Foreign Direct Investment, Domestic Investment, and Sustainable Development: Long-Run and Short-Run Dynamics

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ABSTRACT
Foreign Direct Investment (FDI) is often seen as a catalyst for economic growth and sustainable development. However, its interaction with domestic investment remains an empirical question, especially in emerging economies such as India. By evaluating how external capital flows support domestic capital formation, the analysis specifically advances SDGs 8 (Decent Work and Economic Growth) and 9 (Industry, Innovation, and Infrastructure). The study employs the Autoregressive Distributed Lag (ARDL) bounds testing method with time series annual data on per capita income, FDI inflows, domestic credits to the private sector, gross capital formation, and GDP.
The mixed order of integration verified that the ARDL methodology can be applied using unit root tests. The results of bounds test show a stable long-run cointegrating relation between the variables, and the error correction term highly significant, indicating that the variables are rapidly approaching equilibrium. The long-run estimates indicate that economic growth, financial depth, and rising income levels significantly boost domestic investment in India, while FDI has a statistically insignificant effect. Furthermore, short-run dynamics also confirm that FDI neither crowds in nor crowds out domestic investment. The results indicate that India's domestic investment trajectory is basically primarily driven by internal macroeconomic fundamentals rather than by foreign capital inflows. From a policy perspective, the results infer that achieving sustainable and inclusive growth requires strengthening domestic financial systems, enhancing credit accessibility, and improving absorptive capacity to translate FDI into meaningful domestic investment. The study underlines the importance of aligning FDI policy with broader development strategies to effectively support India's progress toward the Sustainable Development Goals.

Keywords: Foreign Direct Investment, Domestic Investment, ARDL, Sustainable Development Goals, Economic Growth

INTRODUCTION
Foreign Direct Investment (FDI) is a prominent components of international capital flows and is widely regarded as a catalyst for economic growth, technological transfer, and structural transformation in developing economies. Since early 1990s, globalization and financial liberalization have increased the mobility of capital across borders, enabling emerging economies such as India to attract substantial volumes of foreign investment. Policymakers often consider FDI as a means to supplement domestic savings, bridge the investment gap, improve productivity, and integrate host economies into global production networks. However, the developmental impact of FDI remains an empirical question rather than a settled conclusion.
A central issue in the FDI–development debate is its interaction with domestic investment. FDI may generate a crowding-in effect, where foreign capital stimulates additional domestic investment through

technology spillovers, supply-chain linkages, enhanced competition, and improved business confidence. Conversely, FDI may produce a crowding-out effect if foreign firms displace domestic producers, capture market share, dominate credit markets, or reduce incentives for local entrepreneurial activity. The net outcome depends on the host country's absorptive capacity, financial depth, institutional quality, and macroeconomic stability.

India presents a compelling case for examining this relationship. Following the 1991 economic reforms, India progressively liberalized its trade and investment regime, resulting in a sustained increase in FDI inflows across manufacturing, services, telecommunications, infrastructure, and digital sectors. Over the same period, India has also experienced significant changes in domestic capital formation, financial sector development, and economic growth patterns. Despite this, empirical evidence on whether FDI has complemented or substituted domestic investment in India remains mixed. Some studies emphasize positive spillovers and productivity gains, while others highlight limited linkages and the dominance of foreign firms in certain sectors.

Understanding this interaction is also important from a sustainable development perspective. FDI that strengthens domestic capital formation supports SDG 8 (Decent Work and Economic Growth) by promoting productive investment, employment generation, and long-term growth. Similarly, enhanced domestic investment in industry and infrastructure contributes to SDG 9 (Industry, Innovation, and Infrastructure) by building resilient industrial capacity and technological advancement. If FDI fails to stimulate domestic investment, its contribution to sustainable structural transformation may be constrained.

Against this background, the present study investigates whether FDI crowds in or crowds out domestic investment in India over the period **1991–2023**. The analysis employs a time-series framework to examine both short-run and long-run relationships between FDI and gross capital formation while controlling for key macroeconomic factors such as economic growth and financial development. By focusing on India's post-liberalization experience, the study contributes country-specific evidence to the broader debate on the developmental role of foreign capital.

The findings aim to inform policy discussions on how India can better align FDI inflows with domestic investment objectives and sustainable development goals, ensuring that foreign capital complements rather than substitutes domestic productive capacity.

