Provincial Politics and the Attraction of FDI in India and China

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INTRODUCTION

Interest in understanding the correlates of foreign direct investment (FDI) has grown considerably over the past several decades. A number of theoretical and empirical models have been introduced in the economics literature which highlight the benefits of attracting FDI, particularly for developing nations (Dunning 1981). For underdeveloped economies, an inflow of foreign capital—particularly from developed nations—facilitate a transfer of knowledge and technological spillovers with the potential to jump start economic development (Mansfield and Romeo 1980). The vast majorities of studies rely on national level data, analyzing variation in FDI flows across nations. While cross national studies are no doubt useful, past research has paid insufficient attention to the significant variation in FDI within nations. This study attempts to move the literature in this direction.

Investing significant material resources in a foreign country is a risky enterprise. Political systems are designed to best serve domestic constituents and rarely are the interests of foreign investors placed above the exigencies of domestic politics. In order to mitigate the potential negative implications of risk, FDI has traditionally moved between nations with similar legal, political, and societal structures (Kaufmann, Kraay, and Mastruzzi 2003, 2008; De Soto 1989, 2000). However, expanding investment opportunities throughout the developing world are changing the global investment environment (World Bank 2005, 2007). While much of the world’s FDI continues to flow between highly developed nations, the percentage flowing to less developed nations is increasing at steady rate (World Bank 2007). These shifts highlight the opportunities and challenges
facing both domestic governments and international investors in a highly integrated global environment.

In order to address variation in FDI at the sub-national level, we focus attention on India and China—two emerging markets with enormous economic potential. Both India and China are fortunate to have massive populations, substantial resources, and a considerable amount of untapped potential. Further, these emerging markets have made significant steps in liberalizing their economic systems and allowing for FDI inflows. For example, Indian net FDI inflows have grown from US$ 73 million in 1991 to US$ 22 billion in 2008 (World Bank, 2010). Likewise, Chinese FDI inflows increased from approximately US$ 3 billion to over US$ 94 billion for the same period. The natural economic advantages of these countries, however, raise important political questions. Do India and China have the government capacity to realize their economic potential? How is government capacity distributed across the provinces of these nations? Does variation in government capacity help to explain variation in regional FDI flows? We address these questions by examining the spatial distribution of FDI and relative political capacity (RPC) across Indian and Chinese provinces. Using panel data during the period 2000 – 2005, we examine the relationship between RPC and FDI at the provincial level. Our empirical results suggest an inverted U shape relationship between investment and capacity, supporting the presence of an optimum level of capacity at the provincial level.

1 We are extremely grateful to Siddharth Swaminathan and the Trans National Consortium for providing us with provincial level estimates of relative political capacity. Without his and their generosity this study would not have been possible.
There is a well established literature at the national level on the potential drivers of FDI. General explanations tend to focus on two different—though not mutually exclusive—paths: one based on economics and the other on political explanations. This section will briefly review each explanatory framework, with particular attention paid to the empirical literature. Although most empirical studies on the correlates of FDI focus attention at the national level, we will also provide a brief overview of FDI at the sub-national level in India and China.

**Economic Explanations**

Most economic studies on the drivers of FDI flows begin with measures that attempt to proxy market size. The variables typically used to capture the effects of market size include population (Wei 2000; Feng 2003), GDP, and GDP per-capita (Chakrabarti 2001). Theoretically, measures of market size fall into the more general category of ‘location related factors’ described in Dunning’s (1981) classic ownership, location, and internalization (OLI) framework. Each measure attempts to provide an indicator of a particular geographic region’s consumer base and thus provides a rough indicator of the profitability associated with a particular foreign investment (Banga 2003). Empirically, Chakrabarti (2001) demonstrated that measures of market size offer one of the only robust predictors of FDI flows at the national level.
In addition to market size, many studies argue that economic growth explains shifts in FDI flows. A number of studies argue that economic growth facilitates additional business opportunities, changes the economic incentive structures of domestic populations, and transforms the type of FDI available to a particular host economy (Chen & Khan 1997; Billington 1999). Moreover, economic growth has the potential to promote changes in a nation’s industrial structure, aiding the development of industries better positioned to compete on a global stage (Wheeler & Mody 1992).²

