Chapter 1

1 Finances of the State Government

Profile of the State

Karnataka is the sixth largest State in terms of geographical area (1,91,791 sq. km) and the eighth largest by population. The State's population recorded a decadal growth (2001-2011) of about 16 *per cent*. The percentage of population below the poverty line was 20.90 compared to the All India Average of 21.90 (2011-12). The Gross State Domestic Product (GSDP) in 2018-19 at current prices was ₹14,08,112 crore. The State's literacy rate grew from 66.64 *per cent* to 75.40 *per cent* during the period 2001-11. The per-capita income of the State stands at ₹2,07,062 against the country average of ₹1,25,397 (as of March 2019 -Economic Survey Government of Karnataka (GoK), 2018-19). General data relating to the State is given in **Appendix 1.1(A)**.

Gross State Domestic Product

GSDP is the market value of all officially recognised final goods and services produced within the State in a given period of time. The growth of GSDP is an important indicator of the State's economy, as it indicates the standard of living of the State's population. The trends in the annual growth of India's Gross Domestic Product (GDP) and that of the State, at current prices, are indicated in **Appendix 1.1(B)**. As seen from the appendix, in the years 2014-15 to 2018-19, Karnataka's GSDP growth rate at current prices, was more than that of the nation's growth rate, except during 2016-17 and 2018-19.

1.1 Introduction

This chapter provides a broad perspective of the finances of the GoK during 2018-19. It analyses important changes in major fiscal indicators compared to the previous year, keeping in view the overall trends during the last five years. The analysis is based on the Finance Accounts and information obtained from the State Government. The structure of the Government Accounts and the layout of the Finance Accounts have been explained in **Appendix 1.2**.

1.1.1 Summary of fiscal transaction in 2018-19

Table 1.1 and **Appendix 1.3** present the summary of the State Governments' fiscal transactions during 2018-19 *vis-à-vis* the previous year (2017-18), while **Appendix 1.4** provides the details of receipts and disbursement for 2018-19 as well as the overall fiscal position during preceding four years.

Table 1.1: Summary of fiscal transactions in 2018-19

(₹ in crore)

Receipts			Disbursements		
	2017-18	2018-19		2017-18	2018-19
Section A: Revenue					
Revenue Receipts	**1,46,999.65**	**1,64,978.66**	**Revenue Expenditure**	**1,42,482.33**	**1,64,299.86**
Tax revenue	87,130.38	96,829.71*	General Services	34,484.44	42,655.05
Non-tax revenue	6,476.53	6,772.87	Social Services	58,652.35	67,934.35
Share of Union taxes/duties	31,751.96	35,894.83^	Economic Services	42,855.78	48,285.15
Grants-in-aid and Contributions from GoI	21,640.78	25,481.25#	Grants-in-aid and Contributions	6,489.76	5,425.31
Section B: Capital and others					
Misc. Capital receipts	**3.70**	**(-) 5.51**	**Capital Outlay**	**30,666.76**	**34,659.32**
			General Services	977.45	827.41
			Social Services	8,676.76	9,793.56
			Economic Services	21,012.55	24,038.35
Recoveries of Loans and Advances	**136.93**	**31.23**	**Loans and Advances disbursed**	**5,092.22**	**4,487.22**
Public debt receipts**	**25,121.86**	**41,914.06**	**Repayment of public debt****	**8,269.16**	**11,082.62**
Contingency Fund	-	-	**Contingency Fund**	-	-
Public Account Receipts	**2,00,615.43**	**2,37,759.99**	**Public Account disbursements**	**1,94,536.63**	**2,34,329.59**
Opening Cash Balance	**34,353.58**	**26,184.05**	**Closing Cash Balance**	**26,184.05**	**22,003.87**
Total	**4,07,231.15**	**4,70,862.48**	**Total**	**4,07,231.15**	**4,70,862.48**

Source: Finance Accounts 2018-19.

**includes State Goods and Service Tax (SGST) of ₹41,956.03 crore; ^includes Central Goods and Service Tax(CGST) of ₹8,858.76 crore and Integraged Goods and Service Tax (IGST) of ₹707 crore.*

#includes ₹ 10,754 crore towards Compensation for loss of revenue arising out of implementation of Goods and Service Tax (GST).

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

The following are the significant changes during 2018-19 over the previous year:

- Revenue receipts grew by ₹17,979.01 crore (12 *per cent*);
- Revenue expenditure increased by ₹21,817.53 crore (15 *per cent*);
- Capital outlay increased by ₹3,992.56 crore (13 *per cent*), increase was mainly under Economic Services Sector (₹3,025.80 crore, 14 *per cent*) and Social Services Sector (₹1,116.80 crore, 13 *per cent*) and off-set by decrease under General Services Sector (₹150.04 crore, 15 *per cent*).

- Recoveries of Loans and Advances decreased by ₹105.70 crore (77 *per cent*) mainly due to less recovery of loans under '7615-200-Miscellaneous Loans' during 2018-19. The disbursement of Loans and Advances decreased by ₹605 crore (12 *per cent*);
- Public Debt receipts (excluding ways and means advances) increased by ₹16,792.20 crore (67 *per cent*) and repayments increased by ₹2,813.46 crore (34 *per cent*). The increase in Public Debt receipts was mainly due to increase in Internal Debt of the State by 75 *per cent* over the previous year;
- Miscellaneous Capital Receipts decreased from ₹3.70 crore in 2017-18 to (-) ₹5.51 crore in 2018-19 due to retirement of capital/disinvestment of co-operative societies/bank (₹3.29 crore) and refund of Earnest Money Deposit of ₹8.80 crore to Karnataka Industrial Area Development Board (KIADB);
- Public Account receipts increased by ₹37,144.56 crore (19 *per cent*) and disbursements by ₹39,792.96 crore (20 *per cent*); and
- Cash balance of the State Government decreased by ₹4,180.18 crore (16 *per cent*). Though there is decrease in cash balance over the previous year, in view of high cash balance, it is suggested that Government may consider utilising their existing balances before resorting to fresh borrowings.

1.1.2 Review of Fiscal situation

The Karnataka Fiscal Responsibility Act (KFRA) 2002 as amended from time to time was enacted with the objective of achieving inter-generational equity in fiscal management and long-term macro-economic stability. The KFRA, 2002 envisaged sufficient revenue surplus and prudential debt management through limits on borrowings, debt and deficits. The State Government is on a fiscal consolidation path and maintained guarantees within the limits[1] prescribed under the Karnataka Ceiling on Government Guarantees Act, 1999.

The State had recorded revenue surplus since 2004-05 and the fiscal deficit was within the limit of three *per cent* of GSDP as prescribed under the Act. The targets for revenue and fiscal deficits along with their actual levels are given in **Table1.2**.

[1]The outstanding guarantees extended by the Government as on the first day of April of any year shall not exceed 80 *per cent* of the State's revenue receipts of the second preceding year.

Table 1.2: Outcome *vis-a-vis* targets under KFRA

Period	Revenue Deficit/Surplus		Fiscal Deficit/GSDP (in *per cent*)		Debt/GSDP ratio (in *per cent*)	
	Ceiling as per KFRA	Actual	Ceiling as per KFRA	Actual	Ceiling as per KFRA	Actual
2014-15	Maintain Revenue Surplus	Achieved the target	3.00	2.14	25.20	18.00
2015-16			3.00	1.89	25.00	18.10
2016-17			3.00	2.53	25.00	19.54
2017-18			3.00	2.37	25.00	18.78
2018-19			3.00	2.73	25.00	20.26

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

1.1.3 Fiscal Health of the State

As prescribed under the Karnataka Fiscal Responsibility Act, 2002, during 2018-19, the Government was able to maintain the revenue surplus (₹679 crore). The targets for fiscal deficit to GSDP ratio (2.73 *per cent*) and debt-GSDP ratio (20.26 *per cent*) were also achieved. This indicates prudent fiscal management.

1.1.4 Comparison of State's fiscal variables with GoI variables

A comparison of fiscal variables of Karnataka with that of GoI variables for the year 2018-19 is given in **Table 1.3**.

Table 1.3: Comparison of fiscal variables

Sl. No.	Fiscal Variable	Karnataka	GoI#
1	Fiscal deficit/ GSDP(*per cent*)	2.73	3.40
2	Ratio of total outstanding debt of the Government to GSDP (*per cent*)	20.26	44.50

 # Source:Economic Survey, GoI for 2018-19.

As seen from the above table, the fiscal deficit/GSDP and debt/GSDP ratio of Karnataka was less than that of GoI's ratio.

1.1.5 Impact of certain transactions on revenue surplus and fiscal deficit during 2018-19

Scrutiny of certain transactions during 2018-19 revealed that the level of revenue surplus and fiscal deficit were affected by certain accounting adjustments as brought out in Para xxiv of Notes to Accounts of Finance Accounts and as detailed in **Table 1.4.**

Table 1.4: Impact of certain transactions during 2018-19

(₹ in crore)

Sl No.	Subject	Revenue Surplus		Fiscal Deficit	
		Overstatement	Understatement	Overstatement	Understatement
1	Booking of revenue expenditure under capital section	28.06	0.00	0.00	0.00
2	Booking of capital expenditure under revenue section	0.00	64.28	0.00	0.00
3	Non-transfer of expenditure to Karnataka Forest Development Fund	0.00	299.20	299.20	0.00
4	Non-transfer of receipts of Consumer Welfare Fund	0.41	0.00	0.00	0.41
5	Non-adjustment of interest against Reserve fund and Deposits bearing interest	28.20	0.00	0.00	28.20
6	Write back of unspent PRI grants	1,369.12	0.00	0.00	1,369.12
	Total	**1,425.79**	**363.48**	**299.20**	**1,397.73**
	Net Impact	**1,062.31**	**0.00**	**0.00**	**1,098.53**

Source: Notes to Accounts.

The above transactions are discussed below.

- The transactions in respect of Sl. Nos. 1-4 are detailed in Paragraph Nos. 2.4.1, 1.10.4.1(d) and 1.10.4.1(e) respectively;
- In respect of Sl. No. 5, the State Government was required to pay interest on the un-invested balances lying under Reserve Funds and Deposits bearing interest. The balance in these at the beginning of the year was ₹376.05 crore. The interest liability on this at 7.5 *per cent* (average interest rate for Ways and Means Advances) worked out to ₹28.20 crore was not provided and
- In respect of Sl. No.6, the State Government through an order in December 2016 had stipulated that the adjustment of unspent balances of a particular year would be done in the budget of the year next to the immediately succeeding year. Accordingly, the State Government in March 2019 had approved the write back of an unspent amount of ₹468.88 crore in respect of Zilla Panchayats and ₹900.24 crore in respect

of Taluk Panchayats related to the year 2016-17 from the Public Account (Major Head 8448), which led to suppression of expenditure during the current year.

Finance Department replied (March 2020) that provision for write back of unspent PRI grants is based on the standing Government orders and sanction of the Legislature was obtained for this write back.

The fact, however, remains that write back of unspent balances of the previous years to the Consolidated Fund during 2018-19 resulted in the overstatement of revenue surplus and understatement of fiscal deficit of the current year to the extent of ₹1,369.12 crore. This adjustment is, therefore, not depicting the true and fair picture of the fiscal position of the State during the current year.

As seen from the transactions mentioned in **Table 1.4**, the net impact of overstatement of revenue surplus is ₹1,062.31 crore and understatement of fiscal deficit is ₹1,098.53 crore.

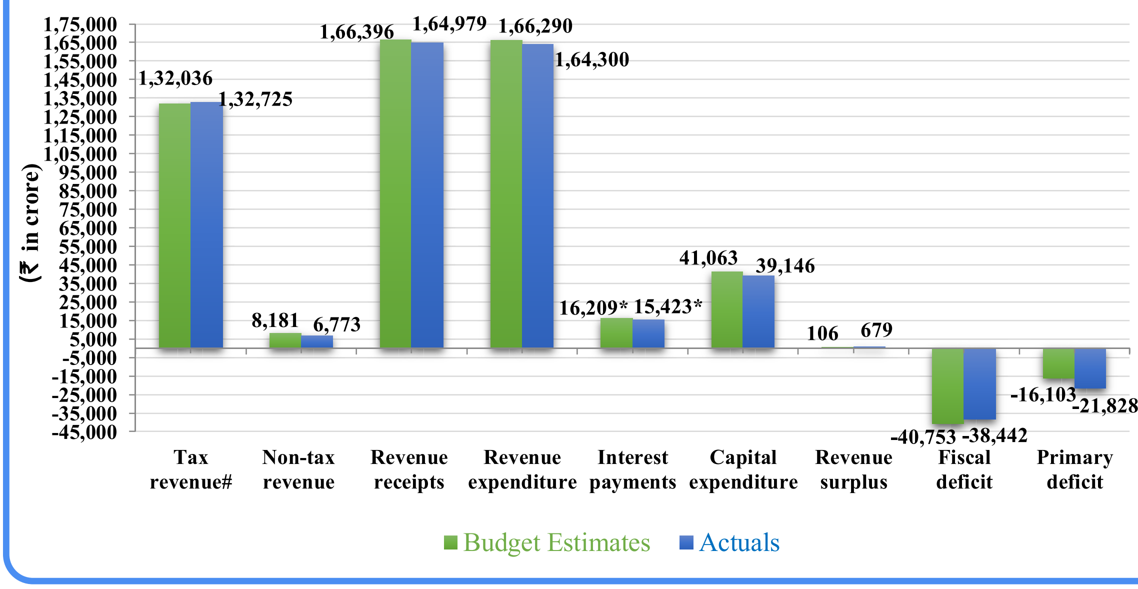
1.2 Analysis of Budget for the year 2018-19

1.2.1 Budget Estimates and Actuals

The budget presented by the State Government indicates projections/estimations of revenue and expenditure for a particular fiscal year. Deviations from budget estimates are indicative of non-attainment/ non-optimisation of desired fiscal objectives, due to a variety of factors, some of which are within the control of the Government while some are beyond its control.

Chart 1.1 presents the budget estimates and actuals of some important fiscal parameters for the year 2018-19.

Chart 1.1: Budget estimates *vis-a-vis* Actuals in 2018-19



Source: Annual Financial Statement and Finance Accounts.

#includes State's share of Union Taxes and Duties also.

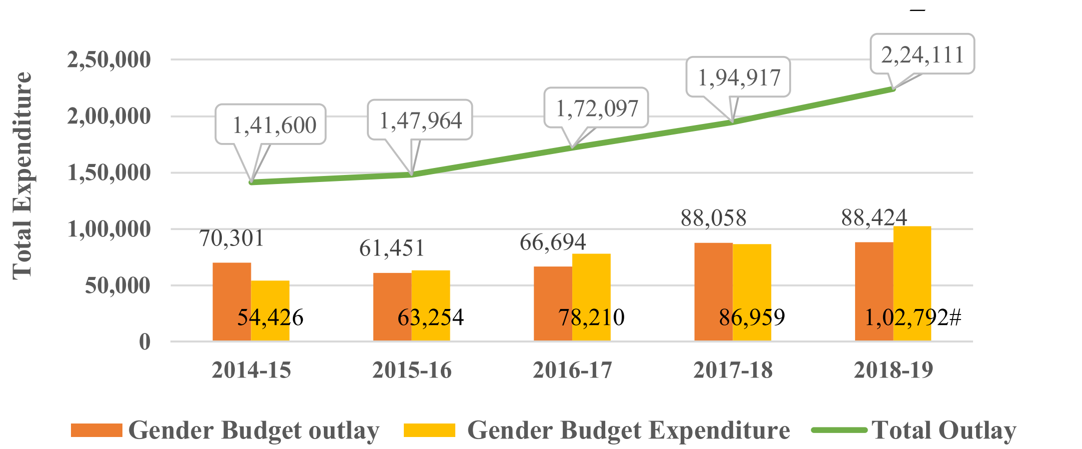
**excludes interest on off-budget borrowings.*

The actual receipts / expenditure were very close to the budget estimates during 2018-19. The primary deficit is more than the budget estimate by ₹5,725 crore *i.e.*, almost 36 *per cent*, whereas the fiscal deficit was less than expected.

1.2.2 Gender Budgeting

The State created a Gender Budget cell (January 2007) and initiated gender budgeting since 2007-08 onwards. The Gender budget discloses the expenditure proposed to be incurred within the overall budget on schemes which are designed to benefit women fully or partly. The trends in total outlay under the Gender Budget to total outlay during 2014-15 to 2018-19 along with expenditure are shown in **Chart 1.2.**

Chart 1.2 : Trends in Total Expenditure vs Total Outlay



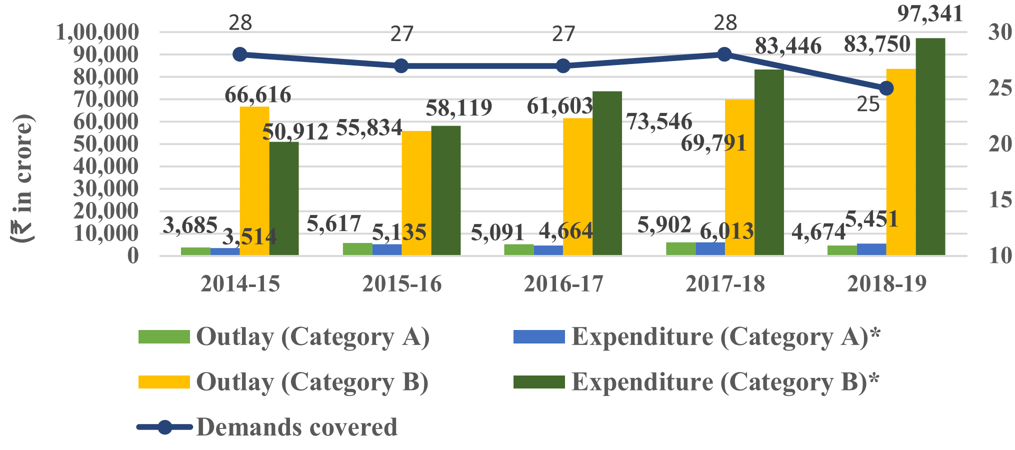
Source: Gender Budget document.

 # Expenditure figures for 2018-19 are revised estimate figures and not actuals.

As seen from the **Chart 1.2**, the total expenditure during 2014-15 to 2018-19 is more than the outlay except during 2014-15 and 2017-18. The decreasing proportion of the outlay *vis-vis* total outlay from 50 *per cent* in 2014-15 to 39 *per cent* in 2018-19 is a matter of concern.

The trends in the total outlay in Category A[2] and Category B[3] schemes under 27 demands on an average during 2014-15 to 2018-19 are depicted in **Chart 1.3**.

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



**Expenditure figures for 2018-19 are Revised Estimate figures and not actuals.*

As seen from the **Chart 1.3**, there was hardly any change in the allocation of Category A schemes in all the four years. In 2018-19, there was a decrease in allocation by 21 *per cent* when compared to the previous year. This was due to drastic reduction in allocation in schemes like Ashraya Basava Vasathi, Stree Shakti, Sabala *etc*. Though the allocation increased under Category B, the increase was marginal (two *per cent*). The total number of schemes under Category A and B which were 58 and 666 respectively in 2017-18 increased to 64 and 701 respectively in 2018-19. The gender budget document also gives a brief explanatory note about the schemes indicating the objective of such schemes.

