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The Impact of Financial Development Levels in Belt and Road Countries on Chinese FDI

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Abstract

Purpose: As globalization continues to advance, China's trade cooperation with foreign countries has become increasingly close, and its outward-oriented economy has entered a rapid development stage. With the launch of the Belt and Road Initiative in 2013, favorable conditions for China's overseas direct investment have been created. This paper is based on the financial development in Belt and Road countries. **Research design, data and methodology:** Using panel data from 2006 to 2020 covering 64 countries along the Belt and Road, the paper classifies regions and compares regions with higher levels of financial development. It provides descriptive statistics and employs the Fixed Effects Model (FEM) for regression analysis to thoroughly study the factors affecting China's Foreign Direct Investment (FDI). **Results:** The research results indicate that the size, efficiency, and structure of financial development all have a significant positive impact on China's FDI. **Conclusions:** However, factors such as trade openness (OPEN) and per capita disposable income (LnAGDP) did not pass the significance test, possibly because the level of openness of a country for outward foreign direct investment is not a significant factor to consider. Finally, based on the empirical findings, a series of policy recommendations are proposed to enhance China's FDI levels.

Keywords : Belt and Road, Foreign Direct Investment, Financial Development, Fixed Effects Model

JEL Classification Code: C58, F13, F23, G15

1. Introduction^a

Against the backdrop of increasingly fierce competition in the global economy, China's outward-oriented economy has been rapidly developing, particularly since its successful accession to the World Trade Organization. The Belt and Road Initiative (BRI) proposed in 2013 further accelerated China's global engagement,

emphasizing connectivity of capital, products, services, and technology between nations. This initiative has garnered widespread international attention. Data reveals that by the end of 2020, China's foreign direct investment (FDI) reached \$153.71 billion, making it the world's top recipient and accounting for 20.2% of the global share. This FDI was diversified, with 41% in new equity investments, 46.6% in reinvestment of earnings, and 12.4% in debt instruments. The majority of these investments flowed into the service

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and financial sectors, and China continued to optimize its investment structure. It is evident that China's domestic supply falls short of its demand for resources like oil and natural gas, which are primarily met through imports. Many Belt and Road countries are rich in natural resources. Hence, China must enhance cooperation with these nations to address its domestic resource scarcity.

Foreign direct investment serves as a crucial tool for international trade cooperation and has a significant impact on all countries. However, China's FDI is influenced by various factors, including the financial development of Belt and Road countries, which has become a key determinant affecting China's FDI. One of the major constraints on China's FDI growth is the challenge of financing. Insufficient development in domestic finance has resulted in an inadequate supply of capital in the capital market. When such situations arise, commercial banks often prioritize addressing the financing needs of state-owned enterprises. Consequently, private enterprises often encounter difficulties in accessing financing. As China's bond and stock markets are yet to mature fully, many enterprises relying solely on bank loans have limited financing channels, leaving them unable to effectively address their financing needs. While numerous studies have explored factors influencing China's FDI, most have concentrated on legal systems, political reasons, and other aspects of Belt and Road countries. Few scholars have conducted analyses from the perspective of a country's financial development level.

In recent years, the level of financial development has gradually become a research hotspot and a key determinant affecting a country's foreign direct investment (FDI). Existing studies have mainly focused on investigating a country's own enterprises' financing conditions and capabilities as the primary factors, with limited generalizability. Additionally, these studies have primarily delved into natural resource endowments, institutional environments, and economic systems in Belt and Road countries. In this study, we utilize data from 2006 to 2020 from 64 Belt and Road countries as our sample. We classify them by region, conduct comparative analyses of their financial development levels, and further explore and evaluate the impact of various indicators of financial development on China's FDI. We provide theoretical support for optimizing China's FDI and offer recommendations. By studying the financial development levels of Belt and Road countries, this research not only assists enterprises in making informed and rational investment decisions but also enhances their international competitiveness through participating in foreign direct investment. Additionally, it guides future financial cooperation, investment activities, and bilateral investment cooperation between Chinese enterprises and Belt and Road countries.

