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State-Owned MNCs and Host Country Expropriation Risk:
The Role of Home State Soft Power and Economic Gunboat Diplomacy

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Abstract

Expropriation risk has a binding effect on foreign direct investment (FDI). However, state-owned multinational corporation (MNCs) may counter the monopoly power of the host state by leveraging the political influence of their home government. The magnitude of this counter force, we argue, may vary, depending on the strength of political relations between the home and host state, and the level of economic dependence of the host country on the home market. We find supporting evidence of our hypotheses using Chinese firm level FDI information between 2003 and 2010.

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1 INTRODUCTION

The perils of expropriation risk on foreign direct investment (FDI) are well documented in the literature (Overholt, 1982; Eaton & Gersovitz, 1984; Caprio, Faccio, & McConnell, 2011). Recent survey data also shows that expropriation risk is the top concern for multinational corporations (MNCs) from both developed and developing countries alike, and far exceed other obstacles such as access to finance, rigid labor market regulations, and macroeconomic instability (World Bank, 2009, 42). The current literature has analysed how MNCs could adopt various strategies such as adjusting leverage level and equity control, employing advanced technologies, or using foreign aid to mitigate expropriation risk (Asiedu & Esfahani, 2001; Asiedu, Jin & Nandwa, 2009; Kesternich & Schnitzler, 2010; Opp, 2012). We depart from these studies by focusing on a special type of MNCs, state-owned MNCs, and examining how international political factors can mitigate their exposure to expropriation risk. We are motivated by the research gap that there is relatively few systematic studies on the role of state-owned MNCs as new promoters of international business. The focus on conventional privately owned MNCs, mostly from western countries, has also marginalized the role of nation states and international political factors in influencing FDI (Murtha & Lenway, 1994).

But history provides us with many examples that nation states leverage their political powers to promote commerce and other national interests (e.g. Findlay & O'Rourke, 2007; Berger, et al., 2013); and firms respond to political factors in their trade and FDI decisions (e.g. Biglaiser & DeRouen, 2007; Li & Vashchilko, 2010). Recent financial crisis sweeping western world has in some ways made state ownership of enterprises less exceptional (Pargendler, 2012). According to a recent survey, state-owned-enterprises (SOEs) are now responsible for approximately one-fifth of global stock market value, which is more than twice the level observed just one decade ago (Economist, 2010). More notably, SOEs are becoming new and significant players in global markets. This provides us with an opportunity to understand how state

ownership and international political factors may extenuate the barriers of international investment, among which host country expropriation risk is the most binding one.

Theoretically, we view the relationship between MNCs and host government as a special type of principal-agent nexus. The vulnerability of MNCs, as the principal, stems from the host government's position as the monopoly of legitimate violence and the ultimate arbitrator of contracts in the host country (Acemoglu, 2003; Acemoglu & Johnson, 2005). However, when the MNC is a state-owned entity, the MNC acts as an agent on the behalf of its principal – its home government, which we argue, may help counter the power asymmetry between the MNC and the host government. The magnitude of the counter force may increase with the strength of home-host political relations because close political relations may reduce the potential benefit of host government expropriation. Conversely, when the host country relies on the home country as its export market, the home government may use economic coercion to elicit cooperative behaviour, thereby reducing the risk exposure of its SOEs.

We base our empirical analysis on Chinese firms' outward FDI. Despite large scale corporation in the 1990s similar to other countries, China remains deeply committed to state ownership and control of enterprises. The conventional view of corporation strategy is that it is a first step in the transition towards private control of enterprise. The goal of the Chinese state was arguably the reverse, that is, to increase state control of economic activity through leverage and its long-term political survival (Clarke, 2003). Although the absolute number of SOEs has declined since privatization in the 1990s, today's SOEs are more powerful and politically charged than ever¹. The recent "go-global" campaign has forged massive state-owned and state-controlled national champions that are designed to be competitive on the international stage (Wooldridge, 2012). In addition, China's outward FDI is often portrayed as politically motivated. With phenomenal economic growth in the past decades, China is rapidly emerging as a significant economic as well as political power in an increasingly multi-polar world. Nevertheless, it remains to be a developing country and considers itself an advocate for developing countries. This may give the Chinese authority an unparalleled political leverage among developing countries, where the risk

of host expropriation tends to be high. As a result, China provides an ideal setting to study state-owned MNC and political factors on FDI.

Using Chinese firm level greenfield FDI information between 2003 and 2010, we find that although expropriation risk reduces Chinese firms' FDI, the negative impact is significantly and positively moderated by the level of state ownership in the enterprise. In addition, the level of state ownership induces firms to increase investment in countries with high expropriation risk but strong political relations with China, or high export dependency on the Chinese market. Our findings support a political economy based argument that in a bilateral context, inter-state relations can have an institutional function compensating the lack of credible government commitment. The research therefore adds to the growing literature in international business (IB) area on the relationship between ownership structure and firms' internationalization (Fernandez & Nieto, 2006; Filtotchev, Strange, Piesse, & Lien, 2007; Bhaumik, Driffield, & Pal, 2010; Wang, Hong, Kafourous, & Wright, 2012), and on international political factors on FDI flows (e.g. Nigh, 1985; Li & Vashchilko, 2010; Biglaiser & Lektzian, 2011).

We structure the remainder of the paper as follows. We introduce the theoretical background and develop our hypotheses in Section two. We explain our empirical strategy in Section three. Our empirical results are reported in Section four. We discuss policy and managerial implications in Section five.

2 THEORIES AND HYPOTHESIS DEVELOPMENT

2.1 Theoretical background

We define expropriation risk as the deficiencies of a country's protection of private property rights, especially their protection against government expropriation (De Long & Shleifer, 1993; Jones, 1981; Olson, 2000). Expropriation occurs when a host government interferes with a foreign investor's fundamental ownership rights. This can take the form of a direct seizure of assets or it can be through a series of discriminatory actions, often called "creeping expropriation" (Kesternich & Schnitzer, 2010).

Based on the predatory theory of the state (North, 1981), the state is an instrument for transferring resources from one group to another. Property rights institutions are intimately linked to the distribution of political power in society. When property rights institutions fail to constrain those who control the state, it is not possible to circumvent the ensuing problems by writing alternative contracts to prevent future expropriation.

In this view, when an MNC sets up a subsidiary in a host country, it also steps into, implicitly or explicitly, a contract with the host state under which the host state is expected to protect and refrain from expropriating the MNC's local operations (Asiedu, Jin & Nandwa, 2009). The vulnerability of foreign MNCs stems not only from the incomplete nature of the contract that cannot anticipate all future contingencies (Bull, 1987; Levin, 2003), but also the fact that the state holds the final arbitration power on contracts (North, 1981; Acemoglu, 2003; Acemoglu & Johnson, 2005). As Djankov et al (2003) succinctly summed up: state powerful enough to enforce contracts and secure property rights can also use this power for its own benefit. In comparison to the power concentrated in the typical national government, there is no equivalent at the international level, limiting the extent to which national governments can be punished for violations of contractual obligations (Opp, 2012). Consequently, unchecked government opportunism will dampen transactions that are transnational. Expropriation risk has a profound negative impact on FDI compared to other types of international investment because much of the costs associated with FDI are sunk and therefore cannot be recouped if disinvestment occurs (Asiedu, Jin, & Nandwa, 2009). Although outright expropriation has become rare in recent decades (Li, 2009), there is a wide range of government policies that can reduce the profitability of foreign investment. Therefore, variations in the credibility of government commitment to particular policy frameworks, or in the stability of the institutions that support those commitments may explain variations of foreign direct investment (North & Thomas, 1973; North & Weingast, 1998).

