

Impact of Host Country Risk on China's OFDI—Evidence from 36 Countries along the “One Belt and One Road”

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Abstract: China's OFDI scale is increasing for countries along the “One Belt and One Road”, and the ensuing investment risk issues deserve our attention. This article introduces ICRG's national risk data, based on panel data from 36 countries along the “One Belt and One Road” from 2006 to 2017, and studies the impact of national risk on China's OFDI. The study found that economic risk has a significant negative effect on China's OFDI, political risk has a significant negative effect on China's OFDI, and financial risk has no significant effect on China's OFDI.

1. Introduction

The rapid development of China's foreign direct investment has become an important promoter for Chinese enterprises to enter the international market which is also one of the important ways for China to enhance the competitiveness of the international market and the right to speak in the economy. In the future, China's foreign direct investment will continue to maintain its upward momentum. According to the *China Foreign Direct Investment Bulletin*, China's net foreign direct investment in 2018 was US \$ 143.04 billion, ranking second in the world, an increase of 50.1 times compared with US \$ 2.855 billion in 2003.

The “One Belt and One Road” initiative has created a platform and opportunities for the spatial layout of China's foreign direct investment. Since the initiative was proposed in 2013, the countries along the route have become a hot spot for China's foreign direct investment, which has increased from USD 1.19 billion in 2006 to USD 17.89 billion in 2018. At the end of 2018, China's direct investment stocks in countries along the “One Belt and One Road” were US \$ 172.77 billion, accounting for 8.7% of China's foreign direct investment stocks.

While the “One Belt and One Road” initiative brings development opportunities to China, we should also be aware of the shortcomings of the countries along the “One Belt and One Road”. Most of the countries along the route are emerging economies where laws, systems, and market mechanisms are not yet perfect. Some countries still have social and political instability, and the national risk level is relatively high. To a large extent, this has brought risks to China's foreign direct investment. However, we find that China is inclined to invest in countries with high national risks along the “One Belt and One Road”. Therefore, it is of practical significance to identify the impact of the three aspects of the host country's national risk on China's OFDI, and then reveal the direction and causes of China's direct investment in countries along the “One Belt and One Road”.

2. Literature References

Most international risk assessment agencies, such as ICRG, classify host country risk into political risk, economic risk, and financial risk. This article uses the approach of most risk assessment agencies for the definition of country risk. Therefore, this article will explain the current status of research on the impact of national risk on OFDI from three dimensions: political risk, economic risk and financial risk.

Political risk is generally considered to be a negative impact on corporate business activities brought about by a series of government actions such as host country regime change, corruption,

wars, and foreign investment policies (Xie, 2015). Generally speaking, a stable political environment for the host country means a safe investment environment and effective property rights protection for the enterprise, thereby promoting more investment in the host country. Rodriguez and Uhlenbruck (2012) found that in most developing countries there are phenomena such as political corruption and imperfect laws and high political risks, which makes enterprises need to pay an additional investment cost in the process of foreign direct investment, which is not conducive to international Capital inflow. However, some scholars have reached completely different conclusions. Yuan and Gao (2018), when studying Chinese companies' direct foreign investment in ASEAN, found that China's investment in ASEAN has a political risk preference. The better the stability of the government and the better the investment environment in the ASEAN region, the more difficult it is for host countries Attract China to invest in it.

Economic risk is generally considered to be the possibility of loss of foreign investment caused by macroeconomic factors at the national level of the host country (Wang and Qi, 2011). Wang and Qi (2011) found that economic risks have a significant negative impact on foreign direct investment; Shen and Bao (2013) used panel data from 2006 to 2011 to point out that economic risks do not have a significant impact on China's OFDI in Africa.

Financial risk is generally considered to be the possibility of changes in the host country's financial system, financial markets, and balance of payments conditions that result in losses of foreign direct investment (Wang and Qi, 2011). The conclusion of the impact of financial risk on OFDI also shows a polarized situation. Dutta and Roy (2011) found that through the panel data of 97 countries, financial development is the determinant of FDI capital inflows, and there is a strict nonlinear relationship between the two. When financial development exceeds a certain value, it will have a negative impact on FDI. Wang and Zhao (2016) studied the impact of national risks and investment motives on China's foreign investment and found that China's foreign direct investment generally favored countries with higher financial risks.

Therefore, this article will study the impact of national risks of countries along the "One Belt and One Road" on OFDI in China from the dimensions of political risk, economic risk and financial risk of ICRG's national risk data.

3. Empirical analysis

3.1 Sample source

According to *China's Belt and Road Network*, there are 64 countries along the One Belt and One Road. Based on the availability of data, a total of 36 countries were sampled: Oman, Azerbaijan, Egypt, Pakistan, Belarus, Bulgaria, Poland, Russia, Philippines, Kazakhstan, Czech Republic, Qatar, Kuwait, Croatia, Romania, Malaysia, Mongolia, Bangladesh, Myanmar, Saudi Arabia, Sri Lanka, Thailand, Turkey, Brunei, Ukraine, Greece, Singapore, Hungary, Yemen, Iraq, Iran, Israel, India, Indonesia, Jordan, Vietnam. The time span is from 2006 to 2017.

3.2 Variables and measures

The interpreted variable in this paper is China's OFDI (OFDI), which uses China's foreign direct investment stock data, and the source of the data is the *China Foreign Direct Investment Statistical Bulletin*.

The core explanatory variable of this article is the country risk. The data comes from the ICRG database. The country risks in the ICRG database are divided into three categories, namely economic risk (ERISK), political risk (PRISK), and financial risk (FRISK).

