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UNRAVELLING CAPITAL CURRENTS AMIDST GEOPOLITICAL SHIFTS

23

Thesis Submitted in Partial Fulfilment of the Requirements for the Degree of

MASTER OF ARTS

in

ECONOMICS

by

Gaura Kandpal

(Roll no. 24/MAE/08)

Under the Supervision of

Dr. Rajiv Arora Assistant Professor, USME



University School of Management and Entrepreneurship

DELHI TECHNOLOGICAL UNIVERSITY
(Formerly Delhi College of Engineering)
Shahbad Daulatpur, Main Bawana Road, Delhi-110042, India

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Gaura Kandpal

24/MAE/08

DELHI TECHNOLOGICAL UNIVERSITY
(Formerly Delhi College of Engineering)
Shahbad Daulatpur, Main Bawana Road, Delhi-42

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I Gaura Kandpal (24/MAE/08) hereby certify that the work which is being presented in the thesis entitled **"UNRAVELLING CAPITAL CURRENTS AMIDST GEOPOLITICAL SHIFTS"** in partial fulfilment of the requirements for the award of the degree of Master's in Arts, submitted in the USME, Delhi Technological University is an authentic record of my own work carried out during the period from July 2025 to June 2026 under supervision of Dr. Rajiv Arora.

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ABSTRACT

Foreign Direct Investment (FDI) plays a vital role in economic growth, technology transfer, employment generation, and global integration, particularly in emerging economies such as India. This study examines the impact of geopolitical risk and key macroeconomic factors on FDI inflows into India during the period 1991–2024. Using annual time-series data from the CEIC Global Database, the study employs an Ordinary Least Squares (OLS) regression model to analyse the relationship between FDI inflows and the Geopolitical Risk (GPR) Index, GDP per capita, inflation, Consumer Price Index (CPI), and exchange rate.

The results indicate that the model possesses strong explanatory power, accounting for approximately 89% of the variation in FDI inflows. GDP per capita positively influences FDI, in contrast, inflation and exchange rate depreciation exhibit negative effects, suggesting that macroeconomic instability discourages foreign investors. The Geopolitical Risk Index is found to have a statistically significant negative impact on FDI inflows, confirming that increased geopolitical uncertainty reduces investor confidence and discourages long-term investment commitments.

The study concludes that maintaining macroeconomic stability, ensuring policy predictability, and mitigating the effects of geopolitical uncertainty are essential for sustaining FDI inflows into India.

Keywords: Foreign Direct Investment, Geopolitical Risk, India, Macroeconomic Stability, OLS Regression.

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List of Abbreviations

AI	Artificial Intelligence
CEIC	Census and Economic Information Center Database
CPI	Consumer Price Index
ER	Exchange Rate
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act
FIPB	Foreign Investment Promotion Board
GDP	Gross Domestic Product
GPR	Geopolitical Risk Index
IPO	Initial Public Offering
IT	Information Technology
MSME	Micro, Small and Medium Enterprise
NCR	National Capital Region
OFDI	Outward Foreign Direct Investment
OLI	Ownership, Location and Internalisation Paradigm

OLS	Ordinary Least Squares
RBI	Reserve Bank of India
SEZ	Special Economic Zone
USD	United States Dollar
WTO	World Trade Organization

CHAPTER 1

Introduction, Background, and Identification of Problem

1.1 Background and Context

In an increasingly interconnected global economy, Foreign Direct Investment (FDI) has emerged as one of the most consequential channels through which capital, technology, and managerial expertise traverse national boundaries. Unlike portfolio investment, which is inherently speculative and short-horizon in nature, FDI represents a long-term commitment by a foreign entity to establish a productive presence in a host economy — making it a particularly sensitive barometer of investor confidence, macroeconomic stability, and geopolitical predictability. For emerging market economies, FDI inflows carry developmental significance that extends well beyond the balance of payments: they catalyse industrialisation, augment domestic capital formation, generate employment, and facilitate integration into global value chains. It is precisely this multiplicity of economic functions that has placed FDI at the centre of both academic inquiry and policy discourse in recent decades.

The global FDI landscape, however, has undergone a structural transformation in the twenty-first century. The post-Cold War era of relatively stable geopolitical order — which underpinned the explosive growth of multinational enterprise activity through the 1990s and 2000s — has given way to a more turbulent and multipolar world. The rise of economic nationalism, recurrent trade conflicts, regional military tensions, sanctions-driven decoupling, and the systemic disruptions wrought by the COVID-19 pandemic have collectively elevated geopolitical risk to a first-order determinant of global capital allocation. Multinational corporations, once guided

predominantly by factor cost differentials and market size, now increasingly factor geopolitical stability and policy predictability into their investment location decisions. This shift has rendered the traditional macroeconomic frameworks of FDI determination incomplete without an explicit account of geopolitical forces.

It is against this backdrop that the present study investigates the determinants of FDI inflows into India — one of the world's most consequential and complex emerging market economies. India occupies a distinctive position in the global investment landscape: it is simultaneously one of the fastest-growing large economies, a major recipient of global FDI, and a nation situated at the epicentre of some of the most significant geopolitical fault lines of the contemporary era. Understanding how geopolitical risk, alongside conventional macroeconomic fundamentals such as GDP per capita, inflation, the Consumer Price Index, and the exchange rate, shapes FDI inflows into India is therefore a question of both theoretical and policy significance.

1.2 India's FDI Trajectory: A Structural Overview

India's experience with foreign direct investment over the past two and a half decades offers a rich empirical canvas for this investigation. The following analysis of India's FDI trends — across gross inflows, net inflows, repatriation, and outward investment — provides the factual foundation upon which the research questions of this study are constructed.

