PERSPECTIVE

Foreign direct investment along the Belt and Road: A political economy perspective

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Abstract

In 2013, China launched its ambitious Belt and Road Initiative (BRI), a large portfolio of infrastructure projects across 71 countries intended to link Eurasian markets by rail and sea. The state-led nature of the Initiative combined with its transformative geopolitical implications have conditioned the type of engagement that many governments and firms in host and third countries are willing to take in Chinese-funded BRI projects. Building on two theoretical streams that have originated in international political economy but have received growing attention in international business, varieties of capitalism and geopolitics, this perspective shows how a greater understanding of the institutional and geopolitical context surrounding BRI helps decipher the selection of host-country firms and third-country MNEs in Chinese-funded BRI projects. We portray firm selection in a BRI project as the outcome of a one-tier bargaining game between China and a host country. We show how institutions and geopolitics influence both the legitimacy gap of Chinese SOEs in a host country and the host country's relative bargaining power, affecting the likelihood that host firms and third-country MNEs are selected in BRI projects. We also discuss the geopolitical jockeying strategies that these firms can adopt to influence the outcome of the bargaining game.

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INTRODUCTION

In 2013, China launched a global development strategy named the “Belt and Road Initiative” (BRI). Touted as the most important international development program of the 21st century and as “China’s Marshall Plan” (Casas-Klett & Li, 2021; Shen & Chan, 2018), the plan consists of developing multiple infrastructure projects to connect Eurasian markets with China by rail and sea, linking at least 71 countries and involving investments that are predicted to grow to over USD 1 trillion by 2027 (Li, Liu & Qian, Li, Liu, et al., 2019; Macaes, 2018). In 2015, China added the Digital Silk Road to the program with the aim of improving BRI host countries’ telecommunications networks, artificial intelligence

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capabilities, cloud computing, e-commerce and mobile payment systems, smart cities, and other high-tech areas (Ly, 2020).

There are clear economic rationales for host countries to participate in the Initiative. Many BRI countries – particularly the small, landlocked, and fragile – face significant infrastructural deficits that have left them poorly integrated in regional and world markets (Ruta et al., 2019). BRI projects provide these countries with the opportunity to address these infrastructural gaps at a cost that is lower than they would be able to receive elsewhere, which may allow them to improve their trade, foreign direct investment (FDI), and welfare in the future (Eurasia group, 2020).

At the same time, China's state capitalism, its growing clout in the global economy, its increasingly proactive geopolitical stance, and the rising tensions between China and the United States require host countries to consider the non-economic motives of BRI investments and the geopolitical ramifications of participating in a BRI project (Li, 2019). A defining feature of BRI is the heavy influence of the Chinese government on multiple levels of BRI projects (Buckley et al., 2018; Ramamurti & Hillemann, 2018). The Chinese government generally selects BRI projects and finances them with loans from Chinese state-owned policy banks, commercial banks, and sovereign wealth funds (Chan, 2018). Funding by these entities is often tied to the use of Chinese state-owned enterprises (SOE) for the execution of projects (Ghossein, Hoekman & Shingal, 2019).

Several critics have raised the concern that this state capitalism allows China to pursue a policy of 'debt-trap diplomacy': luring poor countries into agreeing to unsustainable loans to pursue infrastructure projects so that, when they experience financial difficulty, China can seize the asset, thereby extending its strategic or military reach (Brautigam, 2020; Hurley et al., 2019). Others have worried about the harm that participating in BRI may bring to countries' strategic relations with other geopolitical heavyweights such as India and the United States, which have been openly critical of the Initiative (Balding, 2018). Depending on the political context surrounding a project, a host country government's willingness to work with China and its SOEs in BRI projects may thus diminish.

This is not to say that other governments and firms are uninvolved or play a passive role in BRI. Host-country governments need to agree with the

terms of the BRI project, which give them bargaining power. Furthermore, third-country governments and firms can be asked to contribute to certain projects (Khanna, 2019). For example, since 2015, China has signed memoranda of understanding on third-party market cooperation with 14 developed countries, setting up intergovernmental working mechanisms and platforms for third-party market cooperation (Zhang, 2019). The reality nevertheless remains that 89% of contractors in Chinese-funded transportation projects are Chinese companies and that both host-country firms and third-country multinational enterprises (MNEs) struggle to find the right strategies that allow them to take part in BRI projects (Hillman, 2018).

In this article, we aim to deepen our understanding of the influence of the political context on the strategy and structure of BRI by asking the following questions: *how does the institutional and geopolitical environment surrounding BRI influence the likelihood that local firms or third-country MNEs get selected to participate in a Chinese-funded BRI project? And what strategies can these firms develop to increase their selection chances?*

To address these questions, we take as a starting point Li et al.'s (2013) argument that, in international infrastructure development projects financed by the Chinese government, China and a host country conduct a one-tier bargaining game in which they need to decide which firms to be selected for the participation in a Chinese-funded BRI project. We introduce an institutional and geopolitical dimension to the bargaining game by building on two theoretical streams that have originated in the field of international political economy but have received growing attention in international business (IB): varieties of capitalism (VOC) (Jackson & Deeg, 2008) and geopolitics (Witt, 2019a, 2019b). The former analyzes how a country's institutional system constrains and enables the performance of certain types of firms. We use VOC to identify the type of host countries in which Chinese SOEs face particularly large legitimacy gaps and where therefore local and third-country firms are more likely to be selected to participate in a BRI project. Studies on geopolitics, then again, explore how rivalries between nations affect the attitudes, goals, and foreign-policy decisions of countries. We use it to analyze how geopolitical concerns influence both the legitimacy gap of Chinese SOEs in BRI host countries and the host country's relative bargaining

power in the one-tier bargaining game. Our bargaining model allows us to evaluate how both institutions and geopolitics influence the likelihood that local firms or third-country MNEs are selected to participate in BRI projects. We also discuss the geopolitical jockeying strategies that these firms can adopt to influence the outcome of the bargaining game.

We make three contributions to the IB literature. First, we heed to the calls of Cui et al. (2018) and Witt (2019a) by systematically integrating political context in the analysis of IB patterns. In our study, we show that governments' control over resources, their political intents and the potential geopolitical ramifications of their actions all influence the type of firms that are selected to participate in BRI projects. As such, geopolitical factors have predictable effects on FDI in the world's largest international development program. This contrasts our model with existing FDI studies that typically combine government influence and other environmental factors into a single institutional or political risk variable and thus downplay the rich institutional and geopolitical context in which decisions are made (Jackson & Deeg, 2008; Ramamurti & Hillemann, 2018).

