ECONOMIC DEVELOPMENT OF BACKWARD AREAS

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"Free Enterprise was born with man and shall survive as long as man survives."

—**A. D. Shroff**

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INTRODUCTION

Recently a Committee appointed by the Government of India to look into development of small-scale industries in backward areas has recommended the setting up of a separate authority for this purpose. The Committee noted : "In spite of a number of incentives, which have been given till now and the infrastructure support, it is a matter of deep concern that most of the industrial development that has taken place in our country since Independence has been concentrated round a few metropolitan areas and large cities." In this situation, it is but natural that people living in underdeveloped areas where there is little or no industrial development should aspire for rapid industrialisation of those areas also. In this context, the Forum of Free Enterprise presents an analysis of the subject by Mr. D. R. Pendse who has made an in-depth study of the problem of balanced regional development. This booklet gives relevant excerpts from a note by him which was published in full by "Financial Express", Bombay. Mr. Pendse is Economic Adviser to the House of Tatas but the views expressed are his personal views.

ECONOMIC DEVELOPMENT OF BACKWARD AREAS

By

D. R. Pendse

(I)

During the last decade or so, there has been a considerable growth of literature on regional economics. Much of the analytical framework of regional economics is derived from the theories of location of the firm and from international trade theory, both of which are concerned with the geographical distribution of economic activity. Regional economics thus started as a special case of these two more general theories.

The **laissez-faire** orientation of these theories was clear. Just as economists in favour of unrestricted international trade had argued that in due course it would maximise production and consumption in the different nations; similarly, economists had pleaded that economic forces will themselves achieve in due course an equilibrium in which the standards of living of people in the different regions will be equalised. Very crudely put, the argument was that as more and more industries were set up in a developed region, the costs of setting up additional industries in the same region would tend to increase and in due course it will be cheaper for entrepreneurs to set up industries in the less developed regions; as a result of this process, industries will inevitably disperse to relatively lesser and lesser developed regions. It cannot be denied that the industrial growth of Poona and its environs in the last two decades is at least partly an illustration of the element of validity in this view-point. Government intervention for achieving a balanced development of different regions within a country was, therefore, not favoured. It was pointed out that a deliberate policy of trying to develop depressed regions and restraining the growth in prosperous ones by carrots or by sticks, would amount to rewarding the inefficient and penalising the efficient units, and thus it would inflate costs of final products.

The popularity of these viewpoints has receded considerably over the years. The experience of a number of developed nations has shown that either there is no such automatic movement towards equalisation among different regions, or, at any rate, it is far too slow; and democratic Governments cannot ignore the political and social pressures for quicker remedies. Again, encouraging successful business from more advanced areas to set up branches in depressed areas is neither a reward for inefficiency, nor does it discourage enterprise. Success and failure have to be evaluated in terms of the social benefits resulting from an economic activity. A less profitable venture providing employment in a depressed region may be more desirable than the investment being made in an already advanced and, very likely, overpopulated area.

Another factor which these theories did not take into account was technological advance. There are several instances where areas booming with particular industries suddenly become depressed when due to technological advance these industries become obsolete. The usual illustration given in this behalf is that of the coal mining areas in Britain, which became depressed as new sources of power developed. In Maharashtra, a striking example is provided by Kolhapur, the home of the very active diesel engine industry, which became very much depressed sometime ago as a result of rural electrification and what not. In view of the infrastructure and the capacities available, a relatively smaller dose of conscious Government policy can yield quicker results in such regions.

Thus, the need for an active Government policy to achieve a balanced regional development according to a planned pattern seems now to have been generally accepted by most economists. However, the tasks that befall the Governments of developed and under-developed countries in achieving this objective differ materially. In developed countries, the main problem is of acute unemployment in areas already endowed with the needed infrastructure and human skills. In the country as a whole, there are adequate financial resources and the problem is mainly of redistributing or canalising these resources. Measures such as capital grants, subsidies, tax rebates, concessional finance, etc., therefore suggest themselves readily in such situations.

