Geopolitics and international bank flows[+]

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Abstract

Using the timing of Dalai Lama visits as a unique source of time-varying geopolitical tensions between China and other countries, we show that in the year following a visit where he meets with the head of state, bank flows from China to that country fall by 12-17%. We also document a geopolitical effect on bilateral bank flows in a broad panel of countries: proxies for geopolitical tensions *between* countries are associated with declines in flows. The effect operates through state-ownership in the banking sector, which enables government to direct the flow of international capital according to diplomatic considerations.

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1. Introduction

Not since the Cold War period has geopolitics and international relations attracted so much interest. Events such as Brexit, escalating tensions with North Korea, and the global rise in nationalistic sentiment and ascendance of right-conservative political groups have commentators debating over what the social, economic and financial consequences of such events might be. While the political determinants of trade flows has received considerable attention in the literature (see for example Acemoglu and Yared, 2010; Berger et al., 2014; Fuchs and Klann, 2013; and Martin et al., 2008) we know little about whether geopolitics matters for international capital flows. Accordingly, in this paper, we investigate whether international relations is an important determinant of international capital (bank) flows.

There are at least two reasons to believe that geopolitical considerations matter for international bank flows. First, since the literature demonstrates that geopolitics matters for trade, it will also matter for capital flows if trade and capital flows are complements. Although orthodox trade models (i.e. Heckscher-Ohlin-Mundell) suggest that trade and factor mobility are substitutes, recent theoretical work shows that under financing frictions, trade and capital flows are, in fact, complements (Antras and Caballero, 2009). This new work is consistent with the empirical observation that approximately 80-90% of the global $US30 plus trillion per annum in international trade is financed, typically through banks (Aubion, 2009).[1] Further, there are an increasing number of reported cases where external financing is directly tied to trade.[2]

[1] Global trade value is based on 2015 figures for gross (i.e. exports plus imports) merchandise trade from the World Trade Organization Statistical Review 2016. See here: https://www.wto.org/english/res_e/statis_e/wts2016_e/wts2016_e.pdf (accessed November 9, 2017).

[2] For example, a recent Chinese syndicate led by Industrial and Commercial Bank of China, China Development Bank, and Export Import Bank of China provided a $1.18 loan to Reliance Communications (India) under an understanding that Reliance would buy Chinese telecoms equipment from Huwei Technologies and ZTE Corp. See "China as a lender of last resort…more than just a loan" by Kelvin Soh and Stephen Aldred, January 19, 2012, Reuters: http://www.reuters.com/article/us-banks-china-overseas-lending/analysis-china-as-lender-of-last-resort-more-than-just-a-loan-idUSTRE80I0DN20120119 (accessed October 13, 2017).

Second, anecdotal evidence suggests political relations between countries determines the allocation of capital *directly*, independent of trade. Consider the following example related to geopolitical events emanating from the Chinese province of Xinjiang. The Xinjiang region has had intermittent autonomy but was officially incorporated into The Peoples Republic China in late 1949. The majority ethic population in Xinjiang is Muslim and their language is related to Turkish. In the 1990s, the collapse of the Soviet Union and the emergence of independent Muslim states in Central Asia lead to a rise in open support for separatist groups and continuing ethic-based violence. One such incident in February 2012 resulted in 13 Han Chinese being killed. In a press statement following the incident, Xinjiang Province's Party Charman, Nur Bekri, declared "a thousand and one links" between local terrorists and with Taliban forces in Pakistan. Two weeks later, the Industrial and Commercial Bank of China withdrew a $US1.6 billion loan to fund the Pakistan portion of the controversial Iran-Pakistan cross border pipeline.[3] Up to this point, China had resisted pressure from the United States and Europe to not provide funding for the project given the global economic sanctions on Iran due to its nuclear program.[4]

This discussion highlights several challenges in studying the relation between geopolitics and bank flows. First, geopolitics is very complicated, typically involving more than two actors. Second, geopolitical events are typically unique (i.e. do not repeat). However, to estimate any systematic relation between geopolitics and bank flows, one requires a dyadic measure of the 'quality of political relations' which is consistent over time. That is, we require a way to consistently measure the quality of relations between *only* country *i* and country *j* and then examine the extent of flows between *i* and *j*.

[3] See "Breakup time for Pakistan, China" by Raffaello Pantucci, June 7, 2012, The Diplomat: https://thediplomat.com/2012/06/break-up-time-for-pakistan-china/ (accessed October 13, 2017).
[4] See "Chinese bank pulls out of Pakistan-Iran pipeline project" by Paul Richter and Alex Rodriguez, Mach 14, 2012, Log Angeles Times: http://articles.latimes.com/2012/mar/14/world/la-fg-pakistan-china-pipeline-20120315 (accessed October 13, 2017).

We begin to tackle this challenge by first examining the relation between geopolitics and international bank flows in a unique setting. In our main analyses we study whether political compliance is an important determinant of bank flows from China to recipient countries using the timing of Dalai Lama visits as a unique source of time-varying political tension between China and other countries. China provides us with an ideal setting to study this question for two reasons. First, since China is an authoritarian regime, its administration has significant capacity to influence the lending decisions of its (largely) state-owned banking system. Second, the Chinese government considers the status of Tibet as an internal affair and outside interference is not tolerated. As a result, each time the Dalai Lama travels, as he frequently does, the Chinese government threats that engagement between the Dalai Lama and political officials in the host country will be met with animosity and ultimately harm economic relations.

We track the Dalai Lama's footsteps between 2000 and 2013 and examine whether bank flows from China to 76 host countries vary with the timing of his visits. Our estimates suggest that in the year following a visit where the Prime Minister or President personally meets with the Dalai Lama, bank flows from China to the host country fall by between 12% and 17% (depending on specification) relative to otherwise similar countries. Further, the effect is short-term, lasting only one year. These findings are exemplified in Figure 2 where we plot the difference in the average percentage change in Chinese bank flows between treated countries and control countries (i.e. those where the Dalai Lama met with the head of state vs. countries where the Dalai Lama visited but did not meet with the head of state, or countries where the Dalai Lama did not visit at t-1) from t-2 till t+2. If we focus on the solid blue line which plots the difference in means we can see the following. First, between t-2 and t-1 the line is virtually flat implying that treated and control groups had very similar trends prior to a Dalai Lama meeting the head of state. Second, following the visit, Chinese

bank flows fall significantly relative to the control group between *t*-1 and *t*—the size of the fall is about 16%, which is inside our range of estimates noted above. Third, between *t* and *t*+2 we see a reversal in the geopolitical effect. Finally, this set of results are robust to standard controls documented in the literature, various robustness tests and addressing potential endogeneity concerns.

Next we provide evidence of a geopolitical effect on international bank flows in a broader panel of countries using data from United Nations (UN) voting to proxy for the quality of relations between country-pairs. Precisely, we examine bank flows from 25 source countries to 76 recipient countries and follow recent work by International Relations scholars to estimate the ideological distance between country-pairs based on these voting data (see Bailey et al., 2017). We find that greater ideological distances (i.e. poorer political relations) are associated with a reduction in bank flows. Our estimates suggest that a 1-point increase in ideological distance between the source and host country is associated with a decline in bank flows from the source country by about 4%.

While the above result is robust to country-pair and year fixed effects, as well as standard controls documented in the literature, there is always a concern that omitted variables might be driving our findings. Although this problem is common in the literature and difficult to eliminate, especially for cross-country studies (Bekaert, Harvey and Lundblad, 2005; Bekaert, Harvey and Lundblad and Siegel, 2007) our setting allows us to take the following steps to alleviate concerns. Since we are examining bilateral flows and our ideological distance measure is a time varying dyadic measure, we are able to control for *all* time varying heterogeneity at the source country *and* the host country by including host country-year and source country-year fixed effects (and dropping all other control variables). Further, the average of these fixed effects within country accounts for all time invariant heterogeneity whereas the average across countries also accounts for common time shocks.

Our results stand up to this specification, the point estimate falls to 1.5% but remains significant at 1% implying a 1-point increase in ideological distance is associated with a decline in bank flows by 1.5% from source to host country, annually. All in all, we are confident that our findings results are not driven by omitted variables.

We identify two potential mechanisms for the results documented in the broad panel of countries. First, worsening political relations lead state-controlled banks to curtail lending as in the case with China. And second, worsening political relations lead private banks cut back lending as part of their routine international country (credit) risk management practices. Our analysis reveals that the former channel is driving the result: the reduction in bank flows when international political relations worsen is concentrated in countries where the government controls at least some of the country's banking assets.

Taken together, our results suggest that political tensions between countries can lead to *implicit* sanctions in the form of restrictions on capital flows. We therefore present the first evidence that geopolitical considerations influence the allocation of bank credit globally.

Our work is related to the literature on the political economy of finance. Recent papers study the relation between political uncertainty and corporate investment (Julio and Yook, 2012), the politics of privatization (Dinc and Gupta, 2011), political interference in banking (Brown and Dinc, 2005; Duchin and Sosyura, 2012; Liu and Ngo, 2014), as well as the asset pricing implications of politics (Pastor and Veronesi, 2012; 2013; Belo et al., 2013; Boutchkova et al., 2012). The papers most closely related to ours demonstrate that *domestic* political considerations affect the *domestic* allocation of credit. For example, early work has shown that, in developing countries, state-controlled banks tend to increase lending during election years (Dinc, 2005) and that politically connected firms have preferential access to credit (Khwaja and Mian, 2005). More recent work has shown that political considerations also determine the domestic allocation of credit even in developed countries like the United

States (e.g. Chavaz and Rose, 2017; Akey et al, 2017). We differ from these papers by presenting evidence that diplomatic relations *between* countries determine the allocation of capital globally.

Our work is also related to the vast literature studying the political determinants of cross-border economic activity. While the evidence is mixed, this literature differs from our work in that it has almost exclusively focuses on the influence of international relations or diplomacy (e.g. Rose, 2007; Nitsch, 2007; Head and Reis, 2010; Morrow et. al., 1998; Pollins, 1989; Davis and Meunier, 2011) and conflict (e.g. Martin et al., 2008; Glick and Taylor, 2010) on *trade* flows. In this literature, two papers stand out as being most related to our work. Fuchs and Klann (2013) report a reduction in trade flows *to* China (i.e. imports) from source countries in the year following a Dalai Lama visit to those countries. More recently, Fisman, et al. (2014) study the stock market reaction to two events which triggered increasing tensions between China and Japan. Using firm level data, the authors show that Japanese (Chinese) firms with high trade exposure to China (Japan) suffer abnormally low returns around these two events.