Second, we show how Chinese state capitalism, which fosters effective coordination between industry and government in strategic infrastructure industries, generates new forms of international competition. Unlike traditional FDI theories which focus on the decision-making processes of individual MNEs that operate in a rule-based business environment which is treated exogenous, our study depicts BRI-related FDI as the result of a one-tier bargaining game where the Chinese government has both the incentives and the capabilities to represent the collective interests of Chinese SOEs. Our model thus allows us to identify how "systemic competition" related to China Inc. (Teece, 2020) alters the conditions under which local firms or third-country MNEs can effectively compete with Chinese SOEs.

Third, we identify viable geopolitical jockeying strategies that local firms and third-country MNEs can adopt to increase their likelihood of being chosen for a BRI project. Geopolitical jockeying refers to political positioning strategies that gain legitimacy vis-à-vis rival firms (Lubinski & Wadhvani, 2020). Such non-market strategies can increase a firm's selection chances by allowing firms to position themselves as complementary to both China's and the host country's goals, thus increasing their selection chances.

SCHOLARSHIP ON THE BRI

Since its launch in 2013, much of the scholarship on BRI has focused on three themes. First, it has emphasized the varieties of actors involved in BRI and the relationships among them. Second, it has focused on China's commercial and non-commercial intentions associated with BRI. Third, it has emphasized the geopolitical implications of BRI.

Actor Diversity in BRI

A first theme is the variety of public and private actors from different countries involved in BRI. The Chinese actors include the government (central and local), SOEs, and private firms. The non-Chinese actors include firms and governments in the BRI region and in third countries.

The Chinese government is the orchestrator of BRI projects through its control over the financial resources (Ghossein et al., 2019). Dominating the BRI's design, political, and economic governance (Hu et al., 2019), it has the power to decide which countries should receive funding for BRI projects and which firms should conduct the projects. At home, the Chinese government controls politics, state bureaucracy, and the legal system. China's state capitalism provides state authorities with persistent power over the economy through their control of capital (e.g., bank loans), the SOEs, land, permits and taxes (Haveman et al., 2017; Liang et al., 2015).

Chinese SOEs are a second key player in BRI projects.¹ Chinese SOEs have become the most important force behind Chinese outward FDI, which had increased to 4.9% of the global FDI stock (US\$1281bn) in 2016 (Buckley et al., 2018). In BRI projects funded by the Chinese government, more than 80% were allocated to Chinese firms only, mostly SOEs (Ghossein et al., 2019). Chinese SOEs in a sense represent the Chinese government to manage and implement BRI projects (Mariotti & Marzano, 2019; Sutherland et al., 2020). The Chinese government wholly or partially owns the SOEs and has management and decision-making authority over them (Liang et al., 2015).

Host-country governments also influence the shape of BRI projects that are conducted on their territory (Vangeli, 2019). They may contribute funds and location-specific resources such as land and electricity to the project (Economic Intelligence Unit, 2018). They also have their say in requiring the participation of local firms (SOEs or private) to protect their national interests and

manage nationalist concerns about inward FDI (Janssen, 2017).

Finally, MNEs and governments from third countries also participate in the BRI projects, even though their role to date has been more peripheral. For example, American MNEs including Hewlett-Packard, General Electric, and Caterpillar have been actively seeking roles as subcontractors to major Chinese MNEs involved in BRI-related contracts (Zhang, 2019). Siemens, a European MNE, has signed dozens of agreements for BRI projects with Chinese partners. ABB has actively participated in BRI projects conducted mainly by Chinese SOEs through EPC (engineering, procurement, and construction). Major Korean companies, like Daewoo and Hyundai, have gained big contracts from Saudi Arabia to Uzbekistan. Nissan Corp., a Japanese company, launched its first trial of rail-bound cargo transshipment to Europe with China's Sinotrans in 2018 (Khanna, 2019).

Non-commercial Objectives of BRI Projects

A second theme is both the commercial and non-commercial aims that China's government uses in BRI (Macaes, 2018). China's commercial motives for embarking on BRI include the internationalization of China's currency, the effective use of its foreign currency reserves, the reduction of Chinese excess production capacity, and the development of China's Western areas. The non-commercial aims include exporting its development model, diffusing its political influence, bolstering regional stability, and improving China's energy security. All of these are aimed at increasing China's sphere of influence in the region.

China's non-commercial intents provide a potential source of tension between China and the host country, which in some cases can generate a legitimacy gap for Chinese SOEs (Huang et al., 2020; Li, Li, et al., 2019; Li, Liu, et al., 2019). On the one hand, for some governments that view BRI as a stabilizing force in the region, BRI projects are considered an opportunity to obtain cheap Chinese investment at little political risk, and Chinese SOEs face a limited legitimacy gap. On the other hand, many governments are skeptical of the potential negative ramifications of increased Chinese influence on their local economies. These tensions have, at times, influenced local politics in several BRI countries (Balding, 2018). In the run up to the 2018 election, Malaysian Prime Minister Mahathir Mohamed described BRI as a form of new colonialism that must be rejected. Maldives President

Ibrahim Mohamed Solih has vowed to revisit some of the country's BRI projects which he argued has abetted corruption and weakened the country's sovereignty.

The Geopolitics of BRI

A third theme in the BRI literature focuses on the geopolitics surrounding the Initiative.

China did not launch BRI in a geopolitical vacuum. Its economic rise and accompanying surge in geopolitical power challenge the hegemony of the US, and this has recently tilted the balance between cooperation and competition in Sino-US relations toward the latter (Gertz & Evers, 2020; Pei, 2020). Indeed, the growing schism is considered a major geopolitical shift that is at the source of deglobalization (Witt, 2019a) and that is creating a bifurcated global governance system, that is, a world dominated by two systems that operate under different rules and struggle for hegemony (Petricevic & Teece, 2019).

Several scholars have relied on geopolitical narratives to explain the origin of BRI. Ferchen (2016) and Economy (2018) interpreted the Initiative as the consequence of a more assertive Chinese statecraft aimed at challenging US hegemony. According to this view, BRI reflects China's move towards a more active foreign policy strategy aimed at shaping China's external environment rather than merely adapting to it (Macaes, 2018). Other scholars have depicted it as pushback against the U.S. Obama administration's efforts to "pivot" and expand its sphere of influence in Asia and the U.S. Trump administration's attempts to decouple the two economies (Chatzky & McBride, 2020).

