State Finances
Brickwork Handbook 2016

Brickwork takes great pleasure to present the fifth edition of Handbook on State Finances. This edition looks at the fiscal developments at the State level for the year 2016. Brickwork has unique criteria for rating state governments. It looks at the issues of debt sustainability in terms of states' willingness and ability to honor debt obligations. The criterion considers an analysis of political, economic, budgetary, financial and institutional parameters deemed relevant to the state governments' creditworthiness. It also evaluates states' fiscal parameters from the viewpoint of accelerating growth and improving human development in their respective economies. The Handbook captures some of the important parameters and summarizes each state in a page. Similar metrics for the Government of India are also presented for ready reference.

The seventh schedule to the Constitution of India assigns the responsibilities of the Union and State governments in terms of Union, State and Concurrent Lists. Although the Cabinet Mission which visited India on the eve of independence recommended significant decentralization, the fissiparous tendency by a number of native rulers resulted in a pronounced centripetal bias in the Constitution of India. Over the years, with centralized planning gaining ascendance, got accentuated. On the political front, with the Indian National Congress ruling at both the Union and states in the initial years after independence, the demand for decentralization was subdued. However, the emergence of coalition governments at the Centre with some of the regional parties as pivotal members of the coalition, there have been a vociferous demand for decentralized governance. The attempt by the Fourteenth Finance Commission to rebalance fiscal equilibrium between the Union and States in its recommendations has helped to provide greater financial autonomy to the States. Despite these developments, the Union government continues to hold significant sway and intervenes in undertaking even those functions listed under the state List though Centrally Sponsored Schemes.

The Indian Economy at Crossroads

India's embrace of economic and trade liberalization reforms in the early 1990s— particularly de-licensing, the privatization of state-owned enterprises (SOEs), and liberalization of trade and foreign direct investment (FDI)—contributed to two decades of turbocharged economic growth that gave rise to the so-called "Indian Economic Miracle." In fact, the Indian economy grew 40 percent faster per year in the two decades that followed the 1991 reforms than it did in the two decades preceding it. The liberislation showed up in better banks and better capital markets with regulator playing the key roles in both. The capital markets now require lot of disclosures form the intermediaries and listed firms, making them safer than pre 1991 era.

Unfortunately, Indian economic growth has stagnated in the last few years. In fact, in 2013, Indian economic growth slowed to 5.6 percent—the lowest level in a decade. Since the NDA government led by Mr Modi took over the reins India's economy has witnessed a significant economic growth in the recent past, growing by 7.6 per cent in FY16 as against 7.2 per cent in FY2015. While the growth looks impressive in comparison with other countries, India had grown at higher rates till 2009. Since the outbreak of the global financial crisis in 2009 and until 2014 and with the sharp increase in international commodity (oil) prices, the Congress government had to contend with slowing economic growth, large current account deficit, weakening rupee, high unemployment and high Inflation. Since 2015, the low oil prices backed by conservative macroeconomic policies have helped to contain inflation, fiscal and current account deficits. In addition, better management of the economy has helped to maintain high rate of growth and has put India in the list of fastest growing large countries in the world. Further the NDA government has come up with various programmes like Make in India and Skill India which will help them to employ the 110 million youngsters who are employable. The expected "demographic dividend" may not be realized, unless the governments both at Centre and states are reformed.

Past Decades

The Indian economy was at its worst in 1990-91 when the gross fiscal deficit was at 9.1% of GDP. The foreign exchange reserves were just about sufficient to meet three week's import demand and the country had to pledge gold in London for foreign currency. The banks were facing unprecedented NPA levels at about 22%. The repressive financial system demanded over 22% CRR and 45% SLR. The repressive gathering of funds by the Centre from the banking system left no money for the private sector and the country experienced one of the worst financial crowding out of private investments. While the liberalization and reforms began, the decade of 1990s continued to be stressful for the country.

The Indian States were in tremendous fiscal stress in the late nineties, due to low growth of the economy, stagnant tax revenues, high staff salaries consequent on the revision of pay scales following the adoption of Fifth Pay Commission's recommendations by the Government of India, and other committed expenses and adoption of number of populist schemes, subsidies and transfers. The fiscal deficit of States had surged to 4.55% of GDP in 1999-2000.