Finally, our work is related to the literature studying the determinants of international capital flows (e.g. Gelos and Wei, 2005; Alfaro, et al., 2008; Papaioannou, 2009; Houston et al., 2012). This work emphasizes the role of legal, regulatory and political institutions in attracting foreign capital. While we also study the political determinants of international capital flows, our study differs by emphasising how diplomatic relations *between* countries influences bilateral bank flows while controlling for previously documented political factors such as the degree of institutionalized democracy in the host country.

2. China, Tibet and the Dalai Lama

Tensions between China and Tibet date back more than 100 years. Following the Chinese revolution in 1911, Tibet declared its independence without recognition by the subsequent Chinese Republican government. It existed as an autonomous region until 1951 when it was incorporated into the People's Republic of China following the Battle of Chamdo. Eight years later a failed uprising resulted in the abolition of the Tibetan government and the 14th Dalai Lama—the spiritual and political leader of Tibet—fled to India where he has lived in exile ever since.

Since the Dalai Lama is a leader of the Tibetan and Buddhist communities, he frequently travels globally on invitation from these groups to teach Buddhist scripture to the local adherents. However, the Chinese government views his travels as a means to lobby governments to support the case for Tibetan independence from China. As a result, Chinese authorities refer to him as a "separatist who destroys national unity" and describe him as a "jackal in Buddhist monk's robes".[5]

Accordingly, each time he travels, the Chinese government issues pubic warnings to the host country that engagement between the Dalai Lama and the host countries' senior public officials will be met with animosity, damage diplomatic relations and ultimately hurt economic ties with China.[6] This is because the Chinese administration considers the issue of

[5] See for example "Xi Jinping: China will smash Tibet separatism", July 19, 2011, BBC News: http://www.bbc.com/news/world-asia-pacific-14205998 (accessed October 9, 2017); or "Chinese agree to meet Dalai Lama's envoys", by Tania Branigan and Randeep Ramesh, April 26, 2008, The Guardian: https://www.theguardian.com/world/2008/apr/26/tibet.china (accessed October 9, 2017).

[6] Several examples of such official announcements exist in the popular press, recent examples include: "China will not interfere in other countries' internal affairs, but will certainly not tolerate another country doing anything that harms China's core interests" in "China steps up warning to Botswana over Dalai Lama visit", July 27, 2017, Reuters, see: https://www.reuters.com/article/us-china-botswana-dalailama/china-steps-up-warning-to-botswana-over-dalai-lama-visit-idUSKBN1AB14Y (accessed October 9, 2017); "We urge no country or government give him any space, or do anything that would be strongly opposed by the 1.3 billion Chinese" in "China warms U.S. against meeting with Dalai Lama, Taiwan President by Elizabeth Shim, June 14, 2016, UPI, see: https://www.upi.com/Top_News/World-News/2016/06/14/China-warns-US-against-meetings-with-Dalai-Lama-Taiwan-president/1701465910341/ (accessed October 9, 2017); "US lawmakers should cease contact with the Dalai Lama and take measures to rectify the negative impact of their actions" in "China opposes U.S. lawmakers' meeting with Dalai Lama, May 10, 2017, Xinhua Net, see: http://news.xinhuanet.com/english/2017-05/10/c_136272116.htm (accessed October 9, 2017).

Tibet an internal affair and any actions taken by foreign governments which can be viewed as supporting Tibetan independence from China is staunchly rejected.[7]

The seriousness of this matter to the Chinese government is exemplified in the following recent cases. In 2012, the English Prime Minister, David Cameron, chose to meet with the Dalai Lama during his visit to the UK despite staunch opposition from the Chinese authorities. The result: China put diplomatic relations into a deep freeze—he could not visit China and Chinese officials refused to meet with Cameron for over 14 months.[8] The standoff between Cameron and China only ended when he announced in Parliament the "we do not support Tibetan independence, and respect China's sovereignty" and reassured China that he would not meet with the Dalai Lama again.[9] When the Dalai Lama visited again in September 2015, Cameron refused to meet with him.[10] His actions clearly pleased the

[7] Not only do governments need to worry about Chinese retaliation. The University of Calgary awarded the Dalai Lama an honorary degree in December 2009, in response the Chinese government removed the university from its list of accredited institutions, see "U of C offends Chinese government", February 4, 2010, CBC News: http://www.cbc.ca/news/canada/calgary/u-of-c-offends-chinese-government-1.898139 (accessed October 9, 2017). More recently, the University of California San Diego recently invited the Dalai Lama to speak at its 2016-17 school wide commencement ceremony. Shortly after, the Chinese government announced that the China Scholarship Council (CRC) which funds Chinese students' study overseas would no longer be processing applications for study at UCSD, see "China is retaliating against US university for inviting the Dalai Lama to speak at graduation", by Josh Horwitz, September 19, 2017, QUARTZ: https://qz.com/1080962/china-is-retaliating-against-the-university-of-california-san-diego-for-inviting-the-dalai-lama-to-speak-at-commencement/ (accessed October 9, 2017). Even pop stars have been singled out by the Chinese government. Lady Gaga has recently been added to the Chinese government's list of hostile foreign forces and banned after she met with the Dalai Lama—Chinese websites and media organizations were ordered to stop uploading or distributing her songs. This follows after similar bans on artists like Maroon 5, Bjork and Oasis. See "China bans Lada Gaga after Dalai Lama meeting" by Tom Phillips, June 28, 2016, The Guardian: https://www.theguardian.com/music/2016/jun/28/china-lady-gaga-ban-list-hostile-foreign-forces-meeting-dalai-lama (accessed October 9, 2017).

[8] See "China unhappy at Cameron's meeting with Dalai Lama", May 15, 2012, The Guardian: https://www.theguardian.com/world/2012/may/15/china-unhappy-cameron-dalai-lama (accessed October 9, 2017).

[9] See "How David Cameron's comments to MPs over Tibet ended a 14-month stand-off with China" by Christopher Hope, June 27, 2013: http://www.telegraph.co.uk/news/worldnews/asia/tibet/10049546/How-David-Camerons-comments-to-MPs-over-Tibet-ended-a-14-month-stand-off-with-China.html (accessed October 9, 2017).

[10] See "Money, money, money. That's what it is: Dalai Lama slams Cameron for kowtowing to China and refusing to meet him" by Tom McTague, September 24, 2015, Daily Mail: http://www.dailymail.co.uk/news/article-3246512/Money-money-money-s-Dalai-Lama-slams-Cameron-kowtowing-China-refusing-meet-him.html (accessed October 9, 2017).

Chinese authorities because a month later Cameron announced £30 billion in important Chinese investment deals in the UK.[11]

Another prominent example is from 2008 when French (and rotating European Union) President, Nicolas Sarkozy, announced he would meet with the Dalai Lama. China immediately boycotted the 11th EU-China Summit and cancelled talks to finalize the purchase of 150 airbus planes. Moreover, Reilly (2013) notes that two Chinese trade delegations crossed France off their travel agendas, and before his January 2009 trip, Premier Wen Jiabao noted "I looked at a map of Europe on the plane. My trip goes around France…We all know why." A few months later, the French authorities issued a statement recognising Tibet as an integral part of China. Soon after the release of this statement, a Chinese delegation arrived in Paris.

Given that official meetings with the Dalai Lama generate such decisive and negative responses from the Chinese government, we argue that the timing of his visits provide an ideal setting to examine the relation between geopolitics and bank flows. We gain several benefits by having this narrow focus. First, it is rare the geopolitical events involve *only* two countries, even conflicts or war usually involve many nations. As such, isolating the influence of *bilateral* relations on bilateral flows is usually subject to substantial measurement error.

Second, geopolitical events are usually unique and not repeated. Thus, estimating the average effect of geopolitics on bank flows is misleading as the events are starkly different. In our setting, we argue that the timing of Dalai Lama visits to a given country generates time varying political tensions between China and *only* the receiving country. That is, it is a dyadic measure of political relations. Further, since the political issue at hand is the same–

[11] See "China to invest £30bn in UK plc: how the deals break down" by Peter Spence, October 21, 2015, The Telegraph: http://www.telegraph.co.uk/finance/china-business/11943880/China-to-invest-30bn-in-UK-plc-how-the-deals-break-down.html (accessed October 9, 2017).

the status of Tibet vis-à-vis China—any result we present is free from bias that may arise from unobserved event heterogeneity we cannot control. In sum, the timing of Dalai Lama visits provides a dyadic, time varying and consistent measure of political relations between China and other countries.

Finally, the Chinese banking sector is large and important. The four largest banks in the world, with combined assets of over $12 trillion dollars, are Chinese.[12] Another 15 Chinese banks make the global top 100 list. Further, the international footprint of the Chinese banking sector is ever increasing. For example, in 2016, the Bank of China originated over $330 billion in overseas corporate loans.[13] Lastly, a unique feature of the Chinese banking system is that it is largely state-owned and controlled, with some estimates of the degree of government ownership ranging up to 98% (Chiu and Lewis, 2006). Indeed, China's "Big 4" banks are all government controlled. Such control affords the administration the power to allocate (global) bank credit in order to achieve its political goals. This mechanism is consistent with existing literature showing that politicians can (directly and indirectly) influence the domestic allocation of credit, in both developing autocratic (e.g. Dinc, 2005) and developed democratic countries (e.g. Chavaz and Rose, 2017; Akey et al, 2017).

3. Data and Empirical Approach

In this section, we discuss our data sources, variable construction and empirical approach for the analysis presented in the paper. Complete variable definitions and data sources are summarized in Table AI of our appendix.

[12] See "The World's Top 10 Banks" by Kevin Johnston, April 25, 2017, Investopedia: http://www.investopedia.com/articles/investing/122315/worlds-top-10-banks-jpm-wfc.asp (access October 10, 2017).
[13] See "Chinese banks ramp up overseas loans" by Chuin-Wei Yap, April 9, 2017, The Wall Street Journal: https://www.wsj.com/articles/chinese-banks-ramp-up-overseas-loans-1491649206 (accessed October 10, 2017).

The data for our dependent variable construction are obtained from the Bank for International Settlements (BIS) Table 9B "consolidated foreign claims by nationality of reporting banks" (formally Table B4). For our main analysis we are considering flows from China to 76 host countries for the period between 2000 and 2013. Although these data are notionally available from 1983, we focus on the sample from 2000 which corresponds to when China significantly opened up its economy. Prior to this these data are sporadic resulting in a very unbalanced panel. In subsequent analysis, we look beyond China and into a broad panel of countries considering flows from an additional 25 source countries to same 76 host countries, however, we defer a detailed discussion of this analysis until Section 5 of the paper.