With reference to existing literature, this paper introduces some control variables. Use the host country's gross domestic product (GDP) to measure the market size, and the distance between the host country and China (DIS) to measure the iceberg cost of investment; use the host country's gross domestic product (PGDP) to measure the host country's economic development level; use fuel and metal mineral exports proportion of commodities' exports (RESOURCE) to measure the natural resource endowment of the host country; use the college admission rate (SCHOOL) to measure the

strategic resource spin motivation of foreign direct investment; use high-tech exports proportion of manufactured products to measure the motivation for outward direct investment in technology. In addition to the distance (DIS) data from the CEPII database, the rest of the variables are all from the WDI.

3.3 Model building

Based on the existing literature, logarithmize some variables with large difference in magnitude, and set the following model.

$$\begin{aligned} \ln(OFDI_{it}) = & \alpha + \beta_1 PRISK_{it} + \beta_2 FRISK_{it} + \beta_3 ERISK_{it} + \beta_4 \ln(GDP_{it}) + \beta_5 \ln(PGDP_{it}) \\ & + \beta_6 \ln(DIS_{it}) + \beta_7 RESOURCE_{it} + \beta_8 TRADE_{it} + \beta_9 TECH_{it} + \beta_{10} SCHOOL_{it} + \varepsilon \end{aligned}$$

In the above formula, i is the host country subscript and t is the time subscript and ε is the residual term. This article uses panel data and the software used is Stata16.

The descriptive statistical results of each statistical variable in this article are shown in the following table.

Table 1 descriptive statistical results

Variable	Mean	Std.Dev.	Min	Max
OFDI	1.460e+09	3.820e+09	290000	4.460e+10
ERISK	36.12	5.565	21.83	50
PRISK	64.02	10.33	33.21	84.50
FRISK	39.51	4.817	26.50	48.83
GDP	2.930e+11	4.070e+11	3.410e+09	2.650e+12
PGDP	12936	15841	294.2	85076
DIS	5519	1750	1172	7649
RESOURCE	0.388	0.350	0	1.000
TECH	0.119	0.135	5.81e-06	0.602
SCHOOL	0.450	0.250	0.0499	1.366
TRADE	0.937	0.608	0.00167	4.373

3.4 Results

First, only the core explanatory variables are regressed, and then the control variables are added. The regression results are shown in the following table. Equation (1) is the regression result of the core explanatory variables; Equation (2) and Equation (3) are respectively the regression results of the fixed-effect model and the random-effect model with the control variables added.

First look at the regression results of the core explanatory variables. The regression coefficient of economic risk is significant at the 5% level. This shows that under other conditions unchanged, when the economic risk increase one unit, OFDI will decrease by 6.8%. The regression coefficient of political risk is also significant at the level of 5%, which shows that under other conditions unchanged, if the political risk increase one unit, OFDI will increase 7.6%. The regression coefficient of financial risk is not significant.

Secondly, look at the regression results of the control variables. Both the market size (GDP) and the distance (DIS) are significant at the level of 1%, which indicates that China's OFDI increases with the increase in the market size of the host country, and decrease with the geographical distance between the two countries. The regression coefficients of TECH, TRADE and RESOURCE are not significant. The regression coefficient of SCHOOL is 6.755 and significant at the level of 1%, which shows that China OFDI for countries along the “One Belt and One Road” may be based on strategic resources to seek purpose.

The above regression results indicate that the impact of host country’s risk on China’s foreign direct investment is complex: economic risk has a significant negative impact on China’s OFDI, financial risk has no significant impact on China’s OFDI, and political risk has a significant positive

impact on China's OFDI. China's strong preference for political risks can be explained. Generally speaking, the host country with higher political risks gives Chinese companies some special preferential treatment to encourage investment, such as lowering trade barriers, tax incentives, etc. Despite the host country's high political risk, factors such as the host country's huge overseas market and the saturation of the domestic market have increased the company's tolerance for the host country's political risk.

Table 2 Results

	Equation (1)	Equation (2)	Equation (3)
ERISK	0.00468 (0.0338)	0.0684** (0.0287)	0.0505* (0.0302)
PRISK	-0.169*** (0.0418)	-0.0761** (0.0346)	-0.100*** (0.0285)
FRISK	0.0419 (0.0691)	0.0328 (0.0425)	0.0359 (0.0448)
lnGDP		5.508** (2.058)	0.830*** (0.198)
lnPGDP		-5.170** (2.084)	0.176 (0.341)
lnDIS		0 (.)	-3.378*** (0.462)
RESOURCE		0.0871 (1.342)	0.103 (0.730)
TECH		1.785 (2.371)	1.349 (1.631)
SCHOOL		6.751*** (2.295)	4.414*** (1.144)
TRADE		0.967 (0.809)	0.296 (0.646)
_cons	28.21*** (3.563)	-79.62** (36.98)	26.19*** (6.713)
N	432	261	261
R ²	0.170	0.456	

4. Conclusion

In order to study the impact of "One Belt and One Road" countries' risks on OFDI in China, this paper based on the panel data of 36 countries along the "One Belt and One Road" from 2006 to 2017, and introduced the ICRG country risk data to examine the political risks of countries along the "One Belt and One Road". The research results are: economic risk has a significant negative impact on China's OFDI, political risk has a significant negative impact on China's OFDI and financial risk has no significant impact on China's OFDI.

China does have a certain risk appetite for its investment. This phenomenon can also be understood as the fact that China pays more attention to the huge economic potential behind risk

performance. However, with the further development of the “One Belt and One Road” initiative, Chinese companies’ foreign direct investment will certainly comply with market rules, so risks must still be guarded against during the investment process.

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