

Assessing the Impact of Geopolitical Risk on Foreign Direct Investment Inflows: Evidence from India

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Abstract

This study uses an autoregressive distributed lag (ARDL) approach to investigate the relationship between foreign direct investment (FDI), geopolitical risk, and economic growth in India. The Pesaran, Shin, and Smith bounds testing framework is used to analyse annual time-series data in order to evaluate long-term associations, and an error correction model is used to capture short-term dynamics. The Bai–Perron multiple structural break methodology is used to handle structural regime shifts, and standard diagnostic and stability tests are used to confirm model adequacy. The findings show that geopolitical risk has an adverse effect on foreign direct investment (FDI) over time when uncertainty endures. Long-term economic growth encourages foreign direct investment (FDI), but short-term effects are still negligible or negative. Overall, the results emphasise how crucial geopolitical stability, credible policies, and steady economic growth are to attract foreign investment in emerging economies.

Keywords: Foreign Direct Investment, Geopolitical Risk, Economic Growth, ARDL, Structural Breaks, India

Introduction

For a long time, foreign direct investment (FDI) has been seen as a major force behind economic growth, especially in developing nations where productivity limitations, capital scarcity, and technological gaps continue to exist. In addition to increasing domestic capital formation, foreign direct investment (FDI) promotes technology transfer, managerial expertise, access to global markets, and job creation, all of which support long-term economic growth. Therefore, since the start of economic liberalisation reforms, luring and keeping foreign investment has continued to be a major goal of economic policy in emerging nations, including India.

India's market size, economic potential, and progressive legislative reforms have made it one of the top destinations for foreign direct investment (FDI) among rising economies. However, FDI inflows have shown significant volatility over time, reflecting both external uncertainty and domestic economic situations. Among these, geopolitical risk has become a more significant factor in determining international investment flows. Growing geopolitical tensions, regional conflicts, rivalry between global powers, and policy uncertainty can affect investor confidence, increase risk perceptions, and change the timing and scope of foreign investment choices. The impact of geopolitical risk on FDI inflows is still not well studied empirically, especially when it comes to specific emerging economies such as India which is the 4th largest economy of the world and despite its increasing significance.

The empirical literature currently in publication offers mixed results regarding the connection between foreign direct investment (FDI) and economic growth, as well as the influence of political risk and uncertainty on investment flows. Strong economic growth and macroeconomic stability draw foreign investment, according to numerous studies, however some contend that short-term growth dynamics do not always result in quick increases in FDI. Furthermore, geopolitical risk is frequently overlooked as a unique and dynamic source of uncertainty in favour of traditional political risk indicators or broad institutional measurements. Furthermore, despite the existence of significant policy reforms, worldwide shocks, and structural changes that could modify the investment–growth link, most studies assume parameter stability over time.

In light of this, the current study uses an autoregressive distributed lag (ARDL) framework to investigate the dynamic relationship between foreign direct investment, geopolitical risk, and economic growth in India. This

method enables the simultaneous examination of long-term equilibrium relationships and short-term dynamics among variables that may be integrated of various orders.

This study makes three contributions. First, it offers empirical data unique to India about the influence of geopolitical risk on foreign direct investment (FDI), a topic that is still largely unexplored. Second, it provides insights into how foreign investors react to transient vs persistent uncertainty by differentiating between short-run and long-run effects. Third, the analysis recognises the changing character of India's economic and policy environment and improves the dependability of the calculated correlations by taking structural breakdowns into account. The results should have important ramifications for decision-makers trying to maintain foreign investment in a world that is becoming more unpredictable.