The BIS data publish the stock of foreign financial claims (i.e. claims extended to residents outside the country in which the reporting bank is headquartered) reported by domestic bank head offices as well as the exposures of their foreign branches and subsidiaries. These financial claims include loans, foreign trade-related credit, debt securities as well as other securities. Note that the reporting bank's 'home' country is determined by its nationality (i.e. headquarter location) not its geographical location. In that way, a loan issued by a Chinese bank located in Australia to an Australian firm is recorded as a foreign loan where the source country is China and the recipient country is Australia. However, a loan from the same Chinese bank located in Australia to another Chinese bank located in Germany is not considered as a foreign loan.[14]

Using these data, we construct our dependent variable for bank flows from country *i* to country *j* as the log change between year *t*-1 and *t* (multiplied by 100 to get a percentage change). Table I presents the summary statistics, we can see there is substantial variation in

[14] See BIS (2003) and Wooldridge (2002) for further details regarding these data.

the percentage change in Chinese bank flows globally, the average percentage change in bank flows is about 9% with a standard deviation of 53%.

Our key interest is to construct proxies to capture the geopolitical tension or quality of diplomatic relations *between two* countries.[15] As discussed above, the timing of Dalai Lama visits is one such candidate for the case of China. We obtain the Dalai Lama's historical travel schedule from the Office of His Holiness the 14th Dalai Lama (https://www.dalailama.com/) to construct three variables related to the timing of his visits: (1) *Dalai Lama visit at t*-1 which is an indicator equal 1 if the Dalai Lama visits a county in year *t*-1; (2) *Dalai Lama visit without meetings with Head of State at t*-1 is an indicator equal 1 if the Dalai Lama visits a county in year *t*-1 and does *not* meet with the current Prime Minister or President; and (3) *Dalai Lama visit with meetings with Head of State at t*-1 is an indicator equal 1 if the Dalai Lama visits a county in year *t*-1 and does meet with the current Prime Minister or President. The last of these variables is the one of interest since China only threats that official receptions between the Dalai Lama and host country political leaders will place relations with China in jeopardy.

Many of the Dalai Lama's visits are not associated with a meeting with the political leaders of the host country. During our sample period, approximately 43% of the Dalai Lama visits result in a meeting with the political leader of the host country. Figure I plots the geographical distribution of 77 Dalai Lama visits where he meets with either the Prime Minister or President during our sample period. Some interesting countries are worth pointing out. Japan has a long history of volatile political relations with China, as a result, although the Dalai Lama visits there frequently he has never been received by the Prime Minister during our sample period. Next, neither Spanish nor Russian political leaders have

[15] Caldara and Iacoviello (2017) have recently constructed a monthly geopolitical index based on a count of news articles containing terms related to geopolitical tensions. This index captures the aggregate level of geopolitical tension as opposed to what are interested in, which is a dyadic measure of geopolitical tensions.

met with the Dalai Lama. Interestingly, both these countries have also had to deal with independence movements (Barcelona and Chechnya respectively) in their own countries.

To determine the extent to which geopolitical tensions influence international bank flows, we estimate a gravity model of bank flows. Since Tinbergen (1962), gravity models have been the canonical empirical method for estimating bilateral trade flows and have also been applied to explain international capital flows (e.g. Papaioannou, 2009; Houston et al., 2012). The model applies Newton's *Law of Universal Gravitation* to economics and assumes that bilateral flows are proportional to the product of the two countries' masses in question, proxied by the log of gross domestic product (GDP), and inversely proportional to the distance between them. Precisely, we estimate the following model:

$$(1) \qquad \log\left(\Delta bankflow_{i,j,t}\right) = \beta_1 + \beta_2 Dalai\ Lama_{j,t-1} + \beta_3 \log(GDP)_{j,t} + \beta' X_{j,t} + \alpha_j + \gamma_t + \varepsilon_{i,j,t}$$

To control for unobserved time invariant country-level heterogeneity we include country fixed-effects, α_j, into the specification. This fixed-effect also accounts for the distance between China and country *j*. We also include year fixed-effects, γ_t, to control for common time trends across countries. Finally, the international capital flows literature (e.g. Gelos and Wei, 2005; Alfaro, et al., 2008; Papaioannou, 2009; Houston et al., 2012) points to the quality of legal, political and regulatory institutions in recipient countries as an important determinant of attracting foreign capital. We therefore include a vector, $X_{j,t}$, of time varying institutional controls. These controls include *Institutionalized Autocracy/Democracy* which is an index ranging from -10 to 10, with higher values associated with higher degrees of institutionalized democracy. These data are sourced from the Polity IV Project and available from 1800 (http://www.systemicpeace.org/polity/polity4.htm); and six indicators measuring

different dimensions of governance and institutional quality taken from the World Bank's World Wide Governance Indicators (WWGI) database, available from 1996 (http://info.worldbank.org/governance/wgi/#home). The WWGI data are the most comprehensive data of their kind, aggregating information from over 30 individual data sources produced by a variety of agencies (e.g. think tanks, non-governments institutions, international organizations, survey institutes and private sector firms) to create indexes ranging from -2.5 to 2.5 (higher values correspond to high quality) along the following dimensions: *Control of Corruption*, *Government Effectiveness*, *Political Stability and Absence of Violence/Terrorism*, *Rule of Law*, *Regulatory Quality*, and *Voice and Accountability*. Full descriptions for each these indexes are in Table AI of our appendix. In equation (1), our prediction is that $\beta_2 < 0$ implying that when the Dalai Lama visits (and also meets with the head of state) there will be a reduction in bank flows from China to the host country.

4. Results

This section presents the results of our main analysis, robustness tests, and a discussion of potential endogeneity concerns and our empirical strategy to mitigate these concerns. Finally, the section rounds out with some analysis of foreign direct investment (FDI) flows.

4.1. Baseline

Table II presents the baseline results, standard errors clustered at the country level are in parentheses. We begin by estimating equation (1) without controls using the three alternative indicators for Dalai Lama visits described above. In Model 1 we can see that the coefficient on the indicator for if the Dalai Lama visits a county in year *t*-1 (*Dalai Lama visit*

at t-1) is negative but insignificant suggesting that a visit per se does not have an effect on bank flows from China. In Models 2 and 3 we separate visits into those where he did not meet with the head of state and those where he did, respectively. An interesting picture emerges: while visits where political leaders do not meet with him have no significant impact, those visits in which he personally meets with the Prime Minister or President of the host country results in a 12% decline in bank flows to that country. This result is significant at the 1% level. In Model 4 we add the gravity control of the recipient country's economic mass, $\log(GDP)$, and find that it makes virtually no difference to the magnitude or statistical significance of the Dalai Lama indicator. Model 5 includes the degree of institutionalized autocracy/democracy as an additional control. Again we find that our main finding is largely unchanged. Finally, in Model 6 we include the six Worldwide Governance Indicators as controls for institutional quality in the recipient country. The inclusion of these variables increases both the statistical significance and economic magnitude of the coefficient estimate on the Dalai Lama indicator. In this case, a visit where the Dalai Lama meets with the political leader of the host country results in a 17% decline in bank flows from China. The indicators for institutional quality themselves are not significant—likely due to the high correlation across the different measures. Regardless, the increase in the point estimate on the Dalai Lama indicator suggests that Chinese bank flows tend to flow to countries with better institutions (as shown in the prior literature). At the same time, if the Dalai Lama tends to meet with political leaders in countries with better institutions (i.e. developed countries like the US and UK as shown in Figure 1) then omitting the institutional variables implies $Cov\left(Dalai\ Lama_{j,t-1}, \varepsilon_{i,j,t}\right) > 0$ and thus induces an upward bias in β_2 resulting in the lower magnitudes reported in Models 1 to 5.

Next, we investigate the persistence of this effect in Table III. To do so, we re-estimate Model 6 in Table II replacing our *Dalai Lama visit with meetings with Head of State*

at t-1 with two and three year lagged versions (i.e. *Dalai Lama visit with meetings with Head of State at t*-2, *t*-3). We can see that the effect does not persist significantly beyond one year. In the second year, declines continue with a point estimate of -5.04 but this is not significant, and by the third year, the point estimate itself is virtually zero (0.14). The short-term nature of this effect is consistent with anecdotal evidence regarding China's retaliation against individuals, institutions and governments for meeting with or hosting the Dalai Lama.[16]

The findings presented above are summarized well in Figure 2. Here we plot the difference in the average percentage change in Chinese bank flows between treated countries and control countries (i.e. those where the Dalai Lama met with the head of state vs. countries where the Dalai Lama did not visit or where he visited but did not meet with the head of state at *t*-1) from *t*-2 till *t*+2.

If we focus on the solid blue line first, which plots the difference in means, we can see the following. First, between *t*-2 and *t*-1 the line is virtually flat implying that treated and control groups had very similar trends prior to a Dalai Lama visit. Second, following the visit, between *t*-1 and *t*, Chinese bank flows fall significantly relative to the control group. Third, between *t* and *t*+2 we see a reversal in the geopolitical effect.

Next, the dashed red line plots the difference in medians between treated and control groups. We see a similar effect: a Dalai Lama visit results in a significant fall in Chinese bank loan growth followed by a reversal. The only difference with the prior plot, is that, in this instance, the line in the pre-event period between *t*-2 and *t*-1 is sloping upward implying that the trend in the growth of Chinese bank flows to treated countries is higher than control countries. While this may cause concern, note that this situation actually biases *against* us

[16] For example, the removal of the University of Calgary from the official list of tertiary institutions recognised in China (see footnote 7) lasted only one year. And the freeze in diplomatic relations between China and UK Prime Minister, David Cameron, lasted about 14 months.

detecting our hypothesized effect. In either case, the size of the fall in the growth of bank flows is between 14 to 16%—inside the range of estimates presented above.

4.2. Robustness

4.2.1. Alternative specifications

To ensure the robustness of this result, we perform various robustness tests and present the results in Table IV. In each of the tests, we take our baseline model (Model 6 Table II) make one adjustment and re-estimate the model. First, our baseline result clusters the standard errors by country to account for within country clustering due to the fact that the Dalai Lama tends to visit some countries a lot and others not at all during our sample period (see Peterson, 2009). There might however be a concern the residuals are also correlated across countries in the given point in time—due to the fact the Dalai Lama visits multiple countries in a given year— requiring us to cluster by both country and year (i.e. two-way or double clustering, see Thomson, 2011).[17] We re-estimate the baseline model clustering both by country and by year and report the result in Model 1 Table IV. Our result is robust to two-way clustering and, in fact, the standard error in this instance (3.56) is much smaller than in our baseline result (4.72). To be conservative, for the remaining analyses, we only report standard errors that are clustered in a single dimension (i.e. by country).

