

**One Belt, One Road:
Explaining the Destination of Chinese Foreign Direct Investment**

Angela K. Peterson

Department of Political Science

University of Colorado Boulder

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Honors Thesis Defense Committee

Dr. Andrew Baker, *Thesis Advisor*
Department of Political Science

Dr. Jennifer Fitzgerald, *Honors Council Representative*
Department of Political Science

Dr. Timothy Weston, *Thesis Committee Member*
Department of History

ABSTRACT

What explains foreign direct investment (FDI) from China? It has been assumed by many scholars that investment climate matters when selecting a location of FDI. Factors such as a level of corruption, quality of government, and strength of political institutions, tend to attract more FDI. Despite this, China's One Belt, One Road initiative (BRI) is pouring billions of dollars into some of the most politically unstable and corrupt countries in the world. The goal of this paper is to understand why China invests into these corrupt countries, while many other actors do not. I argue that China has the confidence to invest into corrupt countries by using foreign aid as a strategic policy tool to maintain control over their investments. In doing so, China eliminates the negative effects associated with corruption. Generating an economic dependency through development assistance, China is able to secure long-term bargaining power over its FDI by increasing or decreasing aid when need be. To test my argument, I conduct both quantitative and qualitative analyses. Outflows of Chinese FDI were tested against outflows of Chinese foreign aid into 140 countries over the duration of 10 years. I find that there is a positive and statistically significant relationship between the foreign aid and FDI variables. As foreign aid increases, so does FDI. Cambodia is also examined as a case study for the purpose of this research. Through qualitative analysis, I find that the positive and statistically significant relationship between FDI and aid holds true in Cambodia.

When selecting the destination of foreign direct investment (FDI), investment climate matters. What many states, multinational corporations (MNCs), or state-owned enterprises (SOEs) take into consideration during the location decision process are features such as strong institutions and investor friendly regulations, specifically in developing and transitioning economies (Hornberger, Battat, & Kusek, 2011). These characteristics tend to be highly attractable to foreign investors, so much so, that the recent boom in FDI inflows in developing and transitioning economies can be attributed to improvements in investment climates across the developing world (World Bank Group, 2010).

Thus, scholars generally agree that corruption, weak rule of law, and political risk deter FDI. To some, investors choose to avoid corrupt countries because it is immoral and generates operational inefficiencies (Habib & Zurawicki, 2002). Therefore, to many Western countries, an investor's reputation can be tainted if it chooses to invest into a corrupt country. Others claim that corruption is just simply bad for business. It increases expropriation risk, as well as cripples potential growth, profit, and societal benefits (Asiedu, Jin & Nandwa, 2009).

Despite this, China's One Belt, One Road initiative (BRI) is pouring billions of dollars into some of the most corrupt and politically unstable countries in the world. It has signed agreements to invest into corrupt countries such as Syria, Afghanistan, Yemen and Iraq, among others. Consider China's flagship project in Pakistan. Like many other countries in Southeast and Central Asia, Pakistan has a corruption problem. According to Transparency International, Pakistan is ranked the 117th most corrupt country on a worldwide scale composed of a total of 180 countries, making it an unpopular destination for many foreign investors based in the West (Transparency International, 2017). Yet, the Chinese government began investing into the country in 2001 when it signed the China-Pakistan Economic Corridor initiative (CPEC), a

fundamental component of the BRI. Offering to build a new port in the city of Gwadar, by 2018, the port as well as highways and railway networks have been built across Pakistan. The project has become a US\$62 billion-dollar investment that connected the economic belt to the maritime silk road (Center for Strategic & International Studies, 2018).

Because of China's willingness to invest in corrupt countries, many experts and Western actors call the BRI "a risky" and "unwise plan". Lacking an explanation to justify Chinese investment patterns, many believe that these "bad" habits of investing into corrupt and underdeveloped countries are what will be the demise of the BRI (Chatzky & McBride, 2019). Then, what explains foreign direct investment from China? If corruption deters investments, why do some actors deliberately choose to invest into corrupt countries? More specifically, why does China invest in these corrupt countries, while other countries do not?

Although Chinese outward FDI has recently generated sizeable interest, few empirical studies have been conducted thus far to test the mechanism that differentiates China's investment strategy from others. I argue that China has the confidence to invest into corrupt countries by using foreign aid as a strategic policy tool to maintain control over its investments. In doing so, China eliminates the negative effects associated with corruption. By generating an economic dependency through development assistance, China is able to secure long-term bargaining power over their investments by increasing or decreasing aid when need be. This type of leverage acts as a system of "rewards" for good behavior, or "punishments" for bad behavior, using economic diplomacy as a way to combat corruption and protect investments.

I demonstrate this relationship by conducting both quantitative and qualitative analyses. Using data on Chinese FDI outflows into 140 countries from 2005 to 2014, I conduct pooled time series analysis to reveal the factors that explain China's investment strategy into corrupt

countries. To determine the impact foreign aid has on FDI, this paper uses generalized least squared (GLS) regression analysis. After testing, I find that there is a positive and statistically significant relationship between the FDI and foreign aid variables. The results support my theoretical argument that suggests China uses foreign aid as a tool to protect its interests, specifically foreign direct investment. I then conduct a case study, examining China's economic activities in Cambodia. Since the turn of the century, Chinese investment into Cambodia has drastically risen, along with development assistance. Despite lacking the typical characteristics that attract foreign investors, its poor investment climate does not seem to deter Chinese investors. Thus, these features make it worthwhile to study how Chinese foreign aid is used to secure its investment in Cambodia.

The structure of my paper proceeds as follows. A literature review is provided that attempts to explain the determinants of FDI, focusing on both economic and political factors. This paper is then followed by a section that concentrates on China as a foreign investor. Centering on its engagement in corrupt countries, this section highlights how Chinese investment patterns differentiate from most actors. In efforts to answer the prevailing research question of explaining FDI from China, I then provide my theoretical framework that suggest China uses foreign aid to protect its investments in corrupt countries. Next, this paper provides a methodology section where I begin by operationalizing my variables necessary for conducting the research, and explains what steps need to be taken in order to satisfactorily answer the research question. This is followed by a results section and a case study that examines China's economic activities into Cambodia. This paper closes with an implication section that is followed by a conclusion.

DETERMINANTS OF FOREIGN DIRECT INVESTMENT INFLOWS

The conventional definition of foreign direct investment “reflects the aim of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise)” (Duce & Banco de España, 2003; IMF; OECD). The “lasting interest” refers to a long-term relation between the investing entity and the investment receiver that encompasses a substantial degree of managerial oversight over the long-term investment. These types of investments can be classified as market transactions through acquiring foreign businesses, offshore manufacturing plants, construction contracts, loans, etc. Foreign direct investors can be defined as individuals, governments, or private, public, and/or SOEs (IMF, 2018; OECD, 2018). The main objectives of FDI is to maximize returns by finding new markets with growth potential, natural resource exploitation, and/or strategic purposes.

Why do some countries receive more foreign direct investment (FDI) than others? Explaining the destination of FDI has caused considerable debate among both economists and political scientists. Existing research on the determinants of FDI centers around two broad considerations: economic and political factors.

Economic Motivations

What drives the decision on where to invest abroad for foreign investors is heavily influenced by the endowment(s) they seek. Thus, investors will pick locations that are abundant in the particular resource they desire (Hornberger, Battat, & Kusek, 2011). Research has identified three main motivators that drive states, SOEs or MNCs to invest abroad: natural-resource-seeking FDI, market-seeking FDI, and efficiency-seeking FDI (USAID, 2005).