REVIEW OF LITERATURE

The relationship between foreign direct investment (FDI) and domestic investment has long occupied a central position in development macroeconomics, yet the direction and magnitude of this relationship remain theoretically and empirically contested. From the modernization and endogenous growth perspectives, FDI is viewed as a vehicle for capital accumulation, technological diffusion, managerial upgrading, and integration into global value chains. These channels imply that foreign capital can relax domestic savings constraints and stimulate complementary domestic investment, producing a crowding-in effect. Knowledge spillovers from multinational enterprises, improvements in productivity, and demonstration effects are expected to enhance domestic firms' investment incentives, especially in economies with sufficient human capital and financial depth. In contrast, dependency and structuralist approaches argue that FDI may displace domestic firms, dominate strategic sectors, and create enclave production structures with limited linkages. In such contexts, foreign enterprises may capture market share, skilled labor, and credit resources, leading to a crowding-out of domestic investment. Theoretical predictions are therefore conditional on host-country characteristics, particularly absorptive capacity, financial development, and institutional quality.

Empirical evidence mirrors this theoretical ambiguity. A substantial body of cross-country research reports complementarity between FDI and domestic investment. Studies such as those by Borensztein et al. and de Mello suggest that FDI enhances capital formation when human capital and macroeconomic stability are present. Positive linkages are also documented where financial intermediation channels are strong, as emphasized by Ndikumana & Verick, who argue that FDI can deepen domestic investment through financial sector development and productivity spillovers. These findings underscore the importance of host-economy readiness in converting foreign capital into domestic capital accumulation.

Conversely, several studies identify displacement effects. Agosin & Machado find that FDI crowds out domestic investment in many developing countries, particularly where FDI is concentrated in sectors with weak domestic linkages. Evidence from Sub-Saharan Africa provided by Adams indicates that

while lagged FDI may generate some positive effects, the net impact tends toward crowding out due to competitive pressures on domestic firms. Similar conclusions are drawn by Mutenyo et al., who highlight structural weaknesses and limited competitiveness of domestic enterprises as key drivers of displacement. These studies suggest that the sectoral composition of FDI and the strength of domestic industrial capacity are critical determinants of outcomes.

A third stream of research reports neutral or statistically insignificant effects. Lipsey argues that aggregate FDI flows may not directly translate into domestic capital formation, as much of FDI involves mergers, acquisitions, or profit repatriation rather than new productive capacity. Similarly, Carkovic & Levine demonstrate that once country-specific effects and endogeneity are controlled for, the apparent growth and investment benefits of FDI diminish. These findings caution against assuming automatic developmental benefits from foreign capital inflows.

Recent literature increasingly recognizes the mediating role of financial systems and institutions. Hermes & Lensink show that FDI contributes to growth only in economies with developed financial markets capable of channeling external capital into productive domestic uses. Governance quality also shapes outcomes, as argued by Morrissey & Udomkerdmongkol, who emphasize that institutional structures determine whether FDI complements or substitutes domestic private investment. Strong institutions may facilitate linkages and spillovers, whereas weak governance can amplify rent-seeking and enclave-type investment patterns.

Within the Indian context, liberalization reforms initiated in 1991 significantly increased FDI inflows, yet domestic investment dynamics have continued to be strongly influenced by GDP growth, financial development, and credit availability. While numerous studies assess the impact of FDI on economic growth, relatively fewer directly examine its effect on domestic capital formation over long time horizons. India's structural transformation, financial sector deepening, and evolving industrial policy create a unique environment in which foreign capital may interact with domestic investment through multiple channels. However, empirical consensus is lacking on whether FDI in India acts as a complement, a substitute, or a neutral factor in domestic investment decisions.

Overall, the literature reveals persistent theoretical indeterminacy and empirical divergence across regions and methodologies. Outcomes depend on absorptive capacity, financial depth, institutional quality, and the nature of FDI itself. There remains a need for country-specific, long-run time-series evidence capable of distinguishing short-run adjustments from long-run equilibrium relationships. Addressing this gap is particularly relevant for sustainable development strategies linked to SDG 8 (decent work and economic growth) and SDG 9 (industry, innovation, and infrastructure), where understanding the role of foreign capital in supporting domestic investment is essential. The present study responds to this gap by providing a comprehensive time-series assessment for India, focusing explicitly on whether FDI crowds in, crowds out, or remains neutral with respect to domestic capital formation.