1.2.1 Gross FDI Inflows

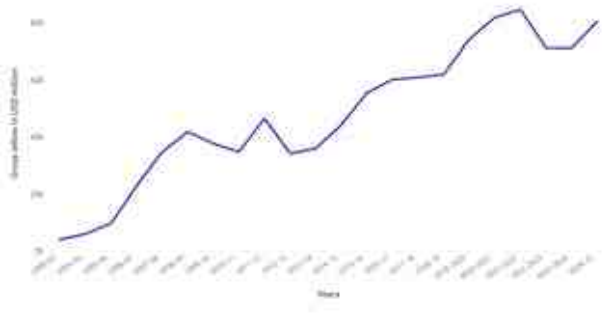


Figure 1.1: Trend in Gross FDI Inflows into India (2000–01 to 2024–25)

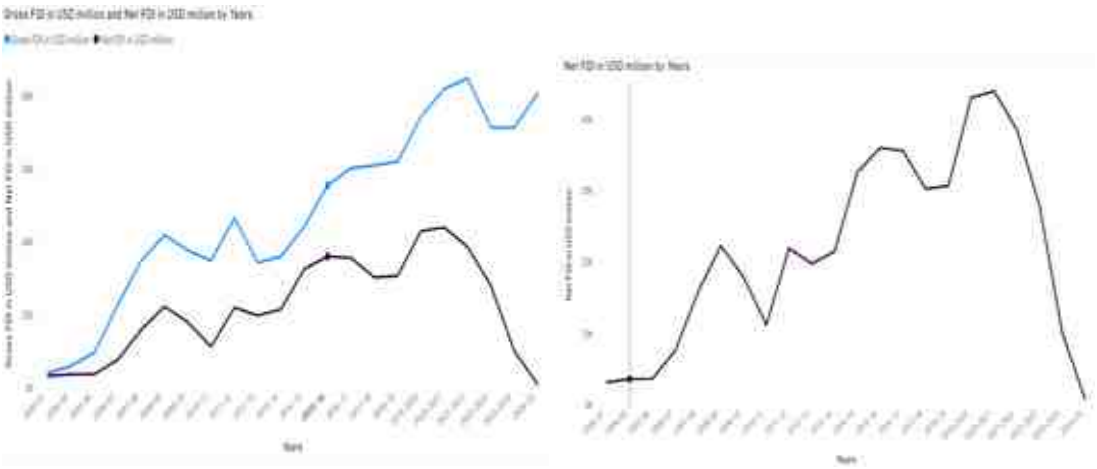
The trend in Gross Foreign Direct Investment (FDI) inflows into India from 2000–01 to 2024–25, measured in USD million, reflects a long-term upward trajectory, punctuated by periods of volatility, external shocks, and cyclical market behaviours. In the early 2000s, gross FDI inflows were relatively modest, starting below USD 5 billion. However, the mid-2000s marked a sharp acceleration in inflows, driven by India's liberalisation of FDI policies, global investor optimism, and strong domestic growth.

The sharp rise in FDI inflows during the mid-2000s was driven by several landmark liberalisation measures. India eased sectoral caps and allowed automatic route entry in key sectors like telecom (up to 74%), construction, real estate, and single-brand retail. The government also dismantled many FIPB restrictions, introduced tax incentives for SEZs through the SEZ Act of 2005, and improved investor protection under the FEMA regime, signalling a more open and stable policy environment. Between 2005–06 and 2008–09, gross FDI inflows saw a significant surge, climbing past USD 40 billion. This period coincided with the global liquidity boom and growing confidence in India's economic potential.

The global financial crisis of 2008–09 led to some moderation, with inflows stabilising around the USD 35–40 billion range during 2009–10 and 2010–11. A temporary rise in 2011–12 was followed by a sharp dip in 2012–13, likely reflecting concerns about India's macroeconomic stability, a weakening rupee, and policy uncertainty. However, from 2013–14 onward, the trend rebounded, particularly after the introduction of pro-investor reforms by the new government in 2014, including increased FDI limits in key sectors like defence, insurance, and railways.

Between 2015–16 and 2021–22, gross FDI inflows showed a strong and consistent upward trajectory, peaking at over USD 80 billion in 2021–22. This period coincided with a wave of digital investment, increased interest from sovereign wealth funds and venture capital, and a global push toward diversifying supply chains away from China — commonly known as the 'China+1' strategy. India benefited from being seen as a stable and high-growth investment destination, especially in IT, fintech, and infrastructure. However, post-2021–22, the trend showed signs of plateauing, with gross inflows declining in 2022–23 and remaining flat in 2023–24, before recovering slightly in 2024–25.

1.2.2 Net FDI Trends



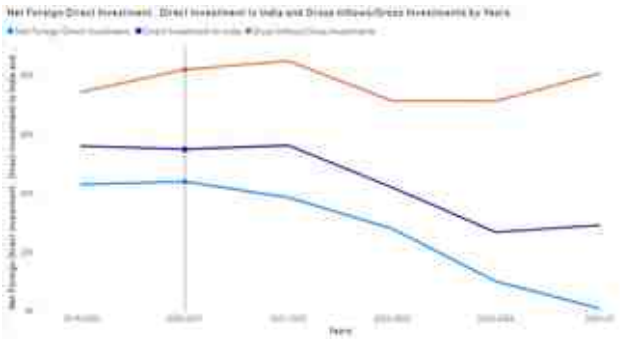


Figure 1.2: Trend in Net FDI Inflows into India (2000–01 to 2024–25)

1.2.2 Net FDI Trends

The trend in Net Foreign Direct Investment (FDI) inflows into India from 2000–01 to 2024–25, when combined with gross inflows, offers critical insights into the underlying structural changes and investor behaviour over time. The period from 2014–15 to 2020–21 marked a significant rise in both gross and net inflows, supported by a more liberalised FDI policy regime, introduction of the Make in India initiative, and broader improvements in the ease of doing business.

Yet, a critical divergence emerges post-2021–22. While gross inflows remained relatively high and stable, net FDI inflows began to decline sharply, plunging to almost negligible levels by 2024–25. This divergence can be explained by the simultaneous rise in repatriation and disinvestment of foreign capital from India. Foreign firms, while continuing to bring in capital, increasingly withdrew profits or divested their holdings, resulting in a steep fall in net retained investment.

The Reserve Bank of India's bulletins, especially those from FY 2023–24 and 2024–25, show a significant reversal in this trend. According to the bulletin published in July 2025, net FDI in FY 2024–25 dropped by 96% to just USD 0.4 billion,

compared to nearly USD 10 billion a year earlier. The RBI attributed this drop not to a fall in gross inflows — which remained relatively stable at over USD 80 billion — but to a surge in repatriation and disinvestment by foreign investors, which rose to over USD 51 billion.