Political Explanations

Although economic explanations have dominated the empirical literature on FDI, several recent empirical studies have begun to acknowledge the importance of political factors (c.f., Wheeler & Mody 1992). Among potential political indicators, a number of recent studies have focused on the importance of government capacity. Adji, Ahn, Holsey and Willett (1997) show that variants of relative political reach and political extraction have significant and substantive positive effects on FDI at the national level. Likewise, Feng (2003) found a statistically significant relationship between relative political capacity and the stock of FDI inflows in his exhaustive empirical study of political institutions. More recently, Coan and Kugler (2008) provide evidence to suggest the presence of an interactive relationship between open market policy environments and a nation’s level of relative political capacity. Coan and Kugler’s finding support the notion that governments attract FDI when they have the political capacity to realize their commitments to liberal economic policies.

² For a complete overview of the whole range of economic variables thought to influence FDI and the empirical robustness of each measure, see Chakrabarti (2001).
Foreign Direct Investment in India

Until recently, India placed high levels of restrictions on the inflow of foreign capital and closely monitored the industries open to foreign investment. Although a number of protectionist policies remain in place, India enacted its first major financial reforms in the mid-1990s. Recent studies indicate that these reforms had immediate, positive implications for India’s level of economic development (c.f., Bhaduri 2005). Moreover, a number of studies suggest that economic liberalization was central to the dramatic increase in FDI over the 1990s and into the 2000s (Shirai 2004). Prior to 1991, in order to gain government approval, foreign firms interested in investing in India were required to enter into a joint venture with a domestic firm. These early investments in the mid-1990s thus represented the creation of India’s first wholly-owned foreign subsidiaries.

While economic liberalization enhanced India’s ability to attract foreign capital, the increase in FDI was distributed unevenly across Indian provinces. According to Bhalla (1998), early investment was concentrated primarily in southern India due to a higher level of perceived commitment to deregulation in southern provinces. As described in more detail below, much of India’s FDI continues to flow to southern India in general and to the province of Maharashtra in particular. In summary, most analysts agree that India has benefited a great deal from economic liberalization; though most experts agree that the country still has a long way to go (Srivastava and Sen 2004).
Foreign Direct Investment in China

Foreign direct investment inflows can be traced as far back as the inception of the People’s Republic of China. Indeed, during the 1950s and 1960s a relatively small level of foreign investment entered China from other socialist nations. For example, during the 1950s, joint ventures such as the Sino-Soviet Xinjiang Non-ferrous Metal Company, Sino-Polish Joint Stock Shipping Company and the Sino-Czechoslovakian International Marine Transport Company were established. With the deterioration of Sino-Soviet relations in the 1960s, however, many of these joint ventures collapsed although a few of the Eastern bloc nations such as Poland continued to invest in China (Wei and Liu, 2001). Nevertheless, the magnitude of FDI inflows during this period was very small.

With the ending of the Cultural Revolution and the rise of Deng Xiaoping to power, China began to liberalize its economic policies and to open itself to the West. The economic reforms that materialized after 1979 had substantial impacts on the magnitude of foreign investment inflows. FDI no longer was constrained to the “socialist world”. Rather, the new political leadership understood that if economic prosperity was to be achieved, capital, technology and managerial experience was required—all of which could be attained through foreign direct investment (Wei and Liu, 2001). Although reforms began in the early 1980s, considerable institutional inertia remained which opposed perceived dependence on foreign sources of investment. It was not until the 1990s that the Chinese government sent serious signals to the outside world that China was truly committed to market-oriented policies and as a result FDI increased dramatically (Wei and Liu, 2001; OECD, 2002).
The ability of India and China to maximize their investment potential in the future will depend in large part on a continued political commitment to maintaining the open market policies crucial to securing a profitable international investment environment. Moreover, maintaining adequate levels of government capacity will be crucial to sustained economic reform in the face of domestic opposition. With these potential challenges in mind, the remainder of this study turns to analyzing the empirical relationship between economic factors, political capacity, and the flow of FDI.

