

Article

# The Political Risk of China's Outward Foreign Direct Investment: Taking the Countries Along the "Belt and Road" as an Example

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**Abstract:** The year 2023 marks the 10th anniversary of the proposal of the Belt and Road Initiative. Over the past decade, China has increasingly engaged in political, economic, and cultural exchanges with the countries along the Belt and Road, and both sides have gained economic benefits during this period. However, some investment issues have emerged, resulting in losses for many enterprises. This paper analyzes and studies this issue and puts forward suggestions.

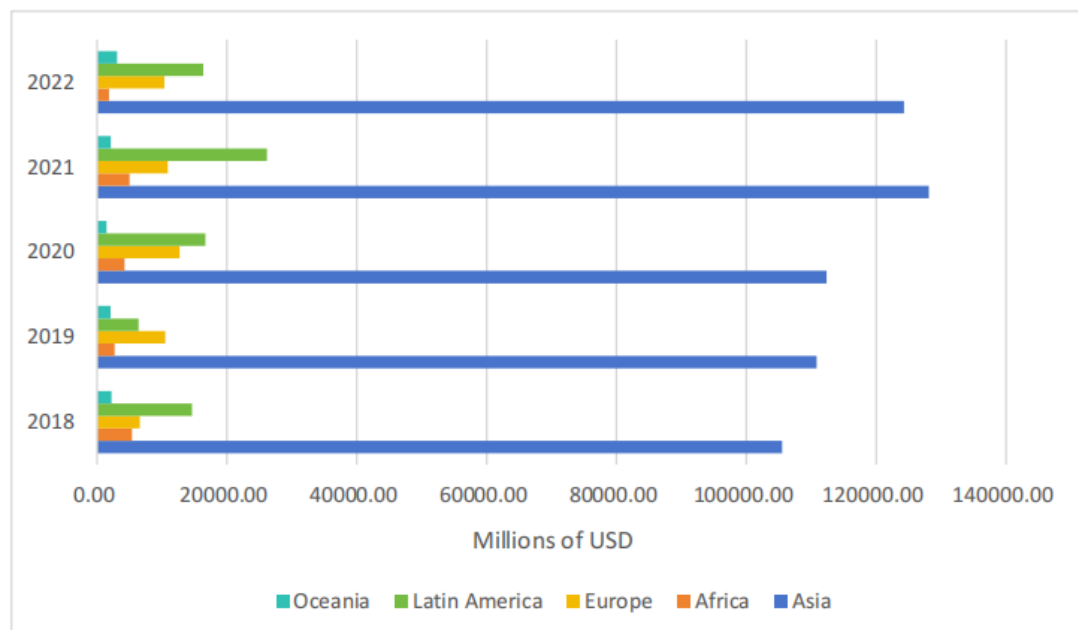
**Keywords:** Investment; Belt and Road Initiative Countries; Political Risk

## 1. Introduction

The year 2023 marks the 10th anniversary of the Belt and Road Initiative (BRI). Since the introduction of the BRI policy in 2013, China has seen increasingly frequent interactions with countries along the route, with growing cooperation in economic and political spheres. The significance of a community with a shared future for mankind has become increasingly evident. Over the past decade, China has signed more than 200 BRI cooperation documents with 151 countries and 32 international organizations, covering 83% of China's diplomatic relations. In 2022, the BRI trade cooperation took new steps forward, with a 7.7% increase in China's non-financial direct investment in BRI countries, maintaining a proportion of 17.9%. In 2018, China's outward direct investment (ODI) volume was 321.6334 billion US dollars, and by 2022, the total volume had risen to 370.5479 billion US dollars, representing a growth rate of 13.2%. This investment trend continues to develop, and in the first two months of 2023, Chinese enterprises' non-financial direct investment in BRI countries reached 27.53 billion yuan, a year-on-year increase of 37.1% (equivalent to 4.04 billion US dollars, a year-on-year increase of 27.8%). These figures all demonstrate China's confidence and determination in building the

BRI, while also indicating the need for a more cautious consideration of the various challenges faced when investing in BRI countries.

**Table 1:** China's Outward FDI Flows by Region, 2018-2022



Source: 2022 Statistical Bulletin of China's Outward Foreign Direct Investment

The economic cooperation of the Belt and Road initiative has brought a certain amount of economic income to China, but it has also brought risks and challenges. The political risks of the invested countries leading to the failure and loss of Chinese enterprises' investments have become hidden dangers for the long-term development of the BRI. The rise of new governments and the change of leaders can induce political turmoil and instability, causing obstacles to the construction of the Belt and Road and affecting the import trade between China and the countries. In 2010, the Poland A2 expressway project was claimed 1.7 billion by the Polish government; On the inauguration of the new Greek administration in January 2015, it was declared that the China Ocean Shipping Group's Piraeus Port initiative had been put on hold; In March 2015, following the assumption of office by the newly elected president of Sri Lanka, a decision was made to place the Colombo Port City project, which was being developed by Chinese companies, under suspension. In April 2016, citing "national interest" as the reason, the Australian Foreign Investment Review Board (FIRB) rejected Dakang Pastoral Industry's proposal to purchase an 80% stake in the Australian pastoral firm Kidman for AUD 370 million. Subsequently, within a few months, the transaction for China State Grid to acquire Ausgrid, an Australian power grid company, for approximately AUD 10 billion was also halted by Australian Finance Minister Scott Morrison, again citing concerns for the "national interest." In October 2021, Belarus issued a temporary ban on the export of wheat and buckwheat, causing heavy losses to China's investment in the wheat product processing industry of Belarus. According to the statistics of the American Enterprise Institute (AEI) and the Heritage Foundation, among the 56 cases of Chinese

investment failures in the Belt and Road countries from 2005 to 2016, a total of 27 countries were involved, and 23% were caused by political reasons. These phenomena may mean that China's current foreign investment has the phenomenon of neglecting the political risks of the target country or not considering them sufficiently.

