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# **UTTAR PRADESH - LAGGING STATE OF INDIA: ECONOMIC DEVELOPMENT AND ROLE OF BANKS**

Rashmi Umesh Arora

A thesis submitted in partial fulfilment  
of the requirements for the degree of  
Doctor of Philosophy  
Centre for Development Studies  
The University of Auckland  
2007

## **Abstract**

The present study challenges the negative and static stance of the recent literature on Uttar Pradesh, the most populous state of India, and espouses a balanced and moderate approach. The existing literature focuses only on human development and ignores the underlying social, political and economic changes taking place in the state. It ignores the decline in credit to the state. The present study synthesises and amalgamates various streams of literature on the state to fill the gap. It uses bank credit and its role in UP's economic development as a tool to explore the changes and structural and regional shifts in the state. It examines bank credit to various regions, districts, occupations, rural and urban populations, large and small borrowers and gender in UP. This study explores credit in a multi-dimensional framework as a route to growth, development, inequality, globalisation, urbanisation, and empowerment. The study further explores the relationship between bank credit and the state's human development.

As a critique of the existing literature, the study examines whether UP is really lagging behind other states of India. Through a twin indicator approach, broadly grouped into income and non-income, the study shows that the state does lag on income front. The non-income indicators analysis, however, shows that a number of other states including high-income states are lagging. The study eschews the watertight categorisation of east and west UP as pursued in the existing literature, and adopts a broader regional classification. This showed that, although gradual, change has occurred in UP.

The overall findings of the study suggest that structural and non-structural constraints characterise the development of the state. The multiple roles of credit have generated growth, helped in poverty reduction, but also influenced regional inequality and rural-urban inequalities, and widened the gap between small and large borrowers in the state. The empowerment of women through credit from commercial banks remains a distant goal as women receive less than 20 per cent of the total credit. Another significant finding of the study is that the income and non-income factors are strongly correlated, for instance, the strong negative relationship between income and the Human Poverty Index. The study, therefore, underlines the need for increased economic growth to achieve better economic and human development outcomes.

Keywords: Uttar Pradesh; India; Development, Economic Growth, Bank Credit; Poverty

## **Acknowledgements**

This thesis would not have been possible without the generous support of my employer, Reserve Bank of India, by granting me study leave to complete this research project. I am, therefore, very grateful to my department of economic analysis and policy (DEAP) and particularly to the then Chief Economist and Principal Adviser, Dr.N. D. Jadhav, Mr. M.R. Nair and Dr. R.K. Pattnaik who supported me immensely. I am also grateful to my dear friend of many, many years Asha Kannan who raised my morale at various times through her emails. I also thank Mr. J.R. Majhi and the staff of the regional office of DEAP who provided the datasets on UP. I also thank Dr. B.B.Bhattacharya, the then Director of the Institute of Economic Growth, New Delhi for giving me time from his busy schedule in early stages of my research.

I acknowledge the support and guidance provided by my supervisors, Associate Prof Kenneth E. Jackson and Dr. Christine Woods. I thank them particularly for their patience in bearing the insufferable drafts of the various chapters, which I regularly thrust on them. I also thank my department, Centre for Development Studies and to the Director, Associate Prof Kenneth E. Jackson for granting me generous financial support, which enabled me to travel and attend various conferences, both national and international. I also thank the University of Auckland's Research Office for providing me research grant which enabled me to travel for conference.

The support received from Christine Jackson and other staff in inter-loans section of the library is gratefully acknowledged as their wonderful inter-loan service enabled me to access vast literature on Uttar Pradesh by sitting here in Auckland. Without their help, this project would not have been possible. I also thank my friend, Sally McAra for helping me in many ways particularly in the early stages of my research.

I thank my family, my husband, the guiding star of my life, who through his overzealous support and indefatigable spirit pushed me beyond my comfort zone. This project is because of him. My thanks and immense love and affection is for my two children who kept on relentlessly pursuing progress of my research through their queries. My gratefulness to my parents, above all, is beyond words. It is because of them that I could reach where I am.

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## List of Abbreviations

ADB	Asian Development Bank
ASSOCHAM	Association of Chamber of Commerce & Industry
ATM	Any Time Money
BIMARU	Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh
BJP	Bharatiya Janata Party
BOU	Bihar, Orissa, Uttar Pradesh
BSP	Bahujan Samaj Party
CAGI	Comptroller and Auditor General of India
CII	Confederation of Indian Industry
C/D	Credit/Deposit Ratio
CMIE	Centre for Monitoring Indian Economy
CSO	Central Statistical Organisation
DFIs	Development Financial Institutions
DISE	District Information System for Education
DIT	Department of Information Technology
FCI	Food Corporation of India
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GER	Gross Enrolment Ratio
GNP	Gross National Product
HDI	Human Development Index
HPI	Human Poverty Index
HYVs	High Yielding Variety
IEM	Industrial Entrepreneurs Memorandum
IMF	International Monetary Fund
IMR	Infant Mortality Ratio
IT	Information Technology
NABARD	National Bank for Agriculture and Rural Development
NFHS	National Family Health Survey
NGOs	Non-Governmental Organisations
NOIDA	New Okhla Industrial Development Authority
NSSO	National Sample Survey Organisation
OBC	Other Backward Castes
OECD	Organisation for Economic Cooperation & Development
OUP	Oxford University Press
RBI	Reserve Bank of India
RCH	Reproductive and Child Health
SSA	Sarva Shiksha Abhiyan
SDP	State Domestic Product
SHGs	Self Help Groups
SSI	Small-Scale Industries
UN	United Nations
UNICEF	United Nations Children Educational Fund
UNDP	United Nations Development Programme
UP	Uttar Pradesh
UPERC	Uttar Pradesh Electricity Regulation Commission

UPFRBMA	Uttar Pradesh Fiscal Responsibility and Budget Management Act
US	United States
USSR	Union of Soviet Socialist Republic
WIPO	World Intellectual Property Organisation
WMA	Ways and Means Advances
WTO	World Trade Organisation

## Glossary

Banias	Businessmen
BIMARU	Sick
Chettys	Caste involved in banking and money lending
Dalits	People belonging to lower caste in India
Jat	A caste in North India
Kutchra	A temporary house made of weak materials
Pucca	A permanent house made of strong materials
Sahukar	Businessman
Tehsils	An administrative division of a state in India
Ulta	Opposite
Zamindari	Derived from the word <i>zamindar</i> (feudal landlords) and refers to a system wherein landlords paid revenue to the British rulers

# CHAPTER 1

## INTRODUCTION

*"I had been to other countries - in Europe, Asia and the Middle East - but none of them had provided even half as much variety, or so much to see and experience and remember, as this one State in northern India--".*

Ruskin Bond  
(Government of UP, n.d.-c)

### **1.1 Background of the Study**

The moneylenders were a major feature of the credit system in India in the pre-independence period and even after independence in 1947. The nationalisation of the banks in 1969 was expected to reduce the role of moneylenders, and alleviate the poverty of the masses. Then, in came microfinance, which also promised to end the poverty. In between, the role of the banks, particularly in the less developed regions, was forgotten.

The nineties was a significant decade for the country. The major event of the decade was the introduction of economic reforms in 1991. The reforms led to major policy changes and to some favourable and unfavourable outcomes. Among the favourable outcomes were an increase in economic growth and per capita income, and a reduction in poverty. One of the unfavourable outcomes was the decline in bank credit to many states. This study explores the role played by bank credit in the economic development of Uttar Pradesh (hereafter UP), the most populous state of India.

The decade of the nineties was important not only for the country, but also for the states of India, and UP in particular. The major reasons were: i) economic reforms were introduced in the states including UP; ii) significant political developments took place in UP; iii) rise of *dalits* (refers to low castes among the Hindus); and iv) a shift in thinking on the state's development, from positive to negative. This study challenges this shift in thinking on the state which emerged in the nineties, and espouses a more positive and balanced approach.

## 1.2 Literature on UP<sup>1</sup>

Broadly, three streams of the literature exist on the state. These are: i) studies with focus specifically on UP; ii) studies with a more broad approach, or the inter-state studies; and iii) studies from multi-disciplinary social sciences. These are further grouped into a pre-90 period and a post-90 period.

A common feature in the first and second streams of literature is the unsatisfactory treatment meted out to UP, particularly in the post-90 period. The literatures in the pre-90 period eulogised the state for its agricultural achievement, and urged other states to emulate its agricultural success. In the post-90 period, the literature is static in nature. Both the literatures did not take into account the underlying economic, social and political changes taking place in the state in the post-90 period. Hardly any study emerged on the economic development of the state during this period. The state has been forgotten in terms of serious academic analysis and some of the recent studies on the economic growth and development of the states have even bypassed UP. Despite its strong cultural and political identity, UP currently does not figure in the mainstream analysis, and the success stories of India's current economic growth exclude UP.

### i) Studies with focus on UP

During the nineties and thereafter, the studies exclusively focused on UP moved from their earlier focus on the state's agricultural achievements to focus solely on its human development, including illiteracy and mass poverty (Kozel & Parker, 2003; Parker, Kozel, & Kukreja, 2003; World Bank, 2002). Incidentally, this literature is not only persuasive in tone, but also influential as it finds its place in the various reports of the World Bank, and has mostly emerged from the World Bank projects and other multilateral organisations. In a more recent study Diwakar and Mishra (2006) also examined the social and economic development of UP in terms of deprivation

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<sup>1</sup> Some parts of chapters 1, 4 and 6 of the present study have been published in the paper 'Economic Reforms and Less Developed regions: A Case study of Uttar Pradesh in India' presented by the author (Umesh, 2006) in the 16<sup>th</sup> Biennial Conference of Asian Studies Association of Australia (ASAA) on 'Asia Reconstructed from Critiques of Development to Post Colonial Studies', held at University of Wollongong, Australia from June 26-June 29, 2006. The peer-reviewed paper was subsequently published as part of the conference proceedings and is available at - <http://coombs.anu.edu.au/SpecialProj/ASAA/biennial-conference/2006/Umesh-Rashmi-ASAA2006.pdf>



and inclusive development. The 'rediscovery' of UP in this literature fails to recognise the changes in the state in the following aspects:

- i) decline in bank credit as a consequence of reforms;
- ii) gradual change taking place in the major regions of the state in terms of redistribution, and shift in credit and output, both agricultural and non-agricultural;
- iii) shift in terms of class and caste relations, agrarian transformation, in particular, the political mobilisation of lower castes.

#### ii) Inter-state Literature

In the inter-state studies, even in the most recent one (Purfield, 2006), a sort of inertness prevails, as UP in this literature appears as a stagnant economy. This literature also labelled UP as a 'lagging state' (Chakravorty, 2000; Shand & Bhide, 2000 among others). These studies construed the state as a stagnant economy, not only in relation to the other states of India, but stagnancy emerges even within the state. A number of studies in this group of literature examined the intra-state economic development of UP only in terms of eastern and western UP, and other regions did not figure in their narratives on the state. Thus, these studies from fifties onwards, and even in the nineties, often drew comparisons and contrasts of the physical attributes of eastern and western UP, their agricultural production, availability of irrigation facilities, etc (for instance see N. Bajpai & Volavka, 2005; N. Pant, 2004). Even within these two regions, this literature failed to show the changes that were taking place in agricultural output, usage of agricultural inputs, and changing class and caste relations. Some of the studies within this group did point to the decline in credit in states including UP (EPW Research Foundation, 2004; D. Narayana, 2000; Shete, 2002). Since these studies were at an aggregate level, the treatment of UP in terms of credit was very fragmentary.

#### iii) Multi-disciplinary literature on UP

Another stream of literature in the nineties led by multi-disciplinary social scientists including sociologists, anthropologists, geographers and political scientists, has examined the changing class and caste relations in the state's regions in the agricultural sector. In contrast to the macro approach of other studies, this literature, through the case studies, points towards the agrarian transformation taking place in

the state, and the various forces involved in this transformation including the farmers' movement (Brass, 1995; Hasan, 1995; Jaffrelot, Zerini-Brotel, & Chaturvedi, 2003; Jeffery & Lerche, 2003; Lieten & Srivastava, 1999; Lindberg & Madsen, 2003). It links the change to the political mobilisation of lower castes in the state (C Jeffrey & Lerche, 2000; Kothari, 1998). The increasing involvement of cultivators and agricultural labourers in the non-farm employment is also highlighted by these studies (J. Lerche, 1998, 1999; R. Sharma & Poleman, 1994). Some studies have even considered rapid growth of newspapers and satellite television media as the source of development and change in the state in the eighties and nineties (Roberts, 2003; Stahlberg, 2003). A significant achievement of the state is the increasing involvement of *dalits* and backward castes in politics. Many studies have commented on this aspect of political change (Kothari, 1998; Pai, Sharma, Kanungo, & Mukherji, 2005; Verma, 2004). Incidentally, the *dalits* are also the poorest in the state, economically as well as in terms of human development.

This literature, combined with the political studies on the state, has put developments in the state in a new perspective. It is this literature which sees hope in the state in sharp contrast to the negative approach of the other two streams of literature, the inter-state literature and studies with a focus on UP. This body of literature, however, as with other streams of literature, did not examine decline in bank credit to UP in the post-reform period as it was concerned mainly with the social and political changes in the state.

### **1.3 Role of Banks and Bank Credit in Economic Development**

What are the functions of the banks and how do they assist in economic development? Banks act as the mobiliser of savings and allocator of credit for production and investment. The other functions performed by the banks are supplying transaction and portfolio management services and providing payment services, and are a source of liquidity for the firms. They monitor borrowers, match illiquid assets with liquid liabilities, and integrate credit and liquidity provision functions (Bossone, 2000). Banks boost economic growth by identifying the entrepreneurs with the best chances of successfully initiating new goods and production processes (King & Levine, 1993a) and facilitate long-run investments in the high return projects (Bencivenga & Smith, 1991). Schumpeter (1934) assigned an important role to the banks in economic development:

The banker, therefore, is not so much primarily a middleman in the commodity “purchasing power” as a producer ---- and stands between those who wish to form new combinations and the possessors of productive means. He is essentially a phenomenon of development though only when no central authority directs the social process. He makes possible the carrying out of new combinations, authorizes people, in the name of society as it were, to form them. He is the ephor of exchange economy (Schumpeter, 1934, p.74).

The accumulation of capital takes place through savings and investment. In the developing countries, the role of credit is important as it finances shortfalls in consumption and ongoing production; and helps in expanding production opportunities by permitting socially efficient investments (Burgess, 2003).

Bank credit has played an important role in the UP’s economic growth. It has assisted in the growth of the agricultural and industrial sector. Most of the studies have analysed the role of credit in growth and output. The debate on credit or finance has evolved around growth. The credit or finance-development nexus however, has remained problematic. In the current literature, this is now associated only with microcredit and bank credit is associated with growth. This can be resolved by moving beyond the narrow confines of microcredit.

The studies on UP, the three streams of literature described earlier, did not consider credit decline as an issue in state’s economic development. A less developed region, however, is not just a distinct “patch” (Higgins & Savoie, 1987, p.381) but is a part of the same nation. A decline in credit, to such a region, therefore, not only leads to lower growth and output, but also affects many other indicators of development.

#### **1.4 Structure of Banks in India**

Banks in India are divided into scheduled banks and non-scheduled banks. Non-scheduled banks refer to those banks that are not included in the Second Schedule of the Banking Regulation Act, 1949<sup>2</sup> while scheduled banks are those that are included in the Second Schedule. They consist of scheduled commercial banks and scheduled cooperative banks. The former are further divided into four categories: a) public sector banks (which are classified into nationalised banks and State Bank of India banks); b) private sector banks; c) foreign banks in India<sup>3</sup>; and d) regional rural banks.

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<sup>2</sup> This Act governs the banking sector in India.

<sup>3</sup> The branch authorisation policy introduced in 2005 lays down that foreign banks can open branches/offices in India based on the following criteria: i) financial soundness of the parent bank; ii) rating of parent bank internationally; iii) India’s commitments at WTO; iv) economic and political relations between the two countries; and also a consideration that the home country of the bank should

The current structure of banking in India evolved as an outcome of the development strategies adopted after independence. Though the banks were nationalised in 1969 i.e., after 22 years of independence, Tandon (1990) opined that the origin of this lay in the White Paper of the Government of India on April 21, 1945 on post-war industrial policy. This paper spelt out for the first time the concept of a public sector.

The role of the banks in development in India since its independence, according to the present study, could be outlined in three stages, stage I-1947-1969; stage II-1969-1991; and stage III-1991 onwards. In most of the studies, 1969-1991 is usually labeled as the pre-reform period, and 1991 onwards as the post-reform period, or pre-nationalisation (prior to 1969) and post-nationalisation period (after 1969). The present study describes the three stages i.e., stage I, stage II and stage III as experimental in nature. The role of banks was tested and experimented in each of the three stages in meeting the ultimate goals of economic growth and poverty reduction as various sectoral policies were framed and implemented. Thus, in stage I-1947-1969 when the emphasis was on industrial sector policies and agriculture, it was expected that banks would lend to these sectors. Towards the end of stage I, it was realised that banks should play a more active role in poverty reduction and push the country on the trajectory of a higher growth path. This was, therefore, the experimental stage II - 1969-1991, which began with the nationalisation of banks and many other policies were directed to lead to the above outcomes. The reforms in the banking sector mark the third stage (1991 onwards) of banks' role in India. During this stage, the market-oriented policies were introduced and banks were largely freed from many regulations.

### **1.5 Objectives**

The present study amalgamates and synthesises the different streams of literature on the state and fills a gap in the literature. It amalgamates by examining change as pointed out in the third literature, and regional analysis and human development in the other two streams. The gap in the literature is the absence of an

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not discriminate against Indian banks. The minimum capital requirement is US\$25 million required at the time of opening first branch in India. Request for subsequent branches is considered only when the capital requirements conditions are met. Also foreign banks, as in the case of Indian banks, are required to submit their branch expansion plan on an annual basis.

analysis on the role of banks and credit provided by the banks. The present study fills this gap and examines credit given by the banks, and links it to the changes taking place in various regions of UP. The study perceives UP as a dynamic economy rather than a stagnant one. It examines regions not in a tight straightforward classification of east and west UP, but also includes other regions in its ambit. The present study recognises that changes, as revealed in the third literature (multi-disciplinary), are occurring within the regions. It also examines the relationship between bank credit and the human development in the state. By doing so, the study delineates the role of credit in the state's economic and social development.

The present study explores credit's role in the state with a difference. It is the contention of the present study that the development outcomes of credit vary for different groups of people, regions, and population (rural and urban). It thus relates credit to a set of G-GUIDE indicators where, *G* stands for growth, *G* for globalisation, *U* for urbanisation, *I* for inequality, *D* for Development and *E* for empowerment. By exploring credit as a source of growth, globalisation, urbanisation, inequality, development and empowerment, it examines whether bank credit has played a role in economic growth, globalisation, urbanisation, regional inequality, poverty reduction, and empowerment of women.

The objective of this study is to present a balanced approach to the development of UP. It portrays the state in a more positive light than is being done currently. The study achieves the balanced approach by portraying bank credit in its multi-dimensional role and its influence on many indicators of development in the state. The study also achieves a balanced approach by examining:

- i) an overview of economic development of the state;
- ii) trend in credit in the pre-reform and post-reform period;
- iii) structural change in the state's economy and the role of credit;
- iv) whether the state is really lagging?

### **1.6 Significance of the Study**

The present study is significant as it challenges the existing literature on UP which focuses narrowly on select issues, and is, therefore, acutely oblivious of several other problems related to the state's economic development. The contribution of this study to the existing literature is two fold: i) it adds to the literature on UP and thrusts the state, which is a major large state of India, into the mainstream analysis. The focus

of analysis on UP is important to prevent any further marginalisation of the state in the current academic analysis; and ii) adds to the existing literature on banking in India. The discussion on UP is important as it is a major large state of India with 16.3 per cent of the country's population and is also less developed. By focusing on this state's economic and human development, the present study brings the state into the limelight. To obtain a balanced, unprejudiced and fair representation of the state's development, it is imperative to examine critically the state's existing image of a 'laggard' or lagging vis-à-vis other states of India. This study is significant as it shows that UP is not really lagging and even other more developed states also lag behind on a number of developmental indicators.

### **1.7 Methodology**

The overall approach of the present study is "to keep it simple, get it right and make it plausible" (Solow, 2001, p.112). The study of large states like UP is, indeed, a complex task. Many studies have identified difficulties in a unified regional econometric modeling, particularly for the large developing regions (B. Bhattacharya, Bhanumurthy, Kar, & Sakthivel, 2004). As the following chapter shows, there is a lack of homogeneity in UP, which is marked by substantial intra-state and intra regional disparities. The structural diversity within the state results in not only the differential demand for bank credit from different parts of the state, but also affects the overall structural features of the state. A unified modeling approach, therefore, will not be able to engender discernible results. The intra-state disparity is studied by examining the district level data on credit. The state is organised into divisions, which are divided further into districts (70 at present). These are sub-divided again into *tehsils*, blocks and villages for administrative purposes. The study covers the period 1972 to 2003-04, which includes the pre-reform phase and the post-reform period in 1990s and thereafter.

An option was to conduct the primary survey by identifying selected parts of UP, and see the relationship between bank credit and economic structure. Survey questionnaires such as personal interviews, mail surveys and telephone surveys are used in many studies to assess a more focal response to the research question (Ethridge, 2004). However, this approach would have deprived the present study of the precise picture of different sectors/regions, and the objective is not to explain individual responses. Therefore, the study used secondary data sources.

## 1.8 Limitations of the Study

The study is restricted to credit from commercial banks only and does not consider:

- i) credit provided by development financial institutions (DFIs);
- ii) cooperative banks;
- iii) credit provided by informal sector, and the dislodgment between formal sector and informal sector in the post-reform period; and
- iv) regulatory and supervision issues in the post-reform period.

The present study concentrates only on the commercial banks and does not include cooperative banks, as similar to development financial institutions (DFIs), their share in total credit is small. The DFIs have been defined as institutions promoted or assisted by Government mainly to provide development finance to one or more sectors of the economy (RBI, 2004e). They were promoted to provide direct and indirect finance, by catering to the long-term financial needs of the industrial sector as against the working capital finance provided by the commercial banks. The share of DFIs in total credit disbursed by the financial system has remained much smaller compared to that of commercial banks. During the period 1971 to 2000, the credit by banks formed 3.3 per cent of GDP. In the same period, the credit by DFIs formed only 0.6 per cent and resources raised from the capital market were 0.9 per cent of GDP (RBI, 2002b). In the post-reform period, the share of DFIs has been declining as: i) they no longer enjoy access to funds at low rates of interest from Reserve Bank of India, or subsidised funds from multilateral and bilateral agencies; and ii) the banks have entered their field by providing long-term finance. Hence, it has been suggested that DFIs must convert into banks (RBI, 2004e).

This study also does not examine the credit provided by the informal sector in the rural and urban credit markets, although there are indications that the credit provided by the informal sector in the rural areas has increased in the post-reform period (Ramachandran & Swaminathan, 2001). In addition, the study does not consider the issue of integration of formal sector and informal sector, and its displacement by the formal sector. The importance of recognising and studying the linkages between the two sources of credit has been highlighted by other studies (Aryeetey, 2003). In the Indian case, Reddy (2004) acknowledged that “even with all the deregulation, the formal credit mechanisms are not able to pierce the informal

system” (Reddy, 2004, p.306). The reasons for not focusing on the informal sector, despite its high importance, are prompted by the lack of availability of data, and the enormity of data collection at the primary level.

The study does not deal with the regulatory or supervision issues of the banks. The regulatory issues are important in the post-reform period in view of factors like faster movement of capital, innovations in financial instruments, advances in technology and diversified activities of banks. The regulation and supervision of banks is essential to ensure the stability of financial system.

### **1.9 Structure of the Thesis**

The thesis is set out in seven chapters. Chapter 2 as a background to the study examines the economic development of the state, UP. It describes the state in terms of physical and human capital accumulation, and examines the regional disparities. The chapter also looks into the economic reforms introduced in the state in the nineties, and the outcome of the reforms.

Chapter 3 reviews the literature on development, and explores how the concept of development has changed from capital to human development. This, along with the movement in the literature on capital accumulation and its views on banking, shaped the government policies. With the growth came inequalities and different regions grew differently, so in came the concept of equality for all. This chapter presents a synthesis of this literature. These literatures have all grown during the similar period. The important point to recognise is that these streams of literature have followed the same path. The nineties was the period when friction was between growth and development. The friction was between physical or human development, finance for growth or for development, and regional imbalances or equality for all. The Indian literature has also moved in tandem with the theoretical developments above. The growth literature led to the shift in thinking on banking and the studies emphasised banks’ role in promoting growth. The tensions in the literature at the theoretical level were reflected in policies: whether growth of state or development for all; finance for growth or finance for development; or equality in income or equality in non-income. The studies pointed out that disparity has increased in the post-reform period. It is the tension in the literature, whether finance for growth or for development, which led to the decline in credit in less developed regions.



The fourth chapter examines bank credit in the state in the pre-reform and post-reform period. The chapter explores the role of credit in a multi-dimensional framework or G-GUIDE as termed by the present study. By examining the spread of credit to various regions, districts, occupations, population groups (rural/urban), size of credit (large borrowers/small borrowers) and even gender, this chapter explores credit as a:

- i) source of growth (G);
- ii) source of globalisation (G);
- iii) source of urban transformation (U);
- iv) source of inequality (I);
- v) route to development (D);
- vi) source of empowerment (E);

Chapter 5 meets the third objective of the study that is, to examine the structural change in the state and the role of credit in structural change. The literature, as noted earlier, also suggested the changing inter-regional and rural/urban equations. Probing it further this chapter sets out to answer the following questions:

- i) has the structural change taken place in the state's economy? Is the change in the economy's structure different from that of the rest of the country?
- ii) what has been the role of banks in structural change?
- iii) what is the role of banks in the growth and development of the services sector in the state?

The literature, particularly the inter-state regional literature, labeled UP as a lagging state. Is the state really lagging and an encumbrance? Are not some other large states of the country in a comparable position? How does it project against the faster growth of the country as a whole in the nineties when 'globalisation' has become the keyword? This question assumes special importance in view of the growing dominance of India in world economy along with China. Chapter 6 aims to accomplish the last objective of the study that is, to examine whether UP is really lagging. The questions, this chapter attempts to answer are:

- i) Is UP really lagging?

- ii) What effect does a large state like UP have on the growth rate and development of the country as a whole?

Chapter 7 is the concluding chapter of the study. It draws on the major findings of the study and spells out the policy implications. It also offers a way forward and scope for further research.

# CHAPTER 2

## ECONOMIC DEVELOPMENT OF UTTAR PRADESH

### 2.1 Introduction

Is UP, as the current literature projects, a mass population of illiterates? Why is it that UP, described as, the ‘citadel of Indian civilization’ (J Lerche & Jeffery, 2003) and ‘the heartland of India’<sup>4</sup> has suddenly turned into an uneducated and crass group of people? UP is endowed with ‘unlimited potential’ (Government of UP, 2002), but is often paradoxically called ‘*ulta* Pradesh’<sup>5</sup>. Some of the achievements of the state are highest food grain production in the country, and second highest percentage share in the country’s total road length next only to Maharashtra. This is considerably higher than Bihar with which the state is often clubbed. The share of the state’s urban roads is 20.3 per cent compared to only 7.6 per cent in Maharashtra, and around 2.0 per cent in Bihar. The state also has the highest share of the country’s railway routes.

This chapter examines the economic development of the state, at the aggregate as well as the regional level. The regional analysis assumes special importance, as it is a large and a diverse state, and each region of the state differs from the other economically, socially, culturally and even politically<sup>6</sup>. This variance reflects in the state’s capital accumulation, both physical and human. This chapter evolves around the keywords: growth, development, finance, and regional disparity.

The layout of the chapter is as follows. Section I describes the physical setting of the state. Section II, using the keywords, growth, and regional disparity examines the trends in the state’s economic growth, and inequalities in its regions. The

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<sup>4</sup> This, perhaps, refers more to the location of the state, but could also imply state, as representing in terms of language, religion, culture and politics.

<sup>5</sup> ‘*Uta*’ in Hindi means ‘opposite’. Evidence of this is the reform measures of the state government and the Ayodhya temple controversy, which affects the investment climate and portrays a negative image of the state to the investors.

<sup>6</sup> The three major political parties in the state currently are Bharatiya Janata Party (BJP), Samajvadi Party (SP) and Bahujan Samaj Party (BSP). Congress used to be in power in the eighties. The support to parties is organised according to caste and class (J Lerche & Jeffery, 2003). BJP is popular in the central UP and with the middle class. SP gathers its support from the Other Backward Castes (OBCs) and Bahujan Samaj Party (BSP) is party of the low castes or *dalits*.

economic reforms<sup>7</sup> were introduced in India in the nineties and were initiated in UP as well by its state government. Section III of the chapter focuses on the developments, which took place in the nineties, including initiation of the economic reforms in the different sectors of the state. Section IV explores the financial development of the state. The conclusion is contained in Section V.

## **Section I**

### **2.2 Physical Setting of UP**

Among all the states of India UP is the most heavily populated state with 166 million of the country's population of 1029 million. Its population is more than the population of Japan and many times more the population of countries like Norway, Ireland, Switzerland, New Zealand, Spain and even UK. In the inter-state literature, discussions focus on the differences across the states in terms of their economic and social development. What, however, is rarely discussed is their basic difference in terms of the geographical area and population. UP has only 7.3 per cent of the country's area, but has 16.2 per cent of the country's population. Table 2.1<sup>8</sup> shows the area and population of some states in India. The table shows that there is no clear-cut pattern between the land area and population among the states. Some states have less population, but more land area, and in many others, the share in population is more than their land area. What, however, is striking is the high density of population in UP that is, a large gap between the state's population and its land area. The growth rates, land area and population of the states also do not show any trend. The states with lesser land area than their population have performed better compared to UP, and the states with more land area than their population have not done well in terms of economic growth.

Can, therefore, the limited land area of the state be a source of state's persistent poverty, and low economic growth? In UP the limited land area coupled with the degradation of the land, declining productivity, and the sodification of land (a situation in which the farm land becomes salty and is unfit for cultivation), has reduced the availability of land for the state's economic development. The

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<sup>7</sup> Economic reforms are defined as "altering the framework for economic activity in ways that significantly improve the prospects for economic growth. Anything that helps remove a distortion or reduce the risk of a future economic crisis is a reform" (Krueger, 2005).

<sup>8</sup> To facilitate easy readability for the reader and enhanced presentation, the tables in the present study from chapter 2 to chapter 6 are provided at the end of the respective chapter.

sodification of the cultivable area of the state led to about 1.25 million hectares of land rendered completely barren. The World Bank launched Uttar Pradesh Sodic Lands Reclamation Project in two phases in 1993 and 1999 to reclaim the land affected by sodification. The project has immensely helped the farmers of the state in terms of improved agricultural growth and productivity (World Bank, 2000).

Besides the imbalance in population and state's land area, the other imbalances identified in the state are:

- a) rich in natural resources, but low in industrial development;
- b) large food grain output, but a large number of marginal operational holdings<sup>9</sup> (that is, farm holdings below 1 hectare);
- c) large population (a potential human resource), but a high level of illiteracy;
- d) large development needs, but political apathy (Chibber & Nooruddin, 2004; Dreze & Gazdar, 1997; Pai, 2002; Schwecke, 2003)<sup>10</sup>.

In 2001, in response to the long-term movement in the hill region for the creation of a separate hill state, UP was divided and a new state, Uttaranchal, comprising 13 districts of the hilly region was created. Table 2.2 shows the approximate economic and social impact of the creation of Uttaranchal on the state.

The geographical area of UP after the creation of Uttaranchal reduced to 241 thousand sq km from 294 thousand sq km (Government of UP, 2002). The decline in revenue from tourism in UP because of the creation of Uttaranchal was marginal. The share of trade, hotels, and restaurants in the total state output declined slightly, by around 1.0 per cent in UP after the creation of Uttaranchal. The share of tourism in the hilly regions of UP (as before 2000) was only 0.6 per cent so the potential loss in the

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<sup>9</sup> An *operational holding* is defined as a *techno economic unit* used wholly or partly for agricultural production and operated (directed/managed) by one person alone or with the assistance of others without regard to title, size or location. The holding might consist of one or more parcels of land provided they are located within the country and form part of the same technical unit. The *techno-economic unit* is a unit with technical resources like land, agricultural equipment and machinery, draught animals etc. Holdings used exclusively for livestock and poultry raising or pisciculture are also considered as operational holdings (NSSO, 1991, 1996).

<sup>10</sup>Political apathy or indifference or the lack of concern of the government and its relationship to development has been examined by a number of studies. Chibber and Nooruddin (2004) demonstrated that the political needs take preference over the development needs in their analysis on the relationship between state governments' performance in multi-party and two party scenario and public expenditure. They argued that the performance of state governments like UP and Bihar is lacking due to the existence of multi-parties in these states. Based on this they concluded that the states with two political parties perform better on the development front than the multi-party.

state output due to tourism is not substantial. The reduction in poverty in UP due to the creation of Uttaranchal is estimated by the present study as 5.5 per cent<sup>11</sup>.

Significantly, while a large number of the studies focus on the movement leading to the creation of Uttaranchal (see Mawdsley, 2003), hardly any study has focused on the economic and social impact of the division on UP. Some observations do exist on the benefits of the division to the state's economy. These mostly relate to the anticipation of better governance of the state due to the reduction in its size.

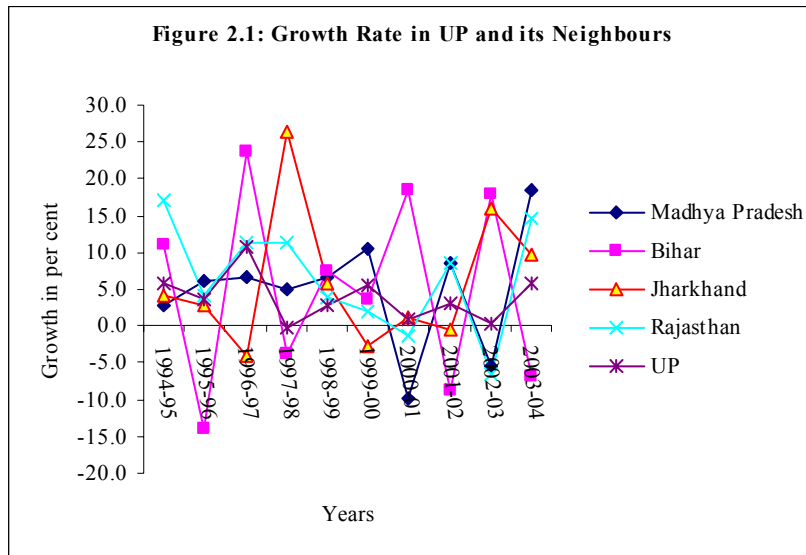
UP is a landlocked state surrounded by other states such as Haryana, Rajasthan, Delhi, Bihar, Madhya Pradesh and Jharkhand, and shares the international border with Nepal. It is far distant from the coastal areas, and the two large cities of the state, Lucknow and Kanpur are away from the sea by 2000-2500 kilometres. The present study finds that the annual average real growth rate of the major landlocked states in India (comprising rich states such as Punjab and Haryana, and other less developed states like Madhya Pradesh, UP and Rajasthan) during the period 1993-94 to 2003-04 was 5.1 per cent. In the coastal states (Maharashtra, Orissa, West Bengal, Andhra Pradesh, Karnataka, Tamilnadu, Kerala, Goa and Gujarat) during the similar period, the real growth rate was higher at 6.1 per cent. This study excluded Punjab and Haryana, the two rich states, from the landlocked states to examine whether their growth rates had influenced the average growth rates of the landlocked states. Excluding them, however, did not change the results.

An issue which has not been explored in the literature on the state so far is the so called 'neighbourhood effect' (Ghura & Mercereau, 2004). A large body of literature exists on the concept of 'neighbourhood effect'. The concept, used extensively in the context of social interaction, examines the effect of neighbours on education, voting pattern, disadvantaged people, housing etc. Do the less developed neighbouring regions of other states such as Madhya Pradesh, Bihar, Jharkhand and Rajasthan detrimentally affect UP's economic growth? Are these states growing in the same direction? Only the western region of UP, which shares border with Delhi and Haryana, is more developed and prosperous. Rest all the regions surrounded by other less developed states are low in development. The 'neighbourhood effect' can be

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<sup>11</sup> The total number of people below poverty line in UP just prior to the creation of Uttaranchal was 52.9 million in 1999-2000. The Planning Commission estimated that the number of people below poverty line in Uttaranchal was 2.9 million in 2000-01. Thus, the reduction in poverty as a result of creation of Uttaranchal works out to 5.5 per cent.

examined by looking into the growth of the less developed regions of other states which surround UP. Figure 2.1 shows the yearly growth rates in UP and its neighbours. It shows that while growth rates in Madhya Pradesh and Rajasthan has been moving, more or less, in the same direction, particularly in the recent years, it is not so in other neighbouring states including UP.



Another question, which arises is, do other developed states of the country such as Maharashtra, Gujarat, Tamilnadu and Karnataka have any effect on UP's growth and development. The present study calls this 'development effect' and the effect of the immediate neighbours of the states (sharing borders with UP) 'the poverty effect'. Is the poverty effect on the state more than the development effect? This study argues that the inter-state barriers in trade (Bhide, Chadha, & Kalirajan, 2005) and political factors such as different regional political parties and their interests, have limited the development effect.

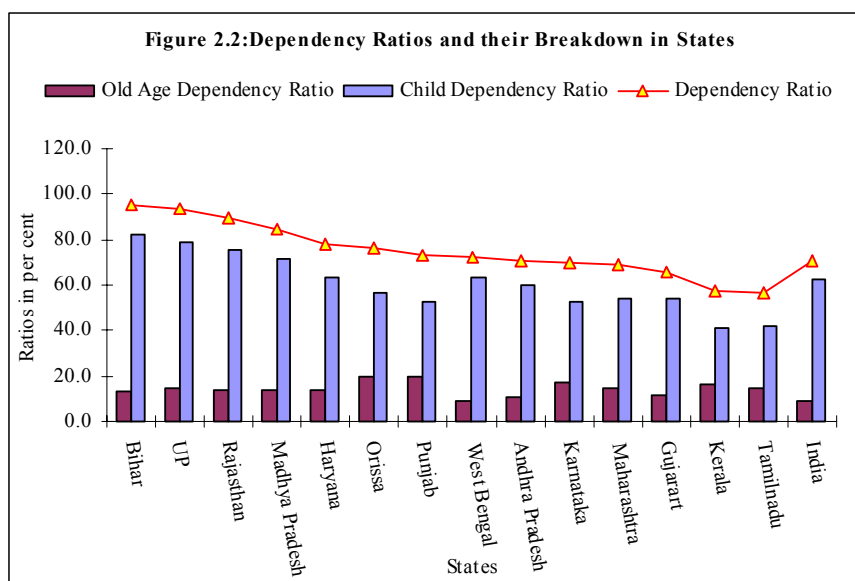
The country, due to decline in the fertility rate and increase in the working age population, is undergoing a demographic change (Planning Commission, 2002c, 2006b). This is projected to have a substantial impact on India's economic growth, provided measures are taken to promote employment (Bloom et al., 2006; Planning Commission, 2002c, 2006b). However, this is still a distant goal for a less developed state like UP, where fertility rate is much higher than the rest of India. Table 2.3 shows the major demographic indicators in UP and India. This shows that the share of the young population (age 10-24) is higher in UP than in all India. The state's active working population (age 15-59) is lesser than that of all India due to its high child

population. The birth rate in the state at 30.2 is highest among all the states, and much higher in comparison to the all India birth rate of 23.2. This is higher in the rural areas in UP at 32.0 as against 26.2 in the urban areas. The death rate in the state at 8.8 is also high compared to the country's death rate of 7.5 and higher than some of the more developed states (Registrar General of India, 2006b).

As mentioned above, the change in age structure of the country's population is expected to have a positive effect on economic growth. However, a different demographic path in the state driven by high fertility implies slower reduction in poverty and lower economic growth (Birdsall, 2001). The dependency ratio of the state, defined as the ratio of dependent population (age 0-14 and 60 and above) to the working age population (age 15-59), as worked out by the present study, at 93.5 per cent is staggeringly high and is much higher than 70.8 per cent of all India.

Dependency ratio and economic growth of the states are inter-related. The states with higher growth rate are associated with lower dependency ratio. For instance, the possibility of such a relationship between dependency ratio and growth rates (shown only for the year 2003-04) can be observed in the Table 2.4 as the states with lower growth rates have higher dependency ratios. The table also shows the dependency ratio further broken into old age dependency ratio and child dependency ratio. Figure 2.2 displays the old age dependency ratio and child dependency ratio for the states. The large difference in the child dependency ratio across the states reflects changing age structure in the country as the old age dependency ratio in Punjab is highest and in Bihar, child dependency ratio is highest. Coale and Hoover (1959) in their seminal study on population growth and economic development of India had predicted that sharp decline in death rate would take place and that the structure of age distribution would be more towards the children (less than 15 years) in the absence of any noted decline in fertility rate. In UP in 2001 child population was 40.8 per cent, similar to the level of all India in 1951 as observed by Coale and Hoover (1959).





This section was crucial to understanding the state’s economy in terms of its physical location in the country, the constraints such as limited land area; neighbouring states and their effects, if any on the state; and high dependency ratio. It is also crucial for understanding the analysis carried out in the later chapters of the study. In the following section, the trends and pattern in the economic growth of UP are examined. Section III looks closer at the changes in the economic policies undertaken in the recent years to accelerate economic growth in the state, also commonly known as economic reforms.

## **Section II**

### **2.3 Growth in UP’s Output**

What does economic growth mean for a less developed state like UP? Growth is known to benefit the poor and result in the reduction of poverty (Dollar & Kraay, 2002). Sustained economic growth for the state could mean reduction in its poverty, higher average income, more employment opportunities, and increased investment. In a narrower context, it signifies a change in the image of the state, moving away from the often ridiculed and derided *BIMARU*<sup>12</sup> group of states to a coterie of developed and fast growing states. It has even been remarked that, had UP’s growth rate been similar

<sup>12</sup> The term ‘BIMARU’ coined by Bose (1988) means sick in Hindi. It has become increasingly popular in the narratives on these states. A criticism of this has been that it focuses only on the low achievers in the northern region of the country and ignores the north eastern states which also face low rates of economic growth, though these states are better performers in terms of human development.

to the country's recent average growth rate, India's growth would be equal to that of China or may be even surpass if the country's current average growth rate continues (G. Bajpai, 2006).

The analysis of growth rates, in this section, is undertaken at three levels: i) growth achieved in the various five-year plan periods; ii) decadal growth rates; and iii) yearly growth rates. The Indian economy before the economic reforms in 1991 was a highly centralised economy in which the Five Year Plans played an important role<sup>13</sup>. In the post-reform period, though the Plans still continue, focus of the five year plans has changed. Noting the change in functions, Planning Commission (2006a) observed that "From a highly centralised planning system the Indian economy is gradually moving towards indicative planning where Planning Commission concerns itself with the building of a long term strategic vision of the future and decide on priorities of nation"(Planning Commission, 2006a).

The average annual real growth rate of UP during the various five year plans is given in Table 2.5. Only during the Fifth (1974-79) and the Seventh Five Year Plan period (1985-90) that is, prior to the reforms, the state's growth rate has equalled or surpassed the country's growth rate. In the post-reform period that is, after 1991 while the country's growth rate has been much higher, the growth rate of the state has lagged considerably behind. The overall growth rate of the state has been very low particularly, since 1997-98 (Table 2.6). During the year 2002-03, the state's growth rate declined by 1.5 per cent, largely due to a decline in the agricultural output<sup>14</sup>.

The low growth rate of the state is a reflection of the growth in the state's agriculture, industry and the services sector. Table 2.7 shows the decadal average growth rate of the three sectors. Of all the decades', growth rate was highest in the eighties while in the nineties, growth slowed down in all the sectors. The two sets of factors, which explain slow growth of the state in the post-reform period, are: i) economic factors; and ii) social and political factors. The economic factors are: tapering of the green revolution effect in the nineties in the western region of the state

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<sup>13</sup> The current plan under formulation is the Eleventh Five Year Plan and relates to the period, 2007-2012. The other Five Year Plans were as follows: First Five Year Plan was for the period (1951-56); Second Five Year Plan (1956-61), Third Five Year Plan (1961-66), Annual Plans (1966-69), Fourth Five Year Plan (1969-74), Fifth Five Year Plan (1974-79), Annual Plans (1978-80), Sixth Five Year Plan (1981-85), Seventh Five Year Plan (1985-90), Annual Plans (1990-92), Eighth Five Year Plan (1992-97), Ninth Five Year Plan (1997-2002) and Tenth Five Year Plan (2002-07).

<sup>14</sup> The state has been facing droughts for the past few years and both the eastern and western part of the state received scanty rainfall in 2002 (a deviation of 65 to 67 per cent from the 'normal rainfall').

(N. Bajpai & Volavka, 2005); decline in investment (Government of UP, 2002) and lack of human capital. The other reasons that explain the state's poor performance are social and political in nature like caste, class and gender relations. Pai (2002) showed that political instability in the state was very high in the state in 1990s and no government was able to complete its term. It was this combination of factors which led to the low growth in the nineties.

## **2.4 Regional Analysis of UP**

Following the aggregate analysis of the state's overall growth and of its sectors, it is logical to investigate the spatial trends and patterns of the growth. However, the data on total state output as derived from state's various regions and districts is not available. The regional analysis of the state, with the help of a number of social and economic indicators, is set out below.

The literature usually classifies the state into four regions: i) western; ii) central; iii) eastern; and, iv) Bundelkhand. The literature has much discussed the physical, geographical, economic, social, and cultural characteristics of these four regions. To understand the reasons for the underdevelopment of the state, it is necessary to explore these characteristics of the regions. The western region is more prosperous (N. Pant, 2004) compared to others. While the central and western regions are fertile, the Bundelkhand region is rocky, and not fit for intensive cultivation. A lot of discussion on the development of UP centres around the eastern and western region, and the central and particularly the Bundelkhand region do not form a part of the mainstream analysis (J Lerche & Jeffery, 2003).

The four regions differed vastly from each other not only in terms of the physical attributes<sup>15</sup>, but historically also were ruled by different rulers. The merger of these regions after independence led to creation of one state. The merger, however, did not lead to a homogenous state and the dissimilarities continued not only associated with their different historical developments, but also in their culture and language. This also perhaps, led to a lack of a UP specific 'identity' or even a

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<sup>15</sup> The regions are classified not only geographically, but also in terms of their physical attributes. Accordingly, the state, before the creation of Uttaranchal could be divided into the Himalayan region in the north: Gangetic plain in the centre; Vindhaya hills and plateau in the South. The Gangetic plain can be further classified into eastern, and central and western regions. The four state physiographic regions of UP are, erstwhile UP-Himalayan region; region between Himalayas and plains; Gangetic Plain and Southern Plateau (Uttar Pradesh, 2007).

language (J Lerche & Jeffery, 2003). This is unlike many other states of the country, such as Maharashtra and Tamilnadu where the identity of people in terms of culture and language is deeply associated with their state. As the regions differ significantly from each other and lack a single state identity, this also led to a lack of a common development objective with regional issues gaining ground over the state as a whole.

The lack of homogeneity in the state is not only inter-regional but also intra-regional. To examine intra-regional disparity, the four regions can be sub-divided further, based on their level of development, such as the central region, excluding Lucknow and Kanpur (two major districts of the state). The level of urbanisation in these two districts at 63.0 and 67.0 per cent is the highest in the state. In the eastern region, both low to high sugarcane cultivation areas co-exist. The regional variation in the state is such that although the entire state produces sugarcane, (except the Jhansi district in the Bundelkhand region), the southern half of the state, including the entire Bundelkhand region, has less than 1.0 per cent of the total area under sugarcane. The total area under sugarcane in the western region was 62.5 per cent of the state's total area under sugarcane in 2002-03. However, within the western region, the southern part is a low sugarcane area, and only the north extreme part of the state, which covers the four districts, is uniformly high in sugarcane cultivation. This is contrary to the commonly held belief that the entire western region has done well in agriculture. Unlike the skewed distribution of the sugarcane growing areas in the state, the areas under wheat cultivation are more even.

The present study also attempted to look at the regional variations using some of the chapter's keywords – growth, development, and globalisation. The indicators of growth in the state considered are length of surfaced roads, and percentage of villages electrified. The indicator of development can be the life expectancy in different regions. The indicator of globalisation can be access to telephones (including cellular phones, also called mobile phones) in the different districts of the state. The telephone can be used as a proxy indicator of globalisation, as it is used for not only communication and conducting business, but is also required for internet access. The growth impact of telephones including cellular phones has been recognised in a number of studies (for instance see Waverman, Meschi, & Fuss, 2005).

Considerable disparity exists across the state in growth (length of surfaced roads and percentage of the villages electrified) and globalisation indicators (access to telephones). The present study attempted to show regional disparity using average life

expectancy and even the infant mortality rate (IMR) as development indicators, but hardly any significant difference across the regions exists in these indicators. Infant mortality is high in all the regions. Also strange, but large, inter-district variations in IMR particularly in the eastern region ranging from 36 per thousand to 123 per thousand births, makes any comparison of average IMR across the state's regions a futile effort. The large disparities arise mainly due to the small sample size at the district level (Registrar General of India, 2002b). The Census nevertheless, reports high IMRs in all the regions of the state ranging from 77.7 per thousand in the southern region to 97.2 per thousand in the central region (Registrar General of India, 2002b). The average life expectancy in the state is lowest in the central region followed by the Bundelkhand region, western and eastern regions. The present study, therefore, takes the Gross Enrolment Ratio (GER) defined as the total enrolment of children at the primary level (Grade I-V) divided by the population in 6-11 age group (Mehta, 2002). This shows that the Bundelkhand region, which is low in terms of growth and globalisation indicators, had a large increase in gross enrolment ratio of primary school children in recent years. The western region, which is more prosperous and performs well in terms of other indicators, had low GERs (Figure 2.3).

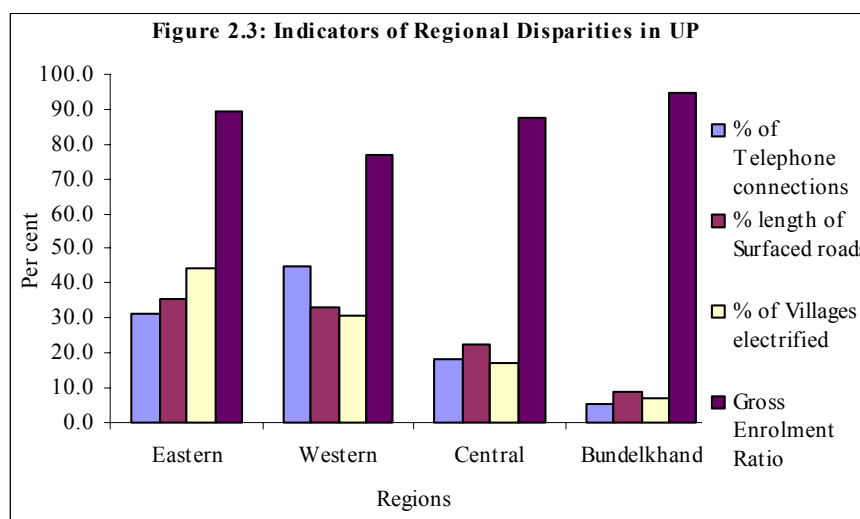


Table 2.8 displays average area and percentage share of population in each region in the state. The Bundelkhand region with its rocky terrain and barren lands is the least densely populated in the state.

## **Section III**

### **2.5 Economic Reforms in UP**

Economic reforms commenced in the country in 1991. Though the central government gave the overall direction to the economic reforms, states also introduced major policy changes at their level. Many states initiated the reforms in the early 1990s though they varied in effectiveness and credibility (World Bank, 2004). The economic reforms, in UP, were introduced in 1998-99. The preoccupation of the government with the rise of communalism, casteism, poor governance and political instability in the nineties, led to the late entry of economic reforms in UP<sup>16</sup>. In the present chapter, the focus is only on the reforms carried out by the state government, and excludes those carried out by the central government and Reserve Bank of India (the central bank of the country). The national level reforms, however, can affect the state level reforms. The state government introduced reforms in agriculture, industry (large as well as small-scale sector) and in the services sector, which includes tourism and information technology. Since the ability of the state government to reorient its policies and expenditure on various sectors would depend on its income, fiscal reforms were the most significant.

#### *2.5.1 Reforms in Agriculture Sector*

A number of studies have observed that the excessive focus on food grains mainly wheat and rice, since the sixties in the western part of the state, has led to decline in the yields. The reforms, therefore, focused on the diversification of the agricultural output to include horticulture, dairying, and fish production. The importance of dairying and livestock products in UP's agricultural sector has been recognised by many studies, particularly its immense potential for the small farmers and landless labourers (R. K. Singh, Babu, & Singh, 2004). A number of case studies

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<sup>16</sup> It could be argued that the reforms and the reformers were not popular with the people. For instance, the erstwhile chief minister of Andhra Pradesh, Chanderbabu Naidu, turned from an icon of liberalisation (Rudolph & Rudolph, 2001) to a reformer resorting to populist measures (G. K. Reddy, 2002) and subsequently failed to retain his post in the elections. Many studies on Andhra Pradesh have shown that the state did not achieve high rates of growth during 1993-94-2003-04 (C. H. H. Rao & Dev, 2003; R. K. Rao, 2004). The average growth rate in Andhra Pradesh was 5.7 per cent, lower than the country's growth rate of 6.3 per cent during this period. This was, nevertheless, much higher than that of UP. Another argument which can be raised on the discussion of economic reforms is: should the less developed states be following a reformist model of development as is being pursued by other states. The development aspirations of people may be more state oriented, rather than market oriented to take care of the development needs (Lieten, 2003).

have pointed out the state's potential for fish production, particularly in the areas which lack adequate irrigation (J. Mishra, Singh, & Singh, 2004; M. Singh & Prasad, 2004).

The shift towards the production of non-food grains also took into account the change in tastes and food habits of the Indian population. The consumption patterns, particularly of the urban consumers are changing from food grains to other products like fruits, vegetables, fats and livestock products (Landes & Gulati, 2004). As in the case of country overall, in UP, the share of food grains expenditure declined during the period 1993-94 and 2002-03, and the shift in diet is towards the increased consumption of milk, fruits and vegetables in both the rural as well as urban areas as shown in Table 2.9 (NSSO, 1996; 2003a).

Along with the emphasis on diversifying agricultural output to horticulture, dairying and fishing, the state government also announced its food processing policy. In the post-reform period, food processing industry in India including fruit and vegetable processing has grown well (Sidhu, 2005). About 10.2 per cent of the fruits and vegetable processing units are located in UP. The Confederation of Indian Industry (CII, 2004), in its recommendations on the growth of state's economy also recommended:

- i) diversification of crops away from food grains;
- ii) development of the dairy industry and inland fisheries;
- iii) development of markets for marketing agricultural products;
- iv) encouraging contract farming<sup>17</sup>;
- v) encourage exports; and
- vi) develop food processing facilities.

In a recent study, Bajpai and Volavka (2005) suggested a number of measures which could help the state in achieving higher rates of agricultural growth. These can be grouped into three broad categories: i) input related; ii) knowledge related; and lastly, iii) those related to output. The measures related to inputs are increased irrigation, and improved rural infrastructure including access to surfaced roads. For

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<sup>17</sup> Contract farming is an "agreement between farmers and processing units and/ or marketing firms for the production and supply of agricultural products under forward agreements, frequently at predetermined prices. The arrangement also involves the purchaser providing a degree of production support through, for example, the supply of inputs and the provision of technical advice" (Eaton & Shepherd, 2001). The advantages of contract farming are that it reduces production risk to the processors and price risk to farmers.

example, surfaced roads formed only 67 per cent of the total road length in the state compared to 85.7 per cent in Punjab and 93.3 per cent in Haryana. The knowledge related measures are increased research and development expenditure in the agricultural universities of the state, and improvement in the agricultural extension system. The third category of measures suggested, to boost agricultural output, was output related and included diversification of crops and an emphasis on agro-based industries. Bajpai and Volavka (2005) however, focused only on the east-west divide in the regions of the state, and ignored the central and the dry and rocky region of Bundelkhand. Even the straightjacket classification of east and west is not appropriate, as it hides disparities in the cropping pattern within these regions (see J Lerche & Jeffery, 2003).

The reforms in the agricultural sector, as announced by the state government, further focused on the improvement in agricultural marketing and laid emphasis on increased irrigation facilities (Government of UP, 2002). The expected outcomes with the increased agricultural production, effective marketing of agricultural produce, coupled with the removal of barriers in inter-state movement of food grains were increase in rural incomes and reduction in poverty.

The present study assessed the reforms in the agriculture sector in terms of long-term and short-term indicators<sup>18</sup>. The long-term indicators could be: i) increase in agricultural output including thrust areas, like horticulture (fruits and vegetables); ii) improvement in agricultural marketing; iii) increase in agricultural income; and iv) income per agricultural worker. The short-term indicators of the effect of a change in agricultural policies could be: i) an increase in government expenditure on agriculture; a proxy for public investment; and ii) loans taken out by the farmers for agriculture purposes, a proxy indicator for private investment. The government expenditure would also indicate whether the priorities of the government have changed in the post-reform period and would reflect its seriousness in implementing the reforms. The state government's efforts to increase output in the food processing industry including fruits and vegetables are limited. The factors affecting output are: i) low domestic demand due to low income; ii) easy availability of fresh fruits and vegetables for most

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<sup>18</sup> In 2001, a committee was appointed by the ministry of agriculture, Government of India to study capital formation in the agricultural sector in India. Although the committee in its final report in 2003 provided a detailed analysis at the overall country level, it did not present any data at the state level on capital formation in agriculture (Government of India, 2003).



of the year; iii) low percentage of full time working women in the state; iv) state's landlocked location and its distance from the sea; and lastly, v) low investment.

The state government's expenditure on agriculture out of its current revenues has declined in the state since 1990-91. Excluding Uttaranchal, agricultural sector's share has not increased since the nineties (Table 2.10). Also evident from the table is the decline in the plan expenditure on agriculture (plan expenditure refers to the expenditure on new projects) and increase in the non-plan expenditure (expenditure on repairs and maintenance of projects). The capital expenditure on agriculture has varied considerably and has not shown any steady trend. In a first such survey conducted by NSSO (2005e) in the post-reform period on the indebtedness of farmer households, it was found that the two most important purposes for taking loans by the farmers in the state for agricultural operations in 2003 were for capital and current expenditure on agriculture. Unlike other major states where current expenditure was the dominant reason for taking loans, in UP capital expenditure was more important<sup>19</sup>.

Among other indicators of change in the agricultural sector in the post-reform period is the trend in the rural bank deposits. Thus, an increase in such deposits would indicate the accretion in wealth and prosperity of the farmers. The decline in deposits would indicate a reverse trend. The data on statewide rural deposits during the period, 1990 to 2004 shows a decline, both in the amount as well as in number of accounts (RBI, 2004b, various issues).

### *2.5.2 Reforms and Industrial Sector*

Though UP is described as agrarian in many studies, it is its industrial sector which has grown fastest since 1950-51 (see Table 2.7). Industries have also claimed more credit than any other sector. It has also been described as the leading sector of the state's economy by some studies (Agarwal, 1996). As in many other states, in UP also a number of policy measures were introduced with the twin objectives of: i) increasing industrial output; and ii) improving investment climate. The reforms, targeted at attracting the private sector, laid thrust on the development of small, medium and large industries in the state. The major reforms introduced by the state

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<sup>19</sup> The other major reasons for which the farmers took the loans were for performing marriages and ceremonies. If the size of the land holding is considered, consumption expenditure was the major reason for taking loans among the farmers with less than 1 hectare of land and capital expenditure as a major reason for large farmers with more than 10 hectares of land.

government in its combined industrial and service sector policy in 2004 are set out in the Table 2.11.

Do these reforms augur well for the industrial investment in the state? Many states introduced the reforms in the industrial sector including the developed states such as Maharashtra, Tamilnadu and Karnataka. The industrial sector reforms in Karnataka, a major industrial and a fast growing state, were carried out in three stages through changes in industrial policy for the periods 1996-2001, 2001-2006 and 2006-2011. In contrast to the industrial policy of UP which was merely a set of measures, mainly incentives like subsidies and tax exemptions, industrial policy of Karnataka is more comprehensive and cohesive, and maintained a sort of continuity over the years, which reflected the seriousness and credibility of the government. The industrial policy of Karnataka not only addressed the need to attract private sector to the state but also aimed to project a positive image to the investors (Paul, 2000).

The usual indicators, in terms of which the success of industrial policy is judged, are additional investment in the existing industries and new investment with set up of industries. Their combined effect is reflected in increased industrial output and employment. The new investment could be domestic or foreign investment, and public and private investment. An indicator of the investment climate<sup>20</sup> in the state could be the trend in foreign direct investment (FDI). During the year 2003-04, 38 project approvals with the total FDI of Rs.1.02 billion that is, a share of merely 1.5 per cent in the country's total, had gone to UP (CMIE, 2004). Across the states, during July 2004 most of the FDI went to Delhi and Maharashtra. From the year August 1991 to November 2004, five states: Maharashtra, Delhi, Tamilnadu, Karnataka, and Gujarat, received the maximum number of FDI approvals forming around 50 per cent of the total FDI approvals (Government of India, 2005a). However, this may not reveal the true picture of FDI as a number of projects do not require approvals and have been placed under automatic route (Government of India, 2004b). Among the reasons influencing the inter-state movement of FDI the major ones are: i) policies of the state governments, particularly, the credibility of the government; ii) presence of large, metropolitan and coastal areas; iii) infrastructure, and iv) availability of skills (K. Rao & Murthy, 2006). Overall, FDI has gone to the developed states and the share of the less developed states is very low. Unlike the

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<sup>20</sup> Khan (2005) identified the traditional definition of 'good investment climate' as good governance, adequate infrastructure including electricity and telephone lines.

major FDI destination states such as Maharashtra, Delhi, Tamilnadu and Karnataka, UP has no metropolitan centre such as Mumbai, Chennai and Bangalore. This also could be influencing FDI in the state<sup>21</sup>.

The number of companies registered each month also indicates the interest of the corporate sector in the state. Monthly data available since January 1999 till 2004 shows that the share of seven states: Maharashtra, Delhi, Andhra Pradesh, Tamilnadu, Karnataka, West Bengal, and Gujarat, has consistently been around 80 per cent and the share of other states including UP was only 20 per cent (Government of India, various issues). A recent survey by an industry association, the Association of Chamber of Commerce & Industry (ASSOCHAM, 2005) projected that the smaller states like Himachal Pradesh, Chattisgarh and Jharkhand would emerge as preferred destinations due to availability of better facilities. This would further affect the industrial development of the state<sup>22</sup>. The state also suffers from power shortage which has affected the performance of the industries in the state (Bisht, 2005). Many industries have relocated in other places due to poor power availability.

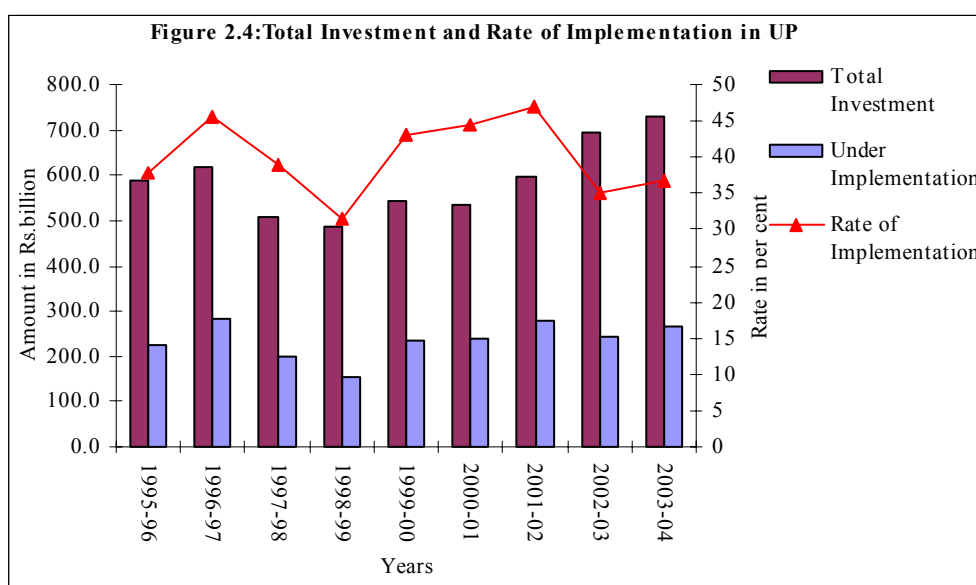
Thus, the above paragraphs indicate that despite the reforms initiated by the UP government in the industrial sector, the performance of large-scale industry in the state has not been impressive. The total investment intentions filed through Industrial Entrepreneurs Memorandum (IEM) during the period April 2003-March 2004 constituted only 1.4 per cent of all India's share of total investment intentions. Among the states, of the total IEMs filed as at the end of July 2004, Maharashtra topped the list with the maximum number of IEMs. During the period August 1991 to March 2004, the total number of IEMs implemented in UP formed 7.0 per cent, on an average, of the total IEMs implemented in all the states with the total investment of around 9 per cent (CMIE, 2004). However, it is not clear as to how in UP, which ranks third in the total number of investment intentions; the number of registered factories is declining along with decline in industrial employment and output. This indicates that the investment intentions are in the existing rather in the new units.

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<sup>21</sup> Less FDI in the less developed regions in the common perception is usually considered as an economic disadvantage. But, is it really necessary that FDI should be forthcoming in these regions. Some studies have pointed out that in the absence of required skills and adequate infrastructure (Mullen & Williams, 2005), the beneficial effects of FDI such as technology spillovers cannot be achieved (Borensztein, Gregorio, & Lee, 1998).

<sup>22</sup> Incidentally UP was adjudged as the 'Best Improved Investment Environment State' among all the states of the country at the Chief Ministers' Conclave held in New Delhi in 2005 (Government of UP, 2005b).

Rather than the investment intentions, it is the implementation of projects which is more important. However, the data on the implementation of projects and their monitoring is very scanty and it is not even known at what stage the project implementation is (Paul, 2000). Figure 2.4 shows the projects under implementation and their rate of implementation in the state. As compared to the total proposed investment in UP, the actual projects implemented were very low thus, the low rate of implementation.



### 2.5.3 Small-scale industries (SSI) in UP

The arguments in the favour of small-scale industries usually are related to their ability in generating employment as they are assumed to be labour-intensive in nature. However, Joshi and Little (1996) argued that small firms need not be labour-intensive as, for example, in India more SSI were having high capital-labour ratio and those with low capital-labour ratio were inefficient. The small-scale industries (SSI) play a significant role in India's industrial activity. The share of SSI in the gross industrial output in the country is around 40.0 per cent and its share in the total manufactured exports is 44.0 per cent (RBI, 2005a). The total number of SSI units in the country was 10.5 million in 2001-02 and increased to 11.9 million in 2004-05. It employed 24.9 million people, which also during a similar period increased to 28.3 million in 2004-05.

Before examining the reforms announced by the state government in its small-scale industrial sector, it would be meaningful to have an understanding of the issues facing SSIs, which necessitated changes in policies in UP. The issues facing the SSI sector can be divided into: i) policy related; ii) knowledge related; and iii) marketing related. Under policy related are issues such as the reservation of items for exclusive production for SSIs, interference by inspectors, tax exemptions and subsidised loans leading to unproductive investment (V. Joshi & Little, 1996). These measures, though initially introduced to help and assist in the development of the small-scale sector, have over the years inhibited their growth (Bhavani, 2002; Guhathakurta, 1993). The knowledge related issues could be technological in nature such as, lack of modernisation and outdated technology, low literacy levels particularly, of the artisans employed or having their own units. The impact of globalisation on the SSIs and the re-employment of the artisans and other workers due to the closure of units and their own low literacy levels has been observed by a number of studies (Bhavani, 2002; M. R. Narayana, 2004; M. Sharma, Sharma, & Naqvi, 2005; Subrahmanya, 2004). The marketing related issues facing the SSI sector include lack of competition, which in turn leads to poor quality of products and affects their exports. Competition and quality of products are related to each other. It is usually argued that less or lack of competition leads to poor quality products. Although competition can result in improvement in the quality of products through innovation and other strategies, in order to maximise profits, excess competition can also lead to a reduction in the product quality.

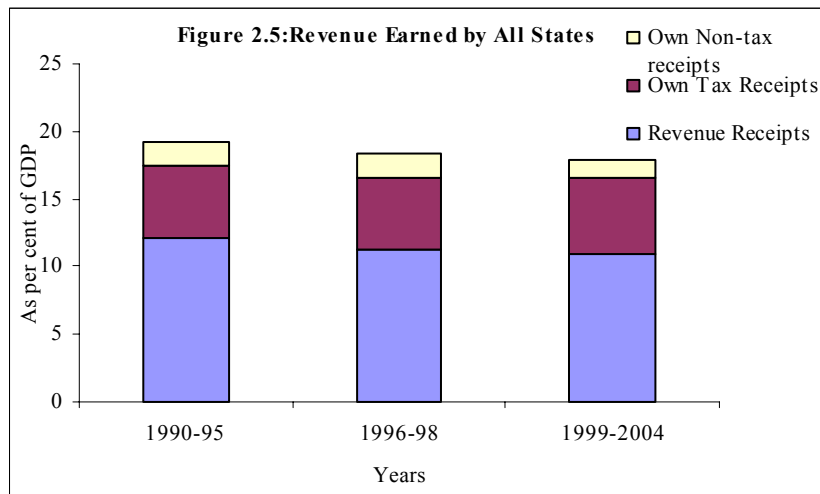
In the Indian context, and in UP, the SSIs have played an important role. However, despite the importance of SSIs for the state, only a few published studies on the small-scale industry in UP have emerged in the recent years (M. Sharma et al., 2005; A. K. Singh, Joshi, & Mehta, 2004). In contrast, a number of studies have appeared on the small-scale industry in other states such as Karnataka, West Bengal, Punjab and Maharashtra (for instance Subrahmanya, 2003). Along with small-scale industries, a large number of tiny household industries (also known as micro enterprises) exist in the state. Since UP is a less developed state with high poverty levels, the problems faced by these tiny household enterprises, particularly due to increased competition after the reforms, is critical for the state's growth and development (see M. Sharma et al., 2005). Such household self-owned enterprises in

the rural and urban areas of the state's eastern and western regions formed 53.8 per cent of the total enterprises in the unorganised sector in state in 1998.

In its Tenth Five Year Plan, 2002-07, the UP government announced the creation of the Small-scale Industries Modernisation Fund, which aimed at providing capital subsidy and interest subsidy to the small-scale industries. The state government also proposed the creation of UP Institute of Design to disseminate knowledge and develop the skills of artisans in the state. It also announced a Handicraft Development Export Policy (Government of UP, 2002).

