

Copyright
by
Harshal Zalke
2020

The Report Committee for Harshal Zalke

Certifies that this is the approved version of the following Report:

**Political Risks of Chinese Investments and the Impact of the Belt and
Road Initiative**

**APPROVED BY
SUPERVISING COMMITTEE:**

Catherine Weaver, Supervisor

Rachel Wellhausen

**Political Risks of Chinese Investments and the Impact of the Belt and
Road Initiative**

by

Harshal Zalke

Report

Presented to the Faculty of the Graduate School of

The University of Texas at Austin

in Partial Fulfillment

of the Requirements

for the Degree of

Master of Global Policy Studies

The University of Texas at Austin

May 2020

Acknowledgements

I would like to thank my advisors, Dr. Catherine Weaver, and Dr. Rachel Wellhausen for their advice and support. I would also like to thank Manasi Doshi for helpful comments.

Abstract

Political Risks of Chinese Investments and the Impact of the Belt and Road Initiative

Harshal Zalke, MGPS

The University of Texas at Austin, 2020

Supervisor: Catherine Weaver

Abstract:

Chinese Outward Foreign Direct Investment (OFDI) has traditionally been attracted to countries with high political risks – a worrying trend as this exposes the investments to additional risks such as economic default on loans and ensuing socioeconomic instability (Drezner 2019). In the context of the Belt and Road Initiative (BRI), this is of significant concern because of the large amounts of Chinese FDI that flow through the BRI.

Yet what do we actually know about political risk considerations in Chinese Outward Foreign Direct Investment (OFDI) with respect to the Belt and Road Initiative (BRI)?

Over the years, academic research has tried to understand the determinants of Chinese Outward Investments - a key instrument in the economic rise of China (Du & Zhang, 2018). Early data on Chinese foreign investment behavior prior to the initiation of

the BRI suggests that Chinese firms were highly acceptant of political risks compared to non-Chinese firms (Buckley 2007; Kolstad and Wiig 2012). Chinese firms invested heavily in countries at significant risk of political and economic instability, largely due to the moral hazards stemming from soft budget constraints affecting the state-owned enterprises (SOEs) in China's command economy (Kornai 1980; Li and Liang 1998). Does this trend hold today in regard to Chinese firms' investment behavior in the context of the major expansion in Chinese OFDI under the Belt and Road Initiative? What is the empirical evidence to support or challenge the assertions that the Belt and Road Initiative will incentivize Chinese OFDI to behave more like non-Chinese standard firms?

In this report, I examine the empirical claims regarding Chinese OFDI political risk behavior. Using the ICRG Political Risk Index and the Chinese Global Investment Tracker for the period 2005 - 2017, I run a panel data regression to investigate how host country political risk affects the flows of Chinese OFDI. The results of the statistical analysis, when analyzed through existing theoretical frameworks, indicate that Chinese OFDI is far less political risk acceptance than previously thought. This suggests that prevailing concerns about Chinese OFDI under the Belt and Road Initiative are not as well-founded as previously thought.

Table of Contents

List of Tables	ix
List of Figures	x
Chapter 1: Introduction	1
Chapter 2: Theory	6
Political Risks	6
Internalization Theory and the OLI theory	7
Soft Budget Constraint.....	9
SOEs and FDI – Difference between State Owned Firm and market firm.....	10
Evidence of Soft Budget Constraints Syndrome in Chinese SOEs	13
Chapter 3: Chinese OFDI and Political Risk.....	15
Relationship between Chinese OFDI and Political Risk	15
Chapter 4: Data	18
Chapter 5: Winds of Change: Changing Pattern of Chinese Investment.....	20
Sector Wise Analysis.....	20
Geographic Analysis.....	24
Chapter 6: Chinese Investments Moving to Safer Shores	26
Chapter 7: Empirical Model.....	29
Variables	29
Empirical Model	30

Chapter 8: Results	32
Chapter 9: Discussion	35
Type of Firms - SOE vs Public	35
Ownership, Location, and Internalization (OLI) Advantage	37
Hedging.....	38
Chapter 10: Conclusions and Future Work.....	40
Appendix.....	43
Components of Political Risk Index (PRS Group)	43
Breusch Pagan Test.....	44
Hausman Test	44
OLS Regression	45
BIBLIOGRAPHY	46

List of Tables

Table 1: Results for correlation between Chinese OFDI & cumulative risk (OLS with Fixed Effects)	32
Table 1A: Results for Breusch-Pagan Test	44
Table 2A: Results for Hausman Test.....	44
Table 3A: Results for correlation between Chinese OFDI & cumulative risk (OLS).....	45

List of Figures

Figure 1: Chinese OFDI in Energy, Real Estate, and Transport Sectors from 2005 to 2017.....	21
Figure 2: Chinese OFDI in Entertainment, Technology, and Utilities Sectors from 2005 to 2017	22
Figure 3: Chinese OFDI in Metals Sector from 2005 to 2017.....	22
Figure 4: Share of Agriculture, Metals, and Transport Sectors as a percentage of Total Chinese OFDI from 2005 to 2017	23
Figure 5: Comparison of Risk Index of China and USA	27
Figure 6: Trends in Chinese Average Risk Index compared to World Risk Index	27

Chapter 1: Introduction

Host country political risk is a key determinant in the Foreign Direct Investment (FDI) decisions of a multinational firm (Busse and Hefeker 2007). The conventional understanding of the relationship between Foreign Direct Investment and Host Country political risks argues that market oriented firms located in more capitalist-oriented countries tend to invest in host countries with lower political risks (Chakrabarti 2001). This behavior of the firms can be explained by the Internalization Theory (Coase (1937); Buckley and Casson (1976); and Rugman (1985)) and the O – Ownership, L – Location, I – Internalization (OLI) Theory (Buckley P. 1988). These theories collectively argue that firms will invest in locations that minimize costs and risks, including dangers of political and economic instability or expropriation. Firms will also invest where they enjoy a comparative or competitive advantage over other firms investing in that foreign market (Ricardo 1817; Buckley and Casson 1981).

However, the risk perception of a state owned firm (also known as State-Owned Enterprise, or SOE) is different from that of a privately-owned firm. SOEs are less deterred by risky environments (Cui and Jiang (2012); and Knutsen, Rygh, and Hveem (2011)). This behavioral difference can be understood by the Soft Budget Constraint (SBC) Syndrome (Kornai, Maskin, and Roland (2003); Kornai (1980)). The SBC syndrome can be found in organizations that have a soft budget constraint (i.e. they are bailed out by a supporting organization, often the government, if they make a loss). This creates a moral hazard problem, wherein SOEs tend to take on more risks when investing in foreign countries, as they can transfer the risk to the supporting organization (Dewatripont and Maskin (1995); Li and Liang (1998); and Lin and Tan (1999)).

Existing empirical evidence, most focusing on data preceding the BRI (that is, before 2013), reveals that Chinese OFDI, driven by the Chinese SOEs, does indeed flow into countries with higher political risks (Buckley, et al. 2007). As Chinese OFDI has grown over the past decades, the global implications of risky investment behavior have attracted considerable attention.

The Belt and Road Initiative, announced by Chinese President Xi Jinping in September of 2013, is an ambitious infrastructure project - a network of rail, roadways and energy pipelines that would span over Asia and Europe (Chatzky & McBride, 2019). Xi envisioned this bold initiative, named the Belt and Road Initiative (BRI), as the means to drive economic development in Asia and Europe, through the funding of large-scale infrastructure and development projects. This was a welcome move considering the funding gap (nearly \$26 trillion as estimated by the Asian Development Bank), for the infrastructure development projects in Asia required by 2030 (Rolland 2019).

The tendency to accept higher risks was particularly concerning with the launch of the Belt and Road Initiative (BRI), due to the sheer amount of investments pledged -- nearly \$8 trillion (Balding (2017); and Hillman (2018)). Many anticipated dangerous debt implications of the BRI on the host countries, most of which are developing economies and fragile or failing states. (Heydarian (2018); and Hurley, Morris, and Portelence (2019)). Observers feared that infeasible and risky projects undertaken by Chinese SOEs could saddle host countries with unsustainable loans or loan conditions that would undermine long term political and socioeconomic stability (Hurley, Morris, and Portelence (2019); and Dave and Kobayashi (2018); and Johnston (2019)).

Chinese actions in the early days of the BRI did little to mitigate concerns that China's investment would contribute to risk in host countries. In Ecuador, China invested in the Coca Codo Sinclair dam in the period between 2011 and 2016 to the tune of \$1.7

billion, largely ignoring feasibility studies as well as environmental concerns (Casey & Krauss, 2018). During this time, Ecuador was going through a period of financial and political instability, with the country expected to slide into recession. The left-wing populist President, Mr. Correa had rejected western institutions and defaulted on a \$3.2 billion foreign debt. With no other options left at his disposal, President Correa turned to China. The investment came in the form of a loan, most of which came from the Chinese Export-Import Bank, that charged a high interest rate and mandated the use of Chinese companies in construction. Effectively, this denied Ecuador companies from any economic benefit arising from the project. The result was that not only did the dam not generate electricity, as intended; the interests on the dam alone costs Ecuador \$125 million in a year (Casey & Krauss, 2018). However, none of this posed any risk to Chinese investments, since according to the terms China will be repaid in oil if Ecuador defaults. So, as part of the FDI agreement, Ecuador was required to hand over 80 percent of its produced oil to China in order to pay back the debt on the Coca Codo Sinclair dam (Wang, 2019).

Likewise, in Sri Lanka, China invested heavily in the Hambantota port in 2010. Again, most of the loan came from China's Export – Import Bank, starting with \$307 million (Abi-Habib 2018). Sri Lanka had just come out of a long civil war. President Rajapaksa, finding his country isolated due to human rights accusations, relied on China for economic and military support. Amidst allegations of bribing officials and taking advantage of the political turmoil in the country, China invested in the Hambantota port. This was despite studies stating that the port would be economically infeasible. These studies were later proven correct by unusually low numbers of shipping through the port, including a measly 34 ships in 2012 (Betigeri, 2018). Consequently, the debt on the Sri Lankan port ballooned to more than one billion USD. Abi-Habib (2018) writes that, while the terms on the loans were reasonable, including variable interest rate of 1 percent in the

beginning, it was around the time the BRI was announced that Chinese government refused any extensions on the repayment and increased the interest to around 6.3 percent. When the Sri Lankan government was unable to service its debt, Chinese government forced the Sri Lankan government to hand over the port and the surrounding area to the Chinese Navy for 99 years. This gave the Chinese Navy a valuable port in the Indian Ocean.

Concerns remain over the feasibility of a multitude of projects undertaken by Chinese (SOEs) companies under the BRI, primarily because a significant number of these investments are in countries that are prone to political volatility. Countries such as Somalia, Syria, Afghanistan, and Iraq – all of them part of the BRI, continue to witness political turmoil and are ranked as the most fragile countries according to the Fragile States Index (Zhang & Xiao, 2017). Even countries that were politically stable at the time of the inception of BRI, such as Turkey, and Ethiopia, have seen a decline in their political stability.

However, my study finds that the BRI may have tapered, on average, the risk acceptant tendency of Chinese firms. My analysis shows that while Chinese firms may still be more risk acceptant than market oriented firms, there is actually a negative correlation between Chinese OFDI and host country political risk post BRI. This means that Chinese foreign investments post BRI flowed into countries with lower political risks compared to pre-BRI. While this does not necessarily prove a change in the preference of Chinese firms, my findings throw light on the puzzling relationship between Chinese OFDI and political risks, suggesting that the BRI may not be exacerbating any of the underlying moral hazard or soft budget constraints traditionally associated with Chinese SOEs and highlighting the need for further research into this topic.

Chunlai (2018) argues that we must correctly understand the nature of Chinese investments with respect to countering China's rising geo-strategic influence, which is

driven by its growing FDI. Yet what do we know empirically about Chinese ODFI today? This paper questions the conventional understanding of the Chinese investment preference vis-à-vis political risk. Previous studies, such as Buckley (2007) and Kolstad & Wiig (2012), focus their research on years prior to 2013 - a landmark year for Chinese OFDI. The empirical study offered here in this report is, to my knowledge, first of its kind to analyze the relationship between Chinese Outward Foreign Direct Investment (OFDI) and political risk in the period *after* the announcement of BRI, from 2013-2017.

