What Determines Chinese Outward Foreign Direct Investment: An Empirical Research

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By

Qiaoli Yu

Claremont Graduate University

2019

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APPROVAL OF THE DISSERTATION COMMITTEE

This dissertation has been duly read, reviewed, and critiqued by the Committee listed below, which hereby approves the manuscript of Qiaoli Yu as fulfilling the scope and quality requirements for meriting the degree of Doctor of Philosophy in Economics and Political Science.

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Abstract

What Determines Chinese Outward Foreign Direct Investment:

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Qiaoli Yu

Claremont Graduate University: 2019

The rise of Chinese multinational enterprises (CMNEs) and the growth of Chinese outward foreign direct investment (OFDI) have been two important trends in the world economy. This dissertation aims to deliver a complete picture of Chinese OFDI by investigating what determines Chinese OFDI. Based on a perspective of international political economy, we use a multilevel framework which includes country level, industry level, and firm level to demonstrate a reciprocal relationship between the Chinese government’s political benefits and CMNEs’ economic benefits. The Chinese government plays the role of an organizer in this relationship to guarantee its political benefits and enlarge CMNEs’ economic benefits. We argue that taking advantage of such a reciprocal relationship and the role played by the Chinese government is an important motivation for Chinese OFDI. We generalize seven situations in which CMNEs’ OFDI could benefit from the reciprocal relationship and the role of the Chinese government. These situations include: CMNEs make OFDI in countries that are friendly to the Chinese government; CMNEs make OFDI in countries that have more Chinese contracted projects; CMNEs make OFDI in countries that have
more Chinese OFDI stock; CMNEs make OFDI in countries that are suitable for production transfer; CMNEs make OFDI in countries that are good at technology development; CMNEs make OFDI in countries that are politically stable; and CMNEs make OFDI in countries that have difficulty in debt repayment. According to these situations, we derive seven hypotheses to test to what extent CMNEs take advantage of their reciprocal relationships with the Chinese government and the role of an organizer played by the Chinese government. A dataset consisting of 175 countries from 2003 to 2016 and regression models are used to test these hypotheses. We find that Chinese OFDI is more attracted to countries with a higher level of partnership with China, more Chinese contracted projects, more Chinese OFDI stock, and more advanced technologies. We have determined that Chinese OFDI uses different strategies in different groups of countries. Chinese OFDI is more likely to go to countries with the combination of higher manufacturing capacities and lower labor costs among OECD countries and developed countries. Chinese OFDI is more likely to go to countries with more natural resources among middle-income and low-income countries. We do not find evidence of Chinese OFDI’s preference for countries with higher political stability and higher debt levels. In general, our findings give some support to our argument that CMNEs take advantage of their reciprocal relationship with the Chinese government and the role of an organizer played by the Chinese government.
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CHAPTER 1

INTRODUCTION

Chinese outward foreign direct investment (OFDI) has been being discussed frequently in different contexts. For example, the concerns on Chinese OFDI have been expressed by foreign government officials for security reasons and by non-governmental organizations for environmental reasons. Besides that, Chinese OFDI has attracted attention from academia. It is regarded as a stimulus within the field of international business (IB) because the novel phenomenon of Chinese OFDI could be the source of new theories (Clegg & Voss, 2018). It is also demonstrated as an approach for China to pursue desired assets and advantages and thus promote domestic economic growth (Knoerich, 2017). As the volume of Chinese OFDI keeps rising, the popularity of the discussions on Chinese OFDI will continue.

The Chinese government has been trying to take advantages of OFDI to enlarge China’s global influence and upgrade domestic industries. For example, Chinese OFDI in infrastructure and the subsequent operation of infrastructure in host countries, which not only improve the living quality of local people but also generate considerable amount of jobs, make China more and more popular among the countries from the African Union, the Association of Southeast Asian Nations and the Latin American Integration Association. Besides that, OFDI in manufacturing allows China to transfer production and corporate acquisition enables China to collect desirable technologies efficiently. To guarantee and increase the benefits from OFDI, the Chinese government has been continuously adjusting and clarifying its OFDI related strategies and policies based on the international circumstance and domestic situation. These strategies and policies could be either obstacles or assists to CMNEs’ OFDI activity. It would be shortsighted for the Chinese government if CMNEs are simply used as tools to achieve its own goals. In the long term, the
Chinese government will have accesses to more powerful and dependable tools if CMNEs can achieve sustainable development.

Despite their great growth in terms of the volume of OFDI, CMNEs have drawn criticisms that their revenue mostly comes from the domestic market (Alon, Wang, Shen & Zhang, 2014) and the home country is the primary source of their competitiveness where they could take advantages of low labor costs and environment standard (Buckley & Hashai, 2014; Hashai & Buckley, 2014). Rugman and Li (2007) predict that CMNEs are very likely to be regional rather than global because CMNEs fail to develop the strong firm-specific advantages such as the advanced technology and management found in the multinational enterprises from developed countries (DMNEs). As time goes on, the domestic market for CMNEs becomes saturated and the domestic labor cost rises. Whether CMNEs can really go global is going to be an unavoidable question if they want to pursue further development or maintain rapid growth. Although the answer to this question has remained unclear, the Chinese government’s involvement in Chinese OFDI must be an indispensable part in the answer because of the huge influence of the Chinese government on CMNEs. The traditional supports from home country governments such as subsidies and concessional loans had helped CMNEs survive in the international competition. New form of government support is highly needed if the Chinese government intends to promote the internationalization further.

In recent years, the Chinese government has announced the Belt and Road Initiative and Made in China 2025. CMNEs have been accused of eroding labor standards and damaging the environment in host countries for a long time. These OFDI-related grand plans raise further worries about Chinese OFDI. The worries are mainly reflected in the issue of debt trap and technology acquisition. It is imperative for the host countries of Chinese OFDI to investigate whether these
worries are based on facts or simply anti-China propaganda. The opportunity for economic development should be undesirable at the cost of national sovereignty and security.

More than a decade ago, the most influential research on Chinese OFDI was conducted by Buckley (2007). He successfully figured out several determinants of Chinese OFDI but failed to explain well his finding that Chinese OFDI prefers the countries with lower political stability. Low political stability is always associated with policy instability and violent riots, which could greatly hurt business operation. His attributing CMNEs’ unexpected preference to CMNEs’ low capital cost and China’s political culture turns to be farfetched. It is not easy for CMNEs to borrow in domestic financial market as before and the relationship between central planning and market mechanism has been rebalanced in China. CMNEs’ operation is being more and more like western MNEs’ operation. Recently, he has admitted that he cannot find other research that makes huge progress on the topic of Chinese OFDI (Buckley, 2018). The lack of a milestone on China’s OFDI does not imply that there are no scholars working on it. Instead, dozens of scholars from different parts of the world have been exploring Chinese OFDI in recent years. On one hand, each of their studies only focuses on one or some aspects of Chinese OFDI and thus is too parochial to depict the whole profile of Chinese OFDI. On the other hand, these studies provide clues and insights which are indispensable and instructive pieces to the puzzle of Chinese OFDI. Comprehensive research seems highly desirable if it can organize existing literature well and demonstrate more features of Chinese OFDI.

This dissertation aims to provide a comprehensive and profound understanding of Chinese OFDI. A rare but highly anticipated multilevel framework is adopted (Alon, Child, Li and McIntyre, 2011; Deng, 2012; Deng, 2013; Lattemann, Alon, Spigarelli and Marinova; 2017). Such a framework not only helps demonstrate the institutional effect of the Chinese government on
CMNEs’ OFDI decisions from top to bottom but also provides national level determinants with more microfoundations. Referring to the determinants of Chinese OFDI figured out by Buckley (2007), we try to find some new determinants of Chinese OFDI based on the reciprocal relationship between the Chinese government and CMNEs and the role of an organizer played by the Chinese government. From a perspective of international political economy, we generalize and analyze several situations in which such relationship and role could affect Chinese OFDI. Our findings support that the CMNEs take advantages of home country government in OFDI activity. Furthermore, this dissertation includes the two frequently discussed issues of debt trap and technology acquisition and gives some implications on both of them.

The next chapter is a literature review on Chinese OFDI. It covers conventional OFDI theories, OFDI theories focusing on emerging markets and China and the perspectives of international political economy which could be applied to the analysis of Chinese OFDI. Chapter 4 conducts a multilevel analysis of Chinese OFDI. China’s OFDI related national strategy and industrial policy are discussed respectively at the national level and the industry level. At the firm level, we investigate the entry model and form of OFDI adopted by CMNEs. After that, we derived ten hypotheses of Chinese OFDI based on the multilevel analysis rather than conventional OFDI theories. Chapter 5 tests these hypotheses after introducing the method to test them. Chapter 6 is the conclusion of this dissertation.
CHAPTER 2
LITERATURE REVIEW

2.1 Conventional OFDI Theories

At the very beginning, international business (IB) scholars put forward OFDI theories based on their observation on the internationalization of multinational enterprises from developed countries (DMNEs). The Uppsala model (Johanson & Vahlne, 1977) which describes internationalization process and the eclectic paradigm (Dunning, 1977, Dunning, 1979; Dunning, 1980) which points out three decisive advantages in the internationalization of multinational enterprises (MNEs) are the two forerunners of OFDI theories. In the Uppsala model, MNEs continuously learn experimental and market-specific knowledge in foreign markets and adjust their commitments there based on their learning results about foreign markets. It takes time and efforts for MNEs to understand the preference and demand of the foreign consumers who grow up in a different cultural environment. MNEs may choose to give up a foreign market after some tentative measures to enter this foreign market fails or formally enter this foreign market if these measures work well. The Uppsala model is still believed to be active (Johanson & Vahlne, 2009). In the eclectic paradigm, MNEs’ OFDI is dependent on the ownership advantages and internalization advantages of themselves and the location advantages provided by target foreign markets. Ownership advantages are the sources of MNEs’ competitiveness in foreign markets, which include patents, management, reputation, etc. Sending out an internal well-trained sales team could be even more beneficial and dependable than hiring a local agency in an overseas market. Internalization advantages are the potential benefits of expanding business within the enterprises. For example, setting up their own branches could help MNEs reduce management costs by avoiding intercultural communication difficulties and setting up their own factories could protect
MNEs from the technology leaks. Location advantages are the advantages available to MNEs in a specific country or region. MNEs seeking overseas production could prefer locations with lower labor cost, lower transportation cost and larger market potential. MNEs seeking research capacity could prefer the locations with clusters of top universities and other scientific institutions. In addition, appropriate location choice could help CMNEs reduce the expenditure on tariff and tax. The more advantages MNEs could exploit from an OFDI project, the more likely it is that this project will be carried out. Dunning kept updating the eclectic paradigm (Dunning, 1988; Dunning, 1992; Dunning, 1995; Dunning, 2000; Dunning, 2001) and made it a most influential theory among OFDI theories.

Based on the Uppsala model and the eclectic paradigm, IB scholars try to explore OFDI theory from different perspectives. These perspectives include a resource-based perspective (Peng, 2001; Barney, Wright & Ketchen, 2001), an institutional perspective (Eden, 2004; Marinova, Child & Marinov; 2012), a global system perspective (Buckley & Hashai, 2004), an evolutionary perspective (Cantwell, Dunning & Lundan, 2010) and a capability-based perspective (Zhang, Tansuhaj & McCullough, 2009; Holburn & Zelner, 2010; Teece, 2014). Respectively, these perspectives make emphases on the resource-seeking motivation of MNEs, the effect of institution on MNEs, the introduction of formal model to internationalization theories, the co-evolution of MNEs and exterior institutional environment and the capacity of MNEs to deal with internationalization.

Overall, conventional OFDI theories give us some basic ideas about the process and the motivations of MNEs’ OFDI. MNEs’ decisions on OFDI need to be cautious. Even without setting up new branches or factories in foreign markets, MNEs could make decent profits through international trade or licensing from these markets. New overseas branches or factories cannot
guarantee an increase in profits. Investigations on foreign markets are carefully conducted by most MNEs before they decide to make more commitments in foreign markets by OFDI. Furthermore, there are various reasons for MNEs participate in the international competition by OFDI rather than international trade and licensing. All the three kinds of advantages in the eclectic paradigm motivate MNEs to expand abroad by OFDI. Compared with international trade and licensing, OFDI not only provides MNEs with the opportunity to expand international market directly but also gives MNEs more accesses to international resources. As to those perspectives applied to the research on OFDI, they have their own focuses and are great supplements to the Uppsala model and eclectic paradigm.

2.2 OFDI Theories Focusing on Emerging Markets

The increasing participation of MNEs from emerging countries (EMNEs) in the international market challenged the conventional OFDI theories above. According to conventional OFDI theories, EMNEs should be much less motivated to make OFDI than DMNEs because they are much less likely to exploit the three advantages of OFDI. Compared with EMNEs, DMNEs seem unrivaled in every aspect, except the access to cheap labor. However, the access to skilled labor could matter more to DMNEs than the access to cheap labor.

Although the fundamental difference between DMNEs and EMNEs in the exploitation of the three advantages is commonly accepted (Cuervo-Cazurra & Genc, 2008; Rugman, 2009; Peng, 2012; Ramamurti, 2012; Hashai & Buckley, 2014; Williamson, 2015; Williamson & Wan, 2018), there emerged a dispute on whether new paradigms are needed to explain the phenomenon of EMNEs (Hernandez & Guillén, 2018). On one hand, some scholars (Verbeke & Kano, 2015; Buckley, 2018) deny the necessity of new paradigms to investigate the internationalization of EMNEs. Institutional perspective has been popular among the scholars who want to investigate
the effect of home country on EMNEs’ OFDI (Hoskisson, Eden, Lau & Wright, 2000; Peng, Wang & Jiang, 2008; He, Xie & Zhu, 2015; Huang, Ye, Zhou & Jin, 2017; Buckley, Clegg, Voss & Chen, 2018). As its name suggests, the institutional perspective is a perspective in which scholars use either formal institutions such as governmental behavior or informal institutions such as social custom to explain MNEs’ OFDI. The institutional perspective seems customized for addressing the effect of active government involvement and the serious market imperfectness on EMNEs’ OFDI. For example, demanding bribes for export quotas could motivate EMNEs to produce in foreign countries. As to other perspectives mentioned in the last paragraph, they also are applied to EMNEs (Hoskisson, Eden, Lau & Wright, 2000; Mathews, 2002a). On the other hand, new models that emphasize the role of learning in the process of internationalization have been developed for EMNEs (Mathews, 2002b; Mathews, 2006; Mathews, 2017; Lu, Ma, Taksa & Wang, 2017). In addition, several new perspectives that treat EMNEs as latecomers to the international market enrich the literature on EMNEs, such as the exploration perspective (Park & Xiao, 2017), the springboard perspective (Luo & Tung, 2007), and the ambidexterity perspective (Luo & Rui, 2009). EMNEs are still “paying tuition” to accumulate the experience of how to internationalize from these three perspectives.