What the literature has not tackled is that when the MNC is owned by a state, instead of a private investor, the power asymmetry between the MNC and the host government can be substantially reduced. In addition, the magnitude of risk-reduction of home government may vary across inter-state political and

economic relations. Therefore, we integrate the inter-state relational context into firms' FDI decisions.

We proceed to develop our hypotheses in details.

2.2. Hypothesis development

The importance of examining the causal linkage between firm's ownership structure and their internationalization strategies rests on micro-firm theories that different types of ownership arrangement render agents with different risk preference and decision-making horizon (e.g. Jensen & Meckling, 1976). Past research focuses on the internal governance structure giving rise to different sets of incentives and abilities that influence firms' internationalization with respect to foreign (Filatotchev et al., 2008), family (Bhaumik, Driffield, & Pal, 2010), and corporate ownership (Lien et al., 2005; Fernandez & Nieto, 2006). We complement the literature by analysing why, in their FDI decisions, state-owned MNCs may respond to expropriation risk in different ways from their private counterparts.

When an MNC invests in a host country, its relationship with the host government can be viewed as a type of principal-agent nexus, under which the MNC has the responsibility to achieve its owner's business goals and the host government should provide institutional support for the MNC (or more precisely, the local subsidiary, which we view as an integrated part of MNC) to operate. Agency costs may arise when the host government prefers to expropriate (the subsidiary of) the foreign MNC due to political opportunism and short-term benefits (Tomz, 1997), namely, its interest diverges from that of the principal. The MNC could reduce the agency costs by aligning its local operation with the economic or political agenda of the host government, or by breaking the investment into several stages, thus turning it into an on-going interaction in which host country credibility may be easier to achieve. But it cannot eliminate such risk because of the sovereign status of national governments. The lack of international governance, especially with respect to FDI, means that MNCs have little recourse when facing host expropriation. However, when the MNC is owned by a home state instead of a private investor, it could leverage the political influence of its home government. Being the principal of its SOEs, the home government should have incentive as well as ability to legitimately retaliate the host government in case of expropriation. Therefore, the dual role of state-owned MNCs, one being the principal of the assets and

facilities of the foreign operation, and the other being the agent of their home government for undertaking FDI abroad, reduces the power asymmetry between the MNCs and a host government. This can significantly increase the cost of expropriation for the host government, and consequently reduce risk exposure for state-owned MNCs.

Our micro-based analysis is consistent with numerous discussions in the literature. For example, SOEs often have non-economic goals that distinguish them from profit-maximizing private business (Ellstrand, Tiyanyi, & Johnson, 2002). The political agenda of the state may compel SOEs to engage in risky FDI to fulfil political missions, such as securing energy to fuel domestic economic growth, accessing advanced technologies, and increasing geopolitical influence (Chen, 2008; Gill & Reilly, 2007). Therefore, SOEs' FDI could operate as the spearheads of a developmental and geopolitical vision that emanates primarily from the central state (Gozales-Vincente, 2001). For example, Chinese state investment has been active in developing world-class refining facilities in partnership with the Organization of the Petroleum Exporting (OPEC) countries to secure energy supply for China's economic growth. Several members such as Algeria, Saudi Arabia, and Venezuela receive large sum of Greenfield FDI by Chinese SOEs in infrastructure and extraction industry despite high level of expropriation risk in these countries (World Bank, 2008). The risk-aversion that usually characterizes private business has to give way to non-economic goals that the state places on SOEs. These state-imposed goals will justify the state to provide more direct intervention and supervision to facilitate SOEs' internationalization. This is consistent with the political capability argument that SOEs have privileged access to or direct ties with pivotal political actors in their home country, which will give them more information, experience, and resources to develop specific routines both to identify risk *ex ante* and to influence political actors to mitigate expropriation risk *ex post* (Delios & Henisz, 2003; Holburn & Zelner, 2010). In case of expropriation, the home state, as the ultimate principal of its SOEs, will have strong financial and political incentives to build a reputation as a retaliatory principal, in order to avoid expensive future SOE bailouts (Knutsen, Rygy, & Hveem, 2011). Therefore, our first hypothesis is:

Hypothesis 1: State ownership positively moderates the negative impact of expropriation risk on the firm's FDI.

Furthermore, the magnitude of the risk-reduction function of the home state may vary, depending on the strength of home-host political relations. This is because, by definition, FDI flows from an origin to a destination country. The “bilateral” context may have an externality on the calculus of host government decision of expropriation. We propose two relational mechanisms which the home government can leverage to reduce host expropriation. The first is the political relations between the two countries, which give the home country a soft power in discouraging host expropriation. The second is economic coercion that the home government is able to expose on the host government, which can, to various degrees, dissuade host expropriation. We discuss them in order.

Past research finds that the strength of political ties between a home-host pair has a direct and positive impact on bilateral trade (Morrow, Silversson, & Tabaresem, 1998; Pollins, 1989; Boehmer, Gartzke, & Li, 2001) and FDI flows (Nigh, 1985; Li & Vashchilko, 2010). We argue that, in addition to this direct impact, bilateral political relations have an indirect impact on FDI through its interaction with host expropriation risk. Cole and English (1992) theorize that host government expropriation of foreign assets tends to arise in two circumstances: one is that when the government places a high value on access to the assets and resources controlled by MNCs in economic recession, and the other is that when it places a high value on the return of foreign assets in economic boom. We infer that for both circumstances, amicable political relations will *ex ante* mitigate expropriation tendency of the host state. Amicable political relations facilitate home and host government dialogue and support that can reduce desperate expropriation arising from economic hardship in the host state. Countries with amicable political relations will also have more established trust through past interactions, which should reduce opportunism impulse of the host state. In addition, political relations may dissuade expropriation *ex ante* by reducing *ex post* gains that the host government can draw from expropriation. This is because when the two countries have amicable political relations, the potential gains of expropriation will be cut short by the damage that it will cause to the political relationships. Conversely, the negative externality of expropriation on bilateral relations would be negligible when the bilateral relations are hostile. Therefore, amicable bilateral political relations could be a natural mechanism to palliate potential predation of the host country.

The support of a home government using its political relations to reduce its firms' risk exposure is not unconditional, but should depend on the relationship between the firm and the state (Bucheli & Aguilera, 2010). We propose that SOEs may stand to benefit more from such soft power than their private counterparts. SOEs are the economic extensions of state institutions. Their success is more critical to realize the state political and strategic missions home and abroad. Host country governments also tend to perceive SOEs as the wings of their home state in addition to commercial organizations, therefore may strive to build a positive relationship with them to enhance potential economic and political gains. For example, China state-owned oil company Sinopec commented that although there was prevailing political risk they have to deal with in Sudan and other African countries, the backing of the Chinese government provided them with confidence that political risk was a problem to be solved through diplomacy (Downs, 2007). Taylor (2006) and Ellis (2011) document that there is growing perception among African and Latin American nations that Chinese state-owned firms are granted special favours and protections by various host governments that are unavailable to other MNCs. It is apparent that the advantageous position accorded by political relations is more accessible to those with formidable political ties (Hellman et al., 2003). Our second hypothesis is:

Hypothesis 2: the strength of home-host political relations positively moderates the negative impact of expropriation risk on firms' FDI. The moderation effect is greater for SOEs.

