

Political Relations and Chinese Outbound Direct Investment: Evidence from Firm- and Dyadic-Level Tests

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So What?

- We argue ignoring the role of international relations in Chinese outbound investment is an important oversight in our understanding of the determinants of Chinese ODI.
- One concern over Chinese investment is how much politics matters vis-a-vis market forces. Part of this concern rests with China's standing in global politics and the role of its SOEs.
- China's political relations may explain one puzzle in the literature on Chinese investment. Why do Chinese firms tend to invest in countries with high political risks?

Causal Mechanisms

- Host officials and citizens often fail to distinguish the interests of the government and investors from the same home country.
- Forward-looking investors anticipate how political violence affects both the expected returns of their investments and hostile policy changes. But investors do not have perfect foresight.
- Interstate military conflict and security alliances often change both government policies toward international business and investor expectations of political risk.
- By changing the fixed and variable costs an affiliate faces in the host, interstate cooperation lowers the productivity cutoff for firm entry from one home country but interstate conflict raises the productivity cutoff for firm entry from another home country.
- China is one of the major powers , so ODI from China has been facing various non-commercial obstacles for national security reasons.
- Much Chinese ODI have been by SOEs, so they are said to be motivated by political reasons for government agendas.

Two tests

- A novel empirical contribution of the paper is to test the effects of interstate political relations on Chinese ODI using two interrelated and complementary empirical tests:
- The firm level test:
China Council for the Promotion of International Trade (CCPIT), European Commission's Directorate-General for Trade, and UNCTAD between December 2009 and March 2010. 3,000 small and medium-sized Chinese firms with experience in import and export activities were contacted and 1,378 firms from agriculture, manufacturing, construction, and financial intermediaries in nearly 30 provinces responded, a 43% response rate. 346 carried out overseas investments.

Table 1 Firm Level Analysis of Investment Decisions in Three Destination Regions

	Invest_EU	Invest_ODC	Invest_LDC
Importance of interstate relations	-2.847*** (2.89)	1.393** (2.19)	-1.406** (2.01)
Importance of regulatory environment	1.145 (1.17)	-0.620 (0.92)	0.141 (0.20)
Importance of market potential	1.449 (1.59)	0.680 (1.04)	1.331** (2.30)
Importance of host market as target	3.793** (2.33)	0.343 (0.50)	-0.646 (1.14)
Importance of export platform	1.005 (1.58)	0.946** (2.10)	-0.683 (0.90)
Importance of natural resources	0.391 (0.41)	0.396 (0.69)	0.920 (1.13)
Importance of skilled labor	-2.345 (1.60)	1.335* (1.70)	-0.324 (0.57)
Importance of low cost labor	-2.392*** (2.67)	-1.412* (1.88)	1.573*** (2.68)
Importance of technology	-1.598* (1.83)	0.152 (0.22)	-0.429 (0.59)
Importance of management practices	-1.054 (1.13)	1.486 (1.39)	-0.418 (0.62)
Importance of established brands	-0.787 (0.94)	-1.137 (1.41)	0.385 (0.55)
Importance of public procurement	1.134 (1.63)	-0.666 (1.04)	-0.580 (0.80)
Importance of host preferential policy	-0.716 (0.85)	-1.271 (1.64)	0.653 (1.00)
Importance of trade barrier avoidance	1.993** (2.52)	1.276 (1.29)	-0.043 (0.07)
Importance of Chinese firm presence	2.733** (2.23)	0.156 (0.21)	0.256 (0.48)
Importance of foreign market entry	2.123** (2.31)	-0.745 (0.93)	0.120 (0.19)
Importance of host public subsidies	0.518 (0.61)	0.765 (1.15)	1.415** (2.25)
Importance of local labor union	-1.396 (1.29)	-1.862** (2.53)	-0.312 (0.50)
Constant	-0.574 (1.01)	1.262** (2.41)	0.523 (1.40)
Observations	132	204	206

Two tests

- The dyadic level test: Chinese ODI flows to some 95 countries from 2003 to 2005.
- Chinese Ministry of Commerce (MOFCOM)'s ODI data since 2002 has been collected in accordance with the OECD definitions and IMF Balance of Payments guidelines. Hence we use the MOFCOM data on Chinese ODI in millions of US dollars since 2002 from MOFCOM's 2009 *Statistical Bulletin of China's Outward Foreign Direct Investment*.
- Dependent variable is real ODI flows from China into a host country in a year, in millions of 2000 constant dollars.
- Key independent variable is a measure of the host's net cooperation actions toward China. We use data on actual events the ODI recipient country initiated toward China to construct a measure of the host's net cooperation stance toward China. Data are from King and Lowe (2003).

