Navigating Geoeconomic Fragmentation: How Political Alignment Shapes Foreign Direct Investment to ASEAN

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Abstract

This research investigated how geopolitical alignment influences bilateral foreign direct investment (FDI) flows into ASEAN amid rising global fragmentation. We construct a geopolitical distance index using Principal Component Analysis (PCA) of United Nations General Assembly (UNGA) voting data and validate it against the Ideal Point Distance (IPD) metric. Using an extended gravity model with bilateral FDI data from 2010 to 2023, the research analysed the heterogeneous effects of geopolitical distance across regions, including the United States, European Union, China, Latin America, and intra-ASEAN partners. The results reveal contrasting dynamics: while EU FDI is positively associated with political alignment, US and Chinese FDI increase with increasing geopolitical distance, suggesting diverse geoeconomic strategies. These findings underscore ASEAN's strategic position as a resilient investment hub and offer new insights into the political economy of FDI in an era of global uncertainty. They also suggest that the impact of geopolitical alignment on investment is not uniform, but mediated by region-specific strategic logics, institutional ties, and the broader role of ASEAN in an increasingly fragmented global economy.

Keywords: Foreign Direct Investment, Geopolitical Distance, ASEAN, UNGA Voting, Gravity Model

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Introduction

Over the past decade, the international economy has entered a period of growing uncertainty and transformation. The rise of geopolitical tensions, the intensification of great-power rivalries, and the spread of protectionist policies have challenged the foundations of globalisation. While global trade has plateaued as a share of GDP, foreign direct investment (FDI), a key pillar of economic integration, has also stagnated. According to UNCTAD (2024), global FDI flows have decoupled from trade and output growth, and a rising share of investment is now directed toward countries aligned with geopolitics. This trend is increasingly referred to as the "geoeconomic fragmentation" of the world economy.

Geoeconomic fragmentation implies that political considerations are becoming more salient in shaping the geography of cross-border investments. Rather than seeking only efficiency or market access, firms and governments are now factoring in strategic trust, security risks, and the geopolitical positioning of host countries. In this context, alignment between investors and host countries, based on shared diplomatic postures, voting behaviour in international organisations, or participation in regional alliances, may act as a new determinant of FDI.

Much of the recent debate has centred on the concept of "friendshoring", whereby firms relocate production and investment to politically aligned or 'trusted' partners to reduce exposure to geopolitical risk (Aiyar et al., 2023; Alfaro & Chor, 2023). There is empirical evidence that FDI and trade are increasingly concentrated among aligned economies. UNCTAD (2024) estimates that between 2013 and 2022, the share of FDI flows between geopolitically distant countries declined by 10 percentage points. Recent studies also suggest that the realignment of global value chains (GVCs) is accelerating, as firms seek to reduce their dependence on countries deemed "risky" or politically misaligned. This reconfiguration is taking place across a wide range of sectors, from semiconductors to green technology and defence-related industries.

However, ASEAN presents a more complex and potentially distinct case. Unlike regions clearly embedded in one geopolitical camp, such as the European Union or North America, the Association of Southeast Asian Nations (ASEAN) occupies an intermediate position in the global order. ASEAN has emerged as a particularly attractive investment hub. Composed of ten diverse economies, ASEAN combines economic dynamism, institutional resilience, and a posture of deliberate neutrality in the US-China rivalry. Its strategic location, growing middle class, and deep integration into global supply chains have made ASEAN a key beneficiary of investment diversion from China, particularly under "China+1" strategies.

Despite a global FDI downturn, ASEAN attracted a record $235 billion in 2024, with Vietnam, Malaysia, and Indonesia emerging as the top recipients (UNCTAD, 2025). The region's ability to preserve political stability while maintaining openness to all major powers has made it a "safe harbour" for multinational enterprises navigating rising global uncertainty. Sectors such as electronics, renewable energy, digital infrastructure, and logistics have seen substantial investment inflows, underscoring ASEAN's growing importance on the global investment map.

However, not all regions of the world are equally engaged in this ASEAN investment boom. For instance, Latin America remains a marginal player in the region's FDI landscape, accounting for less than 0.1% of total FDI into ASEAN. This is striking, given the region's increasing interest in economic diversification and South–South cooperation. While Latin America has intensified investment ties with China (López et al., 2023) and, to a lesser extent, India, its investment linkages with Southeast Asia remain underdeveloped. This raises important questions about the factors behind Latin America's low economic presence in ASEAN.

One potential explanation lies in geopolitical alignment. Nevertheless, the possibility that geopolitical distance may be a barrier to investment has received little attention. In a context where FDI is increasingly mediated by strategic trust and political affinity, this omission becomes analytically and politically relevant. While the US, China, and the EU have increased their share of FDI in ASEAN in strategic sectors, Latin America continues to lag. This divergence suggests that it is not just a matter of geographical distance or market access, but of strategic and diplomatic decisions that condition the attraction and channelling of investment.

This research seeks to fill this gap by systematically examining how geopolitical alignment affects FDI flows into ASEAN from different world regions. Specifically, it investigates whether political distance, measured by voting patterns in the United Nations General Assembly (UNGA), acts as a significant determinant of bilateral FDI, and how different regions respond differently to geopolitical alignment. The research further explores to what extent does geopolitical distance affect FDI flows into ASEAN? Moreover, how does the sensitivity to geopolitical distance vary across investor regions, including Latin America, the United States, the European Union, and China?