Apart from close political relations that would provide state-owned MNCs with political shield from expropriation risk, political science has a long history to study that nation states could deploy their "coercive" power to constrain the behaviour and decisions of other countries (e.g. Beron, Murdoch, & Vijverberg, 2003). Economic coercions are an important part of statecraft that can work more effectively than military actions in the context of increasing economic globalization (Drezner, 2003). With respect to potential expropriation risk in the host country, a home country can attempt to elicit cooperation from a host government and increase the credibility of the host's commitments to its national's property rights by lengthening the shadow of the future with economic coercion. This not only can correct the time inconsistency problem facing the host government in relation to FDI, but also constrain the host state's excess power. Coercion requires some level of common interest between the two sides as well as a level

of asymmetry of common interest between countries since if both sides can use their common interest to impose equal costs on each other, neither side can benefit from threatening to damage the link between them. For the sender to be able to engage in coercion effectively, the target must be more vulnerable to the disruption of the sender-target relationship. This is what Schelling theorized in his discussion of deterrence: coercion is “as inapplicable to a situation of pure and complete antagonism of interest as it is to the case of pure and complete common interest” (1960:11).

Based on this theoretical insight, we suggest that export dependency of the host country on the home market represents a powerful and credible threat that the home government can leverage to protect its FDI. Trade ties are the most common economic links among national economies. The interdependence among nations is often asymmetrical. This may explain the wide application of trade ties as a foreign policy tool by some governments, especially of large countries, to influence the political decisions of trading partners (Askari, Forrer, Yang, & Hachem, 2005). For example, as the leading trade sanction country, the U.S. imposed various trade sanctions against countries such as Cuba, Burma, China, Iran, Libya, Sudan and Syria for a wide range of reasons including geopolitical considerations, national security, human rights, democratization issues, domestic politics, and of course, commercial interests. With the increasing globalization, many countries, not just powerful ones, choose to use trade ties to reward or punish other countries. For instance, *Telam*, Argentina’s official news outlet reported that Ministry officials have asked some 20 companies to cease importing materials from the U.K. in response to diplomatic tensions over the Falkland (Malvinas) Islands (BBC, 2012). More importantly, successful threats need not to be executed (Drezner, 2003). The sanctions literature has recognized the incentives for the sender and the target to reach a compromise before sanctions impositions: such a compromise would allow the two sides to avoid inefficient economic conflict (Eaton, 1999). Therefore, economic coercion is more likely to end at the threat stage than the imposition stage so that the sender achieves its goals due to the coercive effect of threats (Eaton & Engers, 1992).

It is noted that the deployment of threat or an execution of an economic sanction is not without cost to the source country (Shon, 2011). In particular, trade sanctions may affect trade by altering an important

element of the nations' comparative advantage (Farmer, 2000). Imposing restrictions or bans on imported goods and services can also reduce the base for future economic growth (Lucas & Griswold, 2003). Past research has generated much debate with regards to the efficacy, ethical, and humanitarian implications of economic sanctions (e.g. Hass, 1997). The negative externality for domestic actors may therefore raise the challenge for and limit the deployment of economic gunboat diplomacy (Skalnes, 2000; Davis, 2008/09). However, the state ownership of enterprises may address this problem by lowering domestic opposition. Considering the government is the principal of its SOEs, represents the interest of all citizens of the country, and the overseas activities of SOEs tend to carry objectives critical to national security and economic growth, there may be less domestic opposition for the home government to leverage economic threat/sanction to protect its SOEs' properties and interests abroad.

Relating to China, although China politically denounces economic sanctions, its rising economic powers have witnessed a subtle but significant shift in its use of economic gunboat diplomacy (Reilly, 2012). For instance, France, the United States, and Japan saw a two-year drop in their exports to China after their leaders met with the Dalai Lama in recent years (Fuchs & Klann, 2013). China halted fresh salmon imports from Norway after the Nobel Committee awarded its Peace Prize to Chinese human rights activities Liu Xiaobo in 2012 (South China Morning Post, 2013). Therefore, we propose the third hypothesis:

Hypothesis 3: The export dependence of the host country on the home market positively moderates the negative impact of expropriation risk on firms' FDI. The moderation effect is greater for SOEs.

3. METHODOLOGY

3.1 Research data

We use Chinese firm level greenfield investment in the period of 2003 and 2010 to test our hypotheses. The data is drawn from fDi Market of Financial Times, which tracks the global greenfield FDI. There are 1,485 FDI projects undertaken by Chinese firms in this period. The dataset records the amount of the

investment, the location, and the year of investment. We removed 32 investments into Hong Kong and Macao from the sample because they are a part of China; data on their political relations with China are unavailable. We sought parent information from Global Business, GTA Information Technology (GTA), which is a commercial database company based in Hong Kong. We matched 894 observations for which parent information is available.

3.2 Variables and measurement

We use the natural log of the amount of investment as the dependent variable to indicate the scale of the FDI. Expropriation risk is measured by the property right protection index constructed by the Heritage Foundation. The index is reversed to ensure higher values indicate higher expropriation risk. The values range between 95 and 5. Therefore, we expect a negative coefficient to support the baseline argument that expropriation risk reduces FDI. Countries with highest expropriation risk in our sample include Zimbabwe, Vietnam, Iran, North Korea and Turkmenistan, with values higher than 80. Denmark, Switzerland, Germany, U.S. and U.K. are the countries with lowest expropriation risk; all having values lower than 10. State ownership is measured by the % of state equity in the firm. The average state ownership in our sample is 24%. This includes 526 firms without state equity. For the remaining 358 firms with state equity, the average state ownership is 58%, indicating a high level of equity control over the enterprises.

Data of political relations is provided by Gartzke (2008)². The index is measured by the distance between United Nations General Assembly votes for a given bilateral pair and year. Specially, it is measured by $1 - (2*d/d_{max})$ where d is the sum of the distance between votes for a given bilateral pair and year, and d_{max} is the maximum possible distance between votes for a given bilateral pair and year. The distance between votes is calculated by first classifying “Yes” votes equal to one and “No” votes equal to zero. Then for each vote the distance is calculated as the absolute value of the differences in votes. The index values between -1 and 1 for all countries with higher values indicating stronger/better political relationships. We extract all pairwise information for China. The underlying idea of using this index is that countries with good relations are more likely to share similar policy positions, which should be reflected

in the voting patterns in the Assembly. It is also based on direct measure of government behaviour. This index is used in recent finance research such as Knill, Lee, & Mauk (2012). To our knowledge, we are the first to use this data to study FDI. In our dataset, Democratic Republic of Congo, Egypt, Saudi Arabia, North Korea and Iran are the top five countries with strongest political ties with China, all having a value of over 0.95. The expropriation risk of these countries except for Democratic Republic of Congo for which the data is unavailable, however, is around 80 out of 95 on average, making them the most risky environments for FDI in the world. There are some illuminating examples in our dataset that show how political relations can sway Chinese SOEs' massive investment in these risky countries. For example, China Petrol and Chemical (Sinopec) invested US\$ 300 million in Saudi Arabia in 2004 in extraction industry. China Natural Oil and Gas Exploration and Development (CNODC) invested US\$ 3,600 in Iran in extraction industry in 2007. A Tianjin based SOE Huiming invested US\$ 100 million in manufacturing sector in Egypt in 2007.