An analysis of two schemes of Category A is brought out below:

a) Vidya Vikasa Yojane (Reimbursement of fees in Government PU Colleges)

Education is one of the development indicators by which the status of women can be assessed. During 2018-19, the allocation under Education was ₹24.77 crore which constituted 0.56 *per cent* of the total outlay of Category A schemes (₹4,402.02 crore). The allocation was towards the following schemes:

- Kitturu Rani Chennamma Residential School for Girls;
- Women's University in Vijayapura;
- Women's College at Mysuru and
- Reimbursement of Fees in Government PU colleges.

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

Detailed study of reimbursement of fees in Government colleges revealed the following:

In order to encourage girl students studying in Pre-University in Government as well as Private Colleges, the tuition fees are reimbursed by the Government under the Vidya Vikasa Yojane. The financial and physical targets, achievement and shortfall of the scheme is brought out in **Table 1.5** and **Table 1.6**.

Table 1.5: Financial target

(₹ in crore)

Year	Budget	Releases	Expenditure	Savings
2014-15	1.99	1.99	1.28	0.71
2015-16	10.00	4.60	2.22	2.38
2016-17	5.00	5.00	4.52	0.48
2017-18	6.50	6.50	5.18	1.32
2018-19	6.50	5.60	5.12	0.48
Total	**29.99**	**23.69**	**18.32**	**5.37**

Table 1.6: Physical target fixed and achieved

Year	Number of girl students benefitted		Shortfall	Percentage of shortfall
	Target	**Achievement**		
2014-15	42,361	28,057	14,304	34
2015-16	56,727	48,768	7,959	14
2016-17	1,09,650	99,122	10,528	10
2017-18	1,15,779	1,13,596	2,183	2
2018-19	1,15,487	1,12,377	3,110	3

The department attributed the shortfall in both financial and physical progress during 2014-15 and 2015-16 to enrolment of lesser number of girl students and non-approval of revised action plan. Further, the department stated that during 2016-17 to 2018-19, due to technical discrepancies in Khajane-2, certain colleges could not spend the grants, thereby resulting in shortfall in achieving the target.

The reply is not acceptable for the following reasons:

1. The number of girl students in both I PUC and II PUC in Government PU colleges during 2018-19 was 1.88 lakh which was far greater than the target fixed under the scheme and
2. Technical discrepancies in Khajane-2 cannot be cited as a justification for the failure to maximise the benefits for female students.

The Finance Department replied (March 2020) that with the full-fledged reimbursement of tuition fees through Khajane-2, the hurdles in realising 100 *per cent* financial and physical target would be overcome in the ensuing years.

b) Hostel for Disabled Females

The Department of Empowerment of Differently Abled and Senior Citizens is implementing a single scheme covered under the Gender Budget *i.e.,* 'Hostel for Disabled Females'. The purpose of the scheme is to encourage females with disability to pursue education and employment by providing hostel facilities for disabled female employees, trainees and students. While free accommodation and food would be provided to trainees and students, differently abled female employees seeking accommodation in the hostel are supposed to pay mess charges. At present there are 26 hostels in 23 districts of the State maintained by NGOs. The physical and financial progress, achievement and shortfall of the scheme is brought out in **Table 1.7** and **Table 1.8**.

Table 1.7: Physical target fixed and achieved

Year	Target women to be covered	Actual women beneficiary covered	Shortfall/ excess	Percentage of shortfall
2014-15	1,350	965	385	29
2015-16	1,350	1,140	210	16
2016-17	1,350	1,046	304	23
2017-18	1,350	886	464	34
2018-19	1,350	1,009	341	25

Table 1.8: Financial target

(₹ in crore)

Year	Budget	Releases	Expenditure	Savings
2014-15	300.00	298.84	298.84	0.00
2015-16	458.00	400.00	397.27	2.73
2016-17	458.00	321.54	321.54	0.00
2017-18	350.00	350.00	309.28	40.72
2018-19	350.00	350.00	313.32	36.68

From the table, it is evident that while even though there was no change in targets of differently abled women to be covered during the period 2014-15 to 2018-19, the budget allocation was reduced. The department attributed the shortfall in physical targets to availability of free hostels run by Social Welfare Department, limited job opportunities for differently abled persons in most of the districts *etc*. The reply is not acceptable as the targets should not be fixed arbitrarily.

1.2.3 Major policy initiatives of the Budget

The Government announced major policy initiatives in the budget 2018-19 (February 2018 and July 2018). An action taken report has been brought out along with the budget documents for 2019-20.

Audit undertook a study on the action taken by the Government in respect of Departments of Primary and Secondary Education, Medical Education and Transport. In total, the State Government initiated 35 new policies in the three departments. The action initiated by the Government with regard to major policies is summarised in **Appendix 1.5**.

Out of the 35 initiatives, action in respect of 22 was still in preliminary stage. While three initiatives were dropped, the scope of two initiatives was changed and action was yet to be initiated in respect of five. Hence, there was progress in respect of three initiatives only.

The initiatives which could have been implemented based on their importance, but were either dropped or are in their nascent stage is detailed below:

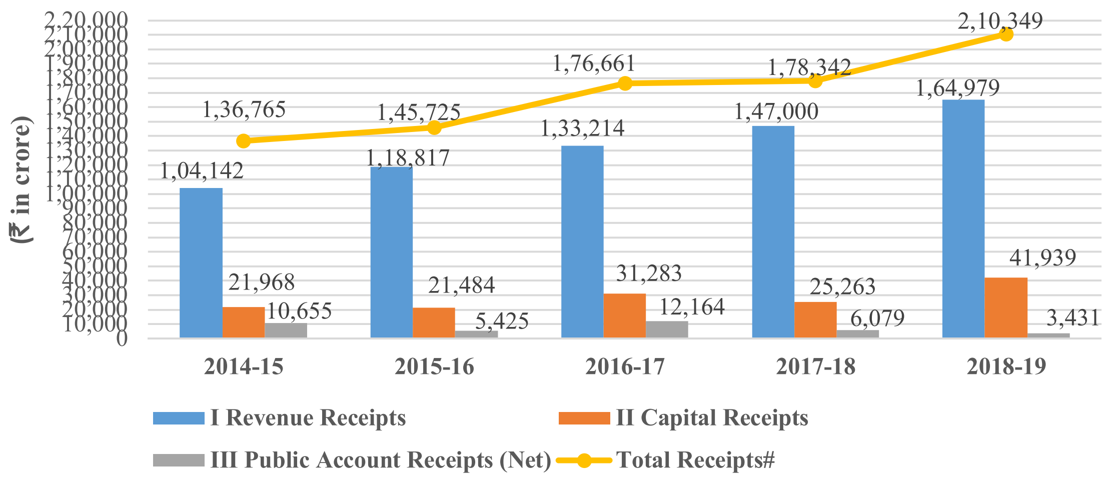
- 13,000 youths was to be imparted training as drivers/mechanics by the State Transport Corporations under Skill Development Scheme. The proposal is still under process;
- Training in heavy vehicle driving for 200 Scheduled Caste and Scheduled Tribe candidates in Bengaluru and Dharwad along with subsidy on loan for purchase of heavy vehicles was to be implemented by Heavy Vehicle Drivers Training Institutes in association with Karnataka State Finance Corporation and Devaraj Urs Truck Terminal Limited. The proposal is still under process and
- The safety of children at Government Primary and Secondary Schools was a priority of the Government and hence it had proposed to install CCTV cameras. However, instead of cameras, computer tablets were procured for children.

1.3 Sources of Revenue in the State

1.3.1 Sources of Revenue of the State as per the Annual Finance Accounts

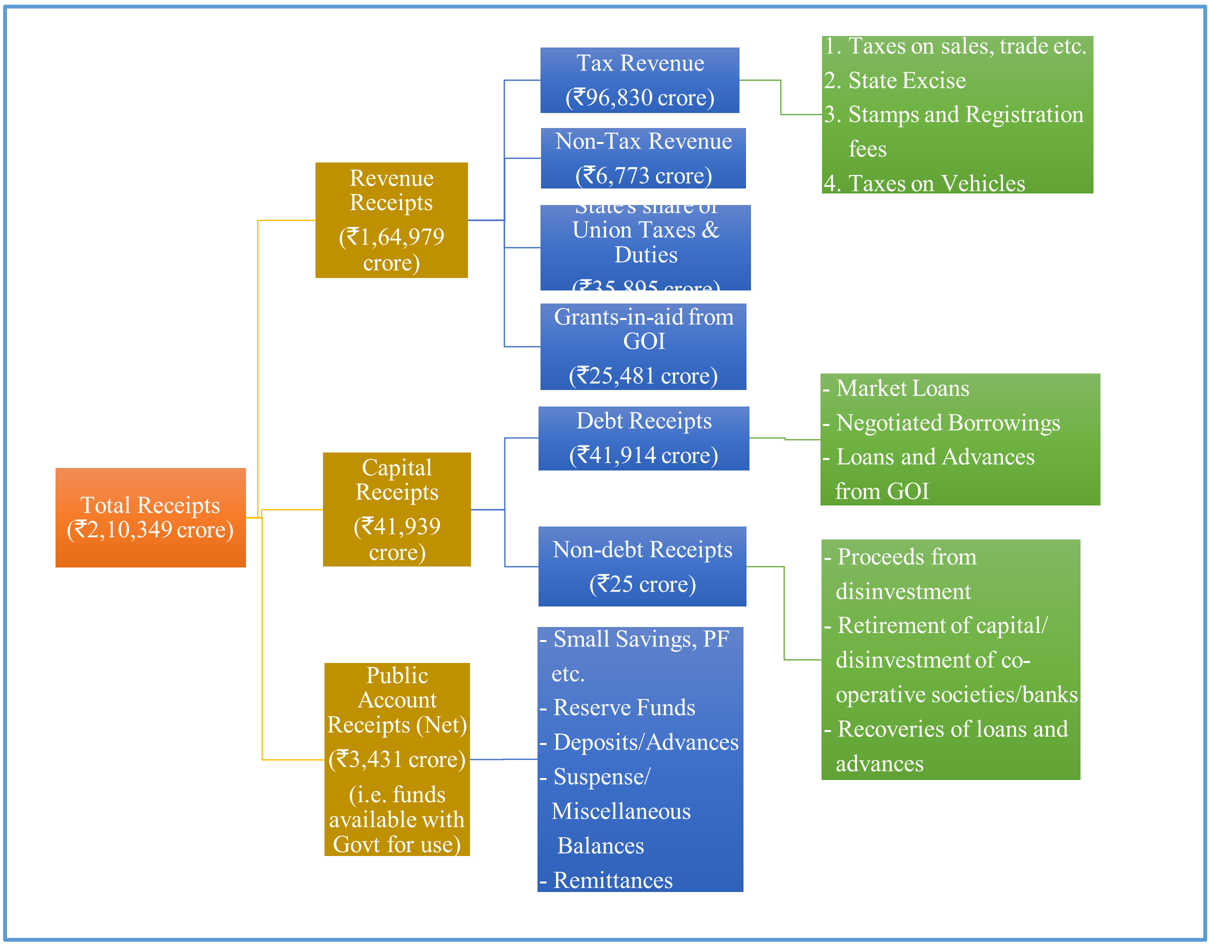
Revenue Receipts consist of tax revenue, non-tax revenues, States' share of Union taxes and duties and Grants-in-aid and Contributions from GoI. Capital receipts comprise miscellaneous capital receipts such as proceeds from disinvestment, recoveries of loans and advances, debt receipts from internal sources (market loans, negotiated loans from financial institutions/commercial banks) and loans and advances from GoI. Net Public Account receipts are also utilised by the Government to finance its deficit. **Chart 1.4** depicts the trends in various components of receipts during 2014-15 to 2018-19. **Chart 1.5** depicts the components and sub-components of resources of the State during 2018-19.

Chart 1.4: Trends in receipts from 2014-15 to 2018-19



#excluding Contingency Fund receipts.

Chart 1.5: Components and sub-components of Resources



Source: Finance Accounts

Total receipts (excluding Contingency Fund receipts) increased by 54 *per cent* from ₹1,36,765 crore in 2014-15 to ₹2,10,349 crore in 2018-19. Compared to the previous year (₹1,78,342 crore), the receipts increased by ₹32,008 crore (18 *per cent*) during 2018-19. The share of revenue receipts in total receipts during 2018-19 was 78 *per cent*. Further details are provided in **paragraph 1.4**.

Capital receipts increased by 91 *per cent* from ₹21,968 crore in 2014-15 to ₹41,939 crore in 2018-19 mainly due to increase in public debt receipts by 92 *per cent*. During 2018-19, the capital receipts accounted for 20 *per cent* of total receipts. Public Debt receipts, the main constituent of capital receipts, increased by ₹16,792 crore (67 *per cent*) over the previous year. There was increase in growth of internal debt receipts by 75 *per cent* and Loans and Advances decreased by 26 *per cent* over the previous year. The non-debt capital receipts showed 82 *per cent* decrease in growth during 2018-19 over the previous year due to less recovery of loans and advances/sale of assets.

Public Account receipts refer to those receipts for which the Government acts as a banker/trustee for the public money. On an average, they constituted five *per cent* of the total receipts during 2014-15 to 2018-19. Net Public Account receipts, which were ₹10,655 crore in 2014-15, increased to ₹12,164 crore in 2016-17, but were on a decreasing trend during 2017-18 and 2018-19. They were lowest in 2018-19 at ₹3,431 crore.

1.4 Revenue Receipts

The GoK's fiscal position is largely influenced by the revenue side. On an average, 67 *per cent* of the revenue came from the State's own resources during the period 2014-15 to 2018-19. The balance was transfers from GoI in the form of the State's share of taxes and duties and Grants-in-aid and Contributions.

Simplification and rationalisation of tax structure, along with simplification of the process of filing tax returns like e-payment of taxes and anywhere registration has ensured effective mobilisation of resources from various taxes which reflected consistent performance on the tax front. Though tax revenues have been growing in terms of value, as a percentage share of revenue receipts, they have declined from 67 *per cent* to 59 *per cent* during 2014-15 to 2018-19. On the other hand, the State has not improved revenues on the non-tax front, which were between four and five *per cent* of revenue receipts during 2014-15 to 2018-19, which is discussed in detail in **paragraph 1.4.1.3**.

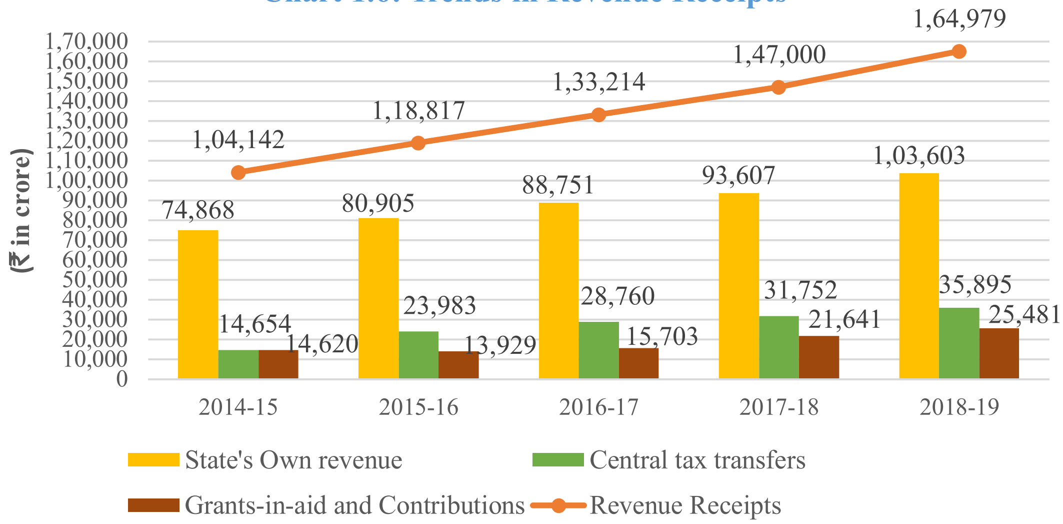
The trends in revenue receipts relative to GSDP over the period 2014-15 to 2018-19 are presented in **Appendix 1.4**.

As seen from the appendix,

- Revenue buoyancy[4] ranged between 0.71 and 1.96 during the five year period;
- The growth rate of Revenue Receipts decreased from 16.31 *per cent* in 2014-15 to 12.23 *per cent* in 2018-19; and
- Buoyancy of State's own tax revenue to GSDP recorded a sharp increase in the year 2018-19 (1.78) over the previous year (0.34) on account of increase in growth of tax revenue as well as change in the GSDP base and methodology. It was 1.03 in 2014-15, 0.53 in 2015-16, 0.93 during 2016-17 and lowest at 0.34 during 2017-18.

While composition of revenue receipts is depicted in **Chart 1.6**, **Chart 1.7** depicts the rate of growth of revenue receipts compared to GSDP and total revenue receipts and **Chart 1.8** depicts the trends of buoyancy ratios.

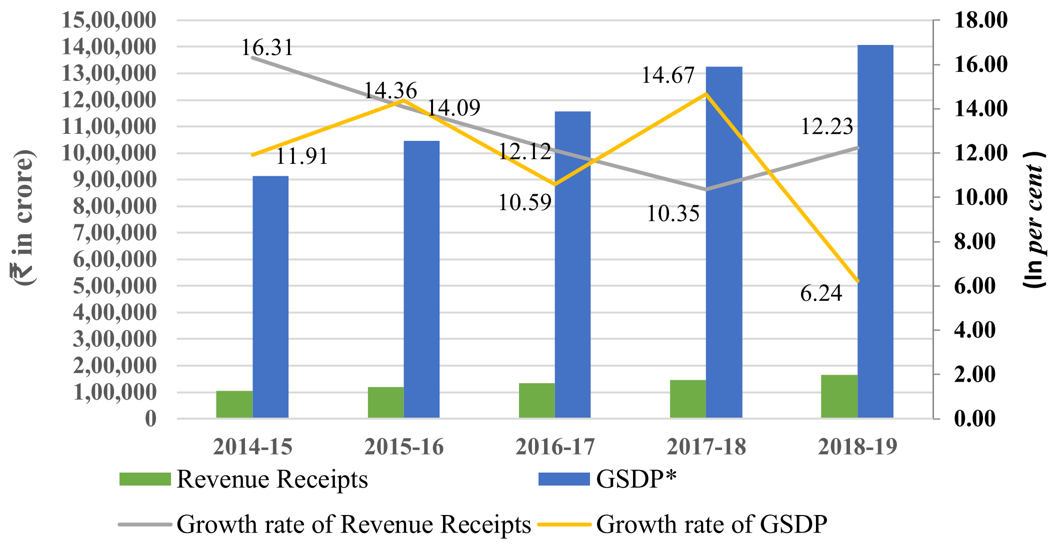
Chart 1.6: Trends in Revenue Receipts



Source: Finance Accounts

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

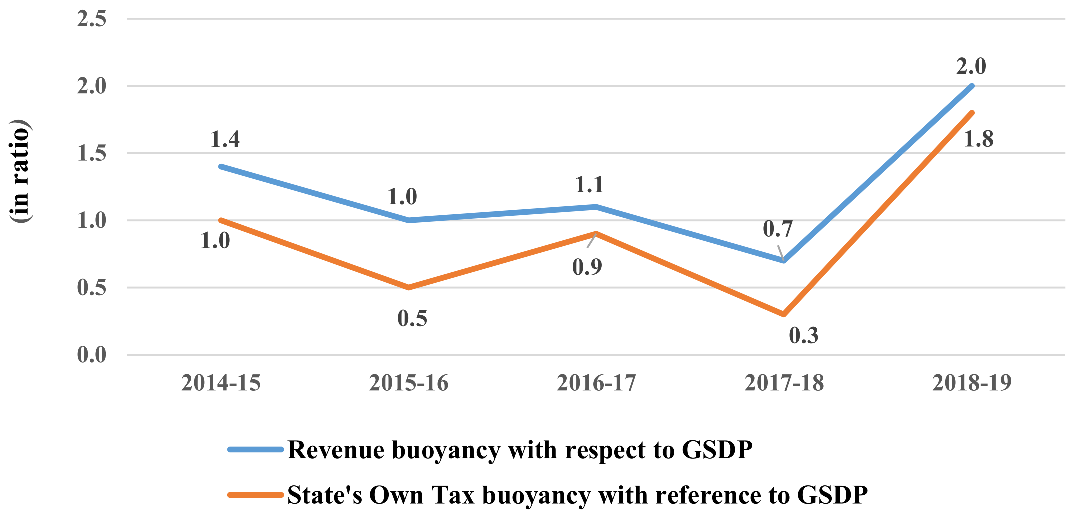
Chart 1.7: Growth of revenue receipts with reference to GSDP



Source: Finance Accounts and Economic Survey,GoK for 2018-19 and MOF, GoI letter dt 20 March 2018.

