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FROM LIBERALISATION TO REGULATION: NATIONAL SECURITY SCREENING OF FOREIGN INVESTMENTS IN INDIA

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ABSTRACT

Foreign investment has historically been regarded as a central pillar of economic development, particularly in emerging economies where capital inflows, technological advancement, and integration into global markets are essential for sustained growth. In India, the liberalisation reforms of 1991 marked a decisive shift toward an open investment regime, facilitating foreign participation across multiple sectors. However, the evolving global economic landscape, characterised by geopolitical tensions, the rise of digital economies, and increasing concerns regarding data security and critical infrastructure, has fundamentally altered the perception of foreign investment. It is no longer viewed solely as an economic instrument but also as a potential vector of strategic influence with implications for national security and economic sovereignty. India's regulatory response reflects this transition, particularly through policy measures such as the 2020 amendment to the Foreign Direct Investment framework, which introduced restrictions on investments from neighbouring countries. While such measures signify an emerging security-conscious approach, they remain largely policy-driven and lack the support of a comprehensive statutory framework. This article critically examines the evolution of India's foreign investment regime, analyses the growing importance of national security considerations, and identifies the structural limitations of the current regulatory approach. Drawing upon comparative practices in jurisdictions such as the United States and the European Union, it argues for the development of a coherent, transparent, and institutionalised mechanism for screening foreign investments. Such a framework is essential to balance economic openness with the protection of strategic national interests in an increasingly complex global environment.

Keywords: Foreign Direct Investment; National Security; Investment Screening; Economic Sovereignty; FEMA; Regulatory Framework; India.

I. INTRODUCTION

Foreign investment has long occupied a pivotal position in India's economic policy, particularly following the structural reforms of 1991 that transformed the country's regulatory landscape. These reforms marked a shift from a protectionist framework to a liberalised regime that actively encouraged foreign capital inflows.¹ The underlying rationale was that foreign investment would accelerate industrial growth, facilitate technology transfer, and integrate India into global value chains. Over time, this approach contributed significantly to economic expansion and positioned India as a major destination for international investors.

However, the contemporary global investment environment has undergone a profound transformation, necessitating a reassessment of this liberal approach. The increasing interconnectedness of economies, coupled with the strategic importance of sectors such as telecommunications, digital infrastructure, artificial intelligence, and financial technology, has blurred the distinction between economic activity and national security. Foreign investment is now increasingly perceived as a potential instrument of geopolitical influence capable of affecting critical infrastructure, sensitive data ecosystems, and national decision-making processes.² This evolving perception has prompted several jurisdictions to adopt mechanisms for screening foreign investments based on security considerations.

India's regulatory trajectory reflects this shift toward a more cautious and strategic approach. While the country continues to promote foreign investment as a driver of economic growth, recent policy developments indicate a growing emphasis on safeguarding national interests. The 2020 amendment to the Foreign Direct Investment policy, which introduced government approval requirements for investments originating from countries sharing land borders with India, represents a significant departure from the earlier liberalisation paradigm.³ This development underscores the emergence of a hybrid regulatory model that seeks to reconcile economic openness with national security concerns. The present article critically examines this transition and evaluates the adequacy of India's existing regulatory framework in addressing the complexities of modern foreign investment.

¹ Foreign Exchange Management Act, No. 42 of 1999, pmb1. (India).

² OECD, *Framework for Screening Foreign Direct Investment into the European Union: Assessing Effectiveness and Efficiency* 15–18 (OECD Publ'g 2022).

³ Dep't for Promotion of Indus. & Internal Trade, Ministry of Commerce & Indus., Press Note No. 3 (2020 Series)

II. EVOLUTION OF INDIA'S FOREIGN INVESTMENT REGIME

India's approach to foreign investment has evolved through distinct phases, each shaped by prevailing economic conditions and policy priorities. In the pre-liberalisation era, the regulatory framework was characterised by stringent controls designed to limit foreign participation in domestic industries.

The Foreign Exchange Regulation Act, 1973 embodied this restrictive approach, imposing tight limits on foreign equity holdings and subjecting foreign enterprises to extensive state supervision.⁴ While this model sought to protect domestic industries and preserve economic sovereignty, it also constrained capital inflows and limited access to advanced technology, thereby hindering economic growth.

