Options for Budgeting in a Downturn
Karnataka 2009 - 2010

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Second Endowment Lecture on State Budget Issues

CBPS

CENTRE FOR BUDGET AND POLICY STUDIES

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CBPS MONOGRAPHS

- 'Decentralisation From Above- Panchayat Raj in the 1990s' by Vinod Vyasulu, March 2000.
- 'Democracy and Decentralisation: a Study of Local Budgets in two Districts of Karnataka' by A. Indira, etal, March 2000.
- 'Democracy and Decentralisation: Zilla, Taluk amd Grama Panchayats,' A. Indira et al, March 2000.
- 'Small Enterprises in Karnataka- Lessons from a survey in Karnataka' A.Indira, B.P.Vani, Vinod Vyasulu, February 2001
- 'Development at the District Level: Kodagu in the 1990s' A. Indira. Note submitted to the District Planning Committee, March 2001.
- 'A Health Budget in Karnataka: A Preliminary Study' A. Indira, Vinod Vyasulu, April 2001
- 'The Estimation of District Income and Poverty in the Indian States' A. Indira, Meenakshi Rajeev, Vinod Vyasulu, August 2001
- 'The Budget for Education-A Study at the District Level in Karnataka', Vinod Vyasulu, A. Indira, November 2001
- 'Civil Society and Budget Analysis- Experience of Civil Society and Budget Analysis in Nepal, Bangladesh and India' Documented by Jonna Vyasulu, June 2002
- 'Budget Transparency, Accountability and Citizen Participation. The PROOF Campaign in Bangalore' Vinod Vyasulu, May 2003
- 'City Government, Budget Analysis and People's Participation in India. The Experience of Bangalore' Seema Dargar, June 2003
- 'Productivity & food security a marginal situation case study' by Sharadini Rath, Nov. 2003.
- 'Exploring Institutional linkage - Panchayati Raj Institutions and Natural Resource Management in Karnataka' by V. Vijayalakshmi & Vinod Vyasulu, March 2004.
- 'Maternal health in Karnataka - as seen from Budget data, a preliminary analysis for discussion among Civil Society Groups' Oct. 2004.
- 'Reproductive and child health services in Karnataka' - by Anaka Aiyar and Poornima Vyasulu. December, 2007.
- The Budget of Apna Pradesh - A Hand Book - December, 2007.
- 'Karnataka : Fiscal correction for Human Development' - by Vinod Vyasulu - 2008.

About the Author

A.Indira, M.A., M.Tech., Ph.D: Has over 18 years of varied experience as researcher, consultant, trainer and teacher. She has worked as a Policy researcher and consultant in the areas of Local Self Governance and Social sectors. Her other main areas of research interest are technology diffusion and development issues. She currently teaches Economics at LIBA.

CBPS

The Centre for Budget and Policy Studies (hereinafter referred as the Centre) is a non-partisan, non-profit, independent society established by a group of professionals based in Bangalore and registered under the Karnataka Registration of Societies Act in February 1998 (no 777 of 199701998). The President is Dr. S. Rajagopalan and the Secretary M.S. Ramaprasad and Director is Dr. Vinod Vyasulu.

The objective of the Society is to contribute through research to understanding and implementing a process of long run, sustainable, equitable development in countries like India. Equity, as we understand it, extends across time - future generations must not be deprived of resources because of irresponsible use - and class and gender - all human beings have inalienable rights that society must ensure.

An area in which the CBPS has made a contribution is in the context of the ongoing process of democratisation and decentralisation following upon the 73rd and 74th amendments to the Indian Constitution. In this context, budgets of different governmental bodies are important statements of policy priority. Budget analysis at local levels is an area where much needs to be done. An example is the work of the Centre in studying the budgets of two zilla panchayats [Dharwad and Bangalore (Rural)] in Karnataka. This report, formally released by the Governor of Karnataka, Her Excellency Smt. Rama Devi on July 4, 2000, is being used in, programmes to orient those who have newly been elected to local government bodies. The CBPS is currently working on a study of the finances of a few city municipal councils in Karnataka.

One way of meeting our objective is by providing inputs into ongoing debates in society on matters of policy priority by collecting and analysing information and presenting scenarios on different options that face the public. Industry is one such area. The functioning of different sectors of industry, its impact on employment, livelihoods, productivity and the like, and the different options open to this country, in the midst of major global changes like the advent of the WTO, need careful study and debate. CBPS did a study and published a monograph. Another area of importance is an understanding of the nature of the local economy. The Centre has worked on this issue and a manual on the method to calculate District Income in India, sponsored by the Planning Commission, is being published by Macmillan India.

