

# Accepted Manuscript

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PII: S0022-1996(13)00048-2  
DOI: doi: [10.1016/j.jinteco.2013.04.007](https://doi.org/10.1016/j.jinteco.2013.04.007)  
Reference: INEC 2688

To appear in: *Journal of International Economics*

Received date: 11 February 2011  
Revised date: 22 April 2013  
Accepted date: 24 April 2013



Please cite this article as: Fuchs, Andreas, Klann, Nils-Hendrik, Paying a Visit: The Dalai Lama Effect on International Trade, *Journal of International Economics* (2013), doi: [10.1016/j.jinteco.2013.04.007](https://doi.org/10.1016/j.jinteco.2013.04.007)

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## Paying a Visit: The Dalai Lama Effect on International Trade

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(This version: April 2013)

**Abstract:** Is political compliance a precondition for healthy trade relations with China? The Chinese government frequently threatens that meetings between its trading partners' officials and the Dalai Lama will be met with animosity and ultimately harm trade ties. We run a gravity model of exports to China from 159 partner countries between 1991 and 2008 to test the extent to which bilateral tensions affect trade with autocratic China. In particular, we empirically investigate whether countries that receive the Dalai Lama despite China's opposition experience a significant reduction in their exports to China. In order to account for the potential endogeneity of meetings with the Dalai Lama, the number of Tibet Support Groups and the travel pattern of the Tibetan leader are used as instruments. Our empirical results support the idea that countries officially receiving the Dalai Lama at the highest political level are punished through a reduction of their exports to China. However, this 'Dalai Lama Effect' is only observed for the Hu Jintao era and not for earlier periods. Furthermore, we find that this effect is mainly driven by reduced exports of machinery and transport equipment and that it disappears in the second year after a meeting took place.

**Key words:** International Trade; International Political Economy; Exports to China; Economic Diplomacy; Tibet; Dalai Lama

**JEL classification:** F51, F14, P33

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## Paying a Visit: The Dalai Lama Effect on International Trade

“We will take corresponding measures to make the relevant countries realise their mistakes.”

Zhu Weiqun, executive deputy head of the Communist party’s United Front Work Department in an official press statement given on February 2nd, 2010, in the forerun of a potential reception of the Dalai Lama by US President Barack Obama

"There is a Tibetan saying: some wounds in the mouth recover by themselves."

Tenzin Gyatsho, 14<sup>th</sup> Dalai Lama

### 1. Introduction

Political determinants of trade have received considerable attention in the literature (e.g, Acemoglu and Yared, 2010; Aidt and Gassebner, 2010; Méon and Sekkat, 2008; Nitsch and Schumacher, 2004; Nunn et al., 2013). Previous research has shown that diplomatic exchanges between trading partners foster bilateral trade through diplomatic representations (Rose, 2007) and state visits (Nitsch, 2007). However, the importance of economic diplomacy for trade has been questioned recently (Head and Ries, 2010). Furthermore, there is mixed evidence on whether the bilateral political climate plays an important role in trade relationships (e.g., Pollins, 1989; Gowa and Mansfield, 1993; Davis and Meunier, 2011). In this regard, Aidt and Gassebner (2010) theoretically and empirically show that a country’s involvement in international trade differs between democracies and autocracies. Since China is neither a democracy nor a free market economy, its administration has a greater capacity to influence trading decisions than a government in a democratic free-market economy. Such significant scope for government intervention opens up the opportunity to utilize trade flows as a foreign policy tool.

Since the leader of the Tibetan community, the 14<sup>th</sup> Dalai Lama, travels frequently and over long periods of time, his travel pattern offers a valuable case to empirically test the extent to which political relations matter for trade with China. The Chinese government considers the status of Tibet as an internal affair, in which any outside interference is rejected.<sup>1</sup> Therefore, official receptions of the Dalai Lama regularly lead to severe diplomatic tensions between China and countries hosting him. In addition to purely diplomatic threats, China warns potential host countries that it will respond to such meetings with a deterioration

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<sup>1</sup> See Goldstein (1997) for a historical overview on the so-called ‘Tibet Question’, i.e., the long-lasting conflict over the political status of Tibet.

of their trade relationships. The government's decisiveness on this matter is reflected in instances such as the prominent case of France, where the country was crossed off the travel agenda of two Chinese trade delegations in retaliation to a meeting between French President Nicolas Sarkozy and the Dalai Lama in 2008. In an interview conducted in 2007, the Dalai Lama himself acknowledged the unwillingness of state officials to receive him, so as not to jeopardize the intense economic ties that their countries have established with China.<sup>2</sup>

To the best of our knowledge, to date no empirical analysis has been conducted unveiling whether China responds to meetings between its trading partners and the Dalai Lama with any systematic economic punishment. This paper aims to fill this gap. Moreover, results may offer valuable insights into the extent to which political relations matter for trade with autocratic emerging economies. We run a gravity model of exports to China from 159 partner countries between 1991 and 2008 to test whether countries that receive the Dalai Lama are economically punished by the Chinese through a reduction in their exports to China. We also test whether the size of the punishment increases with the rank of the highest official receiving the Tibetan leader and how the effect evolves over time. Furthermore, we provide results when controlling for the potential endogeneity of meetings with the Dalai Lama and exploit disaggregated trade data to deepen our understanding of what we call the 'Dalai Lama Effect.'

Does China carry out its threats to sanction non-compliant trading partners or does the emerging economy simply play on its targets' fears? Our empirical results confirm the existence of a negative effect of Dalai Lama receptions at the highest level on exports to China for the Hu Jintao era (2002-2008). Meetings between a head of state or head of government and the Dalai Lama lead to a reduction of exports to China by 16.9 percent, on average. This effect is mainly driven by reduced exports of machinery and transport equipment and it disappears in the second year after a meeting took place.

The paper is structured as follows: Section 2 provides a literature overview to gain insights into how meetings with the Dalai Lama might adversely affect exports to China. Moreover, we illustrate how the bilateral climate between China and its trading partners deteriorates after meetings between foreign officials and the Tibetan leader, and develop our hypotheses. Section 3 presents the empirical approach, the data used and the empirical results. Finally, Section 4 summarizes our findings and concludes.

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<sup>2</sup> "Dalai Lama Visit Jeopardizes German Business Interests," *Spiegel Online*, September 17, 2007, available at: <http://www.spiegel.de/international/world/0,1518,506166,00.html> (accessed: July 12, 2012).

## 2. The Argument

### 2.1 *Political Determinants of Trade and the 'Dalai Lama Effect'*

Trade ties can be exploited as a foreign policy tool by governments to influence the political decisions of trading partners. Research has been devoted to the analysis of the effectiveness of economic sanctions to induce political compliance (e.g., Eaton and Engers, 1992; Hufbauer et al., 2007). Our study, however, investigates whether the threats frequently voiced by China's administration are actually carried out to sanction trading partners in response to an official reception of the Dalai Lama. With the rapidly expanding size of the Chinese economy, the asymmetry of trade dependencies between China and its trading partners is shifting in China's favor. This development enables China to enforce political compliance among its trading partners to an ever increasing extent. Despite the country's growing scope for economic retaliation, the Chinese administration does not communicate in a transparent manner whether, and to what extent, it actually retaliates after a Dalai Lama reception has taken place.<sup>3</sup>

There is a large literature discussing whether politics matter for bilateral trade relationships. While some studies focus on the link between military conflicts and trade (e.g., Martin et al., 2008; Glick and Taylor, 2010), conflicts do not need to be militarized in order to influence trade flows. An anticipated conflict alone might trigger reductions of bilateral trade due to "the threat of future government action to restrict trade" (Morrow et al., 1998: 650). Importantly, trade reductions are not necessarily the result of direct government action to sanction a state. While pure economic theory suggests that economic actors base their trading decisions entirely on intrinsic characteristics of goods and services such as price, quantity and quality, political relations exert additional influence on private actors' decisions. In a public choice model of bilateral trade, Pollins (1989) argues that importing decisions of economic agents are influenced by the place of origin of traded goods and services. Based on security concerns, risk-averse importers reward political friends and punish adversaries in order to minimize commercial risks related to potential trade disruptions.<sup>4</sup> A recent study by Davis and

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<sup>3</sup> Eaton and Engers (1999) argue that such incomplete information about the threatening country's resolve, as well as about the target's cost of compliance, induces the former to carry out threats to sanction non-compliant countries.

<sup>4</sup> Using bilateral event data on conflict and cooperation for the period 1955-1978, Pollins' (1989) empirical results support the hypothesis that greater amity between trading partners increases trade, while greater hostility has a trade-reducing effect. In a related contribution, Gowa and Mansfield (1993) show that alliances between trading partners foster bilateral trade. Incorporating new trade theory, empirical evidence in Gowa and Mansfield (2004) suggests that alliances (and other measures of bilateral relations) are more important factors in trade under increasing returns to scale than under constant returns to scale. Kastner (2007) finds evidence that the

Meunier (2011), however, raises doubts over the link between political tensions and international trade in the era of globalization. They argue that actors that face sunk costs “lack incentives to link political and economic relations” (p. 1). Analyzing trade patterns of the United States and Japan since the end of the Cold War, the authors do not find that political tensions have an impact on bilateral trade.