In under-developed countries the problems are usually much more formidable. There is neither infrastructure, nor employment: and human skills and financial resources are both equally scarcc. The only favourable factors, and that too, not in all under-developed countries, are the good mineral, water or forest resources—all yet to be exploited. It is in this sense that, it is said that in under-developed countries the problem of regional development is not so much a problem of industrialisation, as it is one of backwardness itself.

But several compelling factors have induced Governments of many under-developed countries—not excluding India—to launch programmes aimed at balanced regional development. First and foremost, is of course the awareness that continued regional disparities can cause socio-economic and political tensions. Secondly, judging from the experience of the advanced countries, the percolation effects of imbalanced development to subserve the cause of social justice have been found to be slow. Faster development in terms of macro-growth rates takes too long to result in providing employment for the vast population of the country, in augmenting the supply of mass consumption goods and in achieving social justice. Moreover, high growth rates without regard to balanced development would result in accentuating, rather than bridging, the disparities of income and consumption. Governments of underdeveloped countries, therefore, now believe in tackling the problem where it originates, viz., in the backward regions. Thirdly, in countries like India, whose regions enjoy a vast and diverse geography and excellent natural resources, policies for regional development may actually help resource endowments being more fully exploited, which in turn may favourably affect the growth rate. Finally, the sharply increasing land values and wages in developed urban regions tend to increase costs of production and prices.

These and several other factors have brought issues of balanced regional development to the forefront and have made it a major objective of economic policy in many countries. Regional planning has already been adopted in centrally planned economies like the USSR and Yugoslavia, and also in France since 1962. However, in view of the utter paucity of resources—financial, technical and human—most developing countries have had to fall back on a selective programme. This is best done by first undertaking surveys of the development potential of the backward regions and then evolving a hierarchy of regions and selecting for initial action those areas where, with given doses of these scarce resources, there are chances of better and quicker yields. Once planned development on these lines has proceeded for some time with the help of public investments, private investments come on the scene and carry the task further. The yields from the initial public investments also help the Governments to shift their attention to the areas next in the hierarchy.

(II)

EXPERIENCE IN OTHER COUNTRIES

Almost all countries of the world, even small ones like Belgium, have a problem of regional development in the sense that there is a significant and long-lasted disparity in the prosperity of the different areas of a country. While the problem was not new, the need to adopt conscious and integrated policies for regional development was not really felt until after the Second World War, when popular opinion brought pressure on Governments to carry out such integrated policies.

Britain: In Britain, regional policies have perhaps a longer history than that of national planning for economic growth. As far back as the 1930s, the need was felt for legislation to aid "special areas" or "development areas". This was a result of a general decline in certain industries like cotton textiles, and coal mining in the 1920s and 30s, resulting in a drastic fall in employment in Lancashire, the North-East, Scotland and particularly Wales. The main emphasis was on bringing work to the workers, rather than helping workers to move.

It is an objective of Government policy in Britain that population should be maintained or increased in development areas, and an area which is losing population rapidly by emigration is deemed to be in need of assistance to maintain its population. This is complementary to the policies for moving industry away from areas with severe labour shortage and heavy congestion.

Among the policy tools used for the purpose may be mentioned : (a) controlling industrial expansion in areas of low unemployment, (b) subsidizing capital costs of firms moving to and operating in development areas, (c) subsidizing labour employed in development areas, and (d) improving infrastructure of these areas to make the area more attractive both for industries to be located and for people to live in.

The Town and Country Planning Act of 1947 made it obligatory for any new industrial building above a certain exempted size to obtain an Industrial Development Certificate (IDC) from the Board of Trade. This helped to regulate the location of plants in the already concentrated areas. But the carrots are numerous. These include a new 100 per cent free depreciation allowance allowed to companies in development areas within the first year, in place of the old system of direct cash grants for new investment. Then, there are special building grants of varying percentages up to a maximum of 45 per cent in the hardest core special development areas and these alone cost annually about £ 30 million to the Exchequer. Special grants on plant and machinery range upto 22 per cent. Cheap-rent or rent-free Government built factories are made available, often built to an industrialist's own specification, making the Government the largest industrial landlord in the country. In some cases, grants to meet a part of operational expenses are paid to newly-moved companies, covering upto 30 per cent of the total salary and wage bill for three years.