To answer these questions, this research develops a geopolitical distance index based on a Principal Component Analysis (PCA) of UNGA votes between 2005 and 2023. Votes are coded as 1 (yes), 0 (abstain), or -1 (no), and PCA is used to construct a single dimension of ideological alignment. Each country receives an annual index score, rescaled from 0 (full alignment) to 10 (maximum distance), and bilateral geopolitical distance is calculated as the absolute difference between the two countries' scores. This metric captures both gradual shifts and regional divergences, and offers a transparent, tractable alternative to more complex ideal point models (Bailey et al., 2017)

This research makes three main contributions to the literature. First, empirically, it adds to the growing body of work on how geopolitics affects international investment. While several recent studies have examined trade reconfiguration and "friendshoring", fewer have focused on FDI, especially in a region as geopolitically salient as ASEAN. Second, methodologically, it introduces a geopolitical distance index based on PCA, which complements existing ideal-point estimation approaches by providing a simple, replicable tool for empirical analysis. The index can be updated annually and applied to a wide range of bilateral relations. Third, from a policy perspective, the paper provides actionable insights for governments. If geopolitical misalignment is indeed a barrier to FDI in ASEAN, then diplomatic engagement and strategic realignment could help unlock new investment opportunities in Asia's most dynamic region. More broadly, the results contribute to ongoing debates on the role of South-South cooperation and the diversification of economic partnerships in an increasingly fragmented world.

To estimate the relationship between FDI and geopolitical distance, the study employs a gravity model framework with bilateral panel data covering over 70 countries from 2010 to 2023. The model includes standard covariates such as GDP, geographic distance, contiguity, common language, and the presence of trade or investment agreements, as well as our geopolitical distance index. The analysis is complemented by robustness checks using alternative specifications and alignment metrics.

Literature Review and Analytical Framework

The relationship between FDI and economic development has long been a central topic in international economics. Numerous studies have highlighted the potential benefits of FDI for host countries, particularly in developing economies, emphasising its role in promoting technology diffusion, human capital formation, employment generation, and productivity growth (Asiedu, 2006; Denisia, 2010). However, the empirical evidence is not universally optimistic. While early contributions such as Borensztein et al. (1998) and Daude & Stein (2007) underscore positive spillover effects from multinational enterprises (MNEs) to domestic firms, others suggest that these benefits are contingent on host country absorptive capacities and may even be absent or negative in some cases (Navaretti & Venables, 2004; Crespo & Fontoura, 2007; Navarrete & Sossdorf, 2008).

Sectoral heterogeneity also plays a key role in shaping FDI's impact. Drawing on structuralist insights, Hirschmann (1958) noted that linkages and multiplier effects vary widely across sectors. Later works, such as Vernon (1996) and Dunning (1977, 1988), argue that the lifecycle of products and the strategic motivations of firms, whether resource-seeking, market-seeking, efficiency-seeking, or strategic asset-seeking, affect both the scale and developmental impact of FDI. These insights remain particularly relevant in the current global context, where MNEs are reassessing their locational choices considering shifting geopolitical realities.

Theoretically, there is no single unified model to explain FDI behaviour. As noted by Dorakh (2020), the study of FDI draws on a broad array of theoretical frameworks from trade theory, industrial organisation, and development economics. Among these, the eclectic paradigm, or OLI model, proposed by Dunning (1977), remains widely used. It posits that firms invest abroad when they possess three types of advantages: Ownership (O), such as proprietary technologies or brands; Location (L), such as favourable regulatory or cost conditions in the host country; and Internalisation (I), referring to the benefits of controlling production internally rather than through licensing or outsourcing. These three pillars have become standard in empirical work on FDI determinants.

To improve analytical clarity, this study focuses on two mechanisms that link geopolitics and FDI: economic statecraft and strategic hedging. Economic statecraft involves the strategic use of economic instruments, such as investment, financial restrictions and supply-chain realignment, to advance geopolitical objectives (Blanchard and Ripsman, 2008). In the context of the intensifying rivalry between the US and China, capital-exporting powers may direct FDI towards politically aligned jurisdictions and reduce their exposure to perceived rivals. Under this mechanism, geopolitical alignment effectively modifies bilateral investment frictions, complementing traditional gravity determinants. By contrast, strategic hedging operates at the level of host countries, particularly middle and emerging powers. Rather than fully aligning with one bloc, these states seek to maximise their economic gains from competing great powers while preserving their autonomy. This involves forming diverse partnerships, selectively engaging in sensitive sectors and maintaining diplomatic ambiguity (Kuik, 2024; Bórquez et al., 2025; Borquez & López, 2025; Serrano-Moreno et al., 2026). While middle powers may also pursue multilateralism or coalition-building with like-minded states, hedging offers a more flexible response in an era characterised by institutional paralysis and systemic rivalry (Serrano-Moreno, 2024).