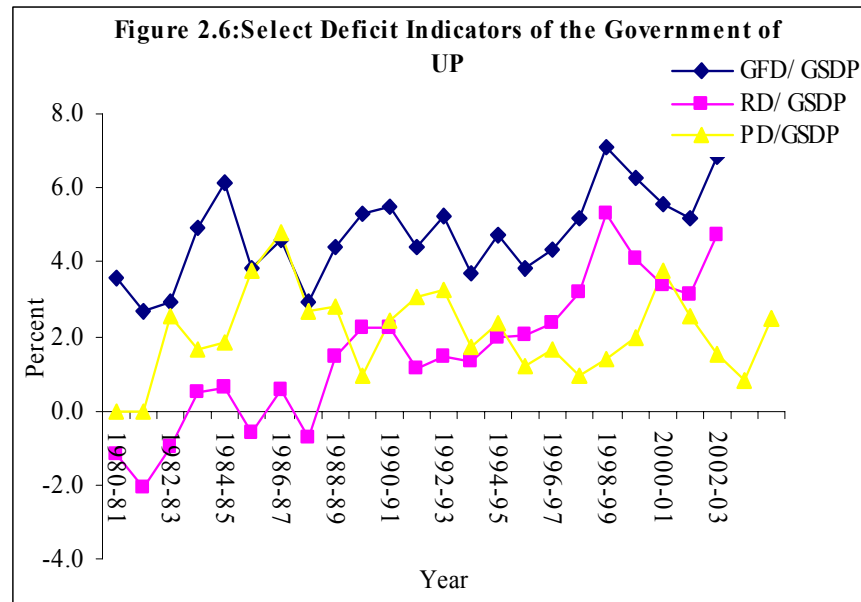
#### 2.5.4 Fiscal Sector Reforms

In almost all the states of India, the finances of the state governments deteriorated in the nineties. The major reasons were: i) high revenue expenditure such as wages, salaries and pensions; ii) losses of the state public sector enterprises; iii) decline in transfers from the central government; and iv) inadequate user charges (RBI, 2006a). Figure 2.5 shows the revenue receipts of the states comprising tax and non-tax revenue (includes user charges) during the period 1990-2004.



In UP also, a major area of concern was the growing resource gap between its expenditure and revenue including tax and non-tax receipts. Table 2.12 shows the resource gap indicators in UP since the eighties. Until the early nineties, the deficit indicators were at a lower level, however, they have risen sharply since then (Figure 2.6). The revenue deficit as share of the gross fiscal deficit has risen substantially since 1992-93. The tax receipts of the state government have remained more or less at

the same level as percentage of gross state domestic product since the eighties. The state's non-tax receipts as percentage of GSDP has remained constant, a trend seen for other states also.



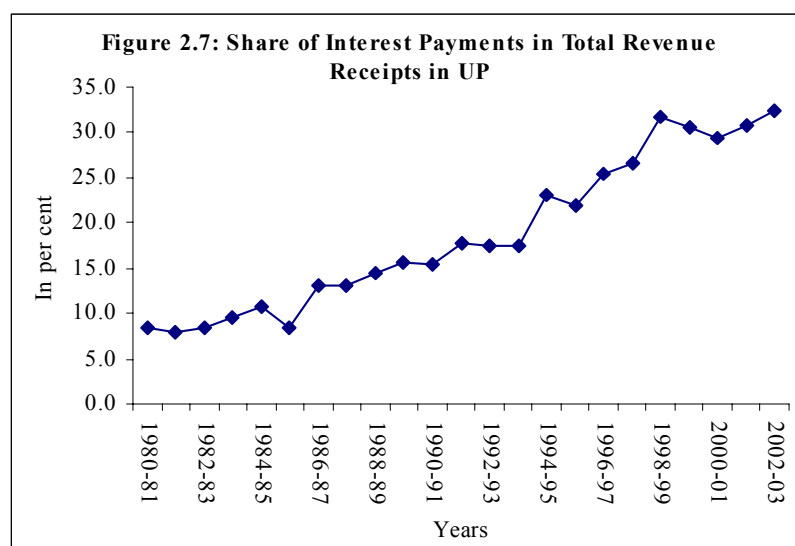
The major sources of funds for the state government, besides tax and non-tax receipts<sup>23</sup>, are: loans from the central government, market borrowings, small savings collection, and short-term advances called Ways and Means Advances (WMA)<sup>24</sup>. The state government also obtains negotiated loans from banks on which not much detail is available. The budget documents of the state governments do not give adequate details on loans from the banks and financial institutions.

Why is it that the fiscal situation of the state deteriorated in the nineties? The total debt liabilities of the state government as proportion of the state's total output doubled from 22.4 per cent in 1980-81 to 45.0 per cent in 2002-03. The interest payments by the state government on its debt liabilities increased sharply since the

<sup>23</sup> The revenue receipts comprise tax and non-tax receipts. The states' tax revenue include taxes on income; taxes on property and capital transactions such as land revenue, stamps and registration fees and taxes on urban immovable property; taxes on commodities and services and share of the states in central taxes. The non-tax revenue includes grants from the centre and states' own non-tax revenue such as interest receipts, state lotteries and those earned from social services and economic services.

<sup>24</sup> Under Section 17(5) of the RBI Act, RBI has been providing WMA to states against the balances maintained with RBI to help them tide over temporary mismatches in the cash flow of their receipts and payments. As against only ten revisions in the limits of WMA carried out between April 1937 and February 1999, as many as five revisions have been done since 1999 considering the position of state finances. The formula for increasing limit was changed in 1999 and reflects the higher revenue receipts of the state governments (RBI, 2004g).

nineties. In 2002-03, about 33.0 per cent of the revenue receipts of the state government were set off in meeting interest payments (Figure 2.7). Wages and salaries were around 23 per cent of the state's total expenditure.



A major factor affecting the interest payments is the cost of raising the resources. The interest rates in India were liberalised in 1992. An effect of the deregulation of interest rates was that the banks could charge at or above the benchmark rates. Also, in the government securities market, the yields were being determined in auctions. Table 2.13 shows the interest rate paid by the state government on its borrowings. As can be observed, the high rates of interest coupled with the increased amount of borrowings and loans from the centre led to increased interest liabilities. A comparison of the borrowings of the central government and state government reveals the following:

- i) weighted average rate of interest paid by the central government on its borrowings is lower compared to that on the state borrowings;
- ii) spread between the interest rates on state market borrowings, and that charged by the centre on its loans to the state has widened;
- iii) rate of interest charged on WMA of states is Bank Rate whereas the interest rates on central government's WMA are market determined.



The large outgoings on interest payments imply lesser expenditure on development, particularly education and health. As the state has high illiteracy levels and poor health conditions these are particularly important<sup>25</sup>. Table 2.14 shows the decline in expenditure on education since 1990-91. The decline has been both in revenue and in capital expenditure on education. The improvement in the literacy rates during the recent years is a consequence of Government of India's programmes and external assistance from World Bank, United Kingdom and European Commission, and UNICEF (Wu, Kaul, & Sankar, 2005).

The state government, to improve the health system of the state, announced a population policy in 2000. This aimed to: i) increase the age at first marriage for women to 19.5 years by 2016; ii) reduce fertility rate from 4.3 in 1997 to 2.6 in 2011; iii) reduce maternal mortality; iv) reduce infant and under five mortality; and v) eliminate severe malnutrition among children by 2011. To achieve the above goals, the state government aimed at an increase in the number of dispensaries, hospitals and various disease control programmes, with the three fold strategy: i) implementation; ii) strengthening management performance; and iii) accountability. The policy measures announced by the government, however, did not match its actions, as its expenditure on health services has not increased (Table 2.15).

The initiative on reforming state's fiscal situation was taken by the state government in 1998-99 with the issue of a *White Paper on the Fiscal Situation in the State* along with its budget of 1998-99 which expressed concern on the growing fiscal deficit of the state (M. Srivastava, 2004). The state government also signed a *Memorandum of Understanding* with the World Bank and the Ministry of Finance, Government of India and announced *Medium Term Fiscal Reform Policy* along with its budget for 2000-01. Also, the Uttar Pradesh Fiscal Responsibility and Budget Management Act, 2004 was introduced by the state government in February 2004. Table 2.16 shows the major commitments and the actual achievements of the state government in terms of this Act. As the table shows, the targets under the Act are far from being achieved. In terms of compliance, the state government aims to review half-yearly receipts and expenditure in relation to budgeted figures. The Act in UP, however, unlike other state governments (Karnataka, Kerala, Punjab and Tamilnadu

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<sup>25</sup> The priorities in which expenditure should be incurred, whether on education, health and physical infrastructure, is not certain (J. Cohen & Bloom, 2005). Even the higher expenditure on these may not result in desired outcomes due to poor governance, corruption and poor targeting (Baldacci, Clements, Cui, & Gupta, 2005).

also had introduced Fiscal Responsibility Acts), did not specify any independent reviewing authority, which would review the performance of the state government in terms of the provisions of the Act.

Value Added Tax introduced in most of the states from April 1, 2005 has still not been introduced by the UP Government due to opposition from the traders (CII, 2005)<sup>26</sup>. The major reform in the power sector was the creation of three Corporations for generation, transmission and distribution of electricity. In addition, the regulatory authority, Uttar Pradesh Electricity Regulation Commission (UPERC) was established under the provisions of the Electricity Regulatory Commission Act 1998. The Commission in its evaluation of performance of the power supply corporation noted that despite reforms its performance is far below expectations, and “even after four years of reform, large parts of the State still spend most hours of the day without electricity ----” (UPERC, 2003, p.6). It recognised the severe limitations of tariff rationalisation in the absence of regular electricity supply.

The Comptroller and Auditor General of India (2004) on a review of power sector reforms in the state also commented:

Unbundling, corporatisation and restructuring of UPSEB and existing thermal and hydro power generating companies and various schemes introduced in the area of metering/system improvement, did not bring out any positive changes in their financial as well as operational performance. The net worth of UPCCCL turned negative. The T& D losses remain high, collection efficiency has not improved and availability of power to most of the consumers group has come down.

The delays, mismanagement and lack of coordination in implementation of various schemes of the reforms, inadequate/improper action regarding billing and recovery resulted in non-accrual of benefits as was contemplated in the reform programme (CAGI, 2004, p.80).

## **Section IV**

### **2.6 Finance and the Providers of Finance in UP**

In the nineties, the literature has been focusing on the lack of human development in the state. As pointed out earlier, this literature does not take note of the decline in credit in the state. In this section, the study examines the outreach of the financial intermediaries in the state. The issues probed are: Have the banks been able to replace the informal sector/moneylenders? Have the banks developed and spread in the state in each region? What are the other sources of finance in the state besides the above? The main providers of finance in the state are moneylenders, commercial banks, and SHG-Bank Linkage Programme or microfinance.

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<sup>26</sup> Since then, VAT has been introduced in the state with effect from January 1, 2008.

### 2.6.1 Moneylenders in UP

The Indian banking was run by the indigenous bankers (*bantias, sahuikars and chettys*)<sup>27</sup> at the time of British arrival in India. These indigenous bankers and moneylenders were different from the banks in two respects: i) they combined other business with banking and money lending; and ii) they were informal in their operations (P. Tandon, 1990). The role played by the moneylenders varied in the different parts of the country. In northern and central India, the moneylenders had a hold on peasantry, particularly the small and marginal farmers, and in southern India they played a significant role in financing trade during the colonial period (S. Bose, 1994). Though the literature on the country's rural areas has discussed mostly the problem of land revenue system and rents, Bose (1994) argued that perhaps credit and finance were the most important features of colonial rural economy. The moneylender played an important role in the colonial period serving the agriculturists.

In UP moneylenders have played an important role in the state's agriculture and business, particularly for the small farmers (Amin, 1994). Money lending was also considered as a "popular way of investing money" (Musgrave as quoted in Amin, 1994, p.91). In recent years, moneylenders are often used in informal remittance money transfers. In the present study, the role of moneylenders as providers of credit in the agricultural sector of UP is examined.

During the early nineteenth century, the moneylender had substantial control over sugarcane production and processing in the eastern UP, in contrast to the western region (Amin, 1994) where the farmers were rich, had larger landholdings and had access to their own resources rather than borrowings. The moneylender used to charge high rates of interest and his mode of lending was mostly against standing crops to farmers, and in cash or kind to others. In the literature, he carries a negative image, an outcome of the usurious and exploitative methods he followed (Chavan, 2003). Lately, there are differing views on the image, and role of money lender in the credit system has turned more positive (Chavan, 2003 for the traditional view; see S. Sharma & Chamala, 2003 for positive views). Bose (1994) observed that despite the unhealthy

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<sup>27</sup> The words '*bania*', and '*sahukar*' in Hindi language means the local shopkeeper. They played an important role in informal financial markets during the British rule and post-independence. Despite considerable expansion of institutional credit since 1969, the economic and political power of sahuikar remains substantial. During the British period '*sahukar*' remained the link between the natives and British and provided for the sale and financing of agricultural operations, and acted as buyer of agricultural products and also agent for collecting taxes. Even now sahuikars dominate in informal credit markets in parts of India and charge usurious rates of interest (Rahul, 2003).

practices of the moneylender, the anti-moneylender uprisings were not frequent, and there was an absence of violence against the moneylenders. A major reason for this was the dependence of the rural peasant on the moneylender. Bose (1994) noted that:

Credit formed the key thread in the complex relationships linking the labour, capital, and land markets and entitlement to subsistence was the minimal demand of subordinated classes if they were to tolerate fundamentally skewed debt relations (S. Bose, 1994, p.27).

Even now, despite the reforms and the spread of banking in UP, agricultural and professional moneylenders still occupy a significant place in the agricultural sector. The credit provided by the informal sector in the rural areas has actually increased in the post-reform period. Various case level studies also indicated the rising importance of moneylenders. In 2003, after banks (51.2 per cent), the moneylenders (19.1 per cent) formed the second most significant source of loans in the state for the farmers (excluding agricultural labourers) (NSSO, 2005e)<sup>28</sup>. Of the average debt of Rs.6241 per indebted rural labour household in 1999-2000, only 33 per cent was from institutional sources, the rest was from non-institutional sources (68.5 per cent) including moneylenders (24.5 per cent). This was higher than their share of 61.7 per cent in 1993-94 (Labour Bureau, 2000). The incidence of indebtedness through non-institutional sources in the state is more prevalent in the rural areas than the non-rural areas.

### *2.6.2 Banks in UP*

The paragraphs below explore various aspects of banking other than credit, such as bank branching, deposits and interest subsidies to the small borrowers in UP.

#### *i) Bank Branching*

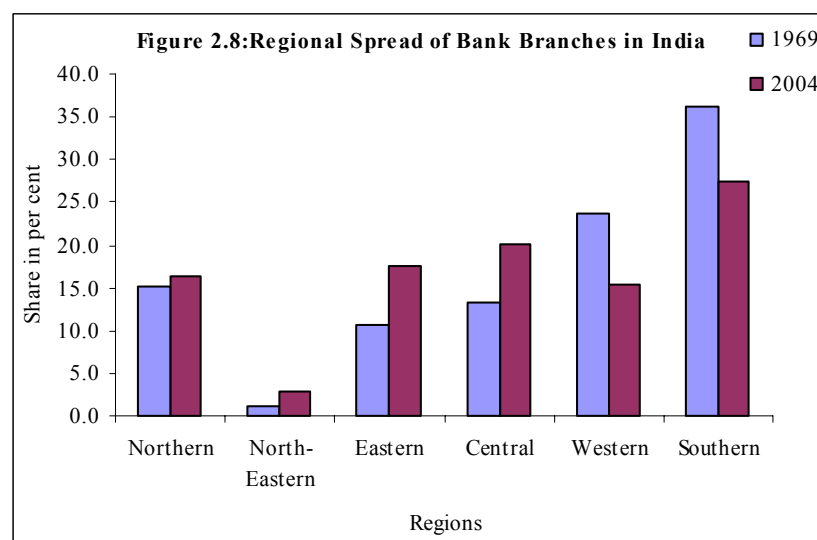
The total scheduled commercial banks in India in 2004 were 284, of which 28 were public sector banks, 29 private sector banks, 31 foreign banks and 196 regional

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<sup>28</sup> Among the eleven of the fourteen major states, the average indebtedness was 60.1 per cent. Household indebtedness is more widespread in states like Andhra Pradesh, Kerala, Rajasthan, Tamilnadu, and Karnataka. Only in Kerala the share of institutional sources was higher than that of non-institutional sources. The borrowings from the non-institutional sources are related to the poverty level. In the states like UP, Bihar and Orissa i.e., the states with lesser income, the borrowings were less than 50.0 per cent as compared to other states. NSSO (2005a) showed that of the total number of farmer households in the state only 40.0 per cent had borrowed for any purpose. The percentage of indebted farmer households was quite low in UP as compared to states like Andhra Pradesh (82.0 per cent) Tamilnadu (74.5 per cent), Punjab (64.5 per cent), Kerala (64.4 per cent) and Maharashtra (54.8 per cent).

rural banks<sup>29</sup>. The number of branches of the banks in India at end March 2004 was 67,062 comprising 32,200 rural branches, 15,023 semi-urban branches and 19,839 urban and metropolitan branches. The number of bank branches per 100,000 people was 6.30 in India. This was, however, much lower than Germany (49.41), Canada (45.60), US (30.86) and France (43.23) among the developed countries. Among the developing countries, it was higher than China (1.33), Pakistan (4.73) and South Africa (5.99) (Mohan, 2004; Peria, Beck, & Demirguc-Kunt, 2007).

In 2004, the southern region of the country had the highest number of bank branches (27.5 per cent). This was followed by the central region (20.2 per cent), eastern (17.6 per cent), northern (16.4 per cent), western (15.5 per cent) and lastly, north-eastern region a mere 2.8 per cent (Figure 2.8). Due to fewer branches in the north-eastern region, the average population served per bank branch was highest in this region (22 thousand per bank branch). In the eastern and the central region, population covered per bank branch was 20 thousand. It was 15 thousand per bank branch in the western region, and 13 per thousand each in the northern and the southern region.



<sup>29</sup> Due to the mergers and consolidation of regional rural banks, and closure of foreign banks, the total number of scheduled commercial banks in India as on June 30, 2006 was 191. This includes 28 public sector banks, 28 private sector banks, 29 foreign banks and 101 regional rural banks.

In UP, the total number of bank branches was 747 in 1969<sup>30</sup>, much higher than in most of the states. The average population per bank branch was, however, 114 thousand, much higher than the all India average. In 2004, the total number of bank branches in the state increased to 8,367 and the population covered came down to 21 thousand per bank branch. This was again higher than the country's population coverage of 16 thousand per bank branch. There is, however, a large disparity within the state, as the population covered per bank branch ranges from 10 thousand to 30 thousand.

The average share of bank branches in the western region of the state during 1991-2004 was 38.1 percent, lower than its share of 45.6 per cent in 1972-76. The share of the eastern region rose during the similar period from 28.8 per cent to 35.5 per cent.

Table 2.17 presents total number of bank branches, branch per population and per capita income of the states. As Figure 2.9 shows, a relationship exists between the states' per capita income, and the coverage of population per bank branch.

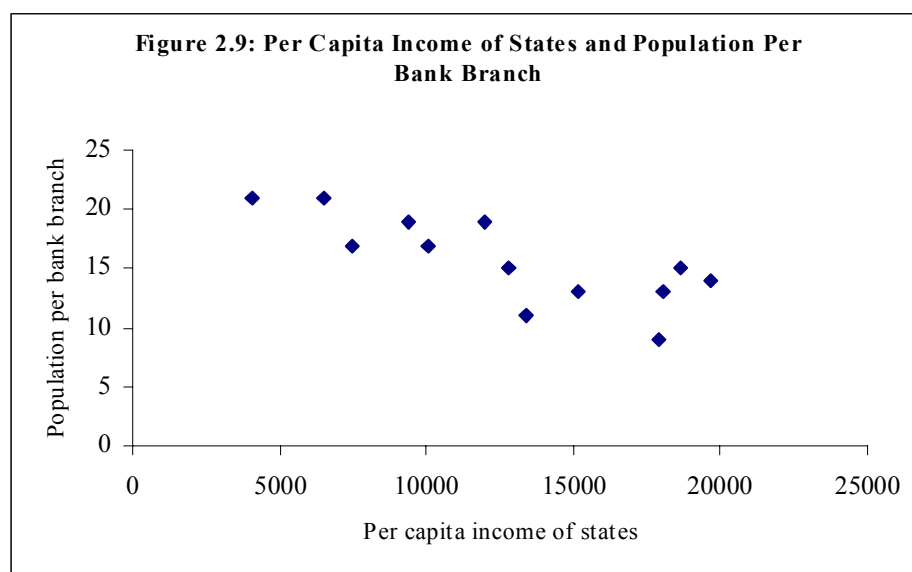


Figure 2.9 shows that the lower the per capita income of the state, fewer the bank branches and the higher the population per bank branch. This is observed in the case of Bihar and UP which are less developed states. The population per bank branch

<sup>30</sup> Even in the eighteenth and nineteenth century, banks were concentrated in the large metropolitan cities like *Bombay, Madras and Calcutta* (now called Mumbai, Chennai and Kolkata respectively) associated perhaps with British trading interests. Some banks though were established in the cities of UP like Agra, Varanasi, Allahabad and Kanpur.

is highest in these two states indicating that banks are less inclined to open branches in the less developed states. Besides bank branches, banks had ATMs (Any Time Money machines), phone banking, internet and mobile banking, though these are also mostly limited to the urban areas and developed states.

The opening of bank branches is a function of many variables, including the bank's own performance, its past branch expansion, extent of under-banking and the state's economic performance (Calcagnini, Bonis, & Hester, 1999). In addition, the economic viability of opening a new bank branch is an important factor. Is it that the business per branch is lower in these states compared to relatively well off states? Deposit per account in Bihar and UP at Rs.18,955 and Rs.19,026 respectively in 2004 was around 31 per cent of the deposit per account of Maharashtra, and 81 per cent of Andhra Pradesh.

Table 2.18 shows the top five districts in UP with a largest number of bank branches and five districts with the lowest number of branch offices. The difference between the two reflects the spread of banking in the state. The number of bank branches in the lowest five districts of the state is nearly stagnant since 1998. The business per capita in terms of deposits and credit in the lowest banked districts is not very different from that of many other districts of the state where the number of branches are higher. Incidentally, except for Baghpat, which is in the relatively prosperous western region of the state, all the districts are located in the low-income Bundelkhand region. The share of the top five districts also has remained constant, around 16 per cent. Table 2.19 gives the number of districts according to the population covered per bank branch. The table shows that:

- i) In 31 districts of UP, population covered per branch is below the state's average of 21,000. This is nevertheless, significantly higher than the national average of 15,000;
- ii) In 39 districts, that is 56 per cent of the total districts, population covered per branch is above the state average of 21,000;
- iii) In as many as 65 districts in the state out of 70, about 93 per cent of the total, the population covered per bank branch is above the national average of 15,000.

Since the western districts are more developed than the eastern part of the state, did the banks discriminate between east and west UP in the opening of bank branches? The bank branch licensing policy was introduced in 1977 according to which, for opening four branches in the under-banked rural areas of a state, the banks could open one branch in urban areas. Was there any difference in the number of bank branches in pre-1977 and post-1977-1990 when the bank branch policy stopped?

Table 2.20 displays:

- i) during the period 1972-76, prior to the bank branching policy the average growth of bank branches was high in all the regions;
- ii) in almost all the regions of the state, the average growth rate of bank branches lowered during the period 1977-90 except in the Bundelkhand region;
- iii) in the post-reform period from 1991-2004, the growth rate has been very low;
- iv) there appears to be no discrimination between the regions of east and west UP, in the opening of bank branches. The eastern region has caught up with the western region as its share increased in the post-reform period. The share of the central region has remained constant throughout.

A large number of rural branches closed down in the state in the recent period. The data on the number of offices closed in the rural areas is available only for three years 1999-00 to 2001-02 (Table 2.21). The rationalisation of the bank branches, particularly in the rural areas, could have affected the availability of credit.

#### ii) Deposits in the state

Most of the bank deposits in UP are with the household sector, the share of which in the state was 76.0 per cent compared to the country's average of 58.0 per cent. The government sector including the deposits of central and state government and other public sector companies was 13 per cent. The deposit of non-residents in the state was only 3.2 per cent compared to Punjab (21.7 per cent), Chandigarh (15.1 per cent), Gujarat (17.9 per cent), Maharashtra (12.9 per cent) and most of all Kerala (44.7 per cent).



The deposits of the private corporate sector also were considerably less in the state at merely 1.9 per cent compared to an emerging state like Delhi with a large presence of private sector (11.4 per cent) (Table 2.22). The share of other states such as, Karnataka was 16.6 per cent, Maharashtra (12.7 per cent), Tamilnadu (11.5 per cent) and West Bengal (8.9 per cent). Compared to the national average of 7.9 per cent also the share of these states was high. Thus, the pattern of ownership in the deposits has varied with the states' economic development.

### iii) Interest subsidy to small borrowers in UP

Another aspect of banking examined in the present study is the extent of interest subsidy in UP. In the pre-reform period, the interest rates were administered and were lower in some occupations like agriculture. This changed in the post-reform period with the abolition of administered interest rates. The interest rates now are according to the size of credit<sup>31</sup>. It would be interesting to calculate the interest rate subsidy in agriculture in UP in the post-reform period, but since the interest rates are no longer administered according to the occupation, but linked to the size of credit this exercise will not be useful<sup>32</sup>.

Borrowers' from the banks are now classified into two groups based on their borrowing limits. The large borrowers are those with credit limit of above Rs.200,000 and small borrowers are up to Rs.200,000. The share of the small borrowers in the total number of credit accounts and credit amount differs substantially from state to state. While in the relatively better-off states, the small borrowers' share in the total amount is much less, in the less developed states like Bihar and UP, it is more than 50 per cent. For instance in Bihar, the share of small borrowers in credit amount is close to 60.0 per cent, while their share in total number of credit accounts is 97.0 per cent.

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<sup>31</sup> Above Rs.200,000 the interest charged is free, deregulated and market related. Below Rs.200,000 the interest charged is less than Benchmark Prime Lending Rate. Thus loan to agricultural sector could be above Rs.200,000 and at the same rate as industry resulting in cross-subsidisation within the agriculture sector. The large borrowers could be subsidising small borrowers. Though the lending rates were deregulated in October 1994, interest rates charged from exporters, small loans up to Rs. 200,000 and Differential Rate of Interest Scheme are still regulated.

<sup>32</sup> The credit flows to several other sectors besides agriculture, industry and services sector which includes heterogeneous activities like trade, transport operations, financial services, personal loans etc. The choice of a sector is rendered difficult due to the existence of these several sectors. This issue is resolved by taking into account the opportunity cost of the credit disbursed. Since the interest rates are no longer occupation based, but are according to size, subsidy to agriculture within the small borrowers would be the ideal choice and this is measured against the credit to the services sector  $C_s/T_c$  by taking the share of sectoral credit in the total credit disbursed. The services sector also could be chosen as its share was found to be highest among all the sectors and it is the fastest growing sector in the state.

In Orissa also, the share was more than 50 per cent. In developed states like Maharashtra, though the proportion of small borrowers in total number of accounts was close to 90 per cent as in other states, their share in the total amount was much less, around 6 per cent. As stated above, the interest rate is now according to the size of credit. The interest rate charged from the small borrowers is less than Benchmark Prime Lending Rate and those for the large borrowers are free.

The present study, therefore, takes weighted interest rate charged from the large borrowers minus interest rate charged from the small borrowers. For the large borrowers, this works out to be 11.02 percent. The interest rate for the small borrowers was 9.0 per cent. The difference between the interest from large borrowers and small borrowers multiplied by the total credit to small borrowers in different states gives the interest rate subsidy for the small borrowers. This exercise has been done for only one year 2004. The interest rate charged from the small borrowers is below the prime lending rate, which was 10.25-10.75 per cent in 2004<sup>33</sup>. Thus, the difference in the interest rate between the large and small borrowers is 2.03 cent. Table 2.23 shows the total interest subsidy and subsidy per account for the small borrowers in different states. It shows that while total interest subsidy is high in UP, per account subsidy was highest in Punjab followed by Haryana.

### *2.6.3 Microfinance, and who provides microfinance in UP?*

Besides moneylenders, cooperative banks and commercial banks, the Self-Help Groups (SHGs) also provide finance in micro terms that is, very small quantities to the poor, in other words, microfinance. Microfinance is defined as “the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro enterprises” (ADB, 2000, p.2). Microfinance is covered in detail in Chapter 4. In the present chapter, focus is on the agencies involved in microfinance in the state.

In India, as in other countries, microfinance is used as a tool for poverty alleviation. In the Indian context, microcredit is defined as “the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and

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<sup>33</sup> The prime lending rate of State Bank of India a major public sector bank was 10.25 per cent. Most of the lending of the bank below Rs.200,000 was in the range of 8.50-9.50 per cent (SBI, n.d.).

improve their living standards” (RBI, 2005c, p. 2). Three models of microfinance exist in India. These are set out in Table 2.24.

The model of microfinance followed in India is mostly through Model II, the SHG-Bank linkage programme, wherein the Non-Governmental Organisations (NGOs) (which exist for rural development, women, child health etc., and microfinance is one of their activities) form the self-help groups and assist the groups in accessing credit from the banks. In UP the share of the above model is 74 per cent. Women are often the targeted groups of these programmes.

The total number of SHGs in India at the end of March 2005 was 1,618,456 of which in UP were 1,19,648 that is, about 7.4 per cent of the total (NABARD, 2005). The percentage of the farmer households with at least one person of the household belonging to SHGs was only 1.5 per cent in the state (NSSO, 2005f). In many areas of the state including non-rural areas, despite a high demand, there is a lack of any micro credit NGOs (Parker et al., 2003). The low share of SHGs in UP could also be due to lesser number of NGOs in the state<sup>34</sup>. The majority of the SHGs are in the southern states, and the share of Andhra Pradesh alone is 30 per cent.

## **Section V**

### **2.7 Conclusion**

A snapshot of the analysis in the chapter reveals:

- i) a typical physical setting of UP wherein its land area is comparatively disproportionate to its population;
- ii) UP is surrounded by eight Indian states of which only two are developed, and the others less developed;
- iii) spurt in state’s growth rate in the years 1974-79 and again in 1980-85, and downturn thereafter;
- iv) measures taken to reverse the downturn in state’s growth rate by introducing economic reforms in the recent years.

The analysis of the economic reforms in UP showed that although efforts have been made by the state government to develop the state, a lot more remains to be done

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<sup>34</sup> Lieten (2003) in his interaction with the villagers of UP on their development priorities, observed that perhaps due to corruption and capture of funds by the village elite there was no demand for microfinance which he labels it as “a neo-liberal development paradigm” (Lieten, 2003, p.63).

particularly on the human development front. The binding constraints are lack of private investment including credit, and the state's key fiscal indicators (i.e. state's fiscal deficit, revenue deficit and debt). The reforms in the banking and financial sector have affected most the cost of borrowing of the state government. The high interest payments and increased debt liabilities have led to the shift in expenditure from developmental to non-developmental. A heartening feature in the recent years has been the discussions and seminars organised in the country on the strategies to develop the state and bring it at par with the other states<sup>35</sup>.

The objective of this chapter was to serve as the launching pad for the rest of the study. This was constructed with the assistance of the analysis of the locale of UP in India, its economic growth and economic reforms carried out in the recent years, disparities within its regions, and lastly, the sources of finance in the state. The relevance of this chapter for the present study is laid in the summary chart 2.1. The following chapter reviews literature on the key themes in the study.

Chart 2.1: Relevance of Chapter for the Study

<u>Major Streams of Analysis in the Chapter</u>	<u>Relevance for the Study</u>
Physical setting of the state	Helps in understanding physical location
Economic growth and economic reforms	Helps in understanding the role of credit in growth
Regional Analysis	Relevant for understanding shifts in regional credit
Financial development of the state	Framework for comprehending role of banks in the state

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<sup>35</sup> For instance, a technical session on 'Economy of Uttar Pradesh' was held in the Annual Conference of Indian Economic Association in December 2004 organised by the Department of Economics, Banaras Hindu University, Varanasi (M. Srivastava, 2004). Another conference was organised by the Planning Commission, Government of India and Centre for Political Studies, Jawaharlal Nehru University, New Delhi in 2004 to discuss the economic reforms and economic development of UP (Pai et al., 2005).

Table 2.1: Share of Area and Population of Selected States in India

(in per cent)

States	Population	Area	Average Growth Rates (1993-94 to 2003-04)
UP	16.2	7.3	3.8
Maharashtra	9.4	9.4	5.4
Tamilnadu	6.1	4.0	5.2
Andhra Pradesh	7.4	8.4	5.7
Gujarat	4.9	6.0	7.9
Bihar	8.1	2.9	4.9
Rajasthan	5.5	10.4	6.5
Madhya Pradesh	5.9	9.4	5.0
Haryana	2.1	1.4	6.1
Punjab	2.4	1.6	4.0
West Bengal	7.8	2.7	7.1
Orissa	3.6	4.7	4.6
Kerala	3.1	1.2	6.0
Karnataka	5.1	5.8	7.0

Source: Registrar General of India (2002a) , Government of India(2004c).

Table2.2: Economic and Social Impact of the Creation of Uttaranchal on UP

(in per cent)

Variables	Approximate Loss/Gain after creation of Uttaranchal
Reduction in geographical area	18.0
Decline in population	5.0
Reduction in poverty	5.5
Loss in the revenue from tourism	0.6

Source: Present Author's Own Estimates, Government of UP (2002).

Table 2.3: Demographic Indicators in UP and India

(rates per thousand)

(growth rate and share in per cent)

Indicators	2001-05		Share of Population		
	UP	India	Age	UP	India
Population Growth Rate	2.0	1.6	0-9	27.4	23.2
Crude Birth Rate	30.2	23.2	10-24	31.1	30.6
Crude Death Rate	8.6	7.5	15-59	51.7	56.9
Infant Mortality Rate	74.3	61.3	60 +	7.5	7.7
Under 5 Mortality	109.0	82.0	-	-	-
Total Fertility Rate	4.4	2.9	-	-	-
Life Expectancy – Males	62.0	63.8	-	-	-
Life Expectancy- Females	61.9	66.1	-	-	-

- not applicable

Source: Registrar General of India (2006a).

Table 2.4: Dependency Ratios in States and their Growth Rate

States	Dependency Ratio	Child Dependency Ratio	Old Age Dependency Ratio	(in per cent)
				Growth Rates (2003-04)
UP	93.5	79.1	14.4	5.8
Punjab	72.8	52.7	20.1	5.3
Orissa	76.2	56.8	19.4	14.4
Karnataka	70.2	52.8	17.4	6.2
Haryana	77.7	63.7	14.0	8.6
Madhya Pradesh	84.8	71.2	13.6	18.6
Kerala	57.8	41.1	16.7	10.7
Rajasthan	89.2	75.5	13.7	14.7
Gujarat	66.1	54.5	11.6	15.4
Tamilnadu	57.0	42.0	14.9	3.6
Bihar	95.5	82.2	13.4	-6.7
Maharashtra	69.4	54.4	15.0	7.3
West Bengal	72.6	63.4	9.2	7.5
Andhra Pradesh	71.0	60.0	11.0	7.6
India	70.9	62.1	8.9	8.5

Source: Registrar General of India (2002a), CSO (2005).

Table 2.5: Growth in UP During Five Year Plans

Plan Period	(in per cent)			
	Annual Growth rate in Total Income		Annual Growth rate in Per capita Income	
	India	UP	India	U.P.
First Five Year Plan (1951-56)	3.6	2.0	1.7	0.5
Second Five Year Plan (1956-61)	4.2	1.9	1.9	0.3
Third Five Year Plan (1961-66)	2.8	1.6	0.0	-0.2
Three Annual Plans (1966-69)	3.8	0.3	1.8	-1.5
Fourth Five Year Plan (1969-74)	3.3	2.3	1.1	0.4
Fifth Five Year Plan (1974-79)	4.7	5.7	2.9	3.3
Sixth Five Year Plan (1981-85)	5.7	3.9	2.7	1.5
Seventh Five Year Plan (1985-90)	5.8	5.7	3.6	3.3
Two Annual Plans (1990-92)	3.4	3.1	0.4	1.1
Eighth Five Year Plan (1992-97)	6.8	3.2	4.9	1.4
Ninth Five Year Plan (1997-2002)	5.5	2.3	3.6	0.0
Tenth Five Year Plan (2002-07)*	6.5	3.1	4.8	-1.5

\* : Refers to average growth rate during 2002-03 and 2003-04.

Source: Government of UP (2002), Planning Commission (2001a).

Table 2.6: Annual Growth Rate of Sectors in UP

Year	Annual Growth Rates				Composition of State Output		
	Agriculture & allied activities	Industry	Services	Overall Growth Rate	Agriculture & allied activities	Industry	Services
1994-95	2.9	17.3	3.6	5.8	38.8	19.2	42.0
1995-96	1.6	4.2	5.3	3.7	38.1	19.2	42.7
1996-97	9.3	16.9	9.1	10.7	37.7	20.3	42.1
1997-98	-5.0	-2.9	5.6	-0.1	35.9	19.7	44.5
1998-99	3.3	-0.5	3.9	2.8	36.1	19.0	44.9
1999-00	8.7	-0.6	5.7	5.5	37.2	17.7	45.0
2000-01	-0.7	-1.2	3.3	1.0	36.6	17.4	46.0
2001-02	2.8	1.3	3.7	3.0	36.4	17.2	46.4
2002-03	-5.1	5.0	2.8	0.4	34.7	17.8	47.5
2003-04	4.8	6.2	6.3	5.8	34.2	18.1	47.7

Source: Data on state output from CSO (2005).

Table 2.7: Decadal Growth Rate of Sectors in UP

(in per cent)

Period	Decadal Growth of Sectors			State Income
	Agriculture	Manufacturing	Services	
1950-51 to 1970-71	1.5	3.5	2.8	2.2
1970-71 to 1980-81	2.0	5.0	3.6	3.0
1980-81 to 1990-91	3.2	9.6	6.4	5.0
1990-91 to 1997-98	2.5	6.9	5.4	4.0
1993-94 to 2002-03	2.3	2.6	4.7	3.8

Source: Government of UP, (2002).

Table 2.8: Area and Population of the Regions in UP

(averages)

Regions	Area (sq.km.)	Population (million nos)	Density of Population (per sq.km.)
Eastern	3254.2	2.51	866.5
Western	3158.0	2.39	799.5
Central	4105.3	2.77	738.7
Bundelkhand	4425.0	2.78	356.0
Total	3442.0	23.7	689.2

Source: Compiled from CMIE (2004).

Table 2.9: Share of Food/Non-Food Expenditure in UP

(in per cent)

Items	Uttar Pradesh				India			
	Rural		Urban		Rural		Urban	
	93-94	2002-03	93-94	2002-03	93-94	2002-03	93-94	2002-03
FD	43.5	39.3	32.2	29.6	44.8	39.4	31.6	29.1
NFD	35.1	48.2	41.5	43.0	32.8	36.9	39.0	40.8

FD: Food grain expenditure includes cereals and cereal substitutes, gram and pulses; NFD: Non-food grain expenditure includes expenditure on milk, eggs and poultry products, vegetables, and fruits.

Source: NSSO (1996; 2003a).

Table 2.10 : Expenditure of the Government of UP on Agriculture

(in per cent)

Years	Agriculture		AG/TE	AG/DE
	Plan	Non-Plan		
1990-91	55.1	44.9	6.4	10.0
1991-92	40.5	59.5	3.3	8.7
1992-93	51.0	49.0	5.5	9.4
1993-94	39.1	60.9	4.7	10.5
1994-95	37.9	68.0	3.2	8.4
1995-96	37.1	62.9	3.5	8.8
1996-97	38.1	61.9	3.1	8.5
1997-98	24.5	75.5	4.1	8.6
1998-99	31.1	68.9	3.7	8.4
1999-00	49.5	50.5	6.3	10.8
2000-01*	44.9	55.1	4.9	6.6
2001-02*	50.6	49.4	6.4	8.4
2002-03*	37.0	63.0	4.7	11.4
2003-04*	36.5	63.5	3.0	13.0
2000-01**	46.8	53.2	5.1	7.3
2001-02**	52.2	47.8	7.0	7.7
2002-03**	32.8	67.2	5.3	10.1
2003-04**	30.1	69.9	3.4	9.9

Notes : \* Including Uttaranchal, \*\* Excluding Uttaranchal, AG : Expenditure on Agriculture  
TE: Total Expenditure including revenue and capital; DE: Development Expenditure.

Source: Compiled from RBI (2003b).

Table 2.11: Major Reforms in the Industrial Sector in UP

Objectives	Policy Measures
i) To develop infrastructure	Creation of Industrial Infrastructure Development Fund (IIDF) and Establishment of IIDA
ii) To attract private investment	Set up a Uttar Pradesh Development Council
iii) Promotion of Exports	State Export Award Scheme
	Market development assistance scheme
	Creation of Export Promotion Bureau to coordinate and facilitate exports
iv) To promote investment in Less Developed Regions	State capital subsidy scheme to attract new investment in Bundelkhand and Eastern region
v) Deregulation and Simplification	Single Window Clearance
	Single combined inspection in year
vi) Encouraging new service sector projects like hospitals, medical colleges, shopping malls	Tax exemptions

Source: Government of UP (2004).

Table 2.12: Resource Gap Indicators of UP Government

(in per cent)

Year	GFD/ GSDP	RD/ GSDP	PD/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	SSE/ GSDP	DEX/ GSDP	IP/ RR	CT/ GSDP	Debt/ GSDP
1980-81	3.5	-1.2	2.5	33.2	-9.6	4.1	1.6	-	-	8.3	6.5	22.4
1981-82	2.7	-2.1	1.6	78.2	15.6	4.9	1.7	-	-	7.8	6.8	23.1
1982-83	2.9	-1.0	1.9	33.1	-7.5	4.7	1.9	-	-	8.4	6.3	22.0
1983-84	4.9	0.5	3.8	9.8	4.0	4.5	1.8	-	-	9.6	5.7	22.4
1984-85	6.2	0.6	4.8	9.9	4.7	4.7	1.6	-	-	10.8	6.7	25.0
1985-86	3.8	-0.6	2.7	16.5	-4.5	4.7	1.9	-	-	8.3	7.4	26.3
1986-87	4.6	0.6	2.8	12.6	4.2	5.0	1.6	-	-	13.0	7.0	26.3
1987-88	3.0	-0.7	0.9	24.9	-4.7	5.8	1.8	-	-	13.0	7.9	26.7
1988-89	4.4	1.5	2.4	33.5	10.7	5.0	1.7	-	-	14.4	7.0	25.2
1989-90	5.3	2.2	3.1	41.5	15.6	5.2	1.8	-	-	15.7	7.1	26.3
1990-91	5.5	2.2	3.2	40.0	14.8	5.7	1.4	6.4	13.1	15.4	7.9	27.4
1991-92	4.4	1.1	1.7	25.5	7.5	5.4	1.7	5.6	10.5	17.7	7.9	27.3
1992-93	5.2	1.4	2.4	27.3	8.7	5.5	2.0	6.0	12.3	17.5	9.0	28.4
1993-94	3.7	1.3	1.2	36.3	9.5	4.8	2.0	4.9	9.8	17.4	7.3	26.7
1994-95	4.7	2.0	1.7	42.0	15.0	4.8	1.9	4.8	9.2	23.1	6.6	26.3
1995-96	3.9	2.1	0.9	53.4	15.4	4.8	2.1	5.0	8.9	21.9	6.5	26.4
1996-97	4.4	2.3	1.4	53.4	19.8	4.6	1.0	4.9	8.7	25.3	6.1	25.1
1997-98	5.2	3.2	2.0	61.0	26.3	4.8	0.9	5.4	9.1	26.7	6.4	27.5
1998-99	7.1	5.3	3.7	74.8	50.0	4.8	0.9	5.6	9.6	31.7	4.9	29.7
1999-00	6.3	4.1	2.6	65.3	33.7	5.3	1.1	5.0	9.5	30.5	5.7	33.8
2000-01	5.6	3.4	1.5	60.9	24.5	6.1	1.1	5.3	13.5	29.4	6.7	35.9
2001-02	5.2	3.1	0.8	60.9	22.2	5.6	1.0	5.3	11.8	30.8	7.6	38.0
2002-03	6.8	4.8	2.5	61.1	29.3	6.8	1.0	6.7	10.7	32.5	8.4	45.0

Notes: GSDP: Gross State Domestic Product; GFD: Gross Fiscal Deficit; RD: Revenue Deficit; PD: Primary Deficit; OTR: Own Tax Revenue; ONTR: Own Non-Tax Revenue; SSE: Social Services Expenditure; DEX: Developmental Expenditure; IP: Interest Payments; RR: Revenue Receipts; CT: Central Transfers (Share in Central Taxes + Grants & Loans from the Centre); DEBT: Total Debt Liabilities.  
- not available.

Source: Compiled from RBI (2003b) and CSO (2005).



Table 2.13: Interest Rates on State Government Borrowings

(amount in Rs. billion)

Year	Interest Rates paid by state government		Amount borrowed by UP Government	
	State Government Securities	Loans and Advances from the Centre	Gross Market Borrowing	Loans and Advances from the Centre
1991-92	11.8	13.0-13.5	5.8	22.3
1992-93	13.0	13.5-14.5	6.4	19.5
1993-94	13.5	14.5-15.0	8.1	17.8
1994-95	12.5	14.5	7.9	32.2
1995-96	14.0	14.5	10.9	27.7
1996-97	13.8	14.5	10.3	32.6
1997-98	12.8 (12.0)	14.5	12.5	42.0
1998-99	12.4 (11.9)	14.0-14.5	21.0	56.9
1999-00	11.9 (11.8)	12.5-14.0	23.1	33.9
2000-01	11.0 (10.9)	12.5-11.0	14.9	25.2
2001-02	9.2 (9.4)	11.0	24.5	27.6
2002-03	7.5 (7.3)	10.5	32.4	35.8
2003-04	6.7 (5.7)	9.5	53.8	41.9

Notes: Figures in brackets are weighted average yield on Central Government market borrowings.

Source: RBI (2004d), RBI (2003b), RBI (2004a).

Table 2.14: Education Expenditure of the Government of UP

(in per cent)

Years	EE/TE	EE/SDP	REE/TRE	REE/TRDE	CEE/TCD	CEE/TCO	CEE/TCDO
1990-91	17.5	-	22.0	34.2	1.2	2.8	3.0
1991-92	15.5	-	19.3	32.7	1.6	6.3	6.8
1992-93	15.9	-	19.8	33.6	1.7	4.6	4.7
1993-94	14.7	2.8	17.8	31.1	1.2	3.9	4.2
1994-95	13.8	3.2	18.6	35.0	0.8	3.9	4.0
1995-96	16.5	3.6	19.3	37.0	1.4	4.0	4.4
1996-97	17.0	3.8	20.2	36.6	1.0	2.8	3.0
1997-98	16.0	4.1	18.9	35.6	1.2	3.3	3.5
1998-99	18.3	5.4	22.0	41.8	0.5	1.4	1.5
1999-00	16.6	5.1	19.9	39.6	0.4	0.8	0.9
2000-01	17.0	5.6	19.9	41.2	0.9	1.6	1.6
2001-02	16.4	5.7	19.4	40.8	0.9	1.6	1.6
2002-03	15.1	-	19.2	37.7	0.9	2.3	2.5
2003-04 (BE)	11.6	-	16.5	35.5	0.7	1.2	1.2

Note: From 2000-01 includes Uttaranchal also. REE: Revenue Expenditure on Education;

TRE: Total Revenue Expenditure; TRDE: Total Revenue Development Expenditure;

CEE: Capital Expenditure on Education; TCD: Total Capital Disbursements;

TCO: Total Capital Outlay; TCDO: Total Capital Developmental Outlay.

Source: Same as Table 2.12.

Table 2.15: Expenditure by the Government of UP on Public Health

( in percent)

Year	EH/SDP	EH/TE	REH/TRE	REH/TRDE	CEH/TCD	CEH/TCO	CEH/TCDO
1990-91	-	5.5	6.5	10.1	2.0	4.6	4.8
1991-92	-	5.2	6.0	10.1	2.1	8.3	8.8
1992-93	-	4.9	5.8	9.9	1.5	4.2	4.4
1993-94	1.1	6.0	6.9	12.2	1.8	5.6	6.0
1994-95	1.1	4.6	5.8	11.0	1.2	5.9	6.1
1995-96	0.9	4.0	4.5	8.6	1.5	4.3	4.7
1996-97	0.9	4.0	4.5	8.1	1.7	4.5	4.8
1997-98	1.1	4.4	5.0	9.3	1.9	4.9	5.3
1998-99	1.0	3.4	3.9	7.4	1.0	2.5	2.6
1999-00	1.0	3.2	3.7	7.3	1.1	2.5	2.5
2000-01	1.1	3.2	3.7	7.6	0.8	1.4	1.5
2001-02	1.0	3.0	3.5	7.3	0.4	0.8	0.8
2002-03	-	3.1	3.9	7.7	0.4	0.9	1.0
2003-04 (BE)	-	2.9	3.9	8.4	0.8	1.3	1.3

Note: From 2000-01 includes Uttaranchal too. EH: Expenditure on Health; TE: Total Expenditure; REH: Revenue Expenditure on Health; TRE: Total Revenue Expenditure; TRDE: Total Revenue Development Expenditure; CEH: Capital Expenditure on Health; TCD: Total Capital Expenditure; TCO: Total Capital Outlay; TCDO: Total Capital Development Outlay.

Source: Same as Table 2.12.

Table 2.16: Targets and Actual Achievements under UPFRBMA, 2004

Target Variables	Targeted Reduction (as percent of GSDP)	Targeted Year	Progress so far (2004-05 R.E.) ( in per cent)
Gross Fiscal Deficit	3.0	2009	5.6
Revenue Deficit	0.0	2009	2.9
Total debt liabilities	25.0	2018	54.7

Note: UPFRBMA- Uttar Pradesh Fiscal Responsibility and Budget Management Act.

Source: RBI (2004g).

Table 2.17: Spread of Bank Branches in Various States (2003)

Selected States	No. of Bank Branches	Population per bank branch (in 000)	States' Per capita real income (in Rs.)
Haryana	1618	13	18067
Punjab	2645	9	17890
Rajasthan	3348	17	10056
Bihar	3560	21	4088
Orissa	2245	17	7447
West Bengal	4469	19	11998
Madhya Pradesh	3456	19	9414
UP	8210	21	6535
Gujarat	3677	14	19673
Maharashtra	6373	15	18614
Andhra Pradesh	5300	15	12792
Tamilnadu	4768	13	15151
Karnataka	4851	11	13354

Source: RBI (2004f), CSO (2005).

Table 2.18: Bank Branches in UP

(in numbers)

Top Five Banked Districts in UP					Lowest Five Banked Districts in UP				
Districts	1998	2001	2003	2004	Districts	1998	2001	2003	2004
Kanpur Nagar	313	321	323	324	Chitrakoot		39	39	38 D(2960.3) C(1486.4)
Lucknow	274	302	314	336	Mahoba	33	34	34	33 D(3131.9) C(1989.2)
Ghaziabad	262	215	222	230	Lalitpur	46	44	44	44 D(3263.6) C(1422.1)
Allahabad	298	247	248	248	Baghpat	n.a.	48	48	47 D(4534.5) C(1417.0)
Agra	231	229	230	229	Kausambhi	n.a.	49	48	48 D(2872.7) C(625.5)
Varanasi	258	209	213	213					
Total	8873	8163	8192	8367	8873	8873	8163	8192	8367

Note: i) The Kaushambi district was carved out of Allahabad district on 4<sup>th</sup> April 1997.

ii) Chitrakoot district was created on 6<sup>th</sup> May 1997 and named Chhatrapati Shahuji Maharaj-Nagar which was subsequently changed to Chitrakoot on Sept 4, 1998.

D: deposit per capita in Rupees; C: Credit per capita in Rupees.

Source: RBI (2004b).

Table 2.19: Population Per Bank Branch in Districts of UP -2001

Population per Bank Branch	Number of Districts
<10000	0
10000-12000	1
12000-15000	4
15000-18000	7
18000-21000	19
21000-24000	23
24000-27000	12
27000-30000	3
>30000	1

Source: RBI (2004b, various issues).

Table 2.20: Regional Spread of Bank Branches in UP

(in per cent)

Years	Average Growth Rate of Bank Branches				Average Share of Bank Branches			
	Eastern	Western	Central	Bundelkhand	Eastern	Western	Central	Bundelkhand
1972-76	15.9	17.4	16.6	10.6	28.8	45.6	19.9	5.7
1977-90	11.1	7.3	8.7	12.3	33.3	40.6	19.8	6.3
1991-04	0.5	0.9	0.7	0.9	35.5	38.1	19.4	7.0

Source: Same as Table 2.19.

Table 2.21: Bank Branches Closed/Opened in UP

(in numbers)

Year	Rural		Semi-Urban		Urban		Metropolitan		Total	
	C	O	C	O	C	O	C	O	C	O
1999-00	24	9	10	16	29	27	7	13	70	65
2000-01	10	8	1	11	7	19	-	5	18	43
2001-02	7	3	4	8	14	21	7	11	32	43

C: Closed ; O: Opened Source: RBI (2002a).

Table 2.22: Private Corporate Deposits in UP

(as per cent to the total)

States	1997	1998	1999	2000	2001	2002	2003	2004
Haryana	0.9	2.0	0.7	0.6	1.8	2.0	1.5	3.7
Punjab	0.4	0.5	0.5	0.6	0.4	0.4	0.3	1.6
Rajasthan	1.1	0.7	1.6	1.9	1.5	0.9	0.6	2.6
Delhi	7.8	7.9	8.6	9.2	9.2	9.2	11.6	11.4
Bihar	0.4	0.2	0.7	0.4	0.4	0.2	0.4	1.2
Orissa	2.1	1.2	0.6	0.1	0.8	0.6	1.0	1.3
West Bengal	4.2	4.3	5.4	5.1	5.9	5.6	4.4	8.9
Madhya Pradesh	1.3	3.2	1.0	0.7	0.5	1.1	3.0	4.5
UP	0.7	0.7	1.8	1.6	1.0	0.8	1.1	1.9
Maharashtra	7.7	7.8	9.7	8.2	9.1	14.1	10.0	12.7
Karnataka	3.2	5.5	4.1	4.3	7.7	6.4	7.6	16.6
Kerala	0.9	0.5	1.0	0.7	0.8	1.6	2.0	1.9
Tamilnadu	6.2	5.5	5.8	4.5	6.2	6.9	5.2	11.5
All India	3.9	4.0	4.1	3.8	4.6	5.7	5.1	7.9

Source: RBI (2005b, various issues).

Table 2.23: Interest Rate Subsidy to the Small Borrowers in Selected States, 2004

States	Subsidy to small borrowers (Rs.)	Share of states in total (per cent)	Interest subsidy per account (in Rs.)
Haryana	9532	2.9	984
Punjab	13654	4.1	1049
Rajasthan	15567	4.7	738
Bihar	10823	3.3	480
Orissa	13142	4.0	584
West Bengal	15279	4.6	467
Madhya Pradesh	15084	4.6	743
UP	34991	10.6	540
Gujarat	12051	3.6	651
Maharashtra	29579	9.0	496
Andhra Pradesh	36547	11.1	491
Karnataka	30631	9.3	548
Kerala	21491	6.5	562
Tamilnadu	37989	11.5	332
All India	330281	100.0	534

Source: Present study's own estimates.

Table 2.24: Models of Microfinance Followed in India

Models	Who creates SHGs	How assistance to SHGs is provided	Share in Total (end March 2005)	
			No. of SHGs	Bank Loan
Model I	Banks	Open savings accounts and provide credit	21.0 (22.1)	15.0 (24.2)
Model II	NGOs	Financing directly by banks	72.0 (74.1)	80.0 (73.2)
Model III	NGOs	Financed by banks through NGOs	7.0 (3.8)	5.0 (2.5)

Note: Figures in brackets indicate share in UP.

Source: Compiled from RBI (2005d), NABARD (2005).

## **CHAPTER 3**

### **BANK CREDIT AND ECONOMIC DEVELOPMENT: A REVIEW OF LITERATURE**

#### **3.1 Introduction**

This chapter explores the literature surrounding credit and development. It examines the different strands of literature revolving around banks, capital accumulation, development and equality-growth, the keywords relevant in the present research.

The meaning of development in the current development literature has changed from sole emphasis on economic growth, to a broader and a more inclusive concept of growth, with the emphasis on human development. This, along with the expansion in the literature on capital accumulation, and its views on banking, has shaped the policies of the governments in the developing countries. With the growth has come inequalities, and, different regions have grown differently. As a result, the reduction in inequality was suggested. This chapter presents a synthesis of these different streams of literature which have emerged and grown during the same period. It is vital to recognise that these streams of literature are not independent of each other, but have followed the same path of thinking. The complexities of the development (or rather underdevelopment) of the less developed regions can be understood only by examining more closely this thinking in the theoretical literature.

During the nineties, friction emerged between growth and development. The debate was between physical capital and human capital; finance for growth or finance for development; and regional imbalances or reducing inequalities for the regions. The Indian literature has also moved in tandem with the theoretical developments above. The economic growth literature led to a shift in the thinking on banking, and the studies emphasised the banks' role in promoting growth. The frictions in the literature at the theoretical level were reflected in policies, whether economic growth or development for all, finance for growth or finance for development (refers to human development and economic growth), equality in income or equality in non-income too. This friction in the literature in the nineties influenced the policies, which

in turn led to increased disparities across the states in India. The present study emphasises that it is this friction, which contributed to the decline in availability of credit in the less developed regions.

A large body of literature exists on the role of finance in economic development. This can be grouped into two: the literature during the period, 1940s to 1980s, which viewed finance as playing a passive role; and the later literature (1990s and beyond), in which finance plays an active role in the economic development. The chapter is organised into four sections. Section I discusses the early literature on banking, capital accumulation, development and regional imbalances including the period 1940s to 1960s. Section II examines the decades of the seventies and eighties, when the focus was on the repressive financial system, and on the concept of development. During the nineties stress was on a more positive role of finance. Section III discusses the literature during this period including endogenous growth literature. During this decade, a substantial contribution was also in the equality and growth trade-off literature. The emergence of the large literature on inequality also was indicative of the concerns on the widening of inequalities in the developing countries. The chapter presents the theoretical developments and policy changes together, to show that the former was influencing the latter. In addition, the four streams of literature on banking, capital accumulation, development and inequality are presented for each period to highlight the point that these literatures, though developing independently, were actually following a similar path.

## **Section I**

### **3.2 Banking, Capital Accumulation, Development and Inequality: The Early Literature**

#### *3.2.1 Banking*

Among the classical economists<sup>36</sup>, Adam Smith highlighted the banks' role in augmenting the productivity of capital stock, and as an outcome, driving growth. According to Bowley (1975), Smith attached special significance to the role of capital in his *Wealth of Nations*. He introduced the concept of capital stock. A lack of

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<sup>36</sup> The word 'classical' refers to the economic thought of the period from mid-eighteenth century to the mid-nineteenth century.

consensus on his theory of banking is however, widespread (Gherity, 1994)<sup>37</sup>. On the treatment of banking by Smith and James Steuart, a lawyer and regarded as the last mercantilist, Checkland (1975) remarked:

Both Steuart and Smith can be accused of allowing the demand of their general systems of thought to affect their presentation of banking. Both left some important theoretical issues unbroached and both left some unresolved. But taken together they provide a most illuminating dichotomy, perhaps the best theoretical starting-point for a consideration of pre-industrial banking, and not without relevance for later times (Checkland, 1975, p.523).

Dunning Macleod, a Scottish barrister and a political economist in the nineteenth century (Skaggs, 1999; 2003), attributed a positive role to the banks in promoting economic growth. He argued that by lending, banks bring underutilised resources into production, extend the market by providing credit, and promote venture capitalists through cash credit facilities (see Skaggs, 1999, p.489). Bagehot, (1853) also argued that the financial system played a critical role in igniting industrialisation in England ( as noted in Levine, 1997). Fisher (1930) also later demonstrated, that in the well functioning competitive financial markets, savers would receive the highest possible returns on their savings, and producers would be able to obtain funds at the lowest possible costs.

As the theoretical views on banking and its role in development were evolving, in India also the demand for modern banking was growing for financing the trade and remittance facilities for the British in India (including troops, administrative staff etc.). The first bank founded in 1720, called Government Bank of Bombay, closed in 1770. During this period, a number of other banks also opened and closed. Many small Indian banks, opened since 1870, either closed, or merged with the other banks (P. Tandon, 1990). The present study thus observed that as in British banking, the experiments on banking were going on in India also. The main causes of a large number of bank failures were: a) incompetence of Directors; b) unrestricted loans to bank directors or firms related to them; c) dishonest management and injudicious investments; d) insufficient paid-up capital and reserves; and e) absence of central bank and no lender of last resort (P. Tandon, 1990).

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<sup>37</sup> Smith was concerned with the abuse of credit, and the over-issue of currency. He believed that bank failures are common, but their effect is limited as there are large numbers of banks. Sir James Steuart, a lawyer and regarded as the last mercantilist, in his *Inquiry into the Principles of Political Economy* [1767] expressing his views on the Scottish banking system during the period 1763 and 1767 was in favour of the public banks as the issuer of currency and control over the private banks (Checkland, 1975).

In the 1940s and 1950s, the theories on economic development, however, did not discuss the role of credit in economic development, and the role of banks was not clear. In the late 1940s, these theories emerged as a tool to the newly independent countries of Asia, Africa and the Caribbean to assist their economic development (Meier & Rauch, 2000). The theories emphasised economic growth through capital accumulation and industrialisation. Even Kalecki, who had considered taxation and foreign capital as a means of financing investment, did not include credit as a source of financing (Ghosh, 2001). Though Sawyer (2004) points out that Kalecki in his early writings in the 1930s, “clearly saw the key role of the extension of credit in the financing of that expansion (of the level of economic activity)” (Sawyer, 2004, p.55).

Overall, though the development theories did not spell out the role of the financial intermediaries, including banks, in economic development, they did lay the framework for policies pursued by developing countries during the fifties and the sixties (Meier & Rauch, 2000). Thus, the emphasis on industrialisation, capital formation, and import substitution strategy vs. export promotion in the developing countries were a manifestation of the impact of these development theories.

Drake (1980) observed that:

In the voluminous literature of economic development, it is remarkable that relatively little attention has been given to financial aspects of the subject. This neglect is especially surprising in view of the key emphasis given to capital formation (Drake, 1980, p.1).

Nevertheless, some economists like Gurley and Shaw (1955) did point out the significance of the financial intermediation in the process of economic development. They argued that the increased role of financial intermediaries increases the debt-income, debt-wealth ratio. On the importance of financial intermediaries in economic development, Gurley and Shaw (1955) remarked:

Economic development is retarded if only self-finance and direct finance are accessible, if financial intermediaries do not evolve. The primary function of intermediaries is to issue debt of their own, *indirect* debt, in soliciting loanable funds from surplus spending units, and to allocate these loanable funds among deficit units whose direct debt they absorb (Gurley & Shaw, 1955, p.518-519).

### *3.2.2 Capital Accumulation*

Capital, as defined in the early development literature, was associated with physical capital. A broader view of capital considered as expressed in Johnson (1969), “anything capable of generating a flow of income as capital” (Johnson, 1969, p.8-9). Therefore, in a broader perspective, capital referred to financial capital, human



capital, and social capital and a number of other forms of capital. On the necessity of capital accumulation, Johnson (1969) observed:

---the condition of being “developed” consists of having accumulated, and having established efficient social and economic mechanisms for maintaining and increasing large stocks of capital per head in the various forms. Similarly, the condition of being “under-developed” is characterized by the possession of relatively small stocks of the various kinds of capital, and the existence of relatively weak and inefficient mechanisms for maintaining and increasing those stocks----- (Johnson, 1969, p.9).

The development theories assigned a significant role to capital accumulation in economic development. Investment in agriculture and industry for growth and development was considered vital. As the accumulation of capital enhances a country’s capacity to produce goods leading to its faster growth, developing economies laid great emphasis on the importance of capital accumulation, and on the need to raise the level of investment in relation to the output.

Lewis (1954) stressed the importance of capitalist surplus for economic development. In his view, development was akin to the shift of surplus labour from the agricultural sector to the modern industrial sector. He, however, did not explain how the capitalist surplus was converted into investment, whether it was through self-finance, use of undistributed profits, plough back, or whether financial intermediaries brought together small savings, and lent them to capitalists for further investment or a combination of all.

Nurkse (1953), in his theory of balanced growth, argued that there is a need to promote increases in output that are diversified in accordance with the domestic income elasticity of demand so that supply equals demand. Contrary to this, Hirschman (1958) saw the impossibility of the simultaneous establishment of many industries all at the same time, and ensuring same rate of progress. He believed in the strategy of unbalanced growth in which growth is accelerated in a few industries and sectors to create disequilibria that would mobilise hidden and underutilised resources. He also believed that it is market forces which govern investment decisions. In cases where markets are inefficient, non-market forces will govern decision-making. The development of key industries with strong linkages (backward and forward) to other parts of the economy could stimulate favourable outcomes.

### *3.2.3 Development*

A large literature has emerged concerning the meaning of word ‘development’. From the meaning of development as growth in the GNP and

industrialisation, it has evolved to ‘people centered’ or human development (see Stern, 1989).

In the 1940s and 1950s, the word ‘development’ was more an expression of the development of underdeveloped areas, referred to in the eighteenth century as ‘rude and barbaric’ (Goodacre, 2005). Until then, economists had referred to economically backward areas, or rich and poor countries. Development was also described as an escape from the condition of underdevelopment (see Esteva, 1992). From the antithesis of underdevelopment, it came to be associated with economic growth in the fifties, wherein growth in the per capita income was the objective of development. This led to the emphasis on industrialisation, and taking into account the scarcity of resources in underdeveloped countries, the crucial tool for economic growth was accumulation of capital. This view of growth as, more or less, synonymous with development surfaced. The ideas thus centered around: i) industrialisation; ii) accumulation of capital; iii) underemployment; iv) planning; and v) state intervention (Sen, 1983). Sen (1983) cautioned that this narrow agenda of development in the 1940s and 1950s has to be viewed in terms of circumstances in those days. The focus in the post-war immediate period was, as Ranis (2004) points out, on the scarcity of capital and savings-pushed growth. Also, as Sen (1983) observed:

Development economics was born at a time when government involvement in deliberately fostering economic growth in general, and industrialisation in particular, was very rare, and when the typical rates of capital accumulation were quite low (Sen, 1983, p.752).

However, the emphasis on development was narrow. It excluded the less developed regions, sectors and groups of people.

### *3.2.4 Inequality*

Inequality is a very broad concept, and could range from inequality in income to inequality in non-income such as education, health, and spatial inequalities (Heshmati, 2004). In the current literature also, the focus on inequality ranges from inequality in incomes to inequality of ‘opportunity’<sup>38</sup>(World Bank, 2005).

The classical economists had paid no attention to spatial distribution issues, though they were concerned with the distribution of income across groups of people.

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<sup>38</sup> This change does recognise that, contrary to the assumption of neoclassical literature that rationality and self interests of human beings would determine opportunities; opportunities to the individuals may not be equal due to the discrimination on grounds of gender, caste, colour, and race.

Ricardo even argued that the political economy should be “an enquiry into the laws which determine the division of the produce of industry amongst the classes who concur in its formation”(as cited by A. Atkinson, 1997, p.298). Marx believed that capitalist distribution creates an increasingly unequal distribution of income. Wages of the labourers are set at subsistence level, whereas capitalists appropriate the profits. As capitalism develops, the rate of profit falls leading to its collapse and is replaced by socialism, which improves the lot of workers (Perkins, Radelet, Snodgrass, Roemer, & Gillis, 2001).

The issue of spatial distribution and growing regional imbalances was not dealt with in the development literature of forties and fifties, presumably because the objective of achieving rapid economic growth of newly independent countries was the focus. The focal point during this period was the country, and the less developed regions within the country were overlooked. Even in India, where distributional issues have attracted much attention<sup>39</sup>, during the First Five Year Plan (1951-56) it was perceived that increasing production in the country was the main objective, and the social issues would be looked into once the production targets were met. The First Five Year Plan was termed largely as a production plan as it laid great emphasis on the development of agriculture and irrigation. During this period, the debate was on the allocation of investment between agriculture and industry, choice of technology and import substitution versus export promotion. It was believed that even the poor would benefit from growth, especially in view of the land reforms undertaken in the country. Also, excessive emphasis on redistribution at an early stage in the growth process was thought to retard growth (Srinivasan, 1977). However, concerns about the distribution of income were occasionally expressed in India (see Gadgil, 1965).

On the theoretical front, Kuznets (1955) did suggest that the relationship between per capita GNP and inequality in the distribution of income takes the form of an inverted U shaped curve. As income rises, inequality increases, reaches a maximum, and declines with further increases in income. The driving force was structural change in a dual economy in which labour moves from a poor traditional sector to a modern productive sector. Therefore, it was recognised that inequality does occur in the process of economic growth.

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<sup>39</sup> The objective of income redistribution with growth was laid down in India’s various Five Year Plans. Observing the substantial focus on income redistribution in Indian Five Year Plans, Williamson (2003) commented that “past policy focused perhaps, excessively on redistributing rather than increasing income” (J. Williamson, 2003).

### **3.3 A Synthesis**

The above brief review of the literature shows that the development economists laid stress on capital accumulation and its formation since the newly independent countries lacked capital. In addition, a point which emerges from the review of this literature is that the classical economists had highlighted the role of banks in economic development, in contrast to its absence in the later development literature. The early development economists, though they laid much stress on investment, did not discuss how the investment would materialise, so the banks were not their focus. The emphasis was on the physical capital as the task of governments lay primarily in building nations.

Also a point noted in the beginning of the chapter needs to be reiterated here. Precisely, these four streams of the literature on banking, capital accumulation, development and inequality among the regions, were all developing at the same period. The development policies followed in India were also influenced by the developments in this literature. Though not emphasised by the development economists, active state involvement came into being with the formation of Plan bodies based on the Soviet model. The section below discusses how government intervention in the banking sector, also called the 'supply-leading' approach, came into existence.

## **Section II**

### **3.4 Banking, Capital Accumulation, Development, and Inequality: The Decades of the Sixties to the Eighties**

While the decades of the forties and fifties were the decades of freedom and liberation for the colonies of Britain, the next three decades, sixties to eighties, were significant in terms of building and consolidating nations, and experimenting with policies. It was also a period when the East Asian countries were achieving rapid rates of growth. As in the previous section, the literature of this period, examined below, is in terms of four major keywords: banking; capital accumulation; development; and inequality.

### 3.4.1 Banking

Patrick (1966) distinguished between the demand-following and supply-leading approach to financial development<sup>40</sup>. The demand-following approach is where the financial development is the result of progress in the non-financial sector, and it is the demand for financial services that creates financial institutions and instruments. In the case of the supply leading approach, the financial development precedes and stimulates the process of economic growth. In the developing countries, a supply-oriented approach to finance was dictated by the following needs: i) urgency to catch up with the developed countries; ii) large size of projects; iii) lumpiness of investments, and iv) scarcity of capital (Gerschenkron, 1962). With the supply-leading approach to the financial institutions in many developing countries, a belief developed that government could step in and jumpstart financial and economic development (La Porta, Lopez-De-Silanes, & Shleifer, 2002).

