India's economic liberalization program: An examination of its impact on the regional disparity problem

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Introduction:

For the past three decades, the buzz word in Economics has been Market reforms and Economic Liberalization. It has been presented as a panacea for ailing economies and as a necessity for continuing economic growth. The problems faced by developing economies has been attributed to excessive state control, stifling of competition and inefficient and loss making state enterprises. Thus, the international organizations, the industrialized countries and a large part of academia is presenting market liberalization as the only option for these economies. For the most part, increasing number of developing countries are accepting this path to economic growth.

It is 15 years, since the start of the economic reform program adopted by India. The program, started in part due to an economic crisis, has now been projected as the path for India's prosperity. There seems to be widespread acknowledgement of the need for such reform programs and the desire to, not steer off course. The reform program is seen as being instrumental in breaking the cycle of 3.5 percent growth rate (often referred to as the Hindu rate of growth) and moving into higher spheres of economic growth.

It is thus necessary to evaluate the impact of these economic policies on the regional disparity that has existed in India. Several scholarly works have been written about the problem of regional disparity in the Pre-reform period (Srivastava 1991; K.R.G. Nair 1982;

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Ashok Mathur 1983, 1987; Raj Krishna 1990; Choudhury 1992; Raman 1998). The post reform analysis of the regional disparity problem has been an ongoing process, hence the need to examine this issue after 15 years of market liberalization. This paper will examine the regional impact of the liberalization program using several criteria, State Domestic Product, availability of infrastructure, Foreign Direct Investment and Human development indicators. It will be shown that the problem of regional disparity is, not restricted to a specific aspect of the Indian economy but, more pervasive.

The paper is divided into 3 sections. In section one, I will discuss the present reform program. I will also present evidence of the uneven nature of the Foreign Direct Investment. In section 2, I will present evidence of regional disparity in the post reform period. This will be done using tests such as the Coefficient of Variation, Standard Deviation of Logarithm and the State Relative. In section 3, I will explore some possible policy options that will help alleviate the problem of disparities in India.

Economic Liberalization Program (1991-2006):

Economic liberalization in India is not a phenomenon of the nineties, infact it was set in motion in the eighties. Cushioned by a healthy foreign exchange reserve and an increase in food reserves[13]; the government decided to embark on a path of selective liberalization in early eighties. Import controls were relaxed in the automobile sector (although the impact was seen more in the two wheeler market than the car industry) and some high tech sectors. Licensing rules were relaxed in some areas.

The immediate impact of these policies was an increase in the growth rate of the GDP, during the eighties the average growth rate was about 5.6 percent. The primary, secondary and

[13] The food reserve was primarily due to the success of the Green Revolution.

tertiary sectors grew at rates of 3.5, 7.0 and 6.7 percent respectively, between 1980 and 1991(Nagaraj 1997). However, this growth was accompanied by two problems, one, the government was increasingly relying on deficit financing and second, the influx of imports was being financed by increased private sector borrowing. During this decade the Indian economy relied on institutional and commercial lenders and the private remittances from its citizens abroad.

By 1991, the Indian government faced a balance of payments crisis. The government had less than a month worth of foreign exchange reserves left. It had to pledge gold in order to meet some of its short term commitments. The government had no choice but to request emergency loans from the IMF and the World Bank. These loans were granted in lieu of conditionalities that India was forced to agree to.

Thus started the second round of liberalization, which was precipitated by actions taken during the first round of reforms. India took several steps as part of the reforms, some of these policies are summarized below:

a. Relaxing the licensing procedures.
b. Increased foreign equity stakes in Indian firms. In many cases more than 51 percent ownership and in some industries such as power, telecommunications, oil exploration and infrastructural projects it was 100 percent.
c. Regulations governing foreign financial capital flows were relaxed. This was done in the assumption that an influx of foreign capital would alleviate the credit crunch.
d. Tariff structure was revised, the average tariff rate was reduced to 50 percent from 150 percent prior to the reform process.
e. Introduction of current account convertibility.
f. Devaluation of the rupee
g. Drastic reduction in government expenditure on social programs.

h. Private banks were allowed the capability of setting lending rates.

