Policy, Institutional Fragility, and Chinese Outward Foreign Direct Investment: An Empirical Examination of the Belt and Road Initiative

Abstract

The Belt and Road Initiative (BRI) is an important policy agenda undertaken by the Chinese government. We explore how the BRI – as well as an associated policy, the creation of Chinese overseas special economic zones – influences Chinese outward foreign direct investment (FDI). We find that host country institutional fragility positively influences Chinese FDI volumes and that the impact of institutional fragility on Chinese inward FDI to the host is amplified in the presence of the BRI. Specifically, BRI policy facilitates FDI to countries with *weaker* rule of law and *less* government accountability. We argue that while the BRI may actively facilitate economic growth (i.e. via infrastructure development) and in turn aspects of human development, particularly in less developed economies, its likely impacts on political rights may not be so promising.

Keywords: Bilateral relationships; BRI, investment policy; political risk; governance, Chinese OFDI

INTRODUCTION

Until quite recently MNEs from developed market economies were largely responsible for driving global FDI flows. The general tenor of policy advice given to less developed countries seeking to receive greater FDI volumes, predominantly from developed market economies, was to move their economies towards market friendly, rules based, well-governed and highly accountable institutional frameworks (World Bank, 1997). This school of thought is perhaps best captured and most closely associated with the now well-known "Washington consensus" view of development policy (Williamson, 1993; World Bank, 1993). Under this set of broad guidelines and overarching philosophy for policy implementation, host countries have been encouraged to foster sound judicial institutions, promote transparency, provide accountability, and safeguard property rights, while maintaining macroeconomic stability under small, lean professional bureaucracies.

With the growth of MNEs from emerging markets, particularly those from China, the international investment environment and related policy advice for attracting inward FDI has changed considerably (Alon et al., 2018). China has become an essential source of FDI for many developing countries, in particular in African and Southeast Asian nations. Chinese MNEs, moreover, are sometimes considered different from developed market MNEs (Sutherland et al., 2018). They are "latecomers", for example, looking to catch-up (via technology seeking) with their developed market counterparts (Sutherland et al., 2020; Anderson et al., 2015; Anderson & Sutherland, 2015a); they may exhibit high levels of state-ownership or involvement (Anderson & Sutherland, 2015b), and associated mercantilist investment strategies (Clegg et al., 2018); and, importantly, they may have so-called "special" ownership advantages – which allows them to more easily do business in markets that are imperfect – i.e. characterized by weak and "fragile" institutions (Buckley et al., 2007; Shi et al., 2017). As such, the types of policies required to attract EMNE FDI could well be different to

those prescribed by the Washington Consensus. As China has started to emerge as a global economic power, an alternative set of policies to the Washington consensus began to emerge – provocatively but accurately referred to as the "Beijing consensus" (Huang, 2017; Hlover & Shaibu, 2019).

Founded upon China's successful economic development experience over the past four decades, the Beijing consensus offers 'an alternative to the policy toolkit offered to developing countries by the International Monetary Fund (IMF) and the World Bank, the so called "Washington Consensus"' (Yagci, 2016: 2). This policy toolkit is typified by things such as incremental reform, innovation and experimentation, export-led growth, and state capitalism (Hlover & Shaibu, 2019; Williamson, 2012). The Beijing consensus 'has begun to remake the whole landscape of international development, economics, society and, by extension, politics' (Yao, 2015: 3). According to Williamson (2012), 'the Beijing consensus basically refers to the Chinese way of doing things' (p. 3).

While some scholars have questioned the efficacy of the Beijing consensus as a sustainable economic model (Huang, 2011; Williamson, 2012), host countries are not required to follow a prescriptive set of pro-market or political (i.e. democratic) ideologies as a precondition for attracting FDI and other associated financial and trade related support measures. The advancement of social institutions linked to democratic political values, such as greater transparency, accountability, strong and independent judicial systems, functioning independent media, are, therefore, not part of Beijing's economic engagement plan. Rather, Beijing is seemingly content, and indeed at times may prefer, to work with what may be considered by Western standards institutionally fragile states. Sometimes these countries are controlled by unelected authoritarian leaders. Such leaders, faced with economic development needs, have a choice between free market, democratic institutions imposed by Western world order on the one hand, and the Beijing model of a quasi-liberal market economy coupled with

authoritarianism on the other hand. As a result, despite theoretical arguments that institutional voids and political risk will negatively impact FDI, much of the research on Chinese outward FDI to date supports the opposite view: Chinese (C)MNE investment significantly increases as institutions weaken and political risk levels increase (Buckley et al., 2007; Kolstad & Wiig, 2012).

The BRI was initiated in 2013 (Duan et al., 2018) and is 'designed to stimulate economic development by dramatically enhancing regional interconnectivity' (Rolland, 2017: 127). More specifically, BRI was 'devised to reconfigure China's external sector in order to continue its strong growth' (Huang, 2016: 314). This is done in several ways, such as infrastructure development and "connectivity" investments (Swaine, 2015). Past studies found that host country engagement in the BRI significantly increases FDI volumes into those countries. More specifically, infrastructure-based projects were found to be primarily driven by state-owned firms, while non-infrastructure projects are primarily driven by private Chinese firms (Du & Zhang, 2018). In the case of private investment in BRI host countries, the development of overseas special economic zones (SEZs) play a particularly germane role. Overseas SEZs are Chinese government funded areas which seek to promote Chinese FDI into host countries with a focus on, for example, logistics, export processing, and manufacturing (Bräutigam & Tang, 2012). In many cases, Chinese overseas SEZs are created for Chinese MNEs exclusively (Bräutigam & Tang, 2014). While these SEZs are not created only in BRI countries, they have become an important policy pillar within the BRI structure and strategic approach. As a policy initiative, BRI – and it subcomponents, such as SEZs – is intricately linked to the internationalization of Chinese firms. Accordingly, this raises a question: does the BRI increase the attractiveness of host-countries associated with institutional weakness (which we refer to hereafter as *fragility)* for CMNE related FDI?

We contribute to the literature on FDI from China by proposing and testing the impact of Chinese policy initiatives on the counter-intuitive relationship found in past articles between institutional fragility and Chinese investment. We confirm that Chinese FDI is more strongly attracted by weak institutional environments. In addition, we find the BRI policy amplifies (i.e. positively moderates) the impact of host country institutional fragility on Chinese FDI volumes. We also find evidence that Chinese FDI is sensitive to weaknesses in specific institutional domains in the presence of the BRI: it is higher in countries with *weaker* rule of law and *less* accountability under the BRI policy. We consider why this might be so, focusing on the difficulties of implementing large-scale infrastructure projects, an important component of the BRI, in nations with strong legal institutions and greater accountability. In addition, we consider how the depth of host country engagement with the BRI (proxied by SEZ creation), may amplify (i.e. moderate) the impacts of institutional fragility on FDI volume. We do so by exploring the simultaneous engagement of host countries in the BRI as well as China's strategic initiative to create overseas SEZs in FDI recipient host countries. As mentioned, Chinese overseas SEZs are an additional component of the BRI and thus creation of an SEZ indicates fuller engagement with the BRI by host countries. In such cases we find the moderation effects of BRI engagement on institutional fragility to be even greater. Our discussion notes that from a host country perspective, approaches for attracting Chinese FDI appear to stand in direct contrast to those advocated in Washington consensus style policy toolkits (i.e. promoting sound institutions). This is because Chinese FDI is more strongly associated with BRI countries when there is less transparency, accountability and weaker rule of law.

The paper proceeds as follows: we first develop three hypotheses, related to the BRI's impacts on Chinese outward (O)FDI volumes, incorporating the moderating impacts on institutional fragility as well as the development of overseas SEZs as representative policies. We then outline our

methodological approach using a panel data set on Chinese greenfield and acquisition equity investments in host countries world-wide, accounting for potential endogeneity concerns. Finally, we discuss our results, highlighting the positive moderation impacts on institutional fragility of the BRI initiative and the further amplifying impacts of the accompanying creation of overseas SEZs.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Host country political and diplomatic ties with China and Chinese outward FDI volumes

That state agencies intervene in the FDI decision of CMNEs, especially state-owned ones, has been established by previous research and is well documented (Quer et al., 2012, 2018, 2019, 2020; Li & Alon, 2019). The state engages its multinationals both directly (e.g., ownership and control), indirectly (e.g., regulation and incentives) and in relation to specific markets (e.g., idiosyncratic bilateral and multilateral institutional relationships).

A number of prior studies have investigated the link between bilateral international relationships and inward FDI volumes from China. According to Zhang, Jiang and Zhou (2014), bilateral diplomatic activities, such as senior government official visits, increase Chinese FDI, especially in resource-rich countries. Quer et al. (2019) report similar findings specifically in visits to Latin American countries. Further, it has been found that ties between political actors in different countries, through UN voter similarity, for example, increases the likelihood that a Chinese firm will establish a foreign subsidiary in that host country (Li et al., 2018). Duanmu (2014) also reports somewhat similar findings, but clarifies that the relationship depends on ownership. These papers provide a foundation for understanding the relationship between creating and strengthening bilateral relationships and increasing levels of Chinese FDI. However, to date this research has largely tested this relationship through implicit means (e.g. senior official visits, UN voter similarity).