Considering the broad connotation of the concept of political risk, it can be manifested in several dimensions. Ignoring the political risks of the target country or not considering them sufficiently is specifically reflected in which aspects, which requires in-depth research. This is necessary for examining the oversight in China's past foreign investment process, reducing the significant losses caused to Chinese enterprises by the political risks of a country, enhancing the confidence of Chinese enterprises in overseas investment, and further affecting trade between the two countries. In order to ensure the safety of investors' investments, promote the construction of a mutually beneficial and win-win business environment for the "Belt and Road", and at the same time accelerate the construction of a new development pattern and the "going out" process of Chinese enterprises, and promote the high-quality development of the "Belt and Road" jointly built, it is necessary to study the impact of political risks and their impact on China's foreign investment.

## **2. Literature Review**

By referring to previous literature, we can understand the research trend and industry status of this industry in recent years, laying a theoretical background for the subsequent research.

### **2.1 The Characteristics of China's Investment in Countries Along the "Belt and Road" Initiative**

The study of the characteristics of China's investment in countries along the Belt and Road" has attracted considerable attention in academia. Various methods have been employed to examine the influencing factors of China's direct foreign investment from the perspectives of both China and the target countries. Liu Yu, Tang Li Zhi, and Jin Meng Jie utilized a semi-parametric varying coefficient spatial panel data model and concluded that an increase in the host country's market size promotes investment from China, and as the host country's institutional environment improves, the marginal effect of the host country's market size on China's outward direct investment first increases and then decreases. Shu Mei Ting, Wang Bo, Deng Hui Juan, Xiong Gui Fang, and Zhu Chang De employed spatial statistical methods for hot spot analysis and panel data for location factor research, revealing that China's investment in "Belt and Road" countries is unevenly distributed, mainly concentrated in neighboring countries, and generally less invested in countries that are geographically distant, with investment hotspots changing over time. Additionally, scholars have been summarizing and generalizing the overall investment characteristics of the BRI and have organized the overall planning: Zhao Hong Jun and Cao Zhiyu used principal component analysis to determine that countries along the Belt and Road exhibit investment robustness from both the national scope and the number of indicators.

## **2.2 The Definition of Political Risk**

Political risk is a crucial concept in political economy and plays a significant role in investment decision-making. However, academia has not yet reached a unified understanding of political risk, but there is a consensus on its core concepts. Zhou Yili, the president of the China Society of International Economic Law, defined political risk into macro and micro aspects. Macro political risk encompasses factors such as changes in domestic regimes, wars and revolutions, social conflicts, and unrest. These factors have widespread effects that impact all enterprises investing in a given country. On the other hand, micro political risk involves issues like differential treatment of multinational companies, local legal restrictions, and industry-specific regulations. These risks specifically target businesses from certain countries or those entering particular industries, necessitating a deeper understanding and preventive measures from the affected enterprises. Zhang Tianyuan mainly explored political risk from two aspects: types of political risk and risk factors. The types of political risk are discussed from the perspectives of the host country's political environment, international environment, and the environment of enterprises and industries. In the classification of risk factors, scholars mainly follow two criteria: the causes of the risk and the scope of its impact. Chen Sheng and Zhang Junlong, based on the global governance indicators data of countries along the Belt and Road", specifically divided into six sub-dimensions such as corruption control, government efficiency, regulatory quality, and rule of law to empirically study the impact of the host country's political system level on China's outward direct investment.

## **2.3 Political Factors in Countries Along the Belt and Road Initiative**

The interaction between the political risks of the target country and the investment amount in it has attracted the attention of scholars for a long time. Yin Yahong used the propensity score matching method to conclude that China's cooperation with the "Belt and Road" countries in the construction of industrial parks significantly promoted China's direct investment in the countries where the industrial parks are located, and that political stability, market size, natural resources, and communication facilities are positively correlated with China's foreign investment. Huang Yuanyuan, Chen Lin, and Zhu Hongquan used the zero-inflated Poisson model to conclude that institutional construction (including infrastructure and trade cooperation) can promote enterprises to carry out investment activities in countries along the route; interpersonal political and business connections have a positive impact on enterprises' investment in countries along the route, while equity political and business connections have a negative impact. Huang He and Liu Yantong used the structural power theory of international political economy to deeply explore the political and economic interactions in the risks of Chinese enterprises' overseas investments, classified the political risks of various countries at the global, regional, and national levels, and put forward suggestions for the restructuring of Chinese enterprises' overseas interests.

## 2.4 The Quantification of Political Risk

Quantifying political risk is an important topic in the field of political economy. However, early research on political risk focused on how to select political risk indicators. Yao Kai and Zhang Ping in their work marked an early stage in China's study of the impact of political risk on investment, innovatively attempting to visualize political risk data; Wang Haijun established a dynamic linear model between political risk and Chinese enterprises' outward foreign direct investment (OFDI), concluding that political risk from the host country has a significant negative effect on OFDI.

