Chinese Commercially-Oriented Financial Flows and UN Voting Realignment

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Abstract:
This paper examines the impact of Chinese commercially-oriented financial flows (COFFs) on voting alignment between recipient countries and China in the United Nations General Assembly. Previous research has shown a positive association between Chinese development assistance and a recipient country's UN voting alignment with China. One implicit, if not explicit, implication is that Chinese COFFs, allegedly driven solely by economic interests, do not act as a channel for the transmission of influence. Given the great benefits associated with FDI and the fast-growing increase in Chinese foreign investment and non-development aid flows, we believe this conclusion to be premature. We contend that economic motivations and interests underpinning commercial flows can under certain conditions have political ramifications. Specifically, we argue that Chinese COFFs ought to positively (negatively) correlate with a recipient country's UN voting alignment with China (the United States). We also expect domestic institutional factors such as the quality of governance and regime-type to mitigate the influence of Chinese COFFs on realignment. The analysis finds strong support for the expectation concerning the direct effect of Chinese COFFs on political realignment with China.

Keywords: foreign direct investment, international organizations, China, United States, non-development aid

I.   Introduction

Chinese financial flows to the rest of the world have increased rapidly since the early 2000s and research on this topic has also surged with increasing data availability. [1]There is an emerging consensus that at least one type of Chinese overseas finance functions as a channel for the transmission of influence. Recent research demonstrates a positive association between Chinese development assistance (e.g. grants, technical assistance) and a recipient country's UN voting alignment with China (Strüver, 2016; Dreher, Fuchs, Parks, Strange, & Tierney, 2016). One implicit, if not explicit, implication of the existing scholarship is that Chinese commercially-oriented financial flows (COFFs) such as foreign direct investment (FDI) or non-development aid (e.g. loans, export credits), allegedly driven by economic interests, do not wield any political influence.

Given the size and diversity of Chinese COFFs, we believe this conclusion to be premature. We argue that political and commercial motivations and interests are not as clearly delineated in reality and so expect financial flows that are not explicitly political under certain conditions to nonetheless have an effect on political outcomes. Accordingly, this paper asks the following questions: how do Chinese COFFs affect international political alignment? Do recipient country institutions, such as the quality of governance and regime-type, condition the effect Chinese COFFs have on alignment?

We examine the impact of Chinese COFFs on the political alignment of recipient countries at the United Nations General Assembly (UNGA). More specifically, the analysis focuses on the effect of Chinese outward FDI (OFDI) on the (dis-)similarity of voting patterns between China and

recipient countries. We expect Chinese OFDI to positively correlate with a recipient country's UN voting alignment with China. Additionally, we include in the analysis the recipient countries' "voting distance" with the United States (US) as a secondary measure of political realignment. The comparison in voting realignments with China and the US allow us to study the direct and indirect effects of Chinese OFDI since China and the US often maintain contrasting positions on numerous international issues and so represent opposite points for alignment. Hence an increased distance from the US ideal point position may be additional or alternative evidence of Chinese influence (Zeng, 2017). Furthermore, we introduce domestic institutional factors to test arguments about the potentially conditional nature of the effect of Chinese OFDI on political alignment. Specifically, we expect more corrupt countries and more autocratic regimes to be more likely to be swayed into a pro-China position as a result of receiving Chinese FDI. Finally, we test the robustness of our findings with an alternative measure of COFFs, namely Chinese non-development aid flows.

Our empirical findings confirm that increasing OFDI from China result in closer political alignment between the recipient country and China. Our results strongly suggest a direct realignment with China rather than an indirect realignment via greater voting distance with China's main rival in the international system. However, we do not find consistent evidence for the mitigating role of our domestic institutional factors. Accordingly, we infer that the impact of Chinese OFDI on political alignment transcend governance quality or regime-type. Importantly, our results are robust to using non-development aid flows as an alternative measure of financial flows, suggesting that Chinese COFFs in general do wield political influence.

Our paper helps to deepen our understanding of the roles and impacts of Chinese outward financial flows on political development and thus have important implications for the political economy of commercially-oriented Chinese financial flows. The paper is structured as follows: section II outlines recent developments in Chinese COFFs (FDI and non-development aid) flows;

section III reviews the existing literature on this issue and highlights the contribution of this paper; section IV elaborates the arguments and sets up the hypotheses; section V describes the data and econometric methods for the empirical analysis; section VI shows and discusses the results. Section VII concludes.

II.   <u>Chinese outward financial flows in recent years</u>

Traditionally, research on the impact of FDI has focused on financial flows from developed to developing countries. However, the globalized world economy is now turning from "made in China" to "owned by China" (Nolan, 2012). Since the early 2000s, as part of its "going out" strategy, the Chinese government has encouraged domestic firms to acquire operations abroad which led to constant increases in financial outflows (Chou, Chen & Mai 2011; Meunier, Burgoon & Jacoby 2014). This has contributed to China becoming an even more interesting subject of research as it moves from a purely FDI receiving country to one engaged in both the receipt and provision of investment. Sinopec's purchase of Switzerland-based Addax Petroleum in 2008, Geely's takeover of Swedish carmaker Volvo in 2010, Zijin Mining's purchase of Altynken Gold Mine LLC in Kyrgyzstan, Sany's purchase of German concrete pumps producer Putzmeister in 2012, China Three Gorges Corporation's acquisition of Brazilian hydroelectric plants worth $3.7bn in 2015, SoShare Mobile's acquisition of Nigerian cell phone operator GiCell in 2016, and the most recent $43bn purchase of Swiss biotech giant Sygenta by ChemChina are examples of high-profile international takeovers carried out by Chinese businesses in recent years. Figure 1 illustrates the steady increase in Chinese OFDI flows from 2003-2015, reaching a record level of over $140bn in 2015.

[Figure 1 about Here]

3

The decomposition of Chinese OFDI by region shows that Asian countries by far attract most Chinese investment, whereas the amount entering African countries is relatively limited (Figure 2). This contrasts with popular conceptions as media and the public often assume that Chinese OFDI mainly targets the African region or solely countries with abundant natural resources. Geographic proximity and other social and economic conditions and affinities lead to relatively much larger flows into Asian countries. Europe is the second largest recipient of region of Chinese FDI. According to official statistics from the European Union (Eurostat 2017; see also Hanemann & Huotari 2017), Chinese investment stocks in the EU-28 increased more than six-fold from €5.6bn to over €35bn between 2008 and 2016, which illustrates that this phenomenon is not restricted to developing countries.

[Figure 2 about Here]

FDI normally pertains to business oriented activities. However, for Chinese OFDI, besides the economic aspects, the government plays a vital role in promoting OFDI as a substantial number of the firms involved in overseas markets are state-owned enterprises (SOEs). According to a report released by the Ministry of Commerce of China (MOFCOM 2016), among the top 100 Chinese firms ranked by their OFDI stock up until 2015, 77 are SOEs. Furthermore, even some of the non-SOE firms on the list maintain close connections with the Chinese government, such as Huawei. In addition, the foreign reserve policy in China gives great power to the government since firms and individuals cannot freely exchange Renminbi (RMB) to foreign currencies. The conversion of foreign currencies and foreign investment transactions need to be approved by the State Administration of Foreign Exchange (SAFE) with justified business documents and evidence.

