NBR THE NATIONAL BUREAU *of* ASIAN RESEARCH
Trade, Economic, and Energy Affairs

Making India an Attractive Investment Destination: Analyzing FDI Policy and Challenges

Pravakar Sahoo

Pravakar Sahoo is an Associate Professor in the Institute of Economic Growth at Delhi University. He can be reached at <pravakarfirst@gmail.com>.

EXECUTIVE SUMMARY

This paper outlines India's foreign direct investment (FDI) policies and highlights challenges for foreign investors, recent policy developments, and the potential for foreign firms.

Main Argument

The Indian economy requires FDI to fill the gap between domestic savings and investment and to boost productivity- and investment-led growth. Although Indian FDI policy has been progressive, inflows have been far lower than expected and lag behind those of competitors like China. Low levels of investment and trade, combined with decelerating growth, have been causes for concern in India. Manufacturing growth, which is essential for job creation, has been sluggish due to flip-flops in government policymaking, a lack of policy reforms, and an unfavorable investment climate in recent years. Some of the factors that affect FDI inflow to India are inadequate infrastructure, inflexible labor markets, difficult land-acquisition procedures, lack of progressive FDI reforms, and lack of center-state coordination. However, the government led by Prime Minister Narendra Modi has undertaken a number of initiatives to restore investor confidence, and several other positive reform measures are expected to be implemented before the 2015-16 budget.

Policy Implications

- Increasing the availability of quality infrastructure is critical to attracting FDI, yet a number of legal and bureaucratic factors may limit future developments. To create a healthy environment for infrastructure development, the Modi administration needs to establish an appropriate institutional framework that incorporates a dispute resolution mechanism, independent regulatory authority, and a special investment law and tariff policy.
- Although the national government is aiming to encourage economic experimentation, special economic zones (SEZ) in India have not been successful. The government needs to rethink the size of SEZs, which are currently relatively small, and provide SEZs sufficient transportation infrastructure to connect to markets. Before approving SEZs, there is also a need to ensure that utilities such as land, water, and power are available.
- Bureaucratic obstruction is one of the major reasons for the slow realization of FDI relative to approvals. Useful steps would be to encourage every state to have a single nodal agency for approval and clearances, and to improve coordination between the central government and state-level nodal agencies.

Since the global financial crisis in 2008, the Indian economy has been suffering from low levels of investment, trade, and growth. India's savings and investment rates were 30% and 35%, respectively, in 2012-13, lower than the pre-crisis levels of 36% and 38%, respectively.[1] Given the underutilized human and natural resources in India, a higher investment rate is one of the crucial determinants of a high sustainable growth rate. However, investment rates in India are relatively low and have yet to reach the level of China, which had an investment rate of 49% of GDP in 2012-13.[2] India's manufacturing growth has been sluggish, affecting millions of young Indians entering the job market every year. Policy flip-flops and lack of reforms have also added to the unfavorable investment and business climate in the past few years.[3] Yet under Prime Minister Narendra Modi's Bharatiya Janata Party (BJP) government, policymakers realize that credible efforts are needed to revive the economy. Such efforts ultimately require upgrading technology, expanding the scale of production, and improving linkages to an increasingly integrated globalized production system.

To achieve these goals, the Indian economy requires foreign capital to fill the increasing gap between domestic savings and investment and the financing required to boost technology, productivity, employment, and export competitiveness.[4] To that end, the Modi government's

---

[1] Ministry of Finance (India), *Economic Survey 2014-15* (New Delhi, 2014).

[2] World Bank, "Gross Capital Formation (% of GDP)," World Development Indicators database, http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS.

[3] For example, FDI up to 51% in multi-brand retail was cleared by the Manmohan Singh administration in November 2010 but suspended in December 2010. This issue was again taken up and abandoned by the previous government in 2013. Similarly, the government of India proposed to amend a 1962 tax law in the 2012-13 budget with retrospective effect that could have resulted in Vodafone paying around $2 billion in taxes on a transaction to buy a controlling stake in the Indian mobile phone unit of Hong Kong-based Hutchison Telecommunications International Limited.

