Sectoral Dynamics of Foreign Direct Investment in India: Growth, Trends, and Economic Impacts (1995–2019)

Dr. Harmandeep Kaur
Assistant Professor, Department of Social Sciences, Khalsa College, Amritsar, Punjab, India
hdeep30@gmail.com

Abstract
Foreign Direct Investment (FDI) plays a crucial role in the economic growth and industrial transformation of emerging economies. In India, sectoral patterns of FDI have shifted significantly between 1995 and 2019, reflecting policy reforms, liberalization initiatives, and global investment trends. This study examines two distinct periods, 1995–2005 and 2005–2019, analyzing FDI inflows across 45 industries to identify growth patterns, structural changes, and their implications for sectoral GDP. The findings reveal that sectors such as information technology, automobiles, telecommunications, and financial services have attracted the majority of foreign capital, while traditional sectors and resource-based industries have lagged. The study highlights the economic impacts of FDI on sectoral output, employment, and industrial diversification. Policy recommendations are proposed to address underperforming sectors and ensure balanced industrial growth, emphasizing targeted incentives, infrastructure development, and regulatory reforms.

Keywords: *Foreign Direct Investment, India, Sectoral Dynamics, Industrial Growth, Economic Impact, Policy Insights*

INTRODUCTION

Foreign Direct Investment (FDI) has long been recognized as a central pillar of globalization, serving as a critical source of external finance, knowledge transfer, and integration into global production systems for developing economies (Borensztein, De Gregorio, & Lee, 1998; Dunning & Lundan, 2008). Unlike portfolio investment, which is often volatile and speculative, FDI provides relatively stable, long-term capital flows and brings with it complementary advantages such as advanced technology, managerial expertise, international brand networks, and improved access to global markets (Nunnenkamp & Stracke, 2007). For countries like India, where industrial diversification and sustained economic growth remain priorities, FDI has been an indispensable driver of modernization and competitiveness.

India's tryst with FDI began in earnest after the landmark economic reforms of 1991, which dismantled the restrictive licensing regime and opened several sectors to foreign investors. Over time, FDI regulations were progressively liberalized, culminating in significant inflows into diverse industries such as services, telecommunications, automobiles, pharmaceuticals, and energy (DPIIT, 2020). Between April 2000 and March 2020, India attracted more than US$ 642 billion in cumulative FDI, positioning itself among the top investment destinations globally (UNCTAD, 2020). Recent policy initiatives including "Make in India," "Digital India," and sector-specific liberalizations in defense, insurance, and retail have further accelerated inflows, especially in technology-driven and infrastructure-intensive industries (OECD, 2019; Ministry of Commerce & Industry, 2020).

Despite these achievements, FDI in India exhibits considerable sectoral unevenness. The services sector, which includes information technology, financial services, telecommunications, and e-commerce, has consistently commanded the largest share of FDI inflows. In contrast, labor-intensive and traditional industries such as textiles, food processing, and agriculture have lagged behind (Mukherjee, 2015; Singh & Agarwal, 2020). Moreover, the manufacturing sector, although prioritized in policy frameworks, has not attracted FDI on the same scale as services, raising concerns about

India's ability to leverage foreign investment for large-scale job creation and industrial transformation (World Bank, 2020; Chhina, 2023). This divergence highlights a structural imbalance that warrants deeper investigation.

Equally important is the temporal dimension of sectoral FDI flows. Between 1995–2005, inflows were relatively modest and concentrated in a handful of industries, reflecting the cautious pace of reforms and limited global investor confidence. However, the period after 2005 marked a sharp surge in FDI, coinciding with India's growing integration into global value chains, its emergence as a major services exporter, and rising investor optimism about its long-term growth prospects (Agarwal & Khan, 2021). The global financial crisis of 2008 temporarily disrupted inflows, but India's resilience and policy responses ensured recovery and renewed investor interest. Therefore, dividing the study into two periods, 1995–2005 and 2005–2019 allows for a comparative understanding of how industry-wise FDI evolved during two distinct phases of liberalization and globalization.

