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Diplomatic relations and cross-border investments in the European Union[☆]

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ABSTRACT

This study investigates the extent to which diplomatic relations are related to cross-border merger and acquisition (M&A) activities in the European Union during the years 2001–2019. Implementing a gravity model, we find a positive relationship between diplomatic distance and M&A activities, meaning that weaker diplomatic relations are linked to increases in inward M&As. This finding holds when foreign investors target high-tech firms, are private rather than state-owned enterprises, or buy larger shares of the target companies. This evidence suggests that cross-border acquisitions could be a way for the investing firm to mitigate issues related to weak diplomatic relations, such as access to host markets' information and technological knowledge.

1. Introduction

The discussion on whether Foreign Direct Investments (FDI) should be incentivised or limited is not close to coming to an end (Bermejo Carbonell and Werner, 2018; Gherghina et al., 2019). On the one hand, FDI are a potential source of economic growth, especially for countries that promote greater financial freedom (Azman-Saini et al., 2010) and with well-developed financial markets (Alfaro et al., 2004). On the other, public authorities may perceive FDI as a threat to their strategic interests and autonomy, especially in areas such as national security and high-technology industries. Therefore, control of certain economic sectors plays a central role in

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governments' strategies, and acquisitions of national firms by foreign investors may be perceived as a threat (Heinemann, 2012).

The European Union (EU) has recently adopted a new regulation on FDI.¹ While the EU intends to remain an open market and welcome FDI, this openness is not unconditional, especially as regards protection of internal security and economic sovereignty.² Therefore, the new FDI screening regulation aims to further increase the level of scrutiny of current and future foreign investments. It introduces a coordination mechanism among member states and the European Commission, including allowing the latter institution to issue non-binding opinions on upcoming FDI in the EU on the grounds of security and public order.³

The rise of worldwide political concerns related to foreign acquisitions in strategic sectors has been observed on different occasions. For instance, in May 2019 the United States banned Huawei from US communications networks with a national security order. This act was implemented because the United States had concerns about the close ties between Huawei and the Chinese government, and they feared that Chinese authorities could acquire sensitive information on other countries and companies using Huawei equipment, especially considering the rise of 5G technology (Kaska et al., 2019). This view was supported by Balding (2019), who highlighted the existence of a deep and lasting relationship between Huawei, its employees and the Chinese state. Finally, in June 2020 the US Federal Communication Commission classified Huawei and ZTE, both Chinese companies, as threats to national security. Advanced technology assets are considered among the strongest assets of advanced economies, and the loss of their control in favour of foreign entities is seen as a strategic threat by many observers. For instance, the acquisition of the German industrial robot maker Kuka in 2016 by the Chinese home appliance maker Midea raised an intense debate on the need to protect national technologies, eventually leading to the introduction of stricter rules regarding the types of businesses whose sale to foreign entities would need government approval.⁴

The monitoring and control of domestic assets became even more important with the scarcity of raw materials following the Covid-19 crisis and climbing geo-political tensions. Concepts such as strategic autonomy and technological sovereignty surged as central issues in the policy debate, in Europe and worldwide, on health, defence, industrial, trade, FDI and technology related domains.⁵

Worldwide M&A activity has intensified since the beginning of the century, especially in Europe, where inward M&As steadily increased in the second half of the 1990s, in the 2000s reaching for the first time magnitudes comparable with those in the United States, and maintaining thereafter high levels (e.g. Moschieri and Campa, 2014; Perafan-Peña et al., 2020). As shown in Fig. 1, cross-border M&A flows have increased in recent years, especially those targeting firms in high-technology industries, suggesting an increased appetite among foreign investors for certain business typologies.

In this context, political factors may affect both the way in which foreign investments are perceived by the authorities of the receiving countries, and the decision to invest by foreign investors. The common view in the political relations literature is that positive political linkages foster FDI, because on the one hand political affinity decreases the probability of an expropriation of foreign assets by the host country's government (Nigh, 1985; Desbordes and Vicard, 2009; Desbordes, 2010) or its intervention against foreign firms' acquisitions (Duanmu, 2014; Bertrand et al., 2016). On the other, foreign firms investing in countries characterised by good diplomatic relations with the country of their headquarters may benefit from more timely access to relevant information facilitated by public authorities and reduced political risks (Li et al., 2018). In fact, governments have an important role in bridging information and knowledge gaps on foreign markets for local actors (Shimizu et al., 2004). Following this line of thought, it is nevertheless also possible that conflicting political relations could undermine the exchange of knowledge and information among countries, and market players may strategically acquire foreign companies to have direct access to valuable information and technological knowledge.

Our study advances the understanding of the relationship between diplomatic relations and foreign investment behaviours by studying M&A flows in the EU in the period 2001–2019.⁶ The focus on the EU is primarily motivated by the lack of previous evidence on the relationship between diplomatic distance (DD) and FDI in Europe, in spite of the steady intensification of inward M&As in Europe since the second half of the 1990s (e.g. Moschieri and Campa, 2014; Perafan-Peña et al., 2020). Furthermore, previous studies on the role of interstate diplomatic relationships and FDI activity have dealt with specific entry modes other than M&As, or have not specified the nature of entry. The study by Bertrand et al. (2016) is the only one that addressed M&As, but used a low number of large foreign acquisitions involving listed acquiring and target companies. Moreover, policy interest in inward FDI has recently been growing in Europe due to the new FDI screening regulation introduced in 2020. Previous studies have attributed an important role to

¹ See EU Regulation 2019/452 (<https://eur-lex.europa.eu/eli/reg/2019/452/>), EC Working document on FDI in the EU (https://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157,724.pdf) and a related data source “The Foreign Ownership dataset—FOWN” (Gregori et al., 2019). It was formally adopted on March 2019 by the European Parliament and the Council of the European Union, and became fully operational in October 2020.

² Press release of the European Commission (<https://trade.ec.europa.eu/doclib/press/index.cfm?id=2124>).

³ As of July 2021, 18 out of 27 European Member States have FDI review mechanisms in place (European Commission, 2021). These mechanisms mainly focus on M&As excluding greenfield investments (while the new EU Regulation, 2019/452 also covers Greenfields), differ in scope (e.g. review of intra- or extra-EU FDI, differing screening thresholds, breadth of sector coverage), process (e.g. pre-authorisation vs ex post screening of FDI), and review timetables and enforcement, generating a non-homogenous review process among EU Member States.

⁴ As also discussed by Elisabeth Braw, “Cutting-edge tech takeovers are a strategic threat to the west”, *Financial Times*, 2019 (<https://www.ft.com/content/763cae4e-e5ed-11e9-b8e0-026e07cbe5b4>).

⁵ For instance, in February 2022 the European Commission proposed the Chips Act to confront semiconductor shortages and strengthen EU digital sovereignty (see: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_729).

