

EFFECTS OF CHINESE FOREIGN DIRECT INVESTMENT IN DEVELOPING  
COUNTRIES

by

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## **Introduction**

Chinese foreign direct investment has grown exponentially in the past few years. According to Chinese Global Investment tracking, China has invested \$198.09 Billion in the Arab Middle East and Northern Africa. By doing this, China has expanded their market in these regions, and secured access to importation of natural resources. Although these efforts have benefitted both parties financially, Chinese involvement seems to have contradicted China's traditional policy of non-interference regarding another country's internal affairs. Another way China has stepped back from its noninterference policies is through military intervention. This has typically been done through conventional arms sales to developing countries (Olson Lounsbury and Pearson, 2020). Chinese military operations have included contributing ground troops and naval support in peace-keeping operations, with over 27,000 military personal as of 2016, and naval expeditions to fight piracy in the Gulf of Aden (Rinehart, 2016). With the Chinese military budget expanding 9.5% every year from 2005 to 2014 (Rinehart, 2016,) it is seen that the military capabilities for intervention has expanded for China and has reflected so in their actions. Economic and military intervention are not new in developing countries, but when discussing China and their policies, it is important to note the uniqueness of their involvement and responses when civil conflict arises.

While economic interventions typically assume to improve target states, unintended consequences can also emerge. Economic inequalities, human rights violations, and increased fighting have all been consequences of foreign involvement that will be discussed later on. Understanding the impact Chinese Foreign Direct Investment (FDI) has on civil conflict and its intensity can allow us to understand whether these investments benefit or hurt developing countries overall. It is also important to understand what lengths states might go to in order to

protect the investments made in a host country. If investments are threatened, situations may arise that require foreign military involvement by the investor country, which can create additional problems within the targeted country. Knowing these impacts can also formulate predictions on what is to come for other countries who receive Chinese investment. To test this, I examine relevant literature regarding conflict intensity, foreign direct investment, and history of Chinese economic and military intervention. From the relevant literature and data collected, we can expect a positive correlation between Chinese FDI and the presence and intensity of conflict, as well as subsequent efforts to maintain target state stability.

Of course, China is not the only major power that pursues its national security and economic interests in the system. While China is not the only major power to do this, I expect that the impact of Chinese Intervention to be different from other major powers. Particularly for Western powers following the end of the Cold War, leaders such as the former President of the United States, George H. W. Bush has called for collective action of major powers under the idea of “New World Order” (Miller and Yetiv, 2001). This collective action idea calls for cooperation between states and international organizations for intervention to protect human rights and to promote stability and democracy for citizens facing suppression and violence by their respective government (Knudsen, 1996). This idea has continued throughout the post-Cold War period and has been the justification for intervention by Western powers such as the United States. Unlike these justifications, China has shown that with its policy of non-interference, the value for its economic assets outweighs the potential human rights violations that may result from their investments. By citing state-sovereignty for its reasons not to involve themselves in other states’ internal affairs, it can be argued the impact of Chinese intervention in a state can lead to a lack of checks and balances, resulting in detrimental consequences.

## **Literature Review and Theoretical Framework**

Previous research has attempted to explain the factors that facilitate civil conflict onset conflict intensification. Civil conflict factors have been categorized into three groups then broken down into subsections: individual analysis, state level factors, and international structure (Olson Lounsbury and Pearson, 2009). Individual analysis explains the reasoning for leaders, individuals, and groups to mobilize, or if thought necessary, take up arms against the government. In order for civil conflict to occur, a large portion of individuals must be able to share common problems and identify with the same group who believe they must change the system. State level factors for civil conflict include the geographic, economic, social, and political characteristics of the state (Olson Lounsbury and Pearson, 2009). Various research findings (Fearson and Laitin, 2003, Olson Lounsbury and Pearson, 2009; and Hegre and Sambanis 2006) point out that civil conflict is more likely to occur in countries with mountainous, rough terrains. Further, regions experiencing political instability, high political corruption, lack of resources and lack of infrastructure are prone to civil conflict (Stewart, 2002).

