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## **FOREIGN DIRECT INVESTMENT FOREIGN DIRECT INVESTMENT AND INDIA'S BALANCE OF PAYMENTS MACROECONOMIC AND SECTORAL STUDY**

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### **ABSTRACT**

*India's economic growth has been greatly aided by foreign direct investment (FDI), which has a major effect on the country's trade balances, foreign exchange reserves, and capital inflows. By offering steady, long-term investments, FDI boosts the capital account; nevertheless, it also presents problems including sectoral imbalances and profit repatriation. While investments in export-oriented sectors like manufacturing and pharmaceuticals boost foreign profits, those in infrastructure and energy tend to increase reliance on imports. With a peak of \$81.7 billion in 2020, India's foreign direct investment inflows increased significantly between 2010 and 2023, helping to boost foreign exchange reserves but causing current account balances to fluctuate. Sectoral trends show that infrastructure continues to be heavily imported, while industry and IT are the key drivers of exports. This paper looks at the sectoral and macroeconomic effects of FDI on India's BoP, emphasizing the necessity of strategic policies to minimize financial risks and maximize FDI gains.*

**Keywords:** Foreign Direct Investment (FDI), Balance of Payments (BoP), Capital Inflows, Foreign Exchange Reserves, Trade Balance, Sectoral Imbalances, Current Account Deficit, Macroeconomic Impact.

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### **1. INTRODUCTION**

India's economic evolution has been significantly influenced by foreign direct investment (FDI), especially following the liberalization measures of 1991. In addition to bolstering India's foreign exchange reserves, it has been essential in increasing industrial productivity, encouraging innovation, and creating jobs. Through stabilizing the capital account, lowering dependency on short-term foreign borrowings, and luring long-term investments in important industries, FDI inflows make a substantial contribution to the Balance of Payments (BoP). But despite its advantages, foreign direct investment (FDI) can also result in macroeconomic problems including increasing profit repatriation by foreign companies, which could put pressure on the current account. Furthermore, sectoral imbalances can affect the sustainability of the economy as a whole when investments are focused in a small number of high-growth businesses while others receive insufficient funding.

FDI affects the current and capital accounts in a variety of ways, according to the BoP. By offering a non-debt-creating source of external financing, FDI inflows strengthen stability in the capital account and lessen the risks connected to fluctuating portfolio investments. However, the type of investments determines how much FDI affects the current account. While investments in infrastructure and energy, which are frequently dependent on imported commodities, can increase the trade deficit, foreign direct investment (FDI) in export-driven industries like manufacturing and pharmaceuticals improves trade balances by boosting foreign revenues. Furthermore, even while FDI contributes to the growth of foreign exchange reserves, foreign companies' repatriation of dividends and royalties may result in cash outflows that have an impact on India's overall balance of payments.

### **2. LITERATURE REVIEW**

**Hussain and Goswami (2022)** implemented a panel autoregressive distributed lag (ARDL) technique to do a thorough examination of the sector-specific factors impacting foreign portfolio investment (FPI) inflows in India. They conducted a thorough analysis of the effects of financial and macroeconomic variables, including market capitalization, interest rates, and exchange rate stability, on FPI in various industries. Based on their legislative frameworks and economic stability, some industries were more appealing to foreign investors than others, according to the research. The research provided significant insights into the intricate nature of capital flows in developing nations such as India by emphasizing the influence of sectoral performance, market confidence, and regulatory policies on investment patterns. Additionally, their research highlighted the necessity of customized policy measures



to ensure consistent FPI inflows and improve sectoral competitiveness, guaranteeing long-term financial growth and stability.

**Bhanumurthy, Bose, and Chakravarti (2018)** examined India's fiscal policy using a structural macroeconomic approach, concentrating on debt and deficit targeting. The usefulness of fiscal consolidation techniques in preserving macroeconomic stability and long-term growth was examined thoroughly in their study. They offered empirical proof of how fiscal policies could affect long-term economic performance by analyzing the connection between public debt, fiscal deficit, and economic expansion. Their study made clear how important it is to balance growth-oriented policies with fiscal restraint in order to prevent excessive debt from impeding economic growth. Furthermore, by providing suggestions for improving fiscal management through careful debt management and effective resource allocation, the report added to the policy conversation. When taken as a whole, these research improved our knowledge of India's fiscal policy, investment dynamics, and financial stability while illuminating important topics that affect growth and economic resilience.