[4] Pravakar Sahoo, "Foreign Direct Investment in India: Unfinished Agenda," in *Economic Reform Processes in South Asia: Toward Policy Efficiency*, ed. Philippa Dee (New York: Routledge, 2012), 109-35, Australian National University; and Pravakar Sahoo, Geethanjali Nataraj, and Ranjan Kumar Dash, *Foreign Direct Investment in South Asia: Policy, Impact, Determinants and Challenges* (New Delhi, Springer 2013), 384.

emphasis on foreign direct investment (FDI) is meant to create a world-class manufacturing sector through vertical value chains, spillover in the domains of technology and human resource management, and productivity gains. The government made a few crucial policy decisions within the first months of its coming to power and initiated several steps to attract FDI into the Indian economy. Meanwhile, investors across the globe who want to tap India's growing domestic market have been watching the Indian economy closely and will continue to follow the progress of reforms as they make their investment decisions. Although the Indian economy has been a top investment destination and was the world's second-largest investment destination in 2012, FDI inflows into India have been far from the country's potential and much less than those into China.[5] Reviving growth through improving the business and investment climate is the priority of the Modi government.

To explore these issues, this paper outlines India's FDI policies and highlights challenges for foreign investors, recent policy developments, and the potential for foreign firms. The first section surveys the evolution of FDI policy in India since independence and considers where the country's policy stands today. The second section examines factors that have prevented greater FDI flow into India and assesses the reform and policy efforts that the Modi government is taking to address these factors. The paper concludes by highlighting the investment potential for foreign firms and offering recommendations for public policy.

[5] A.T. Kearney ranked India the second-best investment destination in the world in 2005, 2007, and 2012 and the third-best in 2010. India's rank slipped to fifth and seventh in 2013 and 2014, respectively.

FDI Policy in India

Over the past 70 years, India's FDI policies have undergone a major transformation, with profound shifts occurring in the last 23 years. From independence in 1947 until 1991, FDI policies were ad hoc and designed to meet domestic requirements, without any consistent direction or proper institutions, resulting in negligible FDI inflows into India.[6] However, a balance-of-payments crisis in 1991 forced the government into making comprehensive structural reforms to the economy overall, including taking steps to attract FDI. The latter were necessary because FDI is a form of capital that could supplement domestic resources without adding to the national debt. Some of the major steps taken included direct efforts to engage foreign capital, such as raising foreign-equity caps in many sectors; diluting provisions of the Foreign Exchange Regulation Act (FERA) (e.g., liberalizing stringent regulations on foreign exchange management and transactions in foreign currencies); and allowing automatic approvals of FDI. To address broader restrictions, Indian reforms also dismantled controls in the areas of industrial policy, taxation, and export-import policy and removed dividend balancing. Finally, rounding out these reforms were additional steps toward liberalization, including de-licensing industry, easing competition controls, deregulating interest rates, opening up capital markets, and conducting trade reforms. Overall, these policies encouraged investment and capital formation.[7]

As a consequence of these reforms, the government's role changed from a regulator to a facilitator of private investment, creating an enabling environment and providing critical infrastructure to encourage investment. Today, FDI can enter most sectors or activities in India

[6] Pravakar Sahoo, "FDI in South Asia: Trends, Policy, Impact and Determinants," Asian Development Bank Institute, Discussion Paper, no.56, November 2006; Sahoo, "Foreign Direct Investment in India"; and Sahoo, Nataraj, and Dash, *Foreign Direct Investment in South Asia*.