It also appears that economic inequality may be a factor leading to war. Civil conflict intensity was found to significantly escalate due to economic inequality, stating that the poorer the countries were, the deadlier conflict was in that country (Chaudin and Peskowitz, 2017; Lu and Thies, 2011). Research has also shown that inequalities in a state have varying effects on different groups, and effects the willingness to engage in rebellion (Regan and Norton, 2005). Lack of income in a developing country may hinder its ability to ward off attacks from non-state actors, who can be motivated by economic grievances. Contradictory findings relating to

economic equality being a factor to civil conflict argue that there was no relationship between poverty and probability of civil conflict (Langer, 2013). Foreign Direct Investment has the capability to alleviate these problems in developing countries. By alleviating poverty, conditions for civil conflict could be reduced. Yet, the research on FDI is rather complicated with opposing views on the impact of foreign direct investment. Some researchers (Ree and Nillesen, 2019; Djankov and Reynal-Querol, 2010) found that FDI and aid had no statistical evidence on onset of civil conflict, while others (Mihalache-O'keef, 2018; Pinto and Zhu, 2011) found that specific forms of FDI regarding the primary sector (agriculture, fishing, forestry, mining, deposits) lead to an increased probability of civil conflict onset. This can be attributed to the fact that many developing countries are resource dependent, as their economy relies heavily on the exportation of natural resources. Therefore, as FDI from other actors continue to invest in the primary sector of the host country, reliance on natural resources increases, creating a dangerous cycle of economic inequality and stunting the growth of the host's economy. Each of these studies examine the issue generally. It is suggested here that Chinese FDI requires a closer look, and may help to explain these contradictory findings on FDI.

Chinese international diplomacy is a unique strategy with many inherent complexities. In a traditional non-interference model, China attempts to refrain from interfering with the sovereignty of other states. Unfortunately, as China expands its investments into developing regions, this policy has proven to be difficult to abide by. As the need for importing natural resources continues, the ability to remain out of other states' internal affairs dwindles. China has invested heavily into the Middle East and African countries, primarily to export natural resources (Chaudoin et al, 2017; Yang, 2018). In order to protect its energy interests, China has invested billions in infrastructure to transport its exports (Chaudoin et al, 2017). With about half of its oil

imports coming from the Middle East, the Belt and Road Initiative (BRI) was forged to link China to the Middle East and Africa (Chaudoin et al, 2017; Mordechai, 2019). Eventually, due to the immense volume of its investments in these regions, China's maintenance of its non-interference foreign policy has become nonviable. The global power's involvement in foreign affairs as a means of protecting its investments has consistently equated to involvement in these countries' national security, especially in regards to protecting its citizens abroad. In the case of the Libya crisis in Africa in 2011, evacuations of Chinese citizens in the area and calls for mediation between the fighting parties were made (Obert, 2016).

Chinese foreign direct investment may be potentially detrimental to developing countries, for a couple of reasons. By receiving large quantities of investment, countries can become heavily dependent on FDI. This reliance on FDI in primary sectors increases the probability of civil conflict onset in these regions, and anywhere China may invest in the future. As previously mentioned, primary sector investments tend to increase the probability of civil conflict onset; Chinese investments in primary sectors of a host's economy can create economic inequality between different groups in the state. Because Chinese FDI is focused heavily on acquiring natural resources needed for domestic use, exploitation of developing countries could be a result of Chinese interests.

If civil conflict begins to emerge, China's non-interference policy is potentially problematic. China's known opposition to international norms relating to human rights and democratic processes is relevant in this discussion. In the post-cold war era, intervention by foreign powers has taken on new characteristics such as an increase in peacekeeping, and policies that apply stabilization and reconstruction operations (Pang, 2008). With the UN creation of the Responsibility to Protect (R2P), member states have made a commitment to

helping populations at risk of human rights violations. Like Western powers, China has accepted the idea of R2P, but has drawn to a different interpretation. With the foreign policy of non-intervention, China has stressed the idea of not becoming involved in what they deem to be internal affairs. This can be seen through in multiple instances such as the conflict in Syria. With reports of human rights violations coming from the Assad regime on its on population, efforts to penalize the Syrian government and help those effected were blocked by China. Vetoes by China on United Nations Security Council (UNSC) resolutions (Drafted by France and the United States) concerning sanctions and referring Syria to the International Criminal Court (ICC) (Snetkov and Lanteigne, 2015), have shown that China's foreign policies creates problems for humanitarian efforts. The same can be said of international efforts to address genocidal conditions in Darfur (discussed in more detail later). It appears evident that China is less concerned about human rights norms than other major Western powers, or at least finds international efforts to address such violations as unnecessary. Potential inequalities that exist in investment states could be potentially exacerbated by Chinese FDI. If conflicts were to arise from states dependent or close to China, it is possible we could witness detrimental human rights violations without a response. Because China is continuing to expand its wealth and influence around the world, its disregard for international norms poses a global security risk.