Consequently, politicians in other nations, their publics, and many scholars tend to be skeptical about the motivations of Chinese OFDI since they may contain underlying political motivations.[2] Concerns about national security, cyber security or potential money laundering behind Chinese OFDI often generate tighter regulations and approval processes in developed countries. A few examples include the larger number of rejections for Chinese OFDI from the Committee on Foreign Investment in the United States (CFIUS) (Griffin, 2017) and the recent investigation raised by the Swiss Takeover Board on HNA's purchase of Gategroup.[3]

Beyond FDI, China has become the second largest global donor of international aid behind the US and the single largest donor in many developing countries. While the US and other developed countries and organizations traditionally focus their efforts on the provision of highly concessional aid earmarked explicitly for economic development, China has instead invested much more heavily in alternative aid flows, when measured in financial terms (Bräutigam 2011). AIDDATA[4] reports that one such type of alternative aid flows, captured by the category "other official finance" (OOF), amounted to $30bn in 2014, accounting for nearly 80% of the total amount of Chinese aid that year. (*see* Figure 3) Much of this finance is "not aid in the strictest sense of the term (development projects with a grant element of 25% or higher)" but comes in forms such as export credits, military assistance, or commodity-backed loans with forgiving terms that might not otherwise be obtainable by developing or less developed countries. (Dreher *et al.* 2017: 2).

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[2] See Reuters article on June 8, 2016. http://www.reuters.com/article/us-china-usa-rqfii-investors/u-s-investors-skeptical-about-chinas-move-to-widen-markets-idUSKCN0YU02H
Also see David Dollar's report: China as a Global Investor, Brookings Institution, https://www.brookings.edu/wp-content/uploads/2016/07/China-as-a-Global-Investor_Asia-Working-Paper-4-2.pdf
Also see The West Australian article on November 22, 2016 https://thewest.com.au/business/finance/barrick-sceptical-of-chinese-bid-for-super-pit-ng-ya-123908
[3] http://www.takeover.ch/transactions/document/id/3126
[4] Dreher, Axel, Andreas Fuchs, Bradley Parks, Austin M. Strange, and Michael J. Tierney (2017).

[Figure 3 about here]

When measured by the number of projects, Chinese aid appears to be geographically concentrated primarily in Africa. This has generated a great deal of attention on the part of both scholars and news media which focus on a new "scramble for Africa".[5] Yet, when taken instead in terms of total project value, Chinese aid is shown to be spread much more broadly (Figure 4). Countries in Asia, Europe, and Latin America have the largest average projects measured in US$, and of the top ten most important recipient countries only three are located in Africa, with the rest spread across the globe (Dreher *et al.* 2017).

[Figure 4 about here]

III.   Literature review

With the economic rise of China, recent research has focused on how this sea change in the international economic structure affects domestic institutions, policies and practices. Some scholars have examined how China's displacement of Western export markets in the African context shapes regulatory standards in areas as distinct as labor and civil society rights. Adolph *et al.* (2017) find evidence suggesting that greater export dependency on China results in deteriorating working conditions in partner countries through the so-called "Shanghai Effect" whereby African countries reflect the lower labor standards of China. Similarly, Adolph and Prakash (2017) argue that civil society promotion is an important component of Western countries' efforts to foster development and democracy around the world and that it has relied on Western trade leverage and

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[5] See Al Jazeera article from 10 Jan 2015
http://www.aljazeera.com/indepth/opinion/2015/01/china-troops-africa-economic-201511810569508263.html

the fear of Western punishment to materialize. They find evidence that as Western economic dominion declines and is replaced by that of China, African governments begin to roll back on NGO-friendly regulation as the new power is not interested in civil society promotion.

While a few scholars have focused on the domestic impact of Chinese bank lending (e.g. Kaplan 2016), a significant proportion of the literature on Chinese financial flows has focused on Chinese aid flows. One reason for this might be that with development aid, politics and economics are integrally tied together. Despite the broad geographical distribution of Chinese aid and its relatively heavier reliance on alternative aid-types (i.e. OOF), the focus of research on the topic has remained somewhat narrow. To date, the focus has been largely constrained to Africa, often focusing on the impact of Official Development Assistance (ODA) flows on corruption (Isaksson & Kotsadam 2016) and economic development there (Mahmoud 2007; Dreher *et al.* 2017), with more recent contributions breaking into the role Chinese aid plays in alleviating conflict following withdrawal of aid from developed Western countries (Strange *et al.* 2017).

A few papers have looked at the effect of Chinese aid or aid-type financial flows on foreign policy behavior of other countries. This research has uncovered the linkages between ODA-type flows and the projection of China's political will on recipient countries' foreign policy preferences as expressed in the UN General Assembly voting. Whereas Strüver (2016) finds that Chinese foreign aid helps buy support in the UN General Assembly, Dreher *et al.* (2016) find that Chinese ODA is allocated closely in line with foreign policy considerations. In addition, past research has established that it is generally common for ODA-type flows to be driven by political conditions or agendas, and are an instrument for garnering international support from recipient countries by other donor countries like the US (Dreher, Nunnenkamp & Thiele 2008).

Analyzing international political alignment through UNGA voting patterns has been widely adopted in the international relations literature. The most common and traditional approach is to

measure the direct alignment between two countries based on the percentage of vote agreement. Some modern research takes an alternative approach with the introduction of multiple influencing countries allowing for an indirect measurement of political influence and affinity. For example, Li (2016) analyzes the impact of Chinese OFDI on ASEAN countries with the UN voting coincidence approach, but the alignment is illustrated through a third-party country – Japan. Since Japan and China pursue different, often opposing, political agendas in the Southeastern Asia region, the idea is that rival competition can be observed at the UNGA voting level through competing alignments which reflect political affinity between voting recipient and donor countries and may reveal more than reliance solely on direct alignment between the donor and recipient countries. At times, perhaps due to political sensitivities or the two-level games involved in international relations, it may not be tenable for a recipient country government to vote in concert with their donor, or in our case investing, country. An alternative form of political support or alignment can be to vote in alignment with a perceived competitor less frequently or vote against the competitor country more frequently.

The rivalry between China and the US has been discussed intensively in recent years. The concept of the Thucydides Trap is frequently mentioned in describing the current Sino-US relationship and illustrates the competitive nature of the relationship well (Brzezinski 2014; Xie 2017). In international relations theory, offensive realism predicts that a rising power will enter into a conflict against an existing power, leading to conflict (Mearsheimer 2014). Power transition theory predicts either a conflict or cooperation between an existing power and a rising power, and points out that there is a greater likelihood of confrontation between them if the rising power is dissatisfied and openly challenges the existing power, as may be the case with the US and China (Tammen & Kugler 2006). As China surpassed Japan as the second largest economy in the world in 2011, the escalation between China and the US has been growing over a wide range of issues

such as the South China Sea, North Korea nuclear issue, Syria, trade, and intellectual property rights protections. With such confrontations, a third country may find itself inevitably drawn into the awkward situation of choosing to support either China or the US, as empirical analysis of the "One-Belt One-Road" countries' ideal points in UNGA voting illustrates (Zeng 2017): the OBOR country ideal points move away from the US to China, and the results support the argument that Chinese OFDI enables China to gain support vis-a-vis the US. The intuition behind Li's Japan-China alignment measurement and Zeng's US-China competition can be applied more generally to the case of Chinese financial flows and recipient countries' international political alignment with China as measured in UNGA voting.