These mechanisms are particularly relevant in ASEAN. Situated at the centre of US-China competition, ASEAN member states maintain deep economic interdependence with China while preserving security and institutional ties with the United States and its partners. Open alignment carries the risk of retaliation or exclusion, which incentivises hedging behaviour. At the same time, the region is a key arena for economic statecraft, with major powers competing through infrastructure finance, supply-chain relocation and strategic investment. Therefore, FDI flows into ASEAN reflect the interaction between external geopolitical pressures and domestic balancing strategies.

In terms of empirical modelling, gravity models are a tool for analysing bilateral FDI flows. These models posit that investment between two countries increases with their economic mass (typically measured by GDP) and decreases with geographic, cultural, or institutional distance. Recent applications of gravity models have incorporated an increasingly rich set of covariates, including not only GDP and physical distance, but also trade agreements, shared language, colonial ties, institutional quality, and infrastructure availability (Anderson & Van Wincoop, 2003; Mariev et al., 2016; Dorakh, 2020; Abreo et al., 2024).

More recently, scholars have begun to explore how geopolitical factors shape FDI decisions. This literature has gained traction amid growing evidence that MNEs are adjusting their international strategies in light of global tensions. For instance, Alfaro & Chor (2023), Clayton et al. (2023), and Freund et al. (2023) argue that firms are increasingly sensitive to political alignment when allocating capital, especially in strategic sectors. Similarly, Goldberg & Reed (2023) and Aiyar et al. (2024) document how FDI flows are fragmenting along geopolitical lines, with capital moving preferentially among politically aligned countries and avoiding those perceived as adversarial or unstable.

Despite these advances, much empirical work on geopolitical alignment has focused on trade or on high-income countries. Few studies have explored how these dynamics play out in the Global South, and even fewer in the context of ASEAN. Moreover, the methods used to measure geopolitical alignment vary widely. While some rely on expert classifications or alliance memberships, others use textual analysis of diplomatic statements or structural models of international voting behaviour. Among the most common proxies for political alignment are voting patterns in the United Nations General Assembly (UNGA), which provide a publicly available and comparable indicator of countries' foreign policy positions over time.

Some recent studies (e.g., Alfaro & Chor, 2023) suggest that political fragmentation generates new 'invisible barriers,' but these findings have not been formalised within gravitational logic. Incorporating a geopolitical distance index, such as the one proposed in this study, would allow the model to be extended to capture the political dimension in the distance function.

Building on this literature, the present study contributes to the emerging field of geopolitics and FDI by focusing on ASEAN as a key recipient region and by developing a tractable index of geopolitical distance based on the Principal Component of UNGA voting records. This approach complements more complex ideal-point models by offering a transparent, easily replicable method that can be incorporated into standard gravity frameworks.

Research Method

To investigate the relationship between geopolitical alignment and foreign direct investment flows into ASEAN, the research compiles a balanced panel dataset covering the years 2010 to 2023. The unit of observation is country-year, where each observation represents the bilateral flow of FDI from a source country into ASEAN as a regional aggregate. While disaggregated FDI data by recipient ASEAN member states is available in some cases, this research focuses on aggregated regional inflows to address data limitations and reflect the regional investment strategies of multinational firms.

The panel includes a broad set of ASEAN's main investment partners, such as the United States, the European Union (as individual member states), Japan, China, India, and intra-ASEAN sources, as well as a selected group of Latin American countries. Moreover, the dependent variable is the annual FDI inflow into ASEAN from each partner country. These data are obtained from the ASEANStats Data Portal, which consolidates information reported by ASEAN member states to the ASEAN Secretariat. The use of ASEAN-level FDI inflows enables us to capture firms' regional investment strategies, which often treat Southeast Asia as an integrated production base, within the context of global value chains.

Because the dependent variable aggregates FDI inflows at the ASEAN regional level rather than for individual member states, geopolitical distance must be defined relative to a collective ASEAN reference point. We therefore construct an annual ASEAN geopolitical centroid, calculated as the simple average of the rescaled PCA scores of the ten ASEAN member states in each year. Bilateral geopolitical distance is then defined as the absolute difference between the source country's PCA score and the ASEAN centroid. This approach preserves the model's bilateral structure while ensuring consistency in the levels of aggregation of the dependent and explanatory variables. Conceptually, it captures ASEAN's average diplomatic posture as a regional actor, without assuming perfect internal cohesion among its members. As such, it reflects how external investors may perceive ASEAN's overall geopolitical orientation when making regional investment decisions.

Explanatory variables fall into two main categories: (i) standard economic gravity controls and (ii) measures of geopolitical alignment. The standard gravity variables include GDP and GDP per capita of the source country (World Bank's World Development Indicators), Geographic distance between capital cities, Dummy variables for contiguity and common official language (Conte et al., 2022), and bilateral investment or trade agreements between the source country and ASEAN (ASEAN Secretariat and WTO RTA database).

A central methodological innovation of this research is the construction of a bilateral geopolitical distance index based on Principal Component Analysis (PCA) applied to voting patterns in the United Nations General Assembly (UNGA). In the field of international political economy, UNGA roll-call votes are commonly used as proxies for states' foreign policy preferences, serving as observable indicators of geopolitical alignment or divergence. Unlike treaty-based measures of political affinity or subjective diplomatic categorisations, UN voting records offer a high-frequency, standardised, and behaviourally grounded dataset covering virtually all sovereign nations.

