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China's Economic Diplomacy and  
the Politics-Trade Nexus

Andreas Fuchs

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# China's Economic Diplomacy and the Politics-Trade Nexus

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**Abstract:** This article reviews the literature on the linkages between political tensions, economic diplomacy and international trade in the light of China's rise in the global economy. The existing scholarly work suggests that economic diplomacy should be more pivotal in economic exchange with China than with Western market economies. In an econometric test, I analyze how diplomatic tensions, measured through foreign dignitaries' meetings with the Dalai Lama, affect the likelihood of an official visit from a Chinese leader. The results show that the likelihood of the Chinese leadership traveling to a country is 13.6 percent lower if the country's government receives the Dalai Lama in a given year but increases in the following year, supposedly to restore ties. This finding underlines that economic diplomacy is an important channel linking political climate and economic exchange between nations.

**JEL classification:** F51, F53, H77, O19, P33

**Keywords:** economic diplomacy, international trade, embassies, political climate, state visits, leadership travel, emerging economies, China, Dalai Lama, Tibet

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“There is no denying that we must, on the premise of country interests, carry out the economy diplomacy against the backdrop of globalization, which is the nature requirement of market economy.”

*Gao Hucheng, China's Minister of Commerce*

## 1. INTRODUCTION

The announcement on October 8, 2010 that the Norwegian Nobel Committee had awarded the Nobel Peace Prize to Chinese human rights activist Liu Xiaobo set off a controversy in the relations between (the People's Republic of) China and Norway. The Chinese government immediately protested the decision with public statements declaring that Liu was a criminal and warning that selecting him for the award could harm China-Norway ties.<sup>1</sup> With a former Norwegian prime minister on the committee, it was difficult for the Norwegian government to distance itself from the award. Three days later, the first effects on Norway's economic diplomacy became apparent: the Chinese government canceled a scheduled meeting with the Norwegian fisheries minister Lisbeth Berg-Hansen after her arrival in China. She was scheduled to visit Norway's pavilion at the Shanghai Expo, where the country also promotes its fishery products. These would not be the only repercussions. A new set of veterinary controls imposed at ports in China on fresh salmon had immediate effects. The data in Figure 1 reveal the sharp drop in fresh salmon exports from Norway to China compared with those to the rest of the world after the announcement of the Nobel Peace Prize. The imposed controls appeared to be Norway-specific; while Norwegian salmon was reported as being left rotting in the ports, the flow of Scottish salmon continued uninterrupted.<sup>2</sup> What is more, China decided to halt plans to sign a free trade agreement with Norway.

This case of salmon trading represents a key example of how economic diplomacy and foreign trade are adversely affected by political tensions. There is a large literature on the trade-politics nexus that analyzes the economic consequences of bad political relations (e.g., Pollins 1989a, 1989b; Davis and Meunier 2011; Pandya and Venkatesan forthcoming). The rise of China to become the world's largest exporter and second largest economy after the United States (CIA 2015) is likely to alter what we know about these relationships. In contrast to the dominating major industrialized economies, China is neither a democracy nor has it obtained WTO market-economy status. Yakop and van Bergeijk (2011: 264) expect that “[t]he emergence of new economies with very different institutions and cultural background will influence global norms and values and this will undoubtedly have an impact on the rules of international trade.” In the case of China, the dominant role of the state and of

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<sup>1</sup> Zheng Xinyi, “Beijing blasts Nobel Peace Prize Meddling,” *People's Daily Online*, October 9, 2010. <http://english.peopledaily.com.cn/90001/90776/90882/7160366.html>.

<sup>2</sup> “Norway's salmon rot as China takes revenge for dissident's Nobel Prize,” *The Independent*, October 6, 2011. See also Chen and Garcia (2015) for an investigation of Norway's salmon sanction.

state-owned enterprises in particular is likely to alter the role of politics in international commerce (e.g., Davis et al. 2014).

This article reviews the existing literature on the linkages between political tensions, economic diplomacy and international trade in the light of the ongoing rise of China. I conclude that economic diplomacy is more pivotal in economic exchange with China than with Western market economies. Economic diplomacy is expected to suffer during political tensions but can also be a tool to restore ties. In this regard, this article also provides systematic empirical evidence that China alters its leadership's travel pattern in response to diplomatic tensions, as measured by official receptions of the Dalai Lama in its trade partner countries. China perceives foreign officials' meetings with the Dalai Lama as interferences into its internal affairs that usually result in worsening relations with China (see Fuchs and Klann 2013). The results show that the likelihood of the Chinese leadership traveling to a country is 13.6 percent lower if the country's government receives the Dalai Lama in a given year but increases in the following year, supposedly to restore ties. This finding suggests that economic diplomacy is an important mechanism linking the bilateral political climate to economic exchange.

I proceed as follows. The second section provides an overview on China's growing diplomatic activities around the globe. In the third section, I review the existing literature on the political determinants of trade in the light of China's rise in the global economy. The fourth section provides the brief econometric analysis of the timing of official receptions of the Dalai Lama and China's leadership by China's trading partner countries. The final section concludes.

## **2. CHINA'S EMERGENCE IN DIPLOMACY**

The Chinese Civil War in the aftermath of the Second World War left the world with two Chinese governments that each claimed to represent the one China: the Communist-ruled People's Republic of China (PRC) on the mainland and the Republic of China (ROC) on the island Taiwan. Both entities followed the so-called One-China Policy, demanding that a country ceases diplomatic relations with the one entity when it recognizes the other. Over the last decades, the PRC and the ROC pursued a "dollar diplomacy" to gain diplomatic recognition from countries around the world (Taylor 1998). While the linkages in the world's diplomatic network are typically driven by geographic proximity, countries' military and economic power, and closeness in terms of political ideology (Neumayer 2008), in the case of China, it appears that the pattern of diplomatic recognition of one of the two Chinas was and is dominated by economic considerations (Rich 2009). An important tool of both governments' economic diplomacy is foreign aid, a major goal of which is diplomatic recognition by the recipient (e.g., Dreher and Fuchs 2015; Strange et al. forthcoming). With the growing economic dominance of the PRC and the associated aid flows of considerable size, Beijing has gained the upper

hand and both entities follow a so-called “diplomatic truce” since shortly after President Ma Ying-jeou of Taiwan assumed office in 2008.