IV.   Hypotheses

Four hypotheses are developed in this paper concerning the influence of Chinese COFFs on political alignment between China and recipient countries. First, Chinese COFFs should be associated with greater political alignment of the recipient country with China. Second, Chinese COFFs should affect the recipient country's alignment with the United States, as the political alignment between China and the US is often quite low and China has come to represent or embody an alternative to the US-led liberal order. Third, recipient countries that are more corrupt should align more closely with China in response to Chinese financial flows, as investment provides opportunities for rent-seeking and opportunistic behavior that are more likely to be exploited in a less accountable institutional context. Finally, regime type should condition the effect of COFFs on political realignment according to an argument and in a manner, that is similar to those for corruption. Namely, foreign investment provides opportunities for autocratic leaders to redistribute the benefits of investment among their narrow coalition in order to ensure their continuing support.

Drawing on previous work on aid and international organization loan provision and political alignment (*see* Wittkopf 1973; Dreher, Nunnenkamp & Thiele 2008; Dreher, Sturm & Vreeland 2009; Dreher & Sturm 2012), our primary hypothesis is that investment flows from China contribute to recipient nations shifting their political alignment toward China. Although FDI has in the past been treated solely as a market-driven phenomenon, we contend that, similar to official aid flows, it is another means to political ends in an economy with significant state intervention, as it is in China. Especially in countries that lack sufficient domestic capital or find themselves overlooked by Western investors due to domestic factors, political support for China should follow increasing financial flows from China as countries seek to maintain or increase investment.

Potential or current recipient nations see themselves as competing for Chinese investment. Previous economic arguments on investment determinants have focused on Dunning's (1988) ownership, location, and internalization advantages that firms seek to capture via investment or on states' abilities to present themselves as safe or stable (and so desirable) locales for investment. Such methods are firm and market centric and do not account for significant state influence which is likely to introduce political as well as economic motives. One such political motivation is obtaining significant political support in order to pursue a state's international political agenda, as in the previously cited work on aid and International Organizations lending. With all of this in mind, we propose that countries competing for Chinese commercially oriented finance will realign their stated political positions and support Chinese global political preferences in order to attract investment from SOEs or state influenced firms. By doing so, recipient countries express their gratitude or as quid-pro-quo following desired investment or commercially-oriented aid flows. We test this process of political realignment in response to COFFs through voting pattern-derived ideal point positions from the UNGA and official Chinese OFDI data.

As an additional measure of commercially oriented financial flows, we include AIDDATA's recently published dataset "Global Chinese Official Finance," specifically their measure of OOF-type aid flows. We believe the same logic applies to these non-development or alternative aid flows as to Chinese FDI and so expect similar outcomes.

Hypothesis 1 – Increasing Chinese COFFs leads to the recipient country being more aligned with China.

China and the US are often thought of as inhabiting opposite poles in international relations toward which countries may gravitate, depending on their political preferences. Each major power presents a different vision of the political economic world order which is reflected in the great distance between their ideal points and public statements regarding one another in the context of international relations. Treating each as an opposite pole, as a third country moves away from one, so it should move toward the other and vice versa (Li 2016; Zeng 2017). It may also be the case that countries not willing or able to shift their stated political preferences explicitly toward China feel capable of shifting away from the US. Thus, we expect that with increasing investment and aid from China, recipient countries' ideal points will move further from that of the US. This effect is likely to be less prevalent than our main effect, as it is an indirect measurement of the political economic process that we are proposing but we do expect to find evidence of its occurrence given the opposing global nature of China and the US and the ideal point variable used.

Hypothesis 2 – Increasing Chinese COFFs leads to the recipient country being less aligned with the United States.

As financial flows from China begin or increase there is an increased opportunity for corrupt officials to extract rents. For example, corrupt officials and politicians may demand bribes,

engage in extortion, or simply embezzle funds sourced from investing firms (Al-Sadig 2009). This provides them with material incentives to ensure that the flow of investment continues or preferably increases, affording further opportunities for rent extraction. In the context of the competition for FDI flows and political realignment as a means to that end, we then expect that as investment flows increase there should be a requisite increase in ideal point convergence between the recipient country and China as the recipient country officials compete for more investment and opportunities to capture rents.

Hypothesis 3 – Chinese COFFs have a larger impact on political realignment in countries with more corruption.

Similar to the argument for the conditioning effect of corruption, we expect countries that are less democratic to respond to Chinese financial flows by re-aligning themselves closer to China than countries that are more democratic. The underlying intuition can be elucidated using selectorate theory. (Bueno de Mesquita *et al.* 1999) In any country, political representatives and elites are accountable and so beholden to some group of supporters (the winning coalition) drawn from the larger sample of all those capable of participating in choosing their leaders (the selectorate). In more democratic countries, these groups are relatively larger, as the representatives in power rely on the support of some majority or plurality of the voting population to remain in power. In less democratic (more autocratic) countries, the group whose support elites are dependent on is smaller, often other elites in the economy and/or the military. Leaders in either case must distribute the benefits of their being in power among their supporters, whether that is a dominant subsection of the voting population at-large or a small group of wealthy or powerful elites. In the latter case, we theorize that potential Chinese investment provides a channel through which leaders in less democratic countries can funnel resources which will provide direct benefits to their

supporters. For example, either in the form of private goods and economic opportunity or increased rent and tax revenue which can be distributed among the relatively narrower group of winning coalition members. Of course, these benefits can also be distributed within more democratic countries among the much larger winning coalitions, but the individual utility to be derived would be much smaller than in less democratic countries as they would be more diffuse. In effect, we therefore expect less democratic (more autocratic) countries to more closely re-align themselves with China as Chinese investment increases. In doing so, the political leaders of the less democratic (more autocratic) states ensure greater opportunity to provide direct benefit to their elite supporters. *Hypothesis 4 – Chinese COFFs have a larger impact on political realignment in countries that are less democratic.*

V.   Data and Methods

Table 1 lists the descriptive statistics for all variables included in the empirical analysis.

[Table 1 about Here]

Our dependent variable is political alignment between countries in the UN. While this has often been measured using some form of voting coincidence (such as S-scores), as outlined by Dreher *et al.* (2008), we opt for an alternative measurement: ideal point distance. In a recent article, Bailey *et al.* (2017) propose a dynamic spatial model which provides an ideal point measurement of support of the US-led liberal order and argue that it be used in place of the standard dyadic voting similarity indicators in use throughout much of the preceding literature. As the authors point out, voting similarity indicators are likely to introduce measurement errors as they treat all votes as comparable.