This report is structured as follows: First, in the following section I review the theoretical framework necessary to understand Chinese OFDI and political risk. In Chapter 3, I examine existing literature on Chinese OFDI and Political Risk and present my null and counter-hypothesis. Chapter 4 lays down the datasets that will inform my study. In Chapter 5, I examine the data on recent Chinese OFDI. In Chapter 6, I visualize the average risks associated with Chinese foreign investments, and check for any trends in the average risk of Chinese investments vis-à-vis average global political risk. Chapter 7 and 8 present the empirical model and the results of the statistical analysis. In Chapter 9, I discuss the significance of the results and the insights they reveal about the investment pattern of Chinese firms. I offer my conclusions in Chapter 10, focusing on the evolution of the relationship between Chinese OFDI and political risk. I lay out the possible explanations for the change in the relationship between Chinese OFDI and political risk observed in my empirical analysis. This study opens up avenues for future research that might add to the existing knowledge about the behavior of Chinese firms.

Chapter 2: Theory

The political risk considerations of a state-owned firm's FDI decisions can be understood from the theoretical framework of Internalization and O - Ownership, L - Location, and I – Internalization (OLI) Theory, and the SBC theory. This Chapter reviews these theories and the concepts that are required to understand the political risks associated Chinese OFDI.

POLITICAL RISKS

Political risks are the risks faced by a foreign firm owing to the imperfections of the host country's government or judicial actions or institutions. Political risks adversely affect the value of the firm's investment in that country (Bekaert, Campbell, Lundblad, & Stephen, 2014). For example, political instability, concluding in a change of regime may result in a drastic change in the government policies with respect to foreign investment, and in extreme cases, may even result in host government expropriation. This is what happened in Cuba after Fidel Castro came to power in 1959. The Castro led Cuban government ordered an expropriation, covering utilities, oil, and sugar. The newly formed Cuban government seized most of the private property, a sizeable chunk of which was investments by American firms. Valued at \$750 million – it accounted for two-thirds of the total US investment in Cuba (Johnson 1964).

Political risks include aspects such as government stability, strength of the legal system, and external or internal conflict (Howell and Chaddick 1994). Political risks can be quantified and estimated by political risk indices. There are many institutions that offer political risk indices for countries, the most well-known of which are indices are by *The*

*Economist*¹, the Business Environment Risk Intelligence (BERI) Political Risk Index (PRI)², and the Political Risk index by the Political Risk Service (PRS)³.

The political risk index formulated by *The Economist* weighs six political variables: neighbor countries, authoritarianism, smooth transition of government, illegitimacy of the government, armed insurrections, and generals in power; and four social variables: urbanization pace, Islamic fundamentalism, ethnic tension, and corruption to calculate a political risk score for each country (Howell 1992). Similarly, the BERI PRI uses social and political variables, covering internal causes, such as fractionalization of the political spectrum, ethnic/ religious divisions and external variables comprising of regional political forces, and dependence of external power. Regional Experts score the countries on these variables, which are then summed to get the final political risk index (Howell and Chadwick 1994).

The Political Risk Index formulated by the PRS evaluates countries over twelve variables ranging from government stability to bureaucratic quality (Howell 1986). I expound upon the PRS index and its variables in detail in the Data section, as I use it for my statistical analysis. Howell and Chadwick (1984), when comparing the above-mentioned three indices, found the PRS Risk index to be the most reliable.

INTERNALIZATION THEORY AND THE OLI THEORY

As explained by (Buckley 1988), "internalization theory rests on two main axioms 1) Firms choose the least cost location for each activity they perform, and 2) firms grow by internalizing markets up to the point where the benefits of further internalization are

¹ <http://country.eiu.com/allcountries.aspx?view=all>

² <http://www.beri.com/Publications/BRS.aspx>

³ <https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/21446>

outweighed by costs.” There is significant literature on internalization, from (Coase 1937) to (Buckley and Casson 1976) and (Rugman 1985).

Dunning (1980) built upon the Internalization theory (Buckley 1988) and proposed the eclectic (OLI) paradigm of production financed by FDI. Applying the OLI framework According to the eclectic paradigm, a firm will invest in international production if:

a) O (Ownership Advantage) - Firms have a competitive edge over other nationality’s firms in serving a particular market. These are ‘ownership advantages’ that are considered exclusive to the firm, at least for a period of time.

b) L (Location Advantage) - In addition to the previous conditions, the firm should have some advantages in producing outside its home countries; otherwise, the foreign market could be served by exports.

c) I (Internalization Advantage) - It is advantageous for the firm to internalize the markets and add value by doing so.

The Internalization and OLI theories give us an insight into why firms may choose to invest in foreign countries. It is understood from the L condition of OLI that a firm will invest in a foreign market if the benefits of doing so outweigh the costs of moving into that market. Political instability in the host country, that threatens to disrupt business operations, will be an added cost to firms when they consider their decision to invest in a foreign market. The higher the added cost of political risk in a country, the higher the advantages need to be for any firm to make an investment in that country, or else, the firm will choose not to invest. Thus, we should observe a positive relationship between FDI and the political risk of the host country.

Political risk is a key component when firms consider their investment decisions (Busse and Hefeker 2007). Firms are more likely to invest in countries that have low levels of internal conflict and corruption, efficient bureaucracy, and a robust governance –

indicators of low political risk (Hayakawa, Kimura, and Lee 2013; Goswami and Haider 2014). This observation – positive correlation between host country political risk and FDI, holds true even for developing countries, where the political risks are relatively higher, there is a positive correlation FDI flows (Krifa-Schneider and Matei 2010).

SOFT BUDGET CONSTRAINT

While market-oriented firms may shy away from exposing their investments to high political risks, State-Owned Enterprises have a higher risk tolerance (Cull and Xu 2000). This behavior of the State Owned Enterprises can be explained by the Soft Budget Condition Syndrome (Kornai, Maskin, and Roland 2003). Kornai (1980) first observed this behavior in the Hungarian SOEs in the 1970s, wherein the loss-making firms were not allowed to fail by the government (Kornai J. 1980). The SBC Syndrome involves a pair of organizations – a BC organization, that faces a budget constraint, and the S organization, which supports the BC organization.

A Soft Budget Constraint Syndrome is when a firm can count on another organization to intervene in case of a budget deficit (Kornai, Maskin, and Roland 2003). The intervening organization is usually another government agency or, in some cases, the government itself. Hence, firms are not penalized if they make any losses. This leads to a distortion in the motivation of the firms, as they now seek to gain favor of the organizations that may potentially rescue them (Krueger 1998). The rescue comes in the form of fiscal means, credits, or some indirect method. The first type of intervention is fiscal means, which include tax subsidies granted to the BC (Budget Constraint) organization in distress. The second mode – credit softening, involves the extension of credit to the distressed BC organization. The third type of intervention is an indirect method – such as the imposition of tariffs, that may rescue a firm in financial hardship (Bonin, Schaffer, and Banks 1995).

While even market firms may exhibit the SBC syndrome under certain conditions, such as when the failure of the market firms threatens the collapse of the entire financial system (Sorkin, 2010), this syndrome is a characteristic feature of State Owned Enterprises (Dewatripont and Maskin 1995; and Schaffer 1998). Several empirical studies have confirmed the SBC theory by studying the behavior of the SOEs (Li and Liang 1998; Lin and Tan 1999).

The prevalence of the SBC syndrome among SOEs can be understood by looking at the causes of the SBC syndrome. That will help us understand why SOEs are particularly susceptible to the syndrome. The first theoretical explanation, given by Shleifer and Vishny (1994) attributes SBC syndrome to the intervention of politicians in firms. In case of SOEs, politicians have direct control over the firm. Hence, a politician's influence on the firm will adversely affect the profitability of the firm. However, a politician would not want the firm to go out of business as the resulting unemployment may create undesired political repercussions. Thus, the politician, will subsidize the firms for losses, softening the budget constraint for the SOE (Shleifer and Vishny 1994; Li and Liang 1998). The second explanation for the SBC syndrome is provided by Kornai, Maskin, and Roland (2003), attributing the syndrome to bureaucratic paternalism, where the state might feel responsible for the performance of the SOE. There is an added pressure on the leaders to prevent a financial failure of the firm, as any such failure would reflect negatively on the leader (Bai and Wang 1996).

SOES AND FDI – DIFFERENCE BETWEEN STATE OWNED FIRM AND MARKET FIRM

A state owned firm is less productive than a privately owned when investing in foreign markets (Boardman and Aidan 1989). This decline in productivity can be attributed to three factors. Firstly, SOEs are likely to have non-economic goals, thus a firms FDI

decision may not always be motivated by profit maximization. Often, other factors such as – the government’s foreign policy, affects the location choice for a SOE’s FDI (Anastassopoulos, Blanc, and Dussauge 1987). Secondly, the SOEs have weaker owner control, which may result in opportunistic behavior when engaging in FDI and are not sensitive to risks (Chen, Firth, and Xu 2009). Thirdly, SOE’s links with the home government can affect how the firm conducts operation in a foreign market. The SOE’s relationship with the home government may either bestow ownership advantages – through friendly relations with the host country government or saddle the firm with disadvantages, like excessive bureaucratic processes for project approval (Knutsen, Rygh, and Hveem 2011).

The three factors explaining the difference in behavior of a state owned firm can be explained by the OLI and the SBC theory. The first and second points explaining the characteristic behavior of SOEs can be understood through the theoretical framework of the Soft Budget Constraint. Kornai, Maskin, and Roland (2003) specifically lay down this behavioral change in the firms due to the SBC syndrome, and state that firms suffering from the syndrome will “rather than wooing customers, concentrate more on winning the favor of potential S-organizations”. This behavioral effect of the SBC syndrome was also observed by Kreuger (1998). This explains why a state-owned enterprise, that relies on the government for its survival, would factor in the home country’s foreign policy decisions in its FDI decision. Additionally, political influence will change the objective of the state-owned firm (Shleifer and Vishny 1994).

The reduced risk sensitivity of the firm is another behavioral effect of the SBC syndrome (Cui and Jiang 2012). This is tied to the moral hazard problem arising due to soft budget constraints. This can be understood by looking at how a state-owned firm might view a risky business environment differently as compared to the risk perception of a

market oriented private firm. A firm might have to face an unfavorable outcome when investing in a risky environment. However, in such an eventuality, a state-owned firm, due to its soft budget constraints, can count on the home government to bail it out, thus transferring the risk to the home government. This results in a moral hazard problem where the SOEs might be less deterred by the risks in foreign environment, knowing that their government will help them if they get into any financial trouble. On the contrary, a market-oriented firm, with a hard budget constraint, enjoys no such favors from the government or any other agency, and hence, will be more sensitive to risks. Additionally, a state owned firm may be less likely to face expropriation because it would pose a significant political risk to the host country government (Kobrin 1980). This adds to the moral hazard problem of state-owned firms investing in countries where the political risks are high.

The third factor, ties with the home country government, explains why a state owned firm might behave differently than a privately owned firm. This can be understood via the theoretical framework of the OLI, specifically, the Ownership advantage. The Ownership advantage states that a firm will invest in a foreign market if it has a competitive advantage over other firms serving in that particular market (Dunning 2001). A state-owned firm, owing to its closeness to the home country government may rely on the government for support when investing in foreign markets. The home country government may intervene on behalf of the state-owned firm when dealing with the host country government, and in some cases, may even sign bilateral or regional agreements to help those state-owned firms (Luo, Xue, and Han 2010). This type of government support provides an ownership advantage to the state-owned firm over other firms when they invest in foreign markets. The direct government intervention also insulates a firm from the political risks, which adds to the ownership advantages of the state-owned firms.

EVIDENCE OF SOFT BUDGET CONSTRAINTS SYNDROME IN CHINESE SOEs

Chinese SOEs often have soft budget constraints owing to their state ownerships. This can be attributed to: 1) the organizational structure within which Chinese SOEs operate, and 2) the banking structure in China.

