CHAPTER ONE
INTRODUCTION

1.1 Background

After independence, India turned towards socialist pattern of economy for a number of reasons. Firstly, India suffered imperialistic exploitation, and as imperialism was considered to be the extension of capitalism, it was no wonder she had an inherent hatred towards capitalism. Secondly, the demonstration effect of Soviet economic growth under socialism had a profound impact on the thinking of leaders and intellectuals of (Hajela, 1993; Singh, 1993). But, in 1970s the world economic scenario began to change drastically. Economic and political disasters of USSR- the role model of socialism for India and other nations- had a devastating impact on the developing countries. In the meanwhile China, still a communist country, adopted almost all the features of market economy in 1978 itself, under the leadership of Deng Xiaoping\(^1\), who took pride in advocating “to earn is not a crime.” Thus, socialist pattern of economy was unceremoniously ousted from its own home-Soviet/Russia and Communist China.

There is no denying in the fact that India’s economy under socialist pattern had some achievements to its credit; but indiscriminate restrictions imposed, widespread corruption and absence of accountability in the government and its machinery resulted in mounting losses in most of the public undertakings. The cumulative effect of all these factors was that in the end of June 1991, our country was faced with an unprecedented economic crisis. Reserves of foreign exchange were just sufficient to pay for two weeks’ imports. New loans were not available. Large amounts were being withdrawn from the accounts of non-resident Indians (NRIs). Faith of international community in Indian economy was shaken. Industrial progress was on reverse gear and prices were sky-rocking. In order to pull the economy out of economic crisis and to put it on the path of rapid and steady economic growth, India launched a programme of economic policy reforms, consisting of stabilisation-cum-structural adjustment measures, announced in the budget, July 1991. The reform programme is seen as being instrumental in breaking the cycle of Hindu rate of growth\(^2\) and moving into higher spheres of economic growth of around 6 per cent.
per annum. Growth rate of GDP, per capita income, and capital accumulation were all higher and their coefficient of variations lower during 1992-2001 than in 1970s and 1980s (Rakshit, 2009). Much more spectacular was performance of the economy in the spheres of poverty alleviation and taming of inflation. The poverty ratio came down from 36.0 per cent in 1993-04 to 26.1 per cent in 1999-2000—a fall that was much steeper than in 1970s and 1980s (Government of India, 2000). The most remarkable improvement in the economy’s performance was, however, in the external sphere. The trade-GDP ratio crawled from 13.6 percent to 14.2 per cent between 1980-81 to 1989-90, but jumped to 22.1 per cent by 2000-01. Other positive developments during 1990-2001 included (a) a reduction, as percentage of GDP, in external indebtedness and current account deficit from 28.7 and 3.1 per cent to 22.3 and 0.5 per cent respectively; (b) an increase in foreign exchange reserve from US$ 5.8 billion (amounting to 2.5 months’ import bill) to US$42.2 billion (providing an import cover for 8.6 months); (c) a decline in short-term debt as percentage of forex reserves from an unsustainable 146.5 per cent to a healthy 8.2 per cent; and (d) a fall in debt service payments as proportion of current receipts from 35.3 per cent to 17.1 per cent (Rakshit, 2004). In spite of these undeniably positive results, India has also shown some weaknesses that threaten to condition its future journey towards development. Probably the most serious problem today that is observed is the unbalanced performance of regions across the country. While some states (Gujarat, Punjab, Maharashtra and others) lay their hand on the star in the sky in terms of most development indicators, there are others (Bihar, Orrissa, Assam, Manipur, Meghalaya and others) who still talk with the grass in the soil (Dholakia, 2009).