[7] Sahoo, "FDI in South Asia"; Sahoo, "Foreign Direct Investment in India"; and Sahoo, Nataraj, and Dash, *Foreign Direct Investment in South Asia*.

via the automatic approval route.[8] The exceptions are a few sectors retained under compulsory licensing, such as agriculture, mining, manufacturing reserved for small and medium industries, broadcasting, and print media, which are liable to additional restrictions such as equity caps, divestment conditions, and lock-in periods on investment.[9]

The post-liberalization period since 1991 has been remarkable in many ways because it has created a significantly more positive environment for foreign investors. While only 29 countries invested in India in 1991, India currently has more than 130 FDI source countries. Major investors in India include Mauritius, the United States, Singapore, the United Kingdom, the Netherlands, and Japan. Mauritius alone accounts for more than 40% of India's FDI, although it is believed that most of this is U.S. investment routed through Mauritius because of the double taxation treaty. The comprehensive reform of India's FDI policy since 1991 has also resulted in a substantial increase in FDI inflows into India in absolute terms as well as in percentage and GDP, as shown in **Figure 1**. Major FDI inflows have come into the manufacturing and services sectors, and a number of industries received a good amount of FDI between 2000 and 2014, including construction ($23 billion), telecommunication ($14 billion), computer software and hardware ($12 billion), drugs and pharmaceuticals ($11 billion), automobiles ($9.8 billion), chemicals ($9.6 billion), power ($8.9 billion), and electronics equipment ($3.3 billion).[10] At the subnational level, well-developed states with a proactive industrial policy—such as Gujarat, Maharashtra, New Delhi, Karnataka, and Tamil Nadu—have received the major chunk of FDI in the past decade.

---

[8] An automatic route is one where foreign investors can directly invest in India by just informing the Reserve Bank of India within 30 days.

[9] Other exceptions are industries like liquor, tobacco, industrial explosives, and hazardous chemicals, where statutory environmental clearances are required.

[10] Department of Industrial Policy and Promotion, Ministry of Finance (India), "FDI Statistics," 2013.

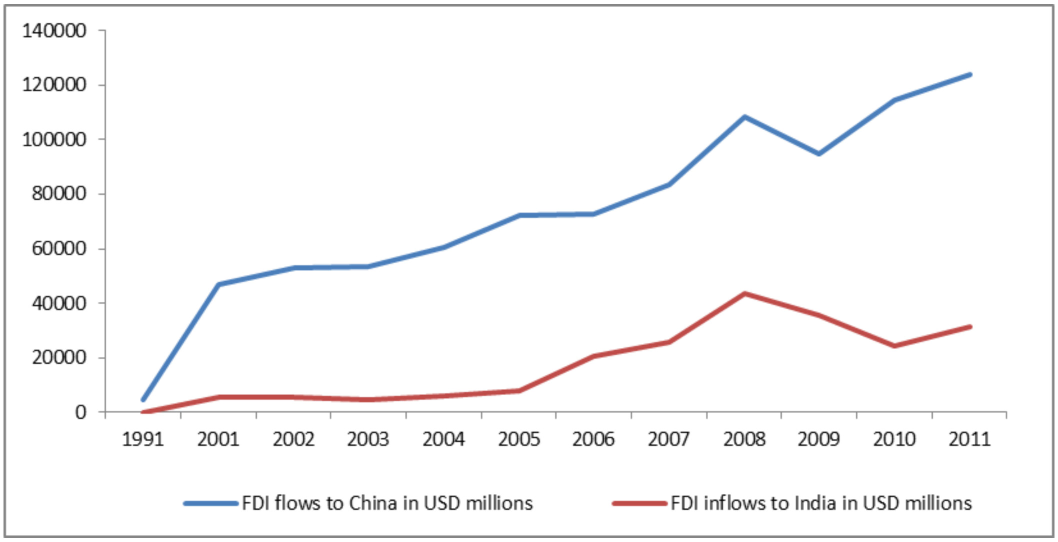
Yet despite this positive trajectory, FDI inflows into India so far have been below their potential if compared with FDI inflows into China, as Figure 1 highlights. Furthermore, the spread of FDI inflows across Indian sectors and states is skewed as few industries and advanced states receive maximum FDI inflows into India. For example, six out of India's 29 states—namely Maharashtra, Delhi, Karnataka, Tamil Nadu, Gujarat, and Andhra Pradesh—received roughly 75% of the total FDI inflows to India between 2000 and 2012.[11] In this context, the next section will analyze the difficulties that foreign investors experience in India.