The economic crisis of 1991 marked a turning point, compelling India to undertake structural reforms that fundamentally altered its approach to foreign investment. The liberalisation programme introduced a series of measures aimed at attracting foreign capital, including the dismantling of industrial licensing, the relaxation of sectoral restrictions, and the introduction of the automatic route for investment approvals.⁵ The replacement of FERA with the Foreign Exchange Management Act, 1999 further signalled a shift from control to facilitation, reflecting a more pragmatic and market-oriented regulatory philosophy.

In the years that followed, India progressively expanded its openness to foreign investment by increasing sectoral caps and permitting full foreign ownership in several industries. However, the post-2014 period has witnessed a more nuanced approach, characterised by a simultaneous emphasis on investment promotion and strategic regulation. While initiatives aimed at boosting manufacturing and infrastructure have sought to attract foreign capital, policymakers have also become increasingly conscious of the risks associated with foreign control over critical sectors. This shift reflects a broader recognition that foreign investment must be regulated in a manner that balances economic benefits with national security considerations.⁶

⁴ Foreign Exchange Regulation Act, No. 46 of 1973, ss. 28–29 (India).

⁵ Ministry of Finance, Government of India, Economic Reforms: New Industrial Policy Statement, 1991, para. 39, presented before Parliament on July 24, 1991.

⁶ Dep't for Promotion of Indus. & Internal Trade, Ministry of Commerce & Indus., Consolidated FDI Policy Circular of 2020, para. 3.1.1

III. LEGAL FRAMEWORK AND REGULATORY STRUCTURE

A. Statutory Foundation under FEMA

The regulation of foreign investment in India is primarily governed by the Foreign Exchange Management Act, 1999 (FEMA), which marked a shift from a restrictive regime to a facilitative approach aimed at managing rather than controlling foreign exchange. FEMA, along with the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, provides the legal basis for foreign capital inflows by defining permissible investment instruments, prescribing sectoral limits, and outlining procedural requirements.⁷ These provisions distinguish between different forms of investment and regulate entry routes such as the automatic route and the government approval route.

B. Role of Policy Framework and Executive Instruments

The statutory framework is supplemented by the Consolidated Foreign Direct Investment Policy issued by the Department for Promotion of Industry and Internal Trade. This policy plays a crucial role in operationalising legal provisions by specifying sector-specific conditions, eligibility norms, and approval procedures. Although flexible and responsive to economic needs, its frequent revisions may create uncertainty for investors, thereby affecting the predictability of the regulatory environment.⁸

C. Institutional Structure and Regulatory Authorities

India's foreign investment regime operates through a multi-layered institutional framework involving several regulatory bodies. The Reserve Bank of India oversees foreign exchange transactions and ensures compliance with FEMA, while the Securities and Exchange Board of India regulates foreign portfolio investments and capital market participation. Additionally, sector-specific regulators exercise control over investments in specialised industries.⁹ While this structure enables focused regulation, it also results in fragmentation and coordination challenges.

D. Absence of a Centralised Screening Mechanism

A key limitation of the existing framework is the absence of a unified authority

⁷ Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, Gazette of India, Extraordinary, Part II, sec. 3(ii).

⁸ Shubham Jain, Regulatory Certainty and Foreign Investment in India, 14 Indian J. L. & Tech. 87 (2022).

⁹ Telecom Regulatory Authority of India Act, No. 24 of 1997, INDIA CODE (1997).

responsible for foreign investment governance.¹⁰ The involvement of multiple regulators often leads to overlapping jurisdictions and inconsistencies in decision-making. This fragmented structure increases compliance burdens for investors and reduces the efficiency of regulatory processes.

E. Limited Integration of National Security Considerations

Most significantly, the current legal framework does not explicitly recognise national security as a central criterion for regulating foreign investments.¹¹ Security concerns are addressed indirectly through sectoral caps and conditional approvals rather than through a structured screening mechanism.¹² In the context of emerging technologies and data-driven industries, this indirect approach is increasingly inadequate, highlighting the need for a more coherent and transparent regulatory model.