Economic diplomacy is one of the channels via which the state of political relations might impact on trade. There is mixed evidence whether diplomatic exchanges among trading partners foster bilateral trade. Analyzing export flows from 22 countries for 2002 and 2003, Rose (2007) finds that the size of a country’s diplomatic service has a positive impact on its exports: each additional consulate leads to an increase of exports by about six to ten percent. Most relevant to our study, Nitsch (2007) finds empirical evidence that state and official visits have a trade-increasing effect. Estimating export flows from France, Germany and the United States for the 1948-2003 period, he finds that one additional visit is associated with an increase in exports of between eight and ten percent. While Gil-Pareja et al. (2008) find that Spanish regional trade agencies abroad have a positive impact on exports, Head and Ries (2010) do not find empirical evidence that Canadian trade missions have a trade-promoting effect.

Arguably, the effect of politics on trade might depend on a country’s regime type. Political relations clearly influence bilateral trade, with the extent of this influence varying between political regimes “since governments in free market economies still set the rules under which firms import and export, while governments in managed economies directly negotiate the terms of trade” (Morrow et al., 1998: 649). In line with this, Mansfield et al. (2000) discuss regime differences in trade policy that emerge as the chief executive does not rely on the approval of a legislative majority in an autocracy. In a related article, Aidt and Gassebner (2010) theoretically and empirically show that autocratic governments exert more influence on trade flows than democratic administrations, which they explain by a lack of political accountability faced by the executive of an autocratic regime.

Taken together, in the case of China, the significant scope of government influence in the Chinese economy provides the country’s political leaders with all the means required to manage trade in such a way that it rewards countries that adhere to China’s political preferences and punishes those that do not. Since meetings of foreign officials with the Dalai Lama cause a deterioration of the bilateral political climate and a decrease in bilateral

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trade-reducing impact of poor bilateral political relations is reduced if internationalist economic interests are strong, which is proxied by low trade barriers.

diplomatic exchanges, a meeting may subsequently lead to a systematic reduction of exports to China through government influence. For example, countries receiving the Tibetan leader might be punished directly through a reduction of trade missions and thus exports of goods typically purchased in the ambit of such missions. Also, tariff and non-tariff barriers might be raised and negotiations regarding free trade agreements might be postponed as a response to receptions of the Dalai Lama by foreign officials.

China's political leadership may be willing to bear the economic and political costs that arise from diverting trade away from countries receiving the Dalai Lama if such 'punishment' increases the likelihood of its political survival. By exerting economic pressure on these countries, the Chinese administration seeks to suppress any notion potentially challenging the territorial integrity of China and intends to strengthen the stability of its Communist regime in the multiethnic country. A punishment is imposed if the benefits from maintaining a reputation for toughness outweigh the costs of punishing a certain nation (Eaton and Engers, 1999). China might be interested in carrying out a threat to sanction countries receiving the Dalai Lama in order to signal resolve, with the intention being to deter foreign leaders from future receptions of the Tibetan leader. However, any economic punishment mechanism will only prevail as long as the expected political gains from stabilizing the regime outweigh the losses incurred through trade diversion.

Finally, it should also be mentioned that a trade-deteriorating effect of official Dalai Lama receptions may also operate through consumer behavior. Prior empirical research indicates that bilateral opinions (or the affinity between nations) impact on trade as they shift consumer preferences (Disdier and Mayer, 2007; Guiso et al., 2009).<sup>5</sup> Similarly, the state of bilateral political relations between China and its trading partners might have important repercussions for consumer behavior. Since media information on foreign officials meeting with the Dalai Lama may alter public opinions towards countries receiving the Tibetan leader, Dalai Lama receptions can be expected to affect the demand for consumption goods, in particular certain symbolic goods that are characteristic of the country hosting the Dalai Lama.<sup>6</sup>

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<sup>5</sup> Using Eurobarometer opinion data on the accession of Central and East European countries to the European Union, Disdier and Mayer (2007) show that 'bilateral affinity' has a trade-increasing effect. In a related study, Guiso et al. (2009) find that trade increases significantly with their measure of bilateral trust obtained from Eurobarometer surveys. Beyond its effect on trade via trust, cultural similarities seem to positively impact on trade volumes via other channels. See also Michaels and Zhi (2010) and Pandya and Venkatesan (2013) for empirical analyses of consumer reactions to U.S.-France tensions over the Iraq invasion in 2003.

<sup>6</sup> For example, the disruption of the Olympic torch relay of the 2008 Beijing Olympic Games through the French capital Paris by pro-Tibet activists caused irritation among the Chinese public and subsequently sparked calls for a consumer boycott against French products.



## 2.2 Hypotheses

Although the Dalai Lama himself emphasizes the non-political nature of his visits, China perceives any meeting of foreign officials with the Buddhist monk as interference with internal affairs. Therefore, Beijing increasingly exerts economic pressure on foreign governments in order to discourage meetings with the Dalai Lama. As early as 1989, when the Dalai Lama was awarded the Nobel Peace Prize in Oslo, China threatened to cut economic ties with Norway if the Norwegian king or government attended the ceremony.<sup>7</sup> Similarly, the plans of Italy's Prime Minister Silvio Berlusconi to receive the Dalai Lama in 1995 provoked warnings by his Chinese counterpart that "if this [the Italian] government will adopt a policy that could damage a matter of principle [for China], it may also damage trade relations."<sup>8</sup> In regards to this, Berlusconi openly admitted that the international community was "caught between the importance of maintaining trade relations and protecting human rights."<sup>9</sup>

Similarly, the reception of the Dalai Lama by Germany's head of government Angela Merkel in the chancellery caused tensions between China and Germany in 2007. Before the meeting, China warned that an encounter would severely damage economic ties. After the reception of the Dalai Lama, China responded by cancelling several bilateral meetings with German officials at various political levels. The chancellor's foreign policy was said to come with a "Merkel cost" for business, according to a press article entitled "The Cost of Being Honest."<sup>10</sup> After the announcement of a meeting between French President Nicolas Sarkozy and the Dalai Lama in 2008, China cancelled the 11<sup>th</sup> annual EU-China summit as well as talks regarding the finalization of a contract to purchase 150 passenger planes from the Franco-German aerospace company Airbus.<sup>11</sup> After the meeting with the Dalai Lama, China crossed France off the travel agenda of two Chinese trade delegations. Our first hypothesis thus reads as follows:

*Hypothesis 1: There is a trade-deteriorating effect caused by foreign officials receiving the Dalai Lama.*

<sup>7</sup> "China Threatens to Cut Ties with Norway over Nobel Award," *The Associated Press*, October 19, 1989.

<sup>8</sup> "Li Peng "diffida" Berlusconi; Il Cavaliere l'aveva promesso a Pannella. Ma Pechino avverte: "Sono in pericolo le relazioni commerciali!," *La Stampa*, June 15, 1994, p. 4, own translation.

<sup>9</sup> "Italia, grazie per il coraggio"; Il leader tibetano a Palazzo Chigi, per la prima volta un governo italiano sfida il veto cinese," *La Stampa*, June 18, 1994, p. 7, own translation.

<sup>10</sup> "Merkel Foreign Policy Is Bad for Business," *Spiegel Online*, October 23, 2007, available at: <http://www.spiegel.de/international/germany/0,1518,513067,00.html> (accessed: July 12, 2012).

<sup>11</sup> "China tells France Dalai Lama meeting could hurt trade," *AFP*, December 4, 2008, available at: <http://www.google.com/hostednews/afp/article/ALeqM5ifBAQ8quVIhgqVgOrfEUzkzrHWg> (accessed: July 12, 2012).



It seems unlikely that this ‘Dalai Lama Effect’ – if existent – is independent of the rank or the political importance of the dignitary met. Meetings with higher-ranking politicians pose a greater affront to the Chinese, who may then retaliate through a more pronounced reduction in bilateral trade. For example, during his 1995 visit to the United States, the Dalai Lama was formally received by a minister of the Clinton administration only, but President Bill Clinton dropped in during the talks. A related New York Times article suggested that a better treatment of the Dalai Lama “would [have] cost us [the United States] trade with the Chinese.”<sup>12</sup>

This example illustrates that some leaders prefer to delegate a meeting with the Dalai Lama to lower-ranking government representatives in the hope of reducing the negative effect that such meetings may have on bilateral relations with China. By employing such a strategy, the government still manages to sedate pro-Tibet lobby groups, human rights organizations and other sympathizers of the Dalai Lama. For example, although Dutch Prime Minister Jan Peter Balkenende feared that a personal meeting with the Dalai Lama would bring “unwarranted risk” to Sino-Dutch relations, some members of parliament and the country’s foreign minister met with the Tibetan leader during his visit in 2009.<sup>13</sup> The Dalai Lama himself remarked that most politicians start avoiding meetings with him after they become minister or president. He concluded that “economic relations with China gain the upper hand.”<sup>14</sup> Therefore, we derive the following hypothesis:

*Hypothesis 2: The detrimental effect of meetings with the Dalai Lama on exports increases with the rank of the dignitary met.*

Facing a trade-off between the economic losses incurred from trade diversion and the political gains from stabilizing the regime, it is in China’s best interest that trade ties are restored as quickly as possible to reduce the economic losses that arise from the political bias in its importing decisions. At the same time, China’s trading partners are also interested in a restoration of trade ties and are likely to direct diplomatic efforts towards restoring these bilateral relations. For example, nine months after the meeting between French President Nicolas Sarkozy and the Dalai Lama, France declared that it recognized Tibet as an integral

<sup>12</sup> “On My Mind; If He Can, Can I?” *The New York Times*, September 15, 1995, available at: <http://www.nytimes.com/1995/09/15/opinion/on-my-mind-if-he-can-can-i.html> (accessed: July 12, 2012).