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

Chart 1.8: Trend of Buoyancy of Revenue Receipt with reference to GSDP

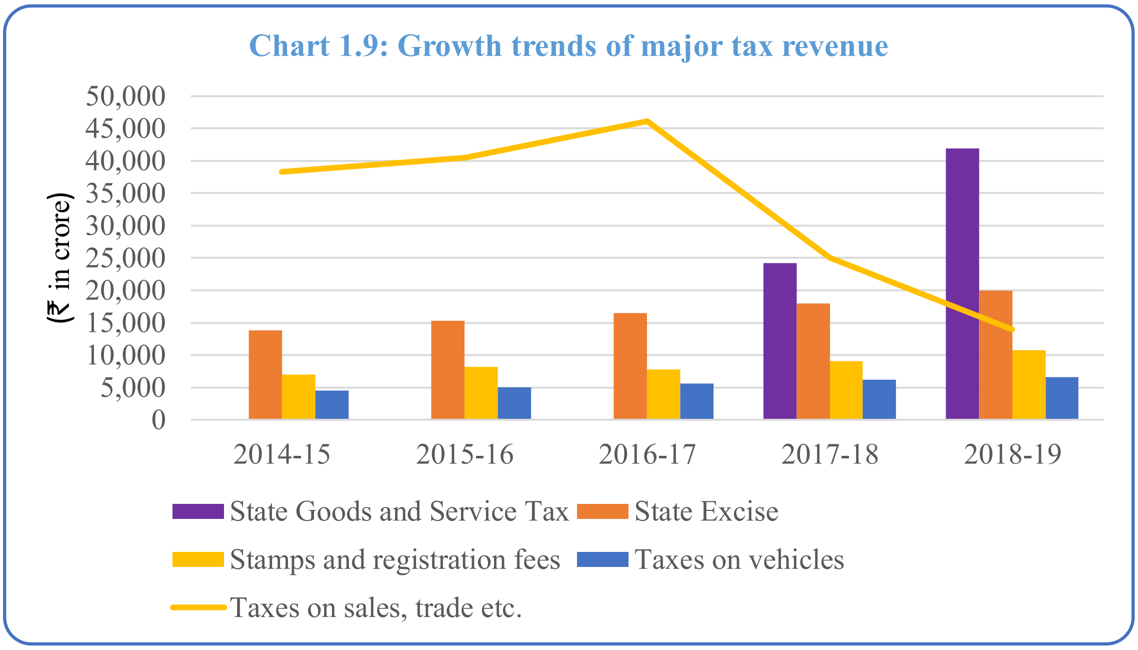


Revenue buoyancy with respect to GSDP increased from 1.4 to 2.0 during 2014-15 to 2018-19 with inter year variations.

1.4.1 State's Own Resources

1.4.1.1 Tax Revenue

State Goods and Service Tax (43 *per cent*) and State Excise (21 *per cent*) were the main source of the State's tax revenue followed by Taxes on sales, trade, *etc*., (15 *per cent*), Stamps and Registration Fees (11 *per cent*) and Taxes on Vehicles (seven *per cent*) during 2018-19. The components and trends of tax revenue during the period 2014-15 to 2018-19 are shown in **Appendix 1.4** and **Chart 1.9**.



The State Goods and Service Tax increased from ₹24,182 crore in 2017-18 to ₹41,956 crore in 2018-19 (74 *per cent*). The taxes on sales, trade *etc*. decreased from ₹38,286 crore in 2014-15 to ₹14,003 crore in 2018-19, a decrease of 63 *per cent* (₹24,283 crore in terms of amount). State Excise, which was the second largest contributor to State's own tax revenues increased by 45 *per cent* during the same period. During the period 2014-15 to 2018-19, the Stamps and Registration fees increased from ₹7,026 crore to ₹10,775 crore, an increase of 53 *per cent*. The Taxes on vehicles also contributed significantly to own tax revenues. It increased by 45 *per cent* (₹2,027 crore in terms of amount) during the period 2014-15 to 2018-19.

Cost of Collection

The gross collection of taxes on motor vehicles, taxes on sales, trade *etc*., stamp and registration fees and state excise, expenditure incurred on their collection and its percentage to gross collection during the years 2014-15 to 2018-19 along with their All-India average cost of collection for the respective previous years are indicated in the **Appendix 1.6**. As seen from the appendix, the percentage of cost of collection to the gross collection was significantly less than the All India Average for the period 2014-15 to 2018-19.

Comparison of Own Tax Revenue to GSDP

A comparison of State's Own Tax Revenue to GSDP of Karnataka for 2018-19 with neighboring States is given in **Table 1.9**.

Table 1.9: Comparison of Own Tax Revenue to GSDP with neighbouring States

(₹ in crore)

Sl. No.	Name of the State	Own Tax Revenue	GSDP	Own Tax/GSDP (in *per cent*)
1	Karnataka	96,830	14,08,112	6.88
2	Kerala	50,654	7,81,653	6.48
3	Tamilnadu	1,05,534	16,64,159	6.34
4	Maharashtra	1,87,436	26,60,318	7.05
5	Telangana	83,235	8,65,688	9.61
6	Andhra Pradesh	90,818	9,33,402	9.73

Own Tax Revenue as percentage of GSDP was better for Karnataka State (6.88 *per cent*), when compared to the neighboring States of Kerala (6.48 *per cent*) and Tamilnadu (6.34 *per cent*) but less than that of Andhra Pradesh (9.73 *per cent*), Telangana (9.61 *per cent*) and Maharashtra (7.05 *per cent*).

1.4.1.2 Goods and Service Tax (GST)

With automation of the collection of Goods and Services Tax (GST) having taken place, it is essential for Audit to transition from sample checks to a comprehensive check of all transactions, to fulfil the CAG's Constitutional mandate of certifying the Accounts. The required access to data is yet to be provided. Not having access to the data pertaining to all GST transactions has come in the way of comprehensively auditing the GST receipts. The accounts for the year 2018-19 are, therefore, certified on the basis of test audit as was done when records were manually maintained, as a one-time exception.

The total collections under GST during 2018-19 were ₹51,521.79 crore[5]. As per sanction orders issued by the Ministry of Finance, GoI, an amount of ₹5,559.04 crore was received on account of advance apportionment of IGST and an amount of ₹9,565.76 crore, which includes share of net proceeds out of CGST (₹8,858.76 crore) and IGST (₹707.00 crore) was assigned to GoK. The compensation for loss of revenue of ₹10,754 crore during 2018-19 includes ₹1,289 crore pertaining to 2017-18, released in May 2018.

Against the projected revenue of ₹53,549.16 crore for the period 2018-19, taxes collected by the State (pre-GST taxes & SGST), IGST portion (including provisional/advance apportionment of IGST) received from the Central Government and GST compensation received aggregated to ₹53,585 crore. The GST compensation received in excess was ₹35.84 crore.

[5]Under Major Heads 0005 – CGST (₹8,858.76 crore), 0006 – SGST (₹41,956.03 crore) and 0008 – IGST (₹707 crore).

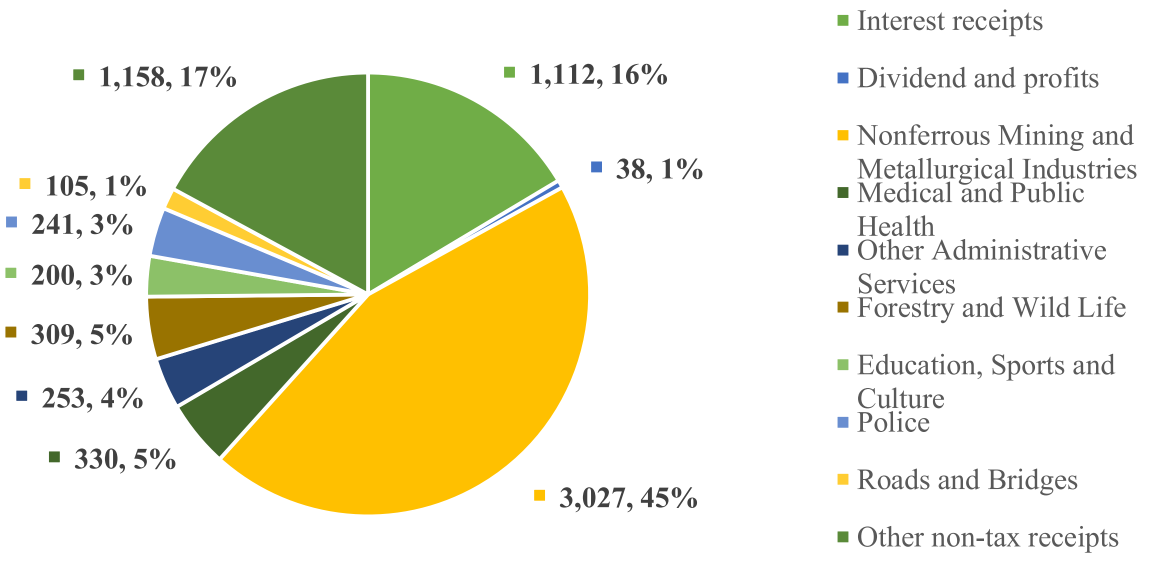
1.4.1.3 Non-tax revenue

Non-tax receipts (fees, user charges, interest receipts, *etc.*) are generally raised through non-statutory mandates. The sources of non-tax receipts included receipts from fiscal services like interest receipts from outstanding advances, dividends and profits from equity investments, royalty fees for allowing use of assets held as custodian like minerals, forests and wild life, or other such services and user charges for various social and economic services provided through the apparatus of the Government.

The trends in collection of non-tax revenue are given in **Appendix 1.4**. The components of non-tax revenue for 2018-19 are presented in **Chart 1.10**.

(₹ in crore/ in *per cent*)

Chart 1.10: Components of non-tax revenue in 2018-19



The share of non-tax revenue in revenue receipts has been around four to five *per cent* during the period 2014-15 to 2018-19. As percentage of GSDP, it is less than one *per cent* during the years 2014-15 to 2018-19. The reason for stagnation include non-revision of user charges periodically.

As opined by the XIII FC and as brought out in reports of the Comptroller and Auditor General of India since 2009-10, the user charges are required to be revised regularly for enhanced non-tax revenue receipts. The Expenditure Reforms Commission, in its fourth report (June 2011) felt that the Government should articulate a clear policy on user charges. In this regard, the Finance Department in its circular (November 2018) instructed all Administrative Departments to conduct a thorough review of all non-tax revenue sources and intimate action to revise the rates of non-tax revenues.

The State's Fiscal Management Review Committee (FMRC) had noted (January 2019) the shortfall in non-tax revenue collections on account of Forest Development Fee and interest receipts. Shortfall in Forest Development Fee was attributed to less collections due to legal issues. The decrease in interest receipts *vis-a-vis* projections was on account of increased expenditure and low cash balances in the beginning of the year.

Further, the Committee directed that there shall be a regular follow up on non-tax revenue after the budget, with concerned administrative departments so as to mop up more resources from non-tax revenues for the next financial year. In spite of making similar recommendation in the past few years, the non-tax revenue was meagre during 2018-19 also.

In the Economic Survey for 2018-19, it was admitted that non-tax revenues are an important fiscal challenge faced by the State. The measures to recover user charges at optimal levels are warranted. The State has one of the lowest non-tax revenues to GSDP ratios in the country. In many departments, the revision of user charges, fees & fines and other such non-tax receipts has not taken place for many years.

Analysis of two sources of non-tax revenue are discussed below:

Royalty Charges

Royalty is levied for allowing the use of Government assets like minerals, water, forest and wild life. The Royalty on Water for Energy sales during 2018-19 is ₹44 crore.

The Karnataka Power Corporation Limited (KPCL) which is a state enterprise has been generating electricity from seven hydro projects. It has four power stations and 17 power houses. The royalty rates fixed for energy sales per Kilo Watt Hour (KWH) in the power houses/stations are detailed in **Appendix1.7**. During the year 2018-19, 11,842 million units of electricity were transmitted, on which royalty of ₹45 crore was paid to the Government. The royalty for energy sale per KWH was fixed at four paise in all stations (September 1983) and at 10 paise each (April 2010) in Ghataprabha Dam Power House and Almatti Dam Power House. While the royalty rates in Almatti Dam Power House were revised to ₹1.00 from March 2019, the revision of royalty rates had not taken place for more than 36 years in respect of all Power stations and Ghataprabha Dam Power House.

On this being brought to the notice of the Government (December 2018), royalty charges were revised to 20 paise in all Power Stations and Ghataprabha Dam Power House with effect from April 2019.

Interest receipts, Dividends and Profits

Apart from the regular source of interest receipts on account of repayment of loans, the other major source is interest proceeds out of investment of surplus cash balance of the State. The details of interest and dividend realised during 2018-19 are discussed below.

- As per Reserve Bank of India's (RBI) regulations, the cash balance maintained by the State is invested in GoI's 14-day Treasury Bills (TBs). To improve cash management, excess cash balance (beyond the immediate requirement) is invested partly in 14-day intermediate TBs of RBI with an average interest rate of 3.18 *per cent* per annum and partly in 91-day intermediate TBs of RBI with an average interest rate of 6.74 *per cent* against an average rate of 8.24 *per cent* per annum at which the borrowings are made. Against the budgeted estimate of ₹1,095 crore during 2018-19, the revenue realised was ₹936.47 crore, of which 14 day TBs yielded ₹307.22 crore and 91 day TBs yielded ₹629.25 crore;

- The interest realised on loans and advances given by the Government to its Companies/Corporations *etc*., stood at ₹107.61 crore, working out to less than one *per cent* of the outstanding balances of loans at the end of the year. The receipts also included interest on capital of departmentally run commercial undertakings[6];
- In addition, substantial sums of money are held in banks by the Departmental Officers in contravention to the financial rules, which preclude the Departmental Officers from depositing the money in the savings bank accounts. The budgetary grants released to the departments in previous years that remain unutilised are kept in banks. The Finance Department initiated action by issuing directions/instructions (May 2018) for remittance of these balances/interest on the balances to Government Account. An interest of ₹18.24 crore was earned on the balances in savings bank account during 2018-19, and
- The return on investment in the form of dividends declared by the Companies/Corporations and credited to Government account during 2018-19 was ₹38.30 crore. Considering the magnitude of Government investment (₹66,518 crore), the return works out to a meagre 0.06 *per cent*.

1.4.2 Central tax transfers

The GoI transfers share of the State Government in Union Taxes and Duties such as Corporation Tax, Income Tax, Service Tax, Union Excise Duties *etc*. The trends in these Central tax transfers during 2014-15 to 2018-19 are given in **Table 1.10**.

Table 1.10: Trends in Central Tax transfers

(₹ in crore)

Sl. No.	Particulars	2014-15	2015-16	2016-17	2017-18	2018-19
1	Corporation Tax	5,117.21	7,547.57	9,211.05	9,721.29	12,481.94
2	Taxes on Income other than Corporation Tax	3,654.18	5,252.47	6,401.72	8,208.94	9,192.40
3	Taxes on Wealth	13.81	1.65	21.08	(-) 0.29	4.58
4	Customs	2,369.95	3,830.22	3,962.25	3,203.80	2,544.18
5	Union Excise duties	1,338.24	3,181.60	4,524.54	3,348.80	1,690.77
6	Service Tax	2,160.75	4,153.56	4,639.22	3,617.15	331.65

[6] Interest on Capital in Silk Filatures of ₹0.72 crore, the adjustments of which were made through book transfer.

Sl. No.	Particulars	2014-15	2015-16	2016-17	2017-18	2018-19
7	**Other Taxes on Income and Expenditure**	0.12	0.15	-	-	65.01
8	**Other Taxes and Duties on Commodities and Services**	(-) 0.01	16.12	0.08	(-) 0.01	18.54
9	**Integrated Goods and Service Tax (IGST)**	-	-	-	3,204.72	707.00
10	**Central Goods and Service Tax (CGST)**	-	-	-	447.56	8,858.76
	Total	**14,654.25**	**23,983.34**	**28,759.94**	**31,751.96**	**35,894.83**

Source: Finance Accounts of the respective years.

Further, the XIV FC recommended that the State's share in the net proceeds of Central Taxes (excluding Service Tax) and net proceeds of Service Tax be fixed at 4.713 *per cent* and 4.822 *per cent*, respectively. During 2018-19, out of the total net collection of Union taxes of ₹7,58,731.13 crore, the net devolution of State's share was ₹35,894.83 crore and the share of Corporation tax, Taxes on income other than Corporation tax, Customs, Union Excise duties and CGST was 4.713 *per cent*, IGST was 5.177 *per cent* and Service tax was 4.822 *per cent*.

1.4.3 Grants-in-aid and Contributions from GoI

Grants-in-aid and Contributions from GoI increased by 74 *per cent* from ₹14,620 crore in 2014-15 to ₹25,481 crore in 2018-19 as shown in **Appendix 1.4**. As compared to the previous year, there was an increase of ₹3,840 crore during 2018-19. The increase was mainly under Other transfers/Grants to States and FC Grants, which was off-set by decrease in Grants for Centrally Sponsored Schemes. The Other transfers/Grants to States apart from Grants towards contribution to National Disaster Response Fund, includes ₹10,754 crore towards compensation for loss of revenue arising out of implementation of GST.

1.4.3.1 XIV Finance Commission Grants

As per the terms of reference of the XIV FC constituted by the President under Article 280 of the Constitution on 2 January 2013, the Commission shall make recommendations in respect of measures needed to augment the Consolidated Fund of the State to supplement the resources of the Panchayats and Municipalities in the State.

- **Grants to Panchayat Raj Institutions (PRIs)/Urban Local Bodies (ULBs)**

The Commission recommended ₹3,425.57 crore during 2018-19 as transfer to the State in the areas indicated in **Table 1.11**.