Another area of importance is ecological and environmental sustainability. The interface between local bodies and environmental programmes is another area of focus. CBPS has studied the working of programmes like drinking water, watershed development and joint forest management to see how local bodies can contribute to the meeting of national objectives.

CBPS was a partner in a campaign called PROOF (Public Record of Operations & Finance, along with 3 other Bangalore based organisations. The PROOF campaign provides an opportunity for citizens & the corporation of Bangalore (BMP) to join hands and demonstrate that public money is being used for public good. This will be achieved by systematic BMT performance report & reviews, substantiated by performance indicators & explanatory statements.

CBPS will remain a small body of professionals who will work by interacting and networking with others who share such interests. Working groups for different studies with professional membership will be set up, and will work with minimal infrastructure. Full use will be made of modern technology in this process. The results of such work will be used in training, in dissemination of results and in follow up programmes.

FOREWORD

On completing ten years of work, CBPS decided to institute an endowment lecture in the Indian Institute of World Culture in which the state budget would be discussed by an expert before a public audience. Today the involvement of the public, of civil society, in the budget process is close to zero. This is unfortunate. The budget is too important a document to be left to officials alone. It provides details of how the government intends to keep the promises it has made, and the data in the budget is useful for citizens to decide upon the priorities, efficiencies etc of government spending, its tax policies etc. This endowment lecture is meant to provide a platform—hopefully there will be others—in which these issues can be meaningfully debated.

The first lecture in the series was given by the distinguished economist, Professor Abdul Aziz last year. We were happy with the response to it.

Since then, the economic environment globally has changed. Rather suddenly, the world finds itself in a recession. India has not escaped the downturn. Karnataka, which has strong export industries in information technology and garments, has also been hard hit. Jobs have been lost, and earnings have come down. The state, which had managed to reduce fiscal deficits, once again finds itself in a position of fiscal stress. Its assumptions about revenue growth have turned out to be wrong. Demands for expenditure have grown. Even the relaxation of the fiscal deficit norms by the union government may not help. After all borrowing leads to debt servicing obligations that persist into the future.

Rather than wait for the Finance Minister to present the budget and then critique it, this year we felt it would be helpful if the options before the state were discussed by an expert. There are many ways in which the state can reduce expenditure. What are the implications of each choice? From the point of view of the poor, are there some that are preferable to others?

Dr Indira dealt with this question in detail, using an econometric model and the data on state finances. She has sketched out different options and discussed the implications. She has assumed that the fiscal targets must be kept. If this is not done the problems becomes much more complex in a sub-national government.

In this, she builds upon an earlier study of CBPS that had raised concerns about the expenditures on the social sector being reduced—proportionally—at a time of raising tax revenues. Given the state's objective of reducing regional and inter-class disparities, and given that there remain unspent balances at the local level, what kind of restructuring must the state do? Indira leads us to this question, but the answer has yet to emerge.

The lecture was well attended, and the debate that followed was lively. It may be viewed on......The paper has been widely circulated among those involved. It is now being presented to the wider public in the hope it will help informed debate.

Vinod Vyasulu
Director

Options for budgeting in a downturn – case of Karnataka[1]

A.Indira

I The recent macroeconomic crises across nations have brought back attention to the intervention that governments can make in helping the local economies. The Union Government of India announced two stimulus packages to help tide over the crises. However more has been expected through the annual budgets of the governments – both at the national and sub-national level.

A budget is clearly a political policy statement defining the objectives and the plans of the government for the next financial year. Over time, the budget exercise has come to be a formality. However in times such as a downturn or a recession, it brings forth an anticipation of the steps that a government could take for the benefit of the citizens. The budget is seen as a policy instrument, through which allocations are made towards the various sectors.

2009-10 being an election year, the Union Government decided to go in for a Vote-on-Account. Following this, those State governments going to elections were advised to have a Vote-on-Account budget. In case of the State of Karnataka, an interim budget was presented.

Karnataka was the first state to pass the Fiscal Responsibility and Budget Management Act (FRBM). Following this the state has been fiscally very prudent. The present paper makes an attempt to understand how the state is faring under the conditions of fiscal prudence and whether it would have any bearing because of the downturn in the economy. Section II looks at the macroeconomic situation in Karnataka, while section III lists the options available under the circumstances followed by conclusion.

