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State Finances: 2013-14

In its endeavor to improve transparency and communication about the conduct of states' financing, the RBI has been annually releasing its study of state finances. The study of state finances has been an under-researched area owing to lack of availability of data, and the inconsistencies in the way states report their performance. In this context, the State Finances report is extremely useful for understanding the nature of states' budgets and its implications for market participants.

As a continuation of the Center –State Finances primer released last year, in this issue, we present an analysis of states' fiscal positions and the policy implications.

I. An Overview

The Fiscal Responsibility and Budget Management Act (FRBM) 2003 initiated the process of reining in the finances of states. While the act was originally constituted in order to get the Centre's financial discipline by aiming to achieve fiscal deficit of 3% of GDP by Mar-08, it had to be eventually suspended in wake of the global financial crisis of 2008. The Act also highlighted the need for the states to address their unhealthy nature of balance sheets. The Thirteenth Finance Commission (FC- XIII) kept the stone rolling by providing momentum for states to adhere to fiscal consolidation.

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The study of the states has been divided in terms of Special Category States (SCS) and Non Special Category (NSCS). The classification, in terms of SCS and NSCS, dates way back to 1969 when the Fifth Finance Commission accorded special status to three states (Assam, Nagaland and Jammu & Kashmir). This was on basis of shared international boundaries, harsh terrain and social backwardness that prevailed in the states. These states get a preferential treatment in terms of getting assistance from the central government and tax breaks. As of now, there are seventeen NSCS and eleven SCS in India.

Table 1: List of States

Non Special Category States (NSCS)		Special Category States (SCS)
Andhra Pradesh	Odisha	Arunachal Pradesh
Bihar	Punjab	Assam
Chattisgarh	Rajasthan	Himachal Pradesh
Goa	Tamil Nadu	Jammu and Kashmir
Gujarat	Uttar Pradesh	Manipur
Haryana	West Bengal	Meghalaya
Jharkhand		Mizoram
Karnataka		Nagaland
Kerala		Sikkim
Madhya Pradesh		Tripura
Maharashtra		Uttarakhand

II. States' Fiscal Position

At the consolidated level, the revised estimates (RE) for 2012-13 showed marginal deterioration in their finances compared to budget estimates. For 2013-14, the budget estimates (BE) however show an improvement.

Table 2: Deficit Indicators of States (as % of GDP)					
	2010-11	2011-12	2012-13 (BE)	2012-13 (RE)	2013-14 (BE)
Gross Fiscal Deficit (GFD)	2.1	1.9	2.1	2.3	2.2
Revenue Deficit (RD)	0.0	-0.3	-0.4	-0.2	-0.4
Primary Deficit (PD)	0.5	0.4	0.6	0.8	0.6

Source: RBI

For 2012-13 while the BE for GFD/GDP was projected to be at 2.1%, it deteriorated largely on account of higher capital outlay and decline in surplus in revenue account for some states.

Table 3: Performance of NSCS in 2012-13							
	2011-12		2012-13 (BE)		2012-13 (RE)		Improvement from BE (per cent points)
	RD/ GSDP	GFD/ GSDP	RD/ GSDP	GFD/ GSDP	RD/ GSDP	GFD/ GSDP	
Bihar	-2.0	2.4	-2.7	2.9	0.2	5.6	-2.7
Goa	-0.8	2.5	0.2	3.8	0.9	5.3	-1.5
West Bengal	2.7	3.3	1.1	2.5	2.1	3.4	-0.9
Punjab	2.6	3.3	1.1	3.1	1.6	3.2	-0.1
Kerala	2.5	4.1	0.9	2.7	0.9	3.1	-0.4
Chhattisgarh	-2.3	0.6	-1.8	2.8	-1.3	2.9	-0.1
Karnataka	-1.0	2.7	-0.2	2.9	-0.2	2.9	0.0
Madhya Pradesh	-3.2	1.9	-1.7	3.0	-1.8	2.9	0.1
Andhra Pradesh	-0.5	2.4	-0.6	2.6	-0.2	2.8	-0.2
Uttar Pradesh	-1.0	2.3	-0.8	3.0	-0.7	2.8	0.2
Tamil Nadu	-0.2	2.6	-0.3	2.9	-0.1	2.7	0.2
Gujarat	-0.5	1.8	-0.5	2.6	-0.6	2.6	0.0
NSCS-Consolidated	**-0.2**	**2.2**	**-0.3**	**2.5**	**0.0**	**2.6**	**-0.1**
Haryana	0.5	2.3	0.7	2.1	0.9	2.3	-0.2
Rajasthan	-0.8	0.9	-0.2	2.1	-0.2	2.3	-0.2
Jharkhand	-1.0	1.4	-3.3	2.1	-2.6	1.9	0.2
Maharashtra	0.2	1.7	0.0	1.7	0.0	1.4	0.3
Odisha	-2.6	-0.3	-0.9	1.8	-1.1	1.1	0.7