To construct the index, researchers assemble a panel of country-level voting data spanning from 2005 to 2023. Each country's vote on selected resolutions is coded numerically: "yes" votes are assigned a value of 1, "abstain" a value of 0, and "no" a value of -1. The research restrict the dataset to votes considered geopolitically salient, primarily those classified as "important" by the US Department of State in its annual Voting Practices in the United Nations report. These include resolutions where the United States has actively lobbied due to perceived national interest. To provide a broader geopolitical perspective, the research also include a set of manually selected resolutions on key global and regional issues, particularly those with implications for ASEAN.

In total, the dataset includes approximately 1,500 UNGA resolutions over the period 2005-2023. Of these, roughly 500 are classified as ‘important votes’ by the US Department of State in its annual *Voting Practices in the United Nations* reports, covering issues such as sanctions regimes, human rights resolutions, nuclear proliferation, Middle East conflicts, and the US embargo on Cuba. This classification is widely used in the literature as an indicator of geopolitically salient voting behaviour. In addition, we include a limited number of resolutions reflecting major global or regionally significant strategic disputes, including questions related to Myanmar, the South China Sea, and multilateral trade governance. The full list of resolutions and coding criteria is available upon request. This selection strategy ensures that the index captures broad patterns of global geopolitical alignment rather than being narrowly tailored to ASEAN-specific events, thereby strengthening both comparability and replicability.

PCA is then applied to this matrix of vote codes. This technique reduces the dimensionality of countries' voting behaviour by extracting unobserved components that explain the greatest variance in the data. The first principal component (PC1) is interpreted as a latent ideological or geopolitical dimension that reflects a country's overall position within the global political spectrum. Countries that tend to vote in tandem will have similar PC1 values, while countries that frequently vote in opposition will be farther apart in the PC1 space.

To enhance interpretability and cross-country comparability, each country's PC1 score is rescaled into a discrete index ranging from 0 to 10. A value of 0 corresponds to full alignment with the dataset's geopolitical centroid, while a value of 10 reflects the maximum distance. For each year, bilateral geopolitical distance is computed as the absolute difference between the rescaled PC1 values of two countries. This yields a time-varying, symmetric, and cardinal measure of geopolitical distance, suitable for empirical modelling and direct comparison across pairs and time periods.

The advantages of this approach are threefold. First, it provides a data-driven summary of complex voting behaviour using minimal parametric assumptions. Second, it is easily replicable and transparent, avoiding reliance on model-specific priors. Third, its flexible structure enables the incorporation of regionally relevant resolutions that may be neglected in global models, making it particularly suitable for studies focused on ASEAN and its strategic partners.

Validation and Comparison with the Ideal Point Distance (IPD)

The robustness and external validity of our PCA-based geopolitical distance index are assessed by comparing it with the IPD, a widely used measure developed by Bailey et al. (2017) and recently revisited by Airaudo et al. (2025). The IPD approach is grounded in a spatial voting model that estimates latent ideological positions, termed "ideal points", for each country based on their observed voting behaviour in the UNGA. These ideal points are typically interpreted as reflecting countries' alignment with the U.S.-led liberal international order, and bilateral geopolitical distance is calculated as the absolute difference between the ideal points of two countries in a given year.

This method benefits from strong theoretical foundations and a sophisticated Bayesian estimation framework. However, its application comes with important caveats. As emphasised by Airaudo et al (2025), the IPD is sensitive to the length of the time window used for estimation, the nature of the selected votes (e.g., peace and security vs development), and the underlying assumptions of the spatial model. Small changes in vote inclusion criteria or sample periods can yield materially different estimates of geopolitical distance, potentially complicating interpretation in contexts of dynamic or regionally contingent alignment, such as in Southeast Asia.

In contrast, the PCA-based index offers a simpler and more transparent methodology that can be more easily adapted to the specific geopolitical context of a study. While it does not provide the same theoretical richness as the spatial voting model underlying IPD, its flexibility allows for better tailoring to regional questions. For instance, by incorporating ASEAN-relevant geopolitical events, such as resolutions on Myanmar and the South China Sea, and trade-related norms, our PCA index can more directly capture alignment dynamics that are particularly relevant to FDI flows into the region.