We draw export data from IMF to measure export dependence of other countries on China. It is measured by the ratio of the country's export to China to its total export to the world. Mongolia scores the highest with an average value of staggering 53% of export dependence on China during the period. Other countries heavily relying on the Chinese market as their export destination include Angola (34%), North Korea (32%), Democratic Republic of Congo (29%), Cuba (27%), and Sudan (24%). These countries also score poorly in terms of expropriation risk with an average of 80. But they managed to attract large investments from Chinese SOEs, such as Sinopec' investment of over 20 million US\$ in Angola in 2007 and several SOEs' investment in telecommunication sector in Angola and Cuba.

The country level control variables are as follows. We indicate the host country's economic size by its GDP. Market access is the most widely acknowledged motive of FDI, and empirically has obtained the most unanimous confirmation (Chakrabarti, 2001). Anecdotal information has suggested that Chinese FDI is market motivated. For example, there has been excessive competition, reducing margins and overcapacity in many industries in China, which have spurred companies to invest abroad with a view to creating an overseas-based platform from which to gain access to local markets (Global Insight, 2006). To show the

wealth level of the host country we use GDP per head as a proxy variable; this also captures market potential. Corporate tax is included because it is argued to be a negative influence on MNCs' activities (Dunning, 2006). But corporate tax is also a good indicator of public infrastructure provision, which can attract new investment, especially when the new investment tends to receive tax exemptions. This makes prevailing corporate tax less important in the short term. We also consider the unemployment rate of the host country. A higher unemployment rate not only means that new FDI is more welcome in the host country, but also facilitates MNCs' recruitment (e.g. Basile, Castellanic, & Zanfei, 2008). Natural resources have been extensively discussed to be one of the motives of China's outward FDI, although a more refined analysis shows that natural resources only matter in some resource-related industries (De Beule & Duanmu, 2012). But we include this to consider the general trend, especially for FDI undertaken by SOEs. Exchange rate is considered because a high foreign exchange reserve and strong Reminbi means greater purchasing power abroad, which could be another incentive for outbound investment (Cushman, 1985). With the economic crisis depressing asset prices worldwide, and the Chinese government promoting outward FDI by easing and decentralizing regulatory procedures, broadening financing channels for firms with overseas ambitions (Rosen & Henemann, 2009), Chinese firms have advantages when purchasing, acquiring distressed resource firms or setting up new business abroad. We also include geographic distance as a common controller in FDI models, despite its ambiguous impact on FDI (e.g. Carr, Markusen, & Maskus, 2001). We also have several firm level control variables that we gathered from GTA database. These are fixed assets, age of the firm, profit value (Yuan) scaled by number of employees, and export value (Yuan) scaled by number of employees. Past studies have demonstrated that these factors influence the decisions on, and the scale of, FDI (Asiedu & Esfahani 2001; Buch, Kleinert, Lipponer, & Toubal, 2005; Javorcik & Spatareanu, 2005). All independent Variables are one year lagged.

3.3. Regression model

We are dealing with cross-sectional data where each FDI observation enters the data only once. We write the following equation:

$$\begin{aligned}
Y^*(FDI_{ikst+1}) = & \beta_0 + \beta_1 ExpropriationRisk_{kst} + \beta_2 SOE + \beta_3 SOE * ExpropriationRisk_{kst} \\
& + \beta_4 PoliticalRelations + \beta_5 ExpropriationRisk_{kst} * PoliticalRelations \\
& + \beta_6 SOE * ExpropriationRisk_{kst} * PoliticalRelations + \beta_7 ExportDependence \\
& + \beta_8 ExportDependence * ExpropriationRisk_{kst} \\
& + \beta_9 SOE * ExportDependence * ExpropriationRisk_{kst} \\
& + \sum_{j=1}^{j=11} \beta_j Controls_{ikst} + \sum_{y=1}^{y=8} \omega_y Year_t + \sum_{r=1}^{r=52} \delta_r Sector_s + \varepsilon_{ikst}
\end{aligned}$$

The equation models the scale of FDI by firm i in the host country k in the year t . The s term is an index for the 4-digit industry classification. We have 52 industries in the sample. The k term is an index for the host country. We have 104 host countries in the sample. The t term is an index for the year. We have 8 years in total. The right-hand side of the equation lists the variables representing our key interests, which includes expropriation risk, and its various interactive terms with state ownership, political relations, and export dependence.

Due to the fact that our data are drawn from two sources, this has resulted in some sample attribution (number of observations from 1485 to 894) that may not be random. To investigate potential bias, we use a simple t test to check variables such as the amount of FDI and country level controls. We do not find systematic difference between the missing observations ($n=591$) and the available observations ($n=894$). We then perform the Heckman correction models (1976) where two equations are developed - one for selection and the other for the dependent variable. These two equations are estimated simultaneously. This method is a two-step estimator model where a probit estimation of the selection model is used in the primary regression model to test if there is a significant selection bias (Berk, 1983). We use industry, year, and host country variables to estimate the selection model to check if the observations that are not included in our main models are systematically different from those that are included in main models. It is noted that the two-stage estimator method only outperforms an ordinary least squares (OLS) method if selection bias is severe (Berk, 1983). In our test, neither is the sample selection bias significant nor do the regression coefficients substantially differ between the two-step estimator and the OLS models. Consequently, we use OLS regression models with robust standard errors in our estimations. Table 1 presents the descriptive statistics for the main variables and their definitions. The correlation matrix is presented in Table 2.

*** Insert Table 1 about here***

*** Insert Table 2 about here***

4. EMPIRICAL RESULTS

The results relating to our first hypothesis are presented in Table 3. In model 1, we find that expropriation risk is a statistically significant and negative estimator. This is in line with the conventional argument that MNCs reduce investment in host countries with high expropriation risk. This result remains unchanged when we include year and industry fixed effects in model 2. It is noted that when we include industry and year fixed effects we tend to lose some observations due to a lack of variations across some industries or years. In model 3, we test whether state ownership reduces Chinese firms' aversion to host country's expropriation risk. We find supporting evidence: the interactive term of state ownership is a statistically significant and positive estimator, confirming the first hypothesis that state ownership positively moderates Chinese firms' concern over expropriation risk. This result holds when we include year and industry fixed effects as shown in model 4.

*** Insert Table 3 about here***

In Table 4, we assess whether strong political relations reduce Chinese firms' aversion to expropriation risk, and whether state ownership accelerates the benefit. In model 1 and model 2, we find that the interactive term of expropriation risk and political relations attains a statistically significant and positive result and expropriation risk remains a statistically significant and negative estimator. This confirms the second hypothesis that Chinese firms are less concerned about expropriation risk in countries with strong political relations with China. To examine if SOEs benefit more than their private counterparts, we split the sample into two based on whether or not the firm has state ownership. We find that the interactive term attains a statistically significant and positive result in model 3 with a coefficient of 0.041. In model 4, this interactive term remains statistically significant but the coefficient drops to 0.005. Since expropriation

risk has a coefficient of 0.009 in SOE sample, and -0.022 in non-SOE sample, the net effect for state ownership is 0.032 and for non-SOEs is 0.027. We interpret that the risk reduction benefit is higher for SOEs than for non-SOEs. We also implement several estimations by using 25% and 50% of state ownership as the cut-off point to assess the robustness of our core results. Our results remain qualitatively unaltered.