Second, since bank flows can be volatile, there may be a concern that our result is driven by outliers. We take the following two approaches to mitigate this concern. In Model 2 Table IV we report the results from estimating our baseline model using quantile (i.e. median) regression (Koenker and Basset, 1978) rather than ordinary least squares. As can be

[17] Thomson (2011) shows that two-way clustering is valid provided N and T are both 'large'. In his simulations, the procedure seems to work well for $N = 50$ and $T = 25$, but there is little justification for clustering for cross-sectional correlation if, for example, $N = 1{,}000$ and $T = 5$. In fact, if there is no time series *nor* cross-sectional correlation then two-way clustering when N is large but T is not may actually produce standard errors are too small. For us, $N = 76$ and $T = 14$ and so the time dimension may not be 'large' enough.

seen, our main finding is robust to quantile regression methods, the point estimate is slightly lower at about 16% and the result remains significant at the 1% level. Next, instead of quantile regression, we winsorize the dependent variable at the top and bottom 1% tails and re-estimate the baseline model. The result is Model 3 shows that our finding is robust to winsorizing the dependent variable, the point estimate falls slightly to 16% but the precision of the estimate increases.

Third, there may be a concern that unobserved differences across countries in regard to trends in growth or technological progress may explain both bank flows from China as well as the frequency and timing of Dalai Lama visits. We therefore create country-specific trend variables by interacting a linear trend with country indicators and include these into our baseline regression. The result reported in Model 4 shows our result remains statistically significant after the inclusion of country specific trends, the point estimate on our variable of interest does, however, fall slightly from 17% to about 15%.

Finally, there may be concerns that the results are specific to certain periods. We do two things to address this concern. First, we only consider the pre-crisis period (2000-2007) in case the post crises period corresponded to a general decline in international bank flows but also corresponded to a period where the Dalai Lama travelled more which would induce a mechanical negative relation between bank flows and visits unrelated to geopolitics. Despite losing substantial power in our tests given the much smaller sample, Model 5 shows that our main finding is robust to excluding the post-crisis period. The point estimate remains at about 17% and is significant at the 5% level. Second, we expand our sample back in time to 1984 to consider all available data. Recall that prior to 2000 China's presence on the global stage was limited thus the early data are very patchy resulting in a very unbalanced panel. Notwithstanding, we estimate the baseline model for all available data and find that our result remains robust (Model 6). One thing to note is that since the institutional control variables

are only available from 1996, the sample period in Model 6 is in fact 1996-2013. Accordingly, we can only use the full sample from 1984 if we drop the institutional controls from the regression (equivalent to Model 4 Table II). When we do this our sample size increases to 1,845 observations and we find that Dalai Lama visits with meetings with the head of state reduces bank flows from China, on average, by about 12% which is the same as the estimate reported in Model 4 Table II. This last result is not reported to conserve space.

4.2.2. Identification

There are two potential sources of endogeneity that may be of concern for our analysis. First, there is reverse causality. In this case, one might imagine that the Dalai Lama is in fact, as the Chinese authorities suggest, simply a political figure rallying support for Tibetan independence. He might then time his visits and seek to meet with political leaders in certain countries when tensions between China and these countries are at their highest (corresponding to lower bank flows from China at the same time) to lobby for foreign government support for his cause. If this were the case, then we expect $Cov\left(Dalai\ Lama_{j,t-1}, \varepsilon_{i,j,t}\right) < 0$ and a negative bias in β_2 making the detection of our hypothesized effect more likely.

The second source of endogeneity is due to a selection effect. That is, stronger economic ties and reliance on China may lead political leaders to be reluctant to meet with the Dalai Lama for fear of Chinese retaliation. In this instance, since selection implies we do *not* observe the counterfactual decline in bank flows then $Cov\left(Dalai\ Lama_{j,t-1}, \varepsilon_{i,j,t}\right) > 0$ inducing an upward bias in β_2 making the detection of our hypothesized effect less likely. In what follows, we argue that the main concern for us is the latter selection issue.[18]

[18] Note, that the selection problem induces the opposite bias in our setting compared to Fuchs and Klann (2013) since they are looking at trade flows *into* China (i.e. imports), whereas we are looking at outflows.

Examining the Dalai Lama's travel patterns is revealing of the main source of endogeneity we should worry about. If reverse causality were the problem, then we should observe his travel to a given country to coincide with identifiable periods of high geopolitical tensions between China and that country. Take Sino-Japanese relations as an example. There is a long and volatile relation between China and Japan, and in the recent past there have been three major events that have significantly soured relations. The events occurred in April 2005, September 2010 and September 2012.[19] If the Dalai Lama were timing his visits to coincide with these periods of heightened tensions then we should observe his travel to Japan to be timed with these events. This is not the case, during our sample period, he travels to Japan every year without fail. This is because Japan has a large Buddhist population and so demand for his teachings is high.

What is interesting, however, is the fact that in all these visits to Japan, never did the Japanese Prime Minister meet with him. This points to the aforementioned selection bias. Evidence of selection can also be found by examining how countries manage the Dalai Lama issue. Take the US for example, since the Dalai Lama's first visit to the country in 1991, there has been two occasions where a sitting President has refused to meet with him. The first occasion was Bill Clinton in 1995 and the second was Barrack Obama in 2009. Clinton's decision was based on the fact that US-Chinese relations where already strained at that point[20], and Obama's decision was because the US was in the heart of the financial crisis and highly dependent on foreign capital, to fund private industry but in particular to buy US

[19] On April 5, 2005, the Japanese government reauthorized the use of a history textbook that, according to critics, whitewashed Japanese war crimes of World War II. On September 7, 2010, when a Chinese trawler collided with two Japanese coast guard vessels in disputed waters just off the Senkaku Islands, leading to the detention of the Chinese trawler captain by Japanese authorities. Finally, on September 5, 2012 China accuses Japan of stealing three disputed islands in the East China Sea.

[20] Relations were strained a result of his executive order (no. 128590) he singled in May 1993 linking China's renewal of most favoured nation (MFN) to 7 conditions related to human rights. This is despite the fact that he reversed this order one year later to the surprise of most people given he was elected in 1992 on a platform of human rights. So when the Dalai Lama visited in 1995, Clinton refused to meet with him, instead he arranged a meeting for the Dalai Lama with low ranked officials and then 'casually dropped in for a chat'.

government bonds—of which, China was the largest single foreign investor owning over $1 trillion worth. The Dalai Lama's visit was also scheduled one month prior to Obama's state visit to China.[21] And when US Presidents do meet with him, the meetings are always followed by a press release from the White House stating "the President reiterated the longstanding US position that Tibet is a part of the People's Republic of China, and the United States does not support Tibetan independence."[22]

Indeed, the Dalai Lama himself believes that political leaders are reluctant to meet him for fear of upsetting China. As he put it in an interview with German magazine SPIEGEL:

> "*It's an interesting phenomenon among politicians: When they are not yet government leaders or presidents, they meet with me. Afterwards, they avoid me so as not to annoy Beijing–then, economic relations with the People's Republic take priority."*[23]

The discussion above suggests that, in our view, selection is the likely source of endogeneity. Since selection leads to an upward bias in the estimate and reduces the likelihood of us detecting an effect, we argue that our least squares estimates should be viewed as the lower bound of the effect.

Notwithstanding, we employ two-staged least squares (TSLS) estimation to account for potential endogeneity. To do so we require instruments that are correlated with the likelihood that the political leader in a given country will meet with the Dalai Lama but uncorrelated with Chinese bank flows to that country directly. That is, the exclusion

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[21] See "Barack Obama cancels meeting with Dalai Lama to keep China happy" by Alex Spillius, October 5, 2009, The Telegrapah: http://www.telegraph.co.uk/news/worldnews/barackobama/6262938/Barack-Obama-cancels-meeting-with-Dalai-Lama-to-keep-China-happy.html (accessed October 13, 2017)

[22] See "Readout of the President's meeting with his Holiness the XIV Dalai Lama", June 15, 2016: https://obamawhitehouse.archives.gov/the-press-office/2016/06/15/readout-presidents-meeting-his-holiness-xiv-dalai-lama (accessed October 13, 2017).

[23] See "Courting Beijing's wrath: Dalai Lama visit jeopardizes German business interests" by Andreas Lorenz, September 17, 2007, SPIEGEL: http://www.spiegel.de/international/world/courting-beijing-s-wrath-dalai-lama-visit-jeopardizes-german-business-interests-a-506166.html (accessed October 13, 2017)

restriction requires that the instrument of choice be correlated to Chinese bank flows *only* through the potentially endogenous variable. Since the endogenous regressor is an indicator which varies by country and year, any potential instrument should also vary by country and year. Further, because meetings between the Dalai Lama and heads of state are not common events we face the additional challenge that there is not much *total* variation for us to work with (i.e. the indicator is equal to one only 77 times for our entire sample) and so purging the endogenous component of this variation in the first stage reduces the variation even further. Consequently, we will lose power in our second stage, even with a perfect instrument.

We propose three instruments based on the Dalai Lama's travel behaviour, two of which are also used in Fuchs and Klann (2013). The first is an indicator equal one if the Dalai Lama visits a given country in a given year, regardless of whether he meets with a political leader or not (i.e. our indicator *Dalai Lama visit at t*-1). The intuition behind this instrument rests on the assumption that the Dalai Lama's travels are not dictated by his desire to meet with political leaders per se but that the meetings occur "randomly" once he is in a given country. To determine whether this assumption is plausible or not requires us to understand his motives for travel and travel patterns. Most of the Dalai Lama's travel abroad follow invitations from local Tibetan and Buddhist communities, not invitations from politicians. His time during his visits is usually taken up delivering planned public speeches and Buddhist teachings, as such, it is usually unclear weeks or even days prior to his arrival whether he will meet with a political leader. For example, in his 2009 visit to the US, President Obama cancelled his meeting with the Dalai Lama two weeks into his visit to the US and one day prior to his arrival in Washington DC. Similarly, his visits to Australia in 2002 and 2005 revealed similar patterns. Prior to his visit in 2002 there was much speculation over whether Prime Minister John Howard would meet with him, in the end, Howard announced that he will not meet with the Dalai Lama only two days prior to his

arrival in Australia. In his next visit to Australia in 2007, Howard reversed his position on meeting the Dalai Lama and made a surprise announcement two weeks before his arrival that he would meet with him.[24] Political leaders usually face significant domestic pressure from human rights groups, pro-Tibet groups, opposition politicians and segments of the media to meet with the Dalai Lama during his visits. As such, the likelihood of the Dalai Lama meeting the head of state in a given country increases with the frequency of his visits since the domestic political pressures increase with each additional visit in which the head of state does not meet with him.

