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Review Article

Understanding The Poor Socio-Economic Investment Performance of Bihar: A Micro Perspective

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Abstract

This paper investigates the underlying causes of poor economic growth of Bihar, India, despite being endowed with relatively rich natural resources. Against the conventional view, the analysis reveals that poor economic growth is not due to a particular factor but an outcome of a myriad of social, economic and political factors rooted in structural, historical and macro-economic policies. The economic marginalization of Bihar began in the colonial era through the establishment of an exploitative landlord class, which constantly resisted economic and social development even after independence in 1947. The process of marginalization has further been reinforced by the federal central government's policy of 'freight equalization', which nullified the comparative advantage of Bihar in natural resources by subsidizing railway freights of industrial inputs like coal, iron ore, steel, cement and other bulk resources. This, combined with relatively low financial resources received from central government over the consecutive plan periods, has undermined these states' capacity to invest in health, education, and other social and physical infrastructure and resulted in low human development. The poor performance of Bihar may be attributed to low human capital, weak institutions and poor infrastructure coupled with political instability and social conflict rooted in sectarian politics based on caste, class and ethnic division.

***Keywords**:Economic Growth,Resources Endowment,Government Policy,Institutions, Bihar, India, Social*

INTRODUCTION

India has experienced impressive economic growth since the 1990s. Its growth patterns, however, are uneven. While some states like Maharashtra, Punjab, Haryana and Gujarat are growing by 7–10%, others, particularly Bihar have lagged behind. Bihar is the least developed states in India. With economies that are still mainly agricultural, is categorized as low economic performers or BIMARU ('sick' in Hindi) states (Ahluwalia, 2001), though recently Bihar's economy has made a remarkable improvement which will be discussed below. Industry and service sectors are still nascent in these states. Per capita state domestic product is very low at Rs5465 in Bihar (rupees), much less than the national average of Rs11 936. Bihar's per capita state domestic product is less than one-third of Maharashtra's. One out of three of India's 400 million poor live in Bihar.

Bihar is lagging behind in socio-economic condition compared with the national average. Paradoxically, Bihar is endowed with better natural resources and agroclimatic conditions than most other Indian states. Most of Bihar is part of theGangetic plains with fertile alluvial soil. Besides the river – the Ganges – a large number of smaller rivers originating from the Himalayas flow through this region to meet the Ganges. High rainfall, along with the melting of snow from the Himalayan Mountains, feeds the Ganges and its tributaries with water during the dry season and provide a perennial source of irrigation to large areas in Bihar. This water and the silt from the Himalaya make the soil fertile and suitable for agriculture, fishery, livestock and forestry. Bihar is also rich in mineral resources and forests. More than 40% of India's coal, 32% of its bauxite, 59% of its copper, 17% of its iron ore, about 80% of its silver and 60% of its mica comes from Bihar. UP is also rich in mineral resources. Such an ample rich resource base would lead to one to expect that Bihar would be relatively well-off compared with other states of India. Unfortunately, this stateseems to be caught in the trap of underdevelopment.

Bihar pose a serious development challenge not only for India, but also for the global community because India's achievement of Millennium Development Goals (MDGs) will be difficult unless poverty is reduced substantially in Bihar. To design policies and strategies for accelerating economic and social development in Bihar, it is vital to identify the underlying factors that have stalled development there. While huge efforts have been made to document the diverse patterns of economic growth in India, little systematic work has been done to understand the factors that contributed to different growth patterns within the country. The focus has often been on micro-issues overlooking the broader structural and policy matters that shape the patterns of development. This paper explores the factors responsible for low levels of economic development in Bihar from a macro-perspective. The purpose of the paper is not to identify the determinants of economic growth and quantify their role or testing hypothesis of any growth model, rather it is to understand what conditioned the economic growth and social development by looking at different strands of thought from an historical perspective. The contribution of this paper is therefore descriptive, aimed at a deeper understanding of social, political, economic and historical context that shaped the speed and path of socio-economic development of Bihar.