<sup>13</sup> “Dalai lama meets foreign minister, but not prime minister,” *NRC Handelsblad*, June 5, 2009, available at: [http://www.nrc.nl/international/article2262841.ece/Dalai\\_lama\\_meets\\_foreign\\_minister,\\_but\\_not\\_prime\\_minister](http://www.nrc.nl/international/article2262841.ece/Dalai_lama_meets_foreign_minister,_but_not_prime_minister) (accessed: July 12, 2012).

<sup>14</sup> “Ich will eine echte Autonomie,” *Cicero Magazin für Politische Kultur*, January 1, 2008, own translation, available at: <http://www.cicero.de/weltbuehne/%3Fich-will-eine-echte-autonomie%3F/23497> (accessed: July 12, 2012).

part of the Chinese territory. As a consequence, France went “back on China’s shopping list” as reported by *China Daily*, which refers to the point when France received the first trade delegation after the tensions.<sup>15</sup> Along these lines, we expect exports to China to recover after a certain period, i.e., the trade-deteriorating effect of Dalai Lama meetings is only of temporary nature:

*Hypothesis 3: The trade-deteriorating ‘Dalai Lama Effect’ disappears as bilateral relations between China and partner countries recover.*

If purchases were only postponed as a signal of temporary Chinese discontent after a Dalai Lama meeting, a positive ‘Dalai Lama Effect’ may even develop after a while as Chinese imports make up for past cutbacks. For the interested reader, Online Appendix B1 offers a more detailed analysis of available anecdotal evidence on how the bilateral climate between China and its trading partners is influenced by meetings of foreign officials with the Dalai Lama.

### 3. Empirical Analysis

#### 3.1 Data and Method

We estimate econometrically whether and to what extent the diplomatic tensions caused by official receptions of the Dalai Lama impact negatively on the volume of exports to China. Our econometric model builds on the gravity equation of international trade, the workhorse for statistical analyses of trade flows, which translates Newton’s ‘Law of Universal Gravitation’ to economics. The gravity model assumes that bilateral trade is proportional to the product of the trading partners’ economic masses, proxied by GDP, and inversely proportional to the geographic distance between them. In order to control for country heterogeneity, we make use of partner country fixed effects. The effect of bilateral distance and other time-invariant factors, such as being landlocked or contiguous, is thus captured by the partner country fixed effects.<sup>16</sup> In addition to partner country GDP, we add population size and the bilateral exchange rate to our specification, two frequently used variables in the gravity framework. Moreover, we control for time-specific factors by including dummy variables for each time period. We run the following econometric model:

<sup>15</sup> “France goes back on China’s shopping list,” *China Daily*, October 29, 2009, available at: [http://www.chinadaily.com.cn/china/2009-10/29/content\\_8865307.htm](http://www.chinadaily.com.cn/china/2009-10/29/content_8865307.htm) (accessed: July 12, 2012).

<sup>16</sup> Note that the inclusion of a set of country-by-time effects is not feasible in our model as we estimate bilateral exports to a single country (China). Therefore, we are not able to control for unobservable time-varying country pricing terms (see Anderson and van Wincoop, 2003).

$$exports_{it} = \beta_1 dalai_{it} + \beta_2 gdp_{it} + \beta_3 pop_{it} + \beta_4 exch_{it} + \gamma_t + \delta_i + \varepsilon_{it}$$

where  $exports_{it}$  is the log of exports of partner country  $i$  to China at time  $t$  in current US dollars;  $gdp_{it}$  is the log of the partner country's gross domestic product in current US dollars;  $pop_{it}$  is the log of the partner country's population size;  $exch_{it}$  is a nominal exchange rate index of the partner country's local currency unit in Yuan;  $\gamma_t$  and  $\delta_i$  are time and country fixed effects; and  $\varepsilon_{it}$  is a stochastic error. Trade data are obtained from the United Nations COMTRADE database. Data on GDP, population size and exchange rates are drawn from the World Development Indicators (World Bank, 2009).

Our variable of interest is the binary dummy variable  $dalai_{it}$ , which takes a value of 1 if the Dalai Lama was received by a dignitary in the partner country in year  $t$  or  $t - 1$ .<sup>17</sup> Information on the travel pattern of the Buddhist leader is obtained from the Office of His Holiness the 14th Dalai Lama.<sup>18</sup> The variable is coded in four different ways: In its narrowest definition, we only include Dalai Lama meetings with heads of state or government. Our second definition extends the first by including all meetings between the Dalai Lama and government members. By also adding encounters with speakers of parliament, the third definition produces a dummy variable that accounts for all meetings between the Dalai Lama and national officials. Finally, we construct a variable that incorporates all meetings of the Tibetan leader that are listed by the Office of the Dalai Lama. This definition also includes regional leaders, party leaders, ex-presidents, ambassadors and scientists, among others. Furthermore, we construct a binary dummy variable that takes a value of 1 if the Dalai Lama travelled to a Chinese trading partner country in a given year, irrespective of whether or not the Tibetan leader met with any dignitary there. Online Appendix B2 summarizes all the variables employed in the analysis along with their definitions and sources. Online Appendix B3 provides descriptive statistics.

Our dataset covers the period 1991 to 2008. Hypothesizing that a potential 'Dalai Lama Effect' might only be observable in more recent years, in which China's economic and political power grew significantly, we further split our dataset into two periods: 1991-2001 and 2002-2008. Two main arguments motivate 2002 as an appropriate point at which to split our sample. First, the leadership change that occurred when Hu Jintao took power of the

<sup>17</sup> The reason why we also include the lagged value is because it may take some time for the diplomatic tensions to translate into an actual decrease in trade values. Since trade flows are tied to contracts, the 'Dalai Lama Effect' may only become visible in trade statistics with a certain time delay. However, our results do not hinge on this choice. At a later point, we also show results for different definitions of the variable of interest.

<sup>18</sup> Data are available at <http://www.dalailama.com/> (accessed: April 2010). Information was cross-checked and completed with information provided on <http://www.buddhismtoday.com> (accessed: April 2010).

Communist Party in 2002 may have reoriented China's foreign policy towards a more assertive advocacy of its global interests. Second, China became a WTO member in December 2001, which is likely to have significantly affected China's trading relations. Next, we extend the analysis by restricting our sample to European partner countries to compare the results from previous estimations with those for this more homogenous set of countries.<sup>19</sup> Europe has been the most important travel destination of the Dalai Lama. Leaving aside his host country India, of the 266 trips that he made between 1991 and 2008, 160 of them were to European countries. Online Appendix B4 lists all countries included in the analysis.

We run Fixed Effects regressions with standard errors adjusted for clustering across partner countries, since a modified Wald test indicates groupwise heteroskedasticity.<sup>20</sup> Panel A of Fig. 1 provides a geographical overview of the Dalai Lama's travel pattern in the 1991-2008 period, whereas Panel B and Panel C show a map indicating where and how many times the Dalai Lama was received by a government official or a political leader, respectively. In many cases, the Dalai Lama was not received by any government member during a visit to a country. Russia and Spain, both of which struggle with independence movements, are examples of this.

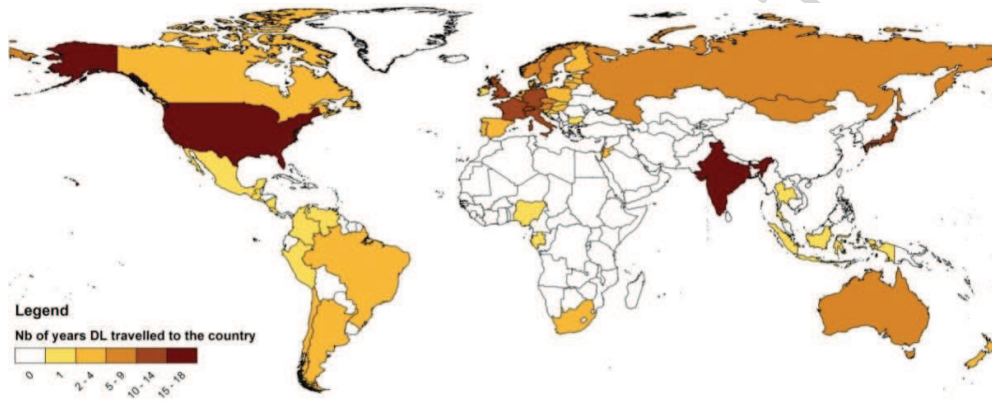
Fig. 2 provides descriptive evidence on the link between Dalai Lama meetings and partner countries' exports to China. We have selected six of the countries for which we also provide anecdotal evidence in our paper or in Online Appendix B1 (three developed and three developing countries). Export values are normalized by partner country GDP. The vertical lines indicate the year in which the Dalai Lama was received by a government member (dashed line) or political leader (solid line). In several cases, exports to China turn out to be smaller in the year in which a meeting took place. The expected pattern is most visible for Italy. Export values show a dip in the year of the Dalai Lama's meeting with prime ministers Silvio Berlusconi (1994) and Massimo D'Alema (1999), as well as after meetings with lower-ranking politicians in 2003. Similar decreases are observable for receptions of the Dalai Lama in Chile in 1999 and 2006, in Mongolia in 2002, and in France in 1996, 1998 and 2008. While Brazil's exports to China do not follow the general increasing trend in years in which a meeting with the Dalai Lama took place, we do not observe the expected pattern in German trade data. Obviously, these graphs are of descriptive nature only and not sufficient evidence

<sup>19</sup> Our definition of European countries excludes members of the Community of Independent States (CIS) to create a rather homogeneous group of countries. However, our results do not hinge on this definition.