The impact of the reform programs can be seen in terms of the growth rates and other indicators. During 1991-1996 period, it is estimated that the GDP grew at 5.3 percent. The primary, secondary and tertiary sectors grew at 2.5, 6.3 and 6.8 percent respectively. The sectors that registered significant growth were Banking and Insurance, Electricity, Trade and hotels and Financial institutions (Nagaraj, 1997).

Foreign Direct Investment and economic growth:

The Indian government relaxed the rules governing foreign investment in India, in the hopes that much needed foreign exchange would flow into the economy. The foreign investment is divided into two categories, sectors that require licenses and the sectors that do not require licenses. In order to invest in a licensed sector, the firm has to fulfill several criteria and obtain a license to operate. This is fulfilled by filing a LOI (Letter of Intent)

In the sectors that do not require a license, the firm has to file a IEM (Industrial Entrepreneur's Memorandum). These sectors do not require any other permission from the government.

The amount of capital India received was significant in comparison to pre-reform capital inflows. However, in comparison to other countries, the amount India received was nothing spectacular. For instance, in 1991 alone China received $43 billion, Malaysia $34 billion, Indonesia $14 billion. India, by contrast has received a total of about $37 billion from 1991-2006[14]. Even though India has lagged behind many other countries in attracting FDI, this amount has grown at an annual rate of 33 percent (see Table 1).

Table 1:

[14] The number was calculated using data provided by the Secretariat of Industrial Assistance Website.

YEAR-WISE FDI INFLOWS:

S. No.	Year (April – March)	AMOUNT OF FDI INFLOWS	
		In rupees crore	In US$ million
1	1991-1992 (Aug.-March)	409	167
2	1992-1993	1,094	393
3	1993-1994	2,018	654
4	1994-1995	4,312	1,374
5	1995-1996	6,916	2,141
6	1996-1997	9,654	2,770
7	1997-1998	13,548	3,682
8	1998-1999	12,343	3,083
9	1999-2000	10,311	2,439
10	2000-2001	12,645	2,908
11	2001-2002	19,361	4,222
12	2002-2003	14,932	3,134
13	2003-2004	12,117	2,634
14	2004-2005	17,138	3,755
15	2005-2006 (up to January 2006)	19,356	4,343
GRAND TOTAL		1,56,154	37,699

The FDI that the states have received are not entirely invested yet and many of the projects seem to be waiting for funds to arrive. The problem with the existing environment of liberalization is that, there exists a wide disparity between the amount of FDI being approved and the amount that is actually invested. Many states have taken a lead in approving a lot of projects that could potentially bring in a lot of money and create jobs however, the actual money invested has often been a fraction of the amount approved. Table 2, shows the disparity in the amounts approved and actual investment. It also highlights the uneven distribution of investment across states.

In the first decade of the reform process, the traditional industrial centers of India, West Bengal, Maharashtra and Gujarat have done well. The approval of IEM's and LOI's, puts Maharashtra and Gujarat at the top. Between them they have 38.6 percent of the overall investment approved. As a share of the approved amount being actually invested, Maharashtra and Gujarat are again among the leaders, with approximately 32 percent of the total being invested in these two states. West Bengal has a share of only 3.5 percent of the overall investments approved in India, however it has a share of 14.5 percent of the overall money being actually invested. Thus it fares much better than most other states in getting the approved projects being actually implemented.

Table: 2

STATEWISE BREAK UP OF IEMs and LOIs APPROVED AND IMPLEMENTED FOR SELECTED STATES (From August 1991 to February 2002)

	Investment approved	Share (%)	Investment implemented	Share(%)
Andhra Pradesh	116851	11.76	13181	7.33
Assam	7574	0.76	1015	0.56
Bihar	4468	0.45	65	0.04
Delhi	6480	0.65	634	0.35
Goa	6327	0.64	587	0.33
Gujarat	179629	18.08	31836	17.70
Haryana	32844	3.31	9482	5.27
Himachal Pradesh	9426	0.95	355	0.20
Jammu and Kashmir	801	0.08	602	0.33
Karnataka	54332	5.47	8237	4.58
Kerala	10513	1.06	1005	0.56
Maharashtra	221227	22.26	26813	14.91
Madhya Pradesh	43774	4.41	9258	5.15
Orissa	26944	2.71	1601	0.89
Punjab	52473	5.28	5706	3.17
Rajasthan	40250	4.05	10790	6.00
Tamil Nadu	67963	6.84	9366	5.21
Uttar Pradesh	75913	7.64	16461	9.15
West Bengal	35880	3.61	26187	14.56