Furthermore, the academic community is continuously exploring to find mathematical models that are more suitable for quantifying political risks. Meng Fanchen and Jiang Fan in their study "Research on Quantitative Evaluation of Political Risk in China's Foreign Direct Investment" were the first to use the entropy method to quantify political risk indicators, constructing a direct investment political risk evaluation model based on "Chinese factors." Zhang Yanhui and others, in response to the 12 elements of host country political risk, used regression analysis and found that the stability of the host country's government and the degree of refusal of corruption have a significant impact on China's foreign direct investment. Wang Wei and Yuan Hang in used an extended gravity model to assess the impact of political risk shocks and institutional quality on China's foreign direct investment. Zhao Hongjun and Cao Zhiyu used principal component analysis to analyze from the perspectives of political risk, risk of relations with China, social resilience risk, sovereign credit risk, and economic risk, concluding that the legal system and regulatory environment of the host country are the greatest risks faced by Chinese enterprises when investing in countries along the "Belt and Road."

## 2.5 Literature Critique

After combing through existing research findings, it can be observed that academia has yet to establish a universally recognized metric for quantifying the political risks associated with a country. However, there is a general agreement that the level of political risk significantly influences the volume of China's outward foreign direct investment (OFDI). The current state of political risk quantification for China's OFDI, based on the literature, has the following characteristics: **【1】** Quantitative indicators increases. The indicators for quantifying a country's political risk are becoming increasingly comprehensive and detailed. **【2】** Diversification of models. Scholars have utilized a rich array of mathematical models to evaluate the political risks of a country from various aspects.

Nevertheless, the occurrence of failed investment cases indicates that existing research still has its shortcomings: **【1】** The research mostly adopts a macro perspective, neglecting microeconomic factors. Current studies predominantly use macro data for analysis, focusing extensively on internal politics, government policies, and institutions, with a lack of introduction and research on microeconomic indicators; investment advice separates government and enterprises, lacking comprehensive recommendations from multiple perspectives and dimensions. **【2】** Political risk is not given enough attention; it is often combined with other types of indicators such as economic risk for analysis. Articles that specifically study the relationship between political risk and China's OFDI are outdated, offering

limited guidance for current investment decisions in the "Belt and Road" countries, which are currently in high demand. This indicates a lack of emphasis on political risk. 【3】 In terms of timeliness, existing literature largely focuses on traditional political risk indicators, such as the degree of government integrity and stability, which are less timely. These are significant for long-term prevention but fall short in research related to identifying and guarding against short-term political risk threats.

### **3. Model design and Assumptions**

The research indicators, including explained variables, explanatory variables and control variables, are described in detail below.

#### **3.1 Approach to Empirical Analysis**

The aim of this project is to examine the adequacy of the consideration of political risk in the current process of China's outward investment, and whether this omission exists. Therefore, the overall idea is first to divide political risk into several dimensions according to its scope, and then to quantify these indicators in order to examine their impact on China's outward investment. If we consider political risk sufficiently, then these indicators should have an economically logical and relatively strong explanation of our outward investment. On the contrary, it means that our consideration of political risk is unreasonable and there is room for improvement. However, which scenario is reflected in the actual situation needs to be rigorously verified.

#### **3.2 Description of Indicators**

Through the development of a sophisticated model, this project undertakes an in-depth modeling analysis to explore the impact of political risk on China's Outward Foreign Direct Investment (OFDI).

##### **3.2.1 Dependent Variable**

The flow data of China's investment in the countries along the Belt and Road in the past 10 years from 2012 to 2021 is used as the indicator, which is derived from the annual "STATISTICAL BULLETIN OF FDI IN CHINA" jointly published by the Ministry of Commerce, the National Bureau of Statistics and the State Administration of Foreign Exchange (SAFE).

##### **3.2.2 Independent Variables**

The political risk indicators consist of six dimensions: 【1】 Corruption Control(CC), reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. 【2】 Government Effectiveness (GE), reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

【3】 Political Stability and Nonviolence (PV), measures perceptions of the likelihood of political instability and politically-motivated violence, including terrorism. 【4】 Supervision Quality

(SQ), reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. **【5】** Legal Construction (LC), reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. **【6】** Expression and Accountability, reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

### 3.2.3 Control Variables

The control variables were calculated in three dimensions and six indicators:

Relations with China: the security indicators of relations with China in the book “China's Belt and Road Investment Security” (Ji Jinbiao and Liang Haoguang 2021) are used, **【1】** political relations index (time of establishing diplomatic relations with China), **【2】** investment relations index (time of signing BITs), **【3】** tax relations index (time of signing Double Taxation Avoidance Agreements), **【4】** humanities exchange index (number of friendly cities established with China), **【5】** mutual visa exemption index (time of mutual visa exemption). In the original book, five dimensions were selected. However, after conducting empirical regression analysis, it was found that the results of the mutual visa exemption index, human relations index, and mutual visa exemption index were not significant. As a result, it was decided to choose the first two indexes, the political relations index (DY1) and the investment relations index (DY2), as the security indexes for relations with China in this paper.

Distance cost with the host country (Dis2), is calculated as the product of the spherical distance between Beijing and the capital of the host country and the Brent oil price, with the geographical distance data obtained from the CEPII database.

