

Research on the Impact of China's OFDI to RCEP Countries from the Perspective of Country Distance

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Abstract. The official implementation of RCEP has created opportunities and conditions for China's OFDI. This paper comprehensively analyzes the influencing factors of China's OFDI to RCEP countries based on three dimensions of country distance: geographical distance, economic distance and institutional distance. It is found that: the greater the gap between institutional distance and geographical distance between RCEP parties and China, the more China tends to make direct investment to them, and China's direct investment behavior to RCEP countries is not significantly influenced by economic distance. From the sub-regional regression results, the key factors and utilities affecting OFDI are different in the three regions of RCEP member countries. ASEAN countries, Australia and New Zealand are mainly influenced by a combination of economic distance and institutional distance, where institutional distance promotes our OFDI behavior, while economic distance plays a hindering role. China's OFDI to Japan and South Korea is mainly hindered by institutional distance, and OFDI in all three regions is not significantly influenced by geographical distance.

Keywords: RCEP; country distance; OFDI.

1. Introduction

The Regional Comprehensive Economic Partnership Agreement (RCEP) has been implemented since January 1, 2022. 15 countries are parties to RCEP, including 10 ASEAN countries, China, Japan, South Korea, Australia and New Zealand. TWhen fully implemented, the RCEP will be larger than NAFTA and the EU. Table 1 compares the population and economic scale of RCEP with those of NAFTA and the EU.

Table 1. Population and Economic Size of RCEP, NAFTA and EU

	Population (billion people)	Total GDP (trillion dollars)	Trade share (%)
RCEP	22.75	26.2	28.87
NAFTA	4.93	24.44	15.76
EU	4.48	15.63	29.56

Data source: World Bank Development Database

Outward foreign direct investment (OFDI) is a powerful contributor to world economic growth and has an important impact on countries around the world. Since 2013, the scale of China's OFDI has been expanding year by year, with more diverse forms and steadily improving levels. Examining the total amount of OFDI, China's OFDI flow in 2021 is USD 145.19 billion, up 9.2% year-on-year. With the signing and formal implementation of the RCEP agreement, China's direct investment in the economies participating in the agreement will also become an important growth point. Exploring the main influencing factors of China's direct investment in RCEP member countries is crucial to promote China's investment cooperation in RCEP countries and boost the economic growth of the contracting parties.

This paper uses panel data of China's direct investment to 14 member countries of RCEP during 2007-2020 to conduct empirical analysis using a two-way fixed effects model and completes robustness tests using substitution effects. On this basis, further regressions are conducted on member

countries by location to measure the impact of country distance on country FDI in different locations, based on which suggestions are made for China's outward FDI to RCEP countries. Previous studies have mainly focused on the study of the respective influencing factors of home and host countries, while ignoring the national distance between home and host countries. This paper selects three national distance factors, namely economic distance, institutional distance and geographical distance, in researching the impact of China's OFDI in RCEP countries. On the other hand, there are few articles in the existing literature that use the two-way fixed-effects gravity model to explore the impact of OFDI from the perspective of country distance. This study takes 14 RCEP countries as the research sample, and the time span is 2007-2020, which fully takes into account the amount of China's direct investment in 14 RCEP countries during the 14 years since 2007, with strong completeness and timeliness, and the fixed-effect model can well circumvent the problems of multidisciplinary and correlation among variables.

2. Literature Review

Regarding the effect of country distance on OFDI, scholars have reached different conclusions. The establishment of friendly cities can significantly increase the level of OFDI in China, and the increase of country distance can enhance the promotion effect of establishing friendly cities on OFDI in China. (Qianyu Zhu and Guangjun Sui, 2021). Katuscia Vaccarini et al. (2017) showed that the greater the country distance, the greater the difficulties for firms, which is not conducive to OFDI by multinational firms. A similar conclusion is reached in the study of Fabio Cassio-de-Souza and Mario Henrique Ogasavara (2018), who found that cross-country distance overwhelmingly increases the risk of firm mortality. Liu et al. (2017) found that combined country distance is significantly and negatively related to China's OFDI to Belt and Road countries, while Jishengbao et al. (2018) found that geographic and cultural distance significantly inhibit China's OFDI to Belt and Road countries, while economic distance and institutional distance significantly inhibit China's OFDI to Belt and Road countries. OFDI, while the effects of economic distance and institutional distance are not significant.

