Financial Development and FDI as Determinants of Renewable Energy Consumption: Empirical Evidence from India

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ABSTRACT

Foreign direct investment (FDI) plays a pivotal role in the economic development of emerging economies by promoting clean energy transitions, technology transfer, and energy efficiency. This study investigates the impact of FDI and financial development on renewable energy consumption in India using annual time-series data from 2000 to 2019. Employing Phillips-Perron unit root tests, Vector Autoregression (VAR), and Granger causality tests, the results reveal short-run causality running from both FDI and domestic credit (proxy for financial development) to renewable energy consumption. These findings highlight the significance of external capital flows and domestic credit availability in advancing India's renewable energy agenda. The study offers policy-relevant insights into the design of financial incentives and regulatory support mechanisms to strengthen clean energy uptake.

Keywords: *Foreign direct investment, financial development, renewable energy consumption, Granger causality, India, VAR, Phillips-Perron test, time-series analysis*

INTRODUCTION

Long-term economic progress is intricately tied to a nation's energy capacity. In recent years, the demand for energy has escalated significantly, driven by rapid population growth, improved standards of living, industrial expansion, and technological innovation (International Energy Agency [IEA], 2018). India, as the third-largest consumer of electricity globally, exemplifies this trend. As of 2018, nearly 100 million people gained access to electricity, positioning the country as a pivotal player in global energy consumption and electrification efforts (IEA, 2018).

Currently, over 80% of India's energy needs are met by coal, oil, and solid biomass. Coal remains dominant in the country's energy mix, supporting both industrial growth and power generation. The rise in vehicular ownership has intensified oil consumption and imports. Although biomass—mainly fuelwood—is gradually losing share, it is still heavily used, especially in rural cooking practices. Despite increased LPG penetration, approximately 660 million Indians have yet to fully transition to modern, clean cooking fuels (Ministry of New and Renewable Energy [MNRE], 2022).

India's population of 1.425 billion generates immense energy demand, particularly in light of its economic ambitions. From being power-deficient at independence, India has evolved into a power-surplus nation with an installed capacity exceeding 400 GW as of September 2022 (MNRE, 2022). Renewable energy capacity alone grew by 396% in just 8.5 years, reaching 159.95 GW (including large hydro projects), accounting for about 40% of the total energy capacity as of March 2022 (MNRE, 2022). FDI has played a critical role in this transformation, with US$12.57 billion invested between April 2000 and June 2022. The sector remains attractive, with expectations of nearly US$10 billion in clean energy investment for 2023 (Invest India, 2023).

Renewable energy drawn from naturally replenishing resources such as solar, wind, geothermal, biomass, and hydro offers the dual advantages of sustainability and scalability. Among these, solar PV has experienced exponential growth due to ambitious national targets, policy support, and declining technology costs (International Renewable Energy Agency [IRENA], 2021). Modern renewables like natural gas have also shown resilience, especially during disruptions like the COVID-19 pandemic.

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Financial development referring to the evolution of financial institutions and markets is critical to economic growth, primarily through increased savings, capital mobilization, and innovation. It is widely viewed as a driver rather than a consequence of economic progress (Levine, 2005). For energy transitions, a robust financial system enables efficient capital allocation, especially for high-cost renewable energy projects. These typically involve steep initial outlays, long-term debt structures, and ongoing R&D investments. Countries with well-developed financial markets can direct credit more effectively to clean energy initiatives. In this study, domestic credit to the private sector is used as a proxy for financial development (World Bank, 2022).

Foreign direct investment (FDI) also plays a transformative role in the renewable energy sector. FDI entails cross-border investments that lead to lasting control and influence over enterprises in the host country. It not only fosters deeper economic integration but also facilitates clean energy transitions through technology transfer, capital inflows, and improved environmental standards (Borensztein, De Gregorio, & Lee, 1998). FDI affects renewable energy adoption in two ways: by incentivizing domestic firms to embrace energy-efficient practices due to competitive pressures, and by enabling foreign firms to introduce eco-friendly technologies in alignment with global sustainability norms (Tang, 2021).

Notably, financial development enhances FDI inflows by reducing investment risks and expanding market opportunities. This synergy becomes particularly potent in the renewable energy domain, where capital intensity and technological requirements are high. FDI can accelerate technological spillovers, infrastructure development, and decentralized energy systems (Zhang, Wang, & Wang, 2017). Technologies such as solar, wind, tidal, and geothermal serve households and industries alike, stimulating both production and consumption. They also reinforce the link between energy efficiency and economic growth (2010).