*** Insert Table 4 about here***

We then examine whether export dependence mitigates Chinese firms' aversion to host country expropriation risk. In Table 5, model 1 finds that expropriation risk remains a statistically significant and negative estimator, consistent with previous results. However, the interactive term of export dependence and expropriation risk does not attain statistically significant result in model 1. The negative coefficient is contrary to our expectation. In model 2, we include year and industry fixed effects, and find that the results remain unchanged. We then split the sample into two. In SOE sample, we find that this interactive term becomes statistically significant with a positive coefficient, suggesting that SOEs benefit from the economic power that the Chinese state holds over host countries. But in non-SOE sample, the results remain largely unchanged from the main results reported in model 1 and model 2. The interactive term is a statistically insignificant and negative estimator in this subsample, suggesting that non-SOEs do not become less concerned over expropriation risk in countries with high export dependence on China. Our third hypothesis therefore receives partial support, that is, the risk-reduction function of export dependence only accrues to SOEs but not to their private counterparts. We implement several estimations by using 50% and 25% of state ownership as the cut-off point to assess the robustness of our core results. Our results remain consistently unchanged.

*** Insert Table 5 about here***

*** Insert Table 6 about here***

We report our final analysis in Table 6 where we put all our key variables in the models to check our results. We find that in model 1 expropriation risk is a negative and significant estimator, and its interactive term with state ownership is a statistically significant and positive estimator. This means that state ownership significantly reduces firms' concern over expropriation risk in the host state. We show the interactive effect in Graph 1 where low state ownership and high state ownership are plotted together to see how state ownership reduces the negative impact of expropriation risk on FDI. We graph the slopes for investment on expropriation risk while holding the value of the moderator, state ownership, constant at either a high value (mean + 1 standard deviation) or a low value (mean – 1 standard deviation) using the method of re-centering. The second hypothesis that Chinese firms are less concerned over the expropriation risk in countries with strong political relations is confirmed by the interactive variable of expropriation risk and political relations. It demonstrates a political power enabled “comparative advantage” that Chinese firms have in these environments. More importantly, SOEs appear to benefit even more than non-state firms as shown by the triple interactive term. Using re-centering method, we show the interactive effect of political relations in Graph 2 by holding it constant at either a low or a high value. We also demonstrate how SOEs and non-SOEs respond in different ways in Graph 3 and Graph 4 respectively.

With respect to the third hypothesis, export dependence appears to be a statistically insignificant and positive estimator, and its two-way interactive term with expropriation risk is a negative and insignificant estimator in model 1. This suggests that Chinese firms do not invest more in countries with high risk but also high export dependence on the Chinese market. That is, part of the third hypothesis does not receive support. The three way interactive term of expropriation risk, export dependence and state ownership receives a statistically insignificant and positive result in model 1. We continue to subject the test with the inclusion of year and industry fixed effects in model 2 and model 3. Most results remain unchanged except that the triple interactive term of expropriation risk, export dependence and state ownership receives a statistically significant and positive result in model 3, suggesting that SOEs increase their FDI in countries with high level of expropriation risk but strong export dependence on China. This lends support to our hypothesis that SOEs benefit from the economic power that Chinese government has

over states with high expropriation risk but high export dependence on China. Therefore these results lend partial support to our third hypothesis. The two way interactions of expropriation risk and export dependence is presented in Graph 5 although the result is not what we expect. We also show how SOEs and non-SOEs respond differently in Graph 6 and Graph 7.

5. DISCUSSIONS

We have provided theoretical argument and empirical evidence to demonstrate how political factors influence firms', especially SOEs' FDI, in countries with high expropriation risk. We find that political relations between the home (e.g. China) and the host state serve as a risk reduction device to mitigate firms' exposure to expropriation risk. Both SOEs and private firms benefit, but SOEs benefit more. However, in terms of the host country's export dependence on the home market, only SOEs benefit from this economic power held by the home government. The beneficial impact is absent among private firms across various estimations. We speculate that with respect to private firms, the differential institutional function of the two types of bilateral relations arises possibly as a result of different information asymmetry, that is, the information on the strength of political relations between the home and the host countries is more accessible, which guides their FDI decisions. In comparison, the information of to what extent the host states rely on the home market as their export destination may be less disseminated. Another reason could be: private firms perceive that political relations, despite being "informal", could be more effective to reduce their risk exposure. Without strong political support, private firms may not expect that its home government will leverage the more formal retaliatory measure to protect their overseas interest.

Our results have significant implications to theory and practice. It is widely recognized that economic globalization requires market-supporting institutions to flourish. But unlike trade and monetary relations, virtually no multilateral rules of FDI exist. From the host country's perspective, our findings suggest that if building up secure property right institutions is prohibitively time-consuming and costly, then external

forces, such as bilateral political and economic relations can provide a temporary avenue to reduce investors' concern over expropriation risk. From this point of view, China's outward FDI, especially SOEs' FDI, fills in the voids left by most western multinationals which may be more constrained by their shareholders and a lack of effective political and/or economic protection from expropriation risk. But by no means does it suggest that it is the optimal outcome for the host country since SOEs from politically powerful nations may not be the most efficient user of resources of the host country.

In addition, the political influence provided by a home state in protecting its MNCs' investment, in essence, is a private provision of governance - private to firms, or a group of firms, from a particular home country. It does not substitute a public provision of global governance that hinges on collective actions by all nation states. In addition, the risk-reduction impact of bilateral political and economic relations may also mask the real impact of expropriation risk on FDI, reducing host countries' incentive to improve their risk profile (Asiedu, Jin, & Nandwa, 2009). This may, in the long-term, contribute to a segmented increase of south-south FDI, led primarily by state owned MNCs due to their political power, but not truly global capital integration. Such segmentation can deepen if the southern FDI receipt countries are small enough to be satisfied with their development need by FDI from large developing countries like China, which will hamper their ability and incentive to attract more FDI from diverse sources. This may make these countries overly rely on southern FDI, but to the advantage of the incumbent investors facing less competition from new investors. On a positive side, if such segmented FDI flow can gradually lead these countries to improve their institutions to a higher standard, then it becomes merely a step towards a greater integration into the world economy. But to achieve this, the source countries, such as China, would have responsibilities to disseminate better international norms and bring these countries to higher standards, which may be counter to their benefit, or their own traditions.

From investors' point of view, Chinese firms, especially SOEs, need to consider whether the risk reduction role of political relations and purchasing diplomacy between China and the host country can be long-lasting to support their long-term and often immobile operations in the host country. Ultimately, it is the long-term investment return that can sustain the growth of these FDI projects and contribute to the

host country's development. Chinese firms including SOEs are relatively newcomers in the global marketplace. Few are making profits. While the initial investment is only one of the first decisions that firms have to make, the success of their on-going operations will depend on how they integrate their business practices with the host country's economic need to ensure a win-win and sustainable development for both sides involved.

In the triangle relations between the SOE, its home government and the host government, it is intuitive to discuss how the SOE may leverage the influence of its principal, its home government, to deter the expropriation impulse of the agent, the host government. But we cannot rule out that the SOE may collude with the host bureaucrats in order to avoid being expropriated, but at the expense of the home state. Alternatively, a powerful home state may capture the policy making in the host country to a degree exceeding the necessity to protect its firms' operation in the host country. Colonialism was the manifestation of this kind. Although colonialism historically promoted a more "integrated" global market because of the political power imposed by, for example, British Empire, on its colonies contributed to reduced institutional risk for British and other European investors (Schularick & Steger, 2008), it does not change the fact that colonialism was an affront to freedom and dignity. More importantly to the purpose of our research, the current lack of global governance affirms that a unilateral political power is no substitute to equitable and enduring global governance. The irony, in fact, is that it is precisely the weak global governance that provided and will continue to provide a fertile ground for powerful nations to exert their influence in international business. Since the exercise of political power naturally brings about a commitment problem, whoever holds the power, it may be to predatory governments' interest to improve their property rights standard so that they will not fall victim to more powerful foreign governments. Our findings of the effectiveness of using political and economic power to curb the risk of poor governance only highlight the vital importance of establishing global governance structure for FDI so that all nation states will abide by a same set of rules governing FDI, eliminating privileges as well as opportunism.