Organizational Structure

There are multiple evidences that point to the existence of soft budget constraints in Chinese SOEs due to their structure. The primary evidence is the strategy of growth adopted by Chinese firms. The pre-reform (before 1978) era was defined by extensive government control of firms (Davies 1995; Child and Lu 1996). In the post-reform era, although managers enjoyed more autonomy, and the firms were made more accountable (Zhang and Yu 1994); the structure and the network remained similar to the pre-reform era (Peng and Harwit 1996). The Chinese SOEs adopted a network-based strategy of growth and development of interorganizational relationships, which blurred the boundaries between organizations and made organizations more interdependent (Powell 1990). Additionally, Chinese SOEs enjoy financial backing of the local and central government (Walder 1995). Chinese SOEs are also institutionally safer. The central government assures the Chinese SOEs that they will be bailed out if and when they are in financial trouble (Ma H. 1991). This gives rise to the SBC syndrome in Chinese SOEs as the government will not let the SOEs fail.

An analysis of the performance of Chinese SOEs also reveals the existence of SBC syndrome. There is a negative relationship between firm performance and state ownership among the Chinese SOEs (Sun and Tong 2003; Wei, Xie, and Zhang 2005). The rate of return of Chinese SOEs was consistently below industrial average (Li and Liang 1998). In

addition, Chinese SOEs suffer from viability issues emanating out of price distortions – a need to keep the price of essential items low, which is another cause for the SBC syndrome (Lin and Tan 1999).

Role of the Chinese State Banking System

China's state owned banks dominate China's financial system (Allen, Qian, and Qian 2005). Some of the largest banks in China, also known as “the big four” – Bank of China (BOC), The Construction Bank of China (CBC), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC) are state owned (Megginson 2014). The principal means by which the Chinese government supports the SOEs is through the state owned banks and financial institutions (Wei and Wang, 1997; Lardy, 1998). The dominance of Chinese state owned banks and the scale of the support they provide to state owned enterprises indicates the prevalence of soft budget constraints.

Chinese state owned banks grant preferential treatment to the Chinese SOEs, especially when they are in distress (Cull and Xu 2000), which results in the state owned firms becoming heavily dependent on the state owned banks and reliant on bailouts when they suffer a financial loss. This softening of budget constraints by credit means, is a common phenomenon observed in post socialist countries (Schaffer, 1998; Claessens and Djankov, 1998).

Chapter 3: Chinese OFDI and Political Risk

Analysts, Gerstel (2018), Smith (2018), Ratner (2018), Raiser and Ruta (2019) for instance, repeatedly refer to the risks, including political, associated with the Chinese investments for projects within the Belt and Road Initiative. However, even Chinese companies are concerned about the political risks, including protests and political volatility, that they face in foreign markets (Shi 2017). A considerable number of the BRI countries such as Afghanistan, Pakistan, and Syria, suffer from civil unrest, political instability, and even armed conflict. These risks are compounded since Chinese firms facing these risks may not get adequate legal protection owing to the weak legal institutions in these BRI countries (McKenzie 2017). Managers of Chinese firms have expressed concern that the Belt and Road Initiative has over-exposed Chinese firms to the above mentioned risks (Shi 2017). An analysis of the risk for a few projects, especially in politically unstable countries, reinforces this concern (Hillman (2018); Greet (2018); and Standish (2019)). What is the nature of these political risks, and how do such risks factor into the decisions driving Chinese OFDI?

RELATIONSHIP BETWEEN CHINESE OFDI AND POLITICAL RISK

Ever since Chinese companies started “going out” (investing in foreign markets), there has been an interest in the determinants of Chinese Foreign Direct Investments. Existing scholarship examining the relationship between OFDI and political risk suggests a negative relationship between the two (countries with lower political risk attract more FDI) (Busse and Hefeker (2006); and Goswami and Haider (2014)). However, with respect to China, FDI researchers observed that Chinese OFDI tended more towards countries with weaker institutions and relative political instability. Such studies have been carried out over

different time periods, mostly using firm-level analysis. For example, Buckley, et al. (2007) analyze the determinants of Chinese investments for the years between 1984 and 2001. Their analysis finds a positive relationship between Chinese ODI and host country political risk. Their study used the ICRG risk index as a proxy for country political risk. Their study found that for every 1% increase in the host country risk index, there was a 1.8% decrease in Chinese ODI to that country (i.e., higher index implies lower political risk). Yeung and Liu (2008) study the behavior of Chinese OFDI over the period 2002 – 2008 and analyze the risk associated with Chinese ventures. They confirm the tendency of Chinese firms to take on excessive risks relative to non-Chinese firms. Employing a slightly different statistical model, Kolstad and Wiig (2012) observed a similar relationship between Chinese OFDI and host country institutions for the period 2003-2006. The authors observed that Chinese OFDI was directed towards countries with weaker institutions. They use the strength of institutions (rule of law index⁴) from the World Bank Institute (WBI) Governance Indicators as an indicator of the political risk in that country, wherein weaker institutions translate to higher risks. This unusual correlation is confirmed by other works as well (see, e.g., Liu, Chen, and Wu (2018); Blonigen (2005); and Chang (2014)).

Researchers attribute this unconventional relationship between Chinese OFDI and political risk to the nature of Chinese firms (Morck, Yeung, & Zhao, 2008). They observe that Chinese firms are different from standard firms in their maximizing objective. Kolstad and Wiig (2012) deduce that this is particularly true with respect to Chinese OFDI in host countries with natural resources. They find that Chinese OFDI “flows into countries with poor institutions and large natural resources”. According to Buckley (2007), a Chinese State Owned Enterprises (SOEs), unlike a standard firm, may not be profit-maximizing,

⁴ <https://databank.worldbank.org/databases/rule-of-law>

and a large portion of their investments in riskier countries may be due to the Chinese government's influence. He suggests that the Chinese firms' decision to invest in a country may have been influenced by the political connection between China and the host country.

It should be noted that Cheung and Qian (2009) do not find the quality of institutions (the proxy for country political risk used by other scholars) to be statistically significant in determining Chinese OFDI. At the same time, I was unable to find any studies that found a *negative* statistical correlation between Chinese OFDI and host country political risk. Thus, we can conclude that the existing literature suggests either a positive correlation or, possibly, no significant correlation. Hence, my null hypothesis is as follows:

H₀ : *The correlation between Chinese OFDI and home country political risk continues to remain positive after 2013 (the year BRI was launched).*

However, the existing literature focuses on the years prior to the Belt and Road Initiative and thereby, does not account for any changes in investment patterns due to BRI. Scissors (2016), studying Chinese OFDI, speculated that the investment pattern itself has undergone a tremendous change. This warrants a review of the existing knowledge about the role of host country political risk as a determinant of Chinese FDI flow to that country. Hence, my counter hypothesis is:

H_a : *The correlation between Chinese OFDI and home country political risk becomes negative after 2013 (the year BRI was launched).*

Chapter 4: Data

I use the following datasets to study Chinese OFDI and political risks. I collect data for the period between 2005 and 2017. I choose the starting year as 2005, as that was the year when Chinese foreign investments gained worldwide attention with Lenovo, China National Offshore Oil Corporation (CNOOC), and Haier attempting to take over IBM, Unocal, and, Maytag (three prominent US firms), respectively (He and Lyles 2008). I limit my analysis until 2017, as I want to study the Chinese investment pattern independent of any external pressures. The US imposed sanctions on China in 2018 (Ching and Li (2018); Liu and Woo (2018); and Haas, Jacobs and Helmore (2018)). Any change in Chinese investment after that will reflect the external US pressure and bias my study.

Chinese Global Investment Tracker (CGIT) Dataset:

The CGIT⁵ dataset is provided by the American Institute Enterprise. It comprehensively covers China's global investment, aggregating firm investments to calculate the total Chinese OFDI in a country. CGIT includes transactions across multiple sectors like energy, transportation, property, and other industries (Scissors, China Global Investment Tracker). The analysis in this paper uses data for the years between 2005 and 2017.

Political Risk Index (ICRG) Ratings:

The ICRG Political Risk Index, constructed by the Political Risk Service group assesses the political stability of countries on a comparable basis. The methodology assigns points to factors termed as components of political risk. Points are assigned on an

⁵ <https://www.aei.org/china-global-investment-tracker/>

increasing scale, 0 being the minimum points that can be assigned to a component. The maximum number of points that can be assigned varies depending upon the weight associated with a component. Higher points indicate a better score. The twelve components and their descriptions are Government Stability (12 points), Socio-Economic (12 points), Investment profile (12 points), Internal Conflict (12 points), External Conflict (12 points), Corruption Index (6 points), Military in Politics (6 points), Religious Tensions (6 points), Law and Order (6 points), Ethnic tensions (6 points), Democratic Accountability (6 points), and Bureaucratic Quality (4 points). (Howell, "International country risk guide methodology"). A detailed description of the components is attached in the appendix.

I compute the total risk index by summing the values for each individual index. Adding ICRG components to create a new variable is consistent with the methodology used by Wellhausen (2015); and Allee (2011). It should be noted that all the indices are scores, with higher scores corresponding to lower risks. Henceforth in this paper, a higher risk index implies lower political risk, and vice versa.

Chapter 5: Winds of Change: Changing Pattern of Chinese Investment

In order to find evidence for my counter-hypothesis, I study if there is a change in the pattern of Chinese OFDI. Chinese foreign direct investment has been increasing steadily over the last decade, with a growth spurt in 2013 after the announcement of BRI. In 2017, China's outbound investment exceeded 100 billion USD, making China the world's second-largest overseas investor. Du and Zhang (2017) claim this event as a "historical transformation of the role of Chinese companies from global manufacturers to global investors." They observe that Chinese state-owned enterprises (SOEs) are the primary investors under BRI, mainly because these SOEs have developed extensive expertise in infrastructure activities within China.

The growth in investment is not perfectly linear, wherein Chinese companies continue to invest in the same industries that they invested in for decades. Instead, there is a change in the distribution of FDI across sectors and countries. A preliminary analysis of the sector-wise and geographic distribution of investments hints at a deeper shift in the investment pattern.

SECTOR WISE ANALYSIS

In this section, I look at the sector-wise distribution of Chinese investments in the period 2005 – 2017. Any change in the investment pattern will be reflected in the change in the distribution of Chinese investments across different sectors. The investments, spread across 12 major sectors: Agriculture, Chemicals, Energy, Entertainment, Finance, Health, Logistics, Metals, Real Estate, Technology, Tourism, Transport, and Utilities, give us interesting insights regarding the evolving pattern of Chinese investments.

A longitudinal analysis of Chinese investments for the period 2005-2017 clearly shows the growth of investments across every sector. The growth, however, is not uniform across all sectors, which reveals a change in investment pattern. In some sectors, such as Metals, there is no net growth at all, with the investments rising initially but then falling sharply back to the initial 2005 level.

The sectors can be broadly characterized into three categories based upon the magnitude of growth of Chinese investments in absolute dollar value. Sectors that show a clear upward trend include Energy, Real Estate, Transport, and Utilities (Fig 1). Then there are sectors such as Technology, Utilities and Entertainment, where there is an observable but moderate growth in investment, with a spike in 2016 (Fig 2). Finally, the Metals sector shows no net growth in investment in the period 2005-2017 (Fig 3).