1.2.3 Repatriation Trend

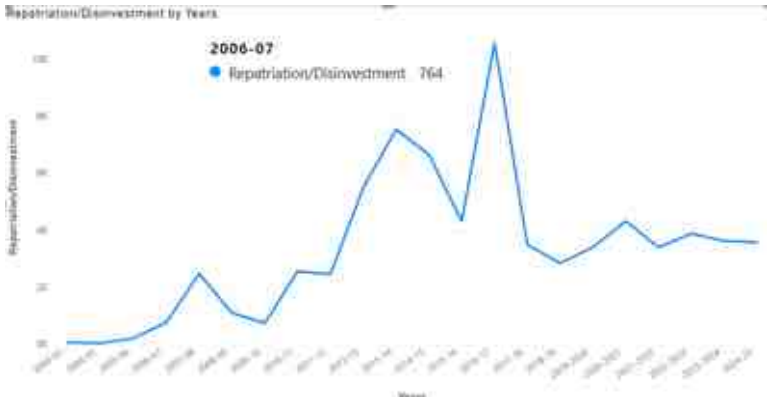


Figure 1.3: Trend in FDI Repatriation from India (2000–01 to 2024–25)

Recent patterns in India's repatriation and disinvestment data reveal a clear shift in global capital allocation, with large episodic spikes in withdrawals driven by both strategic corporate exits and monetisation by major financial investors. Over the past decade, multinationals such as Ford, GM, Vodafone, Whirlpool, and BAT have sold Indian assets, while private equity giants, sovereign funds, and large tech-focused investors — including SoftBank's Vision Fund — have exited stakes in Indian companies through IPOs and block trades.

One of the core reasons India is missing out on the new wave of AI-focused FDI is that it lacks a deep, product-oriented AI sector of its own. While India is globally respected for its IT services industry and produces a vast pool of AI talent,

the ecosystem remains heavily skewed toward outsourcing, SaaS, and consumer internet platforms, rather than capital-intensive AI product development. The absence of large-scale domestic compute infrastructure — such as public GPU clusters and advanced AI data centres — limits the ability of startups to train and deploy cutting-edge models at scale.

1.2.4 Outward FDI by Indian Firms

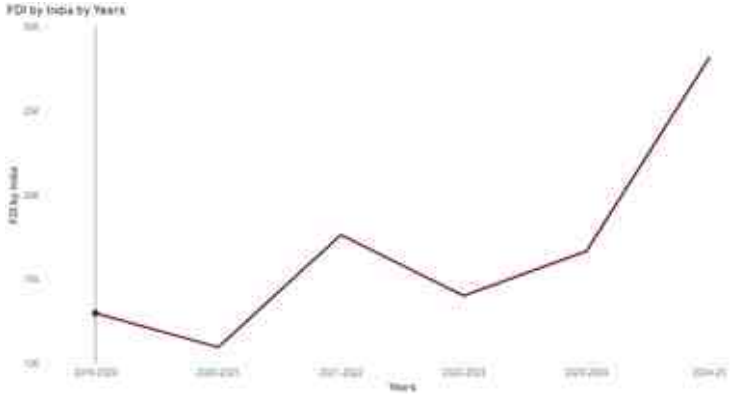


Figure 1.4: Trend in Outward FDI by Indian Firms (2000–01 to 2024–25)

The trend in outward FDI by Indian firms — representing investments made by Indian companies abroad — shows a clear and accelerating pattern that directly explains a significant part of the steep fall in Net FDI. Between 2019–20 and 2020–21, outward FDI remained relatively modest. However, from 2020–21 to 2021–22, there was a sharp spike in outward investment, rising from near USD 11 billion to almost USD 18 billion, which immediately began to erode Net FDI by widening the gap between direct investment inflows and Net FDI.

The most critical shift occurs after 2022–23, when outward FDI rises again, accelerating dramatically in 2024–25 to nearly USD 29 billion — the highest in the

observed period. India's outward FDI surge in 2024–25 was driven by a handful of large overseas acquisitions: Bharti Enterprises' purchase of a significant stake in BT Group in the UK, Tata Motors' acquisition of Iveco Group's truck and non-defence business in Italy, OYO's buyout of Motel 6 in the US, Sun Pharmaceutical's acquisition of Concert Pharmaceuticals, and Syngene's purchase of a biologics manufacturing facility in the US.

1.3 Identification of the Problem

Over the past five years, India's investment landscape has seen a clear divergence between gross FDI inflows, direct investment, and net FDI trends. Gross inflows have remained relatively stable, indicating that global investor interest in India's market potential has not drastically waned. However, direct investment has seen a marked decline, especially after 2021–22, suggesting that while capital is still coming in, a larger portion is being offset by foreign investors exiting or repatriating profits — pointing to concerns over the business environment, profitability, or global portfolio rebalancing.

The most notable decline has been in net FDI, driven by both the fall in direct investment and a surge in outward investments by Indian corporates. Traditional macroeconomic frameworks of FDI determination are thus rendered incomplete without an explicit account of contemporary geopolitical forces. There exists a pressing need to empirically investigate whether and to what extent the Geopolitical Risk Index — alongside established macroeconomic determinants such as GDP per capita, inflation, CPI, and exchange rate — explains the observed dynamics of FDI inflows into India.

1.4 Objectives of the Study

This study seeks to achieve the following objectives:

1. To examine how geopolitical risk affects FDI inflows into India over time.
2. To assess the influence of macroeconomic variables — including GDP per capita, inflation, the Consumer Price Index, and exchange rate — on FDI inflows.
3. To determine the relative importance of geopolitical risk compared to conventional macroeconomic factors as determinants of foreign investment in India.
4. To derive policy implications that can assist India in sustaining FDI inflows amidst conditions of global uncertainty.

1.5 Organisation of the Study

The remainder of this thesis is organised as follows. Chapter 2 presents a comprehensive review of the extant literature on FDI determinants, with specific attention to geopolitical dynamics. Chapter 3 develops the theoretical framework anchoring the empirical model. Chapter 4 details the data sources, variable definitions, and the econometric methodology employed. Chapter 5 presents and discusses the empirical findings. Chapter 6 concludes the study with a synthesis of results, policy recommendations, future research directions, and an assessment of the study's social impact.

