India initiated economic policy reforms in mid-1991 in response to a fiscal and balance of payments crisis. While the Centre has undertaken a series of reform measures ranging from trade to industry to investment, India’s state governments have yet to implement a wide array of reform measures in order to attain high rates of state domestic product growth.

Reforms have mainly concentrated at the Central level. India has to free up its state governments sufficiently so they can add dynamism to the reforms. Greater freedom to the states will help foster greater competition among them. The state governments need to be seen as potential agents of rapid and salutary change.

While healthy competition is evident among the three southern states of Andhra Pradesh, Karnataka and Tamil Nadu, the rest of Indian states are yet to begin competing with each other. Brazil, China and Russia are examples where regional governments have taken the lead in pushing reforms and prompting action by the Centre. In Brazil, Sao Paulo and Minas Gerais are the reform leaders at the regional level. In China, it is provinces on the coast and farthest from Beijing that lead. In Russia, reform leaders in Nizhny Novgorod and the Russian far east have been major spurs to reforms.

India’s overall growth rate can be substantially stepped up should the Centre decentralize economic policymaking and allow states to make crucial economic decisions on their own. Crucial fiscal, infrastructure and regulatory decisions on economic management remain at the central level. Essentially what this Centralized system of governance implies is that the states have little jurisdiction in, or control over, policy and regulatory decisions that would make them more attractive to prospective foreign investors.

A gradual process of decentralization has begun because regional political parties have been lending support in the formation and running of the government at the Centre. This is a healthy development. Greater decentralized decisionmaking will lead to greater competition among states and, therefore, to higher efficiency and productivity in these regions. Coalition governments in New Delhi made up of regional parties from different states exercise great influence in policymaking at the Centre.

Policymaking at the sub-national level is essential in order for state governments to follow development strategies suitable to their socio-economic, cultural and geographic characteristics. Coastal states, say, can follow a more focused export led growth strategy. States with lots of trained manpower, such as information technology professionals in Tamil Nadu or Karnataka, can stress the infotech and service sector.

Reforms at the state level in India have been slow moving for several reasons.

First, limited decentralization of decisionmaking has meant states lack the authority to formulate and implement policies that are under the control of the Centre. Second, unlike the Centre, the state governments do not have sufficient institutional back up. Third, due to the rapid turnover of
state governments, these governments are governed by short term political considerations. Chief ministers change frequently, leading to policy discontinuity, since 1967 chief ministers have been in office an average 2.65 years. Uttar Pradesh has seen 27 governments in 44 years. Fourth, populist policies have been preferred over harsh reform measures. So subsidies on rice, urban transport, water, electricity and so on are pursued to advance the political interests of the party in power.

A few Indian states have been more reform oriented: Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. Analyzing 15 major state based on the progress of state level policy reform, one finds these 15 states can be divided into three categories of reformers on the basis of a number of indices including state domestic product growth, foreign direct investment, industrial investment proposals, software exports and other variables.

The first category is the reform oriented states. These include Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. Then there are the intermediate reformers: Haryana, Orissa and West Bengal. Finally are the lagging reformers of Assam, Bihar, Kerala, Madhya Pradesh, Punjab, Rajasthan and UP.

Real annual average growth rates of per capita gross state domestic product bear testimony to the fact the reform oriented states are also the fastest growing states in India in the post-reform period. Interestingly, among southern states, in Karnataka and Tamil Nadu per capita incomes began to surge and exceed the national average since 1991-92. On the other hand, the lagging reformers, Bihar, Madhya Pradesh, UP and to a certain extent Orissa, have lagged far behind the all India average in this and growth of state domestic product per capita.

With the initiation of economic reforms in 1991 the role of private investment has acquired a great deal of significance. States are now in competition with one another to attract private investment, both domestic and foreign.

Investments tend to be skewed in favour of a few regions. State level data on FDI approvals between 1991-97 and domestic investment proposals and disbursal of funds for investment between August 1991 and December 1996 suggest again that the relatively fast moving reformers have tended to attract higher investments. The secretariat of industrial approvals, under the Union ministry of industry, says the southern states accounted for more than 34 per cent of the proposals approved in 1998. In the period January-December 1998, a total of 428 approvals were given for investments in Karnataka, Tamil Nadu, Andhra and Kerala.

Western India, accounting for 21 percent of the total approvals throughout the country, follows the South. This investment is in Gujarat, Maharashtra and Goa.

On the other hand, northern and eastern states are far behind, except for Delhi. Gujarat has a small population, but receives over a fifth of private investment proposals. Bihar, with a tenth of India’s population, barely managed five per cent of such proposals. Maharashtra and Gujarat account for 37 per cent of total investment proposals. Bihar, Madhya Pradesh, Orissa, Rajasthan and UP together were able to attract only 26 per cent of such proposals.
From August 1991 to December 1996 the bulk of investment proposals were concentrated in states with a relatively high level of human development and to the detriment of states which have a low level of human development.

The cumulative share of financial assistance disbursed by national financial institutions during 1991-96 indicates a big gulf between the less developed and more developed states. Maharashtra alone received almost as much financial assistance as Bihar, Madhya Pradesh, Orissa, Rajasthan, UP and West Bengal put together. Bihar and Orissa have shares of financial assistance that are adversely disproportionate to their respective population shares.

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