⁶ While FDI includes M&A and greenfield investments, we primarily focused on M&As, which are the main mode by which multinational firms engage in FDI (Blonigen and Pierce, 2016), especially among developed countries (see the World Investment Report released annually by the United Nations Conference on Trade and Development, latest issue: https://unctad.org/system/files/official-document/wir2021_en.pdf). In addition, in Section 5 we present the results of the analysis of greenfield FDI, which provides further supporting evidence to the main argument of the study.

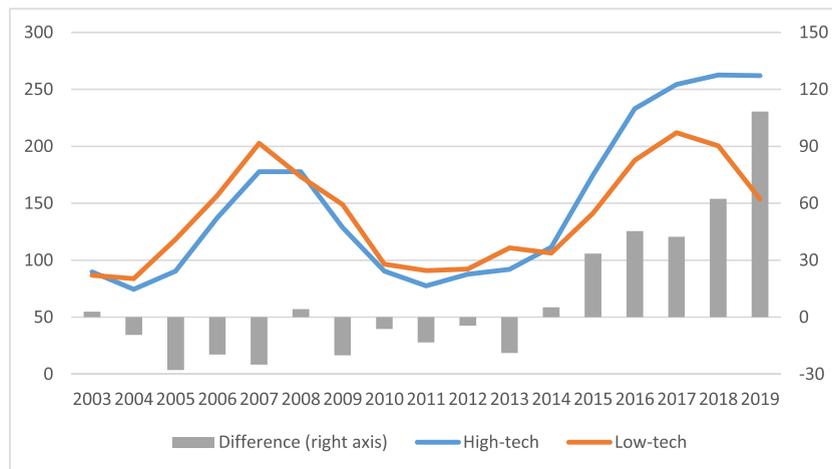


Fig. 1. Cross-border M&A flows in the EU, high-vs low-technology industries (billion Euro).

public control in explaining the negative relationship between DD and FDI activity, which they found empirically in different contexts. However, it is not known to what extent in recent decades European national authorities have screened foreign acquisitions on the grounds of the affinity of foreign policy between the governments of the investing and destination countries rather than merely on the basis of economic reasons concerning fair market competition and consumer protection. This study fills these gaps with evidence on the role of foreign diplomacy on incoming foreign acquisitions and the attitude of European national authorities towards them.

We used an augmented gravity model, with the volume of EU inbound M&A flows as the dependent variable and DD as focal independent variable. To this purpose, we constructed a measure of dyadic diplomatic relations between the country of the investor and the country of the target company using an index of country-pairs' vote alignment in the United Nations General Assembly (UNGA), as in [Bailey et al. \(2017\)](#). In contrast with the dominant evidence found in the literature on political relations and FDI, we found a positive relationship between DD and M&A activities. This finding holds when foreign investors target technology-intensive firms, are private rather than state-owned enterprises, or buy larger shares of the target companies. This evidence suggests that cross-border acquisitions of European companies could be a way for the investing firm to mitigate issues related to weak diplomatic relations, such as access to host markets' information and technological knowledge.

The rest of the study is organised as follows. Section 2 discusses the related literature. Section 3 presents the empirical methodology and the dataset. Section 4 describes the results and includes related discussion. In Section 5 we implement a series of robustness checks, and Section 6 concludes.

2. Conceptual framework

The effects of political and cultural factors on foreign investments have attracted the attention of many authors; most share the view that political and cultural proximity enhances trade and FDI flows. For instance, [Busse and Hefeker \(2007\)](#) studied the effect of political risk and institutions on FDI flows for developing countries. The authors showed that government stability, law and order, and democratic accountability are positively linked to FDI. [Gassebner et al. \(2020\)](#) found that political risk decreases M&A inflows, because instability in the government of the destination country could generate changes in formal rules, lowering FDI expected returns. [Demir and Im \(2020\)](#) found that cultural institutes have a positive effect on bilateral trade and investment flows.

The positive contribution of political and cultural similarities among countries to bilateral trade and FDI flows is in line with many studies that focus on political relations, where positive political links foster FDI. In particular, a first group of studies ([Nigh, 1985](#); [Desbordes and Vicard, 2009](#); [Desbordes, 2010](#)) found that higher diplomatic risks negatively affect the FDI of US multinational enterprises in developing countries, requiring higher returns on investments. Analogously, [Bertrand et al. \(2016\)](#) documented how lower political affinity requires a larger initial acquisition premium. In addition, [Li et al. \(2018\)](#) showed that favourable diplomatic relations increase cross-border investments by Chinese firms. This body of evidence is based on the grounds of two main driving forces. First, a lower level of political affinity is linked to a higher probability that the host government could intervene against foreign firms' acquisitions or expropriate foreign assets after the investment. In fact, as supported by the legitimacy theory, economic agents and observers in the host country are more likely to perceive the control of local assets by companies based in countries with misaligned foreign policy as a threat to national economic and security interests ([Eden and Miller, 2004](#); [Bertrand et al., 2016](#); [Ellis et al., 2018](#); [Hasija et al., 2020](#)), as well as a challenge to national identity and pride ([Shenkar et al., 2008](#); [Riad and Vaara, 2011](#)). Consequently, governments of host countries are more likely to interfere by putting regulatory barriers in place. Second, foreign firms investing in countries characterised by good diplomatic relations can better access and leverage intergovernmental diplomatic connections, benefitting from more timely access to relevant information facilitated by public authorities ([Li et al., 2018](#)). In relation to our analysis, the findings of previous studies suggest the ex-ante prediction that positive diplomatic relationships among pairs of countries is related to an increase in bilateral FDI flows.

While the majority of previous empirical studies have pointed to a negative relationship between DD and FDI activities, there are reasons to expect such a relationship may not necessarily hold in unexplored contexts such as acquisitions in European companies. In fact, the risk of expropriation of investors' assets by destination countries' governments is low in democracies (Jensen, 2008). In addition, screening mechanisms for foreign acquisitions on political grounds are more likely to be operating for deals that attract strong attention from involved stakeholders and public opinion, such as foreign acquisitions of the large listed target companies studied by Bertrand et al. (2016) – due to the economic scale of the deals – and Chinese outward FDI studied by Duanmu (2014) and Li et al. (2018) – due to the growing scale of Chinese foreign activities, combined with fluctuating diplomatic relationships between the Chinese government and some developed countries. In contrast, the majority of incoming foreign activities in European countries may more commonly be screened for economic motives, concerning fair market competition and consumer protection rather than political considerations. In fact, available evidence indicates that the “government control channel” is particularly important in host countries with weak impartiality in its institutions (Li et al., 2018), which we argue is unlikely to be the case for European countries.

