Home Country Economic Policy Uncertainty, Institutional Distance and Chinese Large Enterprises' OFDI

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Abstract： This study takes the large Chinese enterprises from 2005 to 2021 as the research object, empirically analyze the impact of the economic policy uncertainty of the home country on their OFDI. The empirical result shows that the economic policy uncertainty has a significant restraining effect on the OFDI, but institutional distance has a positive moderating effect on this negative impact. The heterogeneity analysis found that economic policy uncertainty has a significant inhibitory effect on the host countries whose institutional quality is higher or lower than China, Sate-owned enterprises, manufacturing industry and service industry, but it has no significant impact on non-state-owned enterprises' OFDI. However, the interaction term has a positive moderating effect on the host countries whose institutional quality is higher or lower than China, and service industry investment. Therefore, this paper further expands the research on the relationship between economic policy uncertainty and OFDI, and provides corresponding theoretical guidance for the government to formulate strategies to promote enterprises' outbound investment and reduce enterprises' investment risks.

Key words: Home country; economic policy uncertainty; institutional distance; OFDI; moderating effect

1. Introduction

With the in-depth development of global economic integration, China has gradually integrated into the world economy, the growth of OFDI has entered the "lane of rapid development," and the structure of OFDI has also been optimized.The continuous advancement of China's deep-level reform has increased the degree of economic policy uncertainty, which has also become an important factor affecting enterprises' foreign investment decisions.After the financial crisis, corporate investment risk increases with the increase of economic policy uncertainty, and the impact of economic policy uncertainty on corporate investment behavior has attracted much attention(Pastor et al.,2013)[1].Enterprises usually respond by reducing R&D investment, investment expenditure(Rao, 2017)[2], and increasing cash flow holdings(Wang Hongjian, 2014)[3].This paper takes China's large enterprises from 2005 to 2021 as the research sample,

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and explores the impact of economic policy uncertainty in the home country on its OFDI decision.

The possible contributions of this paper are as follows: First, from the perspective of economic policy uncertainty,it enriches the relevant literature on the OFDI of large Chinese enterprises;Second,it expands the research scope of the impact of economic policy uncertainty in the home country on the investment behavior of micro firms.

2. Review of literature

2.1 Economic policy uncertainty and enterprise OFDI

After the financial crisis, economic policy uncertainty has increased, and governments around the world have introduced a series of relevant economic policy intervention measures, the investment risk of individuals and enterprises increases, and the investment behavior of enterprises is inhibited.On the basis of Baker et al.(2013)[4], Chen Yinmo et al(2019)[5]. concluded that economic policy uncertainty inhibits enterprises' FDI. Li Fengyu and Yang Mozhu(2015)[6] also concluded that economic policy uncertainty has different impacts on enterprises' OFDI behaviors during economic boom and recession periods. Yang Yongcong et al.(2018)[7] pointed out that the economic policy uncertainty of the home country is positively promoting the scale of China's OFDI, but the economic policy uncertainty of the host country inhibits the scale of China's OFDI. Although the increase of economic policy uncertainty inhibits enterprises' investment in fixed assets, it can promote corporate financial asset allocation(Liu Guanchun et al., 2020)[8].When the nature of the firm is non-state-owned and the degree of irreversibility of investment increases, the heterogeneity of enterprises' OFDI is significantly enhanced by economic policy uncertainty(Shen Huihui et al., 2012)[9].

2.2 Institutional distance and external investment of enterprises

Institutional differences between home and host countries are divided into formal differences and informal differences. Developed countries have advanced technology, high innovation and lack of market, while developing countries are mainly manufacturing, have a broad market, lack of core technology, and the Institutional quality difference makes it possible for the two to complement each other. From the perspective of cultural distance, legal distance, macro and micro distance, Pan Zhen(2006)[10] investigated how the four institutional distances affect enterprises' OFDI, and concluded that the greater institutional distance, the less enterprises' foreign direct investment. Some scholars believe that institutional distance promotes China's OFDI. Jiang Guanhong et al.(2012)[11] found that resource-seeking investment in China is also affected by institutional differences.