Although literature pertaining to intervention and onset have produced mixed findings, the uniqueness of Chinese FDI and non-intervention policies have pushed for state sovereignty without the need to intervene in state internal affairs. By doing this, Chinese foreign policy has failed to address problems such as human rights violations which can prove to be detrimental and increase the probability of civil conflict. Thus, I hypothesize that:

H1: Chinese economic intervention increases civil conflict propensity.

Among those developing states where conflicts do exist, I also suspect that those disputes will be more intense with Chinese FDI presence. Because of Chinese history of non-interference and promotion of state sovereignty, target regimes may feel that intervention due to human rights violations will be less perused by China as compared to the willingness of western states to intervene. With less pressure placed on them by the Chinese government, I believe that conflict will be allowed to continue longer and therefore escalate with Chinese investment present, Therefore I theorize that:

H2: Chinese economic intervention increases civil conflict intensity

### **Foreign Military Intervention**

Foreign Military Intervention (FMI) is a foreign policy tool, among others, that states use in pursuit of foreign policy goals. Motivations for FMI are complex and typically multidimensional. Decisions to support external actors militarily may be a function of strategic, economic, and/or humanitarian goals (Pearson and Baumann, 1998).

Global actors also use Foreign Military Intervention in an attempt to address challenges concerning civil conflicts. Like interstate conflicts, territory and proximity increase the likelihood of FMI in civil conflicts, along with ethnic and religious group kindred group presence (Peksen, 2012). FMI in civil conflict by actors is also used when protecting minority groups in these countries. External actors intervening in civil wars have the capability to support the government, opposition force, or remain neutral. Providing FMI to a particular side is called

directional intervention (Olson Lounsbury and Pearson, 2020). By doing this, it has been found that directional intervention increases the duration of a conflict and complicates the ability to achieve peace (Olson Lounsbury and Pearson, 2020). Intervention in support of the government has been found to not increase the probability of a government victory, unless rebels have an advantage in military capability (Pickering and Mitchell, 2017). But FMI in support of rebels has been found to increase the likelihood of a rebel victory but decreases rebel's willingness to engage in peace talks (Gent, 2008; Olson Lounsbury and Pearson, 2020).

FMI in civil conflicts can have lasting consequences on the state. It has been found that use of FMI typically increases human rights abuses in the state (Peksen, 2012; Pickering and Mitchell, 2017). The use of FMI can also destabilize a region, resulting in violence spilling over borders and increase civil conflict in the region (Peksen and Olson Lounsbury, 2012). But the use of neutral intervention, commonly found in United Nations peacekeeping, has been found to decrease the effects of FMI, particularly directional intervention (Beardsley, 2011). UN peacekeeping has shown to have the ability to decrease the likeness of civil conflict reaching neighboring countries (Olson Lounsbury and Pearson, 2020). Understanding factors that contribute to FMI are important due to these dire consequences.

Despite China's relative reluctance to become entangled in the affairs of other states, it would seem evident that its economic endeavors may have implications for its ability to fully embrace a noninterventionist foreign policy. The use of FMI by the Chinese can be seen in the cases of the conflict in Darfur and Myanmar. In Sudan, China has supplied arms to the Sudanese government since the 1960s, and continued this practice through the 2000s (David, 2009). These armament sales included aircrafts, tanks, vehicles, and small arms (David, 2009). These weapons were found to be used in Darfur, which went against a UN embargo of arms sales, arguably