Source: RBI

Comparing the performance of states in terms of 2012-13RE as against the BE, amongst the NSCS, only six states witnessed better fiscal consolidation than its own budget estimates. Bihar has noted sharpest deterioration in its fiscal health. The revised GFD/GSDP for Bihar notched up 2.7 percent points from 2.9% to 5.6%. Overall, Bihar, Goa and West Bengal have witnessed sharp slippage in 2012-13. Odisha ranks the best in terms of overall GFD/GSDP ratio as well as improving performance from its BE. However, traditionally Odisha has not approached the market for borrowings. Apart from Odisha, Maharashtra has performed visibly better- overachieving its fiscal deficit target and reining it at 1.4% of GSDP.

Table 4: Budgeted performance of NSCS for 2013-14

	2012-13 (BE)		2013-14 (BE)		Projected improvement (percent points over BE)
	RD/ GSDP	GFD/ GSDP	RD/ GSDP	GFD/ GSDP	
Goa	0.2	3.8	0.5	4.9	-1.1
Rajasthan	-0.2	2.1	-0.2	2.5	-0.4
Chhattisgarh	-1.8	2.8	-1.4	3.0	-0.2
Odisha	-0.9	1.8	-0.7	2.0	-0.2
Andhra Pradesh	-0.6	2.6	-0.1	2.8	-0.2
Haryana	0.7	2.1	0.6	2.2	-0.1
Jharkhand	-3.3	2.1	-1.7	2.2	-0.1
Kerala	0.9	2.7	0.5	2.8	-0.1
Karnataka	-0.2	2.9	-0.1	2.9	0.0
Madhya Pradesh	-1.7	3.0	-1.3	3.0	0.0
Gujarat	-0.5	2.6	-0.6	2.6	0.0
Maharashtra	0.0	1.7	0.0	1.6	0.1
Punjab	1.1	3.1	0.6	3.0	0.1
NSCS-Consolidated	**-0.3**	**2.5**	**-0.3**	**2.4**	**0.1**
Uttar Pradesh	-0.8	3.0	-1.1	2.8	0.2
Tamil Nadu	-0.3	2.9	-0.1	2.6	0.3
Bihar	-2.7	2.9	-1.9	2.4	0.5
West Bengal	1.1	2.5	0.5	1.8	0.7

Source: RBI

Under the NSCS, West Bengal has budgeted for a substantial improvement in fiscal deficit position for 2013-14 aiming to be amongst the states with the lowest GFD/GSDP ratio. Bihar, too, has laid down an ambitious target of bringing down GFD/GSDP by 0.5 percent points over 2012-13BE, considering the high slippage seen in 2012-13RE. For Chhattisgarh, the overall GFD/GSDP has stayed above the average level while the 2013-14BE fails to show any significant signs of improvement. Goa leads the list of least healthy states in terms of the fiscal deficit indicator.

On the positive front, Maharashtra's finances appear to be on track of consolidation. The state has consistently performed better than its peer NSCS. The improvement in most states is expected from reining growth of revenue expenditure with relatively stable level of revenue receipts. Capital outlay is budgeted to note a marginal pickup.

With most NSCS relying on market borrowings for financing nearly 88% of the fiscal deficit, the bond market would be closely tracking the improvement in fiscal health of states and correspondingly priced in terms of inter-state spreads. The bond market experienced a period of heightened volatility in the July-Aug'13 period. While the need for funds necessitated most states to raise funds via market borrowings, the elevated level of yields capped the amount aimed to be raised. The average issue size of NSCS was Rs 904 Cr for the year; whereas the accepted amount averaged merely Rs 817 Cr.

