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**DAILY EDITORIAL
ANALYSIS**

TOPIC

**Targeted Reforms Needed
To Attract More FDI**

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TARGETED REFORMS NEEDED TO ATTRACT MORE FDI

Context

- Recently, the Centre asked the state govts for investment-friendly reforms focusing on Foreign Direct Investment (FDI) which **dropped significantly in FY24 from FY23**.

About the Foreign Direct Investment (FDI) in India

- It refers to the investment made by individuals, companies, or entities from one country into another, with the intention of establishing a lasting interest in the host country's economy.
- In the context of India, FDI plays a crucial role in **driving economic growth, creating jobs, and fostering technological advancements**.

FDI Routes in India

- Automatic Route:** Under the Automatic Route, the non-resident investor or the Indian company does not require any approval from the Government of India for the investment.
- Government Route:** Under the Government Route, prior to investment, approval from the Government of India is required.
 - Proposals for foreign direct investment under Government route, are considered by the respective Administrative Ministry/ Department.

CATEGORY 1	CATEGORY 2	CATEGORY 3
100%	UPTO 100%	UPTO 100%
FDI Permitted through Automatic Route	FDI Permitted through Government Route	FDI Permitted through Government + Automatic Route

Prohibited Sectors

- Lottery Business including Government/private lottery, online lotteries, etc.;
- Gambling and Betting including casinos;
- Chit Funds;
- Nidhi Company;
- Trading in Transferable Development Rights (TDR);
- Real Estate Business or Construction of farm houses;
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes;
- Sectors not open to private sector investment- atomic energy, railway operations (other than permitted activities mentioned under the Consolidated FDI policy);

Current Data

- Total FDI inflows in the country in the FY 2023-24 is \$70.95 Bn and total FDI equity inflows stands at \$44.42 Bn.
- Mauritius (25%), Singapore (23%), USA (9%), Netherland (7%) and Japan (6%)** emerge as **top 5 countries** for FDI equity inflows into India FY 2023-24.
- Top 5 sectors** receiving highest FDI Equity Inflow during FY 2023-24 are **Services Sector** (Finance, Banking, Insurance, Non Fin/ Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis, Other)

(16%), **Computer Software & Hardware (15%), Trading (6%), Telecommunications (6%) and Automobile Industry (5%).**

- **Top 5 States** receiving highest FDI Equity Inflow during FY 2023-24 are **Maharashtra (30%), Karnataka (22%), Gujarat (17%), Delhi (13%), and Tamil Nadu (5%).**

Factors Driving FDI into India

- **Market Size:** India's large consumer base and growing middle class make it an appealing market for businesses. Companies seek to tap into this vast consumer pool by establishing a presence in the country.
- **Policy Reforms:** India has undertaken significant policy reforms to ease the FDI process. Simplified regulations, liberalised sectors, and investor-friendly policies have encouraged foreign investors.
- **Taxation:** While tax considerations play a crucial role, India's double tax avoidance agreement with countries like Singapore has provided beneficial provisions for investors.

Challenges and Opportunities

- **Global Uncertainties:** The global economic landscape remains uncertain, impacting FDI inflows. Disturbances in the Middle East and Europe have contributed to a drop in FDI in India during certain periods.
 - ♦ India's FDI landscape has been experiencing some turbulence. Net FDI inflows in FY24 were a mere \$9.8 billion, significantly lower than the robust \$28 billion recorded in FY23. While global FDI flows have generally been on a downward trend, India's situation appears more precarious.
- **Infrastructure and Ease of Doing Business:** India continues to work on improving infrastructure and enhancing the ease of doing business. Addressing these challenges will attract more FDI.
 - ♦ Despite significant improvements, India still faces infrastructure gaps. Inadequate transportation networks, power supply, and digital connectivity can impact business operations and deter potential investors.
- **Bureaucratic Delays and Regulatory Complexity:** Navigating India's bureaucratic processes can be cumbersome for foreign investors. Delays in approvals, complex regulations, and varying state-level policies can create hurdles.
 - ♦ Understanding and adapting to these regulatory nuances is essential for successful investments.
- **Tax and Tariff Policies:** India's tax system can be complex and confusing for foreign investors. Frequent changes in tax laws and uncertainty around tax liabilities can create challenges.
 - ♦ Clarity and predictability in tax policies are essential for investor confidence.
- **Labour Laws:** India's labour laws have often been criticised for being rigid and outdated. Compliance with labour regulations can be challenging for businesses.
 - ♦ Reforms in labour laws are necessary to create a more investor-friendly environment.
- **Corruption and Transparency:** Corruption remains a concern in India. Transparency in government processes and effective anti-corruption measures are vital for building investor trust.
 - ♦ Efforts to improve transparency and reduce corruption are ongoing.