II Macroeconomic situation of Karnataka

In Karnataka, the growth in the domestic economy shows a sectoral composition which has steadily grown in favour of the services sector, showing a little over 50% share in the GSDP. This sector primarily constituting the export segment, currently has seen stagnation in business – especially those of information technology services which were heavily dependent on offshore/ outsourcing resources. It has

[1] A revised version of the lecture given at Indian Institute of World Culture, Bangalore May 13, 2009 as the second annual endowment lecture instituted by the Centre for Budget and Policy Studies, Bangalore.

had a snowball effect in other sectors such as hospitality, transport, building of infrastructure, showing low business activity and investment. The effect of the skewed growth is also being felt as the slowdown begins. These have also had direct detrimental effects on the manufacturing and agricultural sectors, which for a while has already been stagnant and showing low and slow growth.

Fiscal Indicators:

Karnataka's diligence with regards to public finance[1] can be learnt through the three major fiscal indicators, namely the revenue, primary and fiscal deficit numbers. Revenue deficit (RD) is the difference between the revenue receipts and the revenue expenditure. It indicates the extent to which current receipts are not able to cover revenue expenditures necessitating borrowing to finance current, not-asset building, expenditure. It represents government consumption expenditure that requires to be financed by capital receipts. These capital receipts consisting of net borrowing, is called the fiscal deficit (FD), apart from a small

[2] Vinod Vyasulu and Kirti Toshniwal, "Karnataka: Fiscal Correction for Human Development?", Centre for Budget and Policy Studies, Bangalore, May 2008.

portion of non-debt capital receipts. The primary deficit (PD) is equal to fiscal deficit, which represents net inflow of borrowed funds, minus interest payments, which represent outflows in the form of transfer payments. Primary deficits accumulate into debt, unless offset by an excess of GDP growth rate over interest rate. One related measure, namely, the ratio of revenue deficit to fiscal deficit, indicates the extent to which borrowing is used for current expenditures.

Karnataka's GSDP grew from 5.36% between 1980-81 and 1989-90 to 7.17% between 1990-91 to 2001-02. Thereafter it has grown at 7% in 2005-06 and 2006-07 and 8% in 2007-08 and 9% in 2008-09. The fiscal deficit has been kept well below 3% for years 2005-06 to 2007-08, as seen through the figures of Medium Term Fiscal Plan (MTFP)[1]. For year 2008-09 RE the FD is 3.4%.

Revenue Receipts:

The revenue receipts have steadily increased. The commendable point being that the state's own tax revenue has improved.

Table 1: Composition of Own Tax Receipts of Karnataka 2007-08(RE)

	Sources	Karnataka %	All states (% to GDP)
	Own Tax Revenue (OTR), of which	100.0	100.0
1.	Taxes on income (TI)	1.5	1.1
2.	Taxes on professions, trade, callings and employment (TPT&E)	1.5	1.1
3.	Taxes on property and capital transaction (TP)	14.3	14.6
4.	Stamps and registration fees (SRF)	14.0	13.1
5.	Land revenue (LR)	0.3	1.4
6.	Direct taxes (1) +(3)	15.8	15.6
7.	Taxes on commodity and services (TC)	84.2	84.4
8.	Value added tax/ state sales tax (VAT/SST)	49.4	50.3
9.	State excise tax (SET)	17.2	11.7
10.	Tax on vehicles (TV)	6.6	5.3
11.	Indirect taxes (IDT) = (7)	84.2	84.4
12.	Own Tax Revenue (OTR) (6)+(7)	100.0	100.0

Source: State Finances – A study of Budgets of 2008-09, RBI

The four major tax components of the state have grown, they being - commercial tax, excise, motor vehicle tax and stamps and registration fees (table 1). The four components have grown. The trend growth rate over the period 2002-

[3] MTFP 09-13, accessed on 11.3.2009 at 10:44 am at http://www.kar.nic.in/finance/mtfp/mtfp.htm

03 to 2008-09 RE for commercial tax is 18.62%, with a buoyancy of 0.89 in 2008-09RE. The trend growth rate over the period 2002-03 to 2008-09 RE excise 18.85%, with a buoyancy of 1.15 in 2008-09RE. The trend growth rate over the period 2002-03 to 2008-09 RE motor vehicle tax at 18.1%, with buoyancy of 0.46 in 2008-09RE. The trend growth rate over the period 2002-03 to 2008-09 RE for stamps and registration 21.79% with buoyancy of -0.60 in 2008-09RE.

Table 2: Composition of Taxes on Commodities and Services in Karnataka for 2005-09

Taxes on Commodities and Services, of which		**% to total**
1.	Sales tax	71.6
	a. State VAT	59.5
	b. Central Sales Tax	7.5
	c. Sales tax on motor spirit and lubricants	3.0
2.	State excise	13.8
3.	Taxes on vehicles	6.3
4.	Taxes on goods and passengers	3.2
5.	Taxes and duties on electricity	3.9
6.	Entertainment tax	0.3
7.	Other taxes and duties	0.9
		100.0

Source: State Finances – A study of Budgets of 2008-09, RBI

It can also be seen that the taxes on commodities and services has the largest share among the own tax revenue receipts (Table 1). In a downturn there does not seem to be much scope for an increase in any of the components of the taxes on commodities and services. Infact except for the State VAT which has shown a healthy growth during the period of 2005-09, there is likely to be a fall in all other major components. If any other component could see a rise in case of a severe downturn would be the state excise through more consumption of liquor (Table 2).

