

# WHO BENEFITS FROM INDUSTRIAL INCENTIVES? A STUDY OF CAPITAL INVESTMENT SUBSIDY IN KARNATAKA

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## **Abstract**

*Capital investment subsidy is an important fiscal concession aimed at promotion of industry in the backward regions. Government has sharply enhanced the scope and volume of concession during the reform phase. Concomitant to this amount of subsidy released has sharply increased. However, the scheme has not served its purpose very well as its financial benefits have largely accrued to regions that did not deserve subsidy, such as Bangalore Urban district, and many such units have ceased to exist.*

## **Background**

Various fiscal incentives and concessions mark industrial development strategy in India. Some of the important incentives used are fiscal incentives, financial incentives and market preferences. Incentives are aimed at achieving a number of developmental goals. They are used as instruments to lead industrial investments into certain regions, sectors, to influence the nature of investment, and generation of employment. The scope and volume of concessions have varied from time to time and were characterized by stiff interstate competition to attract industrial investment, until recently.

It has been argued that (UNCTAD, 1998) while these incentives may serve a number of developmental purposes they could have the potential for economic distortions and involve financial and administrative costs. Serious concerns have been expressed regarding subsidies with reference to the huge fiscal cost associated with them. There are certain basic issues raised as to whether support through fiscal incentives is the best way of promoting the growth of industry, whether such fiscal incentives announced from time to time are rational and well defined, and efficient and effective instruments. What would be the impact of these concessions on the exchequer as well as on the economy?

Capital investment subsidy is an important component of industrial concessions and has been operating in India for over three decades.

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Promotion of industry in the backward regions is the main objective behind the introduction of the scheme. The New Industrial Policy (NIP) introduced in the country as a part of the economic reforms in 1991 has aimed at liberating Indian industry from various governmental controls. However, the state governments continue to offer incentives such as CIS, more so at an enhanced level such as industrial licensing and location restriction. As a result, sharp increases have been effected in the rate and ceiling of subsidy after the introduction of the New Industrial Policy in Karnataka. The state governments have also been offering concessions competitively to attract industry into their states. There has been a considerable increase in the fiscal burden on account of such fiscal concessions. Government of Karnataka had announced a sharp increase in the rate and ceiling of capital investment subsidy in its industrial policy packages of 1993 and 1996. The state government has been bearing the impact of these policies till date, in view of the huge pendency of subsidy bill with the government.

Against this background, it would be of considerable interest to study the operation of the scheme in Karnataka, the fiscal cost associated and determine/ascertain whether the scheme has worked towards the fulfillment of the professed objectives in the State. More importantly, there is a need to identify the beneficiaries of the scheme and whether they need such benefits. The present paper is based on a study initiated by the Department of Industries and Commerce, Government of Karnataka, to check the genuineness of capital investment subsidy disbursed by the State Government in Bangalore division.

## **Focus of the Paper**

The paper addresses the following issues. First, some issues and concerns pertaining to Capital Investment Subsidy scheme in Karnataka are discussed. Second, an analysis of the regional flow of benefits under the CIS scheme is presented. Third, some insights from a primary survey about utilisation of capital investment subsidy by units in Bangalore Division are highlighted. Fourth, issues pertaining to the functioning of the scheme are addressed. The last section presents some conclusions and remarks.

## **Capital Investment Subsidy Scheme in Karnataka**

Capital investment subsidy is a one-time subsidy given to entrepreneurs on the fixed capital investment<sup>1</sup> made by industrial units. Capital investment subsidy was initially introduced by the central government in 1971 to promote industry in the backward regions of the country. In this scheme, a one-time support of 15 per cent of the fixed capital investment was provided to the industrial units. Under this scheme, the benefits in the state of Karnataka were restricted only to 37 backward taluks in

three districts - Mysore, Dharwad and Raichur - by the central government. However, the state government simultaneously offered subsidy to the remaining districts excluding Zone I<sup>2</sup>. The scale of concessions was however different. Since 1989, with the withdrawal of central government investment subsidy, this has become entirely a state scheme. The scheme is available at a uniform rate of 25 per cent of fixed capital investment to all the zones (since 1993), with the exception of Zone I, where it is restricted to just seven categories of non-polluting industries<sup>3</sup>. There is also an additional subsidy of 5 per cent over and above the 25 per cent limit to the special category of enterprises<sup>4</sup> and for units in the growth centres<sup>5</sup>. Government of Karnataka has also been giving an additional subsidy for the units that expand or diversify. In essence, the subsidy is meant to help industrially backward regions and certain categories of entrepreneurs.

## Issues

The first and foremost issue in the context of the sweeping policy changes taking place in the form of economic reform is whether such a scheme is meaningful in the liberalized regime. While on the one hand, NIP encourages prospective industrialists to set up units anywhere in the country, on the other hand, it is trying to disperse industry to industrially backward regions by luring them with concessions. Thus, there appears to be a contradiction in the approach.

While it is important to mobilise greater investment, it is of greater importance to sustain it in order to meet the global challenges. Are the existing fiscal incentives framed in such a way as to suit such a requirement? The relevance of such concessions in promoting industrial competitiveness is questioned by many studies (CII and The World Bank) in view of the fact that industry in the context of globalisation can flourish mainly on account of the investment climate rather than on factors such as fiscal concessions. Therefore the firms that are located in states with good investment climate are likely to perform well as opposed to the ones located in states with poor investment climate.

Hence, the measures resorted to by the governments such as giving subsidy for starting industrial units are not meaningful, as they would only drain the government exchequer and are not helpful in promoting the competitiveness of industry, which is the main factor in projecting industry at the global level. Apart from the fact that these fiscal concessions result in considerable fiscal burden, they also tend to have serious economic implications for the states concerned. In the first place, these concessions are likely to distort the sectoral investment priorities and the resource allocation. Second, it is observed that state governments have been announcing concessions even in areas where investment would be forthcoming in the absence of such concessions. These amount to redundancy of such concessions. (Rao et al, 1981)

These broader issues apart, there are certain issues related to the actual operation of the scheme. They include issues such as, who are the beneficiaries of the scheme and what is the extent of the benefit? What is the fiscal burden associated with such concessions to the government? This attains special significance in the context of growing fiscal and revenue deficits.