Golden Decade

The period from 2000 to 2008 proved golden years for most States, with revenues expanding due to robust growth in industry, information technology, real estate, shopping malls, increased transfers from the Finance Commission and Centre's buoyant tax revenues, debt relief and consolidation from the Centre as well as implementation of VAT. The momentum of growth continued and the States' GDP in current prices grew by 15.1% during the period 2007-2011. States were able to introduce more schemes that were sometimes of populist variety. In spite of such populist schemes, the state departments were flush with funds from the central grants. The budget of health department for example went up from Rs. 17,000 crores during 2003-2007 to Rs. 42,000 crores in 2011, a CAGR of about 23%.

India - Fastest Growing Now

The IMF and the World Bank have predicted that India's GDP is expected to grow at 8 per cent in 2017 from 7.6 per cent this year, with the hope of revival of rural demand due to better monsoon, major policy changes and renewed confidence in the market brought about by a series of economic reforms pursued by the NDA government. According to Organization for Economic Cooperation and Development (OECD), Only India is expected to experience high growth momentum among the BRICS nations. As per Boston Consulting Group (BCG), India could become the world's seventh biggest nation in terms of private wealth going up from US$ 2 trillion in FY13 to US$ 5 trillion by FY18. In addition, the new “Make in India” initiative is expected to be a vital component in India's quest for achieving rapid economic development.

The New GDP

Last year the Government has estimated the GDP based on a new statistical method with a broader framework that turned up a pleasant surprise: GDP in 2013-14 grew 6.9 percent instead of 4.7 percent, reported earlier. The revision in the base year of India's national accounts itself increased the size of the economy to Rs 120 trillion in FY14! The size of the Indian economy was about Rs 93.89 trillion in FY13. The Indian Economy is showing bullish signs with GDP growth of 7.6% in FY16 and 7.3% in FY15. Further it is expected to grow at 8% in FY17 owing to better monsoon conditions, improved global economy and further fall in Oil prices.

India - Positive:

India has become a promising investment destination for foreign companies looking to do business in emerging nations. Mr Narendra Modi, Prime Minister of India, has launched the 'Make in India' initiative with the aim to give the Indian economy global recognition. The steps taken by the government in recent times have shown positive results as India's GDP growth accelerating to 7.6% in FY16 as compared to 7.3% in FY15. According to the Economic Survey, it is projected to grow at 7.8% in 2017. With better performance of capital goods and infrastructure sectors, thanks to better coordination between power, coal, shipping and transport, railways and environment ministries besides better monsoon conditions, the potential for the economy to record even higher growth in the medium term exists.

Shining in the Dark

While it is heartening to see India's real GDP growth has accelerating to 7.6 % during FY16 from 7.3 % in FY15 and 6.6 % in FY 14, it must be realized that the growth potential of India is much higher and realizing the potential growth requires removal of road blocks for reforms. The economic Survey describes Indian economic reform experience as, “Persistent, creative and encompassing incrementalism”. Removing the roadblocks and changing the reform environment is important to achieve the potential growth of the economy.

Experts are skeptical about possibility of achieving potential growth rate of 8% considering the road blocks to reforms. While India has been hesitating in implementing reforms, few states have done well and competing with one another to change the business climate to attract investments. . In terms of state performance, at disaggregated level, growth rates among the states varied in the range of 5.3% to 17.1% during FY15 in real terms. Figure 1 shows some of emerging and established states which have grown at over 8.5% while other states were stagnant. It is interesting to see that Bihar and Madhya Pradesh, both historically lagging in terms of development and thus forming part of acronym BIMARU, achieved double-digit growth of 17.06% and 16.86% respectively during FY15. These states are catching up with other rich states in terms of industrialization and developments if they are able sustain such growth levels in future. The top five economies are Bihar, Goa, Madhya Pradesh, Gujarat and Meghalaya.

Figure 1: States' Economy Size and Growth Rates (2015)