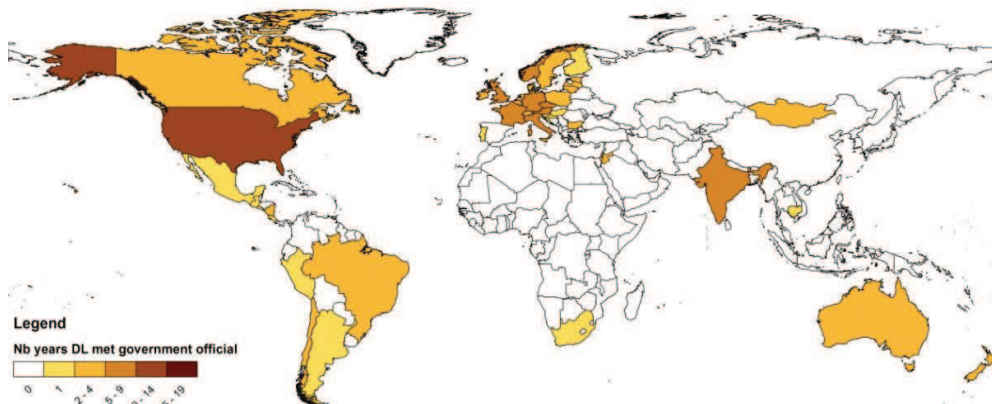
<sup>20</sup> There is an emerging literature on biased estimates caused by the prevalence of zero trade flows in gravity models. In our sample, however, this issue seems to be negligible since the number of zero export flows is very small in our sample (57 of 2,269 observations, i.e., 2.5 percent).

to establish a causal link between Dalai Lama receptions and exports to China. We thus turn to the results of the econometric analysis, which unlike the descriptive analysis will help us to control for confounding factors.

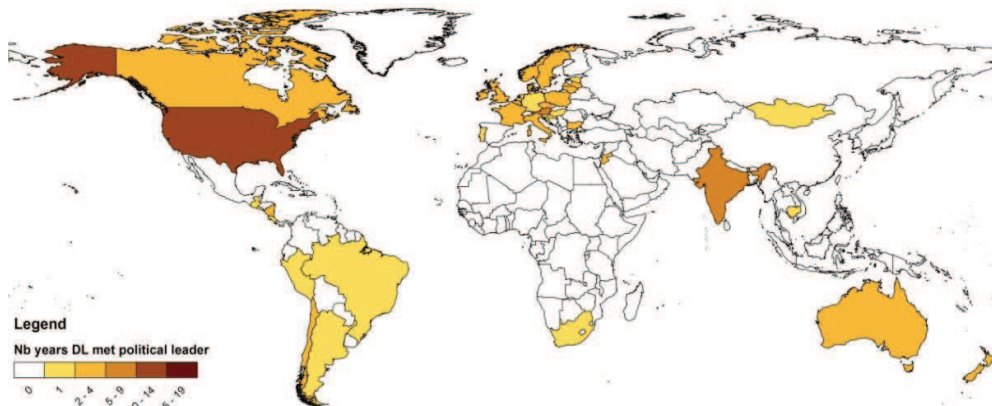
A. *Dalai Lama visits*



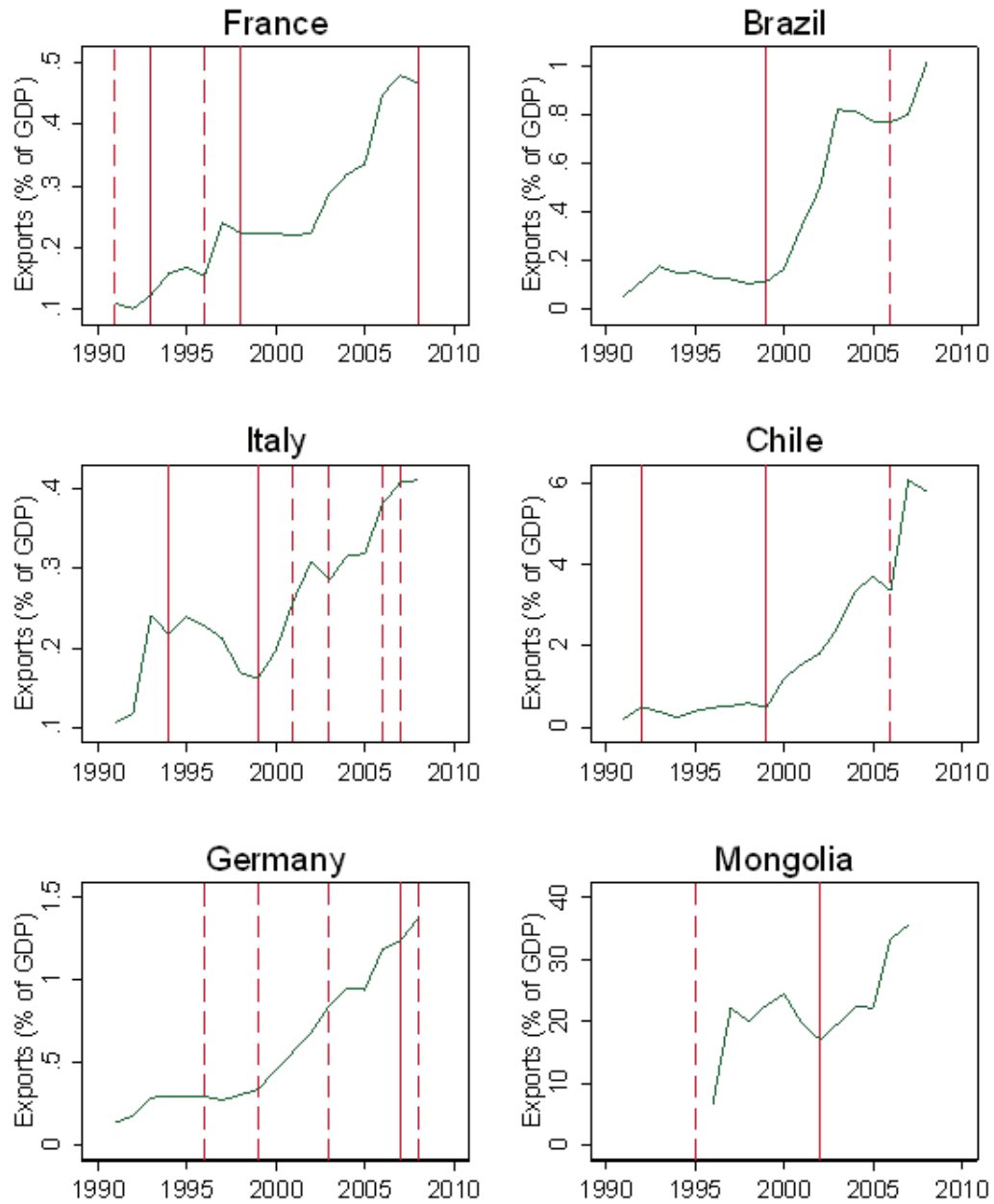
B. *Dalai Lama meetings with government members*



C. *Dalai Lama meetings with political leaders*



**Fig. 1.** Travel pattern of the Dalai Lama (1991-2008).



Note: Vertical lines indicate meetings with a government member (dashed line) or political leader (solid line).

**Fig. 2.** Exports to China and Dalai Lama meetings (selected countries, 1991-2008).



### 3.2 Main Results

Table 1.1 reports empirical results testing our first hypothesis that meetings between the Dalai Lama and foreign officials have a trade-deteriorating effect. We find a negative coefficient on our dummy variable that takes a value of 1 if a government member has received the Tibetan leader in the current or previous year. However, the coefficient is only statistically significant in the second sub-period, which covers the Hu Jintao era (2002-2008).<sup>21</sup> This result is in line with the increased political and economic power China has acquired in the world in recent years. We find that Dalai Lama meetings with a government member decrease exports to China by 12.5 percent on average.<sup>22</sup> The coefficient is statistically significant at the five-percent level.<sup>23</sup>

While the coefficient on GDP is positive and statistically significant at conventional levels and thus in line with the gravity model of trade in the first two columns, we do not find the expected positive coefficient on GDP for the second sub-period. However, if we exclude the time dummies, the coefficient becomes positive and significant as expected (see Online Appendix B6). Most of China's major trading partners were on the same business cycle during the second sub-period. Turning to the effect of the population size of China's trading partners, the corresponding coefficient is positive in all models, but not statistically significant at conventional levels in the first sub-period. This positive coefficient suggests the existence of export-promoting scale effects as a result of a larger population size. The coefficient on the exchange rate does not reach statistical significance at conventional levels. Summing up to this point, empirical results show a trade-deteriorating effect caused by foreign officials receiving the Dalai Lama in the 2002-2008 period (Hu Jintao era).<sup>24</sup> In what follows, we thus restrict our analysis to this relevant time period.<sup>25</sup>

<sup>21</sup> As a robustness check, we ran 159 regressions of the same model specification, each time excluding one of China's trading partners. In each case, the coefficient remained negative and statistically significant at conventional levels. Moreover, we are confident that our result is not driven by missing values as none of the export values are missing for a country-year pair in which a Dalai Lama meeting took place, and there is only one export value missing for a Dalai Lama-receiving country during the 2002-2008 period (one year for Mongolia). We believe that this is reassuring as we identify the Dalai Lama Effect through the within-country variation.