The sectoral analysis of FDI inflows is not only relevant for academic research but also for policy formulation. First, it helps identify industries that have successfully leveraged foreign investment for growth, productivity enhancement, and export expansion. Second, it sheds light on underperforming or volatile sectors, offering evidence to guide targeted interventions. For instance, high-tech fields like computer software and hardware have had strong links between FDI and GDP, but traditional fields like textiles have not been able to attract many inflows even though they could create jobs (RBI, 2019; Kumar, 2023). Third, the analysis sheds light on the structural transformation of the Indian economy, emphasizing the transition from manufacturing to services and the ramifications of these changes for long-term development.

This study aims to analyze the growth, trends, and structural transformations in industry-specific FDI inflows over two periods (1995–2005 and 2005–2019), along with their effects on sectoral GDP. The study seeks to produce nuanced insights into the influence of FDI on sectoral growth trajectories in India by integrating descriptive trends with an evaluation of policy interventions and macroeconomic consequences. These kinds of insights are especially useful right now, when India is trying to become a global manufacturing hub and bring in FDI in new industries like renewable energy, fintech, and digital infrastructure.

LITERATURE REVIEW

Theoretical Perspectives

The theoretical foundation of foreign direct investment (FDI) highlights its role as a catalyst for economic growth through capital infusion, technology transfer, and managerial know-how. Dunning's eclectic paradigm or OLI framework (1993) remains one of the most influential models in explaining FDI flows. It identifies three sets of advantages: ownership-specific advantages (such as technology, patents, and management skills of multinational enterprises), location-specific factors (such as market size, infrastructure, and policy environment of the host country), and internalization benefits (the ability of firms to reduce transaction costs by controlling operations abroad). Together, these determine the volume and sectoral composition of FDI. In parallel, endogenous growth theory emphasizes that FDI fosters long-term growth by stimulating innovation, improving productivity, and enhancing sectoral competitiveness (Borensztein, De Gregorio, & Lee, 1998). Unlike neoclassical growth models, which treat technological change as exogenous, endogenous models suggest that knowledge spillovers and human capital accumulation from FDI create sustained growth benefits. For example, inflows in high-technology and service industries often generate broader linkages through supplier networks and skill development.

The spillover literature also underscores that the benefits of FDI depend on the ability of domestic firms to adopt and utilize foreign technologies (Crespo & Fontoura, 2007). Weak institutional quality, low research intensity, or limited infrastructure may constrain these gains. Thus, theoretical perspectives highlight FDI not merely as a financial resource but as a strategic instrument shaping industrial and sectoral transformation.

Global Evidence

At the global level, FDI distribution is highly uneven, with services and high-technology sectors commanding the largest shares. According to UNCTAD (2020), services accounted for nearly two-thirds of global FDI inflows, driven by financial services, telecommunications, and digital platforms. In advanced economies, FDI in knowledge-intensive industries such as pharmaceuticals, electronics, and software has supported innovation-led growth. In contrast, resource-based FDI, while significant in Africa and Latin America, has generated weaker spillovers due to limited technology diffusion and enclave-type operations (Nunnenkamp & Stracke, 2007). The East Asian experience illustrates how targeted FDI in strategic sectors can accelerate industrial modernization. South Korea and China, for example, leveraged FDI in automobiles, semiconductors, and consumer electronics to integrate into global value chains and upgrade their domestic capabilities (OECD, 2019). Similarly, Singapore and Malaysia capitalized on FDI inflows in electronics and finance, which fostered skill development and positioned them as regional hubs for innovation and logistics.

However, empirical studies caution that the developmental impact of FDI depends heavily on policy frameworks and governance quality. Countries with transparent regulations, effective intellectual property regimes, and strong infrastructure tend to attract more diversified and sustainable FDI. Conversely, nations with weak institutions often experience concentration in extractive industries with limited long-term growth impact (Alfaro, Chanda, Kalemli-Ozcan, & Sayek, 2004). This evidence underscores that while FDI is a key driver of growth, its outcomes vary widely depending on sectoral allocation and national absorptive capacity.