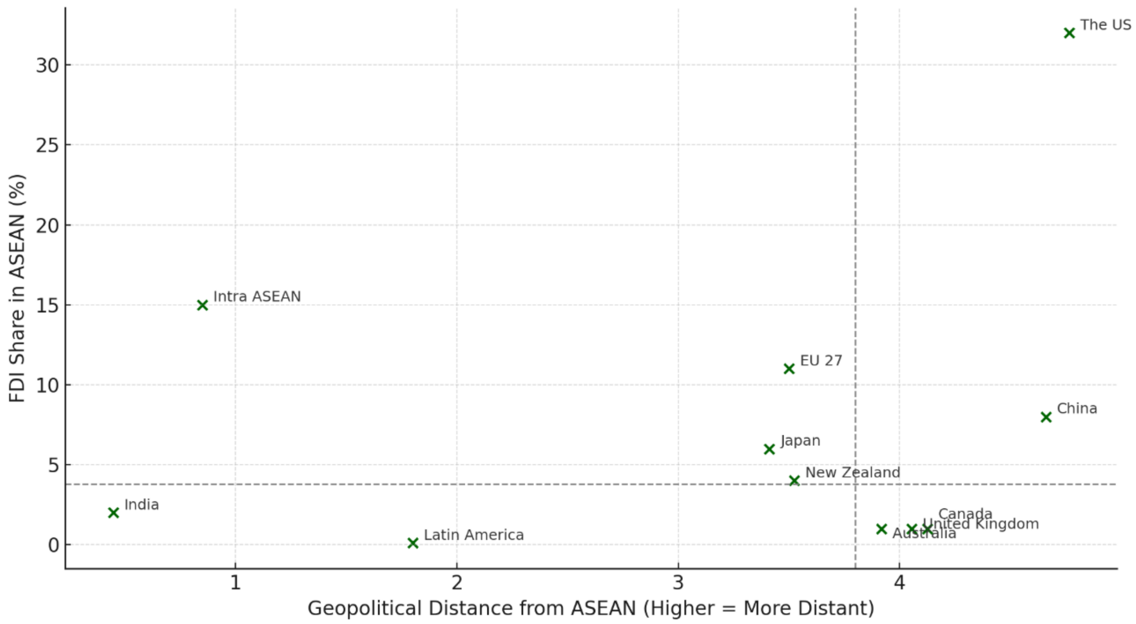
Empirically, the PCA and IPD indices are highly correlated across a broad set of major economies, especially when the IPD is estimated using comparable years and resolutions. This strong correlation provides reassurance that both measures capture a similar underlying dimension of political alignment. At the same time, the divergence in specific dyads highlights the importance of methodological choices when applying geopolitical distance metrics in applied research.

Overall, the results support the PCA-based measure as a valid and useful alternative to the Ideal Point Distance, particularly in applications where regional specificity and methodological transparency are key priorities. The use of both measures in robustness checks strengthens the empirical foundation of our analysis and contributes to a more nuanced understanding of the geopolitical determinants of FDI.

Descriptive Evidence: FDI and Geopolitical Distance

To visually illustrate the relationship between geopolitical alignment and investment intensity, Figure 1 plots the average FDI share in ASEAN (2010–2023) against the average bilateral geopolitical distance index, constructed from PCA-based UNGA voting data.

Figure 1 suggests a complex relationship between the geopolitical distance and FDI share. Countries that are geopolitically aligned with ASEAN, such as intra-ASEAN partners and the European Union, tend to have higher FDI shares. Conversely, countries with greater geopolitical distance, such as the US and China, show a high FDI share in ASEAN. Interestingly, Latin America and India are positioned as geopolitically closer to ASEAN yet have low levels of investment, suggesting the influence of additional institutional or commercial barriers. This pattern motivates a formal econometric analysis to assess the extent to which geopolitical alignment, beyond conventional gravity variables, explains the distribution of FDI flows into ASEAN.



Note: Each dot represents a country or regional group. The X-axis measures average geopolitical distance from ASEAN (higher = more distant); the Y-axis measures average FDI share in ASEAN over the period 2010–2023.

Figure 1. FDI Share in ASEAN vs Geopolitical Distance (Median-based Quadrants)

Empirical Strategy: Extended Gravity Model of FDI

To examine the relationship between geopolitical alignment and foreign direct investment flows into ASEAN, the research employ an extended gravity model framework. Gravity models have become a standard tool in the empirical analysis of international trade and investment due to their ability to account for dyadic economic frictions and bilateral interactions. This approach builds on recent contributions by Abreo et al. (2024) and Aiyar et al. (2024), adapting the traditional gravity structure to capture not only economic fundamentals such as GDP, distance, and institutional proximity but also strategic-political alignment between countries.

In the baseline specification, the dependent variable is the logarithm of bilateral FDI flows $(log\,(FDI_{ijt}))$ from country i (source) to country j (recipient, ASEAN member) in year t. The core explanatory variable is the Geopolitical Distance Index between countries i and j, measured in year $t-1$ to mitigate endogeneity concerns.

Control variables include bilateral characteristics such as geographic distance, contiguity, common language, and the existence of investment agreements, as well as macroeconomic indicators such as GDP and income per capita for both source and host countries.

The baseline model is specified in Equation 1.

$$log\,(FDI_{ijt}) \; = \; = \beta_0 + \beta_1 \left(GeoDist_{ijt-1}\right) + \beta_2 X_{ijt} + \eta_i + \mu_j + \varepsilon_{ijt} \quad (1)$$

Where $log\ (FDI_{ijt})$ denotes the FDI flow from country i to ASEAN (j) in year t. $GeoDist_{ijt-1}$ is the lagged bilateral geopolitical distance index between i and j. X_{ijt} is a vector of control variables. η_i and μ_j are source and destination country fixed effects, respectively. ε_{ijt} is the error term.

