London School of Economics

MSc FINANCE and ECONOMICS

How do Geopolitical Tensions Shape Cross-Border Capital Investment?

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May 2024

Abstract

How do geopolitical tensions shape cross-border capital investment? In times of deteriorating diplomatic ties, understanding this intricate relationship is crucial to providing policy directions that can prevent financial fragmentation. This paper empirically tests the impact of geopolitical distance (measured through voting behavior in the UNGA) on two components of cross-border capital: Portfolio Investment and FDI. The cross-asset (debt and equity) gravity estimation takes into consideration heterogeneity across investor and recipient countries and the fundamental role of tax havens in the geography of capital allocation. Results show that investors allocate a smaller share of capital to recipient countries with more distant foreign policy outlooks (and the effect is more pronounced when the recipient country is an emerging market or developing economy). However, the share decline in Portfolio Investment associated with geopolitical tensions is bigger than that of FDI (especially in emerging markets and developing economies). This conclusion aligns with existing literature suggesting that FDI is resilient to crises, and documents relative FDI stability in the context of geopolitical fragmentation. The analysis also shows that on average Equity Portfolio Investment drops more than Debt Portfolio Investment in geopolitically distant countries. In contrast, Debt and Equity FDI shares decline by comparable amounts. Finally, emerging markets seem to decrease their portfolio share in other geopolitically distant emerging markets more than investor advanced economies do.

Contents

1. Introduction

1.1 Background and Motivation

How do geopolitical tensions shape cross-border capital investment? In a time of deteriorating diplomatic relations and intensifying conflicts, it is natural to wonder if financial fragmentation caused by geopolitical tensions could impact global financial stability, and if so, through which channels. Understanding the intricate relationship between geopolitical tensions and cross-border capital allocation is crucial to providing policy directions that can prevent or contain economic and financial fragmentation.

In the recent years, the world experienced numerous geopolitically strenuous events that pushed it further and further away from the integration that so well defined the late 20^{th} century. Relations between the United States and China steadily worsened, Russia's invasion of Ukraine prompted a forced split in diplomatic blocs (those condemning the war, and those not), and so did the Israeli–Palestinian conflict. Sanctions were enforced, and countries increased their military spending. Even the COVID-19 pandemic negatively contributed, exacerbating relationships between countries and reducing trust (IMF (2023a)). These geopolitical tensions introduced uncertainty, increased transaction costs, and created barriers to investment, altering the flow of capital across national borders.

The literature has widely established that geopolitical events can have profound effects on international trade (e.g., new restrictions on the exchange of goods and services recently prompted a decline in global trade (Góes and Bekkers (2022)). However, research exploring the impact of geopolitical tensions on cross-border capital allocation is ongoing and relatively recent. So far, it has shown that geopolitical tensions reduce bilateral cross-border investment and that effects tend to be more pronounced for emerging markets and developing economies. Moreover, it showed that diplomatic fragmentation arising from geopolitical distance can lead to significant output losses (IMF (2023b), IMF (2023c)).

This paper aims to contribute to the research effort by performing a cross-asset (Debt and Equity) analysis that directly compares Portfolio Investment and Foreign Direct Investment (FDI) while considering heterogeneity across both investors and recipients. Moreover, it stresses the fundamental role of tax havens for Portfolio Investment (Lane and Milesi-Ferretti (2008), Lane and Milesi-Ferretti (2011)). To understand how geopolitical tensions shape investment, we are interested in where exactly capital ends up.[1]. Hence, performing the analysis with nationality restatements is important. Clayton et al. (2023) show that this is even more relevant given China's increasingly significant presence in tax havens.

[1]For instance, after Russia's invasion of Ukraine, Ukraine's allies wished to divest not only from companies registered in Russia, but also from all tax-haven-registered subsidiaries that pass through all their proceeds to Russia

1.2 Research Questions and Contribution

This study explores how geopolitical tensions shape cross-border capital investment through 5 detailed questions.

- Do geopolitical tensions impact cross-border capital allocation?
- Do they have a different impact on Portfolio Investment and FDI?
- Do they have a different impact on Debt and Equity investment?
- How do investor countries change their share of investment if the geopolitically distant recipient country is an Advanced Economy? What if it is an Emerging Market or Developing Economy?
- Do Advanced Economy investors and Emerging Market investors react differently to geopolitical tensions?

By exploring these questions, this analysis contributes to a body of literature that has recently started to study the role of geopolitical fragmentation in international finance. Firstly, in line with the discussion on the role of tax havens in the allocation of cross-border capital flows, it highlights the importance of analyzing the impact of geopolitical tensions on nationality restated measures and provides the analysis for restated Portfolio Investment. It also sets the framework for restated FDI in Table A.2 in the Appendix[2]. Secondly, it provides a direct comparison between magnitudes of FDI and Portfolio Investment allocation in the context of geopolitical fragmentation. Thirdly, it provides insight into the cross-asset (debt and equity) impact of geopolitical tensions instead of the impact on total Portfolio Investment and total FDI. Additionally, it is divided into Emerging and Advanced Economies to examine heterogeneity across recipients and investors. Indeed, there is no reason to believe that Advanced Economies and Emerging Markets should shift their capital share in a geopolitically distant country in the same way. This paper paves the way for a more extensive analysis of how geopolitical fragmentation shapes all the components of cross-border capital, including Other Investment and Reserves.

1.3 Literature Review

This study belongs to two literature strands. The first one is related to the increasingly popular estimation of gravity equations in international finance. The second one explores the implications of geopolitical fragmentation for macro-financial stability.

Papers belonging to the first strand of literature contribute to bridging gravity models from trade theory to international finance. Gravity equations emerged in the 1960s as

[2]While the entire analysis for restated FDI was performed, results were not as conclusive due to low significance

an empirical specification to estimate the impact of trade agreements and were later microfounded by Anderson and Van Wincoop (2003) (Baldwin and Taglioni (2006)). More recently, estimations of gravity equations for cross-border capital flows have also emerged. Okawa and Van Winkoop (2012) is the workhorse of this first literature strand as it develops a theory for bilateral asset holdings that takes a gravity form. Portes and Rey (2005) are among the first to show that a gravity model explains international transactions in financial assets at least as well as goods trade transactions. More recently, Damgaard et al. (2024) exploit a simple gravity model to show that the distinction between Real FDI and Phantom FDI has important implications for the effect of corporate taxation on FDI. Our analysis shares a similar gravity specification with these papers.

The second strand of literature focuses on geopolitical fragmentation in trade and international finance. Campos et al. (2024) ask themselves the economic consequences of geopolitical fragmentation on trade. Using a general equilibrium model, they find that fragmentation into three different trade blocs (defined according to voting behavior in the United Nations General Assembly (UNGA) on the occasion of Russia's invasion of Ukraine) would reduce trade flows between them by 22% to 57%. In the international finance context, IMF (2023b) and IMF (2023c) discuss the main channels through which geopolitical tensions could reshape the geography of capital. Moreover, they explore how financial fragmentation can affect macro-financial stability and the global economy. Their analysis shows that higher geopolitical distance is associated with significantly lower cross-border capital allocation and that the estimated effect is, on average, stronger for emerging markets and developing economies. IMF (2023c) focus on sector FDI and finds that geopolitical distance is more relevant for FDI flows in strategic sectors than in other sectors. Moreover, they show that relevance of geopolitical distance for FDI was declining up to 2017 but started increasing again after then. Our paper contributes to these analyses by i) taking into consideration the role of tax havens, ii) directly comparing Portfolio Investment and FDI, iii) estimating the cross-asset (Debt and Equity) impact on both components, iv) exploring the differences across behavior of Advanced Economies and Emerging Markets as investor countries.

2. Data

Table 2.1: Descriptive Statistics

Variable	Source	Obs.	Mean	Std. Dev.	Min	Max
Portfolio Debt	GCAP	160,204	2,197	47,661	-3,936	2,555,776
Portf. Equity	GCAP	160,193	1,113	22,401	-2,062	1,739,820
FDI Debt	IMF CDIS	110,806	270	4,834	-254,479	204,134
FDI Equity	IMF CDIS	108,376	2,755	25,682	-6,213	1,035,103
GPD	Computed	299,874	-.67	.27	-1	1
IPD	Bailey (2017)	517,222	.94	.76	3.30e-06	4.83
Distance	CEPII	826,968	8,478	4,725	0	19,930
Comm. Lang.	CEPII	759,375	.17	.37	0	1
Colonial Hist.	CEPII	759,375	.12	.32	0	1
Comm. Relig.	CEPII	612,465	.18	.25	0	.99
Contiguity	CEPII	826,968	.01	.11	0	1

[3]Note that Portfolio Debt, Portfolio Equity, FDI Debt, FDI Equity are expressed in millions of US dollars

2.1 Portfolio Investment

The first category of cross-border investment included in this analysis is Portfolio Investment. The database used is based on the work of Coppola et al. (2021).[4] It includes restatements of the US Treasury International Capital (TIC) data and the IMF Coordinated Portfolio Investment Survey (CPIS) data on a nationality basis. While the CPIS represented a significant advance in characterizing the geography of capital allocation, it is compiled on a "residency" basis. In other words, the recipient country of an investment is assigned to be the country where the company issuing a bond is registered. Using the example in Florez-Orrego et al. (2023), if a Canadian bank with a subsidiary in London issues a bond through that subsidiary and the bond is held by a US resident investor, the bond will be registered as a portfolio investment holding of the US in the UK, even if all decisions (and perhaps proceeds) depend on the Canadian parent. However, to understand how geopolitical tensions shape portfolio investment, we are interested in understanding where exactly capital ends up. With rising geopolitical tensions between two countries, we expect to see them reducing their investment share not only in parent companies registered in the geopolitically distant country, but also in subsidiaries abroad.[5] This tendency is particularly meaningful when subsidiaries issuing equity or debt are in countries with little economic activity, such as many tax havens. Since they would directly pass through the proceeds to the parent company, it is reasonable to think that geopolitically distant countries would also want to reduce their positions in subsidiaries. For these reasons, we use Coppola et al (2021)'s nationality restated dataset.

