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Can China's Diplomatic Partnership Strategy Benefit Outward Foreign Direct Investment?

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Abstract

In the context of global integration, whether a diplomatic partnership strategy can promote outward foreign direct investment (OFDI) and how it works are very important issues for China. Based on a dataset featuring China's partnerships collected from the Ministry of Foreign Affairs website, we establish an empirical framework to assess the role of China's diplomatic strategy in its OFDI arising from partnerships since 1993. The results show that the establishment or upgrade of partnerships has had a positive effect on Chinese firms' decisions on OFDI for at least the short term, especially for firms with higher demand for policy guarantees from the government, such as non-central firms and non-Beijing firms. The results also show that the increase in OFDI is concentrated in host countries with higher political risks, such as developing countries, neighboring countries, and Belt and Road countries, which is consistent with China's diplomatic focus. Our research proves that China's diplomatic strategy can assist firms to invest abroad.

Key words: Belt and Road Initiative, outward foreign direct investment, partnership diplomatic strategy, political risk

JEL codes: F21, F59

I. Introduction

Outward foreign direct investment (OFDI) in China has increased dramatically since 2004. From 2004 to 2017, the number of domestic investors increased from 2965 to 25,529, OFDI flows increased from US$5.5bn to US$158.29bn and the accumulated OFDI net stock increased from US$44.8bn to US$1809.04bn (MOF, NBS and SAFE,

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2004, 2017). In 2015, the Chinese mainland's OFDI flows surpassed those of Chinese Hong Kong and Japan, and ranked second in the world.[1] After the Belt and Road Initiative (BRI) was proposed in 2013, Belt and Road (B&R) countries have become priority areas for Chinese investors. In 2017, nearly 3000 Chinese firms set up offices in 57 B&R countries with investment of US$20.17bn, which has increased by 31.5 percent over the last year (MOF, NBS and SAFE, 2017). However, political risks remain major impediments to China's OFDI.[2] In recent years, FDI from China has often been impacted by political events, such as political turbulence, sovereign debt defaults and security reviews for national interests. For example, the US government used the threat of a security review to force China National Offshore Oil Corporation to withdraw its acquisition of Unocal in 2005; the Mexican government revoked China Railway Construction Corporation Limited's winning bid for a high-speed railway project from Mexico City to Querétaro because of corruption, fiscal austerity and pressure from developed countries in 2014; and the Sri Lankan government halted the China Communications Construction Company Ltd. Colombo Port City project, questioning "whether the project had fulfilled the appropriate procedures" and citing a "lack of relevant approval" in 2015.[3] Faced with spreading nationalism and trade protectionism, how to provide a safe and sound investment environment for Chinese firms and encourage them to invest abroad has become a very important issue.

Developing global partnerships may provide a new method for alleviating the political risks faced by firms involved in OFDI. A diplomatic partnership strategy has played an important role in the post-war era, reflecting a country's overall judgment and strategic planning of global economic, political and military affairs and their trust and willingness to share benefits and risks with partner countries. Since the first partnership established with Brazil in 1993, China has established a further 143 partnerships with 99 countries: 50 in 32 Asian countries, 29 in 23 African countries, 33 in 24 European countries, 21 in 12 American countries and 10 in 8 Oceanian countries.[4] Since the 18th National Congress of the Communist Party of China, the pace of development of China's diplomatic partnership strategy has increased. In the period 2013–2018, 78 partnerships were established or upgraded, accounting for 54.5 percent of the total number of Chinese

[1]In the following analysis, we only focus on sovereign countries that have already established formal diplomatic relations with China.

[2]Political risks are defined as the potential risks faced by foreign firms because of host countries' government attitude, governance, political situation, institutional environment and relations with other countries.

[3]Source: http://www.globalview.cn/html/global/info_5295.html.

[4]These figures were obtained from joint statements on the Ministry of Foreign Affairs of the People's Republic of China website, available from: https://www.fmprc.gov.cn/web/.

partnerships (Table 1). In September 2015, in the general debate of the 70th session of the United Nations General Assembly (UNGA), President Xi Jinping gave a speech about working together to build a win-win cooperative partnership. In October 2017, the report of 19th National Congress of the Communist Party of China stated that China has actively developed global partnerships and expanded the convergence of interests with other countries, which confirmed the importance of partnerships in China's diplomatic strategy. It is believed that a partnership strategy will play an important role in China's diplomatic intentions in the new era.

Table 1. Partnerships Established with China during 2013–2018

Year	Country	Number of countries
2013	Australia, Belarus, Congo (Kinshasa), Indonesia, Kenya, Kyrgyzstan, Malaysia, Mexico, Peru, Sri Lanka, Tajikistan, Tanzania and Turkmenistan	13
2014	Algeria, Argentina, Australia, Belgium, Bulgaria, Egypt, Federated States of Micronesia, Fiji, Germany, Maldives, Mongolia, Netherlands, New Zealand, Papua New Guinea, Qatar, Samoa, Senegal, Timor-Leste, Tonga, Vanuatu and Venezuela	21
2015	Costa Rica, Ecuador, Equatorial Guinea, Iraq, Jordan, Liberia, Pakistan, Singapore and Sudan	9
2016	Bangladesh, Chile, Congo (Brazzaville), Czech Republic, Ecuador, Gabon, Guinea, Iran, Morocco, Mozambique, Poland, Saudi Arabia, Senegal, Serbia, Sierra Leone, Switzerland, Uruguay and Uzbekistan	18
2017	Djibouti, Ethiopia, Finland, Hungary, Israel, Kenya, Madagascar, Sao Tome and Principe and Tajikistan	9
2018	Austria, Bolivia, Kuwait, Kyrgyzstan, Namibia, Oman, United Arab Emirates and Zimbabwe	8

Source: Ministry of Foreign Affairs of the People's Republic of China, available from: https://www.fmprc.gov.cn/web/ziliao_674904/1179_674909/.

However, no empirical literature has investigated the role of diplomatic strategy in China's OFDI performance. Men and Liu (2015) and Sun and Ding (2017) conducted qualitative rather than quantitative analyses of China's diplomatic partnership strategy. In order to fill this gap, we collected data from China's Ministry of Foreign Affairs website, applied coding and constructed a dataset of China's diplomatic partnerships to create a solid foundation to evaluate the economic effects of China's diplomatic strategy.