We discuss the limits of our work. First, we use state ownership as a strong proxy of political power, but this is a static attribute. Future studies can extend this by examining how initial political advantages foster further political strategies which may strengthen or hinder SOEs' market positions in risky environments. Questions can be asked about how firms balance the building up of their market and non-market based competences to sustain their internationalization. This way, the enquiry will move from a static efficiency comparison between SOEs and private firms, which has been done in a largely body of literature (e.g. Dewenter & Malatesta, 2001; Shirley & Walsh, 2001), to a more profound question of why SOEs remains active not only in more national markets, but are increasingly found in global marketplace despite their low efficiency. Another weakness of our analysis is that our firm-level information is limited. Future studies can use questionnaire survey to obtain more detailed firm information to improve our analysis. Thirdly, we have placed our study in the Chinese context. The generalization of our findings can be improved if future studies analyse outward FDI from both authoritative and democratic regimes because, arguably, the effect of politics on FDI might depend on a country's regime type (Dixit, 2005; Aidt & Gassebner, 2010).

Table 1: Descriptive statistics for the main variables and their definitions

Variables	Measurement	Source	Mean	SD.	Min.	Max.
<i>Dependent variable</i>						
FDI	The natural log of the amount of investment (million US\$)	This study	7.86	2.07	0.03	13.34
<i>Independent variables</i>						
SOE	% of state ownership	This study	0.24	0.33	0.00	1.00
Expropriation risk	Private property protection index; higher values indicate higher risk	Heritage index	41.50	27.05	5.00	95.00
Political relations	Political relations between China and host countries. Higher values indicate better relations	Gartzke 2008	0.49	0.45	-0.72	0.98
Export dependence	% of export to China as total export	IMF	0.08	0.11	0.00	0.64
<i>Control variables</i>						
GDP	The natural log of the GDP in current US\$	World Bank	26.86	1.97	19.34	30.29
GDP per head	The natural log of the GDP per head in current US\$	World Bank	9.18	1.61	4.97	11.30
Corporate tax	The highest corporate rate applied in the country	World Bank	26.15	19.54	5.00	45.75
Unemployment	% of total unemployment	ILO	6.76	3.69	0.50	31.20
Natural resource	% of metal and ore in country's total export	World Bank	5.97	10.03	0.00	85.37
Exchange rate	Real exchange rate	IMF	101.77	18.97	80.17	597.36
Distance	The natural log of air miles between Beijing and foreign capital city	On-line distance calculator	8.00	1.13	3.24	9.39
Fixed assets	The natural log of total fixed assets (10,000 Yuan)	This study	160.44	15.46	30.91	200.37
Age	Number of years since operation	This study	11.56	9.38	0.00	84.00
Profit	Profit per employee in Yuan	This study	358081	2132552	-539093	30600000
Export	Export per employee in Yuan	This study	161680	495164	0.00	8231394

Table 2: Correlations matrix of key variables

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1 FDI	1.0000															
2 SOE	0.1885	1.0000														
3 Expropriation risk	-0.3963*	-0.1603	1.0000													
4 Export dependence	0.1851*	0.0930*	0.1313*	1.0000												
5 Political relations	0.1667*	0.1636*	0.4756*	0.1252	1.0000											
6 GDP	-0.2556	-0.2243*	-0.6115*	-0.1772*	-0.7081*	1.0000										
7 GDP per capita	-0.3975*	-0.1251*	-0.7001*	0.0438	-0.6512*	0.6535*	1.0000									
8 Corporate tax	-0.0391	-0.0654	-0.1859*	-0.2143*	-0.0023	0.1086*	-0.2230*	1.0000								
9 Unemployment	0.0383	-0.0336	0.1195*	-0.1966*	0.0562*	-0.0806*	-0.0713*	0.1568*	1.0000							
10 Natural resource	0.0895*	0.1507*	0.0967*	0.1053*	0.1131*	-0.2722*	-0.2041*	-0.1288*	0.3390*	1.0000						
11 Exchange rate	0.0811*	0.0463	0.2328*	0.2672*	0.2864*	-0.1672*	-0.1801*	0.4101*	-0.0224	0.0482	1.0000					
12 Distance	0.0654	-0.0264	-0.0552*	-0.4636*	-0.3637*	0.2372*	0.0062	0.2981*	0.2894*	0.1232*	-0.0498	1.0000				
13 Fixed assets	0.1324*	0.2897*	0.1994*	0.0118	0.1730*	-0.2013*	-0.1380*	0.0287	0.0584	0.0376	0.0234	0.0251	1.0000			
14 Profit	0.2076*	0.1972*	-0.0018	0.0128	0.0299	-0.0425	-0.0129	-0.0553	-0.0531	-0.0234	0.0336	0.0209	0.1742*	1.0000		
15 Export	0.0948*	-0.2204*	-0.0554	-0.0550	-0.0926*	0.0962*	0.0966*	0.0583	0.0319	-0.0028	-0.0122	0.0990*	0.0815	-0.0294	1.0000	
16. Age	-0.0632	-0.0885*	0.0712*	-0.0544	-0.0102	-0.0171	-0.0662*	-0.0331	0.0831*	0.0701*	-0.0076	0.0181	0.2567*	-0.0396	0.034	1.0000

Note: N=894 observations; * p<0.05

Table 3: Expropriation risk and SOEs

	Model 1	Model 2	Model 3	Model 4
	Full sample	Full sample	Full sample	Full sample
Expropriation risk	-0.019*	-0.025*	-0.021*	-0.020*
	(0.008)	(0.009)	(0.009)	(0.008)
State ownership			-0.318	-0.299
			(0.904)	(0.890)
Expropriation risk*state ownership			0.016*	0.016*
			(0.007)	(0.006)
Fixed assets	0.116**	0.080*	0.106**	0.072
	(0.036)	(0.040)	(0.038)	(0.042)
Age	-0.001	-0.007	0.001	-0.006
	(0.008)	(0.008)	(0.008)	(0.008)
Profitability	0.007***	0.007***	0.005***	0.009***
	(0.000)	(0.000)	(0.000)	(0.000)
Export	0.004***	0.006***	0.007***	0.011***
	(0.000)	(0.000)	(0.000)	(0.000)
Log GDP	0.092	0.087	0.122	0.105
	(0.078)	(0.076)	(0.079)	(0.078)
Log GDP per capita	-0.588**	-0.546**	-0.580**	-0.571**
	(0.189)	(0.192)	(0.192)	(0.196)
Corporate total tax	-0.002	-0.005	-0.007	-0.009
	(0.008)	(0.008)	(0.008)	(0.008)
Unemployment rate	-0.071**	-0.056*	-0.066*	-0.054*
	(0.027)	(0.026)	(0.027)	(0.026)
Natural resource	0.003	-0.003	-0.000	-0.006
	(0.012)	(0.012)	(0.012)	(0.012)
Exchange rate	0.004**	0.004**	0.012**	0.010*
	(0.001)	(0.001)	(0.004)	(0.005)
Distance	0.118	0.120	0.149	0.155
	(0.216)	(0.216)	(0.216)	(0.218)
Constant	3.313	3.518	1.885	2.244
	(2.879)	(3.539)	(2.951)	(3.617)
Year fixed effects	No	Yes	No	Yes
Industry fixed effects	No	Yes	No	Yes
R-squared	24.1%	34.4%	26.2%	38.7%
N	894	812	894	812