The subsequent chapters are structured as follows: Chapter 2: Theoretical background and literature review. Chapter 3: Analysis of the Mechanism of the Impact of Financial Development in Belt and Road Countries on China's Foreign Direct Investment, starting with theoretical foundations and impact pathways. Chapter 4: Regression analysis of the entire sample of Belt and Road countries from 2006 to 2020 using a panel fixed-effects model, examining the various aspects of financial development's influence. Chapter 5: Research conclusions and policy recommendations.

2. Theoretical Background and Literature Review

2.1. Brief Introduction to Relevant Theories

2.1.1. Monopolistic Advantage Theory

The concept of using monopolistic advantage to explain foreign direct investment was proposed by Stephen Hymer of the Massachusetts Institute of Technology in 1960 (Hymer, 1960). He pointed out that foreign direct investment is different from general financial asset investment, paving the way for a new field of study focused on foreign direct investments. The monopolistic advantage theory, also known as the industrial organization theory, includes the transfer of technology and management skills. The objective of producing abroad is to achieve higher profits through the mobility of resources and structural adjustment of resources. This profit-earning model is completely different from previous ones, where monopolistic advantage is key for a firm to make profits. Therefore, monopolistic advantage has become a critical driving force for multinational corporations to engage in international investment. Later, Kindleberger(1969) supplemented and developed this theory by pointing out the imperfections in market structure and the monopolistic advantages of multinational companies. He argued that due to the problem of information asymmetry, some firms become masters in producing information, allowing them to gain control over technical know-how and monopolize certain raw materials and core intermediate products, as well as distribution channels, hence the existence of monopolistic advantages in the market.

2.1.2. Eclectic Paradigm Theory

The Eclectic Paradigm Theory, proposed by (John, 1981), suggests that the combination of both direct and indirect inducement factors plays a crucial role in a country's engagement in foreign direct investment (FDI). Essentially, the reasons that FDI affects a country include direct factors

such as a company's own profitability and financing capabilities, as well as indirect factors like external institutional environmental factors, economic environment, or a series of policies issued by the government.

The Eclectic Paradigm Theory posits that if a country's enterprises have a well-developed production structure and advanced technological manufacturing, in addition to favorable external policy environments and legal conditions, they possess a significant advantage in gaining profits. Especially in modern society, where the competition in the global market, both financial and non-financial, is becoming increasingly intense, countries are lowering investment barriers. For example, the United States has introduced policies with preferential rates to compete for the inflow of foreign investments. From this perspective, the effects of external, indirect inducement factors are becoming more evident. Thus, the Eclectic Paradigm Theory appears to have more explanatory power than traditional mainstream theories because it considers a more comprehensive set of factors.

2.2. Review of Studies on the Level of Financial Development

2.2.1. Overview of International Research

Researchers both domestically and internationally have focused on the connection between financial development, international trade, and a country's economic development. Andreff (2002) in examining the relationship between a country's financial development and its trade policies, noted that when a country has frequent import and export transactions, government departments may impose tariffs to increase the prices of imported goods. Buckley et al. (2014) indicated that the more developed a financial market's functions are, the more they can improve the trade structure, effectively enhance the level of import and export structures, and promote its international competitiveness. Egger and Winner (2005) found that the more developed a country's financial structure is, the more significant its driving effect on foreign direct investment. Cui (2008) pointed out that the factors affecting a country's foreign direct investment are the financial development models of the target country. Desbordes and Wei (2017) through analyzing the mechanism of the impact of various countries' levels of financial development on China's FDI, concluded that rapid development of the financial system can enhance a country's total factor productivity, promote economic growth, and have a positive impact on foreign direct investment. Sakouba and Chen (2023) examined the causal relationship between infrastructure spending and regional financial development, using the "Belt and Road" initiative spending as an additional variable to expand the traditionally accepted financial development ratio. They found a positive impact

