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A study on fiscal indicators in India: With special reference to Karnataka

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Abstract
In India, the constitutional provision would result in imbalances between revenue capacities and expenditure needs at state level. Constitution provides for the assignment of revenues, sharing of the proceeds of certain centrally levied taxes with the States and making grants to States from consolidated fund of India. States have access to their own sources of revenue and are entitled as well for a share in central taxes and other transfers. The 14th Finance Commission is of the view that tax devolution should be the primary route for transfer of resources to the States. According to the Commission, the increased devolution of the divisible pool of taxes is a compositional shift in transfers from grants to tax devolution. State finances have become a subject of Serious concern in the recent years due to the mounting fiscal distress experienced by them caused by deceleration in the resource growth and an unbridled growth in expenditure, more so of the revenue expenditure.
Fiscal imbalances in Indian Federation are reported to be on the rise especially after the introduction of economic reforms. The need for transfers arises because the own revenues of a lower level government are generally insufficient to meet the expenditure required for providing services. Karnataka for long has proved to be a fiscally prudent state in comparison with many other states in the country. The State experienced a sharp deterioration in its fiscal situation after the mid 1990s into early years of 2000. The State has been experiencing the improvements in the fiscal marksmanship in the recent years.
With this backdrop the present study tries to find out the best fiscal correction method through Fiscal Transfers, Expenditure Minimising Strategy and Revenue maximising technique with the help of Fiscal Federal Theories.

Keywords: fiscal transfers, expenditure minimising strategy, revenue maximizing, technique

1. Introduction

State governments in the Indian Federation have been assigned important functions and responsibilities by the Indian Constitution. State governments have access to their own sources of revenue, share in central tax and other transfers. State finances have become a subject of serious concern in the recent years due to the mounting fiscal distress experienced by them caused by deceleration in the resource growth and an unbridled growth in expenditure, more so of the expenditure. The 14th Finance Commission is of the view that tax devolution should be the primary route for transfer of resources to the States. In understanding the States' needs, it has ignored the Plan and non-Plan distinctions. According to the Commission, the increased devolution of the divisible pool of taxes is a ``compositional shift in transfers'' – from grants to tax devolution. It has chosen to take the entire revenue expenditure for this purpose. Hence, it has decided to take into account a state's entire revenue expenditure needs without making a distinction between plan and non-plan expenditure. The Commission is of the view that sharing pattern in respect to various Centrally-sponsored schemes need to change. It wants the States to share a greater fiscal responsibility for the implementation of such schemes.

The Thirteenth Finance Commission, in its report, had underlined the need for fiscal consolidation both at the Centre and States' levels. The enactment of Fiscal Responsibility Legislation (FRL) both by the centre and states has resulted in considerable improvement in fiscal variables viz revenue deficit, primary deficit and fiscal deficit in the recent years. The country, being in the initial year of the 12th Five Year Plan, is required to mobilize financial resources to achieve a faster and more inclusive growth. India, being a signatory for adaption of the United Nation's Millennium declarations, has to effect reforms in all the sectors, to achieve Millennium Development Goals (MDGs) by 2015. Most of the targets of MDGs relate to the sectors such as health, education and social security. Under Indian fiscal federalism, the States are required to play a major role in achieving the MDGs. Hence, the state finances assume significance.

1.1 Origin of the Research Problem

In India, the constitutional assignment would result in imbalances between revenue capacities and expenditure needs at state level. Constitution provides for the assignment of revenues, sharing of the proceeds of certain centrally levied taxes with the States and making grants to States from consolidated fund of India. State governments in the Indian Federation have been assigend important functions and responsibilities by the Indian Costitution. State governments have access to their own sources of revenue and are entitled as well for a share in central taxes and other transfers. State finances have become a subject of Serious concern in the recent years due to the mounting fiscal distress experienced by them caused by deceleration in the resource growth and an unbridled growth in expenditure, more so of the revenue expenditure. Karnataka for long has proved to be a fiscally prudent state in comparison with many other states i the country. The state experienced a sharp deterioration in its fiscal situation after the mid 1990s into early years of 2000. The State has been experiencing the improvements in the fiscal marksmanship in the recent years. A significant aspect to be noted is that the state, has been one of the early birds in announcing fiscal reforms in the country by passing the Fiscal Responsibility Act and adopting a medium Term approach to achieve fiscal recovery.

