The Center Is Not All: How India’s States Are Luring Foreign Investors
By Tridivesh Singh Maini

A distinctive feature of India’s approach to attracting foreign direct investment — which it shares, in part, with China — is that governments at the state level are increasingly playing an active role in engaging investors in other countries, complementing and in some instances dramatically enhancing efforts at the national level.

In so doing, India’s state governments are also having a greater influence on the country’s foreign policy, writes Tridivesh Singh Maini.

IN LOOKING AT the growth of Asia’s economic giants, China and India, one compelling factor is that sub-regional actors — provinces in China and states in India — have become key players. One important enabling factor in both countries has been the success that these local governments have enjoyed in actively wooing foreign investors. The national governments, while they vary in having a veto over sub-national government when it comes to complex foreign policy matters, are not averse to provinces playing an important role in cultivating strong economic relationships and enhancing linkages in areas such as culture, research and sports. A number of Western scholars have studied this trend, dubbing it both constituent diplomacy (Robert Kincaid, 1990) and paradiplomacy (Soldatos, 1990). The Chinese model of provincial intervention in foreign policy has been successful and offers lessons for India.

One key reason behind the rising power and influence of state governments in China and India is the economic liberalization introduced in both countries. China initiated economic reforms under Deng Xiaoping in the late 1970s; India did so in 1991 during the PV Narasimha Rao government, with the key architect being then finance minister and later prime minister, Manmohan Singh. In India, another important reason for state governments becoming key actors in foreign policy has been the rise of strong regional leaders starting in the late 1990s. They left a strong imprint on national politics and did not shy away from marketing the economic potential of their respective states — despite the fact that the Indian Constitution grants full authority on foreign policy issues to the central government. Hazarika (2014) in this context argues the following:

Despite this constitutional clarity on the role of the center in foreign policy matters, there is an incremental involvement of the constituent units of the country in foreign policy. Indian states with an international border and others with commercially driven agendas are particularly at the forefront of such foreign policy pursuits.

The main aims of this paper are to look at the efforts of state governments in India to develop economic ties and other linkages with the outside world. It will also recommend ways to make this more effective. In addition, it will flag some of the important challenges to the participation of state governments in foreign policy.

We will start by looking at China’s approach.

CHINA’S REFORMS
In the first decade of economic reforms, China’s economic growth was driven by coastal provinces, most notably Guangdong. Deng’s initial focus on developing coastal areas was based on the premise that some provinces would progress faster than others, and there would be a spillover effect. This policy yielded dividends, with China leading the developing world in FDI by the late 1990s, accounting for over a quarter of all FDI flows to developing countries, and second only to the US globally. Yet there were great disparities. Between 1978 and 1991, the contribution of coastal regions to China’s GDP increased from 52 percent to 56 percent (Wong and Yongnian, 2001). Zhang and Kou have illustrated this inequality (2012: p.114):

From 1978 to 1998, Fujian (on the eastern coast), the fastest growing province, experienced an average annual growth rate of 13.9 percent in real GDP; whilst Guansu (in the hinterland), the slowest one, grew only at 6.7 percent. In 2000, the top 10 provincial units with the highest GDP per capita were mostly from the eastern coast of China.

The Chinese government under Deng in the early 1990’s took note of this trend and has since made efforts to develop interior provinces in western China that were earlier considered too backward. Some, such as Yunnan Province, are being developed as economic bridges with neighbors in Southeast Asia.

INDIA’S GROWTH
In the case of India, apart from New Delhi, the most significant contributors to India’s growth story are the coastal states of Tamil Nadu, Gujarat, Maharashtra and Andhra Pradesh. One of the major problems in India is that just a few states manage to draw a sizeable chunk of total FDI (Mukherjee, A, 2011). This trend has continued for over a decade and a half with the top five regions, Maharashtra, New Delhi, Tamil Nadu, Karnataka and Gujarat, accounting for 70 percent of FDI flows into India between 2000-2012 (Mukherjee 2011: p.100); Maharashtra individually received a little over US$70 billion, approximatively 30 percent of the total FDI inflows from April 2000 to November 2014 (The Hindu Business Line, Feb. 8, 2015). During the period between April 2000 and 2014, Maharashtra and New Delhi together received nearly half (49 percent) of India’s total FDI (The Economic Times, Feb. 8, 2015).