**Theory and Hypotheses**

How does politics impact a government’s ability to attract foreign investment? As demonstrated above, there is a burgeoning empirical literature on the relationship between political capacity and FDI. This study seeks to extend these past works by examining the empirical relationship between foreign investment and political capacity at the sub-national level. There exist many conceptualizations of government capacity in the academic literature; however, the approach utilized in this study centers on the influential work on relative political capacity carried out by Kenneth Organski and extended in Arbetman and Kugler (1998). Following Organski, Arbetman, and Kugler, we define political capacity as a government’s ability to carryout a given set of policy objectives in the face of groups with competing political priorities. Regarding foreign investment, high levels of political capacity imply a government’s ability to carryout market friendly economic policies despite the possibility of political opposition.
The ability of governments to extract resources from domestic populations is at the heart of our conception of political capacity. As outlined in Arbetman-Rabinowitz and Johnson (2007),

Governments all require resources in order to enact policies. Taxation represents willingness on the part of the population (or enforcement ability on the part of the government) to transfer resources from private individuals to the government. This resources transfer is the bridge between politics and money; taxation demonstrates an endorsement or at least acceptance of the government by the population. (pg. 4)

Governments with a high level of extractive capacity are in a better position to pursue their political objectives. In the context of FDI, high levels of political capacity imply that governments have the capability to provide the physical infrastructure, political institutions, and mobilize the human resources necessary to ensure a profitable investment environment. This discussion suggests the following proposition relating political capacity and FDI:

*Proposition 1: There is a positive relationship between provincial political capacity and the attraction of FDI.*

Empirical researchers must be careful, however, not to oversimplify the relationship between extractive political capacity and FDI. Over-taxation is likely to hinder business
development, as local governments walk the fine line between developmental and predatory economic policies. Moreover, some have argued that the potential for predation is particularly acute in socialist democratic India.\textsuperscript{3} This argument suggests that positing a monotonically increasing relationship between political capacity and FDI may be inconsistent with empirical realities in Indian provinces. In order to examine the possibility of nonlinearities in political capacity, we examine the following corollary:

Corollary 1: There is an inverted U-shape relationship between provincial political capacity and the attraction of FDI.

To our knowledge, this is one of the first studies to examine the empirical relationship between political capacity and FDI in India and China at the sub-national level. The remainder of this study outlines the data and methods used to test the above propositions; provides a description of the empirical results; and concludes by discussing the relevance of the results for sub-national economic development in India and China.

DATA

Dependent Variable: FDI

In order to examine the empirical relationship between FDI and government capacity in India and China, we examine provincial level data over the period 2000 to 2005.\textsuperscript{4} The


\textsuperscript{4} Problems associated with missing data are common in empirical studies of FDI and these problems are particularly acute at the sub-national level. Consistent with national level studies on the correlates of FDI, close to 50\% of the possible observations are omitted in the analysis below due to missing data and list-wise deletion. In India, as in other developing nations, missing data tends to be highly correlated with the size and development status of the province. Moreover, according to a series of logistic regression models,
dependent variable in the analyses below for India is level of “approved” foreign direct investment provinces.\(^5\) For India, approved FDI is available from the Indian Ministry of Commerce and Industry and is measured as a crore of rupees.\(^6\) Figure 1 displays the geographic distribution of the average level of FDI and Political Capacity across Indian provinces over the 6 year period under study. As shown in the right map, the province with the darkest shade, Maharashtra, serves as a major center for India’s foreign investment. This finding is not surprising given that Maharashtra also serves as the center of India’s industry and commerce. Figure 1 indicates that the average level of FDI falls precipitously as one moves north from Maharashtra into the largely agricultural states of Madhya Pradesh and Bihar. Overall, it appears that provinces located around Maharashtra with access to coastal sea ports tend to attract greater foreign investment—though the spatial relationship appears weak at best.