To sum up, there is a consensus on the existence of the huge difference between DMNEs and EMNEs but there is not a consensus on whether the difference requires new models and perspectives. On one hand, conventional OFDI theories are comprehensively applied to explain the phenomenon of EMNEs. On the other hand, new models and perspectives demonstrate that EMNEs try to secure an opportunity for close observation on and firsthand experience of the international market. As latecomers, EMNEs do not hurry to take radical steps but prefer to wait
and see. These new models and perspectives that emphasize the role of learning in new markets are not consistent with the eclectic paradigm but consistent with the earlier Uppsala model.

2.3 OFDI Theories Focusing on China

In recent years, compared with other EMNEs, CMNEs has been outstanding in performance and growth and thus attracted extra attention. Not surprisingly, institutional perspective is the most popular perspective to investigate Chinese OFDI because of the uniqueness of China’s autocratic institution and the unexpected economic achievements with such institution. China’s political system is said to force Chinese investors to escape from it and thus negatively promote Chinese OFDI (Boisot & Meyer, 2008; Shi, Sun, Yan & Zhu, 2017). At the same time, China’s political system is more often demonstrated as a positive supporter and promoter for Chinese OFDI (Voss, Buckley & Cross, 2009; Luo, Xue & Han, 2010; Yan, Hong & Ren, 2010; Gallagher & Irwin, 2014; Duanmu, 2014; Yang & Stoltenberg, 2014; Pei & Zheng, 2015; Hillemann & Ramamurti, 2018; Holtbrügge & Berning, 2018; Torres de Oliveira & Rottig, 2018). In addition to the effect of home country institutions on China’s OFDI, institutional perspective allows scholars to consider the effect of host country institutions on China’s OFDI. The effect of host country institutions on China’s OFDI varies across countries. OFDI in developed countries is more challenging for CMNEs than that in other countries because of the stricter regulation from developed country governments and the smaller role played by the Chinese government in more mature markets (Cui, Jiang & Stening, 2011; Child & Marinova, 2014; Deng, Yang, Wang & Doyle; 2017).

Furthermore, scholars have begun to distinguish between state-owned CMNEs and private CMNEs in their research (Lu, Liu & Wang, 2011; Cui & Jiang, 2012; Liang, Lu & Wang, 2012; Duanmu, 2012; Ramasamy, Yeung & Laforet, 2012; Huang & Chi, 2014; Alon, Wang, Shen & Zhang, 2014). From an institutional perspective, it is not difficult to speculate that these two types
of CMNEs are affected differently by China’s institutions. Stated-owned CMNEs are confirmed to have more access to loans than private CMNEs (Gallagher & Irwin, 2014) and more protections from political involvement by the Chinese government (Duanmu, 2014). The size and the location of CMNEs are also used to distinguish CMNEs, but less common than the ownership of them (Huang & Chi, 2014; Voss, Buckley & Cross, 2014).

Giving a priority to the institutional perspective, the literature on Chinese OFDI has covered several topics. In their recently released review article, Alon, Anderson, Munim & Ho (2018) generalize four of these topics: testing conventional OFDI theories, the drivers and motivations of OFDI, entry mode choice, and location choice. Besides that, topics such as the performance of Chinese OFDI (Deng, 2010; Zhong, Peng & Liu, 2013; Lyles, Li & Yan, 2015), the networking of CMNEs (Peng and Luo, 2000; Chen, 2017; Hertenstein, Sutherland & Anderson, 2017), and the challenges faced by CMNEs (Rugman & Li, 2007; Lynch & Jin, 2016) also are covered. The last topic to be mentioned is the spillover effect of Chinese OFDI. Chinese OFDI has been found to increase domestic productivity (Knoerich, 2014; Li, Li, Lyles & Liu, 2016). It remains unclear whether Chinese OFDI promotes China’s exports (Lin, 2016; Lu, Lu, Zeng & Li, 2018). Chinese OFDI is well connected with economic cooperation in Africa (Sanfilippo, 2010) and regarded as a threat to national security and global norms among western countries (Rosen & Thilo, 2009; Globerman & Shapiro, 2009; Rugman, Nguyen & Wei, 2014). This research on the spillover effect of Chinese OFDI puts Chinese OFDI into a global context.

Compared with the literature on Chinese OFDI at the firm level, those at the industry level or country level are scarce. Nolan (2014) discusses industrial policies made by the Chinese government, which are supposed to promote the development of CMNEs. Panel data covering different periods of time are used by several groups of scholars in their literature at the country
<table>
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<th>Paper</th>
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Table 1. The Main Results from Existing Studies
level to figure out the determinants of Chinese OFDI (See Table 1, Buckley et al., 2007; Cheung & Qian; 2008, Duanmu & Guney, 2009; Huang and Wang, 2011; Zhang & Daly, 2011; Kolstad & Wiig, 2012; Zhang, Jiang & Zhou, 2014; Liu, Tang, Chen & Poznanska, 2017). The determinants of Chinese OFDI are tested in the pathbreaking and influential research lead by Buckley, among which the absolute market size in the host country, cultural proxy to China, the inflation rate in the host country, the natural resources endowment of host countries, the volume of exports from China, the volume of imports to China, and the open policy adopted in 1992 were found to be significantly positive to Chinese OFDI and political stability is significantly negative (Buckley et al., 2007). Most of these findings are consistent with what he expects based on conventional OFDI theories and more or less supported by later literature, except for the finding of political stability. In later literature, political stability is irrelevant to Chinese OFDI. (Cheung & Qian; 2008; Kolstad & Wiig, 2012; Zhang et al., 2014; Liu et al., 2017). The evolution of China’s institutions and CMNEs may explain to some extent why the results acquired by these groups of scholars are inconsistent (Buckley et al., 2007; Marinova, Child & Marinov, 2011), but it is essential to clarify such evolution itself through checking traditional determinants and searching for new determinants. Wang, Hong, Kafouros and Boateng (2012) provide us with the only multilevel literature on Chinese OFDI, but do not connect any two of the three levels well. The scarcity of literature on Chinese OFDI at the industrial level and the country level has impeded the development of the multilevel analysis of Chinese OFDI, which is seen as a more ideal framework than any single-level analysis (Alon, Child, Li and McIntyre, 2011; Deng, 2012; Deng, 2013; Lattemann, Alon, Spigarelli and Marinova; 2017).

To conclude, IB scholars have produced a large number of literature related to Chinese OFDI which are mostly at the firm level and cover almost all the important facets of Chinese OFDI.
However, these literatures are too fragmented to deliver a whole picture of Chinese OFDI. The few national level literatures with panel data have mixed results and their data are out of date. More national level and industry level literatures will be helpful in presenting a more complete status of Chinese OFDI, especially those can take advantages of the existing firm-level literatures as their microfoundations. The huge influence of the Chinese government on CMNEs makes the institutional perspective commonly adopted. However, without a multilevel framework, we can only discuss the effect of specific and partial political institution on China’s OFDI. There has not any significant top-down analysis on Chinese OFDI.

2.4 Perspectives of International Political Economy

Scholars in the field of international political economy (IPE) paid some attention to the global activities of MNEs but this attention did not last long. To call for the reconsideration of MNEs within the field of IPE, Eden (1991) discussed the enlightening contributions made by IPE scholars. These contributions include product life cycle (Vernon, 1966), sovereignty at bay (Vernon, 1971; Vernon, 1981), obsolescing bargain (Vernon, 1971; Vernon, 1977), the law of uneven development (Hymer, 1972), and the international division of labor (Hymer, 1972, Hymer, 1979). Developing countries and MNEs from developing countries seem doomed to be suppressed by developed countries and DMNEs in terms of the benefit distribution in the global market. In the same year, Strange (1991) added a reason for IPE scholars to study the activities of MNEs: the rise of MNEs and the fall of states had changed the relative power balance between MNEs and states and enabled MNEs to play a larger role in the global stage. What’s more, Strange (1992) emphasized the interdependence of state-state bargaining, state-firm bargaining, and firm-firm bargaining; she pointed out that more attention should be paid to state-firm bargaining and firm-firm bargaining.
It took a long time for IPE scholars to recognize comprehensively the rising status of MNEs in global governance and to demonstrate the power of MNEs (Fuchs, 2005; Fuchs, 2007, Fuchs, 2013). Finally, Mikler (2018) makes a leap when he analyzed MNEs as political actors in the context of international political economy. It has been commonly perceived that host countries benefit from MNEs’ OFDI in terms of capital, productivity, and employment. However, we need to pay more attention to how home country governments achieve their political goals with help from domestic MNEs and how MNEs achieve their economic goals through participating in political activities.

IPE scholars have not done much work exclusively related to OFDI, but IPE scholars give us some clues about how to put Chinese OFDI into a global context. Firstly, the theory of second image reversed points out that international circumstance has a huge impact on domestic policy makers (Gourevitch, 1978). International circumstance deserves being treated equally as domestic situations in the analysis of domestic policy (Feng & Li, 1997). In this way, the involvement of the Chinese government in Chinese OFDI is supposed to address both international and domestic problems. Secondly, the worsening relationship between the United States and China is a threat to further internationalization of CMNEs. The United States and its allies will remain the recipients of most Chinese OFDI for a long time and they have been more cautious than ever about Chinese OFDI due to national security issues. The rise of China has been perceived as a challenge among these countries because of its large population, rapid economic growth, and emerging military power (Tammen & Kugler, 2006). To avoid a fierce conflict with China, the United States encouraged China to follow the western business model by integrating China into the international community and by welcoming it in international alliances (Kugler, Tammen & Swaminathan, 2001). However, China does not seem satisfied with the status quo of the international order led
by the United States and is trying to integrate itself into the international community by constructing a new one. China’s challenge is to either improve investment conditions in countries outside the United States and its allies and or to alienate these allies from the United States. The BRI and the Asian Infrastructure Investment Bank (AIIB) are two significant examples of China’s efforts to construct the new order. Thirdly, OFDI could be an efficient channel for China to enlarge its global influence. International trade is said to make two countries interdependent with each other because one country is sensitive and vulnerable to the other’s change of policy (Keohane & Nye, 1977). Although realists and liberalists hold different ideas on the effect of the economic interdependence brought by international trade on the bilateral relations of involved countries (Gasiorowski, 1986; Maoz, 2009), we have reasons to believe that the economic interdependence brought by Chinese OFDI could improve China’s relationship with host countries, especially less developed countries. Capital dependency theory holds that foreign capital penetration could lead to income inequity in host countries and not increase domestic productivity (Dixon, 1996). On the contrary, the form of OFDI makes it inevitable for CMNEs to hire local laborers in host countries and transfer comparatively advanced technology to host countries. Furthermore, Chinese OFDI in infrastructure help less developed countries remove a main obstacle of economic development. The lack of infrastructure is regarded as a cause of Africa’s poverty (Easterly & Levine, 1997) and the improvement of infrastructure is much more beneficial to African countries than externally imposed economic reform or political reform (Easterly, 2009). The more host countries benefit from the increased jobs, productivity and infrastructure, the better the relationship China could develop with those host countries. The improved relationship with host countries improves China’s global influence.
From the paragraphs above, we find that the perspectives of international political economy have huge potential in the exploration of Chinese OFDI. The increased relative power of MNEs makes MNEs more valuable to home country governments. Home country governments could not only support local MNEs in the international market but also seek political benefits from local MNEs’ OFDI activities. Furthermore, international circumstances should be taken into account when we analyze Chinese OFDI. International circumstances constrain Chinese OFDI as well as domestic situation and should affect the OFDI-related strategy and policy made by the Chinese government. The mightiness of developed countries and DMNEs in the international market motivates the Chinese government and CMNEs to work together. Lastly, whether the Chinese government could gain global influence through CMNEs’ OFDI is not guaranteed. It is necessary to investigate whether CMNEs’ OFDI satisfies host countries’ demand such as economic growth.
CHAPTER 3

The Backgrounds of Chinese OFDI

3.1 An Introduction to Chinese OFDI

Gradually balanced growth could be an appropriate phrase to describe the performance of Chinese OFDI in recent years. In the recent fifteen years, the sustained growth of Chinese OFDI has made China one of the largest global investors in the world (see Figure 1, Figure 2 and Figure 3). However, the great leap for Chinese OFDI seems close to an end. Chinese investors have turned to be more rational and cautious than ever and Chinese OFDI experience a rare decline in 2017. Besides that, Chinese OFDI has been more and more balanced in several dimensions such as the distribution of OFDI among different countries and industries and the ratio of the OFDI made by state-owned CMNEs to the OFDI made by private CMNEs.

Figure 1: The Development of CMNEs and Chinese OFDI

Source: 2017 Statistical Bulletin of China’s Outward Foreign Direct Investment and Fortune Global 500
Figure 2: The Global Ranking of Chinese OFDI Flows

Source: 2017 Statistical Bulletin of China’s Outward Foreign Direct Investment

Figure 3: The Global Ranking of Chinese OFDI Stock

Source: 2017 Statistical Bulletin of China’s Outward Foreign Direct Investment
The rapid growth of Chinese OFDI could be observed in both width and depth. In terms of width, China signed bilateral investment treaties with 104 countries at the end of 2016 and 190 countries or regions were the destinations of Chinese OFDI in 2016 (Ministry of Commerce of China, 2016; Ministry of Commerce of China, 2017). Most exceptions are tiny countries that have diplomatic relations with the Republic of China (Taiwan) instead of with the People’s Republic of China. As to depth, the flow of Chinese OFDI reached its peak in 2016, which was $196.15 billion and maintained China as the second largest global investor in that year (Ministry of Commerce of China, 2017). With a 19.3% decline in 2017, Chinese OFDI was $158.29 billion and China fell slightly behind Japan (Ministry of Commerce of China, 2018). This decline mainly was caused by the actions of the Chinese government against irrational OFDI and the stricter supervision of the acquisition of high technology enterprises in developed countries. In the United States, Chinese OFDI decreased by 66% in 2017 (Ministry of Commerce of China, 2018). However, such a decline in Chinese OFDI seems more like a hypercorrection of the previous great leap. The trend of increasing Chinese OFDI should be unstoppable because China not only has the capacity to export more capital but also because benefits economically and politically through these capital flows.