The Karnataka state has made significant efforts to rationalise and simplify the tax and non-tax resources since 1996-97. There has been some improvement in the state's budgetary resources in the recent years. The proposed study examines the state's tax and non-tax revenue resources and the policies pursued to rationalise the tax and non-tax revenue system. Karnataka derives its finances mainly from the own tax, own non-tax revenue, public debt, capital resources, share in central taxes, grants from the centre, public account and contingency account.

The present study attempted to analyse how fiscal transfers have helped the process of fiscal consolidation through fiscal correction strategy in respect of Karnataka.

1.2 Relevance of the Study

The study points that there has been a structural shift in fiscal transfers to the States, where the share in central taxes and Grants-in-Aid account for a lion's share, with the declining share of central loans. The fiscal transfers, in respect of Karnataka not only helped in the elimination of Revenue Deficit but also have resulted in surplus in the revenue account. The State has been able to effect substantial reduction in the Gross Fiscal Deficit mainly on account of central trasfers. Thus, the higher central transfers have led to higher capital outlay especially in the recent years.

1.3 Review of Literature

D.M.Nanjundappa (1974) [9] has provided systematic and precise methods through which the tensions could be reduced. He has suggested building up of comprehensive integrated index of development to provide an effective criterion for distribution of the proceeds.

H.L.Bhatia (1979) has made an objective analysis of current dissatisfaction with Centre-State financial relations in India. He has also examined the working of Finanace commissions and found fault in its operation. He gave suggestion for recasting the role of Finance Commission in order to solve specific problems like mounting indebtedness of the State it the Centre.

Om Prakash (1992) evaluated the reasons for the problems of Centre-State financial relations in a federal constitution and suggests the suitable criteria for fixation of the shares of individual states in the divisible pool of Income tax and Union Excise duties. The author is of the view that in India, the need for financial transfers from Centre to State governments is a part of constitutional division of functions and resources between the two levels of governments and the division of financial resources between the central and regional governments is based on principle of efficiency and autonomy.

M. Govinda Rao and Nirvikar Singh (2001) provided an overview and analysis of India's federal institutions in the context of economic reform. They suggested that explicit and implicit intergovernmental transfers for capital projects as well as lending by public sector institutions be largely replaced by block grants and by market borrowing.

D.K.Srivastava (2008) has made a study of the Finance Commissions in India. The author is of the view that the Indian Finance Commission is in some ways a unique institution in the world. It is required to interact formally and informally with the central government and all the state governments.

2. Objectives

The purpose of the present study was to examine the effects of fiscal transfers in the State Finances of Karnataka after the reform period. Specifically, the study was devoted to the following objectives.

2.1 To examine the growth and trends of financial transfers from the central government to Karnataka.

2.2 To study the problems and issues relating to revenue sharing and grants-in-aid between Centre and the State and on the recommendations of successive finance commissions and to find out how these transfers have affected the equity and efficiency.

2.3 To analyse how fiscal transfers have helped the process of fiscal consolidation through fiscal correction strategy in respect of Karnataka.

3. Data Base and Research Methodology

The data and relevant information for the present study was obtained from different publications of Government of India like Statistical Abstracts of India; Indian Public Finance Statistics; Reports of successive Finance Commissions; State Finance Commissions Reports; Economic Surveys of Government of India; Annual Budgets of the Central and State Governments; Five-Year Plan Documents; Bulletins published by Reserve Bank of India. Besides, standard work on the subject relevent to the present study were also consulted. Information was also obtained from personal interviews and discussions with the senior persons related to the problem. The study covers the time period of 23 years starting from 1990-91 to 2012-13.

Raw data were first subjected to simple tabulation and then these are to be further processed to get the required form so as to represent various variables required for the study. Simple statistical tools like Correlation, Regression, Ratios, Per centages, Trend values and Growth rates are worked out for the analysis of data.

4. Discussion on Fiscal Indicators of Karnataka and data analysis

In recent years the emergence of a number of political and economic developments have given rise to new awakening of interest to undertake a comprehensive re-examination of Indian Fiscal Federalism. On the economic front, a greater role assigned to the market in resource allocation and on the political front, the transition from a period of one party rule at the centre and state levels to that of coalition government and locally dominated regional parties have given rise to confrontational politics between the centre and the states. The difficult financial position of some of the state governments and existing perceptible degree of inequality among the federating units have compelled the policy makers to give a new look to fiscal scenario. As such, an attempt will be made here to analyze the fiscal position of Karnataka.

