

**MEDIUM TERM FISCAL PLAN
FOR KARNATAKA
2005-2009**

**Finance Department
2005**

MEDIUM TERM FISCAL PLAN 2005-09

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1.1.1 The Indian Constitution entrusts the states with major responsibilities in the areas of human and physical infrastructure development. These responsibilities require major expenditures by the states, but the resource base of the states are insufficient to meet these expenditure responsibilities. Thus, there has always been a mismatch between state's own resources and expenditure requirements. Such imbalances are addressed through a complex system of intergovernmental transfers from Union Government to the State Governments. The model of centralised planning and allocation of resources to the States through Planning Commission and a number of centrally assisted programmes, the Union Government influences the development strategy of states. This dependence of States on the Union Government has led to prominence of Centre in the approach towards development.

1.1.2 1990s witnessed a remarkable transition in Indian economy. With the process of liberalization, involvement of private sector and, more importantly, the States in development has increased. It created opportunities for economic activities and triggered economic growth. New economic activities required the participation of state governments leading to fresh expenditure commitments. But, the states continued to meet the social obligations devised in pre-liberalization era. Instead of taking steps for mobilization of own resources through tax and non-tax measures and to cut down unnecessary non-productive expenditures, the states sought to finance their increasing needs of expenditure through different forms of transfers from the Union Government and by loans.

States faced fiscal stress in late 1990s due to increase in salary expenditure and adoption of unsustainable plan size

1.1.3 During ten year period beginning in the mid 1980s, there was a slow but steady deterioration in the revenue deficits of the states. Starting in 1997-98, however, this steady decline turned into a sharp deterioration. Revenue deficits, which averaged 0.8% of GDP in 1987-88 to 96-97, reached a level of 2.8 % of GDP by 2000-01. States did not make sufficient efforts to increase tax revenues. Even existing tax base was allowed to erode by granting tax incentives to industries. On the expenditure side, few controls were exercised. Uncontrolled recruitments and revision of salaries by state governments consequent to the Union Government implementing 5th Pay Commission award for its employees, led to increased expenditure on wages and pensions. The states could not compromise on development expenditures and continued to adopt unsustainable plan sizes. This led to states running large revenue and fiscal deficits and accumulating unsustainable debt burden. In 2003-04, for instance, the expenditure incurred by Indian states on wages, pension and interest on debt were approximately 76 per cent of the total revenue receipts of the states. Many states compromised budgetary discipline and resorted to off-budget forms of borrowings and accumulated large contingent liabilities with the risk of default. The result of fiscal stress was reflected in the slow development of states and it was increasingly realized that poor fiscal position of states would finally lead to deceleration in economic growth and social development.

1.1.4 Although isolated efforts were made by some states, the Eleventh Finance Commission (EFC) rightly identified the problem. It took initiatives to correct the imbalance. It urged the states to devise a monitorable fiscal reform programme aimed at reduction of revenue deficit and recommended RD/RR to be the monitorable parameter. The states were mandated reduce the RD/RR by 5% year on year during EFC award period. Based on this criteria each state entered into an MOU with Central Government agreeing on a target fiscal framework for the period 2000-05.

1.2 Fiscal Stress in Karnataka

1.2.1 Karnataka state was no exception to the trend of fiscal imbalance seen in other States. However, the state attempted fiscal correction over the last five years and succeeded in its efforts and now is on the path of fiscal consolidation.

1.2.2 In 1980s Karnataka enjoyed good fiscal health. Generally the macroeconomic fundamentals of Karnataka were strong and the state had presented robust and durable growth. However, Karnataka was not an exception to the fiscal crisis of 1990s. Although the economy saw an upward trend, the tax receipts did not increase proportionately. The State's own tax resources witnessed an average buoyancy of 0.91% for the decade of 1990s. The non-tax revenues fell from 2.2% of GSDP to as low as 1.7%. Even the devolution of Union Taxes fell as a percentage of GSDP from around 2.8% to 2.2%. While the resources saw stagnation, revenue expenditure saw a steep increase in the decade of 1990s. The extension of some recommendations of 5th Pay Commission to State Government employees caused severe strain on the available resources. The increase in expenditure especially on salaries, pensions and interest payments imposed serious pressure on State Finances and pre-empted almost 63% of the Total Revenue Receipts by 1999-2000. The absence of any major control over mounting expenditure, the debt burden increased and the resulting interest payments caused fiscal stress. Borrowings were used to fund revenue deficit than capital expenditure. Due to steep increase in non-development expenditure, the development expenditure of the State faced a losing competition. By 1999-00 the state went into a vicious cycle where low resource and high revenue expenditure crowded out development expenditure leading to deceleration in economic growth further affecting the tax growth adversely. It had to act and take up corrective steps.

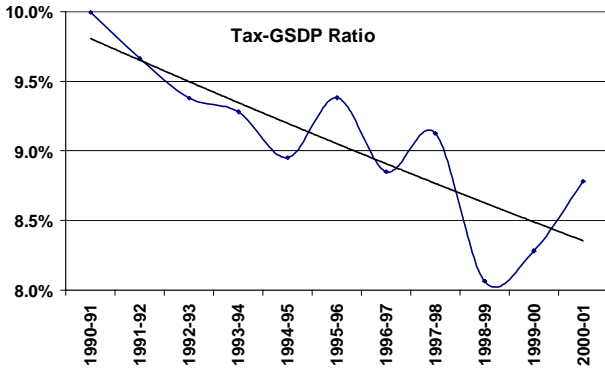


Figure 1: Tax-GSDP ratio in 1990s

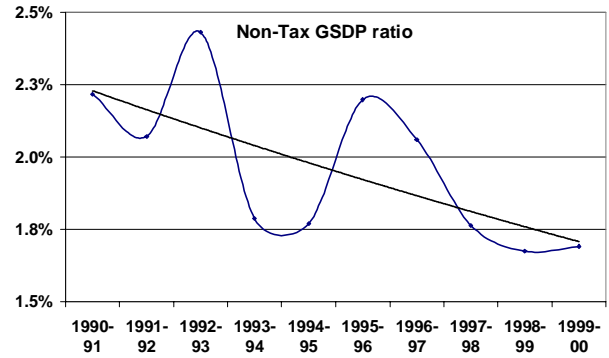


Figure 2: Non-Tax GSDP ratio in 1990s

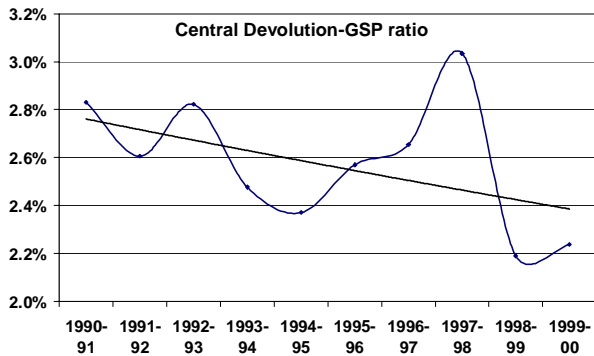


Figure 3: Central Devolution-GSP ratio in 1990s

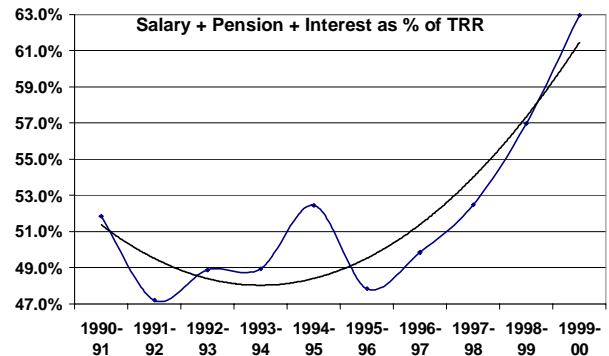


Figure 4: Salary+Pension+Interest as % TRR in 1990s

1.3 The Path of Fiscal Correction in Karnataka:

1.3.1 Realizing the deteriorating fiscal position, the State took a significant step towards fiscal reforms in March 2000 when a White Paper on State Finances was presented in March 2000 wherein issues relating to poor growth in tax receipts, mounting expenditure and debt stock were highlighted. The State recognized that a year-on-year approach would be grossly insufficient to address these problems, which were more structural in nature and a Medium term perspective was found essential to correct the fiscal imbalance. The Budget Speech of 2001-02 emphasized the importance of fiscal reforms and consolidation and the first Medium Term Fiscal Plan was presented in 2001-02 for the period 2001-02 to 2004-05. The need to provide a legislative support to fiscal reforms initiated by the State was increasingly felt.

1.3.2 In 2002 Karnataka Fiscal Responsibility Act (KFRA) was enacted. The KFRA mandated the elimination of revenue deficit by

05-06 and limiting of Fiscal deficit to 3% of GSDP by 05-06. The KFR Act mandates the State Government to place a Medium Term Fiscal Plan (MTFP), which shall set forth the fiscal policy of the State Government in the medium term. Based on this policy, rolling targets for the prescribed fiscal indicators are set out for next four years. The MTFP has to indicate the outlook for the state's economy and the related fiscal strategy on taxation, expenditure, borrowings and contingent liabilities. The MTFP should provide an evaluated summary on the performance of ongoing fiscal policies and indicate corrective measures if required. In addition to MTFP, the State Government is expected to come out with a mid-year review of State's finances vis-à-vis the budget and initiate remedial measures if required. As a step towards increased transparency in financial reporting, details of estimates of salary for Government employees and PRIs, along with details of number of employees for grant-in-aid institution and estimates for the grant-in-aid are also provided.

Karnataka Ceiling on Guarantees Act

1.3.3 In order to rein in the mounting contingent liabilities, the State enacted Karnataka Ceiling on Government Guarantees Act, 1999. In compliance to KCoG Act, it is ensured that total sum of guarantees given by Government does not exceed 80% of revenue receipts of the year one year before the preceding year. Details of outstanding guarantees for each institution under respective departments, including guarantee given on behalf of local bodies; details of shares and securities held by the State Government, and Statement of Public Debt and amortisation are presented to the legislature.

1.4 Revenue Reforms

The Tax Reforms in the State are guided by the recommendations of Tax Reforms Commission and are targeted towards improving the tax base and rationalisation of tax rates

1.4.1 Tax Reforms are the most important aspect of the Fiscal Reforms Programme of the State. A Tax reforms Commission was constituted in 2000 to analyze the problem of stagnant tax buoyancy and make recommendations for improving the tax base and

rationalization of tax rates. The Tax Reforms in the State are guided by the recommendations of Tax Reforms Commission.

1.4.2 **Commercial Taxes** have been the most important tax source of the state and the reform in this area is targeted towards increasing the tax base by restraining the exemptions and simultaneously rationalizing the tax rate structure. A host of administrative reforms to simplify the tax administration have been adopted to make the system tax payer friendly.

1.4.3 **State Excise** had suffered on account of leakages in the system. Non-duty paid production and illicit production were the two most important reasons for the leakages of revenues. This problem was addressed by establishing a canalisation agency to track the production and sales of Indian-made Liquor (IML) and Rectified Spirit, which is the most important raw material for production of country made liquor. The State has liberalised arrack manufacturing and has introduced third party quality check.

1.4.4 Prior to 2002-03 the collections from **Stamps and Registration** duty were stagnant even when the real estate market was witnessing a high growth in the State. The higher rate of registration duty provided incentive for undervaluation of properties leading to evasion of taxes. Existence of fake stamp papers in the system also contributed to low buoyancy of Stamps and Registration taxes. To rectify the problem, the State undertook radical reforms like reduction of Stamp duty and abolition of Stamp Papers.

1.4.5 **Motor Vehicle Tax** has been an exception to the phenomenon of stagnation and this tax had witnessed good growth in the past decade. However, there is a scope for further improvement in this area also. The basic approach towards Motor Vehicles Tax has been de-nationalisation of certain nationalised sectors and certain services.

1.4.6 On the non-tax side, in various cases the user charges had not been revised in last many years. An extensive review was taken and, in many sectors, user charges were revised. Although, there have been signs of improvement, there is a lot to be done in this area not only at the State level but even at the Local Government level.

1.5 Expenditure Reforms

1.5.1 In order to reduce mounting expenditure pressure on the state finances, several expenditure reforms measures were undertaken. The expenditure reforms were mainly targeted towards reduction of expenditure on account of salaries, pensions and interest payments. Wage restraint through control on recruitment has been under practice in the entire country in this decade. Karnataka has also followed this policy in all but some important sectors like education, health, internal security etc. Extensive reviews of functioning of various departments have been carried out and more than 7000 posts have been recommended for abolition consequent to that.