of the "Belt and Road" on the regional financial development of East Africa and increased inclusiveness of the unbanked population in the region. Udeagha and Breitenbach (2023) discovered that financial development increased the polluting effect of energy use while mitigating the adverse impact of economic growth, trade openness, and foreign direct investment on ecological quality. Hasni et al. (2023) using the Pooled Mean Group-Autoregressive Distributed Lag (PMG-ARDL) method and the Granger causality test to analyze different APEC economies from 2000 to 2019, found that financial development promotes sustainable development. This includes encouraging green financial products, strengthening financial regulation, transitioning to a low-carbon economy, increasing the use of renewable energy, and improving governance and institutional quality, while considering the distinct characteristics of each country.

Additionally, Yeaple (2009) focusing on developing countries, demonstrated that interest rates in the financial markets of developing countries are not marketized but are intervened and regulated by the government, leading to financial repression. This has resulted in small and medium-sized enterprises (SMEs), which require funds to operate their businesses, not receiving the necessary loans, causing financing difficulties and society failing to fulfill its social function of capital allocation. Berggren and Jordahl (2006) believe that financial development can promote a country's economic level, finding that through reforms and development of the financial system, the functions of financial markets can be improved, thereby promoting economic growth. In the research, Tadiwanashe et al. (2022) applied a two-stage least squares instrumental variable regression technique to identify a beneficial link between financial technology and financial growth. Additionally, Shahbaz et al. (2023) expanded their study to include factors such as non-renewable energy usage and trade openness, examining their influence on the ecological footprint alongside financial development and economic expansion. Their findings indicate that economic growth, financial development, and the consumption of non-renewable resources collectively exacerbate environmental degradation by enlarging the ecological footprint. On the other hand, the impact of trade openness on the ecological footprint was statistically insignificant.

2.2.2. Overview of Domestic Literature

Recent studies have delved into the interactions between financial development and various economic and environmental factors across multiple regions. According to research by Yang and Ni (2022), examining data from 51 nations involved in the Belt and Road Initiative (BRI) over 2005-2017, it's evident that financial development is crucial for sustainable environmental practices, although certain

aspects like financial scale, depth, and efficiency may detract from the efficiency of green development. In contrast, Gao et al. (2022) used data from 37 Asian countries spanning 2003 to 2017, concluding that financial development significantly mediates the influence of host country governance on Chinese overseas foreign direct investment (OFDI), with governance playing a complex role that forms an inverted "U" relationship as OFDI increases. Additionally, the BRI appears to mitigate the adverse effects of governance quality on Chinese OFDI. Further findings by Wu and Han (2022) from 284 Chinese cities between 2007 and 2018 suggest that the BRI enhances openness and fosters long-term economic growth, positively affecting China's international trade exports. Meanwhile, Wu et al. (2021) analyzing data from 178 countries from 2002 to 2017 across various industries, indicate that the BRI initiative contributes to lower carbon emissions, thus improving environmental conditions and trade relations. Wang et al. (2020) differentiate between BRI and non-BRI regions, noting that economic and financial progress in China promotes RMB settlement more effectively in BRI regions, with trade volume heavily influencing RMB transactions.

On another note, Ding et al. (2023) studied 285 Chinese cities from 2004 to 2020 to evaluate the potential for energy net-zero transition (ENTP), discovering a nonlinear connection between financial development and ENTP that varies with city characteristics. Xiao et al. (2022) analyzing the period from 1970 to 2021, identify how basic exchange rate misalignments and financial development impact carbon emissions in Asia and Africa, highlighting the complex effects of trade, investment inflows, and currency positions on environmental outcomes. Chen et al. (2023) in their study used data from 2002 to 2017, found that financial development significantly boosts China's energy environmental performance (EEP), primarily through technology and human capital, illustrating a "Matthew effect" where benefits accrue to those already advantaged. Xu et al. (2023) investigate the dynamic between financial development, renewable energy, and carbon emissions, pointing to both short-term and long-term impacts under the influence of external regulations. Lastly, Wang et al. (2023) employ data from 30 Chinese provinces to show how green finance, facilitated by ecological improvements, considerably enhances the economic and social green development space.