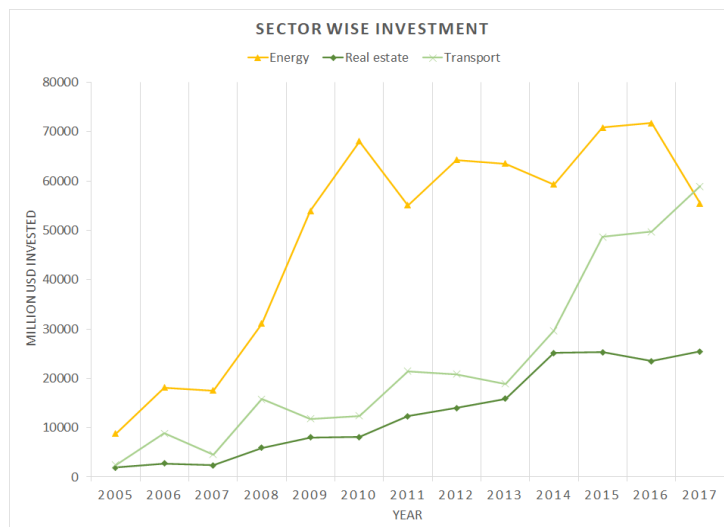


Figure 1: Chinese OFDI in Energy, Real Estate, and Transport Sectors from 2005 to 2017

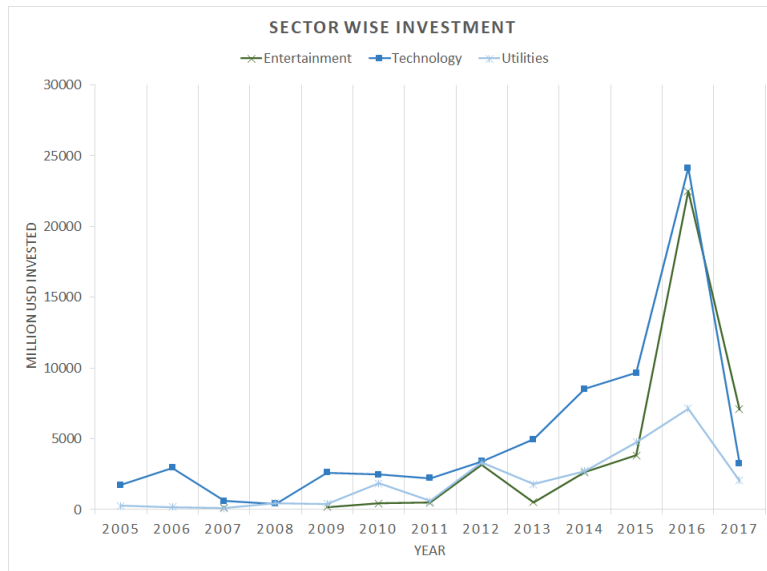


Figure 2: Chinese OFDI in Entertainment, Technology, and Utilities Sectors from 2005 to 2017

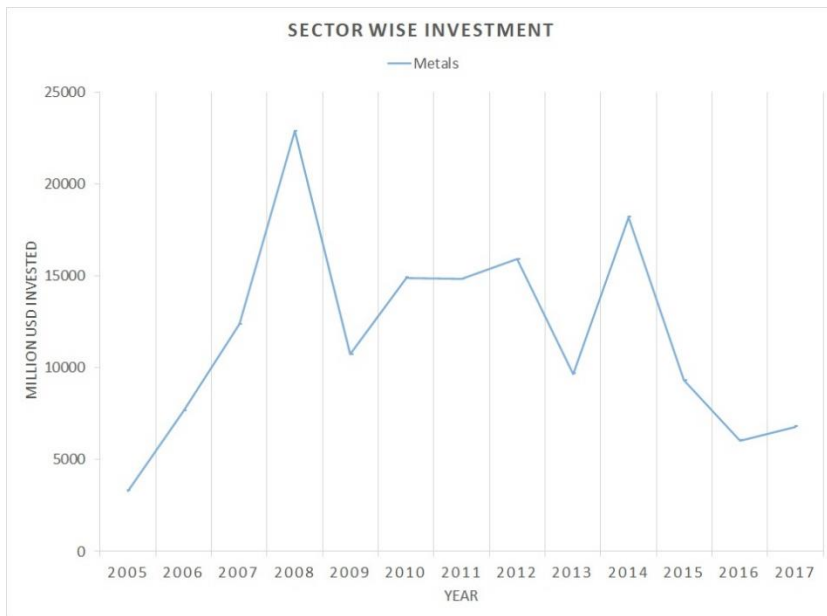


Figure 3: Chinese OFDI in Metals Sector from 2005 to 2017

A Cross-Sectional analysis reveals the extent of the change in investment patterns. Investments in the Metals sector, as a percentage of the total Chinese investments in a year, dropped from 17.2% in 2005 to 2.5% in 2017. Even sectors that experienced growth in absolute terms, such as the energy sector, show a decline in its share of investment relative to the total investment. The only sectors registering a significant growth are the agriculture sector (increasing from 1.5% in 2005 to 17.7% in 2017) and the transport sector, which grew from 12.6% in 2005 to 21.9% in 2017. We can see the plots in Fig 4.

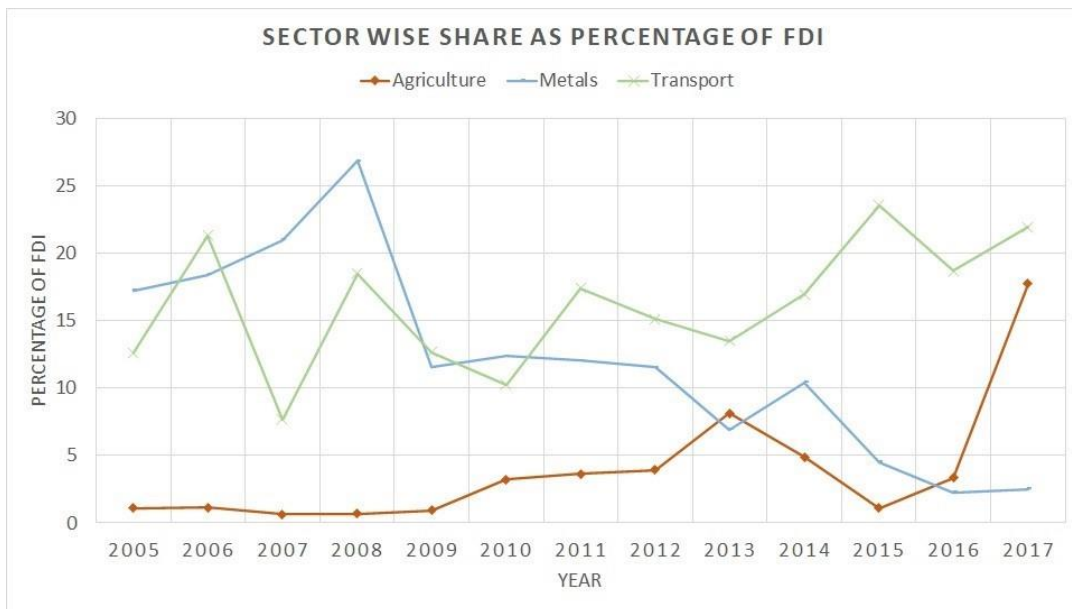


Figure 4: Share of Agriculture, Metals, and Transport Sectors as a percentage of Total Chinese OFDI from 2005 to 2017

The data is indicative of a broader underlying trend. The shift away from metal industry and the decline in share of investments in the energy sector may possibly hint at a move away from resource extraction activities. This change in investment pattern is symptomatic of the strategic shift in investment preferences.

GEOGRAPHIC ANALYSIS

In addition to the sector analysis, another major indicator of the change in Chinese OFDI pattern is the changing destination of investment. This is relevant to the testing of our hypothesis as a change in destination countries will directly affect the political risks that the investments are exposed to since political risks are associated with the country. A shift in Chinese investments from a country with high political risks to a country with low risks would make the investments safer. We can observe distinct patterns in Chinese investments depending upon the location of the investment. Studying Chinese investments patterns in Africa, Asia, and Europe reveals interesting insights.

There is extensive literature on Chinese investments in Africa. Ayadele and Sotola (2014) and Mourao (2017) analyze the motivation behind Chinese investments in Africa. Although Chinese investment in Africa has gone up in absolute numbers, as a relative share of total Chinese outward investment, it has declined significantly vis-à-vis other geographical regions. Africa's share in Chinese OFDI peaked at 9.8% in 2008 and has dropped to 0.3% in 2010 (Kobylinski 2012). Kobylinski (2012) states that most of the Chinese investors, such as Sinopec, Sinosteel, China nonferrous, that invested heavily in China between 2005 and 2008 did not have any major investment in Africa in 2011. The majority of the Chinese SOEs are engaged in extraction activities and are attracted to population size and forest cover (Yodel and Sotola (2014); and Mourao (2017)). Using a stochastic model, Mourao (2017) analyzed the determinants of Chinese OFDI in 48 African countries in the period between 2003 and 2010 and found that population size and forest cover are significant factors.

In contrast, China's investments in Asia have seen significant growth since the 1990s. OFDI to Asia went up from 27.87% in the 1990s to 55.81% of total Chinese OFDI

in 2004 (Buckley, Cross, Tan, and Voss, 2008). Even within Asia, the biggest recipient were countries in South and South-East Asia, where the Chinese OFDI went up from 15.42% in 1990s to 53.38% in 2004 (Buckley, Cross, Tan, and Voss 2008). As argued by the authors, the principal reason for this increase in Chinese investments in South and South-East Asia was geographic proximity to China (Buckley, Cross, Tan, and Voss 2008).

Another aspect of the changing nature of Chinese investments that has attracted attention only recently is the increasing investments in Europe. From being an insignificant player in Europe in 2009 in terms of investments (Nicolas 2009), Chinese investments in Europe stands at around \$318 billion in 2018 (Tartar, Rojanasakul, and Diamond 2018). SOEs account for a majority of this investment, with the largest investor – Chinese National Chemical Corp investing \$58.2 billion over the past decade (Tartar, Rojanasakul, and Diamond 2018).

Africa and Europe offer two contrasting patterns of Chinese investments. Chinese investments in Europe rose significantly after 2009, whereas Chinese investments in Africa as a percentage of its total outward investment dropped drastically after 2008. In both cases, the majority of the investors were Chinese State-Owned Enterprises. Thus, this indicates a clear change in Chinese foreign investment pattern.

The change in the relative proportion of Chinese OFDI in Africa, Europe, and Asia affects the empirical relationship between Chinese OFDI and host country political risk, since the risk profile of countries in Asia and Europe is notably better than the risk profile of countries in Africa (Casanova 2018).

Chapter 6: Chinese Investments Moving to Safer Shores

In this chapter, I perform a preliminary analysis and visualize the trends in the risk index of Chinese investments in order to test support for either of the stated hypotheses.

The empirical data shows that Chinese investments have historically been more acceptant of political risk when compared to investments by firms from other developed nations. This is noted by (Buckley, Cross, Tan, & Voss, 2008), when they observe the growing Chinese investments in Africa in the 1990s and early 2000s. As an example, we can look at the comparison between risk indices for Chinese and American FDI (Fig 5).

The average risk index is a mean of the risk index weighted by investments. The average risk index of Chinese investments is formulated as follows:

$$R_t = \sum_i \frac{I_{i,t} \cdot R_{i,t}}{I_t}$$

Where, R_t = Average Risk index of a dollar of Chinese Investment in year t. $I_{i,t}$ = Chinese investment in country i in year t. $R_{i,t}$ = Political Risk Index of country i in year t. I_t = Total Chinese outward Investment in year t.

We can see that the political risk index for Chinese investments has been lower than the risk index for American investments for the years from 2005-2017, indicating that the political risk associated with Chinese investments is higher than the political risk associated with US investments for the same period.