Figure 2 shows the number of countries (or territories) that recognize the ROC (Taiwan) rather than the PRC (data from Rich 2009, own update). As can be seen, the number of countries recognizing the government in Taipei decreased substantially after the PRC replaced the ROC in the United Nations in 1971.<sup>3</sup> To be precise, the number of entities recognizing the ROC fell from 57 in 1970 to 21 in 2014, of which Burkina Faso, Guatemala and Malawi are the largest countries in terms of population size. Figure 2 also plots the number of embassies received and sent by the government in Beijing. There is a steady increase in diplomatic representations since 1970 so that the PRC maintains 160 embassies in foreign countries in 2010, while hosting almost as many foreign embassies at home (158). In parallel, and mainly fueled by the economic reform program that started in the late 1970s, the PRC’s bilateral trade pattern also diversified (Zhang et al. 2011), so that today the PRC is trading with virtually all countries in the world.

While embassies are good indicators of the *existence* of diplomatic relations between countries, the occurrence of state visits or other high-level meetings serve as proxies of the *intensity* of diplomatic relations. Figure 3 shows a map of the geographic distribution of China’s leadership travel across the globe over the 1998-2006 period (data from Kastner and Saunders 2012). It contains every trip abroad made by President Jiang Zemin and his Prime Minister Zhu Rongji, as well as by his successor President Hu Jintao and his Prime Minister Wen Jiabao. Russia was China’s favorite destination during this period. In seven of nine years a Chinese leader, either president or prime minister or both, made at least one trip to the neighboring country. Germany, the United Kingdom, and Vietnam follow on the list with five years of top-level travels. However, more than half of the world’s countries were blind spots for the Chinese leadership during the Jiang and Hu presidencies, including most of West and Central Africa, the countries of the Andean Community, Sweden, and Norway, among many others.

Since a visit by a Chinese leader is costly in terms of his personal opportunity costs and in terms of preparation time invested by government officials, scholars see their travel pattern as a way to draw inference about China’s foreign policy preferences. Most notably, Kastner and Saunders (2012) analyze the travel patterns of the two Chinese presidents and prime ministers during the 1998-2008 period. They conclude that the travel behavior of China’s leaders is more broadly consistent with China being a status-quo state that integrates into the international system rather than a revisionist

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<sup>3</sup> As discussed by Neumayer (2008), pressure from the anti-Communist opposition in the United States prevented the U.S.—and indirectly also its allies—to recognize the PRC until the U.S. normalized its relations with China under President Richard Nixon.

state challenging the existing order.<sup>4</sup> In line with this, Bader (2015) finds that China's high-level diplomacy has no significant impact on the likelihood of survival of autocratic regimes.<sup>5</sup>

Economic diplomacy can be defined as the form of diplomacy that is concerned with economic-policy issues. China very actively engages in economic diplomacy and through its diplomatic network and tools of economic statecraft. Jiang (2011) claims that China tries to show its 'great power style' through its economic diplomacy. At the same time, Jiang argues that the emerging power "is still far from being a benign hegemon because of its level of development, domestic political constraints, and tension between political and economic interests." Rather than projecting altruistic motivations in its economic diplomacy, China supposedly strives for mutual benefit. Economic motives are shown to be at the forefront of visits of the Chinese leadership. As summarized by Kastner and Saunders (2012: 165), "Chinese leaders typically travel with a large entourage of government officials and business leaders; summit visits often include the announcement of Chinese aid commitments, investment deals, and signing of various political and economic agreements." Shi and Yue (2014) find a positive link between trade and Chinese leadership meetings and take this as evidence that economic motives dominate China's foreign-policy agenda. Despite the dominance of economic goals, there is evidence that China uses its growing diplomatic network to influence outcomes in international politics, including countries' voting alignment in the United Nations General Assembly (Strüver forthcoming).

Today's Chinese economic diplomacy is seen as part of realizing the "Chinese Dream" put forward by President Xi Jinping to realize the "great rejuvenation of the Chinese nation." Gao Hucheng, China's Minister of Commerce, listed four basic principles of economic diplomacy (Gao 2015). First, diplomacy should serve the economy; economic diplomacy is the most important part of diplomacy. Second, economic diplomacy and China's policy of "opening up" should go hand in hand and the country "should plan economic diplomacy through an open mind." Third, China should maintain and expand the role of trade and economic cooperation as the main channels in its economic diplomacy to serve its development. Fourth, economic diplomacy should not be pursued as a zero-sum game but rather create mutual benefits and win-win situations, thereby creating a "favorable international environment." In the light of Xi's vision of the "Chinese dream" and the strongly growing economy—albeit now at a slower pace—it is likely that China's economic diplomacy will continue to flourish over the foreseeable future.

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<sup>4</sup> Note that they also observe some deviations from this pattern. Most notably, they find a higher likelihood of Chinese leaders traveling to rogue states.

<sup>5</sup> The same holds for arms sales and foreign aid from China as well, but Bader (2015) finds exports to China to be associated with autocratic longevity.

### 3. THE POLITICS-TRADE NEXUS AND THE ROLE OF ECONOMIC DIPLOMACY

Political and commercial relations are intertwined (Hirschman 1945; Baldwin 1985).<sup>6</sup> In addition to the purely economic characteristics of goods and services such as price, quantity and quality, political relations can also influence trade. Pollins (1989a, 1989b) develops a public choice model of bilateral trade flows. Extending the concept of welfare to include political ties, Pollins posits that import decisions are influenced by the place of origin of the traded goods and services as they depend on the political climate between trading partners. He argues that risk-averse importers minimize the risks of trade disruptions by rewarding political friends and punishing adversaries. Exploiting bilateral event data on conflict and cooperation for the 1955-1978 period, his empirical results support the hypothesis that greater amity between trading parties increases trade, while greater hostility has a trade-dampening effect. Similarly, Gowa and Mansfield (1993) argue that gains from trade are a source of security externalities as trade-induced efficiency frees resources for military use in the economy of the trading partner. Consequently, it is in a country's strategic interest to concede such gains to befriended countries and deny them to enemies. States may thus rely on trade interdependencies to strategically reward allies or punish adversaries. Empirically, they show that trade is stronger between allied countries.<sup>7</sup> Kastner (2007) provides evidence that the trade-reducing impact of bad bilateral political relations is reduced if internationalist economic interests are strong, which is proxied for by low trade barriers. According to him, this provides an explanation of the strong commercial ties between the PRC and the ROC despite the obvious tensions. Davis and Meunier (2011) argue that globalization constrains governments to politicize trade due to sunk costs.<sup>8</sup>

Despite the constraining effects of internationalist economic interests and sunk costs linked to globalization, several empirical studies provide evidence that the political climate affects trade with China. Fuchs and Klann (2013), for example, find that political tensions caused by foreign dignitaries receiving the Dalai Lama lead to a significant reduction of these countries' exports to China.<sup>9</sup> Che et al. (2015) find that Sino-Japanese historical animosity still affects today's trade between the two Asian economic powers. Analyzing Sino-Japanese tensions following the reauthorization of a controversial history textbook in 2005, Fisman et al. (2014) find that the episode led to a stronger decline in imports of Chinese state-owned enterprises from Japan than for private companies. Splitting total trade into trade through state-owned enterprises and trade through private entities, Davis et al. (2014) show that negative political events adversely affect imports through state-owned enterprises but not private companies. According to He et al. (2015), political tensions between Beijing and Taipei make firms of the PRC's political opponents with strong trade and investment ties to the mainland suffer from a

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<sup>6</sup> While I focus on non-militarized political tensions, a strand of the literature investigates the link between militarized disputes and trade (e.g., Martin et al. 2008).

