Federal India:
A Competitive Assessment of India's States

An IMA study of state-level trends in income, consumption, investment, and employment reveals significant – and business-relevant – variations across India's regions

India's future lies in its states. When India grows at 7 per cent, some states grow at double digits, while others barely grow. Rising federal freedom, as enabled by the Centre, has started with strong fiscal loosening and more power to states, but much remains to be done. All of that, however, is irrelevant after a point. The Centre does not, and is not meant to, direct the future of India's states. Each state and its government must carve its destiny. Getting it right can reap huge benefits in relatively short time spans, as states like Bihar have proven on occasion, whereas getting it wrong can bring a nation down, holding back millions from prosperity and creating internal migration that strains systems. A case in point is the rise – and fall – of Maharashtra and Tamil Nadu. The unevenness of growth in such massive states must be better understood for their trends, possible outcomes, and most of all, for overall competitiveness, of business destination, and of the quality of living. An ongoing IMA research project reviews all the available state data and compares states across multiple parameters, and views it from multiple lenses the quality of growth of India's states and ultimately, that of India.

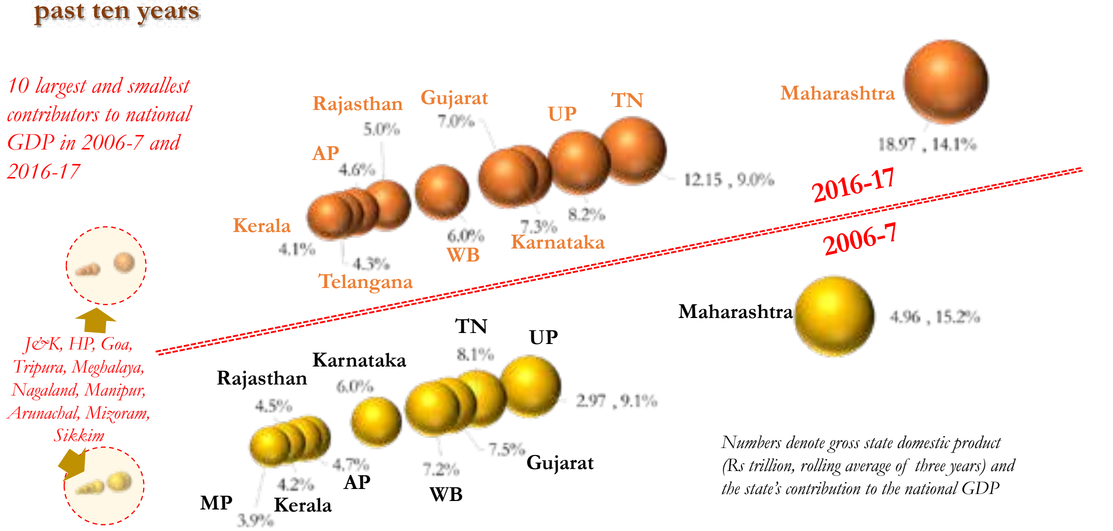
> Income distributions vary massively across India, with the three biggest states making up one third of total annual income

LENS 1: INCOME AND EXPENDITURE

Rising regional economic disparity

There is a massive disparity in how India's GDP is distributed among its states. The three top states – Maharashtra, UP and Tamil Nadu – make up about a third of the total. Maharashtra remains the 'richest' state on an aggregate-GDP basis with a 14 per cent contribution in 2016-17 , though this is down from 15 per cent a decade ago. (However, in absolute terms, its contribution has gone up from Rs 5 trillion to Rs 19 trillion in this

10 states account for 70% of national GDP: this share has not changed in the past ten years



The 10 smallest states account for only about 3% of the national GDP period.) UP, with 8.2 per cent of the total (or ~Rs 10 trillion) has gone from 3rd place a decade ago to 2nd now, switching places with Tamil Nadu. In comparison, the ten smallest states, including Himachal Pradesh, Jammu & Kashmir, Goa, and the seven North-Eastern states, contribute a total of just 3 per cent to GDP.

