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GEOPOLITICAL ALIGNMENT AND FRIEND-SHORING: EVIDENCE FROM TURKISH OUTWARD FOREIGN DIRECT INVESTMENT

Jeopolitik Uyum ve Dost Ülkelere Yönelim: Türkiye'nin Yurtdışına Doğrudan Yabancı Yatırımlarından Kanıtlar

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Keywords:
Outward Foreign Direct Investment, Friend-Shoring, Geopolitical Alignment, Institutional Quality, Emerging Market Economies

JEL Codes:
F21, F23, F50.

Abstract

Geopolitical tensions have increasingly reshaped foreign direct investment (FDI) patterns, leading to "friend-shoring," whereby investments are redirected toward geopolitically aligned countries. Despite growing attention, empirical evidence on the geopolitical determinants of FDI in emerging economies remains limited. This paper examines whether and how geopolitical alignment affects Turkish outward FDI (OFDI) during 2003–2023. Using panel data and a geopolitical distance measure based on UN voting similarity, the results show that Turkish OFDI declines with increasing geopolitical distance, providing strong evidence of friend-shoring behavior. However, this effect is heterogeneous. It is stronger in emerging markets but can be mitigated by better governance, particularly through stronger corruption control and greater voice and accountability. This paper also demonstrates that geopolitical alignment operates through multiple channels. Turkish OFDI responds not only to the degree of bilateral geopolitical alignment but also to countries' positions in the US–China rivalry and their bloc affiliations. Finally, the effect of geopolitical alignment weakens after 2018, indicating that the relationship between geopolitics and OFDI evolves along with geopolitical dynamics.

Anahtar Kelimeler:
Yurtdışına Doğrudan Yabancı Yatırım, Dost Ülkelere Yönelim, Jeopolitik Uyum, Kurumsal Kalite, Yükselen Piyasa Ekonomileri

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Öz

Artan jeopolitik gerilimler, doğrudan yabancı yatırım (DYY) örüntülerini giderek yeniden şekillendirmekte ve yatırımların jeopolitik olarak uyumlu ülkelere yönlendirilmesini ifade eden "dost ülkelere yönelim (friend-shoring)" eğilimini güçlendirmektedir. Bu konu son yıllarda giderek daha fazla ilgi görmesine rağmen, özellikle yükselen piyasa ekonomileri açısından DYY'nin jeopolitik belirleyicilerine ilişkin ampirik kanıtlar hâlen sınırlıdır. Bu çalışma, jeopolitik uyumun Türkiye'nin yurt dışına doğrudan yabancı yatırımları (YDYY) üzerindeki etkisini 2003–2023 dönemi için incelemektedir. Panel veri yöntemi ve Birleşmiş Milletler (BM) oylama benzerliğine dayalı bir jeopolitik uzaklık göstergesi kullanılarak elde edilen bulgular, jeopolitik uzaklık arttıkça Türkiye'nin YDYY akımlarının azaldığını ve bunun dost ülkelere yönelim davranışına güçlü kanıt sunduğunu göstermektedir. Ancak bu etki homojen değildir. Etki, yükselen piyasalarda daha güçlü ortaya çıkmakta; buna karşılık daha iyi yönetişim, özellikle yolsuzluğun kontrolü ile ifade özgürlüğü ve hesap verebilirlik mekanizmalarının güçlenmesi sayesinde zayıflayabilmektedir. Ayrıca çalışma, jeopolitik uyumun birden fazla kanal üzerinden işlediğini göstermektedir. Türkiye'nin YDYY akımları yalnızca ikili jeopolitik uyumun derecesine değil, aynı zamanda ülkelerin ABD–Çin rekabetindeki konumlarına ve blok aidiyetlerine de tepki vermektedir. Son olarak, jeopolitik uyumun etkisinin 2018 sonrası dönemde zayıfladığı bulgusu, jeopolitik ile YDYY arasındaki ilişkinin zaman içinde jeopolitik dinamiklerle birlikte evrildiğine işaret etmektedir.

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1. Introduction

In the past decade, rising geopolitical tensions and concerns about the uneven distribution of benefits from international economic integration have challenged the future of global linkages. Worldwide political upheavals, trade conflicts between the United States (US) and China, pandemic-related supply chain disruptions, and the Russia-Ukraine War have redirected cross-border flows of goods and investment. As noted by the IMF (2023), geopolitical strains and growing skepticism toward multilateralism have made geoeconomic fragmentation more apparent. Geoeconomic fragmentation refers to policy-driven redirections of global economic integration - trade and financial flows (Aiyar et al., 2023; Jean, 2024). The growing number of restrictions on trade and FDI flows in recent years and the growing influence of geopolitical alignment rather than economic proximity make geoeconomic fragmentation a reality in the global economic landscape (Baba et al., 2023). As documented by Gopinath et al. (2025), the emerging global order is tripartite, consisting of US-centered (Western) and China-centered (Eastern) blocs and non-aligned countries. Since the onset of the war in Ukraine, trade flows between the US-centered and China-centered blocs have declined by 12% relative to intra-bloc trade. Similarly, the number of FDI projects fell by nearly 20%. This compelling evidence signals a profound rerouting of global economic linkages along geopolitical lines. As geopolitical tensions and restrictive policy interventions persist, this fragmentation is likely to deepen, and its duration remains uncertain.

In this global map, our focus is on the direction and geography of FDI flows. Recently, UNCTAD (2024) has drawn attention to shifting patterns in global FDI resulting from economic fracturing. One of the appealing diagnoses in UNCTAD (2024) is the role of geopolitical distance between countries in dragging global FDI into a fractured international investment environment (namely "Fracturing along geopolitical lines"). As countries diverge geopolitically, geoeconomic fragmentation increases, and FDI between geopolitically distant countries declines. As location choices become more sensitive to geopolitical alignments, the possibility of long-term stagnation in FDI increases. This could pose a serious risk to the future of international investment networks. UNCTAD (2024) supported this diagnosis by reporting that FDI inflows and outflows have declined in recent years and documented that rebounds in FDI flows were often short-lived.

Against the backdrop of current discussions, this paper concentrates on the role of geopolitics in the location decisions of Turkish outward FDI (OFDI). Türkiye offers a critical perspective on how investors and policymakers in emerging economies navigate a path under intensifying geopolitical pressures. In a geopolitically risky environment, these actors often oscillate between deepening economic integration and safeguarding their interests through strategic realignments. Consequently, Türkiye may serve as a compelling case illustrating the challenges of balancing the rise in OFDI and the shifting shores of global alliances.