Figure 4: The Amount of Chinese OFDI to Africa, Asia and Latin America in Billion US Dollar

Source: Statistical Bulletin of China’s Outward Foreign Direct Investment
Figure 5: The Continent Distribution of Chinese OFDI

Source: Statistical Bulletin of China’s Outward Foreign Direct Investment

Figure 6: The Trend of Chinese OFDI in the Manufacturing Industry

Source: 2017 Statistical Bulletin of China’s Outward Foreign Direct Investment
In recent years, Chinese OFDI has been making efforts to cultivate developing countries and manufacturing industries. Excluding the distortion by the offshore financial center countries and regions such as Hong Kong, British Virgin Islands, and Cayman Islands, we may observe that CMNEs do not overlook Asia, Africa, and Latin America, which are generally poorer than North America, Europe, and Oceania (see Figure 4 and Figure 5). At the same time, the amount of Chinese OFDI that goes to the manufacturing industry and the share of manufacturing industry OFDI in total OFDI has increased greatly (see Figure 6). There are mainly two kinds of OFDI in the manufacturing industry. The first one is greenfield OFDI, in which CMNEs set up new factories and then usually hire and train new workers for their factories. The second one is merger & acquisition (M&A), which allow CMNEs to enjoy the technologies and brands developed by acquired enterprises in a short time. Although the amount of Chinese OFDI through M&A has been increasing quickly, M&A ventures are not overwhelmingly preferred by CMNEs (see Figure 7 and Figure 8). In developing countries, greenfield OFDI is more common for CMNEs. Labor and land are cheap in developing countries. By contrast, there are many more enterprises with popular brands, advanced technologies, and efficient management in developed countries that could be valuable acquisitions for CMNEs. Therefore, greenfield OFDI is a more reasonable choice for CMNEs in developing countries and most acquisitions take place in developed countries. As developed countries become increasingly aware of the need to protect high technology, the prospect of acquisition of enterprises in order to promote technology development remains uncertain. The manufacturing greenfield OFDI in developing countries may be limited by issues including environmental protection and labor standards, but should maintain overall growth because of the improvement of investment conditions such as infrastructure.
Figure 7: Amount of Chinese OFDI for M&A (Billion US Dollar)

Source: Statistical Bulletin of China’s Outward Foreign Direct Investment

Figure 8: The Distribution of Entry Model by CMNEs

Source: 2017 Statistical Bulletin of China’s Outward Foreign Direct Investment
The increasing participation of private CMNEs in OFDI is another phenomenon deserving attention. Among the 500 largest private Chinese enterprises, 271 of them made OFDI in 2016 and 287 of them made OFDI in 2017 (All-China Federation of Industry and Commerce, 2018). The ratio of the OFDI made by private CMNEs to that made by state-owned CMNEs has been rising for more than ten years (See Figure 9). How should we interpret this phenomenon? First of all, the more active participation of private CMNEs in OFDI does not mean that the Chinese government has lost its control over Chinese OFDI. On the contrary, it could be partly attributed to the efforts made by the Chinese government to encourage private enterprises to go abroad (National Development and Reform Commission of China, 2012). Ownership is far from the only decisive factor for the Chinese government to exert huge influence over private CMNEs. We will discuss the two channels through which the Chinese government influences the OFDI of CMNEs in the last section of this chapter. Secondly, private CMNEs generally do not compete fiercely with state-
owned CMNEs. Private CMNEs’ strength mainly concentrates in the real estate, insurance, light manufacturing, mining, and high technology industries (All-China Federation of Industry and Commerce, 2018). None of these industries are oligopolies and occupied by only a few private CMNEs and state-owned CMNEs. The rise of private CMNEs expands the competitiveness of CMNEs to more industries and fields. Thirdly, compared with state-owned CMNEs, private CMNEs are more dependent on firm-specific advantages including technology and management and less dependent on government subsidies or natural monopoly. We should not be blind to the firm-specific advantages occupied by CMNEs anymore. In sum, the rise of private CMNEs are a great enhancement to the comprehensive development of CMNEs and the approaches for China to enlarge its global influence.

As the stock of Chinese OFDI accumulates, CMNEs have been gathering more and more international investment experience and international management talent. Even though the growth rate of Chinese OFDI could slow down in the following years, we may hold a positive attitude to the return rate of Chinese OFDI. Once Chinese OFDI becomes more and more stable, the observation of it may give us more and more implications about the future and strategy of Chinese OFDI.

3.2 International Circumstance

Knowing the international circumstances and domestic situation is an ideal beginning to understanding Chinese OFDI because they are the basis for the Chinese government to formulate OFDI-related national strategies and industrial policies. Some of these strategies and policies could be explicit and openly announced, while others could be implicit and executed quietly. For example, it could be speculative to announce a financing plan for the infrastructure in host countries without providing the information about the collaterals in that financing plan. An
assessment of the international circumstances and domestic situation faced by China may not only help us understand these explicit OFDI-related national strategies but also explore the potential of those implicit strategies.

Among various international relations, U.S.-China relations are of great importance (Friedberg, 2005; Goldstein, 2013). For the only superpower remaining in the world, a challenger with different ideology is dangerous (Feng, 2013; Allison, 2017). The Tiananmen Square incident eliminated the possibility that would China reform its institutions as the United States expected and thus turned to a disaster for U.S.-China relations (Suettinger, 2003). The subsequent blockade of science and technology on China has lasted almost thirty years in terms of the Co-ordinating Committee for Multilateral Export Controls (COCOM) and the Wassenaar Arrangement. Any goods or technology that has the potential to improve China’s military power is not allowed to transfer to China. During that time, China has made a lot of notable achievements by itself. For example, China has developed the stealth jet J-20, which is regarded as the most competitive rival for the F-22 Raptor. Besides that, China’s aircraft carrier, lunar lander, and BeiDou Navigation Satellite System are all examples that China can independently manage great projects requiring a huge amount of high technology. Although the blockade of science and technology on China seems not to work very well, it is not totally useless. We may find that the traditional blockade of science and technology is still useful in the case of ZTE in 2018. ZTE’s dependence on the chip technology from U.S. MNEs put ZTE into a very difficult position in conflict with the U.S. government. ZTE was not able to maintain daily production activities without U.S. chips. As a result, the U.S. government gained a complete victory over ZTE and CMNEs gained a valuable lesson about the necessity of independent research and development. It is hard to decide whether the blockade of science and technology is more of a motivation or an impediment for China’s achievements in
science and technology. Referring to the amount of R&D expenditure and the number of granted international intellectual properties (see Figure 10 and Figure 11), the technology gap between the United States and China should become narrower and narrower in the following decades. If this is true, cases similar to the ZTE case in 2018 should be less and less frequent. In other words, the effectiveness of the blockade of science and technology will inevitably decrease.

![Figure 10: Gross Domestic Expenditure on R&D at Current PPP (Million US Dollar)](source: OECD.Stat)

![Figure 11: Total Patent Grants by Applicant's Origin](source: WIPO IP Statistics Data Center)
The U.S. government has developed new countermeasures to the rise of China. The blockade of science and technology seems to have been upgraded to two-way from one-way. A two-way blockade of science and technology against China rejects not only technology exports to China but also technology imports from China. For instance, the United States has launched a boycott of Huawei, a global leader in the fifth generation of wireless communications technology (5G) due to national security considerations. Huawei is said to stand in for the Chinese government and fail to comply with the U.S. laws (U.S. House of Representatives, 2012). Although not expelled from the U.S. market, high-tech CMNEs such as Dajiang and Hikvision, which have occupied leading positions in drones and video surveillance, have led to serious discussions of whether they stand in for the Chinese government as Huawei and thus threaten foreign countries (Mozui, 2017; Leng, 2018). It is reasonable to expect more and more Chinese technology enterprises will be labeled as dangerous for national security and will be subject to boycotts. No matter whether the boycott of Chinese technology enterprises really protects the national security of the United States, involved CMNEs will lose the world’s largest market and a decrease in revenue is inevitable.

In addition to technology imports from China, Chinese capital has been another target for the U.S. government. The Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) expands the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to investigate Chinese capital. Needless to say, CMNEs are very likely to be banned because of their declarations of acquiring advanced technologies or sensitive information before transactions, CFIUS now has the right to stop a transaction once CFIUS speculates that CMNEs are intended to circumvent the jurisdiction of CFIUS in that transaction. Besides that, the review period is expanded to 45 days from 30 days with a possible extension of 15 days. A review period of 60 days could be annoying to any enterprise with high demand for capital. There should be no doubt
that the new act brings more risks and less attractiveness for Chinese capital investment in U.S. enterprises. The influence of this new act on CMNEs is complicated. In the short term, CMNEs may lose a quick approach to mastering new technology. CMNEs may be forced to increase their expenditures on research and design in the long term and at the same time the Chinese government may be even more determined on the issue of forced technology transfer in the domestic market and fiscal subsidies to specific industries than before.

To make the boycott to CMNEs and Chinese capital more efficient, the United States exercises its huge influence to make other countries join such boycotts. The more countries join the boycott, the more effective this boycott will be. However, it remains questionable to what extent the traditional allies of the United States are willing to join the boycott of China. On one hand, Trump’s administration and his America First policy make the traditional allies of the United States worry about and reconsider the prospect of their alliance with the United States. On one hand, the United States has canceled its negotiation on the Trans-Pacific Partnership. The United States has exited from the Paris Agreement and the United Nations Educational, Scientific and Cultural Organization. On the other hand, the rise of China brings these traditional allies of the United States many opportunities for cooperation with China on various issues, such as clean energy and space exploration (Ministry of Foreign Affairs of China, 2018). Denying these opportunities seems inconsistent with the interest of these countries. The Asian Infrastructure Investment Bank, which was initiated by the Chinese government, has recruited the United Kingdom, Germany, and France as non-regional members. A multi-polarized world seems more attractive to the European Union than a world dominated by one superpower (Lederer, 2019). Recently, a former senior executive from the famous French multinational Alstom has released a book about his experience of being put in jail and how Alstom was suppressed by the United States
government in a deal with General Electric (Pierucci & Aron, 2019). His story may make European MNEs hesitant when they are forced to choose partners between U.S. MNEs and CMNEs. Although Japan, South Korea, Canada, Australia, and New Zealand could be easier for the United States to wield its influence because of shorter geographic distance or significant mutual interests, such as the nuclear threats from North Korea, we have to admit that it will be less and less likely for these countries to give one-sided support to the United States because of the growing attractiveness of the cooperation opportunities offered by China.

Just like the United States, China has its own traditional partnerships. Even before the restoration of the lawful rights of the People's Republic of China (PRC) in the United Nations in 1971, PRC had been a leader among developing countries. In the recent decade, China has been developing its partnership with the Community of Latin American and Caribbean States (CLACS), African Union (AU), Pacific Islands Forum (PIF), and Association of Southeast Asian Nations (ASEAN) and enlarging its influence within these areas. China’s projects have appeared as background on currency issued in Algeria, Guinea, Kenya, Kuwait, Laos, Sri Lanka, Tajikistan, and Thailand (Shen, 2019). By contrast, the collapse of the Trans-Pacific Partnership cast a shadow over President Obama’s Asia Rebalancing Strategy. Although President Trump has put forward new Indo-Pacific Strategy and Africa Strategy, we cannot find many new approaches to promote bilateral cooperation. The most eye-catching new approach could be emphasizing potential threats from China such as debt trap. There is a report that the U.S. government has been sending financial experts to help developing country governments assess Chinese OFDI projects (Kesling and Emont, 2019). However, scholars from Boston University and Johns Hopkins University point that China’s debt trap is unfounded. According to them, China is not the largest creditor with the majority of debt in almost all developing countries; the amount of international capital from other
countries is underestimated (Brautigam, 2019). Furthermore, the large amount of private investment by U.S. MNEs may not follow the guidance by the U.S. government and stick to their former investments in industries such as the mining industry. Although U.S. MNEs are willing to take part in the improvement of infrastructure, CMNEs are able to offer lower price and decent quality. It could be unreasonable to expect that the United States will crowd out China’s investment and influence in developing countries.

To conclude, the international circumstances for Chinese OFDI are slightly positive. Chinese OFDI in the United States could be more and more difficult, especially those intending to acquire high technologies and involving personal information. The obstacles to Chinese OFDI in other developed countries are being weakened because of the shrinking global leadership of Trump’s administration and the growing economic cooperation opportunities offered by China. As to developing countries, Chinese OFDI could maintain a stable growth in these countries for a long time.

3.3 Domestic Situation

In addition to international circumstance, the domestic situation is another source of gist for the national government to make OFDI-related policies and a source of motivation for CMNEs to go abroad. Dunning (1981) relates GDP per capita in a country positively with the amount of this country’s OFDI and points out that OFDI decisions are finally determined by the country, the industries in this country, and the MNEs from this country. For example, MNEs from countries with fewer natural resources and less human resources are more likely to make OFDI in order to make up for their disadvantages. MNEs that are competitive in their own or related industries are more likely to make OFDI in order to exploit their advantages in a larger market.
As implied in the example above, resources are one of the main aspects when we discuss the domestic situation of China. Generally, the huge amount of natural resources promised by the large size of Chinese land are greatly divided by the huge population of China into a low per-capita level. The tradition of saving is another motivation for China to get access to overseas natural resources through OFDI. It is strategically more considerate to exploit overseas natural resources as much as possible and conserve domestic natural resources for future use. In addition to national resources, human resources are another important kind of resource MNEs care about. For a long time, MNEs have benefited from cheap labor brought by demographic dividends. As time goes by, the influence of family planning is being more and more significant. A low birth rate leads to a shrinking supply of labor and at the same time more young people get the chance to receive better education and develop complex skills. In other words, the supply of cheap labor will decrease and the supply of skilled labor will continuously increase. The trend of human resources in China forces CMNEs to deal with the problem of rising labor costs and gives advantages to CMNEs in domestic R&D.

The rising labor cost is not the only factor that drives up the domestic operating cost of CMNEs. The formation of environmental awareness among Chinese people and officials forces Chinese enterprises to not only pay more attention to waste disposal but also to adopt more environment-friendly manufacturing processes. It has been more costly for any enterprise to be labeled as an environment destroyer than to increase expenditures on environmental protection. Besides that, land acquisition has been more and more costly in the recent decade. An enterprise has to spend much more money than before to acquire land if this enterprise wants to set up a new factory. By contrast, the land cost in the neighbor countries of China is much lower, especially when local governments want to attract FDI through concessive land pricing. Increasing domestic
operating costs must make CMNEs think about reducing such costs through OFDI activities such as transfer of production to countries with cheaper resources and looser environmental supervision.