Notes: The dependent variable is natural log of FDI. All independent variables are one year lagged. VIFs are below 6.25 in all models. * p<0.05, ** p<0.01, *** p<0.001

Table 4: Expropriation risk, political relations, and SOEs

	Model 1	Model 2	Model 3	Model 4
	Full sample	Full sample	SOEs	Non-SOEs
Expropriation risk	-0.021*	-0.019*	0.009*	-0.022*
	(0.010)	(0.007)	(0.004)	(0.011)
Political relations	1.468	0.648	0.635*	0.236
	(0.830)	(0.643)	(0.311)	(0.536)
Expropriation risk*Political relations	0.028**	0.014**	0.041***	0.005*
	(0.008)	(0.004)	(0.008)	(0.002)
Fixed assets	0.110**	0.076	-0.210	0.070
	(0.036)	(0.040)	(0.184)	(0.044)
Age	-0.002	-0.008	0.006	-0.002
	(0.008)	(0.008)	(0.020)	(0.010)
Profitability	0.011***	0.011***	0.005**	0.008***
	(0.000)	(0.000)	(0.000)	(0.000)
Export	0.005***	0.007***	-0.000	0.007***
	(0.000)	(0.000)	(0.000)	(0.000)
Log GDP	-0.097	-0.034	0.241	-0.082
	(0.105)	(0.103)	(0.290)	(0.116)
Log GDP per capita	-0.322	-0.421	-0.932	-0.311
	(0.233)	(0.232)	(0.730)	(0.271)
Corporate total tax	0.005	-0.001	0.029	-0.006
	(0.009)	(0.009)	(0.028)	(0.010)
Unemployment rate	-0.067*	-0.053*	-0.089	-0.028
	(0.027)	(0.026)	(0.052)	(0.036)
Natural resource	0.010	-0.001	0.011	-0.007
	(0.013)	(0.013)	(0.028)	(0.027)
Exchange rate	0.003	0.012*	0.031*	0.008*
	(0.014)	(0.005)	(0.013)	(0.003)
Distance	-0.259	-0.121	-0.874	0.076
	(0.264)	(0.266)	(0.695)	(0.309)
Constant	6.307	6.301	8.635	8.452
	(5.522)	(6.244)	(9.928)	(5.814)
Year fixed effects	No	Yes	Yes	Yes
Industry fixed effects	No	Yes	Yes	Yes
R-squared	25.2%	38.3%	36.5%	40.8%
N	894	810	268	502

Notes: The dependent variable is natural log of FDI. All independent variables are one year lagged. VIFs are below 7.03 in all models. * p<0.05, ** p<0.01, *** p<0.001

Table 5: Expropriation risk, export dependence, and SOEs

	Model 1	Model 2	Model 3	Model 4
	Full sample	Full sample	SOEs	Non-SOEs
Expropriation risk	-0.021* (0.009)	-0.027* (0.010)	0.015* (0.006)	-0.029* (0.011)
Export dependence	1.750 (1.650)	1.395 (1.508)	1.261 (1.434)	1.725 (0.925)
Expropriation risk*Export dependence	-0.032 (0.106)	-0.057 (0.067)	0.075* (0.027)	-0.063 (0.073)
Fixed assets	0.114** (0.037)	0.077 (0.040)	-0.180 (0.211)	0.085* (0.041)
Age	-0.000 (0.008)	-0.007 (0.008)	0.004 (0.015)	-0.004 (0.009)
Profitability	0.009*** (0.000)	0.008*** (0.000)	0.003** (0.000)	0.008*** (0.000)
Export	0.007*** (0.000)	0.012*** (0.000)	-0.000 (0.000)	0.011*** (0.000)
Log GDP	0.040 (0.086)	0.059 (0.088)	0.166 (0.236)	0.050 (0.102)
Log GDP per capita	-0.534** (0.194)	-0.523** (0.180)	-1.061** (0.362)	-0.392 (0.210)
Corporate total tax	0.000 (0.008)	-0.005 (0.009)	0.027 (0.024)	-0.010 (0.011)
Unemployment rate	-0.069* (0.027)	-0.053* (0.027)	-0.053 (0.038)	-0.041 (0.038)
Natural resource	0.001 (0.013)	-0.006 (0.013)	-0.008 (0.024)	-0.009 (0.030)
Exchange rate	0.005 (0.014)	0.011* (0.005)	0.039** (0.013)	0.010* (0.004)
Distance	0.328 (0.260)	0.253 (0.252)	0.144 (0.652)	0.308 (0.310)
Constant	2.160 (2.991)	2.852 (3.326)	7.353 (9.538)	0.482 (3.652)
Year fixed effects	No	Yes	Yes	Yes
Industry fixed effects	No	Yes	Yes	Yes
R-squared	24.1%	36.9%	34.0%	39.5%
N	890	810	268	502

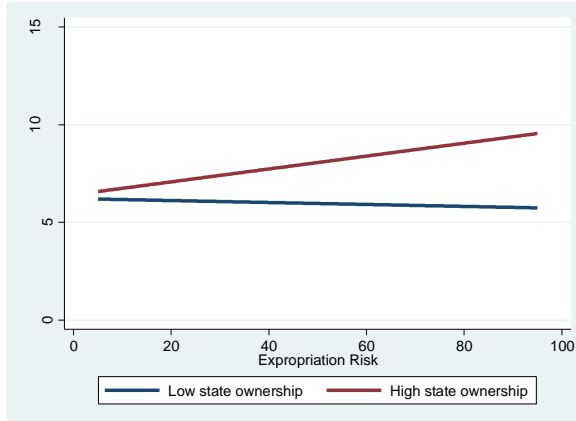
Notes: The dependent variable is natural log of FDI. All independent variables are one year lagged. VIFs are below 6.21 in all models. * p<0.05, ** p<0.01, *** p<0.001