The second instrument is the number of days that the Dalai Lama spends in a country during his visit. The idea is the same as what was reasoned above. The longer the length of his stay in a given country the more scope there is for a meeting given the mounting domestic pressure as the length of stay increases. Our final instrument is based on the distance between country pairs in a given trip. For example, between September 7 and 21 in 2013, he travelled to the following countries: Latvia (8-11), Lithuania (11-14), Czech Republic (14-17) and Germany (17-20). We calculate the physical distance between the two countries in each leg of his trip, we then take the minimum distance for each country and use this as the instrument. For Lithuania, for example, we calculate the distance between Latvia and Lithuania and then Lithuania and the Czech Republic, the smaller of these two distances is our instrument. The idea here is shorter distances are indicative of travel plans based on convenience rather than a political motive, further, the lower cost of travel should increase the likelihood of travelling to a given country and therefore increase the likelihood of meeting with the head of state in that country. In making this calculation, we assume that he always starts and ends a trip in India, his place of residence, and if he does not travel to a given

[24] See "Rudd's Dalai Lama drama" by Sarah Smiles, May 17, 2007, The Age: http://www.theage.com.au/news/national/rudds-dalai-lama-drama/2007/05/16/1178995236229.html (accessed October 13, 2017).

country in a given year, we assign this observation the distance between India and that country.[25]

We employ each of these instruments individually and then all together in our estimation. Table V presents the results. Panel A presents the first stage results, Panel B presents diagnostic testing and Panel C presents the second stage results. From Panel A, we can see that each of the instruments individually are significantly related to whether the Dalai Lama meets with the head of state, and with the predicted signs: more visits increases the likelihood of a meeting (Model 1), longer visits increase the likelihood of a meeting (Model 2), and shorter distances are associated with a higher chance of meetings. In Model 4 we can see that when all three instruments are included simultaneously that only the first remains significant. This is due to the fact that all three are highly correlated.

Before discussing the second stage results, we look at the diagnostic tests in Panel B. First, the test of whether the potentially endogenous regressor is, in fact, endogenous reveals that, across all four specifications, we cannot reject the null that Dalai Lama meetings with the head of state is *exogenous*. This fact suggests that our baseline result is less likely to be contaminated by endogeneity concerns. Second, we can see that our first stage is not underindentified. Third, the weak instruments tests show for Model 1 the two test statistics are both greater than the range of Stock and Yogo critical values and so we reject the null that the equation is weakly identified. However, this is not the case with Models 2 to 4. Here, while the Cragg-Donald statistics exceeds the range of Stock and Yogo critical values the Kleibergen-Paap statistic does not and so, at least according to their test, we cannot conclusively reject the null that the instruments are weak. Finally, Models 1 to 3 are exactly identified and so the Hansen J statistic is not applicable, however, for Model 4 when we use

[25] Fuchs and Klann (2013) use the first two instruments we use but not our third instrument. In addition they also use the number of Tibetan supports groups as an additional instrument. We do not use this instrument as it is too noisy and results in a loss of about half of our sample.

all the instruments, we cannot reject the null that the instruments are jointly valid. Overall, while there is some evidence that our second and third instruments are weak, our first instrument appears valid and sufficiently powerful.

Importantly, we find that our main result is robust in the second stage (Panel C). In Model 1 we see that meeting with the Dalai Lama leads to a 14% decline in bank flows from China which is statistically significant at the 5% level. We find a result similar in magnitude in Models 3 and 4, however, Model 3 is not significant whereas Model 4, when using all three instruments, is significant at 10%. Aside from Model 2, we find that the point estimates are within the range of estimates (12 to 17%) presented in Tables II and III which reassures us of the general stability of the result.

4.3. Foreign Direct Investment

Before moving on to examine a broader panel countries' bilateral bank flows, we consider a second important source of foreign capital, FDI. China's FDI outflows are less impressive than the magnitude of its banking sector—its stock of FDI is $502 billion, ranking 14th globally, and in 2012 its outflows of $62 billion was only half that of Japan's and also lagged behind countries like Germany and the UK. Even though FDI flows are less significant, what is significant is the control that the Chinese government has over these resources. China's 20 largest outward investors which account for 92% of outward FDI are all state-owned (Reilly, 2013). Accordingly, it is plausible that the Chinese government might also restrict FDI flows in the same way it might control the flow of bank funds.

We obtain FDI data from the United Nations Conference on Trade and Development (UNCTAD) FDI/TNC Database. These data are available for a shorter time period compared to the bank flows data, from 2003 to 2012. We build a panel of FDI flows from China to the same 76 countries to replicate the analysis in the preceding sections replacing the dependent

variable with the percentage change in FDI flows. Before discussing the results, two comments are worth making at this point. First, FDI is incredibly lumpy. That is, it is common to observe large investments in a given country followed by zero investment in the following year. Second, the financial crisis had a more profound impact on outward investment than it did on bank flows. The raw data shows a significant contraction in aggregate outflows following the onset of the financial crisis in the US. These two problems imply that the FDI data are very noisy thus making it challenging to estimate the impact of geopolitics—particularly when our proxy is an indicator variable which does not have a huge amount of variation itself.

We do not present the results discussed below in the paper to conserve space. However, they are reported in Table AII of our appendix for interested readers. The baseline regression (equivalent to Model 6 Table II) produces a point estimate for the coefficient on *Dalai Lama visit with meetings with Head of State at t*-1 of -90.1 suggesting that meetings with the Dalai Lama are associated with a 90% decline in FDI to the host country. This result is not significant at traditional level of significance but is significant at about 12%. When we double cluster (by county and by year) this 90% decline becomes significant at the 10% level. The large magnitude of the point estimate is due to the lumpy FDI data leading to outliers. We therefore investigate the influence of outliers using quantile regression and find that the magnitude of the point estimate falls to -13.42. Winsorizing the dependent variable also results in a drop in the point estimate, this time to -78.40. Neither of these last two results are significant at traditional levels of statistical significance and also point to the fact that the magnitudes of the effect are driven by the lumpiness of FDI. As a final test, given the observed large contractions in Chinese FDI during the crisis, we restrict the sample to the pre-crisis periods (2003-2007) and estimate the baseline model. Interestingly, we find that for this period, meetings with the Dalai Lama lead to a 58% decline in FDI from China in the

following year. The result is also significant at the 1% level. Taken together, and despite the data challenges, we find that supportive evidence the geopolitics influences the allocation of other forms of capital other than bank credit.

5. Broad Based Evidence

In this final section we provide evidence for the existence of a geopolitical effect on bank flows from a broad panel of countries. We consider bank flows from 25 source or origin countries to the same 76 recipient countries in our China analysis. The data source for bank flows is the same BIS data. We estimate the effect of geopolitics on bilateral bank flows in a gravity model similar to equation (1) above

$$\log(\Delta bankflow_{i,j,t}) = \beta_1 + \beta_2 Geo_{i,j,t-1} + \beta_3 \log(GDP)_{j,t} + \beta' X_{j,t} + \alpha_{i,j} + \gamma_t + \varepsilon_{i,j,t} \quad (2)$$

The dependent variable is the percentage change in bank flows from country *i* to country *j*. To control for unobserved time invariant country-*pair*-level heterogeneity we include country-pair fixed-effects, $\alpha_{i,j}$, into the specification. This fixed-effect also accounts for the distance between *i* and country *j*. We also include year fixed-effects, γ_t, to control for common time trends across countries. As before, we proxy for recipient country's economic mass using the log of GDP and the vector, $X_{j,t}$, consists of time varying institutional controls.

Here $Geo_{i,j,t-1}$ is a proxy capturing the degree or geopolitical tensions or the quality of diplomatic relations. As we discussed earlier, an ideal measure is one that is dyadic, time varying and consistently measured over time. These types of measures are, however, hard to come by and so we follow recent literature to construct proxies. First, Acemoglu and Yared (2010) use the ratio of military spending to GDP as a proxy for the degree of nationalism.

Their argument is the militarism and nationalism place domestic political limits on globalization and international economic exchange. The idea here is that if two countries simultaneously have higher military spending, this is indicative of greater degrees of nationalism in each country which is likely to be associated with rising tensions between these two countries. The obvious drawback of this measure is that military spending is not dyadic as there is no way to attribute the total spending to particular countries. Military spending data are sourced from the Stockholm International Peace Research Institute (SIPRI) Military Expenditure Database (https://www.sipri.org/databases/milex).

Our second measure follows recent work by International Relations scholars who use United Nations (UN) voting data to estimate the ideological distance between country-pairs based on the voting outcomes from "important" votes (see Bailey et al., 2017). Important votes are those identified by the US State Department as relating issues of significant importance. For example, in 2014, there were 13 important votes in the 69th UN General Assembly covering a range of topics from the "situation of human rights in the Islamic Republic Iran" to "united action towards the total elimination of nuclear weapons".[26] To understand how the measure works, if we take the US position as a benchmark, we can see that countries like Australia, the UK, France and Germany voted in a similar direction as the US, each with a coincidence of votes in line with the US of 90% (i.e. low ideological distance with the US in 2014). In contrast countries like Syria (0% vote coincidence), China (11% vote coincidence), India (25% vote coincidence), Vietnam (36.4% vote coincidence), United Arab Emirates (40% vote coincidence) have larger ideological distances with respect to the US in 2014.

Readers may wonder whether UN voting captures the true extent of political relations between countries. A recent important example sheds some light on this matter. In June

[26] See here: https://www.state.gov/p/io/rls/rpt/2014/practices/244928.htm

2017, the UK suffered an embarrassing defeat in an UN vote over decolonization and its residual hold over the disputed Chagos Islands in the Indian Ocean. The UN vote saw delegates support the Mauritian-backed resolution to seek the opinion of the international court of justice in The Hague over the legal status of the islands. What is interesting is that, 10 European Union (EU) countries (notably Germany and France), broke the tradition of voting in line with their EU counterparts and abstained from voting—presumably due to the strained relations between these countries and the UK over Brexit.[27]

Accordingly, these data provide us a time varying dyadic measure of how far apart the ideals are between any two countries in a given year. Larger differences between ideal points corresponds to a higher likelihood of geopolitical tensions between the two countries. These data are available from the Harvard Dataverse (https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/12379).

5.1. Results

We estimate equation (2) using the two alternative proxies for geopolitical tensions and present the results in Table VI. For each geopolitical proxy we estimate two models, the first does not include institutional controls allowing us to use the full sample period (i.e. 1984-2013) and the second includes the full set of controls which restricts the sample to start in 1996.

For military spending we are interested in the interaction term between the military spending in the source/origin country and the military spending in the recipient country (i.e. A × B in the table). We can see from Model 1 that this interaction term is negative and significant at the 1% level implying that, other things equal, higher military spending in either

[27] See "EU members abstain as Britain defeated in UN vote on Chagos Islands" by Owen Bowcott, June 23, 2017, The Guardian: https://www.theguardian.com/world/2017/jun/22/un-vote-backing-chagos-islands-a-blow-for-uk (accessed November 15, 2017).

the origin and/or the recipient country lowers bank flows between the two countries. However in Model 2, we can see that once controls are added the interaction term is no longer significant. There are two reasons for this. First, the economic and institutional control variables are correlated with military spending. Second, in this model we lose the 1984-1995 period corresponding to the Cold War era when military spending was arguably a better indicator for geopolitical tensions.