1.5.2 The scope has been very little on the pensions side. The State has introduced certain parametric reforms and is planning to introduce certain structural changes in due course. The structural reforms have already been introduced for municipal employees whose pension was, till now, being paid by the State. The State is also developing a database of all the pensioners in KHAJANE, the computerised treasury system.

1.5.3 From 1998 onwards the country witnessed lowering of interest rates. The burden of interest servicing of off budget and on budget borrowings was considerable on the fisc of the state. Karnataka used the southward trends in the interest rates to the best of its advantage. In addition the regular debt swap scheme of Government of India, the State has taken steps for reduction of interest rates through swaps or resetting in case of, both, off-budget as well as on-budget borrowings. The State has, totally swapped Rs.

Administrative Reforms targeted towards right sizing of Government have helped State in containing the Salary burden

The State has been able to reduce the interest burden through extensive debt swaps

5643 Crore of its loan leading to a saving of more than Rs. 2000 Crore towards interest payments over the entire repayment period.

1.5.4 Power and food subsidy are the two most important subsidies being provided by the State. Food subsidy is administered through a system of cards and is fairly regulated. However, Power Subsidy has been one of the major concerns of the State and all efforts to contain have not made any substantial impact. The initial reform process in this sector was mainly on the structural side in unbundling transmission and distribution. It has taken sometime for the distribution company to work in a relatively autonomous way and not being dependent on transmission company. Still some administrative issues need to be resolved. The Regulator in Karnataka has assumed significance strength and has built capacities to play its vital role in reforming the sector. The time is ripe for initiating core reform initiatives once these structures are in place.

1.6 Debt Management Reforms

1.6.1 The debt management of the State are based are two principles, viz. the flow of debt, i.e. fiscal deficit, to be restricted to three percent of GSDP and phasing out of off-budget borrowing. On these lines, the Fiscal Deficit has been brought below the target 3% of GSDP by 2004-05. As a second step to this containment of Fiscal Deficit, a definite move has been made in 2005-06 to replace a portion of the off-budget borrowings of the State with budgetary support.

1.7 Public Finance Management Reforms

1.7.1 Public Finance Management and Accountability (PFMA) Systems are a must to effectively put in place a strong fiscal policy framework and to ensure fiscal discipline. With this aspect in the background, the State initiated a series of PFMA reforms to make its fiscal policy reforms a reality. These reforms include strengthening the budgetary controls on expenditure, reforming the accounting and

reporting mechanisms, improving transparency and accessibility of financial information, targeting unsatisfactory audit responsiveness, enhancing internal controls through capacity building and eliminating distortionary elements in Public Finance Management is a phased manner.

1.8 Fiscal Correction over the Last Four Years

1.8.1 From a state of Fiscal imbalance Karnataka has now attained the state of fiscal soundness. Data in the following table on some fiscal parameters substantiate that over the last four years Karnataka has successfully achieved fiscal correction.

1.8.2 The fiscal performance in the year 2003-04 has been better than what was budgeted for. As against the budgeted revenue deficit of Rs. 2135 Crore, the State was able to reduce the deficit during the course of the year to Rs. 525 Crore. State crossed an important milestone on its path towards fiscal consolidation in the year 2004-05, eliminating the revenue deficit and containing the fiscal deficit to less than 3% of the GSDP. For the year 2004-05, the revenue deficit was estimated to be Rs. (-) 72 Crore and the fiscal deficit to be Rs 4247 Crore. As against the budgeted figures, the revised estimates of revenue deficit and fiscal deficit are Rs (-) 508 Crore and Rs. 4192 Crore respectively.

1.8.3 The actual off-budget borrowings were restricted to Rs 1104 Crore as compared to Rs 1560 Crore budgeted off-budget borrowings. Two important developments took place in 2004-05 on the off-budget borrowing front. The first is a partial replacement of off-budget borrowings with budgetary grants and the second in budgetary support to retire high cost off-budget debt incurred by KBJNL and KNNL, again through budgetary support. This has been in accordance with the policy of the State to reduce its dependence on off-budget borrowings in a phased manner. This has been taken forward in 2005-06 budget also. As against the budget estimates of

Trends and correction in Revenue and Fiscal Deficits

Phasing out of off-budget borrowings

Rs. 1035 Crore, the actual drawals of off-budget borrowings was limited to Rs. 823 Crore.

*Impact on reduction
of Consolidated
Deficits*

1.8.4 Due to a better achievement on the deficits and lower dependence on off-budget borrowings, the achievement on Consolidated Deficits also was better than budgeted. As against, the budget estimates of Rs 3144 Crore of the Consolidated Revenue Deficit, the State could achieve a much lower figure of Rs 1326 Crore and as compared to the budget estimates of Rs. 6141 Crore of the Consolidated Fiscal Deficit, the actual achievement has been Rs. 4851 Crore.

1.9 Finance Commissions and Fiscal Correction

1.9.1 The first countrywide effort to give thrust to State level fiscal reforms was made by the Eleventh Finance Commission (EFC). The EFC recommended a scheme to promote fiscal correction by the States. Under this scheme, RD/RR was identified as the monitorable parameter, which was targeted to be reduced by 5% each year during the EFC award period. A Medium Term Fiscal Reform Facility (MTFRF) was put in place to incentivise the fiscal correction. Based on this criterion, each State was to sign into a MoU with the Central Government agreeing for specific fiscal framework for the period 2000-05. The Commission also recommended that the undisbursed amount under the MTFRF should become a part of the common pool, to be shared by the performing states in the fifth year on a pro rata basis, in addition to the amounts to which they would otherwise be entitled. After the MTFRF was put in place, with many other States, Karnataka also entered into a MoU with the Centre. For achieving the agreed fiscal targets, Karnataka has received its share of incentive grants for the first four years of the award period.

1.9.2 MTFRF was, however, not fully successful in meeting its objective. The mid-term review of MTFRF observed “there was ‘admittedly’ a design failure in prescribing a uniform five percentage

point improvement in the ratio for all states. At the beginning of the reform period, 1999-2000, states had different magnitudes of revenue deficits as a percentage of revenue receipts”. It also observed “The facility has largely failed to address the need for a steady convergence to a stable, sustainable debt path. The ultimate aim of any medium term fiscal reforms is to bring down debt to sustainable levels”. This aspect also got reflected in the fact that many States were not able to receive any incentive despite the fact that they has embarked on a fiscal reforms programme.

EFC had recommended a rigid correction path, however, TwFC has now suggested that States should design their own fiscal correction path within the broad framework recommended by the TwFC

1.9.3 The approach adopted by the succeeding Twelfth Finance Commission (TwFC) has been led by these lessons and the Commission has recommended two debt relief measures as incentives linked to State’s own fiscal reforms path. TwFC has recommended that the past Central loans of the State should consolidated and rescheduled subject to the condition that the State has put in place a Fiscal Responsibility Legislation as per the broad guidelines given by the Commission. The second relief by the Commission is waiver of repayments of central loans linked to the actual reduction of the revenue deficit based on the State’s own fiscal reforms path.

1.9.4 These recommendations of the Commission have been accepted by the Central Government. Since the State has put its FR Act as early as in 2002 itself, it would be eligible for the first relief. The State had initiated a comprehensive fiscal reforms programme, broadly in line with what the Commission has recommended, in 2001 on a medium term framework. The State has been preparing a fiscal correction path in the form of Medium Term Fiscal Plan since then, which sets the targets for four years. The State has been following this path and as mandated by the Act, it has already met the targets recommended by the Commission, and thus, is eligible for the second relief also.

1.10 From Fiscal Correction to Consolidation

1.10.1 The main reason for successful fiscal correction achieved by 2004-05 is the improvement in the exemplary performance of the State's Own taxes. In 2004-05 as against the budget estimate of Rs. 15102 Crore for the five major taxes viz. Commercial Taxes, Excise, Stamps and Registration, Motor Vehicles and Land Revenue, the revised estimate has been Rs. 15736 Crore and as per the preliminary accounts, the actual achievement has been Rs 16190 Crore. Although there has been an increase on the expenditure side, the improvement in the receipts more than made for it. The year of 2004-05 has been the year of correction and the following years have to be the year of consolidation. Although the Fiscal Responsibility Act mandated meeting the deficit targets in 2005-06, they have been successfully met in 2004-05 itself. For the coming years, the State will have to mitigate the risk to the reform process and bring institutional mechanisms in place to eliminate the possibility of any U-turn.

1.10.2 With this in mind, the State, as per the announcement made in the budget speech of 2005-06, has constituted a Fiscal Policy Analysis Cell (FPAC). The main objective of the Cell would be to put in place institutional mechanisms in place to ensure that the right fiscal policies are in place in the right time. The cell would mainly focus tax policy analysis and revenue forecasting, expenditure planning and management, debt, guarantee and investment management and fiscal decentralisation. It is expected that FPAC would prove to be an effective tool in the hands of fiscal policy makers in strengthening the fiscal reform effort of the State.

Table 1: Fiscal Performance in the reform period

Item	1999-00 A/c	2000-01 A/c	2001-02 A/c	2002-03 A/c	2003-04 A/c	2004-05 BE	2004-05 RE
Revenue Receipts	12410	14263	15321	16169	20760	25510	25320
of which							
State' Own Tax Revenues	7744	9059	9853	10440	12570	14958	15748
Non Tax Revenues	1115	1100	1093	1278	2958	4486	3768
Resources from the Centre –							
Devolution	2133	2557	2623	2786	3245	3760	3449
- Grants	1418	1546	1751	1665	1987	2306	2355
Revenue Expenditure	14735	16125	18606	18814	21285	25437	24813
of Which							
Interest	2012	2388	2683	3684	3710	3920	3780
Salaries	4576	4630	5030	4941	5523	5751	5524
Pensions	1539	1583	1641	1773	1901	2214	2060
Subsidies (Food, Transport Housing & Industry)	599	696	691	603	525	905	1320
Power Subsidy	771	868	2302	1842	1675	1400	1400
Devolution to ULBs	416	531	564	574	629	799	799
Major O&M (Roads,Buildings & Irrigation)	342	406	351	211	251	401	437
Other O & M (Edn, Health,RD,WS,Agr, Forest)	1502	1551	1673	1947	2197	2444	2656
Administrative Expenditure	328	367	355	344	440	442	476
Other Revenue Expenditure	2651	3105	3317	2895	4434	7163	6361
Capital Receipt (Non Debt)	145	101	35	928	64	30	30
Revenue Deficit	2325	1862	3284	2646	525	-73	-507
Expenditure on Capital Formation	1701	1876	1833	2115	2937	2502	2326
Fiscal Deficit	4276	4219	5870	5281	4501	4247	4192
Debt							
Total Debt Stock	23047	27271	33123	38470	42954	48384	47555
Interest	2012	2388	2683	3684	3710	3920	3780
Debt Services	2503	2908	3395	5380	7151	5907	7694
Salary+Pension+Interest	8127	8600	9354	10398	11134	11885	11364
Gross Off Budget Borrowings	1011	1648	1533	1388	1104	1035	798
Net Off Budget Borrowings	1011	1551	1408	882	349	-174	-790
Consolidated interest	2407	2874	3345	4529	4511	4558	4596
Consolidated Revenue Deficit	2721	2348	3919	3490	1326	565	308
Consolidated Fiscal Deficit	5288	5770	7278	6163	4851	4073	3402
Consolidated Debt Stock	26461	31968	39227	45738	50136	55009	53796

Table 2: Fiscal Performance in the reform period (as % of GSDP)