[4]Obtained from: www.globalcapitalallocation.com

[5]Capital flight from Russian companies after Russia's invasion of Ukraine is an example

The database offers several versions of restated bilateral external portfolios. We focus on the "Tax Haven Only" restatements, which reallocate only securities that, under residency, are issued by affiliates in tax havens (instead of affiliates from all countries). As discussed above, portfolio investment in subsidiaries registered in tax havens is not used to finance local economic activity. Additionally, the restatements are provided using three different estimation methodologies. We focus on the "Issuance" methodology, which uses issuance distribution matrices constructed using data on global securities outstanding from Dealogic, Factset, and Refinitiv. This methodology is chosen because it provides estimates for all country pairs for which the complete CPIS data is available (while the other two methodologies only provide restatements for less than 9 economies). The final dataset provides yearly restatements for 2007 to 2017 for 70 investor countries and 242 recipient countries. Restated data is available both for debt and equity portfolio investment.

It is also important to note that countries from the European Monetary Union (EMU) are excluded from the analysis as investors (but they individually remain as recipients). This is because, in the restatements, EMU is considered as a block when on the investor side since mutual funds are concentrated in Luxembourg and Ireland but collect investments from the rest of the countries in the European Union. This element complicates the specification of a gravity model (the empirical methodology used in the analysis, explained in Section 3) in at least two ways. Firstly, the EMU does not vote as a block in the UNGA, and the proxies of geopolitical distance in this analysis are based on voting behavior. This limitation could be overcome by attaching the mode of all countries' votes in the EMU as a vote of EMU and then proceeding to compute the measure of geopolitical distance. We attempted this approach for the years 2007-2022 only, which seems sensible given the broad convergence of foreign policy opinions of EMU countries in these years. Results are in Figure A.1 in the Appendix. Secondly, no gravity controls database exists that provides bilateral variables between a country and the EMU as a block. This defeats the purpose of a gravity equation and forces us to drop EMU as a block as an investor country.

Additionally, for the United States, positions are separately reported in four asset classes: i) common equities (excluding fund shares), ii) corporate bonds, iii) sovereign, agency, and local government (muni) bonds, and iv) asset-backed securities. However, for all countries other than the US, the dataset reports positions in two asset classes: i) equities (including fund shares) and ii) all bonds. Since the measures for the US are not perfectly comparable with those of other countries (e.g., equities exclude fund shares for the US and include them for other countries), we drop the US as an investor (but keep it as a recipient). Note that it is not uncommon in the literature to drop the US as an investor country, at least as a robustness test (IMF (2023b)).[6]

[6]We attempted to perform the analysis also including the US as investor country despite the issue with direct comparability,

2.2 Foreign Direct Investment

The second category of cross-border investment included in this analysis is FDI. The database used is the IMF Coordinated Direct Investment Survey (CDIS). Like the CPIS, the CDIS is registered on a residency rather than a nationality basis. Therefore, ideally, it would be better to use restatements of the CDIS rather than the CDIS itself to analyze the impact of geopolitical tensions on FDI. While the literature offers some alternative restatements for FDI, no single dataset that restates on a nationality basis both equity and debt FDI exists. Hence, given our goal to compare equity and debt shares, we use the CDIS in the main specification of the model. Note that Damgaard et al. (2024) disentangle Real FDI and Phantom FDI and allocate Real FDI to ultimate investor economies. An attempt has also been made to estimate the main model specification with this data, and results can be seen in Table A.2 in the Appendix.

The CDIS dataset used is yearly and available from 2009 to 2022. The chosen variables for debt and equity FDI are the outward net debt position and the outward net equity position, both in USD and direct measures. Note that CDIS also provides derived measures. The dataset contains data for 247 investor countries and issuers, but it is important to note that some of these territories do not have direct voting power in the UNGA. Some good examples are many of the tax havens. Hence, observations for countries that do not vote in the UNGA are dropped in the analysis due to the absence of a measure of geopolitical distance between said countries and the rest of the world.

2.3 United Nations General Assembly Voting

We use the UNGA voting dataset to compute the primary measure of geopolitical distance (Voeten (2013), version 32). This dataset contains roll-call votes in the UNGA from 1946 to 2022 (sessions 1-77). Note that voting happens in sessions typically from September to December, but some votes occur the following year. For the computation of measures of geopolitical distance, which are described more in-depth in Section 3, all votes are considered independently of the object of voting (also votes on amendments or paragraphs).

2.4 Gravity Controls

The set of gravity controls used to estimate the gravity model is the CEPII Gravity Database. The data covers all existing countries, from 1948 to 2020, and includes yearly variables (bilateral and non-) that can be considered potential determinants of both trade and capital flows. The dataset is widely used in the literature.

and results are widely overlapping with the specification without the US. However, due to the "poor man's" nature of the approach, it is not included in this paper. We can share it upon request.

3. Empirical Methodology

3.1 Empirical Model

The econometric approach used to explore how geopolitical tensions shape cross-border capital investment is a gravity model. While gravity models have their roots in trade theory (Anderson and Van Wincoop (2003), Head and Mayer (2014)), the past decade has seen a boom of papers estimating gravity equations in international finance, and Okawa and Van Winkoop (2012) provide a formulation of the theoretical foundations of gravity models for financial assets. In our paper, the intention is to check whether countries allocate a smaller share of their cross-border investment to geopolitically more distant countries. Following the literature (Portes and Rey (2005), Courdacier and Rey (2013), IMF (2023b), IMF (2023c), Damgaard et al (2024), Campos et al. (2023)), the following model in its multiplicative form is estimated:

$$X_{i,j,t} = e^{\beta_0 + \beta_1 \, Geopolitical\ Distance_{i,j,t-1} + \Psi \, Gravity\ Controls_{i,j,t} + \nu_{i,t} + \nu_{j,t}} + \epsilon_{i,j,t} \tag{1}$$

$X_{i,j,t}$ is the share of recipient country i in the total cross-border allocation of investor country j at time t. The model is estimated for the share of portfolio investment (restated according to the residency of the ultimate parent entity) and the share of FDI (using CDIS data) as dependent variables. In both cases, the model is separately estimated for debt and equity.

Geopolitical Distance$_{i,j,t-1}$ is the lagged measure of geopolitical distance of countries i and j based on their voting behavior in the UNGA. To measure geopolitical tension, we construct an S score based on voting behavior at every roll-call in the UNGA since 1946 for every country pair (a replication of the S score used by IMF (2023b)). The intuition and computation are described in more detail in the following section. For robustness, the Ideal Point Distance (IPD) from Bailey et al. (2017) is used as an alternative proxy, and its intuition and advantages are also discussed in the section below. Note that geopolitical distance is lagged in order to tackle potential endogeneity concerns.

Gravity Controls$_{i,j,t}$ include a set of country-pair-specific bilateral gravity variables that could affect the ease of completing financial transactions between investor and recipient countries. They are obtained from the CEPII Gravity Database. More precisely, the controls included are i) distance (simple distance in kilometers between the most populated cities in the two countries), ii) common language (a dummy that takes the value 1 if countries share a common language spoken by at least 9% of the population), iii) common colonial history (a dummy that takes the value 1 if countries share a common colonizer post-1945), iv) common religion (an index that indicates religious proximity, by Disdier

and Mayer (2007)) v) contiguity (dummy equal to 1 if countries are contiguous). These controls are among the most often used in the gravity literature.

$\nu_{i,t}$ and $\nu_{j,t}$ are the recipient-time and the investor-time fixed effect respectively. These are the most commonly used fixed effects in the literature, and they account for any possibly country-specific factor that might be varying over time.

Note that all RHS variables are standardized to allow for direct comparison between geopolitical distance and controls.

The intuition behind the equation is that if investor countries tend to allocate a smaller share of their cross-border investment to recipient countries that are geopolitically more distant, then $\beta_1 < 0$.

In its main specification, the model is estimated through Poisson Pseudo Maximum Likelihood (PPML), and errors are clustered at the country-pair level (investor-recipient). Indeed, Santos Silva and Tenreyro (2006) show that under heteroskedasticity, the parameters of log-linearized models estimated by OLS lead to biased estimates of the true elasticities. Hence, they argue that the gravity equation should be estimated in its multiplicative form. However, since many papers in the literature still often present estimates obtained both through PPML and OLS, this paper also proposes the OLS estimation of the following log-linearized model as a robustness test.

$$logX_{i,j,t} = \beta_0 + \beta_1 Geopolitical\ Distance_{i,j,t-1} + \Psi Gravity\ Controls_{i,j,t} + \nu_{i,t} + \nu_{j,t} + \epsilon_{i,j,t} \quad (2)$$

Variables have the same meanings as in the main specification, but now the share of cross-border allocation is in logs. As in the main specification, RHS variables are standardized to allow for direct comparison between geopolitical distance and controls.

The model is estimated using several restrictions. Excluding robustness tests, it is estimated using 36 different specifications, which can be grouped into three steps.

- Firstly, the model is estimated on the entire 4 datasets of debt portfolio investment, equity portfolio investment, debt FDI, and equity FDI.

- Then, the model is estimated over the same 4 datasets but includes either Advanced Economies (AEs) or Emerging Market and Developing Economies (EMDEs) as **recipients**. This specification allows us to extrapolate whether investors reduce their allocation of cross-border investment in the same amount whether the geopolitically distant recipient country is an AE or an EMDE.