Li et al. (2018) also stressed the role that governments have in bridging information and knowledge gaps regarding foreign markets for local actors by connecting them with foreign ones. They documented the fact that Chinese companies with stronger connections with national and local authorities benefit from preferential access to information and consequently invest more in foreign countries with friendly relationships with China. Another mechanism may nevertheless operate in relation to the role of governments in brokering knowledge on foreign markets to local companies. In fact, weaker diplomatic relationships may provoke disruptions to such an information flow (Shimizu et al., 2004), to which local companies may react by strengthening their presence abroad to get direct access to valuable knowledge. Consistently with the internalisation theory, this process may provide a learning opportunity for the investor fostering a bird's-eye view, as opposed to a parochial view (Buckley and Casson, 1976, 2020; Stahl and Tung, 2015).

In contexts where the role of governments of FDI origin countries as brokers of knowledge prevails, the relationship between DD and FDI activity may become positive. The issue therefore requires an empirical investigation, which is the goal of our empirical analysis as described in the next section.

3. Empirical methodology and data

3.1. Empirical methodology

The gravity model is a standard tool implemented in the empirical literature to study trade determinants⁷ and it has been more recently extended to analyse FDI positions. Following an established approach (see, among others, Hijzen et al., 2008; Head and Ries, 2008; De Sousa and Lochard, 2011; Gregori and Nardo, 2021), we specify the baseline model as follows:

$$M\&A_{ij,t} = \exp[\alpha + \beta DD_{ij,t-1} + \gamma \text{Controls}_{ij,t-1} + \varphi_{i,t} + \omega_{j,t} + \varepsilon_{ij,t}] \quad (1)$$

where $M\&A_{ij,t}$ represents the flow of cross-border M&As from country i to country j at time t . $DD_{ij,t-1}$ is the diplomatic distance indicator constructed using the affinity of countries' votes in the UNGA, as further detailed in the following subsection. In line with findings of previous studies (e.g. Eicher et al., 2012; Blonigen and Piger, 2014; Economou, 2019), *Controls* is a vector of independent variables that includes the distance between country pairs, contiguity to account for countries sharing the same border, the use of a common language, the presence of a former colonial link, a common legal origin, time differences between countries, and the presence of regional trade agreements. β is the key parameter of interest associated with DD and γ is the vector of parameters associated with the independent variables. Additionally, we included acquirer and target country-year fixed effects ($\varphi_{i,t}$ and $\omega_{j,t}$ respectively) to capture country-specific time-varying unobserved shocks.⁸ Finally, $\varepsilon_{ij,t}$ is the zero-mean error. Time-varying explanatory variables (i.e. DD and regional trade agreements) are lagged by 1 year to reduce potential endogeneity issues. To account for potential heteroscedasticity, standard errors are clustered by country-pair.

To include each bilateral relation in the model, we manually inserted the value zero when a country-pair does not have M&A flows.⁹ As a consequence, the dependent variable has a high frequency of zeros, generating a bias in the gravity regressors obtained from log-linearised ordinary least squares, because taking logs clears the sample from null observations (Helpman et al., 2008). Therefore, we estimated the model using the Poisson Pseudo Maximum Likelihood (PPML) estimator (Santos Silva and Tenreyro, 2006; Head and Mayer, 2014). The PPML estimators provide an additional advantage, thanks to their robustness to heteroscedasticity in log-linear gravity equations, for instance in the case of correlation between the scale of the residual and countries' GDP (Nordås and Rouzet, 2017).

⁷ See the seminal paper by Tinbergen (1962) and the theoretical foundations provided by Anderson and Van Wincoop (2003). Helpman et al. (2008) and Melitz and Ottaviano (2008) provide additional contributions to the theoretical micro-foundations, suggesting that heterogeneous firm models are compatible with the gravity approach. Theoretical background and micro-foundations of gravity equations are provided by Head and Mayer (2014).

⁸ The interaction between year and country fixed effects subsumes year, target and acquirer country fixed effects.

⁹ We created a full matrix of country pairs per year, with a dimension equal to the number of origin countries multiplied by the destination country, generating 72,072 observations. As shown in the descriptive statistics (see Table 1), we have positive M&A values in 7984 cases, meaning that we filled all the other bilateral relationships with zeros.

3.2. Data

To implement the model delineated in the previous subsection, we built a dataset using different sources. The dependent variable (M&A) was constructed for the period 2001–2019 exploiting the Bureau van Dijk Zephyr database, a Moody's analytics product which contains information about M&A deals between country pairs (in thousands of euros).¹⁰ We considered cross-border deals where the target company is in the EU28 and the deal is defined as completed.¹¹ For each deal we also included all the details needed to perform the analysis, specifically the year of the agreement, information about the target firm in order to detect the destination country and the primary sector in which it operates. To define the country of origin of the investment, we considered the global ultimate owner (GUO) of the investor. Considering the complex structure of multinational firms, using the GUO allowed us to better identify the country in which the decision to implement a specific M&A is actually taken (Alvarez et al., 2017; Gregori et al., 2019). Information about the GUO comes from Orbis (a Bureau van Dijk product that employs the same firm identifiers as Zephyr).¹²

Our focal explanatory variable (DD) measures the distance of countries' foreign policy, relying on the affinity of countries' votes in the UNGA. Previous research in political science and international business has made frequent use of votes in the UNGA to infer countries' preferences (e.g. Desbordes, 2010; Bertrand et al., 2016; Li et al., 2018). Votes in the UNGA show countries' opinions – comparable both across time and between countries – on various issues covering political, social and economic domains (Voeten, 2000). Moreover, they are not binding, providing no (or less) scope for strategic voting behaviour and conversely more room for countries to express their honest opinion (Gartzke, 1998). We constructed a variable measuring the DD of countries following Bailey et al. (2017), who used UNGA votes to elicit countries' preferences over foreign policy defined as ideal points.¹³ Compared with previous measures of state proximity based on UNGA votes (Gartzke, 1998; Signorino and Ritter 1999; Strezhnev and Voeten, 2013), the approach adopted by Bailey et al. (2017) enhances comparability across time by taking into account information about the content of the UN's agenda. We then transformed ideal points into a measure of dyadic DD by taking the absolute value of the difference between the ideal points of each country pair in our sample. This measure assumes that similar votes in the UNGA and therefore similar ideal points imply a good relationship and that the countries act cooperatively because they share similar views and understandings on world issues (Gartzke, 1998).

Table 2 provides descriptive evidence of the distribution of DDs in the estimation sample for the investing countries with the largest investments, to better understand differences in the alignment of their foreign policy with European destination countries. It shows that DDs between EU Member States are generally low, with a median equal to 0.1 across all EU Member States pairs and years. DDs increase strikingly with origin countries outside the EU (median 1.5), though with notable heterogeneity. They are relatively low for Australia, Japan and Ukraine (median between 0.2 and 0.3), increase slightly for Canada (0.5) and the United Kingdom (0.6) and become relatively large for Russia (1.0), China (1.7), and, perhaps surprisingly, the United States (1.7). The most misaligned foreign policy (not shown in the table) is observed for Cuba, Egypt, Iran, Sudan and Zimbabwe (median above 2.3). Table 2 also makes clear that most M&A value is accounted for by acquiring companies based in a limited number of countries. The United States is the origin country with the largest value, accounting by itself for about a quarter of all inflows in the EU, while about half (49%) of M&A value is accounted for by intra-EU foreign M&A investments.