The major contributions of our study are as follows. This is the first study to examine the impact of diplomatic partnerships – long-term, stable, friendly political relations – on Chinese firms' OFDI, which enriches empirical research on the impact of bilateral political relations on bilateral trade. Our study verifies that the establishment or upgrade of partnerships can alleviate political risks in host countries and encourage Chinese firms to invest abroad, which means that China's diplomatic partnership strategy can create

economic benefits. The results prove that partnership is the rational, practical choice. In addition, our study explores whether, to what extent and how diplomatic partnerships influence China's OFDI and its geographic characteristics, which provide credible insights for China to adjust its diplomatic partnership strategy in the future.

This paper is organized as follows: Section II provides a literature review. Section III discusses the mechanism and proposes some hypotheses. Section IV describes the data source and data processing. Section V reports the empirical results, which show that the establishment or upgrade of partnerships has a positive impact on Chinese firms' decisions on OFDI. Section VI discusses the endogeneity problem. Section VII concludes.

II. Literature Review

In this section, we will demonstrate the originality and importance of our research based on a literature review of political risks and FDI, and bilateral political relations and international trade, as well as China's diplomatic partnership strategy.

1. Political Risks and Foreign Direct Investment

Political risk is a preferred determinant of FDI. Hajzler (2014) argued that political risks, including corruption, expropriation and war, are major impediments to FDI in developing countries. Asiedu et al. (2009) established a model to examine FDI and expropriation risks to prove that an increase in expropriation risks will lead to a decline in the optimal level of FDI. Julio and Yook (2016) used elections as a measure of political uncertainty and showed that such uncertainty inhibits FDI. Wei (2000) and Teixeira and Gr (2012) found that multinational companies prefer low equity (i.e. joint ventures with local partners) or non-equity (i.e. exports and contracting) entry modes rather than wholly owned subsidiaries in countries with a high level of corruption. In recent years, the impact of political risks on China's OFDI has drawn considerable attention, particularly regarding political stability, government efficiency and corruption in host countries (Jiang and Jiang, 2012); government intervention, political turbulence, war and civil strife, and expropriation (Li et al., 2013); and voice and accountability, violence and terrorism, and regulatory quality and rule of law (Wang et al., 2014). All of these studies have provided great insights into the motivations and mechanisms of OFDI. Taking political risks as major impediments to China's OFDI, we examine how partnership acts as a positive signal from the government to help firms overcome political risks and encourage them to invest abroad, which will enrich the study of the determinants of firm-level OFDI.

2. Bilateral Political Relations and International Trade

Bilateral political relations have a significant influence on economic exchanges between countries. Acemoglu and Yared (2010) pointed out that openness to international trade, finance and technology is ultimately a political decision made by a country. However, it is difficult to examine the relationship between bilateral political relations and international trade because shifts in power relations between governments are often the result of decisions that are made behind the veil of government secrecy (Berger et al., 2013). The Global Data on Events, Location and Tone (GDELT) and the Correlates of War (COW) Project are commonly used to investigate the impact of bilateral political relations (e.g. Martin et al., 2008; Glick and Taylor, 2010; Qureshi, 2013; Li et al., 2018; Davis et al., 2019). A dataset of China's political relations with other major powers constructed by Tsinghua University is widely used to analyze cases associated with China. Based on an analysis of China's political relations, Du et al. (2017) found that political shocks influence exports to China but that the effects disappear within two months. More often, some key historical events are taken as political shocks, such as French opposition to the US invasion of Iraq in 2003 (Michaels and Zhi, 2010; Pandya and Venkatesan, 2016); meeting with the Dalai Lama (Fuchs and Klann, 2013); and the Diaoyu Islands conflict in 2012 (Fisman et al., 2014; Heilmann, 2016). However, most datasets adopted in these studies have limitations. GDELT and China's political relations are scored on cooperation–conflict events sourced from the media, which suffer potential problems of subjectivity, short-term nature and too much noise. COW is specific for wars and civil conflicts, thus key historical events may not be sufficiently representative. Therefore, we construct a dataset of China's diplomatic partnerships reflecting long-term, stable, friendly political relations between countries, providing a new alternative.

3. China's Diplomatic Partnership Strategy

Developing global partnerships and expanding the convergence of interests with other countries reflects China's diplomatic intentions in the new era, which has become a focus of political science in China in recent years. In a study of relevant literature and news, Tao (2012) examined American mainstream views toward China's diplomatic partnership strategy in the 1990s and concluded that China's diplomatic partnerships are series of friendly, cooperative bilateral relations established on the ground of equality. Men and Liu (2015) characterized the partnerships established by China during 1993–2014 and expressed doubt over their practical effectiveness. Sun and Ding (2017) classified partner countries into fulcrum countries that firmly support China's core interests and node countries that expand China's international energy cooperation and argued that it is easier for China to establish or upgrade partnerships with fulcrum and node countries. Wang

(2018) pointed out that, in recent years, China has accelerated the pace of establishing and upgrading partnerships with other countries and the newly established partnerships are generally positioned at a higher hierarchy. Although China's diplomatic partnership strategy has been comprehensively discussed in the field of international politics and international relations, there has been no quantitative analysis of its hierarchy and economic effects. Therefore, we attempt to prove that the establishment or upgrade of partnerships can positively influence Chinese firms' OFDI and refute the argument that partnerships merely have symbolic meaning without practical effect.

III. How a Diplomatic Partnership Strategy Influences Outward Foreign Direct Investment and Hypotheses

1. Partnership Impact on Foreign Direct Investment

A joint statement is signed when a partnership is established or upgraded between countries and involves specific investment projects or a government promise to provide support for overseas investment and to guarantee legitimate rights and interests. For example, the Joint Statement on Establishing an All-weather Strategic Co-operative Partnership between the People's Republic of China and the Islamic Republic of Pakistan in April 2015 stated:

> [T]he two countries will actively advance a number of key co-operation projects, including Phase II of the upgrade and renovation of the Karakoram Highway, an expressway serving the east bay of Gwadar Port … as well as the completion of a number of infrastructure facilities and energy and power projects.[5]

The Joint Statement of Strategic Partnership with Iraq in December 2015 stated: "Iraq welcomes Chinese enterprises to increase investment in Iraq, and is willing to try [our] best to provide [the] necessary guarantee for this."[6] Accordingly, the establishment or upgrade of partnerships can be regarded as a positive signal of long-term, stable, friendly political relations between governments, a demonstration of their commitment to help firms overcome political risks and make OFDI more convenient. We believe that firms have positive expectations that governments will alleviate political risks, such as reducing policy uncertainty, helping firms avoid sovereign and government credit risk, loosening restrictions on market access and lowering administrative

