Economic and Financial Developments in the North-Eastern States

Deepak Mohanty*

I thank Gauhati University for inviting me to address this distinguished gathering. The North-Eastern States (NES)[1], also known as Land of Seven Sisters, are very richly endowed. The North-Eastern region covers 5.5 per cent of the total geographical area of the country and accounts for 3.9 per cent of the national population and 2.7 per cent of all-India net domestic product (NDP). The lushness of its landscape, geographical and ecological diversity and range of communities residing make NES one of the most ethnically and linguistically diverse regions in Asia. Each state in the region has its own distinct culture and tradition. I am indeed very delighted to be here amidst you this morning.

A well-functioning financial system is the key to sustainable economic development of a country. Although the Reserve Bank has been actively engaged in the development of the financial sector in the country for a long time, it has stepped up its efforts in recent years to enhance the penetration of the formal financial sector and promote financial inclusion with a view to improving the well-being of our society. Given the special difficulties faced by the North-Eastern region, the Reserve Bank has been undertaking special initiatives for extending the outreach of banking facilities in the region. Against this background, I propose to briefly delineate the economic and financial structure of the region. I shall then highlight various financial inclusion initiatives, taken by the Reserve Bank, especially for NES. In conclusion, I shall present some thoughts on policy challenges that lie ahead.

Macroeconomic Trends

Let me begin with some macroeconomic trends. The last decade was characterised by high economic growth at the all-India level. Where do NES stand in this process? They contributed in varying degrees to this uptick in growth. The data on net state domestic product (NSDP) is available on a comparable basis up to 2007-08. Over the 8-year period, 2001-08, the weighted average NSDP growth in NES was lower at 5.2 per cent as compared with 7.1 per cent at the all-India level. There were, however, significant inter-state variations within NES with the growth performances of three states, *viz.*, Nagaland, Arunachal Pradesh and Tripura being better than the all-India average (Table 1). The low growth in Assam and Manipur was mainly due to the poor performance of agriculture and industry. While the growth rate in agriculture has been particularly low in Assam and Mizoram, the growth rate of agriculture in Nagaland was high. An important lesson from this is that if the states replicate the best sectoral growth pattern within the region, growth in NES could easily surpass the all-India level.

Sectoral analysis reveals that the economic structure of the NES more or less mirrors that of the Indian economy as a whole with the services sector dominating the economic activity. However, the share of industry in Gross Domestic Product (GDP) was half

Table 1: Average Growth Rates – 2000-01 to 2007-08

State	Agriculture	Industry	Services	Total (NSDP)
Assam	0.1	5.2	7.0	4.5
Arunachal Pradesh	3.6	13.7	9.1	7.3
Manipur	2.6	3.1	5.4	4.3
Mizoram	0.7	9.1	6.8	5.6
Meghalaya	4.3	12.7	6.6	6.8
Tripura	4.5	10.3	8.4	7.2
Nagaland	11.0	9.2	6.8	8.2
NES *(Simple Average)*	**3.8**	**9.0**	**7.2**	**6.3**
NES *(Weighted Average)*	**1.5**	**5.9**	**7.0**	**5.2**
All India (NDP)	**2.8**	**6.5**	**9.0**	**7.1**

Note: Figures for Nagaland are up to the year 2006-07.

* Speech by Shri Deepak Mohanty, Executive Director, Reserve Bank of India, delivered at Gauhati University on March 24, 2011. The assistance provided by Dr. P. K. Nayak is acknowledged.

[1] North-Eastern States comprise Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura.

Table 2: Average Sectoral Shares – 2000-01 to 2007-08

State	Agriculture	Industry	Services
Assam	31	13	56
Arunachal Pradesh	28	7	65
Manipur	29	8	63
Mizoram	20	4	77
Meghalaya	22	14	64
Tripura	25	5	70
Nagaland #	34	3	63
NES	**27**	**8**	**65**
All-India (NDP)	**22**	**16**	**62**

\# Figures for Nagaland are up to the year 2006-07.

of that of the Indian economy as a whole (Table 2). The need, therefore, is to place a greater emphasis on promoting the growth of the industrial sector in the region.

