Regional Disparities in Foreign Direct Investment and Their Impact on Economic Growth: A State-Level Analysis of India (2005–2019)

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Abstract:
Foreign Direct Investment (FDI) has been a major driver of India's economic growth, bringing capital, technology, managerial expertise, and integration into global production networks. However, its distribution across states from 2005 to 2019 has been highly uneven, with industrially advanced and urbanized regions such as Maharashtra, Karnataka, Gujarat, Tamil Nadu, and Delhi capturing the majority of inflows. Less developed states, including Bihar, Jharkhand, Odisha, and the North-Eastern states, received minimal FDI due to weaker infrastructure, limited policy support, and governance challenges. Sectoral analysis shows concentration in IT, financial services, automobiles, telecommunications, and petrochemicals, reinforcing regional specialization. High-FDI states experienced stronger GSDP growth, employment generation, and industrial diversification, whereas low-FDI states remained reliant on agriculture and domestic consumption. Institutional standards, investment assistance, and policy frameworks all have an effect on persistent disparities. To close these gaps, we need to make specific changes to infrastructure, governance, along with state-level industrial policies to make sure that growth is fair and that differences between states are smaller.

Keywords: Foreign Direct Investment (FDI); Regional Disparities; Economic Growth; Gross State Domestic Product (GSDP); State-Level Development; Investment Distribution

INTRODUCTION

FDI is one of the most important factors in making the world economy more global in the 21st century. For developing economies like India, FDI is not just a way to get money from outside the country; it is also a way to get advanced technology, management skills, and to join global production networks. Many people think that foreign investment is a major driver of growth because it leads to more jobs, more infrastructure, and more industrial development (Borensztein et al., 1998). India has become one of the fastest-growing places in the world for foreign investors since it started liberalizing its economy in 1991. India has consistently been one of the top places to receive FDI flows (UNCTAD, 2020) because of reforms in trade, investment, taxation, and corporate governance that have made the investment environment more open and competitive.

Even though FDI is growing at the national level, it is still very unevenly spread across Indian states. Maharashtra, Karnataka, Gujarat, Tamil Nadu, and Delhi are the states that get the most money from other states. Bihar, Jharkhand, Odisha, and a few North-Eastern states get very little money from other states (Mukherjee, 2015). This regional imbalance has made people worried about inclusive development because FDI tends to make existing gaps worse by favoring states with good infrastructure, skilled workers, and good governance. The uneven distribution of investment has consequences for India's federal structure, as states vie for foreign capital by providing fiscal incentives, land, and policy concessions.

Between 2005 and 2019, India witnessed significant growth in both aggregate FDI and its sectoral diversification. Sectors such as information technology, telecommunications, automobiles, financial services, and renewable energy have emerged as leading recipients, often concentrated in states with established industrial ecosystems. In contrast, states dependent on agriculture or natural resources have struggled to attract sustained foreign investment, leading to limited diversification and slower growth. The link between FDI and gross state domestic product (GSDP) therefore varies significantly across states, with high-recipient states demonstrating stronger economic performance.

The significance of this study lies in examining how regional disparities in FDI inflows have shaped patterns of growth at the state level. While India as a whole has benefitted from FDI, the uneven spread suggests that national growth may conceal substantial state-level inequalities. Previous research has highlighted the national benefits of FDI, but fewer studies provide comparative insights into its distribution and effects across states during the period 2005–2019. This time is especially important because it includes India's consolidation after liberalization, diversification of sectors, and the global financial crisis, as well as major changes to domestic policy like the Goods and Services Tax (GST) and "Make in India."

This paper contends that regional disparities in FDI are not solely the result of market dynamics but are influenced by structural, institutional, and policy-related factors. To fix these differences, both the federal and state governments need to work together to improve infrastructure, help people learn new skills, and make it easier for businesses to invest in areas that are behind.

LITERATURE REVIEW

The examination of FDI and its influence on economic growth has garnered significant interest in both theoretical along with empirical literature. Various frameworks, such as the FDI-led growth hypothesis, the eclectic paradigm, and endogenous growth models, elucidate the role of foreign capital in development. This section looks at important contributions in four main areas: theoretical perspectives, global evidence, studies specific to India, and differences between regions.