Since, as we have mentioned, military spending is not a dyadic measure we focus on our alternative measure based on UN voting. We present the result from estimating equation (2) using this proxy in Models 3 and 4. We can see that for both models the coefficient estimate on the ideological distance between source and recipient countries is negative and significant implying that greater ideological distances and thus higher geopolitical tensions between source and recipient countries reduces bank flows between the countries. The point estimate in Model 4 with the full list of controls suggests that a 1-point increase in ideological distance is associated with a decline in bank flows from source to recipient country by about 4%.

A common concern in the literature employing cross-country data is that omitted variables may be driving any reported result (see for example, Bekaert, Harvey and Lundblad, 2005; Bekaert, Harvey and Lundblad and Siegel, 2007). Our setting allows us to take the following steps to ensure this is not the case for us. From equation (2), for our dyadic time varying geopolitical proxy, ideological distance, we drop all control variables and instead we include both origin country-year and host country-year fixed effects into the specification. Doing so allows us to control for all time varying heterogeneity at the source country *and* the host country.[28] Further, that average of the fixed effects within country

[28] We cannot do this for our military spending measure as this measure only varies at the country-year level and so country year fixed effects absorbs all of the impact.

accounts for time invariant heterogeneity while the average of the fix-effects across countries accounts for common time shocks. We re-estimate the model and present the result in Model 5 of Table VI. Our findings are robust to this specification and so our result is unlikely driven by omitted variables. The point estimate falls to 1.5% suggesting that a 1-point increase in ideological distance between source and host countries is associated with a decline in bank flows by 1.5% annually.

5.2. The Economic Channels

These findings are consistent with those reported earlier documenting a reduction in flows from China to countries hosting the Dalai Lama and whose head of state meets with the Dalai Lama. However, while the economic channel through which geopolitics influences bank flows from China is clear (i.e. the Chinese government is able to influence the allocation of capital through the state owned bank system), it is less clear in this setting given countries like the US and UK are in the sample whose banking systems do not have government ownership in modern times.

We identify two potential mechanisms through which the reduction in bank flows due to geopolitical tensions might occur. The first, as is the case with China, is simply that the result is concentrated in countries where there is official state involvement in the banking sector thus affording the state power over the allocation of bank credit. The second mechanism is that for privately owned banks, for example, like those in the US, rising geopolitics tensions between the US and other countries will increase the credit risk of loans to those countries. Banks may then contract lending to those countries as part of their routine credit risk management strategies. Indeed, both the banks and the regulators worldwide recognise political risk factors as being an important consideration in credit risk management strategies for overseas lending. For example, the Office of the Comptroller of the Currency

(OCC) 2016 publication *Safety and Soundness Handbook on Country Risk Management* explicitly states the banks need to be aware of and manage risks associated with political developments that might increase not only credit risk exposures but also interest rate, reputational and strategic risk.

To investigate which channel dominates we use Bureau van Dijk Bankscsope data to calculate two country-level variables to capture the degree of state involvement in a country's banking sector over our sample period. Bankscsope covers about 80-90% of banking assets in each country. The country level variables are calculated based on firm-level data. There two variables of interest: (1) % *of Banking Assets held by Banks with Government Ownership* which is the percentage of total banking assets held by banks where the government has some ownership position in those banks; (2) % *of Banking Assets held by Banks with Dominant Government Ownership* is the percentage of total banking assets held by banks where the government is the dominant owner in those banks (i.e. state owned and controlled banks).

We take Models 2 and 4 from Table VI and introduce these variables (one at a time) along with their interaction with our proxy for geopolitical tensions (i.e. military spending and ideological distance).[29] The results are presented in Table VII, odd numbered models use % *of Banking Assets held by Banks with Government Ownership* and even numbered models use % *of Banking Assets held by Banks with Dominant Government Ownership*. Further, Models 1 and 2 use the interaction of military spending in the origin with that of the source country as our proxy for geopolitical tensions, whereas Models 3 and 4 use the ideological distance between source and recipient countries as the geopolitical proxy. Although the military spending is not an ideal proxy for geopolitical tensions, and that the results are not statistically significant, we do find that the coefficients of interest are of the correct sign: the

[29] Note that since our bank ownership variables vary at the country-year level we cannot include country-year fixed effects which will absorb all of the variation of interest.

interaction between military spending in the origin country with that of the source country is negative and the interaction with this variable and the proxy for degree of government ownership is negative, suggesting that the economic channel might be through state ownership in the banking sector.

We confirm this result in the subsequent two models which use ideological distance as our measure of geopolitical tensions. Recall that prior to introducing these state ownership variables, ideological distance impacts bank flows negatively and significantly. However, in both Models 3 and 4, when we introduce the state-ownership variables along with their interactions with ideological distance (i.e. C × D and C × E in the table) we can see that the impact of ideological distance on bank flows is concentrated in countries where there is state involvement in the banking sector. That is, the interaction term between state-ownership and ideological distance is negative and significant, while the coefficient on ideological distance becomes insignificant.

Altogether, in this section, we establish that geopolitical tensions are associated with declines in international bank flows in a broad panel of countries. We also identify the channel through which this effect operates: official state involvement (i.e. ownership) in the banking sector allows governments to influence the international allocation of bank credit.

6. Conclusion

Do geopolitical considerations influence the international allocation of capital? In this paper, we provide the evidence that indeed they do. We begin by using the timing of Dalai Lama visits as a unique source of time varying political tensions between China and other countries to show that in the year following a visit where he personally meets with either the Prime Minister or President of the host country, bank flows from China to that country fall by between 12 and 17 percent. This finding is robust to a number of alternative

specifications, alternative samples and two-stage least squares estimation to address endogeneity concerns. We also find consistent, albeit weaker, evidence of a similar effect on FDI.

Next, we employ a measure of ideological distance calculated from UN voting as a proxy of geopolitical tensions between countries and find that greater distances are associated with lower bank flows between those countries. We investigate the mechanism behind this result and find that the effect is concentrated in countries where the government has some ownership in the banking sector. As such we interpret the result to imply that governments, via their ownership, can direct the flow of international credit according to diplomatic considerations. We therefore present the first evidence that international political relations *between* countries matters for the allocation of capital globally. Future research should focus on the interaction between geopolitics, finance *and* trade.

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Appendix

Table AI
Variable Definitions and Data Sources

Variable	Description	Source
Percentage Change of Bank Flow	Log change in banks flows from country i to country j, between t-1 and t	Bank for International Settlements (locational banking statistics)
Dalai Lama visit at t-1	Indicator equal 1 if the Dalai Lama visits a county in year t-1	Office of His Holiness the 14th Dalai Lama (https://www.dalailama.com/)
Dalai Lama visit without meetings with Head of State at t-1	Indicator equal 1 if the Dalai Lama visits a county in year t-1 and does NOT meet with the current Prime Minister or President	Office of His Holiness the 14th Dalai Lama (https://www.dalailama.com/)
Dalai Lama visit with meetings with Head of State at t-1	Indicator equal 1 if the Dalai Lama visits a county in year t-1 and does meet with the current Prime Minister or President	Office of His Holiness the 14th Dalai Lama (https://www.dalailama.com/)
Log(GDP)	Log of US dollar Gross Domestic Product	World Bank (Development Indicators)
Institutionalized Autocracy/Democracy	Index ranging from -10 to 10 with higher values associated with higher degrees of institutionalized democracy	Polity IV Project (http://www.systemicpeace.org/polity/polity4.htm)
Control of Corruption	Index ranging from -2.5 to 2.5 with higher values associated with better governance. Control of corruption captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.	World Bank (Worldwide Governance Indicators)

Table AI (continued)

Government Effectiveness	Index ranging from -2.5 to 2.5 with higher values associated with better governance. Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.	World Bank Worldwide Governance Indicators (http://info.worldbank.org/governance/wgi/#home)
Political Stability and Absence of Violence/Terrorism	Index ranging from -2.5 to 2.5 with higher values associated with better governance. Political Stability and Absence of Violence/Terrorism measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism.	World Bank Worldwide Governance Indicators (http://info.worldbank.org/governance/wgi/#home)
Rule of Law	Index ranging from -2.5 to 2.5 with higher values associated with better governance. Rule of law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.	World Bank Worldwide Governance Indicators (http://info.worldbank.org/governance/wgi/#home)

Table AI (continued)

Regulatory Quality	Index ranging from -2.5 to 2.5 with higher values associated with better governance. Regulatory quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.	World Bank (Worldwide Governance Indicators)
Voice and Accountability	Index ranging from -2.5 to 2.5 with higher values associated with better governance. Voice and accountability captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.	World Bank (Worldwide Governance Indicators)
Military Spending over GDP	Ratio of military spending to gross domestic product	SIPRI Military Expenditure Database (https://www.sipri.org/databases/milex)
Ideology Distance between Recipient Country and Origin Country	A dyadic measure of ideological distance between countries based on United Nations voting patterns with higher values corresponding to larger ideological differences between countries	Michael Bailey, Anton Strezhnev and Erik Voeten 2017 (https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/12379)
% of Banking Assets held by Banks with Government Ownership	Percentage of total (country level) banking assets held by banks where the government has some ownership position in those banks	BvD Bankscope
% of Banking Assets held by Banks with Dominant Government Ownership	Percentage of total (country level) banking assets held by banks where the government is the dominant owner in those banks (i.e. state owned banks)	BvD Bankscope

Table AII
The Dalai Lama Effect: Foreign Direct Investment

This table replicates the results in Table II Model 6 and Table III Models 1-5 (i.e. robustness) using an alternative dependent variable. Precisely, the table presents ordinary least squares estimates of the gravity model described in equation (1) for the period between 2003 and 2013 (inclusive) except the dependent variable is the percentage change in foreign direct investment (FDI) from China to country j between time t-1 and t (rather than bank flows). The independent variable of interest is *Dalai Lama visit with meetings with Head of State at t-1* which is an indicator equal to one if the Dalai Lama visits country j in year t-1 and also meets with the current Prime Minister or President of country j during the visit, and zero otherwise. Complete variable definitions and data sources are contained in Table AI in the appendix. Unless otherwise stated, robust standard errors clustered by country are in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