To illustrate, suppose that in year *t* there are 10 votes and countries *a* and *b* vote identically on only one vote out of the ten, leading to a similarity or affinity score of 10 percent. Then, in year *t+1*, there are again ten votes but five of those are on the issue which had in year *t* divided the two countries and five are on the issue which they formerly voted identically on, producing an updated similarity score in year *t+1* of 50 percent. The preferences of states *a* and *b* would thus appear to have converged to a substantial degree when in fact they had not changed at all. The only change would be the frequency with which the countries had voted on two issues, one on which they agreed and one on which they did not. As Bailey et al points out, the potential for error or bias in voting coincidence indicators has led to their being abandoned in research on other voting bodies and replaced by spatial models which can leverage similarity or volatility of vote issue to produce an improved indicator that more closely models preferences as they appear in reality (Bailey, Strezhnev & Voeten, 2017). For this reason, we adapt the ideal point measurement as the basis for our dependent variables, taking the absolute value of the difference of the ideal point of each recipient country and the ideal points of China and the US. This data is available from 1946-2015.

Our main independent variable is FDI outflows in recipient country per year in billions of US dollars from the Ministry of Commerce of China (MOFCOM) published annually in the *Statistical Bulletin of Chinese Outward Foreign Direct Investment*[6]. Data on FDI outflows are available for the years 2003-2015 and we initially include this full range. While some researchers prefer to log transform FDI flows for empirical analysis (*see* Zeng 2017), the log transformation omits all negative values. Upon deeper review of MOFCOM's FDI data, the amount of negative observations is considerable. As explained by MOFCOM, a negative figure in FDI flow mainly reflects negative reinvested earnings, negative debt instrument investment, and negative

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[6] http://images.mofcom.gov.cn/hzs/201612/20161208100634737.rar

incremental equity investment. This may reflect unsuccessful projects or rejection by the relevant authorities of the recipient countries which leads to reporting of negative flows back to China. Log transformation removes these observations from the analysis whereas these negative values include critical information and therefore may not be simply ignored. Consequently, our empirical analysis focuses on the actual flows instead of log values. This FDI outflow measurement is used alone in direct and indirect effects models as well as interacted with measurements of democracy (polyarchy score) and national corruption in separate conditional effect models. We expect a negative (positive) relationship between FDI flows and ideal point distance between China (the US).

As an alternative measure of Chinese COFFs, we also use flows of non-development aid in billions of USD. AIDDATA's *Global Chinese Official Finance* dataset classifies these flows as Other Official Finance type (OOF) which they differentiate from Official Development Aid type (ODA) and which make up over 60% of China's total aid flows. As mentioned earlier, these flows are not aid in the traditional sense but often target key economic sectors and are made up primarily of export credits and loans given at forgiving rates. As such, they constitute a dependable alternative measurement and robustness check to our main FDI results. The OOF data ranges from 2000 to 2014 and we aggregate the total amount in billions USD from all projects per country per year to generate country-year observations. Following the analysis pattern of the FDI flows, we also expect to see a negative (positive) relationship between OOF and ideal point distance between China (the US).

Unlike the FDI data set which lacks detailed sectoral categorization, the OOF data set provides some information at the sectoral level. We therefore identified five sectors commonly identified as being strategic or otherwise of particular national interest and aggregated aid flow amounts into these sectors per country per year. The sectors are as follows: education, health, government and civil society, transport and storage, and energy generation, distribution and

15

efficiency. These sectors are considered strategic because of their significant impacts on national interests (Dutu & Dobrescu, 2012) Although, the precise definition of strategic sectors may vary across countries a report by the OECD identifies energy and transport as listed by a majority of member states as critical infrastructure sectors, with 6 countries also including the health sector (OECD, 2008). The US government also lists a total of 15 "critical infrastructure sectors"[7], including energy, transportation, health, and government facilities.

Our corruption and democracy variables are taken from the Varieties of Democracy 2.0 dataset compiled by Voeten and Sharanbir (2015) and are also included in the direct effect models as controls. The VDEM corruption variable is a continuous index ranging from 0 to 1. A higher figure implies a more corrupt country, whereas a lower score indicates a country with better domestic governance. The VDEM Polyarchy score normally runs from zero to one, with higher scores indicating a regime type closer to an ideal democracy. For our use, this has been transformed so that the values run from zero to negative one so that more negative scores indicate a lower score on the democracy scale (meaning a less democratic country) reflected by the polyarchy ranking to maintain conceptual continuity and provide easier interpretation of interaction effects in the later models and results. We expect a negative relationship between the corruption indicator and ideal point distance with China and a positive relationship between the converted democracy indicator and China ideal point distance. Where we introduce interactions effects between the corruption and democracy variables and FDI flows, we expect both interaction variables to have a negative relationship with FDI flows, such that as FDI flows increase in more corrupt or less democratic countries there should be a decrease (increase) in the ideal point distance between the recipient country and China (the US).

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[7] https://obamawhitehouse.archives.gov/the-press-office/2013/02/12/presidential-policy-directive-critical-infrastructure-security-and-resil

The time coverage of the corruption and democracy variables varies between countries, resulting in coverage for some countries up until 2015, although for others lasting only until 2012. There does not appear to be a systematic reason for this discrepancy in coverage, as the missing observations are from countries at all levels of development and different regions. It may be that publication of data occurs at different points throughout the year or at different intervals (annually, biannually, etc.) resulting in gaps.

We also include measurements of dependence of the recipient country on Chinese imports and exports. Trade data comes from the International Monetary Fund Direction of Trade Statistics (DOTS) measured by millions USD. We expect that countries with higher levels of penetration by Chinese imports are likely to have ideal points further from China (and by extension closer to the US) while those which depend more on exports to China will have closer ideal points to China (and further from the US). We test for significant collinearity between these variables by regressing them on one another and find that while there is some (as expected) it is not of a statistically significant or large magnitude.

In addition, we control for potentially influential alternative explanations. The first is simply a measurement of GDP per capita from the World Bank WDI, measured in current USD. Per capita GDP is widely recognized as a potential determinant of FDI and provides a general indication of development and national income which is often used as criteria for classifying or grouping nations in the UN and descriptive or empirical articles on voting patterns in the UNGA. We expect that per capita GDP to have a negative relationship with ideal point distance from China.

Following the literature (Strüver, 2016), we also include the Composite Index of National Capabilities (CINC), which provides a measurement of state capacity. This composite index consists of measures of resource consumption, military size and expenditure, and urban and total population. The intuition behind inclusion of this variable is that countries with a higher capabilities

index score will be better able to withstand the political and economic pressure of other states (for example, provision or threat of withdrawal of aid or investment from the US or China). As such, we expect it to exhibit a negative relationship with Chinese ideal point distance. A potential shortcoming of this variable, which is addressed further below in the section on results and analysis, is that the time coverage of State capacity extends to 2012 only, which is shorter than the data on FDI and ideal point measurements and so, in models where it is included, we lose three years of data for some countries. Therefore, we add it into the models as a robustness check.

