crore (16 cases). Loans advanced during the year included expenditure of Rs. 91 crore for discharge of its guarantee obligation in respect of three Government companies (Rs. 88 crore) and one cooperative institution (Rs. 3 crore) besides financial assistance of Rs.22 crore to one statutory board for repayment of loans.

As brought out in the Statement No.5 (ii) of the Finance accounts, recovery of loans and advances aggregating Rs. 2,242 crore (principal Rs. 777 crore; interest Rs. 1,465 crore) was overdue as of March 2008, from 63 government/cooperative institutions (detailed accounts of which were kept by Accounts office). Nearly 50 *per cent* of this pertained to five major defaulters viz., Karnataka Urban Water Supply and Drainage Board, Bangalore Water Supply and Sewerage Board, Karnataka Housing Board, New Government Electric Factory and Mangalore Chemicals and Fertilizers. In these cases the overdue interest (Rs. 732 crore) was twice the amount of the principal (Rs.366 crore) due for recovery.

The State Government ordered (July 2007) waiver of interest of Rs. 7.11 crore on loan outstanding against M/s. Mysore Papers Mills Limited, a State Government undertaking. In the absence of directive on adjustment transaction the same was not carried out in the books of accounts of Government. This resulted in assets still figuring in Statement 5(ii). MTFP 2008-12 also acknowledged the existence of such cases which lead to non reflection of complete information in the finance accounts of the State Government warranting major exercise of reconciliation.

1.6.4 Management of Cash balances

It is generally desirable that State's flow of resources should match its expenditure obligations. However, to take care of any temporary mismatches in the flow of resources and the expenditure obligations, a mechanism of Ways and Means Advances (WMA) - ordinary and special - from Reserve Bank of India (RBI) has been put in place. The operative limit for normal WMA is reckoned on the three-year average of revenue receipts and the operative limit for special WMA are fixed by the RBI from time to time depending on the holdings of Government Securities. During the year, the limit of normal WMA was fixed at Rs. 625 crore. The operative limit of special WMA varied between Rs. 699.75 crore and Rs. 3,732 crore during the year depending on the securities held by the State. WMA and overdraft availed and interest paid by the State is detailed in table 23 below.

Table 23 : Ways and means advances and overdrafts of the State and interest paid thereon

(Rupees in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Ways & Means advances						
Availed in the year	4,045.45	4,623.92	1,462.79	--	---	78.13
Interest paid	5.22	7.94	1.2	--	---	0.04
No. of days availed	170	163	61	--	---	4
Overdraft						
Availed in the year	47.84	757.72	--	--	---	-
Interest paid	0.01	0.9	--	--	---	-
Number of days	1	33	--	--	---	-

During 2007-08, Government availed special ways and means advances amounting to Rs. 78 crore to meet the mismatch between its receipts and expenditure only for four days. The liquidity position of the State continued to be stable and the state did not avail overdraft during the year. The cash balance of the State at the year end was Rs. 3,919 crore. In view of surplus cash balance the possibility of arranging for buy-back option of state development loans with the help of RBI was required to be explored to reduce the future interest liability.

1.7 Un-discharged liabilities

Total liabilities, as defined in the Karnataka Fiscal Responsibility Act, are the liabilities under the consolidated fund and the public account of the State.

1.7.1 Fiscal liabilities-Public debt and Guarantees

There are two sets of liabilities namely, public debt and other liabilities. Public debt consists of internal debt of the State and is reported in the annual financial Statements under the consolidated fund – capital account. It includes market loans, special securities issued to RBI and loans and advances from Central Government. The Constitution of India provides that State may borrow within the territory of India upon the security of its consolidated fund, within such limits, as may from time to time, be fixed by an Act of the Legislature and give guarantees within such limits as may be fixed. Other liabilities which are a part of public account include deposits under small savings scheme, provident funds, and other deposits.