CONCEPTUAL FOUNDATION

The preceding empirical literature establishes that the impact of foreign direct investment on domestic capital formation is theoretically indeterminate and empirically contested. To interpret this ambiguity, the present study grounds its analysis in macro-investment theory, integrating capital accumulation models, the neoclassical investment function, and financial intermediation theory to explain the channels through which FDI may influence domestic investment in India.

From the perspective of capital accumulation theory, economic growth and structural transformation depend on the expansion of the productive capital stock. Domestic investment represents the primary mechanism through which economies build industrial capacity, upgrade infrastructure, and enhance productive efficiency. FDI, as an external source of capital, may supplement domestic savings by introducing additional financial resources, advanced technologies, managerial expertise, and global production networks. Under this mechanism, foreign capital can stimulate complementary domestic investment through backward and forward linkages, supplier development, and productivity spillovers. This represents the crowding-in hypothesis, where FDI reinforces domestic capital formation.

However, neoclassical investment theory also suggests an alternative outcome. Investment decisions are influenced by expected returns, cost of capital, and market structure. If multinational enterprises dominate domestic markets, they may displace local firms by capturing market share, accessing superior financing, and leveraging technological advantages. Domestic investors may therefore reduce

or postpone investment, leading to a crowding-out effect. This mechanism is particularly likely in sectors characterized by limited market size, imperfect competition, or weak domestic firm competitiveness.

The neoclassical investment function further implies that domestic investment depends on output growth and macroeconomic conditions. Higher GDP growth increases expected profitability and capacity utilization, thereby encouraging domestic capital formation. FDI may indirectly affect this channel by stimulating aggregate demand and productivity, but if foreign firms operate as enclaves with limited domestic integration, the transmission to domestic investment may remain weak. This provides a theoretical basis for a neutral outcome, where FDI neither substitutes nor complements domestic capital in a statistically meaningful way.

A crucial mediating mechanism is the financial development channel, represented by domestic credit availability. Financial intermediation theory posits that well-functioning credit markets allocate savings efficiently and reduce investment constraints. If FDI enhances banking sector depth, improves financial infrastructure, or reduces risk perception, domestic firms may gain better access to credit, fostering investment. Conversely, if foreign firms rely primarily on internal or international financing, domestic financial markets may not benefit, limiting spillover to domestic investors.

Macroeconomic stability and growth performance constitute another central channel. Sustained growth strengthens investor confidence, raises domestic savings, and expands market opportunities. In such an environment, FDI may coexist with strong domestic investment without direct interaction, implying that domestic capital formation is driven mainly by internal fundamentals rather than foreign inflows.

These theoretical channels align closely with Sustainable Development Goal 8 (Decent Work and Economic Growth) and SDG 9 (Industry, Innovation, and Infrastructure). Domestic investment is a core driver of industrial capacity, technological upgrading, and employment creation. If FDI effectively complements domestic capital, it accelerates progress toward these goals. If it crowds out domestic firms, industrial diversification and inclusive growth may be hindered. A neutral relationship suggests that achieving SDG-oriented structural transformation depends primarily on strengthening domestic financial systems, institutional capacity, and absorptive capabilities rather than relying solely on foreign capital.

In summary, theory does not predict a single deterministic relationship between FDI and domestic investment. Instead, the outcome depends on the balance between competitive displacement effects and complementary spillovers, the depth of financial intermediation, and the macroeconomic environment. This theoretical ambiguity justifies the empirical investigation undertaken in this study to determine which mechanism dominates in the Indian context.

HYPOTHESES DEVELOPMENT

The theoretical discussion demonstrates that the relationship between foreign direct investment and domestic capital formation is not predetermined. Competing mechanisms operate simultaneously. On one side, FDI may introduce capital, technology, managerial know-how, and global value chain linkages that stimulate complementary domestic investment. On the other side, foreign firms may displace domestic producers through competitive advantages in finance, scale, and productivity, thereby discouraging local investment activity. Financial development, macroeconomic growth, and institutional capacity further condition these outcomes, making the net effect context-specific rather than universal.