Factors influencing economic growth: a conceptual framework

The reason that different countries – even different regions within a country – achieve different levels of economic growth has been the focus of enquiry since the beginning of modern economics. The search for the drivers of national wealth can be traced back to the 1700s to the writings of physiocrats who believed that agriculture was the lone source of production; and that an increase in the productivity of agriculture increases the wealth of a nation. Adam Smith, David Ricardo and other classical economists considered land, labour and capital as the key factors of production and the major contributors to a nation's wealth. The followers of classical economists such as Gallup, Sachs, & Mellinger (1999), Ding & Field (2005) and Stijns (2005) consider resource endowment (i.e., natural wealth, land, soil, weather, climate and mineral resources) as the primary basis of agriculture and industrial growth. The differences in resource endowment among the different countries and regions lead to differential rates and levels of economic growth. While there is general agreement that natural resource endowment is important for economic growth, there is a debate among scholars about whether this alone is the determining factor. The extent to which resource endowment contributes to economic growth depends upon how well the resources are managed. A large number of empirical studies show that though resource endowment may stimulate growth in the short run, abundance of natural resources can be also a 'curse' as it often fails to sustain the growth in the long run as the state is often unsuccessful indeveloping the strong governance institutions and market mechanisms needed to harnessing the resources in an efficient, equitable and sustainable way.

In contrast to classical economists who consider natural capital as the prime basis for economic well-being, neo-classical economists consider human-made capital as the engine of economic growth. They argue that it is not the abundance of natural resources, but technology, investment, capital formation and savings that drive the economy. They contend that for sustained economic growth, productivity needs to be maintained through constant improvement of technologies and increased capital investment. As investment is a function of capital formation and savings of a nation, the growth differences between the countries and regions, therefore, are primarily due to the differences in the rate of savings, capital formation, technological progress and investment.

The neo-classical approach, however, failed to appreciate the policy and institutional environment under which savings, capital formation and investment take place. Institutional economists argue that investment is not a function of savings and capital formulation alone but also depends on the institutional environment – things like property rights, macro-economic management and rule of law that can either support expectations of profit or undermine them. In North's well-known words, institutions are 'the rules of the game' that can shape economic behaviour either in a way that stimulates economic growth or in a way that makes economic players risk averse and reluctant to invest.

Factors responsible for low levels of development of Bihar Structural factors

- High population and low skill

While skilled human resources are a driving force for economic growth, a balance between population and economic growth is essential for the manpower to be absorbed by the productive sector. The population density of Bihar is more than double (800 and 690 persons/km2 respectively) the national average of 329 persons/km2. People are an asset when they are skilled enough to take the existing opportunities or create new opportunities through innovation and entrepreneurship. However, a large section of the population in Bihar has remained unskilled and poorly educated. Due to the absence of a dynamic non-farm or industrial sector in Bihar, the growing low-skilled population has created tremendous pressure on the agriculture sector. The percentage of agriculture workers in Bihar has increased from 41.8% of the economically active population in 1971 to 48% in 2001. while in India as a whole the proportion of agricultural workers in the overall workforce has declined from 31.4% to 26.5% in the same period. As the agriculture sector has limited capacity to absorb the additional labour force, the extra hands have failed to contribute to agriculture production, in what is referred to as disguised unemployment.

Due to high poverty, inequality and a poor education system resulting from low investment and poor governance, the education and health condition of Bihar ispoor. Vocational training has also been inadequate leaving the vast majority of the rural workforce unskilled and engaged mostly in agriculture. Many have been forced to migrate to other states for seasonal or long-term work. Thus, the large population could not contribute to economic growth.

- Weak agrarian structure

Bihar is primarily agricultural states with about 80% of their population living in rural areas and depending on agriculture directly or indirectly. Land, the primary basis of agriculture, and social and political power have remained in the hands of the elite class. Although some efforts were made in land reform, the elite class frustrated them as it went against their economic and political interest.

While large landlords still control vast expanses of land, agriculture generally remains in the hands of small holders and tenants. Tenants who have low levels of savings and who must share the harvest with landlords have little capital to invest in agriculture and less incentive to do so because of their insecure property rights. The landholders, who have the capital, have little interest in investing because agriculture is not their prime occupation and most of them live in towns and cities. As a result, private investment to increase agricultural productivity has remained suboptimal. The situation has been further exacerbated by low investment by the public sector in building physical and economic infrastructures, as explained below.

- Poor physical and economic infrastructure

Like private investment, public investment in agriculture in Bihar has remained inadequate. Per hectare capital expenditure in agriculture in Bihar is less than one-fourth of that of Punjab and less than half the national average.