The introduction of capital investment subsidy was guided by the objective of dispersing industry to the backward regions, to compensate for the inadequacy of regional infrastructure. It needs to be examined as to how far the investment subsidy scheme helps in dispersing industry to backward regions. Given this one has to carefully examine the relevance of extending this benefit to industry in the developed regions and even the growth centres (at an enhanced rate) which are relatively better off in terms of availability of infrastructure. In addition, extension of the investment capital subsidy to all the regions, other than the backward regions, is bound to exert a considerable strain on the finances of the State Government, which needs to be assessed. A district-wise distribution of the subsidy by different regions and industries helps in understanding the pattern of flow of benefit of the scheme. This bears importance in view of the fact that Bangalore Urban district (industrially advanced) gets the largest share in the total subsidy of the State. Further, the special rates made available to special category of enterprises and availability of additional subsidy for expansion and diversification are likely to complicate the administration of the scheme.

## **Economic Reforms and Industrial Incentives**

Introduction of economic reforms and the formulation of New Industrial Policy (NIP) have resulted in stiff interstate competition to attract industrial investment. One of the strategies that the state governments adopted was to announce very attractive fiscal incentives, and in the process, the state government kept modifying the industrial policy packages announced. Thus the 1990-95 and 1993-98 packages underwent many changes in between and were not implemented in total. Hence they are not discussed here. The next package implemented in full was for the period 1996-2001.

A comparison of previous policy packages clearly accounts for the sharp increase that has taken place in the scope and volume of concessions in the 1996-2001 package. Details are presented in Chart 1. Capital investment subsidy, which revolved around 10-15 per cent of fixed capital investment with a ceiling of Rs.10-15 lakhs, has been enhanced to 25-30 per cent with a ceiling of Rs.25-Rs30 lakhs. The scope has been extended to cover certain categories of tiny and SSI units in Zone I, which was not covered under the previous packages.

## **Additional Subsidy**

There is an additional subsidy of 5 per cent over and above the 25 per cent limit to the special category of enterprises and for units in the growth centres. Rate of subsidy offered in Karnataka was very high in the 1996-2001 package in comparison with some other major states. In Madhya Pradesh, the maximum rate was only 10 per cent subject to a cap of Rs.10 lakhs. In some other states, the minimum rate was 15 per cent, whereas in Karnataka the minimum rate is 25 per cent subject to a cap of Rs.25 lakhs. (Rajaraman, Indira, 1999)

## **Fiscal Cost**

Capital investment subsidy being an explicit subsidy, the fiscal burden is tantamount to an increased direct expenditure by the government. Departmental statistics reveal that subsidy released to the industrial units in the State has increased sharply from Rs.7 crores in 1990-91 to Rs.173.14 crores in 1998-99, amounting to 2,373 per cent increase over the initial year. It is understood (discussion with the department officials) that the subsidy sanctions were fully released until 1998-99 and the payment for the sanctions made after that is still pending with the government. Pendency of such subsidy claims at the end of March 2001 was Rs.327.91 crores (4,584 per cent increase over 1990-91.) The number of units receiving subsidy has increased from 7,165 to 12,595 during the above period. In the case of Bangalore division alone, this amount has increased from Rs.10,753.4 lakhs as on December 1999 to Rs.16,328.77 lakhs. (Table 1). Such a spurt in the number of units had occurred despite the restriction of capital investment subsidy to tiny units with an investment under Rs 25 lakh announced in April 1999. However there were some exceptions, which allowed some more units to become eligible (G.O. March 9, 1999) on the grounds such as

- units that have secured industrial land or shed
- obtained first release of term loan instalment from KSFC or any other recognized financial institutions or commercial banks
- in respect of self-financed unit, having invested at least 25 % of the cost of the project substantiated by a certificate issued by chartered accountant prior to March 31, 1999.

All the units fulfilling the above clauses were eligible to claim investment subsidy as per the Government Order, which many industrial units used to their convenience.

All these factors have resulted in a sharp increase in the fiscal burden to the State Government, which is already reeling under huge and increasing fiscal and revenue deficit. Ironically, this sharp increase coincides with the reform phase, which advocates a reduction in subsidies

of all kinds. Fiscal implications of the growing subsidy burden become all the more grave on account of the fact that state government is at present raising loan by floating bonds through KSFC to meet the cost of the subsidy (Government of Karnataka, 2001). State finances are under severe strain on account of such practices, which have resulted in huge and growing revenue deficits.

**Chart 1: Rates and Ceiling for Capital investment Subsidy under Various Policy Packages - Karnataka**

1983-88 Package						
Zones	Tiny Ind.		SSI		M&L Ind.	
	Rate	Max.cing.	Rate	Max.cing.	Rate	Max.cing.
	%	Rs.Lakhs	%	Rs.Lakhs	%	Rs.Lakhs
I	Nil	Nil	Nil	Nil	Nil	Nil
II	10	0.5	10	5	10	10
III	15	0.75	15	7.5	15	15
IV	15	1	15	15	15	15
1993-94 Package						
Zones	Tiny Ind.		SSI		M&L Ind.	
	Rate	Max.cing.	Rate	Max.cing.	Rate	Max.cing.
	%	Rs.Lakhs	%	Rs.Lakhs	%	Rs.Lakhs
I	Nil	Nil	Nil	Nil	Nil	Nil
II	10	0.5	10	5	10	10
III	15	0.75	15	7.5	15	15
IV	15	1	15	15	15	15
1996-2001 Package						
Zones	Tiny Ind.		SSI		M&L Ind.	
	Rate	Max.cing.	Rate	Max.cing.	Rate	Max.cing.
	%	Rs.Lakhs	%	Rs.Lakhs	%	Rs.Lakhs
I	Nil**	Nil**	Nil**	Nil**	Nil**	Nil**
II	25	25	25	25	Nil	Nil
III	30	30	30	30	Nil	Nil
Note:						

\*\* : Only the Tiny and Small Scale Industries set up in developed areas in specified non-polluting high technology Industrial Units shall be eligible for an investment subsidy of 25% of value of fixed assets, subject to a ceiling of Rs.25 lakhs.