- Finally, the model is once again estimated over the same 4 datasets but includes either only AEs or only EMDEs as **investors**. This specification sheds light on whether AE and EMDE investor countries behave similarly in reducing their cross-border investment.[7]

[7]It is important to note that at this step some of the specifications reduce dramatically in sample size, so they might result

The robustness tests follow the same 3 steps, estimating each of the specifications above first with PPML and an alternative proxy for geopolitical distance (IPD), and then with OLS, both with the S score and IPD, for a total of 144 specifications. Additional specifications with restated FDI are also available in the Appendix, bringing the total number of estimations of the model to 216.

3.2 Geopolitical Distance Measures

The proxies used to capture bilateral geopolitical tensions rely on disagreements in voting stances taken by countries in the UNGA. More precisely, countries expressing similar voting behavior during any session will be considered relatively geopolitically close, while countries with repetitively opposing stances will be considered distant. Such an approach is consistent with the literature, which offers various ways to translate observed voting behaviors into measures of geopolitical distance (Gartzke (1998), Signorino and Ritter (1999), Häge (2011), Bailey et al (2017)).

In this analysis, we replicate the S score used by IMF (2023b). In the context of the UNGA, the measure is yearly and subsumes the voting behavior of countries in all the roll calls in a given year (there are about 65 to 95 roll calls every year in the UNGA). The data used to compute the measure comes from Voeten's dataset of raw roll call votes in the UNGA from 1946 to 2022 (Voeten (2013)), described in more detail in Section 2.

The S score (inspired by Häge (2011) and Signorino and Ritter (1999)) assigns a numerical value to each vote (yea=1, abstain=2, nay=3), computes the squared difference of the votes of two countries in a given roll call, sums over all the roll calls in a given year, and then standardizes the value so that GPD = 1 indicates complete disagreement, while GPD = –1 indicates complete agreement. For instance, two countries would have GPD = –1 in a given year if their voting behavior perfectly overlapped in every roll call in that year in which both countries voted.

$$\textit{Geopolitical Distance (GPD)}_{i,j} = (-1) * \underbrace{\left(1 - \frac{\sum_r (V_{i,r} - V_{j,r})^2}{\frac{1}{2}\sum_r (d_{max})^2}\right)}_{S\ score} \tag{3}$$

$V_{i,r}$ is the vote of country i in roll call r, and $V_{j,r}$ is the vote of country j in the same roll call r. d_{max} represents the maximum possible distance in voting between the two countries, which is constant over time and across all country pairs and, in particular, is equal to 3 – 1 = 2 (as mentioned earlier, yea=1, abstain=2, nay=3).

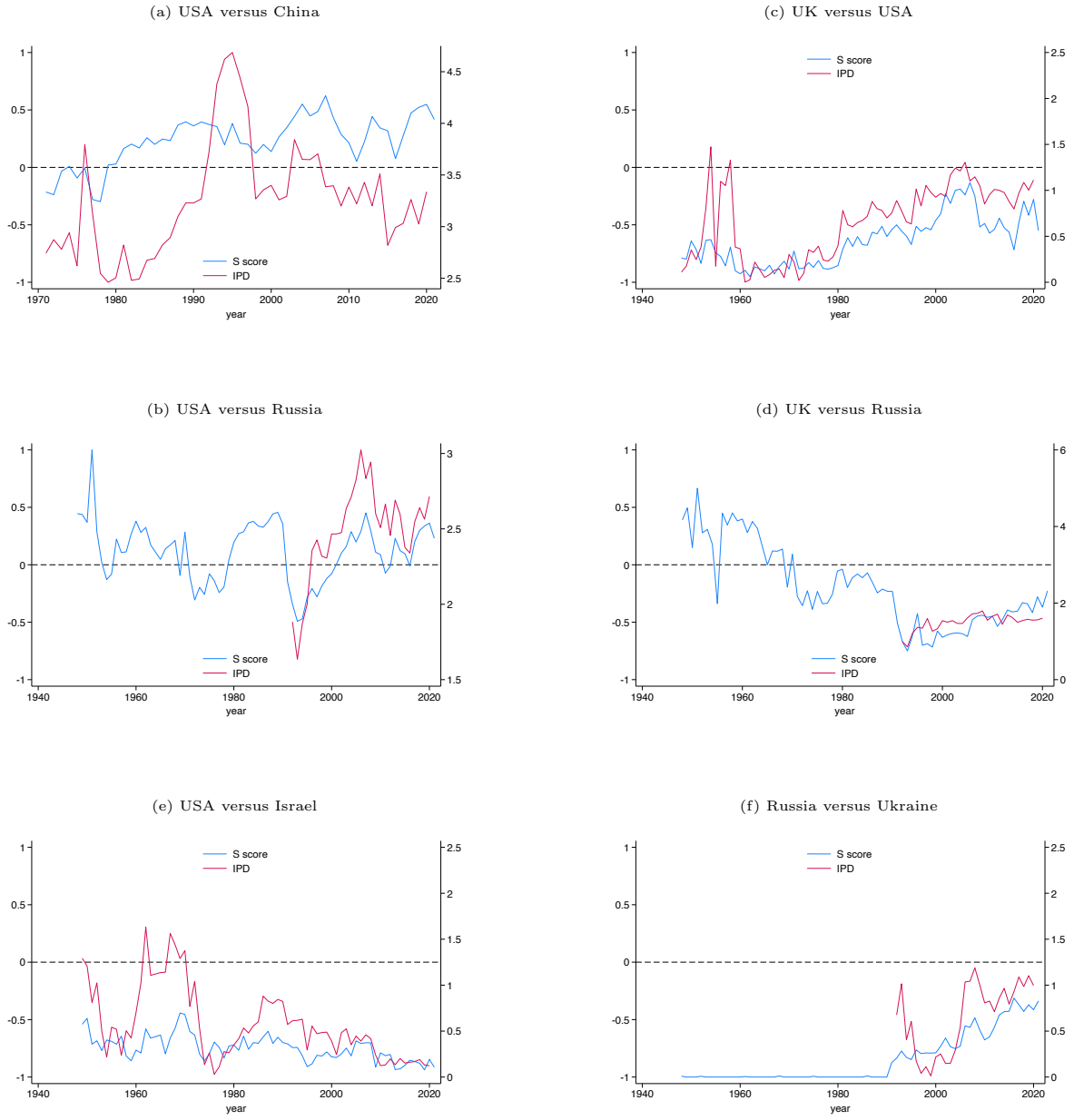
Note that even if the United Nations have one official session every year (composed of many roll calls), the roll calls often run into the first months of the following year. However, since the score computes a yearly measure, it sums over all the roll calls in a given year, not over the roll calls in a given session. Moreover, note that countries do

in non significant coefficients.

not necessarily vote in all roll calls, and when they do not, they are counted absent. As Voeten (2013) highlights, absences differ from abstentions as the former usually do not reflect a country's political view but instead are often caused by external forces such as a temporary lack of government. Hence, to compute the geopolitical distance between two countries, the score only considers roll calls in a given year in which both countries have voted (i.e., it excludes absences).

The S score, a dyadic indicator, is chosen as the primary proxy of geopolitical distance because it is the most commonly used in the literature. However, to perform robustness tests, this paper uses an alternative measure of geopolitical distance, still based on voting behavior in the UNGA, proposed by Bailey et al. (2017). Their IPD measure is derived through a dynamic ordinal spatial model. Authors argue that such an approach has advantages over dyadic similarity measures (such as S scores) since it allows for more valid intertemporal comparisons and distinguishes signals from noise when identifying changes in foreign policy preferences.

Figure 1: Geopolitical Distance Measures according to UNGA Voting



Note: The panel shows two measures of geopolitical distance (S score and IPD score) between some country pairs from 1946 to 2020. The two scores have different scales, where the S score has a minimum of –1, which coincides with complete agreement between the two countries, and a maximum of 1, which coincides with complete disagreement. The IPD has no maximum, but higher values indicate greater geopolitical distance.

4. Results

4.1 Portfolio Investment

Table 4.1 presents the effects of geopolitical tensions (measured in terms of voting behavior in the UNGA) on the cross-border allocation of tax-haven-restated Portfolio Investment. The main coefficient of interest is Geopolitical Distance$_{ij,t-1}$ (β_1 in Eq. 1), and as described in Section 3, $\beta_1 < 0$ implies that investor countries allocate a smaller share of their cross-border investment to countries that are geopolitically more distant.

Columns 1 and 4 present the findings for debt and equity using the broadest specification. This framework investigates how investor countries adjust their portfolio allocations in recipient economies that are geopolitically distant, irrespective of whether the investor or the recipient country are AEs or EMDEs. Results show that the average country allocates a smaller share of its cross-border investment (both equity and debt) to countries with distant foreign policy outlooks. Additionally, albeit only slightly, the negative reallocation is larger for equity than debt. More precisely, a one standard deviation[8] increase in geopolitical distance is associated with a fall in the debt portfolio share by 5%, while the fall is 6% in the equity share.[9] Coefficients are statistically significant at the 1% level. Additionally, gravity controls have economically significant effects, with geographical distance implying lower portfolio shares, and common language, colonial history, and religion implying higher portfolio shares. Comparatively speaking, geopolitical distance does not seem more relevant than other controls, and geographical distance has a large impact.[10]

Columns 2 and 3 show results for Debt Portfolio Investment where the recipient economies are AEs or EMDEs only. Similarly, Columns 5 and 6 show the same framework for Equity Portfolio Investment. This specification allows us to understand if investor countries allocate an even smaller share of capital investment to geopolitically distant EMDEs, as one might expect and was previously found by the literature. Findings show that this is the case for both debt and equity. While the negative coefficient on AEs is small and insignificant for debt and equity (likely due to the much smaller number of observations), it is significant at the 1% level for EMDEs. A one standard deviation increase in geopolitical distance between countries and EMDEs is associated with a 13% reduction in the debt share and a 19% reduction in the equity share. Note that the share decline is over twice as large as that in the most general specification for debt (column 1), and over three times as large as that for equity (column 4). Additionally, compared to other

[8] A one standard deviation increase in geopolitical tensions corresponds to the increase in foreign policy distance between China and the United States during trade tensions.

