



DAILY EDITORIAL ANALYSIS

TOPIC

**A COMPLEX TURN IN INDIA'S FDI
STORY**

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A COMPLEX TURN IN INDIA'S FDI STORY

Context

- India continues to attract significant foreign direct investment (FDI), but rising profit repatriations, disinvestments, and outward Indian FDI have diluted the long-term growth impact.
- The Reserve Bank of India has flagged this dual trend as a risk to India's external resilience.

About Foreign Direct Investment (FDI)

- **Definition:** Investment made by a foreign entity directly into the business or productive capacity of another country.
- **Modes:** Equity participation, joint ventures, setting up subsidiaries, or greenfield projects.
- **Distinction:** Unlike portfolio investment, FDI is expected to provide long-term capital, technology transfer, and management expertise.

Trend in India's FDI

- India attracted **\$81 billion in FY 2024-25**, marking nearly 14% increase from the previous year.
 - ♦ Inflows nearly **doubled between 2011 and 2021**, reflecting India's attractiveness. However, since the peak of FY 2021-22, **net FDI inflows have sharply declined**.
 - ♦ **Gross inflows (post-pandemic):** \$308.5 billion;
 - ♦ **Withdrawals/repatriations:** \$153.9 billion;
 - ♦ **Net retained capital (FY 2024-25):** \$0.4 billion;
- **Key Sectoral Trends:**
 - ♦ **The manufacturing sector** has seen its share fall to just **12% of total FDI**.
 - ♦ **Service sectors** such as finance, hospitality, and energy distribution dominate inflows, however, they **lack the multiplier effects** of manufacturing or infrastructure.
 - ♦ It suggests investors are prioritising quick financial gains, often **routed through tax havens such as Singapore and Mauritius**, rather than strategic, technology-driven commitments.
- **Rising Indian Outward FDI:**
 - ♦ A parallel development is the growth of Indian outward investment, which climbed from **\$13 billion in FY 2011-12 to \$29.2 billion in FY 2024-25**.
 - ♦ Firms increasingly look abroad, citing **regulatory inefficiencies, infrastructure gaps, and policy unpredictability** at home.
 - It weakens domestic capital formation, job creation, and industrial competitiveness.

Other Key Concerns Surrounding India's FDI

- **Structural Barriers to Sustainable FDI:** India faces persistent hurdles, despite reforms and improved rankings, regulatory opacity; inconsistent legal and policy frameworks; and governance challenges.
 - ♦ These issues undermine investor confidence, contributing to both foreign disinvestments and rising Indian capital flight.
- **Macroeconomic Implications:** FDI inflows are crucial for India's balance of payments, currency stability, and monetary policy flexibility.
 - ♦ A decline in **net FDI inflows** heightens risks to external account management.
 - ♦ The **Reserve Bank of India** has acknowledged this **dual trend of high inflows and high outflows**, noting its long-term implications for economic resilience.
- **Geopolitical and Global Headwinds:** FDI inflows from key countries like the US, UK, UAE, and Germany have declined amid global uncertainty.
 - ♦ Policy shifts in the U.S. and economic stimulus in China are also expected to divert capital away from emerging markets like India.
- **Overdependence on Tax Haven Routes:** A significant portion of FDI continues to flow through **Mauritius (25%) and Singapore (24%)**, raising concerns about the transparency and sustainability of these investments.
 - ♦ These routes are often used for tax optimization rather than long-term industrial investment.

- **Policy Execution Gaps:** Despite ambitious reforms like the **National Single Window System** and **Jan Vishwas Act**, investors still cite:
 - ♦ Unpredictable tax enforcement;
 - ♦ Weak contract enforcement;
 - ♦ Slow regulatory approvals;
 - ♦ These issues undermine India's image as a reliable investment destination.

Efforts To Boost India's FDI

- **Liberalization of Sectoral Caps:** 100% FDI under automatic route in major sectors like telecom, insurance intermediaries, coal mining, and contract manufacturing.
 - ♦ Defense sector cap raised to 74% under automatic route for new industrial licenses;
- **Make in India & National Manufacturing Mission:** To boost domestic manufacturing and attract foreign capital;
 - ♦ Focus on 27 strategic sectors under Make in India 2.0, including electronics, pharmaceuticals, and textiles;
- **Ease of Doing Business (EoDB):** India jumped from 142nd to **63rd in the World Bank's Doing Business Report** between 2014 and 2019;
 - ♦ Initiatives like **Jan Vishwas Act** and **Jan Vishwas 2.0** aim to decriminalize business laws and simplify compliance;
- **Digital Transformation & Single Window Clearance:** Implementation of the **National Single Window System (NSWS)** for faster approvals;
 - ♦ Digitization of FDI approval processes and investor grievance redressal;
- **Production-Linked Incentive (PLI) Schemes:** Targeted incentives across 14 sectors, including semiconductors, medical devices, and technical textiles;
 - ♦ Designed to enhance India's global competitiveness and reduce import dependence;

Way Forward

- To transform into a sustainable global investment hub, India needs to:
 - ♦ **Prioritise long-term capital** over short-term speculative flows.
 - ♦ **Simplify regulations** and ensure policy consistency.
 - ♦ **Invest in infrastructure and institutions** to strengthen investor trust.
 - ♦ **Focus on human capital** to attract advanced manufacturing, clean energy, and technology.
 - ♦ **Align FDI with national goals** to ensure developmental impact.

Source: TH

Daily Mains Practice Question

- Q. Discuss the factors contributing to the recent decline in net Foreign Direct Investment (FDI) in India, and evaluate the implications this trend may have on the country's long-term economic growth and investor confidence.