To link geoeconomic fragmentation and outward FDI in Türkiye, we present a snapshot. Turkish OFDI has gained momentum over the last two decades, alongside increasing integration into global markets. Figure 1 displays the patterns of OFDI stock in Türkiye and trade openness to understand how OFDI flows are in relation to international economic integration. Turkish OFDI surged after the mid-2000s and grew until 2014. Although it fell in 2015, it recovered quickly and maintained a rising trend in recent years. The OFDI also followed the increasing trend in global economic integration (trade-to-GDP ratio), particularly in the last decade. This is a signal that integration into the world output markets is an encouraging factor for investing abroad.

Surprisingly, in 2023, trade openness declined, but OFDI grew at a rate of 15%. Figure 2 supports the view that increasing globalization enhances the internalization process of firms. As seen, Turkish firms invest more in the era of rising globalization.

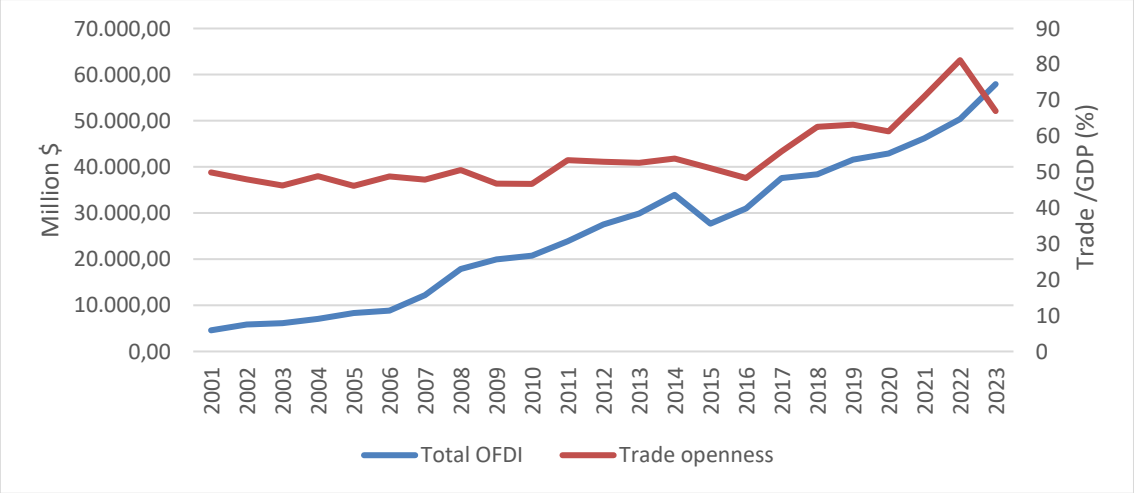

Figure 1. OFDI in Türkiye and Trade Openness

Source: OFDI data is taken from the Central Bank of the Republic of Türkiye, and the trade-to-GDP ratio is obtained from the World Bank World Development Indicators database, 2026.

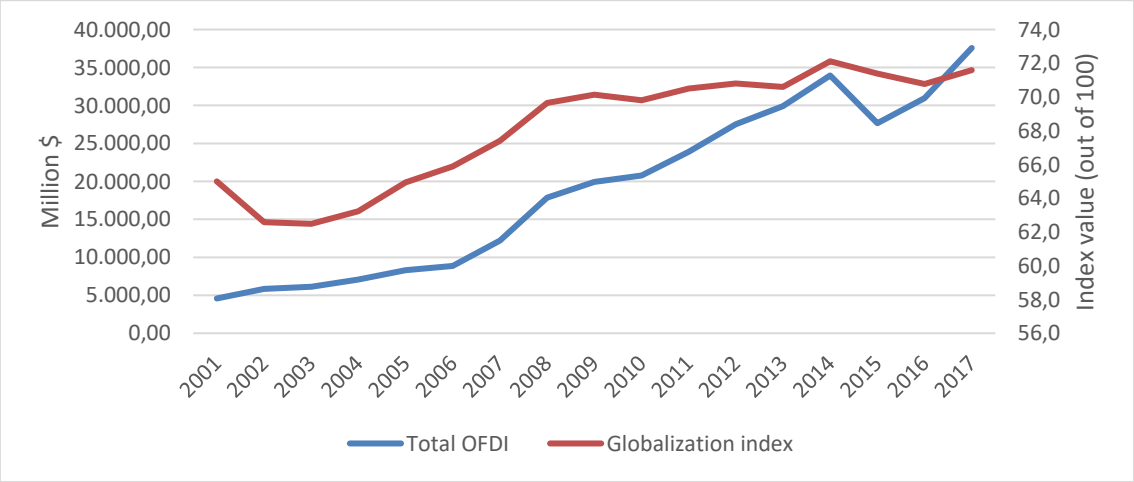

Figure 2. OFDI in Türkiye and Globalization

Source: OFDI data is taken from the Central Bank of the Republic of Türkiye, 2026. The globalization index is obtained from the data constructed by Gygli et al. (2018).

The geographical allocation of Turkish OFDI is given in Figure 3. Türkiye concentrates mostly on European countries. The share of Europe in total OFDI ranges between 60% and 85%. Asia follows Europe, ranging between 7% and 30%. However, noteworthy changes emerge over time. Until 2012, the share of Asia had remained between 25 and 30%, but it strikingly lost ground in the following years, and its share dropped to 8% by 2023. Europe's share is the mirror of this changing path. In 2023, the share of Europe rose to 80%. Not only did the shares of the two regions change, but those of Africa and North and South America were also apparent. In particular, for Africa, there has been an upward trend. Traditionally, market size, geographic

proximity, trade ties, partnerships, and cultural and historical links explained the time path and location of OFDI. Here, geopolitical considerations can be added to the picture.