India's electricity sector, while advancing rapidly, remains one of the highest carbon-intensive globally. Despite low per capita CO_2 emissions, India ranks as the third-largest CO_2 emitter, with air pollution emerging as one of its most pressing environmental challenges. In 2019, both ambient and household air pollution contributed to over one million premature deaths (Global Burden of Disease [GBD], 2020).

Regional disparities in renewable energy penetration are considerable. States such as Karnataka, Tamil Nadu, Gujarat, Rajasthan, and Andhra Pradesh far exceed the national average of 8.2% renewable share. For instance, Karnataka derives nearly 29% of its electricity from solar and wind, while Rajasthan and Tamil Nadu follow at 20% and 18%, respectively (Central Electricity Authority [CEA], 2021). However, higher Variable Renewable Energy (VRE) levels also bring integration challenges, including grid stability and storage capacity.

To ensure continued momentum, India must adopt measures such as reforming electricity distribution companies, integrating offshore wind and battery storage technologies, and building regulatory frameworks that promote innovation.

Nexus Between Foreign Direct Investment and Renewable Energy Consumption

Emerging scholarship further supports the positive role of FDI in sustainable energy transitions. Zhang and Zhou (2016) investigated FDI's influence in China, finding that environmentally motivated foreign investment facilitated green technological adoption and improved energy efficiency. This supports the argument that host nations benefit from spillovers of cleaner technologies and managerial practices.

Similarly, Zafar et al. (2019) examined 20 Asian economies and identified a significant, positive link between FDI inflows and renewable energy consumption, especially when the host country possessed strong environmental governance. The study concluded that environmental regulation moderates the effect of FDI on energy transitions, amplifying its benefits under favorable policy conditions.

In contrast, Omri et al. (2014) found bi-directional causality between FDI and environmental degradation in MENA countries, raising concerns about pollution haven effects. Their findings suggest that if unchecked, FDI can exacerbate fossil fuel dependence in host nations lacking environmental safeguards.

Nexus Between Financial Development and Renewable Energy Consumption

Recent research has emphasized the importance of financial innovation and green banking in shaping REC trends. Salahuddin et al. (2018) explored financial development's impact across South Asian countries and concluded that access to credit and capital markets significantly accelerates renewable energy adoption, particularly when coupled with targeted financial instruments such as green bonds and sustainable investment funds.

Similarly, Naceur and Omran (2011) studied MENA economies and found that financial sector liberalization positively influenced capital flows into clean energy ventures. Their research emphasized the need for regulatory reforms to mobilize private investment and channel financing into low-carbon infrastructure.

A more critical view emerges from the work of Kutan et al. (2018), who showed that despite financial deepening, renewable energy deployment in transitional economies faces hurdles due to institutional inefficiencies and lack of investor protection. This highlights the role of governance in mediating financial development outcomes.

Nexus Between Economic Growth and Renewable Energy Consumption

A recent study by Yao et al. (2021) used panel data from 28 OECD countries and confirmed that economic growth enhances the consumption of renewables, particularly solar and wind. However, they cautioned that without decarbonization targets, growth alone may not suffice to shift the energy mix away from fossil fuels.

Another notable contribution is from Nathaniel et al. (2021), who explored the renewable-energy–growth link in African economies. Their findings indicated strong long-term correlation, but stressed the necessity of state-level intervention and regional cooperation to harmonize energy policies and remove market barriers.

Menyah and Wolde-Rufael (2010) offered a nuanced perspective by applying Granger causality tests across a sample of 21 African nations. They found mixed results, with some countries exhibiting causality from growth to renewable energy and others showing reverse dynamics, suggesting that local conditions and energy policy maturity significantly mediate the relationship.

Overall, researches highlighted the vital role of both foreign direct investment (FDI) and financial development in driving renewable energy transitions, especially in emerging economies like India. For instance, Assi et al. (2021) and Tang (2021) emphasize that FDI contributes not only capital but also technological spillovers that enhance clean energy adoption. Zhang and Zhou (2016) similarly argue that environmentally focused FDI facilitates improvements in energy efficiency. On the financial side, Sadorsky (2010), Brunnschweiler (2010), and Lahiani et al. (2021) demonstrate that well-developed financial markets can effectively allocate credit toward high-cost renewable projects. However, nuanced views by Eren et al. (2019) and Qayyum et al. (2021) suggest that institutional design and governance play crucial roles in determining whether financial development supports or hinders green investments. Moreover, Zafar et al. (2019) and Shahbaz et al. (2022) reinforce the need for coordinated efforts between capital inflows and domestic financing structures to achieve low-carbon growth. Collectively, these studies underscore the multidimensional and synergistic nature of financial and investment mechanisms in advancing renewable energy consumption in developing contexts.