Empirical evidence reviewed earlier reinforces this theoretical ambiguity. Some studies document crowding-in effects through spillovers and linkage creation, while others report crowding-out due to market dominance by multinational enterprises. A third strand of research finds statistically insignificant effects, suggesting that domestic investment may be driven primarily by internal macroeconomic fundamentals rather than foreign capital inflows. These conflicting findings indicate that the FDI–domestic investment relationship remains an empirical question, particularly for emerging economies undergoing structural transformation.

For India, this ambiguity is especially relevant. The post-liberalization period has witnessed substantial FDI inflows alongside rapid financial deepening and growth, yet domestic investment dynamics may be shaped more by domestic savings, credit availability, and macroeconomic conditions than by foreign capital. If absorptive capacity constraints, sectoral concentration of FDI, or limited financial spillovers

exist, the theoretical channels for both crowding-in and crowding-out may weaken, leading to a neutral net effect.

Accordingly, this study advances a unified, testable hypothesis that reflects the theoretical indeterminacy and empirical divergence in the literature:

H_1: *Foreign Direct Investment does not exert a statistically significant long-run or short-run effect on domestic investment in India.*

This hypothesis allows the empirical analysis to determine whether FDI functions as a complementary source of capital, a substitute that displaces domestic investment, or a factor whose influence is statistically indistinguishable from zero once macroeconomic fundamentals are controlled for.

METHODOLOGY

This study employs a macro econometric time-series design to empirically evaluate whether foreign direct investment influences domestic investment in India. The methodological structure follows directly from the theoretical ambiguity and unified hypothesis that FDI may not exert a statistically significant impact on domestic capital formation once domestic macroeconomic fundamentals are accounted for.

The empirical analysis is based on annual data covering the period 1991–2023, corresponding to India's post-liberalization era. This period captures structural reforms, financial sector deepening, and increased openness to foreign capital, thereby providing an appropriate macroeconomic environment for examining the FDI–investment relationship.

Domestic investment behaviour is modelled within a neoclassical investment framework augmented by external capital and financial development channels. Gross capital formation serves as the dependent variable representing domestic investment. FDI is introduced as the key explanatory variable, while additional controls capture macroeconomic growth, domestic financial intermediation, price stability, and domestic resource availability. The empirical specification is expressed as:

$$\ln(GCF_t) = \beta_0 + \beta_1 FDI_t + \beta_2 GDP_t + \beta_3 DCPS_t + \beta_4 GDS_t + \varepsilon_t$$

GCF = Gross Capital Formation (% of GDP) – proxy for domestic investment

- **FDI** = Net FDI inflows (% of GDP)
- **GDP** = Real GDP growth rate
- **DCPS** = Domestic credit to private sector (% of GDP) – financial development channel

Logarithmic transformation is applied to scale variables to interpret elasticities and stabilize variance
.

Data are sourced from internationally recognized macroeconomic databases, primarily the World Development Indicators (World Bank) and UNCTAD, ensuring cross-country methodological consistency and reliability. All variables are expressed in annual frequency.

Data Sources

Variable	Source
GCF (% GDP)	World Bank World Development Indicators
FDI (% GDP)	World Bank WDI / UNCTAD
GDP Growth	World Bank WDI
Domestic Credit	World Bank WDI

All variables are annual.

Given that macroeconomic variables may exhibit different orders of integration, the study adopts the Autoregressive Distributed Lag (ARDL) bounds testing approach. This technique is appropriate for small samples and allows simultaneous estimation of short-run dynamics and long-run equilibrium relationships even when regressors are integrated of order zero or one.

The ARDL(p, q_1, q_2, …, q_k) model is estimated based on optimal lag selection using Akaike Information Criterion (AIC):

$$\ln\_GCF_t = \alpha_0 + \alpha_1 \ln\_GCF_{t-1} + \beta_0 \ln FDI_t + \beta_1 \ln FDI_{t-1} + \gamma_0 \ln GDP_t + \gamma_1 \ln GDP_{t-1} + \delta_0 DCPS_t + \delta_1 DCPS_{t-1} + \varepsilon_t$$

RESULTS AND DISCUSSION

The ARDL bounds test confirms a long-run relationship among domestic investment, GDP, financial development, income, and FDI, as the F-statistic (11.26) exceeds the upper critical bound at the 1% level. Long-run estimates show that economic growth, domestic credit, and per capita income significantly increase domestic investment, indicating that India's capital formation is mainly driven by internal macroeconomic fundamentals. In contrast, FDI is statistically insignificant, implying neither crowding-in nor crowding-out effects in the long run.