Deng and Zhang (2023) based on data from 30 provinces between 2004 and 2019, considered the dynamic impacts of environmental regulation intensity and green finance development on regional environmental sustainability. The study shows that provincial environmental sustainability in China exhibits a significant spatial agglomeration effect, with notable spatial autocorrelation and clustering. From a national perspective,

increasing the intensity of environmental regulation significantly enhances the sustainability of the regional environment, and the development of green finance also significantly improves the sustainability of the regional environment. Wu and Pan (2019) designed an index based on China's investment needs and the financing needs of the Belt and Road Countries (BRC), quantifying the level of cooperation potential. Using this index, they analyzed the distribution of financial cooperation potential among BRCs, revealing its influencing factors. The statistical results show that countries with greater potential for financial cooperation have closer economic ties with China. These countries are mostly low or middle-income countries with a shortage of infrastructure investment but stable economic development. Yang and Zheng (2021) based on the mechanism of argumentation and propositional reasoning and using provincial panel data from China over the years, selected indicators such as the volume of industrial wastewater, industrial waste gas, industrial sulfur dioxide, industrial smoke and dust emissions, and the production of industrial solid waste. The results indicate that China's OFDI has a significant impact on the environmental aspect of the home country's financial development level.

3. Analysis of the Influence Mechanism of Financial Development of Countries along the "Belt and Road" on China's OFDI

3.1. Analysis of Direct Impact Pathways

3.1.1. Path Analysis of Changing Financing Constraints

According to research by domestic and international scholars, due to the imperfections of our country's capital market and the absence of a mature, multi-level capital market structure, the market primarily allows large state-owned enterprises and local governments to raise substantial funds. In contrast, it is relatively difficult for small and micro enterprises to directly raise funds in the market due to high thresholds set against them. It has been found that a prominent feature of our country's investment is the abundance of infrastructure projects with a lack of own funds, and generally, the period required to raise funds is lengthy. Although the domestic financial market is striving to meet the massive demand for funds, it is far from sufficient, leading to decisions to invest and finance in countries along the Belt and Road Initiative (BRI).

The financial development level of countries along the BRI is an influential factor that cannot be overlooked, mainly analyzing how the financial development of these countries can alleviate financing constraints and thereby reduce the financing costs for enterprises.

Firstly, from the perspective of the scale of financial

development, the innovation and expansion of financial instrument scales can provide enterprises with various diversified financing services, such as entrusted loans and trust loans. These methods often do not require high financing thresholds, thereby helping financing entities to a certain extent in obtaining funds; besides, the diversification of financial intermediary institutions and the continuous innovation of financial instruments can significantly enhance financing efficiency. The reduced difficulty of financing methods can enable enterprises to raise the required funds in a short time for foreign direct investment. At the same time, countries along the BRI attract more capital inflow due to their low financing costs, thereby promoting the expansion of our country's overseas investment scale.

Secondly, from the perspective of the structure of financial development, a well-developed structure of financial intermediaries is beneficial for them to offer diversified financing services and enhance their risk resistance to ensure the stability of funding sources. This will provide companies in need of financing with more sources of funds and financing channels, effectively reducing financial risk and helping to alleviate funding issues.

Considering the above factors, it is crucial to pay close attention to the level of financial development in target investment countries, as this affects the related costs in the production and operation of multinational corporations after investment. Countries with a high level of financial development can provide more comprehensive financing channels and higher financial support, easing the difficulty of financing constraints and ensuring the safety of fund supervision. In the long term, countries with a high level of financial development can assist our country's enterprises in financing with lower capital costs and the advantage of transparent information, and this can further drive the scale of our country's foreign direct investment.