Item	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2004-05
	A/c	A/c	A/c	A/c	Pre A/c	BE	RE
GSDP at Current Prices	94972	104541	109016	120062	132498	147956	147956
INFLATION	2.29%	3.32%	2.04%	3.92%	3.92%	5.00%	5.00%
GSDP Annual Real Growth	5.83%	6.76%	2.24%	6.21%	6.44%	7.00%	7.00%
Revenue Receipts	13.07%	13.64%	14.05%	13.47%	15.67%	17.24%	17.11%
of which							
State' Own Tax Revenues	8.15%	8.67%	9.04%	8.70%	9.49%	10.11%	10.64%
Non Tax Revenues	1.17%	1.05%	1.00%	1.06%	2.23%	3.03%	2.55%
Resources from the Centre –							
Devolution	2.25%	2.45%	2.41%	2.32%	2.45%	2.54%	2.33%
- Grants	1.49%	1.48%	1.61%	1.39%	1.50%	1.56%	1.59%
Revenue Expenditure	15.52%	15.42%	17.07%	15.67%	16.06%	17.19%	16.77%
of Which							
Interest	2.12%	2.28%	2.46%	3.07%	2.80%	2.65%	2.55%
Salaries	4.82%	4.43%	4.61%	4.12%	4.17%	3.89%	3.73%
Pensions	1.62%	1.51%	1.51%	1.48%	1.43%	1.50%	1.39%
Subsidies (Food, Transport Housing & Industry)	0.63%	0.67%	0.63%	0.50%	0.40%	0.61%	0.89%
Power Subsidy	0.81%	0.83%	2.11%	1.53%	1.26%	0.95%	0.95%
Devolution to ULBs	0.44%	0.51%	0.52%	0.48%	0.47%	0.54%	0.54%
Major O&M (Roads,Buildings & Irrigation)	0.36%	0.39%	0.32%	0.18%	0.19%	0.27%	0.30%
Other O & M (Edn, Health,RD,WS,Agr, Forest)	1.58%	1.48%	1.53%	1.62%	1.66%	1.65%	1.80%
Administrative Expenditure	0.35%	0.35%	0.33%	0.29%	0.33%	0.30%	0.32%
Other Revenue Expenditure	2.79%	2.97%	3.04%	2.41%	3.35%	4.84%	4.30%
Revenue Deficit	2.45%	1.78%	3.01%	2.20%	0.40%	-0.05%	-0.34%
Capital Receipt (Non Debt)	0.15%	0.10%	0.03%	0.77%	0.05%	0.02%	0.02%
Expenditure on Capital Formation	1.79%	1.79%	1.68%	1.76%	2.22%	1.69%	1.57%
Fiscal Deficit	4.50%	4.04%	5.38%	4.40%	3.40%	2.87%	2.83%
Administrative Expdr as % of RR	2.64%	2.57%	2.32%	2.13%	2.13%	1.73%	1.88%
Debt							
Total Debt Stock	24.27%	26.09%	30.38%	32.04%	32.42%	32.70%	32.14%
Interest/Revenue	16.21%	16.74%	17.51%	22.79%	17.87%	15.36%	14.93%
Debt Services/Revenue	20.17%	20.39%	22.16%	33.27%	34.45%	23.15%	30.39%
(Salary+Pension+Interest)/Revenues	65.49%	60.30%	61.05%	64.31%	53.63%	46.59%	44.88%
Debt Services/GSDP	2.64%	2.78%	3.11%	4.48%	5.40%	3.99%	5.20%
(Salary+Pension+Interest)/GSDP	8.56%	8.23%	8.58%	8.66%	8.40%	8.03%	7.68%
Consolidated Interest/revenue	19.40%	20.15%	21.83%	28.01%	21.73%	17.87%	18.15%
Off Budget Borrowings/GSDP	1.06%	1.58%	1.41%	1.16%	0.83%	0.70%	0.54%
Consolidated interest/GSDP	2.53%	2.75%	3.07%	3.77%	3.40%	3.08%	3.11%
Consolidated Revenue Deficit/GSDP	2.86%	2.25%	3.59%	2.91%	1.00%	0.38%	0.21%
Consolidated Capital expenditure/GSDP	2.86%	3.37%	3.09%	2.92%	3.05%	2.39%	2.11%
Consolidated Fiscal Deficit/GSDP	5.57%	5.52%	6.68%	5.13%	3.66%	2.75%	2.30%

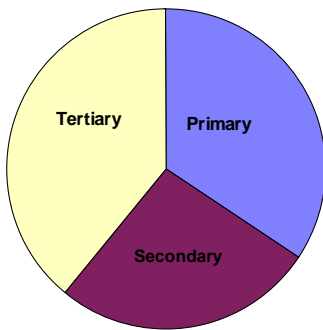
2.1.1 The pattern of monsoon in a particular year has been the most important factor affecting the economy of the entire country and Karnataka has been no exception to this. Poor monsoon affects the agriculture. In addition, it affects the prospects of power generation, as Karnataka is highly dependent on Hydel sources. The State's economy witnessed a slowdown due to sub-normal rainfall during 2002-03 and 2003-04. The financial year

Sector	02-03	03-04	04-05
Primary	-6.4%	-5.0%	6.7%
Secondary	9.4%	6.9%	6.5%
Tertiary	9.0%	10.9%	9.0%
Total	5.3%	6.2%	7.8%

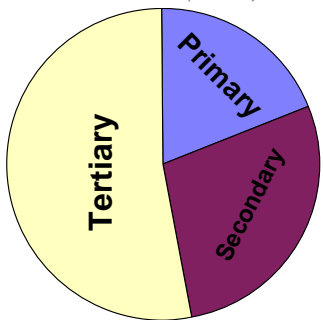
Table 3: Sector wise GSDP growth

2004-05, however, proved to be a year of recovery in this respect. After two years of constrained growth, 2004-05 came with a remarkable recovery recording a real growth rate of 7.8 per cent. In the light of the Planning Commission revising the growth rate for the remaining part of 10th Plan period in its mid-term review, the growth witnessed in Karnataka is noteworthy.

*Composition of
Karnataka's Economy
1994-95*



2004-05 (A.E.)



**Figure 5 Composition of
Karnataka's Economy**

2.1.2 The Economy, of Karnataka has undergone a steep transition in last ten years and the tertiary sector has grown at almost double digit, taking over the share of primary sector, which contributed to a share, equal to that of other sectors ten years ago. In a way, this is a positive development and the economy is less dependent on the rainfall. However, unless this transition is not coupled with a shift of the population dependent on primary sector to tertiary sector, the responsibility of carrying the benefit to the larger sections of the population is left only on the trickle down effect, which may not be able to perform to the desired level. Thus, along with the efforts to promote growth in the primary sector through investment in agricultural infrastructure, an effort has to be made to increase the opportunities in secondary and tertiary sector in the rural areas.

2.1.3 Bangalore, the State capital is the most important growth centre of Karnataka. Initiation of the Bangalore International Airport Project would increase the relative advantage of Bangalore as a major trade centre of the country. Upgradation of other Minor airports like Mangalore and Mysore would go a long way in promoting alternate growth centres within the State. Externally Aided Projects like Karnataka State Highway Improvement and North Karnataka Urban Infrastructure Development Project will contribute to increased economic activity, especially in the relatively backward regions of North Karnataka. Along with the investment in infrastructure, technology and skill upgradation in small and medium sector would provide the required boost to the secondary sector. Power would be an area of concern where investment would be required both in the private as well as the public sector.

2.1.4 The macroeconomic fundamentals of Karnataka have been robust and the State has been providing a thrust to the nation's economic growth. In medium term, although the performance is expected to be good, the projections have been tempered with caution and a real growth rate of 7% with an inflation of 5% has been assumed.

2.2 Policy Interventions

2.2.1 The fiscal policy of the State shall remain focused towards keeping the Public Debt under control by controlling the fiscal deficit and at the same time directing public expenditure towards high priority development areas. Investment on irrigation and transport infrastructure would provide the required support to the primary as well as the secondary sector. Availability of cheap credit and insulating the farmer from the vagaries of nature through schemes like crop insurance and subsidy would contribute to steadiness in the growth in primary sector. Certain deregulation

measures in agricultural sector, especially in agricultural marketing, are long overdue.

Inflation from 1999-00 to 2004-05

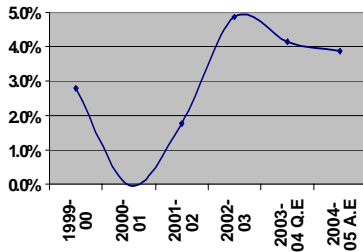


Figure 6: Trends in Inflation

2.2.2 Two elements of the fiscal policy are expected to have a positive impact on the performance of the secondary and the primary sectors. Firstly, the reduction of fiscal deficit coupled with an increase in capital expenditure would progressively increase the opportunities for the private sector by pump priming and crowding in investments. To add, steady inflation, restricted to below national average, would have a positive impact on the investor confidence.

2.2.3 Secondly, the Value Added Tax system introduced from 1st April 2005, not only in Karnataka but in most of the States, would remove the distortions brought in the trade chain due to the turnover based Sales Tax. The turnover based taxation system created an incentive for reduction of transaction in the trade chain since each transaction was taxed *ad valorem* and thus, in turn, incentivised vertical integration, where for each production unit, it was beneficial to produce its inputs rather than outsourcing it. With the newly introduced taxation based on the value added at each transaction, such an incentive does not any longer exist and thus there would be a tendency for each business unit to focus on its core area and outsource the rest. The biggest beneficiaries of this phenomenon would be the small and medium enterprises. The actual phasing out of vertical integration would, however, happen only in medium term and thus gives a time for the SME sector to improve its capabilities and the State to contribute to it.

Composition of State's Revenues

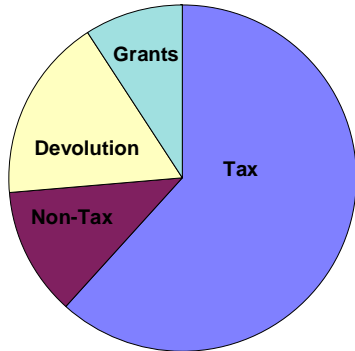


Figure 8: Composition of State's Revenues

Composition of State's Tax Resources

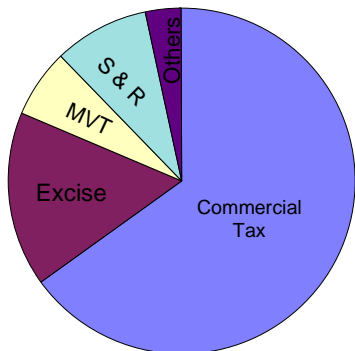


Figure 7: Composition of State's Tax Resources

3.1.1 Of the State's Own Revenue Receipts, 62 % come from the tax resources, 12% from the non-tax resources, 17% from the State's share in Union taxes and the remaining 9% as central grants. Thus, almost three-fourth of the State's revenues comes from its own sources. Post reforms, the revenue receipts of the states have witnessed a high growth rate of 14.8%. This growth can be attributed to various reform initiatives undertaken in past in addition to the general growth of the economy.

3.1.2 Out of the tax-revenues, Commercial Taxes account for almost 65% of the State's own tax revenues, State Excise contributes to 16%, Motor Vehicle Tax 6% and Stamps Duty and Registration Charges 9%. Other taxes e.g. Land Revenue and Electricity Tax contribute only 3% to the State's Own Tax Recourses. The basic approach of the State towards reforms targeted towards enhancement of resources has been guided by the Tax and Revenue reforms Commissions. The recommendations of these Commissions have been progressively implemented.

3.2 Sales Tax

3.2.1 Sales tax is the most important tax source for the state. In the last decade the tax base of Sales Tax suffered a narrowing trend due to various exemptions given in past to invite industrial investments. In addition there were too many rates. The basic approach in the area of Sales Tax has been simplification of tax structure through rationalisation of tax rates, rationalisation of exemptions and administrative reforms. Although these piecemeal reform initiatives were being implemented, the State was aware that there is no better reform than introduction of a Value Added Tax (VAT) system to tax

sale of goods. The State was ready for this change in 2003 itself. The first attempt to introduce this system was made in July 2003 but due to lack of national consensus, this system could not be implemented. In this respect, 2005-06 has become a landmark in the history of State taxation when 21 States reached a consensus and implemented a uniform Value Added Tax system under the guidance of an Empowered Committee (EC) of State Finance Ministers. This single step is not only important because it overhauled the system in the tax which is most important for the States, it also brought home the point that a uniform and integrated system can be put in place even without centralisation of tax administration.

*Salient Features of
Karnataka Value
Added Tax*

3.2.2 The VAT system put in place in the State is a self-assessment system with two general rates of 4% and 12.5% except on certain commodities that have been put at special rates of 1%. Sugarcane, Petrol and diesel are kept out of the purview of VAT. All dealers with turnover more than Rs 2 lakh have been brought in the tax net. However, for the sake of simplicity, a composition scheme has been provided for dealers with turnover less than Rs. 15 lakh. The exports, in line with the uniform design, are zero rated to make the exports more competitive.