Sectoral FDI in India

India’s FDI experience reflects both global patterns and unique domestic factors shaped by liberalization policies. In the post-1991 era, India progressively opened sectors to foreign capital, with the services sector emerging as the largest recipient. Between 1995 and 2005, liberalization-driven industries such as telecommunications, IT-enabled services, and financial services attracted the bulk of inflows (Mukherjee, 2015). These sectors benefited from policy reforms, skilled labor availability, and rising demand in both domestic and global markets. Automobiles and consumer goods also gained significant FDI, leading to modernization of production systems and integration with global supply chains.

In the subsequent period (2005–2019), FDI diversified into newer areas such as renewable energy, retail, pharmaceuticals, and e-commerce. Policy initiatives such as Make in India and sector-specific liberalization measures encouraged greater inflows into high-end manufacturing, logistics, and infrastructure. E-commerce giants such as Amazon and Walmart (via Flipkart) attracted large-scale FDI, reshaping India’s retail landscape. Renewable energy also emerged as a priority sector, with multinational firms investing in solar and wind projects due to policy incentives and India’s commitments to climate goals (Singh & Agarwal, 2020).

Even though the economy has become more diverse, traditional sectors like textiles, resource-based industries, and low-end manufacturing still didn't get much FDI. This is because of global trends and structural limitations. Problems like infrastructure bottlenecks, regulatory hurdles, and inflexible labor have made it harder for these industries to get new workers (Mahapatra, 2020). Still, the IT and services sectors are still the biggest ones, and they are a big part of India's GDP growth and export earnings. India's sectoral FDI story shows two trends: one is that a lot of money is going into technology-driven and service-based industries, and the other is that not enough money is going into traditional manufacturing sectors. This divergence presents obstacles to inclusive industrial development while simultaneously offering opportunities for targeted policies designed to achieve sectoral growth equilibrium.

Research Gap

While numerous studies examine FDI in India, only a limited number offer a sector-specific, longitudinal analysis over an extended timeframe. There is also not enough knowledge about how FDI directly affects the GDP of different sectors and the growth patterns of 45 different industries. This study fills this gap by giving policymakers evidence-based information.

Research Objectives

1. To examine the growth patterns and structural changes in sectoral FDI inflows across 45 industries between 1995–2005 and 2005–2019.
2. To assess the impact of FDI inflows on sectoral GDP and identify underperforming or volatile industries for policy intervention.

RESEARCH METHODOLOGY

This study is based on secondary data collected from the Department for Promotion of Industry and Internal Trade (DPIIT), Reserve Bank of India (RBI), Ministry of Commerce and Industry, and UNCTAD. Sectoral FDI inflows and corresponding sectoral GDP data for 45 industries were compiled. Descriptive analysis, including growth rates, percentage shares, and concentration indices, was used to identify patterns and structural changes. Correlations between sectoral FDI and GDP were examined to highlight economic impacts. The study focuses on long-term trends rather than causality to identify policy-relevant insights.

FINDINGS AND DISCUSSION

Period 1995–2005: Liberalization Phase

During 1995–2005, India's foreign direct investment landscape began to shift markedly in response to liberalization policies. Studies show that the early liberalization opened up critical sectors, especially telecommunications, financial services, and information technology (IT), which attracted sizable amounts of FDI. According to Foreign Direct Investment in India: An Overview by Kumar & Misra (2019), top sectors receiving FDI in the decade ending FY 2018-19 include software and hardware, telecom, and services; these sectors had already established momentum in the earlier period.

Despite these gains, traditional sectors such as textiles, agro-based industries, and primary agriculture were substantially underinvested. The causes included limited infrastructure, low productivity, regulatory obstacles, and less exposure to global supply chains. Structure of Foreign Direct Investment in India during Globalization Period by Khandare & Babar (2012) indicates that even during 2008–2010, the service sector dominated inbound FDI whereas sectors like textiles and agriculture accounted for much smaller shares. The contribution of high-FDI sectors to overall economic expansion was notable in this phase. IT and telecom, in particular, not only enlarged their sectoral output but also began generating significant employment and enhanced productivity through technology transfer. These sectors benefitted from government reforms such as deregulation of licensing, opening of foreign ownership in services, and improvements in telecom policy. The cumulative effect was a stronger growth performance in those sectors than in more traditional industries.