Yugoslavia: An example in an altogether different political and economic context is provided by Yugoslavia, which, though a socialist federal State, seems to rely predominantly on methods and policies of indirect inducements and restrictions. One of their regional policies would be of particular interest to us: Like India, a special feature of Yugoslavia is that the economically backward regions of the country are richly endowed with natural resources. But these natural resources often require enormous initial capital investments. The result is that there have been too many projects chasing too meagre funds for investment. A system, therefore, came to be developed there under which the more developed regions of the country assist the less developed ones in accelerating the latter's rate of economic and social development. A special Federal Fund has been created for the purpose. The Fund consists of an annual contribution amounting to 1.55 per cent of the Yugoslav GNP. Allocations for loans to the various development regions are made out of this Fund. But these allocations are not in the nature of outright donations; rather, they are limits up to which loans can be made. In each individual case of a project, loans are sanctioned by banks after analysis of the relative merits of the various applications. This to some extent introduces the principle of economic efficiency into the development schemes for backward regions.

Brazil: The most interesting aspect of Brazil's regional policies is its emphasis on "decentralised concentration". When backward regions are vast and widespread, the policy-maker has to choose between scattering industries all over or concentrating them in selected compact backward areas. Some concentration is implicit in any regional policy, e.g., if, say, five industrial units are allowed to be set up in one backward taluka, when the other equally backward talukas in the same district have none yet, the policy-maker is tacitly endorsing such concentration. An obvious merit of such "decentralised concentration" is that the infrastructure created in an area is more fully exploited. A more conscious policy of such concentration would aim, first at trying to identify such potential "growth centres" and then at providing the best infrastructure possible, so as to attract a cluster of industries.

In Brazil, we see a striking example of what such policies can achieve. The concept of decentralised concentration has been incorporated in Brazil's national plan. Brazil was endowed with abundant untapped natural resources, but faced at once with (a) a growing intensity and size of rural migration to urban areas, (b) growing regional disparities, and (c) acute scarcity of investible funds in relation to the requirements of infrastructural development of a vast country. Therefore, the country used its public funds for investment in strategic growth centres for the provision of infrastructure adequate to attract private investment in relatively short gestation projects, thus initiating the process of self-sustained regional economic growth. The presumption of course is that in a growth centre, public investment in infrastructural development, and private investment in economically efficient enterprises will support and sustain one another. The long highways across Amazonia State in the North-East of Brazil, or improved port facilities or new energy supplies and hydro-electric projects are some cases to illustrate the public investment in infrastructure.

To finance these public investments, a certain percentage of the gross federal revenue is reserved for the promotion of development in the backward areas. Take the example of the North-East of Brazil which in the 1950s was a depressed and declining area with a backward technology, a decreasing *per capita* gross product and accelerating migration of its best elements to other areas. In 1958, SUDENE (the office of the Superintendent for the Development of the North-East) was established.

SUDENE area enjoys exemption from Income-tax for the first ten years for industries established with the approval of the SUDENE, as also an exemption from various taxes levied by the State and Municipal authorities. There is further an interesting provision. Any Brazilian enterprise can deposit upto 50 per cent of the amount of its federal income-tax in a restricted account of the Bank of the North-East of Brazil (BNB). (This is in addition to the tax-incentive which the different States in the North-East offer to industry). The tax payer can then invest these funds in an industry or he can use them to purchase shares in new industrial and agricultural enterprises or in existing ones that are being expanded; if this option is not used in three years the funds revert to the national treasury. Alternatively, he may even remain a passive depositor and let his money be used as a source of cheap investment finance for other enterprises. These funds can be used to provide for 25 to 75 per cent of the proposed investment, depending on how the particular project is rated in accordance with the priorities laid down by the SUDENE. In addition, the BNB can grant loans upto 50 per cent of the balance of the required investment resources. Thus, for a very highly rated project only 12.5 per cent of the total investment required needs to come from the investor's own resources.

This system of fiscal incentives was quite successful in canalising capital resources for investment in the SUDENE area.