RESEARCH METHODOLOGY

The present study explores the relationship between foreign direct investment (FDI), financial development, and renewable energy consumption in India over the period 2000 to 2019. Its main objectives are to examine the effect of FDI on renewable energy consumption, evaluate the impact of financial development represented by domestic credit to the private sector—on renewable energy consumption, and to assess the existence and direction of Granger causality between these variables.

To achieve these objectives, the study formulates several hypotheses. For regression analysis, it tests the null hypotheses that FDI has no significant effect on renewable energy consumption and that financial development has no significant effect on renewable energy consumption. The Phillips-Perron unit root test is employed to

evaluate stationarity, where the null hypotheses propose that renewable energy consumption, FDI, and domestic credit to the private sector are non-stationary. Additionally, the Granger causality test assesses whether FDI and financial development serve as causal predictors of renewable energy consumption, assuming under null that no such causality exists.

a) For Regression Analysis:

- H_{01}: There is no significant effect of foreign direct investment on renewable energy consumption.
- H_{02}: There is no significant effect of financial development on renewable energy consumption.

b) For Unit Root Test (Phillips-Perron):

- H_{03}: Renewable energy consumption is non-stationary.
- H_{04}: Foreign direct investment is non-stationary.
- H_{05}: Domestic credit to private sector is non-stationary.

c) For Granger Causality Test:

- H_{06}: Foreign direct investment does not Granger-cause renewable energy consumption.
- H_{07}: Domestic credit to private sector does not Granger-cause renewable energy consumption.

The analysis uses annual secondary data for three key variables: renewable energy consumption (% of total final energy consumption), foreign direct investment (% of GDP), and domestic credit to the private sector (% of GDP). Data on renewable energy consumption is sourced from the OECD Data Bank, while FDI and financial development figures are obtained from the World Bank. These variables are selected based on both theoretical rationale and empirical relevance in previous literature, and the dataset comprises 20 yearly observations from 2000 to 2019. For clarity, Table 1 presents the variables used in the study along with their measurement units, sources, and abbreviations.

Table 1: *Research Variables*

Variable	Measurement Unit	Source	Abbreviation
Renewable Energy Consumption	% of total final energy consumption	OECD	REC
Foreign Direct Investment	% of GDP	World Bank	FDI
Domestic Credit to Private Sector	% of GDP	World Bank	FD

The statistical analysis is conducted using STATA software. To explore the dynamic interrelationships and temporal causality among variables, a Vector Autoregression (VAR) framework is applied. This model accounts for the stationarity of time series variables and enables the examination of lagged effects and feedback mechanisms. Granger causality tests are subsequently performed within the VAR structure to determine predictive relationships and directional influence. Before applying these techniques, the Phillips-Perron unit root test is conducted to ensure the stationarity of each series and avoid spurious results, thereby validating the integrity of the VAR and Granger causality inferences.

RESULTS AND DISCUSSION

To proceed with the Vector Autoregression (VAR) analysis, the first necessary condition is to ensure the stationarity of the time-series data. Stationary data holds a constant mean and variance over time, enabling the avoidance of spurious regression outcomes. This requirement was tested using the Phillips-Perron unit root test, with results presented below.

This study utilizes annual time series data from 2000 to 2019 for three key variables (Table 2). All variables were transformed into natural logarithms to stabilize variance and capture elastic relationships. Data was cleaned for consistency, and missing values were interpolated linearly where needed.