Table 5: Performance of SCS in 2012-13

	2011-12		2012-13 (BE)		2012-13 (RE)		Improvement from BE (percent points)
	RD/ GSDP	GFD/ GSDP	RD/ GSDP	GFD/ GSDP	RD/ GSDP	GFD/ GSDP	
Nagaland	-5.8	4.4	-9.9	3.5	-5.4	9.1	-5.6
Arunachal Pradesh	-10.0	9.1	-23.1	3.2	-17.4	8.5	-5.3
Mizoram	-4.1	3.0	-7.8	3.3	-7.3	7.0	-3.7
Jammu and Kashmir	-3.2	5.7	-7.6	2.9	-6.3	3.8	-0.9
Assam	-0.7	1.3	-1.1	3.0	-0.6	3.3	-0.3
SCS-Consolidated	**-2.1**	**2.9**	**-3.7**	**3.1**	**-3.3**	**3.4**	**-0.3**
Meghalaya	1.1	6.6	-5.5	2.1	-5.3	2.3	-0.2
Himachal Pradesh	-1.0	2.6	-0.6	2.9	-0.5	2.8	0.1
Uttarakhand	-0.8	1.9	-0.4	3.4	-1.1	3.1	0.3
Sikkim	-5.1	2.1	-17.5	3.5	-12.1	3.0	0.5
Tripura	-8.4	-1.3	-5.7	2.6	-7.9	2.0	0.6
Manipur	-6.2	10.1	-14.2	4.2	-16.3	0.7	3.5

Source: RBI

For SCS, the process of fiscal consolidation has been relatively slow and painful. Owing to limited avenues to raise tax collections, these states are dependent on the transfers by the Centre to a large extent.

Amongst the SCS, Nagaland has seen a sharp deterioration in its fiscal health. The 2012-13RE spiked to 9.1% as against the BE for 3.5%. Along-with Nagaland; Arunachal Pradesh and Mizoram too have failed to stay within their budgeted fiscal deficit targets. On the other hand, Manipur has over-achieved its GFD/GSDP target with the 2012-13RE standing at 0.7%; lowest among all states.

Table 6: Budgeted performance of SCS for 2013-14					
	2012-13 (BE)		2013-14 (BE)		Projected improvement (percent points)
	RD/ GSDP	GFD/ GSDP	RD/ GSDP	GFD/ GSDP	
Tripura	-5.7	2.6	-5.4	3.6	-1.0
Assam	-1.1	3.0	-1.9	3.8	-0.8
Meghalaya	-5.5	2.1	-6.1	2.6	-0.5
Manipur	-14.2	4.2	-14.6	4.5	-0.3
SCS- Consolidated	**-3.7**	**3.1**	**-3.7**	**3.0**	**0.1**
Himachal Pradesh	-0.6	2.9	-0.1	2.8	0.1
Jammu and Kashmir	-7.6	2.9	-7.5	2.7	0.2
Nagaland	-9.9	3.5	-8.1	3.0	0.5
Uttarakhand	-0.4	3.4	-0.7	2.9	0.5
Sikkim	-17.5	3.5	-9.1	2.8	0.7
Mizoram	-7.8	3.3	-4.2	0.8	2.5
Arunachal Pradesh	-23.1	3.2	-24.5	-1.0	4.2

Source: RBI

Arunachal Pradesh has laid down an ambitious target of reducing its GFD/GSDP by 4.2 percent points. This is contingent on more than halving the expenditure (both development and non development) from previous year. Meanwhile, Manipur has budgeted for highest GFD/GSDP ratio for 2013-14, failing to rein in finances from 2012-13BE. Arunachal Pradesh, on the other hand, is the only state to budget a fiscal surplus for 2013-14.