<sup>7</sup> Incorporating new trade theory, empirical evidence in Gowa and Mansfield (2004) suggests that alliances (and other measures of bilateral relations) matter more for trade under increasing returns to scale than under constant returns to scale.

<sup>8</sup> On the role of regime type in bilateral trade, see Morrow et al. (1998), Mansfield et al. (2000), and Aidt and Gassebner (2010).

<sup>9</sup> See also Lin et al. (2015) on the firm-level dynamics driving this "Dalai Lama Effect."



decline in stock returns. Focusing on consumer reactions, Hong et al. (2011) relate the Chinese boycotts of French products during the 2008 Beijing Olympics to reduced sales of French cars in China. Heilman (2015) analyzes the reactions to territorial disputes over the Senkaku/Diaoyu Islands and identifies a temporary effect on consumer goods and highly-branded signature products. Moreover, there is some evidence that trade dependence on China pushes partner countries' policy positions in China's favor (Flores-Macías and Kreps 2013; Kastner forthcoming). Taken together, this is clear evidence suggesting a strong politicization of trade with China.

Countries' engagement in economic diplomacy is a likely channel linking the bilateral climate to the intensity of bilateral trade. Overall, previous research on economic diplomacy (see Bergeijk 2009 for an overview) suggests that a positive link exists between economic diplomacy and bilateral trade. Analyzing export flows from 22 countries for 2002 and 2003 in a gravity framework, Rose (2007) finds that the size of a country's diplomatic service increases its exports. Each additional consulate is associated with an increase of exports by about six to ten percent. Focusing on export flows of 17 Spanish regions for 1995-2003, Gil et al. (2008) show that the existence of Spanish regional trade agencies abroad is positively associated with exports to the respective partner countries. However, Head and Ries (2010) do not find empirical evidence that Canadian trade missions have a trade-promoting effect. With respect to state visits, Nitsch's (2007) provides empirical evidence that state and official visits foster trade. Estimating export flows from France, Germany and the United States over the 1948-2003 period, his results show that one visit is associated with an eight to ten percent increase in exports. Summarizing the findings of 32 prior contributions in a meta analysis, Moons and Bergeijk (2014) speak of an overall significantly positive effect of economic diplomacy on trade and investment (with the exception of state visits).

Previous research also shows a trade-promoting role of economic diplomacy in the case of China. Empirical evidence in Zhang et al. (2011) confirms for China over the 1950-2002 period that diplomatic relations and state visits are associated with larger bilateral trade flows.<sup>10</sup> Lin and Yan (2015) provide empirical evidence according to which visits of African ministers to China lead to increases in Chinese exports to these countries. This effect appears to mainly operate via the extensive margin, i.e., an increasing number of products exported from China to Africa. Since the effect is dominated by exports in capital-intensive manufacturing goods through state-owned enterprises, Lin and Yan interpret this as "aid" to Africa. While state visits do not appear to robustly boost trade in other contexts (Moons and Bergeijk 2014), these findings are thus in line with the expectations in Veenstra et al. (2011) according to which economic diplomacy matters (more) for trade with "Southern" countries. The finding of McGillivray and Smith (2004) that leadership changes adversely affects trade with autocracies but not with democracies suggests that the role of economic diplomacy should be bigger for commercial relations with autocratic China.

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<sup>10</sup> The same holds for foreign cooperation and political system similarity but not for preferential trading agreements.

It appears that Chinese economic diplomacy assumes a greater role to facilitate trade than in the context of Western market democracies. First, economic diplomacy opens doors in emerging economies like China, where “government is still regarded as a natural partner in the economy” (Moons and Bergeijk 2014: 2). The share of state-owned enterprises in China’s trade is still sizable. These companies do not only have to follow government objectives by their very definition, they are also financially dependent on the government and show a large overlap in terms of the staffing of their leadership (Davis et al. 2014). These linkages make it impossible to regard government and business as separate entities and require a healthy economic diplomacy towards China.

Second, economic diplomacy sends signals that there are no severe political resistances to future cooperation (Moon and Bergeijk 2014). This is crucial since importers may respond to political tensions as they fear the risk of trade interruption, as argued above. An anticipated conflict alone might trigger reductions of bilateral trade due to “the threat of future government action to restrict trade” (Morrow et al. 1998, p. 650). Such signals do not only matter for the producer but also the consumer. As such, economic diplomacy can also send signals to patriotic consumers to not overreact to political tensions between countries. Previous research shows that consumer reactions to political tension can harm bilateral trade (e.g., Michaels and Zhi 2010; Antoniadis and Clerides 2015; Heilman 2015; Pandya and Venkatesan forthcoming). More broadly, the more affinity, trust and admiration exists between nations the stronger is also their bilateral trade—all these factors appear to affect consumer preferences (Disdier and Mayer 2007; Guiso et al. 2009; Rose forthcoming). Since the Internet has reduced the Chinese government’s scope to control protests (Heilman 2015), signaling a cooling of bilateral tensions through diplomatic activities may be particularly helpful to dissolve consumer boycotts.

Third, economic diplomacy can bridge cultural gaps (Bergeijk 2009). This appears crucial in light of Guiso et al. (2009) who find that trade increases with bilateral trust, which is deeply rooted in culture.<sup>11</sup> Since the majority of world trade still lies in the West, economic diplomacy can thus fulfill its role and facilitate commercial relations between culturally distant countries. Moreover, Yu et al.’s (2015) finding that the role of trust is bigger for trade with countries that have a relatively weak rule of law underlines the importance of trust-improving measures of economic diplomacy for trade with China.<sup>12</sup>

The greater the role of Chinese economic diplomacy in facilitating trade, the greater the destruction of commerce if economic diplomacy is interrupted as a consequence of political tensions. During bad times, economic diplomacy is hampered in its role to reduce informal trade barriers, lower

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<sup>11</sup> In a related study, Disdier and Mayer (2007) demonstrate that bilateral affinity has a trade-increasing effect.