In addition to increasing domestic operating costs, CMNEs have to respond to the almost saturated domestic market. Economic growth in China has been slowing for several years, and this trend is expected to continue. To offset the slowdown of domestic demand, CMNEs may have to exploit more potential in overseas markets, especially those of developing countries. For example, CMNEs in the construction industry have accumulated a lot of experience and improved their technology and management during the process of building massive domestic infrastructure. At the same time, these massive infrastructure projects have brought governments at different levels a heavy debt burden and made it impossible to maintain high expenditures on infrastructure (Tsui, 2011). It remains questionable whether the introduction of private capital into infrastructure can fill the gap left by the former government expenditures. From a perspective of decreasing marginal benefits, new infrastructure projects could bring fewer benefits to the Chinese society than before and lead to low returns of public expenditure or private investment. It could be out of date to insist that public expenditure in China is only about officials’ personal will because municipal peoples’ congresses have been more and more strict with local budgets. In this way, CMNEs in the construction industry will have to seek more and more overseas projects to offset their unavoidably slowing domestic business. CMNEs in many other industries such as the automobile industry and the cell phone industry are also faced with slowing domestic business.

The domestic situation faced by CMNEs seems to be deteriorating in terms of labor cost, land cost, environment regulation, and market potential. CMNEs are losing their traditional country-specific advantages in the international marketplace. It has been essential for CMNEs to utilize
international resources and expand international markets if they want to maintain their development and growth.

3.4 How Does the Chinese Government Influence Chinese OFDI

Thanks to the economic reform started at the end of 1978, China has made impressive economic achievements in the last four decades. As a result of this reform, the current Chinese economic system is interpreted in different ways, such as socialism with Chinese characteristics, crony capitalism (Pei, 2016), and state capitalism (Naughton & Tsai; 2015; Hung & Chen, 2018). No matter in which way the current Chinese economic system is interpreted, the role of an organizer played by the Chinese government in economic activities is always emphasized. With more and more significance, Chinese OFDI is surely under the control of the Chinese government or at least the influence of it.

To influence or control Chinese OFDI, the Chinese government mainly has two channels. The first one is relationship and the other is capital control. The continuous reform of state-owned and public-owned enterprises does not threaten the survival of giant central state-owned enterprises but does affect small local public-owned enterprises. The ownership of CMNEs allows the Chinese government to appoint the senior executives of CMNEs. These senior executives have the motivation to carry out strategies that are consistent with national strategies because whether they will be promoted to higher levels is decided by the Chinese government. Making the Chinese government satisfied absolutely increases their chances of getting promoted. As to those private CMNEs, it is essential for them to maintain a good relationship with the Chinese government because the Chinese government offers the licenses, loans, and business opportunities that are attractive or indispensable to private CMNEs. Behaving the way the Chinese government asks allows private CMNEs to receive more resources from the Chinese government.
The second channel, capital control, works like insurance to the first channel. The use of capital control has been thoroughly discussed for a long time. However, the use of capital control on OFDI has not attracted exclusive attention like that on capital flight or financial instability. The capital control on OFDI once required CMNEs to report their potential OFDI projects and wait for the approval from the Chinese government. Once any OFDI project is found to be harmful to China’s interests and too economically or politically risky, CMNEs will not get the permission to send money abroad and have to give up that project. In recent years, the capital control on OFDI has been relieved by the Chinese government in order to encourage OFDI. Only those OFDI projects involving sensitive industries and sensitive countries need to be approved before being carried out (National Development and Reform Commission of China, 2017). These sensitive industries include but are not limited to mass media, water resources development, and military industries. As to sensitive countries, most of them are at war or do not have diplomatic relations with Mainland China. Other OFDI projects may be carried out after being reported to relevant departments. If OFDI projects involve less than US $300 million, they even do not to be reported to the National Development and Reform Commission (National Development and Reform Commission of China, 2017). Being reported to the provincial National Development and Reform Commission is enough for them. The accumulation of OFDI experience is another reason for the Chinese government to relieve capital control. CMNEs have developed stronger abilities to handle OFDI projects and thus it is much safer than before to leave OFDI decisions to the senior executives of CMNEs, who have the motivation to take care of the interests of both CMNEs and the Chinese government.

These two channels enable the Chinese government to use Chinese OFDI as tools to achieve its global ambitions and thus incur criticism of Chinese OFDI. For those who dislike the Chinese
government and the Communist Party of China, Chinese OFDI is messing up the world. They may successfully find some cases in which Chinese OFDI is not welcome by host countries or does harm to local people as propaganda materials. However, considering the amount of Chinese OFDI projects, several case studies are not powerful evidences of what is Chinese OFDI really doing all over the world.
4.1 China’s OFDI Related National Strategy

In the last chapter, we learned that the Chinese government has a huge influence on the activities of CMNEs and China is faced with various challenges from both international circumstances and the domestic situation. It could be ideal for China if the Chinese government could develop an appropriate OFDI-related national strategy and lead CMNEs to follow such a strategy. An appropriate OFDI-related national strategy should be able to deal with these challenges by making contributions in the following three aspects: the enlargement of Chinese global influence, the sustainability of domestic economy, and the development of CMNEs.

The Belt and Road Initiative (BRI) has been commonly perceived as an OFDI-related national strategy since it was originally put forward as “One Belt, One Road” in 2013. This initiative is not the only OFDI-related strategy in China, but most other OFDI-related strategies are at the provincial or municipal levels. Just as the Chinese central government formulates an OFDI national strategy based on the fundamental realities of the country and CMNEs, local governments consider local conditions and CMNEs when they formulate local strategies. These lower-level strategies are generally consistent with the BRI but focus more on the local economy and CMNEs.

As a national strategy, the BRI treats CMNEs as a whole and develops a master plan for them. In the BRI, CMNEs are planned to participate in OFDI activities in two highly interdependent channels. In the first channel, Chinese OFDI goes to the infrastructure industry mainly through contracted projects, such as power stations, railways, and freeways. CMNEs may acquire part or whole ownership of these projects after completion and make profits through their
subsequent management and operation. In the second channel, Chinese OFDI is planned to take advantage of those infrastructure projects completed by CMNEs through further investment in the areas surrounding these projects. For example, industrial parks are planned at locations close to the harbors operated by CMNEs. Being close to a friendly and efficient harbor could significantly reduce transportation costs for CMNEs. In return, a huge amount of imports and exports makes the harbors operated by CMNEs more profitable.

The example above is far from revealing the major strategy of the BRI. The BRI is far more than a plan to promote and guide Chinese OFDI. From a perspective of globalization, the BRI is a plan to connect the countries along the BRI more closely. Countries are connected in various dimensions and the BRI takes advantage of these dimensions. These dimensions include policies, infrastructure, trade, information, capital flows, and people-to-people bonds (National Development and Reform Commission of China, 2015). The communication between countries not only helps avoid vicious competition but also promotes cooperation and thus has a huge influence on the quality of the connections between countries. For example, communications on industry and trade policy may allow the division of labor among the countries with homogeneous industry structures and thus promotes the production efficiency in the countries involved. Communications on infrastructure could make infrastructure projects be more efficient public goods by appropriate choice of location. In addition to the Ministry of Commerce and the National Development and Reform Commission, the Ministry of Foreign Affairs is another department that takes part in composing “Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road.” The participation of the Ministry of Foreign Affairs implies that the communication with host country governments is of great importance.
As the key to communication, partnership is not easy to build. Sharing a similar ideology is a source of partnership, but it does not make much sense for China to develop partnership with most countries in the world. A more practical way for China to develop partnership is to bring more benefits and do less harm to other countries. Several groups of scholars from the World Bank have tried to assess the effect of the BRI on the global economy and other issues. In general, the BRI is beneficial for all countries because it saves transaction costs and promotes economic growth (Chen & Lin, 2018; de Soyres et al., 2018; de Soyres, Mulabdic & Ruta, 2019). It could be advantageous for China to lead project evaluation based on their domestic experience of urban planning to make sure that local governments spend their limited money on the projects that will bring the most benefits, especially when American experts try to discover the defects of proposed projects. Furthermore, countries benefit differently from the BRI and the relative location of countries in the BRI projects matters (Derudder, Liu & Kunaka, 2018; Xingjian Liu Reed & Trubetskoy, 2019). It could be helpful for China to introduce multilateral organizations such as the AIIB to deal with the apportionment of expenditure on public goods among countries. No countries will be happy paying more and at the same time benefiting less. The endorsement made by multilateral organizations could make the Chinese government more trustful. Two of the potential harms to host countries that have been discussed the most frequently are environmental destruction and debt trap. Construction of infrastructure at the cost of the environment and financial security in host countries will not help develop the partnership between China and host countries. To reduce and avoid potential harm to host countries, the Chinese government has made several announcements to inform CMNEs the importance of non-economic factors, including cultural differences between different peoples (Ministry of Ecology and Environment of China, 2017; Ministry of Ecology and Environment of China, 2017; National Development and Reform
Commission of China, 2017). President Xi Jinping confirmed the efforts of the BRI in environment protection and the 2030 Agenda for Sustainable Development of United Nations on the Second Belt and Road Forum for International Cooperation in 2019 (Xi, 2019). Once host countries witness the occurrence of benefits and the avoidance of harms, the partnership between China and host country governments should begin to increase continuously.

To what extent partnership is developed by China and home country governments will determine how successful the BRI will be. With a low level of partnership, CMNEs may only treat host countries as production centers. A higher level of partnership between China and host countries not only allows CMNEs to build infrastructure in the industries related to people’s livelihood and national security (such as the power industry) but also authorizes them to manage the infrastructure. In other words, no country is willing to be dependent on a hostile country and partnership makes it possible for host countries to be dependent on China’s operation in host countries. As host countries become more and more dependent on China, China surely will enlarge its global influence. With a higher level of partnership between China and host countries, CMNEs can transfer more domestic production to host countries and generate stable revenues through the subsequent operation of infrastructure in host countries.

Although the BRI seems promising for China in comprehensive aspects, the BRI, by promoting OFDI, may lead to a decrease in domestic investment. Domestic investment has been regarded as one the most powerful engines for economic growth and thus a decrease in domestic investment could offset all the benefits brought by the promotion of OFDI. Fortunately, scholars have found a crowd-in effect of OFDI on domestic investment in China (Ameer, Xu & Alotaish, 2017; Gondim, Ogasavara & Masiero, 2018). According to them, CMNEs take advantage of OFDI to develop firm-specific benefits such as technology and management and therefore make
themselves more competitive in the domestic market. The increase of competitiveness in the domestic market makes these CMNEs believe in their potential returns from further domestic investment. The crowd-in effect of OFDI is even stronger in the industries receiving more support from the Chinese government (You & Solomon, 2015). It seems that we do not need to worry much that the BRI pushes out domestic investment. On the contrary, the BRI could pull in domestic investment. After the BRI was put forward, the amount of FDI actually utilized and the amount of total Investment in Fixed Assets have continued to increase stably (see Figure 12 and Figure 13).

To conclude, the BRI is designed to help China maintain its domestic economy and enlarge China’s global influence through the international economic cooperation brought by OFDI. At the same time, a major goal of the BRI is for CMNEs to benefit from an internal agglomeration effect and bring CMNEs more business opportunities through government-to-government negotiation.
4.2 China’s OFDI Related Industrial Policies

OFDI-related industrial policies are important supplements to OFDI-related national strategy, especially in terms of the execution of national strategy. Generally, industrial policies reflect the preference of governments for different industries and are more favorable to the industries endorsed by governments. Specifically, OFDI-related industrial policies allow governments to encourage and support CMNEs from certain industries to go abroad through exclusive programs such as accelerated approval, access to loans, preferential tax rate, etc. These programs are supposed to make CMNEs more competitive on the international stage.

“Made in China 2025” has been the most significant industrial policy document since it was released in 2015. This document gives us a strong signal that manufacturing industry is the most important one for the Chinese government. In this document, the backwardness of the manufacturing industry was used to explain the fall of China over the last two hundred years and
the capacity of manufacturing is regarded as an indispensable driving force to the rise of China. Furthermore, the planned contribution of the manufacturing industry to the agriculture and service industries through agricultural machinery and service-embedded manufacturing makes the core position of the manufacturing industry more important. There should be no doubt that advanced agricultural machinery will greatly improve agricultural production efficiency. As to service-embedded manufacturing, it not only makes the manufacturing and service industries more closely connected but also has great potential to improve the quality of both product and service. Producers have their own advantages in the provision of customer service because they are knowledgeable about their products. The dedication to customer service may help collect useful feedback for next-generation products. For example, as the world’s largest port machinery manufacturer, Shanghai Zhenhua Heavy Industries, has been making advances in developing port services through port equipment control systems and automated port terminal operating systems. Because of the core position of the manufacturing industry, it is clear that the Chinese government will give more support to the manufacturing industry when there are limited resources to allocate.

In addition to signaling the endorsement of the Chinese government of the manufacturing industry, “Made in China 2025” clarifies the role of the Chinese government and Chinese enterprises. The Chinese government is supposed to focus increasingly on the top-level design of industry development and make enterprises as the main entities in the process of production and innovation. In other words, the Chinese government aims to reduce its involvement with enterprises’ operation and create an environment that is the most favorable to them. Taking innovation as an example, the Chinese government could draw a roadmap of the most important fields of science and the most desirable technologies based on the relevant suggestions from enterprises and then let the enterprises lead the scientific and technical cooperation with state-
owned research institutions and universities. The Chinese government seems doing what suggested by Rodrik (2004) for industrial development and performing like a collaborative government. The support given by the Chinese government includes but is not limited to special research funds, information-sharing platforms, and risk-sharing mechanisms. In this way, the involvement of the Chinese government in CMNEs’ operation could be more temperate, selective and flexible than before. If it becomes true, on one hand, the increasing autonomous right may allow CMNEs to be more agile in the international competition. On the other hand, CMNEs may benefit from more customized supports and incentive mechanism provided by the home country government, rather than simply low labor cost and subsidies.