Theoretical Perspectives

Endogenous growth models, which stress the importance of technology, innovation, and capital accumulation, are the theoretical basis for looking at how FDI affects growth. Borensztein, De Gregorio, and Lee (1998) contend that FDI fosters growth through the transfer of advanced technologies and expertise, contingent upon the host country's adequate absorptive capacity in human capital. Dunning's (1993) eclectic paradigm, also called the OLI (Ownership, Location, Internalization) framework, does the same thing by showing what factors affect FDI inflows. This framework says that investors pick places to invest based on things like market size, cost structures, natural resources, and the policy environment. States with better infrastructure, government, and skilled workers naturally get more investment, which makes the differences even bigger.

Global Evidence

International literature emphasizes that FDI functions as both a financial resource and a structural catalyst, yet its effects are significantly contingent upon context. Nunnenkamp and Stracke (2007) contend that the developmental advantages of FDI are largely contingent upon institutional quality, political stability, and human capital. In nations characterized by fragile institutions, FDI frequently fails to produce significant spillovers, remaining restricted to enclave activities with minimal integration right into the local economy. For instance, in sub-Saharan Africa, FDI has been significant in extractive industries; however, it has not resulted in widespread growth due to governance issues and limited absorptive capacity (Asiedu, 2006). On the other hand, China, South Korea, and Vietnam in East Asia have shown how FDI can speed up structural change when it is combined with strong state-led industrial policies, investment in skills, and strategies that focus on exports (UNCTAD, 2020).

The World Investment Report (2020) also says that changes in production networks, digitalization, and sustainability goals have an effect on global FDI trends. The rise of global value chains (GVCs) has made it easier for FDI to become a part of host economies, especially in places where manufacturing is done. Countries that don't have the right policies and infrastructure to connect to

GVCs, on the other hand, often stay on the outside. Evidence from Latin America indicates that, despite substantial FDI inflows, insufficient connections with local enterprises and reliance on resource sectors constrained long-term growth impacts (OECD, 2019).

The sectoral composition of FDI is another important part of global evidence. Research demonstrates that FDI in the services and technology sectors generally yields more substantial positive spillovers than investments driven by natural resources, which may intensify inequalities and environmental degradation (Alfaro, 2017). Additionally, FDI in tourism, IT, and manufacturing frequently invigorates small and medium-sized enterprises (SMEs) via supplier linkages, whereas resource-oriented investments may circumvent local economies. These global experiences show that FDI results differ not only in volume but also in quality, sectoral distribution, and policy context.

FDI and Economic Growth in India

India's experience with FDI shows a mixed but mostly positive picture. There have been big gains at the national level, but there are still imbalances at the regional level. Since liberalization in 1991, India has emerged as one of the top global destinations for foreign investment, recording steady inflows particularly after 2000 (Mukherjee, 2015). Kumar (2019) notes that FDI has played a crucial role in enhancing industrial capacity, promoting export competitiveness, and modernizing infrastructure in sectors such as telecommunications, automobiles, and financial services. These investments not only provided capital but also facilitated technology transfer, managerial know-how, and integration into global production systems.

However, the spatial distribution of these benefits is highly skewed. States such as Maharashtra, Karnataka, Gujarat, Tamil Nadu, and Delhi NCR consistently capture the majority of inflows due to their established industrial ecosystems, skilled workforce, and proactive investment policies (Singh & Agarwal, 2020). In contrast, states in eastern and northern India including Bihar, Uttar Pradesh, Jharkhand, and Odisha remain marginalized, receiving only a negligible share of total FDI. This concentration reinforces a core–periphery pattern within the Indian economy, where high-recipient states experience faster industrialization and employment creation, while lagging states remain dependent on agriculture and remittances.

Another key aspect is sectoral concentration. Delhi NCR and Maharashtra have attracted significant FDI in financial services and IT, while Karnataka has become the hub for software development and R&D. Gujarat has leveraged its port infrastructure to attract petrochemical and automobile investments, and Tamil Nadu has consolidated its position as an automotive and electronics manufacturing hub. On the other hand, resource-rich states like Odisha and Chhattisgarh, despite their mineral reserves, face regulatory bottlenecks, weak infrastructure, and land acquisition issues that deter long-term investors (Mukherjee, 2015).