Note: (1) Tiny Ind. - Tiny Industrial Units  
 (2) SSI - Small Scale Industries Units  
 (3) M&L Ind. - Medium and Large Scale Industrial Units  
 (4) Max. cing. - Maximum Ceiling

## Regional Flow of Benefits under the Capital Investment Subsidy Scheme

The paper has made an attempt to trace the regional flow of the benefits from the CIS scheme by analysing the district-wise distribution of the subsidy amount. However, such an analysis could not be attempted for the entire period that CIS has been operating due to non-availability of a consolidated statement giving district-wise data. Hence, the analysis was restricted mainly to districtwise pendency of subsidy for two recent years for which district-wise data was available. District-wise sanction and pendency of capital investment subsidy to the small-scale industries reveals (Table 1) that as on 1998-99, Bangalore Urban district accounts for the largest share (17.59 per cent) in the total subsidy of the State. Ironically, Bangalore Urban district forms a part of Zone I, an industrially advanced zone, wherein the eligibility is restricted to certain non-pollution and special category of entrepreneurs, but still constitutes the largest share in the state. Bangalore Division as a whole accounts for 52 per cent of the subsidy amount.

**Table 1: Pendency of Capital Investment Subsidy by Districts**

District	As on Dec 99		As on March 2001	
	Number	Amount (Lakhs)	Number	Amount (Lakhs)
Bangalore (U)	628 (8.76)	3655.98 (17.6)	1048 (8.32)	5644.61 (17.21)
Bangalore (R)	989 (13.8)	2994.89 (14.41)	1503 (11.93)	4517.96 (13.78)
Kolar	638 (8.9)	1927.77 (9.28)	946 (7.51)	2456.54 (7.49)
Shimoga	157 (2.19)	455.78 (2.19)	255 (2.02)	553.89 (1.69)
Tumkur	422 (5.89)	1117.15 (5.38)	955 (7.58)	2214.6 (6.75)
Chitradurga	273 (3.81)	601.83 (2.89)	408 (3.24)	941.17 (2.87)
<b>Total Blore Dvn</b>	<b>3107 (43.36)</b>	<b>10753.4 (51.74)</b>	<b>5115 (40.6)</b>	<b>16328.77 (49.8)</b>
Belgaum	510 (7.12)	932.87 (4.49)	925 (7.34)	1528.78 (4.66)
Belary	211 (2.94)	882.41 (4.25)	451 (3.58)	1361.79 (4.15)
Bidar	123 (1.72)	334.38 (1.61)	346 (2.75)	391.15 (1.19)
Bijapur	263 (3.67)	580.12 (2.79)	476 (3.78)	913.6 (2.79)
Chickmagalur	158 (2.21)	393.3 (1.89)	193 (1.53)	436.74 (1.33)

As on Dec 99			As on March 2001	
District	Number	Amount (Lakhs)	Number	Amount (Lakhs)
Dakshina Kannada	709 (9.9)	1728.16 (8.32)	1237 (9.82)	2956.41 (9.01)
Dharwad	582 (8.12)	1242.79 (5.98)	838 (6.65)	1595.58 (4.87)
Gulbarga	160 (2.23)	578.9 (2.79)	336 (2.67)	975.58 (2.98)
Hassan	264 (3.68)	385.92 (1.86)	390 (3.1)	640.34 (1.95)
Kodagu	44 (0.61)	78.43 (0.38)	108 (0.86)	262.46 (0.80)
Mandya	99 (1.38)	209.47 (1.01)	245 (1.95)	377.3 (1.15)
Mysore	402 (5.61)	1190.5 (5.73)	850 (6.75)	2605.37 (7.95)
Raichur	169 (2.36)	774.88 (3.73)	274 (2.17)	1017.51 (3.1)
Uttar Kannada	364 (5.08)	716.53 (3.45)	811 (6.44)	1400.34 (4.27)
<b>State</b>	<b>7165</b>	<b>20782.06</b>	<b>12595</b>	<b>32791.92</b>

*Note:* Figures in brackets are percentages to respective totals.

*Source:* Government of Karnataka, Department of Industries and Commerce, Bangalore

## CIS in Bangalore and Gulbarga Divisions

We are able to present some recent trends in two divisions in the state - Bangalore and Gulbarga, based on the statistics that we compiled from the respective District Industries Centres' (DIC) records. The time period covered is from 1993-94 during the year in which the Karnataka government enhanced the rate of subsidy from 15 per cent to 25 per cent until 1998-99. The number of units that had received CIS, amount of fixed capital investment made by these units and the quantum of capital investment subsidy by different size classes received from the government are discussed below.

### Number of Units

As per the District Industries Centres (DIC) data, while 3,339 units in Bangalore division have received subsidy during the period 1993-94 to 1998-99, less than half such units have received subsidy in Gulbarga division. (Table 2) Also, there has been largely an increasing trend in the number of units receiving subsidy in Bangalore division, while that of Gulbarga has been either declining or stagnant.



**Table 2: Units Sanctioned Capital Investment Subsidy:  
Bangalore and Gulbarga Divisions (Numbers)**

Distri- cts	Banga- lore Urban	Banga- lore Rural	Chitra- durga	Kolar	Shi- moga	Tum- kur	Divi- sion
1993-94	85	6	27	76	50	8	252
1994-95	53	14	180	71	95	102	515
1995-96	80	67	68	68	111	209	603
1996-97	66	120	84	10	85	89	454
1997-98	196	287	149	139	109	163	1043
1998-99	101	123	58	78	35	77	472
<b>Total</b>	<b>581</b>	<b>617</b>	<b>566</b>	<b>442</b>	<b>485</b>	<b>648</b>	<b>3339</b>

**Gulbarga Division**

Distri- cts	Bellary	Bidar	Gul barga	Rai chur	Divi- sion
1992-93	81	72	113	63	329
1993-94	24	51	78	75	228
1994-95	66	33	78	21	198
1995-96	46	33	75	40	194
1996-97	42	24	52	43	161
1997-98	108	41	106	55	310
<b>Total</b>	<b>367</b>	<b>254</b>	<b>502</b>	<b>297</b>	<b>1420</b>

Source: DIC Records of respective districts.