Short-run results are consistent. While some lagged FDI terms appear temporarily significant, their effects are not persistent. The error correction term (−0.947) is negative and highly significant, indicating rapid adjustment toward long-run equilibrium and strong system stability.

Diagnostic tests support model reliability. There is no serial correlation, no heteroskedasticity, correct model specification, normal residual distribution, and CUSUM stability, confirming robust estimates.

Overall, the findings indicate that domestic investment in India depends more on domestic growth and financial depth than on foreign capital inflows, supporting the hypothesis that FDI has a neutral effect on domestic investment.

Table 1

ARDL Bounds Test for Cointegration

Test Statistic	Value
F-statistic	**11.261**
Number of regressors (k)	4
Sample size	30

Critical Values (Finite Sample, n = 30)

Source : Authors Calculation

Significance	I(0) Lower	I(1) Upper
10%	2.525	3.560
5%	3.058	4.223
1%	4.280	5.840

Decision: Since F = 11.261 > upper bound at 1%, a long-run cointegrating relationship exists.

Source : Authors Calculation

Table 2

Estimated Long-Run Coefficients (Levels Equation)

Dependent Variable: LGCF

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LGDP	**0.9245**	0.0856	10.8019	0.0000
LNFDI	−0.0485	0.0452	−1.0723	0.3031
DCPS	**0.0243**	0.0029	8.3299	0.0000
GDP_PER	**4.6909**	0.6425	7.3013	0.0000
Constant	−0.2074	1.0164	−0.2039	0.8416

Source : Authors Calculation

Table 3

Short-Run Dynamics (Error Correction Model)

Dependent Variable: D(LGCF)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LGDP)	−36.3962	7.9711	−4.5660	0.0005
D(LGDP−1)	−46.5193	11.3004	−4.1166	0.0012
D(LGDP−2)	−196.2338	24.4696	−8.0195	0.0000
D(LGDP−3)	−183.2272	21.0958	−8.6855	0.0000
D(LNFDI)	−0.0681	0.0279	−2.4441	0.0295
D(LNFDI−2)	−0.1060	0.0261	−4.0596	0.0014
D(GDP_PER)	**0.3739**	0.0778	4.8032	0.0003
D(GDP_PER−1)	−3.6116	0.4020	−8.9836	0.0000
D(GDP_PER−2)	−1.7473	0.2021	−8.6451	0.0000
ECT(−1)	**−0.9471**	0.0979	−9.6725	0.0000

Source : Authors Calculation

Table 4

Model Diagnostic Tests

Test	Statistic	p-value	Conclusion
Breusch–Godfrey Serial Correlation	F = 0.545	0.5945	No serial correlation
Breusch–Pagan–Godfrey Heteroskedasticity	F = 0.623	0.8165	Homoscedastic errors
Ramsey RESET	F = 0.028	0.8697	Correct specification
Jarque–Bera Normality	JB = 0.886	0.6422	Residuals normally distributed

Source : Authors Calculation

Table 5

Model Goodness-of-Fit

Statistic	Value
R-squared	0.9986
Adjusted R-squared	0.9969
F-statistic	57.233
Prob(F)	0.0000
Durbin–Watson	2.23