IV. NATIONAL SECURITY AND THE CHANGING NATURE OF FOREIGN INVESTMENT

A. Strategic Transformation of Investment Sectors

The increasing emphasis on national security in foreign investment regulation is closely linked to the transformation of global economic activity. Contemporary investments are no longer confined to traditional sectors such as manufacturing and infrastructure; they increasingly target digital platforms, telecommunications networks, and data-driven enterprises. These sectors are integral not only to economic growth but also to national governance, security, and public policy. Consequently, foreign participation in such industries raises concerns regarding data protection, surveillance risks, and control over critical infrastructure.¹³

B. The 2020 Policy Shift and Its Implications

India's response to these emerging concerns became particularly evident with the 2020 amendment to the Foreign Direct Investment policy, which introduced government approval requirements for investments originating from countries sharing land borders with India. This measure was justified as a means of preventing opportunistic acquisitions during a period of

¹⁰ Org. for Econ. Coop. & Dev., FDI Qualities Policy Toolkit (2022).

¹¹ Foreign Exchange Management Act, No. 42 of 1999, INDIA CODE (1999).

¹² Consolidated FDI Policy Circular of 2020, Dep't for Promotion of Indus. & Internal Trade (2020).

¹³ European Commission, White Paper on Artificial Intelligence (2020).

economic vulnerability. However, the amendment also reflects a broader shift toward incorporating security considerations into investment regulation.¹⁴ Despite its significance, the policy remains limited in scope, relying primarily on geographic criteria rather than a comprehensive assessment of sector-specific risks.

C. Limitations of the Existing Approach

The current policy-based approach to national security screening is characterised by a lack of transparency and procedural clarity. Decisions are often made on a case-by-case basis, with limited disclosure of the criteria used to assess security risks. This creates uncertainty for investors and raises concerns regarding the potential for arbitrary decision-making. Furthermore, the absence of a formal institutional mechanism for screening investments limits the effectiveness of regulatory oversight.

V. COMPARATIVE INSIGHTS AND REGULATORY GAPS

A. The United States Model: Institutionalised Security Review

A useful point of comparison is the United States, where foreign investment screening is conducted through the Committee on Foreign Investment in the United States (CFIUS). This inter-agency body operates under a clear statutory framework, enabling it to review transactions that may pose risks to national security.¹⁵ The strength of this model lies in its institutional design, which integrates expertise from multiple domains, including defence, finance, and intelligence. The structured nature of the review process ensures consistency, transparency, and accountability in decision-making.

B. The European Union Framework: Coordinated Oversight

The European Union adopts a coordinated approach to investment screening, allowing member states to retain decision-making authority while participating in a mechanism for information sharing and collective risk assessment. This framework promotes cooperation and consistency, ensuring that investments affecting broader regional interests are subject to scrutiny.¹⁶ The EU model highlights the importance of institutional coordination, particularly

¹⁴ Prabhash Ranjan & Pushkar Anand, National Security Review of Foreign Investment in India, 13 Trade L. & Dev. 95 (2021).

¹⁵ Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), Pub. L. No. 115-232, ss. 1701–28, 132 Stat. 2173 (2018).

¹⁶ European Commission, Third Annual Report on the Screening of Foreign Direct Investments into the Union (2023).

in complex regulatory environments.¹⁷

C. Identifying the Regulatory Gap in India

In contrast to these structured frameworks, India's approach remains largely policy-driven and fragmented.¹⁸ The absence of a dedicated screening authority and clearly defined procedural guidelines limits the effectiveness of regulatory intervention.¹⁹ This gap becomes particularly significant in sectors where the implications of foreign investment extend beyond economic considerations, underscoring the need for a more coherent and institutionalised approach.

VI. CHALLENGES IN BALANCING LIBERALISATION AND SECURITY

A. Risk of Over-Regulation

One of the central challenges in incorporating national security screening into India's foreign investment regime lies in avoiding excessive regulatory intervention.²⁰ India continues to rely significantly on foreign capital for infrastructure development, technological advancement, and industrial expansion. Overly restrictive screening mechanisms may create procedural bottlenecks, increase compliance burdens, and generate uncertainty among investors. Such conditions may discourage long-term investments and weaken India's position as a preferred global investment destination. Therefore, regulatory measures must be carefully calibrated to ensure that security concerns do not undermine economic growth objectives.