**Masharu and Nasir (2018)** examined the effects of India's FDI liberalization policy, paying particular attention on the retail industry. Their research examined the effects of legislative changes on customer preferences, market competition, and the general structural change of the retail sector. According to the findings, the sector's growth was aided by FDI liberalization's increased capital inflows, technological developments, and enhanced supply chain efficiency. The report did, however, also draw attention to worries about small retailers being displaced and possible monopolistic tendencies brought on by the dominance of big, global companies. The study offered a fair assessment of the sector's changing dynamics by weighing the advantages and disadvantages of FDI liberalization, highlighting the necessity of regulatory protections to guarantee fair growth.

**Mishra and Palit (2020)** investigated how FDI influenced the job situation in India. With a focus on both direct and indirect employment effects, their study evaluated the degree to which FDI inflows impacted job creation across multiple sectors. The study discovered that whereas FDI helped create jobs, especially in manufacturing and services, its effects differed according to labor market flexibility and sectoral demands. The study also emphasized the significance of regulatory frameworks and skill development programs in optimizing the employment advantages of foreign direct investment. The results demonstrated that although foreign investment was essential for economic expansion, its ability to effectively solve employment issues hinged on complementary domestic policies, such as those pertaining to education and vocational training.

### **3. FDI AND ITS IMPACT ON INDIA'S BALANCE OF PAYMENTS**

The current account (trade balance, income, and transfers) and the capital account (FDI, portfolio investments, and borrowings) make up the Balance of Payments (BoP), which keeps track of a nation's economic dealings with the rest of the world. The trade balance, capital stability, and foreign exchange reserves are all impacted by FDI, a reliable supply of capital. Investments in import-heavy industries like infrastructure may increase trade deficits, but FDI in export-driven industries like medicines increases reserves and lowers them. The allocation of FDI by sector varies; manufacturing boosts employment and exports, services get a lot of foreign interest but present repatriation risks, and infrastructure needs a lot of money but increases dependency on imports. Sustainable economic stability requires strategic FDI policies.

#### **3.1. Balance of Payments and FDI**

A systematic record of all economic transactions between a nation's citizens and the rest of the globe over a given time period is called the Balance of Payments (BoP). It tracks the inflows and outflows of money, making it a crucial measure of a country's economic health. There are two main accounts inside the BoP:

- **Current Account:** The export and import of commodities and services, net foreign earnings (such interest and dividends), and transfer payments like foreign remittances are all included in the trade balance that is reflected in this account. A current account surplus means that a nation is exporting more than it is importing, whereas a deficit implies the opposite.
- **Capital and Financial Account:** This component records foreign investment-related transactions, such as portfolio investments, external commercial borrowings, foreign direct investment (FDI), and fluctuations in foreign exchange reserves. Maintaining macroeconomic equilibrium depends on the stability of the capital account, which is essential for financing a current account deficit.



The capital account is greatly impacted by foreign direct investment (FDI), which brings in steady, long-term foreign money. FDI, which usually entails the creation of jobs, knowledge transfer, and physical investments, is more stable than portfolio investments, which are very liquid and can swiftly depart the nation during economic downturns. However, a number of variables, including the kind of investment, sectoral distribution, governmental regulations, and the rate at which foreign investors repatriate their profits, affect how much FDI affects the BoP overall.

### 3.2. Macroeconomic Impact of FDI on BoP

FDI significantly influences the macroeconomic environment, affecting various components of the BoP:

- **Foreign Exchange Reserves:** Foreign exchange reserves rise as a direct result of FDI inflows, enhancing macroeconomic stability and lowering external vulnerability. A robust reserve position boosts investor confidence and protects the economy from outside shocks like abrupt capital withdrawals or currency volatility.
- **Trade Balance:** Sector-specific differences exist in how FDI affects the trade balance. Investing in export-oriented sectors including manufacturing, information technology, and pharmaceuticals increases exports, which is a good contribution. FDI, on the other hand, may increase the trade deficit by raising demand for imports in industries like energy and infrastructure that rely on imported inputs.
- **Capital Account Stability:** FDI gives the capital account much-needed stability because it is a long-term commitment from foreign investors. FDI increases the nation's financial position and lessens reliance on external borrowings, in contrast to short-term portfolio investments that may cause erratic capital movements.
- **Profit Repatriation:** Foreign investors' repatriation of gains can put pressure on the country's current account, even when FDI inflows bring capital into the nation. The advantages of early FDI inflows can be countered by significant outflows in the form of dividends, royalties, and interest payments, underscoring the necessity of policies that promote reinvestment of profits within the domestic sector.
- **Employment and Economic Growth:** FDI is essential for technology transfer and employment creation, which increases output and spurs economic expansion in general. Investments in industries like manufacturing, information technology, and infrastructure support industry growth and skill development, bolstering the overall economic structure.