Our purpose here is to expand this research by testing the influence of more explicit bilateral investment policies on Chinese OFDI, specifically the BRI. This policy initiative, created by the Chinese government and consisting of two components (the Silk Road Economic Belt and a 21st Century Maritime Silk Road (Fei, 2017: 838)), involves 'the funding and construction of a system of roads, railways, oil and natural gas pipelines, fiber-optic and communication systems, ports, and airports' (Lairson, 2018: 40) and deepening economic integration and engagement with China in order to create new economic opportunities and assert greater international influence (Huang, 2016). It has been referred to as an 'ambitious $1tn project, stretching from the South Pacific to the fringes of Europe and Latin America' (Weinland, 2019: 18). Along with being a massive construction project to fund and construct infrastructure of all kinds, it aims to further integrate Chinese and participant host countries, which covers 'cooperation in all aspects, from policy dialog to trade, from financial cooperation to people-to-people exchange' (Zhang, et al., 2018: 2). The BRI is intended to be a multilateral system of deep interdependence where all participants gain from China's 'efforts in supplying capital, defining and implementing a system designed to provide mutual growth and potentially providing the rules, norms, and institutions to facilitate the operation and management of such a system' (Lairson, 2018: 38). It has set up, for example, specific international dispute resolution mechanisms for BRI related investments (Tao & Zhong, 2018). Finally, it is important to note that policy orientation has also 'shifted from direct financial assistance to the output of development experience….*as a sharing of China's expertise and development success*' (Brautignam & Tang: 812) (emphasis added).

To date, surprisingly, there are comparatively few studies that have explored the economic impacts of the BRI. Perhaps, as Zhai (2018) notes, this is because of some of the challenges in pinning it down: 'the BRI is still a flexible conceptual initiative and far from a well-defined action plan with

top-down design. The vagueness of the BRI program leads to difficulties in quantitatively evaluating its economic impact' (Zhai, 2018: 85). Or, as Hillman (2018) puts it: 'the BRI label evades classification. There is no agreed-upon definition for what qualifies as a BRI project' (p. 3). Extant studies have focused primarily on its potential impacts in facilitating trade flows, particularly between Europe and China (i.e. via land routes) and in doing so spurring economic growth (Zhai, 2018; Maliszewska & Van Der Mensbrugghe, 2019; Herrero & Xu, 2016; Villafuerte et al., 2016). However, as well as improved trading relationships, increased Chinese FDI to host countries would also appear an inevitable outcome of the BRI. There is anecdotal evidence, for example, that those host countries involved with the BRI have increased their levels of overall Chinese OFDI. Hillman (2018), for example, notes how 'Chinese outbound capital restrictions appear to be more relaxed for BRI-related transactions. Deals that might be classified as advancing the BRI are more likely to be approved, and to be approved faster. In contrast, China has been reining in outbound deals for foreign real estate, entertainment, and sports teams' (p. 3). Our purpose, as noted, is to further explore the impacts of the BRI on Chinese FDI.

What types of FDI are BRI countries likely to receive?

China has begun many sizable infrastructure projects throughout the BRI countries, examples include $1.73 billion for transport, energy, and communication projects in Central Asia (Indeo, 2018), China General Nuclear Power Corporation's $7.8 billion investment in a Romanian nuclear power plant and another $11.1 billion for a special investment fund under the BRI for other Eastern European ventures (Vangeli, 2017). Other current infrastructure projects include $1.6 billion Batang Toru dam being built on the island of Sumatra, Indonesia, and in Kenya the construction of a $2 billion coal powered power station (Wilson, 2019). While construction projects may involve the

establishment of foreign subsidiaries, often related to very large state-owned construction firms (China now has eight of ten largest construction firms in the world (Hillman, 2018)), it is important to note such projects are often associated with a range of accompanying private sector initiatives (Parente et al., 2019). Initial construction projects, underwritten at first by soft loans, in time also provide opportunities for all Chinese firms to learn more about foreign markets, develop networks (with local firms and politicians) and thus lead to new market opportunities. Infrastructure, therefore, has been found to act as an important initial catalyst for further subsequent FDI of different types (Parente et al., 2019). As such, we would expect countries that engage with the BRI to, in general, receive higher FDI inflows.

> **Hypothesis 1**: Host country engagement with the BRI is associated with greater volumes of FDI from China.

Do formal policy initiatives moderate the impact of institutional fragility?

Recently, scholars have found that Chinese FDI appears to counter conventional wisdom on the relationship between institutional fragility and FDI (Buckley et al., 2018). Institutional effectiveness stems from complementarity across three set of political institutions: the state, rule of law, and political accountability (Fukuyama, 2014). When these are absent or weak, institutional fragility occurs (Shi et al., 2017).[1] Countries with high levels of internal institutional friction have, at least for developed market MNEs, long been viewed as highly risky for FDI and to be avoided (Kobrin, 1979; Brewer, 1981; Alesina & Tabellini, 1989; Howell & Chaddick, 1994; Alon & Martin, 1998). Yet, a range of cross-sectional and panel studies have found Chinese FDI volumes appear to

[1] The concept of institutional fragility Shi et al. (2017) develop is somewhat different from ours. They argue that rather than focus on a more static view of institutional change, different dimensions of institutions progress (or regress) at different rates, which creates internal friction and conflict during institutional reform.

correlate positively with a country's level of institutional weaknesses (which we also refer to here as "institutional fragility"). Buckley et al. (2007), for example, find a positive and significant impact of institutional fragility on Chinese FDI. Using political stability, Ramasamy et al. (2012) finds similar results. Kolstad and Wiig (2012) find an interaction between institutions and natural resources is negative and usually significant, suggesting Chinese natural resource seeking firms invest in weak institutional climates. Blomkvist and Drogendijk (2013) concluded that the larger the differences in the political systems between China and a potential target market, the less Chinese firms invest in that market. They suggest Chinese FDI is attracted to countries that disregard human rights and have relatively high political risk profiles. Kang and Jiang (2012) argue Chinese firms prefer to locate in risky locations as those locations are similar to their domestic business environment.

The heft of the Chinese government in backing investments of CMNEs through explicit policies, such as the BRI, might create institutional fragility attractiveness for CMNEs. The Chinese state, for example, has the ability to critically engage host countries via its policies, which subsequently may redefine conventional risks commonly associated with institutional fragility. This potentially creates opportunities for CMNEs, as well as a new path for host countries to generate FDI from China. One aim of the BRI is to provide an institutional system to facilitate investment and other economic activity between BRI countries and China. This structural system of cooperation and interdependence through the BRI signals to CMNEs that they have the ability to leverage their government's external policies. This may reduce actual as well as perceptions of risk for Chinese MNEs investing in participant countries and thus increase investment, despite the persistence of institutional fragility within them. Indeed, what may be considered a politically risky unattractive investment location by a Western developed market MNE, owing to lack of legal structures, accountability, corruption, and weak regulatory systems (and no domestic governmental support –

rather hindrances – i.e. laws outlawing corrupt practices like bribery), may be perceived as the exact opposite by Chinese MNEs.

Infrastructure related development projects are a significant component of the FDI projects undertaken in BRI countries (Hillman, 2018). There are also reasons for thinking that undertaking such projects may be easier in institutionally weak environments. The construction of dams, roads, ports, power plants and the like may entail complex political consultation processes when undertaken in institutionally strong environments. Interest groups, represented by NGOs and civil society organizations, must be consulted in institutionally developed settings. Legal restrictions (for example, governing environmental standards, safeguarding of biodiversity etc.), moreover, may potentially cause long delays or even scupper projects in institutionally developed countries. Legal interventions can certainly add uncertainty as to whether some infrastructure projects can be completed. By contrast, such infrastructure projects might be more easily negotiated and implemented in weaker institutional environments. While the financing channels available to BRI countries are significant (involving, among other things, soft loans from Chinese development banks), these cannot be accessed if projects cannot be approved. The legal complexity of many such projects means they may be more easily initiated and completed in authoritarian regimes where rule of law is mandated, often by dictatorships.

