CH-13 - THE 'OTHER INDIA'S': TWO ANALYTICAL NARRATIVES (REDISTRIBUTIVE AND NATURAL RESOURCES) ON STATES' DEVELOPMENT

I. Introduction

- As a result, they have also been a greater focus of policy and research attention in comparison to other states- the so called 'Other India's'. These states include not just hinterland India (the India of rivers) but also the India of forests, of natural resources, and of 'Special Category' status.
- This chapter is devoted to those states that have not been at the mainstream of India's development narrative. But the analysis is conducted through the lens of broader development experience.
- Successful Peninsular India has offered three interesting and different models of development:
    - The traditional East Asian mode of escape from development based on manufacturing (Gujarat and Tamil Nadu);
    - The remittance-reliant mode of development exemplified by Kerala;
    - The distinctive, "Precocious India" model based on specializing in skilled services (Karnataka, Andhra Pradesh and Tamil Nadu
- Other states have been relatively less successful, and perhaps because of that have received less attention. But they are interesting in their own right because they have conformed to other models of development.
- This chapter studies two such models of development:
    - Those based on "aid" or special status,
    - And those based on natural resources.
- The definition of natural resources includes coal, onshore oil and natural gas, major and minor minerals but excludes forest cover. Large forest covers can also lead to a **"forest curse"** but is not analyzed in this chapter.
- The "aid" model is most applicable to the erstwhile 'Special Category' states that includes North-eastern states and Jammu and Kashmir; the natural resources model to Jharkhand, Chhattisgarh, Odisha, Gujarat and Rajasthan.

II. Impact of Redistributive Resources

- At the time of India's independence, most economists held a straightforward view of development. According to this view, developing countries were poor because they lacked capital. And they were unable to overcome this problem themselves, because their people were too poor to save. So the key to development, the only way to solve the conundrum, was foreign aid. There was only one possible exception to this rule. Countries with vast amounts of mineral resources mine and sell them, allowing the proceeds to be invested in physical or human capital. But all others were doomed to rely on aid.
- India was never completely convinced of this paradigm. For many years, it accepted aid, but tried to rely on its resources as much as possible, with the aim of winding down its aid dependence as quickly as possible.
- Why? One hypothesis is that aid perpetuates resource dependency, in the sense that since

their institutions more generally. And it is institutions, tax revenues, and incentives that have been found to be critical for growth, much more than overall resource availability.

- Another potential downside of aid is that it could trigger "Dutch disease", named after the impact that discovery of natural gas in the North Sea had on the domestic economy in the Netherlands. This windfall caused the real exchange rate to appreciate as the extra income was spent domestically, pushing up the price of non-tradeables, such as services geared to the local economy. The higher prices for services then eroded profitability in export and import-competing industries, de-industrializing the economy, with the share of manufacturing in the economy falling. Similar effects have occurred in Canada, Australia, Russia, and Africa.
- Despite these international examples and the lessons of India's own experience with foreign aid, when it comes to development within India, the country has followed the path prescribed by the first development economists. It has provided extensive transfers to certain poorer states in an attempt to spur their development.

III. Redistributive Resource Transfers: Evidence from Indian States

- State governments up to now have received funds from the Centre via different channels: (i) a share of central taxes, as stipulated by Finance Commissions; (ii) plan and nonplan grants; and (iii) plan and non-plan loans and advances. These funds constitute "gross devolution to states" and the entire amount is not "aid".
- Gross devolution entails a strong **redistributive element**. Certain state-specific characteristics (captured in the 'Special Category' status) have determined whether some states are more dependent on such transfers, and particularly concessional assistance (grants).
- The 'Special Category' states have been heavily dependent on such flows for their developmental needs vis-à-vis other states. However, redistributed resources from the Centre differ from traditional "aid" in two important aspects.
    1. These are intra-country transfers and do not augment overall national disposable income like foreign aid does;
    2. The donor recipient relationship is also very different because states benefiting from transfers are part of national governance structures that determine them.
- This chapter utilizes the concept of **'Redistributive Resource Transfers' (RRT)**.
    - RRT to a state is defined as gross devolution3 to the state adjusted for the respective state's share in aggregate gross domestic product.
    - Thus RRT is not identical to gross devolution. This adjustment is made to ensure that only the portion of resources devolved to the states over and above their contribution to Gross Domestic Product is included as RRT.
- The definition of RRT excludes the impact such transfers have on expenditures undertaken by state governments. It is also essential to note that any redistribution that might occur directly by the Centre's spending is also excluded.
- The top 10 recipients are: Sikkim, Arunachal Pradesh, Mizoram, Nagaland, Manipur, Meghalaya, Tripura, Jammu and Kashmir, Himachal Pradesh and Assam (all 'Special Category' states).
- Poorer states receive the highest transfers, exactly as one would expect. However, despite such flows over the past few decades most of the high RRT recipient states (excluding Himachal Pradesh and Uttarakhand) are at lower levels of per capita GSDP.
- Some of these states have significant catch-up to do vis-à-vis the average. These states also spend less on average on consumption. There are some notable exceptions. Nagaland and Mizoram, in particular, have significantly larger-than-average per-capita GSDP and

consumption. Also, Jammu and Kashmir has relatively high consumption for a state receiving significant RRT.