In India, before independence and even after independence, the emergence of a large number of banks in response to the increased trade and other activities was a manifestation of the demand following approach<sup>41</sup>. The supply-based approach came into existence with the emergence of social banking and the nationalisation of banks. A question which can be raised here is, would the development outcomes have been different had the demand following approach been followed? It is, however, hard to visualise such a possibility, as the government's excessive focus on public sector, planned economy and state intervention in various areas of the economy left no possibility for the existence of an independent demand based banking system. The social control and nationalisation of banks was, therefore, a natural culmination of these strategies of economic development.

The concern for the development of backward states also was one of the triggering factors for government intervention. As in many other developing countries, the Indian banks were nationalised in 1969 (Adarkar, 1971; V. K. R. V.

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<sup>40</sup>An alternative approach (interaction of the two approaches) could be when banks are set up and provide finance in desired directions leading to growth of sectors. This in turn leads to increased demand for finance.

<sup>41</sup> After independence, during 1947-51, 242 banks with a paid-up capital of Rs.58.6 million failed. Thereafter too, the bank failures occurred, but the numbers decreased from 14 in 1954 to 4 in 1963 and the mergers, amalgamations and transfers increased from 1 in 1954 to 22 in 1963 and 79 in 1964 (P. Tandon, 1990, p.64). Several practices prevailed in banks during the period: a) a disproportionately large amount of advances against immovable properties; b) advances on inadequate security to Bank directors' firms; c) policy of branch expansion; and d) inter-connected lending.

Rao, 1971; P. Tandon, 1990; also see Torri, 1975). The Narasimham Committee Report (Narasimham, 1991) summarised the objectives of nationalisation as:

Nationalisation was recognition of the potential of the banking system to promote broader economic objectives such as growth, better regional balance of economic activity and the diffusion of economic power. It was designed to make the system reach out to the small man and the rural and semi-urban areas and to extend credit coverage to sectors hitherto, neglected by the banking system and through positive affirmative action provide for such expansion of credit to agriculture and small industry in place of what was regarded as a somewhat oligopolistic situation where the system served mainly the urban and industrial sectors and where the grant of credit was seen to be an act of patronage and receiving it an act of privilege (Narasimham, 1991, p.9).

Also, another factor which might have propelled nationalisation was the introduction of high yielding varieties (HYVs) of crops and the adoption of capital-intensive technologies in agriculture (S. Basu, 2002). The introduction of the HYVs of wheat and rice entailed an intensive usage of inputs including credit. Prior to the nationalisation of the banks, the credit to the agricultural sector was substantially low, with most of the credit going to industry and trade. The nationalisation of the banks was a policy instrument used to direct credit to the agricultural sector.

Providing a rationale for state intervention in the banking sector in India, Arun and Turner (2002) linked government ownership of banks to the asymmetric information view. They argued that the government ownership was a tool for promoting development and providing credit to the neglected sectors and risky groups due to asymmetric information. Basu (2002) ascribed state directed policies in banking to the strategy of the import substitution policy (including introduction of HYVs for increased self reliance in food grains production) followed by the Government. This implied dependence on internal demand for industrial products. In the fifties, there was mass poverty and demand for industrial products in the country was deficient. Basu (2002) argued that the government, to generate this internal demand, used bank credit. He further emphasised that the intervention in the banking sector, government's policy of social control, and subsequent nationalisation, should be seen in this context.

Government intervention in the allocation of credit to accelerate economic development was one of the outcomes (Fry, 1995). The other outcomes of the nationalisation of banks were increase in deposits, and increase in bank branches. The rapid spread of bank branches in the developing countries stemmed from the belief that the development of banking habit (refers to the practice of going to the banks, and performing banking transactions) may precede, or itself promote, the real growth of

the economy (Porter, 1966). He noted that the development of the habit of banking would lead to increased savings and investment, improve the efficiency of allocation of capital, and increase the ability of monetary authorities to stabilise the economy. Lewis (1955) also had argued:

Experience shows that the amount of saving depends partly on how widespread these facilities (i.e. savings institutions) are: if they are pushed right under the individual's nose--people save more than if the nearest saving institution is some distance away (Lewis, 1955, p.229).

### *3.4.2 Branch Banking in India: A Critique*

There are very few studies on the impact of bank branches and the states' development. A recent study by Burgess and Pande (2003) examined the branch expansion policy of 1:4 for commercial banks, which was implemented in 1977 and discontinued in 1990. The rule allowed banks to open a new branch in a location with one or more bank branches, only if they open four branches in locations with no bank branches. Between 1977 and 1990, this rule encouraged banks to open rural branches in states with initial lower financial development. The authors identified the impact of opening a new rural branch on poverty and output, and their results suggested that a 1 per cent increase in the number of rural banked locations reduced rural poverty by 0.36 per cent and increased total output by 0.55 per cent. The rural branch expansion also increased non-primary sector output, and non-agricultural employment. Between 1977 and 1990, the banks disbursed a greater share of the credit to the less developed states, though the trend reversed after 1990. Despite these favourable effects, the authors observed that the branch expansion policy did have an unfavourable effect on banks' balance sheets.

Burgess and Pande (2003) also compared the cost effectiveness of the branch expansion policy vis-à-vis microfinance, and found that the branch expansion policy was more cost effective than microfinance. Burgess and Pande (2003) further pointed to the need to identify specific interventions that facilitate the adoption of new production activities and lead to structural change, growth and reduction of poverty. A beneficial effect of massive branch banking, which their study failed to highlight, is the inculcation of banking habits, which spread among the population, rural and urban alike, and led to increased savings.

### *3.4.3 Critique of Government Interventionist Policies*

Bell and Rousseau (2001) examined whether financial intermediaries have played a leading role in influencing India's economic performance in the pre-reform period. The authors found that: i) financial sector promoted aggregate investment and output and led to a steady shift toward industrialisation; ii) finance affected growth through the accumulation of debt rather than improvements in total factor productivity. The evidence supported the authors' hypothesis that investment, aggregate output and structural change were 'finance enabled' rather than led by government expenditure. They concluded that in India, financial development has promoted economic growth and structural change even in a regulated environment.

However, during the early seventies, there was increasing criticism of the interventionist policies of governments. Emphasis was laid on their removal and thus markets, prices and incentives were the focal points (Meier & Rauch, 2000). Many studies argued that markets, rather than state intervention, would allocate resources efficiently. Cole and Slade (1991) for example, remarked: "The policies deriving from these theories have failed to take account of the complex nature of finance and its multidimensional role in the economy. Instead they have led to distortion and misuse of finance" (Cole & Slade, 1991, p.316).

The literature on 'financial repression', a concept introduced by McKinnon (1973) and Shaw (1973), questioned the distortionary role played by banks in developing countries and argued in favour of financial liberalisation. This included deregulating interest rates and removing other repressive policies. According to McKinnon (1973) and Shaw (1973), loan rate ceilings distort the economy in four ways: i) reduce savings; ii) low yielding projects; iii) lead to capital-intensive projects, and iv) poor quality projects. McKinnon (1973) argued that money holdings and capital accumulation are complementary in the development process. Because of the lumpiness of investment, and reliance on self-financing, savings are needed and high and positive rates of interest play a major part in the mobilisation of savings. Shaw (1973) emphasised the importance of financial liberalisation for financial deepening and the beneficial effect of high interest rates on savings and investment.

Goldsmith (1969) studied financial development and economic growth empirically taking 35 countries over the 1850-1960 period. He observed that in the course of economic development, a country's financial structure grows more rapidly than the national income. He discussed issues such as financial structure, its



development and effect on economic growth, types of financial instruments that exist, their relative importance and diffusion in the economy. Goldsmith (1969) concluded:

The financial superstructure in the form of both primary and secondary securities accelerates economic growth and improves economic performance to the extent that it facilitates the migration of funds to the best user, i.e., to the place in the economic system where the funds will yield highest social return (Goldsmith, 1969, p.400).

Some studies highlighted the negative influence of regulated policies in the banking sector. Demetriades and Luintel (1996) examined the effects of repressive banking sector policies (interest rate controls, reserve and liquidity requirements, directed credit programmes) on financial deepening in the pre-reform period in India. Their results suggested that these policies had a negative influence on financial development. Ketkar and Ketkar (1992) concluded that credit allocation schemes had a negative effect on deposit mobilisation and capital accumulation. They observed this result based on the hypothesis that enhanced and easy access to external credit reduced the need to generate internal finance, thereby depressing financial savings. Meyer and Nagarajan (2000) noted that the evolution of the financial system in India was a consequence of constant governmental intervention over the decades since independence. The study observed that while aggressive branch banking led to the decline in average population per bank branch, the other policies such as directed credit, loan waivers, subsidies and bailing out of non-performing institutions have contributed to a weakening of the banking sector.

These studies did not take into account the positive contribution made by the banks in India in terms of creating awareness for the financial products, sources of finance, and outlet for savings (V. Joshi & Little, 1996). This is particularly noteworthy in view of the inadequate development of a market-based financial system in India, and the only other source of finance being the informal market.

#### *3.4.4 Capital Accumulation and Development*

The concept of capital during this period was evolving from the earlier emphasis on physical capital to the accumulation of human capital. Human capital, defined as “direct expenditure on education, training, health and internal migration” was first recognised as a source of economic growth by Shultz (1961, p.1). Becker in 1964 (third ed. 1993) even titled his book ‘Human Capital’ and described the forms of human capital as schooling, on-the-job-training, medical care and migration to improve income prospects. In the context of slowdown in the growth rate in US,

Denison (1980) pointed out that capital was not the only source, rather only one of the sources of growth, whose contribution to total output was not higher than the contribution of other factors such as knowledge.

Some studies like Morris (1979) attempted to measure indicators on the quality of life. Many studies acknowledged that the backward and underdeveloped regions lacked capital in its various forms including physical capital, and other forms of capital, which holds back the development of these regions. Gradually, it was being realised that the problem of underdeveloped countries was not just lack of growth, and that the “dragon of backwardness” (Hirschman as quoted by Sen, 1983, p.745) in the developing countries cannot be overcome by only emphasising physical capital. Sen (1983) observed, that though capital accumulation is important for growth, growth was only a means to achieve other objectives of human well being. He believed that “economic growth is one aspect of the process of economic development” (Sen, 1983, p.748).

During this period, therefore, it can be seen that the concept of capital accumulation was evolving with the concept of development. Development and capital accumulation no longer referred merely to physical capital accumulation but to a broader view, that of human capital plus physical capital accumulation.

#### *3.4.5 Spatial Inequality*

The distributional issues, relegated to a secondary position in the forties and fifties, emerged again in the early seventies, and economic growth and its impact on income distribution was a subject of much discussion and debate. In the early sixties, doubts were raised in India as to whether the poor had benefited from the growth achieved in 1950s. However, the rise of oil prices in 1973, the preoccupation of the countries with balance of payment issues and debt and adjustment problems, led to neglect of distribution issues during the late seventies and eighties (Fishlow, 1995).

Adelman and Morris (1973), taking data for 44 developing countries, found that the share of income to the poorest decreases when development starts and continues to decline for a substantial portion of the development process. In the most developed phase of a developing country, policy choices determine an improvement in the share of income accruing to the poorest. Ahluwalia (1976) explored the nature of the relationship between the distribution of income and the process of development on the basis of cross-country data of 60 developed and developing countries. He

found a distinct inverse U-shaped pattern between the level of development and inequality as suggested in Kuznets' hypothesis. He found that the factors like the decline of the traditional agricultural sector, urbanisation, education and reduction in the rate of growth of population, improved income distribution and growth. Anand and Kanbur (1993) remarked that Ahluwalia's study on inequality and development was crucial to the literature as firstly, it confirmed the inverse U-shaped curve hypothesis. Secondly, his estimates were used by the World Bank in its Development Reports for the years 1978, 1979 and 1980 for projections of inequality and poverty.

### **3.5 A Synthesis**

An overview of the literature during this period indicates the prevalence of government interventionist policies in banking. Banks in many countries were channeled as the source of financing economic development although dissent was appearing with these policies (McKinnon, 1973; Shaw, 1973). A positive outcome of government intervention overlooked in the literature was the large branch banking network and spread of banking habits among the people.

The two themes raised at the beginning of the chapter, and in the previous section, are revisited here: i) the movement of theoretical literature and policy developments; and ii) pattern in the emergence of the four streams of theoretical literature during this period. Was there any influence of the literature on banking in changing policies in the financial sector? In other words, was there a shift from a repressed to a 'freer' financial sector? Despite the strong emphasis on removal of government interventions, the financial sector reform in different countries was not uniform regarding content, pace and sequencing (RBI, 2002b). Also, some countries, like the Latin American countries which liberalised in 1970s, reintroduced controls again after facing financial crises in the eighties.

The four streams of literature on banking, capital accumulation, development and inequality during this period were showing a divergent trend, as the banking literature was gradually drifting away from development issues, and focusing on efficiency and economic growth. The broader concept of capital including physical and human capital led to a gradual alignment of the literature on capital accumulation and the literature on development. The inequality literature did not progress much during this period, though, in the early seventies, it did show the similar concerns as between economic growth and development.

### **Section III**

#### **3.6 Banking, Capital Accumulation, Development and Inequality: The Decade of the Nineties**

The nineties brought about more changes in the views on development, capital accumulation and banking. Banking in the endogenous literature worked as a source of economic growth. The literature on the issue of growth and inequality, which was largely ignored during the eighties, has burgeoned since the nineties (see Kanbur & Lustig, 1999). Atkinson (1997) for example, wrote ‘Bringing Income Distribution in from the Cold’. With increased economic growth, the inequalities across the regions and groups of population increased, leading to an emphasis on reduction in inequality as being necessary for growth.

The nineties was also the period when economic reforms were introduced in many countries including India. The aim of the economic reforms in the developing countries was to establish and reform market and political institutions. The reforms introduced in India in 1991 had an overall objective of efficient allocation of resources, and rise in the productivity of private sector activities. It was believed that freer markets introduce more competition which would lead to increased productivity and hence incomes<sup>42</sup>. The core idea of the literature was achieving development through competition with an increased role for the private sector, and a reduction in the role of government. The role of the government would be essentially restricted to the social sector, infrastructure development and regulatory activities. This view did not consider the issue that the market treats different regions alike. This view holds that differences exist only in terms of resources, employment, output etc. It presumes that the allocation of resources, guided by returns, depends on the region’s ability to attract resources. The resources move into those activities or regions which generate the highest returns. Markets result in socially desired outcomes as economic self-

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<sup>42</sup> Some of the characteristics of markets are: the market determines the prices when buyers and sellers have full information (based on rational choice) and the value of output is determined jointly. Prices play an important role in the allocation of resources. The other characteristics are the existence of complete markets in all commodities and absence of externalities. Perfect competition assumes that resources would find their way to where they were most valued thereby enhancing wealth. It is this which drives exchange activities. The rational individual, motivated by self-gain, uses the means available to achieve the desired end and will base any decision on its opportunity cost. However, just as an individual is rational and acts in self interest the government too, a collection of rational individuals, may act in self interest. The objective of markets is to maximise private gains, and moral, ethical, and social considerations are not taken into account. It is economic considerations which matter in the market. It does not take into account social norms, behaviour and values like trust, loyalty, truthfulness, information. However it does not function efficiently without these values (Dutt & Jameson, 2001).

interest guides the individuals or firms. A large literature exists on the positive nature, character, and the power of markets; however, this does not take into account backward regions' development.

The immediate reasons for the economic reforms in India in July 1991, however, were not motivated solely by the introduction of market mechanisms. Rather they were precipitated by the macroeconomic crisis led by high budget deficits, the rise in external debt-GNP ratio, a sharp decline in the foreign exchange reserves, and downgrading of India's credit rating (Bhagwati, 1995). Also, major international developments like the disintegration of U.S.S.R. contributed to the reasons for economic reforms (see Bhagwati, 1995). Another reason is the pressure from the international financial organisations, International Monetary Fund (IMF) and World Bank for economic reforms. This, however, according to Pederson (2000), has not been a significant factor in case of India. Rather, Haggard and Kaufman (1992) point out that though international factors have been ascribed as one of the reasons for economic reforms in countries, they doubt whether this can be assigned as a major reason<sup>43</sup>. They argued that the reforms were more likely to take place if favourable conditions of political support and private interests of business exist.

In recent years, a number of developing countries have also been reforming their financial systems, and refocusing the role of banks in the economic development. Some of the factors responsible for generating this impetus for reforms were inefficiencies in the existing systems, external shocks, and pressures from international financial institutions (Cole & Slade, 1991). RBI (2003c) lists the objectives of financial sector reforms in India as: to enhance stability; and to improve the allocative efficiency of financial institutions and financial markets. It stated that the reforms carried out in the banking sector aimed to adopt prudential norms; international benchmarks and strengthen market discipline. The other objectives were organizational change and consolidation, technological upgrading and human resource development in the banking sector. The reforms, however, have been gradual in nature taking into account timing, pace and sequencing (Ahluwalia, 2002; RBI, 2003c).

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<sup>43</sup> According to Haggard and Kaufman (1992), though the reforms commonly are attributed to the ideas of senior officials and economists representing the international organisations, this is however, a narrow view of the situation, as a major reason lay within the domestic economy itself. The external shocks of the 1930s led the Latin American countries to turn inward and the 1980s external shocks led the countries to liberalise.

### 3.6.1 Banking

During the nineties, in the endogenous growth literature, finance is the crucial factor of production in long-run economic growth. The role of the financial institutions is to collect and analyse information, to channel investible funds to the investment projects that yield the highest return, and thus, to stimulate investment and growth (Greenwood & Jovanovic, 1990).

Financial intermediation enhances economic growth by channeling savings into the productive areas of investment, while allowing individuals to reduce the risks associated with their liquidity needs (Bencivenga & Smith, 1991). Financial intermediaries can accelerate the savings rate by offering savings products of different maturities and yields, and allocating these resources to increase investment. The contribution of financial intermediaries to economic development will be determined by the ability of financial intermediaries to reduce information and transaction costs, which in turn will influence savings, investment decisions, technological innovations and long-run economic growth (Levine, 1997). Financial intermediaries can also reduce risks across projects, firms, and industries by risk diversification through which they accelerate technological change and economic growth.

An important role through which financial intermediaries affect economic development, is their acquisition of information (Diamond, 1984)<sup>44</sup>. Financial intermediaries economise on the costs of acquiring and processing information about investment opportunities, and, thereby improve resource allocation. As large number of firms and entrepreneurs seek funds, the selection of the best firms would lead to efficient resource allocation (Greenwood & Smith, 1997).

A number of empirical studies examined the relationship between finance and economic growth. King and Levine (1993a; 1993b) and Gregorio and Guidotti (1995) showed that the higher levels of financial development are positively associated with faster rates of economic growth. Levine (1997) concluded that, “theoretical reasoning and empirical evidence suggests a positive, first-order relationship between financial development and economic growth” (Levine, 1997, p.688). Fase and Abma (2003) examined the empirical relationship between financial development and economic growth in nine emerging countries in the South and South-East Asia. Their main

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<sup>44</sup> Information can be explained as factual knowledge and it can be exchanged among individuals (Lapavitsas, 2003). A market system generates and transmits information and the quality of information disseminated and generated is itself a part of economic development (Johnson, 1969).

finding is that in the early stages of development, the financial sector has an important effect, but its contribution declines in the later stages. They concluded that improvement in the financial structure in developing economies benefits economic development. This literature also suggested that legal institutions and political systems may also be influencing financial development and economic growth (Beck & Levine, 2004; Kroszner, 1999).

Since an efficient financial system was regarded as a necessary precondition for higher growth, several developing countries including India, introduced financial sector reforms (RBI, 2002b). The literature on banking in India in the pre-reform period reflected the concerns on development banking, deposit mobilisation, rural credit schemes. The focus later in the post-reform period shifted to banks' performance, profitability, competition, regulatory and supervision issues (R. Kohli, 1999). The Indian literature in this period recognised:

- i) relationship between finance and economic growth (RBI, 2000);
- ii) need for strong and robust financial intermediaries for efficient resource allocation (Hanson, 2001);
- iii) need to remove financial repression (Demetriades & Luintel, 1997)
- iv) strong regulatory structure for efficient functioning of banks (Ahluwalia, 1999);
- v) strong legal systems and right incentive structure for banks (Patel & Bhattacharya, 2003; Raje, 2000).

Rangarajan (1998) argued that the financial sector reforms in India were introduced as a part of the overall economic reforms. The broad features of these reforms were measures to improve the policy environment, financial health and competitiveness, and strengthen the institutional base of the financial sector. Ahluwalia (1999) emphasised that in India financial liberalisation and regulation in the financial sector went hand-in-hand. Shirai (2002b) too, presented a comprehensive review of the financial sector reforms undertaken in India so far, and also focused on the issues not tackled, like the ownership of banks. Sarkar (1999) analysed the response of the banking sector to the reform measures and identified the major challenges facing Indian banking. She found that weak public sector banks have

continued to under-perform and improvements were limited to large public sector banks. Hanson (2001; 2003) reviewed the Indian banking sector reforms and identified the main impact of liberalisation as increased competition among the banks; decline in the spread between interest paid by the banks and interest earned; increase in the sources of finance other than banks for the private sector in India. Y.V.Reddy (2002) reviewed the monetary and financial sector reforms in India, identifying the emerging issues as ownership of banks; regulatory and supervision issues of banks and non-banking financial companies; and competition in the banking sector.

Some of the studies have compared the reforms in India vs. China and found that banking sector reforms in India have been more comprehensive and implemented at a faster pace than in China (Saez, 2001; Shirai, 2002a). Despite this, the growth rates of China are higher than India, though the gap is narrowing. In 2004, the growth rate of China was 10.1 per cent compared to 8.1 per cent in India. In 2005, China's growth rate lowered slightly to 9.9 per cent and India's growth was 8.3 per cent (IMF, 2006). Hu and Khan (1997), tracing the sources of fast growth in China in the post-1978 period, found that more than the capital accumulation, it was the sharp and sustained increase in productivity which led to increase in growth. They estimated that the productivity in China during the period 1979-94 increased at an annual rate of 3.9 per cent compared to 1.1 percent during 1953-78. Duenwald and Aziz (2003), while examining the link between financial development and economic growth, found that the large bank credit has not led to high growth in China. Moreover, the high non-productive assets of the Chinese banks and low capital adequacy ratio is considered risky for economic growth and may even lead to financial crisis (Swamy, 2006). However, many reforms were introduced in the Chinese banks recently, the effect of the reforms will take time (Podpiera, 2006).

The studies in the Indian context focused mainly on the efficiency of the financial system, particularly the sustainability and profitability of banks. The studies also discussed the reforms not yet introduced, such as ownership of banks. An issue that emerges is what the banking reforms have done for the development of the less developed regions. It has been a grey area whether the lack of credit and low investment in the underprivileged regions has caught these regions in the trap of low investment, low growth and high poverty. The existing studies have focused on the necessity of reforms within which efficiency in resource allocation occupies the central role. The question ignored by this literature is that India is still a developing



country - referred to also as an “emerging country i.e., a country having structural or institutional bottlenecks”(Reddy, 2004, p.304) and has less developed states and growing sectors. The decline in credit to these sectors and states would further affect their hope for economic development.

The lack of any concern on the development of backward states is evident in this literature. The literature implies homogeneity of regions, and that resources would flow where the returns are optimum. In addition, the macro approach of these studies ignores the micro aspects including the differences between states. Burgess and Venables (2003) and Stern (2002) highlighted the importance of studying micro level heterogeneity and diversity. The aggregate approach overlooked two important aspects: i) uneven performance of different states within the country; and ii) different performance across sectors.

Some studies like Narayana (2000) and Shete (2002) did express their concern on the poor credit flow, and the emerging regional and sectoral inequalities in the deployment of commercial credit. Reddy (2004) expressed concern over the decline in credit and raised issues relating to credit delivery and the role of credit in a liberalised banking system. EPW Research Foundation (2004) in its analysis of banks, noted low levels of credit to agriculture, less developed regions and the small-scale sector. The barriers to regional mobility of capital were highlighted by Greenwald, Levinson and Stiglitz (1993). Informal barriers to capital mobility lead to imbalances in regional development.

As was mentioned earlier, a dilemma in the literature appeared during this period as to whether finance is for growth only or for development also. Credit to the poor from the banks was excluded and evolved separately in the form of microfinance. Microfinance was thus hailed as the new revolution in development literature.

### *3.6.2 Criticism of Financial Liberalisation*

Critics of financial liberalisation have also pointed out that in developing countries financial liberalisation has a limited role to play. In Dornbusch and Reynoso’s (1989) terms, empirical support for the growth effects of a liberalised financial system was “episodic” (Dornbusch & Reynoso, 1989, p.206). Pointing to the weak regulatory system, Andersen and Tarp (2003) noted that the widespread presence of severe information imperfections or asymmetries, combined with the

weak institutions and inadequate regulatory framework, impair the allocative role of financial sector in developing countries<sup>45</sup>. Reviewing the studies on financial sector liberalisation and growth, they concluded that while in the cross-section studies there is a positive correlation between financial development and growth, in poorest countries, the correlation is negative. The authors questioned whether financial development in a deregulated environment can be expected to act as the “engine of growth”(Andersen & Tarp, 2003, p.189) in the development process. Arestis and Caner (2005) observed that despite a huge body of literature, the relationship between financial liberalisation and growth and finance-growth overall is not clear and financial liberalisation has led to banking crisis in many countries.

Stiglitz (1994) observed that financial markets, which involve the allocation of resources and are information intensive, are different from other markets (see also Besley, 1994). Grossman and Stiglitz (1976) point out that though the price system is regarded as an efficient way of transmitting information to arrive at optimal allocation of resources, lesser or imperfect information will not reflect prices. Stiglitz (1989) remarked that since information is not perfect, prices and markets are not perfect and hence there can be market failures in financial markets. In his another paper, Stiglitz (2000a) observed:

Perhaps the most important break with the past--- lies in the economics of information. The recognition that information is imperfect, that obtaining information can be costly and that there are important asymmetries of information and that the extent of information asymmetries is affected by the actions of firms and individuals, has had profound implications for the wisdom inherited from the past and has provided explanations of economic and social phenomena that otherwise would be hard to understand (Stiglitz, 2000a, p.1442).

Even presuming that the information is available to banks on borrowers’ credit history, viability of project and credit rating, the banks will still not lend to projects in weaker and less developed regions. The problem is not with the information on borrowers but with the regions.

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<sup>45</sup> Asymmetries in information arise when two individuals enter into a transaction - one individual has lots of factual information while the other does not. If these two individuals enter into a trade, the one with the more information will gain more, resulting in inefficient outcomes and the market could fail or collapse. It is for this reason that the state intervenes to reduce information asymmetries and improve functioning of market. Though the explanation of asymmetric information explains the reason for state intervention, it does not explain the objectives of redistribution of income and regional development.

### 3.6.3 Capital Accumulation and Development

In the nineties, capital accumulation was no longer regarded solely as physical capital, but was a much broader concept which included capital in various forms. The capital accumulation embodied in physical capital had amalgamated with the concept of human capital. At the same time, development was no longer the accumulation of physical capital, as it was known in earlier decades. The publication of the first Human Development Report in 1990 (UNDP, 1990) was a culmination of the doubts and thoughts expressed in the seventies and eighties, and firmly established the broader view of development. The report conceptualised development as growth with 'human development'. This concept was much broader than the concept of human capital and included longevity of life, besides literacy and per capita income. Development came to be associated with human development, and reduction in infant mortality, literacy etc. were the focus (Ranis, 2004).

Stiglitz (2000b) defined development in even a more broad way. Development for him was no longer a process of capital accumulation, but rather a process of change, and "a *transformation of society, of a move from old ways of thinking, old forms of social and economic organization, to new*" (Stiglitz, 2000b, p.15). Stiglitz (1999) also defined development as, "concerned not only with increasing GDP, but also with raising living standards more broadly. It is concerned with democratic, equitable and sustainable development" (Stiglitz, 1999, p.F587).

Capital, thus embodied in various forms assisted development through asset creation, infrastructure facilities, educated and skilled workforce and led to innovations, research and development, and higher production. Through increased participation and greater accountability leading to improvement in services, it added to the welfare of the society.

As in the literature on development, the growth literature also realised the importance of capital in its broader form, and thus learning and knowledge became the key players in this literature. The importance of human capital accumulation was emphasised, and several studies appeared linking human capital to growth. The literature on economic growth in the nineties using human capital as a source to explain growth sharpened the focus of development practitioners and increased emphasis on education was an outcome. Boozer, Stewart, Ranis and Suri (2003), Ranis, Stewart and Ramirez (2000) and Ranis (2004) also acknowledged the growing

integration of the two streams of literature. They showed how economic growth leads to human development in the first stage (Chain A as they call it). In the second stage, from human development to economic growth (Chain B), human development becomes an input for future economic growth.

During the nineties, the new endogenous growth literature, while attempting to understand and explain the differences in the rates of output growth, and per capita income across the countries, showed that with constant or increasing returns to capital there is no convergence of per capita incomes across the countries. Capital, broadly defined, in endogenous growth models, did not experience diminishing marginal returns due to learning by doing, human capital, research and development, or public infrastructure. Thus capital accumulation in the endogenous literature served as a means for the introduction of technical progress and advances in knowledge which determine productivity growth (Thirlwall, 2003).

The endogenous regional growth theory, seeking to explain why some regions may enjoy sustained growth while others do not, also focuses on human development, information and knowledge (Button, 2000). In endogenous theory framework, learning leads to knowledge, and to an enhanced skill base that leads to growth (Stough, 1998). It highlights the role that institutions, like education, learning and property rights, and investments like infrastructure, play in endogenous regional economic development. According to this theory, the growth of regions springs from internal conditions. This literature views regions as the focal point of knowledge, innovation and learning, and highlights the role of universities and public policy, and the importance of technological opportunities in the regional development (Hilpert, 2003). Even though the interest in regions rose due to backwardness in many regions and the lagging states (Higano, Nijkamp, Poot, & Wyk, 2002), the focus currently in regional economics is on knowledge creation and innovation in the regional economy (Atalik & Fischer, 2002) and the 'new economy' relating to internet related activity, high tech developments and global economic integration.

Rolim (2002) pointed out that the new theories of endogenous growth do not concentrate on framing new strategies for the development of the backward regions. Even in this literature, the 'winning' regions display characteristics of concentration. Rolim (2002) also noted that, compared to the developed countries where inter-regional differences are to some extent narrowed down by welfare policies; in the backward regions of developing countries, no such measures exist, leaving the regions

to perish. He therefore questioned the role of the market and globalisation in the context of increasing regional inequalities and measures to boost up the growth of the regions excluded in the core development process.

The endogenous literature states that a basic prerequisite for regional growth in such an environment is the availability of efficient transport and communications, skilled labour, well developed research and development, and favourable government policy. It presumes that a highly skilled labour force, basic infrastructure, entrepreneurial capabilities, innovative environment (high research and development) exists in all the regions uniformly. It focuses on the issues and prospects of regions in the context of developed countries, and does not address the problems and issues of backward areas' development in the developing countries where basic requirements as adequate availability of power, literacy, good road and transport system and the spread of information technology are absent. The studies existing in this literature thus do not explore how, in the presence of globalisation, development of backward regions is to be brought about

#### *3.6.4 Inequality*

The inequality literature focused largely on how inequality affects economic growth. A large number of studies, particularly in the nineties, burgeoned on the issue, a “culmination of several trends in the analytical, empirical and policy literature” (Kanbur & Lustig, 1999, p.20). According to them, ‘inequality is back in agenda’, due to: i) recognition of imperfections in markets and information which create inequalities; ii) assets and demographic shift; iii) divergence among the countries; and also iv) the experience of East Asian countries that increased growth need not be accompanied with increased inequalities.

Research on growth and inequality during this period largely focused on testing the Kuznets hypothesis. Anand and Kanbur (1993) reexamined Ahluwalia's (1976) estimations on inequality. They developed a revised dataset, and re-estimated the relationship between equality and growth to demonstrate the reversal of the U hypothesis. Deininger and Squire (1996) also presented a new data set on inequality in the distribution of income. The authors did not find a systematic link between growth and changes in inequality. On the other hand, they found a strong and positive relationship between growth and reduction in poverty. Many other studies also examined the relationship between inequality and economic growth. The evidence

however, was inconclusive. In most studies, issues encountered related to data (cross-section or time series), consistency in the concept and coverage, and grouping of countries.

In the more recent research, focus is on the channels through which inequality affects economic growth. These include political economy channel (Alesina & Perroti, 1996; Alesina & Rodrik, 1994; Deininger & Squire, 1998; Persson & Tabellini, 1994), according to which unequal societies have higher political instability which has an adverse effect on investment and growth. The other channels are the income distribution and capital market (Banerjee & Newman, 1993; Galor & Ziera, 1993) which relate income distribution and growth through links to the capital market. These studies argued that economic opportunities vary with the unequal distribution of income, and poor people lack opportunities due to deficiency of capital.

Examining the link between income inequality and social conflict, Fajnzylber, Lederman and Loayza (2002) suggested that income inequality is significantly associated with violence levels across the countries. Research in this area emphasised the link between inequality, social conflict and growth. Inequality may cause social unrest and could lead to violence. Another channel was from income distribution to population growth. Khoo and Dennis (1999) explained that higher inequality leads to bigger family sizes amongst the poor. Those who are poor and less educated have bigger families and this in turn, reduces growth. The latest World Development Report, 2006 (World Bank, 2005) has even included equity as its theme and defines equity as 'equality of opportunity'.

Though the problem of regional development affects both the developed and the developing countries, the issues vary greatly across the two sets of countries. In the developing countries, issues like impoverishment of the backward regions, lack of capital, and infrastructural development are important. In the developed countries, particularly in the European countries, issues like networking, innovations, knowledge and learning have gained importance. The widening disparities, particularly in the period of increasing globalisation, is the focus of concern, as during this period it is the developed regions which tend to grow faster. The increasing shift towards the information technology and the services sector in the developed areas leads to agglomeration of economic activity instead of dispersal. The regions without adequate knowledge and access to modern information technology tend to be excluded from this process and may create a "digital divide" (Lloyd, Given, & Hellwig, 2000, p.345).

The innovative activities required for the development of the less developed regions demands a resource pool of qualified and skilled labour and advanced education and training facilities, which are generally not available.

Inequality has been much researched in India in the nineties. Many studies in the nineties emerged on the inter-state and intra-state inequality in the distribution of income, and also on the inequality in rural-urban areas within the states (P. Mishra & Parikh, 1997). D.K.Pant (2004) found that among the factors responsible for widening intra-state disparities in per capita income in India, differences in human capital across the states and per capita development expenditure were significant. Kathuria and Sankar (2005) examined inter-state disparities in the performance of public health system in rural areas of the major states of India and observed that efficiency in the usage of health infrastructure varies across the states. They suggested that for superior health outcomes, investments and efficiency in health infrastructure should be increased. Inter-state disparities have been related to caste also (Deshpande, 2001, 2003). Many studies have extensively examined poverty and inequality across the states. Dholakia (2003) examined the regional disparities in economic and human development of the states and found two-way causality between the two groups of indicators.

A critique of the economic reforms in India has been an 'increase in spatial inequalities in the development process' (J. G. Williamson, 1965). A number of studies examined the regional disparities in the economic performance of states in the pre-reform and post-reform period (Ahluwalia, 1999, 2002; B. Bhattacharya & Sakthivel, 2004b; Kurian, 2000; Nagaraj, Varoudakis, & Veganzones, 1998; M. Rao, Shand, & Kalirajan, 1999; Sachs, Bajpai, & Ramiah, 2002b; Shand & Bhide, 2000). These studies observed widening of regional disparities in the country especially during the nineties. They emphasised the need for reducing inequalities across the states, and rise in the per capita income of less developed states. Joseph (2004) examined exclusively performance of the northern states in the post-reform period. Bhide, Chadha and Kalirajan (2005) examined the spillover effect of the growth rate among the states. Their results suggested that the spillover effects have been limited which could be due to inter-state barriers in trade and other regulations. On a similar note, Chelliah (2003) pointed out the need to develop the less developed states on the grounds that these would create large potential markets for the more developed states. He also urged for the removal of interstate trade regulations.

Some studies have examined whether convergence in incomes has occurred across the states. Using different reference periods, all these studies have arrived at different results on convergence/divergence. Overall, these studies examined regional disparities in various dimensions. Prominent among the studies are (Cashin & Sahay, 1996; D. Dasgupta, Maiti, Mukherjee, Sarkar, & Chakrabarti, 2000; Nagaraj et al., 1998; Purfield, 2006; M. Rao et al., 1999; also see Subrahmanyam, 1999). While Cashin and Sahay (1996) found that convergence across the states did take place between the period 1961-1991, Nagaraj, Varoudakis and Veganzones (1998) for the period 1970-94 find evidence of conditional convergence. Rao, Shand and Kalirajan (1999) find divergence in the growth of per capita incomes of the states. Among the recent studies, Purfield (2006) found that the gap in per capita income between rich and poor states has widened. She also found that state policies matter in influencing pattern of economic growth.

The issue of imbalances in the regions and widening of the gap between more developed and less developed regions in the post-reform period was acknowledged in the Approach Paper to the Tenth Five Year Plan (2002-07) (Planning Commission, 2000). It identified reasons such as initial infrastructure in the states, governance and implementation. A shift also took place in the approach towards financing the plan from emphasis on quantum and size of investment funds, to quality of investments. It also stated that availability of funds might be a necessary but not a sufficient condition for tackling poverty and backwardness. The multi-pronged strategy required to accelerate development of the less developed states comprises higher investment, central assistance and states' own resources, governance and institutional reforms and decentralization of power.

However, the mid-term review of the Tenth Five Year Plan carried out by the Planning Commission did not include in its agenda the progress made in backward regions development. It reviewed states' fiscal resources and observed that factors impeding resource mobilisation of the states are slow growth of states' economy, losses of State Electricity Boards, effect of Pay Commission and lesser devolution of resources from the centre. The Tenth Plan did recognise that it is necessary to break the national targets into regional targets to achieve regional balance. The Union Budget, 2005-06 (Government of India, 2005b) proposed the creation of Backward Regions Grant Fund for the development of backward regions. An inter-ministerial



Group identified 170 backward regions, based on certain socio-economic variables, for focused development.

### **3.7 Conclusion**

An undercurrent of friction in the literature has prevailed during the nineties, as was pointed out at the beginning of the chapter. The friction existed in all the streams of literature. The dilemma existed in whether:

- i) finance serves growth only or is for development (that is, human development and economic growth) ;
- ii) emphasis should be on physical capital or human development;
- iii) reduction in inequality for all regions should be stressed for better distributional outcomes, or regional inequality is acceptable as a corollary of growth;
- iv) emphasis should be on income inequality or non-income inequality.

While the dilemma for capital was resolved by including capital in a broader form, the dilemma on the equality front remained. The friction in the banking literature was sought to be resolved through the emphasis on microfinance. Banks were recognised as the engine of growth, and the literature in the nineties, unlike the previous decades, moved away from the literature on development. The literature was influential as it led to the financial sector reforms particularly banking, although at a gradual pace in many developing countries. Capital was a much broader concept in the nineties compared to earlier decades, as it merged with development. A distinguishing feature of this period was a sort of merging of economic growth and development literature. Inequality literature also, during this period, broadened with emphasis on not only income, but also on non-income inequalities. Thus, focus was on taking a broader perspective of capital, development and inequality.

The relevance of the review of the literature on banking, capital accumulation, development and inequality particularly during the nineties, for the present study, can be assessed in terms of two themes: i) interaction of theoretical developments and policy changes; ii) integration or the disintegration of the four streams of literature. The former led to introduction of financial sector reforms in the country and decline in availability of bank credit to many states. It also led to a considerable focus on

human development, particularly education. The latter led to banks' focus on efficiency and growth; overemphasis on UP's human development by the literature on the state; and neglect of many other important developments such as: i) decline in credit; ii) structural shifts in the regions of the UP in agricultural output and employment; and iii) increase in rural-urban and inter-state disparities. The next chapter examines these issues in UP in detail.

## **CHAPTER 4**

### **BANK CREDIT IN INDIA, STATES AND UTTAR PRADESH: TRENDS AND PATTERNS**

#### **4.1 Introduction**

The inter-state regional literature had pointed out the emerging disparities in bank credit across the states. These studies observed that the less developed states received inadequate credit in the post-reform period<sup>46</sup>. This chapter meets the third objective of the study and examines credit, at three levels: country, states, and lastly UP in particular, in the pre-reform and post-reform period, before and after the 1990. By examining the spread of credit at a disaggregate level to various regions, districts, occupations, population groups (rural and urban), size of credit (large borrowers and small borrowers<sup>47</sup>), and even gender, this chapter explores credit as a:

- route to growth (G);
- aid in globalisation (G);
- source of urban transformation (U);
- source of inequality (I);
- route to development (D);
- source of empowerment (E) ;

The present study termed these indicators as the G-GUIDE of credit where G- stands for growth, G for globalisation, U for urbanisation, I for regional inequality, D for development and E for empowerment. Besides the above, the chapter also examines whether the low human development of a state affects credit availability.

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<sup>46</sup> As discussed in chapter 3 in the pre-reform period prior to the 1990s, narrowing of inter-regional and inter-state disparities was one of the prime objectives of the banks. With this in view a vast network of bank branches was set up in underdeveloped regions and states, and a 60 per cent credit-deposit ratio was targeted for rural and semi-non-rural areas. The creation of Regional Rural Banks, particularly for poorer regions, and the implementation of special employment generating schemes like Integrated Rural Development Programme were all policies intended to develop the less developed regions and states.

<sup>47</sup> When analysing credit to the small borrowers one has to take into account the data limitations. The definition of small borrowers has changed from time to time to take inflation into account. Borrowers are grouped into small and large, according to the size of their borrowing limit. Up to 1999 borrowers were defined as small borrowers if their borrowings were up to Rs.25,000. From 1999 onwards, this limit was increased to Rs.200,000, so borrowers with credit above Rs.200,000 are large borrowers and below this limit are small borrowers.

What is investment<sup>48</sup>? Investment is the end, and credit is one of the means through which the investment takes place. It could be purchase of new capital equipment, or could refer to changes in the level of stocks. Investment can also be the creation of human capital through education and training (Becker, 1993 among others; see Shultz, 1961). The concept of investment is now considered broad enough to include not only capital in physical form, but also human capital. Mere investment in physical capital is not enough if the living standards, education, and health of people do not improve and reduction in poverty does not take place. Whatever definition of investment is adopted it leads to enhanced production, growth and employment. It also leads to development and even empowerment of women. Investment may be unequal across the regions and population, leading to different growth paths in different regions, which could cause inequality.

Investment and economic growth are closely related (De Long & Summers, 1991; 1992 among others). The channels through which investment leads to growth are production and increased output. Economic growth in turn could lead to further investment, which again boosts economic growth, and so on. The investment in human capital would also lead to similar outcomes. However, the direction of causality between growth and investment is a subject of much debate (Cullison, 1993).

The present study believes that investment through credit could also lead to improved development<sup>49</sup> outcomes like reduction in poverty<sup>50</sup>. The relationship

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<sup>48</sup> In the Indian context, the total investment in the state could be classified into public-private; domestic/foreign. It could even be internal-external i.e. investment from internal sources such as the state's own expenditure and investment external to the state. Within this one can place central government spending and foreign direct investment (FDI). Investment comprises indicators, like state government's plan expenditure, bank credit, FDI and private corporate investment. Conceptually, the state government expenditure reflects the state investment. The choice is to take plan or non-plan expenditure as the indicator of state investment. The Plan expenditure reflects the new expenditure every year on schemes introduced in an ongoing Five Year Plan period, and thus is closer to the investment of the state government. Non-plan is expenditure on maintenance and repairs of old projects carried forward to the next year. Plan expenditure reflects the government's investment in enhancing the economy's productive capacity (Planning Commission). To examine how the state government has been allocating its expenditure on plan and non-plan outlay it is important to find out the ratio of plan to non-plan expenditure. The present study found that the ratio between the two was 0.45 in 1990-91, decreased gradually to reach 0.18 in 2001-02, and improved marginally to 0.25 in 2003-04. The decline was in the plan expenditure of the state government, while the non-plan expenditure of the state government increased.

<sup>49</sup> Development, in this context, is used in a broader sense as discussed in chapter 3 of the present study and implies economic growth including human development.

<sup>50</sup> Several indicators of development have been in use in the development field, particularly by the development organisations. The Asian Development Bank (ADB, 2004) brought out a development indicators manual containing a list of four broad groups of indicators, and land related indicators. These

between investment and poverty reduction is indirectly through growth. This channel relies on the provision of infrastructure, and acts through its effect on income and growth, and subsequent reduction in poverty. The other more direct channel is through providing credit in micro quantities to the poor, and enabling them to start enterprises and escape poverty. Investment in physical capital has an indirect effect on development, whereas investment in human capital has a direct effect on development. Education, particularly of women, has a positive impact on their own health, child survival rates, children's education and nutrition amongst other social indicators.

Could investment be a source of inequality? The theoretical analysis is mostly around the effect of inequality on growth. The previous chapter showed that growth and inequality are interrelated. In most of the studies, inequality and growth are inversely related, in other words, higher inequality lowers growth (for instance Alesina & Rodrik, 1994). Some studies have even suggested a positive relationship between inequality and growth that is, the higher the inequality, higher the growth. Could credit or finance generate inequality? Inequality could also affect investment (Barro, 1999). The credit constraints could lead to inequalities in the rural-urban credit, which could further foster inequality in incomes. In a state of existing inequality, liberalising the financial sector also could lead to control over finance by a few, accentuating the inequalities (Claessens & Perotti, 2005). Inequality in income across individuals could be examined in terms of geographical spread that is, rural-urban population, or even rural versus rural population, and small versus large borrowers. The present study adopts credit to rural-urban areas and credit to small and large borrowers as the concept of inequality, as it is constrained by the dimensions of data availability on credit.

A lot of discussion revolves around the word 'empowerment', its meaning and scope (Page & Czuba, 1999). The word could imply allowing power, or providing power, to the disadvantaged groups like the disabled people, women or lower castes as in India. It is more frequently used in the context of the empowerment of women. By allowing investment opportunities through credit to women, it may lead to their

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groups are: land; social indicators; macro economy and finance; international economy; and energy and environment. These groups divided into 17 broad indicators are further broken down into several sub-indicators and are in use by the multilateral international organisations. Besides these, there are hosts of other development indicators which are used. In the present study, some examples of the indicators contained in the ADB manual are: dependency ratio; birth rate; fertility rate; absolute poverty; human poverty index; and GDP at constant prices.

economic empowerment. Investment in the education and training of women will also lead to their enhanced empowerment. Therefore, empowerment is achievable by adopting a narrow (including only physical capital), as well as a broader definition of investment covering both human and physical capital. Empowerment is associated not only with women, but also with other disadvantaged groups and classes such as, the lower castes in the case of India. Has the recent political empowerment of these groups, particularly in UP, been accompanied with their economic empowerment as well? The provision of credit could then also serve as a source of social change.

Could bank credit serve as a source of globalisation? Globalisation is described as the unhindered movement of goods, technology, information, capital and people across countries. Globalisation is also referred as increased importance of the World Trade Organisation (WTO) and other multilateral organisations and even the spread of cultures and values which Bardhan, Bowles and Wallertstein (2006a) call the “Americanization of popular cultures” (Bardhan, Bowles, & Wallerstein, 2006a, p.2). The factors aiding globalisation are reduced transportation and communication costs, and also a shift in the economic policies of the countries (Bardhan, Bowles, & Wallerstein, 2006b). A number of studies have debated the benefits of globalisation to the developing countries and its effect on inequality and poverty. At the sub-national or states’ level, the effect of globalisation would vary from the rich and more developed states to the poor states. The more developed states, due to their better infrastructure and availability of skilled workforce, would be able to obtain more benefits of globalisation compared to the less developed states. In addition, even within the developed states, the rich farmers and large industries will benefit, compared to the small farmers, small artisans and small-scale industry. According to the present study, the less developed states, due to their inadequate infrastructure facilities, and less skilled or unskilled workforce, at the outset, would have to improve their infrastructure. The present study, thus, looks into the credit to infrastructure to examine bank credit as a source of globalisation.

The chapter is organised into four sections. Section I examines the trend and spatial pattern of investment and credit at the country level and across the states. Section II analyses and explores the trends and pattern of credit to UP in detail. The spread of credit to various regions, districts, occupations and rural and non-rural areas of the state is analysed at the aggregate as well as disaggregate level. The districts are the focal point of study at the disaggregate level. These are again grouped into regions

to observe the flow of credit spatially. Section III examines whether any relationship exists between credit and human capital accumulation in UP. Section IV contains a summary of the chapter and the conclusions drawn.

## **Section I**

### **4.2 Spatial Pattern and Trends in Credit in India**

#### *4.2.1 Trends in Food Credit<sup>51</sup>*

While classifications like organised and unorganised<sup>52</sup> credit, formal and informal<sup>53</sup> credit, and state and private sector credit, exist in almost all developing countries, a *unique* feature of the Indian banking system is its credit for the food grains procurement operations in the country<sup>54</sup>. Over the years, this has been termed as food credit, and the rest as non-food credit (that is, credit for all other purposes including agriculture and industry).

Food Corporation of India (FCI) utilises the food credit for financing food procurement in the country. In the pre-reform period, 1970-1990, the average food credit to non-food credit ratio was 9.0 per cent. In the post-reform years, 1991-2004, average food credit/non-food credit ratio was lower at 6.0 per cent. During the years 1975-1980, the ratio was particularly high at 15.3 per cent. On an average, during the period 1970-2004 this ratio was 7.8 per cent. The share of the food credit in total

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<sup>51</sup> G-GUIDE as defined in the present study and credit for food grains procurement or food credit are related to each other. However, this is not discussed in the present study as it is beyond its scope.

<sup>52</sup> CSO (1989) defines organised enterprises as the enterprises which are either registered under the purview of any of the Acts, and or maintain annual accounts and balance sheets. It includes agriculture (including the government irrigation system, non-departmental enterprises and plantations such as tea, coffee and rubber covered in the private corporate sector), forestry, fishing, mining & quarrying, manufacturing (enterprises covered under the Factories Act), electricity, construction; trade, hotels and restaurants; shipping in the public sector and private corporate sector, road transport, banks, real estate companies and recognised educational institutions under private sector. It also includes cooperatives; railways (the entire sector); public administration, defence and other services including public sector medical, education and sanitary services, Television and radio broadcasting. Most of the agriculture comes under the unorganised sector. Within the organised sector, the credit to public sector units (central and state government) was 25 per cent in the eighties. The decline in credit to these units occurred from 1988 onwards and has averaged 15 per cent of the total credit from 1988-2004. Within the public sector, it is the central government undertakings which took the majority of the credit.

<sup>53</sup> Formal credit usually refers to the credit extended by the formal institutions such as banks and informal credit refers to the credit by moneylenders, friends and relatives on an informal basis.

<sup>54</sup> The FCI was set up under the Food Corporation Act 1964 in order to fulfil the following objectives of the food policy: i) effective price support for safeguarding the interests of farmers; ii) the distribution of food grains throughout the country for public distribution system; and maintaining a satisfactory level of operational and buffer stocks of food grains to ensure national food security. For financing the food grains and sugar operations entrusted to the FCI by the Government of India, the working capital is provided by a consortium of 44 banks.

credit has been around 7.0 per cent, while that of the non-food credit has been 93.0 per cent during the period 1970-2004. A linear trend line fitted on the data on food credit-non-food credit ratio by the present study for the period 1970-2004 shows a downward sloping line. The annual growth rate of food credit, however, has been very fluctuating compared to the relative stability in non-food credit.

Has the credit for the procurement of food grains from the farmers by FCI served the growth and development purpose over the years? Farmers and consumers were the expected beneficiaries. Has it actually benefited these two groups? The procurement of food grains and its subsequent distribution policy has met with a lot of criticism. The criticism has centered on that it has:

- i) not served the farmers well and serves only the large farmers (Rakshit, 2003);
- ii) led to rampant corruption in distribution;
- iii) discriminated against the lower castes in many states particularly, UP and Rajasthan (Thorat & Lee, 2005);
- iv) failed to reach the poor and even caused the starvation deaths among the poorest groups in the states like UP. Lack of income to purchase the food grains available under the public distribution system was cited as the reason for these deaths (K. Shankar, 2002). Some of the studies were critical of its weak relationship to poverty, as the off-take of food grains in poorer states was found to be lower than in the states which have lower poverty (Radhakrishna & Ray, 2005).

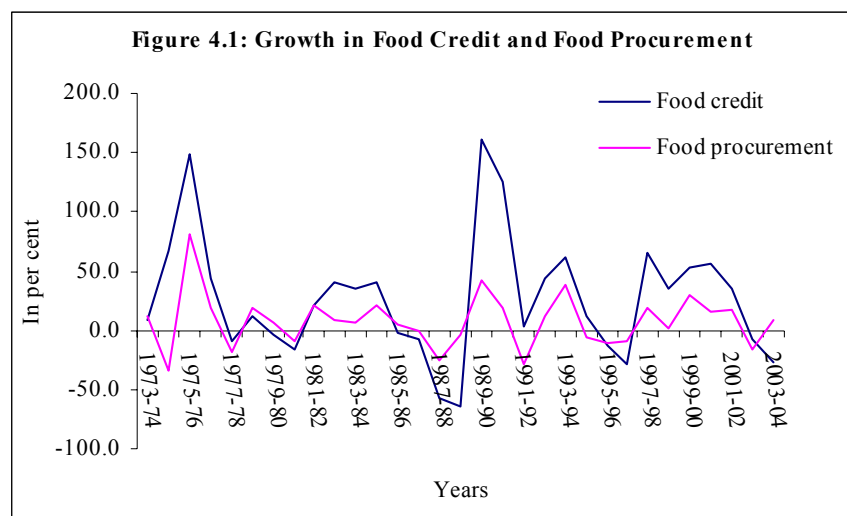
Although almost all the aspects of the public distribution system involving farmers, consumers, huge stocks with FCI and exports of food stocks have been subjected to criticism, little comment has been made on the financing arrangements for food procurement operations involving banks. Considering that there is a trade-off between food and non-food credit, as food credit has formed around 7 per cent of the total credit, is this credit justified?

The complexities in the cost structure of the procurement of food grains influence the growth in food credit. These costs are external costs, over which FCI has no control, and FCI's internal costs. Within the former category are costs like the procurement price of the food grains, buffer stock norms, issue of food grains for the

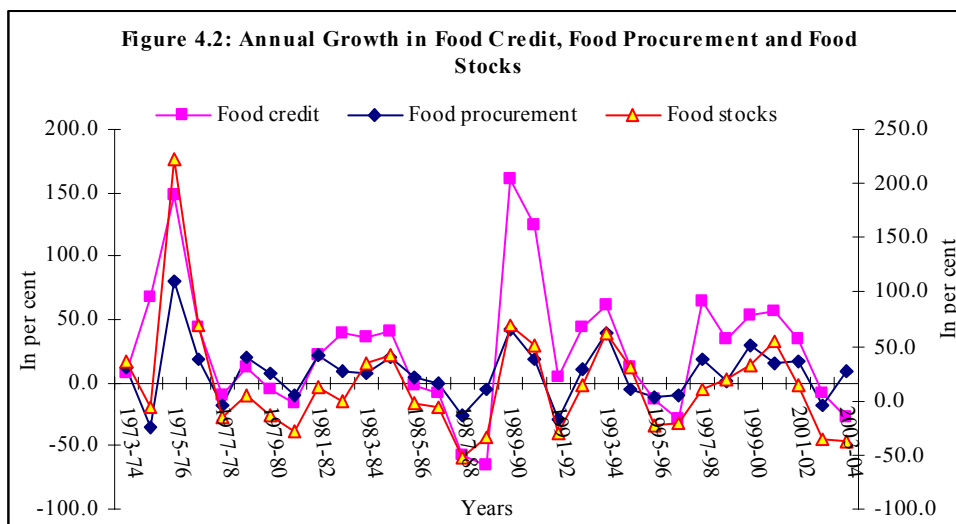


public distribution system, and the export of food grains. These are determined by the Government of India and form approximately 69 per cent of the total cost (Government of India, 2001). FCI's internal costs relate to its efficiency in procurement, storage and food distribution. Food credit is, consequently, an outcome influenced by these factors.

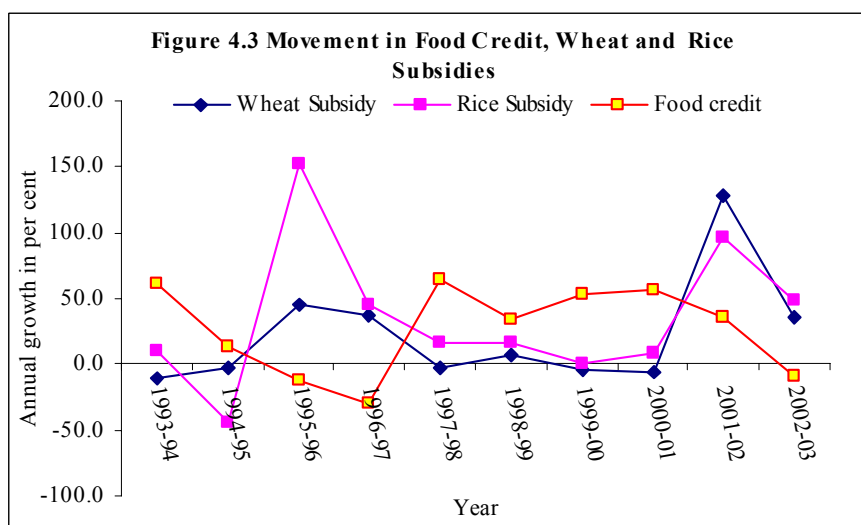
Thus, in the years when the minimum support price is high, the total procurement of food grains (wheat and rice) has been higher, and has led to the increase in food credit. Figure 4.1 shows the growth in food credit and total food grains procurement.



Though the correlation coefficient, as worked out by the present study, between the food credit and total food grains procurement is positive (+0.69), in some years, the increase in food credit is much more than the increase in food grains procurement, mainly due to higher food stocks held by FCI in turn caused by the lower off-take of food grains (Figure 4.2).



The delays in the disbursement of the food subsidy by the Government of India to FCI for food procurement also contributes to the increase in food credit (Government of India, 2001). Figure 4.3 shows the relationship between food credit and food subsidy.



#### 4.2.2 Credit as a Source of Growth and Development

As Table 4.1 shows, the annual average growth rate of the Indian economy during the first three decades after independence (1950-80) was 3.5 per cent per annum. This steady slow rate of growth during the long period of three decades was mockingly termed as ‘Hindu rate of growth<sup>55</sup>,’ a term contested by many Indian

<sup>55</sup> The term has been popularly associated with Raj Krishna, a noted Indian economist, though it was actually used by B.P.R.Vithal, a noted economist and administrator (Virmani, 2004).

economists (Virmani, 2004)<sup>56</sup>. It is often implicitly referred to as the opposite of ‘secular rate of growth’ a phrase commonly used to describe the Indian growth rate (Desai, 2000). It could also refer to the contentedness and belief in fate associated with Hinduism. The term also contrasts, though cautiously, the slow growth rate of the Indian economy with the high growth rate achieved by East Asian countries during the similar period.

During the later decades (1980 and beyond), the average growth rate, though higher, again appears to be stuck at 5.8 per cent. This again has been termed as the ‘new Hindu rate of growth’(see Virmani, 2004). There is, however, a large variation in the growth rates during the latter period, ranging from a high of 10.5 per cent in 1988-89 to a low growth rate of 1.3 per cent in 1991-92. The turning point (whether it was in the eighties or nineties) from the ‘Hindu rate of growth’, to quality and sustainability of growth, much propelled by the services sector, and its future trend, is much debated (Acharya, 2004; Mathur, 2004; Panagariya, 2004; Rodrik & Subramaniam, 2004; Virmani, 2004).

The East Asian financial crisis occurred in 1997. During the year 1997-98, the annual real growth rate of India was lower at 4.8 per cent and in 1998-99 rose to 6.5 per cent. The lower growth in 1997-98 was a consequence of negative growth in agriculture rather than a consequence of crisis. The immediate impact of the East Asian crisis on India was limited due to the capital controls such as restrictions on short-term debt and other controls. The overall long-term impacts on India were positive in nature and crucial. These were: i) the crisis underscored the importance of effective bank supervision and regulatory policies; ii) highlighted the importance of transparency; and iii) led to the fine-tuning and smoothing of macro policies through the adoption of multiple indicator approach which included interest rates, credit and other indicators such as output, exchange rate, and inflation (Reddy, 2000).

As has been pointed out earlier, banks are the most important financial institutions in India. The credit by the Development Financial Institutions (DFIs) and capital market were negligible compared to the bank credit. During the pre-reform period 1971-91, the bank credit/output ratio was 16.3 per cent, which increased to 23.4 per cent, on an average, in the post-reform period (1992-2004). In contrast, the

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<sup>56</sup> Raj (1984), by organising the years from 1950s to 1982-83 into various decades, attempted to show that the Indian economy had not stagnated at 3.5 per cent per annum but had actually grown during the period, and was, therefore, above the Hindu rate. However, the results obtained could have been influenced by the choice of years as different groups of years may produce different results.

credit given by DFIs and capital market formed only 1.2 per cent and 0.4 percent in the pre-reform period, and 2.9 per cent and 0.9 per cent in the post-reform period. The growth of credit has exceeded the growth rate of the Indian economy in almost all the years since 1970.

The annual average growth rate of the three sectors, agriculture, industry and services, since the seventies, thus covering both the pre-reform and post-reform period, is given in Table 4.2. In the pre-reform period, credit helped in accelerating agriculture and industrial sector's output and contributed to the structural change (Bell & Rousseau, 2001). In fact, the nationalisation of banks in 1969; directed credit policies to direct credit in desired directions; and a number of regulatory policies aimed to push agriculture and industrial output. However, it remained a subject of much debate whether credit has benefited the small farmers and small industries. In the post-reform period, the sector which is pushing growth is the services sector. The credit to this sector as share of GDP also has increased in the post-reform period though it is less than the growth in its output.

As noted at the beginning of the chapter, the indicator of development considered in the study is reduction in poverty. The United Nations also adopted reduction in income poverty as an indicator of development (UN, 2003). The World Bank also gave topmost priority to the reduction of extreme poverty in its Millennium Development Goals<sup>57</sup>. In India also, poverty reduction is an important indicator of development (Radhakrishna & Ray, 2005). The headcount poverty or the absolute poverty in India, despite the large debates surrounding it (as discussed below), has come down from its level of 54.9 per cent in 1973-74 to 26.1 per cent in 1999-00. The decline was both in rural and urban poverty from 56.4 per cent and 49.0 per cent, to 27.1 per cent and 23.6 per cent respectively during the same period. The official estimates of poverty are on absolute headcount poverty that is, the number of people below the official poverty line. Relative poverty relates to inequalities in income

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<sup>57</sup> The Millennium Development Goals were set at the United Nations Millennium Summit held in September 2000 when 189 countries took oath to fight against poverty, hunger, illiteracy, gender inequality, diseases and environmental degradation. The first goal is to eradicate extreme poverty and hunger and two targets have been set to achieve this goal. Target 1 is to halve between 1990 and 2015, the proportion of people whose income is less than \$1 a day. Target 2 is to halve during the same period, the proportion of people who suffer from hunger measured by, i) prevalence of underweight in children under 5 years of age; and ii) proportion of population consuming less than minimum level of dietary energy consumption as percentage of total population. The rationale for considering underweight children under 5 years as the proportion of population suffering from hunger is that chronic hunger is reflected early in life and underweight children subsequently grow up to be unhealthy and sick. The measure of extreme poverty is \$1 a day (UN, 2003).

distribution and increases when the income inequality increases. As the inequalities in income between developed and the developing states and the rural and urban areas have increased, relative poverty has increased. The density of poverty that is, the number of poor people per unit of area in India, as estimated by the present study, was 79.2 per sq km in 1999-2000. This, however, varies significantly among the major states of India and ranges from 23.9 people per sq km in Rajasthan to 452 per sq km in Bihar.

The literature on poverty in India is massive. It starts from the 1940s and ranges from the conceptualisation and measurement of poverty, to its clutch over groups of the population, spread spatially across the states, regions, rural and urban population, gender, and even certain social groups like scheduled castes and scheduled tribes and occupations such as agricultural labourers, small farmers and artisans. In 1999, with the 55<sup>th</sup> round of full sample household survey<sup>58</sup> conducted by NSSO (2000), the debate has even intensified further, so much so that it came to be termed as the ‘great Indian poverty debate’(Deaton & Kozel, 2005). The debate arose essentially due to differences in the estimates of poverty between NSSO and National Accounts, and the change in the survey methodology from the usual recall period of 30 days used in earlier household surveys to a mix of 7, 30 and 365 days recall period used in the 55<sup>th</sup> round. The importance of the 55<sup>th</sup> round of survey, which was the first full sample survey after the introduction of reforms, is due to the:

- i) need to judge the effectiveness of economic reforms in terms of reduction in poverty;
- ii) interest not only within the country but also internationally, as this coincided with the increased emphasis on the reduction of poverty by the multilateral organisations; and
- iii) spread of globalisation.

The concept of poverty has become multidimensional now, as against the earlier focus on income poverty only. The basis of poverty estimation used in the official statistics in India is the fixed consumption basket set in 1973-74, which provides minimum calorie requirement of 2,400 calories in the rural areas, and 2,100

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<sup>58</sup> This refers to large sample survey conducted after every five years by National Sample Survey Organisation.

calories in the urban areas (Dev, 2005). The present methodology of estimating poverty does not consider indicators other than income, though some of the studies do include income and non-income poverty in their analysis. The concept of poverty would be more meaningful if the indicators like literacy, primary school enrolment of children, infant mortality rate, and life expectancy were considered. Rather, a broader concept should include the opportunities to an individual, as poverty may exist due to the absence of opportunities to some groups of people such as lower castes in India. Poverty has sometimes been classified as hard core poverty, though it is not clear what is meant by hard core poverty (Radhakrishna & Ray, 2005). Does it imply that poverty is sticky in nature and difficult to reduce, or does it refer to income poverty?

Many direct and indirect measures have been taken to reduce poverty in India. The early initiatives which were indirect in nature, were community development programmes; abolition of *zamindari* system<sup>59</sup> and land reforms; and introduction of HYVs of seeds, mainly of wheat and rice in agriculture. As an indirect measure, the nationalisation of the banks in 1969 also aimed to reduce poverty. Direct attack on poverty was through various schemes primarily targeted at rural areas. As against the earlier focus on whole family, in the nineties many schemes aimed directly at women and children. The agency aiming at poverty reduction has also changed from the government departments, to an increased involvement of NGOs (see Radhakrishna & Ray, 2005). Thus, three major shifts in methods, targets and agency can be observed on the poverty scene in India: i) shift from indirect to direct measures of poverty reduction; ii) shift from family poverty to gender and child related poverty; and iii) shift from the state to NGOs.

In the attack against poverty, the role of credit is limited to its effectiveness in dealing with income poverty only. Credit directly cannot reduce non-income poverty related to human development. The effect of credit on non-income poverty would be through its effect on increasing income, and trickle through its effect on other aspects.

The impact of credit would be directly on income poverty, and as stated earlier, the present study examines this in the context of credit to the small borrowers, and microfinance. The bank credit has assisted the small borrowers, and even the poor to cross the poverty barrier (Burgess & Pande, 2003). The small borrowers constituted 93.2 per cent in terms of the number of bank accounts, and had 18.5 per cent of the

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<sup>59</sup> It refers to the feudal landowners called *zamindars* who paid government a fixed revenue during the British rule.

total outstanding credit as on March 31, 2004. The percentage share in outstanding credit, as worked out by the present study, was 9.2 per cent in 1975 and rose to 14.5 percent in 1983 and further to a peak of 25.4 per cent in June 1989. It declined subsequently to its present level of 18.5 per cent. However, due to change in the definition of small borrowers from time to time, these figures are not exactly comparable. Though a number of schemes aimed to reduce poverty directly were introduced, the number of small borrowers' accounts under these various schemes actually reduced from 39.3 per cent in 2001 to 25.0 percent in 2004, and the share of the individual borrowers not covered by any scheme increased from 60.7 per cent to 75.0 per cent. The amount outstanding had also increased from 69.5 per cent to 78.7 per cent during the similar period (RBI, 2006c).

The composition of credit to small borrowers has changed in the post-reform period. The share of agriculture in the credit amount declined from 32.1 per cent in 2001 to 29.1 per cent in 2004. Credit to industries halved during this period from its share of 8.4 per cent to only 4.0 per cent. In contrast to rest of the occupations, the only increase was in the services sector. Within the services sector, the percentage share of personal loans, including loans for housing, more than doubled from 20.0 per cent in 1996 to 41.8 per cent in 2001, to 43.3 per cent in 2004. More than half of the accounts of small borrowers were in the credit limit of Rs.25,000 and about 62 per cent of the women borrowers had credit accounts of less than Rs.25,000. The share of women in credit amount of less than Rs.25,000 was significantly high at 67.0 per cent.

The increase in the personal loans, including housing, in the post-reform period was reflected in a steep rise in the number of houses constructed or renovated both in the rural and urban areas. The 2005 NSSO report shows that the proportion of *kutcha* (refers to the houses made of mud, bamboo, grass, reeds, thatch, or unburnt bricks) houses has fallen sharply in the rural areas from 30.0 per cent in 2000-2001 to 17.0 per cent in 2003-04. The proportion of rural *pucca* (refers to the houses made of burnt bricks, stone, cement, concrete, and timber, and also includes tiles and asbestos cement sheets) houses has increased sharply. A similar trend existed in the urban areas also. The increase in *pucca* houses in the urban areas was from 75.7 per cent to 85.5 per cent during this period (NSSO, 2005b). The increase in housing construction and renovation activities has also provided off-farm employment to the agricultural labourers (see Ruthven & Kumar, 2002).

The quality of material used in housing construction is an important indicator of living conditions in the developing countries. It is largely a function of income and thus the higher the income, the better the quality of material used in housing. In India, in many studies including official reports of the Government of India, quality of the construction of housing is often adopted as an indicator of economic well being. The Planning Commission (2002a) in its National Human Development Report, 2001, took percentage of population living in *kutcha* houses as an indicator of economic deprivation and basic provisioning. Nevertheless, other than the quality of material used, one also needs to take into account topographical conditions, climate, choices and preferences of individuals. For instance, in the hilly regions of the country, due to cold climate and high altitude, materials other than bricks and tile may be used despite affordability of these materials and, hence the quality of material may not be necessarily related to income (Planning Commission, 2002a).

Housing conditions, including the quality of material used in construction, and health, are closely related. Many studies have related housing and health, and found close association between the two. In India also, people living in *kutcha* houses (rural and urban poor) suffer from poor health, poor sanitation facilities, have no access to safe drinking water, and face other deprivations. The major factor common to poor health and housing is income.