To illustrate how the BRI may positively moderate the impact of institutional fragility on FDI, the case of Chinese investments made by the Queensway Group in Angola (a BRI member) and subsequently other developing countries, is instructive. After a 27year civil war (ending in 2002) Western donors (such as the IMF) were unwilling to support Angola. China, by contrast, quickly developed political ties with Angola, in part owing to it large oil reserves (which China lacks). To date, Chinese engagement with Angola has provided more than 60 billion US dollars in loans for infrastructure projects, including power plants, bridges, 2,800 kilometers of railways, 20,000

kilometers of roads, 100 schools, 50 hospitals and 100,000 houses (He, 2018). Much of this financing has been paid for in kind, by Angolan oil exports (now known as the "Angolan model", where infrastructure packages are paid for by resource deals). Detailed award-winning journalism published in the *Financial Times* documents how China's Queensway Group skillfully nurtured its links with leading Angolan political and business figures, cutting deals via backhanders to high-level insiders, to obtain a significant share of Angola's oil reserves (Burgis, 2014). The Angolan model which was to emerge from Queensway's early interventions was facilitated by an unaccountable authoritarian regime and involved questionable business practices which allowed insider political elites, in both China and Angola, to enrich themselves via secretive deals. In open, transparent and rule-based societies, these oil for infrastructure deals, would likely never have been completed. Subsequently, the Queensway Group has been active in a range of other poorly governed African countries (Guinea, Mozambique, Zimababwe), using identical tactics (developing and exploiting close relationships with unaccountable political elites) to those employed in Angola (Burgis, 2014). The BRI has provided the necessary financial support and legitimacy to Chinese investors like Queensway (for example, the group invited Angola's leaders to meetings in Beijing with China's vice president, Zeng Peiyan), required to grease the wheels of corrupt officials in unaccountable regimes, subject to judicial voids. Political legitimacy and close state to state relations have been important to groups like Queensway, now considered a specialist in working in these types of business environments. Queensway is privately controlled but has received high-level government support in China. By contrast, western developed market MNEs hoping to engage in foreign corrupt business cannot expect their home governments to support them. For example, Swedish network equipment giant Ericsson recently

agreed to pay over $1 billion in fines to US regulators after pleading guilty to bribing government officials in multiple countries over a 17-year period.[2]

We argue the BRI may moderate the impact of institutional weakness on Chinese FDI. Firstly, it supports investments in particular areas – construction and infrastructure development – which may be easier to complete in institutionally weak environments. It provides ample financing mechanisms through Chinese development banks to support these projects. It is prepared, moreover, to work with authoritarian political systems. Secondly, via stronger interstate relationships, investments risks (and perceptions of those risks) in FDI projects are reduced. Chinese FDI has historically been attracted to institutionally weak countries - owing to "special" ownership advantages. BRI positively moderates this tendency owing to the stronger state to state relations it may foster (enhancing CMNE bargaining positions), increased financial resources and lower perceived and actual risk it creates for investing businesses.

> **Hypothesis 2**: Host country formal engagement in the BRI positively moderates the impact of institutional fragility on Chinese FDI inflows.

What are the impacts of the BRI when accompanied by explicit outward FDI promotion? The further moderating impact of China's overseas Special Economic Zones

The BRI is one of the most ambitious foreign policies ever launched. It consists, however, of a number of associated policy measures although owing to the opaque nature of BRI it is not exactly clear which measures are associated with the BRI and which ones are not. As noted, 'the vagueness of the BRI program leads to difficulties in quantitatively evaluating its economic impact' (Zhai, 2018: 85). Hillman (2018), notes, for example, 'BRI is more a brand than a master plan with specific criteria

[2] International law, however, is starting to catch-up with Queensway, whose founder is now being pursued by US authorities.

for project inclusion' (p. 5). For example, it is allegedly integrated with the establishment of multilateral development banks (particularly the Asian Infrastructure Investment Bank, AIIB) and cross-regional economic cooperation programs (Clarke, 2018).

From the point of view of understanding CMNE OFDI, however, a key plank of the BRI initiative, and one specifically related to promoting FDI (as opposed to infrastructure development), has been the addition of overseas SEZs. It has been noted, for example, that 'SEZ development has been adopted energetically at the heart of the BRI…to provide Chinese companies (and executives) with a controlled channel for building familiarity with and exposure to international markets and the global economy' (Fei, 2017: 840). According to MOFCOM (2015), the BRI is not only 'taking advantage of international transport routes, relying on core cities along the Belt and Road' (p. *839) it is also 'using key economic industrial parks as cooperation platforms' (State Council, 2015,* highlights added by the author, quoted in Fei, 2017: 839). As of 2015, 77 of 118 Chinese overseas SEZs were to be built in BRI partner countries (MOFCOM, 2015).

The creation of overseas SEZs have the expressed purpose of improving the institutional environment for CMNE foreign investments, primarily in manufacturing, through 'filling information gaps and reducing risks and high transaction costs' (Brautigam & Tang, 2012: 800). They are also meant to be mutually beneficial; in exchange for furthering Chinese strategic objectives, China is willing to transfer some of its own economic success to other developing countries (Brautigam & Tang, 2014). For example, the SEZ created by China jointly with the Egypt government in Suez reduces red-tape and other institutional costs through a "one-stop-shop" administrative services building housed within the complex (El-Gohari & Sutherland, 2010). In several other African and Cambodian SEZs, the Chinese government intervened in disputes between host governments and Chinese firms (Brautigam & Tang, 2012). Chinese MNEs are also eligible for financial assistance

from major national banks such as the China Development Bank, which offers subsidies of up to $61 million for resource extraction industries and $46 million for others, concessional loans and other incentives to eligible companies operating in SEZs within BRI countries (CDB, 2016; cited in Fei, 2017).

The zones are intended to help offset the considerable liability of foreignness that CMNEs may face, particularly in their initial stages of internationalization. Overseas SEZs provide agglomeration benefits to small and medium-sized Chinese MNEs that have limited experience working in foreign environments (Brautigam & Tang, 2014). Many of the countries CMNEs are attracted to, moreover, may often be poor countries with low labor costs but, in addition, very weak institutional environments (i.e. in sub-Saharan Africa). Some of China's private sector manufacturing firms, for example, are looking to exploit lower cost labor (i.e. in Laos, Cambodia, Democratic Republic of Congo, etc.) owing to shrinking size (and increasing wages) of China's working age population (i.e. its "demographic dividend" is being lost) (Lin, 2012). Hence, the Chinese government has been keen to promote zone development as private sector initiatives.

An important component of the SEZ strategy relates to its exclusivity in restricting investors to Chinese companies alone. By specifically concentrating Chinese businesses together in zones their strength in numbers, as a group, can be leveraged. Their group influence, moreover, is ultimately underpinned by the Chinese state, which may give host countries food for thought in any attempt to take advantage of zone based CMNEs. Host countries, instead of picking-off Chinese companies one by one (as China has been able to do to its foreign investors in China – forcing them into unfavorable joint ventures, for example, in which technologies can be assimilated), are in a far weaker position to negotiate with the economic mass of an entire zone with many affiliated companies supported by "China Inc.". The reasoning is somewhat similar to Duanmu's (2014) finding that stronger trading

relationships weaken the impacts of expropriation risk on CMNEs – because host countries have potentially far more to lose when dependency levels are higher. Host countries clearly have a great deal to lose by alienating CMNEs based in zones. Zones may therefore provide focal points for state to state negotiations (regarding preferential policies, for example).

Why then might zones also moderate the impact of institutional fragility on Chinese investments? It is likely that Chinese zones enhances the bargaining position of the Chinese state (as representative of its investors) and, furthermore, that there is greater scope for bargaining in institutionally weak environments, where more can be negotiated for (as there are fewer legal constraints on what can and cannot be done). There is, moreover, comparatively less concern about being held accountable by other non-governmental and civil society interest groups. The avoidance of institutionally fragile countries by Western MNEs due to the perceived risk, moreover, provides a "blue ocean" for Chinese OFDI. By engaging relatively untapped markets through policy initiatives such as the BRI, which provides multilateral infrastructure and cooperation, combined with overseas SEZs, which provides additional bilateral support, the Chinese government decreases the investment risks associated with these countries and increases their attractiveness for Chinese MNEs.

> **Hypothesis 3**: Host country formal engagement in the BRI combined with the associated SEZ policy strengthens the positive moderation effects on institutional fragility on Chinese FDI inflows.

METHODS

Data and model

Our model specification is along similar lines to Buckley et al. (2007) albeit we estimate models using the annual equity value of FDI projects drawn from commercially sourced FDI flow

data.[3] Officially collected, nationally aggregated FDI data from all countries is increasingly recognized for its biases (Sutherland et al., 2019). This is driven to a large extent by the bilateral way in which FDI is collected. As MNEs often transit FDI via offshore tax havens and financial centers these destinations are greatly overstated in conventional FDI data (OECD, 2015). China's MOFCOM data is no exception, with heavy biases towards Hong Kong, the Cayman Islands, BVI and, in developed markets countries like the Netherlands and Luxembourg (Sutherland & Anderson, 2015).

Value data are estimated using random effects (following the results of a Hausman test) generalized least squares (GLS) models and utilize panel data of FDI flows from China to the rest of the world (173 countries) during the time period of 2003-2017. Estimations are found to be unbiased due to the use of both within and between group variation. This lengthy time period helps capture pre and post BRI impacts on FDI volumes and moderating effects. Our primary model is defined as:

$$FDI_{ti} = f\,(\beta_1 BRI_{ti}, \beta_2 \text{Institutional fragility}_{ti}, \beta_3 \text{Country risk premium}_{ti}, \beta_4 \text{Cultural proximity}_{ti}, \beta_5 \text{Geographic distance}_{ti}, \beta_6 GDP_{ti}, \beta_7 \text{GDP growth}_{ti}, \beta_8 \text{Natural resource exports}_{ti}, \beta_9 \text{Exchange rate}_{ti}, \beta_{10} \text{Inflation}_{ti}, \beta_{11} \text{Open to FDI}_{ti}, \beta_{12} \text{AIIB member}_{ti}, \beta_{13} \text{Bilateral trade agreement}_{ti}, \beta_{14} \text{Pct agree UN vote}_{ti})$$

Where *t* is time and *i* is host country.

