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The Impact of Bilateral Economic Policy Uncertainty on China's High Quality OFDI in Australia

Sen Huang[1, a], Yuping Wang[1, b]

[1]Sichuan International Studies University, National Center for Economic and Business Studies, Leshan, China

[a]360618606 @qq.com, [b]Wangyuping997@163.com

Abstract

In order to promote the high-quality development of China's OFDI in Australia, this paper systematically analyzes the impact of bilateral economic policy uncertainties on China's OFDI in Australia based on the panel data of China's OFDI in Australia from 2009 to 2018.The results show that when domestic enterprises conduct OFDI in Australia, the uncertainty of China's foreign support policy significantly promotes the high-quality development of Chinese enterprises in Australia's OFDI, while the uncertainty of Australia's domestic policy has no significant effect on Chinese enterprises in Australia's OFDI.

Keywords

Australia; Economic policy uncertainty; OFDI.

1. Introduction

In recent years, the outbreak of COVID-19, the rise of unilateral trade protectionism and the frequent Sino-US trade frictions, the changing world economic environment and China's own economic environment have always affected the development of Chinese enterprises and their investment decisions. Although the introduction of economic stimulus policies in various countries did stabilize the global macroeconomic situation in the short term, it also caused the problems of sluggish demand and slow economic recovery in various countries, which made the macroeconomic fluctuations more severe.In this context, the economic and trade relations between China and Australia have also been significantly affected.Although Australia is China's main investment country in Oceania and an old country that has established diplomatic relations with Australia, and China has been Australia's largest trade partner since 2009, China has faced constant frictions with Australia in recent years, which more or less affects China's smooth promotion of OFDI in Australia.

2. Theoretical Analysis and Hypothesis

First, based on the effect of real option, most of the studies related to uncertainty focus on the investment under uncertain conditions.In the face of uncertainty in the market environment, the company's investment behavior will make corresponding adjustments, the application of dynamic management, so as to change the uncertainty.The uncertainty of the domestic market economy will affect the investment behavior of enterprises, which will make them more cautious before making decisions and will not easily expand or shrink the scale of enterprises. As a result, the productivity growth of enterprises will decline, thus inhibiting the effect of the potential government stimulus policies.

Second, the rising uncertainty of trade policy makes it difficult for enterprises to predict changes in the external market environment.The uncertainty caused by the government's

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policies and management will lead to the expansion of credit spreads, resulting in an increase in the external financing costs of enterprises.All these information are needed by enterprises to make foreign investment, which will determine when and where enterprises invest, etc., which will increase the difficulty for enterprises to make investment decisions.

Based on the above analysis, this paper proposes the following hypotheses:

H1a: There is a negative correlation between internal economic policy uncertainty and OFDI. That is to say, the lower the uncertainty of China's economic policy, the more likely domestic high-quality policies will promote domestic enterprises' investment in Australia.

With the development of time, countries will take corresponding measures and means according to the change of their competitiveness. For example, in the process of the trade war between China and the United States, a series of policy changes of the two countries and the unpredictable fluctuations of trade policies lead to the emergence of uncertainty.And trade policy is also closely related to OFDI of domestic enterprises in the fluctuating uncertainty of internal economic policy. It is further proposed that:

H1b: There is a negative correlation between China's trade policy uncertainty and China's high quality policy on domestic enterprises' investment in Australia.

3. Model Setting

Before setting the model, Hausman test was selected in this paper to select the optimal panel data analysis model. The P value in the test result was greater than 0.05, so the Logit model was selected in this paper for regression.In this paper, the uncertainty index of China's trade policy is added into the basic model, which contains three core explanatory variables.In addition, robust standard deviation was used in all subsequent regressions to improve the reliability of regression results.For this reason, the regression model is established as follows:In addition, robust standard deviation was used in all subsequent regressions to improve the reliability of regression results.For this reason, the regression model is established as follows:

$$OFDI_{it} = \alpha_0 + \alpha_1 CEPU_{t-1} + \alpha_2 AEPU_{t-1} + \alpha_3 CTPU_{t-1} + \alpha_4 X_{t-1} + \varepsilon_{it} \quad (1)$$

In the formula (1), is the influence coefficient of China's economic policy uncertainty (CEPU), is the influence coefficient of Australia's economic policy uncertainty (AEPU), is the influence coefficient of China's trade policy uncertainty (CTPU), is the influence coefficient of control variables, and is the residual term.According to the practice of most literatures, the explained variable is a dichotomous variable. According to the growth rate of China's OFDI flow over the years, it is proposed that if Chinese enterprises' investment in the industry in t year increases by more than 50% compared with that in t-1 year, the explained variable will be 1, otherwise it will be 0.

The relevant variables are described as follows:

China's investment flow in Australia (OFDI) : Select China's investment flow in various industries in Australia from 2009 to 2018, and the original data are from China's OFDI Statistical Bulletin.

Economic Policy uncertainty (Ceput-1, CTPUT-1, Aeput-1) : The economic Policy uncertainty in this paper is measured by the China-Australia bilateral economic Policy uncertainty index (data from www.Economic Policy Uncertainty.com).Considering that economic policy uncertainty has a lag effect on OFDI, this paper treated the core explanatory variable as a lag first order. In

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this paper, the arithmetic mean method was used to convert it into the annual EPU index. The specific calculation formula is as follows:

$$\mathrm{EPU}_{\mathrm{t}}=\frac{1}{12}\sum_{m=1}^{12} EPU_{\mathrm{m}}$$

Wage cost (PGDP) : take the natural logarithm of labor wage cost of various industries in Australia.The wage cost affects the profitability of the industry by affecting the production cost of the whole industry. Therefore, when Chinese enterprises invest in Australia, they tend to invest in the industry with relatively low cost.