Table 6: Expropriation risk, political relations, export dependence, and SOEs

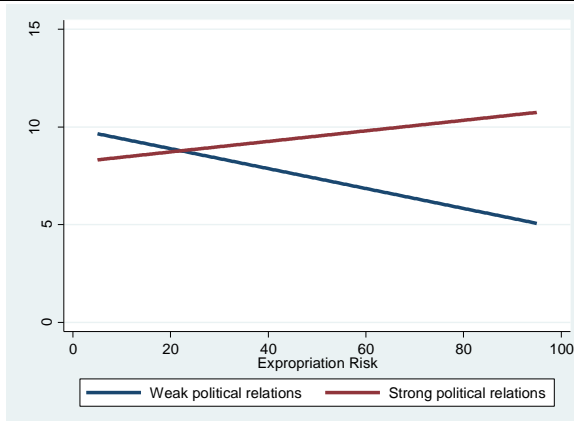
	Model 1	Model 2	Model 3
	Full sample	Full sample	Full sample
Expropriation risk	-0.011* (0.004)	-0.010* (0.004)	-0.009* (0.004)
State ownership	-0.217 (0.988)	-0.195 (0.979)	-0.485 (1.132)
Expropriation risk*state ownership	0.027* (0.013)	0.029* (0.013)	0.032* (0.015)
Political relations (PR)	1.095 (1.823)	1.548 (1.841)	0.571 (1.886)
Expropriation risk*PR	0.018* (0.007)	0.020* (0.010)	0.023* (0.008)
Expropriation risk*PR*state ownership	0.043* (0.016)	0.047* (0.023)	0.055* (0.019)
Export dependence (ED)	4.101 (9.841)	1.605 (10.409)	0.365 (9.759)
Expropriation risk*ED	-0.056 (0.125)	-0.038 (0.130)	-0.026 (0.124)
Expropriation risk*ED*state ownership	0.181 (0.150)	0.187 (0.149)	0.103* (0.041)
Fixed assets	0.097** (0.035)	0.078* (0.035)	0.062 (0.041)
Age	-0.001 (0.008)	-0.000 (0.008)	-0.009 (0.008)
Profitability	0.007*** (0.000)	0.007*** (0.000)	0.007*** (0.000)
Export	0.005*** (0.000)	0.006*** (0.000)	0.0010*** (0.000)
Log GDP	-0.084 (0.121)	-0.060 (0.123)	-0.037 (0.123)
Log GDP per capita	-0.319 (0.251)	-0.261 (0.264)	-0.447 (0.258)
Corporate total tax	0.000 (0.010)	-0.000 (0.010)	-0.004 (0.009)
Unemployment rate	-0.056* (0.026)	-0.057* (0.027)	-0.041 (0.029)
Natural resource	0.003 (0.016)	0.005 (0.016)	-0.007 (0.017)
Exchange rate	0.010* (0.005)	0.004** (0.001)	0.007* (0.003)
Distance	-0.135 (0.421)	-0.280 (0.439)	-0.083 (0.416)
Constant	6.790 (4.261)	7.459 (4.634)	6.960 (4.368)
Year fixed effects	No	Yes	Yes
Industry fixed effects	No	No	Yes
R-squared	29.1%	31.5%	42.3%
N	894	810	810

Notes: The dependent variable is natural log of FDI. All independent variables are one year lagged. VIFs are below 10.84 in all models. * p<0.05, ** p<0.01, *** p<0.001

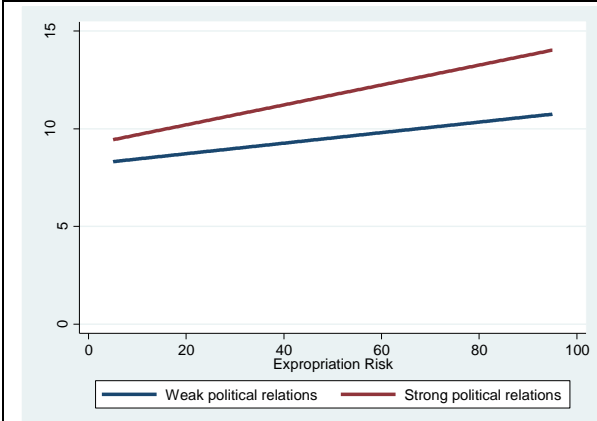
Graph 1: Moderation effect of state ownership



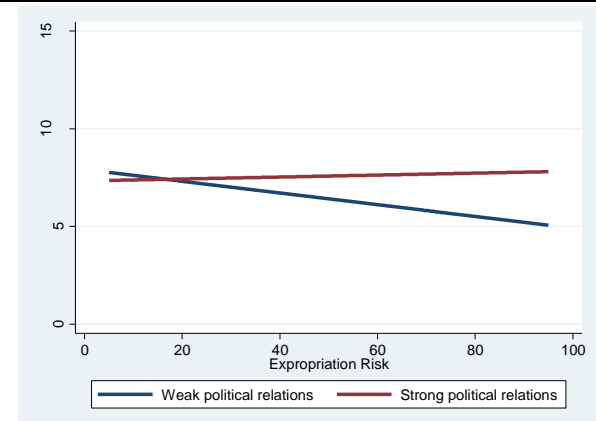
Graph 2: Moderation effect of political relations



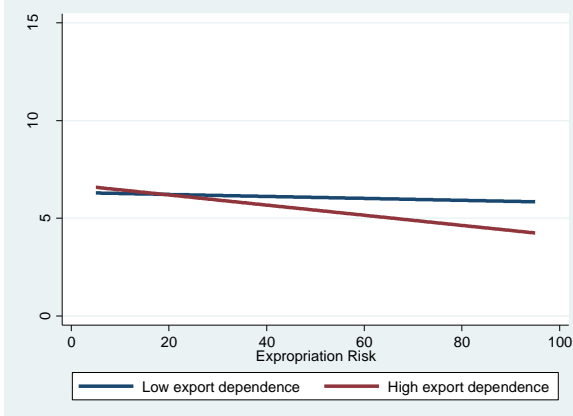
Graph 3: Moderation effect of political relations for SOEs



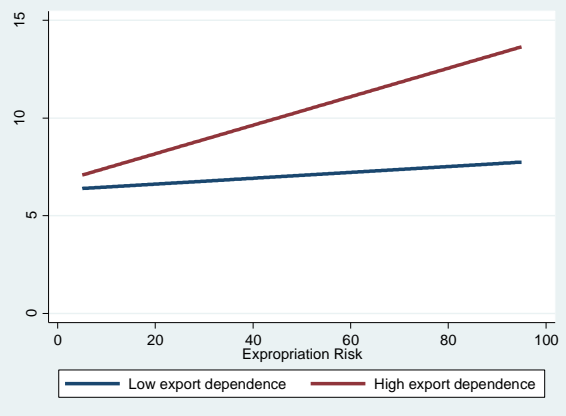
Graph 4: Moderation effect of political relations for non-SOEs



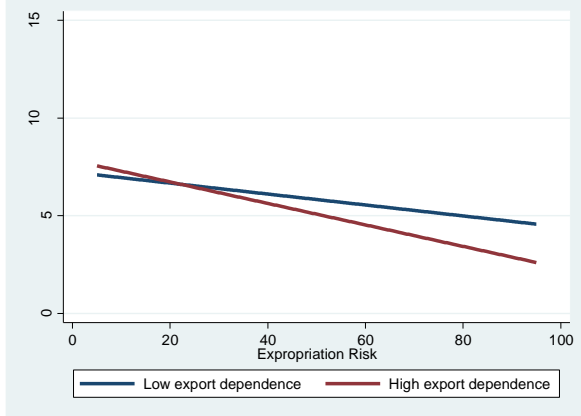
Graph 5: Moderation effect of export dependence: non-significant



Graph 6: Moderation effect of export dependence for SOEs



Graph 7: Moderation effect of export dependence for non-SOEs: non-significant



Endnotes:

1. For example, Fu (2008) reported that China Petroleum and Chemical Corporation (Sinopec) received a government subsidies of 12.3 billion Yuan (\$1.74 billion) to cover refining losses in 2008, which constituted a third consecutive year for its getting a huge cash injection in state compensation. Unirule, a Chinese think-tank, estimated that not having to pay for the land they occupy was a subsidy to SOEs worth some 4 trillion Yuan (\$640 billion) between 2001 and 2009. In 2009 alone, about 85% of China's \$1.4 trillion in bank loans went to SOEs (Economist, 2012). This evidence poses a serious question of how long the Chinese state, regardless how deep its pocket is, can endure the SOEs' slow burn of the country's wealth.
2. To reduce data loss in our sample, we use the average score for 2008 and 2007 to estimate a score for political relations of 2009, because the data from Gartzke (2008) ends in 2008.

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