The geopolitical context surrounding BRI extends beyond US-China relations. For countries that are geopolitically aligned with China or are peripheral in the spheres of influence of its rivals, China's call for developing a "community of shared destiny" through BRI has had a special resonance that increased their willingness to participate in BRI projects (Macaes, 2018). Other countries – especially those more closely aligned to the US and India – have been more reticent to participate in BRI projects. The China-Pakistan Economic Corridor is a prime example. The proposed corridor is expected to connect Kashgar in Xinjiang with the Port of Gwadar in the province of Baluchistan and is strongly supported by Pakistan. Its route, however, passes through the Pakistan-administered Kashmir, which is an area contested by India, and

has thus received strong condemnation from the latter (Blah, 2018).

Finally, the geopolitical context varies across industries. The inclusion of the Digital Silk Road in BRI, for example, has raised concerns in the US and Europe that it will allow China to strengthen its digital prowess by providing a multi-regional base in which it can develop its norms, systems and networks, allowing it to become a digital standard-maker across BRI host countries (Hemmings, 2020).

VARIETIES OF CAPITALISM AND GEOPOLITICS: THEORETICAL BACKGROUND

If we take the themes together, extant scholarship portrays BRI as a Chinese state-led development program that includes a variety of public and private actors from different countries across multiple projects, which is driven by both commercial and non-commercial motives, and that can have potentially important geopolitical ramifications. What this means is that the firms that are selected to participate in BRI projects and the FDI flows that result from the choice may be heavily influenced by the political context surrounding the Initiative. Any framework that aims to explain firm participation and FDI patterns along the Belt and Road thus needs to account for the roles of these political forces.

In this section, we review two theories that originated in the field of international political economy that can help us contextualize how the political environment may influence the type of firms that will be contracted to execute BRI projects: *variety of capitalism* (VOC) and *geopolitical theory*.

The premise of VOC studies is that a country's institutional setting helps form the identity and interests of economic actors, thereby shaping the development of firm resources, capabilities, and bargaining power (Jackson & Deeg, 2008, 2019). As the formal and informal rules of the game, institutions develop a systemic logic that resolves finance, labor, inter-firm relations and other types of coordination problems in an economy (Hall & Soskice, 2001; Verbeke, 2019). In turn, these institutions influence the strategies and actions of economic and non-economic actors through ownership patterns, access to resources, property rights, and so on (Jackson & Deeg, 2008).

A major contribution of the VOC literature, with special appeal in the field of IB, is its theory of comparative institutional advantage (Hall &

Soskice, 2001; Jackson & Deeg, 2008). Countries develop different sets of institutional arrangements, which favor certain patterns of economic activity over others as revealed in comparative strengths and weaknesses of certain firm types and actions (Hall & Soskice, 2001; Witt & Jackson, 2016). Subsequent studies in IB have built on this approach to analyze how a home country's institutional comparative advantage affects firm internationalization. For example, Li et al. (2014) have argued that a country's institutional configuration differentially affects the internationalization paths of central versus local SOEs. In our theoretical framework, we will build on VOC to analyze why Chinese SOEs are favored by the Chinese government in BRI projects and in which type of host countries Chinese SOEs face a particularly large legitimacy deficit.

A shortcoming of VOC is that it mostly focuses on the interactions and complementarities of institutions within a single country but that it is largely de-contextualized from the politics of phenomena that transcend borders. We thus propose to complement VOC with insights from international relations studies, and more specifically from studies that focus on geopolitics (for an IB-tinted review, see Witt, 2019a). Geopolitics refers to the theory and practice of world politics, with a particular emphasis on the geographies that both shape and result from that politics (Dittmer & Sharp, 2014). State competition plays a central role in this research field where world politics is often seen as a zero-sum game. States are assumed to share a common intention: survival in a world which is an anarchical "self-help" system. In other words, states defend themselves using their own "hard" power, i.e., economic and military strength. As we will show in the next section, the introduction of geopolitical considerations provides a theoretical lens that can explain why some countries are hesitant to participate in BRI projects, what the Chinese government can do to entice these countries to participate, and what this means for the type of firms that participate in BRI projects.

VOC and geopolitical studies differ in their views, but they complement each other in providing insights into the forces that influence the structure and governance of BRI projects. VOC focuses on institutional complementarities between actors within a country and the path dependence of changes. Geopolitical studies fill this gap and illustrate how geopolitics affects MNEs and FDI (Lubinski & Wadhwani, 2020; Witt, 2019a). In the

following section, we will use these two theoretical streams to develop a political economy perspective of FDI along the Belt and Road.

THEORETICAL FRAMEWORK

To identify the channels through which institutions and geopolitics influence firm selection in BRI projects, we develop an MNE–host country bargaining framework with “Chinese characteristics”. The premise of our theoretical framework is that various firm types – Chinese SOEs, local firms, and third-country MNEs – can execute a BRI project and that the selection is the outcome of a bargaining game between China and a host country. This approach allows us to investigate how the institutional and geopolitical context surrounding a BRI project influences the outcome of the bargaining game.

Our theoretical framework builds on a vast tradition of studies that have modeled FDI as the outcome of a bargaining game between MNEs, home countries, and host countries (Cannizzaro, 2020; Kobrin, 1987; Ramamurti, 2001; Vernon, 1971). Our model is closest to Li et al. (2013), who suggest that, in strategically important development projects financed by the Chinese government, China and a host country conduct a one-tier bargaining game in which the Chinese government represents the collective interests of Chinese SOEs. This framework differs from the standard approach of modeling MNE–host country bargaining as a two-tier structure where the home and host country in stage 1 negotiate a bilateral or multilateral investment treaty designed to provide a favorable business environment in the host country, and where MNEs in stage 2 enter and operate within that environment by negotiating directly with the host government over specific terms and obligations (Ramamurti, 2001).

We argue that the one-tier bargaining game is an accurate depiction of the conditions surrounding firm selection in the BRI context. Li et al. (2013) identify two conditions under which the Chinese government directly negotiates with a host country to facilitate the foreign investments of Chinese firms. First, the Chinese government has strong *incentives* to support its companies due to the strategic nature of an industry. Second, the Chinese government has the *ability* to negotiate with a host-country government on behalf of Chinese firms due to its formal or informal control of project financing and firm operations. As we have

discussed, BRI’s focus on the highly strategic infrastructure sectors and the Chinese government’s central role in selecting and financing BRI projects imply that these conditions are met.

