The FDI Reversal and the Message

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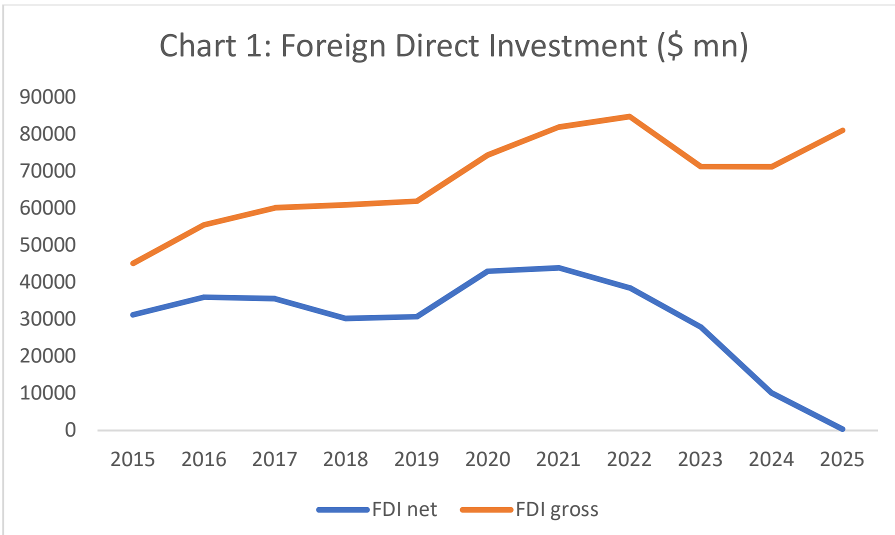
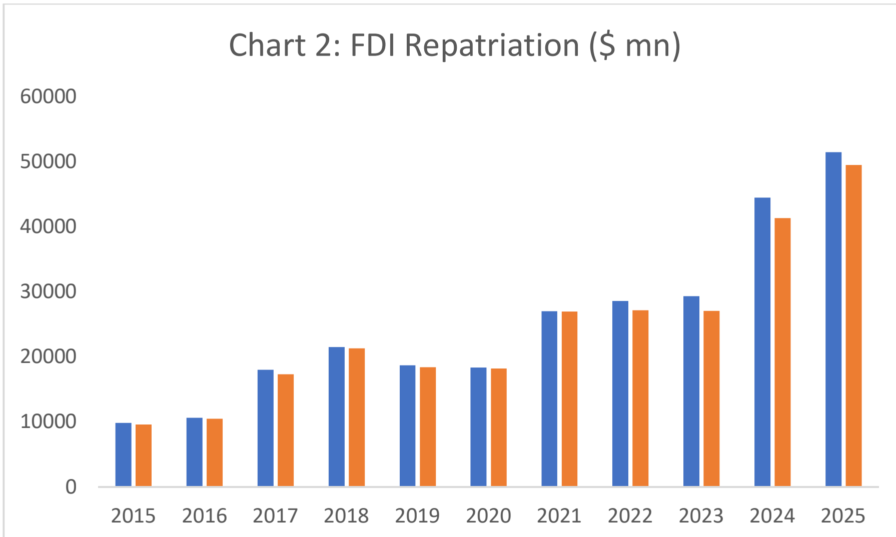
In a surprise turn, India (which had been receiving consistent FDI inflows even in years when foreign portfolio inflows were volatile) experienced a close to 100 per cent decline in net FDI investment in the country to $354 million in 2024-25 (Chart 1). It is still true that *gross* FDI inflows have risen from $71.3 billion in 2023-24 (and more or less the same level in 2022-23) to $81 billion in 2024-25. But FDI outflows, resulting either from retrenchment of assets by incumbent foreign direct investors (Chart 2), or investment abroad by resident firms (Chart 3), also rose to $$29.2 billion in 2024-25 from $16.7 billion in 2023-24. This is by not a sudden and possibly transient shift. As compared with $4.0 billion in 2015-16, outward investment, while displaying considerable year-to-year variation, rose to $14.0 billion in 2022-23, and spiked to $29.2 billion in 2024-25.



There appear to be three factors underlying the collapse of net FDI. First, despite the rise in 2024-25, gross FDI inflow peaked in 2021-22 at $84.8 billion, fell sharply in the next year, and despite the 2024-25 rise remained below the previous peak level. Second, there has been a rise in repatriation of investments made by incumbent foreign direct investors, which rose from $29.3 billion in 2022-23 to $51.5 billion in 2024-25. Most of that repatriation ($27.1 billion in 2022-23 and $49.5 billion in 2024-25) occurred through the divestment of equity. Third, as noted there has been a sharp increase in overseas FDI by resident investors. That was the result of both new equity outflows and investment of retained earnings, with unusual increases in particular years such as 2021-22 and 2024-25.