Through the analysis of previous study on the impact of country distance on OFDI, the vast majority of scholars believe that there is a significant impact of country distance on the home country's OFDI in the host country. For this reason, this paper selects three country distance factors, namely, geographical distance, economic distance, and institutional distance to study the impact of China's direct investment in the 14 RCEP member countries. In addition, this paper further explores the impact of country distance on China's OFDI in different locations along the two-way fixed effects model to provide guidance for Chinese firms' direct investment activities in different RCEP location countries.

3. Model design and data description

3.1. Model Setting and Estimation Methodology

The traditional trade gravity model, originally proposed by Walter Isard (1956) in his book "Location and Economic Space", has become the most widely used model in international trade empirical evidence, and its basic form is: $IMP_{ij} = GDP_i \times GDP_j / DIS_{ij}$, where IMP_{ij} denotes the export value of country i to country j , GDP_i denotes the GDP of country i , GDP_j denotes the GDP of country j , and DIS_{ij} denotes the the distance between the two countries. In order to overcome the heterosexuality and multidisciplinary problems of the data, this paper draws on the practice of most scholars by taking both ends of the traditional gravity model equation and constructing the model as follows.

$$OFDI_{it} = \alpha_0 + \alpha_1 geo_distance_{it} + \alpha_2 eco_distance_{it} + \alpha_3 ins_distance_{it} + \alpha_4 labour_{it} + \alpha_5 resource_{it} + \alpha_6 tech_{it} + \alpha_7 lnGDP_{it} + \varepsilon_{ij} \quad (1)$$

α_0 is a constant term; geo_distance_{it} , eco_distance_{it} , ins_distance_{it} denote geographical distance, economic distance, and institutional distance; labor_{it} , resource_{it} , tech_{it} , and lnGDP_{it} denote a set of control variables that affect OFDI flows in addition to the distance factor, respectively are labor endowment, natural resource endowment, technology level and market size; ε_{ij} is the random disturbance term.

The data in this paper are panel data, which can deal with the problem of missing variables to a certain extent, but there are certain multicollinearity and endogeneity among the variables. The two-way fixed effects model can not only avoid the problem of multicollinearity among the explanatory variables to the maximum extent, but also allow the correlation between the random error term and the explanatory variables. Considering the above multiple factors, and drawing on the practice of Lin and Miaojie Yu (2009), a two-way fixed effects model will be used for estimation in this paper.

3.2. Variable Selection

3.2.1 Explanatory variables

The explanatory variable of this paper is the amount of China's direct investment in RCEP countries, there is a difference between investment stock and flow, this paper uses OFDI flow for the following reasons: firstly, there is no lag in OFDI flow, which can better reflect the economic development and changes in the current year; secondly, the data in this paper are panel data, the trend of OFDI flow over time is more significant (Dong, Youde, Xia, Wenhao 2021). The data are obtained from China OFDI statistical bulletin.

3.2.2 Explanatory variables

The core explanatory variables are the three national distance factors of geographic distance (geo_distance_{it}), economic distance (eco_distance_{it}) and institutional distance (ins_distance_{it}). Zhang, Hai et al. (2021) pointed out that although modern international trade is more convenient in terms of transportation and information, geographical distance is still a resistance that cannot be ignored. This paper adopts the method of Wei Po-Ning (2020), and uses the latitude and longitude data of national capitals disclosed by the CEPPPII database to obtain the continuous time-varying geographic distance based on the straight-line distance from Beijing to national capitals calculated by Google Earth Pro, and uses the annual international crude oil price index to multiply with the straight-line distance.

Economic distance reflects the difference in the level of economic development between China and the host country. This paper follows the method of Feng Zhengqiang et al. (2021), which argued that the economic distance between the two countries is mainly expressed as the income gap, and uses GDP per capita as a proxy variable for income per capita, while the economic scale is taken into account by dividing the absolute value of the difference in GDP per capita between the two places by the product of the GDP of the two places, with data from the World Bank WDI database.

Regarding the measurement of institutional distance, this paper proposes to adopt the approach of Wu et al. (2021) by applying the Global Governance Index (WGI) to measure the institutional quality of the host country, including six institutional factors that reflect the efficiency and policy effectiveness of the host country's public services, the strength and fairness of corporate regulation, the political voice and participation of citizens in public affairs, the integrity of the government and the control of corruption, and to estimate the institutional distance between the two countries using the absolute value of the difference between the scores of the institutional variables of the host country and those of China.

3.2.3 Control variables

The influencing factors of China's direct investment in RCEP member countries are complex, and in order to exclude the interference of other factors as much as possible, control variables need to be included in the model, specifically labor endowment (labor), natural resources of the host country (resource), technology level (tech) and market size (lnGDP).