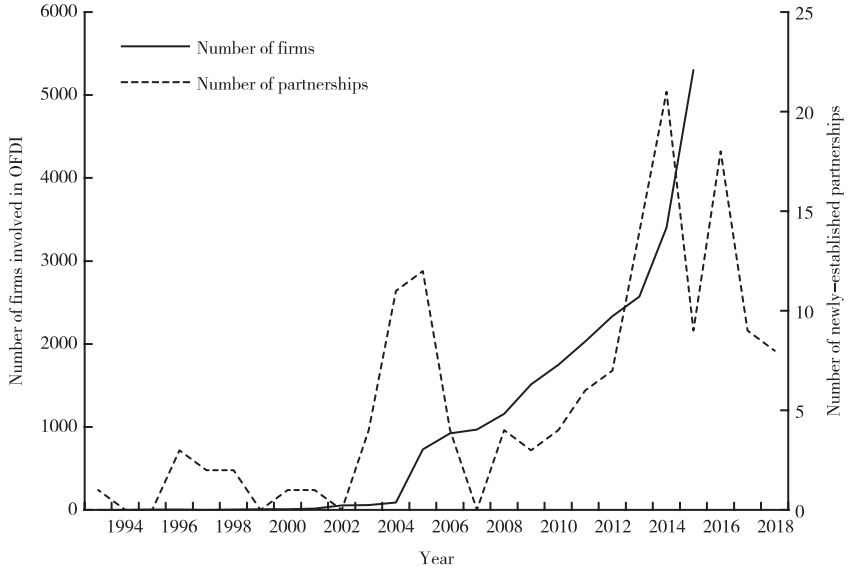
[5]Available from: http://world.people.com.cn/n/2015/0421/c1002-26876898.html.

[6]Available from: http://ir.china-embassy.org/eng/zyxw/t1327529.htm.

barriers, which will boost confidence and encourage firms to invest directly. The trend displayed in Figure 1 also suggests that the number of firms involved in OFDI is positively correlated to the number of newly established partnerships. As such, we have:

Hypothesis 1: Establishment or upgrade of partnership can encourage Chinese firms to make decisions on OFDI.

Figure 1. China's Partnerships and Outward Foreign Direct Investment (OFDI), 1993–2018



Sources: Ministry of Foreign Affairs of the People's Republic of China (https://www.fmprc.gov.cn/web/) and the Ministry of Commerce of the People's Republic of China *Record List of Overseas Investment Enterprises* (http://femhzs.mofcom.gov.cn/fecpmvc/pages/fem/CorpJWList.html).

2. Short-term Effect

Only a few of these joint statements list specific projects, with most listing only areas or constructive framework of bilateral investment cooperation. Some simply express a desire to expand the scale of bilateral trade and investment and enhance the level of economic cooperation between two countries. When it comes to investment cooperation, relevant documents use terms such as "encourage to," "is willing to," and "is committed to" to express good wishes rather than terms with real legal validity. However, whether partnership can really provide a secure and supportive investment environment for firms and help them overcome political risks still needs to be examined. If partnership only

sends a positive signal without effective policy communication with partner countries, cooperation and the implementation of relevant policy guarantees, it will remain difficult for firms to benefit from policy advantages when making OFDI. In this case, the positive effect is only a temporary and spontaneous response to the joint statement and is not sustainable. Therefore, we pose the following hypothesis:

Hypothesis 2: The positive impact of partnership on OFDI only has a short-term effect directly after the partnership is established with other countries.

3. Political Risks

According to our above analysis, partner countries seek to work together to help firms overcome political risks and encourage them to invest overseas Thus, the positive impact of partnership on firms' OFDI is suggested to be more significant for firms that are more sensitive to political risks. We consider two types of firms that are sensitive to political risks: firms with a higher demand for policy guarantees from the government, such as non-central firms and firms that are not located in Beijing; and firms investing in countries with high political risks, such as developing, neighboring and B&R countries. Central firms are subordinate to the central government directly and firms located in Beijing are closer to the central government geographically. In the process of going global they are more likely to receive policy support from the central government. Thus, compared to central and Beijing firms, non-central and non-Beijing firms have a higher demand for policy guarantees and thus are more sensitive to the government's diplomatic behavior. Developed countries have a more stable political situation, more transparent policies, better institutes and a higher level of marketization. All of these factors make developed countries a better market for foreign investors. Political risks remain the major impediment to investment in developing countries, thus, it is believed that the positive impact of partnership is more significant in such countries. Neighboring and B&R countries are key areas in China's diplomatic plans. Most of these are developing countries with great market potential. Therefore, the positive impact of partnerships with neighboring and B&R countries is more significant. We thus obtain:

Hypothesis 3: The positive effect of the establishment or upgrade of a partnership on OFDI is more significant for firms with a higher demand for policy guarantees from the government, such as non-central firms and firms that are not located in Beijing.

Hypothesis 4: The increase in OFDI is concentrated in countries with higher political risks, such as developing, neighboring and B&R countries.

IV. Data

1. Foreign Direct Investment Data: Record List of Overseas Investment Enterprises

Our FDI data are obtained from the *Record List of Overseas Investment Enterprises* (*Record List*) provided by China's Ministry of Commerce. According to China's negative list management for overseas investment, firms investing in non-sensitive countries (regions) and non-sensitive industries abroad are only required to submit electronic data to China's Ministry of Commerce.[7] This dataset records detailed information of each OFDI transaction, including starting year, destination country, domestic investor, FDI enterprises abroad, province and the scope of business. It is the largest and most representative data of Chinese firms' OFDI (Luo and Ge, 2013; Zhou et al., 2015; Fan et al., 2018). To ensure the credibility of the *Record List*, we compared it with the *Statistical Bulletin of China's Outward Foreign Direct Investment* (*Statistical Bulletin*). Table 2 shows that the data in the *Record List* and the *Statistical Bulletin* are generally

Table 2. Comparison between Record List and Statistical Bulletin Data

Year	Domestic investors		FDI enterprises		Destination countries	
	Record List	*Statistical Bulletin*	*Record List*	*Statistical Bulletin*	*Record List*	*Statistical Bulletin*
2003	188	1975	286	3439	77	139
2004	289	2965	413	5163	86	149
2005	1067	4021	1344	6424	114	163
2006	1979	5000a	2465	10,000[a]	129	172
2007	2930	7000a	3706	10,000[a]	144	173
2008	4117	8557	5261	12,000[a]	151	174
2009	5599	12,072	7304	13,000[a]	167	177
2010	7529	13,000a	10,003	16,107	170	178
2011	9770	13,462	13,120	17,951	174	177
2012	12,388	15,994	16,818	21,860	180	179
2013	15,409	15,300	21,062	25,413	183	184
2014	19,848	18,547	27,091	29,699	193	186
2015	26,251	20,207	36,111	30,814	195	188

Sources: *Record List* from the Ministry of Commerce of People's Republic of China (http://femhzs.mofcom.gov.cn/fecpmvc/pages/fem/CorpJWList.html) and *Statistical Bulletin* from the NBS (2003–2015).