<sup>22</sup>  $\exp(-0.133) - 1 = -12.5\%$ . For example, if countries like Germany or the United States had been punished as an average Dalai Lama-receiving country in 2007, exports to China would have decreased by USD 4.9 billion and 7.4 billion respectively.

<sup>23</sup> For interested readers, Online Appendix B5 shows our results when we omit the partner country fixed effects and introduce bilateral distance, contiguity and common language. As can be seen, meetings with the Dalai Lama explain variations in exports to China *within* countries rather than *between* countries.

<sup>24</sup> Note that we do not claim that this finding is necessarily due to the personality of Hu Jintao. Alternatively, it may reflect the economic and political rise of China.

<sup>25</sup> When running a Chow test to jointly test whether the coefficients are the same in the pre- and post-Hu Jintao era, the null hypothesis of equal coefficients is rejected at the five-percent level of significance (p-value: 0.012).



**Table 1.1.** Exports to China and Dalai Lama meetings of government members  
(Hypothesis 1, all countries)

	1991-2008 (1)	1991-2001 (2)	2002-2008 (3)
DL meets government member	-0.104 (0.288)	-0.101 (0.355)	-0.133** (0.027)
(log) GDP	0.598** (0.019)	0.819** (0.040)	-0.007 (0.981)
(log) Population	3.643*** (0.002)	2.809 (0.104)	3.411** (0.035)
(log) Exchange rate	-0.047 (0.617)	-0.058 (0.598)	0.158 (0.357)
R squared (within)	0.444	0.129	0.280
Observations	2,062	1,142	912
Number of countries	159	148	151

Notes:

- All regressions with country and time fixed effects.
- Robust p-values in brackets; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%
- Standard errors are adjusted for clustering across partner countries.

Column 2 of Table 1.2 shows results for a sample restricted to the more homogenous group of European countries that accounts for roughly half of all Dalai Lama receptions by government members. For the reader's convenience, we show the results of our baseline regressions from Table 1.1 in column 1. We also find evidence in favor of a trade-deteriorating effect in our European subsample. The estimated negative effect of Dalai Lama meetings at government level on European exports to China amounts to 11.5 percent.

Next, we include three additional control variables to our baseline regression to further test the robustness of our results. In a first step, we assess the effect of partner countries' export orientation on exports to China. While time-invariant country characteristics are captured by the country fixed effects, changes in export orientation across time are not accounted for in our baseline model. We hypothesize that exports to China grow over time when a partner country's export orientation increases. The export orientation of China's trading partners is measured as the total exports to all countries except China as a share of GDP. Trade data are again retrieved from UN COMTRADE and GDP data are obtained from the World Bank (2009). As a second control variable, we add the log of the trade-weighted bilateral tariff rate to our baseline model in order to account for tariff barriers to trade between each country and China.<sup>26</sup> Tariff data are taken from the UNCTAD-TRAINS database.

<sup>26</sup> Arguably, China's import tariffs themselves may be affected by diplomatic tensions caused by meetings of foreign officials with the Tibetan leader. Hence, the estimated coefficient on the Dalai Lama variable has to be attributed to channels other than the bilateral tariff rate.

**Table 1.2.** Exports to China and Dalai Lama meetings of government members  
(alternative model specifications, 2002-2008)

	World (1)	Europe (2)	World (3)	World (4)	World (5)
DL meets government member	-0.133** (0.027)	-0.122* (0.098)	-0.136** (0.023)	-0.132** (0.030)	-0.127** (0.035)
(log) GDP	-0.007 (0.981)	0.362 (0.587)	-0.025 (0.931)	-0.147 (0.640)	-0.014 (0.962)
(log) Population	3.411** (0.035)	2.208 (0.495)	3.250* (0.055)	3.075* (0.055)	3.325** (0.032)
(log) Exchange rate	0.158 (0.357)	-1.086 (0.320)	0.029 (0.883)	0.101 (0.566)	0.129 (0.465)
Other exports / GDP			2.757 (0.150)		
(log) Tariff rate				-0.030 (0.761)	
UNGA voting alignment					2.020 (0.208)
R squared (within)	0.280	0.502	0.294	0.296	0.283
Observations	912	247	906	887	912
Number of countries	151	36	150	148	151

**Notes:**

- All regressions with country and time fixed effects.
- Robust p-values in brackets; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%
- Standard errors are adjusted for clustering across partner countries.

The third additional control variable aims to account for the effect of political friendship or hostility on trade with China. A frequently used measure for the extent of bilateral friendship is the degree to which countries vote in line with each other in the United Nations General Assembly (UNGA) (e.g., Richardson and Kegley, 1980; Barro and Lee, 2005; Dreher and Jensen, 2007; Dreher and Gassebner, 2008; Friedrich et al., 2013). Although this measure has its drawbacks, it also has the advantage that data are available for virtually every country in the world over a long time period. We construct a variable capturing the voting coincidence at the assembly using the same method as Richardson and Kegley (1980).<sup>27</sup> Therefore, our indicator of friendship with China is the number of times that a trading partner had the same voting behavior as China as a fraction of all voting instances. Votes in agreement are coded as 1, votes in disagreement as 0 and abstentions and absences as 0.5. If greater amity with China promotes trade, we expect to find a positive coefficient.

All three additional control variables show the expected sign, but do not reach statistical significance at conventional levels. Independent of the control variable added, the

<sup>27</sup> The UNGA roll-call voting data are made available by Voeten and Merdzanovic (2009).

coefficient on our Dalai Lama variable is stable and remains significant at conventional levels. The finding that the addition of the tariff rate variable leaves the coefficient on the Dalai Lama dummy virtually unchanged (column 4) can be taken as an indication that the trade-reducing ‘Dalai Lama Effect’ does not operate via an increase of tariff barriers.

In order to test Hypothesis 2, we run a modified version of the basic regression for the relevant time period (2002-2008), accounting for the different ranks of dignitaries who met with the Dalai Lama (see Table 2). To this end, we include four dummy variables covering an increasingly broader group of people (columns 1-4). Furthermore, we include a dummy variable, which takes a value of 1 if the Dalai Lama travelled to the country – regardless of whether he was received by any dignitary (column 5). All dummy variables take a value of 1 if an event was registered in the current or previous year.

The regressions confirm our hypothesis that the trade deteriorations caused by Dalai Lama meetings are associated with the rank of the dignitary that receives the Tibetan leader. We find that meetings between the Dalai Lama and political leaders, defined as head of state or government, have the greatest significant negative impact on exports to China. Dalai Lama meetings at the highest political level reduce exports to China by 16.9 percent. Smaller, but still significant, effects are found when the definition of our variable of interest is extended to include government members and national officials, respectively. The coefficient for the group including all dignitaries listed by the Office of the Dalai Lama does not reach statistical significance at conventional levels. The same is true for the coefficient on the dummy indicating the presence of the Dalai Lama in the country – irrespective of whether he was received by a dignitary (column 5).

Since meetings with political leaders seem to have the highest impact, we test whether *additional* effects occur when the Dalai Lama is also received by lower-ranked dignitaries. As shown in columns 6 to 9, there is no additional effect for lower-ranked dignitaries meeting the Dalai Lama *in addition* to the effect found for political leaders. When controlling for receptions at the highest political level, each coefficient for meetings at a lower level is not statistically significant at conventional levels.<sup>28</sup> This shows that the effect is only caused by a meeting with a foreign leader, whereas the mere presence of the Dalai Lama in the respective country has no effect. Having shown that the trade-deteriorating effect is driven by meetings

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<sup>28</sup> When restricting our sample to European countries, a similar pattern emerges. Once more, we find the largest effect for Dalai Lama meetings with political leaders. Again, the coefficients for Dalai Lama meetings with lower-ranked dignitaries are substantially smaller. However, the size of the coefficient for a Dalai Lama meeting with any dignitary outperforms the size of the corresponding dummy restricted to government members or national officials. See Online Appendix B7.

with heads of state or government, we focus on these meetings in the following regression analyses. Finally, it may be the case that China rewards countries that refuse to receive the Tibetan leader at official capacity. We construct a dummy variable that takes a value of 1 if the Dalai Lama travelled to a particular country and was not received by a government member. As can be seen in column 10, the coefficient on this dummy variable is positive as expected, but fails to gain statistical significance at conventional level. Thus, we do not find empirical support for such a reward mechanism.

To test for robustness, we also control for spatial dependencies. Countries that do not receive the Dalai Lama might benefit from Dalai Lama receptions in geographically close countries and in countries with a similar economic structure through trade deviations. To test this idea, we add a spatially-lagged Dalai Lama dummy to our estimations.<sup>29</sup> First, we use the inverse geographic distance to construct the weighting matrix. Data on population-weighted bilateral distance are obtained from the French research institute Centre d'Etudes Prospectives et d'Informations Internationales (CEPII).<sup>30</sup> Second, we construct a weighting matrix based on an Export Similarity Index (see Finger and Kreinin, 1979). Specifically, we calculate export similarity between country  $i_1$  and country  $i_2$  as  $ESI_{i_1,i_2} = \sum_s \min(\text{share}_{s,i_1}, \text{share}_{s,i_2})$ , where  $\text{share}$  denotes the share of sector  $s$  in a country's total exports. The index is constructed at the 2-digit SITC level and data are again obtained from UN COMTRADE.