Huang Youxing et al. (2022) found that there are obvious motivational tendencies for OFDI in China. Different motivations such as labor force seeking, natural resource seeking, technology

seeking and market seeking will affect the choice of OFDI in China. Labor endowment reflects the factor price and output efficiency of a country's production, and this paper selects the total workforce of the host country to measure labor endowment. The rich and low-cost natural resources are the motivation for greenfield investment, and the share of fuel, ore and metal exports in the total exports of goods in the host country is chosen to measure the natural resources ownership. In the international production trade-off theory, Dunning pointed out that market demand is one of the main motives of OFDI, and Buckley et al. (2007) chose GDP as the measure of host country market; Cao et al. (2022) also took the same approach. This paper follows the practice of domestic and foreign scholars and uses GDP as the measure of host market, and takes logarithms to reduce heterogeneity. The above data are obtained from the World Bank WDI database.

3.2.4 Data description and processing

The data of indicators used in this paper are obtained from the World Bank database, China OFDI statistical bulletin and other international authoritative databases. It should be noted that OFDI, economic distance, geographic distance, labor endowment, natural resource endowment, and market size are logarithmized in order to reduce heteroskedasticity. All the above indicators are taken as inter-period data from 2007 to 2020. The detailed descriptions are shown in Table 3.1.

Table 2. Description of variables and descriptive statistics

Variable	Variable Meaning	Mean	Std.Dev.	Min	Max	Data Source
OFDI	OFDI flow	10.48	1.688	4.595	13.86	Outward Foreign Direct Investment Statistical Bulletin
geo_distance	Geographical distance	12.46	0.666	10.60	14.02	CEPPII
eco_distance	Economic distance	12.80	2.035	6.887	16.92	WDI
ins_distance	Institutional distance	1.819	1.798	0.0848	5.986	WDI
labour	Labor endowment	16.37	1.636	12.11	18.73	WDI
resource	Natural resource endowment	2.573	1.217	0	4.594	WDI
tech	Technology level	22.97	17.13	0.0027	64.36	WDI
lnGDP	Market size	26.18	1.851	22.16	29.70	WDI

4. Empirical analysis

4.1. Baseline regression

The Hausman test was used for the selection of the fixed-effects model and the random-effects model. As can be seen from Table 4.1, the statistic $P=0.0006 < 0.05$, which means that the fixed effect hypothesis holds.

Table 3. Hausman test

Test Summary	Cross-section random
Chi-Sq.Statistic	25.40
Chi-Sq.d.f	7
Prob.	0.0006

This paper uses a two-way fixed effects model to estimate the influence of country distance factors on China's OFDI choice, which can minimize the problem of multidisciplinary among the explanatory

variables and also allows for correlation between the random error term and the explanatory variables. The results are shown in Table 4.1.

The data shows that the explanatory variables of this paper, geographic distance, economic distance and institutional distance, have different directions and degrees of influence on China's OFDI to RCEP countries. The estimated results of the impact of geographical distance on OFDI flows pass the 10% significance level test with a coefficient of 0.275 and a positive sign, which is not consistent with the conclusion that the scale of trade flows between countries with closer geographical location is larger in the traditional gravity model. This indicates that on the one hand, with the improvement of transportation technology and infrastructure, the constraining effect of geographical distance on OFDI is weakened; on the other hand, Tu Niansong and Wang Hao (2019) point out that with the increase of economic and trade exchanges between China and RCEP countries, Chinese firms adopt more greenfield investments in RCEP parties that are farther away, which in turn counteracts the negative impact of geographical distance on investment. The effect of economic distance on Chinese OFDI in the regression is positive but not significant, which indicates that the economic gap between the two countries does not have a significant effect on my OFDI to RCEP countries. This is consistent with the findings of Feng Delian et al. (2018) for the "Belt and Road" countries. Institutional distance shows a significant positive correlation with China's OFDI, with a coefficient of 0.394, which passes the 1% significance level test. According to Jiang Guan hong and Jiang Dian chun (2012), the greater the bilateral institutional difference, the larger the scale of Chinese OFDI investment. Compared with developed countries, the system of developing countries shows a greater "difference", and Chinese OFDI mainly goes to developing countries, and most of the RCEP member countries are also developing countries, so the difference of the system has a driving effect on Chinese direct investment in RCEP countries.