States such as Gujarat, Tamil Nadu, Maharashtra and Andhra Pradesh capitalized on their advantages, which included suitable geographical location, strong human resources and good infrastructure. They have used a combination of methods that include leveraging the Indian diaspora, high-level political delegations, and most recently, investor summits. They also enhanced province-to-province and city-to-city linkages in an approach very similar to what Hocking (1993) has dubbed “multi-layered diplomacy,” involving a number of actors, including business groups and civil society, along with non-central governments. Indian states began reaching out directly to other countries in the late 1990’s, led by Chandrababu Naidu, chief minister of Andhra Pradesh, and Dr. Karunakar Naidu, chief minister of Andhra Pradesh, and Dr. Karunakar Naidu, chief minister of Andhra Pradesh, who has been particularly active in promoting Andhra Pradesh in foreign countries. Naidu has been particularly active in promoting Andhra Pradesh in foreign countries. Naidu eventually became chief minister of Andhra Pradesh, and Dr. Karunakar Naidu, chief minister of Andhra Pradesh, who has been particularly active in promoting Andhra Pradesh in foreign countries. Naidu eventually became chief minister of Andhra Pradesh, and Dr. Karunakar Naidu, chief minister of Andhra Pradesh, who has been particularly active in promoting Andhra Pradesh in foreign countries.

As states have become active participants in economic relations with the outside world, it is a common complaint that the Indian central government does not have any compre-
hensive strategy to deal with this trend, unlike China. In addition, the problem of unequal distribution of the benefits of globalization has also been flagged by a number of chief ministers and scholars. While current Prime Minister Narendra Modi, in his tenure as chief minister of Gujarat, had flagged the first issue, a number of states have complained that central policies result in skewed growth, since New Delhi is out of sync with the needs of poorer states. In recent years, states that were considered economic laggards such as Madhya Pradesh and Bihar have delivered stellar growth rates (Kawadia and Phillips 2014), although they have not been very successful in attracting FDI.

It is also significant that the current leaders in both India and China were strong regional leaders in the past. This has proved to be an enabling factor for both Chinese President Xi Jinping and Prime Minister Modi. While Modi led Gujarat for over a decade, Xi was governor of Zhenjiang Province, and also mayor of Shanghai. William Antholis, in the preface to his book Inside Out: India and China, argues: “The fact that both Xi Jinping and Narendra Modi have been local leaders will help... Indeed, Modi and Xi both used local political autonomy to unleash economic dynamism. And both are currently in the process of renegotiating the compact that connects them to far-flung states and provinces.” (2015)

Interestingly, while Xi, during his visit to India in September, made his first landing in Ahmedabad in Gujarat, Modi too landed in Xian, the home town of Chinese President Xi Jinping, and the latter broke protocol by receiving the Indian prime minister (xinhuanut.com, May 15, 2015).

**MODI’S WAY**

Modi has been speaking about granting a greater role to states in both economic and foreign policy, and he has already sought the co-operation of provinces and repeatedly referred to the need for a “Team India” (The Hindu, May 10, 2015). One important step in this direction is the replacement of the Planning Commission with the National Institution for Transforming India (NITI Aayog). If one looks specifically at foreign policy, it is worth noting that before taking over as prime minister, Modi spoke in favor of having each state in India reach out to one specific country to set up overseas missions. As prime minister, during his numerous bilateral visits to other countries Modi has spoken about the need for economic diplomacy and exchanges beyond national capitals. While inaugurating an investor summit in Madhya Pradesh in October 2014, the prime minister urged states to compete for foreign investment. At another function, he spoke about states having their own export promotion councils that would be encouraged by the central government (The Indian Express, August 16, 2014). During his visit to China, Modi was accompanied by the chief minister of Gujarat, Anandiben Patel and Chief Minister of Maharashtra, Devendra Fadnavis. Both also attended the first India-China State and Provincial Leaders Forum, which was inaugurated by Modi and his Chinese counterpart Li Keqiang (*The Business Standard*, May 15, 2015). During Modi’s visit agreements were also signed for establishing sister-province linkages between Karnataka and Sichuan and sister-city agreements between Chennai and Chongqing, Aurangabad and Dunhuang and Hyderabad and Qingdao (*The Hindu*, May 15, 2015)

**STATE DELEGATIONS ABROAD**

One tool used both to attract foreign investment and promote tourism has been visits by delegations led by chief ministers from numerous states and different parties to a number of countries. In the 1990s, during the early IT boom, the emphasis was on wooing US investors, but more recently the emphasis has been on Southeast Asian countries, especially Singapore; there are a number of reasons for this. The most important one is to reach out to these countries with an increasing emphasis on infrastructure development. One of the pet themes of the current government is the creation of “smart cities.” Certain state governments like Andhra Pradesh are seeking to build new cities. In addition to this, the increasing thrust of India’s Look East Policy, which has been renamed the Act East Policy, has compelled states to look eastward. The US, however, has also shown interest in the smart city project, and during his visit to India in February the former mayor of New York City, Michael Bloomberg, offered assistance on the creation of new smart cities.

**INVESTOR SUMMITS**

In recent years, states have also begun to organize investor summits. While the trend began in Gujarat, now even states such as Bihar, Madhya Pradesh and West Bengal have joined in. Most recently, West Bengal held a successful summit that was attended by Finance Minister Arun Jaitley. According to the state government, investment proposals to the tune of Rs.2.43 trillion (US$38 billion) were received, and the state’s chief minister missed no opportunity to hard-sell West Bengal (*The Indian Express*, Jan. 9, 2015).