3.2.3 The State has not only changed the legal system of taxation but has also reorganised the tax administration to suit the system. The success of the VAT system depends on the strength of the underlying intelligence system within the tax administration machinery. This would require a strong IT support for verification of the taxes paid on the inputs reinforced by a strong audit presence to randomly select and physically verify the returns filed. The Department has been functionally reorganised to take care of these issues.

3.2.4 The reform process of the State in this area would be targeted towards consolidating its tax administration through detailed collection and analysis of the data, using it for audit, intelligence activities and strengthening the system put in place. In a turnover based tax system,

the input-output relationship between various commodities under the tax net has never been of much significance but it becomes extremely important for the new value added taxation system. For the purposes of tax policy analysis and formulation, this kind of data capturing and analysis shall be made a part of regular tax administration and the capacity of personnel involved in tax administration will be developed in this regard. FPAC will play an important role in this regard.

3.2.5 The second important issue in this regard is integration of various taxes with the mainstream Value Added Tax. To take the next step in this direction, it is most important that the new system put in place this year stabilises. With a long-term perspective in mind, the State should chalk out an action plan for integration of various taxes into VAT. One of the most important pre-requisites for such an integration is putting a Service Tax legislation with a national consensus. The State has been representing that since the nature of transactions involving provision of service is similar to that of transactions involved in sale of goods, this tax would be best administered by States' Sales Tax administrative machinery.

3.2.6 As per the compensation policy announced by the Central government, although 100% loss in the first year, *i.e.* 2005-06 would be compensated; in the year 2006-07, only 75% of the loss would be compensated. However, it is expected that the tax base would also expand with time, which would lead to reduction of loss. No phase out of Entry Tax of Central Sales Tax has been assumed while making the projections.

3.3 State Excise

3.3.1 State Excise, which was near stagnant till recent past, has witnessed exemplary growth in last year primarily due to the change in the arrack policy and strong enforcement. The changes brought in the arrack regime have not only brought a jump in the excise revenue from arrack, it has also increased the revenues from IML. In coming years,

the State will have to concentrate on more stringent enforcement. The collections have been buoyant in last year and are expected to follow the same trend this year too. However, with two years of high growth, it is expected that the growth would stabilise and for the projection period, buoyancy marginally above unity has been assumed.

3.4 Stamps and Registration

3.4.1 Radical reforms initiative in Stamps and Registration, targeted to correct the existing situation of high tax rates and undervalued tax base, have more than doubled the realisation in last three years. Revision of market value of properties has been carried out to bring the guidance values in line with the actual market rates. After two years, the Central Valuation Committee has become fully functional and an exhaustive database of the properties is prepared during the process of revision. But it is felt that even now the guidance values are low as compared to the market rates. It is expected that only after several rounds of revision would the guidance values come at par with the market rates.

Transparency and citizen friendliness are key aspects in reforming Stamps and Registration

3.4.2 Certain reforms have been introduced to make the tax administration citizen friendly. The first and most important enabling step has been taken by fully computerising the whole process of registration. KAVERI, the computerised registration system has made the registration system transparent and has removed the human element. The approach in the coming years has to be towards increased transparency, the details of the guidance values are already on the Internet and with the transparent process involved in fixing the guidance values, the registration system has become appropriate as well as citizen friendly. Another big step towards increasing efficiency would be enabling “anywhere registration” against the current system of defined jurisdiction. Such an effect would require a computerised and robust data sharing mechanism with a central repository and a legal framework. This proposed big step would be tried in Bangalore to begin with. Computerisation of encumbrances is another reform

initiative on the anvil for long that needs to be completed in a time bound manner.

3.4.3 The growth in Stamp and Registration duty may witness sluggishness from 2005-06 for some time due to recent restrictions introduced regarding transfer of certain properties to streamline urban growth. This process of streamlining may cause reduction in number of transactions for certain period of time till the new control systems put in place stabilise. In addition to that, the acceleration in recent years caused due to the revision in guidance values may stabilise when the guidance values get more or less aligned with the market rates. Keeping these factors in mind, a slower growth has been projected for next two years and a stabilisation has been projected post this period.

3.5 Motor Vehicle Tax

3.5.1 Unlike other taxes that have been witnessing huge variation, Motor Vehicle Tax has been witnessing a steady growth leaving a few years where due to specific reasons, the collections have been even lesser than previous year. The reforms in this area are not mere tax reforms. They are mainly sector-oriented, targeted towards structural improvements in the transport sector and as a corollary improving the tax base. The main thrust of these reforms has been towards denationalisation of certain areas of operations and making an effort to bring the State owned Road Transport Utilities and private operators on a level playing field. The objective is not only to remove distortions and improve the service delivery through better competition but to also increase the tax base.

3.5.2 The administrative machinery of this tax is not only involved in tax collection but is also involved in provisioning of number of other services. The main offices of the department are computerised and now, when the model is in place and has proved its viability, the remaining offices are planned to be computerised on BOOT basis. Another reform measure that would be tried is out sourcing of tax

Reforms in Motor Vehicle Tax are mainly targeted towards reforming the sector as a whole

collection for lifetime tax for LMV four wheelers and two wheelers. For these vehicles, the collection of the tax payable once in a period of fifteen years can be entrusted to the retailer point which would not only improve the tax compliance but would also make it convenient for the citizens.

3.5.3 Although, there has been a steady increase in the tax base, the tax compliance on part of the State utilities has not been satisfactory and this has been, most of the times, not being ignored on the pretext that these utilities are expected to meet certain social objectives. There has been an effort in the recent past and should be the strategy in future to delink the tax compliance with meeting social objectives. There is a definite improvement in the tax compliance by these utilities, at least, with respect to current tax dues. The projections for MVT have been made based on the past trends and a time bound improvement in the tax compliance by the State utilities.

3.6 Non-Tax Revenue

3.6.1 The problem of stagnation in not-tax revenues has been even more severe when compared to tax revenues. The ratio of non-tax revenues to the GSDP has declined over time. The most important reason for this decline has merely been negligence and non revision of user charges. This has led to a situation where user charges in force have been ridiculously low. This problem has been, to a large extent, been tackled in past few years where most of the user charge rates have undergone at least one round of revision. In many sectors, another round of revision is due and a system of regular revision of user charges has to be put in place.

3.6.2 The process of fixation of rates for non-tax revenues has been fairly arbitrary and in best of the cases, has been linked to the inflation, which has the inherent disadvantage of compounding of existing distortions. A *de novo* review of most of these rates and a radical rationalisation of these levies is necessary. A policy shall be

A comprehensive policy for levy of user charges needs to be formulated to avoid arbitrariness

formulated to fix the user charges and other rates of non-tax revenues based on factors such as nature of the levy (i.e. whether it is regulatory or service charge etc.), cost of provisioning of services, cost of collection etc.

3.6.3 In addition to the revision of user charges, a system of recovery of user charges and regular monitoring of recovery will have to be put in place. Collection of user charges should be monitored with same rigour as plan expenditure is monitored by every department and formats for monitoring the same should be made part of regular departmental and State level monitoring formats.

Reducing returns on investments made and loans extended by Government are major cause of concern

3.6.4 One of the areas within the purview of non-tax revenues that has been left untouched in past many years has been the recovery of returns on Government investments and loans. As at the end of 2003-04, the investments of Government stand at Rs. 7984.19 Crore and outstanding loans given by the government stand at Rs. 5202.95 Crore and the return in terms of dividend and principal and interest recoveries has been of the order of Rs. 100 Crore (0.76 % return). This fact is part of a vicious circle of investments and loans being extended to non-viable proposals which happen due to poor evaluation leading low recovery prompted due to the non-viability and fuelled by inadequate follow-up. Due to the low recovery, there is an attempt to evade investment or lending operation causing good proposals to go unattended. There are several instances where defaulters have, again and again, been lent by the State.

3.6.5 To reverse this vicious cycle, firstly, adequate evaluation mechanisms need to be put in place to ensure that non-viable projects are filtered out. Secondly, proper recovery mechanisms need to be developed, which would not only increase the returns from these investments, they would also help in ensuring filtering non-viable proposals which are posed for assistance to the government with a preconceived notion that any such loan extended need not be repaid.

3.6.6 In addition to the fresh investments and loans to be extended by the Government, there is also a need to take notice of the existing ones and a focussed attention will have to be given. For this purpose, using the services of Department of Small Savings and Lotteries would be apt because in the present scenario, when the loans from NSSF are costliest amongst all the sources that the State has access to reducing the incentive for the State to promote Small Savings collection, the current job chart of the Department has become irrelevant. Thus, instead of using its services to mobilise loan resources for the State, the department shall be reorganised and its services shall be used for tracking Government investments and recovery on Government loans.

3.7 Revenue Forecasting

3.7.1 Revenue forecasting has always been an area of concern for the

State and wrong estimation, especially overestimation, has caused cash problems during the course of the year and eventually hampering plan expenditure when the actual collections are far below the estimation. Although there has been refinement in the method of estimation of resources in the budget, it is still far from being very scientific and as per international best practices.

Percentage of actual tax collection as a percentage of budget estimates

	01-02	02-03	03-04	04-05
CT	96%	84%	101%	110%
StEx	98%	92%	101%	107%
MVT	112%	86%	91%	110%
S&R	97%	109%	100%	118%
Othr	94%	87%	86%	40%
OTR	97%	88%	100%	109%

Table 4: Tax collection as % of estimates

3.7.2 The issue of revenue forecasting is very important since the provision for expenditure is based on the forecast of the resources. Any shortfall in the actual realisation during the course of the year limits the availability of resources for expenditure commitments. Under such circumstances, if a downward revision of expenditure estimates is not done, it may lead to increase in deficits which would manifest into severe cash problems.

3.7.3 The solution lies in building a good revenue forecasting and expenditure tracking systems and capacities for undertaking such an exercise. A scientific system of projection would require availability

and quality of good amount of data about tax collections and tax bases. Today, in many cases, data is not available in standardised form and is not collated at a central place. Thus, the first action point would be to design data requirements for this purpose and put in place a system for regular collection of the data. The Tax Analysis and Revenue Forecasting Unit of the FPAC would be trained and given this responsibility. Secondly, extensive training would be imparted to the staff in FPAC as well as in tax departments to enable them to carry out analysis and make projections on the basis of this data.

EXPENDITURE MANAGEMENT AND PROJECTIONS

4.1.1 The approach on the State towards expenditure management has been two pronged. Firstly, containing the non-development expenditure constituting mainly the salaries, pensions and interest payments so that they do not crowd out the development expenditure and secondly, ensuring that the additional resources made available are deployed in high priority areas. Towards these goals, the achievements of the State have been quite remarkable.

Containing Salaries and Pensions has freed considerable resources for development expenditure

4.1.2 As a major reform measure, the State undertook a drive to abolish vacant posts and initiated action in this regard in 2001. The State decided to abolish 80% of its posts vacant as on 1st April 2000 and enforced a freeze on creation of posts and recruitment except in few high priority departments like Health, Police and Education. As a result of reform measures, the salary payments as a ratio of revenue expenditure net of interest payments and pensions has come down from 39.17% in 1999-2000 to 29.11% in 2004-05(RE). This is in tune with the Twelfth Finance Commission recommendations, which seek to bring down this indicator back to 1996-97 levels. In the area of human resource management, the State is implementing a Human Resource Management System, computerizing the Service Records and other crucial details of all Government and Zilla Panchayat employees.

4.1.3 Procurement reforms; as a part of second strategy, the State brought in certain systemic changes to ensure better deployment of public money. One major initiative in this direction has been in the area of improving the transparency in public procurement. Towards this end, the Karnataka Transparency in Public Procurement Act is being implemented in full measure. This act has brought in certain discipline in government procurement. In order to promote

improvement in procurement operations, government is thinking of adopting e-Procurement procedures. Amendments required to the Act for this will follow.

4.2 MTFP: a Tool for Expenditure Management

4.2.1 To ensure fiscal sustainability, the expenditure of the State has to be guided by the resources available and to be within sustainable limits of debt. The Medium Term fiscal Plan has proved to be an effective tool in ensuring that this principle is followed in expenditure management as it provides a framework for determining the size and the priorities of public expenditure in addition to indicating the direction towards which we are moving. The disaggregation of the MTFP into demand-wise DMTFP has been done in the past three years but it is yet to be dovetailed with the demand-wise annual budgets.