Table 24 below show the fiscal liabilities of the State, their rate of growth, ratio of these liabilities to GSDP, to revenue receipts and to own resources as also the buoyancy of fiscal liabilities with respect to these parameters.

Table 24 : Fiscal liabilities –Basic parameters

(Amount Rupees in crore and Ratios in per cent)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Fiscal liabilities	37,234	41,967	46,940	52,236	57,682	60,142
Rate of growth (<i>per cent</i>)	14.3	12.7	11.8	11.3	10.4	4.3
Ratio of fiscal liabilities to						
GSDP (<i>Per cent</i>)	31.6	32.5	31.3	31.1	30.6	27.9
Revenue receipts (<i>Per cent</i>)	230.3	202.1	176.7	172.1	153.5	146.1
Own resources (<i>Per cent</i>)	317.8	270.3	228.5	232.1	210.5	204.9
Buoyancy of fiscal liabilities to						
GSDP(ratio)	1.8	1.3	0.7	0.9	0.8	0.3
Revenue receipts (ratio)	2.6	0.4	0.4	0.8	0.4	0.5
Own resources(ratio)	2.0	0.4	0.4	1.2	0.5	0.6

Fiscal liabilities of the State increased from Rs. 37,234 crore in 2002-03 to Rs. 60,142 crore in 2007-08 comprising consolidated fund liabilities (Rs. 42,873 crore) and public account liabilities (Rs. 17,269 crore). The rate of growth of fiscal liabilities of the State has been following a downward path and fell to four *per cent* in 2007-08 from 14 *per cent* in 2002-03. In 2007-08, the growth rate of fiscal liabilities continued to be lower than the growth rate of GSDP as in 2006-07 and the buoyancy of fiscal liabilities to GSDP which was 1.8 in 2002-03 fell to 0.3 in 2007-08

As per the recommendation of the TFC, all states were required to set-up a Sinking Fund for amortisation of all loans including liabilities on account of National Small Savings Fund (NSSF), *etc.* The State Government had already constituted a sinking fund for amortisation of open market loans. However, there were no contributions to the sinking fund since 1999-2000 without assigning any specific reasons. The sinking fund was yet to be revived.

1.7.2 Status of Guarantees – contingent liabilities

Guarantees are liabilities contingent on the consolidated fund of the State in case of default by the borrower for whom the guarantee has been extended. The maximum amount for which guarantees were given by the State and outstanding guarantees at the end of year since 2002-03 as per Statement 6 of Finance Accounts is given in table 25.

Table 25 : Guarantees given by the Government of Karnataka

(Rupees in crore)

Year	Max amount guaranteed	Outstanding amount of guarantees	Percentage of outstanding amount guaranteed to total revenue receipts of the second preceding year
2002-03	20,973	13,314	90
2003-04	21,225	14,179	93
2004-05	19,910	11,574	72
2005-06	20,107	8,984	43
2006-07	19,793	9,879	37
2007-08	23,109	10,786	36

The Karnataka Ceiling on Government Guarantees Act, 1999, provides for a cap on outstanding guarantees at the end of any year at 80 *per cent* of the State's revenue receipts of the second preceding year. The outstanding guarantees to the end of 2007-08 constituted 36 *per cent* of the revenue receipts of the year 2005-06 but as stated in the MTFP 2008-12, risk-based assessment of outstanding guarantees to enable corrective action was yet to be taken up. The State was yet to act on TFC recommendation of setting up of Guarantee Redemption Fund through earmarked guarantee fees based on risk weighing of guarantees.

In 2007-08 the Government discharged Guarantee obligation of Rs. 91 crore on account of default by four institutions treating the expenditure as loan to the institutions.

Guarantee fees of Rs. 77 crore remitted to Government account under the head 'miscellaneous general services' in 2007-08 was not transferred to the Guarantee reserve fund.

Failure to transfer the guarantee fee realised and the expenditure on discharge of guarantee obligation to public account resulted in overstatement of revenue receipts/capital expenditure in the consolidated fund.