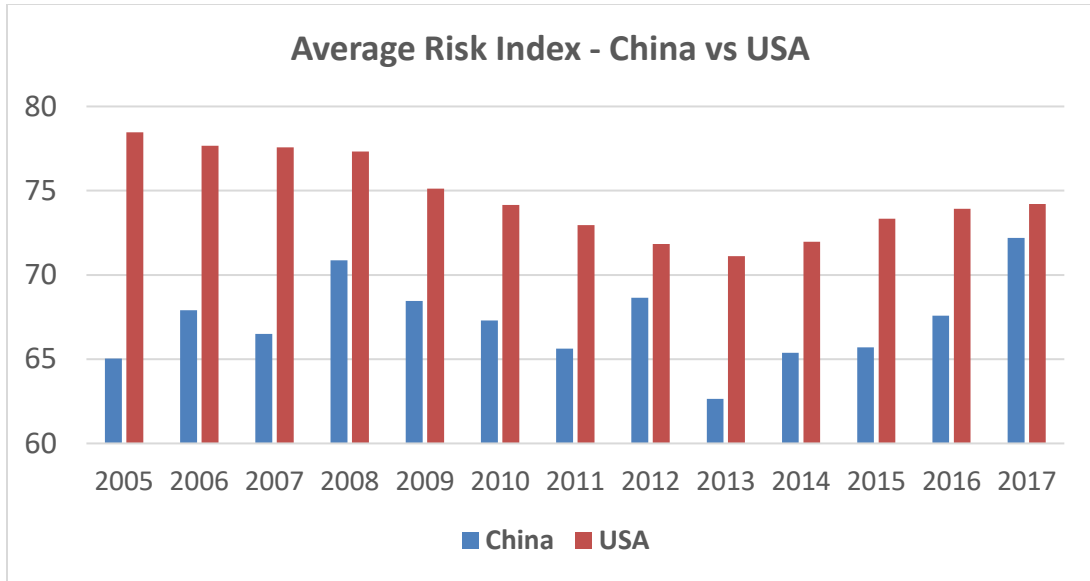


Figure 5: Comparison between Risk Indices of Chinese and US FDI.

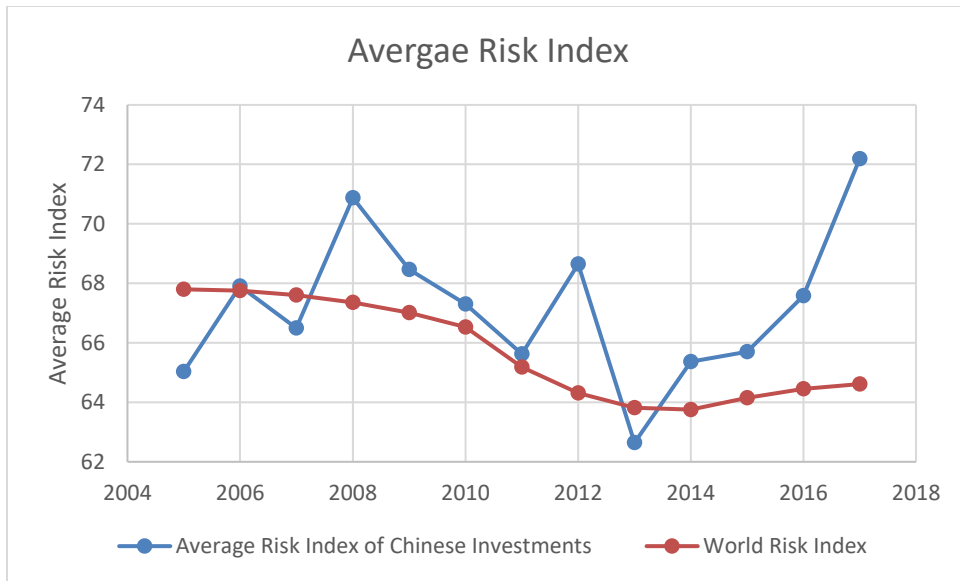


Figure 6: Trends in Chinese Average Risk Index compared to World Risk Index

However, a preliminary analysis - wherein I track the average risk index of Chinese investments, reveals a rise in the risk index post 2013 (Fig. 6). This implies that Chinese

investments have become progressively safer, vis-à-vis prior investments, on a per-dollar basis (with regards to the political risk associated with them) in the period 2013 – 2017 after the Belt and Road Initiative was announced. The average risk index of Chinese investments has been the highest in 2017, indicating that, on average, the investments have been the safest in terms of their exposure to political risk. However, this does not imply that individual projects are not subject to political risks.

Additionally, I plot the global risk index, shown by the red line, on this graph in order to compare its trajectory with that of the risk index of Chinese investment. We can see in Fig.6, that after 2013, the risk index for Chinese investment is not only greater than global average, but the difference between the two is increasing, indicating that Chinese investments, on an average, face lower political risks than the global trends. This is interesting considering that the graph for the World Risk Index is going down , suggesting that on an average, the political risk in the world is increasing.

Chapter 7: Empirical Model

The following section lays down the variables and the empirical model that I employ to test my null and counter hypothesis.

VARIABLES

I use the following variables to build my model:

- Hypothesis Variable: The Risk index of a country in a given year. I obtain the data for this variable from the ICRG dataset.
- Dependent Variable: The amount of Chinese OFDI to a country in a given year. This is taken from the CGIT dataset.

In addition, in line with previous studies on Chinese OFDI and Political Risks by Buckley, Clegg, et al. (2007), and Goswami and Haider (2014), I employ the following control variables in my statistical analysis:

- Control Variable 1: Gross Domestic Product (GDP) of a country in a given year. This is used to control for the absolute size of the host country market. I source this data from the World Bank dataset on GDP.⁶
- Control Variable 2: Gross Domestic Product per Capita (GDP per cap) of a country in a given year. This variable controls the relative size of the host country market. This is sourced from the World Bank dataset on GDP per capita.⁷

In addition to the control variables, I use country fixed effects to account for any country specific attribute. This is consistent with the previous studies by Busse and Hefeker (2007), and Arel-Bundock (2017).

⁶ <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>

⁷ <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD>

I merge the Chinese investment data (CGIT), the country risk data (IRCG), the GDP data, and the GDP per Capita data for countries for the period 2005-2017. The merged dataset contains Chinese investments in 117 countries, their corresponding risks, GDP, and GDP per Capita. We get a large N small T panel dataset.

EMPIRICAL MODEL

In order to check my hypotheses, I use the following log-linear model:

$$\ln(Y'_{it}) = \beta_0 + \beta_1 \cdot \ln(\text{Risk}_{it}) + \alpha \cdot X_{it} + \mu_i + \varepsilon_{it} \quad (1)$$

Where, $Y'_{it} = Y_{it} + 0.01$

Risk_{it} is the hypothesis variable and Y_{it} denotes the Chinese outward foreign direct investment to country i in year t . I perform this transformation as the panel data has zeroes for certain values. I add 0.01 to get valid results when I do a natural log transformation of the data. I choose 0.01, as that is a small value that will allow me to do the log transformation without introducing a bias to the estimators.

X denotes the vector of control variables. I use GDP and GDP per capita to control for the absolute and relative market size respectively. The variable μ_i denotes country fixed effects.

Considering our control variables, Eq. 1 can be written as follows:

$$\ln(Y'_{it}) = \beta_0 + \beta_1 \cdot \ln(\text{Risk}_{it}) + \alpha_1 \cdot \ln(\text{GDP}) + \alpha_2 \cdot \ln(\text{GDP/cap}) + \mu_i + \varepsilon_{it} \quad (2)$$

In order to check for the effects of the control variables, I run the model without control variables. The modified model is as follows:

$$\ln(Y'_{it}) = \beta_0 + \beta_1 \cdot \ln(\text{Risk}_{it}) + \mu_i + \varepsilon_{it} \quad (3)$$

This paper studies the association between Chinese OFDI and country risks before and after the Belt and Road Initiative. I run two regressions, one for the period before the Belt and Road Initiative (2005-2012) and the other for years after the initiative was announced (2013-2017). I then compare the correlation coefficient from the two regressions.

I apply OLS with fixed-effect model (FE) to estimate the two equations. I also considered the regular OLS regression (results attached in Appendix Table 3A); however, regular OLS regression fails to capture the heterogeneity across countries.

The panel data setting combines both cross-sectional and time series data. The cross sectional units (countries) may show heteroskedasticity (Baltagi, Jung and Song 2010). The Breusch pagan test (Appendix Table 1A) confirms the existence of heteroskedasticity in the data. In addition to this, the data will also have a serial correlation. Since firms make investment decisions over multiple years, the amount invested in a country will depend upon the amount invested in previous years. I resolve this issue by using the Arellano method to derive robust standard errors These are clustered by group (in this case, country) and are designed specifically for Large N Small T (~less than 30) panel setting (Arellano 1987). This method is basically an extension of White standard errors (White 1984), applied to a fixed effect setting, and resolves both heteroskedasticity and serial correlation (Millo 2017).

Chapter 8: Results

Table 1 presents the results of the statistical analysis with clustered standard errors. The table shows the OLS with Fixed Effects estimate for the association between the cumulative political risk index of a country and the Chinese OFDI for the two models with and without control variables. The hypothesis variable “Risk” has a negative impact on Chinese outward investment to a country in the period after 2013 for both the models and is statistically significant at 5%. This confirms my counter hypothesis that after 2013, the relationship between Chinese OFDI and host country political risk is negative.

	Pre 2013	Post 2013	Pre 2013	Post 2013
	1	2	(With Control)	(With Control)
			3	4
ln (Risk)	11.904	-16.144	2.644	-16.975
	(-4.082)**	(-5.087)**	(4.630)	(7.414)*
ln(GDP)			4.75	3.06
			(4.384)	(8.223)
ln(GDP/Capita)			0.237	-2.653
			(4.900)	(7.998)
Country Fixed Effects	Yes	Yes	Yes	Yes
Adj R-sq	0.3043	0.5042	0.3656	0.4936
n	116	115	116	115
T	2-8	5	2-8	5
N	921	575	921	575
** 0.01, * 0.05, ‘ 0.1				

Table 1: Results for correlation between Chinese OFDI and cumulative risk (OLS with Fixed Effects)

The coefficient for Political Risk for Pre 2013 analysis is statistically significant at 1% for the model without control variable. However, the coefficient is not significant when I run the model with control variables. More importantly, the correlation in both the cases for the pre-2013 period, is non-negative. This result is in line with previous studies by Buckley, Clegg, et al. (2007); Kolstad and Wiig (2012); and Cheung and Qian (2009) that found either no correlation or a positive one between Chinese OFDI and host country political risk. This positive association between Chinese OFDI and rising host country political risk confounded researchers, as it was not consistent with the conventional wisdom.

I employed the OLS estimator with fixed effects to perform the statistical analysis. The coefficients estimated by the FE model will have a Nickell Bias. However, this bias is always in the downward direction (Nickell 1981). This implies that the coefficients are a conservative estimate. This actually works in my favor because even the most conservative estimate demonstrates a reversal in correlation, which supports my counter hypothesis that the correlation between Chinese OFDI and host country political risk becomes negative after 2013.

While selecting the model, I had to decide between Fixed Effects and Random Effects (Snijders 2005). I use a large N small T panel dataset where T is sufficiently small. The FE model is more convincing theoretically than a RE model unless the individual specific effect is an unrelated effect. However, we are unable to confirm this statistically. The standard test to select between the Fixed effect and the Random effect model is the Hausman test (Green 2008). The results of the Hausman test, shown in Appendix Table

2A, indicate that we may use the fixed effect model for our analysis. However, we must exercise caution while interpreting the results. Hausman test is valid only under the conditions of homoskedasticity (Baltagi, Bresson, and Pirotte 2003). Our data clearly has heteroskedasticity, as proven by the Breusch- Pagan test (results in Appendix Table 1A). Hence, we cannot use the Hausman test to select between the Fixed Effect and Random Effect model. This should not be an issue though because the Fixed Effect model is more strenuous than a Random Effect model.

The country fixed effects model allows me to account for country specific attributes, other than my dependent and control variables, that may change over time within a country. Thus, the OLS with fixed effects estimator for risk will tell me the correlation between a country's political risk and the Chinese OFDI it receives holding constant the average effect of the country.

Chapter 9: Discussion

The results confirm a statistically significant change in Chinese foreign investments post-2013, confirming my counter-hypothesis. This coincides directly with the launch of the Belt and Road Initiative, suggesting that Chinese OFDI behavior changed under the BRI and became less, not more, acceptant of political risk in host countries. This relationship between Chinese OFDI and political risk after the launch of the BRI, as opposed to before, follows the conventional idea about political stability attracting higher FDI (Busse and Hefeker (2007); Goswami and Haider (2014); and Krifa-Schneider & Matei (2010)). Post 2013, contrary to some of the contemporary scholarship raising alarms (Hurley, Morris, and Portelence (2019); Dave and Kobayashi (2018); and Johnston (2019)), Chinese firms are behaving much like standard non-Chinese firms when it comes to considering political risks in their investment decisions, and the association is contrary to that in the period before 2013, when Chinese OFDI flowed into countries with higher political risks (Buckley, et al. (2007); Kolstad and Wiig (2012)).