Notwithstanding significant differences in growth rates, the growth in per capita real income during the period 2000-01 to 2007-08 in NES was almost twice as the all-India level, with significant inter-state differences (Table 3).

Income distribution in NES has been more equitable than the all-India level as reflected in the much lower Gini coefficient of the per capita income in NES as compared with the all-India level (Table 4).

Fiscal Trends

Following a move towards rule-based fiscal consolidation at the Centre in the early 2000s, many fiscal reform measures were also undertaken by the states, including NES. Consequently, NES began to improve their revenue accounts in 2003-04 when most of the states achieved revenue surplus. By 2005-06, all NES had achieved revenue surplus which persisted till 2008-09. Improvement was mainly on account of growth in revenue receipts outstripping growth in revenue expenditure. It may be noted that within revenue receipts, current transfers from the Centre in the form of grants and tax devolution were the key components behind the correction in revenue account achieved by most of the NES. During 2004-09, current transfers accounted for over 80 per cent of total collection, while NES' own efforts towards better revenue collections contributed to a limited extent. Consequently, the consolidated GFD-GSDP ratio of NES declined significantly during 2005-09 (Table 5).

Table 3: Real Per Capita Income $

State	Amount in Rupees		Growth Rate (%)*
	2000-01	2007-08	
Assam	12,447	15,526	25.7
Arunachal Pradesh	14,726	21,582	46.6
Manipur	12,157	15,667	28.9
Meghalaya	14,910	21,597	44.8
Mizoram	16,635	20,688	24.4
Nagaland	15,699	17,129#	9.1
Tripura	14,933	22,493	50.6
NES	**13,129**	**20,655**	**57.3**
All India (1999-00 base)	**17,537**	**22,581**	**28.8**

$ At 1999-2000 Prices
\# Figure pertains to the year 2006-07
* 2007-08 over 2000-01

Table 4: Gini Coefficient – All-India and NES

Year	All India	NE States	All India (excluding NE)
2000-01	0.2178	0.0662	0.2359
2007-08	0.2454	0.0845	0.2556

State finances witnessed considerable deterioration in 2009-10 as is evident from key deficit indicators. Even though there was a moderate impact on States' own tax revenue and tax devolution from the Centre (as ratio to GSDP) due to overall macroeconomic slowdown observed in the Indian economy in 2009-10, revenue expenditure increased due to higher administrative expenditures arising out of revised pay structure. However, capital outlays also increased with a greater focus on transport, water supply and sanitation, irrigation and flood control, education, sports, art and culture. The fiscal consolidation process, however, was resumed by NES in their 2010-11 budgets. It is important for NES to improve the quality of their expenditure with greater

Table 5: Fiscal Indicators for NES

(As per cent to GSDP)

Year	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	Outstanding Debt
2001-02	6.0	2.0	2.5	37.3
2002-03	4.2	0.8	0.6	37.9
2003-04	3.6	-0.4	-0.1	42.2
2004-05	4.8	-0.5	1.4	43.1
2005-06	1.3	-3.4	-1.9	43.4
2006-07	-0.1	-5.2	-3.1	40.1
2007-08	0.1	-5.6	-2.6	38.8
2008-09	0.2	-6.5	-2.4	41.1
2009-10 (RE)	10.5	0.7	7.5	40.3
2010-11 (BE)	7.5	0.3	4.6	37.8

RE: Revised Estimates BE: Budget Estimates
Note: Minus (-) sign indicates surplus.
Source: Budget documents of the State Governments.

Table 6: Banking Development Indicators in NES

State	Population per branch (As on June 2010)	C-D Ratio (Per Cent)		Average Growth (2000-01 to 2009-10)	
		End-March 2001	End-March 2010	Credit	Deposits
Assam	21,000	32.8	36.1	21.7	19.7
Arunachal Pradesh	15,000	12.7	25.3	34.5	24.4
Manipur	34,000	38.9	40.7	23.1	20.7
Meghalaya	13,000	23.5	47.3	31.5	22.6
Mizoram	10,000	16.0	24.4	27.2	19.1
Nagaland	25,000	13.8	29.9	27.7	19.4
Tripura	16,000	20.0	25.3	21.1	20.0
NES	20,000	27.8	33.5	22.5	19.8
All India	14,000	59.2	73.2	21.9	18.9

emphasis on capital expenditure for sustaining the fiscal consolidation process. There is also a need for NES to improve their own tax revenue.