The inherent tension that lies at the heart of our one-tier bargaining game is that China and the host country have different preferences about the firm type to select. While China prefers to select its own SOEs (Ghossein et al., 2019), BRI host countries often have serious concerns about Chinese SOEs’ legitimacy (Sutherland et al., 2020). Legitimacy captures a host country’s perception that an entity’s actions are appropriate and desirable within some socially constructed system of norms, values, beliefs, and definitions (Suchman, 1995). Due to Chinese SOEs’ opaqueness (Li, Li, et al., 2019; Li, Liu, et al., 2019) and concerns about their non-commercial motives (Cuervo-Cazurra, 2018), many countries perceive their investments to pose challenges to national security despite any economic benefits that they might generate. These legitimacy concerns generate a dissimilarity of interests between the parties that need to be resolved through bargaining (Grosse & Behrman, 1992).

China and the host country can overcome their dissimilarity of interests by choosing an alternative firm type to execute the BRI project. For example, China may agree to select a local firm or third-country MNE to ensure the host country’s participation in the project. As we show in Figure 1, China’s willingness to accommodate the host country in terms of firm selection depends on two factors which are influenced by the institutional and geopolitical context: (1) Chinese SOEs’ legitimacy gap in the host country and (2) the host country’s relative bargaining power. For a given level of relative bargaining power, China is more likely to accept local firms and third-country MNEs if Chinese SOEs face a high legitimacy gap in the host country. For a given legitimacy gap, the Chinese government is more likely to accept alternative contractors when the host country has a high relative bargaining power.

VOC and geopolitical studies allow us to identify key institutional and geopolitical drivers that shape Chinese SOEs’ legitimacy gap and the host country’s relative bargaining power. VOC explains the Chinese government’s preference for Chinese SOEs and the institutional conditions in a host country that increases Chinese SOEs’ legitimacy gap. Geopolitical studies identify how geopolitics influences the legitimacy gap of SOEs in host countries

Figure 1 A bargaining model of BRI participation by local firms and third-country MNEs.

and pinpoints the type of BRI projects in which a host country has a larger relative bargaining power. In the remainder of this section, we study how institutional and geopolitical forces affect the bargaining outcome and shape the conditions under which local firms and third-country MNEs are more likely to be selected for BRI projects. Figure 1 summarizes the key propositions of the paper.

VOC helps explain the Chinese government's preference to promote its own SOEs in BRI projects. China's state-led capitalist system provides a comparative institutional advantage to Chinese SOEs in their home country, particularly when related to BRI projects (Hu et al., 2019; Li, 2019). In comparison with Chinese private firms, Chinese SOEs enjoy preferential access to government-controlled resources such as credit availability and subsidies in addition to other state-controlled benefits (Herrala & Jia, 2015). They also have overwhelming control over key BRI sectors including telecommunications, natural gas, power generation, and distribution industries (Naughton, 2015). Moreover, the Chinese government has introduced a series of policies and supporting measures to encourage SOEs' internationalization to "go out" (Gu et al., 2016). These include the conferring of soft budget constraints through the state-owned banking

system (government bailouts, cheap loans, and subsidies) to speed up SOEs' internationalization (Stan et al., 2014).

VOC also helps identify the host countries in which Chinese SOEs face a particularly large legitimacy gap. Core differences among the institutions of countries mold the attitudes, goals, and policies that states have vis-à-vis different firm types (Jackson & Deeg, 2008). In liberal economies, for example, the market plays a much more dominant role in coordinating economic activities than states (Hall & Soskice, 2001), implying that both domestic and foreign SOEs face a larger legitimacy gap and perform less well in liberal than in coordinated market economies (Jackson & Deeg, 2008).

Deeply engrained ideologies can further shape the institutional comparative advantages and disadvantages of certain firm types in host countries. Host countries often have a preference of which type of foreign firms to attract to their economy. Cuervo-Cazurra (2018), for example, made the case that many developed countries are hesitant to attract FDI from emerging markets and from SOEs, albeit for different reasons. Emerging markets are generally considered to lack the ability of generating cutting-edge technologies and products (Awate et al., 2012) and to have weaker institutions

(Khanna & Palepu, 2010; Li & Qian, 2013), and there is therefore the apprehension that this leads to poor and unethical governance in its MNEs (Cuervo-Cazurra, 2018). SOEs, then again, are perceived to be overly opaque and recipients of unfair foreign state support, raising concerns about their non-commercial motives (Li, Li, et al., 2019; Li, Liu, et al., 2019). Both worries can strengthen the legitimacy gap that Chinese SOEs face in certain BRI host countries.

An effective way for the Chinese government to address host countries' apprehensions related to Chinese SOEs' legitimacy gap in their bargaining with a host country is to select local or third-country companies to participate in the BRI project (Mayer & Chang, 2020; Zhang, 2019). It helps overcome the "conflict" in the negotiations and obtain a cooperative solution. This leads to our first proposition:

Proposition 1: In BRI host countries where the institutional complementarity with China is lower, the legitimacy gap of Chinese SOEs is higher, increasing the likelihood that a local firm or third-country MNE gets selected to participate in a BRI project.

A first channel through which geopolitics influences firm selection is by shaping the legitimacy gap of Chinese SOEs in a host country. A major preoccupation for governments is securing their own country's survival and a key tool for doing so is ensuring that the relative power of their geopolitical rivals remains in check (Witt, 2019a). To achieve this aim, host-country governments thus develop attitudes, goals, and policies that shore up their own economic power and weaken that of its geopolitical rivals (Witt, 2019b). Since there is often the perception that SOEs from geopolitical rivals might subjugate private market interests to the political interests of the state (Cuervo-Cazurra, 2018), the concerns about and actions against geopolitical rivals also apply against their state-owned enterprises, increasing their legitimacy gap. Legitimacy concerns about Chinese SOEs are thus significantly higher in countries that see China as a geopolitical rival than in those that see it as a geopolitical ally (Pacatte, 2019). To overcome the host country's legitimacy concerns, there is pressure for China to accept the selection of a local firm or third-country MNE in the BRI project. This leads to our second proposition:

Proposition 2: In BRI host countries that are geopolitically less aligned with China, the legitimacy gap of Chinese SOEs is larger, thus increasing the likelihood that a local firm or third-country MNE gets selected to participate in a BRI project.