CHAPTER 2

Review of Literature and Theoretical Framework

2.1 Introduction

The role of Foreign Direct Investment (FDI) has evolved from a mere capital bridging tool to a strategic instrument of economic integration and geopolitical influence. Contemporary literature increasingly examines FDI through the lens of shifting global dynamics, specifically focusing on how geopolitical fragmentation and supply-chain realignments affect investment stability and direction. This chapter reviews the major theoretical and empirical contributions to the literature on FDI determinants, identifies the gaps that motivate the present study, and presents the theoretical framework informing the empirical model.

2.2 Theoretical Foundations and Historical Evolution

Classical FDI theories, such as Dunning's (1977, 1988) OLI (Ownership, Location, Internalisation) Paradigm, suggest that firms invest abroad to exploit specific factor endowments and market access. The OLI framework postulates that a firm's decision to invest abroad is governed by three sets of advantages: Ownership (O), Location (L), and Internalisation (I). Of particular relevance to this study is the Location advantage, which encompasses the host country's macroeconomic environment, market size, factor costs, institutional quality, and political stability. A deterioration in geopolitical conditions, rising inflation, or exchange rate volatility directly undermines the location-specific attractiveness of a host economy, thereby discouraging inward FDI.

Historically, India's FDI regime transitioned from a restrictive, negative-list approach before 1991 to a progressively liberalised environment characterised by automatic approval routes for most sectors. Early literature focused on FDI as a catalyst for industrial growth and a non-debt-creating source of foreign exchange. Since the 1991 reforms, studies have consistently found a positive correlation between FDI and GDP growth, with foreign capital driving productivity through technology diffusion and managerial expertise (Anand, 2014; Singh, 2010).

2.3 Market Size and Economic Development as FDI Determinants

A foundational proposition in FDI theory, traceable to the work of Linder (1961) and later formalised within the gravity model tradition by Bergstrand (1985) and Helpman and Krugman (1985), posits that market size is among the most robust attractors of foreign capital. Larger markets offer greater revenue potential, economies of scale, and demand absorption capacity — all of which lower the risk-adjusted cost of foreign entry. GDP per capita, employed as a proxy for market size and economic development in this study, captures both the purchasing power of consumers and the productive sophistication of the host economy.

Dunning and Lundan (2008) further categorised this form of investment as market-seeking FDI, wherein multinational enterprises target economies with large and growing consumer bases. Empirical corroboration for this relationship is abundant, with studies by Asiedu (2002) and Chakrabarti (2001) consistently identifying GDP per capita as a statistically significant and positive determinant of FDI inflows across both developed and developing economies.

2.4 Macroeconomic Stability: Inflation, CPI, and Exchange Rate

The role of macroeconomic stability in attracting FDI is well-established in both theoretical and empirical literature. Mundell (1963), in his foundational work on capital mobility, argued that macroeconomic instability — manifested through price volatility and exchange rate misalignments — constitutes a structural impediment to cross-border capital flows. Hymer (1976) emphasised that foreign firms, operating under informational asymmetries relative to domestic incumbents, are particularly sensitive to macroeconomic uncertainty, as such uncertainty amplifies the cost of foreign operations disproportionately.

Inflation and the Consumer Price Index (CPI) serve as barometers of domestic price stability. Persistently high inflation erodes the real returns on investment, distorts relative prices, and signals fiscal and monetary mismanagement — conditions antithetical to the long-horizon commitments that FDI typically entails. Asiedu (2006) and Demirhan and Masca (2008) empirically demonstrated that inflation bears a significant negative relationship with FDI inflows, particularly in developing economies where monetary credibility is fragile.

The exchange rate constitutes another pivotal macroeconomic variable in FDI theory. Cushman (1985) formally introduced exchange rate uncertainty into the theory of FDI, arguing that real exchange rate volatility increases the option value of waiting, thereby deterring irreversible investment commitments. Blonigen (1997) extended this analysis by demonstrating that currency depreciations can, under certain conditions, attract FDI by reducing the relative cost of acquiring host-country assets — a mechanism particularly relevant for mergers and acquisitions-driven FDI.

2.5 Geopolitics as a Determinant of Investment Flows

Recent literature identifies a paradigm shift where geopolitical considerations often supersede traditional economic determinants like labour cost or market size. The 'China+1' strategy — a global supply chain diversification effort driven by US-China decoupling — is a recurring theme in modern assessments. Analysts argue that geopolitical disruptions have redirected capital from traditional manufacturing hubs towards resilient emerging markets like India.

The integration of geopolitical risk into FDI theory finds its intellectual roots in the broader literature on investment under uncertainty. Dixit and Pindyck (1994), in their seminal treatise on real options theory, demonstrated that irreversible investments — of which FDI is a quintessential example — are particularly susceptible to uncertainty. When geopolitical conditions are volatile, the value of the option to delay investment rises, inducing firms to withhold capital commitments until the uncertainty resolves. This 'wait-and-see' behaviour implies that geopolitical risk exerts a negative and potentially nonlinear effect on FDI inflows.

Caldara and Iacoviello (2022), whose Geopolitical Risk (GPR) Index is employed in this study, provided a systematic quantification of geopolitical threats — encompassing wars, terrorism, and interstate tensions — and demonstrated empirically that spikes in the index are associated with measurable contractions in global investment and economic activity. Their findings are theoretically consistent with Kobrin's (1979) political risk framework, which argued that the host country's political environment is a first-order determinant of FDI location, operating through the channels of expropriation risk, policy uncertainty, and erosion of property rights.

2.6 The FDI Paradox: Gross vs. Net Inflow Dynamics

A critical emerging area in the literature is the divergence between gross FDI inflows and net FDI retention. Recent data from the Reserve Bank of India highlights a steep decline in net FDI, which collapsed by approximately 96% in FY 2024–25 compared to the previous year. Scholars attribute this 'FDI Paradox' to surging repatriations, foreign investor exits through IPOs, and rising outward FDI by Indian corporates seeking technology and market access abroad. This suggests that India's challenge has shifted from merely attracting capital to retaining it amidst episodic spikes in disinvestment.