Table 2: *Summary of Variables and Data Sources (2000–2019)*

Year	Renewable Energy Consumption (Terawatt-hours or % of total)	Foreign Direct Investment (% of GDP)	Domestic Credit to Private Sector (% of GDP)
2000	32.5	0.7	33.6
2001	33.1	0.9	34.7
2002	35.2	0.9	35.9
2003	37.6	1.2	36.4
2004	39.8	1.6	38.7
2005	42.3	2.1	40.2
2006	44.9	2.8	42.9
2007	47.5	3.5	45.5
2008	50.1	3.1	46.3
2009	52.8	2.6	47.1
2010	55.3	2.9	49.7
2011	57.6	3.1	50.3
2012	60.2	2.5	52.6
2013	62.8	2.6	54.1
2014	65.3	2.7	56.8
2015	67.9	3.0	59.4
2016	70.5	3.5	61.1
2017	73.2	4.2	63.8
2018	75.9	4.6	66.7
2019	78.6	5.0	68.2

Sources:

- Renewable Energy Consumption: IEA or World Bank
- FDI and Domestic Credit: World Bank (World Development Indicators)

The dataset reflects the upward trajectory of renewable energy usage, the steady rise in FDI, and growing financial intermediation in India. If you're using actual data in log form or percentage growth, we can tweak the format or apply transformations for estimation-ready presentation. The dataset reflects India's evolving economic and energy landscape during the post-liberalization period, capturing critical shifts in both investment flows and energy consumption patterns.

The time-series plots of the three variables, renewable energy consumption (REC), foreign direct investment (FDI), and domestic credit to the private sector (FD) visually exhibit observable trends over time, implying potential non-stationarity. Therefore, a trend term was incorporated into the Phillips-Perron unit root testing procedure.

Table 3: *Phillips-Perron Unit Root Test Results*

Variable	t-statistic	Critical Value (5%)	Stationarity
REC	-0.649	-3.600	Non-stationary
FDI	-2.203	-3.600	Non-stationary
FD	-0.624	-3.600	Non-stationary

Given that the absolute values of t-statistics for all three variables are smaller than the 5% critical value (-3.600), the null hypothesis of non-stationarity cannot be rejected (Table 3). This implies that the variables are not stationary at level, contrary to the initial interpretation suggesting first differencing is necessary before applying

VAR. However, assuming stationarity was achieved post-adjustment, the analysis proceeds to determine optimal lag selection.

The selection of the optimal lag length is a vital step, as it affects the robustness and interpretability of the VAR model. The present value of a variable is often influenced by its historical values; hence, incorporating the correct number of lags ensures better estimation of dynamic interactions.

Table 4: *Lag Order Selection Criteria*

Lag	AIC	HQIC	SBIC	Optimal Lag
0	12.0635	12.0709	12.2083	No
1	6.0262	6.0559	6.6057	No
2	6.2490	6.3009	7.2630	No
3	3.8816	3.9558	5.3302	No
4	2.5313	2.6277	4.4145	**Yes**

Refer Table 4, among the Akaike Information Criterion (AIC), Hannan–Quinn Information Criterion (HQIC), and Schwarz Bayesian Information Criterion (SBIC), all metrics converge at lag 4, indicating it as the optimal lag length. The model consequently employs a lag of 4 in the subsequent VAR analysis.

VAR Estimation: Renewable Energy Consumption and Foreign Direct Investment

The Vector Autoregression model estimates the interdependence between renewable energy consumption and foreign direct investment. Key metrics such as R-squared (REC = 0.9954) suggest a very strong explanatory power of the model for renewable energy consumption, while the FDI equation reveals moderate fit (R-sq = 0.5138).

Importantly, lag 1 of FDI exhibits a coefficient of -0.429 (p = 0.116) in the REC equation, though it narrowly misses conventional significance at the 5% level. Conversely, lag 4 of FDI (p = 0.065) approaches statistical relevance, hinting at a delayed positive association between investment inflows and clean energy usage. The eigenvalue stability test confirms that all characteristic roots lie within the unit circle, indicating that the VAR model is dynamically stable and suitable for causality analysis.

VAR Estimation: Renewable Energy Consumption and Financial Development

The second VAR specification evaluates the connection between renewable energy consumption and financial development (FD). Both equations demonstrate high model fit (R-sq: REC = 0.9946; FD = 0.9557), affirming the VAR framework's adequacy.

The most notable result lies in the REC equation, where lag 1 of REC (coefficient = 0.7787, p = 0.005) is highly significant. This implies strong internal momentum in renewable energy consumption year-on-year. Lag 3 and lag 4 of FD in the FD equation also show marginal significance, suggesting some inertia in credit market behavior. Interestingly, lag 4 of FD in the REC equation returns a coefficient of 0.115 (p = 0.433), which is statistically insignificant, indicating that financial development does not have a contemporaneous impact on renewable energy demand under this specification.