In recent years, microfinance is another strategy adopted for poverty reduction. In India microfinance has taken the role of 'microfinance movement' (RBI 2005c), as in many other countries, and is also considered as an antidote to poverty. In chapter 2 of the present study, the definition and model of microfinance as followed in India was briefly outlined. The total number of Self Help Groups (SHGs) linked to NGOs is 1.61 million as at the end of March 2005, an increase of 50.0 per cent over the previous year. The bank loans per SHG increased from an average of Rs.36,179 to Rs.42,620 during this period. The number of poor families thus benefiting through SHGs increased from 16.7 million as on March 31, 2004 to over 24.2 million as on March 31, 2005, registering a growth of 45 per cent. However, how much is the outreach of SHGs in terms of total number of poor families in India? The total number of poor in India is 260.25 million and the number of SHGs linked thus formed only 9.3 per cent of the total.

The relationship between microfinance and poverty reduction may not be positive, as the credit amount linked to the savings of the group is very small. Since



the credit amount is small, its purpose as investment is limited. Many evaluation studies report that the credit provided through microfinance only enabled low-income short-term activities and temporarily met the consumption needs of the borrowers.

Among the many limitations of microfinance, the major ones are: i) high rates of interest charged with the consequence of exclusion of very poor people; and ii) limited effects on the empowerment of women. The high rates arise due to three types of costs involved in microfinance lending. These are: i) cost of lending; ii) cost of loan default; and lastly, iii) transaction cost that is, the cost of appraising, processing and monitoring the loan. It has been argued that these interest rates are still lower than the interest rates charged by the moneylenders (Groen-Goodwin, 2002). Not only the interest rates are high but they also vary from region to region. Kamesan (2003) observed “microfinance has had an asymmetric growth across the country (India) with diverse rates of interest being charged” (Kamesan, 2003, p.1). In a case study of microfinance groups located in three states of Andhra Pradesh, Karnataka and Kerala, Radhakrishna and Ray (2005) observed that the interest rates charged ranged from 12 to 24 per cent. The interest rates charged by microfinance institutions in Andhra Pradesh are described by Shylendra (2006) as usurious in nature. To lower the interest cost for the borrowers the Andhra Pradesh government is even providing an interest rate subsidy to the SHGs. The banks in the state provide loans at 9-11 per cent, but the borrowers pay only 3 per cent and the balance of the subsidy is borne by the state government (News Bureau, 2005). This is akin to the pre-reform period. The only difference being that earlier, banks were bearing the subsidy, now it is the government.

Some other problems which relate to SHGs and banks in Indian context are operational in nature, such as the delays in the opening of bank accounts, large number of visits to banks to obtain credit and impounding of savings of SHGs as collateral for loans (Vyas, 2004). These operational issues, for instance, opening of bank accounts of SHGs and provision of credit, however, needs to be examined more carefully as the operational issues could arise due to the lack of credibility of the SHG group (Motwani, 2005).

#### **4.3 Spatial Trends and Pattern of Credit in States**

Since the states of India are at different levels of development, it is logical to classify them into groups according to their level of development. As the Table 4.3

shows, the three groups in which the different states can be categorised are high achievers, medium achievers and low achievers. In addition, some small states with faster growth rates can be termed as emerging states.

#### *4.3.1 Credit and Output Indicators: An Overview*

##### a) High and Medium Achievers

Except for fast growing, developed and industrial states like Maharashtra and Tamilnadu, the percentage share of credit in almost all the states has remained around 5.0-6.0 per cent during the period 1972-2004. Maharashtra has received more than 20.0 per cent of the bank credit throughout the years 1972-2004, and even surpassed 30.0 per cent in 2002. The share of Tamilnadu has remained almost constant throughout this period, about 10.0 per cent. Among the medium achiever states, the case of West Bengal is exceptional, as it showed significantly high growth rates in the post-reform period. However, the decline in credit to the state has been steady and substantial, the share declined from 15.7 per cent at the time of the nationalisation of the banks to 5.4 per cent in 2004. Overall, credit throughout the period remained highly unequal with a standard deviation across the states of 6.81 in 2004, slightly lower than 7.01 in 1972.

Besides credit, banks also invest in state government securities and bonds<sup>60</sup>. These, combined with credit, together indicate the total funds to the states from banks. These investments in bonds and securities of state governments were also a part of the broader developmental objective of assisting the state government with their finances. Among the high achiever states, Maharashtra, which came out top in bank credit, retains its position in terms of these investments. The southern states - Andhra Pradesh, Karnataka, and Tamilnadu, received the major share of both credit and investment. In the less developed states, while the share of the banks' investment has

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<sup>60</sup> The banks not only provide credit but also invest in the state government securities (consisting of securities floated by state governments, bonds of state level bodies guaranteed by the state governments, share capital of Regional Rural Banks and debentures of cooperative institutions). As part of the statutory liquidity ratio requirements, banks are required to invest 25 per cent of their net demand and time liabilities in central and state government securities and other approved securities. This ratio was reduced from 38.5 per cent in February 1992 to the statutory minimum of 25 per cent in October 1997. The banks are usually holding securities much over and above the required level and this moved up to as much as 42.7 per cent of the net demand and time liabilities in April 2004. The factors which influence the banks' decisions to invest in state government securities, include the health of the state government finances, transparency of state budgets, policy announcements of the state governments, and credibility of their policy actions. Moral suasion from the central bank also plays a part in banks' investing in the state securities and bonds of less developed states.

remained high in the pre-reform and post-reform period, taking both investment and credit into account, these states have received lesser funds.

As in the case of the above indicator, another indicator which also has a developmental connotation, is credit-deposit ratio (C/D)<sup>61</sup> now less frequently used in policy discussions. The concept was used to judge whether the less developed regions received credit in relation to their deposits. It indicates the “credit direction of banks and is used as a credit efficiency indicator for analysing the role of banks in promoting productive sectors and contributing to economic growth” (RBI, 2003a; 2005d, p.77). In 2004, the ratio has shown large variations across the states, ranging from 8.2 per cent-105.3 per cent. In the western region of the country, C/D ratio was 72.0 per cent, within which Maharashtra was 81.8 per cent. In Tamilnadu, the ratio was 93.1 per cent. The C/D ratio of Kerala was 45.5 per cent (Table 4.3).

This study finds that the presence of large metropolitan cities<sup>62</sup> in the high achiever states influences this ratio. The ratios computed separately by the present study for the metropolitan and non-metropolitan regions present a clearer picture of the C/D ratio. The ratio declines sharply in these states after excluding the metropolitan areas. The C/D ratio of Maharashtra excluding Mumbai, the metro city of the state, falls to 50.4 per cent, which is even lower than the ratio of Rajasthan and Orissa. In a yet another state, West Bengal, the difference between the C/D ratios of metro and non-metro areas is stark. Excluding Kolkata, the C/D ratio of the state falls from 72.5 per cent to 49.5 per cent, indicating the concentration of bank credit only to the selected regions (Table 4.3).

## ii) Low Achievers

The less developed states with their characteristic low growth rates have been derisively termed as ‘*BIMARU*’ states (Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh) (A. Bose, 1988). Orissa was not included in this list. Though Bose (1988) included Madhya Pradesh and Rajasthan among the *BIMARU* category of states, a closer look at their growth rates during the nineties presents a different picture. Based on the data from CSO (2005), the present study estimated that the states of Madhya

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<sup>61</sup> The ratio has also been defined as the number of credit accounts multiplied by the average credit amount per account) divided by the number of deposit accounts X average deposit amount per account (D. Narayana, 2003).

<sup>62</sup> The four major metropolitan cities in India are Delhi, Mumbai (Maharashtra), Kolkata (West Bengal), and Chennai (Tamilnadu). Also Bangalore (Karnataka) and Hyderabad (Andhra Pradesh) are now included among metropolitan cities.

Pradesh and Rajasthan, during the period 1993-94 to 1999-00, grew by 6.3 per cent and 8.3 per cent respectively, at par with Maharashtra. UP, however, during the similar period achieved a growth rate of 4.7 per cent. A number of studies also, have commented on the improved performance of Madhya Pradesh and Rajasthan during the nineties (Kelkar, 2004; J Lerche & Jeffery, 2003). Since 2000-01, growth rates in these states have again slowed. UP again remained the slowest growing with a growth rate of only 2.5 per cent during the period 2000-01 to 2003-04. The *BIMARU* group can, therefore, be altered to BOU now that is, Bihar, Orissa and UP. A point to ponder is should not the expression '*BIMARU*', implying perpetual sickness, be forsaken for a more positive image to induce a better performance from these less developed states.

As pointed out earlier, in many states bank credit declined in the post-reform period, but it declined more in the case of less developed states like Bihar, Orissa and UP. The share of UP in total credit, in absolute terms, is in fact less in 2004 than it was in 1972. Moreover, per capita credit in the state in 2004 was less than 10.0 per cent of that of Maharashtra. Bihar's per capita credit was less than 5.0 percent of that of Maharashtra.

The C/D ratio, a ratio used to judge the "credit direction of banks" (R.B.I., 2005c, p.77) of the state, was only 33.1 per cent in UP in 2004 compared to Tamilnadu (93.1 per cent), Maharashtra (81.8 per cent), Andhra Pradesh (74.4 per cent) and Karnataka (63.1 per cent). The data shows that in 1972, this was 36.9 per cent, compared to the overall India ratio of 75 per cent, increased to around 48 per cent in the eighties and declined in the post-reform period to reach around 28 per cent in 2003. The low C/D ratio in the less developed states has been related to their limited absorptive capacity (Mehrotra, 1992). If the two large cities in UP, Lucknow and Kanpur, are excluded from the analysis, the C/D ratio of the state declines further.

### iii) Emerging Achievers

These states (Himachal Pradesh, Delhi, Goa, West Bengal and newly created states like Jharkhand and Chattisgarh) have been having high rates of economic growth in the post-reform period. A common factor running through all these states, except West Bengal (included in this group due to its better performance in the post-reform period), is their size of population. All these states are much smaller than the large and less developed state like UP. Most of the studies on Indian inter-state

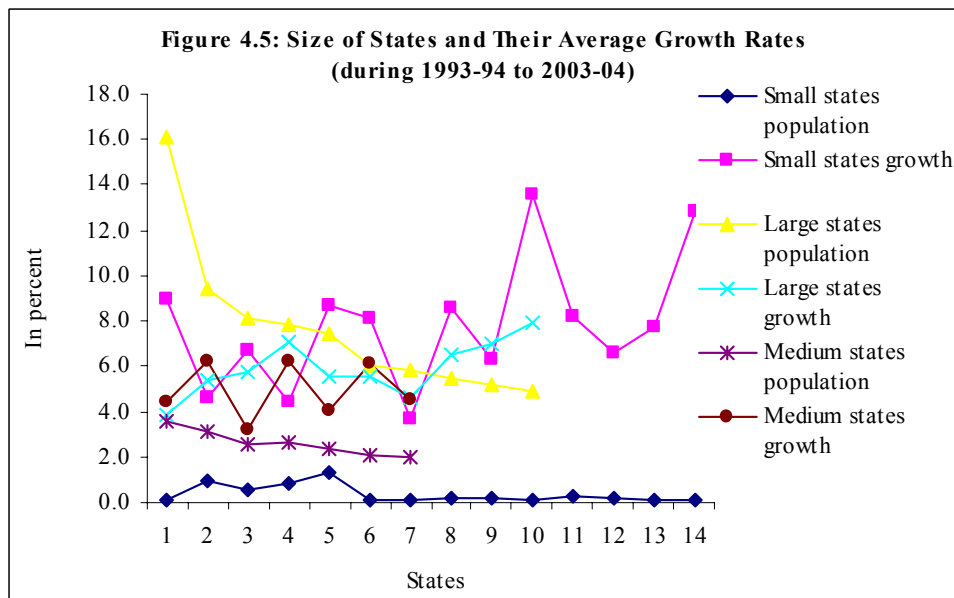
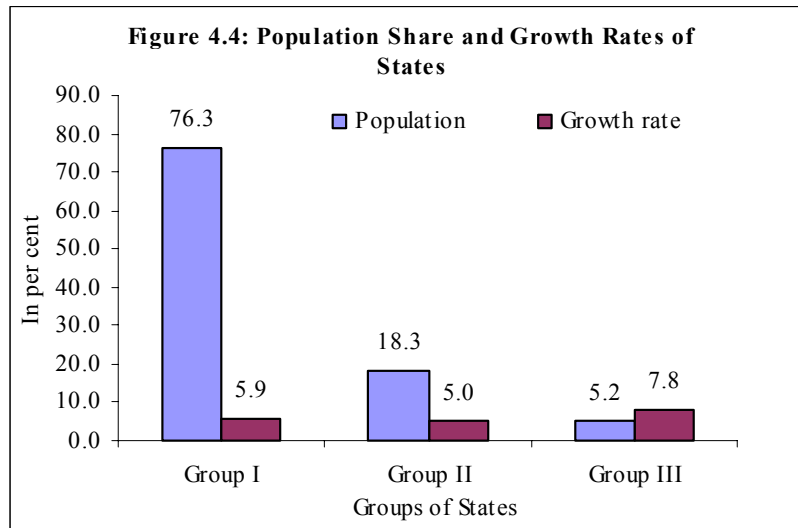
analysis, exclude smaller states on the ground that they do not matter in terms of the size of their population. At the same time, a major reason put forward in the splitting of UP in 2001 was that a smaller size of the state would lead to its better performance and governance. Also an argument of the activists of Uttaranchal movement was that they were different from the plains (rest of UP) and were more homogenous which would improve the development of Uttaranchal (Mawdsley, 2003).

Do the smaller states perform better than the large ones? Does the size then matter? Size does influence economic growth through a number of channels including free trade and public provision of goods (Alesina, Spolaore, & Wacziarg, 2005). Theoretically, though the large countries have a number of benefits over small countries in terms of size of the market, and reduced cost of providing public goods; the smaller countries, through increased trade and higher degree of openness (measured by the ratio of trade to GDP) can achieve higher growth rates.

In order to examine whether the size of the state has a relationship with the growth rates, the present study categorises the states (including union territories), based on population, into three groups (Table 4.4). They are as follows:

- i) Group I- large states (10 states with the proportion of individual states' population ranging from 5 per cent -16 per cent). These 10 states comprise 76.3 per cent of the total country's population;
- ii) Group II- medium category states (with individual state population between 2-5 per cent). These seven states comprise 18.3 per cent of the country's total population; and
- iii) Group III- there is another group of states/union territories (total 14) with individual states' population less than 2 per cent. The total share of this group in the country's total population is only 5.2 per cent.

The three groups with their average growth rates during the period 1993-94 to 2003-04 are plotted in Figure 4.4. The study finds that in Group III states, comprising only 5.2 percent of country's total population, average growth rate has been much higher than Group I large states. Figure 4.5 in a more disaggregate form shows the population share, and average growth rates (1993-94 to 2003-04) of the states in all the groups.



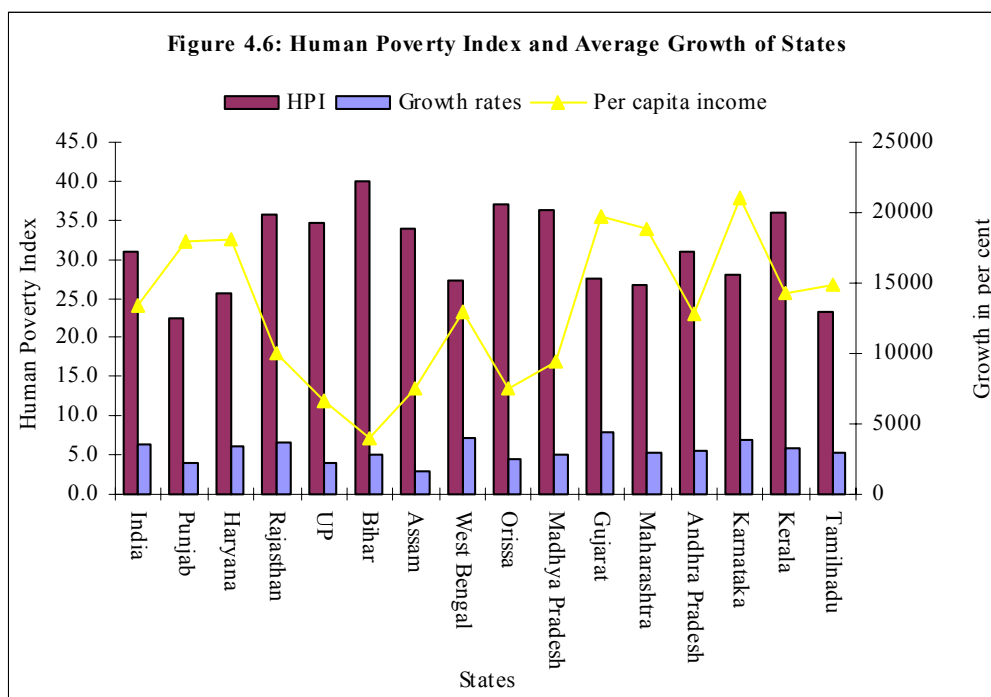
It is the smaller states like Delhi, and Chattisgarh, which have received high credit in the post-reform period. Chattisgarh is a newly created state along with Jharkhand and Uttaranchal, and was bifurcated from Madhya Pradesh and came into existence on November 1, 2000. The state is well endowed with natural resources and its industrial policy focuses on infrastructure and investor friendly climate, particularly for the private sector (Government of Chattisgarh, 2004). Its literacy rate is also higher at 65 compared to 56 in UP and the literacy of males and females is 77 and 52 respectively compared to 69 and 42 in UP. The rural literacy is 60.9 (74.5 for males and 47.4 for females) and in the non-rural areas literacy is 81.1 (89.9 for males and 71.6 for females).

The present study extended inter-state analysis further by looking into human poverty in the states. The UN System Network on Rural Development and Food Security (n.d.) defines human poverty as follows:

Human Poverty is more than a shortfall or lack of income. It is the denial of economic, political, social and physical opportunities to lead a long, healthy creative life and to enjoy a decent standard of living, freedom, dignity, self-esteem and the respect of others (UN System Network on Rural Development and Food Security, n.d.).

This study worked out the human poverty index (HPI) for the states by taking three indicators: i) probability of not surviving up to age 40; ii) adult illiteracy rate; and iii) a composite indicator of percentage of population without drinking water and children underweight for age. Table 4.5 shows HPI index for the selected states of India. Figure 4.6 also presents HPI and the average growth rates of states. The more developed states have lower HPI and higher growth rates. Conversely, the less developed states with much higher HPI had lower growth rates.

The relationship between average per capita income during the period 1993-94 to 2003-04 and HPI was found to be strongly negative at -0.856, which indicates that higher the HPI value, lower the per capita income. On the contrary, states like Punjab, Tamilnadu and Haryana with lower HPI had much higher average per capita income. Kerala had a high HPI value mainly because of its high percentage of population without drinking water. Wells are the common source of drinking water in the state. The strong negative relation between per capita income and human poverty underlines the need to accelerate per capita income in the less developed states. Importantly, high HPI can further act as a constraint on the growth. This vicious cycle of high HPI leading to low growth, which in turn causes high HPI due to lack of income, can be broken, by pushing the growth strategies.



#### 4.4 Credit and Inequality

As stated earlier in the chapter, to examine the relationship between credit and inequality, the indicator adopted in the study is the spread of credit in the rural and urban areas of the states. More credit to urban areas than to the rural areas denotes credit inequality. Credit inequality in turn could accentuate other inequalities in the urban and rural areas. Credit inequality can be measured by the following indicators: i) proportion of rural and urban credit to the total credit of the state; ii) proportion of rural credit to urban credit; iii) change in the rural credit between 1996 and 2004; and iv) proportion of semi-urban credit to urban credit.

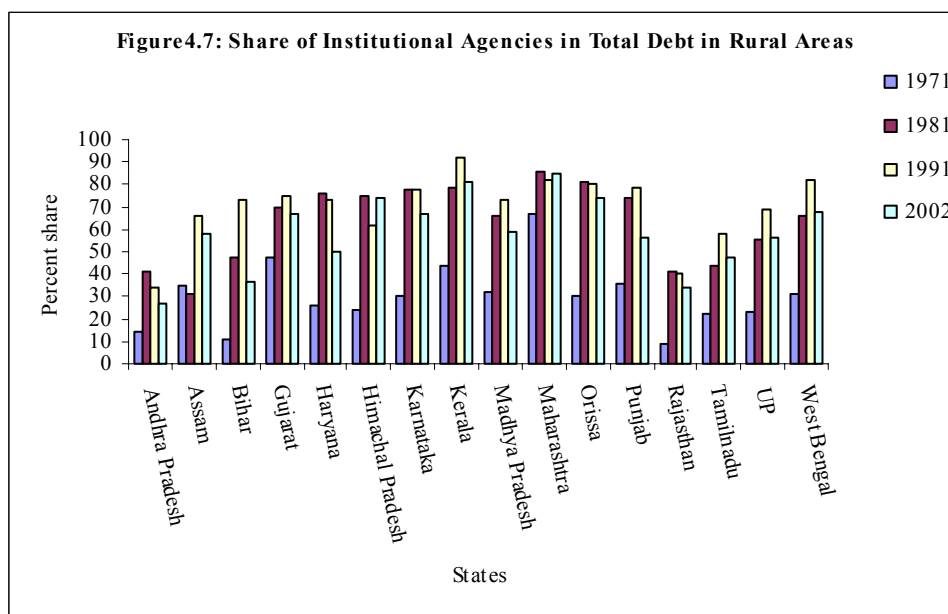
Credit inequality increased in the less developed states and in the developed states. Exceptions to this are the states like Himachal Pradesh in the northern region, and Arunachal Pradesh in the north-eastern region. The latest survey of NSSO (2005c) corroborates these findings. The summarised results, based on the indicators adopted in the present study to identify credit inequality, are:

- i) states with high (more than 10 percent) credit inequality in 2004 over 1996- Haryana, Bihar and Rajasthan;
- ii) states with medium credit inequality (5-10 percent) -Gujarat, Punjab, Madhya Pradesh and UP);



- iii) states with low credit inequality (less than 5 percent) - West Bengal, Maharashtra, Kerala and Tamilnadu;
- iv) states with more than 90 per cent of bank credit in the urban areas are industrialised states like Maharashtra, Tamilnadu and West Bengal;
- v) in the states known for their high agricultural production, such as Punjab, Haryana and UP, urban credit was still between 74-78 per cent of the total (Table 4.6);
- vi) per person credit in rural areas, on an average, formed around 22.0 per cent of urban credit. The exception is Kerala, where in the rural areas the credit amount per person was extremely low, and the state ranked 14th among the states (Table 4.7). Per person credit in urban areas was high among all the states.

The percentage share of the institutional credit agencies (refers to banks, government agencies, insurance, provident fund, financial corporation and financial companies) in the outstanding debt in rural areas since 1971 is shown in Figure 4.7. Compared to the rise in share in the previous years, their share in the rural areas has fallen since 1991 in almost all the states shown below.



It is also possible that a shift in credit was towards the semi-urban areas, which exist in the periphery of the urban areas. The semi-urban areas are the towns with

population of 10,000 and above but less than 1 million<sup>63</sup>. Such towns formed 66.5 per cent of the total number of towns in all India and their share in the country's total urban population was 28.8 per cent. Pursuing this further, the study found that as in the case of rural credit, the semi-urban credit also has declined during the period 1996 to 2004. Thus, it was only the urban and metropolitan areas in which credit increased, while it decreased in the rural and semi-urban areas.

To examine the reasons behind the shift to urban credit in various states, it is necessary to explore whether any relationship exists between urban credit and per capita income of the state. The correlation coefficient between the two at +0.64 was positive and strong in the present study, indicating that the higher the per capita income, the higher is the share of urban credit. A strongly positive relation (+0.77) also exists between the extent of urbanisation in the state and urban credit. Thus, the states such as Maharashtra, having a high share of urban population also had a high share of urban credit. Urbanisation in Maharashtra was the second highest in the country at 42.4 per cent. The credit to the urban areas in the state was 96.0 per cent.

A number of studies have documented the increase in rural-urban inequality across the states of India in the post-reform period. A large number of studies have described it in terms of rural distress and agrarian crisis (Patnaik, 2003; Vaidyanathan, 2006). This rural distress, more specifically in agriculture, is due to the decline in irrigation facilities, depletion of road and rail network, lack of markets for rural areas, lack of adequate agriculture research and extension, low investments, and decline in off-farm work.

The inequality exists not only across the rural and urban population, but also within the population groups, like the large and small borrowers. In some states like Madhya Pradesh, West Bengal and Maharashtra, the small borrowers in both the rural and urban areas received almost the same level of credit and the states' ranking remained the same. Overall, small borrowers in 2004 accounted for 93.2 per cent of total number of accounts; their share in total amount borrowed was only 18.5 per cent.

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<sup>63</sup> In the Census of the Government of India, the towns are divided into six groups based on the population. These groups are Class I towns with population of 1 million and above, Class II with population of 50,000-99,999; Class III as towns with population of 20,000-49,999; Class IV with population of 10,000-19,999; Class V with population of 5000-9999; and towns with population of less than 5000 are classified as Class VI towns (Government of India, 2004c). In the Basic Statistical Returns of Reserve Bank of India, the semi-urban areas are defined as those with population of more than 10,000 to less than 1 million and urban areas as those with population of 1 million and above (RBI, 2004b).

In other words, about 82 per cent of the credit amount went to the large borrowers who have only 6.8 per cent of the credit accounts.

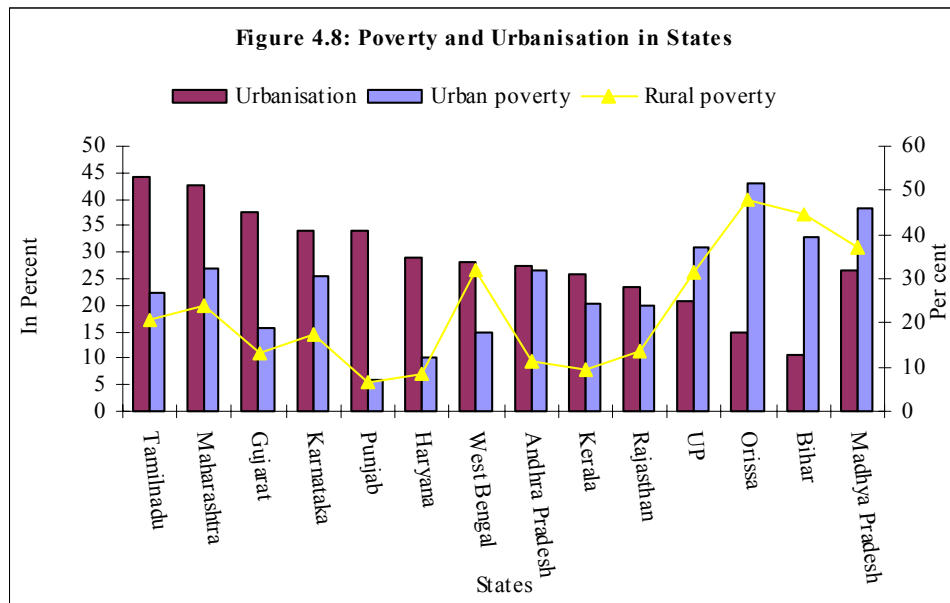
#### **4.5 Credit and Development**

This chapter had earlier examined credit as a source of development in the context of all India. The indicator of development was the reduction in poverty. Therein, the themes and the issues underlying the debate on poverty in India, definitions, poverty reduction strategies, and the role of credit, were briefly outlined. Though the poverty at an all India level has reduced, this varies across the states. Poverty (both in rural and urban areas) across the states has been the subject matter of many studies. The persistence of rural poverty has been related to lower farm yields, and thus, higher farm yields lead to a reduction in poverty (Datt & Ravallion, 1998a). Inter-state poverty is also related to the states' initial physical infrastructure and human capital, and states with better endowments of both have been able to reduce rural poverty faster (Datt & Ravallion, 1998b). Poverty is even related to religious groups (John & Mutatkar, 2005).

The persistence of poverty in certain states in the post-reform period is due to their poor performance in the agricultural and the non-agricultural sector. Since poverty reduction was found to be linked to farm yields (Datt & Ravallion, 1998a), low agricultural performance makes poverty reduction in some states much harder. Even high growth in the non-agricultural sector may not lead to a reduction in poverty, as the states vary in their human development. The inequality in human development across rural and urban areas is a constraint in poverty reduction even with high economic growth (Datt & Ravallion, 2002). Despite the availability of more opportunities in the urban areas and higher urbanisation in some states, poverty is still high in the urban areas. Figure 4.8 shows different patterns for developed and less developed states. These are:

- i) in less developed states like Bihar, UP and Orissa, high urban poverty exists with low urbanisation;
- ii) in some developed states, high urbanisation accompanies high urban poverty;

- iii) even agriculturally prosperous states like Punjab and Haryana have a high level of urbanisation, though not as high as in Tamilnadu, Maharashtra and Gujarat;
- iv) rural poverty exceeded urban poverty in some states, and in this category are less developed states such as Bihar, Orissa and UP and also West Bengal.



To examine the relationship between credit and development, the present study takes credit to small borrowers and microfinance as the indicator. Figure 4.9 shows credit to small borrowers and poverty in different states. It shows the existence of low number of credit accounts of small borrowers, with a high average amount outstanding per account in the prosperous states of Punjab and Haryana. Contrasting with this was the high number of credit accounts, with low credit amounts, of small borrowers in the states with a high incidence of poverty.

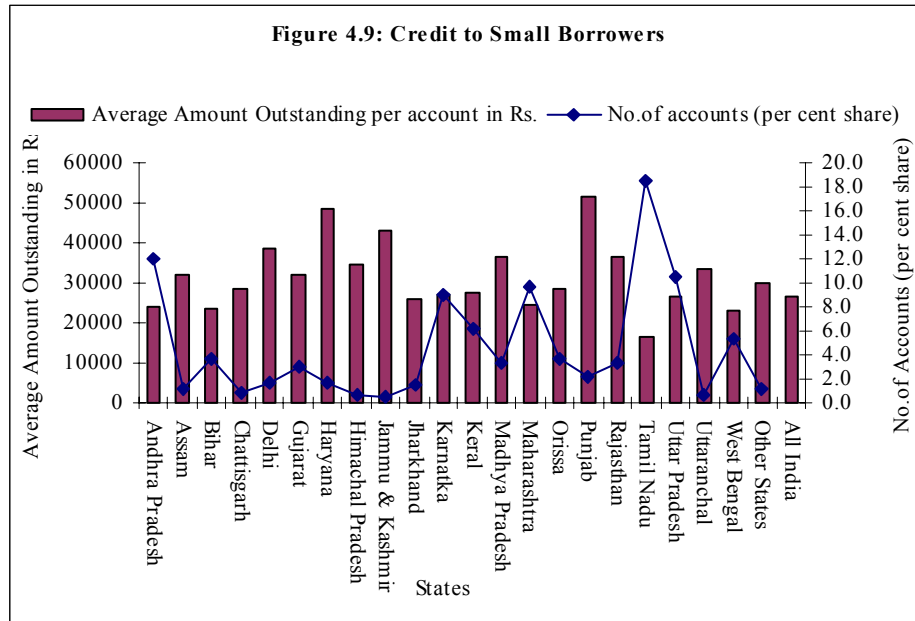
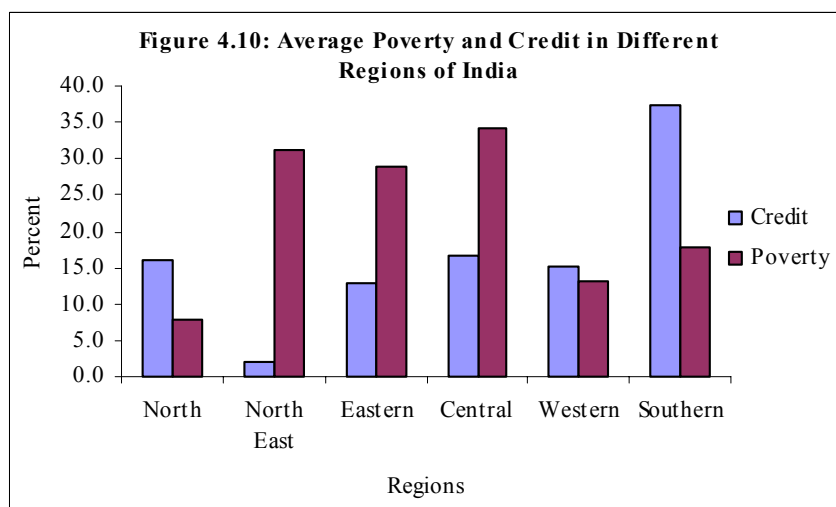


Figure 4.10 highlights the disparity in credit and poverty concentration across the regions. Across the regions, it is the southern region (includes Andhra Pradesh, Karnataka, Kerala, Tamilnadu, Lakshdweep and Pondicherry) which is receiving the most credit in the country. This is in contrast with the average level of poverty in the region. The contrasts in the magnitude of credit and poverty are marked in the central (includes Madhya Pradesh, UP, Uttaranchal and Chattisgarh) and north-eastern region (Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura). Table 4.8 shows credit to the small borrowers in different regions of the country.



Microfinance that is, finance in very small amounts to the poor, is another tool to alleviate poverty and aid development. It includes savings, credit, insurance, leasing, money transfer etc. The model of microfinance followed in India, as mentioned earlier, is through the formation of Self-Help Groups (SHGs) and their linkage with the banks. The states, according to their level of SHG development are: SHG-leading states; and SHG-lagging states. The criteria for classifying the states into these groups are: SHG credit per poor person, coverage of poor families, and the number of SHGs (R. Dasgupta, 2005). The SHG-leading states (includes southern states comprising Andhra Pradesh, Karnataka, Kerala and Tamilnadu) have high SHG credit per poor person, widespread coverage of the poor, and a large number of SHGs. In SHG-lagging states (high poverty states as Bihar, Madhya Pradesh and UP are in this group), the coverage of families, amount of credit per SHG, and the number of SHGs are all low. Though the credit given by SHGs in the less developed states is low, they have assisted in improving the banking habits of the poor, specially women (Varman, 2005).

As in the case of bank credit, microfinance has also concentrated in the southern region, which accounts for 63.0 per cent of SHGs and 79.0 per cent of SHG credit in 2004 covering only 15.4 per cent of the poor. Andhra Pradesh and Tamilnadu were the leading states within this group. In contrast, Assam, Bihar, Madhya Pradesh and UP account for a much smaller share of SHGs and SHG credit. The SHGs are, therefore, more active in those states where poverty is lower, and less active in other states (P. Basu & Srivastava, 2005; R. Dasgupta, 2005). Thus, the SHG-bank linkage programme has suffered from the same trend which afflicted bank credit in the post-reform period: they are concentrated in the states which are more developed, and have less poverty.

Recent data show that the substantial increase in the number of SHGs in all the states in 2005, over the previous year, was again tilted towards the SHG-rich region notably the southern states like Andhra Pradesh, Karnataka and Tamilnadu. The increase in the number of SHGs in these states ranged from 11-20 per cent. The total share of these three states in the increase in the number of SHGs in 2005 was 44 per cent. Conversely, in the less developed states (Bihar, Orissa and UP), the share in the increase in the number of SHGs at 18 per cent was disproportionate to the extent of their poverty.

#### **4.6 Credit and Urban Transformation**

The studies on bank credit have not explored the role of credit as a forerunner of urbanisation. A shift of credit from the rural to urban areas can be an indicator of rural-urban inequality, but can also be a source of urban transformation and urbanisation. Urbanisation is the sum of rural to urban migration, and the natural growth rate of the urban population. Urban transformation and urbanisation, in most of the studies, are used interchangeably (for instance, see Gugler, 1996). In the present study, urban transformation and urbanisation imply different stages of urbanisation. Transformation refers to change within the urban areas in the first stage, and urbanisation occurs in the second stage as a process of transformation. In the present study, the two terms are distinct, as the effect of credit, which is the focus here, would first lead to change and transformation in the urban areas, gradually leading to increased urbanisation via urban growth and migration from rural to urban areas. Therefore, credit in this sense assists in fostering transformation or change and urbanisation, by shifting the loci of activities from agriculture to manufacturing and services.

Urbanisation has assumed greater importance in recent years and is increasingly being regarded as the most important factor leading to economic growth (Sachs, Bajpai, & Ramiah, 2002a). The level of urbanisation in Asia is projected at 54.5 per cent in 2030 from 38.8 per cent in 2003, and the rate of urbanisation during the period 2000-2030 is expected at 1.28 per cent, higher than the other areas in the world (Mohan, 2006; Mohan & Dasgupta, 2005; United Nations, 2004). A number of studies have, however, cautioned on these overoptimistic projections, based on the existing pattern of urban growth and development (B. Cohen, 2004; Kundu, 2003).

The earlier literature considered urbanisation a source of environmental degradation, urban congestion, burden on urban infrastructure, high urban poverty, emergence of slums, squalor and social problems like increasing crime and violence. These studies explained rapid urbanisation as an outcome of the large-scale rural-urban migration which in turn was caused by 'rural distress' (for instance, Todaro, 1981). This conventional view of urbanisation has changed gradually to a more positive view of urbanisation.

The current literature considers urbanisation as an agent of change and engine of economic growth (P. Bhattacharya, 2002; V. Henderson, 2002). Rather than a result of rural suffering, it considers migration to the urban areas as a "livelihood

strategy” (Deshingkar & Anderson, 2004, p.2) for the rural migrants, which “can lead to accumulation of wealth” (Deshingkar & Anderson, 2004, p.2) in the urban areas. Migration of the rural poor to the urban areas is actually a source of escaping the life of poverty and a hope of gaining better employment opportunities. This is, particularly, helpful during the period of droughts and low rainfall when the agricultural crop is affected.

In India, however, rural-urban migration has not been an important contributory factor to urbanisation. The increase in urbanisation in India during the decade 1991-2001 was 30.3 percent. Net rural-urban migration contributed 6.6 per cent, and the remaining 23.7 per cent was due to natural growth rate of population, and reclassification of rural areas to urban areas (Registrar General of India, 2002a). Bhattacharya (2002) opined that low rural-urban migration could be due to the language and caste differences across the states in India. This, however, does not explain the low rural-urban migration rate even within the states where such barriers may not be so high. Overall, the lower urbanisation in India across its various states is due to reasons such as: i) low agricultural productivity due to which the surplus labour is not released from the agricultural sector; ii) weak agriculture-industry linkages; iii) lack of skilled workforce.

Theoretically, industrialisation is the precursor of urbanisation. The agglomeration economies because of spillover benefits lead to the clustering of industries in a particular region and this sets up the process of urbanisation (J. Henderson, Shalizi, & Venables, 2001). However, in many developing countries, it is the services sector which has become the leading economic activity (as is shown in the next chapter), and the growth in information technology, telecommunications, and financial development, rather than the industrial sector, is leading to the growth of urban areas. As these places are more connected to far off places, even international, rather than the local areas (for example in India, cities like Bangalore and Pune in Maharashtra), this may not even lead to urbanisation (Mohan, 2006). Nevertheless, the growth of such cities will create the need for improved local infrastructure, or social overhead capital<sup>64</sup> as termed by Hirschman (1958), which will eventually lead to increased urbanisation.

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<sup>64</sup> Social Overhead Capital is defined as core infrastructure, largely transport and power. According to Hirschman (1958) the criteria for identifying an activity as social overhead capital is: i) facilitates



To examine whether credit can lead to urbanisation, one needs to distinguish the structure and composition of credit. Among all the sectors, credit for infrastructure is the most important, as it has backward and forward linkages. The forward linkage emerges as the credit for infrastructure activities leads to increased investment such as transport and telecommunications, which in turn encourages location of new industries and services. The backward linkages arise as the employment of workers from the rural areas increases. Improved and superior infrastructure facilities are the key to urbanisation. Increased urbanisation without adequate infrastructure will lead to poor quality of life, lack of adequate drinking water facilities, high pupil-teacher ratio, and high child mortality rate etc. Despite the critical role of infrastructure, increased credit to the urban areas in India in the recent years has been for personal loans like housing, which makes little contribution to the immediate and rapid growth of the urbanised areas. Even the effect on urbanisation of increased housing loans for construction and renovation of houses, in recent years, has been limited. This is largely due to the low impact on the rural-urban migration of workers (Ruthven & Kumar, 2002). Under the conditions described, credit does not act as a force of urban transformation except through multiplier effects on increased demand for construction materials leading to establishment of new factories; and movement of the rural workers to the urban areas as a result of increased opportunities.

The rural-urban data on credit during the period 1996 and 2004 reveals that in most of the states, increase in credit to the urban areas has taken place (see Table 4.5). However, in some states, a shift towards the rural areas has taken place. The slight increase in bank credit to the rural areas in 2004 was in Andhra Pradesh, Karnataka and Orissa. The increase in rural credit was in agriculture and rural services such as personal loans. Within agriculture, while direct finance to the farmers declined, indirect finance in 2004 almost doubled from its level in 1996 in these states. Among the other major states, most of the rise in credit to the urban areas has taken place in Gujarat, Kerala, Tamilnadu, Rajasthan, and Haryana, which are more urbanised. On the other hand, in the less developed states like UP and Bihar the rise in credit to the urban areas was lesser.

The pattern of the distribution of credit shows that about 30 per cent of the country's urban population receives 80 per cent of the credit, whereas 70 per cent of

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production; ii) mostly under public sector or private with public sector; iii) pricing free or regulated; iv) imports of these services is not possible; and v) lumpiness in investments.

the population, which resides in the rural areas receives only 20 per cent of the credit. Not only the rural areas, even small towns and centres surrounding rural areas (that is, semi-urban areas) have also received lower credit, suggesting that these areas have not progressed in the post-reform period.

#### **4.7 Summary**

To recapitulate, the objective of this chapter was to examine the trends and pattern of credit at three levels: country; states; and UP in particular. The aim was to explore credit not just in terms of one or two variables, like growth and development, but also to capture the multiple dimensions of credit, such as a source of regional inequality, urban transformation, empowerment, and globalisation. In this section, the study looked into credit as the source of growth, development, regional inequality, and urban transformation in the country and across the states. This multidimensional approach to credit looked at its trends and pattern in rural and urban areas, small and large borrowers and different sectors. To summarise, in the context of the country and states, credit has influenced output growth, but its direction has been more towards large borrowers, developed states, and urban areas. It has had a limited effect on urban transformation. In the following section, credit in UP is examined in detail, and the shifts which have been ignored by the current literature on the state, are explored.

## **Section II**

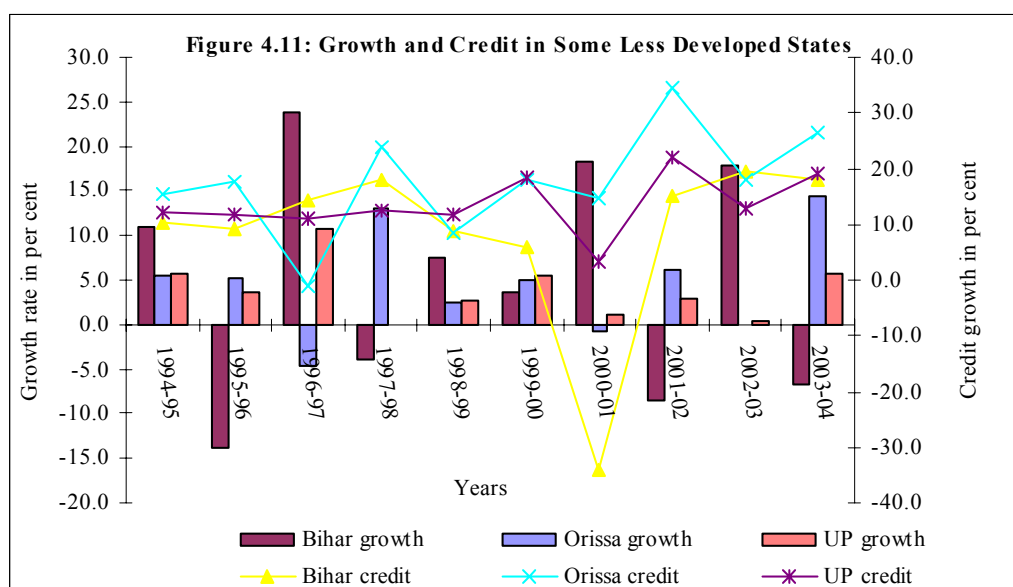
### **4.8 Credit to UP: A Detailed Analysis**

#### *4.8.1 Credit as a Source of Growth*

As observed earlier in this chapter, an intense debate exists in India on the quality and sustainability, and the factors that are propelling economic growth in the country. In the context of UP, this debate appears to be inappropriate, as the concern here is more on the lack of growth, and the factors contributing to low or negative growth in the state. Also, as mentioned in Chapter 1, although UP has been much derided for its low human development, the state has been bypassed in much of the academic analyses on the states' economic development in the nineties, particularly in some of the most often quoted studies (for instance Sachs et al., 2002b).

As stated earlier, within the institutional finance in the state, it is the banks which have occupied a major place. Recapping, the bank credit to the state in 1972

was 4.9 percent of the total credit. In 2004 this had gone down to 4.5 per cent that is, the share has reduced from its low level in 1972. Though the share of UP in total bank credit declined, banks still remained the major source of credit to the state, and other sources like capital market and development financial institutions formed only a very small proportion of the total credit. Per capita credit in the state in 2004 at Rs. 2384 was the lowest after Bihar. It was only 8.9 per cent of Maharashtra's per capita credit and only 3.0 per cent of an emerging state like Delhi. Figure 4.11 shows growth rates and growth in credit to the less developed states such as Bihar, UP and Orissa.



Has credit then worked as the source of growth in UP? The economic growth of the state in the various decades and in different Five Year Plans, as displayed in Chapter 2 of the study, showed that the state's growth rate increased from 2.2 per cent in 1950-1970 to 5.0 per cent in 1980-90. Though manufacturing output increased at a faster rate, agriculture during this decade grew by 3.2 per cent. Within agriculture, the food grains output of the state increased from 2.3 per cent in 1961-62 to 1968-69, to 4.2 per cent in the period 1971-72 to 1983-84. The production of wheat and rice increased to 7.5 per cent and 5.2 per cent in the latter period (Agarwal, 1996). The increase in the output of food grains in UP during this period, and later from 1983-1995, coincided with a decline in Punjab and Haryana's food grains output, though the output in these states still remained higher than that of UP (N. Bajpai & Volavka, 2005). During the period, 1995-2004 the average share of agriculture in the state's

real output was 34.1 per cent but the credit to this sector averaged lesser at 20.6 per cent. The services sector output and the credit to this sector were, however, close to each other (Table 4.9).

#### i) Sectoral output and credit growth

As noted in the earlier chapter, banks under the directed credit lending system shifted the focus of credit to agriculture from industry. The data on credit from banks to different occupations in UP reveals that credit to agriculture, which was only 14.9 per cent in 1972 increased to 26.3 per cent in 1981 but, since then, has declined steadily. Thus, despite the policies on increasing credit to the agricultural sector, credit to this sector in the state did not show a remarkable increase. Rather, it was industry and services which benefited. However, the credit to industry also declined from 60 per cent in 1972 and halved to nearly 30 per cent in 2004.

Table 4.10 shows the average share of the different sectors in total credit to the state during the period 1972-2004. While a more detailed analysis of banks' credit to the services sector takes place in the following chapter, suffice it to note here that the share of services sector<sup>65</sup> credit has continued to rise throughout, accompanied with a deprivation in credit to other sectors. A similar shift occurs in terms of the sectoral output also. In the post-reform period, a sort of sectoral readjustment has taken place with the decline in credit to agriculture and industry, and a rise in the share to the services sector. The pattern in the redistribution of credit to the three sectors shows that:

- i) share of the services credit was 42.4 per cent in 1993-2004, higher by 5.4 percent from its average share in 1983-92;
- ii) industrial credit's share declined by 3.2 percent in 1993-2004 over the previous period of 1983-92 (Table 4.10). In 1972, around 60.0 per cent of credit in the state was to the industrial sector. At the end of March 2004, this had declined to 26.9 per cent;

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<sup>65</sup> Throughout the study, construction is included as part of the services sector in the data series on state output and credit. The issue of classification of construction as industrial or services sector activity has been much discussed in the Indian literature due to its implications for assessment of structural shifts in the economy. While in the Indian national accounts construction is included as industrial activity, the Reserve Bank includes it under services sector. In other countries, also there is no uniform practice (RBI, 2003a). The dilemma was first posed by Clark (1940), who pointed out that as the construction besides, new buildings also involves repairs and maintenance, so it should be a part of the services sector.

- iii) share of agriculture declined to 20.8 per cent in the years 1993-2004, a decline of 1.7 per cent over 1983-92.

a) Agriculture<sup>66</sup>

Most of the studies on UP show agriculture as its predominant economic activity. The 'predominant activity' could represent the activity in which most of the working population is engaged. As around 65.5 per cent of the workforce of the state is in agriculture, perhaps the tag for agriculture is justified. Based on the same criterion, the Indian economy also is predominantly agricultural, as the agricultural workforce continues to be around 58 per cent, despite a substantial decline in its share in total output. This then undermines the country's rising IT sector power, and India's aspirations for a globalised economy. The sector growing fastest in UP (also India) and having highest share in the state output, at present, is the services sector. Can, therefore, the services sector be called the most important economic activity of the state in recent years?

The introduction of the HYV of seeds in the western part of the state in the sixties, along with the adoption of capital-intensive technology, including credit and availability of irrigation, resulted in a rapid increase in food grains output (N. Bajpai & Volavka, 2005). The introduction of HYV of seeds led to the sharp increase in the crop yields. This was popularly termed the green revolution. Besides western UP, other successful green revolution states in the country were the northern states of Punjab and Haryana. Agriculture in UP is different from these states. The reason for the difference lay in rapid technological diffusion in Punjab and Haryana, an outcome of their intensive usage and easy availability of inputs which included inputs such as credit, fertiliser, favourable infrastructure, and well connected roads (D. Kohli & Singh, 1997). Does the small farm size in UP vis-à-vis Punjab also play a role in the difference? The number of marginal holdings in the total operational holdings was 75.4 per cent compared to 18.6 per cent and 47.1 per cent in Punjab and Haryana respectively, and the share of medium and large farmers in UP, Punjab and Haryana

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<sup>66</sup> In India under Article 246 of the Constitution of India, Schedule VII lays down the division of activities into union list, state list and concurrent list (Government of India, 2004a). A number of activities have been grouped under state list including agriculture, state infrastructure, and education. The states thus are responsible for a variety of state subjects. With the changed dynamics created by the reform process, the states now compete for resources and are responsible for the development of the states.

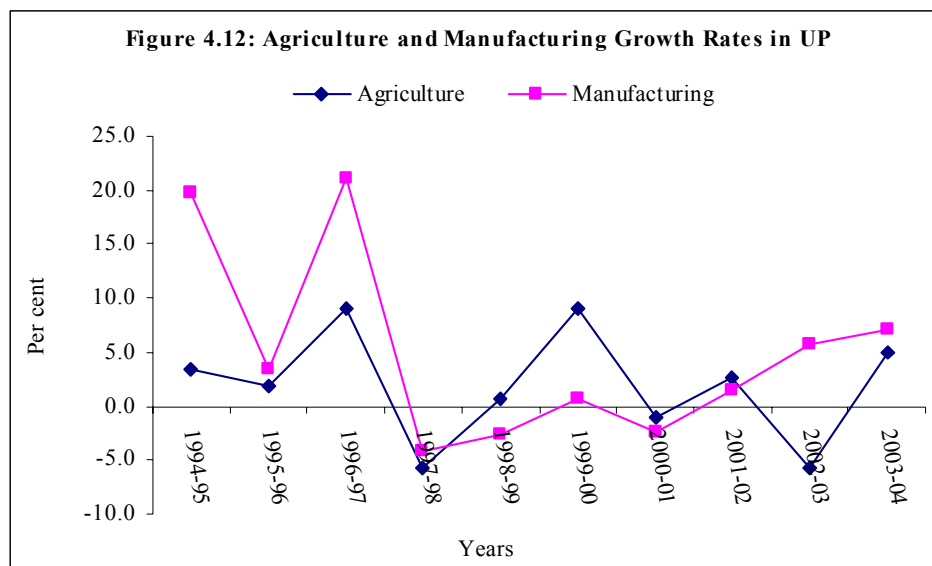
was 2.6 per cent, 35.3 per cent and 14.2 per cent respectively. The use of HYV seeds will lead to high yields on any farm size. Hence, with the use of these seeds farmers in UP, Punjab and Haryana can obtain the similar yields. However, what also matters are the farm inputs other than HYV seeds. These are not scale neutral and this factor distinguishes farming in UP from that in Punjab and Haryana (D. Kohli & Singh, 1997). The most important factor according to Bajpai and Volavka (2005), which separates out the agricultural performance of UP vis-à-vis Punjab and Haryana, also is irrigation. In addition, low investments in research and development in the agricultural universities of UP was one of the factors in explaining differential performance.

Though agricultural output in UP, particularly in the western region, is high, the sector (including the rural sector) still is characterised by low development on all fronts, including economic and social. Low human development, including illiteracy and high rural poverty, are some of the issues in the rural sector. Production in the agricultural sector is affected by poor investment, poor infrastructure, inadequate concentration on cash crops, low technology, poor availability of agricultural inputs, and inadequate availability of power (Government of UP, 2002). Investment in agriculture on the all India level declined from 2.2 per cent of GDP in 1999-2000 to 1.7 per cent in 2004-05. In UP also public investment declined significantly. This, according to the present study, was an outcome of factors like lack of resources with the state government (a consequence of high fiscal deficit), misappropriation of funds, delays in completion of irrigation projects, funds not spent properly. As of March 2005 eight irrigation projects in the state, the original cost of which was 192.8 billion, suffered delays and the cost escalated by 160.6 per cent. The revised cost is Rs.502.6 billion (CAGI, 2006). Often, input subsidies on power and irrigation are cited as the reason for poor investment in the agricultural sector. The present study, however, found that per hectare input subsidies are significantly higher in the high-income states such as Punjab and Haryana than UP and Bihar.

Agricultural output in the four regions of UP namely, eastern, western, central and Bundelkhand region (regional characteristics of the state were discussed earlier in Chapter 2), is shown in Table 4.11.

In UP, agriculture has given rise to a number of industries, particularly in the western region where sugarcane cultivation is most common. During 1967-85, the agro based industries had the highest share, around 30 per cent of total factories in the

state (Agarwal, 1996). The correlation coefficient between agriculture and industrial output covering the years 1993-94 to 1997-98 was positive and strong at +0.881, and between manufacturing and agriculture was +0.892 showing the strong linkage between the agriculture and industry including manufacturing in the state. From 1998-99 onwards, the two have diverged from each other, and the correlation during the period 1998-99-2003-04 turns out to be negative and weak. Figure 4.12 shows that manufacturing and agricultural output followed each other until 1997-98, but from 1998-99 onwards, the trend appears to be diverging. The rise in the agricultural output in the later period did not lead to a similar movement in industrial output. For instance, data on food grains output of the state shows that the output of food grains in 1999-00 increased by 12.9 per cent, and the output of wheat was particularly, high by 10.7 per cent. Manufacturing output rose, on the other hand, only marginally by 0.6 per cent. A major agro-based industry in the state is sugar. In 2002-03 though the food grains output declined by 13.3 per cent, the manufacturing output still rose as the output of sugarcane increased by 2.5 per cent resulting in rise in sugar output by 7.4 per cent (ICRA, 2006). During 2003-04 sugarcane output declined by 6.8 per cent due to pest attacks and the output of sugar also declined by 19.5 per cent from 5.65 million tonnes to 4.55 million tonnes in 2003-04.



Basu (2002), as was mentioned earlier, had assigned the introduction of HYVs of wheat and rice as an important factor in the nationalisation of banks in 1969. Bank credit to agriculture during this period rose from 14.9 per cent of total credit to the

state in 1972, to 26.3 per cent in 1981. This, however, does not reveal the regional heterogeneity in credit, as in the western region, a hub of the green revolution, the credit to agriculture doubled from 33.3 per cent in 1972, to 60.0 per cent of total credit to the agricultural sector in the state in 1985.

Table 4.10 (as discussed earlier) reveals the decline in credit to the agricultural sector since the nineties. Among the components of credit to agriculture, data is available only on the direct finance and indirect finance, and further breakdown of agriculture into credit for food grains and non-food grains is not available. The decline in credit to the agricultural sector is often cited as the indicator of structural transformation of the Indian economy as the share of agriculture in total output also declined (Misra, 2003). This, however, does not explain the increase in informal sector credit in the post-reform period.

#### b) Industry

In the industrialised states such as Gujarat and Maharashtra, the favourable factors for industrialisation were good infrastructure, and the availability of human capital. In UP, unlike these states, poor infrastructure, low human development, instability in government particularly in the nineties, and also the poor and negative image of the state (due to the above factors) led to a decline in the total number, output and employment of registered factories after 1990-91 (Table 4.12).

The traditional large industries in the state are sugar and textiles. Leather too, has been a major industry in the state. Food processing and software industries gained prominence in recent years. The manufacturing sector in the state can be divided into registered<sup>67</sup> and unregistered units. NSSO (2002) includes unregistered manufacturing within the broader concept of unorganised manufacturing and defined it as units not registered under Factories Act 1948, and some units registered but not covered under the Annual Survey of Industries.

The share of registered manufacturing in the UP's industrial output, which was 41.6 percent in 1960-61, increased to 49.5 per cent in 1975-76. This declined to 41.4 per cent in 1980-81. The share of registered manufacturing in UP's total manufacturing output declined again from a high of 67.0 per cent in 1996-97 to 57.0

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<sup>67</sup> Registered units refer to factories registered under sections 2m (i) and 2m (ii) of the Factories Act, 1948 and employing 10 or more workers using power- 2m (i); and, those employing 20 or more workers without using power 2m (ii).

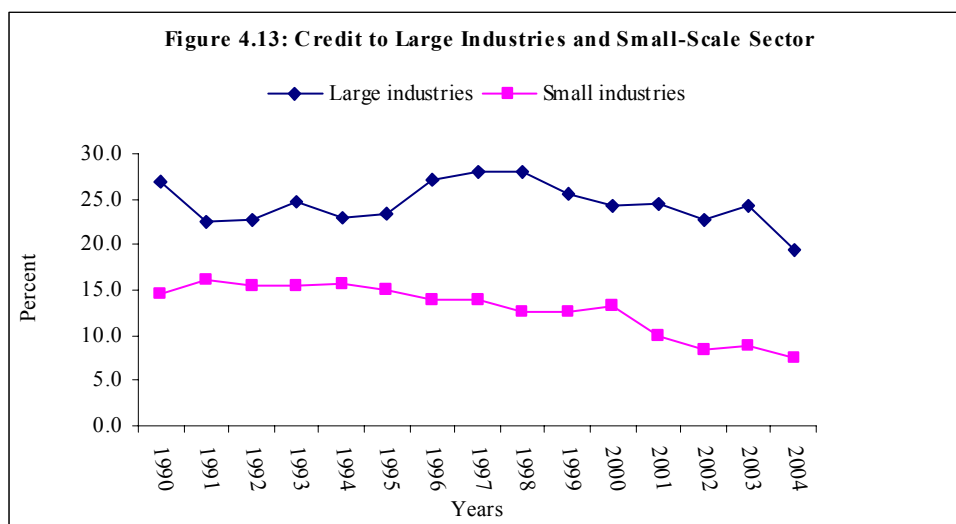


per cent in 2003-04, accompanied by an increase in the share of unregistered sector (Table 4.13).

As was observed earlier, the industrial sector, particularly large industries, were receiving the most credit in 1972 at around 60.0 per cent of the credit in the state. At the end of March 2004, this had declined to 26.9 per cent. The data on bank credit to registered and unregistered manufacturing separately is not available. The outstanding loans (including credit from all sources) of the registered factories in UP had declined during the period 1998-04 as against a rise in rest of the country. Also it can be inferred from the above that the decline in credit has been accompanied by a decline in industrial output, more so in registered manufacturing.

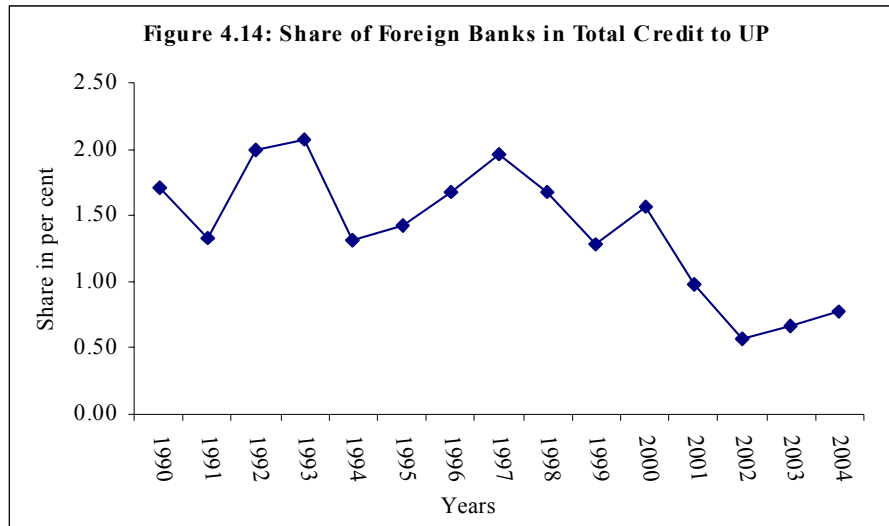
The state has a large number of small-scale units. The small-scale industry (SSI) in India is defined as an industrial undertaking in which the investment in fixed assets in plant and machinery (whether held on ownership terms, lease, hire purchase) does not exceed Rs. 10 million (Government of India, 2006b). The share of UP in the total number of registered small-scale units in India was 15 per cent in 2000-01. UP has great potential in the handicrafts sector and the state enjoys a special place in handloom especially for its silk, carpets and Chikan (special handmade made embroidery); as well as its marble products, wood carving and leather work. Table 4.14 give the regional breakdown of SSI units up to March 2004 in the state. Most of the small-scale units are in the state's western region.

The credit to SSI declined from 14.5 per cent in the total credit to UP to 7.4 per cent in 2004. Also credit to the rural SSI units declined from 30.0 per cent in 1990 to 18.0 percent in 2004 with the rest going to the urban SSI units. Figure 4.13 reveals the proportion of credit to the large and small-scale industries in the state's total credit.



## ii) Bank Groups and Credit Growth

Despite the maligned of public sector banks in the Indian literature (for instance K.W. Ketkar, 1993), it is these banks which have supported the state's output. The public sector banks including the regional rural banks provided about 95 per cent of the total state credit during the period 1996-2004 (Table 4.15). This has so far ruled out any possibility of public-private banking partnership in the state. The share of the private sector banks in the total state credit has remained around 2.0 per cent during this period, though increased to 10.1 per cent in 2003. The share of foreign banks in the state has been negligible (only 1.0 per cent) during the same period (Table 4.16). What is even more striking is that the share of foreign banks in the total credit to the state has been declining in the recent years (Figure 4.14). Even at the country level, the share of foreign banks in total credit in 2004 was 7.2 per cent. In Delhi, Maharashtra and Tamilnadu, the share of foreign banks in total credit was more than 12.0 per cent, and was mostly to the metropolitan areas. The data on credit to different sectors by the different bank groups also shows that compared to a more diversified credit portfolio of the private sector banks and public sector banks, most of the loans by the foreign banks are in the services sector.



### iii) Credit and Regional Output

Has credit been effective in the growth of output at the regional level? It has been pointed out earlier in the study (Chapter 2) that the four regions of the state - eastern, western, central and Bundelkhand, although parts of the same state, are at entirely different stages of economic development. The credit needs of these regions are also different from each other. Within the regions, two shifts in agricultural credit and output have occurred since the seventies. These shifts can be broadly classified as Shift I (1972-80) and Shift II (1980-until present).

#### a) Shift I (1972-80)

In 1972, of the total credit to agriculture in the state, credit to the central region was highest, followed by the western region. The central region received more than 50.0 per cent of the credit; its share, however, halved to around 26.0 per cent between 1975 and 1980, and was only 15.0 per cent in 2004. This shift coincided with the rise of the western region in agricultural credit, which rose to more than 50.0 per cent during the eighties. Table 4.17 highlights credit to different regions of the state for selected years.

The credit shift rather followed the shift in agricultural output which took place in the western region. The spread of the green revolution (R. Sharma & Poleman, 1994), strong farmers' movement<sup>68</sup> in the western part of the state (Brass,

<sup>68</sup> The word 'farmers' has been defined differently from peasants. Peasants are "vast mass of landless agricultural labourers, sharecroppers, tenants, poor artisans and small and marginal cultivators having a close social interface with the socially deprived, such as the scheduled tribes, scheduled castes, other

1995), and a good irrigation system (N. Pant, 2004) were some of the factors explaining agricultural prosperity in the western UP, and thus the credit shift from central to western UP. Many studies described the rise and commercialisation of agriculture in the region as ‘capitalist agrarian development’, but the farmers movement in the state has weakened lately (Hasan, 1995; Lindberg & Madsen, 2003; R. R. Roy, 2004) because of the rise of communal politics in the state. The Muslims and the backward classes who supported the farmers’ movement earlier, changed support to Bahujan Samaj Party (BSP), the political party of the lower castes (Hasan, 1995).

Often, comparison is made between agriculture in the eastern and western regions of the state (for instance N. Bajpai & Volavka, 2005; R. Sharma & Poleman, 1994). However, the present study found that in Shift I, credit and output shift was from the central to the western region. It is in Shift II that the eastern region came into prominence. In 1972, this region received 10.0 per cent of the state’s total agricultural credit, and the Bundelkhand, a rocky region of the state, received only 3.0 per cent.

*b) Shift II (1980 to present)*

The second change, Shift II, took place in the nineties, when the shift in credit and output occurred from the western region to the eastern region. Two major trends noticed in Shift II are:

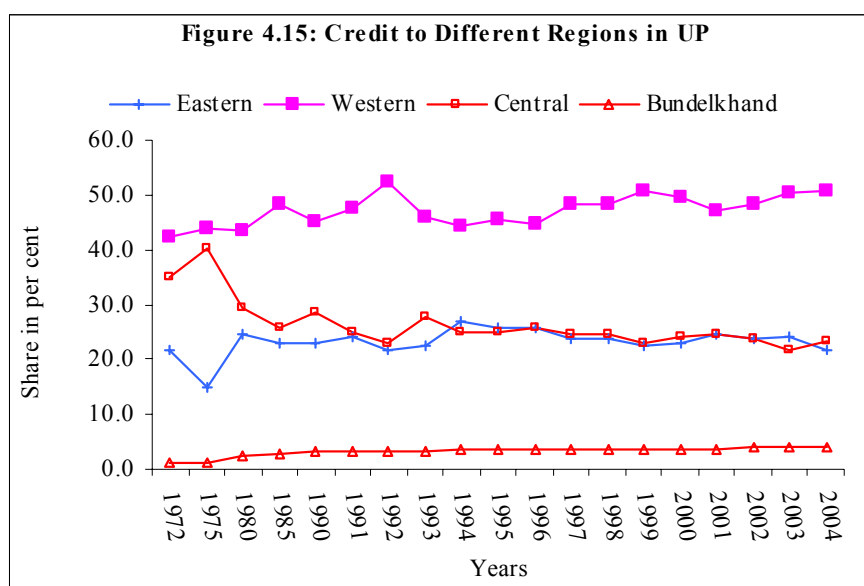
- i) rural credit in the eastern region rose to almost at par with the western region, even higher than that of the western region in some years;
- ii) non-farm activities in manufacturing and services increased in the western region.

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backward classes and women” (SinghaRoy, 2005). Farmers, on the other hand, in the Indian context, are “a person who operates some land and is engaged in agricultural activities during the last 365 days.” ---persons engaged in agricultural and/or allied activities but not operating a piece of land are not considered as farmers. Similarly, agricultural labourers, coastal fishermen, rural artisans and persons engaged in agricultural services are not considered as farmers (NSSO, 2005e). The farmers’ movement in India has been described as ‘new’ by Byres (1995, p.2). This is due to emphasis on: farmers rather than peasants; demand for increased prices rather than land reforms; non-political movements (an anti-urban bias noticed particularly in UP); new strategies used by farmer leaders, and focus on women’s issues in some states though the newness of the movement has been questioned by Brass (1995, p.6-7).

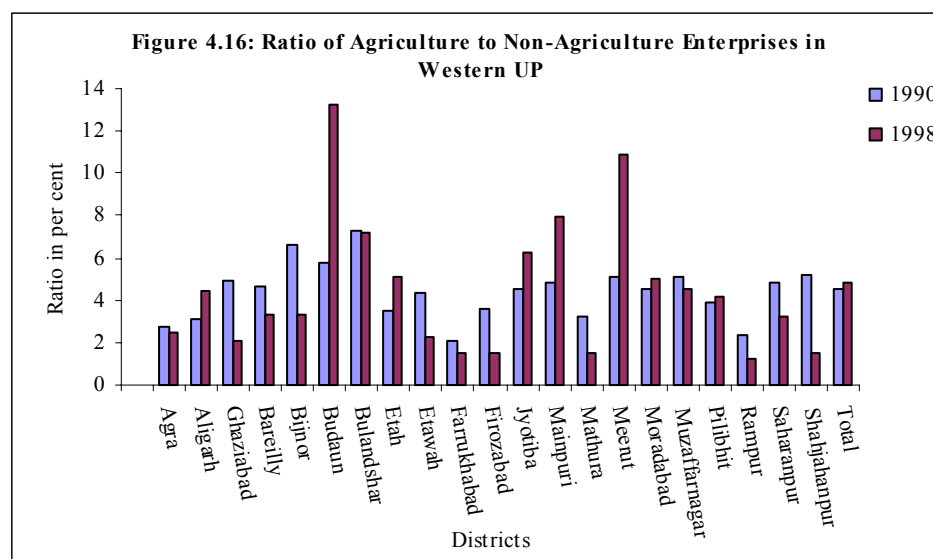
Though the shift was prominent from western to the eastern region in the state, other regions also grew during this period. The average growth of credit was highest in the Bundelkhand (though its share in the total credit is only 4.0 per cent) and the western region, in the nineties. The growth of credit in the eastern and central region was also quite close to those observed in other regions.

In the nineties, the eastern region closed the gap not only between western but also with the central region, mainly due to decline in the share of central region credit. The gap between the eastern and central region began closing in the nineties, and recently the eastern region has even exceeded the central region. Agricultural output in the eastern region of the state has increased since the 1970s, though it is still behind the western region (J. Lerche, 1998). The total food grains output of the eastern region was 35.3 per cent of the total state output in 2003-04. In 2002-03, this was 34.4 per cent, and the western region was 38.6 per cent, central region 17.9 per cent and Bundelkhand region 9.2 per cent. Figure 4.15 displays credit flow to various regions.