2.7 Sectoral Skewness and Regional Disparities

The literature highlights a significant concentration of FDI in knowledge-intensive sectors, particularly Computer Software and Hardware, which attracted the largest share of equity inflows (17.9%) between 2000 and 2024. While manufacturing-linked sectors like Automobiles and Pharmaceuticals have grown, the overall composition remains services-led. Furthermore, research underscores a persistent regional imbalance. FDI inflows are highly concentrated in a few states, with Maharashtra, Karnataka, and Delhi NCR accounting for a disproportionately high share. Lagging states in eastern and northern India attract limited inflows due to infrastructure deficiencies and institutional constraints, perpetuating spatial inequality.

2.8 Gaps in the Literature

Despite the extensive research on FDI in India, several significant gaps remain that warrant further investigation:

1. Lack of AI and Deep-Tech Specific Studies: Current literature focuses on broad sectoral categories like 'Computer Services.' There is a critical gap in understanding how the lack of a strong AI and product-led deep-tech ecosystem in India contributes to capital reallocation towards advanced economies.
2. Long-term Impact of Outward FDI: While the rise in Indian firms investing abroad is noted, there is limited research on whether this outward flow strengthens the domestic base through technology transfer or primarily acts as a drain on net capital formation.
3. MSME Integration and Spillovers: While the positive impact of FDI on large-scale productivity is well-documented, the weak integration of foreign enterprises with local MSMEs remains under-researched.
4. Geopolitical Risk Quantification at the Sector Level: Most studies treat geopolitical risk as a macro-variable. There is a need for research quantifying how specific geopolitical shocks impact different sectors — manufacturing versus digital services — differently.
5. Quality vs. Volume Metrics: Existing literature relies heavily on volume-driven data (gross inflows). There is a lack of comprehensive frameworks evaluating 'Quality FDI' based on net retained investment, job creation per dollar invested, and backward linkages to domestic supply chains.
6. Sub-National Policy Effectiveness: While regional disparities are noted, there is a lack of comparative analysis on why certain state-level single-window clearances succeed while others fail to attract foreign capital despite offering similar fiscal incentives.

2.9 Synthesis and Theoretical Positioning

The variables selected in this study are not theoretically arbitrary but are each grounded in well-established strands of FDI theory. Dunning's (1977, 1988) OLI

paradigm provides the overarching architecture, within which GDP per capita captures location-specific market advantages, inflation and CPI reflect macroeconomic stability conditions, the exchange rate encapsulates currency risk and cost competitiveness, and the GPR index operationalises the political and geopolitical dimensions of the investment environment. The synthesis of these frameworks supports a multi-factor model of FDI determination, wherein both conventional macroeconomic fundamentals and contemporary geopolitical disruptions jointly shape the cross-border investment landscape.

CHAPTER 3

Research Methodology and Data

3.1 Introduction

This chapter describes the research design, data sources, variable definitions, model specification, and the econometric methodology employed to investigate the determinants of FDI inflows into India. The chapter proceeds from a description of the data and sample to the formulation of testable hypotheses and the diagnostic criteria used to validate the estimated model.

3.2 Data Sources and Sample

This study draws on secondary time-series data sourced from the CEIC Global Database, a comprehensive macroeconomic data repository widely used in empirical international economics research. The dataset comprises six key variables: Foreign Direct Investment (FDI) inflows, Geopolitical Risk Index (GPR), Gross Domestic Product per capita (GDP per capita), Consumer Price Index (CPI), inflation rate, and exchange rate, collected at an annual frequency. The sample covers India from 1991 to 2024, yielding a total of 34 observations. The period beginning in 1991 was selected because it marks the initiation of India's economic liberalisation reforms, which significantly altered the country's investment climate and integration into the global economy.

3.3 Variable Description

The variables employed in this study are defined as follows:

3.3.1 Dependent Variable

FDI Inflows (lnFDI): Net inflows of foreign direct investment, measured in USD million. FDI serves as the primary outcome variable capturing the volume of cross-border investment flows into the host economy.

3.3.2 Independent Variables

Geopolitical Risk Index (GPR): Constructed by Caldara and Iacoviello (2022), the GPR index measures the frequency of geopolitical risk-related words in major international newspapers. Unlike the other variables, GPR is retained in its original level form, as it is already a standardised index and log-transformation is not appropriate for index values that may contain zeros or near-zero readings.

GDP per Capita (lnGDPPC): Measured in current USD, this variable proxies for market size, economic development, and the purchasing power of the host country — all of which are established determinants of FDI attractiveness.

Consumer Price Index (lnCPI): Captures the general price level within the economy. Rising CPI may reflect domestic inflationary pressures, which can erode investor returns and signal macroeconomic instability.

Inflation Rate (lnINFL): Measured as the annual percentage change in the general price level. Inflation is included as a distinct indicator of macroeconomic stability, which is a critical consideration for foreign investors evaluating long-term return prospects.

Exchange Rate (lnEXR): Defined as units of domestic currency per US dollar. Exchange rate movements affect the cost competitiveness of exports, repatriation of profits, and the relative cost of establishing operations, thereby influencing FDI location decisions.

Table 1: Summary of Variables, Sources, and Expected Signs

Variable	Symbol	Definition	Source	Expected Sign
FDI Inflows	lnFDI	Net FDI inflows (USD million)	CEIC Database	—
Geopolitical Risk Index	GPR	Index of geopolitical uncertainty	Caldara & Iacoviello (2022)	Negative
GDP per Capita	lnGDPPC	GDP per capita (current USD)	CEIC Database	Positive
Consumer Price Index	lnCPI	General price level index	CEIC Database	Negative
Inflation Rate	lnINFL	Annual % change in price level	CEIC Database	Negative
Exchange Rate	lnEXR	INR per USD	CEIC Database	Ambiguous

3.4 Log Transformation

Following standard econometric practice, all variables — with the exception of GPR — are converted to their natural logarithms prior to estimation. This transformation serves multiple purposes: it reduces heteroscedasticity, compresses the scale of variables with wide ranges, and allows the estimated coefficients to be directly interpreted as elasticities — that is, the percentage change in FDI for a one percent change in the respective regressor. The GPR index is retained in its original level form; its coefficient therefore represents the percentage change in FDI for a one-unit change in GPR.