Variation in Revenue Receipts:

There is a variation in revenue receipts in the years 2007-08 and 2008-09.

Table 3: Variation of Revenue receipts (in Rs.Cr)

	2007-08	2008-09	2008-09	2009-10	Var	Var	Var	Est	Var	Var
	ACS	BE	RE	BE	(2)/(1)	(3)/(1)	(4)/(3)	2009-10	(8)/(3)	(8)/(4)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
REVENUE RECEIPTS OF WHICH	41151	47240	42818	48389	1.15	1.04	1.13	44119	1.03	0.91
(i) State Tax Revenue	25987	31876	287645	32721	1.23	1.11	1.14	29158	1.01	0.89
(ii) Non-Tax Revenue	3358	1932	1906	2130	0.58	0.57	1.12	2464	1.29	1.16
(iii) Share of Central Taxes	6779	7982	7152	7645	1.18	1.05	1.07	7192	1.01	0.94
(iv) Grants in Aid	5028	5450	4996	5893	1.08	0.99	1.18	5305	1.06	0.90

Source: Columns (1) to (4) taken from MTFP 2009-13, GOK.

Column(5) calculates the variance of 2008-09BE over 2007-08; Column(6) calculates the variance of 2008-09RE over 2007-08; Column(7) calculates the variance of 2009-10BE over 2008-09RE; Column(8) calculates the three year moving average of 2007-08, 2008-09RE and 2009-10BE; Column(9) calculates the variance of 2009-10 new estimate over 2008-09RE; and Column(10) calculates the variance of 2009-10 new estimate over 2009-10BE.

The above Table 3 shows the variation of the revenue receipts of the year 2008-09 over 2007-08. It is seen that the variation of state tax revenue for 2008-09 BE over 2007-08 was expected to show a high of 1.15, but the 2008-09 RE shows a decrease to 1.04. However the current 2009-10BE is expecting a growth of 1.13. A simple three year moving average trend figure for revenue receipts for 2009-10 is Rs.44119 crores, showing a decrease to 1.03 from the expected 1.13. In terms of cash flow, the difference in collection is to the tune of Rs.5000 crores approximately.

With respect to the expenditures, it is seen that the total expenditure in 2008-09 was Rs.52,445 cr. of which plan expenditure accounted for Rs.20,062 cr.

In Karnataka, the revenue deficit (RD) has grown smaller over the years 2006-07 and 2007-08. For the year 2008-09 the RD as percentage of GSDP was only 0.29. However both the fiscal and primary deficits had increased. As against the budget estimates of 2.88 for FD and 0.72 for PD, the 2008-09 RE showed that FD increased to 3.49 and the PD to 1.71. This shows that there has been borrowing to finance expenditure[1].

The other critical indicators are the interest payments relative to revenue receipts which hovered around 11.27% in 2006-07 and 11.82% in 2007-08. The combined subsidy component for power and subsidies for food, transport, housing and industry was at 1.48% of revenues in 2007-08. As per the MTFP 2009-13 the expenditure on interest payments, salaries, pensions and subsidies is expected to be 8.28 per cent of GSDP in 2008-09 RE, declining from 9.0 per cent in 2002-03. By the year 2012-13, these expenditures are estimated to be within 8.19 percent, leaving large fiscal space for development expenditure.

Following this, the interim budget presented shows an attempt to cover all the sectors, with a view to keeping the various fiscal indicators under control. Even so the 2008-09 RE shows that the FD has increased to 3.49 over the 2008-09 BE of 2.88 and the previous year 2007-08 RE of 2.44.

This is a cause of concern in the downturn, considering that one of the ways of increasing money supply in the

[4] The Union Government because of the global meltdown has modified the targets under the FRBM by 1% for the states.

economy and revitalizing the business sentiment will be to increase the government expenditures. In Karnataka, the primary sector has a 17.4% share, secondary sector 26.7% and tertiary sector a 55.9% share in 2008-09 AE. The tertiary sector has been a dominant revenue earner for the state. The downturn while affecting the revenue flow in the state will also affect the plans for development in the short-run. The expected shortfall in the revenue from exports, will not allow much of a leeway for the government to increase its FD even when the Central government has agreed to allow an increase of upto 3.5%. The state has already touched 3.49 in 2008-09.