The significance and direction of the regression coefficients of the control variables are basically consistent with the economic facts. The natural endowment, labor endowment and technology level of the host country show significant positive correlation with the choice of OFDI, indicating that there are obvious resource-seeking motives, labor-seeking motives and technology-seeking motives for China's direct investment in RCEP countries. Host country market size has a significant negative correlation with China's OFDI choice, which indicates that China tends to make OFDI to countries with smaller market size. This is consistent with the findings of Sun, Hua et al. (2018): countries with large market size are mostly developed economies, which tend to prevent Chinese firms from entering their markets by setting up trade barriers in order to protect their dominant industries, compared to developing economies with small market size that are more open to foreign capital entry.

In general, the national distance factor has a positive effect on the layout of China's outward FDI to RCEP countries, and China's outward FDI has obvious investment motives.

Table 4. Baseline regression results

	two-factor fe	fe	re
geo_distance	0.275* (0.150)	0.275 (0.254)	0.354* (0.214)
eco_distance	0.147 (0.116)	0.147 (0.135)	0.470*** (0.116)
ins_distance	0.394*** (0.122)	0.394*** (0.140)	0.212* (0.127)
labour	0.982*** (0.204)	0.982*** (0.160)	1.071*** (0.165)
resource	0.220** (0.081)	0.220** (0.108)	0.186* (0.110)
tech	0.029*** (0.007)	0.029*** (0.007)	0.036*** (0.007)
lnGDP	-0.370**	-0.370**	-0.098

	(0.168)	(0.181)	(0.166)
year	control	control	control
_cons	-3.047	-3.047	-16.465***
	(5.185)	(7.731)	(6.384)
F	123.910	9.560	

Note: *, **, *** indicate significant at the 10%, 5%, and 1% level of significance, respectively. Robust standard errors are in parentheses. Same as below

4.2. Expanded Regression

In order to further consider the influence effect of each factor of country distance, this paper examines the role of geographical distance, economic distance and institutional distance on the selection of OFDI in China respectively, the results are shown in Table 4.3.

The results show that: the effect of geographical distance on China's OFDI is significant at 1% confidence level and has a positive effect, taking the logarithm of each unit increase in geographical distance, China's direct investment increases by 0.669 units, which is consistent with the results of the benchmark regression and verifies that China mostly takes the form of greenfield investment for RCEP countries. Economic distance has a significant and positive effect on China's OFDI location choice at 5% confidence level, taking logarithmic economic distance increases China's direct investment in it by 0.28 units for each unit increase. Tsang and Paul (2007) argue that the development of economic differences is conducive to investors to highlight their comparative advantages and thus achieve sustainable development, i.e., the greater the economic distance, the more significant the effect on a country's OFDI. The greater the economic distance, the more obvious the effect on a country's OFDI promotion. Institutional distance has a significant and positive effect on China's OFDI location choice at 5% confidence level, and for each unit increase in institutional distance, China's direct investment in it increases by 0.522 units, further indicating that China tends to invest directly in countries with large institutional disparities. In addition, the effects of control variables on OFDI are all consistent with economic facts and remain consistent with the findings of the benchmark regression.

The results of both the baseline regression and the extended regression indicate that the institutional, economic, and geographic differences between China and the host country are important factors that promote direct investment in RCEP countries by Chinese enterprises. Therefore, enterprises need to give full play to their comparative advantages, weigh the advantages and disadvantages, optimize the global layout of China's outward FDI, and improve the level of outward FDI in order to implement the "going out" strategy.

Table 5. Extended regression results

Variables	geo_distance	eco_distance	ins_distance
geo_distance	0.669*** (0.132)		
eco_distance		0.280** (0.122)	
ins_distance			0.522*** (0.090)
labour	0.438*** (0.090)	0.559*** (0.172)	0.965*** (0.174)
resource	0.057 (0.069)	0.141* (0.070)	0.267*** (0.064)
tech	0.023*** (0.005)	0.022*** (0.006)	0.026*** (0.006)
lnGDP	-0.015 (0.050)	0.117* (0.056)	-0.531*** (0.132)

year	control	control	control
F	50.542	41.866	39.135

4.3. Robust Test

In order to reduce the possibility of "pseudo-regression", this paper adds a robustness test on the basis of the above empirical study. Given that there are flows and stocks of OFDI, and the cumulative effect of China's stock of FDI in RCEP countries may generate investment path dependence, it is still of strong practical significance to use the stock of investment as the explanatory variable. Table 4.5 reports the results of the substitution variable test. The results show that both economic distance and political distance are significantly and positively related to OFDI, with the highest significance level for political distance and insignificant effect of economic distance on OFDI. This all remains consistent with expectations and the robustness test effectively validates the findings of the gravity model.