Source: Secretariat of Industrial Assistance Website: http://indmin.nic.in/

A comment needs to be made about the 3 southern states of Andhra Pradesh, Karnataka and Tamil Nadu, and their progress under the liberalization program. The three states have 24 percent of the overall projects approved and 17 percent of the actual projects implemented. Thus a larger percentage of the investment is flowing into these states and all indications are that this trend will only improve in the coming years.

The three most populous states Bihar, Madhya Pradesh, Rajasthan and Uttar collectively have a share of only 21 percent of the overall investment projects implemented. Bihar, the poorest state in India has lagged far behind in the process of attracting investment. Its share of the approved projects is only 0.45 percent and 0.04 percent of the total amount received.

The new decade of reforms has seen a sharp worsening of the uneven nature of FDI. Between 2000 and 2006 the two states of Maharashtra and Delhi have garnered 45.6 percent of the total investment and the three southern states of Tamil Nadu, Karnataka and Andhra Pradesh have attracted 16 percent of the total investment (see Table 3). These states have a combined 35 percent of the population and managed to attract 61 percent of the total investment. The poorest states in Central India (Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh) have received only 0.21 percent of the total investment. Forty Eight percent of India's population resides in these states. Thus this new trend in uneven investment is a very alarming trend.

Table 3

STATEMENT ON REGION-WISE/STATE-WISE BREAK-UP FOR FDI INFLOWS RECEIVED
(as reported to Regional Offices of RBI)

(from January 2000 to January 2006)

Ranks	***RBI's - Regional Office2z***	***State covered***	***Amount of FDI Inflows***		***%age with FDI inflows (in rupee terms)***
			Rupees in crore	***US$ in million***	
1	NEW DELHI	DELHI, PART OF UP & HARYANA	22,515.7	4,988.0	25.4
2	MUMBAI	MAHARASHTRA, DADRA & NAGAR HAVELI, DAMAN & DIU	17,978.8	3,956.7	20.3
3	BANGALORE	KARNATAKA	6,673.7	1,474.8	7.5
4	CHENNAI	TAMIL NADU & PONDICHERRY	5,277.5	1,157.8	6.0
5	AHMEDABAD	GUJARAT	3,471.7	760	3.9
6	HYDERABAD	ANDHRA PRADESH	2,874.6	634	3.2

7	CHANDIGARH	CHANDIGARH PUNJAB, HARYANA, HIMACHAL PRADESH	1,478.1	320	1.7
8	KOLKATA	WEST BENGAL, SIKKIM, ANDAMAN & NICOBAR ISLANDS	1,243.9	273	1
9	PANAJI	GOA	487.8	106	0.6
10	BHUBANESHWAR	ORISSA	315.9	70	0.4
11	KOCHI	KERLA, LAKSHADWEEP	301.6	67	0.3
12	BHOPAL	MADHYA PRADESH, CHATTISGARH	163.4	36	0.2
13	GUWHATI	ASSAM, ARUNACHAL PRADESH, MANIPUR, MEGHALAYA, MIZORAM, NAGALAND, TRIPURA	41.7	9	0.1
14	JAIPUR	RAJASTHAN	18.8	4	0.02
15	PATNA	BIHAR, JHARKHAND	2.7	0.6	0
16	KANPUR	UTTAR PRADESH, UTTRANCHAL	0.03	0	0
17	NOT INDICATED[3]		25,789.9	5,664.5	29.1
		TOTAL	**88,635.7**	**19,520.7**	**100**

Although the link between FDI and economic growth is not very clear, one can certainly surmise that the inflow of investment money and the creation of employment does have an impact on the states economy. Therefore any increase in the influx of funds directly relates to the economic performance of a state today and most certainly in the years to come. This is corroborated in the study done by Ghosh and De, where they show that there exists a positive relation between FDI and state level income. The rising disparity in the state income can be attributed to the FDI inflows in India.