	(1)	(2)	(3)	(4)	(5)	(6)
	Baseline	Two-Way Clustering (by country and year)	Quantile Regression	Winsorized Dependent Variable	Country Specific Time Trend	Pre-Financial Crisis Period (2003-2007)
Dalai Lama visit with meetings with Head of State at t-1	-90.09	-90.09*	-13.42	-78.40	-96.61	-57.53***
	(57.58)	(46.69)	(33.31)	(48.93)	(64.28)	(13.40)
Log(GDP)	-15.90	-15.90	-59.37	-14.55	35.23	135.6
	(36.71)	(11.13)	(38.68)	(36.67)	(128.3)	(154.1)
Institutionalized Autocracy/Democracy	-3.883	-3.883	-2.663	-3.787	-5.148	-10.20
	(4.477)	(4.088)	(6.502)	(4.473)	(7.842)	(10.75)
Control of Corruption	65.14	65.14**	43.69	59.49	156.7*	226.7
	(52.63)	(27.94)	(83.84)	(51.24)	(91.28)	(164.2)
Government Effectiveness	31.37	31.37	66.22	33.64	6.473	-47.92
	(62.47)	(46.76)	(86.03)	(62.16)	(100.8)	(128.0)
Political Stability and Absence of Violence/Terrorism	-11.12	-11.12	-28.15	-11.18	-45.15	-70.82
	(23.68)	(26.37)	(29.44)	(23.58)	(48.78)	(68.30)
Rule of Law	-21.96	-21.96	45.19	-20.89	-34.82	-109.8
	(63.44)	(109.5)	(83.62)	(63.19)	(102.2)	(168.5)

Table AII continued

Regulatory Quality	-38.69	-38.69	-61.49	-38.59	-111.2	-12.91
	(52.12)	(25.93)	(55.24)	(51.25)	(97.61)	(156.7)
Voice and Accountability	39.44	39.44	100.1	39.18	48.19	56.01
	(71.39)	(71.59)	(94.76)	(71.02)	(99.59)	(146.7)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	765	765	765	765	765	258
R-squared	0.088	0.088	0.033	0.089	0.195	0.283

Figure I
Map of Dalai Lama Visits with Meeting with Head of State

This figure shows the geographical distribution of 77 Dalai Lama visits where he met with either a sitting Prime Minister or President between 2000 and 2013.

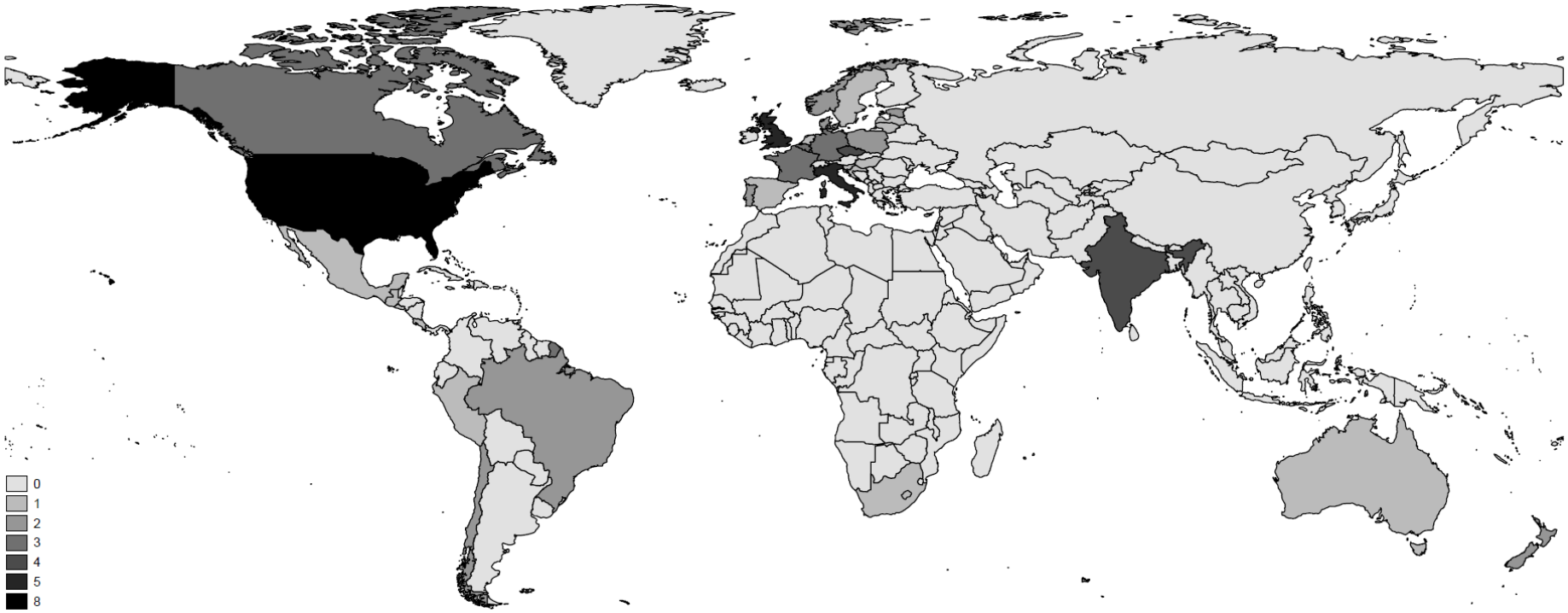

Figure II
Chinese Bank Flows around Dalai Lama Visits

This figure plots the *difference* in the average percentage change in bank flows from China to countries where the Dalai Lama visited and met with the head of state (i.e. treatment countries) and other (i.e. control) countries around Dalai Lama visits at t = -1. The solid blue line is the difference in means whereas the red dashed line is the difference in medians.

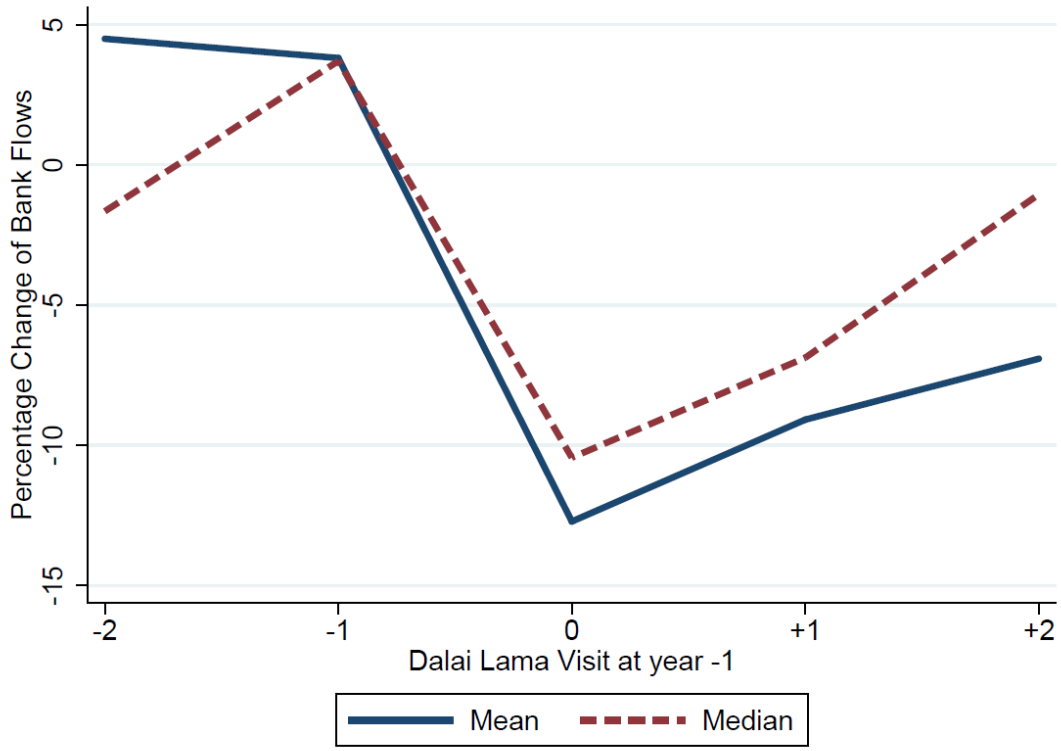

Table I
Summary Statistics

This table presents summary statistics for the main variables used in our analysis for the period between 2000 and 2013. Variable definitions and data sources are contained in Table AI in the appendix.

	Obs.	Mean	Std. Dev.	p = 0.25	p = 0.50	p = 0.75
Percentage Change of Bank Flow	1049	9.163	53.395	-17.512	10.536	35.376
Dalai Lama visit at t-1	1049	0.104	0.305	0	0	0
Dalai Lama visit without meetings with Head of State at t-1	1049	0.059	0.236	0	0	0
Dalai Lama visit with meetings with Head of State at t-1	1049	0.045	0.207	0	0	0
Log(GDP)	1049	25.596	1.734	24.158	25.623	26.699
Institutionalized Autocracy/Democracy	974	7.148	4.803	7	9	10
Control of Corruption	961	0.498	1.044	-0.363	0.294	1.354
Government Effectiveness	961	0.634	0.881	-0.09	0.555	1.461
Political Stability and Absence of Violence/Terrorism	961	0.182	0.902	-0.444	0.372	0.925
Rule of Law	961	0.488	0.968	-0.381	0.545	1.343
Regulatory Quality	961	0.64	0.801	0.023	0.634	1.31
Voice and Accountability	961	0.525	0.811	-0.111	0.637	1.167

Table II
The Dalai Lama Effect: Baseline Results

This table presents ordinary least squares estimates of the gravity model described in equation (1) for the period between 2000 and 2013 (inclusive). The dependent variable is the percentage change in bank flows from China to country j between time t-1 and t. The independent variable of interest is *Dalai Lama visit with meetings with Head of State at t-1* which is an indicator equal to one if the Dalai Lama visits country j in year t-1 and also meets with the current Prime Minister or President of country j during the visit, and zero otherwise. Complete variable definitions and data sources are contained in Table AI in the appendix. Robust standard errors clustered by country are in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

	(1)	(2)	(3)	(4)	(5)	(6)
Dalai Lama visit at t-1	-3.134					
	(3.261)					
Dalai Lama visit without meetings with Head of State at t-1		4.969				
		(4.537)				
Dalai Lama visit with meetings with Head of State at t-1			-12.41***	-12.52***	-12.47***	-17.35***
			(4.068)	(4.079)	(4.093)	(4.716)
Log(GDP)				15.83	15.66	11.09
				(9.512)	(9.743)	(9.466)
Institutionalized Autocracy/Democracy					0.606	1.025
					(0.681)	(1.145)
Control of Corruption						16.01
						(11.82)
Government Effectiveness						2.368
						(11.31)
Political Stability and Absence of Violence/Terrorism						8.970
						(8.589)
Rule of Law						-23.82
						(20.85)

Table II continued

Regulatory Quality						0.932
						(12.72)
Voice and Accountability						-2.400
						(13.69)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,049	1,049	1,049	1,049	974	905
R-squared	0.407	0.408	0.409	0.412	0.412	0.440