1.2 Necessity of the Study

Regional growth and analysis of the factors which contribute to the process of economic convergence is a research area of great interest among regional economists. Over the past decade or so there have been a revival of interest in this topic, which has been marked by new approaches (endogenous growth theory) and a great emphasis on empirical analysis. A major focus of this empirical research has been to quantify the impact of factors such as human capital, economic policies and institutions in explaining differences in economic growth between regions. Another important focus has been on the issue of convergence, that is, whether there has been
a tendency for real per capita income differences between rich and poor countries to
narrow significantly over the long run. Understanding the causes and nature of
differences in levels and growth of income across the regions (countries) is very
important because even small differences in the growth rates, if cumulated over a
long period of time, may have substantial impact on the standards of living of people
(Barro and Sala-i-Martin, 2007). Further, inequality in any respect gives rise to
unequivocal negative effects on subsequent growth and development, and worsens
economic, social, and political tension among regions leading to misallocation of
resources (Chowdhury, 2003). Therefore, it is important to identify the sources of
changes in productivity and growth in order to recommend appropriate policies for
accelerating growth and achieving equity by raising the standards of living of people
in different states. In recent years, the impact of India’s economic reforms on
economic performance has been the subject of much academic and public debate,
but the focus has been largely on the performance of the economy as a whole or of
individual sectors. The performance of individual states in the post-reforms period
has not received comparable attention. What limited studies have been done, that too
excluded the economy of northeastern region except Assam in few cases. Since the
region has a wide untapped resources based on handicraft and handlooms which can
be used to develop internal as well as international trade with the neighbouring
countries under the new market economy spearheaded by economic reforms,
therefore, it will be interesting to study the regional dimensions of economic growth
in Northeast India and to relate this growth performance of NE States with that of
the national economy as a whole.

1.3 Research Aim and Objectives

The main purpose of this study is to analyse the performance of northeastern region
of India during pre and post reforms period and to identify the critical policy issues
that need to be addressed to accelerate the pace of economic development of this
region in future. The specific objectives of the study are:

1. To analyse growth performance of northeastern states, as measured by
growth in (i) NSDP, and (ii) Per capita NSDP for selected time periods from
2. To analyse the contribution of different sectors in growth acceleration or deceleration during post-reform period over pre-reform period.
3. To examine the issue of economic convergence among the states of NER over time.
4. To examine whether economic growth in better-off states stimulates growth in the worse-off states in NER.
5. To examine the causality between growth of India and growth of Northeastern States.

1.4 Research Questions
Since the present study is exploratory in nature, the following research questions have been identified:

1. What is the growth performance of the States of Northeast India during pre and post reform periods?
2. What are the major sources of economic growth in Northeast India?
3. Which sector is contributing the most in acceleration (or deceleration) of economic growth in different states of the region?
4. Is there any tendency of economic convergence among the states of Northeastern Region?
5. Does India’s economic growth precede growth of Northeastern Region?

1.5 Conceptual Framework
A number of concepts have been used in the present study which might carry a different meaning from what is written in dictionary. Therefore it is necessary to define those special concepts in order to avoid discrepancy.

North-Eastern Region (NER): NER in this study has been narrowly defined. It consists of seven states, namely Arunachal Pradesh, Assam, Manipur, Meghalaya, Nagaland, Tripura, and Sikkim. The State Mizoram has been excluded from NER in the present study.

Economic Growth: Economic growth in the present study is defined as an increase in Per Capita NSDP or an increase in NSDP, unless otherwise indicated.
**State Domestic Product (SDP):** The State Domestic Product (SDP) is defined as a measure in monetary terms of the volume of all goods and services produced within the boundaries of the State during a given period of time, accounted without duplication.

**Net State Domestic Product (NSDP):** The estimates of Consumption of Fixed Capital (CFC) for all sectors of the economy are supplied by CSO after preparing the same at the National Level and allocated to the States. This CFC is deducted from GSDP to obtain Net State Domestic Product (NSDP).

**Sectoral Composition of SDP:** Each of the state economy has been divided into thirteen sectors for the purpose of calculation of SDP. These thirteen sectors have further been classified in three broad sectors: Agricultural sector, Industrial Sector and Service Sector.

**Convergence:** It is a process whereby poor states (or economies) grow faster than rich ones. Conversely, when poor economies do not catch up with rich ones through faster growth then this process is called divergence. According to the standard neoclassical theory, economies with low initial capital per capita tend to accumulate capital at a faster rate than economies with initially high capital per capita due to diminishing marginal returns in production. An implication of this model is that regions with low starting values of capital-labor ratios tend to grow faster in per capita income than the countries or regions with relatively higher starting values of capital-labor ratios. The hypothesis known as absolute convergence refers to the idea that initially poor economies grow faster than initially rich economies and eventually catch up with them. As per absolute convergence hypothesis, by assumption, no structural disparities across economies exist, and thus all economies converge towards the same steady-state equilibrium level of per capita income in the long run.