Data on the distribution of credit to rural and non-rural areas with their occupational pattern in different districts of the state is not available. To overcome this problem, the present study examines shift to the non-agricultural activities in the western region of the state through various indicators.

The increase in the number of non-agricultural enterprises<sup>69</sup> in the nineties, in most of the districts of the western region, demonstrates a shift to non-farm activities. In 2005, among the major states of India, in UP non-agricultural enterprises formed a very high proportion of the informal sector enterprises both in the rural and urban areas. This was even higher than the country's overall share of 84.7 per cent (Table 4.18). In the western region of the state, non-agricultural enterprises formed more than 90 per cent of the total enterprises. In as many as 13 districts of the region, non-agricultural urban enterprises during the period 1990-1998 increased. Also urban employment (data on employment in agricultural and non-agricultural enterprises separately is not available) increased in most of the districts. There is also evidence that the income from agriculture was used to fund the non-agricultural enterprises in the region (R. Sharma & Poleman, 1994). A comparison between non-agricultural enterprises in rural and urban areas showed that the increase in enterprises in the urban areas was particularly striking in Etah, Shahjahanpur, Meerut and to some extent, in Ghaziabad (Figure 4.16).



<sup>69</sup> The fifth Economic Census, 2005 (CSO, 2006) defines enterprise as a unit engaged in production and or distribution of goods and services not for own consumption. All the economic activities other than agriculture enterprises are termed as non-agricultural enterprises. The agricultural enterprise includes activities as raising livestock, hunting, forestry and fishing that is, all activities covered under National Industrial Classification, 2004. The codes 012, 013, 014, 015, 020 and 050 under sections A and B of the National Industrial Classification 2004 include agricultural enterprises. This definition does not include farmers and plantations.

A pattern which has emerged is that the districts in which the ratio of agricultural to non-agricultural enterprises increased, urban employment declined, and reversed in others. Increase in agricultural enterprises took place only in eight districts of the state. Of this, the increase in two districts was particularly high. The increase as shown in Figure 4.16 is due to the increase in off-farm activities in these districts such as dairy farming (includes raising cattle, poultry, milk production etc.), mixed farming (like growing crops and practicing dairy farming) and other activities like fishing, forestry and logging.

More recent data on the structure of the workforce in UP for the year 2001 reveals that urbanisation of the workforce in the state is taking place (see Kumar, 2003). Kumar (2003) also observed that in all the regions of the state, a decline in agricultural employment has taken place, and the increase is in the share of tertiary employment. Singh, Joshi and Mehta (2004) also noted the increase in employment in the trade sector followed by the manufacturing sector. The increase was in female workers and hired casual workers. They, however, do not show the regional analysis, though their sample covers districts from each of the four regions. Mishra (2003) also reported an increase in the manufacturing activities in the nineties in the western region and a decline in agriculture activities.

#### iv) Shift to Manufacturing and Services in the Western Region

The industrial sector of the western region received the highest credit in 1972. In addition, credit was more diversified in the region as a number of districts received more than 5 per cent of the total credit. In 2004, the western region was receiving more than 60.0 per cent of the total credit in the state. This was largely due to the presence of Ghaziabad district, and the New Okhla Industrial Development Authority (NOIDA) area on the Delhi-UP border where most of the industries are located.

The central region, including the two largest districts of Lucknow and Kanpur, were the hub of industrial output in the state in the 1970s. Contrary to the western region, credit to the industrial sector in the region was highly skewed as only these two districts received most of the credit. In 1972, the district of Kanpur alone received 75 per cent of the credit to manufacturing within the central region. This had gone down to 42 per cent in 2004. In the state, its share was only around 8 per cent in 2004 from 22 per cent of the total state credit to the manufacturing in 1972. With the decline in the textile industry, the city of Kanpur and its adjoining areas is now more

known for its leather industry. The credit to the textiles mills in the state during the period 1990 to 2004 has shown a steep decline from 7.4 per cent in 1990 to only 2.6 per cent in 2004 in both rural and urban areas of the state.

v) District Level Analysis: Credit as a Source of Growth

A district level analysis of credit during the period 1972 to 2004, covering pre-reform (1972-91) and post-reform period (1992-2004), throws up interesting results. These are summarised below sectorally.

a) *Agriculture*

- i) notable increase in credit to the agriculture sector in the nineties (post-reform period) was in the districts of Maharajganj, Mau, Pratapgarh, Siddarthnagar, and Sonabhadra. All these districts are in the eastern region of the state. Only one district in the western region (Firozabad) had a large increase in credit;
- ii) decline in credit took place in the western region, particularly to some of the agriculturally prosperous districts of Meerut, Muzzafarnagar and Saharanpur in the post-reform period (1992-2004). Credit also declined in the Lucknow district in the central region, but this occurred between the years 1980-85, coinciding with the rise of the western region. The decline in Lucknow was accompanied by the rise of Kanpur Dehat in central region.

b) *Manufacturing*

- i) in manufacturing sector, the district, which received highest credit in the post-reform period, was Ghaziabad, described as the 'industrial hub of Uttar Pradesh' (Government of UP, n.d.-a). The district has a location advantage as it is in close proximity to Delhi. Its share in the region's total credit was around 34 per cent in the manufacturing sector. The total number of small-scale industries functioning in the district is 14,160, employing about 73,130 workers. Around 145 medium and heavy industries operate in the district and have a capital investment of Rs. 293 billion providing employment to about 31,200 workers. The other districts in the western region, which received high credit, were Moradabad and Muzaffarnagar;



- ii) most significant decline in credit took place in the post-reform period in the traditional industrial district of Kanpur (known as the ‘Manchester of India’ due to the large presence of textile mills<sup>70</sup>), and Lucknow in the central region, and Meerut in the western region.

c) *Services*

- i) in most districts of the state, share of the services sector remained negligible;
- ii) most prominent increases were Ghaziabad in the western region, and Kanpur Dehat in the central region;
- iii) decline was in the Kanpur district in the central region and the holy city of Varanasi in the eastern region.

#### 4.8.2 *Credit as a Source of Development*

Typically in the current development literature, credit and development are often associated with microfinance that is, finance in small quantities given to the poor to help them emerge out of poverty. The present study examined this earlier in the context of all India and across the states. The role of SHGs in capital accumulation and poverty reduction is limited in UP because of its inadequate outreach. As pointed out earlier, most of the SHGs are concentrated in the southern states, and the share of northern states is very low. The low presence of SHGs in UP is also seen in less than 1 percent share in total SHGs of most of the districts of the state. As the NGOs form SHGs (Chapter 2 of the study showed that Model II is followed in India under which the NGOs form the SHGs and assist in getting credit from banks), the existence of fewer NGOs in the state compared to other states also explains less SHGs. Besides the existence of fewer NGOs in the state, another factor which explains the lower number of SHGs is the high transaction costs involved in the formation of the groups. Shankar (2006) in a case study of three microfinance groups in north and south India found that transaction costs such as costs incurred in formation of the group were much higher in northern India (though she does not mention the state but it is apparently UP) than the southern India groups. One of the reasons for these high costs is the lower awareness in north India of SHGs.

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<sup>70</sup> Besides leather and textile mills, the other major industries in the district are fertilizer, chemicals, two wheelers, soaps, Pan Masala, hosiery and engineering industries. The regional stock exchange of the state is also located in the city (Government of UP, n.d.-b).

Even within the state, the SHGs had the tendency to become concentrated in certain districts. Thus, out of 70 districts in the state, six districts each had more than 3 per cent of the total number of SHGs in 2005, and their share in the credit was 25 per cent. The percentage share of SHGs in the poorest region of the state, Bundelkhand, was only 7.7 per cent compared with 44.5 percent in the eastern region, and 30.1 per cent in the western region (Table 4.19). Kozel and Parker (2003) observed the sharp differences in poverty levels between the Bundelkhand and other regions in the state. The credit to this region also happens to be the lowest in the state.

The total number of SHGs provided with a bank loan up to end March 2005 in UP was only 7.4 per cent. In 2005 about 4,480 existing SHGs in the state were provided with repeat loans in UP. This was just around 1.96 per cent of the total repeat loans to SHGs in all the states. The southern states, on the other hand, received 90 per cent of the repeat loans.

On the impact of SHGs and poverty reduction in the state, no comprehensive statewide study is available. Few case studies covering particular districts in the state exist. Of these, Singh (2001), comparing a pre-SHG and post-SHG situation to analyse the impact in the Kanpur Dehat district in the central region of UP, observed an increase in the average value of assets per household, reduction in approach to moneylenders for consumption credit, convenience in credit delivery, and increase in household income in the post-SHG period. The maximum loan was for income-generating assets, and enterprises like dairy farming were preferred, compared with manual labour in the pre-SHG period. Mishra, Verma and Singh (2001), on the composition of SHGs in the eastern region, observed the participation of backward castes in SHGs. Their study estimated that the credit by SHGs helped in increasing the income of members by 10 per cent to 15 per cent. They also noted that the major problems of SHGs in the state was the lack of literacy among the members, failure to maintain proper accounts, and lack of training, marketing and credit facilities. These studies have shown that SHGs can influence poverty reduction in UP, but their limited outreach and coverage of the poor, and the low quality of SHGs largely prevents achievement of this objective.

Bank credit in small quantities to small borrowers also assists in the starting of new enterprises, and helps them to escape the low investment-low income trap. In a state like UP, with high poverty levels, this has a different implication from a state like Maharashtra. Credit per account to the small borrowers in the rural areas of the

state was Rs.635 ranking ninth among the 14 major states (see Table 4.7). Even a developed state like Maharashtra ranked 11<sup>th</sup> among all the states, indicating the urban orientation of the credit. The data on small borrowers across the states is available only from 1996 onwards. Thus, only a limited analysis is possible, though this does provide an insight into the trends in credit in the post-reform period. The study observed earlier that a shift had occurred in credit to rural areas in the eastern region from the western region, but was this shift in credit to the small borrowers in the region? The lack of data at the district level on credit to small borrowers limits the study's initiative.

A breakdown of credit to small borrowers in different occupations reveals that, as in the case of large borrowers, more than 50 per cent of the credit has gone to the services sector, and industries share has declined. The credit to small borrowers in the agricultural sector during these years in the state has not shown any increase from their earlier levels. The bank group data since 2001 reveals a slight increase in the nationalised banks' share in the number of credit accounts as well as the amount. On the other hand, share of the other bank groups declined.

#### *4.8.3 Credit as Source of Inequality*

As explained earlier in the chapter, the disparity in credit between rural and urban areas is a proxy indicator of credit inequality in the present study. In 1972, about three years after the nationalisation of banks, credit to non-rural areas of UP was about 92 per cent, and to rural areas only 8 per cent. Despite 33 years of massive branch banking and increased focus on agriculture, credit to the rural areas was still only 26 per cent in 2004.

Table 4.20 shows the credit to rural and non-rural areas in the state since the nineties. The marked inequality in access to credit has particularly taken place in the nineties. On an average, rural credit during the period 1990-2004 was 30.1 per cent, and non-rural credit was 69.9 per cent. Since these are averages, they do not reveal the real extent of decline in credit since 1990. The yearly data on credit shows that the share of rural credit which was 37 per cent in 1990, declined gradually to 26.8 per cent in 2004.

The focus of banks in the nineties shifted to the non-rural areas, and increased credit went to the services sector and retail lending. The average (1990-2004) share of total credit to agriculture in the rural areas was 44.4 per cent, manufacturing 21.5 per

cent, and services 34.1 per cent. In the urban areas, on average, manufacturing received 42.1 per cent, agriculture 11.6 per cent and services 46.1 per cent. As pointed out above, averages may not reveal the true picture, as they do not show the year-to-year movements. The share of manufacturing was higher than services until 1998 in the non-rural areas, but the turning point came in 1999 when the services share surpassed that of manufacturing, which has declined since then. The credit-deposit ratio in the rural areas, which was 60 per cent in 1991, declined to almost half that level in 2004.

A large number of studies have examined the linkages between the farm and non-farm sector (for instance, see Haggblade & Hazell, 1989). The linkages between the two could be through production, consumption and employment. The non-farm sector within the rural areas serves as the strong support to the small farmers and the landless labourers and is livelihood strategy when the income from non-farm activities supplements the income of farm workers and small cultivators. Haggblade and Hazell (1989) suggest that by fostering strong linkages between farm and non-farm activities within the rural areas, the rural-urban migration can be contained.

How strong then are the rural-urban linkages within the country? The rural and urban areas linkages are through demand for each other's output and employment. The urban areas are linked closely to the rural non-farm sector through industrial development and even through outsourcing or subcontracting by urban firms to rural enterprises (Jung-Sup, 2004). To examine closely the impact of credit inequality on the state, it is necessary to understand these rural-urban linkages. Chart 4.1 displays briefly the rural-urban linkages.

Chart 4.1: Rural – Urban Linkages and the Role of Credit

Rural to Urban	Urban to Rural	Role of Credit
i) Demand for:	Demand for:	
a) marketing of agricultural produce	agricultural products for consumption	increasing agricultural output through access to inputs like fertilisers
b) industrial products like fertilisers	farm products as inputs for agro industries	
c) urban services like health facilities, education and other services like electricians, mechanics, barbers etc.	rural demand for other products and services	supporting establishment of urban and rural non-farm enterprises
ii) source of employment for landless workers particularly the small towns (semi-urban area)	a)seasonal employment in agriculture for workers in semi-urban areas b)dependence on agricultural labourers as a source of labour	increased supportive role of credit leads to acceleration in employment in rural and urban areas

Increase in credit inequality could lead to negative outcomes such as decline in agriculture output due to inadequate usage of inputs, closure of rural industries, increase in rural poverty, increased recourse to debt from informal sources, increase in landless labourers, and forced migration of workers from the rural areas. The other social consequences of the increase in credit inequality could be increased impoverishment and other negative social consequences.

Agricultural production in the state has declined, as has the consumption of fertilisers. The number of total enterprises (including agricultural and non-agricultural) in the rural and urban areas of the state was 4,016 in 2005, that is 9.5 per cent of all enterprises in India. This was down from its share of 10.0 per cent in 1998, 10.5 per cent in 1990 and 11.9 per cent in 1980. These enterprises exclude farmers and are in the informal sector. The share of agricultural enterprises in the state was 8.0 per cent and non-agricultural enterprises formed 92 per cent. A number of small-scale units located in the rural areas have also closed. Credit to artisans and other small-scale units in the rural areas also declined sharply during this period, affecting non-agricultural rural employment in the state. The decline in credit to the small-scale sector during the period 1990 to 2004 was indeed sharp, as it declined from 11.9 per cent of total rural credit in 1990 to 5.0 per cent in 2004.

The decline in credit to the rural areas has taken place more in rural manufacturing than in the agricultural sector. Rural manufacturing in the state can be grouped under two main groups - agro-based industries and non-agro industries. Kochhar, Kumar, Rajan and Subramaniam (2006) also classify these industries as labour intensive, and heavy industries like chemicals, metals, and metal products etc. as skill-based capital intensive industries. The share of credit to rural manufacturing, excluding small-scale industries in the state, declined in the nineties. This was more prominent in capital-intensive non-agro industries such as chemicals, cement and basic metals. The credit to agro-based, labour-intensive industries such as food processing, leather products, textiles, paper and paper products also declined. The decline in agro-based industries during 1990 to 2004 was from 11.9 per cent of the rural credit to the state to 6.1 per cent in 2004. The similar drop in non-agro capital-intensive industries was from 19.9 per cent to 8.4 per cent. This finding is in conformity with the results obtained by Kochhar, Kumar, Rajan and Subramaniam (2006) who also report decline in the output of labour intensive industries in the fast-

growing states (Andhra Pradesh, Gujarat and Maharashtra), as well as slow-growing states (Madhya Pradesh and UP).

Lewis (1954) in his famous article had postulated a dual economy model in which development takes place by the shift of output and workers from agriculture to manufacturing and hence, shift of resources from low productivity to high productivity sectors and from rural to urban was an indicator of economic growth. This, however, viewed the contribution of agriculture to development as passive (Byerlee, Diao, & Jackson, 2005) and did not consider agriculture and the rural sector as a vibrant and dynamic input to development<sup>71</sup>. Lately, the rural non-farm sector is recognised as an important channel for development and reduction of poverty (Byerlee et al., 2005; Foster & Rosenzweig, 2004; also see Jung-Sup, 2004). The shift, therefore, from the rural to the urban sector in credit does not augur well for the state's rural sector.

#### *4.8.4 Credit as Source of Urban Transformation*

Credit inequality between the rural and urban areas, as discussed above, leads the study to the question: Does the increased credit to urban areas assist in increasing urbanisation and economic growth? While the following chapter deals with urbanisation in UP comprehensively, the present chapter explores credit as a source of urbanisation only.

Credit became more urbanised in all the four regions of the state. The differences across the districts have narrowed over the years, as the standard deviation in the credit to urban areas narrowed slightly from 3.6 in 1972 to 2.4 in 2004. The two tables 4.20 and 4.21 show credit to each region's urban areas, and to different economic activities in the rural and urban areas. Within rural areas, credit to the western region was highest in 1972, which declined in the nineties and non-rural and non-agricultural activities took up the major share of credit. The credit to rural areas in the eastern region has increased in the state and was even more than the western region in the recent years. The increase in credit to manufacturing and services in the western region is evidence of increasing credit to non-rural areas in the region. A close analysis of the districts reveals that in most of the districts in the western region,

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<sup>71</sup> Some of the criticisms levelled against the Lewis's model are that it rather overestimated the absorption capacity and elasticity of the leading sector (urban sector here) in relation to the lagging sector (rural). Thus, it did not consider the possibility of urban unemployment arising out of the migration from rural-urban areas.

credit did not increase and actually declined in urban areas. The increase since 1972 is mainly due to the high share of credit to the new districts like Gautam Budh Nagar. This district, created in 1997, includes the industrial areas of NOIDA and Greater NOIDA, is adjacent to Delhi and hub of industrial and software technology activities.

The paragraphs above described the shift of credit from rural to the urban areas. Is this an indicator of lesser lending to the rural areas, or does it show the flow of savings from rural to the urban areas? Rural household savings can be in the form of physical and financial assets. The physical assets are assets such as land (including housing) and jewelry, and the financial savings are deposits with banks, non-bank deposits, shares and debentures, life insurance funds and other provident and pension funds. The deposits (current, savings and term deposits) with the banks are an important component of savings in the rural areas. The credit-deposit ratio in the rural areas of UP declined from around 60 per cent in 1990 to 38 per cent in 2004, indicating that in relation to their savings (bank deposits here), credit is much less in the rural areas. The credit-deposit ratio in urban areas in the state also is much less as compared to the credit-deposit ratio in urban areas at the country level. The credit has increased significantly in the urban areas in UP though in relation to its deposits it is much less. This also shows that in UP the flow of savings is not from the rural to urban areas, rather the banks are lending increasingly in the urban areas.

#### *4.8.5 Credit as a Source of Empowerment*

Until now, the present study examined credit not only as a source of growth, regional inequality and urban transformation, but also as a source of development wherein poverty reduction was an indicator of development. In this context, bank credit and micro credit not only function as the tool of poverty alleviation but also as the tool of empowerment. The study examined poverty alleviation earlier, it is, therefore, logical now to look at the other objective of credit that is, credit as the source of empowerment.

Empowerment, which has become a buzzword since the nineties (see Page & Czuba, 1999) is defined precisely, as “to give authority or power to; authorize. • give strength and confidence to” (Soanes & Stevenson, 2004). Cheston and Kuhn (2002) defined empowerment as “*change, choice and power*. It is a process of change by which individuals or groups with little or no power, gain the power and ability to make choices that affect their lives” (Cheston & Kuhn, 2002,p.13). The word

'empowerment' has been used in a number of contexts and perspectives, and has been even used in the context of 'fiscal empowerment'(Reddy, 2006). More often, however, as discussed earlier, it refers to the empowerment of women, and the socially weaker groups like the disabled and low castes as in India.

Women became the target for empowerment in the microfinance programmes, as the:

- i) the relationship between gender inequalities and poverty turned out to be strong in the developing countries;
- ii) women are often very poor and, therefore, need to be assisted with such programmes; and
- iii) also, it was found by many studies that women spend most of their incomes on their families which enhances the welfare of whole family including children (Cheston & Kuhn, 2002) .

Women can be empowered through education and health, and economically through access to financial resources, for instance, bank deposits and credit. The hype of women empowerment has even made the Government of UP include a separate chapter on women empowerment in its Tenth Five Year Plan document (Government of UP, 2002). It spells out the need for empowerment of women in the state and the various areas aimed at are improvement in female education; health and nutrition; economic empowerment of women through improved credit; social and political empowerment through increased participation of women in politics; and improved social security and protection. Empowerment, however, can occur only through social transformation, and takes place through change in deep-rooted attitudes beginning at the family level. The role of the state is to facilitate that change through ensuring legal rights, increasing awareness of those rights and providing basic social services to women. Microfinance is also one such facilitating tool to assist women in their empowerment.

Is the effect of empowerment on growth, or exclusively on development, or is it on both? Empowerment of women can have growth effect as well as development effect. The empowerment of women through education and better health, and increased participation in the workforce leads to contribution to economic growth. The effect of empowerment on development through the mothers' education, leading to better nutrition and health of children, choice of the size of family, reduced birth rates and demographic change, is also enormous. Access to credit enables women to



start their own enterprises and escape poverty. It has been much debated whether credit to women compromises on growth (see Kevane & Wydick, 2001). Theoretically, gender does not matter in the relationship between credit and growth, and the credit to women may not be different from that to the men. However, as the repayments by women are higher than that by men the economic growth outcomes will differ. Credit, therefore, could lead to empowerment and empowerment leads to higher economic growth. Most studies and organisations engaged in providing credit to women, acknowledge development effects of empowerment through credit leading to poverty reduction.

Has microfinance then empowered the women? Kabeer (2005) observed that though microfinance is often seen as a 'magic bullet' for women, credit *per se* does not automatically empower women. Empowerment is an outcome of social transformation and merely providing credit does not automatically lead to empowerment. Rankin (2001) also argued that credit would not result in empowerment itself. She emphasised the differential impacts of microfinance in different countries depending on culture and ideologies, and therefore cautioned that it is not proper to take a unified approach of the effect of microfinance on the empowerment of women.

A number of impact studies are available for other states of India including Andhra Pradesh. Leach and Sitaram (2002) in the case of Andhra Pradesh found that microfinance actually failed to empower women and made their condition even worse. Illiteracy of women; less mobility of women; lack of cooperation within the family and even among the group members; and collapse of businesses leading to accumulation of debt were some of the reasons. The evidence on the impact of credit including microfinance is sparse in UP. Compared to the southern states, where SHGs are mostly comprised of women, in UP mixed groups of men and women, or men only groups with a few women groups are found (P. Basu & Srivastava, 2005). Mishra, Verma and Singh (2001) had also observed the overwhelming membership of men in SHGs in UP as compared with women. In a study of empowerment among women in eastern UP, Pandey and Mishra (2004) found that the empowerment of women is extremely low and that access to ownership of assets, property, credit and even education, has not been important in women's empowerment in this case. They found that decision-making was a more significant factor in women empowerment.

Not much information is available on bank credit to women in UP. The data on credit, according to gender, is available only for small borrowers at the all India level for the year 2004. Further breakdown for the states is not available which does restrict the present analysis. Nevertheless, it does indicate that the share of the credit to women among small borrowers in the rural and non-rural areas is not very different from each other. The share of the rural female borrowers in the number of credit accounts was 17.2 per cent, and that of the urban female borrowers was 19.1 per cent. In the total credit amount also, the share of the women rural borrowers at 14.1 per cent was almost the same as that in the urban areas at 15.3 per cent (Table 4.22). As the data on credit is available only for one year it does not give any idea of women's access to resources in the pre and post-reform period. The available data does show that maximum share of the credit among the individuals has gone to the males. Only in the metropolitan areas is the share for women slightly higher compared to that for males.

The gender data on deposits for the state is available only from 1996 onwards. Table 4.23 shows negligible difference in the pattern of ownership of deposits in the pre and post-reform period. As in credit, men hold more than 60 per cent of the deposits, and the deposits of women were only around 17 per cent. The number of women's accounts has also increased, though this may not be a real indicator as the accounts of women may be opened to spread the family wealth and may have nothing to do with their empowerment.

#### *4.8.6 Credit and Globalisation in G-GUIDE*

The present chapter mentioned earlier the importance of infrastructure and its role in globalisation. The long-term time series data on credit for infrastructure, which includes roads, power, and telecommunications, is available at country level. Such data is, however, not available at state level. The data on bank credit to infrastructure is available from 1998, and its share in total credit to industry in the country increased from 2.0 per cent to 15 per cent in 2005. It is recognised that infrastructure plays a vital role in economic development and also assists in poverty alleviation (Yoshino & Nakahigashi, 2000). In the absence of the data on bank credit to infrastructure at state level, the present study considered availability of power to the industrial consumers, as increased and improved power supply would lead to increased output. In addition, lack of adequate supply of power would be a major factor in industries move to other

states with better power availability. The number of industrial consumers served in the state has declined from 4.0 per cent to 1.5 per cent in 2005, again an evidence of declining industrial output. Power sold to industrial consumers also declined during this period from 30 per cent to 18 per cent (UPERC).

#### 4.9 Summary

Chart 4.2 in brief sums up the analysis and findings in the section above.

Chart 4.2: Summary of Findings in Section II

<u>Credit as a source of</u>	<u>Credit Indicator</u>	<u>Findings</u>
i) Growth (G)	Credit to total output, sectors, regions, districts	Increase in output but shift to services sector, increase in western and eastern region
ii) Globalisation (G)	Credit to infrastructure (power supply)	Power availability to industries declining
iii) Urban Transformation (U)	Credit to urban areas	Effect on urban transformation limited as credit more to services
iv) Inequality (I)	Credit to rural and urban borrowers	Credit unequal across the rural and urban areas
v) Development (D)	Credit to small borrowers, microcredit	Effect on development limited as SHG-Bank linkage is inadequate considering the state's size and extent of poverty
vi) Empowerment (E)	Microcredit, bank credit to women	Effect on empowerment, though positive as shown by few case studies, is also very limited due to inadequate spread of SHGs in the state. Bank credit and deposits more to men than women- control over credit to women, family power and fortune

### Section III

#### 4.10 Credit and Human Capital in UP

So far the analysis in the study was restricted to bank credit in UP. A stream of the current literature on the state has been critical of the state's human development as was pointed out in Chapter 1. Human capital that is, education and training is an integral part of human development. Is human capital then influencing the credit pattern in the state? What is the nature of relationship between the two? Is it different across the states in the country? Does the educational profile of the borrowers really matter?

Physical capital combined with poor human development may produce low growth and poor development outcomes (Bergheim, 2005). Conversely, high human development in the presence of low physical capital may not lead to positive growth outcomes such is the case of Kerala in India, which though lacking in physical capital

scores much higher in almost all aspects of human development<sup>72</sup>. Human capital and physical capital both determine growth endogenously and are crucial to economic growth (Caballe & Santos, 1993). Though both are required for long run growth, the accumulation of physical capital takes place in the early stages and human capital accumulation follows (Graca, Jafarey, & Philippopoulos, 1995). They are determined endogenously as physical capital leads to increase in education levels which in turn influences physical stock (R. M. Grier, 2002). Also tropical climate and land locked regions has no negative effect on physical or human capital (R. Grier, 2005).

Are the returns through accumulation of these forms of capital low for the poor people? The interaction of physical and human capital among the poor highlights the need to increase education, as the poor people obtain poor results in physical capital accumulation (Walle, 2003). The emphasis on physical capital accumulation alone in the development process could lead to emergence of inequalities, which do accentuate growth, but as the human capital accumulation takes place, the inequalities are reduced (Galor & Moav, 2004).

To examine the relationship between credit and human capital in UP, the study worked out the correlation coefficient between credit and literacy rate. The present study did not find strong correlation coefficient between per capita rural credit and literacy rate in the rural areas of the state at the district level<sup>73</sup>. The trend is, however, different in the different regions of the state. In the prosperous western region, the relation is weak at only +0.12 but in the Bundelkhand region, it was relatively higher

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<sup>72</sup> Kerala has been hailed as the model of development due to superior performance in human development amongst all the states of India (Parayil, 2000). The superior performance in human development however, was not accompanied with high employment and growth rates. Therefore portrayal of Kerala as a model has been subjected to much criticism (see Rammohan, 2000). A number of studies opine that a further improvement in human development indicators is still possible. In the nineties, the state did experience a turnaround in economic growth (Babu, 2005) though, the quality of growth and its longevity has been much debated of late. Even the present study's data shows that Kerala did experience high growth rates in the nineties. The share of services sector too, has been much higher than that of other states.

<sup>73</sup> In order to examine whether any relationship exists between bank credit and education of the borrowers, the present study considered specifically rural credit and literacy rate in the rural areas as the literacy rates are particularly low in the rural areas of the state and the objective here was to examine whether credit availability is influenced by the education of the borrowers. The literacy rate is commonly adopted as the indicator of education. The educational profile of the borrowers is not available in the banking statistics data. The NSSO Survey, however, shows the educational profile of farmers in the state, though it too does not give the borrowings from different sources education wise. The literacy (7 years+) among the farmers in the state is 60 among the males as against the national average of 65. This is, however, higher than Andhra Pradesh, Jammu & Kashmir, Madhya Pradesh, Rajasthan. The literacy rate among the farmers (males) in Andhra Pradesh is extremely low at 48. The literacy rate of the female farmers in the state is again woefully low at mere 19 as against the national average of 31.

+0.30. Even across a number of states of India, the study finds a poor relationship between the bank credit and literacy rate.

The literacy rate might not be an appropriate indicator of the level of education achieved. The number of years of schooling (0-9 years of schooling) attained by men and women in the rural and non-rural areas of the state are a more appropriate indicator of human capital. Such data are available from the Reproductive and Child Health Survey (RCH) for only 13 out of 70 districts of UP. At the district level, this is the only source of data on the years of schooling completed. Since these 13 districts are from different regions of the state hence, no particular regional analysis is possible. The correlation coefficient between per capita rural credit and years of schooling in the rural areas (for men) is weak at +0.38 but in the urban areas is considerably strong at +0.78<sup>74</sup>. The strong correlation between education and per capita credit in the urban areas indicates the educational profile of the borrowers. Data on 0-9 years of schooling however, includes data on literates but with no formal years of schooling. The study, therefore, considered schooling years completed of 10 years and above in the rural and urban areas of the state. This also indicated a weak although positive (less than 0.5) relationship between education and credit, higher for males than females in the rural and urban areas.

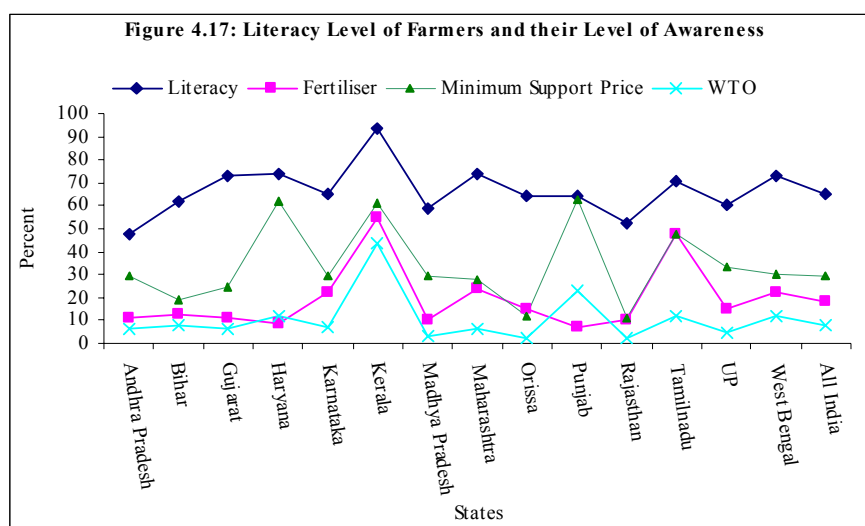
Does education affect rural outcomes other than credit availability? Does education improve agricultural yield/productivity through better utilisation of agricultural inputs? Several studies have observed the importance of education in better farm performance and adoption of technological inputs. However, Kohli and Singh (1997) found that education or literacy rates influence the adoption of technological inputs in combination with other factors, and were not the sole determinant of adoption of technological inputs. Thus, though the literacy rate was higher in states like Maharashtra, Tamilnadu and Kerala, it was Punjab, with a lesser literacy level, which recorded rapid diffusion of agricultural technology. Further evidence of this is also the high level of awareness of the farmers in Punjab (63 per cent) and Haryana (62 per cent) of procurement agencies like Food Corporation of India (FCI), Cotton Corporation of India, Jute Corporation of India, and National Agricultural Cooperative Marketing Federation of India, for selling their crops

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<sup>74</sup> As explained earlier, the reason for examining the relationship between per capita rural credit and years of schooling in the rural areas and the urban areas separately was to explore whether education influences access to credit in the state.

(NSSO, 2005f). In UP where food grains production is highest, awareness among the farmers of minimum support price and procurement agencies was much lower at 33 per cent. Of this, about 22 per cent of the farmers knew about both minimum procurement price and name of the procurement agency, and 11 per cent of the farmers had heard about the minimum support price, but had no knowledge of the agencies involved. The awareness among the farmers of biofertilisers<sup>75</sup> was high in the southern states. Knowledge of WTO showed a direct association with the literacy level and the correlation coefficient between the two was found by the present study, to be high at +0.732. Thus, in Kerala 44 per cent of the farmers had heard of WTO as against only 5 per cent in UP. Although farmers in Punjab again showed greater awareness at 12 per cent compared to the more literate states such as Maharashtra and Gujarat (NSSO, 2005f).

Figure 4.17 plots the literacy level in the states and the farmers' knowledge of procurement agencies, fertilisers and WTO. Sinha, Sen and Kumar (2000), in their small sample study in selected districts in the eastern region of UP, observed that about 38 per cent of the farmers were illiterate and had no knowledge of new agricultural technologies. The lower level of awareness in UP, particularly in the eastern region among the farmers, affects production and leads to lower adoption of technology.



<sup>75</sup> Biofertilisers are not the same as chemical fertilisers, which are manufactured in factories. They are not soil nutrients by themselves but act as direct agent in making plant nutrients available to the soil. They carry some bacteria living on an organic base. They are sold in small quantities and require storage at specified temperatures. The examples of biofertilisers are Rhizobium and Azotobactor.

#### 4.11 Summary

The aim of this section was to examine the interaction of physical capital (credit) and human capital (education measured by literacy rate and years of schooling). The study found that the basic knowledge of procurement agencies was very high in both the major agricultural states, Punjab and Haryana. The link to literacy level was not strong, although higher awareness and understanding required for the grasp of biofertilisers, and WTO and its impact, was high in Kerala where literacy rates are highest in the country. The findings in brief are shown in the chart below:

Chart 4.3: Summary of Findings in Section III

<u>Indicator</u>	<u>Finding</u>
i) Per capita rural credit and literacy rate in rural areas	No strong correlation
ii) Per capita rural credit and years of schooling (0-9 years) in the rural areas	Weak correlation in rural areas
iii) Per capita urban credit and years of schooling (0-9 years)	Strong relationship in urban areas
iv) Schooling 10 years and above and per capita credit in rural and urban areas	Weak correlation
v) Literacy rate and awareness of procurement agencies	Not necessarily related for instance Punjab- high level of awareness despite literacy rates lower than some states
vi) Literacy rates and knowledge of WTO	Related to literacy rates but Punjab again an exception; awareness high in Kerala

### Section IV

#### 4.12 Conclusion

At the outset, a point to be noted on the data limitations is that while the data on bank credit is comprehensive, according to economic activity and spatially, it lacks a human perspective. It lacks coverage of the human population, particularly the disadvantaged groups such as lower castes (considering their predominance in UP), women, and the disabled population of the state.

Overall, this chapter examined the trends and pattern of bank credit to all India, states and UP against selected dimensions. The present study termed this multi-dimensional role of credit as G-GUIDE of credit. In terms of the G-GUIDE of credit, the study observed mixed results. Bank credit has influenced output at the country level, states and in UP but it is more towards large borrowers, urban areas and developed states. It had a limited effect on the empowerment of women as credit to

women including micro credit is concentrated in a few states and even within UP in a few districts.

The study also observed that although credit has been able to usher in change in the regions of UP, the pace has been gradual. The chapter also highlighted the shifts in UP, which the existing studies fail to recognise. The shifts have been from the central to the western region; and from western to the eastern region and from agricultural to non-agricultural activities in the western region. The present study also examined the relationship between bank credit and education in UP and found that education does not affect the access to credit. Education, however, does matter for grasping and understanding of complex issues as for example, farmers in Kerala, a state with the highest literacy rates, showed higher awareness and understanding of WTO than the other states of India.

With the reforms in the banking sector, the banks' focus shifted to economic growth, and profitability and bank soundness were their sole concerns. Microfinance and micro credit lead to development, which among other outcomes mostly refers to reduction in poverty, and empowerment of women. However, the G-GUIDE analysis in the present study showed that banks' role in development did not stop with the banking reforms and they continue to influence the development outcomes.

This chapter had observed the change in the composition of credit to different sectors and regions in UP in the nineties and thereafter. The chapter 2 of the present study also had observed that the composition and structure of the state output is changing gradually from agricultural to non-agricultural sectors. But what is the structural change and how is it taking place in the state? Is it different from the structural change taking place in the country? What has been the role of banks in the structural change of UP's economy? Have reforms in the country and even at the state level brought any change in credit to the services sector and with what development outcomes? The next chapter examines these issues.



Table 4.1: Decadal Growth Rates of Indian Economy

Decades	(in per cent)		
	Growth of Real GDP	GDP Growth at current prices	Growth of credit
1950-60	3.6	-	-
1960-70	3.8	-	-
1970-80	3.0	11.5	18.5
1980-90	5.8	15.0	16.8
1990-00	5.9	14.8	15.9
2000-04	5.8	9.4	17.9

- not available.

Source: RBI (2004c, various issues).

Table 4.2: Growth in Sectors and Credit in India

Year	Average Decadal Growth in			Credit as share of GDP		
	Agriculture	Industry	Services	Agriculture	Industry (large & medium)	Services
1970-80	1.8	4.4	4.2	-	-	-
1980-90	3.5	7.9	6.4	3.7	7.0	2.4
1990-00	2.6	5.9	7.4	2.5	7.5	3.6
2000-04	2.5	6.2	8.0	3.1	8.6	6.2

- not available.

Source: same as Table 4.1.

Table 4.3: States Output and Credit Indicators

States	Output Indicators				Credit Indicators			
	Output Growth (Avg 1993-04)	Per capita Income (Avg 1993-04)	Infrastructure (% of Surface and Roads in total road length)	Globalisation Readiness* (2004)	Credit-Deposit Ratio (2004) Includes Metro cities Excludes Metro cities		Per Capita Credit (2004)	Banks' Investment plus credit (Avg. 1993-04)
<b>High Achievers</b>								
Maharashtra	5.4	16035	78.4	1	81.8	50.4	26871	25.2
Tamilnadu	5.2	12906	75.8	1	93.1	68.9	14524	10.1
Karnataka	7.0	12079	68.3	1	63.1	61.1	11190	6.2
Gujarat	7.9	15335	90.3	2	-	42.2	7048	4.9
Haryana	6.1	14993	93.3	2	-	47.6	6893	1.7
Punjab	4.0	16107	85.7	2	-	43.1	10901	3.3
<b>Medium achievers</b>								
Andhra Pradesh	5.7	10331	61.1	1	74.4	65.9	7329	6.9
Kerala	6.0	11499	33.2	2	-	45.5	9728	3.8
Rajasthan	6.5	9045	62.2	4	-	55.7	3832	2.9
<b>Low Achievers</b>								
UP	3.8	6335	67.1	4	-	33.1	2384	6.3
Bihar	4.9	3678	43.2	6	-	24.9	1080	2.5
Orissa	4.6	6463	22.0	4	-	53.7	3304	1.8
<b>Emerging Achievers</b>								
West Bengal	7.0	9856	53.8	3	72.8	49.5	5937	6.4
Jharkhand	6.2	8238	24.7	5	-	26.3	-	-
Chandigarh	8.9	28924	100.0	1	-	105.3	-	-
Himachal Pradesh	6.7	11855	56.7	4	-	29.7	5370	0.4
Delhi	8.7	25904	90.3	2	-	59.9	79096	-
Goa	7.8	27842	70.6	2	-	21.7	16926	0.3

\*:Globalisation readiness is proxied by E-Readiness Index of the states (covering 91 variables taking into account environment, readiness and usage of information technology in the states) which has grouped the states into six different levels and classified them into Leader; Aspiring Leaders; Expectants; Average Achievers; Below Average achievers and Least Achievers. UP is under Average Achievers group (DIT, 2004).

Source: Compiled from various sources like CSO (2005); DIT(2004); RBI.

Table 4.4: Groups of States/ Union Territories According to Population

(share in percent)

Group I States		Group II States		Group III States	
State	Population	State	Population	State	Population
UP	16.2	Orissa	3.6	Chandigarh	0.1
Maharashtra	9.4	Kerala	3.1	Jammu & Kashmir	1.0
Bihar	8.1	Assam	2.6	Himachal Pradesh	0.6
West Bengal	7.8	Jharkhand	2.6	Uttaranchal	0.8
Andhra Pradesh	7.4	Punjab	2.4	Delhi	1.3
Tamilnadu	6.1	Haryana	2.1	Sikkim	0.1
Madhya Pradesh	5.9	Chattisgarh	2.0	Arunachal Pradesh	0.1
Rajasthan	5.5			Nagaland	0.2
Karnataka	5.1			Manipur	0.2
Gujarat	4.9			Mizoram	0.1
				Tripura	0.3
				Meghalaya	0.2
				Goa	0.1
				Pondicherry	0.1
Total share in population	76.3		18.3		5.2

Source: Registrar General of India (2002a).

Table 4.5 : Human Poverty Index of Selected States

(in per cent)

States	Human Poverty Index	Average Growth Rate (1993-2004)
India <sup>@</sup>	31.02	6.3
Punjab	22.54	4.0
Haryana	25.58	6.1
Rajasthan	35.84	6.5
UP	34.58	3.8
Bihar	40.07	4.9
Assam	33.87	3.0
West Bengal	27.29	7.1
Orissa	37.01	4.6
Madhya Pradesh	36.18	5.0
Gujarat	27.42	7.9
Maharashtra	26.63	5.4
Andhra Pradesh	30.96	5.7
Karnataka	28.14	7.0
Kerala	35.97	6.0
Tamilnadu	23.27	5.2

Source: CSO (2005); HPI compiled from different sources such as Planning Commission (2002a); Registrar General of India (2002a); NFHS (2001); CSO (2004).

Table 4.6: Credit Inequality in Different States

(in per cent)

States	Proportion of rural and urban credit in total credit		Variation in credit (2004 over 1996)		Proportion of rural credit to urban credit		Credit Inequality (2004)	Proportion of semi-urban to urban credit		
	1996	2004	Rural	Urban	R/U	R/U				
Madhya Pradesh	23.4	76.6	19.9	80.1	-15.2	4.6	30.6	24.8	-5.8	29.4
West Bengal	13.0	87.0	9.6	90.4	-26.0	3.9	14.9	10.6	-4.3	6.8
Maharashtra	5.3	94.7	3.9	96.1	-26.4	1.5	5.6	4.1	-1.5	4.3
Gujarat	17.5	82.5	12.3	87.7	-29.8	6.3	21.3	14.0	-7.2	14.7
Andhra Pradesh	21.2	78.8	21.8	78.2	2.9	-0.8	26.9	27.9	1.0	22.6
Karnataka	16.3	83.7	19.4	80.6	18.8	-3.7	19.5	24.0	4.5	16.0
Kerala	8.1	91.9	6.3	93.7	-22.4	2.0	8.8	6.7	-2.1	56.0
Tamilnadu	13.1	86.9	9.4	90.6	-28.8	4.3	15.1	10.3	-4.8	15.1
Haryana	31.1	68.9	22.1	77.9	-29.1	13.2	45.2	28.3	-16.9	32.5
Punjab	29.8	70.2	25.9	74.1	-13.3	5.6	42.5	34.9	-7.6	31.5
Rajasthan	26.7	73.3	20.4	79.6	-23.7	8.6	36.4	25.6	-10.8	22.8
Bihar	46.2	53.8	39.5	60.5	-14.7	12.6	86.0	65.2	-20.8	43.0
Orissa	32.5	67.5	35.0	65.0	7.7	-3.7	48.2	53.9	5.7	39.8
UP	29.5	70.5	26.8	73.2	-9.1	3.8	41.8	36.7	-5.2	24.8

Source: Compiled from RBI (2004b, various issues).

Table 4.7: Per capita Credit to Small Borrowers in Different States – 2004

States	Per capita credit in rural areas (Rs.)	Ranking of state	Per capita rural credit % of urban credit	Per capita credit in urban areas (Rs)	Ranking of state
Madhya Pradesh	602	10	20.3	2963	10
West Bengal	487	12	23.2	2105	13
Maharashtra	527	11	18.6	2838	11
Gujarat	661	8	32.3	2047	14
Andhra Pradesh	1247	5	23.0	5425	4
Karnataka	1405	2	24.7	5699	3
Kerala	416	13	3.6	11717	1
Tamilnadu	1331	3	25.7	5177	5
Haryana	1297	4	28.6	4530	7
Punjab	1706	1	35.0	4874	6
Rajasthan	758	7	22.8	3328	8
Bihar	355	14	11.3	3141	9
Orissa	963	6	15.0	6425	2
UP	635	9	24.7	2575	12

Source: same as Table 4.6.

**Table 4.8: Credit to Small Borrowers in Different Regions of India**

(in per cent)

Years	NR	NER	ER	CR	WR	SR
1996	11.5	2.6	16.4	16.9	12.3	40.3
1997	11.1	2.6	16.7	17.1	11.4	41.0
1998	11.1	2.6	16.6	17.4	11.3	40.9
1999	15.9	2.3	13.4	16.9	14.7	36.7
2000	16.1	2.1	12.8	16.6	15.1	37.3
2001	16.3	2.1	13.2	16.3	14.4	37.7
2002	16.7	2.0	13.4	17.4	13.7	36.9
2003	16.2	2.0	13.0	17.3	13.3	38.2
2004	16.0	2.1	13.5	17.1	12.9	38.5

NR: Northern Region (Haryana, Himachal Pradesh, Jammu & Kashmir, Punjab, Rajasthan, Chandigarh, Delhi);

NER: North-Eastern region (Assam, Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Tripura);

ER: Eastern region (Bihar, Jharkhand, Orissa, West Bengal, Sikkim, A& N Islands);

CR: Central region (Madhya Pradesh, Uttar Pradesh, Uttaranchal, Chattisgarh);

WR: Western region (Goa, Gujarat, Maharashtra, Dadra & Nagar Haveli, Daman & Diu);

SR: Southern region (Andhra Pradesh, Karnataka, Kerala, Tamilnadu, Lakshdweep).

Source: same as Table 4.6.

**Table 4.9: Average Growth of Credit and Output in UP**

Variable	Average growth 1995-04		Average share 1995-04	
	Credit	Output	Share of credit	Share in output
State Output	13.5	10.6	-	-
Agriculture	12.7	8.9	20.6	34.1
Industry	10.6	9.6	36.3	18.5
Services	12.5	12.1	43.0	44.9

Note: Services include construction activities.

Source: same as Table 4.6; CSO (2005).

**Table 4.10 Share of Different Sectors in Total Credit to UP (Averages)**

Years	Agriculture	Industry	Services
1972-1982	20.3	54.3	25.4
1983-1992	22.5	40.0	37.0
1993-2004	20.8	36.8	42.4

Source: same as Table 4.6.

**Table 4.11: Region wise Agricultural Output in UP – Regional Averages**

Regions	OH	GCA	GIA	AUF	OF	FY
Eastern	0.72	427.34	70.97	262.45	479.80	1806.12
Western	1.11	475.71	93.29	232.98	584.12	2682.22
Central	0.83	456.21	72.30	276.49	589.45	2145.73
Bundelkhand	1.60	386.20	43.90	288.80	371.00	1350.60

Notes: OH- Operational Holding (ha/holding); GCA- Gross Cropped Area (000'ha.);

GIA-Gross Irrigated Area (% of GCA); AUF- Area under Food grains (000 ha.);

OF- Food grains Output (000'tonnes); FY- Food grains Yield (kg. per hectare).

Source: Compiled from CMIE (2004).

Table 4.12: Percentage Share of UP in All India's Industrial Output

Year	Number of registered factories	Total Persons Engaged	Total Output	Net Value Added
1960-61	2.6	-	5.0	-
1970-71	5.5	-	7.5	-
1980-81	7.4	-	6.2	-
1990-91	9.5	-	9.7	-
1998-99	8.0	7.2	7.4	7.2
1999-00	7.8	-	6.8	6.6
2000-01	7.3	-	7.0	6.7
2001-02	7.1	6.6	7.0	6.9
2002-03*	7.1	6.8	6.9	7.0

Note: \* Quick Estimates. - : not available.

Source: CSO (2000); Government of UP (2002).

Table 4.13: Share of Registered and Unregistered Manufacturing in Industrial Output in UP

Year	Registered Manufacturing	Unregistered Manufacturing
1960-61	41.6	58.4
1965-66	45.2	54.8
1970-71	49.3	50.7
1975-76	49.5	50.5
1980-81	41.4	58.6
1984-85	44.7	55.3
1993-94	58.5	41.5
2003-04	57.5	42.5

Source: CSO (2005); Government of UP (2005a).

Table 4.14: Regional Breakdown of SSI Units in UP

Region	No. of units	Employment	(in per cent)	
			Investment	
Bundelkhand	5.8	4.3	4.1	
Central	15.9	14.8	19.2	
Eastern	32.2	30.4	23.1	
Western	46.2	50.5	53.6	
Total	100.0	100.0	100.0	

Source: Government of UP (2002).

Table 4.15: Percentage Share of Different Bank Groups in Output in UP (2004)

Bank Groups	(in per cent)				
	Credit/ agriculture	Credit/ Industry	Credit/ services	Output/ Credit	Share of Banks credit (1996-04)
Public Sector Banks	20.6	48.0	34.7	30.5	84.4
Regional Rural Banks	7.6	1.5	2.9	4.0	10.3
Total Public Sector Banks	28.2	49.5	37.6	34.5	94.8
Private Sector Banks	0.1	13.7	4.3	4.1	3.9
Foreign Banks	-	0.6	0.4	0.3	1.3

Source: same as Table 4.6.

**Table 4.16: Percentage Share of Different Bank Groups in Total Credit to UP**

Years	Public Sector Banks (PSBs)	Regional Rural Banks (RRBs)	Total (PSBs+RRBs)	Private Sector Banks	Foreign Banks
1996-2004	85.7	10.4	96.1	2.2	1.7
1997	85.5	10.1	95.6	2.4	2.0
1998	85.5	10.2	95.7	2.7	1.7
1999	85.9	10.1	96.0	2.7	1.3
2000	86.5	9.9	96.4	2.0	1.6
2001	85.8	11.1	97.0	2.1	1.0
2002	80.4	10.0	90.5	8.9	0.6
2003	78.6	10.7	89.3	10.1	0.7
2004	85.7	10.4	96.1	2.2	1.7

Source: same as Table 4.6.

**Table 4.17: Percentage Share of Different Regions in Total Credit in UP**

Years	Eastern	Western	Central	Bundelkhand
1972	21.6	42.1	34.9	1.4
1975	14.9	43.9	40.1	1.2
1980	24.4	43.6	29.6	2.4
1985	23.2	48.2	25.7	2.9
1990	23.1	45.1	28.4	3.4
1995	25.9	45.4	25.1	3.7
2000	22.8	49.4	24.1	3.7
2004	21.9	50.7	23.2	4.1

Source: same as Table 4.6.

**Table 4.18: Enterprises in the Informal Sector in UP, 2005**

(in per cent)

Category	UP			India		
	Rural	Urban	Total	Rural	Urban	Total
Agricultural Enterprises in total enterprises	13.0	1.9	8.0	23.2	2.8	15.3
Non-agricultural enterprises in total	87.0	98.1	92.0	76.8	97.2	84.7

Source: CSO (2006).

**Table 4.19: Regional Distribution of SHGs in Total Number and Credit Amount in UP**

(number & amount in per cent)

Regions	Number	Amount	Credit per SHG (in Rs.)
Eastern	44.5	37.0	2193
Western	30.1	34.1	2988
Central	17.7	21.7	3236
Bundelkhand	7.7	7.2	2462

Source: NABARD (2006).

**Table 4.20: Share of Credit in Rural and Non-Rural Areas in Different Regions in UP**

Year	Eastern Region		Western Region		Central Region		Bundelkhand	
	Rural	Non-rural	Rural	Non-rural	Rural	Non-rural	Rural	Non-rural
1972	29.3	16.4	55.5	35.9	13.4	38.8	1.8	1.4
1975	28.2	12.0	58.9	39.2	10.9	42.6	2.1	1.3
1980	38.8	20.5	43.9	39.5	13.1	35.3	4.3	3.0
1985	33.9	42.0	40.6	30.4	20.8	25.2	4.7	1.8
1990	38.1	20.2	38.4	41.8	17.5	35.5	5.9	3.1
1995	41.9	22.4	37.4	45.2	14.3	29.3	6.4	2.8
2000	41.5	20.3	39.3	47.0	13.0	29.7	6.3	2.7
2004	38.2	19.5	38.4	47.8	15.3	29.4	8.1	3.3

Source: same as Table 4.6.

Table 4.21: Percentage of Credit to Different Sectors in Rural, Non-rural Areas in UP

Years	Rural Credit			Non-rural credit		
	Manufacturing	Agriculture	Services	Manufacturing	Agriculture	Services
1990	31.5	37.5	31.0	45.6	13.2	41.2
1991	25.7	40.2	34.0	44.1	13.1	42.7
1992	23.6	43.0	33.4	43.1	12.0	44.9
1993	23.9	42.8	33.3	46.2	11.1	42.7
1994	22.4	42.2	35.4	44.2	11.6	44.2
1995	20.8	44.5	34.6	44.3	12.0	43.7
1996	22.6	43.8	33.6	47.5	9.7	42.8
1997	24.0	42.0	34.0	48.0	9.9	42.1
1998	21.8	43.4	34.7	45.6	13.2	41.2
1999	22.0	39.6	38.4	44.1	11.3	44.6
2000	24.4	42.0	33.6	42.1	11.2	46.7
2001	16.5	52.0	31.5	40.1	11.6	48.3
2002	13.8	48.0	38.3	33.5	9.9	56.6
2003	14.8	53.0	32.2	37.6	11.4	51.0
2004	14.6	51.7	33.8	29.1	12.1	58.8

Source: same as Table 4.6.

Table 4.22: Percentage Distribution of Credit to Small Borrower Accounts in India (2004)

Area	Individuals				Others			
	Male		Female		Male		Female	
	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount
Rural	81.7	84.1	17.2	14.1	1.1	1.8	81.7	84.1
Semi-Urban	79.8	81.7	17.7	14.3	2.5	4.0	79.8	81.7
Urban	80.5	81.4	16.4	14.3	3.1	4.4	80.5	81.4
Metropolitan	73.8	79.1	23.2	16.5	3.0	4.4	73.8	79.1
All India	79.8	82.0	18.2	14.6	2.1	3.4	79.8	82.0

Source: same as Table 4.6.

Table 4.23: Gender wise Ownership of Deposits in UP

Year	Individuals		Others
	Males	Females	Year
1996	68.7	16.7	14.6
1997	69.0	17.2	13.9
1998	69.6	16.9	13.5
1999	68.7	17.2	14.1
2000	67.8	17.4	14.8
2001	69.6	17.6	12.8
2002	68.7	17.3	14.1
2003	68.7	17.6	13.7
2004	68.2	17.6	14.3

Source: same as Table 4.6.

# CHAPTER 5

## STRUCTURAL CHANGE AND ROLE OF THE BANKS IN SERVICES SECTOR IN UTTAR PRADESH

### **5.1 Introduction**

The previous chapter showed evidence of the shift in credit across sectors and regions. The literature on the state, as set out in Chapter 1, also suggested change in the inter-regional and rural-urban equations. The shift in output and credit from the western to the less developed eastern region of the state, was a positive sign for structural change of UP's economy. The chapter 2 of the present study had also examined the constraints faced by the state including intra-state regional disparities in infrastructure, education and finance. How have these patterns shaped the structural change of the state's economy? This chapter meets the fourth objective of the study and examines structural change, and role of credit in structural change (agriculture and industry were discussed at length in the previous chapter; in the present chapter credit to the services sector is examined) in UP. Probing further, this chapter sets out to answer the following questions:

- a) Has structural change taken place in UP's economy? Is the change in the economy's structure different from that of the rest of the country?
- b) What has been the role of banks in the growth and development of the services sector?

This chapter is organised into four sections. Section I examines structural change in the Indian economy and in UP. It also looks at any differences between the two. Section II examines the trends and patterns of the services sector in India and in UP. Section III, in disaggregate regional analysis, examines the financing of the services sector in UP across the rural and urban populations, regions and districts. Section IV concludes the chapter.



## **Section I**

### **5.2 Structural Change**

Structural change is the change in the structure of the economy from agricultural to a modern service economy. Through this transformation, it brings about change in output composition, employment pattern and income. Structural change is a key driver of economic development and poverty reduction (Dehejia & Lleras-Muney, 2003; Kaldor, 1967; Lewis, 1954). It has also been defined in the development literature as a process during which secondary and tertiary sectors develop into major contributors to output accompanied by a reduced share from agriculture (Clark, 1940; A. Fisher, 1939). It not only affects the economy in terms of sectoral transformation but also changes the social and cultural life of the nation (Cypher & Dietz, 2004) and also leads to demographic change. As Chenery (1988) described it:

This basic shift in the center of gravity of the economy from primary production to manufacturing – and later to services – is related to other types of structural change, of which the most notable are migration, urbanization, and shifts in comparative advantage. Thus, the term “structural transformation” will be used to describe the set of structural changes that are deemed essential to continued growth. These changes both contribute to and are affected by economic growth (Chenery, 1988, p.199).

The earlier literature on structural change did not spell out the order in which the three sectors, agriculture, industry and services, would appear in the growth process. Fisher (1939) cautioned that there could be flexibility in the order of appearance of the three sectors. Nevertheless, structural change emerged in literature as a process, in which the core of economic activity shifts as growth takes place and, therefore, a new leading sector of the economy emerges. The approach underlying such a shift is also in line with Rostow’s stages-of-growth theory (1960) in which a particular sector serves as an engine of growth. The leading sector, in the course of the development of developed countries, has usually shifted successively from agriculture to industry, and then to services (Clark, 1940)<sup>76</sup>. Clark’s (1940) description of the shift of resources from agriculture to industry and then services was based on the statistical evidence of national income data of now developed countries, whereas Lewis (1954) also arrived at the same result by theorising the process of economic

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<sup>76</sup> This observation of movement of workforce from agriculture-industry-services has been attributed by Clark to William Petty, an economist in the seventeenth century and Clark called it as Petty’s law (Clark, 1940). This has also been called the Petty-Clark Law (Goodacre, 2005).

development in a dual economy framework. In the Lewis's dual economy model also, the shift of resources takes place from low productivity sector such as agriculture to high productivity industrial sector. The decline in the share of agriculture in total output is accompanied with changes in diet, prices and wages (Timmer, 1988).

The transformation has not been uniform across all countries, and is affected by factors like resource endowment, initial structure of the economy, and choice of the development policies (Chenery, Robinson, & Syrquin, 1986). In many developing countries, development did not proceed according to the above pattern. The rise in the share of the services sector, instead of industry, accompanied the gradual decline in the share of agriculture in output in many developing countries. The recent theoretical literature on structural change also suggests that as economies mature, the share of the services sector grows along with the decline in agriculture (Kongasmut, Rebelo, & Xie, 2001). The share of industry on the other hand, first increases slightly and then declines (Gordon & Gupta, 2003). This has been termed as new thinking on structural change (S. Dasgupta & Singh, 2005).

The thinking changed not only on the composition of economic activities involved in structural change, but also on the agency involved in structural change. Compared to the earlier emphasis on state and public sector as the source of structural change, the emphasis has now shifted to the private sector, and subsequently has moved to public and private sector partnership. Evans (1992) identified three waves of thinking on structural change. In the first wave, (1950s and 1960s) the state was the main player in structural change. In 1970s and 1980s, thinking shifted to the state with a minimal role and the private sector emerged as the main performer in structural change. In the third wave, a mixed approach was espoused within which both state and private sector play a combined role, with state as the facilitator of structural change.

### *5.2.1 Changed Role of Agriculture in Structural Transformation*

A dilemma faced by many developing countries in recent years with the decline in the share of agriculture in total output (including both nominal and real), is: should the investment on agriculture be increased? (Timmer, 1988). Increasingly it is being realised that although the share of agriculture in most of the developing countries has reduced, its role in poverty alleviation still remains strong (Byerlee et al., 2005).

The role of agriculture in economic development can be analysed in terms of an early stage, and a later stage. In the early stage, agriculture is the provider of food and labour to the non-agricultural sector. In the later stages of economic development despite the decline in agriculture's share, its importance does not reduce. In the later stages, through improved efficiency and high growth, the agricultural sector leads to faster structural transformation and poverty reduction. It is this realisation which has led the World Bank to devote its World Development Report for 2008 (World Bank, 2007) to agriculture and its role in development including poverty reduction. In India also lately, despite the high real economic growth mainly due to the services sector, greater emphasis has been given to increased agricultural investment, research and development, and improved extension services.

### **5.3 Structural Change in India**

In India, as in other developing countries, the conventional pattern of structural change, as described earlier, did not eventuate as the economy moved from agriculture to services-dominated growth. The shift to services occurred, despite the induced structural change sought after independence with a substantial focus on industrialisation (Burgess & Venables, 2003). A large number of studies on the Indian economy have observed the structural change from agriculture to non-agricultural sectors (Byerlee et al., 2005).

#### *5.3.1 Structural Change and Economic Growth*

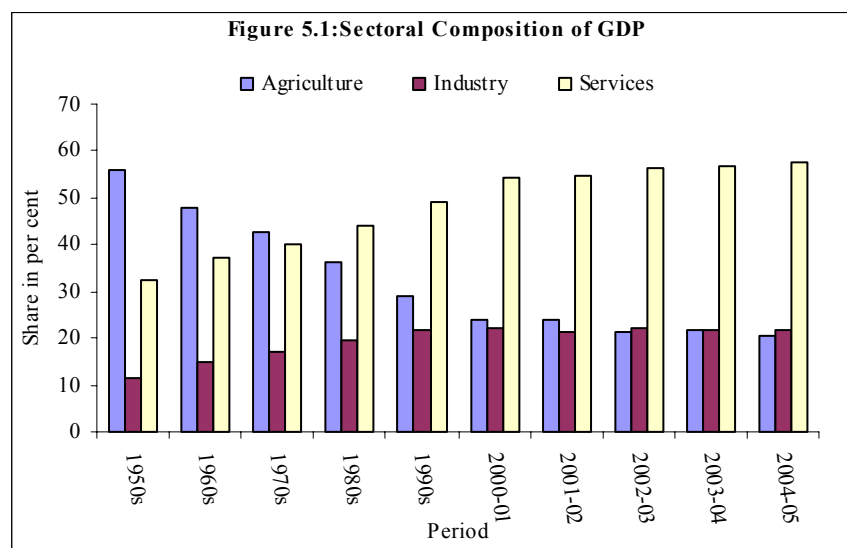
Structural change and economic growth are interrelated. The increase in economic growth leads to a faster structural change (Syrquin, 1988), and structural change itself is required for a faster economic growth. According to Kuznets (1971) “*some* structural changes, not only in economic but also in social institutions and beliefs, are required, without which modern economic growth would be impossible” (Kuznets, 1971, p.248). The quality and pattern of structural change can also influence the growth rate. According to Syrquin (1988) “On the one hand, that change can retard growth if its pace is too slow or its direction inefficient. On the other hand, it can contribute to growth if it improves the allocation of resources” (Syrquin, 1988, p.258).

The average real growth rate of the Indian economy between 1950s and 1970s was around 3.6 per cent per annum. The decline in the share of agricultural sector in

real output during this period was by 13.3 percent. From 1980s onwards, the average real growth rate was higher at 5.8 per cent per annum, and the decline in the share of the agricultural sector in total output was slightly higher at 13.6 per cent. With the higher economic growth from eighties onwards, the share of the services sector rose sharply. The share of the services sector rose by 7.7 per cent from 1950s to 1970s, but from 1980s until 2003-04, the rise was much higher at 11.7 per cent.

### 5.3.2 Growth and Composition of Total Output

Figure 5.1 and Table 5.1 show the composition of real GDP of India since the 1950s. The major features of the Indian economy until the late 1970s were: decline in the share of agriculture, and a corresponding rise in the share of the industrial sector. However, high growth of services in the 1980s overtook the industrial sector and the services sector emerged as the leading engine of economic growth. Although growth of the services sector was high in India, it was still below the share in other developing countries (Kochhar et al., 2006).



During the years 1993-94 to 2002-03, in India the average share of agriculture in real GDP was 26.5 per cent, industry - 22.1 per cent, and services - 50.5 per cent. Within two years in 2004-05, the share of the services increased further to 57.6 per cent, industry to 21.9 per cent, and agriculture's share declined to 20.5 per cent. The country's high growth rates since the nineties have been principally a product of the

rise of the services sector, which has been skill intensive in nature (Leipziger & Zaghera, 2006).

### *5.3.3 Structural Change and Trade*

The pace of structural change depends not only on economic growth rate, but also on the country's trend and pattern of international trade. High foreign demand for domestic goods and services leads to increased output and growth. This leads to change in the contribution of the sectors in real output. In the pre-reform period, India's trade policies were highly regulated, and the proportion of foreign trade in total output was very low. In the post-reform period, exports, which were 5.8 per cent in 1990-91 as percentage share of real GDP, increased to 13.1 per cent in 2005-06. The export of services, particularly software, has been very high in this period. The share of software exports in services exports has averaged around 38 per cent during the period 2000-01 to 2004-05.

### *5.3.4 Structural Change and Trends in Employment*

As was mentioned earlier, the process of structural transformation entails movement of workers from agriculture to the non-agricultural sector. With the decline in agricultural output, the workers move to the other sectors. However, this may not synchronise, as the movement of workers may take more time due to the pace of structural transformation, pattern of economic growth, and availability of urban opportunities. A large proportion of the workers, therefore, may continue to remain in agriculture resulting in low productivity. In the Indian context, despite high growth rates in the overall economy and the services sector in recent years, about 58 per cent of the workforce is still engaged in the agriculture. Syrquin (1988) also pointed out that most of the movement of workers is to the services sector rather than the industrial sector. The paragraphs below show the trends and patterns of employment in India.

Irrespective of the pace and timing (pre-reform period and post-reform period) of structural change of the Indian economy, growth in employment has not matched the country's overall real growth rate. The Indian economy during the period 1972-73 to 1977-78 grew by an average 3.9 per cent per annum, and the employment growth during this period was 2.9 per cent. During the period 1977-83, real growth rate of the overall economy was higher at 4.0 per cent per annum, but the employment growth

slowed to 1.9 per cent. During the period 1983-94, employment grew by 2.1 per cent. However, in the period 1993-94 to 1999-2000, it was significantly low at only 0.95 per cent (McNay, Unni, & Cassen, 2004).

The slower growth in employment in the nineties is particularly striking as it coincided with the period of economic reforms. During this period, on an average, the Indian economy grew by 6.5 per cent per annum compared to 5.4 per cent per annum in 1983-94. This period of high economic growth and slow growth in employment has been termed as the period of 'jobless growth' by many studies (B. Bhattacharya & Sakthivel, 2004a; Gordon & Gupta, 2003; Planning Commission, 2001b). The decline in employment was both in agriculture and in industry. The rise, on the other hand, was associated with the services sector within which employment growth took place in trade, construction, financial services, and transport, storage and communication (McNay et al., 2004).

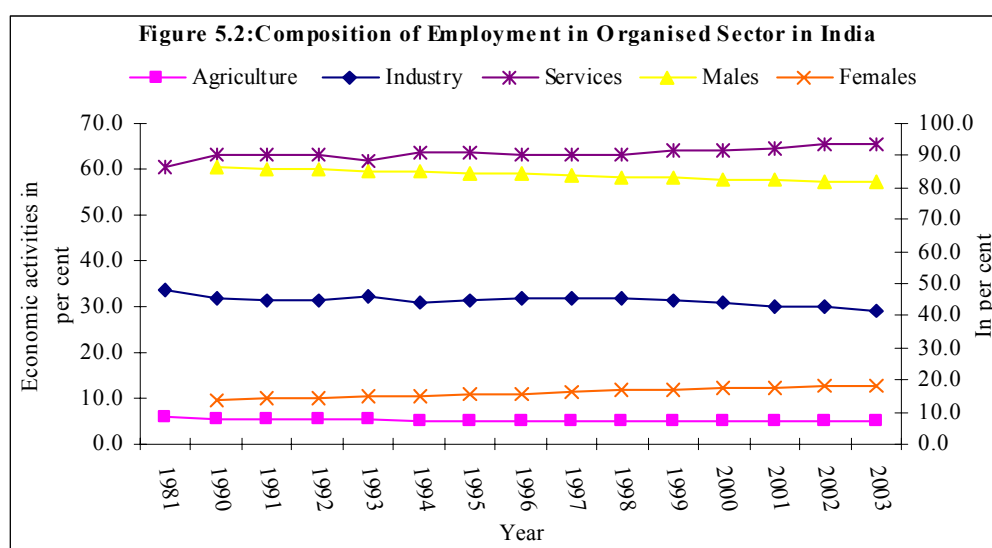
Although employment declined during the nineties, the economic growth rates increased and poverty reduced, both in the rural and urban areas. This high growth with reduced poverty despite the decline in employment is a consequence of positive but slower growth in employment in the unorganised sector in the nineties. The decline in employment was in the organised sector. The employment in the organised sector has been declining since 1998, and the average decline during the period 1998-2003 was 0.75 per cent. In an attempt to resolve the puzzle of decline in poverty, increase in growth rates and decline in employment Handsa and Ray (2006) inferred that the factors contributing to the decline in poverty possibly could be rise in unorganised employment coupled with the high real rural wage rate and remittances (inter-state and from abroad). The lack of data on inter-state remittances and breakdown of remittances from abroad according to states makes it difficult to confirm this possibility.

### *5.3.5 Breakdown of Employment in India*

The three categories in which the employment in India can be grouped are: i) organised and unorganised sectors; ii) rural and urban areas; and, iii) across the occupations. Only about 8 per cent of the employment in the country is in the organised sector and about 92 per cent of the employment is in the unorganised sector (Planning Commission, 2002b). Within the organised sector, the share of public sector employment is high due to the existence of the large number of public sector

enterprises. Though the share of public sector employment in the organised sector is high, its share in total employment is not significant. In addition, it has been declining in the post-reform period. Private sector employment, on the other hand, increased slightly over the years, particularly, in the post-reform period (Table 5.2). The two major trends in the employment in the organised sector, therefore, are increase in public sector employment in the pre-reform period, and increase in private sector employment in the post-reform period. Figure 5.2 shows the breakdown of employment in the organised sector into different occupation groups. It shows:

- i) employment in agriculture in the organised sector was only 5.0 per cent in 2003, and thus, 95.0 per cent of the employment in agriculture is in the unorganised sector;
- ii) employment in the services sector, already 60 per cent in 1981, increased further to about 66.0 per cent by end 2003;
- iii) industrial employment has shown a decline over the years;
- iv) male employment in the organised sector has declined;
- v) female employment rose, both in public and private sector and the rise was in services sector.



