

# Does the Institutional Environment in the Host Country Matter? Determinants of Chinese Outward Foreign Direct Investment in the Belt and Road Initiative Countries

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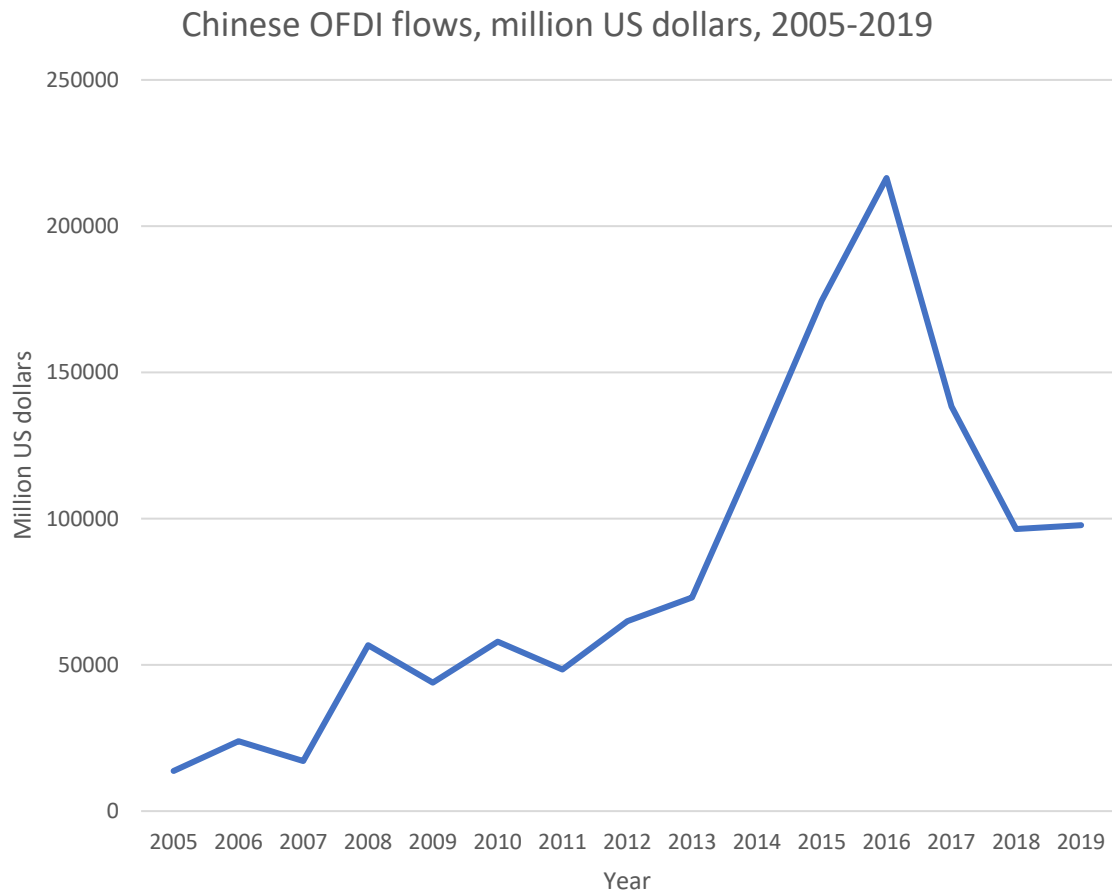


# IIASA as a platform for science-based dialogue to enhance global cooperation

- Currently **21 member countries**, **1 prospective member** and **2 observers**.
- **International, independent, interdisciplinary, policy-oriented research** into issues that are **too large or complex to be solved by a single country or academic discipline** (climate change, energy security, population aging, and sustainable development).
- Results of IIASA research and expertise of its researchers made available to **policymakers** to help them produce **effective, science-based policies**.