Table 1.11: Transfer of recommended and actual release of grants during 2018-19

(₹ in crore)

Sl. No.	Transfers	Recommended amount	Actual release	Shortfall
a	Basic Grants to PRIs	1,856.02	1,841.54	14.48
b	Performance Grants to PRIs	234.08	-	234.08
c	Basic Grants to ULBs	1,040.27	1,040.27	-
d	Performance Grants to ULBs	295.20	-	295.20
	Total	**3,425.57**	**2,881.81**	**543.76**

As of March 2019, the State Government received ₹1,841.54 crore of Basic Grants[7] for PRIs against the recommendation of ₹1,856.02 crore and received the entire recommended amount of ₹1,040.27 crore towards Basic Grants to ULBs.

The XIV FC recommended the following conditions indicated in **Table 1.12** for Gram Panchayats and ULBs to be eligible for Performance Grants.

Table 1.12: Conditions for release of Performance Grants

Gram Panchayats
➢ **Audited annual accounts that relate to a year not earlier than two years preceding the year in which the gram panchayat seeks to claim the Performance Grant are to be submitted.**
➢ **To show an increase in the own revenues of the local body over the preceding year, as reflected in the audited accounts.**
ULBs
➢ **Audited annual accounts that relate to a year not earlier than two years preceding the year in which the ULBs seeks to claim the Performance Grant are to be submitted.**
➢ **To show an increase in the own revenues of the local body over the preceding year, as reflected in the audited accounts.**
➢ **Examine the targets achieved under Swachh Bharat Mission, collection of Property Tax and Water Fee, *etc.***

For the year 2018-19, the Performance Grants[8] to PRIs and ULBs were not released by GoI till the end of March 2019.

[7] The basic grants to PRIs and ULBs for 2017-18 was ₹1,580.18 crore and ₹899.25 crore respectively.
[8] The performance grants to PRIs for 2017-18 was ₹204.08 crore.

Rural and Panchayat Raj department in its reply (September 2019) stated that the claim for 2018-19 Performance Grants pertaining to PRIs had been forwarded to GoI. But the grant was not released. The Municipal Administration Department in its reply (November 2019) stated that the State Government had submitted its claim online in the Central Governments "SMARTNET" portal and also vide letter dated December 2018 for release of Performance Grants for 2018-19. The Ministry of Housing and Urban Affairs, GoI had evaluated the State's claim and had recommended to the Ministry of Finance, GoI for the release of allocated Performance Grants to the State. The proposal is pending with the Ministry of Finance, GoI.

1.4.3.2 Releases under Disaster Relief

As per the recommendations of the XIV FC, contribution towards State Disaster Response Fund (SDRF) is in the ratio of 90:10 between GoI and State Government. Against the recommended amount of ₹288.00 crore as Central share, the State received the entire amount of ₹288.00 crore. The contributions from GoI (₹288.00 crore) together with the State's contribution (₹32.00 crore) are transferred to SDRF account in Public Account of the State.

1.5 Capital Receipts

Capital receipts of the State Government during 2018-19 were ₹41,939 crore which included non-debt (Miscellaneous Capital Receipts and Recovery of Loans and Advances) and debt receipts. In 2018-19, the Public Debt receipts (₹41,914 crore) comprised Internal Debt of ₹40,470 crore (97 *per cent*) and Loans and Advances from GoI of ₹1,444 crore (three *per cent*). Market borrowings had a major share, comprising 94 *per cent* in the Internal Debt, followed by GoI loans (four *per cent*) and negotiated loans (two *per cent*). Loans from GoI comprised other loans only. The composition of capital receipts during the period 2014-15 to 2018-19 are indicated in **Appendix 1.4**.

Overall, capital receipts increased from ₹21,968 crore in 2014-15 to ₹41,939 crore in 2018-19. Debt receipts had a predominant share in capital receipts which were between 98 and 100 *per cent* during 2014-15 to 2018-19. The recovery towards loans and advances was very meagre during the period. Recovery amounted to less than one *per cent* of the outstanding loans and advances as at the end of 2018-19. It also included book adjustment of ₹14.74 crore being the dues of Electricity Supply Companies (ESCOMs), treated as subsidy on revenue account.

1.6 Public Account Receipts

Receipts and disbursements in respect of certain transactions, such as Small Savings, Provident Fund, Reserve Funds, Deposits, Suspense, Remittances *etc*., which do not form part of the Consolidated Fund are kept in the Public Account set up under Article 266(2) of the Constitution and are not subject to vote by the State Legislature. Here, the Government acts as a banker/trustee for custody of public money, since these transactions are mere pass through transactions. The net transactions under Public Account covering the period 2014-15 to 2018-19 are indicated in **Table 1.13**.

Table 1.13: Net transactions under Public Account

(₹ in crore)

Resources under sectors of Public Account (Net)	2014-15	2015-16	2016-17	2017-18	2018-19
I. Small Savings, PF etc.,	2,156	2,086	2,657	2,811	3,292
J. Reserve Funds	1,547	2,081	6,013	3,019	3,197
K. Deposits and Advances	3,702	284	3,041	1,834	3,068
L. Suspense and Miscellaneous	3,282	990	491	(-) 1,509	(-) 6,087
M. Remittances	(-) 32	(-) 17	(-) 38	(-) 76	(-) 39
Total	**10,655**	**5,424**	**12,164**	**6,079**	**3,431**

The net receipts from the Public Account decreased from ₹10,655 crore in 2014-15 to ₹3,431crore in 2018-19. This includes transfer of ₹1,144 crore from general revenues of the State to Infrastructure Funds in Public Account. Net availability of funds under Reserve Funds, Small Savings and Provident Fund had a major share in financing the fiscal deficit. The receipts under Deposits and Advances include ₹639 crore deposits made in Panchayat Bodies Fund. Under Suspense and Miscellaneous, there was increase in transactions relating to un-encashed cheques, which amounted to ₹6,072 crore during 2018-19.

1.7 Application of resources

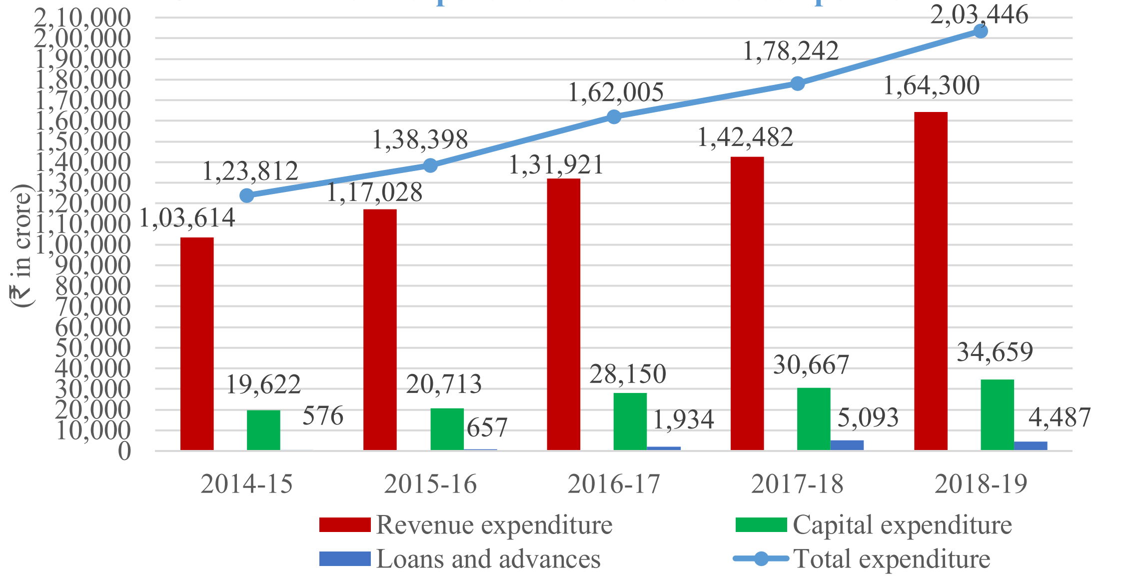
Analysis of the allocation of expenditure at the State Government level assumes significance since major expenditure responsibilities are entrusted to them. Within the framework of fiscal responsibility legislations, there are budgetary constraints in raising public expenditure financed by deficit or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

Prudent fiscal management should aim at creating savings by raising revenue receipts in excess of revenue expenditures. Use of borrowed funds for either directly revenue yielding activities or indirectly productive uses creates returns by way of tax or non-tax revenues which can be used for debt servicing and repayment of loans.

1.7.1 Growth and composition of expenditure

The basic parameters of total expenditure, growth rate and comparison with GSDP *etc*., are furnished in the **Appendix 1.4**. **Chart 1.11** presents the trends in total expenditure over a period of five years (2014-15 to 2018-19) and its composition under revenue, capital and loans and advances.

Chart 1.11: Total expenditure - Trends and composition

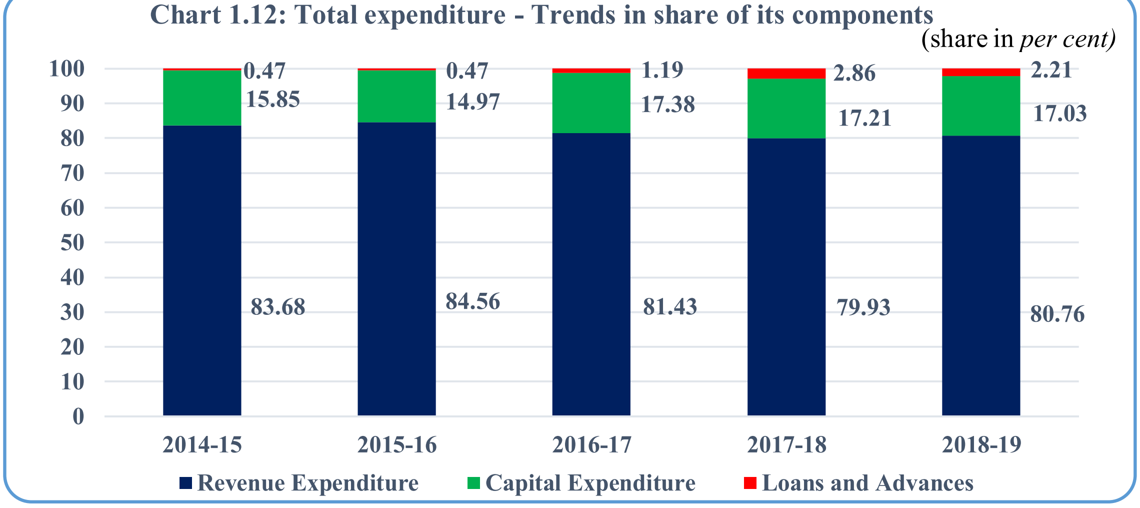


Total expenditure increased by 64 *per cent* from ₹1,23,812 crore in 2014-15 to ₹2,03,446 crore in 2018-19 due to increase in revenue expenditure (₹60,686 crore), capital outlay (₹15,037 crore) and disbursement of loans and advances (₹3,911 crore).

During the period 2014-15 to 2018-19, on an average, 82 *per cent* of the total expenditure was on revenue account. During 2018-19, it was 81 *per cent*. The share of capital expenditure (including loans and advances) was 19 *per cent*.

The share of Revenue Expenditure, Capital Expenditure and Loans and Advances for the years 2014-15 to 2018-19 is given in **Chart 1.12**.

Chart 1.12: Total expenditure - Trends in share of its components



Revenue expenditure had a predominant share in total expenditure. Thus, there was little scope for increase in capital expenditure. The trends of total expenditure by activities under General, Social, and Economic Services, Loans and Advances and Grants-in-aid are given in **Table 1.14**.

Table 1.14: Total Expenditure – Trends by activities

(Share in *per cent*)

	2014-15	2015-16	2016-17	2017-18	2018-19
General Services	23.33	22.97	19.95	19.90	21.37
Social Services	35.17	37.30	37.93	37.77	38.20
Economic Services	36.17	34.87	37.42	35.83	35.55
Loan and Advances	0.47	0.47	1.19	2.86	2.21
Grants-in-aid and Contributions	4.86	4.39	3.51	3.64	2.67

Source: Finance Accounts of the respective years.

The relative share of these components exhibited stability during the period from 2014-15 to 2018-19 with marginal inter year variations. The share of General Services decreased gradually with a slight increase in its share in 2018-19. The share of Social Services was almost steady at 37 *per cent* during 2015-16 to 2017-18. It increased to 38 *per cent* during 2018-19. There was not much change in Economic Services when compared to the previous year. The share of loans and advances was lowest during 2014-15 and 2015-16 and increased to 2.86 *per cent* in 2017-18 and again decreased to 2.21 *per cent* in 2018-19. The share of Grants-in-aid and Contributions was on a decreasing trend and was lowest during 2018-19 at 2.67 *per cent*.

The Expenditure Reforms Commission (ERC) of the State Government, in its first report (February 2010) had recommended that capital investments be stepped up and protected from fiscal uncertainties through prudent allocations. It had also recommended maintaining the capital expenditure (excluding debt servicing) at five *per cent* of GSDP. However, the ratio of capital expenditure to GSDP was less than five *per cent* during 2014-15 to 2018-19. It was two *per cent* during 2014-15 and 2015-16 and increased to three *per cent* on an average during 2016-17 to 2018-19.

The Finance department replied (March 2020) that Capital Expenditure can be stepped up with significant revenue surplus that can only be achieved by compressing revenue expenditure, which is not desirable as revenue expenditure of the Government also entails essential expenditure in the form of maintenance, social sector programme *etc*. The reply is not acceptable. Capital Expenditure is essential for infrastructure creation which has critical implications for growth. Additional avenues for revenue mobilisation need to be explored.

1.7.2 Revenue Expenditure

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

Revenue expenditure increased from ₹1,03,614 crore in 2014-15 to ₹1,64,300 crore in 2018-19, an increase of 59 *per cent*. Compared to the previous year, the increase was 15 *per cent*, due to increase in salary expenditure (₹5,099 crore), interest payments (₹1,641 crore), pensions (₹3,425 crore) and devolution to local bodies (₹1,589 crore) *etc*.

The revenue expenditure during 2018-19 also included ₹4,430.73 crore provided as Guarantee Commission[9] (₹54.19 crore), Adjustment of interest on Karnataka Government Insurance Fund (₹220.26 crore), Adjustment of interest on fund balances under Karnataka Government Insurance Schemes (₹972.89 crore), Adjustment of interest on GP Fund balances under Karnataka General Provident Fund (₹1,164.40 crore), ESCOMs (₹2,018.27 crore) being the dues of electricity tax *etc*., treated as subsidy and adjustment of interest on Capital invested in Government Commercial Undertakings (GCU's) (₹0.72 crore) through book adjustment.

1.7.3 Committed Expenditure

Most of the revenue expenditure is in the nature of committed expenditure on salaries, interest, pension, subsidy *etc*. This affects the maneuverability of the State in prioritising expenditure and in meeting capital investments to meet growing needs of social and economic infrastructure. The expenditure on these components and also certain other expenses such as pensions under social security schemes, subsidies arising under various schemes of the Government, Grants-in-aid & financial assistance, administrative expenses, devolution to local bodies *etc*., which are treated as committed expenditure in Medium Term Fiscal Plan (MTFP) 2019-23 covering the period 2014-15 to 2018-19 is depicted in **Table 1.15** and **Chart 1.13**.

[9] Rajiv Gandhi Rural Housing Corporation Limited (₹12.78 crore), Karnataka Road Development Corporation Limited (₹1.83 crore) and Power Company of Karnataka Limited (₹39.58 crore).

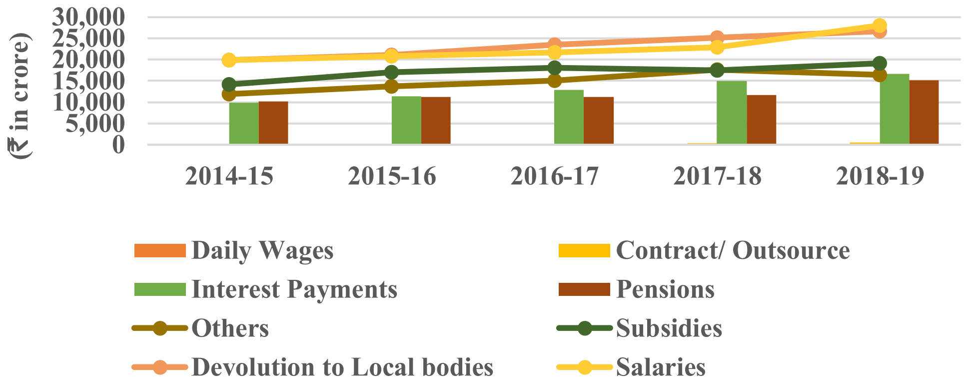
Table 1.15: Trends in Committed Expenditure

(₹ in crore)

Sl. No.	Particulars	2014-15	2015-16	2016-17	2017-18	2018-19 BE	2018-19 Actuals
1	Salaries*	19,952	20,774	21,708	22,958	31,712	28,024
2	Interest payments#	9,804	11,343	12,850	14,973	16,209@	16,614
3	Expenditure on pensions	10,118	11,251	11,295	11,684	17,801	15,109
4	Social Security Pensions	2,322	2,247	2,503	4,055	5,497	5,460
5	a) Subsidies	11,153	13,149	14,387	14,148	24,404	15,400
	b) Subsidies in the form of financial assistance *etc*.	2,973	3,913	3,714	3,318		3,777^
6	Grants-in-aid and financial assistance	9,737	10,840	13,163	11,812	16,834	24,888
7	Administrative Expenses	1,708	1,958	1,966	2,404	2,716	2,136
8	Devolution to Local Bodies	19,952	21,163	23,466	25,131	26,537	26,720
9	Daily Wages	-	-	-	110	139	138
10	Contract/Outsource	-	-	-	457	569	576
11	**Total Committed Expenditure**	**87,719**	**96,638**	**1,05,052**	**1,11,050**	**1,42,418**	**1,38,841**
12	**Revenue expenditure**	**1,03,614**	**1,17,028**	**1,31,921**	**1,42,482**	**1,66,290**	**1,64,300**
13	**Revenue receipts**	**1,04,142**	**1,18,817**	**1,33,214**	**1,47,000**	**1,66,396**	**1,64,979**
14	Committed expenditure as % of revenue receipts	84	81	79	76	86	84
15	Committed expenditure as % of revenue expenditure	85	83	80	78	86	85

** Includes salaries paid out of Grants-in-aid released to PRIs and under centrally sponsored schemes.*
 # Includes interest on off-budget borrowings.
@ includes interest pertaining to Major Head 2049 only.
^Excludes subsidy under Indira AwasYojana which was released as financial assistance.

Chart 1.13: Committed Expenditure during 2014-15 to 2018-19



The high proportion of committed expenditure to revenue receipts and revenue expenditure indicates that the State has limited flexibility in allocation of its resources for new schemes.

Expenditure on salaries

Expenditure on salaries increased from ₹19,952 crore in 2014-15 to ₹28,024 crore in 2018-19. It grew by 22 *per cent* over the previous year. This was mainly due to award of the Sixth Pay Commission to the State Government employees. It was noticed that the Finance Accounts captured data on salaries only in respect of the State Sector, whereas the salary expenditure in case of PRIs (₹14,709 crore) was not captured. Since the salaries in respect of PRIs are released as Grants-in-aid, the total salary expenditure is not reflected in the accounts. The salary expenditure excluding the salary grant relating to ULBs of the State (₹797.95 crore) was 21 *per cent* of the revenue expenditure net of interest payment and pensions, which was within the norms of 35 *per cent* fixed by the XII FC.