Among the key strategic tasks listed in “Made in China 2025” is the internationalization of the manufacturing industry. To complete this task, the Chinese government emphasizes taking advantage of the international market and international resources as a part of the “Two Markets and Two Resources” strategy. The introduction of international resources through FDI is not enough. CMNEs are encouraged to go abroad to enter international market sand acquire international resources such as capital, enterprises, and technologies. Simply selling products in overseas markets is not enterprising enough. CMNEs must improve the added value of products by developing a global marketing system and must enhance product development capacity by setting up overseas R&D institutes. As implied in the last paragraph, the Chinese government has committed itself to the top-level design of international cooperation, which should benefit CMNEs’ OFDI. Specifically, the transfer of production to overseas industrial parks in the countries along the BRI is emphasized in “Made in China 2025”. Successful examples of industrial parks include Haier-Ruba Economic Zone in Pakistan, Thai-Chinese Rayong Industrial Zone, and Cambodia Sihanoukville Special Economic Zone (Ministry of Commerce of China, 2018).
In general, “Made in China 2025” tells us not only the significance of the manufacturing industry to China but also the role of OFDI in the development of the manufacturing industry and related CMNEs. By contrast, in 2017, the Chinese government made an announcement that it would limit OFDI in unproductive industries such as entertainment and real estate (State Council of China, 2017). Together with Made in China 2025, this announcement reminds us of Alexander Hamilton and Friedrich List’s legacy of national industrialization. The determination of the Chinese government to support the development of the manufacturing industry seems unchallenged and OFDI has been perceived as a key route.

4.3 Entry Model and Financial Structure

From the last two parts, we know that the Chinese government increasingly intends to affect CMNEs’ operation through top-level design, which includes national strategy and industrial policies, rather than through direct control over CMNEs’ operations. Among the numerous decisions made by CMNEs during the process of internationalization, the entry model chosen by CMNEs and the form of OFDI flows are two significant categories that not only happen at the very beginning but also continue until CMNEs exit foreign markets. In this part, we will discuss CMNEs’ decisions on the entry model and the different forms of OFDI flows.

CMNEs’ decisions on the entry model originate from their motivation to engage in OFDI and then CMNEs have to make compromises based on internal conditions and external regulatory requirements. No matter if OFDI is market-motivated or resource-motivated, there are more than one option of entry model. An overseas R&D institute could be set up by either a joint venture or a greenfield venture. It is the same for the transfer of production to overseas factories. It is impossible to make a clear conclusion that there is a single best entry model for all CMNEs. For example, the existence of several potential local partners such as original equipment manufacturers could make
greenfield venture less attractive. The time of setting up new factories and the recruiting cost for new staff could be saved by CMNEs in the joint venture. However, local partners may be able to learn simple technology quickly and therefore become local competitors in the future. To avoid the leak of key technology, CMNEs may choose to acquire one of those potential partners. When a problem is solved, a new problem may be created. Should Chinese managers be sent to foreign offices to lead foreign staff or remain the executives of the acquired enterprise?

To deal with this problem, CMNEs need to assess whether Chinese managers are able to cooperate with foreign staff well or whether current foreign executives could serve well after the change of ownership. Simply exporting products to foreign markets has the lowest requirement for the management level of CMNEs. The reports of lethal incidents caused by conflicts between Chinese staff and local people or staff have been continuing, especially among those CMNEs involve in contracted projects (Quadir, 2019). Dealing with the lack of professionals with international business experience has been identified as a measure of support for the internationalization of CMNEs (Ministry of Human Resources and Social Security of China, 2017). CMNEs without enough experts in international management may have to rely on foreign executives and therefore feel unsure about acquisition.

Compared with the internal conditions applied to CMNEs’ decisions on the entry model, those external regulatory requirements are no less challenging and complicated. Strictly speaking, there is no totally free capital mobility. OFDI is always more or less limited by host country governments for different reasons such as shareholding ratios and forced technology transfer. The regulatory requirements in host countries are not fixed and vary among countries. In developing countries, the technological achievements of CMNEs could make them victims of forced technology transfer instead of being the beneficiaries of it. In this situation, forced technology
transfer makes acquisition and greenfield ventures unable to avoid the leak of technology and the joint venture is therefore more likely to be adopted for its lower cost and risk. Developed countries have more reasons to be picky than developing countries because they have more factors to take into account such as different ideologies, environmental protection, cultural preservation, and ethnic diversity. Threatened by the rise of China and CMNEs, some developed country governments could substitute the limit on shareholding ratios with various bans aimed at China’s OFDI in the name of national security. Otherwise, new administrative interventions could be developed just like increasingly abundant non-tariff barriers to international trade. The preference of CMNEs for acquisition as an entry model in the United States was discouraged because acquisition cannot generate as many new jobs as greenfield ventures do. Suggestions were thus made to the United States government to require CMNEs to adopt greenfield ventures more often. Chinese investors were reported to be surprised and regretful when they learned that it is illegal to make any change to the appearance of buildings they acquired (Zhen, 2016). Their remodeling plans for the acquired building to attract Chinese tourists fell through. Whether CMNEs are willing or not, it seems wise for CMNEs to choose a more conservative entry model and rely on local partners when they enter a new market with much uncertainty of external regulatory requirements.

In addition to the entry models for CMNEs to choose, there are three forms of capital flows through which CMNEs can make OFDI. They are incremental equity, reinvested earnings, and debt instrument investment. Each of them can help CMNEs achieve specific purposes. Equity investment allows CMNEs to acquire partial or total ownership of foreign enterprises and therefore enable CMNEs to affect or control the operations of these enterprises. Besides that, CMNEs may benefit directly from the equity they acquired. By contrast, debt instrument investment does not grant CMNEs extra right to participate in the operations of related enterprises. Instead, debt
instrument investment is just domestic parent CMNEs’ lending to overseas branches or joint ventures and thus seems like a more temporary form of OFDI. As to the OFDI through reinvested earnings, it is an extension of former OFDI activities. Such an extension usually takes place because investors are satisfied with the current operation and predict more profits in the future. If we look into the structure of Chinese OFDI, we may find a trend that the share of the Chinese OFDI in the form of incremental equity and reinvested earnings has been generally increasing since 2006 (see Figure 14). Debt instruments seems less and less attractive to CMNEs. This trend implies that Chinese OFDI is more and more interested in a long-term internationalization strategy.

![Figure 14: The Structure of Chinese OFDI](image)

Source: 2017 Statistical Bulletin of China’s Outward Foreign Direct Investment

In this section, we analyze Chinese OFDI at the firm level. As successful latecomers to internationalization, CMNEs are gradually performing more and more like the MNEs from developed countries and experience the same challenges as the latter. The association of CMNEs with the Chinese government leads to stricter regulatory requirements in developed markets, which
forces CMNEs to adjust their entry model. In addition, we investigate the structure of Chinese OFDI and find that the ratios of equity investment and reinvested earnings have been rising in recent years. Such a structure implies that CMNEs could be more interested in long-term development than in short-term financial returns.

4.4 Theoretical Framework and Hypotheses

In this section, we try to develop a theoretical framework for Chinese OFDI based on the last chapter and the multilevel analysis in the earlier sections of this chapter and then derive seven hypotheses to test the determinants of Chinese OFDI. We argue that taking advantage of the reciprocal relationship with the Chinese government in which the Chinese government plays the role of an organizer is another important motivation for CMNEs’ OFDI. Several official documents published by the Chinese government are used as supplements to the theoretical framework in the derivation of the hypotheses (see Table 2).

Because of the substantial influence of the Chinese government on CMNEs, CMNEs more or less take the top-level design of Chinese OFDI made by the Chinese government into account when they make OFDI. Especially when such top-level design is profitable for CMNEs, exploiting the three advantages (ownership advantages, location advantages, and internalization advantages) in the eclectic paradigm will not be the only reasons for CMNEs to make OFDI. CMNEs must try to take advantage of such top-level design. In this way, the explanatory power of the eclectic paradigm could decrease and it turns to be appropriate to explain Chinese OFDI with a reference to the top-level design of Chinese OFDI.

The essence of the top-level design of Chinese OFDI is a reciprocal relationship between the Chinese government’s political benefits and CMNEs’ economic benefits. The Chinese government
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<tr>
<td>Notice on Further Directing and Regulating the Direction of Overseas Investments</td>
<td>2017</td>
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<td>A Five Year Plan for Promoting the Internationalization of SMEs</td>
<td>2016</td>
<td>A five-year plan for promoting the internationalization of SMEs.</td>
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<td>Measures for the Administration of Overseas Investment Projects</td>
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<td>Notice on Issuing the Implementation Opinions on Encouraging and Guiding Private Enterprises to Actively Conduct Overseas Investment</td>
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<td>Notice of Establishing Risk Protection Mechanism for Major Overseas Investment Projects</td>
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<td>2004</td>
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*Table 2. OFDI Related Official Documents Released by the Chinese Government*
utilizes its global influence and industrial policies to help CMNEs expand their global business and at the same time CMNEs’ global business helps the Chinese government enlarge its global influence and deal with domestic political tasks. The Chinese government could enlarge its influence in host countries if CMNEs successfully improve and operate local infrastructure and create local jobs. The Chinese government could also be relieved from the pressure of environmental pollution if CMNEs transfer production to other countries, replenish the National Social Security Fund from the profits gained by state-owned CMNEs, promote industrial upgrading and secure domestic energy consumption. As to CMNEs, they benefit from the reciprocal relationship no less than the Chinese government. The business opportunities identified by the Chinese government could not only increase CMNEs’ revenue but also give CMNEs access to international resources and grant CMNEs the management right of profitable projects. The involvement of the Chinese government reduces CMNEs’ transaction cost by making negotiation more efficient when the Chinese government has a high level of partnership with host countries. In addition, the Chinese government does not force CMNEs to sacrifice their economic benefits. CMNEs are not required to finance overseas aid projects. The Ministry of Finance is supposed to finance these projects, which could be a source of revenue for CMNEs. CMNEs are required to stay away from unstable countries or areas to avoid economic losses (State Council of China, 2017). The official prohibition against environmental damage in host countries could be interpreted as the Chinese government’s effort to guarantee its political benefits rather than CMNEs’ sacrifice of economic benefits.

In the reciprocal relationship, the Chinese government plays the role of an organizer. As an organizer, the Chinese government focuses on two tasks. The first one is to promote cooperation between CMNEs and host countries and cooperation among CMNEs. To promote cooperation
between CMNEs and host countries, the Chinese government learns about the demands of home country governments and then figures out how to turn these demands into business opportunities for CMNEs. For example, a hydropower station not only could help expand electricity consumption in host countries but also benefit the Chinese operators of this hydropower station and the surrounding Chinese factories. Cooperation among CMNEs is more complex. It could be creating positive agglomeration effects for CMNEs and allowing CMNEs to utilize Chinese contracted projects. There could be no significant distinction between working in an overseas industrial park developed and operated by CMNEs and working in China. In this way, CMNEs not only save transportation costs but also overcome the liability of foreignness to some degree. In some situations, the Chinese government promotes cooperation among CMNEs by coordinating the production and strategy of CMNEs. For CMNEs that aim at the international market, the Chinese government tries to help them avoid competition among themselves by coordinating on the differentiation of them or merging them. By contrast, CMNEs that focus on domestic markets, such as those from the mobile communication industry or petroleum industry, are required to maintain a substantial competitive relationship with each other. The second task is to give more support to the CMNEs in the key areas of national development. In other words, this task is to motivate CMNEs to make more contributions to the development of China and consolidate the reciprocal relationship. The Chinese government has made a clear statement on the importance of the manufacturing industry to China in its industrial policy document “Made in China 2025”. CMNEs’ OFDI could not only help CMNEs acquire desired technology in the short term but also enlarge their research capacity in the long term. The more the CMNEs in the manufacturing industry benefit from OFDI, the more quickly China could achieve further industrialization. The effective execution of these two tasks requires the Chinese government to have high political
capacity. Political capacity is put forward to demonstrate governments’ ability to carry out their tasks or achieve their goals (Organski and Kugler, 1980). One of the examples in which the Chinese government’s high political capacity contributes to its political task is China’s family planning (Feng, Kugler and Zak, 2002). A government with high political capacity should capture the following features: the ability to gather and utilize human and material resources efficiently (Arbetman & Kugler, 1997); clear strategic direction; supportive organizational culture and effective accountability relationships (Rand Corporation, 2014). The last chapter and the earlier part of this chapter suggest that the Chinese government has high political capacity and therefore could play the role of an organizer well.

The reciprocal relationship seems beneficial for China but threatening to some other countries. The issue of China’s debt trap is brought about by the worry that the Chinese government could control the economies of host countries through CMNEs and enables CMNEs to exploit huge advantages in host countries. Although the loans provided by the Chinese government to host countries are rarely associated with political prerequisites, the terms of these loans often include collaterals such as natural resources and the management right to local infrastructure. These collaterals could be so profitable that the Chinese government may prefer debt default to timely repayment.

Here we generalize seven situations in which CMNEs could take advantage of the reciprocal relationship between the Chinese government’s political benefits and CMNEs’ economic benefits and the role of an organizer played by the Chinese government in this relationship: CMNEs make OFDI in countries that are friendly to the Chinese government; CMNEs make OFDI in countries that have more Chinese contracted projects; CMNEs make OFDI in countries where they have more Chinese OFDI stock; CMNEs make OFDI in countries that are suitable for production
transfer; CMNEs make OFDI in countries that are good at technology development; CMNEs make OFDI in countries that are politically stable; and CMNEs make OFDI in countries that have difficulty in debt repayment. Below we derive seven hypotheses from these seven situations and explain how the reciprocal relationship and the role of an organizer work in these situations. The operationalization of testing hypotheses will be presented in the next chapter.

Hypothesis 1: Chinese OFDI is more likely to go to countries that have a higher level of partnership with China.

Economic cooperation is formed more easily and efficiently in host countries with a higher level of partnership with China. The partnership we discuss here is political partnership which could reflect the level of mutual trust and the efficiency of communication. CMNEs are encouraged to participate in the international economic initiatives led by the Chinese government, such as the BRI, and thereby take advantage of the negotiations between the Chinese government and the host country governments. China’s partnership with host countries could be strengthened if CMNEs’ OFDI has a positive impact on host countries. There has been a study which demonstrates a positive role of government diplomacy for CMNEs. Whether there is a bilateral investment treaty and the number of diplomatic visits between China and host countries are found to have a positive relationship with the amount of Chinese OFDI in host countries (Zhang et al., 2014). This hypothesis uses the level of partnership as a proxy to the diplomatic relationship between China and host countries and we believe it is a better choice. Diplomatic visits may not be able to promote Chinese OFDI in host countries but bring host countries foreign aid, especially diplomatic visits between China and low-income countries. China has signed bilateral investment treaties with more than 100 countries, including all the main destinations of Chinese OFDI. Having a bilateral investment treaty with China should not give many advantages to host countries to
attract Chinese OFDI. By contrast, the level of partnership tells us about the degree of difficulty in forming economic cooperation between China and host countries. Partnership is not bivariate and thus allows us to observe the effect of it with more precision. With a higher level of partnership, it is more likely for China and host countries to develop economic cooperation and further cooperation on the issues related to national security and people’s livelihood. In other words, CMNEs could gain more business opportunities in countries with a higher level of partnership with China.