Inter-State Disparities in the post reform period:

Evidence of regional disparity in India is well documented. The evidence presented here suggests that the problem of regional disparities has only worsened over the last decade. Using the per capita Net State Domestic Product data, tests done here show that the coefficient of variation and the standard deviation of logarithm both show increases in the post reform period. The Coefficient of Variation increased 7 percent in the last 6 years while the Standard Deviation of the Logarithm shows an increase of about 12 percent. The ratio of the richest state to the poorest state shows an increase from 4.4 to 5.0. (See Table 4)

Table: 4
Regional Disparity Measures across states in the Post-Reform Period

	PER CAPITA MANUFACTURING OUTPUT		**PER CAPITA AGRICULTURAL OUTPUT**		**PER CAPITA INCOME**	
	Coeff. Of Variation	Standard Deviation of Logarithm	Coeff. Of Variation	Standard Deviation of Logarithm	Coeff. Of Variation	Standard Deviation of Logarithm
1993-94	0.91	0.84	0.66	0.62	0.40	0.39
1994-95	0.76	0.86	0.64	0.68	0.40	0.39
1995-96	0.78	0.80	0.67	0.72	0.40	0.40
1996-97	0.92	0.96	0.71	0.78	0.41	0.42
1997-98	1.14	1.00	0.63	0.72	0.42	0.43
1998-99	1.21	1.01	0.71	0.74	0.43	0.44

Source: Indiaeconomicstat.com http://www.indiaeconomicstat.com/

Using the state relative as a measure for examining the extent of disparity, we will show that the problem in India has become worse in the post reform period. The State relative is a measure of the states income as a percentage of the National average. The following table shows evidence of the variation in income between the states. Six of the poorest states in India saw a decrease in their income share in the nineties. States with income shares close to or above the national average saw an increase in their income in the post reform period. Ironically, Punjab one of the richest states in India saw its income share decline. (See Table 4)

The disparity between states can be seen in Per Capita Agricultural output and Per Capita Manufacturing output. In both these variables, the coefficient of variation and the standard deviation has increased. Using data put forth by the CSO for 1993-1999, it can be seen that the trend is for an increase in the disparities between states. (See Table 5)

Table 5
State Relative Per Capita Net State Domestic Product (Constant 1993 prices)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Bihar	35	36	29	33	29	29	29	33	30
Uttar Pradesh	58	57	56	57	53	50	50	48	47
Orissa	56	55	55	48	51	50	51	48	49
Assam	65	63	61	58	55	52	51	51	50
Chhattisgarh	74	71	69	66	65	63	59	55	61
Manipur	66	61	60	60	61	58	63	58	62
Jharkhand	67	66	65	56	69	71	64	62	62
Jammu and Kashmir	74	72	72	70	68	67	66	63	63
Madhya Pradesh	75	72	72	71	69	70	73	61	64
Uttaranchal	77	79	75	74	70	67	64	66	66
Rajasthan	70	78	77	78	82	80	76	69	71
Arunachal Pradesh	99	91	100	86	82	80	79	78	72
Meghalya	78	76	80	76	75	78	80	81	79
Tripura	63	59	61	62	65	68	71	80	85
West Bengal	77	78	80	79	80	80	83	84	86
Andhra Pradesh	84	84	86	85	78	83	84	87	88
Kerala	90	93	93	90	86	88	90	90	89
Sikkim	86	78	81	82	87	88	91	91	93
Himachal Pradesh	89	93	94	91	92	92	98	94	95
Karnataka	89	89	89	90	90	96	97	102	96
Nagaland	104	103	103	99	98	83	78	98	97
All India	100	100	100	100	100	100	100	100	100
Tamil Nadu	102	109	108	104	107	106	108	111	106
Gujarat	111	126	124	132	124	125	118	107	110
Haryana	126	127	123	126	118	116	118	118	118
Maharashtra	138	133	141	134	132	129	135	121	122
Punjab	144	140	139	137	131	131	132	129	126
Andaman & Nicobar	173	177	164	159	156	132	136	135	131
Pondicherry	111	106	105	135	166	176	172	190	191
Delhi	206	214	204	209	223	217	213	225	221
Goa	188	186	191	206	196	232	225	228	230
Chandigarh	224	230	240	248	242	244	244	237	239