Source : Authors Calculation

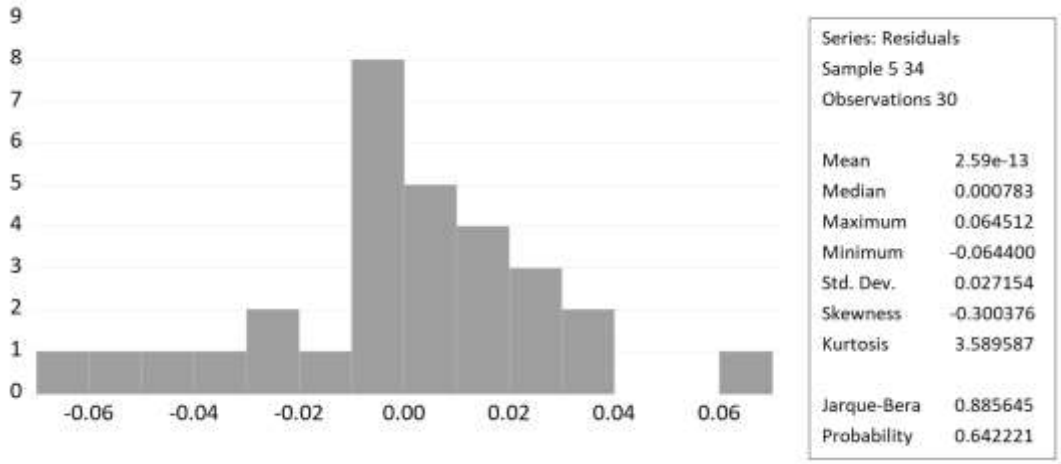

Figure 1. Residual Normality Histogram
(Shows symmetric distribution; JB p = 0.64)

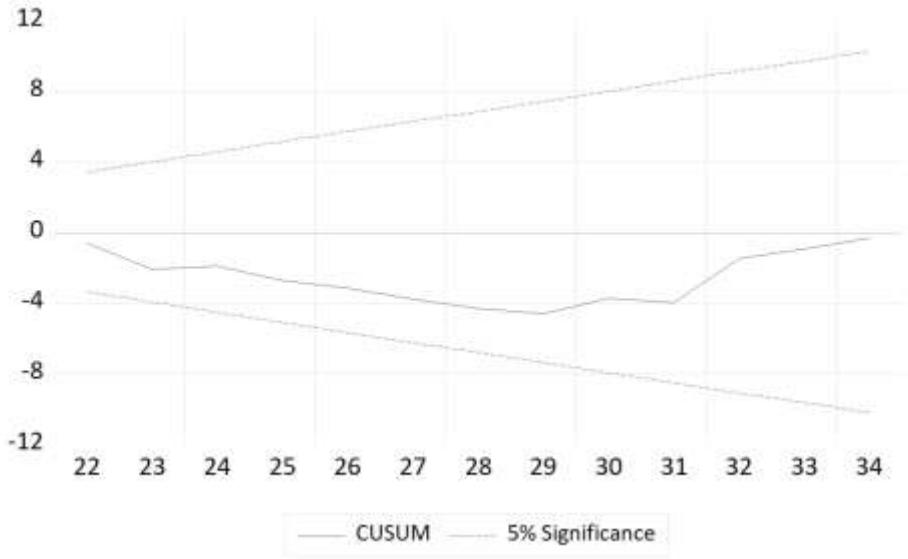

Figure 2. CUSUM Stability Test
(CUSUM remains within 5% critical bounds → parameter stability confirmed)
Source: Authors Calculation

The empirical evidence indicates that foreign direct investment does not exert a statistically significant long-run or short-run influence on domestic investment in India. This neutrality finding aligns with strands of the international literature arguing that the impact of FDI on host-country capital formation is conditional rather than automatic. Studies such as Agosin and Mayer and Carkovic and Levine show that after controlling for macroeconomic and structural factors, FDI often fails to stimulate domestic investment directly. The present results for India reinforce this view: external capital inflows alone do not guarantee domestic capital deepening.

At the same time, the strong and positive long-run effects of GDP growth, financial depth (credit to the private sector), and per capita income confirm the neoclassical and endogenous growth perspectives that emphasize domestic fundamentals as the principal drivers of capital accumulation. This outcome supports findings by Borensztein et al. and Alfaro et al. that financial development and absorptive capacity determine whether foreign capital translates into productive investment. In the Indian context, the credit channel appears more influential than foreign equity inflows, suggesting that domestic financial intermediation remains the dominant mechanism for investment expansion.

The absence of a crowding-out effect contrasts with dependency-based arguments (e.g., Bornschier and Chase-Dunn) that multinational presence suppresses domestic firms. Instead, the evidence suggests a neutral coexistence: FDI neither displaces nor stimulates domestic investment. This may reflect the sectoral composition of FDI in India, where inflows are often concentrated in services, technology, and market-seeking activities rather than direct capital-substituting industrial expansion.

