Our Delhi Letter

Regional Development and National Integration

WITH the increasing attention being paid to national integration, balanced regional development — which in essence is the economic content of national integration—has assumed special significance. Though a 12-page chapter entitled "Balanced Regional Development'' has been included in the voluminous Third Five Year Plan, it is felt in the Capital that the issue has not been clinched and needs further examina. tion A valuable contribution to the subject has been made by Professor Louis Lefeber of the M I T Department of Economics in a paper entitled "Regional Allocation of Resources in India". The author formulate his ideas after discussion with Professor Thomas Balogh of the Oxford University and members of the M I T India Project and submitted them to the Planning Commission for consideration.

Professor Lefeber is of the view that in the context of a planned economy conscious policies to maintain efficient regional resources allocation are crucial for economic growth as also for achieving social finals, particularly to increase employment opportunities. According to him, "in order to provide sufficient increase in employment opportunities to keep abreast of unemployment in the future, capital formation would have to take place at a rate faster than it did during the Second Plan or foreseen in the Third Plan. Increased capital formation must be matched, however, with corresponding increase in saving''. Professor Lefeber suggests that this could be achieved through fiscal policy and rigorous observation of the rules of efficient resource use.

Untenable Assumption

Through fiscal policies, it could be ensured that those who enjoy regular incomes.' including earners at the minimum acceptable level, should not appropriate further benefits from development as long as largescale unemployment exists. However', efficiency in resource use as a method for increasing savings is not properly underlined as it is assured to be assured by the working (of competitive markets. This is an untenable assumption in a country like India where competitive market checks *do* not exist. Efficient resource use ensures increased investment potential in the short run because more projects can be executed with the same amount of resources and increased savings in the intermediate run because returns on investments will be larger. The combined effects will be to accelerate the rate of growth and employment.

Regional distribution of resources is an important aspect of overall efficiency in allocation. The question is. what are the principles which should govern regional allocation? In the very nature of the growth process, there lies a conflict between national and regional goals: on the one hand, every region wants to develop as fast as possible; on the other hand, rapid national growth may require the concentration of investment in particular areas which are better endowed with natural resources. Also there is a powerful motive to agglomerate industrial investment at selected areas because of external economies, consisting of sharing the same *Infrastructure* and social overhead facilities. The rapidly growing areas can yield larger surpluses for future investment, the good part of which must be used initially to maintain growth in these centres. Rut as new investment outlets are needed, more and more resources can be channelled to the development of other areas.

Paradoxical Conclusion

Thus it is a paradoxical conclusion that for developing; the retarded areas the growth of the more advanced regions must be encouraged. If the latter is stifled because of insufficient investment, surpluses will be insufficient and stagnant regions which are unable to raise their own savings must be doomed to an even longer period of waiting and poverty. However, it does not imply that some areas should receive all the attention and others none It is a matter of social decision to what degree the benefits from realised progress should be used to bring immediate relief to those who are not only under-privileged but also tied by immobility to their retarded regions. The question is how to realise such an object in a way which is compatible with the goal of maintaining a high rate of national economic growth and rapid elimination of unemployment. Professor Lefeber warns that "extensive efforts to increase regional balance would interfere with the desired rate of development''.

Industrial investment is not the only way to increase regional betterment of living standards. This conclusion is best substantiated by the Punjab, which did not have a single big industrial enterprise, except the Nangal Fertiliser Factory, during the two Plans period, but still has the highest per capita income in the country. The author suggests labour intensive projects to be undertaken in retarded areas. "Even if five million people would benefit on a rupee a day basis. the total annual cost, over two hundred days a year, including organisational and capital expenditure, should not exceed say 1.5 billion rupees. Whereas this is still a considerable monetary commitment, the real resources equivalent is very low. This is so because a very large part of the total expenditure would have to be matched by foodgrains provisions which in turn could be covered by P L 480 supplies."