Review of Literature

1. Miaozi Yu and Na Wang (2023): FDI Flows and Geopolitical Risk Yu and Wang use a fixed-effects panel model to investigate how geopolitical risk affects FDI inflows in 41 countries between 2003 and 2020. They discover that trade dependency might lessen the detrimental impact of increased geopolitical risk, which substantially hinders foreign direct investment (FDI) in the majority of economies, though the extent varies by development level. Their findings also highlight how important market size, natural resources, and technological prowess are in luring in foreign capital. This study emphasises that geopolitical risk is a significant worldwide factor influencing foreign direct investment (FDI) and that its impacts vary by nation.
2. Geopolitical Risk and Foreign Direct Investment in Vietnam, Loc Dong Truong et al. (2024) Truong and colleagues examine the immediate and long-term impacts of geopolitical risk on Vietnam's foreign direct investment (FDI) between 1986 and 2021 using an ARDL bounds testing approach, which is the same paradigm used in this study. According to their estimation, FDI is significantly negatively impacted by geopolitical risk over the long term, however the short-term effects can differ depending on the lag structure. This study shows how the risk-FDI relationship is shaped by context-specific economic variables in transition economies and emphasises the value of ARDL in separating short- from long-term effects.
3. CS-ARDL Evidence on Geopolitical Risk and FDI by Alper Yılmaz (2024) Yılmaz applies a cross-sectionally enhanced CS-ARDL model to high-risk nations over 2000–2022 and finds that geopolitical risks negatively affect FDI in both the short and long run. Additionally, the analysis underlines the relevance of political stability as an institutional factor that greatly influences FDI, revealing that risk and stability interact to create investment dynamics. This supports the more general theory that foreign investment behaviour is influenced by both political and geopolitical unpredictability.
4. The Interaction of GPR, Institutions, Liberalisation, and FDI by Muhammad Ubaidillah Al Mustofa and Muhammad Haidar Risyad (2025) This study examines the ways in which institutional quality, financial market development, liberalisation policy, and geopolitical risk interact to impact foreign direct investment (FDI) in a panel of Muslim economies between 1990 and 2020. It concludes that the negative effects of geopolitical risk on foreign direct investment can be somewhat mitigated by robust governance, efficient institutions, and sophisticated financial systems. This study emphasises the conditional determinants of FDI under geopolitical uncertainty by concentrating on structural and policy variables, implying that institutional quality can influence investor reactions to risk.
5. Yili Lin and Yucong Mei (2025): OECD Data on FDI and Geopolitical Risk This thesis shows that geopolitical risk has a negative impact on FDI net inflows, with a focus on OECD nations from 1995 to 2023. Additionally, it demonstrates that the negative effects of geopolitical stress on investment inflows can be mitigated by increased GDP per capita and reveals variation in the effect among subregions. This paper supports the negative risk–FDI association in a developed-economy setting and emphasises how economic development moderates this relationship.
6. Liu et al. (2025): FDI in Emerging Economies, Geopolitical Risk, and US-China Tensions Using a PMG–ARDL panel model, Liu, Gozgor, Mahalik, and Pal (2025) examine how geopolitical tensions, particularly the strategic competition between the US and China, impact foreign direct investment inflows across 14 emerging economies. They discover that while strong economic growth and stable exchange rates encourage investment, increasing geopolitical risk, regulatory quality, and exchange rate volatility considerably discourage FDI. Thus, the study emphasises how macroeconomic factors, institutional quality, and geopolitical risk combine to influence FDI patterns, especially in emerging nations dealing with global strategic conflicts.

7. Geopolitical Risk, Policy Uncertainty, and FDI Spillovers in BRICS: Kunjal et al. (2025) Using a time-varying parameter VAR and spillover index approach, Kunjal and colleagues (2025) investigate the impact of both geopolitical risk (GPR) and economic policy uncertainty (EPU) on FDI spillovers among BRICS economies. They demonstrate that GPR has a high impact on FDI spillovers, especially when compared to EPU, and they discover substantial FDI interconnection among the BRICS nations. Their results highlight the systemic vulnerability of emerging countries to external uncertainty and imply that geopolitical variables can reduce investment transmission across markets.

8. Altiner & Bozkurt (2023): Evidence from Turkey on Geopolitical Risk and Foreign Direct Investment In their investigation of the connection between geopolitical risk and foreign direct investment (FDI) inflows in Turkey, another emerging country, Altiner and Bozkurt (2023) discover that increased uncertainty tends to discourage foreign investors because risk erodes investors' expectations of steady returns. They stress that perceptions of volatility have an impact on investment decisions, particularly in nations with little domestic savings and heavy reliance on foreign capital.

