Q5

Justify the need for FDI for the development of the Indian economy. Why there is gap between MOUs signed and actual FDIs? Suggest remedial steps to be taken for increasing actual FDIs in India.

UPSC Civil Services Mains 2016 · GS III · 12 marks · Indian Economy

Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Core demand of the question

- Justify why India needs foreign direct investment
- Explain the gap between Memoranda of Understanding and actual FDI inflows
- **Suggest remedies:** ease of doing business, contracts, land, tax stability, and sector openings

Revision summary

FDI supplies long-term capital, technology and export links that domestic savings alone cannot fully provide.

Make in India opened several sectors to attract that capital into factories and infrastructure.

MoUs are non-binding headlines and often double-counted, so they dwarf actual RBI-recorded inflows.

Land, clearances, tax uncertainty and weak contract enforcement explain the gap.

Remedies are policy stability, single windows, insolvency exit, aftercare and publishing actual inflows.

Introduction

Foreign direct investment (FDI) is long-term capital with technology, management and market access. India needs it to close a **savings-investment gap**, to build factories and infrastructure, and to join global value chains. **Memoranda of Understanding (MoUs)** at summits look large. Actual equity that is reserved with the **Reserve Bank** and the Department of Industrial Policy and Promotion is often much smaller. The gap is a policy and implementation problem, not a mystery of investor mood alone.

Body

Why India needs FDI

- Domestic savings and the **fiscal space** of the Union and States cannot fund all power, ports, urban metro, electronics and defence lines at the speed India needs.
- FDI brings **technology, quality standards and export discipline** that portfolio flows do not.
- Greenfield FDI creates **jobs and supplier clusters**; brownfield FDI can revive stressed assets if regulation is clean.

- A stable FDI base eases the **current-account** constraint compared with hot money.
- **Make in India (2014)** and liberalised caps in defence, railways, insurance and construction were aimed at this developmental role, not at trophy announcements.

Why MoUs exceed actual FDI

- An MoU is a **statement of intent**. It is not a legally binding investment, and it often double-counts the same project across events.
- **Land acquisition, environmental clearances and multi-State approvals** delay or kill projects after the handshake.
- **Contract enforcement** is slow; tax retrospective disputes (the Vodafone-type overhang) and inverted duty structures scare committed equity.
- **Infrastructure and logistics costs**, power quality, and exit through insolvency were still weak in 2016, so money stayed in holding companies or never arrived.
- **Some MoUs are** diplomatic theatre**:** large headline numbers for a visit, with no term-sheet on equity, debt and local partner.
- Restricted sectors, FDI caps, and **Press Note** conditions (sourcing, lock-in) further convert a signed paper into a smaller actual inflow.

Remedial steps

- Keep a **stable, prospective tax** regime and a predictable FDI policy circular; avoid retrospective shocks.
- Shorten **single-window** clearances, digitise land records, and use industrial parks with pre-cleared land rather than plot-by-plot fights.
- Strengthen **Insolvency and Bankruptcy** exit so capital is not trapped; honour contracts and arbitration awards.
- Match **Make in India** openings with skills, quality testing and **special economic** or national-investment-manufacturing-zone logistics.
- Report **actual equity inflows** beside MoUs in public dashboards so States compete on realisation, not on summit signatures.
- **Use Invest India and State investment boards for aftercare:** a plant that is stuck after the MoU needs a named officer, not another brochure.

Flow diagram

Need for FDI -> Capital technology jobs

MoUs -> Gap

Actual FDI -> Gap

Gap -> Land tax contracts delays

Land tax contracts delays -> Stable policy single window aftercare

Stable policy single window aftercare -> Actual FDI

Conclusion

India needs FDI for capital, technology and export jobs. MoUs overstate that need's fulfilment because they are intent, not money. Actual FDI will rise when land, tax, contracts and exit are boringly predictable, and when public scorecards count rupees received, not papers signed.

Facts & figures

FDI
Foreign direct investment: lasting interest in an enterprise, with management influence, unlike portfolio flows.

Make in India
2014 Union programme to raise manufacturing and ease FDI in notified sectors, including defence and railways.

DIPP / DIPP FDI factsheet
Department of Industrial Policy and Promotion (now DPIIT) publishes official FDI equity inflow data.

Retrospective tax overhang
High-profile tax disputes after 2012 damaged India's reputation for tax certainty among foreign investors.

Invest India
National investment promotion and facilitation agency meant to convert interest into grounded projects.