Dimensions of economic development of the host country: **【1】** Level of economic development of the host country (GDPP), is measured by the host country's gross domestic product (GDP) per capital. **【2】** Host country market development potential (GDPR), is measured by the host country's GDP growth rate. **【3】** Host country's human resource conditions (LABOR), are measured by the proportion of the working population (15) years old or older to the total population. The above three data are from the World Bank database.

For the sake of data availability and the purpose of this article, a total of 53 countries along the Belt and Road route have been selected, namely Afghanistan, Albania, United Arab Emirates, Azerbaijan, Bangladesh, Bahrain, Belarus, Brunei Darussalam, Czech Republic, Egypt, Arab Republic, Greece, Croatia, Hungary, Indonesia, India, Islamic Republic of Iran, Iraq, Israel, Jordan, Kazakhstan, Kyrgyz Republic, Cambodia, Kuwait, Lao PDR, Libya, Sri Lanka, Lithuania, Latvia, Maldives, Myanmar, Mongolia, Malaysia, Nepal, Pakistan, the Philippines, Poland, Qatar, Romania Russian Federation, Saudi Arabia, Singapore, Serbia, Slovakia, Syrian Arab Republic, Thailand, Tajikistan, Turkmenistan, Timor-Leste, Turkey, Ukraine, Uzbekistan, Viet Nam, Republic of Yemen.

### 3.3 Model Design

The regression model selected for this paper was designed based on the single equation parallel data model in the book Advanced Econometrics by Zinai Li as follows.

#### Formula 1

$$y_{it} = \alpha_i + x_{it}\beta_i + u_{it} \quad i = 1, \dots, n, \quad t = 1, \dots, T$$

Where  $x_{it}$  is a  $1 \times K$  vector,  $\beta_i$  is a  $K \times 1$  vector,  $K$  is the number of explanatory variables.

The following three scenarios are commonly used:

Scenario 1:  $\alpha_i = \alpha_j, \beta_i = \beta_j$

Scenario 2:  $\alpha_i \neq \alpha_j, \beta_i = \beta_j$

Scenario 3:  $\alpha_i \neq \alpha_j, \beta_i \neq \beta_j$

For scenario 1, when there are no individual effects or structural changes in the cross-section, ordinary least squares (OLS) estimation provides a consistent and efficient estimate between  $\alpha$  and  $\beta$ , similar to pooling cross-sectional data from multiple periods. Scenario 2 is referred to as the varying intercept model, where individual effects differ across the cross-section, reflecting individual differences through omitted variables in the model. This situation can be divided into fixed effects and random effects. Scenario 3 is known as the varying coefficient model, where in addition to individual effects, there are variations in economic structure across the cross-section, implying that structural parameters differ between different cross-sectional units.

If regression is performed according to the requirements of scenario 3, it necessitates conducting regressions separately for each country. However, due to the short time series selected for this paper and the relatively high number of explanatory variables, this could easily lead to overfitting, resulting in poor predictive performance on new data. Therefore, this paper only performs cross-sectional regression and panel regression (including both random effects and fixed effects) based on scenarios 1 and 2.

The change in cross-sectional data regression arises from horizontal comparisons between different individuals, obtaining the relationship between the dependent variable and independent variables from this perspective. One of the significant advantages of panel data is the two-way fixed effects regression, indicating that the changes actually come from individual differences at each time point, thus revealing the relationship between the dependent variable and independent variables from the perspective of individual changes. This paper primarily aims to explore the relationship between political risk and OFDI by comparing the levels of political risk among different countries. Ultimately, this paper selects the cross-sectional data model for explanation. The specific regression model is designed as follows:

#### Formula 2

$$OFDI_{it} = \beta_0 + \beta_1 PV_{it} - 1 + \beta_2 EA_{it} - 1 + \beta_3 CC_{it} - 1 + \beta_4 SQ_{it} - 1 + \beta_5 DY1_{it} - 1 + \beta_6 DY2_{it} - 1 + \beta_7 Dis2_{it} - 1 + \beta_8 GDPP_{it} - 1 + \beta_9 GDPR_{it} - 1 + \beta_{10} LABOR_{it} - 1 + u_{it}$$



Where  $i$  denotes the host country - the countries along the Belt and Road,  $t$  denotes the year, and  $t-1$  denotes the previous year, "OFDI $_{it}$ " is a dependent variable, which denotes the OFDI flow from China to country  $i$  in year  $t$ . PV $_{it}$  is independent variable which denotes the index of political stability and nonviolence degree in country  $i$  in year  $t$ ;  $u_{it}$  is a randomized disturbance term.

Investment is characterized by lagged and long-term nature, etc. in the regression, the political risk and control variables of the previous year are specially selected to do the regression with one lag.

