

Karnataka in good shape, fiscally

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Inability to boost capital expenditure and falling primary sector growth are the only sore points

Anti-incumbency has been a major factor in Karnataka's politics since 1983, when the Janata Party came to power replacing the Indian National Congress, which had an uninterrupted 36-year tenure until then. However, the commonality of the BJP's (2008 to 2013) and the Congress's (2013 to 2018) tenures in the last decade has been the consistent improvement in the State's fiscal profile.

Karnataka is probably the only State that leads in social development while simultaneously maintaining a strong fiscal profile. Revenue deficit has progressively narrowed from 0.48 per cent of gross state domestic product (GSDP) in 2009-10 to a break-even level of 0.01 per cent in 2017-18 (RE).

Karnataka is projected to generate a revenue surplus of 0.01 per cent of GSDP in 2018-19 (BE) for the first time in a decade. This is notwithstanding the ₹8,165-crore farm-loan waivers announced in the 2018-19 State budget.

Gross fiscal deficit has improved in tandem with the reduction in revenue deficit to 2.60 per cent of GSDP. Outstanding liabilities have declined to 19.1 per cent of GSDP in 2017-18 (RE) from 25 per cent in 2009-10. Interest payments at 9.8 per cent of revenue receipts in 2017-18 (RE) is the lowest among peer States such as Tamil Nadu (16.6 per cent), Gujarat (14.5 per cent), Maharashtra (12.8 per cent), Andhra Pradesh (12 per cent) and Telangana (10 per cent).

Snapshot of Karnataka's finances						
	Revenue receipts (₹ crore)	Own tax revenues / RR (in %)	Revenue surplus (deficit) / GSDP (in %)	Gross fiscal (deficit) / GSDP (in %)	Pensions / RR (in %)	Capital expenditure / GSDP (in %)
2009-10	49,156	62.2	-0.48	-3.2	6.9	4.6
2010-11	58,206	66.1	-1.02	-2.6	7.0	4.4
2011-12	69,806	66.6	-0.77	-2.0	7.8	3.4
2012-13	78,176	68.8	-0.36	-2.8	9.2	2.9
2013-14	89,543	69.9	-0.06	-2.8	10.2	2.6
2014-15	1,04,142	67.4	-0.08	-2.9	9.7	1.1
2015-16	1,18,817	63.6	-0.24	-2.6	9.5	2.0
2016-17	1,32,867	61.9	-0.04	-2.2	9.1	2.2
2017-18 (RE)	1,44,892	62.1	-0.01	-2.6	9.1	2.5
2018-19 (BE)	1,62,765	63.6	0.01	-2.5	NA	2.5

Source: <http://niti.gov.in/state-statistics>, Karnataka Budget 2018-19, Economic Survey of Karnataka 2017-18 & author's calculations; Revenue deficit = revenue receipts less revenue expenditure; Gross fiscal deficit = aggregate disbursements (net of debt repayments) less revenue receipts, non-debt capital receipts and recovery of loans & advances

Karnataka's entrepreneurial private sector and the commitment of successive governments to adhere to fiscal prudence despite ruling a State deeply divided along caste lines and prone to agrarian crisis have resulted in the State being the preferred destination for private sector investments in India.

Karnataka's share of industrial entrepreneur memoranda (IEM) filed was an impressive 37 per cent in 2016 and 38 per cent in 2017. An unfortunate aside is Tamil Nadu's IEMs deteriorating from an already paltry ₹6,172 crore (1.46 per cent of total IEMs) in 2016 to ₹3,131 crore (0.79 per cent) in 2017.

The Fourteenth Finance Commission (FFC) recommends a ceiling of 3 per cent to States' fiscal deficit. States whose debt-to-GSDP ratio is lesser than 25 per cent and whose interest payments are lesser than 10 per cent of revenue receipts (RR) have the flexibility to rack up an additional 0.25 percentage points fiscal deficit each, thereby increasing the effective fiscal deficit ceiling for the more prudent States to 3.5 per cent.