The standard gravity variables, distance and GDP, were taken from the CEPII database.¹⁴ The additional control variables, included in the augmented gravity model because as suggested in the literature they could influence cross border investments, were retrieved from two different sources. The CEPII database provided us with the following dyadic variables: contiguity, common language, colonial links, common legal origin, time difference and the membership of a common regional agreement. The indicator "rule of law" was taken from the World Bank's World Government Indicators database¹⁵ and considers institutional factors, such as the degree of property rights protection and the extent to which a country has an environment where the basis for economic and social interactions is formed by fair and predictable rules. This indicator, estimated yearly at country level, includes perceptions of the incidence of crime, the effectiveness and predictability of the judiciary system, and the enforceability of contracts, and it ranges from approximately –2.5 to 2.5 (see Kaufmann et al., 2011). Table 2 reports the descriptive statistics.¹⁶

¹⁰ The use of Zephyr has been widely reported in the literature (Reiter, 2013; Cló et al., 2017; Del Bo et al., 2017, among others). It provides information on different kinds of deals, such as M&As, portfolio investments and Joint Ventures. It has a worldwide coverage starting from 1997 and is updated daily, gathering information from a wide range of sources (such as financial journals, reports, company press releases, and company websites).

¹¹ Therefore we excluded announced, rumoured or uncompleted investments, in order to focus on those deals that had actually been implemented.

¹² When the investor is not part of a group, the GUO is the investor itself and therefore we considered the country in which the direct investor is located as the country of origin of the investment.

¹³ We retrieved ideal points from the UNGA voting database (Voeten et al., 2009), which is regularly updated and freely available (<https://blogs.commons.georgetown.edu/erikvoeten/data/>).

¹⁴ See http://www.cepii.fr/CEPII/en/bdd_modele/presentation.asp?id=8 (Mayer and Zignago, 2011; De Sousa et al., 2012). From 2016 onwards, GDP was taken from the World Bank database. The variable "distance" was calculated as the distance between the biggest cities of each country pair. Inter-city distances were weighted by the share of the city in the country's overall population (Mayer and Zignago, 2011; De Sousa et al., 2012).

¹⁵ See <http://info.worldbank.org/governance/WGI>.

¹⁶ The correlation table can be found in the Appendix (Table A1).

Table 1
Diplomatic distances of the 20 largest investing countries with EU destination countries.

Country of the acquiror	% of total M&A value	Diplomatic distance with destination countries				Cumulated % of total M&A value
		Median	Min.	Max.	SD	
United States	24.6	1.660	0.824	2.876	0.244	24.6
United Kingdom	10.1	0.625	0.037	2.040	0.188	34.7
France	8.2	0.453	0.037	1.799	0.176	42.9
Netherlands	7.0	0.102	0.000	1.412	0.166	49.9
Germany	5.6	0.124	0.001	1.378	0.171	55.5
Japan	4.2	0.332	0.002	1.071	0.205	59.7
Switzerland	3.1	0.236	0.000	1.102	0.209	62.8
Spain	2.9	0.089	0.001	1.165	0.167	65.7
Italy	2.9	0.101	0.000	1.238	0.163	68.7
Luxembourg	2.7	0.093	0.000	1.245	0.166	71.4
Canada	2.6	0.512	0.001	1.915	0.335	73.9
Ukraine	2.5	0.219	0.002	1.385	0.284	76.4
China	2.5	1.717	0.523	2.628	0.267	78.9
Sweden	1.9	0.158	0.000	1.239	0.185	80.9
Norway	1.6	0.118	0.000	1.213	0.168	82.5
Ireland	1.6	0.211	0.002	1.108	0.190	84.1
Australia	1.4	0.357	0.000	1.668	0.203	85.5
Russia	1.2	0.974	0.342	1.810	0.233	86.8
Belgium	1.1	0.091	0.000	1.449	0.168	87.9
Finland	1.1	0.109	0.001	1.209	0.166	89.0

Notes: Median, minimum, maximum and standard deviation statistics are computed on the distribution of diplomatic distance between each of the 20 largest investing countries and EU28 countries between 2001 and 2019.

Table 2
Main descriptive statistics.

Variables	Source	Obs.	Mean	SD	Min.	Max.
<i>Dependent variable</i>						
M&A	Zephyr	7984	664.17	2908.16	0	1,15,586.61
<i>Main control variable</i>						
Diplomatic distance	Bailey et al. (2017)	7984	0.65	0.68	0	3.36
<i>Bilateral indicators</i>						
Distance (in log)	CEPII	7984	7.65	1.08	5.08	9.85
GDP of the origin country (in log)	CEPII, World Bank	7984	27.01	1.79	18.63	30.65
GDP of the destination country (in log)	CEPII, World Bank	7984	26.76	1.56	22.19	29.00
Contiguity	CEPII	7984	0.12	0.33	0	1
Common language	CEPII	7984	0.10	0.31	0	1
Colonial links	CEPII	7984	0.09	0.28	0	1
Common legal origins	CEPII	7984	0.31	0.46	0	1
Time difference	CEPII	7984	2.58	3.11	0	12.00
Regional trade agreements	CEPII	7984	0.67	0.47	0	1
Dummy for origin country from the EU28		7984	0.53	0.50	0	1
<i>Government indicators</i>						
Rule of Law of the origin country	World Bank	7984	1.13	0.84	-1.63	2.10
Rule of Law of the destination country	World Bank	7984	1.24	0.62	-0.26	2.10

Notes: Data for M&A refer to the period 2001–2019 in million Euro (one observation for each country pair, year and subsector), while for all other variables data relate to the period 2000–2018 (diplomatic distance and regional trade agreements are lagged by 1 year to limit endogeneity issues). GDP values are in billion Euro. The table includes information for observations where the value of M&A is positive.

*We measure the diplomatic distance between the countries of acquiring and target companies by the affinity of the two countries' votes in the United Nations (UN) General Assembly in the year before the deal. The data on affinity of UN votes are from Strezhnev and Voeten (2013) [or Bailey et al. (2017), devo capire quale articolo si applica nel nostro caso].

4. Results

4.1. Baseline analysis

Baseline results are reported in Table 3. We first estimated a gravity model, including the core gravity variables (i.e. country distance and GDP of the origin and destination countries), bilateral and country characteristics, and year fixed effects (specification 1). We then added our main control variable of interest, DD (specification 2), target and acquiror fixed effects (specifications 3 and 4 respectively). Finally, we also included the interaction between year and both target and acquiror fixed effects (specification 5). This latter estimation shows the baseline model as presented in the previous section, equation (1).