Amongst the SCS, Himachal Pradesh has been the most reliant on market borrowings for financing its fiscal deficit. Assam has, for FY14 till date, not approached the market for funding its fiscal deficit. Tripura, which has noted an uptick in GFD/GSDP for this year, has raised only Rs 200 Cr from the market as compared to an average Rs 645 Cr in FY13. The upcoming auctions for State Development Loans (SDLs) would likely see Tripura meeting its borrowing requirement. On the other hand, Nagaland, though budgeting for improved fiscal condition, has borrowed nearly Rs 400 Cr via SDLs as against nil in FY13. While the elevated borrowing cost led the NSCS to defer the borrowing or take recourse to other sources of temporary funding, the SCS had to increase their cost of borrowing. Against an average issue size of Rs 177 Cr, the average amount accepted stood higher at Rs 181 Cr.

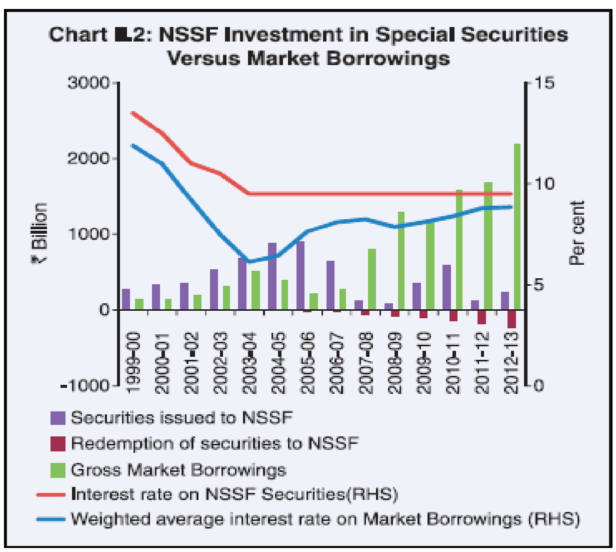
In order to understand the fiscal position of the state, while the GFD/GSDP ratio remains crucial, the ability to service the debt burden becomes crucial. To this end, several indicators like interest payments/revenue receipts, interest payments/revenue expenditure, and interest payments/GSDP are closely tracked. In order to efficiently meet its interest expense it is important to analyze the revenue raising ability of the state. The RBI report on State Finances cites the Dholakia Committee (2004) findings that the 'tolerable ratio' for interest payments/revenue receipts is one fifth. While there has been a steady improvement in the servicing indicators over the period of the year, this ratio still remains markedly higher for Gujarat (17), Punjab (19.9) and West Bengal (25.8) as against an average all states' ratio of 12.2.

III. Financing of Fiscal Deficit

For the Central Government, market borrowings constitute nearly 89%-90% of the fiscal deficit. For states, the 2012-13RE showed the reliance on market borrowings to be 72% of fiscal deficit. This is budgeted to spike up sharply to 88% in 2013-14.

As per the extant practice, after meeting the redemption requirements and management cost of National Small Savings Fund (NSSF), a pre-determined proportion of net collection under small savings is on lent to the respective state government.

The Shyamala Gopinath Committee (2011) recommended that the fund sharing between the Center and the States can be either 50% or 100% (in favour of states). This was accepted by the government in Dec-2011. The interest rate on NSSF continues to be 9.5%. In the Union Budget 2013-14, small savings have been budgeted to witness a net outflow for the year. However, as per the data available on fiscal balances of the central government, collection under this head has stayed quite robust. For the nine month period of Apr-Dec'13 small savings stand at Rs. 36,107 Cr which is presently deployed in financing the Centre's fiscal deficit. Since the state governments have to exercise the 50-100% option at the beginning of fiscal, this buoyed collection would have limited impact on states' market borrowings for 2013-14. If however it is viewed as emergence of a trend, more states may decide to utilize the 100% limit on funds, with the differential between market interest rates and NSSF rates narrowing.



IV. Liquidity Management

In order to tide over their liquidity mismatches, the state governments have access to several lines of credit from the RBI. The state governments have access to Ways and Means Advances (WMA) and Overdraft (OD) facility from the RBI. Under the provisions of section 17 (5) of the RBI Act, the RBI has been extending WMA facility to the states since 1937. The amount under WMA is arrived at by applying pre-determined ratios to the average revenue receipts of the latest three years, with limits getting revised annually every April. The Ramachandran Committee on WMA (2003) fixed the ratio of 3.19 per cent and 3.84 per cent as the ratios for NSCS and SCS respectively.

