

From Protectionism to Liberalization: Foreign Direct Investment Policies in India and Sri Lanka

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Abstract:

This study analyzes the paradigm shift from inward-oriented protectionism to market-driven liberalization in India and Sri Lanka and evaluates how these evolving frameworks influence national economic resilience. While Sri Lanka initiated reforms early in 1977 to dismantle its import-substitution regime, India underwent structural transformation in 1991, dismantling the "License Raj" and transitioning from state-led central planning toward commercial decision-making. Each country used prudential policy changes as a bridge between chronic balance-of-payments troubles (and the corresponding need to access world capital markets). India also used the test of strength to replace another rigid system, the Foreign Exchange Regulation Act (FERA), with a more flexible, even if not ideal, Foreign Exchange Management Act (FEMA in July 2000, enabling current account convertibility. It has led to establishing a dual-governance architecture administered by the DPIIT (Department for Promotion of Industry and Internal Trade) and RBI, which was later expanded when entry channels were opened through automatic route. In contrast, Sri Lanka deployed export processing zones along with constitutional safeguards against arbitrary nationalization. In the beginning, its exposure and early degree of openness often tussled with chronic current account deficits, mounting debt, and bureaucratic delays. Sri Lanka is already bound by IMF mandates set under the Economic Transformation Act of 2024 which ties the government to structured post-crisis targets after it suffers post-crisis reforms. Also, under NPP (2024–2026), a major key is transformation into a rule-based investment platform to restore investors' confidence. The business case highlights that not all liberalization stories are the same. Instead, it is a context-dependent process that is predominantly determined by the underlying quality of its institutions and a country's ability to absorb outward foreign capital flows without losing macroeconomic equilibrium. This research paper is part of the author's Ph.D. research work

Keywords:

Foreign Direct Investment, FDI Policies, Regulations, India, Sri Lanka.