Source: Indiaeconomicstat.com
http://www.indiaeconomicstat.com/

The overall growth rate of State Domestic product shows the continuing problem of rising disparity. The average growth rate of poorer states in the nineties has been significantly lower in comparison to their growth rates in the eighties, while the states benefitting from the liberalization program have seen an increase in their growth rate in the nineties. Thus the problem of inter-state disparities only seems to worsen under the liberalization program. (See Table 6)

Table 6
Growth Rate of State Domestic Product between 1980-90 and 1990-2000

States/UTs	Average Annual Growth Rates (1980's)	Average Annual Growth Rates (1990's)
Andhra Pradesh	6.4	5.2
Arunachal Pradesh	9	6.2
Assam	4.2	2.9
Bihar	4.9	2.5
Goa	5.8	6.7
Gujarat	5.9	7.2
Haryana	6.7	4.8
Himachal Pradesh	5.1	5.9
Jammu & Kashmir	3.5	4.9
Karnataka	5.2	7.5
Kerala	3.7	5.7
Madhya Pradesh	5.2	4.4
Maharashtra	6.1	6.7
Manipur	5.1	5.8
Meghalaya	6	4.8
Nagaland	8.1	4.9
Orissa	3.3	4.7
Punjab	5.3	4.7
Rajasthan	8.1	5
Sikkim	11	7.1
Tamil Nadu	5.7	6.7
Tripura	5.8	6.8
Uttar Pradesh	5.1	4.3
West Bengal	4.4	6.9

Delhi	7.5	7.7
Pondicherry	4.4	9.4
India	5.7	5.8

Source: Indiaeconomicstat.com
http://www.indiaeconomicstat.com/

This increase in disparity is often attributed to several factors, most important among them being the availability of Infrastructure. Ghosh and De (2000), explore the question of whether the availability of infrastructure or lack thereof has contributed to the disparity between states. Their study concludes that the pre-reform period undeniably shows strong linkage between inter-state disparities and the availability of Infrastructure.

It is not surprising to see that states that possessed better infrastructure were able to grow faster and those with poor infrastructure lagged behind. The poorer states are saddled with several problems, among them the lack of physical infrastructure is the most important, such as installed capacity of power, telecommunications, roads and railway. However, the other factors that tend to hold back the states include high birth rate, high illiteracy, high infant mortality, lack of proper health care facilities, lack of availability of bank credit for businesses and others. The following table shows the relative infrastructure development index. The index shows many of the poor states lagging behind the national average and have failed to show any improvements. Based on both an overall infrastructure index and a Human Development index, the poorer states are lagging behind the national average. This in part can explain, why the industrialized states are able to attract foreign investment and hence more jobs into their states. (See Table 7 and 8)

Table 7
Relative Infrastructure Development Index: 1989-90 to 1993-94
ALL INDIA = 100

	1989-90	1990-91	1991-92	1992-93	1993-94
Madhya Pradesh	69.6	69.7	71.5	74	75.3
Assam	79.6	84	81.7	80.4	78.9
Bihar	83.1	79.7	81.7	83.4	81.1
Rajasthan	81.1	79.2	82.6	81.2	83
Jammu & Kashmir	86.6	83.7	79.2	83.2	84
West Bengal	96.3	93.8	92.1	94.4	94.2
Andhra Pradesh	98.9	97	96.8	95.9	96.1
Karnataka	95.2	96.4	96.5	96.1	96.9
Orissa	93.3	93.5	95	97.3	97
Himachal Pradesh	107.4	95.9	97.1	97.7	98.8
ALL INDIA	100	100	100	100	100
Uttar Pradesh	103.9	103.6	102.3	103.7	103.3
Maharashtra	111	111.5	109.6	107.1	107
Gujarat	116.8	122	122.9	122.9	122.4
Haryana	141.9	139.7	143	140.1	141.3
Tamil Nadu	147.4	145.5	145.9	143.3	144
Kerala	153.2	157.4	158	153.2	157.1
Punjab	195.8	192.6	193.4	191.6	191.4