## Fixed Capital Investment

The flow of fixed capital investment by districts reveals a sharp increase in the fixed investment in SSI units located in the Bangalore division from Rs.3,093 lakhs in 1993-94 to Rs 9,034 lakhs in 1998-99 revealing a 192 per cent increase. (Table 3) The highest investment Rs 14543 lakhs was made in the year 1997-98. Further its distribution reveals that among the districts in Bangalore division, Bangalore urban accounts for the largest share, 44 per cent, of the total investment that has been made during the reference period. This is followed by Bangalore Rural district, with 27 per cent investment. Thus, Bangalore Urban and Rural districts together have attracted a large investment, which accounts for 71 per cent of the total investment in the division. Shimoga district has had a persistent decline in its share.

**Table 3: Fixed Capital Investment across Districts in Bangalore Division (Rs in Lakhs)**

Year	B. Rural	B. Urban	Shi-moga	Kolar	Tum-Kur	Chitra-durga	Grand Total
1993-94	135	1740	407	525	56	230	3093
*	4	56	13	17	2	7	100
1994-95	418	886	521	358	754	1891	4829
*	9	18	11	7	16	39	100
1995-96	865	1813	794	450	1021	514	5457
*	16	33	15	8	19	9	100
1996-97	2040	1177	593	43	342	950	5145
*	40	23	12	1	7	18	100
1997-98	3139	5276	987	928	1430	2783	14543
*	22	36	7	6	10	19	100
1998-99	2439	3946	338	805	726	780	9034
*	27	44	4	9	8	9	100

*Note:* \* Refers to percentage to respective year's total  
 - Investment is not available for about 60 cases (Tumkur district).  
 - Percentages may not add up to 100 due to rounding off

*Source:* Records of District Industry Centres of Respective Districts, Government of Karnataka.

## Capital Investment Subsidy

The disparities observed in the number of units receiving subsidy also show up in the amount of subsidy flowing into each of these divisions. It can be observed from the data (Table 4) that while Bangalore and Gulbarga divisions were entitled to almost equal amounts in 1993-94, the disparity has grown substantially in the subsequent years. The total subsidy amount availed by the units in Bangalore division is more than two-and-a-half times that of units in Gulbarga division.

**Table 4: Capital Investment Subsidy: Bangalore and Gulbarga Divisions**  
(Rs in Lakhs)

Years	Bangalore	Gulbarga
1992-93	-	545
1993-94	592	583
1994-95	1124	312
1995-96	1188	372
1996-97	1227	516
1997-98	3613	1254
1998-99	2249	-
Total	9993	3582

Further analysis of the district shares in the total subsidy amount availed by each division reveals that Bangalore Urban district (34 per cent) in Bangalore division and Bellary district (27 per cent) in Gulbarga division account for the largest share in their respective divisions. (Table5).

**Table 5: Distribution of Capital Investment Subsidy by Districts (Rs in Lakhs)**

Bangalore Division	Amount	Gulbarga Division	Amount
Banglore Rural	2075	Bellary	965
**	21		27
Bangalore Urban	3415	Bidar	792
**	34		22
Shimoga	889	Gulbarga	756
**	8.9		21
olar	769	Koppal	697
**	7.7		19
Tumkur	1015	Raichur	373
**	10.1		10
Chitradurga	1832		
**	18.3		
Total	9993	Total	3582

Note: \*\* Indicates per cent to respective Division Total

It has to be noted that both Bangalore Urban and Bellary districts are industrially more advanced than the other districts in their respective divisions. This is borne out by the fact that during the reference period Bangalore urban district has had in all 17,082 SSI units registered, the highest number within the division. Bellary district, on the other hand, has had 3,898 SSI units registered, second largest in the division, next to Gulbarga district (4,307 units).

One could argue that the larger amount of subsidy flowing to Bangalore Division is on account of larger number of units that have received the subsidy. But the analysis reveals that industrial units that have availed of subsidy in Bangalore Urban district are also better off on account of the per unit subsidy received by them. Per unit subsidy between the two divisions ranges between Rs.5.88 lakhs in Bangalore urban district to Rs 1.51 lakhs in Gulbarga district.

These results make one very skeptical as to how far the results are in line with the professed objective of the investment subsidy to encourage industry in the backward regions and dispersal of industry. Given the fact that these measures have operated for a long period, which date back to 1975 when the government announced the second industrial incentive package, there should have been a considerable development of industry in backward regions. A perusal of Table 6 depicting the growth of small-scale industries in the State as under the various policy packages reveals that the benefits that have flown into the backward regions are not very encouraging.

Industrially advanced districts bagging a large share of a scheme meant for backward regions, is a serious anomaly, which is not in line with the objectives of industrial incentives. Further, two of the three-growth centre districts, Hassan and Raichur, have a small share in the total subsidy despite the availability of an additional subsidy.

**Table 6: Incentive Package-wise Growth of Small-Scale Industries (No. of Units)**

District	1969-1974	1975-1982	1983-1988	1989-1995	1996-2000
Bangalore	2300(24.1)	2706 (15.3)	7340 (12.7)	15622 (20.2)	11799 (13.96)
Belgaum	334 (3.50)	1015 (5.74)	6267 (10.85)	6558 (8.46)	9429 (11.15)
D. Kannada	581 (6.09)	1281 (7.24)	4403 (7.63)	4627 (5.97)	5697 (6.74)
Dharwad	504 (5.29)	1381 (7.80)	5280 (9.14)	6996 (9.03)	6243 (7.39)
Mysore	520 (5.45)	1388 (7.84)	6214 (10.76)	5729 (7.39)	7458 (8.8)
B'lore (Rural)	1146 (12.02)	2843 (16.06)	2487 (4.31)	4533 (5.85)	3741 (4.43)
TOTAL	5385 (56.47)	10614 (59.98)	31991 (55.40)	44065 (56.88)	44367 (52.50)
Bellary	698 (7.32)	461 (2.60)	2476 (4.29)	2661 (3.43)	3245 (3.84)
Bidar	83 (0.87)	322 (1.82)	1450 (2.51)	1727 (2.23)	2153 (2.54)
Bijapur	330 (3.46)	513 (2.90)	2268 (3.93)	2912 (3.76)	2692 (3.19)
Chitradurga	560 (5.87)	779 (4.40)	1989 (3.44)	2712 (3.50)	4405 (5.21)