4.2.2 The State Government has undertaken a budget reform programme to integrate the departmental budget with the DMTFPs, which is further disaggregated into programmes and sub-programmes. These programme budgets would be organised demand-wise and indicate the forward estimates at the programme level providing the predictability of fund flow to enable better expenditure management.

4.2.3 Linking of outlays with outcomes has been a matter of concern and various efforts have been made to address this problem. The Union Finance Minister, in his budget speech of 2005-06 aired this concern and announced that a framework would be put in place by Planning Commission to tackle this issue. Linking outlays with outcomes is one of the objectives of the budgeting reform undertaken, and the programme budgets, in addition to indicating the programme-wise outlays, would also indicate the linked outputs and outcomes, both for the review as well as the projection period. This would not only bring the required transparency, but would also

enable the decision makers while deciding on outlays and evaluate the impact of public expenditure. Certain pilot departments have been taken for this effort and programme budgets would be presented parallelly with the current system till the system reaches a comfortable stage.

4.3 Subsidy Management

Inadequate capital investment caused due to low recoveries has put power sector in a vicious cycle

4.3.1 Power subsidy has remained a matter of concern for the State and has been one of the biggest risks in prudent financial management. The situation has been precarious for quite some time with little improvement. The cash losses of the system have been growing due to poor recovery and aggravating situation on the T&D losses. Poor recoveries have added to the existing financial constraints in the power sector thus preventing capacity addition to this sector and improvements in transmission efficiency. In the result, the power sector has been suffering higher losses. The power sector has, thus, got into a vicious cycle of low-level equilibrium.

4.3.2 Power Sector reforms have been gaining importance in recent years. The Electricity Act, 2003 notified on 10th June 2005 has provided the necessary legal framework for reforms in this sector. Establishments of Regulators, unbundling of generation, transmission and distribution are some major reforms. On the power subsidy side, various efforts have been made by the state but with little success. The purchaser-provider model has been proposed. The major constraint in assessing the power consumption is the non-metering of agricultural pump sets. Action has been contemplated to meter the consumption points so that the actual energy consumed is accounted and the subsidy provided to Escoms to the agricultural pump sets is linked to actual submission of the bills by the utilities. This model will have to be fine-tuned and implemented in the succeeding years. Even the collection efficiency of non-subsidised sector needs to be improved. This set of studies

would help the State to focus its efforts on problem areas and would help in better targeting of power subsidy.

4.3.3 Transport subsidy is extended in the form of concessional bus passes to students and other weaker sections. This has been administered through certain studies based on sample surveys but their efficacies have sometimes been questioned in past. In this area, as a reform measure, the State has decided that 50% of the cost shall be subsidised by the Government and the remaining 50% has to be equally borne by the utility and the beneficiary. A purchaser-provider model is also on the anvil for the administration of transport subsidy.

Education subsidies in form of grant-in-aid are input linked and do not have a bearing on the performance

4.3.4 Subsidies in education are given in the form of grants-in aid to educational institutions. In the present system, the Grant-in-Aid (GiA) is linked to the salary and other benefits of the teachers in the absence of administrative control by the Government over these teachers, GiA has been a typical case of an input based subsidy system with no possibility of monitoring. Government spends almost Rs.1100 crore on Grant in Aid. When the salary burden of one primary school is Rs.4.20 lakh, it spends Rs.8.08 lakh per primary school in the form of Grant in Aid. Similarly for secondary education, the average salary cost of one government school is Rs.15.50 lakh on an average, Rs.17.55 lakh is being spent as GiA per GiA School. It is desirable to change to an output linked Grant in Aid system instead of merely linking it to the salary of the teachers. A performance based system would be one in which Grant-in-Aid is linked to the outputs expressed in terms of the performance of the students. A programme to transit from the current input based system to the out put based system would be drawn.

4.3.5 Targeting has not been a major problem in housing and food distribution. The selection of beneficiaries has been satisfactorily transparent. The scheme of housing subsidy is linked with a loan

component and poor recovery of the loan has almost been acting as an implicit subsidy not intended to be given by the Government. There is a need to increase the recovery of the loan component and build a recovery environment through structural reforms. In so far as the food subsidy is concerned, care should be taken to ensure that the incentive of misuse caused due to high differential in the rates is avoided through robust delivery mechanisms.

4.4 High Priority Development Expenditure

4.4.1 Health, Education, Water Supply, Power, Irrigation, and Infrastructure development are some priority sectors in which the Government would like to increase the allocations.

4.4.2 Quality of life is determined by the general status of well being of people. The ingredients for good health care lie outside the traditional health care system. A well-educated community living in safe households, which have access to good drinking water, nutrition and sanitation facilities can be said to have a better quality of life. It is for this reason the state considers Health, Education, and Water supply as priority sectors.

4.4.3 In the area of health, achievement of Millennium Development Goals has been the main objective of the state policy. Access to universal health care has to be ensured for every citizen. Information asymmetry and inadequate access to health care facilities on account of poverty may not allow the citizens to make use of the new developments in the health care. Relatively high level of Infant and Maternal Mortality prevailing in Karnataka has been a matter of great concern. The low level of institutional deliveries reflects the inadequateness of the health care system to provide proper delivery care for both the mother as well as the infant. Occurrence of the communicable diseases, especially the water borne, raises a number of public health issues. The problem of HIV AIDS epidemic spreading in the general population of

Karnataka should be attended urgently. The state has a programme for extending health care facilities to every village. Apart from ensuring availability of life savings drugs in adequate quantities in health care centres steps must be taken to ensure that trained manpower is positioned in the health care centres. The state has embarked on utilizing the private sector providers in public health care by introducing community health insurance for certain vulnerable sections of the population.

4.4.4 Education has been a very important priority sector. The state is focusing rightly on the primary and secondary education. Effort is being made to ensure that every child is enrolled in the schools. The economy measure like reducing the expenditure on salaries by reducing the number of sanctioned posts has not been applied to the Education sector. Programmes for providing free textbooks uniforms, mid day meals to schoolchildren are being implemented with greater vigour. Efforts are being made to provide basic infrastructure in all the public schools. In order to ensure minimum levels of learning a school quality assessment programme has been introduced.

4.4.5 A major portion of Karnataka lies in the rain shadow region and the dry land agriculture practiced in more than 70% of the cultivable area of the State suffers from the vagaries of monsoon. Irrigation has been looked as major factor, which can insulate the agriculturists from the recurring droughts. The state has embarked on major programme to utilize the available water for irrigation. In order to expedite the utilization of water expeditiously the state has created Special Purpose Vehicles and they have done a commendable job so far. In the absence of sufficient resources grater reliance was laid on the Off-Budget borrowings. However, with the fiscal consolidation irrigation projects are being provided with on budget support.

4.4.6 Power is the prime mover of the economy. Karnataka, which was once surplus in power, is suffering from inadequate availability of power. The new power policy has created an environment for investments in power sector. But, many more structural changes are required in the power sector to make it investment promotive. Unbundling and privatization of service providers has been contemplated in the new power policy. On the generation side Hydel projects have faced some bottlenecks and hence the state is concentrating on Thermal power. Another important area in power sector is prevention of losses in the in the distribution system. The T & D losses in power sector are about 30%. In the absence of a robust system to track the technical and commercial losses arising of inefficient power infrastructure and thefts are not being recorded and corrected. The power audit has not been possible. There is a need to locate areas contributing to transmission and distribution inefficiencies and correct technical inadequacies through capital investment, wherever required. An incentive based capital assistance programme for the ESCOMs is being contemplated.

4.4.7 The State has been facing growing need for infrastructure. In order to provide resources for the exclusive development of infrastructure the state has introduced Infrastructure Cess on various taxes and services. This source has been used for funding special infrastructure projects like International Airport at Bangalore and Metro Rail. However, a policy on funding infrastructure projects with private partnership in various models will be developed.

Table 5: High Priority Development Expenditure

Item	2001-02 A/c	2002-03 A/c	2003-04 A/c	2004-05 RE	2005-06 BE	2006-07 Proj	2007-08 Proj	2008-09 Proj
EDUCATION								
Revenue Expenditure	2843	2850	3053	3741	3976	4197	4630	5514
Capex	2	7	5	4	47	90	150	150
Total	2845	2857	3058	3745	4023	4287	4780	5664
Growth	4%	0.4%	7%	22%	10%	7%	11%	19%
HEALTH								
Revenue Expenditure	986	954	959	1066	1214	1464	1724	2072
Capex	100	50	25	15	88	120	150	250
Total	1087	1004	984	1081	1302	1584	1874	2322
Growth	8%	-7.6%	-2%	10%	15%	22%	18%	24%
ROADS								
Maintenance	219	108	114	255	331	713	730	748
Capex	239	418	445	721	791	900	1100	1400
Total	458	526	559	976	1122	1613	1830	2148
Growth	-12%	14.8%	6%	75%	44%	44%	13%	17%
WATER SUPPLY								
Revenue Expenditure	289	275	317	242	126	141	158	177
Capex	277	201	251	374	570	700	850	1050
Total	565	477	568	616	696	841	1008	1227
Growth	-4%	-15.7%	19%	8%	6%	21%	20%	22%
IRRIGATION								
Capex	808	738	534	193	1594	1700	1750	2100
Maintenance	72	34	52	69	73	84	100	117
Total	880	772	587	262	1667	1784	1850	2217
Growth	23.1%	-12.3%	-24%	-55.3%	170%	7.0%	3.7%	19.9%
BUILDINGS								
Capex	27.8	58.5	0.0	0.0	101.0	140.0	190.0	220
Maintenance	59	70	85	113	109	173	191	212
Total	87	128	85	113	210	313	381	432
Growth	-16%	48.0%	-34%	33%	8%	49%	22%	13%
TOTAL	5923	5764	5841	6794	9020	10422	11722	14011
Growth	4%	-2.7%	1%	16%	28%	16%	12%	20%

5.1.1 While the Medium Term Fiscal Programme dovetailed with the Annual budgetary process provides the framework for the fiscal policy, robust public finance management and accountability systems act as the tool for implementation of the reform agenda and their strength is a prerequisite for success of the reform programme. Karnataka, historically, had strong PFMA systems in place; however, with course of time, the need for reforms has increasingly been felt. The State has recognized the need and initiated several reform measures to further strengthen PFMA system to cope up with changing needs.

5.2 Treasury Reforms

5.2.1 One of the major reform initiatives taken in this direction is the use of Information Technology for strengthening of the entire Treasury system. Karnataka has one of the most advanced computerized treasury system in the country. The core objective of this initiative is to capture each transaction at the point of occurrence and use it for reporting as well as for controls. The system has not only improved the accuracy and timeliness of reporting and standardized the processes leaving little room for human interventions.

5.2.2 The most important control that the system enables is the budgetary integrity of expenditure by capturing the cumulative expenditure and allowing any further expenditure only after verifying the existence of the allocations for incurring the same. The level of disintegration is DDO-wise for each head of Account. While this would have been practically impossible in the past, use of IT has enabled this control, which was always very much desired. The system has been in operation for more than a year by now and has more or less stabilized. As of now, this control is applied only for the State

expenditure. However, in so far as the District Sector expenditure is concerned, control is at the aggregate level of ZP/TP fund. Hence there is a need to expand this system to cover even District Sector transactions. The current year can be used for building capacities in these institutions and the system can be rolled out to even ZP/TP transactions from the next year.

5.2.3 Another reform that the system has enabled is closure of the accounts of a particular year exactly on last day of the financial year contrary to the earlier practice of leaving the books of account open for few days even in the ensuing year. This has been made possible simply because the previous scenario could not have been possible in the computerised system. To ensure a smooth year end operation, a back projected calendar is issued now as a matter of practice giving cut-off dates for various kinds of claims to be preferred to the Treasuries to reducing dumping of claims on the last days of the year. This system has been successful to a great extent although lot of improvement is still expected. One important change that requires to be done is to shift the whole chain of expenditure backwards in time and avoid compression at the year end. Presentation of bill is the tail of the chain which has been tackled till now in the year end calendar. However, it is necessary to tackle even the preceding transactions like releases etc. and ensuring that they happen in time to ensure that presentation of bills does not get pushed because of delay in these transactions.