The goal of natural-resource-seeking FDI is to gain access to a particular natural resource that is not available in the investor's domestic market. Empirical evidence suggests abundance in natural resources promotes inflows of FDI (Asiedu, 2006). As demand increased for new resources or raw materials that are not available locally, investors will engage in natural-resource-seeking FDI—determining the location of investment based off of the commodity they seek (Barclay, 2015). As the world's population continues to grow, there is an increased need to “secure natural resources to fuel rapid growth” (Davies, 2015, p. 21). A common form natural-resource-seeking FDI is in the oil and natural gas industry (Campos & Kinoshita, 2003). As the surge in demand for oil increases, and as oil prices remain high and increase profits, there has been a “substantial increase in the exploration of oil around the world” (Asiedu, 2013, p. 1). Thus, countries with large oil reserves will by nature attract larger amounts of natural-resource-seeking FDI relative to other forms of FDI, such as we see in many Central Asian and Northern African nations. For example, about 80 percent of total FDI in Azerbaijan is in the oil and gas industry (Tondel, 2001). As countries feel the need to secure oil reserves for their ever-growing populations, it is essential to partake in natural-resource-seeking FDI. Therefore, when it comes to determining the destination of FDI, scholars agree that natural resources play an influential role in the decision process.

Another large body of literature focuses on market-seeking FDI. Scholars claim that investors are attracted to “strong economic fundamentals in the host economy. The most important ones are market size and real income levels” (OECD, 2002; CMCG, 2003). Empirical evidence has demonstrated that market size and growth are associated with increased FDI inflows. If a host country's market is “large enough to capture economies of scale,” FDI will

occur (Balassa, 1966; Scaperlanda & Mauer 1969).¹ Markets that are “large enough to capture economies of scale” tend to be those of developed countries. These market-seeking investors hope to gain access to new customs and clients and to export markets (World Bank Group, 2011). Therefore, wealthy countries are attractive to investors because the population within the host country has a lot of purchasing power. Richer countries tend to have larger and wealthier consumer bases, increasing the demand for the goods and services provided by the investor (Green & Cunningham, 1975). Market growth potential is equally as important as market size. Investors are always looking for new frontiers in which they can maximize returns. Investing into economies with growth potential, although higher in risk, yields the ability to generate greater returns on investments (UNCTAD, 2018; World Bank Group, 2011).

Other scholars argue efficiency-seeking motivators are the most important factor when determining the location of FDI. Efficiency-seeking FDI is classified as an investors desire to “reduce production costs by gaining access to new technologies or competitively priced inputs and labor” (Hornberger, Battat & Kusek, 2011, p. 2). Specifically focusing on competitive input prices, efficiency-seeking FDI is commonly undertaken in the manufacturing sector. This occurs when MNCs and/or SOEs from countries with high real labor costs seek to invest into countries with low real labor cost to supply labor intensive products (Kudina & Jakubiak, 2008). Larudee and Koechlin (1999) claim that lower labor costs are likely to have an independent influence on the allocation of production, employment, and foreign direct investment flows. When deciding the location of FDI, investors see wages as an important source of competitiveness—thus, low input costs (specifically low labor costs), have the ability to generate the highest returns. Therefore, investors actively seek out countries where labor is cheap (Amaro & Miles, 2006).

¹ A country’s market size is generally calculated by GDP, GDP per capita, or the size of the middle class.

The race to the bottom hypothesis suggests that, because investors choose to move production to where wages are the lowest, countries will decrease labor regulations (Cray, 1974). Since developing countries tend to have lower labor costs, FDI into these countries is “non-market seeking.” The goal of “non-market seeking” investments is to use the host country as an export platform, rather than as a consumer base (Akin, 2009).

Political Factors

Another school of thought examines political factors. One of the largest bodies of literature takes an institutional approach. Empirical evidence demonstrates that on average, investments are significantly higher into democratic countries (Busse, 2003).² Numerous scholars have agreed that democracies provide a more welcoming climate to foreign investors than authoritarian regimes, due to their increased level of transparency and decreased level of political risk (Jensen, 2006; Busse, 2003; Guerin & Manzocchi, 2009).

In democracies, investment confidence is increased through the promotion of transparency in both business and political environments. To begin, it has been agreed upon by scholars that, “greater transparency is an attractive feature in general, as it reduces uncertainty” (Barry & DiGiuseppe, 2018, p. 132). In well-functioning democratic institutions, the free flow of information regarding current and future economic conditions (i.e. unemployment, economic growth, inflations) is readily available. Thus, this access to information allows foreign investors

²Although it has been recognized that democracies tend to attract higher levels of FDI, it is important to acknowledge that many MNCs, SOEs, and states still invest into authoritarian regimes. Some scholars argue that rates of return are greater in autocracies (Oneal, 1994). Other scholars believe that authoritarian regimes can attract FDI by exerting similar qualities to the environment of the investing state. Thus, it is recognized that autocracies prefer to invest into other autocracies due to its preliminary knowledge of operating in environments such as their own (Davidson, 1980).

to predict future economic conditions, increasing confidence and FDI inflows (Graham, Johnston & Kingsley, 2017).

Additionally, democratic countries tend to have more accessible information regarding current and future domestic policies. Investor friendly policies can help actors feel comfortable with the host country's financial and legal framework, and they can potentially generate greater returns. Since policy changes on trade or taxes have the ability to generate operational efficiencies for an investor, institutions that are more transparent give investors the confidence in policy that they need to feel secure with their long-term investment (Nicoletti, Golub & Hajkova, 2003). Moreover, if foreign investors are opposed to a certain domestic policy, they have the future potential to lobby government officials for legislative outcomes that better the foreign investor (Jensen, 2006).

Other scholars that fall in the institutional camp argue that good governance matters most (Gani, 2007; Mengistu & Adhikary, 2011; Elliott & Zang, 2008). Typically, good governance practices tend to be stronger in democratic institutions, since democracy's purpose is to provide checks and balances on elected officials, and in turn "reduces arbitrary government intervention, lowers the risk of policy reversal and strengthens property protection" (Farazmand & Moradi, 2014, p. 40). Thus, for the purpose of this paper, good governance can more simply be classified as states with lower political risk and a control on corruption (Shah & Afridi, 2015).

Political risk can be defined in various ways. Some simply classify it as any non-economic risks (Meyer, 1985), while others provide more complex definitions. For this paper, political risk can be defined as, "discontinuities in the business environment deriving from political change, which have the potential to affect the profits or the objectives of a firm" (Thunell, 1977, p. 73). Political changes can inflict negative consequences on a firm's return on

investment through discriminatory taxation, public sector competition, or direct constraints on operations (Kobrin, 1976). When investing into politically risky environments, firms face the probability of running into various problems—one of the biggest fears is an increased risk of expropriation. Foreign investors' concerns of expropriation exist for good reason. Since there is no supranational entity that can enforce the compliance of contracts across borders, investors are at the will of the host state. Due to the fact that “much of the costs associated with FDI are sunk,” if disinvestment occurs, costs have already been incurred and cannot be recovered or recouped (Asiedu, Jin & Nandwa, 2009; Azzimonti, 2018). Therefore, in order to protect investments and to maximize return, investors will avoid countries with high expropriation risk. By minimizing expropriation risk, MNCs, SOEs, or states can be more confident that a host government will not seize their capital within its borders (Duncan, 2006).