Furthermore, the relationship between FDI and Gross State Domestic Product (GSDP) varies across states. High-FDI states generally exhibit stronger GSDP growth, suggesting that foreign capital acts as a growth multiplier by boosting industrial output, exports, and employment. Low-FDI states, on the other hand, grow mostly because of agriculture or domestic consumption. This growth is less stable and less connected to global markets. Singh and Agarwal (2020) stress that this uneven integration leads to a dual-track economy in which some states gain more from globalization than others.

Lastly, the geography of FDI has also been affected by states competing with each other on policy. States that get a lot of investment often have policies that are good for investors, like single-window clearance systems, tax breaks, and industrial corridors. On the other hand, states that don't get a lot of investment have problems with bureaucracy and governance. This has caused the gap between institutions to grow, which keeps the cycle of divergence going.

Regional Disparities in FDI

The literature on regional disparities in FDI inflows to India highlights both structural and policy factors. Mukherjee (2015) says that the differences are due to differences inside infrastructure, human resources, and policies at the state level. States that get a lot of money have benefited from well-developed transportation networks, and industrial clusters, along with boards that promote investment. On the other hand, states that are behind have problems with bad connections, not enough electricity, and poor government institutions. Singh and Agarwal (2020) assert that policy competition across states has intensified the disparity, as affluent states can offer more attractive fiscal incentives.

Evidence from case studies shows that even states with a lot of resources, like Jharkhand and Odisha, have trouble getting long-term FDI because of problems with regulations, political instability, and land acquisition (Kumar, 2019). On the other hand, states like Karnataka and Gujarat have made investors more confident by using proactive policies, and single-window clearances, along with partnerships between the public and private sectors. The North-Eastern states, despite their strategic location and natural resources, continue to be among the lowest recipients, primarily due to inadequate infrastructure and security concerns.

RESEARCH GAPS

Although there is a lot of research on FDI in India at the national level, there isn't much research on how state-level inflows change over time. A lot of the work that has already been done looks at either overall national trends or short-term snapshots. The years 2005 to 2019 are still not well studied, even though they were a very important time of change around the world and in the US. Additionally, there are limited studies that directly associate FDI inflows with state-level growth metrics, including GSDP, sectoral diversification, and job creation. To make policies that encourage balanced regional development, we need to fill this gap.

RESEARCH OBJECTIVE

1. To map the growth of FDI inflows across Indian states between 2005 and 2019.
2. To examine the relationship between FDI inflows and economic growth at the state level.
3. To provide policy recommendations aimed at reducing regional disparities in FDI inflows and promoting balanced development.

RESEARCH METHODOLOGY

This study employs secondary data from 2005 to 2019, primarily obtained from official sources such as the Department for Promotion of Industry and Internal Trade (DPIIT), the Reserve Bank of India (RBI), along with the Ministry of Statistics and Programme Implementation (MoSPI), supplemented by reports from the World Bank, OECD, and UNCTAD. To look at differences and patterns between regions, we put together state-by-state FDI inflows, sectoral distribution, and Gross State Domestic Product (GSDP) numbers. To find trends and see how things were different, we used descriptive statistics like growth rates, percentage shares, along with concentration ratios. The data analysis integrated quantitative data with qualitative insights, linking inflow patterns to structural, institutional, along with policy-related determinants. Case studies taken directly from both high- and low-FDI recipient states supported this. This method helped us get a balanced view of how FDI affects growth at the state level and gave us a reason to suggest policies that would help close the gap between regions.

LIMITATION OF STUDY

This study is constrained by its dependence on secondary data, which may fail to reflect informal investments or impacts at the community level. The emphasis on total FDI and GSDP neglects micro-level results, including employment quality and income distribution. The analysis concludes in 2019, omitting recent policy modifications and post-pandemic developments. Descriptive methods reveal disparities but fail to determine causality, rendering the findings indicative rather than conclusive.

FINDINGS AND DISCUSSION

The examination of state-level FDI inflows in India from 2005 to 2019 indicates significant disparities in both the magnitude of investment and its correlation with economic growth. A small group of states consistently drew in most of the FDI, while most states stayed on the outside of global capital flows (DPIIT, 2020; RBI, 2019). This uneven distribution has had a direct effect on how regions grow, making developmental gaps in India even bigger (World Bank, 2020).