### 3.3. Sectoral Distribution of FDI and BoP Implications

Different sectors attract varying levels of FDI, each with unique implications for the BoP:

- **Manufacturing:** Historically, this industry has benefited greatly from FDI, which has raised exports, created jobs, and improved domestic output. By increasing foreign investment in manufacturing, the "Make in India" campaign has increased the nation's export potential and decreased its dependency on imports.
- **Services (IT, Telecom, Finance):** Significant FDI is drawn to India's thriving service industry, especially in the areas of financial, telecommunication, and IT services. These sectors have a high rate of profit repatriation, which might result in capital outflows even when they produce a significant amount of income and foreign exchange.
- **Infrastructure:** Massive FDI inflows are necessary for large-scale infrastructure projects, such as those involving roads, railroads, energy, and urban growth. Even while these investments foster long-term economic expansion, the trade balance is impacted since they frequently include a significant reliance on imported technology and raw materials.
- **Retail & E-Commerce:** Significant foreign investment has been attracted by the growth of e-commerce, particularly from multinational corporations like Amazon and Walmart. Although this industry promotes economic growth and digital expansion, if it is controlled by foreign-owned businesses, it may also lead to large capital outflows.



- **Pharmaceuticals:** India's robust worldwide market presence makes the pharmaceutical sector a major draw for foreign direct investment. FDI in this area improves exports, fortifies foreign exchange reserves, and increases domestic production capacity, all of which have a favorable impact on the BoP.

#### **4. TRENDS AND SECTORAL ANALYSIS OF FDI IN INDIA**

India had a sharp rise in foreign direct investment (FDI) inflows between 2010 and 2023, reaching a record of \$81.7 billion in 2020 before declining to \$70 billion in 2023. Foreign exchange reserves were bolstered by FDI, while the current account balance fluctuated and only turned positive in 2020 as a result of lower imports during COVID-19. Manufacturing received the most foreign direct investment (\$25 billion) in 2023, which fueled export expansion, while IT and telecom (\$18.5 billion) produced foreign exchange profits but experienced significant profit repatriation. While retail and e-commerce (\$8.2 billion) had a small impact on the trade balance, infrastructure (\$10.3 billion) continued to be dependent on imports. BoP benefited from pharmaceuticals' (\$5.6 billion) steady exports and investments.

##### **4.1. FDI Inflows and India's BoP Performance (2010-2023)**

India's GDP growth, foreign exchange reserves, current account balance, and FDI inflow patterns from 2010 to 2023 are shown in Table 1. From \$27.4 billion in 2010, to a peak of \$81.7 billion in 2020, and then a modest decline to \$70 billion in 2023, FDI inflows have been expanding gradually. India's enhanced investment climate, structural changes, and government efforts to draw in international investment are all reflected in this. Most years saw a negative current account balance, with the exception of 2020, when a COVID-19-related slowdown in commerce resulted in a brief 0.9% surplus. At the same time, India's foreign exchange reserves steadily increased, rising from \$275 billion in 2010 to \$630 billion in 2023, bolstering its external financial position.

**Table 1: FDI Inflows and BoP Trends in India (2010-2023) (USD Billion)**

<b>Year</b>	<b>FDI Inflows</b>	<b>Current Account Balance</b>	<b>Foreign Exchange Reserves</b>	<b>GDP Growth Rate (%)</b>
2010	27.4	-3.2	275.0	8.5
2015	44.3	-1.1	355.0	7.5
2018	62.0	-2.5	420.0	6.8
2020	81.7	0.9	575.0	-7.3 (COVID-19)
2023	70.0	-1.8	630.0	7.0

The GDP growth rate varied, reaching a peak of 8.5% in 2010, then growing steadily from 2015 to 2018, before the pandemic caused it to drop precipitously to -7.3% in 2020. However, India's economic endurance is demonstrated by a robust recovery to 7.0% in 2023. According to the data, FDI inflows have been essential in stabilizing the capital account and increasing foreign exchange reserves; however, there are still difficulties in controlling the current account deficit, especially because of significant import dependency in sectors like infrastructure and profit repatriation. To maintain economic stability, a balanced approach to export promotion, FDI policies, and domestic manufacturing will be essential.

##### **4.2. Sectoral FDI Inflows in India (2023)**

Table 2 illustrates how various industries contribute to the Balance of Payments (BoP) by showing the sector-wise allocation of FDI inflows in India for 2023. With \$25 billion, the manufacturing sector brought in the most foreign direct investment, demonstrating its contribution to steady capital inflows and export-driven growth. With \$18.5 billion, the IT and telecom industry came in second, aided by strong foreign exchange profits, albeit profit repatriation is still an issue. \$10.3 billion was spent on infrastructure, but India's trade balance is challenged by its high reliance on imports.