While we do not find the spatially lagged Dalai Lama dummy to reach statistical significance at conventional levels if we use the Export Similarity Index as weighting matrix, the coefficient on the spatial lag based on inverse distance is positive as expected and statistically significant at the ten-percent level. However, our regressions for the European subsample do not confirm this finding (see Online Appendix B8 for full regression results). Taken together, we find only weak evidence for trade diversion. It seems that China reacts with a mixture of policies that may also include postponing of purchases and substitution with domestic goods in addition to trade diversion to other trading partners.

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<sup>29</sup> We use the user-written Stata command `spmon` to create spatial lags (Neumayer and Plümper, 2010).

<sup>30</sup> See Mayer and Zignago (2006).

**Table 2.** Exports to China and Dalai Lama meetings at various political levels (Hypothesis 2, all countries, 2002-2008)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
DL meeting with...										
political leader	-0.185** (0.011)					-0.193* (0.068)	-0.177* (0.083)	-0.212** (0.041)	-0.207** (0.017)	-0.230** (0.022)
government member		-0.133** (0.027)				0.010 (0.906)				
national official			-0.128** (0.029)				-0.009 (0.904)			
all dignitaries				-0.084 (0.176)				0.032 (0.710)		
DL visits country					-0.058 (0.311)				0.033 (0.617)	
DL not received										0.053 (0.503)
(log) GDP	-0.031 (0.920)	-0.007 (0.981)	-0.006 (0.984)	-0.004 (0.991)	0.009 (0.976)	-0.032 (0.919)	-0.030 (0.922)	-0.032 (0.917)	-0.036 (0.908)	-0.035 (0.911)
(log) Population	3.433** (0.033)	3.411** (0.035)	3.403** (0.035)	3.396** (0.036)	3.369** (0.037)	3.432** (0.033)	3.434** (0.033)	3.421** (0.033)	3.421** (0.033)	3.431** (0.033)
(log) Exchange rate	0.151 (0.380)	0.158 (0.357)	0.157 (0.359)	0.158 (0.358)	0.165 (0.337)	0.150 (0.380)	0.151 (0.380)	0.151 (0.379)	0.149 (0.386)	0.150 (0.381)
R squared (within)	0.280	0.280	0.280	0.279	0.279	0.280	0.280	0.280	0.280	0.280
Observations	912	912	912	912	912	912	912	912	912	912
Number of countries	151	151	151	151	151	151	151	151	151	151

**Notes:**

- All regressions with country and time fixed effects.

- Robust p-values in brackets; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

- Standard errors are adjusted for clustering across partner countries.

**Table 3.** Exports to China and Dalai Lama meetings of political leaders  
(Hypothesis 3, time-event specification, 2002-2008)

	<b>World</b> (1)	<b>Europe</b> (2)
DL met political leader in t+1	-0.113 (0.203)	-0.092 (0.276)
DL met political leader in t	-0.189** (0.011)	-0.183* (0.065)
DL met political leader in t-1	-0.192** (0.031)	-0.150 (0.300)
DL met political leader in t-2	0.061 (0.441)	0.191 (0.203)
DL met political leader in t-3	-0.019 (0.778)	0.021 (0.854)
(log) GDP	-0.033 (0.914)	0.303 (0.667)
(log) Population	3.368** (0.042)	1.864 (0.547)
(log) Exchange rate	0.145 (0.399)	-1.127 (0.304)
R squared (within)	0.281	0.507
Observations	912	247
Number of countries	151	36

Notes:

- All regressions with country and time fixed effects.
- Robust p-values in brackets; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%
- Standard errors are adjusted for clustering across partner countries.

To test Hypothesis 3, we include separate dummy variables that take a value of 1 if the Tibetan leader is received by a political leader in the next year, current year, previous year, two years ago and three years ago, respectively (see Table 3). Starting with the worldwide sample, we find statistically significant negative coefficients on the Dalai Lama dummies for the current and previous years. Both coefficients are similar in size and a t-test does not reject the null hypothesis that the two coefficients are equal in size at the ten-percent level. All other coefficients on the Dalai Lama variables are not statistically significant at conventional levels. We thus conclude that the trade-reducing impact of Dalai Lama meetings disappears in the second year after the meeting, which is in line with Hypothesis 3. Turning to our smaller European sample, we find a similar pattern. The coefficient for Dalai Lama meetings in the current year is statistically significant at the five-percent level, but the coefficient on the dummy for a Dalai Lama reception in the previous year loses significance. The ‘Dalai Lama Effect’ is short-lived.

### 3.3 Endogeneity Concerns

In analogy to the reverse causal relationship between trade and military conflicts (e.g., Glick and Taylor, 2010), the precise nature of the causal link between diplomatic conflicts and trade is unclear. On the one hand, we hypothesize that receiving the Dalai Lama leads to reduced exports to China. On the other hand, stronger commercial ties might also make it less likely that a political leader invites the Dalai Lama in the first place. There are good reasons to believe that a country is more reluctant to receive the Buddhist leader if it has a well-established trade relationship with China, which it does not want to jeopardize. If this were the case, we would expect to find a negative bias of the Dalai Lama dummy, making the detection of a (potentially spurious) ‘Dalai Lama Effect’ more likely.

We make use of a Two-Stage-Least-Squares (2SLS) model to account for the potential endogeneity of Dalai Lama meetings. The crucial point in a 2SLS regression framework is the choice of an appropriate instrument, which sufficiently explains Dalai Lama meetings with political leaders, but is uncorrelated with the error term in the second stage regression. According to the exclusion restriction, an appropriate instrument should not affect exports to China through channels other than the potentially endogenous variable, i.e., the dummy for Dalai Lama receptions. In other words, an appropriate instrument should have no direct influence on exports to China. In order to find suitable instruments, one needs to gain a better understanding of the Dalai Lama’s travel behavior. According to the Dalai Lama himself, most visits abroad follow from invitations from Tibetan and Buddhist communities (Gyatso, 1990). During his stays abroad, the Dalai Lama gives lectures and religious speeches and meets local Buddhist communities. While most meetings with lower-ranked dignitaries are scheduled long in advance, it is usually unclear some weeks or even days before the Dalai Lama embarks on a journey, whether he will be received by high-ranked officials.<sup>31</sup> In some cases, the head of state or government just “drops in” while the Dalai Lama is meeting with a lower-ranked government member. The political leader’s decision process of whether or not to meet with the Dalai Lama is usually accompanied by discussions in the media and demands from pro-Tibet lobby groups.

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<sup>31</sup> For example, shortly before the Dalai Lama’s arrival in Italy in 2003, Prime Minister Silvio Berlusconi left it open whether he would accept the invitation of the Italian Parliamentary Group for Tibet to meet with the Tibetan leader. Finally, he refused the invitation. In the forerun of a trip to Mongolia in 2006, it remained unclear whether or not the Dalai Lama would be received by President Nambaryn Enkhbayar during his stay in the country. In the end, no meeting was scheduled. In a similar manner, the encounter of the Austrian chancellor Alfred Gusenbauer in 2007 was made public only one day before the actual meeting took place.



We employ the following three instruments in an attempt to control for endogeneity. The first instrument is the binary dummy variable discussed above, which takes a value of 1 if the Dalai Lama travelled to a partner country in a given year. The underlying idea here is that the Tibetan leader is more likely to meet with officials in those years in which he travels to their respective partner countries. Most meetings with foreign dignitaries take place in the dignitary's own country, although meetings have also occurred in third-party countries such as the 2008 meeting between French President Nicolas Sarkozy and the Dalai Lama in Poland. As outlined above, the Dalai Lama usually fixes his travel itinerary based on invitations from Buddhist or Tibetan communities to give teachings and public talks. Since his travel plans do generally not follow invitations from political leaders, we assume that our instrument is exogenous. Our second instrument is the number of days that the Dalai Lama spent in a partner country. We hypothesize that the longer the duration of the Dalai Lama's stay in a country, the greater will be the public awareness of his presence in the country, the more intense will be the public discussion regarding his potential official reception, and the greater will be the pressure on political leaders to receive him.

As a third instrument, we use the number of Tibet Support Groups (TSG) in a trading partner country. TSGs are non-governmental organizations (NGOs) formed voluntarily and maintained by private individuals with the aim of rallying regional, national, or international awareness of and support for the Tibet issue. TSGs work independently from the Central Tibetan Administration and act as non-profit organizations that are open to any individuals willing to join the pro-Tibet movement. The larger the pro-Tibetan network in a partner country, the more inclined the political leader might be to receive the Dalai Lama in order to satisfy the demands of these pressure groups. Moreover, the number of TSGs may serve as a proxy for the extent to which a country's population is interested in the Tibet issue.

The dataset on the number of TSGs was established based on a list of pro-Tibet movements that was released by the Central Tibetan Administration in exile.<sup>32</sup> To account for the evolution of the pro-Tibet movement over time, we construct a time series by collecting information on the year of foundation of each TSG. In order to get information for those TSGs that do not provide this information on their homepage, we contacted them via e-mail and fax. Using this approach, we obtained information on the founding year for about 53.8 percent of all listed 295 organizations. Unfortunately, insufficient information is available on the number of members of each group so that we cannot account for differences in size

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<sup>32</sup> The list is available at <http://www.tibet.net> (accessed: June 2009).

between Tibet NGOs. With 31 recorded organizations, most TSGs in our sample are located in France, followed by the United States with 20 Tibet NGOs.

