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3. Foreign Direct Investment - Economy

India's net Foreign Direct Investment (FDI) has witnessed sharp decline despite strong gross inflows creating paradox of high activity with declining net capital retention.

1. Net FDI fell dramatically from $44 billion in 2020-21 to less than $1 billion in 2024-25 before recovering modestly to $7.6 billion in 2025-26.
2. This decline occurred despite substantial gross FDI inflow of $94.6 billion in 2025-26 indicating large capital outflows offsetting fresh inflows.

1.Understanding FDI - Concepts and Framework

Definition and Prohibition Sectors

1. FDI refers to investments made by foreign entities (individuals or companies) in business interests of another country typically through ownership or control of enterprises.
2. At present, FDI is prohibited in lottery, gambling and betting, chit funds, Nidhi company, real estate business, and manufacturing of cigars and cigarettes using tobacco.

Gross vs. Net FDI Distinction

1. Net FDI represents difference between foreign investment entering the country and capital flowing out through disinvestment and repatriation.
2. Decline in net FDI does not necessarily imply fall in investor interest as gross inflows may remain strong masking underlying outflow pressures.

2.Types of FDI Investors

Real FDI (Most Beneficial)

1. Real FDI is undertaken by multinational corporations establishing production facilities and service operations in host country.
2. Such investments bring technology, managerial expertise, employment generation, and long-term industrial development.
3. Real FDI is considered most beneficial form from developmental perspective yet accounted for only 41.9% of effective inflows during 2022-23 to 2025-26.

Financial Investors

1. Include private equity funds, venture capital firms, sovereign wealth funds, and asset management companies with primary objective of earning capital gains rather than building long-term productive capacity.
2. They accounted for 40.5% of effective inflows, nearly matching Real FDI share creating concern about investment quality.

Diaspora and SPV Investments

1. Diaspora investors and Special Purpose Vehicles (SPVs) contributed 17.6% of effective inflows.
2. Often routed through offshore financial centres and may involve round-tripping of domestic capital inflating apparent FDI numbers.

3.FDI Routes in India

Automatic Route

1. No prior approval required; investors notify Reserve Bank of India (RBI) after making investment.

2. Most sectors including manufacturing and software fall under this route ensuring ease of entry.

Government Approval Route

1. Requires prior approval from concerned Ministry or Department.
2. Sectors including telecom, media, pharmaceuticals, and insurance fall under this route.

4.Reasons for Declining Net FDI

Rising Disinvestment and Capital Repatriation

1. Principal reason for weak net FDI is growing scale of investor exits and capital repatriation.
2. During calendar year 2025, total recorded divestment reached $52 billion.
3. 45 major private equity and venture capital exits accounted for nearly $29 billion representing mature investment cycle exit.

Declining Manufacturing-Oriented FDI

1. Manufacturing FDI declined across three consecutive four-year periods reflecting structural concerns about India's industrial competitiveness.
2. Real FDI into manufacturing accounted for only 10.6% of total effective inflows during latest four-year period limiting employment and industrial growth benefits.

Rising Outward FDI

1. India's outward FDI increased significantly in recent years with Indian firms investing nearly $65 billion abroad between 2023-24 and 2025-26.
2. International Financial Services Centre (IFSC) at GIFT City is emerging as important conduit for cross-border capital flows.
3. OFDI routed through GIFT City increased from $246 million in 2023-24 to $1.18 billion in 2025-26.

Policy Evolution and Structural Concerns

1. Economic reforms of 1991 promoted FDI primarily for acquiring advanced technology, enhancing exports, and conserving foreign exchange.
2. Over time, policy emphasis shifted toward attracting larger volumes of foreign capital rather than quality investments.
3. Concerns relating to investment quality, technology transfer, and future external payment obligations received relatively less attention.

Key Concerns

1. Financialisation of FDI reduces technology transfer and long-term industrial benefits.
2. Weak manufacturing FDI hampers industrialization, employment generation, and exports.
3. SPV and offshore center usage can obscure true nature of investment flows.

5.Way Forward

1. **Prioritize Quality over Quantity** - Attract technology-intensive, export-oriented, employment-generating FDI rather than maximizing inflow volumes.
2. **Promote Manufacturing FDI** - Encourage greenfield investments in manufacturing strengthening industrial capacity and global value chain integration.
3. **Enhance Transparency** - Official data should distinguish between Real FDI, financial investments, and SPV-based flows enabling better policy assessment.
4. **Strengthen Domestic Competitiveness** - Improve infrastructure, logistics, ease of doing business, and innovation ecosystems attracting productive investments.

Source - https -//www.thehindu.com/business/Economy/the-reality-behind-falling-net-fdi/article71084799.ece