B. Risk of Under-Regulation

At the same time, insufficient regulatory scrutiny presents equally serious risks.²¹ In the absence of robust screening mechanisms, foreign investments in critical sectors may result in strategic vulnerabilities, including control over sensitive infrastructure, access to critical technologies, and influence over data ecosystems. The rise of digital platforms, fintech systems, and data-driven enterprises has intensified these concerns, as such sectors possess implications that extend beyond traditional economic considerations.²² A weak regulatory approach may therefore expose the economy to long-term structural risks that are difficult to

¹⁷ Id.

¹⁸ Prabhash Ranjan & Pushkar Anand, *National Security Review of Foreign Investment in India*, 13 Trade, L. & Dev. 95 (2021).

¹⁹ Id.

²⁰ World Bank, *Global Investment Competitiveness Report 2023* (2023).

²¹ OECD, *Acquisition- and Ownership-Related Policies to Safeguard Essential Security Interests* (2020).

²² OECD, *Artificial Intelligence, Data and Foreign Investment* (2021).

reverse.

C. Sectoral Ambiguity and Institutional Fragmentation

A further challenge arises from the difficulty in identifying which sectors warrant heightened scrutiny. While sectors such as defence and telecommunications are traditionally recognised as sensitive, emerging areas like artificial intelligence, digital services, and cloud infrastructure do not fit neatly within existing classifications.²³ This creates ambiguity in regulatory application. Additionally, India's fragmented institutional framework-comprising multiple regulators operating within distinct domains-often leads to coordination gaps, inconsistent decision-making, and delays in approvals. The absence of a unified approach reduces the overall effectiveness of investment screening.

VII. TOWARDS A STRUCTURED SCREENING FRAMEWORK

A. Need for Statutory Recognition

Addressing the limitations of the current framework requires the formal recognition of national security as a core principle within foreign investment regulation. A statutory framework, rather than reliance on executive policy measures, would provide greater legal certainty, consistency, and enforceability. It would also establish clear parameters for regulatory intervention, reducing the scope for discretionary decision-making and enhancing the credibility of the investment regime.

B. Institutional Mechanism and Coordinated Oversight

The establishment of a dedicated screening authority is essential to ensure a coherent and coordinated approach. Such an authority should function as an inter-agency body, bringing together expertise from economic, technological, and security domains. A centralised mechanism would streamline the approval process, reduce regulatory overlap, and enable comprehensive risk assessment. Institutional coordination is particularly important in addressing complex investment structures that cut across multiple sectors.

C. Transparency and Sector-Specific Regulation

For the regulatory framework to remain effective and investor-friendly, transparency must be a guiding principle. Clearly defined screening criteria, procedural timelines, and

²³ European Commission, White Paper on Artificial Intelligence: A European Approach to Excellence and Trust (2020).

review mechanisms would enhance predictability and build investor confidence. At the same time, a sector-specific and risk-based approach should be adopted to ensure that regulatory intervention remains proportionate. By focusing on genuinely sensitive sectors, the framework can avoid unnecessary restrictions while effectively safeguarding national interests.

VIII. CONCLUSION

India's foreign investment regime has undergone a significant transformation, evolving from a restrictive and control-oriented framework to a liberalised system that actively encourages global capital participation. In recent years, however, this trajectory has begun to shift toward a more strategic model that recognises the intersection between economic policy and national security. The growing importance of technology-driven sectors, data governance, and critical infrastructure has necessitated a re-evaluation of traditional approaches to foreign investment regulation.

While recent policy interventions indicate an increasing awareness of these emerging challenges, the current framework remains largely fragmented and dependent on executive discretion. The absence of a comprehensive statutory mechanism for national security screening limits both the effectiveness and predictability of regulatory oversight. This gap becomes particularly significant in an era where foreign investments carry implications that extend beyond economic benefits to encompass strategic and geopolitical considerations.

Moving forward, India must adopt a structured and institutionalised approach that balances openness with precaution. A transparent, legally grounded, and coordinated screening framework would not only safeguard national interests but also strengthen investor confidence by ensuring clarity and consistency in regulatory processes. By aligning its investment policies with global best practices while retaining sensitivity to domestic priorities, India can position itself as both a secure and attractive destination in the evolving global investment landscape.