1.7.3 Off-budget borrowings

The borrowings of a State are governed under Article 293 of the Constitution of India. In addition to the liabilities shown in table 24, the State guaranteed loans taken by Government companies/corporations. These companies/corporations borrowed funds from the market/financial institutions for implementation of various State plan programmes projected outside the State budget. Although the estimates of the plan programmes of the State Government projected that funds for these programmes would be met out of resources of the companies/corporations outside the State budget, in reality the borrowings of many of these concerns were ultimately the committed

liabilities of the State Government termed 'off-budget borrowings'. Though off-budget borrowings are not permissible under Article 293 (3), the State resorted to off-budget borrowings as evident by the data furnished by the Finance Department. Table 26 captures the trends in the off-budget borrowings of the State during 2002-08 while table 27 gives the entity-wise position of borrowings.

Table 26 : Trend in off-budget borrowings

Year	(Rupees in crore)					
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (RE)
Amount as per MTFP*	1,388	1,129	838	1,078	845	720

* figures are yet to be reconciled with those of the financial institutions.

Table 27 : Entity-wise position of off-budget borrowings

Company/Corporation/Board(*)	Off-budget borrowings			Repayment to end of 2007-08	
	upto 2006-07	During 2007-08	Total	Principal	Interest
	Krishna Bhagya Jala Nigam	2,433.17	50.00	2,483.17	947.48
Karnataka Neeravari Nigam Limited	859.10	--	859.10	221.10	75.98
Karnataka Road Development Corporation	534.14	102.82	636.96	63.80	5.64
Rajiv Gandhi Rural Housing Corporation	650.63	--	650.63	58.94	55.04
Karnataka Slum Clearance Board	117.90	--	117.90	20.71	9.30
Karnataka Police Housing Corporation	280.93	--	280.93	30.54	0.38
Karnataka Land Army Corporation	1.60	--	1.60	9.36	19.44
Karnataka Renewable Energy Development Limited	8.06	--	8.06	0.99	0.75
Cauvery Neeravari Nigam	789.55	--	789.55	0.00	40.06
Karnataka Residential Education Institution Society	76.30	--	76.30	34.32	30.34
Karnataka Small Industrial Investment Development Corporation	211.87	--	211.87	2.17	17.94
Total	5,963.25	152.82	6,116.07	1,389.41	666.70

*Information as furnished by the Companies / Corporations.

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2008 worked out to Rs. 64,869 crore⁸ as against Rs. 60,142 crore reflected in table 24. The ratio of fiscal liabilities inclusive of off-budget borrowings to GSDP increases to 30 per cent at the end of the year.

1.7.4 Debt sustainability

Liabilities are considered sustainable if the government is able to service the stock of liabilities over the foreseeable future and the debt-GSDP ratio does not grow to unmanageable proportions. A government which does not generate enough current revenues for debt service will default on its obligations or borrow more to service its past debts and cover its current receipt-expenditure imbalance. Solvency of the state and sustainability are inter-related and unsustainable liabilities will threaten the solvency of the state. Debt sustainability of the State has been examined in terms of debt/GSDP ratio or Domar's Gap, net availability of borrowed funds and

⁸ Fiscal liabilities : Rs. 60142 crore plus Off-budget borrowings: Rs. 6116 crore less Repayment of principal : Rs. 1389 crore

adequacy of incremental revenue receipts to meet the incremental interest burden and primary expenditure and maturity profile of Government borrowings.

1.7.5 Debt stability

An important condition for debt sustainability is stabilisation in terms of debt/GSDP ratio. According to Domar's debt stability equation, if the rate of growth of economy exceeds the cost of borrowings, the debt-GSDP ratio is likely to be stable provided primary balances are positive/zero/ moderately negative. When the quantum spread and primary deficit is negative, debt-GSDP ratio will be high indicating unsustainable levels of public debt and when the quantum spread and primary deficit are positive, debt-GSDP ratio will be low indicating sustainable levels of public debt.

