

State Update – Government of Karnataka

The state of Karnataka has registered a growth of more than 7% between FY07 to FY12, establishing itself as a strong growth driver for the country. The state covers an area of 191,976 square km or 5.8% of the total geographical area of India. The state contributes around 5.5% to India's GDP, with agriculture's share at 6%, industry at 5.6% and services contribution at 5.3%. At the micro-level, the state records a per capita income of Rs 69,051 (as of 2011-12), above the national average level of Rs 61,564 for the same year, indicative that benefits of growth are reaching at the individual level.

This update broadly covers the current economic scenario in the state of Karnataka along with the government's performance in terms of fiscal management; the state recently having announced its budget for 2013-14.

Demographics

- **Population** - 6.1 crore persons (as on March 1, 2011), with decadal growth of 15.1% (2001-2011), lower than national level decadal growth rate of 17.6%. Population density of 319 persons per square kilometre, below national average of 382 persons per square kilometre. Birth rate of 18.8%, death rate of 7.1%.
- **Urbanization** – 38.57% of population stays in urban areas
- **Literacy** – 75.6% (as per Census 2011)
- **Gender ratio** - 968 females per thousand males (Census 2011)

Karnataka's Economy

Karnataka's economy has also been affected by the macro-economic environment prevailing at the national level. As per the Advance Estimates released by the Directorate of Economics and Statistics, the GSDP (current prices) growth rate in FY13 is estimated to be 13.9% compared with 14.0% in the previous year.

The real GSDP growth rate has recorded only a moderate increase from 5.5% in FY12 to 5.9% in FY13. The real growth has been at the same level for the industrial sector. After recording a negative growth in FY12, agricultural sector has seen a moderate increase in its growth rate at 1.8% in FY13. This can be attributed to some extent to the concerted efforts by the State in pushing for farmer friendly policies and making agricultural credit available at subsidized interest rates. However the largest contributor to GSDP, the services sector, has slipped to 8.9% growth from 9.5% growth in FY12, attributed to the global slowdown in economy. Software exports are affected due to lesser global demand. Lower growth of agriculture sector combined with near same growth in industrial sector and a moderate increase in services sector growth has effectively pulled down the overall GSDP growth rate to below 6%.

Budget 2013-14

Table 1 presents actual accounts (A) for the year 2011-12 and revised estimates (RE) for accounts in 2012-13 along with budgeted estimates (BE) for the year 2013-14. We examine Budget 2013-14 for the state with respect to its revenue and capital accounts and performance thereof –

Revenue Account Profile

Karnataka has maintained a revenue surplus position since FY07 in line with the Thirteenth Finance Commission (ThFC) roadmap for fiscal consolidation for state governments. However, the revenue surplus of the state has been declining and is budgeted at Rs 585 crore in FY14.

Table 1: Revenue Account FY12 – FY14 (Rs crore)

Revenue A/c Heads	FY12 (A)	FY13 (RE)	FY14 (BE)
Revenue Receipts	69,806	84,884	94,216
<i>Tax revenue</i>	<i>46,476</i>	<i>53,492</i>	<i>61,012</i>
<i>Non-tax revenue</i>	<i>4,087</i>	<i>3,796</i>	<i>3,838</i>
Revenue Expenditure	65,115	83,941	93,631
<i>Development expenditure</i>	<i>44,326</i>	<i>57,803</i>	<i>60,429</i>
<i>Non-development expenditure</i>	<i>16,445</i>	<i>21,127</i>	<i>27,017</i>
Of which, interest expenses	6,062	6,852	8,500
Revenue Surplus	4,691	943	585

Source: Budget 2013-14, Government of Karnataka

- No new tax proposals were introduced this year.
- Tax allocations from the centre to states have been sluggish over the years, particularly because central tax collections have moderated against a constrained economic environment
- Non-tax revenue receipts (royalties, fees, user charges, central government compensations to state, etc.), is one component that is heavily influenced by extraneous factors. Given that its share in the revenue receipts is just about 4.0% - 6.0%, it does not critically impact budget performance, particularly when in the case of Karnataka own-revenue funds account for 63% - 67% of revenue flows.
- In terms of expenditure, most of the government expenses are developmental in nature and targeted towards funding the creation of social services (education, health, social development, etc.), which in turn helps support improve quality of human capital in the state.
- The state however needs to take proactive measures in curtailing growth in its debt-service obligations, since the growth in interest expense is expected to increase significantly from 13% in FY13 (RE) to 24.1% in FY14 (BE).

Capital Account Profile

The capital account of the state remains in deficit, primarily because project capital expenditure of the state remains high. This may however, be viewed as a positive; with the state government increasing capital expenditure directed towards the creation of physical infrastructure.

