

A close-up photograph of a hand stacking several gold and silver coins on a desk. The hand is positioned on the left side of the frame, with fingers carefully placing a coin on top of a stack. In the background, there are more stacks of coins and a blurred office setting.

# Economic Research

## Karnataka State Finances





# Karnataka State Budget 2021-22: Fiscally Prudent Despite the Pandemic

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## Fiscal Health of Karnataka

Karnataka is one of the States with a history of good management of finances. It was the earliest State to enact the Fiscal Responsibility and Budget Management Act, even before the Union government enacted it. The State had a revenue surplus consistently since 2004-05, and its fiscal deficit has been consistently less than 3% of the GSDP since 2011-12. The Debt to GSDP ratio too has been consistently less than 20%, and this was one of the State's eligible for borrowing more than 3% of the GSDP according to the Fourteenth Finance Commission recommendations. Of course, the State continued to limit its fiscal deficit below 3% of the GSDP. The State has also been transparent by including the off-budget borrowings in the total liabilities, and the Fifteenth Finance Commission has appreciated this. The Commission in its review of the State's finances has Stated that the committed expenditures (interest payments, salaries and pensions) in Karnataka were the lowest among the 29 States.

As in the other States, the pandemic had a disastrous effect on the fiscal health of this State. Due to the lockdown and closure of economic activities, the revised estimate of the State's own tax revenues in 2020-21 was lower than the budget estimate by Rs 17,049 crore, and the tax devolution was lower by Rs 8,538 crore, partly due to lower central tax collections and partly due to the lower tax devolution resulting from the Fifteenth Finance Commission's award. The shortfall in the total revenue receipts in the revised estimate from the budgeted estimate was Rs. 20,211 crore. As a ratio of the GSDP, the revised estimate of revenue receipts at 5.3% was lower than the budgeted by almost one percentage point, and it was lower than the previous year's actual collection by 0.8 percentage point.

Even as the centre provided additional fiscal space of 2% of the GSDP to meet the revenue shortfall and additional expenditure liability due to the pandemic, the government has tried to contain the fiscal deficit and did not avail of the entire additional borrowing space, and contained the fiscal deficit at 3.2% of the GSDP. Of course, the State has had to severely compress capital expenditures. Despite additional demands for spending to save lives and livelihoods, the revenue expenditure was reduced by Rs. 582 crore in the revised estimate over the budgeted, but the capital expenditure reduction was much higher, at Rs. 7,387 crore. Thus, while limiting the fiscal deficit would help arrest the increase in the debt-GSDP ratio, the compression of capital expenditures would have adverse effects on medium- and long-term economic growth in the State.

For the first time after 2004-05, the State recorded a revenue deficit of 1.1% of the GSDP. The fiscal deficit too has exceeded the limit set by the FRBM Act and is estimated at 3.2% of the GSDP. While this is mainly due to the pandemic, it must also be noted that central transfers to the State in 2020-21 were substantially lower than in the previous year. In fact, the Fourteenth Finance Commission, on realising the fact that the tax devolution and grants recommended by it would be lower than the previous year's transfers even in absolute terms, had recommended a special grant of Rs. Rs.5495 crore, which was not accepted by the Union government.

<b>Fiscal Health of Karnataka: Some Important Indicators</b>				
	<b>2019-20 Actuals</b>	<b>2020-21 BE</b>	<b>2020-21 RE</b>	<b>2021-22 BE</b>
State's Own Tax Revenue (% of GSDP)	6.03	6.21	5.26	6.55
State's Own revenue (% of GSDP)	6.48	6.64	5.69	7.04
State's Revenue Expenditure (% of GSDP)	10.26	9.97	9.94	11.01
State's Capital Expenditure (% of GSDP)	2.93	3.22	2.81	3.45
Development Exp as % of GSDP	9.05	8.63	8.29	9.12
Social Sector Exp as % of Total Exp	4.45	4.27	4.10	4.63
Interest Payment to total revenue (own Tax+non-Tax)	13.14	14.98	18.43	18.86
Revenue Deficit (% of GSDP)	0.07	0.01	-1.08	-0.89
Fiscal Deficit (% of GSDP)	-2.25	-2.55	-3.24	-3.48
Revenue Deficit	0.07	0.01	-1.08	-0.89
Fiscal Deficit	-2.25	-2.55	-3.23	-3.48
Primary Deficit	-1.16	-1.32	-1.98	-1.88
Outstanding liabilities (% of GSDP)	19.87	20.44	22.08	26.90
BE: Budget Estimates, RE: Revised Estimates Source: Budget Documents, Karnataka State				

In 2021-22, the tax revenue (own) is estimated to be higher than the 2020-21(RE) by Rs. 16,552 crore. This would require 17.7% growth over the previous year. The estimated tax to GSDP ratio at 6.6% is the highest in recent years. The tax to GSDP ratio in 2021-22 is estimated to be higher than the previous year by 1.3 percentage points, and it is higher than the 2019-20 actuals by around 0.3%. The estimate looks ambitious, particularly because with the continued spread of the pandemic, many sectors requiring social distancing are yet to recover and the adverse impact of pandemic on economic activity is expected to continue.

On the expenditure side, the State's total expenditure is estimated to grow by 7.1% over 2020-21 (RE). The increase in revenue expenditure is estimated at 4.8%, and capital expenditure is estimated to increase by 15.9%. It is too early to say whether the State government will be able to contain the revenue expenditure at the level budgeted, particularly as there are demands by many spending departments for higher allocation as the pressure to contain expenditures, which started in 2020-21, has continued into the next year.

The fiscal numbers give a reasonably good picture of the State; however, the GSDP in current prices for 2020-21 had not changed as a consequence of the pandemic as per the revised budget estimates. On the whole, the State has managed the fiscal situation reasonably well in these pandemic times and has been able to contain deficits and debt at sustainable levels. Of course, the debt-GSDP ratio at 26% estimated for 2021-22 has exceeded the 20% mark for the first time, and the interest payment to revenue ratio at 18.9% is the highest for the State. The compression of capital expenditures too is a cause for worry. However, as the size of the GSDP expands as the pandemic is contained and vaccination gathers pace, revenues will increase in absolute terms, and the debt-GSDP ratio will be below the 20% mark.



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