Table 28: Debt sustainability – interest rate and GSDP growth

	<i>(in per cent)</i>					
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Average interest rate	9.4	9.4	8.5	7.6	7.7	7.6
GSDP growth	7.8	9.6	16.0	12.1	12.1	14.3
Interest spread	-1.6	0.2	7.5	4.5	4.4	6.7
Quantum spread (Rs. in crore)	-595.74	83.93	3,520.50	2,350.62	2,538.00	4,029.51
Primary deficit (-) / primary surplus (+) (Rs. in crore)	-1,990.00	-791.00	194	78	-452.00	- 826

In 2002-04, quantum spread together with primary deficit was negative resulting in increase in debt-GSDP ratio. Thereafter quantum spread with primary deficit or primary surplus remained positive pushing downwards the debt-GSDP ratio. These trends indicated debt stabilisation which would eventually improve the capacity of the State to sustain the debt in the medium and long term.

1.7.6 Sufficiency of incremental non-debt receipts

Another indicator for debt stability and its sustainability is the adequacy of incremental non-debt receipts of the State to cover the incremental interest liabilities and incremental primary expenditure. The debt sustainability could be significantly facilitated if the incremental non-debt receipts could meet the incremental interest burden and the incremental primary expenditure. The persistent negative resource gap indicates the non-sustainability of debt while the positive resource gap strengthens the capacity of the State to sustain the debt. Table 29 indicates the resource gap as defined for the period 2002-08.

Table 29

(Rupees in crore)

Period	Incremental				Resource gap
	Non-debt receipts	Primary expenditure	Interest payments	Total expenditure	
1	2	3	4	5=(3+4)	6=(2-5)
2002-03	1,741	-399	609	210	1,531
2003-04	3,727	2,052	418	2,470	1,257
2004-05	5,793	3,563	84	3,647	2,146
2005-06	3,859	3,138	-29	3,109	750
2006-07	7,171	4,923	471	5,394	1,777
2007-08	3,802	3,670	270	3,940	-138

During the period 2002-07, the State maintained the positive resource gap with inter year variations indicating adequacy to sustain the debt in the medium to long run. However, during 2007-08 the revenue receipts increased by 9 per cent as compared to an average growth rate of little more than 23 per cent during the previous four years (2003-07). Steep fall in non debt receipts by Rs. 3,369 crore in 2007-08 relative to previous year turned consistent positive resource gap position during the previous years into negative in the current year. Since negative resource gap amounts only to Rs. 138 crore, it may not have any significant fallout on the debt sustainability of the State.

1.7.7 Net availability of borrowed funds

The debt sustainability of the State also depends on (i) the ratio of the debt redemption (principal + interest payments) to total debt receipts and (ii) application of available borrowed funds. The ratio of debt redemption to debt receipts indicates the extent to which the debt receipts are used in debt redemption indicating the net availability of borrowed funds. The solution to the Government's debt problem lies in application of borrowed funds, *i.e.*, they are (a) not being used for financing revenue expenditure; and (b) being used efficiently and productively for capital expenditure which either provides returns directly or results in increased productivity of the economy in general, which may result in increase in Government revenue.

Table 30 below gives the position of the receipts and repayments of internal debt and other fiscal liabilities of the State over the last six years.