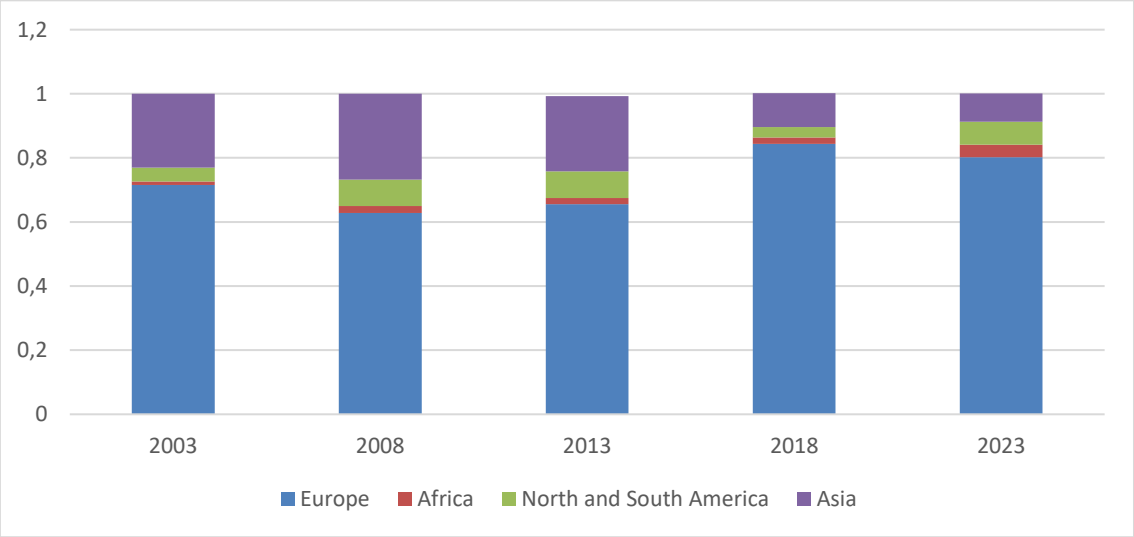

Figure 3. Geographical Allocation of Turkish OFDI
Source: OFDI data is taken from the Central Bank of the Republic of Türkiye, 2026.

In recent years, there has been increasing scholarly interest in analyzing financial flows along geopolitical lines (Aiyar et al., 2024; Fletcher et al., 2024; Catalan et al., 2024; Airaudo et al., 2025). However, evidence for FDI is scant. Even a specific focus on the relocation of FDI in individual countries and destinations is quite limited. To contribute to this emerging literature, we question whether geopolitical alignment plays a role in Turkish OFDI over the last two decades. We identify the geopolitical affinity of the OFDI destinations with a geopolitical distance indicator and quantify the impact of this on OFDI. Our results reveal that geopolitical alignment plays a key role in Turkish OFDI. Türkiye invests more in geopolitically aligned countries. This evidence highlights the increase in friend-shoring behavior in Türkiye and supports widening concerns about geopolitical fragmentation. Second, we control the heterogeneity in geopolitical effects. To do this, we categorize destinations as "friend, close, distant, rival," score their positioning within the US-China rivalry, and specify whether they are members of the US and China blocs. Our results confirm that as countries geopolitically diverge from Türkiye, the level of OFDI declines, suggesting the presence of friend-shoring. We further provide evidence that geopolitical alignment with major global powers affects investment decisions. The closer the country is to the US geopolitical line, the larger the OFDI. Our results for the time-varying nature of the geopolitics of OFDI indicate that the response of Turkish OFDI to the geopolitical alignment weakens, particularly in the post-2018 period.

This paper analyzes whether and how geopolitical alignment influences Turkish OFDI during 2003–2023. Using panel data and a geopolitical distance measure based on UN voting similarity, the study shows that Turkish OFDI declines with increasing geopolitical distance, providing sound evidence of friend-shoring behavior. The results indicate that the friend-shoring effect is stronger in emerging markets but can be mitigated by better governance, particularly through stronger corruption control and greater voice and accountability. Findings further demonstrate that multiple channels matter in geopolitical alignment. Turkish OFDI responds not

only to bilateral geopolitical alignment but also to countries' positions in the US–China rivalry and their bloc affiliations. Finally, the effect of geopolitical alignment weakens after 2018, indicating that the relationship between geopolitics and OFDI evolves.

This study contributes to the literature by providing new evidence on the role of geopolitical alignment in shaping Turkish outward FDI. In doing so, it highlights the challenges faced by emerging economies in balancing the opportunities and risks associated with deeper global integration amid rising geopolitical tensions. It shows that the impact of geopolitical distance on Turkish OFDI is heterogeneous across country groups, operates through institutional mechanisms, changes with different forms of friendship or proximity, and finally evolves. By incorporating multiple dimensions of alignment—including forms of bilateral alignment, global positioning, and bloc membership—the paper offers a more comprehensive and dynamic view of friend-shoring behavior.

The paper is organized as follows: Section 2 reviews the related literature. Section 3 explains data issues and empirical methodology. Section 4 presents the empirical results. Finally, the Conclusion summarizes the key findings and assesses the results.

2. The Related Literature

This paper is situated within the growing geoeconomics literature that examines the interplay between geopolitical relations and international finance.[1] It relates to recent debates on rising geopolitical tensions, geoeconomic fragmentation, and their implications for capital flows. Recent studies, such as the IMF (2023), Aiyar et al. (2024), and Fletcher et al. (2024), emphasize that geopolitical alignment has become increasingly relevant for FDI decisions, as firms tend to concentrate investments in politically aligned countries amid intensifying trade and geopolitical tensions. In particular, the IMF (2023) argues that firms and policymakers have increasingly shifted production and investment toward "trustworthy" or politically allied countries to reduce vulnerabilities associated with geopolitical risks. This tendency also reflects a longstanding concern of multinational firms: securing and protecting the returns on foreign investments, as argued by Li and Resnick (2003) and Desbordes and Vicard (2009). They emphasize that multinational firms are not stateless; their location decisions are related to the international political system. Consequently, political and diplomatic relations between home and host countries can substantially shape investment outcomes. Closer geopolitical ties may encourage "investing in friends" by reducing expropriation risks, strengthening property-rights protection, and lowering political uncertainty (Desbordes and Vicard, 2009). Also, as argued by Li et al. (2018), diplomatic relations between countries matter for FDI location because governments lay bridges between origin and destination countries to establish business networks. These networks benefit firms by providing better access to information, increased legitimacy, acquisition of technology, and reduced political risks. The supporting evidence for investing more in countries where better interstate linkages are built can be found in Desbordes (2010) for the US, Li and

[1] There have been studies examining the link between geopolitics and trade, the financial system, technology, and sectoral competition. For geopolitics and trade linkages, please see Constantinescu et al. (2020), Handley and Limão (2022), Jakubik and Ruta (2023), Hakobyan et al. (2023), Jean (2024), and Qiu et al. (2024). For the geopolitics and financial fragmentation nexus, please see Alsadan et al. (2025). For strategic realignments driven by technological competition and global shifts in trade patterns, please see Airaudo et al. (2025).

Vashchilko (2010) for a broad group of OECD members and non-OECD countries, Desbordes and Vicard (2009) for a mixed sample of developed and developing countries, and Li et al. (2018) for China.

