



Mains Practice Question

Q. Explain the significance of foreign direct investment (FDI) for the Indian economy and analyze the reasons behind the recent decline in FDI inflows. Suggest remedial measures to enhance FDI in India. (250 words)

04 Oct, 2023 GS Paper 3 Economy

Approach

- Begin your answer by giving a brief introduction preferably with some data related to growth and FDI inflow.
- Enumerate the significance of FDI for India.
- Enumerate the reasons for the decline in FDI and the remedial measures needed.
- Conclude by summarizing the key points of your answer and reiterate the importance of FDI for India.

Introduction

Foreign direct investment (FDI) is a type of cross-border investment in which an investor from one country establishes a lasting interest in an enterprise in another country. According to the Global Investment Report 2023, the total foreign direct investment (FDI) inflows have slumped by 12% in 2022.

Body

Significance of Foreign Direct Investment (FDI):

- **Economic Growth:** FDI drives economic growth by infusing foreign capital for infrastructure, industrial expansion, and technological advancement. E.g. Manufacturing of silicon chips in India due to FDI, PLI, etc.
- **Job Creation:** FDI generates employment, addressing India's population-related challenges such as unemployment and poverty reduction.
- **Technology Transfer:** Multinational corporations bring advanced technology and expertise, fostering domestic innovation like Brahmos and Jet Engine or Submarine from France.
- **Balance of Payments:** FDI boosts foreign exchange reserves, vital for economic stability and trade deficit management.
- **Industrial Development:** It stimulates growth in sectors like manufacturing and aligns with the "Make in India" initiative. E.g. Airbus's investment with TATA in airplane manufacturing.
- **Global Integration:** FDI integrates India into the global economy, promoting international cooperation.

Reasons for Decline in FDI Inflows:

- **High inflation and weak demand in the US and Europe:** These factors have reduced the attractiveness of India as an investment destination.
- **Lack of new policy reforms and state-level improvements:** There were few steps to liberalize FDI regulations or improve the business environment at the state level in recent years.
- **Global Pessimism:** Global growth pessimism is an important reason for this big decline in cross-

border mergers and acquisitions (M&As). Western corporations are cautious about making big investments.

- **Geopolitics:** Geopolitical strategy is also important. India had begun to shun Chinese FDI after the 2020 border clashes with China.
- **Tech and Other Industries:** The FDI decline affects industries beyond technology.
- **Policy Uncertainty:** Investors face unpredictability and policy changes mid-course.
- **Uneven Playing Field:** Disparities discourage investments.
- **Absence from Trade Agreements:** India's absence from agreements like RCEP and lack of EU trade deals hinder FDI attraction.
- **Infrastructure Bottlenecks:** Inadequate infrastructure deters investors, especially in the logistics and energy sectors.

Remedial Measures to Enhance FDI:

- **Stable and Predictable Policies:** Ensure a stable and predictable regulatory environment.
- **Ease of Doing Business:** Streamline processes, reduce bureaucracy, and improve the ease of doing business.
- **Investment in Infrastructure:** Develop transportation, energy, and digital infrastructure to support FDI.
- **Participation in Trade Agreements:** Engage in regional and bilateral trade agreements for improved market access.
- **Promotion of 'Make in India':** Encourage manufacturing investments through initiatives like the PLI scheme.
- **Investor Protection:** Strengthen investor protection mechanisms and dispute resolution systems.
- **Skill Development:** Invest in skill development programs to support technology transfer and innovation.

Conclusion

Enhancing FDI is crucial for India's economic growth. However, India should not rely solely on FDI and foreign investment for its growth but also explore other sources of investment.

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