The four hypotheses are tested by way of two-way fixed effects models, run in R with the plm package with country- and year-clustered standard errors. Although initially we considered the use of single individual fixed effects, we opted for inclusion of time fixed effects due to the indication of significant time effects from a Lagrange multiplier test for unbalanced panels, also run through the plm package in R. We test our hypotheses with our two independent variables: FDI and OOF. In both cases, the direct and indirect effects of realignment toward Chinese away from the US, respectively, are examined, followed by the addition of interaction terms for both corruption and democracy. In sum, there are six specifications in the main result approach (three on China and three on the US) and another eight specifications in the robustness checks.

VI.   Empirical results and analysis

The empirical results for Chinese FDI strongly support the Direct Effect from Hypothesis 1. There is robust evidence showing that increasing flows of Chinese OFDI lead recipient countries to be more closely aligned with China. The alternative Indirect Effect from Hypothesis 2 is also supported by our empirical results. However, there is mixed at best empirical evidence for the effect of OOF generally and the mitigating effect of political institutions in the recipient countries

18

Main results

Our main results are reported in Table 2. In Column 1, we find a strong, statistically significant direct effect of Chinese FDI on ideal point distance between a recipient country and China in UNGA voting. As expected, the coefficient for Chinese OFDI flows is highly significant and negative, indicating decreasing distance in the presence of increasing FDI flows. This relationship holds in Column 3 of Table 2, which reports the results with the interaction term for corruption, although in Column 2 it becomes statistically insignificant upon introduction of the democracy-FDI interaction. Both interaction terms themselves are not significant, although the coefficients exhibit the anticipated effects. Surprisingly, the main effects estimations of both corruption and democracy are in the opposite directions of our predictions, with reduced institutional quality (more corruption, less democratic) appearing to increase ideal point distance from China, meaning realignment away from China. Furthermore, our control variables in the first three columns are all insignificant. GDP per capita has an estimated effect of nearly zero, contrary to expectations. Altogether, the first main effect results provide strong support for hypothesis 1, as well as mixed results for our supplementary interaction and institutional hypotheses 3 and 4.

[Table 2 about Here]

Hypothesis 2, the indirect effect of realignment away from the US, is supported by the results reported in column 5, although the main effects modelled in column 4 are not significant; increasing Chinese FDI affects a growing distance between the ideal points of a recipient country and the US in the UNGA when countries have an effective corruption level of 0. Additionally, the controls for the main effects of corruption and democracy are in the predicted directions and significant, implying that more corrupt and less democratic countries tend to align further from the

19

US, a relationship that has no corollary in the results for ideal point distance from China. This seems to suggest that these domestic factors play less of a role in the international economic and political relations of China than they do in the US which tends to use more conditionality (or interference, as some might say). Despite the main effects and contrary to expectations, we do not find significant effects for the interaction effects reported in columns 5 and 6 and, in fact, when including the corruption interaction, FDI is no longer significant, as well. Generally, the indirect effect results in columns 4-6 of Table 2 indicate some (although admittedly weak) further confirmation of the main relationship in question - FDI and political alignment - though they further diminish the likely role of corruption and regime-type as mitigating factors and efficacy of the related hypotheses.

Robustness tests

As a robustness test, we reran the original models including a previously omitted state capacity variable, the Composite Index of National Capability (CINC), the time coverage of which cuts off at 2012. This shorter time coverage means we see a reduction in our sample size with its inclusion. We include this state capacity control as a robustness test for multiple reasons. First, measures of state capacity have become common in research such as this (*see* Dreher et al 2016) and have been found to be influential. Second, theoretically speaking, state capacity represents a measurement of states' ability to withstand the political and economic pressure leveraged by other, often more powerful states. As such, state capacity would be expected to mediate or exert strong influence on political economic relations, such as the one we study here. Finally, its shorter time coverage excluded it from our main models due to the aforementioned reduced sample size yet it is still a control that may be highly influential.

Table A1 reports the results from our robustness test models with a truncated sample and included CINC variable. Column 1 reports a similar coefficient for FDI flows with a high degree of significance, providing further evidence for our first and primary hypothesis and confirmation of the previous results. The controls remain statistically insignificant regressed against ideal point distance from China, as reported in the first three columns of Table A1. Additionally, the interaction terms in the second and third columns are now significant and FDI retains its significance in Column 3 with a substantial increase in magnitude. These results appear to not only support our main hypothesis but our institutional mediation hypotheses, as well. Where the democracy variable is at zero we see our strongest effect yet, with FDI recipient countries most closely realigning toward China. With countries that are "more democratic" this effect decreases, with our interaction effect showing an increase in ideal point distance between China and FDI recipient countries that are scored as more democratic.

[Table A1 about Here]

Turning to the US ideal point distance models, we find some further support for our second hypothesis on the indirect effect of Chinese FDI in Column 4 though in Columns 5 and 6 FDI is now not significant. Across all results for models with ideal point distance from the US as the dependent variable, corruption and democracy are still statistically significant, as they were before, indicating consistent impact of domestic political and economic conditions on alignment with the US. Again, given the US's history of including conditionality and interventionism in domestic affairs with its international political and economic relations (contrary to China's stated policies on the matter), this may not be much of a surprise.

Although the results of these robustness test models do provide further confirmation for our main direct effect hypothesis, support for the other three continues to be mixed. The coefficient magnitudes and significance for FDI regressed against ideal point distance from the US and the interaction terms run against both direct and indirect effect dependent variables at times improve and in others are reduced. It is as yet unclear if the cause of these effects is attributable to the state capacity variable or the reduced time-series. Overall, the results in Tables 2 and 3 together strongly support hypothesis 1 and provide weaker evidence of the indirect effect proposed in hypothesis 2. Hypotheses 3 and 4 find some stronger support in the latter results, though this remains mixed.

Table A2 reports our second robustness test results, replacing the FDI variable with OOF. Our main effect holds in Column 1, as the coefficient is both statistically significant and the sign is negative. This supports our primary hypothesis, that Chinese commercial flows drive recipient country realignment towards China on political issues. Although there is no statistically significant evidence of the institutional mitigation effect or indirect measurement of realignment away from the US, there is a strong and negative coefficient when we shift our focus from OOF flows generally to flows to strategic sectors, as shown in Column 4. The coefficient for the strategic sector variable is statistically significant at the 5% level, much stronger than the OOF variable at the 10% level.[8]

We contend that the stronger political influence of strategic sector OOF is due to recipient countries being more eager to seek external financial support in their strategic sectors. This is particularly the case for developing countries since many of them face limitations in international financial markets (United Nations, 2015), which make them unable to properly fund these sectors. The lack of funding or the deterioration of national strategic sectors may create challenges for the

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[8] We also include the State Capacity as an additional control variable and rerun the specifications with OOF strategic sector variable, and the main result on alignment with China is still negative and significant. To keep our paper concise, we do not report this result.

legitimacy of the regime and thus motivate the recipient countries to align more closely with China if Chinese capital goes to these sectors. According to the regional composition of Chinese OOF (see Figure 4), Asian and African countries are the main recipients of Chinese non-development aid, and many of them have engaged with the Chinese to develop their strategic sectors. They therefore would align more closely with China on political issues. One example of this is the funding of transportation and other infrastructures in Pakistan through the "China – Pakistan Economic Corridor" (Ahmad, Asmi, Ali, Rahman, & Abbas, 2017) including the Gwadar port project which aims to strengthen the Pakistani government and enhance bilateral relations (Tai, 2017).