# Chinese outward FDI



80.9% of Chinese OFDI flows went to Asia, 7.7% to Europe, 4.7% to Latin America, 3.2% to North America, 2.0% to Africa, and 1.5% to Oceania.

Top ten destinations were Hong Kong (66.1%), British Virgin Islands (6.3%), Singapore (3.5%), Netherlands (2.8%), United States (2.8%), Indonesia (1.6%), Australia (1.5%), Sweden (1.4%), Vietnam (1.2%), and Germany (1.1%)

Top ten sectors were leasing and business services (30.6%), manufacturing (14.8%), finance (14.6%), wholesale and retail trades (14.2%), information transmission/software and information technology services (4.0%), mining (3.7%), transportation/storage and postal services (2.8%), production and supply of electricity/heat/gas and water (2.8%), construction (2.8%), scientific research and technical services (2.5%).

Chinese investors made direct investment in nearly 11000 overseas enterprises in 63 BRI countries in 2019. The cumulative investment was 18.69 billion US dollars, a year-on-year increase of 4.5%. accounting for 13.7% of Chinese OFDI flows. From 2013 to 2019, China's FDI flows to BRI countries totaled 117.31 billion US dollars.

# Chinese OFDI determinants of interest

Distance	Expected sign	Description	Source
Economic distance	-	Difference between host country and Chinese GDP per capita in U.S. dollars (e.g., Le, 2017)	World Development Indicators
<b>Institutional distance for each governance indicator</b>	?	Difference between host country and Chinese values for governance indicators (e.g., Aleksynska & Havrylchyk, 2013)	Worldwide Governance Indicators
Infrastructural distance	+	Difference between host country and Chinese mobile cellular subscriptions per 100 people	World Development Indicators
Growth distance	+	Difference between host country and Chinese annual GDP growth rate in %	World Development Indicators
Inflation distance	-	Difference between host country and Chinese annual growth rate of GDP implicit deflator in % (e.g., Zhu & Milcheva, 2016)	World Development Indicators
Tax distance	-	Difference between host country and Chinese corporate income tax rate in %	Tax Foundation
Export	+	Export from China to a host country, million US dollars	World Integrated Trade Solution, UN Comtrade
Import	+	Import from a host country to China, million US dollars	World Integrated Trade Solution, UN Comtrade
BRI	+	Dummy for the presence of the BRI. Equal to 1 since 2013	

