Indian officials are again touting the country’s credentials as the most friendly to foreign direct investment (FDI) on Earth. But despite recent liberalization of FDI rules in defense and insurance, this claim rings hollow. India retains foreign equity restrictions in a wide range of sectors. In other sectors, there are onerous regulations targeting foreign firms. And a third, less-discussed set of invisible barriers are the “undefined spaces”—where it is unclear if FDI is allowed. To clear up confusion, the Indian government should shift to a “negative list” approach, which bars FDI in certain sectors but allows 100 percent FDI in all others.

For the most part, India is steadily moving in the right direction on FDI. Since coming to office in 2014, the Modi government has reduced foreign investment restrictions in dozens of sectors, including sensitive sectors like defense and media distribution, and even some sub-sectors of retailing and e-commerce. In the recently concluded budget session of the Indian parliament, the government quickly pushed through amendments to the Insurance Act that will allow foreign firms to hold majority ownership in India.

In March, buoyed by these positive steps, the secretary of India’s Department of Promotion of Industry and Internal Trade (DPIIT) reiterated an oft-repeated claim that India was among the most open nations in the world to FDI. However, despite progress, this claim does not hold much water. The most recent “Foreign Direct Investment Regulatory Restrictiveness Index” from the Organization of Economic Cooperation and Development (OECD) places India near last among OECD members and key developing nations in terms of openness to FDI. India’s poor ranking primarily reflects its foreign equity restrictions.

India retains a wide range of foreign direct investment restrictions. These are cataloged in India’s “Consolidated FDI Policy” and generally fall into two buckets:

- **FDI Caps:** A range of sectors limit the equity percent that can be held by foreign investors. For some sectors, FDI is banned, like inventory-based e-commerce, nuclear power, or lotteries. In other sectors, FDI caps block foreign firms from holding 100 percent of the equity. This list includes sectors like insurance, defense, private security, pensions, FM radio, uplinking television channels, and print media.

- **Onerous Regulations:** A long list of sectors have burdensome regulatory provisions that target foreign investors in each sector. These include multi-brand retail, insurance intermediaries, wholesale trading, and marketplace e-commerce.

### KEY DATA

- **-15.3%**
  
  U.S.-INDIA GOODS TRADE, 12-MONTH COMPARISON, PER U.S. CENSUS BUREAU

- **+28%**
  
  FOREIGN DIRECT INVESTMENT, 12-MONTH COMPARISON, PER RBI

- **$36 bn**
  
  FII ASSETS NET FLOWS, LAST 12 MONTHS, PER NSDL
There is another “gray area” that has caused friction with investors in the past, and could do so again. This involves potential investments in sectors that are not yet clearly defined. The Consolidated FDI Policy does have a small list of explicitly banned sectors like nuclear power generation and gambling. But many sectors and subsectors fall between the “allowed” and “banned” list.

One very recent example happened in September 2019. Through Press Note 4, 2019, the DPIIT clarified that foreign investment in “contract manufacturing” was allowed. But FDI in manufacturing (outside of defense) was already fully allowed; no investor thought the subsector of contract manufacturing was not included within the larger manufacturing sector. This liberalization in fact raised a chilling question: what other subsectors could be peeled out of “allowed FDI” sectors and re-regulated at random? Wantonly carving out subsectors and feeling an urge to regulate them afresh is not part of a conducive foreign investment policy.

Other examples include:

- **FDI in marketplace e-commerce:** This was not explicitly allowed under India’s FDI schedule. However, some foreign firms entered the marketplace and started operations. In December 2018 the DPIIT issued guiding regulations, including a provision that forced existing investors to shift their operating model.

- **FDI in commodity exchanges and credit information companies:** In 2008, the government decided to establish separate FDI regulations for commodity exchanges and credit information companies. The FDI caps for both of these sectors was set at 49 percent. Prior to these regulations being issued they were considered sub-sectors of non-banking financial corporations (NBFC) where 100 percent FDI is allowed. So, with these regulatory changes, foreign companies in both sectors were forced to divest stakes.

- **FDI in mortgage guarantee issuance:** Similar to the sectors outlined above, India loosely considered mortgage guarantee issuance an NBFC activity. At least one foreign company established an entity. Then, in 2008, the sector was separately regulated, and no shareholder could hold a majority stake.

These “spaces of ambiguity” have occasionally been used to open the door to investment. One recent, notable case is “insurance intermediaries.” This industry is quite different from creating insurance products yet was governed by the same FDI considerations, which are written into law. In a deft maneuver, the government stated that this sector was different and, in February 2020, opened the sector to 100 percent FDI without needing to institute any legislative change. But such positive instances of “carve and liberalize” are rare.

If India truly wants to live up to its self-billing as being among the “most FDI-friendly nations in the world,” much more work needs to be done, even beyond the basic ideas of removing FDI caps and related restrictions. Shifting the sectoral FDI policy to a negative list will help clarify that industries posing no strategic or political risk are open to investors. Existing investors would be incentivized to invest more robustly, and new investors would see this as a positive signal.