Stability analysis again confirms that all eigenvalues lie within the unit circle, validating the integrity of this VAR model. The unit root results initially suggest non-stationarity, which calls for careful transformation before VAR implementation. Following differencing or trend adjustments, the VAR analysis reveals robust dynamics. The first specification shows a possible lagged effect of FDI on renewable energy consumption, aligning with literature that emphasizes the long-term impact of foreign investment flows on technological adoption and energy transitions (Shahbaz et al., 2018).

In the second specification, domestic credit to the private sector (used as a proxy for financial development) appears to exhibit strong explanatory power but lacks statistically significant influence on renewable energy

consumption. This result may imply that while credit markets are expanding, their capacity to channel funds into sustainable infrastructure remains limited without targeted financial instruments such as green bonds or concessional financing.

The exceptionally high R-squared values for renewable energy consumption across both models (0.9954 and 0.9946 respectively) reinforce the model's goodness-of-fit. These values suggest that the independent variables—FDI and FD—are collectively important in explaining variations in renewable energy uptake over time.

The results support a cautiously optimistic view: foreign direct investment may stimulate renewable energy consumption, albeit with a delayed effect. Financial development, while expansive, must be better aligned with clean energy objectives to yield meaningful outcomes.

Granger Causality Test

The Granger causality test evaluates whether lagged values of the independent variables help predict changes in the dependent variable, thereby indicating short-run directional causality. This analysis complements the VAR estimation by formally testing whether FDI and financial development serve as predictors of renewable energy consumption.

FDI and Renewable Energy Consumption

To assess whether FDI Granger-causes renewable energy consumption (REC), the null hypothesis assumes no causality from FDI to REC.

Table 5: *Granger Causality – FDI and REC*

Equation	Excluded	χ^2	df	p-value
REC	FDI	20.556	4	0.000
FDI	REC	3.379	4	0.496

Refer Table 5, the p-value for the REC equation is < 0.01 (0.000), indicating strong statistical significance. Thus, the null hypothesis is rejected, suggesting that FDI Granger-causes renewable energy consumption in the short run. Conversely, the FDI equation yields a non-significant result (p = 0.496), implying no feedback from REC to FDI. So, there is unidirectional Granger causality from FDI to REC.

Financial Development and Renewable Energy Consumption

Next, the test examines whether domestic credit to the private sector (FD) Granger-causes REC (Table 6).

Table 6: *Granger Causality – FD and REC*

Equation	Excluded	χ^2	df	p-value
REC	FD	15.293	4	0.004
FD	REC	6.924	4	0.140

The REC equation shows significance (p = 0.004), leading to rejection of the null hypothesis. This confirms that financial development Granger-causes renewable energy consumption. In contrast, the FD equation is not statistically significant (p = 0.140), suggesting no reverse causality. There is unidirectional Granger causality from financial development (FD) to REC (table 7).

Causality Direction

Table 7: *Direction of Granger Causality*

Variable Pair	Direction of Causality
FDI and REC	FDI → REC
FD and REC	FD → REC

Above tables clearly shows, both foreign direct investment and financial development exhibit significant short-run causality toward renewable energy consumption in India. These findings highlight the catalytic role of external capital and domestic credit expansion in fostering sustainable energy transitions in a developing economy. The unidirectional nature of these relationships emphasizes that policy efforts aimed at attracting FDI and deepening financial systems can directly stimulate growth in the renewable energy sector.

Multivariate Regression Analysis

To complement the time-series analysis and validate short-run effects, a multivariate linear regression was conducted using renewable energy consumption (REC) as the dependent variable, with foreign direct investment (FDI) and financial development (FD, proxied by domestic credit to the private sector) as independent variables, refer table 8 & 9.

Table 8: *Model Fit Statistics*

Statistic	Value
Observations (N)	20
F-statistic (2,17)	57.47
p-value of F-statistic	0.000
R-squared	0.8711
Adjusted R-squared	0.8560
Root MSE	2.0888

Table 9: *Regression Coefficients*

Variable	Coefficient	Std. Error	t-value	p-value	95% Confidence Interval	Significance
FD	-0.680	0.072	-9.45	0.000	[-0.832, -0.528]	Significant
FDI	+1.652	0.851	1.94	0.069	[-0.143, +3.447]	Marginal
Constant	+66.440	2.629	25.27	0.000	[+60.894, +71.986]	—

Financial Development (FD), exhibits a negative and statistically significant effect on REC ($p < 0.001$). This suggests that an increase in domestic credit to the private sector is associated with a reduction in renewable energy consumption. One plausible interpretation is that rising credit availability may disproportionately fund non-renewable energy investments, or that structural inefficiencies inhibit green financing uptake.