To explore heterogeneity by origin, we estimate a second model that introduces interaction terms between geopolitical distance and regional dummies, allowing us to assess whether the sensitivity of FDI to political alignment differs across major source regions (e.g., the United States, the European Union, India, China, Latin America, intra-ASEAN).

$$log\ (FDI_{ijt}) = \beta_0 + \beta_1(GeoDist_{ijt-1}) + \beta_2 X_{ijt} + \sum_r \beta_r(GeoDist_{ijt-1} \times Region_r) + \eta_i + \mu_j + \varepsilon_{ijt} \quad (2)$$

Equation 2 provides a more nuanced understanding of geopolitical effects by explicitly modelling regional differentiation in investor behaviour.

To address potential endogeneity concerns, the geopolitical distance index is lagged one year with respect to the FDI flows. While reverse causality between FDI flows and diplomatic alignment cannot be entirely ruled out, it is unlikely to drive our results for several reasons. First, UNGA voting behaviour tends to be highly persistent over time, reflecting structural foreign policy orientations rather than short-term economic fluctuations. Annual PCA scores exhibit strong temporal stability, suggesting that geopolitical positioning evolves gradually rather than in response to contemporaneous investment flows. Second, large-scale FDI projects typically follow lengthy planning and approval processes, making it improbable that investment decisions in year t would systematically reshape voting behaviour in year t–1. Taken together, these considerations mitigate concerns that the observed relationship reflects reverse causality.

All regressions include fixed effects for both source and destination countries to account for time-invariant unobserved heterogeneity. In addition, year dummies are included to control for global shocks such as the COVID-19 pandemic and financial volatility.

Standard errors are clustered at the dyad level to address autocorrelation and heteroskedasticity across bilateral relationships. As a robustness check, we also estimate specifications using the Ideal Point Distance index and exclude outlier votes to assess the sensitivity of our results to vote selection.

Taken together, our methodological framework offers a rigorous and original contribution to the study of how geopolitical fragmentation influences international investment decisions, with a particular focus on the increasingly strategic ASEAN region.

Analysis

This section presents and interprets the empirical results derived from the estimation of extended gravity models of FDI into ASEAN. The research focuses on two core specifications:

the baseline model using our PCA-based Geopolitical Distance Index and an alternative model incorporating the IPD measure, as proposed by Bailey et al. (2017). In both cases, the research find a positive and statistically significant relationship between geopolitical distance and inward FDI flows to ASEAN.

In the baseline model (see Column 2 of Table 1), the coefficient on the PCA-based geopolitical distance index is positive (0.292) and significant. This implies that, on average, countries that are more geopolitically distant from ASEAN (i.e., that vote more divergently in the UN General Assembly) tend to invest more in the region. This finding challenges the conventional assumption that political alignment reduces investment risks and transaction costs, thereby facilitating capital flows. Instead, it suggests that greater political divergence is not an obstacle and may even be an incentive to investment in ASEAN.

The robustness model using IPD confirms this pattern. In Column 4 of Table 1, the coefficient on the IPD measure is positive and significant. This reinforces the interpretation that geopolitical divergence correlates positively with FDI inflows, regardless of how geopolitical distance is operationalised.

Importantly, both specifications control for standard gravity variables, economic size (log GDP), physical distance, shared language, colonial ties, and contiguity, as well as the presence of investment or trade agreements. As expected, geographic distance has a negative and significant effect on FDI, while investment or trade agreements are associated with increased investment. However, geopolitical proximity does not follow this logic.

Taken together, the results indicate that ASEAN attracts more FDI from politically distant countries, as shown by both the PCA and IPD metrics. This is a counterintuitive but robust result, reflecting the average effect of geopolitical distance on FDI inflows into ASEAN across all source countries. While one might expect political proximity to reduce transaction costs and encourage investment, our findings indicate that, on average, greater geopolitical distance is associated with increased FDI into the region.

Table 1. Baseline Specification

	(1)	(2)	(3)	(4)
PCA	0.123	0.292**		
	(0.089)	(0.104)		
Ideal Point Distance			0.331	1.466***
			(0.268)	(0.271)
Log GDP		0.310		0.451
		(0.738)		(0.784)
FTA/BIT		1.834***		1.772***
		(0.345)		(0.284)
Log Distance		-0.816***		-1.494***
		(0.250)		(0.269)
Common Language		0.077		-0.084
		(0.310)		(0.299)
Colonial Dependency		-0.304		0.025

		(0.384)		(0.332)
Contiguity		-0.757**		-0.611*
		(0.337)		(0.368)
Observations	631	631	631	631
R-squared	0.010	0.114	0.022	0.114

Note: robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1.

There are at least three possible interpretations for this finding. First, a geopolitical diversification strategy in which countries may invest in ASEAN as a way to diversify their exposure and maintain a strategic economic presence, regardless of political alignment. Second, "buying friendship" hypothesis in which major powers might increase their investment in ASEAN as a soft-power tool to maintain influence in a geopolitically ambiguous or neutral region. Third, ASEAN's intrinsic strategic value in which ASEAN may be such a critical hub for global supply chains and market access that investors overlook political misalignment altogether.

However, this result should be interpreted with caution, as it represents an aggregate effect across heterogeneous countries and regions. To explore this further, Table 2 disaggregates the analysis by source region, focusing on the United States, China, the European Union, and Latin America, to uncover differential patterns in how geopolitical alignment shapes FDI decisions.