[9] The effect is computed as $100 * (e^{\beta_1} - 1) * Std.Dev.GeopoliticalDistance$

[10] Note that this comparison is possible because all the RHS variables are standardized

Table 4.1: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.221***	-0.121	-0.656***	-0.264***	-0.0352	-1.256***
	(0.067)	(0.104)	(0.131)	(0.063)	(0.102)	(0.209)
Distance$_{ij}$	-0.628***	-0.541***	-0.897***	-0.681***	-0.644***	-0.819***
	(0.054)	(0.069)	(0.087)	(0.078)	(0.073)	(0.140)
Common Language$_{ij}$	0.300***	0.321***	0.353***	0.262***	0.292***	0.276**
	(0.043)	(0.045)	(0.082)	(0.066)	(0.055)	(0.106)
Common Colonial History$_{ij}$	0.326***	0.198	0.249**	0.336**	0.187	0.187
	(0.078)	(0.134)	(0.083)	(0.106)	(0.112)	(0.102)
Common Religion$_{ij}$	0.260***	0.153*	0.459***	0.421***	0.299***	0.921***
	(0.061)	(0.076)	(0.099)	(0.080)	(0.084)	(0.157)
Contiguity$_{ij}$	0.0321	0.0994***	-0.0297	-0.0429	0.0140	-0.122*
	(0.022)	(0.025)	(0.033)	(0.035)	(0.036)	(0.048)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	70,738	15,926	54,139	71,051	16,021	53,262

[11]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

controls, which are still statistically and economically significant, geopolitical distance now seems highly relevant and is the most relevant for Equity Portfolio Investment.

Tables 4.2 and 4.3 present the effects of geopolitical tensions on the cross-border allocation of tax haven restated Portfolio Investment of AE and EMDE investors, respectively. This specification enables a clear distinction between the behaviors of AE and EMDE investors and represents a contribution to the literature. It recognizes that these two groups of countries are likely to respond differently to geopolitical tensions, prompting varied capital share reallocations. While results are less statistically significant, some trends arise. Especially for Equity Portfolio Investment, EMDE investors seem to allocate a much smaller portfolio share to geopolitically distant EMDE recipient countries than AEs do. For instance, AEs seem to reduce their equity portfolio share in EMDEs by 14% in association with a one standard deviation increase in geopolitical distance, while EMDEs reduce it by 23%. The opposite seems to hold for debt portfolio shares, but the difference is not as striking. Given the lower significance and the steep reduction in the number of observations in some specifications, robustness tests are crucial for more conclusive results on these trends. However, the main conclusions still hold: geopolitical tensions negatively impact cross-border portfolio allocation, and investors allocate an even smaller share of investment to EMDEs. Note that this is in line with the literature, but contributes a cross-investor comparison which was not available for Portfolio Investment. Additionally, this result is derived with tax-haven adjusted restatements, which were not previously considered by the literature in this context.

Table 4.2: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.355***	-0.399***	-1.123***	-0.235**	-0.240**	-0.753**
	(0.081)	(0.079)	(0.277)	(0.077)	(0.075)	(0.287)
Distance$_{ij}$	-0.347***	-0.370***	-0.360*	-0.491***	-0.505***	-0.480***
	(0.065)	(0.068)	(0.141)	(0.083)	(0.088)	(0.109)
Common Language$_{ij}$	0.164**	0.169**	0.281**	0.216***	0.241***	0.169*
	(0.057)	(0.063)	(0.099)	(0.058)	(0.067)	(0.067)
Common Colonial History$_{ij}$	0.113	-0.245*	0.273**	0.0387	-0.455***	0.228***
	(0.091)	(0.108)	(0.097)	(0.101)	(0.115)	(0.064)
Common Religion$_{ij}$	0.325***	0.331***	-0.190	0.260*	0.271*	-0.113
	(0.075)	(0.082)	(0.185)	(0.124)	(0.131)	(0.159)
Contiguity$_{ij}$	0.0732**	0.0646*	0.271***	0.0000869	0.00515	0.109
	(0.027)	(0.029)	(0.056)	(0.038)	(0.041)	(0.075)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	17,903	4,338	13,268	17,278	4,392	12,786

[12]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table 4.3: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.118	0.319	-0.898***	-0.534***	0.393*	-1.937***
	(0.100)	(0.163)	(0.152)	(0.139)	(0.192)	(0.257)
Distance$_{ij}$	-0.701***	-0.542***	-0.983***	-0.732***	-0.751***	-1.007***
	(0.072)	(0.101)	(0.095)	(0.118)	(0.104)	(0.181)
Common Language$_{ij}$	0.297***	0.345***	0.343***	0.234*	0.245**	0.216
	(0.057)	(0.064)	(0.090)	(0.094)	(0.085)	(0.115)
Common Colonial History$_{ij}$	0.353***	0.240	0.237**	0.357**	0.215	0.156
	(0.087)	(0.136)	(0.088)	(0.117)	(0.119)	(0.110)
Common Religion$_{ij}$	0.234**	0.0756	0.480***	0.483***	0.424***	0.971***
	(0.080)	(0.118)	(0.110)	(0.104)	(0.114)	(0.181)
Contiguity$_{ij}$	0.00969	0.172***	-0.0612	-0.0552	0.0499	-0.151**
	(0.029)	(0.029)	(0.034)	(0.046)	(0.053)	(0.049)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	45,842	11,478	34,059	47,323	11,459	34,372

[13]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

4.2 Foreign Direct Investment

Table 4.4 presents the effects of geopolitical tensions (measured in terms of voting behavior in the UNGA) on the cross-border allocation of non-restated FDI. As above, the main coefficient of interest is Geopolitical Distance$_{ij,t1}$ and $\beta_1 < 0$ implies that investor countries allocate a smaller share of their cross-border FDI to geopolitically more distant recipient countries. Columns follow the same framework presented for Portfolio Investment, where Columns 1 and 4 represent the broadest specification for all recipients (Debt and Equity, respectively), and Columns 2-3 and 5-6 show results for Debt FDI and Equity FDI where recipient economies are AEs or EMDEs only.

Results in Columns 1 and 4 confirm that also for FDI, the average country allocates a smaller share of its cross-border investment (both debt and equity) to countries with distant foreign policy outlooks. This conclusion matches that of IMF (2023c). In this case, the difference between debt and equity is subtle, with one standard deviation increase in geopolitical distance associated with an FDI share reduction of 6% for both asset classes. This result contributes by providing a cross-asset analysis for FDI, which the literature has not performed (recall that IMF (2023c) focuses on differences across sectors). Results are statistically significant at 1%, gravity controls are economically meaningful, and Geopolitical Distance is not comparatively more relevant than all controls. Moreover, note that the magnitude of the decline in FDI share is directly comparable to that of Portfolio Investment.

Columns 2-3 and 5-6 also present the same conclusion reached for Portfolio Investment: countries allocate an even smaller share of FDI investment to geopolitically distant EMDEs. A one standard deviation increase in geopolitical distance is associated with an FDI share decline of 10% for both debt and equity in EMDEs (columns 3 and 6). In contrast, the decline is smaller for AEs (columns 2 and 5). Note that while coefficients on AEs are insignificant, the direction is still negative. The fall in FDI share in EMDEs is roughly twice as much as in the most general specification for debt and equity (columns 1 and 4). Moreover, note that, as in columns 1 and 6, the difference between debt and equity is subtle. This conclusion contrasts with results obtained for Portfolio Investment, for which equity shares are much more volatile than debt shares.

Interestingly, the fall in FDI share is significantly lower than the fall in Portfolio Investment share: the Portfolio investment share decline in EMDEs associated with one standard deviation increase in geopolitical distance was 13% for debt and 19% for equity (vs 10% for FDI). This result seems reasonable and is aligned with literature arguing that direct investment is more stable and resilient to crises (Milesi-Ferretti and Tille (2011), Cavallo and Frankel (2008), Busse and Hefeker (2007)). Indeed, FDI often involves long-term investments that are not easily withdrawn at the first sign of trouble. In this case, this could be interpreted as a difficulty in promptly reallocating FDI in the face of rising

Table 4.4: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.251***	-0.155	-0.480***	-0.236***	-0.0135	-0.424***
	(0.058)	(0.087)	(0.085)	(0.063)	(0.075)	(0.109)
Distance$_{ij}$	-0.853***	-0.555***	-1.390***	-1.005***	-0.678***	-1.576***
	(0.084)	(0.081)	(0.096)	(0.072)	(0.072)	(0.154)
Common Language$_{ij}$	0.178***	0.111	0.249***	0.192***	0.241***	0.104
	(0.052)	(0.065)	(0.055)	(0.048)	(0.066)	(0.061)
Common Colonial History$_{ij}$	0.189**	0.147	0.221***	0.174***	0.238*	0.137*
	(0.060)	(0.148)	(0.056)	(0.052)	(0.106)	(0.059)
Common Religion$_{ij}$	0.278***	0.294***	0.236***	0.355***	0.307***	0.436***
	(0.057)	(0.080)	(0.069)	(0.049)	(0.073)	(0.088)
Contiguity$_{ij}$	0.0933***	0.0906**	0.136***	0.119***	0.134***	0.0962***
	(0.021)	(0.031)	(0.023)	(0.017)	(0.029)	(0.020)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	76,894	15,148	58,773	88,150	19,045	68,027

[14]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

geopolitical tensions.