<sup>12</sup> China ranks 71th of 102 according to the Rule of Law Index of the World Justice Project (<http://data.worldjusticeproject.org/>) and 120th of 209 according to the 2014 value of the rule-of-law dimension of the Worldwide Governance Indicators ([www.govindicators.org/](http://www.govindicators.org/)).

transaction costs and increase transparency and trust between foreign actors.<sup>13</sup> A deterioration in the bilateral political climate should not only lead China to shut down its economic diplomacy with a particular country, economic diplomacy can also play an important role in restoring ties at a later stage. To date, the literature on economic diplomacy does not provide systematic evidence of whether a deterioration of the political climate is associated with a reduced engagement in economic diplomacy. This is what we examine for the case of China.

#### **4. A DALAI LAMA EFFECT ON ECONOMIC DIPLOMACY? AN EMPIRICAL TEST**

The Chinese government frequently puts pressure on governments to not receive the Dalai Lama, the religious and formerly political leader of Tibetans. The statement of a spokesman of the Mongolian government, explaining why the Dalai Lama had not been invited by the Mongolian government in 1991, is telling: “Frankly speaking, there is a question of the Chinese president visiting Mongolia this year.”<sup>14</sup> The Mongolian government thus avoided to officially receive the Dalai Lama as it feared the cancelation of a planned visit of President Yang Shangkun. In 2009, when President Barack Obama decided not to receive the Dalai Lama, the media deemed this decision “unprecedented” and surmised that the president had strategically delayed the reception until after his state visit to Beijing.<sup>15</sup>

Anecdotal evidence indeed suggests that the threats to sanction Dalai Lama-receiving countries are carried out and affect economic diplomacy. For example, in 2008 China sent a strong message to France after then French President Nicolas Sarkozy’s meeting with the Dalai Lama: Beijing canceled the 11th annual EU-China summit scheduled for that year. Over a hundred high-ranking Chinese politicians and business leaders would have met with their European counterparts. In what follows, I analyze whether there is a systematic adverse effect of short-lived political tensions on economic diplomacy. Finding such evidence would suggest that economic diplomacy is an important channel for the political climate to affect economic exchange, at least in the case of China.

##### *(a) Research Design*

In order to analyze the relationship between short-lived political tensions and economic diplomacy, I study the effect of meetings of foreign government members with the Dalai Lama on the likelihood of the Chinese leadership, i.e., the Chinese president or prime minister, to visit a particular country. To obtain information on Chinese leadership trips, I use the annual breakdown of the dataset in Kastner and Saunders (2012), which covers parts of the Jiang and Hu presidencies. The data cover all visits

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<sup>13</sup> See again Bergeijk (2009) for a discussion of the benefits of economic diplomacy.

<sup>14</sup> “Mongolia bows to pressure, won’t invite Dalai Lama,” *The Daily Gazette*, 25 April 1991.

<sup>15</sup> See supplementary material of Fuchs and Klann (2013) for more anecdotal evidence.

over the 1998-2006 period as collected through yearbooks and the official website of the Ministry of Foreign Affairs as well as media reports.<sup>16</sup> My variable of interest is a binary variable that takes a value of one if the Dalai Lama was received by a government member in the partner country in a particular year (data from Fuchs and Klann 2013).

Building on previous work on Chinese leadership travel (Kastner and Saunders 2012; Shi and Yue 2014), I use the following control variables. Economic factors include a country's (logged) GDP per capita (in constant 2005 US\$), (logged) total population size, energy depletion, and mineral depletion (the latter two variables as a share of gross national income (GNI); all data from World Bank 2014). I further control for (logged) bilateral trade between China and its partner country (data from UN Comtrade). Institutional and political variables include a country's level of democracy as captured by the Polity2 variable from Marshall et al. (2013), its voting alignment with China (data from Strezhnev and Voeten 2012, extended as in Kilby 2009), a binary variable that takes a value of one if a country maintains diplomatic relations with Taiwan (data from Rich 2009), the trend-indicator value of arms exports from China in constant 1990 US\$ (data from SIPRI 2015), and binary variables that take a value of one if a country is under UN and US sanctions, respectively (data from Hufbauer et al. 2007). All control variables are lagged by one year to mitigate endogeneity concerns. Finally, a set of time-invariant control variables is included in those regressions that exclude fixed effects, namely (logged) distance to China and binary variables that take a value of one if the partner country is an OECD member, a G-20 member, located in Africa, and in Asia, respectively. All regressions include year dummies to account for year-specific determinants of China's leadership trips. The Appendix lists all variables employed in the analysis along with their sources and descriptive statistics.

I start by running a linear probability model to facilitate interpretation of coefficients, continue with logit regressions to take account of the binary nature of the dependent variable, then introduce country-fixed effects to the linear probability model and run a conditional fixed-effects logit model to control for unobserved country characteristics. Finally, I implement an instrumental-variables approach to account for the potential endogeneity of Dalai Lama meetings.

### *(b) Main Results*

Column 1 of Table 1 presents the results of the simple linear probability model. I find that the likelihood of the Chinese leadership traveling to a country is 13.6 percent lower if the country's government receives the Dalai Lama in a given year. The corresponding coefficient is statistically significant at the one-percent level. This also applies to the regression in column 2, where I estimate a logit model rather than ordinary least squares. Taken together, this is evidence in support of my

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<sup>16</sup> Visits for the sole purpose of attending a multilateral meeting are excluded.

expectation that political tensions and economic diplomacy are systematically related. Since this finding may be driven by unobserved country-specific characteristics, the model in column 3 adds country-fixed effects to the linear probability model and the conditional logit is shown in column 4. It is reassuring that the coefficient on the Dalai Lama variable is still statistically significant at the one-percent level (column 3) and five-percent level (column 4), respectively. The coefficient increases in absolute size when I add country-fixed effects: if a country receives the Dalai Lama in a given year, it is 15.1 percent less likely to be paid a visit by the Chinese leadership in the same year.

This finding may not reflect a causal relationship in the sense that a meeting with the Dalai Lama leads the Chinese leadership to cut a country out of their travel plans. It may rather be the case that governments already planning to receive the Chinese president or prime minister do not invite the Dalai Lama during the same year. Such an inverse causal relationship would still be in line with my broader argument as governments apparently have reasons to be less hospitable vis-à-vis the Dalai Lama to avoid harming economic diplomacy. Nevertheless, I make use of a Two-Stage-Least-Squares (2SLS) model to account for the potential endogeneity of Dalai Lama meetings and to identify any causal effects of Dalai Lama meetings on the travel behavior of the Chinese leadership. I employ the three instruments introduced in Fuchs and Klann (2013) in our study of the effect of Dalai Lama meetings on exports to China. The first instrument is a binary variable that takes a value of one if the Dalai Lama traveled to a partner country in a given year. Such visits are usually based on invitations from Buddhist or Tibetan communities to give teachings and public talks rather than invitations from government members. The second instrument is the number of days that the Dalai Lama visits, which proxies for the public awareness of his presence in the country that is likely to exert pressure on the government to receive him. The third instrument is the number of Tibet Support Groups (TSG) in a trading partner country used to account for the demands of such pressure groups on government members to receive the Dalai Lama. The mere presence of the Dalai Lama in the country, the length of his stay, and the number of TSGs should not affect economic diplomacy through channels other than as a result of a meeting between the Dalai Lama and a country's dignitary.