![Insert Figure 1 about here](image)

China has a clearer data collection when it comes to FDI and because of this factor FDI is not “approved” as in India but actual FDI in US Dollars. This data is as been compiled by the China Data Center at the University of Michigan and the National Bureau of

\(^5\) A potential limitation of this measure is that the FDI is ‘approved,’ but not actually spent. However, given the hypotheses above, our concern is primarily with where foreign investors choose to invest—i.e., FDI is the dependent variable in the analyses below. This measure would be less appropriate for scholars interested in using FDI as a explanatory variable.

\(^6\) A crore is equivalent to ten million.
Statistics of China. The clarity of data and the standardization of its measurements allows for a greater degree of understanding on how and where FDI moves within the country. As the top map in Figure 2 shows, FDI in China, over the last five years, is located primarily on the coastal provinces and then has started to move towards the interior. The provinces of Guangdong and Jiangsu are of particular interest as both had many of the first economic reforms. These free economic zones then lead to large investments in physical capital such as new container ports, transportation networks, and other massive construction projects within the cities. Notice that this isn’t due to the conditions on the ground. Policy created the first avenues for FDI and as you can see from the figure FDI has started to move towards the other non-coastal regions of China.

*Key Independent Variable: Political Capacity*

Political capacity is approximated by the measure of relative political extraction (RPE) developed in Arbetman and Kugler, 1997. At the national level, RPE has been used to explain a wide range of economic and political phenomena, from economic growth (Leblang 1997) to civil conflict (Johnson 2007), and more recently FDI (Coan and Kugler 2008). The measure is constructed using a series of multiple regression models to predict the expected levels of government extraction, and compares the expected levels to actual levels of extraction. More importantly for this study, however, is that several recent studies have extended the concept to the provincial level, modifying the empirical specification to incorporate sub-national dynamics (Swaminathan 2005, 2007; Johnson 2007). The measure is constructed such that higher values indicate greater levels of

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7 Extending the measure of RPC to the provincial level requires a number of modifications to the core specification presented in Arbetman and Kugler (1997). Scholars must pay special attention to the structure
provincial political capacity. For India, the average $RPE$ level is 1.04—i.e., the expected level of capacity—and the standard deviation is .46. In China the mean provincial political capacity level is 1.04 while the standard deviation is .52.

The left map in Figure 1 displays the average level of $RPE$ across Indian provinces over the 6 year period under study. As shown in the figure, there is a good deal of spatial dependence associated with political capacity. $RPE$ is relatively high in the southern provinces of Tamil Nadu and Karnataka, close to the expected level in provinces located in the middle of the country, and low in the largely agricultural regions of Uttar Pradesh and Bihar. It is also important to note that even after controlling for federal transfers, the conflict torn northern region in and around Kashmir maintains high levels of extraction.

Insert Figure 2 about here

The lower map in Figure 2 offers a geographic representation of the average level of $RPE$ in China for the sample period. Provincial level political capacity seems to exhibit less spatial dependence compared to that of India. Some descriptive patterns are evident nevertheless. Major metropolitan centers such as Beijing and Shanghai perform above their predicted level of extraction, while the western provinces of Qinghai and Sichuan have low levels of political capacity. Heilongjiang, which borders Russia, along with the coastal provinces of Hebei and Jiangsu also seem to be underperforming on average for the period studied. In contrast, aside from the aforementioned metropolitan areas, the

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of a nation’s tax system, the level of government primarily responsible for tax collection, and the potential confounding influence of inter-government transfers. For an overview of modeling political capacity at the sub-national level, see Arbetman and Johnson (2007) or Johnson (2007, Appendix II).
highest performing provincial governments seem to be located in the southern part of China. 