The partnership between China and host countries could be divided into five levels from the worst to the best: no diplomatic relationship; basic diplomatic relations; basic partnership; strategic partnership; strategic cooperative partnership. OFDI in countries with no diplomatic relationship is strictly regulated (State Council of China, 2017). In countries with a basic partnership, the Chinese government is not involved in Chinese OFDI and Chinese OFDI is purely for economic considerations. The countries with a strategic partnership provide China with strategic assets, which are mainly the natural resources and advanced technology and are willing to cooperate with China on the issues such as national security and people’s livelihood. The involvement of the Chinese government in CMNEs’ OFDI is supposed to guarantee China’s accesses to these strategic assets. As to the countries with strategic cooperative partnership, the Chinese government can communicate with the governments of these countries efficiently and work together for a win-win result. The involvement of the Chinese government in Chinese OFDI plays an important role in these countries.

Hypothesis 2: Chinese OFDI is more likely to go to countries where there are more Chinese contracted projects.
The planning of Chinese contracted projects not only considers the demands of host countries but also those of CMNEs. Chinese contracted projects are supposed to improve the investment environment for CMNEs in terms of power supply, medical treatment, transportation, etc. At the same time, CMNEs are encouraged to take advantage of Chinese contracted projects. A classical model of utilizing Chinese contracted projects is Chinese overseas industrial parks. CMNEs that have expertise in infrastructure and construction build the industrial parks for other CMNEs, which have plans for new factories in these industrial parks. Making full use of Chinese contracted projects enhances the returns of Chinese contracted projects. CMNEs could be the operators of Chinese contracted projects and benefit financially. If not, host countries’ satisfaction with the returns of Chinese contracted projects will make Chinese contracted projects more popular and the negotiation of Chinese contracted projects easier. In this way, a positive circle of Chinese contracted projects and Chinese OFDI will be generated.

Hypothesis 3: Chinese OFDI is more likely to go to countries that have more Chinese OFDI stock.

CMNEs are encouraged to go abroad together (Ministry of Commerce of China, 2018). Going abroad together allows CMNEs to create and benefit from agglomeration effects. Cheung and Qian (2008) find that Chinese OFDI takes advantage of agglomeration effects in terms of Chinese OFDI stock. The explosive growth of Chinese OFDI in the last decade strongly weakens the timeliness of their research. Furthermore, the concentration of OFDI stock years ago could be explained by the limited number of OFDI projects and the parochialism of international business experience, rather than an active exploitation of agglomeration effects.

Active exploitation of agglomeration effects turns out to be practical as the number of OFDI projects increases in a certain country or area. Taking overseas industrial parks as an example, the CMNEs in the same industrial park can share a group of security guards or a huge dining hall.
What’s more important, improving infrastructure for a single CMNE could be as costly as for a lot of CMNEs. Being well planned, a railway not only benefits the CMNEs at the two destination stations, but also all the CMNEs along the railway. Therefore, this hypothesis reinforces the last hypothesis. Making CMNEs benefit from Chinese contracted projects is not enough for the Chinese government. The role of a perfect organizer is to make the most CMNEs benefit from Chinese contracted projects at the least cost. It is much more cost efficient for a cluster of CMNEs to benefit from Chinese contracted projects than a single CMNE.

In addition, the stock of Chinese OFDI in a country could imply the accumulation of business experience and networks in that country. The non-competitive and cooperative relations between CMNEs enables them to share their experience and network with other CMNEs. Both such experience and network could propel CMNEs’ business, especially for newcomers.

Hypothesis 4: Chinese OFDI is more likely to go to countries with a combination of larger manufacturing capacity and lower labor costs.

Both the Chinese government and CMNEs benefit from CMNEs’ production transfer and the Chinese government gives the most support to the CMNEs that transfer their production through OFDI. Through production transfer, especially comparatively low-end production, the Chinese government could be relieved from the pressure of environmental protection to some extent. In addition, production transfer must create local jobs in host countries. If these jobs pay well and offer a decent working environment without producing much pollution, the Chinese government would be appreciated by host countries. In return, CMNEs that transfer production through OFDI could not only utilize cheap laborer or lands in the host countries but also become the largest beneficiaries of the agglomeration effects discussed above. The CMNEs in the service industry
cannot benefit much from the grand construction of infrastructure projects such as power supply, highways, and ports.

Host countries with a combination of large manufacturing capacity and low labor costs could be the most ideal destinations for production transfer. Larger manufacturing capacity implies that it is more likely for CMNEs to find eligible laborers and suitable local partners. These local partners could be either original equipment manufacturers (OEM) or component and material suppliers. The advantage of low labor costs is even more obvious. The missing of either low labor costs or high production capacity makes a host country less attractive to the CMNEs that want to transfer their production. Therefore, we adopt a combination of manufacturing capacity and labor cost in this hypothesis. We admit that more factors are considered when CMNEs make the location choice of OFDI, such as accesses to markets and tariff barriers. Manufacturing capacity and labor costs should be the two factors that are the most directly related to the motivation of production transfer or the two prerequisite factors of production transfer.

Hypothesis 5: Chinese OFDI is more likely to go to countries that have more advanced technologies.

Acquiring overseas technologies is a clear purpose of Chinese OFDI. On one hand, it is a political task for the Chinese government to upgrade domestic industries quickly by acquiring overseas technology. On the other hand, CMNEs need to develop their firm-specific advantages to make themselves competitive in the international marketplace. Acquiring overseas technology is a shortcut for CMNEs.

The reciprocal relationship between the Chinese government and CMNEs on the issue of technology development is explicitly embodied in the national military-civilian integration
strategy (Central Commission for Integrated Military and Civilian Development of China, 2018). CMNEs’ technology development should make huge contributions to the whole society and to national security. To motivate CMNEs to acquire desirable technology through OFDI, the more Chinese society and national security benefit from CMNEs’ acquired technology, the more support the Chinese government will give to CMNEs. This support includes but is not limited to subsidies, concessional loans, and tax reduction.

However, the prospect of acquiring overseas technology through Chinese OFDI is unclear because of the increasing caution in industrialized countries about CMNEs’ acquisition of domestic high-tech enterprises and even CMNEs’ funding to finance domestic research institutions. Recently, University of California, Berkeley and Oxford University have banned new research projects that are funded by Huawei (Delaney, 2019). Acquiring overseas technology seems not an easy task for CMNEs anymore.

Hypothesis 6: Chinese OFDI is more likely to go to the countries with higher political stability.

This hypothesis contradicts Buckley’s finding that Chinese OFDI prefers countries with less political stability (Buckley et al., 2007). According to him, CMNEs overlook political risks because of low capital cost and China’s political culture. Most subsequent studies do not confirm this conclusion (Cheung & Qian, 2008; Huang & Wang, 2011; Zhang et al., 2014; Liu et al., 2017). Kolstad and Wiig (2012) point out that Chinese OFDI could choose to bear some political instability for the sake of natural resources. Although it is true that state-owned CMNEs enjoy low capital costs in the domestic market and there are less political obstacles for CMNEs to make OFDI in countries with similar ideology or political system as China, there are more reasons to challenge the conclusion that Chinese OFDI prefers political instability. Firstly, it has been much more difficult for CMNEs to get loans in the domestic market. On one hand, the recreational activities
provided by CMNEs to bank officials is strictly prohibited (Manion, 2016). On the other hand, CMNEs are required to deleverage by the Chinese government (State Council of China, 2016; National Development and Reform Commission of China, 2018). With less investable money available, CMNEs have to be more careful about their OFDI. Secondly, the Chinese government does not push CMNEs to countries with low political stability for its own political benefits and has made more than one announcement to emphasize the risk management of OFDI (National Development and Reform Commission, 2005; Ministry of Commerce of China, 2010). The executives of CMNEs must pay much more attention to political instability in host countries than before. Otherwise, they will miss the chance to get promoted or even be demoted or dismissed. Thirdly, the comprehensive development of CMNEs allows them to compete with DMNEs in countries with good investment environment and affluent resources instead of countries with poor investment environment and inadequate skilled laborers. It turns to be more practical for CMNEs to stay away from political instability than before because CMNEs have more choices now. Fourthly, the form of equity investment and reinvested earnings have been increasingly adopted by CMNEs to make OFDI. As we discussed in the part of entry model and financial structure, these two forms of OFDI focus more on long-term benefits than short-term benefits. To secure long-term benefits, it is wise for CMNEs to avoid political instability. Last but not least, government changes brought about by political instability create uncertainty in the domestic economy, especially those irregular government changes such as coups (Feng, 1997). After an irregular government change, the new government could abolish the planned Chinese OFDI negotiated between the Chinese government and its predecessors and refuse to compensate involved CMNEs. Therefore, it is likely that Chinese OFDI now prefers countries with higher political stability.
Hypothesis 7: Chinese OFDI is more likely to go to countries with higher debt level.

This hypothesis supports the charge that the Chinese government sets a debt trap in the host countries of Chinese OFDI. Higher debt level is usually associated with a bad economic situation and thus deters FDI. If Chinese OFDI flows to countries with higher debt level, Chinese OFDI should have a special strategy. The rationale of the debt trap is that host countries overborrow from China to finance grand infrastructure projects because the Chinese government intentionally exaggerates the potential benefits of proposed projects and then have to hand over some collaterals because of insolvency. The collaterals are usually key economic infrastructure such as power stations, railway and ports and the important source of fiscal revenue such as mines and oil fields. A healthy debt level gives host countries a buffer to protect themselves from uneconomic infrastructure projects. The higher debt level host countries have, the more likely for these countries to lose collateral. Acquiring the collateral must greatly benefit CMNEs in terms of operational costs and material costs and thus promotes CMNEs’ OFDI. Although the rationale of a debt trap seems plausible, the charge that the Chinese government sets the debt trap is not necessarily true. It is reasonable that such a charge is used as a countermeasure by anti-China forces to hinder the increasing global influence of China.

The establishment of the AIIB could be a significant fact that reduces the possibility of China’s debt trap. As a multilateral bank, all members of the AIIB are the lenders of its projects; sometimes private capital and other multilateral banks such as the World Bank and the Asia Development Bank are included as co-lenders. When China is not the only lender of a project and other lenders are introduced, the transparency of the financing plan for projects must be clear to international society. Compared with the number of projects financed independently by Chinese banks, the number of projects funded by AIIB and its co-lenders remains small. If the AIIB
develops quickly under the leadership of the Chinese government and leads to a decrease in the number of projects financed independently by Chinese banks, it is very likely that the Chinese government will not have a strategy of debt trap. Otherwise, the establishment of the AIIB could be just a cover for China’s debt trap.

The verification of this hypothesis has significant policy implications. If Chinese OFDI is found to be more directed to countries with higher debt level, the host countries of Chinese OFDI must be extremely cautious about any financing plan proposed by China. As a result of setting up debt traps in the host countries of Chinese OFDI, the Chinese government and CMNEs may have some political and economic benefits in the short term but more diplomatic difficulties in the long term. Partnership is one of the things that are much easier to destroy than build.
CHAPTER 5

EMPIRICAL TESTING

5.1 Variables and Data

The operationalization of dependent variables, control variables and independent variables is presented in Table 3 and the correlation of these variables is presented in Table 4.

Dependent variables: Chinese OFDI

We use the amount of Chinese OFDI that goes to host countries as a proxy for Chinese OFDI. It is in current US dollars.

This proxy is aggregated by different types of OFDI. Therefore, the results of a control variable or independent variable could reflect the mix of different types of OFDI. For example, the significance of natural resources is more or less reinforced by OFDI flows that seek for market expansion or go to manufacturing industry.

Control variable 1: Market Size

Market seeking is perceived as one of the most basic motivations for MNEs to internationalize themselves. With appropriate cost control, access to new markets generally promises higher sales and increased profits. Most existing studies find a positive relationship between the amount of Chinese OFDI and the market size of host countries (Buckley et al., 2007; Duanmu & Guney, 2009; Zhang & Daly, 2011; Kolstad & Wiig, 2012; Zhang et al., 2014; Liu et al., 2017). Beyond that, two groups of scholars find that the market size of host countries is not a significant determinant (Cheung & Qian, 2008; Huang & Wang, 2011). In Report on Development of China’s Outward Investment (Ministry of Commerce of China, 2018), taking advantage of international markets is
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Table 4. Correlation Matrix
mentioned many times as a primary purpose of investing abroad. The almost-saturated domestic market makes international markets an attractive alternative source of revenue growth. Both existing studies on Chinese OFDI and the top-level design of Chinese OFDI by the Chinese government make us expect a positive relationship between the amount of Chinese OFDI and the market size of host countries.

Among the studies on Chinese OFDI, both GDP in constant US dollars and GDP in current US dollars are used as proxies for market size. The data on Chinese OFDI flows and Chinese contracted projects are only available in current US dollars. We use the GDP of host countries in current US dollars as a proxy for market size in order to make this proxy consistent with the others.

Control variable 2: GDP per capita

GDP per capita is also related to the market-seeking motivation of Chinese OFDI and helps distinguish whether Chinese OFDI is more likely to go to high-end markets or low-end markets. In his influential work, Buckley (2007) uses GDP per capita in host countries as a proxy for the relative market size of host countries and finds that it is not a significant determinant of Chinese OFDI. We abandon the concept of relative market size and use GDP per capita as a control variable directly. People living in countries with higher GDP per capita are more likely to afford expensive high-end imports rather than only consume basic supplies and food. Chinese OFDI is found to be significantly negative to GDP per capita in developed countries (Cheung & Qian, 2008). The reason provided by Cheung and Qian is that CMNEs were not able to offer high-end products in rich countries. However, it is questionable whether this reason is still tenable. CMNEs have overcome perceptions of low quality and have developed reputable brands. In the top-level design of Chinese OFDI by the Chinese government, CMNEs are encouraged to transfer comparatively
advanced production to other countries. CMNEs now have good reason to prefer countries with higher GDP per capita as OFDI destinations.

This variable is measured by the GDP per capita of host countries in current US dollars. The reason we adopt current US dollars is the same as above.

Control variable 3: Natural resources

According to the “two markets and two resources” strategy, Chinese OFDI is supposed to reduce the domestic demand for natural resources by exploiting international natural resources. Most groups of scholars have established that Chinese OFDI is more likely to go to countries with more natural resources (Buckley et al., 2007; Huang & Wang, 2011; Kolstad & Wiig, 2012; Zhang et al., 2014; Liu et al., 2017) and two groups do not (Cheung & Qian, 2008; Duanmu & Guney, 2009). Chinese contractors have been found to be interested in the natural resources of Africa and Latin America (Feng, Jiang & Yu, 2015; Feng, Gao & Jiang, 2018). The close cooperative relationship between Chinese investors and Chinese contractors gives us more confidence in the positive relationship between Chinese OFDI and natural resources.