Table 30: Net availability of borrowed funds

(Rupees in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Internal debt[^]						
Receipts	3,888.52	6,531.33	6,953.68	4,994.89	2,891.48	1472.55
Repayment (principal + interest)	1,618.53	2,523.27	2,666.13	2,910.82	3,925.98	3902.66
Net fund available	2,269.99	4,008.06	4,287.55	2,084.07	-1,034.50	-2430.11
Net fund available (<i>Per cent</i>)	58	61	62	42	---	--
Loans and advances from GOI						
Receipts	1,544.22	1,457.00	1,555.75	668.66	654.46	806.00
Repayment (principal + interest)	2,932.84	4,196.92	4,703.74	1,132.66	1,491.41	1194.69
Net fund available	-1,388.62	-2,739.92	-3,147.99	-464.00	-836.95	-388.69
Net fund available (<i>Per cent</i>)	-	-	-	-	---	-
Other obligations						
Receipts	15,077.11	16,426.71	19,227.98	18,806.35	22,435.86	22922.95
Repayment (principal + interest)	14,582.31	16,671.81	19,188.30	18,895.15	19,354.70	22149.60
Net fund available	494.80	-245.10	39.68	-88.80	3,081.16	773.35
Net fund available (<i>Per cent</i>)	3	-	0.2	-	14	3
Total liabilities						
Receipts	20,509.85	24,415.04	27,737.41	24,469.90	25,981.80	25201.50
Repayment (principal + interest)	19,133.68	23,392.06	26,558.17	22,938.63	24,772.09	27246.95
Net fund available	1,376.17	1,023.04	1,179.24	1,531.27	1,209.71	-2045.45
Net fund available (<i>Per cent</i>)	7	4	4	6	5	-

[^] Excluding ways and means advances/overdraft from Reserve Bank of India

Debt redemption ratio exceeded the unity for the first time in 2007-08 in last five years with repayments towards the discharge of past debt obligations significantly more than the fresh debt receipts during the year. During the current year the Government raised internal debt of Rs. 1,473 crore, Government of India loans of Rs 806 crore and other obligations of Rs. 22,923 crore and repaid internal debt of Rs. 3,903 crore, Government of India loans amounting to Rs. 1,195 crore and discharged other obligations of Rs. 22,150 crore along with interest obligations thereon resulting in net decrease of Rs. 2,045 crore in debt receipts during the year.

1.8 Management of deficits

1.8.1 Trends in deficits

The deficit in the Government accounts represents the gap between its receipts and expenditure. The nature of deficit is an indicator of the prudence of fiscal management of the Government. Further, the ways in which the deficit is financed and the resources raised are applied are important pointers to its fiscal health. The trends in fiscal parameters depicting the position of fiscal equilibrium in the State are presented in table 31.

Table 31 : Fiscal imbalances – Basic parameters

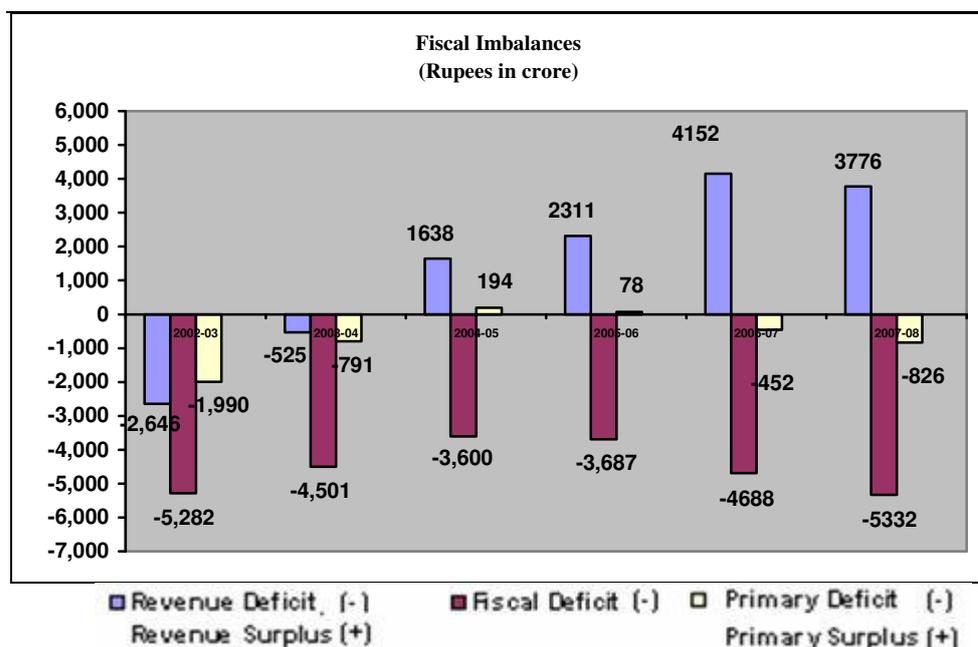
(Amount Rupees in crore and Ratios in per cent)

