

# ISAS Working Paper

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## Understanding Growth Opportunities in Indian States

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The recent Comprehensive Economic Cooperation Agreement between Singapore and India, the first such agreement that India has signed with any country, offers a unique advantage to businesses and industry in Singapore to be part of this growth process in India. Taking advantage of these opportunities, however, requires a deeper understanding of how things work in India, and the investment climate in different states of this vast country.

Comments about India invariably start with the democratic institutions of the country, and the manner in which they have helped or hindered the economic transformation process. India today is the fourth largest economy in the world, in terms of purchasing power parity, next only to the United States, China and Japan. It is likely to overtake Japan in the next few years. The opening up of the economy has integrated it more closely with the rest of the world, with trade registering an average of over 24% growth year on year for the past five years. Trade as a share of GDP has grown from under 22% in the early 1990s to over 37% in 2004-2005 and exports grew to over US \$7.2 billion in July 2005, the third successive month that exports are crossing the \$7 billion mark. Imports, monthly at over US \$ 10 billion, have been recording a healthy 33.2% year on year growth. The stock and commodities markets have touched all time highs, and the overall picture appears to be very positive, with a lot of opportunities for overseas investors and for trade.

For the Singapore investors looking at opportunities in manufacturing, infrastructure, real estate, food processing, trade and logistics, the macro picture has to be supplemented with more intimate knowledge of the states of India, and the conditions there. Interestingly, there have been several recent surveys in the media in India comparing the performances of the different states, from the point of view of business climate and investment friendliness. Most surveys place Gujarat at the top, followed closely by Tamil Nadu and Maharashtra.

At the Institute of South Asian Studies (ISAS) in Singapore, a recent study has focused on identifying growth opportunities in Indian states by looking at parameters of governance and economic development. Rather than arrive at estimates of the current business climate of states, it attempts to analyse the reasons why certain states have forged ahead more than others, and, the likelihood of continuity of policy and opportunity. It is not a snapshot; it is an attempt to forecast credible environment for the future.

The federal structure in India has resulted in considerable development responsibility in the hands of the individual states, especially in areas of roads, urban infrastructure, education,

health etc. The states' own revenues have been inadequate to meet these development needs, and have had to be supplemented by central grants and programmes. The nature of balance between regional and national politics has resulted in uneven development across states, with inter-state disparities on the increase in recent years. These would have important consequences for future investments. Among the larger states, per capita income is highest in Gujarat at Rs19,673 (\$756), followed by Maharashtra, Haryana, Punjab, Tamil Nadu, Karnataka and Kerala. Bihar has the lowest per capita income at Rs4,088 (\$157). The ratio between the highest per capita income state and the lowest is around 4.6, showing huge disparities in income, that have been growing over the years. The study has attempted to identify indices of governance based on the methodology adopted by the World Bank in similar studies across countries, and not surprisingly, the governance indicators correlate closely with the per capita income and development indicators.

Voice and accountability is an important indicator of governance, and is a measure of the responsiveness of the government to the expectations of the citizens. Another measure is peace and stability, especially of the industrial environment, measured by the number of industrial disputes in each state. Ranking of these administration measures indicates that the states of Gujarat, Maharashtra, Haryana, Punjab, Tamil Nadu and Karnataka again score high, with Madhya Pradesh, Orissa, Uttar Pradesh and Bihar bringing up the tail end of the list.

The financial health of some of the states causes concern. Results of the study indicate that the debt to GSDP ratio, or the indebtedness of the state governments, is quite high, the highest being Orissa (62.93%). States such as Bihar (55.33%), Punjab (48.51%), and Rajasthan (45.38%) have also unsustainable debts. While it is understandable that states low on development indicators such as Bihar and Orissa show poor management of state finances, even states such as Punjab and West Bengal have high debts. It is only states such as Gujarat, Haryana, Tamil Nadu and Karnataka among the high growth states that have managed their finances reasonably well so far. Punjab and West Bengal are poor in tax collection as well, with low tax GDP ratios.

Another indicator of governance is the health of the institutions like the cooperative banks, and local bodies. Available data indicates high levels of rural indebtedness in Andhra Pradesh, Punjab and Karnataka, and these are the very states where the cooperative banks, that have the responsibility for providing rural credit, are in a poor shape.

Data on power consumption for industry reveals that Gujarat, Punjab, Maharashtra and Tamil Nadu have the highest ratios of industrial to domestic power consumption, and Gujarat and Maharashtra account for the greatest output from the factory sector, followed by Tamil Nadu. Maharashtra scores highest in approvals for Foreign Direct Investments, followed by Gujarat, Tamil Nadu and Andhra Pradesh.

It is possible to draw several conclusions from the ISAS study. First, it is clear there are some states that rank high on economic development while others such as Bihar, Orissa, Madhya Pradesh and Uttar Pradesh rank low. Next, even among the states that have good economic development rankings, there are fiscal and financial stresses in some states such as Punjab and Andhra Pradesh. High levels of rural indebtedness are an indicator of significant intra-state differences in incomes and of rural impoverishment. It is interesting that there have been notable cases of debt related farmer suicides in Andhra Pradesh, Karnataka and even Punjab, giving credence to the above analysis.

Gujarat, Tamil Nadu, Maharashtra and Karnataka emerge as strong candidates for development opportunities, given their development ratings as well as governance indicators. They are followed by Haryana, Punjab and Andhra Pradesh. Interestingly, these states do not score high on indicators of human development. The ISAS study examines social indicators like education, access to health facilities, drinking water availability etc across states, and the findings indicate that Kerala scores highest on the human development index indicators, followed by Punjab, Tamil Nadu and Maharashtra. Kerala has the highest female literacy rates, and the lowest rates of infant mortality. High levels of education and health contribute to high social welfare, though poorer governance indicators bring down the level of economic development indices.

The study also finds considerable opportunities in the smaller states of Delhi, Goa, Himachal Pradesh, Uttaranchal and Chhatisgarh. Governance as well as development indicators are high, and several of these states have high social development indices. Good governance is also due to the proximity of the decision makers to the people, and the hypothesis that smaller states are better for development and investment, is clearly borne out by the results of this work – a conclusion not surprising, viewed from Singapore.

There appears to be a common thread linking the high performance states that has remained unbroken through changes in political and economic management. These states have a tradition of administrative capability that has remained intact through several structural changes. They share a high level of literacy, social awareness and public participation in governance. They have been fortunate, by and large, in having political leaderships with a governing philosophy with attributes that made them responsible for performance. A combination of expectant and aware citizenry, capable administration, and a positive governing philosophy are the ingredients of sustainable change and development. States that have a cohesive organisational structure of conceptualisation and implementation, an integration of the political and the administrative decision making process, and a closer response to the articulated needs of the people, would be the states that are candidates for further growth and opportunity.

Gujarat, Maharashtra, Haryana, Punjab, Tamil Nadu, Karnataka and Andhra Pradesh among the larger states, and Delhi, Goa, Himachal Pradesh and Uttaranchal among the smaller states are clear candidates for development, and offer the best investment climates.

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