Column 5 of Table 1 shows the 2SLS results. The Angrist-Pischke-F-test statistic supports the relevance of the instruments and they also pass the Hansen test of overidentifying restrictions and the Kleibergen-Paap underidentification test. The coefficient on the binary variable indicating whether the Dalai Lama was received by a head of government in a given year is negative and statistically significant at the one-percent level, i.e., Dalai Lama meetings have a causal negative effect on the travel patterns of China's leadership.

Few control variables explain the travel pattern of China's leaders in the annual panel data set.<sup>17</sup> Excluding country-fixed effects and thus also exploiting variation between China's partner

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<sup>17</sup> Note that my results are not directly comparable to Kastner and Saunders (2012) as they run their regressions on two cross-sectional datasets for the Jiang and Hu presidencies and thus do not exploit variation over time.

countries (column 1), I find that China's leaders are more likely to travel to richer, larger and more open countries, all significant at the one-percent level. Moreover, countries recognizing Taiwan and those sanctioned by the United States are less likely to be visited, while China's neighbors and G-20 members are more likely to be on its travel itinerary. The logit results are similar with the exception of the G-20 binary variable which loses statistical significance (column 2). Focusing on the variation within countries over time (column 3), I find that China's leaders are more likely to travel to countries with growing energy resources. All other control variables fail to reach statistical significance at conventional levels. The conditional logit regressions in column 4 find significantly negative coefficients on Taiwan recognition and UN sanctions in addition to the significantly positive coefficient on energy.

### *(c) Further Specifications*

In order to analyze the timing of the effect of Dalai Lama meetings on the travel pattern of China's leadership, I include separate binary variables that take a value of one if the Tibetan leader is received by a government member in the second year after, the year directly after, the current year, the previous year, two years ago and three years ago, respectively. I expect no significant effect of Dalai Lama meetings in future years, as such meetings have not been decided upon. This serves as a placebo test. Including lagged values helps us understand the duration of the negative effect on high-level diplomacy. If the Chinese leadership only postpones trips or if China makes moves to restore ties, one might also find positive effects of earlier Dalai Lama meetings.<sup>18</sup>

As can be seen from the linear probability model with country-fixed effects in column 1 and from the conditional logit model in column 2 of Table 2, the results show statistically significant negative coefficients on the likelihood of a visit from the Chinese leadership in a given year and no significant effects for future years as expected. Already in the year after the meeting, the coefficient on the Dalai Lama variable turns significantly positive. It appears that trading partners engage in increased diplomatic activities to improve their ties following a visit from the Dalai Lama.<sup>19</sup> This is in line with anecdotal evidence (Fuchs and Klann 2013). For example, after a meeting between the Dalai Lama and Austrian Chancellor Alfred Gusenbauer in 2007, Austrian diplomats were banned from contact with Chinese officials, leading to what the media described as a "minor ice-age" between the

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<sup>18</sup> Anecdotal evidence suggests that it takes about a year for diplomatic relations to recover (Fuchs and Klann 2013). For example, 16 months after the 2013 meeting of Lithuanian President Dalia Grybauskaitė with the Dalai Lama, a Chinese news outlet reports that "China-Lithuania relations are back on track" referring to a recent meeting of China's prime minister Li Keqiang with his Lithuanian counterpart Algirdas Butkevicius "on the sidelines" of a multilateral meeting at which "Lithuania withdrew support of the Tibet independence movement." See <http://www.globaltimes.cn/content/906948.shtml> (accessed 22 November 2015).

<sup>19</sup> Both coefficients are similar in their absolute size and a t-test does not reject the null hypothesis that the two coefficients are equal in absolute size at conventional levels of significance.

two countries. In the following year, a state visit of the Austrian chancellor in Beijing marked the end of the diplomatic tensions caused by the Dalai Lama reception.

Next, I employ a narrower definition of Dalai Lama meetings and restrict the variable to take a value of one only if a president or prime minister receives the Dalai Lama, thus excluding all other government members. Fuchs and Klann (2013) find that systematic trade reductions are only caused by meetings with heads of state or government. In line with this finding, I expect such encounters at the highest political level to lead to more severe interruptions in high-level economic diplomacy. As can be seen from columns 3 and 4 of Table 2, the Chinese government seems to respond more severely to such encounters at the highest political level: The coefficient on Dalai Lama meetings in the current year becomes more pronounced and the positive coefficient on Dalai Lama meetings in the previous year, previously indicating a rapid restoration of ties, loses its statistical significance at conventional levels.

Using the fixed-effects linear probability model, Table 3 shows how the results change in response to alternations of the dependent variable. For the reader's convenience, column 1 shows the results from column 3 of Table 1 for comparison. First, I exclude visits made to a partner country in extension of a multilateral meeting. Arguably, such meetings might be different in character as the leaders do not face additional costs in terms of travel time, which may make it more likely that a leader schedules such a visit. As can be seen from column 2, the coefficient on the Dalai Lama variable is slightly smaller and remains statistically significant at conventional levels. Second, I analyze separately trips by China's president (column 3) and prime minister (column 4). While both coefficients on the Dalai Lama variable are negative as expected, only the coefficient on presidential trips reaches statistical significance at conventional levels. It can thus be concluded that the revealed relationships between political tensions and economic diplomacy are mainly driven by changes in the president's and not the prime minister's travel patterns. Third, I show regressions with the logged number of days that the president and prime minister combined spend in a particular country as a further alternative dependent variable. Again, there is a statistically negative coefficient on the Dalai Lama variable (column 5).

Finally, I replace the dependent variable with a binary variable that takes a value of one if a country's leader directly interacted with the Chinese prime minister or president. In contrast to the baseline dependent variable, this variable thus also captures meetings that take place in China and not only those hosted in partner countries. Data have been obtained from Bader (2015) who collected the information from a list of all Chinese agreements with foreign countries from the *Journal of Current Chinese Affairs*. The measure thus comes with the disadvantage that it only covers those encounters that led to the signing of an agreement. As it could be argued that Dalai Lama meetings can also negatively impact the success of such meetings, I do not employ it as my preferred measure. Using it as a test of robustness, however, yields results that are similar to the leadership travel data (column 6).

