State Finances
Brickwork Handbook 2018

Brickwork takes great pleasure to present the Seventh edition of Handbook on State Finances. This edition looks at the fiscal developments at the State level for the year 2018. 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. 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 - World's fastest-growing major economy

India has regained its title as the world's fastest-growing major economy, after figures confirmed it grew more than 7.7% in the last quarter of FY18. The GDP growth for FY18 is estimated at 6.7%. World Bank and IMF have also projected India's GDP growth rate at over 7.3% in FY19 and estimated to improve further in the forthcoming financial year as well.

In 4QFY18, India's GDP growth has estimated at a 7.7%, which is the highest in the last seven quarters. The growth was driven by increase in government consumption expenditure. GFCF too has at over 14% from 30.3% of GDP in Q4FY17 to 32.2% of GDP in Q4FY18.

Over the medium term, growth rate is expected to gradually rise with continued implementation of structural reforms that raise productivity and incentivise private investment, healthy consumption demand, government expenditure.

The risk of monetary tightening and trade wars, corporate debt overhang and associated banking sector credit quality concerns have exerted a drag on investment in India and the impact of higher crude oil prices on purchasing power of consumers, depreciating rupee and corporate earnings have emerged as risks.

Recapitalisation should be part of a broader package of financial reforms to improve the governance of public sector banks and lenders' debt recovery mechanisms should be further enhanced. The main priorities for lifting constraints on job creation and ensuring that the demographic dividend is not wasted are to ease labour market rigidities, reduce infrastructure bottlenecks, and improve educational outcomes. India's per capita output growth is expected to rise from 5.4% in FY18 to 6% this year, 6.4% in FY20 and further to 6.8% by FY24. Issues related to credit and investment, and enhancing the competitiveness of exports needs to be resolved.

FDI in India

India will be the fifth most attractive market for global industries in 2018 in a survey of global CEOs conducted by PwC. As a major national initiative to boost manufacturing and investment in India, the Make in India program ushered multiple reforms in ease of doing business, thus improving the investment climate in India. The rating upgrade by the Moody's has also improved the investors' sentiments regarding the Indian economy. India's rank in the ease of doing business jumped up to 100 from 130 earlier, indicative of better business opportunities. Better macroeconomic performance is likely to further propel the FDI inflows in the country. India has received cumulative FDI inflow of $367.93 billion (excluding remittance) from April 2000 to December 2017. In 11MFY18, India has received FDI inflow of $40.07 billion.

All these parameters clearly reflect investor optimism in India's economic outlook. The Government has been making consistent efforts to make India an investor-friendly destination. From measures to improve ease of doing business to reforms under the FDI policy liberalizing FDI regulations for the retail sector for domestically manufactured goods and eliminating need for FDI approvals in sectors such as defence, telecom and broadcasting. the intent of the government has been to make the FDI policy more investor friendly and remove the policy bottlenecks that have been hindering the investment inflows into the country.

India - Outlook

The Gross Value Added (GVA) in India has registered a growth of 6.5% in 2017-18 despite the temporary disruptions due to demonetization of high denomination currency notes and implementation of unified goods and services tax (GST) at Central and State levels in the country. The fiscal situation of India has seen slippage in FY18 (RE) due to revenue shortfall on account of lower tax collection under GST, which has been operational from July 2017.

RBI has forecasted the CPI to be in the 5.1%-5.6% range for the first half of 2018-19. Increasing crude prices which may push the inflation by 25 bps and increase in MSP by the central government inflation may make the food inflation trajectory unclear.

Exports have increased by 9.78% in FY18 as against corresponding period of previous year. Imports have also increased by 19.59% in FY18 against corresponding period of the previous year due to the rise in international crude oil prices. The trade deficit has widened to US$ 156.83 billion during FY18 against US$ 108.50 billion in the corresponding period of the previous year. The Economic Survey 2018 estimated that ceteris paribus, a $10 per barrel increase in the price of oil would reduce economic growth by 0.2-0.3% points and worsens the CAD by about $9-10 billion dollars. Rising crude oil prices are expected to have a direct impact on India's GDP by 0.5% and 1%.

The growth of GVA in agriculture, industry and services has seen a modest growth of 3.4%, 5.7% per cent and 7.9% percent respectively in 2017-18. Growth rate of industry sector declined in 2017-18, mainly on account of moderate growth in manufacturing sector. It was the services sector that contributed to more than half of the overall GVA growth rate of 6.5 % in 2017-18. However, in the last quarter of FY18 growth has accelerated in all the three sectors, where manufacturing grew at 9.1% which has given a big boost to the industrial sector.

From the demand side, the final consumption expenditure has been the major driver of GDP growth which has seen a 14.4% growth in the last quarter of FY18 which is accelerating from last three quarters. This is seen as a positive for investment.

Currently, the credit growth for the scheduled banks has been 13% which typically helps gauge investments. This has seen an uptick driven by working capital requirements and consistent growth in retail. Increase in investments and capacity creation expected to take place in FY19. The projected growth is believed to be achievable if adequate support by good monsoon, increased government spending and favourable global growth despite the threats posed by rising oil prices and bad loans.