

State Government Borrowing: April – September 2015

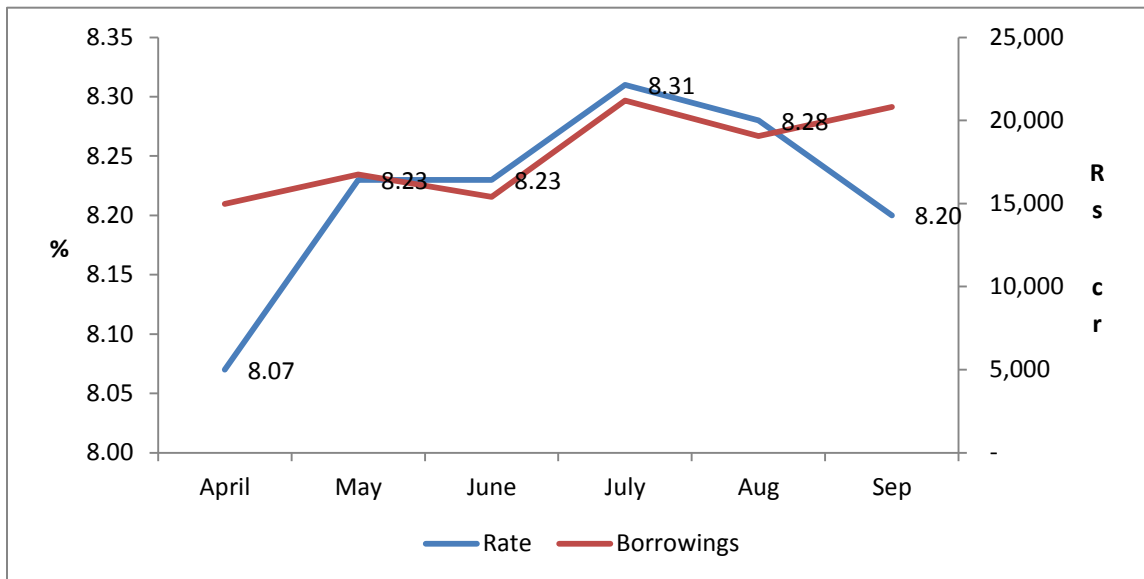
State Development Loans (SDL) are debt issued by state governments to fund their fiscal deficit. States in India like the centre, run budgets where expenditure is higher than revenue leading to deficits. The deficit by the states is financed mainly through market borrowings in the form of SDL. However, unlike Government securities and T-bills, these securities do not have defined issuance calendars and their issuances are random.

In this report we would be analyzing the movement in the cost of borrowing across various states for the first half of FY16 along with the share of each state in the total state borrowing. The second part of the report would be to juxtapose this information with the World Bank ranking of state assessment for business reforms.

Overall Performance

The chart below shows the movement in the average borrowing cost and the total amount of borrowing for all states together.

Chart 1: Average Interest Rate and Borrowing of States



Source: RBI

- The average borrowing cost increased from 8.07% in April to 8.23% in May, which further increased to 8.31% in July. However, the months of August and September witnessed a decline in the interest rate to 8.28% and 8.20% respectively, indicating a downward movement in the last two months. This may be expected to continue with the RBI lowering rates further in September. RBI policy rates do tend to get translated faster in the GSec market including that for SDLs relative to even the corporate debt market.

- The total amount borrowed increased in the months of May, July and September and witnessed a decline in the month of June and August.
- There has been a variation in the rates at which states borrow in any month as well as an auction with the difference being between 2 to 10 bps. This does translate into substantial interest cost for states which have a larger borrowing programme.
 - For the entire period the variation on average cost of borrowing was almost 28 bps between the lowest and highest cost.

State wise Performance

For the period April – September 2015, Rs 1,08,185 crore was raised by 27 states. The table below provides share of various states in total borrowings for the first half of FY16.