Another component of good governance is a firm control on corruption. Various scholars have agreed that corruption plays an important role in deterring FDI. Within a state, corruption can occur in all shapes and sizes—it can come in the form of weak institutions that cannot suppress rent-seeking behavior, bribery, embezzlement, theft of foreign aid, tolerance of smuggling or poaching and extortion (Svensson, 2005; Warf & Stewart, 2016). Foreign investors will choose to avoid corruption due to its ability to produce “bottlenecks, heightens uncertainty, and raises costs” (Habib & Zurawicki, 2002). Additionally, corruption has the capacity to hinder the host country's overall economic performance (Al-Sadig, 2009; Mauro, 1995), as well as the quality of infrastructure and productivity (Tanzi & Davoodi, 1997). A way in which investors reap higher returns is when host countries experience economic growth. Therefore, lower growth rates as the result of corruption leads to smaller returns.

It is evident that the determinants that attract foreign direct investment have been widely studied among the academic community. However, the goal of this paper is to not only understand what explains foreign direct investment, but to determine the mechanism that differentiates China's investment strategy from others. If the conventional economic and political reasons as discussed above are what determine FDI inflows, China is the exception to the rule. In attempt to answer the question of why China invests into corrupt countries, while others do not, it is necessary to take into consideration the role of foreign aid.

CHINA AS A FOREIGN INVESTOR

Between 1978 and 1992, under the leadership of Deng Xiaoping, Chinese foreign policy was virtually non-existent. Rather than engaging in foreign affairs, the country was concentrated on its own domestic issues (Miller, 2017). Focusing on economic growth, China underwent a massive transformation beginning in the 1980s that concentrated on moving in the direction towards a more capitalistic and open economy (Weston, 2007). Since the implementation of post-Mao reforms, China has managed to double its GDP 84 times (World Bank, 2019). This astronomical growth has asserted China as a growing economic power house and a global political player.

However, in recent years, China has been plagued by an economic slowdown. Instead of annual economic growth rates of ten percent, China has entered a "new era" of considerably slower growth and increased unemployment (Council on Foreign Relations, 2016). Calculating China's unemployment rate is notoriously difficult to do. Although China's official reported rate sits around 4 percent, independent experts have estimated that the real unemployment rate is anywhere between 11 to 20 percent (Weston, 2007; Belsie, 2019). The country's economy is also

facing issues of substantial production overcapacity in various sectors including steel, coal, and cement. According to Chinese scholars, many of China's firms have been facing overcapacity issues since 2006, resulting in economic losses and potentially irreversible long-term damage to the industries (Economy, 2018). Feeling these pressures, Beijing is faced with urgency. For decades, the Communist Party has rested its legitimacy on increasing economic growth and the country's standard of living—if they cannot yield these results, its legitimacy diminishes. Therefore, "China's foreign policy may well be driven increasingly by the risk of domestic political instability" (Blackwill, 2016).

Thus, in order to maintain the Communist Party's legitimacy in the times of economic slowdown, President Xi Jinping has abandoned Deng Xiaoping's modest approach to foreign policy. Within the past ten years, China has transformed from a net receiver of FDI to a net investor of FDI. Instead of taking a backseat, China is now an aggressive player in foreign affairs—specifically in Asia. Beijing's "Going Global" strategy strongly encourages foreign investment into international markets. Chinese firms have actively enlarged their overseas footprint in an array of sectors. To date, China's total FDI outflows since 2005 are approaching US\$2 trillion (China Power, 2017). Using foreign policy to maintain Chinese economic and political status on the global stage, the two main goals the "Going Global" strategy is focused on growing its economy and securing geopolitical security/dominance. Therefore, in order to achieve these goals, China has been investing heavily into its neighbors through its Belt and Road initiative, generating a "web of informal alliances lubricated by Chinese Cash" (Miller, 2017, p. 11).

Figure 1 shows the net total of Chinese outward FDI into BRI members, measured in real US dollars between the years 2005-2018 (China Global Investment Tracker, 2019). As seen

below, countries who received over US\$40 billion in Chinese FDI include Russia, Indonesia, Pakistan, and Malaysia (shown in the color black). One characteristic that all these countries have in common is a corruption problem. According to Transparency International, all four of these countries received scores lower than 50.³ Other countries such as Saudi Arabia and Kazakhstan have received about US\$30 billion in Chinese FDI (shown in the color dark grey). Not only are these countries corrupt, they are also undemocratic (Polity IV, 2017). As mentioned previously, unlike other investors who favor good institutions such as democracy and transparency, it is evidence that China does not hold these same values when investing abroad.

[Figure 1 on following page]

³ A country's score indicates the perceived level of public sector corruption on a scale of 0—highly corrupt—to 100—very clean.

FIGURE 1. Chinese outward FDI into BRI members between 2005-2018, measured in US\$ billion

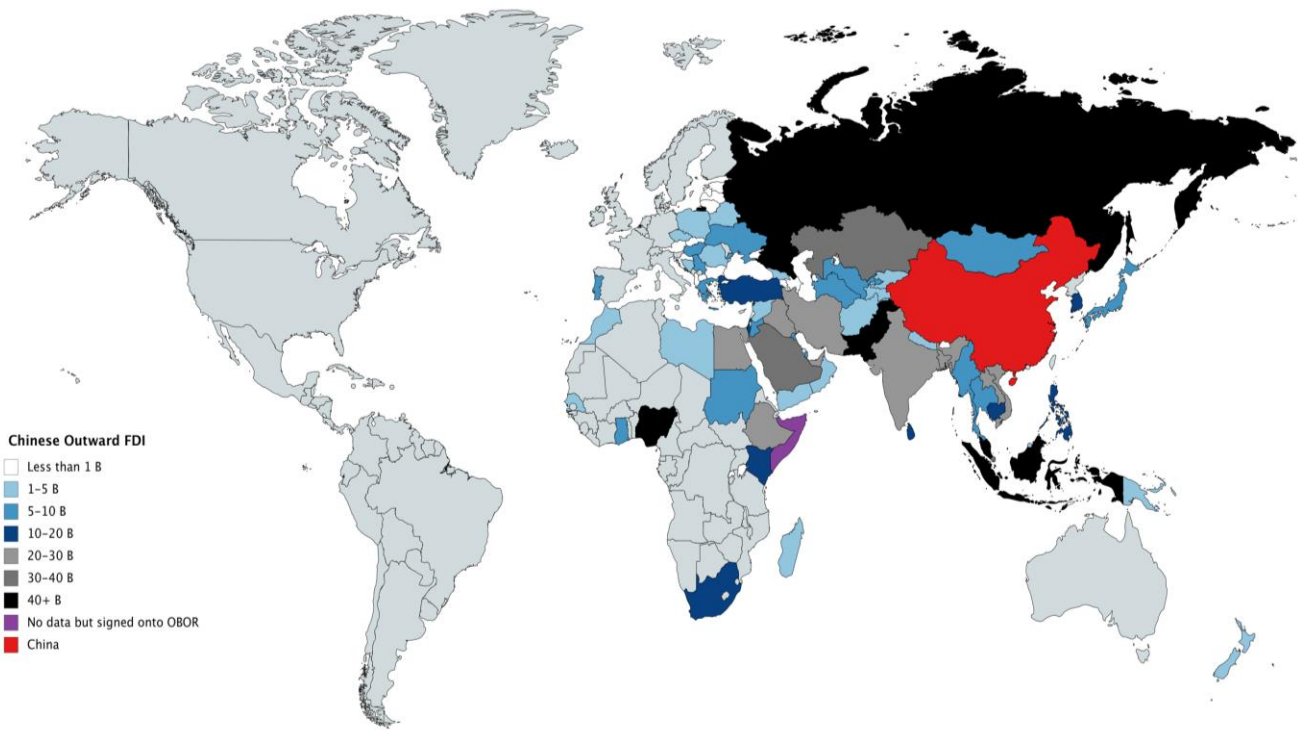
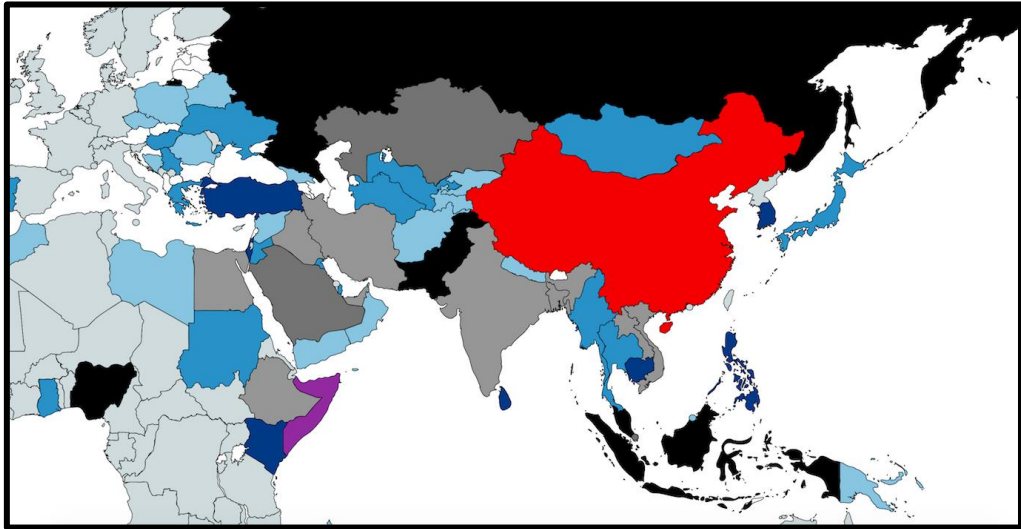