**Table 2:** Variable Descriptions and Sources

Variable	Variable	Measurement indicator	Data source	Literature support
Dependent Variable	OFDI	The flow data of China's investment in the countries in the past 10 year from 2012 to 2021	<i>STATISTICAL BULLETIN OF FDI IN CHINA</i>	-
Independent Variable	Corruption Control (CC)	reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.	Global Governance Indicators WGI database	Jiang Guanhong and Jiang Dianchun (2012)
	Political Stability and Nonviolence (PV)	measures perceptions of the likelihood of political instability and politically-motivated violence, including terrorism		
	Supervision Quality (SQ)	reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development		
	Expression and Accountability (EA)	reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.		
Control variables	Political relations index (DY1)	time of establishing diplomatic relations with aaChina	Ministry of Foreign Affairs, Summary Table of	Ji Jinbiao and Liang Haoguang

			the Dates of the Establishment of Diplomatic Time between the People's Republic of China and Various Countries	(2021)
	Investment relations index (DY2)	time of signing BITs	List of Bilateral Investment Agreements Concluded by China with Foreign Countries, Ministry of Commerce	
	Distance cost with the host country (Dis2)	product of the spherical distance between Beijing and the capital of the host country and the Brent oil price	CEPII database	Jiang Guanhong and Jiang Dianchun (2012)
	Level of economic development of the host country (GDPP)	the host country's gross domestic product(GDP) per capital.	World Bank database.	Wang Ying, Lu Jie (2018)
	Host country market development potential (GDPR)	GDP growth rate of the host country		
	Host country's human resource conditions (LABOR)	Working population (15) years and over as a percentage of total population		Rao Hua (2013)

#### 4. Empirical Testing and Analysis of Results

The project will analyze the experimental data and verify the conjecture in this link, and analyze the experimental data.

#### 4.1 Variable Correlation Test

The originally planned six political risk indicators showed correlation coefficients greater than 0.9 between legal construction (LC) and corruption control (CC), and between supervision quality (SQ) and government effectiveness (GE). The correlation coefficients between government effectiveness (GE) and corruption control (CC), supervision quality (SQ), and legal construction (LC) were also greater than 0.9. This may be due to the fact that the six indicators jointly describe political risk and may use similar metrics in the evaluation process, resulting in some overlap in the final outcomes. As a result, it was ultimately decided to exclude LC and GE from the selection range of independent variables, retaining them for robustness testing. With OFDI as the dependent variable and PV, EA, CC, SQ as independent variables, and DY1, DY2, Dis2, GDPP, GDPR, LABOR as control variables, a multicollinearity VIF test was conducted. The test results, as shown in Table 3, indicated that the average variance inflation factor (VIF) was 3.34, with a minimum of 1.14 and a maximum of 8.11. All variables were below the tolerance critical value of 10, demonstrating that there was no significant multicollinearity issue among the variables.

**Table 3:** Results of Multicollinearity Diagnosis

Variable	VIF	1/VIF
Corruption Control ( CC)	8.110	0.123
Supervision Quality (SQ)	7.990	0.125
Level of economic development of the host country (GDPP)	4.580	0.218
Expression and Accountability (EA)	2.840	0.352
Level of political stability and absence of violence ( PV)	2.260	0.442
Host country's human resource conditions (LABOR)	2.210	0.453
Distance cost with the host country (Dis2)	1.630	0.614
the investment relations index (DY2)	1.400	0.713
the political relations index (DY1)	1.280	0.781
Host country market development potential (GDPR)	1.140	0.875
Mean	VIF	3.340

#### 4.2 Analysis of Empirical Results

The regression results are shown in Table 4, which indicate that China's direct investment in the countries along the "Belt and Road" is significantly associated with the degree of political stability and nonviolence, expression and accountability, corruption control and supervision quality, while in the relationship with China, it is significantly associated with time of establishing diplomatic relations with

China and whether or not to sign BITs with China. Since the regression of cross-sectional data is taken, akin to scenario 1 " $\alpha_i = \alpha_j, \beta_i = \beta_j$ " in the Li Zinai regression model, it suggests that there is no inter-individual influence or temporal effect among the host countries.

The positive regression coefficient of Control of Corruption (CC) confirms, after significance test, that the higher the rating of the host country's residents on the degree of abuse of public power for private gain, including small and large-scale corruption, "control" of the state by elites and private interests, the more abundant the country's investment in the country will be. In addition, the regression coefficient for control of corruption is higher compared to the other independent variables, indicating a more significant effect of control of corruption on OFDI from the country. This finding emphasizes the importance of effective control of corruption for China's outward investment.

The positive Supervision Quality (SQ) regression coefficient, which passes the significance test, indicates that the higher the host country's residents' evaluation of the government's formulation and implementation of sound policies and regulations to promote private sector development, the more this will positively affect the level of our investment in the country. That is, the host country's government is recognized for the measures and policy initiatives it has taken to promote private sector development and has achieved recognition for its positive reforms. The country has responded positively to this positive effort and is willing to increase its investment in the host country in order to further strengthen the economic relationship between the two sides. Such positive investment practices will not only help to promote economic growth and trade between the two sides, but are also expected to lead to more business opportunities and potential for cooperation.

The regression coefficients for Political Stability and Nonviolence are negative and tested for significance. This suggests that we are not particularly concerned about the possibility of political instability and politically motivated violence, including terrorism, in host countries. Meanwhile, we find that the two indicators of relations with China are positively correlated with outward investment and passed for significance. This means that in our investment decisions, more consideration is given to cooperative relations with China and strategic interests, and relatively less attention is paid to the political stability and social security of the host country itself.