While it is beyond the scope of this thesis to test the following claims, I hypothesize that this behavior can be explained by a combination of the following factors, each discussed below: greater participation of Chinese publicly listed firms; realization of the Ownership (O), Location (L), and Internalization (I) – OLI advantages by Chinese SOEs, and a hedging strategy.

TYPE OF FIRMS - SOE VS PUBLIC

The type of firms conducting OFDI may lead to a change in investment behavior. The first, and the largest (in terms of FDI), companies to “go global” (engage in OFDI) were Chinese State Owned Enterprises (SOEs). Chinese SOEs, such as Sinopec, China

National Petroleum Corp, China Minmetals, have unique incentive structure and operate under constraints different from that of a public listed firm (Morck, Yeung and Zhao 2008). They ascribed this difference to their ownership structures and their relationship with the government of China. This leads to the SBC syndrome in Chinese SOEs. As Kornai, Maskin and Roland (2003) explain, SBC syndrome is when firms can count on surviving even when they are loss-making. This happens when firms expect to be bailed out by other organizations, which are usually the government or any other state agency (Maskin and Roland 2003). Additionally, Chinese SOEs enjoy a monopoly status in their sectors, sanctioned by the government (Morck, Yeung and Zhao 2008). Unlike a standard firm, Chinese SOEs do not have to compete with other Chinese firms, an advantage that they enjoy over a standard firm when SOEs conduct foreign direct investments. Thus, Chinese SOEs might not be motivated by profit maximization the same way as a standard firm is, and can take on additional risk. As previously discussed, this moral hazard problem emerges from pervasive soft budget constraints (Kornai, Maskin, & Roland, 2003), forsaking long-term strategic thinking. The Chinese government provides guarantees to SOEs, either explicitly through government-backed insurance or implicitly through Chinese development bank financing (Russel and Berger 2019). Hence, Chinese SOEs were more likely to invest in countries with higher political risk ((Buckley, Clegg, et al. (2007); Buckley, Cross, et al. (2008); and Kolstad and Wiig (2012)), because the risk will be transferred to the supporting organization, responsible for bailing the SOE out in case of a financial trouble. If the investment failed, the SOEs were confident they would be bailed out by the government (Cull and Xu (2000); Kornai, Maskin, and Roland (2003); and Dewatripont and Maskin (1995).

However, Chinese private firms, such as Lenovo and Haier, have completely different attributes. They do not enjoy any of the advantages of domestic monopoly and

access to capital enjoyed by their state-owned counterparts; a handicap they overcome by being more efficient in deploying their limited capital (Antsey 2019). As a result, Chinese private firms are likely to be more sensitive to the risks and invest in countries with lower political risk. The private share of Chinese outward investments has grown tremendously since the announcement of BRI, rising from 14% before 2013 to over 50% in 2016; exceeding the investments by State (Scissors 2016). This surge of private investments post 2013 in countries with lower political risks would explain the negative correlation between Chinese OFDI and host country political risk. One way to test this empirically is to separate the Chinese OFDI to countries by the type of firm. Empirically, this would involve adding a dummy variable for firm type. That should tell us the risk sensitivity of Chinese SOE vis-à-vis their private counterparts.

OWNERSHIP, LOCATION, AND INTERNALIZATION (OLI) ADVANTAGE

The relationship between Chinese firms' political risk acceptance and OFDI behavior may also be understood through the framework provided by internalization theory, and the OLI theory (Dunning 1980)). According to the theory, firms will invest in foreign markets only if the firm enjoys Ownership (O), Location (L), and Internalization (I) advantages in that market. Over the years, Chinese firms, including SOEs, have positioned themselves such that they can leverage the OLI advantages:

- **Ownership (O):** Chinese firms have access to cheap capital (Ma & Andrews-Speed, 2006). This gives them a competitive edge over firms from developed economies, especially in sectors where the importance of brand values is diminishing but has not disappeared (Nicolas 2009). This competitive edge translates into “ownership advantage” and allows Chinese firms to compete in developed markets.

- **Location (L):** Since the Belt and Road Initiative has set up some ambitious goals, Chinese firms are aggressively looking to acquire more advanced technologies. The ‘Made in China 2025’ identifies key sectors for technological advancements – Information Technology, high-end robots, Aerospace equipment, and advanced materials (“Made in China 2025” 2015). Consequently, Chinese firms would invest in countries with higher technological innovation levels, which in turn, implies investing in politically stable countries, since the level of technological innovation in a country is positively correlated with political stability in that country (Allard, Martinez, & Williams, 2012).
- **Internalization (I):** The internalization advantage for Chinese OFDI post the BRI is tied to the Location advantage with respect to access to technology. Investing in developed economies will allow the Chinese firms to internalize the advanced technology typically found in these countries.

The realization of the OLI advantages paved the way for Chinese firms’ entry into developed economies, where the investments are exposed to lower political risks, when the BRI was announced. For example, Chinese investments to Italy grew tremendously after the BRI, and Italy ultimately joined the initiative, becoming the first major European country to do so (Ellyatt 2019).

HEDGING

The final explanation could be strategic hedging. China’s outstanding claims to developing countries exceed those of all Paris club creditors combined (Morris 2019). China is lending to some high-risk countries while at the same time, investing in politically stable developed economies. This could be a way for China to hedge against a possible debt crisis. The research design for testing the “Hedging” argument would involve studying

the debt implications of Chinese OFDI in detail and setting the research in the broader geopolitics surrounding the Belt and Road Initiative.

Chapter 10: Conclusions and Future Work

This report analyzes the impact of the Belt and Road Initiative (BRI) on the association between Chinese outward foreign direct investment and host country political risk over the period 2005-2017. Past studies have explored the political determinants of Chinese OFDI, however, they have not re-examined the relationship with more recent data that coincides with the launch of the BRI. Despite this lack of empirical research, there has been abundant speculation that the BRI would dramatically increase risky Chinese OFDI and, in so doing, exacerbate problems of excessive debt burdens and defaults in already unstable countries (Dave and Kobayashi (2018); Hurley, Morris, & Portelence (2019); and Johnston (2019)). This research questions these claims by statistically analyzing the relationship between Chinese investments and political risk, data for Chinese OFDI from the American Enterprise Institute and ICRG country risk data from PRS that contributed to a data-frame for 117 countries, each with 13 risk attributes.

The announcement of BRI ensued a prominent shift in the investment pattern of Chinese investors. A longitudinal analysis of Chinese investments reveals a change in investment pattern across sectors as well as countries indicating a move towards destinations with lower political risks. In this way, the empirical evidence using data from 2005-2017 contradicts the null hypothesis: the correlation between Chinese OFDI and host country political risk is negative after the announcement of the Belt and Road Initiative. And while this does not eliminate the possibility of consequences such as debt overhangs and defaults, it does give us pause to rethink some of the more alarming assertions out there in the popular press.

In order to test my hypothesis empirically, I build a log-linear regression model. I use the OLS method with Fixed Effects to derive the estimators. The statistical analysis

confirms my counter-hypothesis, which establishes the change in investment pattern of Chinese firms and indicates that Chinese OFDI post 2013 is more sensitive to political risks in host country.

Additionally, in this paper, I build upon the results of the statistical analysis, expounding upon the reasons for the observed change. I delineate the possible reasons for this change, hypothesizing three factors that might be causing the change in investment pattern – a) a growing participation of Chinese private firms in outward investments, b) realization of OLI advantages, and c) a broader hedging strategy to protect the Chinese investments from a potential debt crisis.

I use aggregated Chinese investment data in this research. A shortcoming of this approach is that it does not allow me to analyze the possible explanations for the observed results. A firm level analysis of the investments and the risk associated with each of those investments will allow me to distinguish between investments by Chinese SOEs and public listed firms and develop more insights about the behavior of Chinese firms. That would enable me to ascertain the reasons for the observed results.

This report paves the way for future research that could explain the behavior of Chinese firms. Future work would involve investigating the factors that influence a Chinese firms' FDI decision and reveal some insights about the behavior of Chinese firms post BRI. While a lot of research has been done to study the rationale behind Chinese SOEs' investment decisions (Morck, Yeung and Zhao (2008); and Child and Rodrigues (2005); Cull and Xu (2000)), there is still limited literature on the OFDI behavior Chinese private firms in the contemporary era, despite the extensive attention devoted to Chinese OFDI in the popular press and gray literature. A comparative study of the Chinese private firms and SOEs would reveal insights about the difference in risk perceptions, budget constraints, and how the firms conducts business in foreign markets. While an empirical study will

reveal the broad trends, a qualitative investigation, involving interviews with the top managers of private firms, similar to the study by (Peng M. (1997); and Peng and Harwit (1996)) should fill the gap in the current literature. In addition to this, the implication of Chinese investment on global debt merits an investigation.

Appendix

COMPONENTS OF POLITICAL RISK INDEX (PRS GROUP)

The four major components of the political risk index (PRS Group) are Government Stability, Socio-economic conditions, Investments Profile, and Conflict.

Government stability denotes the government's ability to carry out its programs and its ability to stay in power. A stable government would have popular support and will be able to provide a safer environment for foreign investments.

Socio-economic conditions, such as poverty, unemployment, and consumer confidence assess the socioeconomic pressures in a society that can fuel social dissatisfaction.

The Investment Profile indicator measures the risks that are specific to investments. These risks could be payment delays or contract viability.

The conflict components (Internal and External) measure the risk to the country due to an armed conflict. An armed conflict would adversely affect the governance capabilities of the country and pose a risk to the investments in that country.

These are the major components of political risks and are further divided into sub-components. The other components of political risks are more specific, and they measure explicit political components such as law and order, corruption, bureaucratic quality, or military in politics. These are assigned lower weights than the major components (Howell 2013).

BREUTSCH PAGAN TEST

	p-Value (H₀ – Homoskedasticity exists)
Model (1) – Pre 2013 without Control variables	0.000000400
Model (2) - Post 2013 without Control variables	0.000000342
Model (3) - Pre 2013 with Control variables	0.000173600
Model (4) - Post 2013 with Control variables	0.000000745

Table 1A: Results for Breusch-Pagan Test

HAUSMAN TEST

	p-Value (H₀ – preferred model is Random Effects)
Model (1) – Pre 2013 without Control variables	0.01435000
Model (2) - Post 2013 without Control variables	0.01580000
Model (3) - Pre 2013 with Control variables	0.00000002
Model (4) - Post 2013 with Control variables	0.05312000

Table 2A: Results for Hausman Test.