FIGURE 2. Enhanced image



It is clear from this literature review that foreign investors, particularly Western liberal investors, like good institutions such as democracy and transparency. What, then, explains the China exception? China has the habit of investing in countries with high corruption, poor

governance, lack of infrastructure, and small markets. Countries with these characteristics are attracting billions of dollars in investments, breaking the “conventional” Western liberal standard of determining an investment location.

One possibility that can help explain China’s investment habits in corrupt countries is that corruption can be good for greasing the wheels. Corruption can be broken down into two acts: grabbing hand or helping hand. While grabbing hand corruption includes bribes that can be costly to investors, helping hand corruption can be defined as a way to “grease the wheels” by assisting actors around bureaucratic red tape (Egger & Winner, 2006; Rashid, 1981). These types of agreements between investors and corrupt governments have the possible to promote development by getting around inefficiencies, benefiting both the investor and the overall economic status of the host country (Canare, 2017; Huntington, 1968; Leff 1964). Furthermore, corruption can be beneficial to foreign investors by providing some companies preferential access to profitable markets. Scholars such as Beck and Maker (1986) have gone as far to say that the most efficient firms pay the most bribes. Thus, “corruption enhances allocation efficiency” (Habib & Zurawicki, 2002, p. 293).

Another school of thought that can provide insight into why China investments in corrupt countries is centered around the notion that firms will prefer to invest in a host country that exhibits similarities to their own market. Davidson (1980) explains, “given a choice between familiar and less familiar environments, firms will prefer the former” (p. 16). Thus, it is demonstrated that investors who operate in corrupt environments at home have an upper hand when operating in a “foreign country with a similar institutional environment” (Jose & Mauricio, 2016, p. 123). This advantage is the result of preliminary knowledge concerning the parameters of operating with corrupt governments. Thus, investors who are, or have been, exposed to

corruption will feel more comfortable working within these same parameters, leading to an increased FDI inflows.

Although these theories may play a role in explaining China's foreign investment patterns, they do not tell the whole story. While these arguments propose why an actor would choose to invest into a corrupt country, they do not address how an actor is able to secure protection over their investments over the long-run and avoid the negative effects associated with corruption. As previously mentioned, corruption can provide some benefits, such as a way to "grease the wheels" and passing bureaucratic red tape. However, what is stopping the host country from expropriating or exploiting a foreign investor's assets later? Corruption may have initially helped an investor into a host country, but does not secure long-term protection. Additionally, although Davidson's argument may hold true for China, it does not explain the mechanisms behind how Chinese investors acquire the upper hand position in corrupt investment environments. Yet again, explaining why foreign investors may enter corrupt countries, but not addressing how they are able to maintain operations over an extended period of time.

I argue that in order to preserve control over long-term investments and to combat the negative externalities associated with corruption, China will use foreign aid as a strategic policy tool. Foreign aid has a unique ability to suppress the negative externalities associated with expropriation. Empirical studies have concluded that foreign aid has the ability to mitigate the adverse effect of expropriation risk on foreign direct investments (Asiedu, Jin, & Nandwa, 2009). Although not applicable to all cases, the threat of expropriation on foreign investments can be diluted by increasing foreign aid to the host country. Since expropriation is one of the greatest risk to foreign investors, foreign aid's ability to combat expropriation (along with other negative externalities) can overall help protect investments. Thus, foreign aid can be a powerful

and effective foreign policy tool. Despite its classical role of helping poor nations reduce poverty and increase development, foreign aid allows investors to expand their influence abroad, while simultaneously reaping economic benefits at home through means of foreign investment.

Therefore, increased inflows of foreign aid are associated with increased inflows of FDI. This relationship can be classified as the “Vanguard Effect” (Kimura & Todo, 2010). There are three separate assertions to why the vanguard effect may take place. First, when a country provides foreign aid to a lesser developed country (host country), information regarding their domestic business environment will be transmitted to the investing country, increasing FDI inflows. Second, when a country provides aid to a less developed country, there can be a reduction in perceived political risk due to economic interdependence. By reducing risk, foreign firms will be more enticed to invest. Lastly, foreign aid can have strings attached to it. When a country provides aid, they can require specific business practices, rules, or institutional behaviors attached to the money. Once the receiving country puts these criteria into action, investors from the donor country will be more inclined to partake in FDI.

Considering the previous ideas, I theorize that China is able to remain confident when investing into corrupt countries by using foreign aid to overcome the obsolescing bargain. The obsolescing bargain theory suggests that initially, bargaining power is held by the MNC. Over time, however, as the MNC fixes its assets into the host country, the bargaining power shifts to the host government. Simply put, the theory implies that once an MNC is on the ground in a foreign country, the bargaining power of the investor diminishes (Vernon, 1971). However, this paper will also apply the obsolescing bargain theory to SOEs and state-led investment in the same manner as it is applied to MNCs. I argue that China is able to overcome this dilemma by generating an economic dependency through foreign aid. Once an economic dependency is

created, China is then able to use foreign aid as a leveraging tool—rewarding host countries for compliance, and punishing them for defiance. If a host country does not agree to protect investments or there is an increased future risk of expropriation, China will threaten to stop inflows of foreign aid, and vice versa. This tactic leaves the host no other choice but to obey, or risk losing major inflows of money. Therefore, China’s bargaining power will not diminish over time, allowing them to invest into corrupt countries without losing return. Using the theoretical argument of overcoming the obsolescing bargain theory by means of foreign aid, this paper will argue:

Hypothesis I: Among corrupt countries, higher levels of foreign aid will result in higher levels of FDI.