It seems that under the circumstances it would be difficult for any of the taxes to really rise during the next two to three years. The state would be dependent on the grants as part of the economic stimulus package and the loans that it can raise through the market. The Union

Government as part of its First Stimulus has announced an additional Plan spending of Rs.20,000 crore. It has also allowed the states to raise additional market borrowings of 0.5% of GSDP.

[5] Twelfth Finance Commission Report, accessed 6.4.2009 at 3:20 pm, http://www.mp.gov.in/finance/12fcreng.pdf

As for the loans from the market, the Twelfth Finance Commission (XII FC) has been quite categorical in its approach that the states would be encouraged to approach the market for any extra funds. All plan and non-plan loans given to states from 1.4.2004 till date are at 9%. In the recession period, the banks have been asked to provide credit at much lower rates, though it remains to be seen at what rates credit will flow.

Target level of Interest payments relative to revenue receipts -

One of the first steps in designing the options would be to continue fiscal prudence. This would mean to look at the target level of interest payments relative to revenue receipts, which would give an estimate about the level of borrowing.

The Twelfth Finance Commission has used the following methodology[1] in determining the interest payments to revenue receipts ratio, that a government would need to make in case of increased borrowing.

Using the sustainability conditions, the level at which the fiscal deficit to GDP ratio (f*) will be consistent with a stabilized debt-GDP ratio (b*) at sustainable level was derived as: $f^* = p.g/(g-i)$ and $b^* = p(1+g)/(g-i)$; p being primary deficit. This condition can be written in terms of the interest payments to revenue receipts ratio indicated by (ip) and revenue receipts to GSDP ratio indicated by (r). Revenue receipts include transfers from the centre.

Thus, $f^* = (ip)^* r.g / i$ and $b^* = (ip)^* r (1+g) / i$; where i is the interest rate, g the growth rate.

The target level of interest payments relative to revenue receipts can be written as: $(ip)^* = f^*.i/r.g$

Thus, the level of interest payments relative to revenue receipts consistent with stabilizing fiscal deficit and debt at sustainable levels will be (a) higher, the higher the fiscal deficit target, and the average nominal interest rate, and (b) lower, the higher the revenue-GSDP ratio and the nominal growth rate.

It has generally been observed that for the general category states, on an average the IP-RR ratio increased from 16.7 to 25.5 between the years 1993-96 to 2000-03. In case of Karnataka, for the period 1993-94 to 1995-96 it was 12.08 and between 2000-01 to 2002-03 it was 18.07. For the year 2007-08 the ratio was 11.55, the 2008-09BE was 11.17. The other parameters in this, namely, revenue receipts to GSDP ratio in the state has been hovering at 16. It is quite clear that the higher growth rate at 7-8% in the past few years, together with higher RR has helped keep the interest payments in check.

Table 4: Target level of interest payments

f	0.035				
r	12	13	14	15	16
i/g	6	6	6	6	6
0.06	29	27	25	23	22
0.07	34	31	29	27	26
0.08	39	36	33	31	29
0.09	44	40	38	35	33

In case of an increased borrowing now, the target level of interest payments would be as shown in Table 4. The MTFP 2009-13 has projected that given the uncertainties of the national economy, the state can assume a growth rate at 6%. Table 4 assumes the different possible ratios of revenue receipts to GSDP (r), taking FD (f) at 3.5%, and the different interest rates (i) at which the credit could be made available, given the growth rate (g).

The Table 4 clearly shows that the loans at 9%, as has been the case since 1.4.2004 would be quite high. If the state is able to garner loans at 6% interest rate and manage to keep the revenue receipts to GSDP ratio at 14, the interest payments would be at 25, which would still be double the ratio as achieved in 2008-09. It is also to be noted that the state has already reached a FD of 3.49 in 2008-09, not leaving much of a leeway for any further borrowing.

Table 5: The Amount of Additional Borrowing Needed

FD	Rev Recpts 2009-10BE	Total Exp 2008-09RE	Borrowing
(1)	(2)	(3)	(4)= (3)-(2)
3.49	48389	52445	4056
3.5	48389	52595	4206
3.6	48389	54097	5708
3.7	48389	55600	7211
3.8	48389	57103	8714
3.9	48389	58606	10217
4	48389	60108	11719

The above Table 5 shows how much the state would need to borrow. Column 1 is the various FD ratios. Column 2 assumes the revenue receipts that is estimated to be earned by the state in 2009-10BE. Column 3 calculates the proportionate increase in total expenditure that the state can make, keeping a minimum of Rs.52445 crores total expenditure made in 2008-09. The proportionate increase in total expenditure at various levels of FD is calculated in

Column 3. Column 4 gives the difference between the total expenditure and the revenue receipts at 2008-09 level, the amount that would need to be filled in through market borrowings. These are the amounts that would be carried over as future public debt.