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District	1969-1974	1975-1982	1983-1988	1989-1995	1996-2000
Chikmagalur	101 (1.06)	309 (1.75)	1152 (2.00)	1361 (1.76)	1299 (1.54)
Gulbarga	149 (1.56)	471 (2.66)	2067 (3.58)	2582 (3.33)	4020 (4.76)
Hassan	215 (2.25)	392 (2.22)	1323 (2.29)	1624 (2.10)	3007 (3.56)
Kolar	300 (3.15)	829 (4.68)	1942 (3.36)	2568 (3.31)	3670 (4.34)
Kodagu	141 (1.48)	197 (1.11)	602 (1.04)	751 (0.97)	874 (1.03)
Mandya	309 (3.24)	481 (2.72)	1002 (1.74)	1582 (2.04)	2276 (2.69)
Raichur	157 (1.65)	503 (2.84)	1990 (3.45)	2632 (3.40)	3364 (3.98)
Shimoga	466 (4.89)	836 (4.72)	2958 (5.12)	3524 (4.55)	1712 (2.03)
Tumkur	391 (4.10)	561 (3.17)	3579 (6.20)	5481 (7.07)	4883 (5.78)
U. Kannada	247 (2.59)	433 (2.45)	953 (1.65)	1291 (1.67)	2544 (3.01)
State	9536	17697	57742	77473	84511

Note: Figures in brackets indicate percentage to total.

Source: Gayithri K., 2002, Industrial Incentives in Karnataka, Report prepared for Government of Karnataka, Bangalore.

## **Utilisation of Capital Investment Subsidy: Some Insights from Bangalore Division**

The study attempted to verify the utilisation of capital investment subsidy received by the industrial units; for which a primary survey of 1,500 small and tiny units was conducted. The purpose of the survey was to check whether the units that had availed of subsidy are surviving and honoured government regulations set at the time of sanction of subsidy.

### **Utilization of Subsidy: Government Conditions**

The state government has stipulated certain conditions to ensure proper utilization of the subsidy. The sanction order of Government of Karnataka for sanction of Investment Subsidy lays down the following guidelines for the purpose, failing which subsidy amount can be recovered (Government of Karnataka) from the units.

- Subsidy should not be obtained by misrepresentation of facts, or furnishing of false information.
- Unit should not go out of production within five years (except in cases where the unit remains out of production for not more than six months due to raw material problems) after commencement. This has been recently changed to one year.
- Location of the industrial unit should not be changed either in part or full.
- Contraction or disposal of a part of fixed capital should not be effected within a period of five years after receiving the subsidy.

While it was very difficult for us to verify the adherence to the first regulation, an attempt was made to check whether the units adhered to the remaining ones. Prior to this, a brief outline of the distribution of sample units is presented.

### **Distribution of Subsidy among the Sample Units**

Distribution of the sample units and the subsidy amount within the division accounts for the fact that Tumkur district has the largest number of sanctions and Bangalore urban district has the largest share (36.03 per cent) in the total amount of subsidy. This is followed by Bangalore rural district (22.19 per cent). Kolar gets the smallest share of 6.74 per cent. Tumkur district, which has the largest number of units, however, accounts for only 12 per cent of the total subsidy amount. On the contrary, Bangalore urban district, which constitutes 17 per cent of the units, has received a 36 per cent share in the subsidy amount. These results reveal that financial benefits on account of capital investment subsidy have largely reached

industrial units in Bangalore Urban and Rural districts. They together constitute 58.22 per cent of the total subsidy amount disbursed in Bangalore Division (Table 7).

**Table 7: Distribution of Sample Units by Districts and Amount**

Districts	Number	Percentage	Subsidy Amount (Rs.Lakhs)	Per centage
Bangalore Rural	282	18.8	956.59	22.19
Bangalore Urban	256	17.06	1553.45	36.03
Chitradurga	238	15.87	604.03	14.01
Kolar	182	12.13	290.47	6.74
Shimoga	220	14.67	389.65	9.04
Tumkur	322	21.47	517.57	12.00
Total	1500	100	4311.76	100

Percentages are taken to respective totals

## Categories of Industries

Distribution of units by categories<sup>6</sup> of industries reveals (Table 8) that food products has the largest numbers, 575 (38.33 per cent) as opposed to paper and printing, which has the least, 182 (12.1 per cent). In four of the six districts the food products industry is predominant (Chitradurga, Shimoga, Tumkur and Kolar). In Bangalore urban and Bangalore rural districts the predominant industries are manufacture of electrical industrial machinery apparatus and parts thereof and wool and silk industries respectively. Wool and silk units follow food products.

## Operational Status of the Units

Operational status of the units by categories of industry reveals that of the 1,500 sample units surveyed 987 (66 per cent) units are working, and 513 units (34 per cent) are closed, (Table 8). Thus, on an average, the units that are still working constitute a larger share; nevertheless, the proportion of units that have closed down is not negligible. Further, the per centage of closures is very high in Bangalore urban district than in Tumkur and Shimoga.

Second All India Census of SSI units (1988) in the state has reported 25 per cent closures in the State. If in the normal course about 20-25 per cent of the units close down, the closures observed in the present study especially that of Bangalore Urban, Kolar, Chitradurga, and Bangalore Rural is certainly very high. Looking at the trends one may tentatively



conclude that certain units were started just to take advantage of the scheme. This was quite rampant in Bangalore urban district.

In order to get better insights into the closed cases a more detailed analysis of the closure of units as to what type of industries are closed and where they are located is attempted below.