Summary of India's major policies to attract FDI since 1991

1. The abolition of industrial licensing, privatization of the public sector, and the opening of many sectors, with 100% foreign equity, for foreign participation.
2. The revamping of FERA into the Foreign Exchange Management Act (FEMA) in 1999 to facilitate foreign-exchange management in the capital account.
3. The introduction of an automatic approval channel for 100% foreign equity in priority sectors and automatic permission for high-technology agreements or technological collaborations in priority sectors.
4. The abolition of high local-content requirements, dividend balancing requirements, and export obligation conditions.
5. The establishment of major institutions to promote and facilitate FDI inflows, such as the Foreign Investment Promotion Board (FIPB), Foreign Investment Implementation Authority (FIIA), and Secretariat for Industrial Assistance (SIA).
6. The aggressive signing of bilateral investment and double tax avoidance agreements (currently with more than 70 countries) to benefit and assure foreign investors.
7. Fiscal incentives such as tax subsidies and concessions offered by both central and state governments to foreign investment.
8. Reforms at the state government level, and the establishment of institutions to help implement FDI projects.
9. The opening of major sectors with huge potential, such as multi-brand retail, civil aviation, defense, railway, insurance, banking, and pension to foreign investors in recent years, with plans to open up many more sectors in the near future.

[11] Department of Industrial Policy and Promotion, Ministry of Finance (India), "FDI Statistics."

Figure 1: FDI inflows to India and China



Factors Affecting FDI in India and Policy Actions

Despite the progress noted above, policymakers in India realize that a number of factors are affecting efforts to attract the greater FDI inflows needed to sustain growth. These limiting factors include inadequate infrastructure, inflexible labor markets, difficult land acquisition, a lack of center-state coordination, and a lack of progressive FDI reforms. The last couple of years have witnessed a slowdown of FDI inflows to India—from $35 billion in 2011-12 to 24 in 2013-14—whereas Indian FDI outflows have increased in the past few years.[12] Therefore, the Modi government has prioritized reforms to boost investor confidence and tap the potential of India's manufacturing sector by addressing these pressing issues affecting FDI and overall investment. The following sections highlight specific challenges and discuss the efforts that the Modi government is undertaking to address them.

[12] Ministry of Finance (India), *Economic Survey 2014-15*.

Labor Rules and Regulations

India has a plethora of labor laws—around 250 at the central and state levels together. There is a perception that these laws favor employees, and some foreign investors have argued that a number of the laws discourage investment in labor-intensive manufacturing. For example, India's Industrial Disputes Act (1947) requires compulsory and prior government approval in the case of layoffs, retrenchment, and closure of industrial establishments employing more than one hundred workers, while the Contract Labour (Regulation and Abolition) Act (1970) requires 21 days' notice and the consent of employees to change the nature of their job. Additionally, the Trade Union Act (1926) includes a provision that allows trade unions to engage outside officers, which has allowed political leaders to hold trade union offices and sometimes get involved in labor unrest without much reasoning. Taken as a whole, these laws make it difficult for employers to dismiss unproductive workers, downsize during a downturn in business, or introduce a new technology. As a result, foreign investors worry about entering labor-intensive industries and prefer casual or contract labor to meet business demand instead of regular employees for business expansion.

The Modi government is actively trying to reform labor laws within India. At the subnational level, states are now encouraged to enact appropriate labor reforms, and the BJP-led government in Rajasthan has showed the way. Reforms in that state will make it easier for firms to adopt hire-and-fire policies based on the Chinese model. Under newly proposed labor laws, industrial establishments employing up to 300 workers may retrench employees without seeking the prior permission of the government. In addition, the number of employees required for the purpose of applicability of the Factories Act (1948), which enables labor inspectors to check health, safety, and welfare issues, will be increased from ten to 20 (in electricity-powered factories) and from 20 to 40 (in factories without power). This reform will reduce bureaucratic delays in scores of small units. Finally, membership totaling at least 30% of the total workforce, up from 15%, needs to be recorded for a union to obtain recognition, a move that will halt losses in productivity from politically motivated petty strikes.