METHODS

What explains the direction of Chinese foreign direct investment? To answer this question, I conduct both quantitative and qualitative analyses to rationalize why Chinese investors act the way they do. For the quantitative analysis, I use data on Chinese foreign aid and FDI outflows into 140 countries from 2005 to 2014. I chose this ten year interval due to the fact that there is a limited amount of data available for both Chinese foreign aid and FDI. Thus, these years are where the existing data intersects. I conduct pooled time series analysis to reveal the factors that explain where Chinese actors invest.⁴ This section will begin by operationalizing my variables necessary for conducting the research, followed by a paragraph explaining the models I use. The remainder of this section explains the quantitative methods. For the qualitative analysis,

⁴ In this case, the data is cross-sectional dominate since in this instance, n is large, and t is short.

I conduct a case study on Chinese economic activities in Cambodia. This appears in the last portion of this section.

Foreign Direct Investment

I measure *FDI* as China's global investments and construction contracts. The dataset I use to measure Chinese outward FDI is *The Chinese Global Investment Tracker* created by the American Enterprise Institute (AEI) and the Heritage Foundation (AEI, 2019). The Chinese Global Investment Tracker is "the only comprehensive data set covering China's global investment and construction," providing data on Chinese FDI between the years 2005-2018 (AEI, 2019).⁵ FDI is measured in real US dollars.

Foreign Aid

My primary independent variable is Chinese *foreign aid* outflows. Foreign aid is defined as "grants and loans that are undertaken by the government, with promotion of economic development and welfare as main objectives, at concessional financial terms" (OECD, 2019). The dataset I use to measure the scope of Chinese development assistance is retrieved from AidData, founded by a research lab at William & Mary (Dreher, 2017).⁶ AidData's *Global Chinese Official Finance Dataset*, has collected project-level data from 2000-2014 that includes

⁵ Important to note that, "China does not publish project-level data concerning its financing activities abroad, which makes it difficult to know precisely how much China is actually doing in terms of FDI" (Economy, 2018, p. 223). However, *The Chinese Global Investment Tracker* attempts to fill this void.

⁶Unlike many Western countries, China does not partake in the global reporting systems that tracks foreign aid, such as the OECD's Creditor Reporting System or the International Aid Transparency Initiative, among others. Thus, it is difficult to calculate the scope, nature, and impact of Chinese development finance, generating "uncertainty and speculation about the intentions of non-Western donors" (Strange, Cheng, Russell, Ghose & Parks, 2017). In addition, "both Chinese and international media tend to conflate pledged aid and investment with realized aid and investment, contributing to an exaggerated sense of the level of Chinese investment throughout the developing world" (Economy, 2018, p. 223).

the three main measurements of aid: Official Development Assistance (ODA), Other Official Flows (OOF), and Vague Official Finance (Vague OF).⁷ Foreign aid is measured in US real dollars.

Corruption Perception

This paper operationalizes *corruption* as perception, rather than the physical loss of capital in transaction. Using *Transparency International Corruption Perception Index*, this dataset calculates the perceived levels of public sector corruption across 180 countries (Transparency International, 1995-2018). Based on a composite index crafted by 13 different independent institutional surveys and assessments that measure the overall extent of perceived corruption within a country, Transparency International has gathered credible data between the years 1995-2018. As a score of a hundred being the least corrupt, and a score of zero being the most corrupt, this measurement allows for comparison between countries over time.

Polity Index

Regime type is measured on a polity index, above six being democratic, below six not being democratic. In order to measure regime type, this paper uses a dataset created by the Center for Systemic Peace (Polity IV, 2017). The particular dataset is called *Polity IV Annual*

⁷ ODA-like development finance, commonly referred to as simply ‘aid’, is official finance administered by government entities that promotes economic development and welfare as its main objective. With a grant element of at least 25 percent, and a fixed interest rate of 2 percent or lower, ODA must be concessional in character. On the other hand, OOF-like development finance does not meet the same criteria of ODA finance, but still constitutes as a form of development assistance. OOF-like development finance are grants to developing countries that are commercial or representational in demeanor, but are still intended to promote development. This type of development assistance has a grant element of less than 25 percent, unlike ODA-like financing. Lastly, Vague OF development financing are flows of official financing that can be considered ODA or OOF, but lack sufficient information to be assign as either ODA-like or OOF-like. These projects categorized as Vague OF may have development or commercial/representational intent.

Time-Series, 1800-2017. Captured on a spectrum ranging from -10 (hereditary monarchy) to +10 (consolidated democracy), the polity score encompasses a range of regime types. The index consists of different component measures that keep track of executive recruitment, ability of political competition, constraints on executive authority, and changes in the institutionalized qualities of governing authority.

GDP per Capita

Lastly, using data from the World Bank, *GDP per capita* is measured in real US dollars between the years 1960-2017 (World Bank, 2019). GDP per capita is calculated by a country's gross domestic product divided by its midyear population. According to the World Bank (2019), "GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources". It is important to add GDP per capita as a control to account for different economies of scale. Since low income countries tend to attract more foreign aid, whereas rich countries tend to attract higher levels of FDI, controlling for GDP per capita address these issues of development/wealth.

Models

To determine the impact foreign aid has on FDI, this paper uses generalized least squared (GLS) regression analysis. The first sets of regressions are random effects models. These models provide baseline results, and we will later move to more sophisticated models that address the effects of omitted variables and possible reverse causation. The second set of regressions are

fixed effects models. Since there are extreme cross-national differences between countries that remain constant over time, this type of model controls for these differences. Lastly, the third set of regressions are lagged models, in which I lag all of the independent variables. This type of model is beneficial due to the fact that it attempts to address the issue of possible reverse causation. By lagging the independent variables, we are able to predict the current values of the dependent variable.

Case Study

To further understand how China uses foreign aid as a mechanism to retain control over their investments, I conduct a case study focusing on China's economic activity in Cambodia. Since the turn of the century, Chinese investment into Cambodia has drastically risen, along with its development assistance. Despite lacking the traditional characteristics that attract foreign investors, Cambodia's poor investment climate does not deter Chinese investment nor aid. Thus, these features make this case worthwhile to study. Using both my quantitative data and qualitative reasoning, I am able to deepen my understanding regarding the notable relationship between Chinese FDI and aid.

RESULTS

To begin, table 1 shows the results from random effects GLS models over a ten-year interval. The results support my theoretical argument that suggests China uses foreign aid as a tool to protect its interests, specifically foreign direct investment. Once a host country becomes economically dependent on Chinese foreign aid, the threat of removing it or scaling it back if China does not feel secure with their investments is enough to scare countries into compliance.

As predicted, the foreign aid variable is positive and highly significant. This demonstrates that as foreign aid increases by one unit, FDI simultaneously increases with it. This effect means that for every extra dollar of foreign aid,⁸ FDI increases by an extra seven cents.⁹ Throughout the first three models, this effect does not change, even when controlling for different variables such as regime type and perception of corruption.

[Results of table 1 on following page]

⁸ Measured in US real dollars.

⁹ Measured in US real dollars.