Informal system is a kind of conventional moral code, which belongs to the category of tacit knowledge. Wang Xiaoyu et al.(2019)[12] argue that the informal system has discouraged Chinese companies from investing in Middle Eastern countries. Shen Kunrong et al.(2018)[13] pointed out that differences in informal institutions have a greater impact on enterprises' choice of transnational mergers and acquisitions or greenfield investments. Zhang Wei et al.(2019)[14] believe that the political system distance is large, enterprises prefer to choose the

way of merger and acquisition, the cultural system distance is large, enterprises tend to choose green space investment.

According to the literature review, we can see: First, most of the existing studies are based on macroeconomic data to study the relationship between economic policy uncertainty and foreign direct investment; Second, for enterprises going out, they cannot change the institutional distance, and it is difficult to get rid of it. This paper takes large Chinese enterprises as the research object to empirically test the influence of economic policy uncertainty in home country on OFDI decision-making of large Chinese enterprises.

3. Theoretical framework and research hypothesis

3.1 Economic policy uncertainty of home country and the enterprise OFDI

The process of economic policy making is accompanied by unpredictability, opacity and fuzziness, which leads to economic policy uncertainty(Rao Pingui, 2017)[2].Compared with the changing economic policies of the host country, Chinese large enterprises have "non-market motivation" and are more significantly affected by the economic policies of the home country. Wang et al.[15] shows that governments usually exert pressure on enterprises to change their willingness to internationalize,but also will encourage enterprises to internationalize through various incentives, or issue authoritative orders and laws to restrict the behavior of multinational corporations (Li Shanmin et al. 2013)[16].

Economic policy uncertainty in the home country increases, and enterprise management cannot accurately judge policy trends.Large enterprise investment scale, long cycle, strong irreversibility, overseas projects are likely to be affected by some temporary or restrictive policies, resulting in project delay or shelving, investment risk increase, affect the welfare and reputation of the management, and ultimately inhibit enterprises' foreign direct investment. Accordingly, hypothesis 1 is proposed:

Hypothesis 1: Under the premise that other conditions remain unchanged, the increasing economic policy uncertainty of the home country will restrain the external direct investment of enterprises.

3.2 Institutional distance and external direct investment of enterprises

Institutional distance means that institutional complementary opportunities exist. The academic circle has not reached a unified conclusion on how institutional distance difference affects enterprises' outbound investment behavior. Institutional differences provide convenient conditions for the home and host countries to make use of their own advantages to achieve a win-win situation. The greater the institutional distance, the greater the gap in the degree of economic development, the worse the consistency of the economic cycle countries are in, and the greater the difference in the level of technological innovation. Xie Hongjun et al.(2017)[17] point out that during the recession, foreign asset prices fell sharply, fueling a surge in overseas acquisitions by Chinese companies. In addition, the greater the institutional distance, the greater the difference between the two sides of the industry cycle. Industry cycle has a significant impact on greenfield investment and cross-border mergers and acquisitions. In

order to obtain funds for industry transformation, developed countries may package and sell industries at the late stage of industry cycle to developing countries.

In order to reduce the risk of overseas investment, when the economic policy uncertainty of the home country increases, enterprises tend to invest in the host country with large institutional distance. At this time, institutional distance has a positive impact on Chinese enterprises' OFDI(Jiang Guanhong et al., 2012)[18]. Enterprises investing in countries with low institutional quality can obtain higher rates of return; Investing in countries with high-quality institutions can improve the production skills of local companies and boost economic growth(Wang Zeyu et al., 2019)[19]. With the increasing uncertainty of the home country's economic system, enterprises become more cautious in making investment decisions, and institutional distance plays a positive moderating role. So, the following hypothesises are proposed :

Hypothesis 2: Under the premise that other conditions remain unchanged, the institutional distance will promote enterprises' external direct investment;

Hypothesis 3: Under the premise that other conditions remain unchanged, the institutional distance plays a positive regulating role in the influence effect of the economic policy uncertainty of the parent country on the enterprise OFDI.