## Closure by Industry Category

Analysing the closures by industry categories, it can be observed that a large proportion of units belonging to Non-metallic mineral products, paper and printing, food products is still working. On the contrary, a large proportion of the units belonging to 'Electrical industrial machinery apparatus and parts' thereof and 'Textiles' category (43 per cent) are closed.

**Table 8: Operational Status of Industrial Units**

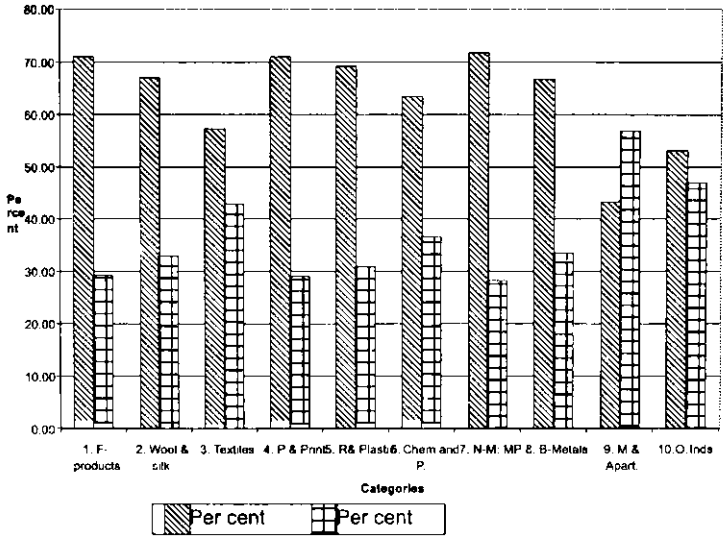
Category	Working		Not Working		Total
	Nos	Per cent	Nos	Per cent	
Bangalore Rural	192	68	90	32	282
Bangalore Urban	142	55	114	45	256
Chitradurga	154	65	84	35	238
Kolar	110	60	72	40	182
Shimoga	157	71	63	29	220
Tumkur	232	72	90	28	322
<b>Total</b>	<b>987</b>	<b>66</b>	<b>513</b>	<b>34</b>	<b>1500</b>

*Note:* The non-working units are inclusive of 16 units, which are not to be traced and change of product.

A large percentage of closure of the units is found to be on the Manufacture of electrical industrial machinery apparatus and parts thereof' industry category (56.69 per cent) which, mainly comprises computer and computer-based systems. 'Textiles and textile products', mainly pertaining to garments, also account for a large share (43 per cent). The percentage of closures is the lowest in 'Nonmetallic minerals' category (28.18 per cent) mainly consisting of bricks, tiles, granite, polishing stone etc., 'Paper and printing' (28.95 per cent). 'Food products' (29.04 per cent) also have lesser closures (Chart 2).

Chart 2

**Working and Closed Units by Industry Categories**



The districts that account for a large number of food-related industries are Chitradurga, Shimoga, Tumkur and Bangalore Rural in the same order. In terms of the working and closed status of the units, while the proportion of closed units is larger in Chitradurga and Bangalore Rural districts, that of Shimoga and Tumkur is much smaller.

Bangalore Rural district has the largest number of closed units belonging to 'Wool and silk' categories. Kolar takes the second place wherein the closed units outnumber the working units. Industrial units in the 'Manufacture of textile products' are mainly concentrated in Bangalore Urban, which account for almost half of the units in the entire division followed by Tumkur district. While the closed units in Bangalore Urban outnumber the working units, there is a very small proportion of the units closed in Tumkur district.

**Subsidy Amount: Working and Closed Units**

Distribution of subsidy amount by the working and closed units reveals that while working units have availed of Rs.3,155.81 lakhs, that of closed units have availed of Rs1,287.57. The subsidy amount given to the closed units' amounts to 29 per cent of the total subsidy amount. While this pertains only to sample units covered in the present study, an estimation for the entire population (applying the same proportion of subsidy amount as that of sample units) reveals that of the total pending subsidy bill, Rs

327 crores, the share of closed units would be Rs 98 crores. Per unit subsidy availed of by the closed units is lesser than the working units in all the categories with the exception of Textiles and other industries. (Table 9). In all probability the units that are closing down belong to tiny and small units and it is very essential to probe into the reasons for closure of these units. However, it becomes very clear that while the CIS may have aided in the starting of many new units, the survival of units continues to be an issue for concern.

## **Closure by Rural and Urban Categories**

Distribution of closed units by rural and urban categories is presented in Table 10. Urban units that account for 49 per cent of total units have larger closures than their rural counterparts, constituting 57 per cent of the total closures. There is an exception in the case of Bangalore Rural and Kolar districts as they have a large proportion of their rural units closed.

## **Subsidy Amount: Rural and Urban Areas**

Subsidy amount involved in the case of closed urban units is Rs 784.6 lakhs (61 per cent) and that of rural areas is Rs 502.99 (39 per cent) (Table 11). Subsidy amount involved in the case of Bangalore urban units is Rs 538.8 lakhs (42 per cent) and that of Bangalore rural units is Rs. 23.51 lakhs (1.83 per cent). Hence, both in terms of number of closed units as well as amount involved, the units located in the urban areas have a larger share in the total closures.

## **Violation of Government Regulations**

### **Shifting/Selling of the Units**

A large percentage of the units (Table 12, Chart 3) in three districts, i.e., Tumkur (49.75 per cent) Bangalore urban, (43.53 per cent) and Bangalore rural districts (39.69) do not fulfil the government stipulation that the location of the unit should not be changed and the unit should not be sold or leased out to any others within five years (This has been recently changed to 1 year) According to the stipulation, the government should have recovered the subsidy given to such units. No recovery was effected in any of these districts, as per our discussions with the department officials. Information was not available for 43 per cent of the units in Bangalore urban district.