Table 2: Capital Account FY12 – FY14 (Rs crore)

Capital A/c Heads	FY12 (A)	FY13 (RE)	FY14 (BE)
Capital Receipts	9,688	14,902	21,767
<i>Internal Debt</i>	<i>8,091</i>	<i>12,677</i>	<i>19,301</i>
<i>Loans from Gol</i>	<i>1,267</i>	<i>1,969</i>	<i>2,231</i>
Capital Expenditure	20,641	20,082	23,374
<i>Capital Outlay</i>	<i>15,506</i>	<i>14,877</i>	<i>16,374</i>
<i>Repayment of Public Debt</i>	<i>3,320</i>	<i>3,644</i>	<i>5,840</i>
Capital Deficit	10,953	5,180	1607

Source: Budget 2013-14, Government of Karnataka

- Karnataka has been self-reliant in its capital fund base, with internal debt accounting for majority share (nearly 84% of total capital receipts in FY12). Consequently, share of loans from the Government of India (Gol) in capital receipts of the state has been declining, indicating lower dependence on central government borrowings.
- The State of Karnataka has endeavored to maintain its Gross Public Debt at prudent levels as required under the fiscal management principles of KFRA.
- In recent years, the borrowing profile of the State has shown an increasing trend towards more reliance on open market borrowings, while share of NSSF loans has reduced considerably. The Committee for comprehensive review of NSSF has recommended that the mandatory component of investment of net small savings collections in State Government Securities be reduced from 80% to 50%. Government of India following the recommendation of Committee for comprehensive review of NSSF provided the States' with an option of either 80% or 50% for the mandatory borrowing. In view of the higher cost of borrowing from NSSF loans, State Government has opted for 50% share of net collections following FY13. Hence the share of NSSF loan in borrowings is expected to come down in the medium term.

Budget Management & Fiscal Prudence

The State Government has been on the path of Fiscal Consolidation ever since the passing of Fiscal Responsibility Legislations (FRLs) like Karnataka Fiscal Responsibility Act (KFRA), 2002 and Karnataka Ceiling on Government Guarantee Act (KCGGA), 1999. It is to the State's credit that such FRLs were brought in much before Government of India had enacted the Fiscal Responsibility and Budget Management Act (FRBM) 2003. Therefore State has chosen on its own volition to bring in fiscal discipline in the management of its finances.

Based on the Thirteenth Finance Commission's recommendations for following a time bound fiscal road map, the State Government vide KFR (Amendment) Act, 2011 has incorporated statutory year-wise ceilings for key fiscal and debt indicators like Fiscal Deficit, Revenue Deficit and Outstanding Debt as percentage of GSDP for the years leading up to 2014-15. Table 3 below provides a snapshot of timeframe and targets for fiscal consolidation and achievement of the same by the state.

Table 3: Key Fiscal and Debt Norms

Particulars	Statutory Norm	Compliance by State
Revenue Deficit (RD)	Reduce RD to Nil by FY06	Achieved in FY05 itself. Maintained adequate Revenue Surplus thereafter
Fiscal Deficit (FD)	Reduce FD to not more than 3% of GSDP by FY06	Maintained FD below 3% since FY05*
Total Liabilities to GSDP (TL/GSDP)	TL/GSDP to not exceed 25.2% by FY15	Achieved in FY11 much ahead of timeline prescribed
Outstanding Guarantees (OG)	OG on 1st April of any year should not exceed 80% of Revenue Receipts of second preceding year.	Since enactment of Karnataka Guarantee of Ceiling Act, 1999 this limit has never been breached

Source: Budget 2013 -14, Government of Karnataka,

**Except in the FY08-11 where it was fixed based on the advice of the Central Government*

- The State continued to maintain a Revenue Surplus at a level slightly higher than budgeted estimate, thereby ensuring that entire current expenditure of the State was being met only from Revenue Receipts and the Revenue Surplus and Capital Receipts were employed purely for capital expenditure. Fiscal Deficit of the state at 2.9% in FY13 (RE) has been well within the prudential norm and is expected to be marginally lower at 2.8% in FY14 (BE).
- The stock of outstanding liabilities of the state is at Rs 114,252 crore in FY13, budgeted to further increase to Rs 130,964 crore in FY14. The 13th Finance Commission had laid down the road map for reducing the debt to GSDP ratio for Karnataka to 25.2% by FY15, which the state achieved in FY11 itself with the ratio standing at 22.6% in FY13 (RE).
- Karnataka was one of the few States in the country which had not yet set up the CSF. RBI had been persistently advocating the need for creating a fund specifically to provide cushion to meet its repayment obligations during times of fiscal stress and enables market borrowing at reasonable cost. The state hence decided to setup a Consolidated Sinking Fund and contribute Rs 1,000 crore to this fund by making provision in the FY13 budget.
- The state also has well-managed short-term liabilities, as is evident from the fact that it has not availed of the ways and means advances (WMA) or overdraft facility of the RBI to tide over temporary liquidity constraints.

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