Bihar have not made enough investment in irrigation infrastructure. Only 50% of agricultural land is irrigated in Bihar, compared with 90% in Punjab and 87% in Gujarat. Owing to poor public infrastructure for surface water and increased water stress, farmers of Bihar have shifted to ground water irrigation as in the case of other states. There was a huge surge in the 1980s in Bihar in ground water irrigation. This, however, did not yield higher productivity because the poor electricity supply and sharp increase in diesel prices increased the costs of irrigation, land preparation and threshing. Fertilizer and pesticide prices also increased substantially. Yet, while input prices had increased significantly, the output price of agriculture remained almost stagnant. Thus, the output–input price ratio changed and reduced profitability. To keep the farming remunerative, the states of Punjab, Haryana, Gujarat, Maharashtra and Karnataka provided concessions in electricity and diesel prices. The Bihar government, however, could not provide such concessions to farmers due to financial constraints. In addition, most of the farmers in Bihar are not able to receive the price incentives given by central government through food grain collection owing to small land holdings and littlesurplus. Bihar's food grain yield is lower than the national average and less than half of Punjab's (Government of India, 2007).

Low public and private investment, poor physical and institutional infrastructure, unequal land distribution, poor agrarian social structure including persistence of feudal elements not only hindered the growth of productivity in agriculture but also reinforced social inequality that creates structural barriers to the overall development of the society and economy.

- Governance and institutional factors

Well-functioning institutions, good governance and strong leadership play critical roles in economic development. Bihar is rated as the most poorly governed states of India (World Bank, 2005). After independence in 1947, Bihar was ruled by the high-caste elites with strong economic and political power. Since the dominant political parties failed to respond to their needs and demands, so-called lower castes and ethnic minorities began to organize themselves in the 1970s under socialist leaders. This led to the alignment of political forces on the basis of caste and ethnic identity. As a result, several parties emerged in UP and Bihar to represent caste and ethnic interests of less powerful groups. Although this has changed the political landscape of Bihar and the parties representing discriminated caste and ethnic groups have won elections in Bihar, sectarian caste-based politics have failed to improve government performance in terms of economic growth. Caste-based politics in Bihar promoted an electoral culture that locks in votes for candidates based on caste, regardless of their competence or performance. The conflict between the so-called 'backward' and 'forward' castes has been an ongoing phenomenon in Bihar since the independence of the country.

Macro-economic factors

- Transfer of resources from the centre to the states

The Indian Constitution divides government functions and financial authority between the central and state governments. Central government provides financial support to state governments through different mechanisms, such as the finance commission, planning commission, allocations to line ministries for centrally funded programmes and through special projects implemented by central government and additional central assistance. Bihar has been receiving less per capita allocation from the centre for development expenditure than any other of the states. Until the 7th Plan (1990), Bihar received less than half the national average allocation. Although in the 8th Plan Bihar received slightly higher per capita resource allocations, they still received much less than the all-India per capita average. After the 8th Plan, allocations to Bihar was once again reduced. Bihar received less than half the all-India average.

If the planned allocation is compared with the developed states such as Punjab, Haryana, Gujarat and Maharashtra, it is clear that Bihar has been systematically deprived of funds. In the 1st Plan, Bihar planned allocation was less than one-fourth of Punjab. This pattern has continued for almost the entire plan period. Contrarily, Gujarat, Maharashtra and Haryana received per capita allocation of more than double that of Bihar during the entire plan period.

Because Bihar has relatively undeveloped industry and services sectors, the fiscal resource base of the state is relatively small. Moreover, their low administrative capacity has weakened the ability of the state to collect revenue. Bihar was not even able to manage the matching funds required for centrally sponsored development programmes. The weak administrative capacity has also led to low utilization of development funds in Bihar. For instance, in the 8th and 9th Plans Bihar's utilization rate of all development funds was less than 50% (Saxena, 2007). In spite of the greatest need for development assistance from the centre, Bihar has the lowest resource utilization rate in India (Saxena, 2011). The unused funds in Bihar are transferred to more efficient states. Moreover, since resource allocation partly depends on resource utilization capacity, Bihar received relatively low per capita allocations. This has resulted in a vicious circle starting from a low fiscal resource base, leading to low resource capacity to attract matching funds, low absorptive capacity, low investment, poor infrastructure, low human resources leading once again to low private investment and low fiscal resource base.

- Industrial policy

Bihar was famous for textile handloom and spinning. During the early 19th century, about 20% of the state's population was involved in spinning and other industrial work. However, due to the British policy of discouraging cottage industries and the promotion of indigo cultivation, these industries employed only 8.5% of the state's working population. This declining trend continued even after independence.