Data sources and Methodology

The data used in this study has been taken up as annual time series of Geopolitical risk index (however, the data for this index was found as quarterly but to maintain the uniformity amongst the variables this index has been averaged to get an accurate representation), Net Foreign Direct Investment inflows and GDP growth rate of India, the time period for this study has been taken from the year 1975 to 2025 which is a period of 50 years. Thus, providing us with substantial time period investigate into any pattern of effects of the independent variable over the dependent variable.

One of the important variable taken for this study that is GPR was developed by Caldara and Lacoviello(2022). This index is based upon the number of newspaper articles that contain terms related to geopolitical tensions and those terms are used by journalists while reporting on geopolitical events and threats (Micallef et.al 2023). This index can be represented as

$$GPR_t = \frac{Nt}{Tt}$$

Where:

Nt= No. of articles related to geopolitical risk in period t.

Tt= Total no. of articles in period t

Then this ratio is normalized to 100 from the points and its base year is 2000.

For India specifically: -

$$GPR\ India_t = \frac{\text{Articles mentioning India+ Geopolitical risk terms}}{\text{Total India related articles}}$$

Table 1: Data and its sources

Data	Data Source
FDI	World Bank
GPR	Caldara and Lacoviello's (https://www.matteoiacoviello.com , accessed on 20 January 2026)
GDP growth	World Bank

Source: Author's own creation

Methodology

To explore the impact of geopolitical risk over FDI inflows to India the following regression model has been employed:

$$FDI_t = \beta_0 + \beta_1.GPR_t + \beta_2.GDPgt + \varepsilon$$

Where:

FDIt= Net inflow of foreign direct investment at time t, GPRt= Geopolitical Risk index at time t, GDPgt= GDP growth rate at time t and ε = Error term.

To investigate the long run and short run effects of GPR over FDI in India, this paper uses an Autoregressive distributed lag model developed by Pesaran et.al (2001) which analyzes dynamic relationship between variables over the time when compared with other co-integration techniques the ARDL model has few advantages. This model's main benefit over other alternative is that it allows for simultaneous computation of the short term and long-term effects of explanatory factors on the dependent variable by estimating on Error

Correction Model (ECM) from the ARDL model. Furthermore, this model does not necessitate that every variable in the model has the same integration order. Rather, all variables must be integrated to the order of either pure zero, pure one or combination of the two thus making it ideal for mixed stationarity data like FDI inflows and GPR indices. However, there are some hurdles in employing this model.

Firstly, this method is based on the presumption that the dependent variable and independent variable have a symmetric (linear) relationship, which means that changing the independent variable have an equal impact on the dependent variable. Secondly this method is not applicable to models where one of the variables needs to be integrated to order 2 or I(2).

Unit Root test

As previously stated, variables must be integrated to the order of pure zero I(0), pure one I(1), or mix of both in order to pass the ARDL bounds test. Therefore, unit root test should be used to examine the order of integration of all variables prior to the bounds test. The Philip Perron test is used in the study to determine whether or not the variables under investigation are stationary.

ARDL bounds test for Co-integration

Before going ahead with the model itself, a Co-integration tests should be operated which is mandatory condition. So, to examine it between the variables this study uses bounds test. Its equation is as under:

$$\Delta FDI_t = \beta_0 + \sum_{i=1}^{p1} \beta_1 \Delta FDI_{t-i} + \sum_{j=0}^q \beta_2 \Delta GPR_{t-j} + \sum_{k=0}^r \beta_3 \Delta GDP_{t-k} + \delta_1 FDI_{t-1} + \delta_2 GPR_{t-1} + \delta_3 GDP_{t-1} + \varepsilon_t$$

Where:

FDI= net FDI inflows

GPR= Geopolitical Risk Index

GDP_{gt}= GDP growth rate

Δ = first differences operator

p,q,r = optimal lag lengths

ε_t = error term

The condition for Null hypothesis (H₀) rejection of the bounds test is $\delta_1 = \delta_2 = \delta_3 = 0$ (no Co-integration in the long run between variables). The Null hypothesis is rejected if the F-statistic derived from the limits test is higher than the critical value of the chosen significance level. This indicates that the variables in the model have a long-term link (Co-integration). If the long run equilibrium relationship is confirmed, the short-run and long-run effects of the GPR on the FDI are estimated using equations as under:

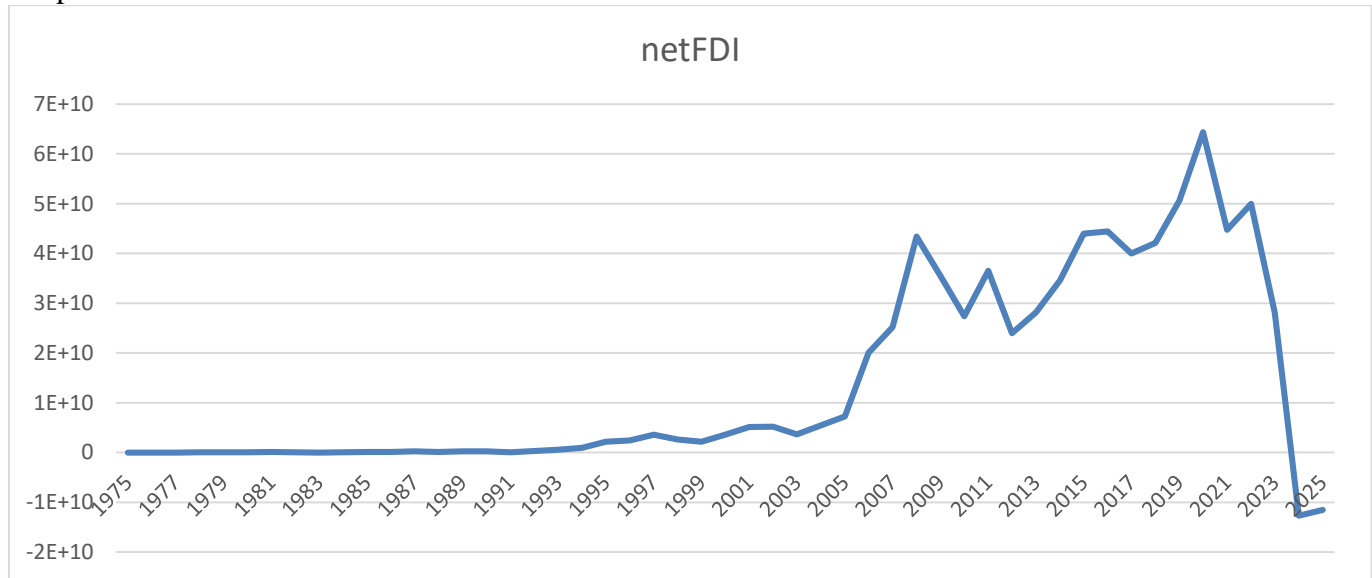
$$\Delta FDI_t = \beta_0 + \sum_{i=1}^p \beta_1 \Delta FDI_{t-i} + \sum_{i=0}^q \beta_2 \Delta GPR_{t-i} + \sum_{i=0}^r \beta_3 \Delta GDP_{t-i} + \delta ECM_{t-1} + \varepsilon_t$$

$$FDI_t = \alpha_0 + \sum_{i=1}^{q1} \beta_{1i} FDI_{t-i} + \sum_{i=0}^{q2} \beta_{2i} GPR_{t-i} + \sum_{i=0}^{q3} \beta_{3i} GDP_{t-i} + \varepsilon_t$$

