Potential of Russian-Chinese Investment Cooperation

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Abstract:- This article provides a series of statistics and research findings showing the growth of Chinese foreign direct investment. China's policy governing the flow of foreign direct investment by Chinese companies is discussed. Private business is playing an increasingly important role in expanding foreign direct investment from China. It provides data on the sectoral structure of Chinese foreign direct investment, according to which Chinese foreign direct investment is becoming more differentiated and is not limited to the commodity industries. China is increasingly attracted to advanced economies and a mature post-industrial sector. Russia is ranked 6th among the recipients of Chinese foreign direct investment. The article deals with the main problems holding back Chinese foreign direct investment, according to the management of Chinese companies. This question is very relevant now. Despite the fact that Russia and China are not major partners in the field of investment now, a mutually beneficial partnership could exist between both countries in the future.

Keywords:- *China; Russia; Investment Cooperation.*

I. INTRODUCTION

It is believed the investment in the state receives is an extremely positive aspect of its economy because there are a huge number of positive consequences. For example, it could lead to an increase in jobs, relatively high wages, the introduction of new technologies and the acquisition of experience from foreigners, which could bring the country to a new level. But it must be remembered that this has a positive effect only when the interests of the host and investing countries coincide. This is not easy to achieve. The relevance of this topic today is high. When it comes to a dynamically developing or developed state of the world, it is simultaneously assumed that the investment climate of this economy is favorable. Today it is impossible to imagine a company which could actively develop without investment money. The situation with the state is exactly the same. Today's welfare is founded on yesterday's investments. Likewise, today's investments lay the foundation for welfare tomorrow. The purpose of my work is to consider the investment attractiveness of Russia in general for China.

The shift of the world economic growth center to countries in East Asia and Southeast Asia has set the stage for the Russian government to actively look to the East for foreign economic activity and expand trade and investment cooperation with China. The Chinese government has proposed to create an economic belt of in the image of the Silk Road, the main trade route from Asia during the 11th century. The implementation of this initiative, also known as "one belt, one road", is intended to ensure broad cooperation among countries along the historic Silk Road. Russia is central to the implementation of this initiative, through which three of the six economic corridors should pass, designed to establish close ties between Europe and Asia.

This creates a significant potential for Russian-Chinese investment cooperation. To finance projects as a "one belt, one road" initiative will require significant funds, some of which will be provided by Chinese companies and banks, which are already active in other countries. China has gradually started to open its stock market to foreign issuers. China has allowed the raising of funds in RMB through the placement of debenture in the country.

II. GROWTH OF FOREIGN DIRECT INVESTMENT FROM CHINA

Having come to the first place in terms of foreign trade and the second in terms of GDP, China quickly began to catch up with the world's leading economies and in terms of foreign direct investment. In 2016, investments reached $183.1 billion, an increase of 14.9 times since 2005, when it amounted to only $12.3 billion. As you can see, foreign direct investment from China during this period grew by an average of 30.7% per year, while the global total increased by 9.2%. As a result, while China accounted for only 1.5% of the world's foreign direct investment in 2005, by 2016 it was already 12.6% (Figure 1). High activity in foreign markets allowed China to rise to the third position in terms of annual investments abroad in 2012. At the end of 2016, China ranked second after the USA ($299 billion), ahead of the Netherlands ($173.7 billion) and Japan ($145.2 billion). At the same time, for the first time, the inflow of foreign investment from abroad was less than that of Chinese companies. In fact, China has become a net creditor of the world economy.