## 5. CONCLUSIONS

This article reviewed the literature on the linkages between political tensions, economic diplomacy and international trade in the light of China's rise in the global economy. Previous research suggests that economic diplomacy should be more pivotal in economic exchange with China than with Western market economies. As such, the deterioration of bilateral commerce should also be more pronounced when economic diplomacy is interrupted as a consequence of political tensions. During bad times, economic diplomacy is hampered in its role to reduce informal trade barriers, lower transaction costs and increase transparency and trust between foreign actors. However, it is not only the case that China's economic diplomacy will be hindered when relations with a particular country worsen, economic diplomacy can also play an important role in restoring ties at a later stage.

In an econometric test, I analyzed how diplomatic tensions, measured through foreign dignitaries' meetings with the Dalai Lama, affect the likelihood of a visit of a Chinese leader. Since the Chinese government seeks to contain the expression of opinions that challenge the status quo of Tibet, it reacts with harsh objections to any meeting of foreign officials with the Dalai Lama, the leader of the Tibetan community in exile. Therefore, such a deterioration of the bilateral political climate should harm bilateral diplomatic exchange. The econometric results showed that the likelihood of the Chinese leadership traveling to a country is indeed lower if the country's government receives the Dalai Lama in a given year. Supporting the idea that economic diplomacy can help restore the bilateral climate, Chinese leadership trips are more likely in the year following a Dalai Lama reception in a particular country. This shows that governments rapidly put efforts into the restoration of bilateral ties. Taken together, the findings are evidence in favor of economic diplomacy being an important channel linking the bilateral political climate and economic exchange between nations.

Future research should help improve our understanding of the importance and mechanisms guiding various forms of China's economic diplomacy. For example, more attention should be devoted to the analysis of the increasing role of preferential trading agreements (e.g., Antkiewicz and Whalley 2005; Hicks and Kim 2012) and economic aid (e.g., Dreher and Fuchs 2015; Strange et al. forthcoming) in China's toolbox of economic diplomacy. Moreover, while our focus was on trade, more research is warranted on the role of economic diplomacy in investment flows (Cheung et al. 2012; Chen et al. 2015), contracted engineering projects (Cheung et al. 2014), the allocation of Special Economic Zones (Bräutigam and Tang 2011), or the promotion of the Renminbi as a world currency (Liao and McDowell 2015, forthcoming), among many other areas of China's growing economic engagement in the world.



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**Table 1:** Chinese leadership travel and Dalai Lama meetings with government members (1998-2006)

	(1) Travel OLS	(2) Travel Logit	(3) Travel FE	(4) Travel Cond. Logit	(5) Travel 2SLS FE
DL meets government member	-0.136*** (0.001)	-1.227*** (0.004)	-0.151*** (0.003)	-1.187** (0.010)	-0.204*** (0.006)
(log) GDP per capita	0.028*** (0.006)	0.355** (0.045)	0.047 (0.620)	-0.391 (0.793)	0.046 (0.629)
(log) Population	0.052*** (0.000)	0.632*** (0.000)	0.257 (0.293)	8.648** (0.049)	0.269 (0.265)
(log) Trade with China	0.001 (0.887)	-0.006 (0.966)	-0.004 (0.696)	-0.029 (0.770)	-0.004 (0.674)
Openness	0.001*** (0.003)	0.006*** (0.008)	-0.001 (0.234)	-0.018 (0.113)	-0.001 (0.233)
Energy/GNI	0.000 (0.569)	0.006 (0.559)	0.006** (0.035)	0.095** (0.013)	0.006** (0.031)
Minerals/GNI	-0.002 (0.658)	0.002 (0.980)	-0.002 (0.861)	-0.075 (0.678)	-0.003 (0.855)
Polity	-0.001 (0.709)	-0.010 (0.640)	0.004 (0.282)	0.065 (0.306)	0.004 (0.265)
UNGA voting	-0.080 (0.243)	-0.078 (0.907)	0.084 (0.461)	1.452 (0.471)	0.089 (0.427)
Taiwan recognition	-0.037** (0.023)		-0.015 (0.763)	-11.272*** (0.000)	-0.015 (0.766)
(log) Arms exports from China	0.013 (0.260)	0.101 (0.405)	0.006 (0.666)	-0.009 (0.937)	0.006 (0.644)
UN sanction	0.049 (0.581)	0.725 (0.524)	-0.055 (0.498)	-11.928*** (0.000)	-0.054 (0.499)
US sanction	-0.077** (0.012)	-1.138** (0.031)	-0.052 (0.138)	-0.582 (0.180)	-0.053 (0.125)
(log) Distance	-0.010 (0.720)	-0.264 (0.336)			
Neighbor	0.228*** (0.000)	1.778*** (0.000)			
OECD	0.025 (0.471)	0.051 (0.884)			
G-20	0.089** (0.011)	0.161 (0.478)			
Asia	-0.036 (0.281)	-0.608 (0.161)			
Africa	0.015 (0.506)	-0.037 (0.912)			
R-Squared	0.16		0.04		0.03
Pseudo R-Squared		0.19		0.10	
Angrist–Pischke F test					46.36
Hansen J (p value)					0.673
Kleibergen Paap LM test (p value)					0.000
Number of countries	156	140	156	78	152
Number of observations	1319	1174	1319	689	1315

**Notes:** Standard errors are clustered at the country level (in parentheses). All regressions include year dummies. \* (\*\*, \*\*\*) indicates statistical significance at the ten-percent (five-percent, one-percent) level.

**Table 2:** Chinese leadership travel and Dalai Lama meetings (time-event specifications, 1998-2006)

	(1) Travel FE	(2) Travel Cond. Logit	(3) Travel FE	(4) Travel Cond. Logit
DL meets government member (t+2)	-0.012 (0.809)	-0.180 (0.616)		
DL meets government member (t+1)	0.048 (0.429)	0.303 (0.455)		
DL meets government member (t)	-0.111** (0.011)	-0.881** (0.049)		
DL meets government member (t-1)	0.187*** (0.007)	1.012** (0.011)		
DL meets government member (t-2)	-0.015 (0.763)	0.015 (0.969)		
DL meets government member (t-3)	-0.050 (0.314)	-0.503 (0.197)		
DL meets political leader (t+2)			-0.034 (0.529)	-0.228 (0.612)
DL meets political leader (t+1)			0.007 (0.918)	0.048 (0.922)
DL meets political leader (t)			-0.135*** (0.004)	-1.132** (0.016)
DL meets political leader (t-1)			0.094 (0.241)	0.475 (0.343)
DL meets political leader (t-2)			-0.091 (0.217)	-0.596 (0.327)
DL meets political leader (t-3)			-0.078 (0.212)	-0.715 (0.144)
Control variables	Yes	Yes	Yes	Yes
R-Squared	0.05		0.04	
Pseudo R-Squared		0.11		0.10
Number of countries	156	78	156	78
Number of observations	1319	689	1319	689

Notes: Standard errors are clustered at the country level (in parentheses). All regressions include year dummies and the other control variables from Table 1. \* (\*\*, \*\*\*) indicates statistical significance at the ten-percent (five-percent, one-percent) level.

