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ECONOMIC REFORMS AND REGIONAL INEQUALITY IN INDIA

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ABSTRACT

India's economic reforms, launched in 1991, raised national growth rates and reduced poverty, yet they were followed by widening differences between states. This paper reviews the evidence on regional inequality in India, drawing on published studies, state income data and official poverty estimates. It finds that the post-reform period witnessed divergence in per capita income across major states, with the southern and western states and a few northern states pulling ahead while Bihar, Uttar Pradesh, Odisha, Madhya Pradesh and Assam remained behind. Private investment, foreign investment and bank credit flowed toward states with better infrastructure, skills and governance, while the dismantling of industrial licensing and the freight equalisation policy removed earlier mechanisms that had favoured backward regions. The paper concludes that reforms raised the level of growth for most states but also magnified initial differences and it recommends targeted public investment, fiscal transfers linked to need and improved state capacity in lagging regions.

KEYWORDS: Economic Reforms, Regional Inequality, Divergence, States Of India, Convergence and Poverty

1. INTRODUCTION

Before 1991, India's planning system included instruments intended to spread industry across regions: industrial licensing, freight equalisation for steel and cement, public sector investment in backward areas and a system of central transfers. The 1991 reforms dismantled most of these controls. Licensing was largely abolished, trade and foreign investment were liberalised and financial markets were deregulated. The central government's role in allocating investment declined, and location decisions passed largely to private firms.

Neoclassical growth theory suggests that poorer regions, with lower capital per worker and higher returns to capital, should grow faster and converge toward richer ones (Barro and Sala-i-Martin, 1992). Yet economic geography and cumulative causation arguments suggest the opposite: market liberalisation can concentrate activity where infrastructure, skills and agglomeration economies already exist (Myrdal, 1957). Williamson (1965) and Kuznets (1955) proposed that inequality may rise in early stages of development before falling. India's post-reform experience offers a test of these competing ideas.

2. OBJECTIVES OF THE STUDY

1. To examine trends in regional inequality in per capita income across Indian states before and after the 1991 reforms.
2. To review the evidence on convergence and divergence.
3. To analyse the channels through which reforms influenced regional patterns, including investment, credit, infrastructure and fiscal transfers.
4. To assess differences in human development and poverty outcomes across states.
5. To suggest policy measures to promote balanced regional development.

3. DATA AND METHODOLOGY

The study is descriptive and review-based. It uses secondary information from the Central Statistical Office, the Planning Commission and its successor NITI Aayog, the Reserve Bank of India, the Census of India and published academic studies. Inequality is discussed using ratios of state per capita net state domestic product (NSDP) to the national average, the ratio between the highest and lowest income states and the coefficient of variation, a standard summary of dispersion. Poverty comparisons use Planning Commission estimates based on the Tendulkar committee methodology for 2011-12.

4. TRENDS IN REGIONAL INEQUALITY

The growth turnaround of the 1980s and the acceleration after 1991 were not uniform across states. Studies by Ahluwalia (2000), Bhattacharya and Sakthivel (2004) and Dholakia (2003) found that per capita incomes diverged in the 1990s. States such as Gujarat, Maharashtra, Karnataka, Tamil Nadu, Haryana and Kerala recorded relatively high growth, while Bihar, Uttar Pradesh, Madhya Pradesh, Odisha and Assam grew more slowly. Rao, Shand and Kalirajan (1999) likewise reported evidence of divergence in the post-reform years, while earlier work found at best weak convergence. Divergence continued into the 2000s, though a few formerly lagging states, such as Bihar, Madhya Pradesh, Chhattisgarh and Odisha, recorded faster growth in the second half of the decade, a recovery that began from a very low base.

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Table 1: Per Capita NSDP of Selected States Relative to the National Average
(approximate, India = 100)

State	1990–91	2011–12	Direction
Punjab	150–160	115–125	Relative decline
Haryana	130–140	150–170	Rise
Maharashtra	130–140	135–145	Stable or modest rise
Gujarat	110–120	125–135	Rise
Tamil Nadu	105–115	125–135	Rise
Kerala	90–100	125–135	Rise
Rajasthan	80–90	80–90	Stable
Uttar Pradesh	75–85	50–60	Relative decline
Odisha	70–80	65–75	Stable to slight decline
Bihar	55–65	30–40	Relative decline

Sources: *Central Statistical Office, state domestic product series; Ahluwalia (2000) approximation. Indicative values.*

The table shows that the poorest large state, Bihar, fell further behind the average, while the better-performing states widened their lead. By around 2011–12, the per capita income of the richest major state was roughly four to five times that of the poorest, up from around three times in the 1980s. The coefficient of variation of state per capita incomes rose over the period, a pattern documented in the literature.

5. CHANNELS OF DIVERGENCE

Investment and the end of licensing. Under licensing and freight equalisation, new capacity could be directed toward backward states and public sector steel, mining and power projects were located in eastern and central India. After 1991, firms chose locations on commercial grounds, favouring ports, large markets, skilled labour and reliable power. Private investment proposals concentrated in Maharashtra, Gujarat, Tamil Nadu, Karnataka, Andhra Pradesh and Delhi and its surrounding region.