Salary expenditure under Capital Section accounted for ₹16.55 crore during 2018-19, when compared to ₹14.73 crore in 2017-18.

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

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

The Finance Department replied (March 2020) that grants to ZPs and TPs cannot be treated as salary and the salary details are presented in the Appendix B. The State Government also stated that the salary component of the grant is shown in the link document and expenditure on salaries is reflected in the annual accounts of each ZP. The reply is not acceptable since the salary details in the Appendix are not shown distinctly but only in the form of foot note. Subsequent to the exit conference, the Finance Department stated (April 2020) that it would examine the issue.

Also, the salary expenditure relating to the employees of ULBs overlapped with those under the State sector (Constitutional dignitaries). This has been discussed in **paragraph 2.4.4**.

Further, FMRC observed that majority of Grants-in-aid institutes were outside the ambit of HRMS and suggested to take necessary steps to bring all such institutes under HRMS framework,in order to have a better budget estimates.

The Finance Department replied (March 2020) that efforts are being made to bring all Grants-in-aid institutions under HRMS.

Pension Payments

The expenditure on pension during 2018-19 was ₹15,109 crore. There was a substantive increase of ₹3,425 crore in expenditure over the previous year. The payment of pension and other retirement benefits to All India Service (AIS) officers prior to 01 April 2008, was a liability to be borne by the State Government. From April 2008, the liability on account of pension payments that is to be borne by GoI is to be booked under suspense head – 8658 and a demand raised for reimbursement. At the end of March 2019, ₹150.26 crore was outstanding for settlement, compared to ₹92.18 crore (March 2018), implying that the State Government was yet to receive the amount.

New Pension Scheme (NPS)

Defined Contribution Pension Scheme known as New Pension Scheme (NPS), for all employees who joined the State Government service on or after 01 April 2006, became fully operational from 01 April 2010. A dedicated NPS Cell has been created under the Directorate of Treasuries to operationalise NPS in the State. The State Government has adopted NPS architecture designed by the Pension Fund Regulatory Development Authority (PFRDA) and has appointed the National Securities Depository Limited (NSDL) as the Central Record Keeping Agency (CRA) for NPS. Axis Bank is the Trustee Bank in charge of operation of Pension Funds.

The details of the scheme and contributions made by State Government and employees as furnished by Director of Treasuries (July 2019) are given below.

- The number of officials allotted Permanent Retirement Account Number (PRAN) was 2,14,438;
- The employee contribution (regular and backlog[10]) till 31 March 2019 is ₹3,447.75 crore and the matching contributions made by State Government since inception of the scheme is ₹3,498.24 crore. This includes the Governments contribution of ₹838.53 crore and employees' contribution of ₹777.74 crore during the current year;
- During the year, ₹1,531.67 crore which included an opening balance of ₹6.23 crore was transferred to NSDL/ Trustee bank, (Employees' and

[10] Refers to the contribution the employee had to make from the date of his entry into service to the date of implementation of the scheme.

Employer's contribution) leaving a closing balance of ₹3.27 crore under the deposit account as at the end of 31 March 2019;

- During 2018-19, ₹4.69 crore was paid from the Consolidated Fund as 'New Contributory Pension Schemes – Extension of benefit to the cases of persons/ families who retired/died while in service' and are covered under New Defined Pension Scheme and
- The Government Departments had been paying compound interest at eight *per cent* on Government backlog contribution of NPS employees with effect from 01.04.2010. Though the Finance Department had issued orders for stopping interest on the Government backlog contribution from 01.07.2016 due to non-submission of schedules by DDOs, the interest was paid by the Departments on the Government backlog contribution up to the end of 31 March 2018 (₹73.86 crore).

Interest Payments

Interest payments increased by ₹6,810 crore (69 *per cent*) from ₹9,804 crore in 2014-15 to ₹16,614 crore in 2018-19. Interest payments during 2018-19 constituted interest on internal debt (₹12,359 crore), interest on small savings, provident fund *etc.,* (₹2,358 crore), interest on loans and advances from the Central Government (₹706 crore) and interest on off-budget borrowings (₹1,191 crore).

The interest on internal debt increased by 10 *per cent* from ₹11,196 crore in 2017-18 to ₹12,359 crore in 2018-19, on account of increase in payment of interest on market loans by ₹1,321 crore (15 *per cent*). The interest on small savings, provident funds *etc*., increased by ₹276 crore from ₹2,081 crore during 2017-18 to ₹2,358 crore in 2018-19, mainly on account of increase under interest on State Provident funds and insurance by 13 *per cent*.

Subsidies

Subsidy expenditure increased from ₹11,153 crore in 2014-15 to ₹15,400 crore during 2018-19, which was nine *per cent* of revenue receipts. The subsidy in 2018-19 was ₹1,252 crore (nine *per cent*) more than the previous year. The four largest subsidy components were power subsidy provided for supply of free electricity to farmers for usage of agricultural pump sets, food subsidy, interest subsidy for crop loans and transport. The details of different subsidies are given in **Appendix 1.8**.

According to the Vaidyanathan Committee Report (March 2008), and as reiterated by PAC, the Governments both at the Centre and in the State should desist from the practice of waiver of recovery of loans and interest to prevent deterioration of the health of the co-operative credit system. However, the practice of waiver continues.

The Finance department in its reply (March 2020) stated that amid growing dissent among the farmers due to calamity conditions, loss of crop, marketing glitches and others, the loan waiver policy by the State Government was adopted as the auxiliary supporting system in the agriculture and the allied sector which provides immediate relief to the farmers who experience acute problem in repayment of loans raised.

Taking note of the steeply increasing subsidy expenditure during 2017-18 and 2018-19, the FMRC recommended for linking direct benefit transfer to Aaadhar to weed out ineligible beneficiaries, if any.

The Finance department replied (March 2020) that direct benefit transfer to beneficiaries through Aaadhar is attempted. To start with, a comprehensive data on beneficiaries coming under various schemes like Social Security Pensions, Anna Bhagya, Subsidy for supply of IP sets *etc*., at the district level would be obtained to help weed out ineligible beneficiaries.

Subsidies in the form of financial assistance, incentives *etc.*

Subsidies *inter alia* arise when the Government is unable to recover the costs it incurs on the provision of social and economic goods/services, even though sometimes these may have extended benefits. They can be indirect, in kind or take the shape of tax concessions. Some of these subsidies extended during 2014-15 to 2018-19 are detailed in **Appendix 1.9**.

These subsidies increased from ₹2,973 crore in 2014-15 to ₹3,777 crore during 2018-19. They mainly include financial assistance for supply of seeds, weaver's package, Ashraya scheme, micro/drip irrigation, minimum floor price scheme, housing for weaker sections, house sites for rural landless *etc*.

During 2018-19 also, the subsidy under Indira Awas Yojana (₹361 crore) was accounted for under HOA '2216-80-198-6-02-300(P)' as block grants to GPs instead of under HOA '2216-80-103-0-21' (Indira Awas Yojana) & '2216-80-800-0-04' (Indira Awas Yojana – State share). Thus, the subsidies were understated to that extent.

Incorrect accounting under Revenue Expenditure

As per paragraph 2.2 of List of Major and Minor Heads (LMMH), 'Refunds of Revenue' shall, as a general rule, be taken in reduction of the revenue receipts. In respect of Major/Sub-Major heads falling under the Sector "A. Tax Revenue", the head "Deduct-Refunds" should be opened as a distinct sub –head below the appropriate minor heads, so that the net collection of each tax/duty is readily ascertainable from the accounts.

During 2018-19, refund of sales tax of ₹299.46 crore which was refund of revenue and was required to be deducted from revenue was incorrectly accounted under 'HOA 2852-80-103-0-01 – Refund of Sales Tax'. Treating the transaction as revenue expenditure was not correct and this resulted in overstatement of revenue receipts as well as revenue expenditure. This is discussed in detail in **paragraph 3.9.1**.

Financial assistance to local bodies and other institutions

The quantum of assistance provided by way of grants to local bodies and other institutions during 2018-19, relative to the previous years, is presented in **Table 1.16**.

Table 1.16: Financial assistance to local bodies and other institutions

(₹ in crore)

Sl. No.	Name of the Institution	2014-15	2015-16	2016-17	2017-18	2018-19
a	**Panchayat Raj Institutions**	24,991.27	26,694.94	29,697.94	31,054.63	35,897.61
b	**Urban Local Bodies**	6,011.45*	6,076.05	5,685.58	6,489.76	5,425.31
c	**Educational Institutions (including Universities)**	1,145.04	1,406.50	1,449.75	1,293.70	1,081.29
d	**Co-operative societies and co-operative institutions**	818.09	1,023.13	1,009.47	1,191.32	1,477.76
e	**Other institutions and bodies (including statutory bodies)**	5,782.63	4,820.87	6,656.29	7,067.08	6,720.59
	Assistance as a percentage of revenue expenditure	37	34	34	33	31
	Total	**38,748.48**	**40,021.49**	**44,499.03**	**47,096.49**	**50,602.56**

Source: Finance Accounts.

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

As a sequel to the recommendations of the XI FC, grants are released to PRIs under three distinct programme minor heads namely 196, 197 and 198. The assistance to PRIs increased from ₹24,991 crore in 2014-15 to ₹35,898 crore in 2018-19, while the assistance to ULBs decreased from ₹6,011 crore in 2014-15 to ₹5,425 crore in 2018-19.

Out of the total devolution of ₹35,898 crore to PRIs during 2018-19, ₹14,709 crore (41 *per cent*) were towards salaries as the State Government's functions *viz.*, education, water supply and sanitation, housing, health and family welfare *etc*., were transferred to PRIs. It also included XIV FC grants released to the State Government (₹1,841.54 crore).

The assistance to ULBs decreased by ₹1,064 crore over the previous year. The decrease was mainly due to short release of funds to Municipal Corporations, Municipalities/Municipal Councils and Nagara Panchayats/ Notified Area Committees by 23 *per cent*, two *per cent* and three *per cent* respectively. The assistance to ULBs included ₹1,330 crore towards creation of capital assets. It also included XIV FC grants released to the State Government (₹1,040.27crore).

Assistance to other institutions (₹6,721 crore) included assistance to Statutory bodies and Development Authorities (₹1,849 crore), NGOs (₹1,848 crore), PSUs (₹57 crore) and others (₹2,967 crore). The assistance to Co-operatives increased by ₹286 crore and for other institutions decreased by ₹346 crore as compared to the previous year. It decreased for educational institutions by ₹212 crore during 2018-19.

Short release of funds

As per recommendations of the Fourth State Finance Commission (SFC) (May 2018) and decision of the State Government (December 2018), 36 *per cent* and 10.5 *per cent* of Non-Loan Net Own Revenue Receipts (NLNORR) excluding compensation for loss of revenue due to GST,was to be released to PRIs and ULBs respectively during 2018-19. As against this, the State Government had released 38.66 *per cent* (₹35,897.61 crore) of NLNORR (₹92,848.58 crore) to PRIs and only 5.84 *per cent* (₹5,425.31 crore) of NLNORR to ULBs. This resulted in short release of ₹4,323.79 crore to ULBs during 2018-19.

The State Government replied that the actual amount released to ULBs was ₹12,235.83 crore. This included SFC grants direct (₹3,756.22 crore), grants released to State owned projects (₹2,994.05 crore), State share against GoI release (₹811.10 crore), grants released to parastatal agencies (₹3,634.19 crore) and Central Finance Commission (CFC) Grants (₹1,040.27 crore). The reply is not tenable as SFC grants should not include funds released for specific schemes of the Central or State Government and CFC grants. Further, grants released to parastatal agencies benefit only those ULBs in respect of which infrastructure schemes are implemented and not the ULB sector as a whole.

1.8 Quality of expenditure

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

1.8.1 Adequacy of public expenditure

The expenditure responsibilities relating to the social sector and economic infrastructure, are largely State subjects. Enhancing human development levels requires the States to step up their expenditure on key social services like education, health, *etc*. Low fiscal priority (ratio of expenditure category to aggregate expenditure) can be stated to have been attached to a particular sector if the priority given to that particular head of expenditure is below the General Category States' (GCS) average for that year. **Table 1.17** analyses the fiscal priority of the State Government with regard to development expenditure, social expenditure and capital expenditure relative to GCS in the current year 2018-19.

Table 1.17: Fiscal priority of the States in 2018-19

Fiscal priority of the State (ratio)	AE/ GSDP	CE/ AE	ESE/ AE	SSE/ AE	DE#/ AE	Education/ AE	Health/ AE
1	2	3	4	5	6	7	8
General Category States* Average	16.05	14.28	30.45	36.59	67.04	14.99	5.07
Kerala	15.23	6.24	16.47	33.73	50.21	16.33	5.96
Tamilnadu	13.70	10.66	26.47	34.74	61.22	14.85	5.48
Karnataka	14.45	19.24	36.55	39.41	75.95	12.06	4.66

AE: Aggregate Expenditure, CE: Capital Expenditure, SSE: Social Sector Expenditure, ESE: Economic Sector Expenditure,DE: Development Expenditure.

#Development expenditure includes Development Revenue Expenditure, Development Capital Expenditure and Loans and Advances disbursed.

Source: For GSDP, data is as per the GoI conveyed figures, adopted by the State Government in its budget documents.

refer note in* ***Appendix 1.1*

Comparative analysis revealed the following:

- As observed from the **Table 1.17**, adequate priority needs to be given to education sector as the ratio of expenditure under this sector is well below the GCS average and also Kerala and Tamilnadu during 2018-19;
- During 2018-19, the ratio of health sector in the State is less than that of GCS, Kerala and Tamilnadu. Hence, adequate priority needs to be given in health sector also.

Thus, as observed in all the SFARs for the period 2014-15 to 2017-18, the State is not extending adequate priority to education as well as health sector. While the priority towards education is decreasing, there is no significant increase in priority towards health sector.

1.8.2 Efficiency of expenditure

In view of the importance of public expenditure on social and economic development, it is imperative for the State Government to take appropriate expenditure rationalisation measures with more emphasis on development expenditure. The higher the ratio of these components to total expenditure, the better would be the quality of expenditure. **Table 1.18** presents the trends in development expenditure relative to the aggregate expenditure of the State during 2018-19 *vis-à-vis* that of previous years.

Table 1.18: Development expenditure (figures in bracket indicate *percentage* to development expenditure)

(₹ in crore)

	2014-15	2015-16	2016-17	2017-18	2018-19
Development Expenditure (DE)	88,904	1,00,441	1,23,988	1,36,286	1,54,528
Percentage of DE to total expenditure	72	73	77	76	76
Components of DE					
Revenue	69,337 (78)	80,153 (80)	94,970 (76)	1,01,508 (74)	1,16,220 (75)
Capital	19,004 (21)	19,722 (20)	27,090 (22)	29,690 (22)	33,832 (22)
Loans and Advances	563(1)	566(0)	1,928(2)	5,088(4)	4,476(3)

Source: Finance Accounts.

Development expenditure increased from ₹88,904 crore in 2014-15 to ₹1,54,528 crore in 2018-19. As a percentage of total expenditure, it increased from 72 *per cent* in 2014-15 to 77 *per cent* in 2016-17 and decreased to 76 *per cent* during 2017-18 and 2018-19. On an average, 77 *per cent* of the development expenditure was on revenue account while capital expenditure, including loans and advances accounted for the balance. In 2018-19, expenditure on salary (₹19,856 crore) and subsidy (₹15,400 crore) formed two major components of development revenue expenditure.

Table 1.19 provides the details of capital expenditure and the components of revenue expenditure incurred on salaries and maintenance of the selected social and economic services.

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

(ratio in *per cent*)

Sector	2017-18			2018-19		
	Ratio of capital expenditure to total expenditure	Revenue expenditure		Ratio of capital expenditure to total expenditure	Revenue expenditure	
		Salaries and wages	Operation and Maintenance		Salaries and wages	Operation and Maintenance
Social Services (SS)						
Education, sports, art and culture	0.64	7.94	0.03	0.54	8.31	0.01
Health and family welfare	0.64	1.61	0.01	0.54	1.52	0.03
Water Supply, sanitation, housing and urban development	1.75	0.09	0.09	1.98	0.09	0.10
Others	1.84	0.49	0.02	1.75	0.53	0.01

Sector	2017-18			2018-19		
	Ratio of capital expenditure to total expenditure	Revenue expenditure		Ratio of capital expenditure to total expenditure	Revenue expenditure	
		Salaries and wages	Operation and Maintenance		Salaries and wages	Operation and Maintenance
Total (SS)	**4.87**	**10.13**	**0.15**	**4.81**	**10.45**	**0.15**
Economic Services (ES)						
Agriculture and allied activities	0.13	0.74	0.04	0.11	0.76	0.03
Irrigation and flood control	5.83	0.09	0.26	5.95	0.09	0.23
Power and energy	0.46	0.02	-	0.31	-	-
Transport	4.14	0.05	0.57	4.35	0.05	0.57
Others	1.23	0.67	0.03	1.10	0.73	-
Total (ES)	**11.79**	**1.57**	**0.90**	**11.82**	**1.63**	**0.83**
Total (SS+ES)	**16.66**	**11.70**	**1.05**	**16.63**	**12.08**	**0.98**

Source: Finance Accounts.

Expenditure on Social Services

Capital expenditure (including loans and advances) on social services increased from ₹9,855 crore in 2017-18 to ₹12,235 crore in 2018-19 and the ratio of capital expenditure to total expenditure decreased from 4.87 *per cent* in 2017-18 to 4.81 *per cent* in 2018-19. The share of salary expenditure (under social services) in revenue expenditure was 10 *per cent* in 2018-19 (**Table 1.19**).

Expenditure on Economic Services

Capital expenditure (including loans and advances) on economic services increased from ₹24,923 crore in 2017-18 to ₹26,073 crore in 2018-19 and its ratio to total expenditure increased from 11.79 *per cent* in 2017-18 to 11.82 *per cent* in 2018-19. The share of salary expenditure (under economic services) in revenue expenditure was two *per cent* during 2018-19 (**Table 1.19**).

The priority sectors identified by the Government in respect of economic services were agriculture, rural development, irrigation and flood control, energy, industries and minerals and transport.

In 2018-19, capital outlay was higher by ₹1,704 crore, ₹1,480 crore, ₹243 crore, under irrigation and flood control, transport, special area programme respectively and was lower by ₹199 crore, ₹117 crore, ₹47 crore, ₹11 crore respectively compared to the previous year under energy, industry and minerals, rural development and agriculture.

1.9 Financial analysis of Government Capital Expenditure and Investments

In the post KFRA framework, the Government is expected to keep its fiscal deficit (borrowing) at low levels and still meet its capital expenditure/investment (including loans and advances) requirements. In addition, the State Government needs to initiate measures to earn adequate return on its investments rather than bearing the same in the form of subsidy, recover cost of borrowed funds and take requisite steps to infuse transparency in financial operations. This section presents the broad financial analysis of investments and other capital expenditure undertaken by the Government during 2018-19 *vis-à-vis* previous years.

1.9.1 Capital expenditure

Capital expenditure increased by ₹3,992.56 crore (13 *per cent*) during the current year. The increase was mainly under Economic Services Sector (₹3,025.80 crore, 14 *per cent*) and Social Services Sector (₹1,116.80 crore, 13 *per cent*) and off-set by decrease under General Services Sector (₹150.04 crore, 15 *per cent*).