Notes: [a]Denotes an approximate value obtained from the *Statistical Bulletin* of that year. FDI, foreign direct investment.

[7]Detailed recording procedures are available from: http://jwtz.mofcom.gov.cn/.

consistent on the number of domestic investors, FDI enterprises and destination countries, verifying the quality of this dataset. However, it should be noted that data from the *Record List* only implies firms' intention to make OFDI rather than actual investment and there is no record of investment performance, such as the amount of investment.[8] Therefore, to examine the impact of partnership on OFDI, we are only concerned with the decision-making and location choice of Chinese firms in this paper.

2. Dataset of China's Diplomatic Partnerships

We collected partnership data from joint statements on China's Ministry of Foreign Affairs website, applied codes for hierarchy and then constructed our dataset. Since the first partnership was established with Brazil in 1993, China has established a further 143 partnerships with 99 countries.[9] We find that there are 18 different names of China's existing partnerships in joint statements. According to importance and the order of upgrading, we extract "comprehensive" and "strategic" as keywords and code for their hierarchy. Finally, we classify these 18 different partnerships into four categories: partnership, comprehensive partnership, strategic partnership and comprehensive strategic partnership, coded from 1 to 4 (Table 3). A higher value means a better diplomatic relationship. Taking Pakistan as an example, we explain the data structure of the variable $partner_{ct}$ in Table 4. We refer to $partner_{ct}$ to capture the three different aspects of establishment or upgrade of partnership (establishment), whether there is a partnership (existence) and partnership hierarchy (hierarchy). Establishment equals 1 whenever a partnership was established or upgraded in the onset year and 0 otherwise. Existence equals 1 when a partnership has already been established for some years. The value of hierarchy refers to the hierarchy of existing partnerships. For example, the hierarchy of Pakistan initially had a value of 2 because a comprehensive cooperative partnership was established with China in 1996; it then had a value of 3 as Pakistan established a strategic cooperative partnership with China in 2005; and after the establishment of the all-weather strategic co-operative partnership between the People's Republic of China and the Islamic Republic of Pakistan in 2015, the value has increased to the highest level, 4.

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[8]The *China Global Investment Tracker* compiled by the American Enterprise Institute and the Heritage Foundation is another commonly used dataset to study Chinese firms' OFDI. It records 3342 investment projects over US$100m since 2005 and provides detailed information on Chinese entity, transaction party, investment amount, sector, whether a project is green or not and whether a transaction is in trouble or not. For the sake of coverage, we choose the *Record List* data.

[9]Our dataset only covers China's partnerships with sovereign countries rather than international or regional organizations, such as the China–EU Comprehensive Strategic Partnership and the China–ASEAN Strategic Partnership.

Table 3. Coding of Partnerships

Partnership	1	Friendly partnership
		New-type cooperative partnership
Comprehensive partnership	2	Innovative comprehensive partnership
		Comprehensive cooperative partnership
		Comprehensive friendly partnership of cooperation
		All-round cooperative partnership
		All-round friendly partnership of cooperation
Strategic partnership	3	Strategic partnership
		Innovative strategic partnership
		Strategic partnership of mutual benefit
		Friendly strategic partnership
		Strategic cooperative partnership
Comprehensive strategic partnership	4	Comprehensive strategic partnership
		All-round strategic partnership
		Comprehensive strategic partnership of cooperation
		Global comprehensive strategic partnership in the 21st century
		All-weather strategic partnership of cooperation
		Comprehensive strategic partnership of coordination

Source: Ministry of Foreign Affairs of the People's Republic of China (https://www.fmprc.gov.cn/web/).

Table 4. Partnership Variables ($partner_{ct}$): Using Pakistan as an Example

Year	Establishment	Existence	Hierarchy	Key historical events
1993	0	0	0	
1994	0	0	0	
1995	0	0	0	
1996	1	1	2	In December 1996, China and Pakistan established the comprehensive cooperative partnership
1997	0	1	2	
1998	0	1	2	
1999	0	1	2	
2000	0	1	2	
2001	0	1	2	
2002	0	1	2	
2003	0	1	2	
2004	0	1	2	
2005	1	1	3	In April 2005, China and Pakistan established the strategic cooperative partnership
2006	0	1	3	
2007	0	1	3	
2008	0	1	3	
2009	0	1	3	
2010	0	1	3	
2011	0	1	3	
2012	0	1	3	
2013	0	1	3	
2014	0	1	3	
2015	1	1	4	In April 2015, China and Pakistan established the all-weather strategic partnership of cooperation

Source: Ministry of Foreign Affairs of the People's Republic of China (https://www.fmprc.gov.cn/web/).

3. Data Processing

We first define the scope of the national sample to the 175 countries that had established formal diplomatic relations with China by the end of 2015.[10] This is because, on the one hand, the concept of partnership belongs to the diplomatic sphere and partnership includes further improvement of diplomatic relations with the countries that have already established formal diplomatic relations with China. On the other hand, according to the *Measure for the Administration of Overseas Investment* issued by China's Ministry of Commerce in 2014, countries without formal diplomatic relations with China have to obtain special approval from the government to invest and are not included in the *Record List* dataset. Second, we regard the filing of multiple overseas investments by the same domestic investor in the same country in the same year as one effective investment record. For example, Original Force Ltd. filed notification of six different foreign investments to the US on China's Ministry of Commerce website in 2015 but we regard these as one effective record of OFDI. Third, taking the firm–country pair as a unique identifiable unit, we complete the missing year and end up with a balanced panel. Finally, we merge this panel with datasets of partnerships, World Development Indicators (WDI), the Index of Economic Freedom (IEF), Worldwide Governance Indicators (WGI) and United Nations General Assembly (UNGA) voting data. It is noteworthy that 23 of the 175 countries are not included in the final panel because of the lack of some key variables. The absence of these 23 countries does not substantially influence our empirical results because: (i) none of these 23 countries currently have a partnership with China; (ii) only 653 firms are involved in OFDI in these 23 countries, which only accounts for 2.88 percent of our sample; and (iii) all 23 countries are developing countries. If the empirical results support the idea that the positive impact of partnership on OFDI is more significant in developing countries, the lack of these samples will only underestimate this positive effect.