Foreign direct investment. FDI approvals and inflows were heavily concentrated in a handful of metropolitan regions. A small number of states typically received the majority of the total, while many lagging states received minimal amounts.

Bank credit. The credit-deposit ratio in several eastern and central states remained far below that in southern and western states, meaning that savings mobilised in lagging regions were partly lent elsewhere. This weakened local capital formation, although priority sector lending norms partly offset the effect.

Infrastructure and governance. Differences in road density, electrification, ports, urbanisation and state administrative capacity affected the ability of states to attract investment and use funds well. States with stronger public finances were able to invest more in infrastructure and human capital.

Fiscal federalism. Finance Commission transfers and centrally sponsored schemes were progressive in formula, favouring poorer states, yet could not match the scale of market-driven private investment flows. Fiscal reforms and the Fiscal Responsibility and Budget Management Acts also narrowed the capacity of some states to borrow for development spending in the early 2000s.

Sectoral shifts. Growth after the reforms was led by services, notably information technology, finance and business services, which locate in urban, skill-rich regions. Agriculture-dependent states with limited urban centres benefited less. Kochhar et al. (2006) emphasise that India's growth pattern favoured skilled-labour-intensive services over labour-intensive manufacturing, with implications for regional spread.

6. HUMAN DEVELOPMENT AND POVERTY

Poverty declined in all major states, but at different rates. The national poverty ratio under the Tendulkar methodology fell from about 37 per cent in 2004-05 to about 22 per cent in 2011-12. State differences remained large: Kerala, Himachal Pradesh, Punjab and Goa had very low poverty, while Chhattisgarh, Jharkhand, Odisha, Bihar and Madhya Pradesh retained high levels. Deaton and Dreze (2002) show that although poverty fell, inequality within and between regions also rose in the 1990s, and that social indicators such as health and schooling progressed unevenly.

Table 2: Poverty Ratio in Selected States, 2011–12

State	Poverty ratio (%)	Relative position
Goa	5	Very low
Kerala	7	Very low
Himachal Pradesh	8	Very low
Punjab	8	Very low
Gujarat	17-21	Near national average
Odisha	33	High
Bihar	34	High
Jharkhand	37	High
Chhattisgarh	40	Highest among major states
India	**22**	

Source: *Planning Commission, Press Note on Poverty Estimates 2011-12; rounding figures*

The states with high poverty are also those with lower literacy, weaker health indicators and higher infant mortality, showing that income and human development gaps reinforce each other. The Raghuram Rajan Committee (Government of India, 2013), which constructed a composite development index based on ten indicators, placed Odisha, Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh, Assam, Chhattisgarh and Jharkhand among the least developed states and recommended that central funds be allocated by a formula combining need and performance.

7. EVIDENCE ON CONVERGENCE AND DIVERGENCE

Table 3: Selected Studies on Regional Inequality in India

Study	Period	Main finding
Cashin and Sahay (1996)	1961-91	Slow convergence, weak role of transfers and migration

Rao, Shand and Kalirajan (1999)	1965-95	Evidence of divergence in later years
Ahluwalia (2000)	1980s-1990s	Growth gap widened in the 1990s; poor states fell behind
Bhattacharya and Sakthivel (2004)	1980-2000	Disparity increased after reforms
Dholakia (2003)	1980-2000	Divergence in economic growth; mixed in human development

Source: *Summary of cited studies.*

The balance of the evidence suggests that the reform decade of the 1990s was characterised by divergence in per capita income, with a weaker and incomplete catching-up by some lagging states in the 2000s. The pattern is consistent with cumulative causation rather than automatic convergence. Ghate and Wright (2012) find that the growth turnaround itself was shaped by initial conditions and policy choices that differed across states.

8. POLICY IMPLICATIONS

Several measures follow from the evidence.

- **Public investment in infrastructure.** Roads, power, railways and ports in eastern and central India raise the returns to private investment there.
- **Human capital.** Better schooling, health and skills improve the ability of lagging states to participate in growth.
- **Fiscal transfers.** A transparent, need-based formula, such as that proposed by the Rajan Committee, could channel funds toward the least developed states without discouraging performance.
- **State capacity and governance.** Improving administration, law and order and the business environment is essential for attracting investment.
- **Credit and financial inclusion.** Strengthening local banking and credit delivery helps keep savings in lagging regions.
- **Special regional programmes.** Area-focused schemes for the eastern and tribal belts can complement general reforms.

9. CONCLUSION

The reforms of 1991 transformed the Indian economy but did not distribute the gains evenly. Evidence from the above mentioned points to widening differences in per capita income among states, driven by the concentration of private investment and services growth in better-endowed regions, partly offset by gradual improvements in some lagging states in the 2000s. Poverty fell everywhere, yet the poorest states remained far behind in both income and human development. Narrowing these gaps requires deliberate public investment, fiscal transfers aligned with need and improved governance in lagging regions, rather than reliance on market forces alone.

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