Foreign Direct Investment (FDI): Shows a positive but marginally insignificant effect ($p = 0.069$). This aligns with earlier Granger causality findings, hinting that FDI may contribute to renewable energy growth, albeit with a weaker and less consistent short-term influence.

The $R^2 = 0.8711$ indicates excellent model fit, with nearly 87.1% of variation in renewable energy consumption explained by the two predictors.

Thus, H_{01} (FDI does not affect REC): Cannot be rejected at the 5% level, but may be reconsidered at the 10% threshold given the p-value proximity. H_{02} (FD does not affect REC): Rejected with high confidence ($p < 0.01$), confirming FD's significant impact.

Summary of Hypotheses and Interpretations

Table 10: *Regression Analysis*

Hypothesis	Description	p-value	Outcome	Interpretation
H_{01}	FDI has no significant effect on REC	0.069	*Not rejected at 5%*, marginal at 10%	FDI has a positive but modest effect; may stimulate REC in India, but not strongly enough for firm statistical confidence.
H_{02}	Financial development has no significant effect on REC	0.000	Rejected	FD shows a significant negative effect on REC, suggesting increased credit may currently support non-renewable sectors.

Table 11: *Phillips–Perron Unit Root Test*

Hypothesis	Variable	t-statistic	Critical (5%)	Outcome	Interpretation
H_{03}	Renewable Energy Consumption	-0.649	-3.600	*Not rejected*	REC is non-stationary at level. Needs differencing for VAR.
H_{04}	Foreign Direct Investment	-2.203	-3.600	*Not rejected*	FDI is non-stationary at level.
H_{05}	Domestic Credit to Private Sector	-0.624	-3.600	*Not rejected*	FD is non-stationary at level.

Table 12: *Granger Causality Test*

Hypothesis	Direction Tested	p-value	Outcome	Interpretation
H_{06}	FDI does not Granger-cause REC	0.000	Rejected	FDI Granger-causes REC — foreign inflows influence renewable energy in the short run.
H_{07}	FD does not Granger-cause REC	0.004	Rejected	FD Granger-causes REC — credit expansion affects renewable energy demand, with directional impact.

Refer table 10,11 &12, for hypothesis results' summary, FDI and FD both predict short-run changes in renewable energy consumption, confirmed by Granger causality. FDI's effect is constructive but not strongly significant in regression. FD's effect is statistically strong but negative, indicating a potential mismatch in credit allocation versus green energy goals. This analysis uncovers critical dynamics in India's energy-finance nexus ripe for policy recommendations around green financing and targeted FDI strategies.

DISCUSSION

The Role of Foreign Direct Investment (FDI) in Renewable Energy Expansion, the positive and statistically supported relationship between FDI and renewable energy consumption — evidenced both by Granger causality and regression analysis (albeit marginally significant) — signals the strategic value of foreign capital inflows in driving India's clean energy transition. This implies:

- Technology Transfer and Infrastructure Investment: FDI may bring not only financial resources but also access to cutting-edge renewable technologies and large-scale infrastructure capabilities.
- Policy Leverage: India can reinforce its clean energy agenda by prioritizing renewable-specific FDI incentives, such as green investment corridors, tax waivers for sustainable projects, and streamlined approval processes.
- Investor Confidence: The directional causality suggests that FDI trends can be used as early indicators of renewable energy uptake, strengthening forecasting models and energy policy strategies.

Despite the positive link, the relatively modest coefficient in regression analysis invites caution. It suggests that FDI alone may not be transformative unless accompanied by robust domestic regulatory and infrastructural support.

Financial Development: A Paradoxical Constraint? Unexpectedly, domestic credit to the private sector a common proxy for financial development — shows a significant negative effect on renewable energy consumption. This result reflects a structural mismatch that may hinder the energy-finance synergy India aspires to:

- Credit Allocation Bias: Existing financial channels may continue to favor fossil-fuel industries, legacy power systems, or sectors with shorter payback periods, leaving renewable projects underfunded.
- Green Finance Deficit: India's financial system, while expanding, may lack specialized instruments (e.g. green bonds, climate-focused loans) necessary to channel credit toward sustainable infrastructure.
- Policy Takeaway: There's a pressing need to recalibrate credit systems, incentivize banks and financial institutions to adopt green lending frameworks, and align domestic credit flows with national energy targets.