Tables 4.5 and 4.6 present the effects of geopolitical tensions on the cross-border allocation of non-restated FDI of AE and EMDE investors, respectively. As for Portfolio Investment, this specification recognizes that these two groups are likely to reallocate capital differently. Note that results in Table 4.5 are widely insignificant, and some coefficients are not economically meaningful. For instance, coefficients of Geopolitical Distance in columns 3 and 6 are positive, suggesting that countries allocate a larger share of FDI to more geopolitically distant countries. Additionally, coefficients of Common Language in columns 1 and 2 are negative, implying that AEs allocate a smaller share of FDI to countries with a common language. These counterintuitive albeit insignificant results suggest that alternative specifications, such as those performed in Section 5, might be more conclusive. Table 4.6 provides more significant results and detects a negative correlation between geopolitical tensions and the debt and equity FDI of EMDEs in EMDEs themselves. This suggests that EMDEs allocate a much smaller portfolio share to geopolitically distant EMDEs recipient countries than AE investors do (AE investors had insignificant yet positive coefficients in Table 4.5 columns 3 and 6).

Note that the same considerations on the role of tax havens made for Portfolio Investment also hold for FDI, meaning that performing the same analysis on restated FDI would be more representative. However, as explained in Section 2, no cross-asset restatement of FDI exists, hence the decision to use non-restated FDI. Table A.2 in the Appendix provides a preliminary analysis for total restated FDI.

Table 4.5: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.152	-0.216	0.346*	0.0506	0.0334	0.754
	(0.138)	(0.136)	(0.166)	(0.094)	(0.103)	(0.393)
Distance$_{ij}$	-0.640***	-0.619***	-0.685***	-0.730***	-0.653***	-1.124***
	(0.052)	(0.059)	(0.099)	(0.068)	(0.064)	(0.107)
Common Language$_{ij}$	-0.0306	-0.0937	0.204**	0.149*	0.0997	0.294***
	(0.054)	(0.063)	(0.065)	(0.059)	(0.073)	(0.076)
Common Colonial History$_{ij}$	0.394**	0.419*	0.407***	0.373***	0.383**	0.284*
	(0.122)	(0.179)	(0.114)	(0.103)	(0.144)	(0.125)
Common Religion$_{ij}$	0.306***	0.298***	0.0788	0.339***	0.310***	0.120
	(0.062)	(0.072)	(0.083)	(0.073)	(0.084)	(0.094)
Contiguity$_{ij}$	0.118***	0.129***	0.167***	0.155***	0.173***	0.151***
	(0.025)	(0.033)	(0.029)	(0.027)	(0.034)	(0.032)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	34,786	7,425	26,877	41,752	10,032	31,502

[15]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table 4.6: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.207	0.332	-0.806***	-0.296*	0.359	-0.796***
	(0.124)	(0.236)	(0.142)	(0.149)	(0.260)	(0.196)
Distance$_{ij}$	-1.155***	-0.537**	-1.875***	-1.273***	-0.784***	-1.894***
	(0.157)	(0.192)	(0.149)	(0.114)	(0.168)	(0.228)
Common Language$_{ij}$	0.377***	0.415***	0.221**	0.232***	0.470***	0.0276
	(0.067)	(0.089)	(0.074)	(0.059)	(0.089)	(0.076)
Common Colonial History$_{ij}$	0.0677	-0.0536	0.167*	0.0793	0.116	0.0951
	(0.072)	(0.149)	(0.069)	(0.060)	(0.115)	(0.073)
Common Religion$_{ij}$	0.268**	0.121	0.280*	0.355***	0.0232	0.459***
	(0.097)	(0.181)	(0.138)	(0.078)	(0.180)	(0.133)
Contiguity$_{ij}$	0.119***	0.105	0.100***	0.110***	0.0781	0.0774***
	(0.030)	(0.054)	(0.029)	(0.024)	(0.057)	(0.023)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	38,206	7,511	28,423	44,183	9,013	34,344

[16]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

5. Robustness

Robustness tests performed include i) the estimation via OLS instead of PPML and ii) an alternative measure of geopolitical distance (IPD). For more details on the empirical estimation, see Section 3. For complete results and tables, see Appendix A.4. Note that coefficients provide information on the correlation of geopolitical distance with capital shares, but are not interpreted as causal relationships.

Firstly, robustness results confirm conclusions achieved in the main specification: countries allocate a smaller share of Portfolio Investment and FDI to recipient countries with more distant foreign policy outlooks. Additionally, the effect is more pronounced for recipient EMDEs. Note that this is true for all types of investors (All, AEs, and EMDEs) in all robustness tests. The only exceptions concern statistically insignificant coefficients.[17] This conclusion matches that of the literature, but is derived by carefully taking into account the role of tax-havens for Portfolio Investment. Additionally, it is reached through FDI flows rather than volumes or number of project (as IMF (2023c) did instead) and shows cross-investor differences.

Moreover, robustness specifications allow us to achieve more conclusive results on less clear-cut trends analyzed in Section 4. One trend discussed above is that geopolitical tensions seem to be associated with a larger decline in equity portfolio share than in debt portfolio share (especially when the recipients are EMDEs). However, there seemed to be no significant difference in the declines of debt FDI and equity FDI. Robustness tests widely support this conclusion. Focusing on recipient EMDEs (columns 3 and 6), the decline in equity portfolio share is larger than the decline in debt portfolio share in all specifications except for one. The same is true for All recipients (columns 1 and 4) for almost all specifications, implying that for the average recipient, the portfolio equity flight is larger than the debt one. See Tables A.3 to A.11. However, the same cannot be said for FDI, which presents coefficients for debt and equity which are very similar in magnitude. See Tables A.12 to A.20. This result is new in the literature and prompts further research to explain the drivers behind the cross-asset difference in the reaction of FDI and Portfolio Investment.

Another recognizable pattern is that the magnitude of FDI share reduction is much smaller than that of Portfolio share, especially when recipient countries are EMDEs. A one-to-one comparison of all robustness specifications of Portfolio Investment versus FDI supports this conclusion. Indeed, while investment share in All recipients (columns 1 and 4 cross-asset) declines by a comparable amount for Portfolio and FDI, the investment share decline in EMDEs is consistently smaller for FDI (columns 3 and 6 cross-asset). As

[17] These isolated cases are mostly on results for AE investors only or on EMDE investors in AE recipients only (the number of observations for those specifications drastically drops to as low as 3,718 for Portfolio Investment and 3,683 for FDI).

discussed above, this can be attributable to the more stable and resilient nature of FDI with respect to Portfolio Investment, which is documented in the literature. However, it represents a new result in the context of geopolitical fragmentation and it paves the way for more extensive research.

Finally, in Section 4, EMDEs seem to decrease their investment in geopolitically distant recipient EMDEs more than AEs do (especially for equity). In the main analysis, the result holds for Portfolio Investment but less significantly for FDI. Robustness tests lead to very similar conclusions. For Portfolio Investment, EMDEs decrease their investment in other EMDEs by more than investor AEs do for both equity and debt in almost all specifications. Albeit significant, the difference between investor AEs and EMDEs is smaller for debt than equity. See Tables A.4 vs A.5, A.7 vs A.8, A10 vs A.11 (columns 3 and 6). This result reminds of IMF (2023c), who conclude that the impact of geopolitical distance on FDI flows is especially driven by South-South flows (both the source and the destination country is an EMDE). However, the effect was not previously tested by the literature for Portfolio Investment, making the result a new contribution. Interestingly, the same analysis for FDI leads to more inconclusive results (as in Section 4), mainly due to the highly insignificant coefficients for investor AEs.

6. Conclusions

This study provides empirical evidence on how geopolitical tensions influence cross-border capital investment, focusing on a direct comparison between Portfolio Investment and FDI. By estimating a gravity model and proxying geopolitical distance through voting behavior in the UNGA, the analysis reveals several key trends that offer insights for policymakers aiming to mitigate financial fragmentation during periods of diplomatic strain. Firstly, the findings indicate that investors tend to allocate a smaller share of capital to countries with foreign policy outlooks that are more distant from their own. This effect is more pronounced for recipient EMDEs and holds for both Portfolio Investment and FDI. Secondly, the study finds that FDI is more resilient to geopolitical tensions than Portfolio Investment. This conclusion aligns with existing literature suggesting that FDI is generally more stable and less prone to sudden withdrawals during crises. Moreover, it paves the way for more extensive research on FDI volatility in the context of geopolitical fragmentation. Thirdly, for Portfolio Investment, results show that equity shares are more sensitive to geopolitical tensions than debt shares, especially when recipient countries are EMDEs. This trend is not observed for FDI, where the declines in equity and debt investments are similar in magnitude. Lastly, the analysis highlights a distinctive pattern where EMDE investors reduce their portfolio investments in other geopolitically distant EMDEs more significantly than AE investors. This effect is stronger for equity investments than for debt investments. The pattern is less clear for FDI.