TABLE 1. Chinese foreign aid relationship with FDI, random effects over a 10-year duration

Foreign Direct Investment (Random Effects)	(1)	(2)	(3)	(4) if corrupt	(5) if un-democratic
Foreign Aid amount	.071*** (.022)	.074*** (.020)	.071*** (.023)	.090*** (.015)	.056*** (.017)
GDP per capita	.042*** (.004)	.042*** (.004)	.042*** (.004)	.050*** (.010)	.024*** (.004)
BRI member	116.862 (163.977)	70.447 (149.210)	105.971 (167.994)	142.582 (91.625)	212.828** (104.014)
Corruption Perception Index	-----	-13.660*** (4.387)	-----	-----	-----
Polity Score	-----	-----	-3.063 (11.581)	-----	-----
Constant	82.810 (109.570)	606.990*** (177.400)	96.001 (119.230)	231.052*** (64.961)	284.890*** (64.144)
Observations	2,882	2,421	2,840	1,500	1,225
R-Squared	0.051	0.0429	0.0512	0.0522	0.0536
Prob > F	0.000	0.000	0.0000	0.0000	0.0000
Entries are GLS coefficients with standard errors in parentheses. * = p<0.1, **=p<0.05, ***=p<.001					

Model 2 shows the effects of corruption on FDI. The corruption perception control variable is highly significant, with its p -value less than 0.001. As the level of perceived corruption increase by one unit, FDI will decrease by US\$14. This means that as a country gets less corrupt by one unit,¹⁰ FDI will decrease with it. Simply put, these results suggest that

¹⁰ In this measurement, a score of 100 is the least corrupt, while a score of 0 is the most corrupt.

countries who are not corrupt receive less FDI than those who are corrupt. After analyzing these results, it is evident that China prefers to invest into corrupt countries.

Moreover, model 3 illustrates democracy's interaction with Chinese outward FDI. Although not statistically significant, the model suggests that as a country's polity score increases by one unit, outward Chinese FDI will decrease. This means that as a country becomes more democratic by one unit, FDI will decrease by US\$3. Therefore, the more democratic a country is, the less Chinese FDI they receive.

Subsequently, model 4 presents findings that has limited the sample to just corrupt countries. In this instance, a corrupt country is considered as a country who has a corruption perception score less than 41 (Transparency International, 2018). I chose the score of 41 due to that fact that it is the mean of the corruption variable. Thus, countries with scores below 41 are considered to have a corruption problem, and countries with scores above 41 are considered to have better governance. The reason I broke up the sample this way is to further demonstrate corruption's influence on Chinese outward FDI. After limiting the sample to just corrupt countries, the foreign aid variable remains positive and statistically significant, and has a bigger coefficient than the last three models. The results demonstrate that for every extra dollar of foreign aid,¹¹ FDI increases by an extra nine cents.¹² As predicted, the results support my theoretical argument that suggests in corrupt countries, China will use foreign aid as a strategic policy tool to protect its investments.

¹¹ Measured in US real dollars.

¹² Measured in US real dollars.

Lastly, model 5 limits the sample to just un-democratic countries. In this case, an un-democratic country is considered as a country with a polity score below 6.¹³ I create a separate model limiting the sample to just anocracies and autocracies to further investigate whether regime type plays a role in determining the destination of Chinese FDI. Although not as noteworthy as the previous models, the foreign aid variable remains positive and highly significant. This demonstrates that as foreign aid increases by one dollar,¹⁴ FDI simultaneously increases with it by about 5 cents.¹⁵

Table 2 illustrates the results from fixed effects GLS models over a ten-year interval. The results remain aligned with my theoretical argument. However, the coefficients in this table are not as significant as the results produced in the random effects models. As predicted, the foreign aid variable is positive and highly significant. This demonstrates that as foreign aid increases by one dollar,¹⁶ FDI simultaneously increases with it by about 5 cents.¹⁷ Similar to table 1, throughout the first four models, this effect does not change, even when controlling for different variables such as regime type and perception of corruption, and when limiting the sample to just corrupt countries.

[Results of table 2 on following page]

¹³ According the Polity Index, scores between +6 to +10 are considered to be “democracies”, scores between -5 to +5 are considered to be “anocracies”, and scores between -10 to -6 are considered to be “autocracies” (Polity IV, 2017).

¹⁴ Measured in US real dollars.

¹⁵ Measured in US real dollars.

¹⁶ Measured in US real dollars.

¹⁷ Measured in US real dollars.

TABLE 2. Chinese foreign aid relationship with FDI, fixed effects over a 10-year duration

Foreign Direct Investment	(1)	(2)	(3)	(4) if corrupt	(5) if un-democratic
Foreign Aid amount	.047** (.022)	.056** (.020)	.048** (.023)	.047*** (.015)	.015 (.0168)
GDPPC	.085*** (.007)	.075*** (.007)	.085*** (.007)	.217*** (.021)	.063*** (.009)
Corruption Perception Index	-----	18.614** (8.380)	-----	-----	-----
Polity Score	-----	-----	26.643 21.117	-----	-----
Constant	- 346.06*** (84.666)	-1069.64** (354.164)	-457.03*** (119.025)	-197.82*** (72.271)	168.32** (58.1045)
Observations	2,882	2,421	2,840	1,500	1,225
R-Squared	0.0472	0.0285	0.0463	0.0204	0.0334
Prob > F	0.0000	0.0000	0.0000	0.0000	0.0000
Entries are GLS coefficients with standard errors in parentheses. * = p<0.1, **=p<0.05, ***=p<.001					

Looking at model 2, it is important to note the change in the corruption perception control variable. In table, 1 model 2, this variable is negative and highly significant. However, in this model, the coefficient is now positive and has slightly lost some statistical significance. Now, as the level of perceived corruption increase by one unit, FDI will increase by US\$18. This change in the value of the coefficient may be the result of eliminating omitted variables that potentially influenced the first outcome. Consequently, this model then suggests that level of perceived

corruption maybe not be an important factor when determining the destination of Chinese FDI. Leading to the conclusion that China will invest into any giving country, whether corrupt or not.

Additionally, model 3 illustrates democracy's interaction with Chinese outward FDI. In this model, the coefficient of the polity variable has significantly changed from the coefficient in table 1, model 3. With its *p*-value remaining greater than 0.1, the coefficient is now positive, rather than negative. In this model, for every unit increase in a country's polity score, outward Chinese FDI will also increase. This means that as a country becomes more democratic by one unit, FDI will increase by US\$26. Nevertheless, these results are not statistically significant and therefore cannot be used to draw conclusions.

Model 4 limits the sample to just corrupt countries.¹⁸ The foreign aid variable is positive and highly significant, similar to the first three models. It shows that for every one dollar increase,¹⁹ FDI will increase by about four cents.²⁰ Once again, although the value of the coefficient is not as large/significant as the last table, it still demonstrates a strong relationship between FDI and foreign aid. This relationship tells us the story that as foreign aid increases, so will FDI. This is accomplished by creating an economic dependency first through foreign aid, giving China the confidence they need to further invest.

Lastly, model 5 limits to sample to just un-democratic countries.²¹ The model attempts to find a relationship between regime type and FDI, however, is unsuccessful. The foreign aid

¹⁸ As the same in table one, a corrupt country is considered as a country who has received a corruption perception score less than 41. I chose the score of 41 as the base number due to that fact that 41 is the mean of the corruption variable.

¹⁹ Measured in US real dollars.

²⁰ Measured in US real dollars.

²¹ According the Polity Index, scores between +6 to +10 are considered to be "democracies", scores between -5 to +5 are considered to be "anocracies", and scores between -10 to -6 are considered to be "autocracies" (Polity IV, 2017).

coefficient is insignificant and does not yield any substantial results. Thus, it is evident that regime type does not play a significant role when determining the destination of Chinese FDI.