Parameters	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Revenue deficit (-) (RD) / Revenue surplus (+)	-2,646	-525	1,638	2,311	4,152	3,776
Fiscal deficit (FD)	5,282	4,501	3,600	3,687	4,688	5,332
Primary deficit (-) (PD) / Primary surplus (+)	-1,990	-791	194	78	-452	-826
RD/ GSDP	2.24	0.41	---	---	---	--
FD/ GSDP	4.50	3.50	2.40	2.20	2.50	2.50
PD/ GSDP	1.69	0.61	0.13	0.05	0.24	0.38
RD/FD	50.1	11.7	---	---	---	--

Revenue surplus is the excess of revenue receipts over revenue expenditure. From 2004-05, the State's finances showed revenue surplus which increased from Rs. 1,638 crore to Rs. 4,152 crore in 2006-07 but declined to Rs. 3,776 crore in 2007-08. The decline in revenue surplus during the current year was due to the growth of revenue expenditure by Rs. 3,940 crore (12 per cent) as against increase in revenue receipts by Rs. 3,564 crore (9 per cent). With more than 70 per cent of revenue receipts of the State being contributed by its own resources, a relatively lower growth rate of 7 per cent in State's own resources in 2007-08 as compared to 22 per cent in previous year (mainly due to absolute decline of Rs. 741 crore in non tax receipts of the State) led to a decline in revenue surplus by Rs. 376 crore in 2007-08 relative to previous year.

Despite the increase of Rs. 238 crore in non-debt capital receipts in 2007-08, an increase of Rs. 506 crore in capital expenditure (including loans and advances) along with a decline in revenue surplus led to an increase of Rs. 644 crore in fiscal deficit in 2007-08 over the previous year. The increase in fiscal

deficit along with increase of Rs. 270 crore in interest payments was the reason for the increase of primary deficit by Rs. 374 crore.



1.8.2 Quality of deficit/surplus

The ratio of revenue deficit (RD) to fiscal deficit (FD) and the decomposition of primary deficit⁹ (PD) into primary revenue deficit¹⁰ and capital expenditure (including loans and advances) would indicate the quality of deficit in the States' finances. The ratio of RD to FD indicates the extent to which borrowed funds were used for current consumption. The ratio of RD to FD declined from 50 per cent in 2001-02 to 12 per cent in 2003-04 and thereafter the revenue account turned into surplus. This trajectory showed consistent improvement in the quality of the deficit during 2004-08 as borrowed funds were used in activities resulting in expansion in the asset backup of the State. Table 32 below shows the bifurcation of the factors resulting in primary deficit or surplus of the State during the period 2002-08.

Table 32 : Primary deficit/surplus-bifurcation of factors

(Rupees in crore)

Year	Non-debt receipts	Primary revenue expenditure	Capital expenditure	Loans and advances	Primary expenditure	Primary revenue deficit (-) / surplus (+)	Primary deficit (-) / surplus (+)
1	2	3	4	5	6(3+4+5)	7 (2-3)	8 (2-6)
2002-03	17,097	15,523	2,936	628	19,087	1,574	-1,990
2003-04	20,824	17,575	3,029	1,011	21,615	3,249	-791
2004-05	26,617	21,138	4,674	611	26,423	5,479	194
2005-06	30,476	24,276	5,822	300	30,398	6,200	78
2006-07	37,647	29,199	8,543	357	38,099	8,448	-452
2007-08	41,449	32,869	8,649	757	42,275	8,580	-826

⁹ Primary deficit defined as the fiscal deficit net of interest payments indicates the extent of deficit which is an outcome of the fiscal transactions of the States during the course of the year.