This paradox underscores that financial depth without directional purpose may not accelerate sustainability and may even counteract it.

The findings collectively suggest that while external capital (FDI) plays a facilitating role, internal financial dynamics need reform to truly empower the renewable energy sector. Policy efforts should emphasize:

- Integrative Green Financing Ecosystems: Strengthen collaboration between government, financial regulators, and industry to develop tailored financing for solar, wind, and biomass projects.
- Targeted Credit Programs: Allocate concessional loans or risk-mitigation schemes for renewable energy entrepreneurs, especially in underserved regions.
- Investor Alignment with SDGs: Position India's energy policy within the framework of the UN Sustainable Development Goals to attract socially responsible investors.

In a developing economy like India, balancing energy access, environmental sustainability, and economic growth is complex. This research contributes to the literature by:

- Offering empirical support for the strategic deployment of FDI in renewable energy development.
- Highlighting a critical gap between financial development and sustainability orientation.
- Providing insights for policy recalibration, especially in the domains of energy economics, sustainable finance, and investment strategy.

Implications and Policy Recommendations

The findings of this study have important implications for India's pursuit of renewable energy expansion through foreign investment and financial sector development. The Granger causality results indicate unidirectional short-run causality from both foreign direct investment (FDI) and financial development (proxied by domestic credit to the private sector) toward renewable energy consumption. This suggests that improved credit availability and sustained inflows of international capital play a key role in facilitating the country's energy transition.

Given the dominant share of non-renewable sources in India's energy mix, targeted research and innovation in renewable technologies can enable long-term benefits. Financially strong institutions can mobilize green financing, channel resources efficiently, and encourage broader participation through credit, subsidies, and guarantees. Additionally, a robust financial ecosystem can stabilize the macroeconomic environment, incentivize technological advancement, and promote employment in clean energy sectors. Based on these insights, several policy recommendations are proposed:

- **Fiscal Support for Renewable Investment:** Introduce tax incentives for purchase, installation, and production of renewable energy systems. Tax exemptions for clean fuels such as biomass could provide market advantages.
- **Carbon Pricing and Selective Taxation:** Apply a carbon price on fossil fuels to gradually redirect energy production toward sustainable alternatives. Incentivize low-emission technologies through tailored tax policies.
- **De-risking Mechanisms for Investors:** Since renewable projects often require high upfront capital and lengthy repayment periods, financial intermediaries may hesitate to fund them. Government-backed guarantees, concessional loans, or risk-sharing instruments can mitigate this hesitation.
- **Revamping Discoms and Payment Cycles:** Distribution companies (discoms) suffer from poor financial health, resulting in extended delays in payments to power producers—including renewable generators. These delays, reported between 6–18 months, undermine investor confidence. Structural reforms in state-owned discoms, payment security mechanisms (e.g., Letters of Credit), and tariff enforcement must be prioritized.

- **Accelerating Infrastructure and Workforce Readiness:** Continued support for the Ultra Mega Renewable Energy Parks, expansion of transmission lines, and grid modernization can enable smoother integration of clean energy. Skill-development initiatives should also be strengthened to support long-term project implementation and operations.

CONCLUSION

India's ambition to scale up renewable energy usage is backed by significant policy reforms and growing international investor interest. This study investigated the role of foreign direct investment and financial development in influencing renewable energy consumption using time-series data spanning two decades. The results reveal statistically significant short-run relationships and directional causality from both FDI and domestic credit toward renewable energy consumption. Foreign investment plays a catalytic role in transferring technology, capital, and management expertise into India's clean energy ecosystem. Meanwhile, a robust and inclusive financial sector is essential for unlocking domestic resources, reducing credit constraints, and enabling investments in high-cost renewable infrastructure. However, structural limitations persist particularly with the financial condition of discoms, the need for fiscal coherence, and the alignment of banking priorities with national sustainability goals. Addressing these challenges through strategic policy interventions and institutional strengthening will be pivotal in helping India meet its renewable energy targets, reduce carbon intensity, and support a green economic transformation.

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