- Has RRT helped states perform better? The results are striking. The higher the RRT:
    - The slower is growth.
    - The smaller is the share of manufacturing in GSDP.
    - The lower is own tax revenues.
- What about the quality of overall governance? If one looks at Transmission and distribution (T&D) losses in the distribution of power can be taken as a reasonably robust indicator of governance. Such losses reflect the quality of both infrastructure and institutions in a given state. In this section, a slightly broader concept - the aggregate technical and commercial (ATC) losses (capturing commercial losses over and above technical losses and power theft that get captured in T&D losses as per cent of net power input energy) - is taken to define the index.
- All of this suggests there might be an "RRT curse". But suggestion is far from proof.
- To get a reliable estimate of the effect of RRT, one needs to separate out that part of these transfers that is unrelated to economic outcomes considered in this chapter (growth, manufacturing share, fiscal effort) and governance. One way address this issue is to identify an instrumental variable (IV) for the explanatory variable (i.e. RRT) which is strongly correlated with RRT but not with economic outcomes or governance. The impact of RRT on each of the variables of interest can then be estimated using the IV regression.
- Larger RRT inflows seem to have no positive impact on per capita GSDP growth, and may negatively impact manufacturing share, fiscal effort and governance.

IV. Impact of Natural Resources

- There is another way that the original development view has been overturned. Initially, economists saw natural resources as a way out of the low saving-low capital development trap. But with the benefit of hindsight it has become clear that economies with abundant natural resources have actually tended to grow less rapidly than resource scarce economies.
- As with foreign aid, the negative association between resource abundance and growth poses a conceptual puzzle. In the literature, three possible channels of causation have been identified.
    - First, the exploitation of natural resources generates rents, which lead to rapacious rent-seeking (the voracity effect) and increased corruption.
    - Second, natural resource ownership exposes countries to commodity price volatility, which can destabilise GDP growth.
    - Finally, natural resource ownership – like foreign aid -- makes countries susceptible to "Dutch Disease".
- While most of the research concerning resource curse effects is pursued in a cross-country set up, it is intriguing to employ the framework for the states of India, which are heterogeneous in terms of their natural resource endowments, especially mineral wealth.
- This approach seems particularly fruitful, since some Indian states were bifurcated in 2000 – Chhattisgarh was split off from Madhya Pradesh, Uttarakhand from Uttar Pradesh, and Jharkhand from Bihar. In this process, mineral wealth was reallocated in favour of the newly created states creating a natural experiment that can be studied profitably.

V. Natural Resources and Evidence from Indian States

- Mindful of this bifurcation, the analysis utilizes two time periods (1981-2000 and 2001-2014), to discern the impact, if any, of the "resource curse" on the new states. For this analysis the key variables are the same as identified in the earlier section on RRT.
- The value of minerals is the sum total of fuels (coal, lignite, crude petroleum [onshore only] and natural gas), all metallic minerals, non-metallic minerals as well as other minor minerals. As per this definition the mineral resource rich states are: Jharkhand, Chhattisgarh, Odisha, Rajasthan and surprisingly Gujarat.
- One way to motivate the impact of natural resource availability is to estimate whether populations in mineral rich areas have emerged out of poverty better than other areas. To this end, poverty trends for the mineral-rich states with other states is contrasted between 1993-94 and 2011-12, the latest year for which NSSO data is available. At first blush, the mineral rich states seem relatively successful. Their poverty ratio fell by around 31 percentage points over nearly two decades, compared with 28.5 percentage points in the other states.
- Viewed from a different perspective, however, the mineral states seem less successful. The gains were not passed on equally to all sections of the population. In particular, the Scheduled Tribes (ST) population of the mineral-rich states, which actually forms the predominant population in these areas, saw only a 17 percentage point decline in poverty, smaller than the 22 percentage points fall in the other states.
- It is clear that resource-rich states, especially Jharkhand, Chhattisgarh and Odisha (with the exception of Gujarat) are at low levels of per-capita GSDP, with low levels of monthly per-capita expenditure. The negative relationship is being driven by the top four mineral rich states Jharkhand, Odisha, Chhattisgarh and Rajasthan.
- If the development experience of the resource-rich Indian states is really characterized by a "resource curse", an important indicator of the same will be a decline in the share of manufacturing in GSDP (the “Dutch disease”). The relationship between the value of resources and the average share of manufacturing to GSDP, it is observed that the relationship is, once again, rather weak.
- Another indicator that can identify **resource curse** is the extent of fiscal effort made by respective states (captured by the share of OTR in GSDP as in the earlier section), which is expected to decline over time in the wake of excess reliance on non-tax revenue from natural resources. As expected, figure 10a shows that for the period 1981-2000, the relationship is mildly negative. Once again, the result breaks down in the more recent period (2001-14).
- There is no evidence that resource value has a negative impact. Interestingly, a resource rich state, viz. Chhattisgarh (apart from Gujarat), seems to be doing above average on governance.