A. Appendix

A.1 Advanced Economies and Emerging Markets Classification

Table A.1: Classification of Economies

Advanced Economies	**Emerging Markets and Developing Economies**
Andorra, Australia, Austria, Belgium, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, United Kingdom, United States	Afghanistan, Albania, Algeria, Angola, Antigua and Barbuda, Argentina, Armenia, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Costa Rica, Croatia, Cuba, Cyprus, Czech Republic, Democratic Republic of the Congo, Djibouti, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Eritrea, Estonia, Eswatini, Ethiopia, Fiji, Gabon, Gambia, Georgia, Ghana, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Hungary, Iceland, India, Indonesia, Iran, Iraq, Israel, Ivory Coast, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kiribati, Kuwait, Kyrgyzstan, Laos, Latvia, Lebanon, Lesotho, Liberia, Libya, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Marshall Islands, Mauritania, Mauritius, Mexico, Micronesia, Moldova, Monaco, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nauru, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Nigeria, North Korea, North Macedonia, Norway, Oman, Pakistan, Palau, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Qatar, Romania, Russia, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, San Marino, Sao Tome and Principe, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Singapore, Slovakia, Slovenia, Solomon Islands, Somalia, South Africa, South Korea, South Sudan, Spain, Sri Lanka, Sudan, Suriname, Sweden, Switzerland, Syria, Taiwan, Tajikistan, Tanzania, Thailand, Timor-Leste, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Tuvalu, Uganda, Ukraine, United Arab Emirates, United Kingdom, United States, Uruguay, Uzbekistan, Vanuatu, Vatican City, Venezuela, Vietnam, Yemen, Zambia, Zimbabwe

Source: IMF World Economic Outlook Apr 2023

A.2 Phantom FDI

As mentioned above, to date, no restatement of FDI that separates equity and debt exists. However, Damgaard et al. (2024) propose an alternative restatement for total FDI, which disentangles Real FDI and Phantom FDI by allocating real investment to ultimate investor economies. More precisely, they define Phantom FDI as investments into empty corporate shells without link to the local real economy. They find that ignoring Phantom FDI and allocating Real FDI to ultimate investors increases the explanatory power of standard gravity variables by around 25 percent. Hence, we attempt to estimate our model specification for the restatements of Real FDI and Real FDI to ultimate investors. While all the attempted specifications are mostly insignificant, we can still see a pattern. Both for Real FDI and Real FDI to Ultimate Investors, countries tend to allocate a smaller share of FDI to geopolitically distant countries, even more so if the distant country is an emerging market.

Table A.2: Effect of Geopolitical Distance on Cross-Border **Real FDI** Allocation of **All Investors**

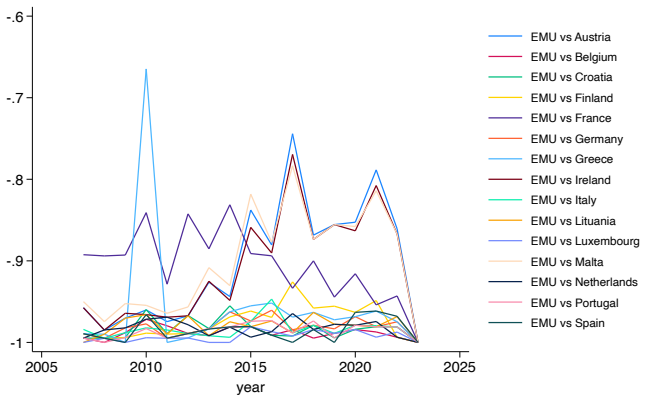
	Real FDI			Real FDI Ultimate Investors		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.379*	0.312	-0.543*	-0.406*	0.400	-0.493*
	(0.160)	(0.391)	(0.238)	(0.167)	(0.422)	(0.246)
Distance$_{ij}$	-1.323***	-0.836***	-1.500***	-1.305***	-0.816***	-1.505***
	(0.051)	(0.096)	(0.068)	(0.054)	(0.108)	(0.070)
Common Language$_{ij}$	1.055***	0.935***	1.081***	1.115***	1.001***	1.103***
	(0.102)	(0.182)	(0.124)	(0.106)	(0.189)	(0.129)
Common Colonial History$_{ij}$	0.803***	1.178***	0.721***	0.829***	1.379***	0.747***
	(0.156)	(0.343)	(0.177)	(0.163)	(0.377)	(0.182)
Common Religion$_{ij}$	1.290***	1.398***	1.197***	1.308***	1.345***	1.190***
	(0.145)	(0.215)	(0.204)	(0.154)	(0.235)	(0.212)
Contiguity$_{ij}$	0.549***	0.546*	0.651***	0.529***	0.548*	0.577**
	(0.138)	(0.232)	(0.176)	(0.142)	(0.235)	(0.181)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	37,290	10,741	26,449	23,940	6,412	17,455

[18]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

A.3 Geopolitical Distance Measure for EMU

In the main dataset for Portfolio Investment, restatements only provide EMU data as a block. We argued that this forces us to drop it because of the absence of bilateral gravity controls between EMU as a block and other countries and also because EMU does not vote as a block in the UNGA. However, we show that from 2007 to 2022, assuming as a vote for EMU the mode of votes of all EMU countries, the geopolitical distance between EMU as a block and EMU countries is mostly hovering around –1.

Figure A.1: Geopolitical Distance Measures according to UNGA Voting



Note: The figure shows the S score measure of geopolitical distance between EMU as a block and some countries in the EMU. The vote assigned to EMU as a block in the computation of these indexes is the mode of the votes of all countries in EMU. Dates span 2007 to 2022. Except for a few deviations like Greece in 2010 (likely due to the debt crisis), the countries are fairly aligned in these years, consistently displaying a geopolitical distance that hovers aroung –1 (–0.9 in few cases)

A.4 Robustness Results

This section includes all the robustness test results performed for Section 5.

Note that the tables follow the following structure:

- Portfolio Investment
  - OLS regressions, S score as measure of geopolitical distance (A.3 to A.5)
  - PPML regressions, IPD score as measure of geopolitical distance (A.6 to A.8)
  - OLS regressions, IPD score as measure of geopolitical distance (A.9 to A.11)
- FDI
  - OLS regressions, S score as measure of geopolitical distance (A.12 to A.14)
  - PPML regressions, IPD score as measure of geopolitical distance (A.15 to A.17)
  - OLS regressions, IPD score as measure of geopolitical distance (A.18 to A.20)

Table A.3: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.544***	-0.236	-0.902***	-0.632***	-0.264	-1.052***
	(0.045)	(0.138)	(0.092)	(0.056)	(0.137)	(0.134)
Distance$_{ij}$	-0.796***	-0.835***	-0.800***	-0.840***	-0.895***	-0.784***
	(0.040)	(0.082)	(0.046)	(0.051)	(0.086)	(0.066)
Common Language$_{ij}$	0.230***	0.210***	0.266***	0.329***	0.289***	0.373***
	(0.038)	(0.063)	(0.047)	(0.048)	(0.071)	(0.061)
Common Colonial History$_{ij}$	0.135**	-0.0488	0.132**	0.208***	0.0777	0.187**
	(0.044)	(0.105)	(0.048)	(0.054)	(0.089)	(0.064)
Common Religion$_{ij}$	0.182***	0.119	0.124*	0.406***	0.221**	0.524***
	(0.040)	(0.070)	(0.049)	(0.061)	(0.084)	(0.085)
Contiguity$_{ij}$	0.159***	0.156**	0.174***	0.148***	0.159*	0.163***
	(0.033)	(0.057)	(0.040)	(0.038)	(0.065)	(0.045)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	31,055	12,247	18,803	26,963	11,258	15,702

[19]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table A.4: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.372***	-0.207	-0.729***	-0.450**	-0.103	-0.811**
	(0.085)	(0.166)	(0.156)	(0.138)	(0.234)	(0.254)
Distance$_{ij}$	-0.538***	-0.544***	-0.539***	-0.590***	-0.728***	-0.595***
	(0.062)	(0.096)	(0.077)	(0.087)	(0.113)	(0.110)
Common Language$_{ij}$	0.133**	0.286***	0.0638	0.100	0.170	0.0131
	(0.050)	(0.077)	(0.058)	(0.064)	(0.088)	(0.083)
Common Colonial History$_{ij}$	-0.0496	-0.241	0.00437	0.0319	-0.259**	0.193
	(0.069)	(0.126)	(0.077)	(0.140)	(0.098)	(0.170)
Common Religion$_{ij}$	0.180*	0.385***	-0.0892	0.240*	0.305*	0.151
	(0.088)	(0.091)	(0.112)	(0.103)	(0.118)	(0.159)
Contiguity$_{ij}$	0.156*	0.0654	0.348	0.0990	0.128	0.0152
	(0.077)	(0.071)	(0.209)	(0.081)	(0.086)	(0.184)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,567	3,822	6,745	9,584	3,718	5,866

[20]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table A.5: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.707***	-0.354	-1.360***	-1.143***	-0.785***	-1.972***
	(0.080)	(0.278)	(0.180)	(0.101)	(0.230)	(0.242)
Distance$_{ij}$	-0.860***	-1.029***	-0.832***	-0.955***	-1.058***	-0.875***
	(0.051)	(0.104)	(0.058)	(0.068)	(0.111)	(0.086)
Common Language$_{ij}$	0.250***	0.184*	0.285***	0.340***	0.314***	0.373***
	(0.052)	(0.083)	(0.065)	(0.064)	(0.093)	(0.083)
Common Colonial History$_{ij}$	0.166**	-0.0128	0.147*	0.192**	0.0675	0.144
	(0.054)	(0.128)	(0.059)	(0.064)	(0.107)	(0.078)
Common Religion$_{ij}$	0.106*	-0.181	0.0958	0.306***	0.110	0.383***
	(0.049)	(0.093)	(0.058)	(0.077)	(0.119)	(0.103)
Contiguity$_{ij}$	0.129***	0.182*	0.110**	0.114**	0.127	0.0849
	(0.035)	(0.076)	(0.042)	(0.041)	(0.087)	(0.046)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	20,212	8,408	11,799	17,054	7,534	9,517