¹⁰ Primary revenue deficit defined as gap between non interest revenue expenditure of the state and its revenue receipts indicates the extent to which the revenue receipts of the State are able to meet the primary expenditure incurred under revenue account.

The bifurcation of the factors resulting into primary deficit or surplus of the State during the period 2003-08 revealed that throughout this period the primary deficit was on account of capital expenditure incurred and loans and advances disbursed by the State Government. In other words, non-debt receipts of the State were enough to meet the primary expenditure¹¹ requirements in the revenue account. But the surplus non-debt receipts were not enough to meet the expenditure requirements under capital account resulting in primary deficit during two spells of 2002-04 and 2006-08. However, during 2004-05 and 2005-06 non-debt receipt were sufficient to meet the expenditure requirement both under revenue and capital account resulting in primary surplus. These trends indicate the extent to which the primary deficit in the past was on account of enhancement in capital expenditure, desirable to some extent to improve the productive capacity of the State's economy.

1.9 Fiscal ratios

The finances of a State should be sustainable, flexible and non-vulnerable. Table 33 below presents a summarised position of Government Finances during the period 2001-2007, with reference to certain key indicators that help to assess the adequacy and effectiveness of available resources and their application, highlight areas of concern and captures its important facts.

Table 33 : Indicators of fiscal health (in per cent)

Fiscal ratios	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Resource mobilisation						
Revenue receipts (RR)/GSDP	13.7	16.1	17.7	18.1	20.0	19.1
Revenue buoyancy	0.7	3.0	1.7	1.2	2.0	0.6
Own tax/GSDP	8.8	9.7	10.7	11.1	12.4	12.1
Expenditure management						
Total expenditure (TE)/GSDP	19.0	19.6	20.2	20.3	22.5	21.7
Revenue receipts /Total expenditure	72.2	82.0	87.9	88.8	88.8	88.0
RE/Total expenditure	84.1	84.0	82.5	82.1	79.0	79.9
Salary expenditure on social & economic services/RE	19.1	17.8	15.6	15.4	14.3	16.0
Non-salary expenditure on social & economic services/RE	40.1	36.7	41.5	44.7	49.6	49.7
Capital expenditure (CE)/TE	13.5	12.4	15.8	17.2	20.4	18.8
CE on social & economic services/TE	13.1	11.9	15.4	16.5	19.6	18.0
Buoyancy of TE with RR	1.0	0.5	0.7	0.9	1.0	1.2
Buoyancy of RE with RR	0.2	0.5	0.6	0.9	0.8	1.2
Management of fiscal imbalances						
Revenue deficit (-) (RD) / Revenue Surplus (+) (Rs. in crore)	-2,646	-525	1,638	2,311	4,152	3776
Fiscal deficit (Rs. in crore)	5,282	4,501	3,600	3,687	4,688	5,332
Primary deficit (-)(PD) / Primary surplus (+)	-1,990	-791	194	78	-452	-826

¹¹ Primary expenditure of the State is defined as the total expenditure net of the interest payments indicates the expenditure incurred on the transactions undertaken during the year

Fiscal ratios	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Revenue deficit / fiscal deficit	50.1	11.7	---	---	---	--
Management of fiscal liabilities						
Fiscal liabilities (FL)/GSDP	31.6	32.5	31.3	31.1	30.6	27.9
Fiscal liabilities/RR	230.3	202.1	176.7	172.1	153.5	146.1
Buoyancy of FL with RR	2.6	0.4	0.4	0.8	0.4	0.5
Buoyancy of FL with own receipts	2.0	0.4	0.4	1.2	0.5	0.6
PD vis-a-vis quantum spread	3.34	- 9.5	-	-	- 0.18	- 0.20
Net fund available (%)	7	4	4	6	5	-
other fiscal health indicators						
Return on investment (Rs. in crore)	21.3	18.0	16.7	16.9	19.5	23.4
BCR (Rs. in crore)	(-) 645	1,571	4,879	5,483	9,415	8,593
Financial assets / liabilities	0.7	0.7	0.8	0.8	0.9	1.0