Geopolitics also influences firm selection by affecting parties' outside options in the bargaining game, resulting in a change in relative bargaining power. An outside option is the utility that a party has in leaving an agreement. It influences bargaining power since it helps determine the credibility of a party's threat to walk away from a deal if it does not receive what it wants.

The geopolitical importance of a BRI project for China is one feature that can asymmetrically affect outside options (Oh, 2018). For China, there are certain projects that are of greater geopolitical importance than others. This includes projects that are of symbolic importance for the Initiative or that are considered difficult-to-avoid gateways to connect to other parts of BRI. For example, many consider the Khorgos Gateway in Kazakhstan to be a flagship BRI project of priority for China since it is a highly visible infrastructure project that is squarely positioned along the historical Silk Road and that serves the purpose of physically connecting East and West and particularly important overland transportation of oil to China. Thanks to the dry port, trains can transport freight from coastal China to Western Europe in around 2 weeks, versus a several-week trip by container ship. For this type of project, China has few outside options, which limits its relative bargaining power. In this case, the host country has significantly more leverage to pressure China to accept the participation of local firms or third-country MNEs. This leads to our third proposition:

Proposition 3: In BRI projects that are of geopolitical priority for China, the host country has a higher relative bargaining power, increasing the likelihood that a local firm or third-country MNE gets selected to participate in the project.

Competition between China and its geopolitical rivals influences the host country's outside options. Depending on the host country's geopolitical importance in terms of politics, economics, military, and geography (Mayer & Zhang, 2020), rivals may counter China's BRI offer by proposing an alternative source of funding. The United States, for example, has responded to BRI with the 2018

BUILD Act that will provide up to \$60 billion in loans, loan guarantees, and political risk insurance to help “de-risk private investment in projects that are needed for modernizing underdeveloped economies” (Pacatte, 2019). While the allocated funds are small compared to BRI, the primary goal is to provide host countries an alternative, and especially for those projects that could endanger geopolitical stability, for example, by endangering a “free and open Indo-Pacific”. Japan, the European Union and Australia have taken similar actions (Pacatte, 2019). These countermoves by China’s geopolitical rivals provide the host country with attractive outside options that weaken China’s relative bargaining power. This leads to our fourth proposition:

Proposition 4: In BRI projects that are of geopolitical priority for third countries, the host country has a higher relative bargaining power, increasing the likelihood that a local firm or a third-country MNE gets selected to participate in a BRI project.

Up to this point, our bargaining model has portrayed local and third-country firms as passive players that await the outcome of the inter-governmental bargaining and only jump into action once they have been selected. This, however, is a too simplistic depiction of firm–government interactions in the context of BRI. While individual companies rarely have the power to influence the latent legitimacy gap that Chinese SOEs face in a host country or the host country’s relative bargaining power, they can affect the bargaining outcome by adopting non-market strategies that politically differentiate themselves from their most direct competitors and thus increase their selection chances. Following Lubinski and Wadhvani (2020), we term this “geopolitical jockeying” and define it as political positioning strategies that are designed not only to gain legitimacy in China and/or a host country but also to delegitimize rivals.

IB scholarship has widely documented that MNEs can take a strategic forward-looking perspective and develop both proactive and defensive non-market strategies to shore up their own legitimacy (Mellahi et al., 2016). Little consideration, however, has been paid to geopolitics as a context for legitimacy building (Lubinski & Wadhvani, 2020). Through lobbying and corporate social responsibility actions, companies may aim to frame discourses around their company that seek to increase their

selection chances through political positioning. For example, in host countries that are not an ally of China or of the US, German or French MNEs could use non-market strategies to take advantage of the growing Sino–US rivalry by promoting themselves as good alternatives to both Chinese SOEs and American MNEs.

Local and third-country firms may alternatively try to politically differentiate themselves by directly aligning themselves with the geopolitical positions of BRI countries. For example, a US MNE may attempt to use advocacy advertising, the development of political ties, and hiring managers from the government in both China and BRI host countries to increase their political competitiveness against both local firms and other third-country MNEs.

This type of geopolitical jockeying strategy is also used by Chinese firms. In our bargaining model, we assumed that the Chinese government represents the collective interests of Chinese firms in the negotiations with the host government, but this downplays the real competition that exists between Chinese SOEs (and other firms) that jockey for the favor of the Chinese government. Since our focus in this paper lies on the selection likelihood of local firms and third-country MNEs, we suggest the following proposition:

Proposition 5: Geopolitical jockeying by local firms and third-country MNEs positively moderates the effects of the Chinese SOEs’ legitimacy gap and the host country’s relative bargaining power on the likelihood that a local firm or a third-country MNE gets selected to participate in a BRI project.

THEORETICAL AND MANAGERIAL IMPLICATIONS

Link to Previous Findings

Our one-tier bargaining model encompasses the three BRI research themes that have been studied in previous research. First, the model acknowledges the diversity of actors that have been documented in BRI projects. On the Chinese side, it recognizes that (1) the Chinese government has strong motivations to promote Chinese SOEs for the implementation of Chinese-funded BRI projects and (2) that the Chinese government has the ability to negotiate with host-country governments on behalf of Chinese SOEs due to its ownership and control of both the state-owned commercial banks

that finance the projects and the SOEs that implement them. At the same time, the model takes into account the situation that host countries have a say in which firm type participates in BRI projects, and that this gives an opening for local firms and third-country MNEs to participate (our dependent variable). Second, the model recognizes both the commercial and non-commercial intentions that the Chinese government has associated with BRI projects. Indeed, the concerns about non-commercial intentions of the Chinese government and its SOEs are key features that influence Chinese SOEs' legitimacy gap in host countries and the host country's relative bargaining power in our model. Third, the model takes into account the geopolitical forces that surround BRI projects by considering the geopolitical alignment of host countries as well as the geopolitical importance of a BRI project for China and for third countries. All of these features are presented in a formal structure that builds on existing scholarship in the field of IB and that facilitates empirical testing in future research.