Empirical Results

Trend analysis of India's FDI inflows and the GPR for the period of 1975 to 2025

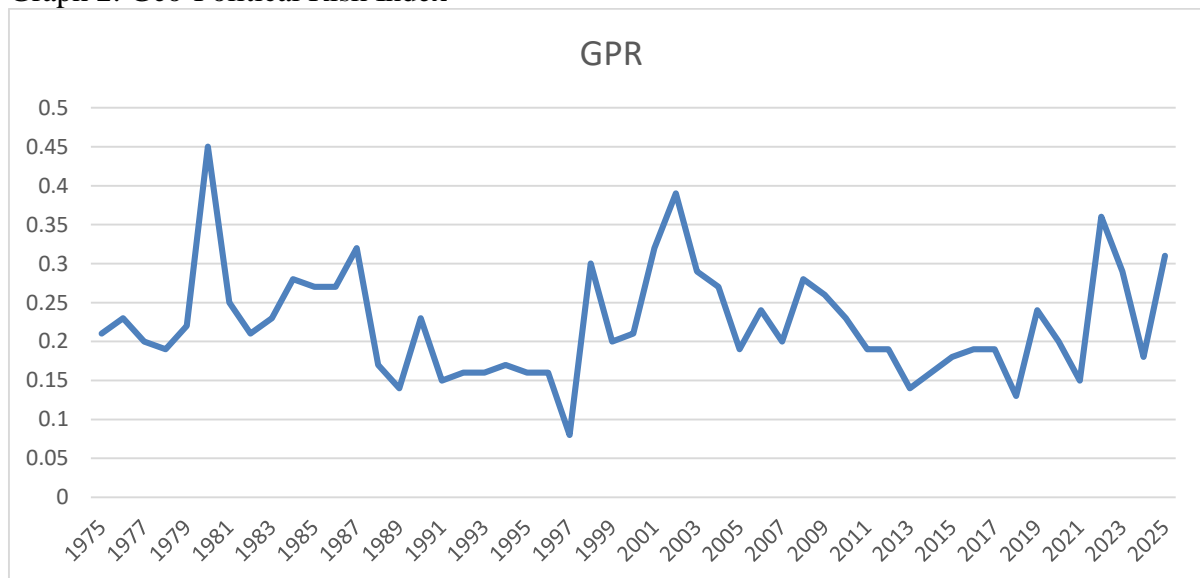
Graph 1: Net FDI



Source: Author’s own creation based on data obtained.

Prior to 1991 liberalisation, India's net foreign direct investment (FDI) inflows, as measured by the World Bank indicator (BoP, current US\$), were small and extremely erratic, averaging less than \$100 million annually between 1970 and 1990, with frequent negatives (e.g., -\$36 million in 1977) because of restrictive socialist policies. Reforms implemented after 1991 led to a sharp increase, rising from low bases to a record \$64 billion in 2020. By late 2024, gross inflows had surpassed \$1 trillion since April 2000. Initiatives like Make in India and PLI policies that prioritise manufacturing and services drove FY25 equity inflows to \$81 billion (+14% YoY). Inflows showed policy-driven resilience in the face of pandemic disruptions, stabilising at 0.71% of GDP in 2024 (historical average ~0.8% since 1970).

Graph 2: Geo-Political Risk Index



Source: Author’s own creation based on data obtained.

Between 1975 and 2025, the geopolitical risk index fluctuated significantly, showing sporadic peaks rather than a consistent pattern. Significant geopolitical events like the Gulf War and post-Cold War realignments are reflected in the relatively mild levels seen in the late 1970s and 1980s, which are followed by greater volatility in the early 1990s. Early in the new millennium, there is a noticeable increase that coincides with the September 11 attacks and the ensuing wars. The index fluctuates at moderate levels throughout the 2010s, with major rises during times of regional and international unrest. Geopolitical risk has increased recently, especially after 2020, showing an ongoing state of uncertainty in world politics. In general, compared to

previous decades, the post-2000 era is characterized by more frequent and prolonged geopolitical risk occurrences.

Unit root test

As previously stated, this study used the Phillips-Perron (PP) unit root test to analyze the variables' stationarity characteristics which is a prerequisite for the ARDL limits test. The findings suggest integration of order zero, I(0), since GDP growth and the geopolitical risk (GPR) index are stationary in levels. On the other hand, net FDI inflows show integration of order one, I(1), since they are non-stationary at level but become stationary after first differencing. The mixed order of integration supports the use of the ARDL limits testing approach to investigate the long-term relationship between the variables because none of the variables are integrated of order two, I(2). The test results are summarised in Table below:

Table 2: Stationarity Test (Phillip – Perron)