The trends in ratios of revenue receipts and State's own taxes to GSDP indicated the adequacy and accessibility of State resources. Revenue receipts comprised of not only the tax and non-tax resources but also the transfers from Union Government. The ratio of revenue receipts to GSDP indicated an increasing trend during the period 2002-07 with a marginal decline in the current year to 19 *per cent* as compared to 20 *per cent* in 2006-07. In tandem with the trends in revenue receipts, own tax to GSDP ratio also showed an increasing trend except a marginal decline in current year. The ratio at 12 *per cent* in 2007-08, however, not only met the budget estimate of Government for the year but was also equal to the national average during the year.

Various ratios concerning the expenditure management of the State indicated quality of its expenditure and sustainability of these in relation to its resource mobilisation efforts. The revenue expenditure relative to total expenditure indicated a declining trend from 84 *per cent* in 2002-03 to 79 *per cent* in 2006-07 with an increase of one percentage point in 2007-08 mainly due to loan waiver, implementation of pay commission award resulting in hike in salaries and pensions. The higher buoyancy ratio of total expenditure as compared to that of revenue expenditure with respect to revenue receipts indicated the propensity of the State Government to create assets by resorting to *inter alia* capital expenditure. Various ratios concerning the expenditure management of the State indicated improvement in quality as well as the sustainability of expenditure in relation to its resource mobilisation efforts. Increasing reliance on revenue receipts to finance the total expenditure to the extent of 88 *per cent* during the last three years (2005-08) indicated that only 12 *per cent* of the expenditure was financed through borrowed funds. This was also reflected by declining ratio of fiscal liabilities to revenue receipts.

The continued prevalence of revenue surplus and maintaining the fiscal deficit below three *per cent* of GSDP along with consistent positive Balance from Current Revenue during 2007-08 indicated sustainable fiscal position of the State. As a result, asset backup fiscal liabilities of the State consistently improved during the period 2002-08 with assets fully matching the liabilities in 2007-08.

1.10 Conclusion

The State continued to maintain the revenue surplus and kept the fiscal deficit relative to GSDP below three *per cent* as laid down under the Karnataka Fiscal Responsibility Act, 2002. However, the fiscal position of the State viewed in terms of trends in deficit indicators revealed deterioration in 2007-08 relative to previous year as revenue surplus declined and fiscal and primary deficits increased. The deterioration in fiscal performance during the current year was primarily on account of a relatively lower growth rate of seven *per cent* in the State's own resources in 2007-08 as compared to 22 *per cent* in previous year due to reduction of Rs. 741 crore in non tax receipts of the State relative to the previous year. The expenditure pattern of the State revealed that the revenue expenditure as a *percentage* to total expenditure continued to dominate with around 80 *per cent* of the total expenditure in 2007-08 and its NPRE component at Rs. 29,062 crore exceeded the normative projection of TFC for the State (Rs. 21,735 crore) for the year. Moreover, within the non plan revenue expenditure, four components – salary expenditure, pension liabilities, interest payments and subsidies – constituted about 73 *per cent* of NPRE. Besides, the quality of expenditure continued to be a cause of concern as there were cases where guarantee obligations discharged by the State government were converted into loans to the selected corporations/companies and off-budget borrowings of special purpose vehicles repaid by the Government were treated as capital expenditure. The share of re-payment of off-budget borrowings in the State in its capital expenditure, however, declined to 17 *per cent* in 2007-08 from 28 *per cent* in the previous year. The increasing fiscal liabilities with negligible rate of return on Government investments and inadequate interest cost recovery on loans and advances might strain the fiscal budget of the State in medium to long run unless suitable measures are initiated to compress the non plan revenue expenditure and to mobilise the additional resources both through the tax and non tax sources in ensuing years.