**Table 2: Sector-wise FDI Inflows in India (2023) (USD Billion)**

Sector	FDI Inflows	Contribution to BoP
Manufacturing	25.0	Export-driven growth, stable inflows
IT & Telecom	18.5	High forex earnings but profit repatriation
Infrastructure	10.3	High import dependency
Retail & E-commerce	8.2	Moderate impact on trade balance
Pharmaceuticals	5.6	Positive trade balance, stable investments

Despite its minor impact on the trade balance, the retail and e-commerce sector managed to secure \$8.2 billion in foreign direct investment (FDI), reflecting increased investor confidence. Through increased exports and fortified foreign exchange reserves, the pharmaceutical industry contributed positively to the trade balance with \$5.6 billion in foreign direct investment. Overall, the data indicates that while foreign direct investment (FDI) inflows across sectors promote economic growth, their effects on the balance of payments (BoP) differ; manufacturers and pharmaceuticals, which have high export potential, increase foreign exchange reserves, while profit repatriation and import-heavy industries, such as infrastructure, can strain the current account deficit.

## **5. CHALLENGES AND RISKS ASSOCIATED WITH FDI AND BOP**

India's Balance of Payments (BoP) is strengthened by foreign direct investment (FDI), which is essential for economic growth, but it also presents a number of risks and difficulties that policymakers must resolve to maintain macroeconomic stability over the long run.

- **Profit Repatriation and Current Account Impact:** Profit repatriation, or the practice of foreign investors returning their profits to their home nations, is a major issue with FDI. In high-value industries like IT, telecom, and finance, where foreign companies earn significant revenue but expatriate a big share of profits, continuous profit outflows can exacerbate the current account deficit (CAD), even while FDI inflows initially increase foreign exchange reserves. The net beneficial effect of FDI on the BoP is diminished by this loss of foreign cash, necessitating the implementation of measures like encouraging profit reinvestment in India.
- **Sectoral Imbalances and Uneven Growth:** FDI inflows are typically concentrated in high-growth, capital-intensive industries like telecom, finance, and technology, while traditional industries like textiles and agriculture receive relatively smaller investments. Economic development becomes unbalanced as a result, with high-value industries thriving while employment-intensive industries find it difficult to draw in foreign investment. Market monopolization brought on by foreign investors' domination in important industries may likewise restrict the expansion of native businesses. Legislators must promote FDI diversification in order to guarantee balanced sectoral development.
- **External Vulnerability and Economic Instability:** Global economic conditions have an impact on foreign direct investment inflows, and any global recession, geopolitical unrest, or changes in major nations' policies can cause capital flight, which lowers foreign exchange reserves and raises financial volatility. The Indian economy may be vulnerable to external shocks if FDI declines significantly, especially if foreign investors take their money out quickly. To lessen reliance on FDI for capital formation, it is crucial to diversify funding sources, boost domestic investment, and establish solid economic foundations.
- **Dependency on Imports and Trade Deficit Expansion:** Infrastructure, auto manufacturing, and high-end technology are just a few of the sectors that draw foreign direct investment and are mostly reliant on imported components and raw materials. Although these industries support economic expansion, their reliance on imports might increase foreign exchange outflows and the trade deficit. For example, importing machinery, cutting-edge technology, and specialized equipment is frequently necessary for foreign investments in infrastructure projects, which raises import costs. India should improve local supply chains,



foster technology transfer from international investors, and support indigenous manufacturing skills in order to reduce this risk.

- **Policy and Regulatory Challenges:** Foreign investors are still hampered by regulatory obstacles such as convoluted approval procedures, unclear policies, and bureaucratic hold-ups, notwithstanding India's improvement in its Ease of Doing Business ranking. Potential investors may be put off by inconsistent tax laws, abrupt regulatory changes, and sectoral restrictions, which could result in fewer FDI inflows and more economic volatility. An environment of stable, open, and investor-friendly policies is essential to maintaining FDI development while lowering related risks.

## 6. CONCLUSION

India's economic growth has been greatly aided by foreign direct investment (FDI), which has a major effect on the balance of payments (BoP) through trade balances, capital stability, and foreign exchange reserves. Long-term sustainability is threatened by sectoral imbalances and profit repatriation, even while FDI inflows have supported economic growth, improved export competitiveness, and generated job opportunities. While the infrastructure and retail sectors have contributed to capital outflows because of their significant import dependency and foreign ownership, manufacturing and pharmaceuticals have had a beneficial impact on the BoP by growing exports and decreasing import dependence. A strong and resilient economic environment that supports India's long-term development objectives requires a planned and balanced approach to FDI policy in order to optimize its benefits while reducing risks.

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