Pattern of Investment in Indian States with special Reference to Bihar during Liberalization

Manoj Kumar Mishra*

Abstract

Investment analysis has been a key issue in development literature in any country. After Liberalisation of Indian economy, there has been a completion among Indian states to attract more and more investment because it concerns to development and economic reforms have been used a tool to enhance investment in most of the states in India. Economic reforms have also been applied in Bihar after globalization of Indian economy. This paper tries to find out the trend of investment in Bihar before and after liberalization but focused on investment after liberalization of Indian economy. This study is based on secondary data as well primary data through observation and experience and discussion with persons having knowledge of investment. This study finds the unsatisfactorily investment trend in India and Bihar during liberalization. Moreover, it also finds the heterogeneous investment in different sectors and regions in India and Bihar.

Keywords: Liberaliation, Investments, Poor infrastructure, Competition, social capital etc.

I. Introduction

Investment analysis has been a key issues in development literature in any country. After Liberalisation of Indian economy, there has been a completion among Indian states to attract more and more investment because it concerns to development and economic reforms have been used a tool to enhance investment in most of the states in India. Economic reforms have also been applied in

* Research Scholar in Economics, Magadh University Bodhgaya, Bihar, India

Bihar after globalization of Indian economy. India is a complex federal democracy where state level politics are dominated by state specific issues rather than national issues, making the economic development of the respective states the focal point of a potential electorate. As economic reforms are now driven by the states, due to the withdrawal of controls exercised by central government in key areas, states are forced to compete against each other in terms of attracting investment which would generate jobs and boost their respective economies. Bihar has been comparatively failed to attract investment particularly the foreign direct investment during liberalization. The capital formation rate and investment rate has been low in Bihar particularly the industrial investment. This paper tries to find out the trend of investment in Bihar before and after liberalization but focused on investment after liberalization of Indian economy.

II. Literature Review:

Investment during liberalization period in Indian states has been heterogeneously distributed only among states but also within the states. Therefore it is said that states have faced the inter-state completion to attract the investment. Do states in India compete for investment? As the opening quotes illustrate, in India today the state governments are desperate to attract private and foreign investment by removing policy bottlenecks that are often viewed as unattractive to firms. Many in the industry feel that this sort of competition is good for the respective states as it not only helps solve problems associated with excessive bureaucratic controls, corruption and creating an investment friendly atmosphere, but also creates enormous job opportunities which form huge political capital for incumbent politicians. Therefore, there is every reason to believe that states in post-reform India tend to compete for Schneider (2004) and Venkatesan (2000) cite examples of large tax and other fiscal incentives the states within India offer to attract investment. In this paper, It has been examined whether states in India compete for big ticket investment proposals. While there is a growing literature estimating the extent of the competition in international taxation and environmental policies, policy reforms and labour standards, to the best of my knowledge there is no empirical evidence examining the potential competition among states within India, a gap the current paper fills.

Spatial econometrics has been used in the literature to examine the race to the bottom arguments regarding taxes, environmental regulations, economic policy reforms and labour standards. The first group of work includes Davies, Egger and Egger (2003), Devereux, Lockwood, and Redoano (2008), Davies and Voget (2008), Overesche and Rinke (2008) and Klemm and van Parys (2009), who focused largely on tax competition to attract FDI between developed countries. Here, they find a positive spatial lag, meaning that as tax rates fall in one nation, this lowers tax rates elsewhere. Likewise, in the environmental literature, Markusen, Morey and Olewiler (1995), Fredriksson and Millimet (2002), Beron et al. (2003), Murdoch et al. (2003), Levinson (2003) and Fredriksson et al. (2004), Davies and Naughton (2006) and Perkins and Neumayer (2010) focused on the joint adoption of environmental agreements and interaction in environmental policies. These studies tend to find evidence consistent with the race to the bottom argument. Focusing specifically on spatially weighted third-country determinants of inbound and outbound FDI, Blongien et al. (2007) and Baltagi et al. (2007) provided empirical support for the existence of various modes of complex FDI. Extending the analysis to labour standards, Davies and Vadlamannati (2009) find strong evidence of the potential race to the bottom in labour standards, i.e., labour rights in one country depend on those elsewhere. On the contrary, Neumayer and de Soysa (2009) find support for a race to the top with respect to women's labor rights in foreign countries with which a country is connected via trade and FDI. Interestingly, Cho, Dreher and Neumayer (2009) also find evidence of a race to the top with respect to human trafficking policies across countries. Using the Economic Freedom Index as a measure of policy liberalization, Pitlik (2007) and Gassebner, Gaston and Lamla (2009) find strong evidence of a race to the bottom among European and developing countries to liberalize regulatory, monetary and trade policies. Similar such findings were echoed by Simmons and Elkins (2004). Finally, Elkins, Guzman and Simmons (2006) also find evidence of a race to the bottom with respect to bilateral investment treaties. While there is a growing literature estimating the extent of the competition in areas related to taxation, environment, labor standards, investment treaties and economic policy reforms internationally, evidence on the potential impact of competition to attract investments (domestic and foreign) within a country is scarce. Coughlin and Segev (2000) is an exception, testing for the existence of spatial heterogeneity and spatial dependence in FDI inflows within China. This is the gap the current paper fills by specifically focusing on competition among Indian states in new investment policy during the post economic reforms period. Using information on large investment proposal approvals in 32