The leading states have relatively low per-capita incomes...

The states that contribute the most to India's GDP in percentage terms are also often low on the affluence scale, which implies that state GDP is mainly a function of its population rather than its affluence. For instance, median per-capita income (PCI) is Rs 252,000 in Delhi, while in UP – the second-biggest state on aggregate – it is just Rs 43,000. On the flip side, barring Sikkim (which has a high PCI), all of the North-Eastern states have both a low Gross State Domestic Production (GSDP) and a low PCI.

> India as a whole is urbanising, but there are big gaps in urbanisation rates, which range from the low-teens in states like Bihar, to the high 40s in places like Tamil Nadu

...but a big share of manufacturing GDP

Industry – measured by the number of factories per million people – has expanded rapidly in India's biggest states. Tamil Nadu leads the way with 630 per million people in FY15 – a two-fold increase in 10 years. Manufacturing also has the highest share of GDP in states like Maharashtra (21 per cent of Rs 19 trillion); Tamil Nadu (19 per cent of Rs 12 trillion); and Karnataka (16 per cent of Rs 10 trillion). It accounts for a smaller share of GDP in Rajasthan (11 per cent of Rs 7.5 trillion) and West Bengal (8 per cent of Rs 8 trillion).

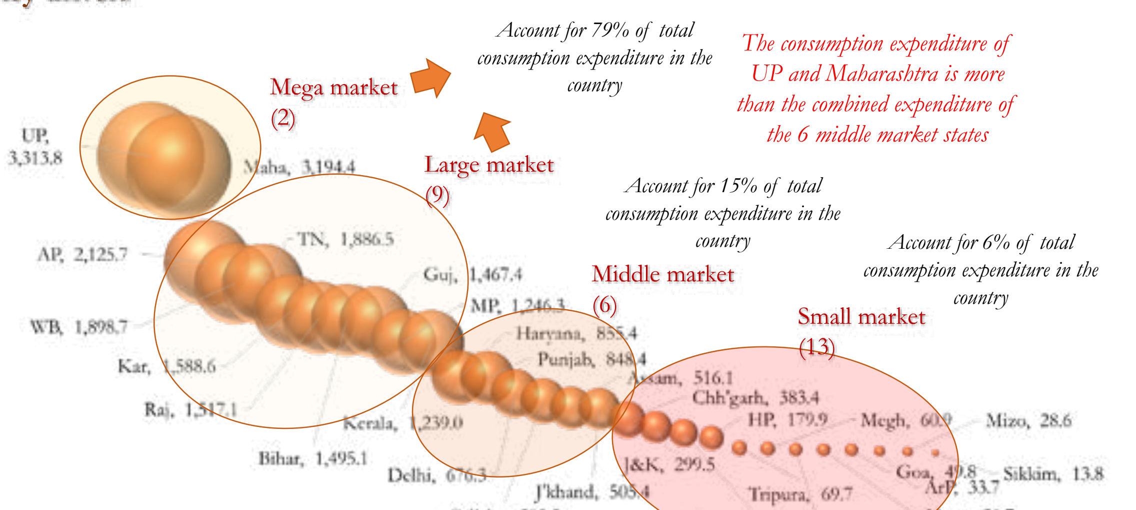
Productivity: smaller states catching up?

While the ranking list of 'most industrialised' states has not changed much in the last ten years, the more industrialised states have not kept up with the 'laggards' of yesterday in terms of productivity. For example, output per worker in Maharashtra (Rs 8.8 million in 2014-15) increased by a mere 7 per cent over the previous 10 years, but it went up by 13 per cent in Odisha, 11 per cent in Jharkhand and 17 per cent in Andhra Pradesh. Agriculture tends to have lower productivity overall, with a median of just Rs 0.5 million per worker across India, compared to Rs 6.2 million in manufacturing. However, smaller states like HP and Goa have the highest levels of agricultural productivity, at Rs 0.19 million and Rs 2.8 million, respectively. Services sector productivity is also relatively low, at Rs 0.15 million per worker in FY15, possibly due to the predominance of low-yielding retail trade that employs a large section of the population.