Among recent studies, Aiyar et al. (2024) highlight the significant role of geopolitical ties among countries in FDI decisions. Using a gravity model with more than 300,000 greenfield FDI projects from 2003 to 2022, they confirm that geopolitical alignment influences bilateral FDI and note that the impact of geopolitics has grown more important since 2018, especially with increasing trade tensions between the US and China. Similarly, Fletcher et al. (2024) examine Germany's inward and outward FDI, showing that the geopolitical distance between Germany and its partner countries is negatively related. A large portion of German FDI has shifted toward countries that are geopolitically closer over the past two decades, and the significance of geopolitical distance has increased after 2017 compared to the 2003-2016 period. Additionally, they find evidence that Germany's FDI links, especially with the China-Russia bloc, are more responsive to geopolitical risks, and Germany's energy-intensive FDI is negatively associated with host country energy costs. These findings support the idea that uncertainty can hinder investment decisions and delay foreign market entry (Jakubik and Ruta, 2023). Growing uncertainty from rising global tensions can influence FDI and heighten the importance of geopolitical alignment, as countries prefer to invest in geopolitically safer destinations. This trend may lead to fragmentation of FDI into "friend-shoring" or "investing in friends," reflecting a focus on geopolitically secure partners.

The paper is also connected to the literature on FDI drivers, particularly the determinants of multinational firms' locational choices. There is a large body of work since Dunning's (1980) eclectic theory of FDI.[2] Within Dunning's framework, geopolitical alignment can be included primarily in location advantages. Beyond traditional locational determinants such as market size and labor costs, geopolitical alignment increases the attractiveness of cross-border investment by reducing political uncertainty, expropriation risk, transaction costs, and information frictions. Countries that are geopolitically closer may provide a more predictable investment environment.

More specifically, after a rigorous review of the empirical studies, a larger market size, high economic growth, lower labor costs, and a favorable exchange rate are widely considered as traditional economic factors that encourage OFDI (Park and Jung, 2020). To better understand the motives behind OFDI, greater attention should be paid to institutional and political factors. Broadly, previous studies indicate that better governance, sounder institutions, and lower political risk in host countries encourage outward investment decisions (Busse and Hefeker, 2007; Kim, 2010; Ochi et al., 2012; Subasat and Bellos, 2013; Gangi and Abdulrazak, 2012; Chen et al., 2016). In addition, dyadic factors between home and host countries also play a significant role in shaping OFDI patterns. These include bilateral investment agreements, participation in international institutions (Egger and Pfaffermayr, 2004; Büthe and Milner, 2008), as well as foreign aid and official development assistance (ODA) relationships (Karakaplan et al., 2005; Harms and Lutz, 2006; Kimura and Todo, 2010; Selaya and Sunesen, 2012; Janský, 2012; Han and Park, 2021), all of which can facilitate and strengthen OFDI flows. In this line, geopolitical

[2] Dunning (1980) develops an eclectic theory of FDI flows, namely the OLI framework. To invest abroad, multinational corporations consider three advantages: The ownership advantage (O), the location advantage (L), and the internalization advantage (I).

alignment and the corresponding concept of friend-shoring can be interpreted as a shift in investors' locational preferences, where geopolitical alignment increasingly complements traditional economic motives in shaping OFDI decisions. This suggests that geopolitical alignment influences OFDI not only directly through political motives but also indirectly by shaping expectations about investment security, trusted ties, market access, and long-term profitability.

While the drivers of OFDI have been widely debated, evidence on how geopolitical connections influence these flows remains limited. This gap is especially clear for flows from emerging markets, where the tension between economic integration and geopolitical protection and resilience is more pronounced. Although some empirical studies on Turkish OFDI (Aybar, 2016; Heavilin and Songur, 2017, 2020; Songur et al., 2024) have identified traditional market and resource-seeking motives and effects of cultural and institutional proximity, they have not yet included the role of geopolitical ties in their analysis. Therefore, using Türkiye as a typical example of an emerging market navigating more secure international linkages, this study investigates whether and how geopolitical alignment serves as a structural driver of OFDI. To the best of our knowledge, this is the first attempt to offer a comprehensive analysis of how geopolitical alignment reshapes the location choices of Turkish OFDI, providing broader insights into the changing global economic landscape.

3. Methodology and Data

We estimate a fixed-effects panel model of Turkish OFDI across destination countries over 2003–2023. As Türkiye is the only source country, the specification should not be interpreted as a full gravity model; rather, it captures how host-country characteristics and geopolitical alignment explain the allocation of Turkish OFDI across destinations. The baseline model is shown as:

$$log(OFDI)_{it} = \beta X_{i,t-1} + \varphi_t + \mu_i + \varepsilon_{i,t} \quad (1)$$

In Equation (1), $\log(OFDI)_{i,t}$ denotes Türkiye's outward FDI stock in the destination country i at time t. In the vector of explanatory variables ($X_{i,t-1}$), the main variable of interest is geopolitical alignment ($GEOPOL_{i,t-1}$) which is defined in terms of geopolitical distance. It is a measure constructed by Bailey et al. (2017) to show vote similarity between countries at the United Nations (UN). Bailey et al. (2017) estimate each country's ideal point on a policy spectrum and define Ideal Point distance (IPD) as the absolute difference between two countries' ideal points. $GEOPOL_{i,t}$ refers to the annual IPD between Türkiye and the destination country, and lower levels imply a closer geopolitical alignment. The other explanatory variables comprise destination-specific ones, such as the logarithm of GDP ($LOG\_GDP_{i,t-1}$), GDP growth ($GDP_{GRW}{}_{i,t-1}$), and the logarithm of GDP per capita ($LOG\_GDPPC_{i,t-1}$), as well as trade openness ($TRADE_{i,t-1}$) and political stability ($POL\_STAB_{i,t-1}$). GDP, GDP growth, and GDP per capita are market-based characteristics that proxy size, potential, and sophistication of the market, respectively. We also add a global variable, the geopolitical risk index ($GPR_{i,t-1}$), which relates Turkish OFDI to geopolitical tensions worldwide. $\varphi_t, \mu_i, \varepsilon_{i,t}$ are the county, year fixed effects, and the error term, respectively. We include destination-country fixed effects to control for unobserved, time-invariant heterogeneity across host countries, such as geographical, cultural,

and historical factors. These factors are likely correlated with the explanatory variables, making the fixed-effects estimator more appropriate than the random-effects estimator. By doing this, we also avoid omitted variable bias and capture all time-invariant bilateral factors between Türkiye and host countries, since Türkiye is the only source country. Year fixed effects are included to control for common shocks affecting all destination countries simultaneously, such as global financial crises, geopolitical tensions, and worldwide changes in investment conditions. While year fixed effects capture unobserved common shocks, the geopolitical risk index (GPR) provides a structured measure of global geopolitical uncertainty. Including both allows us to distinguish between overall time effects and specific geopolitical risk dynamics. To mitigate simultaneity and reverse causality concerns and allow FDI decisions to respond with a delay, we use all explanatory variables with their one-year lag. In the next stages of estimation, we modify this model by adding variables to address heterogeneity and endogeneity and to enhance the robustness of the findings.