For 2013-14, the WMA limit for all states was fixed at Rs 10,240 Cr. However, on 8-Nov-13, the RBI revised upwards the WMA limit for state governments by 50% to Rs 15,360 Cr.

1. WMA:

Recourse to WMA is initiated to tide over temporary mismatches in revenue and expenditure. There are two types of WMA that the states can avail from the RBI

- Normal WMA
- Special WMA

Normal WMA is an unsecured form of lending by the RBI to the concerned state, while Special WMA is a collateralized form of lending. For the states to avail normal WMA, they must first exhaust their drawdown of special WMA. Accepted form of collateral for special WMA is GoI dated securities and T-bills with a uniform margin of 5%.

The rate of interest charged on Normal WMA is Repo rate for a period of 1-90 days. Beyond 90 days, the rate on interest would be Repo rate plus 100 bps. For Special WMA, the rate of interest applicable presently is Repo rate minus 100 bps.

2. Overdraft:

If the liquidity mismatch fails to be addressed by drawdown of both normal and special WMA, the states have overdraft window, in order to tide over temporary shortfalls. A state can be in an overdraft mode for a maximum of 14 consecutive working days. In-case the OD continues beyond 14 consecutive working days, the RBI and its agencies shall stop honouring payments on behalf of the concerned state. OD can be availed up to 100% of normal WMA. The rate of interest applicable would be: Repo rate plus 200 bps for OD up to 100% of Normal WMA and Repo rate plus 500 bps for OD exceeding the 100% of normal WMA.

Table 7: Availment of WMA and Overdraft from the Reserve Bank									
State	Normal WMA			Overdraft					
	2011-12	2012-13	2013-14 #	2011-12		2012-13		2013-14#	
	No. of Days	No. of Days	No. of Days	No. of Occasions*	No. of Days	No. of Occasions*	No. of Days	No. of Occasions*	No. of Days
I. Non-Special Category									
Goa	–	–	2	–	–	–	–	–	–
Haryana	22	12	1	2	6	1	5	–	–
Jharkhand	4	14	6	–	–	–	–	–	–
Kerala	–	–	1	–	–	–	–	–	–
Punjab	177	232	120	6	26	14	139	17	49
West Bengal	59	48	15	5	28	5	13	4	7
II. Special Category									
Himachal Pradesh	–	–	8	–	–	–	–	–	–
Manipur	–	81	6	1	–	4	30	2	6
Meghalaya	–	–	1	–	–	1	–	–	–
Mizoram	1	3	20	–	–	1	–	1	1
Nagaland	20	139	46	1	–	7	34	8	25
Uttarakhand	15	–	–	–	–	–	–	–	–
#: up to January 10, 2014. *: Refers to fresh occurrences of overdraft during the year.									

Amongst the NSCS, Punjab has seen a regular shortfall of funds. Its accommodation under WMA and OD continues to remain highest among all the states.

States have also been caught on the other side of liquidity management, wherein states have accumulated large cash surpluses. These surpluses are directly invested in 14 day Intermediate T-Bills (ITBs), the discount rate on which is fixed at 5%. RBI releases state government's holding of 14 Day ITBs in its Table 13 of Weekly Statistical Supplement.

The average investment in 14 Day ITB increased from Rs 72,200 Cr as on end Mar-12 to Rs 84,900 Cr as on end Mar-13. As per the latest data available, outstanding investment by state governments in 14 Day ITB was Rs 80,960 Cr (as on 31-Jan-14). The states need to increasingly demonstrate better liquidity management by increasing their investment in Auction T-Bills (ATBs) instead of ITBs thus reducing the negative carry on interest rates. This would entail prudent and forward-looking cash management from the states.

V. States' Market Borrowings

The states' gross market borrowings, barring FY11, have seen a secular uptrend in the past five years along-with the interest cost inching up as well. The need for fiscal rectitude has, therefore, become absolutely crucial.