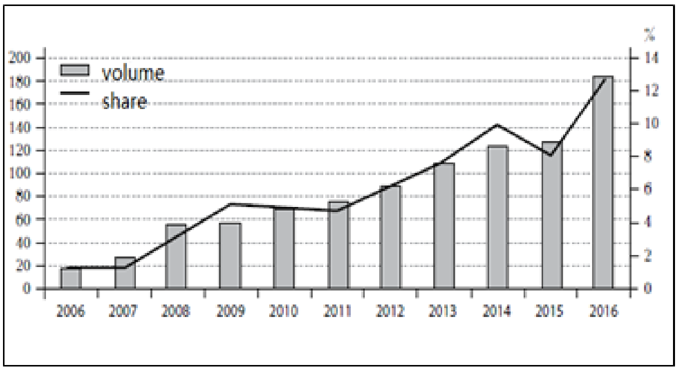

Fig 1:- Dynamics of foreign direct investment from China

The increase in foreign direct investment from China has contributed to policies aimed at the liberalization of conditions for cross-border activities in the framework of the implementation of the strategy of "going out", involving the transfer of excess production capacity outside of China. By encouraging companies to develop foreign markets, the Chinese government expected to rebalance the economy and maintain its high growth rates.

In October 2014, the amendments to the state program for foreign investment management came into force. The new rules replaced the licensing procedure for capital investments abroad with a notification process. In December 2014, at a meeting of the State Council of the People's Republic of China, it was decided to provide additional support to foreign investment projects, including through the simplification of procedures for currency regulation and the stimulation of bank financing. In May 2015, a guide was issued to enhance international cooperation in the field of production capacity and industrial equipment, also aimed at promoting overseas investment by Chinese companies.

In addition, the increase in foreign direct investment from China was affected by the implementation of the “one belt, one road” initiative, which involves the investment of a significant amount of funds in infrastructure and other projects in almost 60 countries. To finance them, the Chinese government has allocated a $40 billion to specially created Silk Road Fund. In May 2017, it was announced that the fund will receive an additional $14.5 billion.

Among other factors that led to a noticeable growth in Chinese foreign direct investment in 2016, foreign experts cited the weakening of the RMB, which stimulated the acquisition of assets denominated in other currencies. In an effort to stop the fall in the exchange rate, which exceeded 6% against the U.S. dollar in November 2016, Chinese regulators began to secretly impose restrictions on cross-border transactions, including foreign investment by national companies.

Officially, representatives of the concerned ministries and departments of China continue to declare the government's commitment to the policy of "going out", however, they recognize that they are closely watching the foreign investments of Chinese enterprises in some sectors. In particular, investments in real estate, hotel business, cinemas, entertainment and sports clubs were mentioned. In January 2017, the state property control and management committee announced plans to introduce a stop list, prohibiting state companies from investing in certain assets. In addition, the committee will strictly monitor the effectiveness of transactions made by Chinese companies abroad.

The measures taken led to a decrease Chinese foreign direct investment. In December 2016, according to the Ministry of Commerce of China, the value of investments decreased by 39.4% ($8.41 billion) compared to the same period in 2015. In 2017, this trend continued. According to the results of the first quarter, investments from China fell by 48.8% compared to the first quarter of 2016 and amounted to $20.5 billion. At the same time, investment cooperation within the framework of the “one belt, one road” initiative continued to develop. In the first three months of 2017, its share in total foreign direct investment amounted to 14.4%, which is 5.4 percentage points more than in 2016.

Private business plays an increasingly important role in increasing foreign direct investment from China, whose share in the total volume of foreign investment is steadily growing. According to the American Enterprise Institute (AEI), prior to 2010, the capital investment of private Chinese companies abroad did not exceed 2% of the total investment. In 2016, they accounted for 47.9% of all Chinese investments abroad (Figure 2). In absolute terms, private sector investments in 2016 ($81 billion) exceeded the total investment from China in 2011 ($70.3 billion). At the same time, private Chinese companies invested twice as much in the U.S. as public ones.