Financial Indicators

The formal financial system in India is dominated by banks. NES, however, lag behind other parts of India in terms of development of banking. This is evident from the low banking penetration (higher average population per branch) in NES as compared with the all-India average, though there were significant variations across states in the region with Mizoram and Meghalaya having much better ratios. The credit-deposit (C-D) ratio in NES is much lower at 34 per cent at the end of March 2010 than that of 73 per cent at the all-India level (Table 6). Even as credit expanded at a faster pace than deposits in the last decade, the gap remained very wide.

The credit penetration, as measured by the ratio of bank credit to the NSDP, in NES also remained significantly lower than the all-India level (Chart 1).

This raises the question as to whether low credit penetration in NES was due to lack of absorptive capacity in the region. However, this does not seem to be the case as non-formal sources of finance in the region dominate the financing activity in the rural sector. As per the 59th round of National Sample Survey (NSS) data on indebtedness of farmer households in NES, 45 per cent of the finance availed of by the farmers was from the formal financial sector, while the remaining 55 per cent was from the non-formal sector. This was significantly higher than the all-India level with the share of the informal sector at 42 per cent (Chart 2). This shows that there is absorptive capacity

Chart 1: Credit Penetration

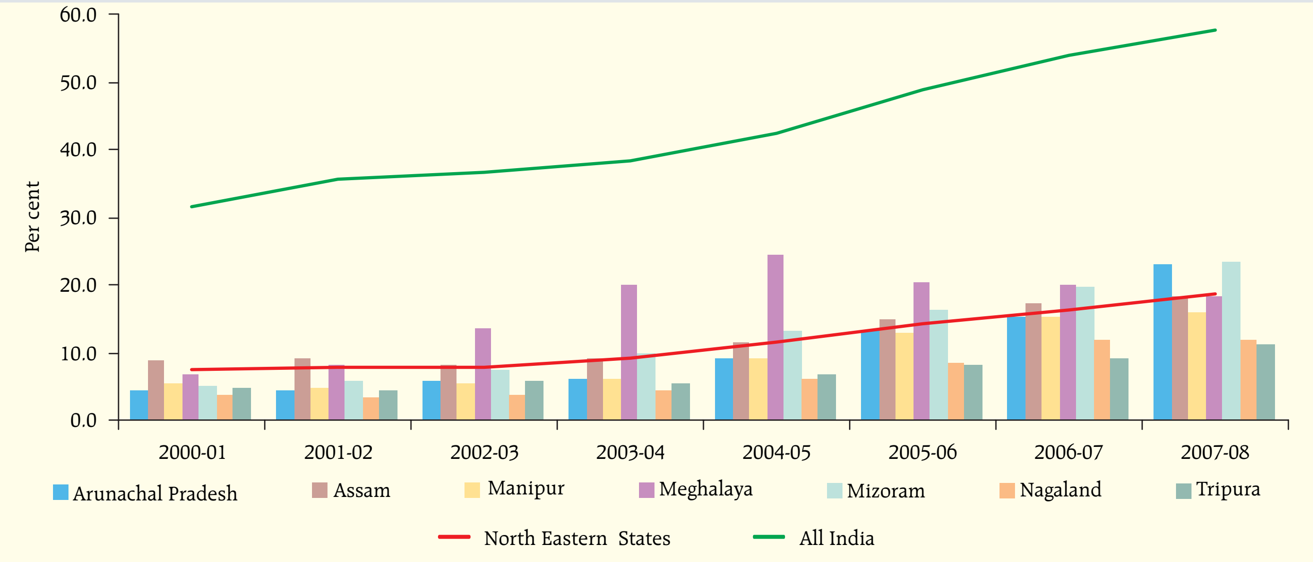
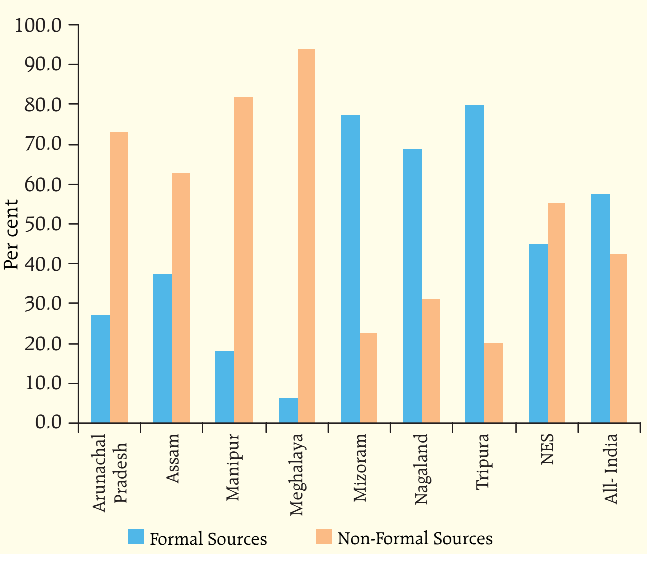