The coefficient of Expression and Accountability (EA) is negative and confirmed by a significance test, reflecting perceptions of the extent to which a country's citizens are able to participate in choosing their government, freedom of speech, freedom of association and free media. This implies that the participation of the host country's citizens in the choice of their government, freedom of speech and etc is not considered very important in our outward investment decisions. This finding suggests that the political system and the level of democracy in the host country have a reverse effect on the country when considering OFDI. This result is partly explained by the relationship between the level of expression and accountability and public skepticism about the efficiency and quality of government. Expression and accountability tend to reflect the level of public expectation and trust in the work of the government. When the level of expression and accountability is higher, it may imply that the public's

concerns and expectations of the government are also higher, while at the same time suggesting a degree of crisis of trust. Under these circumstances, China's behavior in reducing investment in that country's government is a logical response. Because of the risk of trust, investors will naturally take into account the efficiency and quality of the government's performance, which in turn will affect their investment decisions.

The regression coefficients of both the time of establishing diplomatic relations with China and the signing of BIT (DY1 and DY2) are positive, passing the significance test. This indicates that China is more concerned about the relationship between the two countries in its outward investment and is willing to increase its investment in that country based on the friendly relationship between the two countries. This can also explain the negative regression coefficients of the two items of Political Stability and Nonviolence, and Expression and Accountability. These negative coefficients could be due to the effect of friendly relations between the two countries, which may lead to investing abroad without paying special attention to the specific political risks in the host country, such as political instability and the possibility of politically motivated violence, including terrorism. Additionally, there may be relatively little consideration of issues such as democracy and human rights.

The regression coefficient with the host country's distance cost (Dis2) is negative and passes the significance test. This is in line with the expectation of economic theory, indicating that China takes the distance factor between the host country and China into account when investing abroad. Specifically, China prefers to invest in countries that are closer to China. This may be due to a variety of reasons, including considerations of lowering transportation costs, reducing the risk of cross-border operations, and facilitating management. At the same time, closer countries may make it easier to realize economic cooperation and exchanges, which is conducive to the common development of both sides.

**Table 4:** Empirical Regression Results

	(1)	(2)	(3)
	OFDI	OFDI	OFDI
	hybrid model	stochastic model	stationary model
Political Stability and Nonviolence(PV)	-0.186*** (-3.97)	-0.140 (-1.41)	-0.136 (-1.08)
Expression and Accountability(EA)	-0.206*** (-3.33)	-0.303** (-2.36)	-0.482** (-2.50)
Corruption Control (CC)	0.309*** (3.14)	0.00899 (0.06)	-0.000112 (-0.00)
Supervision Quality (SQ)	0.194** (2.03)	0.378** (2.30)	0.354* (1.80)
the political relations index (DY1)	0.148*** (3.71)	0.190* (1.72)	0.433 (0.89)
the investment relations	0.148***	0.160*	0.0980

index(DY2)	(2.94)	(1.73)	(0.33)
Distance cost with the host	-0.346***	-0.346***	-562.7***
country (Dis2)	(-4.42)	(-2.68)	(-4.85)
Level of economic	0.195	0.337***	0.327**
development of the host	(1.43)	(2.69)	(2.00)
country (GDPP)			
Host country market	-0.0153	-0.0309	-0.0293
development potential (GDPR)	(-0.38)	(-1.04)	(-0.97)
Host country's human	0.0258	-0.00770	-0.0350
resource conditions (LABOR)	(0.29)	(-0.06)	(-0.15)
_cons	0.0307	0.0296	-19.08***
	(0.71)	(0.26)	(-4.84)
<i>N</i>	431	431	431
<i>r</i> <sup>2</sup>	0.301		0.123

*T* statistics in parentheses

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

### 4.3 Robustness Tests

In order to make the results more convincing, with no change in other factors, GE, which has a very high correlation with CC and SQ, is replaced and regression is conducted again, and the results are shown in Table 5, the signs of the explanatory variables are all consistent with the results of the original model, and they all pass the significance test, which indicates that the original model is robust.

**Table 5:** Robustness Results

	(1)	(2)	(3)
	OFDI	OFDI	OFDI
	hybrid model	stochastic model	stationary model
Political Stability and	-0.208***	-0.176*	-0.197
Nonviolence(PV)	(-4.27)	(-1.71)	(-1.51)
Expression and	-0.158***	-0.176	-0.383**
Accountability(EA)	(-3.19)	(-1.64)	(-2.26)
Government Effectiveness	0.464***	0.260**	0.276*
(GE)	(5.22)	(2.15)	(1.86)
the political relations index	0.163***	0.190*	0.349
(DY1)	(3.89)	(1.75)	(0.73)
the investment relations index	0.142***	0.186**	0.169
(DY2)	(2.67)	(2.06)	(0.59)
Distance cost with the host	-0.336***	-0.348***	-606.5***
country (Dis2)	(-4.22)	(-2.74)	(-5.24)
Level of economic	0.244	0.391***	0.364**
development of the host	(1.62)	(3.30)	(2.21)
country (GDPP)			

Host country market	-0.0106	-0.0280	-0.0252
development potential (GDPR)	(-0.27)	(-0.94)	(-0.83)
Host country's human resource	0.0181	0.00362	-0.0958
conditions (LABOR)	(0.20)	(0.03)	(-0.43)
_cons	0.0342	0.0339	-20.57***
	(0.79)	(0.30)	(-5.23)
<i>N</i>	431	431	431
r2	0.310		0.122

*T* statistics in parentheses

$p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

## 5. Summary and Recommendations

This project will summarize the conclusions drawn from the experiment, and make suggestions on the problems encountered in China's OFDI at this stage.