At the national level, the government is also undertaking several sweeping efforts. Amendments to some restrictive provisions of the Factories Act, Labour Laws Act (1988), and the Apprenticeship Act (1961) have been cleared by the cabinet and are set to be discussed in parliament. Key changes proposed include dropping the punitive clause of the Apprenticeship Act that calls for imprisoning company directors who fail to implement the act and adding an amendment that would mandate employers to absorb at least half of their apprentices in regular jobs. In order to provide flexibility to managers and employers, the amendment to the Factories Act includes doubling the amount of allowable overtime from 50 hours a quarter to 100 hours in some cases and from 75 hours to 125 hours in cases that involve work in the public interest. Though this amendment may sound anti-labor, the penalty for violating the act has been increased to deter exploitation. Additionally, amendments to the Labour Laws Act will allow companies to hire more employees without needing to fulfil weighty labor law requirements, and companies with 10-40 employees will now be exempt from provisions under labor laws.[13]

Infrastructure Development

The availability of quality infrastructure is essential for lowering production costs, decreasing trade and transaction costs, and enhancing overall competitiveness, all of which are important for attracting FDI. The Modi government has adopted some specific policies to

[13] Although this amendment does allow some potential for abuse, sufficient judiciary measures are in place to address these concerns.

address India's infrastructural deficit. Its first budget allocated $6 billion for national highway development, $2.4 billion for the development of roads to unconnected villages, $16 million for metro schemes in Ahmedabad and Lucknow, and $827 million to the National Bank for Agriculture and Rural Development for the development of rural infrastructure. Civil aviation is one sector where the government is considering further liberalization of FDI caps. The budget also provided adequate sums of money for the further development of airports, using public-private partnerships (PPP) in all tier 2 and tier 3 cities, and allocating $1.16 billion to PPP-led development of 100 smart cities and new airports. Similarly, $1.87 billion was set aside for establishing sixteen new ports, which is important for India's trade.

Yet a number of factors dampen further infrastructure development. As noted by Geethanjali Nataraj, these include a lack of a clear and stable legal framework, efficient mechanisms for dispute resolution, and well-developed financial markets.[14] Moreover, infrastructure projects are often subject to a time-consuming approval process by multiple government agencies. Consequently, a major obstacle for infrastructure development is cost and time overruns in major projects arising from contractual and institutional failures. Finally, it should be noted that while FDI potential is constrained by slow infrastructure development, infrastructure development is also affected by limited access to FDI as a result of limited exit options for investors, lack of deep forward foreign exchange markets, and lack of depth in the government bond market.

In order to address the issues above, India must heed three requirements for building infrastructure: willing investors, government-led policies that encourage sufficient access to

[14] Geethanjali Nataraj, "Infrastructure Challenges in India: The Role of Public-Private Partnerships" Observer Research Foundation, ORF Occasional Paper, no. 49, February 2014.

capital, and proper implementation of projects without unnecessary time and cost overruns.[15] First, to be successful, infrastructure projects need to highlight their ability to achieve their goals in a timely manner. On-time completion of projects requires a two-pronged approach: (1) better designed projects with accurate estimates before contracts are awarded, and (2) clearance from the proper institutional bodies, including officials from major political parties and the administrative heads of relevant ministries at both the central and state levels.

Second, building infrastructure will require a conducive environment for gaining access to capital. Steps that could boost infrastructure financing are removing interest rate caps on external commercial borrowing so as to reduce interest rate spreads for project financing; relaxing investment by banks in corporate bonds to encourage them to invest in infrastructure projects; allowing financial intermediaries to invest in reasonably rated infrastructure projects; encouraging pension funds, insurance funds, and foreign institutions to invest in infrastructure projects; and creating a debt recovery tribunal to build confidence in making large investments. The government can facilitate infrastructure investment by offering fiscal incentives such as reducing the customs duty on capital goods and giving tax concessions on long-term investment in infrastructure. Allowing cost-recovery pricing is also important for attracting private investment in infrastructure. Greater private investment in the power sector, for example, will require regulatory reforms of user charges, along with measures to reduce theft and allow private entry into distribution.