The first stage results of our 2SLS estimation approach (see Appendix A) are in line with our expectations: the likelihood that a political leader meets the Dalai Lama increases when the Tibetan head of government in exile travels to the leader's country, increases with the duration of the visit and also increases with the number of Tibet Support Groups in the partner country. The Angrist-Pischke test of excluded instruments displayed in Table 4 underlines the relevance of the instruments selected in the first stage. The null hypothesis of the test is rejected in all specifications. Only in the smaller European sample does the F statistic fall below the critical rule of thumb value of 10 (Staiger and Stock, 1997).

The regressions in columns 1 to 5 of Table 4 show the results for the second stage regressions of our 2SLS approach.<sup>33</sup> Again, we present results for the relevant time period (2002-2008). Starting with the worldwide sample (column 1), the coefficient on the dummy variable indicating whether the Dalai Lama was received by a head of state or head of government in the current or previous year is negative and statistically significant, i.e., we still find that Dalai Lama meetings have a trade-deteriorating effect when controlling for potential endogeneity. The coefficient is somewhat larger than in the Fixed Effects regression (Table 2, column 1). For the European subsample, displayed in column 2 of Table 4, the Dalai Lama coefficient is significant at the five-percent level.

In order to shed light on the timing of the 'Dalai Lama Effect', we include two dummy variables, the first taking a value of 1 if a Dalai Lama meeting took place in the current period and the second taking a value of 1 if the Dalai Lama was received in the previous period. The results in column 3 of Table 4 show that the coefficients for both dummy variables have the expected negative signs, are of similar size, and are significant at the ten-percent level. Tests for overidentification (Hansen J) and underidentification (Kleinbergen Paap LM test) also confirm the validity of our instruments. Even though the 2SLS regression results support our previous findings, note that the C test for endogeneity does not reject the null hypothesis of exogeneity of the Dalai Lama dummy.<sup>34</sup> Consequently, the Fixed Effects estimates discussed in Section 3.2 are more efficient than the 2SLS estimates.

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<sup>33</sup> All results are based on the user-written Stata command `xtivreg2` (Schaffer, 2005).

<sup>34</sup> Under conditional homoskedasticity, the C statistic is numerically equal to the Durbin-Wu-Hausman test. However, its main advantage is that it is robust to violations of conditional homoskedasticity (see Hayashi, 2000: 232-234).

**Table 4.** Exports to China and Dalai Lama meetings of political leaders (endogeneity, 2002-2008)

	2SLS			GMM					
	World (1)	Europe (2)	World (3)	World (4)	World (5)	World (6)	w/o FRA (7)	w/o IND (8)	w/o FRA&IND (9)
DL meets political leader (t/t-1)	-0.229* (0.052)	-0.242** (0.014)	-0.202* (0.063)	-0.211* (0.057)	-0.195* (0.063)	-0.203** (0.020)	-0.227** (0.040)	-0.153** (0.031)	-0.200** (0.048)
DL meets political leader (t)			-0.221* (0.082)	0.197** (0.134)	0.198** (0.023)	0.373** (0.009)	0.365** (0.018)	0.335** (0.023)	0.339** (0.024)
DL meets political leader (t-1)					0.089 (0.750)	0.810*** (0.000)	0.836*** (0.000)	0.858*** (0.000)	0.872*** (0.000)
(log) Exports (t-1)					3.401** (0.011)	0.121* (0.093)	0.120 (0.124)	0.138 (0.115)	0.144* (0.085)
(log) GDP	-0.041 (0.896)	0.255 (0.697)	-0.040 (0.897)	0.064 (0.822)	0.089 (0.750)	0.201 (0.310)	0.209 (0.294)	0.254 (0.208)	0.229 (0.265)
(log) Population	3.458** (0.031)	2.360 (0.477)	3.447** (0.032)	3.505*** (0.009)	3.401** (0.011)				
(log) Exchange rate	0.147 (0.391)	-1.117 (0.305)	0.147 (0.391)	0.130 (0.410)	0.138 (0.381)				
Angrist-Pischke F test (Test of excluded instruments)	12.69 (0.000)	6.99 (0.000)	23.90/15.40 (0.000)/(0.000)	23.55/15.32 (0.000)/(0.000)	29.12 (0.000)				
Hansen J	1.610 (0.807)	3.258 (0.516)	1.432 (0.698)	0.185 (0.980)	0.236 (0.889)	41.82 (0.723)	40.13 (0.783)	43.66 (0.612)	39.29 (0.780)
Kleinbergen Paap LM test (Overidentification test)	22.40 (0.000)	15.28 (0.009)	21.13 (0.000)	21.17 (0.000)	19.61 (0.000)				
(Underidentification test)	0.082 (0.774)	0.038 (0.846)	0.073 (0.964)	1.131 (0.568)	1.407 (0.236)				
Endogeneity test									
Arellano-Bond test for AR1/AR2						-2.557/1.246 (0.011)/(0.213)	-2.479/1.208 (0.013)/(0.227)	-2.48/1.146 (0.013)/(0.252)	-2.465/1.149 (0.014)/(0.250)
R squared (within)	0.280	0.504	0.280	0.379	0.378				
Observations	912	247	912	863	863				
Number of countries	151	36	151	142	142	149	148	148	147
Number of instruments	5	5	5	5	3	61	61	60	60

Notes: - \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

- 2SLS with clustered standard errors, country and time fixed effects. / System GMM with time dummies, Windmeijer finite sample correction and external instruments.

- Instruments (1)-(4): Number of Tibet Support Groups (lagged), Dalai Lama visit dummy (current and lagged) and Duration of Dalai Lama visit (in days, current and lagged).

- Instruments (5)-(9): Number of Tibet Support Groups (lagged), Dalai Lama visit dummy (current) and Duration of Dalai Lama visit (in days, current).

Next, we tackle a further endogeneity issue, which stems from the potential endogeneity of lagged export values. Since trade relationships are persistent over time, we include lagged exports as an additional explanatory variable in order to explain current exports to China as a function of past export values. Established commercial ties and signed contracts mean that exports evolve with inertia. It is possible that the lagged exports variable is endogenous in a short panel, which could lead to biased results (Nickell, 1981). Unobserved panel level effects may be correlated with lagged exports, thereby making the 2SLS estimator inconsistent. In order to address this issue, we apply the two-step System GMM estimator, which incorporates equations in first differences and in levels (Arellano and Bover, 1995; Blundell and Bond, 1998). Since we have a small T in our setting (T=7), we employ the Windmeijer correction to obtain standard errors which are larger and more reliable in finite samples (Windmeijer, 2005). Meetings with the Dalai Lama and lagged exports are treated as endogenous and all additional covariates as strictly exogenous. Furthermore, we include time fixed effects and employ the same external instruments as in the 2SLS regression framework discussed above. To limit the number of instruments, the matrix of instruments is collapsed as proposed in Roodman (2009).

Before proceeding to the GMM estimation results, column 4 of Table 4 reports for comparison the 2SLS results when lagged exports are included as an additional control variable. The coefficient on lagged exports to China is statistically significant at the five-percent level. Interestingly, the Dalai Lama dummy indicating a meeting with a political leader in the previous period becomes insignificant once we include the lagged exports variable. Arguably, the ‘Dalai Lama Effect’ of meetings in the previous period is already (partially) captured in the lagged export variable. However, the dummy variable indicating a reception of the Tibetan leader in the current period remains statistically significant at conventional levels as expected. In column 5, we therefore exclude the dummy variable indicating a Dalai Lama meeting in the previous period. The coefficients on the remaining variables remain virtually unchanged.

Column 6 shows our GMM regression results.<sup>35</sup> The estimated coefficient on Dalai Lama meetings is negative, statistically significant at the five-percent level, and of similar size as the corresponding value in the 2SLS setting. The coefficient on the lagged exports variable has the expected positive sign and is statistically significant at the five-percent level. The Hansen test on the validity of the instruments used does not reject the exogeneity of the

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<sup>35</sup> All results are based on the user-written Stata command `xtabond2` (Roodman, 2009).

covariates. The Arellano-Bond test does not reject the hypothesis of no second-order autocorrelation in the data, which needs to be absent in order for the estimator to be consistent. As a final robustness check, we exclude France in column 7 and India in column 8 from our sample, since both countries show extreme values in the distribution of our instrumental variables. France is the country with by far the most Tibet Support Groups (31 in our sample). India, in turn, is the country that experiences the longest Dalai Lama visits (up to 124 days per year). Nevertheless, when separately or jointly excluding the two countries from the GMM regression, our variable of interest remains statistically significant at the five-percent level (columns 7-9). We therefore conclude that our results are not driven by these potential outliers.

### *3.4 Disaggregated Analysis*

Finally, we investigate which product groups drive the trade-deteriorating ‘Dalai Lama Effect.’ The effect should decrease with China’s costs caused by trade diversion. The economic costs in turn should increase with the substitutability of goods. In order to test this idea, we disaggregate total export values following the classification in Rauch (1999) into reference-priced, homogenous and differentiated goods (see also Head and Ries, 2010). Table 5.1 shows the results if we run a separate regression for each sector.<sup>36</sup> In contrast to our hypothesis, the Dalai Lama dummy is only statistically significant at conventional levels in the differentiated-goods regression. The same holds if we re-run the same regressions for the European subsample (Table 5.2). While this is surprising at first, as China bears economic costs, this strategy is particularly apt for signaling resolve (see literature on economic sanctions, e.g., Hufbauer et al., 2007).