Chart 2: Sources of Finance



and that there is considerable scope for improving banking penetration in NES.

Financial Inclusion Measures

Financial inclusion is important for bringing the poor and under-privileged sections of society within the banking fold and thereby generating and sustaining equitable growth. Let me now turn to the various measures initiated by the Reserve Bank for promoting financial inclusion.

First, the Reserve Bank for long has instituted a mechanism called 'priority sector lending' through which credit is channelled to certain preferred sectors, which, *inter alia*, include small-scale industry, small businesses and agriculture. In the post-reform period, the priority sector has been expanded to include advances to retail trade, educational loans, micro-finance and low-cost housing. This has helped in furthering the cause of financial inclusion.

Second, the Union Finance Minister announced in the Budget 2010-11 that every village in the country with over 2,000 population must have access to banking services by March 2012. In order to operationalise this process, commercial banks have prepared financial inclusion plans which have been submitted to the Reserve Bank. As brick-and-mortar branches will not be viable in very small centres, the approach is to meet this challenge through the business correspondent (BC) model and by leveraging communication technology. Under this model, banks appoint agents who provide basic banking services at the door-step of a client on behalf of banks.

Third, the Reserve Bank has asked banks to open no-frills accounts. These accounts have no or very low minimum balance requirement and have provisions for small loans by way of overdrafts. This is a very convenient account for small depositors, especially in rural areas.

Fourth, a major impediment for a common person to open bank account is the 'Know Your Customer' (KYC) norm. The norm has been relaxed for small accounts, *viz.*, deposits up to ₹50,000 and credit up to ₹1 lakh. A simple introduction by an existing account-holder in a bank should be adequate to open an account. In this regard, Aadhar, the Unique Identification Number (UID) Project of the Central Government, which aims at providing a unique ID number for everyone in the country, will help the poor to establish their identity to meet the banks' Know Your Customer (KYC) norms.

Fifth, farmers can get credit from banks conveniently through Kisan Credit Cards (KCCs) and General Purpose Credit Cards (GCCs).

Sixth, while several banking facilities are available, a common person may not be aware of them. Hence, financial literacy becomes critically important. Accordingly, the Reserve Bank has initiated a 'Project Financial Literacy' with the objective of disseminating information regarding the central bank and general banking concepts to various target groups. Our 'Financial Education' website link offers basics of banking, finance and central banking for children of all ages. Our website is also available in 13 languages, including Assamese.

Finally, there is also a learning process for the Reserve Bank. We recognise that being responsible for banking, we must be sensitive to the needs of a common person. Accordingly, our Governor, Dr. Subbarao initiated the outreach programme last year as a part of our Platinum Jubilee celebrations. Under the outreach programme, the top management of the Reserve Bank visits at least one village in every state and union territory with state government officials and commercial banks to give focused attention on financial inclusion. This has been a highly enriching experience for us to understand the ground realities. Accordingly, we have decided to continue these programmes. I am glad to indicate that we have already conducted outreach camps in Assam and Arunachal Pradesh. During my current visit, outreach camps have been organised in Manipur, Nagaland and Tripura.