Table 1: Share of States in the total borrowing (%)

States	Share in Total (%)
Maharashtra	12.9
Tamil Nadu	10.4
Uttar Pradesh	10.2
West Bengal	7.9
Telangana	7.6
Haryana	7.2
Kerala	7.1
Andhra Pradesh	5.9
Madhya Pradesh	5.5
Punjab	5.5
Gujarat	5.0
Rajasthan	4.2
Bihar	1.8
Uttarakhand	1.6
Jammu & Kashmir	1.3
Himachal Pradesh	1.2
Jharkhand	0.9
Assam	0.9
Goa	0.6
Chhattisgarh	0.6
Others*	1.6

Source: RBI, * Others include state with a share of less than 0.5%

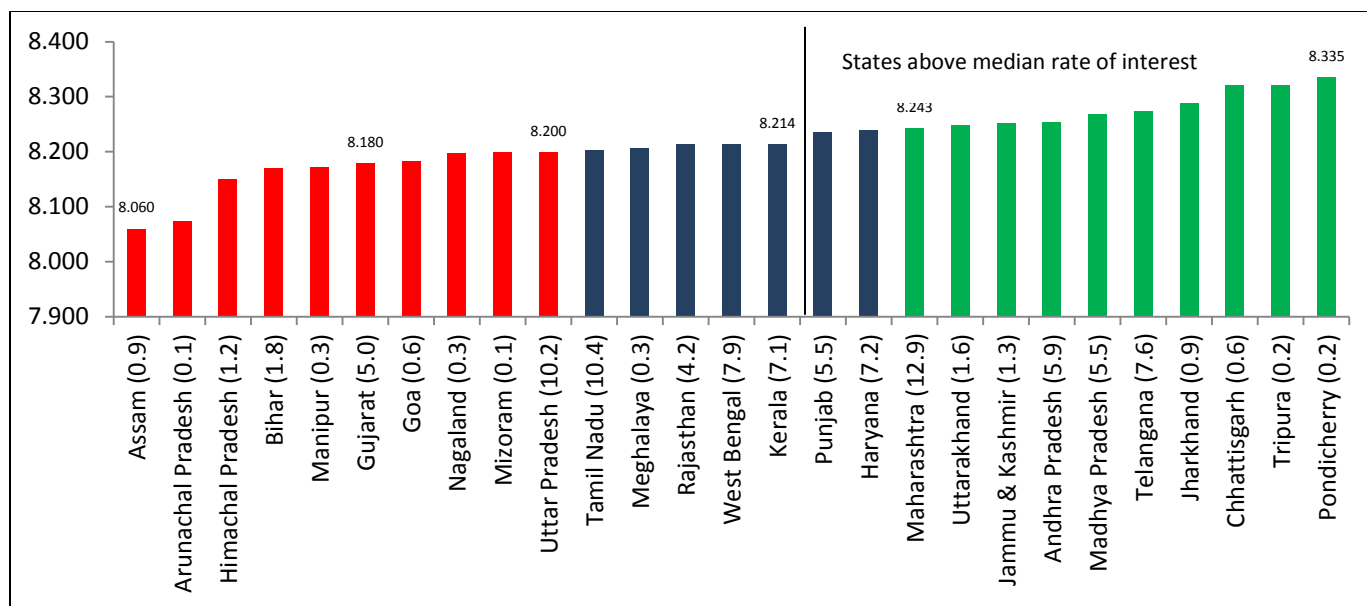
- Maharashtra (12.9%), Tamil Nadu (10.4%) and Uttar Pradesh (10.2%) account for more than 33% in the total state development loans issued in the first half of the year.
- West Bengal (7.9%), Telangana (7.6%), Haryana (7.2%) and Kerala (7.1%) each had shares between 7-8%.

- Smaller states in terms of quantum borrowed such as Bihar (1.8%), Uttarakhand (1.6%), Jammu & Kashmir (1.3%) and Himachal Pradesh (1.2%) each account for less than 2% of share.

The chart below maps the average interest rates for various states. However, the interest rate across states would vary depending on the:

- Timing of the borrowing, which is linked to the interest rate regime in the market.
- Quantity borrowed would be aligned to investors' requirements, and,
- Perception of the 'state' in the market.