Consumer-market size: huge divergence

From the lens of consumption, eleven states together account for 80 per cent of India's annual consumption expenditure. Leading

Huge divergence in consumption market size of states – size and population key drivers



The numbers denote the annual consumption expenditure of each state in 2011-12, Rs bn the way by some distance are Maharashtra (over Rs 3 trillion) and UP (Rs 3.3 trillion), but AP (Rs 2.1 trillion), West Bengal (Rs 1.9 trillion), Tamil Nadu (Rs 1.9 trillion), Gujarat (Rs 1.5 trillion), Karnataka (Rs 1.6 trillion), Rajasthan (Rs 1.5 trillion), Bihar (Rs 1.4 trillion), Kerala (Rs 1.2 trillion) and MP (Rs 1.2 trillion) are massive markets in their own right, too. The 'middle market', accounting for 15 per cent of total consumer spending in the country, includes states such as Delhi (Rs 676 billion), Haryana (Rs 855 billion), and Punjab (Rs 848 billion). The 'small market' – represented by J&K, Himachal Pradesh, Tripura, Uttarakhand and North-East India – account for a mere 6 per cent.

Large population translates to large market size, but the magnitude varies strikingly on account of relative per-capita affluence. For instance, although Haryana's population is a little over a tenth of that of UP, its spending on white goods is more than a third of UP's. Similarly, AP, with half the population size, spends nearly three-fourths of what UP does on processed food, and it actually spends much more than UP, on aggregate on entertainment (including cinema, theatre, and cable TV).

LENS 2: DEMOGRAPHICS AND URBANISATION

Rising urbanisation

Between 2001 and 2011, India for the first time saw its urban population increase as much as its rural population. Expectedly, Delhi has the highest rate of urbanisation (97 per cent), followed by Goa (62.2 per cent), Mizoram (51.5 per cent) and Tamil Nadu (48.4 per cent), while Himachal Pradesh (10 per cent), Bihar (11.3 per cent) Assam (14.1 per cent) and Odisha are India's least urbanised states. In a clear contrast to the Northern states, the Southern and Western states such as Kerala (13.8 million), Andhra Pradesh (6.6 million), Tamil Nadu (5.2 million) and Maharashtra (3.9 million) saw the biggest net increase in their urban population.

> A handful of states account for most employment in India, which is also marked by the predominance of informal employment and the alarming spectre of jobless growth

States vary widely in population density, and often, this influences the growth models adopted by these states. For instance, highly rural states such Bihar and Uttar Pradesh (which are low on the relative affluence scale) demand a policy framework that will essentially have to be different from states such as Kerala, which is not only one of the most densely populated states, but also highly urbanised. On the other hand, high rates of urbanisation in states like Tamil Nadu, Maharashtra, Gujarat and Karnataka – states which are, though, lower in population density – point towards a possible concentration of population in the existing and emerging urban centres, which requires a different policy approach.