Finally, even with a conducive policy environment for accessing capital, infrastructure projects will still need to attract willing investors. Modi's clean image and no-nonsense attitude and his support for steps like online proposal submissions and tendering could entice private

[15] Geethanjali Nataraj, "Infrastructure Challenges in India."

investors. As the chief minister of Gujarat from 2002 to 2014, Modi worked tirelessly to attract investment by providing roads, water, uninterrupted power supply, and single-window clearance to investors. He focused on development of the manufacturing sector by providing quality infrastructure, fast-tracked project clearances, and improved governance, which resulted in an average growth rate of over 10% for Gujarat from 2002-13.[16] It is hoped that the model of development that Modi followed in Gujarat will be replicated for the rest of the country to enhance infrastructure development and put India back on a high growth trajectory. Under his leadership, the BPJ-led government has already initiated reforms in FDI, land acquisition, and labor and cleared a number of projects that had been pending for months.

Land Acquisition

Poor compensation and rehabilitation schemes are among the biggest reasons for protests and stalling of industrial and infrastructure projects in India.[17] The Singh government introduced a new land acquisition act in 2013, which replaced a 120-year-old law, in order to provide fair compensation to landowners while ensuring transparency in land deals. However, the new law is often perceived as anti-industry and its provisions as draconian. Among the provisions that allegedly hurt private investment are the clauses that stipulate the mandatory consent of at least 70% of affected people for acquiring land for PPP projects and 80% for acquiring land for private companies. The compensation structure involving payment of four times the market value in rural areas and twice the market value in urban areas is also a cause of concern. In addition, private companies are required to provide rehabilitation and resettlement to landowners

---

[16] Ministry of Finance (India), *Economic Survey 2014-15*.

[17] Sahoo, "Foreign Direct Investment in India"; and Sahoo, Nataraj, and Dash, *Foreign Direct Investment in South Asia*.

if the land acquired through negotiations is more than 50 acres in urban areas and 100 acres in rural areas.

The BJP-led National Democratic Alliance (NDA) government has indicated its intention to change the law by introducing business-friendly amendments. It focuses on PPP projects for fast-tracked environmental clearances in order to develop physical infrastructure, and it might consider the removal of the consent clause for PPP projects. Amendments to the current land acquisition law may include a review of the definition of "affected family" to make it clearer and more reasonable. More importantly, the mandatory social impact assessment will be reserved for large projects, which has been a demand that the industry lobby has long made. These steps are likely to limit cost overruns, delays, and other hurdles.

Environmental Policy

Environmental clearance has become one of the major problems for industrial and infrastructure projects in the past few years. The lack of transparent policies, environmental activism, and a lack of coordination among ministries has delayed and stalled a large number of mega projects. Approximately 44% of the 285 mega projects in the field of energy—power, coal, and petroleum—are now stalled due to pending environment clearances.[18]

Yet there are some signs of progress on this front. Soon after taking charge, the new NDA environment minister Prakash Javadekar cleared projects worth $14 billion. Many mega projects denied environmental clearance have been cleared. These include a special economic zone (SEZ) in Gujarat, a gas-based power plant and two coal mining projects in Madhya Pradesh, and a state

[18] "Investments to Get Push as Modi Govt Takes Green Clearances Online," *First Post*, June 6, 2014, http://www.firstpost.com/india/investments-to-get-push-as-modi-govt-takes-green-clearances-online-1558893.html.

highway renovation project in Assam. Priority is likely to be given to public-purpose projects such as the construction of highways, roads, and power plants. To expedite environmental clearance, as well as to increase transparency, the process moved fully online in July 2014. The new system will allow applicants and authorities alike to keep a tab on every step of the process while adhering to the timeline for various clearances and rejections. The government is likely to launch an online system for forest department clearances as well.

