

India's strategic shift

Ambuj Sahu says China hawks concerned about signalling weakness have got it wrong; foreign investment rules have not been abolished, only recalibrated

In April 2020, as the world struggled with the Covid-19 pandemic and soldiers from India and China moved towards a large-scale border stand-off, New Delhi amended its foreign direct investment (FDI) policy to require prior government approval for all investments from countries sharing a land border with India – a measure directed at China.

Nearly six years on, India has changed its FDI policy again. It is a significant move for India-China relations.

During the pandemic, the FDI regulation served two purposes. First, it was a supply chain wake-up call. Covid-19 exposed India's acute vulnerability in global supply chains. India needed to build manufacturing capacity. Second, it was an economic response to the brewing border crisis. As the stand-off with China intensified, New Delhi tied the relationship, including investment approvals, to stability at the Himalayan border.

The context has changed. October 2024 brought troop disengagement at the border, followed by the restoration of high-level diplomatic mechanisms. Indian Prime Minister Narendra Modi and President Xi Jinping have since met twice – in Kazan, Russia, and Tianjin, China – marking a meaningful thaw. Air connectivity is being restored and the Kailash Mansarovar Yatra – a pilgrimage significant to Hindus – has resumed. Beijing has also lent support to India's Brics chairmanship.

India's lifting of the FDI restrictions, announced on March 10, is a measured but significant signal that it is willing to follow diplomatic optimism with economic pragmatism.

The revised guidelines establish a two-tier framework. Investments by Chinese entities of up to 10 per cent ownership can now proceed automatically, in line with applicable sectoral caps. For strategic sectors such as capital goods, electronics and the upstream solar supply chain including polysilicon and ingot-wafers, FDI will continue to require government

approval. But decisions will be fast-tracked within 60 days. Crucially, majority ownership in these sectors must remain with Indian entities.

The economic case for reopening to Chinese investment begins with an uncomfortable arithmetic. India's trade deficit with China exceeded US\$116 billion last year on bilateral trade of US\$155 billion. China is India's largest trading partner. At the same time, there has been a structural shift in Chinese exports to India. Indian companies are buying components to add value in downstream supply chains rather than importing finished products.

This trend is neither surprising nor problematic as it reflects India's growing manufacturing ambitions. Yet it also creates a paradox. If Chinese capital cannot enter India, Indian manufacturers will continue purchasing Chinese intermediate goods across the border without any technology transfer, job creation or value addition in India. If Indian manufacturing fails to take off, the trade deficit will widen regardless.

Joint ventures between Indian and Chinese companies offer a practical mechanism to reconcile economic integration with strategic caution, particularly in sectors such as smartphones, solar modules and capital goods. Consider smartphones.

Chinese brands command more than 70 per cent of India's smartphone market. Under previous restrictions, many Chinese companies relied on commercial borrowings from parent companies. These arrangements invited investigations by the Indian authorities over tax and financial irregularities.

The proposed joint venture between Vivo and India's Dixon Technologies, with Dixon taking a 51 per cent stake, is a case towards a more transparent alternative. It preserves Indian ownership and regulatory accountability while allowing Chinese equity.

Capital goods present another dimension. India has made significant strides in downstream manufacturing on both the supply and demand sides. But scaling up production requires further access to manufacturing tools and equipment.

China, the world's largest manufacturer and exporter of capital goods, is an unavoidable partner in this process. Allowing cautious Chinese investment would enable Indian companies to localise these supply chains rather than remain dependent on imports.

Furthermore, prospects of Chinese investments in India's solar industry offer an off-ramp in both countries' World Trade Organization dispute without forcing either to publicly concede ground. China's core complaint is that India's industrial policy in the solar energy sector locks Chinese goods or firms out of the market. Allowing Chinese capital to participate as minority investors would substantially dilute that contention.

The numbers illustrate the stakes. While imports of Chinese solar modules have declined, imports of solar photovoltaic cells surged by over 140 per cent in the last financial year, reflecting India's continued reliance on upstream Chinese capabilities.

India does not get to choose whether its solar supply chain involves China, only whether that involvement occurs onshore or offshore.

China hawks in India argue that easing investment restrictions signals weakness or rewards Beijing without resolving the boundary dispute and other differences. These concerns misread India's careful policy design. FDI regulations have not been abolished, only calibrated. The government approval route remains operative for sensitive sectors. Majority Indian ownership is a prerequisite. What India has done is to distinguish the use of FDI policy as an incentive to mend ties with China.

India's strategic relationship with China is complex enough that it cannot be managed through a single policy instrument. Border stability, trade balances, investment flows, multilateral cooperation and people-to-people ties each operate according to their own logic. Conflating them into a single framework can be an effective tool in times of crisis, but a working relationship demands greater precision. The easing of FDI restrictions suggests New Delhi may be ready to disentangle those threads.

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