Enough flexibility

Karnataka, by virtue of complying with the 3 per cent fiscal deficit, 25 per cent debt-to-GSDP ratio, and 10 per cent interest payments to revenue receipts ceilings, has the flexibility to generate a fiscal deficit of up to 3.5 per cent.

Will Karnataka utilise this flexibility to strengthen its capital spending after the Assembly elections? Karnataka's ratio of capital expenditure to GSDP at 2.2 per cent in 2017-18 (RE) trails those of Andhra Pradesh (4.1 per cent), Telangana (4.3 per cent), and Gujarat (2.8 per cent) and compares favourably with Maharashtra (1.3 per cent) and Tamil Nadu (1.8 per cent).

The inability to incur an optimal level of capital expenditure is likely to dampen Karnataka's business environment. In 2016, the Department of Industrial Policy & Promotion (DIPP) categorised States as leaders, aspiring leaders, acceleration required, and jump-start required based on their success in implementation of business reforms.

Select agricultural statistics						
	Andhra Pradesh	Karnataka	Kerala	Tamil Nadu	Telangana	All India
Cropping Intensity (2014-15, %)	123.3	121.9	128.5	124.4	121.5	141.6
Gross Irrigated Area / Gross Cropped Area (2014-15, %)	50.5	34.2	17.9	56.6	47.6	48.6

Source: Reserve Bank of India's "Handbook of Statistics on Indian States, 2017-18"

Karnataka was categorised as an aspiring leader and its ranking slipped from 9 in 2015 to 13 in 2016. The State scored more than 75 per cent in six out of 10 areas — environmental registration enablers (100 per cent), tax (100 per cent), inspections (98.84 per cent), labour (96.49 per cent), obtaining utility connection (92.86 per cent) and access to information (76.82 per cent).

DIPP identified establishing an online single-window system (46.43 per cent), land and property registration (65 per cent) and enforcing contracts (44.44 per cent) as parameters requiring improvement.

In the World Bank's 'ease of doing business' ranking of 17 Indian cities, Bengaluru is 13th. Ludhiana, Hyderabad and Bhubaneshwar are the top three.

The Karnataka Government is cognisant of the growth impediments posed by inadequate capital expenditure. The 'Economic Survey of Karnataka 2017-18' states that the "Expenditure Reforms Commission (ERC) constituted by the Government of Karnataka has recommended that capital outlay needs to be insulated from revenue adversities."

The performance of the agricultural sector is yet another challenge that Karnataka faces.

The primary sector's share in State income at current prices has precipitously dropped by two-thirds in a span of 17 years to 10 per cent in 2017-18 from 33 per cent in 2000-01. The share of the secondary sector has been maintained at 19 per cent, while the tertiary sector's share has increased to 59 per cent in 2017-18 from 48 per cent in 2000-01.

The State's cropping intensity and percentage of cropped area that is irrigated lags those of peer States and is driving the agricultural sector's below par performance.

Cauvery issue

Karnataka and Tamil Nadu being at loggerheads in the Cauvery water-sharing issue is understandable when viewed against the backdrop of the State's poor cropping intensity and irrigation coverage. This conflict has affected the livelihoods of thousands of farmers in both States and agricultural output for far too long. Karnataka's fiscal profile during the last decade has emerged stronger independent of political changes.

The State has successfully kept its salaries, pensions and interest expenses under control and has reduced its indebtedness, as a percentage of GSDP. Other States are struggling to achieve this. The State can be a model for other States to replicate if it were to up its capital spending and the Cauvery water-sharing issue is amicably and fairly resolved.

A relatively better-managed State like Karnataka struggling to maintain its capital spending is a strong indicator that the Centre ought to increase States' share of central taxes. It is also imperative for both the Central and State governments to improve their tax collection efficiency.

*(This is the fourth in a series on State finances. The third was **on Maharashtra**)*

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