The four independent variables in the model include two determinants pertaining to the host country – institutional complementarity and geopolitical alignment with China – and two determinants pertaining to the BRI project – its geopolitical importance for China and for third countries. Institutional complementarity indicates that a host country's institutional foundations, while different from those of China, may be complementary (Jackson & Deeg, 2019), and that this matters for the legitimacy gap that Chinese SOEs face in the host country. This theoretical link is related to other recent work in IB that illustrates how institutions in China and host countries affect IB transactions. Yan et al. (2018) have found that the Chinese government creates innovative institutional arrangements for Chinese MNEs' OFDI in BRI projects and elsewhere. Buckley et al. (2018) have argued that Chinese domestic institutional framework shapes China's OFDI and the governance of Chinese MNEs. Chhetri et al. (2018) have shown that the Chinese institutional frameworks fit those of the host countries so that BRI connects them into logistics networks. Wei et al. (2017) trace the institutional complementarity to historical business connections between China and BRI host countries. Our paper adds to this literature by arguing that it is the interaction between the institutional foundations of the host and home countries that determines Chinese SOEs' legitimacy gap in host countries.

A host country's geopolitical alignment with China captures the fit between the geopolitical intents of China and host countries, and how this matters for the legitimacy gap that Chinese SOEs face. In a sense, it captures the general attitude that a host country has vis-à-vis China and BRI. It thus complements other studies that have analyzed the general aims of BRI. Li (2019) suggests that the BRI is the outward expansion of a development model which aims to integrate BRI countries into a Chinese system of accumulation. Ohashi (2018) also finds that China aims to take advantage of BRI to create a China-led economic area, internationalize the RMB, and advance industrial adjustment. Chinese geopolitical intents are in line with some, but not all, of the geopolitical intents of the host countries. For example, Risberg (2019) shows that China's infrastructure projects in Africa, including major railroad projects in Nigeria, Gabon, and Mauritania, address African countries' "desperate" need for roads, railways, ports, and energy. In contrast, Wuthnow (2017) indicates that China uses BRI to bolster regional stability, improve energy security, and expand influence and these geopolitical intents do not match those of the receiver countries.

The outcome of the bargaining game not only depends on the general attitudes that a host country has vis-à-vis China, BRI, and Chinese SOEs. It also depends on the geopolitical importance of the project itself for both China and its geopolitical rivals, which influences China's relative bargaining power in negotiations with BRI host countries through outside options. This feature links our model to studies that focus on the geopolitics behind BRI. Chan (2018) makes a list of the geopolitical implications, including the revival of Eastern Mediterranean region as the major gateway to Europe from China and Asia, two major railways in East Africa representing the beginning of a railway development drive in Africa promoted by China's credit, technology, and political will, and the China–Pakistan Economic Corridor from the Pamir to the Indian Ocean coast. These China-led projects are sometimes portrayed as evidence of a rising hegemonic power that threatens the US-led world order and thus invite criticism, ranging from an expanding military agenda, political influence campaigns touting the benefits of authoritarianism, and the use of telecommunications technology to survey other governments (Passi, 2019; Risberg, 2019).

The importance of geopolitical outside options is playing out most clearly in BRI projects related to the Digital Silk Road. In China, this Initiative is also related to two other high-priority initiatives – “Made in China 2025” and “China Standards 2035” – that aim to advance China’s bid for technological independence at home while becoming a standard setter in global networks (Hillman, 2021). The US government has expressed growing urgency for a strategy for competing with China’s Digital Silk Road. Depending on when and how the US government makes this their priority, these actions can substantially influence BRI host countries’ relative bargaining power.

The dependent variable of the model is the participation by local firms and third-country MNEs in BRI projects. This is an area of research that has received growing attention in BRI circles. A key question in business circles is what Western multinational firms can do to increase their participation in BRI projects (Economic Intelligence Unit, 2018).

Our model has identified two mechanisms through which institutional and geopolitical factors influence our dependent variable: the legitimacy gap of Chinese SOEs in a host country and the host country’s relative bargaining power in the negotiations. These two conceptual variables allow us to more concretely reflect on the way how institutions and geopolitics influence firm selection in BRI projects and provide us a way forward to conduct empirical testing.

Legitimacy gap captures the degree to which a host country considers the actions of a generic “Chinese SOE” as desirable, proper, or appropriate (Suchman, 1995). The host-country government, firms, and individuals are all the observers who socially construct the perceptions of the legitimacy. Observers often differ in their perceptions and gaining legitimacy from some observers may result in a loss of legitimacy among others (Bucheli & Salvaj, 2013; Kuilman & Li, 2009; Li et al., 2007). Legitimacy concerns of BRI in general and of Chinese SOEs specifically have been identified to be a key factor that influences the willingness of host countries to participate in BRI. For example, Pendrakowska (2018) conducted a qualitative study on the legitimacy gap in Poland and proposed dimensions to measure it. She found that Poland perceived BRI to be an opportunity for development that could boost regional and sub-regional infrastructure investments, but that the Polish

public was concerned with the competencies, expectancies, and political culture of Chinese SOEs.

A party’s relative bargaining power derives from the resources it controls, the resources that are demanded by the other party, its ability to withhold resources that the latter wants, as well as whether the resources are easily replaceable (Eden & Molot, 2002; Kobrin, 1987). The bargaining in our model is about which firm type is chosen to participate in a Chinese-funded BRI project, and both parties’ outside options are critical to the outcome. China’s outside option to a specific Chinese-funded BRI project is other project that they could finance which would allow them to obtain a similar BRI objective. A first key factor here is China’s ability to finance BRI, which is a key reason why the traditional two-country bargaining model transforms into a one-tier bargaining game (Li et al., 2013). China clearly has a major voice over the BRI funding, including funding from multilateral and institutional lenders such as Asian Infrastructure Investment Bank (AIIB), New Development Bank (NDB), and Chinese national policy banks and Chinese commercial banks (Ghossein et al., 2019). Within Chinese-funded BRI projects, a second factor is the geopolitical importance of a specific project for China.

The BRI host country’s outside option to a specific BRI project is other countries that could finance the same project, sometimes for geopolitical reasons. As we have mentioned above, there is evidence that China’s geopolitical rivals have countered Chinese financing activities for project that are geopolitically important for them. In the case of Poland, its quest to modernize dilapidated infrastructure has quickly transformed into a geopolitical contest once the US got involved (Morries, 2020). In the end, Poland chose the US-led Three Seas Initiative (3SI) over BRI.