Japan : In Japan, the policy of balanced regional development reflects concern more for the problems of over-crowded flourishing areas, than for the economic disparities between the various areas of the country. Growth in the post-war period was largely stimulated by the export-oriented heavy industries and large industrial complexes grew up, especially in port cities. These cities experienced a much higher rate of population growth than the overall population growth rate. The problems visualised clearly were—(a) the deterioration of urban environment, and (b) the adverse effect on the economic efficiency of the industries located in them, and consequently on their competitiveness in foreign markets.

The basic strategy of regional development consists of a programme of removal and relocation of housing and industrial establishments outside the metropolitan areas of Tokyo, Osaka and Nagoye, and the prevention of further industrial and business concentration in these centres. Hence, "adjustment" belts were created around these metropolitan centres to facilitate the dispersion and relocation of population, industry and business from the overcrowded areas, and to cushion off the effect of rural migration to these cities. Beyond these belts are the outermost rings that consist of "developing areas" where new industrial growth points are to be created to act as development agents for the surrounding backward areas.

This approach too has an interesting relevance to the problems which concern us in relation to Bombay City. If the Japanese authorities had merely tried to concentrate on providing better suburban facilities like housing and transport, around the three metropolitan centres, this would have magnified, not eased, the basic problem of overcrowding in these centres by attracting more people and more industries. The problem really was to provide a counter-magnet to these centres, one which would make setting up industries elsewhere more attractive than setting them up in these centres. That is the merit of the Japanese policy of removal and relocation of industries away from these centres, and creating infrastructure and the entire cluster of facilities elsewhere, where not only the further flow of new industries and rural migration will be canalised, but where some of the industries at present located in overcrowded centres will be shifted to.

The problems faced by these four countries in matters of regional development may be different. But they seem to point to two conclusions : The study offers much for us to learn and ponder over. Secondly, whatever policies we adopt, the success cannot much outstrip the financial resources and, more so, the perseverance and the will of the people.

(III)

POSITION IN INDIA

A brief historical review of the Problem in India

In India, the problem of balanced regional development was recognised right from the beginning of planning. The Draft Outline of the very First Five-Year Plan made a reference to the need for reducing regional disparities, although it explained and recognised the difficulties involved in the dispersal of industries.

Throughout the four Plans, balanced regional development has remained one of the policy objectives and though it was recognised that the scope for reducing such disparities was limited primarily due to constraint of resources, it was hoped that as development proceeds, the benefits would extend increasingly to less developed areas. The need for providing infrastructure facilities in the underdeveloped areas was recognised. The concrete measures initiated for removing regional disparities comprised of agricultural and irrigation development programmes, community development and rural works programmes, location of public sector units in backward areas, development of village and small-scale industries by providing all assistance and incentives to them, etc. In particular, the emphasis on development of small scale industries and location of Central projects was continued; in the Fourth Plan, 77 per cent of the total outlays on investment in Central Industrial Projects has been provided for the backward States.

Besides, the National Development Council, as a measure to rectify the inter-regional disparities, modified the criteria for allocation of Central assistance to States in favour of the relatively backward States. The new formula, which provides for setting apart 10 per cent of the central assistance for States whose *per capita* income was lower than the national average, benefited certain States like Bihar, Kerala, Madhya Pradesh, etc., Besides, a special pattern of assistance to Hill Areas was introduced under which 90 per cent of the Plan outlays in Hill Areas in Assam, Jammu &

Kashmir and Nagaland was agreed to be given as grant and 10 per cent by way of loans. In addition, another special pattern of assistance in the form of 50 per cent grant and 50 per cent loan in the proportional assistance for the Hill Areas of Uttar Pradesh, W. Bengal and Tamil Nadu was introduced.

Identification of Backward Areas

It was during the formulation of the Fourth Plan that the growing imbalances in industrial development of different States and regions of the country came to surface. Therefore, at the instance of the National Development Council, the Planning Commission in 1968 set up two Working Groups; the first, under the Chairmanship of Mr. B. D. Pande, (then Secretary to the Planning Commission), was to recommend objective criteria for the identification of backward regions which would qualify for special treatment and the other, under the Chairmanship of Mr. N. N. Wanchoo (then Secretary, Department of Industrial Development), was to recommend the fiscal and financial incentives for setting up industries in backward areas.