Additional Challenges

Two additional challenges are worth noting that are related to programs that are well-intended but perhaps poorly implemented or managed. First, a number of investors have cited ongoing concerns about coordination between the central and state governments. Bureaucratic obstruction, mainly at the state level, is one of the major reasons for the slow realization of FDI relative to approvals.[19] Useful steps would be to encourage every state to have a single nodal agency for approval and clearances and to improve coordination between central government institutions (such as the FIPB, FIIA, and SIA) and these state-level nodal agencies to reduce duplication and the number of clearances. Some of the major causes of delay are state-level issues such as land acquisition, changes in land use, power connection, and approval of building plans. Therefore, coordination on these issues between the central government and the states before the approval of investment projects is required to avoid unnecessary delays at the state level. The Modi government has thus far focused on improving the functioning of the federal

[19] More specifically, while the central government gives approval for investment projects, these projects are implemented at the state level. This then requires state-level approval for developing land and access to other utilities (such as water, power, and connectivity). However, the majority of states are not as proactive as the central government, and the quality of governance varies widely across states. Thus, it is generally time-consuming to deal with bureaucracy at the state level, leading to delays in implementation of infrastructure projects.

system, and it seems that there will be more consultation between the center and states on implementation issues in the future.

Second, although the national government is aiming to encourage economic experimentation, SEZs in India have not been successful.[20] This is due to their size and the lack of motivation of local stakeholders. For example, 60% of the 550 approved SEZs in India are information technology SEZs, which only need a minimum of ten hectares of land to operate. The other 40% of SEZs are in manufacturing, which are also very small in size, mainly due to land-acquisition difficulties, and therefore have not succeeded despite their potential. Further, the lack of interest from local stakeholders leads either to poor cooperation or protests. For example, protests against the Tata plant in Nandigram in West Bengal forced the company to shift its base for manufacturing India's smallest car, the Tata Nano, to Gujarat. Therefore, policy measures to enhance the performance of SEZs in India should include the proper design and operation of SEZs as clusters of specific products. To do this, the government needs to rethink the size of SEZs, which are currently relatively small, and provide sufficient transportation infrastructure for SEZs to be able to connect to markets via railways, ports, roads, or other means. The development commissioner also needs to consult with state agencies to ensure that utilities such as land, water, and power are available before approving SEZs.

The Impact of Reforming FDI Itself

The new government came to power by pledging to improve the business climate and revive investment and manufacturing to provide jobs to millions of people. Toward this end, within the first hundred days of being in power, the BJP-led government cleared 240 projects out

[20] Sahoo, Nataraj, and Dash, *Foreign Direct Investment in South Asia*.

of a total of 325 projects that had been pending for environmental clearance for many months under the previous government. The approved projects are valued at $33 billion in terms of investments, and a majority of the projects focus on the energy sector and on developing the country's overall infrastructure.[21]

Importantly, the current efforts underway go beyond simply reforming issues related to FDI and directly touch on reforming FDI itself. Under Prime Minister Modi, the NDA government has taken specific policy steps to improve investor sentiments and attract FDI. For example, Modi's maiden budget in July 2014 liberalized sectors such as insurance and defense through a hike in FDI equity from 26% to 49%, while also increasing FDI limits in e-commerce and health insurance. Defense is a strategic sector, and without several critical technologies, achieving self-reliance of 70% will be extremely difficult. Although transfer of technology is more likely to occur when the cap is liberalized further, the 49% cap will pave the way for successful joint ventures in defense manufacturing.

Another important step by the Modi government has been the clearance of 100% FDI in railway infrastructure. This is important because the railways have not been able to expand in response to the huge increase in demand, and, as a result, 60% of India's freight still moves by road infrastructure. The cabinet's FDI approval straddles railway subsectors such as high-speed train systems, suburban corridors, and dedicated freight-line projects implemented through PPPs. With the allowing of FDI, the Mumbai-Ahmedabad high-speed rail corridor, along with the other freight corridors currently being planned, is expected to benefit from an investment of foreign

[21] Chetan Chauhan, "Prakash Javadekar Clears 240 Projects in 3 Months," *Hindustan Times*, September 11, 2014, http://www.hindustantimes.com/india-news/on-fast-track-environment-minister-prakash-javadekar-clears-240-projects-in-3-months/article1-1262676.aspx.

capital worth up to $10 billion in the near future. Given the woeful financial state of India's railways, the infusion of private capital—foreign or otherwise—is a welcome development.