This study also demonstrates the moderating role of “geopolitical jockeying”. Existing IB studies largely focus on how MNEs use geopolitical jockeying strategies to enhance their political positioning (e.g., Lubinski & Wadhvani, 2020). Empirical studies of BRI show that third-party MNEs take advantage of the legitimacy gap and bargaining power of Chinese actors to get involved in the BRI projects (e.g., KMPG, 2019; Zhang, 2019). Drawing from the empirical studies, this study reveals the moderation effects of the geopolitical jockeying strategies on the third parties.

In summary, the previous literature has brought institutional and geopolitical forces to the forefront

of discussions on firm selection and FDI in BRI projects, which we have formalized and incorporated into a one-tier bargaining model between China and a host country. These forces interact with each other to encourage the participation of firms from host and third countries. The link to findings in the previous literature not only proves the validity of the variables comprising our BRI model but also sheds light on the measurements of the variables from which future studies are able to test the model's propositions empirically.

Theoretical and Managerial Implications

Our paper provides several broader contributions to the IB literature. First, it highlights concrete channels through which politics influences international business. The policy regimes and institutional patterns of China and BRI host countries generate alternative models of capitalism, which in turn influences the institutional complementarity between countries. Geopolitical forces influence home and host countries' willingness to participate in BRI projects and affect the form of collaboration. While recent IB studies have called for further analysis of how political forces affect MNEs' activities (Cui et al., 2018; Witt, 2019a), IB studies generally treat geopolitics as an abstract and de-contextualized force that mainly influences FDI by affecting political risk. In our study, by introducing insights from VOC and geopolitical studies, we have identified various concrete mechanisms through which institutions and geopolitical forces influence the configuration and governance structure of FDI along the Belt and Road. We propose that the general geopolitical alignment of the home and host countries influences the composition of FDI by affecting the legitimacy gap that Chinese SOEs face in a host country. Furthermore, geopolitical rivalry between the home and third countries influences the composition of FDI by affecting relative bargaining power. Our study thus provides a concrete example of how a deeper contextualization of institutions and politics can provide nuanced insights into BRI-related IB trends that were difficult to capture with traditional IB models.

Second, this study presents a workhorse model for analyzing the impact of state capitalism on IB in state-funded projects, which can be a foundation for future research. Building on Li et al. (2013), but complementing it with institutional and geopolitical drivers, we suggest that Chinese-funded BRI projects can be depicted as a one-tier bargaining game between China and a host country which

helps determine the participation of host country firms and third country MNEs along the Belt and Road. In China's state capitalism, the boundary between the government and its SOEs can be blurred, and they thus more or less behave like a single actor. Host countries are therefore concerned about Chinese MNEs due to their connections with the Chinese government. In line with the saying that "when two dogs fight for a bone, a third runs away with it", we find that local firms and third-country MNEs are more likely selected for a BRI project when institutional complementarity and geopolitical alignment between China and the host country is lower, and when geopolitical rivalry between China and third countries is higher.

A third contribution is its consideration of third-country influences in FDI decisions. There are several channels through which third countries matter in our bargaining model. First, China and the host country may decide to select third-country MNEs to overcome the parties' diverging views about the participation of Chinese SOEs in BRI projects. The involvement of MNEs from third countries changes the traditional FDI configuration patterns, which largely emphasize the institutional settings of two countries (i.e., home and host countries). Second, third countries – and especially geopolitical rivals of China – may influence the legitimacy gap of Chinese SOEs by putting pressure on the host country to determine their degree of geopolitical alignment with China. Third, geopolitical rivals may affect China's relative bargaining power by offering outside options to the host country. All three channels demonstrate how the contextualization of geopolitics tends to emphasize the importance of third countries in the study of FDI.

Fourth, our framework has also allowed us to identify several managerial implications. We have argued that Chinese SOEs, host-country firms, and third-country MNEs can increase their likelihood of being selected to participate in BRI projects by developing strong political capabilities and by conducting geopolitical jockeying. These political capabilities, which complement traditional commercial competencies, require firms to develop an acute understanding of the geopolitical context in which they operate and compel them to create core abilities that allow them to manage the policy-making process.

FUTURE AGENDA

While we believe our model provides a useful framework to theorize about the influence of institutional foundations and geopolitics on BRI-related FDI, we recognize that it by no means offers a complete picture. Among other things, more research is needed to study under which conditions BRI negotiations turn into a one-tier bargaining game, which differ from the traditional two-tier bargaining game that is generally used in IB research (Li et al., 2013). Future studies also need to assess to what extent temporal dynamics matter in BRI projects, what competitive advantage MNEs need to develop to effectively participate in BRI, and how a growing bifurcation of the world order may accentuate some of our results. Most importantly, future research needs to empirically validate some of our theoretical propositions.

The one-tier bargaining model that we presented in this paper is considered to hold under two conditions. First, it suggests that the Chinese government has strong motivations to promote Chinese SOEs for the implementation of BRI projects. Second, it assumes that the Chinese government has the ability to negotiate with host-country governments on behalf of Chinese SOEs due to its ownership and control of both the state-owned commercial banks that finance the projects and the SOEs that implement them. More research is needed to evaluate the degree to which these conditions were met in existing BRI projects and the extent to which they will continue to hold in future projects.

Studying the public procurement practices related to BRI projects will take scholars a long way in addressing these questions (Buckley, 2020). To date, little is known about the processes through which firms are selected to participate in BRI projects (Ghossein et al., 2019). Specifically, most BRI projects are secretive about the extent to which Chinese-funded BRI projects are earmarked for Chinese SOEs. In Sri Lanka's Hambantota port project, for example, it appears that the project only got the green light from China once the Sri Lankan government accepted China Harbor as the port's builder (Ghossein et al., 2019). In other projects, suppliers were identified through selective tendering processes. Understanding these conditions is important, since the one-tier bargaining model is less likely to hold when there is international competitive bidding, thus limiting the

degree to which geopolitics influences firm selection when international best practices in public procurement are adopted. Recognizing how public procurement practices influence bargaining outcomes is particularly important as both China and BRI host countries are under growing pressure – sometimes perhaps geopolitically motivated – to utilize international good practices on competition and transparency in BRI procurement. Future studies should explore how the adoption of rule-based, inclusive, and binding practices may influence the organization and effectiveness of BRI projects.