V. Empirical Analysis

1. Empirical Specification

Taking economic development, infrastructure and institutional environment as important determinants of OFDI, we consider the following specification for our empirical investigation:

[10]The list of countries with formal diplomatic relations with China is available from the Ministry of Foreign Affairs of the People's Republic of China: https://www.fmprc.gov.cn/web/ziliao_674904/2193_674977/. We exclude Dominica, El Salvador and Panama as they established formal diplomatic relations with China after 2015.

$$OFDI_{ict} = \beta partner_{ct} + X_{ct}\gamma + \eta_i + \delta_c + \xi_{pt} + \varepsilon_{ict}\,, \quad (1)$$

where $OFDI_{ict}$ is a dummy variable that takes a value of 1 if a Chinese firm i makes OFDI in country c in year t and 0 otherwise, and $partner_{ct}$ is an indicator variable that takes a value of 1 if China establishes or upgrades partnership with country c in year t and 0 otherwise. X_{ct} is a vector of country-level characteristics, including *GDP*, *Population*, *CPI*, *Access to Electricity* (data from WDI), *Investment Freedom*, *Trade Freedom* (data from IEF), *Regulatory Quality* and *Rule of Law* (data from WGI). Market size and economic agglomeration are traditional determinants of FDI and are proxied by *GDP* and *Population* (Wheeler and Mody, 1992; Kolstad and Wiig, 2012). Firms are less likely to invest in countries with severe inflation and we take *CPI* to capture this effect. We use *Access to Electricity* as a proxy to prove that good infrastructure helps to attract FDI (Head and Ries, 1996; Cheng and Kwan, 1999). According to the proximity–concentration trade-off hypothesis, whether a firm chooses to export or invest in a foreign market depends on the relative costs between them (Markusen, 1984; Helpman et al., 2004), thus we take *Investment Freedom* and *Trade Freedom* into consideration at the same time. We take *Regulation Quality* and *Rule of Law* as proxies for institutional environment (Jiang and Jiang, 2012; Wang et al., 2014). η_i, δ_c and ξ_{pt} represent firm, country and province–year fixed effects, respectively. The firm fixed effects, η_i, account for time-invariant unobserved differences across firms that may affect firms' decisions to conduct OFDI, such as their location and set-up year. The country fixed effects, δ_c, account for time-invariant unobserved differences across countries that may affect firms' decisions on OFDI, such as geographic distance, or whether they share the same border, the same language, or have a colonial relationship. We also use the province–year fixed effects, ξ_{pt}, to capture time varying provincial characteristics, such as provincial GDP, population, institutions and policies of opening up in home countries. Furthermore, a balanced panel, ξ_{pt}, that already includes the year fixed effects can capture the common trend between partnerships and OFDI, and exogenous shocks in specific years.

2. Baseline Results

In our benchmark model, Equation (1), we investigate the onset-year effect of partnership on China's firm-level OFDI during the period from 2005 to 2015, in which we exclude samples from the US and Japan. First of all, we choose establishment or upgrade of partnerships (instead of whether there is a partnership or partnership hierarchy) and partnership hierarchy as the key explanatory variables to capture the onset-year effect of partnership because the positive impact of partnership on OFDI

is a short-term reaction rather than a long-term effective policy guarantee in the initial stage. Second, the choice of the period from 2005 to 2015 is based on the fact that after the promulgation of the *Decision of the State Council on Reform of the Investment System* in 2004, the policy of overseas investment has shifted from an approval to a filing system, and firms in China now have legitimate rights to invest abroad independently. The *Record List* provides more precise data since that time to support our research on the impact of partnership on market-oriented OFDI, which requires independent rights for firms to invest abroad. Third, samples of the US and Japan are outliers in our benchmark. The diplomatic relations between the US and China and between Japan and China are too intricate to discuss within the framework of partnership.[11] But the US and Japan are the largest and third largest destinations for Chinese OFDI, accounting for 18.64 and 3.86 percent of the total amount of Chinese firms involved in OFDI, respectively.[12] If we include them in our benchmark regression, it will create estimation bias.

Table 5 reports the baseline results after testing Hypothesis 1 that the establishment or upgrade of partnerships can encourage Chinese firms to make decisions on OFDI. In column (1) we regress partnership on OFDI directly. In column (2) we add control variables such as *GDP*, *CPI*, *Population*, *Access to Electricity*, *Investment Freedom*, *Trade Freedom*, *Regulatory Quality* and *Rule of Law*. In column (3) we add firm, country and year fixed effects. In column (4) we replace year fixed effects with province–year fixed effects compared to column (3), which is our preferred specification. These four estimated coefficients of partnership are positive and statistically significant at the 1 percent level. Furthermore, in our baseline results in column (4), all coefficients of control variables are also basically in line with expectations. To deal with the coefficient estimation bias caused by the dummy variable, for the establishment or upgrade of partnerships valued 1 or 0, we use logit regression in column (5). The estimated coefficient remains significantly positive. In column (6) we include samples of the US and Japan. The estimate result is 0.0071 and significant at the 1 percent level, but is smaller than 0.0094 in our benchmark regression in column (4). This proves that, even considering outliers of the US and Japan, the establishment or upgrade of partnerships

[11]The US and China had a constructive strategic partnership during 1997–2004 and a constructive cooperative partnership during 2011–2014. It is believed that the constructive partnership is a transitional rather than a formal form of partnership. However, in 2018, the US government stated that there is strategic competition between China and the US. Japan and China announced their intention to establish a friendly cooperative partnership in 1998 but this has never been mentioned in subsequent joint statements. In 2008, Japan and China signed a joint statement to promote strategic mutual benefit relations, rather than any form of partnership. Therefore, China currently still has no formal partnership with the US or Japan.

[12]These figures we obtained from the *Record List of Overseas Investment Enterprises* during 2005–2015.

still plays an important role in promoting Chinese firms' OFDI, but this positive effect will be relatively underestimated.[13]