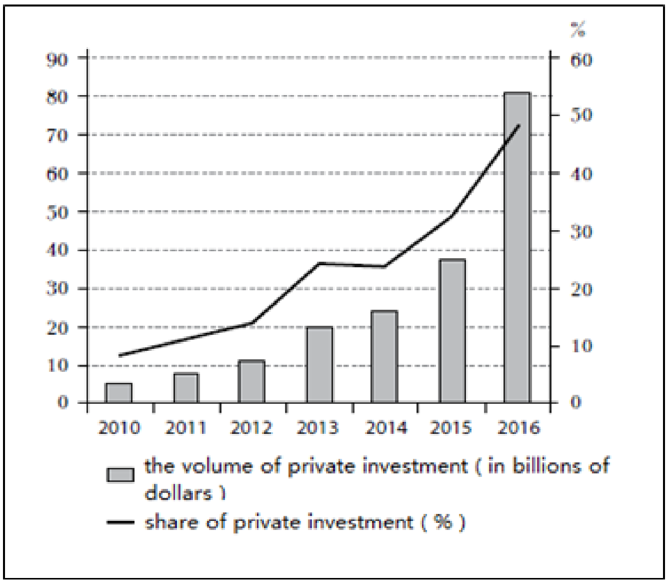

Fig 2:- Foreign investments of private Chinese companies

According to KPMG analysts, the role of private companies will only increase over time. First, they face less resistance from the public and recipient governments of Chinese investment. In addition, China has fairly large private companies that can perform on an equal basis with foreign markets. Secondly, it is the private business that acts as the flagship when it comes to investments in promising scientific developments and technologies.

Thus, the increase in the share of private Chinese companies in the total volume of foreign direct investment is directly related to serious changes in their industry orientation, which are clearly evident in recent years. Chinese foreign investment is becoming more differentiated and is no longer limited to the raw materials industries. According to the official statistics of the Ministry of Commerce of China, the share of the mining sector in the total volume of Chinese investments fell to 7.7% in 2015, compared to 13.4% in 2014 and 23% in 2013. At the same time, the share of the manufacturing industry increased from 6.7% in 2013 to 13.7% in 2015. This is also evidenced by the data collected by the AEI, according to which the share of investments of Chinese companies in fuel and energy assets decreased to 20.3% in 2016 compared to 26.9% in 2014-2015 and 54% in 2009-2013. Similarly, the share of investments in metallurgy decreased from 14.4% in 2009-2013 to 10.5% in 2014-2015 and 3.6% in 2016. They are replaced by investments in such industries as transport, tourism, entertainment and high technology, whose share jumped in 2016 to 41% compared to 17.1% in 2014-2015 and 3.7% in 2009-2013 (Figure 3).

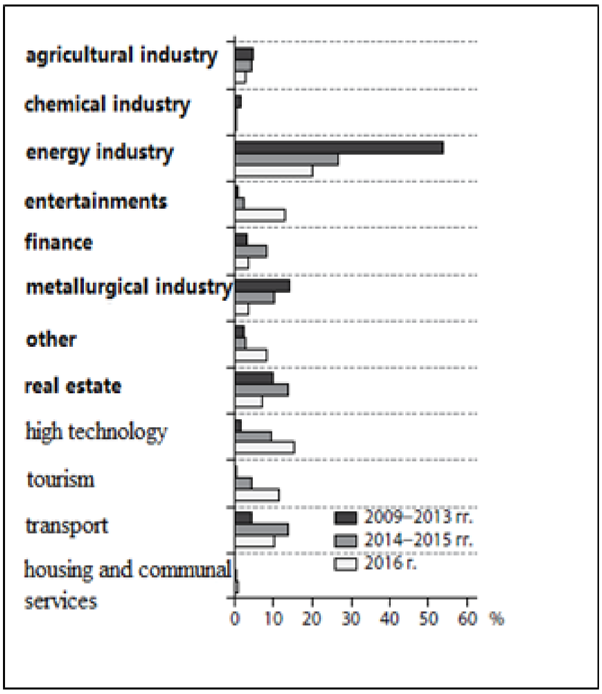

Fig 3:- Industry structure of Chinese foreign investments

Against the background of this trend, the geographical distribution of foreign direct investment from China has changed significantly. The interests of Chinese companies are no longer limited to Asian, Latin American and African countries with rich natural resources. China is increasingly attracting regions with advanced economies and post-industrial sectors, such as Europe and the U.S., whose share increased from 28% in 2009-2013 to 65% in 2016, according to the AEI. Of the four countries receiving more than $10 billion from Chinese investors in 2016, including the U.S., the United Kingdom, Brazil and Germany, only Brazil belongs to the developing world.