Dependent variable

As noted, Chinese outward FDI data is drawn from the commercial databases Thomson ONE Banker and the Financial Times fDi Markets. This consists of 2,031 acquisitions and 4,402 greenfield investments (totaling 6,433 investments). Of these, 782 were positively identified as SOEs. The average investment values for greenfield and acquisition investments are $111 and $161 million,

[3] Count data were also estimated as a robustness check. Results were quantitatively similar to value-based models.

respectively. We focus on all projects in which Chinese ownership exceeds 10%, following standard FDI definitions. Note that our approximation of Chinese FDI does not include intra-company loans or reinvested earnings. It can be thought of as an approximation of first entry equity FDI. In reality, given the difficulties of using officially recorded FDI data, using commercially available data in this way is one of the few realistic ways of gauging CMNE activity (and approximates to the methods used by influential think-tanks like the Heritage Foundation's measurement of Chinese MNE activity).

Independent variables

Our main independent variables are based around the widely used Political Risk Services Group (PRS) institutional stability measures. Disaggregated this includes: control of corruption; political stability; rule of law; regulatory quality; and government accountability. A downside of using these disaggregated measures is the relatively high level of collinearity between them. We also, therefore, create an index based around the average of the five measures (both are used to test hypothesis 2, regarding moderating impacts of BRI). We invert our aggregated and decomposed measures. Higher scores for institutional risk variables therefore represent higher levels of institutional fragility.

Two dummy variables are used to capture affiliation to BRI (hypothesis 1) and the overseas SEZ policy (hypothesis 3), as reported by MOFCOM. To test hypothesis 1 we run a model with the BRI variable. In addition, we incorporate a number of additional policy initiatives, including AIIB relationship, UN voting similarity and bilateral trading relationships, to explore the impacts of other measures on Chinese FDI volumes. Some of these initiatives, such as the AIIB, have been associated with the BRI initiative, but are in fact only loosely tied to it. The AIIB, for example, was initiated and is led by the Chinese government and is self-described as 'a multilateral development bank with a mission to improve social and economic outcomes in Asia' (AIIB, 2019: 1). The main motivation

behind the development of AIIB is for it to be used as 'an important financial tool for China in increasing its geopolitical influence in the region and increasing the international momentum of the [BRI] strategy' (Yu, 2017: 359). But it is not officially part of the BRI. Similarly, trade relationships are not included. They thus provide interesting contrasts with the BRI itself. Other comparators included, are non-explicit policies such as UN voting similarity with China, expressed as a percentage.

To test hypothesis 2 we run models that incorporate the PRS index in our base model combined with an interaction term (PRS*BRI). We also test this hypothesis by looking at the outcomes for individually decomposed elements of PRS indicators (Table 4). Finally, to test hypothesis 3 we incorporate a three-way interaction (BRI*SEZ*PRS) (Table 5).

Control variables

Control variables are similar to those used in other Chinese location choice studies (Buckley et al. 2007). They include: country risk premium (country risk premiums matched to averaged credit default swaps spreads and bond ratings – Moody's and Bloomberg); GDP (World Bank); GDP growth (World Bank); natural resource endowment (Fuels, ores, and metals exports as share of GDP – World Bank); inflation (inflation rate – World Bank); geographic distance (Distance between capital of host country and China – CEPII/World Bank); exchange rate (Host country annual average exchange rate against RMB (fixed to dollar) – World Bank); Chinese diaspora (Ohio University); and openness to FDI (inward FDI stock as a share of GDP – World Bank). State ownership is defined as a greater than 50% government ownership (Orbis). See Table 1 for a summary of variables and data sources.

Insert Table 1 about here

RESULTS

Table 2 presents the descriptive statistics and a correlation matrix. It is noteworthy that many of the PRS elements (control of corruption, political stability, accountability, law, regulatory quality) are correlated with each other. Multicollinearity, however, does not bias our results, though it can lead to complications in hypothesis testing by inflating standard errors. Beyond the PRS variables, multicollinearity is not an issue with regards to other variables in our model (Table 2).

Insert Tables 2-3 about here

Table 3 reports the aggregated institutional fragility measure plus BRI as a dummy, and a combined interaction term (BRI*PRS). Model 1 (without the interaction) suggests FDI volumes to BRI countries are higher than for non BRI countries (supporting hypothesis 1). However, when introducing the interaction term this variable becomes insignificant. This may be because the interaction introduces multicollinearity into the model, an issue common in interaction models.

As regards hypothesis 2, the interaction term itself is positive and significant (5% level), supporting the idea that the BRI positively moderates the impact of institutional fragility on inward Chinese FDI. The other policy measures we include in our models (AIIB and bilateral trade agreements) do not exhibit this same moderating impact. Based on the aggregated results, Table 4 further decomposes the PRS institutional fragility measure into its five different components. Table 4 again (corroborating Table 3) shows that the BRI dummy variable is significant, both in the fully specified model (last column) and most of the models reporting PRS components individually. This again supports hypothesis 1.

Hypothesis 2 predicts that the BRI policy positively moderates the impact of host country institutional fragility on FDI volume. The interaction term in Table 3, as noted, is significant and positive, suggesting the coefficient on PRS (aggregated) is larger for BRI countries than non-BRI countries. In Table 3 the PRS coefficient on its own is also significant, suggesting that even when not explicitly a recipient of the BRI policy, Chinese MNEs are more strongly attracted to institutionally fragile countries. Table 4 further decomposes the PRS institutional fragility measure into its five main components. Table 4 shows that legal institutional fragility stands out as a positive moderator. Accountability is also a significant and positive moderator, albeit the evidence is not quite as clear cut. Only in one of the models (last column) is the interaction term significant.

Hypothesis 3 predicts the BRI policy initiative when combined with the creation of overseas SEZs is a fuller and more complete set of BRI policy measures and thus strengthens the moderation impacts originally hypothesized. Table 5 reports estimations for our full sample. Table 5 shows that the three way interaction of BRI, SEZ and PRS is significant and positive. This implies that a BRI partner hosting an SEZ further positively moderates the impact of institutional fragility. Model 3 in Table 5 supports our earlier hypothesis 2, albeit significance is lost in model 4 (possibly owing to multicollinearity).

Insert Tables 4-5 about here

Supplementary tests: endogeneity and the BRI policy

Do host countries engage in the BRI policy because they have already received significant levels of Chinese FDI, rather than the other way around, as we hypothesize? Do governments that are prone to entering the BRI also have a stronger likelihood/propensity to attract Chinese FDI? Is there

endogeneity or selection problem, in other words?[4] Conceptually, we argue there are strong arguments in favor of our hypothesized direction in causality, namely from policy to inward FDI. This is because the BRI is intimately connected to China's foreign policy and its underlying geopolitical strategic intentions. Strong political drivers motivate the BRI, which is concerned with enhancing China's foreign influence, via both hard and soft power. In doing so, China hopes to create a sphere of political influence around China via engagement in economic development programs subsumed under the BRI (and SEZs). Promoting economic interlinkages is certainly one way of achieving this target. Put simply, if current bilateral economic ties are weak, there would appear to be stronger political incentives to implement the BRI than in the case of already strong economic ties. We believe, therefore, that China's promotion and endorsement of the BRI in a host country is unlikely to be driven by the strength of prior economic linkages or FDI. This reasoning is reflected in many of the countries that have entered the BRI, which includes many less developed, low income countries (i.e. Kenya, Djibouti, Ethiopia, DRC, Egypt, etc.) with comparatively weak economic ties to China – albeit with the potential for considerable expansion.

Nonetheless, to further empirically explore the possibility of endogeneity, we used an instrumental variable (two-stage least square) estimation to explore whether reverse causality is a potential issue in our modelling (Baum, 2006). By establishing a suitable instrument, a variable correlated with the endogenous variable in question (BRI) but not with the error term, we can run endogeneity tests. One potential instrument is the measure the quality of diplomatic relations between China and the host country as measured by the affinity of the two countries' votes in the United Nations (UN) General Assembly. In previous studies, Li et al. (2018) and Duanmu (2014) have used the affinity measure of UN votes (based on Strezhnev & Voeten, 2013) in their investigation of the

[4] We do lag our variables (by one year). Such lags, however, are an insufficient solution on their own to correct for endogeneity and potential biases in coefficient estimates.

impact of political ties on Chinese FDI (as a main explanatory variable, however, not as an instrument). Using this measure as an instrument, however, may be suitable. It is correlated with our BRI explanatory variable as countries joining the BRI are, in general, likely to share closer political ties and likeness to China. According to Li et al. (2018), for example, UN voting similarity:

> "demonstrates the public stance on a large number of issues, including military, security, social, political, and economic concerns (Voeten, 2000). Voting at the general assembly does not bind countries and thus countries are relatively free to express their sincere opinions (Gartzke, 1998). Countries voting similarly are expected to have a good relationship and act cooperatively because they share similar views and understanding on world issues (Gartzke, 1998). Thus affinity of UN votes has been frequently used to capture interstate political relations in political science and international strategy" (Li et al. 2018: 668).