Employment on the current daily status, which measures unorganised and informal employment, grew slowly by 1.1 per cent during the period 1993-94 to 1999-2000 compared to 2.7 per cent in 1983 to 1993-94. Employment growth in the rural

areas was considerably slower at 0.7 per cent during 1993-94 to 1999-2000, compared to higher growth of 2.4 per cent during the period 1983 to 1993-94. In the urban areas also, growth in the informal employment on the current daily basis was slower at 2.3 per cent in the period 1993-94 to 1999-2000. In the earlier period, the growth was higher at 3.6 per cent.

Despite the decline in the share of agriculture in total output in India, it continues to be the major employer with more than 50 per cent of the workforce still in agriculture. In 2001, 58.6 per cent of the workforce (15 years and above but less than 60) was employed in the agricultural sector (includes cultivators and agricultural labourers). This was followed by the services sector (37.6 per cent). Census 2001 provides the data on employment in the different sectors for total workers, and this includes both main workers (employed for more than six months in a year), and marginal workers (employed for less than six months) (Registrar General of India, 2002a). However, in Census 1991 this breakdown is only for the main workers, and does not include marginal workers (CSO, 1997). To this extent, the data between the two census years are not exactly comparable. Nevertheless, in 1991 workers engaged in the agricultural sector were 64.2 per cent of the main workers. This is an underestimate, as it does not take into account agricultural labourers engaged seasonally in the agricultural sector for only part of the year and therefore could come under the category of marginal workers.

The composition of employment as per the 60th round of the employment survey conducted by NSSO (2005a) shows that:

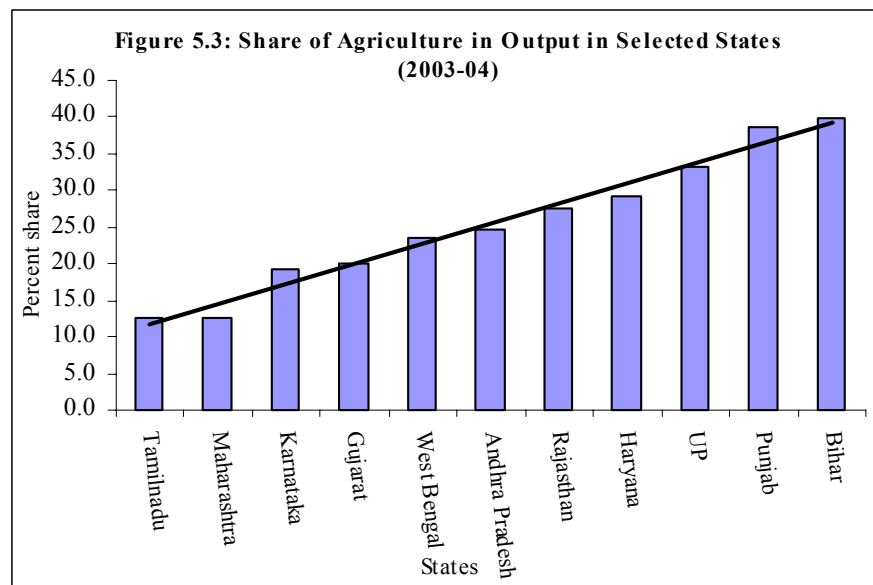
- i) about 65 per cent of the rural males and 82.0 per cent of the rural females are engaged in the primary sector. This is down from 77.2 per cent for rural males and 87.5 per cent for rural females in 1983;
- ii) in the urban areas, 55.1 per cent of the males were employed in the tertiary sector in 1983 which rose to 59.0 per cent in 2004;
- iii) urban females, also, are increasingly being employed in the tertiary sector.

How fast the workers from agriculture are absorbed in the non-agricultural sector, particularly the services, would depend on the country's growth rate, pattern of employment, trends in migration and urbanisation.



#### 5.4 Structural Change in the States

In the states also, the composition of economic activities changed as the output moved towards the services sector from agriculture (Table 5.3). The share of agriculture and manufacturing declined, more so in the states where agriculture had been the major source of output and employment. In some states the share of the manufacturing output rose. The services sector share rose in all the states, but in the fast growing states such as Maharashtra and Tamilnadu, the share was even higher. Thus, by the year 2003-04 a mixed picture of states' economies emerged with: i) a group of states where agriculture was predominant; ii) states with an industrial focus; and iii) some services-dominated states. In fact, in some of the states the pattern of development similar to the developed countries evolved (Kochhar et al., 2006). The share of agriculture in the real output of major states is shown in Figure 5.3. The large range (from 10 per cent to 40 per cent) in the share of agriculture in real output of the states is evident from the figure.



#### 5.5 Structural Change in UP

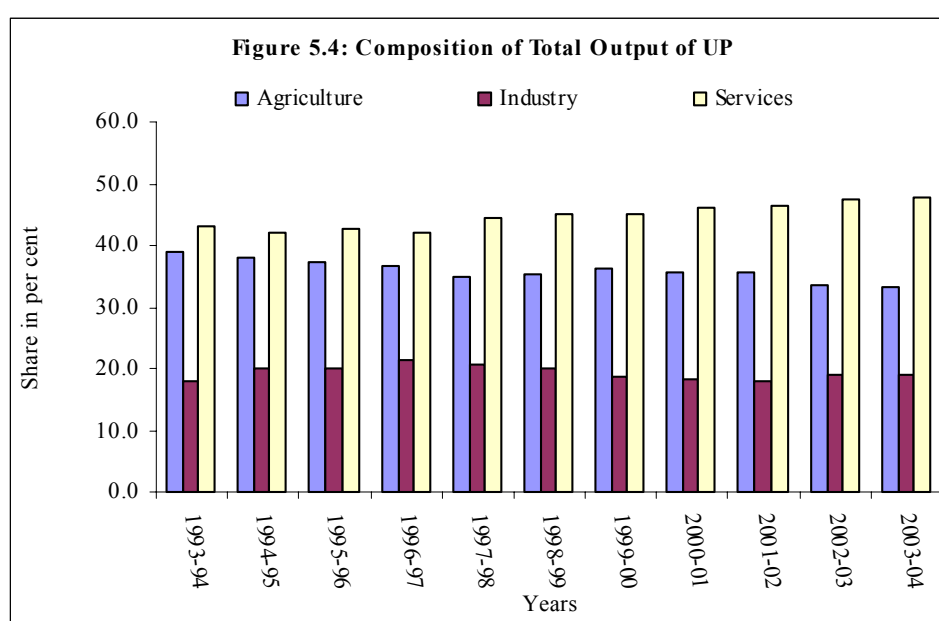
An immense focus on heavy industries in India in the 1950s and 1960s was with the intent of changing the structure of the economy from predominantly agricultural to an industrialised country. However, in UP it was agriculture which ushered in a change, initially in the western region, and gradually in the eastern region of the state. As was observed in the previous chapter of the study, the green revolution occurred in the western part of the state which led to increased agricultural income,

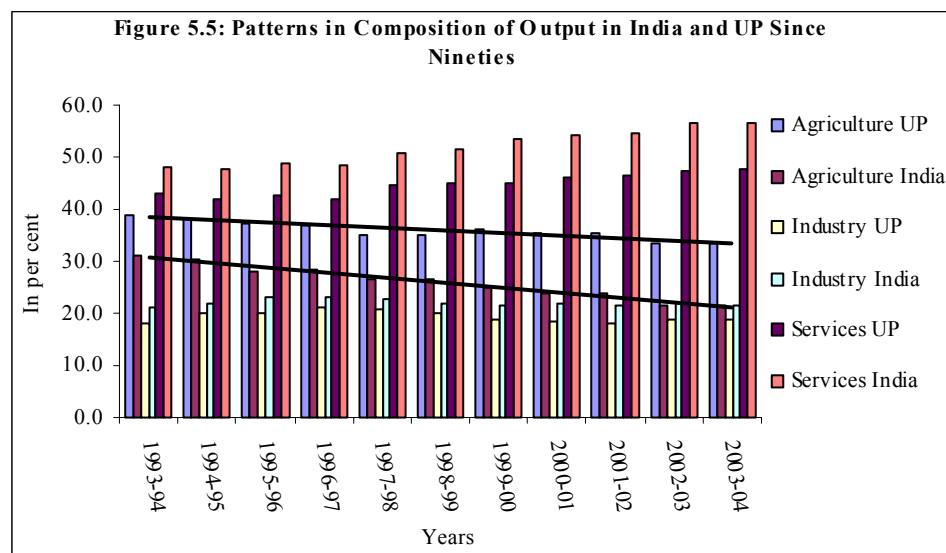
emergence of agro-based industries, development of small towns, and reduced poverty. Two major changes noticed in UP, as pointed out in chapter 4, were:

- i) shift of activity to the eastern region; and
- ii) shift of credit from rural to urban areas in the western region.

### 5.5.1 Growth and Composition of Output in UP

The share of the three sectors, agriculture, industry and services in UP's output and in other states is shown in Table 5.3. It shows the composition of the real output of states in 1993-94 i.e., at the beginning of reforms and a decade later in 2003-04. Figure 5.4 below shows the composition of the output of UP. Figures 5.1 (given earlier) and 5.4 display contrasts in the composition of output in the country and in UP. The main differences between the two figures are: i) much higher percentage share of the agriculture in the state and the growing gap between the country and UP in the share of agricultural sector; and ii) higher proportion of services in India's real output, compared to its lower share in UP. Figure 5.5 makes the trends in composition of total output between the two clearer. The share of agriculture in the UP's real total output declined slowly from 37.7 per cent in 1993-94 to 33.3 per cent in 2003-04, indicating a gradual shift from agricultural to the non-agricultural sectors. The share of the services sector increased, though it was less, compared to the overall share of 57.6 per cent in all India (Figure 5.5).





The year-on-year growth rates in the three sectors fluctuated, even turning negative in a number of years. Similarly, the growth of the services sector also was subject to fluctuations despite increase in its share in real output.

Although share of the agricultural sector declined in UP, it continues to be a critical factor in its development. The western region of the state demonstrated that the opportunities for growth through the green revolution exist. The shift towards the eastern region also is a positive feature, as it would influence not only agriculture, but also non-agricultural growth and regional poverty.

### 5.5.2 Pattern of Employment in UP

As stated in Chapter 2, due to the high dependency ratio, working age population is lower in UP compared to the other states. The dependency ratio is the population of dependents, comprising age groups 0-14 and 60 and above, divided by the working age population (15-59). The higher dependency ratio implies that the population available for employment in the state is less, compared to other states. However, dependency ratio does not reveal accurately the employment trend as:

- i) even within the working age population all people are not employed;
- ii) unemployment is high in the state;
- iii) percentage share of women in the workforce is low in the state which further reduces the active working population;

- iv) children below the age of 14 also contribute to the earnings of the family as the child labour is high in the state as will be shown in the next chapter.

In UP, most of the employment, around 96 per cent, is in the unorganised sector, and the share of the organised sector is only 4 per cent (Government of UP, 2005a). The employment in the organised sector has been declining since 1991. It was 2.7 million in 1991 and declined to 2.1 million in 2004. Within the organised sector, the share of the public sector employment in the state is higher, compared to the rest of the country, and that of the private sector is much lower (see Table 5.2). The increase in employment in the state is in the services which is largely in the unorganised sector (McNay et al., 2004). The decline in organised sector employment and increase in the unorganised sector, though with lower incomes, has been characterised as a deterioration in the quality of employment (McNay et al., 2004).

### *5.5.3 Breakdown of Employment into Economic Activities in UP*

#### a) Agriculture

The employment in UP in the three sectors, agriculture, industry and the services, during the decennials 1981, 1991 and 2001 is given in Table 5.4. A large share of population in the state is dependent on agriculture for livelihood. Agriculture employs about 66 per cent of the workforce in the state, which is higher than 58 per cent in the country as a whole. The large number of people employed in agriculture could be an outcome of factors such as:

- i) lack of opportunities in the non-agricultural sector; or
- ii) higher income in the agricultural sector than the non-agricultural sector;
- iii) lack of mobility to other sectors due to inertia;
- iv) low level of mechanisation in the agricultural sector.

Some of the major features of employment in the state's agricultural sector are:

#### i) Decline in agricultural employment

In recent years, employment elasticity, which shows the responsiveness of employment to change in output, has declined in the agricultural sector. This shows in

the decline in the agriculture's share in total employment from 75 per cent in 1981 to 66 per cent in 2001 (Table 5.4). The decline in agricultural employment in the state, and even in the country, is because of: i) small agricultural farms which do not require much labour; ii) mechanisation of farms; and iii) changing crop pattern from labour intensive crops to less labour intensive crops (R. Sharma & Poleman, 1994). However, McNay, Unni and Cassen (2004) cautioned that decline in agricultural employment should not be taken as a positive feature of structural change, as this has not been accompanied with an increase in rural manufacturing or services employment. In the eastern region of UP, decline in agricultural employment could also be due to the increase in migrant labour from the neighbouring states of Madhya Pradesh and Bihar (Ruthven & Kumar, 2002).

#### ii) High share of employment in agriculture and low agricultural income

Though agriculture constitutes an important source of employment in UP, the average income of the farmers from farming and non-farming business during the year 2002-03 in the state at Rs.1,633 was lower, than the all India figure of Rs.2,115. The income from cultivation in UP was only Rs.836 compared to Punjab (Rs.2,822), Haryana (Rs.1,494), Gujarat (Rs.1,164), and Maharashtra (Rs.1,263). The average monthly income from farm and non-farm activities in UP was high at Rs.7,850 for farmers holding land size of more than 10 hectares. However, this also is lowest within this group amongst all the states. In Punjab and Haryana, the income of the farmers having more than 10 hectares of land was Rs.34,340. In Bihar, the income for this group was Rs.27,766, almost four times than that of the income earned by the UP farmers (NSSO, 2005d).

This, however, does not reveal the regional differences in income within the state and, as stated earlier, though the western region of the state is most agriculturally prosperous, the eastern region is catching up.

#### iii) High share of agricultural labourers in UP

The breakdown of employment in agriculture in the state reveals a decline in the share of cultivators from 58.5 per cent to 41.1 per cent during the period 1981 to 2001. During the similar period, the proportion of agricultural labourers increased. This is due to a number of factors such as:

- a) landlessness of labourers (Diwakar, 2000, p.126);
- b) increased pressure of population;
- c) sale of land or mortgaged to moneylenders;
- d) statistical and conceptual measurement errors.

In the historical accounts, landlessness has been assigned as a major reason for the persistently high trend of agricultural labourers in the state's workforce (T. Roy, 2005). The land reforms initiated after independence to redistribute the land among the landless failed to succeed in the state, and much of the land was recaptured by the rich landlords. Some studies have found important economic and social impacts of the land reforms in UP. These were access to credit, increased agricultural output and income, improved social status, health of children and increased schooling (Diwakar, 2006). Lately, land reforms are back on the agenda. In his interaction with the villagers of UP, Lieten (2003) also observed that the demand for redistribution of land was high on the development agenda, particularly among the poor households.

A number of studies have also noted statistical measurement errors in the estimation of agricultural labourers in the state. For example, Lerche and Jeffery (2003) report the inclusion of rural artisans in the category of the agricultural labourers in Census, 2001. As against the census figures of increase in agricultural labourers, many field studies in western, eastern and even central parts of the state have reported a decline in agricultural labour. In addition, although many studies have reported statistical measurement errors as one of the reasons for increase in agricultural labourers, the blurring of the distinction between various casual occupations also led to large number of agricultural labourers. Many agricultural labourers performed seasonal agricultural jobs and carried on with the other jobs to supplement their incomes, which made the reporting of their principal occupation more difficult.

The proportion of agricultural labourers is high in many states, irrespective of their per capita income, poverty level, growth rate (high in both fast and slow growing states) and even their human development. Table 5.5 shows the proportion of agricultural labourers to the total workforce and some of the indicators including human development of the state. The results are mixed. The states with the high share of agricultural labourers are the states with lower rank in human development. Even

the states with lesser share of agricultural labourers have a lower rank in human development. This trend, thus, is common in many states and not limited to UP alone.

The increase in agricultural labourers also had an impact on agricultural wages. Srivastava and Singh (2006) showed that increase in the supply of agricultural labourers by 1 per cent depressed real agricultural wages in the nineties by 1.2 per cent.

A distinguishing characteristic of the agricultural labourers in UP in the nineties is their struggle against exploitation and oppression by the high caste landlords, poor working conditions, low wages and low social status, followed by their subsequent 'emancipation' from the high castes landlords (J. Lerche, 1999; also see Ruthven & Kumar, 2002). This was a consequence of the political empowerment of the lower castes in the state, made possible with the emergence of BSP (a political party of the lower castes). This is, however, more prominent in the eastern part of the state than the western region (J. Lerche, 1998).

#### iv) High non-farm rural employment in UP

Not only is a large proportion of UP's rural population dependent on agriculture, but also on the non-agricultural rural sector (or the non-farm sector as it is called often). A positive trend in UP has been a rise in the non-farm rural employment since the seventies. This rise has coincided with the introduction of HYVs of seeds and the associated green revolution in the state. Non-farm rural employment not only adds to the income of the households, but also serves as the source of funding for the farm sector. It is particularly important for the landless rural households, and serves as a support in periods of low agricultural activity.

McNay, Unni and Cassen (2004) argued that although rural diversification increases income, it has a limited ability to reduce poverty. In contrast to this, a number of studies have pointed to the increased role of the rural non-farm sector, particularly in UP. Sharma and Poleman (1994) portray a robust picture of the off-farm activities in the western part of the state, and the diffusion of activities, mainly in services, in the small towns' adjoining villages. Even in the eastern districts of the state, non-farm employment was pursued by the landless, and by small and marginal farmers to supplement their incomes (Ruthven & Kumar, 2002). Although this increased the incomes of the households, Sharma and Poleman (1994) pointed out the

limitations of this strategy in poverty reduction due to the lower assets of the rural households.

Lanjouw and Stern (1998) also observed the rising share of non-farm incomes in the western district in UP. Lanjouw and Shariff (2004) also found that the rural non-farm income constituted an important source of income for the rural sector. They showed that the percentage of non-farm income was typically high in states such as Himachal Pradesh, West Bengal and Tamilnadu, and low in states such as Maharashtra, Karnataka, Madhya Pradesh and Gujarat. They, however, did not mention the less developed states, and the importance of the non-farm income as a livelihood strategy in these states. Their data, nevertheless, showed that the significance of non-farm income in UP was highest in the low-income groups. Its significance reduced as incomes increased. Foster and Rosenzweig (2004) concluded from their analysis of agricultural performance in Indian villages that non-farm rural incomes played a significant role in the reduction of poverty. They, however, observed that this was dependent not only on agricultural growth, but on the rural industries which played an important role in increasing non-farm income.

#### b) Industry

As already noted, employment in the industrial sector in the state has declined over the years. Manufacturing in the state in 2001 employed only 5.6 per cent of the workforce, down from 9.0 per cent in 1981. As a number of industries in the state closed or moved out of the state in the nineties, the employment share in manufacturing also declined.

#### c) Services

As also noted, the workforce in UP moved from agriculture to the services, instead of to the industrial sector as was traditionally theorised on structural change. The share of the workforce in the services sector increased in 2001, though this was lower in comparison to its contribution to total output. The services share in total state output rose from 38.8 per cent in 1993-94 to 41.6 per cent in 2003-04 that is, a gain of 2.8 per cent during the period. During that period, increase in employment in the sector was about 10 per cent.

Various rounds of the national sample household surveys also throw light on the employment pattern in UP. Table 5.6 shows the distribution of population



employed in the rural and urban areas, according to gender, in the three sectors, primary, secondary and tertiary. The rural people are largely employed in the primary sector, and urban people in the tertiary sector. The male agricultural labourers are engaged mostly in non-agricultural work, and more and more women are agricultural labourers. Roy (2005) suggests that this current gender organisation of labour in agriculture has emerged due to historical reasons. These are: change in labour contracts from long-term to short-term, and increased participation of women in short term casual labour; emergence of spot market for industrial labour, which was mostly far away from the villages; and migration of men to cities in search of employment. Therefore, a mix of cultural, social and economic factors led to increased participation of rural women as agricultural labourers. In the urban areas, in almost all the states most of the women in the paid workforce were in the services sector.

Structural change involves movement of people from agriculture to non-agriculture sectors. This shift mostly leads to migration from rural to urban areas in search of better employment opportunities. As mentioned earlier, migration is one of four planks which lead to structural change. The paragraphs below explore the roles of migration and urbanisation in structural change.

## **5.6 Role of Migration and Urbanisation in Structural Change**

Migration and urbanisation are an integral part of structural change. The movement of labour from rural to urban areas, and from agriculture to industry, leads to primary and secondary effects on structural change. The primary effect could be urbanisation and increase in non-agricultural employment. The secondary effects are changes in the social and demographic structure (for instance, decline in fertility and mortality rate), which take place initially in the urban areas and gradually in the rural areas.

A large number of studies exist on migration, particularly rural-urban migration and economic development. Rural-urban migration in the development literature has been perceived as a consequence of 'urban bias' (Lipton, 1977), and rural brain-drain, as it often involves migration of young and more literate population (Lipton, 1977; JG Williamson, 1988). Lewis in his dual economy model expected that the movement of workers from agriculture (rural) to industry (urban) would lead to economic progress.

The contribution of migration to development can be both positive and negative. The positive effect of migration is associated with an increase in employment opportunities, and improved incomes. The negative effect of migration is perceived as decline in the quality of urban life, congestion of slums, and a burden on urban infrastructure. In the context of rural-urban migration, Todaro (1981) commented: “We must recognize at the outset, therefore, that migration in excess of job opportunities is both a symptom of and contributing factor to Third World underdevelopment” (Todaro, 1981, p.232).

Some other features of migration are:

- i) occurs due to a combination of economic (including push and pull factors), and non-economic factors like social, physical, demographic, and cultural. For instance, females in India migrate mostly due to marriage;
- ii) can occur at short and long distances. The short distance migration, as in the case of India, can be intra-district and intra-state and long-distance migration could be inter-state and international migration. It can also be classified as domestic and international migration;
- iii) also occurs from rural to urban areas; urban to rural; rural to rural; and urban to urban areas;
- iv) rural-urban migration and rural-rural migration arise due to the differences in wages in the two areas and availability of work opportunities;
- v) urban-rural migration mainly occurs after retirement with the desire to return to the place of birth;
- vi) urban-urban migration is due to availability of better opportunities in other urban areas;
- vii) while domestic migration particularly rural-urban contributes to structural change, role of international migration in the original country’s structural change is through remittances.

### *5.6.1 Migration in India*

Migration (even short-term mobility) has increased lately in the developing countries due to improved transport and communication facilities (Deshingkar & Anderson, 2004). In India, migration increased by about 32 per cent between the

census years 1991 and 2001. Tables 5.7 and 5.8 suggest the following trends and pattern of migration in the country since 1971.

- i) migrants were 30.6 percent of the total population in 1971, increased to 31.3 per cent in 1981, but declined to 27.4 percent in 1991. In the post-reform period, during 1991-2001, migration again increased to 29.8 per cent in 2001;
- ii) increase in the long-distance migration (inter-state and international) in 2001, due to the improved transport and communication facilities;
- iii) short-distance migration (intra-district and inter-district) still favoured as it formed 84.2 per cent of the total migration in 2001 and was, more or less, the same in the previous years;
- iv) within the states, 60 per cent of the migration is from rural to rural areas; and
- v) across the states, movement of the migrants is mostly from rural to urban areas.

The Indian literature has much examined rural-urban migration, but few studies exist on the migration of people from rural to rural areas. A search on Econlit and Google search engines carried out by the present study produced all the results relating to rural-urban migration, and only two (Narayanamoorthy, Jyotishi, & Deshpande, 1999; Parveen, 2005) on rural-rural migration. On rural-urban migration Mukherji (2002) argued that in India, distressed migration occurs, wherein migration is “from rural peasant sector to urban informal sector” (Mukherji, 2002 p.525). He argues that this migration is not the result of structural change, rather the illiterate and unskilled people from villages do not move to the nearby small towns and cities but to urban metropolitan areas. On the other hand, some studies have pointed out that rural-urban migration and even rural-rural migration is rather a ‘livelihood strategy’, rather than a ‘symptom of rural distress’ (Deshingkar & Anderson, 2004).

Critics of the migration from poor rural-rich urban areas fail to realise that this migration, though a strain on the destination areas, is a matter of survival for the rural people and is an escape from poverty, starvation and unemployment. Contrary to the general perception that migration to the urban areas leads to the prosperity and affluence of the migrants at the cost of the local population, some studies have

observed the delay in obtaining employment (up to six months), the lack of support, and the psychological stress on the migrants due to lack of income (Times News Network, 2006).

### *5.6.2 Pattern of Migration in UP*

The pattern of migration varies significantly across the states of India. In the more developed states, rural to urban migration is more prevalent. In most of the less developed states such as Bihar and UP, rural to rural migration is common (Table 5.9). In the developed states, urban to rural migration also exists. The net migration i.e. out-migration-in-migration is high in the states with high poverty.

An understanding of migration and its pattern in the rural and urban areas, and in the regions of the state, is central to the analysis of structural change in UP. Migration plays an important role in the state's economy particularly in the eastern region of the state (Paris, Singh, Luis, & Hossain, 2005) which Lieten even calls a "labour export zone" (Lieten, 2003, p.57). The pattern of migration in UP is, however, different from the other large states. These differences are:

- i) in UP, rural to rural migration (that is, from one rural area to another within the same district) is more widespread. Although this is a source of income for the rural households, its role in state's structural change is limited;
- ii) other noticeable feature of the state's migration is its large outflow of people to other states. This again does not contribute to the state's structural change, and the migratory labour contributes to the urbanisation and development of other states;
- iii) remittances to the rural areas of the state nonetheless do contribute to the state's development. A number of studies, however, have been critical of the effect of such remittances as they are transitory in nature, and may be used for unproductive expenditure (Rempel & Lobdell, 1978).

Migration from UP to other states has been very high due to the existence of better employment opportunities in other states, and the state's own high rate of unemployment and rural poverty. About 74 per cent of the people migrating from the

state are from the rural areas. A major reason for migration, among the males, was for employment. Marriage was the most important reason for the females for migration.

During the period 1991-2001, while the share of in-migrants (people entering the state) in the states such as Maharashtra and Delhi was significant, in UP it was the other way round, where the out-migrants (people leaving the state) were more than in-migrants. As per the Census 2001, 1.1 million persons migrated in to UP from other states, and 3.8 million migrated out of the state. The major destination states were Maharashtra (24.2 per cent), Delhi (23.4 per cent), and Punjab (6.4 per cent). These three states thus, accounted for 54 per cent of the total migration from the state (Registrar General of India, 2002a). The large-scale industrialisation in Maharashtra in the 1960s and 1970s and the availability of better work opportunities in Delhi and Punjab (mainly agricultural labour) are the major reasons for the migration from UP to these states.

The intra-state trend in migration shows that the rural to rural migration was more common in UP and formed 69.8 per cent of the total migration. This type of migration was more common among the low-income states - Bihar incidentally topped the list with rural to rural migration being around 80 per cent of its total migration. Migration from rural-rural areas also includes seasonal migration. The population census of the Government of India, however, does not provide any information on the seasonal migration.

Among the social indicators such as caste, education and occupation of migrants, the scheduled caste (lowest amongst the caste groups) migrants are highest at 8.3 million (23.6 per cent of the total scheduled caste population), and feature most predominantly in rural to rural migration from one village to the other (about 78 per cent of the total scheduled caste migrants). Also the proportion of illiterates (38 per cent) was highest in intra-state rural to rural migration (Registrar General of India, 2002a). The prominence of the scheduled castes (mainly males as female migration is mostly due to marriage) in the rural-rural migration in UP is also an outcome of the caste based economic discrimination which allows them few employment opportunities in their home rural area forcing them to look for employment in other areas.

The census data on migration, however, suffers from a number of limitations such as:

- i) decennial in nature as it is conducted every ten years and therefore, does not capture the year- to - year mobility of people;
- ii) captures only the long-term migration, and does not take into account short-term temporary migration such as the seasonal one which is high in UP.

Although the contribution of intra-state rural-rural migration (including seasonal and short-term) to the state's structural change is limited, it does provide livelihood to people, and adds to the economy of the destination areas. A question which emerges is why rural to rural migration, within the state and within the districts, is high, and why not rural-urban migration? Why do people not move to the urban areas where prospects may be better? Perhaps the lack of job opportunities in the urban areas, and also the lesser skills of people migrating from rural areas obstructs the mobility of people (Parker et al., 2003; Todaro, 1981). Also, the insecurities in the urban area including lack of basic entitlements such as food (Deshingkar & Anderson, 2004), lack of support from the government to the migrant workers, and inadequate public services in urban areas, all act as deterrents in rural-urban migration. In the literature, large rural-urban migration was held responsible for the deterioration in urban life, emergence of slums, squalor etc. Ironically, in the recent years it is these factors, among others, which are dissuading rural people from migrating to urban areas.

### *5.6.3 Remittances from Migrants*

The effect of remittances on development can be economic and social. Among the economic impacts are: i) increased investment; ii) boosts economic growth; and iii) assists in structural change (Glytsos, 2002). Other economic impacts could be reduction in both poverty and inequality. The social impacts could be: i) enables economic empowerment of women; ii) effect on fertility; and iii) increase in the schooling of children. Though both international and domestic remittances have similar economic and social impacts, the international remittances, in addition to the above, also assist the recipient country in its balance of payments.

Although migration from UP has been much highlighted in the literature, the role played by the remittances from migrants (mainly inter-state and intra-state) has not been much examined. The remittances from the migrants would depend on their

skills, job placement, and the cost of living in the host region. In a case study of migration from eastern UP, Paris, Singh, Luis and Hossain (2005) found that the proportion of remittances from the migrants in the rain-fed areas of the region to total household income was about 50 per cent. Remittances in the region helped in food security, better conditions of living such as improved housing, purchase of consumer durables, increase in farm investment and impact on the rice cultivation, and in meeting other social expenditures. However, the effect of the remittances on women's decision-making and empowerment was limited, as the remaining male members of the family took control of the household and farming decisions.

The effect as found by the above study, however, is overstated as these migrants who usually belong to the poor families are unskilled or semi-skilled, and obtain jobs in the urban informal sector with low wages. After meeting the urban costs of living, their remittances are not significant and therefore the impact on poverty reduction and investment is limited. Due to their low paid employment, and the delay in obtaining employment, many migrants do not even send any remittances (Times News Network, 2006).

The pattern of migration, as discussed above, reveals that high rural to rural migration, which is highest in UP, and migration to states, such as Maharashtra, Punjab and Delhi, results in:

- i) low urbanisation in the state;
- ii) continued high share of agricultural sector in output and slow pace of structural change.

## **5.7 Urbanisation**

In the previous chapter, the role of the credit in urbanisation was discussed in India, its states and in UP. This chapter examines urbanisation as a source of structural change.

Urbanisation is a follow-up of growth and occurs as the workforce shifts from agriculture and rural areas to industry and urban areas. As Kuznets (1965) viewed: "Urbanization is largely a product of industrialization, although the former may occur without the latter and the latter does not fully account for the former" (Kuznets, 1965, p.97). Urbanisation and economic growth are closely related. Industrialisation and the consequent economic growth act as the trigger for rapid migration from rural areas to

urban areas. Rostow (1959) suggested that in the pre-takeoff stage urbanisation is high. In the stage of mass consumption, it rises again as the population moves backward from urban areas to the semi-urban areas for lifestyle reasons which leads to further urbanisation. The rates and pattern of economic growth influence urbanisation. Though economic growth and growth in urbanisation are related, urbanisation may take place even in the absence of economic growth. For instance, urbanisation occurring in the stage of mass consumption as laid down by Rostow (1959) is not due to economic growth.

Globalisation with the increased mobility of people and capital also can increase urbanisation. However, due to slowdown in industrialisation; capital intensive industrialisation; low domestic and foreign investment; limited skills of the rural population and with increased information and technology, globalisation may not result in an increase in urbanisation.

#### *5.7.1 Urbanisation in India*

Urbanisation in India was 10.3 per cent in 1911 and, in 1961 was still only 18.0 per cent of the total population (Table 5.10). Even in 2001, its urbanisation level at 27.8 per cent is much lower than all the countries in Latin America, and even many in Africa. Mostly countries with per capita income higher than India had higher levels of urbanisation, nevertheless even countries with per capita income lower than India such as Pakistan and Zimbabwe had higher urbanisation levels. Table 5.10 shows the trends in urbanisation in India. In the post-reform period, urbanisation reflecting the faster economic growth, should have increased faster, however, it actually increased only by 2.2 per cent, a similar increase as in the pre-reform period (1981-1991).

The slowdown in urbanisation in India is attributed to the poor urban policies leading to an inhospitable urban environment (McDonald, 1994). In the post-reform period, despite high economic growth rates, urbanisation failed to increase due to: i) nature and pattern of economic growth, more oriented to services and also skill-intensive which did not involve people from the rural areas with low skills; ii) inadequate urban infrastructure; iii) improved transport facilities which did not involve migration to the urban areas.

In the international literature and in India, mixed views, positive and negative, exist on urbanisation. A large number of studies argue that urbanisation is high in India compared to its urban infrastructure. These studies have vehemently urged for

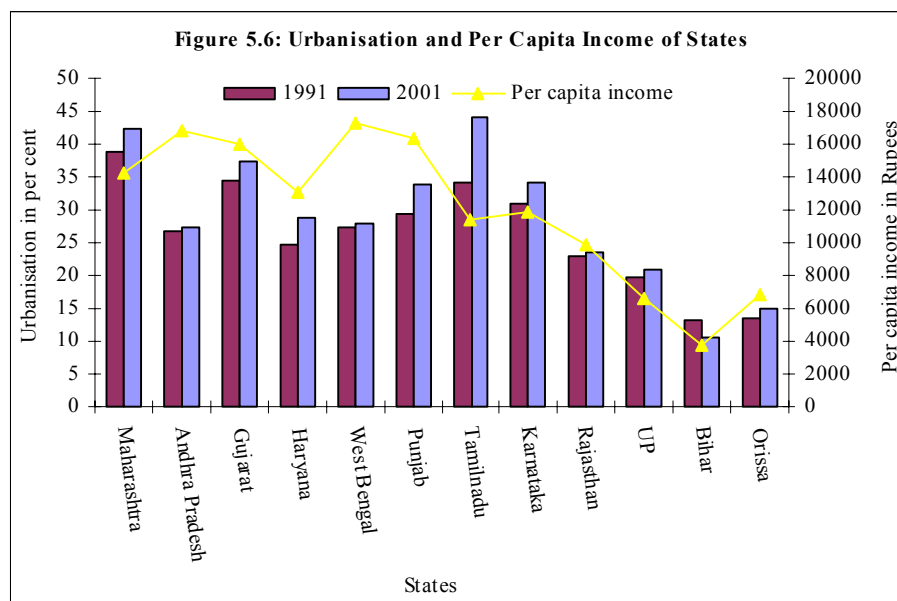


the dispersal of industries in other towns and suburbs to reduce urban congestion. In fact, the dispersal of industries was an important agenda for the Government of India in the pre-reform period. On the other hand, many studies lately posit that urbanisation is actually low in India, and should increase, as it would lead to faster structural transformation of the economy.

The sources of growth in urbanisation are: i) natural growth rate of the urban population; ii) reclassification of the rural areas as urban areas; and iii) migration from rural-urban areas. The contribution of rural-urban migration has not been a significant factor in urbanisation in India. Of the total urbanisation in the country or urban growth of 30.3 per cent during the period 1991-2001, only 6.6 per cent is due to net migration to the urban areas, and the rest is through reclassification, and population growth. The contribution of the natural growth rate of the urban population has also declined in the recent years, mainly due to the decline in urban birth rates (Dyson & Visaria, 2004). Urban birth rates declined from 27.1 per thousand during 1981-1991 to 22.6 per thousand in 1991-2001, and further to 19.1 in 2005.

#### *5.7.2 Urbanisation in States*

Urbanisation in the states during the decade 1991-2001 did not increase uniformly as can be seen from Table 5.11 and Figure 5.6. The most urbanised state in India in 1991 was Maharashtra (38.7 per cent), followed by Gujarat (34.5 per cent) and Tamilnadu (34.2 per cent). In 2001, the top three urbanised states were Tamilnadu (44.0 per cent), Maharashtra (42.4 per cent) and Gujarat (37.4 per cent). The level of urbanisation in 2001 among the states ranged from 10.5 per cent in Bihar to 44 per cent in Tamilnadu.



The states with high urbanisation were also the states with high economic growth rates in the post-reform period, lower headcount poverty and high per capita incomes. Table 5.11 also shows the urban population as percentage of the total population of the states, along with their per capita income in 2001. The states with low per capita income, such as UP, Bihar, and Orissa, have a lower urban population. The correlation coefficient between the per capita income and urbanisation turns out to be high at +0.840. The states with higher per capita income such as Maharashtra, Tamilnadu, and Gujarat had much higher levels of urbanisation. Sachs and Bajpai (2002b) also found a strong association between urbanisation and growth rate in Indian states.

The direction of causality between increase in urbanisation and increase in per capita income can be both ways. Increased urbanisation due to increased productivity causes better employment opportunities and therefore, leads to increase in per capita income. On the other hand, increase in urban income can also act as a pull factor from the rural areas leading to increased urbanisation. Increase in rural income and urbanisation are also related to each other. Increased agricultural output leads to increase in non-agricultural activities, and with the subsequent increase in rural income, the urbanisation also increases. This has taken place in Punjab and Haryana.

### 5.7.3 Urbanisation in UP: Trends and Patterns

The two trends: i) high rural to rural migration within the state and ii) high inter-state migration, are reflected in the low level of urbanisation in UP compared to other states. The percentage of urban population in UP in 1991 was 19.8, and over the span of a decade increased to 20.8 in 2001, an increase of merely 1 per cent. Historically, UP had high levels of urbanisation. In 1901, UP had 21 per cent of India's urban population. This declined to 12.7 per cent in 1991, and further reduced to 12.1 per cent in 2001. Thus, during the period 1901-11, urbanisation in UP increased by 11 per cent, compared to the country's average of 10.8 per cent and during the decade 1931-41 also, the pace of urbanisation was considerably high.

Urbanisation in UP slowed down due to the exclusive focus on migration to the existing urban areas, and precluded migration to other towns in the state (Parveen, 2005)<sup>77</sup>. Table 5.12 further substantiates this point of urbanisation in the state. In 2001, as much as 62 per cent of the urban population of the state was concentrated in just 54 Class I towns with a population above 100,000. Only 3 per cent of the urban population was in 131 Class V towns with a population of 5000-10,000.

Another factor affecting urbanisation in the state is the conceptual and measurement issues (Dyson & Visaria, 2004). The changes in the level of urbanisation between the two census years, 1991 and 2001, are not exactly comparable as a number of districts were created in the nineties. Also, the measurement issues were particularly significant in the 2001 figures as the criteria of urbanisation was applied more rigorously compared to earlier census years (Sivaramakrishnan, Kundu, & Singh, 2005).

#### i) Urbanisation in the Regions of UP

Table 5.13 displays the level of urbanisation and urban concentration in the regions of the state. It shows:

- i) average urbanisation in UP is highest in the western region (28.5 per cent), followed by the central (25.1 per cent), Bundelkhand region (22.5 per cent) and eastern region (11.8 per cent);

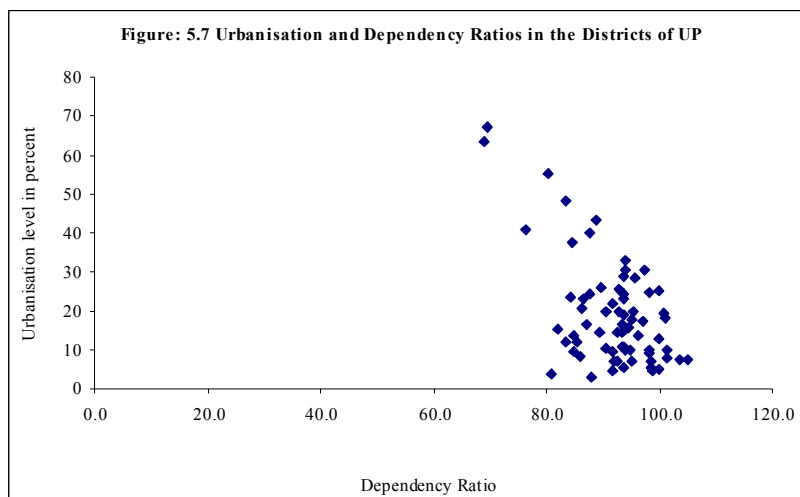
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<sup>77</sup> Parveen (2005), in her analysis on the urbanisation in UP excludes out-migration from the state, and also rural to rural migration. These two trends are highest in UP among all the states, and therefore lead to lower urbanisation.

- ii) only two districts in the eastern, central, and Bundelkhand region were above the state level, compared to seventeen districts in the western region which were above the average state urbanisation level;
- iii) urban concentration was, however, more in the central region. Urbanisation in the two districts of the region, Lucknow and Kanpur, was as high as 63.0 per cent and 67 per cent. The urban concentration in these districts is to such an extent that even the peripheries of the districts have failed to develop and urbanisation is very low in these areas. Excluding these two districts, the average urbanisation in the region falls from 21.6 per cent to 11.9 per cent, the lowest in the state and lower even than that of the Bundelkhand region. The urban concentration in the region, measured by coefficient of variation is 101.2 per cent including the two districts, and excluding them it falls to 26.5 per cent;
- iv) increased urbanisation is accompanied by other social changes as well. As urbanisation increases, the birth rate falls, leading to a change in the age structure of the population. The average dependency ratio, defined earlier as the ratio of the dependent population to the working age population, was lowest in the central region and highest in the eastern region. The paragraphs below show the relationship between urbanisation and the dependency ratio at the district level.

The dependency ratio and the level of urbanisation in the state's districts are closely related. The districts with higher urbanisation had lower dependency ratios and districts with lower urbanisation had higher dependency ratio. In the central region in the two districts of Lucknow and Kanpur with the highest level of urbanisation in the state, the dependency ratio was 69.0 and 69.6 per cent respectively, lower even than the all India level of 70.9 per cent. However, in the region overall, the average dependency ratio was much higher at 84.9 per cent. The correlation coefficient between urbanisation and dependency ratio in the central region was strongly negative at -0.88. In the eastern region with much lower urbanisation levels, dependency ratio was very high even crossing 100 per cent in some of the districts.

Figure 5.7 indicates that the dependency ratio in most of the districts of the state was between 80 and 100 per cent and the corresponding urbanisation level was less than 30 per cent.



#### ii) Why Urbanisation varies within UP

Different factors have been responsible for high disparity in the urbanisation levels across the regions of UP. Historically, the military cantonments and administrative units were established during the British period in some districts of the western and central regions for administrative and strategic reasons. This triggered urbanisation in these regions. While in the central region (refers here only to the two districts of Lucknow and Kanpur) industries and services also gave a boost to urbanisation, in the eastern and western regions agriculture played a major part.

The present study examines the pattern of urbanisation in the eastern and western regions by segregating urbanisation into agriculturally developed areas and agriculturally less developed areas. In the western region, agricultural output in the sixties increased with the use of HYV seeds, which led to increased agricultural output, and shift to non-rural sector activities. Many among the rich farmers, owning more than 12 acres of agricultural land in the region, moved to non-farm employment (Craig Jeffrey, 2003; C Jeffrey & Lerche, 2000). The region also benefited from the proximity to country's capital, Delhi. This perhaps, was due to influence of neighbours or the 'neighbourhood effect' as discussed in the chapter 2 of the present study.

Sharma and Poleman (1994) also pointed out to the rapid off-farm activities which developed after the introduction of the green revolution in western UP. The linkages between agriculture and non-agricultural sectors in the region led to the emergence of agro-industries and small-scale industries and this led to growth in small towns. Also, high agricultural incomes led to increased demand for non-agricultural goods, which further led to increased demand for urban goods, and increased output. Thus, the higher level of urbanisation in the western region compared to the eastern region was a product of faster agricultural development, non-agricultural development, and infrastructure development.

Urbanisation in the eastern region is significantly low in most of the districts. The overall regional average camouflages the extremely low level of urbanisation in some of the districts in the region ranging from 2.8 per cent (lowest in the region) to 40.1 per cent (highest in the region). In the eastern region, not only was agricultural development in its districts low, but also tiny household industries, mainly agro-based and low value added products for instance, oil crushing and extracting units and flourmills, dominated the districts. In contrast, in the western region, most of the SSI units are manufacturing units producing high valued added and export products.

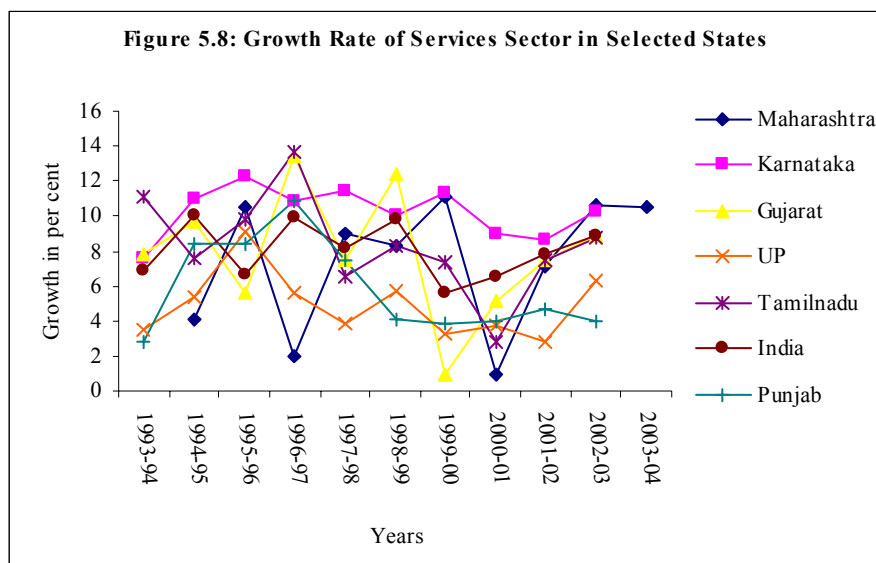
### **5.8 Structural Change in UP vis-à-vis India**

The question posed at the beginning of the chapter was: Is the structural change in the state's economy different from that of the rest of the country? The growth and development in one region has an impact on the other regions. The impact may be, however, limited due to regional barriers and differences in natural endowments. The structural change as witnessed in the Indian economy was replicated in UP, though with a difference.

Among the similarities between country's structural change and that in UP the major ones are: i) decline in the share of agriculture in the state's total output, as in the rest of India; and ii) increase in share of the services sector in UP, as in the rest of India.

The differences in the structural change between the country and UP are: i) the pace of the structural change; and ii) the source of structural change. The rise in the services sector triggered the fast growth of the Indian economy in the nineties and in recent years, compared to its previous slow growth. The annual growth rate of the services sector plotted in Figure 5.8 shows that the services sector in UP has grown,

but has been slowest among the states. Contrary to the trends observed in some of the major developed states of India, in UP it is agriculture which still holds the key to the state's fast growth. Timmer (2002) pointed to the irony of agriculture's contribution to economic development. Although the share of agriculture declines in output, its high growth can sustain the economy and push the overall growth rate. The superior performance of the western region of the state, ignited by the green revolution, proved agriculture's potential in economic growth.



This section observed that the share of the services sector rose in almost all the states throughout the country, and even in UP. Sections II and III below examine the trends and patterns in the growth of the services sector in UP. The section also looks into the financing of the services sector in the state.

## **Section II**

### **5.9 Services**

Unlike agriculture and manufacturing, the services sector is very heterogeneous, and includes a large number of activities ranging from traditional trade and transport services to the knowledge intensive new economy services. Typically regarded as subordinate to agriculture and industry, services is defined as delivering help, utility or care, an experience, information, or their intellectual content (Australian Services Network, 2000). Services are also activities which do not

produce or modify physical goods. Clark (1940) did not consider that international trade in services was possible except for transport and financial services. Trade in services, however, now forms an important component of the WTO negotiations<sup>78</sup>.

Traditionally, the services sector, considered as a passive contributor to economic growth, was dependent on the manufacturing sector's growth. The sector has evolved from earlier emphasis on 'hard' infrastructure like roads, railways etc., to 'soft' infrastructure like networks of customers and supply firms, educational institutions, research laboratories, skilled labour, and knowledge and support for innovation. Nevertheless, transport and telecommunications infrastructure continue to be important for the growth of services sector. Its contribution to structural change now is in terms of growing independence of goods and services production, service expertise, information technology and computers (Marshall & Wood, 1995).

### *5.9.1 Services Sector in India*

#### a) Composition of Services in Real Output

The services sector in India has played a major role in the structural transformation of the economy. Its share in real output edged up rapidly from 38.3 per cent in 1970-71 to 56.2 per cent in 2003-04 as the share of agriculture and industry declined. In the post-reform period, the sector has become a leading sector of the economy and an engine of rapid economic growth (S. Dasgupta & Singh, 2005).

What is striking about the services sector in India is that its share in real GDP is comparable to that of many countries such as Turkey (58.8 per cent), Korea (57.2 per cent), Ireland (56.2 per cent) and Czech Republic (58.5 per cent) (OECD, 2005). These countries are also high-income countries, at least higher than India, and are members of the OECD group. However, the share of agriculture in output in these countries is significantly low vis-à-vis India. The employment in these countries is also skewed in favour of the services sector compared to the agricultural sector in

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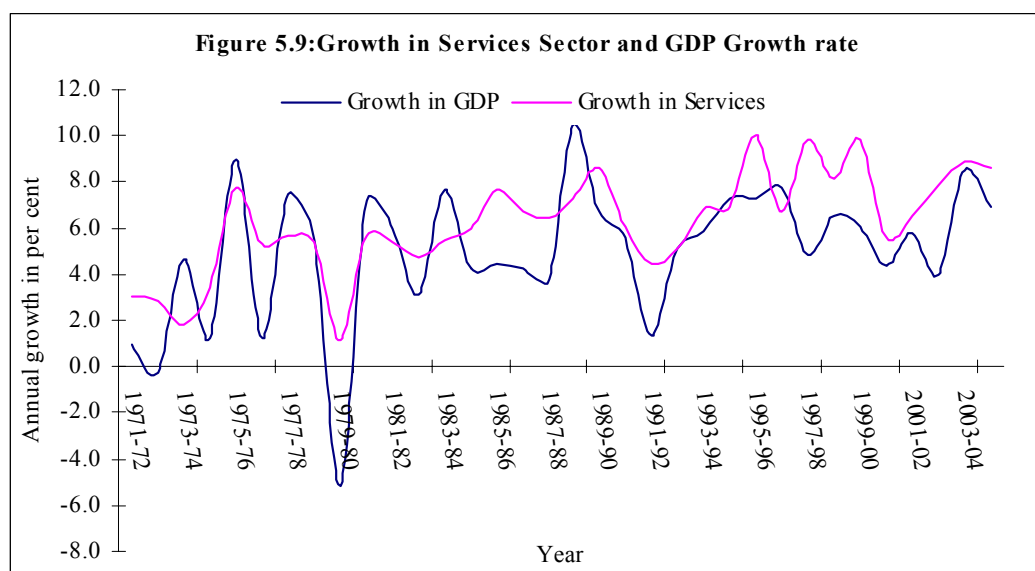
<sup>78</sup> Following the Uruguay Round the General Agreement on Trade in Services (GATS) was formulated in 1995 and covers all the services except services supplied by the government such as police, fire protection, monetary policy operations, mandatory social security and tax and customs administration. Under air transport services, it excludes air traffic rights and related services to traffic rights. It covers 12 core service sectors which are: business services including professional services and computer services; communication services; construction and related engineering services; distribution services; educational services; environmental services; financial services including insurance and banking; health related and social services; tourism and travel related services; recreational, cultural and sports services; transport services; and another miscellaneous group including services not covered elsewhere. Since 2000, services are a part of the multi-lateral trade negotiations (WTO, n.d.).



India. Within the developing countries, a difference between the Indian pattern of services sector development and that of other developing countries is that in India, the share of manufacturing in real output has remained broadly the same over the years. Unlike China and Malaysia, where the decline in agriculture gave rise to manufacturing, the decline in the agricultural sector in India was completely absorbed by services.

#### b) Year-on-Year Growth in Services

Not only has the share of services in real output moved up, its year-on-year growth has been much higher than that of agriculture and industry in the post-reform period. In the pre-reform period (1970-71 to 1990-91), the services sector on average grew by 5.3 per cent per annum. The growth of agriculture and industry was 2.7 per cent and 5.9 per cent per annum respectively. In the post-reform period, 1991-92 to 2003-04, growth of agriculture was 2.7 per cent, industry 5.8 per cent, and services grew by 7.4 per cent per annum. In 2004-05 while the annual real growth rate of agriculture was 1.1 per cent and industry was 8.3 per cent, growth in services was again higher at 8.6 per cent per annum. Figure 5.9 shows the closely related movement in the growth rates of real GDP and the services sector, more so in the nineties.



### c) Breakdown of Services in India: Trends and Patterns

Services, for analytical purposes, can be grouped either: i) according to the type of service delivered such as, producer services, consumer services and government services; or ii) according to their pace of growth such as, fast growers and slow growers (Gordon & Gupta, 2003). The conventional belief is that growth of the services sector is based on the growth of agriculture and industry, and does not require any particular policy thrust. Contrary to that belief, in India many sub-groups of the services sector have grown sharply in the post-reform period when the regulations were removed and favourable policies led to increased private investment and competition.

Figure 5.10 displays the trends in the components of services in India.

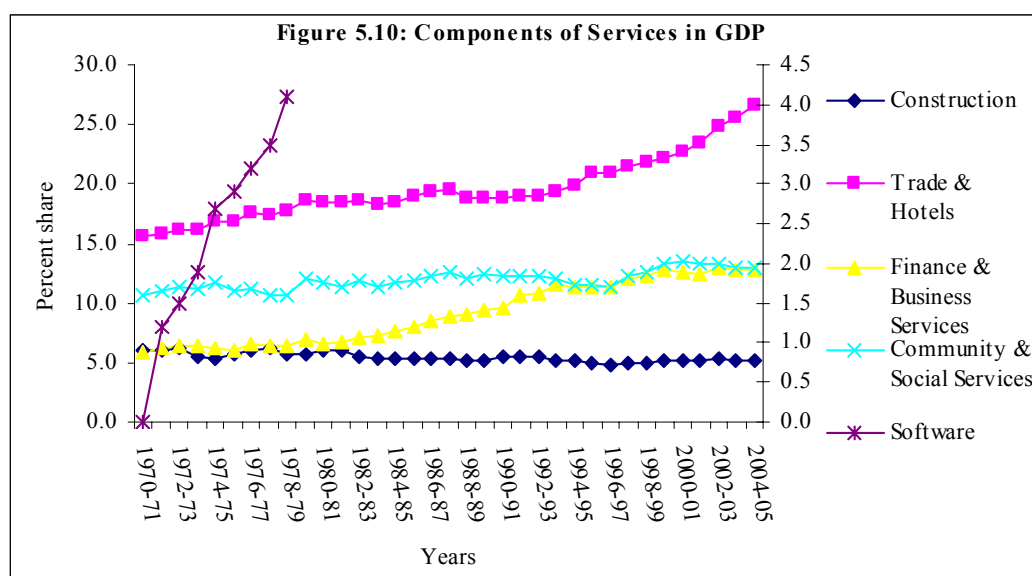


Table 5.14 shows the average share and growth of services groups in India since the seventies. The major trends are:

- i) broadly, business services, communication, banking and community services were the fast growers;
- ii) trade, hotels, transport and communication was the major subgroup, which moved up sharply in the nineties, and was followed by finance and business services which includes software;
- iii) information technology and software services along with communication services, business services and community services

emerged as the most dynamic services in the economy. The share of information technology services was 3.2 per cent in real GDP in 2002-03, of which software and services accounted for 2.4 per cent in GDP (RBI, 2003c). In revenue terms, it was US \$4.8 billion in 1997-98 and rose to US \$36.3 billion in 2005-06;

- iv) among the slow growers were distribution services and personal services. The growth in these services was slower compared to the fast growers in the nineties (Gordon & Gupta, 2003).

### *5.9.2 State-wide Trend in Services*

The states, according to the proportion of services in real state output, are grouped in the present study as services-leading states and services-lagging states. This ratio (share of services in real output) is often considered as the indicator of economic progress of the state. Thus, the higher the share of services in output, the more developed the state is. Though Fisher (1939) argued against any ranking or ordering of the sectors, he did suggest that the rate of growth of services is higher in the later stages of development. The mixed pattern of services sector development in India, however, suggests that contrary to Fisher (1939), in some of the high income states the share of the services sector in real output was low.

#### *a) Services-leading states*

Among the services-leading states are Maharashtra, Tamilnadu and West Bengal. The proportion of the services sector in the real output of these states was above the all India average in 2003-04. The services sector in Maharashtra formed 52 per cent of its real output in 1993-94, and moved up to 63.0 per cent in 2003-04, much above the India's average. Similarly, in Tamilnadu, services in 1993-94 were only 46.7 per cent and rose to 62.9 per cent in 2003-04. Among the key factors determining services output in the major states such as Maharashtra and Tamilnadu are the spread of the information technology, favourable industrial policies, infrastructure facilities, public expenditure on education, health, and overall better human development. According to the present study, the better performance of these states in these indicators has led to their increased share in services output. In addition, some studies on the location of services have argued that, as with manufacturing, services also tend to concentrate in certain areas close to manufacturing.

#### b) Services-lagging states

The share of the services sector in the real output of some states, including low and high per capita income states such as UP, Gujarat, Punjab and Haryana, was much below the all India average (Table 5.15). The low share in Punjab and Haryana is explained by the domination of agriculture in these states. However, the year-on-year growth in services remained high in these states.

The states in which the proportion of services in real output was low and the annual growth rate of the sector was also low were UP and Gujarat (an industrially developed state with much higher per capita income). The rest of all the states recorded much larger increases in services sector output during the period 1993-94 and 2004-05.

As per capita income increases, the share of services in total output rises, as the increased income gives rise to demand for services. The present study found that the correlation coefficient between per capita income and share of the services sector in the real state output of Maharashtra was high and positive, unlike Gujarat and Rajasthan. The rise in the share of services (higher than UP) in Rajasthan is weakly associated with its per capita income as the correlation turns out to be less than 0.5.

#### 5.9.3 Services Sector in UP

The proportion of the services sector in the real output of UP has gone up over the years, though not as high as compared to that of other major states. Some of the trends in the state's services sector are:

- i) share of services sector in the state's real output was 43.0 per cent in 1993-94, which increased to 47.7 per cent in 2003-04;
- ii) UP's services share in real output was however, higher than that of Punjab and Gujarat;
- iii) proportion of service sector at all India level in 1994-95 was 47.8 per cent, and rose to 56.7 per cent in 2003-04. The share of services sector in UP in 2003-04 at 47.8 per cent is similar to the level of 47 per cent reached in 1994-95 by the country as a whole.

#### a) Services output in the unorganised sector of UP

The two major groups in which the service sector in the state is studied are: i) organised and ii) unorganised sectors. Although the data on total state output (both

nominal and real) includes output in the organised as well as the unorganised sector, the figures are not shown separately for the two. Kolli and Hazra (2005) estimated that 96 per cent of the agricultural sector is under the unorganised sector. They further observed that within services, the unorganised segment was high in trade (75.6 per cent), transport (excluding railways) like shipping (83.3 per cent) and real estate (73.8 per cent). Thus, excluding railways and banking, most of the services sector is within the unorganised sector.

The share of UP in total number of enterprises in the unorganised services sector in India was highest at 17.2 per cent in 2001-02. This includes enterprises in hotels and restaurants, transport, storage and communication, real estate, renting, business, education, health and social work, and community, social and personal activities). In the rural areas, the share of unorganised services was 20.3 per cent and 13 per cent in the urban areas.<sup>79</sup> Some of the characteristics of enterprises in the unorganised services sector in UP are:

- i) most enterprises were owned by males both in the rural and urban areas;
- ii) only 24 per cent in the rural, and 40 per cent in the urban areas were registered enterprises;
- iii) most of the enterprises operated without fixed location in the rural areas, and with fixed location in the urban areas in the state;
- iv) most of the enterprises in the state in the unorganised service sector including both in the rural and urban areas did not maintain any written accounts. The share of enterprises maintaining accounts was less than 1 per cent. Even in a state like Kerala with high literacy levels, the share of the enterprises maintaining accounts is only 2.3 per cent.

#### b) Employment in the unorganised services sector

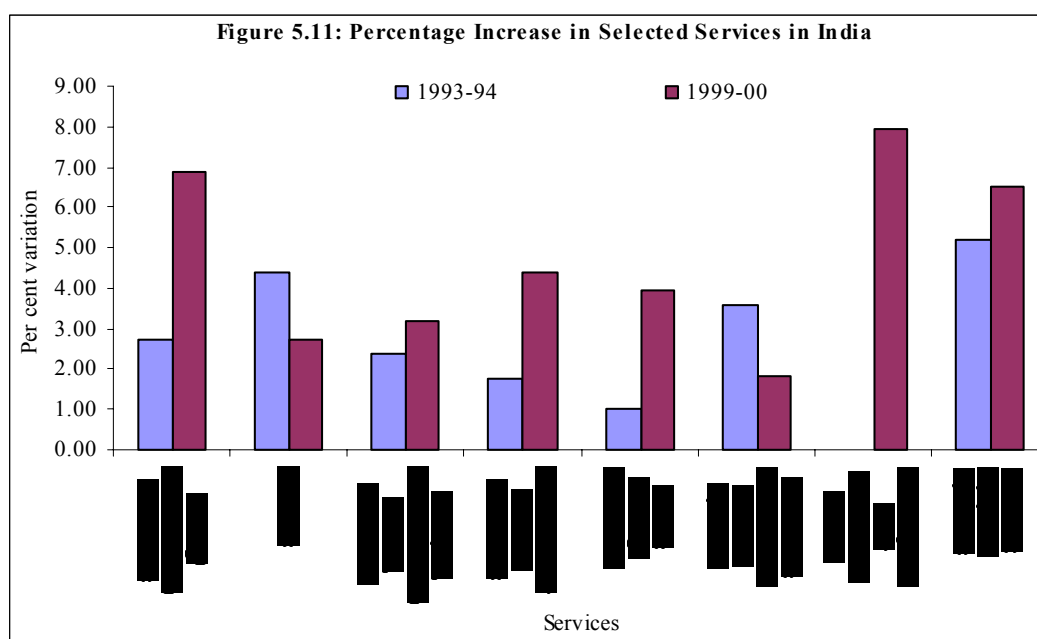
Employment also in the services sector, particularly in the unorganised sector, has been high in the post-reform period. This is revealed by the growth in agricultural

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<sup>79</sup> The survey does not cover enterprises in wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods, financial intermediation, public administration and defence, private households with employed persons or extra territorial organisations.

and non-agricultural enterprises (separate data for non-agricultural enterprises are not available) in UP during the period 1998-2005, when such enterprises, mainly in the informal including the unorganised sector, grew by 5.1 per cent in the rural and urban areas (combined), compared to all India growth of 4.8 per cent. The employment in the state in such enterprises also grew by 3.0 per cent, higher than the all India growth of 2.5 per cent. This was above the growth in other states such as Andhra Pradesh (2.4 per cent), Gujarat (1.4 per cent), Karnataka (1.9 per cent), Maharashtra (1.8 per cent) and West Bengal (0.9 per cent). It was lower only than that of Tamilnadu (4.6 per cent) and Punjab (3.6 per cent).

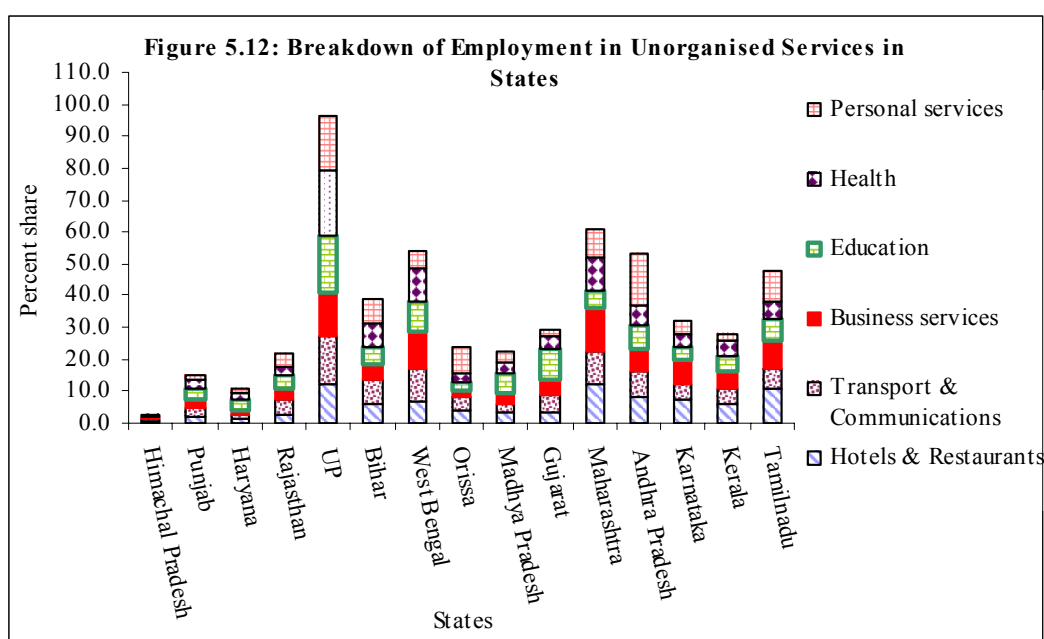
At the all India level, the increase in employment in the unorganised sector in 1999-00 over 1993-94 was in skilled occupations such as professionals, nurses, medical and health technicians, launderers, hairdressers, beauticians, transport operators, brick and other construction workers (Planning Commission, 2002b). Figure 5.11 highlights the growth in selected services in the unorganised sector in India.



In UP, as already mentioned, employment in the unorganised services sector was highest. The total percentage of women workers at the all India level in the unorganised sector (covering both rural and urban areas) was 17.6 per cent. In UP the women in the unorganised services sector were lower at 14.1 per cent, rural and urban

areas combined. This was higher than that of Himachal Pradesh, Rajasthan, Bihar, West Bengal and Assam, but was much lower than the southern states, and Punjab and Haryana in the north.

Figure 5.12 shows the breakdown of employment in the unorganised sector in different states including UP. Employment in the category of transport and communications in UP was highest. Even in the education and health group, the percentage share of the workers in the unorganised sector was highest in the state.



The unorganised services sector has, therefore, provided increased employment and helped in poverty reduction in UP. As the official estimates of the headcount poverty based on the 61<sup>st</sup> round of NSSO are not yet available, the latest available data on poverty is for 1999-2000. The percentage of the population below the poverty line in the state declined from 40.85 per cent in 1993-94 to 31.15 per cent in 1999-2000 (Government of UP, 2005a). The relevance of services sector growth for the poor has been explored by some studies (S. Joshi, 2004; Ravallion & Datt, 1996). Ravallion and Datt (1996) pointed out that the impact of the services sector on poverty reduction was highest compared to agriculture and manufacturing. Nevertheless, despite the poverty reducing effect of the unorganised services sector in the state, its contribution to high growth is limited largely due to the existence of low education, low wages, and low productivity of workers in the sector. Its distributive

effect is greater than the growth effect though even the effect on poverty reduction is limited due to the prevalence of low wages.

c) Components of the services sector in UP

The analysis of the growth in major services in the state is undertaken for two sub-periods, 1994-1999 and 1999-2004. The major trends are:

- i) growth rates of almost all the services sector in the state declined in the period, 1999-2004 (Figure 5.13);
- ii) only transport, business services, and communication grew at a faster rate in the second period, growth in others was lower.

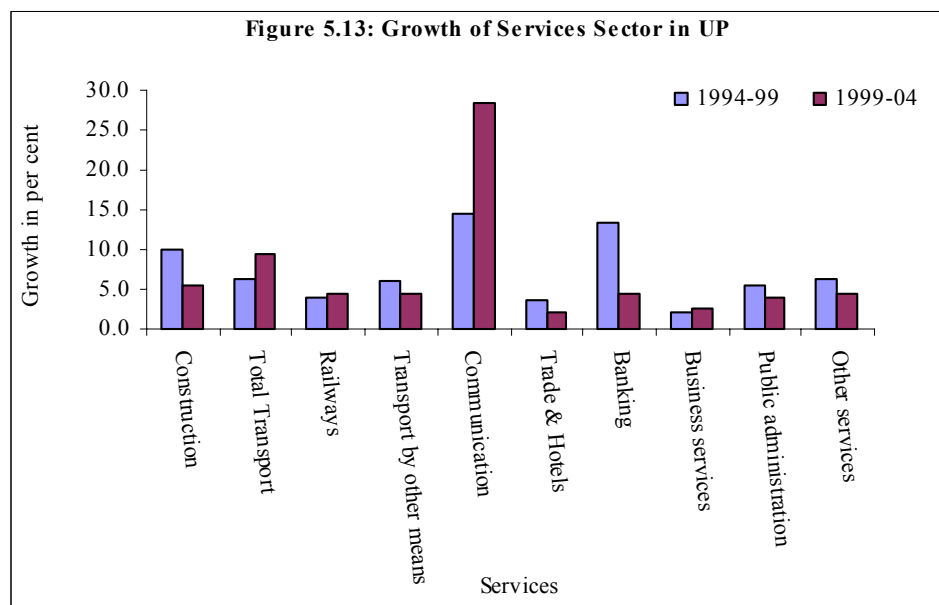
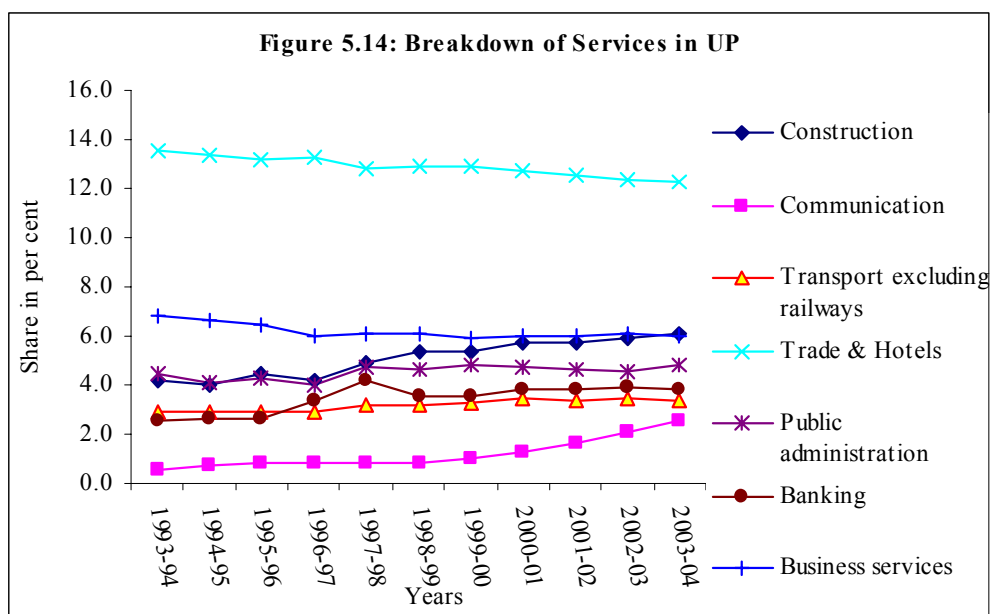


Figure 5.14 further displays year-to-year trend in the growth of the sub-groups of services sector. Table 5.16 also lays out the breakdown of the services sector in UP during the period 1993-94 to 2003-04.