We will start by discussing the results related to our main control variable. Interestingly, DD is positively related with M&A flows,

Table 3
M&As and diplomatic distance, baseline estimation.

	(1)	(2)	(3)	(4)	(5)
Diplomatic Distance _{ij,t-1}		0.31** (0.13)	0.27** (0.12)	0.33** (0.15)	0.43*** (0.16)
ln (Distance) _{ij}	-1.02*** (0.16)	-1.03*** (0.16)	-0.86*** (0.13)	-0.60*** (0.17)	-0.66*** (0.15)
ln (GDP - origin country) _{i,t-1}	0.80*** (0.04)	0.79*** (0.04)	0.79*** (0.04)	0.64** (0.28)	
ln (GDP - destination country) _{j,t-1}	0.83*** (0.06)	0.82*** (0.06)	0.90* (0.48)	0.92* (0.50)	
Contiguity _{ij}	-0.76*** (0.20)	-0.75*** (0.20)	-0.36* (0.21)	-0.06 (0.22)	-0.05 (0.18)
Common language _{ij}	0.27 (0.23)	0.26 (0.23)	0.02 (0.22)	0.36* (0.21)	0.35* (0.18)
Colony _{ij}	0.61** (0.24)	0.59** (0.23)	0.47** (0.21)	0.37* (0.22)	0.34** (0.16)
Common legal origins _{ij}	0.27 (0.17)	0.33* (0.17)	0.31** (0.15)	0.22* (0.12)	0.26** (0.10)
Time difference _{ij}	0.17*** (0.05)	0.17*** (0.05)	0.14*** (0.05)	0.32*** (0.11)	0.26*** (0.10)
Regional trade agreements _{ij,t-1}	0.08 (0.30)	0.24 (0.28)	0.19 (0.25)	2.19** (0.90)	-1.39* (0.72)
Rule of Law - origin country _{i,t-1}	0.54*** (0.15)	0.64*** (0.17)	0.67*** (0.18)	1.25** (0.55)	
Rule of Law - destination country _{j,t-1}	0.47*** (0.14)	0.47*** (0.13)	-0.64 (0.40)	-0.62 (0.40)	
Year fixed effects	yes	yes	yes	yes	no
Target country fixed effects	no	no	yes	yes	no
Acquiror country fixed effects	no	no	no	yes	no
Year * Target country fixed effects	no	no	no	no	yes
Year * Acquiror country fixed effects	no	no	no	no	yes
Observations	64,092	64,092	64,092	64,092	34,036
Number of acquiror countries	122	122	122	122	122
Number of target countries	28	28	28	28	28
Pseudo-R ²	0.653	0.655	0.678	0.731	0.799

Notes: This table shows the results from implementing the PPML model. The dependent variable is the value of bilateral M&A in thousand Euro and covers years 2001–2019. Time-varying explanatory variables are lagged by 1 year and cover the period 2000–2018. Robust standard errors clustered by country pair are shown in parenthesis. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.

with the focal parameter being statistically significant at the 1% level. In contrast with the view found in the literature that good diplomatic relations is positively related to foreign acquisitions, our result means that dissimilar voting behaviour at the UNGA is positively related to the volume of acquisitions of EU companies. As supported by the legitimacy theory, economic agents and observers in the host country are more likely to perceive acquisitions from companies based in countries with sharply misaligned foreign policy as a threat for national economic and security interests (Eden and Miller, 2004; Bertrand et al., 2016; Ellis et al., 2018; Hasija et al., 2020) as well as a challenge to national identity and pride (Shenkar et al., 2008; Riad and Vaara, 2011). However, our findings suggest that some channels to which previous studies attributed a positive relation between diplomatic proximity and FDI activity, namely the risk of expropriation of investors' assets and obstacles to FDI activities by destination countries' governments, do not operate in the context of foreign acquisitions of European target companies.

The positive relationship between DD and inward M&As is, in contrast, in line with the idea that weaker foreign relations between countries with overall friendly diplomatic ties reduce access to information to foreign markets, lowering business opportunities (Shimizu et al., 2004). This view is consistent with the internalisation theory, which suggests that weak bilateral relationships can provide a learning opportunity for the investor, also fostering a bird's-eye view as opposed to a parochial view (Buckley and Casson, 1976, 2020; Stahl and Tung, 2015). It is also in line with the empirical evidence suggesting that governments have a role in bridging information and knowledge gaps on foreign markets to local actors by connecting them with foreign ones (Li et al., 2018). Weaker diplomatic relationships may provoke disruptions to such an information flow (Shimizu et al., 2004), to which local companies may react by strengthening their presence abroad to get direct access to valuable knowledge.

The other control variables are in line with our ex-ante expectations and evidence found in previous studies. In relation to the core gravity variables, the greater the distance between origin and destination countries, the lower the M&A activity. Country-pair contiguity is not statistically significant in our baseline estimation, while the positive coefficients of former colonial relationships and common legal origins suggest that cultural similarities increase M&As. Not surprisingly, the time difference between countries is positively related with foreign investments, in line with the idea of regional specialization and vertical integration in the production process (Marjit, 2007). The variable related to regional trade agreements is significant, suggesting a negative impact of these agreement on M&A activities. Moreover, we introduced country-level variables, namely GDP and the rule of law of investor and destination countries, in specifications (1) to (4) that do not include interactions between year and acquiror country, and year and

target country fixed effects.¹⁷ Companies based in countries with a higher GDP are engaged in more investment activities, in line with previous studies (among others, see Eicher et al., 2012, Blonigen and Piger, 2014, and Economou, 2019). However, the significance of the destination countries' GDP falls once fixed year and country effects are introduced.

4.2. High-technology sectors

Given the importance of timely access to information for innovative companies operating in technology-intensive industries and the strategic relevance of technological development for governments, we expected that the relationship between diplomatic relations and foreign investments could vary across sectors. To further investigate this aspect, we exploited the Eurostat aggregation of manufacturing and service industries that classifies 2-digit level NACE Rev. 2 industries according to their technological intensity.¹⁸

We estimated our model separately according to target firms' industry class, as reported in Table 4. Specifications (1) and (2) split the sample of deals into low- and high-tech industries. The latter firms comprise high-tech manufacturing as well as knowledge-intensive services, while the former refer to low- and medium-low technology manufacturing and non-knowledge-intensive services. Interestingly, DD is significant in high-tech industries, while the contrary is true for M&A activities in low-tech ones. The finding on high-tech firms reinforces the idea that foreign investors may consider acquisitions as a tool to overcome poor diplomatic relations and have direct access to prime information.