Industry staff: take the natural logarithm of the annual average number of employees in each industry in Australia.The size of the industry is one of the important factors attracting OFDI. A larger industry size means greater profits from available resources.

Per capita wage (PCW) : take the natural logarithm of the per capita wage in various industries in Australia.The index reflects the profitability of various industries.

Industry Value Added (ADD) : Take the natural logarithm of the value added of various industries in Australia.Is the value created by Australian industries in the production process. This index reflects the expected value of each industry. Industries with higher value are more likely to attract foreign investment, according to the data from the Australian Bureau of Statistics.

4. Empirical Process and Analysis

In order to ensure that the regression results will not increase the standard error of the coefficient due to the multicollinearity between variables, thus reducing the accuracy of the regression results, this paper first tests the correlation coefficients between OFDI, policy uncertainty index and other control variables of various industries before conducting empirical analysis.It is found that the correlation between variables is low, which ensures the accuracy of empirical results. Meanwhile, VIF values are all below 10, so it can be considered that there is no serious multicollinearity in the data.Meanwhile, robust standard deviation was used in all subsequent regressions to improve the reliability of regression results.

Table 1. Empirical results of the impact of policy uncertainty on China's OFDI in Australia

VARIABLES	(1) OFDI	(2) OFDI	(3) OFDI
CEPUt-1	0.829**		
	(0.394)		
CTPUt-1		0.483*	
		(0.256)	
AEPUt-1			-0.357
			(0.541)
lnstaff	1.206	0.687	0.409
	(1.442)	(1.414)	(1.422)
lnPGDP	-0.518	-0.351	-0.442
	(0.967)	(0.972)	(1.011)
lnPCW	-0.975	-1.033	-0.321
	(1.375)	(1.400)	(1.546)
lnadd	-0.221	-0.241	-0.129
	(0.310)	(0.303)	(0.337)
Constant	1.291	4.183	4.588
	(6.381)	(6.161)	(6.567)

z-statistics in parentheses

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*** p<0.01, ** p<0.05, * p<0.1

Through the test model (1), columns (1) and (2) in Table 1 show the empirical results of the impact of China's policy uncertainty on China's OFDI in Australia.On the basis of the full sample, this paper includes China's economic policy uncertainty and China's trade policy uncertainty into the model respectively, and carries out regression analysis on each industry.In Table 1, columns (1) and (2) use Logit model for regression analysis. The results show that :(1) China's economic policy uncertainty (Caut-1) is positively correlated with China's OFDI in Australia, and it is significant at the level of 5%, which is just contrary to Hypothesis H1a put forward above.(2) China's trade policy uncertainty coefficient (CTPUT-1) is positively correlated with China's OFDI in Australia, and is significantly positive at the 10% level, rejecting the H1b hypothesis in this paper.The results show that China's economic policy uncertainty and China's trade policy uncertainty have a driving effect on Chinese enterprises' investment in Australia.Column (3) shows the empirical results of the impact of Australian economic policy uncertainty on China's OFDI in Australia.On a full sample basis, this paper incorporates Australian economic policy uncertainty into the model and conducts a regression analysis across industries.The results show that there is a negative correlation between Australian economic policy uncertainty (AEPUT-1) and China's OFDI in Australia, and the effect is completely opposite to that of China's policy. However, the result is not significant, indicating that Australian economic policy uncertainty has no significant effect on the impact of Chinese enterprises' investment in Australia.

5. Research Conclusions

This paper is based on OFDI-related panel data of Chinese industries in Australia from 2009 to 2018, including agriculture, forestry, animal husbandry and fishery, mining, construction, construction, wholesale and retail, accommodation and service, transport, postal and warehousing, leasing, employment and real estate services, and other services.Based on Logit regression model, this paper empirically tests the impact of economic policy uncertainty in China and Australia on Chinese enterprises' investment in various industries in Australia, and draws the following conclusions:

First, the uncertainty of China's economic policy can have a significant positive effect on Chinese enterprises' OFDI in Australia and promote the high-quality development of China's OFDI.Due to the obvious difference in the impact of different degrees of economic policy uncertainty and the different sensitivity of the impact, the effect of Australian economic policy uncertainty on Chinese enterprises' OFDI in Australia is not significant.

With the worsening of the COVID-19, trade protectionism and bilateral trade frictions will not disappear in a short time. In the future, China-Australia economic and trade relations will continue to experience significant fluctuations. Both sides need to face up to the root causes of the problems and think about how to deal with them.Based on the above research conclusions, in order to promote the high-quality development of China's OFDI in Australia, the author puts forward the following policy suggestions:

Second, the cooperation between China and Australia is not clear yet, and the economic policy uncertainty of the two countries is also affected by the political relationship. In order to avoid the deterioration of bilateral economic and trade relations, Australia should actively improve the political relationship between the two countries and promote the long-term stability of the development of investment relations.Facing the current Australian bad investment environment, our country enterprise first, combined with effective information provided by the government to fully grasp the market situation of the host country industries, such as employee, business model, consumption habit, focus on the host country to provide effective policy change

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information, combined with the local policy to do preventive measures to reduce the investment risk, improve the regulatory measures to prevent risks.

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