Explicating on the need for sub-national economic activism

Tridivish Singh Maini and Deepanshu Mohan say it is imperative for India to mature as a federation while displaying strong 'cooperative federaism'

To improve the ease of doing business and attracting sustainable foreign direct investment inflows across sectors, it is imperative for India to also mature as a federation while displaying strong "cooperative federalism". With the acceptance of the recommendations of the Fourteenth Finance Commission (FFC) the government seems to be in line to be promoting a cooperative federal polity where both the Centre and State can engage as equal partners. It remains to seen whether this can actually be the case.

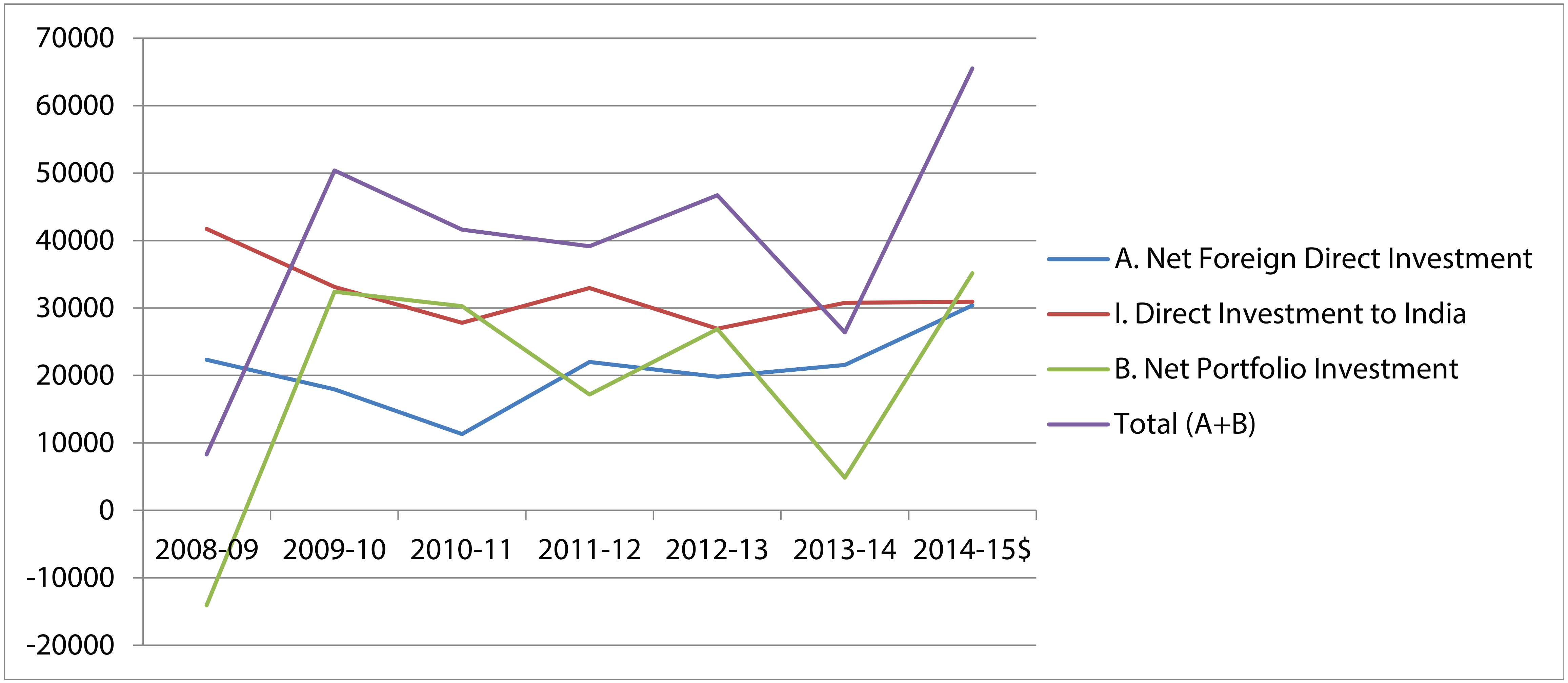
The FFC, headed by former RBI Governor YV Reddy, recommended a move away from scheme and grant based assistance to states to a greater devolution of funds from the Centre's own treasury of revenue collection. With its acceptance, the Centre will now share 42 per cent of the divisible pool with the states; however, the states will now, in order to tackle fiscal burden, have much less money at their disposal to finance varied social security measures.