3.1.2. Pathway to Enhance Resource Allocation Efficiency

The essence of Chinese enterprises engaging in foreign direct investment (FDI) is the unrestricted flow of capital in and out. In recent years, as the level of population aging continues to rise, China is increasingly facing issues such as rising labor costs, total social supply being less than total social demand, and overcapacity. With the gradual opening of China's capital and financial accounts, capital can flow freely in the international market, allowing China to transfer its excess production capacity and utilize the cheap labor force of countries along the Belt and Road Initiative (BRI) to compensate for the domestic labor shortage.

The most crucial link in this process is ensuring the rational allocation of resources, allowing capital to flow

smoothly from surplus to demand sides, thus enabling more comprehensive and efficient utilization of funds. To achieve this goal, countries along the BRI must improve the financing structure for foreign direct investment in the following three aspects, thereby enhancing the rational allocation of resources. First, enhance the level of high-quality financial development to strengthen enterprises' internal risk prevention awareness, reinforce risk management, and use high-quality financial services to improve companies' risk identification and avoidance capabilities, thereby achieving optimized resource allocation. Second, the higher the level of financial development, the more stable and secure the financial system will be, which can improve the transparency of information between transaction parties, reduce the problem of information asymmetry, and enhance market fairness.

Finally, a stable financial system can also promote free competition among various entities, thereby improving the efficiency of resource allocation. Whether analyzed from a macro or micro perspective, improving a country's resource allocation can effectively accelerate the pace of China's investment activities.

3.2. Analysis of Indirect Impact Pathways

3.2.1. Pathway to Improve Operational Efficiency

The higher the operational efficiency of a country's enterprises, the more output they can produce in a fixed time and with fixed input, providing more resources to society, gaining a larger competitive advantage in the market, and improving international competitiveness. Studies have shown that enterprises with higher operational efficiency produce more output under the investment of a series of costs such as human capital, management, and financial costs. Therefore, it is necessary for countries along the Belt and Road Initiative (BRI) to use their financial development to improve operational efficiency, not only attracting more capital inflow but also using the inflow of transnational capital for further investment to enhance the country's development level.

To strengthen the international development of Chinese enterprises, the countries invested in play a significant role, which can improve operational efficiency in the following aspects. Firstly, the more active the capital market in BRI countries, the easier it is for enterprises of all sizes to raise funds in the financial market to address their funding shortages in operational activities, such as management expenses, research and development expenditures, etc. Secondly, within the financial system, financial institutions can play a significant role in transferring risks, reducing losses, and thereby improving the operational efficiency of enterprises. Financial institutions can help avoid moral hazards and adverse selection caused by information

asymmetry, enabling funds to flow from suppliers to demanders in a shorter time. Moreover, introducing some advanced machinery and equipment from developed countries to solve the aging problem of their machinery, or introducing some high-end technology industries to aid China's intelligent industry, as well as strengthening the training of operational knowledge and theoretical knowledge of employees within the enterprise, can also improve operational efficiency to some extent and promote production efficiency, adhering to the "going out" strategy steadfastly.

3.2.2. Pathway to Encourage Technological Innovation

Technological innovation is an important tool for a company to maintain its international competitiveness, and significant breakthroughs in technology can enhance a company's production efficiency, improve its development structure, and attract more capital inflow for investment. However, technological innovation is a challenging process requiring significant human capital investment, and the return on investment is slow. Besides, if a company raises funds beyond its capacity while innovating technologically, it may end up in financial difficulty due to excessive investment with insufficient returns.

Using the financial development of countries along the BRI to promote their enterprises' technological innovation and thereby enhance the R&D efforts of enterprises can improve the production efficiency per unit product. Technological innovation issues can be addressed from the following two aspects. On one hand, from the perspective of a country's resource allocation efficiency, the higher the level of financial development in BRI countries, the more evident the resource allocation role of its financial markets, meaning that multiple channels of financing can provide enterprises with stable cash flows to support their operational needs. On the other hand, from the perspective of risk-bearing, financial intermediaries can transfer risks. With specialized information processing technology and the benefits of economies of scale, financial intermediaries can effectively reduce problems caused by information asymmetry, thereby lowering risks to within a range that enterprises can bear, enhancing external attractiveness, and expanding China's foreign direct investment.