OLS REGRESSION

	Pre 2013	Post 2013	Pre 2013 (With Control)	Post 2013 (With Control)
	1	2	3	4
ln (Risk)	1.58	-0.80	2.13	-0.66
	(0.07)'	0.494	(0.012)*	(0.584)
ln(GDP)			1.43	1.93
			(0.0002)***	(0.0002)***
ln(GDP/Capita)			-0.96	-1.12
			(0.0002)***	(0.0006)***
Country Fixed Effects	No	No	No	No
Adj R-sq	0.00262	0.00090	0.13800	0.23700
N	921	575	921	575
*** 0.001, ** 0.01, * 0.05, ' 0.1				

Table 3A: Results for correlation between Chinese OFDI and cumulative risk (OLS)

BIBLIOGRAPHY

- Abi-Habib, M. (2018, June 25). *How China Got Sri Lanka to Cough Up a Port*. Retrieved April 27, 2020, from The New York Times:
<https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html>
- Abi-Habib, M. (2018, June 25). *How China Got Sri Lanka to Cough Up a Port*. Retrieved October 9, 2019, from The New York Times:
<https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html>
- Allard, G., Martinez, C. A., & Williams, C. (2012). Political instability, pro-business market reforms and their impacts on national systems of innovation. *Research Policy*, 638-651.
- Allee, T. P. (2011). Contingent Credibility: The impact of Investment Treaty Violations on Foreign Direct Investment. 401-32.
- Allen, F., Qian, J., & Qian, M. (2005). Law, finance, and economic growth in China. *Journal of Financial Economics*, 57-116.
- Anastassopoulos, J.-P., Blanc, G., & Dussauge, P. (1987). State-Owned Multinationals. *Wiley/IRM Series on Multinationals*.
- Antsey, C. (2020, January 19). *In China State Ownership Means Worse performance for Stocks*. Retrieved April 2, 2020, from Bloomberg:
<https://www.bloomberg.com/news/articles/2020-01-20/in-china-state-ownership-means-worse-performance-for-stocks>
- Arel-Bundock, V. (2017). The unintended consequences of bilateralism: Treaty shopping and international tax policy. *International Organization*, 349-371.
- Arellano, M. (1987). PRACTITIONERS' CORNER: Computing robust standard errors for within-groups estimators. *Oxford bulletin of Economics and Statistics*, 431-434.
- Ayodele, T., & Sotola, O. (2014). China in Africa: An evaluation of Chinese investment. *Initiative for Public Policy Analysis*, 1-20.
- Bai, C.-e., & Wang, Y. (1996). Agency in Project Screening and Termination Decisions: Why Is Good Money Thrown after Bad?
- Balding, C. (2017, May 16). *Can China Afford Its Belt and Road?* Retrieved from Bloomberg: <https://www.bloomberg.com/opinion/articles/2017-05-17/can-china-afford-its-belt-and-road>

- Baltagi, B. H., Jung, B. C., & Song, S. H. (2010). Testing for heteroskedasticity and serial correlation in a random effects panel data model. *Journal of Econometrics*, 22-124.
- Baltagi, B., Bresson, G., & Pirotte, A. (2003). Fixed effects, random effects or Hausman–Taylor?: A pretest estimator. *Economics letters*, 361-369.
- Bekaert, G., Campbell, R., Lundblad, C. T., & Stephen, S. (2014). Political Risk Spreads. *Journal of International Business Studies*, 471-493.
- (2017). *Belt & Road: Opportunity & Risk The Prospects and perils of building China's New Silk Road*. Baker Mckenzie.
- Betigeri, A. (2018, July 4). *Hambantota: "the Chinese port"*. Retrieved April 28, 2020, from The Interpreter: <https://www.lowyinstitute.org/the-interpreter/hambantota-the-chinese-port>
- Blanchard, J.-M. F., & Devillard, J. (2015, July 26). *Chinese Outward Investment and Host Country Corruption*. Retrieved from The Diplomat: <https://thediplomat.com/2015/07/chinese-outward-investment-and-host-country-corruption/>
- Blonigen, B. A. (2005). A review of the empirical literature on FDI determinants. *Atlantic Economic Journal*, 383-403.
- Boardman, A., & Aidan, V. (1989). Ownership and performance in competitive environments: A comparison of the performance of private, mixed, and state-owned enterprises. *the Journal of Law and Economics*, 1-33.
- Bonin, J., Schaffer, M., & Banks, F. (1995). Bad Debts and Bankruptcy in Hungary 1991-94'. *Centre for Economic Performance, London School of Economics and Political Science*.
- BRI CONNECT: An Initiative in Numbers*. (n.d.). Retrieved February 19, 2020, from Refinitiv: https://www.refinitiv.com/content/dam/marketing/en_us/documents/reports/belt-and-road-initiative-in-numbers-issue-2.pdf
- Buckley, P. (1988). The limits of explanation: Testing the internalization theory of the multinationalial enterprise. *Journal of international business studies*, 181-193.
- Buckley, P. (2007). The strategy of multinational enterprises in the light of the rise of China. *Scandinavian Journal of Management*, 107-126.

- Buckley, P. J., Clegg, L. J., Cross, A. R., Liu, X., Voss, H., & Zheng, P. (2007). The determinants of Chinese outward foreign. *Journal of International Business Studies*, 499-518.
- Buckley, P. J., Cross, A. R., Tan, H. X., & Voss, H. (2008). Historic and emergent trends in Chinese outward foreign direct investment. *Management International Review*, 715-747.
- Buckley, P., & Casson, M. (1976). *The Future of the Multinational Enterprise*. London: Macmillan.
- Busse, M., & Hefeker, C. (2007). Political risk, institutions and foreign direct investment. *European journal of political economy*, 397-415.
- Casanova, C., & Moulin, C. (n.d.). *Rising Political Risks Cloud Outlook for Asian Economies*. Coface Economic Publications.
- Casey, N., & Krauss, C. (2018, December 24). *It Doesn't Matter if Ecuador Can Afford The Dam. China Still Gets Paid*. Retrieved April 5, 2020, from The New York Times: <https://www.nytimes.com/2018/12/24/world/americas/ecuador-china-dam.html>
- Chan, T. F. (2018, March 6). *China's debt-trap diplomacy reaches the Philippines, which is likely to accept Chinese loans 1,100% more expensive than other options*. Retrieved April 29, 2020, from Business Insider: <https://www.businessinsider.com/chinas-debt-trap-diplomacy-hits-philippines-with-exorbitant-loans-2018-3>
- Chang, S.-C. (2014). The Determinants and Motivations of China's Outward Foreign Direct Investment: A Spatial Gravity Model Approach. *Global Economic Review*, 244-268.
- Chatzky, A., & McBride, J. (2019, May 21). China's Massive Belt and Road Initiative.
- Chen, C. (2018). Impact of China's outward foreign direct investment on its regional economic growth. *China & World Economy*, 1-21.
- Chen, G., Firth, M., & Xu, L. (2009). Does the type of ownership control matter? Evidence from China's listed companies. *Journal of Banking & Finance*, 171-181.
- Cheung, Y.-W., & Qian, X. (2009). Empirics of China's outward direct investment. *Pacific economic review*, 312-341.

- Child, J., & Lu, Y. (1996). Institutional Constraints on Economic reform: The case of investment decisions in China. *Organization Science*, 60-77.
- Child, J., & Rodrigues, S. B. (2005). The Internationalization of Chinese Firms: A Case for Theoretical Extension? *Management and organization review*, 381-410.
- Ching, T., & Li, X. (2018). Understanding the China–US trade war: causes, economic impact, and the worst-case scenario. *Economic and Political Studies*, 185-202.
- Claessens, S., & Djankov, S. (1998). Politicians and Firms in Seven Central and Eastern European Countries. *World Bank*.
- Coase, R. (1937). The Nature of the Firm. *Economica*, 386-405.
- Cui, L., & Jiang, F. (2012). State ownership effect on firms' FDI ownership decisions under institutional pressure: A study of Chinese outward-investing firms. *ournal of international business studies*, 264-284.
- Cull, R., & Xu, L. (2000). Bureaucrats, state banks, and the efficiency of credit allocation: The experience of Chinese state-owned enterprises. *Journal of Comparative Economics*, 1-31.
- Dasgupta Aditya, K. G. (2017). (When) Do Antipoverty Programs Reduce Violence? India's Rural Employment Guarantee and Maoist Conflict. *International Organization*, 605-32.
- Dave, B., & Kobayashi, Y. (2018). China's silk road economic belt initiative in Central Asia: economic and security implications. *Asia Europe Journal*, 267-281.
- Davies, H. (1995). China Business: Context and Issues.
- Decline of Global Extreme Poverty Continues but has Slowed: World Bank*. (2018, September 4). Retrieved from <http://www.worldbank.org/en/news/press-release/2018/09/19/decline-of-global-extreme-poverty-continues-but-has-slowed-world-bank>
- Dewatripont, M., & Maskin, E. (1995). Credit and efficiency in centralized and decentralized economies. *The Review of Economic Studies*, 541-555.
- Drezner, D. W. (2019). Counter-Hegemonic Strategies in the Global Economy. *Security Studies*, 505-531.
- Du, J., & Zhang, Y. (2018). Does one belt one road initiative promote Chinese overseas direct investment?. *China Economic Review*, 189-205.

- Dunning, J. H. (1980). Toward an Eclectic Theory of International Production. *Journal of International Business Studies*, 9-31.
- Dunning, J. H. (2001). The eclectic (OLI) paradigm of international production: past, present and future. *International journal of the economics of business*, 173-190.
- Ellyatt, H. (2019, March 27). *Is Italy playing with fire when it comes to China* . Retrieved May 2, 2020, from CNBC: <https://www.cnbc.com/2019/03/27/italys-joins-chinas-belt-and-road-initiative.html>
- Erdener, C., & Shapiro, D. M. (2005). The internationalization of Chinese family enterprises and Dunning's eclectic MNE paradigm. *Management and organization review*, 411-436.
- Feigenbaum, E. (2017, July 25). *Is Coercion the New Normal in China's Economic Statecraft?* Retrieved February 15, 2020, from Carnegie Endowment for International Peace: <https://carnegieendowment.org/2017/07/25/is-coercion-new-normal-in-china-s-economic-statecraft-pub-72632>.
- Forget, E. L. (2011). The Town with No Poverty: The Health Effect of a Canadian Guaranteed Annual Income Field Experiment. *Canadian Public Policy*, 283-305.
- Gerstel, D. (2018). It's a (Debt) Trap! Managing China-IMF. *New Perspectives in Foreign Policy*, 12-15.
- Goswami, G. G., & Haider, S. (2014). Does political risk deter FDI inflow? *Journal of Economic Studies*.
- Greet, T. (2018). *One Belt, One Road, One Big Mistake*. Foreign Policy.
- Haas, B., Jacobs, B., & Helmore, E. (2018, March 22). *US imposes sanctions on China, stoking fears of trade war*. Retrieved April 2, 2020, from The Guardian: <https://www.theguardian.com/world/2018/mar/22/china-us-sanctions-trade-war>
- Hanemann, T., & Huotari, M. (2016, February). *A new record year for Chinese outbound investment in Europe*. Retrieved from Mercator Institute of Chinese Studies: <https://www.merics.org/en/merics-analysis/papers-on-china/cofdi/a-new-record-year-for-chinese-outbound-investment-in-europe/>
- Hardoon, D., & Heinrich, F. (2011). *Bribe Payers Index 2011*. Transparency International.
- Hayakawa, K., Kimura, F., & Lee, H.-H. (2013). How does country risk matter for foreign direct investment? *The Developing Economies*, 60-78.

- He, W., & Lyles, M. (2008). China's outward foreign direct investment. *Business Horizons*, 485-491.
- Heydarian, R. J. (2018, November 14). *Malaysia's bold play against China*. Retrieved October 10, 2019, from The Washington Post: <https://www.washingtonpost.com/news/theworldpost/wp/2018/11/14/malaysia/>
- Hillman, J. (2018). *Game of Loans: How China Bought Hambantota*. 2018: Center for Strategic & International Studies.
- Howell, L. D. (2013). "International country risk guide methodology.". Retrieved July 9, 2019, from <http://www.prsgroup.com/wp-content/uploads/2012/11/icrgmethodology.pdf>
- Howell, L. D. (1986). Area specialists and expert data: The human factor in political risk analysis. In *Global risk assessments: Issues, concepts & applications Book 2*.
- Howell, L. D. (1992). Political risk and political loss for foreign investment. *The International Executive*, 485-498.
- Howell, L. D., & Chaddick, B. (1994). Models of Political Risk for Foreign Investment and Trade. *The Columbia Journal of World Business*, 70-91.
- Hurley, J., Morris, S., & Portelence, G. (2019). Examining the debt implications of the Belt and Road Initiative from a policy perspective. *Journal of Infrastructure, Policy and Development*, 139-175.
- Johnson, L. (1965). US business interests in Cuba and the rise of Castro. *World Politics* , 440-459.
- Johnston, L. (2019). The Belt and Road Initiative: What is in it for China?. *Asia & the Pacific Policy Studies*, 40-58.
- Ken Farr, W. W., Lord, R. A., & Wolfenbarger, J. (1998). Economic freedom, political freedom, and economic well-being: causality analysis. *Cato Journal*, 18(2), 247-262.
- Knutsen, C., Rygh, A., & Hveem, H. (2011). Does State Ownership Matter? Institutions?. *Business and Politics*.
- Kobrin, S. (1980). Foreign enterprise and forced divestment in LDCs. *International Organization*, 65-88.