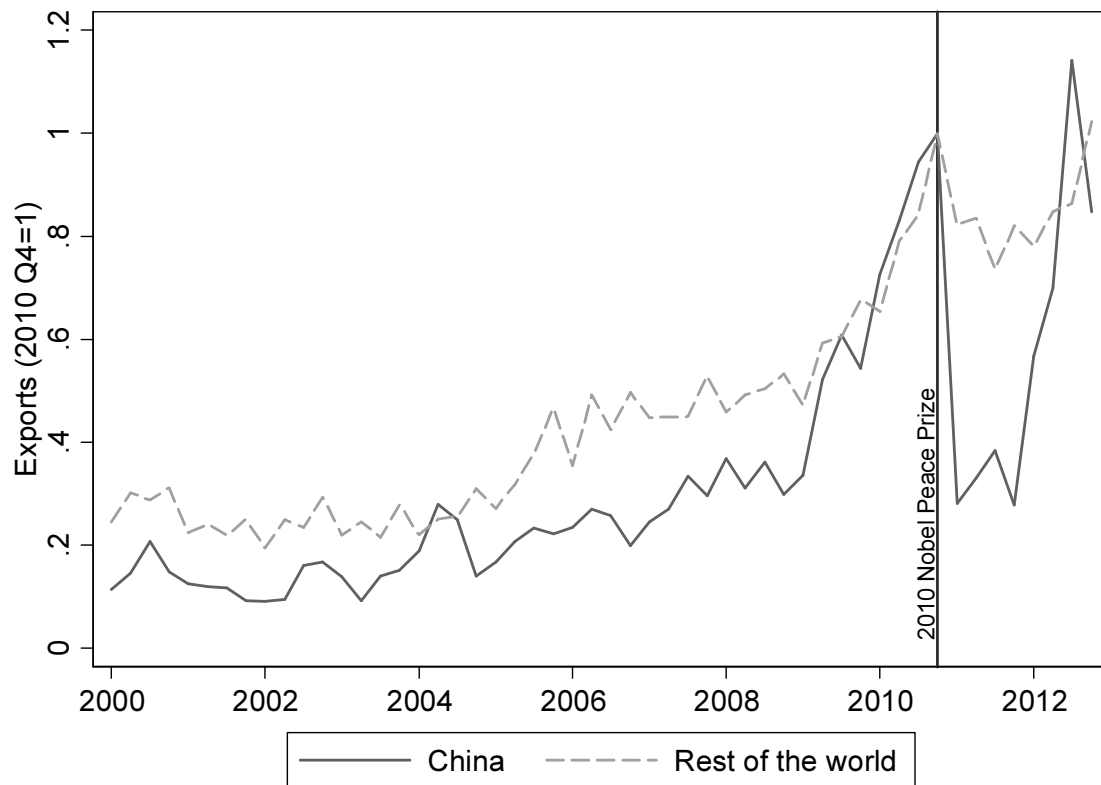
**Table 3:** Chinese leadership travel and Dalai Lama meetings (alternative specifications, 1998-2006)

	(1)	(2)	(3)	(4)	(5)	(6)
	Travel	Travel (no multilaterals)	Travel (president)	Travel (prime minister)	(log) Travel duration	Diplomacy
	FE	FE	FE	FE	FE	FE
DL meets government member	-0.151*** (0.003)	-0.119** (0.019)	-0.101*** (0.007)	-0.051 (0.255)	-0.208** (0.017)	-0.113*** (0.007)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes
R-Squared	0.04	0.03	0.03	0.02	0.03	0.03
Number of countries	156	156	156	156	156	156
Number of observations	1319	1319	1319	1319	1319	1319

**Notes:** Standard errors are clustered at the country level (in parentheses). All regressions include year dummies and the other control variables from Table 1. \* (\*\*, \*\*\*) indicates statistical significance at the ten-percent (five-percent, one-percent) level.



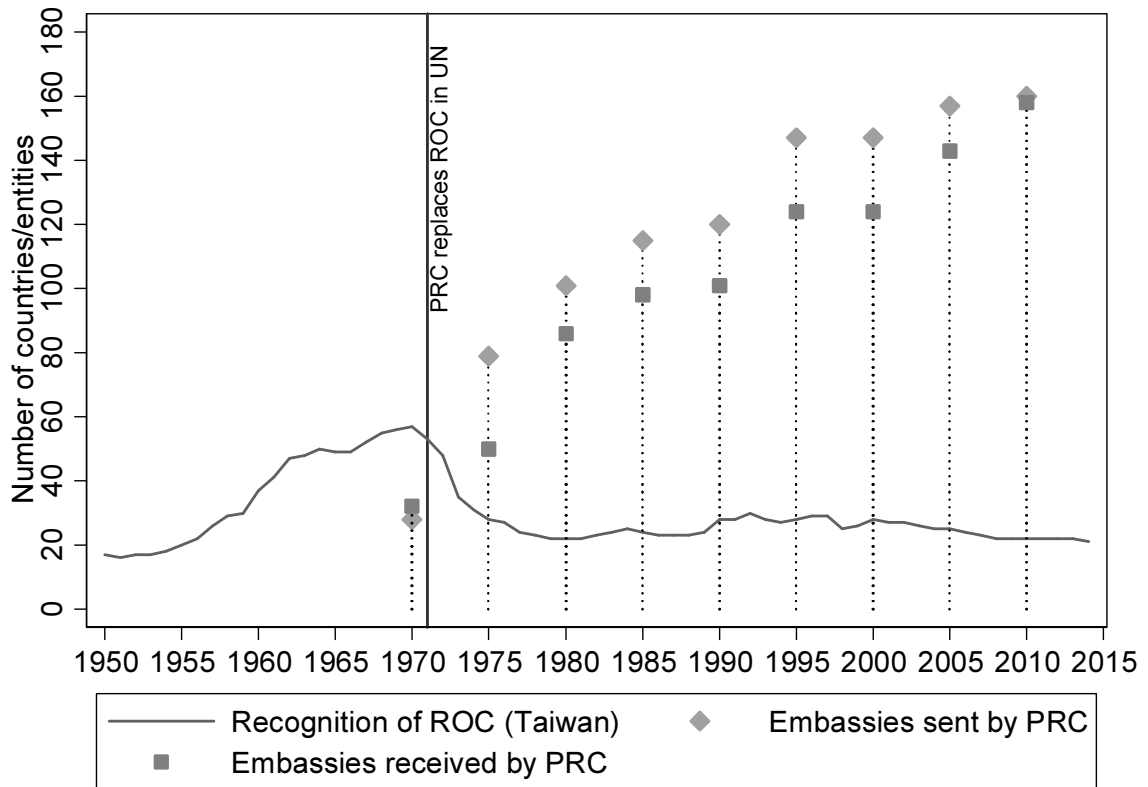
**Figure 1:** Norway's exports of Salmonidae (fresh/chilled) before and after the 2010 Nobel Peace Prize