III

The Budget 2009-10 Implications of State Decisions

In the background of the macroeconomic situation discussed, it is interesting to note that in the MTFP 2008-12, the rolling plan of the state government recognized the possibility of a slowdown. But it had seemed hopeful that the crisis would pass over with the good national record of accumulated savings and the high GDCF. The other strong supporting factor that was thought to be dependable was the huge domestic consumption which would provide opportunities for growth.

But it seems that the state government may find that it would not be able to continue with the same game plan as envisaged in the MTFP 2008-12. Much concerted efforts will have to be taken up in the manufacturing and agricultural sectors. Hence the roadmap for 2009-10 can be set keeping in mind the fiscal objectives that have been put forward in the MTFP 2008-12 document.

The Medium Term Fiscal Plans of the State right from 2001 has had a common thread of fiscal objectives running through them. The guiding principles are as follows: -

a. Widening the tax base while moderating the tax rates.

b. Smart enforcement through use of Information Technology and computerization.

c. Reducing compliance cost and promoting tax payer friendly processes.

d. Focused approach for recovery of arrears of revenue.

e. Priority in allocation to Social Services and Infrastructure upgradation.

f. Emphasis on decentralized and local solutions for implementation.

g. Linking outlay to outcome to improve productivity of expenditure.

h. Zero based budgeting to weed-out schemes which have outlived their utility. Consolidation of schemes to provide impetus to core programmes without spreading the resources thinly.

i. Appropriate staffing and operational expenditure for service delivery sectors like health, education and regulatory functions.

j. *Prudent borrowing guided by affordability rather than availability as per the provisions of the Karnataka Fiscal Responsibility Act 2002.*

k. Bringing down the cost of debt by debt swapping, pre-payment and adopting best debt management practices.

l. Maintaining Government guarantee stock within the ceiling prescribed by the Ceiling on Government Guarantees Act, 1999 and extension of guarantees not on the basis of availability but through rigorous risk analysis.

m. Upgradation and improvement of the existing system of Government transactions to facilitate real time monitoring, reconciliation, accountability and integrity of the financial system.

n. Leveraging of Government assets, especially Government land, and assets of Public Sector Undertakings to generate surplus so as to finance physical infrastructure.

o. *Adoption of Public Private Partnership Route to attract more investment for infrastructure upgradation and to bring in managerial efficiency*

The objectives in italics – (b), (e), (f), (h), (i), (j) and (o) can act as a thumbline in building the various options to push forward a developmental perspective which in the long run would not only help in stemming the slump but also help sustain the economy.

Broadly the building blocks that could be used as basics to be taken care of in the state economy can be illustrated in following terms.

1) Economic services – investing in Public Private Partnerships to help build the capacity in infrastructure, in terms of roads, power, water – irrigation and flood control, non-conventional sources of energy, and urban development.

2) It is seen that General services in terms of general administration needs to be rejuvenated. Over the years the expenditure in terms of salaries and pensions have sought to be cut since they were becoming unviable. But under the changed security situation, they would now have to be taken into account – especially so in the case of police – internal security. This infact has been put forward by the state government under the Twelfth Finance Commission and has been granted. The demands raised and accepted include the following:

(i) *General administration*: an amount of Rs.250 crore for improving the general administration including state-wide WAN and for upgradation of training institutes has been provided.

(ii) *Youth services and sports facilities*: An amount of Rs. 100 crore has been provided for improvement of youth services and sports facilities including construction of multigyms and sports complexes at Taluka levels.

(iii) *Improvement of police administration*: a grant of Rs.100 crore to modernise police administration and improve its effectiveness.

(iv) *Improvement of health services*: A grant of Rs.150 crore for improving health services by providing ambulance services at local level has been provided.

3) Social services – many recent studies have shown that in the period of fiscal prudence social sectors have been the worst hit. But they need to be looked up in a new light. One way in making the sectors attractive would be to link them with the economic services. PPP could work most effectively in case of education

as with vocational education and industrial training. Or in case of health services – para-medical forces and alternative systems of medicine, NGO partnership for health services, where PPP can work together in having a holistic framework of development.

Options available:

It is seen that the plan expenditures of the state for the year 2009-10BE is around 40% of the total expenditure.