Sector-Specific Challenges

- **Retail:** Restrictions on multi-brand retail FDI and local sourcing norms.
- **Real Estate:** Land acquisition issues and regulatory approvals.
- **Pharmaceuticals:** Stringent pricing regulations.
- **E-commerce:** Complex FDI rules and marketplace vs. inventory-based models.

Suggested Reforms

- **Policy Environment and Investor-Friendly Climate:** India needs to step up its game in creating an investor-friendly policy environment. While **recent budgetary measures aimed at simplifying FDI regulations** and

reducing corporate tax rates for foreign companies are commendable, they fall short of what's needed.

- ◆ The **OECD's FDI Regulatory Restrictiveness Index** reveals that India's FDI restrictions remain higher than those of several peers. It is important to learn from countries like **Vietnam, South Africa, Brazil, and Korea**, which have more **investor-friendly policies**.
- **Bilateral Investment Treaties (BITs):** India's decision to terminate or renegotiate most of its BITs may have inadvertently sent a signal of policy unpredictability. Investors crave stability and predictability.
 - ◆ The **2016 BIT model**, emphasising regulatory power over investor protections, hasn't found many takers among our key trading partners. It needs to strike a balance that protects national interests while assuring investors of fair treatment and dispute resolution mechanisms.
- **Sectoral Liberalisation:** To attract more FDI, India must further liberalise key sectors. Areas like insurance, e-commerce, and multi-brand retail need targeted reforms. These sectors offer immense growth potential and can be magnets for foreign capital.
 - ◆ Additionally, we should focus on sectors where India has a comparative advantage. Renewable energy and digital technologies are prime examples. Leveraging our strengths in these areas can make us more attractive to investors.
- **Coastal Economic Zones (CEZs) and Infrastructure:** Setting up CEZs or manufacturing clusters can create localised hubs for FDI. These zones can benefit from proximity to ports, streamlined logistics, and efficient infrastructure.
 - ◆ Continuously improving our overall ease of doing business and investing in critical infrastructure (roads, ports, power, etc.) will enhance our competitiveness.
- **Incentivizing R&D and Innovation:** Encouraging research and development (R&D) and innovation is crucial. Offering tax incentives, supporting startups, and fostering collaboration between academia and industry can attract forward-looking investors.
- **Certainty in Taxation:** Investors appreciate clarity and predictability in tax policies. Ensuring stability and transparency in tax regulations is essential.

Conclusion and Way Forward

- FDI remains a critical driver of India's economic growth, and the country continues to evolve as an attractive investment destination. Whether it's Singapore, Mauritius, or other nations, foreign investors recognize India's potential and contribute to its development journey.
- Experts anticipate that **FDI into India** will pick up in the **latter half of 2024-25**. Initiatives such as regulatory reforms, sector-specific policies, and infrastructure development will play a pivotal role in shaping India's FDI landscape.
- **India's FDI trajectory demands targeted reforms.** India needs to focus on changing global dynamics, and create an environment where investors feel confident about committing long-term capital.
 - ◆ By doing so, it can regain our position as an attractive FDI destination and contribute to our economic growth.

Source: BL



Mains Practice Question

[Q] Evaluate the effectiveness of India's recent FDI reforms in attracting foreign investment. What additional reforms are necessary to further enhance India's attractiveness as a destination for FDI?