Special Financial Inclusion Measures for NES

While financial inclusion measures are expected to improve the banking facilities in general throughout the country, including NES, I would also like to highlight some of the special financial inclusion measures initiated for NES.

First, in December 2009, the Reserve Bank relaxed the branch authorisation policy and permitted domestic scheduled commercial banks (other than RRBs) to open branches in rural, semi-urban and urban centres in NES and Sikkim without having the need to take permission from the Reserve Bank in each case, subject to reporting.

Second, to improve banking penetration in the NES, the Reserve Bank requested the state governments and banks to identify centres where there is a need for setting up either full-fledged branches or those offering forex facilities, handling government business or for meeting currency requirements. We have also offered to fund the capital and running costs for five years provided the state government concerned is willing to make available the premises and put in place appropriate security arrangements. Meghalaya was the first State to take advantage of this facility: eight centres were allotted to three public sector banks, following a bidding process in the state. However, the progress towards opening branches has been slow because of lack of proper infrastructure in the identified centres. In Tripura, five centres were allocated to Tripura Gramin Bank in December 2010. I understand that branches are expected to open shortly in two of these centres. Similarly, the work for identification of centres for opening up branches has been completed for Arunachal Pradesh, Nagaland and Manipur.

Policy Challenges

Let me now turn to broader macroeconomic policy challenges. Development of NES has been high on the agenda of the Central and the respective state governments. Recognising the special requirements of the region and the need for significant levels of government investment, NES have been recognised as Special Category States and Central Plan assistance to these states is significant. As I indicated, the Reserve Bank has also initiated special measures for spread of banking and promotion of financial inclusion. Nevertheless, to accelerate the pace of growth in NES, I may highlight a few challenges that lie ahead.

First, weak market linkages are a major constraint in the development of the region. For this reason, urgent attention needs to be paid to developing roads, air links, telecommunications and other components of transport and communications. Investment in infrastructure could be scaled up through the public-private partnership (PPP) model.

Second, initiatives need to be taken to promote sustainable industrial development compatible with the unique bio-diversity of the region. Agro-based industries, food processing, wood products, traditional textiles and light manufacturing industries can be encouraged to come up in the region.

Third, there is a need to increase agricultural productivity and promote diversification into horticulture and floriculture for which the agro-climatic conditions in the region are well-suited.

Fourth, a sustainable growth paradigm will not only help further acceleration in growth but will also improve fiscal sustainability by helping to lower the debt-GSDP ratio.

Fifth, the high level of literacy and human development levels coupled with bio-diversity provides ample opportunity for development of tourism and exports.

Sixth, a deterrent for bank lending is the high level of non-performing assets (NPAs) in the region. This has been, in part, due to unviability of some of the activities financed by banks and lack of adequate engagement with the borrowers. There is, therefore, a need to improve credit culture in which financial education could play a vital role. In addition, banks will have to augment the staff strength in their branches with an emphasis on staff with knowledge of local customs and practices. Given the preponderance of community-based society in NES, group lending could be a successful mode of credit delivery. Hence, there is a need for promotion of self-help groups (SHGs) with greater linkage with banks. In this regard, NABARD has an important role to play, not only in promotion of SHGs but also in capacity building, along with SIDBI and concerned state government agencies. Another area where there is substantial scope for expansion is low-cost housing. Expansion of housing loan remains poor as mortgages cannot be created in many parts of NES. However, banks can explore innovative structures for housing loans with a greater emphasis on group lending.

Seventh, in any plan for financial sector development, the physical presence of a bank branch is important. But the topography of the region, the dispersal of population, transport bottlenecks and law and order conditions in some areas inhibit branch expansion other than in certain commercial centres. Hence, all the stake-holders – banks, state governments and the Reserve Bank – need to work in close co-ordination for increasing banking penetration and promoting financial inclusion in the region.

Conclusion

To conclude, the North-Eastern Region has immense potential. The need, therefore, is to identify the opportunities and recognise the challenges to work towards a sustainable and inclusive growth of the region with greater penetration of the formal financial sector.