Over the past 5 years, the United States of America has remained the undisputed leader in terms of the volume of annually attracted investments from China. They also occupy the first place in terms of accumulated capital investments of Chinese companies and remain a large margin ahead of other countries (Figure 4). These conclusions of the AEI experts are confirmed by official statistics, if not to take into account investments in Hong Kong and other offshore jurisdictions.

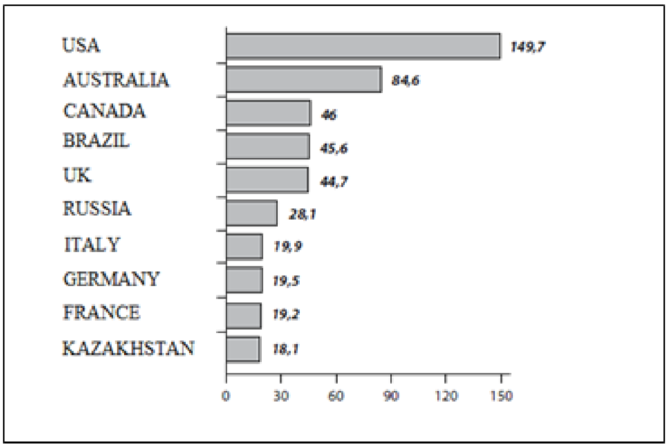

Fig 4:- The first 10 countries in terms of foreign direct investment from China (in billion dollars., since 2005)

In General, the list of the 10 largest recipients of investments from China includes either economically developed or resource-rich countries as well as countries that can be attributed to both types, such as Australia and Canada, respectively, in the second and third positions. Russia takes the 6th place in terms of the volume of investments received from China.

III. ATTRACTING CHINESE INVESTMENT TO RUSSIA.

The development of cooperation with China in the investment sphere is a priority area of bilateral relations in recent years. However, the increase in activity in this area in 2013-2014 has not yet received a proper continuation (Figure 5). According to the Bank of Russia, the inflow of direct investment from China in 2016 decreased and amounted to only $349.6 million. That is 45.8% less than in 2015. At the same time, the share of capital investments of Chinese companies in the total volume of foreign investments attracted in 2016 amounted to 1.1% compared to 9.4% in 2015. Chinese statistics show a similar dynamic. According to the Russian trade mission in China and in reference to the information of the main statistical office of China and the Ministry of Commerce of China, direct non financial investments of Chinese companies in Russia decreased by 26.6% in 2016-to $547 million.

However, the official statistics do not reflect the actual volume of Chinese investments in Russia. The regulators distribute the capital investments received depending on the country in which the direct investor is registered. In international practice, the use of so-called "special purpose vehicles" (SPV) has become widespread, which make it possible not only to optimize taxation but also to ensure the return of invested funds in the event of a conflict with the authorities of the host country. The use of SPV, registered in one of the recognized offshore centers, also allows hidden final investors, which leads to distortions in the official statistics. The real scale of Chinese investments in Russia can be seen from the analysis of the AEI, based on public reports on foreign investments of Chinese companies.