**Economic Control Variables**

In order to ensure proper specification of the regression equations presented below, a number of control variables were introduced. While the economics literature suggests a wide range of potential correlates, Chakrabarti (2001) ‘global sensitivity analysis’ at the national level demonstrates that only measures of market size show a robust relationship with FDI. To control for the potential effects of market size, we include two measures, the natural logarithm of population and a province’s level of economic output which is measured as GDP. In addition to measures of market size, we incorporate real GDP growth given the prevalence of empirical studies that include the measure. Both GDP and economic growth are lagged in order to mitigate problems associated with endogeneity.

**MODEL SPECIFICATION AND RESULTS**

Given that the dependent variable used in this analysis is continuous, we utilize standard ordinary least squares (OLS) estimates to arrive at our statistical results. Before specifying the statistical model, however, it is important to address a variety of statistical issues associated with our dataset, including issues related to pooling observations across time and space. Problems associated with unequal variance across pooled observations may affect the validity of statistical results (Sayers, 1989). To address this issue, we analyzed a series of models that included two-way fixed effects to control for differences
across distinct regions and time. Previous empirical studies on FDI have discussed the problem of first order autocorrelation when estimating investment inflows across units and time. To account for this, we estimate our fixed-effects models with robust standard errors clustered by province (Arellano, 1987; Rogers, 1993). With these econometric considerations in mind, we estimate models of the following form:

$$FDI_t = \beta_0 + \beta_1 RPE_t + \beta_2 RPE^2 + \alpha C_t + \gamma FE_R + \lambda FE_T + \epsilon_t$$  \hspace{1cm} (1)

Where $FDI$ represents the stock of foreign direct investment inflows; $RPE$ represents relative political capacity; $RPE^2$ adjusts the model for possible nonlinearities in political capacity; $C$ is a vector of control variables; $FE_R$ represents regional fixed effects; $FE_T$

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8 While the Indian population is no doubt diverse, historical analysis suggest that the country may be reasonably broken up into four distinct regions. These four regions include:
1. Northern Region: This region consists of the states of Uttaranchal, Haryana, Punjab, Himachal Pradesh, Uttar Pradesh, Jammu, and Kashmir. These provinces are located at the foothills of the Himalayan Mountains and were the area of the great Moghal migrations of the 10th and 12 centuries and the heart of their later empire.
2. Southern Region: This region consists of the states of Tamil Nadu, Goa, Karnataka, Kerala, and Andhra Pradesh. Historically this region was the battle ground of the European colonial wars with the Portuguese, British, and French all having local allies and armies.
3. Eastern Region: This region consists of the states of Sikkim, West Bengal, Tripura, Meghalaya, Mizoram, Manipur, Arunachal Pradesh, Chattisgarh, Manipur, Orissa, Assam, Bihar, Jharkhand, and Nagaland. These provinces have the largest variance in language and culture in India, with Bihar often being associated with Northern Indian groups, Sikkim being an isolated Buddhist Kingdom in the vein of Bhutan, and lastly Mizoram, Nagaland, and Manipur having connections to South-east Asia.
4. Western Region: This consists of Maharashatra, Gujarat, Rajasthan, and Madhya Pradesh. This is the industrial heart land of the country with the majority of its chemical, petrochemical, textiles, steel, and other heavy industries.

9 We aggregate Chinese provinces into three general groups:
1. Western Region: This region consists of the provinces of Chongqing, Gansu, Guizhou, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang and Yunnan. This region has had a great deal of conflict with ethnic and racial tensions increasing in Tibet and the surrounding provinces as well as in in Xiangiang with the local Uighurs. It is also in this region that the central government has mandated increasing the population with forced or incentivized population movements and settlements.
2. Central Region: This region consists of the provinces of Anhui, Heilongjiang, Henan, Hubei, Hunan, Inner Mongolia, Jiangxi, Jilin, and Shaanxi. The region stretches from the center of the country up towards Mongolia and into the ex-Manchurian provinces. It is also the primary source location for coal mines.
3. Eastern Region: This region consists of the provinces of Beijing, Fujian, Guangdong, Hainan, Hebei, Jiangsu, Liaoning, Shandong, Shanghai, Tianjin and Zhejiang. This was the region with the original economic reforms and as it is primarily coastal has also had the largest proportion of trade and increased investment both from the domestic arena and international.
represents time fixed effects; and $\varepsilon$ represents the stochastic error term. The subscripts in (1) denote country $i$ in time $t$ and thus incorporate the model’s panel structure.