Table 5. Baseline Results

	(1) OLS	(2) OLS	(3) FE	(4) FE	(5) Logit	(6) Include US and Japan
Establishment of partnership	0.0165*** (6.91)	0.0139*** (5.76)	0.0107*** (4.08)	0.0094*** (3.52)	0.0934*** (3.44)	0.0071*** (2.69)
ln*GDP*		–0.0010 (–0.89)	0.0595*** (4.20)	0.0540*** (3.73)	0.6333*** (3.89)	0.0737*** (5.20)
ln*Population*		0.0012 (1.04)	–0.0115 (–0.53)	–0.0339 (–1.54)	–0.0052 (–0.02)	–0.0232 (–1.08)
ln*CPI*		0.1725*** (49.81)	–0.0423*** (–5.37)	–0.0540*** (–6.69)	–0.5017*** (–5.52)	–0.0903*** (–12.08)
Access to Electricity		0.0002*** (4.21)	0.0008*** (2.85)	0.0006** (2.06)	0.0068** (2.14)	0.0001 (0.35)
Investment Freedom		0.0006*** (9.76)	0.0007*** (5.22)	0.0006*** (4.80)	0.0086*** (5.34)	–0.0001 (–0.56)
Trade Freedom		–0.0000 (–0.43)	–0.0006*** (–4.12)	–0.0004*** (–2.75)	–0.0079*** (–4.25)	–0.0006*** (–3.69)
Regulatory Quality		–0.0003 (–0.08)	0.0170** (2.28)	0.0198*** (2.63)	0.1713** (2.10)	–0.0220*** (–3.35)
Rule of Law		–0.0129*** (–5.51)	–0.0111 (–1.24)	–0.0105 (–1.15)	–0.1486 (–1.41)	–0.0269*** (–3.11)
Firm FE	No	No	Yes	Yes	No	Yes
Country FE	No	No	Yes	Yes	No	Yes
Year FE	No	No	Yes	No	Yes	No
Province–year FE	No	No	No	Yes	No	Yes
Firm–country FE	No	No	No	No	Yes	No
Number of countries	170	150	150	150	150	152
Observations	184,932	174,050	174,046	174,046	170,714	228,320
R^2	0.0003	0.016	0.041	0.051	0.064	0.057

Notes: *** and ** indicate statistical significance at 1 and 5 percent level, respectively. *t*-statistics are in parentheses. FE, fixed effect; OLS, ordinary least square.

3. Short-term Effect of Partnership Establishment

In order to test Hypothesis 2, we examine the time effect of partnership. If the positive impact of partnership on OFDI is mainly reflected in the indicator of establishment or upgrade of partnership, it means that partnership only generates a signal of a secure and supportive investment environment for firms and this effect is short-lived. If it is mainly

[13]We check for robustness as follows: (i) when considering for policy period, we take subsamples of different periods, such as before the reform of the investment system in 2004 and after 2004; (ii) when considering for other major diplomatic events, we exclude countries that established or restored formal diplomatic relations with China during 2005–2015. More robustness checks are available from the authors upon request.

reflected in the indicator of whether there is a partnership or partnership hierarchy, this means the impact of partnership on OFDI has generated a long-term effect and governments of partner countries have already provided effective policy coordination and policy guarantees to firms. In Table 6, columns (1)–(3) compare the establishment or upgrade of partnership and whether there is a partnership and prove that the effect is mainly reflected in the former, especially when considering *establishment* and *existence* at the same time in column (3). Columns (4)–(6) compare *establishment* and *hierarchy* and draw the same conclusion: that the effect is primarily evident in the early stage. Note that we include the US and Japan in columns (1) and (4) and exclude them in columns (2) and (5). The differences between columns (1) and (2) and columns (4) and (5) support the idea that including samples of the US and Japan will underestimate the positive effect of partnership. To further verify the short-term effect of partnership, we include separate dummy variables that take a value of 1 if partnership is established or upgraded in the years t, $t-1$, $t-2$ and $t-3$ in column (7). We find significantly positive coefficients on establishment or upgrade of partnership for the years t, $t-1$ and $t-2$, but the item $t-3$ is not statistically significant. This confirms that the positive impact of the establishment or upgrade of partnership on Chinese firms' decisions on OFDI only has a short-term effect.

Table 6. Short-term Effect of Partnership Establishment

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Existence of partnership	0.0009	0.0073**	0.0034				
	(0.29)	(2.26)	(0.97)				
Partnership hierarchy				–0.0003	0.0024***	0.0013	
				(–0.39)	(2.64)	(1.22)	
Establishment of partnership			0.0083***			0.0078***	0.0123***
			(2.87)			(2.63)	(4.47)
Establishment of partnership, $t-1$							0.0133***
							(4.92)
Establishment of partnership, $t-2$							0.0102***
							(3.65)
Establishment of partnership, $t-3$							–0.0021
							(–0.68)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number of countries	152	150	150	152	150	150	150
Observations	228,320	174,046	174,046	228,320	174,046	174,046	174,046
R^2	0.057	0.051	0.051	0.057	0.051	0.051	0.051

Notes: *** and ** indicate statistical significance at 1 and 5 percent level, respectively. *t*-statistics are in parentheses. FE, fixed effect.

4. Firms with Higher Demand for Policy Guarantees from the Government

In this subsection, we test Hypothesis 3 that the positive effect of establishing or upgrading partnership on decisions of firms to make OFDI is more significant for firms with a higher demand for policy guarantees from the government, such as non-central firms and firms that are not located in Beijing. Compared with central firms and firms in Beijing who can communicate with the government more frequently and effectively, non-central firms and firms that are not located in Beijing are more sensitive to political risks, have a higher demand for government commitments of policy guarantees and are naturally more inclined to take action when receiving a signal of a secure and supportive investment environment from the government by establishing or upgrading partnerships. In Table 7, we divide our sample into central and non-central firms in columns (1) and (2) and firms located in and not in Beijing in columns (4) and (5), respectively. We repeat the regression of our preferred specification in column (4) of Table 5. As Table 7 shows, the estimated coefficients are significantly positive for non-central firms and firms that are not located in Beijing and insignificant for central firms and firms in Beijing. In column (3) we include an interaction between partnership and the dummy of non-central firms in the regression with the full sample. In column (6) we include an interaction between partnership and the dummy of firms that are not located in Beijing. The results in both columns (3) and (6) confirm that the positive effect of partnership is more significant for firms that are more sensitive to political risks and with a higher demand for policy guarantees from the government, such as non-central and non-Beijing firms.

Table 7. Firms with a High Demand for Policy Guarantees from the Government

	(1)	(2)	(3)	(4)	(5)	(6)
	Central firm	Non-central firm	Full sample	Firm in Beijing	Firm not in Beijing	Full sample
Establishment of partnership	0.0108	0.0091***		–0.0030	0.0100***	
	(1.31)	(3.22)		(–0.27)	(3.42)	
Establishment × Non-central firm			0.0090***			
			(3.20)			
Establishment × Firm not in Beijing						0.0099***
						(3.39)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes	Yes	Yes	Yes
Number of countries	134	147	150	109	147	147
Observations	19,337	154,709	174,046	9588	144,852	154,709
R^2	0.067	0.049	0.051	0.102	0.046	0.049

Notes: *** indicates statistical significance at the 1 percent level. *t*-statistics are in parentheses. FE, fixed effect.

5. Foreign Direct Investment in High Political Risk Areas

In this section, we test Hypothesis 4 that the increase in OFDI caused by the establishment or upgrade of partnerships is concentrated in host countries with higher political risks, such as developing, neighboring and B&R countries.