4.3. Acquiror specificities: state-owned, level of democracy and willingness to control

Previous studies have documented the specificities of the investing behaviour of state-owned enterprises (SoE) as compared to private companies, suggesting the pursuit of non-financial motives or political goals (Knill et al., 2012; Cló et al., 2017). Moreover, SoE are likely to be subject to stricter scrutiny by the host country when trying to buy a foreign company for a variety of reasons including the perceived threat to national security and unfair support by origin countries (Duanmu, 2014). How these specificities reflect in the relationships between M&A activities and diplomatic relations is difficult to predict ex-ante. We therefore studied the role of SoE investors, defined as investors with a public GUO.¹⁹ Table 5 presents the results, splitting cross-border M&As into two groups of investors, private companies (specification 1), and SoE (specification 2). Results suggest that baseline results apply to private companies, while DD is not related with M&A decisions made by SoE, reinforcing the view that it is the private sector that is willing to overcome potential limitations due to a higher DD, such as access to foreign market information, with a direct presence in the market of interest.

We also investigated whether investments from countries with different levels of democracy might behave differently. We divided the countries of investing firms into high-democracy or medium-low democracy countries. To disentangle these groups, we exploited the 2019 democracy index elaborated by *The Economist*.²⁰ Specifications 3 and 4 show the results, suggesting that our findings are confirmed for high-democracy countries.

Finally, we investigated whether our baseline results are different between Portfolio investments and FDI, the former being investment where the acquired stake of the target firm is less than 10% and the latter greater than 10% (specifications 5 and 6). The rationale is that investors should be interested in long-lasting investment (i.e. FDI) to exploit information in destination markets, while portfolio investment may follow speculative goals. Our baseline results are confirmed for FDI, while the DD coefficient is not significant for portfolio investments. This finding is in line with Yoon et al. (2020), who for emerging countries acquiring firms in the UK show that weaker bilateral political relations, which are linked to higher transaction and coordination costs, increase the probability of the investing firms taking full ownership of the target, in order to increase efficient learning through a greater internalised control.

4.4. Change over time

In this section we split the time frame into three sub-periods, namely 2001–2007, 2008–2013 and 2014–2019. This was done to exacerbate potential structural breaks, in line with general macroeconomic conditions and investment flows, as also visually illustrated by the M&A inflows to the EU shown in Fig. 1. The first period refers to before the pre-2008 crisis, with a favourable investment climate. The second period corresponds to the overall shrink in international investment activities that followed the 2007–2008 sub-prime crisis and the subsequent sovereign debt crisis. The last period focuses on the recovery, when foreign investments grew.

Table 6 shows the results, indicating that before the 2008 crisis DD had a positive relationship with M&A inflows to the EU. This

¹⁷ In the baseline model, specification (5) of Table 3, the parameters associated to explanatory variables at the acquiring or destination country level cannot be identified, because these variables are collinear with the interactions between year and acquiror country, and year and target country fixed effects. It must also be noted that the sample size declines in the baseline as compared to specifications (1) to (4). This happens because acquiring countries that do not invest in a given year in any of the EU countries do not contribute to the likelihood function and are therefore dropped.

¹⁸ Eurostat indicators on high-tech industry and knowledge-intensive services are available here: https://ec.europa.eu/eurostat/cache/metadata/Annexes/htec_esms_an3.pdf.

¹⁹ To have control, the public entity should own at least 50.01% of the firm's shares. To define an entity as public, we relied on the classification made by Orbis, specifically when the investor's GUO type is labelled as "public authority, state, government".

²⁰ See <https://www.in.gr/wp-content/uploads/2020/01/Democracy-Index-2019.pdf>. High democracy countries are those identified as "full democracy", while medium-low democracy countries are identified as "flawed democracy", "hybrid regime" or "authoritarian regime".

Table 4
M&As in High-and Low-tech sectors.

	(1)	(2)
	Low-tech	High-tech
Diplomatic Distance _{ij,t-1}	0.11 (0.25)	0.91* (0.51)
ln (Distance) _{ij}	-0.88*** (0.19)	-0.07 (0.36)
Contiguity _{ij}	-0.17 (0.23)	0.16 (0.43)
Common language _{ij}	0.23 (0.22)	-0.31 (0.52)
Colony _{ij}	0.50*** (0.18)	0.78*** (0.26)
Common legal origins _{ij}	0.42*** (0.13)	0.80** (0.33)
Time difference _{ij}	0.46*** (0.12)	0.29 (0.24)
Regional trade agreements _{ij,t-1}	-0.71 (0.61)	-3.92*** (0.80)
Year * Target country fixed effects	yes	yes
Year * Acquiror country fixed effects	yes	yes
Observations	26,819	13,773
Number of acquiror countries	106	81
Number of target countries	28	28
Pseudo-R ²	0.666	0.782

Notes: This table shows the results from implementing the PPML model. The dependent variable is the value of bilateral M&A in thousand Euro and covers years 2001–2019. Time-varying explanatory variables are lagged by 1 year and cover the period 2000–2018. Following the Eurostat definition (see: https://ec.europa.eu/eurostat/cache/metadata/Annexes/htec_esms_an3.pdf), low-tech industries refers to low- and medium-low technology manufacturing and non-knowledge-intensive services. High-tech industries refers to high-technology manufacturing and knowledge intensive services. Robust standard errors clustered by country pair are shown in parenthesis. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.

positive link disappears during the crisis years, and kicks in again in the recovery phase which started in 2014. Therefore these results suggest that the DD-M&A positive relationship is confirmed during periods of positive economic growth.

5. Robustness checks

In this section we describe the implementation of a series of robustness checks to validate the findings discussed in the previous sections.

Table A2 shows the first series of robustness checks. Specification (1) adopts the baseline model using data on greenfield FDI,²¹ and findings are in line with the general evidence on M&As.

Specifications (2) to (5) in Table A2 show that the findings of the analysis are not driven by specific investor countries which may be thought to be disproportionately important because of either their economic or their geo-political role. Considering that the United States is a key EU foreign investor partner, it could be the main driver of the results. We re-estimated the baseline model excluding all deals with a GUO located in the United States, and the results are confirmed (specification 2). Results are also confirmed when excluding the United Kingdom (specification 3), which we included in this test considering its historical specificities and relevance as acquiror of companies located in other EU countries. Results still hold when excluding China (specification 4), a partner with an increasing strategic importance, as well as when contemporaneously excluding the United States, the United Kingdom and China (specification 5). Therefore, the evidence of this set of robustness checks reassures us that no specific investor countries drive our findings.

We then tested the robustness of the results to the possibility that investors strategically choose their location for fiscal reasons. For

²¹ The analysis draws on data on greenfield FDI between 2003 and 2019 from the fDi Markets database maintained by fDi Intelligence, a division of the Financial Times Ltd, which is an ongoing collection of information on the announcements of cross-border greenfield investment projects covering all countries worldwide from 2003. This database is widely used by international organizations – for instance the United Nations Conference on Trade and Development (UNCTAD) has used it since 2009 as a key data source for its annually released World Investment Report – as well as in academic research on FDI in Europe (e.g. Castellani and Pieri, 2013; Crescenzi et al., 2014, 2021; Aquaro et al., 2021). Differently from the case of foreign M&As used in the main analysis, fDi Markets data do not allow for identifying the country of the GUO. We therefore used the country of the investing company in the analysis of greenfield FDI.