3.5 Model Specification

To examine the determinants of FDI inflows, this study employs Ordinary Least Squares (OLS) Multiple Regression. The empirical model is specified as follows:

$$\mathbf{lnFDI = \beta_0 + \beta_1 GPR + \beta_2 lnGDPPC + \beta_3 lnCPI + \beta_4 lnINFL + \beta_5 lnEXR + \varepsilon}$$

Where lnFDI is the natural log of FDI inflows; GPR is the Geopolitical Risk Index in levels; lnGDPPC is the natural log of GDP per capita; lnCPI is the natural log of the Consumer Price Index; lnINFL is the natural log of the inflation rate; lnEXR is the natural log of the exchange rate; β_0 is the intercept term; β_1 through β_5 are slope coefficients capturing the marginal effect of each explanatory variable on FDI; and ε is the stochastic error term.

The present study employs OLS multiple regression as the primary estimation technique for several methodological reasons. Since the analysis is confined to a single country — India — panel data methods such as Fixed Effects or Random Effects models are rendered inapplicable, as these are designed to exploit cross-sectional variation across multiple units. OLS is well-suited for this context as it efficiently captures the temporal relationship between FDI inflows and the selected macroeconomic and geopolitical determinants over the study period. Provided the diagnostic tests confirm the absence of severe multicollinearity, autocorrelation, and heteroscedasticity, OLS remains the most parsimonious and appropriate estimator for time-series data of a single emerging economy like India.

3.6 Hypothesis Development

Based on the theoretical framework and existing literature, the following null and alternative hypotheses are tested:

- Exchange Rate — H_0: Exchange rate has no significant effect on FDI inflows into India; H_1: Exchange rate significantly affects FDI inflows into India.

- Inflation — H_0: Inflation has no significant effect on FDI inflows into India; H_1: Inflation significantly affects FDI inflows into India.
- Geopolitical Risk — H_0: Geopolitical risk has no significant effect on FDI inflows into India; H_1: Geopolitical risk significantly affects FDI inflows into India.
- GDP per Capita — H_0: GDP per capita has no significant effect on FDI inflows into India; H_1: GDP per capita significantly affects FDI inflows into India.

3.7 Model Evaluation Criteria

The estimated model is evaluated using the following statistical measures:

7. Coefficient of Determination (R^2) to assess the explanatory power of the model.
8. Adjusted R^2 to account for the number of explanatory variables and penalise overfitting.
9. F-statistic to test overall model significance — whether the regressors jointly explain FDI inflows.
10. t-statistics and p-values to assess the individual statistical significance of each coefficient.
11. Confidence intervals to evaluate the precision of the coefficient estimates.

Additionally, a restricted and unrestricted model framework is employed to assess the specific contribution of the Geopolitical Risk Index. The unrestricted model includes the GPR variable, while the restricted model excludes it. Comparison of model fit statistics provides evidence regarding the incremental explanatory power of geopolitical risk as a determinant of FDI inflows.

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CHAPTER 4

Findings, Results, and Discussion

4.1 Introduction

This chapter presents and discusses the empirical findings from the OLS multiple regression analysis. The results are organised around model fit, the significance and direction of individual coefficients, and the economic interpretation of each finding in light of the theoretical expectations and existing literature reviewed in the preceding chapters.

4.2 Descriptive Overview of Variables

The analysis is based on 34 annual observations spanning India's post-liberalisation period from 1991 to 2024. FDI inflows, after log transformation, exhibit a broad upward trend over the period, interrupted by episodic contractions corresponding to the global financial crisis (2008–09) and the post-pandemic monetary tightening cycle (2022–24). The GPR index shows significant time-variation, with notable spikes around major geopolitical events including the post-9/11 period, the Iraq War, and recent Russia-Ukraine tensions.

Table 2: Descriptive Statistics of Variables

	FDI ln	ER	Inflation rate ln	Average of GPR Index	GDP pr cap ln
count	34.000000	34.000000	34.000000	34.000000	34.000000
mean	9.202912	51.410296	1.860154	0.204711	10.589784
std	1.709306	16.463989	0.425965	0.070397	1.044132
min	4.317488	22.742433	1.202424	0.071908	8.803940
25%	8.186874	41.775257	1.478745	0.155837	9.788115
50%	10.115694	46.626875	1.848430	0.198004	10.561834
75%	10.566741	64.879163	2.235480	0.244907	11.527392
max	11.072284	83.669282	2.629746	0.396849	12.252326

4.3 OLS Regression Results

Table 2 presents the estimated coefficients, standard errors, t-statistics, p-values, and 95% confidence intervals for the full OLS regression model. The dependent variable is the natural log of net FDI inflows (lnFDI).

Table 2: OLS Regression Results — Determinants of FDI Inflows into India (1991–2024)

Variable	Coefficient	Std. Error	t-Statistic	p-Value	Significance
Intercept (β_0)	-17.0120	2.729	-6.235	0.000	1%
Exchange Rate (lnEXR)	-0.1106	0.025	-4.485	< 0.01	1%
Inflation Rate (lnINFL)	-0.5294	0.096	-1.790	0.084	5%
Geopolitical Risk (GPR)	-3.5617	1.579	2.256	0.032	5%
GDP per Capita (lnGDPPC)	3.0364	0.368	8.254	< 0.01	1%

*Note: ***, **, and * denote significance at the 1%, 5%, and 10% levels respectively. $R^2 = 0.890$; Adjusted $R^2 = 0.874$; F-statistic = 58.41 ($p = 1.85 \times 10^{-13}$).*

4.4 Model Fit and Overall Significance

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The regression model demonstrates strong explanatory power, with an R-squared value of 0.890 and an adjusted R-squared of 0.874. This indicates that approximately 89% of the variation in FDI inflows into India is explained by the included macroeconomic and geopolitical variables. The high adjusted R-squared confirms that the model retains strong explanatory power even after adjusting for the number of regressors. The F-statistic is 58.41, with a probability value of 1.85×10^{-13}, indicating that the model is statistically significant at the 1% level. The joint effect of all explanatory variables is thus highly significant in explaining FDI inflows.