Table 6. Robustness tests

Variables	Replacement variable: investment stock	Traditional gravity model
geo_distance	0.109* (0.110)	0.275* (0.150)
eco_distance	0.189 (0.120)	0.147 (0.116)
ins_distance	0.413*** (0.078)	0.394*** (0.122)
labour	0.953*** (0.122)	0.982*** (0.204)
resource	0.256*** (0.028)	0.220** (0.081)
tech	0.023*** (0.006)	0.029*** (0.007)
lnGDP	-0.279** (0.105)	-0.370** (0.168)
year	control	control
F	653.041	123.910

4.4. Further sub-regional analysis

The above analysis results for the full sample regressions show that the core explanatory variables of this paper, geographical distance and institutional distance, have a significant positive impact on China's outward FDI flows to RCEP countries. Considering the large number of RCEP member countries and their differences, this paper divides the sample of countries along the RCEP into three typical regions, namely ASEAN, Japan and Korea, and Australia and New Zealand, for further sub-regional regression analysis based on the location characteristics of RCEP member countries. Based on the previous econometric approach, the regression results are presented in Table 4.6 using the fixed effects model.

As shown in Table 4.6, the regression results from ASEAN show that geographical distance is not significant, which confirms the view that geographical distance is gradually weakening in OFDI. Economic distance has a significant negative effect on OFDI, which passes the 5% significance level test, which is contrary to the results of the benchmark regression. Zhao, Sweet and Fang, Hui (2019) showed that economic distance has a significantly negative effect on strategic asset-seeking OFDI, while most of China's OFDI to ASEAN countries is strategic asset-seeking greenfield investment. The effect of institutional distance on Chinese OFDI to ASEAN is significantly positive, which is consistent with the benchmark regression.

In the sub-regional regressions for Japan and Korea, geographical distance and economic distance are not significant, which is mainly due to the proximity of Japan and Korea to China and their convenient transportation, and their economic development characteristics are more identical to those of China. And institutional distance has a negative and significant effect on OFDI, passing the 1% significance level test, which is the opposite of the benchmark regression results. Su et al. (2021) pointed out that institutional distance has a significant negative impact on human capital and technology seeking OFDI, while China has significant human capital and technology seeking motives for direct investment in Japan and Korea.

The results of the sub-regional regressions for Australia and New Zealand show that geographical distance is not significant, again indicating that the impact of geographical distance on OFDI is gradually weakening. Economic distance has a negative and significant effect on OFDI, passing the 5% significance level test, which is contrary to the results of the benchmark regression. The results of this Jain (1989) study were consistent with the finding that the economic homogeneity between home and host countries is conducive to OFDI, and the competitive advantage of Chinese firms mainly lies in low cost, especially in labor-intensive industries, but this advantage is difficult to transfer to host countries, especially developed countries. The inability to exploit this advantage leads to high production costs, so economic distance has a negative effect on OFDI when sub-location regressions are conducted for ANZ. The effect of institutional distance on China's OFDI to ANZ is significantly positive, consistent with the benchmark regression.

Table 7. Regression results by region

	ASEAN	Japan&Korea	ANZ
geo_distance	0.505 (0.360)	32.640 (68.753)	38.599 (25.854)
eco_distance	-0.237** (0.081)	7.242 (4.434)	-20.885** (8.784)
ins_distance	1.033*** (0.081)	-2.270*** (0.599)	4.913** (1.747)
labour	0.800*** (0.186)	25.937** (9.797)	4.102 (8.776)
resource	0.000* (0.000)	0.001 (0.001)	-34.511 (50.986)
tech	0.007 (0.005)	0.124 (0.090)	-0.178 (0.410)
lnGDP	-0.542*** (0.154)	-6.648*** (1.790)	-3.003 (2.974)
F	109	13.133	98.804

5. Conclusion

Based on the data of China's OFDI to 14 RCEP from 2007 to 2020, this paper analyzed the impact of country distance factors on China's OFDI to RCEP member countries through a two-way fixed effects model. The study found that: First, based on the benchmark regression of the full sample data, the greater the gap between the institutional and geographical distance between the host country and China, the more China tends to make direct investment in RCEP member countries, and China's OFDI to these countries is not significantly affected by economic distance, which further verifies the conclusion of the benchmark regression through robustness test. Second, from the sub-regional regression results, the key factors and utilities affecting OFDI in the three regions of RCEP member countries are not the same. ASEAN countries, Australia and New Zealand are mainly influenced by the combination of economic distance and institutional distance, where institutional distance promotes China's investment behavior and economic distance hinders China's direct investment in

them. China's OFDI to Japan and Korea is hindered by institutional distance. The results of the line regression show that OFDI in all three regions is not significantly influenced by geographical distance.

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