[21]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table A.6: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.272***	-0.170	-0.600***	-0.308***	-0.0651	-0.883***
	(0.061)	(0.119)	(0.108)	(0.060)	(0.109)	(0.135)
Distance$_{ij}$	-0.616***	-0.538***	-0.889***	-0.665***	-0.643***	-0.872***
	(0.054)	(0.069)	(0.086)	(0.077)	(0.073)	(0.138)
Common Language$_{ij}$	0.292***	0.314***	0.337***	0.253***	0.289***	0.294**
	(0.043)	(0.045)	(0.082)	(0.066)	(0.056)	(0.108)
Common Colonial History$_{ij}$	0.314***	0.189	0.249**	0.327**	0.182	0.201
	(0.078)	(0.132)	(0.086)	(0.107)	(0.114)	(0.103)
Common Religion$_{ij}$	0.247***	0.154*	0.451***	0.413***	0.299***	0.865***
	(0.061)	(0.075)	(0.101)	(0.078)	(0.084)	(0.151)
Contiguity$_{ij}$	0.0333	0.101***	-0.0221	-0.0403	0.0144	-0.114*
	(0.022)	(0.024)	(0.032)	(0.034)	(0.036)	(0.047)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	70,738	15,926	54,139	71,051	16,021	53,262

[22]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.7: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.298**	-0.364**	-0.743***	-0.205*	-0.220*	-1.130**
	(0.107)	(0.130)	(0.218)	(0.094)	(0.110)	(0.354)
Distance$_{ij}$	-0.362***	-0.388***	-0.373**	-0.496***	-0.511***	-0.472***
	(0.069)	(0.070)	(0.142)	(0.086)	(0.091)	(0.102)
Common Language$_{ij}$	0.164**	0.162*	0.301**	0.218***	0.241***	0.171*
	(0.056)	(0.063)	(0.106)	(0.058)	(0.065)	(0.069)
Common Colonial History$_{ij}$	0.0984	-0.280**	0.254**	0.0275	-0.486***	0.214***
	(0.096)	(0.096)	(0.098)	(0.103)	(0.120)	(0.064)
Common Religion$_{ij}$	0.299***	0.305***	-0.164	0.245*	0.258*	-0.0812
	(0.077)	(0.084)	(0.185)	(0.123)	(0.131)	(0.159)
Contiguity$_{ij}$	0.0825**	0.0748**	0.260***	0.00826	0.0130	0.0956
	(0.026)	(0.028)	(0.058)	(0.037)	(0.039)	(0.070)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	17,903	4,338	13,268	17,278	4,392	12,786

[23]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.8: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.258**	0.111	-0.783***	-0.634***	0.153	-1.305***
	(0.088)	(0.189)	(0.121)	(0.114)	(0.226)	(0.149)
Distance$_{ij}$	-0.681***	-0.536***	-0.982***	-0.705***	-0.739***	-1.108***
	(0.071)	(0.100)	(0.095)	(0.115)	(0.104)	(0.182)
Common Language$_{ij}$	0.297***	0.355***	0.323***	0.221*	0.260**	0.244*
	(0.056)	(0.063)	(0.088)	(0.092)	(0.085)	(0.116)
Common Colonial History$_{ij}$	0.336***	0.221	0.245**	0.348**	0.194	0.184
	(0.087)	(0.128)	(0.092)	(0.120)	(0.126)	(0.112)
Common Religion$_{ij}$	0.219**	0.0667	0.468***	0.476***	0.406***	0.892***
	(0.081)	(0.117)	(0.112)	(0.104)	(0.116)	(0.172)
Contiguity$_{ij}$	0.00864	0.176***	-0.0482	-0.0504	0.0554	-0.138**
	(0.029)	(0.030)	(0.032)	(0.046)	(0.055)	(0.048)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	45,842	11,478	34,059	47,323	11,459	34,372

[24]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.9: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.500***	-0.317*	-0.724***	-0.582***	-0.311*	-0.905***
	(0.037)	(0.127)	(0.070)	(0.049)	(0.126)	(0.107)
Distance$_{ij}$	-0.797***	-0.829***	-0.816***	-0.833***	-0.891***	-0.791***
	(0.040)	(0.082)	(0.046)	(0.051)	(0.086)	(0.066)
Common Language$_{ij}$	0.226***	0.204**	0.256***	0.322***	0.284***	0.357***
	(0.038)	(0.063)	(0.046)	(0.048)	(0.071)	(0.061)
Common Colonial History$_{ij}$	0.116**	-0.0655	0.118*	0.189***	0.0662	0.165*
	(0.044)	(0.104)	(0.048)	(0.054)	(0.089)	(0.064)
Common Religion$_{ij}$	0.169***	0.121	0.111*	0.386***	0.222**	0.499***
	(0.040)	(0.070)	(0.049)	(0.061)	(0.084)	(0.085)
Contiguity$_{ij}$	0.159***	0.156**	0.179***	0.149***	0.159*	0.166***
	(0.033)	(0.057)	(0.040)	(0.037)	(0.065)	(0.044)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	31,055	12,247	18,803	26,963	11,258	15,702

[25]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.10: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.326***	-0.0425	-0.640***	-0.389**	-0.0158	-0.853***
	(0.081)	(0.181)	(0.153)	(0.134)	(0.222)	(0.251)
Distance$_{ij}$	-0.539***	-0.549***	-0.543***	-0.593***	-0.731***	-0.584***
	(0.062)	(0.096)	(0.076)	(0.088)	(0.113)	(0.107)
Common Language$_{ij}$	0.132**	0.293***	0.0617	0.102	0.174	0.0183
	(0.051)	(0.078)	(0.058)	(0.064)	(0.090)	(0.083)
Common Colonial History$_{ij}$	-0.0649	-0.264*	-0.0147	0.0139	-0.271**	0.158
	(0.069)	(0.119)	(0.077)	(0.141)	(0.097)	(0.170)
Common Religion$_{ij}$	0.177*	0.381***	-0.0788	0.234*	0.303*	0.153
	(0.088)	(0.091)	(0.112)	(0.103)	(0.118)	(0.158)
Contiguity$_{ij}$	0.157*	0.0680	0.338	0.0995	0.130	0.00254
	(0.076)	(0.071)	(0.208)	(0.081)	(0.085)	(0.182)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,567	3,822	6,745	9,584	3,718	5,866

[26]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.11: Effect of Geopolitical Distance on Cross-Border **Portfolio** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.628***	-0.567*	-0.946***	-0.971***	-0.880***	-1.435***
	(0.061)	(0.223)	(0.119)	(0.082)	(0.194)	(0.175)
Distance$_{ij}$	-0.867***	-1.013***	-0.857***	-0.959***	-1.045***	-0.898***
	(0.051)	(0.104)	(0.058)	(0.068)	(0.112)	(0.086)
Common Language$_{ij}$	0.242***	0.175*	0.272***	0.323***	0.304**	0.337***
	(0.051)	(0.083)	(0.065)	(0.063)	(0.093)	(0.083)
Common Colonial History$_{ij}$	0.150**	-0.0420	0.139*	0.179**	0.0492	0.131
	(0.054)	(0.129)	(0.058)	(0.064)	(0.107)	(0.079)
Common Religion$_{ij}$	0.0900	-0.176	0.0777	0.285***	0.115	0.363***
	(0.049)	(0.093)	(0.059)	(0.077)	(0.119)	(0.104)
Contiguity$_{ij}$	0.130***	0.180*	0.125**	0.118**	0.123	0.103*
	(0.035)	(0.077)	(0.041)	(0.041)	(0.088)	(0.046)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	20,212	8,408	11,799	17,054	7,534	9,517

[27]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.12: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.305***	-0.278*	-0.546***	-0.450***	-0.127	-0.571***
	(0.050)	(0.119)	(0.104)	(0.050)	(0.122)	(0.102)
Distance$_{ij}$	-0.877***	-0.705***	-1.004***	-1.065***	-0.855***	-1.188***
	(0.053)	(0.080)	(0.074)	(0.053)	(0.083)	(0.075)
Common Language$_{ij}$	0.154***	0.151*	0.126**	0.246***	0.230***	0.237***
	(0.036)	(0.059)	(0.046)	(0.037)	(0.059)	(0.047)
Common Colonial History$_{ij}$	0.265***	0.217	0.247***	0.287***	0.370**	0.234***
	(0.043)	(0.147)	(0.047)	(0.046)	(0.130)	(0.051)
Common Religion$_{ij}$	0.240***	0.275***	0.0742	0.354***	0.316***	0.282***
	(0.039)	(0.062)	(0.053)	(0.039)	(0.061)	(0.056)
Contiguity$_{ij}$	0.181***	0.169***	0.200***	0.198***	0.202***	0.195***
	(0.019)	(0.030)	(0.026)	(0.020)	(0.031)	(0.026)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	27,500	10,212	17,223	40,326	14,320	25,918

[28]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table A.13: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.279*	-0.282	-0.181	-0.0349	-0.245	0.423
	(0.113)	(0.145)	(0.200)	(0.119)	(0.134)	(0.243)
Distance$_{ij}$	-0.924***	-0.749***	-0.942***	-1.051***	-0.870***	-1.123***
	(0.071)	(0.081)	(0.102)	(0.071)	(0.095)	(0.101)
Common Language$_{ij}$	0.133**	0.128	0.108	0.289***	0.186**	0.329***
	(0.044)	(0.066)	(0.062)	(0.048)	(0.068)	(0.062)
Common Colonial History$_{ij}$	0.449***	0.474	0.425**	0.272*	0.531	0.275
	(0.122)	(0.255)	(0.147)	(0.126)	(0.296)	(0.151)
Common Religion$_{ij}$	0.179***	0.292***	-0.0238	0.250***	0.334***	0.158*
	(0.053)	(0.066)	(0.074)	(0.049)	(0.060)	(0.072)
Contiguity$_{ij}$	0.172***	0.167***	0.177**	0.210***	0.200***	0.230***
	(0.027)	(0.033)	(0.055)	(0.030)	(0.036)	(0.065)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	16,512	6,522	9,977	24,672	9,104	15,557