4.5 Exchange Rate

The coefficient of the exchange rate is -0.1106, which is statistically significant at the 1% level ($p < 0.01$). This indicates that a depreciation in the domestic currency is associated with a decline in FDI inflows. Economically, this finding suggests that exchange rate instability or depreciation may discourage foreign investors due to increased uncertainty and reduced expected returns when converted into foreign currency terms. The result is consistent with the theoretical argument of Cushman (1985) that exchange rate uncertainty increases the option value of waiting, thereby deterring irreversible investment commitments. For India, the finding underscores the importance of exchange rate stability in attracting long-term capital inflows, even though asset-pricing theory would predict a stimulative effect of currency depreciation on FDI through cheaper asset acquisition.

4.6 Inflation Rate

The inflation rate carries a negative coefficient of -0.5294, although it is only marginally significant at the 10% level (p = 0.084). This suggests that higher inflation tends to discourage FDI inflows, consistent with macroeconomic theory, as inflation reflects macroeconomic instability and reduces investor confidence. The weaker statistical significance, however, indicates that inflation may not be a dominant determinant of FDI inflows in the presence of other macroeconomic controls. This finding is broadly consistent with Asiedu (2006) and Demirhan and Masca (2008), who demonstrated that inflation bears a significant negative relationship with FDI inflows particularly in developing economies. The marginal significance in this study may reflect the relatively successful inflation management in India over parts of the sample period, particularly following the adoption of inflation targeting in 2016.

4.7 Geopolitical Risk Index

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The Geopolitical Risk (GPR) Index exhibits a negative and statistically significant relationship with FDI inflows, with a coefficient of -3.5617 (p = 0.032). This indicates that an increase in global geopolitical risk leads to a decline in FDI inflows into India, holding all other variables constant. This result aligns with standard theoretical expectations rooted in Dixit and Pindyck's (1994) real options theory, as well as the empirical findings of Caldara and Iacoviello (2022), who demonstrated that spikes in the GPR index are associated with measurable contractions in global investment and economic activity.

Economically, higher geopolitical uncertainty increases perceived risk for multinational investors, reduces expected risk-adjusted returns, and prompts firms to delay or reallocate foreign investment to safer environments. In the specific context of

India, geopolitical developments — including regional border tensions, trade policy shifts, and bilateral diplomatic realignments — have periodically altered investor sentiment, making the GPR a theoretically and empirically pertinent variable. The magnitude of the coefficient (-3.5617) underscores that geopolitical risk is not merely a peripheral concern but a quantitatively significant determinant of FDI inflows into India.

The null hypothesis that geopolitical risk has no significant effect on FDI inflows into India is therefore rejected at the 5% level of significance. This finding carries important policy implications: a stable and predictable geopolitical environment is not merely a diplomatic aspiration but a prerequisite for sustaining the capital inflows that fund India's developmental ambitions.

4.8 GDP per Capita

GDP per capita, as the proxy for market size and economic development, is found to be a positive and highly significant determinant of FDI inflows ($p < 0.01$). This result is consistent with the market-seeking FDI hypothesis articulated within Dunning and Lundan's (2008) OLI paradigm, and corroborates the extensive empirical evidence from Asiedu (2002) and Chakrabarti (2001). As India's per capita income grows, it enhances the country's attractiveness as a consumer market, increases the productive sophistication of the domestic economy, and signals improving living standards — all of which augment the location-specific advantages that attract multinational enterprises.

4.9 Discussion

The results collectively suggest that FDI inflows into India are shaped by a constellation of macroeconomic and geopolitical forces, consistent with the multi-factor theoretical framework developed in Chapter 2. Among the variables examined, GDP per capita emerges as the dominant positive determinant, reflecting the centrality of market size and economic development to India's investment attractiveness. Exchange rate stability, inflation management, and a benign geopolitical risk environment are each shown to be necessary — though not individually sufficient — conditions for sustaining robust FDI inflows.

The negative and significant effect of geopolitical risk is of particular policy salience. It suggests that India's FDI trajectory is not insulated from global political turbulence, even when its macroeconomic fundamentals remain sound. This finding resonates with the observed post-2021–22 stagnation in net FDI, which coincided with a marked deterioration in the global geopolitical environment following the Russia-Ukraine conflict, heightened US-China tensions, and realignments in global supply chains. The implication for policymakers is clear: proactive diplomatic positioning, multilateral engagement, and the cultivation of a reputation for geopolitical predictability are as important as domestic economic reforms in sustaining the momentum of foreign capital inflows.

CHAPTER 5

Conclusion, Future Scope and Social Impact

5.1 Summary of Findings

This study set out to investigate the determinants of Foreign Direct Investment inflows into India over the period 1991 to 2024, with particular focus on the role of geopolitical risk alongside conventional macroeconomic fundamentals. Employing an OLS multiple regression framework on annual time-series data, the analysis yields several key findings.

First, the model demonstrates strong overall explanatory power, accounting for approximately 89% of the variation in FDI inflows, with the F-statistic confirming joint significance at the 1% level. Second, GDP per capita emerges as the most robust positive determinant of FDI inflows, consistent with market-seeking investment theory and the broader literature on location-specific advantages. Third, exchange rate depreciation is found to deter FDI inflows at the 1% significance level, underscoring the importance of currency stability for long-term investor confidence. Fourth, inflation exerts a negative influence on FDI, though with weaker statistical significance, suggesting that it operates as a background macroeconomic signal rather than a primary driver. Fifth, and most significantly, the Geopolitical Risk Index is found to exert a negative and statistically significant effect on FDI inflows, with a coefficient of -3.5617 ($p = 0.032$), confirming that geopolitical uncertainty constitutes an independent and quantitatively meaningful deterrent to foreign investment in India.

5.2 Conclusions

The findings of this study carry several important conclusions for understanding India's FDI dynamics. The strong negative effect of geopolitical risk challenges the conventional approach of treating FDI determinants in purely macroeconomic terms. Global political instability — encompassing interstate conflicts, trade wars, diplomatic ruptures, and terrorism — imposes real economic costs on cross-border investment by elevating perceived risk, shortening investment horizons, and inducing multinational firms to exercise real options by delaying or redirecting capital. India, situated at the confluence of several significant geopolitical fault lines, is particularly exposed to this transmission mechanism.