Political Pressures

Unfortunately State Governments frequently compete for certain types of industrial investments not on economic grounds but out of political necessity or misguided eagerness. Rational economic evaluation of regional production patterns and real cost-benefit calculations would demonstrate that many of these projects are wasteful both from the point of view of the nation and the States. The national interest is to make use of the economies of large-scale production, standardisation and other advantages in order to achieve efficient resource utilisation for any desired level of output. The States' interest is to obtain the largest return on whatever investment funds are available to them.

Frequently; less resources if skilfully employed can accomplish more for the welfare of the local population than badly located larger investments.

Correct allocation of industrial investment also involves the application of the competitive principle particularly when Government ownership is prevalent. In India, free market determination of prices may not be desired because of the distortions that might be caused by the prevailing income distribution and certain shortcomings of free market. The price system must, therefore, be adjusted suitably to reflect desirable conditions of production and marketing either in real or in a "shadow" price system. In the context of regional allocation of resources three pricing rules should be followed. First, prices of commodities and rates for services should reflect real costs (including real interest and foreign exchange rates) at the place of production. Second, prices of homogeneous goods should be the same at a given location and when the commodity has to be transported, the difference in price should not lie greater than the cost of transportation. Third, the choice of location for investment allocation should be such that the present discounted value of the project is at a maximum (basing the computation on real costs and interest).

Violation of these principles leads to wasting of resources. As an illustration, railway rates for certain commodities like coal are below cost of hauling and total revenues barelv cover total railway expenditures. The result is that railways cannot finance badly needed improvements and new railway investment fails to keep up with the demand for transportation. Also new location decisions by investors are made in terms of the money cost of transportation rather than the real costs; hence, they have no incentive to seek out the most economical location and production costs must increase consequently. According to Professor Lefeber "the remedy is to undertake a, say, five-year programme to 'rationalise' the rate system". Similarly the "equalization fund" for the' steel and fertiliser industries would lead to over-utilisation of the inefficient units and the underutilisation of the efficient ones

Viability of individual projects in particular areas should be given serious consideration. In this connection, the Nunmati Refinery is a case in point. Refineries are best located in the proximity of markets as the transport of diverse oil products is more expensive than that of crude and Assam will be consuming only a small proportion of the annual production of the refinery. Moreover, the establishment of two refineries (Rarauni with a capacity of 2 million tons and Nunmati with 0.75 million tons) has resulted in that the rapacity of the Nunmati refinery is below the optimum. This is important since the economies of scale in refining are very large. The implication is that the bulk of the output will have to be transported to other places at excessive cost which will add to the already high cost of production. A more or less similar case is the recent decision to locate the precision instruments plant in Kerala. Because of the damp climate there, this plant, including its stores, will have to be completely air-conditioned and this will increase the cost of production. Also the plant has been split in two one part in Kerala and the other in Kotah and this will reduce the cost advantage accruing from large-scale production.

Thus the process of economic development requires growth at different rates in different areas. Attempts to industrialise retarded regions ahead of time and at the cost of slowing down the growth of more dynamic areas must necessarily put off the date of bringing relief to the former. Inefficient regional allocation of investment results in waste and in unnecessary burdening of the transport system. Loss of potential saving and investment go hand in hand with higher cost of production. Inefficient plants operating in unsuitable locations require subsidies which are frequently hidden in complex administered prices.

A nationally integrated economy does not, of course, imply regional self-sufficiency in major industrial activities and the less industrialised States must be persuaded that faster industrial growth in other areas will enhance their own economic development. However, this can be done only if a comprehensive long-run plan is provided for tile entire country setting out goals, phasing and resources development by their geographical and time .pattern. Without such a master plan, the logic of which is open to inspection and can be continuously reworked and improved over time, democratic planning cannot take place. Without it, regional Governments cannot be expected to make sacrifices or to patiently wait for the advancement of their own areas.

The economic rationale of Professor Lefeber's approach is not difficult to appreciate. Rut problems arise when the attempt is made to put his scheme into practice. For instance, the Centre was coerced to set up a refinery in Assam by the united agitation of all political parties in that State. These difficulties are roused mainly by narrow-minded politicians. Quite often demands of this type are of a parochial nature and are not. conducive to national integration. Thus the economics of national integration must be understood and appreciated along with its politics.