They note that diverse issues, moreover, are discussed at the UN general assembly and that voting decisions are not likely 'to be shaped by corporate interests in a foreign country' (Li et al. 2018: 668). Using this measure in their models, they argue, alleviates potential reverse causality to some extent. This measure uses two categories of voting data (1 = "yes" or approval for an issue; 2 = "no" or disapproval for an issue) and ranges from -1 (least similar interests) to 1 (most similar interests). We use a similar approach.

To establish whether UN General Assembly voting similarity is a viable instrument and can therefore be used to test for endogeneity we undertake several tests. First, we test whether UN voting similarity satisfies the requirements defining an independent variable. From our first stage regressions we find it does have a statistically significant and positive effect on our main measure of BRI. We find the F-value of the first stage regression achieves a value of 49.55 (p=0.00) exceeding the critical value of the Wald test (5% level) which has a maximum level of 16.38. We then perform the Durbin (=1.293, p=0.255) and Wu-Hausman (=1.280, p=0.258) tests of endogeneity. The null

hypothesis for these tests is that the variables are exogenous. We cannot reject the null hypothesis based upon our results. This implies that the BRI is exogenous of prior Chinese inward FDI.[5]

DISCUSSION

Why does the BRI policy positively moderate the impacts of institutional fragility on Chinese FDI?

We have found, like a number of other studies (Buckley et al. 2007; Kolstad & Wiig, 2012), that countries with fragile institutions attract greater volumes of FDI from China. Under the BRI, moreover, this affect was found to be even stronger (i.e. that the BRI positively moderates this already counter intuitive result). How might the BRI policy amplify the impact of institutional fragility on Chinese FDI? Arguably, one key competitive advantage Chinese businesses exploit is their special relationships to governmental and quasi-governmental actors (Yiu, 2011). The Chinese developmental state, in other words, has close relationships to both private (and of course) state sector businesses (Brautigam & Tang, 2014). This relationship extends from the domestic to international arena, where the government has been keen to promote the internationalization of Chinese businesses (particularly large groups, i.e. the "national team" business groups) (Sutherland, 2009). Previous research, as noted, has established how different measures of bilateral political ties (such as, for example, official visits and trade agreements) are leveraged to ease Chinese FDI in foreign markets (Duanmu, 2014, Li et al., 2018; Quer et al., 2018). Such linkages reduce expropriation risks, afford Chinese firms relevant information and help overcome a range of liabilities of foreignness (Quer, 2018). Using a similar line of reasoning, we hypothesized that the Chinese state, via its BRI policy, may make it easier for CMNEs to do business in weaker institutional environments (i.e. those with

[5] In addition, we use the instrument to test for omitted variable bias. Sargan and Basmann tests, with a null hypothesis that the instrument set is valid and the model is correctly specified, cannot be rejected, implying our model is correctly specified.

greater fragility). How specifically does the state intervene and what are the mechanisms underlying this positive moderation effect in the case of the BRI? To further explore this question, we can examine in more detail our results pertaining to institutional fragility and decompose them by their various sub-components. Are there any specific institutional factors where the moderation effects can be identified and might these results help us better understand how BRI policy interacts and facilitates Chinese FDI? Interestingly, our results on the decomposed institutional measures showed that the impacts of *weaker* rule of law and *less* government accountability (more authoritarian regimes) were positively moderated by the BRI policy. Why would the BRI make investments to countries with weak accountability and legal systems more attractive or viable?

One plausible explanation, relates to the aforementioned industrial composition of many BRI related FDI projects. Such projects are associated with large-scale infrastructure developments (dams, railways, ports, bridges, roads, etc.) (Parente et al., 2019). These giant construction projects, by their nature, are often politically sensitive and typically have long gestation periods prior to commencement. Project planning may involve many consultation procedures, for example, as such projects typically displace local residents and often entire communities.[6] In most instances, such projects cannot therefore be easily and quickly rolled out. This is likely to be particularly the case in countries with stronger legal and political institutions, where planning procedures are more rigorous. The erection of the BRI's Batang Toru dam in Indonesia, for example, has led to fierce local resistance from local NGOs, as it endangers a critically rare species of orangutan threatened with extinction (Wilson, 2019). Similarly, Indonesia's flagship BRI project, a $6 billion high-speed rail project linking Jakarta with Bandung (140km away), has run into chronic delays and controversies partly over land acquisition disputes (Wilson, 2019). In Kenya, the construction of a $2 billion coal-fired

[6] President Obama came into office on the promise of a massive infrastructure programme. This programme ultimately was a let-down and failed, however, owing to the challenges of finding viable 'ready to go' projects.

power station in close proximity to the World Heritage site of Lamu, envisages creation of the largest power plant in east Africa. According to the Chinese backer it will 'solve the power shortage for millions in the region' (Wilson, 2019: 1). However, recent court rulings have halted the development on environmental grounds, fearing the massive coal-powered station will destroy the pristine natural environment of the region (Wilson, 2019).

These infrastructure projects, moreover, require very large, long-term investments and thus commitments by governments to take on significant long-term debt. In some instances, owing partly to poor project appraisal it has been suggested, these have turned out to be unserviceable. Examples include multi-billion dollar deep sea ports in Malaysia, Myanmar and Sri Lanka (Crabtree, 2019). Negotiating these very large infrastructure deals, however, may be more easily undertaken in the context of regimes that are less accountable to democratic processes and therefore sudden removal. Parente et al. (2019), for example, outline in detail the important impacts of regime stability on the commitment to FDI projects of Chinese MNEs in the Democratic Republic of Congo. These factors may also lead to the positive moderation impact of institutional fragility that we observe, specifically with regards to accountability.

Many Chinese infrastructure-based foreign investments involve projects in which domestic governments have attempted to push through infrastructure developments and related FDI projects with the help of Chinese financial largesse combined with construction expertise. However, many have been, to a greater or lesser degree, frustrated by legal and other political pressures, largely driven by NGOs and other civil society groups. These examples illustrate why BRI countries with weaker legal systems and less accountability may actually suit Chinese BRI related FDI projects. Such projects can be more easily initiated and completed in countries with less governmental accountability (in part related to democratic institutions, freedom of press, media and internet) and weak legal

systems (which otherwise would block heavy handed governmental interference, as in the case of the coal-fired power station in Lamu, Kenya). Powerful institutional forces, therefore, may lead countries with weak legal redress and limited accountability to be first in line to receive Chinese BRI related projects. Ample financing exists, of course, for Chinese projects in BRI partner countries. The challenge many Chinese construction groups face is in finding feasible projects.

Arguments related to speed of infrastructure development initiation are also supported by consideration of the BRI's multifarious objectives. One of these is the creation of new markets for export of Chinese surplus capacity. Implementation of infrastructure development overseas creates immediate markets for Chinese products, such as iron and steel, cement, chemicals and a host of other building materials (glass, tiles, porcelain, gypsum, etc.) as well as manufactured products like machinery and equipment (cranes, bulldozers, tunnel boring equipment, etc.). Clearly, BRI related policy-making, and those tasked in undertaking BRI projects, may opt for and emphasize projects that can be implemented quickly with a relatively fast turn-around. Again, speed of project initiation may be faster in less democratic countries where rule of law and accountability is weaker.

Chinese FDI projects related to BRI are often tied to Chinese soft loans and aid giving. The very significant sums of money invested creates ample opportunities for rent seeking and corruption – and in turn for insiders to privately benefit from these development projects (i.e. Queensway in Angola) (Burgis, 2014). Such windfall opportunities (for the executives involved) may again be more easily exploited in less accountable societies where rule of law is weaker and there is less public scrutiny (via, for example, an independent media). Executives, in other words, may be attracted to these types of environments when appraising projects. Recently the central inspection team of the Chinese Communist Party has assigned members to work with firms undertaking FDI in BRI countries, aware of the growth in large-scale corruption that foreign markets provide for Chinese

executives - who face much tougher scrutiny at home (Weinland, 2019). The aforementioned case of Queensway Group in Angola very much supports the argument that insiders, including senior Chinese executives and politicians embedded in SOEs (Queensway's investments were linked to Sinopec, whose chief executive was later charged with corruption), have much to gain personally (in terms of private wealth) by working in such environments (Burgis, 2014). In short, these factors, when combined, may potentially explain why the BRI policy amplifies the impact of institutional fragility on Chinese FDI.

These findings, of course, can be interpreted in both positive and negative lights. On the one hand, for example, they can be interpreted to suggest China's BRI policy is supporting, intentionally or otherwise, unaccountable and less democratic regimes where legal systems are weak – so undermining political rights of citizens in the BRI countries. From another, more positive perspective, they can be interpreted to show that the BRI policy may help in lowering or mitigating the potential liabilities of foreignness and challenges associated with working in what may be institutionally fragile and difficult business environments, often low income less developed countries. In this sense, the BRI policy can be interpreted as having more positive impacts on the potential economic development of the BRI countries it targets.[7]

SEZs and the impact of a fuller package of BRI supports

As noted, SEZs are also considered an integral element and lie 'at the heart of the BRI' (Fei, 2017: 840). BRI and SEZs are being jointly leveraged as investment platforms for CMNEs (Fei, 2017). Firstly, our findings show that SEZs are significantly associated with increased Chinese FDI. This suggests SEZs may provide islands of stability in fragile institutional environments. They may, for

[7] Albeit we have little way of evaluating what kind of value for money the BRI offers

example, potentially lower the liabilities of foreignness that CMNEs face – one of their intended purposes.