However, the absolute convergence hypothesis is sustained only under the assumption that the regions evaluated are rather homogenous; that is, they have the same structural characteristics, the same parameters and thus the same steady-state positions. In many cases, it is not necessarily the case that the regions under evaluation have the same structural characteristics, hence one cannot expect them to converge to the same steady state position. If structural disparities between regions...
exist, such as differences in saving propensities, preferences, institutions, production modes or rates of technological progress, one cannot expect them to converge towards the same steady state equilibrium level of per capita income and long run growth rate. Under such differences, each region would tend to converge to its own steady state equilibrium: a concept known as conditional convergence.

**Economic Reforms:** Economic reforms in India broadly constitute three fundamental policy changes viz. liberalization, privatization and globalization, which is popularly known as LPG model of economic development. LPG model of economic development precisely attempts to pave the way, at least partially, for a liberal free market economy whose intellectual and philosophical basis can be traced to the writings of the classical economics.

### 1.6 Coverage, Data Source and Methodological Issues

The study is conducted for the period of 1980-81 to 2006-07. This period is chosen because it captures the adoption of economic policy reforms policies in India and hence provides a scope for analysing the performance of the economies of NER during pre and post reforms period. Specific data used in the study are: Net State Domestic Product (NSDP), Sectoral decomposition of SDP, Per Capita NSDP, population, central grants, and literacy rate. The main data sources are various volumes of Central Statistical Organisation (CSO), Handbook of Statistics on Indian Economy, RBI, Basic Statistics of North Eastern Region published by North Eastern Council, Statistical Hand Book of various State Governments, and Domestic Product of States of India, 1960-61 to 2006-07 published by the Economic and Political Weekly Research Foundation (EPWRF), 2009. Seven states of the Northeastern region viz. Assam, Arunachal Pradesh, Meghalaya, Nagaland, Manipur, Sikkim and Tripura have been selected for the study. Mizoram has been excluded from the study due to lack of database for the related variables. The detailed methodology has been presented in a separate chapter (Chapter-Four).

The data have a number of limitations. Firstly, time serious data in developing countries are unreliable because of divergence of data values from different sources. It is also difficult to identify data that are unauthentic. Interstate comparison of SDP is also hampered by the quality of statistics produced by different states, apart from
interstate price differentials (Shetty, 2003). Data deficiencies affect the reliability of results. Besides, unreliable data cause difficulties in policy recommendations because various data sources could result in different policy solutions. In this regard, States of NER is not an exception. Accordingly appropriate care has been taken to test the reliability of the data set and econometric tools are used to test the efficiency of the estimated models.

1.7 Organization of the Study

This study is organized into six chapters. After this introductory chapter, chapter-Two deals with review of literature on the relation between economic reforms and economic growth. An attempt has also been made in this chapter to discuss the issues relating to growth and convergence. Chapter -Three deals with the general profile of the economy of the northeastern region. The historical, geographic and other related aspects have been analysed in this chapter. The various econometric and statistical models that are used to estimate results have been detailed in chapter-Four. Chapter-Five presents a detailed analysis of empirical results. The summary of findings, conclusion and policy suggestions have been presented in chapter-Six.
Reference


Notes:

1. Deng Xiaoping was a Chinese politician, statesman, theorist, and diplomat. As leader of the Communist Party of China, Deng became a reformer who led China towards a market economy. While Deng never held office as the head of state, head of government or General Secretary of the Communist Party of China, he nonetheless served as the Paramount leader of the People's Republic of China from 1978 to the early 1990s (see Yahuda, 1993).

2. The Hindu rate of growth is derogatory expression used to refer to the low annual growth rate of the economy of India before 1991, which stagnated around 3.5% from 1950s to 1980s, while per capita income averaged 1.3%.

3. Resurgence has been witnessed since the 1990s, due to research carried out by Sala-i-Martin and Barro (1991).

4. Definition of each of the sub-sector has been provided in chapter IV.

5. Data on SDP and Per Capita NSDP are not available for the State Mizoram prior to 2000.