**Table 9: Distribution of Subsidy Amount by Working and Closed Units (Rs. in lakhs)**

Category	Working	Per unit	Closed	Per unit	Total	Per unit
1. F-products	1245.80	3.05	276.93	1.66	1522.72	2.65
2. Wool & silk	218.58	1.36	59.80	0.76	278.38	1.16
3. Textiles	312.38	4.34	341.39	6.32	653.77	5.19
4. P & Print	18.88	0.70	2.86	0.26	21.75	0.57
5. R& Plastic	196.29	5.45	46.86	2.93	243.15	4.68
6. Chem and P.	174.07	6.70	82.99	5.53	257.06	6.27
7. N-M: MP	334.78	4.24	82.15	2.65	416.94	3.79
8. B-Metals	367.62	3.47	130.21	2.46	497.83	3.13
9. M & Apart.	235.82	4.29	188.07	2.61	423.89	3.34
10. O. Inds.	51.59	3.03	76.31	5.09	127.90	4.00
<b>TOTAL</b>	<b>3155.81</b>	<b>3.20</b>	<b>1287.57</b>	<b>2.51</b>	<b>4443.38</b>	<b>2.96</b>

**Table 10: Operational Status of the Units by Rural & Urban Categories**

(Number of Units)

Districts	Working			Closed			G. Total		
	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
1. B.Rural	129	63	192	62	28	90	191	91	282
***	67.19	32.81	68.08	68.88	31.11	31.91	67.73	32.27	100
2. B. Urban	32	110	142	20	94	114	52	204	256
***	22.54	77.47	55.47	17.543	82.46	44.53	20.31	79.69	100
3. C.Durga	71	83	154	27	57	84	98	140	238
***	46.10	53.90	64.71	32.14	67.86	35.29	41.17	58.82	100
4. Kolar	66	44	110	45	27	72	111	71	182
***	60	40	60.44	62.5	37.5	39.56	60.99	39.01	100
5. S.Moga	91	66	157	26	37	63	117	103	220
***	57.96	42.04	71.36	41.27	58.73	28.64	53.18	46.82	100
6. T.Kur	155	77	232	43	47	90	198	124	322
***	66.81	33.19	72.05	47.77	52.22	27.95	61.49	38.51	100
Total	544	443	987	223	290	513	767	733	1500
***	55.12	44.88	65.8	43.47	56.53	34.2	51.13	48.87	100

Note: \*\* Indicates percentage to row total

**Table 11: Subsidy Amount by the Working and Closed Units: Rural and Urban Categories (Rs. in Lakhs)**

Districts	Working			Closed			Total		
	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
1. B.Rural	556.98	83.382	640.37	292.707	23.51	316.2	849.69	106.9	956.6
***	18.4	2.8	21.2	22.73	1.83	24.55	19.71	2.48	22.18
2. B. Urban	157.28	837.76	995.04	30.49	538.8	569.3	187.77	1377	1564
***	5.2	27.7	32.9	2.37	41.8	44.2	4.35	31.93	36.27
3. C.Durga	238.88	245.07	483.96	33.357	86.72	120.1	272.24	331.8	604
***	7.9	8.1	14.51	2.59	6.73	9.32	6.31	7.69	14.0
4. Kolar	121.68	59.925	181.61	66.48	42.38	108.9	188.16	102.3	290.5
***	4.02	1.98	6.0	5.16	3.29	8.45	4.36	2.37	6.73
5. S.Moga	179.48	137.27	316.75	23.2	49.7	72.9	202.68	187	389.6
***	5.9	4.54	10.47	1.8	3.86	5.65	4.70	4.34	9.04
6. T.Kur	183.73	222.74	406.48	56.76	43.43	100.2	240.49	266.2	506.7
***	6.07	7.36	13.44	4.41	3.37	7.78	5.58	6.17	11.75
Total	1438	1586.1	3024.2	502.994	784.6	1288	1941	2371	4312
***	47.55	52.45	100	39	61	100	45.01	54.99	100

Note: \*\* Indicates percentage to respective category total (working to working total)

**Table 12: Units Violating Government Regulations**

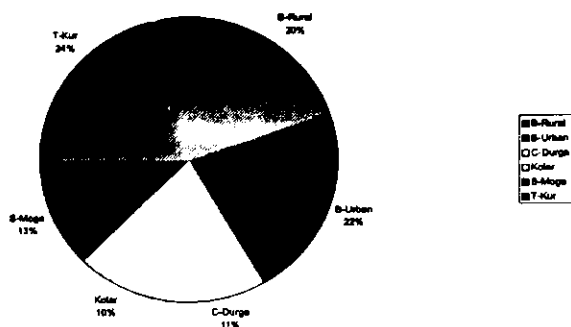
Districts	Shifted	Sold/rented/leased out
Bangalore Rural	5(9.43)	23(30)
Bangalore Urban	14(26)	13(17)
Chitradurga	4(7.55)	11(14)
Kolar	7(13.21)	5(6.48)
Shimoga	5(9.43)	12(15.79)
Turnkur	18(33.96)	12(15.79)
Total	53	76

### Bangalore Urban District

A more detailed analysis of the Bangalore Urban district that accounts for the largest share in the closed units is attempted below. Taluk-wise details of working and closed units are presented in Table 13. In terms of performance of units by working and closed status in the three taluks of Bangalore Urban district, it can be observed that Anekal taluk has the largest share in the working units. Subsidy amount involved in the closed units in this taluk is small. On the contrary, Bangalore north and south taluks account for larger closure. Amount involved is the highest in Bangalore south taluk. Ironically, Bangalore north and south taluks belong to industrially advanced Zone, which according to the policy package has a limited access to incentives and concessions.

Chart 3

Shifted/Sold Units



**Table 13: CIS in Bangalore Urban District (Taluk-wise)**

Taluku	Working		Closed		Total	
	Nos.	Amount	Nos.	Amount	Nos.	Amount
B. North	24	225.39	30	198.40	54	423.79
***	44.44	53.18	55.56	46.82	100.00	100.00
B. South	25	177.30	31	221.57	56	398.87
***	44.64	44.45	55.36	55.55	100.00	100.00
Anekal	93	592.35	52	138.44	145	730.79
***	64.14	81.06	35.86	18.94	100.00	100.00
Total	142	995.04	113	558.41	255	1553.45
***	55.69	64.05	44.31	35.95	100.00	100.00

BU: \*\*\* Indicates the percentage to the row total.