We hypothesized that engagement with the SEZ policy would signal stronger commitment to the BRI policy, and in turn may foster stronger state to state relationships between China and the host country. SEZs, moreover, may also directly leverage the bargaining power of Chinese businesses vis-à-vis the host country, providing additional support to them in negotiating favorable policies – thus attracting greater investment. Within institutionally weak regimes scope for preferential policy negotiation may also be greater (i.e. normal rules may be bent) – thus further amplifying the impact of institutional fragility on FDI. In countries like Egypt, for example, which created the Suez special economic zone, highly preferential policies have been negotiated for members of the Chinese zone (approved via a presidential decree). These policies included: no tariffs or taxes of any kind or permits and other restrictions on imports of raw materials and capital equipment (allowing the Suez SEZ to act as a Chinese import/export processing trade hub); granting of its own customs and taxation administration system; prohibition of the nationalization of zone assets or asset sequestration; simplified labor and employment laws; and minimal taxes on goods which are exported (El-Gohari & Sutherland, 2010; El-Rashidy, 2016). These approved policies were 'greatly inspired' by regulations developed in China's domestic Shenzhen SEZ (El-Rashidy, 2016: 85). SEZs may amplify the potential for preferential policy negotiation in institutionally weak settings. More generally, SEZs when complemented with other favorable BRI policies (particularly financial supports) may potentially lower the liabilities of foreignness and other challenges faced by CMNEs in institutionally weak foreign settings. In line with our original hypothesis, we interpret this to suggest that adoption of SEZs and BRI in tandem implies a stronger overall commitment to the BRI leading to stronger overall moderation impacts.

One unexpected modeling result of interest was the finding that the SEZ*PRS interaction was negative and significant, albeit only weakly significant (at the 10% level) (Table 5). This suggests that investors in SEZs alone (i.e. not in conjunction with the BRI) behave in a more similar way to MNE investors from developed markets. Namely, they do care about institutional fragility. To further explore this interesting result, we further decomposed our sample by ownership to explore whether the role of China's private sector may be playing a stronger role in this outcome. Recall that SEZs were originally developed in China to attract private investments and businesses more strongly driven by market forces. This is also the case for overseas SEZs: while some zones were developed with state-owned businesses in mind (the Chambishi zone in Zambia, for example), even these zones were designed to include strong private sector participation. In contrast to infrastructure development, therefore, SEZs have a stronger focus on private sector investments. The private sector is arguably more affected by institutional fragility and the economic and political risks this engenders (because it does not have the immediate and direct backing of government). In China, private entrepreneurs can be disposed of when they no longer serve a political purpose or serve the "wrong" purpose (Zhang et al., 2014). Thus, private entrepreneurs are arguably not as "protected" as state enterprises and are may be more exposed to adverse political and social actions in the host market. Decomposing our sample by state and private ownership in additional supplementary analysis (see appendices), our results did suggest that it was privately owned firms driving this observed, albeit weak, negatively significant interaction.

The BRI appears to be exporting components of the Chinese development model – in line with the general ideas associated with the widely debated Beijing consensus. While some aspects of this model may be of concern when looked at from a Western, democratic liberal free-market perspectives (i.e. such as the Washington Consensus), not all aspects of the development model

associated with overseas SEZs are necessarily antithetical to them. In the SEZs there are more private sector focused initiatives and Chinese FDI in these cases may be associated with better institutional quality. This also points to a possible duality underlying China's BRI engagement which requires further investigation. Perhaps as the private sector grows in importance these impacts will intensify and the role of SEZs as a catalyst for greater private sector market oriented FDI activities will intensify, overturning the currently observed relationships.

CONCLUSION

Using the BRI and associated policies China is arguably diffusing aspects of its own development model and experience to other countries, particularly developing economies. The Chinese approach to development, however, may favor certain institutional configurations, including weak legal institutions and limited accountability. Whether by design or otherwise (i.e. simply by the play of market forces), our study shows the influence of BRI appears to have amplified the impacts of institutional fragility on promoting Chinese inward FDI to host countries. Looked at from a different angle, the BRI policy appears to be supporting the growth, and possible subsequent integration with, countries more similar to China itself – namely those that lack fully functioning legal systems and high levels of accountability. Viewed from the perspective of liberal, developed market democracies, this may appear as a worrisome trend. However, it is important to note that many of the countries that have received support from the BRI are exactly those that the West has often been unwilling to meaningfully engage with. Through Chinese-led policies, such as the BRI, the economic development of these very same countries may be promoted. At one level, this may not bode well for the future of a liberal democratic world order (as envisioned, for example, in the original post second world war Marshall Plan). The geopolitical vision Chinese leaders have in mind today,

arguably, is one in which Western legal, political and economic institutions might be supplanted by alternatives more akin to those found in China itself. Our findings show that Beijing, deliberately or otherwise, appears to be promoting less accountable and more autocratic governments not subject to inconvenient legal rulings.

Policy Implications

The Chinese development model the BRI currently promotes involves the downplaying of individual human rights and emphasizing, above all else, the paramount gains of economic development. Further, it seems the BRI has enhanced the potential for CMNEs to engage in corruption. The Chinese government will do well to extend their hard line on domestic corruption to the international arena. While there may be downsides in terms of political freedoms, there may, as mentioned, also be considerable upsides in terms of economic development, including poverty reduction. Without Chinese growth, for example, the world would never have gotten anywhere near meeting many of the United Nation's eight Millennium Development Goals. Chinese (domestic) policies have lifted many millions of people out of poverty at home. Externally-focused policies, such as the BRI, may have the same poverty-alleviating impact abroad. Further, the BRI's goal of enhancing the volume of Chinese OFDI is working. It is possible the innovative developmental policies China has created is relevant to other countries – both developing and emerging.

Better understanding and acknowledging the impacts of China's growing global influence, whatever one's moral or ethical standpoint on it, is vitally important if Western policy-makers are to successfully engage in shaping the future international geopolitical landscape. International political relations between the US and China, for example, are nearing an all-time low as the US embarks upon an inward-looking phase. The European Union is struggling to successfully counter Chinese BRI

related influence in its own backyard. Better understanding the nature of the BRI policy, including its impacts on Chinese FDI and growing economic integration between China and other BRI member countries, may help inform high level policy making in the major developed market economies as we grow into a post-Washington consensus era of international political and economic engagement. The OECD led developed market economies, in particular, must further reflect on how best to engage with lower income emerging market economies in the face of an ever more assertive China.

Looked at from a host country perspective, our findings suggest countries that do engage with Chinese BRI policy can potentially attract higher levels of FDI and that this, in turn, could benefit their economies. Special economic zones, as a Chinese development tool, may also hold out considerable longer-term potential for the attraction of a wide variety of Chinese MNEs, particularly from the private sector. Future research would do well to explore the impacts of these zones specifically and the BRI more generally. While we have shown they do impact on FDI, better understanding other impacts, such as on employment, exports, domestic linkages between Chinese and host market firms, as well as economic growth and poverty reduction more generally, is required.

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Table 1: Variables, descriptions, and data sources.

Variable	Proxy	Data source
Chinese outward FDI	Value of Chinese FDI projects in host country	Financial Times fDi Markets; Thomson ONE
Country risk premium	Mature equity market premium plus additional country risk premium	Moody's; Bloomberg
Cultural proximity	Dummy variable where percentage of host country population is Chinese is 1% or greater = 1; zero otherwise	Ohio University
Geographic distance	Geographic distance from Beijing to the capital of the host country	CEPII/World Bank
GDP	Host country gross domestic product	World Bank
GDP growth	Gross domestic product growth	World Bank
Natural resource exports	Fuels, ores, and metals exports as a share of GDP	World Bank
Exchange rate	Host country annual average exchange rate against RMB (fixed to dollar)	World Bank
Inflation	Inflation rate	World Bank
Open to FDI	Inward FDI stock as a share of GDP	World Bank
Institutional fragility	Index based around the average of five institutional fragility factors: control of corruption; political stability; rule of law; regulatory quality; and government accountability	Political Risk Services Group
SEZ	Dummy variable where the host country has at least one nationally approved Chinese overseas special economic zone = 1; zero otherwise	China Ministry of Commerce
BRI	Dummy variable where host country has committed to at least one BRI project = 1; zero otherwise	China Ministry of Commerce
AIIB member	Dummy variable where AIIB member country = 1; zero otherwise	Asian Infrastructure Investment Bank
Bilateral trade agreement	Dummy variable where having a bilateral trade agreement between the host country and China = 1; zero otherwise	China Ministry of Commerce
Pct agree UN vote	Percentage of United Nations votes the same for the host country and China	United Nations