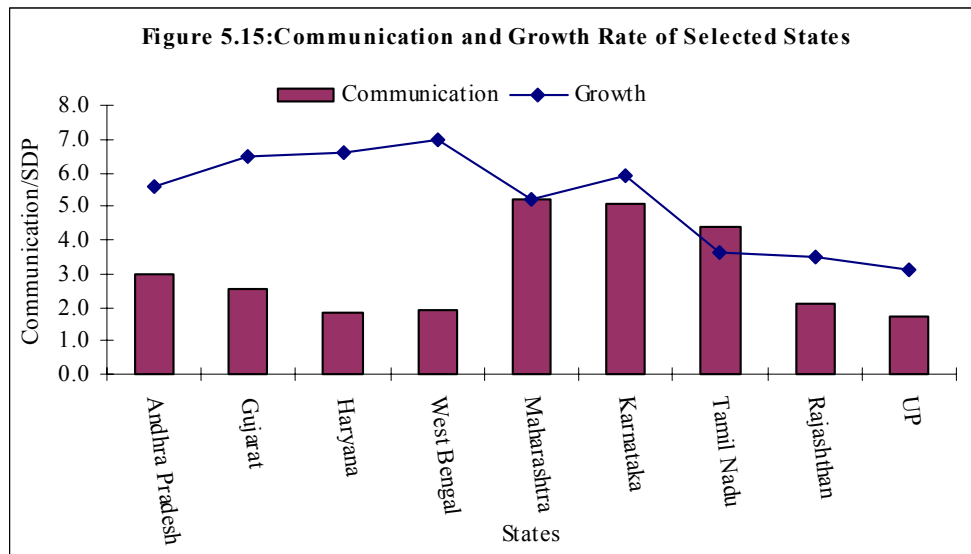
Some of the services sector activities in UP are elaborated below.

#### i) Communication services in UP

The proportion of communication services in the real state output increased substantially by four times, from 0.6 per cent in 1993-94 to 2.5 per cent in 2003-04. This was due to the increased number of cell phone users, and telephone connections in the state. According to CMIE (2004) the total number of cellular subscribers in the state jumped from 59 thousand in 1997-98 to 719 thousand in 2002-03 i.e. more than a twelve fold increase in a period of just six years. The telephone connections in the state increased from 810 thousand in 1995-96 to 2822 thousand in 2001-02. The share of communication in UP's output was as impressive as in some other states, such as Maharashtra, Karnataka and Tamilnadu. In Maharashtra, communication's share in real SDP rose three times from its share in 1993-94 (from 2.2 per cent to 6.1 per cent in 2003-04). In Karnataka, the rise was six times from 1.7 per cent to 7.0 per cent during the similar period, and in Tamilnadu, the rise was about three times from 1.7 per cent in 1993-94 to 5.9 per cent in 2003-04 (Table 5.17).

Figure 5.15 displays real average growth rates of the selected states during the period 1999-2004 and the share of communications in real SDP. The states with a high share of communications in real output, such as Maharashtra, Karnataka and Tamilnadu were also the states with high growth rates. In some states such as Gujarat and Haryana, though the share of communications in real output was more or less similar to UP, their real growth rates during this period were much higher. The role

played by communication services in the overall growth of the services sector in India has been observed by a number of studies (Gordon & Gupta, 2003). The deregulation in the private sector, increased private sector investment, and widespread usage of cell phones were the factors leading to the increased share of communications in real output. This was, as observed above, irrespective of the state's per capita income and their growth rates.



#### ii) Construction services in UP

The share of construction activities in UP's total output increased, as in the other states such as Andhra Pradesh, Punjab, Karnataka, Tamilnadu and Rajasthan (Table 5.18). In UP construction has shown a steady rise contrary to the states such as Gujarat, West Bengal, Haryana, and Maharashtra, where construction activities declined in the recent years. The credit by banks for housing has also increased substantially during this period. Though the share of construction has increased in the real state output, its growth rate was much higher in the period 1994-1999 (10 per cent) compared to 5 per cent during the second period, 1999-2004 (see Figure 5.13).

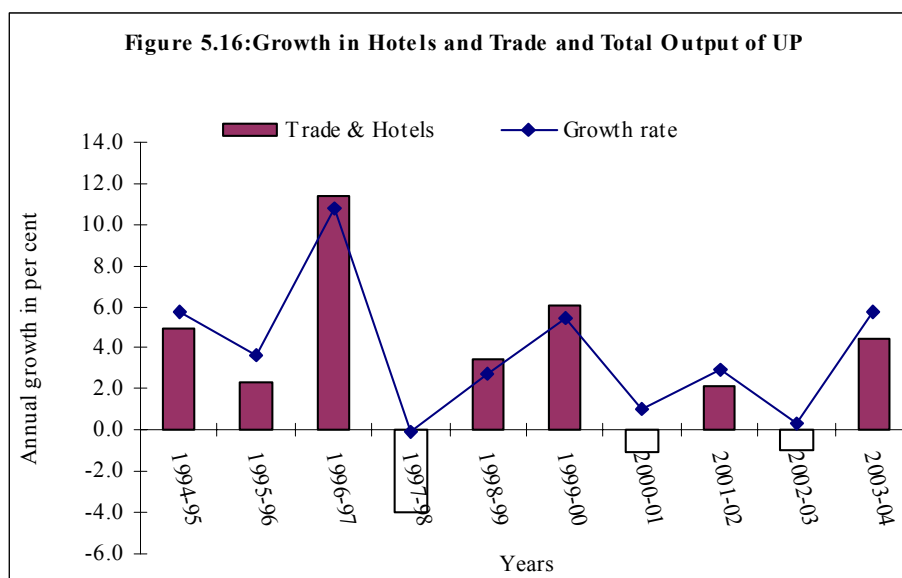
#### iii) Business services in UP

The share of the category 'real estate, ownership of dwellings and business services, which also includes software, declined by more than half during the period 1999-2004. Further classification of this category is not available. The economic activities covered in this subheading are: i) ownership of dwellings (occupied

residential houses), ii) real estate services (activities of all types of dealers such as operators, developers and agents connected with real estate), iii) business services (CSO, 1989).

iv) Trade, Hotels and Restaurants in UP

Among the other service sector activities where growth slowed from the later half of the nineties and beyond are trade, hotels and restaurants. The data on trade, and hotels and restaurants is not separately available. However, the two are closely related as increased trade and business activities may lead to increased hotel occupancy and restaurants. Trade plays a major role in the state's services sector. Its share in services sector output was 13.5 per cent in 1993-94, but declined to 12.2 per cent in 2003-04. The growth in the real output of the state also slowed down in the latter period. Figure 5.16 below shows the close association between the two. In 1993-94, the ratio of trade, hotels and restaurants to total state output was highest in UP among the major states such as Maharashtra, Haryana, West Bengal, Punjab, Karnataka, Tamilnadu and Gujarat. An indicator of the economic decline of UP in the subsequent years is the increase in this ratio in all the major states of India except UP.



d) Services in Different Regions of UP

The breakdown of the services sector output in the different regions of the state is not available. Nevertheless, many studies have observed that non-farm

employment is highest in the western region of the state and most of the jobs in the non-farm sector were in services (R. Sharma & Poleman, 1994).

#### e) Services in Rural and Urban Areas in UP

Is the rural economy of the state service-oriented? The data on the total state output from rural and urban areas further broken into different occupations is not available. In most of the studies on rural areas in India, service sector activities, including employment and output, are often grouped in rural non-farm sector which includes both manufacturing and service activities (for instance see Lanjouw & Shariff, 2004).

An indicator of the growth of services sector output in the rural areas could be the number of non-agricultural enterprises in the state. During the period 1998-2005, the growth rate of such enterprises in the rural areas of UP was 7.1 per cent. This was higher than the all India growth of 5.5 per cent. Much of the non-farm employment in the rural areas also is in the services sector (unorganised). Of the all India employment in rural and urban areas in the unorganised services sector, the share of UP in rural areas was 18.9 per cent, and 15.7 per cent in urban areas (NSSO, 2003b).

### **5.10 Summary**

Continuing with the discussion on structural change from the previous section, in this section the present study explores the role of services in India and UP. The induced structural change in India from agriculture to the industrial sector through policies and investments did not materialise as the economy moved over to the services sector from the eighties onwards. This was not uniform across the states as even in some of the high-income states, unlike India overall, the services sector did not gain prominence. One of the objectives of the chapter was to explore the role played by the banks in the growth and development of the services sector in UP. The section below examines this issue in detail.

## **Section III**

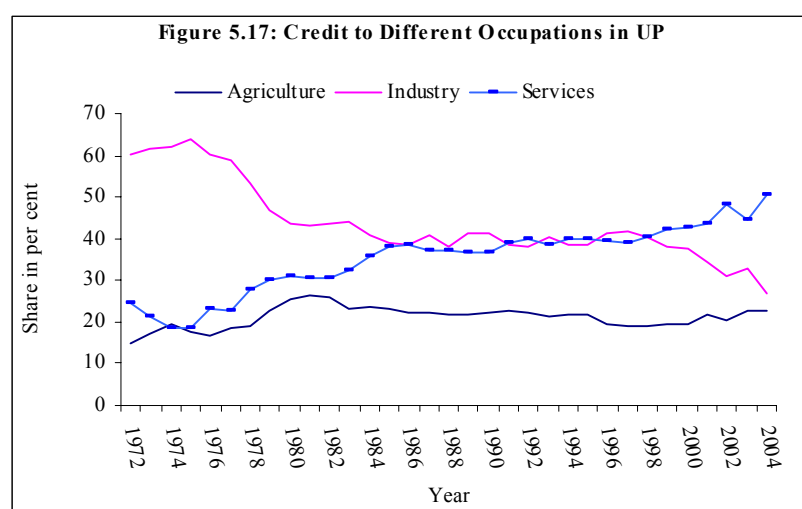
### **5.11 Financing of the Services Sector in UP**

In the earlier chapter the role of bank credit in UP's total output was examined. The chapter also looked at the bank credit to different sectors of the state and its role in sectoral output. It was also observed in the chapter that a sectoral

redistribution of credit and output has taken place in the state and that the services sector output and the credit to this sector have been close to each other (also see Table 4.9). However, despite the predominance of services in India's economic growth (even in UP), particularly services like communication, financial services, and business services including information technology; financing of this sector has not been examined in depth. The literature has dealt with the financing of agriculture and industry, perhaps because of the tremendous focus in the country on industrial and agricultural development in the earlier decades (RBI, 2004a). Some studies exist on individual categories of services like education, information technology, and health. However, hardly any study has examined credit to the services sector in an aggregate form. The lack of studies on the sector as a whole may be due to the heterogeneous nature of activities included in the services sector as has been noted in the preceding discussion. In this context, the present study examines the role of the banks in the financing of the services sector in UP comprehensively covering different service activities individually.

#### 5.11.1 Credit and Output of Services in UP

Of the total bank credit to the state, the credit to the services sector in 1972 was 24.7 per cent, while credit to the industrial sector was 60.4 per cent. The gap between the two sectors was large. By 2004, the trends had reversed and the service sector's share of the credit was almost twice that of industry. In the nineties, the share of services in the real state output increased by 2.8 per cent. During the similar period, credit to this sector increased by 5.7 per cent. Figure 5.17 shows credit to the services sector in the state during the period 1972-2004.



The services sector share of credit rose by 11.1 per cent during the period 1991-2004. This was a consequence of the combined effect of the industrial and banking sector reforms. Some of the outcomes of industrial reforms were choice of location of industries an outcome of delicensing, closure of many industrial units because of increased competition, and access of industries to sources of financing other than bank borrowings. The banking sector reforms led to freeing of interest rates from the earlier administered interest rates and increased competition among the banks.

As was mentioned earlier, the state has a high share of services in the unorganised sector. The credit figures however, do not distinguish between organised and unorganised sectors at the state level. In 2001-02, UP had the highest percentage share of service sector enterprises in the unorganised sector in the country (NSSO, 2003c). Despite the high proportion of enterprises in the state, credit to this sector in the state has been inadequate (NSSO, 2003c). The states with large outstanding loan amounts were Maharashtra and Punjab.

#### *5.11.2 Credit to Services in Rural and Urban Areas in UP*

Prior to the economic reforms in 1989-90, credit for service activities in the urban areas in UP was about 70 per cent and rural areas 30 per cent. This indicates that the urban bias in credit existed even in the pre-reform period. Fan, Connie and Mukherjee (2005) point to the existence of three types of effects of urban bias: gaps in labour productivity; per capita income; and poverty rates. Credit is one source through which urban bias occurs, and it culminates in widening of the gaps in per capita income, labour productivity and poverty. After a decade of reforms in the banking sector, credit for the service activities in the rural areas almost halved to 17.0 per cent in 2004 from 30 per cent in 1989-90, reflecting the shift of the service activities to urban areas. In the non-rural areas, credit share moved up to reach 83.0 per cent of the total.

#### *5.11.3 Credit to Services in Different Regions of UP*

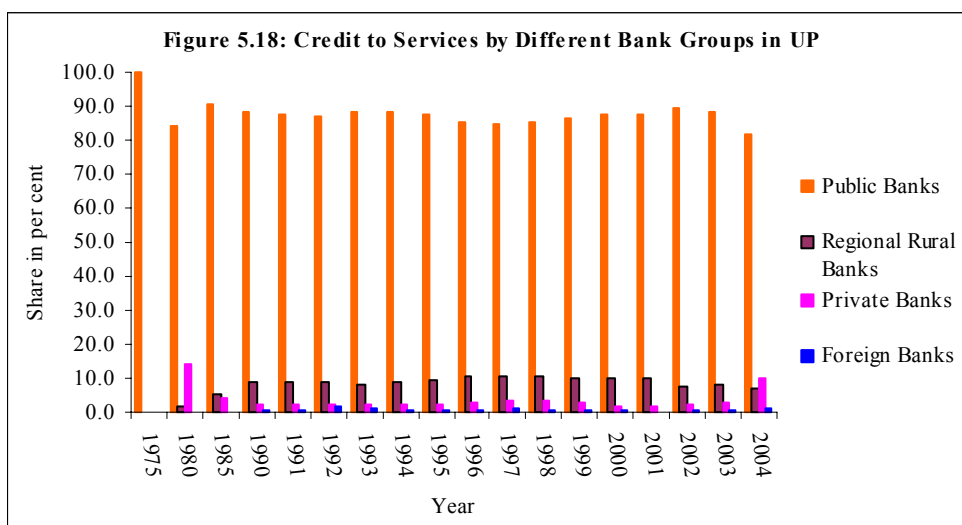
The regional distribution of credit within the state presents a dismaying picture. Despite the spread of bank branches far and wide in the state, inequality in credit to the services sector amongst the different regions of the state remained high

during the period 1972-2004. The main features of regional credit to the services sector during 1972 and 2004, and two sub-periods 1972-1991 and 1992-2004 are:

- i) pattern of distribution of credit in the years 1972 and 2004 remained the same;
- ii) western region received highest credit in the state in 1972 and in 2004 also a similar picture emerged. Its share actually increased over the years, and was 45 per cent of the total credit to the services sector;
- iii) share of the central region which was close to the western region in 1972 and even exceeded it in some of the years, declined in subsequent years. Its share in 2004 was a little more than half of the western region in 2004,
- iv) during the years 1994 and 1995 share of the eastern region increased to 30 per cent, but declined thereafter;
- v) average share of the western region in the two sub-periods - 1972-1991 (pre-reform years) and 1992-04 (post-reform years) has remained almost the same, around 40 per cent;
- vi) share of the central region in the post-reform period declined;
- vii) on the other hand, share of the eastern UP, on an average, increased from 22 per cent in the pre-reform period to 27 per cent in the post-reform period.
- viii) among other factors, the increase in credit also could be due to a number of new districts created in the region.

#### *5.11.4 Credit to Services and Different Bank Groups*

Data on credit by the different banks to the services in UP are available from 1975 onwards. Of the total credit to the services sector by all the banks, share of the public sector banks was above 80 per cent throughout the period 1975-2004 followed by regional rural banks, private sector banks and foreign banks (Table 5.19). Even in 2004, more than a decade after reforms in the banking sector, the share of credit by the public sector banks is a massive 81 per cent. The share of the private banks during 2004 increased slightly in the total credit. Figure 5.18 shows the credit by different bank groups.



A different picture emerges, however, if one examines the share of these bank groups in the credit to the services sector as percentage of their own total credit. The private sector banks were giving about 49 per cent of their credit to the service sector including trade in 1980, whereas the public sector banks provided only 29 per cent. The share of the private banks to services declined to around 13 per cent in 2003. Foreign banks in the state have been increasingly allocating credit to the services sector. In the year 2004, around 70 per cent of their credit to all the sectors went to the services sector. The increase has been highest in the personal loans category.

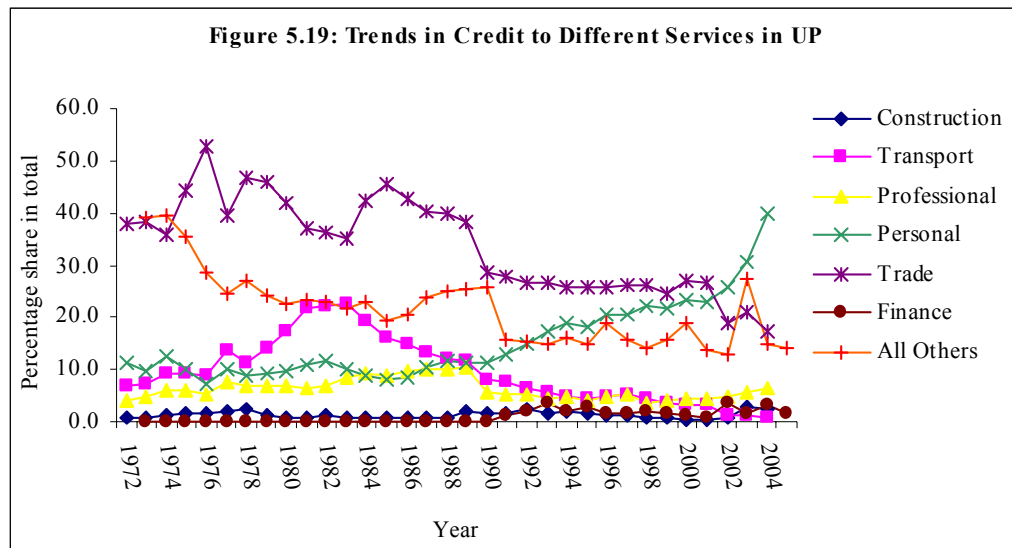
#### 5.11.5 Credit to Different Services in UP

Bank credit to the services sector includes activities such as construction, transport operators, professional services, personal loans and trade-wholesale and retail. The analysis on the services sector is divided into two sub-periods, pre-reform (1972-1991) and post-reform period (1992-2004). Table 5.20 displays the average share during the two sub-periods. It shows that:

- i) share of transport operators, professional and other services, trade and miscellaneous services declined in the post-reform period;
- ii) increase in the post-reform period was in construction, personal loans, and finance;
- iii) decline in the credit to trade, and transport operators is associated with the slowdown in agricultural and industrial output in the state.



Figure 5.19 shows credit to the different services during the period 1972-2004. As can be seen from the figure, except ‘personal loans’ and ‘professional services’, credit declined to all the other categories within the services sector.



#### a) Personal Loans:

The personal loans are broken into housing and non-housing loans. The non-housing loans include loans for consumer durables and other personal loans. While the data on total personal loans in the state is available from 1972 onwards, further data on the breakdown of this group is available only from 1987. Data on personal loans in the rural and urban areas is available from 1990. The major trends are:

- i) in 1973 personal loans formed only 9.7 per cent of the state’s total services credit and rose sharply to 40 per cent in 2004;
- ii) on an average, the share of personal loans in credit to services, was 23 per cent in the post-reform period compared to only 10 per cent in the pre-reform period;
- iii) ratio of personal loans to real state output was 1.6 per cent in 1993 and rose by six times to 9.8 per cent in 2004;
- iv) housing loans have shown a sharp rise in recent years in the state (Table 5.21);
- v) among the non-housing loans, credit to purchase consumer durables was 5.4 per cent in 1987, but declined as the reforms in

the banking sector progressed, and was only 2.3 per cent of the personal loans to the state in 2004;

- vi) of the total credit for consumer durables, credit to rural areas was 16.1 per cent in 1990 but more than doubled in 2004. Data on the demand for consumer durables is not available for UP, though various market research companies have found potential for a large increase in the demand for these items, particularly in the rural sector of the state (Mehra & Mishra, 2003);
- vii) share of the urban credit for the purchase of consumer durables declined from 83.9 per cent in 1991 to 64.3 per cent in 2004;
- viii) personal loans (other than housing and consumer durables) which were 95 per cent in 1987 declined to 52 per cent in 2004. The further breakdown of this category is not available.

Increased housing loan credit should show up in the increased number of houses or in renovations of existing houses. The construction output (which includes non-residential buildings) has shown a rise in the early years; and output derived from real estate and ownership of dwellings has shown a rise in the state. The increased activity of real estate developers and builders is shown in state output.

Across the regions, in 2004 credit to the western region was highest (47.3 per cent) for personal loans followed by the central (28.7 per cent) and eastern regions (20.7 per cent). As the western region is more prosperous, personal loans also were higher in this region. While the credit for consumer durables in the rural areas did show an increasing trend (as noted above), the proportion of overall personal loans in total credit to services moved downwards. In the urban areas, the personal loans increased.

b) Credit for construction:

Credit for construction increased marginally in the post-reform period and is more in the rural than the non-rural areas. Thus, average credit for construction in the non-rural areas was higher in the period 1989-97 at 2.6 per cent, compared to 1.6 per cent in the latter period 1998-04. Credit for construction in the rural areas in the late nineties and recent years, particularly from 2002 onwards, was much above the early reform years.

c) Credit for Trade:

The deceleration in the contribution of trade to SDP, shown earlier in the previous section, is corroborated by the trend in trade credit which in the post-reform period grew at a much smaller rate compared to the pre-reform period. During the period 1972-91 the average credit to trade was 40.9 per cent, this lowered to 32.5 per cent in the period 1991-2004. In the rural areas, the average share of credit to trade during the period 1989-1997 was 43.8 per cent, which subsequently lowered to 31.6 per cent. In the urban areas, the share of trade declined during the two sub-periods. The decline in credit was in both the retail as well as wholesale trade. This was a consequence of a slowdown in economic activity in the state in the post-reform period.

d) Credit to Transport Operators:

As in trade credit, similar trends were noticed in credit to the transport operators. The share of transport operators in rural areas in 1989-90 was close to 50 per cent of the total services credit. In the post-reform period, credit for transport was less than half of the pre-reform credit reflecting the decline in economic activity.

## **Section IV**

### **5.12 Conclusion**

One of the objectives of the study stated in Chapter 1 was to adopt a balanced approach and to examine the changes taking place in UP's economy. Keeping the above objective in view, this chapter set out the task as exploring structural change in UP compared to the rest of the country. It examined the structure of output, employment, migration and urbanisation in the state. This was also examined within the broad framework of other states and country as a whole. The study found that although structural change is taking place in UP's economy as in the country overall and other states, the difference lies in the pace and source of structural change. The slow pace of the change, an outcome also of the low growth rates has characterised the state's economy. The regional disparities as noted in the earlier chapters of the present study showed up in the differential pattern of structural change in UP. Very low levels of urbanisation in some of the UP's eastern districts and low share of services sector are an evidence of this different trend within the state. The demographic indicators such as dependency ratio have also moved in a similar

direction. High agricultural growth, higher non-farm activities and higher levels of urbanisation were observed in the western region of the state.

With so much focus lately on the services sector, and as the composition of the state output has changed, this chapter also ventured to examine whether the services have become the lead sector of the state's economy as in some other states. The findings in the chapter suggested that while in India the services sector is playing a major role, in UP it is agricultural growth and development which is more significant. The unorganised services sector in the state is vibrant and significantly contributing to the employment in the state. This also, perhaps led to decline in poverty in the nineties.

The vastly improved share of communications in services output in the state in the nineties also could be an outcome of increased credit for personal loans in the state. Nevertheless, a comparative picture of the breakdown of services in other states vis-à-vis UP highlighted the crucial role played by services sector in the economic growth of some of the developed states. The divergence in some services in UP such as, decline in trade, hotels and restaurants occupancies and sharp rise in communications services shows the slowdown in the state.

The role of the banks in the structural change has been crucial. This has been through increased credit to the sectors and branch expansion as has been discussed in the previous chapters. The previous chapter had examined credit in its multi-purpose role including as a source of growth in total output and sectoral output. It was also observed therein that bank credit has been increasingly going to the services sector. The present chapter examined the credit to the services sector in detail. The increasing shift towards the services, particularly personal loans including housing, is reflected in the increased share of construction in total state output.

The data on composition of total output in different states showed that UP was not the only services-lagging state. Some of the high-income more developed states were also among the services-lagging group. Moving over to the next objective of the study, the following chapter examines whether UP is really lagging, and what effect does a large state such as UP have on the growth rate and development of the country?

**Table 5.1: Composition of Gross Domestic Product of India**

(share in per cent)

Decades/ Year	Agriculture	Industry	Services	Per capita Income (Rs)
1950s	56.1	11.7	32.6	292
1960s	47.8	15.1	37.3	533
1970s	42.8	16.9	40.3	1188
1980s	36.4	19.5	44.0	3299
1990s	29.1	21.9	49.0	11117
2000-01	23.9	22.0	54.1	18506
2001-02	24.0	21.5	54.4	20047
2002-03	21.5	22.0	56.5	21140
2003-04	21.7	21.6	56.7	18506

Source: Planning Commission (2001a); RBI (2006b).

**Table 5.2: Employment in the Organised Sector in UP and India**

(in per cent)

Years	UP			India		
	Public Sector	Private Sector	Total	Public Sector	Private Sector	Total
1991	80.0	20.0	100.0	71.3	28.7	100.0
2001	79.0	21.0	100.0	68.9	31.1	100.0
2002	79.0	21.0	100.0	69.0	31.0	100.0
2003	78.0	21.0	100.0	68.8	31.2	100.0
2004	78.7	20.8	100.0	-	-	-

Source: Government of UP(2005a).

**Table 5.3: Composition of Output in Different States**

(in per cent)

States	Agriculture		Industry		Services	
	1993-94	2003-04	1993-94	2003-04	1993-94	2003-04
Andhra Pradesh	33.3	24.7	19.4	20.0	47.3	55.3
Gujarat	22.4	20.1	34.3	36.3	43.3	43.6
Haryana	42.2	29.3	19.5	21.8	38.3	48.8
West Bengal	32.4	23.5	20.1	17.6	47.5	58.9
Punjab	46.1	38.6	17.6	18.4	36.3	43.0
Karnataka	35.6	19.2	21.1	22.3	43.4	58.5
Tamilnadu	24.1	12.5	29.2	24.5	46.7	62.9
Rajasthan	34.0	27.6	18.2	21.5	47.8	51.0
Maharashtra	19.5	12.6	28.5	24.5	52.0	63.0
UP	39.0	33.3	18.0	19.0	43.0	47.7
Bihar	48.6	39.7	6.7	5.6	44.7	54.6

Source: CSO (2005).

**Table 5.4: Structure of Employment in UP**

(in per cent)

Sectors	UP			India	
	1981	1991	2001	1991	2001
Agriculture	74.5	72.2	65.9	64.8	58.2
Manufacturing	9.0	7.6	5.6	2.4	4.2
Services	15.8	19.3	28.5	32.8	37.6

Source: Registrar General of India (2002a); CSO (1997).

**Table 5.5: Agricultural Labourers in States and Ranking in Human Development Index (HDI)**

States	% of Agricultural labourers in total workforce	Ranking in Human Development Index (HDI)
Andhra Pradesh	39.6	10
Assam	13.2	14
Bihar	48.0	15
Gujarat	24.3	6
Haryana	15.3	5
Karnataka	26.5	7
Kerala	15.8	1
Madhya Pradesh	28.7	12
Maharashtra	26.3	4
Orissa	35.0	11
Punjab	16.3	2
Rajasthan	10.6	9
Tamilnadu	31.0	3
UP	24.8	13
West Bengal	25.0	8

Source: Registrar General of India (2002a); Planning Commission (2002a).

**Table 5.6 : Rural-Urban Pattern of Employment in UP (as per 60<sup>th</sup> round of NSSO)**

(in per cent)

Sectors	Rural			Urban		
	Male	Female	Total	Male	Female	Total
Primary	68.2	88.1	75.1	8.5	24.4	11.1
Secondary	15.0	7.2	12.5	35.2	36.9	35.4
Tertiary	15.8	4.7	12.4	56.3	38.7	53.5

Source: NSSO (2005a).

**Table 5.7: Trends in Migration in India**

(population in million)

Census Year	1971	Per cent share	1981	Per cent share	1991	Per cent share	2001	Per cent share
I. Total Population	528.6	30.6	659.3	31.3	838.5	27.4	1028.6	29.9
II. Total Migrants	161.8	100.0	206.4	100.0	229.8	100.0	307.1	100.0
a) Short Distance	136.2	84.2	176.9	85.8	195.3	84.9	258.5	84.4
i) Intra-District	101.2	62.6	126.4	61.3	136.2	59.2	181.7	59.2
ii) Inter-district	35.0	21.6	50.5	24.5	59.1	25.7	76.8	25.0
b) long distance	24.9	15.4	29.4	14.3	34.1	14.8	48.4	15.8
iii) Inter-state	18.3	11.3	23.4	11.4	27.2	11.8	42.3	13.8
iv) International	6.6	4.1	6.0	2.9	6.9	3.0	6.1	2.0

Source: Data for 1971 and 1981 from Dyson and Visaria (2004, p 109). For the years 1991 and 2001 data are from Registrar General of India (2002a).

**Table 5.8: Patterns in Migration in India**

(in per cent)

	1971	1991	2001
<b>I. Intra-state</b>			
Rural to rural	62.0	57.2	60.5
Rural to urban	16.6	21.1	17.6
Urban to urban	13.6	14.0	12.3
Urban to rural	7.8	7.7	6.5
<b>II. Inter-state</b>			
Rural to rural	30.1	26.1	26.6
Rural to urban	27.4	32.6	37.9
Urban to urban	32.3	32.8	26.7
Urban to rural	10.3	8.5	6.3

Source: Data for the years 1971 and 1991 are from Dyson and Visaria (2004 , p.110-111) and for 2001 from Registrar General of India (2002a).

Table 5.9: Migration in Selected States in 2001

(in per cent)

Rural to Rural		Rural to Urban		Urban to Rural		Urban to Rural	
Bihar	79.9	Gujarat	25.9	Goa	26.7	Tamilnadu	27.4
Jharkhand	75.8	Tamilnadu	23.3	Kerala	13.3	Goa	21.9
Assam	73.0	Haryana	21.9	Tamilnadu	11.5	Maharashtra	19.2
Himachal Pradesh	71.8	Maharashtra	21.2	Andhra Pradesh	8.2	Punjab	15.5
UP	69.8	Karnataka	21.2	Karnataka	7.4	Karnataka	15.3
Rajasthan	69.7	-	-	-	-	Gujarat	14.6
Chattisgarh	69.2	-	-	-	-	-	-
Orissa	67.5	-	-	-	-	-	-
West Bengal	66.5	-	-	-	-	-	-

- not applicable.

Source: Same as Table 5.4.

Table 5.10: Extent of Urbanisation in India

(population in million)

Year	Population	Urban Population	Urban Population as % of total population	Variation in Population
1911	252.0	-	10.3	-
1921	251.2	-	11.2	-
1931	278.9	-	12.0	-
1941	318.5	-	13.9	-
1951	361.5	62.4	17.3	-
1961	439.1	78.9	18.0	0.68
1971	548.2	109.1	19.9	1.94
1981	683.3	159.5	23.3	3.43
1991	846.3	217.6	25.7	2.37
2001	1028.6	283.6	27.8	2.07

- not available.

Source: CSO (1997); Dyson and Visaria (2004).

Table 5.11: Urbanisation in Different States in India

States	% of urban population		Variations in level of urbanisation	Per capita income 2001-02 (Rs.)	Demographic Indicators(2004) (Urban)	
	1991	2001			Birth Rate	IMR
Maharashtra	38.7	42.4	3.7	16797	17.9	27.0
Andhra Pradesh	26.9	27.3	0.4	11906	16.1	39.0
Gujarat	34.5	37.4	2.9	15962	21.1	38.0
Haryana	24.6	28.9	4.3	16395	21.2	47.0
West Bengal	27.5	28.0	0.5	11369	12.9	32.0
Punjab	29.5	33.9	4.4	17254	17.6	36.0
Tamilnadu	34.2	44.0	9.8	14261	16.2	35.0
Rajasthan	22.9	23.4	0.5	9877	23.7	42.0
UP	19.8	20.8	1.0	6539	26.2	53.0
Bihar	13.1	10.5	-2.6	3712	23.1	47.0
Orissa	13.4	15.0	1.6	6787	17.3	58.0

Source: CSO (1997; 2005) ; Registrar General of India (2002a; 2006b) .

Table 5.12: Distribution of Urban Population in UP

	Population Groups	1991		2001	
		No of cities	% of population in urban population	No of cities	% of population in urban population
Total		702		670	
Class I	100000>	41	55.5	54	61.9
II	50,000-99,999	46	11.8	52	10.2
III	20,000-49999	130	14.0	174	14.6
IV	10000-19999	236	12.3	250	10.2
V	5000-9999	209	5.8	131	3.0
VI	>5000	40	0.5	9	0.1

Source: CSO (1997).

Table 5.13: District Level Urbanisation in UP in 2001

(in percent)

Regions	Level of Urbanisation	Number of Districts above state average	Urban concentration (CV%)	Dependency Ratio
Eastern	11.1	2	72.92	94.7
Western	27.4	17	36.74	92.3
Central	21.6	2	101.2	84.9
Bundelkhand	17.8	3	56.9	89.3
UP	20.8	-	-	93

Source: Registrar General of India (2002a).

Table 5.14: Trends in Components of Services in India

(in per cent)

Services Groups	Average Growth Rate of Broad Services Groups				Average Share of Broad Services Groups in GDP			
	1970s	1980s	1990s	2000+	1970s	1980s	1990s	2000-01 to 2003-04
Construction	2.2	4.8	5.6	6.3	5.9	5.5	5.2	5.1
Trade, Hotels & Restaurants	4.8	5.9	7.6	9.4	16.9	18.8	20.3	23.1
Finance, Insurance, Real Estate, & Business	4.3	9.3	8.9	7.6	6.3	7.9	11.4	12.3
Community, Social & Personal Services	4.0	6.3	6.9	5.2	11.2	11.9	12.1	12.7

Source: Same as Table 5.1.

Table 5.15: Share of Services Sector in SDP

(in per cent)

States	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	Average
Andhra Pradesh	47.3	48.4	48.3	48.5	52.0	50.0	52.3	52.2	53.4	55.4	55.3	51.2
Gujarat	43.3	39.6	41.2	38.1	42.3	42.4	47.2	48.5	47.3	46.2	43.6	43.6
Haryana	38.3	37.9	39.4	40.1	42.6	43.1	44.5	45.9	47.5	48.9	48.8	43.4
West Bengal	47.5	47.6	48.4	49.1	49.3	52.1	53.1	54.9	54.6	57.8	58.9	52.1
Punjab	36.3	36.2	37.7	38.1	41.0	41.7	41.0	41.2	42.2	43.5	43.0	40.2
Maharashtra	52.0	52.8	52.3	50.8	52.4	54.9	55.6	58.5	59.6	61.2	63.0	55.7
Karnataka	43.4	44.2	46.1	47.5	49.2	48.6	50.8	51.4	54.6	56.4	58.5	50.1
Tamilnadu	46.7	46.1	48.0	50.2	52.8	53.7	54.8	54.7	57.5	59.9	62.9	53.4
Rajasthan	47.8	44.6	46.0	45.8	46.4	47.5	49.1	53.1	50.5	54.4	51.0	48.7
UP	43.0	42.0	42.7	42.1	44.5	44.9	45.0	46.0	46.4	47.5	47.7	44.7
Bihar	44.7	43.2	47.4	44.6	49.6	48.5	52.3	50.3	53.4	50.6	54.6	51.2
India	48.0	47.8	49.0	48.5	50.8	51.6	53.4	54.1	54.4	56.5	56.7	51.9

Source: Same as Table 5.3.



Table 5.16: Share of Components of Services Sector in UP

(in percent)

Items	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Construction	4.2	4.0	4.4	4.2	4.9	5.4	5.4	5.7	5.7	5.9	6.1
Railways	1.8	1.6	1.7	1.6	1.7	1.8	1.8	1.7	1.8	1.9	1.9
Transport excluding Railways	2.9	2.9	2.9	2.9	3.2	3.2	3.3	3.4	3.3	3.4	3.4
Storage	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Communication	0.6	0.7	0.8	0.8	0.8	0.8	1.0	1.3	1.7	2.1	2.5
Trade, Hotels & Restaurants	13.5	13.4	13.2	13.3	12.8	12.9	13.0	12.7	12.6	12.4	12.2
Banking & Insurance	2.5	2.6	2.6	3.3	4.2	3.6	3.6	3.8	3.8	3.9	3.8
Real estate, ownership of dwellings & business services	6.9	6.6	6.5	6.0	6.1	6.1	5.9	6.0	6.0	6.1	6.0
Public administration	4.4	4.1	4.3	4.0	4.7	4.6	4.8	4.7	4.6	4.5	4.8
Other Services	6.1	6.1	6.2	5.8	6.1	6.6	6.4	6.6	6.9	7.2	7.0

Source: Same as Table 5.3.

Table 5.17: Communication as Share of SDP in Selected States

(in percent)

States	AP	Gujarat	Haryana	West Bengal	Maharashtra	Karnataka	Tamilnadu	Rajasthan	UP
1993-94	1.1	1.3	0.6	1.1	2.2	1.7	1.7	0.8	0.6
1994-95	1.1	1.3	0.8	1.1	2.4	1.9	1.7	0.9	0.7
1995-96	1.2	1.6	0.9	1.3	2.6	2.2	2.0	1.0	0.8
1996-97	1.4	1.5	1.0	1.6	2.9	2.5	2.3	1.0	0.8
1997-98	1.7	1.9	1.3	1.5	3.5	2.8	2.4	1.1	0.8
1998-99	1.9	1.9	1.7	1.7	3.5	2.7	2.6	1.6	0.8
1999-00	2.1	2.3	1.9	1.6	3.7	3.4	3.1	1.8	1.0
2000-01	2.5	2.7	1.7	1.8	5.1	4.2	3.5	2.1	1.3
2001-02	2.8	2.8	1.9	1.9	5.5	4.9	4.4	2.0	1.7
2002-03	3.5	2.7	1.9	2.1	5.5	5.8	5.0	2.3	2.1
2003-04	4.1	2.4	2.0	2.2	6.1	7.0	5.9	2.2	2.5
2004-05	4.9	-	-	-	-	-	6.5	-	-

- not available

Source: Same as Table 5.3.

Table 5.18: Construction in SDP in Selected States

(in percent)

Years	Andhra Pradesh	Gujarat	Haryana	West Bengal	Punjab	Maharashtra	Karnataka	Tamilnadu	Rajasthan	UP
1993-94	5.0	4.6	7.0	4.4	4.2	4.9	5.1	5.2	5.1	4.2
1994-95	5.4	3.8	7.0	4.3	4.1	4.8	4.6	5.2	4.6	4.0
1995-96	5.2	3.9	7.1	4.2	4.8	4.4	5.2	5.1	5.2	4.4
1996-97	4.9	3.4	6.3	4.2	4.1	4.5	5.5	5.2	5.5	4.2
1997-98	5.7	4.2	6.6	4.0	5.4	4.7	6.3	5.7	6.3	4.9
1998-99	5.3	4.2	6.8	4.1	6.3	5.0	6.7	6.2	6.7	5.4
1999-00	5.7	5.6	6.6	4.2	4.8	4.2	7.1	6.6	7.1	5.4
2000-01	5.7	4.7	6.5	4.4	5.0	4.1	6.7	6.1	6.7	5.7
2001-02	5.9	3.9	6.7	4.4	5.5	4.3	6.9	6.7	6.9	5.7
2002-03	6.3	3.6	6.5	4.3	5.7	4.6	7.0	6.8	7.0	5.9
2003-04	6.3	3.5	6.3	4.1	5.7	5.7	6.9	7.2	6.9	6.1

Source: Same as Table 5.3.

Table 5.19: Different Bank Groups and Credit to Services in UP

(in per cent)

Years	Public Sector Banks	Regional Rural Banks	Private Banks	Foreign Banks
1975	100.0	0.0	0.0	0.0
1980	83.9	1.8	14.3	0.0
1985	90.6	5.3	4.1	0.0
1990	88.2	8.9	2.4	0.5
1991	87.7	9.0	2.6	0.6
1992	86.8	8.8	2.6	1.9
1993	87.9	8.5	2.4	1.2
1994	88.3	8.9	2.3	0.6
1995	87.7	9.5	2.1	0.7
1996	85.4	10.7	3.1	0.8
1997	84.7	10.8	3.5	1.0
1998	85.1	10.7	3.4	0.9
1999	86.5	10.0	2.9	0.6
2000	87.8	9.8	1.8	0.6
2001	87.9	9.8	2.0	0.3
2002	89.1	7.7	2.5	0.7
2003	87.9	8.4	3.0	0.7
2004	81.8	6.9	10.2	1.1
Average	87.6	8.1	3.6	0.7
1975-1992	89.5	5.6	4.3	0.5
1993-2004	86.7	9.3	3.3	0.7

Source: RBI (2004b, various issues).

Table 5.20: Average Share of Credit to Different Services in UP

(in per cent)

Categories of Services	Average Share in Total	
	1972-91	1991-2004
i) Construction	1.3	1.8
ii) Transport Operators	13.7	5.0
iii) Professional & Other Services	7.5	6.3
iv) Personal Loans	10.7	30.0
v) Trade	40.9	32.5
vi) Finance	0.2	2.8
vii) All Others	25.7	21.5
viii) Total	100.0	100.0

Source: Same as Table 5.19.

Table 5.21: Credit for Personal Loans in UP

Year	Credit for Consumer Durables (share in total)		Breakdown of Personal Loans to UP (per cent share)		
	Rural	Urban	Consumer Durables	Housing	Rest of Personal Loans
1987	n.a.	n.a.	5.4	0.0	94.6
1988	n.a.	n.a.	5.2	0.0	94.8
1989	n.a.	n.a.	5.5	0.0	94.5
1990	16.1	83.9	3.8	0.0	96.2
1991	20.5	79.5	4.0	36.8	59.1
1992	26.1	73.9	3.5	35.4	61.1
1993	21.4	78.6	3.0	38.3	58.6
1994	33.3	66.7	7.7	36.5	55.8
1995	27.1	72.9	3.0	35.3	61.7
1996	26.4	73.6	2.9	31.4	65.7
1997	22.2	77.8	3.1	32.5	64.4
1998	23.9	76.1	3.5	28.2	68.3
1999	19.3	80.7	4.5	33.0	62.6
2000	19.9	80.1	5.1	37.6	57.3
2001	21.9	78.1	5.2	36.9	57.9
2001	24.7	75.3	4.5	38.4	57.2
2003	27.6	72.4	3.2	41.2	55.6
2004	35.7	64.3	2.3	45.4	52.3

Source: Same as Table 5.19

## **CHAPTER 6**

### **IS UTTAR PRADESH A LAGGING STATE?**

#### **6.1 Introduction**

In Chapters 4 and 5 of the present study, it was observed that a change in the composition of output is gradually emerging in the regions of UP. The flow of credit from the banks also demonstrated the change and its direction. The literature, however, ignored this change and still preferred to call UP a ‘lagging state’. But is the state really lagging and an encumbrance? Are not some other large states of the country in a comparable position? In the nineties and more recent years when India is achieving high growth rates and is playing a major role along with China in the world economy (IMF, 2005), and ‘globalisation’ has become a keyword, the label of ‘lagging’ to a major large state of the country assumes special significance. As noted in chapter 2 of the present study, UP is the most populous state in India and has 16.3 per cent of the country’s population. This chapter serves as the critique of the current literature, which has been critical of the state’s human development and carries forward the overall aim of presenting a balanced approach to the state’s development. The chapter also accomplishes the last objective of the study, and the questions which it examines, are:

- iii) Is UP really lagging?
- iv) What effect does a large state like UP have on the growth rate and development of the country?

How is the word ‘lagging or lag’ defined? The Oxford English Dictionary defines lag as: “To fail to maintain the desired speed of progress; to slacken one’s pace, as from weakness or sloth; to fail to keep pace with others; to hang back, fall behind, remain in the rear” and lagging is the “the action or condition of lag” (OUP, 1989). The Collins English Dictionary (2000) gives two definitions of ‘lagging’. These are: “1. (often followed by *behind*) to hang (back) or fall (behind) in movement, progress, development etc. 2. to fall away in strength or intensity”. The words ‘desired speed’ and ‘slacken’ in the first definition and ‘fall (behind)’ in the

second are particularly noteworthy, and the emphasis is on the relative pace and speed of change. Lagging (or lag) has also been defined as: “to stay or fall behind” and “to move, function, or develop with comparative slowness” (Merriam-Webster Online). All these definitions define lagging and lag in terms of rate and pace of change, which is lower in UP, compared to some other states.

These definitions of ‘lagging or lag’, however, are not a voice of despair as it is projected in the current literature on UP. On the contrary, these definitions raise hope that change is occurring in UP, but at a slower rate compared to some states. In economic terms, for instance in Lewis’s (1954) dual economy model, the subsistence sector (agriculture) is the lagging sector and is a source of unlimited supply of labour to the leading capitalist sector (industrial sector). The lagging sector in Lewis’s analysis is dynamic, transforming, and not stagnant. Through supply and demand linkages with the capitalist sector, the lagging sector is an important contributor to economic development. The analysis in the previous chapters has also shown a positive trend occurring in UP, although the pace of change is slow.

This chapter uses a multi-indicator approach, further broken into income and non-income indicators<sup>80</sup>, to examine the two questions raised above. The chapter is organised into three sections. Section I examines the income indicators. Section II, through non-income indicators, examines whether UP is really lagging, and if it has any effect on the growth and development of the country. Section III concludes the chapter.

## **Section I**

The present study uses the inequality framework introduced in chapter 3 to examine income and non-income indicators across the Indian states. Income inequality ranges from inequality in the income of individual to the community and society’s income, and covers geographical units at a regional, country and even global level. The income measures adopted by most of the studies are household or personal income. Some regional studies also consider investment as an income measure. The non-income inequalities often begin from gender inequality at the family level, and

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<sup>80</sup> Alternatively a four pillared set, further broken into various indicators, also could help in identifying the ‘lag’ in UP. These are: i) economic; ii) social; iii) political; and iv) cultural. This approach has an advantage over the income and non-income classification as it separates out the political and cultural changes in which the state leads. The present study uses income and non-income indicators as in the alternative method the economic and social indicators may overlap into each other.

culminate into a host of outcomes reflecting the state of the society. So far, the inequality literature has considered only the income inequalities. Very few studies exist on inequality analysed in terms of non-income indicators which include indicators like skills, education, opportunities, happiness, health, life expectancy and social mobility (Heshmati, 2004).

To examine whether UP is really lagging, the income indicators, further broken into several other indicators, are analysed in this section. The indicators of income considered in the present study are: i) per capita income; ii) overall growth rate; and iii) investment. These indicators are also called monetary indicators.

## **6.2 Income Indicators**

### *6.2.1 Per Capita Income*

Within the monetary or income indicators group, the most significant is per capita income as it indicates income per person in the country. Per capita income is a very crude indicator of a person's income. Two factors influence this indicator: i) total income; and ii) total population. Thus, higher population would depress the per capita income even if the total income is high. Low total income coupled with high population would also depress the per capita income.

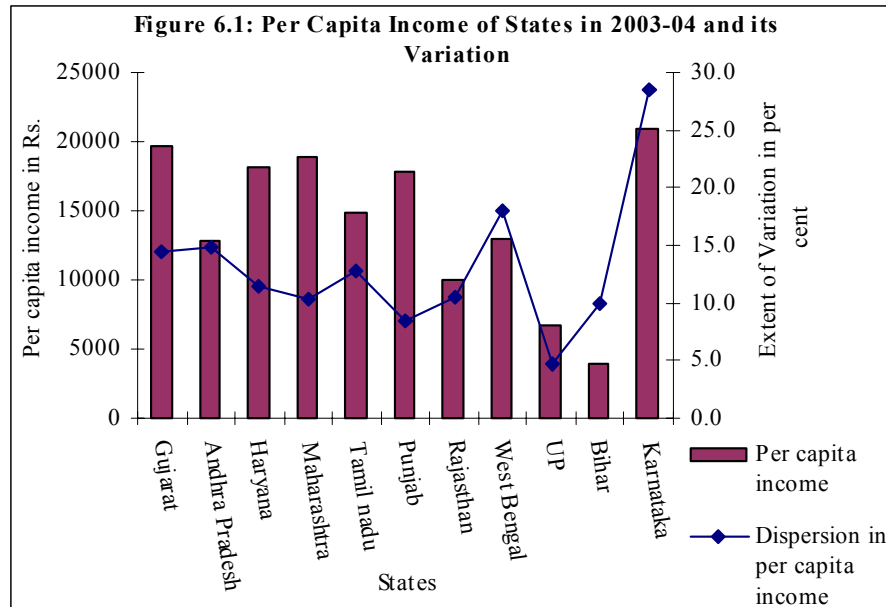
Though commonly adopted, per capita income is not considered as a satisfactory indicator to measure the quality of life and well-being, and a host of other indicators are used, more so since the nineties, to judge well-being (P. Dasgupta & Weale, 1992; UNDP, 2005; Yoruk & Zaim, 2003). The search for an alternative indicator has even led to adopting per capita energy consumption in kilograms of coal as the indicator of development (see Tsakloglou, 1990). Nevertheless, although per capita income is a crude indicator, as it merely distributes the total output among the population, it is useful in comparing the relative performance of states, regions and countries. In the present study per capita income is adopted to examine the relative performance of UP vis-à-vis other states.

#### a) Trends in UP's per capita income

The relative performance of the per capita income in UP vis-à-vis other states, during the period 1993-94 to 2003-04, set out in Table 6.1 shows that:

- i) per capita income of UP was less than half the per capita income of the states like Gujarat, Haryana, Maharashtra, Tamilnadu, and Punjab;
- ii) UP's per capita income is slightly above 50 per cent of states like Andhra Pradesh, Kerala, West Bengal and Rajasthan, Himachal Pradesh;
- iii) gap between the per capita income of UP and that of the smaller emerging states including union territories like Delhi, Chandigarh and Goa is vast. UP's per capita income was only 23.7 per cent, on an average, of these states;
- iv) UP's per capita income is even lesser than Orissa's per capita income, another less developed state, and exceeds only that of Bihar in the nineties;
- v) UP's per capita income was only 58 per cent (average during the period 1993-94 to 2003-04) of India's per capita income in the post-reform period. This ranged from 65.6 per cent in 1993-94 to 50 per cent in 2003-04;
- vi) average growth rate of real per capita income for India was 4.5 per cent; in UP it was only 1.5 per cent and even declined in some of the years;
- vii) India's per capita income in the recent years has followed the trend as seen in Maharashtra, Punjab and Haryana.

Figure 6.1 shows the per capita income in different states of India in 2003-04 and its dispersion during the period 1993-94 to 2003-04. The near stagnancy in the per capita income in UP is evident as the fluctuations over the years are lowest of all the states. The variation is highest in Karnataka as its per capita income moved up sharply during this period. The other state to show large fluctuations in per capita income is West Bengal. The coefficient of variation in the per capita income of West Bengal at 18 per cent was considerably higher than 4.2 per cent in UP. The average real per capita income of the states shown in the figure below moved up from Rs.9298 in 1993-94 to Rs.14,254 in 2003-04.



b) Analysis of variations in per capita income

Why has the per capita income varied so much across the states? The average (1993-94 to 2003-04) real per capita income in the states has ranged from Rs.3,678 in Bihar to Rs. 16,107 in Punjab. The two factors- total income and population as pointed out earlier, prima facie explain this large variation. UP, for instance, is the most populous state and has 16.3 per cent of the country's population. Its output, however, has not matched the growing population. The state's fertility rate is highest among all the states. The total state output in absolute terms in UP is higher than that of Tamilnadu and Delhi, the fast rising emerging state. For example, the output of Tamilnadu was only 88 per cent of the total output of UP in 2003-04. This, however, examined in terms of its distribution, leads to a very different picture, and UP ranks low among the states. The standard deviation (which shows how close the values are to the average) in the per capita income, has increased in the post-reform period.

Bauer, Schweitzer and Shane (2006) examined the reasons for variation in per capita income across the states of the United States. They postulated that although according to the neoclassical growth theory, per capita income in the states of US should converge due to the mobility of capital and labour, from the mid-1970s the convergence has actually not taken place despite capital mobility. They, therefore, incorporated knowledge stocks (innovation and education) in their model built within endogenous growth theory framework, and found that innovation (measured by the stock of patents per capita in each state), and presence of skilled workforce



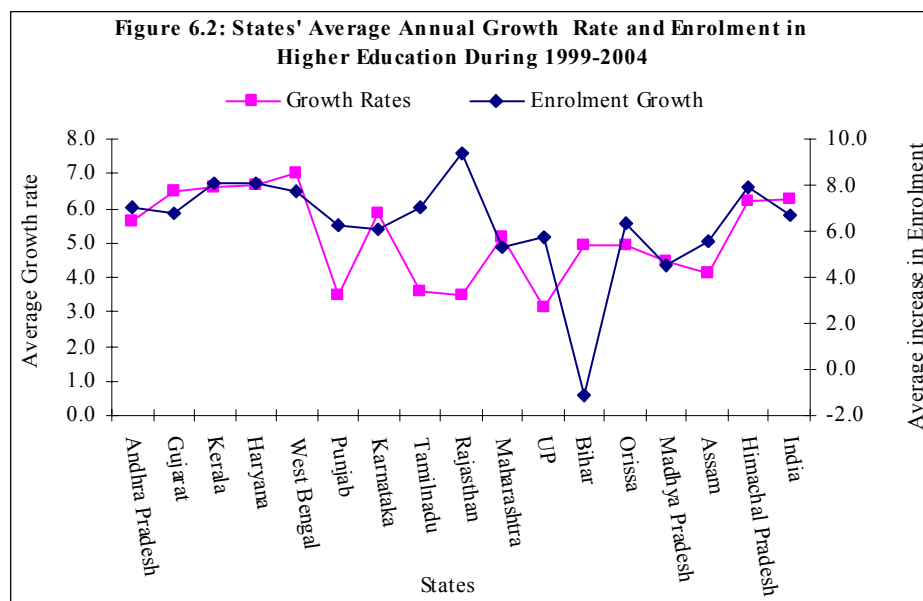
(proportion of the population with high school and bachelor degree) were the important explanatory variables in income variation across the states. They also considered other factors for inter-state differences such as infrastructure, tax rates, industrial development, financial markets and climate, but found knowledge stocks as the most significant factor in explaining the per capita income variations in US states. Have these factors played any role in inter-state variations in per capita income in India?

In US, the total number of patents filed by the residents was 645 per million population in 2004. In India, it was only seven per million population. Since 1995, however, a significant increase in the patent applications has taken place in India and China. In fact, growth in the number of patent applications was highest in these two countries during the period 1995 to 2004 (WIPO, 2006). In US, patents, due to their sheer numbers, played an important role in variation in per capita income across the states<sup>81</sup>. The analysis in the Indian context is limited by two factors: firstly, at present, the role of patents, as a source of economic growth is limited due to their comparatively low numbers; and secondly, lack of any statewide information on patents.

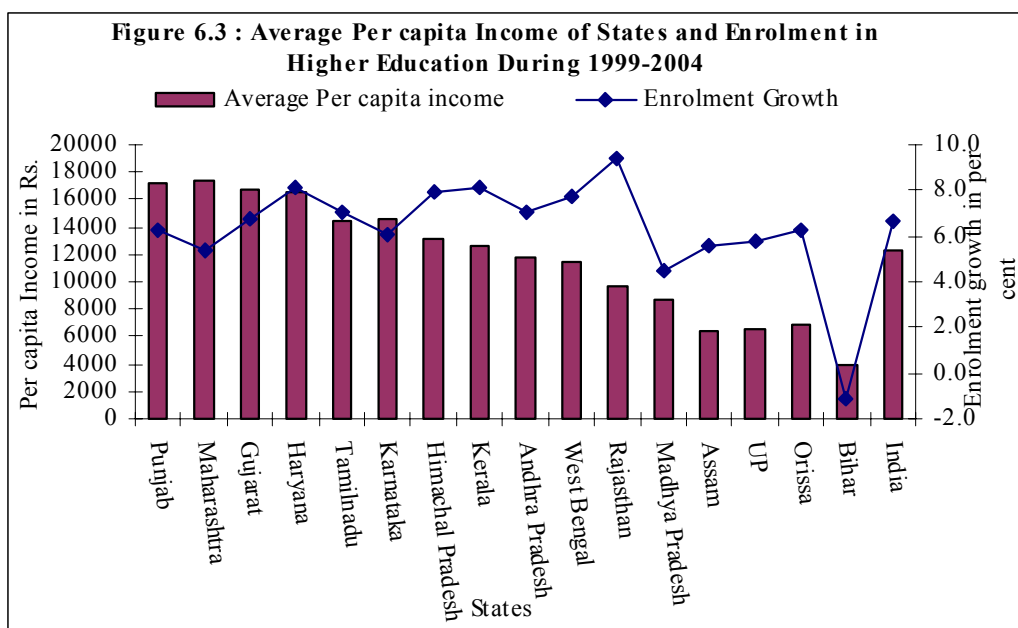
Chapter 4 of the present study examined the relationship between education (literacy rate and enrolment in primary schooling) and per capita credit in the rural and urban areas of the states of India. In this chapter, the relationship between education (undergraduate and above) and economic growth of the states is examined. Figure 6.2 shows the states' annual average growth in enrolment in higher education (undergraduate and above) and their annual average growth rates in real output during the period 1999-2004. The present study found that in many states, the growth rate in real output, and enrolment rates have moved in opposite directions.

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<sup>81</sup> In including patents as a variable in explaining variations in per capita income, Bauer, Schweitzer and Shane (2006) explained that in a state with higher patents per capita, the technology, that is, the creation of new products and production techniques in use, would be better, leading to higher personal incomes.



As higher education is related to income, the per capita income of the states would be a more appropriate indicator instead of states' annual average growth rate of total output. The relationship between the states' economic performance in terms of per capita income and their enrolments levels is positive, but not strong as the correlation coefficient works out to less than 0.5. This indicates that the states with high per capita income do have high enrolment growth, but the relationship does not hold as many other states with low per capita incomes also had high enrolment growth. Figure 6.3 reveals this trend. This could be due to two reasons: i) people in states with low per capita incomes seek higher education more as opportunities are limited, and also to improve their economic prospects; ii) higher education such as degree courses may not be related to per capita income as higher education is subsidised in India.



### 6.2.2 Growth Rate in State Output

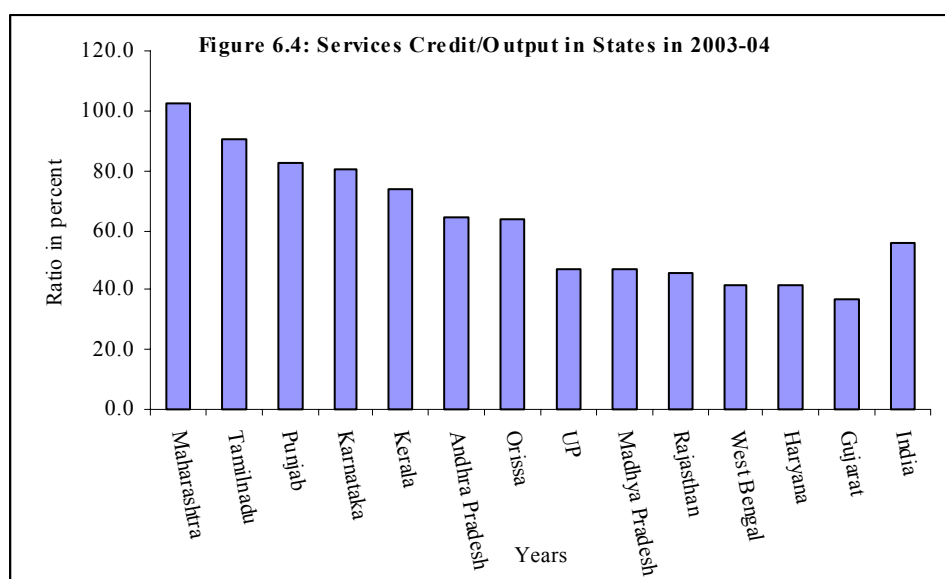
The other income indicators considered by the present study, besides per capita income, are: growth rate of real output of the state, and investment measured by bank credit to the services sector. In the Indian context, some of the limitations of data on total output at the state level are: i) difference in prices across the states; ii) different methods of estimating state domestic product in the states; and iii) also the quality of data involved is in question. Ahluwalia (2001) points out that although the data at the state level must add up to the GDP figures at the national level, due to the data limitations noted above, the figures on states' output does not add up to the national output. The present study found that in 2002-03, the latest year for which the data are available on all the state and union territories, the real GDP figure at the national level was higher from the states' real output added together by around 10 per cent. In 1993-94, this variation was 5 per cent. Despite these statistical limitations, SDP still remains an important indicator of the state income and output (Dholakia, 2003; Shetty, 2003).

As noted earlier in chapter 2, the annual average real growth rate of UP's output, in the post-reform period has been lowest among the major states, even among the so called '*BIMARU*' states (refers to Bihar, Madhya Pradesh, Rajasthan and UP, and means 'sick' in Hindi). The country's growth rate has been pulled up by the better performing states, in particular, the emerging states like Delhi.

### 6.2.3 Bank Credit to the Services sector

Inter-state disparity in many studies is examined in terms of investment proxied by the state government expenditure (Ahluwalia, 2002; B. Bhattacharya & Sakthivel, 2004b). In the absence of any other indicator on investment, the present study took bank credit to the services sector as ratio of services output as an indicator of investment in the major states of India vis-à-vis UP. The choice of the services sector is due to its sharp growth in nineties in almost all the states of India, and as the previous chapter showed, it was preferred by the banks in providing credit.

Figure 6.4 indicates that in 2003-04, largely the ratio of services sector credit to services output was high in the developed states and low in less developed states such as UP, Bihar and Rajasthan. The outliers among the developed states (states with low ratios) were Gujarat, Haryana and West Bengal. Among the less developed states, Orissa was an outlier as its ratio was more than 60 per cent. The standard deviation in the ratios across the states increased over the years from 9.4 in 1995-96 to 21.8 in 2003-04 (Table 6.2).



### 6.3 Summary

All the three indicators used in the study: i) per capita income; ii) growth rate in state output; and iii) ratio of services credit/services output, showed the divergence of UP from the all India trend. The major finding of this section was low per capita income of the state particularly in the post-reform period. This was the consequence

of the combined effect of slow down in total state output and increase in population. In almost all the major states of India, the birth rate has declined. In UP, however, it continues to be higher than the all India level and highest among all the states. This has pulled down the per capita income of the state. The annual average real growth rate of UP's output was the lowest among the major states of India. The services credit/output ratio was also low in UP as in other less developed states except Orissa. A major reason for variations in per capita income across the US states was innovation and knowledge. The present study, however, did not find this as a significant factor among the states in India.

## **Section II**

The performance of UP in the non-income indicators group (stated earlier in the chapter) is examined in the paragraphs below. The section further examines the issues such as: Was the performance of the state as poor in non-income indicators as in the case of income indicators? Can the state pull down the country's development?

### **6.4 Non-Income Indicators<sup>82</sup>**

The choice of the non-income indicators (indicators other than income, also called quality of life indicators) depends on the objective of the study. There is no uniform set of non-income indicators and they vary between developed and developing countries, rural and urban areas, and males and females. They could also differ within the rural and urban areas (see Bloom, Craig, & Malaney, 2001).

As the developed and developing countries are at different stages of development, the non-income indicators also vary with the level of their development. In the Human Development Report (UNDP, 2005 and various issues), for example, the indices on non-income are different for the developed and developing countries. A snapshot of the non-income indicators adopted by the different multilateral organisations is given in Table 6.3. In developed countries, the non-income indicators

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<sup>82</sup>Much of the data in this section is from the second round of National Family Health Survey (NFHS) for the year 1998 (NFHS, 2001). The latest round of NFHS 3 is for the year 2005-06 (NFHS, 2006). However, detailed data on many of the indicators used in the present study such as participation of the women in workforce, attitudes and preferences of women, infant mortality, under-five mortality and child mortality in the rural and urban areas, and for boys and girls separately, are not yet available in the latest survey. The study, therefore, used the data from the NFHS 2. The other sources of data, such as, the publications of the Office of Registrar General of India do not provide data on many of the indicators examined in this section.

are concerned with the quality of life. In contrast, in the developing countries more urgent and immediate issues relate to survival and basic education.

The indicators could be amount of free time, number and quality of consumer goods consumed, health and educational facilities. The World Development Report 2006 (World Bank, 2005) in discussing the inequalities within and across countries, besides income, considered inequalities in opportunities reflected in health, education and freedom. Overall, adult literacy rates, life expectancy at birth and infant and child mortality are the common non-income indicators in most studies.

The non-income indicators adopted in this study are those related to: i) status of women; ii) child health; iii) child labour; and iv) living conditions in the different states of India. These are further broken into various sub-indicators (except child labour) in order to probe the questions raised at the beginning of this chapter.

#### *6.4.1 Status of Women in UP*

The status of women is an important indicator as it is linked to economic growth and development. However, this study finds while the relationship between the status of women and development is clearly positive and stronger, this is not equally so with economic growth.

For example, in a recent study on gender differences and their macroeconomic outcomes, Stotsky (2006) found that low status of women lowers economic growth in developing countries and, therefore, improving the status of women relative to men will add to economic growth. Stotsky (2006) also observed that one of the channels through which this takes place is increased exports, and women's employment in export-oriented industries. However, the present study finds that the relationship between increased economic growth and the improved status of women is problematic. High economic growth need not lead to improved status of women, because of deep rooted cultural and social factors, as for instance in the western UP. The direction of causality between the status of women and economic growth also is not clear.

The development outcomes of the higher status of women are reflected in reduced maternal mortality and improved maternal care, better education, reduced fertility, and increase in average age at first marriage (Shen & Williamson, 1999). The improved status of women in general, and better education of the mother in particular, influence overall attitudes, including preferences of women towards the girl child. As

will be shown later in the chapter, it is the discrimination against the girl child from the moment she is born, or even before her birth, which culminates eventually in the lower status of women and leads to many other economic and social outcomes.

As an indicator of development, the status of women gained significance with the inclusion of a gender related development index for the first time in the 1995 Human Development Report (UNDP, 1995). The indicators on the status of women in the present study relate to: a) education; b) health; c) participation in the paid work force; d) empowerment; and e) attitudes and preferences of women.

#### a) Education

Some of the core indicators relating to the well-being of women are their education and their health. The importance of examining progress in education and health lies not only *per se*, but also due to their contribution in accelerating economic growth. Many studies have emphasised the link between education and economic growth. Increased innovation, productivity and technological improvements are some of the benefits of education (Hanushek, 2005). The lack of education or low and poor education of women prevents them from contributing to economic growth and development. The relative performance of UP in terms of the education indicators is given below:

- i) illiteracy among females (age 6+) was highest in Bihar (65.2 per cent) followed by Rajasthan (62.9 per cent). The state having the lowest illiteracy among women was Kerala (14.9 per cent). Though the female illiteracy was high in UP (57.3 per cent), in Andhra Pradesh also, it was equally high at 54.6 per cent); and
- ii) percentage of female children (age 6-14) attending school was highest in Kerala and lowest in Bihar. In UP the percentage of females attending school was almost the same as in Andhra Pradesh and Madhya Pradesh.

The gross enrolment ratio (GER)<sup>83</sup> in primary education in India, during the period 1991 to 2001, went up from 82 per cent to 95 per cent and has been likened to a “quiet revolution” in India’s elementary education (Wu et al., 2005). This trend was

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<sup>83</sup> GER as defined earlier in Chapter 2 is the total enrolment of children at the primary level (Grade I-V) divided by the population in 6-11 age group.

observed in UP also, as the state recorded improvement in literacy rates during the period 1991 to 2001. The perception that UP is a mass body of illiterates, as presented in a stream of current literature, is poised to change as the enrolment of children, particularly out-of-school children, has increased sharply in the state in the recent years.

In 2004-05 GER in UP was 98.3 per cent, much higher than that in the high incomes states like Punjab, Haryana, Maharashtra, Gujarat and Andhra Pradesh. It was way above the GER of Bihar at 91.05 per cent (Table 6.4). Table 6.4 also displays enrolment of girls in the different states. The enrolment of girls in primary schools has increased marginally in some of the states. The gender parity index that is, the ratio of girls to boys in the primary classes, increased in the state, and in 2004-05 in the primary level (Classes I-V) at 0.92 was higher than that of many other states such as Gujarat, Haryana, Madhya Pradesh, Maharashtra, Punjab and Rajasthan.