Finally, we recognize the potential problem posed by endogeneity in our work. It is possible that instead of the proposed relationship between financial flows and realignment the causal relationship may in fact run in the opposite direction, with political realignment preceding investment or aid flows or even that both are simultaneously determined. Although there most likely is some iteration between finance and alignment, we believe that the relationship exists primarily as we have described it, that finance is used as a means to "purchase" support. As a simple (and preliminary) test of our results' robustness against the effects of endogeneity, we reran our main regressions with our primary independent variable (Chinese OFDI) lagged by one year and found no significant change in results.[9]

Overall, our results indicate a strong and significant direct relationship between Chinese FDI flows and political alignment. Increasing finance from China leads to a strong direct effect of realignment towards China with a somewhat weaker indirect effect of increased ideal point distance from the US. Evidence for hypotheses 3 and 4 are mixed, with some indication that regime-type

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[9] To keep our paper concise, we do not report these results, either.

and quality of governance may act as channels to amplify or mitigate the effect of Chinese investment on political alignment. The direct effect result remains when including a measure of state capacity and replacing FDI with OOF, which further confirms our main hypothesis that the recipient countries reorient themselves politically toward China in response to Chinese financial flows. These preliminary results also seem to indicate more work needs to be done on parsing out the role that domestic institutional or regime characteristics may play in the translation of investment flows into political realignment or other political outcomes.

VII.   Conclusion

This paper aims at exploring the potential political motivations behind commercial-orientated financial flows from China. The empirical results support the argument that Chinese COFFs are positively related to recipient countries' political realignment toward China. Our results also suggest that in some cases recipient countries turn away from the US following Chinese aid or investment.

We also find preliminary indications that in some cases the results are more solid when including quality of governance and regime-type measurements although these results generally do not hold up in the longer time-series when omitting the control for state capacity. This could be due the influence of the state capacity variable, expanded time series, or incomplete coverage by the indicators we used. We intend to revisit this issue in upcoming work. Our alternative independent variable robustness test further indicates that Chinese capital flowing into strategic sectors can exert stronger political influence on recipient countries. Our paper helps to deepen the understanding of the roles and impacts of Chinese outward financial flows on political development and thus have important implications for the political economy of commercially oriented Chinese financial flows as well as the global the political landscape. Given the different results when

introducing institutional variables on corruption and democracy, and sectoral results from the OOF data, further research is necessary to better understand the role and impact of domestic governance in recipient countries when facing inward Chinese capital flows. Other potentially valuable extensions would be to decompose Chinese FDI data by sectors or OOF by receiving agencies.

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Figure 1: Chinese OFDI 2003 - 2015
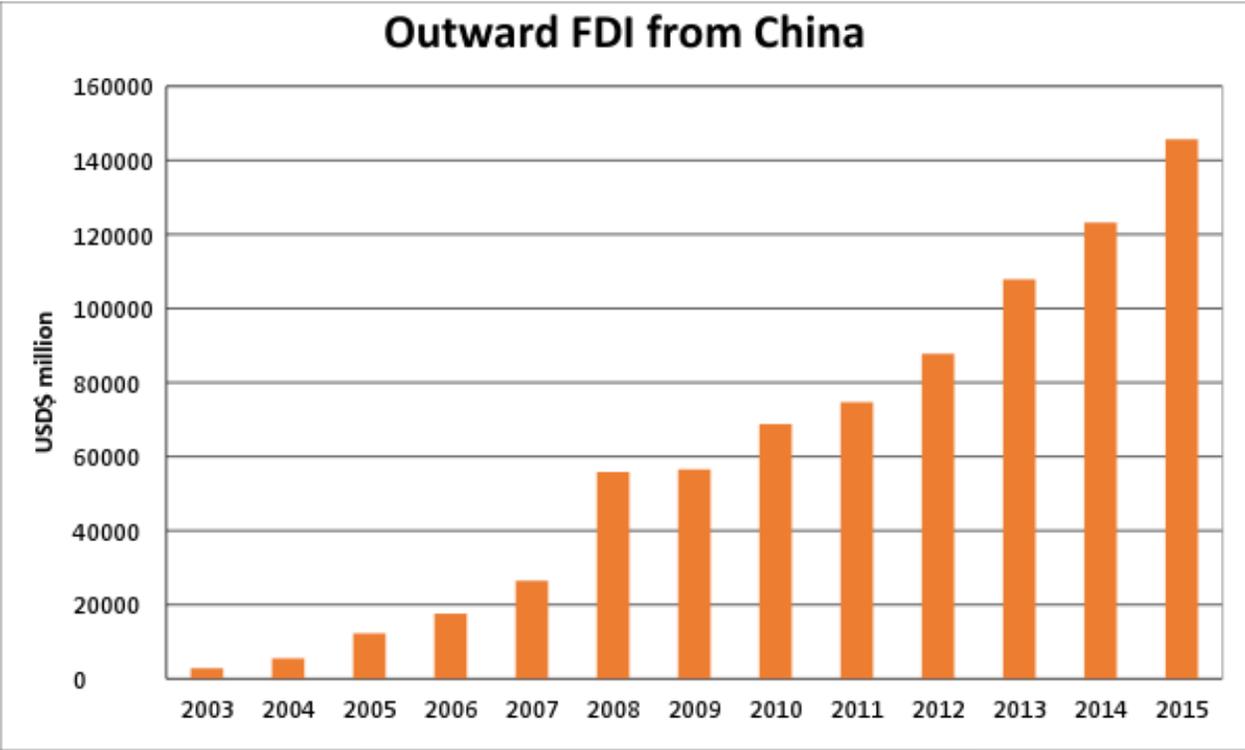

Data source: MOFCOM annual report http://images.mofcom.gov.cn/hzs/201612/20161208100634737.rar