While it is true that the state will now have an opportunity to dip in to a greater pool of resources from the Centre's share, it is still to be seen how the state governments manage their expenditure in the social sector. The Business Standard in a recent article supports this point by presenting a clear picture on the increasing of states' expenditure on social sector over the years, raising serious questions on how can the increasing gap (between revenue and expenditure over time) be financed. In our article, we try to analyse and explore the possibility of using foreign investment as one of the alternatives that the states in India can explore in bridging the investment gap.

Trends in Foreign Direct Investment across Indian states

Before we look at how attracting more foreign investment can be used as the ideal option for states to grow and develop over time, we first present a macro picture of the foreign investment levels in India. Figure 1 provides a picture of the overall trends in foreign investment inflows (indicators: net portfolio investment, net foreign direct investment, direct investment into India). In this, post 2013-14 we do see an upward trend in almost all the sub indicators reflecting an increasing level of investment into India.

Figure 1. Overall trends in foreign investment inflows



Source: Extracted from RBI Database on Foreign Direct Investment

Now, to deconstruct this level of Foreign Direct Investment (inflows) it is critical to provide a picture of the sector-wise allocation of the investment coming into India. Table 1 provides a sector-wise allocation of the FDI inflows in India where the top 13 sectors attracting most investment are given.

Turning to the States, if we observe the pattern of attracting maximum amount of FDI (inflows) for equity capital components only, the picture doesn't seem very positive from the data below (table 2). In the past three-four years, states like Uttar Pradesh, Madhya Pradesh, Maharashtra, Punjab have seen a downturn in the level of FDI (inflows) primarily because of either the lacklustre reform process (owing to a policy paralysis in terms of their FDI policy) or the political transformation seen in most of the states (say in Maharastra, we saw the NCP-Congress coalition giving may to BJP-Shiv Sena which is likely to change the policy and direction of investment over time).

Contrarily, states like Rajasthan, Gujarat, Karnataka, Delhi, Tamil Nadu have done extremely well in attracting more investment inwards. In the NCR (National Capital Region) of Delhi maximum investment has been in the part of UP (Noida, Ghaziabad) and in small part of Haryana (Gurgaon) which come under the NCR belt. Rajasthan, especially, can be considered as a benchmark in seeing a ten times jump in its FDI level (from 230 crores in 2010-11 to 3,233 in 2014-15). The state also seems to be on the right track in terms of its socio-economic indicators (especially in the path to poverty eradication, increasing employment opportunities, accessibility to health and education).

The states that need more focus and effort in terms of attracting bulk investments inwards are Bihar, Andhra Pradesh, Madhya Pradesh & Chhattisgarh, Kerala, Goa, West Bengal and the North Eastern States (Assam, Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Tripura) where the rise has been quite marginal when weighed in comparison to other states with the same potential. It has been a pleasant surprise to see the Prime Minister paying more attention to the North East Region where the level of investment (domestic and foreign) seems to be the lowest. On the same lines, we explore some of the options available with these states in attracting more foreign investment that will not only help these states to grow to their potential over time but also help in financing bulk of their social sector expenditure (which seems to be 40% of their total expenditure).