4. Empirical Research

4.1 Research Design

4.1.1. Selection of Variables and Data Sources

Based on data availability, this chapter selects panel data from 2006 to 2020 for 64 countries along the Belt and Road Initiative (BRI) as the full sample for empirical

analysis, with Chinese FDI as the dependent variable. Considering that the data on foreign direct investment amounts may fluctuate due to financial market turbulence at the time, causing missing data for some years, this paper adopts the method for handling missing data, assigning a value of 1 to missing data, and then taking the logarithm to make the value 0.

Regarding the selection of core explanatory variables, this paper evaluates the financial development level of BRI countries using the financial development scale, financial development efficiency, and financial development structure. The financial development scale (PRIV) is represented by the proportion of broad money M2 to GDP; financial development efficiency (FDE) is represented by the proportion of domestic credit to the private sector to GDP; financial development structure (FDS) is represented by the proportion of the total trading volume of stocks and bonds to GDP.

For the other control variables involved in this paper, the following explanations are provided:

Market Size (LnGDP): This variable represents the logarithm of the GDP of BRI countries, and according to the eclectic paradigm theory, it is one of the key factors inducing investment. Per Capita Disposable Income (LnAGDP): This variable indicates the balance available for consumption per person after deducting a series of taxes, thus evaluating the general income and expenditure situation of residents in a country. Trade Openness (OPEN): Represented by the proportion of goods and services imports and exports to the GDP of BRI countries. This variable reflects a country's openness level, indicating the closeness of its trade interactions with foreign enterprises. Urbanization Level (URL): Represented by the proportion of the urban population to the total population in BRI countries. This variable reflects the degree of population concentration in urban areas.

Table 1: Variables description

Variable name	Variable symbol	Variable calculation
Foreign direct investment	LnOFDI	The logarithmic form of foreign direct investment
The scale of financial development	PRIV	M2 of broad money as a proportion of GDP
Financial development efficiency	FDE	Private sector domestic credit as a share of GDP
Financial development structure	FDS	Share of total stock and bond trading in GDP
Market size	LnGDP	The logarithm of gross domestic product
Per capita disposable	LnAGDP	The logarithm of GDP per capita

income		
Trade openness	OPEN	Share of a country's imports and exports of goods and services in GDP
Urbanization level	URL	The proportion of a country's urban population in its total population

Source: CSMAR Database

4.1.2. Model Construction

To test the impact of financial development in countries along the Belt and Road Initiative (BRI) on Chinese FDI, the following econometric model is established in this paper:

$$\ln OFDI = \alpha_0 + \alpha_1 PRIV + \alpha_2 FDE + \alpha_3 FDS + \sum_{i=1}^4 \beta_i Control + \varepsilon \quad (1)$$

Table 2: Abbreviations of variables in the model and their meanings

Abbreviations	Meaning of symbol
α_i	Coefficient of each variable
β_i	Coefficients of each control variable
LnOFDI	China's outward direct investment
PRIV	The scale of a country's financial development
FDE	The efficiency of a country's financial development
FDS	A country's financial development structure
Control	A collection of control variables
ε	Residual term

4.2. Regression Analysis and Testing

4.2.1. Descriptive Statistics

Before conducting the empirical regression analysis, the data were processed, logarithms were taken for variables with large variances, and descriptive statistics were performed for all variables.

As seen in Table 3, the maximum value of the logarithm of Chinese FDI is 18.901, the minimum value is -4.504, and the standard deviation is 3.511, indicating significant variance fluctuation, i.e., there exist considerable differences between countries. The mean values of LnPRIV, FDE, and FDS are relatively low, suggesting that among the countries selected for China's foreign direct investment, there are countries with less than ideal financial levels.