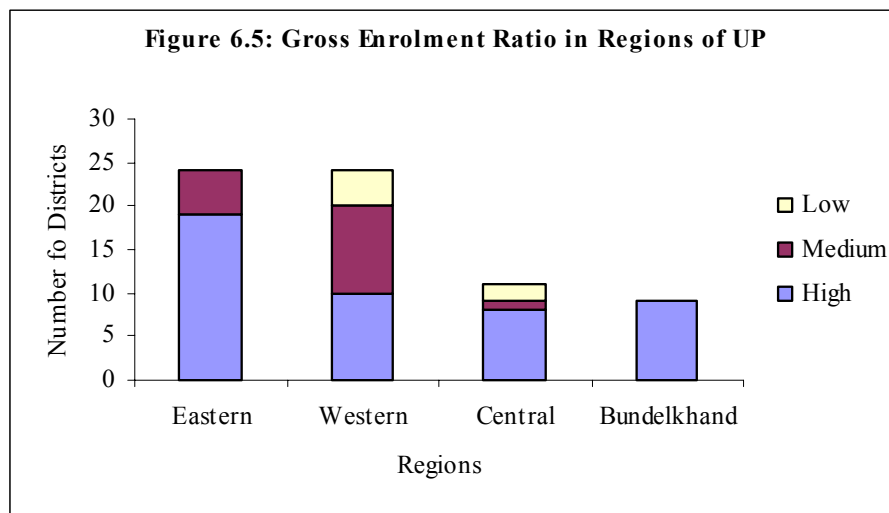
The evidence of a shift in UP in enrolment rates in primary schooling is clear also from the data on GERs at the district and regional levels. Table 6.5 shows that almost all the districts of the state had a sharp increase in their enrolment rates. The western region, particularly the north-western region which is more economically prosperous, however had low enrolment rates. The persistently low enrolment rates in the region could be because of the predominance of the *Jat* community in the region, which is resistant to the development of women. This is reflected in female infanticide, less mobility of women and high girl child mortality prevalent in Punjab, Haryana and western UP. Within the central region, the problem of low enrolment lay in the two large cities of Lucknow (state capital) and the industrial city, Kanpur Nagar.

Table 6.5 shows literacy rates in the districts of UP and their GERs for 2002-03 and 2004-05. The enrolment ratio in the districts in 2004-05 is largely related to their initial literacy rates. Thus, the districts in which the literacy rates were high (higher than the state's overall literacy rate) enrolment rates were low and conversely, in many districts with low initial literacy rate (lower than the state's overall literacy rate) had high enrolment rate. For instance, twelve districts in the region had literacy rate below the state level. The GER was also high in the all these districts in the region. Similarly, in the western region, literacy level in eight districts was below the state's overall literacy rate. The GER in all these districts except Bareilly was in the high category that is, 80 per cent and above.



The 70 districts of UP, according to their extent of enrolment in primary schools in 2004-05, have been classified by the present study into three groups- districts with high GER (80 and above), districts with medium GER (60-80) and districts with low GER (less than 60). Figure 6.5 shows the number of districts in each region of the state with high, medium and low GERs. It shows that GER is:

- i) high in 19 districts of the eastern UP;
- ii) in the western region only ten districts had high level of enrolment;
- iii) all the districts of Bundelkhand, a region with low development, fall under high GER group.



The improved performance in GER is due to the incentives like free books and stationary given by the Government of India under the scheme known as *Sarva Shiksha Abhiyan (SSA)*<sup>84</sup>, and the introduction of the mid-day meal scheme, which provides meals to the poor children in schools at the primary level. These incentives have helped in increasing enrolment and improving the attendance rates (Wu et al., 2005).

The data available for out-of-school children is only for the year 2000-01. These formed 45.5 percent of the total child population of the state in 2000-01. This

<sup>84</sup>Sarva Shiksha Abhiyan (SSA) (universal education programme) is a centrally sponsored scheme for universalization of elementary education. SSA was started in 16 districts of UP during 2001-02. The Government of India meets 85 per cent of the expenditure on the scheme and the share of the state government is 15 per cent. During 2002-03 to 2003-04, SSA was launched in all 70 districts of the state.

percentage has come down in recent years as the enrolment rates have increased. Nevertheless, even though the enrolments in the age group 6-14 have increased, the illiteracy among women in the next age group (15-19), is still very high in the state, and around 70 per cent of the women in this age group are illiterate (NFHS, 2001). Along with UP, other states with high female illiteracy in this age group are Bihar, Madhya Pradesh and Rajasthan.

#### b) Health

Increased focus on education with existing poor health may not lead to positive outcomes, hence the importance of a good health system. Baldacci and Clements (2005) found a significant association between health spending and growth. The expenditure on health by the UP government has been abysmal and formed only 1.0 per cent of the SDP, and even in relation to expenditure on education its share has fallen steadily (see Table 2.15). The health needs of the people are met increasingly through private hospitals and doctors. Peters, Yazbeck, Sharma, Ramana, Pritchett and Wagstaff (2002) and World Bank (2002) point out that the health care in UP is largely provided by the private sector and even the poor rely on the private sector, though usually they obtained concessions in the private market (Peters et al., 2002). In the rural areas of the state the percentage distribution of the average monthly medical expenditure, according to provider, was 1.6 per cent through the public sector, compared to 7.2 per cent through the private sector (NSSO, 2003a). In the urban areas of the state, the medical expenditure was 2.5 per cent through the public sector, and 5.0 per cent through the private sector.

Maternal care in UP lags behind other states, and the variation across the states is large. Maternal mortality ratio (maternal deaths per 100,000 live births) in UP was highest among all the states at 517 in 2003 (Registrar General of India, 2006d). The findings of the latest National Family Health Survey (NFHS, 2006) further confirm the improvement in the ratio. A sharp increase in the antenatal care (maternal care during pregnancy) in UP was reported by the survey between the years 1998 and 2005, up from 35 per cent to 67 per cent. The percentage of women receiving antenatal care increased more in the rural areas from 29 per cent to 64 per cent and from 63 per cent to 79 per cent in the urban areas. The deliveries by trained medical personnel also rose from 15 per cent to 22 per cent in the state. Although it has declined from about 600 per 100,000 in the early nineties, the maternal mortality ratio

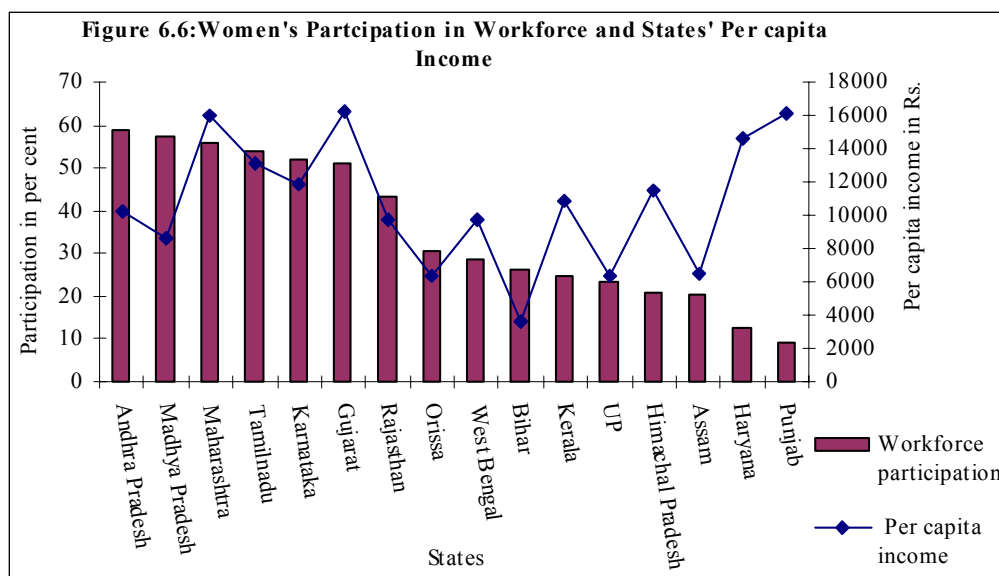
is still significantly higher than many other states, and more than 60 per cent higher than the all-India ratio of 301 per 100,000 live births.

Besides maternal care, other indicators of women's health are consumption of healthy and nourishing diet, and medical treatment. The health of women in UP is also governed by cultural factors. For instance, it is a typical practice, particularly among the more traditional and conservative families, for women members of the family to have food at the end, after the men have eaten. Often, this leads to consumption of the leftovers by the women, disregarding the nutritional necessities. Women in the family also often give less priority to their medical requirements reflecting both their low status and lack of empowerment.

### c) Participation of women in the paid workforce

Improved health and education of women will lead to better development outcomes, but their contribution to economic growth will only take place if the women increasingly participate in the paid workforce.

Women's participation in the paid workforce in the rural and urban areas is low in UP at 23.4 per cent, but so is the pattern in many states of India including Delhi (20.9 per cent), Himachal Pradesh (20.8 per cent), Haryana (12.6 per cent) and Punjab (9.4 per cent). Figure 6.6 shows women's participation in the workforce and the per capita income of the states. Irrespective of per capita income, the participation of women in the paid workforce varies from about 60 per cent in Andhra Pradesh to only 10 per cent in Punjab. In some high-income states such as Punjab and Haryana, the participation of women in the paid workforce is extremely low.



The data available on women’s employment is for the age group 15-49, and further breakdown of this age group and employment is not available. Availability of detailed data on women’s participation in the workforce according to their age, perhaps, could have thrown up a different pattern of women’s workforce participation from the above trend<sup>85</sup>.

d) Indicators relating to women’s empowerment

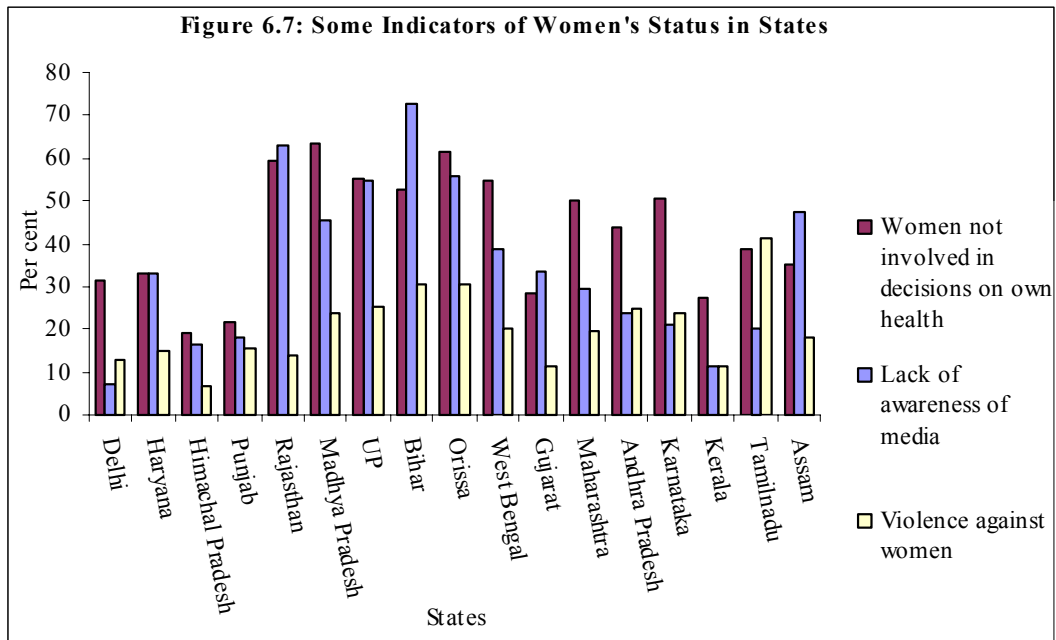
The empowerment measures adopted in the present study are: i) involvement in decisions on own healthcare; ii) exposure to media; and iii) violence against women. Figure 6.7 shows these indicators graphically for the states. The trends reveal that:

- i) women’s involvement in the decisions about their health care varied significantly across the states. The percentage of women in UP involved in the management of their own healthcare is 44.8 per cent, almost the same as 45.1 per cent in West Bengal. The state with the highest percentage of women involved in their own health

<sup>85</sup> Roy (2005) points to the existence of an M shaped curve in developed countries in the participation of women in paid workforce according to the age-group. According to this, the participation of women is high in the younger age groups, declines in the childbearing years, and rises again when women increasingly join back into the workforce. In contrast to this, he points out that in India, because of a number of socio-cultural barriers, M shaped curve in the participation of women in the workforce does not exist. The pattern of women in workforce participation which exists in India is that of a inverted prolonged (somewhat flat) U shaped curve which implies entry of younger women in the workforce and exit from the workforce after marriage.

care decisions is Himachal Pradesh (80.8 per cent) closely followed by Punjab (78.5 per cent);

- ii) awareness of women proxied by exposure to the urban media was highest in Delhi and Bihar was at the other end of the scale. In UP about 55 percent of the urban women were not exposed to any media, a figure comparable to that of Orissa; and
- iii) in the states which scored low in autonomy and urban women's awareness of media, violence against women was also high. Surprisingly in Tamilnadu, which has a high percentage of women taking decisions on their own health and aware of the media, violence was high against the women.



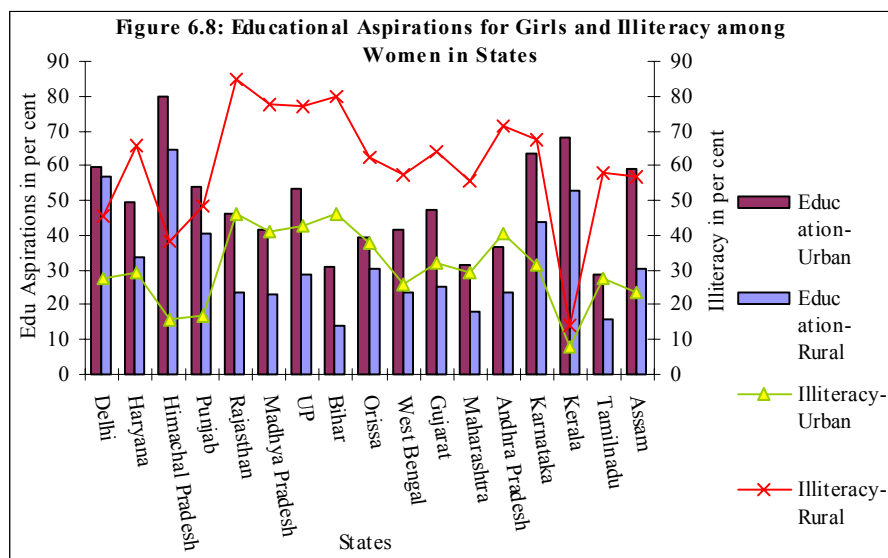
e) Attitudes and preferences of women

Almost all the studies on development cover indicators like the education and health. What however, is not explored enough is the psychological well-being of people, that is their attitudes and preferences. White, Leavy and Masters (2002) deplored the overemphasis on the 'conventional indicators', which are adopted by almost all the studies to the neglect of factors like parental attitudes and psychological well-being. It is these factors, which lead to desirable or undesirable outcomes. For example, discriminatory attitudes against the girl child leads to several negative

outcomes such as: low survival rate of female children, low or no education of girls, malnutrition, high girl child mortality, low participation in the work force etc. The present study, therefore, examined: i) these discriminatory attitudes, which shape the outcome indicators; and ii) whether UP is any different from the other states of India in this respect.

This analysis of the attitude of women in the different states of India towards the education of girls indicates that in seven states (including UP) more than 50 per cent of the women in the urban areas aspire to providing their daughters with as much education as they want. Topping the states in this category is Himachal Pradesh, followed by Kerala. In UP, 53.6 per cent of the women in urban areas want to educate their daughters as much as they would like. This is much higher than a number of relatively better-off states, like Maharashtra, Tamilnadu and Gujarat. On the other hand, in the rural areas of the state, the attitudes of women towards their daughters' education is lukewarm at 28.8 per cent, although it is better than in a number of other states like West Bengal, Tamilnadu, Rajasthan, Maharashtra and Madhya Pradesh.

A reverse relationship is observed between the aspirations of the mothers' for the education of their daughters and their own education levels and poverty. This was despite 42.5 per cent of the women in the urban areas and 71.1 per cent of women in the rural areas being illiterate. Figure 6.8 portrays the educational aspirations of women in the states and the level of illiteracy among women in the rural and urban areas. The contrast between urban women in UP and developed states such as Maharashtra and Gujarat can be seen in the educational aspirations for girls and their level of literacy.



This study also examined the data on the preference for sons versus daughters. A significant gap exists in the preference for a son vis-à-vis a daughter as an additional child in the rural and urban areas in all the states. In urban areas, except in Bihar less than 50 per cent of women in all states preferred sons. On the other hand, in the rural areas, in eight states more than 50 per cent of the women desired a son as an additional child. The preference for daughters in all the states was less than 50 per cent and ranged between 9.9-28.3 per cent in the urban areas and 6.4-23.1 per cent in the rural areas. Overall (rural and urban areas together), Kerala topped in the desire of women to have daughters and UP was the lowest with only 7.1 per cent of women preferring a girl as an additional child.

#### *6.4.2 Child Health Indicators*

Child health is an important determinant of productivity and economic growth. In the current development literature, considerable focus is on the child and “children mainstreaming” (T. Atkinson & Marlier, 2005, p.4), besides the gender mainstreaming. The present study, therefore, takes into account child focused indicators which comprise child health, and survival indicators such as infant mortality rate, under-five child mortality and child mortality rates, and child labour.

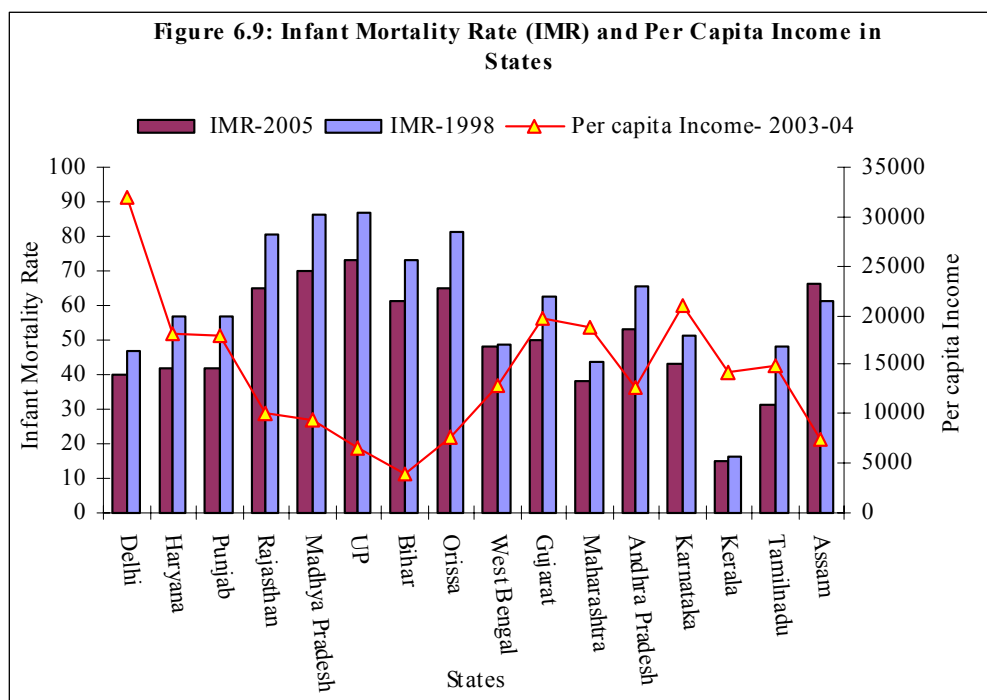
##### a) Infant mortality rate<sup>86</sup>

Among child health indicators, the infant mortality rate (IMR) is high in almost all the states of India except Kerala.

Although high in almost all the states, IMR does have a relationship with the per capita income of the state. The correlation coefficient between the two was negative and strong at -0.606 indicating that the higher the per capita income, the lower the infant mortality rate. The V pattern emerging in the centre of the Figure 6.9 shows the contrast between low per capita income of the states and their high infant mortality rate. Other studies also have found that income and child mortality are related (A. Tandon, 2005). Although even high-income states have high mortality rates, the overriding importance of increased economic growth is not reduced. Since UP has the highest fertility rate in the country, the necessity of directly attacking IMR is important, as high IMR is known to influence the fertility rate.

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<sup>86</sup> Infant mortality is defined as the probability of a child dying before the first birthday; child mortality is probability of a child dying between the first and fifth birthday; and under-5 mortality is the probability of dying before age five (NFHS, 2001).



In 1998 UP had the highest IMR of 87 per thousand of live births<sup>87</sup>, more than five times the rate of Kerala. As per the latest available data, in 2005 UP still had the highest IMR at 73 and the gap between Kerala and UP remained the same at about five times. This however, has come down from its 1998 level. The state with the lowest IMR in 2005 was again Kerala. Mortality rates are high for both boys and girls, but are slightly higher in the case of girls. Only six states had a mortality rate of less than 50 per thousand of live births, while eleven states had an IMR of more than 50 (Table 6.6).

The reasons for high IMR are poor child feeding practices, low nutrition and poor health and education of the mother. The strategy to reduce IMR is two-fold: direct and indirect. The direct and immediate measures are: i) spread of knowledge on the importance of proper feeding practices through extension workers; and ii) increase in vaccinations of children. Among the long-term indirect measures are: i) emphasis on education of women; ii) correcting the gender disparities; and iii) overall increased economic growth.

<sup>87</sup> According to the latest data thrown up by the Sample Registration System (Registrar General of India, 2006c), in 2005 the state with the highest IMR is Madhya Pradesh, followed by Orissa and UP, whereas according to the NFHS-3 (NFHS, 2006), UP tops the list followed by Madhya Pradesh, Rajasthan and Orissa.



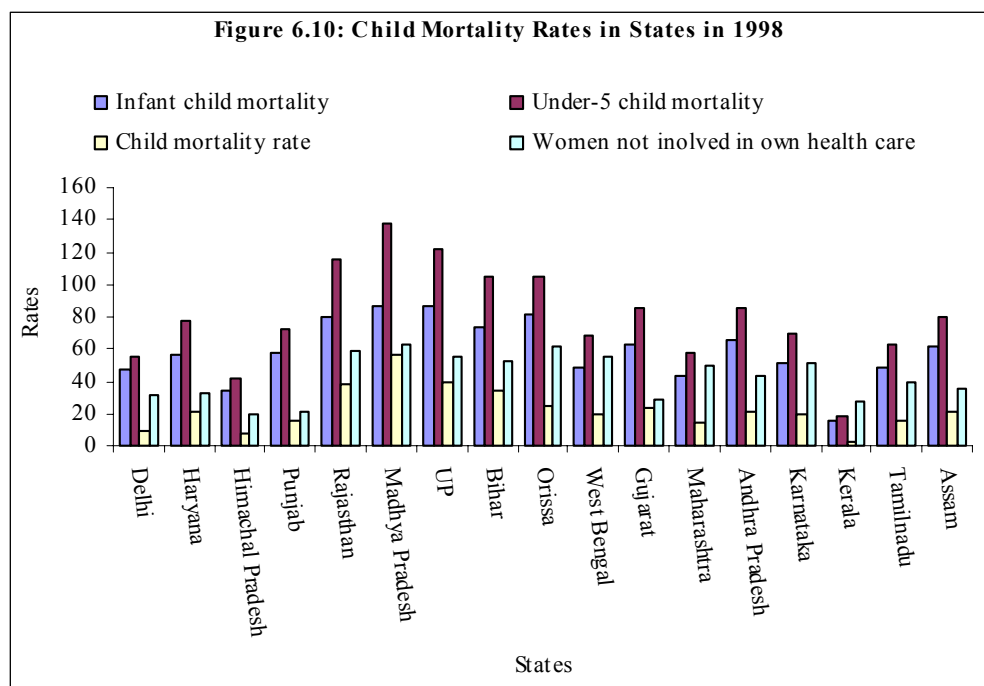
#### b) Under-five child mortality

The under-five mortality rate was also very high in UP and Madhya Pradesh compared to the other states. Only two states had a mortality rate of less than 50. About 15 states had mortality rates of more than 50 for children less than five years of age. It was much higher in the rural areas than in the urban areas, and significantly higher among the girls (about seven times more than that of Kerala) than with the boys. Since there are three states which have under-five mortality rates for girls more than 120, it is not just UP alone which would pull down the country's development (Table 6.6).

#### c) Child mortality rate

Is there any pattern in the child mortality rate (children between the ages of 1-5)? Is UP statistically an outlier among the states on this indicator? The child mortality rate in many northern as well as southern states is high and is higher for girls than boys. Among the northern states, the prominent ones are Haryana, Punjab, Rajasthan, UP and among the southern states of Andhra Pradesh and Tamilnadu. Even in Maharashtra, the rate is slightly higher for girls than for the boys.

Figure 6.10 shows the trends in child mortality rates in the different states of India. It also shows that in the states where the percentage of women not involved in decisions on their own healthcare (an indicator of women's autonomy) was high, the child mortality rates were also high. In a study on the status of women and child development including nourishment of children, Haddad (1999) found that the low status and low decision making of women influences child survival rates.



### 6.4.3 Child Labour in UP

Among the other child focused indicators, child labour is an important indicator on the state of the children in the society. Many ambiguities surround the definition of child labour (see Fares & Raju, 2007). There is also considerable vagueness on the definition of ‘child’ for the purposes of defining child labour. Some countries consider 14 years as the appropriate age limit for child labour, while some take 15 as the age limit. It is also not clear what work done in or outside the home, by the children, is acceptable as child labour. Despite these ambiguities and differences from country to country, the International Labour Organisation defines child labour as:

The term “child labour” is often defined as work that deprives children of their childhood, their potential and their dignity, and that is harmful to physical and mental development. It refers to work that:

- is mentally, physically, socially or morally dangerous and harmful to children; and
- interferes with their schooling:
  - by depriving them of the opportunity to attend school;
  - by obliging them to leave school prematurely; or
  - by requiring them to attempt to combine school attendance with excessively long and heavy work.

In its most extreme forms, child labour involves children being enslaved, separated from their families, exposed to serious hazards and illnesses and/or left to fend for themselves on the streets of large cities- often at a very early age (Hilowitz et al., 2004 p.16).

A large body of literature exists on child labour in the developing countries. This literature examines causes of child labour and its relation to economic growth, family income and child welfare. It views the existence of child labour in two aspects - positive and negative. The positive approach perceives the existence of child labour as a source of income generation for the family and a route to escape poverty, and learning of life skills by children. The negative approach examines it in terms of its negative impact on children, their schooling, their low human capital accumulation and exploitation (Gupta, 2001).

Many developing countries have not completely abolished child labour on the pretext that the income earned by the children is an important source of income for poor families. In India child labour (children less than 14 years of age) has not been banned fully on such poverty grounds. The government also expressed difficulties in abolishing it only through legislation (Government of India)<sup>88</sup>. Basu (1999) also argued that the abolition of child labour through legislation alone would not be effective, and more appropriate legislation would be compulsory education for all children.

Some studies have argued that the logic of low income and necessity of child labour is dubious (Weisbrot, Naiman, & Rudiak, 2002). According to these researchers, the developing countries have higher per capita incomes than the present developed countries when they abolished child labour in the 19<sup>th</sup> and 20<sup>th</sup> century. They argued that the ban on child labour would lead to increased wages of adult workers, more schooling of children, and thus would change the structure of the workforce. However, the present study believes that the outright abolition of child labour leading to increased schooling of children, as argued by these studies, appears to be too simplistic in the absence of adequate school infrastructure.

Despite the debates surrounding child labour, it continues to form a large proportion of the active workforce. Child labour in UP as proportion of the total child labour at all India level was 12.3 per cent in 1971 and increased further to 15.2 per cent in 2001. Seven major states of India altogether had almost 70 per cent of the total child labour in the country in 1971, which declined to 62.5 per cent in 2001. The decline in the child labour, which could be over reporting, has taken place in almost

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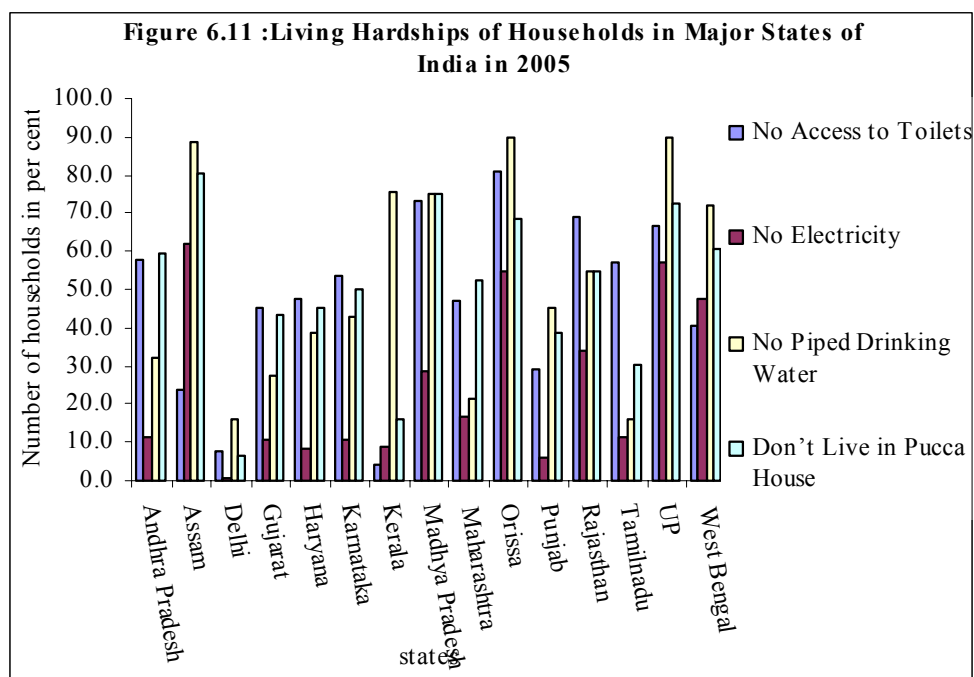
<sup>88</sup> In a recent legislation, in force from October 10, 2006, child labour in India has been banned from employment in roadside eateries, restaurants, hotels, motels, teashops, resorts or other recreation centers under the Child Labour (Prohibition & Regulation Act, 1986). The employment of children (under 14 years of age) as domestic servants is also banned (Government of India, 2006a).

all the states, except UP and Rajasthan. However, as a proportion of the total child population in the age group 5-14, it was five per cent in UP. In Rajasthan, Andhra Pradesh and Madhya Pradesh, the child labour was much higher at 10.2 per cent, 9.5 per cent and 8.3 per cent respectively (Table 6.7).

#### 6.4.4 Living Conditions in UP

A few useful indicators of the conditions of living in different states in India are availability of toilet facilities, access to safe drinking water, electricity and the type of housing. Ideally, it should be possible to construct a living conditions index, which could show the different dimensions of living conditions in a single numeric. However, the availability of these facilities varies from household to household and not all the four facilities may be available to a single household at the same time. Therefore, the present study shows the hardships of living in major states of India through a group of indicators. These are: households with no access to toilets, absence of electricity, lack of piped drinking water, and lack of houses made of strong materials like bricks and cement, also called *pucca* houses. Chapter 4 of the present study also pointed out that the type of material used in house construction is a living condition indicator and has been adopted by other studies as well.

In respect of hardships of living, UP though not performing well, is still not an exception, and stands at a comparative level with many other states (Figure 6.11).



The major trends in the living conditions in the states in 2005 are set out below:

- i) percentage of households with no electricity in 2005 in UP at 57.2 is almost the same as in Orissa (54.6 per cent). The vast disparity in the living conditions in the states is noticeable from the fact that in Punjab only 5.7 per cent of the households had no electricity while in Bihar 72 per cent of the households had no electricity;
- ii) more than eight states in 2005 had no access to proper sanitation facilities. More than 50 per cent of the households in these states had no access to toilet facilities. In Bihar, more than 75 per cent of the households lack this facility;
- iii) among the sources of drinking water, piped drinking water and the hand pumps are widely used in India. Piped water facility is easier to use and is easily accessible. In 2005, in eight states, more than 50 per cent of the households did not have access to piped drinking water, although their access to hand pumps was significantly high as the 1998 data shows. In 1998, only in one state, Kerala, more than 50 per cent of the households had no access to drinking water (piped or hand pump). This was because wells are the common source of drinking water in Kerala. This rises (as hand pumps were not considered in the survey in 2005) to eight states in 2005, which are mostly in the eastern and the central region of the country; and
- iv) in ten states, more than 50 per cent of the households do not live in houses built of bricks and cement. All the states have performed well on the urban front. It is in the rural areas primarily where the pucca houses are few.

Table 6.8 shows the trends in living conditions in major states of India for the years 1998 and 2005. The conditions of living have decreased from the 1998 levels, although not remarkably. In 1998 in 13 states, more than 50 per cent of the population was without pucca houses. By 2005, this had gone down to ten. Most of the improvement was in the access to sanitation facilities as the number of states with more than 50 per cent of the population without access to the toilet facilities dropped

from 12 to 8. In 1998, in five states more than 50 per cent of the households in urban and rural areas had no electricity. This dropped to four states in 2005.

### **6.5 Summary**

The section above showed the relative performance of UP compared to the major states of India through different non-income indicators. A variety of indicators relating to human development such as the status of women (including their health, education and empowerment) and health of children were chosen by the present study to examine where UP stands amongst the states. The present study also looked into a set of living conditions indicators or hardship indicators to examine whether UP, as claimed by the literature, was a lagging state. Chart 6.1 summarises the major findings on the non-income indicators considered in the present study.

A point which repeatedly emerges from the trends in various non-income indicators and the graphical displays, is that the states with higher per capita income have performed better in almost all the non-income indicators. This reveals that the income and non-income indicators are related to each other. Even though income is considered to be not necessarily related to the non-income indicators by many studies, in India the states with higher per capita income have done better than many lower income states on indicators related to women's development, child health, and living conditions.

Chart 6.1: Summary of Major Findings on Non-income indicators in UP

Non-income indicators	Findings in UP	Findings in Rest of the States
I. Status of women	low in UP	
i) Education	illiteracy high but GER increased significantly in recent years in most regions	Illiteracy highest in Bihar followed by Rajasthan; Illiteracy in Andhra Pradesh almost same as in UP
ii) Health	maternal care low in UP; cultural factors also govern women's health in UP	Maternal care in rest of the states though not good but better than UP
iii) Participation of women in workforce	low in UP	Low in high income states such as Punjab and Haryana, and also others such as Himachal Pradesh and even Kerala
iv) Indicators related to women's empowerment	low empowerment of women	Empowerment of women highest in Punjab and Himachal Pradesh; lowest in Bihar and other states such as Orissa, MP, Rajasthan, Orissa
a) decisions on own healthcare	high per cent of women not involved on decisions on their own health care	Percentage of women not involved in own health care decisions high in low income states such as Rajasthan, MP, Bihar and Orissa and even in high income states such as Maharashtra, Karnataka and West Bengal
b) awareness to urban media	an equal proportion of women lack any awareness of media	Lack of awareness of media was highest in Bihar, followed by Rajasthan and Orissa, UP and Assam
c) violence against women	violence against women in the family	Highest in Tamilnadu, followed by Bihar, Orissa, UP, Andhra Pradesh and Madhya Pradesh
v) attitudes and preferences of women for girls' education and preference for son vis-à-vis daughter	attitudes and aspirations better than the existing state of women	Attitudes/aspirations for girls' education highest in Himachal Pradesh, Kerala. UP in urban areas scored better than developed states
II. Child Health	low in UP	Child health poor in many states
i) child mortality rates	high in UP but declining gradually	Child mortality rates high in all states except Kerala
ii) child labour	high in UP but as percentage of child population low	Child labour/child population ratio high in Rajasthan, Andhra Pradesh and Madhya Pradesh and is much higher than UP
III. Living Conditions	not well and improvement over 1998 in post-reform period not significant	Living conditions poor in all states
i) Access to toilets	poor	Access poor in many states including developed states as Tamilnadu; good only in Kerala and Delhi
ii) Availability of piped drinking water	low but hand pump is more common in the state	Low in all states except Tamilnadu
iii) Availability of electricity	continues to be low as more than 50 per cent of households still live without electricity mainly in rural areas	Sharp variations in electricity in states. In southern and western region electricity is high. Bihar, Orissa, Assam and West Bengal access to electricity poor
iv) Live in Pucca houses	Poor housing conditions as more than 50 per cent of population lives in houses not made of strong materials such as bricks and cement	Except Kerala and Delhi in all other major states a high percentage of households do not live in pucca houses

### **Section III**

#### **6.6 Conclusion**

This chapter set out to explore whether UP is lagging and whether its laggardness<sup>89</sup> has effect on the growth and development of the country. This was examined in terms of income and non-income indicators. The analysis in the above paragraphs showed divergence of UP in terms of the income indicators which included per capita income, growth rate and ratio of credit to services to services output. The per capita income of UP was examined in terms of the per capita income in the developed states, emerging states and also other less developed states. Higher education and innovation (measured by number of patents) were not found to be the significant factors in explaining the variations in per capita income across the Indian states. The more important factors in explaining inter-state income variations are infrastructure and investment including bank credit. The present study showed that credit has certainly moved in favour of the developed states with higher per capita incomes.

In terms of the non-income indicators, it was expected that UP, being the most populous state and ‘lagging’ as repeatedly marked out in the literature, would negatively affect the development outcomes of the country. There are no fixed non-income indicators and different studies and different organisations such as UNDP, OECD and ADB (as shown in Table 6.3) have adopted different indicators depending on the context, place and subject of study. The non-income indicators selected in the study reflect human development (women and children here) and the living conditions in different states of India.

The findings of the present study suggested that except for maternal care, rest in all other indicators (includes status of women; child health), other states including even high-income states have performed similar or even lower than UP. For instance, violence against women is highest in Tamilnadu, and the low participation of women in the paid workforce is in Punjab. Even in indicators like discriminatory attitudes towards girls and their education, UP particularly in the urban areas, performed better than many developed states such as Maharashtra, Tamilnadu and Gujarat. The living conditions are also not favourable in almost all the states. Overall indicators showed

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<sup>89</sup> Derived from the word ‘laggard’ (noun) (Oxford Reference Online, 2005).



that the so-called quick reformer states also have also not done well on the development front.

The non-income indicators in UP have constantly and steadily improved over the years as the NFHS-2 (1998) and NFHS-3 (2006) findings have shown, though the pace of change is slow. It is in the income indicators front (including low bank credit) that the state has slowed in the post-reform period. The present study has repeatedly stressed the need to achieve higher growth rates to obtain better outcomes on both income and non-income indicators.

The next chapter summarises the findings of the study, lays down the policy implications and explores the way forward.

Table 6.1: Per Capita Income in UP in Relation to Selected States

(in per cent)

Years	UP/ Gujarat	UP/ Andhra Pradesh	UP/ Harya na	UP/ Mahara shtra	UP/ Tamilna du	UP/ Punjab	UP/ Rajasth an	UP/ West Bengal	UP/ Bihar
1993-94	50.7	69.2	45.5	42.3	57.6	40.4	81.7	77.0	172.4
1994-95	45.3	68.8	45.0	43.6	53.5	41.4	73.8	76.0	164.5
1995-96	44.4	66.8	45.6	40.5	53.0	41.0	73.7	72.9	198.4
1996-97	42.8	68.9	45.4	42.6	55.2	42.2	73.5	75.0	177.9
1997-98	41.5	69.0	44.8	40.2	50.3	-	66.1	68.7	185.3
1998-99	39.4	62.4	43.7	39.8	48.7	39.5	65.4	65.9	177.5
1999-00	41.7	62.1	42.9	38.1	47.8	39.3	67.7	64.4	181.4
2000-01	42.9	56.8	40.7	39.9	44.2	38.2	69.6	60.5	155.4
2001-02	41.0	54.9	39.9	38.9	45.9	37.9	66.2	57.5	176.2
2002-03	37.1	53.5	38.0	36.0	44.8	37.2	71.5	53.6	149.3
2003-04	33.9	52.1	36.9	35.3	44.8	37.3	66.3	51.7	168.8
Averages	41.9	62.2	42.6	39.7	49.6	39.4	70.5	65.7	173.4

- not available

Source: Basic data from CSO (2005).

Table 6.2: Ratio of Services Credit to Services Output in Selected States of India

(in per cent)

States	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Andhra Pradesh	25.7	26.7	30.2	30.2	39.6	39.9	45.9	52.3	64.3
Gujarat	17.8	18.3	19.9	20.2	23.0	30.5	31.8	31.4	36.7
Kerala	33.6	39.2	43.3	45.0	47.8	50.5	62.5	65.4	73.6
Haryana	16.3	17.0	18.3	19.6	22.2	22.9	30.1	35.4	41.4
West Bengal	22.8	23.1	22.6	22.4	27.6	29.7	39.0	37.6	41.7
Punjab	33.3	29.9	32.7	37.4	44.6	54.5	72.7	72.5	82.7
Karnataka	34.6	37.7	41.3	42.0	46.7	46.8	57.6	65.7	80.5
Tamilnadu	39.3	41.2	41.9	42.3	49.8	58.0	66.7	79.8	90.8
Rajasthan	14.0	16.2	19.3	20.3	24.0	25.9	35.5	37.4	45.7
Maharashtra	45.3	43.8	46.0	51.9	64.8	82.7	95.7	97.4	102.7
UP	17.0	18.0	20.5	23.2	26.0	27.6	36.5	37.9	47.1
Bihar	25.6	24.1	29.8	31.5	33.9	20.8	25.6	29.5	37.8
Orissa	21.2	21.3	24.1	26.8	24.7	32.9	44.8	52.4	63.8
Madhya Pradesh	25.9	25.9	27.6	25.7	32.0	30.1	33.3	39.9	47.0
Std	9.4	9.5	9.8	10.6	12.9	17.2	20.0	20.7	21.8

Source: CSO (2005), RBI (2004b, various issues).

Table 6.3: Summary of Indicators Adopted by Multilateral Organisations

Organisations	Income Indicators		Non-Income Indicators	
	Developed Countries	Developing Countries	Developed Countries	Developing Countries
World Bank	GNP per capita, consumption level	GNP per capita, Consumption levels	n.a.	A host of indicators including social exclusion
UNDP	\$11 a day \$4 a day	\$1 a day \$2 a day	i) Probability at birth of not surviving up to age 60; ii) Population lacking functional literacy skills; iii) Long term unemployment	i) Probability at birth of not surviving upto age 40; ii) Adult literacy rate; iii) Availability of improved water supply; iv) Children underweight under age 5
ADB*	n.a.	GNP per capita	n.a.	i) Education; ii) health; iii) nutrition; iv) environment; v) inequality indicators; and vi) urban/rural population indicators
IMF**	n.a.	n.a.	n.a.	n.a.
OECD	n.a.	n.a.	i) Tertiary attainment; ii) International student assessments; iii) Life Expectancy at birth; iv) Infant mortality; v) Obesity; vi) Indicators relating to work& leisure (number of hours worked, hotel bookings); and vii) Quality of roads, road accidents among others	n.a.
WTO***	n.a.	n.a.	n.a.	n.a.
Other Studies: Social Report 2005, New Zealand**	Income per capita to assess economic standard of living in New Zealand	n.a.	Total 42 indicators of social well being grouped into i) health; ii) knowledge; iii) civil & political rights; iv) cultural identity; v) leisure & recreation; vi) physical environment, safety and viii) social connectedness	n.a.

n.a.: not available.

Sources:

\* In its Key Indicator Series, an annual publication, Asian Development Bank (2006) adopts a host of indicators relating to developing countries and also separately for rural and urban population.

\*\*IMF is involved mainly with macroeconomic imbalances, financial development, external imbalances and investment climate. No information on non-income indicators is available.

\*\*\*WTO with 149 members' deals with the rules of trade between the nations and the reference to development and its indicators occurs in its World Trade Report 2003 (WTO, 2003). These development indicators are mostly those constructed by UNDP in its Human Development Report.

\*\*\*\*For Indicators of social well being relating to New Zealand see, Ministry of Social Development (2005).

Table 6.4: Enrolment of Children in Primary Schools in Different States of India

States	Gross Enrolment Ratio		Percentage of Girls Enrolled		
	2003-04	2004-05	2003-04	2004-05	% variation
Andhra Pradesh	86.63	96.54	50.2	49.8	-0.8
Assam	85.51	99.92	49.2	49.1	-0.2
Bihar	76.20	91.05	43.9	44.5	1.4
Gujarat	91.35	95.68	47.2	47.4	0.4
Haryana	51.81	59.08	48	48.2	0.4
Himachal Pradesh	111.30	109.35	48.8	48.7	-0.2
Karnataka	106.23	106.95	49.7	49.4	-0.6
Kerala	89.08*	76.44*	49.7	49.7	0.0
Madhya Pradesh	93.04	116.28	47.9	48.3	0.8
Maharashtra	102.41	84.31	47.6	47.4	-0.4
Orissa	109.16	116.14	48.4	48.4	0.0
Punjab	-	73.16	48.1	47.3	-1.7
Rajasthan	87.5	100.2	46.9	47.5	1.3
Tamilnadu	106.25	114.83	48.6	48.6	0.0
UP	85.68	98.33	47.6	48.0	0.8
West Bengal	103.43	106.37	49.5	49.6	0.2

- not available. \* : Low GERs in Kerala is due to non-availability of data on some of the districts.

Source: Mehta (2006).

Table 6.5: Gross Enrolment Ratios in the Districts of UP

Sr. No.	Districts of UP	Literacy Rates	Gross Enrolment Ratios		Sr. No.	Districts of UP	Literacy Rates	Gross Enrolment Ratios	
			2002-03	2004-05				2002-03	2004-05
1.	Allahabad	62.89	55.4	62.6	36.	Etawah	70.75	69.2	94.0
2.	Ambedkar	59.06	100.5	101.4	37.	Farrukhabad	62.27	74.1	89.0
3.	Azamgarh	56.15	76.5	101.4	38.	Firozabad	66.53	77.5	77.4
4.	Bahraich	35.79	80.0	93.6	39.	Gautam Budh Nagar	69.78	50.3	63.1
5.	Ballia	58.88	88.0	95.4	40.	Hathras	63.38	53.8	78.5
6.	Basti	54.28	124.2	91.1	41.	Jyotiba	50.21	87.3	92.3
7.	Balrampur	34.71	72.8	96.2	42.	Mainpuri	66.51	72.2	85.3
8.	Chandauli	61.11	78.3	89.6	43.	Mathura	62.21	67.8	75.2
9.	Deoria	59.84	68.0	79.2	44.	Meerut	65.96	42.4	45.3
10.	Faizabad	57.48	72.3	88.1	45.	Moradabad	45.74	85.0	95.3
11.	Ghazipur	60.06	80.8	84.8	46.	Muzaffarnagar	61.68	40.2	57.0
12.	Gonda	42.99	89.2	98.0	47.	Pilibhit	50.87	92.4	92.2
13.	Gorakhpur	60.96	55.9	74.7	48.	Rampur	38.95	-	99.2
14.	Jaunpur	59.98	86.6	91.1	49.	Saharanpur	62.61	59.0	67.9
15.	Kushinagar	48.43	72.6	100.8	50.	Shahjahanpur	48.79	85.6	94.3
16.	Maharajganj	47.72	87.2	97.9	51.	Auriya	71.5	65.9	95.7
17.	Mau	64.86	83.9	96.3	52.	Barabanki	48.71	80.9	107.0
18.	Mirzapur	56.1	-	-	53.	Hardoi	52.64	112.5	118.4
19.	Pratapgarh	58.67	87.5	107.0	54.	Kannauj	62.57	71.2	79.4
20.	SKNagar	51.71	60.9	70.0	55.	Kanpur Dehat	66.59	70.1	91.4
21.	SRD Nagar	59.14	-	-	56.	Kanpur Nagar	77.63	37.5	54.5
22.	Shrawasti	34.25	87.2	100.7	57.	Lucknow	69.39	48.8	57.9
23.	Siddharthnagar	43.97	73.8	82.1	58.	Raebareli	55.09	75.7	82.9
24.	Sonabhadra	49.96	80.0	87.9	59.	Sitapur	49.12	79.5	88.9
25.	Sultanpur	56.9	86.0	92.0	60.	Unnao	55.72	81.9	90.0
26.	Varanasi	67.09	50.5	58.8	61.	Kheri	49.39	86.7	94.8
27.	Agra	64.97	64.5	66.1	62.	Banda	54.84	82.6	94.5
28.	Aligarh	59.7	54.7	60.5	63.	Chitrakoot	66.06	85.0	108.4
29.	Baghpat	65.65	59.5	54.0	64.	Fatehpur	59.74	81.5	89.2
30.	Ghaziabad	70.89	32.1	51.1	65.	Hamirpur	58.1	82.2	90.5
31.	Bareilly	47.99	77.0	77.7	66.	Jalaun	66.14	79.7	88.4
32.	Bijnor	59.37	72.7	76.6	67.	Jhansi	66.69	77.2	84.7
33.	Budaun	38.83	84.8	95.1	68.	Kaushambi	48.18	74.1	88.5
34.	Bulandshahar	60.19	63.6	66.3	69.	Mahoba	54.23	95.1	103.0
35.	Etah	56.15	87.4	94.0	70.	Lalitpur	49.93	99.9	106.4
	<b>State Overall</b>	56.3	-	98.33					

-: not available.

Source: Registrar General of India (2002a), DISE (2006).

Table 6.6: States' Performance in Child Health Indicators

Rates Intervals	Indicators	IMR	IMR -B	IMR -G	IMR -U	IMR -R	UR5	UR-R	UR-U	UR-B	UR-G	CM R-B	CM R-G	CM R-U	CM R-R
	States														
< 20		1		1	1		1		1			9	5	12	5
20-30			1			1		1			1	6	6	5	6
30-40		1		1	3	1				1		1	2		2
40-50		4	2	2	6	1	1	1	4		1	1	1		2
50-60		3	5	5	3	2	2		4	2	1		2		
60-70		3	2	3	2	4	3		3	4	2		1		1
70-80		1	2	1	2	4	3	3	1	1	3				
80-90		4	1	3			2	3	2	3	2				
90-100			4	1		2		2	2	1	2				
100-110						2	5	7		1	1				
110-120										1	1				
120>										3	3				
No. of States		17	17	17	17	17	17	17	17	17	17	17	17	17	16
<50		6	3	4	10	3	2	2	5	1	2	17	14	17	15
>50		11	14	13	7	14	15	15	12	16	15		3		1

Note: IMR- Infant Mortality Rate (IMR); IMR-B: Infant Mortality Rate - Boys; IMR-G : Infant Mortality Rate - Girls; IMR-U: Infant Mortality Rate - Urban; IMR-R: Infant Mortality Rate -Rural; UR 5- Under 5 Mortality; UR-R: Under 5 Mortality -Rural; UR-U: Under 5 Mortality - Urban; UR-B: Under 5 Mortality- Boys; UR-G: Under 5 Mortality-Girls; CMR: Child Mortality Rate; CMR-B: Child Mortality- Boys; CMR-G: Child Mortality Rate- Girls; CMR-U: Child Mortality Rate- Urban; CMR-R: Child Mortality Rate – Rural.  
Source: compiled from NFHS (2001).

Table 6.7: Share of Child Labour in UP and Other States in Total

States	(in per cent)				
	1971	1981	1991	2001	% to child population (5-14 years)
UP	12.3	10.5	12.5	15.2	5.0
Andhra Pradesh	15.1	14.3	14.7	10.8	9.5
Tamilnadu	6.6	7.1	5.1	3.3	4.5
Madhya Pradesh	10.3	12.5	12.0	8.4	8.3
Bihar	9.9	8.1	8.3	8.8	5.8
Rajasthan	5.5	6.0	6.9	10.0	10.2
Maharashtra	9.2	11.4	9.5	6.0	4.4
All India	69.0	69.9	69.0	62.5	6.2
Kerala	1.0	0.7	0.3	0.2	0.6

Source: Government of India (2006c).

Table 6.8: Trends in Living Conditions in the States in India

Households (in per cent)	Number of States							
	No Access to Toilets		No Electricity		No Piped Drinking Water		Don't Live in Pucca Houses	
	1998	2005	1998	2005	1998	2005	1998	2005
0-25	2	3	7	9	11	3	2	2
25-50	2	5	4	3	4	5	1	4
50-75	9	7	4	4	0	3	8	7
75-100	3	1	1	0	1	5	5	3
Total states	16	16	16	16	16	16	16	16
>50	12	8	5	4	1	8	13	10

Source: NFHS (2001; 2006).

## **CHAPTER 7**

### **CONCLUSION**

#### **7.1 Introduction**

The present study challenged the shift in the thinking on the state in the nineties and espoused a reasoned, balanced and moderate picture of UP in contrast to the negative and extreme approach of the recent literature on the state. This negativity in the current literature was due to its sole focus on UP's poverty, human development and stagnation and overshadowed the achievements of the state. The present study by eschewing the watertight categorisation of east and west UP as usually pursued in the literature and adopting a broader regional categorisation of the state showed that change has occurred in UP although gradual.

The present study used bank credit as a tool to explore the changes and structural and regional shifts in the state. This was examined within the framework of multidimensional variables as growth, globalisation, urbanisation, inequality, development and empowerment, which the present study called as G-GUIDE of credit. The study further explored the relationship between bank credit and state's human development. The present study thus, achieved its twin objectives which were: i) synthesis and amalgamation of various streams of literature; and ii) filled the gap in the literature by setting out the role of bank credit. The contribution of the study to the existing literature was, therefore, twofold: i) contribution to the existing studies on UP; ii) contribution to the literature on banking in India.

The forward looking, yet balanced, approach of the present study showed the multiple dimensions of the development of UP. The chapters from 2 to 6 in the study examined its economic growth, bank credit, structural change including growth of the services sector, trends and pattern of migration and urbanisation in the state. As a critique of the current literature, the study also examined whether UP is a lagging state. The present chapter concluding the study has limited objectives. It brings together the various findings of the study, suggests policy implications, and offers a way forward.

As in the previous chapters, this chapter also, to achieve better clarity and focus, is organised into three sections. Section I summarises the major findings of the

study. Section II draws any policy implications of the study and section III spells out the agenda for further research.

## **Section I**

### **7.2 A Recap of the Study**

As noted in the beginning of the present study, the existing studies on UP focused exclusively on poverty and human development in the state. The poverty focused literature though glorifying the state's poverty and using it as a 'poster state' on underdevelopment did not consider UP's physical and economic environment. It also did not consider the economic reforms introduced by the state government. The present study, therefore, at the outset, reviewed comprehensively the state's physical and economic environment. An overview of its physical setting showed that the state is well endowed with natural resources and fertile soil, and leads in agricultural output in the country.

Nevertheless, these physical attributes camouflaged certain constraints on the state's economic growth and development which the present study termed as structural and non-structural. The principal structural constraints which the present study identified were: disproportionate size of the land area and large population of the state; landlocked from all sides, and distant from the sea. Another constraint, structural in nature and ignored in the literature on UP so far, is the so called 'neighbourhood effect'. The present study noted the state's poor 'neighbourhood', as it is surrounded by other less developed states on all sides except the western region. The other constraint, although not structural but long-term in nature, is the composition of the population. Due to the highest birth rate in the country, the dependency ratio is very high in the state leading to a lower working age population. This ratio is a crude indicator of employment, as it does not reflect the child labour in the state, the high percentage of women who do not participate in the paid workforce, or the unemployment in the state. The current high dependency ratio, though a constraint at present, is a future asset, as the populations of many other states will be ageing.

The present study also identified the primary non-structural constraints in UP. These are: high fiscal deficits which leave fewer resources with the government for



development purposes; lack of investment such as credit; and high population per bank branch particularly in some districts. Other major constraint on the state is large economic disparity including disparities in infrastructure across the state's regions, leading to different patterns of industrial and agricultural development in the regions. The present study showed that these regional and intra-regional disparities within the state moulded and shaped the current pattern of structural change in the state.

The present study strongly believes that while the non-structural constraints are alterable and outcomes can be changed, the structural constraints are also not entirely beyond the control of the government. For instance, although the land area is given and fixed for the state, efforts have been made to improve the quality of the agricultural land to increase agricultural output. Similarly, the effect of the poor and less developed neighbours can be worked upon and development barriers can be reduced through determined strategic cooperation among the less developed states. Even proximity to the coastal areas does not necessarily translate to growth as is in the case of Orissa in India, which is close to sea, yet is less developed. The present study showed that to correct non-structural constraints the state government in the recent years took measures to reverse the downturn in the state's growth rate, and introduced economic reforms.

The outcomes in state's real economic growth, not positive in the post-reform period led some studies to label UP as 'lagging'. A careful interpretation of the term lagging by the present study showed that it is a comparative term and refers to the slow pace in relation to others. As against the swift pace of structural change in the rest of the states in the post-reform period, in UP the real growth rate was slow. The present study adopted income indicators such as per capita income; growth rate; and investment measured by the ratio of credit to services sector to services output, to examine the laggardness of the state. The laggardness was evident as the per capita income and real growth rate slowed compared to some fast moving states.

This study examined the claim of 'lagging' in the literature by looking at not only the income indicators such as growth rate as is usually shown, but also analysed laggardness thoroughly by exploring the non-income indicators. The non-income indicators are defined differently by various studies based on their objectives and context. The present study used three broad non-income indicators. These were status of women; child health; and living conditions across the states and UP in particular. The present study demonstrated through this indicator approach that the tag of

'lagging' associated with UP in the literature can be justifiably extended to other states as well including even the high-income states. The living conditions indicators considered in the present study also do not vary significantly across the states and over the years have not shown any significant improvement. The present study showed that laggardness in living conditions exists in all the states except Kerala and Punjab.

To break free of the tags of 'lagging' and BIMARU attached to UP in the literature, the present study highlighted the significance of high economic growth. This study found that the income and non-income factors in India are correlated. The present study for instance, found that the relationship between the Human Poverty Index (HPI) and per capita income is strongly negative. The strong negative correlation showed that the higher the HPI, the lower the per capita income. Therefore, the present study concluded that income is an important factor in explaining the low outcomes on the non-income front. This also proves the importance of higher and faster economic growth in UP.

The present study traced the reasons for the current emphasis in the literature on poverty and human development in UP. It found that the origin of this current emphasis lay in the evolution, growth and subsequent frictions in the various decades in the theoretical literature on economic development, banking, capital accumulation and inequality. The friction in the literature, reflected even at the policy level, shows the interaction between the two. The review of the literature also highlighted the origin and causes of the financial sector reforms; shift in the banks' focus to efficiency and profitability from the earlier developmental objectives; and the decline in credit. It also showed the shift in focus from physical capital to human development. This friction was reflected in the inequality literature, which also wavered between income and non-income indicators. The concepts - development and inequality - broadened in almost all fronts. The banking literature, however, narrowed its focus exclusively to growth.

As the present study showed, the two aspects that emerged from the above theoretical developments were firstly, interaction of theoretical developments and changes in policies; and secondly, integration and the disintegration of the four streams of literature on development, banking, capital accumulation and inequality. It is this evolution, interaction and moulding of literature that led to the focus of the studies on UP on its poverty and low human development. The broadening of the

literature on development, however, led to a narrowing of the scope of the studies on UP as they repeatedly and persistently emphasised the state's poverty and its low human development. It also led to the failure of a stream of current literature to recognise that changes are occurring in the state. It failed to observe that credit and access to credit, has declined.

The existing literature on UP not only solely focused on human development and poverty but also projected the state as a stagnant and static economy. In contrast, the present study forsaking the rigidity and extreme stance in the current literature showed that change is taking place in UP though gradually. It took bank credit in the state as a tool to show the changes taking place in UP's economy. It showed changes by adopting a broader perspective of credit, than that of the current literature. As against the narrow focus of the existing studies which relate credit only to growth, the present study taking a broader and disaggregated approach related credit to many development indicators besides growth. As pointed out in chapter 1 of the present study, in the few studies on credit in India which observed divergence in credit to the states, the treatment of UP was very fragmentary as they had taken an aggregate approach.

In contrast, the present study analysed bank credit comprehensively at an aggregate and disaggregate level, that is, country, states and UP level. Further, it took into account the spread of credit to various regions, districts, occupations, rural and non-rural areas of UP, and even a gendered distribution of credit. This multi-purpose and multi-dimensional picture of credit revealed that bank credit could be a source of growth (G); globalisation (G); urbanisation (U); generate inequalities (I) between rural and urban areas and small and large borrowers; a source of development (D); and could lead to the empowerment (E) of women. The study termed these multiple roles as the G-GUIDE of credit.

Credit, within this framework as set by the present study, generated growth in UP and helped in poverty reduction. It however, perpetrated regional inequality, rural-urban inequalities, and widened the gap between the small and large borrowers. The empowerment of women through credit remained a distant goal. The limited data available on the gender distribution of bank credit showed that more than 80 per cent of the credit was to men, and women received less than 20 per cent. Another channel through which the economic empowerment of women can take place is through microcredit by the self-help groups (SHGs). The study found that not only is bank

credit unable to reach women, but even microcredit is paltry in UP due to the inadequacy in the outreach of SHGs. The study showed that the findings on G-GUIDE of credit were at similar levels for the country, other states, and for UP.

The present study, based on the economic achievement of the states, classified the states as high, medium, low, and emerging achievers (as these states are achieving high growth rates in recent years). The study examined credit and output of these states and observed that credit was high in the high achiever states and even the credit-deposit ratio in these states was very high. These high achiever states also had dynamic fast growing metropolitan cities with high credit-deposit ratios. Excluding the metro cities, the credit-deposit ratio is mostly similar to the rest of the states although still higher than the less developed states.

This credit inequality in the states led to an increase in the share of the informal or non-institutional agencies. The inequalities were between not only rural and urban areas, but also small and large borrowers. Credit to small borrowers was lower in the high poverty states, and the reverse in the low poverty states. The low presence of SHGs in the states with high rural and urban poverty showed that credit is not assisting in the development of these states.

Regarding UP, the present study observed that a sectoral and regional redistribution of credit has taken place in the nineties in UP. The sectoral redistribution of credit indicated that credit moved away from agriculture and industry to the services; and the regional trend was from the western to the eastern region. In contrast to the implicit inertness and stagnancy in the literature on UP, the present study as an evidence of change showed the two shifts which took place in the state. In shift I credit and output moved from central to the western region and in the second shift from the western to the eastern region.

As noted earlier, a stream of the current literature on the state has been critical of the state's human development. The present study therefore, examined whether this impedes the access to bank credit in UP. The findings suggested that there was a weak correlation between education and credit. The present study, however, observed that educational achievements in the rural areas did matter in comprehending complex issues like WTO and its impact on agriculture.

The present study showed changes and shifts in the state not just in sectoral and regional distribution of credit, but also observed that these changes, and the inter-regional and intra-regional disparities within the state as pointed out in the study

earlier, were all influencing the structure of the economy. The change in the structure of the economy or structural change, as usually called, is a broad concept and implies change not only in the economic structure of the economy but also social and even political change. Economic change involves a shift in the composition of output and employment from agriculture to industry and subsequently to services. Contrary to this, in UP and many other states of India, the structural change was from agriculture to services. The slow pace of shift in output in UP, regionally and occupationally, marred the positive aspects of shifts in credit to the eastern region from the western region.

The present study noted that services in the states and also in UP are associated with the levels of urbanisation. The more urbanised states have a higher share of services. The present study analysed the growth and composition of the services sector in UP, both in its regional spread and across the population. The services in the state have risen but with a difference from the overall country. The reason lies in diversity in the state. Different patterns of development exist in the state's regions (includes western, eastern, central and Bundelkhand region) and there is a lack of any integration among these regions. The different patterns of services growth in the state's regions is an evidence of this regional predisposition. In the western region, the study found that credit and output of the services sector was the highest in the state. The roots of this are traceable to the region's agricultural development and growth of the non-agricultural sector. In the central region services growth and its output was concentrated in two districts, Lucknow and Kanpur. The growth of services in the Lucknow district is due to its being the state capital. The effect of the state capital led to the demand for a better educated population including professionals such as doctors, hospitals, schools and colleges. This led to the rise in the services in this district. The industry in the Kanpur district gave rise to services.

In sharp contrast to the myopic view of the existing studies which focused only on its poverty and human development and were oblivious of many aspects of state's development, the present study notes that the regional disparities and fragmented and disintegrated development is blocking the path of UP's growth and development. The growth impulses of the western region failed to spread to the eastern and other regions in the earlier years. On the contrary, the western region, like a parasitical development, drew away resources from the other regions, including credit and even state resources. Thus, overall, a two fold explanation of services

growth in UP is: a rise in agriculture in the west; and the effect of the state capital in the central region.

Taking forward the disaggregated approach and seeking evidence of change in the state the present study examined the overall trends and pattern in the services sector and also its further breakdown in the state. The present study thus observed that composition of the services sector also has important implications for UP's structural change. The rise in communications output in many states was accompanied with a rising share of trade, and hotel and restaurant occupancies. In UP, however, the rise in the share of communications, although lower compared to other states, was accompanied by a decline in trade, indicating that the communications and economic activity, including business, did not move together. Thus, although the services sector rose in the state, its composition was not growth oriented. Much of the growth in services was in the unorganised sector. Unorganised services are buoyant in the state and are assisting in poverty reduction.

A hallmark of the present study was to examine credit as the source of change in the state. In this context the study considered an array of variables which displayed the multi-functional role of credit. To situate the extent of the role played by credit and also to examine the change, the present study not only examined the overall services sector and its components but also looked closer at its financing by the banks in UP. In this context the present study noted that the financing of the services sector on an aggregate has not been explored in the literature so far. The study found that a mixed trend in credit to services sector prevailed in the state. Credit for some major service activities such as trade declined. Increased activity was in the housing in the state, which should have led to increased employment and rural-urban migration, however, studies suggested that rural workers were not migrating to the urban areas and labour from other neighbouring states, mainly Bihar, was filling the gap.

The social change is also taking place in the state, although again gradual. The birth rates, death rates, infant mortality rate and maternal mortality rate all declined but at a slow pace. A positive aspect of these changes in the state was a steady downward trend in all the ratios. The gross enrolment ratio in the primary schooling also rose sharply in the state.

Summing up, the present study explored the role of banks in the economic development of UP. By examining various dimensions of credit, the present study highlights that credit is not just an act of lending, but could lead to a whole range of

other changes not related necessarily to income. Although in the current literature microfinance is associated with development, credit by the banks also implicitly performs a similar role. The study does not suggest that bank credit is less relevant for growth; nor is its allocative and efficiency functions challenged. The study certainly highlights the other developmental roles of credit, which remain implicit and have not been approached in the earlier research.

The balanced approach of the present study leads it to consider the positive and negative factors involved in the state's economic development. The positive features considered in the study showed that regional output and credit has been shifting to the eastern region.

## **Section II**

### **7.3 Policy Implications**

The present study highlighted the issue of development of the less developed regions, an issue that is at the very heart of the reforming economies. It threw open a question for wider discourse: Will the faster economic growth achieved in reforming countries like India be all-inclusive, or is targeted at only a few states or regions?

The present study emphasises that some of the major keywords of the study such as development, economic growth, regional inequality, urbanisation, empowerment and globalisation have a deeper implication for the state. Lack of growth for the state implies low incomes, poverty and hardships of living. Lack of development indicates high poverty and high infant mortality rate. Lack of equality across the regions mean some regions suffer from lack of growth while others prosper; and a widening rural-urban divide. Empowerment means little to the disempowered population of the state, mainly women in the present study's context. There is a lack of credit empowerment among the women due to inadequate outreach of SHGs and a low reach of bank credit. UP's readiness for globalisation has meant little for the state's illiterate population. The policy implications of the present study therefore, evolve around the above keywords.

Referring to the increased western interest in slum tourism in Kibera, a slum in Nairobi, Kenya, it was remarked, "But people just want to talk about poverty, poverty, poverty all the time" (Cawthorne, 2007, p.B3). In a similar vein, though in a different context, the present study reiterates that in UP, the increased emphasis should be on

growth, growth and growth, rather than poverty. The present study had observed the strong negative relationship between income and non-income indicators including HPI and per capita income; and other indicators such as, child health indicators, women's development, and living conditions and per capita income. It is, therefore, high economic growth which matters; so the policies have to strongly focus on growth. The widespread perception that UP is a laggard and a burden, will change when growth occurs. High economic growth will alter not only the economic performance of the state, but also the social indicators. Consistently high economic growth would even influence the fertility rate, eventually reducing the birth rate as has occurred in other states of the country.

India is currently undergoing demographic change, a factor considered by the policymakers while framing and enacting policies on the issues surrounding education, health, employment, and growth. As the present study noted, this transition, at present, is in the more developed states and the developing states such as UP are not yet on the path to transition. For the country, the differential paths of demographic transition within the country are advantageous as it can reap the benefits of the availability of a young working population for a long time. Demographic change, however, underlines the need for investment in education and health, particularly in UP.

As mentioned earlier, the structural constraints facing the state are substantial but so are the non-structural constraints. Removing the non-structural constraints would unleash the path to growth and development. As pointed out in the study the fiscal constraints; and a lesser number of bank branches in the state resulting in high population coverage per bank branch; and regional infrastructural constraints, are some of the non-structural constraints confronting UP.

A more comprehensive growth strategy would be to work upon the states surrounding UP to limit negative growth spillovers, and maximise the positive development effect on the state. A more novel strategy would be for these states to cooperate and form a unified approach to push economic and social development. Such a determined approach to weed out the negative spillovers by focusing on growth and development would lead them on to higher growth paths. However, poor governance, different regional political parties in the concerned states and their own stakes, and lack of consensus, all contribute to rule out any such initiative.



The persistently negative and prejudiced approach to UP prevents from rationally judging the situation and applying the correctives. The hallmark of the present study was, therefore to adopt a balanced approach. The positive outcomes and changes noted by the study were shifts in credit and output from the western to eastern region and from the agricultural to the non-agricultural sector in the western region. Credit performs multiple roles, such as globalisation, development and empowerment and can help the state to grow.

The policy implication is: for credit to assist in multiple roles, it should increase. As the present study found that about 93 per cent of the districts of UP have per bank branch population much above the national average of 15,000. This calls for establishing more branches in the state to reduce the population per bank branch, and improve bank branch density. This does not include ATMs or other modes of banking, which are not so popular and are sparse in the state.

For services to be the lead sector of the economy in UP as it is in many developed states, the growth oriented services such as retail and wholesale trade, business services and banking services, need to increase. The infrastructure, sound investment climate, and commitment to economic policies and reforms, have to be put in place for the growth of the services sector in UP.

### **Section III**

#### **7.4 The Way Forward**

As Fisher (1939) raised the question “---in what direction is it desirable at this stage of our history to accelerate the rate of economic development?” (A. Fisher, 1939, p.30). A similar question in the context of the present study can be: in what direction should the future research agenda be for the state’s economic growth and development?

A question not covered in the present study, but with wide implications for the country currently is, considering the persistently low growth rate of UP, will equalising the growth rate across the states lower the overall national growth rate? This question assumes particular importance as India has been achieving high growth rates and this superior performance of the country is UP exclusive. Will a more UP-inclusive performance, with investments more spread out to the less developed states, lower the growth momentum of the country?

In discussing the multiple dimensions of credit and its potential in achieving higher growth and development, the present study did not consider the issues of profitability of banks. It can be examined further how the G-GUIDE of credit as highlighted by the present study and the banks' own compulsions and requirements to achieve profits and yet maximise these outcomes can be integrated.

The other research agenda is the issue of demographic transition and the financial sector. As shown in the study, the demographic transition presently occurring in other states of India will, in time, take place in UP. How will this transition influence bank credit? Also, the need for additional bank branches or promotion and development of other modes of banking can be examined by further studies.

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