Table 1. Sector Wise Foreign Direct Investment (FDI) Inflows in India (2000-2015)

Sectors	Amount of FDI Inflows		%age with Total FDI Inflows (+)
	Rs. in Crore	In US$ Million	
Services Sector*	201,728.28	42,101.98	17.32
Construction Development: Townships, Housing, Built-Up Infrastructure And Construction-Development Projects	112,916.36	24,028.19	9.88
Telecommunications	83,697.07	16,994.68	6.99
Computer Software & Hardware	67,693.78	14,125.19	5.81
Drugs & Pharmaceuticals	63,629.47	12,856.02	5.29
Automobile Industry	60,725.08	11,857.11	4.88
Chemicals (Other Than Fertilizers)	48,641.77	10,229.69	4.21
Power	46,358.87	9,512.02	3.91
Metallurgical Industries	40,737.61	8,480.9	3.49
Hotel & Tourism	40,198.41	7,774.03	3.2
Trading	41,315.28	7,660.73	3.15
Petroleum & Natural Gas	31,650.29	6,519.53	2.68
Food Processing Industries	36,360.11	6,215.46	2.56
Sub Total	1,199,386.19	243,106.8	100
	533.06	121.33	
Grand Total	1,199,919.25	243,228.2	

*Note : * Services sector includes Financial, Banking, Insurance, Non-Financial/Business, Outsourcing, R&D, Courier,*

Source: Ministry of Commerce and Industry, Govt. of India.

Table 2: Foreign Direct Investment in States

RBI Regional Office-wise Foreign Direct Investment (FDI) Inflows* Received (with State Covered) in India (2010-2011 to 2014-January 2015) Rs. in Crore, US$ in Million							
RBI's Regional Office	State Covered	2010-11	2011-12	2012-13	2013-14	2014-15	Cumulative Inflows (Apr. 2000 to Jan. 2015)
Mumbai	Maharashtra, Dadra & Nagar Haveli, Daman & Diu	27,669 (6,097)	44,664 (9,553)	47,359 (8,716)	20,595 (3,420)	30,360 (4,983)	344,449 (71,740)
New Delhi	Delhi, Part of UP and Haryana	12,184 (2,677)	37,403 (7,983)	17,490 (3,222)	38,190 (6,242)	35,433 (5,779)	242,204 (48,315)
Chennai	Tamil Nadu, Puducherry	6,115 (1,352)	6,711 (1,422)	15,252 (2,807)	12,595 (2,116)	20,384 (3,340)	85,790 (10,536)
Bangalore	Karnataka	6,133 (1,332)	7,235 (1,533)	5,553 (1,023)	11,422 (1,892)	13,886 (2,258)	74,753 (14,934)
Ahmedabad	Gujarat	3,294 (724)	4,730 (1,001)	2,676 (493)	5,282 (860)	6,811 (1,112)	51,193 (10,622)
Hyderabad	Andhra Pradesh	5,753 (1,262)	4,039 (848)	6,290 (1,159)	4,024 (678)	7,621 (1256)	48,536 (9,901)
Kolkata	West Bengal, Sikkim, Andaman and Nicobar Islands	426 (95)	1,817 (394)	2,319 (424)	2,659 (436)	1,229 (201)	14,393 (2,943)
Chandigarh	Chandigarh, Punjab, Haryana, Himachal Pradesh	1,892 (416)	624 (130)	255 (47)	562 (91)	234 (39)	6,360 (1,331)
Jaipur	Rajasthan	230 (51)	161 (33)	714 (132)	233 (38)	3,233 (540)	6,791 (1,264)
Bhopal	Madhya Pradesh, Chhattisgarh	2,093 (451)	569 (123)	1,208 (220)	708 (119)	600 (100)	6,095 (1,216)
Kochi	Kerala, Lakshadweep	167 (37)	2,274 (471)	390 (72)	411 (70)	641 (105)	5,373 (1,086)
Panaji	Goa	1,376 (302)	181 (38)	47 (9)	103 (17)	208 (34)	3,864 (822)
Kanpur	Uttar Pradesh, Uttarakhand	514 (112)	635 (140)	167 (31)	150 (25)	502 (82)	2,267 (454)
Bhubaneshwar	Odisha	68 (15)	125 (28)	285 (52)	288 (48)	51 (9)	1,957 (397)
Guwahati	Assam, Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Tripura	37 (8)	5 (1)	27 (5)	4 (1)	9 (1)	361 (80)
Patna	Bihar, Jharkhand	25 (5)	123 (24)	41 (8)	9 (1)	66 (11)	265 (50)
Grand Total		**97,320 (21,383)**	**165,146 (35,121)**	**121,907 (22,424)**	**147,518 (24,299)**	**155,489 (25,526)**	**1,199,919 (243,228)**

*Note: *Includes equity capital components only. The Regionwise FDI inflows are classified as per RBIs. Regional Office received FDI inflows, furnished by RBI, Mumbai. Represents, FDI inflows through acquisition of existing shares by transfer from residents to non residents*

Source: Ministry of Commerce and Industry, India

What the States need to do?