The results also highlight a structural challenge facing the Indian economy: the widening divergence between gross and net FDI inflows. Even as India continues to attract headline FDI, the surge in repatriation, disinvestment, and outward investment by Indian corporates has eroded net retained capital. Addressing this challenge requires a policy framework that goes beyond merely attracting capital — it must create conditions that encourage long-term retention, reinvestment, and deepening of productive linkages between foreign and domestic firms.

To address these challenges, India needs a dual strategy. On the inward side, reducing policy unpredictability, improving contract enforcement, and accelerating infrastructure upgrades can help retain foreign capital. On the outward side, while global expansion of Indian firms should not be discouraged, policies that promote joint ventures, technology transfer agreements, and in-market R&D partnerships could ensure that outward investments also strengthen India's domestic industrial base.

5.3 Policy Recommendations

Based on the empirical findings and the broader structural analysis, the following policy recommendations are advanced:

12. Geopolitical Risk Mitigation: India should invest in proactive multilateral diplomacy, strengthen bilateral investment treaty frameworks, and cultivate a reputation for geopolitical predictability. Engagement in regional and global forums — QUAD, G20, and ASEAN — can help signal stability and reduce the risk premium perceived by foreign investors.
13. Exchange Rate Management: The Reserve Bank of India should maintain a managed float regime with active intervention to prevent excessive exchange rate volatility, particularly during periods of global financial stress. Predictable exchange rate dynamics reduce the option value of waiting and encourage irreversible FDI commitments.
14. Inflation Targeting: Continued adherence to the inflation targeting framework, with the RBI's mandated target of 4% (+/-2%), is essential for maintaining macroeconomic credibility and providing a stable pricing environment for long-term investment.
15. AI and Deep-Tech Ecosystem Development: To capture the next wave of global FDI, India must urgently develop a dedicated AI industrial mission, scale up public compute infrastructure, establish robust data governance frameworks, and foster patient capital for deep-tech ventures. Without these foundations, India risks remaining a services hub that trains AI talent for the rest of the world.
16. Capital Retention Policies: India should develop targeted incentives to encourage foreign investors to reinvest profits domestically rather than repatriate them, including sector-specific reinvestment tax credits, long-term visa and establishment security guarantees, and streamlined exit-and-reinvestment mechanisms.

5.4 Limitations of the Study

This study is subject to several limitations that should be acknowledged. First, the sample size of 34 annual observations, while spanning the entire post-liberalisation period, limits the statistical power of the analysis and constrains the application of more sophisticated time-series techniques such as Vector Autoregression or Cointegration analysis. Second, the OLS framework, while appropriate given the single-country design, cannot fully capture potential nonlinearities, structural breaks, or feedback effects in the FDI-geopolitical risk relationship. Third, the GPR index, constructed from English-language newspaper coverage, may not fully capture the geopolitical risks specific to South Asia or the India-specific diplomatic context. Fourth, the absence of disaggregated sectoral FDI data prevents an assessment of whether geopolitical risk affects manufacturing, services, and digital sectors differentially.

5.5 Future Scope of Research

The findings and limitations of this study suggest several productive directions for future research. First, future studies could employ a more granular monthly or quarterly dataset, enabling the application of time-series techniques — including autoregressive distributed lag (ARDL) models, threshold cointegration, and structural break tests — that can capture the dynamic and potentially nonlinear relationship between geopolitical risk and FDI. Second, a sector-level analysis of FDI determinants would enrich understanding of how geopolitical shocks differentially affect capital-intensive manufacturing, digital services, infrastructure, and deep-tech sectors, each of which may respond to geopolitical risk through distinct transmission channels. Third,

a comparative cross-country study placing India alongside peer emerging economies — Vietnam, Mexico, Brazil, and Indonesia — would illuminate the extent to which India's geopolitical risk sensitivity is distinctive or reflects broader developing-country patterns. Fourth, qualitative research methods, including structured interviews with multinational executives and investment promotion officials, could complement the econometric findings with insights into the decision-making processes through which geopolitical risk is assessed and incorporated into FDI location choices. Fifth, future research should specifically investigate the AI and deep-tech investment gap, examining why global AI-focused capital gravitates toward the US, EU, and certain East Asian economies rather than India, and what policy interventions could most effectively close this gap.

5.6 Social Impact

The social impact of this research extends across multiple dimensions, reflecting the centrality of FDI to India's developmental trajectory. At the most direct level, FDI inflows are a principal driver of employment creation — particularly in manufacturing and technology-intensive sectors — thereby contributing to poverty reduction, income growth, and upward social mobility for millions of Indian workers. Understanding the conditions under which FDI is attracted and retained is therefore not merely an academic exercise but a matter of direct welfare significance.

The finding that geopolitical risk deters FDI has indirect social implications as well. A reduction in FDI inflows, triggered by elevated geopolitical uncertainty, translates into slower capital formation, reduced technology transfer, and diminished integration into global value chains — all of which constrain India's long-run growth

potential. Given that India must generate approximately 8–10 million new jobs annually to absorb its demographic dividend, any structural impediment to the FDI flows that support industrialisation and services expansion carries profound social consequences.

The study also highlights the social cost of India's growing AI and deep-tech investment gap. As global capital increasingly flows toward AI product development, semiconductor manufacturing, and advanced computing — sectors in which India currently lacks the ecosystem to compete — the country risks falling behind in the next wave of technological transformation. This has distributional implications: while India's elite IT workforce may find opportunities abroad, the broader population stands to benefit less from the productivity gains, job creation, and income growth associated with AI-driven industrialisation unless corrective policies are pursued.

More broadly, by providing rigorous empirical evidence on the determinants of FDI inflows — and by quantifying the specific contribution of geopolitical risk — this study equips policymakers, investment promotion agencies, and diplomatic officials with an evidence base for designing more effective strategies to attract, retain, and leverage foreign capital in service of India's socioeconomic development goals. In this sense, the research's social impact lies not only in its direct findings but in the quality of policy discourse it is intended to inform

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