The growth rate in GSDP is expected to be around 6%. The options are calculated at 3.5% FD, the total expenditure taken as a proportion to the current total expenditure of 2009-10BE. It is assumed that the current expenditure allocation made under the interim budget is unchanged. An additional amount of Rs.4200 crores, if made available the tune is spent on the options given. It is to be recognized that under the circumstances, effectively there would only be eight months before the entire sums are spent. Therefore it would also be safe to assume that in the social sectors there already exist some programs or plans which have not been implemented or taken up due to paucity of funds, which if they fall under the requisite fiscal objectives would be given priority.

Following the fiscal objectives (f) and (h), there is a need to clean the entries under the various heads, subheads so that only the relevant schemes show in the link documents making easier for preparation of the district level budgets at the ZP. Examples include under Health Department, entry for leprosy, night blindness and others which are not seen in specific districts.

Table 6: Sectoral State Plan Allocation during 2009-10

Sector	Rs. Cr.	in %	Opt 1	%	Opt 2	%	Opt 3	%	Opt 4	%
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
A) Economic Services										
Agricultural & Allied Services	2122.13	7.19		6.30	210	6.92		6.30		6.30
Rural Development	1502.93	5.09	200	5.05	420	5.71		4.46	420	5.71
Special Area Programmes (HKDB & MADB)	144.19	0.49	210	1.05		0.43		0.43		0.43
Irrigation & Flood Control	3983.82	13.50		11.82		11.82		11.82		11.82
Energy	3621.11	12.27	1260	14.48		10.75		10.75		10.75
Industries & Minerals	828.06	2.81		2.46	210	3.08		2.46	1260	6.20
Transport	3804.61	12.9	210	11.91	2100	17.52		11.29	840	13.78
Science, Technology & Environment	35.63	0.12	1260	3.48		0.11		0.11		0.11
General Economic Services	765.86	2.60		2.27		2.27		2.27		2.27
subtotal economic services	16808.34	56.98	3140	59.19	2730	57.98		49.88	2520	57.35
B) SOCIAL SERVICES										
Education, Sports, Arts & Culture	2297.52	7.79	1260	10.56		6.82	1260	10.56	1260	10.56
Health & Family Welfare	897.50	3.04		2.66		2.66	840	5.16		2.66
Water Supply & Sanitation	1352.57	4.58		4.01		4.01	840	6.51		4.01
Housing	729.22	2.47		2.16		2.16	420	3.41		2.16
Urban Development	4583.64	15.54		13.60	1260	17.34	840	16.09	420	14.85

Information & Publicity	15.60	0.05		0.05		0.05		0.05		0.05
Welfare of SC's & ST's,OBCs, Social Welfare & Nutrition	2142.51	7.26		6.36		6.36		6.36		6.36
Labour & Employment	167.65	0.57		0.50		0.50		0.50		0.50
SUB-TOTAL SOCIAL SERVICES	12186.21	41.31	1260	39.90	1260	39.90	4200	48.62	1680	41.15
C) GENERAL SERVICES	505.45	1.71		1.50		1.50	350	2.54		1.50
Total	29500	100		100.59		99.38		100.00		100.00
			4200		4200	100	4200			4200
			4400				4550			

In Table 6, columns 2 and 3 give the sectoral allocations as per 2009-10BE. It is seen that the economic services (56.98) have a greater share than the social services (41.31) under the plan expenditures.

Option 1 (column 4)

we look at the 3Es, namely education, environment and energy. The government has an opportunity to focus on the key issues of education, environment and energy with a long term perspective of development. One of the considerations of the XII FC is the need to manage ecology, environment and climate change consistent with sustainable development. The state government in keeping with the MTFP expenditure strategy, could only concentrate all its efforts in the areas of education, environment and energy. This would be one way the state shows a model way of reform in having an integrated framework of building a holistic model for primary and vocational education. In case of environment, more work be done in the clearly defined agro-climatic zones of the state.

The option shows an allocation of 30% of the available funds on all the three major heads.

Education – Karnataka already has made considerable strides with respect to accessibility and the content of material. A greater impetus to help focus on the IT needs would strengthen the existing programs. This would also be in line with the XI FYP objectives and help identify the monitorable national targets of drop out rate in elementary schools, literacy rate, and gender gap in literacy rate.

Environment – this again would be in line with the national policy on disaster management. Karnataka with its long coastal belt could be sustainably developed for the marine resources. The Western Ghats is the other major natural resource which needs to be ecologically protected.

Energy – the higher outlay suggested is towards further strengthening of promoting non-conventional energy sources. The conventional power resources are not discussed here, as it would need a more critical examination.

With these allocations, it is seen that the proportion of economic services to the total plan expenditure would further increase to 59.19 (56.98), while the social services would see a drop to 39.19 (41.31).