Rapidly-changing age dynamics

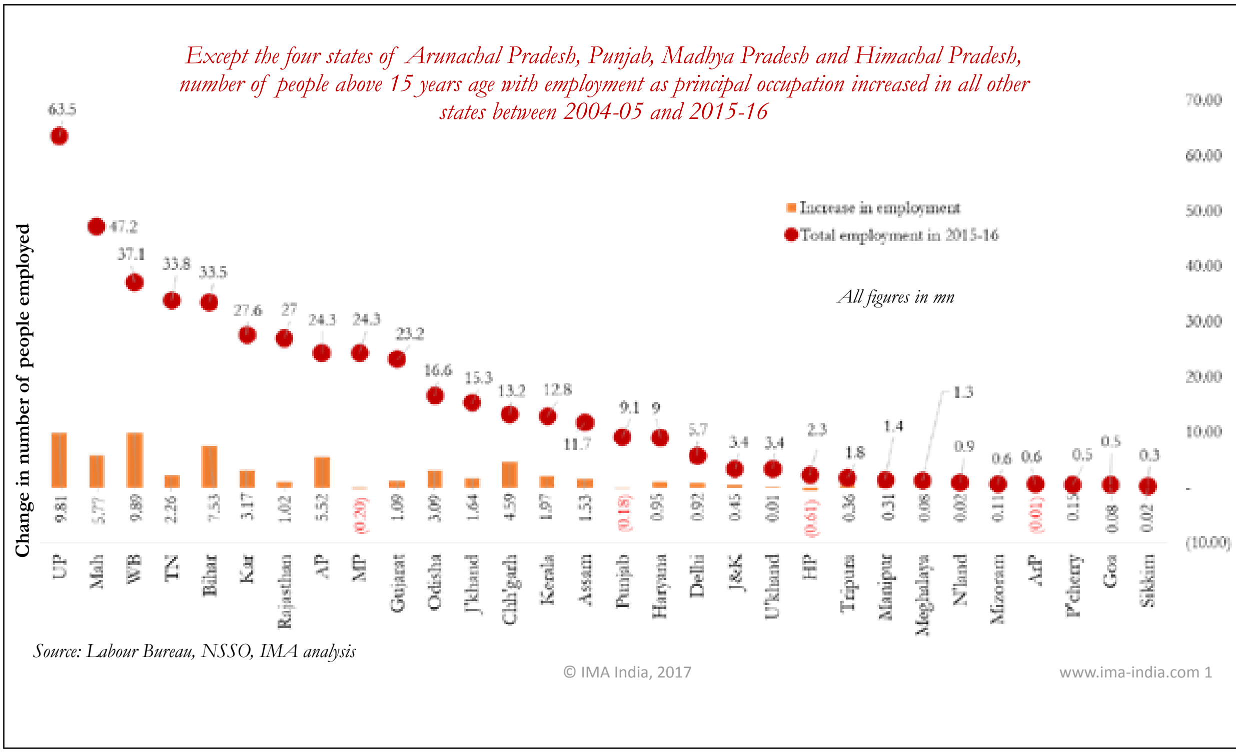
The lion's share of India's 'young' population – those in the 5-14 age group – resides in UP (50 million), Bihar (29 million), Maharashtra (20 million), West Bengal (17 million), Rajasthan (16 million) and AP (15.5 million). By 2021, the total number of people in this age group will drop to 225 million (from 260 million in 2011), while 15-59 year olds will see the biggest increase, from 730 million in 2011 to 860 million. It is the elderly (60+), however, who will see the biggest percentage jump in population – a 38 per cent rise, from 104 million to 143 million. This vast, ageing population will be hugely prosperous – creating many business opportunities, but also some social-security challenges.

Improving education levels

Except for Mizoram and Nagaland, all of India's states have seen significant improvements in their gross enrolment ratios (GER) for higher education in the past half-decade. Delhi tops the list, with 45 per cent of its 18-23 population enrolled in college in FY16 (up from 34 per cent in FY09), followed by Tamil Nadu (44 per cent, up from 18 per cent), and Sikkim (37 per cent, from 23 per cent). Rather than taking the pressure off education, the slightly declining share of the young is, on the contrary, expected to raise expectations, primarily due to greater access and longer duration of education that is rapidly permeating this age group. Rising education levels, in turn, will set the stage for new consumption patterns and demand for employment.

LENS 3: EMPLOYMENT SCENARIO: FUNDAMENTAL SHIFTS

Ten states account for 75 per cent of all employment. UP comes out on top, with 63.5 million workers in FY16, followed by Maharashtra (47.2 million), West Bengal (37.1 million), Tamil Nadu (33.8 million), Bihar (33.5 million), and Karnataka (27.6 million). Except in Arunachal Pradesh, Punjab, Madhya Pradesh and Himachal Pradesh, the number of people over 15 with employment as their principal occupation everywhere between 2004-05 and 2015-16. However, employment is not keeping pace with the number of people being added to the working-age population. Between FY05 and FY15, for every



Except the four states of Arunachal Pradesh, Punjab, Madhya Pradesh and Himachal Pradesh, number of people above 15 years age with employment as principal occupation increased in all other states between 2004-05 and 2015-16

100 people entering working age, Jharkhand was able to employ just 71, Mizoram 70 and Manipur 63. Even more concerning, there was slow or negative employment growth in India's most populous states, including Maharashtra (+3 per cent), Uttar Pradesh (-4 per cent), and Madhya Pradesh (-27 per cent).