The Pande Working Group reported in February 1969. It advocated a selective approach. Thus, it first selected some States as "Industrially backward States" and then suggested criteria to select backward districts only in respect of each of these "backward States", which would qualify for special treatment by way of incentives. The distinction was made between the industrially backward States and others on the ground that the former had neither industries nor resources of their own to grant suitable incentives and they did not receive adequate support from financial and banking institutions. After using a number of economic indicators like total *per capita* income, *per capita* income from industry and mining, number of workers in registered factories, *per capita* annual consumption of electricity, length of surfaced road and railway mileage in relation to the population and the area of the State—as the criteria—, it concluded that only six States, viz., Andhra Pradesh, Bihar, Madhya Pradesh, Orissa, Rajasthan and Uttar Pradesh, whose aggregate percentages were lower than the national average, and Assam, Jammu and Kashmir and Nagaland, owing to their special problems of backwardness, should qualify for special treatment.

It also indicated detailed criteria for selecting backward districts in these States and had suggested that these States would be requested to furnish data for three to six such districts. It finally recommended that only 20 to 30 districts, among those for which data would be supplied, may be selected for grant of special incentives during the Fourth Plan period. In substance, the approach of the Pande Committee was very selective.

The Wanchoo Working Group, while reviewing the earlier promotional measures, made two significant observations, viz: (a) Very few small-scale industries had been established in backward areas, despite various incentives and their growth has been concentrated around a few metropolitan cities; and (b) despite the establishment of a number of large-scale projects in some of the backward States like Bihar, Madhya Pradesh and Orissa, the object of overall balanced development was not met. In other words, the percolation effect had been insignificant and the rest of the States remained broadly as backward as before.

Among its recommendations were these: (a) Instead of a very massive and widespread programme, a suitable concentrated programme at 2 or 3 selected growth points in every State may be drawn up. These growth points may be selected on the basis of potential for development and additionally new townships at 2 carefully selected centres, with an attached Industrial Estate, (on the pattern of Faridabad) may be created; (b) Delicensing should be favoured particularly for a location of industry in backward areas; but so long as licensing continues, preferences should be given to the setting up of viable schemes in the backward areas; (c) Special incentives and facilities should be given in the matter of fixed assets, i.e., supply of developed plots, built-up accommodation, machinery and equipment, etc.; (d) Fiscal incentives like higher development rebate to industries set up in backward areas, transport subsidy, exemption from payment of import duties, excise duties, sales tax, corporation tax, etc. may be granted.

The Committee of the National Development Council considered these two reports—the Pande and the Wanchoo report—and, contrary to the Pande Committee's recommendations, decided : (a) that financial incentives offered by institutions should be made available to backward areas of all States; (b) that financial and credit institutions will formulate suitable criteria in consultation with the State Government and the Planning Commission to identify such backward areas requiring incentives; and (c) that Central Government should grant subsidy of 1/10th of the total fixed capital of investment projects in two districts in each of the 9 industrially backward States and in one district in the remaining States and Union Territories. Thus, the recommendations or both the Pande and the Wanchoo Groups, were considerably diluted at the hands of the NDC when it settled down for the purpose of formulating new policies.

We must never lose sight of the obvious fact, that in the last analysis, policies for balanced regional development aim at developing the lot of the *people* in the backward areas; the focus is, and must always be on the people, and not on the areas. To take an extreme case, it is always possible to come across areas which are practically uninhabited because of the extremely unfavourable geographical, physical or economic factors, (like, say the valleys of Sahyadri, or the deserts of Rajasthan). All statistical criteria will show such areas as the most backward, and the most poor. But it would be nothing short of being absurd to identify these areas as eligible for incentives for dispersal of industries and to pour vast resources to create infrastructure in such areas! It would be much more practical perhaps in such cases to take up a rehabilitation programme for the few unlucky inhabitants of these areas. The acute shortage of financial, managerial and technical resources, and the need to accelerate the industrialisation process quickly are constraints which we have to reckon with. Therefore, in drawing up plans for regional development it is of utmost importance not to let pre-mature enthusiasm get the better of a mature balancing of social costs and social benefits.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

—**Eugene Black**

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