Under General Services Sector, the reduction in capital expenditure was witnessed mainly under Police (22 *per cent*) and Public Works (11 *per cent*). Though capital expenditure under Public Works had decreased during the current year, it contributed to the major share of capital expenditure in the General Services (65 *per cent*).

Under Social Services Sector, the major share of capital expenditure was incurred under Water Supply, Sanitation, Housing and Urban Development (41 *per cent*) followed by Welfare of Scheduled Castes, Scheduled Tribes, Other Backward Classes and Minorities (35 *per cent*).

Under Economic Services Sector, the major share of capital expenditure was incurred under the Irrigation and Flood Control (50 *per cent*) followed by the Transport Department (37 *per cent*).

Capital expenditure amounting to ₹10,767 crore was incurred by various PSUs in Karnataka during 2018-19. The major share incurred by Karnataka Neeravari Nigam Limited (₹3,702.67 crore), Krishna Bhagya Jala Nigam Limited (₹3,538.74 crore) and Visweshyaraya Jala Nigam Limited (₹1,703.40 crore) was mainly towards land acquisition charges, payment of pending bills for capital expenses and other capital grants.

The details of capital expenditure under various service sectors, sub sectors and PSUs for the period 2014-15 to 2018-19 are given in **Appendix 1.3(A)**.

1.9.2 Incomplete projects

Locking up of funds in incomplete works, which includes works stopped due to reasons like litigation, *etc*., impinge negatively on the quality of expenditure. The department-wise information pertaining to incomplete projects as of 31 March 2019 is given in **Table 1.20**.

Table 1.20: Incomplete projects

(₹ in crore)

Department	Incomplete Projects*				Cumulative expenditure as of March 2019
	Number	Budgeted Cost	Cost over run		
			Number	Amount	
Public Works, Ports & Inland Water Transport Department (PWP&IWTD)					
Buildings	74	368.26	14	8.18	338.22
Roads and Bridges	718	2,845.44	165	76.91	2,579.51
Irrigation	86	200.09	18	11.50	196.88
Total	**878**	**3,413.79**	**197**	**96.59**	**3,114.61**

Source: Finance Accounts.

**projects scheduled to be completed on or before 31 March 2019 have been included.*

Against the initial budgeted cost of ₹3,413.79 crore in respect of 878 works, stipulated to be completed on or before March 2019, the progressive expenditure was ₹3,114.61 crore as of 31 March 2019. Out of this, in 197 cases, the cost overrun aggregated to ₹96.59 crore. The delay in completion of the projects is in the range of greater than five years (eight), less than five years but greater than one year (317) and less than one year (553). No reasons for delay in completion of the works was given by the PWP&IWT and Irrigation Departments.

In order to minimize escalation of time and cost, FMRC had advised (July 2018) that projects which were nearing completion were to get funds on priority. However, audit noticed that number of incomplete projects had increased from 236 as on 31 March 2018 to 878 as on 31 March 2019. This indicated that no steps were initiated as per the advice of FMRC. Further, in respect of 14 works that were to be completed during the period from July 2013 to December 2016, the physical progress in work was between 10 *per cent* and 60 *per cent*, implying the need to take up and complete the works on priority basis.

The Finance Department replied (March 2020) that detailed guidelines were issued in April 2013 regarding execution of works. According to the guidelines, procurement of administrative approvals, implementation of the projects within the stipulated time frame and budget allocation are required to be adhered to by the PWP&IWT and Irrigation departments.

1.9.3 Investment and returns

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

As on 31 March 2019, the Government had invested ₹66,518 crore in 87[11] Government Companies (₹60,278 crore), Nine Statutory Corporations (₹2,664 crore), 44 Joint Stock Companies (₹3,033 crore) and Co-operative Institutions, Local bodies and Regional Rural Banks (₹523 crore). This was spread under various sectors[12]. The return from investment was negligible **(Table1.21)**.

Table 1.21: Return on investment

	2014-15	2015-16	2016-17	2017-18	2018-19
Investments at the end of the year (₹ in crore)	61,726.92	61,335.89	63,115.06	65,145.88	66,518.28
Return (₹ in crore)	74.84	69.40	82.50	78.83	38.30
Return (*per cent*)	0.1	0.1	0.1	0.1	0.1
Average rate of interest on Government borrowings (*per cent*)	6.5	6.5	6.3	7.7	8.2
Difference between interest rate and return on investment (*per cent*)	6.4	6.4	6.2	7.6	8.1

Source: Finance Accounts

Though the State Government had accepted (July 2011) that the return on these investments was meagre, it stated that it would not shy away from investing in social infrastructure involving long gestation and pay back periods. The PAC while agreeing (December 2011) with the reply had noted that the Finance Department had not initiated any mechanism to evaluate the expected yields in financial terms. Hence it had recommended for framing guidelines for the same. The Government further stated that efforts would be made to ensure due returns. Despite PACs recommendations and our consistent observations for the past ten years, no guidelines had been framed. Further, audit found that MTFPs placed before the Legislature did not contain a road map for ensuring proper return on investments.

The above investment included ₹38,949 crore (59 *per cent*) in the following Companies/Corporations, which have significant losses and where the investments were substantial (**Table 1.22**).

[11]includes investment of ₹68 crore in 16 non-working Government Companies

[12]Irrigation (₹36,779 crore), Power (₹11,209 crore), Infrastructure (₹4,734 crore), Financing (₹3,320 crore), Transport (₹2,399 crore), Social (₹1,851 crore), Housing (₹1,451 crore), Industries (₹1,017 crore), Construction (₹2 crore) and Other sectors (₹113 crore).

Table 1.22: Investment in Companies/Corporation under loss

(₹ in crore)

Company/Corporation	Investment up to 2018-19	Cumulative loss as at the end of 2017-18
North Western Karnataka Road Transport Corporation	266.85	792.48
North Eastern Karnataka Road Transport Corporation	183.43	542.42
Karnataka Road Development Corporation Limited	1,145.70	143.73
Krishna Bhagya Jala Nigam Limited	23,745.34	2,587.22
Karnataka Neeravari Nigam Limited	13,034.03	3,492.46
The Mysore Sugar Company Limited	335.78	289.42
Mysore Paper Mills Limited	237.37	425.94
Total	**38,948.50**	**8,273.67**

Source: Finance Accounts

Up to 2018-19, the Government invested ₹38,948.50 crore in these companies and the cumulative loss accounted for is ₹8,274 crore. The Finance Department in its reply to PAC (July 2011) had stated that investment in the above Companies/Corporations which were established for creation of infrastructure needs of the State/Public Service could not be viewed in financial gains. PAC while agreeing with the view in general, recommended to assess the viability of the loss making Companies/Corporations and also to identify the Companies/Corporations not functioning in the core areas for closure as recommended by XIII FC. However, the State Government had not initiated any such action. In the year 2018-19, ₹37.00 crore was invested in Mysore Sugar Company Limited despite the fact that it was a loss making company.

During 2018-19, the Government invested ₹1,375.69 crore in Government Companies (working) (₹933.37 crore), Joint Stock Companies (₹300.00 crore), Statutory Corporations (₹68.45 crore), and Co-operative institutions (₹83.87 crore).

During 2018-19, the investment account was reduced under 'Other Co-operatives and Fisherman's Co-operatives' by ₹3.29 crore, due to retirement of Government investment in share capital institutions, the proceeds of which stand accounted under 'Miscellaneous Capital Receipts'.

1.9.4 Loans and advances by the State Government

In addition to investments in Companies, Corporations and Co-operative Institutions, the Government also provided loans and advances to many institutions. **Table 1.23** presents the position of outstanding loans and advances as on 31 March 2019 and interest receipts *vis-à-vis* interest payments during the last five years.

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

(₹ in crore)

	2014-15	2015-16	2016-17	2017-18	2018-19
Opening balance	12,724*	13,216	13,813	15,578^	20,525@
Amount advanced during the year	576	657	1,934	5,092	4,487
Amount repaid during the year	84	60	100	137	31
Closing balance	13,216	13,813	15,648	20,533	24,981
Net addition	492	597	1,835	4,955	4,456
Interest receipts	127	264	145	99	108
Fiscal Liabilities	1,64,279	1,83,322	2,21,319	2,46,231	2,85,238
Interest Payments	9,804	11,343	12,850	14,973	16,614
Interest receipts as *per cent* to outstanding loans and advances	1.0	1.9	0.9	0.5	0.4
Interest payments as *per cent* to outstanding fiscal liabilities of the State Government	6.0	6.2	5.8	6.1	5.8
Difference between interest receipts and interest payments	(-)5.0	(-)4.3	(-)4.9	(-)5.6	(-)5.4

Source: Finance Accounts.

**differs by ₹5 crore on account of conversion of loan into equity in respect of MSIL during 2014-15.*
^differs by ₹70 crore on account of conversion of loans into equity during 2017-18.
@differs by ₹ 8 crore on account of conversion of loan into grant during 2018-19.

The outstanding loans as on 31 March 2019 aggregated to ₹24,981 crore. Interest spread of Government borrowings was negative during 2014-15 to 2018-19, which meant that the State's borrowings were more expensive than the loans advanced by it.

The amount advanced during 2018-19 was ₹4,487 crore which includes ₹2,297 crore released to Public Sector and other undertakings under Urban Development Schemes and ₹1,500 crore to Electricity Boards under Power Projects. Repayment of loans during 2018-19 accounted for ₹31 crore.

Detailed accounts of recovery of loans which are maintained in the office of the Principal Accountant General (Accounts & Entitlement) (Pr. AG) (A&E) indicated that recovery of loans and advances aggregating ₹8,505 crore (Principal: ₹4,644 crore and Interest: ₹3,861 crore) were overdue as on 31 March 2019 from 21 institutions (**Appendix 1.10**).

Information in respect of overdue principal and interest contained in Statement No.7 of Finance Accounts of 2018-19 is incomplete, as only 19[13] out of 842 institutions in respect of whom the detailed accounts are maintained by the

[13]In 2017-18, 18 out of 842 institutions have furnished the information

Heads of Departments/Chief Controlling Officers of the GoK, had furnished the required information.

Indian Government Accounting Standards (IGAS)-3 requires disclosure of loans that were sanctioned without specific terms and conditions governing such loans. Out of the 82 loans valued at ₹4,487.22 crore sanctioned by the State Government in 2018-19, 35 loans valued at ₹3,149.23 crore were sanctioned without specifying any terms and conditions. Details are available as additional disclosures under Statement No.18 of the Finance Accounts.

The Finance Department in its circular (August 2018) had stated that the State Government has revised the terms and conditions and other procedural aspects that had to be followed by departments relating to loans sanction vide GO dated November 2013. All departments were instructed to adhere to the instructions delineated in general loan GO issued by the Finance Department in November 2013. Since the loans sanctioned during 2018-19 did not specify the terms and conditions, it indicated that the compliance by the various departments was poor to the instruction issued.

The meagre recovery of loans as well as sanction of loans without specifying terms and conditions has been pointed out since 2006-07. The State Government has issued circulars time and again on revision of terms and conditions. However, it had not prepared any road map for recovery of loans/interest or enforced any measures for non-compliance to its circulars by the various departments.

The transactions under loan account includes certain non-cash transactions like conversion of loans into equity, grant *etc*., and reconciling the investment of the Government with the books of the companies. A soft loan amounting to ₹8.28 crore in respect of Indian Coffee Marketing Co-operative Limited (COMARK), Hassan was converted into grant.

The FMRC noted that recovery of loans given to PSUs, Co-operatives and other organisations was meagre and hence suggested follow up action to ensure recovery of loans advanced as per the repayment schedule.

The Finance Department replied (March 2020) that persistent efforts were being made by the Government to prescribe terms and conditions while sanctioning loans. It further stated that all efforts were made by the department to recover loans which were overdue by conducting periodic review with the institutions concerned.

1.9.5 Cash balances and investment of cash balances

Table 1.24 depicts the cash balances and investments made by the State Government during 2018-19.

Table 1.24: Cash balances and their investments

(₹ in crore)

	Opening Balance on 01-04-2018	Closing Balance on 31-03-2019	Increase (+)/ Decrease (-)
a) General cash balance			
Cash in treasuries	-	-	-
Deposits with RBI	723.77	989.96	266.19
Deposits with other banks	-	-	-
Remittance in transit- Local	0.01	0.01	-
Sub Total	**723.78**	**989.97**	**266.19**
Investments held in cash balance investment account	12,655.49	5,139.28	(-)7,516.21
Total (a)	**13,379.27**	**6,129.25**	**(-)7,250.02**
b) Other cash balances and investments			
Cash with departmental officers *viz.* PWP&IWT department officers, Forest department, DCs	2.09	2.09	-
Permanent Advances for contingent expenditure with departmental officers	1.75	1.87	0.12
Investment of earmarked funds	12,800.94	15,870.66	3,069.72
Total (b)	**12,804.78**	**15,874.62**	**3,069.74**
Grand Total (a+b)	**26,184.05**	**22,003.87**	**(-)4,180.18**

Source: Finance Accounts

Claims against dues of Government are settled by preferring bills at treasuries, against which cheques are issued (by debit to the Consolidated Fund) to the claimants. The Major Head 8670 – Cheques and Bills is credited with the amount of each cheque and paired off with its encashment at the Agency Banks. Thus, credit balances under this head indicate the value of cheques that remained un-encashed. Article 75(1) of the Karnataka Financial Code, 1958, prescribes that the Treasury Officer should propose an Alteration Memorandum for the value of cheques outstanding for more than 12 months from the date of issue on the 15th of May each year. The opening balance of un-encashed cheques at the beginning of the year was ₹12,637.18 crore. Against issue of cheques worth ₹1,66,604.02 crore during 2018-19, cheques worth ₹1,72,676.13 crore were encashed. The balance of un-encashed cheques amounted to ₹6,565.08 crore as on 31 March 2019.

Audit observed that the net credit under the account during 2018-19 was ₹6,072 crore. Action is required to be taken for analysis of data for clearing of the balances.

The GoK permits departments to operate funds through bank accounts under special circumstances. Guidelines for operation of bank accounts are also issued

(January 2017) in this regard. However, unspent balances in these accounts are not obtained in order to forecast its cash requirement.

The cash balance of the State at the end of the year was ₹22,004 crore. The decrease in the cash balance was 16 *per cent* over the previous year.

1.10 Assets and Liabilities

1.10.1 Growth and composition of assets and liabilities

In the existing Government accounting system, comprehensive accounting of fixed assets like lands and buildings owned by the Government is not done. However, Government accounts do capture the financial liabilities of the Government and the assets created out of the expenditure incurred. **Appendix 1.11** gives an abstract of such liabilities and assets as on 31 March 2019 compared with the corresponding position as on 31 March 2018.

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

The internal debt includes market loans, special securities issued to RBI and other negotiated loans. The Public Account liability includes small savings, provident funds *etc*., reserve funds and other deposits. The liabilities of the State as depicted in Finance Accounts, however, did not include pension, other retirement benefits payable to retired/retiring State Government employees/guarantees/letters of comfort issued by the State Government and borrowings through SPVs, termed off-budget borrowings.

Assets comprise assets under the Consolidated Fund and cash. The assets under the Consolidated Fund consist of capital outlay on fixed assets – investments in shares of companies and corporations and loans and advances, which consist of loans for power projects and other development loans. The growth rate of components of assets and liabilities is summarised in **Table 1.25**.

Table 1.25: Summarised position of Assets and Liabilities

(₹ in crore)

Liabilities				Assets			
	2017-18	**2018-19**	***Growth rate (per cent)***		**2017-18**	**2018-19**	***Growth rate (per cent)***
Consolidated Fund	**1,63,135**	**1,93,967**	**19**	***Consolidated Fund***	**2,56,146**	**2,95,251**	**15**
a. Internal Debt	1,48,581	1,79,309	21	Capital Outlay	2,35,614	2,70,270	15
b. Loans and Advances from GoI	14,555	14,658	1	Loans and Advances	20,533	24,981	22
Off-budget borrowings	**13,173**	**14,862**	**13**	**Cash**	**26,184**	**22,004**	**(-)16**
Public Account*	**69,922**	**76,410**	**9**				
a. Small savings, Provident Funds etc.,	27,731	31,024	12				
b. Reserve Funds	16,873	17,001	1				
c. Deposits	25,318	28,385	12				

**The liabilities are on net basis. It does not include investments from earmarked funds of ₹12,801 crore (2017-18) and ₹15,871 crore (2018-19).*

The growth rate of assets decreased from 16 *per cent* in 2017-18 to 15 *per cent* in 2018-19, while that of liabilities inclusive of off-budget borrowings, increased from 12 *per cent* in 2017-18 to 19 *per cent* in 2018-19.

The Finance Accounts reflected an amount of ₹1,79,309 crore as internal debt outstanding at the end of 2018-19 after taking into account the difference of ₹561.59 crore in the accounts of LIC, GIC, NABARD, NCDC *etc*. Further, the RBI in its quarterly statement of outstanding balances of the GoK as on 31 March 2019 reflected closing balance of Market Loans – not bearing interest as ₹0.09 crore. However, the Finance Accounts reflected an amount of ₹0.65 crore, indicating that reconciliation of loan balances (capital account) was required. It was also observed that certain loan balances which figure in the Finance Accounts had not been reckoned in RBI books (three cases). In respect of six cases, there were differences which require reconciliation. In respect of four cases, the balances as per the books of accounts of Pr. AG (A&E) tallied with those of RBI.

The Finance Department replied (March 2020) that the difference in balances of Finance Accounts and RBI is under correspondence and the balances of RBI would be adopted and incorporated in the next year accounts after clearance from CAG's office.

Further, as per the communication from the RBI, there still exists a balance of ₹0.40 crore to be discharged in respect of compensation bonds, the transactions of which are accounted under the minor head 106. However, these loans do not figure in the outstanding balances in the Finance Accounts as they are accounted as subsidies. The loans and advances from GoI reflected an amount of ₹14,658 crore as at the end of 2018-19.

In its reply the Finance Department (March 2020) stated that RBI was requested to provide details of compensation bonds and appropriate action would be taken after obtaining details from them.

The assets shown in the Finance Accounts (Statement No. 1 - Investment from earmarked funds - ₹15,871 crore) were understated to the extent of ₹903.71crore. This is on account of the interest accrued on the investment of Consolidated Sinking Fund (CSF) account made during 2012-13 and 2018-19, which had not passed through the Government books and stands reinvested in the CSF.