(1) Developing Countries

The major impediments faced by investors in developing countries are still political risks, such as political instability, an unsound legal system, administrative inefficiency and corruption. We examine whether the positive impact of partnership on Chinese firms' decisions on OFDI mainly takes place in developing countries. In Table 8, we divide our sample into developed and developing countries based on the Human Development Index (HDI)[14] in columns (1) and (2). When HDI > 0.8, it is identified as a very high level of human development, which we define as a developed country. The rest of our sample is developing countries. We find that the estimated coefficient of partnership for developing countries is 0.0164 and statistically significant at the 1 percent level, while it is insignificant for developed countries. In column (3) we include an

Table 8. Foreign Direct Investment in High Political Risk Areas: Developing Countries

	(1)	(2)	(3)	(4)	(5)	(6)
	HDI			World Bank		
	Developed countries	Developing countries	Full sample	Developed countries	Developing countries	Full sample
Establishment of partnership	0.0010	0.0164***		0.0002	0.0141***	
	(0.24)	(4.41)		(0.05)	(3.95)	
Establishment × Developing countries			0.0152***			0.0138***
			(4.20)			(3.98)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes	Yes	Yes	Yes
Number of countries	44	106	150	46	104	150
Observations	80,609	93,437	174,046	68,930	105,116	174,046
R^2	0.057	0.054	0.051	0.063	0.051	0.051

Notes: *** indicates statistical significance at the 1 percent level. *t*-statistics are in parentheses. FE, fixed effect; HDI, human development index.

[14]HDI is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living. Available from http://hdr.undp.org/en/content/human-development-index-hdi/.

interaction between partnership and the dummy of developing countries in the regression with the full sample. The coefficient of this interaction is significantly positive. We then use World Bank criteria to divide our sample into developed and developing countries in columns (4)–(6). We regard high-income countries defined by the World Bank as developed countries and the remainder as developing countries.[15] The results are not substantively different from those in columns (1)–(3). All of these results support Hypothesis 4 that the positive effect of partnership mainly occurs in developing countries with higher political risks.

(2) Neighboring Countries

Neighboring countries are a key area of China's diplomatic strategy. In this area, with the exception of Japan, Singapore and South Korea, other developing countries all have high political risks. We test whether the positive effect of partnership is more significant in countries neighboring China. In the narrow sense, we define neighbors as countries that share borders with China; in the broad sense, we define them as countries in Asia. In Table 9 we run a regression of bordering countries in column (1) and non-bordering countries in column (2). While positive for both groups, the coefficient of partnership is statistically significant at the 1 percent level for the bordering countries but insignificant for non-bordering countries. We include an interaction between partnership and the dummy of bordering countries to run the regression with the full sample in column (3).

Table 9. Foreign Direct Investment in High Political Risk Areas: Neighboring Countries

	(1) Bordering countries	(2) Non-bordering countries	(3) Full sample	(4) Asian countries	(5) Non- Asian countries	(6) Full sample
Establishment of partnership	0.0207***	0.0041		0.0126***	0.0006	
	(3.46)	(1.31)		(3.36)	(0.14)	
Establishment × Bordering countries			0.0201***			
			(3.86)			
Establishment × Asian countries						0.0115***
						(3.17)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes	Yes	Yes	Yes
Number of countries	11	139	150	37	113	150
Observations	42,955	131,091	174,046	81,963	92,083	174,046
R^2	0.055	0.055	0.051	0.054	0.055	0.051

Notes: *** indicates statistical significance at the 1 percent level. *t*-statistics are in parentheses. FE, fixed effect.

[15]This criteria is available from https://data.worldbank.org/income-level/high-income?view=chart.

The coefficient of the interaction is also significantly positive. We take Asian countries as neighbors in columns (4)–(6) and repeat our empirical analysis. The results are not substantively different from those in columns (1)–(3). The results support Hypothesis 4 that the positive effect of partnership mainly occurs in neighboring countries with higher political risks.

(3) Belt and Road Countries

Most B&R countries are also developing countries with high political risks and great market potential. We test whether the positive effect of partnership on OFDI is more significant in B&R countries. In Table 10 we run a regression of B&R countries in column (1) and non-B&R countries in column (2) and find that the coefficient of partnership is significant for B&R countries but insignificant for non-B&R countries. In column (3) we further add an interaction between partnership and the dummy of B&R countries and run the regression of the full sample. The coefficient of the interaction is 0.0095 and statistically significant at the 1 percent level. The results in Table 10 also support Hypothesis 4 that the positive effect of partnership mainly occurs in B&R countries with higher political risks.

Table 10. Foreign Direct Investment in High Political Risk Areas: Belt and Road Countries

	(1)	(2)	(3)
	B&R countries	Non-B&R countries	Full sample
Establishment of partnership	0.0110***	0.0068	
	(2.97)	(1.62)	
Establishment × B&R countries			0.0095***
			(2.66)
Control variables	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Country FE	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes
Number of countries	56	94	150
Observations	90,610	83,436	174,046
R^2	0.052	0.057	0.051

Notes: *** indicates statistical significance at the 1 percent level. *t*-statistics are in parentheses. B&R, Belt and Road; FE, fixed effect.

VI. Endogeneity Concerns

Based on our analysis, the endogeneity problem in our specification is not severe. On the one hand, we control for the firm, country and province–year fixed effects, as well

as a set of control variables including *GDP*, *CPI*, *Population*, *Access to Electricity*, *Investment Freedom*, *Trade Freedom*, *Regulatory Quality* and *Rule of Law* to reduce the problem of omitted variables. On the other hand, the establishment or upgrade of partnership is one of the consequences of games among countries, which is relatively exogenous of firm behavior. We are inclined to believe that partnership, indicating better political relations between two countries, is the external macro environment setting for firm-level OFDI activity. Of course we have to admit that economic relations can also affect political relations in reverse. As Gartzke and Li (2003a) argued, in the post-war era, frequent economic exchange reduced the possibility of political conflict between countries. Gartzke and Li (2003b) showed that globalization has had positive externalities on international politics. Li (2008) concluded that no military confrontation would occur between countries with close economic ties. Sun and Ding (2017) indicated that economic influence and trade dependence are also important factors for establishing or upgrading partnerships. In this section, we take two strategies to address potential endogeneity concerns: one that controls for more macroeconomic variables and the other taking UNGA voting data as an instrument to conduct two stage least square (2SLS) regression.