For natural resources, we use the percentage of total natural resources rents to GDP as a proxy. Total natural resources rents are the sum of oil rents, natural gas rents, coal rents, mineral rents, and forest rents. The higher the percentage is, the more natural resources are available to CMNEs in a host country.

Independent variable 1: Partnership

The Chinese government has different levels of partnership with host countries. The partnership variable reflects the level of partnership the Chinese government has with host countries. To measure it, we have an integer scale from -1 to 3. We assign -1 to the countries that
do not have diplomatic relations with China. In other words, these countries have diplomatic relationships with the Republic of China (Taiwan). We assign 0 to the countries that have diplomatic relations but not any partnership with China. We assign 1 to the countries that have a basic partnership with China. We assign 2 to the countries that have a strategic partnership with China. 3 is assigned to the countries that have a strategic cooperative partnership with China. The level of partnership is decided based on the official description by the Ministry of Foreign Affairs of China.

Independent variable 2: Contracted projects

We use the annual value of fulfilled contracted projects as a proxy for contracted projects. The higher the value is, the more Chinese contracted projects are operated in host countries. We expect a positive impact of contracted projects on Chinese OFDI.

Independent variable 3: OFDI stock

For OFDI stock, we use the amount of Chinese OFDI stock in host countries as a proxy. It also is in current US dollars. Using the ratio of Chinese OFDI stock in host countries to total Chinese OFDI as a proxy for the agglomeration effect, Cheung and Qian (2008) have confirmed that Chinese OFDI tries to take advantage of the agglomeration effect. Such a proxy is appropriate only if the total Chinese OFDI stock is still low. With a much higher total OFDI stock than ten years ago, China now does not need to strictly concentrate its OFDI stock to take advantage of agglomeration effects. Even one one-thousandth of total Chinese OFDI stock is a huge amount of money and enough to generate the agglomeration effects of CMNEs.

Independent variable 4: Combination of manufacturing capacity and labor cost
The percentage of industry output to total GDP is adopted as a proxy for manufacturing capacity in host countries and GDP per capita is adopted as a proxy for labor costs. A higher percentage of industry output to total GDP implies larger manufacturing capacity. Higher GDP per capita implies higher labor costs because it is usual for laborers in richer countries to be paid better for the same work than those in poorer countries. Using GDP per capita as a proxy for labor costs could be confusing because it is more often used as the measurement of countries’ affluence. However, as a proxy, it enables us to measure the labor costs of most countries. Dividing the percentage of industry output to total GDP by GDP per capita, we get the combination of manufacturing capacity and labor cost. The final value of this combination is multiplied by one thousand in our dataset. The higher the value is, the more suitable it is for a country to be the destination of production transfer.

Independent variable 5: Technology

We use total patent grants counted by applicants’ origin country as the proxy for technology. The more patents granted to a country, the more technologies this country masters. Total (resident plus non-resident) annual patent registrations in host countries is used as a proxy for the variable of strategic assets by Buckley (2007), but this variable is found to be insignificant.

Independent variable 6: Political Stability

For political stability, we use the percentile rank on political stability from The Worldwide Governance Indicators as a proxy. The higher the percentile rank is, the higher political stability a host country has.

Independent variable 7: Debt Level
We use the percentage of total external debt to gross national income as a proxy for the debt level of host countries. The higher the percentage is, the higher the debt level is in host countries.

We admit that we adopt a crude proxy here. The level of debt is also affected by other factors such as debt maturity and domestic economic growth rate. Long-term debt gives a country more time to repay a debt and a high economic growth rate often implies a growing debt-paying ability. In addition, borrowing money for profitable grand projects can even lower the debt level of host countries in the future.

Our dataset covers the period of time from 2003 to 2016.

We have 175 countries included in our dataset (see Table 5). These countries are sorted into eight groups. The sorting of the first four groups is based on the identity of OECD-countries and the availability of debt data. The sorting of the later four groups is based on 2018 gross national income per capita. The groups are: high income, $12,375 or more; upper middle income, $3,996 to $12,374; lower middle income, $1,026 to $3,995; low income, $1,025 or less (World Bank, 2019). It should be noted that the level of GDP per capita varies greatly among the countries in the same group.

The division of countries into these eight groups allows us to observe whether Chinese OFDI has different strategies in different groups of countries. For example, Chinese OFDI could be attracted to natural resources only in low-income countries and could seek technology only in high-income countries and upper-middle-income countries. Although the group of high-income countries overlaps with the group of OECD countries, the variable of partnership could be only significant in the former group. The latter group is composed of countries that are mostly the traditional allies of the United States and thus opposed to the involvement of the Chinese
government in OFDI. In addition, such a division gives us an opportunity to do some robustness analysis.

Group 1: Full samples

This group includes all 175 countries in our dataset.

Group 2: Non-OECD countries with debt data

This group includes the 109 non-OECD countries that make their debt information available in the World Bank Development Indicators database. The 30 non-OECD countries without published debt data are not included in this group.

Group 3: OECD countries

This group includes 36 OECD countries.

Group 4: Non-OECD countries

This group includes 139 non-OECD countries. Both the non-OECD countries with debt data and those without debt data are included.

Group 5: High-income countries

This group is composed of 55 high-income countries.

Group 6: Upper middle-income countries

This group is composed of 53 upper middle-income countries.

Group 7: Lower middle-income countries

This group is composed of 41 lower middle-income countries.
Table 5: The Eight Groups of Countries

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<th>Non-OECD Countries with Debt Data (109)</th>
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<td>Gabon</td>
<td>Namibia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Kyrgyzstan</td>
<td>Salvador</td>
<td></td>
</tr>
<tr>
<td>Bolivia</td>
<td>Laos</td>
<td>Sao Tome and Principe</td>
<td></td>
</tr>
<tr>
<td>Cambodia</td>
<td>Lesotho</td>
<td>Senegal</td>
<td></td>
</tr>
<tr>
<td>Cameroon</td>
<td>Mauritania</td>
<td>Solomon Islands</td>
<td></td>
</tr>
</tbody>
</table>
Group 8: Low-income countries

This group is composed of 26 low-income countries.

5.2 Equations and Models

This dissertation has the following two equations:

\[
\text{ChineseOFDI}_it = \alpha + \beta_1(\text{Market size})_{it} + \beta_2(\text{GDP per capita})_{it} + \beta_3(\text{Natural resources})_{it} + \beta_4(\text{Partnership})_{it} + \beta_5(\text{Contracted projects})_{it} + \beta_6(\text{OFDI Stock})_{it} + \beta_7(\text{Manufacturing capacity/labor cost})_{it} + \beta_8(\text{Technology})_{it} + \beta_9(\text{Political stability})_{it} + \varepsilon_{it}
\]

\[
\text{ChineseOFDI}_it = \alpha + \beta_1(\text{Market size})_{it} + \beta_2(\text{GDP per capita})_{it} + \beta_3(\text{Natural resources})_{it} + \beta_4(\text{Partnership})_{it} + \beta_5(\text{Contracted projects})_{it} + \beta_6(\text{OFDI Stock})_{it} + \beta_7(\text{Manufacturing capacity/labor cost})_{it} + \beta_8(\text{Technology})_{it} + \beta_9(\text{Political stability})_{it} + \beta_{10}(\text{Debt level})_{it} + \varepsilon_{it}
\]

The difference between these two equations is that we introduce the debt level of host countries as an independent variable to the second equation. To estimate these two equations, we
Table 6: The Regression Results for Full Samples

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Size</td>
<td>0.0001621 (0.00001599)</td>
<td>0.000919 *** (0.000079)</td>
<td>0.00016538 *** (0.000019029)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>0.2794 *** (0.08288)</td>
<td>0.6026 ** (0.305)</td>
<td>0.3061 *** (0.09869)</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>-109.8 (102.7)</td>
<td>387.68 (278.51)</td>
<td>-67.055 (121.08)</td>
</tr>
<tr>
<td>Partnership</td>
<td>825.6 (1332)</td>
<td>7777.5 ** (3099.7)</td>
<td>1399.7 (1553.2)</td>
</tr>
<tr>
<td>Contracted Projects</td>
<td>0.1058 *** (0.0147)</td>
<td>0.0551 *** (0.0204)</td>
<td>0.10569 *** (0.015839)</td>
</tr>
<tr>
<td>OFDI Stock</td>
<td>0.0274 *** (0.0016)</td>
<td>0.0141 *** (0.0016)</td>
<td>0.025962 *** (0.0015791)</td>
</tr>
<tr>
<td>Manufacturing capacity/ labor costs</td>
<td>125.2 * (71.47)</td>
<td>124.26 (126.08)</td>
<td>125.84 (81.034)</td>
</tr>
<tr>
<td>Technology</td>
<td>-0.1406 * (0.07265)</td>
<td>1.105 *** (0.24)</td>
<td>-0.08289 (0.086996)</td>
</tr>
<tr>
<td>Political Stability</td>
<td>99.9 * (59.69)</td>
<td>27.924 (144.64)</td>
<td>95.278 (69.519)</td>
</tr>
<tr>
<td>Number of Observations</td>
<td>2450</td>
<td>2450</td>
<td>2450</td>
</tr>
<tr>
<td>R Square</td>
<td>0.2991</td>
<td>0.25735</td>
<td>0.25838</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.2965</td>
<td>0.19738</td>
<td>0.25564</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Size</td>
<td>0.0004411 *** (0.0003869)</td>
<td>0.0015378 *** (0.00037613)</td>
<td>0.00045147*** (0.000041391)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>0.3117 (0.1956)</td>
<td>0.33518 (1.3678)</td>
<td>0.32812 (0.21309)</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>-223 (295.4)</td>
<td>870.8 (1054.7)</td>
<td>-202.98 (319.39)</td>
</tr>
<tr>
<td>Partnership</td>
<td>522.9 (2947)</td>
<td>23205 ** (10613)</td>
<td>779.57 (3188)</td>
</tr>
<tr>
<td>Contracted Projects</td>
<td>0.1089 *** (0.02789)</td>
<td>0.077023 (0.071652)</td>
<td>0.10638 *** (0.029918)</td>
</tr>
<tr>
<td>OFDI Stock</td>
<td>0.01258 *** (0.002677)</td>
<td>0.0036272 (0.0026317)</td>
<td>0.011024 *** (0.0026298)</td>
</tr>
<tr>
<td>Manufacturing capacity/ labor costs</td>
<td>389.7 (269.7)</td>
<td>-582.66 (1257.2)</td>
<td>376.06 (293.17)</td>
</tr>
<tr>
<td>Technology</td>
<td>-0.5221 *** (0.154)</td>
<td>2.2172 * (1.3407)</td>
<td>-0.5267 *** (0.16784)</td>
</tr>
<tr>
<td>Political Stability</td>
<td>285.3 * (153.2)</td>
<td>-801.18 (539.15)</td>
<td>266.53 (165.81)</td>
</tr>
<tr>
<td>Number of Observations</td>
<td>875</td>
<td>875</td>
<td>875</td>
</tr>
<tr>
<td>R Square</td>
<td>0.3844</td>
<td>0.08256</td>
<td>0.34376</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.378</td>
<td>-0.16045</td>
<td>0.33693</td>
</tr>
</tbody>
</table>

Chi(9)^2 = 280.13 in the Hausman test for the full sample 2003 - 2016 group. Random effect model is thus rejected. ***significant at 0.01 level; ** significant at 0.05 level; * significant at 0.1 level
try to use pooled ordinary least squares regression, fixed effect regression, and random effect regression.

5.3 Empirical Results

The results for the group of full samples are presented in Table 6. In the pooled ordinary least squares regression, GDP per capita is significantly positive as a control variable and four of the six independent variables are significantly positive. These independent variables are contracted projects, OFDI stock, the combination of manufacturing capacity and labor costs, and political stability. Technology is a significantly negative independent variable and partnership is irrelevant. The results from pooled ordinary least squares regression give some support to our hypotheses related to contracted projects, OFDI stock, the combination of manufacturing capacity and labor costs, and political stability.

However, the most suitable regression method for the two equations should be fixed effect regression or random effect regression because our dataset is panel data. To decide which one is preferable between fixed effect regression and random effect regression, we run a Hausman test. The result of the Hausman test is shown at the bottom of Table 6. Random effect regression is rejected by the Hausman test. Therefore, fixed effect regression is the most preferable regression method and we will focus on the results from fixed effect regression.

In the fixed effect regression for the group of full samples, four of the six independent variables are significantly positive. Chinese OFDI is more likely to go to countries with a higher level of partnership with China, more Chinese contracted projects, more Chinese OFDI stock, and more advanced technology. The combination of manufacturing capacity and labor costs and political stability are two irrelevant independent variables. It could take a much longer time for
CMNEs to set up overseas factories for the purpose of production transfer than to acquire or merge with foreign enterprises for the purpose of overseas technology acquisition. Hypotheses 1, 2, 3 and 5 are supported by the results of fixed effect regression for the group of full samples. By contrast, hypotheses 4 and 6 are not supported. In addition, Chinese OFDI is more directed to countries with larger market size and higher GDP per capita but not more natural resources.