Table 2: Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
(1) FDI	1.00																				
(2) Corruption	-0.12*	1.00																			
(3) Political instability	0.04	0.02	1.00																		
(4) Legal fragility	-0.06	0.70*	0.11*	1.00																	
(5) Reg. fragility	-0.13*	0.79*	-0.08*	0.64*	1.00																
(6) Unaccountability	-0.04	0.53*	-0.30*	0.29*	0.57*	1.00															
(7) Risk premium	-0.12*	0.65*	0.11*	0.63*	0.61*	0.38*	1.00														
(8) Cult. proximity	0.15*	-0.05	-0.04	0.01	-0.15*	-0.00	-0.08*	1.00													
(9) Geo. distance	-0.06*	0.11*	0.07*	0.40*	0.17*	-0.10*	0.21*	-0.11*	1.00												
(10) GDP	0.44*	-0.25*	0.04	-0.19*	-0.31*	-0.22*	-0.25*	0.17*	-0.03	1.00											
(11) GDP growth	-0.02	0.16*	-0.18*	0.10*	0.19*	0.15*	0.13*	0.04	-0.07*	-0.07*	1.00										
(12) Natural resources	0.00	0.04	0.09*	0.07	0.13*	-0.02	0.07*	0.00	0.16*	-0.07*	0.07*	1.00									
(13) Exchng. rate	-0.00	0.11*	0.04	0.01	0.02	0.04	0.15*	-0.01	0.01	-0.01	-0.08*	0.02	1.00								
(14) Inflation	-0.01	0.13*	0.05	0.14*	0.13*	0.09*	0.17*	0.05	0.05	-0.06*	-0.05	0.05	0.12*	1.00							
(15) Open to FDI	-0.01	-0.19*	0.01	-0.16*	-0.21*	-0.14*	-0.09*	-0.03	0.09*	-0.04	-0.03	-0.02	-0.00	-0.04	1.00						
(16) AIIB member	0.19*	-0.01	0.01	-0.02	-0.01	0.12*	-0.01	0.13*	-0.20*	0.01	-0.01	-0.00	-0.00	-0.02	-0.01	1.00					
(17) Bilat. trade_agree	0.12*	-0.15*	0.08*	-0.08*	-0.16*	0.04	-0.14*	0.31*	-0.21*	-0.02	0.04	0.09*	-0.01	-0.03	-0.02	0.25*	1.00				
(18) PCT UN_vote	-0.15*	0.58*	-0.27*	0.49*	0.60*	0.61*	0.43*	-0.00	0.16*	-0.37*	0.20*	0.11*	0.02	0.05	-0.13*	-0.06*	0.04	1.00			
(19) BRI	0.11*	0.07*	0.08*	0.02	0.08*	0.11*	0.05	0.03	-0.24*	-0.02	-0.04	-0.04	-0.01	-0.03	-0.02	0.56*	0.13*	-0.13*	1.00		
(20) SEZ	0.13*	0.12*	0.15*	0.17*	0.14*	0.10*	0.07*	0.13*	-0.09*	0.03	-0.01	-0.04	-0.00	0.13*	-0.02	0.16*	0.18*	0.04	0.12*	1.00	
(21) Institutional frag.	-0.10*	0.89*	0.06	0.79*	0.89*	0.70*	0.71*	-0.06	0.20*	-0.29*	0.15*	0.08*	0.04	0.16*	-0.19*	0.02	-0.09*	0.65*	0.09*	0.17*	1.00
Mean	315.76	0.45	0.66	0.63	0.59	0.7	0.03	0.16	8931.94	331686.9	0.04	0.09	2840000	0.06	3.04	0.03	0.07	0.73	0.07	0.03	0.61
S.D.	1362.76	0.2	0.13	0.21	0.24	0.26	0.03	0.37	3851.52	1330000	0.06	0.15	1.38E+08	0.26	32.72	0.17	0.25	0.16	0.25	0.18	0.16

* shows significance at the 0.01 level

Table 3: Aggregated institutional fragility interacted with BRI and other policy measures.

	(1) FDI value	(2) FDI value	(3) FDI value	(4) FDI value	(5) FDI value	(6) FDI value	(7) FDI value	(8) FDI value	(9) FDI value
Country risk premium	-2705.26	-2773.37	-2108.73	-2124.86	-1615.76	-1625.48	-1349.12	-1082.94	-1525.86
	(3420.42)	(3414.01)	(3384.93)	(3385.09)	(3389.01)	(3397.21)	(3237.80)	(3241.31)	(3063.11)
Cultural proximity	253.89	259.72	216.11	213.06	207.00	204.85	360.69**	380.33**	226.65
	(189.68)	(189.20)	(186.24)	(186.76)	(186.56)	(187.38)	(168.72)	(168.93)	(158.77)
Geographic distance	-0.01	-0.00	-0.01	-0.01	-0.02	-0.02	-0.01	-0.01	0.01
	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
GDP	0.00***	0.00***	0.00***	0.00***	0.00***	0.00***	0.00***	0.00***	0.00***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
GDP growth	-116.15	165.93	-267.45	-284.93	-887.50	-898.90	-465.43	-445.42	475.74
	(1285.18)	(1290.55)	(1277.34)	(1280.13)	(1280.59)	(1281.58)	(1281.92)	(1281.57)	(1263.09)
Natural resource exports	914.74*	888.71*	804.62*	803.97*	756.10	748.83	791.09*	743.72*	542.43
	(485.41)	(484.37)	(477.30)	(477.07)	(474.65)	(476.84)	(439.28)	(439.85)	(406.32)
Exchange rate	0.05	0.05	0.04	0.04	0.03	0.04	0.05*	0.05*	0.04
	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)
Inflation	1315.40	1180.54	1232.83	1238.73	1091.77	1082.91	844.63	926.37	1294.95
	(985.22)	(985.83)	(978.96)	(979.53)	(985.09)	(986.18)	(956.99)	(958.69)	(934.24)
Open to FDI	282.97***	287.46***	276.55***	276.20***	278.72***	277.59***	121.23	114.83	69.55
	(75.63)	(75.50)	(74.77)	(74.78)	(74.71)	(74.97)	(78.53)	(78.57)	(74.52)
Institutional fragility	1123.45*	1019.65*	1137.39*	1148.49*	1329.73**	1382.90**	985.03	3250.34	469.03
	(610.19)	(610.84)	(600.32)	(602.45)	(593.08)	(604.57)	(618.53)	(2009.48)	(1922.76)
BRI	952.34***	-922.46							-1591.82
	(195.84)	(925.44)							(985.42)
BRI#Ins.fragility		4297.36**							5482.65**
		(2073.34)							(2311.50)
AIIB member			1441.59***	1619.67*					2468.74**
			(275.84)	(862.04)					(967.75)
AIIB member#Ins.frag				-428.33					-3970.06*
				(1966.20)					(2320.31)
Bilateral trade agreement					483.27**	701.06			149.63
					(202.37)	(500.83)			(497.97)
Bilat.trade agree#Ins.frag						-645.70			358.44
						(1351.06)			(1293.25)
Pct agree UN vote							-54.77	1264.01	792.10
							(492.86)	(1215.82)	(1141.76)
Pct agree UN vote#Ins.fr.								-3528.23	-584.46
								(2975.71)	(2820.98)
cons	-529.88**	-508.88*	-469.46*	-470.25*	-440.32*	-450.67*	-277.08	-1084.69	-777.73
	(263.07)	(262.58)	(257.44)	(257.36)	(253.71)	(255.37)	(336.43)	(760.39)	(709.60)
Obs.	1204	1204	1204	1204	1204	1204	1191	1191	1191
Pseudo R^2	.235	.238	.239	.244	.227	.227	.222	.2214	.z

Standard errors are in parenthesis (**** p<0.01, ** p<0.05, * p<0.1)*

Table 4: Institutional fragility decomposed and individually interacted with BRI.