### 5.1 Conclusion

In outward investment, the factor of relations with China outweighs the political risk factors of the host country. It is crucial to comprehensively consider the political risks of the host country in investment decisions. Theoretically, if we can conduct a thorough assessment and consideration of political risks, the scale of our investment in countries with higher political risks should be correspondingly reduced. However, in the actual regression results, it was found that there is a certain discrepancy in the impact of political risk indicators on China's outward investment. Some indicators show a positive relationship with Outward Foreign Direct Investment (OFDI), while others show a negative relationship. This situation indicates that, on the political level, Chinese enterprises have not fully considered the dimension of the host country's political risks, but have given more consideration to relations with China. For example, after the new government took office in Sri Lanka in 2015 and the Colombo project was suspended, the visit of Sri Lankan Prime Minister Wickremesinghe to China deepened the political and economic cooperation between the two sides, and subsequently part of the Colombo City project resumed work. This shows that good relations with China have played a positive role in promoting the outward investment of Chinese enterprises.

China actively develops diplomatic relations and economic and trade cooperation, striving to build a mutually beneficial and win-win partnership, which has enabled Chinese enterprises to receive government support and encouragement in their investment activities in some countries. This cooperative relationship helps to provide political guarantees and a stable policy environment, reducing investment risks. It also indicates that China's outward investment is not only based on economic considerations but also stems from the maintenance of friendly relations and the demonstration of great power responsibility. For instance, in international investment, the Middle East continuously has conflicts and instability. Despite this, China still considers investing in these countries. The main reason behind this is the consideration of friendly relations between the Middle East and China.

Although the "Belt and Road" initiative is a political action, the essence of investment is to obtain corresponding returns. Economic losses caused by misjudgment or neglect of political risks not only bear unnecessary blows to our government and enterprises in terms of economy but also reduce investment confidence, ultimately failing to have a positive impact on the relations of countries along the "Belt and Road" route, which goes against the original intention of the "Belt and Road" initiative, which is undoubtedly unfavorable for China.

## **5.2 Recommendations**

The project will be divided into the following three aspects, and put forward targeted suggestions for different objects, so as to help the decision-making of enterprises and countries.

### **5.2.1 At the Level of Investment Target Country Evaluation System**

In the process of outward investment, if the regression results meet expectations for certain indicators, the government and enterprises should continue to strengthen their monitoring and continue to guard against risks according to the original monitoring system to ensure the security of China's outward investment. For indicators that do not meet expectations, even stronger monitoring should be strengthened to establish a more comprehensive and integrated risk supervision system. By continuously strengthening monitoring, improving the risk management system, and responding to risks in a timely manner, China's outward investment can achieve better controllability and effectiveness, providing strong support for economic development and national interests.

Currently, China's Outward Foreign Direct Investment (OFDI) has indicators where supervision meets expectations:

Supervising the control of corruption in the host country is of great significance for the country and enterprises in the process of outward investment. Corrupt behavior may lead to the misappropriation of funds, contract breaches, unfair competition, and other issues, thereby damaging the stability and returns of investment projects. By controlling the corruption risks of the host country, we can enhance trust between all parties, promote cooperation and mutual benefit. Establishing a clean environment also helps to prevent the breeding of criminals, as corrupt behavior is often accompanied by illegal activities and criminal acts, including money laundering, embezzlement, and bribery. By severely cracking down on corruption, we can weaken the influence of criminals, improve social security levels, and protect the interests and safety of enterprises and investors. It also responds to the call at the first "Belt and Road" International Cooperation Summit Forum in 2017 to strengthen international anti-corruption cooperation and make the "Belt and Road" a clean road, showing China's firm determination and attitude to strengthen international anti-corruption cooperation.

Monitoring the regulatory quality of the host country is beneficial for Chinese enterprises to identify host countries with relatively sound policies and regulations. Sound policies and regulations can provide a stable and transparent investment environment, allowing Chinese enterprises to invest more confidently. It can also help enterprises better understand local market rules and mechanisms,



reducing unnecessary risks and misunderstandings. The private sector is one of the key forces driving economic development, and the host country's government's formulation and implementation of policies and regulations that allow and promote the development of the private sector can effectively promote local economic development, providing Chinese enterprises with a broader market and more business opportunities. The transparency and stability of policies and regulations can also reduce unnecessary disputes and litigation, protecting the legal rights of enterprises. Countries with high regulatory quality usually have efficient administrative management and approval procedures, simplifying the registration, approval, and operational procedures for enterprises in the country, providing investment convenience. This will reduce the operating costs and time costs of enterprises, promoting their outward investment.

Monitoring expression and accountability helps Chinese enterprises reduce investment risks and ensure investment security when investing abroad. Freedom of speech, association, and a free press can ensure the transparency and openness of information, making it easier for Chinese enterprises to obtain reliable information during the outward investment process, reducing risks and misunderstandings. At the same time, these freedoms can also help enterprises promptly obtain local political and economic dynamics to make better investment decisions, thereby ensuring investment security. The existence of freedom of speech, association, and a free press allows foreign enterprises to better understand local culture and values during the outward investment process, which is more conducive to reducing cultural conflicts, trade frictions, actively fulfilling social responsibilities, and promoting good communication and cooperation.

For these three indicators, the monitoring intensity and evaluation system of the investment enterprises are in line with the actual situation, and it is sufficient to maintain the monitoring intensity.