To examine the mechanisms more closely, we also disaggregate exports by the Standard International Trade Classification (SITC). As indicated in the first column of Table 5.1, the value of exports to China is especially concentrated among the following SITC product groups: ‘Machinery and transport equipment’ (41.0 percent of total exports to China), ‘Manufactured goods classified chiefly by material’ (13.3 percent), ‘Chemicals and related products’ (12.4 percent), and ‘Crude materials, inedible, except fuels’ (12.1 percent).

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<sup>36</sup> To save space, we only present the coefficients on our variable of interests. Full results are available in Online Appendix B9 (all countries) and Appendix B10 (European countries).

**Table 5.1.** Exports to China and Dalai Lama meetings of political leaders  
(by product groups, all countries, 2002-2008)

Product Group	% trade	World 2002-2008			
		Coefficients		Obs	Countries
<i>Rauch classification</i>					
(1) Reference-priced goods	23.9	-0.132	(0.494)	856	139
(2) Homogenous goods	17.7	-0.318	(0.224)	772	131
(3) Differentiated goods	58.3	-0.211**	(0.038)	892	148
<i>Standard International Trade Classification (SITC)</i>					
(4) Food, live animals (SITC 0)	1.7	-0.197	(0.283)	710	124
(5) Beverages and Tobacco (SITC 1)	0.2	0.181	(0.545)	467	91
(6) Crude materials, inedible, except fuels (SITC 2)	12.1	-0.140	(0.328)	840	140
(7) Mineral fuels, lubricants and related materials (SITC 3)	7.8	-0.432	(0.275)	481	84
(8) Animal and vegetable oils, fats and waxes (SITC 4)	1.0	-0.206	(0.661)	349	69
(9) Chemicals and related products, n.e.s. (SITC 5)	12.4	-0.096	(0.593)	722	125
(10) Manufactured goods classified chiefly by material (SITC 6)	13.3	-0.031	(0.874)	800	132
(11) Machinery and transport equipment (SITC 7)	41.0	-0.605***	(0.000)	756	129
(12) Miscellaneous manufactured articles (SITC 8)	7.3	-0.232	(0.291)	754	128
(13) Not classified elsewhere (SITC 9)	2.2	-0.294	(0.324)	504	100

**Notes:**

- All regressions with country and time fixed effects.
- Robust-p values in brackets; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%
- Standard errors are adjusted for clustering across partner countries.
- "% trade" denotes the average share of each product group in total exports to China (in %).

**Table 5.2.** Exports to China and Dalai Lama meetings of political leaders  
(by product groups, European countries, 2002-2008)

Product Group (SITC)	% trade	Europe 2002-2008			
		Coefficients		Obs	Countries
<i>Rauch classification</i>					
(1) Reference-priced goods	15.0	-0.234	(0.232)	244	36
(2) Homogenous goods	3.5	-0.278	(0.331)	218	34
(3) Differentiated goods	77.3	-0.241***	(0.006)	247	36
<i>Standard International Trade Classification (SITC)</i>					
(4) Food, live animals (SITC 0)	1.3	-0.539**	(0.029)	213	33
(5) Beverages and Tobacco (SITC 1)	0.4	0.126	(0.784)	190	32
(6) Crude materials, inedible, except fuels (SITC 2)	5.7	-0.052	(0.742)	242	36
(7) Mineral fuels, lubricants and related materials (SITC 3)	1.0	-0.132	(0.695)	191	29
(8) Animal and vegetable oils, fats and waxes (SITC 4)	0.1	-0.280	(0.715)	142	26
(9) Chemicals and related products, n.e.s. (SITC 5)	9.5	-0.004	(0.985)	237	36
(10) Manufactured goods classified chiefly by material (SITC 6)	12.5	-0.306	(0.187)	241	36
(11) Machinery and transport equipment (SITC 7)	58.3	-0.396**	(0.025)	246	36
(12) Miscellaneous manufactured articles (SITC 8)	7.0	-0.191	(0.304)	245	36
(13) Not classified elsewhere (SITC 9)	3.6	0.060	(0.820)	177	30

**Notes:**

- All regressions with country and time fixed effects.
- Robust p-values in brackets; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%
- Standard errors are adjusted for clustering across partner countries.
- "% trade" denotes the average share of each product group in total exports to China (in %).

Exports of goods of the most important product group, ‘Machinery and transport equipment,’ are expected to be closely associated with the state of political relations between countries as negotiations over the purchase of such goods are commonly carried out during the course of high-rank trade talks between national representatives and trade delegations. Running separate regressions for each SITC product group, Table 5.1 reports the full-sample results for the period 2002 to 2008. With the exception of ‘Beverages and tobacco,’ the coefficients for all subgroups exhibit the expected negative sign. However, only SITC group 7, which incorporates ‘Machinery and transport equipment,’ the most important product group, turns out to be statistically significant at conventional levels.

Table 5.2 reports our results when the regressions are repeated for European countries. We find negative and statistically significant results for the group of ‘Food, live animals’ and, once again, ‘Machinery and transport equipment.’ The coefficients on Dalai Lama meetings for the remaining groups are not statistically significant at conventional levels. Taken together, the only product group for which we find a statistically significant negative effect at conventional levels for both samples is ‘Machinery and transport equipment.’ This result suggests that the ‘Dalai Lama Effect’ exists predominantly for those goods that are commonly sold in the course of state visits and trade missions. Our results lend at least weak support in favor of a ‘Dalai Lama Effect’ operating through consumer opinions since negative coefficients on Dalai Lama meetings are found for consumption goods, namely ‘Food, live animals.’

#### **4. Conclusion**

Our article contributes to the literature on the political determinants of trade through an assessment of the importance of the state of bilateral relations for trade with China. The Chinese administration frequently threatens, in a more-or-less open manner, that meetings between its trading partners’ officials and the Dalai Lama will be met with animosity and lead to a subsequent deterioration in their trade relationships. Using data on the travel pattern of the Dalai Lama, we run a gravity model of exports to China from 159 partner countries in the 1991-2008 period to test for political influences on China’s trading decisions. All models are estimated using Fixed Effects with clustered standard errors. In order to account for the potential endogeneity of meetings with the Dalai Lama, the number of Tibet Support Groups



and the travel pattern of the Buddhist leader are used as instruments in 2SLS and GMM regressions.

Empirical evidence confirms the existence of a trade-deteriorating effect of meetings with the Dalai Lama for the Hu Jintao era (2002-2008). However, we find no evidence to support the existence of such an effect in earlier years. While our results suggest that systematic trade reductions are only caused by meetings with heads of state or government, we find no additional impact for meetings between the Dalai Lama and lower-ranking officials. As a consequence of a political leader's reception of the Dalai Lama in the current or previous period, exports to China decrease 16.9 percent on average. Furthermore, we find that this effect will have disappeared in the second year after a meeting took place. Analyzing disaggregated export data, 'Machinery and transport equipment' is found to be the only product group with a robust negative effect of Dalai Lama meetings on exports across samples and estimation techniques.

To sum up, this is strong evidence that bilateral political relations are of large importance for trade with China. Chinese trade relations are not free of political biases and the country seems to exploit trade ties as a foreign policy tool. While political leaders should be aware of potential export losses as a consequence of receiving the Dalai Lama, not meeting with him is not necessarily the conclusion to be drawn from our findings. Internationally coordinated receptions of the Dalai Lama by political leaders, or even joint meetings, are a possibility to reconcile commercial interests with domestic demands to receive the Tibetan leader. Such a strategy may reduce China's scope to play one trading partner off against another. As sanctions imposed on one country can generate rents to third countries through trade deviation, coordination among countries receiving the Dalai Lama can prevent the problem of one country avoiding the Dalai Lama to strengthen its commercial links with China at the expense of the others. Nonetheless, with the increasing economic power of China and other (autocratic) emerging countries, the (ab)use of trade ties as a foreign policy tool is likely to grow in importance.

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**Acknowledgements:** The authors thank Christian Bjørnskov, Ronald B. Davies, Axel Dreher, Jana Friedrichsen, Martin Gassebner, Marina Henke, Stephan Klasen, Samuel S. Kortum, Christoph Moser, Randall E. Newnham, Bernd Süßmuth, and two anonymous referees; seminar participants at presentations at University of Goettingen, Germany, RWTH Aachen University, Germany, and Princeton University, U.S.A.; and conference participants at the Beyond Basic Questions Workshop 2010 at the University of Aarhus, Denmark, the Annual Conference of the Verein für Socialpolitik Research Committee Development Economics at the Leibniz University Hannover, Germany, the Warsaw International Economic Meeting at the University of Warsaw, Poland, the Silvaplana Workshop of Political Economy 2010 in Pontresina, Switzerland, the Annual Conference of the European Trade Study Group 2010 in Lausanne, Switzerland, the CESifo Workshop on Political Economy in Dresden, Germany, the Simposio de la Asociación Española de Economía (SAEe) in Madrid, Spain, the ISA Annual Convention 2011 in Montreal, Canada, and the Meeting of the European Public Choice Society 2011 in Rennes, France, for valuable comments on earlier drafts. Excellent research assistance was provided by Hendrik van Broekhuizen, Juliane Kästner, Karla Henning and Katharina Richert. Finally, Andreas would like to thank his fellow students and friends at Dauphine University Paris for fruitful discussions of Dalai Lama meetings during coffee breaks. All remaining errors are the responsibility of the authors.

**Highlights**

- Assessment of the role of the state of bilateral relations for trade with China
- Evidence that officially receiving the Dalai Lama reduces exports to China
- Trade reductions are caused by meetings with political leaders
- Effect disappears in the second year after a meeting took place
- Dalai Lama Effect driven by reduced exports of machinery and transport equipment

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