Table 2. Heterogeneous Effects by Source Region: Interaction Model

Variable	PCA Model	Ideal Point Model
Geopolitical Distance	-0.039	-0.270*
	(0.062)	(0.147)
Effect USA	0.290***	0.766***
	(0.058)	(0.126)
Effect Latin America	-5.097	-17.086
	(4.604)	(21.782)
Effect EU	-0.464***	-0.873***
	(0.092)	(0.175)
Effect China	0.489***	2.530***
	(0.059)	(0.619)
Effect ASEAN	-0.073	-0.831
	(0.205)	(0.887)
Controls:	Yes	Yes
Observations	715	715
R-squared	0.316	0.317

Note: robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1.

Table 2 yields several novel and policy-relevant insights into the relationship between geopolitical distance and foreign direct investment flows into ASEAN. Contrary to the prevailing assumption that geopolitical misalignment would deter investment, we find that geopolitical distance from both the United States and China is positively and significantly associated with increased FDI flows into the ASEAN region. This counterintuitive result challenges the expectation that political affinity is a necessary condition for cross-border capital flows.

One possible explanation is that ASEAN economies are strategically leveraging their geopolitical neutrality to attract investment from multiple rival powers. Rather than aligning unilaterally, ASEAN cultivates an open and balanced investment climate that appeals to both US and Chinese firms. In this context, political distance may reflect ASEAN's perceived neutrality or flexibility, thereby reducing perceived political capture and increasing investor confidence from competing blocs. This logic resonates with the notion of "strategic hedging" in international relations, wherein countries avoid overt alignment with any single major power to preserve autonomy and maximise strategic options (Khong, 2004; Lim & Cooper, 2015; Kuik, 2016, 2022, 2024).

Alternatively, this result may reflect a form of "economic statecraft" or "investment diplomacy" by the superpowers themselves. Faced with rising geopolitical tensions and competition for influence in the Indo-Pacific, both the US and China may be using FDI to maintain or expand their presence in the region, particularly in politically ambiguous or non-aligned countries. Under this interpretation, the positive relationship between geopolitical distance and FDI flows may signal attempts by major powers to "buy friendship" or secure strategic footholds, regardless of voting alignment, in forums such as the United Nations General Assembly. This logic is consistent with the growing literature on geoeconomic fragmentation and the instrumental use of investment flows as tools of influence (Alfaro & Chor, 2023; Aiyar et al., 2023, 2024; Gopinath et al., 2025; Grover & Vézina, 2025).

A third possibility is that geopolitical distance does not matter for certain regions or sectors because the economic logic of investment dominates. In other words, ASEAN is a critical hub for supply chains, consumer markets, and manufacturing, so firms from the US and China will continue to invest there, irrespective of the broader geopolitical climate. This hypothesis would suggest that in high-stakes economic zones, the calculus of profit, cost, and logistical efficiency outweighs political considerations. This finding aligns with arguments from structural political economy, which emphasise the role of productive interdependence and global value chain logic in driving capital allocation decisions even in the presence of political frictions (Bondi et al., 2025).

In contrast, FDI from the European Union shows a markedly different pattern. Our analysis reveals a positive and statistically significant relationship between geopolitical alignment and EU FDI flows to ASEAN. That is, European investors tend to favour ASEAN countries with which they share similar foreign policy preferences or voting behaviour at the UN. This finding suggests that political affinity remains a relevant determinant of investment flows in the EU.

There are several possible mechanisms behind this pattern. First, the EU's foreign economic engagement is often framed within broader normative agendas based on "shared values" such as democracy promotion, multilateralism, environmental standards, and respect for human rights. As such, EU firms may be more sensitive to the political and institutional context of recipient countries. Second, EU investment decisions may be shaped by risk aversion and the need to ensure institutional compatibility to protect long-term capital. Finally, the EU and ASEAN have built a longstanding institutional relationship rooted in shared values, culminating in the 2020 upgrade to a Strategic Partnership and the 2022 Commemorative Summit. The EU has also committed significant funding to ASEAN connectivity and regional cooperation through initiatives such as the Global Gateway, which further embeds political and economic alignment.

Taken together, these findings suggest that the role of geopolitical distance in shaping FDI flows is both region-specific and actor-dependent. While the US and China appear to invest heavily in ASEAN regardless of political affinity, possibly due to strategic hedging, economic statecraft, or market logic, European investors exhibit a stronger preference for political alignment, which reflects value-based economic diplomacy or normative conditionalities.

This actor heterogeneity has profound implications for understanding the drivers of South–South and South–North investment dynamics in a fragmented global order. It challenges the one-size-fits-all assumption often embedded in gravity models of investment and calls for greater attention to the geopolitical preferences, corporate behaviour, and institutional frameworks of investing countries. Furthermore, it suggests that ASEAN's geopolitical positioning, neither fully aligned with the US, China, nor the EU, constitutes a comparative advantage in attracting diversified sources of FDI. Such positioning could be leveraged further through targeted diplomatic and regulatory initiatives that preserve neutrality while enhancing institutional attractiveness.