The empirical results for the statistical model specified in (1), including the non-standardized regression coefficients and robust standard errors are presented in Tables 1 and 2 for India and China, respectively. Three alternative specifications are provided: 1) the ‘Base Model’ tests the non-linear political capacity hypothesis without other controls by including $RPE$ and $RPE^2$; 2) the ‘Base + Population Control’ incorporates the effects of population size; and 3) the final model introduces the key economic variables described above. Each model includes both region and time fixed effects.

*Insert Table 1 about here*

*India Empirical Results*

Turning first to the Base Model results for India displayed in Table 1, although the $RPE$ and $RPE^2$ parameters are statistically insignificant, they display the correct theoretical signs—positive and negative, respectively. Further, the base model explains approximately 19 percent of the variation of provincial FDI inflows in India. The political capacity measures become statistically significant once the economic controls are included in the fully augmented model. The empirical results provide strong support for the proposition that there is an inverted U shape relationship between political capacity and the accumulation of foreign capital in the Indian context. Regarding the economic controls, both the natural logarithm of population and the lagged market size indicator have a positive and statistically significant relationship with provincial FDI inflows, although, curiously population is in the opposite direction (negative) once the
economic indicators are included. It should be noted that the explained variance of the Full Model is quite large ($R^2=0.62$) indicating that the model fits well with observations of FDI in India over the period studied.

In order to provide a more meaningful interpretation of the empirical results, it is useful to outline the substantive implications associated with increasing $RPC$ across Indian provinces. The curvilinear shape of the political capacity effect suggests that there is a critical point at which additional capacity begins to imply diminishing returns for foreign investment. Maximizing the Full Model with respect to $RPE$ demonstrates that political capacity must reach a level of 1.72 before it begins to diminish a province’s ability to attract FDI. This result suggests that Indian provinces can extract a good deal more than expected based on economic characteristics alone before deterring foreign investors. A survey of the changes in predicted values of FDI inflows for specific Indian states as political capacity approaches the aforementioned inflection point gives us a sense of the substantive role which government capacity plays in investment flows. Beginning with the province of Maharashtra—i.e., India’s major industrial hub—the Full Model suggests that an increase from the province’s 2005 level of $RPE$ (0.96) to the optimal level of extraction (1.72) leads to an expected 610 crore increase in approved FDI or an approximate 22 percent increase in accumulated capital. Moving to the southern tip of India, these data suggest that if the province of Tamil Nadu increased $RPE$ from its 2005 level (1.21) to the optimal level, the province would experience a 30.7 percent increase in FDI. Moreover, given the nonlinear nature of the Full Model, the effects are particularly pronounced for provinces with low levels of political capacity. For instance, a similar
move for the eastern province of West Bengal—i.e., from its 2005 level of .61 to the optimal value—implies an expected shift from a net inflow of 390.12 crore to one of 1,692 crore. These results are quite strong and suggest that capacity is not only statistically, but also substantively significant in the Indian context.