contributing to the human violations conducted in Darfur. With the attack on oil companies, speculated to be around \$5 billion, and Chinese citizens in this region, Chinese interests were placed at risk (David, 2009). Using its influence in this region, agreements by South Sudan and China were made in order to protect its investments (David, 2009). In Myanmar, China had a trade surplus of around \$3.7 billion, with plans of constructing both natural gas and crude oil pipelines (Enze, 2017). China has had a history of arm sales in the country with an agreement in 1994 of \$400 million worth of tanks, planes, and small arms (Bert, 2004). As conflict has continued in Myanmar, along with Myanmar becoming more involved with the West, Myanmar forces have attacked ethnic militarized groups near the Chinese border. Speculation of arms sale to ethnic Chinese groups, such as the Kachin Independence Army (KIA), have been made due to discoveries of these groups being armed with weapons that were made in China (Chaudhury, 2020). Because of these clashes near the border, along with instances of bombs landing in Chinese territory, China has used its influence in the country to call upon the Myanmar government to protect its interests, and an official apology for the bombings (Enze, 2017). In both cases, Chinese intervention was largely motivated by its need to protect its economic interests. The escalation of conflict in Darfur and the calls for direct military intervention by other major powers threatened Chinese investment in Sudanese oil (Barber, 2020). In Myanmar, China invested heavily in the Myitsom Dam in the northern Kachin State only to find that project under fire when the KIA renewed its insurgency against the Myanmar military.

It is argued here that Chinese Military intervention is unique compared to intervention by Western powers following the end of the Cold war era. While China has participated in the sales of arms that have been used in conflict, China ultimately wants to secure its investments in

foreign countries. With the influence it has, China will push to ensure that conflict should not disrupt its economic assets. As a result, the following hypothesis is presented for testing:

H3: Foreign military intervention is more likely in developing countries where there is also Chinese economic investment.

## **Methodology**

To advance the research on Chinese economic and military intervention, and to test the hypotheses presented above, multiple data sets were identified and will be employed. The population of interest is developing countries. Descriptive statistics will be done for all variables in the tests, located in the appendix. As countries are developing internally, it is important to know possible effects interventions made by foreign states, specifically China, have on the stability of this State. In order to determine what is a developing country, I will use the model of Pickering and Kisangani (2006) of defining developing countries as states with an annual Gross Domestic Product (GDP) per capita of 50% or lower of the highest GDP per capita in the international system. Due to the lack of data concerning flows of FDI, the time frame of analysis of hypothesis 1 and 2 will cover the time period of 2000-2012. With the UCDP external dataset examining up to 2009, hypothesis 3 will include all developing countries for the time period of 2000-2009.

The first two hypotheses suggest that civil conflict propensity and intensity are a function of Chinese economic intervention. Both outcome variables for Hypothesis 1 and 2 are identified and defined using the UCDP Battle-Related Deaths Data (Pettersen and Öberg, 2020). **Conflict Propensity** is defined as “The presence of intrastate armed conflict in a given area, with an armed conflict being a contested incompatibility that concerns government and/or territory over

which the use of armed force between two parties, of which at least one is the government of a state, has resulted in at least 25 battle-related deaths in one calendar year” (Pettersson and Öberg, 2020 p. 3). Intrastate conflicts involve armed conflict between a recognized member of the nation-state system and a non-state actor emerging from within its borders. Conflict propensity is given a value based on if there is armed conflict (1) and if there is not (0). **Conflict Intensity** is measured by the number of battle-related deaths occurring in a given year. Because of the challenge of identifying the exact number of deaths as a result of civil conflict, for each conflict identified by the Armed Conflict Dataset (Pettersson and Öberg, 2020) provide three battle death estimates: Best, Low, and High (Pettersson and Öberg, 2020). The best estimate will be used in all analyses using this variable.

The third hypothesis predicts the occurrence of Military Intervention when Chinese economic investment is supplied to the State. To define this, the UCDP External Support data will be used. **Foreign Military Intervention** is support to a primary party in an ongoing conflict in a variety of forms including material/weapons, provision of sanctuary, financial assistance, logistics, and military support of troops (Stina, Pettersson and Themnér, 2011). This dependent variable, coded in any given year, has two values: if there is support (1) and if there was not support (0). The dependent variable will be broken down into two parts: FMI broad, which will consist of all forms of intervention mentioned above, and FMI narrow, which will only consist of troops, weapons, and money.