- Kobylnski, K. (2012, July). *Chinese investment in Africa: checking the facts and figures*. Retrieved from Association for International Affairs: <https://www.amo.cz/wp-content/uploads/2015/11/amocz-BP-2012-7.pdf>
- Kolstad, I., & Wiig, A. (2012). What determines Chinese outward FDI? *Journal of World Business*, 26-34.
- Kornai, J. (1980). The dilemmas of a socialist economy: the Hungarian Experience. *Cambridge Journal of Economics*, 147-157.
- Kornai, J., Maskin, E., & Roland, G. (2003). Understanding Soft Budget Constraint. *Journal of Economic Literature*, 1095-1136.
- Kreuger, A. (1998). The Political Economy of the Rent Seeking Society. *American Economic Review*, 291-303.
- Krifa-Schneider, H., & Matei, I. (2010). Business climate, political risk and FDI in developing countries: Evidence from panel data. *International Journal of Economics and Finance*, 54-65.
- Lardy, N. (1998). China and the Asian contagion. *Foreign Affairs*, 78-88.
- Li, D., & Liang, M. (1998). Causes of the Soft Budget Constraint. *Journal of Comparative Economics*, 104-116.
- Lin, J. Y., & Tan, G. (1999). Policy burdens, accountability, and the soft budget constraint. *American Economic Review*, 426-431.
- Liu, H., Chen, X., & Wu, Y. (2018). Political Environment and Chinese OFDI Under RMB. *Emerging Markets Finance & Trade*, 3470-3484.
- Liu, T., & Woo, W. T. (2018). Understanding the U.S.-China Trade War. *China Economic Journal*, 319-340.
- Liu, X., Buck, T., & Shu, C. (2005). Chinese economic development, the next stage: Outward FDI? *International Business Review*, 97-115.
- Luo, Y., Xue, Q., & Han, B. (2010). How emerging market governments promote outward FDI: Experience from China. *Journal of world business*, 68-79.
- Ma, H. (1991). How to revitalize large and medium size enterprises. *Jinju Yanjiu (Economic Research)*, 3-8.

- Ma, X., & Andrews-Speed, P. (2006). The overseas activities of China's national oil companies: rationale and outlook. *Minerals & Energy-Raw Materials Report*, 17-30.
- 'Made in China 2025' plan issued. (2015, May 19). Retrieved April 30, 2020, from The State Council The People's Republic of China: http://english.www.gov.cn/policies/latest_releases/2015/05/19/content_281475110703534.htm
- Millo, G. (2017). Robust standard error estimators for panel models: a unifying approach. *Journal of Statistical Software*.
- Mitchell, E. (2018, June 15). *Mattis: US must 'remain vigilant' toward countries pursuing nukes*. Retrieved May 1, 2020, from The Hill: <https://thehill.com/policy/defense/392519-mattis-us-must-remain-vigilant-toward-countries-pursuing-nukes>
- Mogato, M. (2017, August 15). *Philippines says China agrees on no new expansion in South China Sea*. Retrieved March 3, 2020, from Reuters: <https://www.reuters.com/article/us-southchinasea-philippines-china-idUSKCN1AV0VJ>
- Morck, R., Yeung, B., & Zhao, M. (2008). Perspectives on China's outward foreign. *Journal of International Business Studies*, 337-350.
- Morris, S. (2019, October 24). *HIPC with Chinese Characteristics: Why Yesterday's Debt Relief Is the Wrong Point of Reference for Today's Crises*. Retrieved from Center for Global Development: https://www.cgdev.org/blog/hipc-chinese-characteristics-why-yesterdays-debt-relief-wrong-point-reference-todays-crises?utm_source=191029&utm_medium=cgd_email&utm_campaign=cgd_weekly
- Mourao, P. R. (2018). What is China seeking from Africa? An analysis of the economic and political determinants of Chinese Outward Foreign Direct Investment based on Stochastic Frontier Models. *China Economic Review*, 258-268.
- Nickell, S. (1981). Biases in Dynamic Models with Fixed Effects. *Econometrica*, 1417-1426.
- Nicolas, F. (2009). *Chinese direct investment in Europe: Facts and fallacies*. Chatham House.

- Nigerian railway: A tale of failed contracts, dashed hope.* (2016, February 4). Retrieved April 29, 2020, from Punch: <https://punchng.com/nigerian-railway-a-tale-of-failed-contracts-dashed-hope/>
- O'Donnell, F. (2018, April 23). *China deepens militarization of One Belt, One Road initiative.* Retrieved April 27, 2020, from Axios: <https://www.axios.com/china-deepens-militarization-of-one-belt-one-road-initiative-889c773b-cd8b-4af4-95e7-ce0142c3a427.html>
- Panda, A. (2018, May 3). *Possible Use of Blinding Laser Weapon Near China's Djibouti Base Spurs US Warning to Aviators.* Retrieved 20 2020, April, from The Diplomat: <https://thediplomat.com/2018/05/possible-use-of-blinding-laser-weapon-near-chinas-djibouti-base-spurs-us-warning-to-aviators/>
- Panday, J. (2018, November 11). *US officials warn China's BRI could lead to debt trap, undermine sovereignty.* Retrieved April 25, 2020, from The Himalayan Times: <https://thehimalayantimes.com/nepal/us-officials-warn-chinas-bri-could-lead-to-debt-trap-undermine-sovereignty/>
- Peng, M. (1997). Firm Growth in Transitional Economies: Three Longitudinal Cases from China, 1989-96. *Organization Studies*, 385-413.
- Peng, M. W., & Harwit, E. (1996). Controlling the Foreign Agent: The government-MNE relationship in China. *Proceedings of the Academy of International Business*.
- Powell, W. (1990). Neither market nor hierarchy: Network forms of organization. *Research in Organizational Behavior*, 295-336.
- Raiser, M., & Ruta, M. (2019, June 20). *Managing the risks of the Belt and Road.* Retrieved February 5, 2020, from World Bank Blogs: <https://blogs.worldbank.org/eastasiapacific/managing-the-risks-of-the-belt-and-road>
- Ratner, E. (2018, January 25). *Geostrategic and Military Drivers and Implications of the Belt and Road Initiative.* Retrieved March 1, 2020, from Council on Foreign Relations: <https://www.cfr.org/report/geostrategic-and-military-drivers-and-implications-belt-and-road-initiative>
- Ricardo, D. (1817). *Principles of political economy and taxation.* London: J. Murray
- Rugman, A. M. (1985). Internalization is still a general theory of foreign direct investment. *Weltwirtschaftliches Archiv*, 570-575.
- Russel, D. R., & Berger, B. (2019). *Navigating the Belt and Road Initiative.* Asia Society Policy Institute.

- Ruta, M. (2018, May 4). *Three Opportunities and Three Risks of the Belt and Road Initiative*. Retrieved February 26, 2020, from World Bank Blogs: <https://blogs.worldbank.org/trade/three-opportunities-and-three-risks-belt-and-road-initiative>
- Schaffer, M. (1998). Do firms in transition economies have soft budget constraints? A reconsideration of concepts and evidence. *Journal of Comparative Economics*, 80-103.
- Scissors, D. (2016, July 2). *China's Outward Investment Explodes, and Peaks?* Retrieved February 3, 2020, from American Enterprise Institute: <https://www.aei.org/wp-content/uploads/2016/07/China-Tracker-July-2016.pdf>
- Scissors, D. (n.d.). *China Global Investment Tracker*. Retrieved August 28, 2019, from American Enterprise Institute: <https://www.aei.org/china-global-investment-tracker/>
- Shepherd, W. (2020, January 20). *Is China's Belt And Road Already In Retreat?* Retrieved April 29, 2020, from Forbes: <https://www.forbes.com/sites/wadeshepard/2020/01/30/is-chinas-belt-and-road-already-in-retreat/#38da0e005ebe>
- Shi, T. (2017, May 23). *China Firms View Political Risks as Top Concern for Belt & Road Project*. Retrieved from Insurance Journal: <https://www.insurancejournal.com/news/international/2017/05/23/451861.htm>
- Shleifer, A., & Vishny, R. (1994). Politicians and Firms. *The Quarterly Journal of Economics*.
- Smith, J. (2018, August 9). *China's Belt and Road Initiative: Strategic Implications and International Opposition*. Retrieved April 23, 2020, from The Heritage Foundation: <https://www.heritage.org/asia/report/chinas-belt-and-road-initiative-strategic-implications-and-international-opposition>
- Snijders, T. (2005). *Encyclopedia of Statistics in Behavioral Science*(Vol. 2.). John Wiley & Sons, Inc.
- Sorkin, A. (2010). *Too big to fail: The inside story of how Wall Street and Washington fought to save the financial system--and themselves*. Penguin.
- Standish, R. (2019). *China's Path Forward Is Getting Bumpy*. The Atlantic.
- Stewart, F. (2002). Root Causes of Violent Conflict in Developing Countries. *BMJ : British Medical Journal*, 342-345.

- Sun, Q., & Tong, W. (2003). China share issue privatization: the extent of its success. *Journal of Financial Economics*, 183-222.
- Tartar, A., Rojanasakul, M., & Diamond, J. S. (2018, April 23). *How China is Buying its Way into Europe*. Retrieved February 7, 2020, from Bloomberg: <https://www.bloomberg.com/graphics/2018-china-business-in-europe/>
- Volodzko, D. J. (2017, November 18). *China wins its war against South Korea's US THAAD missile shield – without firing a shot*. Retrieved February 5, 2020, from South China Morning Post: <https://www.scmp.com/week-asia/geopolitics/article/2120452/china-wins-its-war-against-south-koreas-us-thaad-missile>
- Walder, A. (1995). Local governments as industrial firms: An organizational analysis of China's transitional economy. *American Journal of Sociology*, 263-301.
- Wang, O. (2019, May 3). *US steps up belt and road offensive saying it offers fairer deals than China's 'debt trap'*. Retrieved 10 5, 2019, from South China Morning Post: <https://www.scmp.com/news/china/diplomacy/article/3008640/us-steps-belt-and-road-offensive-saying-it-offers-fairer-deals>
- Wei, F., Xie, F., & Zhang, S. (2005). Ownership structure and firm value in China's privatized firms: 1991-2001. *Journal of Financial and Quantitative Analysis*, 87-108.
- Wei, S. J., & Wang, T. (1997). The Siamese twins: do state-owned banks favor state-owned enterprises in China?. *China Economic Review*, 19-29.
- Wellhausen, R. L. (2015). Investor-State disputes: when can governments break contracts? *Journal of Conflict Resolution*, 239-261.
- Wells, L. T. (1983). *Third world multinationals - The rise of foreign direct investment from developing countries*. Cambridge, Massachusetts: MIT Press.
- Woody, C. (2018, March 7). *China is 'weaponizing capital' — and it's keeping the head of the US Navy awake at night*. Retrieved April 29, 2020, from Business Insider: <https://www.businessinsider.com/china-weaponizing-capital-us-navy-chief-awake-at-night-2018-3>
- World Bank Indicators*. (n.d.). Retrieved October 27, 2019, from World Bank: <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD>
- World Development Indicators*. (n.d.). Retrieved October 29, 2019, from The World Bank: <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>

- World Economic Situation and Prospects 2018*. (2018). New York: United Nations.
- Yeung, H. W.-c., & Liu, W. (2008). Globalizing China: The rise of mainland firms in the global economy. *Eurasian Geography and Economics*, 57-86.
- Zhang, C., & Xiao, C. (2017, December 21). *China's Belt and Road Initiative Faces New Security Challenges in 2018*. Retrieved April 16, 2020, from The Diplomat: <https://thediplomat.com/2017/12/chinas-belt-and-road-initiative-faces-new-security-challenges-in-2018/>
- Zhang, Y. C., & Yu, D. (1994). China's emerging securities market. *Columbia Journal of World Business*, 112-121.