	At Level	At First Difference	Stationarity
GDP growth	0.01	-	I(0)
Net FDI	0.5677	0.01	I(1)
GPR	0.01	-	I(0)

Source: Author’s own calculation

ARDL Bounds Test for Co-integration

Using the ARDL bounds testing method suggested by Pesaran, Shin, and Smith (2001), the presence of a long-term link between net FDI inflows, geopolitical risk index (GPR), and GDP growth was investigated. 3.358 is the calculated F-statistic. At the 10% significance level, the F-statistic falls between the lower and upper bounds when compared to the critical boundaries; at the 5% and 1% levels, it stays below the upper bound. This result suggests that at traditional significance levels, the null hypothesis of no cointegration cannot be rejected. As a result, the limits test offers weak and equivocal evidence on the presence of a stable long-term link between the variables.

Table 3: Pesaran, Shin and Smith (2001) Cointegration Test

	F-test	
	I(0)	I(1)
10% critical value	2.788	3.513
5% critical value	3.368	4.178
1% critical value	4.695	5.758
F-statistic: 3.35802351190277		

Source: Author’s own calculation

Short Run and Long Run effects of the GPR on India's net FDI inflows

Both short-term dynamics and a steady long-term association between foreign direct investment inflows, geopolitical risk, and economic growth are demonstrated by the ARDL error correction results. A legitimate long-run equilibrium between the variables is confirmed by the error correction term's negative and statistically significant value. Although there is some overshooting, the coefficient's magnitude suggests a quick adjustment process, indicating that departures from long-run equilibrium are remedied quickly.

Table 4: Short-run Results

	Estimate	Std. Error	t value	Pr(> t)
ec.1	-1.43E-01	4.93E-02	-2.905	0.00624**
dGPR.t	1.51E+10	1.47E+10	1.027	0.311141
dGPR.1	-2.70E+10	1.61E+10	-1.682	0.10114
dGPR.2	-4.13E+10	1.53E+10	-2.701	0.010468*
dGDPgrowth.t	-3.74E+08	3.19E+08	-1.172	0.248987
dGDPgrowth.1	-1.31E+09	5.23E+08	-2.5	0.017126*
dGDPgrowth.2	-1.62E+09	4.42E+08	-3.663	0.000795***
dGDPgrowth.3	-1.31E+09	3.38E+08	-3.88	0.000427***

dnetFDI.1	2.90E-01	1.31E-01	2.219	0.032908*
dnetFDI.2	1.49E-01	1.82E-01	0.817	0.419072
dnetFDI.3	1.08E-01	1.99E-01	0.545	0.589263

Source: Author’s own calculation

In the short run, geopolitical risk does not immediately affect foreign direct investment (FDI) inflows; nevertheless, after two periods, its impact turns negative and statistically significant, suggesting that ongoing geopolitical uncertainty deters foreign investment with a lag. The cautious and forward-looking nature of investment decisions, where corporations reevaluate risk if uncertainty becomes prolonged, is reflected in this delayed response. While its lagged coefficients are negative and statistically significant over a number of periods, GDP growth has no contemporaneous effect on FDI. This suggests that short-term economic expansions may not always result in higher foreign investment, possibly because of cyclical dynamics, sectoral composition of growth, or crowding-out effects from domestic investment. Furthermore, although this influence diminishes after a single period, the first lag of FDI inflows is positive and significant, suggesting short-term durability in investment behaviour.

Table :5 Long-run results

netFDI	-1.43E-01
GPR	2.72E+09
GDP growth	1.67E+09

Source: Author’s own calculation

These conclusions are supported by the long-run coefficients, which show a negative correlation between geopolitical risk and FDI inflows. This suggests that persistent geopolitical uncertainty erodes investor confidence and lowers long-term foreign investment commitments. GDP growth, on the other hand, shows a positive long-term correlation with foreign direct investment (FDI), indicating that improved economic fundamentals and growth prospects eventually make a nation more appealing to overseas investors. When considered collectively, the findings indicate that while geopolitical risk has a negative impact on foreign direct investment (FDI) in both the short and long term, strong economic growth is essential to sustaining long-term FDI, even while its short-term effects may be negative or muted.