The sample covers 39 destinations of Turkish outward FDI over the period 2003-2023[3]. The data for OFDI are obtained from the Central Bank of the Republic of Türkiye (CBRT)'s data portal. For GDP, GDP growth, GDP per capita, trade openness, and political stability, the World Bank's World Development Indicators (WDI) and World Governance Indicators (WGI) databases are used. The geopolitical distance data is from Bailey et al. (2017), and the geopolitical risk index (GPR) is from Caldara and Iacoviello (2022)[4]. The data descriptions, summary statistics, and correlations among variables are presented in the Appendix Tables A1, A2, and A3.

4. Empirical Results

We present the results of the baseline model in Table 1. Column (I) shows the results for all countries in the sample, while Columns (II) and (III) correspond to advanced- and emerging-country destinations. We consider that obtaining the average effect from the full sample and the overall assessment of the relationship may hide substantial cross-country heterogeneity. Motivated by this, we split the sample into advanced and emerging economies to examine whether the impact of geopolitical alignment differs across country groups. This approach allows us to reveal heterogeneous effects that would otherwise remain concealed in full-sample estimation.

The results reveal that geopolitical alignment matters differently across country groups. As seen in Column (I), the coefficient of geopolitical distance is significantly negative, indicating that Turkish OFDI decreases as geopolitical distance increases for the full sample. This suggests Türkiye tends to invest more in geopolitically aligned destinations. We provide evidence on the "investing in friends" argument highlighted by Aiyar et al. (2024). However, the results in Columns (II) and (III) reveal an important heterogeneity in the effect of geopolitical distance when country groups are considered. Geopolitical distance does not have a statistically significant impact on Turkish OFDI toward advanced economies (AEs), whereas it remains negative and

[3] Destination countries are Algeria, Austria, Azerbaijan, Belgium, Brazil, Bosnia Herzegovina, Bulgaria, China, Egypt, France, Georgia, Germany, Greece, Hungary, Indonesia, Iran, Ireland, Italy, Kazakhstan, Kyrgyzstan, Libya, Macedonia, Malta, Morocco, Netherlands, Poland, Romania, Russia, Saudi Arabia, Slovakia, Spain, Switzerland, Tunisia, Turkmenistan, Ukraine, United Emirates, United Kingdom, United States of America, Uzbekistan.

[4] For the details on the measurement of geopolitical distance, please see Bailey et al. (2017). For GPR, definition and measurement details can be found in Caldara and Iacoviello (2022) and at https://www.matteoiacoviello.com/gpr.htm.

significant for emerging market economies (EMEs). We highlight that the friend-shoring trend in Türkiye is not uniform across destinations but is particularly relevant for emerging market economies. This evidence shows that the role of geopolitical alignment is responsive to the level of development. This pattern may reflect the fact that investment decisions in EMEs are more sensitive to geopolitical considerations, possibly due to relatively higher uncertainty compared to AEs. By contrast, the absence of a significant effect in AEs suggests that geopolitical distance is less decisive in these contexts. Consistent with the arguments of the IMF (2023), EMEs may be more exposed to geopolitical frictions compared to advanced economies. Overall, these results emphasize the importance of accounting for country heterogeneity, as the effect of geopolitical considerations would be partially unclear in aggregate estimations.

We find that the effects of control variables are not uniform. For the full sample, Turkish OFDI is significantly driven by GDP growth, GDP per capita of destination countries, and geopolitical risk. As GDP growth -a proxy of the destination country's market potential or overall performance- increases, Türkiye invests more. However, a rise in GDP per capita deters Turkish OFDI, suggesting that Türkiye tends to invest more in countries with lower GDP per capita[5]. When we compare AEs and EMEs, GDP growth is significant only for EMEs, while GDP per capita is significant only for AEs. When Türkiye invests in AEs, investors are likely to be affected by the level of market sophistication. As the country becomes more sophisticated, Türkiye invests more. However, Türkiye does not respond to the level of sophistication in EMEs. Instead, Turkish OFDI in these countries is driven by economic growth. The larger the economic activity, the higher the level of OFDI. It seems that Turkish investors tend to penetrate the domestic markets of host countries with market-seeking motives. Countries may see internationalization opportunities in larger markets and prefer to be active to benefit from the market potential, as argued by Holtbrügge and Kreppel (2012). The coefficient of the geopolitical risk index is negatively significant in all estimations, indicating that Turkish firms respond to changes in the international geopolitical climate. In sum, Turkish OFDI tends to invest more in friends and locations that offer larger market potential and higher performance. Also, rising geopolitical tensions deter Turkish OFDI.

Table 1. Results for Baseline Model

Variables	I (All)	II (AEs)	III (EMEs)
geopol	-0.405** (0.183)	0.261 (0.382)	-0.459** (0.206)
log_gdp	1.061 (1.064)	1.606 (1.788)	0.156 (1.169)
gdp_grw	0.013** (0.006)	-0.005 (0.007)	0.021*** (0.005)
log_gdppc	-1.994* (1.124)	-4.090* (2.121)	-1.402 (1.155)
trade	0.000 (0.002)	0.004 (0.003)	0.002 (0.004)
pol_stab	0.147 (0.111)	0.093 (0.157)	0.174 (0.123)

[5] There are three market-based variables: GDP, GDP growth, and GDP per capita, each of which points to different features of the national markets. Before the exercise, the correlations across them are controlled and found no substantially high correlations. To be precise, estimations are repeated by adding them individually. The signs and significance of the variables remain the same.

Table 1. Continued

gpr	-0.070***	-0.061***	-0.087***
	(0.009)	(0.012)	(0.013)
constant	9.989	11.037	20.086
	(9.560)	(12.344)	(11.721)
# obs	819	378	441
R^2	0.510	0.524	0.565
time fe	yes	yes	yes
country fe	yes	yes	yes

Notes: Robust and clustered standard errors are in parentheses. ***, **, * indicate significance levels of 1%, 5%, and 10% respectively.

The baseline results confirm that geopolitical distance negatively affects Turkish OFDI, but they do not reveal whether destination-country characteristics can moderate this effect. To address this, in the next step, we introduce interaction terms (GEOPOL_GOV) between geopolitical distance and governance indicators, allowing us to explore whether institutional quality serves as a mitigating factor. Our approach is motivated by the argument that strong institutions can provide a more predictable and secure investment environment, potentially reducing investors' sensitivity to geopolitical strains (Bussy and Zheng, 2023). Accordingly, we expect that the negative impact of geopolitical distance will be weaker in countries with better governance. Put differently, sounder institutions can moderate the negative impact of geopolitical distance.