# Institutional environment

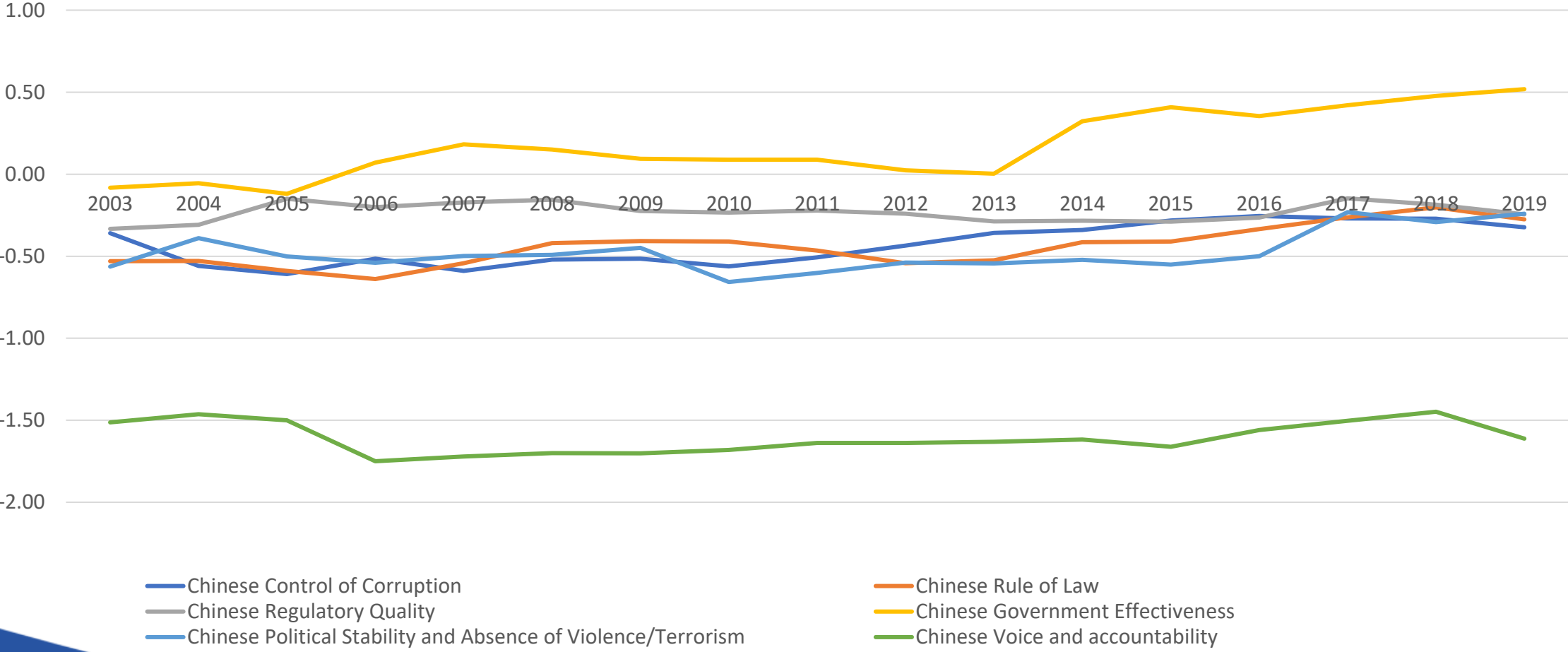
A general policy framework including economic, political, and social stability, good governance, private property protection and other factors which affect FDI (approximated by the Worldwide Governance Indicators: control of corruption, government effectiveness, political stability and absence of violence/terrorism, regulatory quality, rule of law, voice and accountability)

The effect of institutional OFDI determinants is conditional on the home environment of investors, which implies that not all investors are attracted by a favorable institutional environment, and not all investors are deterred by bad institutional conditions.

Separate governance indicators are overlapping and tautological, which suggests using some average of them to present governance in a broad sense. For this, a combined variable governance is introduced measured as a weighted average of regulatory quality, control of corruption, rule of law, and government effectiveness (also used by the European Bank for Reconstruction and Development to capture the quality of economic institutions).

# Institutional development in China

World Governance Indicators in China



# Regression outcome

Independent variables	Coefficient (Robust standard error)	Standardized beta coefficient
Export from China to host country	0.1821421* (0.1142231)	0.143291
Import from host country to China	0.0179218 (0.0839482)	0.0210362
Economic distance	-0.3023922* (0.1809166)	-0.1733719
Infrastructural distance	0.0336539 (0.0753616)	0.0127698
Growth distance	0.0197236' (0.014872)	0.0409821
Tax distance	-0.0355998*** (0.0090108)	-0.1331286
BRI	3.982337*** (0.4841102)	0.8708492
Governance distance	-0.2558902 (0.1794892)	-0.1122448
Political stability and absence of violence/terrorism distance	0.2870062*** (0.1096043)	0.1217826
Constant	-3.772337* (1.967296)	.
Year fixed effects	Yes***	
R-squared	0.8634	
Number of observations	959	
Number of countries	63	

# Political stability and absence of violence (World Bank)

Orderly transfers

Armed conflict

Violent demonstrations

Social unrest

International tensions /  
terrorist threat

Political terror scale

Security risk rating

Intensity of internal  
conflicts: ethnic, religious  
or regional

Intensity of violent  
activities of underground  
political organizations

Intensity of social conflicts  
(excluding conflicts relating  
to land)