Table 8: Market Borrowings of State Governments

	Total Amount Raised (Rs Cr)	Wt Avg Interest Rate (%)
2008-09	1,18,138	7.87
2009-10	1,31,120	8.10
2010-11	1,04,040	8.40
2011-12	1,58,630	8.79
2012-13	1,77,280	8.84
2013-14*	1,41,060	9.03

Source: RBI **- Up to Jan-14*

In keeping with their endeavor to steadily move towards fiscal consolidation, most states have budgeted an improvement in their consolidated debt to GDP ratio for 2013-14. The all states consolidated debt-GDP ratio declined 0.5 percent points for 2012-13 and is budgeted to decline further 0.3 percent points to 21.4% for 2013-14 (better than 24.9% as stipulated by FC- XIII).

A brief overview of the outstanding liabilities of states is as under:

Table 9: Composition of States' Outstanding Liabilities (%)

	FY12	**FY13 (RE)**	**FY14 (BE)**
Total Liabilities (1+2+3+4)	100.0	100.0	100.0
1. Internal Debt (a+b+c)	66.3	66.9	68.5
a. Market Loans	37.2	40.2	44.8
b. Special Securities from NSSF	24.4	22.4	19.7
c. Loans from Banks and FIs	4.2	3.9	3.7
2. Loans and Advances from Center	7.2	6.9	6.6
3. Public Account	26.3	26.0	24.7
4. Contingency Fund	0.2	0.2	0.2

Source: RBI

Increasingly, the reliance on market borrowings has increased in the recent time, while the contribution of NSSF securities whose composition has marked a secular decline. For 2013-14, 17 states/UTs have opted for 50% allocation from NSSF. The windfall collection under NSSF, therefore, should strengthen funding for states like Gujarat, Kerala, Madhya Pradesh, Uttar Pradesh and West Bengal since they have opted for 100% allocation (assuming collection has strengthened from the respective state). This may explain Gujarat's reluctance to accept bids in the SDL auction where average yields have stayed elevated at 9.40%-9.60%. However, the other states have largely stuck to their borrowing schedule.

For 2013-14, states' funding via market borrowing has remained under considerable strain owing to in-conducive market conditions. Following the slew of measures initiated by the

RBI starting 15-Jul-13 to contain volatility in currency market, bond market yields spiked to record high levels along-with nose-diving volumes. As a result, illiquidity and price risk premium got built into spreads for SDLs. This led to a sudden spike in states' borrowing cost. While the weighted average cut-off in the SDL auctions before the measures stood at 7.92%, the post 15-Jul-13 measures saw the weighted average cut-off jump to 9.44%. State governments, therefore, have remained rather reluctant in terms of conceding higher yields.

Table 10: SDLs' Primary Market Activity

States	2012-13			2013-14 (till Jan-14)		
	No of auctions	Avg Auction Size (Cr)	Avg Accepted (Cr)	No of auctions	Avg Auction Size (Cr)	Avg Accepted (Cr)
Andhra Pradesh	20	1,000	1,000	11	1,423	1,310
Bihar	8	888	888	3	1,167	1,167
Chattisgarh	1	1,500	1,500	3	767	767
Goa	5	170	170	5	160	160
Gujarat	14	1,057	1,114	14	1,250	648
Haryana	15	622	622	15	663	446
Jharkhand	7	514	514	4	375	325
Karnataka	12	775	897	7	1,529	1,400
Kerala	10	1,158	1,158	13	746	746
Madhya Pradesh	4	1,125	1,125	4	750	750
Maharashtra	12	1,359	1,458	14	1,707	1,336
Odisha	-	-	-	-	-	-
Punjab	17	571	571	13	562	562
Rajasthan	14	607	574	17	500	471
Tamil Nadu	15	1,020	1,258	17	929	1,059
Uttar Pradesh	8	1,188	1,188	8	844	875
West Bengal	15	1,333	1,367	15	1,091	1,054
Arunachal Pradesh	3	57	57	1	100	100
Assam	1	300	300	-	-	-
Himachal Pradesh	7	337	337	8	273	233
Jammu and Kashmir	4	538	538	5	300	297
Manipur	4	69	69	2	100	100
Meghalaya	7	62	46	3	87	87
Mizoram	4	164	164	4	53	53
Nagaland	-	-	-	4	98	98
Sikkim	3	31	31	3	60	60
Tripura	5	129	129	1	200	200
Uttarakhand	3	583	583	1	500	500
Puducherry	2	151	151	1	270	270

Source: RBI, STCI PD Research

Acceptance ratio (amount accepted against notified amount) has stayed markedly lower than 100% for most states. Lowest acceptance for the year has been for Gujarat. It has accepted (till Jan-14) bids worth Rs 11,629 Cr as against total notified amount of Rs 19,700 Cr (excluding green shoe option). Acceptance ratio has been higher than 100% only for Tamil Nadu owing to acceptance of allocation under green shoe option. Total amount allotted by TN amounted to Rs 17,999 Cr while the total notified amount stood at Rs 15,800 Cr.

