Analysis on the Belt and Road Initiative and Outward Direct Investment

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Abstract. The Belt and Road initiative provides mutual opportunities for China and the countries along the line. This paper analyzed the structure, influencing factors and the impact of outward direct investment from China to the countries along the Belt and road initiative. The investment is unevenly distributed and inclines to countries with abundant strategic resource, lower labor cost and better infrastructure. Various macro level factors from both host countries and China influence the scale, scope and location choice of outward direct investment. Outward direct investment from China into countries along the Belt and Road initiative would have positive impact on China’s development in various aspects, such as positive trade effect, reverse technology spillovers, industrial transformation and upgrading, and internationalization of RMB. Investment policies should be established and perfected to facilitate investment.

Introduction

The Belt and Road initiative, also known as the Silk Road Economic Belt and the 21st-Century Maritime Silk Road, was launched in 2013, in accordance with the internationalization and economic development in China. The Belt and Road initiative, which facilitates international investment, removes the investment barriers and expands bilateral investment areas, has an important influence on the structure and distribution of international investment behavior of China. Opportunities and challenges coexist in the Belt and Road initiative, both for the host countries and China. Mutual investment could lead to common prosperity. The disparity of economic development amongst the countries in the Belt and Road, the complicated political risks situation would raise risk in outward direct investment. This paper will analyze the structure, the influencing factors and impact of China’s outward direct investment in the region of the Belt and Road initiative. This paper is organized as follows: firstly analyze the structure of China’s outward direct investment in the Belt and Road region, include the geographic destination and strategic distribution; secondly explain the influencing factors at macro level, both home country factors and host country factors would be illustrated; then the impact of the outward direct investment in the Belt and Road will be illustrated in different perspectives; finally concludes and gives some policy implications.

The Structure of Outward Direct Investment in the Belt and Road

The economies along the Belt and Road initiative can be divided into different categories by various criterions. The Belt and Road initiative promotes
economic relations between countries with great diversification, includes developed and developing economies; Asian, European and African economies; economies with stable political and macroeconomic environment and economies in conflicts and adverse economic environment; major international trade partners and economies with limited previous interactions. Measured by the stock of outward direct investment from China at the end of year 2015, the top ten investment destinations are Singapore, Russia, Indonesia, Kazakhstan, Laos, UAE, Myanmar, Pakistan, India and Mongolia. Singapore has a stable political, social and economic environment, positive international trade relation with China, long history of cooperation and relatively close cultural distance. Investment in developed countries such as Singapore could bring the benefit of reverse technological spillovers, and market shares overseas. Russia, with abundant natural resources, has relatively stable domestic political environment, however some tension in international relations could give rise to uncertainties in investment. Indonesia, Laos, and Myanmar are ASEAN countries with relatively positive economic relations with China. While the sum of outward investment from China to ten ASEAN countries reach up to approximately half of total investment in countries along the Belt and Road initiative. The outward direct investment in ASEAN countries concentrated in mining industry, utilities and electronic industry. The natural resource such as oil has strategic importance. The increase in outward direct investment in India and Pakistan coincides with the fast economic development in South Asia. However the geopolitical uncertainties seem to slow down the trend. The investment in the countries along the Belt and Road concentrated in relatively better developed economies with relatively stable political and economic environment.

The Influencing Factors of Outward Direct Investment in the Belt and Road Region

Various macro level factors from both host countries and China influence the scale, scope and location choice of outward direct investment. This section will analyze the factors in host countries and China respectively.

Influencing Factors in Host Country

Several macro level factors in host countries affect outward direct investment from China to the countries in the Belt and Road region. The political and social stability, the resource endowment, the market scale, the ability in science and technology creation, labor cost and infrastructure in host countries would influence decision making in outward direct investment from China. The political stability, the transparency and consistence of foreign investment policies, and social stability affect investment in the Belt and Road region. Some countries in the region have internal and external conflicts and disputes. Sound legal system and regulations is absent in some countries. Corruption and diplomatic tension could also negatively affect outward direct investment. Lower labor cost attracts companies to invest in Southeastern Asia and South Asia, transfer the manufacturing and other labor intensive industries to those countries would mitigate the dilemma the domestic companies are facing from surging labor costs at home. Abundant natural resources in some countries in Central Asia, Middle East and North Africa motivate investment from China to obtain strategic resource. Cultural distance also affects outward direct investment choices. The diversification of ethnic and cultural features in the region of the Belt and Road initiative makes the issue more complicated in the area.
**Influencing Factors in Home Country**

The macro factors in home country would influence scope and scale of outward direct investment, as well as destination selection and the performance and profitability of the investment. The macro level factors, such as the level of macroeconomic output, the development of international trade, the scale of foreign reserve, foreign exchange rate of home currency, as well as existing stock of direct investment, would influence outward direct investment in China. GDP per capita of the home country is a main influencing factor in outward direct investment. The advantages derived from economic growth would increase demand and ability for outward direct investment. The ownership advantage, internalization advantage and location advantage attributes to the development of outward direct investment. The economic openness, the level of international trade and other businesses, facilitate international capital flows, and acceptance of China’s outward direct investment in countries along the Belt and Road. The growing scale of foreign reserve, over-capacity of productivity, structural reform in China are pressing issues that call for investment overseas, while the Belt and Road initiative provide opportunity for larger international market and more development opportunities.