Table 1: Fiscal Indicators of Karnataka (RS in Crore)

years	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit
1	2	3	4
1994-95	1,513	296	642
1995-96	1,457	-62	409
1996-97	1,944	579	736
1997-98	1,610	277	216
1998-99	3,112	1,215	1,496
1999-00	4,277	2,325	2,264
2000-01	4,219	1,862	1,832
2001-02	5,870	3,285	3,187
2002-03	5,281	2,646	1,989
2003-04	4,501	525	791
2004-05	3,600	-1,638	-194
2005-06	3,687	-2,311	-78
2006-07	4,688	-4,152	452
2007-08	5,331	-3,776	826
2008-09	8732	-1,631	4200
2009-10	10870	-1,620	5658
2010-11	10690	-4170	6158
2011-12	12300	-4690	6240
2012-13(RE)	15240	-940	8390
2013-14(BE)	17450	-600	8950
CAGR	12.6	-	-

***Source*:** RBI reports of Various Years
CAGR- Compound Annual Growth Rate

The above table 1 shows that the Gross Fiscal Deficit (GFD) of Karnataka was Rs.1513 Crore in the year 1994-95. And gradually it raised to Rs.17450 Crore in the year 2013-14.GFD of Karnataka has shown an increasing trend and Compound Annual Growth Rate of 12.6 per cent over the period of 20 years. Revenue deficit has recorded Rs.-4690 Crore in 2011-12 and Rs -600 in2013-14, indicating good sign. Primary deficit also increased over the study period.

Table 2: Trends in Fiscal Indicators of Karnataka (Per cent)

years	Percentage share of Net State Domestic Product			Percentage share of State's Revenue Expenditure as		
	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	Interest Payment	Qwn Tax Revenue	Own Non-Tax Revenue
1	2	3	4	5	6	7
1994-95	3.1	0.6	1.3	12.0	59.0	11.7
1995-96	2.9	-0.1	0.8	12.4	62.2	14.6
1996-97	3.3	1.0	1.3	11.8	56.5	13.2
1997-98	2.5	0.4	0.3	12.8	58.9	11.6
1998-99	4.0	1.5	1.9	13.0	55.8	11.8
1999-00	5.0	2.7	2.6	13.2	50.8	10.6
2000-01	4.6	2.0	2.0	14.3	54.2	9.95
2001-02	6.2	3.4	3.3	14.4	53.0	5.87
2002-03	5.1	2.6	1.9	17.5	55.5	6.79
2003-04	4.0	0.5	0.7	17.4	59.1	13.9
2004-05	2.8	-1.3	-0.1	15.2	64.5	17.9
2005-06	2.1	-1.3	-0.0	13.4	66.4	13.8
2006-07	2.3	-2.0	0.2	12.7	69.7	12.3
2007-08	2.2	-1.6	0.3	12.1	69.5	8.98
2008-09	3.1	-0.6	1.5	10.9	66.4	7.58
2009-10	3.6	-0.5	1.9	11.0	64.3	7.01
2010-11	2.9	-1.1	1.7	10.4	71.2	6.22
2011-12	3.0	-1.1	1.5	9.31	71.4	6.28
2012-13(RE)	3.3	-0.2	1.8	8.16	63.7	4.52
2013-14(BE)	3.3	-0.1	1.7	8.73	64.1	4.15
CAGR	-	-	-	-1.9	1.1	-4.5

***Source*:** Reserve Bank of India, State Finances – A Study of Budgets of Various Years. Handbook of Statistics on State Government Finances (2010) RBI. Note: CAGR = Compound Annual Growth Rate

The Table 2 clearly indicates that over the period of 20 years, Interest payment as percent of Revenue expenditure has declined from 12.0 per cent in 1994-95 to 8.73 in the year 2013-14. Own tax revenue as per cent of revenue expenditure has maintained a average growth rate of percentage of 59.0 per cent to 71 per cent in between 1994 to 2014. Own non tax revenue has come down from 11.7 in 1994-95 to 4.1 in 2013-14. Compound Annual Growth Rates of Interest payments, Tax revenue and Non tax revenue are -1.9, 1.1 and -4.5 respectively. Among these parameters Own Tax Revenue has positive sign.