More about Oil

DESPITE the bold statement of Malaviyaji to the contrary, a section in the Government, particularly the Finance Ministry, it is reliably understood, do see "a case in the stand of the nil companies * The companies' proposal to increase the throughput of refineries to their full capacity. may thus be difficult to reject straightaway. The line of thinking in the Finance Ministry is that it would be economical to utilise the unused capacity of refineries, particularly when it would mean saving in foreign exchange.

It was partially under the pressure of this line of thinking that Shri Malaviya has left this issue open. However, the Oil Ministry. feels that the motive behind the new proposal just forwarded by the oil companies is to secure the expansion of their refineries through the backdoor. The Ministry has primarily two reservations to make about the companies' proposal.

First, the cost of crude oil. Though the Damle Committee has accepted the 8 per cent discount on the posted price obtained by the oil companies, the Oil Ministry's information is that discount up to IB

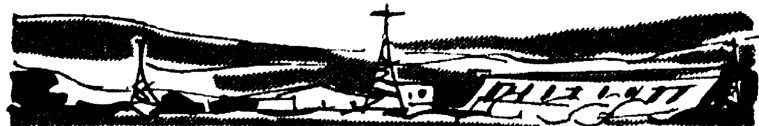
per cent is available from Middle Eastern suppliers. Moreover, the Soviet Union — the terms of whose offer were not made public — offered as much as 25 per cent discount on the posted Persian Gulf prices of crude. They also offered to charge a freight equivalent to that from the Persian Gulf to Indian ports. Government has accepted the Damle Committee's recommendation only in regard to the present intake of refineries. If the supply is to increase, it must be outside the ambit of the Damle Committee and on higher discounts.

Second, the Oil Ministry maintains that under the "import parity" formula in the Refinery Agreements for fixing prices of their products, the oil companies earn "unreasonable" profit. An example is that of the Digboi Refinery which prices its products on the basis of posted prices *plus* freight from the Persian Gulf to Calcutta *plus* transportation cost from Calcutta to Digboi. If the companies are to increase their production from the existing level they must surrender the "import parity" rights, at least for the additional production.

The oil companies offer to increase the throughput of their refineries has also strengthened the Oil Ministry's suspicion that the companies misinformed the Government regarding the capacity of their refineries at the time when they were set up. The throughput is already about 44 per cent higher than the original capacity. The Burmah-Shell Refinery, for instance, was given a licence for two million ton capacity and the investment sanctioned was £ 25 million. But the company spent only £ 18 million and its throughput today is 2.8 million tons. It has offered to expand its capacity to 3.5 million tons with a foreign exchange investment of only £ 7 million. It is more than a little intriguing how this was possible, unless the refinery was planned for a capacity higher than two million tons.

The refusal of the oil companies to accept the Damle Committee's Report, which implies as the London *Times* says "the threat to discontinue supplies" is regarded here as a big affront to the Government of India. Apart from its, serious political implications, what holds back the Government from taking resolute measures against the companies are two-fold. First the possible impact of such measures on the inflow of foreign capital. Second, the inability of the public sector distributing agency, the Indian Oil Company, to undertake the gigantic task of distributing imported oil products which at present constitute nearly a third of the total consumption in the country. Alternative sources from where oil could be imported and at heavy discounts, may not be wanting. But difficulty would arise in respect of tankers. Even the USSR does not have sufficient number of tankers. However, the Government is taking no chances. During the next six months — for which Shri Keshav Dev Malaviya has given the concession to the Companies — the Ministry plans to make all-out efforts to develop the organisation of the I O C. For this, it is seeking the assistance of the ENI, Russians and Rumanians.

An interesting side issue of this controversy is the attention it focusses on the Refinery Agreements. So far the impression was that the Refinery Agreements were for a period of 20 years. Even the Secretary of the Ministry said so during his examination before the Damle Committee. But later, the Committee found that "the Refinery Agreements are for indefinite duration", only the "no nationalisation" commitment is for 20 years. N R Pillai, C C Desai. A K Chanda and the late S S Bhatnagar were the men from the Indian side who negotiated these agreements. It may be worthwhile to investigate the circumstances under which these agreements were entered into.



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