In FY13, some states like Karnataka, Gujarat and Himachal Pradesh took recourse to raising funds via short-tenor bonds, instead of standard 10Y security. These states issued 4-5 years' SDLs in order to reduce cost as the absolute 10Y SDL yields were hardening. The states took benefit of the 10-15 bps in the 5 X 10 spread. For FY14, while Himachal Pradesh resorted to borrowing via 5Y SDL on three occasions, the recourse to short tenor SDL has declined as the asking rate on 5Y SDL was almost similar to 10Y.

Gujarat has, in FY14, reissued its 9.37% GJ SDL maturing 4-Dec-23 on two occasions up to Jan-14 leading to consolidation of its outstanding debt. These re-issuances have ensured that the floating stock of the bond remains high which would have a favourable impact on the liquidity of security and diversify the holding of the security.

VI. Spread Analysis

Pricing of State Development Loans is largely determined as a spread over the benchmark 10Y benchmark G-Sec. Typically widening spreads reflect uncertain conditions while narrowing spreads reflect an overall conducive interest rate environment. Analysis for the past three years' trends show that the spread has ranged from a low of 25 bps to 167 bps. For FY14 up to Jan-14, the average spread has been 68 bps largely similar to previous year's 70 basis points spread. The weighted average cut-off, though, has gone up from 8.84% to 9.04% mirroring the hardening of the sovereign yield curve. A brief summary of the spreads is as under:

Table 11: Spread of SDLs' auction cut-off over benchmark 10Y G-Sec

	2011-12		2012-13		2013-14	
States	Avg Spread	Wt Avg Cutoff	Avg Spread	Wt Avg Cutoff	Avg Spread	Wt Avg Cutoff
Assam	-	-	74	8.95	-	-
Karnataka	48	8.32	59	8.71	85	9.42
Andhra Pradesh	40	8.74	69	8.84	81	9.34
Madhya Pradesh	47	8.91	75	8.69	81	9.40
Jharkhand	43	8.89	77	8.76	78	9.31
Haryana	48	8.73	72	8.81	77	9.08
West Bengal	46	8.72	76	8.97	76	9.07
Manipur	29	8.78	67	8.88	75	9.63
Sikkim	50	8.78	67	8.78	75	9.44
Bihar	52	8.85	74	8.85	74	9.40
Meghalaya	32	8.80	70	8.81	71	9.12
Maharashtra	44	8.76	72	8.76	70	9.25
Punjab	40	8.68	66	8.90	70	8.84
Arunachal Pradesh	61	9.02	68	8.70	69	9.30
Himachal Pradesh	44	8.87	64	8.77	68	8.59
Rajasthan	44	8.97	68	8.84	68	8.93
Chhattisgarh	-	-	70	8.65	64	8.76
Gujarat	44	8.80	63	8.84	64	9.04
Kerala	45	8.81	72	8.85	64	8.95
Tamil Nadu	44	8.79	71	8.83	63	8.90
Jammu & Kashmir	59	9.12	80	8.83	61	8.65
Puducherry	63	8.86	73	8.60	61	9.35
Nagaland	57	8.91	74	8.86	60	8.80
Uttarakhand	42	8.67	79	8.99	58	9.40
Tripura	44	8.89	67	8.75	57	9.39
Uttar Pradesh	43	8.83	74	8.95	57	8.47
Mizoram	44	8.58	63	8.87	55	8.56
Goa	43	8.97	69	8.77	53	8.61

Source: RBI, STCI PD Research

In terms of spreads, amongst the NSCS, Karnataka, Andhra Pradesh and Madhya Pradesh have typically witnessed highest spreads over the benchmark. If we look at the primary cut-off yields, Karnataka has the highest average cut-off yield followed by Madhya Pradesh and Bihar. We can conclude that Karnataka and Madhya Pradesh have had to bear higher spreads and higher costs despite the finances for both the states remaining largely steady.