Table 2 Dyadic Level Analysis of Determinants of Chinese ODI Flows

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	all	low-inc	high-inc	all	low-inc	high-inc	All	low-inc	high-inc
Host net cooperation	0.437*** (6.52)	0.377* (1.69)	0.301* (1.92)	0.433*** (6.42)	0.387* (1.90)	0.254 (1.60)	0.726*** (3.58)	0.544*** (7.26)	0.847** (2.50)
Property rights	1.170 (0.38)	-4.671** (2.19)	9.728 (0.93)	3.185 (0.93)	-1.492 (0.75)	15.168 (1.56)	4.220 (1.26)	3.426 (1.08)	-7.782 (0.63)
GDP	2.422* (1.81)	1.678** (2.52)	5.197 (1.01)	2.702 (1.65)	1.385* (1.81)	9.424 (1.49)	-0.388 (0.44)	-0.367 (0.44)	5.889** (2.70)
Growth	0.305 (1.36)	0.308* (1.76)	1.746 (1.10)	0.391 (1.31)	0.325* (1.96)	0.757 (0.58)	0.182 (0.40)	0.063 (0.23)	3.015 (1.03)
Distance	2.528 (0.64)	-1.750 (0.56)	18.519 (1.61)	1.699 (0.42)	-2.943 (1.02)	14.874 (1.03)	2.396 (0.66)	-2.894 (0.88)	11.306 (0.79)
Colonial tie	33.526*** (3.65)	25.779*** (4.15)		29.881*** (3.09)	21.483*** (3.73)		18.815* (1.84)	18.085** (2.16)	
Fuel export				0.129** (2.25)	0.123** (2.48)	0.318 (1.08)	0.210*** (2.87)	0.216*** (2.87)	0.238 (1.58)
Mineral export				0.162 (1.53)	0.092** (2.42)	3.597** (2.33)	0.148 (1.64)	0.108* (1.96)	6.187*** (3.62)
Lagged FDI							0.978*** (4.12)	0.573*** (4.42)	0.679** (2.49)
Constant	-59.21 (1.12)	-10.34 (0.31)	-266.4 (1.40)	-61.60 (1.10)	2.70 (0.10)	-339.1 (1.40)	-18.35 (0.46)	32.35 (0.87)	-230.7 (1.47)
Observations	219	168	51	198	150	48	108	86	22
Countries	95	70	25	88	64	24	66	51	15
R-squared	0.21	0.22	0.24	0.24	0.28	0.40	0.66	0.43	0.85

Country	Real ODI	Property rights	Net Coop Actions to China
Algeria	29.301	-0.76	2.90
Australia	104.827	1.79	12.40
Kazakhstan	29.704	-0.49	3.13
Kenya	1.658	-0.38	3.73
Libya	0.124	-0.64	1.77
Malaysia	19.875	0.23	6.97
Niger	3.256	-1.29	0.00
Nigeria	37.338	-1.33	3.27
Pakistan	4.743	-0.63	16.07
Russia	49.864	-0.83	52.50
USA	125.642	1.57	108.80

What do we learn?

- The more importance a Chinese firm attributes to interstate relations, the more likely its investment decisions will be affected
- Chinese ODI tends to flow to countries that initiate more cooperative actions toward China.
- Our analysis addresses the puzzle of why Chinese ODI tends to go to countries of high political risks. Chinese investors go to those environments, not because of their risk acceptant preferences, but rather because of the risk-reduction effect of good political relations.
- International politics does matter to the distribution of international production capital.