*Insert Table 2 about here*

**China Empirical Results**

The results of the estimation of FDI inflows in China are presented in Table 2. Turning to the Base Model, the political capacity indicators are statistically insignificant at the traditional levels. The variance of the dependent variable which is explained by political capacity alone is 5 percent. Once the economic controls are accounted for, however, the U shaped relationship takes form and $RPE$ becomes significant at the 10% error level. It should be noted that $RPE^2$ is marginally significant ($p$-value=0.141). The lagged provincial GDP indicator has a strong statistically significant positive effect on FDI inflows. The lagged provincial growth rate is insignificant across all specifications. Similar to the Indian case, we find that once the economic controls are included in the specification, population once again exhibits a significant negative direction. Lastly, regarding model fit, the Full Model explains a significantly large share of the variation of inward FDI flows at the provincial level in China ($R^2$=0.834).

**Conclusions and Policy Implications**

The analysis above provides additional empirical support for the proposition that political capacity impacts the accumulation of foreign capital. Consistent with a number of recent
studies on the politics of FDI (Adji et al. 1998; Feng 2003; Coan and Kugler 2008), the present study demonstrates the utility of taking a political-economic approach to understanding FDI flows. Furthermore, the present study extends political explanations centering on government capacity to the sub-national level, suggesting that RPC helps to explain intra as well as international variation in FDI flows. Specifically, our core findings include:

1. The econometric results suggest that the relationship between government capacity and FDI is both statistically and substantively significant.

2. Investment within India is more open, as would be expected. Within China we have less of a clear consideration of the reasons to invest due to the central governments historical restrictions. As these restrictions decline so too will investors increasingly start to evaluate provinces in competition with each other. This could mean that the measurements of political efficiency will have an increased importance as China becomes more of an open economy.

In addition to extending the academic literature, these findings have a number of important policy implications. First, the Political Economy Model could be used to identify areas that will benefit considerably from small changes to political efficiency. As demonstrated above, we would anticipate nontrivial increases in FDI in a province such as West Bengal, with its population center in Calcutta, for India but also equally large increases in FDI to in the Central Regions of China in provinces such as Shanxi and Jiangxi. This information may prove useful to policy makers interested in facilitating
Indian and China economic development but could be more important to investors who are increasingly allowed to invest in interior provinces due to economic liberalization. These limitations have profound importance as economic polarization increases within both countries. This problem of inequality is one of the primary questions for the future of each country and it will be in the provinces that the policies are enacted to either deal with the issue or help to exasperate it.

In future research, we hope to explore the predictive capabilities of our political-economic explanation, extending the current specification to provide a nuanced view on the dynamics of FDI in India and within China. We would also like to create a greater degree of policy variables so that provincial level protectionism or political theory can be added to our models. Nevertheless, this study provides additional support for the benefits of politics used to attract FDI flows, while also demonstrating the utility of taking a sub-national approach to understanding the dynamics of capital accumulation.
REFERENCES


Figure 1: Indian State FDI Inflows and Political Capacity, 2000-2005 Average

Note: Foreign Direct Investment is measured in crore rupees
Figure 2: Chinese Provincial FDI Inflows and Political Capacity, 2000-2005 Average

Note: Foreign Direct Investment is measured in US$ 10,000
## Table 1: FDI Analysis, India (2000-2005)

<table>
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<th>Base Model</th>
<th>Base + Population Control</th>
<th>Full Model</th>
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Standard errors in parentheses

Note: Two-way Fixed Effects Results; Coefficient (Standard Error); Standard errors clustered by State

* *p < 0.10, **p < 0.05, ***p < 0.01

## Table 2: FDI Analysis, China (2000-2005)

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<th>Full Model</th>
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<td>(54692.2)</td>
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<td>---</td>
<td>98.74***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(8.140)</td>
</tr>
<tr>
<td><strong>Region FE</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Year FE</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Observations</strong></td>
<td>186</td>
<td>186</td>
<td>186</td>
</tr>
<tr>
<td><strong>R&lt;sup&gt;2</strong></td>
<td>0.050</td>
<td>0.119</td>
<td>0.834</td>
</tr>
</tbody>
</table>

Standard errors in parentheses

Note: Two-way Fixed Effects Results; Coefficient (Standard Error); Standard errors clustered by Province

* *p < 0.10, **p < 0.05, ***p < 0.01