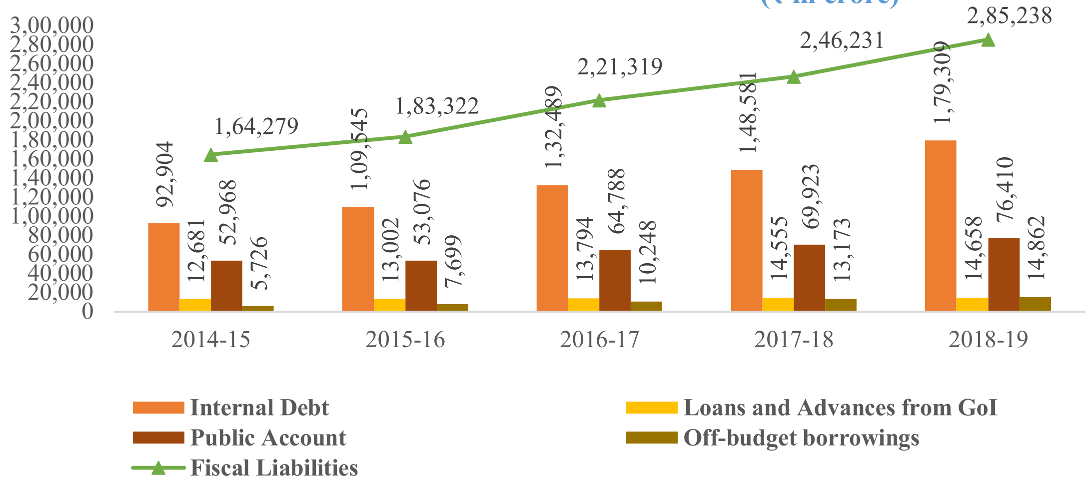
The Finance Department replied (March 2020) that it was actively pursuing the matter of routing of interest accrued on the investment of Consolidated Sinking Fund through the Consolidated Fund of the State with the Pr. AG (A&E).

1.10.2 Fiscal Liabilities

The trends in outstanding fiscal liabilities of the State are presented in **Appendix 1.4**. The composition of fiscal liabilities during the year 2014-15 to 2018-19 is presented in **Chart 1.14**.

Chart 1.14: Composition of outstanding Fiscal Liabilities

(₹ in crore)



Source: Finance Accounts

The Fiscal liabilities of the State, their rate of growth, ratio of these liabilities to GSDP, revenue receipts and own resources as well as buoyancy of fiscal liabilities with respect to these parameters are brought out in **Appendix 1.4**. The fiscal liabilities of the State increased by 74 *per cent* from ₹1,64,279 crore in 2014-15 to ₹2,85,238 crore in 2018-19.

1.10.2.1 Internal Debt

The internal debt which is a part of Consolidated Fund liabilities increased from ₹92,904 crore in 2014-15 to ₹1,79,309 crore in 2018-19, an increase of 93 *per cent*.

1.10.2.2 Loans and Advances from GoI

The loans and advances from GoI showed an increase of 16 *per cent* from ₹12,681 crore in 2014-15 to ₹14,658 crore in 2018-19. Due to increased borrowings in 2018-19, the growth rate of fiscal liabilities was 16 *per cent* when compared to 2017-18. Further the buoyancy of fiscal liabilities to revenue receipts was at 1.10 *per cent* and 1.30 *per cent* in 2017-18 and 2018-19 respectively. Also, the buoyancy ratio of fiscal liabilities to own resources gradually decreased from 1.52 in 2014-15 to 1.48 in 2018-19.

1.10.3 Off-budget borrowings

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

During 2018-19, capital expenditure of ₹39,146 crore included ₹1,339.44 crore towards servicing of principal amount of off-budget borrowings. **Table 1.26** captures the trend in the off-budget borrowings of the State during 2014-15 to 2018-19 while **Table 1.27** gives the entity-wise position of borrowings till the end of 2018-19.

Table 1.26: Trend in off-budget borrowings

(₹ in crore)

Year	2014-15	2015-16	2016-17	2017-18	2018-19
Amount as furnished by entities*	3,081.50	2,372.00	3,005.16	3,500.23	3,523.65

Source: As reported by the concerned entities.

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

Table 1.27: Entity-wise position of off-budget borrowings

(₹ in crore)

Company/Corporation/Board	Outstanding off budget borrowing*	Borrowings during 2018-19	Repayment during 2018-19		Closing Balance
			Principal	**Interest**	
Krishna Bhagya Jala Nigam Limited	6,609.23	1,064.65	586.93	610.61	7,086.95
Karnataka Neeravari Nigam Limited	2,635.58	765.00	411.75	233.48	2,988.83
Karnataka Road Development Corporation Limited	123.16	3.50	12.52	12.84	114.14
Rajiv Gandhi Rural Housing Corporation Limited	1,068.77	-	176.59	86.10	892.18
Karnataka State Police Housing and Infrastructure Development Corporation	8.47	-	3.08	0.71	5.39
Cauvery Neeravari Nigam Limited	1,735.00	500.00	-	164.41	2,235.00
Visvesvaraya Jala Nigam Limited#	497.14	1,190.50	148.57	82.46	1,539.07
Total	**12,677.35**	**3,523.65**	**1,339.44**	**1,190.61**	**14,861.56**

**as there were differences in the closing balances of these entities (2017-18), the principal repayments have been adjusted to bring them in concordance with the closing balances of 2018-19.*

#The difference in opening balance of the entity with that of closing balance of previous year is due to drawal of ₹495.00 crore in 2018-19, sanctioned during 2017-18.

Taking into account the off-budget borrowings of the State, the total liabilities at the end of March 2019 worked out to ₹2,85,238 crore. The rate of outstanding liabilities (including off budget borrowings) to GSDP works out to 20.26 *per cent* at the end of the year. Financing expenditure through off-budget borrowings affects the fiscal parameter targets as stipulated under the KFRA Act. Further, these off-budget borrowings are fraught with the risk of exceeding the Fiscal Deficit limit set for the State especially in such a situation when the Fiscal Deficit-GSDP ratio in Karnataka is already on an increasing trend. Such extra-budgetary liabilities need to be clearly identified and reported.

1.10.4 Public Account transactions

1.10.4.1 Reserve Funds

Reserves and Reserve Funds are created for specific and well defined purposes under the Sector 'J' in the accounts of the State Government (Public Account). These funds are fed by contributions or grants from the Consolidated Fund of India or the State or from outside agencies. The Government contributions are treated as expenditure under the Consolidated Fund. The expenditure relating to the fund is initially accounted for under the Consolidated Fund itself for which the vote of the Legislature is obtained. At the end of the year, at the time of closure of accounts, the expenditure relating to the fund is transferred to Public Account. The funds may further be classified as 'Funds carrying interest' or 'Funds not carrying interest'. Generally, the Reserve Funds are classified under the following three categories based on the sources from which they are fed.

- Funds accumulated from grants made by another Government and at times aided by public subscription, *eg*., Fund formed from subventions from the Central Road Fund;
- Funds accumulated from sums set aside by the Union/State from the Consolidated Fund of India or Consolidated Fund of the State, as the case may be, to provide reserves for expenditure to be incurred by them for particular purposes, *e.g*., Depreciation Fund and
- Funds accumulated from contributions made by outside agencies to the State Government.

As given in 'Notes to Accounts' for the year, out of the total outstanding balance of ₹32,871.47 crore available in various reserve funds as on 31 March 2019, the GoK invested ₹15,871 crore (48 *per cent*). This is mainly in the form of Capital Outlay on infrastructure projects (₹13,101 crore) and investment from Consolidated Sinking Fund of ₹2,770 crore.

Analysis of certain major reserve funds having a bearing on the liability position of the Government, its funding and expenditure are detailed below.

a) Consolidated Sinking Fund

The GoK constituted a Consolidated Sinking Fund in 2012-13 for the amortisation of all loans as recommended by the XII FC and transferred ₹1,000 crore towards its corpus in 2012-13. The fund is administered by the RBI which had invested the corpus in GoI Securities. As per Government notification (February 2013), the State Government may make minimum annual contributions to the fund at 0.50 *per cent* of the outstanding liabilities (excluding off-budget borrowings) at the end of the previous financial year. During 2018-19, against the requirement of ₹1,165 crore, the State Government contributed ₹700.00 crore to the Fund under Major Head 2048 – Contribution to Consolidated Sinking Fund.

The XIV FC in its report had also analysed that the Consolidated Sinking Fund is an integral part of prudent fiscal management. It creates a cushion to meet repayment obligations in times of fiscal/market stress, as it boosts investor confidence and thereby facilitates borrowings in the primary market at a reasonable cost even in normal times. The balance under the fund at the end of the year remained at ₹2,770 crore.

The Finance Department replied (March 2020) that the State Government reiterates its stand on determining the investment under the CSF based on the fiscal space available during the year.

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

b) Green Tax

The GoK vide the Karnataka Motor Vehicles Taxation (Amendment) Act, 2002 introduced collection of a Cess called 'Green Tax'[14] to control air pollution.

Vide para 1.3.1.1 of the Report of the Comptroller and Auditor General of India on State Finances for the year ending 31 March 2016, on 'Improper accounting and non-utilisation of Green Tax Cess collections', it was stated that the green tax cess collected is to be accounted under revenue receipt head '0041-00-102-0-11 – Green Tax'. A Reserve Fund to transfer the Green tax cess collected is opened under Development and Welfare Funds – '8229-00-200-0-63 – Green Tax'.

During the year 2018-19, ₹27.20 crore has been collected under the revenue receipt head apart from the amount of ₹57.89 crore collected from 2006-07 to 2017-18. Hence the total green tax cess collected up to 2018-19 (₹85.09 crore) along with the relevant expenditure needs to be transferred to fund account in Public Account. However, neither the revenue receipts of green tax cess collections nor its corresponding expenditure have been transferred to the Public Account.

The Finance Department replied (March 2020) that the proposal to transfer the receipts for the year 2016-17 to 2018-19 has been taken up with the Administrative department. On successful initiation of operation of the fund, similar action would be taken on the pending dues from 2006-07 and regular transfer made annually thereafter.

c) State Disaster Response Fund

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

The XIV FC recommended that the contribution to the fund is to be in the ratio of 90:10 between GoI and the State Government respectively. The GoI accepted

[14]Green Tax Cess is cess on old vehicles which have completed fifteen years in respect of two wheelers and non-transport vehicles and seven years in respect of transport vehicles at the time of renewal of Certificate of Registration in addition to the tax levied at the rates specified for the purpose of implementation of various measures to control air pollution.

this recommendation with the modification that the percentage share of the States will continue to be as before (75:25) and the flows will also be of the same order as in the existing system and that once GST is in place, the recommendations of the Commission on disaster relief would be fully implemented. With the implementation of GST *w.e.f.* July 2017, the contribution to the fund during 2018-19 was in the ratio of 90:10.

During 2018-19, an aggregate amount of ₹1,279.84 crore was transferred to the fund account (contribution from GoI of ₹288 crore and the State's contribution of ₹32 crore to the SDRF and ₹959.84 crore GoI contribution from National Disaster Response Fund). Out of the total fund balance of ₹1,322 crore, ₹887 crore was released to the Deputy Commissioners of the districts under the Major Head '2245 - Relief on account of Natural Calamities'. The balance in the fund as on 31 March 2019 was ₹434.62 crore.

Further, the State Government had to pay interest to the SDRF at the rate applicable to overdrafts and credit the same on a half yearly basis by a charge to Major Head '2049-Interest Payments'. However, no interest was paid on the opening fund balances during 2018-19. The Finance Department agreed (March 2020) that it had not paid interest on the opening balance of ₹41.98 crore and stated that it would be provided in the Supplementary Estimates of 2020-21.

d) Forest Development Fund

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

There was a balance of ₹2,947.09 crore as on 1 April 2018 and during the year 2018-19, an amount of ₹26.38 crore was credited to the fund. However, expenditure of ₹299.20 crore incurred during the year had not been transferred to the fund. The balance in the fund was ₹2,973.47 crore at the end of March 2019.

Regarding non-transfer of expenditure to KFDF, the department replied (March 2020) that decision on operating the fund will be communicated on receipt of the awaited court orders. The reply of the department is not tenable as the writ petition filed relates to the enhancement of Forest Development Tax from 5 to 12 *per cent* and do not relate to transfer of expenditure from the Consolidated Fund to the KFDF account.

e) Consumer Welfare Fund

State Consumer Welfare Fund has been established under Rule 3 of the Karnataka State Consumer Welfare Fund Rules, 2005, under Reserve Fund (not bearing interest) under the Major Head '8229-00-123-Consumer Welfare Fund' in the Public Account.

According to the provisions contained in these rules, the fund shall be credited with the seed money released by the GoI, assistance/grants provided by the Central Government for strengthening consumer movement in the State, matching grants or any other assistance by the State Government and the Court fee accrued with the District and State Consumer fora, any penalty paid by the manufacturers of consumer products or service providers and any income from the investment of the fund balances and any other amount received by the State Government for the purpose of the fund. The accumulation in the fund shall be utilised by the State Government for the welfare of the consumers.

During 2018-19, receipts amounting to ₹0.41 crore accounted under the Head 1456-00-800-0-01 were to be transferred to the fund account. Though provision was also made in the budget under HOA '3456-00-797-0-04-261' for transfer of receipts, no amount was transferred to the fund. A provision of ₹0.42 crore was made in the budget under HOA '3456-00-104-0-02' towards expenditure but no expenditure had been booked during the year. The opening and closing balances at the credit of the fund remained at ₹1.43 crore.

The Finance Department replied (March 2020) that it is in communication with the Food and Civil Supplies department to initiate transfer of receipts to the fund and meet the expenditure out of the fund account.

Impact of transactions of Reserve Funds

The impact/result of the transactions of the above reserve funds during 2018-19 is given below.

- Shortfall in contribution to the Consolidated Sinking Fund had resulted in overstatement of revenue surplus and also understatement of fiscal deficit;
- Non-transfer of both receipts and expenditure to the Green Tax Fund in Public Account resulted in overstatement of revenue receipts/expenditure;
- Transferring only the receipts, without transferring the corresponding expenditure to Forest Development Fund had resulted in overstatement of revenue expenditure, fiscal deficit and understatement of revenue surplus;
- Non-transfer of receipts and expenditure into Consumer Welfare Fund had the effect of overstatement of revenue receipts/expenditure; and
- The unspent balances in the Personal Deposit accounts of the Deputy Commissioners for SDRF were not reflected in the accounts but merged with the general balances. These unspent balances resulted in understatement of the fund account in Public Account and had also resulted in overstatement of expenditure towards calamity relief in the Consolidated Fund.

Inoperative Reserve Funds

As at the end of 31 March 2019, out of 125 Reserve Funds, 106 funds remained inoperative. Of these 106 inoperative reserve funds, 83 reserve funds had zero balance, 12 reserve funds had a credit balance of ₹3,514.84 crore and 11 reserve funds had a debit balance of ₹5,239.89 crore as on 31 March 2019. The impact on accounts is that the liability of the Government has decreased by ₹1,725.05 crore (net) under reserve funds.

1.10.5 Contingent liabilities

1.10.5.1 Status of guarantees

Guarantees are contingent liabilities on the Consolidated Fund of the State in case of default by the borrower for whom the guarantee was extended. The details of the last five years are available in **Appendix 1.4**.

The Karnataka Ceiling on Government Guarantees Act, 1999 provides for a cap on outstanding guarantees extended by the Government as on first day of April of any year at 80 *per cent* of the State's revenue receipts of the second preceding year. The outstanding guarantees on 1 April of each year were within the prescribed limit. The outstanding guarantees amounting to ₹24,091 crore at the end of the year 2018-19 (principal + interest) included guarantees extended to 158 institutions/ companies under irrigation (₹13,849 crore), co-operation (₹1,798 crore), finance (₹1,285 crore), power (₹4,234 crore), housing (₹2,083 crore), transport (₹288 crore) and other sectors (₹554 crore).

Against the total estimated guarantee commission of ₹433.30 crore receivable as reported by the State Government, only ₹226.66 crore was received during 2018-19. The guarantee commission received includes book adjustment made by the State Government towards the guarantee commission payable to it by Rajiv Gandhi Rural Housing Corporation Limited (₹12.78 crore), Karnataka Road Development Corporation Limited (₹1.83 crore) and Power Company of Karnataka Limited (₹39.58 crore) by way of subsidies/Grants-in-aid/financial assistance. Consequently, the net shortfall in guarantee commission received was ₹260.83 crore (₹433.30 crore minus ₹172.47 crore, excluding book adjustment of ₹54.19 crore).

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

The PAC also recommended (July 2015) that suitable efforts should be made to operate and continue the Guarantee Reserve Fund. However, the State Government is yet to constitute the Guarantee Reserve Fund.

The Finance Department replied (March 2020) that the operation of the Guarantee Reserve Fund by the Government will be initiated from the financial year 2020-21.

1.11 Debt Management

1.11.1 Debt Profile

The revenues of the Government are of two types *viz*. current revenues which are termed as revenue receipts, realised through administration of taxes, user charges and grants received from GoI and capital receipts that comprise of borrowings, non-debt receipts and surplus from Public Account. For working out the borrowings, certain book adjustments are also reckoned as if these are cash transactions. Such transactions are in the nature of subsidy dues of electricity supply companies, student/elderly concession passes *etc*., which on one side are shown as expenditure and on the other, as revenues, under relevant receipt heads (tax/non-tax). Such accounting amounted to ₹2,075 crore during 2018-19. These transactions had the impact of showing the tax/non-tax revenues without actual cash flow. Such revenue, adjusted through book adjustment was ₹1,955 crore (tax revenues) and ₹120 crore (non-tax revenues) constituting one *per cent* of revenue receipts.

Table 1.28 gives details of outstanding fiscal liabilities of the Government under Consolidated Fund and Public Account compared with the per capita liability.

Table 1.28: Debt Profile of the State

(₹ in crore)

Sl. No.	Borrowings through	2014-15	2015-16	2016-17	2017-18	2018-19
a	**Open market loans**	69,419	84,334	1,08,359	1,25,708	1,57,890
b	**Negotiated loans**	3,318	3,482	3,973	4,289	4,430
c	**NSSF loans**	20,167	21,729	20,157	18,584	16,989
d	**GoI loans**	12,681	13,002	13,794	14,555	14,657
e	**Public Account Borrowings**	52,968	53,076	64,788	69,922	76,410
f	**Off Budget Borrowings**	5,726	7,699	10,248	13,173	14,862
g	**Total Fiscal Liabilities**	1,64,279	1,83,322	2,21,319	2,46,231	2,85,238
h	**Population (in crore)**	6.35	6.42	6.49	6.56	6.63
i	**Per capita debt ratio (in ₹)**	25,871	28,555	34,102	37,535	43,022

Source: Finance Accounts

During the period 2014-15 to 2018-19, the Market Loans increased by 127 *per cent* and the GoI loans by 16 *per cent*. The Public Account borrowings increased from ₹52,968 crore in 2014-15 to ₹76,410 crore in 2018-19, an increase of 44 *per cent*. The off-budget borrowings increased from ₹5,726 crore in 2014-15 to ₹14,862 crore in 2018-19, an increase of 160 *per cent*. The per capita debt ratio had significantly increased from ₹25,871 in 2014-15 to ₹43,022 in 2018-19, an increase of 66 *per cent*.

1.11.2 Debt Sustainability

Apart from the magnitude of the debt of the State Government, it is important to analyse various indicators that determine the debt sustainability of the State. Debt sustainability is defined as the ability of the State to maintain a constant debt-GDP ratio over a period of time and also embodies the concern about the ability to service its debt. This section assesses the sustainability of debt of the State Government in terms of debt as a percentage of GSDP, rate of growth of outstanding debt, interest payments/revenue receipts ratio and net debt available to the State. **Table 1.29** analyses the debt sustainability of the State according to these indicators for the period from 2014-15 to 2018-19.