Second, in our discussion of the model, we have ignored temporal dynamics in the bargaining game, which have proven to be important in previous IB research. In Vernon's (1971) theory of the obsolescing bargain, the sunken nature of FDI implied that a bargain "obsolesces" over time as power gradually shifts from the MNE to the host country. At this point, the host country's government has an incentive to change the rules of the game in order to extract more benefits from the MNE, ranging from higher taxes to expropriation of MNE assets. Theoretically speaking, a similar obsolescing bargain could also occur in our one-tier game, this time in favor of the investor country. As we have discussed, the host country *ex ante* has considerable power to influence the terms of a BRI project to compensate for its geopolitical concerns. *Ex post*, however, the argument could be made that a host country's bargaining power declines as the host country gets locked into a costly development project financed by the investor country. Especially in cases where the host country experiences financial difficulty, the investor country may then want to renege on the concessions that it gave *ex ante*, leading to asset seizures or other measures. This reverse obsolescing bargain could thus provide an explanation of the conditions under which "debt-trap diplomacy" emerges, where the investor country uses debt to *ex post* extract strategic concessions from the host country.

Any discussion of "debt-trap diplomacy" should of course also take into account that "social influence" can also change over time and influence bargaining outcomes (Cannizzaro, 2020). That is, the mere perception of a debt-trap diplomacy strategy by China – whether real or not – could make BRI host countries more wary of China's goals in the BRI (Brautigam, 2020). Adding to this, geopolitical rivals could strategically attempt to fuel this negative perception in an attempt to weaken China's bargaining position. This could

increase the legitimacy deficit of Chinese SOEs and reduce the investor country's relative bargaining power as host countries start considering outside options more carefully. This, in turn, would reduce the incentive of host countries to participate in BRI projects, disincentivizing an investor country's use of debt-trap diplomacy. Future studies should explore the various mechanisms that could push or prevent investor countries from considering debt-trap diplomacy strategies.

Third, future studies should evaluate how a growing bifurcation in the world order might influence the organization of BRI projects. Petricevic and Teece (2019) have argued that growing techno-nationalistic competition between China and the United States risks leading to an increase in volatility, uncertainty, complexity, and ambiguity (VUCA), which will heavily influence a reconfiguration of international business. Our model allows us to provide some insights, even though more research on this topic is needed. Growing geopolitical competition between China and the United States will affect both the legitimacy gap of SOEs in host countries and the relative bargaining power of China, even though the direction critically depends on what side of the fence host countries are. Future work in IB should provide further insight into the factors that determine how geopolitics alignments may influence bilateral VUCA conditions, and what this means for IB. Specifically, future studies could attempt to (1) identify the key differences between VUCA conditions, especially those embedded in different countries, (2) understand why the divergences have developed, and (3) explain how firms might best take advantage of contrasting patterns of sectoral, technological, and political specialization and rivalry. Deeper analysis of the Digital Silk Road and its geopolitical implications would be particularly fruitful in this respect.

Fourth, more work is needed that evaluates which dynamic capabilities MNEs need to develop that allow them to better navigate geopolitical forces, and how MNEs can help shape the geopolitical context. There is growing acknowledgement in the field of IB that firms and locations co-evolve as they adjust to shifts in the global economy (Cantwell et al., 2010; Lundan & Cantwell, 2020). While most studies have focused on contextualizing institutions to interpret such co-evolution patterns, we call for more work on the influence of the geopolitical context on firm-location co-evolution. For example, studies show that Chinese SOEs and private MNEs suffer different legitimacy

gaps in host countries due to their different connections with Chinese governments (e.g., Li, Li, et al., 2019; Li, Liu, et al., 2019).

Finally, research on BRI desperately needs more empirical analysis that links geopolitics with international business. Configuration analysis can in this respect be a very useful methodology (Jackson & Deeg, 2019; Lundan & Li, 2019). Configuration analysis emphasizes interdependence between institutions, which include not only coherence and complementarity but also conflicts and tensions between different institutions. However, the configuration analysis overlooks the geopolitical processes and conditions, which also influence the interactions between actors of diverse institutional background. Future studies can look into how MNEs and governments can be classified into different clusters based on their institutional and geopolitical features and how different clusters interact.

CONCLUSION

Building on the extant literature on BRI in IB and adjacent fields, this study has identified an important phenomenon of Chinese-funded BRI projects; that is, the peripheral yet non-negligible participation of firms from host and third countries. This study has developed a model to explain the phenomenon, tracing the inclusion of local or third-country MNEs in BRI projects to Chinese SOEs' legitimacy gap in host countries and host countries' bargaining power. On the one hand, institutional complementarity and geopolitical alignment between China and BRI host countries influence Chinese SOEs' legitimacy gap in host countries. On the other hand, the geopolitical importance of a BRI project for China and its geopolitical rivals determines the host country's relative bargaining power. The selection of local firms and third-country MNEs to participate in BRI projects increases with Chinese SOEs' legitimacy gap in a host country and the host country's relative bargaining power.

Our BRI model provides three important theoretical insights. First, it illustrates the importance of contextualizing geopolitics in FDI studies. We have identified various channels through which geopolitics affects the type of firms that participate in BRI projects. It influences the concerns that host countries have about the non-commercial motives of Chinese SOEs, affecting this firm type's legitimacy gap, and it affects the host country's relative

bargaining power depending on the geopolitical importance of the BRI project for China and its rivals. Second, and relatedly, we have shown how the effective coordination between the Chinese government and its SOEs, which is driven by geopolitical concerns, generates new forms of international competition that require more attention in future research. Third, we have identified viable geopolitical jockeying strategies that local firms and third-country MNEs can adopt to increase their likelihood of being chosen for a BRI project.

More broadly, our paper has illustrated both the need and the power of conducting more phenomenon-based research on BRI and its implications for IB (Doh, 2016). We identified several phenomena related to BRI – the variety of actors, China's non-economic motives, and the geopolitical context – and used them to legitimate the need for a political economy perspective on FDI in BRI. We then conducted a relatively simple adaptation of a traditional IB model to obtain empirically testable hypotheses that relate the institutional and geopolitical context to firm choice in BRI projects. While we in this article have only scratched the surface of how the political context influences IB

transactions in the context of BRI, we see this type of phenomenon-based research to be an important way forward in our thinking of FDI and IB along the Belt and Road.

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NOTES

¹While Chinese private firms are also involved in BRI projects, they have received less attention in the BRI literature since they are peripheral in Chinese infrastructure industries (Buckley et al., 2018).

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