By combining data used by the International Trade Centre (ITC) and OECD we can see if economic investment was sent by China to a developing country. These datasets list the amount of Foreign Direct Investment (FDI) given to each state in the international system by a state. Using these data sources, **Economic Investment** is measured as the presence (dichotomous

variables) of FDI supplied to a developing country in a given year (ITC and OECD, 2020). In order to prevent China from acting outside of the international norm, Chinese FDI will be compared to western major powers such as the United States, the United Kingdom, and France. These major powers FDI will be combined to into one variable, indicted as Western FDI, and China will stand alone as Chinese FDI. Foreign Direct Investment will be defined as **Economic intervention** which is measured by whether FDI was supplied to a developing country (1) or not (0) (ITC and OECD, 2020).

To address any spurious relationships for the first and second hypotheses predicting conflict presence and intensity, region of the target state and the regime type, specifically anocracy, will serve as control variables. Using the Correlates of War Country Codes Dataset, **Region** is coded for each developing country, which include Western Hemisphere, Europe, Africa, Middle East, Asia, and Oceania. It is important to note that conflicts generally occur more often in certain regions such as Africa and Asia, over other regions. (Gleditsch, et al. 2002). Therefore, Africa and Asia will be included as dummy variables. **Regime Type** is the system of government use by a country and measured with scores from -10 to 10 from the Polity IV data set. Specifically, scores from -6 to 6, or **anocracies**, will be used as a control variable (Marshall and Gurr, 2020). Previous research has found that states considered as anocracies were more likely to experience civil conflict (Hegre, Ellingsen, et al. 2001). Therefore, it is important to address semi-democratic countries to prevent spurious relationships in the findings.

When looking at the third hypothesis, the regions of Africa and Asia, and conflict propensity, will be used as control variables to eliminate potential spuriousness when predicting foreign military intervention.

Prior to testing the hypotheses, descriptive statistics will be presented for each of the variables included in the study. Hypotheses will be tested in multivariate models using ordinary least squared (when predicting conflict intensity) and logistic regression (when predicting conflict presence and FMI), clustering on the country with robust standard errors.

Autocorrelation in the models will be addressed using lagged dependent variables due to the time series nature of the dataset.

## **Findings**

In Table 1 found below are the findings from the logistic regression testing H1 and ordinary least squared regression testing H2. For H1, two models were estimated. The bivariate analysis presented in Model 1 shows that Chinese foreign direct investment is a statistically significant predictor of civil conflict occurrence. In the second model, the controls of Africa, Asia, and anocracy were added. The finding is robust with these controls, which supports the first hypothesis. The control variable, Asia, had statistical significance in the first hypothesis, meaning that developing countries in Asia are more likely to experience conflict with Chinese FDI presence. Baseline predictions were shown that conflict occurrence in developing countries is 16.9%, and with the presence of Chinese intervention, the probability of conflict occurring in developing countries is increased an additional 4.6%. Asia, as a control variable, shows that the probability of conflict occurring is again raised another 5% (see Table 3 in the Appendix).

Table 1 presents models 3 and 4 which include the results from the ordinary least squared regressions testing my expectations for H2. Model 3 included the dependent variable of Chinese FDI and lagged battle deaths. In model 4, the control variables were incorporated into the model.

These results produced no significance; therefore, findings do not support hypothesis 2. This suggests that although Chinese economic intervention is associated with the presence of conflict in developing countries, it does not account for the intensity of said conflict at least for those states experiencing conflict.

**Table 1.**

	(1) Propensity	(2) Propensity	(3) Intensity	(4) Intensity
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main				
Chinese FDI	0.755** (2.95)	0.837** (2.67)	62.28 (0.49)	141.6 (1.20)
Western FDI	-0.00719 (-0.03)	0.0704 (0.26)	163.9 (0.81)	-47.57 (-0.23)
Lagged Propensity	4.921*** (11.72)	4.564*** (9.74)		
Africa		0.327 (0.99)		-261.2 (-0.68)
Asia		0.827* (2.10)		321.3 (1.66)
Anocracy		0.104 (0.37)		161.0 (0.38)
Lagged intensity			0.968*** (9.68)	0.940*** (4.90)
_cons	-3.922*** (-11.43)	-4.186*** (-9.59)	-91.65 (-0.38)	-63.42 (-0.18)
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N	1419	922	174	128
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t statistics in parentheses  
\* p<0.05, \*\* p<0.01, \*\*\* p<0.001

Lastly, Models 5-8 tested H3, with Foreign Military Intervention measured as both broad and narrow intervention. Models 5 and 7 were bivariate analyses, and the later models for each incorporated the control variables. None of the FDI variables reached statistical significance. Therefore, between the years of 2000-2009, it cannot be concluded that Chinese FDI had any

impact on FMI in developing countries. The control variable Propensity of the conflict however, had statistical significance on the presence of FMI in developing countries.