Table III
The Persistence of the Dalai Lama Effect

This investigates the persistence of the effect documented in Model 6 of Table III. The dependent variable is the percentage change in bank flows from China to country j between time t-1 and t. The independent variable of interest is *Dalai Lama visit with meetings with Head of State at t-2 (t-3)* which is an indicator equal to one if the Dalai Lama visits country j in year t-2 (t-3) and also meets with the current Prime Minister or President of country j during the visit, and zero otherwise. Complete variable definitions and data sources are contained in Table AI in the appendix. Robust standard errors clustered by country are in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

	(1)	(2)
Dalai Lama visit with meetings with Head of State at t-2	-5.039	
	(8.373)	
Dalai Lama visit with meetings with Head of State at t-3		0.140
		(6.990)
Log(GDP)	11.28	9.709
	(10.18)	(10.08)
Institutionalized Autocracy/Democracy	0.709	0.748
	(1.366)	(1.380)
Control of Corruption	5.805	7.399
	(13.51)	(13.27)
Government Effectiveness	6.555	9.151
	(12.76)	(12.50)
Political Stability and Absence of Violence/Terrorism	5.880	5.321
	(8.982)	(8.968)
Rule of Law	-16.02	-17.75
	(20.38)	(20.29)
Regulatory Quality	7.047	7.493
	(15.20)	(15.23)
Voice and Accountability	-2.994	-3.417
	(16.84)	(16.79)
Country Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Observations	837	836
R-squared	0.374	0.375

Table IV
Robustness of the Dalai Lama Effect

This investigates the robustness of the effect documented in Model 6 of Table III. The dependent variable is the percentage change in bank flows from China to country j between time t-1 and t. The independent variable of interest is *Dalai Lama visit with meetings with Head of State at t-1* which is an indicator equal to one if the Dalai Lama visits country j in year t-1 and also meets with the current Prime Minister or President of country j during the visit, and zero otherwise. Complete variable definitions and data sources are contained in Table AI in the appendix. Robust standard errors clustered by country are in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

	(1) Two-Way Clustering (by country and year)	(2) Quantile Regression	(3) Winsorized Dependent Variable	(4) Country Specific Time Trend	(5) Pre-Financial Crisis Period (2000-2007)	(6) Extended Sample (1984-2013)
Dalai Lama visit with meetings with Head of State at t-1	-17.35***	-15.72***	-16.18***	-14.53***	-16.68**	-16.53***
	(3.560)	(3.822)	(4.133)	(4.822)	(7.096)	(4.593)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	905	905	905	905	485	1,008
R-squared	0.440	0.397	0.499	0.497	0.331	0.390

Table V
The Dalai Lama Effect: Instrumental Variables

This table presents two-stage least squares estimates of the gravity model described in equation (1) for the period between 2000 and 2013 (inclusive). Panel A presents the first stage results. Panel B presents the results from diagnostic testing. Panel C presents the second stage results. The dependent variable is the percentage change in bank flows from China to country j between time t-1 and t. The independent variable of interest is *Dalai Lama visit with meetings with Head of State at t-1* which is an indicator equal to one if the Dalai Lama visits country j in year t-1 and also meets with the current Prime Minister or President of country j during the visit, and zero otherwise. We use three instruments: (1) *Dalai Lama visit at t-1* which is an indicator equal one if the Dalai Lama visits country j in year t-1, and zero otherwise (regardless of with he meets with the head of state of not); (2) *Length of Visit at t-1* is the natural logarithm of the number of days he visits country j for in year t-1; and (3) *Distance at t-1* is the natural logarithm of minimum distance between any pair of countries in a given trip itinerary. Complete variable definitions and data sources are contained in Table AI in the appendix. Robust standard errors clustered by country are in parentheses in Panels A and C. P-values are in paratheses in Panel B. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Panel A: First Stage	(1)	(2)	(3)	(4)
Dalai Lama visit at t-1	0.419***			0.434***
	(0.0604)			(0.0787)
Length of visit at t-1		0.0112***		0.00106
		(0.00392)		(0.00171)
Distance at t-1			-3.87e-05***	8.83e-06
			(1.34e-05)	(1.44e-05)
Economic and Institutional Controls	Yes	Yes	Yes	Yes
Country Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes

Table V (continued)

Panel B: Diagnostic Tests				
Endogeneity test. H0: X is exogenous				
χ^2 Statistic	0.205	1.169	0.025	0.03
	(0.6504)	(0.2795)	(0.8749)	(0.8634)
Underidentification test. H0: equation is underidentified				
Kleibergen-Paap rk LM statistic	20.103	6.71	8.615	20.485
	(0.000)	(0.009)	(0.003)	(0.000)
Weak identification test. H0: equation is weakly identified				
Cragg-Donald Wald F statistic	438.882	58.486	60.104	147.97
Kleibergen-Paap rk Wald F statistic	48.134	8.107	8.263	17.179
Stock-Yogo weak ID test critical values	5.53-16.38	5.53-16.38	5.53-16.38	5.39-22.30
Overidentification test. H0: instruments are jointly valid				
Hansen J statistic	n/a	n/a	n/a	1.498
				(0.473)

Table V (continued)

Panel C: Second Stage				
Dalai Lama visit with meetings with Head of State at t-1	-14.39**	-2.186	-14.81	-14.16*
	(7.359)	(9.875)	(17.27)	(7.354)
Log(GDP)	11.09	11.07	11.09	11.09
	(8.928)	(8.983)	(8.925)	(8.929)
Institutionalized Autocracy/Democracy	1.017	0.985	1.018	1.017
	(1.079)	(1.083)	(1.086)	(1.079)
Control of Corruption	15.92	15.56	15.93	15.91
	(11.19)	(11.22)	(11.20)	(11.19)
Government Effectiveness	2.743	4.289	2.691	2.773
	(10.67)	(10.82)	(10.71)	(10.68)
Political Stability and Absence of Violence/Terrorism	8.792	8.056	8.817	8.777
	(8.054)	(8.167)	(8.134)	(8.054)
Rule of Law	-23.51	-22.24	-23.56	-23.49
	(19.68)	(19.74)	(19.66)	(19.68)
Regulatory Quality	0.569	-0.925	0.620	0.540
	(12.00)	(11.99)	(11.86)	(12.02)
Voice and Accountability	-2.174	-1.244	-2.206	-2.156
	(12.93)	(13.08)	(13.05)	(12.93)
Country Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Observations	905	905	905	905
R-squared	0.424	0.422	0.424	0.424

Table VI
Geopolitics and Bank Flows: Evidence from Large Panel of Countries

This table presents ordinary least squares estimates of the gravity model described in equation (2) for the period between 1984 and 2013 (inclusive) for a panel of 25 origin countries and 76 recipient countries. The dependent variable is the percentage change in bank flows from country i to country j between time t-1 and t. The independent variables of interest are (1) the interaction between Military Spending over GDP at Origin Country and Military Spending over GDP at Recipient Country (i.e. A × B); and (2) Ideology Distance between Recipient Country and Origin Country. Complete variable definitions and data sources are contained in Table AI in the appendix. Robust standard errors clustered by country-pair are in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

	(1)	(2)	(3)	(4)	(5)
Military Spending over GDP at Origin Country [A]	2.121	9.322***			
	(1.536)	(3.585)			
Military Spending over GDP at Recipient Country [B]	1.523**	-2.866			
	(0.768)	(2.719)			
A X B	-0.696***	0.611			
	(0.181)	(1.562)			
Ideology Distance between Recipient Country and Origin Country			-2.269***	-4.271**	-1.554***
			(0.856)	(1.932)	(0.571)
Log(GDP) at Recipient Country		17.46***		17.64***	
		(3.094)		(2.904)	
Institutionalized Autocracy/Democracy at Recipient Country		-0.552		-0.372	
		(0.485)		(0.485)	
Control of Corruption at Recipient Country		2.637		4.140	
		(3.741)		(3.680)	
Government Effectiveness at Recipient Country		1.313		2.664	
		(4.403)		(4.412)	
Political Stability and Absence of Violence/Terrorism at Recipient Country		5.019*		4.722*	
		(2.569)		(2.598)	

Table VI (continued)

Rule of Law at Recipient Country		-24.76***		-22.73***	
		(5.742)		(5.735)	
Regulatory Quality at Recipient Country		17.21***		14.20***	
		(3.824)		(3.907)	
Voice and Accountability at Recipient Country		6.574		4.304	
		(4.822)		(4.731)	
Country-Pair Fixed Effects	Yes	Yes	Yes	Yes	No
Year Fixed Effects	Yes	Yes	Yes	Yes	No
Origin Country-Year Fixed Effects	No	No	No	No	Yes
Recipient Country-Year Fixed Effects	No	No	No	No	Yes
Observations	24,449	15,423	26,712	16,132	26,712
R-squared	0.235	0.290	0.229	0.284	0.386

Table VII
The Role of State Bank Ownership

This table investigates the mechanism behind the results reported in Models 2 and 4 of Table VI. The dependent variable is the percentage change in bank flows from country i to country j between time t-1 and t. We use two proxies for state involvement in the banking sector: (1) % of Banking Assets held by Banks with Government Ownership is the percentage of bank assets that are controlled by banks in which the government has some degree of ownership; (2) % of Banking Assets held by Banks with Dominant Government Ownership is the percentage of bank assets that are controlled by banks where the government is the dominant owner (i.e. state owned banks). The independent variables of interest are the interactions between these state ownership variables with (1) the interaction between Military Spending over GDP at Origin Country and Military Spending over GDP at Recipient Country (i.e. A × B × D and A × B × E); and (2) Ideology Distance between Recipient Country and Origin Country (i.e. C × D). Complete variable definitions and data sources are contained in Table AI in the appendix. Robust standard errors clustered by country-pair are in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

	(1)	(2)	(3)	(4)
Military Spending over GDP at Origin Country [A]	12.32***	12.05***		
	(2.677)	(2.667)		
Military Spending over GDP at Recipient Country [B]	-0.543	-0.605		
	(2.270)	(2.275)		
A × B	-0.604	-0.588		
	(0.955)	(0.946)		
Ideology Distance between Recipient Country and Origin Country [C]			-2.152	-2.225
			(2.047)	(2.040)
% of Banking Assets held by Banks with Government Ownership [D]	10.77**		17.36***	
	(4.979)		(4.901)	
% of Banking Assets held by Banks with Dominant Government Ownership [E]		12.37**		18.94***
		(5.214)		(5.449)
A × B × D	-1.544			
	(1.340)			
A × B × E		-1.765		
		(1.289)		

Table VII (continued)

C × D			-9.555***	
			(2.751)	
C × E				-9.717***
				(2.782)
Economic and Institutional Controls	Yes	Yes	Yes	Yes
Country-Pair Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Observations	15,360	15,333	16,069	16,042
R-squared	0.291	0.291	0.285	0.285