

Interstate Competition Policies and the Regional Convergence Hypothesis: A Framework of Analysis of Regional FDI Inflows

Satya Prasad Padhi*

The present paper shows that regional FDI inflows (on the approval basis) conform to a regional divergence process where already rich states in terms of existing manufacturing bases (or gainers in terms of per capita income) are the gainers. This makes the interstate competition policy irrelevant in the sense that (1) incentives independent of growth centres do not play a role in attracting FDI inflows; (2) incentives should form the part and parcel of regional policies that try to develop manufacturing bases in backward regions via growth centres.

The distinguishing feature of the ongoing market reforms process in India is that the manufacturing firms have greater freedom to define themselves in the market, as production as well as spatial units, guided by expectations of profits. And it entails realignment of firms' activities, hitherto developed under the regulatory regime, that also involves searching for favourable regional destinations. Accordingly, one important development, in response to market reforms in India, is the increased competition amongst states to attract private direct investment inflow, especially foreign direct investment inflows into the manufacturing sector. The competition amongst states can be conceptualised in terms of an interstate competition policy where each state tries to provide incentives, both financial incentives and infrastructure facilities, to attract private direct investment into the region (NCEAR, 2000). Financial incentives offered to attract FDI include both fiscal (tax holidays, exemptions, etc.) and financial (capital investment subsidies, etc.) incentives; infrastructure advantages refer to physical, financial and social infrastructures.

The relevance of the interstate competition policy is an issue, inasmuch as it is apparent that states that are already developed would be in a better position to attract private investment inflows. The competitive stance of states, insofar as it aims at FDI inflow, targets internationally standardised incentives that would make the state more foreign direct investor friendly. That is, even states with higher existing infrastructure and financial bases would need further resources for the purposes of upgradation. The expectation runs in a cumulative manner, higher capacity to provide incentives, high investment inflows, higher revenue, higher incentives, etc.

The new development of states to compete for FDI inflows has important policy implications. Higher intensity of competition amongst states to attract FDI entails an increased competition amongst states for 'total fiscal resources' in an economy. In other words, the interstate competition policy points to independent fiscal stance by each state; each state utilise the resources at disposal optimally to attract FDI that in turn enhances

* Lecturer, Department of Economics, Punjab University, Chandigarh 160 014 (India). liton@pu.ac.in.
The author is indebted to the anonymous referee for critical comments on the earlier draft of the paper.