On the other hand, Goa has enjoyed the lowest spread despite sharp deterioration in its fiscal position. The state noted a fiscal slippage of 1.5 percent points over its BE for 2012-13, while the 2013-14BE has not improved significantly. This could likely be on account of the smaller average auction size of around Rs 160 Cr-Rs 170 Cr. Uttar Pradesh, too, has enjoyed relatively lower spread coupled with lowest average interest cost. This could be attributed to a marked decline in average issuance size of the Uttar Pradesh SDL.

Amongst the SCS, Manipur and Sikkim have paid highest spread over the benchmark 10Y. This despite the states' finances suggesting a strong improvement in its fiscal position.

VII. Comprehensive Summary

We juxtapose the analysis of spreads and borrowing cost of states with their fiscal health as indicated by GFD/GSDP ratio and the servicing capability with interest payments to revenue receipts ratio as the key indicator, and come up with following key observations:

- Karnataka has noted the highest spread over benchmark 10Y G-Sec with the highest average cut-off yield. The fiscal health of the state, however, has stayed stable with the GFD/GDP ratio budgeted to remain constant at 2.9%. The debt servicing capability of Karnataka, on the other hand, has undergone marked improvement with interest payments to revenue receipts ratio declining from 11.1 (2005-06 to 2009-10) to 8.9 (2010-11 to 2013-14).

  The higher yield and spread is probably on account of the uptick in the average size of issue, which has nearly doubled from last year. (~ Rs 800 Cr in FY13 to ~ Rs 1,500 Cr in FY14) (Table 10)

- Maharashtra has budgeted for the lowest GFD/GSDP ratio for 2013-14 amongst the NSCS. To be sure, the state even noted a 0.3 percent points improvement from its 2012-13BE to 2012-13RE. Additionally, the debt servicing ratio has registered an improvement with interest payments to revenue receipts ratio declining from 16.9 (2005-06 to 2009-10) to 14 (2010-11 to 2013-14). The average spread that Maharashtra had to pay, however, stayed closer to the average of all states at 70 basis points with average cut-off at 9.33%.

  The reason for this can again be attributed to large average auction size of around Rs 1,700 Cr. (Table 10).

- Punjab has shown a GFD/GSDP ratio much higher than the average GFD/GSDP ratio amongst the NSCS with debt servicing still remaining among the highest (second only to West Bengal). Despite weaker fiscal health as compared to other states, Punjab SDLs have noted an average spread of 70 basis points with average cut-off at mere 8.92%.

  This benefit is due to relatively smaller average auction size of around Rs 500 Cr, which has ensured the state does not have to bear high interest burden.

- Goa has on a sustained basis showed weak fiscal health. Its GFD/GSDP ratio has been on an uptrend (an uptick of 1.5 percent points in 2012-13RE and 1.1 percent points for 2013-14BE). It has, however, paid an average spread of 53 basis points, lowest amongst all the states. Again, average auction size for Goa has stayed notably low. This has helped the interest cost remaining markedly for the state.

VIII. Conclusion

The bond markets while subscribing to and trading State Development Loans have on multiple occasions failed to reflect the true fiscal position of the respective states. The reasons for this are two-fold:

1. Fiscal health of a state is not the sole determinant for pricing for SDLs at a spread over the 10Y benchmark G-Sec. Demand supply dynamics including average issue size, total issue size, frequency of issue, market liquidity and market perception of the state have empirically had more bearing in determining the spreads of primary and secondary market trading of SDLs.

2. The study of State Finances suffers from lack of availability of standardized data, unavailability of contingent/off-balance sheet liabilities (eg: state guaranteed bonds) which has distorted the true standing of states' fiscal position.

There have been increased calls for standardized and relatively frequent presentation of states' fiscal position in the public domain. The need for this cannot be overemphasized considering the fact that states' borrowings are now close Rs 2,00,000 Cr a year. Efforts towards improving the robustness and quality of data need to be taken in a decisive manner. In the meantime, the RBI's annual publication of States' Finances continues to remain the sole source of centralized data.

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