In summary, the empirical patterns observed underscore the increasing salience of geopolitical factors in international investment decisions but also reveal important variations across source countries. The ASEAN case suggests that investment flows can be shaped by a complex interplay between strategic positioning, political affinity, and market fundamentals, a dynamic that merits further investigation in other regions and policy domains. Likewise, the results show no significant relationship between geopolitical distance and FDI of intra-ASEAN countries. This is expected, as regional investment is likely to be driven by geographic proximity, regional supply chains, and institutional familiarity rather than ideological factors.

The most striking finding is perhaps the near-zero foreign FDI share from Latin American countries, and the absence of any statistically significant relationship with geopolitical distance. This outcome suggests not merely political neutrality, but structural disconnection. Unlike firms in the US, China, or the EU, which are deeply embedded in ASEAN's manufacturing, digital, and infrastructure ecosystems, Latin American outward FDI remains concentrated in natural resources, energy, and services within the Western Hemisphere. There is limited sectoral complementarity with ASEAN's core investment hubs in advanced manufacturing, semiconductors, electronics, and logistics.

Furthermore, Latin America lacks the dense institutional, financial, and corporate networks that would link it to Southeast Asia. The absence of major bilateral trade agreements, limited development finance instruments, a sparse multinational corporate presence and high logistical costs reduces incentives and capabilities for sustained investment engagement. In this sense, geopolitical distance becomes largely irrelevant because the binding constraints are structural and sectoral rather than ideological.

Taken together, these patterns reinforce the argument that the impact of geopolitical distance on FDI is not uniform across actors or sectors. In strategically sensitive or supply-chain-intensive industries, market logic and geoeconomic positioning may override political alignment. In contrast, in value-driven or institutionally embedded investment models, political affinity plays a greater role. The Latin American case study illustrates how limited sectoral integration and weak interregional institutional links can marginalise entire regions from dynamic investment circuits, regardless of their geopolitical positioning.

Thus, these findings have several important implications for policymakers and development practitioners, particularly in emerging regions that are seeking to expand their presence in dynamic markets such as ASEAN.

Conclusions and Policy Implications

This research has examined the role of geopolitical alignment in shaping the geography of FDI into ASEAN, using both a PCA-based Geopolitical Distance Index and a robustness check based on Ideal Point Distances derived from UN General Assembly voting patterns. Our results contribute to the growing literature on geoeconomic fragmentation, offering robust empirical evidence that political alignment matters, but in ways that differ significantly across source regions.

A key finding is that greater geopolitical distance from ASEAN is associated with more FDI from the United States and China, a counterintuitive pattern that may reflect either a strategic diversification logic, the use of FDI as a soft power instrument ("buying friendship"), or ASEAN's intrinsic strategic value as a hub too important to ignore, regardless of alignment. In contrast, European Union investors display a preference for politically aligned ASEAN countries, suggesting that shared values, ESG standards, or institutional norms may guide European capital more strongly than economic imperatives alone.

Latin America maintains a limited presence in ASEAN, reflecting two critical dimensions: on the one hand, its limited capacity to attract investment to the Latin-Pacific basin; on the other, its weak investment projection towards the new gravitational centres of the Indo-Pacific, including ASEAN. This situation highlights a strategic lag in a global scenario in which value chains, energy transition, and technological innovation are increasingly being articulated in Asia. If Latin America aspires to become more than a passive observer of Indo-Pacific transformations, a strategic shift is needed. State-owned enterprises and private firms could use ASEAN as a platform not only for market access but also for value chain integration, joint ventures in clean technologies, and knowledge spillovers. This would require moving beyond a North–South extractivist paradigm toward a more dynamic South–South investment approach.

For ASEAN, these patterns reaffirm its emerging role as a geopolitical safe harbour and investment hub amid growing global polarisation. The region has managed to attract FDI from competing geopolitical blocs without clearly aligning with either. This non-alignment, or strategic ambiguity, has become an asset, allowing ASEAN to deepen economic ties across the board while minimising political risk exposure. These results reinforce the importance of ASEAN's pragmatic diplomacy and multilateral engagement in safeguarding its economic relevance in a fragmented world.

At the same time, policymakers in the Asia-Pacific region should note the differentiated role that geopolitics plays in shaping FDI sources. For instance, initiatives such as the Free Trade Area of the Asia-Pacific (FTAAP) or the ASEAN+ frameworks could be strengthened by mechanisms that shield investment from geopolitical retaliation and promote confidence-building across regions. ASEAN's strength lies in its ability to remain open without being naïve, and to be strategically engaged without becoming partisan.

Finally, this paper opens several avenues for future research. Our geopolitical alignment measures, while robust, are limited proxies that could be enriched by incorporating indicators of diplomatic intensity, defence cooperation, or elite-level signalling. Additionally, sectoral disaggregation and firm-level heterogeneity in responses to geopolitical risk remain underexplored. Future studies might examine whether capital-intensive, high-tech, or resource-based industries are more sensitive to shifts in alignment.

In conclusion, ASEAN is not just a recipient of geopolitical capital; it is actively shaping the contours of global geoeconomic reordering. For Latin America, the European Union, the United States, and China alike, engaging ASEAN is no longer optional; it is a test of strategic vision. Whether this engagement results in deeper integration or a missed opportunity will depend on the institutional readiness, strategic clarity, and diplomatic adaptability of all parties involved.

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