The results of fixed effect regression for the other seven groups of samples are presented together with those for the group of full samples in Table 7. We now discuss the results for each of these seven groups of samples. In the group of non-OECD countries with debt data, natural resources is significantly positive as a control variable. Contracted projects and OFDI stock are significantly positive as independent variables. Debt level is an irrelevant independent variable and the result of debt level does not support hypothesis 7. The results for the group of non-OECD countries are not very different from those for the last group. Natural resources and OFDI stock remain significantly positive but contracted projects turns to be irrelevant. The group of non-OECD countries with debt data is mostly composed of lower middle-income and low-income countries. By contrast, there are more upper middle-income countries and even high-income countries in the group of non-OECD countries. Chinese contracted projects in these upper middle-income countries and high-income countries may not have a positive impact on the local investment environment as strong as those in lower middle-income countries and low-income countries. The results for the group of OECD countries are quite different from those for the former two groups. Market size is significantly positive as a control variable. Contracted projects, OFDI stock, and the combination of manufacturing capacity and labor costs are significantly positive as independent variables and therefore the result of these variables give some support to hypotheses 2, 3, and 4. The results for the group of high-income countries are similar to those for the group of
Table 7: The Regression Results for Eight Groups of Countries

<table>
<thead>
<tr>
<th>Adjusted R Square</th>
<th>R Square</th>
<th>Number of Observations</th>
<th>Debt Level</th>
<th>Political Stability</th>
<th>Technology</th>
<th>Manufacturing capacity/labor costs</th>
<th>OFDI Stock</th>
<th>Contracted Projects</th>
<th>Partnership</th>
<th>Natural Resources</th>
<th>GDP per capita</th>
<th>Market Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0.19738</td>
<td>2450</td>
<td>0.25735</td>
<td>27.92 (144.64)</td>
<td>1.105 ***</td>
<td>0.0141 *** (0.24)</td>
<td>0.0551 *** (126.08)</td>
<td>0.0141 *** (0.24)</td>
<td>0.0551 *** (126.08)</td>
<td>0.0141 *** (0.24)</td>
<td>0.0551 *** (126.08)</td>
<td>0.0141 *** (0.24)</td>
</tr>
<tr>
<td>0</td>
<td>0.17012</td>
<td>1526</td>
<td>0.23433</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>0.39072</td>
<td>1946</td>
<td>0.43677</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>0.24981</td>
<td>504</td>
<td>0.31543</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>0.23374</td>
<td>770</td>
<td>0.29652</td>
<td></td>
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<tr>
<td>0</td>
<td>0.085721</td>
<td>742</td>
<td>0.16099</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>0.46881</td>
<td>574</td>
<td>0.51423</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>0.19127</td>
<td>364</td>
<td>0.26701</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>0</td>
<td>109</td>
<td>0.33318</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Significant at 0.01 level, ** significant at 0.05 level, * significant at 0.1 level
OECD countries. The primary difference is that partnership turns out to be significantly positive in the group of high-income countries. Overlapping with the group of high-income countries, the group of OECD countries is mostly composed of the traditional allies of the United States and may thus limit the role of China’s partnership with host countries. It is a little surprising that Chinese OFDI is attracted to countries with a combination of larger manufacturing capacity and lower labor costs in the groups of OECD countries and high-income countries. Production transfer to these groups of countries requires high value-added production to cover the high labor costs in these countries. The research and development capacity of CMNEs could be larger than we expect. Chinese contracted projects in OECD countries and high-income countries may not improve the local investment environment greatly but target CMNEs’ demands well. In the groups of upper middle-income countries and lower middle-income countries, natural resources and OFDI stock are significantly positive. Contracted projects is a significantly positive variable in the group of lower middle-income countries but not the group of higher middle-income countries. The results for the group of low-income countries are quite different from those for the other seven groups. Natural resources, contracted projects, and OFDI stock are significantly positive in this group. However, we get three significantly negative independent variables in this group. They are partnership, the combination of manufacturing capacity and labor costs, and technology. The Chinese government may not push CMNEs to the austere investment environment provided by low-income countries. Low income countries are obviously the destinations for CMNE to transfer production and the sources for CMNEs acquire technology.

The division of countries allows us to determine whether CMNEs adopt different strategies in different countries. CMNEs are seeking larger market size and the combination of larger manufacturing capacity and lower labor costs in the group of OECD countries and high-income
countries. It seems that CMNEs not only intend to sell more products to rich countries but also try to produce these products locally. By contrast, CMNEs are more attracted to countries with more natural resources only in the groups of non-OECD countries with data, non-OECD countries, upper middle-income countries, lower middle-income countries, and lower-income countries.

The division of countries into eight groups also allows us to get some ideas about the robustness of our variables. OFDI stock, contracted projects and natural resources are three robust variables. They have a significantly positive relationship with Chinese OFDI in most groups of countries. By contrast, the other two control variables and five independent variables are less robust. These mixed results of control variables and independent variables could be caused by CMNEs’ different strategies in different countries.

In general, our empirical results more or less give support to six of the seven hypotheses. Hypotheses 1, 2, 3, and 5 are supported by the results of fixed effect regression for the group of full samples. Chinese OFDI is more likely to go to countries that have a higher level of partnership with China, more Chinese contracted projects, more Chinese OFDI stock, and more advanced technologies. Hypothesis 4 is supported by the results of fixed effect regression for the group of OECD countries and high-income countries. Chinese OFDI is more likely to go to countries with a combination of higher manufacturing capacity and lower labor costs among OECD countries and high-income countries. Hypothesis 6 is only supported by the results of ordinary least squares regression for the group of full samples. It could be arbitrary to conclude that Chinese OFDI prefers countries with higher political stability. The results of fixed effect regression for the group of non-OECD countries with debt data do not support hypothesis 7. Chinese OFDI is not more likely to go to countries with higher debt level.
CHAPTER 6

CONCLUSION

China has been one of the largest global investors and the footprints of CMNEs have been almost everywhere in the world. Despite the success achieved by CMNEs, CMNEs’ going abroad has not been getting easier and easier. CMNEs have been losing traditional cost advantage because of the increasing domestic operation cost and drawing hostility from protectionists in foreign markets.

To make the further internationalization of CMNEs smoother, the Chinese government tries to make a top-level design for CMNEs’ OFDI. The huge influence of the Chinese government on CMNEs makes it possible that the top-level design could be well carried out by CMNEs. The top-level design for CMNEs is mainly reflected in the BRI and Made in China 2025. The BRI is a national strategy which is supposed to make China and participating countries connected more closely in terms of transportation, policy coordination, economic cooperation, etc. The international market and resources are more accessible to CMNEs than before because of the BRI. Made in China 2025 gives a priority to the development of manufacturing industry and a guide about how the whole Chinese society could support the CMNEs in manufacturing industry improving their international competitiveness and taking advantage of international market and resources.

The essence of the top-level design for CMNEs’ OFDI is a reciprocal relationship between the Chinese government’s political benefits and CMNEs’ economic benefits and the role of an organizer played by the Chinese government in that reciprocal relationship. We argue that taking advantage of such a reciprocal relationship and the role played by the Chinese government could
be an important motivation for Chinese OFDI. We generalize seven situations in which CMNEs’ OFDI could benefit from the reciprocal relationship and the role of the Chinese government. These situations include: CMNEs make OFDI in countries that are friendly to the Chinese government; CMNEs make OFDI in countries that have more Chinese contracted projects; CMNEs make OFDI in countries that have more Chinese OFDI stock; CMNEs make OFDI in countries that are suitable for production transfer; CMNEs make OFDI in countries that are good at technology development; CMNEs make OFDI in countries that are politically stable; and, finally, CMNEs make OFDI in countries that have difficulty in debt repayment. According to these situations, we derive seven hypotheses to test to what extent CMNEs take advantage of their reciprocal relationship with the Chinese government and the role of an organizer played by the Chinese government. We find that Chinese OFDI is more attracted to countries with a higher level of partnership with China, more Chinese contracted projects, more Chinese OFDI stock and more advanced technologies. We notice that Chinese OFDI has different strategies in different groups of countries. Chinese OFDI is more likely to go to countries with the combination of a higher manufacturing capacity and lower labor cost among OECD countries among developed countries. Chinese OFDI is more likely to go to countries with more natural resources among middle-income countries and low-income countries. We do not find evidence of Chinese OFDI’s preference to countries with higher political stability and higher debt level. In general, our findings give some support to our argument that CMNEs take advantage of their reciprocal relationship with the Chinese government and the role of an organizer played by the Chinese government.

This dissertation makes distributions in the following three aspects. Firstly, it is the first study to investigate Chinese OFDI at national level, industrial level and firm level with a multilevel framework. We discuss China’s OFDI-related national strategy, China’s OFDI-related industrial
policy, CMNEs’ entry model and the financial structure of Chinese OFDI after an introduction to the international circumstances and the domestic situation of Chinese OFDI. Although CMNEs’ overseas activities are required to be consistent with the top-level design by the Chinese government, CMNEs reserve their decision rights on many issues such as the entry model and the financial form of OFDI. National-level, industry-level, and firm-level analysis deliver a whole picture of Chinese OFDI together. Secondly, the hypotheses of this dissertation are not simply derived from conventional OFDI theories as those in existing studies. We argue that taking advantage of a reciprocal relationship between the Chinese government’s political benefits and CMNEs’ economic benefits and the role of an organizer played by the Chinese government in the reciprocal relationship could be an important motivation for Chinese OFDI. From such a relationship and role, we derive the hypotheses of this dissertation. The testing results of these hypotheses support that CMNEs have been enjoying an exclusive advantage in international competition. Thirdly, this dissertation not only argues against existing studies but also discusses some popular topics relating to Chinese OFDI such as debt trap and national security. From the entry model and investment form chosen by CMNEs and the official documents published by the Chinese government, we find solid reasons for CMNEs to prefer political stability rather than political instability. The form of OFDI preferred by CMNEs is dependent on long-term benefits, which require a stable environment to secure. Besides that, the executives of CMNEs are supposed to be punished for their ignorance of the political risk in host countries and the capital cost for CMNEs is not as low as before. Political instability could also lead to the abolishment of planned OFDI projects once irregular government changes or major regular government changes take place in host countries. The results of fixed effect regression do not support neither the preference of CMNEs for countries with higher political stability nor the preference of CMNEs for countries
with lower political stability. Our findings offer some evidence to two frequently discussed issues in international society. Chinese OFDI does not prefer countries with higher debt level where debt traps are more feasible. Therefore, China may not strategically exploit other countries with debt traps. Chinese OFDI is more likely to go to countries that have more advanced countries. China seems acquiring overseas technologies effectively by Chinese OFDI.

In addition, this dissertation has policy implications for the following three issues. The first issue is the relationship between home country governments and domestic MNEs. The reciprocal relationship between the Chinese government and CMNEs examined in this dissertation is an example in which the home country government is not simply a supervisor of domestic MNEs. To cultivate the reciprocal relationship, the Chinese government makes its political benefits compatible with CMNEs’ economic benefits through the top-level design of Chinese OFDI and playing the role of an organizer. Such a reciprocal relationship requires the ability of home country governments to exert huge influence on domestic MNEs and thus may not be applicable to many countries. Fortunately, what the Chinese government has done should not be the only way for home country governments to develop a reciprocal relationship with domestic MNEs. For example, a top-level design of philanthropy could be helpful in developing a reciprocal relationship between developed country governments and domestic MNEs, especially if those owners or executives of MNEs really want to make their countries better. The redistribution of MNEs’ profits, especially monopoly profits, should improve the public profile of MNEs and reduce financial pressures on governments. The second issue is home country governments’ support to domestic MNEs’ OFDI. What the Chinese government does for CMNEs’ OFDI could be unrealistic for other home country governments. Taking the utilization of overseas contracted projects as an example, China has several of the largest international project contractors in the world, such as China Communications
Construction Group, Power Construction Corporation of China, China State Construction Engineering Corporation, and China Railway Construction Corporation. Only a few countries have capable international project contractors such as the United States, Spain, Germany, France, Japan, Austria, and India. Even in these countries, governments’ involvement in business could be unacceptable to the public because of the idea of small government. It is questionable whether these governments have the political capacity to promote cooperation between these MNEs and coordinate the interests of all parties in that cooperation. What we can learn from China could be not what China is doing but making strategy and policy based on national conditions. The third issue is how should host countries treat Chinese OFDI. Although our finding that Chinese OFDI does not prefer countries with higher debt level could relieve the accusations about China’s debt trap to some extent, it is imperative for host country governments to conduct financial assessment of potential projects, especially large projects. No matter whether foreign experts may distort intentionally the benefits of potential projects, they are very likely not to be familiar enough with local conditions to give the most accurate assessment. Another finding of this dissertation is that Chinese OFDI is more directed to countries that have more advanced technologies. Developed countries have been more and more cautious about potential threats to national security from CMNEs in the recent years. It is worth discussing whether the host countries of Chinese OFDI should forbid or encourage domestic MNEs or institutions to develop a cooperative relationship with CMNEs on the issue of technology development, especially those host countries with comparatively advanced technologies. If the current blockade of science and technology from host country governments fails to stop CMNEs’ technology development, CMNEs will charge a lot for their own new technologies or will not share these technologies in the future. It is good timing to develop a cooperative relationship on technology development with CMNEs when CMNEs are
not overwhelmingly advanced in technology and have shown great potential for technology development. In practice, some other factors are considered in the decision of whether to develop cooperative relationships with CMNEs, such as national security and elections, and hinder the formation of such relationships.

Many future research issues remain for Chinese OFDI. Firstly, the measurement and construction of variables need to be improved. Other proxies could be used for the variables such as political instability. The political risk ratings provided by The International Country Risk Guide is an ideal alternative to measure political stability. It has been used by several groups of scholars in their research on Chinese OFDI (Buckley et al., 2007; Cheung & Qian; 2008, Liu, Tang, Chen & Poznanska, 2017). The use of other proxies should not only make the measurement of variables more precise but also allow us to do more robustness analysis of the adopted models. New variables could be created to reflect whether a country is suitable to be the destination of production transfer. The combination of manufacturing capacity and labor costs is quite a crude variable. Secondly, more efforts could be made to explore the effects of Chinese OFDI on host countries. For example, it could be meaningful to investigate whether a higher Chinese OFDI stock in a host country makes this country outperform other countries in economic development. If so, it could be concluded that the FDI from China is more beneficial to the economic development of host countries than the FDI from other countries. If not, it implies to host country governments that it does not make much sense to make concessions to the Chinese government or Chinese investors in project negotiation. Thirdly, comparative research could be conducted to investigate the government relationships of U.S. MNEs, European MNEs and Japanese MNEs. The absence of a home country government could also give an advantage to domestic MNEs in international competition. Such comparative research may help us explore the optimal level of a home country’s
involvement in domestic MNEs’ internationalization. Lastly, more attention could be paid to the cooperative relationship between CMNEs. We discuss the agglomeration effects of CMNEs in this dissertation. Creating the agglomeration effects is only one of the patterns in which CMNEs cooperate with each other to increase international competitiveness. The merger of the two largest high-speed rail markers in China, China North Railway and China South Railway, was completed in 2015 to avoid price competition between them in the international market. Such a merger is another pattern for CMNEs to cooperate with each other: internalization for internationalization. The merger of the two largest shipbuilding enterprises, China State Shipbuilding Corporation and China Shipbuilding Industry Corporation, is being pursued for the same reason. Setting up overseas joint ventures is another pattern for CMNEs to cooperate with each other. The pattern could vary based on whether the potential cooperation is between state-owned CMNEs, private CMNEs, or state-owned CMNEs and private CMNEs. Our underestating of Chinese OFDI should benefit greatly from the exploration of the different patterns of CMNEs’ internationalization.
REFERENCES