4. Model construction and variable design

4.1 Econometric model construction

Firstly, this study examines the impact of economic uncertainty in the home country on foreign direct investment of large Chinese enterprises. Secondly, the moderating effect of institutional distance in this relationship is verified.

$$OFDI_{ijt} = \beta_0 + \beta_1 CEPU_t + \beta_2 x_{ijt} + \sigma_i + \mu_t + \varepsilon_{ijt} \quad (1)$$

$$OFDI_{ijt} = \beta_0 + \beta_1 rdiff_{ijt} + \beta_2 CEPU_t + \beta_3 rdiff_{ijt} * CEPU_T + \beta_4 x_{ijt} + \sigma_i + \mu_t + \varepsilon_{ijt} \quad (2)$$

Among them, i, j and t represent foreign investment enterprises, investment host country and investment time respectively.OFDIijt represents the investment amount of the enterprise i in the host country j within time t;$CEPU_t$ represents China's economic policy uncertainty index within the time t;rdiffijt represents the institutional distance between China and the host country;$rdiff_{ijt}$*$CEPU_t$ represents the interaction term of the institutional distance and the uncertainty of the economic policy of the home country, to verify whether the existence and direction of the regulatory effect of the institutional distance.

4.2 Selection of variables and description of data

Dependent variable.

If firm i invests in host country j at time t, it takes the value OFDIijt.

Core explanatory variables.

Referring to Baker et al. (2013)[4] approach, the economic Policy Uncertainty Index (CEPU) of the home country is measured by adding the average data of China over 12 months,namely:

$CEPU_t = \sum \text{China's monthly economic policy uncertainty index} / 12$

Institutional distance (rdiff). Referring to ShenKunrong (2018)[13] and Ding Shihao (2019)[20]select the World Bank's global governance index, including political stability (gs), government efficiency (ge), institutional regulation (rq), laws and regulations (rl), discourse rights and accountability (va), and corruption (cc). The institutional differences between China and the host country are selected to depict the institutional distance between the two countries.

The dependent variable, core explanatory variables and control variables of this study are shown in Table 1:

Table 1 Interpretation of variables and data sources

Serial number	Variable Symbol	Variable Definition	Data Source
1	OFDI	Amount of outward foreign direct investment by enterprises	China Global Investment Tracking Database
2	CEPU	China's economic policy uncertainty	Economic Policy Uncertainty Indices
3	rdiff	Institutional distance	WGI database
4	GDPG	Host country GDP growth rate	Word Bank database
5	gdp	Host country GDP	Word Bank database
6	BIT	Bilateral investment agreements	UNCTAD database
7	DTT	Double Taxation Avoidance Agreement	Official website of the National Tax Administration
8	WTO	Member of the World Trade Organization	WTO database
9	labor	Number of host country labour force	Word Bank database
10	export	Total exports of goods and services of the host country	Word Bank database
11	dis	Host country corporate disclosure index	Doing Business database
12	political	Bilateral political relations	Ministry of Foreign Affairs website

5. Empirical analysis

5.1 Baseline regression results

It can be seen from Table 2 that the economic policy uncertainty of the home country will significantly inhibit the OFDI of large Chinese enterprises, and institutional distance (rdiff) will positively promote the OFDI behavior of large Chinese enterprises. Hypothesis 1 and

hypothesis 2 are verified. The reason is that enterprises going global are affected by relevant domestic and foreign economic policies, so the management will become extremely cautious when making overseas investment decisions, and eventually restrain the OFDI behavior of enterprises.

From columns (5) and (6) of Table 1, it can be seen that economic policy uncertainty of the home country (CEPU) inhibits the outbound investment behavior of large Chinese enterprises, and institutional distance has a positive moderating effect, which conforms to hypothesis 3. As the economic policy uncertainty of the home country increases, enterprises going global will face higher investment risks. Institutional distance provides more complementary opportunities for enterprises and reduces the perception of risks of FDI. Both parties involved in investment can also take advantage of their own advantages to complement each other and achieve a win-win situation.

Table 2 Baseline regression results

	(1)	(2)	(3)	(4)	(5)	(6)
Variable	OFDI	OFDI	OFDI	OFDI	OFDI	OFDI
CEPU	-0.099***	-0. 123***	-0. 101***	-0. 117***	-0. 153***	-0. 170***
	(0.0339)	(0.0356)	(0.0340)	(0.0354)	(0.0429)	(0.0450)
rdiff			0.0299**	0.0334*	0.000947	0.0115
			(0.0146)	(0.0191)	(0.0209)	(0.0223)
CEPU*rdiff					0.000246*	0.000263*
					(0.000132)	(0.000148)
Control variable	no	yes	no	yes	no	yes
Constant term (math.)	6.596***	5.867***	6.616***	5.910***	6.820***	6. 168***
	(0. 185)	(0.283)	(0. 187)	(0.286)	(0.212)	(0.317)
Time fixed effect	yes	yes	yes	yes	yes	yes
Corporate fixed effect	yes	yes	yes	yes	yes	yes
Observation	3125	2908	3120	2904	3120	2904

Note: The statistics in parentheses are t-statistics and ***, **, * represent 1%, 5%, and 10% significance levels, respectively.

