

ABSTRACT

The present study attempts to examine the trends and determinants of foreign direct investment (FDI) inflows across Indian states, with special emphasis on the role of infrastructure and institutions. The basic objectives of the study include examining the trends and variations in FDI inflows as well as in physical and social infrastructure facilities in Indian states, understanding the role of infrastructure as a determinant of inter-state variations in FDI inflows controlling the influence of other factors like profitability, risks of investment, research and development intensity and domestic investment, and understanding institutions-FDI relationships at the state-level. The study is based on a panel dataset consisting of 16 groups of Indian states over the period from 2001-02 to 2005-06 and uses standard statistical tools and econometric techniques to address the objectives. The necessary data and other related information are collected from a variety of secondary sources. It is found that there are wide-scale differences in FDI inflows and availability of infrastructure facilities in Indian states. Further, trends in FDI inflows and development of infrastructure vary across the states as well. It is found that there is no significant impact of infrastructure on inter-state differences in FDI inflows. Instead such differences are caused by business performance of the existing firms, i.e., by the level of and variability in their profitability. While higher profitability of the existing enterprises in a state raises FDI inflows, greater variability in it reduces the same. The business performance of the firms, in turn, is determined by the institutional factors like crimes and industrial disputes. While higher crime rates indicate weak law and order, large number of industrial disputes stands for non-conducive business environment. All these influence business performance adversely and hence discourage FDI inflows. This means that institutional factors determine inter-state variations in FDI inflows via business performance of the existing firms. Hence, the present study suggests that bringing in greater FDI inflows into a state requires a stable government with effective regulation of the market forces and creating conducive business environment with good governance practices to induce potential foreign investors.

Keywords: FDI, Infrastructure, Profitability, Risks, Institution, Governance, Policy