Table 5
M&As and investors specificities.

	(1)	(2)	(3)	(4)	(5)	(6)
	Private	SoE	High democracy countries	Medium-low democracy countries	Portfolio	FDI
Diplomatic Distance _{ij,t-1}	0.48*** (0.17)	1.52 (1.17)	0.43** (0.17)	1.22 (0.89)	-0.32 (0.46)	0.33* (0.17)
ln (Distance) _{ij}	-0.58*** (0.15)	-1.97** (0.86)	-0.69*** (0.15)	2.14** (0.90)	-0.82*** (0.17)	-0.27 (0.21)
Contiguity _{ij}	-0.08 (0.18)	1.12 (1.00)	-0.11 (0.19)	2.22*** (0.62)	-0.09 (0.23)	0.00 (0.20)
Common language _{ij}	0.32* (0.18)	3.69*** (0.99)	0.29 (0.18)	2.25*** (0.75)	0.32 (0.23)	0.47** (0.19)
Colony _{ij}	0.35** (0.17)	0.15 (0.38)	0.35** (0.16)	0.15 (0.44)	0.85*** (0.21)	-0.04 (0.16)
Common legal origins _{ij}	0.26** (0.10)	-0.35 (0.25)	0.36*** (0.11)	-0.07 (0.21)	0.30** (0.13)	0.22* (0.12)
Time difference _{ij}	0.22** (0.10)	1.89*** (0.45)	0.24** (0.11)	0.08 (0.37)	0.23* (0.12)	0.33*** (0.12)
Regional trade agreements _{ij,t-1}	-1.46** (0.72)	1.92 (1.94)	-1.46** (0.74)	7.74*** (1.65)	-1.37* (0.73)	0.07 (0.96)
Year * Target country fixed effects	yes	yes	yes	yes	yes	yes
Year * Acquiror country fixed effects	yes	yes	yes	yes	yes	yes
Observations	33,117	1864	24,709	6900	17,793	9748
Number of acquiror countries	120	54	66	56	93	112
Number of target countries	28	28	28	28	23	16
Pseudo-R ²	0.803	0.796	0.798	0.858	0.753	0.842

Notes: This table shows the results from implementing the PPML model. The dependent variable is the value of bilateral M&A in thousand Euro and covers years 2001–2019. Time-varying explanatory variables are lagged by 1 year and cover the period 2000–2018. SoE stands for State-owned Enterprises, while Private refers to non-SoE. Following the 2019 Democracy Index developed by The Economist, a country is identified as high-democracy if categorised as “Full democracy”, while it is medium-low democracy if it is “Flawed democracy, Hybrid/Authoritarian regime”. Portfolio includes M&As where the acquired stake is lower than 10%, while FDI considers M&As where the acquired stake is equal or greater than 10%. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.

Table 6
M&As splitting the sample period.

	(1)	(2)	(3)
	2001–2007	2008–2013	2014–2019
Diplomatic Distance _{ij,t-1}	0.60** (0.29)	0.19 (0.22)	0.53** (0.23)
ln (Distance) _{ij}	-1.15*** (0.20)	-0.66*** (0.21)	-0.25 (0.21)
Contiguity _{ij}	-0.09 (0.26)	0.01 (0.22)	-0.18 (0.25)
Common language _{ij}	0.22 (0.25)	0.57** (0.23)	0.39 (0.26)
Colony _{ij}	0.49** (0.20)	0.06 (0.21)	0.43** (0.22)
Common legal origins _{ij}	0.40** (0.16)	0.35*** (0.13)	0.06 (0.14)
Time difference _{ij}	0.16 (0.13)	0.21 (0.13)	0.29** (0.14)
Regional trade agreements _{ij,t-1}	-1.38* (0.75)	3.36*** (0.80)	
Year * Target country fixed effects	yes	Yes	yes
Year * Acquiror country fixed effects	yes	Yes	yes
Observations	11,231	10,816	11,988
Number of acquiror countries	91	99	104
Number of target countries	28	28	28
Pseudo-R ²	0.799	0.771	0.814

Notes: This table shows the results from implementing the PPML model. The dependent variable is the value of bilateral M&A in thousand Euro and covers years 2001–2019. Time-varying explanatory variables are lagged by 1 year and cover the period 2000–2018. Robust standard errors clustered by country pair are shown in parenthesis. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.

instance, a company may choose to have its main economic activity in a high-tax country and its GUO strategically in a tax haven to lower the overall tax burden. To address this point, we exploited the tax haven classification provided by Gravelle (2013),²² which is widely used in the literature (see, among others, Fatica and Gregori, 2020), excluding investors with GUO from these countries. As shown in specification (6), the significance of the main coefficient of interest is confirmed.

In specification (7), we included country-pair fixed effects in the model to test for possible unobserved dyadic factors influencing our results.²³ The coefficient associated to the focal variable, DD, is confirmed as positive and statistically significant at the 1% level.

Results are also confirmed for further robustness checks. We tested for DD non-linear relationships, adding as a control the quadratic term. While the linear coefficient is still positive and significant, the quadratic one is not statistically different from zero. We also used alternative estimators, namely OLS and the Gamma Pseudo Maximum likelihood estimator, as suggested by Head and Mayer (2014). Furthermore, we checked that our findings are not affected by controls characterised by a high correlation. As shown in Table A1 in the Appendix, there is a high correlation between “distance” and “time difference” and between “time difference” and “regional trade agreements”. We tested the baseline model excluding in turn: (i) both “time difference” and “regional trade agreements”; (ii) only “time difference”; (iii) only “regional trade agreements”, and the main results are confirmed.²⁴

6. Conclusions

This study investigates the link between diplomatic relations and M&A activities, using a gravity model. To proxy diplomatic relations, we exploited the dyadic countries’ voting behaviour at the UNGA, creating an index of diplomatic distance.

In contrast with the dominant evidence found in the literature on political relations and FDI, we found a positive relationship between diplomatic distance and M&A activities in the EU. This finding suggests that some of the mechanisms to which previous studies attributed the positive relationships between diplomatic proximity and FDI activity they found in different contexts, do not operate in Europe. In particular, the risk of expropriation of foreign assets and obstacles to foreign acquisitions made by governments of receiving countries for political reasons appear to have played no or a limited role in inward cross-border acquisitions of European target companies. In contrast, the finding is consistent with the idea that weaker foreign relations between countries with overall friendly diplomatic relationships reduce access to information to foreign markets by economic actors, who may find it more difficult to leverage intergovernmental diplomatic connections (Li et al., 2018). Therefore, from the point of view of the foreign investors, weaker diplomatic relations limit their access to information about target firms, the industry in which those targets operate and the host country (Shimizu et al., 2004). Companies may react to these disruptions of information flows by strengthening their presence abroad to get direct access to valuable knowledge. This view is consistent with the internalisation theory, which suggests that weak bilateral relationships can provide a learning opportunity for the investor, also fostering a bird’s-eye view as opposed to a parochial view (Buckley and Casson, 1976, 2020; Stahl and Tung, 2015).