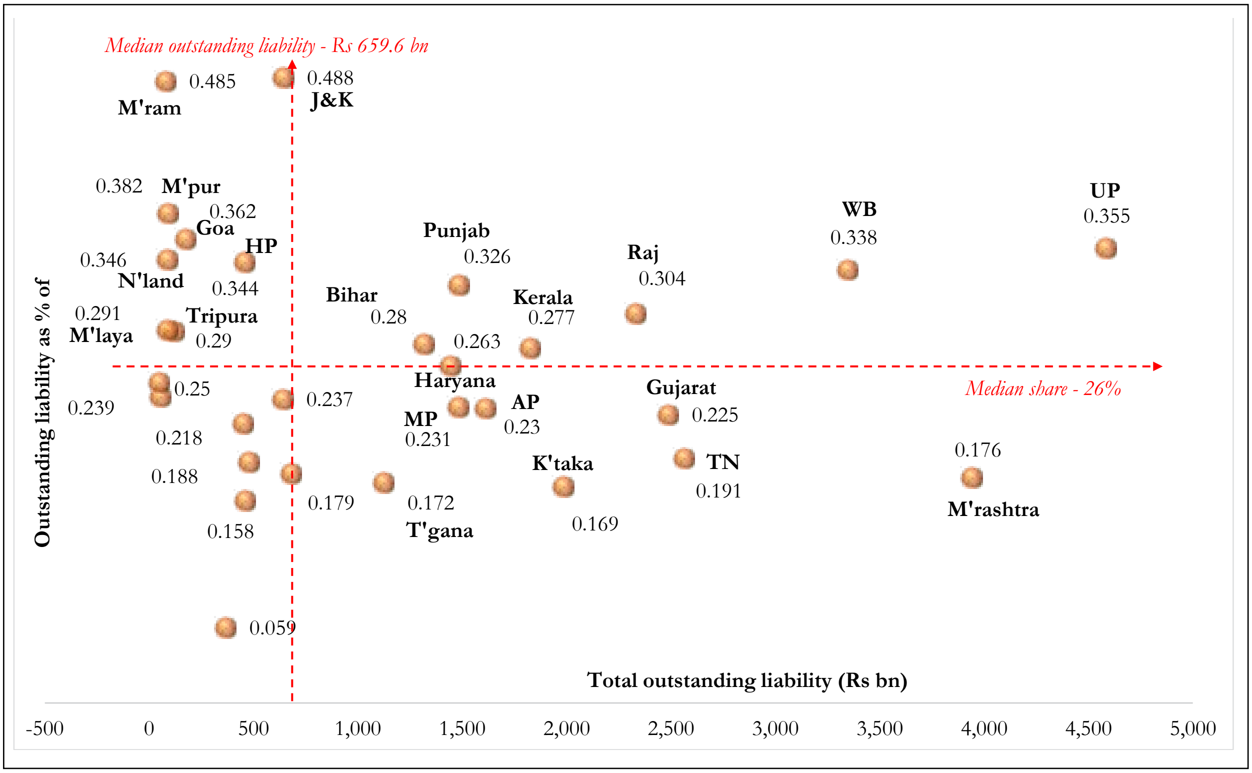
Jobless growth is a worrying reality for India, as are recent changes in the sector-wise employment numbers. Between FY05 and FY16, the number of workers employed in agriculture declined in 19 states. UP saw a drop of 10 million agricultural workers, followed by Madhya Pradesh (7.3 million), Karnataka (4.2 million) and Tamil Nadu (3.2 million). Meanwhile, 17 states saw a decline in the number of people employed in manufacturing. Clearly, workers are finding employment in the construction sector or other miscellaneous services, an overwhelming share of which is in the informal domain.