5.2.4 Although the computerised treasury system makes available huge amount of fiscal data almost online, the data has been put to little use other than for conventional reporting for preparation of accounts by the Accountant General. The detailed level to which data is available can easily be used for monitoring, projections and exception analysis. Efforts are being made to use this data, dovetail it with historical data and use it for projections of receipts, expenditure and cash flows. This would entail two pronged approach, firstly, systems need to be put in place at the disposal at various levels to enable such

activities and, secondly, the capacities in government in these areas has been limited since such activities were never taken up and thus a good amount of capacity building would be required in the treasuries, finance department and the Accountant General's office.

5.3 Public Account Restructuring

5.3.1 Public Account liability has not only been a matter of concern due to the distortion that it creates but also that it gives room for non budgeted or illegitimate withdrawals that lead to cash problem for the State. Several attempts were made to clean up this mess, some have been successful but some were not.

5.3.2 The Zilla/Taluka Panchayat funds were the ones that ranked first in this regard. Over the years, huge balances had accrued in these accounts that the administering authorities were not authorised to operate but in the audit reports, the Accountant General had been pointing to such instances. The first clean up through a write back was attempted in 2001-02 but due to some technical problems could not be operationalised. This was again attempted with a different strategy in 2003-04 and all balances as on 31st March 2004 were written back to the Consolidated Fund. The attempt was obviously not flawless and lead to write back of amounts that, ideally, should not have been written back. Taking lessons from this, the ZP/TP funds have now been divided into three funds with separate streams going into separate funds and the write back exercise has been made a regular activity to be executed every 1st April.

5.3.3 In addition to the ZP/TP funds, Personal Deposit Accounts also have been a cause of concern. Although these accounts are supposed to act only as an instrument to enable drawal of money, it has been used in the past for public account financing of the plan and to park funds to avoid lapsing at the year end. The legal provision with regard to these accounts that unless specifically stated otherwise, the balance as on every 1st April should be zero, this has never been enforced in past.

Recognising the seriousness of problem, this system has been enforced from 1st April of 2005 to be made a practice for future years also. Some accounts e.g. that of Deputy Commissioners being used for Calamity Relief Fund are exception to this system. This would not only prevent build-up public account liabilities, but would also eliminate the incentive to transfer funds at the year end to prevent lapse.

5.3.4 Further, there have been some PD accounts that have lost their relevance due to change in circumstances. It may be worthwhile to clean-up those accounts where huge amount of similar fictitious balances lie.

5.4 Debt Management

5.4.1 The whole issue of fiscal reforms revolves around the stability and sustainability of Public Debt. The quantum of debt, obviously, cannot be controlled overnight, but by limiting the fiscal deficit, which is the flow to the stock of debt, the problem will be under control over a longer period of time.

5.4.2 While the stock of debt would be the most important parameter that needs to be watched, there are several other issues that need attention. One such parameter is the portfolio itself. Even with the reducing interest rates, the effective interest rate for State debt did not see corresponding reduction because of existing high cost debt of huge amount. The State used the opportunity created by the southward moving interest rates by replacing high cost debt with low cost debt. The Debt Swap Scheme of Government of India was used to swap all the high cost Small Saving Loans extended by GoI. In addition, Rs. 790 Crore of NABARD loans till have been prepaid.

5.4.3 As recommended by the Twelfth Finance Commission, the Central Government has decided to consolidate all loans contracted till 31st March 2004 and outstanding as on 31st March 2005 and reschedule it for a repayment period of 20 years at an interest rate of 7.5%. This

benefit would be available only to States which have put in place their Fiscal Responsibility Legislation and are adhering to it. Since Karnataka had passed its Fiscal Responsibility Act as early as 2002 and has already met the target specified, the State would be eligible to get this benefit. The Twelfth Finance Commission has also recommended write-off linked to the reduction of Revenue Deficit as compared to the base Deficit (average of 2001-02, 2002-03 and 2003-04). This benefit would also be available to the State since it has eliminated the Revenue Deficit by 2004-05.

5.4.4 Off-Budget Borrowings

5.4.5 As per the KFR Act, the State is expected to phase-out its off-budget borrowings and with this objective in mind off-budget support to various SPVs, either partially or fully, has been replaced with budgetary support. The off-budget borrowings in the irrigation sector have been reduced and financial support has been provided in the budget. Similarly, the borrowing programmes of other Boards and Corporations like KLAC and KUWS&DB have been completely replaced by budgetary support. A beginning has been made to completely eliminate off-budget borrowings in a phased manner.

5.4.6 Contingent Liabilities

5.4.7 Although the quantum of outstanding government guarantees is governed by the Ceiling on Guarantees Act, the procedural aspect has evolved with time. Finance Department has been issuing various guidelines to evaluate the proposals for guarantee support but there is a need to put in place a comprehensive set of guidelines that would set out the procedure for making a request for Government Guarantee. An appraisal mechanism and methodology to scrutinize shall be prescribed for proposals for which Government has to stand guarantee. If required, these guidelines may be issued as rules to the Act or even as circular instructions. Although the data on GGs outstanding is being maintained, there is a need to capture other details like the evaluated

risk attached and a good monitoring system to monitor repayment of loans guaranteed and payment of Guarantee Commission needs to be put in place. The Debt, Guarantee and Investment Unit that is proposed to be a part of FPAC shall be given the responsibility to handle these issues.

5.5 Fiscal Policy Analysis

5.5.1 The success of any initiative lies in the analysis that goes before it is put in place and also on the feedback channel that exists to foster correction measures, if required, based on the post facto analysis of the consequences of the initiative being put in place. The Fiscal Policy Analysis Cell, which is expected to act as the analytical brain shall play this role and provide inputs to government. The cell is envisaged to have following units performing six different functions.

5.5.2 Tax Policy Analysis and Resource Forecasting unit will be responsible for analyzing macroeconomic indicators and revenue trends, tracking revenue collections, analyzing tax policy and the impacts on Government finance, and providing accurate and credible revenue estimates and projections to support Government fiscal planning and management. Initially, this unit should be able to possess some degree of macroeconomic analytical ability, but this capability will have to be enhanced in future years;

5.5.3 Expenditure Planning and Analysis unit will support budget formulation through its analytical work in the areas of baseline spending estimates, expenditure prioritization, fiscal impacts of policy changes and program trends, medium-term expenditure planning, and the integration of Plan initiatives and capital projects into the medium-term fiscal plan. The cell would also study on sequencing of expenditure by the Departments and how best it could be programmed with revenue forecast so that there is less of mismatch between revenue flows and expenditures. The analysts assigned to this division also would conduct evaluations of programs, schemes, or policies to assess their effectiveness and efficiency. Information about efficiency

and effectiveness could be used for multiple purposes: to help fine-tune the programs or policies to enhance their usefulness to the government, to help ensure that programs are continuing to provide the desired outcomes, to help the government redirect resources from less-productive to more productive uses, and finally to aid the Government in the process of curtailing or eliminating unproductive programs in favour of other more worthy causes.

5.5.4 Debt Management unit will represent a reinstatement and strengthening of the Department's former debt management cell. It will be responsible for tracking, managing, and planning for the government's debts, loans, guarantees, payment schedules, contingent liabilities, cash flow plans, risk management strategies and other debt-related information. The linkages between this unit and the Expenditure Planning and Analysis unit will be critically important to the government's resource planning efforts.

5.5.5 Fiscal Decentralisation unit would be responsible for monitoring the efforts made by the State towards fiscal decentralisation and putting in place, systems to better the fiscal relations between the State and the Local Bodies and to fiscally empower the Local Bodies even further.

5.5.6 Information Systems Support unit will work with all components of the FPAC to provide information support and functional integration within the cell and in connection with other units in the Government. They will work on computerized integration for the cell, provide functional inputs into the development of new budget formulation systems, serve as liaison with the Treasury on automation linkages, and conduct special studies in support of the cell's mission.

6**MEDIUM TERM FISCAL PLAN 2005-09**

6.1.1 Based on the past trends, the real growth of the economy has been projected at 7% and the inflation has been projected to be at 5%. This is also in line with the projections of the Central Government in the Medium Term Fiscal Policy Statement. Seeing the past trends of growth rates, especially in the secondary and the tertiary sectors, and the contribution of Karnataka in the national economy, this may be an under-estimate but the excessive dependence of the State's economy on the monsoon requires such caution.

6.2 Resources

6.2.1 The projections for the Commercial Taxes assume a buoyancy of 1.075 with VAT loss compensated in next three years to the extent of 100%, 75% and 50% as per the policy of the Central Government. It is assumed that the loss would reduce in three years and the system would stabilise in coming three years and the loss would be eliminated in the fourth year.

6.2.2 The State Excise has seen phenomenal growth in past years and the current year's trends are also encouraging. However, it is assumed that after the initial jump caused by the reforms would taper off in the coming years and the buoyancy is projected to stabilise around 1.025.

6.2.3 Although Stamp and Registration duties have also witnessed a good growth after rationalisation of Stamp duty and discontinuation of stamp papers, partially due to these reforms and partially due to the growth of real estate business, the impact of reforms in form of correction of the base would fade out and only the growth in the economy would contribute to the growth in collections and thus a unity buoyancy has been assumed. One factor, which has been taken into consideration while making the growth projections is the recent

decision of Government to disallow registration of certain transactions that are detrimental to, planned urban growth. This may lead to initial sluggishness in 2006-07 and for that year buoyancy less than one has been assumed.

6.2.4 Motor Vehicles Taxes have been projected at a buoyancy of 1.025 but success of reforms in the transport sector and financial strengthening of State PSUs would definitely prove an improvement over these projections. Other taxes have been projected at unity buoyancy. Non-tax revenues have been projected on historic growth rates and the Cesses linked to the corresponding growth in taxes.

6.2.5 The central grants are projected on the guidelines of the Planning Commission given to the States when the estimates of financial resources are prepared for the annual plans. For the purpose of projecting the devolution of Central Taxes, a rough estimate of Central Taxes is prepared, based on the growth rates of past few years, after removing distortions, if any, and then the share of the State has been calculated based on this estimate. The grants recommended by the Twelfth Finance Commission have been taken into consideration while estimating the resources as well as the expenditure.

6.3 Expenditure

6.3.1 The projections of salary expenditure are broken into those for basic pay, dearness allowance and other allowances. The basic pay is projected to be growing at 2.5%, dearness allowance linked to the inflation rate and the other allowances at 1%. The pension payments are projected on the basis of the historical growth rates for pension payments. The interest payments are based on the actual repayment schedule for the previous borrowings and the interest payments for future borrowings. While projecting the interest payments, two vital aspects have not been taken into consideration. Firstly, the projections exclude the benefits expected due to the debt relief measures recommended by the Twelfth Finance Commission since the decision

regarding extending the relief to the State has not yet been taken up. Secondly, for Externally Aided Projects, the back-to-back arrangement is not taken into consideration, one, the exact policy is not yet known whether the arrangement shall apply even to existing projects or only to future projects and, two, the lack of data on the interest rates on which the loans have been negotiated with the external lending agency.

6.3.2 The expenditure for the HPDE sectors have been projected based on the priority that needs to be given to the sector and the resources available. The non-salary expenditure in education has been given a growth ranging from 25% to 30% in various years. The non salary health expenditure has been projected to be a percentage of salary expenditure and in the projection period, it has been increased from 98% to 200%. Overall, health expenditure witnesses an increase of almost 20% in the projection period. Similarly, in the projection period, expenditure on roads witness an average growth of 29.6%, buildings of 23.2%, irrigation of 50.3% and water supply of 17.1%.

6.3.3 On the subsidies front, the effort has been to peg them in case of power, food and industries (after removing the distortion caused due to provision made to clear arrears). In case of power subsidy, however, backlog of subsidies is expected to be provided that have been made available based on the resources available. Housing Subsidy has been given a jump in 2006-07 as per the existing priority of the Government and subsequently has been projected to grow at historic plan size growth.