Indian states during the 1991–2009 periods, the paper finds that the inflow of investment proposals in one state are positively correlated with the investment proposal inflows in other states. Furthermore, I find that industrial or high income states compete for investment among themselves, as well as with low income states. On the other hand, low income states seem to compete only among themselves. This study interprets these results as direct evidence of interstate strategic interactions in investment policy; we find that investment policies are strategic complements, a key requirement for finding a ‘race to the bottom/top’ in attracting investments. Since there is a noticeable upward trend in investment proposals being put up for approval over the sample period, one might consider this evidence as a race to the top. However, critics of globalization might well consider this as an evidence of race to the bottom, citing large anecdotal evidence reported in press, media and NGO reports on the side-effects (such as lapses in environmental regulations, labor standards, land acquisition policy and revenue foregone from tax incentives) emanating from such fierce competition to attract investment. Overall, if the benefits associated with such competition outweigh the costs, then such competition is welcome. On the other hand, if there are less overall benefits than costs, then such fierce competition might well be the path towards mal-development. We leave it to future research, perhaps by usefully employing the comparative case study method, to examine whether fierce competition among states is necessarily leading to race to the bottom, or otherwise.

III. Analysis and Discussion

In an extremely diverse country like India, when a private or foreign firm intends to undertake large scale investment, usually they narrow their options down, after extensive research, to a few specific potential destinations (states) for various reasons. Often, this results in intense competition among those potential states to attract big ticket investment. One such example is Tata’s new Nano car project in 2008, which after withdrawing from the West Bengal state, was offered several packages by other states including Karnataka (in the outskirts of Bangalore), Maharashtra (in Pune), Andhra Pradesh (near Vizag) and Gujarat. After studying each possible location, the decision to locate the project in Gujarat was finally taken b It was widely cited in the Indian media that the Gujarat state offered free land, commitment to construct new roads near the project site, and initiate employee training programs hosted at the site (Businessweek 2008, Business Standard 2008). Over the years, such incentives offered by states in India to attract large scale investment projects have not only increased drastically, but have become commonplace. In fact, Kanta (2010), Schneider (2004) and Venkatesan (2000) cite numerous examples of large tax and other fiscal incentives offered by states within India to attract investment. It began in 1991, when the government of India embarked upon a series of economic liberalization measures, thus ending the 'license and permit raj' which required firms to obtain licenses from the central government of India, not only for setting up businesses, but even for expansion and increasing their production capacity. The objective behind such restrictive policy was to spread investment evenly across the states. Instead of creating a balanced regional development, however, the 'license-raj' did not allow firms to benefit from economies of scale. In addition, Biswas and Marjit (2002) find that industrial licences were granted to the states based on the political considerations of the central government. Thus, this licensing system was also subject to political manipulation leading to market distortions created by political incentives. The system was abolished in 1991 and since then, industrial firms with investments of Rs. 10 crores (20 US$ million) in the manufacturing sector, and Rs. 5 crores (10 US$ million) in the services sector, are now only required to file information in the Industrial Entrepreneurs Memorandum (IEMs hereafter) with the Secretariat of Industrial Assistance in New Delhi. Thereafter, no further approvals are required. The IEMs basically originate from each state every (month) year after finalizing business proposals, and acquiring all the required permission from the respective state governments where investments are proposed. Thus, IEMs coming from state i in year t reflects the openness of the prevailing investment environment in that particular state. Since economic liberalization, two things have changed dramatically. First, increasing reliance on markets, which has proven to be an enabling factor for the emergence of a market economy driven by the states and not by the center? This is result of a major shift in the role of the center and the states in the economic policy decision making process. Post 1991, the dominance of the center in economic policy decision making has significantly diminished, paving way for the state governments to design their own policies. It highlights the role of state governments in the Indian economy. According to them, in recent years, aggressive competition among states for private and foreign investment has attracted the attention of the media and policy makers locally and internationally. In addition, there was a marked decline in public investment, which coincided with a rapid increase in private investment. As a consequence, the center's financial leverage over the states declined steadily as states looked more and more towards attracting private and foreign investment to finance their investment requirements. It shows how the central government allocated financial transfers to the state governments purely based on political considerations, leading to equity and efficiency distortions4. As a result of opening their doors to investment, economic factors predominantly determined the number and magnitude of investment inflows into the states. In the process, states which possessed location advantages such as larger markets, better infrastructure, a more skilled labor force, and the presence of a large investor base in comparison to less well-endowed states, started to benefit. This in turn put more pressure on less developed states, and all states for that matter, to increase their competitiveness in order to gain investment. In addition, if the benefits associated with these investments do in fact spillover in to other states in the country, then this agglomeration (in the case of private and foreign investments) might lead to more investment proposals coming from the other states.

IV. Conclusion:

India is a complex federal democracy where state level politics are dominated by state specific issues rather than national issues, making the economic development of the respective states the focal point of a potential electorate. As economic reforms are now driven by the states, due to the withdrawal of controls exercised by central government in key areas, states are forced to compete against each other in terms of attracting investment which would generate jobs and boost their respective economies. Bihar has been comparatively failed to attract investment particularly the foreign direct investment during liberalization. The capital formation rate and investment rate has been low in Bihar particularly the industrial investment. The investments in Bihar have not very low during liberalization for income, employment and output. This in turn put more pressure on less developed states, and all states for that matter, to increase their competitiveness in order to gain investment. In addition, if the benefits associated with these investments do in fact spillover in to other states in the country, then this agglomeration (in the case of private and foreign investments) might lead to more investment proposals coming from the other states.

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