[29]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table A.14: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.365***	-0.254	-0.672***	-0.498***	-0.0669	-0.802***
	(0.093)	(0.283)	(0.167)	(0.091)	(0.291)	(0.149)
Distance$_{ij}$	-0.943***	-1.049***	-1.090***	-1.187***	-1.147***	-1.301***
	(0.096)	(0.171)	(0.133)	(0.091)	(0.183)	(0.123)
Common Language$_{ij}$	0.189**	0.255*	0.118	0.237***	0.359***	0.151*
	(0.058)	(0.100)	(0.072)	(0.059)	(0.102)	(0.074)
Common Colonial History$_{ij}$	0.164**	-0.0570	0.175**	0.186***	0.262	0.142*
	(0.052)	(0.174)	(0.057)	(0.054)	(0.160)	(0.060)
Common Religion$_{ij}$	0.424***	0.292	0.168	0.506***	0.245	0.418***
	(0.075)	(0.177)	(0.099)	(0.068)	(0.177)	(0.092)
Contiguity$_{ij}$	0.188***	0.232***	0.193***	0.184***	0.240**	0.175***
	(0.028)	(0.058)	(0.033)	(0.027)	(0.075)	(0.030)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,593	3,683	6,857	15,475	5,213	10,185

[30]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the S score.

Table A.15: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.250***	-0.239*	-0.359***	-0.235***	-0.0452	-0.299***
	(0.051)	(0.111)	(0.070)	(0.058)	(0.093)	(0.088)
Distance$_{ij}$	-0.846***	-0.556***	-1.394***	-1.004***	-0.672***	-1.596***
	(0.078)	(0.079)	(0.096)	(0.072)	(0.070)	(0.153)
Common Language$_{ij}$	0.174***	0.0966	0.259***	0.190***	0.238***	0.115
	(0.053)	(0.066)	(0.057)	(0.049)	(0.067)	(0.064)
Common Colonial History$_{ij}$	0.186**	0.125	0.222***	0.172***	0.231*	0.136*
	(0.060)	(0.155)	(0.055)	(0.052)	(0.108)	(0.060)
Common Religion$_{ij}$	0.272***	0.288***	0.229**	0.348***	0.304***	0.423***
	(0.055)	(0.077)	(0.070)	(0.049)	(0.072)	(0.086)
Contiguity$_{ij}$	0.0967***	0.0936**	0.140***	0.121***	0.134***	0.0991***
	(0.021)	(0.031)	(0.023)	(0.017)	(0.029)	(0.021)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	76,894	15,148	58,773	88,150	19,045	68,027

[31]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.16: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.142	-0.249	0.341	-0.0465	-0.0192	-0.101
	(0.144)	(0.156)	(0.196)	(0.112)	(0.125)	(0.378)
Distance$_{ij}$	-0.649***	-0.637***	-0.679***	-0.722***	-0.648***	-1.099***
	(0.051)	(0.058)	(0.099)	(0.067)	(0.064)	(0.106)
Common Language$_{ij}$	-0.0319	-0.103	0.205**	0.143*	0.0952	0.303***
	(0.055)	(0.066)	(0.065)	(0.060)	(0.074)	(0.074)
Common Colonial History$_{ij}$	0.390**	0.410*	0.409***	0.378***	0.389**	0.256
	(0.122)	(0.177)	(0.115)	(0.101)	(0.141)	(0.146)
Common Religion$_{ij}$	0.303***	0.293***	0.0816	0.337***	0.310***	0.136
	(0.062)	(0.072)	(0.083)	(0.071)	(0.084)	(0.099)
Contiguity$_{ij}$	0.120***	0.132***	0.168***	0.154***	0.172***	0.148***
	(0.025)	(0.032)	(0.029)	(0.027)	(0.034)	(0.033)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	34,786	7,425	26,877	41,752	10,032	31,502

[32]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.17: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.275**	-0.344	-0.520***	-0.208	0.210	-0.428**
	(0.101)	(0.403)	(0.091)	(0.107)	(0.266)	(0.138)
Distance$_{ij}$	-1.117***	-0.486**	-1.875***	-1.290***	-0.760***	-1.944***
	(0.149)	(0.188)	(0.148)	(0.113)	(0.167)	(0.229)
Common Language$_{ij}$	0.370***	0.416***	0.242***	0.232***	0.477***	0.0537
	(0.066)	(0.089)	(0.073)	(0.061)	(0.088)	(0.078)
Common Colonial History$_{ij}$	0.0670	-0.122	0.166*	0.0839	0.104	0.0905
	(0.071)	(0.159)	(0.068)	(0.060)	(0.120)	(0.074)
Common Religion$_{ij}$	0.251**	0.122	0.286*	0.351***	0.0206	0.446***
	(0.097)	(0.183)	(0.139)	(0.077)	(0.176)	(0.130)
Contiguity$_{ij}$	0.123***	0.111*	0.111***	0.111***	0.0811	0.0829***
	(0.031)	(0.053)	(0.030)	(0.025)	(0.057)	(0.024)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	38,206	7,511	28,423	44,183	9,013	34,344

[33]PPML regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.18: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **All Investors**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.274***	-0.274*	-0.456***	-0.399***	-0.0841	-0.487***
	(0.046)	(0.126)	(0.090)	(0.045)	(0.125)	(0.089)
Distance$_{ij}$	-0.882***	-0.704***	-1.021***	-1.073***	-0.861***	-1.198***
	(0.054)	(0.080)	(0.074)	(0.053)	(0.082)	(0.075)
Common Language$_{ij}$	0.155***	0.149*	0.131**	0.247***	0.231***	0.237***
	(0.036)	(0.059)	(0.046)	(0.037)	(0.059)	(0.047)
Common Colonial History$_{ij}$	0.264***	0.205	0.245***	0.286***	0.373**	0.234***
	(0.044)	(0.149)	(0.048)	(0.046)	(0.132)	(0.051)
Common Religion$_{ij}$	0.237***	0.274***	0.0704	0.349***	0.315***	0.278***
	(0.039)	(0.062)	(0.053)	(0.039)	(0.061)	(0.056)
Contiguity$_{ij}$	0.182***	0.171***	0.203***	0.200***	0.203***	0.198***
	(0.019)	(0.030)	(0.026)	(0.020)	(0.031)	(0.026)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	27,500	10,212	17,223	40,326	14,320	25,918

[34]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.19: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Advanced Economies**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.275*	-0.230	-0.00542	0.0505	-0.120	0.497
	(0.128)	(0.168)	(0.267)	(0.137)	(0.145)	(0.337)
Distance$_{ij}$	-0.927***	-0.758***	-0.944***	-1.052***	-0.879***	-1.118***
	(0.071)	(0.080)	(0.103)	(0.071)	(0.094)	(0.101)
Common Language$_{ij}$	0.134**	0.130	0.108	0.290***	0.193**	0.328***
	(0.045)	(0.067)	(0.062)	(0.048)	(0.068)	(0.062)
Common Colonial History$_{ij}$	0.447***	0.460	0.423**	0.274*	0.520	0.271
	(0.122)	(0.259)	(0.147)	(0.127)	(0.301)	(0.153)
Common Religion$_{ij}$	0.178***	0.290***	-0.0223	0.250***	0.332***	0.157*
	(0.053)	(0.066)	(0.074)	(0.049)	(0.060)	(0.073)
Contiguity$_{ij}$	0.173***	0.170***	0.176**	0.210***	0.202***	0.230***
	(0.027)	(0.033)	(0.055)	(0.030)	(0.036)	(0.064)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	16,512	6,522	9,977	24,672	9,104	15,557

[35]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

Table A.20: Effect of Geopolitical Distance on Cross-Border **FDI** Allocation of **Emerging Markets**

	Debt			Equity		
	All	AEs	EMDEs	All	AEs	EMDEs
	(1)	(2)	(3)	(4)	(5)	(6)
Geopolitical Distance$_{ij,t-1}$	-0.348***	-0.330	-0.581***	-0.420***	-0.102	-0.610***
	(0.080)	(0.273)	(0.129)	(0.076)	(0.282)	(0.122)
Distance$_{ij}$	-0.944***	-1.033***	-1.120***	-1.204***	-1.141***	-1.330***
	(0.094)	(0.172)	(0.133)	(0.088)	(0.181)	(0.122)
Common Language$_{ij}$	0.188**	0.251*	0.124	0.235***	0.358***	0.153*
	(0.058)	(0.100)	(0.072)	(0.059)	(0.102)	(0.075)
Common Colonial History$_{ij}$	0.162**	-0.0697	0.172**	0.189***	0.258	0.143*
	(0.052)	(0.178)	(0.057)	(0.054)	(0.161)	(0.060)
Common Religion$_{ij}$	0.422***	0.292	0.173	0.504***	0.245	0.423***
	(0.075)	(0.177)	(0.099)	(0.068)	(0.177)	(0.093)
Contiguity$_{ij}$	0.189***	0.231***	0.195***	0.186***	0.240**	0.179***
	(0.028)	(0.058)	(0.033)	(0.027)	(0.075)	(0.030)
Source Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Recipient Country x Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,593	3,683	6,857	15,475	5,213	10,185

[36]OLS regressions. Fixed effects and constant not reported for the sake of simplicity. Standard errors (in parentheses) are clustered at the country-pair level). Measure of geopolitical distance is the IPD score.

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