Currently, there are indicators in China's Outward Foreign Direct Investment (OFDI) where supervision is lacking:

The effect of the host country's political stability and the degree of non-violence in regression is not good, indicating that Chinese enterprises have neglected this aspect when investing abroad. However, political instability and the emergence of terrorism in the host country can have a significant impact on Chinese enterprises' outward investment. Political instability and terrorism may lead to social disorder, unstable legal systems, and a poor security environment. These factors will increase the risk of Chinese enterprises investing in the country. If political instability and terrorism are so serious as to affect local economic and social activities, related projects may be delayed or suspended, which will also affect investment returns and increase corporate costs and risks. For example, in February 2011, internal unrest broke out in Libya and quickly escalated into large-scale armed conflict. The eight-month-long unrest caused a huge impact and loss to Chinese enterprises in Libya. More than 50 large-scale contracting projects of China in Libya were affected by the war, involving a contract amount of up to 18.8 billion US dollars. Therefore, in future outward investments, the Chinese government and enterprises should focus on strengthening supervision of the host country's political stability and the degree of non-violence, which will help ensure the smooth progress of investment projects and avoid

obstruction or loss due to social unrest or violent incidents. It helps to build a more comprehensive and integrated risk monitoring system. By timely identifying and responding to potential risks, understanding the local environment and policy dynamics, and accumulating experience and lessons, enterprises can better manage risks and achieve stable and sustainable outward investment.

For this indicator, the monitoring intensity of the investment enterprises is not enough, and in the future, it should increase the measurement, evaluation, and follow-up in this aspect to avoid unnecessary investment losses.

### **5.2.2 Government Level**

The Chinese government should strengthen the research and judgment of the political risks of the investment country and provide this information and public products for enterprises through means such as think tanks and big data. The government can build a corruption risk country database, (Jiang Tao, 2018) a political stability and non-violence degree database, etc., to provide Chinese enterprises with sufficient information, guide enterprises to pay attention to the political risks of the investment target country, and prevent and avoid risks in emergencies. In the process of building these databases, the government needs to integrate information from different fields and channels, including policies and regulations, industry reports, social public opinion, news media, and other sources. At the same time, the government also needs to strengthen the monitoring and analysis of the investment country, timely discover and early warning of potential political risks, provide enterprises with accurate references and guidance, and in necessary cases, the government needs to intervene to solve problems and protect the rights and interests of investment enterprises. In addition, the government can also hold seminars, meetings, and other forms to invite experts, scholars, and industry insiders to deeply discuss the political risks of the investment country, share the latest research results and experience, and update the research and findings in related fields in a timely manner, which will help to enhance the risk awareness and management capabilities of Chinese enterprises, and further strengthen the controllability and effectiveness of outward investment.

### **5.2.3 Enterprise Level**

Investment enterprises cannot only consider the feasibility of investment projects from an economic perspective during the investigation process of outward investment projects. They must fully consider the political risks of the investment country. This requires enterprises to establish a comprehensive risk management system, including political risk assessment, risk monitoring and early warning mechanisms, risk response measures, etc. Enterprises need to pay attention to the government's release of relevant policy information, actively cooperate with relevant government departments, think tanks, and professional institutions to obtain accurate information and professional opinions, in order to make wise decisions, reduce investment risks, and protect the interests of the enterprise. Only by fully considering and managing political risks can enterprises avoid possible losses and adverse effects, and ensure the long-term sustainable development of investment projects.

### **5.3 Research Deficiencies**

For the current achievements of this paper, we still have value that is worth in-depth exploration. Future research directions can be more detailed and rich, and improve the existing deficiencies to achieve more accurate control of the political risks of China's outward investment. The current paper has the following areas for improvement:

Group regression by different regions of the country sample Group regression by region can consider the particularities of different regions, and more meticulously study the impact of the political risks of different regions on China's outward investment.

Improve the indicator of relations with China This paper only considers the time of establishing diplomatic relations with China and the time of signing bilateral investment agreements for the indicator of relations with China, and the selection of indicators is not comprehensive enough. On the basis of available data, other aspects can be considered, such as the number of visits to China by the host country's president, the trade volume between the two countries, the degree of political trust, etc.

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### **Author Contributions**

The authors confirm their contribution to the paper as follows: Yanting LU: Writing, Methodology. Wanqi QIU: Conceptualization, Writing–review & editing. Jiale XING: Writing, Supervision.

### **Availability of Data and Materials**

The data on which the study is based were accessed from a repository and are available for downloading through the following link.

<https://com.gd.gov.cn/attachment/0/560/560984/4500585.pdf>

<https://www.worldbank.org/en/publication/worldwide-governance-indicators>

[https://www.gov.cn/guoqing/2017-06/14/content\\_5202420.htm](https://www.gov.cn/guoqing/2017-06/14/content_5202420.htm)

<https://www.chinatax.gov.cn/chinatax/n810341/n810770/c5171677/content.html>

<https://data.worldbank.org.cn/indicator/NY.GDP.MKTP.KD.ZG?view=chart>

<https://data.worldbank.org.cn/indicator/SL.EMP.TOTL.SP.ZS?view=chart>

<https://data.worldbank.org.cn/indicator/NY.GDP.PCAP.KD.ZG?view=chart>

## Conflicts of Interest

The authors declare that they have no conflicts of interest to report regarding the present study.

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