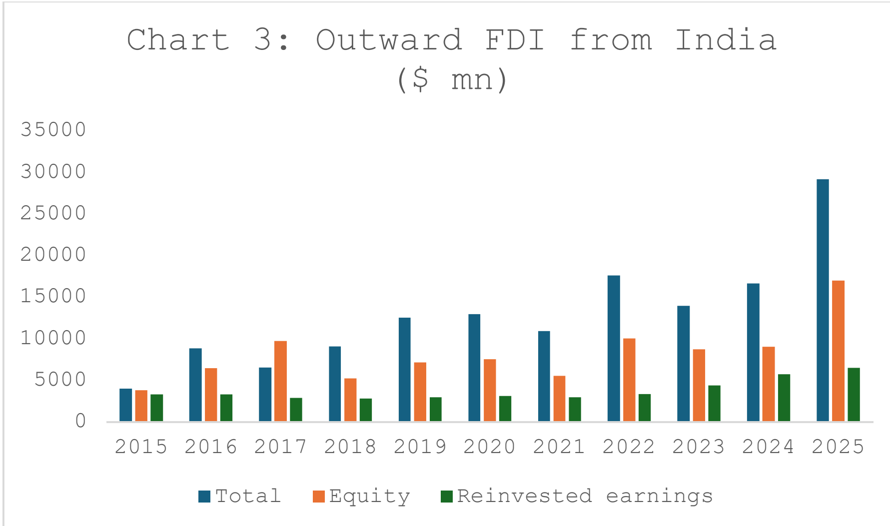
The dampening of gross flows of FDI may be partly explained by sluggishness in domestic demand and uncertainty regarding profits. But to fully understand the behaviour of foreign investors, both in terms of delivering new gross FDI and repatriating past investment through reduction in equity holding, it may be useful to turn to the definition of foreign direct investment that has become pervasive since the 1980s when countries adopted the IMF definition. That definition treats any inflow from a single investor that leads to the acquisition of more than 10 per cent of the equity of the target firm or entity as direct investment.

This marks a departure from the "conceptual" distinction between foreign direct and foreign portfolio investment, with the former seen as undertaken by investors with a long term interest and commitment seeking to earn profits from production, whereas the latter are seen as investors looking to make investments for the short term with returns expected mainly from appreciation of capital values. The 10 per cent figure is in principle meant to provide an arbitrarily chosen empirical boundary to statistically separate out the two kinds of investment.



In practice, however, as the volume of purely financial capital moving into less developed countries with limited quantities of traded financial actively increased, it led to inflation in stock prices in the recipient country and a degree of stability (or even appreciation) of the exchange rate of that country. As a result, speculative portfolio investors were willing to buy into chunks of equity in individual firms in excess of 10 per cent. This, like portfolio investment, was footloose capital, which tends to exit in a context of uncertainty or falling returns. Recent years have seen considerable volatility with negative net flows of investments from foreign institutional investors to the tune of $14.1 billion in 2021-22, $4.8 billion in 2022-23, and positive inflows of $44.6 billion in 2023-24 and $$2.4 billion in 2024-25. This volatility is possibly what partly explains outflows from those portfolio investors, whose investment gets recorded as direct investment because of the arbitrary empirical distinction between the two.

The instability in net FDI inflow trends, in a context in which there has been a substantial accumulation of footloose portfolio foreign capital in Indian markets, increases the danger of capital flight if developments abroad or domestically affect the so-called "confidence" of investors. The government has subjected India's economy and society to external financial fragility by liberalizing capital controls. That fragility has considerably increased because in a world dominated by finance, even foreign direct investment flows are not free of volatility.



The presumption that this poses no danger because of India's large foreign exchange reserves is completely misplaced. Those reserves are built by taking on liabilities and are not free stocks generated through current account surpluses. They cannot be expended for other purposes without increasing vulnerability. But riding on those reserves, the government has liberalized access to foreign currency, opening up other routes of enhanced outflow of foreign exchange. One such route contributes to the fall in net FDI inflows, through an increase in outward foreign direct investment from India.

The concentration of capital and profits has increased hugely in recent years and left a few leading Indian business groups cash rich. With easy access to foreign exchange given the large portfolio capital inflows in recent years, as well as easy access to credit, Indian firms have decided to move out of relatively saturated domestic markets to acquire assets and invest abroad. According to one semi-official source, between April 2024 and February 2025, overseas direct investments from India amounted to $20.6 billion, which is a substantial share of the $29.2 billion recorded in official statistics for financial year 2024-25. There are also reasons to believe that flows of 'direct investment' to destinations such as Mauritius and even Singapore may be reflective of a round tripping exercise which too appears to be on the rise. Just as rich Indian are exploiting the liberalized remittance scheme, that allows transfer of a sums of $250,000 a year per person for a wide range of permissible transactions, to take their excess savings abroad, corporates are taking their domestic currency surpluses to foreign destinations. That reduces the quantity of net FDI. And both outward FDI and the LRS scheme are a drain of foreign exchange.