	(1) fdi_all_val	(2) fdi_all_val	(3) fdi_all_val	(4) fdi_all_val	(5) fdi_all_val	(6) fdi_all_val	(7) fdi_all_val
Country risk premium	-2093.17	-2491.95	-2039.45	-1536.23	-2034.89	-2029.16	-795.70
	(3465.87)	(3463.23)	(3476.30)	(3293.07)	(3424.32)	(3473.58)	(3562.75)
Cultural proximity	229.46	235.83	232.23	235.44	226.62	223.31	189.35
	(245.89)	(243.30)	(247.65)	(243.83)	(243.61)	(248.18)	(197.59)
Geographic distance	-0.02	-0.02	-0.02	-0.01	-0.02	-0.02	-0.01
	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
GDP	0.00***	0.00***	0.00***	0.00***	0.00***	0.00***	0.00***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
GDP growth	333.45	509.06	243.94	184.16	289.28	494.27	221.25
	(961.45)	(968.97)	(967.75)	(930.20)	(962.33)	(1039.99)	(1351.95)
Natural resource exports	957.31*	915.63*	964.47*	943.47*	957.65*	946.21*	890.90*
	(515.84)	(515.38)	(517.59)	(513.94)	(517.18)	(516.78)	(501.46)
Exchange rate	0.04	0.04	0.04	0.03	0.04	0.04	0.03
	(0.04)	(0.04)	(0.04)	(0.03)	(0.04)	(0.04)	(0.03)
Inflation	1566.61	1382.61	1562.38	1512.55	1588.98	1541.84	1520.44
	(1534.07)	(1438.88)	(1550.18)	(1466.44)	(1524.45)	(1486.60)	(1052.84)
Open to FDI	261.94	268.52	266.07	272.70	260.64	259.52	262.21***
	(182.96)	(184.91)	(183.50)	(185.70)	(183.43)	(184.05)	(77.07)
BRI	868.64**	1691.65**	2180.07	3129.52**	769.57	1191.82	4917.92***
	(419.71)	(849.68)	(2081.70)	(1481.32)	(560.43)	(785.10)	(1901.72)
Corruption	-170.21*	-184.76**	-174.28*	-171.97*	-170.41*	-172.52*	-199.01**
	(91.47)	(91.31)	(90.79)	(91.03)	(90.98)	(92.49)	(98.60)
Political instability	58.05*	57.88*	55.01*	59.26*	57.91*	56.71*	50.89
	(32.76)	(32.81)	(31.74)	(32.51)	(32.53)	(33.13)	(38.75)
Legal fragility	181.16**	185.75**	256.45	146.13*	179.82**	184.20**	140.20
	(85.29)	(85.80)	(85.51)	(81.06)	(85.88)	(85.54)	(90.27)
Regulatory fragility	37.89	41.35	38.98	44.81	40.96	44.01	105.43
	(137.15)	(135.32)	(137.48)	(134.18)	(134.79)	(135.48)	(141.94)
Unaccountability	112.81**	115.90**	119.90**	123.84**	112.54**	101.11*	95.88
	(52.05)	(51.12)	(52.00)	(49.83)	(51.87)	(55.53)	(62.64)
BRI#corruption		341.02					438.63
		(369.21)					(458.76)
BRI#political Instability			256.45				155.27
			(308.36)				(261.17)
BRI#legal fragility				990.42**			938.64***
				(467.74)			(307.12)
BRI#regulatory fragil.					-45.79		-946.24**
					(459.25)		(392.71)
BRI#unaccountability						221.19	341.99**
						(185.73)	(167.30)
cons	1023.75*	1021.38*	1009.18*	933.44*	1023.37*	989.05*	799.28
	(557.50)	(559.76)	(554.60)	(559.23)	(556.49)	(577.05)	(504.11)
Obs.	1181	1181	1181	1181	1181	1181	1181
R^2	.241	.244	.242	.249	.241	.242	.254

Standard errors are in parenthesis
**** p<0.01, ** p<0.05, * p<0.1*

Table 5: Total FDI regressed on SEZs and BRI combined, including moderation.

	(1) FDI value	(2) FDI value	(3) FDI value	(4) FDI value
Country risk premium	-2950.22	-2969.02	-2912.78	-2507.80
	(3382.22)	(3384.62)	(3391.18)	(3305.28)
Cultural proximity	240.00	245.10	244.97	262.17
	(185.65)	(186.15)	(187.18)	(180.36)
Geographic distance	-0.00	-0.00	-0.00	-0.01
	(0.02)	(0.02)	(0.02)	(0.02)
GDP	0.00***	0.00***	0.00***	0.00***
	(0.00)	(0.00)	(0.00)	(0.00)
GDP growth	112.48	313.73	194.04	-572.14
	(1281.93)	(1287.37)	(1288.78)	(1270.66)
Natural resource exports	862.36*	847.69*	821.15*	900.00*
	(476.41)	(477.46)	(479.94)	(464.04)
Exchange rate	0.03	0.03	0.02	0.01
	(0.03)	(0.03)	(0.03)	(0.03)
Inflation	1332.25	1224.33	1369.37	1499.19
	(979.00)	(981.17)	(985.04)	(965.44)
Open to FDI	283.00***	286.56***	288.46***	289.91***
	(74.60)	(74.71)	(74.92)	(72.84)
SEZ	829.21***	754.58***	3876.72**	3251.08*
	(273.05)	(276.79)	(1865.32)	(1832.60)
BRI	862.55***	-597.41	-659.41	1345.01
	(197.52)	(930.86)	(930.93)	(964.93)
Institutional fragility	913.35	852.51	933.94	1135.06*
	(603.76)	(605.95)	(609.84)	(592.05)
BRI#Institutional fragility		3365.16	3501.24*	-2452.27
		(2096.67)	(2096.70)	(2252.83)
SEZ# Institutional fragility			-5998.08*	-6343.53*
			(3541.70)	(3475.59)
BRI#SEZ#Institutional fragility				7353.63***
				(1123.04)
cons	-487.11*	-475.80*	-505.40*	-487.21*
	(257.87)	(258.58)	(260.37)	(251.21)
Obs.	1204	1204	1204	1204
Bet/within R^2	.241	.245	.248	.275

Standard errors are in parenthesis
**** p<0.01, ** p<0.05, * p<0.1*

Appendix

Appendix A: SOE FDI, impacts of SEZs and BRI combined, including moderation.

	(1) fdi_soe_val	(2) fdi_soe_val	(3) fdi_soe_val	(4) fdi_soe_val
Country risk premium	-2172.60**	-2173.47**	-2173.40**	-2106.84**
	(908.95)	(910.79)	(913.07)	(905.15)
Cultural proximity	141.92***	142.97***	142.92***	144.63***
	(46.72)	(46.92)	(47.14)	(46.60)
Geographic distance	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)
GDP	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)
GDP growth	-598.40*	-562.65	-568.85	-697.43*
	(361.92)	(363.76)	(364.60)	(363.57)
Natural resource exports	158.33	156.15	155.28	171.04
	(122.05)	(122.51)	(123.11)	(121.86)
Exchange rate	0.02**	0.02**	0.02**	0.02**
	(0.01)	(0.01)	(0.01)	(0.01)
Inflation	129.76	108.54	116.11	145.18
	(272.50)	(273.50)	(275.14)	(273.23)
Open to FDI	15.92	16.53	16.62	16.80
	(19.82)	(19.87)	(19.93)	(19.75)
SEZ	75.25	62.03	212.23	105.61
	(76.43)	(77.58)	(525.56)	(522.62)
BRI	220.27***	-42.51	-45.48	307.90
	(56.40)	(264.64)	(264.99)	(277.60)
Institutional fragility	271.43*	260.35	263.95*	301.57*
	(157.48)	(158.33)	(159.31)	(158.01)
BRI# Ins.fragility		606.00	612.49	-437.24
		(596.25)	(597.01)	(648.20)
SEZ#Ins.fragility			-288.27	-363.78
			(997.83)	(991.12)
BRI#SEZ#Ins fragility				1305.32***
				(324.88)
cons	-37.74	-35.55	-36.82	-35.48
	(65.41)	(65.70)	(66.11)	(65.38)
Obs.	1204	1204	1204	1204
Pseudo R^2	.063	.0639	.064	.077

Standard errors are in parenthesis
*** *p<0.01*, ** *p<0.05*, * *p<0.1*

Appendix B: Private FDI value, impacts of SEZs and BRI combined, including moderation.

	(1) fdi_private_val	(2) fdi_private_val	(3) fdi_private_val	(4) fdi_private_val
Country risk premium	85.58	116.31	37.10	125.29
	(1271.06)	(1267.70)	(1266.10)	(1222.21)
Cultural proximity	27.92	33.12	31.97	35.26
	(58.23)	(58.11)	(58.01)	(56.00)
Geographic distance	0.00	0.00	0.00	-0.00
	(0.01)	(0.01)	(0.01)	(0.01)
GDP	0.00***	0.00***	0.00***	0.00***
	(0.00)	(0.00)	(0.00)	(0.00)
GDP growth	468.95	622.48	547.36	146.62
	(571.41)	(572.66)	(572.70)	(554.49)
Natural resource exports	24.11	12.84	-6.42	61.21
	(157.75)	(157.38)	(157.36)	(152.07)
Exchange rate	0.01	0.01	0.00	-0.00
	(0.01)	(0.01)	(0.01)	(0.01)
Inflation	1014.55**	904.64**	1020.24**	1182.88***
	(415.37)	(416.22)	(418.75)	(404.60)
Open to FDI	17.87	20.76	22.26	21.39
	(27.54)	(27.48)	(27.45)	(26.49)
SEZ	741.92***	685.35***	2486.33***	2112.39***
	(117.71)	(119.23)	(816.76)	(789.44)
BRI	471.80***	-650.58	-690.47	571.84
	(92.01)	(422.59)	(422.27)	(429.26)
Institutional fragility	-200.79	-249.66	-213.05	-76.55
	(210.42)	(210.62)	(210.91)	(204.12)
BRI#Institutional fragility		2593.66***	2679.91***	-1082.59
		(953.23)	(952.43)	(1003.09)
SEZ#Institutional fragility			-3456.21**	-3821.02**
			(1550.70)	(1497.41)
BRI#SEZ#Institutional fragility				4815.40***
				(513.36)
cons	-24.91	-15.28	-27.99	-24.74
	(82.88)	(82.73)	(82.79)	(79.92)
Obs.	1204	1204	1204	1204
Pseudo R^2	.118	.0123	.1267	.187

Standard errors are in parenthesis
*** *p<0.01*, ** *p<0.05*, * *p<0.1*