6.4 Fiscal Indicators

6.4.1 The MTFP 2005-09 projects the Consolidated Revenue Deficit to come down from 0.21% of the GSDP to 0.32% maintaining a negative deficit for the entire period as mandated by the Fiscal Responsibility Act. Similarly, the MTFP projects for a revenue surplus ranging from 0.59% to 0.74% of GSDP as mandated by the Twelfth Finance Commission. The Consolidated Fiscal Deficit is projected to

remain below the 3% mark as mandated by the Fiscal Responsibility Act and would stabilise at 2.4% of GSDP. The Fiscal Deficit is projected to remain within the 3% mark as mandated by the Twelfth Finance Commission and by the end of projection period, is expected to stabilise at 2.75% of GSDP. Due to a sustained control on Fiscal Deficit, which is a flow to the debt stock, the stock is expected to show an improvement from the current level of 31.9% to 29.6% by the end of projection period. With these factors under control, the High Priority Development Expenditure is projected to grow at an average rate of 18.9% in the projection period and the total expenditure on capital formation, *i.e.* capital expenditure excluding the repayment of off-budget borrowings is projected to grow at 28.2% and would increase from 1.57% of GSDP to 2.89% of GSDP in the projection period.

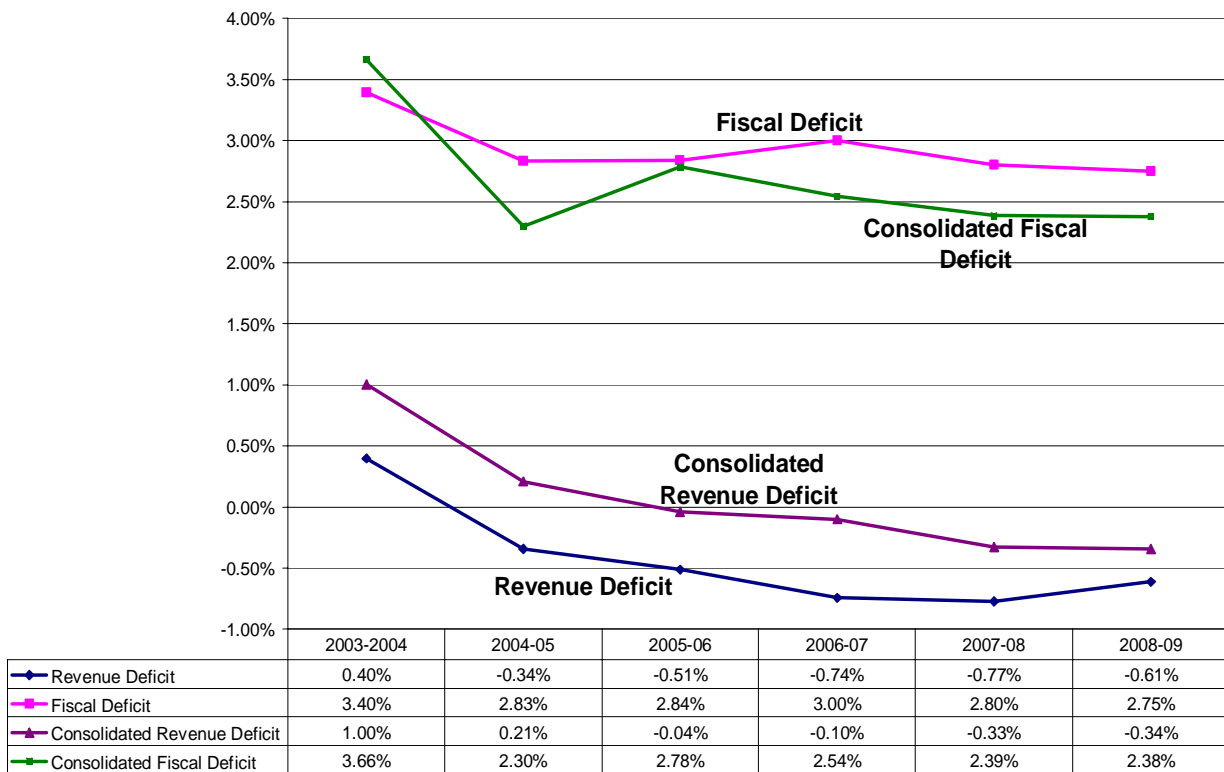


Figure 9: Fiscal Indicators for the MTFP period

Table 6: Medium Term Fiscal Performance 2005-09

Item	2003-04 A/c	2004-05 BE	2004-05 RE	2005-06 BE	2006-07 Proj	2007-08 Proj.	2008-09 Proj.
Revenue Receipts	20760	25510	25320	29218	32472	36282	40514
of which							
State' Own Tax Revenues	12570	14958	15748	18680	20865	23417	26488
Non Tax Revenues	2958	4486	3768	4090	4516	5009	5491
Resources from the Centre - Devolution	3245	3760	3449	3760	4136	4550	5005
- Grants	1987	2306	2355	2688	2954	3306	3530
Revenue Expenditure	21285	25437	24813	28364	31084	34660	39069
of Which							
Interest	3710	3920	3780	4029	4492	5053	5640
Salaries	5523	5751	5524	6169	6539	6907	8740
Pensions	1901	2214	2060	2427	2661	3209	3518
Subsidies (Food, Transport Housing & Industry)	525	905	1320	1573	1203	1258	1317
Power Subsidy	1675	1400	1400	1750	1750	2100	2100
Devolution to ULBs	629	799	799	1160	1428	1743	2130
Major O&M (Roads,Buildings & Irrigation)	251	401	437	513	970	1021	1078
Other O & M (Edn, Health,RD,WS,Agr, Forest)	2197	2444	2656	2530	3155	3836	4641
Administrative Expenditure	440	442	476	559	589	621	654
Other Revenue Expenditure	4434	7163	6361	7654	8296	8913	9251
Capital Receipt (Non Debt)	64	30	30	30	100	100	100
Revenue Deficit	525	-73	-507	-854	-1388	-1622	-1445
Expenditure on Capital Formation	2937	2502	2326	3774	4316	5346	6300
Fiscal Deficit	4501	4247	4192	4714	5603	5875	6483
Debt							
Total Debt Stock	42954	48384	47555	53185	60465	66340	72823
Interest	3710	3920	3780	4029	4492	5053	5640
Debt Services	7151	5907	7694	4925	5695	6555	7660
Salary+Pension+Interest	11134	11885	11364	12625	13692	15169	17898
Gross Off Budget Borrowings	1104	1035	798	949	715	450	250
Net Off Budget Borrowings	349	-174	-790	-85	-857	-867	-873
Consolidated interest	4511	4558	4596	4820	5695	5870	6120
Consolidated Revenue Deficit	1326	565	308	-63	-185	-687	-807
Consolidated Fiscal Deficit	4851	4073	3402	4629	4746	5008	5610

Table 7: Medium Term Fiscal Plan (as % of GSDP)

Item	2003-04 A/c	2004-05 BE	2004-05 RE	2005-06 BE	2006-07 Proj	2007-08 Proj.	2008-09 Proj.
GSDP at Current Prices	132498	147956	147956	166228	186757	209822	235735
INFLATION	3.92%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
GSDP Annual Real Growth	6.44%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Revenue Receipts	15.67%	17.24%	17.11%	17.58%	17.39%	17.29%	17.19%
of which							
State' Own Tax Revenues	9.49%	10.11%	10.64%	11.24%	11.17%	11.16%	11.24%
Non Tax Revenues	2.23%	3.03%	2.55%	2.46%	2.42%	2.39%	2.33%
Resources from the Centre –							
Devolution	2.45%	2.54%	2.33%	2.26%	2.21%	2.17%	2.12%
- Grants	1.50%	1.56%	1.59%	1.62%	1.58%	1.58%	1.50%
Revenue Expenditure	16.06%	17.19%	16.77%	17.06%	16.64%	16.52%	16.57%
of Which							
Interest	2.80%	2.65%	2.55%	2.42%	2.41%	2.41%	2.39%
Salaries	4.17%	3.89%	3.73%	3.71%	3.50%	3.29%	3.71%
Pensions	1.43%	1.50%	1.39%	1.46%	1.42%	1.53%	1.49%
Subsidies (Food, Transport Housing & Industry)	0.40%	0.61%	0.89%	0.95%	0.64%	0.60%	0.56%
Power Subsidy	1.26%	0.95%	0.95%	1.05%	0.94%	1.00%	0.89%
Devolution to ULBs	0.47%	0.54%	0.54%	0.70%	0.76%	0.83%	0.90%
Major O&M (Roads,Buildings & Irrigation)	0.19%	0.27%	0.30%	0.31%	0.52%	0.49%	0.46%
Other O & M (Edn, Health,RD,WS,Agr, Forest)	1.66%	1.65%	1.80%	1.52%	1.69%	1.83%	1.97%
Administrative Expenditure	0.33%	0.30%	0.32%	0.34%	0.32%	0.30%	0.28%
Other Revenue Expenditure	3.35%	4.84%	4.30%	4.60%	4.44%	4.25%	3.92%
Revenue Deficit	0.40%	-0.05%	-0.34%	-0.51%	-0.74%	-0.77%	-0.61%
Capital Receipt (Non Debt)	0.05%	0.02%	0.02%	0.02%	0.05%	0.05%	0.04%
Expenditure on Capital Formation	2.22%	1.69%	1.57%	2.27%	2.31%	2.55%	2.67%
Fiscal Deficit	3.40%	2.87%	2.83%	2.84%	3.00%	2.80%	2.75%
Administrative Expdr as % of RR	2.13%	1.73%	1.88%	1.91%	1.81%	1.71%	1.61%
Debt							
Total Debt Stock	32.42%	32.70%	32.14%	32.00%	32.38%	31.62%	30.89%
Interest/Revenue	17.87%	15.36%	14.93%	13.79%	13.83%	13.93%	13.92%
Debt Services/Revenue	34.45%	23.15%	30.39%	16.86%	17.54%	18.07%	18.91%
(Salary+Pension+Interest)/Revenues	53.63%	46.59%	44.88%	43.21%	42.17%	41.81%	44.18%
Debt Services/GSDP	5.40%	3.99%	5.20%	2.96%	3.05%	3.12%	3.25%
(Salary+Pension+Interest)/GSDP	8.40%	8.03%	7.68%	7.59%	7.33%	7.23%	7.59%
Consolidated Interest/revenue	21.73%	17.87%	18.15%	16.50%	17.54%	16.18%	15.11%
Off Budget Borrowings/GSDP	0.83%	0.70%	0.54%	0.57%	0.38%	0.21%	0.11%
Consolidated interest/GSDP	3.40%	3.08%	3.11%	2.90%	3.05%	2.80%	2.60%
Consolidated Revenue Deficit	1.00%	0.38%	0.21%	-0.04%	-0.10%	-0.33%	-0.34%
Consolidated Capital expenditure	3.05%	2.39%	2.11%	2.84%	2.69%	2.76%	2.78%
Consolidated Fiscal Deficit/GSDP	3.66%	2.75%	2.30%	2.78%	2.54%	2.39%	2.38%

Table 8: DMTFP Allocations

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Revenue Expenditure												
Legislature		38.43	38.43		40.27	40.27		42.19	42.19		44.14	44.14
Governor		2.22	2.22		2.34	2.34		2.46	2.46		2.59	2.59
Council of Ministers		9.59	9.59		10.00	10.00		10.43	10.43		10.88	10.88
Law		187.76	187.76		198.59	198.59		209.88	209.88		221.22	221.22
Elections		25.25	25.25		26.60	26.60		28.00	28.00		29.45	29.45
Colln of Taxes on Inc & Exp		3.23	3.23		3.42	3.42		3.62	3.62		3.82	3.82
Land Revenue		118.85	118.85		125.87	125.87		133.20	133.20		140.51	140.51
Stamps & Regn Fees		63.46	63.46		66.30	66.30		69.26	69.26		72.30	72.30
State Excise		44.37	44.37		46.90	46.90		49.54	49.54		52.17	52.17
Sales Tax	11.00	94.52	105.52	11.55	99.89	111.44	12.13	105.50	117.62	12.73	111.10	123.84
Vehicles	0.50	31.81	32.31	0.52	33.61	34.13	0.54	35.49	36.04	0.56	37.38	37.95
Other Taxes & Duties		5.66	5.66		5.97	5.97		6.29	6.29		6.62	6.62
Other Fiscal Services		47.49	47.49		49.46	49.46		51.50	51.50		53.62	53.62
Interest Payments		4028.95	4028.95		4491.99	4491.99		5053.32	5053.32		5640.20	5640.20
Public Service Commission		6.67	6.67		7.02	7.02		7.39	7.39		7.76	7.76
Secretariat General Services	4.00	49.65	53.65	1.00	52.20	53.20		54.86	54.86		57.54	57.54
District Admistration		96.25	96.25		101.97	101.97		107.94	107.94		113.92	113.92
Treasury Accunts & Admn		45.55	45.55		48.60	48.60		51.36	51.36		54.14	54.14
Home		964.12	964.12		1030.58	1030.58		1089.02	1089.02		1148.12	1148.12