The West Bengal Summit was followed by the 2015 Vibrant Gujarat Summit. Due to Modi’s presence, a number of high-level delegates attended, including US Secretary of State John Kerry, Bhutanese Prime Minister Tshering Tobgay, UN Secretary General Ban Ki Moon and World Bank President Jim Yong Kim. A number of top political leaders from other countries along with the Indian prime minister spoke of the need for both competitive as well as co-operative federalism (Vora, Jan. 11, 2015).

Other states that have held investor summits include Rajasthan, Maharashtra and Madhya Pradesh. Some 20 countries partnered with Madhya Pradesh for the Global Investors Summit held in Indore in October 2014. Of course not all summits are successful in fetching foreign investment, but they serve the purpose of increasing awareness about states (*The Business Standard*, Jan. 11, 2015).

In addition to economic diplomacy, there is also growing interest in sister city agreements with other Asian cities. In China, these include Kolkata-Kunming, Bangalore-Chengdu and Ahmedabad-Guangzhou; there is also a tie-up
between Varanasi and Kyoto, Japan. The aim of these agreements is not just to learn about infra-
structure development and civic issues, as is the case with Varanasi and Kyoto, but also to develop
cultural linkages. The Kolkata-Kuning agreement is specifically important in the context of
the BCIM Corridor (Bangladesh-China-India-
Myanmar), an important component of the Chi-
nese version of the New Silk Road. A number of conferences have been held in both cities (The

REACHING OUT TO NEIGHBORING STATES
In addition to traditional foreign policy focused on strengthening relations with the US, Europe
and South Asia, some states are keen to increase economic diplomacy with neighboring coun-
tries. While the role of state governments in eco-
nomic diplomacy with neighbors has been a sore
point, some states like Tripura, which shares a
border with Pakistan, have played a positive role in promoting economic ties and greater people-to-people contact. There is a
strong political consensus in both these states for
better trade ties with their respective neighbors and the business community has been generally
supportive (Rajamohan, Nov. 29, 2014). Tripura, unlike West Bengal, has sought to play a con-
structive role in India’s ties with Bangladesh. In
2012, Prime Minister Sheikh Hasina was invited to
the state and conferred an honorary doctorate; only a few months after West Bengal Chief Min-
ister Mamata Banerjee prevented the signing of a
treaty between the two countries to share water
from the Teesta River (Talukdar, Jan. 12, 2012).

OBSTACLES AND CHALLENGES
Some major challenges exist, however, to inter-
ventions by state governments in foreign policy:
First, it is often argued that as growth is
skewed, certain regions are not able to partici-
pe in this process. This point has been acknowl-
edged by the prime minister on a number of
occasions. In this context, there is a significant
thrust to develop the northeast and other back-
ward regions. The current government has not
only urged greater infrastructure connectiv-
ity between the northeast and the rest of India,
but also between the northeast and important
neighbors such as Myanmar. In addition to the
prime minister, senior leaders who have visited
the region include Commerce Minister Nirmala
Sitharaman and Home Minister Rajnath Singh
(Thokchom, Mar. 2, 2015). One of the important
steps being taken is the setting up of a trade zone
at Behiang, adjacent to Chin state in Myanmar
(The Telegraph, Feb. 10, 2015).

Second, while the current government has been
encouraging states seeking foreign investment,
the issue of trying to forge better overall relations with neighboring countries is more sensitive. It
remains to be seen, for example, whether New
Delhi will permit Pakistan to foster economic and
people-to-people contact links with Pakistan.

Third, while the idea of granting autonomy
to states in foreign policy and economic pol-
cy is one thing, tangible measures are also
required to ensure that state governments can actually play a meaningful role. India could
look to the Chinese model, where two organi-
izations exist at the provincial level — the Pro-
vincial Foreign Affairs Offices and the Foreign
Economic and Trade Commission (FETC). The
former handler non-economic issues such as
people-to-people interactions and visiting for-
ign delegations. The FETC, meanwhile, han-
dles economic relations with other countries.
As mentioned earlier, on more than one occasion
Modi has spoken of the need to create export
promotion councils in India’s states, while also
calling for states to set up representative trade
offices abroad. In addition, India can grant
greater powers to its existing branch secretari-
ats so that they can effectively fulfill the func-
tions of Provincial Foreign Affairs Offices.

In conclusion, it is important to realize that
links between state governments and the out-
side world should not be restricted to only a few
regions in India. This phenomenon should ben-
efit larger numbers of sub-regions, and apart
from economic ties, states and provinces should
explore other areas where they can co-operate and
learn from each other.

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NEWSPAPER & MAGAZINE ARTICLES


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