Structural break

The Bai and Perron (1998, 2003) multiple structural break methodology is employed in this study, which enables the endogenously determined estimation of several breakpoints in the regression parameters, is used to identify structural breaks. The Bayesian Information Criterion is used to determine the ideal number of breaks.

Table 6: Structural Breakpoints

m = 1				2005		
m = 2				2005	2013	
m = 3			1994	2005	2013	
m = 4		1991	1998	2005	2013	
m = 5		1991	1998	2005	2013	
m = 6	1981	1988	1995	2004	2011	2018

Source: Author’s own calculation

Table 7: Information Criteria

m	0	1	2	3	4	5	6
RSS	1.88E+22	6.82E+21	6.71E+21	6.61E+21	6.61E+21	6.61E+21	7.05E+21
BIC	2.57E+03	2.52E+03	2.53E+03	2.54E+03	2.55E+03	2.55E+03	2.57E+03

Source: Author’s own calculation

The findings suggest a number of possible break dates; however, three structural breaks are shown to be best by model selection using the Bayesian Information Criterion as stated above. The dates of these breaks—roughly 1994, 2005, and 2013—indicate that different regimes existed during the sample period. Significant changes in the underlying data-generating process are shown by the break years of 2005 and 2013, which emerge consistently across alternate specifications. The highlighted breakpoints reflect shifts in India's

investment climate and exposure to international economic conditions, and they align with significant governmental and economic shifts. Therefore, accounting for these structural fractures improves the dependability of the ARDL long-run and short-run results and is necessary to prevent parameter instability and biased estimations.

Diagnostic and Stability Test

The effectiveness of the estimated ARDL model is evaluated by a series of diagnostic tests. The Ljung-Box test further supports the lack of serial dependency over several lags, while the Breusch-Godfrey serial correlation test is unable to reject the null hypothesis of no residual autocorrelation at the five percent significance level. There is no evidence of heteroskedasticity, according to the Breusch-Pagan test, indicating that the error variance is constant throughout the sample period. Furthermore, the null hypothesis that the residuals are normal is not rejected by the Shapiro-Wilk test. The robustness of the generated ARDL model is supported by the diagnostic results, which generally show no significant breaches of the traditional regression assumptions.

Table 8: Diagnostic Tests

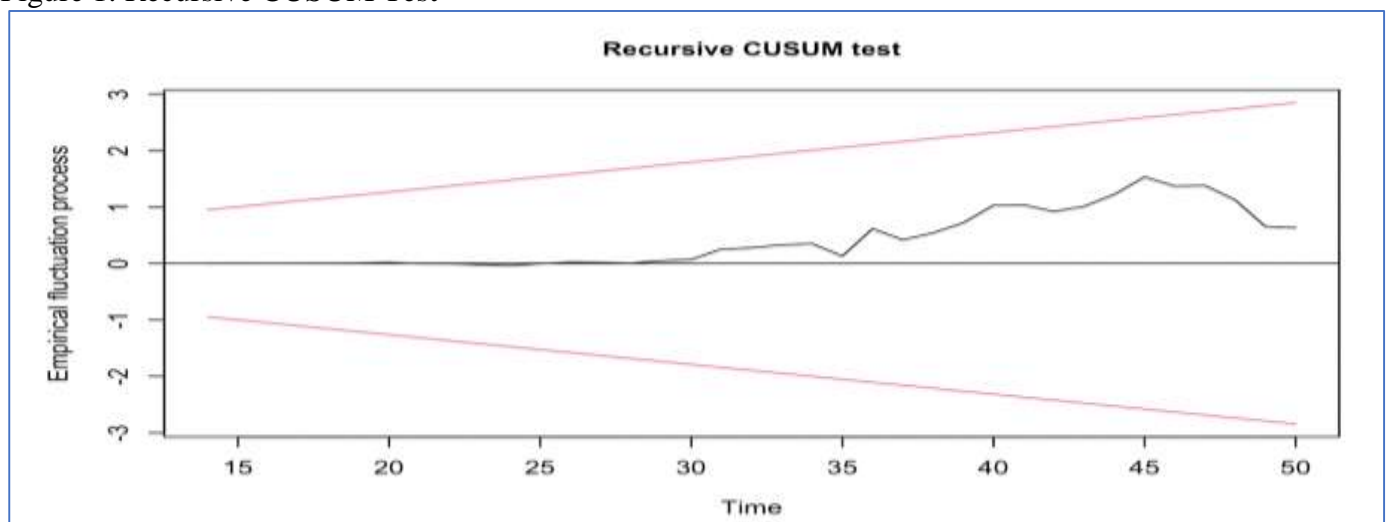
Diagnostic Tests	Test Statistics	P Value
Breusch-Godfrey Test	3.1476	0.08556
Ljung-Box Test	1.3702	0.2418
Breusch-Pagan Test	19.394	0.1114
Shapiro-Wilk test	0.97392	0.3706