Figure 2: Chinese OFDI Flows 2003 - 2015 by region
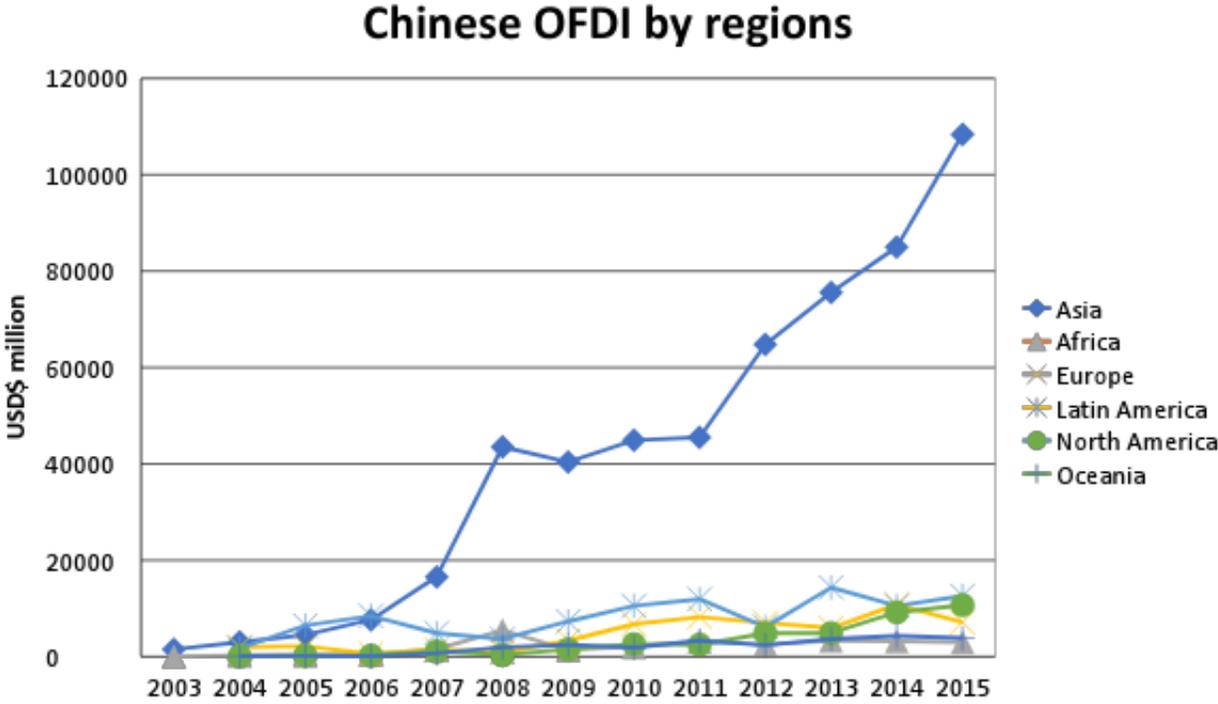
Data source: see Figure 1

Figure 3: Chinese Aid 2000 - 2014
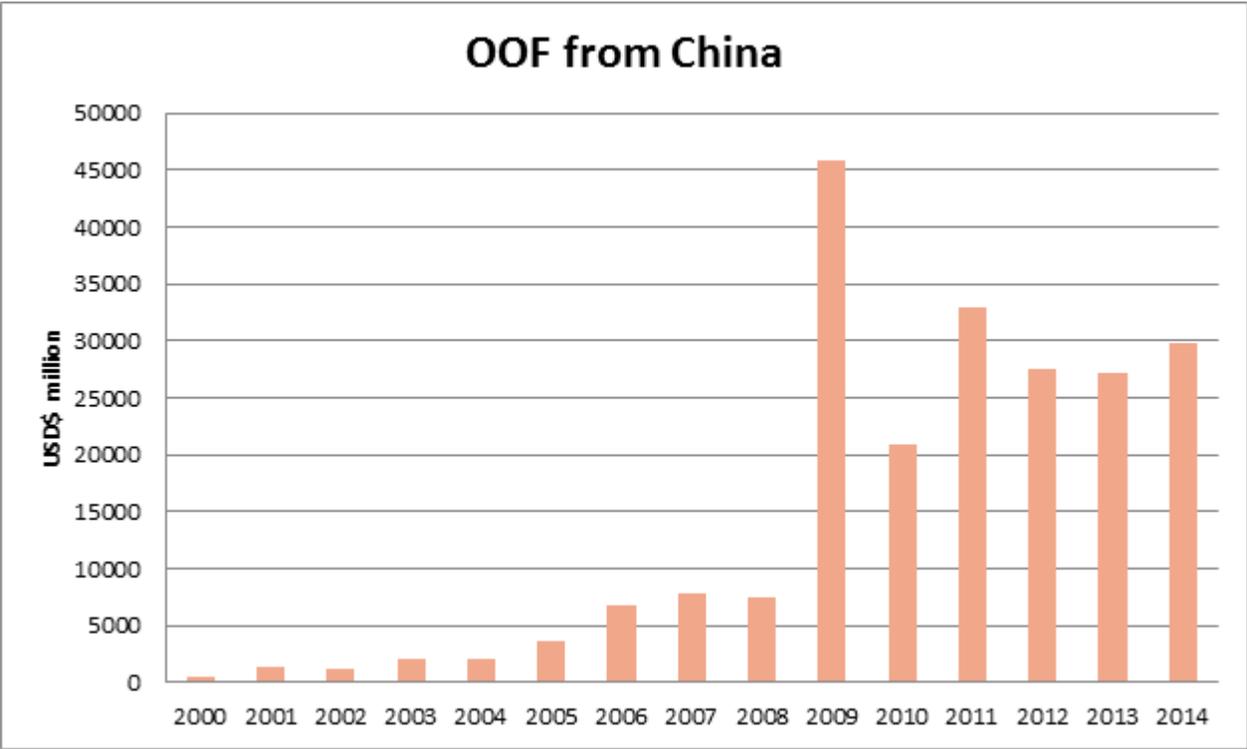
Data source: Dreher, Axel, Andreas Fuchs, Bradley Parks, Austin M. Strange, and Michael J. Tierney (2017).

Figure 4: Chinese OOF 2000-2014 by region
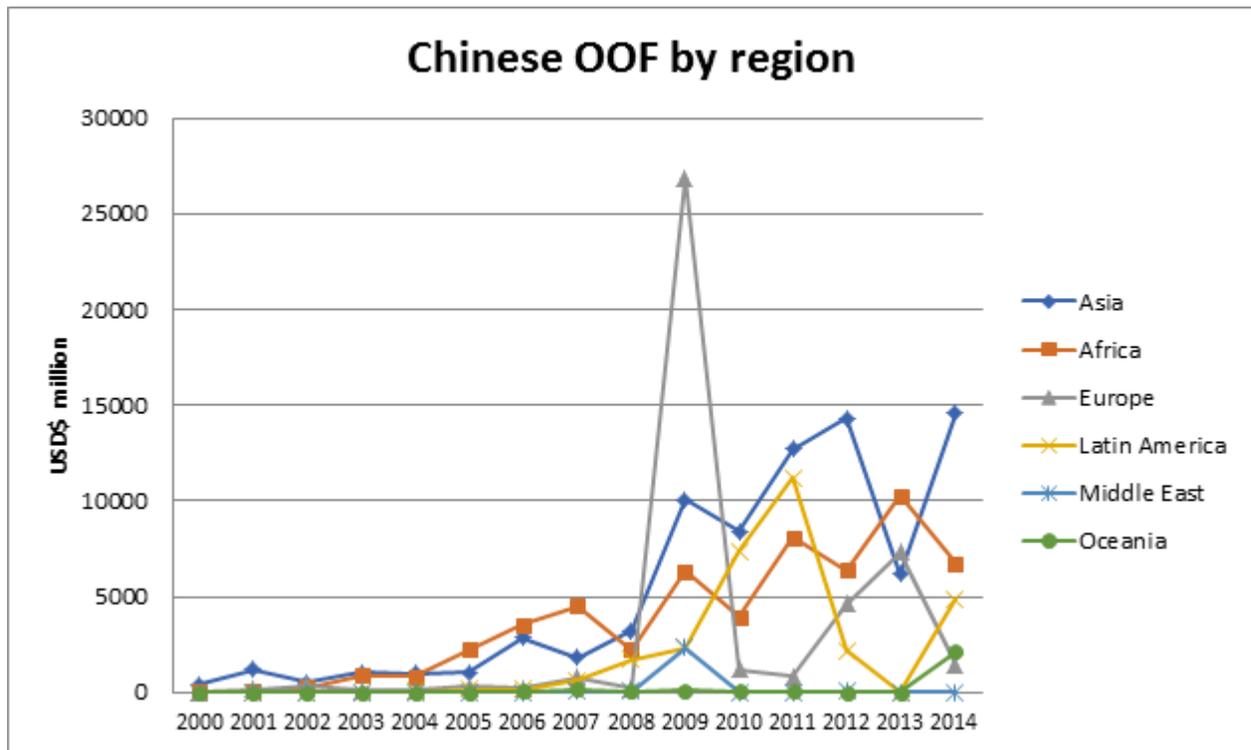
Data source: see Figure 4