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Jails		48.62	48.62		51.28	51.28		42.19	42.19		44.42	44.42
Supplies & Disposal												
Stationery & Printing	1.00	56.54	57.54	1.06	47.86	48.92	1.11	50.29	51.40	1.17	52.79	53.96
Public Works	2.00	269.23	271.23	2.10	341.87	343.97	2.21	367.81	370.01	2.32	395.88	398.19
Other Admn Services	13.00	339.03	352.03	2.93	363.05	365.98	3.07	763.99	767.06	3.23	1233.75	1236.97
Pensions		2427.00	2427.00		2660.66	2660.66		3208.74	3208.74		3517.93	3517.93
Misc General Services		2580.83	2580.83		3310.82	3310.82		3617.78	3617.78		3954.23	3954.23
Education	895.43	3684.40	4579.83	939.18	3905.03	4844.21	989.26	4085.19	5074.45	1055.21	4312.84	5368.05
Technical Education	72.25	88.47	160.72	71.71	93.42	165.12	127.83	98.59	226.42	134.24	103.83	238.08
Youth Services	8.82	23.31	32.13	9.26	24.53	33.79	9.72	25.80	35.52	10.20	27.11	37.30
Kannada & Culture	22.95	40.66	63.60	24.11	42.86	66.97	25.33	45.16	70.49	26.60	47.51	74.11
Expdr on Health	270.37	764.02	1034.39	364.05	912.34	1276.39	473.74	1082.85	1556.59	571.17	1237.05	1808.22
Family Welfare	172.49	6.97	179.45	180.51	7.38	187.89	149.95	17.61	167.56	174.25	20.46	194.70
Water Supply	122.35	9.30	131.65	137.20	10.02	147.21	153.92	10.79	164.71	172.77	11.61	184.38
Housing	155.06	23.15	178.20	249.81	25.92	275.73	272.30	29.80	302.10	296.91	34.26	331.18
Urban Development	581.27	75.38	656.64	610.33	79.23	689.56	640.84	83.28	724.12	672.89	87.49	760.38
Information	1.75	15.30	17.05	1.84	16.05	17.89	1.94	16.83	18.77	2.04	17.63	19.66
Social Welfare	717.33	543.47	1260.80	749.59	575.28	1324.88	789.79	608.90	1398.69	832.15	654.56	1486.70
Labour	14.32	44.10	58.42	15.04	46.64	61.68	15.79	49.29	65.08	16.58	51.94	68.52
Natural Calamity		90.64	90.64		94.27	94.27		98.04	98.04		101.96	101.96
Other Social Services	83.00	31.63	114.63	87.15	33.21	120.36	91.51	34.87	126.38	96.08	36.61	132.69
Secretariat Social Services		8.53	8.53		9.03	9.03		9.55	9.55		10.06	10.06
Agriculture	417.31	156.41	573.72	458.21	166.10	624.31	525.22	176.60	701.83	602.18	187.23	789.41

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Soil Conservation	276.51	25.17	301.67	287.35	26.67	314.02	301.82	28.24	330.06	316.98	29.80	346.78
Animal Husbandry	52.40	124.56	176.96	55.08	131.95	187.03	57.88	139.67	197.55	60.77	147.42	208.19
Dairy Development	3.54		3.54	3.72		3.72	3.90		3.90	4.10		4.10
Fisheries	15.85	11.16	27.01	16.64	11.82	28.46	17.47	12.50	29.97	18.34	13.18	31.52
Forestry & Wild Life	46.81	159.93	206.74	49.38	168.75	218.13	51.91	177.96	229.87	54.54	187.31	241.85
Food		517.32	517.32		518.32	518.32		519.37	519.37		520.42	520.42
Agriculture Reserch & Edn	44.00	73.88	117.88	46.20	77.57	123.77	48.51	81.45	129.96	50.94	85.53	136.46
Co-operation	90.47	491.11	581.58	95.00	44.50	139.50	99.75	47.13	146.89	104.74	49.77	154.51
RDPR	753.68	143.77	897.46	791.43	151.76	925.68	831.07	160.11	972.78	872.66	168.53	1021.88
Land Reforms	7.51	2.39	9.90	7.88	2.53	10.41	8.27	2.68	10.95	8.68	2.82	11.51
Other Spl Area Programme	60.00	150.35	210.35	63.00	157.87	220.87		165.76	165.76		174.05	174.05
Major Irrigation	3.59	51.15	54.74	3.80	75.23	79.03	4.00	90.20	94.20	4.20	107.80	112.00
Minor Irrigation	21.25	78.75	100.00	17.30	82.97	100.27	18.33	87.38	105.71	19.36	91.92	111.28
Command Area Development	46.72		46.72	49.06		49.06	51.51		51.51	54.09		54.09
Flood Control		0.25	0.25		0.26	0.26		0.28	0.28		0.29	0.29
Energy	26.22	1752.06	1778.28	27.53	1752.16	1779.69	28.90	2102.27	2131.17	30.35	2102.38	2132.73
NCSE	8.81		8.81	9.25		9.25	9.72		9.72	10.21		10.21
Village Industries	126.41	135.77	262.18	120.34	133.24	253.58	126.37	140.53	266.90	132.69	147.87	280.56
Industries	7.00	40.96	47.96	6.83	21.96	28.79	7.17	22.80	29.97	7.52	23.67	31.20
Mines & Geology	2.89	4.86	7.75	3.04	5.14	8.17	3.19	5.43	8.62	3.35	5.72	9.07
Other Outlay on Ind & Minerals	4.00		4.00	4.20		4.20	4.41		4.41	4.63		4.63
Ports & Light Houses		3.62	3.62		3.83	3.83		4.05	4.05		4.27	4.27
Civil Aviation		0.72	0.72		0.75	0.75		0.79	0.79		0.82	0.82

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Roads & Bridges	217.29	299.35	516.64	244.31	662.81	907.12	275.11	659.27	934.37	310.23	652.71	962.94
Transport		80.77	80.77		80.79	80.79		80.82	80.82		80.85	80.85
Inland Water Transport		1.55	1.55		1.64	1.64		1.73	1.73		1.83	1.83
Other Scientific Services	12.64	0.01	12.65	13.27	0.01	13.28	13.93	0.01	13.94	14.63	0.01	14.64
Ecology & Environment	31.05		31.05	32.61		32.61	34.24		34.24	35.96		35.96
Secretariat Economic Services	11.43	25.22	36.65	5.76	26.65	32.41	6.05	28.14	34.19	6.35	29.64	35.99
Tourism	16.50	1.55	18.05	17.32	1.64	18.96	18.18	1.73	19.91	19.08	1.81	20.90
Census Surveys & Statistics	5.92	11.02	16.94	6.17	11.64	17.81	6.43	12.28	18.71	6.69	12.93	19.62
Meteorology	0.27		0.27	0.28		0.28	0.30		0.30	0.31		0.31
Civil Supplies	2.49	3.60	6.10	2.64	3.81	6.45	2.79	4.03	6.82	2.94	4.25	7.19
Gen Financial & Trading Ins		0.01	0.01		0.01	0.01		0.01	0.01		0.01	0.01
Other Gen Economic Serv	323.98	36.94	360.92	311.86	39.15	351.01	343.58	41.44	385.03	379.15	43.74	422.88
Local Bodies		1160.00	1160.00		1430.16	1430.16		1745.32	1745.32		2132.52	2132.52
												779.16
Total Revenue Exp	5785.40	22578.62	28364.01	6208.36	24884.03	31074.87	6661.00	27998.59	34641.20	7216.77	30772.46	38749.07
Capital Expenditure												
Home	25.66		25.66	63.67		63.67	66.72		66.72	66.02		66.02
Public Works	165.90		165.90	199.08		199.08	298.62		298.62	373.28		373.28
Education	44.87		44.87	90.00		90.00	150.00		150.00	150.00		150.00
Technical Education	0.75		0.75									

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Kannada & Culture	0.75	1.00	1.75	0.90	1.00	1.90	1.35	1.10	2.45	1.69	1.21	2.90
Expdr on Health	80.01	1.00	81.01	111.60		111.60	137.40		137.40	234.25		234.25
Family Welfare	7.00		7.00	8.40		8.40	12.60		12.60	15.75		15.75
Water Supply	570.36		570.36	700.00		700.00	850.00		850.00	1050.00		1050.00
Housing	166.17		166.17	199.40		199.40	299.11		299.11	373.88		373.88
Urban Development	29.33		29.33	35.20		35.20	52.79		52.79	65.99		65.99
Information	0.80		0.80	0.96		0.96	1.44		1.44	1.80		1.80
Social Welfare	123.09		123.09	125.49		125.49	128.49		128.49	130.99		130.99
Other Social Services												
Agriculture	0.30		0.30	2.00		2.00	2.20		2.20	2.42		2.42
Soil Conervation	30.61		30.61	36.73		36.73	55.10		55.10	68.87		68.87
Animal Husbandry	1.67		1.67	2.00		2.00	3.01		3.01	3.76		3.76
Fisheries	4.67		4.67	5.60		5.60	8.40		8.40	10.50		10.50
Forestry & Wild Life	0.50		0.50	0.60		0.60	0.90		0.90	1.13		1.13
Food	0.10		0.10	0.12		0.12	0.18		0.18	0.23		0.23
Agriculture Reserch & Edn	2.80		2.80	3.36		3.36	5.04		5.04	6.30		6.30
Co-operation	0.20		0.20	0.23		0.23	0.35		0.35	0.44		0.44
RDPR		1.21	1.21		1.45	1.45		2.18	2.18		2.72	2.72
Major Irrigation	1249.45	3.35	1252.80	1345.98	4.02	1350.00	1493.98	6.02	1500.00	1992.47	7.53	2000.00
Minor Irrigation	340.81		340.81	350.00		350.00	250.00		250.00	100.00		100.00
Command Area Development	0.00		0.00	0.00		0.00	0.00		0.00	0.00		0.00
Flood Control	7.80		7.80	9.36		9.36	14.04		14.04	17.55		17.55
Energy	19.52		19.52	23.42		23.42	35.13		35.13	43.91		43.91
Village Industries	3.43		3.43	3.77		3.77	5.66		5.66	7.07		7.07

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Industries	10.00	30.00	40.00	12.00	50.00	62.00	18.00	63.00	81.00	22.50		22.50
Other Outlay on Ind & Minerals	0.05	1.00	1.05	0.06	1.20	1.26	0.09	1.80	1.89	0.11	2.25	2.36
Ports & Light Houses	5.75		5.75	6.90		6.90	10.35		10.35	12.94		12.94
Roads & Bridges	790.56		790.56	900.00		900.00	1100.00		1100.00	1400.00		1400.00
Tourism												
Gen Financial & Trading Ins	-6.20	0.01	-6.19		0.01	0.01		0.01	0.01		0.01	0.01
Dairy dev	0.01		0.01	0.01		0.01	0.02		0.02	0.02		0.02
Misc General Services	3.00	56.57	59.57	3.30	1.00	4.30	3.63	1.10	4.73	3.99	1.21	5.21
Total	3679.72	94.13	3773.84	4240.16	58.67	4298.83	5004.59	75.21	5079.80	6157.86	14.93	6172.79
Off Budget Repayments			1825.00			2774.79			2252.16			1760.48
KBJNL 4701			1022.26			1924.86			1359.91			747.61
KNNL 4701			496.65			464.87			395.31			429.64
KRDC 5054			89.84			124.74			135.74			133.24
Mahiti Bonds 5465			7.65			7.65			67.65			
KREIS 4225			10.28			10.21			9.70			9.18
KPHCL 4055			53.87			63.67			66.72			66.02
KSCB 4217			43.00			42.13			39.50			36.64
KSIIDC 5465			19.61			19.49			18.51			16.55
KLAC 4215			34.50			32.23			34.18			32.37

Description	BE			Projections								
	2005-06BE			2006-07			2007-08			2008-09		
	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total	Plan	Non Plan	Total
Cauvery NNL 4701			37.96			77.96			117.96			282.96
SSA 4202			5.85			3.45			3.45			3.25
Keonics-Hudco- 4851			3.53			3.53			3.53			3.02
Total Capital Expenditure			5598.84			7073.63			7331.96			7933.28