**The Impact of Outward Direct Investment in the Belt and Road Region**

Outward direct investment from China into countries along the Belt and Road initiative would have positive impact on China’s development in various aspects, such as positive trade effect, reverse technology spillovers, industrial transformation and upgrading, and internationalization of RMB.

**Trade Effect**

Outward direct investment could have a positive effect in promoting international trade in home countries. The Belt and Road initiative facilitate economic cooperation amongst China and countries in the region, including bilateral trade. Outward direct investment in the countries along the Belt and Road, could further promote international trade, by avoiding trade barriers and deepening of economic cooperation. The interaction between direct investment and foreign trade could result in a generally more positive effect for both China and the host countries. Outward direct investment could promote scope and scale of international trade with existing trade partners in the region. While outward direct investment into competitors in the international market, such as India, could brought opportunities for bilateral trade, and enhancing international competitiveness for both sides. Transferring marginal industries in less developed countries could also lower costs and acquire competitiveness of export goods in international market. Moreover, the Belt and Road initiative could play an important role in regional disparity of international trade in China. Provinces in Western China, where international trade are less developed, could grasp the opportunity to develop trade and other international business in neighbor countries, make full potential of their geo-economic advantage, participate in differentiated competition. The provinces in the west and middle region could develop international trade with their own characteristic, gives a momentum to unleash their productivity and boost economic growth.

**Reverse Technology Spillovers**

The effect of reverse technology spillovers from outward direct investment are supported by numerous researches. However, the technological advance for home countries was considered to be in the scenarios in horizontal investment or
invests from developing countries into developed countries. The countries along the Belt and Road are mostly developing countries, and many countries are less developed than China, both in macro economy and technology. The effect of reverse technology spillovers can be result from lower cost in research and development, which can be realized in investment into less developed countries. Even though the effect of reverse technology spillovers has not yet been significant, the positive effect could emerge in the future. Although outward direct investment from China to developing countries along the Belt and Road are more likely in lower value-added labor intensive industry, information technology companies, such as Huawei Technology, have already established research institutions in Southeastern Asia.

**Industrial Transformation and Upgrading**

With more competitors, growing labor cost, adverse international market and shrinking profit margin in the export of manufactured goods, the role of export as driven force in macroeconomic development would be less important. Decreasing demographic dividend calls for a new engine for economic growth. Industrial transformation and upgrading is an important issue in economic growth, both in the domestic market and international market. The Belt and Road initiative could be the springboard for the economic structural transformation and industrial upgrading. Outward direct investment could promote industrial transformation and upgrading in emerging economies. China could benefit from outward direct investment in the Belt and Road region from reverse technology spillovers, avoidance of trade barriers, market share and strategic resources in host countries. China could benefit from reverse technology spillovers in outward direct investment, by obtaining technology, knowledge, skills, and management experience from host countries. With growing number of trade arbitration, China could also benefit from avoidance of trade barriers by direct investment in the target market, taken up market share in host countries as well as export market. Strategic resources in host countries could be the driving force in industrial transformation and upgrading. The diversification of the countries in the Belt and Road initiative provides abundant natural resources, technology and skills, and market opportunities.

**Internationalization of RMB**

The Belt and Road initiative promote international economic activities between China and countries along the Belt and Road. The initiative facilitates international trade and investment. The increase in international trade could establish the position of RMB as settlement currency in neighboring countries. Outward direct investment could further consolidate the position of RMB as an international currency, and gives an opportunity to the liberalization of capital account. It also gives some insight into the selection of the path of RMB internationalization. The international investment could facilitate international economic interactions, which could provide opportunity in opening capital account orderly. The Belt and Road required financial support. Especially, in infrastructural investment, large scale of financing requirement would stimulate international demand of RMB. The demand of RMB in the industrial and commercial transaction could lead to demand in financial transaction, which would contribute to the deepening and widening of offshore RMB market. In addition, the risk management, hedging and other demand could help promote derivative market of RMB. The development of offshore RMB market, the growing role of RMB as settlement currency, the rising demand of hedging,
would lead to the willingness of holding RMB in offshore market, and its role as foreign exchange reserve in other countries. The degree of the internationalization of RMB is much higher than other currencies of the countries in the Belt and Road, thus gives RMB the dominant role in building an integrated financial system in the region. The Belt and Road initiative provides a platform for RMB to catch up with other international currencies. Moreover, the Belt and Road initiative has far reaching significance in internationalization. The more important role in international community promotes the internationalization of the currency.

Conclusions and Policy Implications

The Belt and Road initiative provides mutual development opportunities for China and the countries along the line. Outward direct investment plays a more and more important role in economic growth. Outward direct investment from China to the countries along the Belt and road initiative is unevenly distributed. The investment inclines to countries with abundant strategic resource, lower labor cost and better infrastructure. The macro level factors from both host countries and China influence the scale, scope and location choice of outward direct investment. Outward direct investment from China into countries along the Belt and Road initiative would have positive impact on China’s development in various aspects, such as positive trade effect, reverse technology spillovers, industrial transformation and upgrading, and internationalization of RMB. Investment policies should be established and perfected to facilitate investment. While legal, financial and technical support should be in place. BITs could bring mutual benefit and provide insurance for companies participate in outward direct investment. The information platform which provides investment opportunities and uncertainties could help build an orderly and healthy investment environment. The uncertainties in some countries along the Belt and Road initiative would require proper risk management measures in the outward direct investment. The policy measures could also be implemented to help firms to improve their capacities in negotiation skills, investment decision making, risk management, social responsibility and localization in outward direct investment.

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References