Finally, table 3 provides lagged models, meaning that models use lagged IVs rather than contemporaneous IVs. This type of model addresses the issue of reverse causation. To establish the direction of causality, a change in X must precede a corresponding change in Y , but the previous models have not established this timing. By lagging the IVs, we are able to predict the future value of FDI through using current values of foreign aid.

Consider table 3. In model 1, FDI is the DV (as in previous tables), and *lagged* foreign aid is the IV. A one dollar increase in foreign aid is followed by a seven-cent increase in FDI.²² The coefficient is positive and statistically significant. This means that FDI follows the aid: China first gives a country foreign aid, and this increases the probability that FDI from China follows in the subsequent year. By contrast, model 2 shows that aid does not follow FDI, suggesting that, as I argue, China uses aid to pave the way for FDI. This model finds that a one dollar increase in FDI is sequentially followed by just a one-cent increase in foreign aid.²³ In this case, the coefficient holds no statistical significance. Therefore, current or past values of FDI does not help to predict future values of foreign aid. Concluding that through the lagged models, we can see that there is a causal connection present between foreign aid and FDI.

[Results of table 3 on following page]

²² Both values measured in US real dollars.

²³ Both values measured in US real dollars.

TABLE 3. Chinese foreign aid relationship with FDI, lagged with random effects over a 10-year duration

	(1) DV= Foreign Direct Investment	(2) DV= Foreign Aid
Foreign Aid amount _{t-1}	.070** (.025)	-----
Foreign Direct Investment amount _{t-1}	-----	.011 (.020)
GDPPC	.053*** (.006)	.007* (.004)
BRI member	97.918 (178.710)	177.120* (98.328)
Corruption Perception Index	-18.089*** (5.462)	-14.742*** (3.596)
Polity Score	10.114 (13.726)	-3.776 (8.142959)
Constant	719.790*** (209.958)	798.698*** (127.153)
Observations	2,390	2,390
R-Squared	0.0513	0.0207
Prob > F	0.0000	0.0000
Entries are GLS coefficients with standard errors in parentheses. * = p<0.1, **=p<0.05, ***=p<.001		

Overall, the regressions tell us that there is a positive and statistically significant relationship between Chinese foreign aid and FDI. Table 1 yields the strongest results, suggesting that a one dollar increase in foreign aid will result in a seven-cent increase in FDI.²⁴ The table additionally tells us that the relationship between foreign aid and FDI is even more significant when limiting the sample to just corrupt countries. The results of table 2 continue to

²⁴ Measured in US real dollars.

remain aligned with table 1. What differentiates the two tables is that the relationship between foreign aid and FDI remains constant across different models, even when limiting the sample to just corrupt countries. Lastly, table 3 demonstrates that there is a casual connection present between foreign aid and FDI. This suggests that foreign aid paves the way for FDI.

THE CASE OF CAMBODIA

Over the few past decades, Chinese money into Cambodia has drastically increased. Although not a common destination for FDI due to its high levels of corruption and poor economic conditions, China has nevertheless poured billions of dollars of investment and development assistance into the country. While China has claimed that its development assistance has no strings attached to it, it is evident that there is a “close link between economic ties and political influence” (Chheang, 2017, p.1). Therefore, China’s pattern of investment flows into Cambodia illustrates how it uses aid to improve the climate for its investors.

After decades of political violence and civil war, Cambodia continues to be ruled by corrupt governments. Crawling into virtually every public sector, the effects of corruption are widespread, making it an uncommon destination for foreign investment. Throughout the entirety of the 21st century, Cambodia has averaged a corruption perception score of 20, earning it the title of most corrupt country in Southeast Asia and third most corrupt country in the greater Asia Pacific region (Transparency International, 2018). Not only does the country suffer from a corruption problem, the rule of law in Cambodia is exceptionally weak. According to the *Rule of Law Index 2019*, Cambodia is ranked the second lowest in the world, just slightly above Venezuela, when it comes to how the rule of law is perceived and experienced within a country

by the general public (World Justice Project, 2019). However, Chinese investors seem “perfectly happy to play the game” (Miller, 2017, p. 119).

Overall, Cambodia’s “small population, low per capita income, low labor productivity, high corruption and weak rule of law should put it near the bottom of any foreign investor's list of ideal investment locales” (O'Neill, 2014). Nevertheless, China is undoubtedly pouring billions of dollars of investment into Cambodia. So why is China choosing to contradict these traditional red flags by investing heavily into Cambodia? More importantly, how are they so confident when investing into the country?

Table 4 shows us just how large the scope of Chinese foreign investment is in Cambodia. From 2005 to 2018, accumulated foreign direct investment from China into Cambodia reached about US\$14.7 billion (China Global Investment Tracker, 2019).²⁵ Since major inflows of investment began to enter Cambodia in 1995, China has held the largest share of FDI inflows—compromising over one-third of Cambodia’s total FDI (Council for the Development of Cambodia, 2017). Chinese investments are concentrated in four main sectors—agriculture, industrial, infrastructure, and tourism (see table 4). Within these sectors, China’s investments into the agro-industry cover around 237,406 hectares of land, dominate the footwear and garment industries, account for one in every three roads built, and have nearly spent US\$2 billion constructing six dams (Chheang, 2017; Miller, 2017).

[Findings of table 4 on following page]

²⁵ Important note that this number may likely be underestimated. Precise FDI data into countries such as Cambodia is difficult to come across due to corruption and reporting failures.

TABLE 4. Chinese investment capital in Cambodia, measured in US\$ million

Year	Agro- industry	Industrial sector	Infrastructure	Tourism	Total
2005-2007	252	1,017	534	920	2,723
2008	45	166	3,805	467	4,483
2009	322	166	70	798	1,356
2010	191	156	No data	482	829
2011	7	324	No data	1,094	1,425
2012	27	487	No data	No data	514
2013	213	290	No data	8	711
2014	141	537	No 156	50	884
2015	63	316	No data	400	779
2016	304	453	115	114	986
Total	1,565	4,112	4,680	4,333	14,690

Source: Yusof Ishak Institute (formerly known as Institute of Southeast Asian Studies)

Looking at table 4, it is evident to Cambodia that being China's friend comes with great benefits. Over the last two decades, with the help of Chinese investment and development assistance, Cambodia has retained an average growth rate of over seven percent (Asian Development Bank, 2019). Compared to other Southeast Asian countries, this is the highest GDP growth rate, making it one of the fastest growing economies in the region. Additionally, through the help of Chinese money, the poverty rate has been cut in half almost twice since 2004 (Asian Development Bank, 2016).²⁶ By directly or indirectly creating jobs in Cambodia, through means of foreign investment, the country's GDPPC has been continuously increasing every year with Chinese help. Although still categorized by the United Nations as a Least Developed Country

²⁶ Unable to find more recent poverty data.

(LDC), it is evident that Cambodia has been economically benefiting from its relationship with China.

Through massive sums of money going into Cambodia, China has made it apparent that it is very comfortable and confident when investing into the country. Despite an extremely unfriendly investment climate, as previously mentioned, it seems that investments into Cambodia have been going smooth and will continue to do so. How did China accomplish this? I argue by generating an economic dependency through means of foreign aid, China has been able to secure/protect its investments from increased risk in corrupt countries, such as Cambodia. This relationship can be examined through analyzing Chinese foreign aid flows relative to FDI in Cambodia.