CMIE Publication: Basic Statistics on States, 1998

Table 8
Major State-wise Human Development Index - Combined (1981 to 2001)

States/UTs	1981		1991		2001	
	Value	Rank	Value	Rank	Value	Rank
Andhra Pradesh	0.298	9	0.377	9	0.416	10
Assam	0.272	10	0.348	10	0.386	14
Bihar	0.237	15	0.308	15	0.367	15
Gujarat	0.36	4	0.431	6	0.479	6
Haryana	0.36	5	0.443	5	0.509	5
Karnataka	0.346	6	0.412	7	0.478	7
Kerala	0.5	1	0.591	1	0.638	1
Madhya Pradesh	0.245	14	0.328	13	0.394	12
Maharashtra	0.363	3	0.452	4	0.523	4
Orissa	0.267	11	0.345	12	0.404	11
Punjab	0.411	2	0.475	2	0.537	2
Rajasthan	0.256	12	0.347	11	0.424	9
Tamil Nadu	0.343	7	0.466	3	0.531	3
Uttar Pradesh	0.255	13	0.314	14	0.388	13
West Bengal	0.305	8	0.404	8	0.472	8
India	0.302		0.381		0.472	

Source: Indiaeconomicstat.com

Conclusions and Policy Issues:

It is clear that the post reform period has not altered the spatial pattern of economic development in India. Regional disparity has been a problem in India, since independence and the last 10 years have not changed that. Although the reform program was not explicitly adopted to address this issue, it can be seen that it has not helped alleviate it. If anything it is setting the stage for further deterioration of regional disparity. It is therefore important for the policy makers both at the centre and the state to give serious considerations to this issue.

The problem needs to be addressed from several fronts. Infrastructure is one of them. The Centre should take an active role in ensuring that the disparity between states in Infrastructure is reduced. It is the opinion of this author that Infrastructure development is an important key to solving the regional disparity problem. However, eliminating the differences in infrastructure involves a significant lag period. During this time it is likely that the disparity will increase. The immediate changes that can be enacted could be in terms of power generation, telecommunications, roads and rail services. These facilities can be provided in a much shorter time period. Other factors such as improving literacy, lowering population growth, improving health care facilities and increasing the access to such facilities by all, will take time. However, the centre can begin assisting the states in these areas as well.

The Centre will have to use its planning commission and Finance commission disbursements to reverse the trend of widening disparities in Infrastructure. Since Independence, the commissions have not been known, for their equitable treatment of states, however in the present situation, they would have to favor the poorer states over the richer states.

The second front in this effort, should be to attract foreign investment. It is clear that foreign investment and technology will be reluctant to explore opportunities in areas that are not as developed. However, with central and state assistance, it would be possible to achieve this. This is obviously not a new recommendation and states have been using this for some time. However, the centre should play an active role in attracting funds to more disadvantaged regions. It is possible to make an argument that the competition between states, in attracting foreign investment could be harmful to the states. However, as the global and domestic markets are large enough they can accommodate new entrants.

The third front is to forge a new relationship between the centre and the states and the transformation of market economy. State run enterprises need to be reevaluated and efficiency should be promoted. State intervention is crucial in this effort. The state and the centre should have the will to make the tough choices to evaluate and either eliminate inefficient state enterprises or make them efficient. As mentioned by C. Rangarajan (2001), The New Economic Policy of India has not necessarily diminished the role of state; it has only redefined it, expanding it in some areas and reducing in some others. As it has been said, somewhat paradoxically 'more market' does not mean 'less Government', but only 'different Government'. However, if the public sector is truly to play its role, it needs to improve its efficiency and productivity and generate the necessary surpluses as were originally envisaged. It is only an efficient public enterprise system that can enable the Government to meet its social obligations. If one hears the word 'market' mentioned more often these days, it was only because 'market' was very nearly a dirty word in this country for well over four decades. What is needed is an optimal mix of 'market' and 'State'.

The new approach to market liberalization should not be one of abdication of government controls to market forces, rather a harnessing of market forces for the greater good of the nation.

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