Table 3: Descriptive statistics of each variable

Variable	Mean	Std. Dev.	Min	Max
LnOFDI	9.287	3.511	-4.504	18.901
LnPRIV	-0.601	1.238	-10.718	2.846
FDE	-0.968	1.257	-10.821	0.624
FDS	-2.751	2.186	-11.742	1.314

lnGDP	11.118	1.804	6.812	16.508
lnAGDP	8.631	1.231	5.616	11.456
URL	58.408	21.059	15.503	100.002
OPEN	49.078	29.107	0.001	211.631

To test whether the above variables have an impact on Chinese FDI, the empirical results are examined in the following text.

4.2.2. Basic Regression Analysis

This paper selects the Fixed Effects Model (FEM) for regression analysis. The specific impact of each variable on Chinese FDI is shown in Table 4.

Table 4: Results of regression

VARIABLES	Results
lnPRIV	0.656*** (1.786)
FDE	0.181** (0.638)
FDS	-0.051* (-1.491)
URL	0.063** (2.062)
OPEN	0.004 (1.636)
lnGDP	2.011*** (4.791)
lnAGDP	-0.623 (-1.338)
Constant	-17.485*** (-7.471)
Observations	472
R ²	0.693
Company FE	YES

Note: *** p < 0.01, ** p < 0.05, * p < 0.1, represents 1%, 5% and 10% significance level, respectively.

From the perspective of core explanatory variables, PRIV, FDE, and FDS all have a significant positive correlation with the dependent variable. Firstly, the financial development scale is significant at the 1% confidence level at 0.656, indicating that the larger the proportion of broad money M2 to GDP, the greater the positive impact on Chinese FDI. This suggests that the higher a country's level of financial development, the larger the scale of lending by its banking system and the easier it is for companies to finance, making it easier for investors to find financing channels in the target investment country's financial market that meet their funding needs. Secondly, financial development efficiency is significant at the 5% confidence level of 0.181, with the selected variable being the proportion of domestic credit to the private sector to GDP. This means that the improvement of financial development efficiency in countries along the Belt and Road Initiative can

promote the development of Chinese FDI to some extent. From the pathway of changing financing constraints, the increase in financial efficiency, i.e., the increase in private sector credit, allows privately-owned enterprises that were previously under significant financing pressure to more easily raise funds in the financial market, thereby attracting Chinese direct investment. Lastly, financial development structure FDS is significant at the 10% confidence level at -0.051, indicating that the proportion of the total trading volume of stocks and bonds to GDP also drives Chinese FDI, meaning the more developed the financial structure, the richer and more diverse the types of financial instruments in its financial market, reflecting the multifunctionality of financial tools. According to the pathway of encouraging technological innovation, the innovative development of financial tools is beneficial for a country's enterprises to finance at lower costs, thereby expanding a business's scale and operational scope, diversifying business operations, which is beneficial for expanding the company's own profits as well as promoting the scale of China's foreign direct investment.

Looking at the results for control variables, the LnGDP of countries along the Belt and Road Initiative is significant at the 10% confidence level positively, indicating that the market size of BRI countries has a direct impact on Chinese FDI. China tends to invest in countries with larger market sizes when investing abroad, and a coefficient of 2.011 indicates that every 1% increase in the market size of BRI countries can attract a 201% increase in Chinese FDI. Urbanization Level (URL) is significant at the 5% confidence level at 0.063, indicating that China often chooses countries with relatively high levels of urbanization for foreign direct investment, as a high level of urbanization implies relatively well-developed infrastructure and a richer range of investable businesses. The control variables Trade Openness (OPEN) and Per Capita Disposable Income (LnAGDP) did not pass the significance test, possibly because the openness of a country is not a critical factor considered in foreign direct investment, or because these two factors are influenced by many variables, making them less stable.

5. Conclusions and Policy Recommendations

5.1. Research Conclusions

This paper focuses on the financial development of countries along the "Belt and Road" Initiative (BRI) and deeply studies its impact on China's FDI.