Another important concern for foreign investors has been reforming investment in the brand retail sector. With respect to proposals involving FDI beyond 51% in single-brand retail, the policy requires sourcing of 30% of the value of goods purchased locally, preferably from micro, small, and medium enterprises, which implies that Indian suppliers and vendors for these retailers would have the opportunity to become part of their global supply chains. The Modi government is likely to allow FDI in retail e-commerce, and the government's emphasis on inviting FDI in solar energy is also welcome step.

U.S. FDI in India, which reached a peak of $28.4 billion in 2012, is expected to respond positively to the liberalization of FDI caps for services (mainly finance/insurance and the information sectors) and for high-end manufacturing (particularly automobile, defense, and multi-brand retail).[22] FDI is capped now at 74% for private banks and 20% for national banks. The defense sector also presents huge potential, as do civil aviation (currently capped at 49%) and airports. Overall, the liberalization of FDI caps announced in Modi's budget bodes well for U.S. commercial interests in India.

Additional measures to raise the ceilings for foreign equity in sectors such as telecommunications, civilian goods used by defense forces, civil aviation, power generation, oil refineries and oil marketing, insurance, banking, investment, real estate, and other infrastructure sectors would certainly increase FDI inflows. However, the government is required to ensure independent and autonomous regulatory systems to control market distortions and allow fair

[22] Kenan Fikri and Mark Muro, "U.S.-India Business Ties Already a Strong Foundation for Relationship," Brookings, Avenue, October 1, 2014, http://www.brookings.edu/blogs/the-avenue/posts/2014/10/01-us-india-business-fikri-muro.

competition. Investment is still held back by outdated laws, controls, regulatory systems, and government monopolies. It is expected that the government will revisit sector-specific laws and regulations to make it easier for first-time foreign investors in India.

Conclusion

The Modi government has introduced a number of initiatives to both attract FDI and liberalize FDI policy. These include improving infrastructure, revisiting the land-acquisition law, reforming the labor law, and streamlining the process for obtaining environmental clearances.

The next level of reforms and policies will need to address a broad range of issues. Indian policymakers need to create a better environment for infrastructure development with an appropriate institutional framework such as a dispute-resolution mechanism, independent regulatory authority, and special investment law. India will also need to revisit outdated laws, controls, regulatory systems, and government monopolies affecting investment. As part of this, both states and the national government need to agree on a Uniform Labour Code after an independent review and proper consultation with stakeholders. To make SEZs more attractive, proper planning and design should include local-level solutions for land acquisition and infrastructure connectivity to SEZs, along with sector-specific policies to attract FDI. Finally, to address concerns raised by international stakeholders, Indian policymakers need to work to increase FDI caps in sectors with FDI potential and allow more sectors to come under the country's automatic approval route to decrease the hurdles to investing in India.

Foreign investors still find it difficult to navigate India's bureaucratic controls and procedures to get the necessary clearances and approvals. Therefore, improving coordination between the states and the central government for project clearance is imperative. The new government has instructed different ministries to work together, and meetings are now frequently held between ministries to sort out differences for quick project clearance. However, this happens only at the level of the central government, and it is yet to be seen how the Modi government will coordinate with state governments to eliminate outdated laws and improve governance. While the Modi government is serious about improving the investment climate, foreign firms need to better understand the Indian market and have their own R&D in India to design products to cater to the price sensitivity of the Indian consumer market. Although the reform measures announced by the new government are only small steps, these measures have revived the hope of investors that in the coming months, the Modi government will take more incremental steps to restore investor confidence and once again make India into one of the most attractive destinations for FDI in the world.