Not only is China Cambodia's top foreign investor, it is also its most generous aid donor. Between 2000 to 2014, China has given nearly an estimated total of US\$11 billion to Cambodia.²⁷ This is more than the United Nations, World Bank, Asian Development Bank, and other multilateral financiers put together (Council for the Development of Cambodia). In the year 2013 alone, China spent approximately US\$2.9 billion in development assistance. Between 2000 to 2005, China devoted around US\$906 million in foreign aid. The following year, China invested US\$280 million. After analyzing my data, there is an evident trend that suggests, in Cambodia, China foreign aid and FDI move incremental with each other. When foreign aid increases, so does inflows of FDI, and vice versa. This suggests that as China invests more money into Cambodia, in order to secure their investments, it will increase foreign aid simultaneously. Thus, the steeper the investment, the more need for protection, thereby

²⁷ China does not partake in the global reporting systems that tracks foreign aid, such as the OECD's Creditor Reporting System or the International Aid Transparency Initiative, among others. Thus, it is difficult to calculate the scope, nature, and impact of Chinese development finance. This figure includes ODA, OOF, and Vague OF.

increasing aid given. When the investment is not as large, less aid will be given, as the measure of protection needed is smaller. This pattern of aid matched with investment continues on, as seen in figure 3.

FIGURE 3. Chinese outward FDI and foreign aid into Cambodia, measured in US\$ million



Figure 3 allows us to see how China is able to overcome the obsolescing bargain theory, securing long-term control over their investments. Through aid and investment, Cambodia has been able to develop on a scale that it would otherwise not be able to achieve without China. China delivers trade, investment, and other economic goodies such as aid, to Cambodia if it does not challenge their core interests and accommodates to Chinese demands (Miller, 2017). Therefore, through this system of increasing aid incremental to FDI, Cambodia's wisest option is

to comply with the demands of China, one being protection over its investments. Thus, China is extremely confident when investing into Cambodia due to the economic dependency they have created. Concluding that the relationship Beijing has fostered with Phnom Penh is clearly marked by “an invisible cord attached to China’s aid” (Ly, 2018).

As the year 2019 plays out, we are continuing to see future commitments of Chinese foreign aid into Cambodia. Headlines such as “China pledges over \$100 million military aid to Cambodia,”²⁸ “China Pledges Nearly US \$600 Million in Aid to Cambodia Over Three Years: PM Hun Sen,”²⁹ and “China lends Cambodia \$351 million for road, as leaders mark 60th anniversary of diplomatic ties,”³⁰ dominate news sources around the world. In order for my theory to hold true, we should see increased amounts of Chinese FDI in Cambodia in the near future. As China moves forward with the BRI, so does its future committed investments into Cambodia, suggesting my theoretical argument to hold true.

IMPLICATIONS

More than two centuries ago, Napoleon Bonaparte said that “China is a sleeping lion. Let her sleep, for when she wakes she will shake the world.”³¹ It is undeniable that over the past 50 years, China has transformed from an economy on the verge of collapse into a global power. Although there is very little agreement among American scholars and policymakers regarding the implications of China’s rise to power, it is an area that should continue to be addressed. Throughout the past two decades, it has become apparent to the international community that China is trying to grow its sphere of influence through means of economic diplomacy (i.e.

²⁸ (Thul, 2018)

²⁹ (Khmer Service, 2019)

³⁰ (ABC news, 2018)

³¹ (Fish, 2016)

investment and development assistance). According to Beijing, Chinese money is designed to expand “well beyond infrastructure to include connectivity through telecommunications and culture, the development of financial and free trade accords, and the opportunity for China to increase the use of its currency in global trade and investment” (Economy, 2018, p. 191). But as China’s global presence continues to expand, what does this mean for the rest of the world?

Based on the above findings, it is evident that China is defying the pre-established liberal world order by investing into illiberal democracies and corrupt countries. Since the end of World War II, the United States has fostered a world order based on “principles of economic and political liberalism and a commitment to global open markets and the promotion of free market democracies” (Graaff & Apeldoorn, 2018). For decades, many Western powers have avoided investing into illiberal democracies or corrupt regimes because it is considered to be morally wrong or too risky. In this established liberal order, countries use foreign aid as a way to reward friendly or compliant regimes who promote democracy and decreased corruption. On the contrary, foreign aid is withdrawn as a punishment to those unfriendly or ideologically antagonistic regimes (Apodaca, 2017).

Therefore, doing business with China is unlike any other Western country. Beijing’s policy of non-interference often translates “into a willingness to put aside environmental, labor, and governance concerns to accomplish work more cheaply and quickly” (Economy, 2018, p. 208). While many Western donors often withhold funds, citing endemic corruption and human rights violations, China continues to pump in the money. Removing itself from domestic politics, China had provided numerous countries with foreign investment and aid “without imposing conditions such as political and economic performance criteria” (Lum et al., 2008). China’s approach to economic diplomacy has gained them access to new markets, raw materials, and

international esteem, promoting a “win-win” mantra. Yet, what Western donors should be wearied of is how this approach is capturing the attention of many developing countries. Many nations who seek economic development without the conditionalities tied to traditional Western aid seem to appreciate, and even prefer, this style of economic diplomacy. Will this shift in preference alter, or even destroy, the liberal world order?

A world influenced by Chinese economic diplomacy would, by nature, threaten the underlying principles of globalization. Globalization is constituted as an increased interdependence and integration among the world’s populations, economies, and nations. This is achieved through the free-flow of information, capital, technology, and people. Yet, President Xi Jinping has “sought to control the flow of capital leaving the country, to restrict opportunities for foreign firms to compete with domestic companies in critical areas such as clean energy, and to force multinationals to transfer core technology in order to do business with China” (Economy, 2018, p. 232). He has also taken action to prohibit the teaching of Western ideas of governance and economics, and has restricted internet content and technological advances—significantly limiting the free-flow of information. Although Beijing promotes its “Going Global” strategy and has a desire to lead, it “embraces globalization insofar as it controls the flow of ideas, as well as human and financial capital” (Economy, 2018, p. 233). Although the urgency of this issue may not be felt for many years, Western powers should understand that there is a shift occurring in economic diplomacy.

CONCLUSION

The purpose of this paper was to address China as a foreign investor. Unlike many conventional liberal actors who value good governance and favorable economic conditions,

China does not share the same view. Investing into numerous economically disadvantaged and corrupt counties, the question guiding this research was focused on why China deliberately chooses to invest into corrupt countries, while other countries do not. I claim that China has the confidence to invest into corrupt counties by using foreign aid as a strategic policy tool to maintain control over their investments. Referencing the theoretical argument of the obsolescing bargain theory, I argued that China is able secure long-term bargaining power over their investments by increasing or decreasing aid when need be. In order to answer this question, I conducted both quantitative and qualitative analyses. I found that there is a positive and statistically significant relationship between the FDI and foreign aid variables, proving my hypothesis to be true. My case study found that in Cambodia, Chinese investment patterns illustrate how it uses aid to improve the climate for its investors.

China's Belt and Road initiative has drastically increased its global footprint. To date, the BRI spans across three continents (Asia, Europe, and Africa) with over 65 countries signed onto the initiative, ranging from Yemen to Italy.³² The scale of the project will generate an economic cooperation area that comprises 62 percent of the world's population, 30 percent of the world's GDP, and 24 percent of the world's household consumption (Chin & He, 2016). However, because of China's willingness to invest in corrupt countries, many experts and Western actors call the initiative "a risky" and "unwise plan". Despite push back that the BRI has received, if the project succeeds, it will be the most ambitious infrastructure project undertaken in modern history that will ultimately redesign global trade routes. As America continues to become more isolationist and invests less around the world, the BRI could set China on the path to become the next global leader.

³² Italy is the first G7 nation and the largest EU member to sign onto the BRI and accept funds from Beijing.

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