Table 1: Summary Statistics

	Mean	SD	Min	Max	N
Distance from China ideal point	0.7649	0.7348	0.0005	3.792	2759
Distance from US ideal point	2.8668	0.8874	0	4.7098	2759
FDI	0.1416	0.7061	-11.4532	13.4628	1679
Corruption	0.5213	0.2771	0.0094	0.9462	2204
Democracy	-0.557	0.2571	-0.9584	-0.0258	2198
GDP per capita	11571.92	18702.58	108.066	179478.6	2735
Import dependence	0.0459	0.1381	0	3.4002	2702
Export dependence	0.0236	0.0493	0	0.4157	2620
State capacity	0.0047	0.0139	0	0.1565	2221
OOF	0.078658	0.648119	0	26.1	2759
Strategic sector OOF	0.0521	0.5884	0	25	2759

Table 2: Chinese OFDI and UNGA voting dissimilarity with China and the US

	Ideal Point Distance from China			Ideal Point Distance from the US		
	1	**2**	**3**	**4**	**5**	**6**
FDI	-0.044***	-0.044**	-0.037	0.016	0.024*	-0.027
	(0.016)	(0.021)	(0.056)	(0.011)	(0.013)	(0.039)
Corruption	0.193	0.193	0.194	0.350**	0.348**	0.346**
	(0.207)	(0.207)	(0.207)	(0.156)	(0.156)	(0.156)
Democracy	-0.135	-0.135	-0.134	-0.324*	-0.328**	-0.332**
	(0.160)	(0.159)	(0.160)	(0.167)	(0.167)	(0.167)
FDI*Corruption		-0.000			-0.032	
		(0.058)			(0.039)	
FDI*Democracy			-0.009			0.055
			(0.068)			(0.047)
GDP per capita	-0.000	-0.000	-0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Import dependence	0.058	0.058	0.058	-0.059	-0.058	-0.058
	(0.060)	(0.060)	(0.060)	(0.038)	(0.038)	(0.038)
Export dependence	-0.085	-0.085	-0.087	-0.322	-0.317	-0.311
	(0.247)	(0.245)	(0.244)	(0.257)	(0.256)	(0.256)
R^2	0.019	0.019	0.019	0.055	0.056	0.057
Number of countries	150	150	150	150	150	150
Num. obs.	1317	1317	1317	1317	1317	1317

***$p < 0.01$, **$p < 0.05$, *$p < 0.1$

Appendix: Robustness checks

Table A1: Chinese OFDI and UNGA voting dissimilarity with China and the US, state capacity included

	Ideal Point Distance from China			Ideal Point Distance from the US		
	1	**2**	**3**	**4**	**5**	**6**
FDI	-0.041***	-0.003	-0.129***	0.033**	0.024	0.047
	(0.012)	(0.020)	(0.039)	(0.015)	(0.018)	(0.051)
Corruption	0.496	0.495	0.497	0.357*	0.358*	0.357*
	(0.308)	(0.308)	(0.307)	(0.207)	(0.207)	(0.207)
Democracy	-0.119	-0.123	-0.123	-0.396**	-0.396**	-0.396**
	(0.175)	(0.176)	(0.176)	(0.185)	(0.185)	(0.185)
FDI*Corruption		-0.118**			0.026	
		(0.051)			(0.053)	
FDI*Democracy			0.119**			-0.020
			(0.050)			(0.060)
GDP per capita	-0.000	-0.000	-0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Import dependence	0.056	0.056	0.055	-0.044	-0.044	-0.044
	(0.067)	(0.067)	(0.067)	(0.040)	(0.040)	(0.040)
Export dependence	-0.282	-0.280	-0.275	-0.214	-0.215	-0.216
	(0.355)	(0.367)	(0.363)	(0.330)	(0.331)	(0.330)
State capacity	6.619	9.574	9.190	0.148	-0.502	-0.279
	(9.160)	(10.017)	(10.073)	(8.065)	(8.059)	(7.996)
R^2	0.029	0.033	0.032	0.056	0.056	0.056
Number of countries	146	146	146	146	146	146
Num. obs.	1075	1075	1075	1075	1075	1075

***$p < 0.01$, **$p < 0.05$, *$p < 0.1$

Table A2: Chinese non-development aid and UNGA voting dissimilarity with China and the US

	Ideal Points Distance from China				Ideal Points Distance from the US			
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**
OOF Flows	-0.006*	-0.035	-0.019		0.008	0.052	-0.011	
	(0.003)	(0.022)	(0.013)		(0.005)	(0.043)	(0.013)	
Corruption	0.122	0.121	0.122	0.123	0.045	0.048	0.045	0.045
	(0.146)	(0.146)	(0.147)	(0.146)	(0.143)	(0.142)	(0.143)	(0.144)
Democracy	-0.025	-0.027	-0.025	-0.024	-0.635***	-0.632***	-0.635***	-0.638***
	(0.133)	(0.133)	(0.133)	(0.133)	(0.195)	(0.194)	(0.194)	(0.195)
OOF *Corruption		0.036				-0.055		
		(0.027)				(0.052)		
OOF*Democracy			0.038				0.055	
			(0.039)				(0.038)	
Strategic Sector OOF				-0.007**				0.001
				(0.003)				(0.004)
GDP per capita	-0.000	-0.000	-0.000	-0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Import Dependence	0.048	0.048	0.049	0.048	-0.043	-0.042	-0.042	-0.043
	(0.079)	(0.079)	(0.079)	(0.079)	(0.059)	(0.059)	(0.059)	(0.059)
Export Dependence	-0.185	-0.183	-0.177	-0.186	-0.390*	-0.394*	-0.379*	-0.384*
	(0.188)	(0.189)	(0.186)	(0.189)	(0.225)	(0.227)	(0.224)	(0.226)
R^2	0.008	0.008	0.009	0.008	0.060	0.061	0.061	0.059
Number of Countries	152	152	152	152	152	152	152	152
Num. obs.	2130	2130	2130	2130	2130	2130	2130	2130

***p < 0.01, **p < 0.05, *p < 0.1