India's informal sector employs 180 million people, of which 72 per cent work in organisations with less than 6 people. The government employs 30 million informal workers and the private sector 19 million. In the last few years, informal job creation has accelerated, with about 25.7 million workers added between 2005 and 2012. This is worrisome, because informal sector is characterised by lower education levels than in the formal sector, where close to 90 per cent of workers are educated up to the primary or higher-secondary level.

Worryingly, most states have seen a decline in their overall capital expenditure. On the flip side, there has, in recent years, been a big up-tick in power- and roads-sector spending

LENS 4: INVESTMENT AND INFRASTRUCTURE

Most states have seen a worrying decline in capital investment. Except in Gujarat, Madhya Pradesh and Odisha, Gross Fixed Capital Formation (GFCF) as a percentage of GDP has declined across the board. In absolute terms, Gujarat (over Rs 700 billion), Maharashtra (more than Rs 500 billion) and Tamil Nadu (over Rs 200 billion) top the GFCF list. Promisingly, though, power-sector investment has picked up sharply, particularly in yesterday's 'laggard states'. In particular, UP, Rajasthan, Madhya Pradesh and Chhattisgarh have rapidly scaled up their installed capacity for power generation. On the other hand, there is massive divergence in terms of road infrastructure. Maharashtra has added over 200,000 km to its road network between 2009 and 2015, while Madhya Pradesh (~100,000 km) and UP (~85,000 km) are a bit further down the list. 12



of the larger states in fact spent the highest share of their capital expenditure in the past five years on developing road infrastructure. The share of capital expenditure in the total state budget is also the highest in states which have traditionally seen slower growth – such as the North-Eastern states, Bihar, UP, MP and Jharkhand – demonstrating a clear intent to raise their game.

In terms of private investment, too, the large majority of states have fared poorly, failing to attract corporate investments, which have been largely concentrated in the economically progressive states such as Maharashtra, Gujarat, Karnataka, Andhra Pradesh, or in resource rich states such as Madhya Pradesh.

STATE FINANCES: A WORRYING TREND

Under the current NDA government, an increased devolution of money to the states (from 32 per cent to 42 per cent of the total) has left them with more money to spend. Further, the GST could be a game-changer, adding a lot more to the state coffers. However, the current deteriorating state of state finances is reflected in a rise in their consolidated fiscal deficit to over 3 per cent of GDP. Not only are the quantum of outstanding liabilities of states like UP, West Bengal, Rajasthan, Kerala, Punjab, Haryana and Bihar high in absolute terms, but the share of their debts range from a quarter to a third of the respective state GDPs. On the other side, although the outstanding liabilities of states like Maharashtra and Tamil Nadu are high, the share of the debt to the size of the state economy are much lower, giving them the room to service the debt without running into a crisis. Another disquieting development is the loans and advances taken under the Ujwal Discom Assurance Yojna (UDAY). Until now, states kept these liabilities one step removed by reporting them as commercial borrowings. However, under the scheme, states have absorbed Rs 2.3 trillion worth of liabilities by issuing bonds, with a one-time impact on their fiscal deficit. Policies like loan waivers are also set to impact state finances adversely. Following the example of UP, which recently announced a Rs 36,000 crore loan waiver, other states, including Maharashtra (Rs 30,000 crores), Karnataka (Rs 8,000 crores) and Punjab (Rs 24,000 crores) have made announcements totalling close to Rs 100,000 crore.

THE SUM IS GREATER THAN THE COMPONENTS

Clearly, as the discussion above shows, each state is uniquely poised to chart its own growth story, but nonetheless needs to start with basic housekeeping. The ability to build up on their strengths will not only improve the economy of the state, but also place them as better engines of India's growth. ■

IMA's study on the assessment of the states, 'Federalism: India's Power Unleashed', will be available from the second week of January, 2018. For more details, please contact Chandrachur Ghose (chandrachur@ima-india.com)