Table 3: Selected Committed Expenditures as Ratio to State's Own Revenue (Per cent)

years	Interest Payments	Administrative Services	Pension	Total (2+3+4)
1	2	3	4	5
1994-95	17.0	10.7	9.1	36.8
1995-96	16.1	9.59	8.6	34.3
1996-97	17.0	9.9	10.0	37.0
1997-98	18.2	10.4	11.0	39.1
1998-99	19.2	10.7	12.0	41.4
1999-00	21.5	12.1	16.0	50.0
2000-01	22.3	10.5	15.0	47.6
2001-02	24.5	11.8	15.0	51.3
2002-03	28.1	11.2	15.0	54.4
2003-04	23.9	9.06	12.0	45.2
2004-05	18.5	7.54	10.0	36.5
2005-06	16.7	7.7	9.9	34.4
2006-07	15.5	7.04	9.1	31.6
2007-08	15.4	7.89	11.0	34.3
2008-09	14.7	8.8	13.0	36.9
2009-10	15.4	9.1	10.0	34.6
2010-11	13.5	7.6	9.7	30.8
2011-12	12.0	7.16	11.0	29.9
2012-13(RE)	12.0	8.59	13.0	33.6
2013-14(BE)	12.8	9.52	13.0	35.1
CAGR	-2.3	-1.7	0.2	-

***Source*:** Reserve Bank of India, State Finances – A Study of Budgets of Various Years. Handbook of Statistics on State Government Finances (2010) RBI.

Table 3 states the major expenditures of State's Own revenue. CAGR of Interest payments is -2.3, Administrative services is -1.7 and pension is 0.2 over the period of 20 years. Interest payments and administrative services as per cent of State's Own Revenue has come down, but percentage share of Pension has increased in an average manner.

Table 4: Selected Committed Expenditures as Ratio to Revenue Expenditure (Per cent)

years	Interest Payments	Administrative Services	Pension	Total (2+3+4)
1	2	3	4	5
1994-95	12.0	7.6	6.5	26.0
1995-96	12.4	7.4	6.6	26.3
1996-97	11.8	6.9	7.0	25.8
1997-98	12.8	7.3	7.4	27.5
1998-99	13.0	7.2	7.8	28.0
1999-00	13.2	7.4	10	30.7
2000-01	14.3	6.7	9.5	30.5
2001-02	14.4	6.9	8.8	30.2
2002-03	17.5	7.0	9.4	33.9
2003-04	17.4	6.6	8.9	33.0
2004-05	15.2	6.2	8.7	30.1
2005-06	13.4	6.2	8.0	27.6
2006-07	12.7	5.8	7.5	25.9
2007-08	12.1	6.2	8.7	26.9
2008-09	10.9	6.5	9.9	27.3
2009-10	11.0	6.5	7.2	24.7
2010-11	10.4	5.9	7.5	23.8
2011-12	9.31	5.6	8.3	23.2
2012-13(RE)	8.16	5.9	8.9	23.0
2013-14(BE)	8.73	6.5	8.7	24.0

***Source*:** Reserve Bank of India, State Finances – A Study of Budgets of Various Years. Handbook of Statistics on State Government Finances (2010) RBI. Note: CAGR = Compound Annual Growth Rate

Interest payments and administrative services as ratio to Revenue Expenditure has declined except Pension which has raised from 6.5 percent in 1994-95 to 8.7 in 2013-14 is mentioned in the Table-4.4.

5. Findings and Conclusion

In recent years the emergence of a number of political and economic developments have given rise to new awakening of interest to undertake a comprehensive re-examination of Indian Fiscal Federalism.

- The Gross Fiscal Deficit (GFD) of Karnataka was Rs.1513 Crore in the year 1994-95. And gradually it raised to Rs.17450 Crore in the year 2013-14. GFD of Karnataka has shown an increasing trend and Compound Annual Growth Rate of 12.6 per cent over the period of 20 years.
- Revenue deficit has recorded Rs.-4690 Crore in 2011-12 and Rs -600 in2013-14, indicating good sign.
- Interest payment as percent of Revenue expenditure has declined from 12.0 per cent in 1994-95 to 8.73 in the year 2013-14.

GFD of Karnataka has shown an increasing trend and Compound Annual Growth Rate of 12.6 per cent over the period of 20 years. Interest payment as percent of Revenue expenditure has declined. Total debt as per cent of NSDP has higher as CAGR of 14.5 per cent. Debt ratio has badly developed. Among southern states, with respect to Own Revenue as per cent of revenue expenditure, Tamil Nadu is in Higher position having 81.0 percent. Andhra Pradesh is in second place having 73.0 per cent. Kerala is in third position having 71.0 percent. Karnataka has last place having 70.0 per cent of OR/RE ratio. This clearly indicates the urgent need of restructure the fiscal scenario of Karnataka. The FC-XIV has also emphasized effective independent regulation in insulating the pricing of public utility services from avoidable policy fluctuations. Regarding revenues from natural resources, coal rich states would have windfall gains from coal block auctions, which should be utilised for funding developmental needs. With this back ground the present study focuses on fiscal consolidation effort made by Karnataka and how central transfers helped to achieve this.

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