5.2 Robustness tests

1.Replace the explained variable

Replacement of OFDIijt with enterprise outbound investment scale (SOFDIit) indicates the investment amount of enterprise i in the host country in time t.

2.Replace the economic policy uncertainty indicators of the home country

Replace the CEPU with a geometric average(GCEPU) of 12 months of monthly data on China's economic policy uncertainty Index.

3.Replacement of the institutional distance from the variable selection

According to the method of Shen Kunrong et al. (2018) [13], sub-indexes are selected for testing, and the institutional distance (gediff) of government efficiency (ge) index is taken as the proxy variable. It can be seen from Table 3 after a series of robustness tests.

Table 3 Robustness tests

	(1)	(2)	(3)	(4)	(5)	(6)
Variable	SOFDI	SOFDI	OFDI	OFDI	OFDI	OFDI
CEPU	-0.142*** (0.0475)	-0.142*** (0.0475)			-0.124*** (0.0356)	-0.146*** (0.0512)
GCEPU			-0.110*** (0.0350)	-0.162*** (0.0448)		
rdiff	0.0423** (0.0202)	0.0142 (0.0236)	0.0332* (0.0191)	0.0120 (0.0224)		
gediff					0.0361* (0.0193)	0.0239 (0.0281)
CEPU*rdiff		0.000338** (0.00016)				
GCEPU*rdiff				0.000276* (0.00016)		
CEPU*gediff						0.000116* (0.000197)
Control variable	yes	yes	yes	yes	yes	yes
constant	5.602*** (0.307)	5.937*** (0.339)	5.864*** (0.283)	5.864*** (0.283)	5.932*** (0.284)	5.905*** (0.293)
Time fixed	yes	yes	yes	yes	yes	yes
Corporate fixed	yes	yes	yes	yes	yes	yes
Observation	2907	2907	2904	2904	2907	2907

Note: The statistics in parentheses are t-statistics and ***, **, * represent 1%, 5%, and 10% significance levels, respectively.

6. Sub-sample regression

6.1 Different institutional distance "bias" and OFDI by large Chinese firms

If the institutional quality value of the host country is higher than that of China, the institutional distance(rdiff) is positive (rdiff higher). Otherwise, the institutional distance is negative (rdiff lower).As can be seen from Table 4, in host countries with different "bias" of institutional distance, economic policy uncertainty of home country significantly inhibits OFDI behavior of enterprises, and the interaction term between it and institutional distance (CEPU*rdiff) has a significant positive moderating effect on OFDI of enterprises.

Table 4 Institutional "bias" of different heterogeneity analysis

	(1)	(2)	(3)	(3)
Variable	rdiff higher	rdiff higher	rdiff lower	rdiff lower
CEPU	-0. 116* (0.0626)	-0.221** (0.0899)	-0. 109** (0.0437)	-0. 188*** (0.0579)
rdiff	0.0563 (0.0376)	-0.00312 (0.0525)	-0.00355 (0.0295)	-0.0223 (0.0303)
CEPU*rdiff		0.00153* (0.000904)		0.0003* (0.000162)
Control variable	yes	yes	yes	yes
constant	6.216*** (0.496)	6.552*** (0.535)	5.441*** (0.361)	5.867*** (0.418)
Time fixed	yes	yes	yes	yes
Corporate fixed	yes	yes	yes	yes
Observation	1609	1609	2051	2051

Note: The statistics in parentheses are t-statistics and ***, **, * represent 1%, 5%, and 10% significance levels, respectively.

6.2 Different firm nature and OFDI of large Chinese firms

This paper divides China's large enterprises into state-owned enterprises and non-state-owned enterprises according to enterprise ownership. As can be seen from Table 5, the inhibitory effect of economic policy uncertainty of the home country on OFDI behavior of enterprises is significant in state-owned enterprises, but not in non-state-owned enterprises, and the moderating effect of institutional distance is not significant in the two types of enterprises.