Concentration of FDI inflows

According to official statistics, Maharashtra, Karnataka, Delhi (including NCR), Gujarat, and Tamil Nadu together received more than 70% of all FDI during the study period (DPIIT, 2020). These states had a lot going for them, like a strong industrial base, good infrastructure, big cities, and policies that encouraged investment (Kumar, 2020). On the other hand, Bihar, Jharkhand, the Northeastern states, and some parts of central India got very little FDI. This is because of structural problems, problems with governance, and bad connectivity (OECD, 2019).

Sectoral Dynamics and Regional Specialization

The distribution of FDI inflows also reveals sector-specific clustering. Maharashtra and Delhi NCR attracted major inflows into financial services, IT-enabled services, and telecommunications, reflecting their role as service-sector hubs (KPMG, 2024). Karnataka remained a magnet for information technology and R&D-related investments, while Gujarat attracted significant inflows in petrochemicals, automobiles, and port-led infrastructure (Ministry of Commerce & Industry, 2020). Tamil Nadu consolidated its position in automobile manufacturing and electronics, further strengthening regional specialization (UNCTAD, 2020).

Linkages with Economic Growth

An examination of gross state domestic product (GSDP) growth rates highlights that states receiving higher FDI inflows also experienced stronger growth trajectories (RBI, 2019). Gujarat, Maharashtra, and Karnataka consistently recorded above-average GSDP growth, partly attributable to foreign capital flows that boosted industrial capacity, technology transfer, and employment (World Bank, 2020). Conversely, states with minimal FDI presence such as Bihar and Uttar Pradesh saw growth driven largely by domestic consumption or agriculture, with weaker integration into global value chains (Agarwal & Khan, 2021). This suggests that while FDI is not the sole determinant of growth, it plays an enabling role in amplifying state-level economic dynamism.

Persistent Regional Disparities

Despite three decades of liberalisation, the gap between high-FDI and low-FDI states has not narrowed significantly (DPIIT, 2020). Rather, the agglomeration effect has intensified, with global investors preferring states that already possess strong institutional capacity, world-class infrastructure, and favorable business environments (Hudson & Ritchie, 2006). This self-reinforcing cycle has meant that underdeveloped states face a “low equilibrium trap,” where limited FDI inflows restrict their ability to accelerate growth, further deterring future investments (Riley, Baker, & Van Doren, 1998).

Community and Employment Implications

In high-FDI states, foreign investments translated into direct employment opportunities in manufacturing, services, and infrastructure, alongside indirect benefits for local suppliers and service providers (KPMG, 2024). However, in lagging states, the absence of such opportunities contributed to continued outmigration of skilled and semi-skilled workers (OECD, 2019). This trend has exacerbated intra-national labour mobility, further strengthened the growth poles while leaving lagging regions dependent on remittances (World Bank, 2020).

Policy and Institutional Factors

The findings highlight that FDI disparities are not merely a function of geography but are strongly linked to state-level governance, regulatory efficiency, and investment facilitation (Ministry of Tourism, 2023). States such as Gujarat and Karnataka implemented proactive single-window clearance systems and sector-specific industrial policies, which significantly enhanced investor confidence (DPIIT, 2020). Conversely, states characterized by inadequate governance frameworks and land acquisition impediments did not succeed in attracting substantial investments (Agarwal & Khan, 2021).

DISCUSSION

These patterns show that FDI inflows inside India are uneven across regions and closely linked to how ready states are for development. Pumping a lot of money into a few states could lead to uneven development, which goes against the goal of balanced regional growth (World Bank, 2020). India must transcend mere aggregate inflows of FDI and tackle structural impediments in underperforming states to fully leverage foreign direct investment as a catalyst for inclusive growth. To close the gaps, it is important to improve infrastructure, make it easier to do business, and encourage investments in specific sectors in areas that are not yet fully developed (KPMG, 2024; UNCTAD, 2020).

CONCLUSION

Since 2005, FDI has helped India's economy grow a lot, but it is still not equally dispersed out across the country. Cities and industrial areas still get most of the money that is brought in. States that aren't as developed are falling behind because their governments are having trouble, their infrastructure isn't as strong, and their policies aren't as strong. This imbalance makes the variances in growth along with development between regions even bigger. To make sure that everyone benefits from FDI, we need to make specific changes to infrastructure, strengthen institutions, and make state-level policies that include everyone. In the long run, equitable allocation of FDI can help India prosper by encouraging growth that benefits all individuals and making the differences between states smaller.

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