Based on the above, there seems to be no concrete evidence either in favour or against a "resource curse" in the context of Indian states. The results are, however, relatively strong for levels of per capita GSDP and consumption.

With regards to manufacturing share and governance, even though there is no negative correlation, it must be emphasized that there is no strong positive relation either. This implies that the resource rich states need to bolster efforts to counter any possible downsides of a "resource curse" that may emerge in the future.

As is clear from the diagrams above, despite significant resource endowments, some states, most prominently Gujarat, has performed better than average on many indicators.

VI. Conclusion

Infrastructure and Connectivity: It is, of course, possible, that the "RRT curse" and "natural resource curse", to the extent they are valid, could be a result of poor connectivity in particular and poor infrastructure - physical, financial, and digital in general that most of these states suffer from. This is clearly true of the north-east but also true of many parts of resource-rich India. Enhancing connectivity - financial and physical - on a war footing (as the government has attempted for financial inclusion with the Pradhan Mantri Jan Dhan Yojana (PMJDY), expediting the optical fibre network, etc.) will have a moderating effect. However, despite the above observations some simple but important policy recommendations can be considered.

A. Redistributive Resource Transfers

- In sum, it seems as if the new view of development economics may be right. There may well be some version of the phenomenon referred to internationally as the “aid curse”.
- If so, how should this view inform policy? Clearly, the answer cannot be to dispense with RRT altogether, since in a federal system the Centre must play a redistributive role: it will always have to redirect resources to under-developed states. Rather, the Centre will need to find ways of ensuring that the resources it redistributes are used more productively.
- There are, in fact, a number of factors that can be taken in the account while determining the quantum and architecture of redistributive resource flows to the states. In the spirit of cooperative federalism these proposals can be suitably modified to address the priorities and concerns of various states. For example:

Redirecting flows to households: One possibility would be to redirect a certain portion of RRT and channel the resources directly to households as part of a Universal Basic Income (UBI) scheme. As chapter 9 shows, targeting issues plague existing development interventions and transfers directly to households could eliminate some of these problems.

Conditioning transfers on fiscal performance: Another possibility would to find ways to offset the fiscal bias uncovered by the above analysis, in which higher resource flow leads states to relax their own tax effort. Perhaps future Finance Commissions could revert to the practice of the 13th FC of conditioning transfers on the tax effort of states; in fact the weightage could be even greater than suggested by the 13th FC.

Making governance- contingent transfers: Given that some high RRT recipient states have performed better than others, it is possible that the capacity of states to utilize funds optimally plays an important role. To encourage better governance and sound institutional practices, the fund transfer mechanism could explicitly include a few monitorable institutional indicators as criteria for receiving transfers.

B. Natural Resource Revenues

To ensure that the revenue from minerals are utilized for the development and welfare of the citizens of the concerned states, the Mines and Minerals (Development and Regulation) Amendment Act, 2015 included the following in the Act:

• Establishment of a trust, to be called the District Mineral Foundation (DMF) for districts affected by mining related operations.

• The composition and functions of DMF are to be prescribed by the respective State governments. The foundation shall work for the benefit and interest of persons affected by mining related operations.

One way to increase citizens’ participation is via creation of a dedicated Fund to which all mining

state as trustee for the people – including future generations. Therefore, the revenue from the natural resources should be saved in a non-wasting asset- in a Permanent Fund. The real income accrued by the Fund can be redistributed to citizens affected by and having a stake in the extraction of the resource.

The proposal to create a Fund at the district level in laudable and is a recognition of the state being cognizant of the possible ill-effects of a "resource curse" at some point in future.

An alternative structure would be to redistribute the gains from resource use directly into the accounts of the concerned citizens as part of a UBI. However, to make this income transfer effective and to make the citizens feel invested in the management of the resources, the state could impose a nominal tax on the post - UBI disposable income of citizens and use this revenue for development purposes. Correspondingly, it is also likely that this arrangement (UBI and tax) may lead to citizens having a more benign view of taxation, since they will see the social contract as tangibly affirming their wellbeing.