Source: Author’s own calculation

The recursive CUSUM test is used to further investigate the stability of the predicted ARDL model. The findings show that there is no indication of parameter instability because the cumulative total of recursive residuals stays within the 5 percent critical boundaries during the sample period. This result suggests that, despite previously identified structural regime shifts, the predicted coefficients remain stable over time. As a result, it is possible to regard the short-run and long-run ARDL estimations as robust and dependable for inference. The CUSUM test’s confirmation of stability indicates that regime variations in the underlying connection

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Figure 1: Recursive CUSUM Test



Source: Author’s own calculation

Discussion

The empirical results offer a sophisticated understanding of how foreign direct investment, geopolitical risk, and economic growth in India are related. The findings imply that while geopolitical risk does not immediately affect foreign investment inflows, its long-term negative effects on FDI reveal that chronic uncertainty deters long-term investment commitments. When geopolitical concerns become persistent rather than fleeting, multinational corporations reevaluate their investment choices, which is reflected in this delayed response. Due to cyclical dynamics, the sectoral makeup of growth, or an increased reliance on domestic investment during expansionary phases, economic growth does not produce immediate positive effects in the short term and may even temporarily dampen FDI.

The discovery of several structural regime alterations emphasises the fact that the relationship between investment, risk, and growth is not constant over time, highlighting the significance of taking institutional and policy changes into consideration when examining FDI behaviour. Overall, the results highlight that long-term economic growth continues to be a critical component in increasing a nation's appeal to foreign investors, while maintaining geopolitical stability and policy legitimacy is essential for sustaining foreign investment inflows. These findings imply that, especially in an increasingly unstable global context, policy initiatives targeted at lowering uncertainty and bolstering institutional stability can be crucial in drawing in foreign investment.

Conclusion

Using an ARDL paradigm that takes structural regime transitions into account and permits both short-run dynamics and long-run equilibrium linkages, this study investigated the relationship between foreign direct investment inflows, geopolitical risk, and economic development in India. The empirical findings support the existence of a consistent long-term correlation between the variables, with geopolitical risk gradually becoming a significant determinant of foreign investment choices. Although geopolitical uncertainty may not immediately affect FDI inflows, its enduring character deters investment over the medium to long term, underscoring foreign investors' sensitivity to long-term risk circumstances rather than transient disruptions. Long-term economic growth is observed to encourage foreign direct investment, highlighting the importance of solid macroeconomic fundamentals and growth prospects in drawing in foreign investment. However, the lack of favourable short-term effects of growth on FDI indicates that expansionary phases do not always result in instantaneous increases in foreign investment; this could be because of sectoral growth characteristics or cyclical adjustments. The discovery of several structural breaks further suggests that the link between investment, risk, and growth is susceptible to regime shifts, highlighting the significance of institutional continuity and policy stability in influencing investor confidence.

Overall, the results indicate that sustained foreign investment inflows depend on policies that lower geopolitical uncertainty, bolster institutional legitimacy, and preserve long-term economic growth. This work adds to a more comprehensive understanding of the dynamics regulating foreign direct investment (FDI) in an environment marked by changing geopolitical and economic situations by explicitly accounting for structural breaks and model stability. In order to better understand investment behaviour in emerging economies, future research may expand this analysis by adding sector-specific FDI flows or different metrics of geopolitical risk.

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