The option also takes into consideration that the Union Government could be convinced to share Rs.20,000 crore package to be spent as plan expenditure, as grants to states in lieu of economic stimulus. Following the share of the devolution to the states as per Twelfth Finance Commission or the share of Central Taxes and other grants, then the state could hope to get 2% of the stimulus package. The amounts could ideally be devolved to the states through the PRIs. Karnataka would receive about 200 crores which is used towards those sectors as decided upon in consultation with the PRIs, and the Central Government Plans. This would also be in accordance of objectives of (e) and (f).

Option 2 (column 6) :

The idea is at emphasizing overall modernization through increased allocations for Transport, RD, and Urban Development. It is seen that there is a pressing need for connectivity across the state. Hence a massive fillip could be given towards designing an Integrated mass transport system. Hence about Rs.2100 crores would be allocated towards building of infrastructure for transport, which would help in connecting the rural sector to the larger markets.

Rural Development – it is seen that over the years, the share of funds being transferred to the local self governments has grown from 2% to 4.28% in 2007-08. There is a greater need for devolving higher amounts to the local self governments. A beginning could be made by transferring 10% of total borrowing to rural development.

The option also looks at allocation of 30% towards urban development – PURA model focusing more on the provision of necessary amenities in rural areas.

The allocations would see an increase in ES to the tune of 57.98 (56.98), while a dip in SS of 39.19 (41.31).

Option 3 (column 9)

The option looks at a sustenance model in the aftermath of the recessionary market. The state could concentrate only on rural development as a strategic model for building the state's economy. Much of the state is concentrated in Bangalore. This rethink would help in building all the zones of the state and planning for a broader urbanization plan through the PRIs. This could help in preparing a PPP template to take care of the basic amenities.

The allocations would be made in the key areas of SMEs through industries and minerals (30%) , RD (10%), Education (30%), Urban Development (10%), Transport (20%).

The option would see a rise in ES 57.35(56.98), and a slight dip in SS of 41.15(41.31).

Option 4 (column 8)

The option looks at all allocations made to social sectors only. The division of outlays is education 30%, health and WSS 20%, housing 10% and urban development 20% respectively.

As per the XII FC grants, a sum of Rs. 350 crores is to be spent towards general administration and police. Infact it has been well argued and commended that the state has done well in bringing down the salary component over the years. As per the RBI Report, (State Finances – A study of State Budgets, 2007-08) has mentioned that expenditure on salaries in Karnataka as percentage of total revenue expenditure at 22 percent is one of the lowest as compared with the all-State average of 29 percent. The XII FC has also said that in general a ratio of salary expenditure to revenue expenditure net of interest payments and pensions could be 35%, if the state has enough evidence to show that the human resources are required and that it can be sustained within its own revenue receipts.

Considering the general manpower crunch that is seen across the various social sector departments, it could be suggested that the government increase its intake of personnel on contract basis in technical posts, as part of its intent to improve the ICT products for a better civic governance.

The option would see a dip in the proportion of ES 49.88 (56.98), and a rise in SS 48.62 (41.31).

Table 7: Composition of Own Non Tax Receipts 2007-08 (RE)

Own Non Tax Receipts of which		State (% to GSDP)	All states (% to GDP)
1.	Interest receipts IR	10.4	20.8
2.	General servicesGS	28.4	22.2
3.	Social services SS	7.7	9.0
4.	Economic Services ES Of which	53.3	47.3
a)	Forestry and wildlife	7.9	3.8
b)	Power	2.4	9.9
c)	Industries	25.2	20.5
d)	Irrigation	1.3	3.0
e)	Road		1.5
f)	Others*	16.5	8.6

Source: Source: State Finances – A study of Budgets of 2008-09, RBI

*including crop husbandry, animal husbandry, fisheries, plantations, cooperatives, other agricultural programs, petroleum, ports and lighthouses and tourism.

All of the above options do not consider the likely future revenue receipts on the investments made. The general composition of the Own Non Tax receipts for the state is given in the above Table 7. It is quite clear that the receipt from the social services is the lowest. But the investment in social services strengthens the economic services.

Conclusion

The above exercise clearly brings forth the tight position the government is in with respect to the market conditions. An increased expenditure through public debt does seem a plausible way if the government is able to committing itself to using the resources effectively and controlling the other leakages in the economy.

The study however raises a few other issues which would need to be looked at by any government in such a downturn.

a) Should the finance departments act fetish about fiscal deficit or is there an option to increase expenditure by raising funds? The state government would be well disposed if with an increased FD in the short run, borrowings are made to rejuvenate the economy.

b) The state can also have a relook at the option of increasing taxes and increasing tax base and hence its own revenue.

c) Can the states influence the Union government to have a special stimulus packages for the state governments?