Table 2. Results for the Mitigating Role of Governance Measures

Variables	**I (CC)**	**II (GE)**	**III (PV)**	**IV (RL)**	**V (RQ)**	**VI (VA)**
geopol	-0.374**	-0.399**	-0.396**	-0.408**	-0.338**	-0.420**
	(0.163)	(0.189)	(0.180)	(0.178)	(0.162)	(0.173)
geopol*gov	-0.262***	0.055	0.046	-0.015	-0.161	-0.273***
	(0.101)	(0.108)	(0.147)	(0.134)	(0.113)	(0.100)
log_gdp	1.352	0.981	1.095	1.059	1.252	1.247
	0.991	(1.000)	(1.085)	(1.073)	(0.967)	(1.001)
gdp_grw	0.011**	0.014**	0.013**	0.013**	0.012**	0.010*
	(0.005)	(0.005)	(0.006)	(0.006)	(0.005)	(0.005)
log_gdppc	-2.271**	-1.982*	-2.025*	-1.981*	-2.215**	-2.080*
	(1.049)	(1.093)	(1.142)	(1.152)	(1.028)	(1.061)
trade	0.000	0.000	0.000	0.000	0.000	0.000
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
pol_stab	0.112	0.143	0.102	0.150	0.135	0.079
	(0.100)	(0.112)	(0.186)	(0.112)	(0.106)	(0.102)
gpr	-0.067***	-0.071***	-0.071***	-0.070***	-0.069***	-0.067***
	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)
constant	7.309	11.011	9.766	9.919	8.487	7.709
	(8.886)	(8.946)	(9.638)	(9.552)	(8.788)	(8.877)
# obs	819	819	819	819	819	819
R^2	0.524	0.511	0.511	0.510	0.516	0.527
time fe	yes	yes	yes	yes	yes	yes
country fe	yes	yes	yes	yes	yes	yes

Notes: Robust and clustered standard errors are in parentheses. ***, **, * indicate significance levels of 1%, 5%, and 10% respectively.

Governance indicators are control of corruption (CC), government effectiveness (GE), political stability and absence of violence/terrorism (PV), the rule of law (RL), regulatory quality (RQ), and voice and accountability. The results given in Table 2 indicate that, particularly control of corruption and voice and accountability, can partially mitigate the adverse effect of geopolitical distance on Turkish OFDI. Columns (I) and (VI) suggest that the marginal effect of geopolitical distance becomes less negative as governance improves. This result supports the view that a better institutional environment can cushion the geopolitically weakened OFDI, making investors less responsive to geopolitical distance. Overall, the institutional environment of host countries can be a buffer against geopolitical misalignments.

Having established the presence and conditional nature of the negative impact of geopolitical distance on Turkish OFDI, we further explore how different forms of geopolitical alignment shape it. Here, we focus on the structure of alignment and ask how the effect of geopolitical alignment works or differentiates. Rather than treating geopolitical distance as an aggregate measure alone, we decompose it into categories and alternative alignment structures to better capture the multidimensional nature of geopolitical links between Türkiye and host countries.

First, we categorize destination countries into four groups based on the quartiles of the geopolitical distance distribution, following Bosone and Stamato (2024). This categorization allows us to distinguish between "Friend," "Close," "Distant," and "Rival" destinations. We then include these categories as dummy variables to interpret how Turkish OFDI responds to varying degrees of political alignment.

Second, we incorporate a continuous measure of geopolitical positioning within the global US–China rivalry by following Airaudo et al. (2025)'s framework that constructs a normalized alignment score given below:

$$Score\ (s) = \frac{IPD\ (s, China) - IPD\ (s, US)}{PD\ (s, China) + IPD\ (s, US)} \tag{2}$$

where IPD is the ideal point distance, as in Bailey et al. (2017). This score measures the relative proximity of each destination country to the US and China. The index ranges from −1 (full alignment with China) to +1 (full alignment with the US), helping us to assess how "leaning towards either country" affects Turkish OFDI.

Third, we construct a bloc-based categorization by splitting countries into the "China bloc," "US bloc," and "between blocks" based on the distribution of the alignment score. This approach allows us to evaluate whether belonging to broader geopolitical blocs shapes Turkish OFDI beyond bilateral geopolitical alignment.

Taken together, these further approaches allow us to complement our empirical analysis by capturing the structural and multidimensional nature of geopolitical alignment. In this step, we expect to provide a more nuanced understanding of how global geopolitical fragmentation affects Turkish OFDI. The results of these estimations are given in Table 3.

As seen in Column (I) of Table 3, the categorization of geopolitical alignment reveals a clear pattern across geopolitical groups, suggesting Turkish OFDI is significantly higher toward "friend" destinations and significantly lower toward "rival" countries. This result provides strong support for the presence of friend-shoring in Turkish OFDI. To better interpret this finding, we

recall that the quartile-based classification aims to capture relative differences in geopolitical distance rather than formal political alliances. For instance, countries in the rival category are not necessarily political adversaries in a strict diplomatic sense; rather, they represent destinations that are relatively more distant from Türkiye in terms of geopolitical positioning within our sample. Therefore, we assess categories as relative positions within the sample rather than strict political labels. To improve interpretability, we now discuss the economic meaning of the classification in greater detail. Economically, the countries classified as "friends" represent destinations with lower geopolitical frictions. In these countries, investment decisions offer greater predictability, lower political risk, and stronger bilateral trust. In contrast, "rival" countries are relatively more geopolitically distant. In these countries, investors are likely discouraged by increasing uncertainty, weaker political ties, and greater exposure to geopolitical frictions.

Table 3. Results for the Dimensions of Geopolitical Alignment

Variables	I	II	III
geopol		-0.425**	-0.366**
		(0.185)	(0.182)
friend	0.173*		
	(0.087)		
close	0.130		
	(0.086)		
distant	0.188**		
	(0.085)		
rival	-0.314*		
	(0.172)		
score_us_chn		0.465**	
		(0.210)	
us block			-0.033
			(0.060)
chn block			-0.210**
			(0.071)
log_gdp	1.398	1.133	1.004
	(0.907)	(1.043)	(1.065)
gdp_grw	0.014**	0.012**	0.012**
	(0.005)	(0.006)	(0.005)
log_gdppc	-2.400**	-1.984*	-1.873*
	(0.952)	(1.101)	(1.123)
trade	0.000	0.000	0.000
	(0.002)	(0.002)	(0.002)
pol_stab	0.182	0.155	0.139
	(0.112)	(0.105)	(0.105)
gpr	-0.069***	-0.067***	-0.070***
	(0.009)	(0.009)	(0.009)
constant	7.159	8.705	10.223
	(8.282)	(9.346)	(9.503)
# obs	819	819	819
r^2	0.528	0.517	0.520
time fe	yes	yes	yes
country fe	yes	yes	yes

Notes: Robust and clustered standard errors are in parentheses. ***, **, * indicate significance levels of 1%, 5%, and 10% respectively.