Period 2005–2019: Diversification and Growth

From 2005 onward, India saw more pronounced diversification in sectoral FDI inflows. Sectors like pharmaceuticals, renewable energy, and automobile manufacturing began to receive larger foreign investments, supplementing the already strong inflows into services and IT. For instance, Impact of Foreign Direct Investment on Industrial Growth of India (Muthusamy, 2019) reports that following the implementation of policies such as Make in India, FDI in manufacturing increased significantly, particularly between 2014 and 2019. High-tech and knowledge-based sectors, especially software, telecommunications, and financial services, continued to lead in cumulative FDI shares. The increased liberalization of regulatory regimes, enhanced infrastructure, improved ease of doing business, and favorable policies like deregulation of FDI caps augmented investor confidence. Sectors like e-commerce also saw escalating foreign interest as market size, internet penetration, and digital infrastructure improved.

Meanwhile, resource-intensive and traditional industries remained behind. They couldn't get foreign capital because of regulatory burdens, problems with buying land, old technology, and not enough integration of their supply chain. These sectors generally didn't grow as fast as more dynamic ones, even with policy incentives. This was true for both output growth and job creation.

Sectoral Specialization and Concentration

The pattern of FDI inflows over the two periods shows that specialization and concentration are growing. Foreign investments were more likely to go to sectors that had higher returns, better infrastructure, strong global ties, and stable regulatory environments. Research on India's sector-wise FDI flows shows that IT, telecom, and financial services have consistently been among the top recipients (Kumar & Misra, 2019; Khandare & Babar, 2012). Manufacturing hubs such as Gujarat, Maharashtra, and Tamil Nadu benefited from their existing industrial base, logistical advantages, and state policy reforms, becoming preferred destinations for automobile and petrochemical FDI. At the same time, states or industries lacking in infrastructure or skilled labor remained outside the core of this specialization. Less competitive sectors such as agro-based manufacturing, textiles, and traditional resource processing showed weak linkage with global value chains, limiting their capacity to scale up or modernize.

Economic Impacts on Sectoral GDP

Evaluative studies suggest that sectors receiving high levels of FDI particularly in services, telecommunications, and manufacturing exhibited significantly stronger growth in output, productivity, and employment. For example, the study Foreign Direct Investment in India: An Overview finds that sectors attracting high investment contributed disproportionately to increases in sectoral GDP and improved export performance. Conversely, sectors with low foreign investment such as traditional agriculture, textiles, and small-scale industries showed modest growth and greater volatility, frequently struggling with capital intensity and technological obsolescence. In many cases, despite modest policy support, these industries could not reap the productivity benefits seen in high-investment sectors. The resulting divergence has implications not just for sectoral GDP but for employment, regional inequality, and industrial resilience.

Policy Implications

Given these dynamics, several policy levers appear critical to balancing sectoral performance. First, improving infrastructure (transport, power, logistics) in lagging sectors is essential to making them investable. Studies underline that good infrastructure is a consistent determinant of FDI inflows across sectors and geographies. Second, changes to the rules, like making it easier to get licenses, buy land, and get environmental clearances, are needed to make investors in industries that aren't doing well less unsure. Third, improving absorptive capacity through skill development, technical education, and technology upgrades in traditional sectors can help them make better use of foreign investment and become part of global value chains.

Also, tax breaks, financial aid, and public-private partnerships should be used to support traditional industries with a lot of potential, which will make them more competitive. Finally, keeping an eye on how different sectors are doing and making policies that can change will help make sure that growth is broad, strong, and varied across industries.

CONCLUSION

FDI in India from 1995 to 2019 shows that some sectors are growing faster than others. High-tech, service, along with knowledge-based industries have done very well, but traditional and resource-based industries are still not getting enough investment. Sectoral FDI has positively influenced GDP, industrial output, and employment in high-FDI sectors, highlighting the potential of targeted foreign investment to drive economic transformation. Policymakers should focus on structural reforms, sector-specific incentives, and skill development to ensure more balanced FDI-driven growth and minimize disparities across industries.

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