**Table 2.**

	(1) FMI (broad)	(2) FMI (broad)	(3) FMI (narrow)	(4) FMI (narrow)
main				
Chinese FDI	-0.486 (-1.23)	-0.500 (-1.26)	-0.576 (-1.65)	-0.632 (-1.75)
Western FDI	-0.289 (-0.58)	-0.403 (-0.79)	-0.511 (-1.09)	-0.794 (-1.88)
Propensity	8.408*** (8.47)	8.629*** (8.96)	7.920*** (8.10)	8.319*** (8.67)
Africa		-0.656 (-0.76)		-1.247 (-1.62)
Asia		-0.439 (-0.50)		-0.353 (-0.47)
_cons	-6.502*** (-5.72)	-6.184*** (-4.98)	-6.309*** (-5.60)	-5.789*** (-4.98)
N	1161	1161	1161	1161

t statistics in parentheses  
 \* p<0.05, \*\* p<0.01, \*\*\* p<0.001

For all models in the research, it can be seen that the number of observations (N,) fluctuates between tests. This is attributed to a few factors. First, the inclusion of lagged dependent variables produces less observations in the data in order to prevent autocorrelation in the models. Secondly, specifically for H2, not all countries in the data set experienced conflict in all years observed, therefore the amount of observations for H2 are lower than the total amount of observations in the dataset.

## Conclusion

When interpreting the results of the study, it is important to discuss the restraints and scope of the research. Data concerning foreign direct investment and specific amounts given by countries can be difficult to come by, specifically for China. Because of this, a very limited time period could be observed as data was not readily accessible. Although the timeline of the research was not as long as I intended it to be, the discovery through testing was still significant. With these results, one can make realistic and educated inferences about the future of major power's investments. But extensive future research must be conducted in order to come to conclusions. It is my hope that in the future, myself, or other researchers, can have access in order to further this study.

With China's non-interference policies combined with its history of not acknowledging human rights violations, it can be concluded that receiving economic investment from this major power could prove to be detrimental to a developing country. Specifically, could contribute to the presence of conflict. While China has made progress in changing its noninterference policy, such as supplying peacekeepers in areas such as Sudan, it is almost impossible to not question the real motivation for this action. With Chinese investments continuing in developing regions, Chinese influence expands and could prove to be another factor that maintains instability in developing areas, which will continue to be a major problem within the international system. When compared to major western powers, results have found that the presence of Chinese FDI increases the chance of conflict propensity. While it can be argued that 4.6% increase in the prediction of conflict occurrence is relatively low, one must note that China has investments in a large amount of developing countries. Because of this, major powers, and the international system, must hold themselves accountable when it comes giving FDI to developing countries. Investments into developing countries should not only benefit those who give it, but it should

also benefit the countries that receive it, rather than being detrimental. It is important for other major powers and international organizations to monitor and respond to China's growing economic footprint.

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## Appendix

**Table 3. Hypothesis 1**

	Change	p-value
Chinese FDI		
1 vs 0	0.046	0.008
Western FDI		
1 vs 0	0.004	0.796
Intensity, lag		
1 vs 0	0.714	0.000
Africa		
1 vs 0	0.018	0.344
Asia		
1 vs 0	0.050	0.087
Anocracy		
1 vs 0	0.006	0.714
Average predictions		
	0	1
Pr(y base)	0.831	0.169

**Table 4. Descriptive Statistics**

Variable	Obs	Mean	Std. Dev.	Min	Max
Chinese FDI	1,548	.494186	.5001278	0	1
Western FDI	1,548	.7745478	.4180148	0	1
FMI (broad)	1,161	.118863	.3237668	0	1
FMI (narrow)	1,161	.1042205	.305678	0	1
Asia	1,548	.2170543	.4123731	0	1
Africa	1,548	.3023256	.4594139	0	1
Anocracy	1,024	.3320313	.4711723	0	1
Intensity	229	921.0655	1600.324	25	10165
Propensity	1,548	.1479328	.3551481	0	1
LagIntensity	212	914.9104	1583.042	25	10165