1. Robust Check by Controlling for More Macroeconomic Variables

By including an additional set of macroeconomic variables that might affect firms' OFDI decisions we try to reduce the potential endogeneity caused by omitted variables, such as *Exchange Rate*, *Real Interest Rate* and *Tax Burden*, that may also influence OFDI. When the official exchange rate rises it indicates that the local currency depreciates against the US dollar, which will affect firms' decisions on OFDI through at least two channels: (i) the domestic assets in host countries will become cheaper for foreign investors, promoting foreign investment; and (ii) foreign goods will be more expensive for host countries and it is more difficult to enter these markets through export, which will also promote foreign firm investment. In column (1) of Table 11 we include the macroeconomic variable of exchange rate. The coefficient of exchange rate is significantly positive as expected and the coefficient of partnership remains robust. *Real Interest Rate* refers to the lending interest rate adjusted for inflation as measured by the GDP deflator. If the real interest rate rises the cost of establishing factories and doing business will increase, and this will influence foreign investment. In column (2) we include the macroeconomic variable *Real Interest Rate.* The coefficient of *Real Interest Rate* is almost 0 and not significant, but the coefficient of partnership is still robust. *Tax Burden* is also an important factor to influence firms' investments. However, the coefficient of tax burden in column (3) is not statistically significant either. In column (4)

we put these three variables into the regression. All of their coefficients are insignificant, but the coefficient of partnership remains robust and is similar to the baseline results. These results indicate that the estimation of partnership remains robust even when controlled by more macroeconomic variables.

Table 11. Robust Check by Controlling for More Macroeconomic Variables

	(1)	(2)	(3)	(4)
Establishment of partnership	0.0120***	0.0099***	0.0110***	0.0095**
	(4.18)	(2.93)	(3.66)	(2.42)
ln*Exchange Rate*	0.0082***			–0.0217
	(3.27)			(–1.57)
Real Interest Rate		0.0000		0.0001
		(0.18)		(0.37)
Tax Burden			0.0000	0.0001
			(0.64)	(0.94)
Control variables	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes	Yes
Number of countries	138	118	150	113
Observations	154,157	119,379	149,086	97,977
R^2	0.052	0.064	0.068	0.080

Notes: *** and ** indicate statistical significance at 1 and 5 percent level, respectively. *t*-statistics are in parentheses. FE, fixed effect.

2. Robust Check by Taking Voting Data as an Instrument

We take UNGA voting data as an instrument to run the 2SLS regression. Since the UN was founded in 1946, the UNGA votes annually on six types of major international issues relating to the Palestinian conflict, nuclear weapons and material, arms control and disarmament, colonialism, human rights and economic development. The results of the voting effectively reflect a county's political preferences and the similarities among countries (Signorino and Ritter, 1999; Voeten, 2013; Bailey et al., 2017). We use the voting similarity index, *agree2un* and *agree3un* (UNGA voting data), compiled by Voeten (2013).[16] The higher the voting similarity index, the greater the similarity

[16]Voting similarity index = Total number of votes which both states agree/Total number of joint votes. *agree2un* is computed using two category vote data (1 = yes or approval for an issue; 2 = no or disapproval for an issue); *agree3un* is computed using three category vote data (1 = yes or approval for an issue; 2 = abstain; and 3 = no or disapproval for an issue).

between two countries' political preferences. The UNGA voting similarity index is a suitable instrument for our specification. As for its correlation with partnership, it is believed that countries with similar political preferences are more likely to share interests and establish or upgrade their partnerships. As for exogeneity with Chinese firms' OFDI, the voting similarity index is a comprehensive indicator reflecting one country's overall national interests, particularly for politics rather than economics. There is no direct relationship between the voting behavior of one country and the FDI behavior of an individual firm. For comparison, Table 12 uses the same data sample for baseline regression in column (1) and 2SLS regression in columns (2) and (3), in which we exclude the samples without the variables *agree2un* or *agree3un*. The coefficient of baseline estimation here is 0.0106 and significant at 1 percent. The coefficients in columns (2) and (3) are also significantly positive. The 2SLS results still verify the hypothesis that the establishment or upgrade of partnership positively affects Chinese firms' decisions on OFDI.

Table 12. Robust Check Using Two Stage Least Square Regression

	(1)	(2)	(3)
	Baseline	*agree2un*	*agree3un*
Establishment of partnership	0.0106***	0.0681***	0.1070***
	(4.05)	(2.95)	(4.07)
Control variables	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Country FE	Yes	Yes	Yes
Province–year FE	Yes	Yes	Yes
Underidentification test		2046.82	1587.98
Weak identification test		1909.08	1476.77
Number of countries	148	148	148
Observations	157,674	157,674	157,674
R^2	0.052	0.049	0.043

Notes: *** indicates statistical significance at the 1 percent level. *t*-statistics are in parentheses. FE, fixed effect.

VII. Conclusion

Based on our analysis, we find that China's diplomatic strategy, which resulted in the creation of partnerships between 1993 and 2015, has helped to encourage Chinese firms to invest abroad. We collected partnership data from China's Ministry of Foreign Affairs website and ran a regression of FDI from China to 150 countries to test the extent to which establishment or upgrade of partnerships affects firms' decisions on

OFDI. Our empirical study proves that: (i) establishment or upgrade of partnerships has a positive impact on Chinese firms' decisions on OFDI; (ii) in the initial stage it is a signal of a short-term rather than a long-term policy guarantee for firms; (iii) the positive effect is more significant for firms with a higher demand for policy guarantees from the government, such as non-central firms and firms that are not located in Beijing; and (iv) the increase in OFDI is concentrated in areas with higher political risks, such as developing, neighboring and B&R countries, which is consistent with China's diplomatic focus. The results are still robust when controlling for more macroeconomic variables and taking UNGA voting data as an instrument to solve the potential endogeneity problem.

China's diplomatic partnership strategy provides a new channel to encourage Chinese firms to invest in developing and B&R countries with high political risks. However, the role of partnerships only presents a positive signal of a secure and supportive investment environment for firms to invest abroad and likely only generates a short-term effect. What is more important is that partnerships could act as a bridge to enhance policy communication and coordination with partner countries, implement relevant laws and regulations and finally, provide a long-term effective policy guarantee for firms' OFDI. We suggest that China takes the following measures after establishing partnerships with other countries to achieve long-term benefits: (i) accelerate the establishment of an information service system to provide sufficient information about host countries' political stability, government effectiveness, regulatory quality, rule of law, religious beliefs and cultural customs to reduce policy uncertainty in overseas investment; (ii) strengthen protection of the legitimate rights and interests of firms making overseas investment by establishing a risk warning system, providing consular protection and judicial assistance in a timely manner and helping firms avoid sovereignty and government credit risks; and (iii) speed up negotiations over market access for overseas investment.

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