Chart 2: Interest Rates across States (from lowest to highest) (%)



Source: RBI, *red indicates states with lowest borrowing rates, green indicates states with highest borrowing rates, blue indicates states with medium borrowing rates, () indicate share in total borrowing

- Assam had the lowest cost of borrowing at 8.06%, followed by Arunachal Pradesh and Himachal Pradesh at 8.074% and 8.15% respectively. Along with low interest rates, Arunachal Pradesh and Himachal Pradesh account for less than 1% of the total state borrowings, while Himachal Pradesh accounts for 1.2% of the borrowings
- Except for Gujarat and Uttar Pradesh, all the other states with low cost of borrowing also have a share of less than 2% in the total state borrowing
- Puducherry has the highest cost of borrowing, followed by Tripura and Chhattisgarh.
- Out of 10 states, which have more than 6% share in the amount borrowed, 6 of them have borrowing costs above the median rate.
- Out of 15 states, which account for less than 2% of borrowings, 10 states have borrowing costs below the median

State wise business environment

The states of India had agreed to a 98-point action plan of reforms to improve the regulatory framework. The World Bank in its report on 'Assessment of State Implementation of Business Reforms'; has taken stock of progress made by states in addressing this urgent priority. The ranking is based on how states are working towards reducing the regulatory burden on businesses. The states are divided into four groups;

- **Leaders:** States with an overall implementation status of 75% and above
- **Aspiring Leaders:** States with an overall implementation status between 50% and 75%
- **Acceleration Required:** States with an overall implementation status between 25% and 50%
- **Jump Start Needed:** States with an overall implementation status between 0% and 25%.

The states with higher ranking indicate a more friendly business environment, attracting more private sector investments. Easy business environment also results in most of the expenditure coming from the private sector, thus reducing the burden on the state government.

The table below presents the ranking of the state alongside the borrowing cost. The idea here is to see if a better ranked state also enjoys lower cost of borrowing. Here, only states with a share of more than 1% in the total borrowing are taken into consideration.

Table 2: World Bank Ranking & Borrowing Cost

	Share (%)	Rank	Score (%)	Borrowing cost (%)
Gujarat	4.99	1	71.14	8.180
Andhra Pradesh	5.92	2	70.12	8.254
Madhya Pradesh	5.55	5	62.00	8.268
Rajasthan	4.16	6	61.04	8.213
Maharashtra	12.94	8	49.43	8.243
Uttar Pradesh	10.17	10	47.37	8.200
West Bengal	7.86	11	46.90	8.214
Tamil Nadu	10.35	12	44.58	8.202
Telangana	7.58	13	42.45	8.273
Haryana	7.21	14	40.66	8.239
Punjab	5.45	16	36.73	8.235
Himachal Pradesh	1.25	17	23.95	8.150
Kerala	7.12	18	22.87	8.214
Bihar	1.85	21	16.41	8.170
Uttarakhand	1.62	23	13.36	8.249
Jammu & Kashmir	1.34	29	5.93	8.252

Source: DIPP, RBI

- States such as Gujarat, Andhra Pradesh, Madhya Pradesh and Rajasthan fall under the category of aspiring leaders. These states would attract more private sector expenditure, hence will have less pressure on the state government.

- Maharashtra, Uttar Pradesh, West Bengal, Tamil Nadu, Telangana, Haryana & Punjab are the states where more needs to be done in order to improve the overall environment. With relatively high cost of borrowing, these states would experience pressures in terms of debt servicing. Adhering to the FRBM rules would pose as a challenge with increased borrowing costs.
- Himachal Pradesh, Kerala, Bihar, Uttarakhand, Jammu and Kashmir fall under the lowest category. However, except Kerala, the other states have very low share in the amount borrowed.

Concluding remarks

- The overall trend in cost of borrowing varies with market conditions but is largely a function of the RBI policy rate.
- States do borrow at differential rates and hence perception matters.
- There are no clear trends whether smaller states (defined as those with lower requirements) source funds at a lower rate. The same holds for larger states too.
- States which are lower in the doing business ranking will progressively have to spend more for development which can also enhance cost of borrowing.

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