The results in Column (II) further show that global geopolitical positioning matters for Turkish investors. The positive and significant coefficient on the US–China alignment score indicates that Turkish OFDI increases as destination countries become more aligned with the US, highlighting that not only does bilateral alignment shape investment destinations, but also countries' positions within the broader global geopolitical structure play a role. Finally, the bloc-based specification in Column (III) suggests that belonging to the China bloc significantly reduces Turkish OFDI. This result stresses the significant role of major geopolitical blocs in fragmenting FDI patterns. In sum, these findings demonstrate that geopolitical alignment affects Turkish OFDI through multiple mechanisms, including bilateral alignments (i.e., belonging to groups of friends, close, distant, or rivals), relative positioning vis-à-vis major global powers, and bloc membership. In this sense, Turkish OFDI configures under an evolving architecture of global geopolitical fragmentation.

Next, we examine whether the relationship between geopolitical alignment and OFDI evolves. To do so, we first split the sample into five-year intervals. However, given that such short periods may not fully identify the changes, we also divide the sample into the pre-2018 (2003–2017) and post-2018 (2018–2023) periods. The results are presented in Table 4.

Table 4. Estimation Results for Different Time Periods

Variables	I	II
geopol		
2003-2007	-0.446**	
	(0.189)	
2008-2012	-0.392**	
	(0.180)	
2013-2017	-0.209	
	(0.157)	
2018-2023	-0.201	
	(0.189)	
2003-2017		-0.349**
		(0.164)
2018-2023		-0.247
		(0.196)
log_gdp	0.286	0.818
	(1.127)	(1.139)
gdp_grw	0.011*	0.012*
	(0.006)	(0.006)
log_gdppc	-1.256	-1.754
	(1.233)	(1.214)
trade	0.002	0.001
	(0.002)	(0.002)
pol_stab	0.150	0.143
	(0.107)	(0.110)
gpr	-0.057***	-0.064***
	(0.012)	(0.010)
constant	13.324	10.522
	(9.757)	(9.907)
# obs	819	819
r^2	0.514	0.506
time fe	yes	yes
country fe	yes	yes

Notes: Robust and clustered standard errors are in parentheses. ***, **, * indicate significance levels of 1%, 5%, and 10% respectively.

Column (I) indicates that the effect of geopolitical distance weakens over time. While geopolitical distance is negatively and significantly associated with Turkish OFDI in the pre-2018 period, this relationship becomes statistically insignificant in the post-2018 period. Column (II) confirms this finding by providing evidence that Turkish OFDI does not respond to geopolitical distance in the post-2018 period. These results suggest that the effect of geopolitical alignment is not static but evolves in response to changes in the global landscape. The weakening of the effects in the post-2018 period contrasts with Aiyar et al. (2024), who find a strengthening effect of geopolitics after 2018. This may reflect Türkiye's relatively flexible geopolitical positioning. Türkiye can engage across different blocs rather than align strictly with major camps. In addition, in the post-2018 period, Türkiye encountered several macro-financial constraints. These pressures may be a factor directing firms to invest in greater market and financing opportunities rather than considering geopolitical ties. Finally, this period includes increasing complexity of global economic linkages such as the COVID-19 pandemic and the Russia–Ukraine war, which may have altered investors' focus in ways not fully captured by geopolitical distance alone. Overall, our results highlight the dynamic nature of geopolitical alignment in shaping Turkish OFDI decisions.

Finally, we evaluate the robustness of our findings using a series of alternative specifications, reported in Table 5. First, we use an alternative dependent variable defined as the share of OFDI relative to total outward investment. As seen in Column (I), the coefficient of geopolitical distance remains significantly negative, showing that the baseline results are not sensitive to the measurement of OFDI. Second, to smooth the effects of short-term fluctuations, we take the 3-year averages of the data and re-estimate the model. The results in Column (II) confirm that Turkish OFDI decreases as geopolitical distance increases. Third, we extend the baseline specification by including additional control variables that may influence OFDI, such as political regime differences and the World Uncertainty Index (WUI) for advanced and emerging economies[6]. As reported in Columns (III) and (IV), the negative effect of geopolitical distance remains. Among the additional controls, only the WUI has a statistically significant impact. Finally, to address potential endogeneity and capture the dynamic nature of investment behavior, we estimate a dynamic panel model using the GMM estimator. The results in Column (V) reveal that the negative effect of geopolitical alignment persists. As seen, a range of alternative specifications supports the presence of friend-shoring behavior in Turkish OFDI. Overall, these robustness checks confirm that our results are stable across measurement choices, additional controls, and estimation methods.

[6] The data for the political regime difference is taken from the V-Dem dataset. See https://www.v-dem.net/data/. The data for the World Uncertainty Index (WUI) is obtained from https://worlduncertaintyindex.com/data/.

Table 5. Robustness Checks

Variables	I (OFDI/Total OFDI)	II (3-year averages)	III (Political regime difference)	IV (WUI)	V (GMM)
geopol	-1.119*	-0.728**	-0.453**	-0.405**	-0.145***
	(0.588)	(0.301)	(0.186)	(0.183)	(0.035)
log_gdp	-0.706	1.471	2.082*	1.061	2.156***
	(1.097)	(1.005)	(1.054)	(1.064)	(0.263)
gdp_grw	0.038***	0.015*	0.015***	0.013**	-0.012***
	(0.010)	(0.007)	(0.005)	(0.006)	(0.000)
log_gdppc	-2.478*	-2.676**	-2.638**	-1.994*	-0.000***
	(1.495)	(1.029)	(1.029)	(1.124)	(0.000)
trade	0.001	-0.000	0.001	0.000	0.002***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.000)
pol_stab	0.349**	0.036	0.091	0.147	-0.030
	(0.133)	(0.140)	(0.124)	(0.111)	(0.021)
gpr	-0.043	-0.013***	-0.013***	-0.007***	-0.002***
	(0.014)	(0.002)	(0.002)	(0.000)	(0.000)
pol_reg_dif			-0.002		
			(0.002)		
wui_adv				-0.000***	
				(0.000)	
wui_eme				0.000***	
				(0.000)	
lag_ofdi					0.271***
					(0.038)
constant	22.714**	-1.437	-9.030	-1.928	22.876***
	(10.449)	(8.714)	9.133	(8.512)	(2.897)
# obs	819	273	819	819	819
R^2	0.303	0.460	0.494	0.510	
time fe	yes	yes	yes	yes	
country fe	yes	yes	yes	yes	
# inst					36
Sargan test (p-value)					0.231
AR (1)					0.001
AR (2)					0.872

Notes: Robust and clustered standard errors are in parentheses. ***, **, * indicate significance levels of 1%, 5%, and 10% respectively.