Table 1.29: Debt Sustainability indicators and trends

(in per cent)

Debt Sustainability Indicators	2014-15	2015-16	2016-17	2017-18	2018-19
Debt*/GSDP	11.57	12.10	12.92	12.44	13.77
Rate of growth of Outstanding Debt*	19.28	16.06	19.37	11.52	18.90
Rate of growth of GSDP#	11.91	14.36	10.59	14.67	6.24
Average interest rate of Outstanding Debt (Interest payments/(opening balance of Public Debt +closing balance of Public Debt/2)	10.10	9.94	9.56	9.68	9.30
Interest Payment/Revenue Receipts	9.41	9.55	9.65	10.18	10.07
Net availability of borrowed funds (₹in crore)	9,324	8,060	13,609	5,005	17,766
Debt Repayment/ Debt Receipts**	57.37	61.75	56.32	80.08	57.61
Maturity profile of Internal debt (in years) (₹ in crore)					
0-1					0.64(-)
1-3					18,099.41(10)
3-5					22,540.29(13)
5-7					37,902.47(21)
7 and above					1,00,766.50(56)

Source: Finance Accounts.

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

GSDP growth rate for 2014-15 to 2017-18 are taken from Economic Survey, Government of Karnataka 2018-19 and for 2018-19, as conveyed by Ministry of Finance, GoI, vide letter dated 20 March 2018.

** *The figures differ from those of earlier reports due to inclusion of interest payments.*

- The rate of growth of outstanding debt was 18.90 *per cent* during 2018-19, being 7.38 *per cent* increase over the previous year (11.52 *per cent*);
- Though there was decrease in Debt Repayment/Debt Receipts ratio, there was increase in total debt receipts by ₹16,792 crore due to increase in market loans during 2018-19 and debt repayment by ₹2,814 crore; and
- Increase in net debt available to the State was mainly due to increase in receipt under internal debt from ₹23,179 crore in 2017-18 to ₹40,470 crore in 2018-19 (**Appendix 1.4**) and off-set by decrease of ₹499 crore under Loans and Advances from GoI.

To examine debt sustainability, it is also important to study the growth in the debt and assess the fiscal balance (especially primary balance) being generated which would worsen or improve the debt situation.

The public debt sustainability of Karnataka was analysed based on Domar's model. E.D Domar(1944) explained that a continuous Government borrowing results in an ever rising public debt, the servicing of which will require higher taxes which would destroy the economy. Hence, he assumed that the indebtedness degree needs to converge to a finite value, in order to avoid further increasing of the tax burden. Thus, Domar model concludes that for sustainability of public debt, the real growth of economy should remain higher than the real interest rates. The conditions to ensure the stability of public indebtedness are indicated in the **Table 1.30**.

Table 1.30:The dynamics of public debt depending on the interest rate, the growth rate of GDP and the primary budget balance

g-r/s	s<0 (primary deficit)	s>0 (primary surplus)
g-r>0 (strong economic growth)	Public debt will converge to a stable level greater than 0	Public debt will converge to a stable level lesser than 0 leading to public savings
g-r<0 (slow economic growth)	Public debt will increase indefinitely, without converging to a stable level	Undefined situation

g: *Real Economic Growth Rate;* ***r:*** *Real Interest Rate;* ***s:*** *Primary Deficit/Surplus*.

Applying the analysis to Karnataka showed that the public debt has converged to a stable level as shown in the **Table 1.31**.

Table 1.31:Analysis of debt sustainability using Domar's model

Year	Real growth rate(g)*	Real interest rate(r)	g-r	Primary Deficit/Surplus (s) (₹ in crore)	Remarks
2015-16	11.09	3.26	7.83	(-) 7,826	As g-r>0 and s<0, public debt will converge to a stable level.
2016-17	7.61	4.69	2.92	(-) 15,814	
2017-18	10.41	6.63	3.78	(-) 16,128	
2018-19	9.59	6.00	3.59	(-) 21,828	

Real growth rate is calculated at real GDP (in *per cent*).

Real interest rate is calculated as interest rate minus inflation (in *per cent*).

**Real growth rate are GSDP at constant prices taken from the Economic Survey, Government of Karnataka 2018-19*.

Even though the primary deficit increased over the time, as 'g' was greater than 'r', the public debt was sustainable.

From the **Table 1.31**, it is evident that Karnataka has so far stabilised its debt level. An area of concern is decline in the real growth rate, which decreased from 11.09 in 2015-16 to 9.59 in 2018-19 and the consequent impact was on the g-r, which had also decreased from 7.83 in 2015-16 to 3.59 in 2018-19. This indicates that with increased primary deficit and lower g-r ratio, the State may reach an 'undefined situation' as per Domar, if the real rate of growth is not adequately addressed.

1.11.3 Interest on Off-Budget Borrowings

The ratio of interest payment to revenue receipts (IP/RR) determines the debt sustainability of the State. During 2018-19, the IP/RR ratio of the State was 10.07 *per cent*, which is 0.95 *per cent* more than the norm of 9.12 *per cent* fixed by XIV FC. During 2014-15 to 2018-19, the ratio was between 9.41 *per cent* and 10.18 *per cent* on account of buoyancy in revenue receipts. By an amendment to KFRA in February 2014, the scope of the total liabilities was amplified to include the borrowings by PSU and SPVs and other equivalent instruments, where the principal and /or interest are to be serviced out of the State Budget. Thus, the off-budget borrowings are part of the State's own liabilities for working out the total liabilities of the State.

The State Government in its MTFP 2019-23 on the ratio of IP/RR had included the interest payment serviced under the HOA 2049 only. But the interest on off-budget borrowings which are serviced through other heads of account is not part of this ratio of IP/RR. Due to non-inclusion of interest on off-budget borrowings, the IP/RR ratio was between 9.03 *per cent* and 9.47 *per cent* during the period 2014-15 to 2018-19. The State Government should also consider inclusion of interest on off-budget borrowings for working out this ratio, in the MTFP.

After audit observation in SFAR since last year, the Finance Department replied (March 2020) that inclusion of interest on off-budget borrowings to work out the ratio of IP/RR in the MTFP of the State Government will be considered.

1.11.4 Debt stability

Fiscal liabilities are considered sustainable if the Government is able to service these liabilities over the foreseeable future and the debt-GSDP ratio does not grow to unmanageable proportions. A necessary condition for stability is that, if the rate of growth of economy exceeds the cost of borrowings, the debt-GSDP ratio is likely to be stable provided primary balances are positive/zero/ moderately negative. Primary revenue balance is the difference between revenue receipts and primary revenue expenditure and indicates whether the balance of revenue receipts left out after meeting current revenue expenditure is sufficient for meeting the interest expenditure. During 2014-15 to 2018-19, the primary revenue balance was positive and sufficient to meet incremental interest expenditure (**Appendix 1.4**).

1.11.5 Sufficiency of incremental non-debt receipts

Another indicator of debt sustainability is the adequacy of incremental non-debt receipts of the State to cover the incremental interest liabilities and incremental primary expenditure. Debt sustainability is facilitated if the incremental non-debt receipts[15] meet the incremental interest burden and the incremental primary expenditure. Negative resource gap indicates non-sustainability of debt while positive resource gap indicates sustainability of debt. The details for the last five years have been indicated in **Table 1.32**.

[15] Incremental non-debt receipts are the increase or decrease in revenue receipts and non-debt capital receipts over the previous year

Table 1.32: Sufficiency of incremental non-debit receipts

(₹ in crore)

Sl. No.		2014-15	2015-16	2016-17	2017-18	2018-19
1	Incremental Non-Debt Receipts	14,497	14,993	14,112	13,800	17,863
2	Incremental Interest Payments	1,777	1,539	1,507	2,123	1,641
3	Incremental Primary Expenditure	15,204	13,047	22,101	14,114	23,563
4	Resources Gap	(-) 2,484	407	(-) 9,496	(-) 2,437	(-) 7,341

The resource gap, which was negative in 2014-15 turned positive during 2015-16 and again turned negative from 2016-17 to 2018-19. This was mainly on account of the growth of revenue receipts being less than the growth of total expenditure. This meant that the State had to depend on borrowed funds for meeting current revenue and capital expenditure.

1.11.6 Net availability of borrowed funds

Debt sustainability also depends on the ratio of debt redemption (principal plus interest payments) to total debt receipts and application of available borrowed funds. The ratio of debt redemption to debt receipts indicates the extent to which the debt receipts are used in debt redemption indicating the net availability of borrowed funds for capital spending. The debt redemption to debt receipts ranged between 56.32 *per cent* and 80.08 *per cent* during 2014-15 to 2018-19. During 2018-19, the debt redemption ratio decreased by 22.47 *per cent* compared to the previous year.

1.12 Fiscal parameters

Three key fiscal parameters – revenue, fiscal and primary deficits indicate the extent of overall fiscal imbalances in the finances of the State Government during a specified period. The deficit in the Government accounts represents the gap between its receipts and expenditure.

The nature of deficit is an indicator of the prudence of fiscal management of the Government. Further the ways in which the deficit is financed and the application of resources raised are important pointers to its fiscal health. This section presents trends, nature and magnitude and the manner of financing these deficits and also the assessment of actual levels of revenue and fiscal deficits *vis-à-vis* targets set under KFRA for the financial year 2018-19.

1.12.1 Trends in deficits

a) Revenue Surplus

Revenue surplus represents the difference between revenue receipts and revenue expenditure. Revenue surplus helps to decrease the borrowings. The revenue surplus had increased from ₹528 crore in 2014-15 to ₹4,518[16] crore in 2017-18,

[16]includes ₹3,400 crore of loan waiver which was wrongly classified as capital expenditure.

but decreased to ₹679 crore in 2018-19. Considerable decrease in revenue surplus was on account of less growth rate of revenue receipts (12 *per cent*) as against 15 *per cent* growth rate of revenue expenditure during 2018-19.

The State Government in MTFP (2019-23) had stated that 'though the size of budget had gone up over the years, it is characterised by a substantial portion being in the nature of committed expenditure. This reduces maneuverability around expenditure decisions and the State has limited revenue space available after accounting for its committed expenditure needs'. The State Government needs to make medium term corrections on the expenditure side to moderate such committed expenditures.

b) Fiscal Deficit

Fiscal deficit represents the net incremental liabilities of the Government or its additional borrowings. The shortfall could be met either by additional public debt (internal or external) or by the use of surplus funds from Public Account. Fiscal deficit trends along with the trends of the deficit relative to key components are indicated in **Table 1.33**.

Table 1.33: Fiscal deficit and its parameters

(₹ in crore)

Period	Non-Debt Receipts	Total Expenditure	Fiscal deficit	Fiscal Deficit as *per cent* of		
				GSDP	Non-debt receipts	Total expenditure
2014-15	1,04,236	1,23,812	19,576	2.14	18.78	15.81
2015-16	1,19,229	1,38,398	19,169	1.89	16.08	13.85
2016-17	1,33,341	1,62,005	28,664	2.53	21.50	17.69
2017-18	1,47,141	1,78,241	31,101	2.37	21.14	17.45
2018-19	1,65,004	2,03,446	38,442	2.73	23.30	18.90

Source: Finance Accounts

During the period from 2014-15 to 2018-19, fiscal deficit as a percentage of GSDP increased from 2.14 *per cent* to 2.73 *per cent*, with marginal variations in between. The fiscal deficit as *per cent* of GSDP, non-debt receipts and total expenditure increased during 2018-19 over the previous year, on account of increase inborrowings due to decrease in revenue surplus.

c) Primary Deficit

Interest payments represent the expenditure of past obligations and are independent of ongoing expenditure. To look at the imbalances of current nature, these payments need to be separated and deducted from the total imbalances. The Primary Deficit is the fiscal deficit net of interest payments. Thus, the primary deficit indicated total borrowing requirement of the Government other than interest payment. The primary deficit and its parameters for the last five years are indicated in **Table 1.34**.

Table 1.34: Primary deficit and its parameters

(₹ in crore)

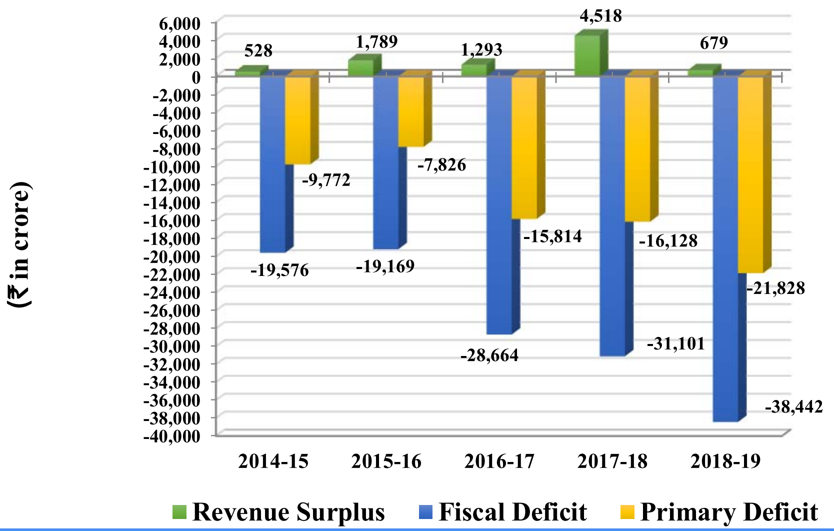
Period	Fiscal Deficit	Interest Payments	Primary Deficit
2014-15	19,576	9,804*	9,772
2015-16	19,169	11,343*	7,826
2016-17	28,664	12,850*	15,814
2017-18	31,101	14,973*	16,128
2018-19	38,442	16,614*	21,828

Source: Finance Accounts

**includes interest payments of ₹400 crore, ₹597 crore,₹817 crore ₹1,043 crore and ₹1,191 crore towards interest on off-budget borrowings during 2014-15, 2015-16, 2016-17, 2017-18 and 2018-19 respectively.*

During 2016-17 to 2018-19, the fiscal deficit was more than twice the amount of interest payments. Containing interest payments would help to increase revenue surplus which in turn can be utilised towards capital expenditure. The trends in deficit indicators over the period from 2014-15 to 2018-19 is shown in **Chart 1.15**.

Chart 1.15: Trends in Fiscal Indicators



1.12.2 Composition of fiscal deficit and its financing pattern

The financing pattern of fiscal deficit has undergone a compositional shift as reflected in the **Appendix 1.12**. Breakdown of fiscal deficit reveals the extent of various borrowings resorted to by the State to meet its requirement of funds over and above revenue and non-debt receipts.

The components of fiscal deficit are Deduct Revenue Surplus, Net Capital Expenditure and Net Loans and Advances. Since the State had attained revenue surplus in 2004-05 itself, the surplus on revenue account along with market borrowings, loans from GoI *etc*., were utilised to finance capital expenditure. As seen from the appendix, the capital expenditure could be financed by revenue surplus to the extent of three, nine, five and 15 *per cent* in 2014-15, 2015-16, 2016-17 and 2017-18 respectively. In 2018-19, revenue surplus could finance only two *per cent* of capital expenditure due to the huge decrease in revenue surplus.

As a result, in 2018-19, there was increase in market borrowings and their share in financing fiscal deficit increased to 84 *per cent*. There was decrease in loans from GoI, loans from financial institutions and suspense and miscellaneous balances which comprised transactions relating mainly to cheques and bills, the net transactions of which were added for financing the fiscal deficit over the previous year. There was increase in Deposits and Advances, Small Savings, Provident Fund marginally over the previous year. As per recommendations of the XIV FC, the State Governments are excluded from the operations of NSSF with effect from 1 April 2015. As such there were no receipts under NSSF from GoI from the financial year 2016-17 onwards.

1.13 Follow up

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

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

1.14 Conclusion and recommendations

Fiscal Position

The State continued to maintain revenue surplus during 2014-15 to 2018-19. During 2018-19, it continued to keep fiscal deficit relative to GSDP below the limit prescribed under KFRA.

Failure to carry out required adjustment (₹1,165 crore) and contributing partially (₹700 crore) to the Consolidated Sinking Fund resulted in maintaining surplus on revenue account. The fiscal deficit during 2018-19 was 2.73 *per cent* of GSDP (₹14,08,112 crore), which was within the limit laid down under KFRA.

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

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

State's own resources

The ratio of State's tax revenue to GSDP showed a declining trend from 7.68 *per cent* in 2014-15 to 6.88 *per cent* in 2018-19. There was no improvement in the ratio of non-tax revenue to GSDP and it continued to be less than one *per cent* of GSDP during 2014-15 to 2018-19 also.

Recommendation: Non-tax revenues require significant thrust by rationalising user charges and reviewing the same regularly as recommended by the FMRC (MTFP 2019-23) and the Expenditure Reforms Commission.

Revenue expenditure

During 2018-19 there was 16 *per cent* growth under the social sector over the previous year though the share of expenditure on social services to total revenue expenditure remained at 41 *per cent* in 2017-18 and in 2018-19. The growth in expenditure on economic services was at six *per cent* during 2017-18 where as it was 13 *per cent* in 2018-19.

Eighty-five *per cent* of revenue expenditure comprised committed expenditure on salaries, interest payments, pensions, subsidies, Grants-in-aid and financial assistance, administrative expenditure and devolution to local bodies. Expenditure on subsidy of ₹19,177 crore contained subsidy amounting to ₹3,777 crore which was in the form of financial assistance under various schemes of socio-economic services.

Recommendations: Adequate priority needs to be given to both education and health sectors as the ratios under these sectors are below GCS average during 2018-19. Since the costs of salary, pension and interest are inflexible, the expenditure on subsidies, Grants-in-aid other than to local bodies, which are increasing steadily, requires utmost attention from the State Government through better targeting of beneficiaries.

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

Quality of expenditure

The share of capital expenditure to total expenditure during 2018-19 (19 *per cent*) decreased by one *per cent* from that of the previous year. The percentage of developmental expenditure to total expenditure remained at 76 *per cent* in 2017-18 and 2018-19. Funds aggregating ₹3,128 crore were locked up in incomplete projects at the end of 2018-19.

The return from investment of ₹66,518 crore as of 31 March 2019 in Companies/Corporations was negligible (₹38.30 crore). The investment included ₹38,949 crore (59 *per cent*) to Companies/Corporations which were under continuous loss.

Recommendations: The State Government should formulate guidelines for quick completion of incomplete projects and strictly monitor reasons for time and cost overrun with a view to take corrective action. In addition, it should give priority to works nearing completion as suggested by FMRC.

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

Funds and other Liabilities

Reserve funds of the State *viz*., corpus fund of Guarantee Redemption Fund was not created. The interest of ₹903.71 crore accrued on re-investment made on Consolidated Sinking fund balances by RBI did not pass through the accounts. During the year, Green Tax collections of ₹27.20 crore were not transferred to fund account.

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

Debt sustainability

Open Market Loans had a major share (55 *per cent*) in the total fiscal liabilities of the State. The burden of interest payments measured by interest payments to revenue receipts ratio (IP/RR) was between 9.41 *per cent* and 10.18 *per cent* during 2014-15 to 2018-19. The net debt available to the State during 2018-19 (₹17,766 crore) increased by 255 *per cent* when compared to the previous year. Real growth rate decreased from 11.09 *per cent* in 2015-16 to 9.59 *per cent* in 2018-19. The State had limited revenue space available after accounting for its committed expenditure needs.

Recommendations: Interest on Off-budget borrowings should form part of the calculation of IP/RR ratio. The State Government needs to make medium term corrections on the expenditure side to moderate committed expenditures. The State needs to adequately address the real rate of growth.

The Finance Department stated (March 2020) that the department was in correspondence with the Pr. AG (A&E) and trying to adopt judicious practices in the accounting structure. However, as per the recommendations made, needful action would be initiated at the earliest in the ensuing years.