Note: Values are normalized to take a value of one in the last quarter of 2010 when the Nobel Peace Prize was conferred.

Source: Own figure based on Davis et al. (2014) using data from Eurostat.

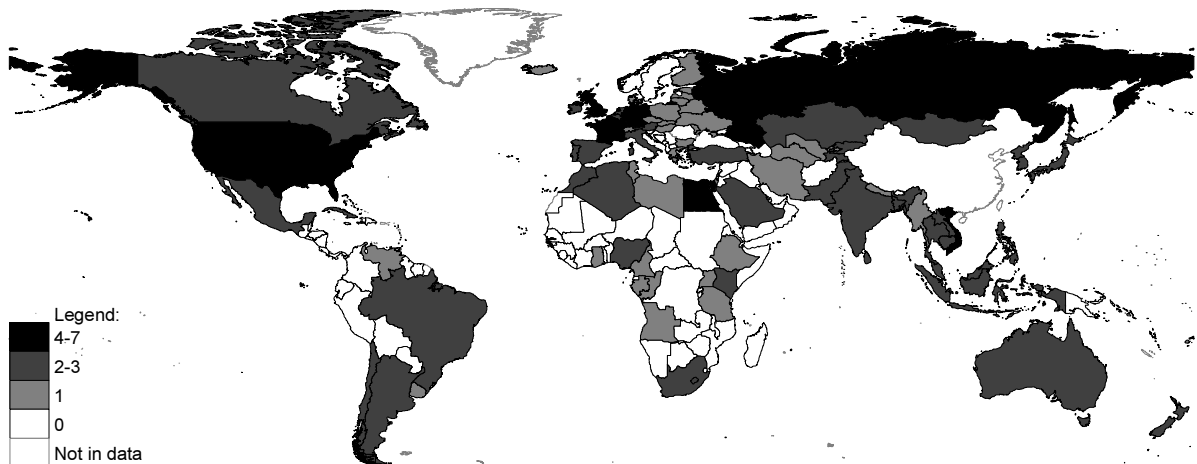
**Figure 2:** China's diplomatic ties over time (1950-2014)



Note: The graph shows the number of countries (entities) that recognize the Republic of China (ROC, Taiwan) rather than the People's Republic of China (PRC). The dots indicate the number of embassies received/sent by the government in Beijing (PRC). The vertical line indicates year in which the PRC replaced the ROC in the United Nations.

Source: Own figure based on data from Rhamey et al. (2013) and own update of data from Rich (2009).

**Figure 3:** Number of years with visit by Chinese president or premier (1998-2006)



Source: Own figure based on data from Kastner and Saunders (2012)

**Appendix: Variables, sources and descriptive statistics**

Variable	Source	Obs	Mean	Std. Dev.	Min	Max
<i>Dependent variables</i>						
Travel	Kastner and Saunders (2012)	1719	0.10	0.30	0.00	1.00
Travel (no multilaterals)	Kastner and Saunders (2012)	1719	0.08	0.28	0.00	1.00
Travel (president)	Kastner and Saunders (2012)	1719	0.05	0.23	0.00	1.00
Travel (prime minister)	Kastner and Saunders (2012)	1719	0.05	0.21	0.00	1.00
(log) Travel duration	Kastner and Saunders (2012)	1719	0.14	0.43	0.00	2.40
Diplomacy	Bader (2015)	1712	0.16	0.37	0.00	1.00
<i>Variables of interest</i>						
DL meets government member	Fuchs and Klann (2013)	1746	0.04	0.19	0.00	1.00
DL meets political leader	Fuchs and Klann (2013)	1746	0.03	0.16	0.00	1.00
<i>Control variables</i>						
(log) GDP per capita	World Bank (2014)	1656	7.99	1.64	4.87	11.75
(log) Population	World Bank (2014)	1719	15.39	2.17	9.14	20.99
(log) Trade with China	UN Comtrade	1746	13.40	4.24	0.00	21.47
Openness	World Bank (2014)	1604	84.44	49.19	0.31	531.74
Energy/GNI	World Bank (2014)	1613	3.75	9.34	0.00	75.44
Minerals/GNI	World Bank (2014)	1630	0.27	1.12	0.00	15.85
Polity	Marshall et al. (2013)	1445	13.05	6.62	0.00	20.00
UNGA voting	Strezhnev and Voeten (2012)	1701	0.78	0.14	0.15	0.96
Taiwan recognition	Rich (2009)	1700	0.14	0.35	0.00	1.00
(log) Arms transfers from China	SIPRI (2015)	1746	0.16	0.73	0.00	5.70
UN sanction	Hufbauer et al. (2007)	1746	0.03	0.17	0.00	1.00
US sanction	Hufbauer et al. (2007)	1746	0.08	0.27	0.00	1.00
(log) Distance	Mayer and Zignago (2011)	1701	8.98	0.55	6.70	9.87
Neighbor	Mayer and Zignago (2011)	1701	0.07	0.26	0.00	1.00
OECD	Own construction	1746	0.15	0.36	0.00	1.00
G-20	Own construction	1746	0.09	0.29	0.00	1.00
Asia	Mayer and Zignago (2011)	1746	0.24	0.43	0.00	1.00
Africa	Mayer and Zignago (2011)	1746	0.27	0.45	0.00	1.00
<i>Instrumental variables</i>						
Tibet Support Groups	Fuchs and Klann (2013)	1746	0.54	2.49	0.00	31.00
DL travel	Fuchs and Klann (2013)	1746	0.06	0.24	0.00	1.00
DL days	Fuchs and Klann (2013)	1746	0.86	6.54	0.00	124.00

Note: All time-varying control variables are lagged by one year.