The government policy of 'freight equalization' introduced in 1952 further marginalized Bihar. Under this policy, railway freight rates for industrial inputs like coal, iron ore, steel and cement were structured in a way that would ensure that they were available at the same price in all parts of the country through government subsidies. The impact of this policy is distributed unevenly. While this policy helped some states of the south and west to build industries with raw materials sourced from Bihar and UP at subsidized transport costs, it neutralized the benefits of proximity and comparative advantage of Bihar in establishing locally available mineral resource-based industries. While coal and other natural resources available in Bihar and other eastern states were made available inexpensively to other parts of India, other industrial inputs available in other parts of India were not included in the freight equalization scheme, such as petroleum products. This policy negated the comparative advantages of Bihar's mineral resources and affected industrial and economic growth through dynamic loss of forward and backward linkages (Mukherji & Mukherji, 2012). For instance, the Tata group decided to invest in Bihar because of its natural advantage of minerals but changed its decision after the introduction of this policy. Even after withdrawal of the policy, industrial agglomeration bias continued. Engineering industries were established in areas closer to markets or elsewhere where better infrastructure was available or there were other financial incentives or benefits.

While the freight equalization policy was cancelled in 1992, Bihar had already fallen behind and in addition they continued to be constrained by an unfriendly investment climate arising from weak physical and social infrastructure and poor governance. While state–business relationship has improved significantly since the mid-1980s in most states of India, it deteriorated in Bihar. The poor economic environment brought about by conflict and poor governance reduces the security of property rights, increases costs and the risks in investment. It drives investors to safer places and quick-earning activities. As a result, private investment in Bihar is only 2.68% of gross state domestic products, while the average is 16.45% in major 14 states.

Foreign direct investments (FDI) has remained negligible in Bihar. Bihar has received only 0.10% of national FDI since 1991 to 1998. While per capita FDI is Rs5019 in Maharashtra, in Bihar it is only Rs89 and in UP Rs289 (Government of India, 2007). Because of its proximity to Delhi, UP should have attracted much more investment from the private sector. However, private investment is also much less in Bihar due to weak physical and economic infrastructures together with social and political instability and poor governance.

Conclusion

Bihar is classic examples of how a rich natural resource-based economy can be caught by a low-level equilibrium trap. This study analysed the underlying causes of low levels of development of Bihar. The analysis revealed that a host of interacting factors ranging from social and economic to historical and political directly or indirectly influenced the development path and pace of Bihar. The causes of poor economic performance of Bihar can be traced back to British colonial policy that not only created an intermediary exploitative class through Permanent Settlement, but also destroyed local knowledge-based industries that provided livelihoods to many urban and rural artisans.4 This policy also frustrated agricultural growth by strengthening the elite feudal class and creating landless agricultural workers. Moreover, it increased the pressure on agricultural land by transforming industrial workers to agricultural labourers. This has not only retarded the agricultural and industrial growth but also created an unproductive class that has been constantly resisting the economic and social development as the tsar and landlord class opposed industrialization in Russia in the early 19th century. This policy has also created a political ethos of class-based resentment that has damaged the trust essential for being able to act together in the collective interest.

First, Nitish Kumar's government made an attempt to give development aspirations to all sections of society including low caste and ethnic minorities and practical measures have been taken to improve the quality of governance, including law and order, an increase in the efficiency of administration, the curbing of corruption, as well as increased development funds from the centre – all have contributed significantly to bring confidence and enhance development effectiveness. Law and order have improved recently; the efficiency of the judiciary in terms of the disposal of cases has increased; and the effectiveness of bureaucracies, including law enforcing agencies, has increased, all of which have helped to increase confidence of citizens and enhanced the development effectiveness of government. This has created favourable conditions for investment and growth. This process was further facilitated by the increased resource allocation by central government. Due to increased funds from central government, Bihar's planned development expenditure has increased from Rs12 billion in 2002 to Rs160 billion in 2009. More than 6800 km of roads have been rebuilt and some 1500 bridges and culverts have been constructed or repaired in the last five years.

The present economic growth of Bihar supports the findings of this study that improvement in governance, effective administration and large investments are major stimuli of economic growth. The findings of this study offer some important insights into the economic literature that often considers economic growth as a function of selected parameters. This finding also supports the views who considers economic growth to be a dynamic process that depends on resource endowment, social structure, institutional arrangements, economic policies, and environment and technological and human resource development. The result suggests that a holistic analysis that focuses not only on individual choices but also on social structure, caste, class, institutions and historical factors is necessary to understand the sources of economic growth.

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