In the past year, we have witnessed a proliferation in the number of Investor Summits coupled with visits by Chief Ministers overseas in the last year or so. The Investor Summit to draw maximum attention was the Vibrant Gujarat Summit (January 2015), since it was attended by the PM himself, Narendra Modi, who had conceived the idea of this event when Chief Minister. Eight countries, including the US, UK, Canada, Netherlands, South Africa, Japan, Singapore and Australia signed up as partners for the summit. In addition to top corporates from India and abroad, the list of participants this year included US Secretary of State John Kerry, Bhutanese Prime Minister Tshering Tobgay, UN President Ban Ki Moon, and World Bank President, Jim Yong Kim. The PM's thrust during his address was on co-operative federalism and ease of doing business.

It would be pertinent to point out that while the Vibrant Gujarat Summit draws more attention it is not the sole state which hold summits. Apart from Gujarat, some of the other states to hold investors summits were West Bengal (January 2015), Madhya Pradesh (October 2014), Rajasthan and Maharashtra. Finance Minister Arun Jaitley attended the summit to send an unequivocal message that the Modi government is genuinely committed to 'cooperative federalism' ie. a harmonious relationship between Centre and States.

All these summits claim to be successful, though it is not clear to what extent the figures which they cite with regard to investment received are true. These summits certainly achieve one goal ie. greater exposure for state gov-

Greater participation of states in international trade and commerce is a good beginning but it needs to be done in such a way that it benefits a large number of states and not just a few ernments. Investors also get an opportunity to interact directly with policy makers and convey some of their apprehensions. Governments through their interactions with investors also learn more about what needs to be done to become sought after investment destinations.

Apart from investors summits, Chief Ministerial delegations overseas have also become a common practice. These delegations are not from a handful of states like Andhra Pradesh, Tamil Nadu and Maharashtra, but recently CM's of Rajasthan, Madhya Pradesh and West Bengal have led delegations overseas to attract investment. While all these steps are laudable and will help in fostering competition between different states, there are a few issues which clearly need to be addressed.

The main objective of such summits is to draw FDI. A number of reports state that states managing to draw FDI possess some advantages such as better connectivity and infrastructure. The current government has so far sent out an unequivocal message that it will give greater attention to the North-East, and has continuously referred to the region as a pivot of its Act East Policy. The frequent visits made by Ministers to the region, with an increased focus on building adequate infrastructure within the region, including border posts with Myanmar, is a strong reiteration of this point. Even with regards to Eastern India, there has been some positive feelers. One clear illustration being the fact that Finance Minister Arun Jaitley attended the West Bengal Investors summit, even though TMC and the central government have been at loggerheads.

Similarly, the royalty from coal auctions to Eastern India. During his recent visit to the Rourkela steel plant in Orissa, PM Modi stated that India cannot depend upon a few states for its growth and prosperity.

Second, it is time that participation of state governments in foreign policy (specifically economic diplomacy) is institutionalized. While this government has taken the first positive step towards accepting this reality the next logical step would be to take some tangible steps and give state government's greater leeway and reduce the number of clearances required from the central government. One possible way could be for the Ministry of Commerce to have representatives in states and reduce the burden of officials in Delhi. MEA already has branch secretariats. PM Modi has already suggested one possible reform, that each state should have its export councils. These words need to be translated into action.

Greater participation of states in international trade and commerce is a good beginning but it needs to be done in such a way that it benefits a large number of states and not just a few. For this, it is important that the government carries out the required political and economic reforms. ■

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