Government stability

Internal conflict

External conflict

Ethnic tensions

Protests and riots

Terrorism

Interstate war

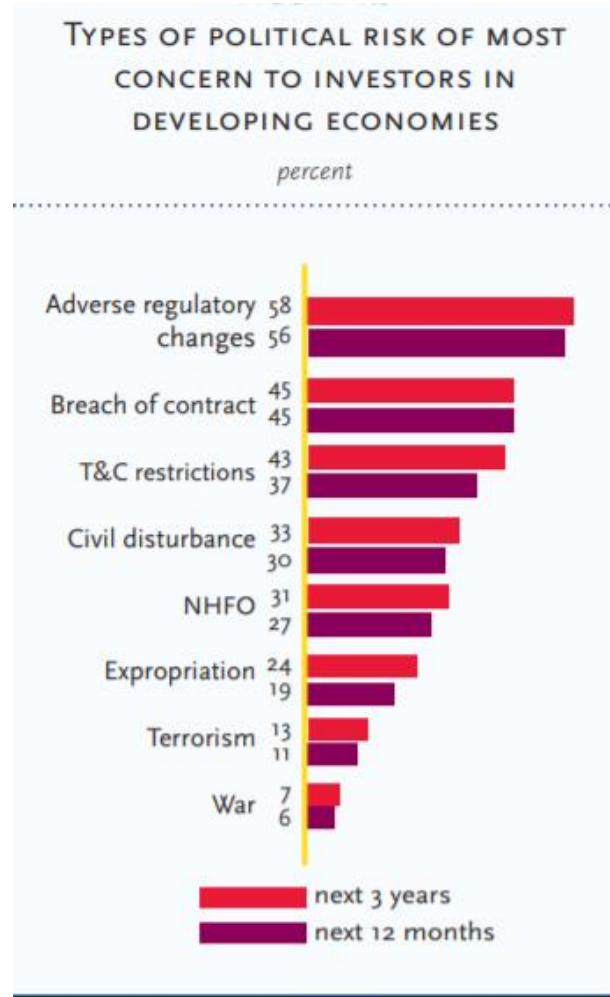
Civil war

The risk of political  
instability

Civil conflict

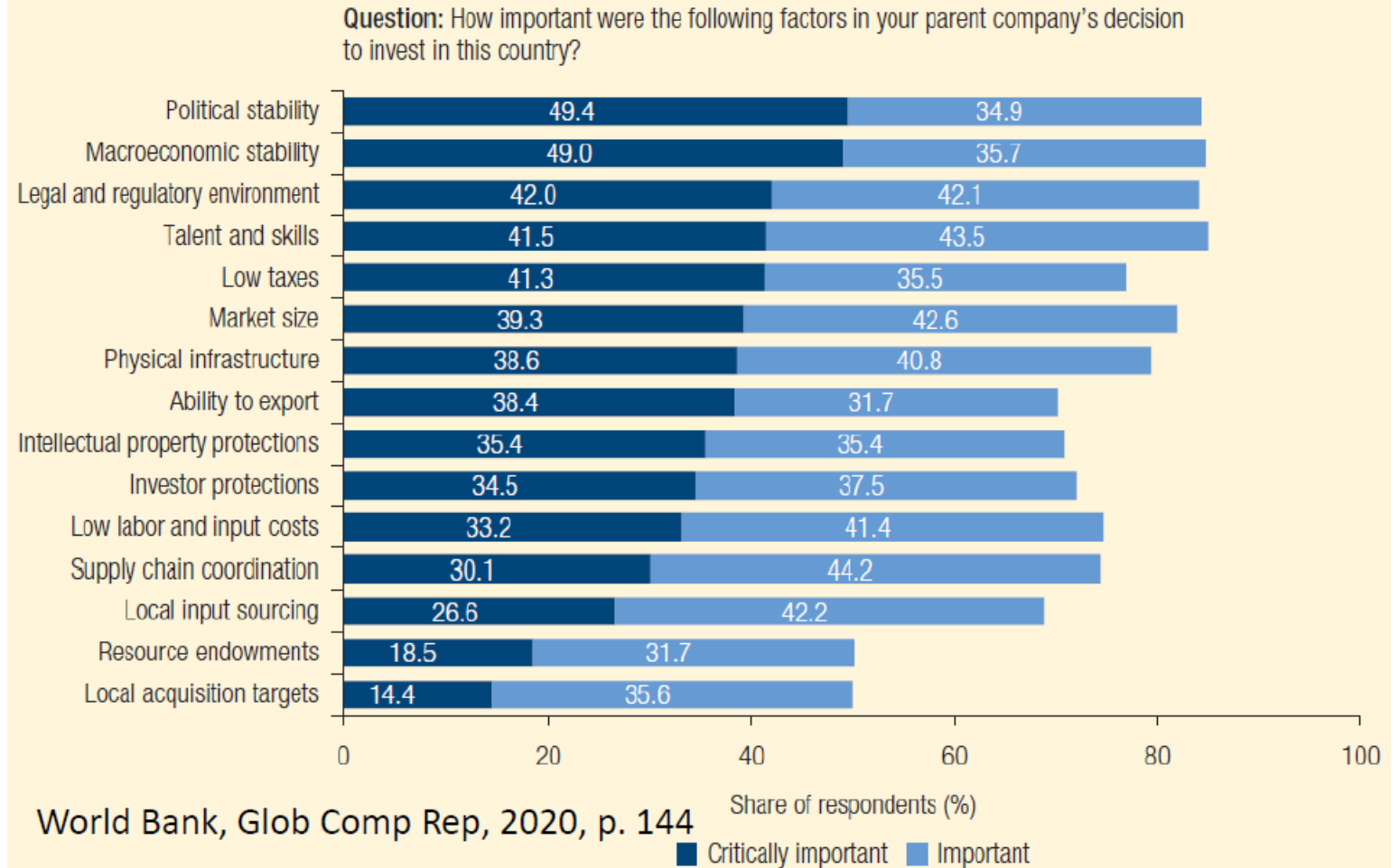


# Political stability and absence of violence



Source: MIGA-EIU Political Risk Survey 2013

**FIGURE B4.3.1 Legal and Regulatory Environment Is the Third Most-Cited Investment Decision Factor**



# FDI gaps and policy recommendations

Country	Political stability and absence of violence/terrorism distance gap	Tax distance gap
Afghanistan	97.07%	5.90%
Albania	0	0
Armenia	6.54%	5.90%
Azerbaijan	12.02%	5.90%
Bahrain	11.39%	0
Bangladesh	19.90%	26.54%
Belarus	0	0
Bosnia and Herzegovina	3.35%	0
Brunei	0	0.40%
Bulgaria	0	0
Cambodia	0	5.90%
Croatia	0	0
Czech Republic	0	2.20%
Egypt	25.11%	15.76%
Estonia	0	5.90%
Georgia	4.70%	0
Greece	0	22.11%
Hungary	0	0
India	12.71%	51.19%
Indonesia	5.77%	26.54%
Iran	49.99%	26.54%

# Conclusion

- Economic, growth, tax, and political stability distances as well as exports and BRI are significant determinants of Chinese OFDI in the BRI countries.
- Governance has a negative but insignificant impact on OFDI.
- The findings have been used to estimate the investment gaps in the host countries and make policy recommendations on how to close them. In the short term, improving political stability, decreasing corporate tax rates, promoting trade with China, and supporting economic growth are attractive for increasing Chinese investment.
- These policies have a positive impact not only on investment but also many further positive spillover effects on the economy and society. In this regard, one of the applications of the gap data would be to calculate the benefits and costs of each policy measure.

Thank you!



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