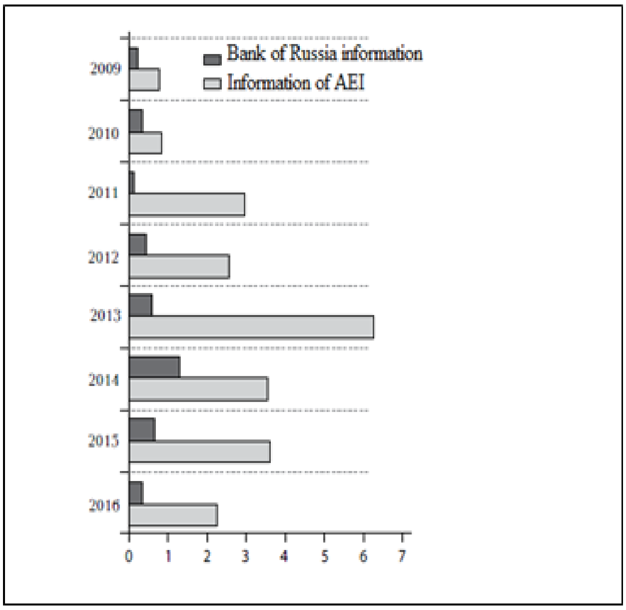

Fig 5:- Dynamics of Chinese investments in Russia (in billion dollars.).

According to this information, Chinese companies invested $6.25 billion in 2013 in the authorized capital of Russian enterprises. In 2014, investments decreased to $3.53 billion. At the same time, contracts were signed for new construction in the amount of $4.67 billion. Thus, in 2014, a total of $8.2 billion of Chinese funding made its way to Russia. But that growth stalled in later years.

In 2016, according to the AEI, Chinese investments in Russia amounted to $2.23 billion. that is 38% less than in 2015. The volume of new construction contracts fell to $ 440 million. compared to $3.3 billion in 2015.

According to experts at the Eurasian Development Bank, the weak activity of Chinese investors in the Russian market was caused by the completion of a number of large-scale transactions concluded earlier in 2011-2014. The fears of large Chinese companies, and especially banks operating in the U.S. and EU markets, of falling under the economic sanctions imposed against Russia also affected growth. In addition, some Chinese investors can expect better offers to start investing.

Specialists at the Analytical Credit Rating Agency (ACRA) associate the decrease in investment from China with the above-mentioned decrease in Chinese companies' interest in projects in the extractive sector, while in Russia the raw materials industry provided about 67% of the increase in Chinese investment in 2009-2015. New investments in the post-industrial sector, declared a priority for Chinese state-owned companies, are constrained by the relatively weak development of the service sector in Russia and the closure of the high-tech sector to foreign capital.

Nevertheless, it should be noted that the list of sectors attracting the attention of Chinese investors in Russia is gradually expanding. They are already interested in investing in online cinemas and mobile games. Thus, in the next few years, investment projects in traditional areas of cooperation (energy, construction, forestry, etc.) may well be supplemented by projects of information technology and services. In addition, the interest of Chinese companies in the Russian pharmaceutical industry, projects in the field of biotechnology and medical research has been indicated.

As for the temporary decline in activity on the Russian market, Chinese investors explain it by the state of the Russian economy to a large extent. This is evidenced by a study conducted by Ernst & Young (EY) in May 2015. The heads of 142 Chinese companies with turnover of more than $30 million were interviewed, including 31 large companies with a turnover of more than $1 billion. About a quarter of the respondents (34%) have representative offices in Russia.

Most often, as an obstacle to investment in the Russian economy, the leadership of Chinese companies called problems with compliance with legislative norms (Figure 6). This answer was given by 39% of respondents. The most serious legal shortcomings are perceived by large Chinese companies (71% of those who took part in the survey). Another 34% of all respondents noted economic instability. Moreover, 63% of the companies that are already present in the Russian market pointed to the deteriorating macroeconomic situation. At the same time, only 15% of Chinese companies operating in Russia complained of difficulties in finding interesting projects for capital investment, compared to 22% in general.

Similar results were obtained by a survey of 60 Chinese companies represented in Russia conducted by the domestic consulting company IPT Group at the end of 2015. However, this time the majority of respondents (57%) believed that the inflow of investments from China is hampered by the unstable macroeconomic situation. While traditional for the Russian market problems with compliance with legislative norms were mentioned by only 43% of the survey participants.