The rapid and significant error-correction adjustment further indicates that domestic investment in India is structurally anchored in internal macroeconomic dynamics. Thus, policy strategies focused solely on increasing FDI volumes may not produce proportional gains in capital formation unless accompanied by improvements in domestic credit systems, institutional quality, and technological absorption.

From a Sustainable Development Goals perspective, the findings have direct implications for SDG 8 (Decent Work and Economic Growth) and SDG 9 (Industry, Innovation, and Infrastructure). Since domestic investment is more responsive to growth and financial deepening than to foreign inflows, sustainable industrialization requires strengthening domestic productive capacity rather than relying exclusively on external capital. FDI can complement development, but only where domestic systems convert foreign technology and finance into local industrial expansion.

Overall, the study contributes to the debate by demonstrating that in a large emerging economy like India, FDI plays a supplementary rather than catalytic role in domestic investment dynamics. This supports a balanced development strategy in which foreign capital is integrated into a broader framework of domestic financial strengthening, institutional capacity building, and inclusive growth pathways aligned with the SDGs.

Policy Implications

The findings of this study indicate that foreign direct investment (FDI) does not independently determine domestic investment behaviour in India, either in the short run or the long run. This has important implications for development strategy. First, the absence of a statistically significant crowding-in or crowding-out effect suggests that FDI inflows cannot substitute for domestic capital formation. Investment dynamics in India remain fundamentally driven by internal macroeconomic conditions—particularly economic growth, financial intermediation, and income expansion. Therefore, policy emphasis should shift from the mere attraction of foreign capital to the strengthening of domestic investment fundamentals.

Second, the significant role of domestic credit highlights the importance of financial sector depth and efficiency. Expanding access to long-term finance, improving credit transmission, and strengthening banking and capital market institutions would enhance domestic firms' capacity to invest. Financial development functions as a critical absorptive mechanism through which both domestic and foreign capital can translate into productive investment.

Third, the results underscore the need for a linkage-based FDI policy framework. Rather than pursuing FDI inflows indiscriminately, policy should encourage foreign investments that generate backward and forward linkages with domestic enterprises, facilitate technology diffusion, and promote local value addition. Sector-specific incentives in manufacturing, infrastructure, green energy, and high-technology industries would better align FDI with structural transformation objectives.

Fourth, macroeconomic stability and institutional predictability remain essential enabling conditions. Stable growth prospects, regulatory transparency, and policy consistency improve the investment climate and reduce uncertainty for both domestic and foreign investors. Such an environment fosters complementarity between domestic enterprise development and foreign participation.

From a sustainability perspective, these policy directions align with the objectives of SDG 8 (decent work and sustained economic growth) by strengthening domestic productive capacity, and SDG 9 (industry, innovation, and infrastructure) by supporting industrial upgrading and technological progress. FDI should therefore be integrated within a broader development strategy that prioritizes domestic investment capacity and structural resilience.

CONCLUSION

This study investigated the long-run and short-run relationship between foreign direct investment and domestic investment in India using the ARDL bounds testing approach over the post-liberalization period. The empirical evidence confirms the presence of a stable cointegrating relationship among domestic investment, FDI, economic growth, financial development, and income levels. However, the estimated coefficients reveal that FDI does not exert a statistically significant influence on domestic investment in either time horizon. These results indicate the absence of both crowding-in and crowding-out effects.

Domestic investment in India is primarily shaped by internal macroeconomic drivers rather than foreign capital inflows. Economic growth, financial depth, and rising income levels emerge as the principal determinants of capital formation, emphasizing the centrality of domestic structural factors. This outcome contributes to the ongoing debate in the literature by demonstrating that the FDI–investment nexus is not universally positive or negative but is mediated by country-specific institutional and economic conditions.

The findings suggest that foreign investment should be viewed as a complementary component of development rather than a primary engine of capital formation. Policies aimed at strengthening domestic financial systems, improving absorptive capacity, and promoting industrial capability are more critical for sustainable development than reliance on external capital alone. Aligning FDI strategies with domestic industrial and financial policies can enhance the developmental effectiveness of foreign inflows.

Overall, the study reinforces the argument that sustainable and inclusive economic development in emerging economies depends fundamentally on domestic investment capacity, institutional quality, and structural transformation. FDI can support this process, but its effectiveness depends on how well it is integrated within a broader, domestically driven development framework.

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