5. Conclusion

This paper examines whether and to what extent geopolitical alignment has shaped Turkish OFDI over the period 2003–2023. Using a geopolitical distance measure based on UN voting similarity and panel estimation techniques, this study provides strong evidence on the role of geopolitical alignment in the investment patterns of Turkish investors.

The findings reveal several important insights. First, Turkish OFDI is significantly concentrated in geopolitically aligned countries. We provide strong empirical support for the presence of friend-shoring behavior. However, this effect is not uniform. It is primarily driven by emerging market destinations and weakens in the post-2018 period, indicating that the influence of geopolitical alignment is both conditional and time-varying. Second, institutions play a moderating role. Better governance—particularly in terms of corruption control and

accountability— mitigates the negative impact of geopolitical distance on Turkish OFDI, suggesting that sounder institutions can partially buffer the adverse effects of geopolitical strains. Third, geopolitical alignment operates through multiple mechanisms. The results indicate that Turkish OFDI responds not only to bilateral and different forms of geopolitical alignments (friend, close, distant, rival) but also to countries' positions within the US–China geopolitical rivalry and their bloc membership. Overall, these results suggest that geopolitical alignment is an important but non-uniform driver of OFDI, whose effect depends on both the institutional environment and the evolving structure of global geopolitics.

The results have several implications. The increasing concentration of FDI in geopolitically aligned countries may constrain the growth potential of both home and host countries, reduce diversification, and limit access to broader markets and the diffusion of knowledge. At the same time, for policymakers, improving institutional quality emerges as a key strategy to attract and sustain foreign investment in a geopolitically fragmented environment.

More broadly, our results point to an important shift in the determinants of OFDI, where considerations of political alignment and strategic positioning complement traditional economic motives. This transformation poses challenges for emerging economies, which must balance integration into global markets with the need to maintain national security and resilience amid rising geopolitical constraints. In this context, strengthening institutions and enhancing the predictability of the investment environment appear critical. Furthermore, policymakers should avoid concentration of investments in a limited number of geopolitically aligned countries, as reducing the number of partner countries can restrict access to broader markets and limit the benefits of international integration. At the same time, international cooperation mechanisms, including political risk insurance and investment facilitation frameworks, may also play a role in mitigating the adverse effects of geopolitical fragmentation and safeguarding countries against future global losses.

This study has some limitations. First, the UN voting similarity may not fully capture several dimensions of geopolitical alignment, such as national security concerns and diplomatic and strategic alliances. Second, this study uses aggregate OFDI data; hence, the effects of geopolitical distance on the sectoral distribution of OFDI are not examined specifically. Addressing these limitations could offer a more comprehensive analysis. Future analysis can be extended through deeper insights. Relying on sectoral data to understand how geopolitical distance affects investment decisions across different sectors could be an important contribution to the literature. Further, focusing on a comparative study including a broader set of emerging economies and analyzing the post-2023 period could improve our understanding of how international investment patterns evolve under recent geopolitical developments.

Declaration of Research and Publication Ethics
This study, which does not require ethics committee approval and/or legal/specific permission, complies with the research and publication ethics.

Researcher's Contribution Rate Statement
I am the single author of this paper. My contribution is 100%.

Declaration of Researcher's Conflict of Interest
There are no potential conflicts of interest in this study.

Declaration of Artificial Intelligence Usage
The author used artificial intelligence tools only for grammar checking, language editing, translation support, and improving the readability of the manuscript. After using this tool/service, the content was reviewed and edited as necessary, and the author takes full responsibility for the content of the published article.

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APPENDIX

Table A1. Data Descriptions and Sources

Variable	Description	Source
log_ofdi	The stock of outward FDI measured in million US$ (in logarithms)	Statistical data platform (EVDS) from the Central Bank of the Republic of Türkiye
geopol	Geopolitical distance measured by ideal point distance (the absolute value of the difference between the inferred vote-specific preference parameter)	Database of Bailey et al. (2017).
log_gdp	Gross Domestic Product measured by constant 2015 US$ (in logarithms)	World Bank World Development Indicators Database
gdp_grw	Annual growth of GDP (%)	World Bank World Development Indicators Database
log_gdppc	Gross Domestic Product per capita measured by constant 2015 US$ (in logarithms)	World Bank World Development Indicators Database
trade	The sum of exports and imports as a percentage of GDP (%)	World Bank World Development Indicators Database
pol_stab	Political Stability and Absence of Violence/Terrorism (ranges between -2.5 and +2.5) (index values)	The World Bank World Governance Indicators (WGI)
gpr	Geopolitical Risk (index values)	Database of Caldara and Iacoviello (2022)

Note: Prepared by the authors.

Table A2. Summary Statistics

Variable	Observation	Mean	Standard deviation	Minimum	Maximum
log_ofdi	819	2.029	0.861	0	4.37
geopol	819	0.874	0.578	0	2.65
log_gdp	819	11.376	0.825	9.6	13.34
gdp_grw	819	3.323	6.020	-50.34	86.83
log_gdppc	819	4.047	0.489	2.9	4.99
trade	819	92.755	53.015	22.11	333
pol_stab	819	-0.016	0.811	-2.57	1.55
gpr	819	102.311	24.943	77.293	176.301

Note: Calculated by the authors.

Table A3. Correlation Matrix

	log_ofdi	geopol	log_gdp	gdp_grw	log_gdppc	trade	pol_stab	gpr
log_ofdi	1							
geopol	-0.083	1						
log_gdp	-0.085	0.091	1					
gdp_grw	0.231	0.165	-0.102	1				
log_gdppc	0.323	-0.255	-0.161	0.533	1			
trade	0.169	-0.464	0.015	-0.359	0.272	1		
pol_stab	0.184	-0.435	-0.093	0.161	0.759	0.521	1	
gpr	-0.154	0.026	0.116	-0.021	-0.030	-0.025	-0.031	1

Note: Calculated by the authors.