It is also noteworthy that Chinese investors in this case gave a low estimate of difficulties associated with corruption. This was stated by only 14% of the companies participating in the survey. Meanwhile, EY's research has revealed a great concern of the Chinese companies' management about this problem. It was pointed out by 30%

of respondents, including 52% of companies operating in Russia.

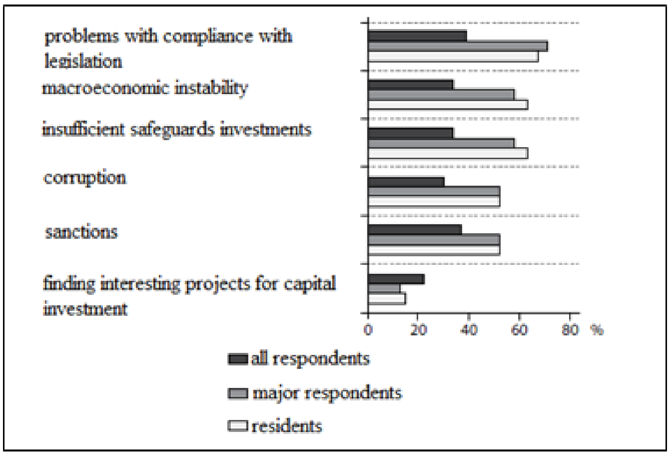

Fig 6:- The main obstacles to investing in Russia

Chinese officials also pointed to the predominant influence of economic factors. For example, the Director of the Department of Eastern Europe and Central Asia of the Ministry of Commerce of China, Mr. Lin Ji, said that the reduction of investment from China in the first seven months of 2015 by 20% was directly related to the depreciation of the Russian currency, which took place during that period.

The weakening of the ruble has not only reduced the influx of new investment but has also caused the release of a number of Chinese investors from the Russian assets. In February 2016, the investment Fund Chengdu Investment Corporation (CIC) fully sold its share in the capital of the Moscow Exchange, selling 5.2% of shares at the price of 89 rubles apiece. Since the shares were mainly acquired during the IPO at a price of 55 rubles per share, the Fund formally made a profit.

At the same time, as the results of the IPT group survey showed, Chinese investors maintain a positive attitude towards the Russian economy. Only 14 % of respondents believe that in the next two years the volume of investments from Chinese companies in the Russian economy will continue to decline. Another 29% believes that there will be no significant changes in the dynamics of investments. At the same time, 57% of respondents noted that Chinese companies plan to expand their presence in the Russian market. According to the EY analysis, 61% of Chinese companies participating in the survey plan to invest in the Russian economy over the next five years.

Thus, the continuing high interest of Chinese investors in the Russian market allows us to count on a quick intensification of investment cooperation. To a large extent, this will be facilitated by the beginning of macroeconomic stabilization of the Russian economy.

IV. CONCLUSION

The development of cooperation between Russia and China in the field of investment meets the mutual interests of both countries. It should also be kept in mind that China is increasingly integrating into the global financial system.

Chinese leadership does not want a confrontation with the West and will therefore avoid directly violating the economic sanctions imposed on Russia. This limits the opportunities for realizing the potential of investment cooperation.

In order to achieve maximum effect, it is necessary to focus on solving domestic problems of the Russian economy that impede full interaction with Chinese partners. In particular, it seems appropriate for the Intergovernmental Russian-Chinese Investment Cooperation Commission to assist in the development and harmonization of common rules and requirements for mutual investment, which will help to eliminate misunderstanding between representatives of Russian and Chinese businesses.

It is advisable to establish a special fund at the Foreign Economic Bank or other Russian development institute, which has qualified personnel, whose task would be to support Russian businesses in the preparation of project documentation necessary to obtain Chinese financing and attract investors from China.

At the same time, it is necessary to promote the promotion of domestic companies to the Chinese capital market. At the moment, this is especially appropriate for businesses that have assets in China or are active in trading with them.

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