Firstly, by reviewing relevant literature from domestic and international scholars, the paper understands the basic

financial development theoretical mechanisms and different impact pathways. Secondly, it analyzes the relationship between financial development in BRI countries and Chinese FDI, and conducts a regional classification to study the differences in financial levels across regions, finding that areas with higher levels of financial development are more attractive for China's overseas investments. Finally, by processing data on variables affecting foreign direct investment and employing the FEM model for empirical testing, the following conclusions are drawn:

The level of financial development in a country has a significant positive correlation with Chinese FDI. Increases in the proportion of broad money M2 to GDP, domestic credit to the private sector to GDP, and the trading volume of stocks and bonds to GDP all promote Chinese FDI. As the financial system expands, improves efficiency, and enriches financial innovation tools, constructive suggestions for China's foreign direct investments are proposed. Additionally, from the control variables, trade openness (OPEN) and per capita disposable income (LnAGDP) did not pass the significance test, possibly indicating that these factors are not considered in China's foreign direct investments. On the other hand, when selecting locations for foreign direct investment, China considers factors such as market size and urbanization level, indicating that larger markets attract higher returns due to the presence of capable investors; high urbanization levels also reflect well-developed financial infrastructure and high consumer standards, positively affecting China's foreign direct investment. Given the intense competition in China's domestic market, strong motives for overseas investment to meet market demands make mature market systems and efficient financial systems key factors in investment location choices.

In summary, when selecting target countries for foreign direct investment, countries not only filter through regional classifications to invest in economically better-off nations but also choose countries with higher levels of financial development, considering the size, efficiency, and structure of their financial development.

5.2. Policy Recommendations

Firstly, the fixed effects model shows that countries with higher levels of financial development have a significant positive correlation with China's foreign direct investment. China should be guided to choose countries with higher financial development levels for foreign direct investment as much as possible, using this as a driving force to fully utilize market resources and improve investment efficiency and intensity in BRI countries through changing financing constraint conditions and technological innovation pathways. Recognizing that a high level of

financial development also implies a more developed financial system and larger financial scale, the banking system's credit scale will expand, creating more derived deposits to expand the credit scale, providing more diversified financing channels for enterprises, especially those primarily relying on bank loans without other financing channels.

Secondly, despite the acceleration of "going out" under the BRI policy, China faces unprecedented investment opportunities in developing countries, which may carry greater potential financial risks. The government should prepare for investment risk by monitoring risks in foreign direct investment, focusing on the financial status and credit level of enterprises in the target countries, conducting stress tests if necessary to determine the maximum loss under extreme conditions, and ensuring investment standards are met. From a regional classification perspective, China should increase investment in West Asia, Southeast Asia, and Central Asia due to their relatively high levels of financial development, indicating safer investments and relatively higher returns. Implementing preferential policies by the government can give Chinese enterprises a competitive advantage in international cooperation.

Thirdly, China's growing scale of foreign direct investment signifies its gradual entry into the international market and the ongoing strategy of "going out." With the opportunity for RMB internationalization, leveraging the rich capital and technological resources of BRI countries is essential for promoting the use of RMB in international settlements. Additionally, establishing financing platforms in the target countries' markets and issuing relevant financing policies can facilitate investment and financing, providing diversified financing tools like stocks and bonds to meet China's financing needs and offering more authoritative and reliable financial guarantees for enterprises.

5.3. Limitations of the Study

In assessing the level of financial development, the study mainly selects data from the banking system and capital market indicators. Given the varying levels of financial development across countries and the difficulty in data acquisition, it might not comprehensively measure the impact of financial development, leading to a lack of comprehensiveness. Additionally, the lack of data for some BRI countries makes the overall data incomplete.

Data Availability

The data used to support the findings of this study are available from the corresponding author upon request.

Conflicts of Interest

All authors declare there are no conflicts of interest.

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