By way of a summary, it can be stated that the financial benefits of Capital Investment Subsidy have largely accrued to regions that did not deserve the subsidy and to the units that did not continue to produce.

## Functioning of the Scheme

In this section, issues relating to implementation of the CIS scheme are discussed. Our field survey and the discussions with the entrepreneurs during our primary survey reveal that there are many areas that need to be strengthened in the implementation of the scheme.

In the first place, inadequate database posed a serious constraint in the pursuit of the study. There was considerable difficulty in getting data related to the number of units that have received subsidy and the category of industry they belonged to. This was because the departments concerned had not prepared consolidated statements. We had to spend considerable amount of time searching the old DIC records to get the data and classify them. Bangalore Rural DIC, however, has computerised the entire data. Second, there was no proper maintenance of details such as complete address of the units, the product-manufactured, etc.

These apart, there were problems related to the implementation of the scheme. A large number of the entrepreneurs have expressed dissatisfaction over the implementation of the scheme due to the delays that have occurred in the release of subsidy. In many cases the delay extended for almost for two to three years. On a positive note, the entrepreneurs have in general appreciated the CIS scheme.



The scheme had also resulted in certain distortions. In quite a few cases subsidy has been availed of by a large number of units under the same management. Such a practice is permissible under the scheme when industrial units avail of an additional subsidy for expansion or diversification. On the contrary, the field observations revealed that fresh subsidy was raised more than once by the same unit, either by putting an annex to the existing unit or in the name of another member of the family. In such cases, there is no fresh investment taking place even while the government is increasingly draining resources in the form of subsidy.

There are also cases of excess capacity creation caused by the incentives-CIS coupled with sales tax concessions. The oil industry in Chitradurga district offers a good example. Despite a sharp decline in the oil seed production, which forms the raw material base for the industry, the district has had a sharp increase in the number of oil manufacturing units. The survey also reported that a number of such new units that had come up were dummies of their parent company started with the purpose of availing fresh concessions. These observations prove that industrial incentives have not only been draining the fiscal resources but are also leading to a number of distortions in the investment patterns and decisions.

The responses from some of the units revealed that corruption was prevalent in the administering of subsidy. Cases of middlemen negotiating sanction and release of subsidy were reported in certain districts. As the intermediaries cut into the share of subsidy, the benefit of subsidy is not reaching the entrepreneurs in full.

## **Summary and Conclusions**

Capital investment subsidy is an important component of various concessions announced by the government for promotion of industrial development. Promotion of industry in the backward regions is the main objective of the scheme. The scope and volume of concession under the scheme has varied from time to time. Introduction of economic reforms and the formulation of New Industrial Policy (NIP) have resulted in a stiff interstate competition to attract industrial investment. One of the strategies the state governments had adopted was to announce very attractive fiscal incentives. A review of Karnataka Government's industrial policy packages over a period clearly account for the sharp increase that has taken place in the scope and volume of concessions during the reform phase. Capital investment subsidy being an explicit subsidy, the fiscal burden is tantamount to an increased direct expenditure by the government. Departmental statistics reveal that subsidy released to the industrial units in the State has increased sharply. Such a sharp increase is very burdensome to the state government, which is already reeling under huge and increasing fiscal and revenue deficit. Ironically, this sharp increase

coincides with the reform phase, which advocates a reduction in subsidies of all kinds.

Financial benefits on account of Capital investment subsidy have largely reached industrial units in Bangalore Urban and Rural districts. They together constitute 58.22 per cent of the total subsidy amount disbursed in the Bangalore Division.

Results of primary survey conducted to check the utilisation of subsidy show that a significant number of units have closed down after availing of the subsidy. A large percentage of closure of the units is found to be in the industry category, 'Manufacture of electrical industrial machinery and parts thereof', mainly comprising computer and computer-based industry and 'Textiles and textile products', mainly pertaining to garments also account for a large share in the closure of units. Percentage of closures is the lowest in 'Nonmetallic minerals' category, mainly consisting of bricks, tiles, granite, polishing stone etc., 'Paper and printing', 'Food products' also have lesser closures.

Between the rural and urban units, more closures are observed in the urban areas. Large numbers of units are closed in Bangalore urban district. Incidentally, Bangalore urban district has bagged the largest share in the benefit on account of CIS scheme.

Based on the present study's findings it can be concluded that the basic objective of promoting industry in the backward areas is not being met very effectively through the Capital Investment Subsidy scheme. Looking at the distribution of subsidy benefits by various districts, one tends to become very skeptical as to how far the government has been able to fulfil the objective of dispersing industry to the backward areas. In addition, a significant proportion of the units have closed down within the first five years. Thus while the scheme may have aided in setting up an industrial unit, it has not helped in its survival. This hints at the need for changing the strategy of promoting industrial development. Many studies highlight the need for strengthening infrastructure rather than offering fiscal concessions. This attains special significance in the context of the New Industrial policy.

## Notes

- 1 Fixed capital investment includes items such as land, building and civil works, plant and machinery, electrical installation, tools, jigs, dies and moulds, goods carriers and other fixed assets.
- 2 Zone-I had comprised Bangalore Urban agglomeration, Bangalore south and north taluks and Mysore City Corporation area.
- 3 Electronics, telecommunications, informatics, precision tooling, readymade garments, units manufacturing pollution control and effluent treatment plant, biotechnology industries.
- 4 I) Scheduled Castes and Scheduled Tribes; (II) Minority Communities (as specified by the State Minorities Commission); (III) Women; (IV) Physically Handicapped; (V) Ex-Servicemen; (VI) Units employing more than 50 per cent of skilled women workers, on a permanent basis for a period of more than 3 years provided minimum employment is 20; (VII) Technocrat Entrepreneurs.
- 5 Growth Centres include Hassan, Raichur and Dharwad; Mini Growth Centres include Bijapur, Bellary, Kolar, Nippani, Gadag, Chikmagalur and Chitradurga.
- 6 An attempt was made to categorise the industries that were surveyed in to the Annual Survey of Industry groups in order to have a meaningful comparison.

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