Table 5 Enterprise Ownership Heterogeneity

	(1)	(2)	(3)	(4)
Variable	state	state	non state	non state
CEPU	-0.148*** (0.0411)	-0.166*** (0.0504)	0.0927 (0.0689)	-0.0176 (0. 101)
rdiff	0.0380* (0.0210)	0.0297 (0.0252)	-0.00966 (0.0436)	-0.0465 (0.0461)
CEPU*rdiff		0.000108 (0.000184)		0.000364 (0.000281)
Control variable	yes	yes	yes	yes
constant		6.018*** (0.375)	5.696*** (0.549)	6.247*** (0.663)
Time fixed	yes	yes	yes	yes
Corporate fixed	yes	yes	yes	yes
Observation	2424	2424	682	682

Note: The statistics in parentheses are t-statistics and ***, **, * represent 1%, 5%, and 10% significance levels, respectively.

6.3 Different investment sectors and OFDI by large Chinese enterprises

According to the characteristics of the industry, the investment industry is divided into service industry and manufacturing industry. As can be seen from Table 6, the increase of economic policy uncertainty in the home country inhibits the investment in the service and manufacturing industries. The moderating effect of institutional distance plays a positive moderating role in the service industry, but is not significant in the manufacturing industry.

Table 6 Investment sector heterogeneity

	(1)	(2)	(3)	(4)
Variable	Service	Service	Manufactur	Manufactur
CEPU	-0.0953	-0.224**	-0. 119***	-0. 152***
	(0.0742)	(0. 109)	(0.04)	(0.0495)
rdiff	0.00995	0.0685	0.0388*	0.0235
	(0.0506)	(0.0573)	(0.0205)	(0.0245)
CEPU*rdiff		0.000581**		0.000364
		(0.000287)		(0.000281)
Control variable	yes	yes	yes	yes
Constant	5.211***	5.905***	6.213***	6.371***
	(0.563)	(0.655)	(0.332)	(0.360)
Time fixed	yes	yes	yes	yes
Corporate fixed	yes	yes	yes	yes
Observation	664	664	2240	2240

Note: The statistics in parentheses are t-statistics and ***, **, * represent 1%, 5%, and 10% significance levels, respectively.

7. Conclusion and policy implication

7. 1 Conclusion

Taking the large Chinese enterprises from 2005 to 2021, this paper uses the economic policy uncertainty index to empirically analyze how the economic policy uncertainty in the home country affects the foreign direct investment of large Chinese enterprises. The results show that the economic policy uncertainty of the mother country significantly suppresses the OFDI behavior of enterprises, and the institutional distance plays a positive regulatory role.The conclusion of the study remains robust through a series of robustness tests. Heheterogeneity analysis found that the improvement of economic policy uncertainty significantly inhibited the investment of host countries, state-owned enterprises, manufacturing and service industries with higher or lower than Chinese system quality, but has no significant impact on the foreign direct investment of non-state-owned enterprises; meanwhile, the institutional distance can significantly regulate the host countries with higher or lower than that of China and the investment industry in service industry.

7.2 Policy implication

Firstly, in order to reduce the negative impact of economic policy uncertainty in home countries on overseas investment enterprises, we should more firmly promote the "One Belt, One Road" initiative, further enhance the degree of transparency in policy formulation, and formulate legal and regulatory policies on OFDI with long-term impact; Secondly, for going global enterprises, they can accurately grasp the dynamics of economic development and accurately understand the meaning of policies, and at the same time reasonably plan their investments according to policy adjustments, so as to avoid the occurrence of unsuccessful investments due to a lack of grasp of policies; thirdly, against the macro background of domestic economic policy uncertainty, they should also take into account the possible impact of the distance between the home country and the host country system on their investments, comprehensively grasp the internal and external environment, and Fourthly, under the strategic forecast of the "Great changes unseen in a century" in the international situation, the understanding of economic policies may be beyond the control of enterprises. Therefore, home country enterprises must strengthen the early warning mechanism of overseas investment risks and continuously improve the overseas investment insurance system to compensate for the losses caused by the economic policy uncertainty of home country to enterprises' overseas investments.

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