Furthermore, we distinguished foreign investments according to the technology-intensity of the target company’s industry, finding that diplomatic distance exerts a significant impact, especially for technology-intensive deals. This evidence reinforces the idea that foreign investors may consider acquisitions as a tool to overcome weak diplomatic relations and have direct access to prime information. In addition, results are confirmed for private rather than state-owned investors, as well as for long-lasting investments and not for speculative ones. Disentangling our time-span based on booms and busts in M&As, there is evidence that our findings are driven by periods characterised by increasing M&A activities.

While providing first evidence on the relationship between interstate diplomacy and cross-border M&As in Europe, this study has some limitations. In particular, the analysis is geographically restricted to EU28 destination countries. Moreover, the foreign entry mode mainly focuses on cross-border M&As. The extension of our framework to other countries (for instance the United States) or geographical blocs (for instance Asian countries), as well as the comparison of the role of bilateral diplomatic relationships in M&As and other foreign entry modes would provide interesting insights and could be addressed in future research.

Declaration of competing interest

The authors whose names are listed immediately below certify that they have NO affiliations with or involvement in any organization or entity with any financial interest (such as honoraria; educational grants; participation in speakers’ bureaus; membership, employment, consultancies, stock ownership, or other equity interest; and expert testimony or patent-licensing arrangements), or non-financial interest (such as personal or professional relationships, affiliations, knowledge or beliefs) in the subject matter or materials discussed in this manuscript.

²² Gravelle (2013)’s tax havens combines the following sources: (i) Hines and Rice (1994), more oriented to business issues; (ii) Tax Justice Network, “Identifying Tax Havens and Offshore Finance Centers: http://www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf; (iii) OECD (2000). See Gravelle (2013) for further details.

²³ The introduction of this extra set of fixed effects implies that only the parameters of time-varying bilateral covariates can be identified, while time-invariant ones get dropped because of collinearity. Moreover, the sample size decreases as pairs of investor-destination countries with no investment in the period do not contribute to the Likelihood function and are therefore dropped.

²⁴ Tables available upon request from the authors.

Data availability

The authors do not have permission to share data.

Appendix

Table A1
Correlation table

Matrix of correlations													
Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
(1) M&A	1.00												
(2) Diplomatic distance	0.05	1.00											
(3) Distance	0.01	0.62	1.00										
(4) GDP of the origin country	0.16	0.11	0.19	1.00									
(5) GDP of the destination country	0.15	0.21	0.15	-0.06	1.00								
(6) Contiguity	0.01	-0.22	-0.49	-0.02	0.01	1.00							
(7) Common language	0.07	0.06	-0.07	-0.07	0.11	0.33	1.00						
(8) Colonial links	0.10	0.19	0.07	-0.09	0.09	0.12	0.47	1.00					
(9) Common legal origins	0.01	-0.04	-0.16	-0.09	0.01	0.27	0.29	0.28	1.00				
(10) Time difference	0.07	0.54	0.84	0.35	0.10	-0.26	0.01	0.08	-0.09	1.00			
(11) Regional trade agreements	-0.04	-0.62	-0.75	-0.25	-0.07	0.21	-0.03	-0.10	0.06	-0.83	1.00		
(12) Rule of Law of the origin country	0.07	-0.45	-0.28	0.13	-0.09	0.06	0.07	-0.04	-0.10	-0.20	0.35	1.00	
(13) Rule of Law of the destination country	0.10	0.13	0.07	0.01	0.39	0.01	0.17	0.10	-0.05	0.09	-0.06	0.01	1.00

Table A2
M&As and diplomatic distance, robustness checks

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Greenfield FDI	US excluded	UK excluded	CN excluded	US, UK and CN excluded	No tax havens	Baseline plus country-pair fixed effects
Diplomatic Distance _{ij,t-1}	0.26* (0.15)	0.56** (0.26)	0.48*** (0.18)	0.45*** (0.16)	0.75*** (0.29)	0.52*** (0.18)	0.78*** (0.28)
ln (Distance) _{ij}	0.16 (0.22)	-0.87*** (0.14)	-0.67*** (0.16)	-0.67*** (0.15)	-0.86*** (0.15)	-0.78*** (0.15)	
Contiguity _{ij}	0.13 (0.21)	-0.22 (0.18)	-0.01 (0.19)	-0.07 (0.18)	-0.15 (0.18)	-0.05 (0.19)	
Common language _{ij}	0.85*** (0.19)	0.44** (0.20)	0.34* (0.18)	0.34* (0.18)	0.44*** (0.19)	0.38* (0.22)	
Colony _{ij}	-0.27* (0.14)	0.37 (0.24)	0.44*** (0.17)	0.32* (0.16)	0.45** (0.21)	0.37** (0.18)	
Common legal origins _{ij}	0.54*** (0.13)	0.26*** (0.10)	0.25** (0.10)	0.28*** (0.11)	0.29*** (0.10)	0.30*** (0.11)	
Time difference _{ij}	0.05 (0.08)	0.15 (0.13)	0.28*** (0.10)	0.25** (0.10)	0.12 (0.15)	0.26** (0.11)	
Regional trade agreements _{ij,t-1}	1.15 (1.19)	-1.24* (0.75)	-1.37* (0.72)	-1.38* (0.72)	-1.18 (0.74)	-1.74** (0.75)	-1.27** (0.51)
Year*Target country fixed effects	yes	yes	Yes	yes	yes	yes	yes
Year*Acquiror country fixed effects	yes	yes	Yes	yes	yes	yes	yes
Country-pair fixed effects	no	no	No	no	no	no	yes
Observations	11,563	33,508	33,413	33,508	32,294	27,971	21,072
Number of acquiror countries	62	121	121	121	119	101	96
Number of target countries	28	28	28	28	28	28	28
Pseudo-R ²	0.745	0.758	0.797	0.801	0.752	0.810	0.847

Notes: This table shows robustness checks from implementing the PPML model. The dependent variable in specification (1) is the value of bilateral Greenfield FDI in thousand Euro and covers years 2003–2019. The dependent variable in specifications (2)–(7) is the value of bilateral M&A in thousand Euro and covers the years 2001–2019. Time-varying explanatory variables are lagged by 1 year and cover the period 2000–2018. Robust

standard errors clustered by country pair are shown in parenthesis. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.

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